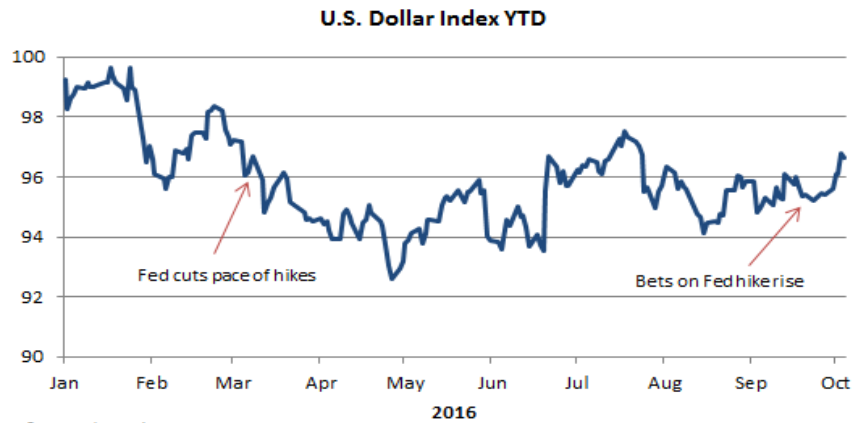


Analyzing The Events In Q4 2016

- Probable rate hike in December
- USD strength towards other major currencies in medium term
- Trump vs Clinton outcome has impact on global trade
- Italian referendum could punish banking and utility sectors
- A “no” vote is a threat to Italy’s long-term membership in the EU

Analysts	Contact Details
Alex Mikaelsson <i>Msc. Economics</i>	LINC - Lund University Finance Society
Martin Nilsson <i>Msc. Economics</i>	Tycho Brahes Väg 1 SE-220 07 Lund Sweden www.linclund.com



Key Events in the Fourth Quarter

For neutral viewers, the last quarter of 2016 could be a very exciting one. As for portfolio managers, traders and corporate treasurers, it could potentially be nerve-wrecking as we gear up for some highly anticipated events that will surely have an impact on numerous asset classes. The unusually divisive natures of the United States presidential election, a probable interest rate hike by the Federal Reserve and an important forthcoming referendum on constitutional reform in Italy are all examples of events likely to keep investors on their toes. The aim of this article is to provide general background regarding these events and their possible impact on the financial markets.

The Italian Referendum

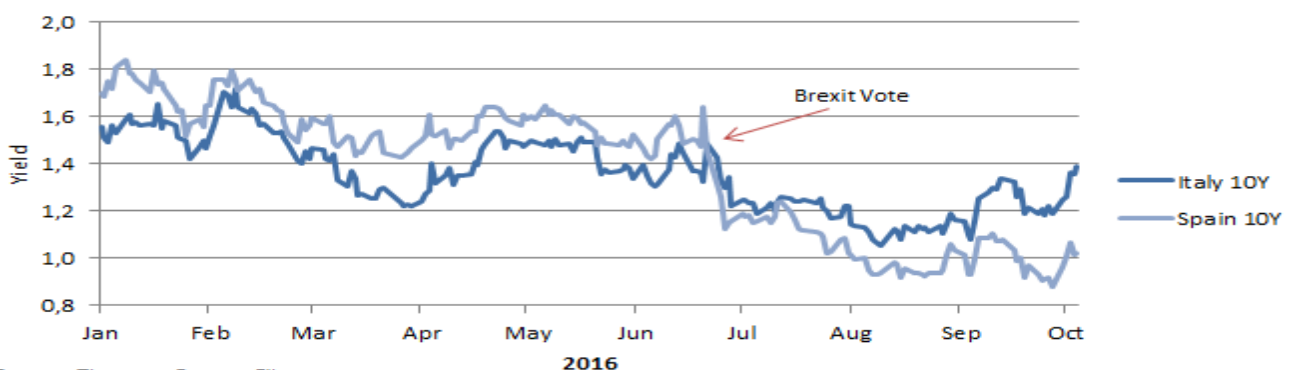
This important event has played second fiddle to the upcoming execution of Brexit with regards to media attention in Europe but the potential economic consequences of the December 4th referendum should not be underestimated. Matteo Renzi, leader of the Centre-left

Democratic Party, has put his political career on the line à la David Cameron for a referendum to decide on a major overhaul of Italy’s political system. In short, If Renzi wins the vote, political uncertainty is said to decrease and his proposed measures to streamline Italy’s legislative process will be implemented. Constitutional reform is therefore seen by the IMF and OECD as a key part of the reform agenda to simplify decision making, along with further implementation of the Jobs Act labour market reform. If the referendum is voted down, political uncertainty is said to increase due to the possibility of opening up a political vacuum for populist and Eurosceptic parties, such as the 5-Star movement to exploit. A “no” vote is therefore seen by many not just as a fall of Renzi’s government, but also a threat to Italy’s long-term membership in the EU.

“The markets are too complacent about the referendum outcome and its impact”

- Daniele Antonucci, Senior European Economist, Morgan Stanley

Italy & Spain 10Y Government Bond Yields YTD



Implications of "No" Vote to Markets

Our view is that a "no" vote will lead to an initial shock to markets consisting of large sell-offs in Italian equities, where the banking and utility sectors will be hit the hardest driven by political uncertainty and their high correlation to the real economy and domestic sovereign outlook. A vote against the referendum is also a vote against the structural reforms needed to ensure Italy's growth in the Eurozone. We therefore see the domestic sovereign outlook for Italy weakening significantly. Italian bonds have risen since the Brexit vote along with other markets in the Euro Zone in part due to the European Central Banks' quantitative easing program. Compared to Spain the picture is less positive considering that Spanish 10-year bonds yielded seven basis points more than the Italian 10-year bond the day after the Brexit vote. They now yield 37 basis points more, which shows the Brexit vote's psychological effect.

The U.S. Presidential Election and Probable Rate Hike

The presidential candidates are on the final sprint of the marathon towards the White House. Whoever emerges victorious on November 8th will replace Barack Obama and accordingly control the fate of the chair of the Federal Reserve.

"The mere uncertainty over what will happen after the US presidential election could be damaging to the economy and investor sentiment"

- Johnny Bo Jakobsen,
Nordea Chief Analyst

While Hillary Clinton follows President Obama regarding the reappointment of current Fed chair Janet Yellen in 2018, Donald Trump carries a hawkish stance and an outspoken agenda to replace Yellen. Both candidates would like to see higher rates in the near future, however, we see that the nature of a Trump rate hike is likely to be more aggressive than that of Clinton. Subsequently, if Clinton would be elected president, Yellen will remain in control of the Federal Reserve and would therefore be able to continue on the current strategy of slow step-by-step rate hikes. A key factor in the election is trade policy, where Trump advocates a strictly protectionist view that threatens the structure of various trade agreements.

Clinton has also expressed modestly protectionist views, but has previously been a known promoter of free-trade deals, which questions whether Clinton actually would pursue any grand restructures in key trade agreements if elected. A step towards global protectionism could be damaging for many emerging markets, which leads us to believe the USD could be subject to a *safe haven*-effect and strengthen in the event of a Trump win on November 8.

The Effect on the Dollar

Our stance is that Donald Trump would bring uncertainty to the global markets and a strictly hawkish rate strategy. The USD will stand to benefit from a *safe haven* effect and the effect of a hawkish rate policy. The strengthening effects may however diminish from the increased risk associated with uncertainty. A U.S. run by Hillary Clinton offers stability to foreign investors in *business as usual* for another four years and modest rate hikes. Our view is that the USD will stand to gain in the medium term regardless of the outcome of the U.S. Presidential Election. The turmoil around the presidential election decreases the likelihood of a rate hike in November- we see a rate hike in December to be the most probable scenario.

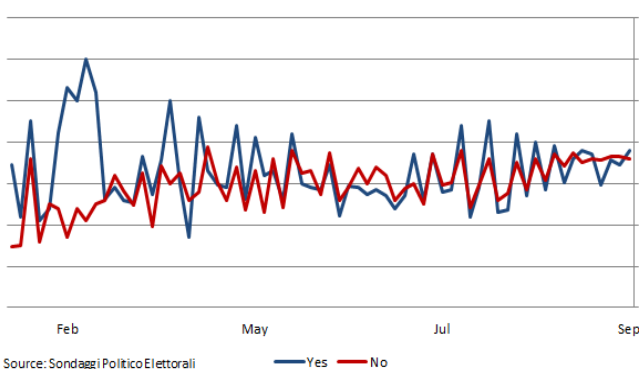
Recommendation

Our view is that a "no" vote in the referendum will spark a sell-off in European equities due to the increased level of perceived political uncertainty in the Eurozone where we see the banking and utility sectors taking the largest hit. If you are an investor currently holding Italian bonds or European stocks we advise selling to avoid political risk. We believe the U.S. dollar will strengthen towards other major currencies in the medium term due to the high probability of an interest rate hike, the looming execution of Brexit as well as the weak outlook for the Eurozone. A stronger greenback benefits U.S. companies that import most of their goods and sell domestically since their top-line and bottom-line benefit from stronger domestic demand and lower costs for inputs. Foreign companies that generate a large portion of income in USD will also benefit from an appreciation.

"The U.S. currency will strengthen to \$1.05 against the euro by the end of the year from \$1.1201"

- Deutsche Bank forecast

Italian Referendum Poll Average



General Election Poll Average Clinton vs. Trump

