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Investment
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Revolution at the Bank of Japan

It was an eventful week. The Bank of Japan surprised markets with an exceptional monetary easing programme, which may bolster global growth. The eurozone appears to be finding it harder to make the recovery catch, and the chance of a rate cut by the ECB appears to have increased. In the US, momentum appears to be slowing, although compared with the eurozone, it does not look so bad.

The new management at the Bank of Japan, described as Prime Minister Shinzo Abe's dream team, surprised markets by announcing more monetary easing than expected. The central bank plans to roughly double the amount of money in circulation within two years, by scaling up its monthly purchases of Japanese government bonds from JPY 4 trillion to JPY 7 trillion.

JPY 7 trillion amounts to roughly USD 74 billion, which is almost equal to the US Federal Reserve's USD 85 billion monthly longer-term asset purchases. But the economy of the US is roughly four-times larger than Japan's. This suggests that the Bank of Japan's programme is far more aggressive than the Fed's.

It smacks of revolution. It is likely that the Japanese central bank will continue this scale of asset purchasing as long as its 2% inflation goal is unmet. A further stepping up of monetary stimulus could follow later in the year, if there are insufficient signs that price dynamics are changing.

And it's not just the central bank acting to spur growth in Japan. Government measures, such as lower corporate tax rates and tax breaks for capital expenditures are also being introduced to improve industrial competitiveness. Japan has also entered into free-trade negotiations with the US and ten other Pacific countries as part of the Trans-Pacific Partnership (TPP). Japanese equities are expected to get a boost from all this stimulus. For more information, read our latest Japan Country Note.

Eurozone weakness continues

At the ECB, which met on Thursday, benchmark rates were

Equity index performance in EUR

| | Value | P/E 2013 | Year-to-date |
|------------|---------|----------|--------------|
| S&P 500 | 1560 | 12.6 | 9.4% |
| Euro Stoxx | 2625 | 9.8 | -0.4% |
| FTSE100 | 6335.8 | 10.6 | 7.4% |
| AEX | 346.1 | 10.3 | 1.0% |
| Nikkei 225 | 12833.6 | 15.4 | 23.5% |

Important rating changes

| Company | From | To |
|-------------------|--------|-----------|
| Oracle | Hold | Buy |
| Boskalis | Buy | Hold |
| Royal Dutch Shell | Buy/RL | Buy |
| Dow Chemical | Hold | Buy/RL |
| L'Oreal | Hold | Not rated |
| Ebay | Hold | Buy |

Government bond yields

| | Yield (%) | One week change (bp) | One year change (bp) |
|-----------------------|-----------|----------------------|----------------------|
| US Treasuries 2-year | 0.22 | -2 | -11 |
| German Bunds 2-year | 0.01 | -1 | -13 |
| Japan 2-year | 0.07 | +3 | -3 |
| US Treasuries 10-year | 1.78 | -7 | -47 |
| German Bunds 10-year | 1.25 | -3 | -52 |
| Japan 10-year | 0.44 | -7 | -47 |

Bond index yields

| Index | Yield (%) | One week change (bp) | One year change (bp) |
|--------------------|-----------|----------------------|----------------------|
| CDX NA IG | 88.25 | -24 | -17.5 |
| iTraxx Euro 5-year | 120 | -7 | -5 |
| JPM EMBI+ | 293 | -4 | -26 |

Performance data as of 16:00 PM Thursday, 4 April

Source: Bloomberg

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left unchanged at the record low of 0.75%. ECB President Mario Draghi also left the door open for a cut in the refinancing rate. He emphasised downside risks to the economy, noting that weakness had spread to the core of the bloc and that inflation would be on the low side of 2% this year.

The chances of a rate cut appear to have increased, as Draghi says the central bank is monitoring information very closely and stood ready to act. It will depend on the data coming in over the next weeks.

European financial sector: whistling in the dark

The events in Cyprus continued to have repercussions this week, not the least of which is reminding everyone that the eurozone's essential problems are far from resolved and political risks remain attached to the region's recovery.

Cyprus might have been dealt with differently if the banking union for Europe, agreed last year, had been in place. The ECB is worried that funding for banks facing a flight of deposits could increase substantially. It is possible that the bail-in of bank creditors (senior and subordinated) could become the new norm. For more information, read Research & Strategy's European Banking Sector Bond Report. Risks are rising, with credit spreads on European senior bank debt increasing since the beginning of the year.

Over the week, government bond yields sank to the lowest levels in two months, with Japanese bonds falling to a record low, after the central bank announced its gigantic asset purchases.

US momentum sputters

In the US, politicians remain inactive or vague regarding fiscal solutions, while a new sequester deadline looms in April. After a strong first quarter, this week's data suggests that the US economy is starting to lose momentum. The peak in inventories is in the rearview mirror, and households will need to adjust spending as taxes are raised and spending cuts begin to bite.

The long rally in US stocks was interrupted this week, with the S&P 500 seeing its largest decline in a month. Equity markets had been due for a correction, or, at least, a consolidation. There are worries enough, especially with weaker-than-expected growth in the US and disappointing March employment data released on Friday. The uncertain situation in North Korea is also not a help. Japan's new giant stimulus programme, however, could lift global growth. And, indeed, US and Japanese stocks rallied after the Bank of Japan's announcement.

Sentiment for equities remains positive overall, especially for the US and Japan. It's an attractive asset class, as an alternative to low-yielding fixed-income investments and a proxy for the global economic recovery.

Asset allocation

US and Japanese equities increased

The Global Investment Committee, at its meeting on 4 April 2013, adjusted the regional equity allocation by increasing the weights in Japan and the US to neutral and decreasing the allocation to Europe underweight. The overall tactical asset allocation remained unchanged.

The GIC recommends an overweight in equity and property, an underweight in bonds, a neutral position in commodities and a hedge fund allocation that varies relative to the risk profile of the portfolio. For more information, see the Global Investment Committee Update.

Stocks to watch: JP Morgan and ABB

The Q1 earnings season is starting, with US aluminum producer Alcoa, the first to announce, as usual, followed by JP Morgan on Friday. While overall results may not be too impressive, they are likely to be in line with expectations.

ABB to see new orders from the US and China

US and Chinese corporate investments are rising. Partly due to the business cycle, as both economies pick up steam, and also stemming from China ramping up productivity to international levels. Capital goods in general and suppliers and users of robots, IT software & services and electrical systems, in particular, are set to benefit.

ABB, the Swiss multinational formed by the merger of Swedish Asea and Swiss Brown Boveri is a stock to watch. It is active in both robotics and in electricity systems and will be a main recipient of new orders from the primary growth areas of the US and China.

Currency outlook

For most of last week, weaker US data barely hurt the US dollar. The main reason is that it is even worse elsewhere, such as in the eurozone. But the much weaker-than-expected US employment data on Friday pushed the US dollar lower versus the euro and the EUR/USD is back at 1.30. The prospect of more monetary easing in Japan has made the US dollar more attractive, and it is again strengthening against the yen.

The weaker data in the eurozone continued to weigh on the single-market currency. We expect this will continue. Our

year-end target for EUR/USD is 1.20. The uncertainty in the Korean peninsula resulted in weakness for the Korean won.

Currency forecasts

| | Today | Q2 2013 | Year-end 2013 |
|---------|-------|---------|---------------|
| EUR/USD | 1.30 | 1.30 | 1.20 |
| GBP/USD | 1.53 | 1.49 | 1.41 |
| USD/JPY | 96.7 | 90.0 | 95.0 |

Source: ABN AMRO Group Economics

New publications from Research & Strategy

Japan Country Note

The Japanese government's focus on economic growth and the accommodative stance of the new BoJ leadership, together with Japan entering free-trade negotiations may boost the Japanese economy and subsequently Japanese equities.

Exporters of automobiles, auto components, consumer electronics and machinery may benefit the most if Japan joins the TPP, owing to a reduction of foreign import tariffs. And the financials sector stands to profit both from an increase in long-term economic growth and further monetary easing. For more information, see our Japan Country Note.

What's coming

| | | Date |
|-------------------------|----|----------|
| Industrial Production | DE | 08 April |
| CPI | CH | 09 April |
| Trade balance | CH | 10 April |
| M2 money growth | CN | 10 April |
| US Fed Minutes (March) | US | 10 April |
| Machinery orders | JP | 11 April |
| Initial jobless claims | US | 11 April |
| Industrial Production | EC | 12 April |
| Retail sales | US | 12 April |
| UMI consumer confidence | US | 12 April |

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