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FAB

First Abu Dhabi Bank

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Market corrections are normal

The bell-weather S&P 500 index closed 1.38% lower over the week, at 2,604.47 (or 9.34% below its all-time high reached in late January this year), mainly based on journalistic chatter about the possibility of a trade war between the US and China - with the week ending with some disappointment regarding US non-farm payrolls (NFPs) for March. The NASDAQ Composite index was 2.10% lower over the same period. Importantly, last week's move was not on the back of elevated trading volumes. Market participants usually define a correction as a fall of 10% from a high - and let's not forget that corrections in markets are totally normal. By the beginning of Friday, investors were beginning to get slightly rattled by President Trump's threat of an extra $100 billion-worth of tariffs, superimposed on the initial amount of $60 billion (which China had already rapidly matched, and as anticipated in a highly-targeted fashion, emphasizing agricultural products). Friday was a difficult day in risk-asset markets in the US, and further consideration of the NFPs provided the excuse for a sell-off in the final two hours of trading. Accordingly, the STOXX Europe 600 index missed the final sell-off, closing 1.07% to the good over the week (at 374.82), with Japan's TOPIX slightly ahead (at 1,719.30). **Chinese equities were just over 1% lower over the week, and with a slightly lower renminbi, so our favoured Asia-Pacific (ex-Japan) grouping (as measured by the MSCI index of that name, at 560.683) closed 0.58% lower over the week.**

"Any genuine worsening in the trade situation would almost certainly cause the FOMC to tread much more carefully on rates - which would in turn be supportive of risk assets"

Meanwhile, in global bonds, the Bloomberg Barclays Global Aggregate index (unhedged) closed a quarter of one percent lower over the week (broadly reflecting 3½ basis points on the US 10-year Treasury yield, at 2.7735%), so there was certainly no sustained dash into haven assets resulting from trade concerns. At the shorter end of the curve, the US 2-year yield was exactly unchanged over the same period, at 2.2661%, keeping the 10-minus-2 year spread at just above 50 basis points. Foreign exchange markets were essentially quiet, with the dollar 0.15% firmer on its index over the week, at 90.108, so hanging onto the 'big figure'. Lastly, in commodities, in recent weeks the price of oil appears to have been pushed about by equity prices to a greater extent than usual, with Brent crude closing at $67.11, down 3.22% over the week. Gold in dollars was 0.57% higher over the week, at $1,333.03/oz, and just under one percent higher in euro terms - a study in genuine disinterest, and so far encouraging for those of us looking to weather volatility in risk assets prices in pursuit of the gains in equities that typically occur in the final quarter of bull markets. Lastly in this section, we note disappointment on the part of some commentators that Jerome Powell, US Federal Reserve Chairman, in a speech last week indicated the FOMC would continue hiking rates this year (surely no surprise, unless new data dictates otherwise). **A slightly different take on the same story is that he underlined a likely "patient" approach to the raising of interest rates, which doesn't sound particularly hawkish to us - and as we emphasized a few weeks ago, during his first Fed Q&A Mr. Powell made it very clear that the FOMC is very mindful of any adverse developments in the world trade environment.**

"In the NFPs, having wage growth at 2.7% is satisfactory, and so is having unemployment as low as 4.1%"

US non-farm payrolls rose by 103,000 in March, rather below the average forecast of 193,000 in a Reuters poll. This followed an outsized gain in February of 326,000 (after revision, see below). Last month employment grew in manufacturing, health care, and mining, according to the US Labor Department. The headline unemployment rate was unchanged, at 4.1%, for the sixth consecutive month. Similarly, the labor force participation rate, at 62.9%, was little changed. Average hourly earnings rose by 0.3% last month, with the year-on-year gain rising to 2.7% - a number in the 'middling' range, causing neither comments of "too high", nor "too low". As always, the revisions need to be looked at carefully. The change in total non-farm payroll employment for January was revised down, from +239,000 to +176,000, and the change for February was revised up from +313,000 to +326,000; after these revisions, job gains in January and February combined were 50,000 less than previously reported. **However, after making these adjustments the average gains have been just under 202,000 for the last three months - and this is the kind of number generally considered to be healthy for the economy, or at least the minimum necessary to adequately absorb net new entrants coming onto the job market.**

"No one can be sure, but we do expect cool 'trade' heads to prevail"

Turning to trade discussions, these are continuing behind the scenes, according to Mr. Kudlow, President Trump's new economic advisor. Trump does have to be seen to be taking a hard line with China for him to avoid looking weak politically in the light of 'America First'. China's Commerce Ministry said last Friday they won't hesitate to react with a "major response" to the new tariffs from the US. Trump tweeted: "China, which is a great economic power, is considered a Developing Nation within the World Trade Organization. They therefore get tremendous perks and advantages, especially over the US. Does anybody think this is fair? We were badly represented. The WTO is unfair to US". The markets were slightly unnerved after US Treasury Secretary, Steven Mnuchin, said there was a possibility of a trade war with China. Separately, Trump advised that these trade developments could cause investors some short-term pain, although the end result would in his opinion be better for the US. It hasn't been lost on investors that China's response to the further $60 billion of Chinese tariffs was rapid, and highly targeted (as expected, at US agriculture). We have been saying that the current trade spat initiated by Trump has been about establishing a solid negotiating position - and that he will in all likelihood do as he recently did with the aluminium and copper tariffs i.e. then take a step backwards. It is nonetheless true that, if actually enacted, the numbers quoted have begun to bother some economists. Additionally, we note that the official managed Chinese renminbi quote was marked higher during the last week or so .i.e. the Chinese currency was weakened. Just as we had suspected that China, in strengthening its currency in recent months (more of a net advantage to the US in their trade) had wanted to show willing, the Chinese may now want to show that a reversal to renminbi strength can just as easily be engineered if the US really does want to play hard-ball. **While of course we can't be sure exactly what will happen, we still definitely expect the bluster to subside, and for cool heads to prevail.**

"The equity bears have largely stopped saying equities are expensive"

INVESTMENT SUMMARY: The FAB Asset Allocation Committee (AAC) met towards the end of last week, and below are some of the discussion points from its meeting: (1) Looking at Citi Eurozone Economic Surprises, the recent very poor trend (well into negative territory) encapsulates the steady stream of economic 'misses' - and before a wave of French rail strikes - which reminds us why Eurozone equities usually trade at a discount to other developed markets; **(2)** The robust performance of Emerging Market equities for the year-to-date speaks volumes about the 'New World' of EM equities, and note the solid performance of the MSCI EM Currencies index. In the Old World, EM would have crumbled faced with the prospect of rising US rates, and/or concern about global trade. From now on, the EM world will increasingly trade within its own members, and drive each other's growth; **(3)** Considering the technical picture of global equities (as per the MSCI All Country World index), this admittedly has a slightly battered look about it, but important support levels have held. A 'risk-on' stance exists to be tested, but the Committee believes the equity bull market is intact; **(4)** With the US Equity Risk Premium (the forward earnings yield on stocks minus the US 10-year Treasury yield) up from 2.50 to 3.09 since year-end, equities are rather better value than they were - and the fact that the 3% yield on the 10-year bond hasn't been broken to the upside remains supportive of equities; **(5)** Turning to the MSCI All Country Information Technology index, the fundamental future for technology (especially ex-social networking) still looks excellent. Stay long, with the broad sector supported by excellent estimate revisions; **(6)** Managed money positioning in Brent crude is looking very 'full' (i.e. speculators are already very long). While this can always go to new extremes, existing enthusiasm may delay a break above $70; **(7) With the S&P500 currently trading on 15.1 x earnings for the current year, falling to 13.7 x for 2019, the siren calls of 'expensive' have almost totally dried up. In making no changes to the model portfolios last week, the AAC decided to maintain its overall 'risk-on' stance in global equities, although may make a few structural changes during the next few meetings.**

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