NBAD

From West to East

Weekly Investment View

19th March, 2017

Markets Adhere To The Fed Dot Plot

Markets started the week in repositioning mode, ahead of an expected US rate hike. More hawkish members of the US Fed alluded to perhaps a more aggressive rate path in the so called 'dots' that outline the future path for US interest rates. At the start of the week crude oil prices were coming off, looking as though $45/barrel (for West Texas Intermediate) might be tested. Higher than anticipated US oil inventories led to a 9% fall from the previous week. The US rates picture came into focus as the US Federal Open Market Committee (FOMC) started its two-day meeting on Tuesday, with a 25 basis point increase widely expected by the markets. Prior to the FOMC the US dollar had a firmer look about it. Recent US economic data has signaled a healthy economy, so far continuing into Donald Trump's presidency. Good levels of consumer confidence, augmented by the February Non-Farm Payrolls posted the previous week set the scene for Fed Chair Janet Yellen and her FOMC colleagues to raise rates sooner rather than later. Some market participants had begun to talk in terms of four rate increases this year, rather than just three. The statement that came with the announcement was less aggressive and more in tune with the three rate hikes the market was expecting for the year, despite several members of the US Fed reiterating calls for further rate hikes in the coming months. Given the more dovish tone, US stocks rose after the FOMC rate announcement, with the S&P500 actually rising 0.2% over the week. This put the index on track for one of its best quarterly performance in some years. For the year-to-date the S&P is up 6.7%, led by Information Technology, which is up by 12.3%. **The US 10-Year Treasury bond, which has been trading within a yield range of 2.30%-2.65% for the year-to-date, closed as high as 2.62% last Monday, only to trade back down to end last week at 2.50% vindicating our call to be long investment grade bonds at the more elevated yields at the beginning of last week.**

"Voters in the Netherlands find Dutch Courage"

The Dollar index closed 1.08% lower over the week, at 100.30, on a more tempered outlook for US interest rate expectations. This led a relief rally for the Euro along with the relatively poor showing of Geert Wilders' Freedom Party in the Dutch elections (and with hopes that Marine Le Pen might suffer a similar fate). The EuroStoxx 600 index closed up 1.5% over the week. Although it was encouraging to see Wilders gain fewer seats than forecast, we are aware that Marine Le Pen has quite widespread support in France. Some maintain that she still may not reach the second round of the Presidential elections which is due on the 7th May, the first round of which is due on 23rd April. **Thereafter, Germany's Federal elections are due in September/October, and must be held before 23rd October. Chancellor Angela Merkel and her CDU Party face mounting opposition from the far right, as the polls indicate.**

"UK Brexit – Permission granted, but spoilt by a Scottish twist"

After many weeks and months of debate, UK Prime Minister, Theresa May, was given the go-ahead by Parliament to trigger 'Article 50', so beginning the long-waited Brexit. Tough negotiations with Brussels now face the Premier and her team, including at least six different charters

Claude-Henri Chavanon

Managing Director
Head of Global Asset Management

that need to be rescinded. Immigration, covering the free movement of labour between the European Union and the UK, remains a contentious issue. The UK's future ability to trade in the so-called 'common market' of Europe also remains a question mark. Sterling, which had ended the previous week at $1.2167 (and looking vulnerable to further downside), actually rallied by almost 2% over the week, to $1.2396, helped by the rate and US dollar logic discussed earlier. It has finally dawned on markets that the triggering of Article 50 is not going to be a seminal moment, after which all the concerned parties move on. Certainly very tough Brexit negotiations could cause further volatility in sterling (and indeed the euro), although in our view they will contribute to the tracing-out of a bottom for currency. **We maintain our NBAD Global Investment Outlook 2017 forecast for sterling, which we expect to see closing this year within a range of $1.35-1.40 as the major parameters become clearer.**

We should mention that matters were complicated further last week, when Nicola Sturgeon, Scotland's First Minister, mooted the idea of a second referendum on independence from the United Kingdom. Theresa May hit back on what she characterized as ill-judged timing of such a statement, saying that Brexit should be allowed to complete first, and accusing the Scottish National Party (SNP) leader of 'playing politics with the future of our country', and creating 'more uncertainty and division'. Deputy SNP leader, Angus Robertson, dismissed Mrs May's comments, warning her not to attempt to block such a vote. None of the above prevented the FTSE100 index posting new all-time highs last week, assisted by still-weak sterling. **In terms of us officially reviewing UK equities (and bond markets), we continue to have 'no view' at this time.**

"Crude oil steadies, following Saudi Arabia's comments"

Comments by OPEC, led by Saudi Arabia, suggested the oil output reductions agreed at last year's Algerian summit would be extended another six months through to the end of the year, to help with rebalancing in crude oil markets. This came after crude dropped nearly 7% after recent data showing US oil inventories continuing to grow, and reports that Saudi Arabia had reversed about one third of its committed production curtailment in the short-term. Of course Saudi Arabia will not want to feel they are in any way single-handedly propping up the market. WTI closed at $48.78 last week, a dollar above its mid-week closing low. **We reaffirm our target price range of $45-$60 for WTI, with the growing likelihood that $65 should be tested by the end of the year. Other things being equal, lower crude prices in the short-term will help buoy end-demand, prior to a further expected gradual improvement in prospects for global GDP growth. Accordingly, we continue to advocate taking long positions in oil-related assets into any weakness. Increasing exposure in markets such as MENA equities would clearly be one way of playing it.**

"We recently took some profits in developed country equities – purely tactically"

INVESTMENT SUMMARY: The NBAD Asset Allocation (AA) Committee meets later this week, and will fully review all recent economic and market data. Readers will be aware that we recently 'took some money off the table', by reducing overweight positions in US and European equities – although purely on a tactical basis. On technical grounds, looking at the S&P500, for instance, the index is now looking extended relative to its medium-term moving averages, and while the latter continue to rise and be supportive, we still believe a market correction is likely. Politically, Trump's honeymoon is over, although we continue to like the overall 'pro-business' tenor of his Administration's policies. Next week's report will contain the salient points of the AA discussion, including any changes to investment policy. **In conclusion, although believing a moderate correction is overdue in developed equities markets, we remain constructive regarding risk assets.**

Any inquiries related to this article, please contact
Alain.Marckus@nbad.com or
Clint.Dove@nbad.com

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