Weekly Market Summary

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The Wonderful Reflation OR Horrendous Stagnation Trump Trade?! Take Your Guess....
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The reflation trade is stronger than ever .. Long live the reflation trade!!

Up until recently, financial markets were guided by 3 basic rules:

- Do NOT fight central bankers and their all-powerful expansionary monetary policies.
- Do NOT expect a sudden surge in inflation.
- And COUNT on ultra-low bond yields in Europe and Japan to continue pushing money out of those places and into the U.S.

In less than a month, it seems as if everyone's ideas have totally changed! Donald Trump's election as U.S. president in early November has driven global markets to levels not seen in nearly two decades, and the "polarization" of emerging and developed markets is all part of "Trump reflation". Simply put - in the post-Trump era - emerging market assets have been feeling the heat, retreating sharply in past weeks as investors/traders increase wagers on US Federal Reserve interest-rate increases. The MSCI Emerging Markets Index of stocks has now fallen some 5.5% since its close on November 8th, the day of the U.S. election, whilst the India's rupee, Malaysian's ringgit and Turkish lira have all been driven to record lows.

Nonetheless, things are looking much better across the Pacific. All four major U.S. equity benchmarks - the S&P 500 Index, the Dow Jones Industrial Average, the Nasdaq Composite Index and the Russell 2000 Index – have climbed together to record peaks. The surge, which was helped by rallies in commodities, has taken place simultaneously for the first time since 1999. Not only that, the USD greenback has now recorded 11 days of gains that were its longest winning streak against the euro since the Eurozone currency was first introduced back in 1999, and US benchmark rates have surged in excess of 50 bps on steadily increasing inflation expectations, even as European and Japanese yields remained low (there were signs that some foreign investors were withdrawing cash from dollar-denominated government bonds even as the debt offered some of the biggest premiums relative to German debt in more than a decade!).

Markets are simply operating under the assumption that fiscal spending in the U.S. is set to drastically increase (big spending on roads, railways and airports + tax cuts), under Trump and a Republican-controlled Congress, and these reflationary and supportive drivers for U.S. growth are in turn sending U.S. assets - its currency, rates and equities - higher.

But what if the real estate tycoon preparing to take over the White House creates inflation, but no real growth?

Stagflation is the potential “horror scenario” that the head of fixed- income at Alfred Berg Kapital AS in Oslo says unnerves him about President-elect Donald Trump’s policies. “I am not convinced that what Trump stands for will create that much growth,” Morten Steinsland, who oversees $5 billion in bonds fund at the firm, said in an interview early this week. “But I am rather convinced that it will create inflation, so that would be a terribly negative spiral. It is not good for anything in the world.” Whilst Trump’s promises of fiscal stimulus are expected to boost growth, his protectionist trade policies could ultimately hurt the global economy.

Those remarks were echoed by Bill Gross (previously head of PIMCO’s $ 270 billion Total Return Bond Fund and currently portfolio manager of the Janus Unconstrained Bond Fund), who stated – in a November commentary - that the president-elect’s plan to reduce taxes and increase infrastructure spending is unlikely to bolster economic growth or equities. “There is no new Trump bull market in the offing,” said Gross. “Investors must drive with caution, understanding that higher deficits resulting from lower taxes raise interest rates and inflation, which in turn have the potential to produce lower earnings and price/earnings ratios”. In a piece he titled “Populism Takes a Wrong Turn,” Bill Gross added that many of the policies Trump favors represent the status quo - and a Clinton administration would have been no better. “Neither party as they now stand has bold policies beyond the reach of K Street lobbyists,” he wrote. Gross also questioned the need for corporate tax cuts, saying that U.S. companies are among the world’s most lightly taxed. Another popular Republican idea, the repatriation of trillions of dollars of corporate profits held overseas, probably would not lead to more investment in America, he concluded.

Last, a quick note for all confused readers (join the club!) on the current price action in gold:

Gold investors got it right on Brexit’s consequences, while misreading the aftermath for bullion of Donald Trump’s surprise win, according to Jake Klein - an industry veteran and executive chairman at Evolution Mining Ltd., who offered a cautionary note on the potential for inflation as the new U.S. president gets down to business. Gold has been whipsawed in 2016 as investors responded to unexpected political developments, as well as a rate-shy Federal Reserve in the first three quarters of the year. While bullion surged after the U.K.’s vote in June to quit the European Union amid expectations for dislocation, it rallied only briefly, then sank, as Trump emerged victorious this month, in a reversal of analysts’ predictions before the poll. The new U.S. leader’s policies, which have helped spur U.S. equity markets to records, may carry risks, according to Klein. “Markets have cheered on the Trump victory in anticipation of stimulatory economic policy in the form of reduced regulation, lower corporate taxes and potentially trillions of dollars of fiscal stimulus through infrastructure spending,” Klein told investors at the company’s annual general meeting. That reaction has come “without any immediate concerns around the inflationary effect of these policies.”

Gold for immediate delivery sank to $1,171.06 this morning, the lowest since February, as investors continue focusing on a surging dollar, record U.S. equities and the potential for upcoming US rate rises. The metal, which peaked this year above $1,375 in July as investors contemplated Brexit, surged for a few hours as Trump was seen winning the race, then dropped, countering predictions for sustained gains.

With Chinese demand failing to rebound and India’s gold imports already 60% lower in 2016 year-to-date, some analyst’s project gold prices could soon be headed towards the psychological $1,000 mark (or possibly **lower)! However, with** Trump’s triumph adding unpredictability to an already uncertain world, my take is that it will only be a matter of time until global markets re-enter a risk-off environment that would be marked by higher volatility.

And once that materializes, expect gold to shine again!

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