NBAD
From West to East
Weekly Investment View
1st May, 2016

Central banks driving into summer...

The S&P500 fell 1.2% on the week, the EuroStoxx fell by 1.8% (partly due to a firmer euro), and Japanese equities fell 4.8%, adversely affected by the renewed strength of the yen, and perhaps a sense that the BoJ has run out of stimulus options. In the US, technology and healthcare stocks were hit hard, the highlight of which was the notable results miss by Apple, the world's largest company by market value, which investors believe may have gone ex-growth. On the US earnings front, according to Goldman Sachs, with about two-thirds of US companies having reported first quarter earnings thus far, the results are similar to historical averages. Elsewhere, oil prices continued firm, to just below $46 on WTI (a fraction above our chosen range - see below), as did gold, having traded up to $1,293 currently, driven by dollar weakness and the belief that US rates are unlikely to move by much (if at all) in June. Meanwhile, the US bond market has been steady, the Bunds less so, the latter probably registering a better-than-expected growth performance by the eurozone in the first quarter (an annualized rate of 0.6%), comparing quite well with US first quarter GDP, which came in at 0.5% (below expectations of 0.7%). The most significant happening this week has been continued dollar weakness, aided and abetted by euro and yen strength. ***For the time being we remain 'neutral' in US and eurozone equities, and underweight in Japanese equities. Our preferred and overweight equity class is still Global Emerging Markets.***

"Fed thinks global risks have abated"

Bearing in mind the current remaining uncertainty in many equity markets, and/or the trading range mentality that we are seeing, the time could be right to re-visit high dividend yield stocks. Academic studies have shown that funds run on this basis outperform the main equity indices over time, with the exception of periods of the most extreme financial stress. The key here is for portfolio managers to not go for too much yield (i.e. so high that dividend cuts are inferred), but to look for maybe dividend yields of perhaps 15-20% above those on a standard benchmark. The core component of such funds tend to include tobacco stocks, which produce large free cash flows, and for reasons generally understood tend to trade at above-average yields. ***Income/high dividend yield funds provide the kind of defensive attributes that look applicable to current equity market conditions.***

The wording in the statement following last week's FOMC meeting confirmed that a rising savings rate on the part of consumers is adversely impacting growth in the US economy, as is slack business investment (and lower exports). Excerpts from the statement included, **'**Growth in household spending has moderated, although households' real income has risen at a solid rate and consumer sentiment remains high. Otherwise, '...business fixed investment and net exports have been soft'. Inflation is still running below their 2% target. As expected, rates were left unchanged, although the more dovish tone of the statement (there was no press conference) reduced the probability of a 25bp rate increase in June from 33% prior to the meeting, to 19% afterwards, and just 12% as we go to print. The Fed stated that, '...the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run'. Crucially, the Fed regarded global economic conditions to be less worrisome than in recent months, at least that is how we read the omission of the previous statement referring to this collection of factors. ***The Fed made it clear they see the US economy is weakening, and accordingly we expect a maximum of one rate hike in the current year at the very most.***

Durable Goods Orders in the US rebounded in March, but missed expectations quite badly. New Orders came in at +0.8%, short of expectations of about +1.9%. Capital goods orders ex-defence were flat (vs. expectations of +0.6%, month-on-month). These so-called 'core' capital goods orders were previously reported to have decreased 2.5% in

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February. Economists had forecast 'core' durable goods orders growing 0.8%. The report implied weakness in business spending had continued, and ushered in a low Q1 GDP estimate, as had other recent reports on retail sales and personal consumption. In other data, the Conference Board's consumer confidence index softened in April, to 94.2 (vs. expectations of 95.8), and from a downwardly revised 96.1 in March, thus completing the picture. The services sector isn't doing so badly, however, with Markit reporting that their 'flash' services PMI came in at 52.1 (in line with expectations of 52.0), compared to 51.3 for the previous month.

"Market quietly likes BoJ caution?"

Turning to Japan, the BoJ last week refrained from expanding monetary stimulus, as Governor Kuroda and his colleagues are taking more time to assess the impact of negative interest rates. Many forecasters had expected an increase in overall monetary stimulus, so the decision to do nothing came as a disappointment to the

market. The BoJ also pushed out their time frame for reaching their 2% inflation target to the second half of 2017. The yen jumped after the announcement, however, with the market in reality applauding a more cautious approach, with monetary policy on hold. Many would like to see a greater emphasis on fiscal policy, and also Prime Minister Abe deciding to postpone a sales tax increase originally scheduled for this April.

According to Bill Sarubbi's 'Cycles Research', the 'Sell in May' (SIM) effect commences in the first week of May - but what is the reality? The period from 5th May to 27th October has contributed just 0.1% to the S&P's annualized gain of 8%+ since 1950. Certainly, the past may not always be a good guide to the future, but it might be instructive.

"Sterling has risen far enough for the moment"

The UK's manufacturing and construction sectors had a hard time in the first quarter, with the economy only growing by 0.4%, after growth of 0.6% in the final quarter of 2015. Industrial production contracted by 0.4%, while the construction sector shrank by 0.9%. Furthermore, the Bank of England Governor, Mark Carney, warned that leaving the European Union could result in higher inflation and lower economic growth. In a letter to a Select Committee, the Governor suggested that leaving the EU could lead to a stagflation-type scenario (a combination of stagnation and inflation). The OECD also weighed-in, saying British families would be worse off with a Brexit. Cable pushed 10 week highs above 1.46 as the polls have been showing some consistency in favour of the UK remaining in the EU, so sterling bears have been stopping themselves out. As our forex experts advise, sentiment remains cautious, however, with the currency remaining prone to the occasional bad headline before the 23rd June, and especially if the UK economy continues to underperform. ***Sterling is probably fairly valued for the moment; the Brexit risk remains, however.***

The FT has reported that China's debt total climbed to 237% of GDP in the first quarter, an all-time high. Data from the Bank of International Settlements shows China's debt load is far greater than emerging markets as a whole, which carry debt at an average of 175% of GDP. The IMF has expressed growing concern about China's corporate debt issues, and has urged Beijing to respond in much more effective ways. Debt-for-equity swaps could play a role, they said, but so-called 'zombie' firms should not be allowed to continue to operate. Some 60% of non-performing loans in China are owned by state-owned enterprises, and are concentrated in a few distressed industries, the IMF said. We are ourselves becoming much more aware of the extent of China's problems, not just in terms of some of the layers of debt, but also for instance the huge environmental clean-up that has to be effected over a period of years. The services sector, however, is now likely to be more than half the Chinese economy, while the nay-sayers conveniently overlook the very high domestic savings rate. ***The current exposure to Chinese equities via our TAA model portfolios is very limited, however, mainly because the MSCI effective weightings are low.***

"A period of assessment in Saudi assets is due"

The IMF has been reassured by the efforts of GCC states to address their fiscal positions following the reduction in oil revenues, and they were also complimentary about Saudi Arabia's proposed National Transformation Plan (NTP). Saudi equities have recovered about 22% from their 16th January lows, and there is clearly some excitement about the NTP (which reminds one very much of the 'Abu Dhabi Economic Vision 2030'. ***There are a range of sectors that could benefit from Saudi Arabia's Plan, although it looks as though a quieter period in that equity market might be expected, following the initial disclosure of the Plan.*** **Staying with the work of the IMF in our region, they now expect economic growth in the Gulf states to slow to 1.8% this year as the oil-dependent region cuts spending to battle fiscal deficits reaching 11.6% of GDP.** Within this, they revised their growth outlook for the UAE, with real GDP growth now forecast to be 2.4% in 2016, compared to 3.9% in 2015. Abu Dhabi Emirate is expected to grow at 1.7% in 2016, vs. 4.4% last year, with Dubai expected to grow 3.7% this year, up slightly from 3.6% in 2015. ***If anything like these numbers can be achieved, they will in all likelihood compare very well with much of the developed world.***

As mentioned earlier, oil prices had a very good week, closing a few dollars above our previously assumed trading range limit of $45, basis WTI. We will this week increase our average price forecast for this year and next by a few dollars. In summary, oil prices have ignored continued net additions to US oil inventories, helped (we think) by the weaker dollar, reasonable demand elsewhere in the world, and supply-side pressures and sentiment emanating from current events in Iraq, the discussion over locked-up Iranian assets, and ongoing operational difficulties in Nigeria, amongst others. US Energy Information Administration (EIA) data showed that US crude inventories climbed 2 million barrels at the end of last week (vs. expectations of +2.4 million), and Baker Hughes reported that the weekly US oil rig count fell by 11 to 332 (vs. 679 oil rigs operating at the same time last year). US oil output declined for a seventh week, according to government data, so US output has declined almost 300,000 barrels a day from this year's high in January. Nationwide, inventories have increased to 540.6 million barrels, more than 100 million barrels above the 5-year average. ***We still expect the price of WTI to be capped at about $50 in the immediate months to follow, as at this price more and more US shale producers once again become profitable. The bottoming process undoubtedly occurring in global oil markets is likely to stretch into the final quarter of the current year.***

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