



global weekly

Investment
Communication
12 February 2016

Central banks hold the key

Risks to the global economic outlook are mounting, as financial conditions tighten and oil prices slide. Central banks have the power to break the gloom.

The horrible start to 2016 continued this week. The decline seen in equity markets and rising spreads in bond markets are largely owing to the pricing-in of a recession scenario. We believe this goes too far, although, admittedly, we are not as positive regarding the economic outlook as we were at the beginning of the year.

Central banks hold the key to improving market sentiment. They should not be counted out as having no resources left – there is still plenty of firepower in central bank arsenals. From putting prospective rate hikes on hold, shifting to more deeply negative rates to increasing quantitative easing through a broader range of asset purchases or enhanced public spending – lots of options remain. The financial crisis clearly proved that central banks can be innovative and effective in fighting destructive market forces.

So far, the missing ingredient is conviction. Federal Reserve Chair Janet Yellen reiterated her concerns this week about risks to the economy, signaling that tighter financial conditions were an issue that the Fed is watching. The Fed, however, needs to communicate more decisively that rate hikes are not in the offing until the market situation improves. The European Central Bank and Bank of Japan could also do more. Although they are clearly heading toward more monetary easing, it is not clear to the market that they will do whatever it takes to revive growth and inflation.

We think central banks will eventually deliver and that global reflation efforts will intensify. The risk is that the longer they wait, the more damage that can be done.

Asset allocation

At its meeting on 11 February, no changes were made to the asset allocation. The overweight allocation to equities and the underweight to bonds was maintained, as were the overweight allocations to hedge funds and commodities. The Global Investment Committee believes that markets

Equity index performance

	Value	One week change (%)	Year-to-date (%)
MSCI ACWI	353.4	-3.6	-11.5
S&P 500	1829.1	-4.5	-10.5
AEX Index	385.9	-6.8	-12.7
EuroStoxx 50	2680.4	-5.5	-16.7
DAX Index	8752.9	-4.4	-17.4
Nikkei 225	14952.6	-12.3	-21.4
Hang Seng Index	18319.6	-5.8	-16.4

Important rating changes (RL=Recommended List; NR=not rated)

Company	From	To
Arcadis	Buy	Hold
Fresenius	Hold	Buy
Siemens	Hold	Buy
Tesla Motors	Hold	Buy
JPMorgan Chase	Hold	Buy

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	0.660	-6.4	3.4
German Bunds 2-year	-0.540	-4.4	-31.4
Japan 2-year	-0.165	3.1	-20.9
US Treasuries 10-year	1.699	-13.7	-28.6
German Bunds 10-year	0.218	-7.7	-10.1
Japan 10-year	0.079	5.7	-31.1

Spreads

Index	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	124.60	12.91	58.48
iTraxx Euro 5-year	122.72	12.54	64.61
JPM EMBI+	486.94	36.28	75.09

Performance data as of Friday, 12 February

Source: Bloomberg

In this issue

Asset allocation	1
Equities update	2
Bond markets update	2
Currency outlook	2
Published this week	2

are exaggerating the threat of recession and that the situation remains manageable by policymakers. Clients who are significantly underweight in terms of risk relative to the tactical asset allocation should consider taking steps toward increasing equity positions. Careful selection is needed, and it is not suggested to “buy the market.” Instead, selective investments in sectors with defensive characteristics in the current environment, such as health care, and in the growth area of the information technology sector, are recommended.

In fixed income markets, it is believed that risks in the global high-yield market have risen, largely based on the sizable proportion of energy and mining companies in the US high-yield market, where default risk is increasing. Clients are therefore advised to switch to European high-yield bonds, where the risk profile is more attractive.

Equities update

Losses on all major indices worldwide total around 12% or more (in euros) year-to-date. This week saw equities again deeply in the red, with Japan leading, followed by Europe and the US. A large portion of Asian markets were closed during the week because of the Chinese new year.

Market fears were focussed on the banking sector this week. Financials is one of the worst performing sectors so far in 2016. The market is worried about a recession in developed markets and contagion risk within the banking sector. Although earnings prospects for banks are worsening, given lower economic growth expectations and the Fed delaying tightening, we believe that recession and contagion risks are overdone.

Investors appeared to forget the earnings season this week, which is in full swing. Despite the gloom hanging over markets, there were not many profit warnings, but, in general, company guidance is cautious.

Bond markets update

As yields decline, it appears that the market is testing new and lower boundaries for government bonds with safe-haven status. Such yield compression is typically seen only in an environment where economists expect a worldwide recession, which is not our view.

The market is pricing in no further rate hikes by the US Federal Reserve in 2016. The difference between ten-year and two-year US Treasuries is now below 1%. More risky bonds, such as peripheral eurozone government and corporate bonds (investment grade and high yield) are exhibiting more stress with wider spreads. Financial sector bonds are under extreme

Reporting calendar

Company	Date
Reckitt Benckiser, Sembcorp Marine, Newcrest Mining, Bank of East Asia, Amcor, Telecom Italia	15 Feb
Michelin, CSL, United Overseas Bank, EDF, City Developments, Devon Energy, TNT Express, Air Liquide, Orange, Starhub, HeidelbergCement	16 Feb
Enel Ente Nazionale Per L'Energ Elet Spa, Oversea-Chinese Banking, Asustek Computer, DSM, Marathon Oil, Beiersdorf, Capitaland Limited, Crédit Agricole, Williams Cos, Schneider Electric, Coca-Cola Amatil, Deutsche Boerse, Priceline.com, Barrick Gold, Newmont Mining, Woodside Petroleum, Lend Lease	17 Feb
KBC, Wal-Mart, Wilmar, Telstra, Duke Energy Corp., Fluor, Vallourec, Applied Materials, Randstad, Nestle, Centrica, Accor, Arcadis, Vastned Retail, Ordina, BAM, BAE Systems, Capgemini, Genting Singapore, Vivendi, Sydney Airport	18 Feb
Deere & Co, VF Corp., Kering, Allianz, Aegon, Wessanen, Essilor International, Santos	19 Feb

stress. European banks have been under pressure to raise capital buffers to meet tougher regulatory requirements, while, at the same time, cutting costs and shrinking their securities businesses.

At Deutsche Bank this week, co-CEO John Cryan was forced to reassure investors and employees that the bank is “rock solid,” as concern about capital and funds drove the value of its stock and bonds downward. In Italy, the banking sector is preparing a tough restructuring to consolidate the banking sector, leading to a significant increase in credit spread risk.

Currency outlook

Deterioration in investor sentiment caused a dramatic rally in the Japanese yen and weighed on the US dollar. The greenback suffered mainly due to a downward adjustment in Fed rate hike expectations and concern over the US economy.

The Japanese yen has rallied by more than 8% against the US dollar since the Bank of Japan announced negative interest rates on 29 January. The yen is also benefiting from inflows due to its role as a safe-haven currency. As financial markets have scaled back expectations that the Fed will tighten monetary policy this year, US two-year Treasury yields have declined considerably. This has increased the downward pressure on the US dollar versus the yen.

Published this week

Market turmoil: assessment & advice

Since the beginning of the year, financial markets have been in turmoil. The trigger has been a succession of fears, ranging

from the threat of currency devaluation in China, the consequence of low oil prices on the energy sector and the fear that policymakers will not be able to avert a global recession.

Contributors

Investment Strategy & Portfolio Expertise

Ralph Wessels - ralph.wessels@nl.abnamro.com
Maurits Heldring - maurits.heldring@nl.abnamro.com
Edith Thouin - edith.thouin@nl.abnamro.com
Roel Barnhoorn - roel.barnhoorn@nl.abnamro.com
Jaap Rijnders - jaap.rijnders@nl.abnamro.com
Willem Bouwman - willem.bouwman@nl.abnamro.com
Chris Huys - chris.huys@nl.abnamro.com

Group Economics

Georgette Boele - georgette.boele@nl.abnamro.com
Roy Teo - roy.teo@nl.abnamro.com
Nick Kounis - nick.kounis@nl.abnamro.com
Aline Schuiling - aline.schuiling@nl.abnamro.com
Maritza Cabezas - maritza.cabezas@nl.abnamro.com

Disclaimer

© Copyright 2016 ABN AMRO Bank N.V. and affiliated companies ("ABN AMRO"), Gustav Mahlerlaan 10, 1082 PP Amsterdam / P.O. box 283, 1000 EA Amsterdam, The Netherlands. All rights reserved. This material is provided for informational purposes only and does not constitute an offer to sell or a solicitation to buy any security or other financial instrument. While based on information believed to be reliable, no guarantee is given that it is accurate or complete. While we endeavour to update on a reasonable basis the information and opinions contained herein, there may be regulatory, compliance or other reasons that prevent us from doing so. The opinions, forecasts, assumptions, estimates, derived valuations and target price(s) contained in this material are as of the date indicated and are subject to change at any time without prior notice. The investments referred to in this material may not be appropriate or suitable for the specific investment objectives, financial situation, knowledge, experience, or individual needs of recipients and should not be relied upon in substitution for the exercise of independent judgement. ABN AMRO or its officers, directors, employee benefit programs or co-workers, including persons which were involved in preparing or issuing this material, may from time to time hold long- or short-positions in securities, warrants, futures, options, derivatives or other financial instruments referred to in this material. ABN AMRO may offer and render at any time investment banking-, commercial banking-, credit-, advice-, and other services to the issuer of any security referred to in this material. Pursuant to offering and rendering such services, ABN AMRO may come into possession of information not included in this material and ABN AMRO may prior or immediately after publication thereof have acted based on such information. In the past year, ABN AMRO may have acted as lead manager or co-lead manager with regard to a public offering of securities from issuers as mentioned in this material. The stated price of any securities mentioned herein is as of the date indicated and is not a representation that any transaction can be effected at this price. Neither ABN AMRO nor other persons shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way from the information contained in this material. This material is for the use of intended recipients only and the contents may not be reproduced, redistributed, or copied in whole or in part for any purpose without ABN AMRO's prior express consent. This document is solely intended for dissemination amongst private/retail customers in a PC country. Distribution to private/retail customers in any jurisdiction that would require registration or licensing of the distributor which the distributor does not currently have, is not permitted. Material means all research information contained in any form including but not limited to hard copy, electronic form, presentations, e-mail, SMS or WAP.

US Securities Law

ABN AMRO Bank N.V. is not a registered broker-dealer under the U.S. Securities Exchange Act of 1934, as amended (the "1934 Act") and under applicable state laws in the United States. In addition, ABN AMRO Bank N.V. is not a registered investment adviser under the U.S. Investment Advisers Act of 1940, as amended (the "Advisers Act" and together with the 1934 Act, the "Acts"),

and under applicable state laws in the United States. Accordingly, absent specific exemption under the Acts, any brokerage and investment advisory services provided by ABN AMRO Bank N.V., including (without limitation) the products and services described herein are not intended for U.S. persons. Neither this document, nor any copy thereof may be sent to or taken into the United States or distributed in the United States or to a US person.

Other jurisdictions

Without limiting the generality of the foregoing, the offering, sale and/or distribution of the products or services described herein is not intended in any jurisdiction to any person to whom it is unlawful to make such an offer, sale and/or distribution. Persons into whose possession this document or any copy thereof may come, must inform themselves about, and observe, any legal restrictions on the distribution of this document and the offering, sale and/or distribution of the products and services described herein. ABN AMRO cannot be held responsible for any damages or losses that occur from transactions and/or services in defiance with the restrictions aforementioned.

Sustainability Indicator Disclaimer

ABN AMRO Bank N.V. has taken all reasonable care to ensure the indicators are reliable, however, the information is unaudited and subject to amendment. ABN AMRO Bank is not liable for any damage that constitute from the (direct or indirect) use of the indicators. The indicators alone do not constitute a recommendation in relation to a specific company or an offer to buy or sell investments. It should be noted that the indicators represent an opinion at a specific period of time considering a number of different sustainability considerations. The sustainability indicator is only an indication regarding the sustainability of a company within its own sector.

Company disclosures

ABN AMRO may beneficially hold a major shareholding or a significant financial interest of the debt of this company. ABN AMRO currently maintains a market in the security of this company and otherwise purchases and sells securities of this company as principal. ABN AMRO has received compensation for investment banking services from this company, its subsidiaries or affiliates during the previous 12 months. All disclosures made herein refer to ABN AMRO and its affiliates, including ABN AMRO Incorporated, which is regulated in the United States by the NYSE, NASD and SIPC.

Personal disclosures

The information in this opinion is not intended as individual investment advice or as a recommendation to invest in certain investments products. The opinion is based on investment research of ABN AMRO Research and Strategy. The analysts have no personal interest in the companies included in this publication. Their remuneration for this work is not, was not and will not be related directly or indirectly to the specific recommendations or views expressed in this opinion.

80.7212 (02.16)



ABN·AMRO Private Banking