



global weekly

Investment
Communication
9 October 2015**A positive mood**

According to the Federal Reserve minutes, the Fed kept its policy rate unchanged due to worries over emerging markets. The Fed's decision, however, together with risen oil prices, brought markets in a positive mood.

Macro outlook

In September, the Federal Reserve (Fed) left its policy rate on hold, although markets had expected a rate hike. The Fed's minutes show that risks in emerging markets, particularly in China, raised concerns on the effects that these developments would have for the US economy and the inflation outlook. The delay of the first rate hike will give the Fed time to allow financial conditions to stabilise, external uncertainties to wane and data to improve again.

We think that the Fed will further delay raising interest rates beyond December and into 2016. When exactly is uncertain, but our sense is that the first hike will not come until June 2016. After that, we expect a rate hike every other meeting, which would leave the target for the fed funds rate in a range of 0.75-1% in December 2016.

When the Fed does delay its December rate hike, this will lead to reactions from other central banks. We already expect the ECB to increase its monthly purchases from EUR 60 billion to EUR 80 billion. We now think that the ECB will also extend the time horizon for its asset purchasing programme through the end of 2016. Meanwhile, the Bank of Japan will likely step up its monetary easing early next year, but the chances of an earlier move are now much bigger. Finally, we are also pushing back our forecast for the first rate hike by the Bank of England to the third quarter of next year, from previously the first quarter.

Equity markets update

The MSCI World Index rose by around 3% this week. The sectors energy and materials significantly outperformed. Fading worries about China's economy, changed expectations for the Fed's first rate hike and recovering oil and commodity prices supported the markets.

Equity index performance

	Value	One week change (%)	Year-to-date (%)
MSCI ACWI	405.2	4.4	-2.9
S&P 500	1995.8	3.7	-2.2
AEX Index	444.0	4.5	4.6
EuroStoxx 50	3262.1	5.4	3.7
DAX Index	10113.0	5.7	3.1
Nikkei 225	18438.7	3.9	12.1
Hang Seng Index	22458.8	4.3	1.4

Important rating changes (RL=Recommended List)

Company	From	To
GENERAL ELECTRIC CO	Buy	Hold
ALIBABA GROUP HOLDING LTD	Buy	Hold
EI DU PONT DE NEMOURS & COMPANY	Buy	Hold
TELEFONICA SA	Buy	Hold
PETROLEO BRASILEIRO SA PETROBRAS	NR	Buy

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	0.639	5.8	19.7
German Bunds 2-year	-0.255	1.4	-19.2
Japan 2-year	0.002	0.3	-4.5
US Treasuries 10-year	2.096	10.2	-21.8
German Bunds 10-year	0.603	9.4	-30.2
Japan 10-year	0.314	0.2	-17.3

Spreads

Index	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	82.33	-12.16	13.38
iTraxx Euro 5-year	81.10	-10.99	13.62
JPM EMBI+	404.05	-33.48	62.44

Performance data as of Friday, 9 October

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Oil prices soared on positive notes from the US Energy Information Agency (EIA). The EIA expects global oil demand to increase by most in six years. In combination with declining US oil inventories, this fuelled energy shares. Also helpful were remarks from Shell's CEO Ben van Beurden. He said to do whatever it takes to continue the dividend policy and share buy-back programme. Total issued a similar statement, tempering worries that dividend pay-outs by major oil companies are at unsustainable levels.

Several profit warnings were issued this week. Biotech multinational Monsanto was hurt by declining commodity prices. Chemical company Du Pont had to deal with sluggish agro chemicals sales and negative currency moves. Illumina, a US company in genetic research, was impacted by lower demand in Europe and Asia Pacific. Operator of fast food restaurants Yum! Brands was dented by slow China sales and negative currency effects and Deutsche Bank had to write down billions of goodwill on its investment banking activities.

Next week, the earnings season really starts. On a year-on-year comparison, according to Bloomberg, companies in the S&P 500 index are expected to report a 3% decline in earnings. By contrast, STOXX Europe 600 companies are expected to report a 10% increase in earnings. In the US, banks such as Goldman Sachs, Citigroup and Bank of America will report their third-quarter earnings. US companies such as Intel, General Electric and Netflix will also publish results. In Europe, ASML is among the companies that will report earnings next week.

Bond markets update

This week, bond markets were in a positive mood, pushing bond prices somewhat up. Yields on ten-year US Treasuries traded around 2% and yields on 10-year German Bunds around 0.6%. Rising oil prices and expectations that the Fed will not hike its rate this year, added to the positive sentiment.

Credit markets, that have underperformed so far this year, rose this week. Since the start of the ECB's asset purchasing programme in March, investment-grade credit spreads have been rising. The spreads climbed from a low of 89 basis points (bps) in February to a high of 147 bps last week. The rally of this week resulted in spreads of 135 bps, about 10 bps lower. Even companies in disarray, such as Volkswagen and Glencore, saw their spreads tightening.

The question, however, remains whether this momentum will continue when the issuance of new bonds will rebound. This year far more bonds have been issued than have matured. Especially US companies have been issuing bonds, as the difference in interest rate and spread levels makes it cheap for these companies to issue in the euro market. Liquidity in credit markets, however, has been declining over the last few years. When the new bond issues enter the market, there will be not enough demand for the large supply. As a result, bond prices can rise too much in this low-liquidity environment. This is especially the case for older bonds, where prices easily overshoot fair value.

The ECB may provide additional liquidity with its asset purchasing programme, and the expected step-up of its programme. This programme will gradually shift investors from government bonds into credits, that offer higher yields. From that perspective, we continue to prefer euro investment-grade credits over core government bonds.

Currency outlook

Until 2016, we expect the US dollar to lower versus the euro in a range of 1.10-1.15. The first rate hike by the Fed is expected to be delayed and will probably not come until June 2016. This delay will have a neutral to modestly negative impact on the US dollar versus the euro in 2015.

When the Fed will eventually lift-off, it will not form a serious headwind for the US dollar. The Fed will hike interest rates when US economic growth for 2016 strengthens and emerging markets and commodities stabilise. A stronger US economy and upbeat investor sentiment will be positive for the US dollar versus the euro in 2016.

We still expect parity, but have delayed our call for parity by a year, based on uncertainty surrounding the global economy and financial markets and the response of the Fed and the ECB.

Asset allocation

The Global Investment Committee, at its meeting on 8 October, left the current allocation unchanged. It consists of an overweight in equities, a strong underweight in bonds and overweight allocations to hedge funds and commodities.

Published this week

Bond Markets Monthly: Unusual bond markets

- ▶ During recent equity volatility, bond prices did not rise
- ▶ Credit demand is picking up, indicating that recovery is underway
- ▶ Markets seem to question the accommodative policies of central banks
- ▶ We maintain a minimal allocation to government bonds, with an overweight position in credits

Bond report: Peripheral bonds: Spain in favour

European peripheral government bonds remain more attractive than core government bonds. Bonds from Spain, Italy as well as Portugal are in favour, but Spanish bonds have our preference due to their higher yields and reduced risk.

Reporting calendar

Company	Date
JPMorgan, Kuehne & Nagel, Johnson & Johnson, CSX, Intel	13 Oct
Wells Fargo, Bank of America, Netflix, Delta Airlines, ASML	14 Oct
Citigroup, Schlumberger, Goldman Sachs, Philip Morris, Vopak, TSMC, PPG Ind	15 Oct
Honeywell Int. General Electric	16 Oct

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