Nobody expects the Spanish Inquisition

The surviving members of the iconic and influential comedy group Monty Python recently closed out their re-union show. One of their famous sketches is the Spanish Inquisition which we thought was an apt title for this week's Alpha- Bites given the drop in Spanish 10 year bond yields to a level below that of the UK!

The other news this week has been about profit warnings from UK companies which have hit a three year high despite the continuing recovery in the UK and US economies. This is on top of company specific issues like FTSE 250 constituent Afren last week which, saw over 25% of its value wiped out in a morning when both the CEO and COO were temporarily suspended pending an investigation. **UK listed companies issued 137 profit warnings in the first half of 2014 up 9% on the same period last year while the trend deteriorated into the third quarter.**

Increased competition, slowdown in emerging markets, squeezed margins and currency were the reasons for the profit warnings. The main factor has been the strength of Sterling and the market is now pretty well discounting a rise in UK interest rates ahead of the 2015 general election. With these factors and analysts having modelled in higher exchange rates into their forecasts and some recent weakening of Sterling relative to the US Dollar then **the number of profit warnings from currency should be expected to diminish**. It goes without saying that we are constantly monitoring our investments to avoid any possible nasty surprises.

What are we watching this week?

There was **some justified criticism from the IMF alongside that of many others, about the Bank of England's muddled attempts to explain its forward guidance strategy** over the last few months. The **IMF also said that it believed Sterling's exchange rate is overvalued by between 5%-10%** preventing the re-balancing of the UK economy away from a reliance on consumer spending and imports.

Summer market volumes continued to be subdued with fewer than 750m shares traded on some days with geo-political issues ongoing although Brent oil remained around $107. **The market continues to work out the likely impact from the latest sanctions against Russia**. Interestingly, within the FTSE 100 **BP** which has a 20% interest in Russian energy giant Rosneft, said, that although it had not yet been affected by sanctions that it could be in future. This is in marked contrast from a number of leading German companies. Adidas issued a profit warning saying it would accelerate the closure of Russian stores while Volkswagen reported an 8% decline in sales of its cars in Russia. **Siemens CEO warned that Ukraine geo-political tensions posed serious risks to European growth.**

Russian sanction concerns led a flight to safety within Europe with German 10 year bond yields falling to 1.12% their lowest level since the depth of the euro crisis. Eurozone headline inflation slipped to a new low of 0.4% in July. Spain's 10 year bond yield fell below 2.5% for the first time in over 200 years, comparable to the yield on US 10 year treasury stock and below that of the UK 10 year treasury at 2.75%. **To quote Monty Python 'I wasn't expecting that or the Spanish inquisition!'**

In the USA, consumer confidence surged in July with the Conference Board index hitting its highest level since October 2007 which reflects the continued improvement in the jobs market. US Q2 GDP growth came in at 4% towards the higher end of expectations with consumer spending which makes up over two-thirds of economic activity increasing by 2.5%. **The Fed continues to taper monthly bond buying by $10bn citing the improving labour market and looks on course to end the purchase programme by October.** It re-iterated that it would keep rates near zero for a considerable time while an accommodative stance was still needed. However**, a notable feature of the Fed statement was the dissension from Philly Fed Chairman Plosser and the change in language**

regarding inflation which has moved somewhat closer to the Committee's longer-run objective. This slightly more hawkish statement saw Sterling continue to weaken against the US Dollar to under $1.69.

In **Asia** the MSCI Asia Pacific index hit a new six year high. Official Chinese manufacturing data touched a 27 month peak. **Sentiment was also helped by rumours that the Chinese state owned asset management companies might consider buying bad loans from financial institutions. A China Securities Journal also suggested that the authorities would shift their focus from mini-stimulus to structural reforms in the second half of 2014**.

In **Japan**, industrial production for June dropped more sharply than expected while economists refined forecasts ahead of the forthcoming Q2 GDP data release which will reflect the impact of the sales tax hike. This has seen some estimates widen to an expected drop of over 8% which would be greater than the Q1 growth and the biggest drop since the earthquake/tsunami/Fukushima in Q1 2011.

Argentina defaulted on its debt for the second time in thirteen years and needless to say there is a high degree of uncertainty about what will happen in the bond market and the country itself.

.. .and just as if the market didn't have enough to worry about with Ukraine, Gaza, Iraq and Argentina there is now growing news about the deadly Ebola virus which may have an indirect impact on certain sectors as with previous avian flu outbreaks. Fortunately, judging from the trading updates most of our investments look to be in pretty good health although we expect continued volatility over the summer due to geo-political tensions and the fact that many fund managers will be away on summer vacation.

If you wish to discuss any aspect of this newsletter, please do not hesitate to contact us.

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