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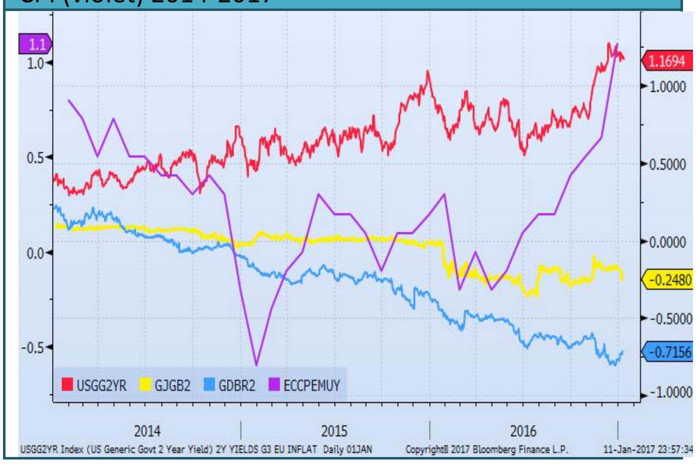
ECONOTE No. 56: Starting the year with the minimum of "blah" and maximum of facts. **13/1/2017**

Summary	**Investment Conclusions**
Econotes has a record of not starting the year with detailed forecasts and investment suggestions. Indeed we feel that these are, in general, not very useful as they can change soon after issued. This is particularly true for 2017 which will turn out to be a special year. See below why. However, we do believe in starting with a few undisputed facts and see if they lead to some investment ideas. This is hardly rocket science, but it starts with the known to proceed to the unknown. So here we go. **Fact**: Trumps starts his presidency with a basketful of controversial policies, not the least being protectionism. **Fact**, Brexit will happen in 2017 but no idea yet as to how and of its final impact on the EU. **Fact,** elections in France and Germany in 2017,with important consequences for the EU.	Trump may cut taxes and hike spending, thereby needing to borrow more, so continue to keep clear from UST. Equities in the US could be hurt by higher yields and by trade restrictions. The investment environment in the EU will stay uncertain because of politics and accelerating inflation. (Fig. 1). Japan may stay stuck in the mire of Abenomics while Asian economies could be hurt, a little and selectively, by US protectionism, but not half as much as headlines would have you believed. USD and Asian interest rates have long disconnected, so we are more bullish on Asian equities. We, however, continue to prefer investment in real assets as a class of investment more appropriate to this environment.

Is 2017 going to be special ?

What is unusual about 2017 is the introduction to the political scene of an element of frankness in discourse, which is death for diplomacy but pure gold for journalism and for the "common man and woman" (whatever the latter means). Couples, groups of friends etc. can gather around a dinner table or a bar counter and, under their breadth, express crude, obscene and outrageously racial, religious and political views but only for the close and trusted circle of friends. Trump does the same except in public. So if I can say that to my wife or my brother-in-law why can't I say it to 360 million Americans? I am writing this Econote in Uruguay, whose last president, P.Mujica, gloried in being shabbily dressed and with long uncut toenails in tatty sandals, and told victims of muggings that they provoked the perpetrators by showing off their wealth. For a good measure, he confided after a visit to K.Kirchner, the then president of Argentina, who had succeeded her husband Nestor, famous for his "lazy eye", that he didn't know who was worse to deal with "this old hag or the crossed-eyes".Mujica is being actively promoted for re-election in 2020. Uruguay is not the US, but the example fits beautifully. There is a "refreshing " air of honesty about policy-making, at least in the US, and possibly later on in the UK, which the markets may take a while to get accustomed to. However markets can not be toyed with, as they have a habit of disregarding what they do not like. There is also the added issue of "tough politics", key exponents of which are Turkey's Erdogan and Russia's Putin.Trump's inclination is to go for toughness, but this works both ways. And in the middle of all this floats China, the ultimate example of power concentration in the hands of one man (in any case ,there are no women in the Politburo), with an economy which is bottoming and whose relative independence from world trade insulates it from US, and from anyone else.(Fig.2)

Fig.1: 2Y Govies, UST (red), JGB (yel), Bunds (blu), EU CPI (violet) 2014-2017



Source: Bloomberg

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Do not confuse me with facts

Consider the following statistical tit bits.In the US, exports to China account for 7.0% of all exports and less than 1.0% of GDP.In absolute terms,US exports to Canada and Mexico are bigger than those to China (2015).Total exports as percent of US' GDP stood at 13.0%. However the exports driver of GDP is the net exports contribution to GDP (that is the growth of exports-imports).In the case of the US, this was a negative 16 bps for every one percentage point of GDP growth (2010-2015 average).EU exports to China accounted for 9.5% of all EU exports and for 1.1% of EU's GDP (2013-15).In order to avoid a statistical overkill, we finish with the contribution of net exports to China's GDP which was zero or negative from 2008 to 2014!

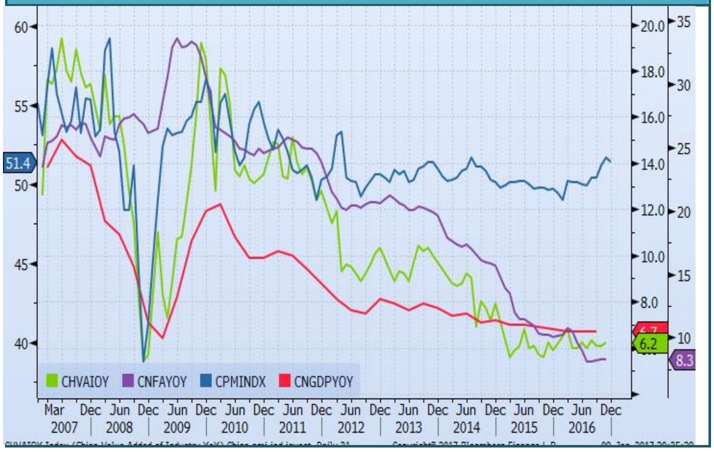
Moral of the story. Exports are not what they are made out to be in terms of their importance in GDP and ,hence, to growth,

FACT BOX: Defining investment in "real assets"

Investing in real assets may involve investment on claims on these assets, in other words on paper backed by real assets. The difference between buying a mine and then collateralizing it, from buying shares in mining companies is that the first type of investment looks to the physical value of the asset as collateral, including, of course, for resale purposes, as well as being focused on one project only, as opposed to mining companies which may be exposed to various projects and/or metals. Similarly, investment in real estate projects follows the same path of reasoning. Buying real assets at the perceived bottom of the cycle is neither simple nor risk- free and, hence, a case-specific rather than a purely sectoral approach is crucial here. (Econote No. 45 25/1/2016)

The role of China is all this, is from limited to relatively small. It would follow that if Trump did restrict trade with China the impact on both countries' GDP growth would be small. This would not apply to all countries everywhere, and Mexico, for example, could be hit harder by restrictions than China would. The concerns over China's financial sector are also exaggerated with the markets failing to take into account that the main four banks in China are state- owned that any debt bubble leading to erosion of the capital bases of smaller and non-state banks could be dealt with by a widening of China's fiscal deficit, still about 3.0% of GDP and domestically financed. China's forex reserves (USD 3.0 trillion after years of capital flight) are irrelevant, as the state will need to sell USD for CNY to fund a banking rescue and this would lead to an appreciation of CNY as well higher domestic rates.

Fig 2 China,Ind Q(gr),FA Invst (vio),PMI(blu)GDP (red)



Source: Bloomberg

Why go for real assets ?

As we have indicated, the investment enviroment of 2017 will be sui generis not so much because of economic events, cyclical patterns etc which will be unique, but because policy-making in the US has entered a different phase altogeher and politics in the EU are in unchartered waters.The majority of Asian economies are much less trade-dependent on the US or EU than is believed, and hence the cyclical disconnect between the G3 and Asia will be more accented than ever. The Fed may hike once more in 2017, the EU may stop its QE as inflation rises, and Japan will stay, for ever it seems, on Abe-QE.All this makes G3 equities and bonds subject to totally divergent pressures--and we are not very good at guessing ! We need to reiterate our disclaimer that Econotes do not offer investment suggestions on named or specific paper assets nor do they make specific and named buy or sell calls. Hence our "theme" on real assets investment for 2017 is, by necessity, broad.Assets which we have looked at in 2016 included agricultural land, real estate occupied by mobile telephony antennas and property used for rental storage facilities as well as "property" such as bus stops used for advertising. We also looked at funds backed by diamonds or by rare whiskeys and, finally in metals used in mobile telephony, a topic that can be extended to metals used in batteries for electric cars. The privatization drive of hard-pressed oil-producers such as Saudi Arabia could also offer real assets openings. (See also Econote No. 47, 13/3/16) Andrew Freris(12/1/2017)