



Global Weekly

Growth Connectors in 2017

Investment
Communication
9 December 2016

Improving economic conditions, major stimulus in the US and technological transformation are creating the trends that will be the basis of investing in 2017.

This week, we released our annual Investment Outlook, Growth Connectors in 2017. It details our belief in stocks as the engine of portfolio returns in an environment of improving economic indicators, earnings growth and attractive yields relative to other asset classes. In particular, we are moving toward cyclical stocks and away from interest-rate dependent sectors.

It is not all clear sailing, however. Challenges include a divergence in fiscal stimulus measures between Europe and the US, the possibility of fiscal stimulus leading to more assertive Fed rate hikes and inflation and the threat of rising political risk in Europe. [Read our Investment Outlook 2017 here.](#)

One aspect of European political risk was the Italian referendum held 4 December. Markets appeared, however, to take the “no” vote in stride.

Equity index performance in local currency

	Value	One week change (%)	Year-to-date (%)
MSCI ACWI	423.1	2.6	5.9
S&P 500	2,246.2	2.5	9.9
AEX Index	468.6	4.2	6.1
EuroStoxx 50	3,185.8	5.7	-2.4
DAX Index	11,179.4	6.4	4.1
Nikkei 225	18,996.4	3.1	-0.2
Hang Seng Index	22,761.0	0.9	3.9

Performance data as of Friday, 9 December 2016

Source: Bloomberg

This week, the European Central Bank, decided to extend its asset purchases beyond the stated end date of March 2017, but at a lower amount. Through March, purchases will continue to be EUR 80 billion per month, but during the extension, from April through December 2017, monthly purchases will be EUR 60 billion.

In the US, the Federal Reserve meets next week and is expected to hike rates, with a few more hikes next year.

Across the board and in a large number of countries, cyclical indicators are moving in the right direction. Markets also appear to be reconsidering recent events and becoming more positive regarding the Trump administration. It now appears that Trump's agenda is more geared to growth than to populist or anti-immigrant issues. The appointment of former military personnel to important cabinet positions supports the view that substantial deviations in foreign policy are unlikely.

Equities market update

Global equities had a strong performance over the past week, following a post-Italian-referendum rally. Clearly the "no" vote was already factored into markets and investors were apparently relieved that the uncertainty around the referendum was removed. In addition, investors were still in a risk-on mode after the US elections, in anticipation of fiscal stimulation measures and tax cuts. Central banks were closely watched this week. Equity markets were supported by the ECB's continuation of its buying program.

From a sector positioning perspective, the recent flows from defensive stocks towards cyclicals continued. European financials, in particular, were in focus. After the Italian referendum, investors are anticipating a positive outcome for the Italian banking situation. Although no final solution is reached yet, investors expect that in one way or the other, the authorities will sort out this issue. Consequently the European banking sector revealed a strong performance this week, with Italian banks in the lead.

The health care sector again lagged, as US President-elect Trump hinted at plans to lower medicine prices. So although the general thesis had been that a Clinton administration would be negative for health care, Trump also is turning out to be less supportive.

We believe that the most dominant drivers for equity markets continue to be improving fundamentals and the lack of expected returns in other asset classes. We see increasing confirmation on the macro side that global growth is getting better and earnings revisions are also showing further improvement. So leaving aside the recent political events, the underlying fundamental dynamics for equities are improving, which we believe largely explains the current positive sentiment in markets.

Bond markets update

After the "no" vote from the Italians on Sunday, we saw movement in bond markets, but not in the direction as one would have imagined. First, the spread between Italy and Germany

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	1.12	2.2	19.5
German Bunds 2-year	-0.75	-0.8	-43.0
Japan 2-year	-0.18	0.2	-15.2
US Treasuries 10-year	2.43	4.6	21.3
German Bunds 10-year	0.35	7.5	-24.5
Japan 10-year	0.06	2.4	-24.5

Spreads

	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	69.12	-3.73	-17.26
iTraxx Euro 5-year	74.35	-3.72	-1.41
JPM EMBI+	369.53	-18.55	-28.55

Performance data as of Friday, 9 December 2016

Source: Bloomberg

narrowed. Then financials rallied, while the dire state of Italian banks and political uncertainty would have suggested taking risk off the table. And if that were not enough, Moody's moved Italy's Baa2 rating outlook from stable to negative. The market appeared to believe that the ECB would contain the situation. So, did we, and accordingly, we increased our position in Italian bonds, moving from underweight to neutral, as we believe that European institutions have strong incentives to support Italy.

Drama surrounded the troubled Monte dei Paschi di Siena bank this week. It must raise EUR 5 billion in new capital to offload EUR 30 billion in troubled loan assets to private investors. It managed to generate EUR 1 billion through a debt swap with large investors. The Italian treasury seems willing to buy the remainder of debt from smaller retail investors and to swap this for equity. The Qatar sovereign wealth fund will fill the remaining gap as an anchor investor. But following the "no" vote, a private solution became distant. Then rumours surfaced that Italy would bail out banks through a EUR 15 billion loan from the European Stability Mechanism, which would be positive. The big question, however, is whether public intervention in the banks, whether indirect or direct, will be allowed under new banking regulation. These rules require a bail-in of bondholders before support can be granted. This would be precarious, as bonds are largely held by retail investors for pension purposes. A possible way out is to compensate these investors after the fact.

Currency outlook

In currency markets, the US dollar has come to a standstill. After the ECB meeting this week, currency markets initially reacted as if the ECB had taken a "hawkish," less accommodative,

stance, but released afterwards, when it became clear that this was not the case. As a result, the EUR/USD gave up all its gains and dropped to 1.06. The focus now turns to the Federal Reserve and its meeting next week. The EUR/USD is expected to break through parity, where 1 euro = 1 US dollar, in 2017.

Asset allocation

At the meeting of ABN AMRO's Global Investment Committee this week, no changes were made to the overall asset allocation. It consists of a strong overweight to equities, an underweight in bonds and an overweight in cash. Within alternatives, there are overweight allocations to commodities and real estate, and a neutral stance taken to hedge funds.

Published this week

Investment Outlook: Growth Connectors in 2017

This Investment Outlook addresses the positioning of private clients for 2017 – a time of momentous change that is accelerating the transition toward improved economic prospects.

Bond Markets Monthly: U-turn in bond markets

We are shifting away from negative/zero interest rates. This means that bond yields could become attractive again in what would be a more normalised world for investors. Initially, however, this is likely to have a negative impact on bond returns.

Investment Strategy 7 December 2016: Italy says no to reforms

In Sunday's referendum, the Italian people voted against reforms of the Italian Senate. Prime Minister Matteo Renzi offered his resignation, meaning that we are entering a period of political instability in Italy.

Investment Strategy & Portfolio Expertise Group Economics



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