# FFTW Weekly Commentary

FOR PROFESSIONAL INVESTORS

# Failure to Launch

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## Key takeaways

- Market participants are abandoning the "Trumpflation" trade leading many to question support for yields and spreads at these levels
- The track record of policy implementation would appear to suggest that this skepticism is warranted
- We should look at a broader picture of opportunities and data before concluding that the post-November moves were unjustified

## Full commentary

"Failure to Launch" is a 2006 film starring Matthew McConaughey and Sarah Jessica Parker which is forgettable in almost every way, bar two. First, McConaughey's character has a stunning 1973 Porsche 911 2.4 which purists point out has been modified from the original, but for those who like such things, this film is worth watching for the car alone: there are, in truth, few other reasons to do so. The second is the title, which perfectly captures the flattening mood around any chance of meaningful reform from the US Administration, and Congress. It evokes nothing so much as a balloon deflating.

We have had, in short order, the failure to "repeal and replace" Obamacare, followed by the House of Representatives passing a bill that in its current form stands no chance of passing the Senate. This matters because it takes up legislative time that could be used elsewhere. We have had two executive orders on immigration that have been both struck down by Federal courts. At best, this communicates that the Administration's sincerity in effecting change promised on the campaign trail, and might reinforce voters' beliefs in the need for change so clearly being obstructed. Unfortunately it also seems to have communicated that there are deep fissures within the Administration, and raises questions as to administrative competence. The tax plan, while bold, is not deficit-neutral and nor do its benefits seem to fall equally enough on a broad range of taxpayers as to ensure easy passage. The stance on trade renegotiation has retreated enormously from the stated positions during the elections and while it remains to be seen what comes of this, one possible conclusion is a perception of a lack of follow-through from position to action. We may also be seeing the same thing with respect to foreign and defense policy, with the intervention in Syria both antagonizing supporters, and seeming not to form part of a broader change in policy. Against this, clearly there have been roll-backs of regulation, specifically as it relates to environmental protection, and an appointment in Justice Neil Gorsuch to the Supreme Court. However, looking only at the pattern of implemented policies versus ones that have stalled or which may never be implemented, this has been a challenging start for the Trump Administration. The firing of FBI head James Comey only adds to this. Leaving aside more lurid speculation, the appointment of his successor promises further to tie up the legislative agenda, and frustrate progress on healthcare reform, tax cuts, and infrastructure spending.

This "failure to launch" has caused market participants to question giddy assessments following the election that saw 10 year US bond yields rise to as high as 2.60%, and which has seen spreads narrow (using the Markit CDX North American Investment Grade Index (CDX IG) as a proxy) from over 80 basis points to as low as 54. Equities have also managed to make new record highs, and the analog of this has been the CBOE Volatility Index (VIX) measure of equity options volatility falling to lows not seen for 20 years – as the Chart of the Week shows. Worse, recent data has not been supportive of the reflation theme. Inflation and gross domestic product (GDP) data have both been a little soft, and while reported consumer confidence remains strong, that has not fed through to retail sales. So, if "Trumpflation" isn't happening, should we also say goodbye to risk asset valuations at their current levels?

## This week's market developments

**Monday, May 8**

- Germany factory orders growth decreased to 1.0% m.o.m. (s.a.) for March

**Tuesday, May 9**

- Germany industrial production growth decreased to -0.4% m.o.m. (s.a.) for March
- US wholesale inventories growth increased to 0.2% m.o.m. (s.a.) for March

**Wednesday, May 10**

- France industrial production growth increased to 2.0% m.o.m. (s.a.) for March

**Thursday, May 11**

- UK industrial production growth increased to -0.5% m.o.m. (s.a.) for March
- UK manufacturing production growth decreased to -0.6% m.o.m. (s.a.) for March
- US PPI final demand growth increased to 0.5% m.o.m. (s.a.) for April

**Friday, May 12**

- Germany 1st Quarter GDP growth (prelim estimate) increased to 0.6% q.o.q.
- US CPI growth increased to 0.2% m.o.m. for April
- US retail sales advance growth increased to 0.4% m.o.m. (s.a.) for April

Source: Bloomberg, as of May 15, 2017

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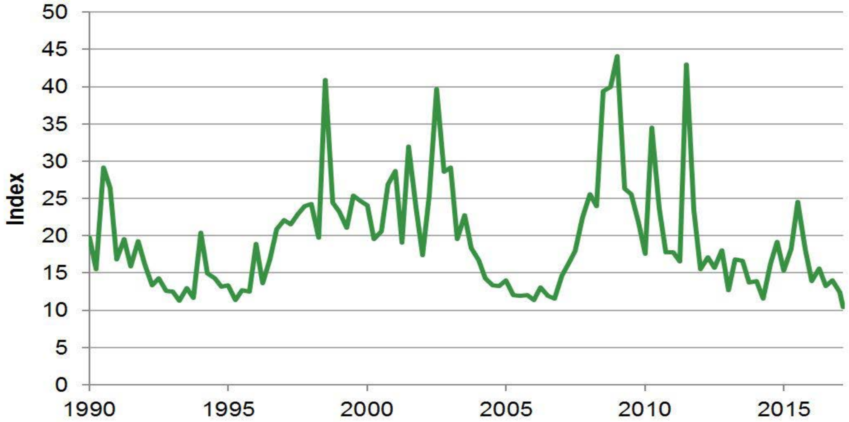
Perhaps. But it is worth considering that those same 10 year US Treasury yields are over 25 basis points lower now than they were in December. The US Dollar Index (DXY) is more than 4% weaker versus the currencies making up its basket. There is more. Unemployment continues to fall, as does the U6 measure of under-employment. Europe continues to defy predictions of gloom and emerging markets are, on average, performing well. It is undeniably the case that the frothiest expectations of what the incoming US Administration could implement are very unlikely to be achieved, and cannot be in anything like the timeframe once thought possible with control of all branches of Federal government. But we should be careful not to fall into the trap of assuming that this means a continuation of secular stagnation. The Federal Reserve is still raising rates. Other central banks continue to plan their withdrawal from policy accommodation. It may be worth reflecting on the view many had that pursuing pro-cyclical policies when the macroeconomic picture looked favorable was ill-advised. Can it also be bad when those policies are much less likely now to be implemented?

## Chart of the Week

### Chicago Board Options Exchange SPX Volatility Index (1/1/1990 – 5/15/2017)




Sources: Bloomberg, as of May 15, 2017

## Central Bank Watch

| | Last move | Date of move | Current policy rate | Implied 3-Month Rate on June 2017 Interest Rate Futures Contract | Next meeting |
|---|---|---|---|---|---|
| Fed | +25 basis points | March 15, 2017 | 0.75% - 1.00% | 1.00% | June 14, 2017 |
| ECB | -5 basis points | March 10, 2016 | 0.00 % | -0.18% | June 8, 2017 |
| BoJ | -20 basis points | February 16, 2016 | -0.10 % - 0.00% | 0.06% | June 16, 2017 |
| BoE | -25 basis points | August 4, 2016 | 0.25% | 0.32% | June 15, 2017 |

Sources: Bloomberg, as of May 15, 2017

## Next week's market developments

**Monday, May 15**

- US empire manufacturing is expected to decrease to -1.0 for May

**Tuesday, May 16**

- Japan Tertiary Industry Index growth is expected to decrease to 0.1% m.o.m. for March
- UK CPI growth is expected to remain at 0.4% m.o.m. for April
- UK Core CPI growth is expected to increase to 2.3% y.o.y. for April
- UK PPI output growth is expected to decrease to 0.2% for April
- Eurozone 1st Quarter GDP growth (prelim estimate) is expected to remain at 0.5% q.o.q.
- US housing starts are expected to increase to 1,260,000 for April
- US industrial production growth is expected to decrease to 0.4% m.o.m.

**Wednesday, May 17**

- Eurozone CPI growth is expected to decrease to 0.4% m.o.m. for April
- Japan 1st Quarter GDP growth is expected to increase to 0.5% q.o.q.

**Thursday, May 18**

- UK retail sales growth (ex auto/fuel) is expected to increase to 1.0% m.o.m. for April
- US Leading Index growth is expected to remain at 0.4% m.o.m. for April

**Friday, May 19**

- Eurozone consumer confidence (advance estimate) is expected to increase to -3.0 for May

Source: Bloomberg, as of May 15, 2017

## Disclaimer