

Global Weekly

One more step back to normal

Investment
Communication
16 June 2017

The Federal Reserve hiked rates this week, in a confirmation that economic growth remains steady. It is also a clear signal that the US central bank is committed to normalising rates.

The US Federal Reserve raised the federal funds rate by a quarter percentage point to a range between 1.0% and 1.25% this week. The move was widely expected. The Fed is also providing clear guidance that one more hike is expected in 2017.

While a synchronised global recovery continues, there are some gradual changes underway. US economic growth, for example, weakened in the first quarter, but has strengthened more recently. US confidence data, however, paints a mixed picture and recent US indicators have fallen short of expectations. We consider all of this to be a normal part of short-term business cycle fluctuations. Nonetheless, it deserves to be monitored. In the eurozone, the economy continues to grow, with no signs of the disappointments seen in the US.

Inflation remains below central bank target levels in both the US and Europe. One explanation is that we have entered a

Equity index performance in local currency

	Value	One week change (%) [*]	Year-to-date (%)
MSCI ACWI	464.7	-0.4	10.2
S&P 500	2432.5	0.0	8.6
AEX Index	518.8	-1.6	7.4
EuroStoxx 50	3525.5	-1.7	7.1
DAX Index	12691.8	-1.0	10.5
Nikkei 225	19831.8	-0.9	3.8
Hang Seng Index	25565.3	-1.8	16.2

Performance data as of Thursday, 15 June 2017

Source: Bloomberg

phase where inflation is structurally lower than in the past, due to the impact of digitalisation on prices in the service sector. So far, low inflation is obviously not keeping the Fed from raising rates or the ECB from slowly beginning to take very small steps towards reducing its supportive monetary policy. The first sign from the ECB was a slight change in its forward guidance last week. We believe that actual reductions in ECB asset purchases will begin in January.

Equity market update

After the equity market approached earlier highs, the Federal Reserve's decision to increase rates this week resulted in a soft retreat. Investors adopted a more cautious stance and moved into the safer parts of the markets.

From a sector perspective, information technology experienced some headwinds, as investors become nervous over high valuations. Investors moved to more defensive and interest-rate sensitive parts of markets, such as utilities and consumer staples. The energy sector remained weak, owing to increasing concerns regarding oversupply. This resulted in a renewed decline in oil prices. We continue to avoid the energy sector. From a regional perspective, US stock markets rose during the week, while European and Asian markets declined.

Leaving aside near-term noise, we believe that positive macro-economic trends and encouraging earnings developments will continue to support equity markets. Corporate news flow is relatively low in the run-up to the second-quarter earnings season, which starts next month. In general, investors are expecting favourable earnings reports that should confirm positive underlying growth trends.

Bond market update

The fixed income market appears to be in a holding pattern, with bond yields in a tug of war between improving fundamentals (but sagging inflation) and the political risks related to Donald Trump and European elections. The interest rate curve further flattened this week. The US ten-year rate dropped sharply, due to disappointing inflation data and continued political concerns related to the Trump administration.

The first details on how the Fed plans to reduce its large balance sheet, which were made known this week, were not sufficient to push longer yields higher. We see the Fed rate hike and ensuing communication on balance sheet reduction as a path to the normalisation of monetary stimulus. Future actions could be less dictated by observed inflation and match a strengthening of the US economy, as also forecasted by the Fed.

Italian sovereign bonds rallied, as the likelihood of early Italian elections declined and a proposal for change in the electoral system did not occur. The dark skies have not cleared for Italy, however, as the anti-establishment party still enjoys great popularity. The situation could worsen, and we therefore continue to avoid Italian sovereign debt.

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	1.35	1.7	66.6
German Bunds 2-year	-0.64	9.8	-3.6
Japan 2-year	-0.12	-1.0	16.6
US Treasuries 10-year	2.17	-3.2	59.0
German Bunds 10-year	0.30	4.2	32.7
Japan 10-year	0.05	0.0	25.0

Spreads

	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	60.20	0.26	-24.93
iTraxx Euro 5-year	56.89	-2.28	-30.69
JPM EMBI+	329.96	5.47	-75.42

Performance data as of Friday, 15 June 2017

Source: Bloomberg

Currency outlook

The US dollar retreated this week in the face of lower-than-expected inflation and retail sales data. Currency markets were also caught wrong-footed when the Federal Reserve sounded less accommodative than expected with its plans to continue hiking rates at a gradual pace. The US dollar regained the lost ground the day after the Fed decision. Going forward, the US dollar could strengthen if US data turns more positive than expected, but if this is not the case, and economic data disappoints, it will likely again come under pressure.

Asset allocation

The ABN AMRO asset allocation continues to consist of a strong overweight in equities, a strong underweight in bonds and a large cash position. Within alternatives, real estate is overweight and hedge funds are neutral. There is no position in commodities.

Published this week

Market Comment: Fed on a mission to normalise rates

As widely expected, the US Federal Reserve decided yesterday to lift the federal funds rate by 0.25% and gave details on how it intends to reduce its balance sheet.



Disclaimer

General

The information provided in this document has been drafted by ABN AMRO Bank N.V. and is intended as general information and is not oriented to your personal situation. The information may therefore not expressly be regarded as a recommendation or as a proposal or offer to 1) buy or trade investment products and/or 2) procure investment services nor as an investment advice. Decisions made on the basis of the information in this document are your own responsibility and at your own risk. The information on and conditions applicable to ABN AMRO-offered investment products and ABN AMRO investment services can be found in the ABN AMRO Investment Conditions (Voorwaarden Beleggen ABN AMRO), which are available on www.abnamro.nl/beleggen.

Although ABN AMRO attempts to provide accurate, complete and up-to-date information, which has been obtained from sources that are considered reliable, ABN AMRO makes no representations or warranties, express or implied, as to whether the information provided is accurate, complete or up-to-date. ABN AMRO assumes no liability for printing and typographical errors. The information included in this document may be amended without prior notice. ABN AMRO is not obliged to update or amend the information included herein.

Liability

Neither ABN AMRO nor any of its agents or subcontractors shall be liable for any damages (including lost profits) arising in any way from the information provided in this document or for the use thereof.

Copyrights & distribution

ABN AMRO, or the relevant owner, retains all rights (including copyright, trademarks, patents and any other intellectual property right) in relation to all the information provided in this document (including all texts, graphic material and logos). The information in this document may not be copied or in published, distributed or reproduced in any form without the prior written consent of ABN AMRO or the appropriate consent of the owner. The information in this document may be printed for your personal use.

US Person

US Securities Law Disclaimer

ABN AMRO Bank N.V. ('ABN AMRO') is not a registered broker-dealer under the U.S. Securities Exchange Act of 1934, as amended (the '1934 Act') and under applicable state laws in the United States. In addition, ABN AMRO is not a registered investment adviser under the U.S. Investment Advisers Act of 1940, as amended (the 'Advisers Act' and together with the 1934 Act, the 'Acts'), and under applicable state laws in the United States. Accordingly, absent specific exemption under the Acts, any brokerage and investment advisory services provided by ABN AMRO, including (without limitation) the investment products and investment services described herein are not intended for U.S. persons. Neither this document, nor any copy thereof may be sent to or taken into the United States or distributed in the United States or to a US person.

Other jurisdictions

Without limiting the generality of the foregoing, the offering, sale and/or distribution of the investment products or investment services described herein is not intended in any jurisdiction to any person to whom it is unlawful to make such an offer, sale and/or distribution. Persons into whose possession this document or any copy thereof may come, must inform themselves about, and observe any legal restrictions on the distribution of this document and the offering, sale and/or distribution of the investment products and investment services described herein. ABN AMRO cannot be held responsible for any damages or losses that occur from transactions and/or services in defiance with the restrictions aforementioned.

Sustainability Indicator

Sustainability Indicator Disclaimer

ABN AMRO Bank N.V. has taken all reasonable care to ensure the indicators are reliable, however, the information is unaudited and subject to amendment. ABN AMRO Bank is not liable for any damage that constitute from the (direct or indirect) use of the indicators. The indicators alone do not constitute a recommendation in relation to a specific company or an offer to buy or sell investments. It should be noted that the indicators represent an opinion at a specific period of time considering a number of different sustainability considerations. The sustainability indicator is only an indication regarding the sustainability of a company within its own sector.