NBAD

From West to East

Weekly Investment View

20th June, 2016

A British Exit To Cause Summer Doldrums? We Think Not…

'Fed leaves US rates unchanged Brexit in focus'

The US Federal Reserve left US rates unchanged on Wednesday as expected. Fed Chair Janet Yellen stated that the condition of the US economy remained healthy while outlining growth and productivity had moderated recently. The Federal reserve pared down its 2016 growth expectations to 2.0% from 2.2% as originally forecast while Yellen said the path to rising US rates would remain 'gradual' that opened the door to a lengthier timetable. This diminished the prospects for two rate rises this year as most had expected. Market participants however are still pricing in the prospect of a September rate hike with 'normalisation' very much underway. **Our view remains unchanged that a maximum of one rate rise could happen before the year is out to ward off future inflation expectations by the Fed. We still believe overall, the Fed Funds rate will be much higher next year from today's rate.** The US Producer Price index as well as Empire manufacturing data that was released the day after the FOMC announcement came in stronger than expected suggesting inflation continues to tick higher. The US Dollar closed unchanged on the week after seeing heightened volatility during last week. It was also suggested that the Fed had refrained from raising rates ahead of the UK referendum on leaving Europe termed 'Brexit'. Yellen had also highlighted the potential risks to the US economy should the UK leave Europe. With that in mind, campaigning on the issue continued throughout last week by both sides. The 'Leave' campaign maintained a narrow lead over the 'Remain' camp in most opinion polls last week. The tragic assassination of 'Remain' campaigner and British MP Jo Cox last Thursday may have cruelly and perversely altered the potential outcome of the vote. Both sides have suspended campaigning post her death with the latest opinion polls this morning now suggesting the 'Remains' maintain a small lead over the 'Leaves' as a result of her death. **Our opinion remains unchanged in that we think the UK will remain in Europe.** We highlighted last week that even within the 'Leaves' most had said that a leave with a tie still to Europe through trade was very much favoured. The event of last week may perhaps leave some of them to rethink their vote. The British currency, Sterling saw a decent rally at the end of the week closing at 1.4358 versus the US Dollar. Sterling had been as low as 1.4013 Thursday after implied volatility in the Sterling options market suggested bets on a Sterling collapse as a result of Brexit had reached its peak so far this year before the pull back on Friday. After a very volatile risk off session in markets on Thursday, Friday saw the relief rally some were looking for. It remains to be seen if this translates to a further retracement on Monday, but expect volatility to persist throughout next week leading up to the Brexit vote. The S&P 500 closed -1.2% and off the lows witnessed on Thursday. The Euro Stoxx 50 closed down -2.16% showing a similar trend as markets brace themselves ahead of the June 23rd vote.

The volatility index (VIX) a cheap form of protection for portfolios we highlighted several weeks ago, closed up 14.6% on the week reflecting these nerves. Haven assets across markets fared well again with the benchmark 10 year German Government Bund now giving a negative yield for the first time like the Japanese Government bond. In currencies the Japanese Yen also seen as a haven in uncertain times saw inflows with the Yen trading at 104.16 versus the Dollar exacerbated by the fact that the Bank of Japan left policy unchanged in the week keeping its monetary base and negative 0.1% interest rate unchanged.
Commodities also registered healthy gains overall with Gold reaching $1300 an ounce with commodity currency the Australian Dollar slightly firmer on the week. Overall, despite the Brexit vote, slowing growth around the world we think markets are in a much better position than where we were in 2009 as some markets suggest. The fear factor has very much gripped markets and think this may be short term. This was highlighted at last week's Tactical Asset Allocation Committee meeting (TAA), where the 'underweight' position held in Japanese equities was taken to 'neutral' given the fear factor witnessed in the Yen and Japanese Government bonds that was thought to be excessive. No other major changes were made to portfolios but The TAA intimated its desire to re-enter risk markets such as the Emerging Markets, when the time is right to do so which would of course be post Brexit. There is a general feeling that the current fear has made valuations overall attractive and a sharp bounce back could be seen across markets if the Brexit outcome is favourable.

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'Middle East markets steady'

Middle East markets continued to be buoyed by new issues in the fixed income space. National Oil Company Of Abu Dhabi (TAQA) closed the week up 50 basis points from the initial launch price last week. Other recent new issues such as the Qatar Telecom 10 year bond issue in the MENA space continued to perform well showing the region has continued appetite even during the slower trading months of the summer and Ramadan. More new issuance activity is expected to pick up in the MENA region after Ramadan is over. US rates remaining lower for longer will keep MENA bond spreads down that is ultimately attractive for issuers looking to tap the market.

Qatar National Bank completed its acquisition of Turkish lender Finansbank with the National Bank of Greece, selling its near 100% stake in the bank to QNB. Finansbank is prevalent mainly in the consumer banking space of Turkey, the acquisition is expected to see a recovery in the rating of existing Finansbank bonds that trade on a high yield rating at Ba1 (Moody's) versus Qatar National Bank's Aa3 Moody's rating. Dubai's Emirates NBD Bank was upgraded by Moody's to A3 from Baa1 with a stable outlook. Moody's highlighted the improved asset quality at the bank despite slowing UAE growth with lower oil prices since its last assessment. Moody's also raised Dubai's Emaar Properties from Ba1 (below investment grade status) to Baa3 (Moody's minimum investment grade status). Moody's stated that Emaar had strong credit metrics at a time when the macro environment was weak. Emaar's market leadership, balance sheet strength along with stable recurring revenues all went toward its upgrade to investment grade status as the company enters a phase of elevated capex ahead of Dubai's Expo 2020 it commented. In other UAE news, IPIC of Abu Dhabi (International Petroleum Company Of Abu Dhabi) sought USD$6.5 Billion from troubled Malaysian Government investment company 1MDB through a London court of arbitration. The filing yesterday by IPIC and its subsidiary Aabar Investments involves a long-running dispute between IPIC and strategic state fund 1Malaysia Development Bhd (1MDB), which was set up in 2009 by Malaysia's prime minister, Najib Razak. Four years ago, IPIC guaranteed $3.5bn of 1MDB bonds but claims it has not received payment for the guarantee or other monies and interest owed. In a filing with the London Stock Exchange last month, IPIC said it had to make good on its guarantee – the third default by 1MDB – with an interest payment of more than $52 million. IPIC also said that it would demand 1MDB and the Malaysia's ministry of finance, which owns the fund, make good on an amount owed under the terms of a deal last year in which IPIC agreed to extend additional support to 1MDB, including covering $1bn of interest payments due, in return for commitments by Malaysia to acknowledge its liabilities and make payments. Last month's filing put the amount owed at just over $1.2bn plus accrued interest.

In UAE equity markets, market volumes remained very thin with Ramadan. Abu Dhabi's ADX closed marginally up +0.12% on the week, Dubai's DFM was down -0.6% reflecting the less liquid conditions as well as crude oil that failed to break the $50 a barrel mark last week.

'MSCI disappoints the Chinese…Rajan resigns from the Indian Central Bank'

Last Wednesday MSCI announced its delay to include China's A shares market to the coveted MSCI Emerging Market index. The MSCI decision came after months of intervention by the Chinese Government to prop up Chinese markets after the collapse witnessed in the market in January. On the positives MSCI noted 'significant improvements' it said to accessibility to the market for global investors. They also said China would be included for consideration at the next classification review in June 2017. The MSCI could iterate a one-off potential cycle announcement should significant positive developments occur in the market before June 2017. The announcement was greeted with initial disappointment that saw Chinese markets fall after a 3 day China Dragon Festival holiday (Tuen ng) at the start of the week when markets were closed Monday through to Wednesday last week. We had said last week that a positive announcement that would include China A shares could see the market catapult with the large international inflows from fund managers. That didn't happen however **but valuations across Chinese markets are now looking very attractive for the long term and could start moving higher if we get improved Chinese data that we still seek before making a buy call.** The market closed flat overall last week. In India, Central Bank Governor Raghuram Rajan said he will step down when his term ends on September 4th. There had been speculation that he might step down but the swift tone of the announcement yesterday came as a surprise. Rajan had been criticised for keeping interest rates in India too high for too long in the war against inflation that had at the same time curtailed growth in the world's largest democracy. In his letter to staff yesterday, he pointed out his achievements during his tenor when he took office in 2013. He highlighted that more needed to be done on inflation as well as cleaning up the country's banks. We highlighted in our last comment on India that an announcement of this nature risks much needed investment in the country that was triggered by the election of the Narendra Modi government. **In the short term, there may be capital outflow in the Indian capital markets but longer term we see the Modi administration overcoming their challenges with India's congress that has been a block to many reforms proposed. India would be investible on better valuations after a correction we feel that may come with this announcement.**

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