



global weekly

Investment
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Markets not reacting to US elections

The expectations of a US interest rate hike in December and upcoming elections in the US and other countries have not had a big impact on markets so far.

Bond markets update

While the US elections are in the spotlight, bond markets are more occupied with central bankers and their monetary policies than with politicians and the fiscal stimulus they might produce. Although central bankers are not planning to loosen their grip on markets any time soon, their convinced tone-of voice is gradually fading. It looks like US Federal Reserve Chair Janet Yellen does not mind if the US economy would run a little hot, to jumpstart inflation and increase labour market participation. The US Federal Reserve is on track to raise its rates in December.

Mario Draghi, President of the European Central Bank (ECB), eased tapering concerns and rumours around the ECB, but did not provide further details yet on how the asset purchasing programme will be continued after March. Market inflation expectations have been rising steadily over the last three months, although the ongoing rise in headline inflation is due to low oil prices one year ago and not supported by higher core inflation. It will likely take until early next year before we see headline inflation levels of above 1%. Credit spreads in high yield and investment grade both continued to grind lower, but it looks like the ECB corporate bond purchases at the current pace are no longer driving them much lower.

Soon after the US elections, European politics will take center stage with French and German elections in the limelight. The Italian referendum kicks off on 4 December and will

Equity index performance in local currency

	Value	One week change (%)	Year-to-date (%)
MSCI ACWI	414.3	0.7	3.7
S&P 500	2141.3	0.4	4.8
AEX Index	457.1	1.5	3.5
EuroStoxx 50	3076.6	1.6	-5.9
DAX Index	10701.4	1.1	-0.4
Nikkei 225	17184.6	1.9	-9.7
Hang Seng Index	23374.4	1.5	6.7

Performance data as of Friday, 21 October 2016

Source: Bloomberg

draw attention, as polls are increasingly indicating a no vote, reflected in rising yield spreads with German Bunds. With the ECB committed to keep buying if needed, this could present buying opportunities for Italian bonds going forward.

Macro update

The US election continues to grab attention, but so far, market volatility has remained low. Over the past few weeks, what had once been a close race has seen Democratic nominee, Hillary Rodham Clinton, gaining steadily. She now has a significant lead, outdistancing Republican nominee, Donald Trump, by almost 10% in national polls.

Our base-case scenario is for Clinton to be elected President of the United States on 8 November, with a Democratic majority in the Senate and a Democratic minority in the House of Representatives. Clinton's election is seen as a continuation of current policies, with no big changes expected in terms of US monetary policy, inflation rates or unemployment.

Market volatility has remained low in historical terms in the run-up to the election. The mounting political rhetoric was not reflected in market volatility. It now seems clear that markets are anticipating a Clinton win.

In the ECB meeting on Thursday, the central bank left its policy rates and asset purchases unchanged. ECB President Mario Draghi's main message was that December would be a decision moment for the Governing Council. In our view, the ECB is likely to extend its loose policy in December. We continue to think that the ECB will expand the duration of its asset purchasing programme from March 2017 currently to September 2017 in December. To expand the universe of assets, the ECB will likely decide to start buying bonds that yield less than the deposit rate (so far restricted) as well as buying bonds with less than two-year maturities.

Core inflation in the US, calculated using the consumer price index (CPI), remained contained in September. It was up by 0.1% m-o-m, which brought the annual rate down to 2.2% from 2.3% the previous month. The modest core inflation came despite a strong reading for housing (+0.4%), which has a heavy weight in the CPI, meaning that cyclical inflationary pressures are relatively weak. This reflects moderate demand and wage growth. Looking forward, we think inflationary pressure from the labour market is unlikely to rise strongly. We believe this will allow the Fed to take its time in raising interest rates. We expect one step in December followed by two moves in 2017.

Equities update

Equity markets rose slightly this week. For now, markets do not seem to be disturbed by the prospects of a US interest rate hike, approaching elections in multiple countries and historically high valuations. Investors still see equities as an attractive alternative for low-yielding bonds. The announcement of Norway's oil fund to increase its exposure to equities at the expense of bonds illustrates this point. The fund is a major worldwide investor as it owns more than 1% of every single stock listed worldwide - on average - and even close to 3% of each European company.

The largest surprise so far from the third-quarter earnings season came from internet television network Netflix, which reported strong subscriber growth and stated that it now services more than 90 million people worldwide. The Netflix shares gained 20% following the results and are approaching all-time highs again. China still remains a blind spot for the company, as the government restricts foreign companies

Reporting calendar

Stora Enso, Kimberly-Clark, Binckbank, Philips, TNT Express	24 Oct
Sprint Nextel, Valero Energy, Merck, Novartis, Apple, Lockheed Martin Corp, AT&T, Baker Hughes, United Tech., General Motors, Fortum, Caterpillar, Eli Lilly, 3M. Kon. Wessanen, Du Pont. Randstad, Saipem, Neste Oil, France Tel., Procter & Gamble	25 Oct
Exelon Corp, General Dynamics, Biogen Idec, Southwest Airlines, Coca-Cola, Logitech, Iberdrola, Texas Instr., Comcast, Newmont Mining, Canon, Bayer, Santander, Santander, EDS, ASM Int, Kraft Foods, Llyods TSB, Glaxosmithkline, Nintendo, Peugeot, Heineken, Barrick Gold, Bank of China	26 Oct
Kon. KPN, BASF, Telefonica, Fresenius, BT Group, Nokia, Alcatel-Lucent, Volkswagen, Samsung, Thermo Fisher, ABB, Google, Amazon.com, Stmicroelectronics, Hartford Financial, Britsol Myers Squibb, Bristol-Myers Squibb Co, Deut. Boerse, Statoil, Barclays. Amgen Inc, Deut. Bank, Altria Group, Intl Paper, Dow Chemical, Ford, Technip, Colgate-Palmolive, ConocoPhillips, Nomura, United Parcel Service, BBVA	27 Oct
Linde, Sanofi-Aventis, Eni, RBS, USG People, Exxon Mobil, Chevron, BNP Paribas, Belgacom, Inbev, GEA Group, Takeda Pharma, Hitachi, Total, NTT Docomo, China Telecom, Geberit	28 Oct

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	0.825	-1.1	20.2
German Bunds 2-year	-0.669	-0.3	-41.0
Japan 2-year	-0.255	2.0	-26.6
US Treasuries 10-year	1.748	-5.1	-27.6
German Bunds 10-year	0.002	-5.5	-56.6
Japan 10-year	-0.059	0.0	-37.2

Spreads

Index	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	73.94	-1.68	-6.93
iTraxx Euro 5-year	70.87	-3.14	-7.12
JPM EMBI+	346.63	-0.06	-53.79

Performance data as of Friday, 21 October 2016

Source: Bloomberg

from distributing content in China. For the time being, Netflix therefore decided to license its content to local players to gain exposure.

There were disappointments in the consumer staples sector. Food multinational Nestlé lowered its sales forecast on

reduced demand from emerging markets, as it has become more difficult to put through price increases. Reckitt Benckiser – known for products such as Dettol, Nurofen and Durex – also became more cautious for the year, due to weak demand from Russia. It is also suffering from a scare in South Korea, where its humidifier sanitizers have been linked to over a 100 deaths.

Except for a profit warning from Irish airline Ryanair due to the weak British pound, European airlines had a strong week. The good performance was attributable to German airline Lufthansa lifting its earnings forecast. The financial sector also did well, benefiting from the strong earnings at US banks, good data from Goldman Sachs and a rebound in southern European bank shares.

Currency outlook

The British pound sterling has collapsed over recent weeks. It has fallen by close to 20% since the start of this year in trade-weighted terms, taking it to historical lows. Investors have started to price in the impact of a hard Brexit on the economy and the current account driven by the political stalemate between the UK and the rest of Europe. In addition, there

is concern that an inflation surge will prevent the Bank of England from supporting the economy. Assuming a bumpy, but generally constructive EU-UK negotiation in our base case, the pound sterling should gradually recover.

Asset allocation

The asset allocation consists of an underweight allocation to bonds and a neutral allocation to equities. Within stocks, those of emerging-markets Asia are preferred over US and European equities. Real estate and commodities are overweight. There is a neutral stance to hedge funds.

Investment Strategy & Portfolio Expertise Group Economics



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