NBAD

From West to East
Weekly Investment View
8th of December, 2016

Stocks party on – don't 'fight the tape'!

Markets around the world are continuing to assess the implications of a Trump presidency, and with positive conclusions. This is despite the imminent announcement of a hike in the Fed funds rate by the FOMC next week, and also the growing tide of Eurozone political turbulence expected next year. Similarly, the results of last week's Italian referendum - and the practical problems regarding the recapitalization of its banks - have been taken on board by the markets, and initial nervousness quickly dissipated. In market parlance, these are so-called 'bullish divergences', when short-term bearish influences are brushed to one side. As we go to print the ECB is discussing whether to extend its monthly bond purchases, and our expectation is that that they certainly will. This will help deal with the Italian banking situation on the one hand, and encourage relative weakness in the Euro should the US dollar continue to correct following its recent strength.

"Stay overweight in US and Eurozone equities – with the Euro hedged"

Our Asset Allocation Committee was neutral in US, and overweight Eurozone equities at the time of the US elections, and moved overweight in US equities a week afterwards, in the expectation that the rotation out of safe-haven assets like bonds, precious metals and the Japanese Yen into riskier assets like equities was very likely to be sustained. As we discussed in last week's report, equities are capable of rising further provided that real GDP growth forecasts continue to move ahead, and this is what is happening. Hence earnings expectations are also increasing, and justifying higher market levels – leaving behind commentators and investors who are still saying that valuations are expensive. We are likely to see more well-meaning advice from strategists saying the upside in equities seen has all gone too far, yet the simultaneous achieving of new all-time highs by so many indices does suggest a very powerful move is underway. In our opinion equities will continue to be firm into 2017. Certainly this will at some stage result in a truly overbought condition, but that is not the case yet. Any consolidation will likely be the 'pause that refreshes', with investors increasingly looking around for the stocks and sectors that have been unfairly left behind. As Donald Trump continues to leave more of his campaign messages behind, in favour of more realistic stances resulting from the advice provided by his new cabinet (and his own common sense), the positive tone should be sustained. Threats regarding trade protectionism, for instance, are unlikely to go down to the wire; rather, the President-elect will not allow the US to be corralled into collective trade agreements where his Administration has little control. In the same way, they are unlikely to bring in legislation that damages corporate America – rather, the reverse will be true, and this results in higher forward P/E ratios, net of any allowance for higher interest rates. Again, as we said in last week's report, the 10-year Treasury yield would have to move into the 4-4.50% range to damage equities – and in the short-term many bonds yields have moderated from over-blown levels. **So at the risk of repetition our main message is to remain overweight equities, with the emphasis on the US and Eurozone; for those mandates able to do so, we recommend being overweight in Indian equities, with position sizes in the latter recognizing**

Claude-Henri Chavanon

Managing Director
Head of Global Asset Management

the higher risk/reward stance relative to more developed equity markets.

The Italian constitutional election result last Sunday saw a 'No' vote for incumbent Prime Minister Matteo Renzi, who had been proposing reforms that he believed would better facilitate growth in the sluggish Italian economy. He duly tendered his resignation after promising to do. This was yet another vote for the populism that is sweeping the world as many electorates cast aside established political elites - although in this particular case Mr Renzi's proposed reforms looked as though they would have actually been for the best, and supportive of the country at large. Renzi's democrats lost out to the anti-establishment 'Five Star Movement' party, who won by 53%, to the Democrats' 47%. This effectively gives Five Stars a majority in the lower chamber of the Italian parliament. Like all other major election results in 2016

there was an initial negative knee jerk reaction in Italian stocks and bonds, but which quickly gave way to rallies in those markets. The 10-year Italian Government bond yield had opened up by about 15 basis points, to about 2.06%, before correcting back downwards to 1.89% currently. This has taken pressure off Italian and other equity markets, and the intial turnaround was surprisingly quick, similar to that seen in the immediate aftermath of Trump's win. In Italy itself the apparent reaction of voters on the ground was very relaxed, reflecting an electorate that has grown accustomed to regular new coalition governments over a period of many years. The Euro/ dollar exchange rate had slipped to an 18-month low before it rallied, as fears of Italy wanting to leave the European Union subsided. **We like markets that climb 'walls of worry', and indeed our Asset Allocation Committee is relatively keener on Eurozone stocks, given their fairer valuations compared to US equities, and also reflecting the continuation of monetary relaxation by the ECB.**

"WTI at $55-60 is possible by the second quarter of 2017"

The price of WTI oil has corrected from highs of just under $52 after last week's OPEC agreement, to a fraction above $50 currently, despite the US Energy Information Administration (EIA) reporting that US crude inventories fell by 2.4 million barrels in the week ending 2nd December, more than the market had expected. Oil market watchers are now looking to this Saturday, for extra comfort that the scheduled meeting including OPEC and non-OPEC producers will confirm the stated intentions of Russia and Mexico (and hopefully others) to reduce production, by 300,000 in the case of Russia, and 215,000 for Mexico. Some commentators are still skeptical that promised output reductions will actually materialize. **We remain cautiously bullish on oil prices, with $55-60 in mind for the second quarter of 2016. Looking further out, we think $65 is possible, once the capital expenditure reductions by Big Oil begin to tighten a market that should also see moderate global demand growth, although US shale producers (and forward selling) should continue to cap the top of the range – so in our view the upside price limit might move upwards by $10 or so over the next year.**

In the UK, Prime Minster Teresa May has agreed to publish her cabinet's Brexit plans, thereby winning the backing of Parliament to begin the Article 50 Brexit talks at the end of March next year. This should go some way to reduce the uncertainty of what it all means for industry, and the population at large. MPs will have a vote on the final overall deal. Earlier in the week there had been some badly-received UK industrial output figures. **For the time being our Asset Allocation Committee is still not recommending any position in UK equities or bonds.**

"We expect the ECB to extend its bond purchases for six months at the same level"

INVESTMENT SUMMARY: Following on from the opening paragraphs of this report, we recommend overweight positions in US, Eurozone, and also Indian equities, matching an underweight position in cash. After such a shakeout in many global bond markets, we are neutral overall in this asset class, although with the comment that Investment Grade bonds are now looking much more appealing after last week's correction. We are now neutral in corporate bonds, having earlier been underweight.

What is now being described as the 'seasonal rally' in equities should proceed into 2017, and we are happy to see reports of some sizeable so-called 'program buying. The Italian finance authorities have asked the EU to allow more time for an orderly rescue of Monte dei Paschi to be achieved, and we would be very surprised if such a request is denied, linked with a €15 billion amount from the European Stability Mechanism. Regarding the ECB, Mario Draghi is about to provide a policy update, and we expect an extension to monetary accommodation by at least a further six months, but no increase in the monthly amount, and with no guidance regarding any future tapering of the ECB's quantitative easing. On the path of the US Fed funds rate, we expect two rate hikes in 2017 to follow the one expected next week.

For any inquiries related to this article, please contact Alain.Marckus@nbad.com or Clint.Dove@nbad.com

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 Authorized 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.