Will the Year of the Fire Rooster Ruffle Feathers?

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In the Chinese calendar, the current year – the year of the Fire Monkey – is also drawing to a close. The prediction that it would be a year full of changes that could affect coming years arguably has proven to be true. Unexpected political events, including the Brexit vote and the results of the US presidential election, shook the capital markets, yet none of these headlines resulted in any severe, lasting market disruptions. With regard to (geo)politics, the global economy and monetary policy, will the focus now shift back more toward fundamental drivers?

- To begin with, the new year also promises to be highly political one. In the US, President-Elect Donald J. Trump will take office on 20 January 2017. So far, it is unclear which of his campaign promises Trump will ultimately be able to fulfil. In Europe, the Dutch, French, Germans and possibly even the Italians will go to the polls and in the spring the Brexit negotiations are set to begin. Worries about gains by populist parties may cause politicians to focus more on pandering to voters and less on implementing structural reforms in super election year 2017.

- Nevertheless, the global economy has proven to be quite resilient in the face of the recent unexpected developments. In virtually every major region, the economy is now trending upward or has at least stabilized. This, combined with a recovery in commodity prices, should mean that consumer prices will continue to increase over the next few months; i.e., for the time being, signs seem to be pointing toward reflation instead of deflation.

- Unlike in the US, though, inflation in the Eurozone and Japan should be significantly lower than the central banks’ targeted level. The divergence in monetary policy on different continents therefore continues to be a central theme for investors. All in all, global monetary policy remains expansionary. However, as inflation rates gradually return to normal, there are increasing signs that central-bank liquidity may reach its peak in the foreseeable future – possibly by the beginning of 2018.

What does this augur for the financial markets?

- The prevailing “reflation theme” is currently supporting the equity markets. Still, the super election year 2017 could cause some surprises and occasional financial market volatility (although investors seem to have grown accustomed to the unexpected).

- With inflation expected to increase and central banks likely not to adopt further expansionary measures, upward pressure on yields in the bond markets will persist, especially in the US. For the time being the Dollar’s strength should continue, given diverging monetary policies.

- In an environment of lower trend growth, alpha will continue to predominate.

One thing is certain: 2017 will be another exciting year. It’s a good thing that the Chinese calendar year beginning on 28 January is the Year of the Fire Rooster – because strong-willed fire roosters remain cool-headed, even when facing unexpected situations.

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