



Weekly Market Comment

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UK Pound Sterling / Euro FX Cross Rate GBPEUR



Source: FT.com, 2 Dec 2016

Exchange rates return to the spotlight

The past week brought some surprises as well as some interesting developments, which in combination supported recent improvements in market sentiment, even if the UK's stock market fell slightly over the course of the week. Interestingly it all still hangs together.

In the UK, some progress in the planning of the EU exit negotiations revealed there is unlikely to be enough time available over the 2-year notice period of Article 50 to actually arrive at anything else but a Hard Brexit. Even the most hardnosed Brexiteers appeared to accept that such a scenario without any transition arrangement may carry too much risk for the UK's economy to seriously contemplate. When Brexit secretary David Davis hinted that the government may see merit in continuing to pay EU contributions in return for a temporary extension of preferential treatment of trade in services and goods, financial markets took this as a strong indication that they were correct in their suspicion that this divorce would be far more drawn out than 2 years. With more time, things can change and more importantly the status quo is extended into the future. And the status quo is not so bad right now, with the UK sporting the highest GDP growth rates this side of the Atlantic.

The subsequent further recovery of £-Sterling was evidence that the currency markets are the most vigilant opposition the UK's government has at the moment, in that they seemed to signal approval of the development towards seeking an extension of the current UK-EU relationship framework. However, the Sterling strength became a headwind for the UK stock market. Just as the weakening currency had pushed it up as it increased the Sterling-value of overseas revenues and profits, the strengthening results in the opposite.

The other very notable news item was the surprise success of the Organisation of Petroleum Exporting Countries (OPEC) oil cartel to agree to production cuts next year – by 3.4%. While by no means translating to these actually happening, oil markets nevertheless took it as a signal that the price war over market share is coming to an end. This should mean less price volatility next year, which should encourage a return of

exploration investment planning stability and consequently return some very welcome industrial demand to the global economy.

Predictably the oil price shot up - from \$46 per barrel (bbl) to \$54/bbl - a whopping 17.4%. Given a price above \$50/bbl turns much of the US shale oil industry back into profit, the price may have already overshot on the upside, because shale oil volumes can be turned back on in matter of months.

The higher oil price and the general upward price pressures that come in its wake, together with the improved industrial output prospects, immediately fed into rising inflation expectations. These had already moved up significantly since the summer and even more since the Trump win, in anticipation of fiscal stimulus measures which would be necessary to stem the rise of the global populism movement. The oil push reaccelerated the rise in yields and related sell off in bonds as investors seek to protect their wealth from rising inflation. So while the fiscal argument appeared to run out of momentum, oil has given it another life.

Overall good or bad news then? Well, as the UK's bank stress test results of the past week also showed, there are still clouds on the horizon, but at least there are now a number of the factors that recently undermined confidence (not much inflation, poor growth prospects, low yields) which are now moving in the opposite, improving direction.

This leads us back to political risks and here the focus will be on Europe over this past weekend. At the time of writing on Friday, there was an expectation that the Italian constitutional referendum would fail and lead to Italian Premier Renzi's resignation. This could spell trouble for the weak Italian banking sector, but probably only if the No side wins by a landslide, as this would open the prospect of a populist government next year. If the No margin is small, then we should expect just a continuation of the typical Italian muddling through politics.

The re-run of the Austrian presidential election may be more insightful in terms of whether the right-wing populism is spreading further or has gone past its peak with Trump's election. This is because there the subject matter is less complex than in Italy – the electorate has a straight forward choice between a xenophobic right wing nationalist and a liberal candidate.

Given the experience of Brexit and the US presidential election I now doubt very much that outcomes in either will have far reaching negative market impact, as markets appear to have accepted extreme electoral results as the new normal. However, given the recent weakness of European stock markets despite significant economic and corporate growth improvements, a surprise return to more moderate voting has the potential to cause a bit of a market rally.

RBS fails UK bank stress test – are banks becoming a threat again?

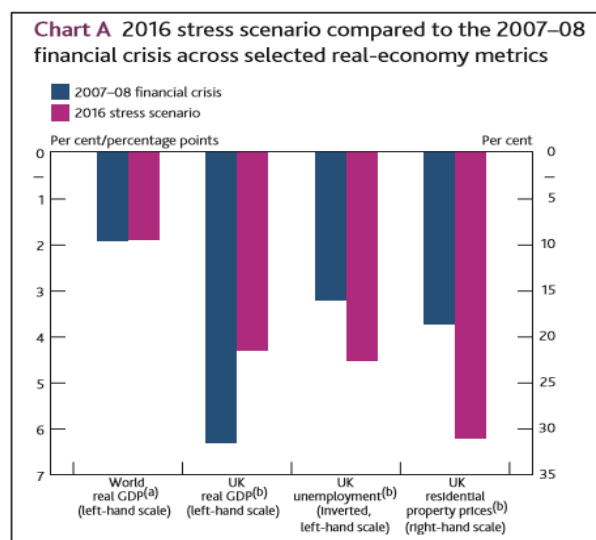
Perhaps one of the key lessons from the global financial crisis (GFC) that triggered the 2008/2009 global recession was the domino effect a series of bank failures can have. While the crisis was caused by a failure of trust in the shadow (non) banking sector of structured credit securities, it was only when the contagion spread to banks that the issues became a systemic and global economic threat. This is because banks and other financial institutions effectively underpin the functioning of the entire monetary side of our economic system. As a result, given the global inter-connected nature of the banking sector and financial instruments, banks are critical to an effective operation of the *real* economy.

At the time, Governments rushed to “nationalise” failing banks, not only to ensure financial stability, but to prevent the possible spread of wider negative socio-economic effects (and an even worse economic crisis similar to the 1930 Great Depression that followed the financial crisis of 1929). Recognising that (solvent) banks provide the foundations for a working economy, and to avoid the severe spill-over effects of any future bank failure, the UK’s central bank, the Bank of England (BoE) conduct annual “stress tests” on the UK’s biggest banks. This year, a number of banks struggled to pass some of the tests, but it was RBS that came “bottom of the class”.

The BoE’s 2016 stress test covered seven major UK banks and building societies, accounting for around 80% of regulated banks’ lending to the UK economy. The stress tests allow policy makers to assess banks’ ability to withstand very severe economic and financial market shocks, and still maintain the supply of credit to the *real* economy during times of economic stress. However, compared to previous years, this test posed the toughest ‘war-game’ scenario examination of banks’ resilience yet.

For the first time, banks were tested against a combined scenario of very severe UK and global economic recessions, with a further amplification through a financial market shock and a separate misconduct cost stress (fines for past miss-selling etc.). The scenario assumptions were a global GDP fall of -1.9%, as per the 2008 financial crisis, and UK GDP falls of -4.3%, accompanied by a 4.5% rise in the unemployment rate. In addition, falls in UK residential property and commercial real estate (CRE) prices- house prices by -31% and commercial property prices by -42%. Arguably, the stress test exceeded, or was at least level with, what banks experienced during the GFC.

A tough test - the Bank of England’s exam paper for 2016



Source: BoE, Stress Testing the UK Banking System, November 2016

A bank’s resilience is effectively measured by assessing the bank’s capital buffers – in this case, its core equity capital compared with its total risk-weighted assets. In other words, the test measures a bank’s ability to withstand losses given the quality of its loan book and any pending liability (E.g. misconduct fines) relative to its equity base. The higher the remaining ratio of core equity to total assets – after applying the losses under the stress scenario - the stronger the financial strength of the bank.

The impact of the BoE’s test scenario differs substantially across banks. This is due to differences between business models, the types of risks the banks are most exposed to and, in some cases, the extent of progress

through ongoing restructuring programmes. RBS is still undergoing “restructuring” and remains 72% owned by Government.

	Actual (end-2015)	Minimum stressed ratio after 'strategic' management actions and before conversion of AT1			Minimum stressed ratio (after the impact of 'strategic' management actions and conversion of AT1)	Hurdle rate	Systemic reference point	Actual (2016 Q3)
		Minimum stressed ratio (before the impact of 'strategic' management actions or AT1 conversion)	Non-dividend 'strategic' management actions only ^(e)	All 'strategic' management actions including CRD IV distribution restrictions				
CET1 ratios								
Barclays	11.4	5.9	5.9	6.9	8.3	6.8	7.8	11.6
HSBC	11.9	7.6	7.8	9.1	9.1	6.1	7.3	13.9
Lloyds Banking Group	12.8	9.7	10.3	10.3	10.3	7.0	n.a.	13.5
Nationwide	22.6	15.0	15.6	15.6	15.6	8.1	n.a.	23.3
The Royal Bank of Scotland Group	15.5	5.5	5.8	5.9	6.7	6.6	7.1	15.0
Santander UK	11.6	9.9	9.9	9.9	9.9	7.3	n.a.	11.1
Standard Chartered	12.6	5.5	6.1	6.7	7.2	6.1	6.6	13.0
Aggregate	12.6	7.3	7.6	8.4	8.8	6.5	7.3	13.5

Source: Bank of England, *Stress Testing the UK Banking System*, November 2016

In general, the stress has the greatest impact on those banks with significant international and corporate exposures against current levels of equity capitalisation. Unlike RBS, the three banks operating principally in domestic markets — Lloyds Banking Group, Nationwide and Santander UK — remain well above their hurdle rates throughout the stress test.

(Stress) Test Results – RBS fails to meet the hurdle rate

In the BoE's test scenario, RBS's common equity tier one ratio — capital relative to all risk-weighted assets — falls from 15.5% to 5.9% after management (mitigation) actions, but before conversion of hybrid debt (to equity). This means that RBS would be below its so-called 'hurdle rate' of 6.6% and approximately £2bn short of its 7.1% “systemic reference point” (this is for banks judged to be systemically important for either the global or domestic economy).

According to the FT and others, the main reason RBS fared worse than its rivals was the potential misconduct and litigation costs in the stressed scenario. RBS was one of the biggest issuers of controversial mortgage-backed securities before 2008. Following Deutsche Bank's recent experience with a similar background, analysts now estimate it could end up costing the bank more than \$12bn to settle the current investigation by the US Department of Justice into these sales (see our past article on Deutsche Bank).

In our view, and despite the headlines, RBS is not set to fail and not inherently weak. The BoE's stress test represents a very significant step up from previous tests. For example, the stress scenario is estimated to lead to system-wide losses of £44bn over the first two years of the test – around five times the net losses incurred by the same banks over 2008/09. While we agree that RBS is likely to face some stiff penalties in the US for misconduct, we believe the BoE's overall test scenario is relatively aggressive and slightly unrealistic regarding RBS' situation in assuming that substantial fines would be enforced during times of global financial stress.

In addition, the much improved general health and strength of the sector is reflected in the BoE's test. The tests did not reveal any weaknesses for four of the participating banks; HSBC, Lloyds Banking Group, Nationwide Building Society and Santander UK. Also, while some capital inadequacies were revealed for three banks (RBS, Barclays and Standard Chartered), only RBS will have to present additional plans to

overcome the identified potential weaknesses while the other two already have suitable plans in place to build the required further resilience.

Furthermore, it can be seen that RBS has among the highest actual capital buffers (15% as at Q3/2016, relative to 11.1% for Santander). Therefore, all of the BoE's aggressive assumptions in respect of RBS would have to hold in order for there to be a default. Even if this were the case, given that RBS remains Government owned, the potential 'bailout' costs would be somewhat less than if any of the other (privately owned) banks failed.

All of the above therefore also explains why the BoE itself stated: *"The banking system is in aggregate capitalised to support the real economy in a severe, broad and synchronised stress scenario."*

In summary then, we would observe that the portrayal of a weakening UK banking sector, as some of the media were quick to report, is far off the mark. Compared to 2008, UK banks are far better capitalised and therefore far more resilient against insolvency, even under the most severe loss pressures. This doesn't, however, mean that because of the much improved capitalisation of banks, the financial sector could not still experience severe stress and, as a consequence, underperform in its role of providing the financial infrastructure for the UK economy – as it did in 2008/2009.

Why? Because any commercial banking system is built on trust. If some unforeseen event undermines the public's general trust in the banking sector, resulting in everyone wanting their deposits and savings paid out immediately, then banks may still be unable to fulfil their obligations, because they may lack the liquidity to satisfy all withdrawal requests, while remaining perfectly solvent from a balance sheet point of view. This risk factor is the reason why central banks also fulfil the function of 'lender of last resort'. Only they have the ability to create limitless liquidity for the commercial banking sector (against suitable but temporarily illiquid collateral assets) to overcome this systematic risk, which is inherent to any financial system.

From our perspective, the bigger take away from this week's stress test result publication is that the BoE warned that there is potential for the current situation to deteriorate. If the new US administration was to reverse past economic benefits of globalisation through a far more restrictive trade policy and a 'hard Brexit' did the same to inter European trade, then the resulting economic decline would further undermine the long term profitability of the banking sector. The slow growth of the past years has already been a strain on banks' ability to build up capital from retained profits and attract further capital due to lack of profit perspectives.

It would appear, then, that the report is a qualified 'all-clear' from the BoE, as well as a stark warning to the political class that their actions can and will have an immediate impact on the long term financial stability of the UK's (and indeed the world's) economy.

Big Trouble in Little Italy: Why a no vote could mean Ciao Signore Renzi

It wasn't meant to be like this. When the then-newly-elected Italian Premier Matteo Renzi first announced the constitutional reforms that are the subject of the nation's referendum yesterday, few outside Italy paid much attention. On offer is a package designed to increase the efficiency of Italian legislature by reigning in some of the regional autonomy granted to Italy's provinces, as well as dampen the powers of the Senate – one of the nation's two legislative houses – to obstruct government policy. While no doubt of great importance to voters on the Italian peninsula, all in all the reform seemed fairly innocuous for the international community.

Fast forward two years, and it's anything but what it first appeared to be. In the time since the bill's introduction in 2014, Mr Renzi has firmly nailed his colours to the mast of a 'yes' vote, to the extent that Italy's youngest

ever Prime Minister has offered up his head should 'no' be victorious. In the eyes of many disgruntled Italians, this referendum is about so much more; now there's a scalp up for grabs, and a big one at that. Perhaps this is why the head of Milan's Chamber of Commerce Gianfelice Rocca opined this summer, "THE biggest risk in Europe is the Italian Referendum,"

It's not an uncommon view. After the successes of Nationalist populism in Britain and the US this year, there are worries that the displacement of Renzi – commonly regarded as markets' favourite for his commitment to sorting the deep-seated issues in Italy's banking system – could trigger an election which might see him replaced by a populist candidate. To this end, Italian Comedian Beppe Grillo and his populist Five Star Movement are hoping to capitalise on the growing fervour over Italy's chronically stagnant economy, and use the referendum as an effective vote of no confidence in Mr Renzi.

On the other side of the Alps, and on the same day as Italy's fated vote, Austria faces a rerun of May's election which saw far-right candidate Norbert Hofer come within touching distance of the presidency. Back then, the 'Freedom Party' candidate lost by the narrowest of margins to his opponent, the Green Party politician Alexander Van der Bellen, with the latter taking just 31,000 more votes than Hofer. A recount and controversy over faulty glue on postal-vote envelopes later, the Austrian public are facing a redo-election that, by all accounts, looks to be as neck-and-neck as before. Were Mr Hofer, a hard-line anti-immigrant nationalist who is critical of further EU integration, to win on Sunday, he would be Western Europe's first far-right head of state since the Second World War.

In fact, Austria's vote could be even more important than Italy's. While the Austrian Presidency is largely ceremonial, with the government being led by the Chancellor (currently Social Democrat Christian Kern), the President does have the power to appoint and dismiss ministers, as well as call parliamentary elections. Should Mr Hofer emerge from Sunday's contest victorious, he could exercise these powers for the Freedom Party's gain, or at least use them as leverage to get a harder line on immigration from the government. And, with elections in the Netherlands, France and Germany looming in 2017, the results could well be a marker of things to come.

Furthermore, now that the shocks of Brexit and Donald Trump are behind us, the Austrians' choice of President will give some indication as to whether recent events have strengthened or weakened the nationalists' resolve. Indeed, we think it likely that the Brexit result and especially the ascendancy of US President-elect Donald Trump will have an effect on Austria's decision. Voters will by now have understood that there is no such thing as a low consequence protest vote and should therefore be taking their voting right perhaps more seriously than before. However, whether this will be for the advantage of the more moderate voices or emboldening those pressing for radical change is impossible to tell.

If Austria does indeed lurch to the right, the populist vote across Europe would be further strengthened. In The Netherlands, Geert Wilders and his far-right Party for Freedom are already topping some polls in the run-up to March's election, while the next French President looks set to be either Republican candidate François Fillon or Marine Le Pen of the National Front. A double whammy of the election of Hofer, coupled with the displacement of Mr Renzi, is feared by some to become the domino that sees Europe fall into nationalism once more.

In light of this then, the recent underperformance of European equities begins to seem more explainable. On the face of it, European stocks should be moving along nicely; the euro has weakened considerably relative to the US\$ - normally a boon given that 40% of Eurozone sales are made abroad – while Morgan Stanley is predicting growth in earnings per share for European equities for the first time in 5 years. However, the

EuroStoxx 50, the Eurozone's main index, has lost 2.8% since the end of October, while the larger EuroStoxx 600 is down around 7% in 2016. Investors, it seems, are spooked by the packed schedule of political gauntlets in the year to come, unsure of what the European political landscape will look like in the future. As such, a considerable \$98bn has been pulled out of European equities so far this year.

So, are these fears justified? Well, yes and no. As we have seen from the unexpected electoral results already this year, the potential for political shocks is very real, and we do not underestimate the far-reaching consequences that a wave of nationalist governments across western Europe could have. By the same token however, it's possible that, after the surprises of Brexit and Trump, investors are beginning to treat these unexpected cases as the norm – a kind of methodological pessimism. As JP Morgan strategist Mislov Matejka points out, "Investors are now shifting to a view that what were previously tail risks should now be seen as base cases ... that you should expect the unexpected,"

Effectively, one could make the case that many of the downside political risks have already been priced in by markets. What this means is that the potential for surprises to the upside – markets' preferred outcomes prevailing – is increased. Should these far-right candidates fail over the next year, starting with Italy and Austria, it is possible that we could see a marked rebound in European equities. After all, the underlying economic fundamentals for the region are strengthening, as we have pointed out in numerous weeklies over the past few months. Whatever the case, however, this weekend will give some indication of what the future holds for Europe, and whether the political situation is as dire as feared. For now, then, Europe holds its collective breath. Watch this space.

Chinese currency manipulation?

China's currency, Yuan/Renminbi (Renminbi is equivalent to "Sterling" while Yuan is the unit like "Pound"), caught some attention over the past weeks. The central bank, (People's Bank of China or PBoC) repeatedly intervened through the state banks to push its value up (!) against the dollar as the rate approached CNY 7 per USD.

Bloomberg said on Thursday: "PBoC Governor Zhou Xiaochuan already has one policy headache with the currency falling to near an eight-year low. He could have an even bigger one next month."

To stem further downward pressure on the currency from outflow pressures, a new PBoC rule came into force. For a 12-month period, starting January, individuals can only convert Yuan into foreign currency for amounts worth up to \$50,000. Bloomberg pointed out that the reset may mean another sudden outflow. They posited that, if 1% of China's almost 1.4 billion people "max out those limits, that's an outflow of about \$700 billion- more than the estimated \$620 billion that Bloomberg Intelligence estimates indicate has already flowed out in the first 10 months of this year".

The PBoC also restricted domestic firms from evading capital controls. Previously, some firms were lending Yuan to overseas affiliates to convert the cash into US dollars as well as to purchase overseas assets.

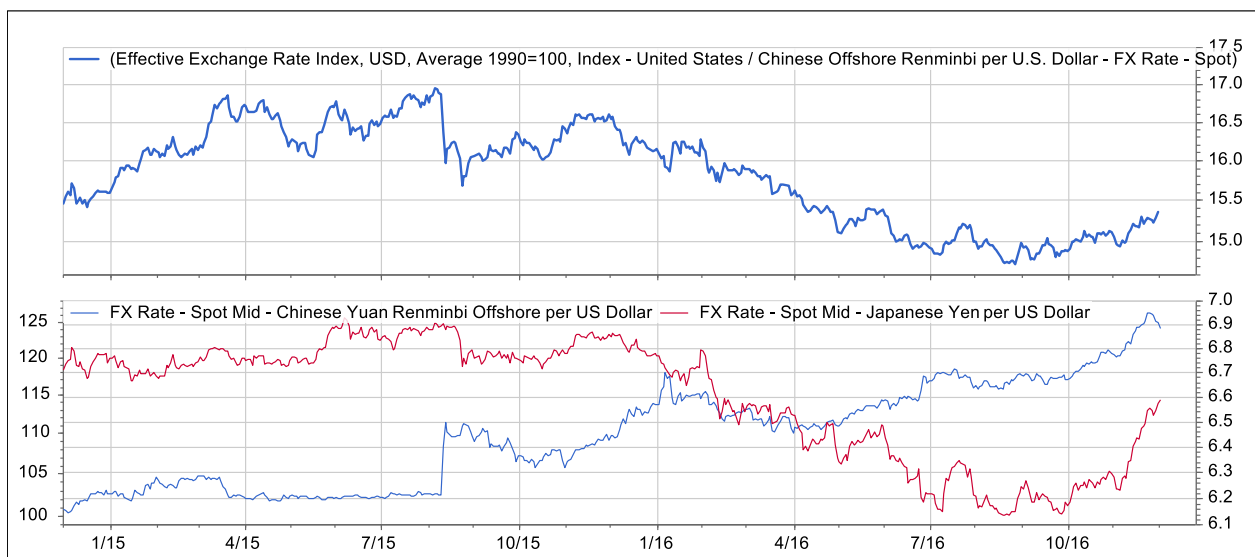
The outflow seen from August last year to around April coincided, and was most likely caused by, China's marked weakness in the economy. Sellers of the Yuan were mostly domestic, seeking better returns for their money outside China. Fears about the economy came from the Chinese, not external investors. This is no surprise, given that the stock of Yuan overseas is tiny compared to the stock of US dollars held by Chinese entities.

So, does this renewed outflow suggest that those closest to the domestic economy are once again running for the hills? We think not. It seems that the pressure is coming from Chinese perceptions about the external rather than the internal, and the perception of things will change sooner rather than later.

As the FT said on Thursday, “they [Chinese leaders] correctly identify that Mr Trump is by instinct a protectionist; when he talks about a general tariff of 45 per cent on Chinese goods, and about his determination to declare China a “currency manipulator”, he might not be joking”.

His proposal to block Chinese buyers of US companies is as important. This means that the Chinese see a small window of opportunity to get money into the US. Thus, the flow is very heavily skewed to the dollar.

In fact, the Yuan has strengthened, rather than weakened, on a broad basis, when we look beyond the USD! The chart below shows the Yuan strength (the line goes up recently) in the top panel. The second panel shows actual levels of how many JPY and CNY can be bought for 1 USD. Clearly the Yen is much weaker, suggesting even more pressure being felt by the Japanese.



Source: Factset, 1 Dec 2016

There is no sign of Chinese economic weakness at the moment. On the contrary, the momentum is upwards. Yesterday’s manufacturing PMI rose from 51.2 to 51.7, well above expectations, with steel industry sub-data at 51 (50 is neutral). Services are doing even better, at 54.7 from 54.

One potential issue for the future is the way in which the capital outflow can transmit a tightening of monetary policy for the domestic Chinese environment. Short-term rates spiked up above 4% in Hong Kong, from around 2%. Meanwhile, policy makers have (rightly) withdrawn economic support in the form of easier credit conditions, in particular to stem the sharp upswing in property prices. This tightening may have further to run, especially if the outflow rises ahead of any pinch-point before Trump is sworn in.

We hope that Mr Trump has, by now, a few advisers around him who can relay to him the interconnections between what he says to woo his domestic audience and what it does in the real economy. It’s a great irony that, by accusing Chinese authorities of manipulating the Yuan to weaken against the USD, he has actually caused a further weakening, resulting in the PBoC being able to immediately prove him wrong by taking the opposite action. The restraint that comes with what people may call acting ‘presidential’ is not just a formality or out of respect for the office of US president, but rather a necessity; words from the leader of the (still) biggest economy on the planet create facts and consequences rather quicker than one might think.

Vienna's OPEC Deal: 'The Devil is in the Details'

As we reported last week, after months of speculation, promises, and backroom negotiations, OPEC's decisive moment had come where they either reached a deal at their Vienna conference or failed once again to manage their combined output. To the surprise of many – us included – the announcement on Thursday was that its members had successfully reached agreement to cut production by 1.2 million barrels - around 3.6% - a day for six months from the start of January. The standoff between members over a production cut, which began April this year in Doha, was concluded after six hours of talks.

Unsurprisingly, it will be Saudi Arabia and its Gulf Arab allies of Kuwait, UAE and Qatar that will shoulder the bulk of the cuts. But, their willingness will be based on the hopes of a quick recovery in price, so as to avoid the loss of revenue and market share. Non-OPEC nations will contribute a further 600,000 b/d cut, with approximately half of that coming from Russia. Markets were quick to embrace the deal as a major success, with US energy stocks hitting their highest levels since July 2015, helping to drive the S&P 500 equity index to a record intraday high of 2,214.10. The oil price as represented by the international benchmark Brent crude, surged from \$46 to \$54 per barrel (bbl) or a staggering 17.4% - thereby far more than compensating the oil exporters for their lower production volumes.



Source: Bloomberg, 2 Dec 2016

Without a doubt, this was a make or break deal for OPEC. The failure to reach a deal would have seen the cartel's credibility in tatters. Moreover, it could have prompted oil prices to plummet – at least in the short term, contributing further to concerns over the stability of the market. On the back of a much lower oil price than a few years ago and much downside uncertainty about its further development in light of the persistent supply overhang, we have seen investment in new oil exploration project fall for a record third year. This was simply due to the fact that energy giants lacked the willingness to invest without a clear perspective whether the future price of oil may be \$50 or perhaps just \$30. What this deal potentially offers is a greater certainty in where the oil price will be further down the line. If OPEC and non-OPEC producers can follow through on their promises and help to reduce global oil stockpiles, this could establish a \$50 floor for oil, which would return some planning certainty to oil producers for their exploration project business cases.

This potential 'floor' would create a more investible environment for energy firms, who have so far, in less than 2 years, deferred more than \$1 trillion in investment. The group's demonstration of cohesiveness, and the markets willingness to reward it, breathes new confidence in what has been a pretty dire market over the last two years. In this sense, Ecuador's representative at OPEC is accurate in his conclusion that the group "did the energy market a huge favour".

However, as with any OPEC deal, the devil is in the detail. The obvious elephant in the room is the issue of compliance. OPEC members have a history of producing significantly more than their allotted target, with actual production consistently above OPEC agreements. This issue has only been broadened with the inclusion of Russia in this production cut. Russia had made no suggestion of lowering its oil production in 2017, instead focusing on the alternative of a freeze. As such, some analysts believe that Russia's contribution will amount to little more than a combination of their predicted natural declines for the following year and a slowdown in production increases. Russia's caveat that any cut 'is conditional on its technical abilities' leaves the door open for abandoning its promises. This would not be the first time Russia has reneged on a production cut, as 2001 is testament to. Furthermore, there will be questions over what role Russia's privately owned oil producers will play in this agreed cut of 300,000 b/d. In this way, there remains major reasons for caution surrounding the oil market, with any initial rises in pricing likely to be reversed if these cuts do not materialise.

However, what we are set to see in the short-term is competition between these traditional oil producers and the returning US shale industry. With regulatory conditions for shale set to become more favourable under Trump and with oil prices hovering above \$50, US rigs could be set to return in their numbers. November saw the highest number of rigs probing for oil in the US since January, whilst US shale fields could reportedly raise production in as little as four months. So it may be fair to conclude that the Vienna volume reduction accord has put a formal end to the battle for market share that OPEC had initiated with its production volume free-for-all back in 2014. If OPEC members manage to stick to their agreement, then they may stand a chance to establish apparent shale oil production price floor of \$50/bbl as the new price floor for the overall oil market. The new dynamism of short term production volume adjustments, however, that the shale technology has introduced, means that \$50/bbl may well turn out to be the ceiling as well.

UK - AIM market insight: Orwellian dreams or nightmares?

As part of our research into investment opportunities in the Alternative Investment Market subsection of the UK stock market, we have identified a very interesting and expanding market sector. With the exponential growth of e-commerce, we focus here on one data intelligence company that provides businesses a means to identify their customers, employees and suppliers.

Globally, every five minutes, there are more than 1 billion emails sent, 20 million google searches, \$12.5 million of ecommerce sales and 10 million pieces of content shared. These numbers will continue to increase dramatically, with an estimated 900 million additional people gaining access to the internet within the next year alone. Although this provides great opportunities for existing and new businesses, it also creates new and previously unknown risks. For example, in 2015, 500 million identities were stolen online and 75% of companies fell victim to fraud. So, with this increasing data usage, comes a need for companies to adapt to evolving threats, in order to keep their data and their clients' data safe. Enter GB Group.

GB Group, who we saw this week, specialise in identity data. That is, they look for information about individuals which can be acquired from digital sources. With this information, they can help companies check that the people they are dealing with are really who they say they are. As they have grown, so has their client base, which now includes many well-known names such as Barclays, HSBC and Ford. On top of helping businesses with new and evolving threats, they are also helping the UK government with its online services, by using data which will allow them to verify individual identities within just 10 minutes, compared to the several days it currently takes. This allows UK citizens to have quick and secure access to government services, as well as significantly reducing the government's cost. However, not everything GB Group does is

just about checking and verifying identities. Identity data also enables companies to improve strategic decision making, by allowing them to better understand their customers. As the amount of digital data grows, so do the opportunities for GB Group to help governments, businesses and individuals.

As the demand for GB Group's services has increased, so has the performance of the group. Revenue has grown by 25% per annum or CAGR (Compound Annual Growth Rate) over the last 5 years to £73.4m at year-end March 2016. Operating profit has similarly grown by 51% CAGR over the same period, demonstrating good operating leverage. These results have been achieved on the back of the company's very healthy operating margin of 18%, and is paired with little debt and a cash generative financial set up. The current management team has successfully steered GB Group through this growth path for the last 15 years.

With the increasing need for GB Group's services, we expect the business to continue to deliver positive financial dynamics and it is in a very good position to continue its expansion as the demand for data intelligence grows ever bigger.

We will always remind readers that we present businesses here in the context of general interest in progressive themes and companies. As far as investment is concerned, these articles should never be interpreted as any form of recommendation to buy or sell such companies, as their viability as an investment is very much driven by the valuation that market forces have already put onto such businesses' traded stocks. However, we believe it is appropriate to present good examples of interesting British companies we encounter in the AIM market, to further a more general understanding of investing – especially in the small cap end of the UK stock market.

Sources: GB Group, World Economic Forum, DOMO, Symantec, Kroll Global Fraud Report

PERSONAL FINANCE COMPASS

(Last week's data – apologies)

Global Equity Markets

MARKET	CLOSE	% 1 WEEK	1 W	TECHNICAL
FTSE 100	6840.8	1.0	65.0	→
FTSE 250	17603.4	-0.3	-55.8	→
FTSE AS	3719.3	0.7	27.1	→
FTSE Small	4923.8	0.4	21.5	→
CAC	4550.3	1.0	45.9	→
DAX	10699.3	0.3	34.7	→
Dow	19133.6	1.2	229.8	→
S&P 500	2210.0	1.0	22.8	→
Nasdaq	4866.7	0.8	40.1	→
Nikkei	18381.2	2.9	518.6	→

Top 5 Gainers

COMPANY	%	COMPANY	%
ANGLO AMERICAN	13.4	FRESNILLO	-4.4
GLENCORE	8.2	BARRATT DEVELOPM	-4.3
BHP BILLITON	7.3	BABCOCK INTL	-4.0
ASSTEAD GROUP	6.6	PERSIMMON	-3.9
RIO TINTO	6.1	TAYLOR WIMPEY	-3.7

Sovereign Default Risk

DEVELOPED	CDS	DEVELOPING	CDS
UK	35.8	Brazil	307.0
US	19.3	Russia	231.3
France	39.7	China	121.3
Germany	22.8	South Korea	51.0
Japan	49.0	South Africa	255.7

Currencies

PRICE	LAST	%1W	CMDTY	LAST	%1W
USD/GBP	1.25	0.91	OIL	47.5	1.4
USD/EUR	1.06	0.10	GOLD	1181.0	-2.2
JPY/USD	113.08	-1.92	SILVER	16.5	-0.4
GBP/EUR	0.85	0.80	COPPER	267.6	7.0
JPY/GBP	6.92	-0.47	ALUMIN	1770.0	4.9

Commodities

Fixed Income

GOVT BOND	%YIELD	% 1W	1 W
UK 10-Yr	1.4	-3.0	-0.04
US 10-Yr	2.4	0.9	0.02
French 10-Yr	0.8	3.4	0.03
German 10-Yr	0.2	-13.2	-0.04
Japanese 10-Yr	0.0	5.0	0.00

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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My apologies, but due to a technical issue this week's data sheet did not update and so the data above is – I am afraid – still last week's!

If anybody wants to be added or removed from the distribution list, just send me an email.

Please note: Data used within the Personal Finance Compass is sourced from Bloomberg and is only valid for the publication date of this document.

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

Lothar Mentel

