



global weekly

Investment
Communication
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Message received (finally)

Bernanke's dovish tone and the market's apparent acceptance that after the quantitative easing programmes are unwound it will take a long time before rates will be raised, led to an improvement in financial market sentiment.

"No preset course"

Federal Reserve Chief Ben Bernanke struck a dovish tone during his testimony before the US Congress this week, emphasising that unemployment, underemployment and low inflation are all hurdles to the US economic recovery. Bernanke also stressed that the Fed's tapering of its asset purchasing depends on economic and financial developments and are "by no means on a preset course."

It was the latest example of the Fed calibrating its communications. And, finally, the market seems to have gotten the message, which even Bernanke admitted. There is growing acceptance that a reduction in the Fed's quantitative easing programmes will not lead to imminent rate hikes. And, indeed, unlike after previous communications, markets were relatively calm after the Fed chief's testimony.

Bond market update

Fixed income conditions are becoming calmer. Not only because market liquidity has reduced significantly with the summer holiday in the northern hemisphere, but also because the US Federal Reserve's tapering has been discounted. Policymakers are capping yields via soothing zero-interest-rates-forever type comments, as evidenced by UK and EMU policymaker forward guidance and the Fed chief's dovish comments this week.

It is possible that the next big theme to play out in bond markets is not US tapering, but the materialisation of downside growth risks. The IMF and Standard & Poor's both have recently downgraded global growth. And over the past 12 months, the real cost of capital, based on ten-year Treasury yields, has increased by 100 basis points. Fear of downside risks to the economic recovery could move bond investors from a bearish to a more neutral or even bullish positioning, accompanied by active buying along the yield curve.

Equity index performance in local currencies

	Value	One week (%)	Year-to-date(%)
MSCI ACWI	373.62	0.9	10.0
S&P 500	1689.37	0.9	18.5
EuroStoxx 50	2717.99	1.0	2.5
DAX	8337.09	1.1	9.0
Nikkei 225	14589.91	0.8	40.4
Hang Seng Index	21362.42	0.4	-5.7

Important rating changes

Company	From	To
Intel	Buy	Hold
Citigroup	Hold	RL *
Goldman Sachs	Hold	RL *
eBay	Hold	Buy

* recommended list

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	0.305	-1.0	8.10
German Bunds 2-year	0.074	-2.6	13.50
Japan 2-year	0.132	1.0	3.20
US Treasuries 10-year	2.529	0.0	103.40
German Bunds 10-year	1.519	-5.2	32.00
Japan 10-year	0.809	-0.3	5.00

Spreads

Index	Spread (bp)	One week (bp)	One year
CDX NA IG	74.02	-4.25	-34.23
iTraxx Euro 5-year	102.25	-3.50	-61.29
JPM EMBI+	305.82	-43.50	-31.75

Performance data is as of 12:00 pm Friday, 19 July

Source: Bloomberg

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Shift in focus in Q2

We have seen a big change of focus in bond markets between Q1 and Q2. Over the past three months, attention moved away from Europe to increased expectation of the tapering of the quantitative easing in the US and to concern about sufficient available liquidity in China's financial system. The change in focus towards a more macroeconomic perspective ultimately created a very different yield environment in Q2 compared to Q1 and the whole 2012.

With US tapering now discounted, European challenges are again attracting attention. The Troika (ECB, IMF and the EU) has warned of increasing uncertainty on Greek debt servicing. In addition, the credit-rating agencies are also taking action in recognition of certain risks within Europe (see below). As these forces play out and the groundwork becomes laid for gradual normalisation, we expect interest rates to move sideways over the next three months, which will support corporate credits and new bond issuance performance.

European banks downgraded after sovereigns

Fitch has downgraded the long-term ratings of most French banks (SocGen, BPCE, and Dexia) by one notch to single A, except for BNP which remains A+. The rating action was driven by the downgrade of the French sovereign rating (from AAA to AA+). After the downgrade of the Italian sovereign (rating BBB) on 9 July, S&P downgraded Unicredit and Intesa to BBB with a negative outlook for both. Generali was downgraded to A- from A. The rating agency commented that it continues to rate Generali two notches above sovereign Italy, as its operations span the eurozone, with leading market share in Austria, Germany and France. Italian second-tier banks were placed on negative credit watch. Moody's downgraded UniCredito's credit to Baa3, which prompted the downgrade of subordinated debt to Ba1 (non-investment grade).

Moody's said sovereign ratings in the Asia Pacific region will remain largely stable, despite China's slowdown, continuing global headwinds and volatility in global capital markets. It added that major support for Asia-Pacific's growth outlook is coming from the moderate pace of recovery in the US and the sturdy economic and fiscal fundamentals of most countries in the region.

Equities update

It has been solid week for equity investors. While the week started poorly, there was a nice recovery later on. This was partly due to the comforting words from Bernanke about the pace of the Fed's exit policy and partly due to relatively strong second-

quarter results from, among others, some major US banks.

Overall, and even though it is still the start of the results season, earnings surprises generally seem to be on the upside rather than the downside. Although this is admittedly partly due to reduced expectations. We expect the profit trend to remain mixed for the next one or two quarters. But, later this year or early next year, a recovery is expected. Accelerating top-line growth in combination with strong margins, due to lower input costs, should bode well for earnings in the medium to longer term.

Health care allocation reduced

Given the strong outperformance of the health care sector since inception of our active bet, we have locked in some profits in our sector positioning and downgraded the health care sector from overweight to neutral.

We still strongly believe in some of the positive trends in the health care sector, including biotech products coming to market, demand from emerging markets and mergers & acquisitions, but think that due to the recent outperformance, this is already priced-in for some segments. We continue to like certain pockets within the industry, especially the more innovative research and biotech leaders, such as Gilead Sciences (Buy/RL), Sanofi Aventis (Buy/RL), Amgen (Buy/RL) and Novartis (Buy/RL)

As we are expecting a cyclical recovery, which will induce gradual tapering, we would expect relatively expensive yield-oriented stocks to lag at a certain stage. In such a scenario, we would expect cyclical stocks to outperform. Therefore we propose to add weight to existing overweight positions in the industrials and IT sectors. Here, we like names such as FedEx (Buy), Schneider (Buy), CSX (Buy/RL) within industrials; and eBay (Hold) and Samsung Electronics (Buy) within IT. These favourites also fit with our most recent thematic equity research focused on increasing productivity and new retailers.

Currency outlook

Last week, the EUR/USD moved sideways. The market was positioned for a dovish Bernanke and as a result his reassuring comments failed to hurt the US dollar versus the euro.

A united BoE prefers forward guidance to steer policy

According to July's meeting minutes, Bank of England's Monetary Policy Committee (MPC) was united in its decision to keep monetary policy unchanged at the first meeting chaired by new Governor Mark Carney. It was the first time

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since October that no MPC member voted in favour of more asset purchases. Overall, the minutes seem to suggest that more asset purchases are off the table, and that the MPC will start implementing, similar to other major central banks, more detailed forward guidance as a policy tool. The British pound recovered after the release of the minutes.

Emerging markets FX recovery

Bernanke's dovish tone and the market's apparent acceptance led to an improvement in financial market sentiment, pushed US yields lower and supported emerging markets currencies. The largest recoveries were seen in our top picks, the Polish zloty and the Mexican peso. In general, Asian currencies have underperformed other emerging markets currencies.

Currency forecasts

	Today	Q2 2013	Year-end 2013
EUR/USD	1.3081	1.25	1.20
GBP/USD	1.5197	1.49	1.45
USD/JPY	100.26	106	110

Source: ABN AMRO Group Economics

Asset allocation

This week, the Global Investment Committee reduced the allocation to the health care sector to neutral, adding the proceeds to the already overweight allocations in the industrials and information technology (IT) sectors. The overall equity position remains unchanged.

The committee also reaffirmed its current asset allocation, consisting of an overweight in equities, an 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. For more information, read the 18 July 2013 issue of the GIC Update.

New publications

Singapore Country Note: reality check

Singapore (neutral) is better positioned than other emerging markets to withstand current capital outflows. Nonetheless, a steepening yield curve, a stronger US dollar and a slowdown in China are expected to hurt the earnings growth of Singapore stocks.

- ▶ Real estate and real estate investment trusts are negatively affected by a steepening yield curve.
- ▶ A strong US dollar hurts commodity prices, leading to a negative outlook for plantation and commodity supply-chain stocks.

- ▶ As Singapore's second largest export market, a slowdown in China will affect growth and companies with a large exposure to China.

Equity Thematic Update: the new retailer

After more than ten years, the internet has revolutionised how consumers shop. Coupled with the popularity of smart-phones and tablets, global shopping habits have undergone a fundamental change. The investment opportunities arising from this shopping revolution is the basis for our latest equity theme: the new retailer.

- ▶ China is expected to be the largest online retail market in 2013.
- ▶ Traditional retailers need to invest in a multi-channel strategy to compete.
- ▶ Large online retailers and platforms, logistics firms and malls capable of offering a 'shopping experience' will benefit from new retailing trends.

GIC Update: health care allocation reduced to neutral

For information, see Asset allocation on this page.

Next week's calendar

Important dates next week

		Date
Existing home sales	US	22/July
Consumer confidence	EC	22/July
PMI manufacturing	CN	23/July
PMI manufacturing	EC	24/July
PMI services	EC	24/July
New homes sold	US	24/July
Ifo business climate	DE	25/July
Durable goods orders	US	25/July
CPI	JP	26/July

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