NBAD

From West to East

Weekly Investment View

12th June, 2016

Taking Up The Gauntlet. Markets In A Holding Pattern

'All attention on the US Fed this week'

For the next few weeks we have a packed calendar in terms of news and events to digest with the start of the Euro 2016 football tournament leaving us to ponder in between games as to what happens next in markets as the events begin to unfold. After a disappointing set of US Non-Farm Payroll (NFP) number the previous week, Fed Chair Janet Yellen's press conference in Philadelphia on June 6th outlined that the economy remains an improving dynamic. The market had originally been pricing in a June or July rate rise prior to the NFP data which now looks like a September hike. Janet Yellen's testimony at the beginning of the last week was devoid of a next rate move timing while outlining the US economy was still in a positive track. The Dollar retraced about half of its losses last week after US claims data proved to be strong. **The FOMC US rate decision will be announced this week on June 15th. While we are not expecting any US rate rise, the Fed's timetable for the next move upward will be closely watched.** US retail sales data as well as producer prices will be published just before the rate news which could also be of interest to Yellen before the Fed's next iteration. A Donald Trump/Hillary Clinton showdown has not featured in market moves and ultimately Fed decision making as yet, but will be watched closely in the coming weeks and months leading to Novembers election. Last Thursday **Mario Draghi** the ECB President called on politicians to accelerate reforms in the EU at a speech he gave in the Brussels economic forum. The ECB is still undershooting on its inflation targets after monetary stimulus efforts over recent years. Draghi stated fiscal policy should not work against monetary policy while outlining other proposed measures such as increasing workforce participation to improve productivity. He warned this lack of realignment posed risks to the desired inflation outcome in the Eurozone. With this in mind the Euro gave back some of its gains made in the week at the expense of the US Dollar. This 'objective not achieved' speech by Draghi saw German Govt. Bund yields drop to new lows. UK Government Bonds (the UK Gilt) also touched new lows exacerbated by the talk of 'Brexit'. **The 10 year US Treasury yield sunk to 1.64% in the current risk off mood but see yields increasing again over time with the longer term rising rates picture.**

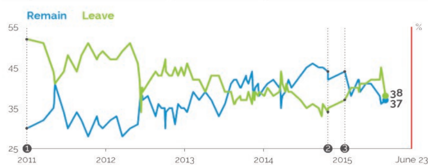
'Brexit nerves elevate'

Twelve days to go and the latest UK opinion polls show a narrow lead by a few percentage points to the 'leave Europe' campaign. Volatility in July German Bund futures options that expire June 24th (the date of the referendum) reached the highest level for the contract last Friday. Sterling had a tough week with the currency falling to its lowest level since April this year on the opinion poll news. Sterling closed on Friday at 1.4257 after seeing an intraday low of 1.4180. Some analysts have been quoted as suggesting Sterling could fall to as low as 1.25 versus the Dollar which hasn't been witnessed yet. For now markets appear to be reacting more to the opinion polls rather than the actual economic performance of the UK economy as well as the implications for the actual vote. But what would happen if the UK were to leave or indeed remain as the case may be? For the 'leave' camp it seems the British electorate is very much in favour of maintaining the trading relationship with the continent as polls suggest. Norway is not a member of the European Union but already enjoys access to the single market in Europe without having to comply with EU rules. Norway also maintains its status as a member of the European Free Trade Association (EFTA). If the UK were to take this route it would be viewed as a less draconian exit analysts believe. The economic consequences of the Brexit have been heavily debated but a Norway type arrangement would have less of an impact on UK growth as a full blown exit would. **Long term the UK economy remains sound albeit in a lower growth environment.** Immigration has been a particular bone of contention. The 'Schengen' area of Europe covers 26 countries with a common visa policy. Twenty two of the twenty eight EU member states participate in the Schengen Area. Of the six EU members that do not form part of the Schengen Area, four – Bulgaria, Croatia, Cyprus, and Romania – are legally obliged and wish to join the area, while the other two – the Republic of Ireland and the United Kingdom – maintain opt-outs. All four European Free Trade Association (EFTA) member states – Iceland, Liechtenstein, Norway, and Switzerland – have signed agreements on association with the Schengen Agreement, even though they are outside the EU. With the recent influx of refugees from troubled countries such as Syria and Libya to the Eurozone, this has caused a wave of concern among UK voters such as the lack of control on the EU's borders. A pressured welfare and benefits system in the UK is being tested along with a UK electorate that is by and large charitable and historically open to immigration. In polls that show UK voting behavior, it seems an opinion is forming where it is perceived Germany dictates the influx of immigration with its open borders for much needed labour through 'corridors' provided by the other economically stretched countries in the EU that are suffering from high unemployment and a general lack of resources to cope with the current problem.

Claude-Henri Chavanon

Managing Director
Head of Global Asset Management

Schengen Area



Sources: Wikipedia/YouGov

UK economic data remains on track overall. With the Bank of England (BOE) Governor Mark Carney steering clear of any Brexit debate. He stated last month it was the bank's 'responsibility to continue business as usual'. Others including Jean-Claude Trichet the former ECB President along with Christine Lagarde the Managing Director of the IMF have been more vocal about the unintended consequences of such a UK departure. The IMF is due to publish its annual health check of the UK economy, in which it will outline a slower, lower growth dynamic with higher unemployment if the UK exits. **Whichever it ends up being, volatility is expected to rise led by Sterling in the days ahead. Our view is long term UK assets have been a sound investment. If a UK exit were to happen, diversifying exposure away from just being invested in the UK would be advisable. Downside protection through appropriate hedging for short term moves would be prudent.** Global markets started a small sell off on Friday reflecting nervousness ahead of the vote. The S&P 500 handed back gains earlier in the week to close -0.3% on the week.

'Commodities resilient the Iron Ore story develops'

Commodities broke out of a five year bear market with a move in the commodity index rebounding 31% from the lows seen since February. This was further propelled by recalibration of the US Dollar in recent weeks that also saw a lift in commodity currencies such as the Australian Dollar which was up 2% on the week. This provided a much needed catalyst the effects of which were most pronounced in the industrial metals space. This despite Sterling volatility, a recovering US Dollar and resurgent G3 Government Bonds. Gold continued its march upward in sight of $1300 an ounce with Palladium putting in a steady unchanged performance for the week in a continuing risk off picture that grips markets in the short term. **Intra week the TAA committee decided to implement a small conservative investment allocation to Iron Ore.** A theme we talked about last week where we see the technical factors of Iron Ore being an improving one. Chinese demand for the metal continues to post healthy gains in a seemingly oversupplied commodity in the current less than impressive growth of the Chinese economy. Perplexing somewhat, but a Chinese economic surprise in the coming months could propel the metal back to the highs at $70 a ton we saw in April from the current level of $52. The rising Dollar proved to be a headwind for crude oil prices that saw a sharp pull back last Friday to $49.07 on the WTI measure and $50.54 for Brent almost back to the previous weeks closing level for the black stuff. **We remain of the opinion oil remains range bound with any pull back to the mid $40's a barrel as a good re-entry point for those that want to be invested.** MENA markets fared well through last week with Dubai's DFM registering a 2.35% rise for the week with Abu Dhabi's ADX registering a gain of +2.56% in a continuing improving theme witnessed in the region. The chairman of Abu Dhabi's Department of Economic Development Ali Majed al-Mansoori forecast a 5% rise in real GDP growth for the emirate in 2017 from just 2% expected for this year. MENA bond markets continued to be energized by new issuance. Commercial Bank Of Qatar and Oman sovereign both printed successfully last week with TAQA (National Oil Company Of Abu Dhabi) and Ooredoo (Qatar Telecom) coming this week. Separately S&P affirmed Bahrain's rating at BB with a 'stable' outlook that kept Bahraini sovereign bonds firm last week.

'Inclusion Of China to MSCI ? – Our EM theme this week'

Emerging market assets were moving in tandem with the fortunes of the US Dollar as well risk in markets last week. Chinese trade data last week showed imports beat estimates that gave some relief. Imports slipped -0.4% in Yuan terms the smallest drop since late 2014. This gave the markets comfort that perhaps the Chinese economy is stabilizing in the current 'longer for lower' US rates picture. The inclusion of Yuan denominated A shares in the MSCI Index is a 'historical certainty' a Chinese securities regulatory official said just days before the announcement. 'The China A shares market is the world's second largest market. It is also the largest emerging market and fastest growing', Qi Bin the head of China's Securities Regulatory Commission internal affairs department commented. It's the first time an official of the securities regulator has spoken on next week's review by New York's MSCI the announcement of which will be June 14th. The news could attract very large inflows into Chinese stock markets that have been languishing thus far in 2016. The market has been the world's worst performer in the equities. CEO of the London Stock Exchange Xavier Rolet, said the inclusion of some A shares in the MSCI index will help make a link between Shanghai and London's stock exchanges more possible, he said. **The announcement could be the trigger that ignites Chinese markets and we would review allocation to them subject to this in the coming days.**

For any inquiries related to this article, please contact Alain.Marckus@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 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.