



global weekly

Investment
Communication
20 September 2013

The Fed's big surprise

Contrary to most expectations the Federal Reserve postponed the start of the tapering of its quantitative easing policy. Financial markets welcomed the Fed's dovish stance.

Macro update

The Federal Open Market Committee (FOMC) on Wednesday decided to continue its asset purchasing programme at USD 85 billion per month. Even though the FOMC admitted that the US economy continues to expand at a "moderate pace", it stated that it needs more evidence that progress is sustainable. Moreover, Fed chairman Ben Bernanke in his press conference sounded less sure that the Fed will start tapering its quantitative easing policy in the coming months, saying that there is "...no fixed calendar schedule." The central bank also lowered its economic forecasts. The midpoint GDP growth this year was revised from 2.5% in June to 2.2%, while GDP growth in 2014 was reduced to 3.0%, from 3.3%.

Financial markets widely perceived the FOMC decision as positive to the growth outlook. Equities rose to new highs and bonds, emerging-market and growth-sensitive currencies rallied, while the US dollar came under heavy pressure.

We view a delay of the Fed's tapering decision as positive for the economic outlook and growth assets, as it shows that the central bank is determined to support the recovery and to prevent a premature tightening in financial conditions. That said, we also think that an acceleration in growth in the remainder of the year will prompt the Fed to eventually act in December.

Bond markets update

After the FOMC decision, the elements of 'the great unwinding' – the unwinding of US quantitative easing, of China's leverage (which is likely to lead to a more fragile Chinese banking sector) and of emerging markets' domestic excess credit – are likely to remain in place until policy makers provide a credible response or a sustainable rebalancing is seen to be underway.

For fixed income investors this means that the normalisation process will be a multi-year process. Even if there is no reason to panic, investors need to know the risks. Corporate

Equity index performance in local currencies

	Value	One week (%)	Year-to-date (%)
MSCI ACWI	390.06	2.7	14.8
S&P 500	1722.34	2.3	20.8
EuroStoxx 50	2936.2	2.6	11.4
DAX	8694.18	2.4	14.2
Nikkei 225	14742.4	2.5	41.8
Hang Seng Index	23502.5	2.4	3.7

Important rating changes

Company	From	To
TNT Express	Buy	Hold
Teva Pharmaceuticals	RL	Buy
ANZ	Buy	RL
Santos	RL	Hold
Allergan	Buy	RL

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	0.33	-11.6	6.9
German Bunds 2-year	0.18	-4.3	14.1
Japan 2-year	0.10	-1.7	0.5
US Treasuries 10-year	2.74	-17.4	97.1
German Bunds 10-year	1.92	-8.5	34.1
Japan 10-year	0.70	-3.7	-10.5

Spreads

Index	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	70.15	-7.73	-28.41
iTraxx Euro 5-year	89.25	-8.17	-38.62
JPM EMBI+	313.97	-33.68	30.73

Performance data is as of 12:00 pm Friday, 20 September

Source: Bloomberg

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credits - either investment grade or non-investment grade – remain interesting, as the default risks remain low. Interest rate risk can only be managed by staying relatively neutral in duration, meaning a maturity of no more than five years. As we expect more volatility due to increased rate expectations, investors could use this as an opportunity to position for the long term or use the window to reduce their current exposure in anticipation of higher real yield levels. We keep our current year-end interest forecasts for 2013 and 2014 unchanged: German ten-year Bund 2% (2013) and 2.75% (2014), US ten-year Treasury 3% (2013) and 4% (2014).

Equity update

Equity markets across the world rallied this week. Following a cautious start, indices climbed further in the second part of the week after the Federal Reserve's surprise announcement not to start tapering yet. The Dow Jones and the S&P 500 Index both reached new all-time highs. Most major European indices fell short of their all-time highs, yet reached their highest level in years. Most major Asian indices also gained.

On the earnings front came good news from FedEx. The express company reported higher-than-expected profits due to cost cutting. FedEx customers have been shifting to cheaper - lower priority – services, forcing the company to adjust its business model. FedEx now relies more on third-party networks and uses cheaper transportation methods, such as ocean shipping. Dutch postal operator Post NL also surprised investors positively by raising its guidance for 2013, as the company will raise stamp prices in the Netherlands.

In the software sector, Oracle disappointed by providing a cautious guidance for its next fiscal quarter. The company cited sluggish IT spending as the main reason for the subdued business conditions, but we believe that larger software companies - including Oracle - also have problems competing with pure plays in cloud computing, such as Salesforce.com and Workday. A company more successful in adapting its traditional software model to the cloud is Adobe. The company's shares rose by almost 10% after the company reported earnings that showed that more than one million users are now subscribing to Adobe software via the web instead of having it installed on their PCs.

In Europe, the retailers H&M and Inditex issued upbeat statements about their current trading conditions. Both companies cited improving clothing sales in August. The current cooler weather across large parts of Europe should be beneficial for

retailers as well, as consumers will likely pull forward their purchases of winter clothing.

Stock to watch: Allergan

We have added Allergan (USD 88.90 - Buy/RL) to our Recommended List this week. Allergan makes several products that are in high demand in the cosmetics treatment area. Botox is the biggest product, representing 30% of total revenues. New therapeutic applications of Botox – such as migraine, incontinence, and epilepsy - are becoming increasingly relevant for earnings. The (misuse of) cosmetic Botox applications and on other Allergan products such as stomach bands led to much controversy lately, leading to negative publicity and a financial settlement for the company. Other growth drivers besides cosmetic products are a range of specialised treatments for eye care and cosmetic innovations like hair growth applications. Allergan has a very strong franchise and is one of the best-in-class regarding free-cash-flow generation. Its shares have been lagging the healthcare sector for a while, which we believe is unjustified.

Currency outlook

The financial markets were rocked by a very dovish Fed. Equities, bonds and currencies all welcomed the Fed's decision to postpone its tapering and rose, except for the US dollar. The dollar came under heavy pressure across the board. With the yield spread between Germany and the US widening, following the drop in US yields, the EUR/USD surged to above 1.35. On Thursday, however, the dollar strongly recovered against the Japanese yen. The rally in the EUR/USD continued, as the two-year spread between German Bund and US Treasury widened further.

With sentiment remaining positive the markets clearly see the Fed as supportive of growth and liquidity. But as soon as they take a step back and become concerned about the US economy, the current wave of risk seeking will come to a halt. Or, if US economic data start to surprise on the upside, the markets may become concerned that the Fed is behind the curve. All in all, enough uncertainty remains and this is likely to limit the initial risk-on sentiment experienced in currency markets following the Fed's big surprise. In the near term, the dollar will likely remain under pressure, as the Fed is perceived as being more dovish than the ECB. This reduces the likelihood that our year-end forecast of a EUR/USD of 1.20 will be reached. We nevertheless believe the recent rise to be merely a delay in an ongoing downward trend.

Clients are invited to contact their ABN AMRO Private Banking Advisor for publications mentioned in the Global Weekly. Core publications are also directly available on ABN AMRO's Research App for the iPad, which can be downloaded from Apple App stores.

GBP

For most of the week the EUR/GBP was stuck in a narrow 0.8360-0.8410 range. On the one hand, sentiment towards the UK further improved, while on the other hand the stronger-than-expected German ZEW survey supported the euro. A weak retail sales report pushed the EUR/GBP to above 0.8430. We nevertheless continue to believe in a modestly strong pound versus the euro, driven by an outperformance of the UK economy compared to the eurozone. We keep our forecast of a EUR/GBP at 0.84 at the end of September.

Currency forecasts

	Today	Q4 2013	Year-end 2014
EUR/USD	1.3553	1.20	1.10
GBP/USD	1.6074	1.45	1.38
USD/JPY	98.91	110	120

Source: ABN AMRO Group Economics

Asset allocation

There are no changes in the current asset allocation. The Global Investment Committee maintains 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.

New publications

Q4 Quarterly Outlook 2013 – Gaining traction

The global recovery is accelerating. Central banks are on track to return to more-normal monetary policies. The surrounding volatility is an opportunity to buy growth-oriented equities. In particular, ABN AMRO Private Banking recommends targeting small and mid-size companies in the United States and Europe.

Next week's calendar

Important dates next week

		Date
HSBC PMI manufacturing	CN	23 Sep
PMI manufacturing & services	EU	23 Sep
Markit Flash PMI	US	23 Sep
Ifo business climate	DE	24 Sep
FHFA house price index	US	24 Sep
Conf. Board consumer confidence	US	24 Sep
Durable goods orders	US	25 Sep
New homes sold	US	25 Sep
GDP qoq	US	26 Sep
CPI	JP	27 Sep
Economic sentiment monitor	EU	27 Sep
Consumer spending	US	27 Sep
Uni of Michigan consumer confidence	US	27 Sep

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