Weekly Market Summary

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A Market Rally Largely Built on Hopes & "*Unpresidented*" Trump Tweets!!

Fadi Nasser - Head of Treasury Sales

In a week that saw a US underwater drone - operating off the coast of Philippines - seized by a Chinese naval vessel (later returned), a Russian ambassador to Turkey shot dead in "revenge for Russia's hostile role in Syria and Aleppo", a terrorist truck ramming into crowds at a Berlin Christmas market (killing 12 innocent bystanders), a cautious rescue package proposition by the Italian government to support its ailing banking system, increased Chinese capital outflows on the back of persistent weakness in the Yuan and rising concerns over its domestic financial markets, an IMF chief (Christine Lagarde) convicted of negligence by a Paris court over her handling of a multi-million euro dispute during her time as France's finance minister nearly a decade ago (and the list goes on!...), one would have expected markets to trade in a risk-off environment - with stock investors staying still or covering profitable long positions, and bond holders rushing into the safety of government bonds (higher prices, lower yields). Instead, equity markets marched to new highs (the Dow Jones Industrial Average traded 13 points short of 20,000, up from 19,250 prior to Trump's November 8th presidential election win), whilst bond yields hovered close to their recent high (UST 10-year rate last at 2.55%, versus 1.82% on November 7th!!).

It is often said that hope is not an investing strategy to live by! Yet most - if not all - of the post-election stock market gains and run to new highs have been built on hopes Donald Trump's pro-growth, "America First" economic policies will morph from talk to reality and deliver benefits. "*The rally is based primarily on hope, since no one knows the specific policies and legislation that will be proposed or implemented*," says Kate Warne, investment strategist at Edward Jones. The Dow Jones industrial average has rallied more than 700 points, or roughly 4%, to a fresh record high since Trump's election, with forward-looking investors pushing some sectors and stocks (companies that benefit from infrastructure spending promised by Trump, for example) up too far, too fast despite the dearth of details. Still, Warne says she thinks the president-elect's agenda of tax cuts, fewer regulatory burdens and fiscal spending will soon be implemented. That will have a positive impact on economic growth and corporate earnings, "*providing fuel for the stock bull market to run further*," Warne added.

Needless to stress that markets are now just focused on positives, with investors ignoring potential downside risks related to Trump's less market-friendly views, such as his criticism of U.S. trade deals and immigration, as well as widespread rising geopolitical and political concerns which will eventually lead to heightened market volatility. Additionally, a recent surge in the USD dollar against a basket of foreign currencies is threatening to shave nearly a full percentage point off U.S. economic growth in the final quarter of 2016, hurt profitability of U.S. multinationals and put increased pressure on emerging market's assets.

In early 2016, investors – seeing nothing but bad times ahead – sold stocks and piled into government bonds that yielded less than they cost (hedge funds and central bankers – "la crème de la creme" amongst the investing community – have been aggressively buying UST 10-years at or below 1.50% in past months, at a time your reliable GIB banker was issuing multiple warnings that valuations had become overstretched: "*The Bond Bubble Keeps Growing ..Bond Vigilantes Nowhere In Sight!*" – July 29th 2016, "*Bond Traders Getting It Wrong All Over Again!! Time for a Sizable Market Shakeout?!"* – May 13th 2016, "*When Global Markets No Longer Obey Economic Common Sense !!*" – April 8th 2016). Back then, investors and analysts' sole focus was the global trade slowdown and secular stagnation trade (which refers to a persistent shortfall in global aggregate demand, in turn leading to economies being unable to bounce back to their full employment level of output). Now, as 2017 approaches, those same traders and economists are starting to focus more on what could go right with the global economy rather than just worrying about all the things that might go wrong. Behind the lifting of the gloom are high hopes that a combination of easier fiscal policies, bigger wage gains and stepped-up business investment will break the world free of the slow-growth trap it has been caught in for the last five years.

That said, much depends on the execution. Trump's plans remain sketchy, and could go terribly wrong in numerous ways. And if his hilarious, often narcissistic and hyperbolic – sometimes idiotic – tweets on the state of both national and foreign affairs are any guide, then better brace for a period of significant uncertainty and instability. The other big question mark is what happens next in China, which confounded pessimists' predictions of an economic crash with a surprisingly steady expansion in 2016 (roughly 6.7% YoY). The world's second-largest economy faces what senior economic official Yang Weimin has called a "*flurry of risks*," including excessive corporate leverage and a bloated property market. Surely there is also a lot that could go wrong with the world economy in 2017, not least of which is the possible outbreak of a trade war between China and the U.S. if Trump follows through on his campaign threats against the Asian nation (Trump actually appointed yesterday China hawk Peter Navarro as trade advisor!), or further fragmentation of the EU as support for populist, anti-establishment parties across Europe continues to rise.

To my mind, U.S. President-elect Donald Trump has given the world ample reasons for concern about what the New Year might look like. So far, though, financial markets appear to be assuming that everything will be awesome, placing very low probabilities on undesirable outcomes materializing! If and when such assessment changes, and as markets start paying more attention to negative rhetoric/factors, expect an abrupt wake-up call and a clear acknowledgment that the market got ahead of itself!

I strongly feel that 2017 will be another interesting/exciting year, and one that will prove - once again - the limitations/inefficiencies of herd behavior.

Wishing our valuable clients/readers a Christmas filled with happiness and Prosperity! Merry Christmas

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