NBAD

From West to East

Weekly Investment View

5th June, 2016

Keep The Faith With An Unchanged Strategy…

'OPEC disappoints on lack of production cuts, Draghi presses ahead'

Jon Bon Jovi the famous rock singer produced a song in 1992 'Keep the faith' the chorus of which echoes our investment views this week. A continued reluctance by the market to make further progress in sentiment hampered by 'Brexit', US electioneering as well as the US FOMC meeting on June 14th has left that feeling of 'rain' (as the song goes) in a 'what will happen next scenario'. The barometer of risk, the US 10 year Treasury continued to fall short of the 2% level with yields contracting further to 1.7% as investors remained somewhat sidelined last week. Investors still seem to have appetite for longer duration US Treasuries in continued holdings that reflect safety. With Ramadan fast approaching, it was a timely OPEC meeting that took place last Thursday. In that meeting OPEC ministers rejected a proposal to adopt a new output ceiling in a unified view that perhaps global oil markets are improving. Crude dipped on the news with the $50 a barrel slipping away from bullish bets taken over the weeks by traders some of whom expected a production cut might be announced. The WTI measure closed at $48.62 a barrel. This despite earlier in the week US stockpiles of crude oil dropping more than expected. MENA markets were already slipping before the news with the DFM -2.2% and the ADX -0.6% on the week**. Crude oil continues to trade within our $35-$50 view. $50 looks a resistance level until fresh impetus on global growth is confirmed before the next move up eventually to $60 a barrel which would be the ceiling for this year.** In Europe, Mario Draghi the President of the ECB left policy unchanged. He raised 2016 inflation forecasts for the Eurozone by +0.2% while outlining inflation expectations remained unchanged at 1.3% for 2017 and 1.6% for 2018. He reiterated the ECB's Quantitative easing program of injecting EUR 80Bn a month to counter the effects of the very low inflation environment that continues to dog the Eurozone.

Commentators highlighted the lack of growth progress despite the expanded stimulus being launched 3 months ago**. What was more important was the provision for corporate bond buying announced back in March that will start this week on June 8th Draghi said. This along with a -0.4% deposit rate in force should trigger Euro denominated assets buying. European high dividend stocks and high yield should outperform in the coming months we think.** German Bund yields continued to compress over the week reflecting the European QE panacea. **Prior to the ECB announcement, the TAA took the decision to book some profits closing half of its position in the EUR/$ foreign exchange hedge that was long the US Dollar.** Overall the committee still remains long US Dollars. No other changes were made to the other asset classes at the meeting last week.

'The Greenback Abandoned on Friday'

US markets had a 'speculative' feel last week with indices finishing flat. What started with talk of impending higher US interest rates ended quickly with a reversal in Dollar strength seen over the week. Weak US payroll data for May disappointed Dollar bulls. Ahead of the US FOMC rate setting meeting, markets paired expectations for a June rate hike to just a 4% chance after the numbers were released. July was put at a 34% chance. A stark and somewhat emotional reversal it seems. Some commentators had said the data may have been distorted somewhat by seasonal factors including a strike last month at US tech company Verizon. This may have contributed to the softer number. The Dollar index fell back sharply back a 3 week low trading at 94 from 95.5 a few days earlier . Despite this 'flash' move, the US economy on the whole continues to demonstrate resilience with a continuing improving macro picture when looking at recent data points. Employment growth still remains on track with inflation beginning to show some signs of growth when it comes to wages. The

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impending 'Brexit' vote on June 23rd may be a short term deterrent to raising rates in June but we still believe a 'one rate increase' could happen as a preemptive inflation strike by the US Fed in the coming months. It's more a case of when not if. **Overall, the normalization of US interest rates remains very much on the table we believe**. For year end 2017 we are still expecting Fed funds to reach a 'normalized' 1.5%-2% rate. Investors should still be positioned in the longer term in the US dollar where growth is expected to outpace others in G3. A continuing positive interest rate differential versus the Euro and the Japanese Yen should see Dollar gains continue. **Last week we discussed the merits of being invested in US Financial stocks in raising US rates.** Banks and investment companies are able to make bigger profit margins with these increasing rates. We would expect outperformance over time in their share prices which have been lagging US stock markets so far**.**

'India - Rajan the cog in the Modi machine'

Resignation rumours continue over

Reserve Bank Of India's Governor, Raghuram Rajan. Behind the scenes the question is whether the Modi government has been trying to persuade him to stay on? His policies of high interest rates and a stronger Rupee to fight inflation has impacted an already slowing Indian economy. His decision to quit could also be because of criticism from within the Finance Ministry. It would be a near 3 year tenor if it were to end. One thing is for sure, internationally he is well liked. The once youngest person to hold the Chief Economist role at the IMF does not happen by accident. Like Narendra Modi (India's Prime Minister), he has a track record of performance. A Rajan departure could risk divestment in India to the tune of Billions its feared if he were to leave. Modi himself is being tested by India's Congress on the ratification of his policies. Barring these events, the market sees positives in the dynamics of the Indian economy longer term, particularly in Indian manufacturing. China as a manufacturer is increasingly looking less competitive over time when compared to India. It would be all systems go if the current challenges Modi faces with Congress can be overcome. The Indian stock market trades at a P/E of over 20, that is expensive when compared with other global emerging market equities and compared to India's historical P/E ratio. Indian bank balance sheets remain under pressure as well as an earnings season that has just ended that was disappointing. The BSE Sensex is up +2.78% YTD and looks fully valued. **As per the TAA position on emerging market equities we remain neutral. We apply the same rationale to India given where cheaper valuations on a pull-back would be a better entry point to Indian equities.**

'A theme to watch – Iron Ore and Palladium'

Commodities have been in a bear market for the last 5 years almost in tandem with a slowdown in the mega consumer of them, China. Iron Ore slumped in January along with most markets around the world. The Chinese contract at the port of Qingdao (62%) the measure most closely watched in the space fell to below $40 a ton back then. The contract rallied to $70 a ton this April after technical indicators showed it had been oversold along with Chinese trading that reached a frenzy through derivatives contracts that distorted iron ore pricing. We started revisiting the lows again last week where prices revisited $50 a ton. We have been saying over a number of weeks the merits of looking at the Chinese stock market but have fallen short of making a firm recommendation until Chinese data starts to look convincing again. The same could be said for iron ore. The major producers of the world Brazil and Australia export two thirds of the world's supply. The bulk of this goes to China. The technical argument on iron ore suggests that perhaps a Chinese recovery could be around the corner with demand for the metal remaining high despite the pull back in prices this year through increased supply by the major producers. This was debated at the TAA last week as one to watch, especially if a Donald Trump 'Make America great again' through infrastructure spend triggers further demand for the metal post US elections (should he win). Gold as a metal seems to always get the spotlight with a mixed reception by markets. The debate continues as to whether the metal remains a 'store of value' in times of uncertainty with a rising Dollar normally a headwind to price appreciation historically. The TAA continues to remain unconvinced with respect to gold investing. Palladium on the other hand, the silvery metal used in the manufacturing of cars has been quietly bottoming out as well. Car manufacturers globally have been posting strong sales this year. 70% of the metal is mined in Russia. With sanctions in place on Vladimir Putin and his inner circle, supply from Russia has not been as easy as it was in the past. This factor along with the demand outlook could just be the catalyst for the metal to start seeing a prices move upward like iron ore. It was debated at the TAA and one to watch as well.

'What's in store for the week ahead'

Markets for now are expected to tread water ahead of the US FOMC meeting June 14th. This Thursday sees US jobs claims data that will be watched closely . Wednesday will be an important day for China with trade data in the import/export numbers for May. Tuesday sees the publication of European GDP data. In Japan we have Q1 GDP data published on Wednesday. Thursday will be Japanese Machine Order numbers that will give us clues to the Yen's resilience with respect to Japans manufacturing sector. Here in the GCC new issues continue to be the focus in fixed income markets. Commercial Bank Of Qatar, TAQA (National Oil Company Of Abu Dhabi) as well the Sultanate Of Oman sovereign bond issues are this week's business. The recent deals launched last week continue to hold their own with several issues trading at a slight premium to the new issue price. MENA bond spreads narrowed last week when compared with emerging market ones. This factor along with more stable crude oil prices has seen good appetite for deals that is positive going into Ramadan where liquidity is expected to be challenging in the weeks ahead. All in all the wait and see picture will be played out in the weeks ahead.

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