

A Short Update on Our Equity Market View

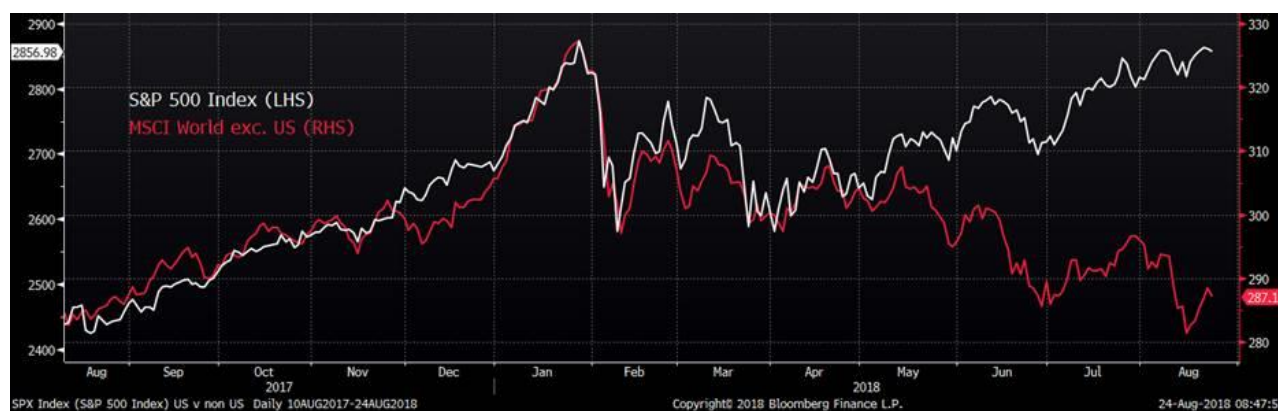
25th August 2018

Heading into the bank holiday weekend in the UK, and the end of summer, markets have been extremely quiet. We will keep this week's commentary short as there is not a huge amount new to say. We do, however, plan a longer commentary for next weekend (so please stay tuned in).

Equity markets have bounced a bit in the last week or so; something we allowed for in last week's commentary. From our little perch, we continue to see the US as showing the best momentum with emerging markets the worst and Europe and Japan somewhere in the middle. A closer look shows US indices generally flirting with all time highs whereas the MSCI World excluding the US is down about 12% (in US\$ terms) from the high seen in January.

From a technical/momentum perspective, it is difficult to be cautious on a market that is flirting with all time highs. Our multi-month topping thesis has been centred on global equities, but when we split US from the rest of the world, our thesis has a little more weight to it. Even allowing for a little more strength in the weeks ahead, we are cautious on non-US equities here and would view a break of recent lows (on the MSCI World exc. US index) as pretty much confirmation of the bearish thesis.

Chart 1 – US & non-US equities



For the US market, as we suggested a couple of weeks ago, a failure near January's high would leave the impression of a "double top" which would be a bearish pattern if the February and March lows around 2580 were broken on the downside. Chart 2 below shows a few things in more detail. First up, price has obviously been rising since the low in early May, and is above the rising 50 day moving average; this is bullish. However, there has so far been a hesitancy in the last two weeks to break out into new high ground. There is also a rising wedge being formed (red lines) which in technical text book analysis is an ending pattern and therefore ultimately bearish.

So, perhaps we were a little premature in a cautious call of a couple of weeks ago, but so far the index has failed to break out to new highs, so our view remains valid. For those that want to remain bullish short term, we would point out the chart support in the 2800 area (green horizontal line) which sits near the 50 day moving average. So long as the 2800 area holds, we have sympathy with the bullish view, however, we are very intrigued by the potential for a double top pattern.

Chart 2 – US S&P 500 with 50 day moving average (in blue)



We are regularly asked what it would take to change our cautious view. Well, from a pure price perspective, if US equities break high ground, then we would move back to at least a neutral position. For Non US equity markets, we would need to see price start to 1) trend higher, 2) start trading above medium and long term moving averages and 3) trade above obvious resistance levels. Either that, or become so oversold that a mean reversion rally were likely.

As an example, let’s look at the German equity market. Chart 3 below shows the Dax index, which bounced nicely off support a week or so ago. This has us on watch for a more constructive view, but to actually adopt such a view, we would want to see price start to trade above the 50 day moving average and for the moving average to start trending higher as well. A move above the declining trend line (in red) would bolster a bullish view as would price trading above the May and June highs in the 13170/13200 area.

Chart 3 – Dax Index with 50 day moving average (in blue)



From a fundamental perspective, a shift to a more dovish stance by the Federal Reserve would cause us to sit up. On this point, this weekend will see comments and speeches from central bankers at the annual Jackson Hole symposium, but of much greater interest to us will be the FOMC meeting at the end of September. President Trump is increasing the verbal pressure on Chair Powell, and it will be interesting to see both the outcome of the September meeting and also the press conference. At the moment, we don’t expect the Fed to be swayed by political interference, but we shall know more in a few weeks time.

So until we see signs of real price improvement in markets, or a demonstrable shift by central banks back to very dovish policies, we will maintain our current equity market views. Overall, we are cautious, with our main working thesis being that global equity markets are in a multi-month topping pattern. Short term, the US remains the strongest and emerging markets the weakest. We will have to become more constructive on the US if price breaks to new high ground, which is really not far away. For global markets excluding the US, a lot more work needs to be done before we would become bullish.

So that's it for this week; nice a short for a long weekend. As noted at the beginning, we will be writing a longer update.

Stewart Richardson

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