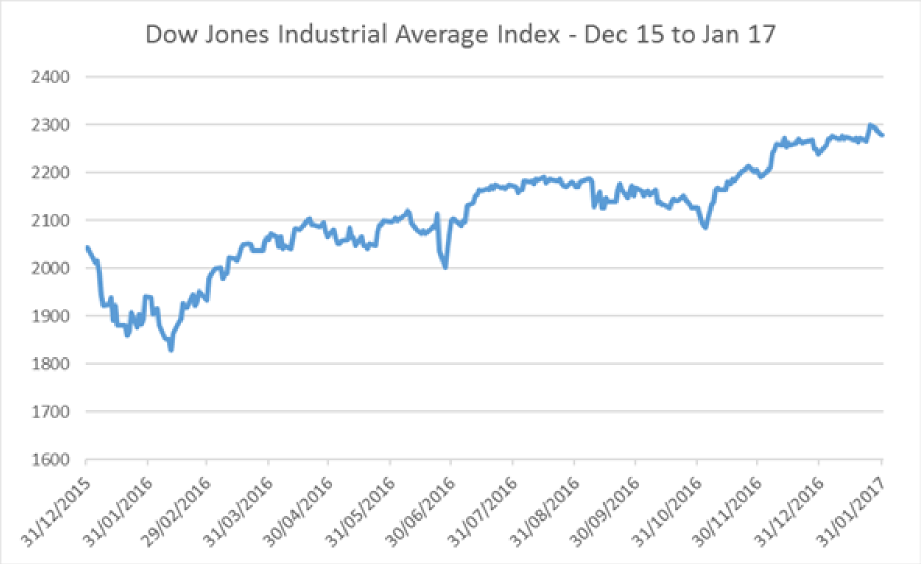
January 2017 – Market Commentary

As in 2016, markets in January were fixated with politics and political developments, mainly with the inauguration of the 45th President of the USA, Donald Trump, on 20th January. Markets followed every tweet and Executive Order from the new President, and Trump didn't waste any time in enacting orders to implement some of the policy proposals that he campaigned for. He repealed Obamacare, withdrew the US from the Trans-Pacific Partnership (TPP), ordered a renegotiation of the North America Free Trade Agreement (NAFTA), approved projects to build new oil pipelines, planned the construction of the infamous wall along the Mexican border and imposed an immediate travel ban on nationals from 7 majority-Muslim countries. It was a busy first week at the office. A lot of the executive orders were largely symbolic, particularly from an economic point of view, although there is no doubting the social impact of some of the orders, particularly the travel ban. The markets still await details of policies with a bigger economic slant, such as tax reform.

Outside of the US, there is still plenty happening to keep the markets interested. In the UK, while the press dwelled on the news that Mrs May was the first world leader to visit President Trump in Washington DC, Brexit still dominated the headlines. The main story was that the government lost its appeal at the Supreme Court surrounding the need to consult Parliament before triggering Article 50. This was hardly a surprising decision, and Mrs May wasted no time in pushing through a White Paper to allow Parliament to vote on the matter. The House of Commons voted overwhelmingly to trigger Article 50 and, although the White Paper still must pass through the House of Lords, this has effectively removing any further political obstacle to adhering to the end of March timetable. The Prime Minister also made a speech that indicated that Britain is aiming for a "Hard" Brexit, with no Single Market access. In Europe, the forthcoming elections in the Netherlands, Germany and particularly France have remained forefront in investor's concerns. The Presidential vote in France is heating-up. Marine Le-Pen is ahead of rivals Fillon, Macron and the new Socialist candidate Benoit Hamon, in the first-round opinion polls, although she is not expected to win in the second-round. However, last year's political experiences suggest we should take opinion polls with a pinch a salt.



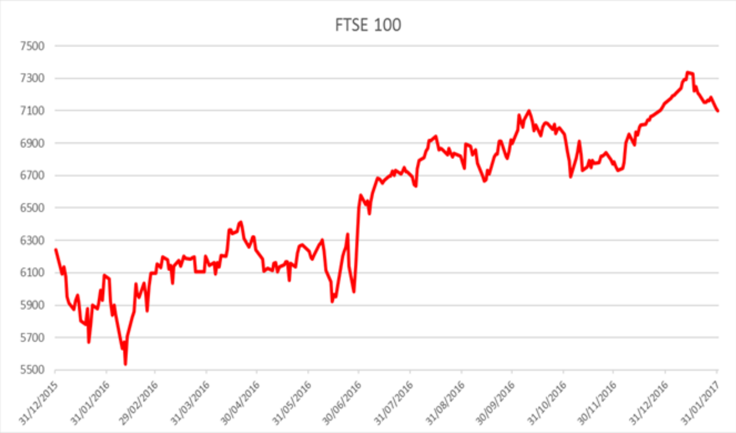
Source: Bloomberg

The markets started the year on a positive note. Equities rallied with some indices reaching all-time highs. After testing the level for most of December, the Dow Jones Industrial Index finally broke the 20,000 barrier at the end of the month. The FTSE 100 Index reached new highs mid-month after a record breaking 14 consecutive days of increases, although finished the month slightly down. European and Japanese equity indices were fairly flat and bond markets were also range-bound. However, the dollar gave up some of its recent gains, particularly against the Euro, Yen and Renminbi, having the worst January performance in over 30 years as the new administration accused Germany, Japan and China as being currency manipulators. This is another example of comments from Trump and his advisors having an immediate and decisive impact on the markets, which is likely to be major theme as we move through 2017.

UK

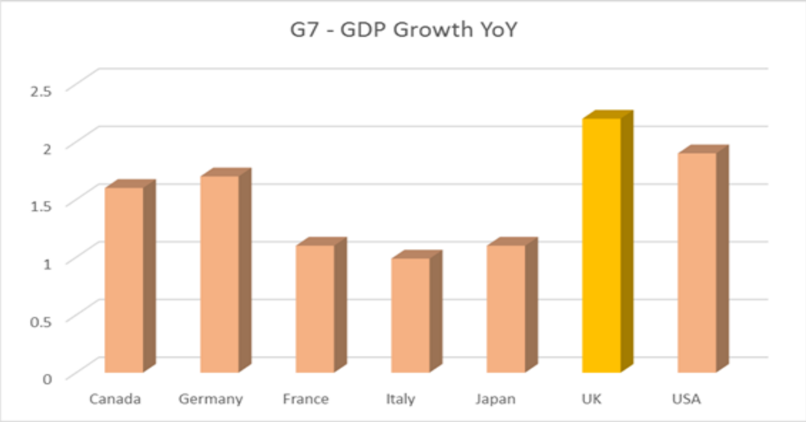
January was another busy month for UK politics. Prime Minister, Theresa May, was the first world leader to visit the newly inaugurated President Trump at the White House. In return, the President has been invited to pay a state visit to the UK later in the year. On the face of it, this was a success for Mrs May, as the visit appeared to cement the "special relationship" between the UK and the USA, and the images echoed those of the Thatcher-Reagan era in the 1980s. President Trump was a vocal supporter of Brexit and the meeting suggested the possibility of future trade deals, which could help alleviate some of the impact of leaving the Single European Market, which Mrs May made clear was her intention in a speech earlier in the month. The visit was largely symbolic, however, as the UK cannot negotiate any independent trade deal with another country until it has triggered Article 50. Mrs May did get the new President to commit to the future of NATO, an organisation that he heavily criticised just a couple of weeks before. However, she appeared to be side-stepped over his Executive Order shortly afterwards to ban nationals from 7 countries from entering the USA. This included individuals from the UK with dual-nationality with one of the banned countries. Mrs May also has to deal with a petition looking to stop Mr Trump's state visit which has now received over 1.8m signatures and will be debated in Parliament. Therefore, while history will remember who was the first world leader to visit President Trump, it is unlikely that the meeting will be remembered for anything other than symbolism.

In January, the Supreme Court rejected the Government's appeal against the High Court decision that Parliament needs to be consulted before triggering Article 50 to start the process of the UK to leave the European Union. This decision was not much of a surprise, although Sterling did rally off the back of the announcement. The Government quickly announced a Brexit White Paper to be discussed in Parliament and cleared time for an immediate parliamentary debate. The House of Commons voted overwhelmingly in favour of the Government proposition to leave the EU. While the Bill still has to pass through the House of Lords, and there are further readings in the House of Commons, both of which could amend the Bill, neither is likely to derail or delay the process, given the strength of the initial House of Commons vote. It is very likely, therefore, that Mrs May will be able to stick to her end of March timetable for triggering Article 50. Except for long-time Europhile, Ken Clarke, the members of the Conservative Party voted for the proposition. Labour leader, Jeremy Corbyn, enforced a three-line whip for the vote, effectively enforcing all Labour MPs to vote for the Proposition and with the Government. In the end, 47 out of the 229 Labour MPs defied the leadership and voted against, including several members of the Shadow Cabinet who subsequently lost their jobs. This continues to indcate how divided the Labour Party still is at present.



Source: Bloomberg

Economically, the UK continues to be strong post-Brexit. GDP figures came in better than expected, at 0.6% QoQ growth in the fourth quarter, and 2.2% YoY growth, giving it the best GDP growth of any of the G7 countries. The Bank of England also increased the UK GDP growth expectation in 2017 to 2%. The surprise on the upside was attributed to increased consumer spending, although UK retail sales fell in December on inflation concerns which could impact GDP growth going forward. Also on the positive side, the manufacturing sector in the UK grew faster than expected, at 1.2% YoY, which is the highest since early 2015. Economic growth is remaining robust although the markets are looking ahead to March and the forthcoming Brexit negotiations.

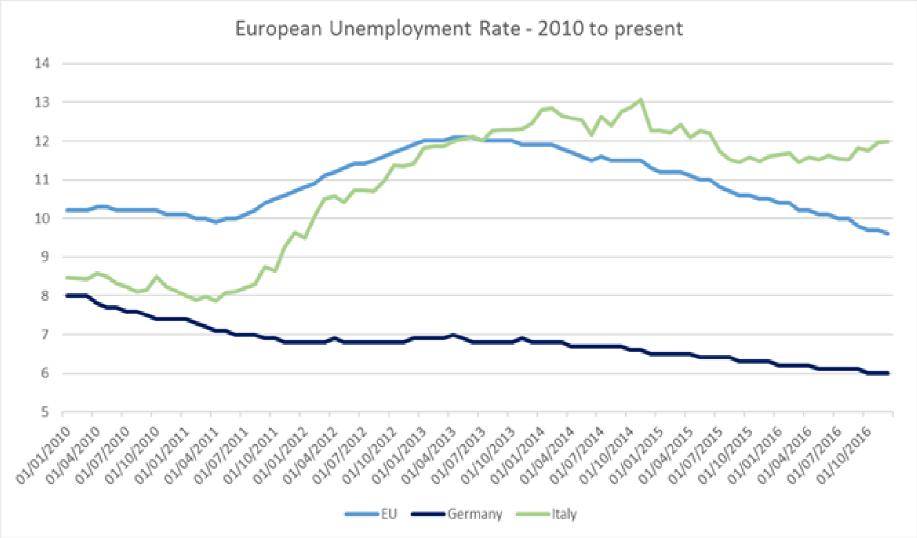


Source: Bloomberg

EU

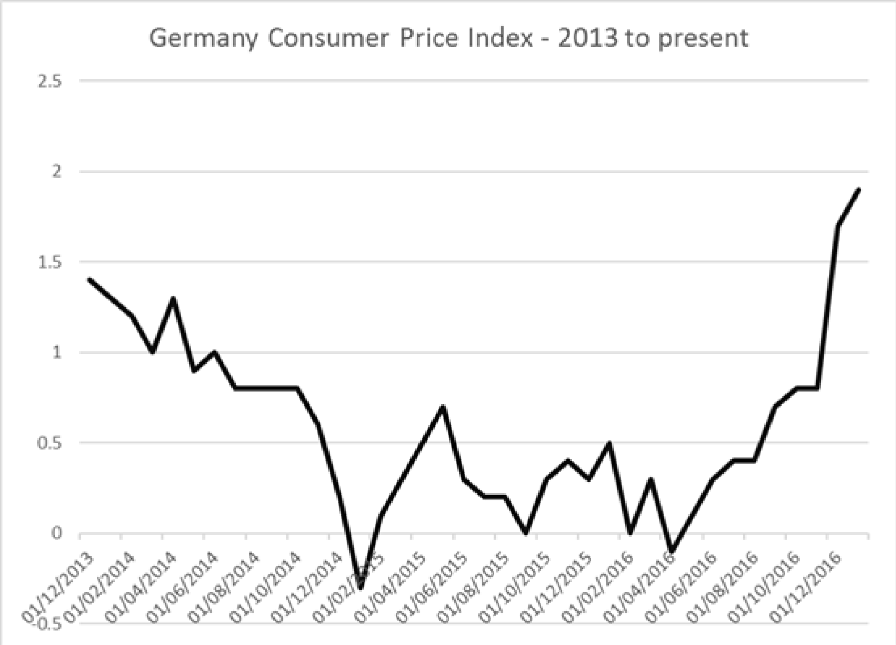
Politics continues to dominate the European Union with elections approaching fast. The Dutch election is up first, on the 15th of March, with the far-right Freedom Party (PVV) and Geert Wilders leading the polls, ahead of the incumbent, and also right-wing, party, the People's Party for Freedom and Democracy (VVD). These two parties are likely to win the election; however, the Dutch political system is designed to be run by coalitions. It is unlikely that they will enter a grand coalition together, as current Prime Minister, and VVD leader, Mark Rutte has ruled this out. It is also unlikely that the PVV will be able to create a coalition with smaller parties, given the extremist nature of their beliefs. It is, however, an indication of rising populism and Euroscepticism in the EU.

The first round of the French Presidential election will take place in April. The ruling Socialist Party chose Benoit Hamon, situated on the left-wing of the party, as their candidate. He is behind the other major candidates in the polls, and is being outshone by independent candidate and former Socialist minister, Emmanuel Macron. His popularity is, no doubt, being increased by a scandal engulfing François Fillon, the Republican Party candidate, surrounding payments to his wife, Penelope, for political undertakings. This scandal has reduced his support in the opinion polls and there have been some calls for him to resign from the candidacy, which he has shown no indication that he would do. Of course, the other candidate to benefit is Marine Le-Pen of the National Front, who is currently leading the first-opinion polls. She has a decisively anti-Europe, anti-Euro and anti-immigration platform which is gaining in support. Pollsters predict that it will be a run-off between Ms Le-Pen and either Mr Macron or Mr Fillon, but that Ms Le-Pen will lose the second-round vote. Polls do not always reflect the election reality, however, as evidenced by 2016. Markets will be watching this election with interest.



Source: Bloomberg

Away from the political side, concerns over the releasing the next tranche of Greek debt also impacted the markets. Greece will require the next part of the financial aid package previously agreed in Q3 of this year. However, the release of new Eurozone loans relies on participation of the IMF in the bailout. The reason that this started to impact the market was that the IMF warned that Greek debt was on “an unsustainable path”, questioning whether the bailout will actually be made. Greek equities fell and bond yields rallied strongly into the month end. This could lead to a revisit of core/periphery concerns. German unemployment fell in January, while Italian unemployment grew. Eurozone GDP is growing overall though, and beat expectations in Q4, +1.8% YoY. Inflation is also creeping up on the continent, particularly notable in Germany, which was 1.9% YoY in January, the highest figures since 2013. The ECB kept rates on hold in January but they may have a difficult time ahead, trying to temper inflationary pressures in the core, and improve economic growth in the periphery, particularly Greece.



urce: Bloomberg*

US

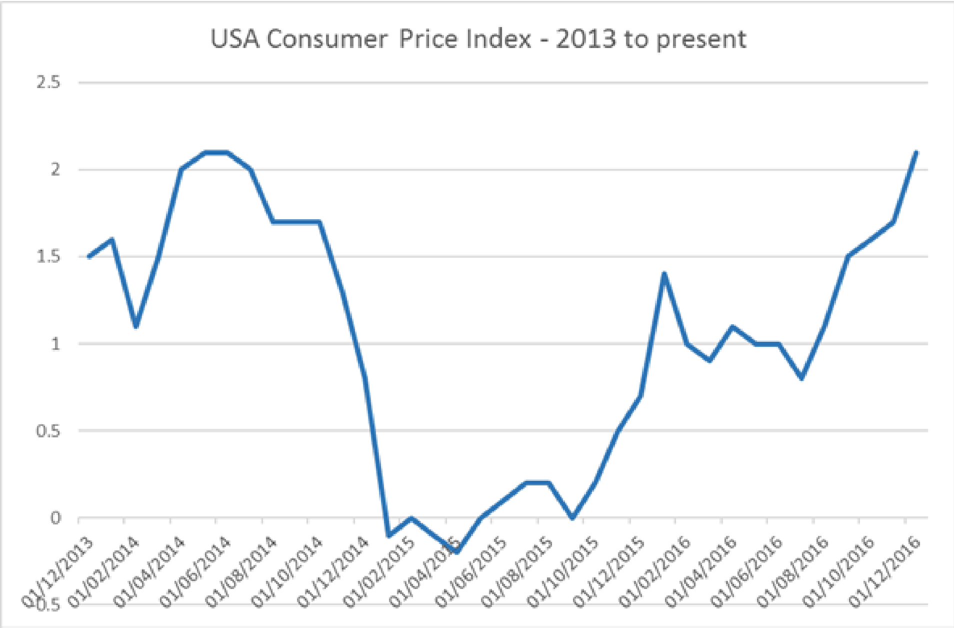
In the US, it is all about the new President, Donald Trump, who was inaugurated on the 20th of January. He immediately set to work, implementing a series of Executive orders to implement the policy proposals promoted during his election campaign. Firstly, he repealed Obamacare, which was widely expected. More importantly, he signalled his intentions on a move towards protectionism. He appointed Robert Lighthizer, a lawyer who had previously criticised China for unfair trade practices, as his trade representative. He also withdrew the USA from the Trans-Pacific Partnership (TPP) and ordered a renegotiation of the North American Free Trade Agreement (NAFTA) between the US, Canada and Mexico. His negative comments about Mexico have been well documented, and he officially signed an order to start the infamous wall. Throughout his campaign and now into his Presidency, Mr Trump has been using Twitter to announce policies and criticise his opponents. His comments about the US car industry are a case in point. His tweet about General Motors making cars in Mexico and shipping them back to the US caused rivals Ford to announce it was planning to scrap plans for a new car plant in Mexico in favour of redeveloping an existing plant in Michigan. His determination to “put America First” can be seen from his initial orders.

In other orders, he approved the construction of two oil pipelines, Dakota Access and Keystone XL, to help boost infrastructure. These projects are controversial, particularly on environmental concerns. Obama postponed the Keystone project as he said it would contribute to climate change. Trump has said that the pipes used in the building of these pipelines should be made in the US. Perhaps his most controversial order, so far, was his ban on nationals from 7, mainly Muslim, countries from entering the US. The legality of this travel ban was questioned by Sally Yates, the acting US attorney general, who President Trump subsequently fired. It was then ruled as unconstitutional by a federal judge in Washington State and over-turned, despite comments about this judge from Mr Trump. However, this issue is not going to go away and it sets up a confrontation between President and the judiciary.

Source: Bloomberg

Equity markets continued their rally from the end of 2016. The Dow Jones Industrial Average Index moved above 20,000 for the first, a level which it has been threatening to breach since the middle of November. The S&P500 Index, a broader based index, also reached all-time highs. The dollar had its worst January performance for over 30 years, as it gave back some of its post Trump gains. This was mainly on comments from the Trump administration talking down the value of the dollar, and criticising other countries, mainly Germany, China and Japan, as being currency manipulators. Peter Navarro, a senior adviser to the President, made comments specifically about the Euro at the end of the month, saying that Berlin using a weak Euro to exploit its US and EU trading partners. These types of comments should not come as a surprise, as they were similar comments to what Mr Trump said during his campaign, but they did allow the dollar to readjust after a strong couple of months. The US economy continues to be strong. Manufacturing figures beat expectations.

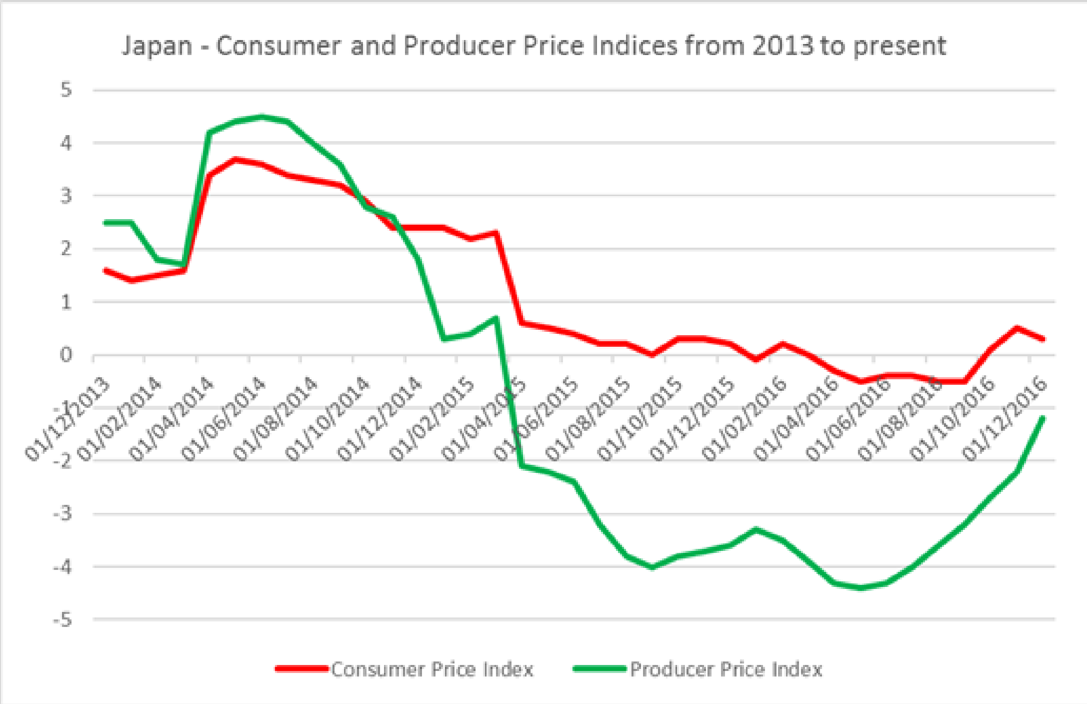
Inflation continues to increase, up 2.1% YoY, although GDP growth came in under expectations at +1.9% YoY Growth. Although markets are still heavily focused on President Trump’s tweets to see what comes next.



Source: Bloomberg

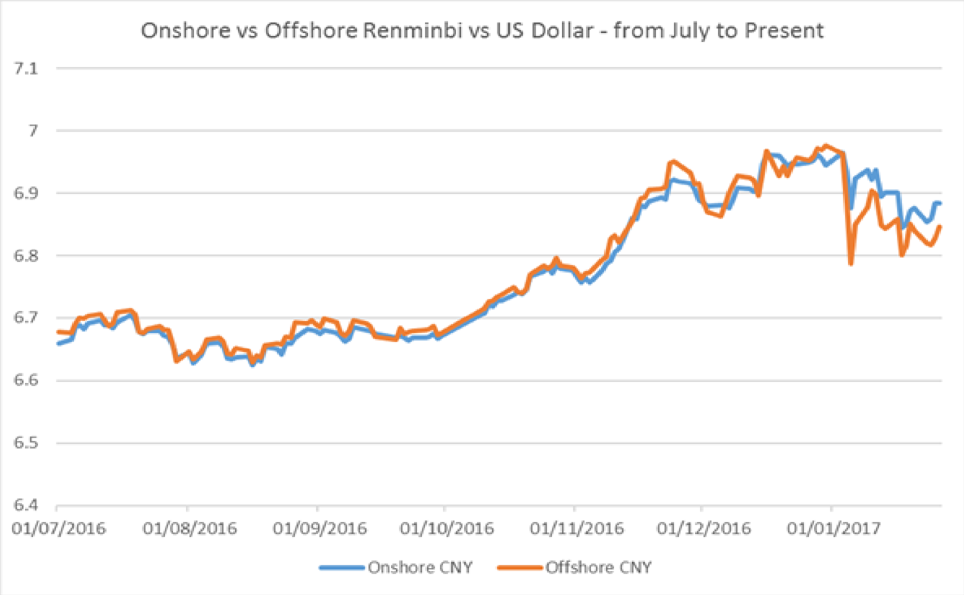
Asia Pacific & Emerging Markets

Japan had a fairly quiet start to the new year. Yen rallied over 3% against the dollar. This would have normally caused equities to fall due to the impact on exporters. While the Nikkei 225 Index did finish the month down, it was only down 0.4%. Japanese Government Bond yields have risen, with 10-year JGBs at 0.087%, the highest rate for 12 months and above the target rate of 0% set by the Bank of Japan (BoJ). At their meeting at the end of the month, the BoJ kept stimulus measures at the same rate, which was widely expected, however they did raise the growth expectations for the country. Inflation expectations, both in Consumer Prices and Producer Prices (CPI and PPI Index respectively), are increasing with CPI making a move back above 0% and away from deflation. Whether inflation continues to be positive remains to be seen although the BoJ are hoping that by targeting the 10-year yield curve, it will increase the spread between US and Japanese 10-year bonds, putting downward pressure on the Yen and therefore increasing economic growth over the longer term.



Source: Bloomberg

China was closed for New Year celebrations for part of January, as we enter the Year of the Rooster. Economically, China started the year with upbeat statistics. At the start of the month, positive figures from the manufacturing sector showed economic expansion in December. Then mid-month, GDP figures showed +6.8 YoY growth, which was above expectations. Markets are still concerned about capital outflows. The government imposed capital control measures in December and, while outflows slowed in January showing that the measures are taking effect, there is still a significant difference between the offshore and the onshore Renminbi, indicating that stresses still exist. Xi Jinping became the first Chinese President to attend the World Economic Forum in Davos. He used his speech there to defend free trade and globalisation, in stark contrast to the increasing protectionist rhetoric from President Trump.



ource: Bloomberg

Elsewhere, in Emerging Markets, Indonesia came into market headlines for severing ties with JP Morgan after the investment bank downgraded the country's sovereign debt. Indonesia's finance minister, Sri Mulyani Indrawati, cut official ties with the bank as she was unhappy with the downgrade, saying that it was poor analysis. She also spoke of the "special privileges" that JP Morgan has in the country, suggesting that this comes with some accountability, raising concerns about the independence of investment analysts. The downgrade itself came because of the global implications of the Trump victory and expectations of capital outflow from emerging markets, particularly if the US look to repatriate cash back to the US following tax restructuring. This is likely to hit Indonesia particularly hard as it runs a current account deficit. JP Morgan reversed its view and upgraded Indonesian equities a couple of weeks later, and claims the upgrade had nothing to do with the tensions between the bank and the country, although there are now questions over the impartiality of its research.

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