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JAMIESON COOTE BONDS

Insights on Interest Rate and Bond Markets Post Trump

JCB are a specialist, active Government Bond manager based in Melbourne founded by Charlie Jamieson and Angus Coote. JCB are assisted by one of the most experienced advisory boards in the country that includes Mark Burgess, ex-CEO of the Future Fund, and Saul Eslake, former Chief Economist of BAML and ANZ.

JCB's macro observations post Trump's historic victory

As we've seen time and time again, markets tend to overreact to news flow. In this regard, the markets have ***only*** traded on expectations not data, which makes finding fair value much harder.

What has been most interesting over this past week is that the same strategists who never saw Trump coming, are now ***certain*** his election is 'reflationary' and as such, interest rates can normalise. We need to be careful what we wish for here. Sustained inflation means sustained rate hikes, which given the world's largest ever debt burdens - cannot end well as the maths is not adding up. It is amazing to see the same crowd who found Trump unpalatable early last week, now think he is a modern day Ronald Reagan.

JCB has a different view. Reagan did stimulate the American economy successfully during the 1980's (with a then low debt to GDP ratio in the upper 20% range), but this also coincided with massive falls in interest rates, providing a large growth tail wind. In the forward period of Trump-O-Nomics, we are looking at mainly headwinds under already mid 70% level debt to GDP ratios, together with a congress very weary of further extending the current large debt burdens.

Emerging markets have suffered greatly post Trump's election with Bond yields soaring and local currencies being crushed. As is widely known, Emerging Markets have heavy US$ debt burdens, much of which are unhedged hence making these emerging economies debt load's more expensive to service post the recent gain in US$ post Trump. This Emerging Markets scenario should create added drag on global growth.

The fiscal prime (i.e. contribution) in the US is estimated to be approx US$100billion a year in a US$15 trillion dollar economy. Against the above macro-economic backdrop, we are envisaging two additional weeks of Bond supply as the US typically issues approx US$50billion per week.

Most observers are estimating US inflation will rise from 2017-18 onwards by 0.2 – 0.3% per annum and yet, we have seen an Australian longer dated term premium (i.e. longer dated Bonds excess yield to maturity vs. RBA cash rate) rise by more than 0.8% per annum over October and November.

Bond market behaviour post Trump's election

Against the above macro-economic sentiment, JCB agree that the first snap reaction in US sentiment is to push Bond yields higher - as has been seen via 65% of this sell-off move happening in the overnight session immediately after Trump's election (very binary for Australian Fixed Income markets). However, it is our observation the markets shoot first and ask questions later...

During this past week, asset-market correlations have grown increasingly negative, showing significant divergence between rates/credit and equities performance.

The outlook for interest rates post Trump

Markets have suffered a de facto rate hike as a result of the post election Bond sell-off and a strengthening USD. A follow up rate hike from the US Federal Open Market Committee (FOMC) in December is expected and essentially fully priced into markets at a 94% probability (as evidenced by Fed Fund Futures contracts for December 2016) - this will likely be the 2nd material tightening of financial conditions in a short time frame.

We have been here before with similar moves of "expected" lifts in inflation expectations; firstly when Obama was elected, again at the launch of QE1, and at the start of Abenomics in Japan. All events have failed to materially generate sustained inflation. The resulting Bond market sell-off's were swift, but then the Bond market slowly rallied back on the realisation that these policies take significant time to implement. The near term "in coming" data should reflect tightening financial conditions across the global economy.

Moving forwards, JCB believe, in a highly indebted world (from a cost of credit perspective) that global interest rates will need to remain at lower historical levels from a serviceability perspective, which should be paramount to ongoing health and performance of economies.

Against the above backdrop, JCB remain convinced that the RBA are on hold for a sustained period, hence there is a limitation to how far longer dated Bond yields can rise in sympathy to the US market.

Concluding comments on asset allocations

Bonds may well continue to decay in the very short term, but by implication that is sinister for the various highly leveraged economies that are reliant on low funding costs.

JCB's investment team and Advisory Board believe that markets will continue to experience heightened uncertainty and instability with episodic bouts of volatility. Investors will also have to continue to digest lower return expectations from traditional asset classes such as equities.

In this volatile global macro and investment environment, only diversified portfolios will and can navigate all scenarios.

As such, Australian investors (like their global counterparts) therefore need ***uncorrelated*** and ***defensive*** investment products in their portfolios. In this regard, an active Australian Government Bond allocation should provide sound diversification benefits to a well diversified portfolio.

Anecdotally, within the CC JCB Active Bond Fund, we have observed negative correlations between the Fund's performance and domestic and global equities markets during and post Trump's election, demonstrating the true-to label defensive nature of an allocation to the dedicated Australian Government Bonds sector.

For more information on the CC JCB Active Bond fund please click here

To see the latest video presentation click here

The CC JCB Active Bond Fund is distributed by Channel Capital.

About Jamieson Coote Bonds

Jamieson Coote Bonds (JCB) is a duration management specialist with security selection expertise, focused on generating superior defensive risk-adjusted returns. JCB are a specialist active Bond manager based in Melbourne founded by Charlie Jamieson and Angus Coote. The Investment team also includes Paul Chin, head of Investment Research and Strategy.

JCB are assisted by one of the most experienced advisory boards in the country that includes Mark Burgess, ex-CEO of the Future Fund, and Saul Eslake, former Chief Economist of BAML and ANZ. The JCB strategies bring together a unique global network of Bond market specialists, built over decades working in the world's major financial centres to apply a strict and disciplined approach to Government Bond investing whilst paying particular attention to capital preservation.

About Channel Capital

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