NBAD

From West to East

Weekly Investment View

8th May, 2016

Holding your nerve through the summer

Claude-Henri Chavanon

Managing Director
Head of Global Asset Management

In the US the S&P500 closed 0.4% lower over the week, 3.4% below its all-time high achieved in May last year. The US Non-Farm Payrolls (NFPs) for April were very poor (see below), although immediately led markets to assume an even smaller chance of the Fed increasing rates next month – so in that sense alone they were supportive of equity valuations. Opinion is still deeply divided regarding whether the rather tantalizing price action of late should serve to encourage, or worry, investors. The Euro Stoxx 600 index fell 2.9% over the week, reflecting the relative firmness of the euro, despite the late rally in the dollar from oversold, and weak energy stocks. Japanese equities fell 3.2%, very much affected by the continued overall strength in the yen, despite this closing off its strongest levels. Tellingly, the yield on the policy-sensitive two-year US Treasury note fell slightly, by 3bps over the week, to 0.74%, following the NFP data. The 10-Year Bund was firmer, with its yield falling to 0.14%, with recent euro strength likely further restraining inflationary expectations within the bloc. Oil prices rose at the end of the week on news of the Canadian wildfires, but closed about 5.7% lower over the week. The 'risk-off' sentiment elsewhere caused the US 10-Year Treasury yield to fall to 1.78%. Gold briefly traded above the 'roundaphobic' $1,300 level earlier in the week as the dollar weakened, but ended the week down $5, at $1,288/oz. Prior to the release of the NFP stats, a few Federal Reserve officials had been keeping the possibility of a June interest-rate increase alive.

'Why did analysts get the NFPs so wrong?'

Turning to US economic data, the US NFPs for April came in at only 160,000 for April, about 40,000 below expectations, and the readings for the previous two months were revised downwards by a total of 19,000. The stated headline jobless rate held steady at 5.0%, despite a fall in the labour participation rate. On the positive side, average hourly earnings rose by 0.3% month-on-month, and hence by 2.5% over 12 months. Average weekly hours worked edged up to 34.5 from 34.4. According to US private sector data from ADP, private employers added the fewest workers in three years in April, well below expectations, and across most sectors. The payrolls processor showed US companies hired 156,000 people in April, vs. Reuters' expectations of 196,000; although these - like the NFP data - can be revised, this was a big 'miss', and showed that the ADP data can indeed serve as a clue to the subsequent NFP numbers.

Elsewhere in US economic data, the ISM manufacturing PMI index fell to 50.8 in April, from 51.8 in March (and below expectations of 51.4), thus barely signaling expansion. Although not a very good reading, the last two data points taken together are a better result than the numbers of recent months. An increase in export orders helped, together with signs that an inventory overhang had moderated. The manufacturing sector is thought to account for about 12% of the US economy.

'Services are important in US economy, and doing well'

The US ISM Non-Manufacturing (i.e. services) index increased in April, to 55.7 from 54.5 in March, and above expectations of 54.8. The US services sector accounts for more than two-thirds of the economy. New orders grew by 3.2%, and construction firms reported 'severe' shortages of unskilled labor. While this is good news, in other data the consumption side of the economy doesn't look so good, as US consumer sentiment fell to its lowest level in seven months in April, according to the University of Michigan consumer-sentiment index, which fell to 89.0 (vs. 90.0 expected), and below March's 91.0. This is consistent with recent personal consumption and retail sales data, which have been soft, as the average US consumer is saving more. As we have said in recent months, the Fed continues to be in a tight spot - they would like to re-build the interest rate cushion, but cannot when the data doesn't come in strong enough for them to do so. As we have said, this is a problem entirely of their own making by trying to act to raise rates a few years too late - and now the Presidential election is not far away. ***Being in this situation in the run-up to such a visible and important event was totally avoidable.***

Senior figures within the Republican Party have refused to back Donald Trump as the party's nominated candidate in November's Presidential Election, detracting from him being widely referred to as the 'presumptive' candidate. Donald Trump's 'electability' cannot be in anything but serious question - take for instance his interesting comments last week regarding how he might try to bring about the buying-back of part of the US's national debt at a discount. His ultra-simplistic approach to this - and many other matters - has the majority of us scratching our heads. Given his well-publicized personal qualities and track record, we - like the investment markets - are assuming he will stumble. Hillary Clinton may not be perfect, but the markets have long since decided she will win, and this is one reason why the US markets seem unflustered by Mr Trump

having got this far. Certainly the GOP (Republicans) have some problems ahead .i.e. how on earth could this have happened? Mr Trump may only be a few votes short of the magic number, but it is the actual number of votes cast from the floor of the Republican Convention that counts. In short, we are now entering a period in which there will be some scares for the markets. Think, for instance, of the 'foreign policy' speech of a few weeks ago; it doesn't matter about the genuine lack of knowledge of the background – Mr Trump may have sounded credible to many Americans, a high percentage of whom, for instance, don't even have a US passport. Hopefully not many of them were listening. ***The point is this: it could be rather a tricky summer for the markets, and investors should be prepared for recurrent volatility.***

'Eurozone composite PMI good - but consumers now more cautious'

Turning to eurozone economic data, Markit's Composite PMI index came in at 53.0 for April, close to March's 53.1 and in line with expectations. Elsewhere within the report, however, data suggested that firms cut prices for the seventh month in a row, indicating a lack of pricing power. Otherwise, data from Eurostat showed that retail sales in the eurozone fell by 0.5% in March, month-on-month, compared to Reuters' expectations for a 0.1% fall. It seems that the ECB's stimulus programme, while probably supportive, will be unable to boost inflation and growth beyond a moderate level. ***Further reforms are necessary.***

In Chinese data, the reading on China's private Caixin Manufacturing PMI index fell to 49.4 in April, missing a consensus estimates of 49.8, and down from 49.7 in March. This unofficial survey therefore signaled continued moderate contraction in factory output. The official version from the Chinese National Bureau of Statistics announced that their Manufacturing PMI for April fell to 50.1 (vs. the 50.3 expected, and compared to 50.2 in March). Turning to Chinese service sector growth, this fell in April, with the private Caixin PMI reading falling to 51.8. The official services PMI dropped to 53.5 in April, from 53.8 in March. ***The Chinese services sector continues to be in quite good shape.***

'Oil capped at sub - $50 for time being'

In US energy data releases last week, oil production fell by 113,000 barrels/day, to 8.83 mbd in the previous week, according to the Energy Information Administration. US oil production has now fallen for 11 consecutive weeks, however oil inventories in the country are still rising, increasing by 2.8 million barrels, to 543.4 million barrels, a new multi-decade high. In Canada, the wildfires in Alberta have reduced oil production capacity by about 800,000 barrels a day, according to Bloomberg. The latter figure could be as high as 1 mbd, and appears to be a precautionary measure/ temporary suspension. Meanwhile, OPEC's oil output rose in April to close to the highest level in recent history, according to Reuters. Production increases led by Iran and Iraq more than offset a strike in Kuwait and other outages. Iraq's oil exports approached a record high in April, adding to a worldwide supply glut. Iraq shipped 3.36 million barrels a day last month, according to its oil ministry, and remained unaffected by subsequent political factors during the last few weeks. Libyan oil production, however, has suffered recently. ***The price of WTI continues to look quite well capped at about $45-48 for the time being, pending a more obvious rebalancing in the physical oil markets; we would buy oil-related assets upon any downside to about the $35 level.***

Looking at when the Federal Reserve might raise rates, we believe December now looks a much better bet than anytime sooner, for the following reasons: (a) US business confidence could well have stabilized after the November election; (b) the US economy will probably by then be getting close to the end of its growth (- or outright) recession; (c) the stockmarket will be in better shape, certainly at least from a seasonal point of view; (d) we would expect China to be that much closer to stabilization in terms of its well-known weaknesses; (e) global oil prices could have recovered to the $60 range, along with firmness in a few other members of the commodities' complex, causing commentators to talk far less about 'insufficient' inflation; (f) US and corporates from other countries might even have some pricing power by then, causing estimate revision to turn positive, and (g) the resurgence of Greece's debt issues - and the next series of papering-over of related cracks - should be in the past.

'Took profits in EM - but purely tactically'

Our TAA Committee met last week, and remains overweight in Emerging Market bonds and equities, although it was judged that these asset classes had become extended to the upside in the short-term, so decided that some profit-taking was appropriate. The EM currencies (in the cases where the assets are not denominated in hard currency) had done very well, and had been helped by recent dollar weakness. ***The Committee, although continuing to structurally favour EM assets as a whole, is mindful that the immediate months to follow will likely see market risks and volatility increase, and that EM assets are likely to demonstrate above-average volatility until the end of the summer. Having said this, the outcome for equities probably looks increasingly good provided one looks toward the year-end, by which time various of the commodity markets should be looking much better - including oil trading towards about $60/ barrel. Looking at all-important estimate revisions in equities, the only segment showing convincing signs of improvement is Emerging Markets.***

Disclaimer:

This report has been prepared and issued by the Global Asset Management ("GAM") of the National Bank of Abu Dhabi PJSC ("NBAD") outlining particular services provided by GAM and does not constitute or form part of any offer or invitation to sell, or any solicitation of any offer to purchase or subscribe for, any shares in NBAD or otherwise or a recommendation for a particular person to enter into any transaction or to adopt any strategy nor shall it or any part of it form the basis of or be relied on in connection with any contract therefore. This report was prepared exclusively for the benefit and internal use of NBAD. This report is incomplete without reference to, and should be viewed solely in conjunction with the associated oral briefing provided by GAM. The report is proprietary to GAM and may not be disclosed to any third party or used for any other purpose without the prior written consent of GAM. The information in this report reflects prevailing conditions and our views as of this date, which are accordingly subject to change. In preparing this report, we have relied upon and assumed, without independent verification, the accuracy and completeness of all the information available from public sources or which was otherwise reviewed by us. In addition, our analysis are not and do not purport to be appraisals of the assets, stock or business of the recipient. Even when this presentation contains a kind of appraisal, it should be considered preliminary, suitable only for the purpose described herein and not be disclosed or otherwise used without the prior written consent of GAM. NBAD clients may already hold positions in the assets subject to this report and may accordingly benefit from the buying or selling of such assets as referred to in this report. This document does not purport to set out any advice, recommendation or representation on the suitability of any investment, transaction or product (as referred to in this document or otherwise), for potential purchasers. Potential purchasers should determine for themselves the relevance of the information contained in this document and the decision to purchase any investment contained herein should be based on such investigation and analysis as they themselves deem necessary. Before entering into any transaction potential purchasers should ensure that they fully understand the potential risks and rewards of that transaction (including, without limitation, all financial, legal, regulatory, tax and accounting consequences of entering into the transaction and an understanding as to how the transaction will perform under changing conditions) and that they independently determine that the transaction is appropriate for them given their objectives, experience, financial and operational resources and other relevant circumstances. Potential purchasers should consider consulting with such advisers and experts as they deem necessary to assist them in making these determinations and should not rely on NBAD for such purposes. NBAD is acting solely in the capacity of a potential arm's-length contractual counterparty and not as a financial adviser or fiduciary in any transaction unless we have otherwise expressly agreed so to act in writing. NBAD does not provide any accounting, tax, regulatory or legal advice. NBAD is licensed by the Central Bank of the UAE.

London

NBAD London Branch is Authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from NBAD London branch on request. Registered in England & Wales: Company No: FC009142: VAT No: GB245 3301 91.

Paris

NBAD Paris Branch is licensed by the French Prudential Control Authority as a credit institution. NBAD Paris is registered in France under the company number: RCS Paris B 314 939 547.

Switzerland

This publication is for your information only and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. Certain services and products are subject to legal restrictions and cannot be offered worldwide on an unrestricted basis and/or may not be eligible for sale to all investors. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness. All information and opinions as well as any prices indicated are currently as of the date of this report, and are subject to change without notice. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. At any time the National Bank of Abu Dhabi PJSC and/or NBAD Private Bank (Suisse) SA may have a long or short position, or deal as principal or agent, in relevant securities or provide advisory or other services to the issuer of relevant securities or to a company connected with an issuer. Some investments may not be readily realizable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. Futures and options trading is considered risky. Past performance of an investment is no guarantee for its future performance. Some investments may be subject to sudden and large falls in value and on realization you may receive back less than you invested or may be required to pay more. Changes in foreign exchange rates may have an adverse effect on the price, value or income of an investment. National Bank of Abu Dhabi PJSC expressly prohibits the distribution and transfer of this document to third parties for any reason. National Bank of Abu Dhabi PJSC and/or NBAD Private Bank (Suisse) SA will not be liable for any claims or lawsuits from any third parties arising from the use or distribution of this document. This report is for distribution only under such circumstances as may be permitted by applicable law. The "Directives on the Independence of Financial Research", issued by the Board of Directors of the Swiss Bankers Association (SBA) do not apply.