Welcome to the Xmas 2016 Edition of the Martin Bros Monitor.

In this edition of the Martin Bros Monitor:

An Early Santa Rally and A Trump Kind of 2017

In the year of the underdog (Brexit, Bulldogs!) we should perhaps not be surprised that Trump won the US election. Without the support of any mainstream media outlet, Donald Trump pulled off the unimaginable by sticking to the same, seemingly lunacy, rhetoric throughout the US election campaign.

On the day / night of the US election, Asian markets were the only markets open during the counting of votes. This saw our Australian equities market swing from up 1% at the start of the day to be down 4% in the middle of the day before closing down 2%. At the close of our market the US futures were still indicating a 4% fall was coming to the US markets.

Then the Trumpinator (after Terminator) emerged to give his victory speech at approximately 7pm that night. As the world held its collective breath and he began to speak, gradually the fear started to subside and world markets started to recover. The ranting lunatic of the past six months was no where to be seen. He was complimentary of his opponent, Hillary Clinton, and encouraged her and the rest of the nation to come together and work together for the betterment of the nation. I remember thinking at the time that the markets are going to like this. No more crazy talk of locking up opponents, closing the borders etc, but lots of talk about fiscal accommodation through tax cuts and government spending – music to businesses ears.

And hence the Santa Claus rally we wrote about in the last edition of MBM had begun early. Often the Santa Claus rally really kicks off mid December and ends sometime around New Years Eve. Whether we get some down days over the next week and then a final push up or whether we continue to grind a little higher to NY, only time will tell.

Looking forward to 2017 we suspect there may be some challenges for markets to overcome in the first quarter or two. Firstly, if we do rally to New Years Eve then markets will be starting 2017 from a relative high point. Then, Trump's inauguration is on 20th January and whilst there is optimism about his fiscal plans, there will be uncertainty about the scale and timing of these. One other canary in the coal mine may be rising bond yields.

Several times we have written about bond yields in the MBM and it seems this time the sell off that began from mid-year onwards has taken hold. Twenty years of falling interest rates culminated in a third of global government long bond yields going into negative territory. It appears this long term trend of falling rates may be over, however we are not predicting an eventual return to interest rates seen in the early 1990's. With the level of global indebtedness, this seems almost impossible as interest rates even half as high as those seen in the early 1990's would crimp economies.

The bond sell off (rising yields) started when the Japanese Central Bank and European Central Bank both questioned the effectiveness of further quantitative easing to boost economic growth. Low interest rates globally was targeted by almost every country in a bid to stimulate business investment and hence jobs, leading to economic growth and inflation (yes, they want inflation but just not too much). To some extent this worked as since the GFC it has kept most countries out of recession. However, it has not resulted in strong growth.

So with central banks now starting to question the effectiveness of ultra low interest rates to stimulate growth, the bond sell off began. Then, when Trump was elected, his big talking fiscal stimulus (as opposed to monetary stimulus) raised the prospect of more domestic spending in the US, supporting jobs and business investment. If this works, the resulting effect will be higher growth and higher inflation. Therefore, since his election, the bond markets have further extended the sell off and in fact, substantially sped it up.

Below is the same table of global long bond yields we included last edition, now updated to today's prices. You can see the substantial increase in all long government bond yields of major global economies. To put this in perspective, if you bought a US 10 year bond yield on 30th June this year, your capital loss to-date is about 8%. On a bond that was yielding 1.45%, that equates to over 5 years of no return. If this sell off continues next year, the losses could be substantial. Do we think it will continue. Yes, we do over the next couple of years.

Bond	31 March 2016	30 June 2016	9 Dec 2016
Japan 5 year bonds	0.04%	-0.32%	-0.09%
Japan 10 year bonds	0.04%	-0.24%	0.05%
German 5 year bonds	-0.33%	-0.57%	-0.40%
German 10 year bonds	0.15%	-0.13%	0.37%
France 5 year bonds	-0.21%	-0.35%	-0.26%
France 10 year bonds	0.48%	-0.19%	0.80%
UK 5 year bonds	0.84%	0.35%	0.52%
UK 10 year bonds	1.41%	0.87%	1.25%
US 5 year bonds	1.20%	0.99%	1.85%
US 10 year bonds	1.77%	1.45%	2.43%
Australia 5 year bonds	2.05%	1.63%	2.30%
Australia 10 year bonds	2.49%	1.97%	2.83%

Beyond the potential for volatility in the first part of next year, we believe that if the Republican Party in the US (Trump as President but he really won't be responsible for the economic planning) can do what they have promised, then equity markets will like this, and will rally in anticipation of the boost to GDP (economic growth). Bonds will be further sold off and some of this money will flow into equities seeking a new home.

Rising bond yields while good for savers, is negative for anyone who needs to borrow as they will pay a higher price. Some investments like property trusts and infrastructure stocks are known as bond proxies because they provide stable income. However, when their alternative – bonds – start to offer higher yields, they in turn look less attractive. In addition, any new re-financing to be done will be done at higher prices as interest rates go up. You may have heard about Australian banks starting to raise interest rates on fixed rate mortgages and variable rate investment mortgages. This is because their wholesale funding (the rate they borrow at) has increased, hence they are passing it on. This trend may continue in 2017.

Merry Christmas.

ASX Market Hours - Festive Season

Please note the amended ASX trading hours below over the upcoming Christmas and New Year period.

Members of the Martin Bros. Team will be available each day the market is open.

- Friday 23rd December - Reduced Trading (10am to 2.30pm)
- Monday 26th December - Market & Office closed (Boxing Day)
- Tuesday 27th December - Market & Office closed (Christmas Day Holiday)
- Wednesday 28th December - Normal Trading

- Thursday 29th December - Normal Trading
- Friday 30th December - Reduced Trading (10am to 2.30pm)
- Monday 2nd January - Market & Office closed (New Years Day holiday)
- Tuesday 3rd January - Market returns to normal trading hours

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