The Weekly Market View

November 14 2016

Republican "clean sweep" triggers fiscal stimulus rally

The unexpected conquest by the republican party of both the US presidency ***and*** *the US congress, is fuelling speculation of higher US economic growth and sustained inflation. We have little doubt that the new republican administration will be able to boost fiscal deficits. We think that it should boost economic growth and inflation through 2017. Yet, for the boost to be truly significant it will be important that it focusses on effective infrastructure spending, rather than tax cuts. Politically, however, the reverse might be more likely. If that would occur, we would at some point in time see more, rather than less, need for central bank action. For now, the "assumption of fiscal success" is allowing the Fed to proceed with a rate hike in December, and plausibly more in 2017, boosting the US dollar and keeping yields at a higher level. Also, more inflationary growth might partly undo the negative correlation of energy and commodities with the US dollar.*

Trump is getting the benefit of doubt

There are many "ifs" attached to what President Trump will ultimately do. There are two reasons which might induce markets over the next months to speculate for the better, rather than the worse. First, the republicans unexpectedly also won the congress, making - for the first time in years - fiscal policy change a realistic possibility. Second, candidate Trump, in spite of his many controversial proposals, has been very light on detail. As such, expectations were low and he can now manage that by gradually giving more "positive" policy indications until he effectively takes over in early 2017. Downside risks might well emerge beyond the next months as US markets remain highly valued, the story is less good for global growth, and even bad for emerging markets. Ultimately success will depend on what kind of fiscal boost the new administration will be able to deliver. If it consists of significant effective public debt-financed infrastructure spending, the positive effects might last longer, certainly for the real economy, and to some extent also for financial markets. Alternatively downward moves will come back with a vengeance. In the meanwhile volatility is here to stay.

Luciano Jannelli, Ph.D., CFA
Head Investment Strategy
Tel: +971 (0)2 696 2340
luciano.jannelli@adcb.com

Wietse Nijenhuis
Equity Strategist
Tel: +971 (0)2 205 4923
wietse.nijenhuis@adcb.com

Rahmatullah Khan
Economist
Tel: +971 (0)2 696 2843
rahmatullah.khan@adcb.com

Prerana Seth
Fixed Income Strategist
Tel: +971 (0)2 696 2878
prerana.seth@adcb.com

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Past week global markets' performance

Index Snapshot (World Indices)			
Index	**Latest**	**Weekly Chg %**	**YTD %**
S&P 500	2,164.5	3.8	5.9
Dow Jones	18,847.7	5.4	8.2
Nasdaq	5,237.1	3.8	4.6
DAX	10,668.0	4.0	-0.7
Nikkei 225	17,374.8	2.8	-8.7
FTSE 100	6,730.4	0.6	7.8
Sensex	26,818.8	-1.7	2.7
Hang Seng	22531.1	-0.5	2.8
Regional Markets (Sunday to Thursday)			
ADX	4282.5	0.0	-0.6
DFM	3274.1	-0.7	3.9
Tadawul	6528.1	7.7	-5.6
DSM	9961.0	0.0	-4.5
MSM30	5417.67	-0.8	0.2
BHSE	1160.9	1.4	-4.5
KWSE	5480.4	1.3	-2.4
MSCI			
MSCI World	1,697.0	2.2	2.1
MSCI EM	849.1	-3.5	6.9

Global Commodities, Currencies and Rates			
Commodity	**Latest**	**Weekly Chg %**	**YTD %**
ICE Brent USD/bbl	44.8	-1.8	20.0
Nymex WTI USD/bbl	43.4	-1.5	17.2
OPEC Baskt* USD/bbl	42.7	2.0	36.5
Gold 100 oz USD/t oz	1227.6	-5.9	15.7
Platinum USD/t oz	945.2	-5.4	6.0
Copper USD/MT	5900.0	19.4	25.5
Alluminium	1743.5	1.5	15.8
Currencies			
EUR	1.0855	-2.6	-0.1
GBP	1.2596	0.6	-14.5
JPY	106.65	3.4	12.7
CHF	0.9880	2.0	1.4
Rates			
USD Libor 3m	0.9057	2.6	47.8
USD Libor 12m	1.5879	1.9	34.8
UAE Eibor 3m	1.3134	-2.0	24.5
UAE Eibor 12m	1.9511	1.9	32.3
US 3m Bills	0.4669	27.5	187.0
US 10yr Treasury	2.1501	21.0	-5.3

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It is the "clean sweep" that makes the difference

"Clean sweep" gives Trump excellent "lame duck" session

Last week we wrote that the risk-reward payoff on any outcome of the US election would not have been favourable for risk assets. We were mistaken. And we were so because, amongst the possible outcomes, we had simply not taken into account that the republic party would take the presidency and congress. Some point out that the swift recovery of the equity market and the plunge of the bond market are related to the fact that money managers are assuming only the "fiscal policy part" of Mr. Trump's agenda, as they think that the suggestions of prohibitive tariffs and draconian anti-immigration measures will remain confined to "election talk". There is some truth in that. Just as it is true, however, that it is exactly the conquest of congress, in *addition* to the presidency, that will make it easier for Trump to pursue a pro-growth fiscal policy. As he is now morphing from candidate into president, he can take advantage of the fact that he has been very light on details during the campaign (in spite of, or perhaps because of, some headline grabbing controversial proposals, mostly on foreign policy, trade and immigration). As a result he can now please the markets and the business community by gradually introducing sound proposals, and appointing competent people to his administration. He has shown to be very good at that, beginning with his victory speech, and he can keep on doing that – here is the key point – without committing himself too much until his inauguration day on January 20 2017. Thus, *independently* of whether his overall policy framework will ultimately make sense, for the next months he can keep on sending signals to the markets which will appease investors.

But emerging markets are less sanguine

Emerging equity markets did not participate in last week's feast as the Emerging Equity Markets MSCI Index tumbled more than 3% for the whole week (and -6% since Mr. Trump was elected). One could, of course, mainly explain this by US dollar strengthening since expectations are that a more expansionary fiscal policy, combined with Fed hiking is good for the greenback. Many emerging markets have significant levels of US dollar debt, such that an increase in its real value would limit their fiscal room for manoeuvre. Also, a rise in the value of the greenback would push up inflation in domestic emerging economies such that local central banks would be forced to tighten, and thereby reduce growth. It would be naïve, however, to not link the correction of emerging markets *also* to the threat of reduced global trade implicit in Mr. Trump's trade policy proposals. Paradoxically, Mr. Trump is, however, damaging the US trade case since he is forcing both the Chinese and Mexican governments – the two main culprits in his view – to prop up the value of their currencies so as to fight devaluation that his election is favouring. If and when negotiations would start, those governments would immediately point that out to him that, by protecting the value of their currency, they are in fact reducing domestic growth thus ultimately also reducing demand for US goods. If, on the other hand, they would let their currency go the price-effect of cheaper Mexican and Chinese goods versus more expensive US goods, would likewise be detrimental to US trade prospects.

Domestic growth the new game in town and Trump has the benefit of doubt: Japan, value and cyclicals to profit

The above dilemma somehow shows that Mr. Trump has his hands tight on trade policy. It also shows that fiscal policy and domestic growth must be at the top of his agenda. This is what we will watch most carefully. For now, he has the benefit of doubt, and markets are likely to benefit in a reflation trade that might last at least some months. Thus we further reduce our emerging equity stance from neutral to underweight and at the same time we go for a currency-hedged position in Japanese equities. The latter is favoured because Japanese yields are capped at 0% (by BoJ policy), whilst other global yields will face upward pressure with US Treasuries moving up, and the ECB likely to start tapering. Also, yen weakness will boost Japanese exports which is good for many Japanese companies. We will shortly send out a note on these calls, as well as a review on our sector calls where – at a general level - we will move from growth stocks to value stocks, and from defensives to cyclicals.

We are reviewing our global asset allocation

Trump's fiscal policy might well fail as we move further into 2017. It might indeed be easier to convince the republican congress to enact tax cuts than to authorize meaningful infrastructure investments. Note that the Trump campaign has talked a lot about public-private partnerships and tax credits to induce infrastructure investment spending. In our view, fiscal policy will only be effective if the government picks up the full bill of infrastructure projects. Mere tax cuts, on the other hand, would only increase the deficit at a time that wages are creeping up, and thus inflation might force the Federal Reserve to hike even if growth is fragile.

For the moment the market is likely to ignore these concerns. That is why we are considering to reduce or bond overweight, and increase our equity asset allocation. Within the equity space, we would maintain however a bearish stance, overweighting the less volatile US equities, and maintaining currency hedged calls on UK equities and Japanese equities.

Summary market outlook

Bonds	
Global Yields	Yields have spiked up 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 the prospects of 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 were relatively resilient when compared with the general emerging markets equity index, and in consideration of the further correction in the oil price. As has been the case over the last weeks, the Saudi market is still pulling positive moment.
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 Japan 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 with emerging markets, whilst the global inflation prospects remain subdued and the US dollar strong. Geopolitical risks and economic risks are here to stay, however, and the latter potentially inflationary. We stick to our gold call.
Energy	Energy prices remain under pressure with the stronger US dollar and no clear policy agreement across oil producing countries. We expect a further sideward move.
Industrial Metals	Industrial metals performed strongly last week, this time not because of economic data from China, which in fact were bad, but on the prospect of increased US infrastructure spending. With Asian currencies under pressure and the US dollar strengthening we would be reluctant to pick up that trade.

Currencies								
EURUSD	The US dollar has strengthened following Mr. Trump's election win. Last week we were considering the US dollar to strengthen if the Democratic Party would regain full control of the US Congress. Instead it was the republican party who carried the day. The resulting more expansionary fiscal policy – combined with Fed hikes – will keep the dollar moving upward.							
Critical levels	R2	1.0962	R1	1.0909	S1	1.0816	S2	1.0776
GBPUSD	The pound sterling was the only currency to appreciate against the US dollar, most likely because of expectations of better UK-UE relations as the country exits the EU. We are not sure these expectations are realistic or relevant.							
Critical levels	R2	1.2747	R1	1.2671	S1	1.2523	S2	1.2451
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 yields at 0%. Only major global risk off moments could reignite yen appreciation.							
Critical levels	R2	107.43	R1	107.04	S1	106.15	S2	105.65

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
11/15/2016	Retail Sales Advance MoM	Oct	0.6%	0.6%	Retail sales, industrial production along with the inflation numbers will be closely watched this week
11/16/2016	Industrial Production MoM	Oct	0.2%	0.1%	
11/16/2016	Capacity Utilization	Oct	75.5%	75.4%	
11/16/2016	NAHB Housing Market Index	Nov	63	63	
11/17/2016	Housing Starts	Oct	1155k	1047k	
11/17/2016	Building Permits	Oct	1190k	1225k	
11/17/2016	CPI YoY	Oct	1.6%	1.5%	
11/17/2016	CPI Core YoY	Oct	2.2%	2.2%	

Japan

	Indicator	Period	Expected	Prior	Comments
11/14/2016	GDP SA QoQ	3Q P	0.2%	0.2%	Focus will be on the GDP print
11/14/2016	Industrial Production YoY	Sep F		0.9%	
11/14/2016	Capacity Utilization MoM	Sep		2.6%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
11/15/2016	GDP SA YoY	3Q P	1.6%	1.6%	Markets to closely watch the GDP and CPI numbers
11/17/2016	CPI YoY	Oct F	0.5%	0.4%	
11/17/2016	CPI Core YoY	Oct F	0.8%	0.8%	

United Kingdom

	Indicator	Period	Expected	Prior	Comments
11/15/2016	CPI YoY	Oct	1.1%	1.0%	Headline inflation for October is expected to jump higher
11/15/2016	Retail Price Index	Oct	265.3	264.9	
11/15/2016	House Price Index YoY	Sep	8.1%	8.4%	

China and India

	Indicator	Period	Expected	Prior	Comments
11/14/2016	Industrial Production YoY (CH)	Oct	6.2%	6.1%	Market attention will be on China industrial production and retails sales numbers as well as India CPI print
11/14/2016	Retail Sales YoY (CH)	Oct	10.7%	10.7%	
11/14/2016	Fixed Assets Ex Rural YTD YoY (CH)	Oct	8.2%	8.2%	
11/13- 11/15	Exports YoY (IN)	Oct	-	4.6%	
11/15/2016	Wholesale Prices YoY (IN)	Oct	3.74%	3.57%	
11/15/2016	CPI YoY (IN)	Oct	4.15%	4.31%	

بنك أبوظبي التجاري
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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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