



# global weekly

Investment  
Communication

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## Transition time

The potential reversal of the Federal Reserve's monetary easing is rattling markets. This is despite our view that rising rates are not necessarily negative for stocks. And, similarly, the recent market wobble is not signaling an end of the equity bull market. Instead, during times of transition, wobbling is to be expected.

## Market wobbles

High volatility with a negative bias dominated equity markets last week. Uncertainty about the impact of the end of quantitative easing in the US as well as renewed worries about high government debt levels in Europe and Japan were the main reasons for the market's uncertainty.

Positive news, which should be underpinning the stock markets, was perceived as negative. And, again, the driver was fear of higher interest rates.

During transition periods, capital markets start to wobble. This is true whether the transition is owing to economic or social circumstances (for example, the evolution of China from an export- to a domestic demand-driven economy) or resulting from political or economic policy changes, as is the case now, with the end of aggressive monetary stimulus. In our opinion, the market wobble is not an indication that the end of the bull run for equities is upon us.

Here's why. Corporate earnings, especially in the US, have again reached record levels, although growth is only starting to move back to average levels. In fact, many drivers of growth are only now starting to gear up. This includes retail spending, vacations & travel, (financial) services etc. While European economies are mostly still in recession, the positive impact of the global trends now developing in the US will benefit corporate earnings.

## Focus on US mid-caps

The most dynamic growth drivers since the credit crisis erupted in 2008 have been exports and overseas demand, both for US firms and for large European multinationals. The rapid expansion of emerging markets was a large contributor to this demand.

## Equity index performance in local currencies

	Value	One week	Year-to-date
MSCI ACWI	362.43	-1.4%	6.7%
S&P 500	1,622.56	-1.9%	13.8%
EuroStoxx 50	2,676.21	-3.3%	1.7%
DAX	8,098.81	-3.0%	6.4%
Nikkei 225	12,877.53	-6.5%	23.9%
Hang Seng Index	21,569.31	-3.7%	-4.8%

## Important rating changes

Company	From	To
China Mobile	Hold	Buy
Estee Lauder	Sell	Hold
McDonald's	Hold	Buy
Novartis	Hold	Buy
Baker Hughes	Hold	Buy

## Government bond yields

	Yield	One week	One year
US Treasuries 2-year	0.29%	-29.04 bp	-25.90 bp
German Bunds 2-year	0.13%	-6.31 bp	-6.11 bp
Japan 2-year	0.12%	-13.48 bp	-9.08 bp
US Treasuries 10-year	2.05%	-210.77 bp	-163.87 bp
German Bunds 10-year	1.49%	-148.89 bp	-131.79 bp
Japan 10-year	0.84%	-83.86 bp	-82.96 bp

## Spreads

Index	Spread	One week	One year
CDX NA IG	83.92 bp	4.41 bp	-38.00 bp
iTraxx Euro 5-year	112.82 bp	12.64 bp	-63.40 bp
JPM EMBI+	321.80 bp	27.30 bp	-68.36 bp

Performance data is as of 12:00 pm Friday, 7 June

Source: Bloomberg

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The focus has shifted, however, and become more inward looking. The US is restoring its domestic manufacturing base and benefiting from the revival of the oil & gas industry. A high level of innovation, both technological and scientific, is speeding up the productivity and success of US businesses, with positive effects on global industries. Automation and robotics, software to manage business operations, very intensive use of the internet (including online retailing) and the new trend in 3-D printing as well as new discoveries in bio and nanotechnologies are reinvigorating the corporate landscape.

For investors, it can pay off to increase exposure to the often not-so-giant companies that are now benefiting from these trends. A well diversified investment in US mid-caps is possible through a low-cost exchange-traded fund (ETF). We prefer the SPDR S&P 400 US Mid Cap ETF.

### **Bond market update**

Bond markets stabilised this week, after taking a large hit in May when market participants positioned for higher bond yields. The prospect of an earlier than expected reduction of monetary stimulus by the Fed and confusing statements by the Bank of Japan about its commitment to quantitative easing have caused a broad repricing in financial markets, predominantly affecting the assets that have most been reflationed by cheap central bank liquidity.

Risk sentiment has since deteriorated across all asset classes, including the riskier segments of the bond markets, resulting in spread widening and higher volatility. At the same time, markets have started discounting higher bond yields. Along with the change in sentiment, we expect market volatility to remain at more elevated levels during the next few months, at least until markets get more clarity on the expected time schedule for the eventual scaling back of monetary stimulus measures. Meanwhile, markets will keep a close eye on key economic data and central bank communications.

Despite the recent correction, we expect yields to rise only gradually, as the Fed will probably wait for more improvement in the US labour market and inflation data, before they actually start tapering. We expect the tapering process to be long and prudent, as the Fed will want to prevent adverse shocks, both in financial markets and the economy. The last thing it wants is to kill the economic recovery in a premature stage. So far macroeconomic fundamentals are still not very supportive of an early scaling back. In addition, higher US rates will not only affect the US economy, but will also have a large impact on other economies. Especially commodity-related economies will be hurt by higher rates, after having been able to flourish on low global interest rates.

### **ECB update**

At its meeting on 6 June, the ECB left its policy rates on hold, as expected. This reflected that the institution's base scenario for the economy was broadly unchanged. It continued to expect the economy to stabilise and slowly recover during the course of this year. Indeed, its growth forecasts were broadly unchanged. This was supported by recent survey data that had shown some improvement.

Despite the ECB sticking to its base scenario for the economy, Mario Draghi certainly did not close the door to rate cuts, but suggested that economic data would need to suffer a relapse over the next few months to trigger fresh action. Financial markets interpreted these remarks as relatively hawkish, with short rate expectations, bond yields and the euro all rising. This, however, may be more reflective of positioning before the meeting, with some commentators expecting significant downward revisions to the ECB's economic outlook.

Nevertheless, the ECB clearly has an easing bias in place, and emphasised that its monetary stance will remain 'accommodative for as long as necessary'. Our central view is that the economy will slowly improve going forward, which should keep the ECB on the sidelines through this year and next.

### **Asset allocation**

The Global Investment Committee, at its meeting on 6 June, implemented several adjustments to the investment policy. The intention was to (i) further reduce sensitivity to interest rate risk (by lowering both the fixed income and the property allocations) and (ii) to anticipate a potential further rise in equity market volatility during the summer by tempering the strong overweight in equities.

The underweight fixed income allocation was further increased; property was decreased from overweight to neutral; and the strong overweight in equities was trimmed. As a result of the reductions to equity, bonds and property, the tactical cash allocation has returned to overweight in all risk profiles.

The investment policy continues to be positioned to benefit from a cyclical recovery that is expected to unfold during the second half of 2013 and in 2014. The committee advocates an overweight allocation in equities, neutral allocations to property and commodities and a strong underweight in bonds. An allocation to hedge funds is found only in defensive profiles (overweight) and more balanced profiles (neutral). For more information, read the Global Investment Committee Update, published today.

## Currency outlook

For most of the week, the US dollar has been on the defensive across the board, as US data disappointed. This lowered expectations for tapering by the Federal Reserve. The US employment report came in as expected. The Fed's tapering off is on every one's mind and it will continue to drive currency markets. We expect US data to improve in the second half of this year, which will only increase the nervousness regarding the Fed's monetary policy. We remain bullish on the US dollar.

The reduction of the ECB balance sheet is tightening the conditions in the eurozone. This and the pricing out of ECB rate cuts has supported the euro. As a result EUR/USD and the two-year yield spread Germany/US have moved in tandem higher. At its meeting this week, the ECB sounded neutral, but the market perceived it as not dovish and this also supported the euro.

The Japanese yen and the Swiss franc continued to find support, as the market is nervous about the impact of lower monetary stimulus by the Fed. This nervousness has resulted in lower risk appetite. Lower risk appetite is generally positive for the Japanese yen and the Swiss franc, as they are the ultimate safe-haven currencies. We believe this nervousness will fade as soon as US economic data improves.

### Currency forecasts

	Today	Q2 2013	Year-end 2013
EUR/USD	1.3141	1.30	1.20
GBP/USD	1.5455	1.53	1.41
USD/JPY	99.01	104	110

Source: ABN AMRO Group Economics

## US Payroll update

US nonfarm payrolls rose by 175,000 in May. The outcome was slightly stronger than the consensus forecast of 163,000, although April's figures were revised downward by 16,000 to 149,000. Still, the report eased some concern that the labour market recovery had lost momentum following the weak ADP report earlier in the week. Looking at the Household survey, the unemployment rate edged up a tenth to 7.6%, although this reflected a sharp inflow into the labour force, and hence should not be seen as labour market weakness. In terms of when the Fed will start to reduce its asset purchase programmes, we judge this report to be neutral. FOMC officials have signalled that they need to see three consecutive months of above 200,000 growth in employment before

they will decide to let their quantitative easing programmes taper off.

We think that these conditions will be met around the December meeting, which should prompt the Fed to announce a reduction of its asset purchases during that meeting (though a September move remains a possibility).

## New publications

### Volatility is back: Bond Markets Monthly

Financial markets got a wake-up call from central banks last month. The Fed suggested the possibility of an earlier than expected reduction of monetary stimulus and the Bank of Japan confused markets with inconsistent statements about its commitment to its recently stepped-up asset purchases. As a result, risk sentiment deteriorated across all asset classes, including the riskier segments of the bond markets, resulting in spread widening and higher volatility. At the same time, markets have started discounting higher bond yields.

### Global Investment Committee Update

At its meeting on 6 June, the Global Investment Committee adjusted the tactical asset allocation.

- Fixed income underweight increased
- Equity overweight reduced
- Property reduced from overweight to neutral in balanced portfolios
- Building cash positions in all portfolios

## Next week's calendar

### Important dates next week

		Date
Consumer confidence	EU	10 June
BoJ rate decision	JP	11 June
Wholesale inventories	US	11 June
BoJ monthly economic survey	JP	12 June
Industrial production	EU	12 June
Constitutional court ruling on ECB Bond buying	GE/EU	12 June
Business inventories	US	13 June
ECB monthly report	EU	13 June
CPI	EU	14 June
Consumer sentiment	US	14 June

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.

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