Weekly Market Comment

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2016 – Final Edition

For this final edition, we thought we would alter the usual format a little to reflect that most of us are busy getting ready for various festive family events and therefore may not have much time to read 11 pages of Tatton's Weekly (If you were expecting an outlook for 2017 in this final edition, then please refer back to last week's edition – 16 December 2016 – and our lead article "Good-bye 2016 – Hello 2017!")

Instead, we will provide you with a wrap up of markets as we have observed them this week. And, on an editorial note, we thought that readers of Tatton's Weekly may also find some volume figures of our coverage for 2016 of interest.

50 editions of Tatton's Weekly during 2016

If you received the Weekly from the beginning of the year, you would have found 50 editions of Tatton's Weekly in your email inbox. If you read the lead article of each edition, you will have digested 252,132 words of my summary comments of the main events of the past week and how they may influence the economic direction and impact the direction of capital markets.

If you opened the attachment for the full edition, then you will have read 249 articles over 503 pages of text, graphs and the occasional cartoon. For this, we required a total of 222,274 words for which we hit the characters on our keyboards 1,359,522 times.

Depending on how in-depth your interest is, you will have invested between 8.3 hours (15 minutes per edition) and 25 hours (30 min per edition) in reading our weekly. I am grateful for your interest and the time you've spent following our comments on market events. 2017 is already promising to be an eventful year, as the 2016 changes to the world's political framework will either turn out to be of support for the recently accelerating economic growth, or manage to undermine sentiment and thus become a headwind. We are looking forward to once again bringing you the Tatton view on the latest developments every week!

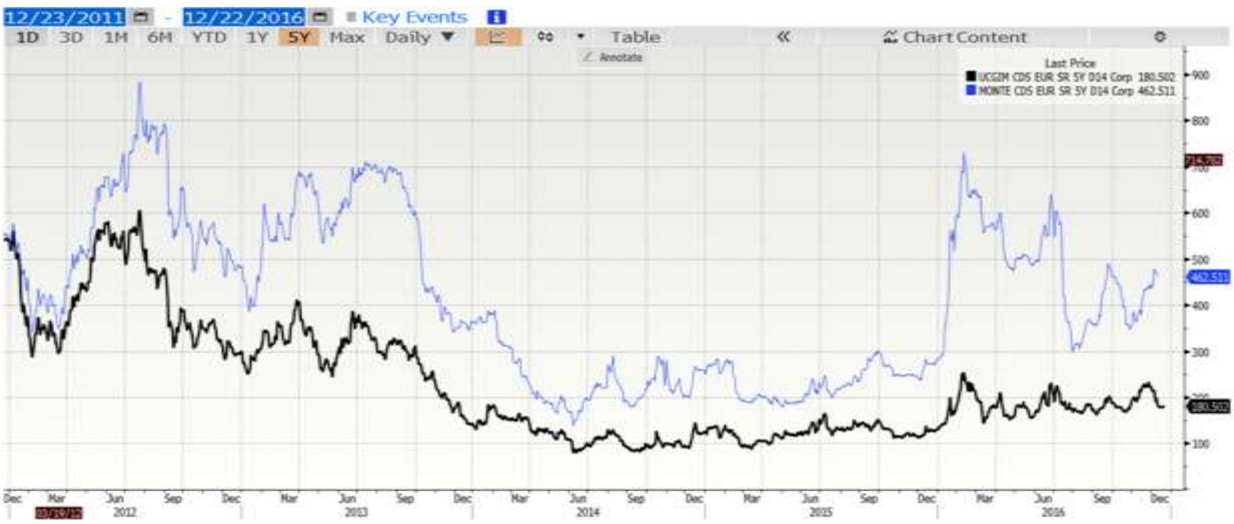
2016: An Epilogue

As so often is the case at the closing of the year, this past week has seen a number of the year's big stories coming to an end. In Italy, apparent disaster has been decisively avoided, with the ailing Monte dei Paschi di Siena (MPS) set to receive a €20bn bailout package from the state.

It was hoped that a last-minute recapitalisation plan from the private sector would avoid the need for state intervention, but the European Central Bank's (ECB) refusal to extend the deadline for the scheme meant ramped up fears over the MPS' liquidity levels. The plan, led by US bank JP Morgan, hoped to inject €5bn of capital into Italy's third largest bank in a bid to keep it afloat. A failure to find an anchor investor, however, precipitated the deal's collapse, leaving the government little choice but to step in to stop a default which would risk, at the very least, a financial contagion across the nation's – and perhaps the continent's – banks.

However, the state bailout is politically very unpopular among the Italian public, because the bailout package will force some losses on junior bondholders – many of them Italian retail investors. New EU rules concerning the injection of public funds to save banks require that junior bondholders take a share of the hit, converting their bond holdings into equity. Despite this, the bank's riskier bonds actually saw a reasonable climb on Wednesday, though the 'bail-in' did little to alleviate the swings in share price.

It is a relief to note, however, that the struggles at MPS don't seem to be causing the wider contagion that many had feared. As the chart below shows, the rise in MPS' borrowing costs doesn't appear to be affecting the borrowing costs of other banks in Italy – let alone the wider Eurozone. Measured against the same debt for Italy's largest bank Unicredit, one can clearly see that, for the past few years, the trends in MPS' borrowing



Source: Factset, 22 Dec 2016

costs have been largely the same as Unicredit's – though admittedly much more exaggerated. In the past few days however, Unicredit's borrowing rates have actually decreased despite a sharp rise in those same costs for MPS.

This is a good sign, showing that the dreaded financial domino effect will most likely be avoided, thereby drawing an end to what was an uncomfortable theme for the latter parts of this year. In the same vein, the much discussed fine from the US authorities for Deutsche Bank (DB) came in considerably below the $14 billion headline-grabbing figures first bandied around three months ago. The now imposed roughly $7bn settlement is more in line with (but still slightly above) what the bank had made provisions for – but will certainly not mean the ruin of the bank.

So, as has been the case repeatedly this year, the big bad downside shocks have materialised – and yet flattered to deceive. Once again, markets have shrugged off the fear and kept on climbing towards better things. All in all, it's looking like the end of the year is seeing a continuation of the normalisation of conditions: The recent bond selloff is coming to an end as yields have stopped the steep incline of recent months, the situations of MPS and DB are drawing to a close, the currency volatility of the past year is dampening down and economic indicators are finally beginning to catch up with the slightly surprising buoyancy of markets over the second half of 2016.

While the closing of the year has seen a winding down of many prominent themes from the past 12 months, it's also given us a sneak preview of what is potentially to come in the year ahead. On this front, it was interesting to see the sharp movements in Chinese bond markets over the past week. The yield on the government's benchmark 10-year bond jumped to 3.4% on Wednesday – a 15 month high – before settling down to 3.3% the following day. The year-end can often be a pinch point in liquidity terms, with potential weak spots being amplified by the rush to cash from many investors. And, in this sense, the shooting up of Chinese yields over December has brought the world's second largest economy back under the microscope.

As the chart below shows, Chinese bonds have remained very stable over the past year but, while the last week has seen the selloff in US bonds abating, long-term interest rates in China are still rising significantly. Much of the tightening of credit conditions in China over the past few months has been ascribed to the end of the bond rally across the globe and the tightening of conditions in the US. However, I believe that these

Source: Factset, 22 Dec 2016

recent moves in China, as well as comments from government officials this week, are evidence that the tightening is a deliberate policy by the government, and perhaps indicative of what is to come in 2017.

President Xi Jinping went on state radio this week to proclaim the need to rein in the growing real estate bubble in the country – the second time in 2 weeks that the government has emphasised the need to address the property situation. This is, in my view, the early stages of what may become a very prominent theme of 2017 – the tightening of monetary conditions in the world’s second largest economy.

Officials in China are clearly also worried about the recent capital outflows from the country, and are hoping to stop the bleeding with a tightening of conditions – as already seen through the attempts to impose restrictions on the amount of money citizens can move out of China. This, combined with the monetary tightening cycle being embarked on in the US, will undoubtedly make for an interesting story in the year to come. This is particularly true considering the appointment by president-elect Donald Trump of hardline anti-China economist Peter Navarro to his newly created National Trade Council. The appointment of Navarro, author of the polemical book *Death by China*, is a clear signal from the incoming administration that Trump is willing to follow through with the tirade against China unleashed in his election campaign.

How markets will respond to monetary tightening in the world’s 2 largest economies will be something we will be watching very closely over the coming year. The potential for upsets is undoubtedly there but, following the resilience markets have shown throughout 2016, I’m certainly not minded to proclaim the China story the next great looming crisis.

PERSONAL FINANCE COMPASS

Global Equity Markets

MARKET	CLOSE	% 1 WEEK	1 W	TECHNICAL
FTSE 100	7063.7	0.9%	64.7	↗
FTSE 250	17891.6	0.7%	122.3	↗
FTSE AS	3831.3	0.9%	33.9	↗
FTSE Small	5105.2	1.1%	54.6	↗
CAC	4834.6	0.3%	15.4	↗
DAX	11456.1	0.8%	89.7	↗
Dow	19918.9	0.3%	66.6	↗
S&P 500	2261.0	0.0%	-1.1	↗
Nasdaq	4934.4	0.0%	1.0	↗
Nikkei	19427.7	0.8%	153.9	↗

Currencies / Commodities

PRICE	LAST	%1W	CMDTY	LAST	%1W
USD/GBP	1.230	-0.88%	OIL	55.1	1.9%
USD/EUR	1.046	0.4%	GOLD	#N/A	0.1%
JPY/USD	117.52	-0.9%	SILVER	15.9	-0.5%
GBP/EUR	1.176	-1.3%	COPPER	5426.0	-4.5%
JPY/GBP	144.50	-1.8%	ALUMIN	#N/A	#N/A

Top 5 Gainers / Top 5 Losers

COMPANY	%	COMPANY	%

Fixed Income

GOVT BOND	%YIELD	% 1W	1 W
UK 10-Yr	1.23	-0.09	-0.11
US 10-Yr	2.54	-0.03	-0.07
French 10-Yr	0.73	-0.06	-0.05
German 10-Yr	0.26	-0.29	-0.11
Japanese 10-Yr	0.05	-0.35	-0.03

UK Mortgage Rates

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

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

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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.

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