Weekly Market Summary

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US Financial Markets Grind to a Halt! All Eyes & Ears on the Timing and Outcome of the US Health Bill Vote...

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This week was supposed to be relatively quiet in terms of economic data releases and market movements, with scattered US housing data (FHFA house price index, existing home sales, new home sales), as well as UK inflation (CPI & RPI) and retail sales publications. After all, the US Federal Reserve ("FOMC") had just convened the week before, raised short term rates by 25 bps in line with market expectations, and reassured traders that it would be proceeding cautiously with future rate hikes (the "gradual approach" wording that always brings a smile to a dear friend's face!)

Instead, U.S. stocks fell the most since January, the dollar extended its retreat to the longest since November and crude slumped through US$ 48 a barrel as investors assessed the prospects for Donald Trump's pro-growth policies gaining Congressional approval. Treasuries climbed, with 10-year US yields dipping roughly 25 bps from highs witnessed on the day of the FOMC decision (a sharp move down from 2.63% to 2.38%, which has prompted many dealers to wonder whether the Fed had actually cut rates on March 15th !), whilst gold rallied some US$ 25 (or 2%) to end at $ 1245 an ounce. The VIX, or so-called fear gauge which measures options volatility on the S&P 500 finished at 13.12 overnight - its highest level of the year.

As of yesterday evening, the S&P 500 Index was headed for a fourth straight loss (though still a mere 1.4% down on the week!), with banks leading the way as a drop in US yields damped the prospects for higher lending revenue. Industrial and technology shares slumped as House Republicans warned failure to pass a health-care bill could imperil tax and spending reforms, in turn causing investors to question whether Trump might be forced to wind back his promises to provide massive tax relief, regulatory reforms and a major boost to infrastructure spending, which are of far more importance to markets. "*With the health-care chaos, the Trump effect is taking a little bit of a backseat in peoples' minds*," said Steve Sosnick, an equity risk manager at Timber Hill LLC, the market-making unit of Greenwich, Connecticut-based Interactive Brokers Group Inc. "*It feels like the market needs another catalyst. The catalysts had been coming largely from the Fed and the Trump effect. Something is spooking people*."

With a health care bill backed by President Donald Trump running into trouble in Congress (as a reminder Republicans control both the legislative and executive branches of the US government), questions are now being raised about his agenda of faster economic growth spurred on by lower taxes and cuts in regulations. "*President Trump promised that this health care bill would be signed, sealed, delivered within the first couple of weeks of him taking office*," said Jack Ablin, chief investment officer for BMO Capital Markets. "*All this is doing now is pushing the rest of the agenda out*." Still, the lingering hope that US President Donald Trump has only encountered a temporary setback in his plans for overhauling the US healthcare system - rather than suffering a humiliating defeat in his first major legislative initiative - continues providing a critical support for US equity markets and the USD, despite the weakness prevailing in past days. And whilst investors go through a roller-coaster ride of emotions, as confidence that hardline conservative Republicans would fold and allow US President Donald Trump's embattled healthcare reforms to pass turned to dismay after intense negotiations and lobbying by Trump himself failed to bring the rebels into line and caused the vote to be postponed, the argument that the situation is still retrievable and that Trump might still be able to claim victory continues to provide some consolation - especially after the White House signaled that it expected a vote early Friday.

There are some financial reasons why investors are so pre-occupied with Trump's efforts to repeal Obamacare. Analysts estimate that overhaul will reduce Washington's spending on healthcare by around US$ 1 trillion, over the next decade and lead to tax cuts to the tune of US$ S600 billion. However, the non-partisan Congressional Budget Office, initially projected the Republican proposal would reduce the US federal deficit by US$ 337 billion over the next decade, although <u>it would result in 24 million Americans losing their health insurance over the same period</u>!! The CBO said this week that the revised version of the bill would result in smaller budget savings, reducing the federal deficit by around US$186 billion over the next decade. Investors are hoping that these healthcare savings can be used to appease Republican deficit hawks who otherwise might object to Trump's promised individual and corporate tax cuts, which are likely to cause the US deficit to swell. But it is also clear that those same investors are more interested in the symbolic importance of Trump securing a major legislative victory in the early days of his presidency by delivering on a key campaign promise to dismantle President Barack Obama's signature 2010 healthcare reforms. After all, and during the election campaign, Trump painted himself as a practical man of action, one who could use his negotiating prowess, honed at the top levels of the business world, to overcome the political divisions that have so often frustrated previous US leaders. Failing to deliver on such promises would surely weaken his stance throughout future negotiations (US President Donald Trump apparently told lawmakers that he does not want any more delays and even threatened that anyone refusing to toe the line would face consequences within the party)!

House Republican leaders are now expected to vote later this evening on a revised version of their embattled health-care bill that includes a provision that conservatives negotiated with senior White House officials (effectively removing Obamacare's requirements that certain essential benefits be covered by insurance), according to several lawmakers and aides. "*We're going to vote and we'll see*," Steve Bannon, senior White House strategist, told reporters after the meeting yesterday with lawmakers and other key administration officials. The fact that it was mainly the White House ensuring the vote would take place on Friday does not necessarily suggest that Trump really does have the required number of votes (with 100% certainty). Hence, if he does fail today the markets are likely to question the implementation of a major tax reform or a wider-reaching infrastructure program in the future, and this would surely affect the dollar (weaker), equity (weaker) and bond markets (higher prices, lower yields). Should the House of Representatives agree today, this could only lead to temporary gains, as the Senate - where the next vote will be taken - still constitutes a serious obstacle.

In the summer of 2007, the former CEO of a large financial services firm famously remarked "*When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance*." With investors' concerns starting to undermine the "reflation trade" that has been in place since last November, questions will soon arise as to the sustainability of the rally in global risk assets. Of course, the analogy is stretched, with few investors seriously worried about another financial crisis. Nonetheless, many analysts are now skeptical of a further uptick in equity and commodity prices. On balance, and for the past five months, markets have been on fire, whilst political upheavals, the prospect of global trade wars, and earlier-than-expected Fed hikes have had little negative impact on asset prices, with equities shrugging all bad news off and continuing to relentlessly rally. Credit spreads are at multi-year tights, equity multiples are well above historical averages, and volatility is near pre-crisis lows.

Will investors continue to dance, the query goes, just because the music is playing? And if so, could the risk rally soon falter should political/geopolitical uncertainties continue mounting?

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