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Exit blues and market jitters

Federal Reserve Chairman Bernanke's dovish tone regarding continued monetary easing was disturbed this week, when he also referred to stepping down the pace of the Fed's easing programme. As a result, markets were rattled by the 'exit blues.' An improving global economy and low inflation, however, should ease the move toward the exit.

Dovish tone, but...

On Wednesday, Federal Reserve Chairman Ben Bernanke struck a dovish tone during his testimony before Congress, saying that in the current economic environment, meeting the Fed's objectives required a highly accommodative monetary policy.

In the Q&A session after the testimony, Bernanke continued to tilt to the dovish side. But he also said that if FOMC members continued to see improvement in the labour market and had the confidence this would be sustained, the pace of purchases could be taken a step down "in the next few meetings."

We think that the FOMC will not have clear evidence that the labour market has well and truly taken off until later in the year. As such, we believe that the Fed will announce a tapering-off of its QE programmes at its December meeting. The balance of risks, however, is skewed towards an earlier date, with September being the leading candidate.

Although financial markets were hit by the exit blues, an easing in the pace of Fed purchases would be accompanied by stronger economic prospects, and low inflation means that the central bank can exit gradually.

Negative momentum is fading

There was evidence this week that the negative momentum in the world economy is starting to fade. Although the drop in China's manufacturing grabbed headlines, eurozone manufacturing actually rose in May. And, in the US, there was an increase in a more forward-looking new orders indicator in manufacturing data. Germany's Ifo business climate index also rose by more than expected in May. Other positive signs

Equity index performance in local currencies

	Value	One week	Year-to-date
MSCI ACWI	372.66	-1.4%	9.7%
S&P 500	1,650.51	0.2%	15.7%
EuroStoxx 50	2,776.78	-1.1%	5.8%
DAX	8,351.98	-0.5%	9.8%
Nikkei 225	14,612.45	-3.5%	40.6%
Hang Seng Index	22,643.19	-1.9%	-0.1%

Important rating changes

Company	From	To
Pepsico	Hold	Buy
BSkyB	Hold	Buy
Schlumberger	Hold	Buy
Coca-Cola	Hold	Buy
Exelon	Buy/RL	Buy

Government bond yields

	Yield	One week	One year
US Treasuries 2-year	0.24%	1.3 bp	-4.6 bp
German Bunds 2-year	0.02%	3.0 bp	-3.4 bp
Japan 2-year	0.12%	-0.5 bp	2.5 bp
US Treasuries 10-year	2.02%	15.2 bp	28.8 bp
German Bunds 10-year	1.45%	12.9 bp	6.8 bp
Japan 10-year	0.82%	4.5 bp	-3.8 bp

Spreads

Index	Spread	One week	One year
CDX NA IG	73.32	1.7 bp	-45.7 bp
iTraxx Euro 5-year	92.50	-2.5 bp	-87.7 bp
JPM EMBI+	276.39	2.9 bp	-111.2 bp

Performance data is as of 12:00 pm Friday, 24 May

Source: Bloomberg

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included US initial jobless claims continuing to trend downward, in line with a gradual strengthening of a recovery in the labour market.

Equity markets rattled

Talk about the end of the Federal Reserve's easing programme, the disappointing news from China and a selloff of Japanese equities, as interest rates rose and the yen strengthened, were a toxic combination for equity markets this week. After a good start, markets got the jitters with indices correcting sharply on Thursday, as investors took profits.

We believe the end to very low interest rates should not deter investing in equities. Some inflation, coupled with higher economic activity, is a good scenario for corporate profits. And any fears of galloping inflation rates eroding future earnings are overdone.

Earnings numbers are scarce now that the first-quarter earnings season is over, but indications of good revenue developments in April and May should again encourage buying.

Pharma companies rallied

Pharmaceutical companies benefited from this week's risk-off attitude. Industry heavyweights, such as Bristol Myers Squibb and Merck, rallied strongly on plans to return cash to shareholders. Other pharma and biotech companies are also in the comfortable situation of buying back shares and remain an attractive proposition for shareholders.

As investors shed risk, the main losers were highly interest-rate sensitive sectors, such as European financials, where both banks and insurance companies suffered.

The market's reaction to somewhat more definite plans to end the Fed's quantitative easing programme should not be a surprise. It had to happen at some point. It is important to look beyond this event and to see that future global growth continues to be promising, with little inflationary pressures in sight (and they are not expected to appear very soon.)

Stock of the week: SBM Offshore

One of the few gainers this week was the Dutch oil services company SBM Offshore. It performed well, as its trading update was received positively, new orders are coming through and its outlook for 2013 was reaffirmed.

As exploration and production of oil and gas is ramped up, the company's floating platforms and storage facilities are again in high demand. Visibility can be difficult, however, due to very long project lead times. On the back of this, margins can also come under pressure from time to time.

SBM is now recovering well from a recent setback and a rights issue has been successfully put through to help repair the balance sheet. We rate the company a Buy.

Bond market update

Recent macroeconomic data is feeding the markets mixed signals about the global economic recovery. This kept bond markets within their medium-term trading range last week. Government bond yields initially crept up a bit early in the week, but lost ground after the weaker-than-expected Chinese manufacturing data was released before European markets opened on Thursday.

Next to macro data, markets were mainly focused on central bank communications, and, in particular, Bernanke's testimony. As the unprecedented global monetary stimulus programmes are at the heart of the rally in financial markets over the past few years, investors are keen on any signals pointing to a slowing pace of asset purchases.

Unsurprisingly, financial markets initially reacted positively to Bernanke's statement that "Monetary policy is providing significant benefits," and that "A premature tightening [...] would also carry a substantial risk of slowing or ending the economic recovery."

Markets retreated, however, in reaction to both Bernanke's comments during the Q&A and to the minutes of the latest FOMC meeting, which showed that members disagree on the timing of when to slow down the asset purchasing programme, that is currently adding USD 85 bln worth of bonds to the Fed's balance sheet every month.

While we expect the US to regain economic momentum in the second half of this year, the eurozone is still struggling. It faces contraction, high unemployment, risk of deflation and, in a number of member countries, elevated debt-to-GDP ratios.

Against this bleak backdrop, European leaders also still have to agree on a common solution in order to start shoring up the overleveraged European banking system. The enormous challenges that the badly needed banking reform will bring, both on the economic and political side, seem to be keeping European bond yields anchored for the foreseeable future. As a result, further decoupling of German Bunds and US Treasuries seems likely.

Currency outlook

Statements from the Federal Reserve affected currency markets this week. Markets were positioned for a dovish Bernanke, after comments by New York Fed President William

Dudley on Tuesday. As a result, the US dollar was clearly on the defensive. The EUR/USD rallied to 1.30 and gold prices broke above USD 1,410 per ounce.

But markets staged a dramatic U-turn on Bernanke's statement about stepping down asset purchases. As a result, the US dollar rallied across the board. The EUR/USD dropped below 1.2850 and gold prices fell to below USD 1,360 per ounce.

The reaction clearly shows that markets are sensitive to a slowing of stimulus, but when the exit comes, a stronger economy will be a silver lining for growth assets, though Treasuries and gold will experience a double whammy. For the dollar, it will represent a double boost.

After expectations regarding the Federal Reserve affected the EUR/USD, it recovered on Thursday, on the better-than-expected eurozone PMI data.

The Bank of Japan left monetary policy unchanged as expected, at its meeting this week. Worries regarding the global economy resulted in profit-taking on the Japanese yen.

Currency forecasts

	Today	Q2 2013	Year-end 2013
EUR/USD	1.2899	1.30	1.20
GBP/USD	1.5071	1.49	1.41
USD/JPY	101.61	104	110

Source: ABN AMRO Group Economics

Asset allocation

The asset allocation recommended by the Global Investment Committee continues to call for an overweight in equity and property, an underweight in bonds and a neutral position in commodities. An allocation to hedge funds is found only in defensive profiles, where an overweight position is recommended as an alternative to bonds. A neutral hedge fund position is recommended in the more balanced profiles. For more information, read the latest GIC Update, published 17 May 2013.

Next week's calendar

Important dates next week

		Date
Case Shiller house prices	US	28 May
Consumer confidence	US	28 May
Consumer confidence	EU	30 May
Economic Sentiment Monitor	EU	30 May
GDP qoq	US	30 May
CPI	JP	31 May
CPI & core inflation	EU	31 May
Unemployment	EU	31 May
Consumer spending	US	31 May
Business & consumer confidence	US	31 May

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