



Global Weekly

Change in full swing

Investment
Communication
25 November 2016

Bond and equity markets are anticipating and adjusting to the pro-growth agenda of president-elect Trump. We also updated our growth forecasts.

Equities update

This week, equity markets in the US rose, with the Dow Jones index closing above 19,000 for the first time ever. Investors continue to positively assess the plans of President-elect Donald J. Trump for more fiscal spending and company-friendly tax cuts. His 'America first' agenda benefited small and mid-cap stocks more than large caps. US companies with smaller market capitalizations are perceived to be less sensitive to potential trade restrictions by Trump. At the same time, in European markets the tight polls on the Italian referendum of 4 December took centre stage. This put further pressure on Italian bank shares.

In the meanwhile, equity investors remain focused on interest rates and the oil price. The potential interest rate rise by the US Federal Reserve (Fed) in December, is perceived by the market as sure to happen. It has hardly hampered the performance of developed equity markets because the focus is on (earnings) growth. It did, however, add to a decline in emerging market

Equity index performance in local currency

	Value	One week change (%)	Year-to-date (%)
MSCI ACWI	413.1	0.9%	3.4%
S&P 500	2204.7	1.0%	7.9%
AEX Index	456.2	1.2%	3.3%
EuroStoxx 50	3032.7	0.4%	-7.2%
DAX Index	10660.1	0.0%	-0.7%
Nikkei 225	18381.2	2.3%	-3.4%
Hang Seng Index	22723.5	1.7%	3.7%

Performance data as of Friday, 25 November 2016

Source: Bloomberg

equities as investors are concerned that emerging markets will suffer from a stronger US dollar.

The energy sector benefited from higher oil prices this week on the expectation that the organisation of petroleum-exporting countries, OPEC, will come to an agreement on 30 November to restrict production and as such, raise oil prices. The health care sector was under pressure on negative company news from Eli Lilly and Medtronic.

Given our more positive outlook for global growth, we have become more positive on equities. We advise to invest more in cyclical sectors such as industrial stocks and less in interest-rate-sensitive sectors such as telecommunication and consumer staples.

Bond markets update

Directly after the unexpected election of Trump as US president, bond markets took a big hit. This week, they managed to stop much of the bleeding, but a recovery to last month's yield levels is not in sight. We scaled back our emerging markets bonds position to neutral. We base our downgrade on a significant risk that slowing growth, increasing protectionism and fear of a (much) more aggressive Fed policy will add to ongoing capital outflows.

US corporate spreads, both investment-grade and high-yield, continue to tighten as Trump's 'America First' policies are expected to predominantly support the domestic economy and companies. The expected growth impulse from Trump's policy has driven up inflation expectations. Trump could still spoil this rosy growth scenario by increasing his protectionism towards countries such as Mexico and China more than we currently expect.

While US Treasury yields are edging higher between 2.3% and 2.4%, German Bund yields are grinding lower - between 20 and 30 basis points (bp). The impact on eurozone bond yields is mostly a side effect from correlated global financial markets. The outlook for growth, inflation and monetary policy in Europe is still quite different from the outlook in the US. In contrast to US spreads, European corporate spreads, both investment-grade and high-yield, have been widening

Political risks in Italy are rising, as the referendum on 4 December is drawing near. This has pushed Italian sovereign spreads higher towards 185 bp, dragging all peripheral spreads wider. The European Central Bank (ECB) will meet on 8 December and the bank has many reasons not to make the markets speculate about reducing its loose policy. At the same time, a Fed rate hike on 14 December now seems a done deal.

Macro update

We have updated our global scenario for the economy and financial markets. As such, we have upgraded our forecasts for the US economy on the view that president-elect Trump and the Republican Congress will pass sizeable fiscal stimulus. We now expect US economic growth of 2.4% in 2017 (up

Reporting calendar

USG People	28 Nov
Tiffany & Co., TNT Express	29 Nov
PVH	30 Nov
Enel Green Power S.P.A.	01 Dec

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	1.149	7.9	21.2
German Bunds 2-year	-0.753	-7.9	-33.1
Japan 2-year	-0.147	2.8	-13.5
US Treasuries 10-year	2.369	1.3	13.4
German Bunds 10-year	0.237	-3.4	-23.3
Japan 10-year	0.035	0.3	-26.4

Spreads

	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	73.98	-2.34	-10.50
iTraxx Euro 5-year	81.87	-0.35	11.35
JPM EMBI+	379.41*	-0.76	1.80

Performance data as of Friday, 25 November 2016

* Price is as of Wednesday due to Thanksgiving

Source: Bloomberg

from 1.9% previously), and 2.8% in 2018. With unemployment already low, this will lead to an acceleration in inflation. As such, we now expect a somewhat faster pace of Fed rate hikes. Following a 25 bp step in December, we expect three hikes in 2017 from June onwards and an additional two in the first half of 2018. Crucially, we take the view that Trump's protectionist policies will be relatively moderate and that he will not start a full-blown trade war. With that in mind, we think Trump's inflation impact on the rest of the world will be modest.

Our forecast for eurozone growth is broadly unchanged for next year (1.4%) though we do expect a lower euro to contribute to stronger growth in 2018 (1.8%). The ECB is seen continuing its loose policy through to March 2018 before eventually starting to scale down its asset purchases.

We think global government bond yields have passed their lows, though there are still forces that will moderate the extent of the rise, especially in Europe. We expect 10-year US Treasury yields to rise to 2.9% by the end of next year. German government bonds should remain supported in the near term by the extension of the ECB's loose policy and weak underlying eurozone inflation. For more please see the Global Macro Outlook – The brave new world of 2017 and 2018 of Group Economics.

Currency outlook

We have upgraded our forecasts for the US dollar. Our upgrade is based on early views on Trump's economic impact. We expect the US dollar to be supported by the combination of strong US growth – which will also be above inflation in 2017 – wider yield spreads and a rise in (less negative) US real yields. Therefore, we now expect that the US dollar will see another leg upwards.

Asset allocation

The Global Investment Committee adjusted the asset allocation at its meeting on 17 November by increasing the overweight equities position to a strong overweight. Within the equity sector allocation, the industrials sector was increased to neutral, consumer staples was reduced to underweight and telecoms was reduced to underweight. The regional allocation has been adjusted to restore a neutral allocation to all regions. Bonds remain strongly underweight. The decision was made to reduce the overall duration of the bond portfolio from overweight to neutral. Within alternatives, commodities and real estate are overweight. Hedge funds are neutral.

Published this week

Investment Strategy: Global growth to support equities

Given a more positive outlook for global growth, the Investment Committee increased the allocation to equities. After increasing the allocation to stocks in October, the Investment Committee

believes that the positive conditions that were identified then have strengthened. The equity allocation was further increased at the committee's meeting on 17 November.

Video- Rising bond yields and the Italian referendum

Bond yields are rising and the Italian referendum of 4 December is coming closer. What does this mean for investors? In this interview, Mary Pieterse-Bloem, Global Head of Fixed Income Strategy, explains investors what to expect and what to do.

Video - Outlook for equities has improved

Watch the interview with Annemijn Fokkelman (Global Head of Equity Strategy) about the improved expectations for global growth and our more positive advice on equity.

Bond sector note - Utilities lack energy (neutral)

We are revising our overweight call on utilities, which we established in August 2016, to neutral. The sector's fundamentals remain weak, but the ECB's purchases of corporate securities have been—and continue to be—a supportive factor for bonds. In terms of spread performance, however, utility bonds only managed to track the broad investment-grade benchmark.

Investment Strategy & Portfolio Expertise
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