

The information, news and data provided below highlight the key macro economic and corporate events currently affecting global markets. You should ensure that you are familiar with these issues in order to demonstrate your market knowledge and interest.

## MACRO ECONOMIC NEWS

### EQUITY MARKETS FALL ON GEOPOLITICAL TURMOIL BUT LOSSES PROVE SHORT LIVED, OIL REMAINS WEAK

- Seeing the recent tragic world events it would be easy to assume that we would have seen significant weakness in global financial markets, in fact this has not happened. The news that a Malaysian Airlines plane was shot down over Eastern Ukraine and the continued conflict in Gaza saw the S&P 500 fall over 1% last Thursday, the first time this has happened in 63 trading sessions (highlighting the recent lack of volatility), however markets have recovered and now stand higher than before these events. The oil price, which has been drifting lower since its 2014 peak in June, staged a small rally on the unfolding events in Gaza but the response was very modest. Traditionally any tension in the Middle East causes a sharp rally in the price of oil on fears of supply disruption however as the US moves towards self sufficiency markets have worried less about these events. Speculators had been actively buying oil in June on the belief that the situation in Iraq (OPEC's second largest producer) would lead to a significant squeeze on supply, this proved not to be the case and many of those long positions were cut at the end of June and the beginning of July. The level of bullish bets on the price of oil has been cut to its lowest level since 8<sup>th</sup> April. In a sign of how weak crude prices have been prior to the events in Gaza Brent crude fell intra day from \$108 to \$104, the biggest one day fall for many months.
- On news that the Malaysian Airlines flight had crashed, shares in the major US airline companies fell on average 2.5%, however their European counterparts fared better with only modest losses. Usually after such events you would expect to see significant weakness in the sector, I think part of the reason we didn't see this is due to the fact that two of the largest European airlines had recently had profit warnings. In mid July Lufthansa shares fell 14% on the announcement that profits could be 33% less than some analysts prediction and Air France KLM said that rising competition and weak cargo demand would adversely affect numbers, causing a 5% drop in its share price.
- In another sign that investors are not unduly concerned about the geopolitical situation the VIX index (sometimes referred to as the 'fear gauge') rose sharply on the day of the plane crash but is now back to previously low levels.
- **Q:** What level of the VIX index implies investors are comfortable taking greater risk?
- **A:** Until recently a level below 15 was seen by investors as a signal of confidence, however recently there has been such low market volatility that the 12/13 level is now more representative of a risk on attitude. During times of extreme market weakness, such as post Lehman's collapse, the VIX index traded as high as 80, presently it stands at 11.85.

### SHORT INTEREST STANDS AT LOWEST LEVEL SINCE THE FINANCIAL CRISIS BEGAN

- Short interest is the amount of stock that has been sold by speculators who are looking to benefit from a fall in prices, this can be measured as part of the index, for example the S&P 500. Figures compiled this month show that this short interest stands at ultra low levels, for example in the FTSE all share the short positions stand at under 1%. In the S&P 500 it is just 2%, having peaked at 5.5%. It is easy to assume that shorting stocks is negative for markets, it is fact healthy for markets to have a reasonable level of shorts. If an event leads to significant market weakness then investors who are short will look to buy back those positions (for a profit) creating some stability, usually well ahead of pension and investment funds.
- **Q:** What sort investors use short positions and why?
- **A:** Although most funds can create 'short' exposure we usually refer to hedge funds as 'long/short' funds, that is they will run a portfolio that has a combination of long and short positions within it. The benefit of having some short positions is that the fund can make money under any market conditions, even when they are falling sharply, hence the name 'hedge fund'. Some funds will have a 'delta neutral' mandate, that is that the value of the long and short positions will be the same which limits market exposure, effectively trying to pick winners over losers, without exposing the fund to excessive market risk. For this reason it is very hard for delta neutral funds to compete with 'tracker funds' (who look to mirror the move in a markets such as the FTSE 100) when markets are as strong as they were last year. If, however, we saw a dramatic sell-off in markets you would expect these long/short funds to perform considerably better than the trackers.

### THE HEAD OF THE CBI WARNS POLITICIANS NOT TO DAMAGE THE ECONOMIC RECOVERY

- John Cridland, the director-general of the UK's biggest business lobby group, the CBI, has warned the new ministerial appointees and their Labour counterparts to make decisions that encourage economic growth rather than playing politics. He was confident that the UK could achieve 3% economic growth this year but added that companies faced an array of political issues, including the referendum on Scottish independence, next May's general election and the 2017 vote on EU membership.
- The CBI director also called for 'A' levels to be offered in vocational courses such as engineering that would have the same 'parity of esteem'.

### US EARNING SEASON IN FULL SWING, ALCOA KICKS OFF WITH A 50% EARNING BEAT

- The financial statement from the US aluminum giant Alcoa always kicks off the US reporting season and is hotly anticipated as the strength (or otherwise) of these figures is seen as a measure of US corporate health. This time Alcoa cheered the market with a 50% earning beat and its share price rose by over 2%. In the US tonight we have one of the busiest sessions with the likes of Apple, Verizon, Microsoft and McDonalds all reporting. All of these figures will be announced once the market has closed (the closing level of the S&P tonight will not be as important as the reaction to these numbers will not be registered until the following day). US stocks do trade in what is known as the 'after market' so investors are able to trade and market commentators are able to get a good idea of the likely opening prices. Apple makes up about 3.5% of the entire S&P index by value, therefore a significant move the Apple share price can have an affect on the index.
- **Q:** Why do a lot of US companies report their financial statement after the market has closed.
- **A:** In the US many companies report 'after hours' (post the official close) and in the UK most companies report at 7am (prior to the official market open of 8am) because it gives research analysts and investors time to digest the news, if the shares of the company who was reporting were in live trading there is a chance that the investors could be disadvantaged by knee jerk reactions in share prices before a true picture emerges of how a company is doing.

## CORPORATE NEWS

### AFTER ANOTHER PROFITS WARNING TESCO CEO STANDS DOWN AND IS REPLACED BY FORMER UNILEVER EXECUTIVE

- Investors were shocked yesterday by the news that Philip Clarke, Tesco's CEO, is to stand down in October and is to be replaced by Dave Lewis. Lewis is the global head of personal care at Unilever and was widely seen as the heir apparent to Unilever CEO, Paul Polman. Lewis will be the first non-retailer to run Tesco's in its 95 year history. Yesterday Tesco's shares initially rallied over 3% but finished the day up just 1% and today they are down 3.5%, highlighting the difficulty of the task ahead for the new chief executive. Lewis is seen in the industry as a turnaround specialist. Shares in both Sainsbury and Morrison's have fallen 3% since the announcement as investors reacted to the fact that there is unlikely to be any let up in the savage price war that has beset the supermarket sector recently.

### SHARES IN MAJOR TOBACCO COMPANIES FALL AFTER REYNOLDS RULING

- Last week a Florida court awarded Cynthia Robinson damages of \$23.6bn against R J Reynolds, the US second largest cigarette manufacturer, who blames the company for the death 18 years ago of her husband Michael. A spokesman for Reynolds said that the fine was 'grossly excessive and impermissible in state and constitutional law'. Shares in Reynolds fell as much as 4% before recovering some of the earlier losses. The damages are equivalent to 75% of the market capitalization of the company. In the UK we have two FTSE 100 listed tobacco companies, British American Tobacco (known as BATS) and Imperial Tobacco. The shares in the UK listed companies fell about 1%. This falls seem very small given the magnitude of the damages awarded but is worth remembering that Reynolds will appeal against the ruling and that Philip Morris (the world's largest cigarette manufacturer) had a \$28bn claim reduced to a \$28m award on appeal.

### GRADUATE JOBS IN FINANCE STILL THE BEST PAID

- The Times recently wrote an article in conjunction with a graduate employment company about the most popular and well paid graduate entry positions and the financial services sector came out as the highest paid at, with on average a £45,000 starting salary. Since the financial crisis and the subsequent criticism of the banking sector it has been harder for the top financial institutions to attract the best graduates, missing out to the big law firms and consultancies. As well as trying to improve their image banks have also been keen to recruit across a more diverse group of candidates, along with making sure that they are the best payers in the market place

### ABBVIE FINALLY SECURES SHIRE WITH A \$54 BILLION OFFER

- The board of Shire Pharmaceutical has recommended a cash and shares offer from AbbVie that values the company at \$54bn or £53.20 per share. The deal will create one of the 50 biggest companies in the world and is the latest of many corporate deals announced this year. As we discussed in previous emails part of the rationale for the deal is so that AbbVie can move their tax headquarters to the UK, thus reducing their level of corporation tax from 22% to just 13%.

### INTERVIEW QUESTION: Why does the current extremely bad geopolitical environment appear to have such a small affect on markets and sentiment?

- A:** As we have discussed in this email markets have been largely unfazed by recent global events including, turmoil in Egypt and Syria, a coup in Thailand, violence in Iraq and the situation in Gaza and Ukraine and yet equity markets remain near all time highs and volatility at near all time lows, can this situation continue? Most of the global unrest we have seen has little impact on near-term economic growth in the world. There is a belief that the global economic powers do not want to see an escalation of the conflicts around the world. Central banks are also seen as a backstop to markets (as discussed in previous emails), not allowing situations to damage the economy and keeping a firm grip on monetary policy. The recent corporate activity has also supported markets with investors rewarding companies that make acquisitions. The tension in the Middle East has failed to see any sustained rise in the price of oil (which could cause economic headwinds). There is also a trend of 'buying the dip', that is any sell off is an opportunity to buy cheap assets, whilst this view prevails there are plenty of investors who are happy keep buying.
- It is worth sounding a note of caution, when investors become complacent about risk it can be a signal that markets are due correction, at the beginning of this year the 'put/call ratio (a measure of how much market participants are protecting themselves against a market shock) fell to its lowest level for many years, the FTSE fell 7% at one stage in February.

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EUROPEAN MARKETS (22/07)	Price	14 day change	52-wk High
<b>FTSE:</b>	6786	-0.5%	6894
<b>DAX:</b>	9709	-2%	10051
<b>CAC:</b>	4358	-1%	4598
<b>US MARKETS (22/07)</b>			
<b>S&amp;P 500:</b>	1982	0.25%	1985
<b>NASDAQ:</b>	4456	unch	4485
<b>COMMODITIES (22/07)</b>			
<b>BRENT:</b>	\$107.8	1.8%	\$119
<b>GOLD:</b>	\$1310	-0.5%	\$1796
<b>BOND YIELDS (10yr on 22/07)</b>			
<b>US TREASURIES:</b>	2.48%	-4%	
<b>GERMAN BUND:</b>	1.16%	-12%	
<b>UK GILTS:</b>	2.59%	-5%	
<b>SPANISH:</b>	2.58%	-4%	
<b>CURRENCIES (22/07)</b>			
<b>GBP/USD:</b>	1.7057		
<b>EUR/USD:</b>	1.3465		
<b>JPY/USD:</b>	101.46		
		VIX Index: 11.85	

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