بنك أبوظبي التجاري ADCB

Geopolitical risks weigh on sentiment, benefitting safe havens

Equity markets finished the shortened trading week lower. Risk-off sentiment was driven predominantly by rising tension between the US and North Korea as well as potential for wider scale US military involvement in Syria. The result was a rotation into traditional safe haven assets, the Japanese yen (+2.2% last week), gold (+2.5%) and US Treasuries (-15bps on the 10-year) all benefitted from the uncertainty. This environment would typically also see a strengthening of the US dollar vs. emerging currencies, however, this did not materialize thanks to a verbal intervention by President Trump, stating in a Wall Street Journal interview that the US dollar is "getting too strong". Emerging Market equities took advantage of this and outperformed developed market equities during the week. The continued rebound in oil prices also offering support.

A cyclical soft patch or a structural slow-down?

The equity rally has stalled with global equities finishing down 3 out of the past 4 weeks. However, overall stocks are only down 1.6% from their mid-March highs, so we cannot yet speak of a real pull-back. Nevertheless, at this stage it does seem likely that equities will struggle to push meaningfully higher unless lofty expectations surrounding the economy and corporate earnings (which have been built into equity prices) are met ***(see our recent note)****. With many "Trump-flation" trades having reversed, the key question now is whether potential further equity market softness in the coming months will merely represent a cyclical slow down or whether it could be a structural shift. Our view is that although risks are growing both to the equity rally as well as the latest economic revival, equities can continue to outperform on a 6-month view. This is founded in our belief that economic data remains reasonably robust and that President Trump still has some levers to pull (tax reform and deregulation). For the week ahead investors will focus on developments in the French elections where round one voting takes place on 23 April. The surge in the polls of far-left Eurosceptic candidate Jean Luc Melenchon has raised the prospect that two Eurosceptic candidates (Marine Le Pen and Melenchon) could face each other in round 2 of the vote on May 7. Previously pollsters had been focusing almost exclusively on two scenarios; Emmanuel Macron vs. Le Pen and Francois Fillon vs. Le Pen. We expect this to weigh on risks assets this week and Eurozone financial markets in particular.*

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,329.0	-1.1	4.0
Dow Jones	20,453.3	-1.0	3.5
Nasdaq	5,805.2	-1.2	7.8
DAX	12,109.0	-0.9	5.5
Nikkei 225	18,335.6	-1.8	-4.1
FTSE 100	7,327.6	-0.3	2.6
Sensex	29,461.5	-0.8	10.6
Hang Seng	24261.7	-0.0	10.3
Regional Markets (Sunday to Thursday)			
ADX	4518.1	-2.1	-0.6
DFM	3509.3	-1.6	-0.6
Tadawul	7076.9	0.0	-1.9
DSM	10451.5	-0.0	0.1
MSM30	5571.62	-0.7	-3.7
BHSE	1356.2	0.2	11.1
KWSE	7007.9	-0.3	21.9
MSCI			
MSCI World	1,832.3	-0.7	4.6
MSCI EM	960.4	-0.1	11.4

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	55.9	1.2	-1.6
Nymex WTI USD/bbl	53.2	1.8	-1.0
Gold USD/t oz	1285.7	2.5	12.0
Silver USD/t oz	18.5	2.8	16.4
Platinum USD/t oz	973.2	1.9	7.8
Copper USD/MT	5655.0	-2.0	2.8
Alluminium	1900.75	-2.7	12.2
Currencies			
EUR USD	1.0618	0.3	1.0
GBP USD	1.2523	1.2	1.5
USD JPY	108.64	-2.2	7.7
CHF USD	1.0055	-0.4	1.3
Rates			
USD Libor 3m	1.1584	0.1	16.1
USD Libor 12m	1.7718	-1.5	5.1
UAE Eibor 3m	1.4677	3.4	-0.5
UAE Eibor 12m	2.2005	1.6	5.0
US 3m Bills	0.8025	-1.3	61.3
US 10yr Treasury	2.2374	-6.1	-8.5

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Political and geopolitical risks rising, but this is not the only thing weighing on equities

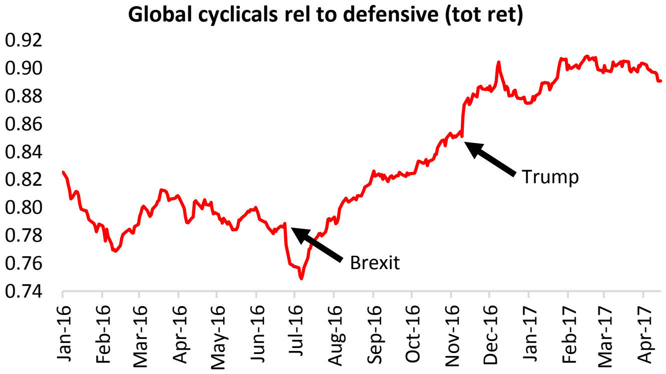
Equity market momentum has stalled due to reflation disappointment, not because rising political risks

Recent tensions between the US and both North Korea and Syria have naturally been headline news, however, we do not believe that it is to blame for the stalling of momentum in equity markets. Stocks have found it difficult to grind higher for several weeks already. The reality is that markets have run a long way in anticipation of improving fundamentals. As is typically the case in a positive market environment, equities have rallied the hardest. The main drivers of the strong equity performance in Q1 were:

1) *Softer US dollar*
2) *Rising US growth expectations on the back of Mr Trump's election*
3) *Expectations of stronger US growth spilling over to other parts of the world*
4) *Chinese authorities continuing to provide stimulus, underpinning EM growth as well*

These four factors combined to create a goldilocks environment for risk assets. Given the scale of the equity rally, the market now requires validation. In other words, hope and optimism have driven equities higher, but these expectations have to be measured against reality. Validation could come in several forms, for example Mr Trump delivering on deregulation or tax reform. It could also come from earnings growth rising strongly or economic data strongly beating expectations.

However, if this validation does not arrive, it is likely markets will be stuck in a weaker environment for a period. We have already seen a number of the so called "reflation trades" unwinding. For example, the performance of cyclical sectors (those benefitting most from a pick-up in growth) rose aggressively post-Brexit and post-US elections. This outperformance has now stalled (chart below). US 10-year Treasuries are another clear example. If US economic growth is genuinely believed to be on a more positive path, treasury yields would have continued to rise in the US. Instead they peaked (twice) at around the 2.64% level and are currently at their lowest levels since mid-November (around 2.24%).



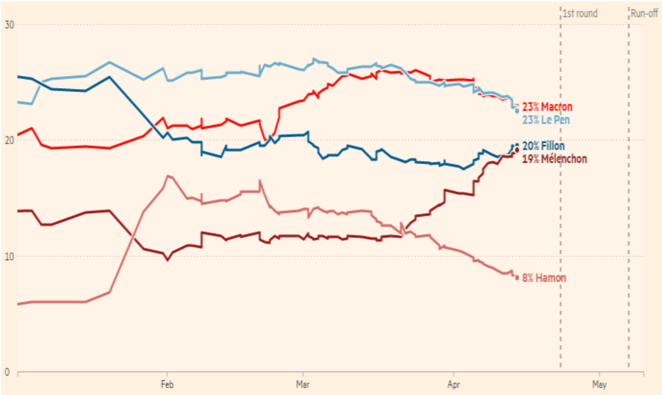
Source: ADCB, Thomson Reuters

On the immediate horizon is Q1 2017 earnings season in both the US and Europe. In the US earnings have already gotten underway but will really get going later this week as the big banks report. For the quarter as a whole the consensus forecasts earnings to be up 6.5% vs. the same time last year (down from expectations of +10.4% late last year). The energy sector is forecast to be the major contributor of overall earnings growth, contributing as much as 4 percentage points to the headline 6.5% growth number. Failure to at least match expectations will further undermine investors' belief in the reflation theme which as powered markets since November.

All options now open in French elections

For several months as Eurozone equities rallied the prospects of far-right candidate Marine Le Pen becoming the next President of France were dismissed. Pollsters have been anticipating her to win the most votes in the first round, meaning she would then face a runner-up in the second round (presumed to be Emmanuel Macron or Francois Fillon) only to then lose by a wide margin. The surge of Jean Luc Melenchon has thrown this consensus into doubt. Second-round polling even suggests that Mr Melenchon would win against all three other main candidates (Macron, Le Pen and Fillon). This would mean a Eurosceptic becoming the next President of France. Markets do not like uncertainty, especially when they have for months been pricing in a victory for pro-EU candidate Macron.

First round voting intention (%) – All options now open



Source: FT

Turkish referendum result creates bond opportunity

Finally a word on the referendum in Turkey which (according to news sources) has been narrowly won by President Tayyip Erdogan. Although the vote highlights the divided nature of the country, following a great deal of political uncertainty ever since last year's failed coup this result could now offer investors the "stability" and clarity they seek to re-enter Turkish bonds and equities. Already the Turkish lira has rallied sharply against the US dollar and we will shortly be initiating a tactical call on Turkish sovereign dollar bonds as well.

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Summary market outlook

Bonds	
Global Yields	The rally in US Treasuries extended for another week, boosted by safe haven demand as geopolitical concerns rose. Slower than expected rise in core inflation cast further doubt on the sustainability of the reflation trade. With the lack of US fiscal policy clarity we expect bond yields to remain supported. In Europe, German bunds also benefitted from the global fixed income rally. We expect OATs-bund spreads to remain under pressure as we inch closer to the first-round of French elections.
Stress and Risk Indicators	Volatility rose with the surge in geopolitical tension coupled with a pull-back in equity markets. The VIX jumped to the highest level since the US elections last year. With ongoing global political uncertainty, we expect volatility to remain high.
Equity Markets	
Local Equity Markets	GCC equity markets were mixed in spite of the weaker dollar and jump in oil prices. We remain neutral on GCC equities given the potential for further dollar strength and limited upside in oil prices.
Global Equity Markets	The rally in global stock markets is showing signs of stalling thanks to the increase in geopolitical tension and scepticism about President Trump's fiscal policy agenda. Global equities ended the week down with the Nikkei being the worst performer, mainly led by sharp yen appreciation. US equities also declined to their lowest level in almost two months. Emerging markets were relatively resilient helped by the softer dollar.
Commodities	
Precious Metals	Gold prices jumped as investors rushed to safe-haven assets amidst the latest political developments. We stick to gold as a risk hedge against the ongoing political and inflationary risks.
Energy	Energy prices rose amidst increasing tension in the middle east. While we expect normalisation to take place, we argue against any significant jump as the rising US rig count and downbeat China demand should weigh on energy prices.
Industrial Metals	Industrial metals were mixed in spite of the weaker dollar. We expect industrial metals to remain under pressure given ongoing concerns around Chinese demand.
Currencies	
EURUSD	The euro rose slightly versus the greenback yet failed to convincingly breach the 1.06 level. We expect the euro to remain under pressure given the upcoming election calendar in key Eurozone countries.
Critical levels	R2 1.0641 · R1 1.0630 · S1 1.0606 · S2 1.0595
GBPUSD	The pound strengthened versus the dollar mainly on account of the weaker dollar following Mr. Trump comments arguing for a weaker greenback. With Brexit risks likely to linger, this is unlikely to sustain.
Critical levels	R2 1.2554 · R1 1.2539 · S1 1.2505 · S2 1.2486
USDJPY	The yen appreciated against the dollar driven by the safe-haven demand. However, this trend is unlikely to continue given the potential for dollar strength.
Critical levels	R2 109.48 · R1 109.06 · S1 108.38 · S2 108.13

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
04/17/2017	NAHB Housing Market Index	Apr	70	71	Light week in terms of data. Industrial Production and Manufacturing PMI will be important.
04/18/2017	Housing Starts	Mar	1250k	1288k	
04/18/2017	Building Permits	Mar	1250k	1216k	
04/18/2017	Industrial Production MoM	Mar	0.40%	0.10%	
04/18/2017	Capacity Utilization	Mar	76.1%	75.9%	
04/21/2017	Markit US Manufacturing PMI	Apr P	53.5	53.3	

Japan

	Indicator	Period	Expected	Prior	Comments
04/20/2017	Exports YoY	Mar	6.20%	11.30%	Attention will be on the exports print.
04/21/2017	Tertiary Industry Index MoM	Feb	0.30%	0.00%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
04/19/2017	Trade Balance SA	Feb	18.5b	15.7b	PMI and CPI will be the main focus this week.
04/19/2017	CPI YoY	Mar F	1.50%	1.50%	
04/19/2017	CPI Core YoY	Mar F	0.70%	0.70%	
04/20/2017	Consumer Confidence	Apr A	-4.8	-5	
04/21/2017	Markit Eurozone Manufacturing PMI	Apr P	56	56.2	

United Kingdom

	Indicator	Period	Expected	Prior	Comments
04/21/2017	Retail Sales Ex Auto Fuel YoY	Mar	3.80%	4.10%	Retail sales data will be important.

China and India

	Indicator	Period	Expected	Prior	Comments
04/17/2017	Retail Sales YoY (CH)	Mar	9.70%	10.90%	China GDP and India WPI will be the main focus.
04/17/2017	Fixed Assets Ex Rural YTD YoY (CH)	Mar	8.80%	8.90%	
04/17/2017	Industrial Production YoY (CH)	Mar	6.30%	6.00%	
04/17/2017	GDP YoY (CH)	1Q17	6.80%	6.80%	
04/17/2017	WPI YoY (IN)	Mar	6.00%	6.55%	

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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