Weekly Market Summary

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Investors Turning Nervous About Some Popular Trump Trades.. You Bet They Should!!

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At the end of each year, commentators traditionally reflect on emergent themes likely to shape the future. Those predictions for 2017 have heavily relied on widespread consensus over two themes: Rising populism and the Trump reflation trade - i.e. stronger growth and the return of inflation. Worried about declining living standards for the majority, electorates have embraced simplistic explanations for the problems confronting many Western societies and economies, therefore supporting candidates with great and painless promises, magical solutions and a rapid restorations of prosperity. They will almost certainly be disappointed! The scale and complexity of modern societies, entrenched private interests, and institutions paralyzed by powerful countervailing forces increasingly make radical reformations difficult - even in the face of widespread dissatisfaction (and sometimes idiotic Presidential tweets!). In all likelihood, very little will change in 2017.

President-elect Trump's promise to "*drain the swamp*" of politics could be the first populist pledge to be exposed. He will require tested political operatives to manage the practical exigencies of government. He will also need to work closely with established institutions to pass any of his promised policies. Those policies will require uprooting deeply entrenched interests (starting with his own!). Reversing free trade and reshoring jobs will be a slow and maybe impossible task. Forcing change on complex global supply chains and business models may be more challenging still, especially if corporate America has any say in the matter. Brexit, likewise, may not turn out to be the radical break many voters expected. The British government has made minimal progress in disengaging from the EU. The threat to the unity of Great Britain, domestic electoral imperatives, a desperate attempt by the EU to preserve itself if Italy and France entertain departure, and new security or political crises may yet dilute or even overtake the referendum outcome.

Additionally, belief in the reflation narrative is similarly misplaced, because it also assumes that today's politicians are capable of making hard choices. The idea that looming tax cuts and new government spending on infrastructure, presumably financed by deficits, will soon reverse years of stagnation remains a big uncertainty! Trump has promised such an agenda, and policy makers in Europe and Japan are watching closely. But these proposed measures are not fundamentally much different from those tried over the past eight years, which have failed to resuscitate growth or create significant inflation. And they ignore the problems of high debt levels and existing fiscal pressure from aging populations. With even worthy projects taking time to get started, quick results may be elusive, and seeing them through will require political will. Japan, which remains mired in stagnation despite decades of such policies, shows just how hard the challenge is. A further complication is that the reflation argument depends on China's economy rebounding. Yet China continues to support weakening growth with unsustainable debt-fueled stimulus and a managed currency devaluation. Hard choices -- such as necessary structural reforms – are not on the horizon there, either.

Whatever the merits of reflation, it is likely to worsen current-account imbalances, distort capital flows and exacerbate currency volatility, while a stronger dollar and higher interest rates will disadvantage U.S. exporters. None of this was on Trump's agenda, and all of it may weaken commitment to his policies. In short, a rebound in growth and inflation might prove short-lived at best: Many of the underlying problems are not being addressed.

The challenges of debt, weak banking systems, waning demand, slowing global trade and capital flows, changing demographics, and a deteriorating environment are once again being put off for another day. Much like the hated establishment figures they strongly criticized, the new populists will soon be exposed as politically impotent.

That gloomier scenario is starting to shape up and slowly get reflected in asset movements! Almost two months after Donald Trump's election victory, investors' frenzy over the president-elect's policies is finally experiencing a reality check. The dollar's biggest two-month rally against the yen in two decades came to an abrupt halt yesterday, with the greenback slumping as much as 1.7%. Several triggers fueled the slide, including China's central bank muscling into the funding market to support the yuan, as well as improving economic data from China and Europe juxtaposed with U.S. figures suggesting the job market may be softening (weaker than-expected ADP survey). Additionally a bit of skepticism is also creeping around the euphoria that has run rampant in US stocks over the past weeks. After falling to multi-year lows amid the rally that has added $2 trillion to share prices, hedging costs on the S&P 500 Index just jumped back to their bull market average. While framing this development as bearish may be a stretch, a hint of anxiety is evident alongside a rally that just notched its best two-day advance in a month. Treasuries have also rallied across the curve yesterday, driving down benchmark yields by the most since the days after the June Brexit vote, as traders across financial markets backed away from crowded bets. The benchmark 10-year U.S. yield plunged nine basis points to 2.35%, touching the lowest level since December 8th. Finally, gold climbed to a four-week high as a weaker dollar and uncertainty over the impact of Donald Trump's policies bolstered demand for safe haven. Bullion has increased in value every trading session this year, with spot prices rising as much as 1.8% to $1,185 an ounce on Thursday (after touching a low of $1,121 on December 12th, 2016).

Last - but not least - the monthly U.S. jobs report* for December will be released this afternoon (4:30 pm Bahrain time). As always, welcome to random number generator, also known as US Non-Farm payrolls ("NFP"): Bloomberg's consensus is for a 175,000 increase in jobs on the month (although the whisper number is possibly lower at 160,000 following the weaker-than-expected US ADP Employment release yesterday) , a slightly higher unemployment rate (4.7% following a sharp drop to 4.6% in November), an unchanged workweek (at 34.4 hours) and a healthy wage component (+0.3% month-month and 2.8% YoY versus a 2.5% annual rate in November). The report will help shed light on the upcoming path of policy interest rates, especially that the balance of risks to the U.S. economy has shifted to the upside for both growth and inflation since the Fed last met in December (as a reminder, the US Federal Reserve raised the o/n Fed funds rate by 25 bps - on December 14th – to 0.625% and suggested it will raise short term rates by an additional 75 bps - 3 times - in 2017).

**U.S. payroll release: It wasn't a blowout number, but it will do! While non-farm payrolls increased by a below consensus 156k in December, net revisions and a solid rebound in wage growth more than offset that disappointment. Net revisions for the prior two months saw employment increase by 19,000 extra jobs. Moreover, following a decline in average hourly earnings in November, the most recent month's data revealed a monthly increase of 0.4%, more than offsetting the prior month's weakness. <u>The annual rate of wage growth now stands at 2.9%, the fastest pace since mid-2009</u>, leaving the Fed in a position to continue gradually edging rates higher. All told, the data releases today should be negative for fixed income (bonds) and positive for the US dollar and equities*

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