Viewpoint

GiB

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Key Themes for the next 3-6 months

- Donald Trump faces growing headwinds after suffering defeat over Obamacare
- UK has officially started its separation from the European Union
- A number of European countries are facing a challenging year with elections coming up

Contact Details

Andrew Houghton

T: +44 207 259 3149

E: Andrew.Houghton@gibuk.com

A: One Knightsbridge
London
SW1X 7XS

Political and Macro Environment

The US president Donald Trump is facing a growing resistance in the implementation of his pre-elections commitments. Most recently he suffered a bitter defeat as he failed to deliver on his major campaign promise to repeal and replace Obamacare (The American Health Care Act of 2017). Trump was forced to cancel a vote on the bill moments before it was due to take place, as support among Republican congressmen faded away.

The failure to pass the bill was a huge setback for the president and instilled doubts about his ability to enact his wider agenda, not only on healthcare but other major promises like tax reform and infrastructure investments. It was the first big legislative test for Republicans since they won back the White House and retained control of the House and Senate in last elections. The intention to introduce the border adjustment tax may be another looming challenge for Trump.

Much like the failed repeal of Obamacare, the border adjustment tax is dividing conservatives, the business sector and some of the wealthiest groups funding conservative politics. A growing number of organisations are launching a fierce campaign against a new tax on imports proposed by House Republicans, thus jeopardising a cornerstone of the Republican tax overhaul effort.

The battle could not only undermine Mr. Trump's second major legislative initiative, but also redefine the boundaries of conservative economic policy.

The UK Prime Minister Theresa May activated Article 50 shortly before 12:30pm on 29 March 2017. Britain now starts a two-year process of complicated negotiations about conditions of separation and should leave the EU no later than April 2019.

Any deal must be approved by a "qualified majority" of EU member states and can be vetoed by the European Parliament.
The terms of exit will be negotiated between Britain's 27 counterparts, and each will have a veto over the conditions. It will also be subject to ratification in national parliaments.

Leaving the EU appears to be the easy part. Reaching an agreement about a new trading relationship, establishing what tariffs and other barriers to entry are permitted, and agreeing on obligations such as free movement will be much harder. EU leaders claim that establishing a viable framework for future relationship could take another five years.

Europe is facing a politically challenging year with elections coming up in France and Germany. According to the polls Ms Le Pen may lead in the first round of French elections, or come very close to the centrist former economy minister Emmanuel Macron. The polls also suggest that then she will lose in the run-off. The first round of the French presidential elections will take place on 23 April 2017. The result can be still quite unpredictable as recent experience evidences that the outcome of public polls can be significantly different from reality. The French elections will represent a defining moment not only for one country but for Europe as a whole. The second and final round on 7 May will decide whether France blocks the rising tide of populism that has been spreading across the west. Dutch voters have already demonstrated that it can be done. Markets do not seem to be pricing in the possibility of Le Pen's victory.

FED stays the course undisturbed by weak "soft" data

The FED officials continue to anticipate additional monetary policy tightening this year. The FED is not changing its course for now and two more interest-rate increases are likely. The weakness seen in "hard" economic data based on actual performance relative to "soft" data, such as surveys, is enough to temper concerns that the FED is falling behind the curve with the next hike likely in June at earliest.

Obtaining a clear economic picture is not easy due to the divergence between soft survey measures and hard data. The former strengthened in the wake of the election, while the latter remained weak. For instance, the consumer report in February revealed a marginal 0.1% increase in consumer spending, seemingly in contradiction with strong consumer confidence numbers.

The Atlanta Federal Reserve currently anticipates an unimpressive 1.2% gain in Q1 annualized economic growth. Such a growth figure is unlikely to prompt FED to increase rates further. The FED policy going forward depends more on the evolution of data in the Q2 than weakness in headline growth for Q1.

What does this mean for the US dollar?

We have to recognise the US Dollar has appreciated significantly during the last two years, we believe this currency will remain well supported but volatility could pick up going forward. Trump's economic policies if implemented have the potential to support the US Dollar and this is in an environment where the US has the best prospect of economic growth of the G3 economies. The US Federal reserve monetary policy cycle and the political uncertainties in other countries could also provide support for the US Dollar.

Fixed Income

March was a month where fixed income market pulled back with the 10y US Note yield peaking at around 2.62% but it closed unchanged on the month at 2.38%. The European bonds closed the month with slightly negative returns. The FED seems now more inclined to start unwinding the $4.5trillion balance sheet towards the end of this year and reiterated its gradual approach to interest rate hikes.

The FED committee is split in relation to inflation risk and this could have an impact on the end target rate, at this time it is difficult to judge this risk. For now headwinds to Mr. Trump policies and/or any other major political turmoil globally may help to keep US treasury yields anchored towards these years' lows.

We expect 2 to 3 extra hikes this year and the 10-year US note to continue trading within the current 2.30%-2.60% range with possibility of breaking the upper range of the band towards year end. In the short term this backdrop paints a positive picture for risky assets in general including global spreads products (in particular high yield) despite expensive valuations.

In our opinion the opportunistic approach is warranted at this point in order to sail through potential market turbulences. Given these considerations, we believe value could be created and there are likely to be good entry levels for investors going forward.

The emerging markets saw the largest first quarter inflows of funds on record in Q1 2017. This was reflected in strong performance of hard currency debt in the same period.

Equities

The risk appetite ensured gains were seen across equity markets with the S&P 500 touching record highs at the start of the month although ending March only 0.1% higher whilst in Europe, substantial gains were seen across the region. The powerhouse of Germany advanced 4.0% whilst France and Spain saw significant gains in surging 5.6% and 9.6% respectively. In Asia, a stronger yen weighed on equity markets where the Topix fell 0.7%, whilst the rest of the region saw strong gains. The positive regional returns ensured the MSCI World Index gained 1.1% over the month.

We acknowledge we have seen an extremely strong rally in equity markets and valuations are currently rich as investors remain optimistic around the Trump-led US economic recovery and US rates, and interest rate policy, remain accommodative we see no immediate reason for a significant pull back in equity markets. We expect equity markets to stabilise around current levels but remain cognizant of the potential impact of the next attempt by Donald Trump to implement a policy change, elections in France and Germany or any complications around the UK's Brexit divorce.

We continue to believe that investors will keep on searching for yield within a low growth/return environment and this should result in more money flowing into equities as they offer better value relative to government bonds.

Asset Allocation

We are close to neutral weight versus the benchmark between equities and bonds, and within bonds we remain allocated to EM debt via our EMOF product. Going forward we see limited value for investors in G7 bonds whereas the positioning of our EMOF product should provide income with a chance of capital gains based on a relatively short duration assets.

If you have any questions or wish to speak to someone about our investment products, please contact your relationship manager or email us at: **investment.enquiries@gibuk.com**

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