



## A return to realpolitik

*Political volatility is as high as at any time since 1989*

Over the past week, volatility has remained low in financial markets, but there were two events that had the potential to cause a pick up in uncertainty. The Federal Open Market Committee meeting was perceived to be marginally dovish as there was little to prepare the market for a March rate hike. The US payrolls figures showed more jobs were added than expected, but investors preferred to focus on soft hourly earnings data. As neither of these headline events created any volatility, investors continued to increase exposure to risky assets. In EM, spreads tightened further and EM FX as a whole continued to appreciate against the US dollar.

A key theme of our strategy over the past week has been to take more active positioning in those countries we perceive as winners from Trump's foreign policy agenda. The ambivalent approach of the Obama administration to engaging with authoritarian leaders in the Middle East will be jettisoned as Trump prioritises a defeat of ISIS. A return to "realpolitik" will, we believe, be positive for Egypt, Tunisia, Bahrain and Saudi Arabia.

Continuing the geopolitical theme, we witnessed an increased level of fighting in south east Ukraine. We believe this is Putin's way of making sure he continues to capture Trump's attention. We do not believe we are likely to see a wholesale reengagement between Russian and Ukrainian forces, but Putin needs to secure a

### News Analysis



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US-Russia summit to confirm Russia's Great Power status. Continued bubbling unrest in the Donbass is one way of achieving that.

We have underestimated the extent of EM FX strength to start the year. In Mexico, we think the respite is only temporary. We continue to take Trump at face value when he says he wants to renegotiate the North American Free Trade Agreement. In Asia, we still believe a combination of higher Fed funds rate and reduced global trade is negative for Asia FX. Over the past week, we have been trying to game plan the Chinese response to heightened US trade barriers. In most scenarios, the results still seem to suggest FX depreciation for the region.

In summary, we are still in a rather strange environment where financial market volatility remains low, as political volatility is as high as at any time since 1989. Eventually, we still believe financial markets must more accurately reflect today's global political developments. We have to remain patient as the year begins, but we still believe it is the prudent investment strategy.

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