



Global Weekly

# Relaxed for now

**Investment  
Communication**  
12 May 2017

With the French elections behind us and the first-quarter earnings season coming to an end, financial markets now seem to have some room to relax.

## Bond markets update

After their low of 2.16% in April, 10-year US Treasury yields now have returned to their trading range between 2.30% and 2.60% where they moved between November and March. For the 2-year US Treasury, pressure is building as the market is anticipating a rate hike at the meetings of the US Federal Reserve (Fed) in both June and September. This is in line with our expectations. 10-year German Bunds now trade at 0.43%, still moving in the range between 0.15 and 0.50% that was established in January.

Over the past six months, French politics have been the key driver of most eurozone peripheral government spreads, with Spanish bonds trading at a spread of 119 basis points and Italian at 185. We now expect other factors to take stage, such as macroeconomic dynamics, ECB policy and local political risks.

## Equity index performance in local currency

	Value	One week change (%) <sup>*</sup>	Year-to-date (%)
MSCI ACWI	459.11	0.0	8.8
S&P 500	2,394.44	-0.2	7.0
AEX Index	534.24	0.2	10.6
EuroStoxx 50	3,623.55	-1.0	10.1
DAX Index	12,711.06	0.0	10.7
Nikkei 225	19,961.55	2.7	4.4
Hang Seng Index	25,125.55	2.7	14.2

<sup>\*</sup>Thursday close compared with Friday last week

Performance data as of Thursday, 11 May 2017

Source: Bloomberg

The market seems relatively relaxed, with peripheral spreads expected to remain low for the next few weeks. For the second half of the year, we expect wider spreads on the back of ECB tapering and political risk in Italy. Markets expect that the spread between Italian and German government bonds could widen significantly in the run-up to the Italian general election, which is currently expected to take place early 2018. When the ECB starts tapering its asset purchases, we expect a negative

impact on Italian government bonds, which is already priced in somewhat. In general, the spreads look fair when compared with emerging markets sovereigns, but political risk could make Italian bonds look like weak emerging markets credit.

## Equity markets

The first-quarter earnings season is largely over, with more than 80% of companies having reported their figures. In the US, sales figures were as expected, while earnings per share came in 5% better than expected. European companies did even better: sales were 2% higher than expected – on average – while earnings per share were almost 10% ahead of analyst estimates. The strong earnings performance of European companies confirms our view that European stocks currently are more attractive than their US peers.

Most equity markets were largely unchanged this week. The election of Emmanuel Macron as the new French president hardly inspired investors in Europe. The Euro STOXX 50 Index was around the same level as last week. The same was true for the S&P 500 Index. Nevertheless, the S&P 500 set a new all-time high and has risen 8% year-to-date. In Asia, Japanese shares did well and rose about 3% for the week – the Nikkei Index almost touched 20,000.

Energy stocks recovered somewhat as the oil price rose on lower-than-expected inventory levels in the US. Investors will, however, focus on the meeting of the Organization of Petroleum Exporting Countries (OPEC) at the end of May before making strong bets on the longer-term direction of the oil price.

## Currencies outlook

The British sterling recovery seems to have stalled for now. In 2016, sterling lost 15% of its value against a basket of currencies. So far this year, sterling has rallied by 4% versus the US dollar and 1% versus the euro. For many, this has been a surprise because they thought that Brexit would send sterling much lower in 2017 as well. Therefore, speculative net-short positions have been very large. At some point in time, every investor who wanted to be positioned for sterling weakness was positioned. Under those circumstances prices will not decline anymore. This is exactly what has happened so far this year.

Some investors have closed short sterling positions on the back of better-than-expected UK data and expectations that the Bank of England might be forced to tighten monetary policy because of higher inflation. This has resulted in GBP/USD rising towards 1.30. The Bank of England, however, did not meet the expectations and as a result, sterling came under pressure across the board.

## Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	1.33	2.0	57.6
German Bunds 2-year	-0.68	1.0	-16.2
Japan 2-year	-0.18	2.4	7.7
US Treasuries 10-year	2.37	2.4	62.2
German Bunds 10-year	0.41	-0.2	26.0
Japan 10-year	0.04	2.3	16.2

## Spreads

	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	62.61	-0.22	-19.01
iTraxx Euro 5-year	62.89	-0.24	-14.59
JPM EMBI+	320.23	-3.60	-70.37

Performance data as of Friday, 12 May 2017

Source: Bloomberg

## Reporting calendar

Belle Intl Holdings, Golden Agri-Resources, Mitsubishi Financial, Mizuho Financial Group, Nippon Telegraph & Telephone, RWE, Sumitomo Mitsui Financial	May-15
China Resources Beer, Home Depot, Vodafone Group	May-16
Bouygues, China State Construction, Cisco Systems, Flow Traders, Tencent Holdings	May-17
Alibaba Group Holding, Applied Materials, Merck, National Grid, NN Group, Salesforce.com, Singapore Airlines, Singapore Telecommunications, Wal-Mart Stores	May-18
Deere & Co, Euronext	May-19

We think this sell-off is healthy after the recovery sterling has experienced so far this year. We expect GBP/USD to move towards 1.25 in the coming weeks, also because of a recovery of the US dollar. However, we do not expect sterling to weaken beyond that. Investors will likely use any weakness in sterling as an opportunity to close some of their excessive sterling shorts. As a result, GBP/USD may not even reach 1.25.

## Macro update

On Wednesday, ECB President Mario Draghi appeared before the Dutch parliament. He was positive about the economic outlook, but judged that very accommodative monetary policy remained appropriate. He said that recent economic reports confirmed that the recovery 'is becoming increasingly solid and that downside risks have further diminished'. However, he insisted that 'the time hasn't come yet' to exit or think about exiting accommodative monetary policies.

We think that the ECB will still gradually move towards the exit, given the limits of the quantitative easing programme. We think that in June, the ECB will confirm that growth risks are now balanced and no longer to the downside and that the central bank will start to reduce the pace of its monthly asset purchases (from EUR 60 billion per month currently) in January of next year, in steps of EUR 10 billion a month. That would lead to an end of the asset purchasing programme by June 2018.

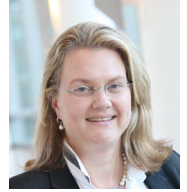
### Asset allocation

Our overall asset allocation consists of a strong overweight in equities, a large underweight in bonds and an 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

#### **Why the return of diversification between asset classes is good news for investors**

PWM published an article written by Mary Pieterse-Bloem. Pieterse-Bloem analyzes the effect of returning to an environment of lower correlations between asset classes and the resulting diversification opportunities, both between asset classes as well as amongst these.



### **Investment Strategy & Portfolio Expertise Group Economics**



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