



global weekly

Investment
Communication
10 June 2016**Central banks and politics**

The hike in US interest rates looks delayed, the ECB's corporate bond buying is underway and Britain votes in less than two weeks on whether to stay in the EU. Central banks and politics are dominating markets.

Disappointing US labour data modified market expectations for a rate hike in the US. The probability of a hike, as indicated by Fed funds futures rates, has radically declined, with just an 18% likelihood of a hike in July priced-in. Group Economics does not expect a hike by the Federal Reserve in 2016. If a hike would occur, it is expected to be the slowest rate-hike cycle ever, with limited market effect.

With the US rate hike off the table for now and the commencement of the ECB's corporate credits buying programme, bond yields dropped. Despite solid growth in Europe, yield curves remain low and flat. Central banks are exerting more influence on markets than positive growth.

Equity markets are stable or even grinding higher, despite an environment that could lead to volatility. The negative US labour report, mixed US data and Britain's EU referendum have not had much of a lasting effect on markets. Instead, low interest rates and the relative attractiveness of stocks versus other asset classes is holding sway. Stabilising oil and currency markets, including emerging markets currencies, have also supported weaker regions and sectors.

The date of Britain's vote on leaving the European Union is less than two weeks away on 23 June. Polls regarding the outcome of the vote are very tight. The base-case scenario from Group Economics calls for Britain staying in the EU with a probability of 65%. So far, volatility related to the Brexit vote is largely limited to currency hedging in the options market, while the spot market for the British pound remains relatively calm.

Equity markets update

Stock markets remain in wait-and-see mode before the Brexit referendum on 23 June. They appear torn between the positive forces of inflows and the probability of Britain staying in the EU versus negative influences related to a subdued earnings outlook and expected returns that are lower than historical averages.

Equity index performance in local currency

	Value	One week change (%)	Year-to-date (%)
MSCI ACWI	407.1	0.8	1.9
S&P 500	2115.5	0.8	3.5
AEX Index	441.3	-0.7	0.1
EuroStoxx 50	2957.8	-1.2	-9.4
DAX Index	9966.0	-1.3	-7.1
Nikkei 225	16601.4	-0.2	-12.8
Hang Seng Index	21059.2	0.6	-3.8

Important rating changes

Company	From	To
Mosaic	Buy	Hold
Vallourec	Buy	Hold
Royal Bank of Scotland Group	Hold	Buy
Carnival Corp	Hold	Buy
Baker Hughes	Sell	Hold

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	0.769	-0.5	4.2
German Bunds 2-year	-0.545	-0.8	-37.7
Japan 2-year	-0.274	-2.9	-28.1
US Treasuries 10-year	1.677	-2.4	-80.7
German Bunds 10-year	0.035	-3.3	-94.5
Japan 10-year	-0.155	-5.1	-66.1

Spreads

Index	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	75.8	-2.1	9.5
iTraxx Euro 5-year	75.9	0.4	9.7
JPM EMBI+	384.3	-7.6	-4.4

Performance data as of Friday, 10 June

Source: Bloomberg

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The materials and energy sectors performed best, while the more defensive health care and consumer discretionary sectors slightly underperformed. The correlation between oil prices and equity markets remains above average. The momentum for oil is positive, as the US dollar has weakened and inventory data is declining faster than previously expected.

Royal Dutch Shell (buy) held its first capital market day after its acquisition of the British integrated oil company BG Group. With the slogan 'Reshaping Shell to create a world-class investment case', the company presented its updated strategy. Operational costs and investments will be further reduced to align with a USD 60 oil price assumption. Moreover, cash-flow generation will be sufficient to guarantee the current 8% dividend yield and there is still room for share buy-backs.

Bond markets update

Bund and Treasury rates dropped this week, as US payrolls seriously undershot expectations. The Federal Reserve did not get the strong jobs report they were looking for, modifying expectations for a summer rate hike. Ten-year Bund rates are inches away from going into negative territory, and US 10-year Treasury rates dropped by 15 basis points to 1.7%. Corporate bonds performed well this week, as credit spreads and rates declined.

The European Central Bank (ECB) started its corporate bond buying programme this week. Although the exact details on the size of the programme are not known, the market is expecting purchases of EUR 5-10 billion a month. The ECB is likely to start slowly and then gradually increase the size of its purchases. One of the first corporate bonds bought by the ECB was Telecom Italia (Ba1/BB+/BBB-). It is rated as high-yield by two out of the three main credit-rating agencies. It is proof that the ECB is willing to buy lower-rated paper.

Currency outlook

The US dollar has been on a slide since the weak US employment report released last Friday. Together with comments from Fed Chair Janet Yellen earlier in the week, this has resulted in the market substantially reducing expectations for a Fed rate hike this year. Our view is that while there is a case for a hike, the case for the Fed to remain on hold and to be more cautious strongly outweighs it. The Fed remaining on hold should nurture US growth and support sentiment on financial markets. It is likely that it will weigh on the US dollar across the board and support currencies of commodity-exporting countries

such as the Norwegian krone and the Canadian, Australian and the New Zealand dollars. The disappointing labour report also had an impact on emerging market currencies, which have rallied strongly.

Asset allocation

At the Global Investment Committee meeting of 9 June 2016, the decision was made to keep the asset allocation unchanged. It continues to consist of a modest overweight in equities, an underweight in bonds and a significant overweight in cash. Commodities are overweight, with neutral allocations to real estate and hedge funds.

Investment Strategy & Portfolio Expertise
Group Economics



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