Franklin Templeton’s Notes from the Trading Desk offers a weekly overview of what our professional traders and analysts are watching in the markets. The European desk is manned by eight professionals based in Edinburgh, Scotland, with an average of 15 years of experience whose job it is to monitor the markets around the world. Their views are theirs alone and are not intended to be construed as investment advice.

Last week, global equity markets showed signs of running out of steam as they fell from recent highs and a general “risk-off” tone was evident. Profit taking in certain sectors and some disappointing macro data from China seemed to act as a catalyst for these moves. Meanwhile, over the weekend, talks to form a new government in Germany collapsed, contributing to increased market volatility as we kick off this week.

The Digest

German Coalition Talks Break Down

On the first day of trading this week, the collapse of talks between Chancellor Angela Merkel and potential coalition partners to form a government in Germany has captured attention.

The talks between Merkel’s Christian Democratic Union of Germany (CDU), the German Green party and the Free Democratic party (FDP) have been running for five weeks. While it was known they were stalling on issues of immigration and tax policy, news of the collapse still came a surprise to many observers.

If Merkel cannot reengage with her partners to establish a coalition, her options appear to be somewhat limited:

- Try to form a minority government with the Greens;
- Call fresh elections;
- Form a coalition with the Social Democratic Party of Germany (SPD).

This last option would be unlikely as the SPD had previously ruled out a coalition.

Given Markel’s previous political longevity, we think it would be too hasty to write her off yet, but this is perhaps the greatest test she has faced in recent years. For many years, observers have regarded her as the stable figurehead of Europe. If she were to fail to form a new government, it could unsettle markets.
Whatever the outcome, it is important to remember that Germany remains on a sound economic footing. Third-quarter gross domestic product (GDP) data released last week came in ahead of expectations.

**Brexit Negotiations Weigh on UK Sentiment**

Investor sentiment towards the United Kingdom remains brittle as uncertainty surrounding Brexit negotiations remains a concern.

It appears to most that Brexit talks are deadlocked over a variety of issues.

UK Prime Minister Theresa May’s hold over power continues to look fragile amid reports she could face a no-confidence vote from members of her own party.

Still, her government managed to progress its European Union (EU) Withdrawal Bill through Parliament, albeit by offering concessions such as a vote on the final deal to MPs.

Meanwhile, there are reports the United Kingdom could be prepared to increase its offered contribution to the Brexit divorce settlement to €40 billion, halfway between the current €20 billion offer and the EU’s €60 billion demand.

Although sentiment remains weak in the United Kingdom, and UK equities appear to remain out of favour, we believe it could be interesting to see the impact on equity markets if there were to be some positive news from the negotiations.

**Last Week**

**Europe**

A stronger euro acted as a headwind for European equities last week, with markets lower across the board. Supportive macroeconomic data and central bank commentary boosted the euro currency as yield curves flattened, commodities sold off and investors took some profits. The United Kingdom’s equity market was a relative outperformer, while equities in Italy underperformed last week, driven lower by weakness in the Italian bank stocks.

Oil and gas, basic resources and utilities were the worst-performing sectors. Weakness in basic resources was largely attributed to underlying commodity weakness following disappointing Chinese macro data.

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**LOOK OUT FOR... (NOVEMBER 20 - 27):**

**Monday, November 20**

- German PPI Link
- ECB President Mario Draghi Speaks at the ECON Hearing at the European Parliament, Brussels, Belgium Link
- ECB Board Member Sabine Lautenschlager Speaks at the IIF European CRO Forum, Frankfurt, Germany Link
- RBA Publishes Monetary Policy Meeting Minutes Link

**Tuesday, November 21**

- UK Public Sector Finances Link
- ECB Board Member Benoît Coeuré Chairs Policy Panel at the ECB Conference “Public Debt, Fiscal Policy and EMU Deepening”, Frankfurt,
On the macro front, German GDP came out strong, while GDP and consumer price index (CPI) for the eurozone were in line with expectations. In the United Kingdom, CPI and unemployment remained at 3% and 4.3% respectively.

**Americas**

It was a mixed week for US equities as uncertainty over the Trump administration’s proposed US tax plan and the continuing Russian probe weighed on the US dollar.

As expected, the House passed its US$1.5 trillion tax-reform legislation on Thursday (November 16) and the Senate Financial Committee advanced its own measure along party lines with a vote expected after the Thanksgiving holiday (Thursday 23).

The difficulty now is that Republican lawmakers must find a way to bridge the big differences between the two bills, especially the timeline for implementing corporate tax cuts.

Another factor which weighed on the US dollar was the latest report covering the former FBI Director Robert Mueller’s probe into alleged Russian interference in the 2016 US election.

Outside of those issues, it was a busy week for US macroeconomic data. The much-anticipated release of the October CPI was in line with expectations, and saw little reaction. Retail sales, industrial production, producer price index and housing starts were all better than expected.

**Asia**

A number of lacklustre macrodata points weighed on China, as retail sales, industrial production and asset management growth came in below estimates. Volatility in the Chinese bond market also weighed as yields spiked. Elsewhere, Japanese equities was another drag on the region. The stronger Japanese yen was a factor, and Japanese GDP growth missed estimates, further weighing on sentiment.

**Crude Oil**

The price of crude oil settled lower last week (a stark contrast to recent moves), with a few economic moves at play. Firstly, Chinese data disappointed with the key data point, industrial production, reporting a fall. The weaker showing immediately raised concerns about demand. This was complemented by an announcement from the International Energy Agency (IEA), which cut its demand forecast for 2018.

The IEA report offset an earlier statement from the Organization of the Petroleum Exporting Countries (OPEC), which said it had increased demand forecasts for 2018.
Finally, it was interesting to see Norway’s sovereign wealth fund, the largest in the world, announce it was proposing to remove oil and gas holdings amid fears it was overly exposed to volatility in the commodity. The initial market reaction was relatively subdued.

Week Ahead

Monetary Policy

- Minutes from the most recent monetary policy meetings of the Federal Reserve and European Central Bank are scheduled to be published on Wednesday and Thursday (November 22 and 23) respectively.

Economics

- Markets will be closed on Thursday (November 23) in the United States (Thanksgiving) and Japan (Labour Thanksgiving).
- In Europe, we expect the following data points to be published: German PPI; UK public finances; UK Autumn budget; German GDP. US data points will be limited due to the holiday-shortened week.

Politics

- Focus will be on the aftermath of the collapse of German coalition talks.
- The UK Autumn budget will be unveiled on Wednesday (November 22), where focus will be on inheritance tax, housing plans, utility price caps and North-Sea oil investment. The reaction to the budget might be seen as a key barometer showing how much confidence there is in Theresa May’s government.
- On Brexit, EU leaders convene to assess negotiation progress ahead of next month’s summit.
- In the United States, we’ll continue to watch for any progress on tax reform.

Views You Can Use

Insight from Our Investment Professionals

Structural Growth Drivers Behind Emerging-Market Economies

The Templeton Emerging Markets Group have been championing the message that emerging markets have changed—they are no longer just commodity plays. Old economic models are undergoing a transformation in many cases, opening up exciting new investment opportunities. Here, Carlos Hardenberg, executive vice president and managing director, explains how the changing consumer dynamic in emerging markets has driven the demand for new and innovative goods and services. Read More.

Self-Driving Vehicles: Evaluating the Possible Impacts

The race to develop truly autonomous vehicles continues to pick up speed. Not only are passenger cars in the race, but also trucks and buses. Autonomous vehicle technology truly holds the potential to reshape many industries, in ways we probably haven’t even thought of yet. Recently, Franklin Templeton Investments assembled a panel of industry experts to talk about where they see the future of self-driving technology, and how long they think it will take to get to the finish line. Read More.

Croatia’s Many Cultural Ties
Mark Mobius documents his recent travels to the popular tourist destination of Croatia, and shares why he thinks the Eastern European country could hold interesting future investment opportunities. Read More.

**A Story of Risk Management, and Flying to the Moon**

Risk management is a key part of many endeavors, from space travel to investment management. In either case, achieving one’s goals requires awareness of what could go wrong, as well as careful attention to details in often-changing conditions to ensure the smoothest possible journey. Tilak Lal, vice president, Performance Analysis & Investment Risk at Franklin Templeton Investments, describes what risk is within the investment space, and how risk management is essential to success. Read More.

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Past performance is not an indicator or guarantee of future performance.
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