

MARKET COMMENT – Q4 2017

With 2017 already behind us, the final quarter saw the spotlight shift away from central bank headlines toward geopolitical matters mentioned in our very first comment of the year.

The key question is: how long will this last? At the dawn of 2018, all investment banks communicate their outlooks and raise the obvious worries concerning higher US interest rates and the nearing end of quantitative easing measures from the ECB and the BoJ. Will it trigger the end of the goldilocks economy?

From the terrible hurricanes Harvey and Irma in October, to a historical winter snowstorm and extreme temperatures in December, the US certainly weren't spared from exceptional weather conditions in the fourth quarter. But the impact was more muted than expected. It simply delayed, as indicators published during the period continued to signal a positive path. The growth figure reported for the third quarter was encouraging. The labour market remains tight throughout the last months of 2017 and provides hope that core inflation will reach the US Central Bank target. It is therefore not surprising that the US federal reserve would have raised its benchmark rate by 0.25% to a range of 1.25%-1.50% in December. The nomination of Jerome Powell, as new chairman of the institution who will start his term in February 2018, didn't shake up the investment community as there are strong expectations that he will continue implementing the current policy (i.e. a cautious and gradual increase of interest rates). Investors were more sensitive about a government playing with temporary measures to avoid its shutdowns, President Trump recognising Jerusalem as Israel's capital and the ongoing investigations into alleged Russian interference in the 2016 United States elections. Nonetheless, the focus of investors monitoring the US political scene was obviously the fate of the significant tax reform plan, one of the key campaign promises of the current government. After a long but eventually successful process, the senate finally passed the Tax Cuts and Jobs Act in December. Rejected by all Democrats and a few Republicans, the majority prevailed and despite questionable tax relief to US Households and an indisputable additional burden to the government debt, the boost for US companies will be substantial. Unchanged from the eighties, the US corporate tax will indeed be decreased to 21% from 35%.

Europe continues its slow but positive economic trajectory. The Italian credit rating was revised upward and growth was encouraging across the Eurozone. The labour market is also improving. However if the regional unemployment rate decreases, it remains far from a satisfactory level, notwithstanding the wide dispersion amongst the various countries. Germany keeps struggling to form an effective government as coalition discussions remain essentially fruitless. Brexit negotiations between representatives of the European Union and the UK continue to be tricky. Although an agreement covering some critical points of the "divorce" was reached in mid-December, Theresa May, the UK Prime minister, lost a critical vote which will result in greater involvement of the parliament in the EU withdrawal process, implying additional delays and complications to an already difficult process.

During the same period, China and Japan stood out in the Far East by displaying relatively stronger governments. In October, China held its 19th Communist Party's National Congress during which Xi Jinping confirmed his leadership with a new five year term. And in Japan, Shinzo Abe was successfully re-elected following the snap elections he himself had called. The Japanese economy continues to display a strong labour market and positively surprised investors with a

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growth revised up for the 3rd quarter at 2.5% from 1.4% and November inflation jumping to 1% from 0.3% in October.

Finally, the fourth quarter also witnessed further tensions in the Middle East. Combined with the OPEC extension of the oil output restrictions, backed by Russia, the environment supported a significant rally of the oil price.

Taking a step back, it looks like central banks have finally effectively passed the baton to governments to support their economies. And one may wonder whether there's now a shift from a currency war, in which the rule of the game was central banks devaluing their currencies, to governments that are now engaging in a fiscal one.

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Performance of key global indices:

Markets	Indices	Q4
Equity World	<i>MSCI All Countries World Daily Total Return Net USD Index</i>	5.7%
Equity Emerging Market	<i>MSCI Emerging Net Total Return USD Index</i>	7.4%
Global Fixed Income	<i>Barclays Global-Aggregate Total Return Index USD</i>	1.1%
Global Commodity	<i>S&P GSCGI Index Spot Index</i>	7.2%
Hedge Funds	<i>Hedge Fund Research HFRX Global Hedge Fund Index</i>	1.6%
EUR/USD	<i>Euro Dollar</i>	1.6%