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Investment
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Almost last call

The increasing likelihood that the punch bowl is going to be taken away and the Fed will start scaling back its asset purchases in September is again making markets uneasy. US equities led the way down this week, while European equities held up relatively well. News that the eurozone is exiting its recession pushed up European bond yields.

Equities markets update

This week, most global equity indices initially returned to a growth path, but gave back profits towards the end of the week. This time, it was the US market that took the lead in bringing markets down. Disappointing results from Walmart and Cisco didn't help. But the main reason was better-than-expected employment data and rising consumer prices in the US, which fed fear that the Federal Reserve might start tapering its bond buying and that the scaling back of asset purchases might be more aggressive than earlier anticipated.

We believe that the Fed will most likely start its tapering process in September and that it will be at a relatively modest pace. More importantly, the Fed and other central banks have put a lot of emphasis on guiding the market in the right direction. We believe central bank communication has been and will continue to be clear and that it will calm market jitters about the gradual end of the very accommodative monetary policies of the past few years.

Good news from the eurozone

European markets held up relatively well last week. The region has started to recover from the underperformance that has been prevalent for more than a year. Regional indicators show that the Euro Stoxx 600 Index has gained an average of 3% (in EUR) over the past month, as compared to -2% for the S&P 500 Index. Anticipating a gradual improvement of the macro environment, earnings growth in Europe is set to continue, albeit at a moderate pace given continued headwinds from deleveraging and fiscal austerity.

European equities are attractively priced. The average 2014 price/earnings ratio is 10.8x compared with 12.7x for the US and 14.5x for Japan. Earnings-per-share growth is expected to be 12.9% in

Equity index performance in local currencies

	Value	One week (%)	Year-to-date (%)
MSCI ACWI	373.09	-1.0	9.8
S&P 500	1661.32	-2.1	16.5
EuroStoxx 50	2835.86	0.3	7.5
DAX	8376.29	0.2	9.7
Nikkei 225	13650.11	0.3	31.3
Hang Seng Index	22508.75	3.9	-0.7

Important rating changes

Company	From	To
Easy Jet	Sell	Hold
RyanAir Holdings	Sell	Hold
Vodafone	Hold	Buy
PepsiCo	Hold	Buy
General Electric	Hold	Buy

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	0.35	0.3	0.3
German Bunds 2-year	0.22	0.2	-0.02
Japan 2-year	0.11	0.1	0.1
US Treasuries 10-year	2.77	2.6	1.8
German Bunds 10-year	1.87	1.7	1.6
Japan 10-year	0.76	0.8	0.8

Spreads

Index	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	79.58	75.25	103.21
iTraxx Euro 5-year	98.82	95.65	146.02
JPM EMBI+	331.77	338.12	298.27

Performance data is as of 12:00 pm Friday, 16 August

Source: Bloomberg

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2013 and 10.5% in 2014, compared to 10.9% and 10.4% respectively for the US. As a result, even though risks in Europe are probably still higher than in other regions, the recovery potential is attractive.

Favourite stocks include German automaker Daimler; Dutch health care, lighting and consumer lifestyle leader Philips; and the French pharmaceutical developer and manufacturer Sanofi. A slightly more speculative recovery play is Bouygues, one of the largest engineering and construction firms in Europe.

Reporting calendar

Company	Date
Coca-Cola Amatil, Home Depot, BHP Billiton, Medtronic, Best Buy	20 August
IKB Bank, China Telecom, Lowe's Cos, HP, TKH, Vestas Wind, Heineken, Unit 4 Agresso, Heijmans	21 August
Ahold, BAM	22 August
Vopak	23 August

Bond markets update

Better-than-expected economic data from the US and the eurozone are confirming our view of recovering growth in these economies. Strong inflows into money market funds, however, indicate that investors are not yet willing to carry out "the big rotation," i.e. a large-scale shift from bonds to equities.

Demand for bonds from less creditworthy companies is accelerating, as investors deem the risk that a borrower defaults to be a safer bet than losses sparked by rising interest rates. ABN AMRO Private Banking bond research supports this trend. In our latest Fixed Income Digest, published August 14, 2013, we focus on bond issuer opportunities within corporates carrying the lower quality ratings of triple-B to single-B.

Stronger EMU GDP figures saw European government bond yields moving up this week. They could test higher levels if economic data continues to improve. German ten-year Bund futures did break the first support level of 140.56. This could signal, from a more technical perspective, a further weakness and a move to the next technical level at 140/139.90, which was tested in February and on 21 June 2013.

Eurozone out of recession does not trigger rate hikes

Markets may be concerned that even a whiff of good data will bring forward expectations of ECB rate hikes. We do not believe this view is justified by fundamentals. And, with an anaemic inflation outlook, there is no case for a rate hike. We continue to believe that if money market rates drift too far beyond what

were considered unwarranted levels at the time of the August ECB meeting, then the Council will threaten action on rates. Then, if words do not do the trick, they will deliver rate cuts.

Limited government bond new issuance in H2 2013

Market estimates of gross funding needs by eurozone governments indicate that Germany has completed 62% of its 2013 bond issuance requirement, France 70%, Italy 74%, Spain 77%, the Netherlands 81%, Belgium 77%, Austria 62% and Finland 57%. As a result, the European issuance calendar for the second half of 2013 is not crowded. This could result in low volatility for bond markets and a less aggressive increase in government bond yields.

Asset allocation

The Global Investment Committee at its meeting on 15 August made no change to the asset allocation. The committee reaffirmed its overall asset allocation, consisting of a strong overweight in equities, a strong underweight in bonds, neutral allocations to property and commodities and a hedge fund allocation only in the defensive (overweight) and the more balanced (neutral) profiles.

Currency outlook

Usually the ingredients for a strong dollar rally come into place when USD/JPY and USD/CHF stage a powerful move higher. The rise in USD/CHF and USD/JPY ran out of steam on 22 May and capped the general US dollar rally.

In addition, changing expectations regarding Fed actions also affected the fortunes of the US dollar. Initially the Fed was more hawkish than expected and this supported the greenback, but the subsequent campaign to pour cold water on expectations that tapering would be followed by early rate hikes pushed the dollar lower again.

USD/JPY may have seen its low last Friday, and the pair should see a strong rebound going forward. News that the Japanese government is weighing a corporate tax cut pushed the yen much lower this week. This signals that the authorities are not happy with the momentum in the economy, which could eventually open the door for additional monetary stimulus. The bounce higher in USD/JPY certainly helped the dollar across the board. Even a stronger-than-expected German ZEW economic sentiment indicator and eurozone economic data more generally, which resulted in higher yields in Germany, failed to hurt the US dollar versus the euro. This is another sign that the situation of the dollar is about to change for the better. We expect ongoing positive US economic data and a start of Fed tapering

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in September to be US-dollar positive. At the same time, efforts by ECB President Mario Draghi to tamp down rate expectations will weigh on the euro

Currency forecasts

	Today	Q3 2013	Year-end 2013
EUR/USD	1.3350	1.25	1.20
GBP/USD	1.5640	1.49	1.45
USD/JPY	97.28	106	110

Source: ABN AMRO Group Economics

Macro update: eurozone recession ends

Eurozone GDP expanded by 0.3% in Q2, which was slightly higher than the consensus forecast of 0.2%. The rise follows six quarters of contraction and marks the end of the recession in the eurozone. Looking at individual countries, Germany and France outperformed, but there was also good news from the peripheral countries, where the recession appears to be abating. There was a reduced pace of contraction in Spain, Italy and Greece, while Portugal even saw a sharp jump in output, although that appears to be largely statistical. The impact of reduced uncertainty, easier financial conditions and, in some countries, sharply improved competitiveness, appears to be making an impression.

Data from other core eurozone countries was mixed, with Belgium and Austria registering modest growth, while the Netherlands experienced another quarter of modest contraction.

Gradual recovery in the cards

We think that the eurozone is set for a gradual economic recovery, helped by a sharp slowing in the pace of austerity, an acceleration in global demand growth and a sustained easing of uncertainty and financial stress. However, a number of drags remain in place. Unemployment is likely to continue rising for some time, while fiscal consolidation, although easing, is still a negative. At the same time, bank deleveraging and, in some member states, housing market corrections, are ongoing. Overall, we expect a year average contraction of around 0.5% this year, before the economy expands by 1.3% in 2014.

The better economic data over the last few weeks will obviously be welcomed by the ECB, however it also faces a challenge to ensure that rising short-term interest rate expectations do not lead to an early, unwelcome tightening in financial conditions. As such we expect the central bank to continue its efforts to dampen market rate expectations with a further stepping up of its forward guidance

New publications

Fixed Income Digest: making every position count.

Bond markets, interest rates and words such as quantitative easing, tapering and dovish are increasingly seen in news stories. Even casual readers are also now acquainted with the heads of the Federal Reserve and European Central Bank, Ben Bernanke and Mario Draghi. It is easy to interpret the current focus on rates and central bank policies as worrisome for bond markets. Instead, we believe the current environment offers opportunities. Just like cash, bonds should continue to play a key role in investment portfolios and wealth preservation strategies.

GIC Update: asset allocation confirmed

The Global Investment Committee, at its meeting on 15 August, made no adjustments to the asset allocation.

Next week's calendar

Important dates next week

		Date
Existing home sales	US	21 Aug
PMI manufacturing	CN	22 Aug
PMI manufacturing & services	EU	22 Aug
Initial jobless claims	US	22 Aug
Markit flash PMI	US	22 Aug
FHFA house price index	US	22 Aug
Q2 GDP final estimate	DE	23 Aug
Consumer confidence	EU	23 Aug
New home sales	US	23 Aug

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