



global weekly

Investment
Communication
13 November 2015**More divergence ahead**

Central banks continue to dominate markets. In December, the paths of the European Central Bank and the US Federal Reserve will further diverge, as the ECB adds to its accommodating monetary policy and the Fed hikes rates for the first time since 2006.

Bond markets update

Financial markets seem to be prepared for the first Federal Reserve (Fed) rate hike in December. The probability of a rate hike priced in by markets has risen from below 25% to 70% in just three weeks. Last week's US labour market report for October is seen as a game changer. Additional hints from Federal Reserve policymakers added to the probability.

We think that after the Fed lift-off in December, the pace of the following rate hikes will be slow. We expect the Fed policy rate to reach 0.5% in December 2015. The next hike will be in June, giving the Fed more time to assess the impact on the US economy, followed by hikes every other meeting reaching 1.25% at year-end 2016. If this scenario plays out as we expect, US Treasury yields reach 2.5% at year-end 2015 and 3% at year-end 2016.

Markets currently seem to be ignoring that most other central banks are not following the Fed's direction. The European Central Bank (ECB) may expand its asset purchasing programme further in December and the Bank of Japan and the Peoples Bank of China are both still in accommodative policy mode. Also, the Bank of England (BoE) made clear that the UK will not follow the US in the coming months. The BoE could keep European government bonds stable when the ECB adds to its asset purchasing programme.

This week, 10-year US Treasury yields rose to 2.31%, which is almost the same level as in September, but lower than in the summer when it approached 2.5%. Corporate credit spreads could benefit from the current momentum as corporates try to benefit from the current low interest rate. This momentum could fade towards the end of the year, due to lack of market liquidity and given the expectation for a hike in rates by the Fed.

Equity index performance

	Value	One week change (%)	Year-to-date (%)
MSCI ACWI	402.1	-2.2	-3.6
S&P 500	2046.0	-2.6	-0.6
AEX Index	457.1	-2.7	7.7
EuroStoxx 50	3387.7	-2.5	7.4
DAX Index	10782.6	-1.9	9.9
Nikkei 225	19596.9	1.7	12.3
Hang Seng Index	22396.1	-2.1	-5.1

Important rating changes (RL=Recommended List)

Company	From	To
SANOFI	Hold	Buy
CHEVRON	Hold	Buy
SYMRISE	Hold	Buy
EXXON MOBIL	Hold	Buy
KINDER MORGAN	Hold	Buy

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	0.877	-1.1	36.0
German Bunds 2-year	-0.362	-6.8	-31.5
Japan 2-year	-0.010	-0.6	-4.5
US Treasuries 10-year	2.307	-1.9	-3.4
German Bunds 10-year	0.592	-10.1	-20.7
Japan 10-year	0.299	-1.7	-19.8

Spreads

Index	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	83.38	4.01	18.49
iTraxx Euro 5-year	73.71	2.75	10.34
JPM EMBI+	387.58	7.29	47.24

Performance data as of Friday, 13 November

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Macro outlook

ECB President Mario Draghi spoke on Thursday to the European Parliament. Although the Fed is likely to hike its rate in December, Draghi's message was clear: new stimulus measures are still in the cards for December. Draghi noted that the Governing Council of the ECB had always said that the asset purchasing programme 'would run beyond the end of September 2016 in case (it did) not see a sustained adjustment in the path of inflation'. In addition, 'other instruments' – which we think refers to rate cuts – could also be activated.

Draghi's explicit remarks on a deposit rate cut and an extension of the asset purchasing programme suggest that these steps are very likely. He did not, however, signal increasing the size of the asset purchasing programme or its composition. We think this is probably still a live issue that has to be discussed and agreed within ECB's Governing Council, but we think ultimately the ECB will decide to increase the scale of the programme and add new assets.

Equity markets update

Equity markets were mixed this week. In the US and Europe, markets were lower with the S&P 500 Index and STOXX Europe 600 Index declining by 2 to 3%. Shares in most major Asian markets were up. The Nikkei Index rose by 2% this week, while the Shanghai Index remained flat and the Shenzhen Index increased by 3%.

The energy and materials sectors, both commodity-related, were the worst performing sectors this week, as oil and raw materials prices fell. Glencore shares dropped by more than 20% this week after having rebounded strongly from their September low. The best performing sectors were defensive, such as telecoms, utilities and consumer staples. We believe the strong performance of consumer staples companies was owing to the solid growth figures in their third-quarter results.

The US department store Macy's reported weak quarterly numbers and issued a profit warning. The shares dropped by almost 15%. The company attributed the weak performance to the unusually warm US weather and lower tourist spending, which was hurt by the high US dollar. We believe, however, that department stores are also structurally challenged by online players such as Amazon.

In China, the retail environment seems better than feared. Retail sales jumped by 11% y-o-y in October. By way of example, e-commerce giant Alibaba reported a 60% rise in

Single's Day sales compared with last year. Single's Day has become China's equivalent of Cyber Monday. Year-to-date, Chinese consumers spent USD 14 billion on Alibaba.

Currency update

The adjustment in the timing of our Fed rate hike call has prompted us to upgrade the US dollar view versus the euro. We have lowered our outlook for EUR/USD and now think that the EUR/USD will reach parity in the first half of 2016.

Before the end of the year, we expect a test in EUR/USD of the low of March just below 1.05, making our new year-end forecast 1.05. After the December rate hike, we expect some stabilisation in EUR/USD at the start of 2016. We have also lowered our EUR/USD forecast for the end of 2016, mainly because of more monetary policy divergence in both the eurozone and the US, with the ECB likely to continue its monetary easing policy through the year.

We have more Fed rate hikes than financial markets currently anticipate. We expect financial markets to catch up with our view in the course of next year. We expect parity in EUR/USD to be reached in March 2016 and 0.95 in June 2016. As a result, we have put EUR/USD back on our list of high conviction shorts.

We have kept our forecast for emerging markets currencies largely unchanged. In general, the sharp weakness in emerging market currencies will likely result in positive developments in the trade balances of these emerging markets. In addition, a stabilisation and slight upward momentum in commodity prices should take away some of the negative sentiment in currencies of commodity exporters. Moreover, the slowdown in China will likely be less severe than financial markets currently anticipate. Last but not least, we expect investor sentiment to be positive, resulting in a search for global growth exposure and higher-yielding currencies. This is positive for currencies where central banks have stopped their easing cycle and the next step is to tighten.

There are, however, also negatives for emerging markets currencies. Most of them remain vulnerable as interest rates in the US rise. Other headwinds could be the domestic political situation, the economy and possible downgrades.

This leaves the overall picture for emerging markets currencies mixed. We see some recovery in Latin American currencies, Russian rouble, South African rand because of stabilisation of commodity prices and some improvement on the domestic

front. We remain bearish on Asian currencies as a weaker Chinese yuan, euro and Japanese yen will remain headwinds for Asian exports.

Reporting calendar

Company	Date
KBC	16 Nov
Unit. Internet, Wal-Mart, Home Depot, Easyjet	17 Nov
Lowe's Cos Inc	18 Nov
Thyssenkrupp, Best Buy	19 Nov
Dexia	20 Nov

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