



meridian
ASSET MANAGEMENT (C.I.) LIMITED

INVESTMENT MEMORANDUM

This has been a very strong quarter for international equity markets with a fairly uniform pattern of performance. Signs of strong economic growth have given equity investors more confidence. There has been a mixed performance in international bond markets whilst, in the foreign currency markets, sterling showed moderate weakness. In the commodity markets both gold and oil improved.

The tables below detail relevant movements in markets :

International Equities 30.11.16 - 28.02.17

Total Return Performances (%)				
Country	Local Currency	£	US\$	€
Australia	+6.7	+11.5	+11.1	+10.9
Finland	+7.3	+7.9	+7.5	+7.3
France	+6.3	+6.9	+6.5	+6.3
Germany	+10.9	+11.5	+11.1	+10.9
Hong Kong, China	+3.1	+3.4	+3.0	+2.8
Italy	+10.7	+11.4	+10.9	+10.7
Japan	+4.3	+6.7	+6.2	+6.1
Netherlands	+9.8	+10.4	+10.0	+9.8
Spain	+11.3	+12.0	+11.5	+11.3
Switzerland	+8.4	+10.7	+10.2	+10.0
UK	+7.9	+7.9	+7.5	+7.3
USA	+8.1	+8.6	+8.1	+7.9
Europe ex UK	+8.8	+9.9	+9.5	+9.3
All World Asia Pacific ex Japan	+6.1	+8.9	+8.4	+8.3
All World Asia Pacific	+5.4	+7.9	+7.5	+7.3
All World Latin America	+5.7	+12.7	+12.3	+12.1
All World All Emerging Markets	+6.0	+9.3	+8.8	+8.6
All World	+7.4	+8.5	+8.1	+7.9

Source FTSE World Indices

FTSE UK Government Securities Index All Stocks (total return) : +3.1%

International Bonds - Benchmark Ten Year Government Bond Yields (%)

Currency	30.11.16	28.02.17
Sterling	1.42	1.08
US Dollar	2.39	2.35
Yen	0.02	0.05
Germany (Euro)	0.20	0.21

Sterling's performance during the quarter ending 28.02.17 (%)

Currency	Quarter Ending 28.02.17
US Dollar	-0.6
Canadian Dollar	-1.6
Yen	-2.6
Euro	-0.7
Swiss Franc	-2.1
Australian Dollar	-4.3

Other currency movements during the quarter ending 28.02.17 (%)

Currency	Quarter Ending 28.02.07
US Dollar / Canadian Dollar	-1.0
US Dollar / Yen	-1.9
US Dollar / Euro	-0.1
Swiss Franc / Euro	+1.4
Euro / Yen	-1.8

Significant Commodities (US dollar terms) 30.11.16 - 28.02.17 (%)

Currency	Quarter Ending 28.02.17
Oil	+8.1
Gold	+6.6

MARKETS

It has been another positive quarter for international equity markets with no significant negative performances. The total return on the FTSE All World Index was +7.4% in local currency terms, +8.5% in sterling terms, +8.1% in US dollar terms and +7.9% in euro terms. There was quite a narrow dispersion of performance in local currency terms with no relatively strong or weak performances worthy of comments. The same is the case with sterling adjusted returns except that it is worth noting that the FTSE All World Latin American Index returned +12.7% and the FTSE Australia Index +11.5%.

In the international bond markets, as measured by ten year benchmark government bonds, the feature was the strong performance of UK government bonds where the gross redemption yield fell by 34 basis points to 1.08%. Elsewhere, yields were little changed. In the case of the US Treasury bond, the gross redemption yield fell by 4 basis points to 2.35%, whilst it rose by 3 basis points on the Japanese Government Bond to 0.05% and by just 1 basis point to 0.21% for the German Bund.

In the foreign exchange markets, sterling weakened. The biggest fall in our table was against the Australian dollar against which sterling fell by 4.3%. Against the yen, sterling fell by 2.6%, against the Swiss Franc by 2.1%, against the Canadian dollar by 1.6%, against the euro by 0.7% and against the US dollar by 0.6%.

In commodity markets, oil, as measured by Brent crude, and gold were both stronger with rises of 8.1% and 6.6% respectively.

ECONOMICS

We live in a period of change. The opportunity to vote for change was offered to the people of the United Kingdom and the United States and, in different ways, the outcome is a new path. There has been a noticeable rejection of the status quo and it is important to reflect on why that has happened and what the economic consequences may be. We live in a period where we receive perpetually the wisdom of the news channels, opinion pieces, the press and our leaders and then there are occasional reminders from the other side that what is broadcast is not received. 2016 will be a year remembered for the peoples of those two countries not following the script.

In the face of such uncertainty, and there is a great deal of it at present, another aspect of 2016 comes to mind, which was that political turbulence does not necessarily translate into market turbulence. In the first quarter of 2016 there were abrupt falls in markets, China suspended its stock market because of rapid downward movements and the sages at the World Economic Forum were more or less universally bearish about the outlook. Had the crystal ball foreseen Brexit, Trump and the Italian referendum at that time then it would have been hard to see world equity markets returning 9.9% in local currencies, let alone factoring in the exceptional returns when measured in sterling terms. As well as the highly significant political news, 2016 represented an important turning point in economic terms. The risk of deflation seems to have disappeared and, moreover, inflationary pressures are now a real concern, yields in bond markets seem to have (finally) reached a point of inflection, the role of quantitative easing may now start to diminish and the use of fiscal stimulus may be more palatable.

A definitive change in the tide of interest rates may be something which has not quite happened yet, though it may be close.

Some analysis of Donald Trump's victory informs us of some of the forces at play among the everyday folk of America; this is rapidly becoming yesterday's news but as some of the drivers of change in 2016 – frustration with the ruling elite, protectionism, anti-globalisation and fiscal stimulus, inter alia, may continue to influence those at other ballot boxes in 2017 it is worth looking at what we now know about the 45th President. The first comment to make is, of course, to note that 62,979,636 votes were cast in his favour, which was 2,864,974 fewer than Hillary Clinton. He was not the most popular candidate but he won in the states where it was important. In exit polls conducted by CNN, the question asked was 'Which candidate quality mattered most?' 39% of respondents chose 'bring change', 21% chose 'right experience', 20% selected 'good judgement' and 15% 'cares'. Within the 39% who prioritised change Trump garnered 83% of voters against 15% who voted for Clinton. Clinton won, but by smaller margins, in the other three. This month has been the first full month of his presidency and the contrast with his predecessor could not be more striking in terms of personality, style and policy. Trump clearly feels his mandate is strong and that his strength is his ability to bring change. He stands as a man who wears his frustration at the system on his sleeve and with this he carried many voters along as they, too, felt similar frustrations. It is clear his shortest route to goal in every situation will apply and it is also clear that he sees America as being at the top of the food chain - with everything that goes with that.

We do not yet have a clear picture of how his rhetoric will translate into policy but already we saw at the beginning of January Ford scrapping a planned Mexican car factory and adding 700 jobs in Michigan following criticism by the President. News is awaited on whether the threat of a 'big border tax' on small cars made in Mexico for importation into the U.S. will be turned into reality. Trump and his core voters will be buoyed by such a decision though General Motors explains that the Chevrolet Cruze cars it makes in Mexico are part of its strategy to supply customers globally, not just sell into the United States. The implications here are not to be ignored. The economic law of comparative advantage states that in sum the most efficient model is one where each individual, firm or nation produces the goods in which it has a comparative advantage not an absolute advantage. If America chooses to produce its own cars at a higher unit cost then either the producer will absorb that cost and reduce profitability or pass the cost on to the purchaser through a higher sale price. In the case of a car manufacturer this may lead to reduced competitiveness unless the playing field is kept level by forcing a similar inefficiency on all other car manufacturers in the domestic market. By spending more on a new car purchase consumers may spend proportionately less on other goods and services which would be another unwanted consequence. In the first eight months of 2016 Ford shipped 265,000 cars from Mexico to the United States. If Trump were to levy a 35% tariff on the whole year's imports Ford would have paid \$2.8 billion in taxes, which is more than a quarter of the whole group's annual profit. Mexico is United States' third largest trading partner and the ramifications of such an action are, at the same time, clear and unknown. In considering this example involving Mexico we quickly arrive at big figures and bigger implications, yet Trump has also talked about a 45% tariff on goods from China.

Trump has cited President Reagan's policies on tariffs on numerous occasions and likes to compare his proposals with those. With the benefit of hindsight those policies enacted in the 1980s had mixed outcomes. Japan was Ronald Reagan's main target and had been accused of dumping goods on the American market with the aim of building market share. Areas that troubled the administration were cars, motorbikes and consumer electronics. In 1981 a quota was introduced limiting the number of cars imported from Japan, with the goal of assisting America's domestic brands such as Ford, General Motors and Chrysler. At that time the US economy was in recession, unemployment was rising and inflation was high. US car companies responded by raising prices and improving profits. US companies also reduced production and between 1982 and 1984 the industry lost 60,000 jobs. Car prices rose, on average, by \$1,000. In 1983 a 49.4% tariff on imported Japanese motorcycles was introduced as a means of protecting Harley-Davidson, then, its last remaining large scale motorcycle

manufacturer, which was struggling greatly at that time. The tariff only covered large capacity motorcycles, which in any case Kawasaki and Yamaha were producing in the US, so were exempt from the tariff. Also the punitive tariff started at 700c.c. so Japanese manufacturers tweaked their model range and started marketing bikes with a cubic capacity of 699c.c. It was generally considered that the tariffs were ineffective and Harley-Davidson did become profitable by 1986 for the first time for five years, but a large part of its growing success was, perversely, through exporting its prestigious brand to other markets, such as Japan. In 1987 Harley's sales in Japan rose 56% over the previous year. A third area of intervention involved a 100% price loading on Japanese semiconductors. Japan had been guilty of flooding the US market with below-market price memory chips and denying access to its domestic market to US chip producers. The cost of such chips more than doubled to \$5.50 in 1988 from \$2.50 in 1986, a cost borne by US consumers. US job losses in this industry stopped and, in fact, numbers employed increased, though never regaining pre-tariff levels. It is also worth noting that it is not an industry that is now dominated by U.S. companies.

It is easy to see that the imposing of tariffs leads to a great number of varied consequences, many of which are difficult to predict, and many of which are difficult to legislate against and in almost all cases the benefits to the country imposing the tariffs are not universally felt amongst its people.

Given the resilience of markets at the start of Donald Trump's (first?) four year term there is an implied confidence in the Republican Party's stewardship of the economy that extends far beyond Trump's big headline quotes. Any corporation in any country would welcome small government, low level regulation, low corporate tax and open markets. These conditions should foster healthy levels of economic growth which translates into higher spending power within the economy as well as higher levels of investment. These two should increase productivity and a higher velocity of circulation of money, which in turn should lead to self-sponsoring growth. The detail behind the big headlines suggests that policy is likely to focus on many areas which would be favourable to the business world through lower corporate taxation, government investment through infrastructure spend and less regulation. Trump is a businessman and uniquely inexperienced in the office of President. In his positioning there are echoes of Ronald Reagan's "government is not the solution to our problem, government is our problem". Also in Reagan's first inauguration speech he spoke of the need to "reawaken this industrial giant" and "to lighten our punitive tax burden". These are common Republican themes though Trump's popularity has been raised by his invective opposing trade deals, criticising Wall St. and rejecting entitlement reforms, all of which would be considered left of the Republican mainstream.

If there was any surprise about the tone of Trump's inauguration speech then it would have come from those who thought his campaign was purely an exercise in winning an election and that high office would sober his thinking and elevate his rhetoric. As an inauguration speech it appealed less to the heart but more to the red-blooded. By the last day of February markets, and perhaps the 48 million viewers, appeared reassured by the more measured and less threatened tone adopted in his State of the Union address to Congress. Over the intervening period the economic weather forecast would appear to have improved. Confidence in a faster rate of growth is higher, the dollar has strengthened and now, and before any change to government policy, the Federal Reserve is seeking to abandon crisis-times monetary policy by raising interest rates incrementally towards something far more normal. There is an increasing chance of the first of a series of rises in March. This would allow subsequent rises to be stretched over as long a period as possible. The employment market is healthy and the economy has shown consistent, if below trend, growth for some years and to have interest rates at close to zero is no longer appropriate. To a degree both the policy changes at the White House and at the Federal Reserve have been priced in but against a background of what is happening elsewhere and what other central bankers are saying, such as Mario Draghi, the argument for a strong and strengthening dollar is compelling. A stronger dollar will, perversely, favour imports over exports as U.S.-manufactured goods are more costly in other currencies and U.S. consumers enjoy more buying power with their dollars overseas.

Against the economically positive must be weighed the uglier side to Trump's policies. It would be easy to characterise Trump's perception of the country he now heads as being at the top of the food chain and that he struggles to see relations with countries such as Mexico or China as being symbiotic. His thinking, if it is reflected by his talking, would suggest that the relationship is more parasitic. He represents the buyer, they, the seller. And the customer is always right. This perception of their being a Trumpian hierarchy of other countries would seem to be supported by the absence of proposed tariffs with Canada and an appetite to engage with the U.K. on a quick and easy free trade agreement. Somewhere in between sits the Trans-Pacific Partnership, a deal among 11 Pacific Rim countries, which Trump sees as a very poor deal for the U.S. and which he would replace with fair bilateral trade deals.

Much has been made of the movement in the value of the dollar. Against the pound we have experienced a pronounced movement as the markets' view of the pound has changed in the light of Brexit, but also there has been an uptick in the value of the dollar against the euro and the yen and the new policies which may be coming are unlikely to lead to any weakening of the greenback – excepting a trade war which rapidly escalates, though that is likely to have some impact on the other currency in many pairs as well. There is a domestic impact of imposing tariffs, separate from the inflationary effect on costs of imports which relates to opportunity cost. If the man on Main St. buys his next Ford and it has been built in the US where previously it may have been built in Mexico, he may have had to pay \$500 more. Whilst the domestic production of the car is a positive, it must be balanced against the \$500 that will no longer be spent on other goods within the US economy. A similar situation could arise where tariffs on Chinese-produced goods create price inflation in, for example, the discount supermarkets such as Wal-Mart and Target, reducing spending power. The irony here is that those hit worst by these two examples may well be the very voters who were captured by Trump's electioneering.

Extending this thinking, the intention would be for domestically produced goods to increasingly replace foreign imported goods, even if they were produced at a higher cost, because the input costs would translate into higher wages for those involved in the manufacturing process, which would increase the velocity of circulation of money as those increased wages are spent, creating growth. The risk is that as production switches to the domestic market (and is uncompetitive in the export market), price inflation would match or even outstrip wage growth creating an increasingly false market compared to other countries. This would not bring the efficiencies which were hoped for.

It may be that, against the consensus view of economists, Trump views international trade as a zero sum game. In his eyes, if another country is benefitting from free trade, then America must be losing out. It is noticeable that the countries he has targeted so far are those which have healthy trade surpluses with the U.S. namely China, Japan, Mexico and Germany. Of those four the deficit with Mexico is the smallest, just behind Japan and Germany but almost half of the U.S. total goods trade deficit is with China.

Trump has established a National Trade Council which considers such matters and its tests for a country being a currency manipulator are threefold. A manipulator will have a trade surplus with the US that exceeds \$20 billion, have a current account surplus greater than 3% of GDP and there will be constant and one-sided intervention on the currency market. The first two are easy to acknowledge but the third criterion is a little more opaque. It would be difficult to argue that Germany manipulates its currency, however, it does enjoy the benefit of being one of the strongest constituents of an economic bloc where monetary policy has been steered towards those parts most in need of loose conditions and a weak currency. If Germany had its own currency it would be far stronger than the euro. Speaking on 31st January to the Financial Times the head of the unit, Peter Navarro, said that Germany was one of the main hurdles to a U.S./E.U. trade deal. By far the largest contributor to this trade deficit is Germany's exportation of cars and car parts. This is an area of special attention as it would fit with other comments from the new executive.

As outlined above the figures involved in international trade very quickly become very large and consequential damage to trade caused by government intervention is quickly noticed by trade participants. China exports roughly \$350bn. more in goods and services to the U.S. than go in the opposite direction but that is not to say that China is a supplicant in the arrangement. It is unthinkable that China would not retaliate in some way as a result of U.S.-imposed trade restrictions because that is the nature of international relations and, furthermore, because China no longer sees itself as a secondary player on the world stage. What is very difficult, and here lie the risks of deteriorating relations, is the ability to predict how the situation would evolve. China could choose to target certain individual high profile American businesses such as Boeing or Caterpillar. Another tactic would be to target areas that are sensitive for the Trump administration, such as agricultural products. This represents \$20bn. of American exports, which are largely sourced from the Midwestern states, which were a key part of Trump's victory. The agricultural lobby is also very powerful in Washington. Another tactic could be to target companies that are based in the electoral districts of politicians who are ardent supporters of the new policy. This could get nasty and costly. China is likely to respond proportionately, particularly as it undergoes a twice-in-a-decade political transition later this year. Instead of tariffs, China could reallocate reserves out of US Treasuries, or fix the yuan weaker against the dollar, or facilitate regional trade deals.

What is clear to see is that there is a sense of direction in the U.S. at present, certainly compared with this side of the Atlantic. Leadership takes many forms and it is sure that Americans have never had a leader like their current one. At this stage he exudes the confidence of someone who is clear in his mandate, settled on his policy approach and comfortable with his ability to execute on it. Businesses like that and as he spoke at the Harley Davidson factory on 3rd February he referred to the Reagan era protectionism and renewed his promise to protect the American worker: "our allegiance will be to the American workers and to American businesses... we are going to make it really great for business... we're going to be competitive with anyone in the world" before reassuring those gathered that he will shortly be addressing taxation, healthcare costs, tariffs and trade.

Our confidence in investing in American companies has been high for some time and such overseas exposure has contributed positively to returns over many years. Trump's desire and intention to fight for the prospects of the American worker and, ergo, American businesses reinforces this positive sentiment towards the country... up to a point. To use an overused aphorism – patriotism is loving one's country and nationalism is hating all others. There is a risk that Trump's wholehearted pledge to the American worker, to fight for his or her opportunity to work and compete on the world stage is valid unless it is a principle that is underwritten by the belief that America's woes are the sum of the malign policies of other countries.

We are now in March and much of this memorandum so far has concerned itself with reflection on the force for change which we saw so vividly in 2016. Looking forward, and to Europe, we have forthcoming elections in the Netherlands, France, Germany and, possibly, Italy. This month we consider France, because of the size of the country and similarities with the United States and Italy because it appears to be a country gradually growing weary of its long term economic plight more than sudden discontent with the ebbs and flows of party politics.

In France, again, we find ourselves in the position that we think we know the outcome of the forthcoming Presidential election: Marine Le Pen of the National Front will win the first round, when multiple candidates from the leading parties and independents all compete for votes, but will lose to the independent Emmanuel Macron in the run-off, the second round where all but the leading two from the first round are eliminated, on the realistic assumption that no candidate will achieve a majority in the first round. Both are candidates for change and appetite for change is strong after a period of economic disappointment under Francois Hollande. Neither represents the two leading political movements of the country. France has an over-sized government sector with the costs that go with that, high unemployment, complicated employment laws that have discouraged inward investment and productivity gains that have lagged other leading economies. At 57% of GDP, France

has one of the highest public spending ratios in the OECD, which necessitate high levels of tax and which has meant that the government has been running an oversized deficit for some years. EU member rules restrict government deficits to 3% under the Stability and Growth Pact and the country is forecast to come within this limit in 2017 for the first time since before the financial crisis, unless government policy changes. France's national auditor, Didier Migaud, recently described the country's public finances as "fragile and vulnerable" casting doubt on this forecast. More positively, unemployment is high but falling due to a lowering of social security contributions, tax cuts, hiring subsidies and a weaker euro helping consumption. Confidence, as measured by the composite purchasing managers' output index, has been rising over the last three years and is well into expansionary territory. This is a good time for a politician to step forward for an election, particularly in France. One area where globalisation is most definitely an unstoppable force is in news and any French politician would feel emboldened by recent election and referendum outcomes in the United States, United Kingdom and Italy. Allied to this, the tenure of President Hollande has not been seen as a complete success and the stock of the Socialists is very low. The momentum at the time of writing is with Le Pen and Macron both of whom are campaigning some distance from the current administration in terms of policy. For Le Pen, think Trump, as she campaigns increasingly on anti-globalisation, less so on Islamification and plays to the blue collar workers of industrialised and formerly industrialised France. To her the euro is a strait jacket which must be jettisoned and her long game would appear to be a France outside of the E.U. She promises a referendum on it. Le Pen would replace the euro with a basket of national currencies, comparable with the European Currency Unit – the predecessor of the euro. Le Pen would also create money to finance welfare, industrial strategy and repay debt. Macron farms the centre ground and plans to revive the French economy by relaxing tough labour laws, cutting bureaucracy and encouraging innovation. He aims to smooth out the discrepancies between public and private sector pensions whilst keeping the retirement age at 62. The election centre ground has opened up for him as the Socialists have fielded a candidate from the far left and the great hope of the right, François Fillon of the Republican party, has stumbled explaining what his wife did as a paid assistant in return for €800,000 of government salary but, at the time of writing, remains in the race. Such elections are often won in the centre ground. Economically Le Pen represents the largest leap of faith. It is likely markets would take fright at a National Front victory as its adherence to its values may be at significant economic cost. Their current plan is to introduce a "new French franc", which would initially be equivalent to a euro. Whether the euro would continue to exist would depend on the other eurozone countries deciding to retain it or opting for a complete break up. Either way, if the euro is retained and France goes its own way, it is probable that the new French franc would be speculated against and would depreciate, though this may be welcomed by French business and farmers. More likely the victory would have already led to a euro crisis with Italy the most likely to take a similar position leading to the collapse of the euro. It must be stressed that a National Front victory is not the likely outcome as it has its core vote plus the disaffected, but the French political spectrum is wide and to a significant part of the electorate the National Front will never be an acceptable option. But we have been wrong before.

Were Le Pen to win, the progression of events may well depend on the size of her victory. Her ability to convert strategy into policy would be hampered by the strong likelihood that her party could not achieve a majority in France's Assemblée Nationale (the lower house) meaning France would experience another "cohabitation" - where the parliament is led by a party which is different from the President's. To exit from the eurozone would require a constitutional amendment which would be a long and complex process. A Le Pen victory, however, could lead to capital flight out of the country, as well as having a similar effect on the peripheral countries of the eurozone. It could be a loss of confidence that is never regained.

Despite this uncertainty in France, Italy remains the elephant in the European room with the largest debt problem in Europe, excepting Greece, with an economy still smaller than it was before the financial crisis, with high levels of unemployment and a banking system crippled by bad loans. At some point rational people ask themselves if something needs to change. Change in Italy has come through having many different governments which have struggled to work to a mandate, hindered by

the over-democratic political system. There is now a groundswell of Italians who are questioning the wisdom of remaining in the eurozone and who recall the years with the lira when devaluation of the currency enabled its goods and services producers to remain as competitive exporters and to defend their home market. As much as Germany benefits from the euro, countries like Italy are trapped in low growth deflationary trap. Domestic demand is low and productivity does not improve.

According to Eurobarometer, the European Commission's own analysis tool, in April 2002, a few months after the introduction of euro notes and coins Italy was the most pro-euro nation in the bloc, after Luxembourg, with 79% of respondents expressing a positive opinion. With the possibility of economic decline continuing towards a third decade, and youth unemployment at 40% the same pollsters observed that in December only 41% said the euro was "a good thing" while 47% said it was "a bad thing". Notwithstanding the presidential election in France it may be Italy where the greatest threat to the status quo lies.

The date for the next election in Italy is scheduled for early 2018. The longer term direction of the current government in the country is more fluid than in most countries and the anti-establishment Five Star Movement is showing a level of support amongst voters that threatens the Democratic Party. At the end of February its respected Economy Minister, Pier Carlo Padoan, was forced to deny that he had threatened to resign if certain reforms and planned privatisations did not take place. This is symptomatic of the current administration which many commentators are seeing as an increasingly fractured and ineffective unit. Economics is driving politics here and one casualty is the relationship between Rome and Brussels. In January the European Commission asked Italy to cut its budget deficit by some €3.4bn. more than Rome had planned. There are two situations where such outside intervention is particularly unwelcome. The first is when a country has grown tired of austerity and the second is when its government is struggling to govern and an election looms. Whilst the ruling government sees such E.U. edicts as unhelpful, the best placed party at times like these is the Five Star Movement which sees the Commission's edicts as most definitely helpful.

Whilst the Democratic Party is pro-euro and wants more European integration, though it complains of rigid fiscal rules, the three other largest parties are hostile, in varying degrees, to Italy's membership of the single currency. There is a sensitivity to a wider, reasoned questioning by Italians of the pros and cons of being in the eurozone. Those in favour of leaving point out the benefits for exporters of using a weaker currency and being freed from fiscal rules could allow more government spending to stimulate the economy. The risks to leaving are significant too as interest rates and inflation could rise, savings could be devalued, banks may be subsumed with bad debts and that the country could end up having large parts of its significant debt burden denominated in a foreign currency, leading to potential default.

The risks to France and Italy are reflected in the interest rate premium investors demand to hold the debt of either country compared with Germany's. Both spreads have grown, at a time when interest rates remain artificially low. It is difficult to say what the true cost of borrowing is for any country in the eurozone given the yield suppression deliberately created by central bank policy though nobody should be surprised at falling demand for sovereign debt in Europe. For some years the planets have aligned to pull yields down (due to demand-led price rises for bonds) with the European Central Bank buying regardless of return, with Europe's banks being strongly encouraged to hold such bonds for regulatory reasons and many other mandated buyers of sovereign debt forced to participate in a market with more buyers than sellers. Now inflation expectations are rising, the potential for a political shock is a relevant risk, there is a wider feeling that interest rates have passed their lowest point and the finances of the weakest countries of the eurozone are contrasting as strongly as ever against the finances of the strongest. Germany's inflation figure for February was 2.2%, above the ECB's target rate. Here we enter another different phase of difficult interest rate management for the central bank.

A central theme of this month's memorandum is change and very often in the investment world change can equate to risk. It can mean a repricing of assets, preferential buying of certain sectors or geographic areas over others and, in the most extreme and rare cases, buyers' strikes where certain assets lose all intrinsic value. With this in mind we continue to adhere to the same investment strategy and remain guardedly optimistic about direction for the coming years. Equally, the need to avoid complacency remains and our preference for constituting highly diversified portfolios with heavyweight, resilient businesses continues to be justified, in our opinion, as a significant market adjustment can never be ruled out. Donald Trump's expansionist policies, whilst light on detail, are driving markets higher as is growing confidence in Europe but there is the possibility that the highest point in markets in 2017 may be reached early in the year.

Meridian Asset Management (C.I.) Limited is regulated by the Jersey Financial Services Commission, under the Financial Services (Jersey) Law 1998, to carry on investment business. "Meridian" refers to Meridian Asset Management (C.I.) Limited. This document is provided for interest only. Any opinion expressed in this document is a matter of judgement at the time of writing and may be subject to change without notice. No representation or warranty, express or implied is made nor responsibility of any kind accepted as to the accuracy, completeness or correctness of the information stated herein or that material facts have been omitted. The information contained in this document is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product or service by Meridian. Various products or services referred to in this document are subject to legal and regulatory requirements in applicable jurisdictions. They may not be available in all jurisdictions. Meridian makes no representations about the suitability of the information published in this document for any purpose. It does not constitute investment advice. No information contained or referred to in this document should be construed as such. A professional adviser should be consulted with respect to your particular situation. The value of investments and the income derived from them may fluctuate and you may not receive back the amount originally invested. Past performance is no guarantee of future performance. Currency movements may also affect the value of investments. The investments and services referred to in this document may not be suitable for all investors.

© Meridian February 2017