NBAD

From West to East

Weekly Investment View

25th September, 2016

Global Central Banks Steady Impetuous Markets

Asset valuations across world markets have been galloping ahead throughout the course of the summer. The rises have been above the usual trend witnessed so far this year. Continued global easy money policies have been the culprit. The upward momentum continued even ahead of key Central bank meeting announcements last week in both Japan and the U.S. As a result volumes were uninspiring leading up to the meetings announcements. Markets paused for breath as well as some trepidation about what might be said by the central bankers. In crude oil markets, speculation mounted over whether Saudi Arabia would cut oil production that would be linked to similar measures expected of Iran ahead of planned informal talks by OPEC set to take place in Algiers 28th September. Over the weekend the Saudi's poured cold water over the news with no such agreement being struck. Crude oil gave up its gains seen during the week with the wti settling back at the lower end of last weeks range at $44.48 a barrel. The S&P 500 closed +1.2% for the week below its' intraweek high, with the Euro Stoxx 50 index finishing similarly +2.16%, also off its highs for the week. The weeks' Proceedings began Wednesday morning with the Bank Of Japan (BOJ) maintaining its policy rate at -0.1%. More importantly the BOJ modified its mammoth Quantitative Easing program (QE) of 80 trillion Yen annually (USD $790 Billion). It announced its intension to stabilize the JGB bond yield curve by focusing on keeping the 10 year Japanese Government Bond (JGB) around its current yield of near zero. It would do this by controlling its asset purchases of short term bonds versus longer dated maturities thus stabilize the price of 10y JGBs. The BOJ vowed to continue stimulus measures as long as was necessary in order for them to achieve a desired inflation target of above 2% they said. This measure has been somewhat elusive with some in the market speculating that further stimulus may ensue at their next meeting this November. No time frame was given by the BOJ in terms of when stimulus measures would be rolled back further fueling more stimulus to come. The news saw the Japanese Yen weaken initially, then it strengthened back close to pre-announcement levels at 101.02 versus the USD by the end of last week. The foreign exchange markets reflected the disappointment of the absence of greater stimulus measures. The Nikkei 225 benchmark stock index of Japan was more cheerful closing +1.4% on the week. This reflected an ongoing weaker Yen from the year highs of sub 100 Yen. The weaker Yen should improve exports from the country which have been on the back foot all year given the strength of the currency. **The asset allocation committee (AA) maintains its long US Dollar position versus the Japanese Yen** in the continuing belief that the 'pair' will correct to 105 levels and beyond in time. **Overall we stay 'neutral' in terms of our exposure to Japanese equities with a feeling that the recent BOJ action as well as global events affecting the country leave us indifferent on Japan overall.**

Yellen stays put for now gets markets psyched for December

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Wednesday was the big day for markets last week with yet another anticipated US rate decision by the Federal Reserve that was closely watched hot on the heels of the BOJ meeting. US data has remained respectable overall with jobs growth staying on track. More recently, poorer ISM data for both manufacturing and the non-manufacturing sector as well as continual undershooting in US inflation expectations left most economists to suggest there would be no rate increase at the Fed meeting. As it happened there was no rate rise, but Fed chair Yellen while saying there was no rush to raise rates did emphasis that she was pleased with US economic performance with 'some more room to run' making reference to wanting to see more positive data in the next month or two. Markets viewed it as preparing markets for a December hike. What was more interesting was 3 of the 7 Fed's voting members favoured an immediate 25 basis point rise leaving Yellen to admit Fed officials had 'struggled' to reach a consensus. The market initially rallied positively on the 'more of the same' news then quickly scurried back and turned negative on Friday. The Fed's next meeting takes place in November but is unlikely to take any action in what may be seen as the 'eye of the US election storm' we think. It's more likely that gradual US rate increases will continue over the course of many months as 'normalisation' progresses. While Fed Funds may reach 0.75% by year end, we think the Fed Funds target will eventually be in the range of 1.5%-1.75% for year-end 2017. Some have called Yellen's decisions this year as inaction with some accusing the Fed of being behind the curve. We think events this year have been quite unprecedented. The year started with the Chinese stock market crash in January, followed by the Brexit upset to markets in June. The market now faces the prospect of further heightened volatility in the run up to US elections that will take place in less than 7 weeks. It's no accident the Federal Reserve has had to ponder since their aggressive stance on rates last December. Back then the Fed raised rates 25 basis points outlining three rate rises were to come for this year. We will barely achieve one rate rise this year it seems. We think the Federal Reserve has been prudent in its management of one of the greatest monetary policy experiments this century, that is quantitative easing. Unwarranted volatility witnessed throughout 2016 does not go hand in hand with rate rises so it's no accident the Fed has been more dovish then some expected 9 months ago. **The AA pared back its 'overweight' position in US equities several weeks ago to 'neutral' from 'overweight' on the deep seated feeling that valuations only seem to be going one way…higher ! Last Friday's stalled performance of US markets may well vindicate the view. With gradual rate rises underway longer term versus it's G3 peers, the committee continues to feel the currency of choice to be invested in remains the US Dollar and as such maintains foreign exchange hedges that are short Japanese Yen and Short Euro versus long Dollars in both pairs.**

Super Mario reinforces double hatted role at ESRB

Mario Draghi is not only the President of the European Central Bank, but he also 'double hats' as the Chair of the European Systemic Risk Board (ESRB). He outlined at the ESRB conference in Frankfurt last week the importance of policy makers to act on signs of systemic risk. It was a mixed picture for the Eurozone in terms of data points last week. September Euro manufacturing PMI data came in stronger than expected at 52.6 versus 51.5 previously (a reading above 50 is expansionary). The French economy saw services growth expand the most in 15 months with overall consumer confidence in Europe for September registering a stubborn -8.2 (unchanged on last month). European QE is set to come to an end March next year. This will make way for the more important programme of 'targeted longer term refinancing operations' (known as TLTRO's). The ECB handed over 45.3 Billion Euro's in the assisted programme compared with 31 Billion it undertook in a similar programme in June. In that round, the Spanish as well as the Italian banks were the main participants. In the latest auction, Intesa San Paulo of Italy took 5 Billion Euro's with Banca Populare and Mediobanca taking 500 million Euro each, underlying the problems the Italian banking industry faces. Troubled Monte Paschi declined to comment on whether they had even taken part in the auction. The main aim of TLTRO II (as it's called) is to boost credit to the real economy which we think longer term could be more effective than the more creative method employed in straightforward QE. The programme allows banks to borrow according to the loans they issue to both the corporate as well as the retail sector in an effort to boost lending and spur economic growth. In Greece we saw a positive step being taken last week with the ECB lowering the Emergency Liquidity Assistance (ELA) to the country to 51.9 Billion Euros from 52.8 Billion. The ECB highlighted that liquidity in the Greek banking system had improved along with the reduction in uncertainty over deposit flows to the financial system there. The Greek Prime Minister Alexis Tsipras hoped Greece would rejoin the ECB's QE programme by early next year and reiterated Greece's growth would reach a positive +0.2% to +0.4% for this year while hoping foreign investment would return to the country. **The AA remains confident with the events taking place in Europe. Valuations in the stock market don't appear to be as stretched as witnessed in the US and the portfolios remain 'overweight' European equities to that end.**

'Glistening' protection for portfolios – Enter 'Goldmember'

Precious metals have historically performed well in times of uncertainty as well as a hedge to inflation. The safety plays that are the G3 Government bonds have seen zero to negative yields of late with impressive flows backed by a QE fueled world we have become accustomed to. Precious metals such as gold while also yielding nothing, are seen as a tangible store of value beating negative yielding instruments the market seems to be awash with. We have been devoid throughout the year of making an investment in the metal that is up over 25% year to date thus far, but took the plunge at last week's AA meeting. So what changed ? We have been anticipating rising US rates that have been absent with the years volatility. Rising US rates have been a headwind to price appreciations in precious metals. With the no change in US rate policy last week with a looming US election, markets have not been factoring in a Donald Trump, Republican victory. In fact global markets seemingly appear to be continually moving to a state of easy monetary policy mantra without the need to focus on a Trump presidency. After Hillary Clinton's untimely illness last week and the lack of clarification on the matter, opinion polls have swung back to a 50:50 outcome to the election that should unnerve markets. But why unnerving? Trump talks about wanting to build a wall to Mexico, renegotiate US trade with its world partners. Pledges to renegotiate its debt obligations. Market moving events for sure but that's not all. Cutting taxes aggressively to boost consumer spending matched with a cut in Federal Government spending (to be reduced by 1% annually). A large programme of defence spending. All of this hinges on uncertainty and is completely different to the incumbents policies. Will markets have the same effect with a Trump win as they did sleep walking into Brexit? We don't gamble. The gold purchase is to protect such an unrealized outcome that could catch markets off guard, until such time the coast becomes clear again.

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