



Just because you do not take an interest in politics doesn't mean politics won't take an interest in you.

- Pericles (430 B.C.)



Summary:

2017 was yet another superb year for the S&P 500 (SPX) index and the eighth full year of the current bull market run that began in March 2009. However, sluggish wage growth in the US has been a consistent theme of this economic cycle, confounding many, who believe a falling unemployment rate should herald higher pay for workers. Hopefully, the proposed cut in corporation tax in the US will drive investments and hence wages. If corporations however, use the tax cut to buy back stock and pay a dividend (as many have done so far), the impact of the cuts on GDP growth will not be so dramatic as consumption fails to take off. Unless the coal miner in West Virginia or the single mother in South Side Chicago has more to spend, businesses will have fewer reasons to invest. This equity market Bull Run will only come to an end when the US Federal Reserve starts raising interest rates aggressively, as was the case in 2006/07 and the yield curve inverts. The rule of thumb is that an inverted yield curve indicates a recession in about a year's time. Yield curve inversions have preceded each of the last seven recessions. On *Brexit*, a breakthrough last Friday in the gruelling "divorce" talks between the UK and the European Union (EU) has paved the way for talks on trade. The agreement has significantly reduced the likelihood of a "no deal" scenario when the UK leaves the EU in March 2019. Bitcoin was and still is a gamble. At this point all I would say is: A fool and his money are soon parted. A fool and his Bitcoin may take longer, but they will be parted.

Penny Post and Christmas cards

As the year draws to a close, it is maybe time to look at the markets and the economy for one last time. However, before we embark on this adventure, let me share that, last night, as I tucked in my 16-month-old daughter and said goodnight, I found her holding a Christmas card. She had picked it up from the table earlier in the evening and wouldn't let it go. It got me curious about the origin of Christmas cards. So where did it all begin?

Christmas cards first appeared in the UK in the 1840s. At the beginning of the Victorian era, Christmas was hardly celebrated in Britain and its status as a civil holiday was non-existent. Factories operated on December 25 and shops were open. The wealth generated by the industrial revolution of this era however changed the face of Christmas forever - as did Prince Albert's introduction of Christmas traditions from Germany, Charles Dickens' penning of a "A Christmas Carol" and the introduction of the "Penny Post." The Penny Post meant that a penny stamp paid for the postage of a letter or card to anywhere in Britain. In 1834, to send a letter from Edinburgh to London, could cost you as much as a day's wages. A Committee of Enquiry set up in 1835, as a result of public complaints, led to the introduction of Penny Post and it had a major impact. In 1839, there were 76 million letters posted in the United Kingdom. In 1840, after the introduction of the Penny Post, there were 168 million letters posted. People sent letters and cards more frequently than ever before. Henry Cole, a prominent civil-servant, educator, and the first director of the Victoria & Albert (V&A) museum, was a passionate supporter of the Penny Post. In Victorian England, it was considered impolite not to answer letters. Cole had the misfortune of having too many friends and during the holiday season of 1843, he faced a particular anxiety - the piling up of unanswered mail. Cole was a busy man and a timesaving solution was needed. He asked John Callcott Horsley - a painter and illustrator - to make a card for him so he could send it out at Christmas. Thus, the Christmas card was born in the UK in 1843. The rest is history...

Markets & The Economy

Fast forward to 2017, which was yet another superb year for the S&P500 (SPX) index (+18.81% YTD) and the eighth full year of the current bull market run that began in March 2009. Last week, the US Jobs report did not disappoint either - unemployment stayed down at record levels (+4.1%, the lowest level since December 2000). However wages are not keeping up (+2.5% in November from a year earlier) and the labour force participation rate remained stagnant (62.7%). Sluggish wage growth has been a consistent theme of this economic cycle, confounding many, who believe a falling unemployment rate should herald higher pay for workers. We haven't seen this yet.

One reason why wages have been flat is that capital investments have been rising slowly. Hiring has improved, stock markets have rallied and consumer confidence has rebounded. However, capital expenditure has not kept pace. Hopefully, the proposed cut in corporation tax in the US will drive investments and hence wages. If corporations however, use the tax cut to buy back stock and pay an increased dividend (as many have done so far), the impact of the cuts on GDP growth will not be so dramatic as consumption fails to take off. Unless the coal miner in West Virginia or the single mother in South Side Chicago has more to spend, businesses will have fewer reasons to invest. If we do not see an increase in capital spending, tax cuts will only benefit the ones who already have plenty and not those who really need it. Sure, they will drive share prices higher as dividends and buybacks continue - but for how long?

According to a one-page analysis by the US Treasury, the Republican tax proposals would pay for themselves over the next 10 years, with the report expecting GDP to increase an average of +2.9%, which would lead to US\$1.8trn in new revenue. This growth number will obviously be challenged. While I am bullish on US equities, I am also mindful that much of the rally in the last couple of weeks has been driven by the expectation that US tax reform will pass. Stimulative as that may be, more importantly, it will give President Donald Trump his first big legislative win and indicate that the Republicans can actually get things done.

In the US today, there is a special general election in Alabama to fill the US Senate seat which has been vacated by

Republican Jeff Sessions. It was initially thought to be an easy win for the Republicans as no Democrat had won an election for the Senate in Alabama in almost 20 years. However, the race has tightened with polls suggesting it is too close to call. If there is a surprise and Democrat Doug Jones were to win over Republican Roy Moore, expect equities to sell-off and bonds to rally. A win by a Democrat would put Trump's 2018 legislative agenda at risk as the Republican advantage in the Senate would be cut to 51-49 (from 52-48) i.e. Republicans can afford only one defection. The Democrats have shown the unity of the Chinese Politburo in their ability to vote as a bloc, while the Republican majority in the Senate has not been quite so united.

While the US Federal Reserve (Fed) is all set to raise rates by +0.25% at its meeting this week, in Europe, the European Central Bank (ECB) having announced at its last meeting that it would continue its asset purchase programme (APP) until September 2018, is unlikely to unveil any further policy changes at its meeting this Thursday. The key macro data to focus on at the ECB meeting will be - the update of the ECB's staff forecasts on GDP growth and inflation. An uptick will force the ECB to rethink its monetary policy stance in the Q1 of next year and we could easily see the end of the APP when its current schedule expires.

Meanwhile, in Japan, Q3 GDP grew +2.5%, in what is now seven consecutive quarters of growth, the longest streak in 16 years. The previous longest run of expansion was for eight quarters, between April 1999 and March 2001. Exports grew +1.5% from the previous quarter amid solid overseas demand as the global economy gains traction. However, once shouldn't cheer too soon. Private consumption, a key factor accounting for nearly 60% of GDP, continued to be sluggish, with a -0.5% decline from the previous quarter, as spending on automobiles and mobile phones fell. One key win for Prime Minister Shinzō Abe is that he has managed to alter Japanese people's expectations about prices. It's safe to say that today, they no longer expect the next generation to be poorer and prices to continue falling.

I continue to be fully invested in the equity markets with an overweight position in US equities and a sector bias to Technology (XLK), Financials (XLF) and Healthcare (XLH). However, I have my eyes firmly on US wage and inflation data. This equity Bull Run will only come to an end when the Fed starts raising rates aggressively, as was the case in 2006/07 and the yield curve inverts. The rule of thumb is that an inverted yield curve indicates a recession in about a year's time. Yield curve inversions have preceded each of the last seven recessions. In the most recent case of a US recession in 2007, the yield curve inverted in August 2006 and a recession started in December 2007. There have been two notable false alarms - an inversion in late 1966 and a very flat curve in late 1998 that didn't lead to a recession. I have very little immediate concern on the yield curve inversion front. Keep your equity positions long.

As I mentioned in the last month's newsletter, I am looking to add to my Emerging Market allocation (EEM US) as well as my Japanese equity position (DXJ US) at any sell-off. One element to worry about EEM is that five of the top ten holdings in the Index are technology companies - Tencent, Samsung, Alibaba, Taiwan Semiconductors, and Baidu and they make up nearly 20% of the Index. Therefore, if Tech valuations are questioned in the short term, expect the EEM to sell-off. Any such sell-off should be seen as a buying opportunity to build positions. The Emerging Markets cycle is set to continue as the risk of a very strong USD, and high oil prices are not on the horizon. The International Monetary Fund (IMF) expects Emerging economies as a whole to grow +4.9% in 2018, up from +4.6% this year, and more than double the growth rate in advanced economies. Emerging Markets are also helped by a spurt of synchronized global growth. All 45 countries monitored by the Organization for Economic Cooperation and Development (OECD) are on track to grow this year. That phenomenon has only occurred three times in the past 50 years.

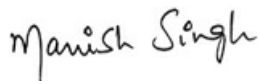
One trade to look at for next year is to go Long - the Oil & Gas Exploration & Production sectors via single names or an ETF (XOP, IEO, PXE). The sector is highly unloved, but things may change next year. If you look at the WTI Oil chart, for the last 2 years, \$50 has looked like a cap. It may now become the floor, due to massive cuts on all sides. OPEC has no option but to continue with cuts, when they have just extended for another nine months and this will continue to push more buyers to buy oil from the US. Besides, the US tax reform bill will be a boost to consumers i.e. more miles travelled.

On *Brexit*, a breakthrough last Friday in the gruelling "divorce" talks between the UK and the European Union (EU) has paved the way for talks on trade. The agreement has significantly reduced the likelihood of a "no deal" scenario when the UK leaves the EU in March 2019. Regular readers of this newsletter will know that I have always believed there will be an EU-UK trade deal, as both sides benefit from it. However, the next phase of discussions will be even trickier, as details are worked out and the success of it will depend on the political willingness of the two sides to reach a deal. Over the last two weeks, there has been a strong willingness on both the sides to work together and find a solution.

I have talked about Bitcoin before and nothing has changed my mind even as Bitcoin hits \$16,000. It was and still is a gamble. All I can say: A fool and his money are soon parted. A fool and his Bitcoin may take longer but they will be parted. According to Joseph Borg, President of the North American Securities Administrators Association, Bitcoin is in the "mania" phase, with some people even taking out mortgages to buy Bitcoin.

On that note, I wish you and your family all the best for this holiday season as well as a very Happy New Year. And if you celebrate Christmas - have a lovely Christmas!

Best wishes,



Manish Singh, CFA

United Kingdom
9 South Street
London W1K 2XA
United Kingdom

Singapore
One Wallich Street
#24-05 Guoco Tower
Singapore 078881

Monaco
Le Park Palace,
Bloc A, 8ème Etage
5, Impasse de la Fontaine
98000 Monaco

Visit our website:
crossbridgecapital.com

CROSSBRIDGE
CAPITAL