

---

# Weekly Market Summary

June 29th, 2018

## Markets' Focus Shifting Away from Economic Data to Politicians' Stupidities!

Fadi Nasser - Deputy Chief Investment & Treasury Officer

Over the centuries, politics has passed through many eras: There have been periods of imperial conquest, isolationism, racism & discrimination, egalitarianism and nationalist aggression. Now, in the transatlantic sphere at least, we seem to be entering a new historical phase: The “*Era of Stupid!*” American and European politicians at the highest level appear to be engaged in a competition to see who can utter the most defiantly ill-informed, aggressively ignorant statements about precisely the issues that governments have traditionally regarded as life-and-death matters. Somehow, this bold inexperience - the shameless display of the failure to understand even the basic meanings of significant words – seems to be playing a major role in the latest markets’ movements and bout of volatility, and could soon help trigger or exacerbate a serious financial crisis / market meltdown. Napoleon Bonaparte once said, “*In politics stupidity is not a handicap*”. This surely never rang more true with the recent election of inexperienced and incompetent politicians!

Moving to the latest price action in financial markets, it is becoming clear that what began as first-half “*melt-up*” euphoria is now ending with “*melt-down*” fears! Investors started the year expecting to pick up easy returns from steadily rising asset prices; After all, the growth outlook for 2018 looked quite favourable, with the stars aligned for a continuation of the positive above-trend global growth, and a low but gently rising inflation. Additionally, easier financial conditions, coupled with fiscal stimulus, were certainly expected to lead to sustained economic development over the coming months (in line with a December 2017 / January 2018 economic assessment by the International Monetary Fund (IMF) and the World Bank, with both hailing the “broadest synchronised global growth upsurge since 2010”, as well as a brightening outlook and a “solid cyclical recovery, reflecting a rebound in investment, manufacturing activity, and trade”). Add to that a strong message by the US Federal Reserve – at its January 31<sup>st</sup> FOMC meeting - that an expansion with “*substantial underlying economic momentum*” is in place and would sustain additional increases in interest rates this year, and you had the perfect recipe / greenlight for “risk-on” winning dealings (long equities & emerging market currencies, short G7 government bonds)!

Instead, traders and fund managers are now nursing losses on bets that had – just few months back - delivered the biggest gains from a decade’s worth of buoyant liquidity. Stocks, bonds and currencies of developing nations soared over the past 2 years, despite tremors on the global landscape from Brexit to Donald Trump’s U.S. presidency, not to mention coups and impeachments in their own backyards. And whilst emerging economies began the year as a market darling, they were quickly toppled by a surge in the dollar, rising benchmark US interest rates, and mounting political risks. A brewing trade war proved to be the final knock-out, dashing all hopes that a synchronized global growth would keep pumping-up equities. China, long seen as the world’s growth engine, saw its stock market slipping into a bear market (a drop in excess of 20% from highs posted in late January). As a result, developing-nations’ stocks are now the biggest losers of the year so far - handing investors a loss of 8.75% once dividend payments have been taken into account. Emerging-market and euro-denominated debt are close runners-up, with losses of more than 4%. Oil remains the standout winner as investors bet on tightening supply against the backdrop of the increased isolation of Iran, rising tensions in Libya and the collapse of Venezuelan output.

This volte-face was captured in a Goldman Sachs Group Inc. barometer of risk appetite - which slumped to an 11-month low in late June after signalling the most accommodative investment environment since 2000 in January. But the sea change stems more or less from the snap stock sell-off of early February, which was blamed on traders unwinding huge short-volatility positions. Since then, markets have become more vulnerable to mounting political risks as investors – unwilling to get caught again when asset bubbles go “pop” - grew increasingly risk-averse. *“We’ve gone from an extreme of market psychology where all risks could be ignored to one that is hyper-sensitive,”* said James Athey, a senior investment manager at Aberdeen Standard Investments in London. *“The February turn, when equities suddenly started selling off, that was the moment when shock waves rippled across financial markets and people woke up to a different world.”*

The million dollar question going forward is whether the turbulent first half proves to be just the beginning, as markets continue adjusting to central bankers paring stimulus that had propped up asset prices with liquidity and low rates for the past decade, and to politicians upping the ante on future trade tariffs and wars. On the latter, President Trump is betting that Beijing will blink first in the showdown over tariffs, but such an outcome is far from assured - and it could also take a while. Economists – on their part - see an increasing risk that the world is headed towards an all-out trade war, one the World Trade Organization may be ill-equipped to respond to!

Anyone trying to gauge how markets will fare in the second half of the year may want to have a look at the demand for price protection against large swings in major global equities and currencies, which has recently approached its highest level since late February, according to the Bank of America Merrill Lynch hedging skew index. But if history is a guide, gains and losses in developing markets – in the long run - are more influenced by domestic stability levels, while the impact from external political risks gets often exaggerated. *“It’s not that political risk isn’t relevant,”* said Charles Robertson, Renaissance Capital Ltd.’s London-based global chief economist. *“It’s just that it shouldn’t be overstated. Unless there’s a real negative impact on economic growth, then markets won’t suffer as much as some fear”*, he added.

At least for now (*the second week in a row*), we continue to hope that the base case remains more “trade skirmish” than “trade war”, whilst acknowledging that the risks continue to grow! As noted last week, we also pray that calmer heads and pragmatism will eventually prevail, and that positive news would soon start emerging on all fronts. Otherwise, better prepare for a tumultuous second half for 2018!

## 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 compiled 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 realised.

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.

GIB retains all right, title and interest (including copyrights, trademarks, patents, as well as any other intellectual property or other right) in all information and content (including all text, data, graphics and logos) in this document. All recipients must not, without limitation, modify, copy, transmit, distribute, display, perform, reproduce, publish, license, frame, create derivative works from, transfer or otherwise use in any other way for commercial or public purposes in whole or in part any information, text, graphics, images from this document (excluding publicly available information) without the prior written permission of GIB.