20 March 2017

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INVESTMENT MANAGEMENT

WEEKLY INVESTMENT UPDATE

Fed undertakes a "dovish" hike

KEY MESSAGES:

The Fed raised its benchmark lending rate a quarter point without accelerating the timetable for future hikes. The outlook was less hawkish than market participants foresaw. Global equities were on course for the best week since January, even though the initial rally lost some of its momentum.

Treasuries due in a decade yielded 2.52%. WTI crude closed at $48.94 a barrel. Gold gained 2.2% this week closing at $1,230.52 per ounce.

USD closed the week with a 0.1% decline. GBP rose as investors now allot 80 % chance of rate hike by BOE by Sept 2018. Euro also rose to record highs this week, as Dutch elections saw Greet Wilder's party losing as the populist surge wanes.

Market developments during the week

The Fed raised its benchmark lending rate a quarter point without accelerating the timetable for future hikes. This move was interpreted as a "dovish" hike, meaning that though interest rates were increased, the overall message from the Federal Reserve was a very cautious one. Chair Janet Yellen said that the "simple message is the economy is doing well." Investors anticipated the tightening and Treasury yields had climbed with the dollar on speculation the central bank might signal a faster pace of tightening. Those trades unwound late Wednesday, as policy makers indicated they haven't fallen behind with efforts to keep inflation in check.

Chair Yellen said the central bank was willing to tolerate inflation temporarily overshooting its 2% goal and that it intended to keep its policy accommodative for "some time." In their first forecasts in 3 months, Fed policy makers penciled in two more quarter-point rate increases this year and three in 2018, unchanged from their projections in December. Yellen noted the economy may have "more room to run." Stronger business and consumer confidence hasn't yet translated into increased investment and spending, said Yellen. Retail sales in February grew at the slowest pace since August, a government report showed earlier Wednesday.

President Trump's 2018 budget proposals came up this week revealing historic cuts across Government to fund defense. He is proposing historically deep budget cuts that would touch almost every federal agency and program and dramatically reorder government priorities to boost defense and security spending, although it's likely to face a fight in Congress. The State Department would be hit with a 28% reduction below fiscal 2016 levels that mainly targets international aid and development assistance; the Environmental Protection Agency would face a 30% reduction. Also in the crosshairs are agriculture programs, clean energy projects and federal research funding. However, as before, even these proposals lack specifics. The document doesn't account for his proposals to cut taxes, resolve internal Republican disputes over entitlement spending, or reveal what the White House forecasts for economic growth. That is to come as part of a larger document in May.

On the economic front, US economy continues to show positive performance with manufacturing output rising in February for a sixth consecutive month, underscoring a sustained rebound in the industry. The 0.5% gain at factories, which make up 75% of overall industrial output, matched the prior month's advance, marking the best back-to-back performance in 3 years, a Federal Reserve report showed Friday. More appropriate levels of inventories, a recovery in global markets and stronger corporate spending on equipment have put manufacturers on firmer footing. Also, consumer sentiment in the U.S. rose as household finances improved. The University of Michigan said Friday that its preliminary index of sentiment increased to 97.6 from 96.3 in February.

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The Dutch election results came up as a big surprise. The loss of Geert Wilders' Freedom Party brought down global concerns over the rise of populism.

It was also a busy week for global central banks, other than the Fed, as majority of them concluded policy meetings. Just hours after the Fed's decision, the BOJ left its plans unchanged, increasing the policy divergence between the two central banks. The spread between U.S. and Japanese 10-year government bond yields this week reached the widest level since 2010, a key factor behind expectations for dollar strength. A weaker Japanese currency creates desirable inflationary pressures by raising the prices of imported goods, though it can undercut purchasing power for consumers. Increase in U.S. yields would likely put more upward pressure on those in Japan, which could force the BOJ to either increase bond purchases, conduct more fixed-rate buying operations or raise its target for the yield.

China's central bank raised borrowing costs as a stable economy and factory reflation give it scope to follow the US. The PBOC increased the rates it charges in open-market operations and on its medium-term lending facility. The cost of 7, 14 and 28 day reverse-repurchase agreements was raised 10 basis points each.

The Swiss National Bank kept its deposit rate at minus 0.75% and reaffirmed its threat to intervene to keep a lid on the franc. The triggering of Article 50 could cause the central bank to intervene again, as it did in the wake of last year's Brexit referendum and at the height of the Greek debt crisis, so could a win by euro-skeptic Marine Le Pen in France's presidential election in May. While apprehension among investors about European politics or U.S. protectionism may keep the SNB active in markets, Switzerland appears to have overcome an episode of falling consumer prices.

Turkey's central bank raised the late liquidity window rate by 75 basis points to 11.75% and indicated it will maintain a tight monetary policy until the inflation rate, which is running at more than double the regulator's target, improves. The central bank's second tightening in as many meetings comes after policy makers used a series of extraordinary measures to push the cost of lending to commercial banks to the highest level in almost five years to boost the currency. The regulator has been forcing lenders to use the little-used late liquidity window, which is more expensive than Turkey's three other key rates, since January to tighten liquidity. The lira extended gains after the decision and was trading 0.7% higher at 3.6504 per dollar.

Currencies

The dollar slipped 0.1%. It weakened against all its major peers except the Canadian dollar.

The euro was little changed at $1.0768, on course for its best week since the period ending Jan. 13. It touched a 5-week high this week on Dutch election outcome, where populist surge was let down.

Equities

The S&P 500 was little changed at 2,382. The index is up 0.4% in the week. Its post-Fed rally ran out of steam after the index climbed within 0.5 % of an all-time high.

The Stoxx Europe 600 Index was little changed. European shares rose during the week after the Dutch election eased concerns about the rise of populism.

The MSCI Emerging Markets Index rose 0.3%, bringing its rally for the week to 4.4%, outpacing a 1.3% advance for the MSCI All-Country World Index. Also, Indonesia's stocks rallied to record as it saw biggest daily fund inflow of $138 million into the local stock market on Thursday, the biggest one-day inflow since October.

Bonds

Treasuries looked to cap a weekly advance falling 3 basis points to 2.52% spurred by the Federal Reserve's signal it's in no rush to lift rates.

French yields for bonds of the same duration climbed two basis points to 1.1%, while German bunds were little changed at 0.46%. That of Italian peers added three basis points to 2.4%.

Commodities

West Texas Intermediate gained 0.4% to $48.94 a barrel and Brent traded up 0.4%

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to $51.93. Both showing their first weekly gain this month. The surge in prices came after Saudi Arabia's Energy Minister told the kingdom may prolong production cuts. But among the 11 non-members joining OPEC in the accord, compliance is lagging. Led by Russia, the countries reduced their February output by 240,000 barrels a day from October-November levels, or 43% of their promised 558,000-barrel reduction, according to Bloomberg. The OPEC will meet on May 25 to decide whether to continue its production cuts, aimed at ending a slump in prices. Also helping a revival of crude prices was easement in U.S. stockpiles which declined by 237,000 barrels last week.

Gold was poised for its first weekly advance this month adding 0.3% to $1,230.52 an ounce, on track for a weekly gain of 2.2%.

Other major economies:

China

China's economy continues its signs of improvement with February seeing the first net fund inflows via cross-border payments since June 2015, data from the currency regulator showed Thursday. Meanwhile, net outflows via yuan payments slowed to the equivalent of $5.5 billion, down from a record $44.7 billion in September, as capital controls by officials over the past four months to prevent money leaving China took effect. With U.S. tightening looming and the People's Bank of China interest rate at a record low, China's capital outflow pressures are poised to intensify this year.

The central bank has stepped up scrutiny of requests to move money out of the country since last year, and it's also speeding reforms to open up the domestic bond market to lure more foreign investors. The yuan has gained 0.6% in 2017 to 6.9030 per dollar on Friday, while bets on future volatility in the currency are the lowest among emerging markets.

In the bond market, there are moves to make the country's $9 trillion domestic debt market more global as the central bank pledged to create a "more convenient and friendly environment" for foreign investors. The head of China's currency regulator said in an interview that policy makers support opening the market to let money flow both in and out of the economy.

Euro area

The Dutch elections did not produce the expected lurch to the far right, with Geert Wilder's Freedom Party winning 20 seats in the 150 seat parliament, with more than 90% of the votes counted. Prime Minister Mark Rutte's Liberals, who won 33 seats, must now seek partners to form a coalition government. Dutch voters turned out in force to back pro-European parties and help Prime Minister Mark Rutte's Liberals easily beat off an election challenge by the Freedom Party of Geert Wilders, drawing a line in the sand over the spread of populism in the U.K., U.S. and Italy which surprised the markets. With this, the probability of a victory for the France's anti-euro candidate Marine Le Pen also declined. France heads to the polls in April and May, followed by German elections in September.

On the economic front, Spanish and German inflation were confirmed this week and have raised at a 5-year and 4-year highs respectively in February, continuing the Eurozone's impressive macroeconomic performance over the last few months. Spanish and German inflation are now at 3.0% and 2.2% respectively. The confirmation comes after ECB's President Mario Draghi did not discard the possibility of an interest rate hike at the last ECB's press conference last week in case price indices get close to the central bank's target of 2%.

Due to the strength of the Eurozone data over the last months and lower probabilities of a populist political surge in the Eurozone, the euro could well continue to appreciate over the coming days, although new surprises coming from the French elections cannot be entirely discounted.

Canada

The loonie holds the gains registered versus the USD this week after the Federal Reserve meeting, supported by stable crude oil prices that have recovered some 5% from this week's lows. Also job report revealed employment grew by an impressive 15,300 jobs against expectations of just 600 jobs, and the unemployment rate fell to 6.6%, the lowest since February 2015, and 0.1% above 8-year lows.

20 March 2017

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INVESTMENT MANAGEMENT

WEEKLY INVESTMENT UPDATE

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UK

U.K. employment statistics showed the unemployment rate unexpectedly falling to 4.7% in 3 months through January, while wage growth disappointed as the basic wage growth slowed to 2.3%. With the falling pound pushing up inflation, real incomes on some estimates are set for their worst year since 2013, putting a brake on the consumer spending that drives growth.

UK Gilts fell and GBP was trading at its highest levels this month, as investors begin pricing in a higher chance of a rate increase. This came as BOE policy maker Kristin Forbes voted for an interest-rate increase. The central bank kept the benchmark rate at a record-low 0.25% in an 8-1 vote yesterday. Investors are now pricing an 80% chance policy makers will raise rates by September 2018, compared with about 60% just a day before the vote, money-market pricing shows. GBP/USD traded little changed at 1.2354 after high of 1.2399; set for a 1.5% weekly gain after a 2.4% decline in the previous 2 weeks. EUR/GBP fell 0.2% to 0.8691. Gilt 10y yield was up 1bps to 1.26% after rising to 1.29%, set for 3bps weekly advance. However, GBP is expected to see further trouble ahead as Article 50 trigger nears.

U.K. equity investors are not losing any sleep over Article 50. The stock volatility as measured by the VFTSE Index is near a record low. That’s in large part because members of the benchmark FTSE 100 Index get about three-quarters of sales from abroad, so their profits have been benefiting from the slide in the pound. If the currency sees a significant drop from here, the index may rise further, after hitting a record high this month. Yet some analysts argue that upside is limited, as the weak pound has been priced in. Members of the FTSE 250 Index get about half of revenues from the UK, and that’s at 70 % for the FTSE Local UK Index, so these firms may struggle if UK growth shows more signs of a slowdown.

Regarding Brexit update, the UK Parliament has passed legislation allowing Prime Minister Theresa May to invoke Article 50 of the Lisbon Treaty, with two officials familiar with her plans saying she will use that clause to trigger Brexit negotiations by the end of the month. The House of Commons rejected two revisions by unelected peers that would have guaranteed rights for EU citizens living in the U.K. and given Parliament a final binding say on what May negotiates with the EU. The government argued against the changes, saying it wanted to preserve May’s flexibility in the talks. However, Brexit talks might slip to June as the 27 other members of the EU have pinpointed a meeting of government ministers in Luxembourg on June 20 as the moment to authorize the opening of talks. Until now, May has set the agenda, but once she triggers the exit, and the clock starts on the two-year negotiation, power shifts to the EU and she will have to be patient.

Safety First Portfolio update

In the scenario of rising geo-political risks, particularly due to the upcoming euro area elections, Brexit negotiations, Fed actions, we slightly changed our assets allocations to reflect our Safety First strategy.

We reduced our equity risk in all markets- US, UK and EM by protecting meaningful profits in Q1 2017. We also reduced holding in UK fixed income as this asset class faces high inflation risk. Consequently, cash realized was held on deposit so that we remain in a position to quickly recommit these funds when suitable opportunities arise and market volatility settles. Portfolio cash increased to between 52% & 60% levels. We also increased our bullion holdings.

Jason Granite
Chief Investment Officer
18 March 2017

Please see FTIM Safety First portfolio performance on the next page

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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%	0.73%	2.08%
FTIM Safety First 3	3.26%	1.09%	2.42%
FTIM Safety First 4	4.38%	1.51%	3.30%
FTIM Safety First 5	5.63%	2.18%	3.61%
FTIM Safety First 6	10.10%	3.40%	5.24%

Date: 17 March 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.