the technical analyst
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FINALIST

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Multi-Asset Market Update:

UPDATE
Technical
Fundamental

The accelerating UK Gilt market

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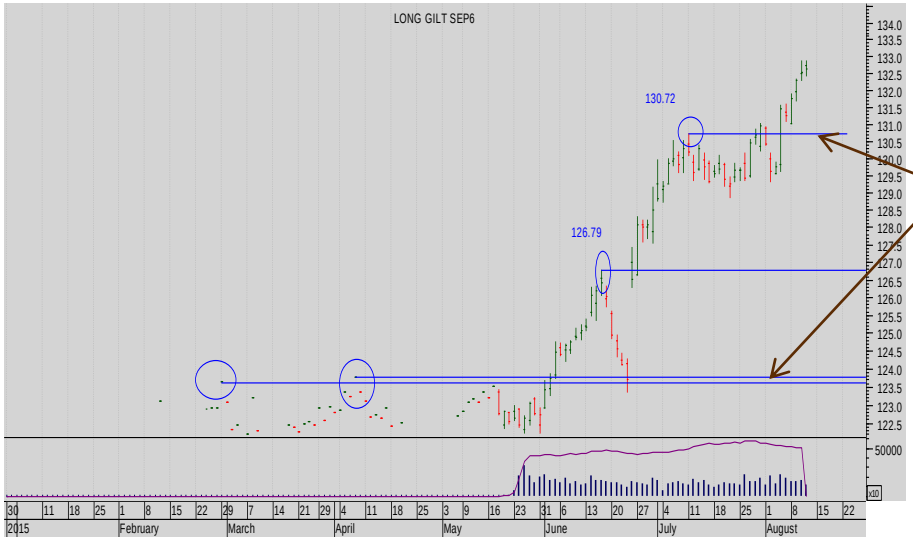
iShares UK Gilt chart

The exponential rally through the top of the ten-year long-term bull channel in the Gilt market is extraordinary.

Note the well-structured bull trend within the channel:

The bounces off Prior Highs, the completion of a continuation H&S pattern…

But the break of the channel places the rally into a different dimension.



DAILY Gilt Sep16 futures chart

The exponential rally of recent months is as well-constructed as the long-term rally: <u>note the successive bounces off Prior Highs</u>.

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FUNDAMENTALS:

The Gilt is currently in a full-blown bull market, that has for the first time, turned yields negative. That means investors are effectively paying the UK Government for holding its debt.

But what intrigues most about the current rally is that in the weeks leading up to the "BREXIT" vote politicians were constantly warning about the negative impact a vote to leave the EU would have on the UK economy, government finances and foreign direct investment.

The implication was clear: if the UK voted to leave disaster would strike!

1. The Pound would sell off hard,
2. The economy would experience recession,
3. Government finances would be wrecked
4. Direct inward investment would dry up.

The Pound has sold off. But it has established a trading range of 1.28 – 1.33 over recent weeks .

The economy may yet experience recession. It is still too soon to tell, but recent PMI surveys have been weak.

Government finances may need some tweaking, but the threatened emergency budget has been dropped and the target of running a surplus by the end of this Parliament has too.

As for investment, several large foreign firms have committed to remaining engaged with the UK and several large economies; the US, Canada, India and China are more than open to negotiating trade deals with the UK, even though the terms of the UK's exit from the EU have yet to be agreed.

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FUNDAMENTALS: CONTINUED

Clearly the installation of a new Prime minister and government so quickly after David Cameron resigned on the morning after the "BREXIT" vote result was announced has gone a long way to steadying nerves and restoring a good degree of confidence.

Additionally, unlike when the financial crisis hit and the Bank of England was slow to react seven years ago, the Bank has been clear from the start about how it saw the risks to the economy and what it was prepared to do to stabilise the situation.

True to their word, last week the Bank of England cut interest rates to their lowest level since the Bank was founded and increased its asset purchase program by £60 Bn. This makes the Bank a very major player in the gilt market. So although the AP program had remained static at £375 Bn for several years, prior to last week's announcement, the Bank has been actively managing its portfolio, replacing maturities when needed.

So far from investors fretting that the UK authorities might have to run up a bigger deficit, they are focussed on the current still low level of inflation, and the relatively robust state of the public finances and the Bank of England's presence in the Gilt market.

So, how much higher can the Gilt go?

We judge this market can rally a good deal further. The Governor of the Bank of England has said rates can fall further and they can increase the AP target too. With the UK's debt maturity profile relatively long at around 12 – 13 years, there is no pressure or indeed problem facing the government about financing its debt. In fact, with gilt yields so low, the authorities may decide to issue new 30-year debt to finance infrastructure spending. Then the Bank of England could obligingly buy that new 30-year debt.

In summary, global bonds remain supported and the UK Gilt especially so.

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