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Other challenges besides tapering

With tapering of quantitative easing (QE) in the US largely priced in, the financial markets are likely to focus on other key events that are scheduled for this month. In Europe, ECB President Draghi's statements to the press on 5 September only briefly reversed the rise in bond yields, while in the US employment data paint a mixed picture.

Challenges ahead

In September, financial markets are likely to be driven by a number of key event risks, in addition to the ongoing uncertainty about US growth and heightened emerging market volatility. The impact on rates of possible military action against Syria depends on the severity and duration thereof; yields could rally on falling equities and a flight to safety, should the conflict escalate. Markets would therefore like to see a quick strike (as seen against Libya), but given the current geopolitical constellation, this is not likely to happen. While markets have been focused on the timing of the Fed's tapering, a number of other important topics are on the Federal Open Market Committee's (FOMC) agenda for its September 18 meeting. Aside from discussing possible guidance about the tapering process, the FOMC will consider possible changes in the thresholds for future interest rate hikes as well as changes to the staff's economic projections. For the first time, the FOMC will reveal its forecasts for the level of the Fed funds target rate at the end of 2016. This could shift the market's focus from when to how far rates will be hiked. The forecast could well come as a surprise to the market, in turn causing the three- and five-year bond curves to steepen. Also on tap for September is a likely announcement concerning the replacement of both Chairman Bernanke and other FOMC Board Members. The market will focus on any shift in the dove/hawk balance that could result from these changes. The US fiscal debate could re-emerge as US Congress returns from its recess on September 9. The Federal government faces expiration of the continuing resolution and a looming debt ceiling in October. Europe could re-enter the spotlight, as elections and reviews could revitalise dormant contentious issues.

Equity index performance in local currencies

	Value	One week (%)	Year-to-date (%)
MSCI ACWI	370.22	1.7	9.0
S&P 500	1655.08	1.2	16.0
EuroStoxx 50	2774.2	2.0	5.3
DAX	8234.98	1.4	8.0
Nikkei 225	13860.81	3.5	33.3
Hang Seng Index	22656.04	4.3	0.0

Important rating changes

Company	From	To
AIA Group	Hold	Buy
Canon	Buy	Hold
Kinder Morgan	Hold	Buy/RL
Renault	Buy	Hold
BMW	Buy	Hold

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	0.51	11.0	24.7
German Bunds 2-year	0.31	7.5	27.5
Japan 2-year	0.12	0.0	0.9
US Treasuries 10-year	2.98	21.7	130.1
German Bunds 10-year	2.03	17.0	46.6
Japan 10-year	0.78	7.0	-2.6

Spreads

Index	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	83.64	1.1	-11.1
iTraxx Euro 5-year	105.52	0.6	-26.4
JPM EMBI+	365.61	-7.9	76.8

Performance data is as of 12:00 pm Friday, 6 September

Source: Bloomberg

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Macro update

Following Draghi's warning that short-term interest rate expectations in money markets were unwarranted in August, financial markets were keen to hear whether ECB President Draghi would step up his rhetoric at the press conference on 5 September. Revealing that he was "very, very cautious about the recovery" Draghi said that a rate-cut had been discussed, but that rates had ultimately been kept at their current level. The ECB also maintains its forward guidance that it initially gave in July. The bank expects its key interest rates to remain at current or lower levels for an extended period of time. Draghi also stated that, watching money market rates very closely, the ECB is "particularly attentive" of the implications as regards the Bank's stance on monetary policy. He stated that the ECB has the tools to push market rates down if necessary, hinting at the possibility of a new long-term refinancing operation (LTRO) or a rate cut.

While dovish in tone, Draghi did not go far enough to succeed in dampening financial markets' rate-hike expectations. Vague about whether the ECB sees current rate expectations as appropriate, he also suggested that the central bank is not considering changing its forward guidance. Short-term interest rate expectations and government bond yields dipped only temporarily following Draghi's comments and then resumed the rise they had begun in the run-up to the conference, in line with the sell-off in the US Treasury market.

Recent macro data from the US pave the way for the Federal Reserve to announce a tapering of its quantitative easing programmes at the FOMC's September meeting. The ISM manufacturing and non-manufacturing indexes both came in stronger than expected, the first rising to 55.7 from 55.4, the highest level since 2011, and the second climbing to 58.6 from 56.0, the highest level since 2005. Most encouragingly was the jump in the employment sub-index, which rose from 53.2 to 57. Friday's employment report disappointed with 169,000 new jobs, where 180,000 were expected. Moreover, job growth in June and July was revised downward by 74,000 jobs. Despite the mixed picture in employment data, we remain convinced that US job market growth will accelerate later this year.

Bond markets update

US and German 10-year government bond yields rose further and are now challenging the new psychological levels of 3% and 2%, respectively. Better-than-expected US and European macro data as well as the Fed signalling the upcoming tapering of QE not only triggered a major rise in bond yields - or

the end of the global hunt for yield – but a revival of classical cyclical exposure as well. It also led to changing correlations between assets and asset classes. Diversification between risk assets has become more beneficial, whereas the diversification benefits of safe-haven bonds have declined. ABN AMRO's Group Economics is convinced of continued moderate global growth: They do not see the turmoil in emerging markets tipping the global economy over the cliff. We believe the major adjustments in bond yields are over for now, resulting in range trading around psychological levels for the time being. Higher bond yields increase fixed income assets' attractiveness. We remain balanced in our bond allocation, with an underweight in sovereign debt and an overweight in more risky debt (like investment-grade (20%), and high-yield credits (15%) and emerging markets (10%)) as well as cash.

Equities update

Equity markets were volatile last week. Possible military action by the US, and maybe others, against Syria was still on investors' minds, but better-than-expected macro data helped sentiment. European and US markets ultimately performed very well, while sentiment in Asia was quite bullish. Headline company news was the USD 130 bln deal between Verizon and Vodafone, in which the latter sold its lucrative 45% US wireless stake to joint venture partner Verizon, prompting a surge in Vodafone shares. Its shareholders will receive a cash and stock dividend. Another deal announced this week was Microsoft's EUR 5.4bln bid for Nokia's handset operations. Nokia shares opened almost 50% higher. The Finnish company will refocus on its telecoms infrastructure business. Microsoft shares dropped on the news. Longer term, however, the company needs Nokia's business to push sales of its Windows Phone software. Currently, Windows ranks third after Apple's IOS7 and Google's Android. With M&A increasing for a while now, investment banks benefit. UBS and Goldman Sachs are expected to share as much as USD 118 mln in Vodafone advisory fees from the Verizon deal. Increasing M&A is also a bullish signal for equity markets. Bad news came this week from Ryanair, which issued a profit warning, blaming price competition, some capacity increases, weak economic conditions in Europe and weaker exchange rates. Several European airline companies felt the profit warning, seeing their shares drop. News from another IT-giant was the launch of Samsung's Galaxy Gear smartwatch, ahead of Apple's iWatch and Google's Glass headset, but it had little impact on the stock.

The agenda for next week remains empty as the second quarter earnings season has ended. Syria may continue to

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weigh on investor sentiment, but for now we do not expect the situation to escalate and therefore remain overweight in equities.

Stock to watch: Philips

We believe Philips will announce an EBITA margin target range of 12-14% for 2016 at its Capital Market Day (CMD) on 17 September, up from 10-12% in 2013 and with consensus around 12%. Consumer Lifestyle (CL) is the main driver behind margin expansion in our view. We believe strong margin expansion in CL is feasible, as 1) the mix has improved after divestments; 2) strong top-line growth as a result of Philips' focus on local relevance should enable operational leverage, and 3) peer group margins – from Proctor & Gamble, for example - suggest there is a significant gap to close. The announced cost savings programme (known as "Accelerate!" and mainly focused on Healthcare and Lighting), should also help overall margins. Ambitious margin targets could be accompanied by a new share buyback or higher dividends. We re-iterate our Buy/RL recommendation and target price of EUR 28.

Currency outlook

The movements in emerging market currencies diverged last week. The Mexican peso, South African rand and Turkish lira remained under pressure, while the Brazilian real moved sideways (but showed intraday volatility). The recent run-up in US yields was again partly responsible for the pressure on emerging market currencies. Sentiment towards Brazil looks to be improving, mainly because of a vigilant and credible central bank and interventions in currency markets. The minutes from the latest policy committee meeting showed that the current pace of rate hikes will continue. If, in the current environment, domestic economic data come in better than expected and overall investor sentiment improves, the real should recover further. New Bank of India Governor Rajan impressed financial markets with his first statement, which resulted in a recovery of the rupee. The uncertainty surrounding Syria continues to haunt the lira.

The euro/dollar rate continues to track movements in the two-year yield spread between Germany and the US. The better-than-expected US data releases early in the week pushed US yields higher, resulting in support for the dollar versus the euro. On Thursday, Draghi's comments caused intraday volatility. While Draghi was initially able to talk down German yields (which pushed the euro/dollar lower), halfway through the press conference, the market changed its view. By the end of the conference, German yields were back at the same level as before the ECB's rate decision. The disap-

pointing employment report pushed US yields down, supporting emerging market currencies.

The Bank of England left its monetary policy unchanged, but UK economic data continue to surprise on the upside, resulting in an appreciation of the pound versus the euro and higher UK yields. Safe-haven currencies, the Swiss franc (CHF) and the Japanese yen (JPY) fell under pressure as uneasiness around Syria eased somewhat and economic data came in better than expected.

Currency forecasts

	Today	Q3 2013	Year-end 2013
EUR/USD	1.3155	1.25	1.20
GBP/USD	1.5615	1.49	1.45
USD/JPY	99.92	106	110

Source: ABN AMRO Group Economics

Asset allocation

The Global Investment Committee has maintained the current asset allocation: a strong overweight in equity (profiles 2 to 6), a neutral in property and commodity (profiles 2 to 6) and a strong underweight in bonds (profiles 1 to 5), while hedge fund allocations occur only in the 'defensive' profiles (overweight) and the more 'balanced' profiles (neutral). Cash is overweight in risk profiles 1 to 4 and underweight in profiles 5 and 6.

Next week's calendar

Important dates next week

		Date
GDP qoq	JP	9 Sept.
Fixed investments	CN	10 Sept.
Retail sales	CN	10 Sept.
Industrial production	CN	10 Sept.
NFIB small business optimism	US	10 Sept.
Industrial production	EC	12 Sept.
Initial jobless claims	US	12 Sept.
Industrial production	JP	13 Sept.
Retail sales	US	13 Sept.
Producer prices	US	13 Sept.
Un. Michigan consumer confidence	US	13 Sept.
Business inventories	US	13 Sept.
Unemployment	US	6 Sept

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