MERRION
PRIVATE

# Key Themes for 2017

## Welcome to Merrion Private's Key Themes for 2017

This document provides a summary of ten key investment themes that the Merrion Private Investment Committee believe investors should be most aware of for the year ahead. We have also included charts to further illustrate the themes.

As we enter an environment in which President Trump leads the USA, given his spending plans, it is perhaps unsurprising that half of the members of the committee selected themes related to inflation.

In recent years, global central banks have sought to keep interest rates at record low levels but this stance has changed in recent months as more hawkish monetary policies have been implemented.

After a multi-decade bull market for bond investors, a revival of inflation expectations would pose a significant threat to the status quo asset allocation among typical institutional investors.

This development could therefore lead to a meaningful move out of fixed income investments and into equities.

With several elections due to be held across Europe during the year, there could be significant ramifications and potential changes to the construct of the European Union that will present both challenges and opportunities for investors.

Investment committee members are also conscious of the increasing protectionist rhetoric emanating from the USA and the potential impact that this could have with large trading partners such as China and the value of the US dollar.

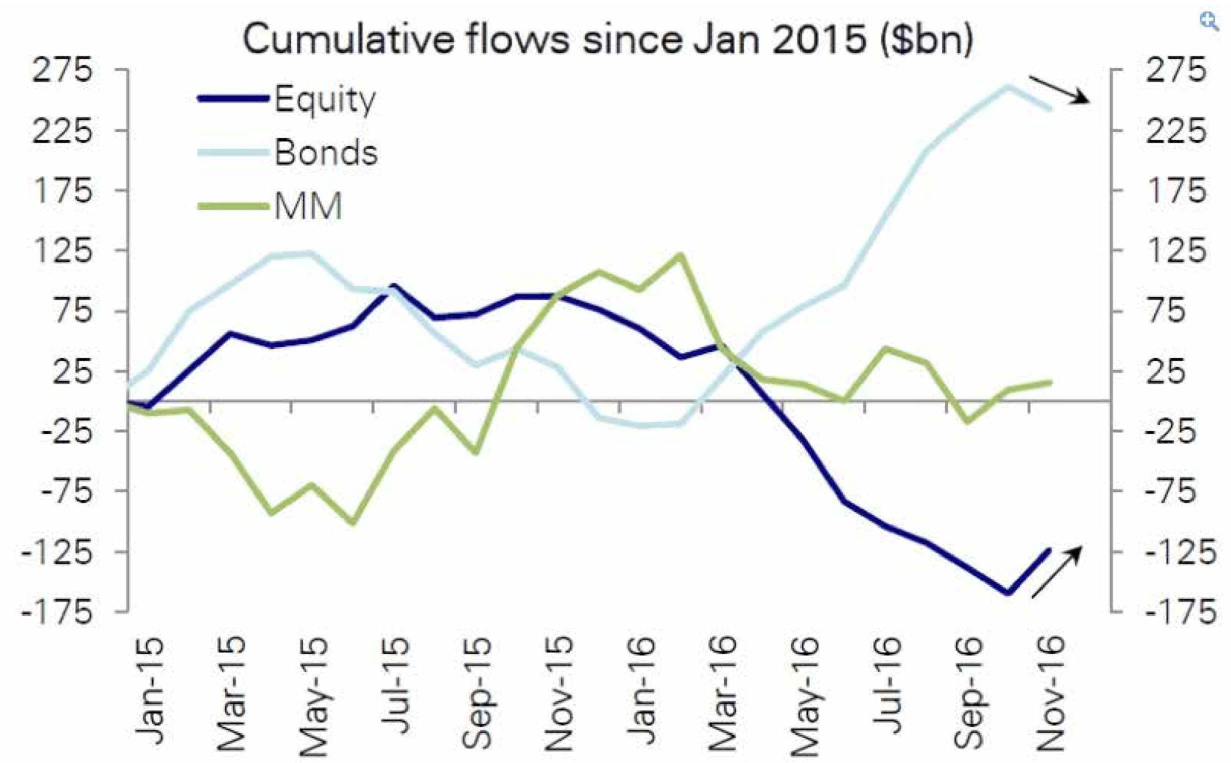
At Merrion, we are well positioned to guide investors through what may well be a repeat of the volatility seen during 2016, supported by the extensive breadth and experience of our investment professionals.

**David Holohan**
**Chief Investment Officer**

# Introduction

**Pramit Ghose**
**Global Strategist**

The arrival of Mr.Trump as president-elect in early November has sparked a sudden rush into equity funds and out of bond funds. As the US economy continues to improve, and if Mr.Trump does indeed adopt some reflationary policies, and as more and more defined pension funds wind down and 'encourage' members to set up their own pension arrangements with decent transfer values, then we believe this 'return of the equity investor' can continue and underpin the equity market in 2017.




# Return of the Equity Investor?

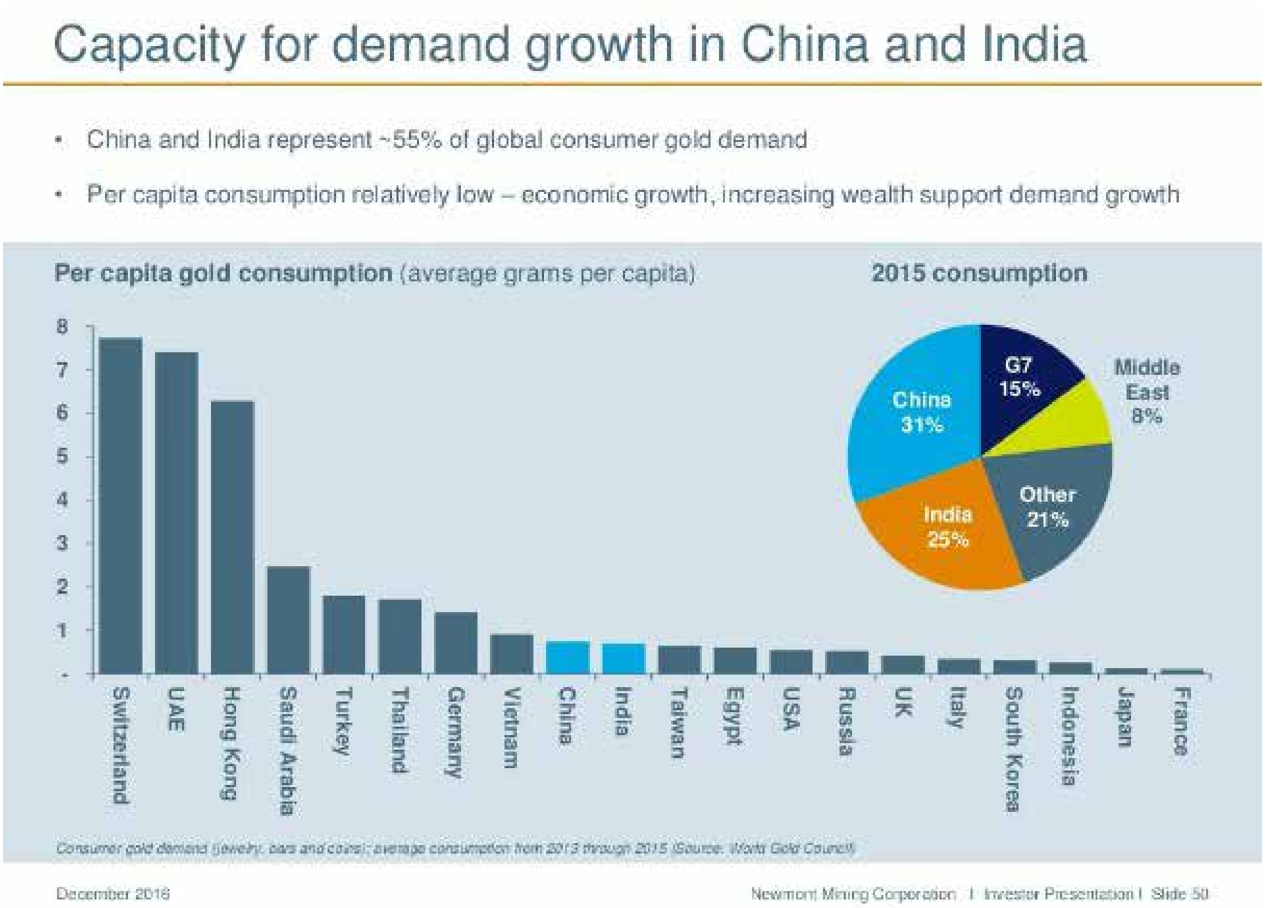
**Gary McCarthy**
**Merrion Absolute Return Strategies**

A key theme for markets in 2017 will be how the command economy of China balances the downward pressures on its currency while preserving stability in its real estate and corporate debt markets. To add complexity to this balancing act the 19th National Congress of the Communist Party of China is due to take place in Autumn 2017 which is, in effect, a leadership transition event. A successful transition will be supportive of financial, industrials and commodities sectors. In contrast, a failure would present President Trump with a significant industrial demand problem irrespective of air conditioner manufacturing staying in the US.


# China

**David Holohan**
**Chief Investment Officer**

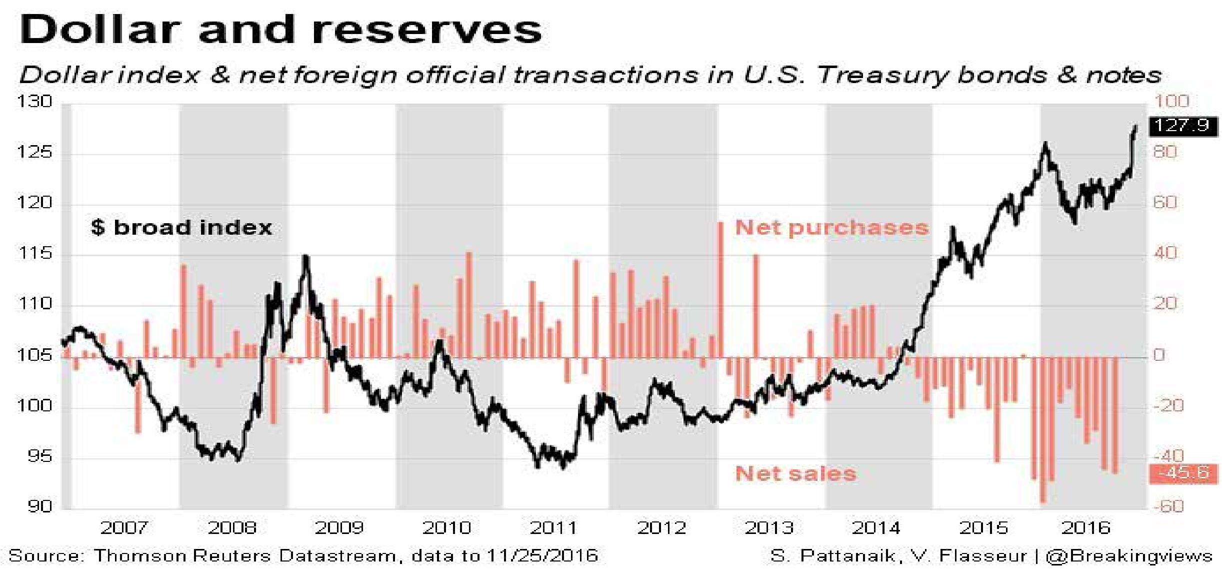
Gold should outperform as interest rates rise in the US but also during the subsequent period when economic growth levels begin to slow. Gold remains 40% below levels seen during 2011 while risks to the global financial system have steadily been increasing in recent years. The precious metal may surprise investors by outperforming during the interest rate increase cycle in the US and further build on those gains as global economies struggle to deal with higher interest rates. The demand/supply dynamic is also favourable for gold prices with the decline in the yields of production grade ore becoming a growing issue for producers while per capita consumption levels remain low in key markets such as China and India.




# Gold

**Alan McQuaid**
**Chief Economist**

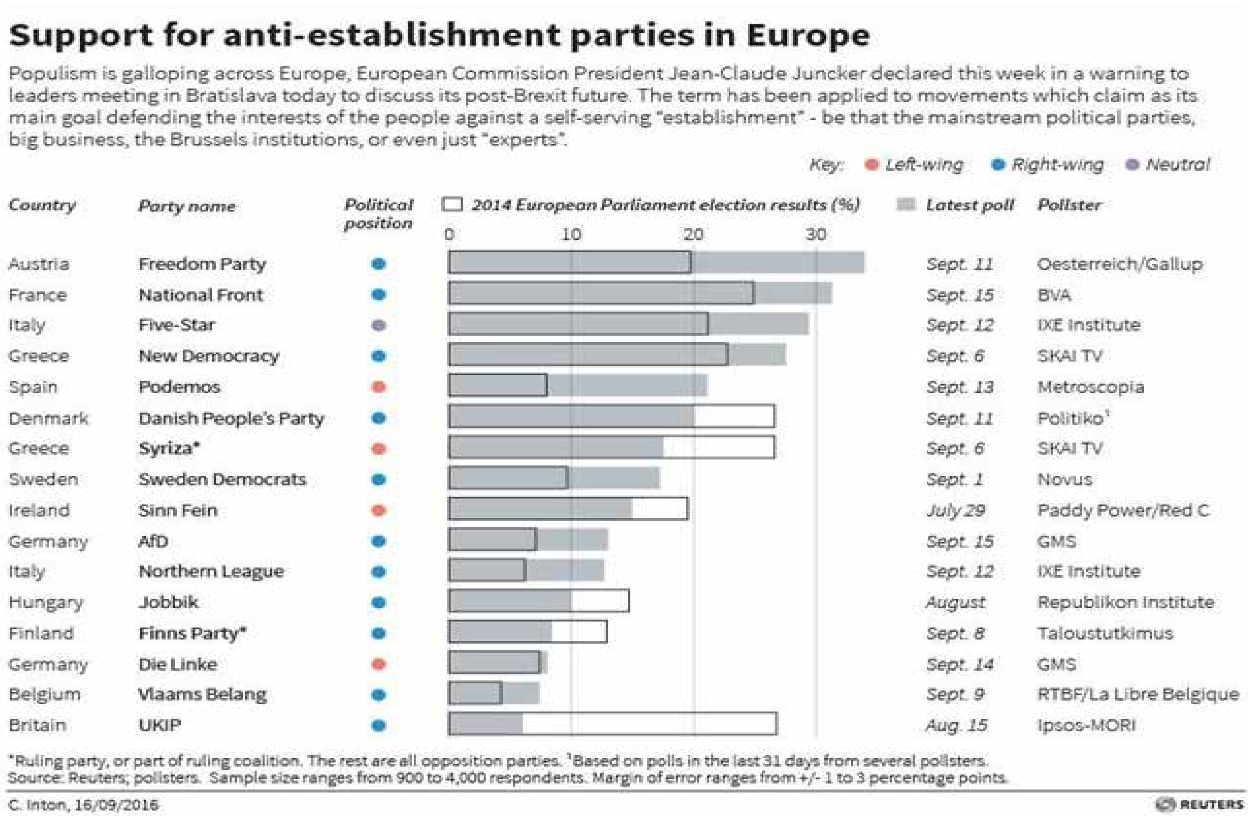
Stronger USD/ Higher Bond Yields: Strong dollar/ higher US bond yields: The Federal Reserve's broad dollar index, which tracks the US currency's value against a range of developed and emerging market currencies hit a fourteen year high in the weeks following the US election. Some of those gains have been given up at the start of 2017 but we stick to our stronger USD views on the basis of higher US GDP growth this year and further increases in official rates from the Federal Reserve. The strong dollar spells more weakness for US government bonds. Emerging market currencies have been wilting against the resurgent greenback, prompting countries like India to dip into foreign currency reserves to try to stave off such pressure. Others, most notably China, will be forced to follow suit if President-elect Donald Trump's plans to loosen fiscal policy keep pushing up expectations of inflation and higher US policy rates. It's clear that any country forced to keep intervening to support its currency will, sooner or later, end up selling US Treasuries.




# Strong dollar/ higher US bond yields

**Alan McQuaid**
**Chief Economist**

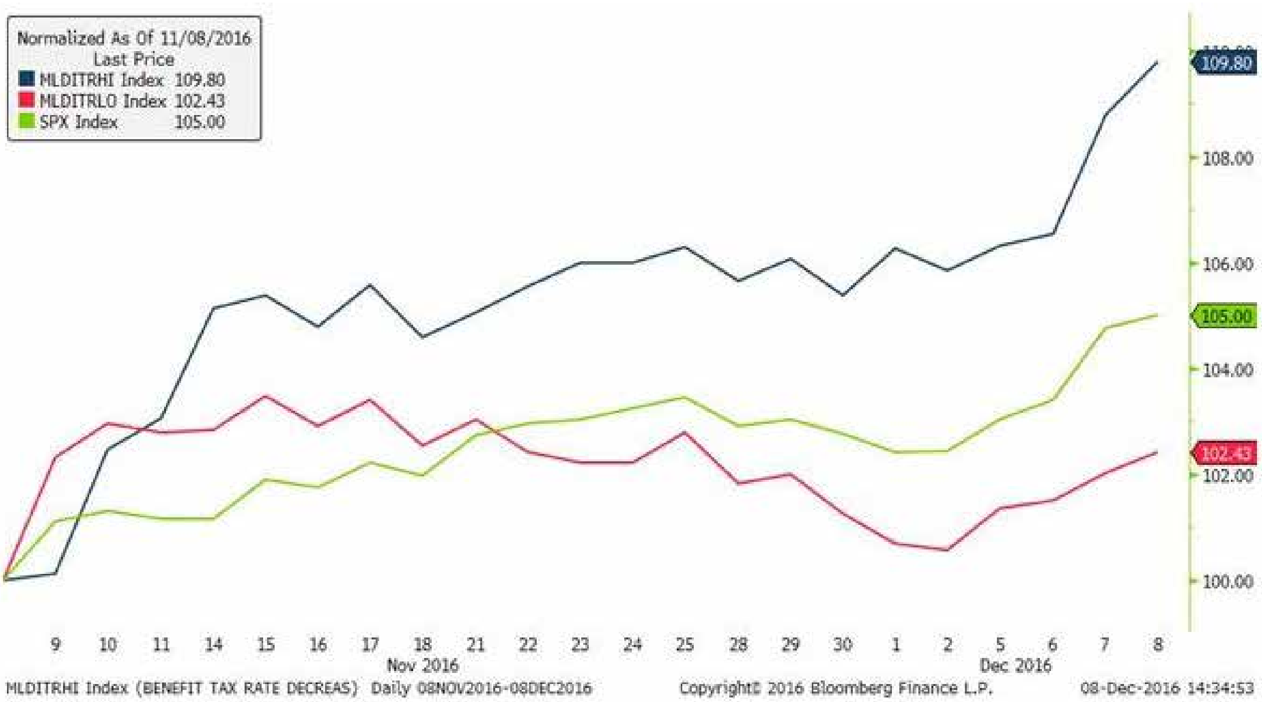
The resounding defeat for Italian Prime Minister Matteo Renzi in his Senate referendum on December 4 and his subsequent resignation has set the scene for what looks like being a very turbulent year ahead on the European political front. The talk now is that Italy will hold a General Election in the first half of 2017 rather than 2018 when the next election was formally due. It is also possible that the UK could end up going to the polls again depending on what happens on the "Brexit" front. Further scheduled elections for 2017 in The Netherlands, France and Germany only add to the political risk profile of the region and is the key reason why we are negative on the euro this year.




# European Political Risks

**David Flynn**
**Investment Manager**

The Republicans have a full majority, so it is logical to assume that they will be able to push through their agenda. Companies with the highest tax rates should benefit the most from these tailwinds. S&P 500 companies that stand to benefit the most from tax decreases are depicted in the following Merrill Lynch indices MLDITRHI Index below (blue) & S&P 500 companies that stand to benefit the least with already low tax rates are depicted in the MLDTRLO Index below (from election day forward).

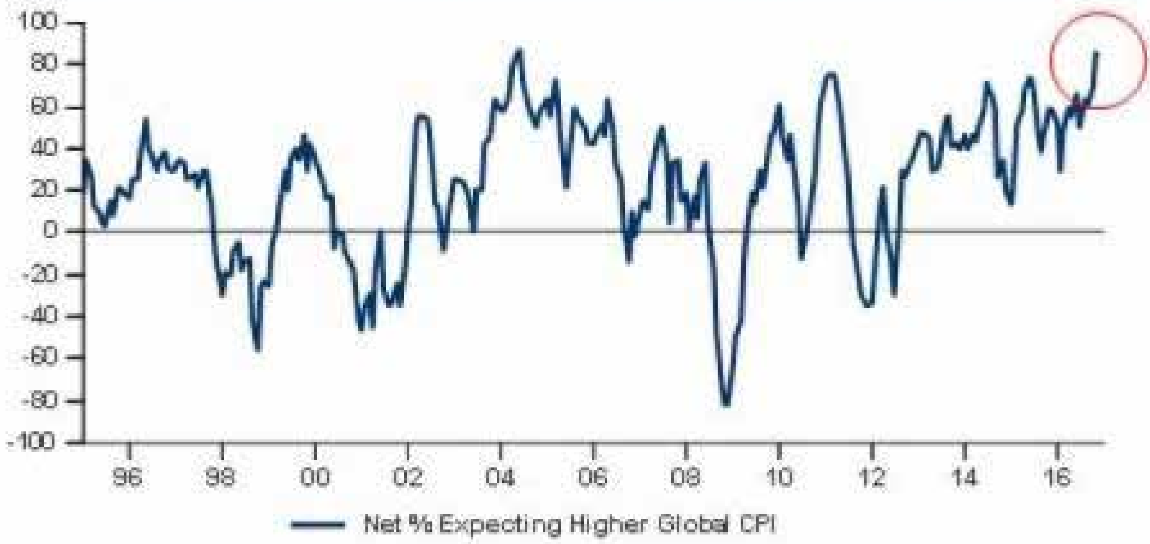



# Lower US Taxes

**David Wilson**
**Head of Advisory**
**Stockbroking**

Further inflation surprises and steepening yield curves provide further helpful tailwinds for European and US bank sectors. Post the US election financials were the best performing sector and, despite recent weakness in bank shares, we expect steeper yield curves and rising inflation expectations to persist and continue as a support for sector outperformance.

**Exhibit 9: Inflation expectations**

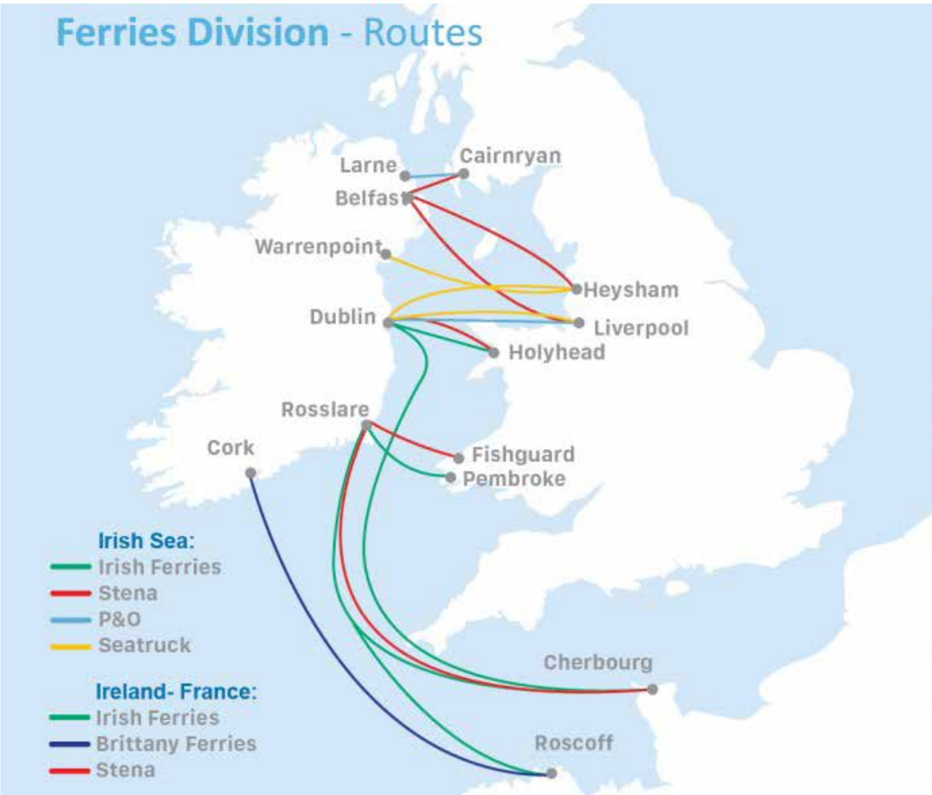



Source: BofA Merrill Lynch Global Fund Manager Survey

# Inflation to Boost Banking Sector

**Darren McKinley**
**CFA: Senior Equity Analyst**

With Irish-owned firms exporting two fifths of their products to the UK, we expect a continued theme of earnings downgrades as a result of currency translation and loss of competitiveness to UK peers. US President-elect Donald Trump has won over US voters with his policy of bringing jobs "home" again by cutting US corporate tax rates and regulation. This further adds risk to the Irish investment case given the amount of jobs US companies have created here. Sterling weakness should translate to currency headwinds for Ryanair, Kerry Group, Total Produce, Bank of Ireland, C&C, Origin Enterprises and UDG Healthcare. Alternatively, recent Irish budget and central bank changes are likely to positively impact the construction, real estate and employment market. These measures should be supportive of Permanent TSB, Grafton Group, I-RES, Cairn Homes and FBD Holdings.




| Weekly Sailings | |
|---|---|
| **Dublin - Holyhead** | |
| Ulysses | 28 |
| Jonathan Swift | 28 |
| Epsilon | 18 |
| | **74** |
| **Rosslare - Pembroke** | |
| Isle of Inishmore | 28 |
| Total Ireland - UK | **102** |
| **Ireland - France** | |
| Oscar Wilde | 7 |
| Epsilon | 2 |
| | **9** |
| Total | 111 |

# Irish Headwinds

**Pat O'Neill**
**CEO**

As Europe watches the initial positive impact of the populist shock election of Donald Trump, it is facing an even more pronounced populist threat to its own existence. There is a real possibility that a newly elected French President and a threatened Germany make significant fiscal efforts to save the EU project. At this moment in time, Europe is out of favour with investors and has lagged in performance terms significantly. A genuine fiscal response could lead to a surprise outperformance by European indices to catch up with the S&P 500 charted below.


# Contrarian Themes: Europe Reflation?

# Contrarian Themes: Dollar Disappointment

**Pascal Conroy**
**Portfolio Manager, Global Opportunities Strategy**

Sentiment and behavioural indicators can be very useful for contrarian investors who like to take the opposite side of a consensus view. The idea being that when a view becomes accepted and commonplace then investors have already positioned themselves accordingly. This can be a dangerous time however as market prices often peak/trough when participants have already made their move and the marginal buyer/seller no longer exists. As investors, we like to keep an eye on the level of bullishness exhibited by the market overall as extreme levels of bulls/bears are useful indicators of market turning points. Another everyday example of this effect however, can be seen from the front covers of business magazines such as the Economist and Businessweek. The effect is not just anecdotal however as many studies have concluded that a preponderance of positive media stories generally signal the end of superior performance and vice versa. When a story makes the front page of such publications it has usually been in vogue for some time and most of the move has usually already occurred. With this in mind, the following graphic might argue for caution to all those dollar bulls going into 2017.

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