NBAD

From West to East
Weekly Investment View
26th March, 2017

Learning political lessons from US healthcare

The S&P 500 closed only 1.4% lower over the week, despite the US House of Representatives vote on healthcare reform being cancelled last Friday, after it had been delayed the previous day once it became clear that lobbying in its favour was not working. Some nervousness had become evident earlier in the week as doubts began to emerge about the success of the vote, and therefore about the prospects for the passing of the Trump Administration's other plans (principally adjusting the tax code, and increased infrastructure spending), in addition to the relaxing of the regulatory environment, the latter of which is designed to especially encourage banks to lend to corporates. Last Wednesday was the first time in about 150 days that the S&P500 closed more than 1% lower, and many market participants pointed to this as the start of a correction, with a few saying it was the end for 'Trumpflation' stimulatory policies, based on the view that other measures being brought in by the new Administration could suffer a similar fate to their amended healthcare Act. Many healthcare stocks bounced strongly on Friday. The S&P500 is ahead by 5.1% for the year-to-date, (and by 9.6% since the election), and the NASDAQ 100 (better representing technology stocks than the NASDAQ Composite) is up 10.3% for the year-to-date. The EuroSTOXX 600 index was down 0.4% over the week, with Japan's TOPIX matching the S&P, down 1.4%. Economic data released late in the week added to evidence that the eurozone is performing quite well, at least relative to its own experience over recent years, with Germany and France in the vanguard, and this helped the euro during a week when the dollar was still suffering slightly from the 'dovish hike' rate hike from the Fed the previous week. Although the eurozone's continuing structural problems will come back to the fore sooner or later, the markets were in the short-term happy to see Marine Le Pen perform poorly in a televised election debate, with Mr Macron doing very well. Gold rose by 1.2% over the week, closing at $1,243, partly reflecting the 0.7% fall in the dollar index, and still below strong resistance located at $1,260-64. Given the 'gradual rate of normalization' message from the Fed the previous week, futures markets were pricing-in a 13.3% hike probability for May, rising to 50.2% for June, according to Bloomberg (and 76.1% for September). The yield on the US 10-Year Treasury bond fell by 9 basis points over the week, reflecting a move away from 'risk-on', while the 2-Year yield fell by 6 basis points. **Lastly, the UK is set to trigger Article 50 this Wednesday, which we will cover in some detail in next week's report.**

"Worries about global trade are probably over-stated"

At the beginning of the week the basics of the weekend's G20 talks on trade were published on the wires, with Bloomberg saying that Steve Mnuchin, according to Germany's finance chief Wolfgang Schäuble, appeared to have "no mandate" to settle his country's position on free trade and protectionism. Other delegates found Mnuchin positive, and rather more fairly commented that he was still familiarizing himself with what his job entails. Of course he has only been in the role a matter of weeks and must still be arriving at his own conclusions - which must then be discussed with President Trump and the senior members of the Administration. So it is a bit too early to expect defined positions on trade, further than what the new representatives of the US have already said i.e. that it has to be 'fair'. So at the G20 talks the US was unable to clearly support free trade, leading to a watered-down joint communique to the effect that members were 'working to strengthen the contribution of trade to our economies'. **As one commentator (from UBS) reminds us, the preoccupation with physical trade doesn't adequately take into account the US's surplus in services.**

Claude-Henri Chavanon

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The Trump Administration has just received a profound lesson in real-world US politics. The fact that the Republicans have not voted as a block means that the Affordable Care Act ('Obamacare') may have to remain in place for some time. It is said that Trump himself had questioned the wisdom of tackling healthcare first, and it looks as though that instinct was correct; his attitude towards it now will be 'just watch this thing go further wrong', leading to an almost inevitable 'told you so'. The Trump Administration had promised that after health-care reform, tax reform would follow, and by August, and it looks as though investors are naturally placing far greater importance on taxes, regulatory reform, and infrastructure spending. The House of Representatives' conservative Freedom Caucus had threatened to vote against the new proposals without significant changes to it. Although a short-term factor, we have taken it as a bullish divergence that US equities avoided a major sell-off on Friday after the vote pulling was made known (pulling the vote was better than losing it). **Paul Ryan spoke well after the**

event, and he and the Trump Administration will now as stated move on to tax reform, for which there should be much greater agreement.

> *"The Republican's American Healthcare Act has been a huge lesson for them"*

In terms of getting Republican policies passed, from this point there should be benefits from the fact that for the first time in 11 years, the Republicans control the presidency and both chambers of Congress (there are 44 more Republicans than Democrats in the House of Representatives). The Freedom Caucus is composed of 29 members, and will admittedly have to be well managed in future by the Administration and Speaker Ryan. The conservatives had felt the new American Healthcare Act had not gone far enough, whereas moderates were afraid the new legislation would leave too many of their constituents without medical insurance cover. The Republican replacement for the Affordable Care Act sought to save money by winding down the its expansion of Medicaid and capping its subsidies. This would have adversely impacted revenue for doctors, hospitals, and medical insurance providers. Republican conservatives wanted an even more complete re-working, with moderates apparently shocked when the Congressional Budget Office estimated the proposed plan would leave 24 million more Americans without health insurance by 2026. In conclusion, we believe the subject of US healthcare reform to be hugely emotive and contentious – and that fiscal and regulatory policy changes are very unlikely to suffer the same fate. **Sean Spicer, White House Press Secretary, is almost certainly correct when he said last week, "There's a huge appetite for tax reform", - and we continue to believe the roll-out of such policies will be bullish for US equities, with knock-on effects elsewhere.**

The NBAD Asset Allocation Committee met last week, and decided to leave investment policy unchanged, with the exception of a decision to slightly increase the overweight position in MENA equities across the model portfolios. It was thought that the weakness in oil prices towards $47/barrel (WTI), down from $54 on 21st March represented an opportunity to add to this asset class for the medium term. On a country basis, the recommended overweight positions are currently the UAE, Kuwait, and Oman (with a 'neutral' weight in Saudi Arabia). In the UAE, 'dividend season' is over (with stocks having gone ex-dividend), the markets have corrected, and the MSCI UAE Index is trading at a P/E ratio of 10.4x 2018 earnings (down from 11.6x for the current year), and based on 11.73% estimated earnings growth next year. Favoured sectors are the Banks, based on their attractive valuations, the likelihood that provisions have normalized, plus the improvement in net interest margins to come, and Real Estate, especially after the recent correction. In Kuwait, valuations remain attractive, whilst the expected increase in the weight of Kuwait in the MSCI FM index could drive further inflows, with our preferred sectors being Banking and Telecoms. Within the overall neutral stance for Saudi equities, the recommended approach is to overweight selected National Transformation Plan beneficiaries, principally in Real estate and Healthcare. Real estate is progressing at a faster pace than expected, while in Healthcare the receivables issue with the government is expected to be resolved in tranches. The correct stance in Saudi banks is probably to be underweight, given that provisions have begun to rise. **On a more positive note for Saudi equities generally, the market is moving to 'T+2' settlement, while the criteria for MSCI EM index inclusion should be met in due course.**

> *"As Warren Buffet says, "The US has the secret sauce"*

INVESTMENT SUMMARY: Developed equity markets may still see the 4-5% correction that we have been discussing since the publication of the NBAD Global Investment Outlook 2017 in January. Markets have needed, and would be well served by, such a technical correction. So many are now calling for this that it may not actually happen. US equity market action late on Friday was not the immediate downside that some scaremongers had called for, consistent with 'end of Trumpflation' warnings. Readers will be aware that the Asset Allocation Committee (AA) had already reduced the overweight position in developed market equities on a tactical basis. The AA Committee met ahead of the initially postponed vote last Thursday, and briefly discussed the option of going to neutral – but decided against doing so. By this point it looked as though repealing Obamacare would fail, but the Committee does not think it's 'the end' for the Trump Administration or their policies. The failure of this legislation is certainly painful for the Administration, without any doubt – but we do not regard it as a disaster. We would reiterate that healthcare, especially in the US, is very emotive and highly politicized – whereas US tax reform in the manner likely is arguably not – and should succeed. **As Warren Buffet recently said, it's not just about Trump, it's about the evidence (as he sees it) that the US has 'the secret sauce'.**

> *"We still believe in the ability of the Trump Administration to succeed"*

Although President Trump's policy initiatives are important, they are actually not the 'be-all and end-all' for global equity markets. The world's largest SWFs had already made major investment policy decisions to gradually increase weightings in equities relative to bonds, probably predicated as much on an eventual end to the multi-decade bull market in bonds and historically very low bonds yields vs. equity market yields. **We are not yet calling the end of the bull market in global bonds; rather, as we have argued, these continue to be in a broad trading range, still characterized by a range in the US Treasury 10-Year yield of between 2.30-2.65%, resulting in trading opportunities that we have taken advantage of in recent months.**

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