Weekly Market Summary

December 22nd, 2017

2017 Coming to an End! Time for Reflections & Reality Checks.... Who is Counting Really?!

Fadi Nasser – Deputy Chief Investment & Treasury Officer

Bitcoin at $12,600 this morning (last back at $13,900)! After trading to a high of $19,511 earlier this week, the digital currency dropped abruptly this morning (15%!) - extending its loss over the past few days, from Monday's intraday high, to more than 30% (the big question now is whether a 20%+ correction lower - usually defining a "*bear market*" move – alters the technical outlook for this virtual asset that remains up a staggering 1,375% year-to-date!). Investors are having a "*reality check*," said Stephen Innes, head of trading for Asia Pacific at Oanda Corp. "*At the heart of the matter was a frenzied demand for coins with limited supply that has now led to unsophisticated investors holding the bag at the top*." Indeed, there are growing signs of mania for anything cryptocurrency related: Long Island Iced Tea Corp. shares rose as much as 289% yesterday after the unprofitable Hicksville, New York-based company rebranded itself Long Block chain Corp. Banks are also sensing opportunity, with Goldman Sachs Group Inc. currently setting up a trading desk to make markets in digital currencies such as bitcoin, according to people with knowledge of the strategy.
And to think that many commentators/analysts can't yet figure out that those bitcoin price moves are the "very definition of a bubble" that has already - or will soon burst!

US President Donald Trump is about to deliver his "*Big, Beautiful Christmas Present*" for the people of America - or so he believes! This is the Tax Cuts and Jobs Act ("TCJA"), which has just been passed by both Houses of the US Congress over the past 48 hours, and which Mr. Trump will soon sign into law. Its highlight is the slashing of the US corporate tax rate to 21% effective next year, from the current top rate of 35%, coupled with temporary tax cuts for most individuals. This will be the most (and ONLY maybe!) significant legislative achievement of Mr. Trump's presidency so far, but it is controversial to the point of being politically polarising, and its impact will be decidedly mixed. Tax cuts can be expansionary and are best approved when an economy is weak. But the US economy is buoyant: Its recovery from the 2008 to 2009 financial crisis is now in its eighth year, with growth running at an annual rate of 3.0% and unemployment at a low of 4.1% (and falling). Thus, as Mr. David Lafferty, global chief market strategist at Natixis Investment Managers, puts it, the TCJA "*is like throwing a small cup of gasoline on a fire that's already burning fairly well*". More importantly, and whilst Trump administration officials claim the tax cuts will "*pay for themselves*" by boosting economic growth, there is hardly an independent economist who believes that the marginal increase in growth associated with the tax cuts will be enough to offset the revenue losses. Thus the tax cuts will add to US fiscal deficits to the tune of 0.6% of GDP per year, according to the Congressional Budget Office, as well as to debt (to the tune of $1.5 trillion over 10 years). Finally, the tax cuts could have serious political implications. They have been bitterly opposed by the Democrats in the US Congress, not a single one of whom supported the legislation and who have variously described it as "a travesty" (Senator Cory Booker of New Jersey), "highway robbery" (Senator Tim Kaine of Virginia), and "an all-out looting of America" (House Minority leader Nancy Pelosi). Those sentiments seem to be resonating with the majority of the US public: According to a CBS news poll, 53% of Americans oppose the tax cuts, compared with 35% who approve. People, on average, see the new tax law as likely to benefit large corporations, the super-rich, Wall Street investors and big political donors. Some 44% think it will hurt their families, while only 24% believe it will help. Other polls show similar results. If such sentiments (combined with Mr Trump's poor approval ratings) persist or get worse over the next couple of years, the Republican party could face an uphill battle in the mid-term congressional elections in 2019. Should they lose their majority in one or both Houses, the Trump tax law could become a political target.
As such, there is reason to doubt not only TCJA's effectiveness, but also its longevity!

US and European bond markets are finally starting to feel the heat! Are yields set to close at their highest levels for 2017, as the year draws to a wild end? In a few swift moves this week, 10-year Treasury yields smashed above key levels to the highest since March (last trading at 2.485%). The yield curve, which had been relentlessly flattening, steepened the most since September 2016 (check our pre-emptive November 24th economic piece: "*A Mysterious Curve Flattening Trade That Never Made Sense! Time for a Reality Check!"*), whilst market-implied inflation rates reached an eight-month high as U.S. tax cuts become law. Moreover, the pain is not constrained to US Treasuries, but also being inflicted on fixed-income investors worldwide. Ten-year German yields have jumped higher by twelve points this week, the most since July. Considering they started the week at 0.30%, the move is all the more dramatic (12/30 = a 40% weekly jump in rates!). It appears that investors have been spooked into unwinding long bond positions they probably expected to carry into the New Year. Whilst some analysts attribute the recent losses to thin trading during the Holiday season, which curbs market liquidity and magnifies market movements, I stand firmly in the camp looking for further bond losses due to the following reasons:

- Global growth remains synchronized and extremely favourable over the near-term, whilst public debt burdens stay high. That is generally quite negative for fixed-income markets (stripping out central banks' QE programmes & market manipulations!).
- The U.S. is about to sell the most debt in eight years in 2018, with JPMorgan Chase estimating net issuance at $1.3 trillion next year, more than double this year's tally. That is not exactly good timing, given the Federal Reserve's plan to gradually step up the pace at which it shrinks its bond holdings. While central bankers may not care about the price they pay for government securities, investors do, and they may demand higher yields.
- With the US Congress passing the most extensive re-write of the US tax code in more than 30 years, the added fiscal stimulus is expected to accelerate growth and spur inflation, adding to bond traders' expectations that the Fed will have to follow through on its tightening projections in 2018.
- In Europe, a trio of European Central Bank policy makers have sounded hawkish earlier this week, contributing to the bund retreat. Jozef Makuch, an ECB Governing Council member, said discussions were moving toward using interest rates rather than asset purchases to regulate the economy. Fellow policy maker Jens Weidmann once again called for a definite end-date for bond buying. Ardo Hansson, governor of Estonia's central bank, said he expects officials will adjust their communication in the first half of next year.

Last, but not least, some common sense in this otherwise mad, mad world!! The United Nations General Assembly overwhelmingly backed a measure critical of President Donald Trump's decision to recognize Jerusalem as the capital of Israel despite U.S. Ambassador Nikki Haley's warning that the move could put funding for their nations and the global body at risk. The non-binding UN resolution passed Thursday night by a vote of 128-9, with 35 nations abstaining. Key U.S. allies - backing the measure over Trump's threats - included the U.K., France, Italy, Japan and Germany. The U.S. was joined in opposition by countries including Guatemala, Nauru and Micronesia (Seriously?! Is that the best the US administration can pull, with all its might & persuasive bullying?!☺). Abstentions included Australia, Canada and Argentina. A similar resolution, earlier in the week, had 14 votes in favour in the 15-member Security Council last week, prompting Haley to exercise the first U.S. veto since 2011 "*The United States will remember this day when it was singled out for attack in the General Assembly*," Haley said at the UN podium ahead of the vote. "*We will remember it when so many countries come calling on us, as they often do, to pay even more. This vote will be remembered*." Haley's threat carries weight because the U.S. is the largest contributor to UN operations, providing 28.5% of the $7.3 billion UN peacekeeping budget and 22% of the core budget of $2.7 billion. Haley walked out of the General Assembly soon after her speech, though members of the U.S. delegation remind behind, awaiting the vote. A day before the vote, US President trump also weighed in on the Jerusalem vote, stating that "*I liked the message that Nikki sent yesterday at the United Nations to all of those nations that take our money and then they vote against us in the Security Council, they vote against us potentially at the Assembly ... They take hundreds of millions of dollars and even billions of dollars and then they vote against us. Well, we're watching those votes. Let 'em vote against us*."

Guess on this last story update, someone was actually counting! ☺

Disclaimer

It is important that you only use this report if you are the intended recipient of this report and you have satisfied yourself that you are eligible to receive such information. This report is provided to you because you are one of our esteemed customers and have previously shown interest in receiving the type of information contained in this report.

The Treasury and Investment Management department of Gulf International Bank B.S.C. ("GIB") have compiled the information in this report. GIB is incorporated in the Kingdom of Bahrain and is licensed by the Central Bank of Bahrain (the "CBB") as a conventional wholesale bank. GIB's head office is located at Al-Dowali Building, P.O. Box 1017, 3 Palace Avenue, Manama, Kingdom of Bahrain.

This report is intended for the accredited investors, as defined in the Investment Business Code of Conduct published by the CBB. This information has not been reviewed by the CBB or any other regulatory authority in any jurisdiction and neither CBB nor any other regulatory takes any responsibility for the correctness or accuracy for the information contained in this report.

The information contained herein is not directed at or intended for use by any person resident or located in any jurisdiction where (1) the distribution of such information is contrary to the laws of such jurisdiction or (2) such distribution is prohibited without obtaining the necessary licenses or authorizations by the relevant branch, subsidiary or affiliate office of GIB and such licenses or authorizations have not been obtained. The recipient of such information is responsible for ensuring that this information has not been received by it in breach of laws and regulations of any jurisdiction.

This report contains publicly available information only, which has only been complied by GIB. The information provided herein is on "as is" and "as available" basis and without representation or warranty of any kind. GIB hereby disclaims any representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability, fitness for any particular purpose or non-infringement of any of such information. In no event shall GIB or its subsidiaries, affiliates, shareholders or their directors, officers, employees, independent contractors, agents and representatives (collectively, "GIB Representatives") be liable (1) for any inaccuracy, delay, loss of data, interruption in service, error or omission or for any damages resulting there from, or (2) for any direct, indirect, incidental, special, compensatory or consequential damages arising from any use of information or arising from any error (negligent or otherwise) or other circumstance or contingency within or outside the control of GIB or any GIB Representative, in connection with or related to obtaining, collecting, compiling, analyzing, interpreting, communicating, publishing or delivering any such information. The information here is, and must be construed solely as, compilation of information (unless expressly stated otherwise) and not statements of fact as to credit worthiness or recommendations or opinions of GIB.

This report does not provide individually tailored investment advice. Any materials contained herein have no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. The document is provided for information purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. GIB makes every effort to use reliable, comprehensive information, but we do not represent that it is accurate or complete. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the materials, nor are they a complete statement of the securities, markets or developments referred to herein. Recipients should not regard the materials as a substitute for the exercise of their own judgement. Any opinions are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or groups of GIB as a result of using different assumptions and criteria. GIB is not under any obligation to update or keep current the information contained herein.

The value of, and income from, your investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realized.

The information contained in this report is just for informational purposes. Information does not constitute a solicitation, an offer, or a recommendation to buy or sell any investment instruments, to effect any transactions, or to conclude any legal act of any kind whatsoever. GIB does not intend to provide investment, legal or tax advice through this report and does not represent that any securities or services discussed are suitable for any investor. When making a decision about your investments and business, you should seek the advice of professional advisors.

The report may contain statements that constitute "forward looking statements". While these forward looking statements may represent GIB's judgment and future expectations, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from GIB's expectations. GIB is under no obligation to (and expressly disclaims any such obligation to) update or alter its forward-looking statements whether as a result of new information, future events, or otherwise. The historical information is provided for information purposes only. Performance figures are calculated before tax (if any) and after deducting ongoing fees and expenses. The performance figures are historical and past performance is not necessarily an indication of future results. Certain amounts (including %ages) included in this document may have been subject to rounding adjustments. Accordingly, figures may not be an exact arithmetic aggregation of the figures to which they relate. The values and forecasts shown represent our current indicative valuations and forecasts of the relevant transactions, currencies, interest rates, commodities or securities as at the date shown. Any value or forecast shown herein is not an indicative price quotation. We expressly disclaim any responsibility for the accuracy of the values or forecasts shown, any errors or omissions in the report

With the exception of information regarding GIB and save as otherwise specifically indicated, the information set out in this report is based on public information. We have, where possible, indicated the primary source of information. We strongly recommend the recipients consult the primary source of information. Facts and views in this report have not been reviewed by, and may not reflect information known to, professionals in other GIB business areas.

This Report, and the information contained herein (save to the extent that such information is publicly available) is confidential and may not be disclosed by you to any other person outside of your organization without our consent.