**Blog 14/12/2016 – New Year Horror Stories**

At first sight, the financial markets are set fair for 2017, with steady economic growth and inflation under control in the major economies. Life couldn’t be better … or could it? Here are four potential horror stories around the world which could foretell an unhappy new year.

**The Apprentice President.** The Trump Trade has been in vogue since 8th November. The new president will be inaugurated on 20th January and the markets look forward to corporate tax cuts, $1trn of infrastructure spending and a bonfire of regulations. This could easily go wrong.

On the one hand, Mr Trump may be unable to deliver. He is a fiscal liberal; Congressional Republicans are fiscal conservatives. When it comes to budget talks, it is unclear how much can be achieved. On the other hand, he may also deliver his promise to impose tariffs and to restrict immigration. If so, then he will give to the markets with one hand and take away with the other.

And, finally, even if he gives but does not take away, then the result could be an over-heating economy. This could push the Fed into more rapid interest rate rises and topple an over-valued US equity market.

**Populists In Europe.** The big danger in Europe is politics. On 15th March, Geert Wilders’ Party for Freedom could become the largest party in the Dutch parliament; on 7th May, Marine Le Pen could win the French presidency; and in September or October, Angela Merkel could be ousted as German Chancellor.

Current polls suggest that only the first of those is likely. But we cannot rule anything out and either of the latter two would scare markets. This is not to mention problems in Spain with Catalonia or in Italy with the banks.

**Brexit Bungling.** Somehow this seems less of a risk and more of a likelihood. The government claims to have a plan but Brexit secretary David Davis will not tell anyone what it is until February. In the meantime, ministers offer contradictory views.

Markets do not like uncertainty and Brexit is riddled with it. For now, markets assume that serious work is going on behind the scenes and that there will be a softer rather than harder divorce. The key date, of course, is 31st March.

**China’s Borrowing Habit.** China is making a difficult transition from a manufacturing/export-led economy to a services/consumption-based one. This involves a slowing growth rate and massive reforms. So far, so good but in the process China’s debt ratio has ballooned to 255% of GDP.

We reckon that there is less to worry about than generally reckoned (see our blog post of 3rd November) but, even so, there is a distinct risk of a bad outcome so we include it in our horror stories.

**Conclusion.** The economic cycle and equity market upswing are looking tired and our monthly risk register is getting longer. Investors should continue to hold risk assets but refrain from irrational exuberance. At some point in 2017, there will be difficult times.