

Market Insights – Politics and markets: The New Indifference

31 January 2017

*“The aggregate output of this country per capita is going to keep going up...America will be a wealthier country five years from now...Long-term the stock market is going to be higher”
Warren Buffett, 05 December 2016*

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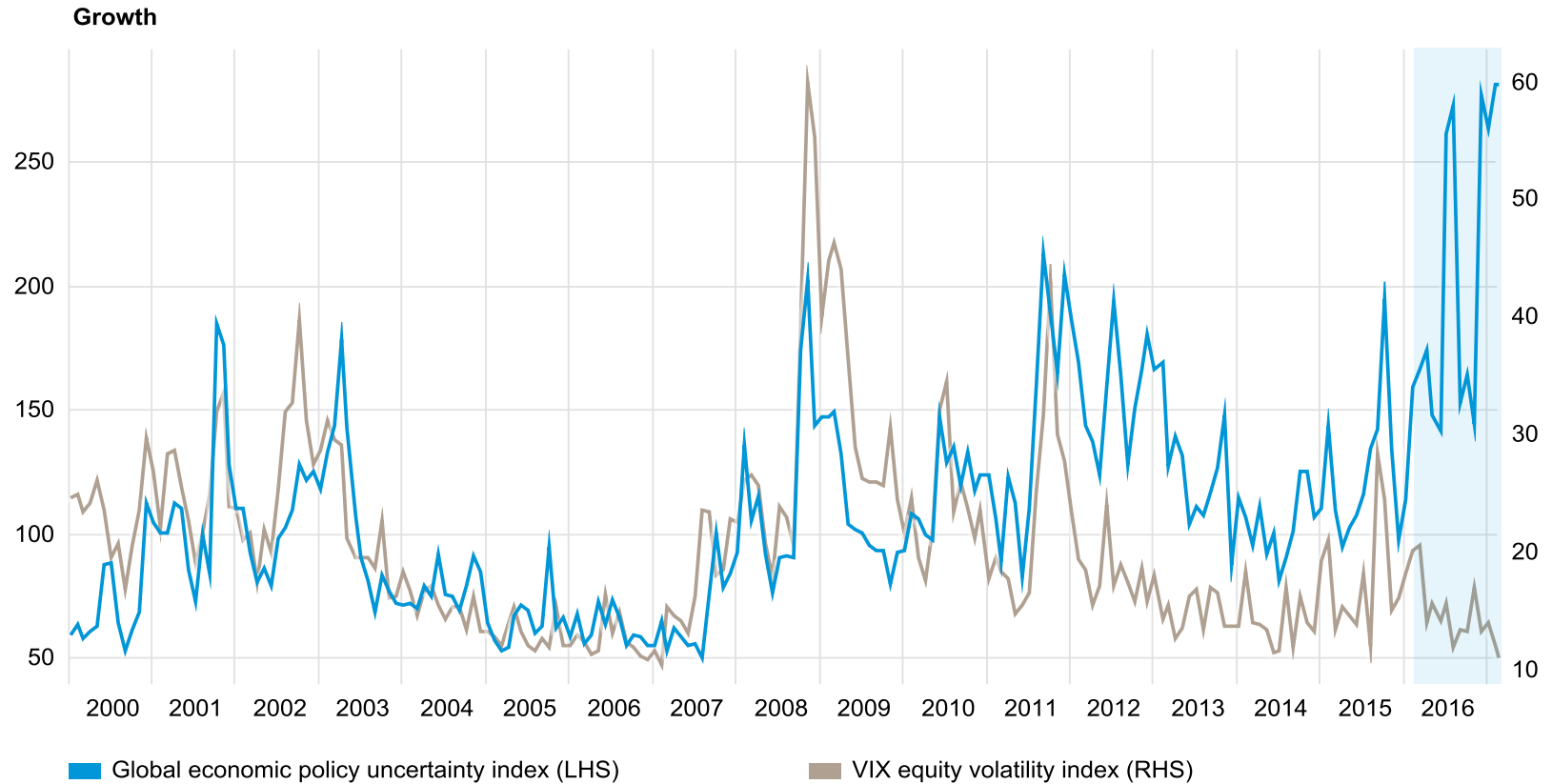
The New Indifference

- **Equity markets have stopped caring about political risk**
- **Why? Benign economic and liquidity environment**
- **Also the changed profile of equity ownership**
- **US consumer in good shape**
- **US earnings picture to brighten**
- **Inflation coming but won't get out of control**
- **Capital (mis) allocation by Twitter – myth and reality**
- **Europe – equities divorced from fundamentals...**
- **...ECB divorced from reality**
- **Emerging Markets have nearly recovered post-Trump**
- **Victims of the new order are specific, localised**
- **Risks to watch out for: dispersion, valuation**
- **Scenarios and Views**

Equity markets have stopped caring about political risk



From 31 Dec 1999 to 9 Feb 2017



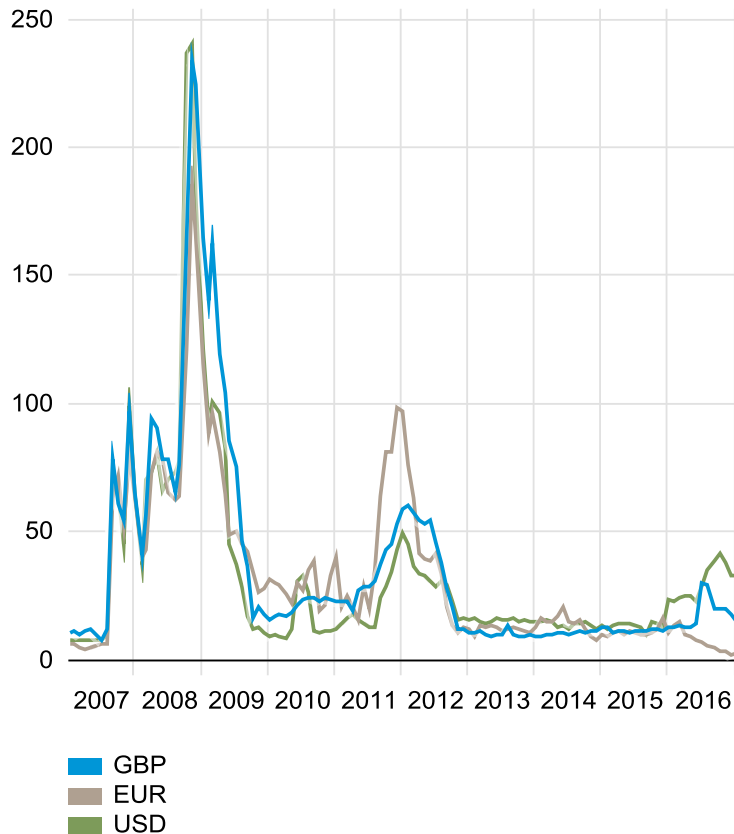
Past performance is not indicative of future performance.

Source: Bloomberg

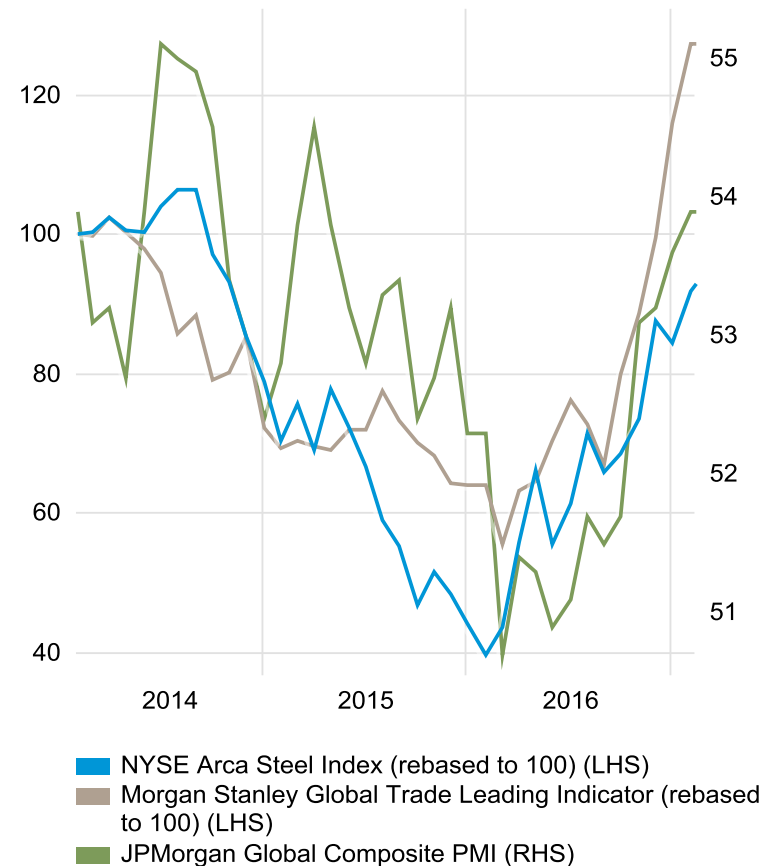
Why? Benign liquidity and economic environment

From 1 Jan 2007 to 8 Feb 2017

3 month LIBOR-OIS spreads



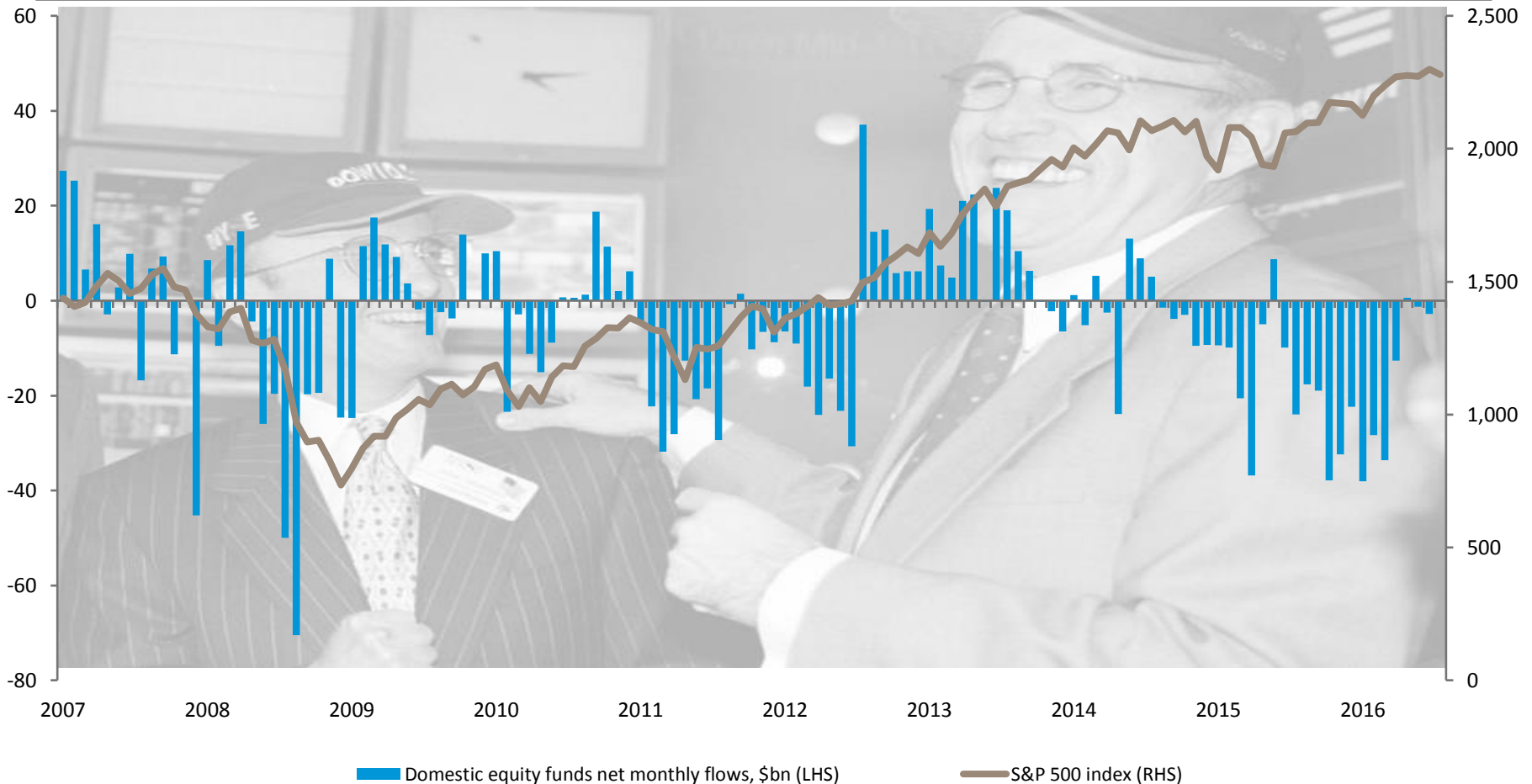
High frequency growth indicators



Past performance is not indicative of future performance.

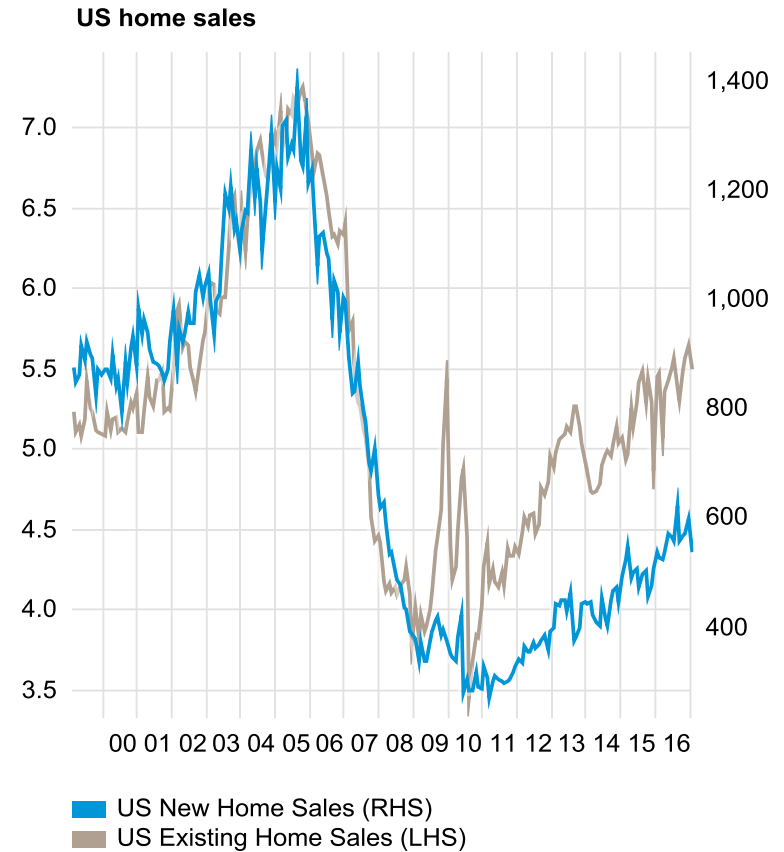
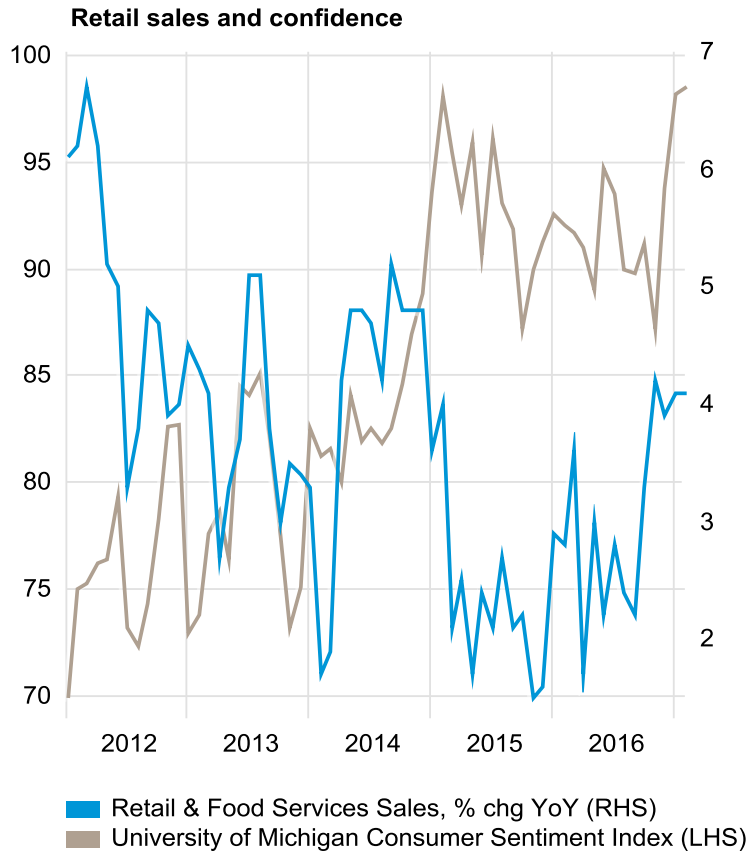
Also the changed profile of equity ownership

Data from 31 Jan 2007 to 1 Feb 2017



US consumer in good shape

31 Dec 2011 to 31 Jan 2017



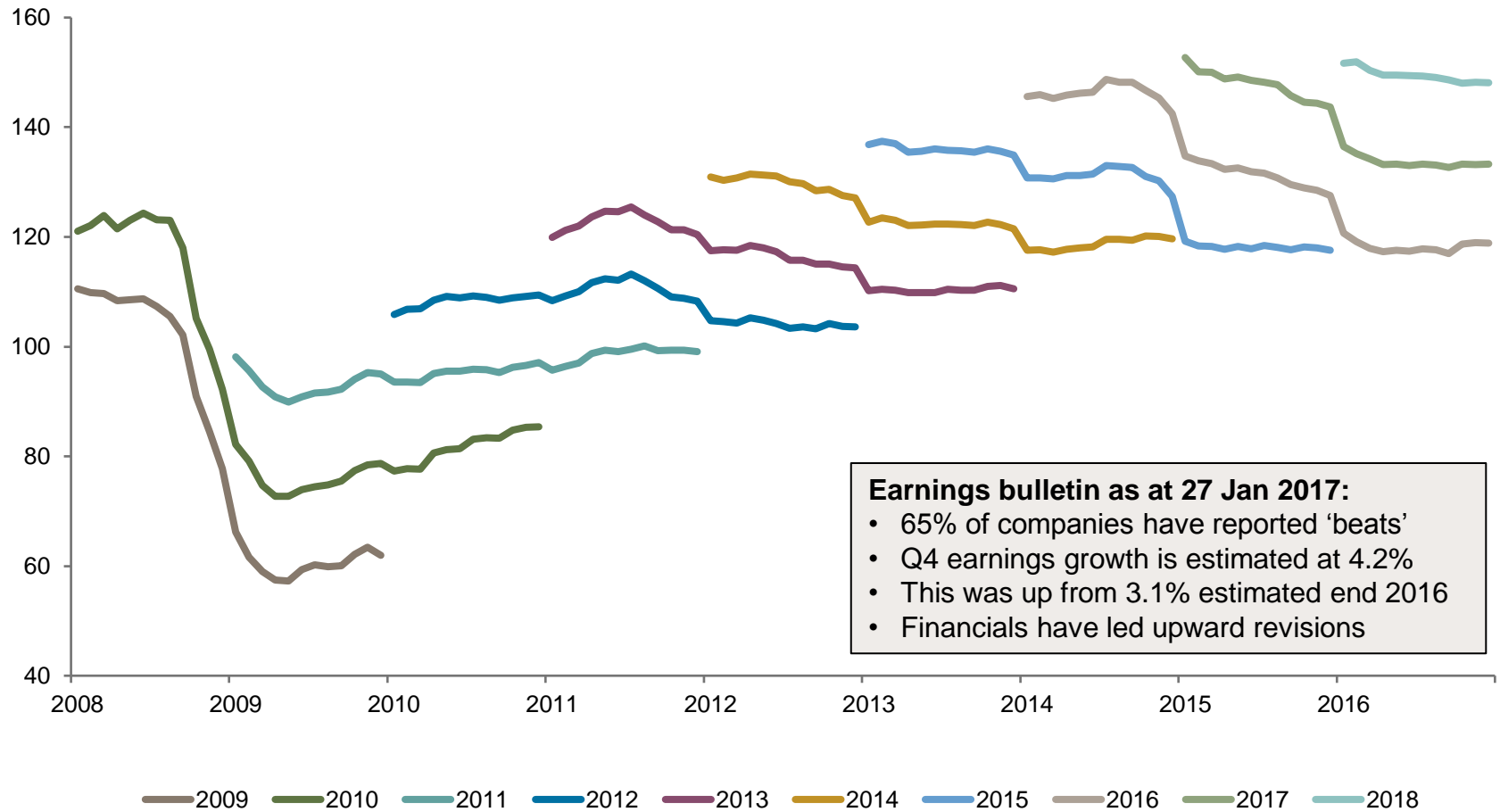
Past performance is not indicative of future performance.

Source: Bloomberg

*US new home sales and existing home sales data to 31 Dec 2016

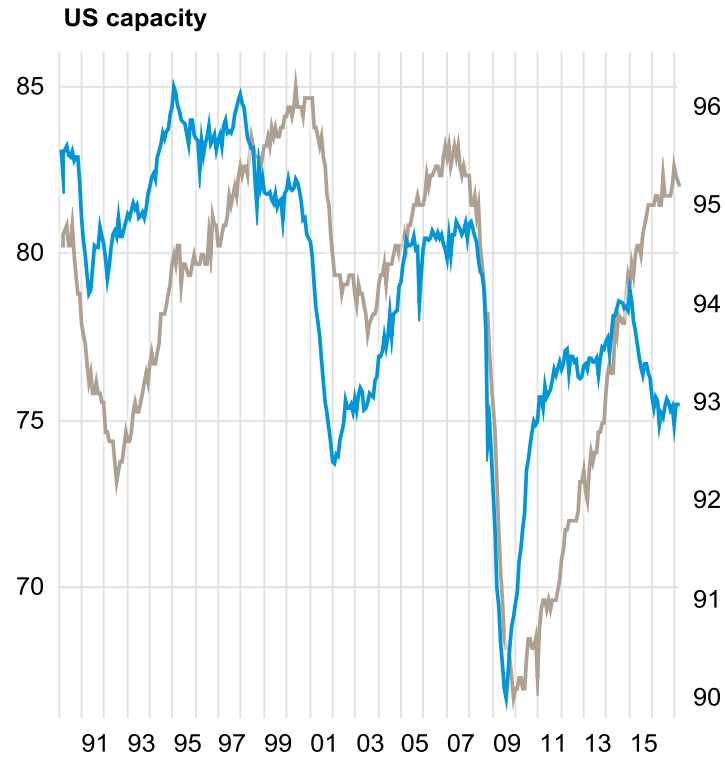
US earnings estimates starting to improve

Consensus EPS estimates for calendar years from 2008 to 2018

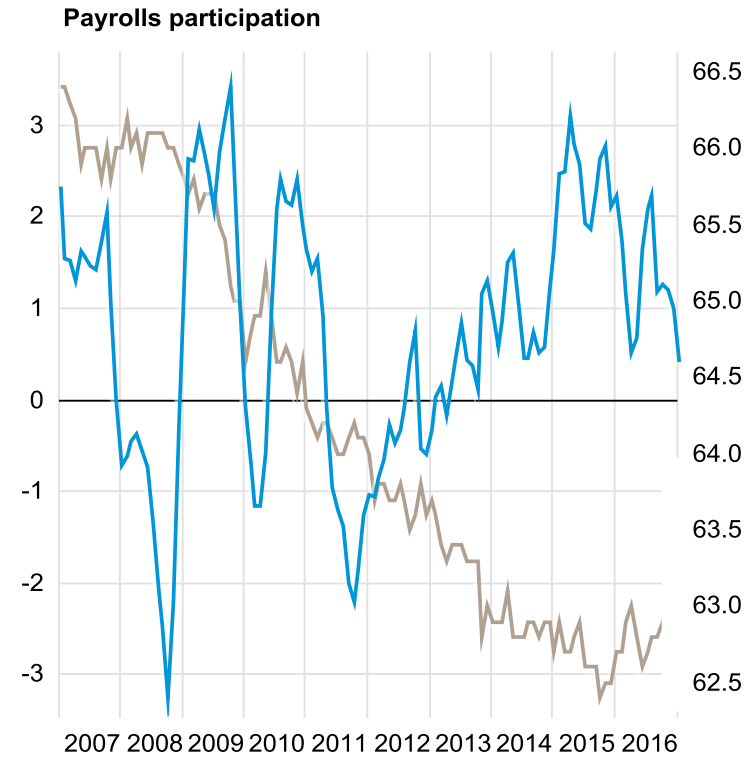


Inflation coming but won't get out of control

31 Dec 1989 to 31 Jan 2017



■ US capacity utilization, % (LHS)
■ 100-US unemployment rate, % (RHS)



■ Weekly non-super. earnings, % chg YoY 3 mma (LHS)
■ Labor force participation rate, % (RHS)

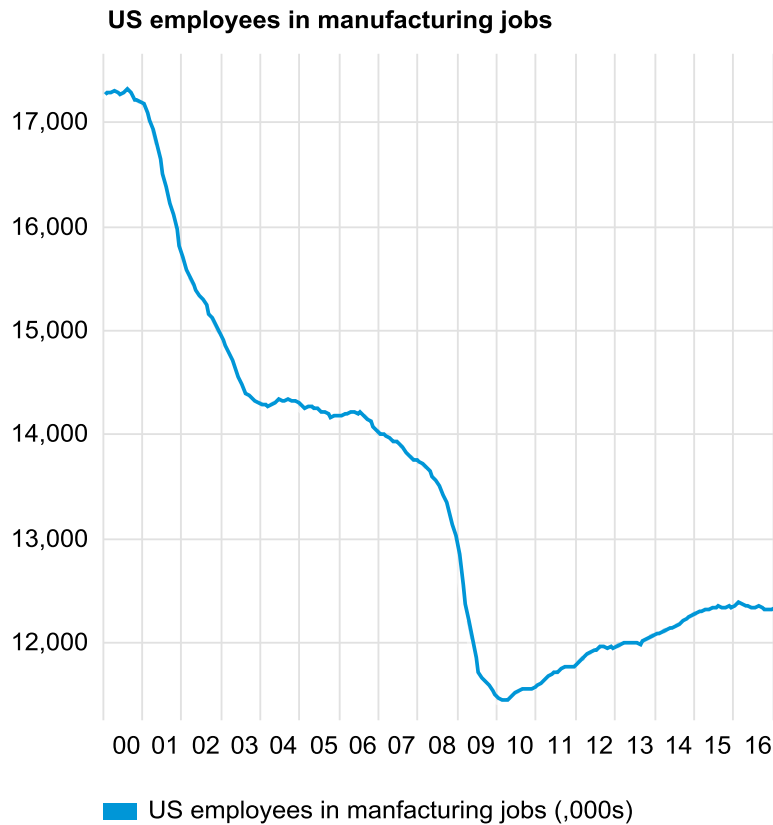
Past performance is not indicative of future performance.

Source: Bloomberg, Bureau of Labor Statistics, GAM

*Payrolls participation data to 31 Dec 2016

Capital (mis) allocation by Twitter - myth and reality

From 31 Dec 1989 to 31 Jan 2017



Trump saves 1,000 jobs at Carrier

Amazon announces 100,000 jobs to be created

Walmart to add 10,000 jobs in stores in 2017

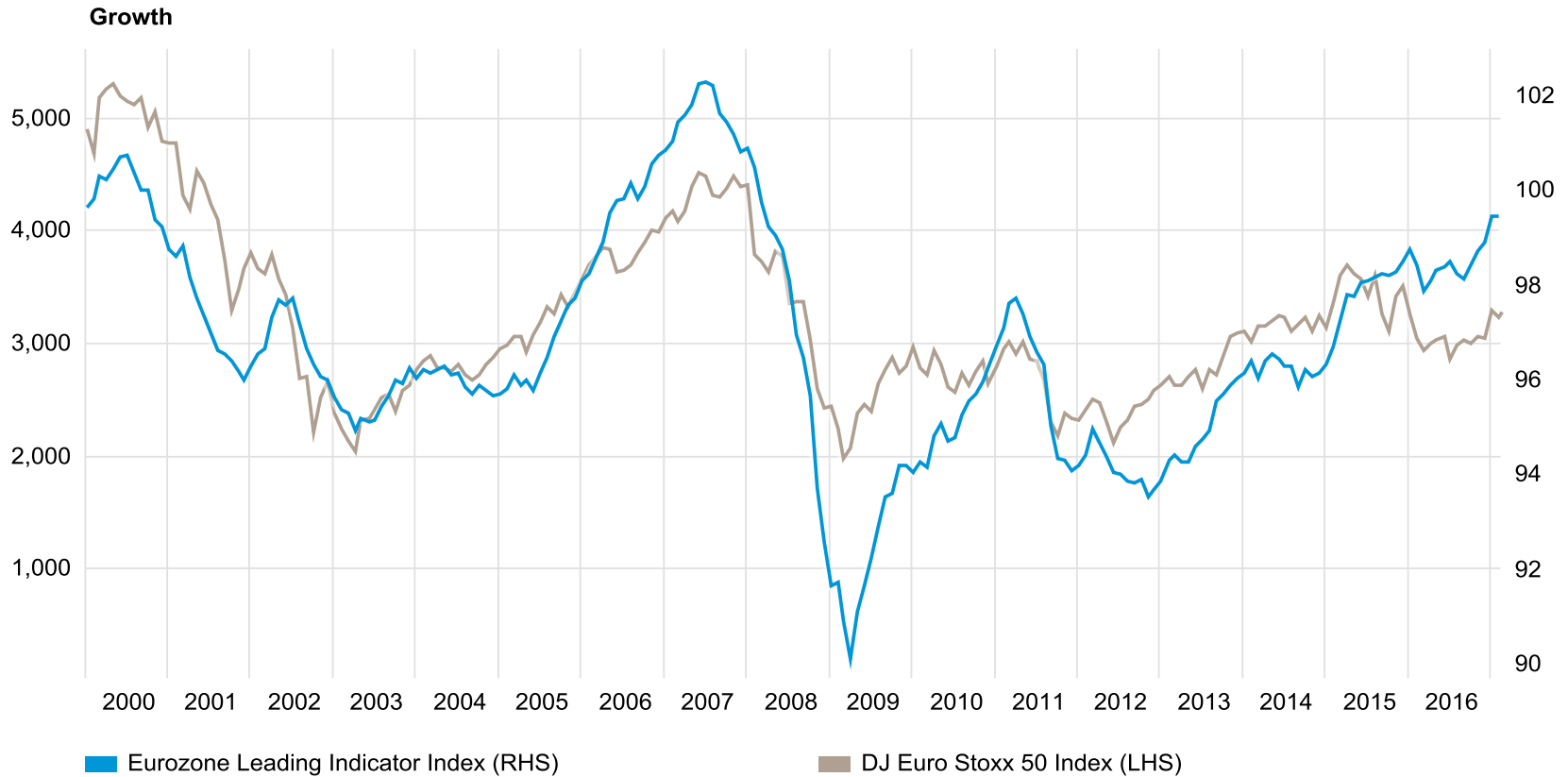
GM to invest \$1bn and create 1,500 jobs

Past performance is not indicative of future performance.

Source: Bloomberg, Standard & Poor's

Europe - equities divorced from fundamentals...

From 31 Dec 1991 to 9 Feb 2017

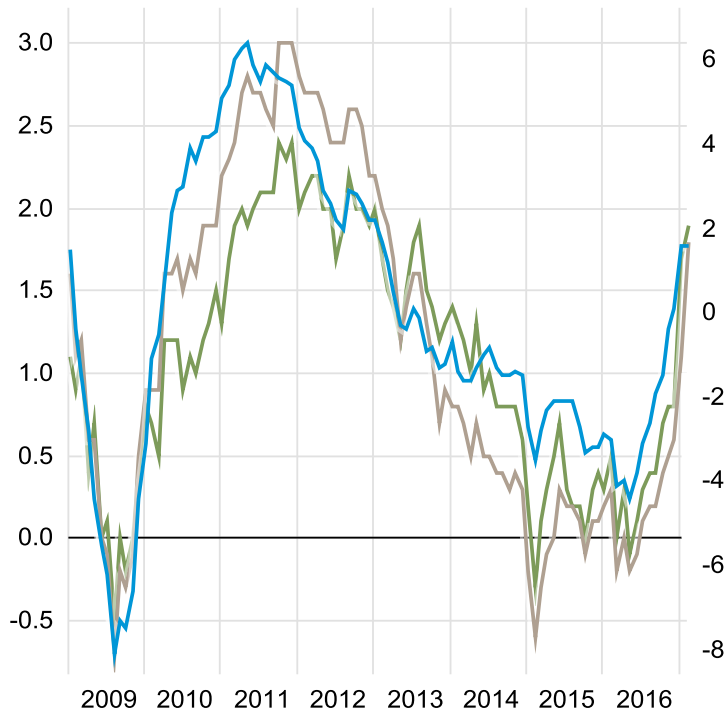


Past performance is not indicative of future performance.

ECB divorced from reality

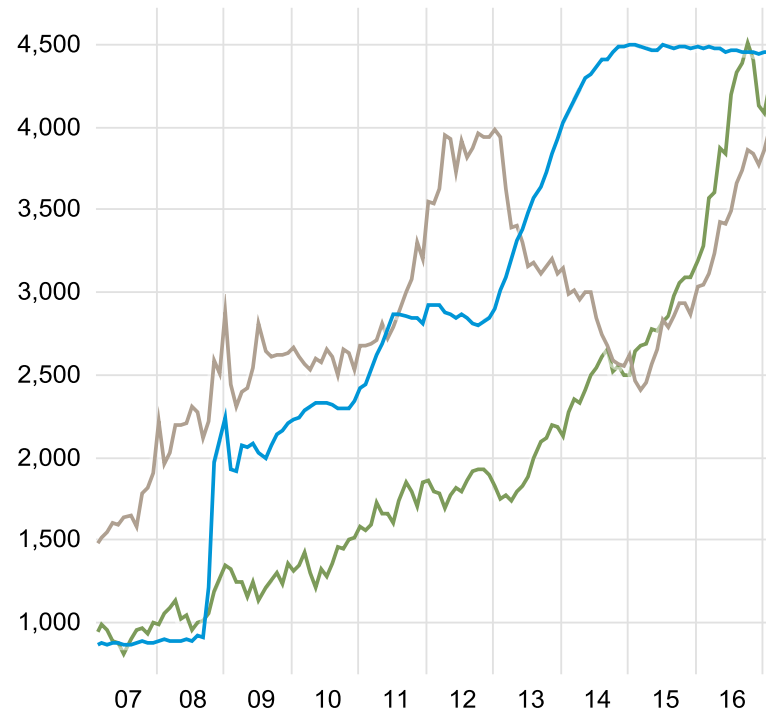
31 Dec 2007 to 3 Feb 2017

German inflation cannot be ignored



■ Euro Area PPI, % chg. YoY (RHS)
■ Euro Area CPI, % chg. YoY (LHS)
■ Germany CPI, % chg. YoY (LHS)

ECB balance sheet nearly as bloated as Fed's



■ Fed (USD billions)
■ ECB (USD billions)
■ BOJ (USD billions)

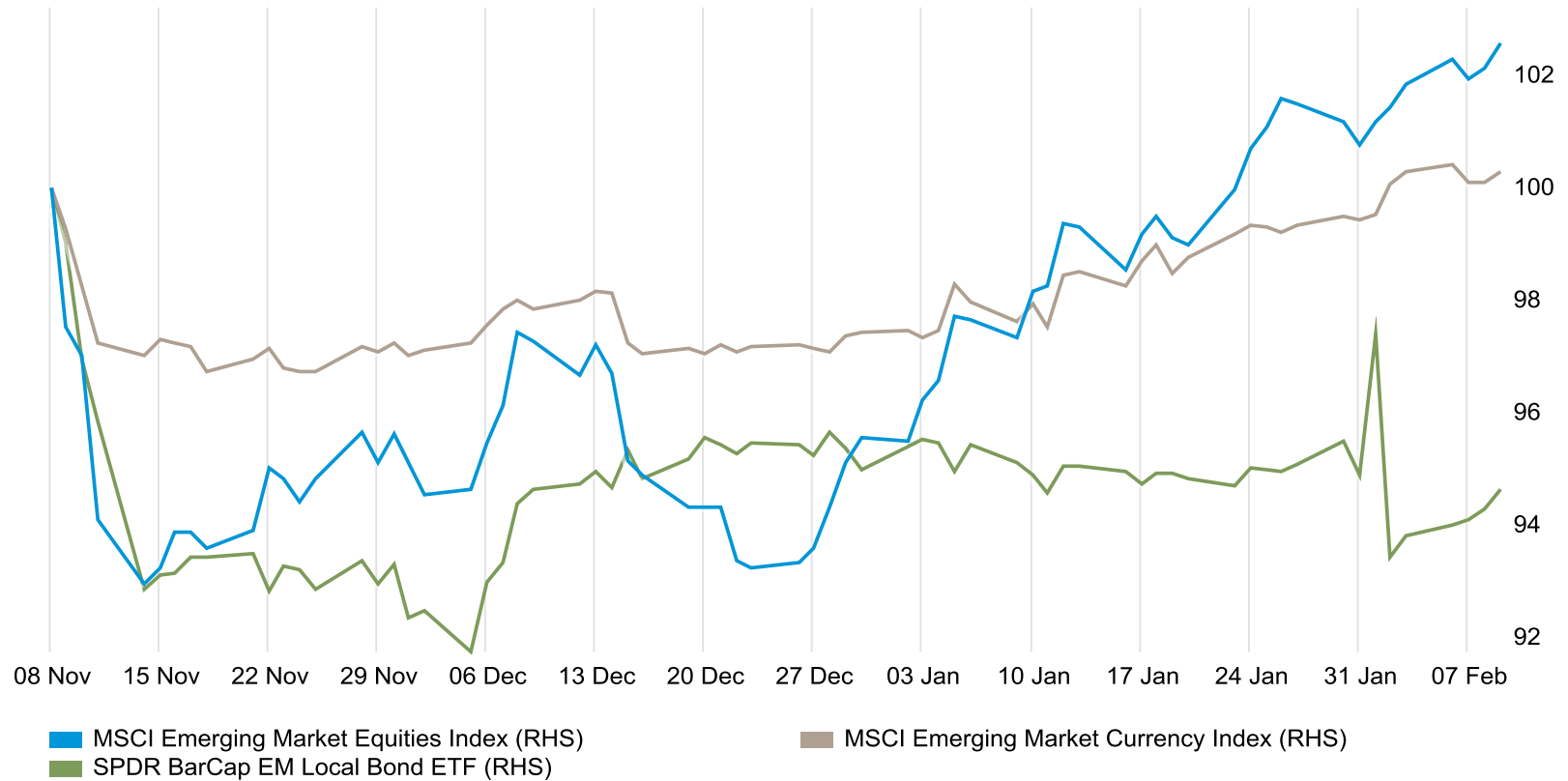
“...there are no signs yet of a convincing upward trend in underlying inflation.” ECB President Mario Draghi, 19 Jan 2017

Past performance is not indicative of future performance.

Emerging markets have nearly recovered post-Trump

From 8 Nov 2016 to 9 Feb 2017

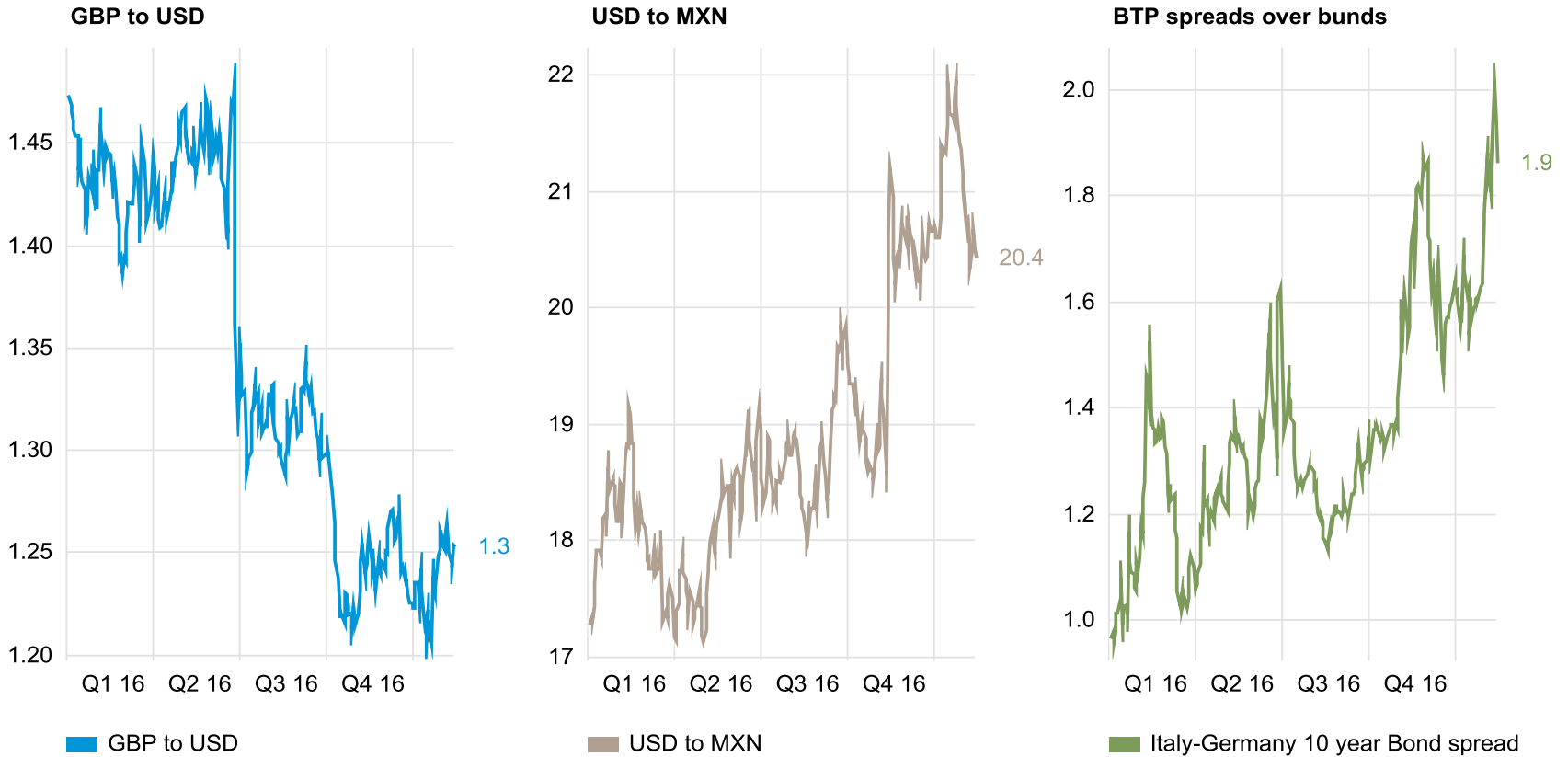
Developing resilience



Past performance is not indicative of future performance.

Victims of the new order are specific, localised

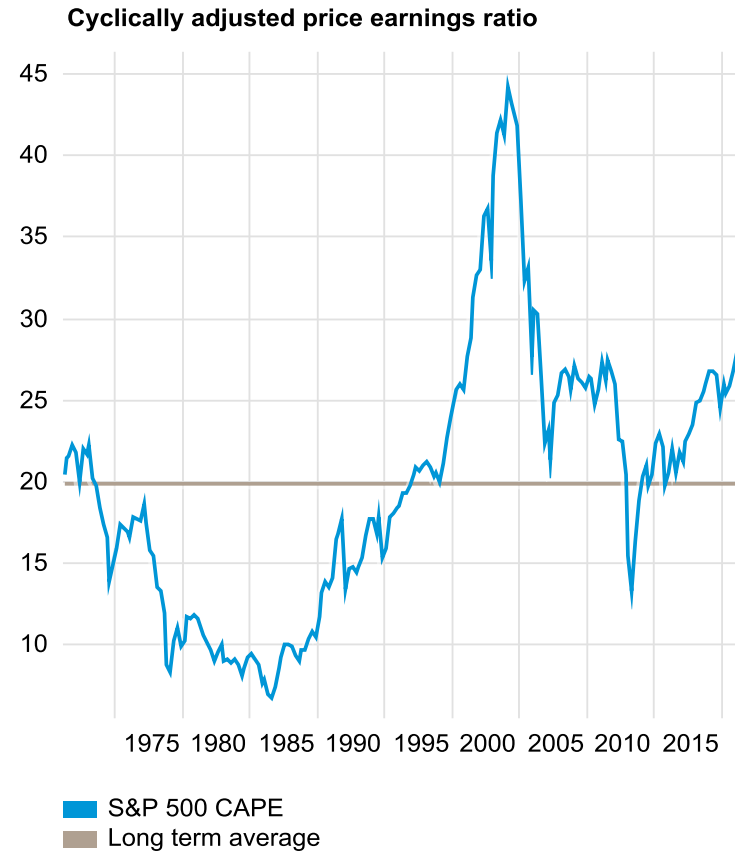
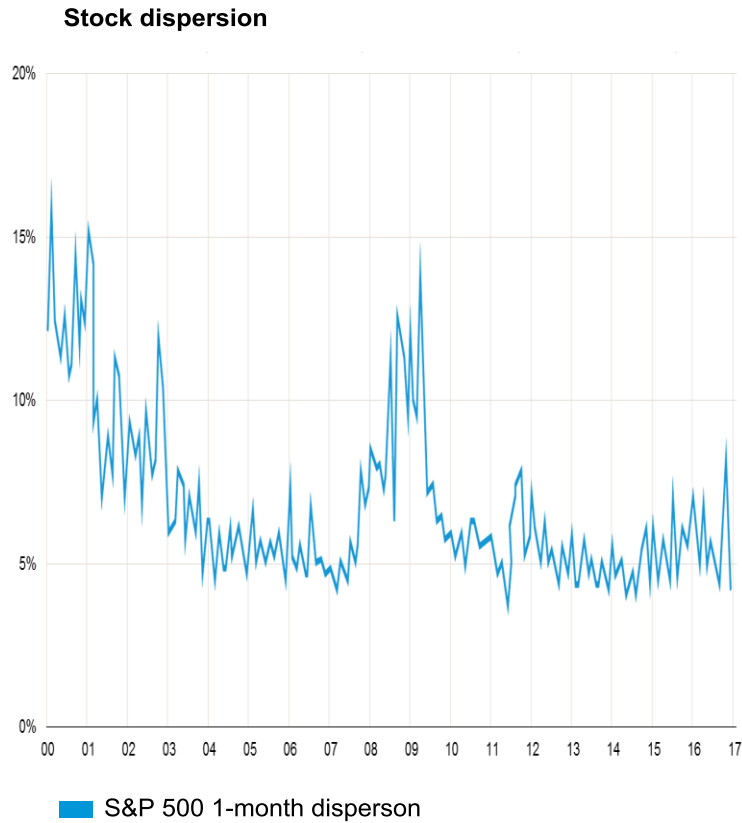
From 31 Dec 2015 to 9 Feb 2017



Past performance is not indicative of future performance.

Risks to watch out for - dispersion, valuation

From 31 Jan 1967 to 2 Feb 2017



Past performance is not indicative of future performance.

Scenarios for 2017

Data as at 04 Jan 2017

Probability: %	Crisis: 10%	Stagnation: 20%	Reflation: 60%	Boom: 10%
	<ul style="list-style-type: none"> Global GDP <2% DM slows, EM follows Geopol. / systemic crisis Profits relapse Markets tumble 	<ul style="list-style-type: none"> Global GDP <3% Reflation stalls, EM lags Geopolitical tensions Profits go sideways Markets correct 	<ul style="list-style-type: none"> Global GDP >3.5% DM, EM growth Geopolitics contained Profit recovery continues Gradual market progress 	<ul style="list-style-type: none"> Global GDP >4% DM recovers, EM takeoff Geopolitics benign Profits smash forecasts Bull market
Equities	-20 to -10%	-10 to 0%	2 to 7%	7 to 15%
Allocation	10%	15%	40%	50%
Implied contribution	-1.5%	-0.8%	1.4%	5.5%
Fixed Income & Credit	2 to 5%	1 to 4%	0 to 3%	-3 to 1%
Allocation	55%	50%	30%	25%
Implied contribution	1.9%	1.3%	0.5%	0.1%
Alternatives	-2 to 5%	-1 to 5%	-1 to 5%	-2 to 5%
Allocation	20%	25%	25%	20%
Implied contribution	0.3%	0.5%	0.5%	0.3%
Liquidity	0% to 0.5%	0% to 1%	0.5% to 1.5%	2% to 3%
Allocation	15%	10%	5%	5%
Implied contribution	0.0%	0.1%	0.1%	0.1%
Expected return	0.8%	1.1%	2.8%	5.7%
Including alpha	1.6%	2.0%	3.8%	6.6%

Probability-weighted expected return including assumed alpha = 3.3%

Source: GAM. For reference, OECD full year 2017 forecast for world GDP growth is 3.3%.

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Strategic and tactical views – summary

Data as at 14 Feb 2017

	Low Conviction	Cautious	Neutral	Positive	High Conviction
Equities		UK [sterling recovery, recession risk] Japan [currency risk]	Europe [Political risks elevated, but economy improving]	US [growth is back but valuations high] Emerging Mkts [sound fundamentals, opportunity]	
Neutral					
Fixed Income		Active aggregate bonds [diversification rather than upside]	Absolute Return approaches [rates opportunities, careful risk control]	Financial credit [regulatory trend, steady underlying cashflows] Liquid high yield [safer return extraction]	MBS [steady return profile] Insurance-linked [low correlation to major indices]
Positive					
Alternatives			Macro trading [potentially rich opportunity set for managers to exploit]	Market neutral Equity L/S [innovative non-directional approaches]	Merger Arbitrage [spread extraction with diversification can provide steady return profile]
Cautious					
Flexibility	Government bonds [valuations, growth, inflation]			Mexican bonds and currency [carry, FX v JPY] SEKNZD [rising inflation in Sweden unnoticed]	Thematic equities [growth re-rating]
Positive					

Q & A

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