30 June 2017

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INVESTMENT MANAGEMENT

WEEKLY INVESTMENT UPDATE

Hawks Multiply at Major Central Banks

KEY MESSAGES:

Bond markets sold off sharply this week on remarks from monetary policymakers.

Bond yields rose by 20 to 25 basis points in Germany and the UK, respectively. Yields on Treasuries also rose, but markedly less as US data has underwhelmed.

The euro and pound rallied, developed bonds sold off, as investors digest central banks' hawkish statements. USD saw 1.3% monthly decline.

The S&P500 fell 0.5% to 2,425. US 10-year treasuries yielded 2.28%.

WTI Crude closed at $45.53, gold closed at $1,242.29 an ounce.

Market developments during the week

Volatility is making a comeback, though still low by historical standards, as the debate on normalizing central bank policy intensifies after nine years of unprecedented stimulus. That suggests some investors are growing concerned about the economy's ability to withstand a tightening cycle, even as data remains supportive. The last two weeks of comments from the world's most important central bankers have prompted investors to reassess the outlook for the second half of 2017. The Bank of England and the Bank of Canada are now seen as more likely than not to join the Federal Reserve in raising rates before the year is out, based on overnight index swap rates. Even the possibility of a European Central Bank hike, once seen as all but impossible, is slowly growing.

Comments from Federal Reserve President, Janet Yellen, and other Fed speakers this week about overvalued asset prices also helped take the wind out of the equity market's sails, with weakness at the US close feeding into Asian and European trading. Janet Yellen signaled the economy is robust enough to withstand higher interest rates. Yellen's comments that the Fed remains on track to tighten came even as economic data continues to fall short of expectations.

The US data came in relatively weak this week. While still supportive of growth in the second quarter, momentum in personal spending dissipated slightly from the robust performance in the previous two months. Purchases rose 0.1% from prior month (matching est.) after 0.4% increase in April. However, gains in real income surprised to the upside, and should underpin spending going forward. Incomes rose 0.4% (est. 0.3% rise) after 0.3% gain. But, this was partly related to the weakness in prices. There was also weakness in durable goods orders, which fell in May according to the advance estimate, suggesting weaker capital investment in the second quarter.

But, not all data was soft. Consumer confidence metrics rose according to both the Conference Board and University of Michigan surveys. Moreover, the goods trade balance narrowed slightly in May as automotive exports rebounded following two consecutive months of underperformance. The string of data that has missed expectations recently has been leading markets to push out the timeline for further rate hikes, with another hike this year now priced in below 50%. This is particularly the case for inflation, which has been stubbornly weak, while wage growth has recently lost some momentum too. There was also a strong upwards revision of Gross Domestic Product growth in the 1st quarter, up to 1.4% from 1.2% previously. However, an unexpected decline in US orders for business equipment in May indicates cooling capital-goods investment may weigh on second-quarter economic growth. Orders for non-military capital goods excluding aircraft fell 0.2% (est. 0.4% gain) after 0.2% increase in prior month. The broad slowdown in equipment orders and shipments raises the

risk that business investment will provide less of a boost than anticipated to the economic rebound this quarter, leaving the heavy lifting to household spending.

Some investors worry the Fed is taking too rosy a view as it sets the path for increasing borrowing costs, especially after weakness in data Monday added to concerns about the strength of growth. The International Monetary Fund sounded a similar alarm earlier Tuesday, cutting its growth forecast for the US in part because of policy uncertainty.

The hawkish sentiment by most of the global central bankers is shocking traders after years of easing, with the dislocations in money markets also rippling through global bonds. The euro had its best day since April on Tuesday, as ECB President Mario Draghi said that reflationary forces had replaced deflationary ones in the region. UK’s 2-year gilt yields reached the highest since June 2016 on Thursday and GBP surged after Governor Mark Carney appeared to move closer to the hawks on his Monetary Policy Committee by saying it may need to begin removing stimulus. Across the Atlantic, the yield on Canada’s two-year government bonds shot up above 1% for the first time since January 2015 and the loonie surged the most in over a year as BOC Governor Stephen Poloz reiterated the central bank may be considering higher rates. Swaps trading suggests investors are see a roughly 70% chance of a rate hike at the bank’s July 12 rate decision, up from about 40% Tuesday.

Even in the US, where inflation gauges have tumbled below the Federal Reserve’s 2% target, Chair Janet Yellen has reiterated that the central bank’s tightening is on track, keeping two-year Treasury yields close to an eight-year high. The yield spread between US and Canadian 10-year debt fell to 58 basis points on Wednesday, the lowest since October. Compared with German bunds, Treasuries offer the smallest yield pickup since November. On Thursday, the US-UK 10-year yield differential, fell to 105 basis points, the smallest since February.

On political front, Trump administration continued its attempts to gain major milestones in its campaign promises with the first this week being the US Supreme Court’s declaration that a narrowed version of President Trump’s travel ban can take effect. The case is due to be heard in October. When the Supreme Court partially resurrected his executive order banning travel from six mostly Muslim nations, Trump called it a clear victory for national security. However, by the end of the week, the revised travel ban faced a new court challenge, as Hawaii asked a judge to clarify whether the government violated instructions from the US Supreme Court in defining who’s covered by the ban and who’s excluded.

Also, the plan to repeal Obamacare seemed less likely to succeed after at least three Republican senators said they would vote to block the current version of their party's health care bill, moving Majority Leader further away from the 50 votes he needs to secure passage of the measure. The Congressional Budget Office estimated that the bill would increase the number of uninsured Americans by 22 million. Later in the week, President Trump said that if Republican senators can’t strike a deal on their health bill, they should immediately repeal Obamacare and then replace it later, a reversal of the president’s earlier position.

The upcoming meeting of President Donald Trump with Russian President Vladimir Putin in next week’s G-20 summit in Germany will gain much of the attention amid a widening federal investigation into possible collusion between Trump associates and the Russian government. Trump last week gave a rare explicit acknowledgment of the Kremlin-directed effort to disrupt the US presidential campaign.

Currencies

The Bloomberg Dollar Spot Index headed for a monthly decline of 1.3%. It’s poised for a fourth month of losses and is down 3.3% this quarter. Dollar bullishness has been disappearing recently, with Commodity Futures Trading Commission data showing the lowest net bullish wagers in the futures markets of the year in recent weeks.

The yen gained 0.8% in the week closing at 112.2 per dollar.

The euro gained 1.8% to $1.1415. It’s gained 7.1% this quarter.

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The pound rose 1.6% to $1.2999, following seven days of gains. The currency is up 3.4% this quarter.

Equities

The S&P500 fell 0.5% to 2,425 over the week buoyed by gains in the industrial and consumer discretionary sectors. Technology stocks have been under pressure this week, while banks have been supported on the prospect for higher rates. The Nasdaq 100 Index dropped 2.7% for the worst week of the year, reversing its gain for June to a loss. The decline ended a seven-month winning streak, the longest since 2009. The Wall Street strategists are fighting historic odds when urging investors not to chase the rally in the US stock market. They're predicting the S&P 500 Index will see momentum fade in the second half after shares climbed 8.2% for the best first-half performance since 2013. The average year-end prediction, 2,439, represents a 0.6% increase by December, the least bullish forecast as per data by Bloomberg.

Europe's benchmark equity gauge added to its fourth straight weekly loss. The Stoxx 600 Europe Index fell 0.3% as gains in technology and consumer shares couldn't offset losses in chemical makers.

FTSE 100 lost 1% to close at 7,343.

The MSCI Asia Pacific Index dropped 0.6%, paring its advance so far this year to 15%. Technology shares, which slipped 0.9% Friday, have been the biggest boost to the gauge this year, surging 31% since December. Australian stocks dropped the most since November.

Stocks in Japan declined, led by electronic makers and technology companies, following the biggest selloff on the S&P 500 Index in six weeks as investors assessed the prospects that central banks worldwide are turning hawkish. Japan's Topix dropped 0.8 %, bringing its quarterly gain to 6.6%.

Bonds

Bonds steadied after yields rose across the globe this week as central bankers shifted toward a more hawkish tone. The yield on 10-year Treasuries rose 14 basis points to 2.28%.

Benchmark yields in the UK increased by 25 basis point to 1.27%.

German yields gained 22 basis point to 0.48%.

Commodities

Oil rose above $45 as oversupply concerns eased. The commodity came out of the bear market it entered last week. A report that US gasoline stockpiles dropped helped futures cap a 5.5% increase over the past five sessions on Wednesday. Inventories that have remained stubbornly high at the start of the summer driving season fell 894,000 barrels last week, the Energy Information Administration stated. While total US crude stockpiles rose by 117,999 barrels, the amount of oil held at the Cushing hub fell for the sixth week in a row. Futures added as much as 1.6% in New York, advancing for a seventh session. U.S crude output last week fell by the most in almost a year amid field maintenance in Alaska and tropical storm Cindy, while gasoline inventories fell for a second week.

West Texas Intermediate for August delivery gained as much as 71 cents to $45.64 on the New York Mercantile Exchange, and closed at $45.53. Total volume traded was about 25% below the 100-day average. Prices are down about 5.8% this month and are 10% lower this quarter.

Brent for August settlement, which expires Friday, rose 38 cents to $47.80 a barrel on the London-based ICE Futures Europe exchange. Prices are down 5% in June and 10% lower this quarter. The global benchmark crude traded at a premium of $2.17 to WTI.

The picture does not look so rosy when we widen the shot as oil has lost 10% in the second quarter, a drop that has helped wipe $113 billion from the value of companies listed in the MSCI World Energy Sector Index. The first half of the year ends with major banks cutting their end-of-year forecasts for the commodity. Bank of America lowered its 2017 WTI forecast to $47 and 2018 to $50, citing a continuing rise in oil output and disappointing demand.

Gold fell 0.3% to $1,242.29 an ounce. The precious metal is heading toward its first monthly decline this year.

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Other major economies:

Euro area

Markets were keen on Mario Draghi's speech this week which gave much awaited signal lifting the euro. Mario Draghi stated he is "confident" that the European Central Bank's policies would restore inflationary pressures in the eurozone and that the scars inflicted by the crisis will fully heal. The bullish assessment of the eurozone recovery fueled speculation that monetary policymakers could soon begin discussing a withdrawal of stimulus. The euro rose to its highest level in more than a year against the US dollar, trading at $1.1361. Draghi, however, did state that although reflationary forces have replaced deflationary ones, he also made it abundantly clear that in his view the ECB's accommodative policy remained necessary to sustain said reflationary forces. The speech nonetheless seems to indicate that the market views any hint of possible ECB policy normalization as strongly euro positive, and that further such hints may well have the same effect.

Among this week's data releases were Euro-Area inflation slowed, with consumer prices rising annual 1.3% in June after 1.4% in May, backing the European Central Bank's call for a prudent approach toward policy normalization. The core rate, which strips out volatile components such as energy and food, increased to 1.1% from 0.9% in May. The pickup in underlying inflation is encouraging for ECB President Mario Draghi and his fellow Governing Council members who want to see proof that price growth can be sustained at their goal of below but close to 2% without central-bank support.

German Inflation data revealed prices were up 1.6% year on year. Spanish inflation was up 1.5% year on year, although this was slightly shy of expectations. German Retail Sales smashed expectations today at 0.5% vs 0.3%, and the French Consumer Spending jumped in May to 1.0% vs 0.5% expected, the highest monthly increase since March 2016.

GfK consumer climate figures this morning have followed yesterday's investor sentiment survey higher, suggesting a particularly robust German economy. German IFO Business Climate hit record high at 115.1 in June as the 7000 German businesses surveyed reported soaring economic activity and a strong outlook for the future.

The economic and financial backdrop for European equities remains largely favorable despite some remaining political risk. It's an area which, despite increasing valuations, is preferred over other asset classes. Europe's median price-earnings ratio is close to 20x. Despite this, unless bond yields rise sharply or growth collapses equities still look like substantial value next to bonds.

The upcoming headwinds to European assets include the German election, which we do not expect to be a source of concern, the Italian election which will have to take place by May 2018, could see upsets if populist, anti-EU factions gain momentum. A negative growth surprise in China could also cause headaches for Europe.

As of half year ending, the update on political scenario is as below

The continued good health of the German economy is indicating it will be a struggle for the opposition led by Social Democratic candidate Martin Schulz to unseat Angela Merkel in September's election.

In Italy, the second and final round of municipal elections on Sunday showed a re-surgence in support for former Prime Minister Silvio Berlusconi's Forza Italia party, and its center-right allies. Berlusconi-backed candidates won runoffs in mayoral races across the country marking a significant setback for Prime Minister Paolo Gentiloni's ruling Democratic Party, which is led by his predecessor Matteo Renzi. The Berlusconi bloc is running at about 30% in nationwide polls, neck-and-neck with the anti-euro Five Star Movement and Renzi's PD. Berlusconi is seeking to overturn a ban on running for public office that was the result of his 2013 tax-fraud conviction.

Italy is due to hold a general election in the first half of next year, though the rules that will govern the vote are unclear. A multi-party deal to make the electoral system for the parliament in Rome more stable unraveled earlier this month. The existing system is purely proportional and the main parties want to change it in order to produce less fragmented legislatures.

Also in news from Italy was the bail out deal by the Italian Government regarding its two particularly troubled banks, a deal that raises questions about the consistency of Europe's bank regulations. Italy has committed as much as 17 billion euros ($19 billion) to the intervention at Banca Popolare di Vicenza SpA and Veneto Banca SpA. The agreement bolstered bank stocks across Europe, with Intesa leading gainers, while putting into question the effectiveness of European rules meant to ensure that private investors share the burden of bank bailouts.

Canada

The loonie pushed above 77 US cents to a 9-month high vs its US counterpart at 1.2947 this week, due in part to a rise in oil prices back above US$45 per barrel. However, the more important driver of currency strength of late has been hawkish remarks by central bank officials, which have prompted markets to bring forward expectations of when rate hikes will begin. As of this week, markets had priced in a nearly 80% chance that the Bank will hike the overnight rate at the next meeting in July. As a result, 5- and 10-yr bond yields rose by about 25 basis points on the week to a 3-month high. Inflation is still the Bank of Canada's single mandate and has yet to show any signs of moving toward target. Real GDP expanded by 0.2% in April, in line with expectations. This puts the economy on track for growth of around 3% in the second quarter. The Business Outlook Survey showed that business activity continues to gain momentum, with forward looking indicators improving for a third straight quarter.

China

Despite the slowdown from double-digit growth rate to a respectable single-digit rate the Chinese economy continues to have a considerable influence on the global economy given its larger size compared to a decade or two ago. The recent tightening of monetary policy by the Central Bank of China, the mixed signals in the purchasing managers index (PMI) and worries by the government about "systemic risk" from some large enterprises in relation to overseas acquisitions have reignited doubts about the Chinese and global economic outlook. The Caixin's China PMI, a private survey, has been slowing down since the beginning of the year and is currently below the neutral 50 level. This contrasts with an official reading which points to continued expansion. China's official PMI report released this week revealed the manufacturing PMI increased to 51.7 in June compared to the 51.2 reading in May while the non-manufacturing PMI rose to 54.9 compared to 54.5 a month earlier. Compared with the official PMI, the Caixin survey is tilted towards more small and mid-sized manufacturers. The difference between the surveys suggests that smaller firms are under more pressure than their larger peers. The risk is that of an over-tightening of monetary policy will have an adverse effect on the economic momentum.

The current indicators, which sceptics of the Chinese economic momentum point to, are the slowing in the money supply growth and the inversion in the yield curve. Money supply grew by 9.6% YoY in May which is the slowest rate of growth going back 15 years. Meanwhile, short term interest rates are higher than those for 10-year government bonds. This would normally be a signal of pessimism on the economic outlook by investors with a flight to safe short-term securities and a fall in the longer term interest rates. This has not been the case in China with both the short and long-term interest rates rising over the past six months. The slower growth in money supply and the inverted yield curve are therefore more likely to be reflecting the modest monetary policy tightening by the authority in an attempt to limit some of the excesses in the financial system. China will look to deleverage and tighten regulation to reduce the risk within the financial system. Crucially, for the global economy and investors, China monetary authority is unlikely to risk over-tightening ahead of the twice-a-decade National Party Congress in late 2017. We remain positive on the Chinese and global economic momentum for the time being.

Japan

Japan's core consumer prices crept higher for a fifth straight month to 0.4% in May from a year earlier, but inflation remains far from the Bank of Japan's 2% target, government data showed. Industrial production slipped 3.3% last month compared with April, more than economists forecast, while the jobless rate unexpectedly climbed.

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While Friday's decline pared the Topix index's weekly gain to less than 0.1%, it still rose 2.8% in June, its best monthly performance this year. The benchmark gauge ended the quarter 6.6% higher, bouncing back from a decline in the first three months of 2017. A Tokyo assembly election Sunday will be watched as a barometer of support for Prime Minister Abe's government.

India

India rolls out massive tax reform which its Government expects will boost GDP, improve macro stability. Businesses and citizens across the country steeled themselves for the economic turmoil that's expected to follow as they are confused by a complicated structure, which includes four tax slabs ranging from 5% to 28% and numerous exemptions. It's also not clear what sort of damage the nationwide roll out will inflict on the country's fast-growing, $2 trillion economy before the long-term benefits kick in. The Reserve Bank of India has said the impact from GST is likely to be minimal. India's inflation has eased to a record low of 2.2% as the central bank's battle against price pressures gains traction. It could ease further as businesses offer hefty discounts to consumers in "GST sales" before July 1.

UK

Sterling erased its post-election losses and rose against most of its 16 major peers Thursday after BOE Governor Carney appeared to rein back on some of his rhetoric from last week when he suggested that he was firmly placed among the other doves on the MPC. It extended gains past $1.30 as chief economist Andy Haldane told the BBC that the BOE needs to look seriously at raising rates.

On the economic front, the final reading of first-quarter GDP remained unaltered from the previous print showing 2% annual growth, with the Office for National Statistics saying the country's saving ratio has fallen to 1.7%, the lowest level on record, from 3.3% in the previous quarter. Britons saved a smaller proportion of their incomes than at any time on record and household incomes adjusted for inflation fell for a third straight quarter, the Office for National Statistics reported. GDP as a whole grew an unrevised 0.2%, the weakest in a year.

For Bank of England Governor Mark Carney, the debate over when to raise interest rates hinges among other things on whether business activity picks to compensate for the weakness of consumer spending. Figures this week showed business investment rising an annual 0.7%, the best performance in more than a year. There was also some good news from the dominant services industry, where retailers helped output grow 0.2% in April. That puts the economy on course for 0.4% growth in the second quarter and keeps open the possibility of a rise in the UK benchmark rate when policy makers next meet on Aug. 3.

A GfK report showed consumer confidence falling to its lowest level since just after the Brexit vote, with this month's inconclusive election adding to people's concerns. The Nationwide House Price Index, which rose 1.1% in June, erasing the previous three months of contractions. Separate figures showed the current-account deficit widening, though remaining well below recent quarterly averages.

The Bank of England's Financial Policy Committee released the findings of its latest Financial Stability Report, and raised the capital requirements for banks as it warned debt levels were becoming elevated to the point where they required precautions. Rapid growth in car loans and other consumer debt items were areas of particular concern. Money and Credit data from the Bank of England revealed the unsecured consumer credit was up 10.3% year on year, vastly outstripping wage growth over the same period. M4 Money Supply contracted 0.1% however, compared to previous monthly growth of 1.3%.

Regarding update on Brexit, Business groups responded on Monday with frustration to the government's proposals on EU citizens' rights post-Brexit, which they said lacked the clarity employers needed and would lead to a big increase in the administrative burden on companies and individuals. The Conservative Party finally managed to strike a deal with the Democratic Unionist Party, which enables the Conservative's to stay in power as a

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minority government. The price negotiated for the support of the DUP's ten elected parliament ministers for Prime Minister Theresa May's continued premiership will be one billion pounds of extra funding for the province.

Jason Granite
Chief Investment Officer
30 June 2017

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

	2016 Performance	2017 Performance	Volatility* 04/01/16
FTIM Safety First 2	1.53%	0.08%	2.35%
FTIM Safety First 3	3.26%	0.31%	2.63%
FTIM Safety First 4	4.38%	0.64%	3.42%
FTIM Safety First 5	5.63%	1.09%	3.77%
FTIM Safety First 6	10.10%	2.11%	5.18%

Date: 30 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.

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