26 September 2016

WEEKLY INVESTMENT UPDATE

Markets Eye US Election Debate

KEY MESSAGES:

Fed leaves rates unchanged in September meeting

BoJ introduced a new target for 10-year government bond yields of around zero percent

Emerging market currencies rally after the Fed's decision to keep rates on hold

Trump edges closer to Clinton on the eve of the First Presidential Debate in the US

Safety First remains our focus throughout a period of significant market uncertainty

Our Safety First approach

As the world focusses on the US over the next few weeks we retain a defensive stance in the allocation to equity in our portfolios. Maximum equity allocations are well below those of more standard industry benchmark allocations which offer little protection to investors during uncertain times.

Having held back on equity allocations for most of the year we are pleased to see returns in line with our expectations. We are concerned about the potential for bursts of volatility around major events, including the US election, and we will not deviate from our focus on Safety First by snatching at returns in uncertain and volatile markets.

As continued economic and political uncertainty causes stress for investors we employ safe allocations to deliver considered, steady growth in cautious portfolios designed to maintain their risk cap first, rather than chasing volatile returns. Volatility measures on the Safety First strategies currently rest close to half that of standard benchmark strategies.

Market developments during the week

The Federal Reserve left short-term interest rates unchanged this week but planted the seed for an increase before the end of the year. Three FOMC members dissented to the decision to hold rates, preferring to raise now. We see this as a strong indicator and anticipate that Janet Yellen may move to raise rates shortly.

Central banks started cutting interest rates to near zero after the 2008 stock market crash; eight years later, the shadow of the Great Recession is keeping rates super-low, but even when it has passed, in our view rates are unlikely to rise fast. We are positioned for rates to be low for longer.

The BoJ kept interest rates on hold at -0.1%, describing further rate cuts as a "possible option for additional easing," but announced a framework with two main elements. The first is a pledge to cap 10-year government bond yields at 0%. Second, to continue buying assets until inflation exceeds the price stability target of 2%. How the world has changed over the past few years. Quite extraordinary to think that one of the most developed economies in the world is pledging to issue 10-year government bonds at zero coupon.

Commodities

Oil got an additional lift from a drop in the dollar to its lowest against the yen in four weeks after the US Federal Reserve kept monetary policy unchanged.

Oil prices extended gains, after data from the US energy department showed a large drawdown in US crude stockpiles, but is still trading at less than half its mid-2014 level at $47.40 a barrel.

Crude inventories fell by 6.2m barrels in the week to September 16, the second biggest drop in a year. The large drop in US crude inventories emboldened investors ahead of

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next week's meeting between OPEC members and Russia to discuss supply.

The US government laid out a plan this month to drive installation of 86,000 megawatts of offshore wind by 2050, and has awarded 11 leases to developers planning projects in the Atlantic.

Gold, which is sensitive to monetary policy expectations, is down 0.1% at $1,335 an ounce.

Copper, aluminium and nickel all climbed to multi-week highs after the FOMC decision. In the metals, copper moved above the $4,800 per tonne level to set a one-month high, aluminium cleared $1,600 to touch its best for three weeks and nickel rose to a six-week peak.

Bonds & Equities:

Bonds advanced across most of Asia on Friday, with China's 10-year yield dropping two basis points to 2.74%.

The 10-year Japanese government bond yield fell 2.5 basis points to -0.055% while the 30-year yield fell 4.0 basis points to 0.470%, hitting a two-week low of 0.450% at one point.

The 10-year US Treasuries yield dropped to as low as 1.608%, down sharply from Wednesday's high of 1.738% and hitting its lowest level in almost two weeks.

Rates in Australia and New Zealand fell to two-week lows of 2% and 2.40 %, respectively.

On Wednesday the 10- year German bond yield also fell about 10 basis points, from +0.005% to -0.093%.

In post-FOMC markets, equities were firmer with the Euro Stoxx 50 up 0.5%, the Dow closed up 0.9%, the Nikkei is up 1.9%, the Hang Seng is up 0.9%, as is the CSI 300, while the ASX 200 is up 1% and Kospi is up 1.1%. Japan's Nikkei 225 dipped 0.3%, reflecting the yen's gains during Japan's market holiday on Thursday.

The MSCI Asia Pacific Index held near a two-month high, while European equity index futures declined. The Stoxx Europe 600 Index ended the last session at a two-week high and the Nasdaq 100 Index had its best close on record.

Asian shares held near 14-month highs on Friday as investors restored bets the Federal Reserve is settling into a phase of very gradual interest rate rises, while Japanese bond yields fell after the Bank of Japan's radical new policy scheme.

Our observation is that global equities remain at all time valuation highs in an extremely volatile world with a number of risks to the downside and immediate events on the horizon which could give rise to shocks.

Major economies:

The BoJ shifted the focus of stimulus from expanding the money supply to controlling interest rates. Markets initially reacted positively, with the yen losing 1% to ¥102.7 against the dollar. But skepticism about the BoJ's overhaul set in and the yen reversed its early losses, appreciating by 1% by mid-afternoon on Wednesday in London. Global equity markets were broadly higher, with Japan's Nikkei 225 jumping 1.9%, and the Pan-European Euro Stoxx 600 advancing 0.6%.

Banks dominated the list of leading shares on the Euro Stoxx 600. Barclays gained by 3.5% in London. Holland's ING rose 3.5%, while France's Société Générale was 3.2% stronger. Japanese government bond yields reacted to the BoJ's new strategy, adding 2 basis points to -0.03% and the yen weakened to ¥102.78 a dollar.

During the week the President of the US met Premier Li Keqiang on the sidelines of the United Nations General Assembly in New York and urged China to address the issue of overcapacity. China has been accused of unfair practices by firms overseas for dumping products at low prices. In April, China promised to reduce its steel output, following a crisis meeting attended by 30 nations.

New Zealand's dollar was the biggest loser among major currencies.

The euro's historical volatility versus the dollar is now the lowest among G-10 currencies, displacing even the Danish krone. Its one-month volatility is now 6.14 percentage points, the lowest since Sept. 2014. At the start of the year, the gauge was at the middle of the G-10 table.

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South Africa's central bank has held the repo rate unchanged this month at 7%. Inflation was set to be slightly higher in the short-term, but consumer prices are expected to fall within target by next year.

Emerging markets:

EM currencies are benefitting from a general weakening of the dollar after yesterday's Federal Reserve decision.

The peso which is the world's eighth most traded currency slumped to its lowest-ever level against the US dollar, hitting 19.77, before regaining some ground.

The peso is widely used as a hedge to be sold in turbulent times against other emerging market positions. It has been the worst EM performer this year, losing nearly 12% of its value.

The foreign funds program pumped money into local assets amid the Federal Reserve's decision not to raise U.S. interest rates helping India's rupee head for its biggest weekly gain since July. The yield on Indian government notes maturing in September 2026 slipped seven basis points over five days to 6.79%.

UK economy:

Sterling is 0.5% weaker at $1.29 as uncertainty over Brexit timing weighed heavily.

The BoE announced it would keep stringent capital rules regardless of Britain's future relationship with the EU and has warned of challenges for UK financial stability after the Brexit vote.

Britain's manufacturers are expecting to accelerate their output over the next three months, according to the Confederation for Business Industry.

The sales by Britain's largest food and drinks producers suffered a 0.1% drop in sales in the last year compared with 2014, the first drop in 15 years. Profit margins were unchanged at 5.4%, but the return on capital employed by the groups fell to 12.4%. The OC&C report shows that small producers grew faster on average than larger companies with annual sales of more than £500m.

US Election 2016:

Donald Trump has steadily been gaining momentum in national polls, though he still trails Clinton by a few percentage points in latest Wall Street Journal/NBC poll. Clinton's advantage over Trump shrank in August and Trump may take the lead following the critical First Presidential Debate.

According to a Wall Street Journal/NBC News poll in May the number of people having a negative opinion on Hillary Clinton and the Republican candidate Donald Trump are 20% and 29% higher than those in favour respectively. Obama had 8% more in favour than against him heading into 2012's election. It seems that many Americans feel that the Presidential race is a choice between two candidates who are both flawed.

Trump's vow to "Put America First" includes focusing on cutting taxes, by reducing the number of tax brackets from seven to three; he would reduce the top rate of tax to 33% from 39.6%. He proposes a child care deduction that would cover the average cost of child care and also eliminating the estate tax or "death tax" completely. He would also reduce the US corporate tax rate to 15% from the current rate of 35%. This plan would reduce the amount of income the government collected by $4.4tn over a decade. It is a big bet on how these measures would stimulate growth in the US economy, a big bet indeed.

Clinton, on the other hand proposes raising the national minimum wage, raising taxes on high-income taxpayers, modifying taxation of multinational corporations, repealing fossil fuel tax incentives and increasing estate and gift taxes. A majority of the revenue raised by Clinton's plan would come from a cap on itemised deductions, the Buffett Rule, and a 4% surtax on taxpayers with incomes over $5 million. However, all of the tax increases would fall on the top 1%; the bottom 95% of taxpayers would see little or no change in their taxes. Clinton risks an exodus of high net worth individuals and corporations but may be making the bet that in this uncertain world, where else would they go?

Clinton plans to increase regulation and cap prices could be a threat to banks and drug makers. While on the other hand Trump's frenkel topping

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attempt to boost lending, as he is seeking to protect American industry, could see a protectionist economic policy introduced with tariffs on foreign goods. Trump could be a threat to the companies that import goods into the US and industries that rely on cheap labour.

A study released on Monday by researchers at the non-partisan Peterson Institute for International Economics says Trump's protectionist trade policies would send the US into recession, result in the loss of almost 4.8m private sector jobs and lead to shortages and higher prices of consumer goods — including popular products such as smartphones — and potentially even have an impact on US retirement savings. We don't think this is a fair reflection because we believe that Trump would soften his protectionist agenda but it is certainly a risk.

As Trump focuses on renegotiating trade deals to favour the US and walk away from trade deals like the North American Free Trade Agreement (NAFTA), the inadvertent impact on the US economy in the short term could be significant.

The Trans-Pacific Partnership (TPP) agreement between the United States and 11 other Pacific Rim countries lacks a set of restrictions and/or enforceable penalties against member countries that engage in currency manipulation. In 2015, the U.S. deficit with TPP countries translated into 2 million U.S. jobs lost, more than half (1.1 million) of which were in manufacturing. Both Clinton and Trump oppose the Trans-Pacific Partnership (TPP) trade deal, arguing that it will hurt American workers.

Trump called for a 35% tariff on Mexican goods and a 45% tariff on Chinese goods and said that he will label China a 'currency manipulator'. The idea behind imposing tariffs is to make American companies more competitive with their foreign counterparts, however, imposing substantial tariffs carries many more risks than benefits in our view. The increased cost caused by tariffs would be borne by consumers. Retail prices for imported goods into the US, and for domestic goods that are reasonable substitutes for imported goods, would increase, resulting in a higher cost of living.

Among those hardest hit with these tariffs would be the US auto industry, which has fully integrated Mexico into its production network. Clinton has said these tariffs will lead to a trade war making it harder for the US to compete on a global stage. While she has criticised some trade deals, she hasn't ruled out signing new ones if elected.

Trump focusses mostly on increasing manufacturing jobs, which have declined by around 5 million since 2000. While Clinton focusses more on increasing production in the US by offering tax incentives to companies that build there rather than barring imports out. Clinton called for increasing jobs training - in part paid for by tax revenue from wealthier Americans. She has pushed for infrastructure spending and investment in new energy to lift the number of jobs in those sectors. Clinton will offer state and local governments new federal incentives to cut red tape and to make it less costly to start a small business. She also plans to introduce employee profit sharing schemes and other measures to support a balance in work and home life, including earned sick days and paid family leave.

Since 1833, the Dow Jones Industrial Average has gained an average of 10.4% in the year before a presidential election, and nearly 6%, on average, in the election year. The Dow racked up an impressive 27% in the first year of President Obama's second term, and 7.5% in year two. Last year, which was supposed to be the strongest of the cycle, saw the Dow Jones industrial average drop 2%.

As an interesting data point, since 1945, the average annual gain under a Democratic president is 9.7%. Under a Republican president, it's only been 6.7%. Perhaps Trump can buck that trend, if he wins.

Either way, we expect to see substantial volatility ahead of the US Presidential election in November and perhaps a reasonable amount of volatility following the First US Presidential Debate.

Trump says the Fed is playing politics in keeping the interest rate low until after the election and that equity markets are being propped up by those low rates. Low rates propping up equity and bond markets has been of great concern to us for some time. The flexibility of tactical asset allocation in our Safety First strategies is designed to serve clients well should uncertainty

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around low rates materialise in volatility and portfolio loss.

Since it is not our job to take arbitrary risks or bets with our clients' money, we are as always positioned defensively ahead of these key events.

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26 September 2016

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Frenkel Topping Investment Management's ("FTIM's") Safety First performance

	Since inception (04 Jan – 23 Sept 2016)		Since launch (29 Apr – 23 Sept 2016)	
	Performance	FTIM Volatility*	Performance	FTIM Volatility*
FTIM Safety First 1 is currently a cash product with returns in line with base rate				
FTIM Safety First 2	2.22%	1.56%	1.77%	1.42%
FTIM Safety First 3	3.48%	2.06%	2.55%	1.85%
FTIM Safety First 4	3.59%	3.22%	2.35%	1.97%
FTIM Safety First 5	4.93%	3.48%	2.99%	2.83%
FTIM Safety First 6	8.07%	5.11%	5.55%	4.86%

Date: 23 September 2016
Source: FTIM / FE Analytics
All figures are on a bid - bid, total return basis and are quoted net of underlying fund charges, our DFM fee of 0.6% including VAT and a platform fee of 0.2%. Advice charges would depend on the charges made by your independent financial adviser. The deduction of these charges would reduce the performance shown.
Actual Past Performance Data is from 29/4/16 only as the models only launched on this date and therefore 5 year performance data is not available and 12 month performance figures are not able to be shown. Pre - launch performance from 4/1/16 – 29/4/16 is Simulated Past Performance.
The figures represent performance of a model portfolio; individual account performance may differ if your account does not follow the model.
Past performance is not a reliable indicator of future performance. Investment values can go down as well as up and may be affected by exchange rate variations.

*Volatility is a measure of the movement in the price of an asset around its average return. The higher the volatility the more risk involved in the investment.