NBAD

From West to East
Weekly Investment View
6th of November, 2016

Markets Braced for US Elections Next Week

The US presidential election is just a few days away now. Market volatility started to pick up last week. American stock indices gave back ground last week with the S&P 500 closing down -2.15%. The technology heavy Nasdaq composite was down -3.17% on the week as nerves elevated on a race being too close to call. Global markets started to feel a chill also, the Euro Stoxx 50 index was down -3.93%. Other major markets around the world registered losses also. The volatility index (VIX) spiked on the nerves. The US dollar which has been resilient since the spring also started giving back gains. The Dollar index (DXY) pulled back from recent highs that were close to 100 trading back to 97.065 at the close on Friday. Markets are wrestling with what the economy would look like under a Republican Donald Trump policy versus a Hillary Clinton one for the Democrats. Wednesday last week ended up being a non-event at the Federal Reserve Open Market Committee (FOMC) meeting that resulted in no change in policy on US interest rates markets expected. All attention will be on next month's meeting where it is widely expected that Fed Chair Janet Yellen will raise benchmark rates 25 basis points that would take the Fed Funds rate to 75 basis points from 50 basis points currently. US data points throughout last week continued to be encouraging. ISM manufacturing and personal spending all came in ahead of expectations following on from the previous weeks US Q3 GDP beat of 2.9%. Last Friday's jobs claims numbers were slightly below expectations. October payroll gains came in at 161,000 versus 173,000 expected. The previous month's data had a strong revision upward to 191,000 jobs versus the 156,000 originally reported. All in all, this kept the gradual rate tightening argument alive and well barring next week's election result.

"The next US President – The blame game of 'Will she or won't he?"

Singer and song writer Boy George produced the track the 'The Crying Game', a song that reminds one of former Republican hopeful Ted Cruz's failed campaign to run against Hillary Clinton. In the end Trumps tenacity and resilience came through to voters and cannot be underestimated. We have highlighted in recent weeks appropriate hedges should be in place in the event of a Trump win that opinion polls up until now had not been pricing in. The 'blame game' has now taken over from the 'crying game' that is clouding the meaning of both candidate's policies. This is making it very difficult in trying to predict the outcome of who will win.

Why is Trump such a big deal and not Clinton? Markets have taken the view that a Hillary Clinton win will be an extension of President Obama's policies. In other words more of the same to come. While that is not thrilling to some, it represents 'continuity'. Republican hopeful Donald Trump has talked about renegotiating US debt with its creditors suggesting even a 'haircut' on US Treasuries. He's accused the US Federal Reserve of cow towing to the Democrats, an institution that has not been aggressive enough in raising interest rates and serving the economy properly. We all know about his proposed idea of having a wall built at the border with Mexico or vetting 'Muslims' who enter the Unites States. This alarmist rhetoric is precisely what upsets markets. The media and the public at large appear to be focusing on the trading of insults and misdemeanors of both candidates when you look at opinion polls. But it is the sea change in American policy that may possibly ensue that is finally dawning on markets. The Brexit vote of June took all by surprise. Markets don't like surprises. So how are we hedged ? Traditionally in times of risk aversion a number of risk off tools are out there. G3 Sovereign government bonds such as US Treasuries and German Bunds historically have been the place to run. We highlighted several weeks ago that US Treasuries are a tool of confidence in the US economy but in the case of the US election should therefore be avoided. European data as a whole has been improving generally, and we have seen bond yields rise there lately as speculation has started about continuing quantitative easing perhaps being reigned in. Both US Treasuries and Bunds have underperformed. We suggested the best way to protect portfolios would be through

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precious metals in particular gold. In addition to an 80% chance being factored in now for a Fed rate hike in December the headwind of a Trump win could see an initial spike in US treasury yields with the price of the bond falling due to his suggested policy changes. Gold has now crossed the $1300 an ounce level (a 1 month high). **As we approach the election next week, we would advise to continue to hold the precious metals positions to hedge risk portfolios until the result of the election is known.**

"Brexit mania continues – A reprieve for Sterling in the short term"

Two major events took place in the UK last week that had profound implications for the debate on the UK economy as well as Brexit. First up was the Governor of the Bank of England (BOE), Mark Carney. He sought to put to an end weeks of speculation as to whether he would stay at the BOE. While highlighting that he had the full support of Theresa May and the UK Government, he announced that he would stay as Governor until June 2019. This one year extension to his original suggested tenor but shorter than the statutory eight year term, was he said, to help the UK see through the transition of the economy post Brexit. He declined to comment on speculation beyond an extension to that date. Carney had come under criticism for his gloomy forecasts on the outcome of the UK economy post the Brexit result back in June. The market viewed the latest news positively, and Sterling rallied. The currency got a further lift last week on the surprise announcement by the UK high court that ruled UK ministers would have to seek the consent of parliament before triggering 'Article 50' that would start Britain's exit from the European Union. UK Prime Minister Theresa May reassured voters in an article published in the Sunday Telegraph that she would be true to her word in delivering Brexit however things play out. Either way, the two events saw Sterling start the week at $1.2202 versus the US Dollar and end the week at $1.2517. An impressive gain of 2.58% and the best weekly gain by the currency since 2009. While this is welcome news to British asset holders we think this may be temporary relief. Technically the Pound has seen players go short since the onset of Brexit at the same time and in the run up to the US election, the US Dollar's sell off saw Sterling buyers as well as short sellers closing positions on the UK news as well as ahead of the US results next week. **We would caution on taking new long positions in Sterling and see the recent rally as an opportunity to sell. Overall, the asset allocation committee (AA) of NBAD remains long the US Dollar versus both the Japanese Yen and the Euro. Longer term the committee still sees the overall trend in the US dollar remaining higher while also using the Euro/Dollar currency pair as a hedge to the mild 'over weight ' position the committee has to European equities.**

"Asset allocation meeting – The view remains Unchanged"

The committee was in session last week with the various topics debated about the world in addition to the implications of the US election. By and large the committee was in unison not to change any of the weights in the asset allocation model. In MENA markets it was discussed that the situation remains fairly neutral overall with MENA fixed income markets in a holding pattern offering spreads that are still attractive long term compared to elsewhere in the world. MENA equities after experiencing a period of volatility have been very much ruled by the events in Saudi Arabia that we commented on over the weeks and may have found some stability after the Kingdoms bond issuance. Crude oil remains the main dynamic dictating the fortunes of companies in the region with the markets in the UAE continuing to be the regions outperformers. Emerging markets exposure overall within the asset allocation profiles remains neutral overall. The committee stays fully invested in precious metals through gold across all the profiles until the result of the US election as we explained.

Other news last week: S&P upgraded the outlook for Turkey from 'negative' to 'stable' while maintaining Turkey's BB rating. Etihad Airways has started marketing a possible sukuk transaction with issuance of trust certificates. Going forward the outcome of the US election result will give us direction through to the end of the year. The US debt ceiling talks that will start post the result will be the first focus for US markets as well as the upcoming elections across Europe. Neutrality remains the watch word until then. We've mentioned the need for hedges and perhaps an amount of cash to be sidelined where we think opportunities will start to present themselves in the coming weeks where we will comment further to give investor's clarity.

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