Cloudy with a chance of meatballs

The remains of Hurricane Bertha have hopefully passed over without apparent major damage or loss of life. Although downgraded to a tropical storm, it was forecast to hit the UK with torrential rain and high winds, prompting numerous weather warnings across the UK. The Met Office said however, in the week running up to it, that its definite course was unknown and that it could alternatively head towards France and miss us completely. In terms of timing, there was also a wide spread of possibilities as they were not sure whether it would affect the UK on Sunday or early this week. **Where is weather legend Michael Fish when you need him? 'Earlier on today apparently a woman rang the BBC and said she had heard there was a hurricane on the way. Well if you are watching, don't worry there isn't'**. In the early hours of 16 October 1987 winds reaching 122mph hit the south –east corner of Britain and the rest as they say is history. Which got us thinking that weather forecasting sounds just like the stock market. Interest rates are going to rise in the UK and everyone has an opinion of the likely timing of the first hike but no one knows precisely when. Sounds like it's going to be cloudy with a chance of meatballs!

What are we reflecting on this this week?

Last week marked the centenary of the First World War that engulfed Western Europe, sparked by an assassination in Sarajevo and believed at the time to be the war to end all wars. Fast forward to today and we have fighting across the world in the Ukraine, Syria, Iraq and Gaza as well as increasing anti-western militant action across parts of Africa.

Russian sanctions continue to be the main concern for equity markets and the potential impact on Eurozone growth. Mr Putin was reported to be preparing retaliatory moves including considering a ban on certain European food imports and airlines flying across Russian airspace to Asian destinations. This would add 4000km to a journey and $30,000 to fuel costs. However, Russian airline Aeroflot could in turn lose $300m in fees from European airlines. This is a good example of how sanctions could hit both global and Russian businesses and why stock markets are so uneasy – **markets hate uncertainty.**

Increased risk aversion was particularly notable in Europe with the 10 year German bond yield falling to a new low of under 1.1% while the two year bond briefly moved into negative territory. One would've thought such times were a thing of the past.

Thin summer holiday trading volumes added to volatility. The mood was not helped particularly in the USA by the collapse of two $120bn mega-bids, Fox/Time Warner and Sprint/T-Mobile. The pharmaceutical sector moved lower as mega-bids were also in the spotlight with a spoke person for the US Treasury suggesting that it was reviewing options to address the ability of US companies to engage in tax inversions. However despite this Walgreen pushed ahead with its takeover of Alliance Boots.

More importantly, Russian sanctions together with Argentinian debt default and the €4.9bn bail out of Portugal's Banco Espirito Santo has **overshadowed the more hawkish inflation noises from the US Fed with speculation that the Fed will raise interest rates sooner than expected. The CEO of HSBC informed analysts that he felt a UK rate rise was possible in Q4 2014 and a US rate rise in H1 2015.**

In the **UK** the construction sector CIPS survey was a fraction lower but still within striking distance of the 2007 peak. There was a continued acceleration in civil engineering activity while not surprisingly residential building saw the steepest rise in activity since 2003. The CIPS services PMI improved to an eight month high suggesting that UK Q3 GDP is on track for +0.8% in line with Q2. However, house builders slipped on news that Lloyds, the biggest mortgage provider in the UK, was curtailing its Help- to-Buy lending to £150,000. **The UK economy remains unbalanced as the manufacturing sector continues to lag behind consumer driven areas of the economy** with the CIPS survey also suggesting that manufacturing will provide only a modest contribution to growth in Q3.

UK Gilts, Sterling and FTSE 100 companies with material Scottish operations have also had to contend with the uncertainty created from the Scottish independence vote which is just six weeks away. However, **Scottish independence hopes took a knock after Alex Salmond was adjudged to have lost the US style TV debate with Alistair Darling.** Sterling dropped to $1.68 against the US Dollar.

In Europe, German manufacturing data for June fell unexpectedly at the fastest rate in three years. To add to market woes **Italy slipped back into recession for the third time since its economy peaked in 2007**. Clearly the challenges to European recovery are intensifying although this has helped to achieve one of Mr Draghi's goals which was to weaken the euro which hit its lowest level against the US Dollar for nine months.

In the **US** the ISM non-manufacturing index recorded the strongest reading since 2005 with business activity, new orders and employment improving but prices are increasing at a slower rate which suggests early action by the central bank is not required.

Confidence in the **Chinese** growth outlook were shaken a little by the lowest HSBC services PMI reading for nine years on weaker business. However, as the authorities push ahead with structural reform in the second half of 2014 it seems only logical that Chinese growth should slow.

Interest rate hike timing, Scottish independence vote, Russian sanctions ....sounds like it's going to be cloudy with the chance of meatballs.

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