IMPERIUM CAPITAL momentum NEWPORT

Weekly Digest

Week ending **19 March 2017**

Trump and the Fed stick to the script

The Federal Reserve's interest rate decision and President Trump's skinny budget dominated midweek headlines last week, with the general election in The Netherlands providing further intrigue. The two events in the US may be said to have stuck to script, thanks to the effective management of expectations in their build ups, whereas a democratic vote judging on repeated evidence in the past 12 months, appeared to risk more of a surprise. Oddly, The Netherlands' rejection of the far right candidate Geert Wilders and re-election of incumbent Prime Minister Mark Rutte was surprisingly unsurprising in a political environment that has taught us all to expect the unexpected. Markets tend not to like uncertainty, but the European Union will no doubt have been toasting the success of Prime Minister Rutte as a modest shoring up of the status quo following a year in which the bloc has come under substantial scrutiny. What this means for Marine Le Pen's bid in the French presidential election in little over a month's time remains to be seen, but tellingly it is a step back from a similar type of populism within a northern European peer.

On Wednesday evening the Federal Reserve undertook the second hike in interest rates in three months to a target range of 0.75%-1.00%. Even with two of the last three meetings yielding a hike, this is also only the third time that interest rates have been put up in ten years; such is the depth and length of the global economy's post financial crisis woes. Indeed, even though the US has tightened, the move has been dubbed a 'dovish hike' after the measured tone of the post-meeting statement. Furthermore, not all members of the committee agree that it is necessary to increase rates at this juncture and this resistance will keep expectations of further raises in check. It is pleasing to see that the market is now relatively sanguine with respect to interest rate raises. A couple of years ago the thought of monetary policy tightening was greeted with dismay but now, thanks either to excellent communication from the Fed, or greater positivity on the US economy (or both), the market was relaxed about the move. The increase in rates had been well telegraphed ahead of the event and this will certainly have helped to avoid nasty surprises. The only downside to this approach is that monetary policy changes tend to be more effective when they are a surprise. For now the Fed will be happy to be able to put interest rates up without too much chagrin.

President Trump also stuck to his script with his 'skinny budget' last week. This is essentially a wish list for newly elected presidents and can highlight their likely direction of travel in terms of policies and approach. Despite being unusually low on detail, the broad thrust was clear. The likely beneficiaries are defence and homeland security. Foreign aid, clean energy related expenses and public sector broadcasting are likely to be areas from which costs are shaved as well as the widely publicised rescinding of Obamacare. Following the event commentators were keen to identify sectors that are expected to benefit from the president's largesse and those that will suffer from the cuts. The obvious place to expect increases in profits are defence stocks as an increase in spending should lead to higher revenues for defence companies. Thematic investing on the basis of such unsubstantiated information can be dangerous, however. It was only a couple of months ago that President Trump used his inauguration speech to berate the F-35 fighter programme and commit to shaving hundreds of millions of dollars from the cost of the fighter which, even in the world of multi-billion dollar procurement contracts, could mean the difference between good and bad business for the supplier. As a result an increase in defence spending need not translate into increased profitability if the US government negotiates well. Similarly the healthcare stocks that were savaged post Trump's election have recently rallied as the market has realised things may not be as bad as first thought. Often it pays to take a longer term view in this and we would rather make investments on the basis of fundamentals ahead of a theme that may prove to be unfulfilled in time.

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

The **Marketplace**

- Fed carries out expected US rate hike
- Liberal Party wins most seats in Dutch election
- BoJ & BoE hold tight on policy
- Emerging markets outperform as China raises rates
- UK Parliament passes Brexit bill

Market **Focus**

US

- On Wednesday the Federal Open Markets Committee (FOMC) voted to raise the US Federal Funds rate by 25 basis points to a 0.75-1% target range. The hike was the first of 2017, with FOMC members, on average, forecasting two more hikes this year.
- Despite the increase in interest rates, the FOMC member forecasts for long term rates were below what some had expected pre-meeting. As such the dollar sold off following the meeting, dropping 0.9% on the day. Conversely equities and government bonds rose following the meeting, with yields on 10-year Treasuries, which move inversely to prices, falling to 2.49% intraday, their lowest since June 2016.
- For the week the dollar index retreated 0.9%, while US equities and government bonds rose 0.3% and 0.5%, respectively.

Europe inc. UK

- Voters went to the polls on Wednesday in the Dutch general election. It resulted in the mainstream VVD party, led by longstanding Prime Minister Mark Rutte, coming top by gaining 33 out of the 150 parliamentary seats. The closest rival was the far-right PVV Party, led by controversial populist Geert Wilders, who gained 20 seats.
- Although Wilders's party was never likely to gain power, the result assuaged fears that the populist tide following Brexit and Trump's election would spill over into Europe ahead of French and German elections in 2017. The VVD now has to try to form a majority coalition, with a four party majority the most likely eventual outcome.
- Continental European equities outperformed for the week, rising 1.2%, while the euro appreciated 0.7% versus the US dollar, ending the week at USD 1.07.
- In the UK, the Bank of England's Monetary Policy Committee left the base interest rate unchanged at 0.25% in their monthly meeting Thursday. Only one member of twelve, Kirsten Forbes, voted to raise rates.
- On Tuesday, the UK Parliament voted by 274 votes to 118 to pass the Brexit bill, which later gained Royal Assent to become law, meaning Prime Minister May is free to trigger Article 50 and begin formal negotiations for exit terms.
- Sterling fell 0.5% versus the dollar on Tuesday, but rose 1.8% over the week to finish at USD 1.24. UK equities, meanwhile, recorded a 1.3% weekly gain.

Japan

- The Bank of Japan's monetary policy meeting produced, as expected, no changes to the current interest rate or asset purchasing regime. Market reactions were minimal, but the Fed's rate hike highlighted the increasingly divergent path of developed central banks.

Emerging Markets

- Emerging market equities outperformed, as the MSCI Emerging Markets index rose 4.3% to record its largest weekly gain since 8th-15th July last year.
- On Wednesday, China, which dominates emerging market indices, increased borrowing costs on short term (7, 14 and 28 day) reverse repurchase contracts by 10 basis points, in a bid to curb the increasing indebtedness within the economy. The Chinese offshore renminbi fell 0.8% versus USD following the announcement.

James Klempster (CFA) & Oliver Bickley

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Weekly Digest

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Asset Class/Region	Currency	Currency returns			
		Week ending 17 March 2017	Month to date	YTD 2017	12 months
Developed Market Equities					
United States	USD	0.3%	0.7%	6.6%	18.3%
United Kingdom	GBP	1.3%	2.5%	5.1%	24.6%
Continental Europe	EUR	1.2%	3.1%	5.7%	16.0%
Japan	JPY	-0.5%	2.0%	3.2%	17.8%
Asia Pacific (ex Japan)	USD	3.6%	3.1%	12.8%	20.2%
Australia	AUD	0.5%	2.1%	3.6%	17.2%
Global	USD	1.0%	1.4%	6.8%	15.7%
Emerging Market Equities					
Emerging Europe	USD	4.6%	2.7%	2.4%	14.8%
Emerging Asia	USD	4.5%	3.6%	13.6%	21.5%
Emerging Latin America	USD	2.6%	0.4%	11.8%	24.8%
BRICs	USD	3.5%	2.3%	12.3%	27.2%
MENA countries	USD	0.0%	-0.7%	0.8%	12.0%
South Africa	USD	6.4%	6.8%	11.8%	20.6%
India	USD	4.2%	5.1%	16.4%	25.3%
Global Emerging Markets	USD	4.3%	3.2%	12.2%	21.0%
Bonds					
US Treasuries	USD	0.5%	-0.7%	0.0%	-1.4%
US Treasuries (inflation protected)	USD	0.8%	-0.8%	0.6%	2.2%
US Corporate (investment grade)	USD	0.6%	-1.0%	0.4%	3.8%
US High Yield	USD	0.2%	-0.9%	2.0%	15.9%
UK Gilts	GBP	0.4%	-0.7%	0.5%	6.0%
UK Corporate (investment grade)	GBP	0.1%	-0.4%	1.1%	9.2%
Euro Government Bonds	EUR	0.2%	-1.5%	-2.4%	-2.1%
Euro Corporate (investment grade)	EUR	0.2%	-0.8%	-0.2%	2.5%
Euro High Yield	EUR	0.1%	-0.2%	1.6%	9.2%
Japanese Government	JPY	0.3%	-0.2%	-0.6%	-1.4%
Australian Government	AUD	0.8%	-0.5%	0.2%	0.8%
Global Government Bonds	USD	1.2%	-0.7%	0.6%	-3.8%
Global Bonds	USD	1.0%	-0.6%	0.7%	-2.4%
Global Convertible Bonds	USD	0.8%	0.4%	3.5%	4.3%
Emerging Market Bonds	USD	0.9%	-0.2%	3.2%	7.4%

Source: Bloomberg

Asset Class/Region	Currency	Currency returns			
		Week ending 17 March 2017	Month to date	YTD 2017	12 months
Property					
US Property Securities	USD	2.4%	-3.4%	-0.2%	2.5%
Australian Property Securities	AUD	1.6%	-0.6%	-2.3%	0.6%
Asia Property Securities	USD	2.4%	2.0%	10.5%	11.8%
Global Property Securities	USD	2.6%	-1.0%	3.5%	4.4%
Currencies					
Euro	USD	0.7%	1.3%	2.1%	-5.1%
UK Pound Sterling	USD	1.8%	-0.2%	0.3%	-14.4%
Japanese Yen	USD	1.9%	-0.6%	3.9%	-1.1%
Australian Dollar	USD	2.3%	0.4%	7.1%	0.8%
South African Rand	USD	3.6%	3.0%	7.6%	19.2%
Swiss Franc	USD	1.4%	0.7%	2.2%	-2.9%
Chinese Yuan	USD	0.1%	-0.5%	0.8%	-6.1%
Commodities & Alternatives					
Commodities	USD	1.0%	-3.5%	-2.3%	8.2%
Agricultural Commodities	USD	0.6%	-0.6%	2.4%	4.5%
Oil	USD	0.8%	-6.9%	-8.9%	24.6%
Gold	USD	2.3%	-2.1%	6.7%	-2.3%
Hedge funds	USD	0.3%	0.1%	1.8%	6.8%

Source: Bloomberg

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