08 December 2017

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INVESTMENT MANAGEMENT

# WEEKLY INVESTMENT UPDATE

## UK & EU strike deal opening path for trade talks

### KEY MESSAGES:

**Mid-week selloff reversed, as investor optimism boosted. US employers are reported to have added 228k jobs, the U.S. government averted a shutdown and tax reform negotiations made progress. A rate hike by Fed next week is imminent.**

**Geopolitical concerns heightened, as President Trump announced recognition of Jerusalem as Israel's capital drawing criticism from other nations.**

**The dollar headed for its best week this year. Global equities rose, FTSE 100 Index gained 1% to close at 7,379. Commodities declined with gold edging 2.4 % lower to close at $1,249.5 an ounce. WTI Crude closed at $57.39 a barrel.**

**Market developments during the week**

Global assets recovered from risk-off sentiment that took hold of global markets mid-week. The selloff saw a host of reasons, ranging from profit-taking to the continued drop in technology stocks. Trump administration is actively moving ahead with its campaign promises after months of hits and misses. Last week's progress in US tax overhaul was a major milestone, which continued to buoy assets this week. Senate Majority Leader Mitch McConnell named eight Republican lawmakers to be part of the conference committee responsible for negotiating a final tax bill with GOP House lawmakers. It is planned to resolve differences between the two versions over the next two weeks. As legislators in Washington work on a final tax bill, regions including the European Union and China are expressing their concern that the bill may not comply with international rules and frustration about the effect it may have on local markets. The EU is concerned that some provisions in the U.S. tax bill currently being debated could result in a double taxation of European companies.

As lawmakers rush to finish work on tax legislation before Christmas. Congress passed a two-week extension of federal funding, a must-pass in order to avert a government shutdown this week. The government has been funded under a temporary measure known as a "continuing resolution" for about three months. Lawmakers now have until Dec. 22 to settle some larger issues on spending and legislation.

President Trump also announced he intends to reveal his infrastructure spending plans in January. Given tax reform legislation has finally passed, the promise may end up being taken with a little less salt by market participants.

Another major victory boosting confidence of Trump administration was a ruling by US Supreme Court allowing the President Trump's travel ban relating to six mostly Muslim countries take full effect while legal challenges go forward, suggesting the court ultimately will uphold the restrictions. Trump will now be able to bar or limit entry by people from the Mideast and North African nations even if they have a relationship with a U.S.-based person or institution.

An important headline that will dominate markets in the coming weeks is the Federal Reserve meeting where a rate hike is said to be imminent. Boosting probability of tightening by Fed came in November's US jobs report. It revealed employers added 228k jobs in November, and the nation's unemployment rate stayed the same at 4.1%. November marks the 86th straight month of U.S. job growth, the longest such streak on record. However, average hourly pay for workers rose 2.5% from a year earlier, to $26.55 from $25.91. Wage growth has failed to pick up this year despite a steady decline in the unemployment rate. This lack of a sustained acceleration in wages could factor into the pace of increases in 2018. Initial Jobless Claims came in around expectations with 236.000 initial claims in



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the week that ended on the second of December.

Looking ahead to next week, traders see an interest-rate increase by the Federal Reserve as pretty much a given.

Other important releases were as below;

Consumer sentiment in the U.S. cooled for a second month, while remaining around levels consistent with a steady economy and solid job market, according to a University of Michigan report. Sentiment index fell to 96.8 after 98.5 in November. Even with the decline in the main index and a higher inflation outlook, Americans remain relatively optimistic about employment prospects and the economic outlook, with the report showing improved household finances.

US Trade Balance deteriorated significantly in October, with exports down 1.8% and imports rising 1.3%. This deterioration was likely enough to negatively impact US growth in the fourth quarter.

US Non-manufacturing activity remained strong in November, as indicated by The Institute for Supply Management's (ISM) non-manufacturing index, which remained in healthy expansionary territory yet dropped 2.7 points to 57.4 in November, marking a much sharper drop than expected. A pullback in the headline index was anticipated as the recent uptick resulting from hurricane-related supply chain disruptions faded. There's little cause for concern since the score is still near last month's reading, which was the highest in 12 years.

There were a host of reasons spurring geopolitical concerns; the prominent one was President Trump's recognition of Jerusalem as Israel's capital. He also announced moving the U.S. embassy there, despite warnings from world leaders across the globe that the move would undermine peace efforts and spark violence. Recognizing Jerusalem as Israel's capital is provocative because the eastern sector of the city, home to some of the holiest ancient sites in Judaism, Christianity and Islam, is also claimed by Palestinians as the capital of a future state. Trump's declaration risks alienating Muslim allies assisting in U.S. military operations in the region and sacrificing U.S. credibility as an arbiter in the decades-long effort to broker peace in the region. World leaders in both Europe and the Middle East have denounced the plan.

**Currencies**

The dollar headed for its best week this year, after U.S. tax-cut legislation made progress in Congress. It briefly edged lower as investors assessed tepid wage growth that missed estimates, then resumed its fifth consecutive gain.

The euro slipped 0.84% to $1.18.

The British pound fell 0.74% to $1.34. GBP is due to see more headwinds as the more difficult trade talks begin.

The Japanese yen rose 1% to 113.4 per dollar.

The bitcoin frenzy continued this week. The cryptocurrency that has sparked so much debate went on a wild ride on Thursday. On Coinbase Inc.'s GDAX exchange, prices zoomed up to almost $20,000 from $16,000 in only about 90 minutes before crashing back down. The largest digital currency is still up more than 16-fold this year. It traded around $16,000 in Asia. The access is now widening as Cboe Global Markets Inc. and CME debuts futures on the cryptocurrency. The entrance of Cboe and CME is a watershed for bitcoin because many professional investors have been unwilling to do business on the unregulated platforms where bitcoin currently trades. Cboe and CME are regulated, potentially assuaging those concerns.

**Equities**

U.S. stocks climbed along with equities in Europe and Asia as the latest jobs report bolstered investor optimism. The S&P 500 Index rose 0.15% to 2,646. The advance was led by drug makers and biotech companies. The positive stock moves will be a welcome reversal for many investors, who earlier in the week booked profits amid an equity rotation and waning risk sentiment.

U.S. stocks have hit new highs this year as a bull market that started in March 2009 is poised to become the longest on record. Stock volatility is close to historic lows. Investor enthusiasm for technology shares

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and optimism over the potential benefits of U.S. tax reform have helped drive returns.

The S&P/TSX Comp. Index rose 0.2% to 16,072.

The Stoxx Europe 600 Index climbed 0.7% to a one-month high.

The Stoxx 600 Banks Index climbed as much as 3% Friday as it was observed that Basel III capital rules will see no significant increase in provisioning for the institutions thereby freeing up more cash than expected for dividends.

The U.K.'s FTSE 100 Index gained 1% to close at 7,379.

Japan's Nikkei 225 Stock Average climbed 1.4% to the highest in a week, closed at 22,811.

The MSCI Emerging Market Index jumped 1%.

**Bonds**

The yield on 10-year Treasuries rose a basis point to 2.37%.

The flattening of the Treasury yield curve, a persistent theme over the past several weeks, continued this week. The spread between five- and 30-year U.S. yields tumbled to 58 basis points as the market prices in more rate hikes from the Federal Reserve next year.

Germany's 10-year yield fell one basis points to 0.3%.

Britain's 10-year yield climbed seven basis points to 1.30%.

**Commodities**

West Texas Intermediate crude rose 1.2% to $57.39 a barrel.

Oil prices fell the most in two months on Wednesday after reports depicted expanding gasoline inventories for the first time in four weeks. After last week's OPEC meeting, demand is seen as the biggest driver of the oil price over the coming year. The threat from shale also seems to be waning somewhat as major producers in that space switch to generating cash returns rather than increasing investment. All signs are pointing to crude prices remaining stuck in a narrow range in the short term.

Gold edged lower for a fifth day. It slumped 2.4% to $1,249.5 an ounce. It accounts for the biggest weekly drop since May as investors anticipate higher U.S. interest rates and progress on tax reform buoys the dollar, marking a spectacular reversal for the metal which less than two weeks ago flirted with $1,300.

While Stocks and bitcoin are having a stellar year, commodities are crumbling. The Bloomberg Commodities Index has fallen 4.1% in the past month, putting it on course for its sixth year of losses out of seven. One bad sign for commodities going forward are expectations for a slower growth in China, particularly due to the country's pollution cleanup and a cooling property market.

Nickel has been hit hardest recently as the fever over electric car batteries wore off.

Copper closed at $2.9765 a pound. The metal slumped as much as 4.7% on the LME on Tuesday to the lowest in two months. The metal is still up 19% this year, the most since 2010, at $6,564 a metric ton. On one end, the demand is showing signs of decline. China's fixed-asset investment in infrastructure will grow 12% next year, down from almost 20% in the first 10 months this year. Copper has borne the brunt of the nervousness and prices are near a two-month low. On the other end, supply seems swelling as indicated by copper inventories at global exchanges that remain stubbornly high, even after heavy disruptions to supply from mines in Chile and Indonesia at the start of the year. Even loose spreads depict headwinds for a price rise. Benchmark three-month copper prices are trading at a discount to forward contracts expiring at later dates, a condition known as a contango that's common in oversupplied markets.

**Other major economies:**

**Euro area**

Brexit preparations are gaining momentum in the EU as well after European Commission President Jean-Claude Juncker has stated he will tell the European leaders at the European Council meeting next week that sufficient progress has been

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made for the talks to move to the next stage of Brexit talks about the future trade relationship between the European Union and the UK.

On economic front, a Purchasing Managers' Index for manufacturing and services rose to 57.5 in November, IHS Markit said on Tuesday. That's up from 56.0 in October and matches a Nov. 23 flash estimate. Output was bolstered by booming manufacturing, which only saw one stronger expansion in the 20-year survey history.

The economy expanded 0.6% from the second quarter, unrevised from an earlier estimate. Growth in the third quarter was driven by private consumption and investment. Consumer spending contributed 0.2 percentage point to gross domestic product, with gross fixed capital formation adding another 0.2 point, the European Union's statistics office said on Thursday.

The data come as European Central Bank officials brace for updated economic projections and a first outlook for growth and inflation in 2020, published after their final policy meeting of the year on Dec. 14. Current forecasts already anticipate that 2017 was the economy's best year in a decade. With business confidence at the highest level in 17 years, order books filled to the brim and unemployment steadily declining, policy makers may be presented with stronger numbers.

Individually, German Industrial Production contracted with 1.4% in October. The reading, which is typically volatile, compares with forecasts for a 0.9 % gain in a Bloomberg survey. Production was up 2.7% from a year earlier. The vacation days workers took after two public holidays in October contributed considerably to the decline in output, the ministry said in an emailed statement. Still there is positive sentiment because factory orders unexpectedly rose for a third month in October by 0.5% as exporters benefited from surging demand for investment goods from outside the euro area. German Trade Balance printing came up slightly weaker than expected, with a surplus of 19.9 billion in October.

As the threat of a repeat election hangs over Europe's biggest economy, the three-day convention was the first step in a possible alliance with Merkel 10 weeks after the SPD initially swore off re-establishing a coalition with her Christian Democratic-led bloc. Germany's Social Democratic leaders secured an endorsement from the restive party base to begin talks with Merkel, the strongest signal yet that the SPD will consider a re-run of a governing coalition with her.

### China

China's trade came in at the upside with a surprise export surge accompanied by further acceleration in imports that signals robust demand in the domestic economy. Exports rose 12.3% in November in dollar terms. Imports also beat projections with a 17.7% increase, widening the trade surplus to $40.2 billion. The official factory gauge unexpectedly rose to near a five-year high in November, despite campaigns to clean up the environment and the financial system. The government recently announced tariff reductions to help boost imports as the economy evolves to depend more on consumption.

### Japan

Japan's growth reading was revised at 2.5% in the third quarter, as a nearly year-long recovery in exports helped fuel business investment. It was revised from a preliminary reading of 1.5%. The Japanese economy has grown for seven straight quarters, which now registers as its longest expansion since the mid-1990s, following the government revision. A slew of key October indicators suggested that while growth may slow a bit, the GDP expansion will continue in the fourth quarter.

While export growth is driving corporate profits and business investment, wage gains and consumer spending remain lackluster. Wages rose a slower-than-expected 0.6% in October from a year earlier. Spending by households on durable goods and services fell during the third quarter from the April-June period.

A separate data release showed Japan's current-account surplus was 2.18 trillion yen in October.

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**Turkey**

Inflation and political events loom as the strongest headwinds for the Turkish market. Deepening political tensions between President Recep Tayyip Erdogan and the U.S. and Europe have weighed on investor confidence in recent months, increasing awareness of the risks around Turkish assets. Add to the mix the latest inflation figures, which showed annual consumer prices accelerating by almost 13% in November, the fastest pace since 2003. Monday's higher-than-estimated reading came less than three weeks after Erdogan said the country's central bank was on a wrong path in its fight against rising prices. The bank said it will tighten monetary policy if needed, as it announced monetary and exchange-rate policy for 2018 in a statement on its website Tuesday.

The rising concern of a hard split with NATO and from the West is growing as a trial continues in New York, alleging what amounts to a Turkish conspiracy, right up to President Recep Tayyip Erdogan, to undermine U.S. sanctions against Iran. A break with NATO would deprive the alliance of its second largest military, and leave Turkey to deal with Russia, Iran and other regional rivals alone. As regards relations with the West, economically, Turkey is still more deeply integrated. The U.S. and Europe account for more than half of Turkey's exports, compared with about a tenth for the Middle East and Russia. Of $131 billion in foreign direct investment in Turkey, more than 75% is from Europe and the U.S.; China accounts for just $571 million. U.S. and European credit is especially important to a nation that has to finance a persistently wide current account deficit, and whose private companies owe well over half of their $214 billion foreign debt to western banks. Should the supply of credit dry up, the shock to the Turkish economy could be harsh.

**Canada**

Homebuilding activity was extremely solid in November, rising to its highest level since April 2012. Canadian builders broke ground on 252k (SAAR) housing units in November, 13% higher than October and marking a very robust level of activity. The 6-month moving average rose to 226k from 217k during the month. The growth was broad based among various components with residential, commercial and industrial permits all adding to the growth, indicating there is still a large willingness to invest in the Canadian real estate sector. Further bolstering the attractiveness of the property market came in report from the Toronto Real Estate Board showing benchmark home price index fell for the sixth consecutive month, down another 0.4% from October. The index has fallen 8.8% since May, the largest six-month decline in the history of data back to 2000. The prices seem to fall on account of abundant supply.

The Ivey Purchasing Manager Index came in at target at 63.0, slightly down from 63.8 last month, but still comfortably in growth territory. Canada's Trade Balance deficit shrunk to just $1.5b in October $3.4b in September, fueled by a strong increase in exports to the US. Canada's trade surplus with the U.S. widened to $3.5b during the month (previously $2.0b), as exports rose 4% while imports were down 0.6%. Overall, exports rose 2.7% while imports slid 1.6%.

Amid strong economic performance, Bank of Canada reiterated caution in holding rates steady. The Central Bank held its benchmark overnight rate at 1% at its last interest rate decision of 2017. It's the second straight hold after consecutive hikes in July and September. Even as it acknowledges borrowing costs will eventually need to rise, the Bank of Canada is handling the normalization of rates very carefully, wary of triggering another downturn. One argument, repeated Wednesday, is that geopolitical uncertainties remain around U.S. trade policies. The Canadian dollar reversed gains after the statement, weakening 0.7% to C$1.2777 per USD. Yields on Canadian government bonds fell across all maturities, with the rate on the country's two-year bonds dropping four basis points to 1.5%. Swaps trading suggests investors pushed back their expectations for the next rate increase, with the likelihood of a hike in the first quarter now at 60 % from as high as 75% earlier this week.

**UK**

On economic front, record car production drove UK manufacturing extend its winning streak with six consecutive increases. Factory output rose 0.1% from September. Overall industrial production was unchanged as warmer weather reduced

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demand for energy. But, the start of the fourth quarter was marred by another mediocre performance from construction firms, which saw output drop by 1.7%. The trade deficit also widened to $1.9 billion as imports grew 1.6 % outpacing a 1.1 % gain in exports. Manufacturing is being buoyed by the boost to exports from the fall in the pound since the Brexit vote and a broad-based global economic upswing. The main driver in October was transport equipment, which gained 2.8%. Exports of cars were almost 18% higher in October than a year earlier, the ONS said.

However, the main headline that contradicted all the speculation that happened over the week came Friday that U.K. and EU struck Brexit deal, opening path to trade talks. Breaking the gridlock took months of work and a series of missed deadlines. Prime Minister Theresa May travelled Friday morning with an offer: a financial settlement, an agreement on Europeans living in the U.K. and a solution for keeping open the border that divides the island of Ireland after the split. The last turned out to be the thorniest, requiring delicate four-way talks as the Northern Irish party that holds the balance of power in London wielded a powerful veto until the last minute. There is still precious little in the way of solutions in the Ireland section. But what's key is that the U.K. has guaranteed there will be no hard border between Northern Ireland and the Republic of Ireland. Here is a breakdown of the key points

- The U.K will contribute to EU budgets for the years 2019 and 2020 as if it had remained in the Union
- The U.K will contribute its share of financing of EU budgetary commitments outstanding at 31 December 2020
- The U.K. will contribute its share of the financing of the EU's liabilities incurred before 31 December 2020
- The citizens' rights part of the final Withdrawal Agreement is to be interpreted in line with the case law of the Court of Justice of the European Union
- In the context of the application or interpretation of those rights, U.K. courts shall have due regard to relevant decisions of the ECJ
- There will be a mechanism enabling U.K. courts to ask the ECJ questions of interpretation and it will last eight years.
- The U.K. will either propose a solution for keeping the Irish border open that will be acceptable to the EU, or continue to by EU's single market and customs union rules which, now or in the future, support North-South cooperation, the all-island economy and the protection of the 1998 Agreement

The pound was flat after jumping late on Thursday and gilts fell. The yield on U.K. 10-year government bonds rose six basis points Friday to 1.31%, taking the week's increase to seven basis points. The pound rose 0.2% to $1.3503, after gaining 0.6% Thursday. The pound's gains evaporated soon as cognition grew among traders that the negotiations have reached a crucial second phase: if just the first phase of unlocking the divorce bill was this challenging, the path ahead could be even more frustrating and time-consuming. If anything, the EU seems unwilling to accede to any demands from the U.K. for a custom-made deal. Another risk is that if trade talks run into trouble, political support at home for those concessions might drain away. May has already faced down one attempted coup and there's a sense she's one crisis away from losing her job.

Further shaking the confidence of UK side, news appeared this week that May's Conservative administration is fiercely divided over Brexit. The apparent leanings towards a so-called 'soft Brexit' have drawn the ire of Foreign Secretary Boris Johnson and Environment Secretary Michael Gove, who campaigned for Brexit. Also, her Cabinet has yet to decide what kind of trading arrangements it wants from Europe. This is crucial because the second phase will be even more delicate and important than the first. German Chancellor Angela Merkel has said it will be far more complex than the divorce proceedings of the last eight months. Britons will also be watching to see if talks live up to what was promised: they were told that Brexit would mean free trade deals with Europe and the rest of the world, controls on European immigration and the repatriation of regulation.

The EU has already started mapping out what it intends to put on the table, a deal along the lines of the one it offered Canada.

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May has said she wants a deep and special partnership and a better deal than the free-trade agreement that Canada secured from the EU. But ministers will have to decide what they are willing to sacrifice in order to get what they want, and the answer will vary from one faction to another within government and within the Tory Party. Divisions may also emerge between EU members in the second phase of negotiations as each country's interests differ. In short, headwinds for GBP are only increasing as talks progress.

**Upcoming events**

- Among top U.S. economic reports next week are consumer inflation and retail sales for December.
- The U.S. Federal Reserve is set to announce its third interest-rate increase of the year on Wednesday, and signal more for 2018.
- ECB policy meeting on Dec. 14, when the highlight will be the ECB's updated estimates for economic growth and inflation.
- The Bank of England will probably stay on hold when it sets policy on Thursday.
- North America Free Trade Agreement (NAFTA) negotiators are due to meet again.
- Key Brexit summit expected to open path for trade talks.

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

| | 2016 Performance | 2016 Volatility | 2017 Performance | 2017 Volatility | Volatility since inception *04.01.16 |
|---|---|---|---|---|---|
| FTIM Safety First 2 | 1.53% | 1.42% | 2.25% | 3.43% | 2.37% |
| FTIM Safety First 3 | 3.26% | 1.91% | 2.86% | 3.55% | 2.62% |
| FTIM Safety First 4 | 4.38% | 2.93% | 3.61% | 4.02% | 3.31% |
| FTIM Safety First 5 | 5.63% | 3.23% | 4.52% | 4.45% | 3.64% |
| FTIM Safety First 6 | 10.10% | 5.04% | 6.13% | 5.09% | 4.91% |

Date: 11 December 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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