CROSSBRIDGE CAPITAL

Market Viewpoints

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"There are no facts, only interpretations."

- Friedrich Nietzsche (1844-1900)

Summary:

The US unemployment rate, currently at +4.3%, has now hit a 16-year low and shows that the labour markets are tightening. However, wage growth is still stuck at a low level. The US Federal Reserve (Fed) is still faced with a disinflation problem. The European Central Bank (ECB) is not ready to commit to any timescale on tapering or to provide any "forward guidance" on it. In fact, there appears to have been very little debate at the ECB meeting last week about how much more easing may or may not be needed going forward. Recently the media has been abuzz with reports that central bankers in the US, Canada, the Eurozone and the UK had signalled that the days of easy money are nearing an end. Sounds like wishful thinking to me! The Fed, the ECB and the Bank of England (BoE) have all pulled back, after sounding hawkish temporarily. The easing bias is set to continue and, therefore, there is little risk of an equity market sell-off anytime soon. If President Trump could do anything to ease the regulatory burden that the US economy carries, it would be a big boost to the GDP growth. Americans spent an eye-watering $1.9 trillion in 2016 just to comply with federal regulations. If it were a country, US regulation would be the world's seventh-largest economy, ranking behind India and ahead of Italy. The regulatory tab of the US is nearly as large as the total pre-tax profits of all its corporations.

Pride and Prejudice

"What has happened to summer?
That's what I want to know.
Is she on a vacation?
Who knows where did she go?
- Dorothy Ardelle Merriam, *One July Summer*

If you live in England, you will probably identify with the phrase: "What has happened to summer." I hope you are enjoying your summer where you are. Winchester and South-East England it is for me. The weather? A scorching hot 18 degrees. However, it's history that makes up for the lack of proper sunshine. Winchester, a city steeped in history, is England's ancient capital and former seat of King Alfred the Great, King of Wessex from 871 to 899. King Alfred is remembered as the medieval King who protected southern England from the Vikings, as well as introduced many social and educational reforms. A remarkable combination of soldier, statesman and scholar earned him the title "the Great" - an honour bestowed on no other English king. The city of Winchester and its surrounding district, have inspired a host of literary classics - from John Keats *Ode To Autumn* to Jane Austen's *Sense and Sensibility* (also the birthplace of the latter). This month marks the 200 year anniversary of the death of Austen and, to commemorate this occasion, the Bank of England will issue a new £10 note featuring Austen (the economist Adam Smith is on the £20 note, and the £50 note features James Watt and Matthew Boulton of steam engine fame). Austen was born in 1775 and wrote six novels before dying at the young age of 41. Austen succeeded at a time when it was all but impossible for a woman to write novels. She is one of the few authors from that era who is still widely read today. The copyright to one of her most popular works - *Pride and Prejudice* was sold for all of £110 in 1812. Publisher Thomas Egerton offered Jane £110 for the copyright to *First Impressions* (later *Pride and Prejudice*). It came out in January 1813, price 18 shillings, and was an instant hit. In the past 200 years, it has sold 20 million copies worldwide and has never been out of print.

Turning to the markets, there is little prejudice in the minds of investors as regards the markets. US equity indices – the Dow Jones Industrial Average (DJIA) and the S&P 500 (SPX) scaled new all-time highs last week as the Q2 earnings season continued.

As of Friday, 65% of US companies, that have reported so far have beaten consensus analyst earnings estimates. However, more encouragingly, it's the revenue beat rate, which stands at 67% (the highest since Q2 2011) that will keep the markets buoyant. Remember that top line revenue numbers are much harder for companies to manipulate. The fact that the revenue beat rate is higher than the earnings beat rate, is a sign of the good health of corporate America.

In Europe, at his press conference last week, European Central Bank (ECB) President Mario Draghi indicated that nothing had been decided about the ongoing Quantitative Easing (QE) which is currently running at €60 billion/month until the end of 2017. The ECB was not ready to commit to any timescale on tapering or to provide any "forward guidance" on it. In fact, there appears to have been very little debate at the ECB meeting about how much more QE may or may not be needed going forward. Draghi is scheduled to speak at the US Federal Reserve's (Fed's) annual economic policy conference in Jackson Hole, Wyoming at the end of August. That speech, could lay the groundwork for a policy move two weeks later, at the ECB's September meeting. The ECB's QE hasn't achieved what it set out to do - i.e. push the Eurozone inflation up to +2%. The Eurozone inflation slid to just +1.3% last month. If the ECB were to taper now, bond yields and the Euro would rise, and inflation could ease further, making the ECB's task of achieving its goal that much more difficult.

As US President Donald Trump's agenda has stalled, the rally in the US Dollar has fizzled. This, in turn, has seen US tech stocks; mining stocks and Emerging Market stocks perform well. US Tech stocks only generate 55% of their revenues domestically, which is the second lowest after the Materials sector. A strong USD environment hurts these two sectors more than others.

The Fed will conclude its two-day monetary policy meeting this week, and I do not expect it to announce an interest rate hike. In fact, a rate hike looks unlikely until the end of the year. The US unemployment rate, currently at +4.3%, has now hit a 16-year low and shows that the labour markets are tightening. However, wage growth is still stuck at a low level. Wages in May rose by +2.5%, the same annual rate as late 2015 and inflation is drifting lower. The Fed, therefore, will keep the borrowing costs low for longer to build price pressures and meet its +2% inflation target. US inflation has remained below that target almost continuously for more than eight years, including virtually the entire five and a half year period since the Fed formally adopted the target in January 2012. The Fed is still faced with a disinflation problem. When the unemployment rate was +4.4% in May 2007, wages for non-managerial workers were growing at over +4% annually. In May 2001, those wages were up +4% from a year earlier. Last month, non-managerial workers' wages grew by +2.4% from a year earlier. The slowdown in wage growth is worrying because consumer spending, which makes up the majority of US GDP, cannot accelerate unless wages grow. Hopefully, wage gains pick up over the course of the year.

Yields on inflation-adjusted bond have fallen, indicating doubts about the US economy's growth prospects. The yield on the 10-year Treasury inflation-protected security, or TIPS, is now at +0.50%, down from a recent high of +0.65%. The 10-year TIPS yield is the real yield or the yield on the benchmark 10-year Treasury note minus the rate of inflation. Recently, the media has been abuzz with reports that central bankers in the US, Canada, the Eurozone and the UK had signalled that the days of easy money are nearing an end. Sounds like wishful thinking to me! The Fed, the ECB and the Bank of England (BoE) have all pulled back, after sounding hawkish temporarily. The easing bias is set to continue and, therefore, there is little risk of an equity market sell-off anytime soon.

There is little else to note markets-wise - with plenty in the political arena to keep us occupied however, as the Trump circus continues. Trump's incessant claim that the Russia investigation is a "witch hunt," brings to mind the movie *The Untouchables*, and Al Capone's sneering taunt to federal agent Eliot Ness: "You got nothing." Capone, of course knew better. We don't know how this investigation will end and how long it will take, therefore, it is best to focus on economic data - and the data looks good if not stellar. If Trump could do anything to ease the regulatory burden that the US economy carries, it would be a big boost to the GDP growth. According to one estimate by Wayne Crews of the Competitive Enterprise Institute, Americans spent an eye-watering $1.9 trillion in 2016, just to comply with federal regulations. If it were a country, US regulation would be the world's seventh-largest economy, ranking behind India and ahead of Italy. The regulatory tab of the US is nearly as large as the total pre-tax profits of all its corporations. In next month's newsletter, I will share more on the regulatory burden that the Obama administration placed on the US economy.

I wish you a good summer and I will now head down to Jane Austen's former home in Chawton, Winchester, today a museum dedicated to the life of the novelist. As you walk down what was the main Winchester Road in the early 1800s, one can easily imagine the chaos it would have been then: Horse-drawn carriages clattering the road and all manner of conversation as people walked down main road and alleyways. Conversations, which could be overheard, had a window been open. No wonder Austen was such an astute observer of society. I read that she walked 2.7 miles each way to get her mail. That's two hours of walking. Thankfully, a simple click of a key on my iPhone delivers mine.

Best wishes,

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