Range-trading going into the summer

US-China trade talks continue, with the trade war on hold

The cancelled US-North Korea summit could be back on

Political uncertainty in Spain has added to that already in Italy

Apart from in certain asset classes, markets are reasonably calm

US banking regulations are about to be relaxed - this is bullish

INVESTMENT SUMMARY: The FAB Asset Allocation Committee is scheduled to meet later this week, pending which investment policy remains unchanged. Global equities are only slightly overweight in our models. Our favourite countries for the medium-term are China and India. Global bonds are neutral. Cash is quite overweight, with the intention to reinvest this in equities before the fourth quarter, which we expect to be very strong. The outlook for global Information Technology is excellent, and sustainable.

Major Events: The markets were rather sanguine about President Trump's decision to cancel his upcoming summit with North Korea, almost as though after aggressive rhetoric from the North Koreans it had been the right thing to do. North Korea's response, however, was professionally cordial, and it looks as though the meeting could now be back on. Certainly the surprise meeting over the weekend between the Presidents of South and North Korea in the DMZ bode well, even if the situation is rather volatile. The lack of engagement from the North Korean side for the Singapore meeting means President Trump and President Kim might keep protocol to a minimum. In Europe, some political uncertainty reared its head in Spain, with the main opposition party demanding a vote of confidence in the government, having said government officials are implicated in corrupt dealings. This is superimposed on the difficulties the new Italian ruling coalition appears to be having finding ministers acceptable to the Italian President. Worries that the new populist coalition will cause difficulties for the EU and its leadership seem very real, and a factor forcing the euro lower last week. At the beginning of the week markets accepted the inevitable political result in Venezuela, and then marked oil prices lower with the news that OPEC and Russia intend to increase oil production (by about a million barrels/day) to offset sharply falling production in Venezuela, as well as reductions in deliveries from Iran. **Meanwhile, the latter has demanded financial recompense from those nations still in favour of keeping the Iran oil deal alive - but in reality the practical issues of European corporates (and banking systems) being non-compliant with US authorities is likely to determine what happens.**

The Markets: Given the events discussed above, global equities in terms of the MSCI All Country World index closed 0.43% lower over the week, 'developed' being -0.47%, and 'emerging' being -0.10%. Within developed markets, European stocks closed 0.91% lower, with European auto-makers like BMW, Daimler & Volkswagen hit by an announcement that the US is launching an investigation into automotive imports on the grounds of 'national security', similar to steel and aluminium. US equities were resilient last week - the S&P500 was 0.31% to the good - displaying on the one hand sector rotation to defensive sectors (such as utilities) on weaker days, yet with Information Technology doing well over the week as a whole - as evidenced by the NASDAQ Composite index gaining 1.08%. Global bonds, as measured by the Bloomberg Barclays Global-Aggregate index, closed 0.48% higher, with the slightly nervous tone translating into some renewed demand for 'haven' bonds, consistent with a fall in the US 10-year Treasury yield of 12 ½ basis points (to 2.9313%). The barrier of 3.00-3.02% seemingly needs more time to be broken convincingly, and participants may well have become prematurely bearish of the asset class. Related to this were the minutes of the Federal Reserve's last policy meeting being interpreted dovishly, although in truth they matched the statement after that meeting: the Fed intends to increase rates gradually. Also underlined was a willingness to permit inflation to run higher than the 2% target (it is 'symmetrical'). The German 10-year Bund yield collapsed by just over 17 basis points last week (to 0.406%), as investors concentrated on the safer parts of the EU, bond-wise, and bearing in mind that the minutes from the ECB's policy meeting last month underlined that economic uncertainty in the bloc had increased, so frustrating concrete moves towards monetary normalization. Consider for instance that Markit's Eurozone Composite PMI for May came in at 54.1, down from 55.1 in April, and vs. a recent high of 58.8 in January. In foreign exchange markets, the dollar closed 0.66% firmer on its index (DXY) to 94.253, reflecting a euro/dollar pair that was 1.03% lower (at $1.1651), and sterling, which weakened by 1.19% (to $1.3309, affected by weaker-than-expected inflation, and BoE comments regarding the difficulties a disorderly Brexit could bring), partly offset by some weakness vs. the yen (at ¥109.41). The MSCI Emerging Markets Currency index was much steadier, up 0.35%, although the Turkish lira continued weakening despite Wednesday's 300 basis point rate hike by its central bank (see separate paragraph). In commodities, Brent crude closed a few dollars lower over the week (at $76.44/barrel), with its spread above WTI widening to $8.56. **Gold closed $9.21 higher (at $1,302.25/oz), in moderate 'haven' fashion.**

US ECONOMIC POLICY UPDATE: Early last week the US Congress passed the 'Economic Growth, Regulatory Relief and Consumer Protection Act', which effectively rolls back many of the restrictions imposed on banks by the 2010 Dodd-Frank Act. Only banks with less than $ 50 billion in assets are affected, meaning the 13 largest US financial institutions continue to be crippled by the post-crisis legislation. The new legislation, soon to be signed-off by President Trump, has the potential to accelerate economic growth ahead of November's mid-term elections. Banks with less than $10 billion in assets will be allowed to ease mortgage lending standards. That could boost home prices, a key component of the wealth effect in the US. In addition, credit unions, previously restricted from most mortgage lending under Dodd-Frank, will now again be able to create home loans for investment and for business properties. All these institutions will be able to lend to people with lower credit scores, and borrowers will have smaller down-payments. After its enactment, these lenders will simply have to abide by a leverage ratio of more than 8%. Finally, institutions with less than $50 billion in assets will be exempt from proprietary trading restrictions – leaving only a dozen very large institutions (e.g. Citibank, JP Morgan and Wells Fargo) restricted from using their own balance sheets to trade stocks and bonds. The legislation can be expected to bring back low documentary requirements and sub-prime mortgages, therefore helping to spur home prices, subject to Fannie Mae and Freddie Mac's appetites for lower credit standard loans. These lending agencies, however, are widely expected to restart purchases of these mortgages to provide lending to lower-income families. After five years of falls, the average US home price has increased 24% since the start of 2013, increasing approximately 5% per annum during this period. That recovery was at a much slower pace than the double-digit rises in the years leading up to the 2008 financial crisis. Data suggests that about 5.6% of US economic expansion stems from rising home prices. Hence, a rally in home prices would cause US GDP to expand faster, something that would impact stocks and inflation. US equities tend to front-run moves in home prices so it is not exactly clear to what extent the passage of the bill is already priced into the S&P500. Specific sectors, such as homebuilders and the smaller lenders (all of which should see an increase in return on equity) could catch a useful tailwind. **The move is likely to be inflationary, in time hitting US Treasury yields, causing them to rise further.**

AN UPDATE ON TURKEY: The Turkish central bank made a flash decision last week to increase its policy rate by 300 basis points (to 16.5%, the highest since 2014). The Turkish lira recovered about 5.5% on the back of this, but then gave back all of that gain, suggesting possible further weakness. It may be premature to expect more aggressive moves by the central bank in the short-term, given the impending 24th June election. The bank was already hamstrung by President Erdogan, who wanted to ensure the economy was humming ahead of the polls. In all likelihood he will change policies once he is confirmed, to fix the problems that made the lira a shorting target as US yields rose. The fall in the lira will resolve some of the problems that brought about its plunge: the country's stubborn current account deficit should reverse over time as Turkish products become cheaper and imports get more expensive (a caveat being investments outflows, which may accelerate). Inflation could further accelerate as imports become more expensive. There is a risk that last week's move could trigger corporate defaults in Turkey, affecting financial institutions. Official data indicates that at 31st December, Turkish companies owed $316.4 billion in foreign debt, 84% more than at the end of 2009, after the financial crisis. About 13% of that is in bonds, whereas in 2009 the percentage was close to zero. Bonds tend to react quite quickly to currency issues and can be the catalyst for bankruptcies. The industry most likely to suffer in that case is banking. Not only are they the biggest issuers of foreign currency bonds, they are also the biggest lenders to Turkish companies. Accordingly, Turkish bank stocks could be vulnerable. A rise in defaults would increase non-performing loans and spur higher provisioning, forcing lenders to seek new equity. Ultimately, that could trigger a second round of pain down the line for the country. **We are watching events carefully in Turkey as they unfold.**

Alain.Marckus@bankfab.com
Clint.Dove@bankfab.com

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