SYZ WEALTH MANAGEMENT

1 MONTH IN 10 SNAPSHOTS

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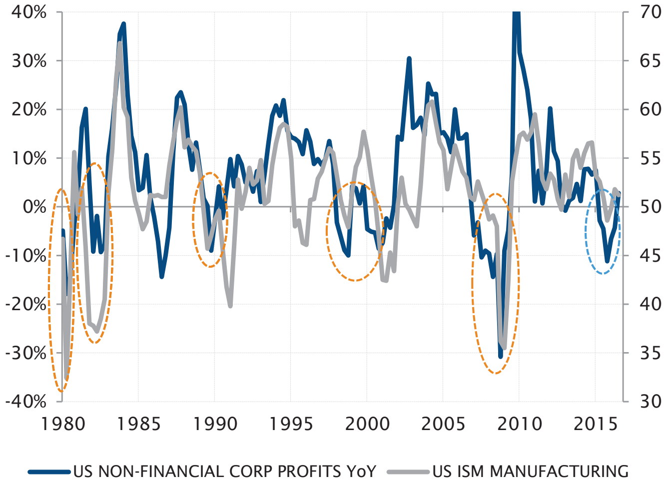
1. The US cycle fends off the profit and investement decline

- All lights have recently turned green for the US economy. The election of Donald Trump, his shift in tone from campaign exuberances and the emphasis on the fiscal side of his program have come as the cherry on the cake of an already improving economy. With activity in the manufacturing and service sectors accelerating, previous growth concerns have vanish.
- While a simultaneous decline in non-financial profits and ISM manufacturing had always been followed by a recession in the past 35 years, it seems that “this time has been different”, as overall GDP has withstood the industrial contraction caused by falling oil prices and a strong dollar.
- As a consequence, downside risks to the US growth outlook have markedly declined. However, as optimism grows, it may be worth bearing in mind that the upside potential remains limited by low potential growth and the impact of rising interest rates on a highly rate sensitive economy…

Profits and ISM declines sent a false recession signal this time

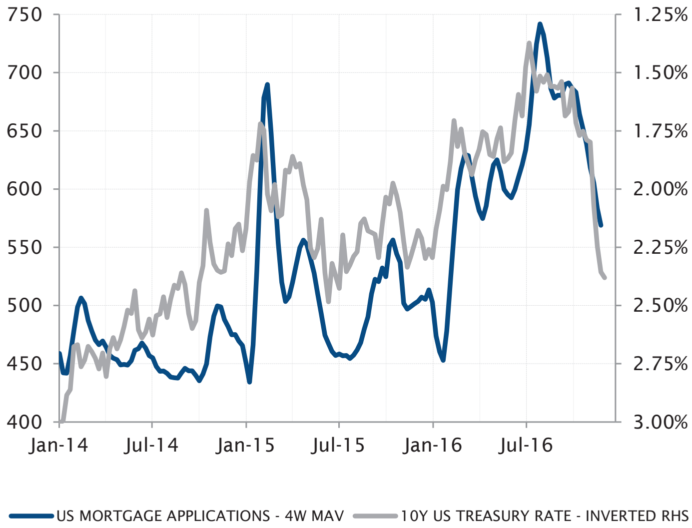


Source : Datastream, SYZ AM

2. Higher US rates limit upside potential to growth for 2017

- Over the past two years, the industrial part of the US economy went through a recession of its own, caused by the combination of cut in capex in the energy sector and of US dollar strength. In the meantime, the resilience of the household sector maintained GDP growth in positive territory as low and declining unemployment, but also rising real estate prices and easy financing conditions suported consumer spending.
- Looking into 2017, while tax cuts and low unemployment will remain supports to spending, consumption will be tempered by the recent increase in interest rates and especially its impact on the positive real estate dynamic. Indeed, mortgage applications have already started to decline. Consumer credit is also likely to slow down in response to higher rates. The net effect of the fiscal stimulus/tighter financial conditions mix may not prove to be as spectacular as expected on total GDP growth next year…

Rising interest rates are negative for the real estate sector

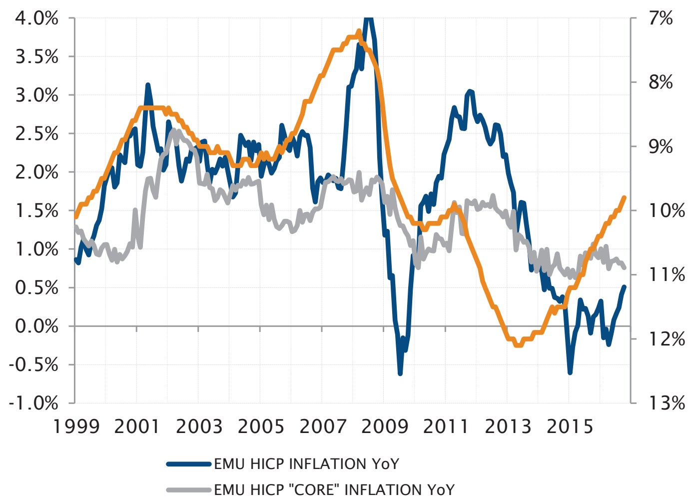


Source : Datastream, SYZ AM

3. Still no time to rest for the ECB

- Latest economic data shall bring relief to the ECB after several years of activism aiming at reversing the downward trend in growth and inflation. Indeed, activity indicators reflect firm growth in the euro area, whith Germany and Spain leading the way. The unemployment rate has just droped below 10% for the first time since 2009. Headline inflation is moving away from zero, thanks to positive base effects on commodity prices.
- However, the ECB cannot lower its guard. Political risk, with coming elections in Holland, France and German and political instability in Italy, has the potential to awaken euro breakeup fears and exert upward pressures on government spreads. Moreover, any attempt by the Fed to normalize its monetary policy in parrallel of Trump's fiscal stimulus risks to hover European rates higher and to undermine the fragile ongoing recovery in credit growth. No time for rest yet for the ECB…

Improving growth and inflation dynamics are not enough for the ECB

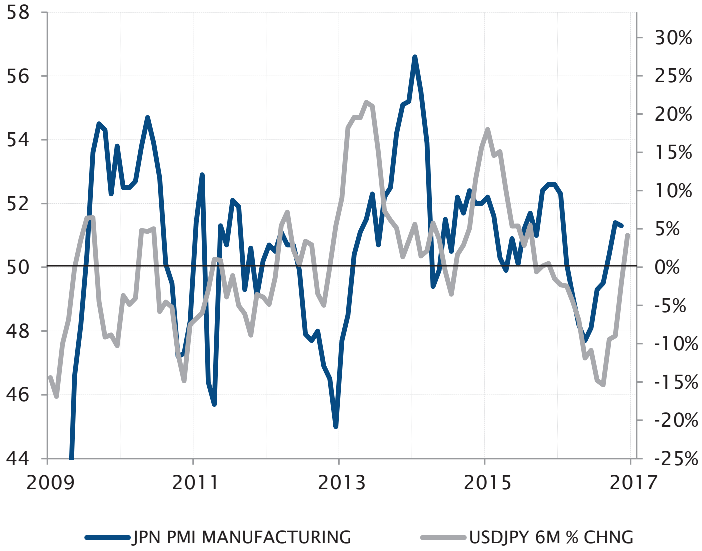


Source : Datastream, SYZ AM

4. The Japanese business cycle driven by the yen

- Since the burst of Abenomics-driven hope and the later delusion caused by the VAT rate hike, the Japanese economy has resumed its slow, volatile growth pattern. In fact, it went through three technical recessions in the past six years, while maintaining avrage yearly growth around 1%, still above its potential growth rate.
- Interestingly, the main driver of growth volatility, even on the short run, now appears to be currency fluctuations. Periods of stronger yen weight on the cyclical/industrial part of the economy, while the non-cyclical part, made of services and consumption, is mildly positive and stable. On the other hand, as soon as the yen gets lower against the dollar, the Japanese business cycle rebounds and the industry resumes activity growth. With very limited room for manoeuvre on the fiscal and monetary policy fronts, the currency has become the key variable for growth movements in the Archipelago.

It's all about the yen...

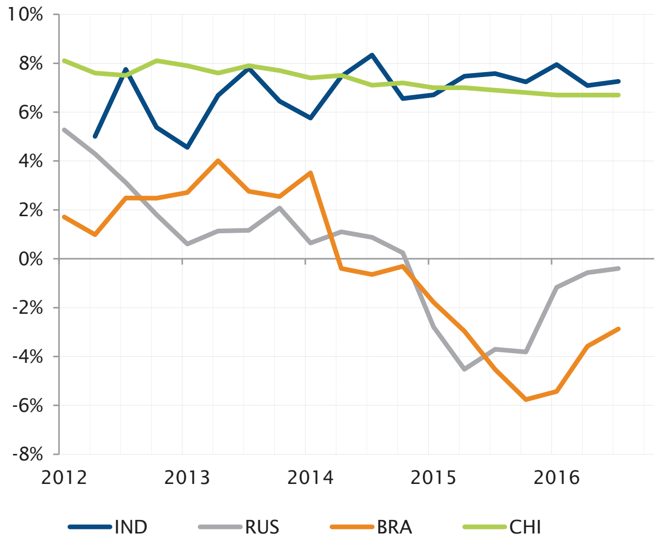


Source : Datastream, SYZ AM

5. Encouraging growth trends in large emerging economies

- The emerging world was under intense pressure in 2015, hurt by the combination of falling energy and commodity prices, stronger US dollar and concerns about China's slowdown and its yuan devaluation. While all those issues have not disapeared, their impact has declined in 2016.
- China's GDP growth has stabilized just above 6.5% after six consecutive years of slowdown, helped by the extension of the currency depreciation and looser credit conditions. Russia is resuming positive growth, helped by the rebound in oil prices. Brazil is still in its deepest recession of the past thirty years but the economy is bottoming out with a more sensible fiscal policy allowing the central bank to untighten interest rates. In the meantime, India's growth remains fueled by positive demographic and productivity dynamics, with the recent demonetization shock likely to be only temporary. Overall, economic trends are encouraging and clearly better than a year ago in the emerging world.

Encouraging dynamics in key emerging economies

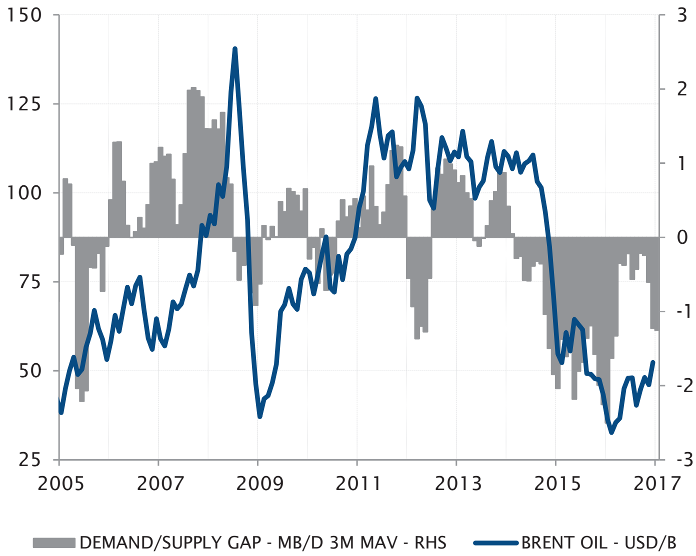


Source : Datastream, SYZ AM

6. OPEC: a production cut to prevent another price decline

- On November 30th, the OPEC finally reached an agreement to cut oil production by 1.2 million barrels a day in January, with Russia announcing the same day that it may go along with a 300k barrels a day cut. The announcement pushed oil prices to their highest level in more than a year, extending the recovery witnessed after the lows of early 2016 (+100% since then).
- Effectively, this production cut appears essentially designed to prevent another round of oil price weakness. In 2014 and 2015, a large supply glut had been the key driver of the price collapse and had only be reduced in early 2016 when oil prices bottomed below 30$/bbl, forcing well closures in the US. Since the spring, however, US rig count is on the rise again as oil prices have recovered, and a supply glut has consequently reappeared, estimated by the US EIA at… 1.2 million barrel per day for January 2017. Precisely the magnitude and timing of the OPEC production cut agreement…

The OPEC production cut matches the reappearing supply glut

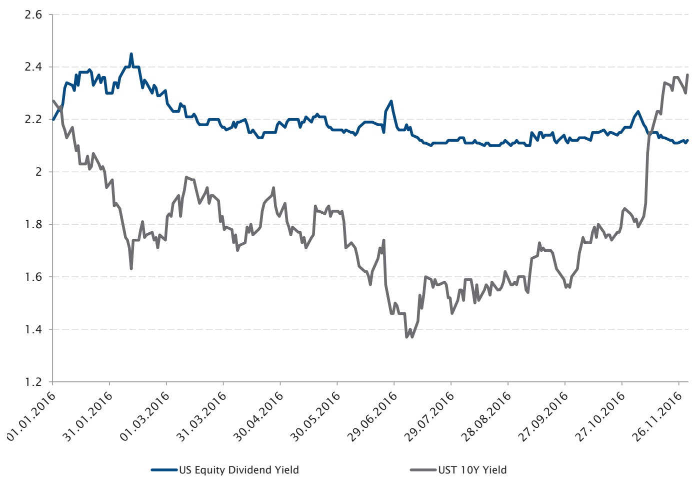


Source : Datastream, US EIA, SYZ AM

7. Rates - Bonds are maybe becoming less expensive than equities

- One of the most crucial geopolitical events of the year had finally approached, and what was deemed as an impossible scenario did materialize: Donald J Trump was elected to be the 45th President of the United States. Investors' anticipation of a new growth mix for the United States did trigger a great deal of asset movements.
- Interest rates continued to experience a sharp increase in November, pushing long term government rates to their highest level since last spring and US equity markets reached new highs. Nominal rates were also driven higher by the prospect of less accommodative monetary policies due to this growth and inflation environment, with the Fed expected to hike in December and speculation about an ECB QE tapering in 2017.
- In this context, UST 10Y yield increased +53bps reaching 2.37% at the end of the month and now yields more than US equities (measured by Datastream dividend yield on the S&P 500).

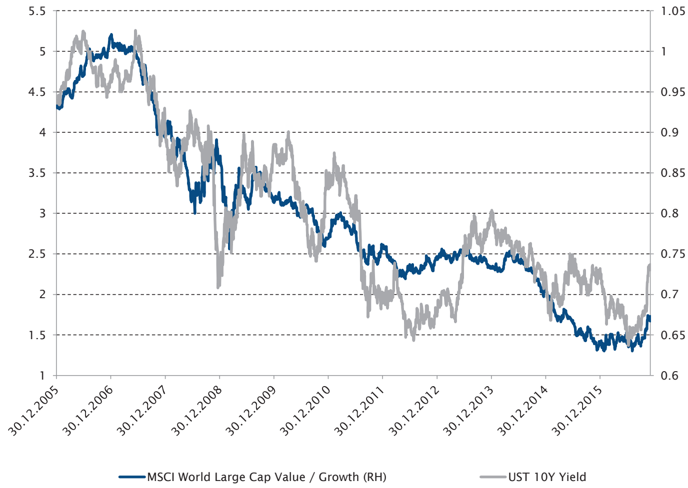
US Equity Dividend Yield and US Treasury 10 Year Yield



8. Equities - Is value investing coming back around?

- Since a few years, value stocks have been structurally underperforming growth stocks. We can identify a strong correlation between US Treasury 10Y yield and the outperformance of value style over growth i.e. when US 10Y rate increases, value investing tends to outperform growth. Moreover, value is recently trading at a discount to growth on a price to book ratio for example.
- With the US monetary policy that is turning more restrictive and hence bringing some upside pressure on interest rates, it is supporting the case for a return to value investing as we saw recently.
- Nevertheless, the market could be overconfident by giving a too high probability to a sustainable and accelerating rate rising cycle coupled with also an overpricing in earnings momentum. Finally, in the short term, the recent euphoria linked to Trump's victory could also be slowly fading away.

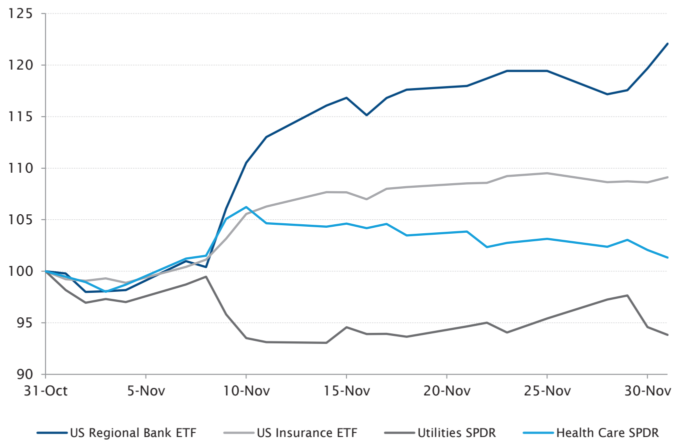
MSCI World Large Cap Value/Growth and US Treasury 10 Year Yield



9. Post-Election rotation

- Following the surprise election in the US of Donald Trump as the next US President, equity markets suffered a violent sector and factor rotation. President-elect Trump pledged for robust investments in infrastructure, fiscal stimulus as well as a potential repeal of the Dodd-Frank regulation. Although it is hard to tell at this stage the likelihood of those measures to be fully implemented, the market welcomed the announcement with a sector-specific rally.
- From a sector perspective, banks rallied as pro-cyclicals and reflation-oriented measures had the effect of increasing interest rates, which benefit to bank through lower pressure on margins. Insurances had also a boost as they should see a pickup in their re-investment income given higher interest rates. Finally, telecom and utilities are among the biggest losers of the Trump-reflation trade, as investors have moved portfolios into pro-cyclicals names.

Impressive sector dispersion



Source : Bloomberg, SYZ AM

10. Turkish lira hits record low

- For the first time since 2014, the central bank tightened its monetary policy with an increase of 50bps of its benchmark interest rate. But this unexpected announcement failed to halt the slump of the lira. The currency rebounded only during the first trading hour following the decision, and then it plunged to record low.
- Being under persistent selling pressure since the abortive military coup in July, the Turkish lira weakened further with Mr. Trump's victory. Vulnerable to the expectations of stronger inflationary pressures and higher interest rates in the US, the currency continues also to suffer from the current political instability in the country.
- Although the decision from the central bank has been recognized as a positive sign of its monetary authority's independence, the measure has been judged insufficient by the market. In this environment, the stability of the Turkish lira might remain a question mark in the coming months.

The lira depreciated by -15% against the US dollar on a YTD basis

Source : Bloomberg