UK: +44 (0)207 989 0813
NA: +1 646 896 3065
AU +61 2 9280 0700
action@proactiveinvestors.com

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JP Morgan says FTSE 100 is a good investment due to weak pound and dividends

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The FTSE 100 is a potential counterintuitive bet for JP Morgan Cazenove as the index as the US dollar appears to bottom out and dividend cancellations seem to have stabilised.

London's blue chip equity index is "looking more and more interesting", equity strategists at the investment bank reckon, after five years in the dog house.

"This might appear counterintuitive given the Brexit uncertainty and the likely continued labour market and activity weakness," they said in a note on Monday.

However, the pound and bond yields are actually still the "key drivers" of the Footsie, with the strategists noting that FTSE 100 valuations are at "record cheap levels".

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As most followers of the UK's blue chip benchmark know, it has a strongly inverse correlation to sterling, especially its relationship with the dollar.

"If GBP is softer due to Brexit risk, FTSE 100 will likely hold up better," the strategists said.

"Also, UK equities are a big dividend play and outperform when bond yields are lower. We think the peak of dividend cancellations is behind us, and the weakening UK labour market is likely to keep bond yields subdued."

The prediction is the FTSE 100 will outperform the FTSE 250 on the weaker pound and subdued UK activity, which will hit the mid-cap index more.

Long positions, 'buys' in other words, were also suggested in pharma, consumer staples, tech, mining, utilities, while keeping a bearish stance on energy and banks.

There are also implications of the US dollar potentially bottoming out on the overall equity market and it is "not a great sign for the overall equity market, in our view", the strategists said, especially if the dollar rebound is coupled with factors such as stalling economic data, as seen in the PMI reports last week in Europe, more EPS revisions, weaker oil price and bond yields remaining stuck in a range.

A recovery in the US dollar would be bad news for emerging markets, but if the euro has peaked it's good news for European exporters.

JP Morgan's cross asset team, meanwhile notes that defensive assets were not providing much defensiveness of late.

"Equities continue to experience their deepest correction since bottoming in March, but focusing only on stock market declines misses the equally-important erosion in cross-asset correlations that has emerged this month," they said.

Few of the safe assets are moving in the expected direction: the US dollar is up 2% versus emerging market currencies,

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10-year German yields are down 10 basis points, but US 10Y and 30Y yields, USD/JPY and EUR/CHF are almost unchanged. Gold is off 6%.

"So a typical basket of defensives is functioning about as well as fire insurance that covers just one bedroom in the house."

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