

POLITICAL UPSET REMAINS THE NORM

This week has been fairly routine, a couple of elections, a populist revolt and the toppling of a government, so far so ordinary. In Italy, the rejection of constitutional reform has resulted in the resignation of prime minister Matteo Renzi – prompting calls for an early election in which the anti EU Five Star party is expected to do well. While Italy shocked no one by reverting to its default state of political chaos, in Austria however there was something of an upset when the far right candidate lost to a liberal pro-European. The selection of a left-leaning politician, or even half way decent human being, is something of a novelty in 2016.

Elsewhere there has been much attention on who Donald Trump is picking to serve in government, with nothing so far suggesting his term will be any less controversial than his campaign. Markets have been untroubled by much of this, either viewing these events as positive developments, or more likely, becoming immune to the noise generated by political events.

THE MARKETS THIS WEEK

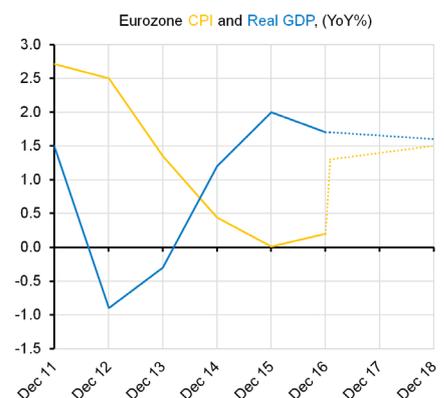
FTSE 100	S&P 500	Nikkei 225	Euro Stoxx 500	Hang Seng	US 10 Yr	UK 10 Yr	Brent Crude	Gold	Wheat	GBP USD
+3.11%	+2.52%	+3.10%	+5.65%	+0.87%	+0.04%	+0.05%	-0.80%	-0.68%	+5.18%	-0.94%



EU: ECB TRIMS QE

The European Central Bank surprised analysts by deciding to reduce monthly bond purchases from €80bn to €60bn starting in April next year. The ECB also extended the programme from March 2017, to December 2017. These statements provided investors with two alternate views of the policy as the approach seems both hawkish and dovish. Initially the euro rose over 1 per cent against the dollar as investors sold Eurozone bonds but the comments from the ECB president, Mario Draghi, swiftly curbed expectations of reduced stimulus and the euro was down 1.3 per cent in late trading in London.

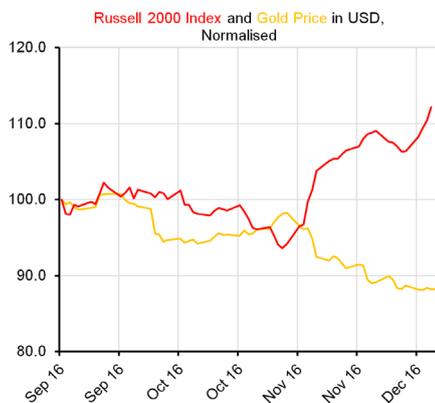
Elsewhere in Europe, Italy chose to reject the prime minister, Matteo Renzi's, proposed reforms on Sunday with a 60 per cent majority. The overwhelming vote to reject the changes was larger than anticipated with only 3 out of the 20 regions in Italy voting yes. The euro saw a large decline of 1.5 per cent in early Asian trading, but recovered in early European trading to finish down just 0.16 per cent. Moody's dropped the country's credit rating from stable to negative.



US: EQUITIES GO FROM STRENGTH TO STRENGTH

A month on from Trump's victory and markets continue to show signs of strength. The president elect's repeated pledge to boost the US economy with spending increases and tax cuts, are persuading investors to move to a risk-on outlook. The value of global equity markets has jumped by \$2tn over the last month with a huge rotation from debt to stocks. US small-cap stocks in particular have experienced large inflows as investors expect a stronger domestic economy. The Russell 2000 index (comprised predominately of smaller companies) has risen 14 per cent over the last month.

On the other hand, gold and the Japanese yen have suffered in the wake of the US election, although the latter is not necessarily a bad outcome for Japan. Gold was a good bet if market chaos had ensued after the election, however, the looming increase in interest rates and potential rise in inflation have seen a hit to gold of about 8 per cent. The drop in Japanese yen has been a major contributor to the dollar index's (a measure of the USD against foreign currencies) success, which has climbed over 2 per cent since the election.



JAPAN: POSSIBLE PROGRESS FOR ABE

The implementation of the UN accounting standards for compiling national accounts has helped Japan's economy to grow by 6.3 per cent overnight. GDP had originally been valued at ¥499tn for 2015 however after the UN standards were applied this shot up to ¥531tn. Prime minister Shinzo Abe vowed to put an end to Japan's on-off deflation and increase the country's economic output to ¥600tn by 2020. This latest development brings him considerably closer to his target. The UN includes spending on research, development, patents and copyrights as investment which in turn contributes to GDP. Japan's high spending in some of these areas has had a huge impact on the view of the country's economy.

The strengthening of the US dollar in response to Trump's potential expansionary policies has put downward pressure on the safe-haven Japanese yen. The US dollar versus the Japanese yen is up from ¥103 in November, to ¥114 this week. The decline in the currency will help make exports more competitive and raise the price of imported goods, which should give the country's inflation a boost [with time].

