Weekly Market Comment

2 June 2017

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2017 asset class returns up to 31 May

Asset Class	Index	May	YTD	2016
Equities	FTSE 100 (UK)	4.9%	7.3%	19.1%
	FTSE4Good 50 (UK Ethical Index)	4.8%	4.4%	12.6%
	Dow Jones Euro-Stoxx 50 (Euro-Zone)	4.5%	12.2%	20.1%
	S&P 500 (USA)	1.6%	4.0%	33.6%
	Nikkei 225 (Japan)	3.4%	3.8%	23.6%
	MSCI All Countries World	1.9%	5.0%	26.7%
Bonds	FTSE Gilts All Stocks	0.5%	2.3%	10.1%
	IA Sterling Corporate Bond Index	1.4%	4.0%	9.7%
	Barclays Global Aggregate Bond Index	1.8%	0.0%	21.8%
Commodities	Goldman Sachs Commodity Index	-1.3%	-12.4%	32.8%
	Brent Crude Oil Price	-2.5%	-15.3%	81.8%
	LBMA Spot Gold Price	0.1%	4.4%	30.2%
Inflation	UK Consumer Price Index (annual rate)		1.0%	1.08%
Cash rates	Libor 3 month GBP	0.03%	0.2%	0.6%
Property	UK Commercial Property (IPD Index)		3.0%	1.4%

*** Source: Morningstar, all returns in Pounds - Sterling (£ - GBP)**

Expected and unexpected turns of events

May brought global multi asset class investors a welcome boost of their 2017 year to date returns. With reports of strongly growing corporate profits over the first quarter of the year, global investors appeared happy enough to abandon the ‘Trump Trade’ as the justification for their ‘risk-on’ attitude and embraced the corporate earnings growth dynamic instead. This is not bad, because it is based on hard numbers rather than vague expectations.

Nevertheless, as we also wrote over the course of the month, much of what looks good and promising at the moment is a reflection in the ‘rear view mirror’ of company results and economic data points that lie behind us. If we look ahead, then we can see some headwinds to further corporate profit growth in the form of slowing Chinese growth and a far more lacklustre performance of the US economy than expected. This makes the lofty equity valuations that we have reached as a result of the continued strong equity returns appear vulnerable to any slowing of the anticipated, continued high pace of corporate profit growth. As I wrote last week, we are therefore taking some profits in our portfolios' and are reducing equity allocations by around 5% across the board until this vulnerability has passed.

In terms of the past week, the UK general election only a week away and president Trump touring Europe and meeting G7 leaders had politics once again firmly dominating the news agenda.

Anybody who follows Trump closely will not have been as surprised as the press saw it about his cold shouldering of the international community and mannerism that bordered on bullying. German chancellor Angela Merkel conceding - in a beer tent speech - that Europeans should perhaps get used to the idea that old allies like the US and the UK can no longer be relied on to the same degree as before was widely rejected as alarmist, unhelpful and untrue. My take is that with the German general election looming in the autumn, any public speech now is a campaign speech and as such this wasn't a policy statement but political rallying. External threats tend to benefit the incumbent political leadership not the opposition.

I fear that instead of 'Making America Great Again', Trump is swiftly 'Making America Less Relevant', because his behaviours are forcing the Europeans in particular to take things into their own hands. Perhaps this is the catalyst or proverbial 'kick up the backside' the EU needs to reform itself towards a truly relevant Europe?
Markets didn't even appear to notice the potentially epochal shift in Global leadership away from the US – not even when Trump announced that the US would isolate itself by leaving the Paris Climate Agreement and join Syria and Nicaragua as the only other non-members.

Political dynamics in the UK saw political uncertainty return with a vengeance, as latest polls showed to many commentators' great surprise Labour rapidly closing the gap to the Tories. This raises the risk of a hung parliament in which Scotland's SNP could suddenly be bestowed the role of king maker. While we still judge the probability of such a scenario as low, last year's surprise referendum result seems to have made anything possible. At the very least it shows that Theresa May might be just as poor at judging public sentiment as her predecessor. A far more politicised younger generation than we have perhaps had since the early 1970s, has made the 8 June 2017 election a far more nail biting event than it ever seemed possible 8 weeks ago.

Markets have already indicated what they think of increased political uncertainty, with £-Sterling falling back to the pre-election-announcement levels of March. It would be unwise to feel compelled to take a highly defensive position in anticipation of a surprise result, because as last year's events have shown, markets only react very briefly and then often take surprising turns relative to perceived wisdom.

Eurozone: growing apart?

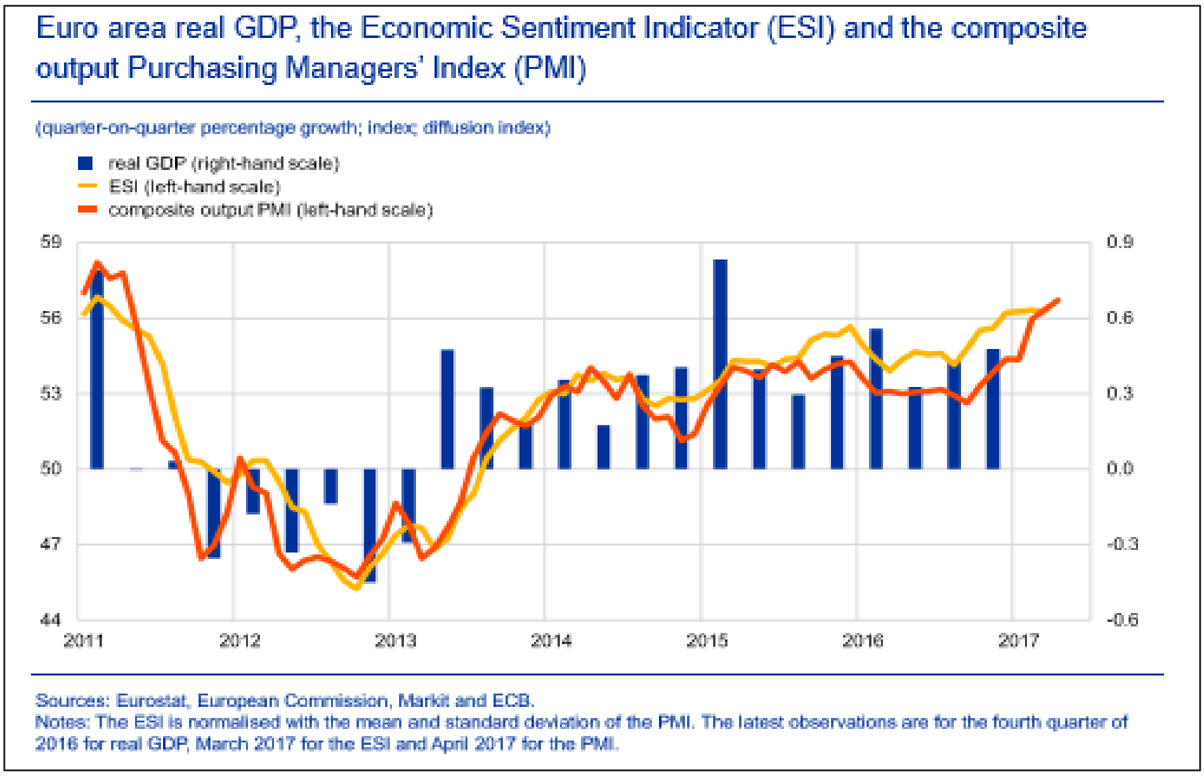
Some months ago, in the context of Brexit, we considered the short-to-medium term economic prospects for the Eurozone (EZ). We observed that, while the EZ is on a positive growth trajectory, the ECB's accommodative (monetary) policy will be required for some time yet, especially given that there were other potential risks on the horizon.

We indicated that these likely 'bumps in the road' were not just related to Brexit, but also Greece's continuing travails, EZ-wide political risks, and the challenges posed by Italy's banking system (and the country's general economic malaise). A few months onwards, the EZ remains on a positive trajectory, but these downside risks to growth are unresolved.

According to the ECB's latest Economic Bulletin, domestic demand-driven economic expansion in the EZ appears to be firming and broadening. Real GDP increased by 0.5% quarter on quarter in the fourth quarter of 2016, as a result of increases in domestic demand and (to a lesser extent) changes in inventories. At the same time, net trade exerted a negative contribution to EZ GDP growth, as import growth significantly outpaced the rise in exports.

Nonetheless, the latest economic indicators, both hard data and survey results, are quite buoyant. And, they are suggestive of ongoing growth in the first half of 2017 – at around the same rate as that observed in the fourth quarter of last year.

Eurozone economies: GDP, economic sentiment and PMIs



Source: European Central Bank, June 2017

We note that Germany remains the engine room of the EZ, and appears to be motoring along nicely, with the economy expanding a seasonally-adjusted 0.6% in Q1 2017, following a 0.4%

growth in the previous period and matching the preliminary estimate. It was the strongest rate of expansion since Q1 2016, supported by both domestic and foreign demand.

Some forecasters are predicting that Germany is set to achieve 4% to 5% GDP growth this year. While we expect the German economy to continue to expand, we are not persuaded by estimates of up to 5% growth for Germany. Our initial view of existing sources suggests an upper bound in annualised GDP growth in Germany of ~4% (an upper bound assuming Q-on-Q growth).

It is not just the German economy that is performing well. The so-called weaker EZ economies are also helping to drive the EZ average up. For example, Spain's recovery puts it among the strongest performers, with its economy growing by 0.8% in the three months to March of 2017, following a 0.7% expansion in Q4 2016.

Even Italy is forging ahead; this week it doubled its growth estimate for the first quarter of the year to 0.4% compared to the previous quarter's 0.2%, outpacing both the UK and US (and matching France).

Signs from the ECB are also encouraging, if cautious. Despite the ongoing expansion across Europe and continuing falls in unemployment, inflation has yet to follow suit. Inflation remains some way below the ECB's target of 2% - which leads us to expect no changes to the ECB's loose monetary policy in June (no increase in interest/deposit rates).

However, the ECB's policies are clearly working for the economy. Low interest rates and QE are driving up corporate lending, and household lending is also at a post-crisis high. Altogether, the EZ economy appears to be ticking along nicely.

But, there remain risks. The Italian banking sector's bad debt issue has only been partially resolved. Even though the Italian Government and Brussels have agreed a way forward for the troubled bank Monte dei Paschi di Siena (which involves a possible injection of state capital, significant cost cuts, and investors taking a hit on bonds), other banks like Banca Popolare di Vicenza and Veneto Banca are still at risk, and there is no obvious path to a resolution.

In Greece, the scale of the credit extended to Greece looks insignificant relative to overall EZ GDP. The loan package of ~€100bn previously agreed with the IMF and the rest of EU is a fraction of total EZ annual GDP (at ~€12tn). However, any risk of – or actual – default by Greece would clearly still be felt by the rest of Europe's economies (and on the €-Euro).

Moreover, the spat between the IMF and the EU's finance ministers is unresolved. There is disagreement on the conditions of the loan to Greece, and the IMF maintains that, without some form of debt relief, Greece could be facing an unsustainable level of public debt.

In short, there are still some potential downside risks for the EZ. While expansion and growth in other member countries would help to "de-scale" or mitigate the risks posed by the Italian and Greek issues, if unresolved, both would be enough to become a significant, albeit temporary, drag on the EZ.

Perhaps as a result of the continuing and very different economic conditions across the EZ, that lead to substantial regional differences in the cost of finance, the EU recently published details of a proposal for the launch of a market of "sovereign bond-backed securities" – in simple terms, a

EZ government bond. Under the plan, Eurozone countries' existing national debt could be packaged into a new asset to sell to investors.

The creation of a European government bond is not, by any means, a new idea. It was widely debated during the EZ crisis, because of the inability of individual EZ member countries to conduct currency devaluations to adjust to economic shocks, while also being unable to tap the bond markets as a bloc. This leaves individual government bond markets far more exposed to bond market credit-worthiness concerns, which can lead to unwarranted and highly destructive debt spiral dynamics. However, it is precisely the issue of credit-worthiness, and the relative degree of sovereign risk across the EZ, that has Germany, France and others nervous of any form of debt mutualisation.

We think the EC's proposal will be ineffective. Absent convergence in bond spreads (yield differentials between different countries) over a very long period, it would not solve the root cause of the problem as described above. Structured or bundled credit products are no alternative to common issuance, as the vulnerability of the structured subprime credit market taught us when it triggered the financial crisis.

The EC would be better focussing its efforts on either persuading the EZ members to create a genuine Eurobond, or, failing that, turn to improving economic crisis resilience. This could be achieved by addressing sluggish structural reform and balancing trade and funding flows as required in a number of countries and sectors. This would underpin the positive economic developments in the EZ, and provide a basis for the ECB to begin to normalize monetary policy.

Echoes of 2007-08? Subprime fears in US car loan market

Mark Twain said “history doesn’t repeat but it rhymes”. Accordingly, the news of rising delinquencies and defaults of subprime borrowers in the US may bring back memories of the world economy on the cusp of the Global Financial crisis in 2007.

Back then, the issue was determining the true value of AAA rated tranches of securitised mortgages (Residential Mortgage Backed Securities – RMBS), as borrowers defaulted on their property loans. Now, the focus is on securitised, structured credit products backed by bundled car loans in the US, known as Asset Backed Securities (ABS).

A little history

In 2007/08, banks sharply cut mortgage origination on their balance sheets at the same time as off-loading that balance sheet risk by packaging up loans into so called CDOs (collateralised debt obligations). They then sold these CDOs onto third parties, like pension funds and insurance companies around the world.

When the underlying components (mortgages) in those structured bond products began to be defaulted at higher than anticipated levels, the value of those assets were difficult to determine. This first caused unexpected write-offs in the value of those bonds, and then led to a complete loss of confidence, first in structured credit products and ultimately in the entire financial system. The rest, as they say, is history.

What is different today?

Before we get too concerned about another crisis, we must consider the size of outstanding car loan sector. While the sector has grown rapidly – up 70% since 2010 – the total amount of car ABS is $1.17 trillion at the end of Q1 (with just 2.3% or ~$27 billion in serious arrears of 90 days or more). This does not represent the same level of systemic risk to the financial system as the over $9 trillion in the RMBS market.

That said, it is still possible for any disturbance in lending standards in ABS products to impact on consumers, investors and also the car industry, with potentially wider ripple effects on the wider economy.

Where are the risks?

There are signs emerging that suggest that car ABS, like the RMBS products from a decade ago, are not as 'safe' as investors may have initially thought, despite being backed by an asset – the car.

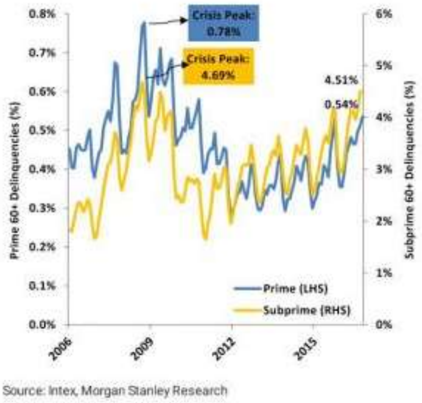
Wells Fargo is the number one provider of car ABS and, just like the now defunct Bear Stearns in 2007, it has stated that fewer borrowers are making extra payments on loans that were packaged into bonds in 2015 and 2016, compared with such loans from 2013 and 2014. This may indicate that consumers with lower credit scores are running into more trouble paying their bills, and borrowers are defaulting on a rising amount of debt. Both delinquency and default rates have risen at their fastest rates since the financial crisis.

The issue is that this is a growing problem, as the share of loans issued to borrowers with a credit score below 550 ("deep subprime") on the FICO credit scale has grown from 5.1% in 2010 to 32.5% in 2016, according to Morgan Stanley.

What are banks doing about it?

The US Federal Deposit Insurance Corporation revealed the first sequential fall in car loans outstanding in nearly 6 years, following a rush of firms into the sector looking for returns. The total loans outstanding fell $1.6 billion to $440 billion from Q4 16 to Q1 17. This suggests that banks have learned some of the lessons of the subprime mortgage crisis.

Exhibit 3: 60+ delinquencies are up across prime and subprime, with the latter approaching crisis-peak levels



Source: Intex, Morgan Stanley Research

Exhibit 4: Default rates increased in similar fashion, with subprime printing close to crisis levels

Source: Intex, Morgan Stanley Research

While the risks to banks from subprime car ABS is smaller, as noted above, banks provide lines of credit to other finance firms who make loans to consumers. These are a relatively small part of a large bank's balance sheet.

Banks have become more cautious on making new car loans when using capital from their own balance sheets. Both Wells Fargo and JP Morgan have tightened lending standards and cut the volume of loans to car buyers in Q1 by 29%, following a rise in delinquency rates. Other firms like Citizens Financial (9th largest by assets) and aggressive specialist loan firm Capital One are reigning in lending.

Additionally, banks have off-loaded balance sheet risk by packaging at a faster pace in Q1 17, compared to the same period last year. Both Wells Fargo and JP Morgan are now number 1 and 2 in underwriting car ABS. This came at the same time as investment research from Wells Fargo's wealth investment division which warned, back in March, that investors should begin cutting exposure to car ABS products.

Relaxed lending standards to blame?

Exhibit 9: Auto lending standards eased considerably from 2011 through 2016

Source: New York Federal Reserve

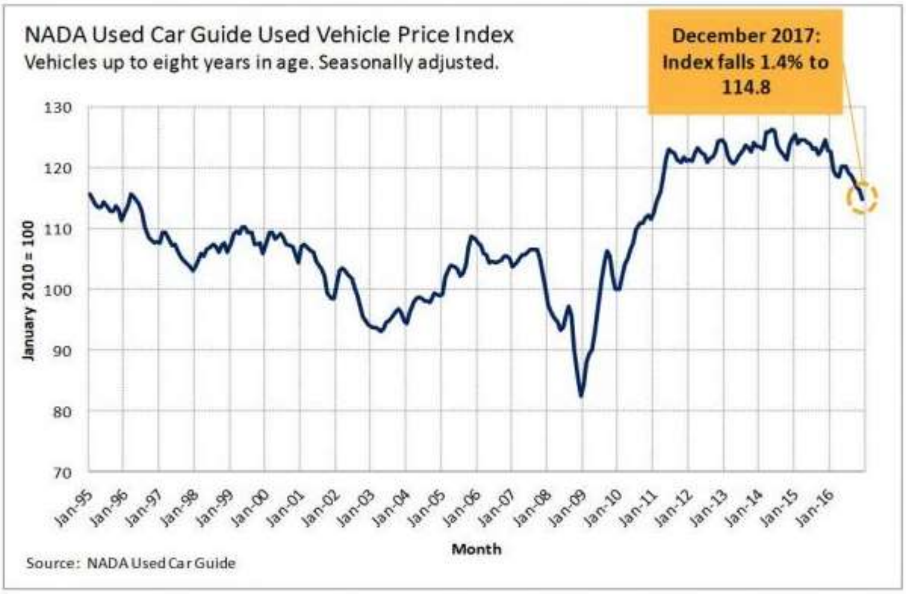
The risks in car ABS might not be the banks as provider, but more the investors who buy such products without fully understanding the risk dynamics. The introduction of Dodd-Frank required mortgage lenders to take specific steps to determine if a borrower had the capacity to repay the loan. If a firm did not follow those rules, then a US homeowner could sue and win large potential pay-outs.

Unfortunately, car loans do not have the same level of protection, and the regulator for car dealers is the Federal Trade Commission, a body that has kept an eye on advertising standards rather than financial matters.

Dealers have extended loan duration from standard 60-month contracts, to as many as 84 months, which means that borrowers could be 'underwater' on the loan for a longer period. Additionally, some dealers have increased LTVs (Loan to Value ratio) and also debt-to-income ratios, meaning that borrowers are more sensitive to changes in amount of household cash flow available to repay loans.

Essentially, these are expensive loans, where an individual may owe more than the car is worth for the duration of the loan.

Additional risks from falling used car prices?



Prices of used cars are down about 8% so far this year, and experts expect further falls, due to higher charge-offs (customers who default on loans which exceed the value of the car and smaller recovery rates – RR – on forced sales).

In 2016, the Office of the Comptroller of the Currency warned of rising credit risk in car loan portfolios due to relaxed lending standards. Now, regulators are looking at possible abuses of fair-lending standards.

As a result of possible investigations, falling used car prices and rising delinquency rates, the share prices of subprime loan firms like Santander Consumer USA and Ally Financial have seen their share prices fall by about 20% since the beginning of March, as losses on car ABS have been higher than expected.

Those losses could be on the rise if lenders begin repossessing cars from defaulted buyers, then selling them at a reduced price. Industry watchers have seen a large number of used cars back on the market, as a result of those forced sales, and another 7-8 million cars are expected to be available by the end of next year as existing lease arrangements end, according to Morgan Stanley. This is about twice the amount of the long-term average.

Forced sales also have another negative impact on recovery rates (RRs) at finance firms. Data from Ally Financial shows that it received just 60 cents for every dollar owed to it in April, down from 72 cents last year. The RR for Santander is in a less healthy state, getting 46 cents in April from 53 cents last year.

Opportunities for the short-seller?

The parallels of the troubles in the RMBS market in 2007/08 with today's car ABS are fairly obvious, and could attract short-sellers. Compared to the mortgage subprime crisis, we see similarities in terms of deteriorating credit standards in the US car loan market. While not exactly the same situation at the height of the mortgage credit crisis, some institutional investors might sense an opportunity to short-sell (profit from falls) the shares of smaller subprime lenders, as losses for those firms could rise beyond what they can afford in bad debt provisions.

Not the end of the world for banks

While the mix of higher defaults, falling used car prices and lower RRs could be painful for some subprime lenders, it is hardly the end of the world. Exposures for banks are relatively small. Number two car loan provider JP Morgan has total of $2.5 trillion in assets on its balance sheet, of which total car loan exposures are 'just' $79 billion, or 3.2%. It might be a bit harder for specialist car loan subprime firms like Ally Financial, Santander Consumer or Capital One, to stomach higher losses and it is entirely possible that default rates on certain types of ABS high yield bonds increase again after having been very low, by historical standards, since the aftermath of the financial crisis.

It needs to be stressed that the general US banking system is today far better capitalised and far more risk aware than it was 10 years ago. We therefore rate the risk of contagion from the subprime car ABS market to the wider financial system as low. However, it may create the opportunity of a live test of the protection mechanisms, which the reform of the structured credit markets has created.

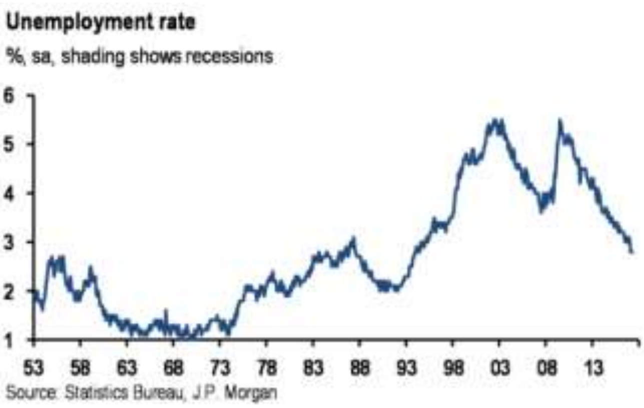
We will, as always, monitor the developing situation closely. But, for the time being, we believe that the increased media focus on the rising car loan delinquencies is predominantly driven by a sense of 'déjà vu' by journalists, rather than a real threat to wider credit markets.

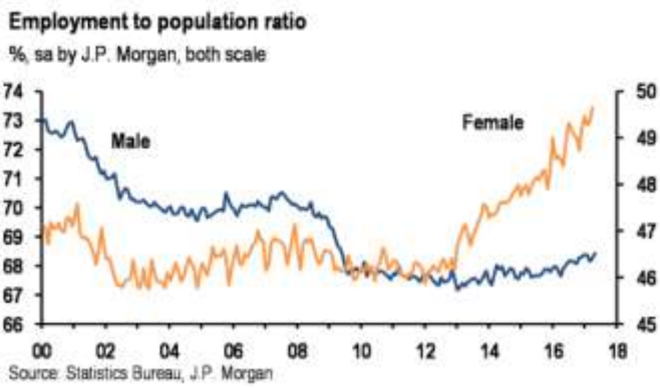
In this context, we would also like to note that, elsewhere, the renowned Wall Street Journal reported last week, that the average credit score of US consumers hit a record this spring, while the share of Americans deemed to be some of the riskiest borrowers hit a record low (Link: WSJ.)

Is Japan's economy hitting its stride?

It has been a tough ride for Japan over the past three (!) decades, suffering from persistent deflation and weak domestic demand. This week's economic data releases suggest there is now a bright light at the end of the tunnel, a result of the concerted effort of both the Bank of Japan (BoJ) and the government to revive growth and defeat deflation.

The combination of aggressive quantitative easing (QE) from the BoJ and four years of structural reforms ('Abenomics') finally seems to be paying off. Not only are companies seeing profits, output



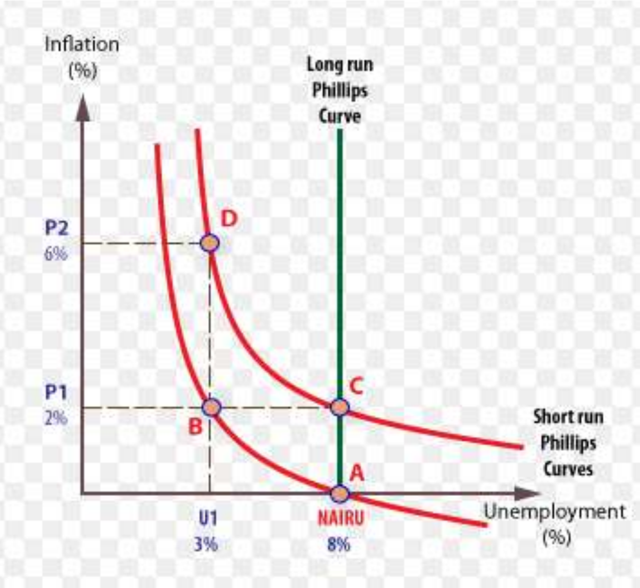


and sales rise, but, encouragingly for future prospects, they are also expanding investment spending (Capex).

The impact of these economic improvements is most visibly showing in the labour market. Japan's labour market is now the tightest it has been since the peak reached in 1974. Official statistics reveal that the ratio of open jobs to applicants touched 1.48 in April, the highest level since February 1974.

Japan's unemployment rate remained at an extremely low 2.8% in April - the lowest level since June 1998. Splitting the labour data by age and gender reveals some interesting trends, with numbers of female employees increasing rapidly, while there was also a steady rise in those over 65.

The country is experiencing labour shortages in a number of sectors, notably in healthcare (doctors and nurses – as the population continues to age), construction workers and restaurant staff.



Source: Wikipedia

In light of this data, the subdued wage and inflation growth has puzzled economists, who, using the Phillips Curve (see chart above; the natural rate of unemployment that allows steady inflation or price rises), would expect to see stronger inflation for the given unemployment rate. Typically, you would expect a tighter labour market to exert upward pressure on wages, which in turn should drive inflation towards the BoJ's goal of 2%.

Japan does have some fairly unique characteristics that may explain some of this softness.: decades of (on/off) inflation, a large number of 'jobs for life' (people rarely change jobs and competition for staff is generally low) and the steady rise in the availability of 'new' workers (predominantly females entering in the labour market).

While the April inflation reading of 0.4% year-on-year might seem low, the extent of the improvements in the labour market suggest that future inflationary pressures are building, albeit at a gradual pace. The labour force is becoming more flexible, and people are beginning to move jobs faster, meaning companies may need to compete for skilled workers by raising wages.

The slow but steady improvements in inflation readings are feeding through into increased corporate optimism. We note that small business sentiment (Shoko Chukin survey) rose to 49.9, the highest level since Q1 2014, suggesting that economic momentum continues to build.

There are other positive impacts of rising optimism. Japan's industrial production moved back into expansionary territory, up 4% in April, driven by growth in the manufacture of transport equipment, machinery and electronic components.

Improving domestic and global conditions are leading to better sales and profits. The Ministry of Finance (MoF) said that Q1 domestic sales rose 5.6% YoY, while recurring profits showed a sharp acceleration of 26.6% in Q1. The biggest beneficiaries were the transport machinery (+111.2% YoY) and electrical machinery industries (+314.8% YoY).

Corporate sales and recurring profit

Source: MOF

Capex

Source: MOF

This seems to have had an encouraging effect on capex, which bodes well for future growth. Manufacturing saw capex grow +1.1% in Q1, but non-manufacturing grew an impressive +7.4% over the quarter. The trend is clear, with three quarters of solid and consecutive growth.

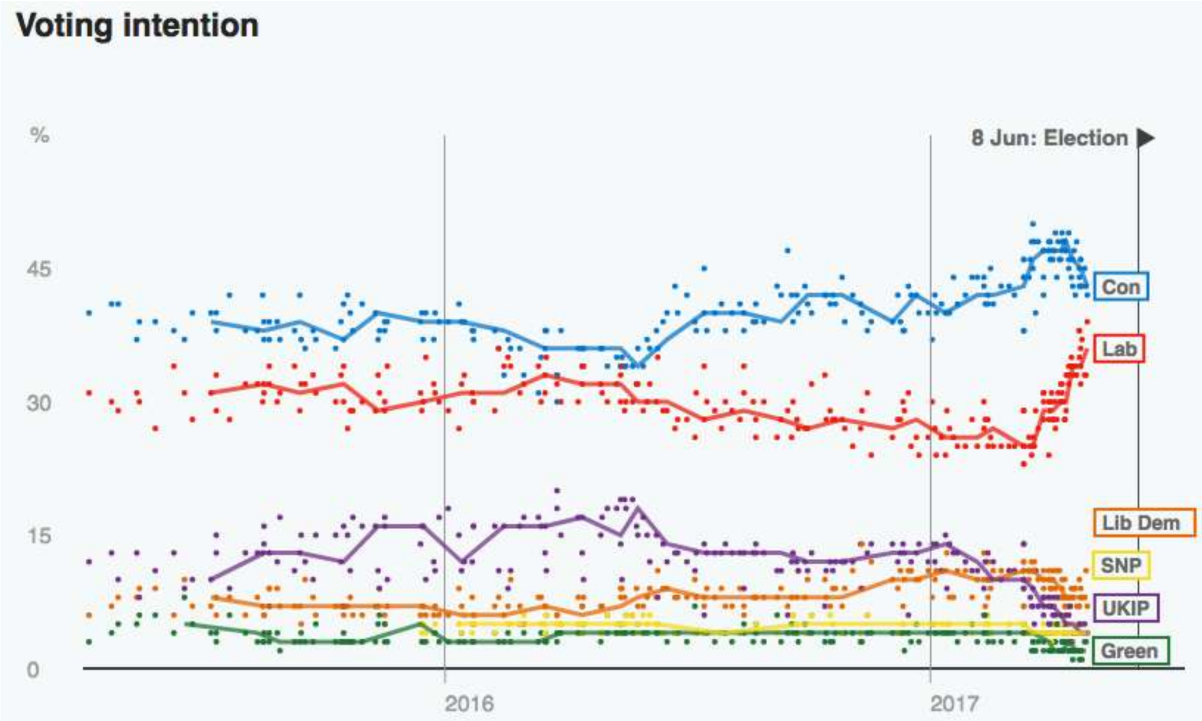
Lastly, consumers are beginning to take part in the recovery, with real consumer spending up 3.5% in April (driven by clothing) and retail sales on a slow upward trend.

Overall, Japan's economic prospects look brighter than they have for a very long time. We expect that, if the global backdrop remains solid, this will feed into further improvements on Japanese corporate profitability, which, along with an increased focus by company management on raising shareholder returns (Return on Equity – RoE), should gradually attract investor attention over the long-term.

UK Election: Political uncertainty returns

When Theresa May called the snap election six weeks ago, market reaction was positive. £-Sterling, the biggest indicator of market confidence in the UK, rose from its suppressed $1.25 level to around $1.30, where its stayed since. The reason? May's Conservatives were a shoe-in; the whopping 20+ point poll lead the government had over the Labour party meant a landslide looked certain, thereby – in the view of international capital markets - bolstering the Prime Minister's Brexit bargaining position and making a hard Brexit less likely.

It must boggle readers' minds how quickly this assumption has changed. Over the past week, that lead has been decimated to single figures in the majority of national opinion polls. The latest YouGov poll even puts May's party on 42%, just 3 points ahead of Labour's 39% – the highest poll rating Labour have achieved since 2014. This is, of course, just one poll – and many others still show a 10-12% Tory lead – but the recovery of Labour is undeniable.



Source:BBC

On the investment side, the narrowing to single digits has coincided with a fall in £-Sterling – to $1.28 last Friday. In fact, intraday currency moves saw the pound fall to a six-week low of around $1.27 on Wednesday, in reaction to YouGov's new seat-prediction model forecasting a hung parliament on June 8. However, the currency recovered most of these falls to close between $1.28/$1.29. Theresa May had been a boon for the pound previously, but her popularity with voters and markets appears to have been hurt by a number of U-turns and a badly received manifesto. Indeed, it seems capital markets once again identify the UK as a bigger potential source of political risk than the rest of Europe.

For May and her team, this election was meant to be all about Brexit; the public needed to give her the mandate to negotiate with Brussels, went the rhetoric. The Conservatives thought that an election fought on Brexit, and the issue of personal leadership, was going to be a consolidation more than an election. It seems that this made them overly confident, to the point where they chose to abandon the pension triple-lock and suggest introducing what is now referred to as the ‘dementia death tax’– effectively going against their core voters.

But, the debate over the past few weeks has only had scarce reference to Brexit, and the familiar themes of living standards, public services and security (particularly since the Manchester attack) have taken centre stage.

This focus seems to have played into the hands of Corbyn’s party, whose manifesto of re-nationalisations and increased government spending has tapped into the wellspring of discontent that the UK’s prosperity stagnation and austerity burdens since the financial crisis created.

On her part, May has tried to drink from that well too. Her commitment last October to make Britain work for “ordinary working-class people” has now been added to a manifesto that promises to put price controls on energy companies and keep net migration below 100,000 a year. Even former Ukip centre-piece Nigel Farage said that “the Conservative party has taken our agenda,”.

So, does the narrowing of the polls mean it’s time to get scared/excited (depending on your views)? It’s hard to say. The situation will naturally call to mind the recent ‘against-all-odds’ victories of Donald Trump and the Leave vote, but we shouldn’t get carried away by such comparisons. In most polls, the Tories still have a lead ranging from 6-10%, which, while not much in terms of national vote share, could still translate into a very large lead under the first-past-the-post system. Indeed, the likeliest case is still a Tory majority, albeit not as large as the landslide of 100+ additional Tory seats that political pundits indulged themselves in predicting six weeks ago.

A few things bear mentioning however. Interestingly, the YouGov seat predictor mentioned above that currently expects a hung parliament was first used (secretly as a test-run) last year, to model the outcome of the referendum, where YouGov say that – contrary to virtually all traditional polls – it predicted a Leave majority every time. The model is the first of its kind from a polling company, and vastly different to traditional opinion polls. Again, nothing conclusive can be drawn from this yet, but it’s possible that continued predictions of this sort will have an influence on markets over the next week.

Furthermore, it’s always important to respect the subtleties of polls. On Tuesday, ICM gave a poll showing a 12% lead for the Tories. However, disregarding demographic weightings, this lead would have been just 3%. The discrepancy is partly due to how the ‘don’t knows’ are reallocated, but mainly due to the turnout projections. As with a lot of polling companies, ICM base how likely respondents are to turn up on election day by the percentage of their age and social class that voted in 2015. And, turnout among younger voters is perennially lower than other age groups – just 43% of 18-24s voted in 2015, compared with 78% of over 65s.

One of the most prominent themes of Corbyn’s rise to national prominence has been the invigoration of younger people who previously felt disillusioned with a political class many felt didn’t represent them. Take, for example, the (now viral) unofficial Labour party fliers being handed around in Croydon, featuring Grime artist Stormzy: “the Tories hold Croydon by just 165 votes. *Even your dad’s got more Facebook friends.* Stormzy says vote Labour!” Given this enthusiasm, it’s possible that youth turnout will be much higher than many expect, which would skew the result much more towards Labour than currently expected (given Labour’s humungous lead among young voters – 57 points for under 25s).

On the other hand, it's also possible that, with three nationwide votes in as many years, voters are tired of politics and are therefore less likely to turn up. This would skew the result the other way, given the Tories' commanding lead among the regularly-voting over 65s (this is what happened in 2015 and is largely why the polls were so wrong).

This brings us to the next point: The political ground has shifted greatly over the past few years. The rise of populism across the western world (both left and right) has arrived at our shores, and both the main parties are trying to capitalise on it – Labour through the Corbyn movement and the Conservatives by adopting parts of Ukip's agenda. What's more, despite expectations, these moves have been largely well received. The Corbyn supporters' 'Jez we can' has a distinct air of 'feel the Bern' – reminiscent of when self-proclaimed socialist Bernie Sanders barnstormed his way across the US to come within a whisker of a presidential nomination, despite not having the support of any of the democratic party establishment (or the financial backing).

And, the predicted collapse in Labour party support just hasn't seemed to have happened. It was thought that the Tories would make huge inroads into Labour heartlands, but, if recent polling is anything to go by, the Tories haven't taken any of Labour's 2015 vote-share (YouGov). Rather, their big increase has come entirely from absorbing nearly all of Ukip's votes. The only main party to campaign on globalist and centrist policies is the Lib Dems (who were expected to make double gains from disillusioned Labour supporters and remain-voting Tories) – and they have yet to see their polling climb above their 2015 share.

Regardless of the outcome next week, the agenda has shifted greatly. Large parts of the population have been (re-)politicised, which will potentially lead to a substantial change in voter behaviours and participation rates across demographic groups, making the pollsters job ever more difficult. On the back of the rapid changes of observed voter intentions over the past weeks, in conjunction with the experience of last year's surprise referendum outcome, suddenly anything seems possible. This perceived utter uncertainty about the election outcome, and potential split across the British society between young and old, is in our opinion what worries markets about the UK's general election next week.

We lastly want to point out that, while the base case for the election is still a Conservative majority, the 'shock case' *isn't* a Labour majority, but a hung parliament. Even if Labour smash expectations and beat the Tories in popular vote and seats, a majority will almost certainly remain out of their hands. This has nothing to do with Jeremy Corbyn, but more the fact that Scotland, which used to be one of their heartlands, is now an SNP stronghold. Labour are essentially fighting this election with a 50-seat handicap. Labour wins in England and Wales would need to be of a landslide proportion to overcome this, making a Labour majority enormously unlikely.

Whatever the case, there's much more to say about this election than previously thought. Accordingly, expect some (currency) market nervousness in the UK over the next week.

PERSONAL FINANCE COMPASS

Global Equity Markets

MARKET	CLOSE	% 1 WEEK	1 W	TECHNICAL
FTSE 100	7541.3	0.3	23.6	↗
FTSE 250	19982.2	0.1	14.6	↗
FTSE AS	4125.7	0.3	11.0	↗
FTSE Small	5653.4	0.2	8.5	↗
CAC	5337.4	0.0	0.7	↗
DAX	12815.2	1.7	213.0	↗
Dow	21201.0	0.6	118.1	↗
S&P 500	2434.0	0.8	18.9	↗
Nasdaq	5858.7	1.4	80.4	↗
Nikkei	20177.3	2.5	490.4	↗

Currencies

PRICE	LAST	%1W
USD/GBP	1.29	0.76
USD/EUR	1.13	0.86
JPY/USD	110.45	0.80
GBP/EUR	0.87	-0.13
JPY/GBP	6.81	0.67

Commodities

CMDTY	LAST	%1W
OIL	49.7	-4.7
GOLD	1278.3	0.9
SILVER	17.5	1.0
COPPER	257.8	-0.8
ALUMIN	1927.0	-0.9

Fixed Income

GOVT BOND	%YIELD	% 1W	1 W
UK 10-Yr	1.0	2.2	0.02
US 10-Yr	2.1	-4.4	-0.10
French 10-Yr	0.7	-7.3	-0.06
German 10-Yr	0.3	-18.1	-0.06
Japanese 10-Yr	0.1	31.0	0.01

Top 5 Gainers / Top 5 Losers

COMPANY	%	COMPANY	%
CAPITA	8.2	TAYLOR WIMPEY	-7.9
RANDGOLD RESOURC	7.9	MARKS & SPENCER	-5.5
3I GROUP	6.8	LLOYDS BANKING	-5.1
INFORMA	5.5	UNITED UTILITIES	-4.9
GLAXOSMITHKLINE	5.4	NATIONAL GRID	-4.7

UK Mortgage Rates

MORTGAGE BENCHMARK RATES	RATE %
Base Rate Tracker	2.3
2-yr Fixed Rate	1.4
3-yr Fixed Rate	1.7
5-yr Fixed Rate	2.1
Standard Variable	4.5
Nationwide Base Rate	2.25
Halifax Standard Variable	3.74

Sovereign Default Risk

DEVELOPED	CDS	DEVELOPING	CDS
UK	21.6	Brazil	237.1
US	19.3	Russia	150.5
France	28.2	China	76.0
Germany	15.2	South Korea	55.6
Japan	49.0	South Africa	187.9

For any questions, as always, please ask!

If anybody wants to be added or removed from the distribution list, just send me an email.

Please note: Data used within the Personal Finance Compass is sourced from Bloomberg and is only valid for the publication date of this document.

The value of your investments can go down as well as up and you may get back less than you originally invested.

Lothar Mentel