



global weekly

Investment
Communication
20 May 2016**Testing the waters**

The US Federal Reserve surprised markets as it may be more inclined to a rate hike than had been expected. We believe the central bank will remain on hold this year.

Macro update

The minutes from the latest meeting of Federal Reserve policymakers revealed that a rate hike may not be as far away as markets had expected. The minutes reported that the majority of policymakers believed that data appeared to show economic growth picking up, the labour market strengthening and inflation making progress toward the 2% target.

We believe that the Fed is in a difficult position. While domestic factors may support raising rates, the international situation is more complicated, given that the US economy affects everything related to the US dollar, including the large amount of US-dollar-denominated debt. We continue to believe that the Fed will remain on hold in 2016, but that the risks related to a rate hike later this year have increased.

Our view is that the Fed will remain careful before taking any decision to hike rates. This is because the conditions for more normal rates are not completely in place. Instead, the minutes distributed this week could be interpreted as "testing the waters" for a hike later. The Fed is also believed to be sending more positive signals regarding a hike because risk signals have improved, in terms of oil prices, equity market confidence and stabilisation in currency markets.

Equity update

Equity markets worldwide moved sideways or even slightly down this week. Markets. Similar to last week, commentary from regional Fed bank presidents exceeded market expectations for just one rate hike this year. This made markets somewhat jittery, as it might signal earlier tightening and

Equity index performance in local currency

| | Value | One week change (%) | Year-to-date (%) |
|-----------------|---------|---------------------|------------------|
| MSCI ACWI | 391.1 | -0.6 | -2.1 |
| S&P 500 | 2040.0 | -0.3 | -0.2 |
| AEX Index | 434.0 | 0.0 | -1.8 |
| EuroStoxx 50 | 2959.6 | 0.1 | -9.4 |
| DAX Index | 9902.4 | -0.5 | -7.8 |
| Nikkei 225 | 16736.4 | 2.0 | -12.1 |
| Hang Seng Index | 19852.2 | 0.7 | -9.4 |

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

| Company | From | To |
|----------------|------|------|
| Tesla Motors | Hold | Buy |
| Adecco | Hold | Buy |
| Apache | Hold | Sell |
| Bureau Veritas | Hold | Buy |
| First Solar | Hold | Buy |

Government bond yields

| | Yield (%) | One week (bp) | One year (bp) |
|-----------------------|-----------|---------------|---------------|
| US Treasuries 2-year | 0.886 | 13.9 | 29.9 |
| German Bunds 2-year | -0.505 | 1.1 | -28.9 |
| Japan 2-year | -0.242 | 1.3 | -22.4 |
| US Treasuries 10-year | 1.846 | 14.5 | -40.3 |
| German Bunds 10-year | 0.167 | 4.4 | -46.3 |
| Japan 10-year | -0.110 | 0.4 | -49.6 |

Spreads

| Index | Spread (bp) | One week (bp) | One year (bp) |
|--------------------|-------------|---------------|---------------|
| CDX NA IG | 85.19 | 3.63 | 21.16 |
| iTraxx Euro 5-year | 78.85 | 1.91 | 18.85 |
| JPM EMBI+ | 397.73 | 10.88 | 31.12 |

Performance data as of Friday 20 May

Source: Bloomberg

Reporting calendar

| Company | Date |
|--|--------|
| Ryanair Holdings | 23 May |
| Hewlett-Packard, Tiffany & Co., Marks & Spencer, PVH | 25 May |
| Lenovo | 26 May |
| CTrip.Com Int. | 27 May |

In this issue

| | |
|---------------------|---|
| Macro update | 1 |
| Equity update | 1 |
| Bond markets update | 2 |
| Currency update | 2 |
| Asset allocation | 2 |

potentially a less friendly equity environment, especially for emerging markets. This region has already experienced considerable outflow over the past weeks, thereby largely wiping out its outperformance year-to-date.

The first-quarter earnings season is gradually coming to an end. At first sight, aggregated earnings are softly in decline on a year-on-year basis. Although this trend was already largely anticipated, a small majority of companies reported earnings slightly ahead of expectations. The revenue side, however, shows that we are in a slow-to-no-growth period. Moving deeper into 2016, we expect this trend to gradually improve, albeit modestly.

On a sector level, we saw positive signals in technology after a weak period in April. The improvement in sentiment around the sector was largely triggered by Warren Buffett announcing to take a stake in Apple and expanding his position in IBM. In addition, Cisco reported better-than-expected results with encouraging underlying dynamics.

The financials sector in the US showed a small uptick after the Fed minutes' publication. Although Fed rate hikes might be positive for banking margins, we continue to believe that the environment for financials remains challenging. The energy sector further stabilised, as the oil price continued its upward path.

In April, we cut our strong overweight equities position to a moderate overweight. Although we still believe that equities as an asset class offer a better expected return than other asset classes, earnings growth is low, room for multiple expansion is limited and the general risk environment is challenging.

Bond markets update

Bund yields continue to move around 0.2%, as seen mid-February, when investors' risk appetite suddenly returned. Since then, 10-year Bund yields touched 0.1% three times and now seem to be heading towards the 0.3% top that was seen before. Bund and US Treasury yields are torn between central bank messages on loose policy on the one hand and improving economic data and growing risk appetite on the other hand. This week, Fed minutes added to a rise in yields.

The risks related to a Fed rate hike later this year have increased. The ECB, however, is still likely to step up the pace of its asset purchases over the summer, with or without a Brexit. In contrast to the US, long-term inflation expectations in Europe have hardly reacted to rising oil prices so far.

Slower growth into the second quarter, low inflation, a vigilant ECB and a lower Brexit risk contain Bund yields and allow spreads to continue grinding lower. Sentiment remains vulnerable, however, and Brexit is only one of many political risks this year. Therefore we continue to explore other options, while we remain comfortable with positions in peripheral government bonds (including inflation-linked bonds), European corporates (both investment-grade and high-yield) and actively managed global government bonds.

We have added a UK bank to our opportunistic issuers' list. Please refer to your investment advisor for more information.

Currency update

The US dollar (USD) gained across the board as the April minutes of the Federal Reserve policymakers were more leaning towards a rate hike than expected. The euro declined by one cent against the US dollar to around 1.12 as the interest rate spread between the eurozone and the US declined. Market sentiment has become more negative on the euro. In the near term, this move could continue. However, we expect the euro to find some support around 1.1140 ahead of the ECB monetary policy meeting on 2 June. As the dollar strengthened, emerging market currencies came under pressure, despite firmer commodity prices.

Asset allocation

At its meeting on 19 May 2016, the Global Investment Committee left the asset allocation unchanged. It continues to call for a moderate overweight in equities, an underweight in bonds and a significant overweight in cash. Commodities are overweight, with neutral allocations to both real estate and hedge funds.

Investment Strategy & Portfolio Expertise
Group Economics



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 spe-

cific 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. 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.