Linear Talk – Macro Roundup –6th December 2016

November was dominated by the outcome of the US presidential election. It set the tone for currencies, stocks and bonds. Many of the predictions about a Trump win appear to have been wide of the mark. Time will tell, but, as the dust settled last month, markets began to digest the implications of his unconventional mix of economic policies.

The first policy impact will be that of a US tax cut. This should stimulate spending – the month-end second revision of US Q3 GDP (from 2.9% to 3.2%) merely abetted. Second will be the fiscal stimulus of infrastructure spending. The renegotiation of NAFTA and related protectionist measures will take much longer to feed through.

So how did this play out in the markets?

Currencies

The US$ Index tells the tale most clearly:-

Source: Barchart.com

The low of the month was seen in the initial aftermath of the election (95.91). By 24th it had reached 102.12, up 6.5% to the highest since March 2003. If the combination of a Republican Senate, Congress and President is perceived as capable of getting the job done we may be returning to the "strong dollar" era of 2000-2002 when the Index tested 120.

The two largest components of the US$ Index, EURUSD and USDJPY, unsurprisingly followed the tone. EURUSD tested 1.0515 on 24th, within 60 pips of the March 2015 low of 1.0456. The Japanese currency recorded its weakest reading since March testing USDJPY 114.56 at month-end.US policy may finally be proving a boon to Japanese PM Abe.

Even the "semi-pegged" Chinese currency could not keep pace with the "mighty dollar", USDCNY reached 6.9661 on 24th – the weakest since June 2008.

Stocks

Despite a surging currency, the S&P500 wobbled momentarily then rallied to an all-time high of 2213.75 at month end. The US stock market drew comfort from the political hegemony of the GOP triumvirate. 70% of the earnings of the constituents of the S&P500 are domestic – a tax cut, infrastructure spending and the more distant prospect of protectionism is a heady cocktail, even for the most sober equity analyst.

Yen weakness and hope of preferment after Trump's comments about China, helped Japanese stocks – for example:-

> *I'd love to have a trade war with China.*
>
> *…If we did no business with China, frankly, we will save a lot of money.*

Japan has a number of world class businesses and, unlike other markets where government bond prices could fall, the Bank of Japan has committed to maintain 10yr JGBs at around zero, making the dividend yield of the Japanese stock market (more than 2%) attractive. The Nikkei225 made a high of 18,483 on 25th, the highest since January. As I mentioned last month, from a technical perspective, the Nikkei looks constructive - a retest of the 21,000 level of June 2015 is the next stop, a convincing break above there takes into territory last travelled in the 1990's.

European bourses were range-bound. They ignored the "sound of the Trumpet", held back by the political uncertainty of populism, especially in Italy and Austria. Even the FTSE100, which had risen as Sterling declined, failed to hitch a ride on the American dream.

Bonds

Bond yields continued to rise last month, driven by US Treasuries. 10yr yields reached 2.42% on 23rd- they had spiked lower on Election day, touching 1.72%, but closed the month at 2.39%. These are the highest yields since July 2015. From a technical perspective, if they break above 2.50% before month and year end, we will have an "outside reversal" on the annual charts – a strong signal of a change in market direction. To elaborate, the 2015 range for 10yr yields was 2.5% to 1.64%. During 2016 the low (1.64%) was breached, with 10yr yields testing 1.32%. If the yield should rise above 2.5% before the end of December we will have seen a lower "low" and higher "high" than the previous year. This would be technically indicative of a "price failure" heralding a further, substantial rise in yields in 2017.

German 10yr Bunds followed the US in more muted fashion. They touched 0.40% on 14th – the highest yield since January, but the widening of the spread with Italian 10yr BTPs (which have also risen against Spanish Bonos) tempered their ascent. Bunds closed the month at 0.27% whilst BTPs reached 2.23% before prices recovered – they closed the month at 1.99% as traders' squared positions ahead of the referendum on constitutional reform.

Gilt yields followed the US, with the 10yr rising to 1.50% on 18th – this is a tripling of yields since its lows in August. With increasing talk of a Hard Brexit, an autumn statement which set aside fiscal restraint and no sign of the government rushing to invoke article 50, it is likely that Gilt yields will rise further.

JGBs ignored the other major markets. The Bank of Japan made it clear that they would target a zero yield on 10yr JGBs, which closed the month at +0.02%. If US and European yields continue to climb next year it will be interesting, to mis-quote Shakespeare, to see the *mettle* of the BoJ's *pasture*.

Commodities

Gold fell from an election high of $1,318/oz on 9th to close the month just above its low at $1171. The political triumvirate of Republican control is historically good for stocks and good for the dollar – Gold has been a casualty.

The copper market is a different story. Starting the month at its low of 2.2c/lb, it rallied, post-election, to trade 2.72c/lb. Expectation that US policy will be expansionary is supportive for this bellwether of industrial metals.

Oil had its own issues which overshadowed even the US election. OPEC finally agreed to cut production by 1.2mln bpd (4.5%) on 29th and WTI closed the month within half a dollar of its high at $49.44. The fact that Russia agreed to cut production by 300,000 bpd offset Iranian recalcitrance – they refused, even, to freeze their output. WTI rallied 7% on the day of the announcement – it remains to be seen whether OPEC members now proceed to cheat, as they have always done in the past, and how US producers, spurred on by higher prices, respond. The Baker Hughes US rig count continues to rise (from 450 on 4/11 to 477 on 2/12) but there is plenty of room for expansion. As recently as October 2014 the rig count was over 1,600.

Mexico

Perhaps the greatest market impact of the US elections was felt in Mexico. The peso weakened to an all-time low of USDMNX 21.42 on 11th versus $18.15 on 9th- an 18% move in two days! 10yr Mexican bond yields jumped from 6.16% of 8th to 7.50% on 23rd – the highest yields since March 2011. Meanwhile the IPC Stock Index fell from a high of 48,673 on the 8th to a low of 43,999 on 18th. Stocks have since recovered somewhat, closing the month at 45,316.

The weakness of the peso has afforded the stock market some protection but fears about the US imposing tariffs, tearing up NAFTA, building a wall and deporting illegal immigrants, will be felt more keenly in Mexico than anywhere else.