IMPERIUM CAPITAL

momentum

NEWPORT

Weekly Digest

Week ending **12 February 2017**

Confidence is high – why are we surprised?

Survey data out of both the US and UK in recent months has confounded perceived wisdom because despite significant political upheaval in these countries last year, confidence has improved. This is something of a surprise because such substantial changes may be considered a destabilisation risk given the relative fragility of confidence following the global financial crisis. Indeed, only twelve months ago the market would seemingly fall regardless of news flow as a combination of weak resource prices, concerns over China and now long forgotten whispers about the end of the credit cycle provided a negative background that was difficult to overlook. To paraphrase Charles Mackay, author of Extraordinary Popular Delusions and the Madness of Crowds (first published in 1841) market participants were gripped by fear and in that condition investors saw risk even in enticing opportunities.

Now there is no doubting that confidence is solid and there is a risk that the emotion that occupied a lot of Mackay's attention, greed, is in the ascendancy. This time last year, disciplined investors were able to use the market wobbles to buy assets at a reasonable discount. Today this is a more challenging feat to achieve with the possible exception of US government bonds, where 10 year yields have moved from around 1.4% to 2.4% over seven months. While this is hardly an enticing headline yield by long term historical standards, it does, for the first time since 2015 provide some scope for protection from duration (interest rate risk). Once again, room exists for rates to go down should they need to and as bond prices are inversely related to yields, this would mean positive returns for bond holders. While we still think there is upside from today's yields (downside for bond prices) there will undoubtedly be bumps along the way and so we have started to dip a toe into this asset class for portfolio event risk insurance.

There is a conundrum when it comes to positive sentiment. A little is very useful as it tends to provide the lubricant that allows an otherwise stuck market to rise, but too great a level of confidence suggests that too much good news can be creeping into asset prices giving scope for negative surprises to destabilise markets once more. There is nothing to suggest outright that sentiment is unjustifiably positive at the moment but it is always worth bearing in mind that the post-Brexit and Trump world may not remain as stable as it appears to be today. In the short term, perhaps it is unsurprising that many consumers are in a positive frame of mind following these results as they were what large swaths of the populations voted for and these voters will see the change to the status quo as immensely positive. But it is easy to envisage an environment where that sentiment could turn. Brits, for example, may baulk at heightened inflation in 2017 as a weaker sterling hits home in import prices, yet unless these are compensated for in improved nominal wages and, for example, if Trump is unable to deliver some of his key election pledges, then the mood could soon turn.

One conclusion that we can probably make from news out of the UK and US is the confirmation that we like certainty. Given both polls were closely fought there is a reasonable proportion of the population (indeed the majority in the US) that ended up with the 'wrong' results. Nevertheless, sentiment has improved materially. In economies such as these two, where the consumer represents the majority of consumption, this should translate into good news for the domestic economies. Even business which, on the whole, took a more circumspect view of these polls seem to see a positive angle. Indeed, countless management books have been written extolling the virtue of embracing change and perhaps we are starting to see just that.

Source: Bloomberg. Returns in US dollars unless otherwise stated.

The **Marketplace**

- President Trump announces "phenomenal" tax reforms
- Greek debt burden back in focus
- Japan's Q4 growth disappoints marginally
- Improving Chinese trade data aids commodities rally
- UK House of Commons clears Brexit bill

Market **Focus**

Europe inc. UK

- Attention returned to Greece amid the government's ongoing negotiations with its creditors to reach a bailout deal before EUR 7 billion worth of debt is due to mature in July. Greece's Prime Minister, Alexis Tsipras, warned the IMF and Germany to "stop playing with fire", as both parties question Greece's ability to achieve the economic reforms that were a condition of the most recent EUR 86 billion bailout.
- Greek government bonds experienced volatile trading. Finishing as high as 9.8% for 2-year bonds on Thursday. 2 year and 10 year yields finished the week 34.1 basis points higher and 17.2 basis points lower, at 8.6% and 7.3% respectively.
- Government bond yields were also in focus in relative terms in France and Germany, where the spread between 10 year French and German bonds reached a three year high on Monday (1.14% for French versus 0.37% for German) following Marine Le Pen's increasing strength in polls amid Francois Fillon's ongoing payments scandal.
- The euro fell 1.4% against the US dollar over the week, to USD 1.06, while Continental European equities finished 0.3% higher.
- In the UK, on Wednesday, the House of Commons voted 494 to 122 to approve the bill that would allow the Government to Trigger Article 50 of the Lisbon Treaty and formally begin the Brexit process. Sterling was up 0.2% on the day, but finished the week flat at USD 1.25.

US

- A rise in global stock markets and the US dollar on Friday was partially attributed to President Donald Trump's statement that in the next "two to three weeks" there will be an announcement of something "phenomenal in terms of tax".
- The dollar index rose 0.9% over the week for its first aggregate five day gain in five weeks, while US equities also rose 0.9% for the period.

Japan

- JapaneseJapanese GDP rose at an annualized rate of 0.2% over the final quarter of 2016. This compares to a rate of +0.3% over Q3, and was also slightly below expectations of +0.3% growth.
- The yen has thus far depreciated 0.5% to JPY 113.7 following the release. Although this has seemingly boosted Japanese equity markets, which, after rising by 2.1% last week, have risen another 0.5% overnight.

China

- Data for January showed China's trade surplus rising to CNY 354bn, up from CNY 275bn as of the previous month. Total exports for the month were 15.9% higher than for the same period a year earlier, vs +5.2% expectations, while imports were also up 25.2% compared to January 2016, up from the +10.8% rise between December 2016 and December 2015.
- This data, as well as Trump commenting that he is willing to honour the 'one China' policy, contributed to a rally in metals and oil on Friday, with the Rogers International Commodity Index rising 1.1%, including a 1.9% rise for Brent crude oil to USD 56.70 per barrel, while gold rose by 0.4% on the day to finish +1.1% for the week at USD 1,233.65 per ounce.

James Klempster (CFA) & Oliver Bickley

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Asset Class/Region	Currency	Currency returns			
		Week ending 10 Feb 2017	Month to date	YTD 2017	12 months
Developed Market Equities					
United States	USD	0.9%	1.7%	3.6%	27.0%
United Kingdom	GBP	1.1%	2.3%	1.8%	33.1%
Continental Europe	EUR	0.3%	1.5%	1.4%	20.4%
Japan	JPY	2.1%	1.6%	1.9%	25.0%
Asia Pacific (ex Japan)	USD	1.5%	2.2%	8.1%	27.6%
Australia	AUD	1.8%	1.8%	1.0%	25.2%
Global	USD	0.5%	1.3%	3.7%	24.6%
Emerging Market Equities					
Emerging Europe	USD	-1.0%	1.2%	3.0%	41.0%
Emerging Asia	USD	1.6%	2.4%	8.4%	25.5%
Emerging Latin America	USD	1.3%	3.3%	11.2%	55.3%
BRICs	USD	2.0%	2.7%	9.2%	40.1%
MENA countries	USD	-0.2%	-0.4%	1.2%	21.6%
South Africa	USD	-0.6%	1.4%	4.2%	31.6%
India	USD	1.0%	3.8%	9.3%	25.4%
Global Emerging Markets	USD	1.2%	2.3%	7.9%	30.3%
Bonds					
US Treasuries	USD	0.5%	0.3%	0.5%	-1.9%
US Treasuries (inflation protected)	USD	0.6%	0.2%	1.0%	4.1%
US Corporate (investment grade)	USD	0.5%	0.3%	0.6%	5.9%
US High Yield	USD	0.1%	0.5%	2.0%	24.5%
UK Gilts	GBP	0.9%	1.1%	-0.8%	4.6%
UK Corporate (investment grade)	GBP	0.6%	0.8%	-0.2%	9.5%
Euro Government Bonds	EUR	0.2%	0.1%	-2.0%	-0.5%
Euro Corporate (investment grade)	EUR	0.3%	0.5%	-0.1%	4.5%
Euro High Yield	EUR	0.2%	0.3%	1.1%	13.7%
Japanese Government	JPY	0.1%	-0.1%	-0.8%	0.6%
Australian Government	AUD	0.6%	0.2%	0.8%	0.6%
Global Government Bonds	USD	-0.3%	-0.5%	0.4%	-2.6%
Global Bonds	USD	-0.3%	-0.4%	0.4%	-1.0%
Global Convertible Bonds	USD	-0.2%	0.5%	2.6%	9.2%
Emerging Market Bonds	USD	0.6%	1.6%	3.1%	12.9%

Source: Bloomberg

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Asset Class/Region	Currency	Currency returns			
		Week ending 10 Feb 2017	Month to date	YTD 2017	12 months
Property					
US Property Securities	USD	1.2%	1.6%	1.6%	19.8%
Australian Property Securities	AUD	2.7%	3.2%	-1.9%	7.3%
Asia Property Securities	USD	2.4%	2.2%	7.8%	23.6%
Global Property Securities	USD	1.4%	1.9%	3.1%	18.2%
Currencies					
Euro	USD	-1.4%	-1.4%	1.1%	-5.8%
UK Pound Sterling	USD	-0.1%	-0.6%	1.1%	-14.0%
Japanese Yen	USD	-0.7%	-0.3%	3.2%	0.0%
Australian Dollar	USD	-0.1%	1.5%	6.7%	8.2%
South African Rand	USD	-1.0%	1.0%	2.4%	18.8%
Swiss Franc	USD	-1.2%	-1.3%	1.5%	-3.0%
Chinese Yuan	USD	-0.7%	-0.2%	1.0%	-4.5%
Commodities & Alternatives					
Commodities	USD	1.1%	1.9%	2.8%	28.6%
Agricultural Commodities	USD	1.4%	2.3%	5.5%	11.7%
Oil	USD	-0.2%	1.8%	-0.2%	83.9%
Gold	USD	1.1%	1.8%	7.0%	3.0%
Hedge funds	USD	0.1%	0.5%	1.0%	8.3%

Source: Bloomberg

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