# Melville Douglas Income Fund Ltd - USD Income Class

Minimum Disclosure Document as at 30 September 2016

## Quarterly Commentary

The Federal Reserve continue to delay what is becoming a much called for second hike in interest rates. Ongoing ultra-low rates and QE are not only losing their effectiveness but more worryingly, continue to play their part in prolonging yields at artificially low levels. Without doubt, US economic data is not robust but does continue to grow at a pace that is not consistent with interest rates in the 0.25% to 0.50% bound. Having spent much of 2015 hovering around 0%, headline inflation, now at 1.1%, appears to be on an upward trajectory and importantly, the negative base effects of a strong US Dollar and falling oil price are slowing dropping out of the equation. Job growth remains solid, buoyed by the service sector, and is arguably at or close to the full employment level consistent with ongoing wage growth.

Turning to the US Dollar, our outlook over the short term remains positive and the Fund remains at a full 100% weight. The long awaited second US policy hike should become a reality in December, further benefitting the already positive interest rate differential versus other majors such as the Euro, Yen and Sterling. However, over the longer haul we have reservations that the currency can continue to rally at the pace experienced since 2011. Arguably, much of the positive news has been factored in and unless the future pace of hikes proves to be more aggressive than anticipated, an element of profit taking may ensue. A Trump victory in November also carries concerns as populist policies such as tax cuts would both stoke inflationary pressures, lowering real returns and widen the US's budget deficit.

Much remains speculation of course but for now, the US Federal Reserve remains in tightening mode whilst all others continue to ease. Taking a global view, our view on government bonds remains unchanged. Low, and often negative, interest rates combined with massive quantitative easing experiments have instilled a false sense of security in the debt markets that central banks will forever step in and save the day. Essentially, this safety net needs to remain firmly in place for yields to continue to languish at these low levels. To understand this connection is vital, as we are starting to see signs emerging that central banks are at their limits and the mere hint of less ultra-easy accommodation, in whatever form, should provoke a lift in yields. Historically, a jump in yields would be cushioned by a much higher coupon return but with about 70% of global government bonds yielding less than 1%, the outlook is somewhat less comfortable. The Fund remains defensively positioned with a short-duration strategy until such time as yields rise to levels that we view as attractive over a medium to long term horizon.