



global weekly

Investment
Communication

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Guardians of growth

The actions of central bankers and policymakers soothed markets this week. The slowdown in China, while negatively affecting other emerging markets, should not impact global growth.

Financial markets are settling down after a tumultuous couple weeks since the “Black Monday” of 24 August. Ten-year Treasury and Bund yields have moved lower, commodity prices are stabilising and equity markets are edging higher.

A key reason for the reduced nervousness is that central banks and policymakers have stepped in and are taking action to reassure markets and investors. The European Central Bank (ECB) is now expected to increase its asset purchasing programme in the next few months, and we believe that the US Federal Reserve will likely postpone its first rate hike until December. This week Chinese officials confirmed the government’s commitment to support economic growth by accelerating the introduction of proactive fiscal policies and reforms. And, in Japan, investor sentiment was improved by the prospect of further monetary easing by the central bank and the government’s plans to reduce taxes.

While market volatility has lessened in response to the actions of policymakers, a lag between implementation and results could rekindle market nervousness. And, with central bankers back to extinguishing fires, the return to more normal monetary policy is being delayed.

Macro update

Recent data has been positive for developed markets. Europe, the US and Japan are doing well. Improvements in the euro-zone economy are broad and credit growth is now positive. Moreover, consumer demand is strengthening, unemployment is falling and business confidence is improving. In the US, there is a broad swath of improving data, ranging from labour and housing markets, to consumer and business confidence. Industrial output is also expected to strengthen in the months ahead.

Equity index performance

	Value	One week change (%)	Year-to-date (%)
MSCI ACWI	391,2	1,8	-6,2
S&P 500	1952,3	0,2	-5,2
AEX Index	431,6	-0,3	1,7
EuroStoxx 50	3221,1	0,3	1,4
DAX Index	10210,4	0,7	3,0
Nikkei 225	18264,2	2,7	4,7
Hang Seng Index	21504,4	3,2	-8,9

Important rating changes (RL=Recommended List)

Company	From	To
Cooper Companies	Hold	Buy
Southern Co	Hold	Buy
Boskalis	Hold	Buy
Pernod Ricard	Hold	Buy
Glencore	Buy	Hold

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	0,731	2,3	16,9
German Bunds 2-year	-0,232	0,8	-15,6
Japan 2-year	0,010	-0,1	-6,3
US Treasuries 10-year	2,200	7,5	-35,1
German Bunds 10-year	0,680	1,3	-36,0
Japan 10-year	0,339	-1,6	-22,2

Spreads

Index	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	79,82	-3,69	20,70
iTraxx Euro 5-year	71,33	-2,24	12,14
JPM EMBI+	414,72	-5,96	109,35

Performance data as of Friday, 11 September.

Source: Bloomberg

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Emerging markets, however, are a different story. As the Chinese economy slows, countries that export to China are being hurt. This affects emerging economies more than Europe or the US. And the depreciation of the yen over the past two years has hurt the competitiveness of Asian emerging markets in general. Nonetheless, Group Economics maintains that a “hard landing,” where the Chinese economy would tip into recession, is unlikely. But the risks have clearly increased.

The effect on the eurozone of slowing growth in emerging markets is expected to be limited. This is because a slow-down in emerging markets imports is being offset by growing domestic demand within Europe and the US. Demand has also been helped by the euro’s 5% depreciation over the course of 2015. As a result, developed markets have so far been resilient to the problems in emerging markets.

Equity markets update

After a turbulent period, financial markets moved upward, helped by statements from the ECB and China’s Ministry of Finance. Cyclical stocks outperformed. Volatility indicators remain at elevated levels, indicating short-term risks remain. After Japan’s prime minister pledged to follow through with a corporate tax-cut to support domestic investment, Japanese stocks rallied by 7%.

This week corporate headlines were mainly dominated by news from the information-technology sector. Apple revealed a new series of iPhones and Apple TV, but as a future earnings driver, the launch of the iPad Pro was of greater importance. Due to an alliance with Microsoft, we think the new iPad Pro will be readily adopted by corporations.

Internet company Yahoo announced that the US tax authorities refused to grant a ruling for a tax-free spinoff of its 16.3% stake in Chinese web portal Alibaba. Yahoo plans to spin-off the stake later this year, but given the ruling, it could have a USD 9 billion tax bill. Yahoo shares, however, were little changed this week, as there had already been rumors about the ruling. Alibaba lowered its guidance for gross merchandise volume, due to the economic situation in China and the psychological effects of the recent market downturn. It is one of the first companies to cite a slower pace of consumer growth in the region.

Although in the short term, further volatility can be expected, we maintain our long-term positive stance toward equities, based on low interest rates, positive economic growth and earnings momentum. In terms of regions, we favour Europe over the US and have a slight preference for Asian emerging

markets. Here, we favour commodity-importing countries, such as China and India, which can benefit from low prices, over commodity-exporting countries, such as Indonesia or Malaysia. While cautious given the economic outlook, we believe that valuations in China and India are attractive and are already discounting a very negative scenario.

Bond markets update

Bond yields in the US and the eurozone rose slightly over this week. The main factors driving fixed-income markets are the volatile equity and oil markets and market uncertainty about the timing of the first rate hike by the Federal Reserve.

Core government bond markets are being driven by investor risk appetite. For instance, when equity markets rallied on Tuesday, bond yields rose as investors switched from the perceived safe-haven of bonds to equities. The prospect of further monetary stimulus in Asia was the main reason for the switch. Investor sentiment was further lifted by the prospect of further monetary easing by the Bank of Japan.

We maintain our negative view on emerging-markets bonds. The negative sentiment surrounding this bond segment was exemplified by Brazil losing its investment-grade rating this week, as Standard & Poor’s lowered its opinion for the country to BB+ and the outlook remained Negative. The main reason for the rating agency to lower the rating to high-yield status was the revision to a fiscal deficit in August, shortly after a projection of a surplus in July. Overall, we believe that a positive change in the fundamental story for global emerging markets will take considerable time and that any rally is likely to be temporary.

Asset allocation

The Global Investment Committee, at its meeting on 10 September, confirmed its conviction in the existing asset allocation. It consists of an overweight allocation to equities (profiles 2 to 6) and commodities (profiles 2 to 6) and a strong underweight in bonds (profiles 1 to 5), with no bond allocation in profile 6. Real estate, which is strongly correlated to equities, is underweight (profiles 2 to 6). Hedge funds are overweight in all profiles. Cash is overweight in profiles 1, 2, 3 and 4 and underweight in profiles 5 and 6.

Currency outlook

The environment for emerging market currencies remains very poor. There has been a negative feedback loop between lower commodity prices, concerns about global growth, deterioration in investor sentiment, weak domestic growth and expectations

that the Fed will start hiking rates in 2015. Group Economics believes that the currencies of Brazil, South Africa, Turkey, Colombia, Malaysia and Indonesia are the most vulnerable.

In developed markets, the euro and the US dollar are expected to reach parity, based on monetary policy divergence and an expectation of constructive financial markets. The bearish view on the yen is maintained, based on additional monetary policy stimulus by the Bank of Japan, a widening difference in interest rates with the US and less interest in the yen as a safe-haven currency.

Published this Week

Bond Markets Monthly: Question Marks over Global Growth

- ▶ The ECB strongly believes that the current accommodative monetary policy stance needs to be maintained
- ▶ Market expectations regarding the Fed's rate lift-off have shifted back and forth, reflecting economic data, Fed comments and the July FOMC meeting minutes
- ▶ Our economists recently changed their expectations for a first Fed rate hike: the Fed will probably not start lifting rates in September, but in December

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