



Weekly Market Comment

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Are financial markets ignoring the Trump risk?

A deeply divided nation has elected the maverick outsider Donald Trump to be president of the United States. Voters thereby taught the establishment of the political and professional class that they feel disenfranchised enough to experiment with a person and ideas that the overwhelming majority of experts regard as not just populist but outright dangerous to society and economy.

Sound familiar?

Well as I pointed out last week, in the event that Trump was to win the US election, I expected somewhat of a replay of the post-Brexit Referendum scenario – in the financial markets, as well as in politics.

And so it unfolded. Firstly, an election night which felt like a déjà vu of the night of 23/24 June in the UK, with all the same failings of the pollsters as we had in the run-up to our referendum. The only difference perhaps that the defeated Hillary Clinton actually won the popular vote by a slim majority of 200,000. Donald Trump still won by a large margin of electoral college votes as he managed to get enough states behind him, which is how the US system has always worked.

Secondly, a 6% sell-off in stock markets which were open at the time ensued- Asia. Similarities with the post Brexit scenario then fast forwarded and financial markets avoided spending another 3 days in a state of panic. When Donald Trump's acceptance speech sounded far more sensible and conciliatory than anybody could have hoped, financial markets very quickly regained their balance. US stocks rallied, while bond markets sold off, jolting long term government bond yields upwards at a speed and to levels not seen since last year. Quite a bullish verdict by markets for the economic development of the US under President Trump?

How is such a U-turn possible, when just a week earlier a majority of market commentators and analysts had predicted the almost exact opposite?

Well, markets know no moral and are also perhaps sometimes prone to selective hearing. Financial markets clearly disregarded the painful division Trump had brought upon the American and discounted any success of him being able to progress his trade curbing protectionist promises or cutting the US off from the Global labour market.

What I believe they focused on was firstly that Trump appeared to have turned from aggressive electioneer into political pragmatist, which meant he would not pose an immediate risk to the current positive upward momentum of US economic growth. Secondly, they focused on the combination of this Republican Party President elect coming into government with a Republican US Congress and his immediate policy focus on fiscal stimulus through infrastructure improvement programs to create well paid construction jobs for the lesser educated.

Essentially, market participants appeared to assume that he would be able to get everything with potential to stimulate economic growth through Congress, where Obama had been deadlocked, but that Congress would prevent him from progressing anything truly detrimental for the US economy, like a trade war with the rest of the world. So, yes to sweeping tax cuts like Ronald Reagan and a New Deal 2.0 infrastructure program like Roosevelt, but no wall, no tariffs and no removal of illegal immigrants.

The effect of such a Trump initiated policy shift would be accelerating economic growth and corporate earnings, while inflation would return as a consequence of wage pressures in the face of an already tight labour market and increased government borrowing.

However, just as with Brexit, nothing can and will change over the shorter term and in the absence of a nasty reaction from financial markets the economy just carries on. Additionally, the prospect of fiscal stimulus finally coming to the aid of monetary stimulus to re-deploy idle cash and rebuild business confidence levels from whoever may be able to deliver it is welcomed by markets.

In the longer term, however, things are not quite as clear. Financial markets appear to have currently assumed little change to the geopolitical balances, which is somewhat unlikely given Trump's deep rooted belief that the US should not attempt to mediate or intervene where humanitarian and democratic values come under attack. We also have to expect headwinds for the already lagging development of global trade and free movement of labour (and talent!).

In summary, Donald Trump's unexpected success to be elected US president has just like the UK's Brexit vote been largely shrugged off by financial markets and as a result 2016 investment returns did not come under any significant downward pressure.

However, contrary to the post Brexit developments, longer maturity bonds sold off considerably and this has sparked a wider debate whether bond yields, after falling steadily for nearly 36 years have now finally reached their inflection point, ending almost 4 decades of bond bull market conditions.

Since the beginning of October, longer term bond yields have risen more than we had anticipated, but while major central banks remain large scale buyers of bonds through their continued QE obligations, we see this as much of an overshooting to the upside, as the summer's yields' plunge towards 0% proved to be an only temporary overshooting to the downside. Once the initial euphoria over the rediscovery of inflationary prospects ebbs away and the next economic worry appears on the horizon, bond markets are likely to moderate once again.

Trump's First 100 Days: The most likely areas of initiatives

The initial shock and surprise of the US presidential election outcome is now a few days behind, and the world must come to terms with Donald Trump's victory. Predictions are therefore made everywhere on what we can expect in Trump's first 100 days, given the array of quite outrageous promises he made during his campaign. Historically Presidents have sought to set a precedent for their 4-year term during these initial days in power. Obama time in office started in the depths of the Great Financial Crisis in 2009 and sought to create his presidential footprint by passing the American Recovery and Reinvestment Act. Likewise, Trump may seek to forge some form of economic stimulus package. In fact, at the end of October he released a plan for his first 100 days in the form of a 'contract with the American people'. But from a man who is inherently unpredictable and occasionally absurd with regards to future policy, how many of his promises will actually be achieved or are even achievable?

Curbing Immigration:

Immigration was a perhaps the corner stone to Trump's campaign, but his grand promises during the election are unlikely to have much success in his first 100 days. In his October 'contract' he already quietly dropped his earlier promise to remove all undocumented immigrants from the US. While both hugely impractical, it was a policy that would have severely damaged the US economy by removing many million GDP generating workers from the labour market. As for the wall along the border with Mexico, that promise also looks highly unfeasible. Congress will not fund a wall and nor will Mexico, even if he thought he would achieve it by threatening economic sanctions. Such sanctions would likely hit the economy of the US' South West as hard as Mexico. Instead, we expect focus to turn immediately to expediting the process of deporting illegal immigrants and foreign nationals with criminal records.

Washington Reforms:

Reforming "corrupt" Washington was another pillar of his campaign. He will almost certainly seek to pass some form of legislation that will have the symbolism of "draining the swamp" – as he called it. Trump promised in October that he would propose a constitutional amendment to impose term limits on all members of Congress. But his proposal is just that, a proposal and for it to come into force would take years. Senate Majority Leader, the Republican Mitch McConnell, has already killed that plan, stating "It will not be on the agenda in the Senate." Though, a 5 year-ban on White House and Congressional officials becoming lobbyists after they leave government service, does appear to be a far more reasonable request and could very well be implemented in this initial stage of Trump's presidency.

Furthermore, the fact that he will only be able to progress any of his plans effectively with the support of the Republican dominated US Congress means that his leverage for reforms of the political establishment in Washington may also prove quite limited.

Economy:

Crucially, it will be Trump's promises on the economy that will potentially face the greatest resistance from his party. McConnell has already been critical of Trump's infrastructure rebuilding plans, labelling it as far from a top priority. Although Trump has the fortune of a Republican majority in both Houses, he does not have the fortune of unequivocal support for his chosen plans. Fundamentally fiscally conservative Republicans at large will be unlikely to support a big unfunded tax cuts or increase in state infrastructure spending, and allow the fiscal deficit to balloon. The economy itself is in pretty good health, with unemployment at 4.9%. The economic backdrop Trump is inheriting, is - unlike 2009 - not in desperate need of a 1930s type 'New Deal'. What is more likely is that there will be some form of personal tax code overhaul, where the number of brackets are reduced from 7 to 3, as he promised in his pledge. However, calculations have shown that while bringing some relief to the lower middle class, the biggest earners at the top will still benefit the most. It is also reasonable to expect the corporate rate to be lowered, but by how much remains to be seen.

Trade:

His rhetoric with regards to trade resulted in some of his more perceived as extreme promises. He has said that in his first 100 days he will label China a currency manipulator and impose duties; announce America's withdrawal from the Trans-Pacific Partnership; immediately begin renegotiations of the North American Free Trade agreement with Canada and Mexico. It is highly unlikely he will keep to the word of any of his threats against China. Labelling a chief trading partner, a currency manipulator is simply reckless and nothing good will come of potentially initiating a global trade war between the 2 economic super powers. With regards to the trade agreements, there may well be symbolic rhetoric of initiating renegotiations but withdrawal is not an immediate possibility when there is no clear replacement. His wild promises made during his campaign may well have been acceptable then, but Trump's integral pragmatism, and more importantly his political advisors, should see him adopt a more reserved approach as his acceptance speech appeared to indicate already.

Social Reforms:

It is Trump's social agenda that has the greatest potential to further divide an already polarised nation. The Affordable Care Act, also known as Obamacare has long been a whipping boy for Republicans. But plans to repeal it early on are unlikely to take effect. To remove it wholesale, which is what Trump has promised, would leave millions of Americans without insurance and has the making of a PR disaster. Instead, Trump may well seek to curtail the progressive pro-choice (right to abortion) movement that was endorsed by his predecessor. He will almost definitely nominate a Republican leaning supreme court justice and thence potentially seek to repeal the Roe V Wade ruling through the supreme court, thereby allowing individual states to prohibit abortions. Moreover, with strong Republican backing we can expect that he will revoke Federal Funding for Planned Parenthood. These symbolic measures will potentially be made as a substitute for his inability to implement many of his more extreme promises that would face difficulties getting through the Senate.

Trump will not want to start his presidency with a list of failed initiatives and thus broken promises. With this in mind the plan he lays out for the first 100 days will likely be far more reserved than his earlier promises and therefore much more likely to succeed. That said, his proposals will still remain reactionary and attempt to unwind much of the very progress with which the Obama administration was trying to overcome some of the deepest rifts between the top and the bottom of US society.

The “Forgotten”, as he labelled the less educated lower end of society will suffer from such measures and to avoid the wrath of his most determined supporters his best option will be to announce the creation of large numbers of well-paid construction jobs across the country through a major infrastructure upgrade program. With employment already very near full levels, this would pull labour from lower paid and perhaps less prestigious service sector jobs. How those would then be back-filled, when he is at the same time closing the country to immigrants, is one of the many conundrums a President Trump will find himself challenged by.

In conclusion, we would expect that in all probability Trump will focus on the quick wins of tax cuts and announcements of infrastructure modernisation support programs and other fiscal stimuli that will benefit wider parts of the underprivileged parts of society to gain time to progress with his more substantial promises. Much will hinge on how collaborative he will find the Republican Congress and how much he can keep the public support momentum of his election campaign alive to put pressure on his fellow politicians.

Tesco bank hack: Challenger banks in the digital age & the need for intermediaries

In what has been described by cyber-security experts as the “most serious” and visible attack to ever occur in the UK banking sector, we believe the widely media publicised Tesco ‘hack’ highlights the growing pains of the new challenger banks in an increasingly digital age. It also shines a light the rising importance of expert intermediaries, such as financial advisers and the ability of institutions to service their customers in the face of continued branch closures.

First a little background. Tesco announced that nearly 40,000 bank accounts had been subjected to a number of “suspicious transactions” and about half (or 20,000) of those accounts had money taken from them. The amount taken from each customer varied from as low as £10 to as much as £1,000 or more in rare cases, but the total sum was about £2.5 million.

On the week that the British Banker’s Association (BBA) began ‘CyRes Week’, a series of events that sought to teach banks how to improve cyber security, experts said the scale and sophistication of the attack on Tesco appears to be unprecedented in UK history. It is the largest bank robbery since 2004’s Northern Bank robbery in Northern Ireland when £26.4 million was physically stolen.

As a result, Tesco temporarily suspended the ability of all its 136,000 customers from making online and contactless payments. The company has confirmed that it would repay all monies lost by its banking customers in an effort to restore confidence and has since lifted restrictions on all transactions – noting that “normal service has resumed”.

The hack exposes an issue for online security, potentially some wider implications for the UK’s new challenger banks, and also the fact that the shift to online-based services reduces the ability to deal with crisis situation through the decentralised, traditional face-to-face communication route (customer services) that banks used to have.

Over the past decade, retailers like Tesco and M&S have offered store cards, credit cards, insurance and foreign currency services, but the move into providing bank accounts and loans is a recent development. As customers have moved more of their activity online – particularly online banking – firms like Tesco saw an easy win. There was no need for an expensive network of branches, given the rise of accessing our money via the web and now even on a smartphone.

In the event of last week, customers became very frustrated that Tesco appeared to be unable to respond when they called in, prompting the company to launch a special twitter account as their call centres to provide timely information. The lack of relevant staff and the capacity for direct contact with online services can feel disturbing when things like the Tesco hack happen. This is a bigger problem for the new challenger banks than it is for the likes of Barclays, HSBC, Lloyds and others given their large branch networks.

For the traditional high street banks, the increased use of online banking allowed them to cut costs by reducing the number of branches. They argue that a rising number of customers now rarely enter a branch so fewer are needed.

The larger issue for customers of online financial services is one of being able to talk to someone directly when needed. This is where online struggles. Firms have long used automated telephone systems, with their familiar yet frustrating “Press 1 to...” but now banks are looking at deploying new artificial intelligence (AI) ‘bots’ that can analyse a customer’s question and respond dynamically with a relevant solution.

So called robo-advice (essentially a self-select service) have also begun to attract corporate investment in the hope to repeat what transactional banking has achieved in cost reduction through the power of computers. However, the public appears far more reluctant to embrace the idea. To our mind, financial advice, particularly around investments is just too complex and reliant on personal relationships underpinned by trust for a computer process to be trusted by any more than a minority.

However, last week’s events showed that there may be a better application for ‘Robo’ than trying to compete with financial advice from humans and that is to help financial organisations to deal with peaks in urgent customer enquiries. This could be as the result of mass cyber security breaches as was the case with Tesco, but might as well apply to more general system failures as have happened to the traditional high street banks. The data interconnectedness of our world has made it more probable that everybody wants to be spoken to at once. Even the big traditional banks would be unable to satisfy such peak demand.

The banking community stated that cyber-attacks like the one on Tesco Bank could never be entirely eliminated and the incident may therefore have got the large financial institutions thinking. A – in the overall scheme of things – relatively small financial loss through fraud may have triggered a much, much larger loss of potential revenue as less costumers may be willing to switch to challenger Tesco Bank after reading about their customers’ frustrations. Clever, ‘robo’ applications, both on the phone lines, but also institutions websites, may have significant potential to soothe clients’ concerns en masse and thereby prevent the type of negative PR Tesco experienced last week.

India gets away with scrapping and reissuing overnight most of Rupees in circulation

In a highly surprising move, Indian Prime Minister Narendra Modi announced last week that the government would be withdrawing the country’s two largest denominated notes from circulation with immediate effect, to replace them with new, harder to counterfeit ones. He cited not just fighting counterfeiting as an objective but also presented it as a major initiative against corruption.

Effective from 9 November, the government cancelled both the 500 and 1,000 Rupee notes (equivalent to approximately £6 and £12). These two notes account for about 85% of the currency in circulation. Banks and cash machines were closed on Wednesday so that the old notes could no longer be withdrawn and new 500

and 2,000 Rupee notes could be issued. The government imposed a daily withdrawal limit of 2,000 rupees (£24) per day at ATMs.

Individuals have just 50 days in which they can exchange their old notes for new ones, but only at the banks as they are no longer legal tender. People would be required to provide ID when returning old notes, as finance minister Das said that banks would be closely monitoring such exchanges for those that had large piles of illegitimate cash at home. Anyone exchanging notes they could legitimately account for would only be given 4,000 rupees in cash and any excess provided as bank credits.

The announcement led people to a quick dash to the ATM so they would not be left without cash over the next few days. Critics of the move said that it would make it more difficult for those who chose to keep large amounts of cash at home rather than in bank account. India remains a predominantly cash based society and physical cash accounts for about 10% of domestic household assets.

Modi's announcement follows the recent four-month tax amnesty period, which saw some \$9.8 billion worth of assets declared by individuals and this appears to be the next step in curbing the black economy, where physical money could have been acquired corruptly or deliberately withheld from tax authorities.

Modi said that "fake money and terrorism are ruining the nation's fabric" and the "cash economy aides black money, corruption and makes life difficult for the poor". Observers have said that a high percentage of political corruption takes place in cash to effectively buy votes.

So what does this mean for India in economic terms?

The anti-corruption reform drive may have a fairly large impact on the domestic money supply, consumer spending, fiscal policy and even rates of inflation.

The supply of money (currency circulation) in India has seen a sharp increase over the past year, rising 17.3% year-on-year in October, contributing almost 20% of the overall increase in the money supply over the same time frame. We believe these reforms are likely to lead to increased use of bank accounts for cash deposits and as time passes more transactions will take place within the banking system. This should allow the central bank to improve the effectiveness of monetary policy via the transmission mechanism of the banks.

However, in terms of economic growth, a reduction in the amount of currency circulating the country in the short-term could have a detrimental effect by curbing consumer spending, as consumption accounts for 55% of GDP in India. We note that cash-heavy sectors like jewellery, restaurants, food and transport may see a drop in sales. These sectors represent about 50% of consumer spending, which increases downside risks to growth in the short-term.

Additionally, as India is a large traditional buyer of gold, imports of the precious metal could fall, which may put downward pressure on gold prices via reduced demand for jewellery. From an inflation viewpoint, weaker demand and prudent spending could help contain the headline rate of inflation.

We do think that despite the short-term issues, this move is a positive longer-term step that should help improve transparency and accountability, as it shifts more transactions electronically through the banking system. Additionally, any undeclared cash that is exchanged should be able to be tracked by the tax authorities, which could lead to increased tax receipts for the government. This should help the government to reduce its fiscal deficit from an estimated 3.5% in 2017 to 3% in 2018.

We noted the action of the Indian government as a very brave move that should prove very beneficial over the medium to long term. We were amazed that the move didn't result in widespread riots as so many still operate entirely in the cash economy and would have experienced it as blatant expropriation. We presume that small accounts of cash, as the poorer masses would hold, will require less proof of legitimacy. Additionally, and also given corruption has not disappeared over night, there are probably means and ways of exchanging even slightly above average cash hordes for a 'fee'. This would only leave the large illegitimate cash piles which were the target of the exercise, but the population numbers behind those would be small enough not to fear riots.

Nevertheless, the Modi government must feel quite confident given it was willing to take on all those with large amounts of cash but also influence!

PERSONAL FINANCE COMPASS

Global Equity Markets

MARKET	CLOSE	% 1 WEEK	1 W	TECHNICAL
FTSE 100	6724.1	0.5	30.8	↓
FTSE 250	17425.4	0.9	154.1	↓
FTSE AS	3660.6	0.5	18.7	↓
FTSE Small	4868.0	0.1	3.8	↓
CAC	4480.8	2.4	103.3	↓
DAX	10658.4	3.9	399.3	↓
Dow	18749.4	4.8	861.1	↓
S&P 500	2155.4	3.4	70.2	↓
Nasdaq	4719.1	1.3	58.7	↓
Nikkei	17374.8	2.8	469.4	↓

Top 5 Gainers

COMPANY	%	COMPANY	%
GLENCORE	17.5	MEDICLINIC INTERNA	-13.3
ASHTAD GROUP	13.8	RANDGOLD RESOURC	-12.3
PRUDENTIAL	13.3	FRESNILLO	-11.7
SHIRE	12.9	IMPERIAL BRANDS	-10.1
RIO TINTO	12.5	SAINSBURY (J)	-7.7

Sovereign Default Risk

DEVELOPED	CDS	DEVELOPING	CDS
UK	19.0	Brazil	493.9
US	19.3	Russia	304.2
France	26.0	China	26.0
Germany	12.5	South Korea	12.5
Japan	49.0	South Africa	49.0

Currencies

PRICE	LAST	%1W	CMDTY	LAST	%1W
USD/GBP	1.26	0.51	OIL	44.4	-2.6
USD/EUR	1.08	-2.71	GOLD	1231.1	-5.7
JPY/USD	106.60	-3.26	SILVER	17.6	-4.3
GBP/EUR	0.86	3.31	COPPER	250.2	10.4
JPY/GBP	6.81	-0.82	ALUMIN	1770.0	2.3

Commodities

Fixed Income

GOVT BOND	%YIELD	% 1W	1 W
UK 10-Yr	1.4	20.9	0.24
US 10-Yr	2.2	21.1	0.37
French 10-Yr	0.8	62.5	0.29
German 10-Yr	0.3	131.1	0.18
Japanese 10-Yr	0.0	64.5	0.04

UK Mortgage Rates

MORTGAGE BENCHMARK RATES	RATE %
Base Rate Tracker	2.2
2-yr Fixed Rate	1.5
3-yr Fixed Rate	1.8
5-yr Fixed Rate	2.3
Standard Variable	4.2
Nationwide Base Rate	2.25
Halifax Standard Variable	3.74

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For any questions, as always, please ask!

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The value of your investments can go down as well as up and you may get back less than you originally invested.

Lothar Mentel

