

Weekly Digest

Week ending **15 October 2017**

Will The City Get Its Deal?

In March 2017, the UK Government gave formal notice of the UK's intention to leave the European Union, and thus started the process of withdrawal, for which a two year period is provided. The Prime Minister also laid out the basis of Britain's negotiating position; that there would be a clean break with the EU, unless something more attractive was on offer. Clearly any other stance would not be a negotiating position at all in the sense that it would be too conciliatory to use as a starting point. The EU side is however, still declining to negotiate about future trade arrangements until significant progress has been made on the leaving settlement in which it wants to include significant payments from the UK.

The rational assumption that the EU would not want to disrupt trade with a major economy with which it has a very large trade surplus may be trumped by the absolute determination of the European political class to maintain the project of ever closer union. Although more European workers might lose their jobs than British ones, all else being equal, the impact would be proportionately smaller on the larger economic bloc than on a single nation, and the politicians appear to be calling the shots. This is even though it is Germany which could suffer most, given the fondness of Brits for nice cars and other well engineered German goods.

Whilst Germany should want to keep its ability to export physical goods to the UK, the UK's greatest concern is that London should continue to be Europe's main financial centre, a very high value-add service industry, which drives the British economy.

The ability to provide financial services across Europe from a UK base is very important and the City of London is very keen to maintain the regulatory passporting arrangements under which it can do so. The alternative, of getting subsidiaries regulated in other European countries, is onerous, but a number of organisations are already making plans to change their group structures and relocate some activities from the UK to Europe.

From the point of view of the asset management industry, the biggest regulatory change for a number of years is the Second Markets in Financial Instrument Directive (MiFID II). This change in the regulatory landscape started life in the immediate aftermath of the financial crisis, now nearly ten years ago, and

seeks to introduce more transparency to financial markets and more protection for investors. The changes are numerous and very technical, and involve a great deal of reporting to regulators and information sharing between different parts of the industry. Whilst the aims are worthy, the changes in will add significantly to the costs of financial services businesses, of which the UK has far more than any other country in Europe. The texts published to date are approximately the same length as "War and Peace".

The date by which the changes need to be implemented is the 3rd of January 2018, at which point the UK will still be a member of the EU, and obliged to follow the new rules in full. Great efforts are being made by the industry, and the regulators, to achieve compliance with MiFID II, considerably more effort than is being expended in some other EU countries. This is partly because the UK had always taken the real, practical, implementation of regulations very seriously, and partly because many of the changes reflect the views of the UK regulators, as expressed over a number of years of negotiations. The consequence is, however, that very significant costs are being expended on meeting the requirements of regulations set by an organisation the UK is in the process of leaving.

As well as achieving the desirable objectives of MIFID II, the prize for the industry is still being deemed to have equivalent regulations to the EU, which should mean that most interactions with European investors can continue with only relatively technical changes. The worry is, however, that, although much of the regulatory regime emanated from the UK, and will be followed in it, the political negotiations may move in quite a different direction, either because of increasing ill-feeling or a desire by some European cities to eat the City of London's lunch. The losers from an impasse would be not just the very large number of Britons who work in the industry, but the far greater number of European consumers who benefit from the depth of its expertise.

Perversely, the main beneficiaries would be New York, Singapore and other Financial centres thousands of miles from Europe. By symmetry, the main beneficiary of an impasse on trade in goods could well be Jaguar, an Indian-owned business.

The Marketplace

- Oil rose 2.8% on the week with Brent at USD 57.8
- Gold rose 2.2% to \$1305
- Miners led a six month high in commodities
- Global stock indices rise

Market Focus

US

- The S&P 500 Index closed at 2553 (up 0.2%) in yet another record breaking week
- 10 year Treasury yields remained steady on the previous week at 2.3%
- Another record broken with The Dow Jones index ended the week at 22872, up 0.4%
- The Nasdaq was up 0.5% at 6092, another record
- September core inflation rose below expectations (1.34 vs 0.2 month-on-month) meaning expectations have been missed on six out of the last seven months
- Donald Trump equivocates over the Iran nuclear deal. Talk of scrapping it all together toned down to a strengthening of existing restrictions

UK

- British economy has dropped to the bottom of the group of seven growth league
- Consumer price index is likely to show inflation running at 3%, throwing doubt on an expected rate rise in November

- The FTSE was up 0.2% on the week, closing at 7535
- Contingency planning for no deal in Brexit talks underway. Theresa May due to fly to Brussels on an unannounced visit to attempt to break the deadlock over the exit bill

Europe

- ECB consider halving QE next year
- The Eurostoxx has been at its calmest since 1991 based on 30-day historic volatility. Finished the week +0.2% at 3609
- Austria's far-right Freedom party set to join a coalition government
- The Dax increased 0.3% to 12992
- Catalonia declared independence but immediately suspended it. A market friendly move that sent the Ibex surging and tightening the spread between Spanish and German bonds

Asia

- The Nikkei was up 2.7% at 21256
- The Hang Seng finished the week up 0.8% at 28692
- Japanese steelmaker Kobe's shares declined by 40% over the week after it emerged the company has been falsifying quality statements for possibly more than a decade. One in of long line of corporate scandals to hit Japan recently
- China's CPI for September was in line with expectations at 1.6% year on year

John Hinde & James Jones

| Asset Class/Region | Currency | Currency returns | | | |
|-------------------------------------|----------|--------------------------|---------------|----------|-----------|
| | | Week ending 13 Oct. 2017 | Month to date | YTD 2017 | 12 months |
| Developed Market Equities | | | | | |
| United States | USD | 0.2% | 1.4% | 15.3% | 21.5% |
| United Kingdom | GBP | 0.3% | 2.4% | 9.1% | 12.3% |
| Continental Europe | EUR | 0.2% | 0.7% | 12.9% | 21.8% |
| Japan | JPY | 1.3% | 2.0% | 14.7% | 30.0% |
| Asia Pacific (ex Japan) | USD | 2.1% | 3.9% | 31.8% | 27.5% |
| Australia | AUD | 1.8% | 2.3% | 6.3% | 11.8% |
| Global | USD | 0.7% | 1.4% | 17.7% | 22.3% |
| Emerging markets equities | | | | | |
| Emerging Europe | USD | 2.7% | 2.4% | 17.4% | 28.7% |
| Emerging Asia | USD | 2.0% | 4.5% | 37.7% | 31.7% |
| Emerging Latin America | USD | 0.4% | 1.7% | 28.9% | 23.0% |
| BRICs | USD | 0.8% | 4.2% | 38.6% | 33.1% |
| MENA countries | USD | -1.6% | -1.4% | -0.5% | 12.0% |
| South Africa | USD | 5.6% | 7.4% | 20.4% | 26.2% |
| India | USD | 1.8% | 3.6% | 30.3% | 22.5% |
| Global emerging markets | USD | 2.1% | 4.1% | 33.0% | 29.3% |
| Bonds | | | | | |
| US Treasuries | USD | 0.5% | 0.3% | 2.7% | -0.7% |
| US Treasuries (inflation protected) | USD | 0.7% | 0.5% | 2.4% | 0.3% |
| US Corporate (investment grade) | USD | 0.6% | 0.6% | 5.8% | 3.1% |
| US High Yield | USD | 0.0% | 0.2% | 7.2% | 8.6% |
| UK Gilts | GBP | 0.3% | 0.0% | -0.1% | -1.5% |
| UK Corporate (investment grade) | GBP | 0.1% | 0.1% | 2.7% | 2.5% |
| Euro Government Bonds | EUR | 0.5% | 0.4% | 0.0% | -1.9% |
| Euro Corporate (investment grade) | EUR | 0.4% | 0.4% | 2.2% | 1.5% |
| Euro High Yield | EUR | 0.3% | 0.5% | 6.5% | 8.3% |
| Japanese Government | JPY | 0.0% | 0.0% | -0.3% | -1.8% |
| Australian Government | AUD | 0.2% | 0.4% | 2.3% | -0.3% |
| Global Government Bonds | USD | 1.0% | 0.3% | 6.1% | -0.3% |
| Global Bonds | USD | 0.9% | 0.3% | 6.7% | 1.4% |
| Global Convertible Bonds | USD | 0.3% | 0.8% | 10.1% | 8.7% |
| Emerging Market Bonds | USD | 0.4% | 0.3% | 9.0% | 4.1% |

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| Asset Class/Region | Currency | Currency returns | | | |
|---------------------------------------|----------|--------------------------|---------------|----------|-----------|
| | | Week ending 13 Oct. 2017 | Month to date | YTD 2017 | 12 months |
| Property | | | | | |
| US Property Securities | USD | 1.7% | 2.0% | 4.7% | 5.3% |
| Australian Property Securities | AUD | 1.1% | 0.2% | -5.1% | -3.6% |
| Asia Property Securities | USD | 1.0% | 2.8% | 24.8% | 21.2% |
| Global Property Securities | USD | 1.4% | 1.9% | 14.0% | 12.9% |
| Currencies | | | | | |
| Euro | USD | 0.9% | 0.2% | 12.4% | 7.0% |
| UK Pound Sterling | USD | 1.9% | -0.7% | 7.6% | 8.5% |
| Japanese Yen | USD | 0.8% | 0.7% | 4.6% | -7.3% |
| Australian Dollar | USD | 1.5% | 0.6% | 9.6% | 4.2% |
| South African Rand | USD | 3.4% | 2.0% | 3.1% | 7.4% |
| Swiss Franc | USD | 0.4% | -0.5% | 4.5% | 1.2% |
| Chinese Yuan | USD | 1.1% | 1.0% | 5.8% | 2.4% |
| Commodities & Alternatives | | | | | |
| Commodities | USD | 2.2% | 1.2% | -0.3% | 2.2% |
| Agricultural Commodities | USD | 0.7% | 1.1% | -2.7% | -1.7% |
| Oil | USD | 2.8% | -0.6% | 0.6% | 9.9% |
| Gold | USD | 2.2% | 1.4% | 12.9% | 3.4% |
| Hedge funds | USD | 0.0% | 0.3% | 4.8% | 6.3% |

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