From West to East

Weekly Investment View

30th July, 2017

Claude-Henri Chavanon

Head of Products & Services
Wealth & Private Banking

Quite a lot for investors to digest

The S&P 500 index was virtually unchanged over the week, at 2,472.10, closing a fraction below Wednesday's all-time record. Below the surface there was a rapid rotation, however, with some downside returning to technology stocks (including the non-tech stocks within that grouping) being essentially offset by strong rallies in telecoms and energy stocks. The NASDAQ Composite index closed 0.24% lower over the week. In European, the STOXX Europe 600 index closed 0.46% lower, led by technology, and also given recent euro strength. In Japan, the TOPIX index fell 0.53% over the week, again led lower by tech stock weakness. In terms of news, investors had to digest the statement from the Federal Reserve after its meeting, the run-up to (and ultimate failure of) the latest attempt by the Republicans to get a "skinny" version of 'repeal and replace' health-care proposals voted through the Senate, two more important staff changes at the While House, a slew of economic data (including the official estimate of US second quarter GDP growth, as well as serious demonstrations in Venezuela (against impending changes to its constitution) and the firing of North Korea's latest intercontinental ballistic missile. Against this backdrop the dollar weakened further, by 0.74% on its index over the week, to 93.259, with Fed funds futures now judging the probability of a US rate rise to be 38.7% in December, down from just above 42% a week ago. Meanwhile, the oil price rallied quite sharply back to the middle of its recent range, to $49.71 basis WTI, as the market swung to a net-bullish interpretation of recent fundamental news, with a large fall in US crude inventories and the announcement of a capex reduction by Anadarko probably to the fore. **Gold rallied by just over 2%, to $1,269.64, reflecting dollar weakness, and probably also partly in sympathy with copper, which closed just over 6% firmer over the week in what looks like a continuation of positive sentiment as investors continue to positively reassess the growth outlook in China.**

"Markets will need central bank balance sheet tapering to be very gradual – and orchestrated"

In other markets, in fixed income the yield on the US 10-Year Treasury bond firmed 3 basis points over the week, to 2.2889%, still in the lower half of its recent range, and not by itself yet signaling any strong impending move in either direction. At the more policy-sensitive end, the yield on the comparable 2-Year eased by half a basis point, to 1.3472%. Commentators did their best to extract any new clues from the Fed's statement after the FOMC meeting last week, but in reality little had changed, dictating that rates should be left unchanged. Attempting to read between the lines, it sounds as though Ms Yellen and her colleagues continue to be frustrated by the lack of upward trajectory in inflation, yet they are still saying the 2% level should be reached in the 'medium-term', and also that in the meantime the Fed's balance sheet reduction could start 'relatively soon' (taken by many in the market to mean their 20th September meeting), although with the usual 'data-dependent' caveats. The US economy was growing moderately, they said, and job gains had been solid. Other US economic data released last week was consistent with moderate growth: IHS Markit's 'flash' manufacturing PMI rose to 53.2 for July, from 52.0 in June, while more importantly (services being a much larger part of the economy), their flash services PMI remained at 54.2, signaling moderate health. In other data, the Conference Board's consumer confidence index rose to 121.1 in July (a 16-year high), from 117.3 in June, and ahead of expectations. In hard, rather than survey-based data, June's headline durable goods index rose 6.5% month-on-month, although the 'core' measure (excluding aircraft) was only up 0.2%, having been up 0.4% in May. Late in the week the initial reading for US second-quarter GDP was posted, coming in at an annualized 2.6%, following 1.2% in the first quarter. Market expectations had been in the region of 2.7%. **It is looking like a very long economic cycle in the US, and the view of the IMF (to follow) fits this scenario, provided proposed balance sheet tapering by the Fed is achieved very gradually.**

"Reduced growth in the US is being offset by improvements in China and the Euro Area"

In a report entitled, "A Firming Recovery", the IMF last week updated its global growth forecasts. They have, however, kept their global growth forecast unchanged, at 3.5% for the current year, and 3.6% in 2018.

From West to East

Weekly Investment View
30th July, 2017

From earlier in the year we have expected their forecasts for the US to be reduced, and our readers will not be surprised that this has occurred. The key takeaway is that China, the European Union (and in a small way, Japan), are making up for slower US growth. US growth is now expected to be 2.1% for 2017 and 2018, slightly down from projections of 2.3% and 2.5% in April; they note that no details of President Trump's plans have been made public. They revised down their 2017 forecast for the UK, by 0.3 percentage point (to 1.7%), although left the 2018 forecast unchanged at 1.5%. The IMF now expects Euro Area growth to be slightly stronger this year and next, and pointed to "solid momentum" in the bloc; accordingly, they expect the overall area to achieve growth of 1.9%, up by 0.2 of a percentage point from its April number, and 1.7% for 2018 (up 0.1%). Within the bloc, Germany is projected to grow by 1.8% this year (0.2 percentage point up from the previous estimate), while France is forecast to grow by 1.5% (up 0.1 of a percentage point). The estimates for Italy and Spain have both been revised substantially higher, by 0.5 of a percentage point. Their forecast for Japan now stands at 1.3% for 2017, up slightly from 1.2% in April. The number for China is 6.7% for the current year, up by 0.1 of a percentage point. The IMF kept their forecasts for India for its current fiscal and the following year unchanged, at 7.2% and 7.7% respectively. We take the IMF as the baseline of our economic growth assumptions, and they provide much useful material, to which we'll be returning in subsequent Weeklies. **In essence, the economic picture they paint is supportive of continued global growth, with that growth being weighted towards 'Emerging and Developing Asia', and India.**

"In the short-term the euro rally vs. the dollar looks to have gone too far"

Last week some clients asked for our written view on the Euro/dollar, and for those who didn't see it a summary is reproduced below. As FAB Asset Allocation Committee investment policy currently stands, euro-denominated assets are 100% hedged (i.e. the Committee believes the euro is more likely to be weaker than the US dollar in the months ahead). We believe this reasoning should continue to apply, despite recent short-term strength in the euro vs. the dollar. A two-day New York close above 1.18 would be our 'stop-loss'. A week or so ago, we had expected Mr Draghi, President of the ECB, to talk the euro down, but he declined to do so. Such a strong move, if sustained, would harm the ability of the EU to export, with negative effects on growth. Technically the euro/dollar pair is now looking very overbought, just as the dollar looks oversold on its index (DXY) against a basket of its peers. Fundamentally, while major exporting blocs like the EU and US will each want to win the competitive currency depreciation war (for exporting and favourable translation purposes), each also wants to avoid encouraging capital outflows. So what is the balance of probability now – will the bullish euro trend continue for a while longer? Firstly, our take on the 'Dollar bearish' factors: President Trump's short-term struggles in Washington, including growing Russia-related distractions, are slowing down the rollout of his Administration's agenda to reform and stimulate the economy. As discussed earlier, the IMF has just revised downwards its US GDP growth forecasts by 0.2% and 0.4% for 2017 and 2018 respectively, resulting in envisaged growth of 2.1% for both years. If influential forecasters (including the Federal Reserve) continue to reduce their US growth assumptions, especially while those elsewhere are being edged upwards (e.g. for the eurozone), then the 'normalization' of US rates (i.e. increasing them towards where they might be in a more normal cycle, a percent or so above inflation) could be impeded – keeping the dollar relatively weak. Now the 'Dollar-bullish' factors: The US still has much more of the 'secret sauce' (to quote Warren Buffet) to run a capitalist economy than the eurozone does. One only has to compare the return on equity of the S&P500 index to that on the Euro STOXX 600 – the former is almost twice that of the latter. The US still has a superior rate of innovation – and far higher employment levels – compared to the eurozone. In the short-term, given the relentless tide of bad news (now including concern about the US debt ceiling), any good news could rally the dollar, perhaps by 2-4%. Turning to possible 'Euro-bearish' arguments: The eurozone still has lots of structural problems - unknown negative fall-out from Brexit, immigration and growing nationalism, inflexible labour markets, Greek debt, a weak Italian banking sector, a relatively impoverished periphery, and a series of elections to face in the months to come – to name a few. All of this is before revisiting the inherent problems of gluing together so many dissimilar parts in the first place (now breaking-out in nationalism and sovereignty issues) – plus the perennial one of trying to operate one monetary policy and currency for the whole bloc. Lastly, the 'Eurozone-bullish' view: The election of Mr Macron has brought some optimism to France's future (although the national psych he is up against is very rigid), and Mrs Merkel is enjoying a resurgence in Germany, now looking as though she will win the Federal elections due by this October. At the same time there is little doubt that the eurozone is enjoying a cyclical economic improvement; the IMF has just revised its GDP growth forecasts upwards slightly for the current year and next, by 0.2% and 0.1% respectively, to 1.9%, followed by 1.7%. Such rates of growth are almost back to what could be called 'respectable', and this could be improved upon if unemployment wasn't so stubbornly high. In the short-term, the euro has held above the 1.1630 (the post-ECB level last week), supported by notable inflows. **Also, we note last week's successful Greek bond issuance, the portents of which might be good for the periphery.**

"The dollar has probably discounted much Trump-related bad news"

Turning to what might happen with (especially Fed and ECB) statements regarding QE reversals, we intuitively expect the ECB to wait until the Fed has already started. Either way, we expect prudence to prevail, and for the ECB to begin to taper its balance sheet later than the Fed - and to keep its policy rate rather lower than the Fed's for the foreseeable future. Absent political disaster in the US, we expect the ECB to narrowly 'win' the currency depreciation war on a 6-12 month view.

First Abu Dhabi Bank

From West to East

Weekly Investment View

30th July, 2017

Mario Draghi's speech at Jackson Hole (24 -26th August) is being billed as a landmark, at which he might provide a few clues regarding ECB balance sheet-tapering, although in practice we expect him to 'follow the Fed' in this, partly to keep the euro down. To reiterate: the major central banks will not want to individually or collectively provoke a 'taper tantrum' by tapering at the same time, or in size; although the emerging world is much stronger than it was in 2013, there are still frailties. **In conclusion: the dollar has probably already discounted much Trump-related bad news (and lower US GDP forecasts), while markets should not get too excited about cyclical improvement in the eurozone when the degree of required structural change in the single-currency bloc remains substantial. We expect the euro/dollar rate to trade in a range of 1.17 to about 1.05 on a 6-12 month view.**

"US health-care will take a long time to put right"

Republicans were last week unable to find 'repeal' or 'repeal and replace' proposals capable of getting at least 50 votes in the Senate (where the party has a 52-48 majority), so it looks as though the whole discussion will start from the beginning, and as Republican Senator John McCain had indicated it should. Replacing Obama care was supposed to provide significant savings, designed to facilitate tax reform and infrastructure spending. Also, Republican leaders working on tax reform released a statement confirming the scrapping of the Border Adjustment Tax, following opposition from the retail sector. Again, this was supposed to be a major revenue generator. Looking forward, Republican leaders will try to get a tax reform deal through Congress in the autumn. Hopefully the party will be more united on this issue, and certainly this was the earlier expectation, and also one on which many Democrats might agree. Otherwise, General John Kelly, head of Homeland Security, was chosen late last week by President Trump to replace Reince Priebus as White House Chief of Staff, and following accusations that Priebus had leaked information. **The selection of Priebus in the first place was designed to help bridge gaps between Trump and substantial parts of the Republican Party.**

"The overweight in Asia-Pacific equities has been averaged-up"

INVESTMENT SUMMARY: The Asset Allocation Committee met late last week, and decided to further edge up the weighting in Asia Pacific (ex-Japan) equities, out of cash. This includes China, Australia, South Korea, Hong Kong, Taiwan, Singapore, Indonesia, Malaysia, Thailand, and the Philippines. A small underweight position has been retained in North American equities, and also in European equities, although readers will remember that a few weeks ago profits were taken in Technology, a sector in which the models are now neutral. Health-care is overweight.

"The work done by the IMF is important in our analysis"

Last week's results from Amazon (for instance) may be a sign that a short-term, market-bearish rotation may now evolve. Returning to the big picture, the logic of gradually increasing the Asia Pacific (ex-Japan) equity weighting in many ways draws on the kinds of observations and conclusions discussed in the IMF summary provided earlier. In all other respects investment policy remains unchanged.

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

From West to East

Weekly Investment View

30th July, 2017

Disclaimer:

This report has been prepared and issued by Global Asset Management ("GAM") of First Abu Dhabi Bank PJSC ("FAB") 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 FAB 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 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. FAB 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 FAB for such purposes. FAB 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. FAB does not provide any accounting, tax, regulatory or legal advice. FAB 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 First Abu Dhabi Bank 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. First Abu Dhabi Bank PJSC expressly prohibits the distribution and transfer of this document to third parties for any reason. First Abu Dhabi Bank 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.*