Global Asset Management

BlueBay Asset Management

Portfolio Manager Perspectives
Mark Dowding's Global Macro Update

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Done Up Like a Kipper!

Longer-term conditions bullish, but potential for a summer squall.

Core rates drifted lower over the past week in quiet summer conditions, while equities have largely tracked sideways as we embark on earnings season. However, bond spreads have continued to grind tighter, especially in the European context, as expectations for a dovish European Central Bank (ECB) build ahead of next week's meeting.

In the US, the dollar has staged a bit of a comeback of late as European data has remained weak and rhetoric from ECB officials has generally been to the dovish side. In contrast, we have had more firm data out of the US (eg the Philadelphia Fed Business Outlook, retail sales and US labour data).

US data in general has remained fairly robust so far in 2019, and will feed into the Federal Reserve's (Fed) decision on whether or not — or by how much — to ease monetary policy later this month. We believe the Fed will deliver what the market expects in the short term, but further out the market is far too pessimistic on the robustness of the US economy.

Dollar intervention?

In the FX world, there has been increasing speculation around the potential for President Donald Trump to order the US Treasury to actively intervene to weaken the dollar. Trump has tweeted regularly about how the US is being disadvantaged by the dovish monetary policy stance being adopted by central bankers around the world (particularly the ECB).

There are tools at his disposal to put this into action, and we don't doubt that he'd be prepared to use them. Again, right now this is speculation, but we don't discount it becoming a reality by the end of the year. After all, there is a presidential election to be won in 2020.

This possibility has made us less enthusiastic about running long USD, despite the strong performance of the US economy, and our view that US rates should move higher.

UK Parliament prevents prorogation

The soap opera in the UK continues apace. We reduced the short position we have in sterling as Parliament voted positively on an amendment to prevent the next PM — most likely Boris Johnson — from proroguing Parliament to ensure the UK leaves on 31 October. This increases the probability that the next PM will be forced to call an early election and request a further extension from the EU.

We continue to believe that uncertainty and chaos will persist into the autumn and expect volatility around the party conference season, but for now it makes sense to be reducing the position. The pound hit a two-year low versus the US dollar earlier in the week and we believe risks will continue to lie to the downside.

All eyes on the ECB

We remain 'risk-on' in terms of spread-duration exposure, via European sovereign risk (Greece and Italy stand out particularly from a valuation perspective), and in terms of corporate and financial credit risk.

On credit, we continue to be constructive on global investment grade, favouring taking risk in European subordinated financials, as well as defensive issuers from non-cyclical sectors such as tobacco and healthcare, with a strong focus on deleveraging and positive free cash flow generation.

In European sovereign risk, all eyes will be on the ECB governing council next Thursday, when policy action is widely anticipated by market participants, following Mario Draghi's dovish Sintra speech last month. We are concerned that expectations for the ECB next week are somewhat elevated, increasing the risk of disappointment, and this may warrant a short-term reduction in 'risk-on' beta ahead of the meeting.

Short-term clouds

Looking ahead, at the margins, we are also becoming a little more uneasy over progress being made on the China/US trade deal. There have been a few worrying reports in the media and, after a good run for risk assets, we are concerned that the storm clouds may be building for a summer squall.

This is a nuanced view, as we still believe conditions are bullish for risk over the longer term, especially for spreads in Europe. Here's hoping summer markets stay cool and investors are not 'done up like a kipper', unlike so much of the British public!

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