



Global Weekly

Happy new year

Investment
Communication
6 January 2017

Equity markets have had a good start to the year. While the number of trading days in 2017 can still be counted on one hand, it is a welcome contrast to 2016.

The new year has started much more positively than 2016. Stock markets are calm and continue to be buoyed by the end-of-year rally that took place in the last weeks of 2016. Activity is expected to pick up, given the impact of the fourth-quarter earnings season, which is getting underway next week, and the inauguration of the new US president later in the month. Double-digit earnings growth, driven by improving macroeconomic data and strengthening company fundamentals, should support equity prices for the time being.

Equity markets update

The first week of the year was quiet but positive for equities. Most major markets rose, driven by prospects of improving global economic growth and further shifts from bonds into equities. Japanese shares were particularly strong with the Nikkei Index rising by 3% over the week.

Equity index performance in local currency

	Value	One week change (%)	Year-to-date (%)
MSCI ACWI	429.6	1.8	1.8
S&P 500	2,269.0	0.8	1.3
AEX Index	485.9	0.6	0.6
EuroStoxx 50	3,316.5	0.4	0.4
DAX Index	11,584.9	0.6	0.6
Nikkei 225	19,454.3	0.3	1.8
Hang Seng Index	22,503.0	3.3	2.3

Performance data as of Friday, 6 January 2017

Source: Bloomberg

European banking stocks did well this week. UBS, Credit Suisse, Deutsche Bank and Commerzbank all rose by some 10%. Next to generally positive sentiment for financials since the election of Donald Trump, European banks benefited from the announcement this week that new Basel III rules will be postponed. This may give the sector more time to lobby against the new rules, which are expected to have substantial consequences for various European banks. The delay could also mean that the draft Basel III plans are relaxed, as the Trump administration may pursue looser banking regulation.

US car producers, such as Ford and GM, also had a good week after reporting better-than-expected vehicle sales for December. Traditional retail stocks, however, had a tough week. The UK department store operator Next Plc issued a profit warning and its shares tanked. Its US peers, Macy's and Kohl's, also issued warnings on Wednesday. In our view, this confirms that department store operators continue to face intense pressure from online retailing.

Companies will begin reporting their annual results next week. Industrial metals producer Alcoa will kick off on Monday, followed by the US banks, including JPMorgan, Wells Fargo and Bank of America, which are set to report on Friday.

Bond markets update

Eurozone government bond yields surged after strong German inflation data. The 10-year Bund yield rose to 0.27%. Since the German inflation data was higher than expected, the 10-year inflation expectations rose to 1.30%, the highest level since mid-2015. This benefits inflation-linked bonds, which offer protection against inflation.

Global debt issuance of USD 21.2 billion so far in 2017 has been the strongest start to a year on record. Companies are locking-in borrowing costs before Trump's inauguration on 20 January. Spreads on investment-grade corporate bonds remained flat, compared to year-end 2016. High-yield corporate bonds in Europe and the US tightened by 15 basis points, leading to higher index values. This could be explained by the search for yield by investors and/or positioning in bonds with a shorter duration in anticipation of Donald Trump's economic policies and potential Fed rate hikes.

Emerging-markets bonds are moving between risk-on/risk-off brackets. Stable oil prices and increasing global growth seem supportive for emerging markets, but Trump's foreign-trade policy leaves emerging markets vulnerable, and hence more volatile. These factors drove emerging-markets bond investors to other sub-asset classes and emerging-markets equity investors into emerging-markets bonds.

Currency outlook

The US dollar had a strong start to 2017. A surprise jump in the Institute of Supply Management prices-paid index and the surge in eurozone inflation turned the focus of currency markets back to inflation. Since then, the US dollar has been on the defensive. Lower US Treasury yields and a narrower 10-year yield spread versus Germany have also weighed on the US dollar.

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	1.168	-2.3	19.0
German Bunds 2-year	-0.726	7.4	-33.8
Japan 2-year	-0.213	-2.8	-20.3
US Treasuries 10-year	2.351	-9.4	18.0
German Bunds 10-year	0.248	4.5	-25.3
Japan 10-year	0.052	1.1	-19.3

Spreads

	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	64.11	-3.39	-27.79
iTraxx Euro 5-year	69.06	-3.25	-12.05
JPM EMBI+	353.78	-8.34	-55.80

Performance data as of Friday, 6 January 2017

Source: Bloomberg

Overall, we expect US real yields to rise in the coming months, and for the Federal Reserve to initiate three hikes of 25 basis points each in 2017. Meanwhile, the ECB should keep an accommodative monetary policy in place. Eurozone political uncertainty will likely weigh on eurozone sentiment. We are therefore retaining our forecast that the EUR/USD will break parity and reach 0.95 in the first half of 2017.

Asset allocation

At the meeting of the Global Investment Committee on 5 January, no changes were made to the asset allocation. It consists of a strong overweight in equities and an underweight in bonds. Within alternative investments, commodities and real estate are overweight, and there is a neutral stance toward hedge funds.

Investment Strategy & Portfolio Expertise Group Economics

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