20 February 2017

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INVESTMENT MANAGEMENT

WEEKLY INVESTMENT UPDATE

In Trump We Trust

KEY MESSAGES:

It was a strong week in equity markets which rose 1.1% reaching record highs mid-week. This optimism was spurred on by hard data showing retail sales, as well as consumer and producer inflation metrics surprising to the upside.

US Treasury yields peaked to 2.5%, amid an improved possibility of Fed rate hike by March. French and German bond yield spreads widened, as France faced heightened political uncertainty.

GBP, Euro were lower this week; a trend we see continuing. Oil traded at $53 a barrel. Gold closed at $1,239 an ounce.

Market developments during the week

President Trump is approaching completion of his first month at the White House; a month where he has dominated global news flow. His executive orders have demonstrated his commitment to his campaign promises and surprised many who thought those promises would be softened when he came into office, or that the pace of activity would be slower. Democrats remain stunned and arguably in denial of the election result and the media remains polarized. A war of words broke out at an extraordinary Presidential press conference on Friday, as President Trump went on the attack. You might think that this would unsettle investors in the US, but the DOW and S&P Indices hit all-time highs. We see this momentum continuing, as Trump's policies start to drive economic growth and productivity in the US.

Our view is strengthened as US consumer confidence is near a 12-year high. Gauges of sentiment spanning everyone from small business owners to asset managers and CEOs on earnings calls are surging. This week, the NFIB's Small Business Optimism index surprised to the upside, rising to the highest level since December 2004. On the fiscal stimulus front, a major tax overhaul plan is due to be released in the coming weeks, as too, is the trillion dollar infrastructure stimulus program.

The mantra of "In Trump we Trust" could not be more apt. He has a pretty long track record of doing what he sets out to do, not as a politician, but as a businessman, and he has surrounded himself with people with similar reputations. Moreover, he has control of the Senate and the Congress and remains extremely popular with Americans mistrustful of the media and a decade of economic stagnation under Obama. Trump seems to be aggressive with his planned implementation timetable and the economic indicators suggest further momentum to follow in the economy and the stock market. We remain bullish.

This week's economic data included the core CPI and PPI measures, which surpassed expectations, rising by 0.3% and 0.4% in January, respectively, with the headline consumer inflation measure accelerating to 2.5%. Retail sales rose 0.4 %, more than forecast in January, in a broad-based advance. This stronger than expected data, combined with comments from Fed Chair Janet Yellen to Congress that the FOMC is not basing hiking plans on fiscal plans and that waiting too long could also have costs, helped push the Fed funds futures market-implied chance of a rate hike in March to 44%, up from 34% the day before.

Currencies

USD rebounded to rise during the week, erasing a 0.2% drop to advance 0.2%.

GBP fell 0.5%, heading for the weakest closing level in a month after weak economic data. We see further weakness as the UK gets properly embroiled in Brexit negotiations with a hostile EU and the

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effects of inflation drip through into corporate earnings.

The euro slipped 0.6% to $1.0608, as political pressured continues to weigh on the currency.

Equities

The Stoxx Europe 600 Index ended higher by less than 0.1%, capping a 0.8% advance for the week. Stoxx 600 banks dropped the most in almost two weeks. The sector is still poised for a fifth straight monthly advance, which would be the longest winning streak in three years. Improving economic growth and good corporate profits in Europe and globally should drive higher demand for European equities as noted in our Investment Outlook 2017 note but the volatility could be significant as we approach key EU elections in France, Germany and Holland.

Emerging-market equities slid 0.8%, trimming a fourth weekly gain to 0.8%.

Some commentators believe that stocks look expensive, but we remain confident in valuations, especially across the US in our preferred sectors, that performance will continue to justify valuations in the coming months.

Bonds

It was a choppy week for the 10-year Treasury note; at one point yields slid below 2.42% before rising again to near 2.5%, as Janet Yellen testimony to Congress reversed the course by the end of the week. America's biggest creditors are re-thinking their financing of the US government amid the prospect of bigger deficits and more inflation under President Donald Trump or higher interest rates from the Federal Reserve.

Japan, the largest holder of Treasuries, cut back US debt by the most in almost 4 years in December, per data from the Ministry of Finance. China's holdings of US Treasuries declined by the most on record last year, as the economy dipped into its foreign-exchange reserves to control yuan performance. China held $1.06 trillion in US Treasuries, notes and bills in December, up $9.1 billion from November, but down $188 billion from a year earlier, according to TIC data.

Globally, bonds are currently less preferred compared to equities, as bond valuations face a risk that interest rates could rise faster than expected if inflationary pressures prove to be stronger than anticipated, weighing heavily on investor sentiment. This is our view. Whether the Fed in the US, the ECB in Europe or the BoE in UK, investors remain wary regarding the pace of rate hikes. Treasury Inflation Protected Securities (TIPS), that are indexed to inflation, give a clear idea of market perception towards inflation expectations.

The iShares TIPS Bond ETF, the largest exchange-traded debt fund featuring TIPS, had $547 million of inflows during the past two weeks, according to data compiled by Bloomberg.

The 10 largest TIPS ETFs have seen aggregate net inflows in each of the last 10 weeks. TIPS have returned 4.1% over the past 12 months, versus a 1.7% loss for nominal Treasuries, per the Bloomberg Barclays bond indexes.

We expect inflation to remain contained, but we have adjusted our clients' portfolios to protect them against the concerns of devaluation due to rising inflation.

European government bonds were mixed. French notes fell, with yields on 10-year notes rising two basis points to 1.03%. German bonds gained, with benchmark yields dropping five basis points to 0.3%, while gilts advanced following the retail report, driving benchmark yields five basis points lower to 1.21%.

Commodities

Oil traded near $53 a barrel in New York, after government data showing that US crude inventories rose to the highest levels in weekly data going back to 1982. As OPEC approaches its meeting in May to assess the market and decide if they should extend their output cuts into the second half of the year. Kuwait, OPEC's fifth-largest producer, reported that it is sticking with plans to add half a million barrels a day of oil-production capacity ,as it prepares for the eventual expiration of the output quotas OPEC adopted to help drain a global oversupply. This comes after Saudi Arabia stated last week that current production cuts would suffice for a rebound in energy prices and an extension would not be

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required. We have an eye on US / Iranian relations and growing tension there which could see the Iranian deal torn up and sanctions re-introduced – this would potentially remove significant Iranian production from the global supply dynamic and drive oil higher.

Gold slipped 0.2% to $1,239.20 an ounce, paring its seventh weekly gain in eight weeks.

Copper rose 0.1% in London to $6,035 a ton, rebounding after UBS Group AG said the rally has “more to go” amid mine supply disruptions and rising Chinese demand.

Major economies:

China

There was not much economic data from China with the major release being PPI and CPI data. Producer price index reflected an increase 6.9% in January from a year earlier. Though much of that reflects a rebound in commodity prices including iron ore and oil, China’s economic stabilization and its efforts to shutter surplus capacity are also having an impact. It’s consumer-price index climbed 2.5%, boosted by the week-long Lunar New Year holidays in January this year. For the global economy, it’s the pass-through of China’s rising costs via exports that matters. Leverage in the Chinese economy continues to be extraordinary and we are extremely cautious about Chinese exposure. Period.

Euro area

The euro-area economy grew 0.4% in the fourth quarter of 2016, slightly less than initially reported as German and Italian expansion disappointed. German GDP rose 0.4%, Italian GDP was up 0.2% in fourth quarter – but strains on Italian banks and concerns over the trustworthiness of data leads us to stay away from exposure. In a sign of mounting concerns, German investor confidence declined more than forecast in February. A gauge by the ZEW Center for European Economic Research in Mannheim, fell to 10.4 from 16.6, compared with a median estimate of 15.

Rising political risk continues to weigh on business confidence. Also this week. Swedish central bank delivered an unexpectedly dovish view on interest rates, citing “considerable political uncertainty abroad.” They also held the main rate at a record low of minus 0.5%, left intact a bond-buying program and extended a warning that they stand ready to intervene in the currency markets.

Greece is also beginning to make headlines, as a rift between European officials and the IMF looks to delay the next disbursement of much needed funds.

The French elections saw a new twist this week as the left-wing laggards are reported to be in talks about joining forces, a move that may elbow out centrists from the second round and improve the anti-euro Marine Le Pen’s chances of victory. Polls suggest that a unified left bid would dent the chance of pro-market candidate Emmanuel Macron, the current front-runner, to advance in the May 7 decisive round. Markets are perceiving this move to be a strong point for a Le Pen win. French bonds dropped, widening the spread over similar-maturity German bunds by 6 basis points. The euro fell, as concerns about improved chances of a Marie Le Pen presidency roiled the country’s assets. French stocks were down taking the broad Stoxx Europe 600 Index down with French banking stocks leading the fall.

The European Union’s trade surplus with the US narrowed in 2016 at 115.3 billion-euro ($122 billion) surplus last year, compared with 122 billion euros in 2015.

The European Parliament approved a landmark free-trade agreement with Canada. The deal, known as the Comprehensive Economic and Trade Agreement, is slated to end 98% of tariffs on goods from the outset and 99% after seven years (each side plans to dismantle all industrial tariffs and more than 90% of agricultural duties). Markets for services and public procurement are also due to be opened.

The EU says CETA, which took five years to negotiate, would boost the bloc’s economic output by around €12 billion ($13 billion) a year and expand two-way trade by about a quarter.

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Canada

The highlight of the week was Prime minister Justin Trudeau's visit to Washington to promote Canada's close economic relationship with the US. Investors looked for more clarity on President Trump's current stance on NAFTA. He was clear that the agreement will be tweaked, adding that it would be in ways that would benefit both countries. Hard to read too much into that.

The Canadian Prime minister was also in Europe, where CETA, free-trade agreement between Canada and euro area, reached a major milestone of approval by the European Parliament reflecting strengthening ties between the two which is now much necessitated amid President Trump's protectionist stance.

On the economic front, better than expected labor market data boosted the loonie, as Canada's unemployment rate fell to 6.8% and net employment jumped by 48,300, the second consecutive month of strong job gains. On the home front, data on existing home sales showed a continued slowdown in activity, and considerable divergence in price growth across the country. The hottest markets,being those around the Greater Toronto area, where prices are up over 20% over the last year. There is little doubt that the sharp rise in prices has cut into affordability and is unlikely to be sustained. However, one point of caution on an expectation for a major turnaround in prices is that the supply of listings remains very tight.

Egypt

Egypt reported the highest inflation rates in emerging markets with annual inflation reaching 28% in January. Still, markets perceive it unlikely to persuade Egyptian policy makers to raise borrowing costs, as the central bank looks to a rebounding currency and weak consumer demand to do the work instead. The bank last raised borrowing costs by 300 basis points in November, at the same time that it removed currency controls. Government and IMF officials say they had expected the surge in prices following the reform package, which also included raising fuel prices and introducing value-added taxation. They expect it to slow down once these effects wear off, and so long as budget and monetary policies remain tight.

UK

GBP was battered by poor economic data this week.

UK retail sales unexpectedly fell 0.3% for a third month in January. The fall confounded market expectations for a 1% rise. In the 3 months through January, sales dropped 0.4%, the worst quarterly performance since 2013. This sent GBP to a drop to $1.24 level, not seen in more than 2 weeks. UK 10-year bonds advanced a third day with yields falling 5 basis points to 1.21%. A report on UK inflation reflected an increase in the rate to 1.8% from 1.6% in December, however this turned out to be lesser than expected. Yet inflation is still running at the fastest pace in more than two years.

Another report on UK unemployment showed a decline in the number of jobless fell 7,000 in the fourth quarter to 1.6 million people, leaving the unemployment rate at 4.8%, the lowest in more than a decade. However, wage growth has been sluggish, with basic pay growth slowing in the quarter to 2.6% from 2.7%, weaker than forecasts.

These add to evidence that the cooling in household spending due to slower wage growth is materializing into reduced purchasing power for consumers, which is not a good signal for this consumers' dependent economy. Adding to a string of companies to blame the weaker pound for a price hike, wireless-speaker maker Sonos said on Monday it will raise the cost of its products in the UK by as much as 25%.

Other signs that the squeeze is taking its toll emerged in BOE figures last month, showing a big drop in the amount borrowed by consumers in December. With the BoE Governor Mark Carney stating that rates could move in either direction in 2017, investors now see a 13% chance of an interest rate hike by the end of this year. That's down from almost 50% at the start of the year. We do not expect a rate hike in the foreseeable future and we remain negative on GBP outlook.

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

	2016 Performance	2017 Performance	Volatility* 04/01/16
FTIM Safety First 2	1.53%	0.08%	1.86%
FTIM Safety First 3	3.26%	0.30%	2.23%
FTIM Safety First 4	4.38%	0.59%	3.13%
FTIM Safety First 5	5.63%	1.29%	3.47%
FTIM Safety First 6	10.10%	1.94%	5.19%

Date: 17 February 2017
Source: FTIM / FE Analytics

Safety First Portfolio strategies were launched on 29/04/16. 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.