NBAD

From West to East

Weekly Investment View

22nd of January, 2017

Yes, this US Presidency will really be different

Most equity markets were very calm last week, largely taking Donald Trump's inauguration on Friday as US President in their stride. The S&P500 closed a few points lower on the week, at 2,271.31. The yield on the US 10-year Treasury bond, however, closed 7 basis points higher, at just below 2.47%. The dollar index was 0.4% lower, at 100.74. Oil prices rallied by 3% towards the end of the week, with WTI therefore closing little changed on the week, at $52.42, as investors await feedback from the OPEC-led production compliance committee meetings this weekend in Viena. Regarding one or two day price movements in oil, about 3% or so either way now seems quite normal, and within the realms of what investors should expect. **Lastly, it has been underlined that Trump's energy policy is pro-fracking, although they will work with Gulf interests as and when it suits the US.**

"Trump stuck very much to the script in his inauguration speech"

Many of our readers will have watched Donald Trump's inauguration speech, in which he returned to his central election theme of 'Making America Great Again'. The new President didn't hold back in any way whatsoever, making a powerful (and well-delivered) populist speech, pledging to put 'America first', with repeated promises to get jobs 'returned' to the US. The rest was familiar, including the direct comment that "Protection will lead to great prosperity and strength", and that he would "…fight for you with every breath in my body, and I will never ever let you down". **His remarks regarding the 'draining of the (Washington) swamp' must have been felt acutely by many of those sitting close to him, and/or with him at the official luncheon event an hour or so later.**

Commentators have made something of the views on the dollar expressed by Steven Mnunchin (Trump's proposed Treasury Secretary) during his Senate confirmation hearing on Thursday, seemingly at odds with Trump's own latest comments on the currency. The latter had expressed concern about the damage to exports done by a strong dollar, whereas Mnunchin said a firming dollar was desirable in terms of making the US attractive for purposes of foreign direct investment. We can be sure that these two gentlemen will confer more closely in future – although it does depend on the context, with both views being correct in their own way. The answer lies in a compromise, that the dollar should ideally rise, albeit gradually. In that eventuality exports and foreign-based earnings upon translation would not be hurt too much (and the dollar cost of imported basic materials and goods would be lower than otherwise) on the one hand, while prospective buyers of dollar-based assets would enjoy a measure of exchange gains. So we think it would be highly unlikely that the new Administration would favour a weak dollar policy. **President Trump probably had the Chinese renminbi in the front of his mind at the time he expressed that concern.**

"A US equities correction could be about to begin, and should be bought into in the weeks to come".

As mentioned in last week's 'NBAD Global Investment Outlook 2017', we expect equity markets to be on the downside for the next few weeks, although not sufficiently for holders to trim positions with the aim of buying them back lower profitably after dealing costs. We would regard this as a buying opportunity. In sentiment terms, it seems likely that the markets might begin to get slightly impatient if more information regarding policies is not forthcoming quite soon. In the meantime, the negatives are being rolled out: insiders are saying that by this stage the new Administration should have more of its proposed team in place, with only about 30 close to being finalized; the new team won't be able to finance its fiscal plans, and lowering government tax revenues at a time of increased spending will boost debt levels beyond what is acceptable; we have been reminded not to

Claude-Henri Chavanon

Managing Director
Head of Global Asset Management

forget the new President's Trump's misogynist rhetoric, and against the embarrassment of widespread anti-Trump rallies; lastly, for instance, he has been described as 'an imposter' - and so on. Mr Trump is certainly not averse to a change in view, whether it be on Obamacare or climate change. **Also, it has been observed that he probably uses 'chaos theory' to gather information before making decisions.**

Donald Trump has spent his career doing deals, certainly, and isn't a politician, we don't think that will matter very much. Investors have begun to understand that while the array of people (from some interesting backgrounds, if mainly from business) have yet to demonstrate they can come together and be marshalled as a team, Trump has undoubtedly surrounded himself with a collection of very smart people, various of whom are expert in raising – or making – money. **Warren Buffet himself, in an interview a few days ago, said he isn't worried, and that he believes the stock market will be fine, as the US has "the secret sauce".**

"Washington is in for a huge shock".

So, yes, it's going to be different in Washington, with policy-making likely about to be thoroughly shaken-up. If Japan's Mr Abe can roll out 'Abenomics' – with all that has implied for the size of the BoJ's balance sheet, for instance – then it could very well be that new policy on a truly grand scale is something that investors should now get used to, in addition to populism and nationalism. **Intractable problems (in this case, low growth, deflation, or dis-inflation) in developed markets arguably do require 'big' solutions.**

In market terms, however, we like to see a 'wall of worry' building, especially one that we expect can be climbed. Despite the description of America's large industrial wastelands in his speech, Trump's message is essentially one of optimism – and doing things very differently, very much in a disruptive fashion. Above all, Trump and his Administration will be business-friendly, and we don't for a moment believe they are about to put at nought the new optimistic level of business confidence by needlessly starting trade wars. **Rather, the rhetoric oftentimes sounds like a negotiating ploy, probably rather like that being used by UK Prime Minister Theresa May as she goes about establishing the UK's economic position outside the EU.**

"We're not afraid of Trump's team applying new methods"

If US corporation taxes are cut, the largest companies will be more inclined to bring their cash hoards back home – and will probably invest a good part of these monies in the US, leading to even more 'multiplier effects', and boosting US growth. We would expect the Trump team to find ways to bring those who should be in the workforce into it (or back into it), via training schemes, in other words to make the US labour market less tight than a basic unemployment rate of 4.7% suggests. Janet Yellen talks about this often, and links it with a complaint that the level of US labour productivity is too low. Looking abroad, the leaders of the world will have to get used to a new frankness, regarding comments and actions global 'dumping', or the effects of letting a million or so migrants into Europe, or the realities of whether or not the Eurozone has worked. **The Eurozone is the exact reverse of most of what Trump and his Administration will stand for.**

Janet Yellen gave a speech last week in which she said the US risked the possibility of some "nasty" surprises if the Fed waited too long before raising rates again. She apparently wants to guard against the US economy running too hot, resulting in inflation moving up sharply. Reading between the lines, and thinking back to Ms Yellen's last Q&A with the press following December's FOMC meeting, she had said then that some of her colleagues had begun to factor-in the possible effects of the new Administration's policies, with the implication that not all had done so. The approach of the inauguration, together with the announcements of senior Trump advisors will have concentrated their minds in relation to what might lie ahead this year. While we are looking ahead to some exciting times once the (probably inventive) reality hits, it is of course the Federal Reserve's role to be cautious. **She is also reported to have commented that the downward pressure that the Fed's approximate $4.5 trillion balance sheet has been exerting on rates over several years is declining, making it more difficult to correctly enact interest rate changes.**

"Theresa May took her place on the World Economic Forum stage last week".

Commentators have said that British Prime Minister Theresa May's speech at Davos last week, in which she made it clear she was actually prepared to follow-through on Brexit, wasn't received very well. The question remains, however, is she? A few short weeks ago she said she was intending to bear in mind the views of the 48% of the electorate who had not voted for Brexit. At Davos, Mrs May said that the UK was intending to step up to a new leadership role in the global economy after Brexit. The speech itself contained few new details of Britain's Brexit strategy for when it triggers Article 50 to leave the EU. Leaving the EU would force the UK to leave the single market, while staying would have required ensuring freedom of movement of people. Staying, however, would prevent bilateral trade deals being negotiated with countries such as the US and China. According to Bloomberg, Mrs May is now set to visit President Trump and his team next Friday to discuss a post-Brexit trade accord. Either way, sterling will likely begin to recover some of its lost ground once investors begin to get a sense of what is actually going on. **With some patience, cable could trade once again in the $1.35-1.40 area, perhaps by later this year.**

Last week the ECB decided to keep its main interest rates on hold for the rest of this year, in a distinctly dovish move. Mario Draghi was apparently very apologetic to German savers regarding the maintained level of rates and the hardship that entails. Asset purchases are to continue to the end of 2017, or beyond if necessary. This move will prolong the policy divergence between the ECB and the likes of the US, whose monetary policy is heading in the other direction. **Thus euro weakness will be perpetuated, as will the favourable effect on export and therefore corporate earnings across the Eurozone – and this will further enhance the immediate prospects for holders of Eurozone equities (and also bonds).**

Chinese officials last week announced that the country's GDP growth rate averaged 6.7% in 2016, down from 6.9% in 2015. The annualized growth rate for the fourth quarter along came in at 6.8%, slightly ahead of forecasts. Fixed asset investment slowed to 8.1%. We continue to be skeptical (like many) regarding the actual GDP growth rate, and think the real rate is in the 5% region (although of course we can't prove it!). Despite high debt levels at State Owned Entities, China has continued to side-step the so-called 'hard-landing' that has been forecast for so long. **We continue to watch with interest, waiting for the time when estimate revision for the major Chinese equity indices begins to turn positive.**

For any inquiries related to this article, please contact Alain.Marckus@nbad.com or Clint.Dove@nbad.com