Global Asset Management

BlueBay Asset Management

Portfolio Manager Perspectives
BlueBay Investment Grade Debt Update

January 27, 2017

Ill-informed Discourse

Uncertainty swarms President Trump's policy agenda while US economic data remains firm and the Fed returns to the spotlight.

A week of meetings in Washington has reinforced our relatively upbeat view on the US economy and bearish stance on US rates. We continue to believe that a Federal Reserve (Fed) rate hike in March is likely and have the impression that next week's Federal Open Market Committee (FOMC) meeting may deliver a hawkish surprise with reference to firmer growth and inflation. There seems to be a sense that, whereas the balance of risks in 2016 was heavily skewed to the downside (partly due to catalysts overseas), the backdrop has now changed materially to the point where risks are now in a positive direction. Indeed, in some circles, there is already some concern that the Fed could be guilty of falling behind the curve if it does not move forward with further monetary tightening relatively soon.

Turning more specifically to the incoming administration, the policy agenda regarding key issues such as the budget, or a border (adjusted) tax remain very unclear. It is striking how under-populated many departments currently are and it will take a number of weeks before slots are filled so that progress can be made. There also appears to be a number of mixed and at times contradictory messages coming from the Trump team. For example – plans to raise spending on infrastructure and cut taxes seem to conflict with the appointment of a key fiscal hawk in the form of Mick Mulvaney as White House Budget Director.

There remains substantial uncertainty at the highest levels with respect to how the policy agenda may evolve. However, it seems clear that Trump's modus operandi seems to be to make public threats and bold claims first, before negotiating later. This is likely to lead to elevated volatility as investors seek to interpret the various tweets and messages coming from the White House and it will be important to monitor events in DC very carefully in the next few weeks as we seek to draw investment conclusions. From an economic perspective, the possibility of a border adjusted tax (BAT) is something which could be profoundly significant in our view and it would likely push the US dollar and inflation materially higher. Although Trump has disavowed the Ryan plan as overly complex and has leant towards direct tariffs as a policy instead, it could be that this could mean that BAT becomes viewed as the lesser of two evils. Notwithstanding this, pushing such a bill through the Senate will be particularly challenging with politicians from Arkansas likely to vote against (due to lobbying from Walmart). If cross party support is required, then it will be interesting to see if legislation is advanced on a stand-alone basis or as part of a broader set of budgetary and tax proposals.

In summary we can only conclude that there are a number of issues, which are still yet to be resolved. What we can feel more confident on is the US economy and the Fed. It seems ironic that with so much attention on Trump and the circus surrounding his early days in office, next weeks' FOMC meeting seems rather overlooked. We believe that market participants are wrong to view Janet Yellen as a dove and with the current Fed Chair likely to depart in 12 months time, she won't want her legacy to read that she kept rates too low for too long. So it would seem strange at the least, if the Fed wouldn't want to leave the door open to a March hike, should data continue to run firm through the rest of the current quarter.

Away from the US, market developments have been more muted. Yields have risen globally and equities have rallied with the Dow finally topping 20,000. The eurozone periphery has continued to trade with a heavy tone after a number of new issues have met with limited demand from long term investors. As the economic outlook improves and it becomes more likely that QE will end early next year, there has been limited demand for long dated bonds at a time when investors already seem to have more than enough duration in their portfolios. Demand in corporate credit has been more robust and new issues have performed better, though at a macro level, there is a sense that we are trading in something of a range – notwithstanding equity markets breaking to the upside.

Looking ahead, it seems that we will be an environment of some uncertainty for the next few weeks and we feel that through this period it will be important to stay close to events in the US capital. Mark Bathgate from our team will be spending further time in DC in February as we continue to believe that proprietary research will help us to generate insights that can positively impact returns across our portfolios. We continue to be in a position where politics and policy are driving markets and in a changing landscape it will be key to investment performance to get calls in Washington right in 2017. In particular, we are currently struck at the ill-informed discourse around President Trump that takes place in the European media at the moment – which has echoes to us of how ill-informed the Anglo Saxon press was around the time of the European sovereign crisis in 2011/2.

It is too early to tell how successful Trump will be in many regards. It seems he has been fortunate to inherit an economy in rude health and to be honest, Trump could actually do well if

he did nothing at all. That said, by the next election it is equally possible that growth could then dip and if the economy today has already reached full employment, it is possible that there will be fewer Americans in jobs when Trump leaves office than when he has started. On a slightly different note, it has certainly been interesting to be an observer at the Trump hotel this week (which is not only a very good hotel but a surprisingly affordable one thanks to many deciding to boycott the premises). It is just to be hoped that regarding trade policy he does not rush to erect barriers as quickly as those outside the hotel lobby.

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