31 March 2017

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INVESTMENT MANAGEMENT

WEEKLY INVESTMENT UPDATE

UK Prime Minister May triggers Article 50

KEY MESSAGES:

The key highlight of the week was the triggering of Article 50 by UK Government. Focus now shifts to whether the UK will be able to pursue divorce talks and trade talks in parallel. Strong resistance for this is coming from the EU.

As much of the UK's plans were already announced, the market impact of it was quiet. GBP, Euro were little changed. S&P 500 closed the week with a 1% gain. FTSE 100 closed at 7,341 compared to 7,337 last week. The Stoxx Europe 600 fell 0.3%. Yields on 10-year Treasuries fell one basis point to 2.43%.

WTI crude rose to $50.31 heading for the biggest weekly gain this year. Gold closed at $1,245.7 per ounce, gaining 0.2% this week.

Market developments during the week

Markets, at the beginning of the week continued to show the effects of the pullback of US healthcare reform which now stands postponed indefinitely. As such, major indicators opened lower on Monday, but risk sentiment recovered quickly as the week progressed.

Positive developments on the economic front included pending home sales data and an upward revision to fourth quarter US GDP growth. Conversely, new data pointed to a deceleration for real consumer spending growth to below 1% (annualized) this quarter. That said, this appears to be only a temporary setback.

US Q4 growth was revised upwards to a 2.1% annualized pace (forecast was for 2%),revised from 1.9%. Consumer spending, the biggest part of the economy, rose at a 3.5% rate, revised from 3%; added 2.4 percentage points to growth. The 7-year expansion continues to be led by consumers, who are cushioned by a firm labor market and rising confidence. At the same time, rising corporate profits which jumped 9.3% from a year earlier and rose 0.5% from the previous three months, in the first estimate for the Q4. This could provide continued momentum for hiring and support further capital investment. Trade continues to have a drag on GDP subtracting 1.82 percentage points, on weaker exports and higher imports.

Filings for US unemployment benefits declined by 3,000 to 258,000 in the week ended March 25, while remaining at levels consistent with a solid labor market, a Labor Department report showed Thursday.

The Trump administration showed signs of faltering; the pull back of its healthcare bill did show an impact at the beginning of the week. Apart from this, one of Trump's first acts as president was to withdraw from the Trans-Pacific Partnership trade deal his predecessor negotiated. Yet key promises such as renegotiating NAFTA, imposing border taxes on companies that move production overseas and labelling China a currency manipulator remained unfulfilled.

The White House on Thursday also distanced itself from a document suggesting it was softening its goals for a renegotiation of NAFTA. A letter sent to key members of Congress as part of a consultation process required before triggering a renegotiation suggested the administration would seek more modest changes and would leave in place controversial pieces of the trade deal, including an arbitration panel that lets investors bypass the court system to redress claims under the pact. All good news for Canada and we repositioned our client portfolios to benefit from this softening.

It was reported that President Trump will order a comprehensive study to identify every form of "trade abuse" that contributes to US deficits with foreign countries, Commerce Secretary Wilbur Ross said. Wilbur Ross is no fool and we expect him to be bold in his conclusions.

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Trump also indicated that he will take steps to toughen enforcement of trade penalties just a day after announcing the date for a meeting with Chinese President Xi Jinping, leader of the country Trump has blamed most frequently for trade deficits and job losses. The trade study, to be completed within 90 days, will examine deficits “country by country and product by product” to assess the extent they are caused by “cheating or inappropriate behaviour,” Ross said.

Trump also will announce an order to strengthen enforcement of existing countervailing duties and anti-dumping penalties against foreign products to address under-collection, said Peter Navarro, director of the White House National Trade Council. Anti-dumping penalties target exporters that sell goods below the cost of production and countervailing duties are intended to compensate for foreign-government subsidies to producers. Navarro said such duties stand under-collected by a cumulative $2.8 billion since 2001. Last year, the nation collected $1.5 billion in the penalties, he said.

In a further worsening of relations between the US and Europe, the European Commission President Jean-Claude Juncker hit back at Donald Trump’s support for the UK’s withdrawal from the EU, saying that he would champion American states that wanted to secede from the union.

Currencies

The Bloomberg Dollar Spot Index rose 0.1%.

The euro was little changed at $1.0679 after tumbling 0.9%Thursday.

Even GBP was little changed against the USD since last week. However, it remained markedly stronger against the euro, despite the week’s long awaited and historic activation of Article 50 by Theresa May.

Rand plunged as much as 2.6% before paring losses to trade 0.7% lower as South African President Jacob Zuma replaced Finance Minister Pravin Gordhan and overhauled his cabinet in a late-night move that threatened to trigger a revolt against the administration.

Equities

As we approach the end of a quarter, global stock markets gained significantly during the 3-month period, but with significant volatility. Futures on the S&P 500 closed the week with a 1% gain. Over the quarter, the S&P 500 was up 5.8%, The Dow has gained 4.9% in past three months

The Stoxx Europe 600 fell 0.3%, trimming a quarterly advance to 5%. However, we saw European banks rally this week as options traders doubled down pushing the volume of bullish contracts on the Euro Stoxx Banks Index to levels never seen before, and the number of outstanding calls reached a two-year high versus bearish puts. Even after the rally, members of the banking gauge trade at a valuation that’s half the multiple for the broader market. At 0.7 times book value, they still trade at a significant discount to the broader market, and US banks. We are looking at this relative value and even with the problems of Spanish, Italian and Greek banks filtered out, there seems to be significant value – especially in a rising rate environment.

FTSE 100 closed at 7,341 compared to 7,337 last week.

Japan’s Topix became one of the few gauges in Asia posting a loss this quarter, wiping out a morning rally despite positive economic data.

Asian stocks fell as investors took profit amid the strongest quarter for the region’s equity markets in five years. The MSCI Asia Pacific Index lost 0.9%. All 11 industry groups slid, led by healthcare and consumer staples companies. The gauge is still set to gain about 8.7% this quarter as demand for riskier assets grew on reflation trades triggered by Trump’s election, expectations of a gradual path for US rate hikes, and stronger global growth.

The Shanghai Composite Index added 0.4% also supported by reports that China’s official factory gauge climbed to the highest in almost 5 years evidencing growing momentum in the economy.

Bonds

2-year notes underperformed as the government sold $26 billion of new securities in the first of this week’s three

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auctions. Yields on 10-year Treasuries fell one basis point to 2.43%, after climbing four basis points on Thursday.

German 10-year yields were steady at 0.34%.

Commodities

West Texas Intermediate crude rose to $50.31 heading for the biggest weekly gain this year spurred by a report Kuwait and other countries support prolonging production cuts.

The latest comments from Kuwait's oil minister are bolstering confidence on prolonging production reductions led to the gains with futures up 4.7% this week. The market also rose after a US government report showed the nation's refineries boosted crude use by the most in almost three years while fuel supplies fell. Still, prices are down about 6.5% for the first three months of 2017, their biggest quarterly loss since late 2015.

The ministerial committee of OPEC ministers from Kuwait, Algeria and Venezuela and their counterparts from Russia and Oman concluded meetings in Kuwait City on Sunday with a statement asking OPEC to review the market and give them a recommendation in April on rolling over the cuts. Kuwait, four other OPEC nations and Oman want an extension of the cuts because more time is needed to drain swollen stockpiles. Kuwait reiterated Saudi Arabia's concerns that oil inventories need to fall to the 5-year average. They now stand about 285 million barrels above that, Kuwait Oil Minister Issam Almarzooq said. If OPEC and 11 other producers that agreed to reduce output reach their targeted cuts, inventories should fall to the 5-year average by the end of the third quarter, he said. Compliance was 94% in February, according to the monitoring committee headed by Almarzooq.

Prices also rose after US government data showed that gasoline inventories dropped more than expected, while refineries boosted the amount of crude they processed by the most in almost 3 years. US gasoline inventories dropped by 3.75 million barrels last week, according to an Energy Information Administration report on Wednesday. Refineries processed 16.2 million barrels a day of crude last week, up 425,000 barrels from the prior week, according to the EIA. Nationwide crude stockpiles rose by 867,000 barrels to all-time high of 534 million. Oil output climbed further to above 9.1 million barrels a day.

Brent for May settlement, which expires Friday, slipped 28 cents to $52.68 a barrel on the London-based ICE Futures Europe exchange. The global benchmark crude traded at a $2.46 premium to WTI.

Gold closed at $1,245.7 an ounce, gaining 0.2% this week. Gold has been one of our best performing asset classes in Q1 2017.

Major economies:

Euroarea

Euro-Area Inflation slowed more than predicted, remaining at 1.5% in March. This was down from 2% in February. The core inflation rate also fell 0.7%, more than expected, to the lowest in nearly a year. The slowdown, partly reflecting the timing of the Easter holiday, was predicted by the ECB. While the inflation rate picked up in the past year on the back of the ECB's bond purchases, the rise has been chiefly due to volatile items such as energy and food. Underlying price pressures are still considered weak, and President Mario Draghi has said he's looking for further assurances that the medium-term upturn in inflation is sustainable. After this week, the ECB will reduce monthly purchases of public and private debt to €60 billion ($64 billion) a month from €80 billion, though it plans to continue the program until at least the end of the year.

Consumer price growth in Germany and Spain also weakened more than expected in March. The better inflation picture, compared with sub-zero monthly prints in early 2016, coincides with data showing a pickup in momentum within the EU, even in the face of potential political risks due to Brexit and elections in France. Business sentiment in Germany climbed to the strongest since 2011 in March, in a sign that the economy is sustaining its momentum as revival in global trade trounces fears of rising protectionism. The Munich-based Ifo institute's business

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climate index rose to 112.3 in March from a revised 111.1 in February. German unemployment slid to record low with number of people out of work falling 30,000 to 2.6 million in March, most since 2011, Jobless rate declined to record-low 5.8% in March.

Also showing strength of manufacturing in the euro area, a key gauge of activity rose to a near six-year high in March jumping to 56.2 in March from 55.4 in February and an index of services surged to 56.5 from 55.5. Employment increased the most since July 2007, with hiring picking up both in services and manufacturing. The jump in the headline IHS Markit Purchasing Managers Index compared with economists' expectation for a decline and the latest reading is in line with a quarterly economic expansion of 0.6%. That's faster than the 0.4% pace in the last three months of 2016.

Regarding Brexit, the EU drew up its tough stance on the transition deal with the Initial Brussels guidelines prioritizing withdrawal terms over future relations. EU President Donald Tusk sent draft negotiating guidelines to European capitals. In the draft guidelines for the Brexit talks, Donald Tusk said outlining future trade ties would not take place until "sufficient progress" was made resolving thorny topics such as borders and budgets. Substantial negotiations can begin as of May 22, according to an EU official, and Tusk said the first round of discussions may run until "the autumn." It will be fascinating to see how the process unfolds.

Although Theresa May again pitched this week for the divorce and trade talks to run in parallel, the EU is holding fast to its argument that the "disentanglement" comes first. That means finding agreement on issues such as the Irish border, the rights of citizens already living in each other's territory and, most crucially, the €60 billion-($64 billion) bill that EU officials want to impose and which May's government is already challenging.

The draft guidelines will now be discussed by the EU's governments and a final version will be approved by leaders at a summit in Brussels on April 29. A more detailed mandate for the bloc's chief Brexit negotiator, Michel Barnier, needs to be approved later, before substantial talks with the government in London can begin. A day after May reached out to voters in seven EU states via newspaper columns, the EU said, "there will be no separate negotiations" between individual capitals and the UK

Europe's political uncertainty eased this week, as markets were buoyed somewhat by an impressive, and unexpected, victory for incumbent German Chancellor Angela Merkel's party in the German region of Saarland. Merkel's Christian Democratic Union (CDU) which posted its biggest win in 13 years, underscoring the challenge facing the Social Democratic Party trying to deny the CDU a fourth term. This has helped further reduce some of the perceived potential political risk that has dogged the single currency over recent months, given that Merkel is up for re-election later on this year. It is perhaps time to look again at European equities which have been discounted partly because of political risks and partly because of the fiscal environment.

China

China Manufacturing Gauge climbed to highest in almost 5 years to 51.8 in March. Services index increased to a 2-year high of 55.1 from 54.2. The fact that the real strength is with the non-manufacturing PMI suggests that there's fundamentally a good story going on as Manufacturing growth reflects the effects of stimulus. Still, the brighter picture has been boosted by surging producer prices that may be close to peaking, and the government will have to deal with the hangover of this investment-driven growth. We remain very concerned about the leverage and inflationary pressures in the Chinese economy.

Canada

The Canadian economy started 2017 with a bang as GDP rose 0.6% month-over-month in January on broad-based strength. This sets the stage for another strong quarter of economic growth. Despite an improvement in the economic backdrop, recent Bank of Canada communication has remained dovish in tone. This seems to be due to the level of economic slack, which will take time to be absorbed, resulting in limited near-term inflationary pressure. We remain of the view that the Bank of Canada is unlikely to raise rates until late 2018 and we like the

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global macroeconomic outlook picture in Canada.

Japan

Japanese inflation registered its first back-to-back rise since 2015 as core consumer prices rose 0.2% for a second month in February. Many economists expect higher oil prices and a weaker yen to push core inflation to near 1% later this year. But Bank of Japan Governor Haruhiko Kuroda has warned that price momentum toward the central bank's goal of 2% is not sufficient, and that he would need solid evidence of underlying inflation before raising a key long-term interest-rate target. For now, there is little sign of sustainable inflation, with weak wage gains during spring negotiations indicating consumer spending will likely remain subdued.

The jobless rate dropped to the lowest level since 1994. Unemployment rate hit 2.8%, easily the lowest among the Group of 7 leading industrialized nations and undoubtedly the envy of many more. But it symbolizes Japan's challenges as much as its successes. The number of unemployed fell, reflecting a shrinking workforce that is driving a labor shortage as Japan's population ages and shrinks. The lower jobless rate isn't leading to higher wages because companies are hiring people on poor terms. It all adds up to a disconnect, so far, between the unemployment rate and pressure on wages and inflation, one that is limiting domestic consumption and leaving exports to carry a bigger growth burden.

Profit at Japanese companies climbed to a record 20.8 trillion yen in the 3 months ended Dec. 31, according to the Ministry of Finance. Record profit at Japan's biggest companies didn't translate to big raises for wage earners at spring pay negotiations as prospects for exporters were clouded by risks to trade and growth in the US and Europe. Trump has threatened to impose a border-adjusted tax that could hurt Japanese exporters, including Toyota, while the UK's plan to exit the European Union could undercut automakers such as Nissan, which builds cars there for export.

Trade restrictions are not the only potential challenge for exporters. The Japanese currency, which has shed about 8% of its value against the dollar since Trump's election, has a history of strengthening when risks to global economic growth rise. That happened after the UK voted to exit the European Union, eroding the yen value of Japanese companies' overseas earnings.

Other major economies

Turkey is due to vote on April 16 on a proposal to reshape Turkey's democracy by abolishing the post of prime minister and handing President Recep Tayyip Erdogan sweeping executive powers. The vote comes on the heels of a difficult start to the year that's seen Turkey's lira drop to record lows, its central bank take more unorthodox steps to buoy markets, and government efforts to tempt voters and kick-start a slowing economy. While the changes to Turkey's politics will be transformational if the package is approved, it's less clear how it would alter the nation's economic trajectory. Investors are struggling to see much upside in either result. If the outcome is yes, markets are expected to go on a relief rally in Turkish assets as status quo maintained and Erdogan's role formalized. Investor focus will return to economic fundamentals while attention on the political front shifts to new elections. If no wins, it could prove negative for markets. Erdogan probably won't leave it here, meaning the likelihood of markedly increased political tensions and early elections increases. Most money managers see a "no" vote as more destabilizing for markets.

UK

It was a big week for the UK, as its Prime Minister Theresa May was successful in achieving her own set timeline for triggering Article 50 this week. As this was interpreted to have simply confirmed previously announced plans by the government, the market impact of the events has been diminished. Looking ahead, it is new information, particularly about the specifics of how much single market access Britain will lose, and about the health of the negotiations process itself, that is likely to retain the ability to move sterling.

Just a day after Theresa May formally triggered the process for Brexit, it was confirmed that the insurers Lloyd's of London and Royal London are setting up subsidiaries outside the UK, while the investment banks JP Morgan and Citigroup are actively exploring the relocation of key

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operations. A number of banks and insurers have already confirmed they could move staff. Goldman Sachs is to move hundreds of bankers to Frankfurt and Paris, while HSBC could switch 1,000 investment banking jobs from London to Paris. A key concern for financial firms is whether the UK will still hold passporting rights that allow British-based banks and insurers to do business in the rest of the EU.

EU leaders have said there will be no talks on Britain's future relationship with the bloc until the UK government makes enough "progress" on the Brexit divorce, including settling its bills and citizens' rights. Now focus shift on whether May will be able to undertake parallel talks.

On the economic front, there was a good amount of data for investors on the condition of the economy. UK current account deficit shrank narrowing sharply to 2.4% of GDP, with Britain running a £7.4bn surplus with non-EU countries. But savings ratio hit record low in the fourth quarter to 3.3% from 5.3% in the third quarter suggesting that people are increasingly dipping into their savings to maintain spending. Disposable incomes too fell in a warning sign for the economy that a squeeze in living standards is under way. Real household disposable income, which adjusts for the impact of inflation, shrank by 0.4% compared with the previous 3 months, the steepest drop in nearly three years.

UK GDP grew an unrevised 0.7% with a bumper contribution from trade of 1.7 percentage points. But while trade is expected to underpin the economy this year, it may not be enough to outweigh the hit to consumers from rising food and fuel prices, the downside of a weaker currency. Economists see growth slowing modestly from 2016's 1.8%.

UK house prices fell this month for first time in almost 2 years. Nationwide index shows home values dropped 0.3% in March. The 0.3% monthly drop, the first decline since June 2015, pulled the annual rate down to 3.5% from 4.5%. That's the weakest year-on-year increase in values since August 2015. British consumer borrowing grew at its weakest rate in nearly two years over the past three months, according to Bank of England data, highlighting households' sense of caution as Britain moved closer to leaving the European Union. Unsecured consumer lending in the three months to February rose at the weakest rate since July 2015 as annualised growth slowed sharply to 8.7% from 10.1% in January, a far cry from November's recent peak of almost 12%.

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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%	0.46%	2.12%
FTIM Safety First 3	3.26%	0.82%	2.45%
FTIM Safety First 4	4.38%	1.26%	3.34%
FTIM Safety First 5	5.63%	1.90%	3.65%
FTIM Safety First 6	10.10%	3.16%	5.24%

Date: 31 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.

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