NBAD

From West to East

Weekly Investment View

21st March, 2016

Rekindling Markets. Easy Money Policies Reinforced.

Equities continued their upward momentum last week with another 2.5% gain on the S&P 500. We are now into the fifth straight weekly gain for the average. Not surprising really after easy money policies have been initiated around the world in recent weeks. The Bank Of Japan was first, followed by the European Central bank. Last Wednesday it was the turn of the U.S. A 'dovish' statement by Janet Yellen the U.S. Federal Reserve's Chair suggested a more tempered path to rising interest rates in America. A far cry from December last year when the Fed forecasted four rate increases for 2016 back then. The U.S. Dollar strength we've seen lately corrected lower, with the U.S. Dollar Index (DXY) moving down to its lowest since last October. The U.S. 2 year Treasury bond a good indicator of near term interest rates had a big readjustment in expectations with the yield collapsing well below 1% again reflecting the more benign U.S. interest rate environment markets have now priced in.

We had said at the beginning of the year we expected no interest rate rises in the U.S. through the course of 2016. Developed market economies are now all in easing or holding off from higher rates. Higher yielding assets elsewhere in the world are starting to look attractive again from currencies to stocks to bonds. In time we expect investors to borrow in the G3 currencies with their very low rates versus buying higher yielding risk assets that give greater returns (known as 'carry trades'). The returns offered in emerging markets bonds for example versus developed markets continues to widen. After a torrid start to markets this year, they have begun to regain their poise. Conditions look set now for a retracement rally that in fact may have already started we feel. The Tactical Asset Allocation committees decision a fortnight ago to invest in such assets has been vindicated as a result.

We reinforce our view to be long the market through global emerging market stocks and bonds as well as the U.S. high yield market. Emerging markets around the world have seen many events take place this week. In Brazil pressure mounts for President Dilma Rouseff's impeachment that has seen markets rally there quite nicely. In South Africa benchmark interest rates were hiked another 150 basis points in a country that has seen confidence sapping of late. The Chinese continue to talk about state lending to the corporate sector as being too high while being balanced by an IMF report suggesting that the current level of the Chinese Yuan reflected the country's fundamentals. In Middle East markets talks that started with a ceasefire in Syria ended the week with a sudden withdrawal of Russian forces from that country. This has stabilized MENA markets which were also helped by steadier crude oil prices. The Egyptian Pound was devalued by 13% last week that ratings agency Moody's suggested was credit positive for the country.

Overall *from a global macro perspective not much has changed we feel. Easier monetary policies around the world will fuel asset prices from current levels. Central Banks around the world remain concerned about growth. The recent monetary measures announced have been designed to boost confidence and ultimately ward off a protracted slowdown that some including the IMF had been warning of earlier in the year.*

Claude-Henri Chavanon

Managing Director
Head of Global Asset Management

'Crude Oil. A great run coming to an end for now'

Crude oil got a further boost this week with the WTI and Brent measures reaching year highs after the news from the Federal Reserve. A weakening U.S. Dollar that ensued also helped sentiment, but prices pulled back markedly later into Fridays session. Crude oil continues to trade in our forecasted 2016 range of $25-$45 a barrel. Prices have stabilized quite nicely in this range and the volatility we have witnessed at the start of the year has abated. The dynamics of the market remain the same however with crude oil production globally continuing at the record high levels recorded in January. Oil consumption in the U.S. the world's largest consumer remains weak. Crude oil storage tanks remain at full capacity showing inventories of crude oil remain stubbornly high.

These measures along with continuing weak global growth suggests prices may have peaked for now at our upper end range of $45 a barrel. We advise taking profits until fundamentals have changed which would only really start in a meaningful way in the run up to the next OPEC meeting in summer while discussing production cuts (if that were to happen).

We reaffirm, any correction back towards $30 a barrel as a good opportunity to be buying crude oil and related assets which would include buying MENA equities that are heavily correlated to crude oils move.

'Tactical plays in our reinforced world'

FX:
Although we had a more muted statement from the Federal Reserve, we believe that market have overreacted in the short term to a dovish Fed. The **currency of choice to be holding in cash portfolios we believe is the U.S. Dollar longer term.** The current interest rate differentials favour the U.S. Dollar over its main rivals the Japanese Yen and the Euro as well as against Sterling (on Brexit fears). We see the falling Dollar index of last week as an opportunity to be buying the U.S. Dollar.

Bonds:
We have already highlighted the **merits of adding emerging market debt where we favour hard currency debt over local currency.** In the riskiest asset class **high yield**, default rates remain low. **Yields differentials in that market are at their highest for 5 years**. For clients seeking safety in G7 bonds over cash, in the short term we like **U.S Treasuries against German Bunds and Japanese JGBs** as we expect the spread differential between them to narrow in favour of U.S. Treasury bonds after the cooling of U.S. rates expectations.

Equities:
Tactically we remain underweight the asset class overall. The underweight is principally in developed market equities, but we are **overweight emerging market stocks**. This will be led by a better appetite for risk we feel going forward, with a tail wind behind those emerging economies that have benefitted from falling commodity prices that we have witnessed.

In the U.S. we remain less underweight overall as the market undergoes a technical rally. We have said the outlook for U.S. earnings going forward is a declining fundamental with forward earnings still looking optimistic in our opinion. We remain **neutral European equities**. Despite a more aggressive monetary easing exercise undertaken by Mario Draghi the week before last, the 'Do whatever it takes' mantra may change to 'this might be all of it'. Rising European asset prices one would expect from European QE may give way to a realization that Earnings in Europe are also very weak in relation to fundamentals that will ultimately put pressure on European equity markets. Japanese markets have been trickier to predict with the Yen firmly in charge undermining the Bank Of Japan's intentional negative rate policy. This unwanted strength will ultimately hurt Japanese exporters that make up the backbone of the Nikkei 225 index. ***Our underweight position in Japanese equities has been proven to be correct thus far.***

Precious Metals:
We remain agnostic on gold and see the rally there as an initial response to money flows moving from negative yielding currencies in the developed world as well as shaky global markets of late to a safer zero yielding asset class that is gold. Eventually however zero is still negative in inflation terms! This could eventually see a selloff in gold which has been bolstered by global QE with money flows that could move back to assets that beat inflation in an ever more fertile environment today for risk assets.

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