EQUITY

Notes from the Trading Desk - Europe

August 21, 2017

Equity markets experienced a mixed performance last week. Focus shifted to US politics, particularly President Donald Trump's response to the violence in Charlottesville, Virginia. This week, we expect investors' attention to turn to the upcoming meeting of international central bankers in Jackson Hole, Wyoming.

The Digest

Trump Administration under Scrutiny

Markets started last week in a calmer mood as US rhetoric around North Korea, which had peaked during the previous week, abated.

However, Donald Trump's controversial response to violence in Charlottesville—in particular his delayed criticism of Far Right protesters—contributed to a selloff in US equity markets. The subsequent resignation of several high-profile business leaders from Trump's Manufacturing Council added more fuel.

In addition to his falling out with business leaders, Trump also sparred with fellow Republicans. He called Senators Lindsey Graham "publicity-seeking", and Jeff Flake "toxic". Importantly, there was also speculation that top economic advisor Gary Cohn was going to step down. This was particularly concerning for markets, as he is seen as a key member of the administration given his pragmatic approach to policy.

Although the level of political noise seen last week is not unusual for the Trump administration, the level of uncertainty appeared to be starting to spook markets.

There seems to us to be real concern that Trump is undermining his chances of implementing the market-friendly reforms hoped for when he was elected. As a result, we are starting to see signs of some of the so-called "Trump Trade" unwinding.

US equity markets had their worst one-day performance of the year on Thursday (August 17) amid a flight to safety.

However, last week did end on a more positive note for markets as controversial strategist Steve Bannon left his White House post on Friday. Meanwhile, Gary Cohn stayed in his role.

Looking ahead, to re-establish equity market confidence, we believe the Trump administration needs to demonstrate some signs of tangible progress in terms of legislation, and in particular on tax reform.

In addition, if Trump fails to agree a deal with Congress on a new debt ceiling next month, prompting a government shuts down, it could be extremely damaging for sentiment.

Last Week

Europe

Last week, the European Central Bank (ECB) governing council published the minutes from its most recent meeting. The markets interpreted them as dovish.

ECB officials expressed concern over the risk of the euro overshooting on the upside more than a strengthening economy justifies. The euro had been under pressure last week after media reports played down the likelihood ECB president Mario Draghi would announce a new policy direction during his appearance at the Jackson Hole, Wyoming get-together for central bankers later this week in the United States.

In macroeconomic data announced last week, preliminary second-quarter eurozone gross domestic product (GDP) came in higher than expected at 2.2%. Quarterly GDP growth in Germany was at its fastest annual pace since 2014. Continued strengthening data underpins market consensus that the ECB could make its tapering announcement this year.

Americas

Minutes from the most recent US Federal Open Market Committee (FOMC) released last week also had a dovish slant. Some Fed officials, concerned with weak US inflation numbers, saw a drop in the probability of another rate hike this year.

These revelations added to softness in Treasury yields, which weighed on the financial sector stocks. Meanwhile, utilities outperformed on the week.

Asia

Asian markets rallied in the early part of last week amid easing tension around North Korea.

There were further headlines regarding the rising potential for a trade war between the United States and China. These apparently stemmed from suggestions President Trump had voiced regarding a possible US investigation into Chinese trade practices.

On Monday, the White House announced that Trump had signed an executive trade order to investigate “China’s laws, policies, practices, and actions related to intellectual property, innovation, and technology”. The move was seen as the first shot in a potential trade war.

LOOK OUT FOR… (AUGUST 22 TO AUGUST 25):

Tuesday August 22

- ECB Board Member Vitor Constancio Addresses European Economic Association in Lisbon Link
- Canadian Core Retail Sales Data Link

Wednesday August 23

- ECB President Mario Draghi Addresses Economic Science Meeting in Germany Link
- South African Inflation Data Link
- US New Home Sales Link

Thursday August 24

- Spanish Gross Domestic Product Data Link
- UK GDP Data Link

Friday August 25

- Japanese Inflation Data Link
- US Durable Goods Data Link
- German GDP Data Link
- ECB President Addresses Jackson Hole Economic Symposium Link

Week Ahead

Monetary Policy

- The annual gathering of global central bankers in Jackson Hole, Wyoming, runs from August 24 to 28. Both US Federal Reserve Chair Janet Yellen and ECB President Mario Draghi are scheduled to speak.

Economic Data

- In Europe, investors are primed for French, German and eurozone purchasing manager index (PMI) data and Spanish, German and UK second-quarter GDP through the week.
- In the United States, new home sales and durable goods orders figures are due out.
- There is a bank holiday in UK on Monday, August 28; US markets are closed for the Labor Day holiday September 4.

Views You Can Use

Insight from Our Investment Professionals

US Tech Sector: Continued Run-Up or Correction Coming?

Since the infamous “dot com” meltdown nearly two decades ago, people have tended to question any sort of extended run-up in technology-sector stocks. Stephen Dover, executive vice president and head of equities at Franklin Templeton Investments and chief investment officer, Templeton Emerging Markets, recently recorded a podcast centered on the theme of technology and how investors’ might view the sector. Read More

Why It’s Time to Get Back to Basics

In a world of rapid change, it can be easy to lose focus and chase the next big thing. When it comes to investing in smaller stocks, Richard Bullas, vice president, portfolio manager and research analyst, Franklin UK Equity team, thinks investors should go back to the basics and focus on the fundamentals. He explains why he’s sticking with a bottom-up approach and focusing on individual companies in his search for small-capitalisation value opportunities. Read More

Navigating an Uncertain Second Half

Receding political anxiety and a gathering economic recovery in Europe helped global equity markets advance in the first half of 2017. Yet Templeton Global Equity Group’s Cindy Sweeting and Tony Docal say investors should be somewhat cautious in the second half of the year. They believe rich stock valuations and shifting central bank policies could lead to bouts of volatility. Read More.

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