Equities offset Fed tightening, for now

The Week Ending Friday May 11th 2018

US equities stormed back up last week rising 3%, while the USD was volatile but ended up flat. Bond yields and commodities were also flat. A reasonable result for nominal growth expectations after the previous week's disappointment based on USD strength reflecting fears of, or itself being, excessive monetary tightening.

The main economic news that partly drove the outcome this week was the weaker than expected Core CPI reading for April. Although hawks tried to claim it was due to some funny one-off movements markets ignored it altogether, thus allowing the great tech stock bounce back to continue driving up equity markets. Even the much feared US budget deficit showed a healthier than expected surplus in April, at least for now calming fears of a ballooning deficit. There was little other news in the week.

Fear of four hikes in 2018 ignored for now

The slew of FOMC member comments had little impact. The expectations to have three more 25bps rate hikes during the year (in June, September and December) has continued to move up to a 50% chance according futures markets. If that really happens then that is a very tough signal of intent by the FOMC. It spooked the markets a month ago when four hikes first became a real proposition, but markets seem to have gotten used to the idea. One reason why fears have calmed is the resilience of equity markets.

Equities resilient

According to Factset, for US equities reporting 2018Q1 earnings over the past few weeks, results have been very positive, especially for companies with a bias towards overseas earnings and revenues. Aggregate company revenues are a good sideways take on nominal GDP growth. Real global revenue growth is strong at 4% projected for 2018 and 2019, helping 2018Q1 show 8.2% YoY growth. Even for more domestically focused US companies, sales growth was 6.4% YoY in 2018Q1.

Whether Emerging Markets really can cope with three more actual Fed hikes is uncertain. Reports of EM Equity fund outflows would appear to indicate markets are somewhat worried. If these flows are correct, then slowing global growth could begin to cause disappointment amongst US company earnings. For now though, US company earnings expectations are doing quite well.

Next week sees data for April on Retail Sales and Industrial Production, plus some current month surveys. Retail sales have disappointed a bit in recent months, so April figures will be interesting. In contrast, Industrial Production and its subset Manufacturing Production have shown an upward trend over recent months. Since the outlook from US companies remains positive, these indexes should maintain their positive trend.