



global weekly

Investment
Communication

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Withdrawal symptoms

This week's market volatility was a symptom of the upcoming withdrawal from central bank largesse. The exit narrative was strengthened by the Bank of Japan keeping its monetary policy on hold.

Equity outlook

Volatility remained high last week as investors worried about the pace of the potential slowing of the Federal Reserve's asset purchasing programmes. Other issues affecting markets were the hearings of the German high court on the legalities of the ECB's OMT bond-buying programme and the World Bank cutting its growth forecasts.

Mergers and acquisitions are picking up. Telecom giant Vodafone approached Kabel Deutschland regarding a possible takeover. And, the CFO of KPN, a Dutch telco that is under pressure, said the European telecom sector is "more than ever" ready for a round of consolidation that could create additional value. For now, we remain underweight on the telcoms sector.

Other mergers and acquisitions news this week included Google beating out Facebook and Apple to pay USD 1 billion for Waze, a fast-growing traffic and mapping app.

This week also saw Facebook's first shareholders meeting. A year after it went public, CEO Mark Zuckerberg was under pressure, as investors worry about the social network's long-term business prospects. Facebook is trading almost 40% below its USD 38 IPO price, although this is still 30% above its all-time low

Stock to watch: CSX

This week we added CSX to our recommended list. The company provides rail freight transportation over a network of approximately 21,000 miles and 36 terminals across the eastern US. We expect CSX to benefit from higher energy demand, the shale-gas revolution and US re-industrialization. Over the past few years, CSX has closed the gap with its competitors, as it improved operational efficiency and pricing. The company expects earnings per share growth of 10-15% in the coming years and recently set up a two-year USD 1 billion share buyback programme.

Equity index performance in local currencies

	Value	One week	Year-to-date
MSCI ACWI	362.71	-0,8%	6,8%
S&P 500	1636.36	0,9%	14,7%
EuroStoxx 50	2661.71	-2,0%	1,3%
DAX	8095.39	-1,4%	6,9%
Nikkei 225	12686.52	-1,5%	22,0%
Hang Seng Index	21106.5	-3,4%	-6,8%

Important rating changes

Company	From	To
Samsung Electronics	Hold	Buy
PPR	Hold	Buy
CSX	Buy	Buy/RL
ABB	Hold	Buy
Hennes & Mauritz	Hold	Buy

Government bond yields

	Yield	One week	One year
US Treasuries 2-year	0,27%	-1,35 bp	-1,59 bp
German Bunds 2-year	0,13%	-0,36 bp	0,8 bp
Japan 2-year	0,12%	0,5 bp	2,9 bp
US Treasuries 10-year	2,12%	4,72 bp	53,14 bp
German Bunds 10-year	1,53%	0,6 bp	4 bp
Japan 10-year	0,81%	-0,9 bp	-3,5 bp

Spreads

Index	Spread	One week	One year
CDX NA IG	81.77	-2,15 bp	-42,92 bp
iTraxx Euro 5-year	113.06	0,25 bp	-69,12 bp
JPM EMBI+	318.36	-3,44 bp	-63,65 bp

Performance data is as of 12:00 pm Friday, 14 June

Source: Bloomberg

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Bond outlook

The dramatic market reaction to Chairman Bernanke's May testimony to the US Congress about tapering asset purchases is part of the educational topic "how will markets react to normalisation of monetary policies," being studied by central bankers.

Normalisation of monetary policy (whether just a piece or the whole enchilada) affects the economy because of its impact on interest rates and asset prices. Attempting to reduce uncertainty about future monetary policy decisions is crucial but can in itself revive volatility.

Both bond buyers and issuers remain cautious heading into the FOMC rate decision next Wednesday. ABN AMRO Group Economics expects no rate change and a more dovish communication from Bernanke. It is just one more step toward normalisation, a process during which we will see strong and weak spots within the credit markets.

Our bond research publications and allocations are based on the strong spots: we prefer senior bonds over subordinated. Moreover, the latest big new bond issues have cheapened, as weak investors have bought in (for example, Apple and Microsoft USD-denominated issues). Retail target issues have shown more resilience. Investment-grade credits, such as the latest euro-denominated bonds from German chemical manufacturer Evonik and automotive supplier Bosch, have had stable performance.

Central bank update

European Central Bank

While investors have been fretting about the Fed's balance sheet rising at a slightly slower pace, the ECB's balance sheet has actually been outright shrinking in recent months and this has been occurring at a rather significant pace. It reflects commercial banks continuing to repay their three-year long-term refinancing operations (LTRO) loans early. As such, total ECB lending to banks fell to EUR 822 billion in the first week of June, down from a high of EUR 1.26 trillion in July of last year.

The repayments are positive to the extent that they point to healing in bank funding markets, but they could eventually have a negative outcome. Although liquidity in the financial system is still plentiful, if LTRO repayments continue at the pace of recent months, there is the possibility that the liquidity surplus will dwindle towards the end of the year.

Less liquidity could then put upward pressure on short-term interest rates, which would essentially represent an unwanted tightening of financial conditions. The possibility of this scenario is already becoming visible. EONIA futures rates

have been rising, as have two-year German government bond yields. In addition, this has driven the euro higher against the dollar.

Refi cut not off the table

The message from ECB officials is that they are ready to take more standard action (meaning a refi rate cut) if necessary, but a negative deposit rate is a much more distant prospect that would require a major change in the economic scenario. For instance, the ECB's Chief Economist recently said that there was room for action in the 'standard measures'. At the same time, he pointed to a 'very big difficulty' with negative interest rates. A refi rate cut could help to pressure the euro and also cap the rise in interbank rates, so it could easily come back on to the agenda if euro strength is sustained or if the liquidity surplus is threatened. However, this is not our base case.

We think that before long US economic outperformance will lead to renewed falls in the euro versus the US dollar, while we think that the pace of LTRO repayments could well ease as many peripheral banks are still experiencing impaired market access. In addition, we expect the eurozone economy to continue to slowly recover. This week's industrial production numbers, showing a rise of 0.4% in April after a 0.9% gain in March, pointed in this direction.

Bank of Japan stays on hold

The BoJ left its policy path unchanged during its meeting this week. It will continue to target increases of its monetary base of 60-70 trillion yen a year, primarily by buying 7 trillion yen (USD 72.3 bln) of Japanese government bonds a month, and to a lesser extent, by purchasing exchange-traded funds, real estate funds, commercial paper and corporate bonds.

Although the outcome was in line with the consensus forecast of economists, in the run-up to the meeting, there was speculation that the central bank would decide to extend the maturity of its low interest loan programme to commercial banks, with the aim of reducing market volatility. As such, the decision to keep its policy on hold dented investor risk appetite and hurt equity and core bond markets, as it also lent encouragement to the central bank exit narrative.

Currency outlook

Fed tapering supports dollar, but euro firms on rates

The fall-out in global currency markets from the building expectations for the Fed to taper its asset purchases have been varied. The EUR/USD has paradoxically moved higher, while the US dollar rallied versus most other currencies. This reflects that there is a euro move and US dollar move playing out at the same time.

The euro is an interest-rate sensitive currency and short-term interest rate expectations in the eurozone have risen. This reflects the pricing out of rate cuts – following better data and a less dovish tone from the ECB – as well as faster than expected LTRO repayments, which have led to a significant shrinking of the central bank's balance sheet. This trend has supported the euro. Indeed, EUR/USD and the two-year Germany-US yield spread have moved higher in tandem.

The speed of LTRO repayments is difficult to call, but at some stage we think it will slow, as many banks in peripheral countries still face impaired market conditions. In addition, the ECB is committed to keeping monetary policy accommodative and could intervene to cap rates. In any case, we think that the slow economic recovery and subdued inflation will prevent the ECB from hiking its policy rates through the end of next year. The bottom line is that this cushion for the euro is likely to deflate.

Emerging markets and commo currencies suffer, safe-havens supported

Most emerging market and commodity currencies have suffered due to expectations of Fed tapering. Stronger US economic growth remains the missing ingredient. This has resulted in lower risk appetite and currencies with a safe-haven character, such as the Swiss franc and Japanese yen being favoured.

The yen was also supported by the BoJ's wait-and-see stance. Bond prices and equities declining together reflects the fear of an easing of exceptional stimulus. Our view is that the US economy will accelerate noticeably in the coming quarters, meaning that improving risk appetite will go hand-in-hand with Fed tapering. As such, the US dollar will rally versus the euro and carry trades will revive.

Currency forecasts

	Today	Q2 2013	Year-end 2013
EUR/USD	1.333	1.30	1.20
GBP/USD	1.567	1.49	1.45
USD/JPY	94.40	104	110

Source: ABN AMRO Group Economics

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 latest Global Investment Committee Update, published 7 June 2013.

Next week's calendar

Important dates next week

		Date
Empire State Manufacturing Index	US	17 June
NAHB housing market	US	17 June
Industrial production	JP	18 June
ZEW economic sentiment	GE	18 June
CPI	US	18 June
Housing starts	US	18 June
PMI	EU	20 June
Consumer confidence	EU	20 June
Existing home sales	US	20 June

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