

Global Weekly

Oil and Italy

Investment
Communication
02 December 2016

This week, only two things seemed to matter: the agreement among oil-exporting countries to cut their oil production and the upcoming Italian referendum.

Equities update

The equity market rally after Trump's election flattened this week. Markets moved sideways as investors look ahead to the impact of the Italian referendum on Sunday.

The energy sector was significantly boosted by the agreement of the Organization of Petroleum Exporting Countries. On Wednesday, OPEC agreed to the first production cut in eight years, an agreement which could extend to involving non-OPEC countries in the future.

The US financials and materials sectors also continue to perform well, based on investor optimism after the US elections. In Europe, the utilities, energy and IT sectors improved this week. European purchasing managers index results were slightly above consensus, supporting this optimism. The financials sector in Europe moved sideways, after reporting

Equity index performance in local currency

	Value	One week change (%)	Year-to-date (%)
MSCI ACWI	412.5	-0.2	3.3
S&P 500	2191.1	-0.6	7.2
AEX Index	448.8	-1.9	1.6
EuroStoxx 50	3002.7	-1.2	-8.1
DAX Index	10447.0	-2.3	-2.8
Nikkei 225	18426.1	0.5	-3.2
Hang Seng Index	22564.8	-0.2	3.0

Performance data as of Friday, 02 December 2016

Source: Bloomberg

good earnings -except for RBS-, tougher UK stress tests, and concerns around the performance of UK banks Standard Chartered and Barclays.

Japanese markets moved notably higher on earnings and improved export prospects due to a weaker yen. It still remains to be seen whether the rally will become a trend, as Trump's stance on the Trans-Pacific Partnership trade agreement and possible tariffs may be translated into policy in 2017. Japan stands to lose both directly as an exporter, and

indirectly through a potential drop in trade with China and the Asia-Pacific region.

This week, China is signaling to limit offshore mergers and acquisitions activity and foreign real-estate investment. China is trying to show an ability to manage capital flows via multiple channels. The local Chinese purchasing managers index reported mixed positive results.

Macro update

Oil prices surged more than 8% Wednesday after OPEC decided to cut its crude production by 1.2 million barrels per day (mb/d) as already indicated at the September meeting in Algeria. Non-Opec producers will cut production by another 0.6 mb/d, of which half will be borne by Russia.

Although reaching an agreement was already quite a struggle, executing the agreement in practice will be an even greater challenge. Many Opec members will have difficulty in cutting production although their fiscal budgets are based on higher oil prices. After all, there is a risk that higher oil prices would trigger a rise in non-Opec crude production. This would lead to a shift in market share, rather than a sustainably higher oil price.

Deal or no deal, we expect higher oil prices in the course of 2017. That is because the market is heading for a balance between supply and demand anyway. Global demand is expected to rise by 1.2 mb/d in 2017, and non-Opec supply will fall under pressure, due to a lack of investments in the sector because of the still low oil prices. The Opec agreement may speed up the process of shifting towards a balance, bringing oil prices towards USD 60/barrel next year. So, if this agreement fails after all, it would only temporarily cap the upside potential of oil prices.

Investor concern about European political risk has sharpened further following the surprise outcome in the US presidential elections. That result, following Brexit, is seen as confirming the surge of an anti-establishment movement fueled by discontent at the impact of globalisation. There are a number of polls coming up, but the Italian referendum on 4 December and its potential ramifications have been in the spotlight recently.

The Italian referendum is viewed as too close to call. The bond market, however, is already showing signs of stress. The spread between Italian and German government Bunds widened to 190 basis points, before retreating to 175 basis points. A no vote is expected to lead to further stress in the bond market, while a yes vote could provoke a short relief rally.

Reporting calendar

USG People	05 Dec
Lululemon Athletica	07 Dec
Enel Green Power S.P.A., Cooper Companies	08 Dec

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	1.150	3.0	21.3
German Bunds 2-year	-0.749	0.8	-30.4
Japan 2-year	-0.186	-3.9	-17.5
US Treasuries 10-year	2.435	7.7	25.4
German Bunds 10-year	0.340	10.2	-12.9
Japan 10-year	0.031	-0.5	-28.6

Spreads

	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	73.51	0.35	-8.21
iTraxx Euro 5-year	79.35	-1.72	10.16
JPM EMBI+	388.08	8.67	-7.28

Performance data as of Friday, 02 December 2016

Source: Bloomberg

Bond markets update

In the years to come, we might look back at the last month as a pivotal one, especially regarding the path of future interest rates. Since Trump was elected US president, the market is pricing in more aggressive Fed hikes.

In the US, we saw bond yields creep up the most. In July, 10-year US Treasuries touched their lowest yield of 1.35%. Since then, bond yields moved slowly higher on improved US economic data. Yields of 10-year US Treasuries peaked above 2.40%, with 30-year US Treasuries yields over 3.10%, breaking technical levels and most likely bringing higher trading ranges in the future.

The US Federal Reserve is gradually moving to a rate hike for the second time in 10.5 years. Investors expect the global recovery to gain more momentum in 2017 than previously thought. Their view is supported by accelerating US growth, stable growth in other developed markets and rebounding momentum in emerging markets.

Inflation in developed markets might very well move towards, and in some cases surpass, central bank targets. In that case, it will result in tighter monetary policy globally. The US Fed is expected to take the lead in this process. Fiscal stimulus will be high in the US and potentially copied throughout the globe, offsetting less accommodative support from central bankers.

Currency outlook

The US Dollar Index lost some of its gains this week after rising by almost 4% in the last three weeks. This is despite the fact that US economic data releases exceeded market expectations. A combination of a better-than-expected purchasing managers index in China, recovery in crude oil prices and profit-taking ahead of the Italian referendum on 4 December weighed on the US dollar. Indeed, technical indicators imply that the US dollar gains since the middle of November were probably overdone.

The euro recovered modestly after news agency Reuters reported that the ECB is ready to temporarily step up purchases of Italian government bonds if the outcome of the Italian referendum leads to a surge in the country's bond yields.

Asset allocation

The asset allocation consists of a strong overweight position to equities. The regional allocation is neutral to all regions. Bonds remain strongly underweight. The overall duration of the bond portfolio is neutral. Within alternatives, commodities and real estate are overweight. Hedge funds are neutral.

Published this week

Equity Sector Note: Telecom vulnerable (underweight)

We recommend an underweight stance on telecommunication as the sector is vulnerable to a rise in bond yields. Within the sector, we prefer high yielding, low valuation telecom companies.

Investment Strategy & Portfolio Expertise Group Economics

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