The Weekly Market View

November 21 2016

More of the same; bond yields up, equities up, emerging markets down

The election of Mr Trump almost two weeks ago continues to drive a shift in investors' asset allocation. Bond yields rose for another week while equities witnessed small gains. The shift from bonds to equities could remain with us in the coming months as in the absence of details investors appear content to continue giving Mr Trump's expected reflationary policies the benefit of the doubt. We too have decided that the republicans' clean sweep is a meaningful enough event to change our asset allocation, upgrading equities and downgrading bonds last week (now both neutral, ***see link****). Emerging markets remained under pressure, seeing heavy selling with flows out of both bonds and equities around $6bn mark each. Oil prices rose on tentative renewed hope of a cut in oil output ahead of a meeting between the Saudi and Russian energy ministers while gold prices fell again.*

Long sound bites, short details

*Mr Trump's election campaign can generally be described as one which has been long sound bites and short details. The result is that investors are speculating more than before on what the new administration's policies will mean for financial markets. What markets are telling us is that fiscal policy will take over from monetary policy in driving the US economy forward. They are betting that this means growth and inflation will accelerate as a result. This is not without risks as there is a chance that tax cuts and not infrastructure spending will be the favoured avenue by the republicans. However, given that Mr Trump was elected on a mandate to generate jobs and revive America's industry, coupled with the Republicans' clean sweep (occupying the Presidency, the House and the Senate) means that the fiscal spending markets are hoping for is more likely than not be delivered. Whether or not it happens in an efficient manner is something only time will tell. We have also made changes to our US equity sector allocation, now preferring cyclicals sector to defensives (****see link****).*

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,181.9	0.8	6.7
Dow Jones	18,867.9	0.1	8.3
Nasdaq	5,321.5	1.6	6.3
DAX	10,664.6	-0.0	-0.7
Nikkei 225	17,967.4	3.4	-5.6
FTSE 100	6,775.8	0.7	8.5
Sensex	26,150.2	-2.5	0.1
Hang Seng	22344.2	-0.8	2.0
Regional Markets (Sunday to Thursday)			
ADX	4287.7	0.2	-0.5
DFM	3326.2	1.1	5.6
Tadawul	6628.9	1.5	-4.1
DSM	9775.0	-1.9	-6.3
MSM30	5498.9	1.4	1.7
BHSE	1180.3	1.7	-2.9
KWSE	5523.5	0.6	-1.6
MSCI			
MSCI World	1,697.4	0.0	2.1
MSCI EM	844.5	-0.5	6.3

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	46.9	4.7	25.7
Nymex WTI USD/bbl	45.7	5.3	23.4
OPEC Baskt* USD/bbl	42.8	3.1	37.0
Gold 100 oz USD/t oz	1207.9	-1.6	13.8
Platinum USD/t oz	922.0	-2.5	3.4
Copper USD/MT	5446.0	-7.7	15.8
Alluminium	1697.75	-2.6	12.8
Currencies			
EUR	1.0588	-2.5	-2.5
GBP	1.2342	-2.0	-16.2
JPY	110.91	4.0	8.4
CHF	1.0101	2.2	-0.8
Rates			
USD Libor 3m	0.9162	1.2	49.5
USD Libor 12m	1.6207	2.1	37.6
UAE Eibor 3m	1.3707	4.6	29.9
UAE Eibor 12m	2.0191	3.0	36.9
US 3m Bills	0.4313	-7.6	165.1
US 10yr Treasury	2.3548	9.5	3.8

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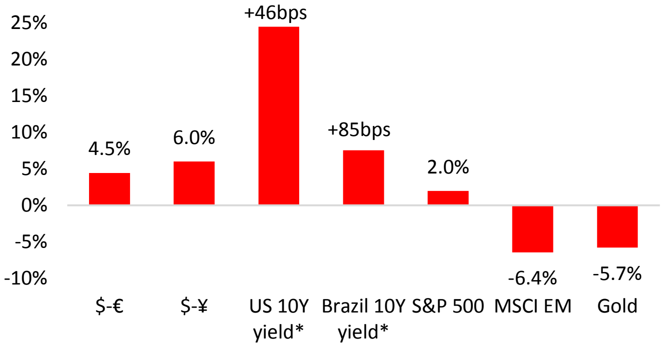
Every action has a reaction

A potential game changer

Every once in a while a major event comes along and changes everything. One would think these event would be easy to spot, but they aren't always – Brexit threatened to be such an event but has proven not to be, at least so far. In hindsight these are events are much more obvious of course. The election of Mr Trump, more likely than not *is* such an event and markets seem to agree. Mr Isaac Newton once said that "every action has an equal and opposite reaction". In physics this may be true, in financial markets we agree but question the "equal and opposite" part of Mr Newton's theory. What is clear, however, is that the election of Mr Trump is widespread reactions across global financial markets. Naming a few these are:

1. US dollar strengthening
2. December Fed funds rate hike all but assured
3. US inflation expectations rising sharply
4. Bonds selling off
5. Emerging markets selling off
6. EM central banks hiking rates

Trump a game changer for markets



*Note: Red bar shows the % change in the yield, number above the bar is the actual change in yields in basis points (bps)
Source: Bloomberg

The changes we have made in our asset allocation and equity strategy (**see the Investment Strategy website**) reflect our belief that at least over the coming months, these trends will persist. The extent to which they last beyond the near-term very much depends on how closely the new administration's policies match the expectations which are currently building.

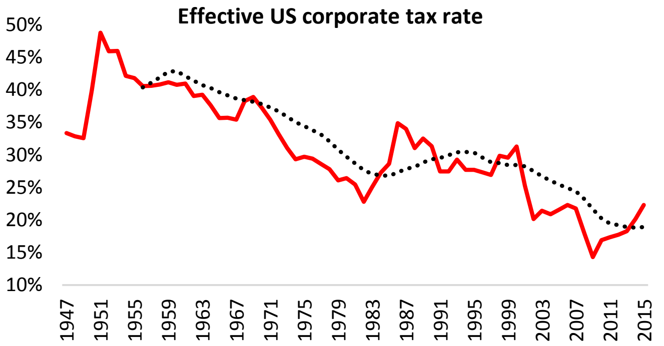
Change in equity sector allocation; focus on cyclicals over defensives and small caps over large caps

For the greatest part of this year we have held a preference for defensive equity sectors, especially those with elevated dividend yields. The rationale was simple; central banks in the key economies of the world forced yields down to such an extent, that investors' hunt for yield took them into the equity market and towards sector such as utilities and telecoms with yields in the range of 3-4%. Not only that, but we felt that risks to economic growth, especially in the US remained high, making the stable and predictable income streams of defensive sectors attractive. This has now changed along with Mr Trump's victory. Although telecoms and utilities have outperformed the S&P 500 year-to-date, since our implementation in May they are down, underperforming in the better cyclical environment. We therefore take losses on these calls and shift our sector preferences to those sectors which will benefit from rising growth and inflation expectations as well as higher interest rates. **These are industrials, energy, banks and health care (see link).**

Small caps to outperform large caps

Another segment of the market we believe has scope to do well are small cap equities. Much of Mr Trump's campaign rhetoric focused on US companies taking jobs outside of the US as well as large tech companies exploiting tax loopholes. A clamp down on this will hurt the larger multi-nationals. At the same time his plan to reduce the 35% corporate tax rate to 15% may sound very favourable for business, the reality is that most large US domiciled multi-nationals don't pay anywhere near the 35% tax rate, instead they take advantage of write-downs and loopholes which means that their effective tax rate is already much closer to the 15% level which Mr Trump proposes (see chart below). Mr Trump finding a way to lower corporate taxes would therefore provide hardly any benefit to large multi-nationals (and may even hurt those who pay below the 15% threshold). Instead, the major beneficiaries would be smaller companies who don't have the financial firepower or know-how to hire expensive tax consultants able to help them lower their effective tax rate. **Bottom line: Mr Trump is good for small business but bad for big business (see link).**

Effective US corporate tax rate



Source: Bureau of Economic Analysis, St Louis Fed

Bank of Japan passes a test

Last week we upgraded Japanese equities to overweight (**see link**), the main argument being that in a world where bond yields are rising, the BoJ's policy of pegging 10-year JGB at 0% keeps downward pressure on the yen, boosting Japanese corporate earnings. The BoJ's policy was tested this week as 10-year yields briefly rose to 0.035%, prompting the BoJ to intervene and successfully bringing yields back to 0%.

Summary market outlook

Bonds	
Global Yields	Yields have spiked as the prospects of an expansionary fiscal policy have emerged. Mr. Trump should be able to maintain that momentum over the next months. So, whilst it is likely that they will remain in a higher range, for now we think that lower foreign yields and US dollar appreciation should prevent them from shooting massively above 2.5%.
Stress and Risk Indicators	The VIX index has plunged as the likely fiscal boost is now expected to be positive for growth, and thus equities. This sentiment might well last for the next months.

Equity Markets	
Local Equity Markets	GCC equity markets remained resilient when compared with the general emerging markets equity index, the oil price gained in the expectation of a production cut by OPEC. As has been the case over the last weeks, the Saudi market continued its rebound.
Global Equity Markets	The positive momentum for advanced equities might continue for some months to come as markets continue to speculate about a more expansionary US fiscal policy. Limits to this story would be high valuation and rate hikes for US equities, increased political risks for European equities, strong dollar and increased political risks for emerging markets. UK and Japanese equities could do relatively well as their monetary policy framework remains more accommodating and their currencies have further depreciation potential.

Commodities	
Precious Metals	Precious metals prices are once more under pressure along with emerging markets. However, geopolitical risks and economic risks are here to stay, we therefore stick to our gold call.
Energy	Energy prices gained on the prospect of a production cut agreement across oil producing countries. We expect a sideward move.
Industrial Metals	Industrial metals gave up the prior week's gain over the last week. With Asian currencies under pressure and the US dollar strengthening we remain cautious on the industrial metal.

Currencies								
EURUSD	The US dollar has strengthened following Mr. Trump's election win. It continued its trend even last week. Expected more expansionary fiscal policy – combined with Fed hikes – will keep the dollar strong.							
Critical levels	R2	1.0954	R1	1.0771	S1	1.0487	S2	1.0386
GBPUSD	The pound sterling gave up its resilience against the US dollar and joined other currencies in moving down. We expect further downward movement in the currency in the near term.							
Critical levels	R2	1.2737	R1	1.2539	S1	1.2223	S2	1.2105
USDJPY	US dollar strength could persist, not only because of the change in US policies, but also because the BoJ has clearly committed to keeping the 10 year yield at 0%. Only a major global risk off episode could reignite yen appreciation in our view.							
Critical levels	R2	113.90	R1	112.40	S1	107.96	S2	105.02

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
11/22/2016	Existing Home Sales	Oct	5.43m	5.47m	Housing data and PMIs will be important for the market.
11/22/2016	Durable Goods Orders	Oct P	1.2%	-0.3%	
11/22/2016	Durable Ex Transport	Oct P	0.2%	0.1%	
11/23/2016	Markit Mfg PMI	Nov P	53.4	53.4	
11/23/2016	New Home Sales	Oct	590k	593k	
11/23/2016	Univ. of Mich. Sentiment	Nov F	91.6	91.6	

Japan

	Indicator	Period	Expected	Prior	Comments
11/21/2016	All Industry Activity Index MoM	Sep	0.0%	0.2%	PMIs will be looked at closely by the market.
11/24/2016	Nikkei Mfg PMI	Nov P	--	51.4	
11/25/2016	Natl CPI YoY	Oct	0.0%	-0.5%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
11/23/2016	Markit Mfg PMI	Nov P	53.3	53.5	Markets to closely watch the PMI and IFO
11/24/2016	IFO Business Climate (GE)	Nov	110.5	110.5	
11/24/2016	IFO Expectations (GE)	Nov	106.0	106.1	

United Kingdom

	Indicator	Period	Expected	Prior	Comments
11/25/2016	GDP QoQ	3Q P	0.5%	0.5%	GDP and foreign trade data are important for the market.
11/25/2016	Exports QoQ	3Q P	1.0%	-1.0%	
11/25/2016	Imports QoQ	3Q P	-0.2%	1.3%	

China and India

	Indicator	Period	Expected	Prior	Comments
11/27/2016	Industrial Profit YoY (CH)	Oct	--	7.7%	
This Week	Infrastructure Industries Growth (IN)	Oct	--	5.0%	

Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTTNews
4. Reuters
5. Gulfbase
6. Zawya

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