

Weekly Digest

Week ending 15 January 2017

Obama – Can Legacy be Priced In?

As Barack Obama's presidency began in January 2009 – deep in the market sell-off following the global financial crisis – it was reasonable to presume that his job was at best thankless and at worst almost impossible. Yet, in many ways history may well tell us that his job was simple in comparison to that of his successor. Obama rode to victory on a tide of optimism and expectation that set him apart starkly from George W. Bush. Obama's youth and eloquence stood him apart from the man he replaced. During that time tensions and the risk of policy missteps were high, but equally expectations were low due to the volume of bad news. In fact, Obama's legacy has benefitted from the fact that he took over with the stock market in a cyclical trough. Conversely, Trump will take the reins of an economy that, while not firing on all cylinders, has recovered a long way since the dark days of 2008 and 2009. Furthermore, the stock market is a long way ahead of eight years ago, with a total return of 235% from the S&P 500 over the period. Adding to the challenge, interest rates are at historical lows and government borrowing is at record highs. The consumer is in reasonable shape and unemployment is low and this is starting to feed into wage growth inflation which reduces policy makers' room for error.

The US market has performed well in recent years and has generally reflected a better operating environment than in other developed markets such as the UK, Europe and Japan. The US stock market was underweight in 2016 on valuation grounds and we continue to hold this position. We have made the point repeatedly that a surprise election result (such as the Trump victory) need not be a risk for markets, but the converse is also true, it will not necessarily be a positive. Political direction and its impact on companies (if any) are extremely difficult to determine. We therefore take the view that unless President Trump's political direction is akin to a substantial regime change in the US then the local market should be, on average, indifferent to the new president over the medium term. On a stock by stock level there are new risks, however. Sectors such as pharmaceuticals and defence

have been buffeted by his rhetoric that singles out these and other major suppliers to the US government. This could result in these sectors coming under substantial pricing pressure. For example in his press conference last week Trump stated: "We're the largest buyer of drugs in the world and yet we don't bid properly and we're going to start bidding and we're going to save billions of dollars... And we're going to do some big things on the F-35 [military aircraft] program... And we're going to get those costs way down..."

While he may not be able to control the state of the nation he inherits, some of Donald Trump's challenges are of his own making: he has not been afraid to ruffle feathers both at home and abroad. From Friday, President Trump will need to decide whether to quietly distance himself from some of his more controversial policies and ideas or whether to plough on with the telegraphed rate hikes, tax cuts and protectionist trading policies. The latter, in particular, would be a controversial step given a substantial body of academic thought which holds that tariffs primarily hurt the domestic consumer. This is a particularly acute risk given Trump's core voters appear to have been from the lower income echelons of the nation who have been 'left behind' and disaffected by the wealth enhancements that have been experienced by 'the elite' thanks to globalisation.

So there are plenty of challenges for the incoming President, especially for one so divisive. Perhaps this could be to Trump's benefit. When individuals are put on a pedestal and expectations are high that it becomes more difficult for them to impress. Indeed Obama seems to have foreseen this difficulty in 2006's *The Audacity of Hope*, in which he writes: "I serve as a blank screen on which people of vastly different political stripes project their own views. As such, I am bound to disappoint some, if not all, of them." Few would argue Trump to be a blank screen and this singularity of purpose may be to his advantage.

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The Marketplace

- UK market hits twelve consecutive days of record highs
- Sterling dips ahead of PM May's Brexit speech
- Dollar retreats following Trump press conference
- Chinese trade data shows fall in exports
- US small business confidence soars

Market Focus

UK

- The FTSE 100 index rose every day last week, and Friday's rise marked the twelfth consecutive day the index has reached a new record high, and the first time in history that the index has recorded thirteen consecutive daily gains.
- Positive economic data releases continued, as the latest production figures surprised to the upside: industrial and manufacturing production rose 2.1% and 1.3% respectively month-on-month in December.
- Sterling, however, fell 0.9% over the week against the US dollar, and is down to USD 1.206 at time of writing – its lowest level since the flash crash in October – amid fears that Theresa May would declare her willingness to sacrifice access to the EU's single market in order to regain control of immigration. She is due to make a speech on Tuesday detailing her plans for Brexit.

US

- Momentum in the US dollar and equity market reversed last week, with both falling 1.0% and 0.1%, respectively.
- Markets seemed to be disappointed after President elect Donald Trump's press conference on Tuesday in which he gave few details of policy frameworks or timelines, instead focusing on his business interests and

the scandal over potential Russian interference in the presidential campaigns.

- US retail sales for December were also slightly disappointing, rising 0.6% month-on-month; the figure was flat when excluding automobiles and gasoline sales.
- More positive was the National Federation of Independent Businesses' small business optimism survey, which surged 7.4 points in December to 105.8 versus 99.5 expected. This was the largest ever one month gain for the index, leaving it at its highest level since 2004.

China

- Chinese trade data disappointed in December, with exports falling 6.1% year-on-year in US dollar terms, compared to a 0.1% increase in November, and imports rising 3.1%; down from 6.7% in the previous reading.
- This left China's exports and imports 7.7% and 5.5% down respectively in 2016 compared to the prior year. Although in Chinese yuan terms the respective figures were -2% and +0.6%.
- Chinese economists highlighted that the decline wasn't as worrying as first appears, given the near 10% increase in average annual Chinese wages increasing the cost of Chinese goods.

Commodities

- Gold rose 2.1% to USD 1,197 per ounce off the back of nominal Treasury yields falling slightly in the New Year, combined with a continuing rise in inflation figures and expectations. Year-to-date return for the metal is now 3.9%.

James Klempster (CFA) & Oliver Bickley

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Asset Class/Region	Currency	Currency returns			
		Week ending 13 Jan 2017	Month to date	YTD 2017	12 months
Developed Market Equities					
United States	USD	-0.1%	1.6%	1.6%	22.2%
United Kingdom	GBP	1.7%	2.7%	2.7%	28.1%
Continental Europe	EUR	0.2%	1.6%	1.6%	10.2%
Japan	JPY	-0.5%	1.7%	1.7%	9.5%
Asia Pacific (ex Japan)	USD	1.9%	4.5%	4.5%	21.4%
Australia	AUD	-0.6%	1.0%	1.0%	19.9%
Global	USD	0.3%	2.1%	2.1%	18.2%
Emerging Market Equities					
Emerging Europe	USD	-0.4%	0.7%	0.7%	35.1%
Emerging Asia	USD	1.8%	4.3%	4.3%	20.1%
Emerging Latin America	USD	1.7%	3.6%	3.6%	49.1%
BRICs	USD	1.7%	4.3%	4.3%	29.9%
MENA countries	USD	-1.1%	0.1%	0.1%	19.6%
South Africa	USD	3.3%	4.6%	4.6%	38.2%
India	USD	1.9%	2.4%	2.4%	10.3%
Global Emerging Markets	USD	1.7%	3.9%	3.9%	25.8%
Bonds					
US Treasuries	USD	0.2%	0.4%	0.4%	0.3%
US Treasuries (inflation protected)	USD	0.5%	0.8%	0.8%	5.1%
US Corporate (investment grade)	USD	0.3%	0.6%	0.6%	5.8%
US High Yield	USD	0.2%	1.2%	1.2%	19.9%
UK Gilts	GBP	0.0%	-1.7%	-1.7%	6.8%
UK Corporate (investment grade)	GBP	0.1%	-0.7%	-0.7%	8.5%
Euro Government Bonds	EUR	0.1%	-0.8%	-0.8%	1.8%
Euro Corporate (investment grade)	EUR	0.1%	-0.2%	-0.2%	4.5%
Euro High Yield	EUR	0.0%	0.5%	0.5%	10.7%
Japanese Government	JPY	0.0%	-0.1%	-0.1%	2.9%
Australian Government	AUD	0.0%	0.5%	0.5%	2.5%
Global Government Bonds	USD	0.5%	0.3%	0.3%	0.8%
Global Bonds	USD	0.4%	0.3%	0.3%	1.5%
Global Convertible Bonds	USD	0.4%	1.4%	1.4%	5.0%
Emerging Market Bonds	USD	0.2%	1.6%	1.6%	12.3%

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Asset Class/Region	Currency	Currency returns			
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Property					
US Property Securities	USD	-2.0%	0.2%	0.2%	12.3%
Australian Property Securities	AUD	-3.2%	-3.2%	-3.2%	5.9%
Asia Property Securities	USD	1.1%	5.2%	5.2%	14.8%
Global Property Securities	USD	-1.0%	1.1%	1.1%	12.0%
Currencies					
Euro	USD	1.1%	1.2%	1.2%	-2.1%
UK Pound Sterling	USD	-0.9%	-1.4%	-1.4%	-15.5%
Japanese Yen	USD	2.2%	2.2%	2.2%	2.8%
Australian Dollar	USD	2.8%	4.2%	4.2%	7.8%
South African Rand	USD	1.8%	1.3%	1.3%	22.6%
Swiss Franc	USD	0.9%	1.0%	1.0%	-0.3%
Chinese Yuan	USD	0.6%	0.8%	0.8%	-4.6%
Commodities & Alternatives					
Commodities	USD	0.6%	1.3%	1.3%	24.3%
Agricultural Commodities	USD	1.3%	3.3%	3.3%	6.9%
Oil	USD	-2.9%	-2.4%	-2.4%	82.9%
Gold	USD	2.1%	3.9%	3.9%	9.5%
Hedge funds	USD	0.1%	0.6%	0.6%	5.2%

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