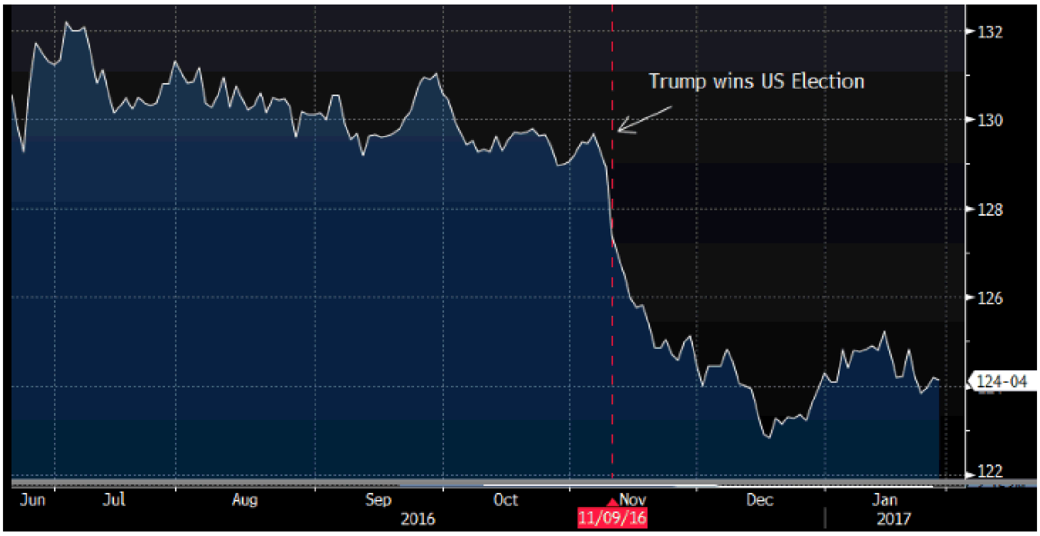
## Armstrong Investment Managers LLP

## Investment Outlook Q1 2017

### Trump & Brexit

The combination of the Brexit outcome and Donald Trump's victory in the US presidential election has opened the doors for a new cooperation between the US and UK, particularly in terms of trade between the two nations. Evidently thus far, Trump's election victory has improved investor confidence and there have been upside revisions to the expectations of an interest rate hike by the FED.




*US 10yr Bond Future [Source: Bloomberg]*

From 2009, central banks around the world have been buyers of bonds. In their efforts to bring inflation towards 2% and boost economic growth, government bond prices appreciated to record levels, indeed with yields in some regions turning negative. The ECB has signalled that it will begin tapering in 2017 and work on fiscal expenditure programs. Inflation linked bonds remain an attractive allocation within the fixed income space, and we'd expect some normalisation of both monetary policy and bond yields in the coming months as fears of economic slowdowns are fading away.

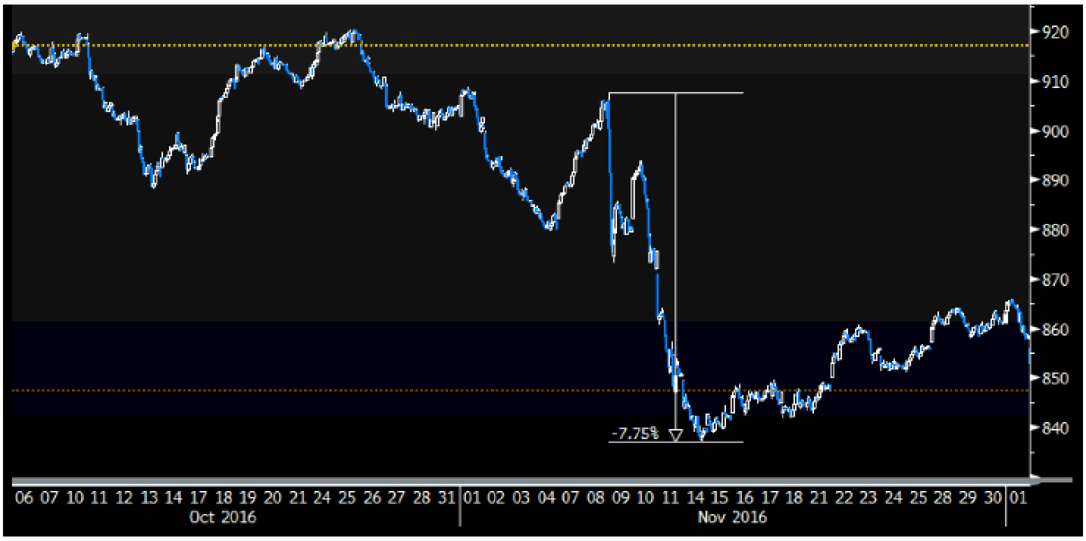
### Shift from Monetary to Fiscal Policy

Corporate profit repatriation will be a great source of revenue for the US government, encouraging a range of supportive fiscal policies and domestic investment. US companies held in excess of $2 trillion of their profits abroad in 2015, with the main intention of not paying tax in the US. Repatriation of those profits would be hugely beneficial in funding some of the government's proposed initiatives.

By imposing a corporate tax rate of 35% on these companies, tax revenues could amount to almost $800bn. However, there would indeed be difficulties in the practicalities of implementing such a tax rate on prior revenues, since this all would have been perfectly legal under the tax frameworks at the time. A possibly smarter approach would be to incentivise these corporations to bring their profits back onshore, one such incentive being lower tax rates, which is arguably why their profits are stashed away in the first place. The American Job Creation Act provided a low rax regime for a limited period of time, offering rates at 5.25% to US companies. Expansionary fiscal policies such as these will be key in lowering their debts as a percentage of GDP.

**Emerging Markets**

The Trump presidency is arguably not favourable news for emerging market economies. Indeed in the aftermath of the election result, the MSCI Emerging Markets index lost almost 8% in value, as investors pulled money out of this region.




*MSCI Emerging Markets Index [Source: Bloomberg]*

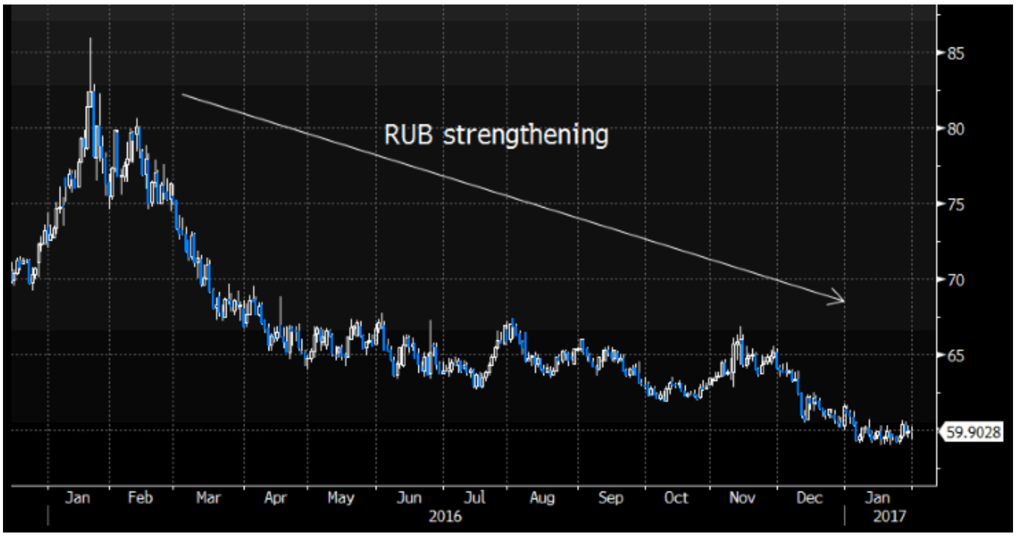
Those countries that depend heavily on exporting to the US will be most likely to suffer at the start of the Trump presidency. This includes Mexico, Taiwan and South Korea. The relevant exchange rates for these economies have started adjusting to lower equilibriums, given the expectation for potentially negative changes in US foreign policy. Although the impacts are most pronounced for countries with close trade links to the US, the increase in yields had a contagion effect on emerging market debt, too.

**Russia and China**

China's economic growth has been stabilising and it is apparent that the growth has successfully been shifting towards domestic growth and consumption, with less focus on exports. The Trump impact here is somewhat clear, that the US will aim to dramatically reduce its consumption of Chinese exports. Nonetheless, the outlook for China is still somewhat positive if it can successfully demonstrate a shift towards greater organic growth. One such project included the One Belt One Road (OBOR) initiative that aims to strengthen Chinese ties with more than 60 countries across Asia, Europe and East Africa through infrastructure, trade and investment. This is opening up vast areas of

Central Asia that still retain long-established trade links but often lack the modern infrastructure required to attract larger-scale trade and investment.

Sanctions on Russia will likely soon be lifted under President Trump's administration, which signals excellent news for the region. The Rouble has strengthened considerably over the last year, propped up by rising oil prices and a brighter growth outlook.




*USD/RUB exchange rate [Source: Bloomberg]*

Normalisation of inflationary expectations will support quality styles, value stock and consumer discretionary stocks. Trump's victory has impacted bond markets through steepening of the yield curve. Foreign investors will be sellers of Treasuries and their yields are on the rise.

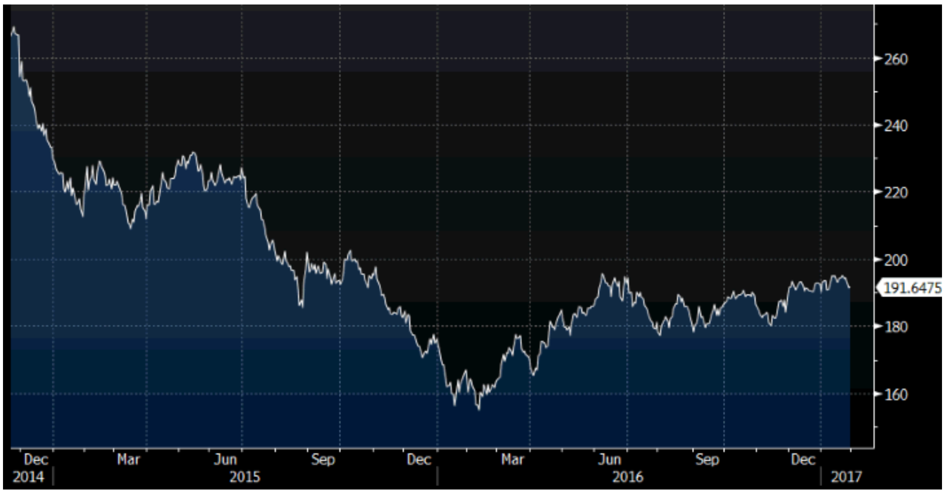
**Equities, Bonds, Commodities**

There is no question that the equity market, as well as general market optimism, has gone from strength to strength following Trump's victory. His administration's focus on domestic growth, infrastructure investment, repatriation of corporate profits, job creation, tax cuts and relaxation of some of the regulations in the banking sector are predominantly supportive of the US economy and the US equity markets.

The benefits of monetary policy easing (since 2009) are now increasingly showing signs of exhaustion. Consequently, the focus has instead shifted to fiscal policy to boost growth. It is worth noting that the economic environment has largely moved from deflationary to one that exhibits signs of moderate inflation.

Net positioning on US mid caps, interestingly, has surged to the upside following the election, showing incredible investor conviction of growth in this area. On the other hand, net positioning in US 10yr's has fallen to historical lows as consensus solidifies on the prospect of rising bond yields in the US, and we see further shifts from bonds to equity markets.

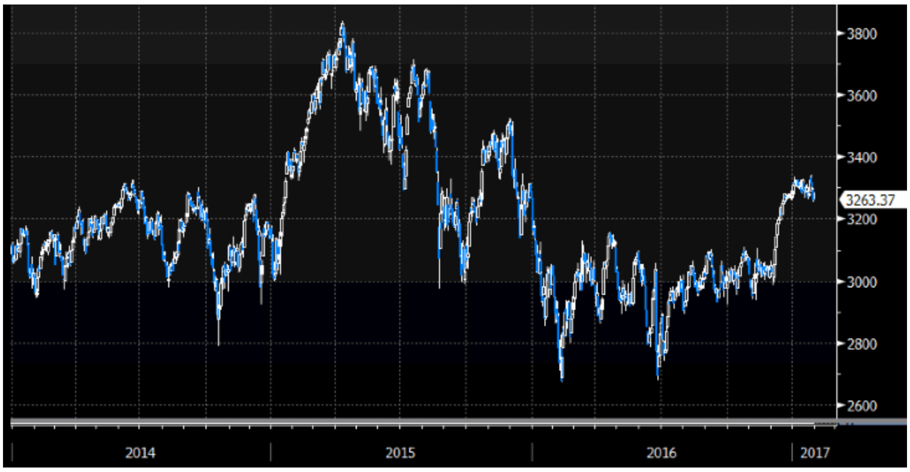
We do not see any significant downside risks to the commodities market overall. In fact, the outlook is positive, given the expected growth in infrastructure investment in both the US and China, and the shift towards fiscal policy in Europe. Also, as China stabilises its economic growth, this will provide further easing to the commodity market risks.




*CRB Commodity Index [Source: Bloomberg]*

**Europe**

Elections in France and further political uncertainty in Europe have not been encouraging for equity investors. Indeed, while other global equity markets are breaking to all time highs, Europe is clearly still lagging. The question is whether this is a great opportunity or instead more indicative of the problems in the region.




*Euro Stoxx 50 Index [Source: Bloomberg]*

Positive themes from the area are the increased infrastructure spending, upward revisions in inflation expectations and positive earnings momentum. These will all largely be supportive for equity investors in Europe. In the UK, the resurgence in commodity prices coupled with the dramatic depreciation in the Sterling currency should be beneficial for the FTSE 100.

**Japan**

Abenomics and its 3 Arrows have largely been successful in their desired improvements to corporate transparency, succession planning, devaluing its currency and of course a massive boost to the Japanese equity markets. Further Yen depreciation will provide support to its domestic equity market, while the sovereign wealth fund has been steadily increasing its holding in domestic equities since 2014.