ALPHA BITES……bite sized pieces of information

Fluffing the economy?

Many of our readers may have noticed a slightly European theme to Alpha Bites in recent weeks with Eurovision, euro elections and European contestants in BGT. We were therefore amused to see last week that the UK is to join a number of European countries including Austria, Estonia, Finland, Norway, Slovenia and Sweden by adding prostitution and drug dealing in the measurement of GDP. The Office for National Statistics (ONS) has estimated that **prostitution and illegal drugs could add as much as £9.7bn to UK GDP.** The ONS has calculated that each of the UK's 60,879 prostitutes took about 25 clients a week in 2009 at an average price of £67.16. I wonder who worked this one out at the ONS…. busy day at the office darling? Apparently, on further investigation this is an ONS estimate based on research undertaken in the Netherlands which brings a whole new meaning to the phrase 'going Dutch'.

What are we watching this week?

Market volumes have remained subdued with investors awaiting for news from the ECB and in the absence of any mega-bids although rumours continued to focus on Smith & Nephew. In the UK the CIPS manufacturing purchasing manager's index edged up further in May having shown growth every month now since March 2013. **While good news for the UK manufacturing sector this has not been reflected in share prices. This is because earnings revisions continue to languish in negative territory. In many cases this can be attributed to the strength of Sterling** which has masked an improved trading performance. However there continue to be more company specific profit warnings such as Fenner (coal mining related) and ASOS (margin pressure from higher discounts).

The May 2015 General Election is appearing on the horizon and with the prospect of another hung parliament means that politics may start to have some impact on Sterling. CIPS **construction PMI eased back slightly in May reflecting some shortages in the supply chain.** Brick prices have already risen by over 7% in the last 12 months and imports of bricks have returned to pre-recession levels. Despite politician's demands for more houses you can't build new homes if you haven't got sufficient bricks!

Market research data revealed the **weakest level of trading activity for UK supermarkets for about 11 years** which to quote the late David Coleman is 'quite remarkable' when you consider the magnitude of food inflation and population growth. **Tesco's first quarter trading update was expected to be poor, the worst from the company in a generation and so it turned out to be.**

Quote of the week within the food retailing sector must go to Sir Ken Morrison who addressed the Morrison management team and CEO Dalton Philips at the AGM with the following comment. 'When I left work and started working as a hobby, I chose to raise cattle. I have something like 1,000 bullocks and having listened to your presentation, Dalton, you've got a lot more bullshit than me'. Sounds like a great AGM to have attended!

The Mining sector recovered slightly following the re-assuring Chinese manufacturing PMI although the iron ore oversupply debate continued with the iron ore price finishing at a third below where it started in 2014. Reflecting this **Rio Tinto's yield premium relative to the market moved to a thirty year high.**

 **In Europe Mr Draghi outlined a three pronged attack with policy easing (interest rate cut), enhancing the transmission system (two targeted long term refinancing operations or TLTRO's of €400bn) and the promise of further use of unconventional instruments if needed (QE). The main headline however was his comment that the ECB was not finished here.** Whether a 10bps interest rate cut is sufficient to reverse the downward inflation data remains to be seen, likewise will potential corporate borrowers have the confidence to take up the funds offered by the ECB? We may well be **back to the crazy situation over the summer months where bad news is good news in that disappointing economic data is likely to increase the chances of outright QE** later this year by the ECB. **The Spanish 10-year bond yield is now 2.6% and below that of the UK at 2.62%.**

 **In the USA the recovering economic growth story still looks intact although data while generally supportive is still mixed.** The manufacturing sector is still growing, after initial confusion over an erroneous seasonal adjustment. The corrected May manufacturing services index improved reflecting steady growth. US factory orders grew in April and order backlogs continued to grow. The Fed beige book confirmed that the US economy continues to grow in every region with labour demand building and house prices rising. Jobs data was also better than expected with non-farm payrolls advancing by 217,000 last month. **Net trade looks set to continue to remain a drag on US growth after the monthly deficit grew to over $47bn as imports hit a record high. However, on a positive note this does reflect strong consumer demand and US car sales increased by 11% in May.**

 In Asia, Japan's industrial production data for April missed expectations raising hopes of more Abenomic stimulus measures, although there was an upward revision to Q1 GDP thanks to better capital spending. Elsewhere there was commentary that the Chinese are gradually turning up the stimulus tap behind the scenes and there was cut in the reserve requirement ratio for some qualified banks. Against this the HSBC China Services PMI dropped slightly. China's exports grew by 7% in May, ahead of estimates but imports dropped slightly. This trade data is consistent with economic recovery in the advanced economies and weakness in domestic investment.

Overall trading volumes remain subdued heading into the summer holiday season. **The recent fall in bond yields might have bearish implications for equities given that bond markets typically tend to be 12 months ahead of equities on economic outlook. However the fall in yields may partly be** partly explained by the currently **subdued inflation outlook**, **a shortage of new bond issuance** and actions by the Fed in the USA and the ECB in Europe. Certainly the flow of **economic data remains supportive for equities and cash flow supportive of dividend growth and acquisition activity.** A major reversal in the strength of Sterling would be helpful to many UK listed companies although Mr Draghi's comments suggest the headwinds are likely to remain for the foreseeable future.

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