07 July 2017

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INVESTMENT MANAGEMENT

WEEKLY INVESTMENT UPDATE

Geopolitics in focus as tensions with North Korea intensify

KEY MESSAGES:

European Central Bank (ECB) hinted it could start to scale down support for the eurozone.

Oil markets remain oversupplied, despite efforts to cut production.

The U.S. threatened trade ties with countries that continue to do business with North Korea following test of intercontinental ballistic missile.

Bond prices fell. The yield on the 10-year Treasury note rose to 2.40% from 2.37%.

Decrease in manufacturing, construction slowdown and widening of trade deficit, knock pound lower against dollar & euro.

US nonfarm payrolls total 222,000 in June vs 179,000 expected.

Market developments during the week

The hawkish tone from developed-nation central banks continued to roil financial markets, with U.S. stocks falling the most in seven weeks, Treasury yields rising to levels last seen in May and crude settling below $46 a barrel.

With the earnings season set to kick off this month, analysts have started lowering their expectations for corporate earnings, both in Europe and globally as gains in macro data may be peaking and a long-awaited rebound in inflation hasn't materialized. The change, from months of positive revisions, coincides with central banks giving signs that they are ready to tighten liquidity.

The big market surprise in the first half was that volatility actually fell. Traders who shorted the VIX saw their bets pay off as the gauge plunged 20%, taking its quarterly average to the lowest level since 2006. As the CBOE Volatility Index continued to edge lower this year, investors increasingly paid up to protect against a rebound, sending the cost of calls versus puts to the highest level since October 2015. VIX options volume has surged this year, with an average of almost 680,000 contracts changing hands on average each day. The hawkish shift of rhetoric in recent weeks is increasing the odds that the next move of four of the world's five largest central banks will be to tighten monetary policy, setting the stage for an uptick in volatility in the second half of the year. But while hedgers are putting on strategies to protect against market turmoil, the crucial question of timing remains.

US Economy

On data front, ADP data on private hiring suggested U.S. job market is moderating. Private payrolls rose by 158k (est. 188k) after revised 230k gain in May. The second-lowest increase in 2017 probably reflects the challenge of finding skilled workers amid a tightening job market, and may also be a sign businesses are holding off on expansion plans until they see more evidence the new administration's plans are translating into legislation.

The U.S. trade deficit narrowed in May with gap decreased 2.3% to $46.5b (est. $46.3b) from $47.6b in April. Exports rose 0.4% on increased shipments of cars and consumer goods. Imports fell 0.1% to $238.5b as cooler demand for autos and consumer merchandise offset record shipments of capital goods. At the same time, a record $52.8 billion of imported capital equipment indicates U.S. business investment may be gaining momentum.

Globalization is showing signs of resilience to Trump's America First agenda. The better mood is a key reason central banks are adopting a more hawkish tone, or at least a more upbeat one, after years of pumping cheap money into their economies. At the European Central Bank, policy makers have expressed confidence the global recovery is increasingly supporting trade and euro-area exports, underpinning an upswing that has so far

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been largely driven by domestic forces. Bank of Canada Governor Stephen Poloz, who is expected to raise interest rates next week, has been citing the synchronized nature of global growth as a major positive for the recovery.

A divided Federal Reserve policy committee couldn't reach an agreement in June on the timing of when to begin shrinking its massive balance sheet, according to minutes of the meeting. Fed officials updated their balance-sheet policy in the gathering, laying out a path of gradual reductions with caps. The central bank wants to start winding down the $4.5 trillion bond portfolio without roiling longer-term interest rates, while gradually raising the policy rate. The minutes indicated that the committee wants to begin the balance-sheet process this year.

Geopolitical tensions intensified this week as North Korea said Tuesday it successfully test-fired an intercontinental ballistic missile, a claim that brings the isolated state closer to its aim of building a device capable of hitting the continental U.S. with a nuclear warhead. The United Nations Security Council held an emergency meeting this week with regard to the matter. The U.S. threatened trade ties with countries that continue to do business with North Korea following Pyongyang's test of an intercontinental ballistic missile, a warning to China and other nations the administration says aren't doing enough to rein in Kim Jong Un's regime.

It comes ahead of a planned meeting this week between President Donald Trump and Chinese counterpart Xi Jinping at the Group of 20 summit in Germany. There are already renewed tensions between the U.S. and China about how best to rein in Kim, with Trump saying Xi has not done enough to curtail his neighbour and ally. Russia and China issued a joint statement calling for a halt to North Korea's weapons tests and for the U.S. and South Korea to stop large-scale military drills, in order to create room for talks. Still, China's prior calls for such a deal have been rebuffed by both the U.S. and North Korea.

The U.S. president has said all options including military force are available against Pyongyang, though North Korea's neighbours have warned a strike could be disastrous for North Asia, given the risk of retaliation. South Korea's new government has also urged talks with Kim, a stance that puts it potentially at odds with Trump's administration, which says negotiations can only happen if Kim halts his nuclear program. However, Kim is not being slowed by international sanctions, Trump's threats against him, or pressure from China. If anything he's accelerating his efforts to acquire a bigger nuclear deterrent, with the ultimate prize a missile that can carry a nuclear-tipped warhead to the U.S. mainland. The regime has also used provocations to secure concessions from neighbours in the form of aid. China, the main economic lifeline of North Korea, has been reluctant to press too hard in case it leads to the collapse of the regime and chaos on its border.

While financial markets in Seoul were mostly sanguine after North Korea's intercontinental ballistic missile launch, a flurry of derivatives activity signalled some investors are looking for protection against further deterioration in the won and local debt.

US jobs growth rebounded adding 222,000 jobs as per report from the labour department benefitting from gains in healthcare, social assistance and financial activities. Average hourly earnings were up 2.5% year over year, while the average workweek climbed to 34.5 hours, from 34.4 in May.

Currencies

USD weakened initially before regaining against the other major currencies, after the monthly U.S. nonfarm payrolls report showed a mixed picture of the job market, with solid headline numbers and weak wage-growth rate.

Pound fell around 0.3% against the Euro to 1.132 and US dollar, after Britain's trade deficit has widened and industrial output fell in May.

Equities

U.S. indexes advanced following information on the labour market and the first official meeting between Donald Trump and Vladimir Putin as the Group of 20 leaders meet in Hamburg. The S&P 500 added 0.6 % to 2,423.

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frenkel topping
INVESTMENT MANAGEMENT

WEEKLY INVESTMENT UPDATE

Geopolitics in focus as tensions with North Korea intensify

Stock markets across Europe have crashed to their lowest level in almost three months, after the European Central Bank (ECB) hinted it could start to scale down support for the eurozone. The ECB slashed interest rates and launched a huge money-printing programme in an effort to boost growth and inflation across the bloc.

World stocks are poised to end the week at six-week lows in the face of oil weakness, a spike in bond yields and anticipation of tighter monetary policy, particularly in the United States.

Bonds

U.S. Treasuries joined a sell off in European government bonds sparked by weak demand for French debt, heightening a nervous mood that spilled into the American equity market. The sell off came as central banks from Asia to Europe and the U.S. have taken a more hawkish stance as they seek to remove nearly a decade of accommodation. Hedge funds that built up bullish long-end Treasury wagers to the highest outright level since 2008 are rushing for the exit as a government bond rout that started in Europe is spreading to the U.S. market.

Commodities

U.S. oil moved sharply lower due to rise in oil production weighed heavily on the commodity. U.S. crude oil lost $1.20, or 2.6%, to $44.32 a barrel, Brent crude oils fell $1.19, or 2.5%, to $46.92 per barrel. Data from the Energy Information Administration said U.S. crude inventories fell by 6.299 million barrels in the week ended June 30, compared to expectations for a drawdown of 2.28 million barrels.

Oil markets remain oversupplied , despite a pledge by the Organization of the Petroleum Exporting Countries to cut production from January of this year until March 2018 in a bid to support the market. The group's efforts to rebalance the market have been undermined by rising production from Libya and Nigeria, which are exempt from the output-cut agreement and by increasing shale production in the U.S

Oil also tumbled this week as Russia was said to oppose any proposal to deepen OPEC-led production cuts. Russia wants to continue with the current deal and any further supply curbs would send the wrong message to the market, according to government officials. While prices have surged during the past week, oil remains in a bear market amid concerns that rising global supply will offset output cuts from the Organization of Petroleum Exporting Countries and its partners.

Major economies:

Euro area

EU and Japan agreed to eliminate 99% of tariffs between the two partners, expand markets for services and public procurement, and bolster regulatory cooperation. The political green light on Thursday in Brussels came a day after negotiators for both sides reached a breakthrough over food and car exports, which had been sticking points since talks started in 2013. The commercial deal is the EU's biggest to date, surpassing an accord with South Korea, and marks the 28-nation bloc's second with a fellow member of the Group of Seven leading industrialized nations following a recent pact with Canada.

The Central bank published account of its June 7-8 policy meeting which indicated the ECB policy makers considered removing a pledge to increase their bond-buying program if needed. As the likelihood of calls for unconventional policy measures to be stepped up had "clearly diminished," the Governing Council discussed removing the easing biases in their policy communication. While they ultimately opted only to change the wording on interest rates, "it was argued that the improved economic environment with vanishing tail risks, in principle, suggested also revisiting the easing bias with respect to the asset-purchase program." The reasons for retaining the bias on quantitative easing included that stronger growth had yet to translate into stronger inflation dynamics.

On data front, Euro-area manufacturing expanded at the strongest pace in over six years with IHS Markit's PMI climbing, as data for Greece showed an expansion for the first time since last August. However, euro-area businesses appear to struggle to hire workers fast enough to meet increasing demand as the recovery strengthens. PMI for manufacturing and services signals economic expansion of 0.7% in the second

frenkel topping INVESTMENT MANAGEMENT

WEEKLY INVESTMENT UPDATE

Geopolitics in focus as tensions with North Korea intensify

quarter, despite a slight slowdown in activity in June. The gauge dipped to 56.3 from 56.8 in May, exceeding estimates.

China

A private gauge of China’s manufacturing exceeded estimates in June, adding to evidence that the economy is maintaining some momentum after a strong start to the year. The Caixin Media and Markit Economics manufacturing purchasing managers’ index rose to 50.4 from 49.6 in May, which had been the first time the index had slipped below 50 since June 2016. Output increased to 50.6 from 50.2 in May while new orders also rose. The measure, which relies on a smaller sample size, compares with the official government PMI released on June 30 that rose to 51.7 in June. The official report signaled that robust global trade is aiding Chinese momentum, giving policy makers extra room to tackle the buildup of financial risks.

Other economies

Qatar

The Saudi led block ultimately rejected its response to their conditions for ending their monthlong showdown yet stopped short of announcing new penalties, a reflection of the constraints they face in trying to dictate changes to its foreign policy. The bloc had demanded that Qatar yield to 13 demands so additional punitive measures may emerge from the meeting. Qatar has said the conditions to end the standoff were deliberately framed to be unacceptable, and Saudi Arabia has called them non-negotiable.

The month-long crisis has seen about $15 billion wiped off Qatar's stock exchange with bank shares were among the most pressured during Saudi-led boycott. The country's credit outlook was cut to negative watch by Moody's. Barring a “swift resolution,” economic activity will likely be thwarted after countries including Saudi Arabia and United Arab Emirates cut air, land and sea links with Qatar, Moody’s said.

Thailand

Thailand’s central bank held its benchmark interest rate near a record low, seeking to preserve policy room despite signs that the economy is heading deeper into deflation again. The one-day bond repurchase rate was left at 1.5 %, with monetary policy committee members voting unanimously in favour. Policy makers are struggling to get inflation into the 1% to 4% target range. After about a year of low but positive inflation, consumer prices declined for a second month in June, prompting the central bank to lower its forecasts for this year and next. Even so, officials have been reluctant to cut interest rates despite a stronger currency and amid worries over consumer debt levels. Policy makers were more optimistic on the economy as they raised growth estimates. Government is predicting expansion of more than 4 % in 2018, which would be the highest in six years, while the World Bank sees growth of less than 3.5% until 2019.

UK

U.K. manufacturing slowed more than forecast in June with the PMI falling to a three-month low of 54.3 from a downwardly revised 56.3 in May. The survey adds to evidence that the inconclusive general election and the start of Brexit talks last month are weighing on companies and households. The rise in factory orders was the weakest in 11 months as growth of new business slowed in both the domestic and export markets, IHS Markit said. The slowdown was broad-based, with weakness across the consumer, intermediate and investment goods industries.

Pound saw decline as UK Services sector slowed down. the reading fell more than expected to a three-month low of 54.3, down from 56.3 in May. Services confidence fell “markedly” from May, with respondents citing concerns about the Brexit negotiations, the economy and political uncertainty, IHS Markit said. Also, IHS Markit’s Purchasing Managers Index fell to 53.4 from 53.8 in May. The survey follows IHS Markit’s factory and construction reports earlier this week that showed both industries cooling. Businesses are calling on Prime Minister Theresa May to prioritize the economy in talks to leave the European Union after she lost her parliamentary majority in a snap election. The overall picture is one of business spending, investment and exports failing to provide sufficient impetus to fully offset the consumer slowdown.

Still, faster inflation is pushing some Bank of England policy makers to step up their hawkish rhetoric, which is weighing on

frenkel topping
INVESTMENT MANAGEMENT

WEEKLY INVESTMENT UPDATE

Geopolitics in focus as tensions with North Korea intensify

government bonds. The central bank, this week, told lenders to prove they're not underestimating the risks of rapidly growing consumer credit given the current "benign economic environment." With BOE interest rates at a record low, shoppers have borrowed and run down the rate at which they save to fuel spending and prop up the economy since the Brexit vote, with many first-time borrowers never having experienced an increase in official borrowing costs. Governor Mark Carney said last week that "some removal of monetary stimulus is likely to become necessary," tweaking his previous remark that it's not yet time to start making that adjustment. Members of the MPC are weighing up the risks of faster inflation against the need to support growth ahead of their next announcement on Aug. 3. They have publicly split in recent weeks, with three of eight officials in June dissenting for tighter policy and a fourth subsequently suggesting he might follow suit. The balance for the August decision is difficult to predict, not least because the rate-setting panel may have two new voters without a track record.

One risk of raising rates too soon is that highly indebted households curtail their spending, putting the brakes on an expansion not getting enough of a boost from exports. However, officials have also warned about the potential threats posed by leaving policy too loose for too long, which include losing control of inflation expectations and fuelling consumer credit.

On Brexit update, EU Brexit negotiator Michel Barnier laid out the difficulties the U.K. will face in retaining access to the single market if it goes ahead with a so-called 'hard Brexit'. He signaled that even a partial withdrawal from the bloc will have consequences on the U.K.'s ability to interact with the EU and that a "frictionless" trade relationship isn't feasible.

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07 July 2017

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WEEKLY INVESTMENT UPDATE

Geopolitics in focus as tensions with North Korea intensify

Frenkel Topping Investment Management's ("FTIM's") Safety First performance

	2016 Performance	2017 Performance	Volatility* 04/01/16
FTIM Safety First 2	1.53%	0.07%	2.33%
FTIM Safety First 3	3.26%	0.30%	2.62%
FTIM Safety First 4	4.38%	0.63%	3.40%
FTIM Safety First 5	5.63%	1.08%	3.75%
FTIM Safety First 6	10.10%	2.10%	5.15%

Date: 07 July 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.