

Global Weekly

Muted markets

**Investment
Communication**
7 April 2017

Equity markets edged lower this week, moving in tandem with bond yields. The US missile attack on Syria only evoked a muted market response.

Equity markets moved slightly lower in the past couple of days. US markets were off to a cautious start of the week, as investors pondered the possibility that President Donald Trump may need more time to implement his tax plans for the US economy. Later in the week, strong US job data provided support to equities. The US strikes on Syria on Friday did not materially impact markets.

European markets retreated somewhat as well. Paints and coatings company AkzoNobel is increasingly pressured by its US peer PPG to talk about a possible takeover. PPG's CEO said that the vast majority of Akzo's biggest shareholders wants the Dutch company to reconsider its earlier rejection of PPG's offer. PPG intends to make a formal bid in the coming months.

The minutes of the Federal Reserve's (Fed) March meeting, published on Wednesday, showed that participants of the meeting suggested to trim the Fed's balance sheet earlier

Equity index performance in local currency

	Value	One week change (%)*	Year-to-date (%)
MSCI ACWI	447.6	-0.3	6.1
S&P 500	2,357.5	-0.2	5.3
AEX Index	516.3	0.0	6.9
EuroStoxx 50	3,489.6	-0.3	6.0
DAX Index	12,230.9	-0.7	6.5
Nikkei 225	18,597.1	-1.7	-2.7
Hang Seng Index	24,273.7	0.7	10.3

*Thursday close compared with Friday last week

Performance data as of Thursday, 6 April 2017

Source: Bloomberg

than expected. Equity markets – especially financial stocks – in the US, Europe and Asia reacted negatively on the hawkish remarks. The reason behind these remarks, however, is that the economy is getting in good shape faster than expected. And that is an important driver for equity performance. The upcoming earnings season should show decent results. First-quarter earnings growth is expected to be solid compared with relatively low earnings for the first quarter of 2016, when

commodity prices were under severe pressure. The first big companies to report are US banks Citigroup, JP Morgan and Wells Fargo next week.

Bond markets update

Both US Treasury yields and Bund yields moved towards the lower end of their trading range. Since the election of Donald Trump, yields are trading in a range where the bottom is roughly 2.3% for 10-year US Treasuries and 0.2% for 10-year Bunds. The reflation theme lost further support as the prospect of significant fiscal stimulus in the US is fading with every week Trump is not delivering on any election promise.

Meanwhile, European inflation numbers in March fell much more than expected, though largely caused by statistical effects through a combination of the timing of Easter and a lower oil price. This still allowed Mario Draghi, President of the European Central Bank (ECB), to counter premature market speculation about a much earlier tightening of monetary policy through tapering in 2017 or even raising official rates this year.

However, the strong momentum in the global economy, where Europe continues to surprise on the upside despite all the political action, is expected to keep the normalisation of policy and interest rates on track way into 2018. Discussions about the timing of tapering and rate hikes will resurface over this summer, once the uncertainty of the French elections is out of the way. We expect the ECB to respond by announcing and starting tapering earlier than we thought before, which will have its impact on (higher) Bund yields and credit spreads as well. We therefore expect negative returns for most European bond market segments for the remainder of this year, even while the first quarter was already negative (despite some relief since mid-March).

Opinion polls continue to signal a very limited probability that Marine Le Pen will become the next French president. In the second half of this year, markets can switch focus from the French elections to the German elections. We believe the German elections will be easier to deal with, given a lack of disruptive tail risks. Meanwhile, German populist parties are struggling to cross the 5% threshold to make it into parliament at all, contrary to France. In Italy, however, mainstream parties are not yet managing to effectively oppose the more opportunistic parties, which together continue to enjoy more than 40% support in the opinion polls. Elections in Italy are supposed to take place in February 2018 at the latest. Risks for Italian spreads could rise again, perhaps after a relief rally following the French election.

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	1.236	-2.0	54.6
German Bunds 2-year	-0.801	-5.1	-29.0
Japan 2-year	-0.216	-2.1	2.9
US Treasuries 10-year	2.326	-6.3	63.6
German Bunds 10-year	0.245	-8.0	15.6
Japan 10-year	0.054	-1.1	11.5

Spreads

	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	65.50	-0.78	-15.99
iTraxx Euro 5-year	74.62	0.97	-7.12
JPM EMBI+	337.51	8.07	-66.95

Performance data as of Friday, 7 April 2017

Source: Bloomberg

Macro update

The minutes of the Fed's March meeting suggested that policymakers discussed the potential benefits and costs of approaches for reducing the balance sheet of the US central bank. The Fed's balance sheet now amounts to around USD 4.5 trillion dollars. The Fed has maintained its policy of reinvesting principal payments from its holdings of US Treasury securities and mortgaged-backed securities, as well as rolling over maturing Treasuries.

Most participants judged that if the economy continues to perform as expected, a change in reinvestment policy would be appropriate this year. Overall, the minutes were unclear as to whether the Fed will opt to phase out reinvestment or end it all at once. We think a phasing strategy would be smoother and likely to start once there is more clarity about the timing and size of fiscal stimulus.

As a result of the decision to pull the Republican bill to repeal Obamacare, we have become a bit more sceptical about the means to push through the tax reform. The Trump administration's ability to find the necessary support for passing future plans has been put in doubt. However, despite the delay and the uncertainty regarding the size of the tax cut, we think the US economy is resilient enough to deal with the muddle-through situation. We have revised slightly downwards our GDP growth forecast for 2017 (2.3% y-o-y; was 2.4%) and for 2018. As for inflation, our forecast for headline inflation is now 2.5% (was 2.7%) for 2017 and unchanged for 2018.

Currencies outlook

Recently, we have adjusted our US macro-economic forecasts, as well as our global government bond yield forecasts. Taking into account these changes, we decided not to change our US dollar and EUR/USD views. We keep our year-end forecasts for EUR/USD at 1.10 (2017) and 1.20 (2018), respectively. For a start, we only expect a modest rise in US real yields in 2017. Therefore, the upside of the US dollar in 2017 is limited, in our view. Moreover, speculative net-long positions in the US dollar are quite sizeable. Investors are well positioned for US dollar strength but if this fails to materialise, they will slowly but surely close parts of these positions. This will result in downward pressure on the US dollar.

Even though investors have downscaled their expectations about Trump's fiscal stimulus, they are still giving him the benefit of the doubt. We now expect that fiscal stimulus will take longer to arrive and that the overall size of the stimulus will be smaller, which will probably weigh on the US dollar going forward. We expect that the euro will continue to receive support as market expectations build and the ECB monetary policy will gradually become less accommodative.

We expect two more rate hikes of 25 basis points by the Fed in 2017 and three more in 2018. Financial markets have almost priced in our scenario for this year, but only two hikes for 2018. If markets move in our direction, the US dollar should get some support in 2017 (also anticipation for 2018 rate hikes). But this will probably not be enough to cause a major US dollar rally, mainly because investors are already positioned for this. Next year, we expect the US dollar to weaken across the board because of lower US real yields, a deterioration in the growth inflation mix and other central banks moving towards more restrictive or less accommodative monetary policy.

Asset allocation

Our overall asset allocation remains unchanged. It consists of a moderate overweight in equities, a large underweight in bonds and a significant overweight in cash. Within alternatives, real estate is overweight, a neutral stance is taken to hedge funds and there is no allocation to commodities.

Published this week

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