

# weekly digest

Week ending 17 September 2017

global investment management

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## The Third Way

Thus far President Trump's leadership has been long on noise but short on results. He has failed to come up with any legislative wins in his first eight months, despite the Republicans' control of both chambers of Congress and the executive. This is mostly due to intransigence – the White House has simply not been playing its traditional coordinating role to help bills through Congress. But as Congress appears increasingly dysfunctional, Trump surprised everyone by finally making his first deal last week with the Democrats, rather than his own party, to extend the debt ceiling and government spending until December. This was a very surprising move as the Republican leaders were offering a similar but longer deal of at least 6 months and it's ironic that the president's first successful deal was made with the opposition party. The Republican leaders were understandably livid at the announcement. There are also now rumours of another potential deal with the Democrats on DACA, a program to legalise people who arrived in the country illegally as children and have grown up in the US. Yet to be confirmed, this deal would be in exchange for additional border security funding but surprisingly doesn't mention the wall with Mexico, a key issue for Trump's base.

Those deals have brought up an important question - is Trump becoming a truly independent president? There was initial speculation when Trump started his campaign that he might look to become a "third way" president, happy to work with both parties to get his agenda through. This view was reinforced by his overall ambivalent attitude towards his own party, raising questions as to whether or not he considered himself a real Republican. This question is important for investors because being able to rely on the Democrats' support for some reforms could bring a solution to unlocking the legislative process and passing Trump's major initiatives, including infrastructure spending and tax reform.

Looking more closely at the situation we believe that, although this is an interesting move that could open more opportunities for the President, it's unlikely that he will fully move to the third way of doing politics. Trump probably proceeded with the Democrats because he was under strong pressure to finally make a deal. He was very keen for a win, no matter where it came from and, of course, we do not know what it will ultimately cost in terms of political goodwill. Additionally, the Republican Party is also very keen to continue to work with him, mostly because they want to stay in line with their base but also because the party structure is still wrapped around him. They need him and his base to raise money and win the 2018 elections. It's probably true that he has less allegiance to the party than previous Republican presidents; after all he wasn't a member for a long time and his rhetoric regularly breaks with Republican orthodoxy. But it's very unlikely that he will move away from the party because his electoral base is Republican and has continued to stick with him. Of the Republicans who voted for Trump in the primary, 98% approve of his performance in office and two thirds of the overall Republican base still support him according to Slate Magazine; statistics that are surprising given the lack of any major reforms since the start of the term but key for Trump to remain in power. The President is probably very conscious of this fact, which reduces the chance that he will steer away from his core base.

Even if he decided to become independent, Trump would probably not be a moderate but actually move further to the right to consolidate his base, which would make it harder to work with the Democrats. Finally, a key requirement to become an independent president able to make deals with both parties is to retain the trust of Republicans and build ties with the Democrats. There is little to suggest that Trump is capable of doing both. The first part is probably easier since, as discussed above, the Republican Party has many reasons to work with him even though Trump may have undermined them with his recent deal. But building a relationship with the Democrats will take time and face significant hurdles. Democrat voters are unlikely to be supportive of their party dealing with Trump and the leadership could face a huge backlash if they chose to cooperate regularly. The debt ceiling deal was a special case because of the emergency needs for hurricane Harvey.

At Momentum, as Outcomes Based Investors we continue to follow our policy of maintaining well diversified portfolios across a range of parameters, including by asset class, investment strategy, geography and managers to reduce risk. Although we continue to watch Trump's ability to pass reforms and how this may impact markets, we prefer to stick to our long term, proven, valuation process which lead us to lower positions in US equities rather than try to speculate on when or what deals he will be able to get through.

## The Marketplace

- Oil rose 3.4% on the week with Brent at USD 56
- Gold fell 1.8 % to 1315
- Haven assets decline, global equities rise
- North Korea launches second missile over Japan

## Market Focus

### US

- Retail sales down 0.2% in August extending losses on the dollar. Lower demand for autos and the effects of the hurricane large contributing factors
- Fed expected to leave interest rates unchanged this week with a rate rise of 0.25% due in December
- The S&P 500 Index was up 1.6% last week closing at 2500
- The Dow Jones index ended the week at 22268, up 2.2%
- Nasdaq was up 1.3% at 5988

### UK

- UK inflation near a 5 year high but wage growth remains subdued, a dilemma for BOE's monetary policy committee, though increasing expectations (65% probability) for a rate rise in November
- The FTSE was down 2.2% last week closing at 7215
- Sterling climbed to its highest level since Brexit on the back of BoE's more hawkish tone on rate rises. Up 3% vs the Dollar and 3.8% vs the Euro on the week
- Yield on 2 yr gilts quadrupled over the last 3 months to -0.45%
- UK employment rose by 181,000 over the last three months: at 4.3%, unemployment is standing at a 40 year low

### Europe

- Juncker gives EU address pointing at further Euro Zone integration, particularly in bank regulation
- Munich Re and Swiss Re expected to be hit with up to \$3bn losses after Hurricanes Harvey and Irma
- Angela Merkel the clear frontrunner in the upcoming German elections
- The Eurostoxx 50 was up 2% closing at 3516
- The Dax increased 1.8% to 12525

### Asia

- Nikkei closed +3.3% on the week at 19909
- The Hang Seng finished the week up 0.5%
- China suspends cryptocurrency trading prompting a 5 day fall in Bitcoin to 3750
- China Industrial output rose 6% (vs. 6.6% expected) with retail sales up 10.1 (vs. 10.7% expected) over the last 12 months. Curbs on credit expansion seen as the main driver for the cooling.
- North Korea launched a second missile over Japan, markets appear risk resilient to near constant provocations

Source: Bloomberg. Returns in local currency unless otherwise stated.

Jeromine Bertrand (CFA) & James Jones



| Asset class/region                  | Currency | Currency returns            |               |          |           |
|-------------------------------------|----------|-----------------------------|---------------|----------|-----------|
|                                     |          | Week ending<br>15 September | Month to date | YTD 2017 | 12 months |
| <b>Developed markets equities</b>   |          |                             |               |          |           |
| United States                       | USD      | 1.6%                        | 1.2%          | 12.8%    | 18.1%     |
| United Kingdom                      | GBP      | -2.3%                       | -2.9%         | 4.3%     | 11.4%     |
| Continental Europe                  | EUR      | 1.4%                        | 1.8%          | 9.9%     | 17.9%     |
| Japan                               | JPY      | 2.9%                        | 1.3%          | 9.2%     | 28.7%     |
| Asia Pacific (ex Japan)             | USD      | 0.9%                        | 1.3%          | 28.9%    | 25.6%     |
| Australia                           | AUD      | 0.5%                        | 0.2%          | 4.1%     | 13.6%     |
| Global                              | USD      | 1.2%                        | 1.5%          | 15.2%    | 18.9%     |
| <b>Emerging markets equities</b>    |          |                             |               |          |           |
| Emerging Europe                     | USD      | -0.6%                       | 0.0%          | 16.2%    | 27.7%     |
| Emerging Asia                       | USD      | 1.4%                        | 1.6%          | 34.0%    | 28.0%     |
| Emerging Latin America              | USD      | 1.6%                        | 4.0%          | 29.8%    | 31.4%     |
| BRICs                               | USD      | 2.0%                        | 2.7%          | 35.3%    | 31.1%     |
| MENA countries                      | USD      | 0.2%                        | 1.0%          | 6.5%     | 15.4%     |
| South Africa                        | USD      | -2.0%                       | -3.5%         | 15.8%    | 13.2%     |
| India                               | USD      | 1.2%                        | 1.5%          | 32.1%    | 21.8%     |
| Global emerging markets             | USD      | 1.1%                        | 1.4%          | 30.1%    | 26.8%     |
| <b>Bonds</b>                        |          |                             |               |          |           |
| US Treasuries                       | USD      | -0.7%                       | -0.3%         | 2.9%     | -0.6%     |
| US Treasuries (inflation protected) | USD      | -0.6%                       | 0.2%          | 2.7%     | 1.4%      |
| US Corporate (investment grade)     | USD      | -0.4%                       | -0.2%         | 5.1%     | 3.2%      |
| US High Yield                       | USD      | 0.2%                        | 0.4%          | 6.5%     | 9.6%      |
| UK Gilts                            | GBP      | -3.1%                       | -2.6%         | -0.1%    | -2.6%     |
| UK Corporate (investment grade)     | GBP      | -2.3%                       | -2.0%         | 2.5%     | 1.0%      |
| Euro Government Bonds               | EUR      | -0.7%                       | -0.4%         | -0.3%    | -2.2%     |
| Euro Corporate (investment grade)   | EUR      | -0.4%                       | -0.3%         | 1.7%     | 0.8%      |
| Euro High Yield                     | EUR      | 0.1%                        | 0.3%          | 5.7%     | 8.0%      |
| Japanese Government                 | JPY      | -0.2%                       | -0.1%         | 0.1%     | -0.9%     |
| Australian Government               | AUD      | -0.9%                       | -0.1%         | 2.3%     | -0.6%     |
| Global Government Bonds             | USD      | -1.3%                       | 0.0%          | 7.0%     | -0.9%     |
| Global Bonds                        | USD      | -1.0%                       | 0.0%          | 7.2%     | 0.9%      |
| Global Convertible Bonds            | USD      | 0.3%                        | 1.1%          | 9.9%     | 7.9%      |
| Emerging Market Bonds               | USD      | -0.3%                       | 0.6%          | 9.4%     | 5.5%      |

Source: Bloomberg. Past performance is not indicative of future returns



| Asset class/region                    | Currency | Currency returns         |               |          |           |
|---------------------------------------|----------|--------------------------|---------------|----------|-----------|
|                                       |          | Week ending 15 September | Month to date | YTD 2017 | 12 months |
| <b>Property</b>                       |          |                          |               |          |           |
| US Property Securities                | USD      | 0.4%                     | 1.5%          | 4.5%     | 3.1%      |
| Australian Property Securities        | AUD      | 0.0%                     | 1.4%          | -4.3%    | -3.1%     |
| Asia Property Securities              | USD      | 0.4%                     | 1.4%          | 23.8%    | 16.8%     |
| Global Property Securities            | USD      | 0.6%                     | 1.9%          | 13.6%    | 9.6%      |
| <b>Currencies</b>                     |          |                          |               |          |           |
| Euro                                  | USD      | -0.7%                    | 0.5%          | 13.5%    | 6.2%      |
| UK Pound Sterling                     | USD      | 2.9%                     | 5.3%          | 9.8%     | 2.5%      |
| Japanese Yen                          | USD      | -2.7%                    | -0.6%         | 5.6%     | -7.9%     |
| Australian Dollar                     | USD      | -0.7%                    | 1.0%          | 11.2%    | 6.5%      |
| South African Rand                    | USD      | -1.9%                    | -1.2%         | 3.9%     | 8.1%      |
| Swiss Franc                           | USD      | -1.4%                    | 0.2%          | 6.1%     | 1.2%      |
| Chinese Yuan                          | USD      | -0.9%                    | 0.9%          | 6.3%     | 2.0%      |
| <b>Commodities &amp; Alternatives</b> |          |                          |               |          |           |
| Commodities                           | USD      | 1.1%                     | 1.5%          | -1.5%    | 5.9%      |
| Agricultural Commodities              | USD      | -0.4%                    | 0.8%          | -3.0%    | 0.4%      |
| Oil                                   | USD      | 3.4%                     | 6.2%          | -2.1%    | 19.4%     |
| Gold                                  | USD      | -1.8%                    | 0.4%          | 14.8%    | 0.6%      |
| Hedge funds                           | USD      | 0.2%                     | 0.3%          | 4.1%     | 5.9%      |

Source: Bloomberg. Past performance is not indicative of future returns

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