24 February 2017

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INVESTMENT MANAGEMENT

WEEKLY INVESTMENT UPDATE

China shifts focus towards growth concerns

KEY MESSAGES:

USD declined on Fed minutes revealing officials were confident they could raise interest rates gradually, without triggering short-term inflation.

The odds for an increase in March held at 38%.

U.S. Treasuries gained, Brent closed at $56 a barrel. Gold closed at $1,257.35 an ounce, heading for a fourth weekly gain.

Chinese economy's rising growth concerns are at the forefront, as government introduces initiatives to fuel growth. Even after government efforts, yuan is expected to depreciate in 2017 making long USD over CNY trade attractive.

Amid looming trade war concerns with the US, Chinese economy is slowing, domestic real estate is becoming increasingly unaffordable and the yuan is depreciating. While attempting to minimize yuan depreciation, China's foreign currency reserves fell for a seventh straight month in January to $3 trillion, the lowest in almost six years. The government is making persistent efforts, as it acknowledges a rapid slowdown in growth could create social and political instability. China is now prioritizing growth over economic and structural reform as its key objective. The further expansion of credit is expected to ensure the economy's growth target of 6.5% to 7% is achieved in 2017.

However, regulatory tightening, higher interest rates and a liquidity squeeze will likely weigh on credit surge which is necessary for maintaining growth. Thus, reforms are continuing, but at a slower pace, as China aims to curb leverage without derailing growth.

There is also increasing need for China to crack down on credit growth, as its off balance sheet wealth management sector has grown to a size where mismanagement could give rise to systemic risks. The CBRC, together with the central bank, and the securities and insurance regulators, are working together to draft sweeping new rules governing the surge in these products. The level of collaboration signals a shift toward a more unified approach to financial market supervision in drawing up new measures to curb the nation's $8.7 trillion of asset-management products, which include investments in bonds and risky off-balance-sheet lending by banks extending up to more than three quarters of China's $11 trillion GDP. These products issued by banks surged 30% to 26 trillion yuan ($3.8 trillion) last year. China's banks, with total assets of $34 trillion, are also grappling with rising soured credit and slower profit growth.

By adopting a timely shift in strategy, China has bought itself time. The hope is that global economic conditions begin to improve during the latest phase of this borrowing binge. This should help Chinese growth to become self-sustaining and allow the authorities' attention to return to much-needed economic reforms. With the shift back towards prioritizing growth in China, coupled with accommodative policies across the major developed markets, riskier assets around the world (such as shares and bonds) are likely to be supported in the near-term. However, on a longer-term horizon it is prudent to consider a range of potential outcomes, including those where China is faced with a sharper slowdown in growth, with particular focus on securities in sectors such as banks and lower-quality property companies, which would be at the center of any longer-term issues. Investments in high quality corporate bonds appear attractive, but come with a risk of corporate defaults.

Authorities in China are also preparing contingency plans for the yuan and capital outflows. With analysts expecting further weakening of the yuan this year, doubt has already been cast on whether moves to

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support the currency can be effective for anything more than a short time. There is an opportunity to profit from the USD outperforming the Chinese currency. As efforts from China to maintain its currency levels continue, there a consensus that yuan will decline in the long run.

Market developments during the week

This week's important release was Federal Reserve minutes, which showed that officials thought a rate increase may be appropriate "fairly soon," to avoid overheating the US economy. While the report was dovish enough to slightly weaken the dollar, it did not contain enough clear direction to cause a major market move. The odds for an increase in March held at 38%.

Services and manufacturing PMIs from Markit both missed expectations, however, both reports indicated strong output growth nonetheless. Weekly unemployment claims crept up slightly to a still low 244,000.

Investors now await President Trump's first speech to Congress next Tuesday. It will be three weeks since President Trump promised something 'phenomenal' with respect to tax reform and investors are starting to count on this opportunity for tax reform disclosure.

Currencies

USD declined, on Fed minutes' revealing officials were confident they could raise interest rates gradually without triggering short-term inflation.

On Friday, the Bloomberg Dollar Spot Index dropped 0.2% after falling 0.3% in the previous session.

The euro strengthened 0.3% to $1.0605. The currency rebounded, after briefly falling below $1.05 for the first time in more than six weeks, as French centrist Francois Bayrou bowed out of the presidential race and offered his support to independent candidate Emmanuel Macron.

The yen added 0.4% to 112.22 per dollar, after rising 0.6% Thursday.

Equities

Futures on the S&P 500 fell 0.4%.

The Stoxx Europe 600 Index fell 1.2%, heading for the biggest one-day decline since Sept. 26. The slide comes as both BASF SE and Vivendi SA gave downbeat outlooks for 2017 in their earnings statements. Royal Bank of Scotland posted its third-largest loss in the past decade, and Standard Chartered's profit missed estimates.

Japan's Topix index lost 0.4%.

Bonds

U.S. Treasuries gained, with the yield on benchmark 10-year notes falling two basis points to 2.35%. European debt advanced, with the ECB's bond-buying program seen supporting the sector. German 10-year yields fell three basis points to 0.21%, while French benchmark yields shed four basis points to 0.95%. U.K. 10-year gilts are trading at their lowest level since before the U.S. election yielding 1.12%.

Commodities

West Texas Intermediate traded 0.8% lower at $53.98 a barrel. Brent fell 0.9% to $56.06. Oil pared its weekly advance after data showed crude inventories rose less than expected in the U.S. OPEC committee sees group's compliance at 90%, allies at 60%.

Gold climbed 0.6% to $1,257.35 an ounce, heading for a fourth weekly gain.

Silver rose 0.8%, headed for a ninth weekly increase, the longest run of gains since 2006 as political risk in the U.S. and Europe has boosted investor demand for a haven.

Natural gas, the worst-performing major commodity of 2017, is headed for a fourth weekly loss.

Copper rose 0.7% to $5,897.50 a metric ton, rebounding from the biggest daily drop in 17 months as traders turned bullish amid supply disruptions at big mines. Nickel added 1.1%.

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Other major economies:

Euro area

Optimism breaks out in the euro area with PMIs surging. Economic activity unexpectedly rose to the highest level in almost six years, with the composite PMI for February climbing to 56.0 from 54.4 in January, according to IHS Markit. Companies are currently firmly focused on expanding in the face of rising sales and fuller order books. Though signs of stronger growth and further upturn in price pressures are appealing, there are still concerns that impact of uncertainty around the elections and Brexit could disrupt the business environment this year. The rise was driven by the common-currency area's two largest economies, with composite PMIs for both Germany and France coming in above 56.0 for the month. IHS Markit noted that a key difference between the German and French recoveries in February was prices. Whereas both saw input costs rising by the most since mid-2011, French firms didn't pass these costs on to customers, while German output prices showed the largest monthly increase since June 2011. The eurozone Consumer Price Index remained unchanged at 1.8% year on year inflation.

Greece and its creditors missed this week's meeting of eurozone finance ministers. as a deadline for a new debt agreement passed, meaning discussions will continue on an informal basis in the coming days. The possibility of Greece being forced to leave the euro not completely ruled out.

On the political front, French Politician Francois Bayrou withdrew from the Presidential race and declared support for Emmanuel Macron. The move caused a rally in French government bonds and other assets. Mainstream candidates in the race are widely expected to attempt to consolidate support behind one candidate further, as the French electoral system encourages, and polling indicates that such a development will ultimately prevent eurosceptic Marine Le Pen from winning the Presidency.

Canada

CAD resisted further depreciation against the US dollar, thanks to higher crude oil prices, during a volatile session. The North American oil inventory data showed that stockpiles of crude had finally stopped growing at an explosive rate, with stockpiles rising by only 0.6m barrels. Canadian retail sales fell short of expectations, with headline sales falling 0.5% in December after last month's 0.3% expansion. Monthly wholesale sales rose an impressive 0.7% in December, marking a third consecutive monthly increase, with machinery, equipment and supplies leading the increases.

UK

U.K. GDP revised up 0.1% points from prelim estimate to 0.7% in Q4. Trade and consumer spending provided the biggest contributions, as business investment fell. However, this comes up ultimately as an old news for GBP, concerns about the future after a recent deterioration retail sales are likely to outweigh rosy Q4 GDP data. As analysts gauge the longer term, issues in the mix range from the fallout on trade, investment, knock-on effects on hiring, inflation and demand. The loss of EU passporting rights may entail a reduction of over 25% in the U.K.'s total financial services trade, the London School of Economics said in its Growth Commission Report. The study also revealed U.K. needs to retain near-equivalent EU passporting rights and warned that alternatives are "costly and time-consuming" as industry warns of job losses and relocation of business.

Major data releases this week revealed UK factory orders picking up pace in February, together with pricing pressures, mostly due to the decline in GBP. The survey published added to other signs of a pickup in manufacturing on the back of Britain's strong economic growth in 2016, when British car production hit a 17-year high. The Confederation of British Industry released its industrial order expectations index, which showed a slight improvement in February that was nonetheless enough to put total orders at a 2-year high.

Jason Granite
Chief Investment Officer
24 February 2017

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

	2016 Performance	2017 Performance	Volatility* 04/01/16
FTIM Safety First 2	1.53%	0.17%	1.84%
FTIM Safety First 3	3.26%	0.45%	2.22%
FTIM Safety First 4	4.38%	0.63%	3.11%
FTIM Safety First 5	5.63%	1.26%	3.44%
FTIM Safety First 6	10.10%	1.91%	5.14%

Date: 24 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.

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