



global weekly

Investment
Communication
5 August 2016

Central bank action and inaction

In a slow news week, central banks were the main story. There appears little impetus, however, for further meaningful stimulus.

Global economic growth is around trend level, but there are early signs that the disappointing industrial production indicators are turning. Within the national accounts data, profits increased in the first quarter. Companies have been meeting demand from inventories, which supports a reversal in the second half of the year.

Central banks remain accommodative. Group Economics expects further quantitative easing by the ECB in September and for the Federal Reserve to remain on hold in 2016. So far, the effect of the Brexit vote has been relatively mild. The most extreme effect is the weakening of the British pound, which makes the UK more competitive. Business confidence has fallen and a mild recession is expected in the UK.

Bond markets update

This week bond markets were dominated by central bank action and inaction. While last week the Bank of Japan decided not to increase its quantitative easing, this week the Japanese government decided to increase its fiscal stimulus package. Bond investors were negatively surprised by these actions.

For some time there has been a debate that quantitative easing can only be really effective if governments make their fiscal policy more stimulative too. The Japanese situation appears to be proof of this concept. And it applies not just to Japan. Interest rates in Japan have risen as a consequence of the policy change, and the Japanese ten-year government bond rate came very close to Germany's. Both remain negative, however.

Equity index performance in local currency

| | Value | One week change (%) | Year-to-date (%) |
|-----------------|---------|---------------------|------------------|
| MSCI ACWI | 413.2 | -0.7 | 3.5 |
| S&P 500 | 2164.3 | -0.3 | 5.9 |
| AEX Index | 446.7 | -0.7 | 1.1 |
| EuroStoxx 50 | 2932.3 | -1.4 | -9.7 |
| DAX Index | 10227.9 | -0.7 | -4.4 |
| Nikkei 225 | 16254.5 | -1.9 | -14.6 |
| Hang Seng Index | 22144.0 | -0.1 | 1.0 |

Important rating changes

| Company | From | To |
|-----------------------|------|------|
| Pfizer | Buy | Hold |
| Mitsubishi Heavy Ind. | Hold | Buy |
| PayPal | Hold | Buy |
| Celgene | Buy | Hold |

Performance data as of Friday, 5 August 2016

Source: Bloomberg

Globally, rates have risen, as investors fear that other central banks will also be less willing to do more quantitative easing. The Bank of England, however, went in the other direction. This week it surprised investors by lowering the UK policy rate, cutting rates for the first time in seven years, to 0.25%, and expanding quantitative easing to include corporate bonds and a lending program for banks. This is owing to the drastically changed economic outlook for the UK after the Brexit vote. As a result, interest rates across Europe declined vigorously.

Equity markets update

Most major stock markets failed to find a clear direction this week. The European STOXX 600 Index and the S&P 500 Index

were both slightly lower. There were also no major changes seen in Asian markets, although the Japanese NIKKEI 225 Index lost 2% as the yen strengthened.

The energy sector was the worst performing sector this week, as the oil price declined. The price of WTI oil is now some 25% below the peak of this year, which was USD 52/barrel in June. The utility sector also underperformed this week, in particular, European utilities. Health care and IT were the best performing sectors, as the results from most companies in these sectors were good.

About 75% of companies in the US and Europe have now reported their second-quarter results. Our conclusion is that results have been generally matching expectations. The energy sector is the only exception, as various companies reported worse-than-expected profits. Oil majors, such as Royal Dutch, BP and Exxon all disappointed, but oil services players, such as Fugro, also failed to meet expectations.

Reporting calendar

| Company | Date |
|--|--------|
| DBS Group Holdings, Davita Healthcare Partners, IFF, Nuance Communications, Allergan, PostNL | 08 Aug |
| Exelon Corp, Walt Disney, HCP, Daikin Industries, Munich Re, China Overseas Land & Investment, MTR Corporation, Cochlear | 09 Aug |
| Noble Group, Adecco, E.ON, Lanxess, Prudential, SBM Offshore, Commonwealth Bank Of Australia, Hong Kong Exchanges and Clearing, Corbion, Wharf Holdings | 10 Aug |
| Enel Green Power S.P.A., Bank of East Asia, Wilmar, Petroleo Brasileiro Sa Petrobras, Henkel, China Mobile, Deutsche Telekom, Thyssenkrupp, Symrise, SYMRISE, KBC, Aegon, RWE, Zurich Insurance, Singapore Telecommunications, Telstra, Cheung Kong Holdings | 11 Aug |
| Asustek Computer, First Resources, Golden Agri-Resources, A.P. Möller-Maersk, City Developments, Toshiba Corp. | 12 Aug |

Currency outlook

The Japanese yen has been the strongest currency since the end of last week. The yen rally continued, driven first by the disappointing actions of the Bank of Japan last week and spurred on by the disappointing fiscal package introduced this week. Some deterioration in investor sentiment also supported the yen. The USD/JPY moved below 101 again, but then it lost momentum. Our target for USD/JPY for the end of September is 100.

The other important action in currency markets concerned the British pound sterling. After the Bank of England eased

Government bond yields

| | Yield (%) | One week (bp) | One year (bp) |
|-----------------------|-----------|---------------|---------------|
| US Treasuries 2-year | 0.652 | -0.5 | -7.6 |
| German Bunds 2-year | -0.615 | 1.7 | -36.7 |
| Japan 2-year | -0.197 | 6.3 | -20.4 |
| US Treasuries 10-year | 1.496 | 4.2 | -77.4 |
| German Bunds 10-year | -0.087 | 3.4 | -84.0 |
| Japan 10-year | -0.099 | 9.6 | -49.5 |

Spreads

| Index | Spread (bp) | One week (bp) | One year (bp) |
|--------------------|-------------|---------------|---------------|
| CDX NA IG | 73.22 | -0.73 | 1.18 |
| iTraxx Euro 5-year | 67.62 | -0.15 | 4.68 |
| JPM EMBI+ | 367.66 | -2.95 | -39.00 |

Performance data as of Friday, 5 August 2016

Source: Bloomberg

monetary policy more aggressively than expected, the British pound weakened substantially.

Asset allocation

The Global Investment Committee made no changes to the asset allocation at its meeting on 4 August. It continues to consist of a neutral allocation to equities and an underweight in bonds. Within alternative asset classes, the allocation to commodities is overweight, real estate is overweight and hedge funds is neutral.

Published this week

Bond Markets Monthly: Referendum Repercussions

While the Italian government faces the challenge of how to recapitalise Italian banks, the Brexit aftermath is supporting lower interest rates.

Bond sector report: Utilities (overweight)

We are positive on the bonds of European utilities. Despite the weaker cash flows of integrated utilities, due to lower energy power tariffs, the ongoing demand from the ECB through their asset purchase program will continue to lift the prices of all utility company bonds.

Investment Strategy & Portfolio Expertise Group Economics



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