16 June 2017

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INVESTMENT MANAGEMENT

WEEKLY INVESTMENT UPDATE

Global central banks signal on continuity of monetary stimulus efforts

KEY MESSAGES:

Soft economic data in the US and UK spurred concerns over economic fundamentals, however, this did not impact the central bank decisions. Fed raised interest rates for the second time in 2017, even after inflation pressures remain subdued. The BOJ kept rates unchanged amid worries of rising inflation and absence of a corresponding wage growth. The BOJ and the SNB also kept rates unchanged.

USD declined, euro was stable and GBP closed at 1.28. Equity markets saw tech sell off, with Nasdaq 100 index declining 1.3%. S&P 500 closed at 2,430. FTSE 100 was down 0.98% to 7,453. European and Asian equities recorded gains. WTI crude was at $44.65 a barrel, down 2.5% for the week. Gold closed at $1,254.82.

Market developments during the week

It was a busy week on policy front, as major Central Banks concluded their policy meetings with the investors keenly watching the developments to gain an understanding of the ongoing continuity of monetary stimulus. Majority of them responded, indicating shifting attention to the eventual withdrawal of stimulus, while monetary policy still expected to remain highly accommodative.

The week ended with global equities performing well, havens including the yen and bonds declined, while oil rose with metals. US assets moved in response to political developments relating to Trump administration, soft US economic performance and the Fed's confident tone accompanying a rate hike.

Fed raised interest rates for the second time in 2017 this Wednesday, bringing the Fed's target for the federal funds rate, which covers overnight loans between banks, to a range of 1% to 1.25%, while maintaining their outlook for one more hike in 2017. Fed also set out some details for how they intend to shrink their $4.5 trillion balance sheet this year. In a press conference after the decision was announced, Fed Chair, Janet Yellen, said the unwinding plan could be put into effect "relatively soon" if the economy evolves as the central bank expects. The Fed has in recent weeks wrestled with contradictory signals from unemployment and inflation. Fed Chair Yellen suggested weak readings on inflation won't persist amid a tightening labor market. Stock and bond prices weakened after the Fed's moves as some investors worried that the actions would throttle back economic growth.

The May retail data was a bit soft, this was in part due to weak inflation. Retail sales contracted by 0.3%, the biggest monthly drop in 16 months. May's CPI report indicated core inflation at its lowest reading in 2 years, at 1.7% year on year. There was an encouraging firming in core services price pressures, ending the cooling in the prior two month but core goods prices remained in deflationary territory. Following the report, the probability that the June hike would be followed by another increase this year dropped to about 28% from 48%, according to pricing in fed funds futures contracts. There is evidence that goods price pressures are building further up the supply chain. Moreover, domestic wage pressures have picked up over the past two years as the labor market has tightened. With job growth continuing to put downward pressure on unemployment, this is likely to continue. Eventually rising wages will squeeze profit margins and put upward pressure on inflation.

Three straight months of declines in new-home construction show U.S. homebuilding may weigh on second-quarter growth, Commerce Department data showed. Residential starts decreased 5.5% to a 1.09m annualized rate (est. 1.22m), the weakest since September. May starts were pushed lower by declining construction in South and in the Midwest.

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Regarding the unwinding of the balance sheet, Fed Chair Yellen told reporters that the Fed wants the balance sheet contraction “to run quietly in the background over a number of years.” It intends to start the draw-down with small monthly cuts of $6 billion of Treasury debt and $4 billion of mortgage-backed securities, and gradually increase them thereafter. President Donald Trump’s budget director said he expects the Federal Reserve to continue to run an easy monetary policy even as it unwinds the “unprecedented experiment” that swelled its balance sheet to $4.5 trillion. Mulvaney said the administration did not factor the Fed’s balance sheet intentions into Trump’s proposed budget. A reduction in the Fed’s holdings of Treasury and mortgage-backed securities will probably put some upward pressure on long-term interest rates by adding to the supply of those securities in the market, economists said. The administration’s budget does expect the federal government’s interest rate costs to rise, but that is due to the faster economic growth the program is expected to foster, Mulvaney said.

Washington remained in focus as the special counsel investigation on Russia’s interference in the 2016 election progressed along with an investigation into possible obstruction of justice by Donald Trump.

While the political investigations continued, Trump administration was on course to push forward its campaign promises. It laid out its highly anticipated plan for overhauling bank rules, calling on the government to ease, though not eliminate, many of the strictures that were imposed on Wall Street after the financial crisis. The changes urge federal agencies to re-write scores of regulations that bankers have frequently complained about in the seven years since the passage of the Dodd-Frank Act. They include adjusting the annual stress tests that assess whether lenders can endure economic downturns, loosening some trading rules and paring back the powers of the watchdog that polices consumer finance. The Treasury said its plan was designed to spur lending and job growth by making regulation “more efficient” and less burdensome. Unlike the bill passed last week by House Republicans, the report consistently calls for most Obama-era rules to be dialed back, not scrapped. Through the move, President Trump expects banks to plow their windfall back into the economy by making more loans to home buyers, small businesses or companies looking to expand. While some on Wall Street predict a lot will flow straight into the pockets of shareholders. One measure would ease annual stress tests, giving firms leeway to increase dividends, according to Credit Suisse Group AG analysts.

The Trump’s administration is also expected to be taking ahead an executive order aimed at lowering U.S. drug costs, a move that could come within weeks on a campaign issue that has been largely left out of Republican legislative efforts in Congress.

Currencies

The Bloomberg Dollar Spot Index is down 0.3% for the week. The weekly drop came in after soft economic data, more recently, new-home construction which faltered for a third straight month and consumer confidence which fell by the most since October.

The yen is up 0.45% for the week closing at 110.8 per dollar. Yen slightly pared its gains after Bank of Japan diverges from hawkish Fed.

The euro is stable at $1.12.

GBP closed at 1.28 gaining 0.8% over the week.

The Australian dollar rose after employment surged in May.

Equities

Equities had largely weathered a week that saw the Federal Reserve hike rates and renewed tumult in Washington that continues to delay the Trump administration’s policy agenda. The S&P 500 closed at 2,430, leaving it lower by 0.1% on the week.

U.S. tech shares slipped, pointing the Nasdaq 100 Index to a second straight weekly decline with a 1.3% slide. Companies from Facebook Inc. and Apple Inc. to Netflix Inc. and Nvidia Corp., spurred losses that sent the Nasdaq 100 to its biggest drop relative to the Dow Jones Industrial Average since 2008.

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Investors are growing skeptical about remaining invested in equities, which are already up nearly 10% over the last 5 months. We have been noting that this upside is largely driven by economic performance and strong corporate earnings rather than the Trump trade and continue to hold the same. Regarding the tech stocks rout, markets are worrying, as the S&P 500 Technology Sector stands within a few per cent of its March 2000 peak, stoking fears of another tech bubble. Neither the technology sector nor the broader market resemble a bubble, in our view as we consider the valuations are not stretched relative to their macroeconomic fundamentals, as they were in the late 1990s.

The Stoxx Europe 600 Index rose 0.7%, paring its weekly decline to 0.6%. European stocks advanced by the end of the week as a rally in food and beverage firms offset a plunge in retailers.

FTSE 100 closed at 7,453, down 0.98% this week.

Most Asian stocks rose as Japan equities got a boost from a weaker yen as the Bank of Japan kept its monetary policy unchanged. The MSCI Asia Pacific Index declined less than 0.1% with more stocks gaining than falling. The gauge has lost 0.6% this week, on course for its biggest weekly slide since March. Japan's Topix Index gained 0.5%.

The Gulf crisis involving isolating of Qatar appears to have battered the Middle Eastern emerging markets. The average spread paid by governments in the Middle East to borrow in bond markets has since risen seven basis points, compared with a three-basis point decline for emerging-market debt, according to JPMorgan Chase & Co. indexes. While yields on Qatar bonds rose above those of Saudi Arabia to 3.5% last week, the highest level since March.

French shares outperformed ahead of the weekend's election as Emmanuel Macron heads for a clear majority in the National Assembly.

Pakistan's KSE100 Index declined 3.8%, the most globally on Monday as Prime Minister Nawaz Sharif was called to appear before a team investigating corruption allegations against his family. It was the index's biggest decline in almost two years. The political turmoil is the latest hit to the nation's stock market, which was upgraded to emerging markets status by MSCI Inc. this month. Instead of flocking to Pakistani equities, foreign investors have continued dumping stocks worth $372 million this year, more than the entire amount of $334 million offloaded last year, according to data compiled by Bloomberg.

Bonds

The yield on 10-year Treasury notes rose to 2.15%, a five basis points gain for the week. The rate dropped on Wednesday to 2.13%, the lowest level since November.

German benchmark 10-year bund yielded 0.28%. UK 10-year gilts yielded 1.01%.

Commodities

West Texas crude futures rose 0.5% to $44.65 a barrel. Oil is down almost 2.5% for the week. Oil saw a fourth straight weekly decline, the longest run of weekly losses since August 2015 as OPEC member Libya restored production just as U.S. inventories fell less than forecast last week, keeping supplies more than 100 million barrels above the five-year average, according to data from the Energy Information Administration. Also, OPEC said output climbed the most in six months in May because of renewed pumping in Libya and Nigeria, members exempt from the group's accord to lower production.

Brent for August settlement rose 44 cents to $47.36 a barrel on the London-based ICE Futures Europe exchange. Prices are down 1.6% this week. The global benchmark crude traded at a premium of $2.35 to August WTI.

Gold closed at $1,254.82. The metal is heading for a second weekly loss, falling 0.9% as Fed pursued a rate hike.

Copper rose 0.3% to $5,677.50 per ton.

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Other major economies:

Euro area

German investor confidence unexpectedly dropped in June,in a sign that exaggerated optimism in Europe's largest economy is beginning to moderate. The ZEW Center for European Economic Research in Mannheim said on Tuesday that its index of investor and analyst expectations, which aims to predict economic developments six months ahead, fell to 18.6 from 20.6 in June, while economists predicted an increase. With business confidence climbing to the highest level since 1991 and manufacturers and service providers reporting the fastest expansion in six years, sentiment indicators have recently exceeded already strong economic fundamentals. ZEW's measure for expectations in the euro area advanced to 37.7 from 35.1.

Germany's Consumer Price Index was confirmed to have contracted 0.2% in May. French CPI remained unchanged in May. The eurozone Industrial Production rose 0.5% in April, and quarterly labour market data showed Employment had increased 0.4% in the first quarter.

The political risks continue to ease in the region. In France, President's party won 32 % in first-round assembly vote. In an alliance with the centrist MoDem party, Macron's group will have between 415 and 455 seats out of 577 in the lower house of parliament, according to projections by Ipsos. The results, which need to be confirmed in a final round of voting next Sunday, would give Macron the biggest majority in the Assembly since 1993, giving the president carte blanche to pursue the labor-market overhaul that is high on his agenda.

Meanwhile south of the border, Italy's anti-euro Five Star movement suffered a setback in Sunday's local elections, helping Italian bonds climb. Five Star failed to make it to the second round of voting, according to projections. Centrist-oriented parties fared better in the approximately 1,000 towns and cities that voted, with the second round scheduled for June 25. Turnout was just over 60%. A multi-party deal on a new electoral law unraveled last week, making it highly unlikely that a snap national vote will be held this year. Investors had been concerned that an election in 2017 could lead to either a hung parliament or a win for the anti-establishment Five Star. The current legislature expires in 2018. Speculation in the last month that Italy was headed toward elections as early as September drove up bond yields and pushed down stocks. Investors had said that a potential agreement on an electoral law was a negative given that a non-market-friendly party could win. On Italy's stock market, the FTSE MIB benchmark index fell 0.6% on. The yield on the Italian 10-year bond fell to 2.02%, narrowing the spread with equivalent German bunds to 177 basis points from more than 200 basis points in the middle of last week.

Regarding the Greece bailout update, the euro region's finance ministers approved €8.5 billion ($9.5 billion) of aid on Thursday, and its most indebted state, Germany got a commitment that creditors will make sure it's able to service future debt. If necessary, repayments can now be extended on emergency loans by up to 15 years. The International Monetary Fund then lent its credibility to the Greek bailout. The compromise, nonetheless, leaves Greece with less than what it had sought, as it wasn't enough to get the International Monetary Fund to acknowledge the country's debt is sustainable. IMF will only dole out fresh loans once it receives further assurances on debt relief measures. The Athens Stock Exchange gained as much as 1.4%. Yields on 2-year Greek bonds fell by 20 basis points to 4.78%, close to the yield that the latest bond had been issued at in 2014. An explicit recognition by the IMF that Greek debt will become sustainable could have cleared the way for the country's bonds to be included in the European Central Bank's quantitative easing, which would cut borrowing costs and ease its return to the market, a promise the government in Athens has been making for months. But without the fund's approval, inclusion in the central bank's asset-purchase program remains unlikely, according to EU officials.

A statement by IMF confirmed the euro area's economic recovery "has gained momentum" while warning that some of the region's high-debt countries may face difficulties when monetary policy accommodation is reduced. It also cautioned that "inflation expectations, however, remain subdued, with core

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inflation at undesirably low levels." It said countries already operating at capacity should accept inflation above 2% "for a prolonged period." After years of stimulus from quantitative easing and negative interest rates, the European Central Bank has managed to spur economic growth but has so far failed to turn that into sustainable inflation at its goal of just under 2 %.

Japan

The BOJ maintained its policy rate and kept its 10-year bond yield target at about zero, % with statement by Governor Haruhiko Kuroda that it was too soon to show any stimulus exit plan, which many investors had been watching for. With inflation still distant from its target, the Bank of Japan left its monetary stimulus program on cruise control, saying improving private consumption will support a growing economy. The policy statement Friday came on the heels of the Federal Reserve's third interest rate increase since December, underscoring how the BOJ continues to fall behind its global peers in normalizing policy. It will continue to manage the yield curve through a negative interest rate and buying trillions of yen worth of bonds.

While Kuroda has said talk of any exit from monetary stimulus is premature and would end up confusing markets, the bank is re-calibrating its communications to acknowledge that it is thinking about how to handle an eventual exit. Talk about exiting monetary easing is gaining momentum around the world. The Fed gave further details of its plan to normalize its balance sheet this year as it raised rates. The European Central Bank softened its easing bias at a meeting this month, reinforcing a view that it is moving toward the exit. The wider debate about winding down stimulus in Japan doesn't indicate confidence that the central bank will reach its goal.

Canada

With the pre-Fed USD sell off, the CAD managed to reach a new high against the greenback, but reversed its progress after the US rate hike. The currency gained later as investors digested a marked change in tone from the Bank of Canada suggesting that the era of emergency level interest rates may end earlier than expected. It now appears likely that the first policy interest rate increase in more than six years will take place in October. This gain in the loonie comes despite falling oil prices and soft equity markets.

Qatar

As the crisis in the Gulf entered a second week, with no sign of a diplomatic resolution between the tiny Arab state and the Saudi-led bloc that severed ties with it. The unprecedented measures have prompted investors and economists to ponder how long Qatar can weather the pressure without having to devalue its currency or sell any of its global assets. Qatari officials struck a defiant tone on Monday. The finance minister and the central bank said Qatar has the financial firepower to defend its currency and economy, while the head of Qatar Airways, suffering from the regional overflight blockade, accused the U.S. of exacerbating regional tensions. The central bank adopted a similar tone, saying it had sufficient reserves to meet all requirements and that banks were functioning normally without disruption, state-run Qatar News Agency reported.

However, tensions eased by the end of the week as Saudi Arabia and the United Arab Emirates are expected to relay to mediators what they want Qatar to do in return for ending their isolation of the tiny Gulf nation. The proposals, which may come in the next two days, would make it easier to end the dispute. The two sides could possibly seek help from Kuwait, Turkey to mediate. Kuwait has played a role in trying to end the Gulf conflict since it started, with the country's emir visiting Saudi Arabia, the U.A.E. and Qatar last week. Turkey has joined the efforts, with Foreign Minister Mevlut Cavusoglu holding talks with Qatari and Kuwaiti officials this week. Qatar's benchmark stock index rose after the report, closing 0.7% higher.

Turkey

Turkey's GDP grew faster than expected in the first quarter at 5%. The government boosted spending on everything from wages to investments to spur the economy after a failed military coup hurt growth last year. The report showed that expansive fiscal policies also boosted household consumption, which makes up about two-thirds of the economy and has traditionally driven Turkey's growth. The recovery in

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Europe, Turkey's largest trade partner, also boosted exports and industrial output. The lira strengthened 0.4% to 3.5243 after the report.

Switzerland

The Swiss National Bank kept its key rate unchanged at minus 0.75%, citing the strong currency and an absence of price pressures. It also affirmed its commitment to wage currency market interventions and reiterated that the franc was "significantly overvalued." The central bank has been using a combination of negative rates plus purchases of foreign exchange for two-and-a-half years to limit the franc's appeal. The rallying currency, sought out by investors at times of heightened risk aversion, has caused consumer prices to tumble and weighs on exporters, as their wares become more expensive abroad. While the franc has dipped about 1.5% against the euro this year as election outcomes in France and the Netherlands helped reduce political risks in the region, it remains stronger than 1.10 against the single currency. That's far off the minimum exchange rate of 1.20 francs enforced by the SNB between 2011 and 2015. The central bank trimmed its inflation outlook for 2018 and 2019 with growth roughly forecasted at 1.5% this year, with consumer prices expected to rise 0.3% in 2017, 0.3 % in 2018 and 1% in 2019 respectively.

UK

U.K. inflation resumed its upward march last month rising to 2.9% at the fastest pace in four years. Core inflation, which excludes food and energy, also unexpectedly quickened in May to 2.6%, according to the Office for National Statistics. The price pickup means additional pressure on households, who aren't seeing their wages keep pace. Faster inflation is already weighing on the economy. Growth slowed to 0.2% in the first quarter, partly because of weaker consumer spending, and the National Institute of Economic and Social Research estimates it hasn't picked up so far this quarter. Consumers may further retrench after this month's snap election saw Prime Minister Theresa May lose her parliamentary majority, adding to uncertainty surrounding Brexit negotiations. That prompted investors to pare bets on a BOE interest-rate increase by the end of 2018 to 36% from 52% before the vote.

Consumer spending fell an annual 0.8% in May, the first decline since September 2013, according to IHS Markit and Visa. Separately, accountancy firm BDO said its U.K. business activity index weakened as services, the largest part of the economy, ground to a halt. Citing the impact of the weaker pound, it said services companies are seeing no growth in demand. U.K. retail sales excluding auto fuel dropped 1.6% for the second time in three months as rising inflation ate into the purchasing power of consumers. The volume of goods sold in stores and online fell 1.2% from April. Except for fuel, every retail category saw sales fall last month, suggesting that rising prices triggered by the weak pound are forcing households to cut back on discretionary items.

The squeeze on U.K. households intensified in the three months through April as weaker wage growth inflicted the biggest loss of purchasing power in almost three years. Average earnings rose 1.7%, the slowest annual pace since early 2015, the Office for National Statistics reported. Taking inflation into account, they fell 0.6%, the largest drop since August 2014. The fall in living standards is already sapping consumer confidence, weighing on an economy that relies on household spending and piling further pressure on Prime Minister Theresa May, following the election that cost her Conservative Party its parliamentary majority. Retailers are the second-worst performers in the FTSE 350 Index over the past month.

Amid the disappointing economic data, the Bank of England convened its policy meeting keeping interest rates unchanged at 0.25%. Bank of England Governor Mark Carney expects inflation to keep accelerating this year before falling back slightly from 2018. The BOE targets a 2% rate. The markets focus, however, was on the increase in number of members voting for a rate hike from one to three, swelling the ranks of dissenters. The minutes suggest that the BOE may be beginning to edge towards normalization, though Brexit and the cooling economy mean that its progress is likely to be cautious. The MPC

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said any rate increases will be at a “gradual pace and to limited extent.”

Regarding update on Brexit, the UK Brexit secretary David Davis will start talks in Brussels next week with plans to make a “very generous” offer on rights for the 3m EU citizens living in the UK. Also, the Premier is appeared to have bowed to European Union demands to focus the initial stage of Brexit talks on settling the divorce rather than trying to arrange a future trade relationship at the same time. Post snap elections, with a lost parliamentary majority, Theresa May is expected to soften the approach to the split and adopt a more conciliatory tone as May previously wanted the trade deal to be discussed in tandem with the split given the lack of time on hand and to win trade-offs, grant certainty to businesses and maintain support for Brexit back home. Her Conservative Party called such an arrangement “necessary” in its election manifesto.

Barnier and British Brexit Secretary David Davis will open the talks next week on Monday in Brussels, with the aim of wrapping up a deal by the end of 2018 so that it can be ratified by the European and British parliaments before the U.K. leaves the bloc in March 2019.

Upcoming events

Sunday sees the second round of France's parliamentary election in which President Emmanuel Macron's party is expected to win a clear majority.

In the U.K., preparations are underway for the start of Brexit negotiations which will be begin on Monday.

Jason Granite
Chief Investment Officer
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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%	0.10%	2.38%
FTIM Safety First 3	3.26%	0.33%	2.67%
FTIM Safety First 4	4.38%	0.67%	3.46%
FTIM Safety First 5	5.63%	1.11%	3.82%
FTIM Safety First 6	10.10%	2.14%	5.24%

Date: 16 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 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.