Weekly Market Comment

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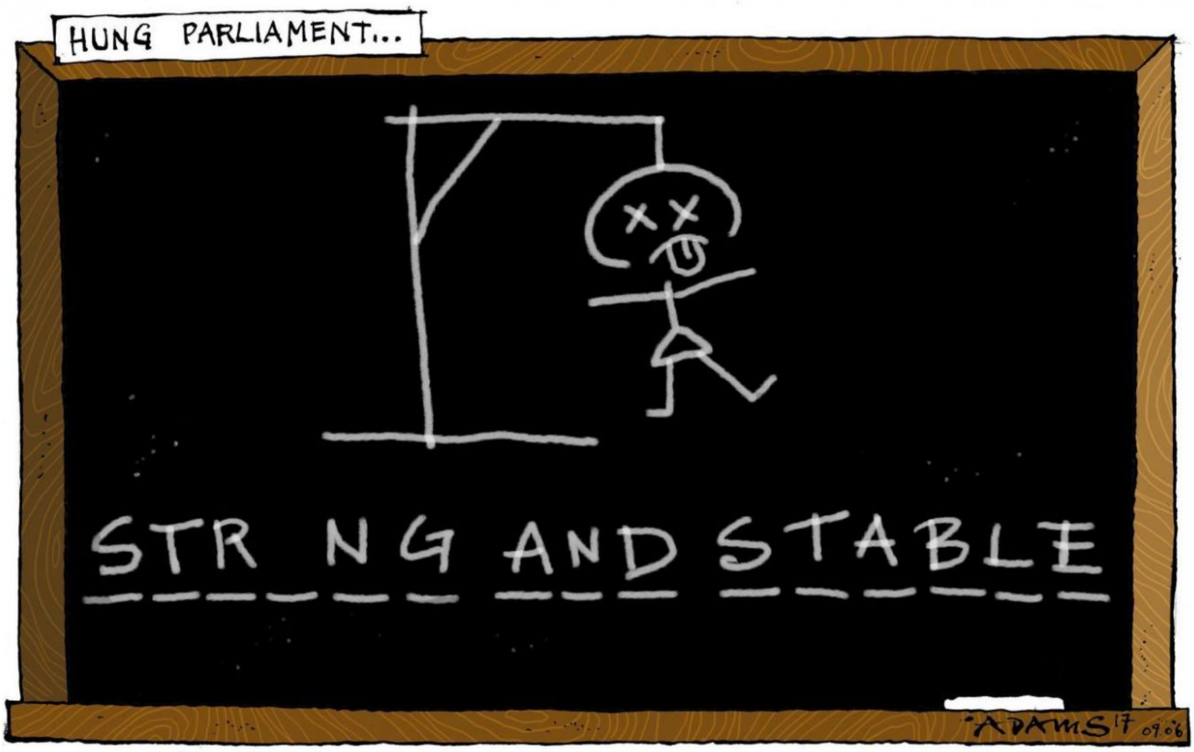


Source: Evening Standard; adams.newsprints.co.uk

Strong and Stable?

On 18 April, when PM Theresa May announced that she would ask the UK's electorate to give her an enhanced Brexit negotiation mandate by way of an early election, my (well documented) view was that she would improve her majority and this should in turn be positive for the UK's Brexit negotiation prospects, which turn should contain the Brexit damage for the economy. The argument was that she would have gained more headroom to negotiate compromises with the remaining EU, because of a larger majority and because she would have 2 more years until she faced re-election.

So, has the disastrous miscalculation that this election turned out to be for May's government changed our views? Well, yes and no. As I wrote in my quick piece this morning, the way the UK public delivered its message might actually lead to a softer Brexit route, with the "no deal is better than a bad deal" approach certainly no longer a winning formula. This should be better for the UK economy, if the market's verdict of the past 12 months' is anything to go by.

On the other hand the UK's government has certainly come out of this gamble weaker, not stronger and that cannot be an improvement to where we have been.
However, it has to my mind also shown that different to previous popular belief, the UK's society had not united behind a general 'let's get on with it' position toward Brexit. Instead the UK appears even more divided than it was a year ago. Not just rural versus city, professional versus basic skilled but with the young finally not just politicising, but actually turning up to vote, also young versus old. I would argue that this together with a less bold PM, might lead to a slightly less hostile reception on the EU side of the negotiating table, who can no longer take comfort from the argument that the British public is seeking a hard Brexit.

As so often over the past 2 years, markets reacted surprisingly sanguine to the political earthquake. £-Sterling fell as one would expect when political uncertainty rises, but with around 1.5% no further than it had done just after May's announcement of the election back in April. So, no change then?

For the UK economy and capital markets it seems the verdict is 'no better or worse' than back in March. Clearly, the hung parliament outcome is a missed opportunity for more political stability or even strong majorities to address some of the UK's structural problems and Brexit challenges, but no disaster compared to where we were anyway.

Only time will tell whether the May government will be allowed to how the political landscape of the UK will develop and what type of Brexit the UK's political class will eventually pursue. Given all the very insightful commentary that I read over the course of Friday, I will leave the political assessment and speculation to the journalists, even if I have once again come to realise that despite all their very thoughtful analysis they seem less good at forecasting political outcomes than my combined team at Tatton.

We will therefore continue to focus on the economy at home and abroad and its prospects to expand or contract, which is ultimately what drives investments. From that angle we will once again this week travel around the world to observe whether our central case remains in place of has changed.

For the UK we have to report that there is more evidence again that it is the prospect of Brexit which is leading to a slowdown in growth, while short term domestic politics play a subordinate role.

In the US, Donald Trump continues to fail to deliver, despite constantly telling the public that he will announce some great policy initiative in the next couple of weeks and then does not. However, it also appears that his administration is slowly finding traction with their own Republican party, as they begin to explore compromises to at least have something to show before the year is out.

In the Middle East the Sunni Arab world has suddenly decided to isolate one of the biggest alleged financial supporters of radical Islamism – Qatar. Interestingly, this time around the resulting increased tensions in the Gulf have not led to a spike in oil prices, but a decline. We reiterate our view that global oil supply and demand dynamics have changed and require a new perspective. Until the oil exporters find out how to suppress the downward price pressures, the oil consuming world will enjoy an extended stimulus of being able to spend more money on more productive things than fossil fuels.

In the Eurozone, economic momentum pick-up has once again been confirmed by economic data flow, but more importantly the new 'bail-in' regime to stabilise failing banks has passed its first live test. Ailing Banco Popular in Spain was taken over and bailed out by Santander after the European Central Bank declared Popular unsound. However, importantly Santander did not have to take on the bulk of the debt burden which was instead written off at the loss of subordinated and contingent convertible (Coco) debt holders. The lack of credit market reaction in Spain informs us that the new system works, even though we would suggest it only works when a single bank falters, as was the case in Spain. In Italy, which has more than one very weak bank, the news from Spain did lead to a notale deterioration of bank credit conditions, which tells us that the new system will not be adequate to bail-in a whole section of a national banking sector.

Last but not least, returning to London we have found that Londoners have taken the attacks on London Bridge and Borough as what they are; a very sad and tragic derailment of human behaviours of a few, while the many have shown great resolve to fight back and not allow terrorists to succeed. City professionals returned to work on Monday as they do after every half-term and even if this time it happened right where we often go after work for a drink, markets didn't even seem to flinch. Remarkable civil spirit shown once again and together with increased effectiveness of counter-terrorism efforts probably the best way to eventually eradicate this menace.

Political cycles and economic imperatives

Risk comes in many different forms and arises because of uncertain outcomes. In the case of the general election this week, as the campaign progressed the outcome actually became more, not less, uncertain. However, the general level of financial risk did not appear to materially change. Do markets care about the outcome of this election?

As we know, the polls narrowed very substantially over the course of the campaign. And, while markets were still betting on a Conservative victory, debate increasingly turned to the prospect of a reduced Conservative majority and other possible outcomes, e.g., a Labour majority, a new coalition with the Liberal Democrats and even the possibility of a now realised hung Parliament. Each outcome carried a different type and scale of risk but - arguably, a hung Parliament carries the most risk.

Despite the apparent ideological divide in the respective manifestos and the very different economic agendas, electioneering by both the main parties seemed to largely ignore the underlying economics. Moreover, even markets – buoyed by initial polls signalling a Conservative majority – appeared only marginally interested in this election campaign.

Prior to Thursday, there had been little movement in £-Sterling, a continuing upward trend in most of the key indices and a generally muted reaction to the most recent economic data. However, this apparent apathy was not solely a result of market confidence in a "business friendly" Conservative majority.

Markets recognised that, even in the unlikely event of a Labour victory, there would be a low probability of a Labour Government achieving many of its manifesto pledges within the next 5 years. Also, as we have recently seen with the election of President Trump, political cycles might only have a transitory impact on markets; they cause some – potentially material – adjustments over the short term, but markets subsequently revert to a position that reflects the underlying economics.

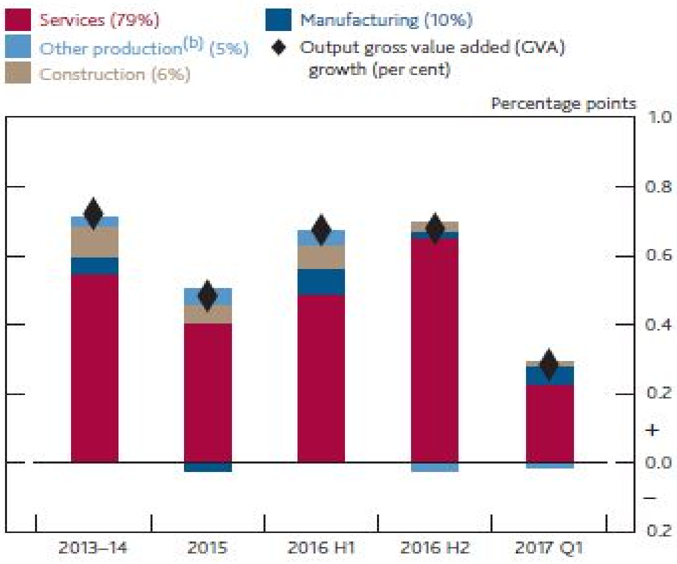
Regardless of the fact that no party has achieved a majority, over the short-to-medium term the result is unlikely to affect the underlying economic data, the monetary cycle, or the truly fundamental economic challenge facing the UK – Brexit. In other words, the political uncertainty associated with different outcomes, and by definition, fundamental changes to the long-term UK economic agenda, would not outweigh the more tangible and current economic concerns of EU divorce proceedings.

In that context, we note that the UK economy is showing increasing signs of a potential slowdown. For example, consumer spending has slowed considerably over the last quarter - the combined effects of inflation (from the depreciation in £-Sterling), and a dip in consumer confidence. The British Retail Consortium retail sales monitor showed a 0.3% fall on a like-for-like basis, and only a 0.2% increase on a total basis.

Similarly, the key services sector is also displaying signs of nervousness and weakness. The possible slowdown in the services sector was highlighted by the recent PMI data; the PMI fell to 53.8 in May *vs* four-month highs of 55.8 in April. Some economists suggest this could result in growth below 0.5% in Q2 (if the June data also disappoints).

This general slowing of consumption and service activity is also reflected in the Bank of England's analysis from its recent Inflation Report (see below).

The reduction in Q1 output growth was caused by reduced activity in the service sector



Sources: ONS and Bank calculations.

Perhaps more significantly still, the UK property and housing market also appears to be going through a process of adjustment. According to recent survey data from both Nationwide and Halifax, on a monthly basis, prices fell 0.2%, following on from April's 0.4% reduction. This marks the first time in eight years that house prices have declined for three months in a row.

As we know, the property market in the UK provides one the key metrics for assessing current and future 'economic health'. So, and to the extent falling property prices affect overall asset wealth, this may have a knock-on effect on consumer confidence and future levels of consumption.

More positively, we note that UK manufacturing remains at its 2016 average level of growth and both manufacturing and exports will continue to benefit from the global economic recovery and a lower £-Sterling. This may also generate a modest increase in business and infrastructure investment, and provide a much needed boost to productivity.

The slowing in consumer spending and consumption may be temporary, in as much as some of the current inflationary pressure is temporary (import led inflation resulting from the depreciation in £-Sterling). However, the relative buoyancy in manufacturing and exports may also be temporary, both having benefitted from the significant depreciation of £-Sterling after the EU referendum. And, this remains the key economic issue for the UK – the uncertainty and risk surrounding the economy during and post-Brexit.

While the political cycle (and election) will clearly have a bearing on the long-term direction of the UK, it is the imminent geo-political and structural economic changes that will determine investor and market behaviour over the short-to-medium term.

As we have noted, UK growth and inflation will continue to be influenced by the response of households, companies and markets to the prospects for the UK's departure from the EU. To date, the BoE's and other projections infer a smooth transition to an average of possible outcomes for the UK post-Brexit trading arrangements (as reflected in the current equilibrium rate on £-Sterling).

A fractious transition and uncertain end to Brexit, combined with a potential slowdown in economic activity, will have a more significant and immediate impact on markets than the general election. Therefore, markets do care about the outcome of the election, but more in the context of the economy and the UK's path to Brexit.

New EU bank insolvency regulations pass the market test

This week saw a major European bank being declared at risk of failure by the European Central Bank (ECB). For the first time, a European bank was bailed out by investors, rather than taxpayers, as was the case during the financial crisis in 2007/08.

Interestingly, both bond and credit markets have been remarkably calm following the news and the reason seems to be the quick and decisive action to rescue long-struggling Spanish Bank Banco Popular (POPSM) using the ECB's new bank insolvency rules.

The ECB helped broker and approve Spanish banking giant Santander's acquisition of POPSM for just €1 (one!). The transaction safeguard's POPSM's customers and senior creditors.

During the financial crisis of 2007/08, governments used taxpayer money to rescue banks. But this time, the ECB's new rules will see investors foot the bill by imposing losses of up to €3.3 billion on shareholders and junior bondholders.

Investors appeared to view the use of these new bank rescue rules as a positive for the financial sector, with European bank shares remaining firm. It would seem that Europe has learned its rather painful lesson and that these new rules are effective at providing an orderly wind-up mechanism for insolvent banks with minimum disruption.

Background on Banco Popular's issues

POPSM's struggles over the past decade are well-known and relate back to property loans made before the global financial crisis which caused a large drop in Spanish housing prices and wider economic troubles for the country.

POPSM had the chance to take part in a state aid package in 2012, but it preferred to launch a series of rights issues (creating new shares) that provided €5.5 billion in capital. These capital raises never fully convinced investors that the bank was able to shore up its balance sheet and rid itself of its non-performing loans (NPLs), with Q1 earnings showing that it still had nearly €37 billion

NPLs on its balance sheet. As a result, POPSM's measure of financial health, the Core Equity Tier 1 ratio stood at 7.33% in March, which is one of the weakest of all European lenders.

Why did the ECB act now?

The ECB declared that POPSM was "failing or likely to fail" and ordered a "resolution action" to transfer all shares and capital of Banco Popular to Banco Santander for €1. The forced sale comes in the wake of an increase in urgency for POPSM, after the bank failed to find a buyer and would have otherwise been unable to cover its debts and other liabilities.

As a result, funding was becoming increasingly expensive and difficult to obtain, while a ratings downgrade from Moody's further hit confidence in the bank.

What news rules governed this move?

Following the disorderly approach to governments (i.e. taxpayers) funding rescues of troubled banks in the wake of the financial crisis, the ECB decided that it needed a new framework that limited taxpayer involvement, provide a bigger role for investors to absorb losses (a bail-in rather than bail-out) safeguarded customers and minimised risks to financial stability.

The ECB formed the Single Resolution Board (SRB) to manage the orderly wind-up of insolvent banks under the Single Resolution Mechanism (SRM). Santander's acquisition of POPSM is the first official use of the SRM and so far, the results must be relatively reassuring for officials and investors despite the imposed losses.

What are the impacts on investors?

In order for the SRM to be implemented and recapitalise Banco Popular, the SRB decided to utilise its powers to write-down and convert current capital instruments prior to the sale. Shareholders are generally the first in-line when banks fail and it is no different this time. At the start of 2017, the bank had a market capitalisation of €4 billion and now its shares are worth a total of just €1.

POPSM had about €2 billion worth of junior bondholders, who are also effectively being wiped out. This looks like the new normal for any future failures of European banks.

However, this is also the first time that new special bonds which are designed to absorb losses, called Contingent Convertibles (CoCo's) or AT1s (Additional Tier 1s) have also been wiped out. While mainly institutional investors held POPSM's AT1s, some junior bondholders maybe retail investors, which means there is the potential for legal action over mis-selling, according to experts.

Who has not been impacted?

As noted above, the aim of the SRM is to secure both corporate and retail deposits while the holders of about €1 billion in senior unsecured debt remain untouched. As the price of POPSM's AT1s fell to zero, senior debt saw a price increase and these bonds transfer to Santander.

Why Santander?

Analysts regard Santander as one of the best managed banks in Europe. It benefits from a strong and improving balance sheet, robust earnings profile and well-diversified global revenue streams. Analysts also believe that the deal is positive for Santander from a credit perspective and the company does not anticipate a hit to its credit rating. The transaction should be credit neutral when factoring in the proposed €7 billion capital raising through a fully underwritten rights issue.

Santander said it expects the €7 billion CET1 capital raise to strengthen its balance sheet, while it off-loads non-performing loans to further reduce risk.

The company has a solid and proven track record of acquisitions (Abbey National and Bradford & Bingley in the UK) and has been highly active in managing subsidiaries over the years, which should reduce execution risk.

The deal also provides Santander with improved market positions in both Spain and Portugal, taking market share to around 20%, according to Goldman Sachs. Additionally, the combined business should drive cost synergies (€500 million expected by 2020) and expand its share of the SME lending market in Spain to around 25%. Given the economic improvements in the Spanish economy of late, this could be an interesting addition at this stage of the cycle.

What does this mean for European banks?

Spain's prompt and decisive approach stands in complete contrast to that of Italy, which is currently attempting to inject billions of euros into troubled Monte dei Paschi while Portugal is providing funds to a state-owned bank.

We note that AT1s at other European banks, who have an NPL problem were relatively unchanged this week. The $140 billion AT1 bond market was also stable, suggesting that investors may feel that the worst may be over. Now that regulators have their first seemingly successful case of a bank rescue using the SRM, we think this should be reassuring to investors.

The calm market reaction to the orderly resolution of POPSM should tell us all we need to know. Perhaps other European nations could take a leaf out of Spain's book.

Trump's Softening Stance

Donald Trump is going "all in" on getting the repeal of Obamacare through the US Senate, according to top Republicans. The President met with congressional leaders on Tuesday to urge them to follow through with an aggressive timetable for repealing the law, so that the administration's other key concerns – the ever-present national debt ceiling and promised tax reform – could be seen to quickly.

The affordable healthcare act, commonly known as Obamacare, was the flagship policy of the previous President, and one which became a regular battleground for the Republican Party. The most famous conflict on that site was the federal Government shutdown of 2013, when the Republican-controlled congress refused to pass the necessary budget bill to raise the government's debt ceiling unless provisions to defund Obamacare were included. The country was then held to ransom for 16 days, as failure to pass the bill meant government services were shutdown.

That episode was just one of a tiresome trend in US Congressional politics: using the annual budget bill to force concessions out of the government. Trump is eager to avoid any repeat of that situation, and as such is trying to get the repeal of Obamacare through before a hectic autumn full of key fiscal deadlines. The repeal already made its way through the US' lower chamber, the House of Representatives, last month, where Trump directly involved himself in working the rank-and-file House members to achieve the bill's passage.

As for the Senate, however, Mr Trump appears to be taking a different approach. For one, Republicans have reported that the President has asked the Senate leaders to tone down the more fiscally hawkish measures included by the House – who are on the whole more right-wing than their Senate counterparts. More importantly, the commander-in-chief is reportedly taking a far softer touch, not involving himself in the direct details of the bill or attempting to persuade wavering Senators. "He's definitely leaving it to Mitch (McConnell – the Senate Majority Leader) to lead." Says Senator Bob Corker, who added that the President still "wants results."

This marks a break from Trump's previously more confrontational style. Our reading on this is that the President is warming to a party that he knows he'll have to placate rather than blackmail if his fiscal reform plans are to ever see the light of day. This week has been the administration's 'infrastructure week', and has seen the President travel to Ohio on Wednesday to give a speech about the need for greater infrastructure investment – one of Trump's cornerstone campaign pledges – as well as outline a plan to use $200bn in federal money to leverage the promised $1tn investment.

In that Tuesday meeting with Republican leaders, the President made it clear that he is well aware that his own policy goals – the above infrastructure spending and the much-discussed tax reform – will play second fiddle to the Congressional party's own desires, of which the repeal bill has long been front and centre. The tax reform specifically won't be fleshed out in detail before Congress' August recess, according to National Economic Council Director Gary Cohn.

Tax reforms might even have to come after a raising of the budget debt ceiling. The next budget plan was originally not scheduled until Autumn, but it was revealed on Wednesday by the Congressional Budget Office that the government's tax receipts were $60-$70bn less than what was expected at the beginning of the year (quite possibly due to citizens delaying some tax items until after Trump's planned tax cut). This has pushed up the timeframe for increasing the US' debt ceiling, with the administration now wanting a budget bill to be passed before the August recess.

With last year's market euphoria over the 'Trump trade' now firmly behind us, there's a growing feeling that now is the do or die time for the administration. Trump himself appeared to acknowledge this pressure a few weeks ago when he took to twitter to lament that the "media will kill" over his apparent lack of policy action in his first 100 days as President. Now that we're quickly approaching the point where Trump's promised stimulus policies need to show results, he appears to be becoming more amenable to the Congressional Republican party.

Of course, there is a more cynical explanation for his softer stance with the Republicans. The elephant in the room here is the testimony of former FBI director James Comey before the Senate intelligence committee. Mr Comey, who was abruptly fired by Trump last month, swore under oath that the President was telling "lies, plain and simple" and accused Trump of trying to coerce him into abandoning an ongoing investigation into former National Security Adviser Michael Flynn. Comey stopped short of claiming Trump had obstructed justice, but, if links between the former director's dismissal and his refusal to grant Trump "loyalty" can be proven, we can be sure that those accusations will be made. According to Guardian columnist Richard Wolffe, "Comey's testimony was effectively the first hearing into what will surely become the impeachment of Donald J Trump."

Sure enough, the odds on an early exit from the White House for Trump have gone up since Comey's testimony on Thursday. And, if the impeachment patter grows into a furore, Trump will need the support of the congressional party to survive. On the face of it, the Republicans – who control both houses of congress – are unlikely to want to impeach a President who wears their own colours. But, up until now, there has been quite a rift between Trump and the rest of the party and, ultimately, the Republicans' allegiances lie with their own electoral campaigns. With the midterm elections now just over a year away, an impeachment process might be seen by the party as what's needed to distance themselves from an unpopular President.

Perhaps the impeachment talk is a little hasty. Many Republicans were eager to emphasise that Comey did not directly accuse the President of obstructing justice, and that Trump himself is not under any investigation from the Russian election-hacking probe. Despite the heavy implications, the former director's testimony lacked a 'smoking gun'. This is arguably why markets were relatively sanguine about the news – the S&P 500 traded marginally up and the US 10-yr Treasury bond fell only slightly. For markets, the primary political concern still appears to be the extent and timing of the heralded fiscal stimulus package.

Whatever the case, we note with interest Trump's softening stance towards his party. A sign of things to come, and a President finally settling in after a tumultuous start to life in the White House? Or a calculated move to buy policy room and a potential vote of confidence (should it come to that)? Only time will tell.

Gulf States sever ties with Qatar – implications on oil

The Gulf States, led by Saudi Arabia, shocked the world this week by cutting ties with neighbour Qatar and closing all borders with the small mineral rich nation. The Gulf States, which have large Sunni populations, stated that Qatar had provided funding for terrorist organisations and supporting Iran, which has a Shia majority.

The move comes just days after US President Trump's first visit to the region, where he pushed for an end to terrorist funding and as a result, tensions between Sunni and Shia regions have risen. The rise in geopolitical tensions between the Gulf States and Qatar over the past week produced a curious reaction in oil prices, sending oil down below $50 a barrel, but not up as one might expect.

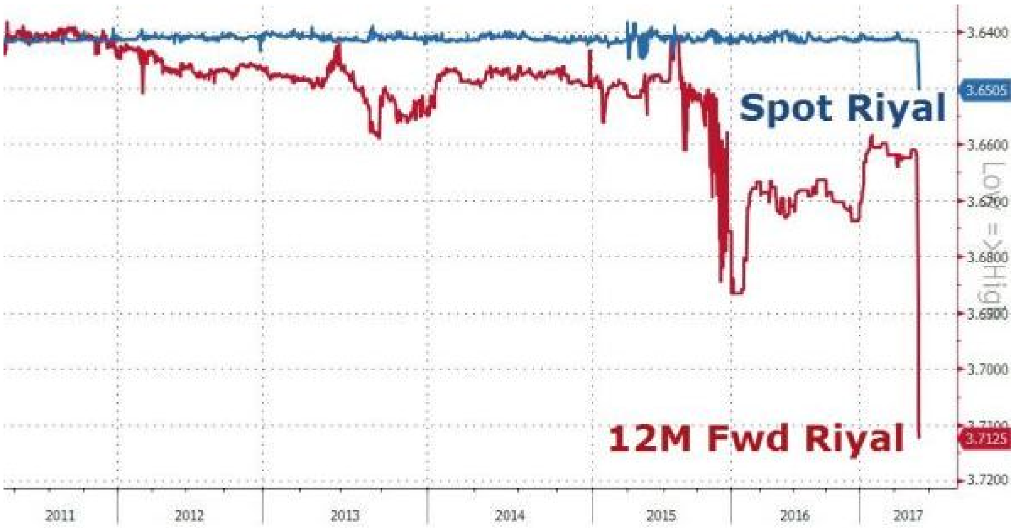
The question of why would oil prices fall might be explained by the fact that unity among OPEC members appears to be undermined at a crucial time. OPEC has taken action to cut production so that global oil inventories can start to fall. However, compliance rates for the agreed production cuts look to be under threat, especially if Qatar were to leave the oil cartel and OPEC continues to fade in importance, particularly for its ability to impact pricing in the future.

Additionally, the latest news from the US shale sector suggest that new technologies might push the cost of production from around $45 per barrel to $10 or even lower, which brings production costs closer to levels seen in Saudi Arabia. The Saudi government could come under increased pressure if prices fall further, given its budget deficit.

Therefore, the outlook for oil prices remains weak and is highly dependent on growing demand to absorb current global oil glut, but demand looks more elusive in light of slowing economic growth in China and the US.

Market reaction

Some have dubbed the move by Saudi Arabia and its 6 Gulf partners to turn their backs on Qatar a "Qatarstrophe", particularly for the maverick Gulf State itself. The reaction of Qatari asset prices would certainly suggest trouble ahead.



Source: Bloomberg

The Qatari stock market (Qatar Exchange Index - DSM) fell 7% on Monday, the biggest one day fall since December 2014 and is down 9.4% on the week. In the bond space, yields rose at their fastest one day pace in 7-months. Qatari CDS – a measure of default risk – spiked to 2-month highs.

Qatar's currency, the Qatari Riyal, crashed to record lows as Saudi Arabia's central bank ordered lenders in the country to avoid increasing exposure or processing the payments of Qatari clients. The plunge in the 12-month currency forward suggests that its currency peg is under threat.

What happened?

On Sunday night, a Saudi-led alliance shocked the world with the news that they had severed ties and closed all borders with Qatar, the smallest member of the Gulf Cooperation Council. The move comes just days after President Trump's first visit to the region, after the GCC accused Qatar of "spreading chaos" by funding terrorism and supporting Iran. Additionally, Saudi Arabia said it would shut all land crossings, which could deprive Qatar of imports through its only land border.

The Saudi's said that Qatar had supported "terrorist groups aiming to destabilise the region" and singled out "Iranian-backed terrorist groups" alleged to be operating across the Gulf. As a result, the GCC gave Qatari diplomats just 48 hrs to leave.

How important is Qatar?

The country's population is smaller than Houston in the US (2.2 million) yet it has one of the world's largest sovereign wealth funds ($355 billion) that invests in a range of global companies. Qatar's real influence is down to the fact the country is one of the biggest producers of LNG (Liquefied Natural Gas) and is host to the US' central military command in the Middle East.

Conspiracy? – Is Qatar's LNG dominance the 'real' reason for the Gulf States to sever ties with Qatar?

We know that Trump urged regional players to crack down on the financial support of terrorism during his visit to the region. The FT reported that through ransom payments for Qatari's kidnapped in Iraq, Qatar this year provided almost $1 billion in funding to al-Qaeda affiliates. This was the final straw for Saudi Arabia.

That funding, according to the FT, was allegedly paid by Qatar "to release members of the Gulf state's royal family who were kidnapped in Iraq while on a hunting trip, according to people involved in the hostage deal".

However, beneath the headlines is a theory that revolves around Qatar's LNG dominance. The country is the world's largest LNG exporter, followed relatively closely by Russia. The story goes that Qatar wants to run a LNG pipeline through Syria. However, the country was not overly keen, leading to Qatar supporting Syrian rebels to oust the incumbent government, so its pipeline could be built.

Another 'reason' may be the fact that Qatar is host to the Al-Jazeera news network, which provides what some consider a balanced view of the Muslim world, but has proved to be a 'thorn in the side' of more oppressive countries, which tend to have large Sunni populations, such as Saudi Arabia.

Interesting theories – but what are the economic implications?

Qatar Airways has cancelled all services to Saudi, but losing large chunks of airspace access could effectively ground the flag carrier. Qatar is a hub that connects Asia with Europe, which is what caused much of QA's recent growth. Given the cancellations, journeys that took 6 hours, will now take 8/9 due to flight rerouting.

In terms of access to food, most desert countries struggle to grow their own food, but food security is particularly important for Qatar, given the only way into the country by land is a single border with Saudi Arabia. An estimated 40% of food imports comes via this route, meaning Qatar could become more reliant on sea and air deliveries. This may have an impact on inflation rates.

Qatar is due to hold the 2022 FIFA World Cup tournament, but this action has now placed the world cup in doubt, along with the multi-billion dollar investments in associated stadiums and infrastructure. The knock-on to the construction sector could see a shortage of materials for various projects, including those for the World Cup.

In terms of people movement, the cutting of ties could impact people travelling to or through Qatar, but more significant is the number of foreign citizens working in engineering, medicine and law along with construction. A sudden loss of large numbers of workers in those sectors could pose a large problem for the economy but also for both local and international firms operating in Qatar.

Lastly, on trade and business, investors have become nervous as seen in by the local stock market's falls. We note that many firms in the Gulf region have a presence in Qatar, including retail outlets. Now the expectation is that they may close, even if temporarily. Sponsorship deals appear under threat, with Saudi football teams cancelling their deals with Qatar Airways.

How does this link back to oil prices?

Qatar is a member of OPEC and that membership could come under review. Compliance rates with OPEC production cuts could now be in doubt and the possible loss of Qatar could see the country drop its own commitment to cut 30,000 barrels per day which could impact oil prices. While 30k barrels might sound low, relative to daily global production of 97 million barrels per day, the fear is that other OPEC countries might review their own commitments to cut production, meaning that high global oil inventories could take longer to reduce and put additional downward pressure on prices.

Saudi Arabia's budget issues could become more acute should prices remain below the key $50 per barrel level. We suspect other Gulf States could face similar issues in the event of a prolonged period of lower prices. Therefore the need for consistent revenues might outweigh the need to cut production.

If investors doubt OPEC's future, then its ability to impact prices could diminish. This comes at the same time as US shale producers are relentlessly innovating with new technologies to lower costs but also increase efficiency.

Some oil analysts believe that the new methods from US firms could lead to another oil boom domestically. This time, firms are not relying on a brute force approach but rather the clever use of science.

Older technology, such as steam injections, allowed US producers to reduce costs to around $45-$50 a barrel. However, new techniques like impulse waves and thermobaric extraction to improve recovery rates by forcing heavy oils to become less viscous and more liquid (via the thixotropy effect) could drastically reduce the cost of extraction to around $10 a barrel and perhaps lower, brining production costs closer to that of the Saudis.

Analysts estimate these two technologies alone could bring previously uneconomic wells into play. This includes possibly as much as reserves of over 2 trillion barrels of oil, at much lower costs, with greater efficiency and also a smaller environmental impact.

With global inventories already high and new sources of production coming on line in the US, OPEC has a problem to which they appear to have few answers for. In terms of demand, economic indicators are now suggesting a pause or slowdown in growth on a global basis, which means that those who were expecting oil markets to find balance at the end of 2017/early 18 have to push back those estimates.

The economic problems for Qatar could be just beginning. For now, we think that at the very least, the recent upside momentum in oil prices has stalled and prices could face downward pressure until supplies moderate and/or demand improves.

PERSONAL FINANCE COMPASS

Global Equity Markets

MARKET	CLOSE	% 1 WEEK	1 W	TECHNICAL
FTSE 100	7523.8	-0.3	-23.8	→
FTSE 250	19761.2	-1.2	-241.6	→
FTSE AS	4109.9	-0.5	-19.2	→
FTSE Small	5628.6	-0.4	-23.1	→
CAC	5300.2	-0.8	-43.2	→
DAX	12815.6	1.2	150.6	→
Dow	21290.9	0.4	84.6	→
S&P 500	2445.3	0.3	6.3	→
Nasdaq	5874.6	-0.1	-6.9	→
Nikkei	20013.3	-0.8	-164.0	→

Top 5 Gainers / Top 5 Losers

COMPANY	%	COMPANY	%
ANGLO AMERICAN	5.0	CAPITA	-9.7
STANDARD CHARTER	4.8	KINGFISHER	-6.0
FRESNILLO	4.5	MERLIN ENTERTAIN	-6.0
RIO TINTO	3.5	BABCOCK INTL	-5.8
GLENCORE	3.0	WHITBREAD	-5.8

Sovereign Default Risk

DEVELOPED	CDS	DEVELOPING	CDS
UK	21.6	Brazil	236.9
US	19.3	Russia	157.1
France	27.4	China	72.1
Germany	16.5	South Korea	52.8
Japan	49.0	South Africa	187.3

Currencies / Commodities

PRICE	LAST	%1W	CMDTY	LAST	%1W
USD/GBP	1.27	-1.17	OIL	48.3	-3.2
USD/EUR	1.12	-0.79	GOLD	1267.9	-0.9
JPY/USD	110.62	-0.20	SILVER	17.3	-1.7
GBP/EUR	0.88	-0.34	COPPER	263.6	2.4
JPY/GBP	6.80	0.18	ALUMIN	1902.5	-1.3

Fixed Income

GOVT BOND	%YIELD	% 1W	1 W
UK 10-Yr	1.0	-3.3	-0.03
US 10-Yr	2.2	2.6	0.06
French 10-Yr	0.6	-9.2	-0.07
German 10-Yr	0.3	-4.0	-0.01
Japanese 10-Yr	0.1	1.8	0.00

UK Mortgage Rates

MORTGAGE BENCHMARK RATES	RATE %
Base Rate Tracker	2.3
2-yr Fixed Rate	1.5
3-yr Fixed Rate	1.8
5-yr Fixed Rate	2.0
Standard Variable	4.5
Nationwide Base Rate	2.25
Halifax Standard Variable	3.74

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