10 April 2017

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INVESTMENT MANAGEMENT

# WEEKLY INVESTMENT UPDATE

## Geopolitical angst intensified putting US-Russia ties at stake

**KEY MESSAGES:**

**The US military strikes on Syria after civilians were attacked with poison gas saw support from world leaders except Russia and Iran.**

**Weaker-than-forecast hiring data in the US, and the Fed signaled towards a reduction of its balance sheet this year. The ECB underscored its dovishness in a risk off week.**

**Global currencies weakened, Equities closed lower as demand for haven assets rose. Treasuries advanced with the yield on 10-year Treasury notes dropping to 2.29 %. Gold climbed 1.4 % to $1,2671.20. West Texas Intermediate crude added 0.7 % to $52.01, after touching the highest in a month. Oil is up almost 3 % for the week.**

**Market developments during the week**

Caution spread across financial markets as US jobs data disappointed and geopolitical angst intensified after the first military strike undertaken by President Donald Trump's administration.

The week witnessed a disgusting and immoral sarin gas attack on civilians in Syria. In response to this, the US launched 59 tomahawk missiles at Syria after accusing the regime of Bashar al-Assad, a Russian ally, as responsible for the incident, an act President Donald Trump called "an affront to humanity." World leaders rallied around the United States after it launched a missile strike in response to the chemical attack, while Russia condemned the move as "aggression" and suspended coordination with Washington in Syria's congested skies. British, French and German leader issued statements in support of the US.

Markets responded to this with a risk-off move with treasury yields falling, gold and oil spiking higher, and equities selling off. We were well positioned for these moves.

Emerging-market currencies fell, with the Won leading declines in Asia. West Texas Intermediate for May delivery on the New York Mercantile Exchange rose as much as $1.24 to $52.94 a barrel. Brent for June settlement on the London-based ICE Futures Europe exchange surged as much as $1.19 to $56.08 a barrel, also the highest level since March 7.

On the political front, the key event was the summit between Donald Trump and Xi Jinping in President Trump's Mar a Lago resort in Florida. Amid data showing the US trade balance which registered a smaller than expected deficit in February with a bilateral deficit with China narrowing 26.6%, the summit was keenly followed by investors. China also overtook Canada as the biggest buyer of US oil exports, highlighting that the US-China bilateral relationship remains of paramount importance for both countries. The main topics of the meeting included how to respond to North Korea's attempts to refine missile and nuclear weapons technology. Trump and Tillerson have made clear that the US has lost its patience with attempts to negotiate with North Korea.

The Trump administration was keen to demonstrate its commitment during the week to push forward with its campaign promises. Major developments include talks in progress to improvise GOP healthcare bill to enable its smooth passage through the Congress. The administration also took a further step ahead relating to its campaign promise to crack down on a work visa program that channels thousands of skilled overseas workers to companies across the technology industry rolling out a trio of policy shifts making it harder for companies to bring overseas tech workers to the US using the H-1B work visa.

An update from the Fed included its release of minutes of the Federal Open Market Committee's March 14-15 meeting. The minutes showed that most officials agree

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that they will begin reducing the size of the bank's $4.5 trillion balance sheet later this year, as they reiterated their outlook for gradual interest-rate increases. Three rounds of bond purchases from 2008 to 2014 aimed at pressing down long-term lending rates bloated the Fed's balance sheet from less than $1 trillion before the financial crisis. The Fed's balance sheet is so huge, however, that the impact is difficult to predict. The Fed's portfolio includes $426 billion of Treasury securities set to mature in 2018, and $352 billion more that will mature in 2019. Not all of that will have to be financed by private investors in a single year because the Fed wants gradual runoff. The matter on how the balance sheet could affect the funds rate path won't be settled until investors know the amount the Fed plans to run off but it is concerning. The committee also discussed phasing out versus simply ending reinvestments. A phase-out was seen as less likely to trigger volatility, but slower and more difficult to communicate to investors. The committee made no decisions regarding the balance sheet and agreed to renew the discussion at subsequent meetings. Traders are betting that the reduction in bond holdings will have a monetary effect, which may slow the pace of interest rate rises for the rest of 2017.

The minutes also showed that some members are getting worried about stock valuations. As part of their discussion of the economy, many Fed officials observed a rise in equity prices in recent months as contributing to an easing in financial conditions. It was also observed that prices of other risk assets, such as emerging market stocks, high-yield corporate bonds, and commercial real estate, had also risen significantly in recent months.

On the economic front, the most watched report this week was US payroll gains which slowed in March while the jobless rate unexpectedly dropped to the lowest in almost a decade. The 98,000-increase followed a 219,000 rise in February that was less than previously estimated (c. 190,000 consensus), a Labour Department report showed. The unemployment rate fell to 4.5 % from 4.7 %, and wage gains slowed to a 2.7 % year-over-year pace. Employment has been on a healthy run, giving Federal Reserve policy makers enough confidence to raise interest rates in March and forecast two more hikes this year. Businesses have been challenged by a dwindling pool of unemployed, and are gradually giving in to pressures to raise wages in order to attract and retain talent.

Other releases include Services PMIs from ISM and Markit both showing modest growth in reported output. Passenger car sales plummeted again in March falling 1.6 % to just over 1.55 million vehicles, dragging US auto sales to their third straight monthly decline, a strong indication that years of sales growth have come to an end. The industry's annualized sales pace, adjusted for seasonal trends, slowed to 16.6 million in March, from 16.7 million a year earlier, according to researcher Autodata Corp. March was supposed to be the month US auto sales rebounded from decreases in January and February. Instead, ample discounts were unable to spur demand for models like GM's Chevrolet Malibu and Ford Fusion. Deliveries of those models each plunged by more than 35 % in March. The collapse in car demand is also likely to put pressure on President Donald Trump's factory jobs policy.

**Currencies**

USD generally weakened after data showed American payroll gains slowed in March.

The Euro lost 0.9 % this week closing at USD1.06 per EUR.

GBP dropped 1.6 % to USD1.24.

The Yen lost 0.4 % this week closing at JPY110.9 per USD.

The ruble dropped 1.1 %.

South Africa's Rand touched the weakest level this year after Fitch Ratings became the second company to cut the country's credit assessment to junk. It traded at 13.799 per USD, lower by 0.3 %.

**Equities**

Equities closed lower. The S&P 500 was down 0.3 % this week to 2,357. Stocks turned lower as reports of a possible terrorist attack in Sweden added to the unease ahead of the weekend. Futures fell as much as 0.7 % in the hour after Thursday night's attack in Syria.

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Lenders led declines after Economic Council Director Gary Cohn said the Trump administration wants a modern version of the regulation that separated banking businesses.

The CBOE Volatility Index rose 3.3 % to 12.79. It topped 13 after the payroll data.

As regards earnings update, investors seeking hints on the first-quarter earnings season are getting little help from companies. In the past month, only 83 have published profit guidance of any variety, the least at this time of the year. The stretch of quietness comes as large banks including JPMorgan Chase & Co. and Citigroup Inc. are set to kick off first-quarter reporting next week. The silence adds to the air of mystery in US equities, where valuations are considered high and volatility non-existent as prices again lock themselves into a range after the four-month Trump bump. Analysts are sticking to their bullish calls, forecasting 9.7 growth in S&P 500 earnings for the March quarter and 12 % for the full year. That's a departure from the last two years, when growth estimates shriveled to zero as reporting season drew near.

The Stoxx Europe 600 Index dropped 0.2 %. Volatility measures from Hong Kong to Europe increased.

FTSE 100 closed at 7,316 compared to last week close of 7,323.

Japan's Topix index climbed 0.7 %, rebounding after erasing a rally of as much as 1.2 % during the morning session.

The Shanghai Composite Index rose 0.2 %, giving it a 2 % gain for the holiday-shortened week.

**Bonds**

Treasuries advanced with yield on 10-year Treasury notes dropping to 2.29 %.

Core European government bonds opened higher amid the broad flight-to-quality move after the Syria strikes. The yield on the 10-year German benchmark fell three basis points to 0.24 %.

UK 10-year Gilts yielded 1.07 %, seven basis points lower than last week.

**Commodities**

West Texas Intermediate crude added 0.7 % to $52.01, after touching the highest in a month. Oil is up almost 3 % for the week.

On supply demand front, statement from OPEC's Secretary-General Mohammad Barkindo indicated crude stockpiles are starting to decline in a sign that the production cuts implemented this year are bringing the market to balance. However, crude dropped temporarily as the reopening of Libya's biggest oil field countered OPEC's optimism about production cuts. Libya's output had dropped to about 500,000 barrels a day last week when production was halted at the Sharara field. Also, inventory data released by the US Energy Information Administration showed a 1.6m barrel increase in stockpiles, disappointing oil bulls and most forecasters, who were expecting a fall in stockpiles.

What Trump does with Iran will in our view be the game changer. If sanctions are re-imposed and the Iran deal stuck by Obama is ripped up as Trump promised on the campaign trail; the supply / demand dynamic will shift considerably in favor of Oil price rises.

Gold climbed 1.4 % to $1,2671.20, the highest since November, following two days of declines.

**Major economies:**

**Euroarea**

Decent growth across the Euro-area was seen as manufacturing PMIs for various eurozone countries showed the sector expanding at a fairly healthy rate across the euro zone, although Spain's index fell. The eurozone's Unemployment Rate also ticked down to 9.5%, although youth unemployment remained worryingly high. Services PMIs were also showed a decent rate of growth across the Euro-area, with eurozone wide PMI reading 56.0.

Among other reports were industrial production in Germany which revealed an unexpected rise. Output, adjusted for seasonal swings and inflation, gained 2.2 % from January. Production was up 2.5 % from a year earlier. Construction sector output surged almost 14% in February. The data came a day after a report showed

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German factory orders recovered with a 3.4% growth in February, led by a jump in domestic demand, unwinding last month's sharp 6.8% drop.

Another dovish statement from ECB President Mario Draghi that inflation in the Euro-area is not strong enough for a shift to tighter monetary policy drove the euro to $1.0668 levels which later steadied by the weekend. Draghi's message comes after weeks of diverging signals from policy makers on the strategy the central bank will follow to exit its unprecedented stimulus. With the region's upturn gaining momentum, the threat of deflation off the table, and slower purchases in the ECB's 2.28 billion-euro ($2.43 billion) quantitative-easing plan as of this month, some governors have been urging tweaks to central bank's forward guidance.

On Brexit, a top European Parliament ally of German Chancellor Angela Merkel said London's financial-markets business tied to the Euro must be pared back after Brexit, highlighting one of the possible red lines in the upcoming negotiations. Among the potential prizes for capitals across the EU are financial-markets jobs now based in London, including at the European Banking Authority, an agency whose seat will move as a result of Brexit. As banks prepare to relocate employees from the UK in anticipation of the country's exit from the EU, the fate of British-based work tied to the clearing of euro-denominated derivatives trades remains unclear.

The EU Parliament is gearing up to set out its priorities for Brexit talks due to start next month, offering signals about how much room for maneuver the UK and its 27 partners in the bloc will have during the two-year divorce process covering everything from finance to fisheries. While the Parliament won't take part in the negotiations, it does have veto power over any agreement and will play a consultative role.

Also, there was a statement from Germany's economy minister that her country will weather Brexit because of its strong global market position, though a new European trade relationship with the UK also is needed. It is looking forward to start strengthening its ties with China at the G-20 meeting. It is also reaching out to Japan as ally on free trade.

This month's French elections also pose some risks with the latest television debate revealing Marine Le Pen labelled soft on her Euro exit plans that failed to win over viewers. The National Front leader's opposition to the European Union has been a signature issue in the presidential election. Yet with all candidates granted a hearing in a four-hour discussion, Le Pen repeatedly lost her cool and was confronted by a marginal rival who tried to paint himself as the true anti-euro firebrand. Two snap polls rated her only the fourth-most-convincing candidate, with roughly half the endorsements of front-runner Emmanuel Macron.

**Canada**

Canada's GDP grew 0.6% in January, double most expectations, as the manufacturing sector outperformed. The statistical release noted that with the exception of October, GDP rose every month since June 2016. The resource extraction industries contributed significantly. Canada's Trade Balance fell into deficit in February, as exports fell 2.4% after reaching a record high in January.

Another important release this week for Canada was jobs report which revealed it added 19,400 jobs in March, for an employment gain of 276,400 over the past 12 months. Yet, the pace of annual wage rate increases fell to 1.1 %, the lowest since the 1990s. The two-faced nature of Canada's labour market was on full display as employers continued to hire but resisted raising wages.

**Other major economies**

Unrest in emerging markets is on the rise while investors are not yet running for the exits.

In Latin America, there are anti-government protests in Paraguay, Ecuador and Brazil. Brazil's real joined the Colombian Peso and Mexican Peso in the five most volatile currencies among 31 major peers tracked by Bloomberg, based on their one-month implied volatility. President Michel Temer's disapproval rating has jumped to 73 % from 64 % in December, according to an Ibope

poll published Friday by the National Industry Confederation, or CNI.

Venezuela's top court reversed its decision to strip power from the opposition-led National Assembly, taking the country back from the brink of dictatorship.

In South Africa, the political fallout from President Jacob Zuma's decision to fire his finance minister continues with parliamentary Speaker Baleka Mbete saying she is considering whether to allow a vote of no-confidence in the president to be held. This week S&P Global Ratings cut the country's debt to junk and Moody's Investors Service placed it on review for a downgrade. The loss of investment grade status for the first time in 17 years saw a sell-off in the Rand, which was trading at 13.8272 to the US dollar. South African equity trading volumes are projected to fall by half as protesters amass across the country to demand the removal of President Jacob Zuma following a cabinet purge that resulted in the country's credit rating being downgraded to junk. Later in the week, a second junk rating drove South African Yields to year-high as Fitch cut its credit assessment to junk.

There are other markets in the emerging markets region drawing interest from investors, with Argentina exiting recession and Mexico's Peso going from last year's worst-performing major currency to this year's best. Leveraged funds are shorting the USD versus the Mexican Peso for the first time since May, as Donald Trump's presidency has so far proven far less toxic for the relationship between the US and Mexico than his campaign-trail rhetoric suggested.

**UK**

On the economic front, UK manufacturing PMI showed a decline to 54.2 in March as inflationary pressures continue. A measure of new orders also weakened. Manufacturing and construction unexpectedly shrank in February, which saw pressure on the GBP resume. Total industrial production declined 0.7 % as unseasonably warm weather reduced demand for energy. Construction dropped 1.7 %, the most in almost a year. While industrial output and construction are still likely to contribute modestly to growth in the first quarter, the economy will get no help from trade, which drove the expansion in the final period of 2016. The deficit in goods and services grew to GBP3.66 billion in February, meaning the shortfall will widen in the first quarter unless March posts a near-unprecedented surplus. The reports added to a trend this week indicating that, with the exception of the country's dominant services sector, UK data is disappointing economists.

In March, the weaker Pound helped export competitiveness and firms' confidence remained high. Bank of England Deputy Governor Ben Broadbent said last month that exporters are enjoying a post-referendum, pre-Brexit "sweet spot" because while sterling has fallen, EU trading arrangements remain in place.

PMIs for the service sector released Wednesday saw better than expected results. IHS Markit's PMI for services rose to 55 from 53.3 in February. The anecdotal sections in the report highlight several themes of Britain's post-Brexit economy, including sterling weakness boosting foreign demand, rising input costs, and ongoing uncertainty hampering investment intentions. Consumer orientated sectors were the worst performers, and so the weakness in retail sales over the last few months has indeed dented some parts of the economy.

Pressure on GBP continued as Bank of England Governor Mark Carney urged banks to get contingency plans in place for all potential Brexit outcomes. Describing better international coordination on regulation as taking the "high road," he said this would lead to "more jobs, higher sustainable growth and better risk management across the G20."

A dovish statement from Bank of England policy-maker Gertjan Vlieghe that faster UK inflation alone would not force a rate hike reinforcing the idea that some traders may have overreacted to faster-than-forecast inflation and news that one of the nine Monetary Policy Committee members voted to hike the benchmark interest rate. Sterling swaps data put the probability of a BOE increase within the next year at more than 50 % at one point during March. They've since slipped back to about 31 %. While consumer-price growth is accelerating more than the BOE projected, Vlieghe said there's no mechanical link to higher

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borrowing costs. The surge may just mean the impact of the pound's sharp decline since the Brexit vote is hitting home faster and could, potentially, fade faster as well.

Gibraltar tensions bubbled over into British war talk. Spain dealt another blow to UK by withdrawing opposition to Scottish independence.

There was another warning on the UK's approach to Brexit negotiations from the EU side, with the EU's chief Brexit negotiator Michel Barnier warning that Britain must settle the terms of its exit before seeking a trade deal, or risk having no deal at all.

PM Theresa May, this week, accepted possible extension of EU rules after 2019.

She also suggested unrestricted EU migration to continue post-Brexit, as she eyes an “implementation phase” after 2019, while new border systems and a trade deal are put in place.

All in all a very busy and uncomfortable week.

There are plenty of cumulonimbus clouds gathering, producing gusty winds, heavy rain and sometimes hail. The basic ingredients for a thunderstorm are all present.  We will watch carefully so see if the moisture, unstable air and lift come together over these coming weeks to trigger that thunderstorm.  I think the odds are shortening and we will continue to position our Safety First Portfolios accordingly to protect our clients.

Mindful of our cautious approach to capital management and our concerns over rising geo-political risks heading into quarter 2, we felt that turning down the Safety First portfolio risk dial was prudent.

We raised portfolio cash balances twice over the month by locking in gains on profitable positions, in some cases double digit. An element of de-risking was instituted on 14 March, with an element of the proceeds being added to existing Oil and Gold holdings. Both Oil and Gold offer the benefit of being uncorrelated to equity markets and are excellent portfolio risk diversifiers, enjoying different return profiles to equity. Gold has been long recognised as a hedge against geopolitical risk.

Further capital was raised on 31 March, as President Trump's political manifesto appeared to run into a political quagmire and room for investor disappointment increased markedly.

Cash balances currently stand at SPF6 64.48%, SFP5 67.24%, SFP4 69.27%, SFP3 71.78%, SFP2 69.20%, and we are conservatively positioned to capture any reinvestment opportunities should and when they present themselves.

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**10 April 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% | 0.87% | 2.14% |
| FTIM Safety First 3 | 3.26% | 1.25% | 2.45% |
| FTIM Safety First 4 | 4.38% | 1.68% | 3.33% |
| FTIM Safety First 5 | 5.63% | 2.31% | 3.63% |
| FTIM Safety First 6 | 10.10% | 3.46% | 5.20% |

Date: 07 April 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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