09 June 2017

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INVESTMENT MANAGEMENT

WEEKLY INVESTMENT UPDATE

Theresa May's Conservative party loses parliamentary majority

KEY MESSAGES:

Markets have reacted with relative calm to the UK election resulting in a hung parliament. USD, euro rose while GBP fell up to 2.4% to $1.2651 on the election result.

S&P 500 closed at 2,440 reaching intraday records mid-week. FTSE 100 closed at 7,505. US 10-year Treasuries yielded 2.22% and UK 10-year gilts yielded 1.03%. WTI crude oil closed at $46.02 per barrel. Gold fell 0.95% to $1,267 per ounce.

ECB remained dovish while signifying it's cautiously edging toward an exit from stimulus. With the dust settling after Thursday's U.K. elections, the Fed's June 14 decision is the next focal point for investors.

Market developments during the week

The markets were in for high volatility risk this week. Caution prevailed before testimony Thursday from former FBI Director James Comey, the ECB's policy decision and the U.K. election. As each of the events unfolded, relatively, the UK election result was a huge surprise resulting in a hung parliament. The Conservative Party's outright control of Parliament evaporated, leaving the UK facing the prospect of a coalition government, mainly affecting the government's stance on Brexit. Prior to election, few opinion polls continued to point to a Conservative win, while others noted a tightening lead for Tories.

At this point, we sensed the looming geopolitical risks and though we do consider political events to have less long-term impact on markets than economic events, we decided to take up risk averse attitude by moving to 100% cash avoiding any short-term volatility on our Safety First portfolios. Though we are seeing some initial market volatility, but once that has calmed down, hopes for a softer, less combative approach may help the pound and also the UK stock market. We will continue to monitor market reactions as events unfold and redeploy funds as market volatility eases.

With the European Central Bank shifting its language on interest rates, former FBI chief characterizing the U.S. president as having lied and US election result of a hung Parliament, markets have still kept the proverbial stiff upper lip. The pound was one of the few assets to react as the vote tally came in,dropping almost 2.4% as the election intended to strengthen Prime Minister Theresa May's hand in negotiations with the European Union instead left her battling to survive. The currency's retreat gave British stocks a boost, as the FTSE 100 Index gained along with most major global equity gauges. It's a Britain issue not a global issue, and the markets are reflecting that.

There was nothing wild for volatility though. The CBOE SPX Volatility Index slipped more than 2% to 10.16, below its 13.16-point 12-month average. There have been many theories about why volatility has come down in financial markets, but some are concluding it may be as simple as the fact that economic indicators haven't been varying much, with solid job markets in most developed countries, alongside contained inflation and modest expansion rates.

Early Friday, as the election results surprisingly had Britain's Conservative Party coming in shy of a majority, futures on the measure of U.S. equity swings were basically unmoved. As trading kicked off on Friday with a cloud gathering over the outcome of UK election, share trading seemed impervious. U.S. futures were steady and Asian stocks notched gains, with gauges of expected equity volatility in

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Japan, South Korea and Hong Kong all declining.

US Economy

On data front, U.S. CEO sentiment is at 3-year high as they become more sanguine about sales and spending, a good omen for the economy after a lackluster first-quarter expansion, according to a quarterly survey from the Business Roundtable. Prospects for legislation that will reduce taxes and spur growth continue to hearten business leaders, who had boosted their confidence in the economy following President Donald Trump's November election victory. While companies see sales gaining and increasingly plan capital investments, a dwindling pool of skilled and experienced labor for hire may be restraining efforts to boost headcounts. The CEOs estimate the economy will grow 2% this year, down from 2.2% in the previous survey and slightly below the median forecast.

Data on job openings and the non-manufacturing sector confirmed last Friday's payroll report of slowing job growth, something that is to be expected at this point in the cycle. An increase in job openings in April to a record high, indicates demand for workers remains strong while the supply is tightening, a Labor Department report showed. Number of positions waiting to be filled rose by 259k to 6.044m (est. 5.75m), from revised 5.785m in March. Americans faced with lack luster income growth have been financing more of their spending with debt instead. Household borrowings have surged to a record $12.73 trillion, and the percentage of debt that is overdue has risen for two consecutive quarters. And with economic optimism having lifted borrowing rates since the election and the Federal Reserve expected to hike further, it's getting more expensive for borrowers to refinance.

Markets now expect a rate hike by Fed next week as practically a lock, increasing doubts on next hike as soon as September, following soft reports on U.S. employment and inflation. At this point, further hike in December seems probable. The same sentiment was reflected in eurodollar futures, where traders place bets and hedges tied to the path of central-bank policy, as confidence builds that after the June hike, officials pause in September and resume raising borrowing costs at year-end.

On the political front, the main event the investors were looking forward to, was former FBI director James Comey's testimony most of which passed with relatively little fuss. He probably didn't change anybody's mind about President Donald Trump, but he didn't do Trump any favors, either. He told the Senate Intelligence Committee on Thursday that he was convinced that Trump fired him on May 9 because he refused to damp down the Russia investigation. He said he took notes of his conversations with the chief executive because he feared that Trump would lie about them, and accused the White House of spreading lies about why he was ousted. He demurred when asked whether he thought Trump was obstructing justice, saying that matter should be left to the newly appointed special counsel, Robert Mueller, in whom he expressed confidence. President Donald Trump's lawyer said he denies ever pressuring former FBI Director James Comey to pledge his personal loyalty or to drop an investigation of his first national security adviser, Michael Flynn, and accused Comey of undermining Trump's administration. A day before the testimony, President Trump said he will nominate former Justice Department official Christopher A. Wray as the new FBI director.

President Trump faced widening rift from the UK as his tweets signalled this week's terror attack in London as argument to justify executive order on travel ban to the U.S. from six predominantly Muslim countries. President Trump risked provoking a diplomatic row with the UK, as he amplified his mockery of London Mayor Sadiq Khan over the terrorist attack that killed eight people.

As regards the campaign pledges, the House Republicans voted to overhaul major parts of Dodd-Frank law and make sweeping changes to the financial regulatory system. The measure, which is heading to the Senate for a vote, would exempt banks from stricter supervision if they hold more capital, give Congress more authority over the CFPB and eliminate

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regulators' authority to designate companies as systemically important. The bill overhauling bank rules, which is sponsored by House Financial Services Committee Chairman, represents Republicans' most aggressive effort to ease strictures that the president blames for stifling lending and economic growth. House lawmakers approved the legislation in a 233-to-186 vote. But the bill, called the Financial Choice Act, has little chance of passing the Senate in its current form. Senate Democrats, whose votes will probably be needed to adopt it, have repeatedly said they have little interest in revisiting Obama-era constraints on Wall Street that were meant to make the financial system safer.

Currencies

The Bloomberg Dollar Spot Index added 0.3%. The euro slipped to $1.12, falling 0.9% during the week. With the current situation, investors are positive on USD and euro.

GBP weakened 1.7% over the week to $1.2733. British pound tumbled almost 2.4% as the U.K.'s ruling Conservative Party lost its parliamentary majority, plunging the country into uncertainty just days before Brexit negotiations were due to start. The currency plunged to a 7-month low against the euro and was headed for its biggest single-day drop against the dollar since October. It gave up all gains from the announcement of the election last month, which were spurred by optimism the vote would strengthen the Conservative Party's negotiating hand in Brexit talks. Still, the 2% drop against the dollar was much milder than the 7% loss some analysts were forecasting.

The yen gained 0.3% over the week to 110.7 per dollar.

Equities

S&P 500 closed at 2,440 gaining 0.4%, building on two straight days of gains. However, it did reach intraday records mid-week. The Dow Jones Industrial Average and Nasdaq Composite Index all hit record highs. Overall, the Dow Jones Industrial Average rose 0.5%, while the Nasdaq Composite Index gained 0.3%.

FTSE 100 closed at 7,505, falling 0.6% for the week. Mid-week, the pound's drop gave a 0.6% boost to the FTSE 100 Index as a weaker currency makes British exports more competitive. The FTSE 250 Index of midcaps dropped 0.3%, and another gauge of smaller companies fell 0.5%. As we remain negative on sterling strength, gains for industries that rely on sales abroad are expected.

The Stoxx Europe 600 Index rose 0.3%. We remain positive on European equities as these valuations are being driven by the economic fundamentals and global growth rather than UK.

Bonds

The yield on 10-year Treasuries rose six basis points to 2.22%.

German bund yields remained at same level of 0.27%. Also, French 10-year yields were essentially flat.

U.K. 10-year gilt yields lost one basis point to close at 1.03%. The reaction in the bond market was muted, even as short-term borrowing costs increased relative to U.S. peers.

Commodities

West Texas crude closed at $46.02 per barrel, after two days of losses. Oil headed for a 3rd weekly drop as rising supplies from the U.S. and Nigeria showed that OPEC is still struggling to clear a global oil surplus. Futures fell as much as 5.3% after the Energy Information Administration said American crude supplies rose by 3.3 million barrels last week, following eight straight weeks of declines. Gasoline inventories rose by about the same amount. As concerns about supply persist, U.S. drillers have added rigs for 20 straight weeks, the longest streak in at least three decades, undercutting efforts by the OPEC to cut production and eliminate a global glut. Rigs in the U.S. have more than doubled in the past year, according to Baker Hughes Inc. In Nigeria, Royal Dutch Shell Plc lifted restrictions on exports of a key grade halted for more than a year. Also, Libya is said to have resumed production at the Sharara oil field, the nation's biggest. It closed Wednesday after a protest by workers.

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Brent for August settlement dropped 2 cents to $47.84 per barrel on the London-based ICE Futures Europe exchange. Prices are down 4.2% so far this week. The global benchmark crude traded at a premium of $1.97 to WTI for August.

Gold fell 0.95% to $1,267 an ounce, declining a third day.

Major economies:

Euro area

The ECB kept its monetary policy broadly unchanged, tilting its forward guidance slightly hawkish given the strong economic performance. However, downward revisions to its inflation forecasts suggests that the ECB is unlikely to join the Fed in tightening monetary policy anytime soon. As markets predicted, the ECB president indicated the risks to growth are balanced. But on inflation, the ECB’s primary mandate, he insisted that nothing substantial has changed. He also indicated the job market is still far from healthy. The remarks, accompanied by a cut in the ECB’s inflation forecasts, mean that monetary stimulus could be around for a long time to come. While the Governing Council’s tone provided a ray of light after years of battling to avert deflation, rates remain at a record low and there was no formal discussion on how to taper the 2.3 trillion-euro ($2.6 trillion) bond-buying program.

Data releases this week include German factory orders which fell after 2 consecutive months of expansion in a sign that growth may be steadying after a strong start of the year. Orders, adjusted for seasonal swings and inflation, dropped 2.1% in April, after expanding an upwardly revised 1.1% in March, data from the Economy Ministry in Berlin showed. The typically volatile reading compares with a median estimate for a 0.3% decline in a Bloomberg survey. Orders were up 3.5% from a year earlier, when adjusted for working days. After its best performance in a year in the first quarter, German economic prospects still appear to be positive. Business confidence is at the highest level since 1991 and manufacturers and service providers are seeing the fastest growth in six years.

Euro-area manufacturing and services continued to expand at the fastest pace in 6 years, powered by growth in Germany and France. A composite Purchasing Managers’ Index held at 56.8 in May, unchanged from the previous month, IHS Markit said, confirming a May 23 estimate. A gauge for services slipped slightly, while one for manufacturing that was published on June 1 remained unchanged. Meanwhile, separate reports showed Italy and Spain, continued to show strong momentum in May. Business activity and order books remained strong in Italy, while Spain saw further increases in employment for the month. Input costs and selling prices eased somewhat in May but remained elevated and close to highs reached earlier in the year, IHS Markit said. Service providers saw a strong increase in costs, often linked to wage pressures as staffing levels continued to increase.

On political front, France legislative elections are coming this weekend and pollsters project that Marcron’s Republic on the Move party will emerge from first round positioned for a comfortable majority in parliament. A month ago, that prospect looked unlikely. His party has been steadily rising in the polls as French public opinion increasingly approves of his first few weeks in office as he set out plans to loosen French labor rules, impose new ethics restrictions on elected officials, and simplify the tax system. According to Ifop, the percentage of people saying they will vote for Macron’s party in the parliamentary election has risen to 31% from 24% a month ago. France’s bond spread has almost halved since Macron’s victory in the first round of the presidential election on April 23 signaled the threat of a populist backlash was on the wane. Investors on Thursday were demanding an extra 40 basis points to hold French 10-year government bonds instead of similarly dated German bunds. On April 19, they wanted 75 basis points.

Canada

The loonie stumbled on the oil price drop midweek, before regaining some poise on robust economic data. Canada’s labor market continued surprising in May, with a greater-than-expected 54,500 jobs gain that also came with signs of a pick-up in wages. Economists had forecast a 15,000 increase

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in employment. Canada's currency appreciated after the report, rising 0.3% to C$1.35. Benchmark two-year government bonds yielded 0.75%, up 3 basis points from Thursday. However, Canada's unemployment rate also increased to 6.6 % in May, in line with economist expectations, from 6.5% in April. Adjusted to the way calculations are made in the U.S., Canada's unemployment rate was 5.6% in May, compared with 4.3% in the U.S. There was a slowdown in total actual hours worked, to 0.7% annual from 1.1% in April. Also, the gain in hourly wages is still well below historical averages, 2.6% over 10 years, and it's still lower than inflation.

Canada's trade deficit was wider than forecast in April, and there was further disappointment in revised figures showing larger gaps in the prior two months. Imports exceeded exports by C$370 million ($274 million) in April, Statistics Canada reported. In addition to the April setback, the agency boosted the March deficit to C$936 million from an initial reading of C$135 million. It also increased February's shortfall to C$1.41 billion from C$1.08 billion. The latest trade figures are another signal of Canada's complicated transition after an oil shock, where exports and business investment have been weak spots while consumers keep borrowing and spending. Policy makers have said a long period of above-average production is needed to restore the economy to full health. The Bank of Canada's June FSR highlighted a growing concern about both household indebtedness and housing market imbalances, with a sharp correction in home prices in overheated markets flagged as a key risk for financial stability. Odds of a rate increase this year climbed to 37% from 7% a month ago.

Other economies

Qatar

Saudi, U.A.E., Egypt and Bahrain severed ties with Qatar wishing to punish the region for its ties with Iran and Islamist groups. Countries suspended air, sea travel shutting land border, potentially depriving the emirate of imports. Emboldened by warmer U.S. ties under President Donald Trump, the Saudi-led alliance is seeking to stamp out any opposition to forming a united front against Shiite-ruled Iran. Qatar is one of the world's richest countries and of strategic importance, being the biggest producer of LNG. By contrast, the OPEC member accounts for only about 2% of the world's oil supply. The crisis only worsened by the end of the week with U.A.E. downplaying any chance of quick fix. Anwar Gargash, the U.A.E. minister of state for foreign affairs, said the alliance is willing to take further measures against Qatar if it doesn't pledge to overhaul its "subversive" foreign policy. However, Turkey choose to defend Qatar in the Gulf conflict.

Some banks in Saudi Arabia, the United Arab Emirates and Bahrain are cutting their exposure, withdrawing deposits from Qatari banks and stopped trading riyals and bonds, to Qatar amid concerns of a widening of the blockade on the gas-rich Gulf state. Qatari stocks plunged Qatar's QE Index for stocks tumbled 8%, the most since 2009.

South Africa

South Africa's economy fell into a recession for the first time since 2009 after it contracted for a second straight quarter in the first 3 months of the year as all bar two industries shrank. GDP receded an annualized 0.7% in the first quarter from a contraction of 0.3% in the previous 3 months, Statistics South Africa reported.

UK

GBP stumbled by almost 2.4% to $1.2651 as the U.K government's leadership has been thrown into doubt just 10 days before Brexit negotiations are due to start, as Prime Minister Theresa May not only failed to get the broad majority she had bet on when calling the snap election, but also lost parliamentary seats held at the start of the campaign. Markets hoped to see an end to political uncertainty as a conservative victory was priced in but the result sees a lot of questions unresolved. The following days are likely to see further developments as talks unfold about potential coalitions or one or other party forming a minority government. Faced with calls to resign, May moved fast to bolster her position. She held talks Friday morning with Northern Ireland's Democratic Unionist Party, reaching a quick understanding before

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heading off to seek Queen Elizabeth II’s permission to form a government.

Assuming the Conservative Party will form the next government, they will be depending on the support of other parties to see any deal through a vote in Parliament. This is likely to mean compromise around key topics such as immigration from Europe, the status of European Human Rights legislation and the scale of any payments that need to be made to the EU before exiting, and potentially a softer Brexit overall. This would be supportive for the UK market. Either way the U.K. is set to lose more negotiating time. Europeans may welcome the chaos, which could provide them with leverage, although some will be disappointed not to have a stable and familiar negotiating partner they hoped could cut deals. One thing they won’t do is extend the deadline for talks. That would risk conflicting with 2019 EU elections. Though Sterling has weakened overnight against other currencies, falling to $1.27 and €1.12 but we are not seeing the sharp falls that followed the referendum in 2016 or any immediate sell-off in equities.

The stock volatility measure plunged as election risk passed. The FTSE 100 Volatility Index tumbled 9.7% on Friday, compared with a 2.5% drop in the euro area’s VStoxx Index. History shows that the gauge of U.K. equity swings tends to reverse the moves from the run-up to a vote in the week following the event. Analysts now see a 35% increase in earnings for members of the gauge this year, compared with 11% for those in the Euro Stoxx 50. That’s pushed the valuation of the British gauge to 14.7 times estimated earnings, near the cheapest since 2014 relative to the European measure.

Headlines crossing from Moody's states the credit rating agency is monitoring the U.K.'s process of forming a new government and will assess the U.K. credit implications in due course.

There was less attention to economic data which included U.K. services activity report that reported a cooled activity more than economists expected in May. IHS Markit’s Purchasing Managers Index fell to 53.8 from 55.8 in April. Election uncertainty and tightening household budgets is expected to have weighed on demand. The report contrasts with stronger-than-expected surveys on construction and manufacturing last week. Markit said the three snapshots together point to the economy expanding at a 0.5% rate after growth slumped to 0.2% in the first three months of the year. New orders weakened because of the pinch on consumers from rising prices and delayed decision-making ahead of the June 8 general election, Markit said.

Retail sales fell for the fourth time in five months on a like-for-like basis in May, according to the British Retail Consortium and KPMG. The 0.4% annual drop followed a surge in April, when the figures were distorted by the timing of the Easter holiday. Total sales gained just 0.2%. The pound’s decline since the referendum has pushed up inflation while wages have failed to keep up. Consumers are being forced to spend more on food and have cut back on non-essential items, the report said. The Bank of England would be concerned of stagflation indicators rising.

Upcoming events

Attention will now turn to the week ahead, when the Fed is expected to raise interest rates and the Bank of England, the Bank of Japan and the Swiss National Bank meet.

French voters go to the polls over the weekend, this time as part of a two-step process for parliamentary elections. The outcome will decide how much control new President Emmanuel Macron will have to enact his legislative agenda.

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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%	0.11%	2.41%
FTIM Safety First 3	3.26%	0.34%	2.70%
FTIM Safety First 4	4.38%	0.68%	3.51%
FTIM Safety First 5	5.63%	1.12%	3.87%
FTIM Safety First 6	10.10%	2.15%	5.32%

Date:02 June 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