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FAB
First Abu Dhabi Bank

From West to East

Weekly Investment View
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Confidence is growing across global markets

Claude-Henri Chavanon

Head of Products & Services
Wealth & Private Banking

The S&P500 index closed up 0.15% over the week, just below the all-time high reached a few days earlier, with the NASDAQ Composite inching to a new all-time high on Friday. So Wall Street's main equity benchmarks continue to set record highs, almost certainly driven by US 'core' consumer prices coming in on the weak side for last month (see below). The MSCI World equity index rose by 0.69% over the week, also to a new all-time high. In European stocks, the STOXX 600 closed ahead by 0.50%, helped by a recovery bounce in Spanish stocks following Catalonian politicians not immediately proceeding to secession from Spain. Japan's TOPIX index rose by 1.27% to a recent high as confidence became even greater that Mr Abe would be returned as Prime Minister in the general election due on the 22nd October; Japanese stocks remain 3.7% below their all-time high reached in June, 2007. Mr Abe being returned is expected to ensure the continuation of the existing leadership at the Bank of Japan, and interest rates staying at current ultra-low levels – probably for a long time to come, and irrespective of the extent to which other central banks might be reigning-in quantitative easing (QE). Significantly for the region (and important to us as our largest overweight relative to the benchmark), the MSCI Asia-Pacific (ex-Japan) index rose by 2.10%, to a new all-time high, although this partly reflects a 'catch-up' following China's recent closure for Golden Week. In bonds, the Bloomberg Barclays Global-Aggregate Bond index rose by 0.89%, broadly consistent with the yield on US 10-year Treasuries coming off by 8 ½ basis points over the week, to 2.2730%, and that on the German 10-year bund falling by 5 ½ basis points (to 0.4030%). As mention previously, we expect the ECB to very definitely lag the Federal Reserve in rolling back QE. The more sensitive US 2-year Treasury saw its yield fall by just a basis point, to 1.4929%, in line with a small reduction in the market-inferred probability of a Fed rate rise this December to 73.3% (from 78.5% at the end of the previous week). In FX markets, the dollar was 0.76% lower on its index, having been a bit bruised by disappointment that the core inflation number was not stronger. The euro/dollar pair was similarly 0.76% firmer over the week, closing at $1.1820. **Cable was volatile this week, ending 1.68% up (at $1.3285) in the main bouncing back from a Brexit sentiment 'hit' the previous week (with that negative sentiment remaining, as the clock appears to be counting down with little or nothing yet achieved in exit negotiations).**

"The University of Michigan consumer confidence reading helps more than storm-affected retail sales"

The small wobble in US rate increase sentiment seen last week appears to be more about what happens with rates next year, rather than what is expected this December. The official inflation data from the US Labor Department for September came in at a 0.5% month-on-month increase at the headline level, largely driven by higher gasoline prices resulting from September's tropical storms, which took the year-on-year rate to 2.2%. However, markets were naturally looking more at the 'core' number, excluding food and energy, which was up 1.7% year-on-year in September, unchanged from the previous month. US producer prices were similarly affected by the aftermath of the storms. In other US data, retail sales recorded their biggest increase in 2 ½ years in September, artificially driven by reconstruction in the states affected badly by the storms, as well as autos under the same heading; for the record, retail sales increased by 4.4% in September, vs. expectations quoted by Reuters for an increase of 1.7%. Otherwise, the University of Michigan said its consumer sentiment index climbed to a 13-year high of 101.1 in October, from 95.1 in September, way ahead of consensus expectations in the 95 area. There were also big improvements in their 'current economic conditions' and 'expectations' indices, which rose to 116.4 (from 111.7), and to 91.3 (from 84.4) respectively. Overall, US consumers are more optimistic than for quite some time. Moving to oil markets, Brent crude, the international marker, rose by 2.79% over the week (to $57.17/barrel), with sentiment apparently driven by (a) perceptions of improving global demand, including Chinese strategic purchases, and (b) confirmed reports that thousands of Kurdish peshmerga fighters have been moved to the Kirkuk area to counter a build-up of Iraqi government forces to the south; Kirkuk is oil-rich, and the area is claimed by Kurdistan (which voted to secede from Iraq last month), and by the central Iraqi government. Kurdistan has recently been exporting as much as 550,000 barrels/day of crude oil, so this is a 'market-moving' amount if it comes under threat. Lastly, gold has just regained the $1,300 level (as we have said, this is more than simply 'roundaphobic), being up $27 over the week. **If gold can at least maintain current levels there would be an increasing chance of at least a gradual bull market, with market participants**

being aware that precious metals will usually follow the overall trend in base metals; prices of the latter have continued to appreciate, with the LME Metals index rising a further 2.13% last week (to 3,266.10), consistent with a 'late' (or extended) cycle thesis, helped by IMF global growth estimates once again being revised upwards.

"Spain will probably adjust its constitution to enhance regional autonomy"

In a brief update on the Catalonia situation, had Carles Puigdemont, regional president, declared independence last Tuesday during his historic speech in their parliament, he almost certainly would have been immediately arrested by the Spanish authorities for acting illegally. He was forced to walk a fine line between going for independence at that moment - only for it to be snuffed out - or choosing to 'defer' the decision to be seen to be willing to enter into discussions with Madrid. Following his very skillful speech in which he put the move to secede on ice, Madrid has given Mr Puigdemont until Monday, 16th October, to clarify his position on independence. In the meantime, Mr Mariano Rajoy, prime minister and leader of Spain's conservative Popular party, and Pedro Sánchez, leader of the opposition Socialists, have instructed their teams to draw up a plan for overcoming the crisis by means of a reform of Spain's 1978 constitution (last amended in 1992, and then again in 2011). We have yet to hear what their proposals will contain, but it seems possible that modernization of Spain's laws relating to regional autonomy may occur, and in a way that formally respects Spain's diversity. It goes without saying that making concessions for only Catalonia would upset other regions, so this will have to be handled as delicately and as fairly as possible. If things go badly, Mr Rajoy will be forced to enact Article 155 of the constitution, leading to the suspension of Catalonia's autonomy, creating trouble. In Austria, the country today goes to the polls today in a general election likely to replace its current coalition with a new government backed by anti-immigration nationalists, led by a politician who would become the world's youngest leader. A 31-year-old, Foreign Minister Sebastian Kurz, is leading his conservative People's Party into today's election. Commentators say that would lead to a coalition with Heinz-Christian Strache's populist Freedom Party, bringing to an end a decade of Social Democrat-led governments. For the last six years or so the Austrian economy has performed well, but (like other countries in Europe) there are problems outstanding relating to immigration and issues of fairness linked to the allocation of welfare. Europe has seen a crop of nationalist/populist candidates this year (in the Netherlands, France and Germany), and in this instance it does look as though the country will be run by an anti-immigration alliance, intent on restricting access to social security and making Austria's borders tighter. **In the latest opinion polls, Mr Strache's Freedom Party is leading the Social Democrats, by 33% to 27%.**

"In line with 'Outlook 2017', the IMF has once again revised its global growth forecast upwards"

Last week the IMF increased its GDP growth forecasts for the world economy for 2017 and 2018, to 3.6% (from 3.5% in July), and to 3.7% (from 3.6%) respectively. GDP growth is estimated to have been 3.2% in 2016. They commented that the recovery is not complete, held back by low wage growth, restrained productivity, adverse demographic factors, and still-low commodity prices. However, "The global upswing in economic activity is strengthening," the IMF said in its executive summary, also saying, "Broad-based upward revisions in the euro area, Japan, emerging Asia, emerging Europe, and Russia - where growth outcomes in the first half of 2017 were better than expected - more than offset downward revisions for the US and the UK". They reduced their UK's growth forecast for this year by 0.3 percentage points, to 1.7%, while raising forecasts for Germany, France and Italy. The forecast for China was raised to 6.8% for this year, up from its previous estimate of 6.7%, due to stronger recorded growth in the first half, and for 2018 the forecast was raised to 6.5%, from 6.4%. In raising those estimates, the IMF said it expects the Chinese authorities to maintain a high level of investment-fuelled growth, while urging the Chinese to rein in the expansion of credit. Turning to India, the forecast for the current financial year (ending in March, 2018) was lowered to 6.7% (from the 7.2% predicted in July); for 2018/19 the forecast was reduced from 7.4%, from the earlier 7.7%. The report mentioned strengthening growth across most of Asia, including for Japan, whose forecast was raised to 1.5% for the current year (vs. the earlier 1.3%), and 0.7% for 2018 (up from their earlier number of 0.6%). The Fund expects the UAE to grow at 1.3% this year, followed by 3.4% in 2018. They expect the oil price to average $50.3 a barrel this year, and to remain in the $50s until 2022. **In our January 'Outlook 2017' we said we expected global growth prospects to be revised upwards, thinking especially of the forecasts from the IMF, which we use as our consensus baseline. At that time the IMF was expecting growth of 3.4% in 2017, and 3.6% for 2018. The fact is that for a number of years, investors have grown accustomed to growth forecasts being revised downwards during the year – but we said this year would be different – and that is what is happening. This was an important part of our thesis to be overweight risk assets, namely equities, during 2017. Although the forecast revisions by the IMF have been piecemeal, that is to be expected; as we said earlier in the year, it's the direction that counts.**

"We still hope for an equity correction – it's too soon to be bearish"

INVESTMENT SUMMARY: The FAB Asset Allocation Committee meets later this week, and pending that investment policy remains unchanged. Next week's report will contain a full update from that discussion. **Until then, we would comment that although we are still hoping for a moderate correction to enable long positions to be added to, we have in reality not yet reached any kind of euphoria that would signal the end of the long equity bull market.**

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

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