

FFTW Weekly Commentary

FOR PROFESSIONAL INVESTORS

Politics as Usual?

November 28, 2016

by Tim Johnson
Head of Total Return Multi-Sector
timothy.johnson@fftw.com



Key takeaways

- U.S. growth continued with equities edging higher and multiple U.S. indices reaching all-time highs
- Many investors now believe that Trump will deliver a large unfunded fiscal stimulus, infrastructure spending, tax reform and de-regulation package
- Most emerging market rates have outperformed U.S. rates since the global steepening began in September

Full commentary

In a holiday shortened week in the U.S., the post-election euphoria fueled by speculation regarding the Trump administration calmed modestly but showed no significant signs of abating. The theme of improving US growth continued, equities edged higher with multiple US indices reaching all-time highs, discussions about economic stimulus as potential Treasury Secretary Nominees made headlines, and commodities inflation including industrial metals continued to rebound. The little new information that did impact markets during the week was consistent with the theme of Federal Reserve (Fed) rate hikes beginning in December and continued discussion about populism and the impact on politics and markets, with the current focus on Europe.

A new narrative has emerged about the macroeconomic and market implications of Donald Trump's agenda since his election as President. It seems that many if not most strategists and investors now believe that Trump will deliver a large unfunded fiscal stimulus, infrastructure spending, tax reform and de-regulation and that package will confirm America's economic prowess on the world stage. Treasury yields remained significantly higher and the yield curve flattened in anticipation of more growth, inflation and supply. High yield indices crept closer to their August highs as oil flirted with \$50 per barrel. The Dow, NASDAQ, and S&P 500 all reached all-time highs with each up 6, 8 and 9 percent, respectively, for the year, and about half of those gains occurring since the presidential election. Meanwhile, as of Tuesday afternoon, President-elect Trump was expected to name investment banker Steven Mnuchin as Treasury Secretary. This supports the market's belief that Trump would be good for banks and the financial sector. The S&P 500 financials index has outperformed the broader index since the election by over 8%. It seems that all of Trump's nominees have been subject to a positive spin by investors. His short list of Secretary of State Nominees includes Mitt Romney, who tried to disqualify Trump for running for president. Trump's reconciliation with Romney has been interpreted at least initially as a pragmatic move by a thoughtful president-elect who values experience and diplomacy over confrontational swagger.

There has been too little time since the election to determine if the economic data supports the "America will be great again", theme but preliminary reading on the Black Friday/Thanksgiving weekend shopping trends are as good a place as any to start. The National Retail Federation's survey (which samples 4,330 consumers) showed that while the number of shoppers rose by an estimated 3 million this year, the average spend was down -3.5% and the nominal decline in retail spending fell -1.5%. However, there appeared to be significant discounting as evinced by 50% of consumer saying "deals were too good to pass up". Thus in real terms, a notable year over year increase is very possible and the survey excludes activity on "Cyber Monday", which has become incrementally more important over the years.

While we believe there is some selection bias given the minimal focus on the potentially damaging protectionist measures Trump touted during the campaign. Financial markets have not supported our view. With the exception of perhaps Mexico, emerging market rates have not only outperformed US rates since the election and since the global steepening began in September, but also significantly in relation to the taper tantrum of 2013 when those rates had a positive but muted correlation to US rates. Copper was up 8% on the week, 15% since the election, and 27% on the year to \$5860 per metric ton, the highest level since June 2015, all in anticipation of a pickup in global demand, ostensibly led by the U.S.

The political theme was not confined to the U.S. In Europe, former Prime Minister François Fillon emerged victorious from the Republican primary process. The conservative Fillon defeated the more moderate Alain Juppé, and now looks the favourite to face off against Marine Le Pen in a battle between the right and the far right in the final round of the Presidential elections in May. The default assumption will be that Le Pen will lose because a sufficient numbers of voters from the centre and the left will fall in behind a candidate who claims to admire Margaret Thatcher and uncharacteristically wants to slash spending and cull half a million public sector jobs. In our view, a greater threat to the European project from populist insurgents probably lies in Italy, where



This week's market developments

Tuesday, November 22

- US Existing Home Sales growth increased to 5,600,000 for October
- Eurozone Consumer Confidence (advance estimate) increased to -6.1 for November

Wednesday, November 23

- Markit Eurozone Manufacturing PMI (prelim estimate) increased to 53.7 for November
- Markit Eurozone Services PMI (prelim estimate) increased to 54.1 for November
- US Durable Goods Orders growth (prelim estimate) increased to 4.8% m.o.m. (s.a.) for October
- Markit US Manufacturing PMI (prelim estimate) increased to 53.9 for November
- US New Home Sales growth decreased to 563,000 for October

Thursday, November 24

- Japan National CPI growth increased to 0.1% y.o.y.

Friday, November 25

- UK GDP growth (prelim estimate) remained at 0.5% q.o.q. for Q3

Source: Bloomberg, as of end November 25, 2016

FFTW

there is a December 4th referendum “officially” on constitutional reform but “effectively” on the leadership of Prime Minister, Matteo Renzi. Thus far, polls suggest a “no” vote, which coincided with the yearly highs on both 10-year Italian bonds of 2.13% and their spread to 10-year German bonds of 187 basis points during the week.

Political risk overshadowed the economic data in Eurozone, which included flash PMI data that suggested a sharp improvement in activity. The Composite index rose from 53.3 in October to 54.1 in November – an 11 month high. The preliminary break down of the data surprisingly shows strength in the periphery. Beyond Germany and France, growth of business activity accelerated markedly to a ten-month high, with new orders and employment likewise recording stronger rates of increase. It remains to be seen whether this rebound shows up in the hard data but the improvement will only bolster German opposition to additional ECB stimulus and support for tapering Quantitative Easing (QE) on the grounds that extraordinary policy is no longer necessary. In our view, such a decision would be premature.

Declining cost in the U.S. and the reduced regulatory hurdles we could see under the Trump presidency will likely add U.S. supply and challenge forecasts of \$60/barrel by the end of next year. A key discussion topic for the week was the upcoming OPEC meeting in Vienna on November 30th. We do not expect OPEC will succeed in regaining much upside pricing power due to the cost compression in the U.S. heightened political risk, and distrust among members, most notably Saudi Arabia, Iraq, and Iran. Oil prices were essentially flat on the week.



Next week's market developments

Monday, November 28

- Japan Jobless Rate is expected to remain at 3.0% (s.a.) for October

Tuesday, November 29

- UK Mortgage Approvals are expected to increase to 65,000 for October
- US Consumer Confidence Index is expected to increase to 101.5 for November
- Japan Industrial Production growth (prelim estimate) is expected to decrease to 0.0% m.o.m. (s.a.) for October

Wednesday, November 30

- US ADP Employment Change is expected to increase to 169,000 for November
- US Personal Income growth is expected to increase to 0.4% m.o.m. (s.a.) for October
- US Personal Spending growth is expected to remain at 0.5% m.o.m. (s.a.) for October

Thursday, December 1

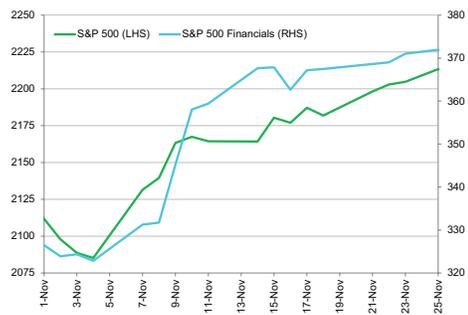
- Eurozone Unemployment Rate is expected to remain at 10% for October
- US Construction Spending growth is expected to increase to 0.6% m.o.m. (s.a.) for October

Friday, December 2

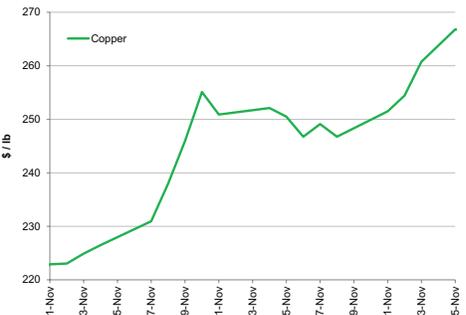
- US Change in Nonfarm Payrolls is expected to increase to 180,000 for November
- US Unemployment Rate is expected to remain at 4.9% for November

Charts of the Week

S&P 500 and S&P 500 Financials Indices (Nov. 1 - Nov. 25)



Copper Price (Nov. 1 - Nov. 25)



Sources: S&P Dow Jones Indices and Bloomberg, as of November 25, 2016

Source: Bloomberg, as of end November 25, 2016



Central Bank Watch

	Last move	Date of move	Current policy rate	Implied 3-Month Rate on December 2016 Interest Rate Futures Contract	Next meeting
Fed	+25 basis points	December 16, 2015	0.25 % - 0.50 %	0.53 %	December 14, 2016
ECB	-5 basis points	March 10, 2016	0.00 %	-0.18 %	December 8, 2016
BoJ	-20 basis points	February 16, 2016	-0.10 % - 0.00%	0.06 %	December 20, 2016
BoE	-25 basis points	August 4, 2016	0.25%	0.39 %	December 15, 2016

Source: Bloomberg

Disclaimer

Bloomberg is the source for all data in this document as of November 25, 2016, unless otherwise specified. This material is issued and has been prepared by Fischer Francis Trees & Watts* a member of BNP Paribas Investment Partners (BNPP IP)**. This document is confidential and may not be reproduced or redistributed, in any form and by any means, without Fischer Francis Trees & Watts' prior written consent. This material is produced for information purposes only and does not constitute: 1. an offer to buy nor a solicitation to sell, nor shall it form the basis of or be relied upon in connection with any contract or commitment whatsoever; or 2. any investment advice. Opinions included in this material constitute the judgment of Fischer Francis Trees & Watts at the time specified and may be subject to change without notice. Fischer Francis Trees & Watts is not obliged to update or alter the information or opinions contained within this material. Fischer Francis Trees & Watts provides no assurance as to the completeness or accuracy of the information contained in this document. Statements concerning financial market trends are based on current market conditions, which will fluctuate. Investment strategies which utilize foreign exchange may entail increased risk due to political and economic uncertainties. Investors should consult their own legal and tax advisors in respect of legal, accounting, domicile and tax advice prior to investing in the financial instrument(s) in order to make an independent determination of the suitability and consequences of an investment therein, if permitted. Please note that different types of investments, if contained within this material, involve varying degrees of risk and there can be no assurance that any specific investment may either be suitable, appropriate or profitable for a client or prospective client's investment portfolio. Given the economic and market risks, there can be no assurance that any investment strategy or strategies mentioned herein will achieve its/their investment objectives. Returns may be affected by, amongst other things, investment strategies or objectives of the financial instrument(s) and material market and economic conditions, including interest rates, market terms and general market conditions. The different strategies applied to the financial instruments may have a significant effect on the results portrayed in this material. The value of an investment account may decline as well as rise. Investors may not get back the amount they originally invested. Past performance is not a guarantee of future results. The information contained herein includes estimates and assumptions and involves significant elements of subjective judgment and analysis. No representations are made as to the accuracy of such estimates and assumptions, and there can be no assurance that actual events will not differ materially from those estimated or assumed. In the event that any of the estimates or assumptions used in this presentation prove to be untrue, results are likely to vary from those discussed herein. This document is directed only at person(s) who have professional experience in matters relating to investments ("relevant persons"). 1 Any person who is not a relevant person should not act or rely on this document or any of its contents. The performance data, as applicable, reflected in this material, do not take into account the commissions, costs incurred on the issue and redemption and taxes. * Fischer Francis Trees & Watts, Inc. is registered with the US Securities and Exchange Commission as an investment adviser under the Investment Advisers Act of 1940. BNP Paribas Investment Partners UK Limited, is authorized and regulated by the Financial Conduct Authority. Registered in England No. 02474627, registered office: 5 Aldermanbury Square, London, England, EC2V 7BP, United Kingdom. FTW is a brand name of BNP Paribas Investment Partners UK Limited in the UK. BNP Paribas Investment Partners Singapore is registered with the Monetary Authority of Singapore for the conduct of Fund Management business and is the holder of a Capital Markets Services License. BNP Paribas Investment Partners Singapore is also registered with the US Securities and Exchange Commission as an investment advisor under the Investment Advisers Act of 1940, as amended. References in this material to Fischer Francis Trees & Watts Singapore are to the registered business name (Business Reg. No. 53207544K) of BNP Paribas Investment Partners Singapore Limited (Co. Reg. No. 199308471D). ** "BNP Paribas Investment Partners" is the global brand name of the BNP Paribas group's asset management services. The individual asset management entities within BNP Paribas Investment Partners (if specified herein, are specified for information only and do not necessarily carry on business in your jurisdiction. For further information, please contact your locally licensed Investment Partner. For investors located in the United Kingdom, any investment or investment activity to which this document relates is available only to and will be engaged in only with Professional Clients as defined in the rules of the Financial Conduct Authority.

