

Markets take Fed rate hike in their stride

After a year of sitting on their hands, the Fed raised interest rates for only the second time since the global financial crisis, by 25 basis points. Financial markets had assigned a 100% probability to the hike, as such it was a non-event. More interesting was the more hawkish than expected shift in the Fed's outlook. The famous dots now suggest three hikes in 2017 vs. two previously. This suggests that FOMC members, in the back of their minds are factoring in some impact of a Donald Trump Presidency. The impact of the "additional" rate hike was not enough to push equities down across the board, however, US equities did underperform their European and Japanese counterparts which were boosted by further dollar strength. Emerging Markets were inevitably hurt while Treasuries rallied further and precious metals suffered.

Major central banks' divergence leads to further dollar strength

Less than two weeks ago the ECB's monetary policy committee decided to extend its bond purchase program by a further 9 months, albeit they will purchase bonds at a slower pace (€60bn a month instead of €80bn). This has been interpreted by the market as more dovish than expected. The Fed on the hand, thanks to an upward shift in the dots (the expected appropriate level of Fed funds rate) surprised markets on the hawkish side. The outcome of this divergence has been higher Treasury yields and further dollar strength. Both the dollar and Treasuries have moved a long way since the US election on November 8th, and whilst it seems reasonable to expect a pause, we do not expect a major reversal of this trend in the coming weeks. This means that EM assets are likely to remain under pressure.

Wietse Nijenhuis

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

Luciano Jannelli, Ph.D., CFA

Head Investment Strategy
Tel: +971 (0)2 696 2340
luciano.jannelli@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

Visit [Investment Strategy Webpage](#) to read our other reports.

Past week global markets' performance

Index Snapshot (World Indices)

| Index | Latest | Weekly Chg % | YTD % |
|------------|----------|--------------|-------|
| S&P 500 | 2,258.1 | -0.1 | 10.5 |
| Dow Jones | 19,843.4 | 0.4 | 13.9 |
| Nasdaq | 5,437.2 | -0.1 | 8.6 |
| DAX | 11,404.0 | 1.8 | 6.2 |
| Nikkei 225 | 19,401.2 | 2.1 | 1.9 |
| FTSE 100 | 7,011.6 | 0.8 | 12.3 |
| Sensex | 26,489.6 | -1.0 | 1.4 |
| Hang Seng | 22020.8 | -3.3 | 0.5 |

Regional Markets (Sunday to Thursday)

| | | | |
|----------|---------|------|------|
| ADX | 4463.0 | -1.2 | 3.6 |
| DFM | 3554.5 | -0.1 | 12.8 |
| Tadaw ul | 7090.9 | -0.4 | 2.6 |
| DSM | 10224.1 | 1.7 | -2.0 |
| MSM30 | 5728.65 | 1.1 | 6.0 |
| BHSE | 1188.7 | -0.3 | -2.2 |
| KWSE | 5668.5 | 1.4 | 1.0 |

MSCI

| | | | |
|------------|---------|------|-----|
| MSCI World | 1,754.7 | -0.3 | 5.5 |
| MSCI EM | 856.4 | -2.4 | 7.8 |

Please refer to the disclaimer at the end of this publication

Global Commodities, Currencies and Rates

| Commodity | Latest | Weekly Chg % | YTD % |
|----------------------|--------|--------------|-------|
| ICE Brent USD/bbl | 55.2 | 1.6 | 48.1 |
| Nymex WTI USD/bbl | 51.9 | 0.8 | 40.1 |
| OPEC Baskt* USD/bbl | 51.0 | 0.0 | 63.0 |
| Gold 100 oz USD/t oz | 1134.9 | -2.2 | 7.0 |
| Platinum USD/t oz | 927.6 | 1.3 | 4.0 |
| Copper USD/MT | 5649.0 | -3.0 | 20.1 |
| Alluminium | 1724.5 | -1.8 | 14.5 |

Currencies

| | | | |
|-----|--------|------|-------|
| EUR | 1.0451 | -1.0 | -3.8 |
| GBP | 1.2496 | -0.6 | -15.2 |
| JPY | 117.93 | 2.3 | 1.9 |
| CHF | 1.0261 | 0.9 | -2.3 |

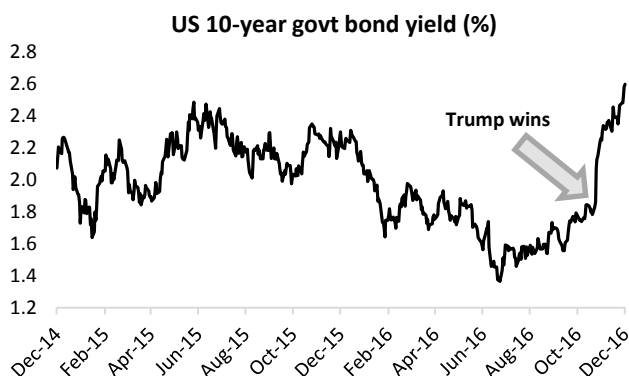
Rates

| | | | |
|------------------|--------|------|-------|
| USD Libor 3m | 0.9973 | 4.3 | 62.8 |
| USD Libor 12m | 1.6934 | 2.7 | 43.8 |
| UAE Eibor 3m | 1.3336 | -2.1 | 26.4 |
| UAE Eibor 12m | 2.1903 | 2.4 | 48.5 |
| US 3m Bills | 0.4923 | -7.6 | 202.6 |
| US 10yr Treasury | 2.5916 | 5.0 | 14.2 |

What happens to bond yields and the dollar?

The 64 million dollar question

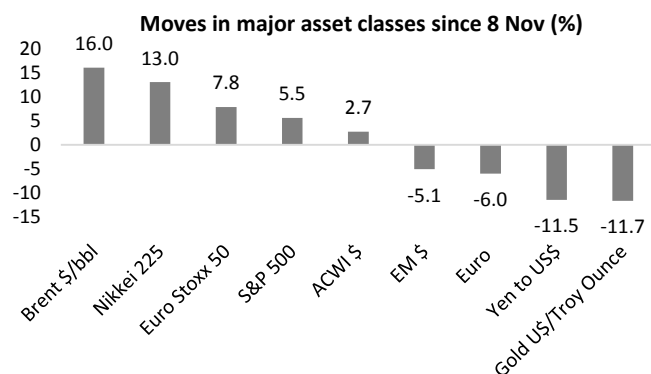
The main question investors will have for the coming year is what will happen to bond yields and the US dollar. The consensus is unclear, some market commentators calling for permanently higher US bond yields, others believing the post-election move higher is an overreaction which will reverse early in 2017. At ADCB Asset Management we are somewhere in the middle. We are not confident enough in Mr Trump's reflationary policies to position for significant further jump in yields, especially considering that 10-year Treasury yields have virtually doubled from their July lows. However, neither do we expect an imminent reversal in yields, given that Mr Trump's honeymoon period really only starts on January 20th meaning that markets will likely give him at least a few months from the date of taking office to gauge the impact his policies have on growth and interest rates. This means that benign equity market conditions for developed markets could persist for a little while longer.



Source: Thomson Reuters

Monetary policy underpins post-Trump trend

Since the election of Mr Trump as President of the United States, the dollar has strengthened substantially, US yields have surged, equities have rallied and gold has slumped.



Source: Thomson Reuters

Rather than undermine these moves, recent Fed and ECB actions have reinforced them. This can continue for a little while

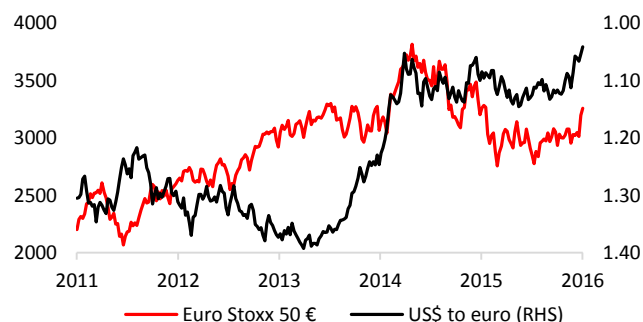
longer, however, ultimately higher US yields and continued dollar strength become self-limiting in that this tightens financial conditions in the US and risks choking off growth, meaning that monetary policy will need to be looser in order to compensate. For this reason we are also sceptical of the FOMC dots, believing that one or two rates hikes in 2017 are more likely than the three currently pencilled in.

What about Europe?

We have been underweight European equities since mid-January, during this time the region has underperformed US equities either by 13% (\$) or by 9% (local currency). European equities look set to end the year on a strong note, however, we caution against extrapolating the performance over the past few weeks into Q1 2017 as there are still significant headwinds facing European equities.

The main problem is we do not see where earnings growth is going to come from. Just like in Japan, the corporate sector in Europe should in theory be enjoying stronger earnings on the back of a weak currency (the euro has averaged 1.11 vs. \$ in the past two years compared with 1.33 in the two years before that). Nevertheless, earnings growth for each of those four years has been negative. More worrying perhaps, is that the consensus systematically over-estimates earnings year after year. 2017 earnings growth expectations are currently 13%, significantly up from the 0% in 2016. However, the last time European earnings growth was positive was in 2011.

Euro weakness not boosting equities sufficiently



Source: Thomson Reuters

Of course it is possible that earnings growth, thanks to a pick-up in the global business cycle does come through in Europe, however, valuations are stretched meaning that scope for disappointment is low. For investors wishing to play currency weakness as a driver of equity returns, we believe the link between Japanese equities and yen weakness is far stronger than between European equities and the euro.

Summary market outlook

| Bonds | | | | | |
|-----------------------------------|--|--------------------|--------------------|--------------------|--------------------|
| Global Yields | Higher Fed funds rate trajectory envisaged by the Fed pushed 10yr yields higher. A hawkish Fed combined with Trump's expected fiscal reflationary policies are likely to keep the upward pressure on yields in the coming weeks. | | | | |
| Stress and Risk Indicators | Resilience in the US equity market fed through to lower levels in the VIX index. However, the index is close to its lower bound which suggests that it is unlikely to go down much further. | | | | |
| Equity Markets | | | | | |
| Local Equity Markets | GCC equity markets were mixed with major markets ending on the lower side. With the oil price stabilizing around USD55 per barrel, regional markets are also expected to move sideways in the near term. However, the strong dollar could create some pressure on the DFM. The next big catalyst will be government budgets in coming weeks. | | | | |
| Global Equity Markets | Global equity markets ended the week on slightly lower, especially EMs were affected by the strong dollar and higher Treasury yields. As the Fed sounded hawkish last week, the strength in the dollar is likely to sustain, which will continue putting pressure on EM equities in the very near term. | | | | |
| Commodities | | | | | |
| Precious Metals | Hawkish Fed and higher interest rate trajectory negatively affected the gold price. Strong dollar could still have downward pressure on the price. However, geopolitical risks and economic risks are here to stay, we therefore stick to our positive view on the gold price. | | | | |
| Energy | A production cut by OPEC boosted oil prices significantly. Near-term sentiment still seems positive for oil, however, we caution against positioning for a further significant rise from here. | | | | |
| Industrial Metals | Industrial metals declined last week, again due to the strong dollar. Moreover, we have doubts about the resilience of industrial metals since most of the demand comes from China and not the United States. | | | | |
| Currencies | | | | | |
| EURUSD | The euro lost against the greenback on the back of the more hawkish Fed. The strength in the broader dollar is likely to continue to exert the pressure on the euro in the very near term. | | | | |
| Critical levels | <table border="0"> <tr> <td>R2 → 1.0799</td> <td>R1 → 1.0625</td> <td>S1 → 1.0322</td> <td>S2 → 1.0193</td> </tr> </table> | R2 → 1.0799 | R1 → 1.0625 | S1 → 1.0322 | S2 → 1.0193 |
| R2 → 1.0799 | R1 → 1.0625 | S1 → 1.0322 | S2 → 1.0193 | | |
| GBPUSD | The broader strength in the dollar also pushed cable lower. We expect downward movement in the currency to continue in the near term, not least because of the political uncertainty in the UK. | | | | |
| Critical levels | <table border="0"> <tr> <td>R2 → 1.2885</td> <td>R1 → 1.2691</td> <td>S1 → 1.2339</td> <td>S2 → 1.2181</td> </tr> </table> | R2 → 1.2885 | R1 → 1.2691 | S1 → 1.2339 | S2 → 1.2181 |
| R2 → 1.2885 | R1 → 1.2691 | S1 → 1.2339 | S2 → 1.2181 | | |
| USDJPY | The yen continued its depreciating trend. The one sided movement in the currency has been sharp over the last few weeks, meaning that a pullback cannot be ruled out. | | | | |
| Critical levels | <table border="0"> <tr> <td>R2 → 121.03</td> <td>R1 → 119.48</td> <td>S1 → 115.56</td> <td>S2 → 113.19</td> </tr> </table> | R2 → 121.03 | R1 → 119.48 | S1 → 115.56 | S2 → 113.19 |
| R2 → 121.03 | R1 → 119.48 | S1 → 115.56 | S2 → 113.19 | | |

Forthcoming important economic data

United States

| Indicator | Period | Expected | Prior | Comments |
|------------|--------------------------|----------|-------|----------|
| 12/21/2016 | Existing Home Sales | Nov | 5.5m | 5.6m |
| 12/22/2016 | GDP Annualized QoQ | 3Q T | 3.3% | 3.2% |
| 12/22/2016 | Durable Goods Orders | Nov P | -4.5% | 4.6% |
| 12/22/2016 | Personal spending | Nov | 0.3% | 0.3% |
| 12/22/2016 | PCE Core YoY | Nov | 1.7% | 1.7% |
| 12/23/2016 | New Home Sales | Nov | 575k | 563k |
| 12/23/2016 | Univ. of Mich. Sentiment | Dec F | 98.0 | 98.0 |

Housing market and consumer sentiment likely to be the focus of the market.

Japan

| Indicator | Period | Expected | Prior | Comments |
|------------|---------------------------------|----------|-----------|----------|
| 12/19/2016 | Exports YoY | Nov | -2.3% | -10.3% |
| 12/20/2016 | BoJ Policy Meeting | Dec | No change | |
| 12/21/2016 | All Industry Activity Index MoM | Oct | 0.1% | 0.2% |

The BoJ's monetary policy meeting is the main event, albeit no change is expected.

Eurozone

| Indicator | Period | Expected | Prior | Comments |
|------------|---------------------------|----------|-------|----------|
| 12/21/2016 | Consumer Confidence | Dec A | -6.0 | -6.1 |
| 12/19/2016 | IFO Business Climate (GE) | Dec | 110.6 | 110.4 |
| 12/20/2016 | PPI YoY (GE) | Nov | -0.2% | -0.4% |

Very little of note in Europe data-wise this week.

United Kingdom

| Indicator | Period | Expected | Prior | Comments |
|------------|-------------------------|----------|--------|----------|
| 12/23/2016 | GDP QoQ | 3Q F | 0.5% | 0.5% |
| 12/23/2016 | Current Account Balance | 3Q | -28.2B | -28.7B |

Industrial production and foreign trade data will be important for the market.

China and India

| Indicator | Period | Expected | Prior | Comments |
|-----------|--------|----------|-------|----------------|
| | | | | No major data. |

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

Disclaimer

This publication is intended for general information purposes only. It should not be construed as an offer, recommendation or solicitation to purchase or dispose of any securities or to enter in any transaction or adopt any hedging, trading or investment strategy. Neither this publication nor anything contained herein shall form the basis of any contract or commitment whatsoever. Distribution of this publication does not oblige Abu Dhabi Commercial Bank PJSC ("ADCB") to enter into any transaction.

The content of this publication should not be considered legal, regulatory, credit, tax or accounting advice. Anyone proposing to rely on or use the information contained in the publication should independently verify and check the accuracy, completeness, reliability and suitability of the information and should obtain independent and specific advice from appropriate professionals or experts regarding information contained in this publication.

Information contained herein is based on various sources, including but not limited to public information, annual reports and statistical data that ADCB considers accurate and reliable. However, ADCB makes no representation or warranty as to the accuracy or completeness of any statement made in or in connection with this publication and accepts no responsibility whatsoever for any loss or damage caused by any act or omission taken as a result of the information contained in this publication. This publication is intended for qualified customers of ADCB.

Charts, graphs and related data or information provided in this publication are intended to serve for illustrative purposes only. The information contained in this publication is prepared as of a particular date and time and will not reflect subsequent changes in the market or changes in any other factors relevant to their determination. All statements as to future matters are not guaranteed to be accurate. ADCB expressly disclaims any obligation to update or revise any forward looking statements to reflect new information, events or circumstances after the date of this publication or to reflect the occurrence of unanticipated events.

ADCB does and may at any time solicit or provide commercial banking, investment banking, credit, advisory or other services to the companies covered in its publications. As a result, recipients of this publication should be aware that any or all of the foregoing services may at time give rise to a conflict of interest that could affect the objectivity of this publication.

Past performance does not guarantee future results. Investment products are not bank deposits and are not guaranteed by ADCB. They are subject to investment risks, including possible loss of principal amount invested. Please refer to ADCB's Terms and Conditions for Investment Services.

This publication is being furnished to you solely for your information and neither it nor any part of it may be used, forwarded, disclosed, distributed or delivered to anyone else. You may not copy, reproduce, display, modify or create derivative works from any data or information contained in this publication.