

Weekly Market Summary

19th of May 2017

To Be or Not to Be IMPEACHED !! Is That Really the Question ?!
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In last week's economic write-up I covered recent market complacency and extremely low equity and bond volatility levels - whilst commenting that whenever investors and traders (weird species!) think they have it all figured out, the market can and typically does bite! As turmoil surrounding President Donald Trump's administration started roiling markets this week, options speculators traded more than a million of call contracts that bet on a rise in the VIX (the CBOE Volatility Index), triggering a 5.7 points rise (or roughly 55% jump) in the fear index on Wednesday and Thursday, its biggest 2-day jump since September 2016.

So what exactly triggered this latest mini-market panic? And should we prepare ourselves for more turmoil in coming days/weeks?

On Tuesday May 16th, markets learned that President Trump had asked FBI Director James Comey in February to drop an investigation into former national Security Adviser Michael Flynn, and that according to a person who was given a copy of a memo Comey wrote following his Oval Office conversation with the US president. "*I hope you can let this go...Flynn is a good guy*" Trump told the FBI director, according to the memo, as cited by the New York Times. Whilst Trump strongly denied and rejected any suggestions that he tried to interfere with the investigation - during a news conference at the White House yesterday (suggesting instead that the entire thing has been a witch hunt and that it divides the country) - the damage had already been done! Even before the report of the Comey memo, members of Congress were negotiating to bring in the former FBI chief to hear his account of interactions with Trump. Following the leak, the Chairman of the House Oversight Committee, Utah Republican Jason Chaffetz, wrote a letter to McCabe (acting FBI Director) demanding that he provides by May 24th all FBI memos and other records documenting communications between Comey and Trump.

The revelation deepened a political crisis for Trump's White House by introducing the possibility that the US President may have obstructed justice, an impeachable offense. His administration was already on the defensive following criticism of his firing of Comey the previous week, and over a report Monday that Trump disclosed sensitive intelligence to two top Russian officials in the Oval Office. It also added to tensions in financial markets that were already reacting to concerns about the Trump administration. The yen jumped 3% for the week, trading to a low of 110.30 per dollar yesterday from 113.60 last Monday. The S&P 500 dropped 1.9% during the same period, while the Bloomberg Dollar Spot Index hit its lowest level since November. U.S. 10-year Treasury bond yields sold off 12 bps and were last trading at 2.24%.

Even before disclosure of the memo, key Republicans were showing fatigue with the president's political problems. Senate Foreign Relations Chairman Robert Corker said last Monday that the White House is "*in a downward spiral*." The usually cautious Senate Republican leader, Mitch McConnell said Tuesday morning the party needs "*less drama*" from the President, while Representative Carlo Curbelo, a Florida Republican, said Congress should have a special select committee focused on Trump and Russian interference in the 2016 election because the administration "*needs to be held accountable*." Several Democrats, on the other side, have called Comey's memo - as reported - a "*powerful evidence of obstruction of justice*". If verified, it would amount to obstruction of justice, a crime that was among the articles of impeachment drawn up against Richard Nixon (Nixon resigned office in 1974, engulfed by the Watergate scandal).

Whatever happens next remains anyone's guess! Trump's failures risk a constitutional crisis: The White House is paralyzed by leaks and the US President is unlikely to succeed at completely derailing the FBI investigation into his campaign's ties to Russia. But he might undermine it enough to avoid any serious consequences. Even without his deceptions, the investigation could prove inconclusive! The crisis of public trust in the country's leadership will remain over the near term and lead to an erosion in confidence for what America is about and what role the most important democracy in the world would play on the world scene in months to come. The government will never regain its footing unless discipline is imposed, not just on the executive branch but also on the President. For that, Mr. Trump has to stop shooting from the lip and focus on the business of state, starting with his upcoming trip to the Middle East and NATO allies. He could also begin by ending his rhetorical wars with anyone who criticises him!! Congress too should still tread carefully before setting in motion the steps to remove the US President.

Elsewhere, a quick update on a major story we have been tracking over the past 48 hours: Brazilian markets were hit hard yesterday as political crisis reignited. Both the local currency (Brazilian Real) and stock market (Bovespa) plunged roughly 10% as a leading Brazilian newspaper has involved President Michel Temer in bribery allegations, putting his reform agenda in jeopardy and opening the door for yet another disruptive change of president just as the country was showing signs of emerging from two years of deep depression. Investors had piled into Brazil's currency, stocks and bonds this year, believing that the government of President Michel Temer — installed last August after the impeachment of his predecessor Dilma Rousseff — would enact reforms to balance the public accounts and lead the economy back to growth after a combined contraction of 7.4% in 2015 and 2016, according to the central bank. But many feared such hopes have now been dashed after national television reported on Wednesday night that Mr. Temer had been recorded encouraging the bribery of a key figure in the Lava Jato corruption scandal that has engulfed large sections of Brazil's business and political leadership (*Operation Car Wash* or "*Lava Jato*" is an investigation being carried out by the Federal Police of Brazil, Curitiba Branch, and judicially commanded by Judge Sérgio Moro since March 17, 2014. Initially a money laundering investigation, it has expanded to cover allegations of corruption at the state-controlled oil company Petrobras, where executives allegedly accepted bribes in return for awarding contracts to construction firms at inflated prices). The president's office denied he had done anything improper but investors appeared to have dumped assets in large size, fearing that the episode could derail his reform programme.

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