TRY-based assets recovered quickly to see a significant positive decoupling in December...

The BIST saw a significant decoupling, testing new highs in December…

The BIST has recovered quickly, advancing 11% on a monthly basis to close at 115,333 at the end of December 2017, after having reached a new all-time high of 115,840 within the month. The index had decoupled somewhat negatively in November. Yet, thanks to the resolution of the US visa issue, fading negative expectations regarding the Zarrab case, strong growth figures, and its relative discount compared to other EMs, it saw a significant positive decoupling in December 2017. Coupled with relative TRY appreciation against USD, the BIST10 was one of December's best performers among the MSCI EM, closing the year in parallel with this index having outperformed it throughout most of the year, excepting its strong decoupling after September 2017. Global risk appetite was also strong and supportive, with Mr. Powell's nomination as the US Fed's next Chairperson, and on unaffected expectations of three further gradual rate increases from the Fed in 2018.

The Fed has increased policy rates to a range of 1.25% - 1.50%, as expected…

The Fed increased its policy rates by 25bps, as expected, to the range of 1.25%-1.50% at its last meeting in December. FOMC members have maintained their expectation of policy rates rising to 2.10% at end-2018 via three further gradual 25 bps rate increases. The minutes of the meeting underlined that economic activity had continued to expand at a moderate pace, with growth expectations raised to 2.5% from 2.1% previously in the latest set of quarterly forecasts for 2018. Risk appetite for the EMs was, thus, sustained following this decision; TRY-based assets in particular were positively affected. The ECB maintained its policy rates and stimulus plans unchanged at its last meeting in December; in October 2017 the central bank had announced a reduction in the monthly level of its purchases from the current €60bn to €30bn from January 2018 onwards until September 2018.

The CBRT has increased the LON lending rate by 50bps to 12.75%…

The CBRT increased the Late Liquidity Window (LON) lending rate by 50bps to 12.75% at its December 2017 meeting, leaving all other interest rates unchanged. The market had expected at least a 100bps cut in the LON rate. Yet, thanks to rising global risk appetite, TRY depreciation has remained limited. The MPC minutes underlined the robust course of demand conditions and strong loan growth. The CBRT has also said that current levels of inflation, and the fact that inflation expectations and pricing behavior indicate no sign of improvement, jeopardized the inflation outlook. Duly, the Committee decided that the weighted average funding cost is to be increased by 50 bps to 12.75%. The TRY regained strength, rising against the US$, also supported by rising global risk appetite and resolution of the US visa issue. The currency gained c.3.5% against the basket. The CBRT expects inflation, which has reached 13%, to decline gradually.

The focus will be on the Fed policy decision and FOMC members' statements…

The markets will be Fed-watching in January as well; among key topics is prospective new board members. US inflation announcements, the main indicator of the Fed's rate decisions, will also remain under close scrutiny. Global risk appetite for EMs is expected to continue should the US inflation outlook indicate that inflation is not raising to the 2% level persistently. However, should inflation trend above the Fed's 2% goal, expectations of the central bank raising policy rates faster would increase, which could in turn pressure the EMs, led by TRY-based assets. Meanwhile, even though they are not on the agenda, geopolitical risks such as North Korea and Syria will remain relevant. Weaker Chinese data prints may also curb global risk appetite. Yet, appetite seems set to persist, with EMs decoupling positively in January as well. The recent rise in oil prices could especially favor oil exporting countries, which might prompt some underperformance of TRY-based assets among the EMs.

The BIST is expected to test new highs in January…

Locally, investors will follow geopolitical and local developments, namely bilateral relations with the US, the result of the Zarrab case on January 4th, and the EU. Fitch's rating review will also feature. On the macroeconomic front, the CBRT's policy decisions and other macroeconomic data led by inflation announcements will be key topics of the moment. The BIST is expected to advance in January, too, testing new highs with fresh positioning of institutional investors. Yet risks pertaining to the US case may spark swift negative pricing in the market. Overall, TRY-based assets are expected to advance with intermittent profit taking in January, due to the BIST discount compared to EM peers to the backdrop of sustained risk appetite for EMs, amid expectations of the Fed gradually raising its policy rates in 2018, and the ECB and BoJ maintaining their expansionary policies.

We maintain the distribution of our portfolio in January…

In light of these expectations, we maintain the distribution of our portfolio at 55% in bonds, 15% in FX and 30% in equities.