Multi-asset markets outlook

November 2016

General overview

Mister President

We have cautious portfolio positioning

	Portfolio	BM	active
Equities Developed Markets	22.0%	25.0%	-3.0%
Equities Emerging Markets	5.0%	5.0%	
Real Estate Equities	5.0%	5.0%	
Commodities	5.0%	5.0%	
Core Gov Bonds 1-10	16.0%	20.0%	-4.0%
Core Gov Bonds 10+	7.5%	7.5%	
Investment Grade Corp Bonds	24.0%	20.0%	4.0%
High Yield Corp Bonds	5.0%	5.0%	
Emerging Market Bonds LC	5.0%	5.0%	
Cash	5.5%	2.5%	3.0%
EUR/USD	-4.5%	0.0%	-4.5%
EUR/JPY	1.5%	0.0%	1.5%
EUR/GBP	0.0%	0.0%	
EUR CASH	3.0%	0.0%	3.0%

- Remarkable. That's the best way to characterize the speed with which the stock markets went from fear to faith in less than 24 hours following the surprise Trump victory. Reflation was all of a sudden the name of the game. Tax cuts and new bridges for all! Good news for equities (the Dow Jones Industrial Average managed to reach a new all-time high), but bad news for bonds. Tax cuts and new bridges stimulate the economy (=more inflation) and cost a lot of money (=more debt), which explains why bonds bore the brunt of it.

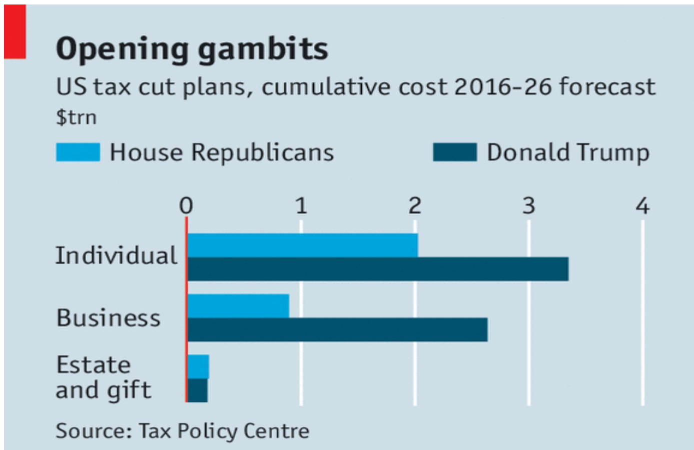
- To us this sounds like a pretty one-sided interpretation of what may be in store. Sure, Trump has mentioned taxes and infrastructure, but what about bringing back jobs from China, canceling the Nafta trade agreement, and deporting millions of undocumented foreigners? These kinds of measures are certainly not going to boost domestic demand, and could come as a shock to a financial system that was not looking very strong to start with. The Great Depression was so great because of the trade wars that took place during that period.

- Timing is everything. Although we see an increase in risks and uncertainty, the market has opted to go for the positives. Markets can be irrational longer than we would like to see, which is why we currently have a tight stop-loss in our short position in equities, but we remain underweight government bonds.

Economy

Our highlight this month: Trump triumphs

US tax cut plans



Economist.com

Ifo: Trump presidency viewed as 'major risk' to world economy

Assessments by WES experts of the impact of the following situations on their country's economy*

Economic or political risks	Slowdown of the economy in China	Trump as American President	Clinton as American President	Problems in the EU	Threat of terrorist attacks	Emerging markets crisis
World	-56.5	-42.8	5.9	-50.5	-32.6	-40.0
North America	-45.9	-51.0	-17.2	-37.9	-43.1	-42.5
Asia	-74.7	-39.2	7.7	-45.4	-32.8	-42.0
Latin America	-40.8	-62.4	29.4	-33.6	-13.5	-63.8
Western Europe	-50.4	-44.2	10.6	-66.8	-31.7	-29.6
Eastern Europe	-34.2	-33.5	10.7	-61.3	-21.5	-27.7
Near East	-40.8	-31.4	-2.7	-33.5	-30.7	-40.7
CIS	-46.9	-13.1	-12.3	-33.9	-41.5	-59.9
Africa	-35.2	-30.6	20.0	-45.4	-40.2	-59.5
Oceania	-88.2	-56.9	16.2	-40.1	-23.9	-68.1

Colour scale: -100 high negative impact, -50 negative impact, 0 no impact, +50 positive impact, +100 high positive impact. *The individual country responses were aggregated to regions. Within each country group, the results are weighted according to the share of the specific country's exports and imports in the total world trade.

Source: Ifo World Economic Survey IV/2016.

- With a Republican majority in both the Senate and the House of Representatives, President Trump has a strong position from which to implement his agenda. There is, however, huge uncertainty about the nature of this agenda, and his priorities for the composition of his team. A more likely isolationistic stance could increase geopolitical risks in a number of flashpoints. Any US president has a large room for maneuver on trade policies. TPP and TTIP will in any case be filed away for an indefinite period. During the campaign, Trump has moreover threatened to tear up major trade agreements, and to slash hefty tariffs on, for example, Chinese and Mexican imports, after which retaliatory measures can be expected. As a consequence, we consider a US-Chinese trade war to be a major risk which could cause major collateral damage to the world economy.

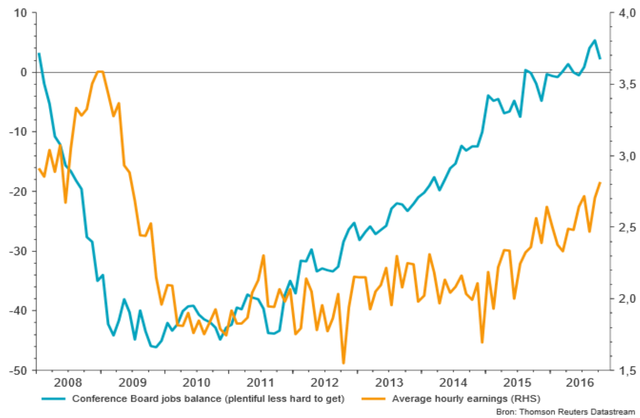
- For the US economy, a major fiscal stimulus involving the improvement of infrastructure is to be expected. Furthermore, huge tax cuts will be proposed, as well as incentives for companies to repatriate cash held outside the US. Less regulation for the financial and energy sectors will give an additional boost to the domestic economy.

- On balance, risks to the feeble world economy have risen, and are clearly tilted to the downside.

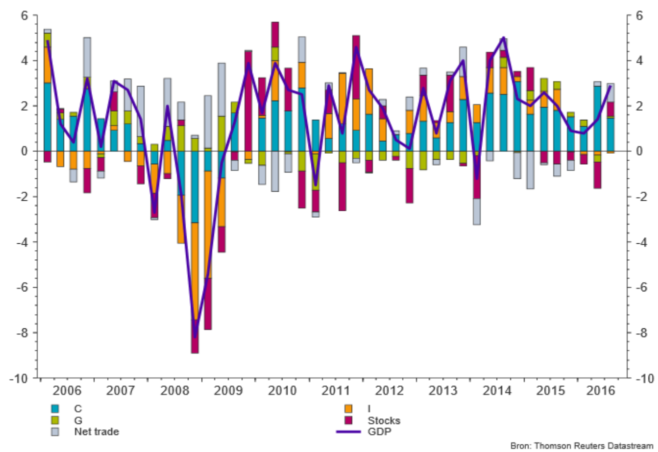
Economy

United States

Rising wages and consumer confidence



Q3 GDP growth was less driven by consumption



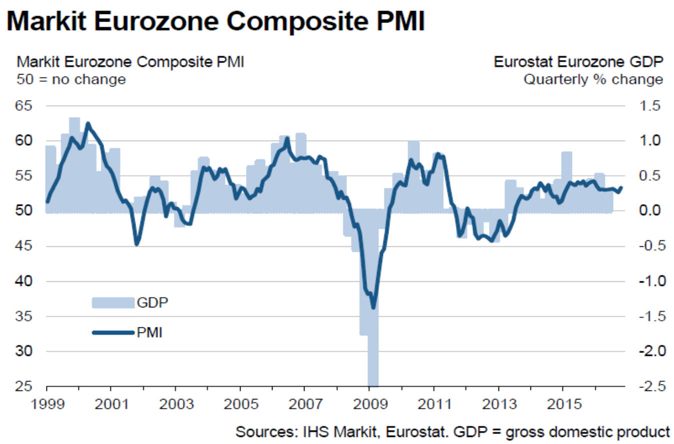
- The US economy failed to accelerate in the third quarter. Moreover, growth was driven by one-off boosts in exports, and by the building up of inventories. Consumer growth declined. Prospects for consumption growth are improving nevertheless as wage growth is steadily improving, also leading to a steady rise in consumer confidence.

- Trump’s surprise win initially led to some turbulence, but stock markets recovered remarkably quickly. If this calmness persists, the way is open to a modest rate hike by the Fed in December. Core PCE is 1.9%, so it is very close to the 2% target, and it could be argued that the US economy is close to, or is at, full employment. Earlier, the Fed had signaled a December rate hike. But during the campaign, Trump had accused the Fed of an overly accommodative monetary policy to support his rival, so pressure is high. Nevertheless, should volatility return to financial markets, a policy of holding rates is more likely.

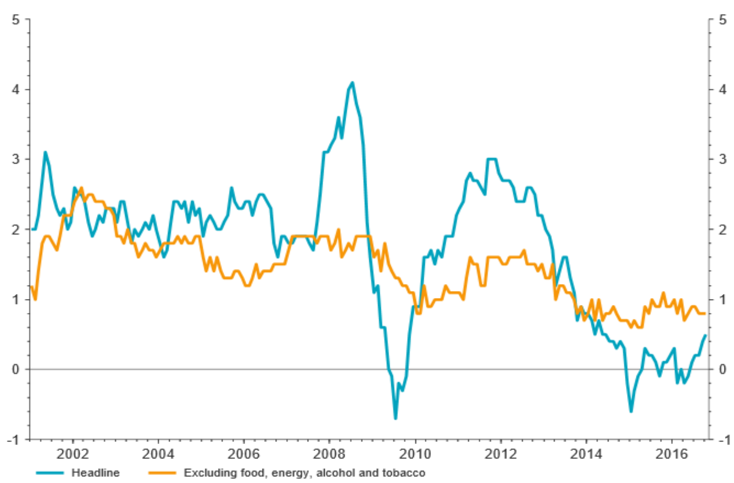
- Uncertainty over future policy is high. Will President Trump give priority to tax cuts and massive infrastructure spending increasing growth, or will the focus be on trade and the deportation of illegal immigrants, which is probably detrimental to growth?

Europe

Stronger Eurozone growth was led by Germany



Core inflation is going sideways

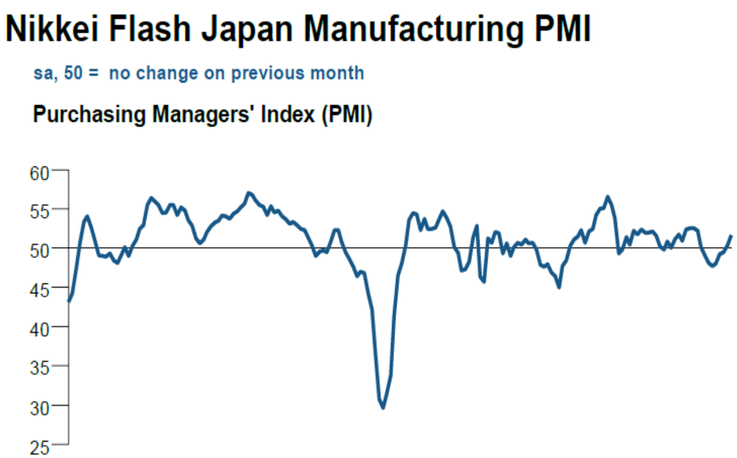


- Once again, Germany turns out to be a major growth driver in the euro area. Spain is also doing fine, and some sort of political stability has returned to the country, with the return of Rajoy as prime minister of a minority government. However, Italy continues to be a major headache, with an economy that is almost coming to a standstill. This is bad news for Prime Minister Renzi ahead of the 4 December referendum on constitutional reform. Polls suggest that he will lose, which given the current global wave of populism isn't a surprise. It is unlikely that this will provoke fresh elections, as the Italian President will do his utmost to prevent this. It cannot even be ruled out that Renzi, after his inevitable resignation, will be invited to head a reshuffled cabinet. Short-term political stability is therefore likely ensured, but major longer-term worries will persist.

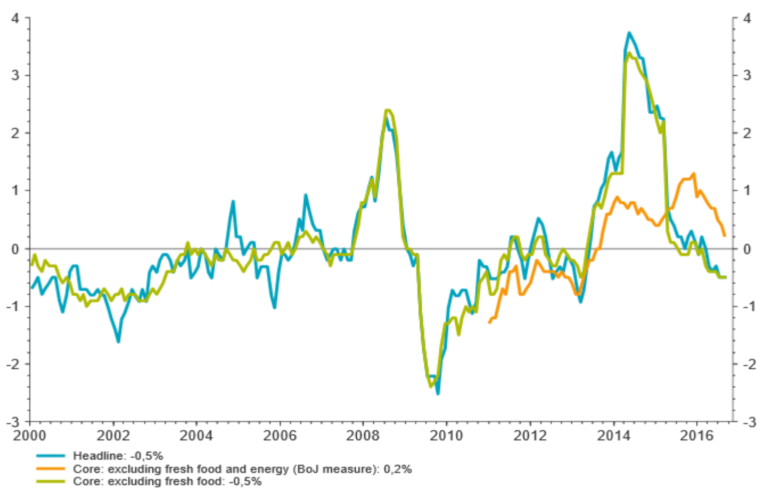
- Headline inflation is rising steeply in the Eurozone, but core inflation is moving sideways. The ECB has postponed its policy decisions to its December meeting, when working committees will report on policy options. We don't expect the decision-making council to be in the mood to declare victory and scale back its quantitative easing program. More likely it will opt for an extension of the QE program with six months. Increased global economic and political uncertainty and looming presidential elections in France suggest the need for continuing accommodative policies.

Japan

Japanese manufacturing continues to improve



Japan is still heading towards deflation



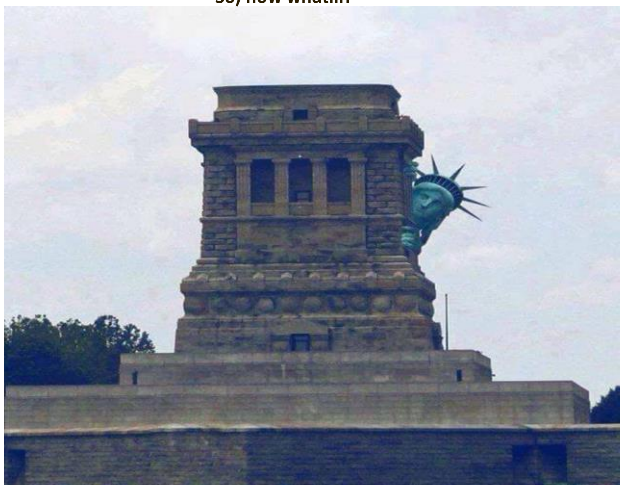
- As suggested by the manufacturing PMI, industrial production is on the rise. The domestic economy is also improving. Housing starts are increasing, and the continued rise in labor income helped by the tight labor market paves the way for an increase in consumption. The outlook for Q4 GDP growth looks promising for once.

- The deflationary trend in Japan on the other hand shows now signs of abating. It is likely that the core inflation rate preferred by the BoJ will touch 0% in the coming months. BoJ Governor Kuroda has now conceded that the inflation target of 2.0% won't be reached during his term (ending April 2018). The BoJ will nevertheless probably refrain from lowering short and long-term interest rates further, as financial institutions oppose this, and the negative interest rate policy is unpopular with the electorate. As the BoJ already owns more than a third of Japanese government debt, it probably also has to scale down is buying program. Basically, the BoJ is standing pat, and is waiting for meaningful additional fiscal stimulus by the Japanese government. Speculation is rising that the government will indeed compile another extra budget for this fiscal year.

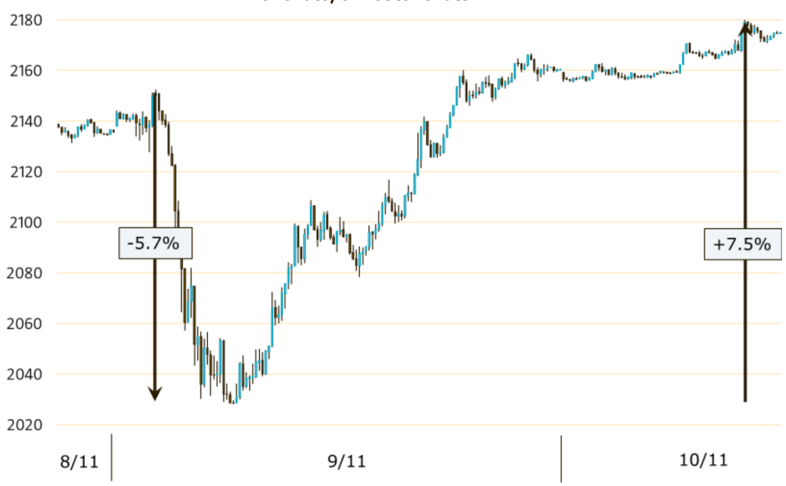
- The Japanese parliament has ratified the Trans-Pacific Partnership (TPP) from which China was excluded. As Trump will probably bury the TPP, this creates an opportunity for Beijing to push for its more inclusive Free Trade Area of the Asia-Pacific.

Equities (I)

So, now what...?



To reflate, or not to reflate?

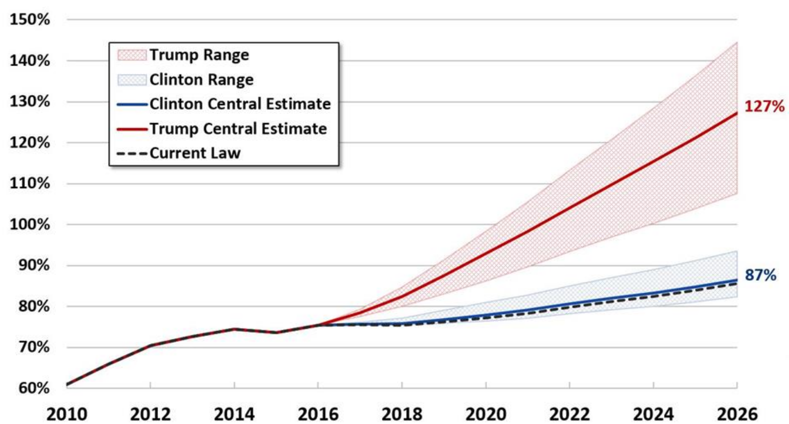


- From fear to faith. That's the best way to describe the stock markets' reaction following the outcome of the election of the 45th President of the United States. Once it became clear that Trump was on his way to win, financial markets reacted in a massive risk-off fashion, with bonds rallying and stocks crumbling. Trump, the man who threatened to reject the North American Nafta treaty, to deport millions of undocumented foreigners, and even to jail his 'nasty' opponent, as the next President? All cards were taken of the table and markets tanked. Just around the time that Europe woke up, markets started to bottom out, and by the time Trump took the stage for his victory speech, the recovery was on the way. Trump managed to strike the right tone, which further eased concerns. By the time the US markets opened, gone was the fear, and the attention had clearly shifted from the potential negatives to the possible positives. From fear to faith in less than 24 hours.

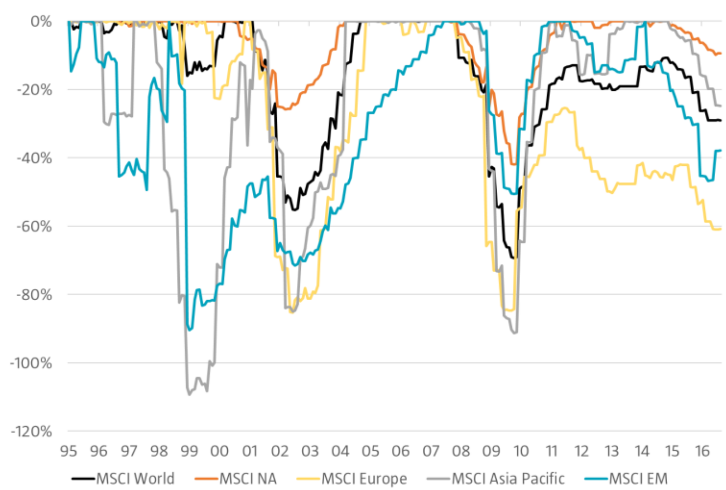
- Faith in what? Faith in the 'good' part of the many election promises Trump has made. The promise to boost the US economy, or – to use the latest buzzword – to reflate the economy. Specifically, Trump indicated that he would boost infrastructural spending (a wall, anyone?) and cut taxes for US households and the corporate sector. Clinton would have gone down the same route, but it is clear that Trump's plan are much more ambitious on both counts. Finally **>>**

Equities (II)

Spending it is! Or is it?



With the exception of emerging markets, earnings have been falling universally



- a country that is not solely dependent on monetary policy, but will benefit from the positive cocktail of both fiscal and monetary stimulus! Markets rejoiced.

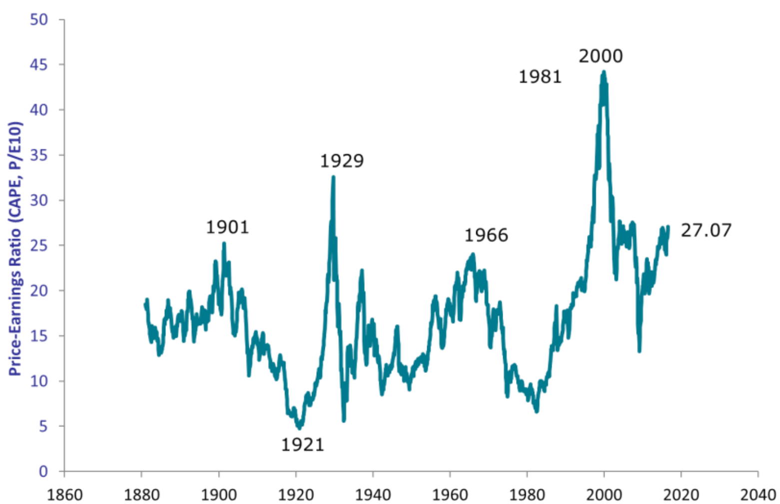
- We do not want to be party poopers, but we have some problems with the positive twist that markets are currently embracing. For one thing, the tax cuts that Trump has spoken of so far seem to be mostly aimed at the rich and the corporate sector, parts of the economy that are not exactly the driving force behind domestic demand. Infrastructural spending will have a more direct impact, but as a general rule, the multiplier effect of this kind of spending is quite low. Although both measures will stimulate the economy, it is questionable whether this is the most effective way to 'reflate' it. More importantly, cutting taxes and boosting infrastructural spending will have a pretty negative impact on the government deficit, and will boost outstanding debt. This may not be a big concern for Trump, but is happens to be one of the principle no-go areas for the influential Tea Party members within the Republican party. Putting together a plan that will be passed by Congress may much less easy than the market currently seems to assume.

- So much for the positive element of the Trump plans. As for the negative bits, the trade front is the risky bit to be concerned about. US Presidents have a **>>**

Equities (III)

Macro data offered limited direction this month

Shiller PE is at its highest level since 2007



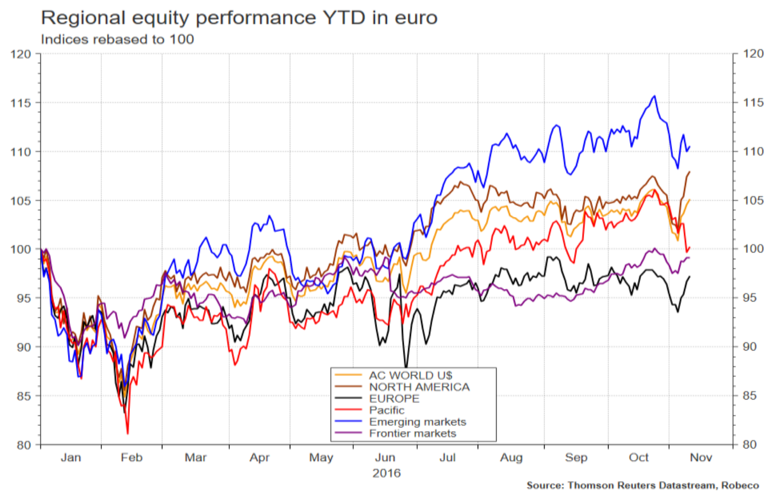
- far-reaching degree of freedom with respect to trade relations, requiring no approval of Congress to revoke existing trade deals. Mexico and China are the most direct targets, but with a structural current account surplus of 9% of GDP, it is clear that Germany is not outside the danger zone either. Things could get nasty for all parties involved.

- The biggest problem is that no one knows which policy mix the newly elected President is going to follow. Based on his past track record, temperament and keeping the path of least resistance in mind, we think the odds for a negative outcome outweigh those of a positive one. Looking beyond Trump, it is clear that electorates around the world are moving away from status quo, something that may produce adverse results in the upcoming European elections as well. Trump's victory has added a lot of uncertainty to a system that was not looking very strong to start with. As such, we are inclined to stick to our underweight position in stocks.

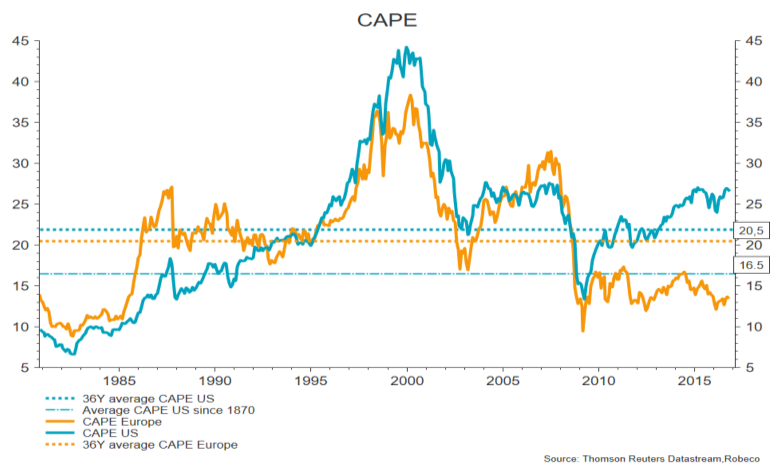
- Having said that, timing is everything. Even if we are heading for an adverse scenario somewhere down the road, it could very well be that the current sense of optimism will dominate in the short run. For this reason, we currently have a pretty tight stop-loss position in place.

Developed Market Equities

The US takes the lead again



CAPE shows US optimism

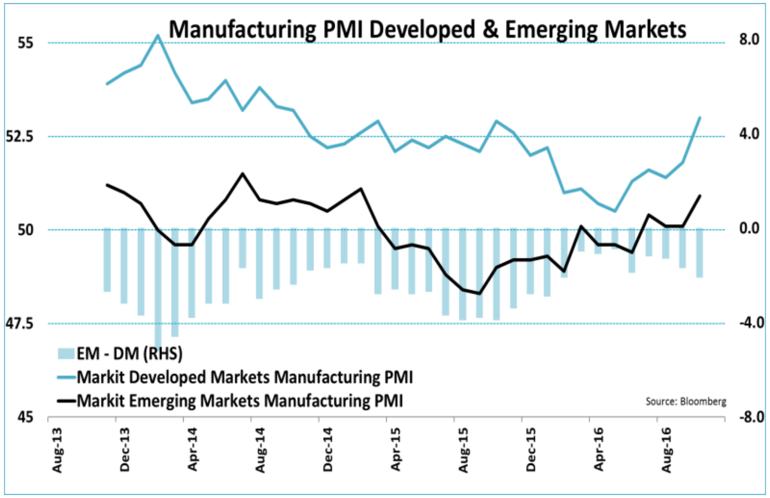


- Global stock market momentum on a one-month basis in euros has turned positive after the US elections, with US stocks currently showing the strongest momentum. Asia-Pacific stock showed negative momentum, partly as the yen depreciated against the euro on safe haven flow reversals and a somewhat bleak macro outlook. European equities did marginally better against the threat of a hard Brexit, the upcoming Italian referendum and uncertainty about the economic consequences for the region from a Trump presidency. With the market hoping for a business-friendly environment for US corporates, momentum for US stocks could remain strong, so long as Trump does not show his 'trade war' card. Longer-term momentum (12m-1m) favors Pacific equities within developed markets, closely followed by US stocks.

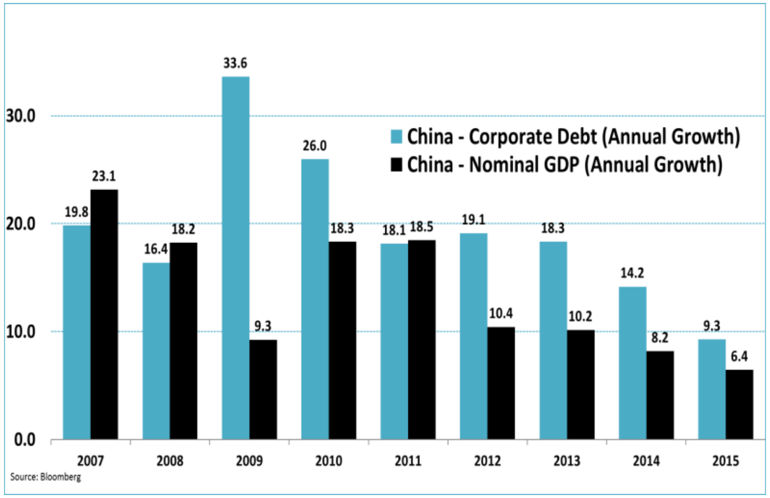
- Developed equity valuations based on CAPE barely moved last month, as improved earnings growth largely tracked price developments. On this CAPE metric, Europe still shows a discount to the US, a discount which first emerged from the early days of the Eurozone crisis. The fact that political risks are higher in Europe explains a significant part of this discount. It remains an open question whether US economic uncertainty will rise under a Trump presidency relative to Europe's, which would converge valuation levels. We prefer US equities to Asia-Pacific and Europe.

Equities: Emerging vs Developed (I)

EM v DM Manufacturing PMI



China's credit-led growth model



- In October, the outperformance of emerging markets stalled. As tensions surrounding the US presidency grew, emerging markets gave back the outperformance they had realized earlier in the month.

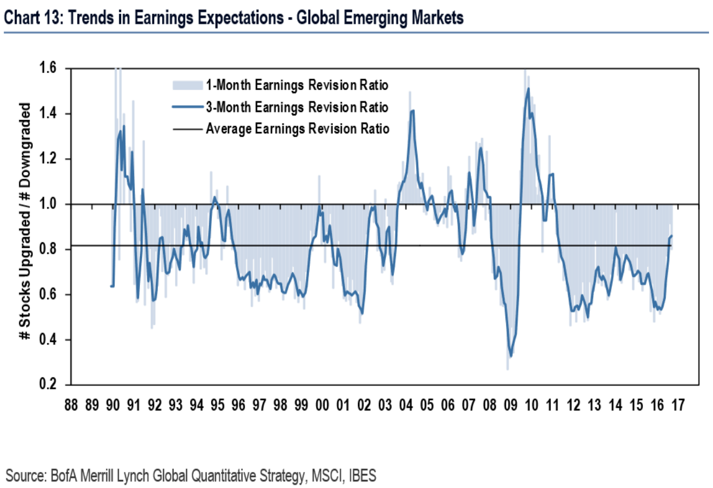
- The graph on the top left shows that Manufacturing PMIs are rising globally. The EM Manufacturing PMI recorded its third straight reading above 50, continuing the upward start trend that started in September 2015. However, the graph also shows that EM still lags developed markets. In fact, the gap between EM and DM PMIs increased for the fourth consecutive month. This underpins the fragile nature of the improvement of emerging economies as they work through a vast list of economic problems (Brazil, South Africa, Russia) and political issues (Brazil, South Africa, Turkey, and most recently, South Korea).

- China has been the elephant in the room with its unsustainable credit-led growth model for sever years now. The chart on the bottom left shows credit growth outpaced nominal GDP growth in every year except 2011. But China also has proven itself to be a master of kicking the can down the road. China remains a risk, but at the same time the government is trying to reduce the amount of (bad) loans in the system. The stimulus earlier this year buys time.

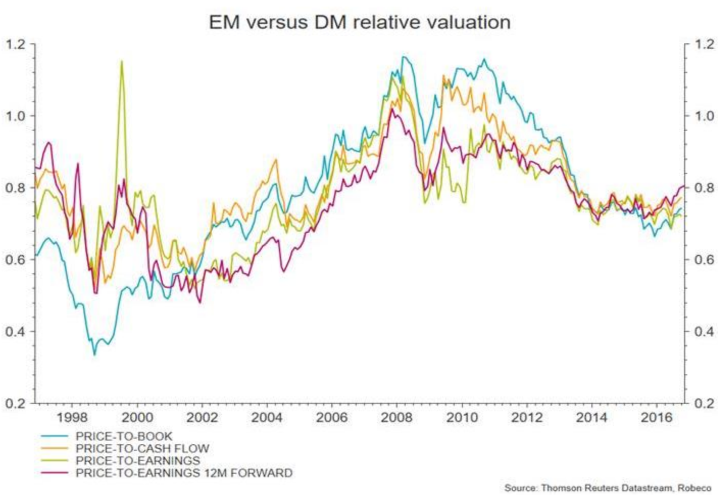
ROBECO

Equities: Emerging vs Developed (II)

Earning revisions



The valuation discount



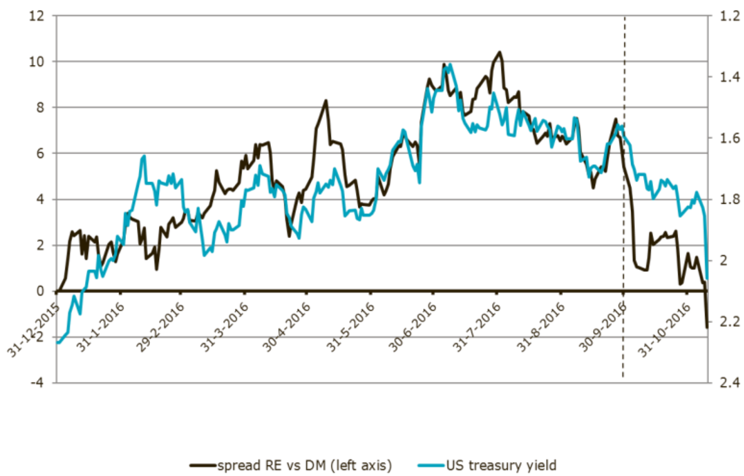
- Recently, another elephant has entered the room. President-elect Trump has been very vocal on global trade, and trade wars can't be ruled out at this point. Emerging markets have proven very vulnerable to trade disputes, which could also provoke protectionist measures. As far as we can judge now, the future Trump presidency poses risks for emerging markets.

- The fundamentals still look pretty decent though. Earnings are growing (after years of decline) and analysts are becoming more upbeat. Although we should add that this is also the case for other regions, emerging markets are somewhere in the middle. Valuations continue to be attractive, albeit less so than they were earlier this year as emerging assets rallied.

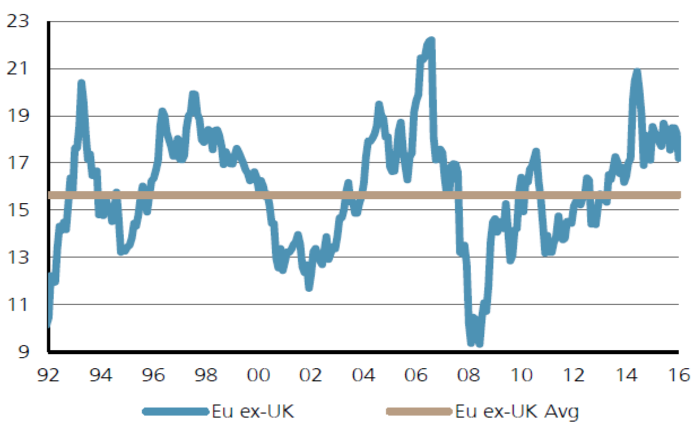
- As the surprise US election outcome brings more uncertainty, we think this will be priced into riskier assets. Given the outspoken language of Trump on international trade, emerging countries look vulnerable to any form of restrictions that hamper world trade. As we already reduced emerging markets to neutral based on the Fed and the US dollar (we still think a Fed rate hike in December is on the table, but with a reduced chance) mid October, we now hold a small underweight of emerging equities in the portfolio.

Real estate

Relative performance of real estate



Valuation of European real estate is above average



Source: Worldscope, I/B/E/S, DataStream, UBS estimates, as of 28 Oct 2016.

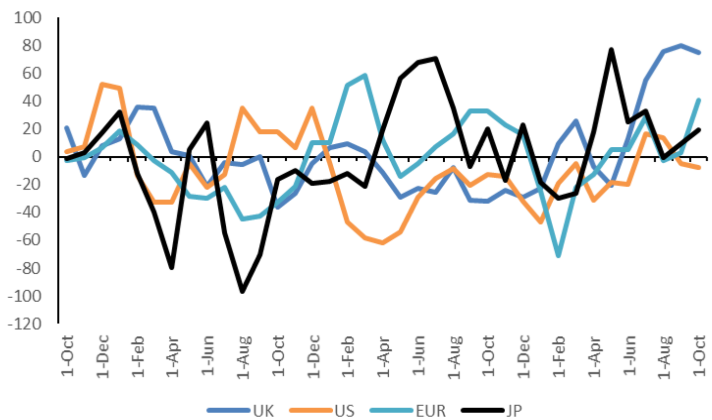
- Before the presidential elections, bond yields in the US were already on the rise, a process which accelerated after Trump was elected president. These rising bond yields had a strong impact on real estate performances. In a short time, the S&P developed real estate index (USD) erased its prior solid year-to-date outperformance against global equities, declining 5% in October and falling a further 2.7% in the first 10 days of November.

- Real estate declined on a broad level. In continental Europe, where bond yields also rose, its performance wasn't any better. Real estate in the UK has been a major underperformer since the end of June, when the British people voted for Brexit. Since then, all segments of the market plunged by nearly one third. The fact that the British parliament probably has to vote on the Brexit decision did not improve sentiment. Valuations in the UK are of course lower, but are still relatively high, just as they are elsewhere in Europe and the rest of the world.

- We expect bond yields to rise in the coming period, in the US as well as in Europe. This makes real estate less attractive compared to equities. We still have a neutral stance for now, but we are carefully watching the bond markets going forward.

AAA Bonds (I)

Economic momentum is improving



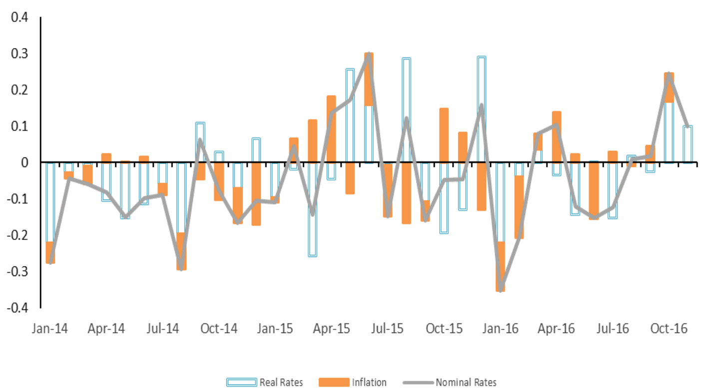
Divergent rates expectations between the Fed and market after December 2016

- The fact that Trump managed to take the White House while the Republicans also secured a majority in both the House and Senate means there is now an opportunity to break the political gridlock and implement change. By itself, this should be seen as a positive. The one problem is that no one currently knows which direction this change will take. In the run-up to the elections it was difficult to distinguish between rhetoric and serious political intentions. What seems to be on table are tax cuts, infrastructure spending and protectionism. The latter will be a major risk for global trade and geopolitics. Depending on how determined Trump is to deliver on his promises, the longer-term impact looks to be inflationary. In the shorter term, the uncertainty regarding fiscal and monetary policy will have an upward impact on yields, as risk premiums will need to rise to compensate for it.

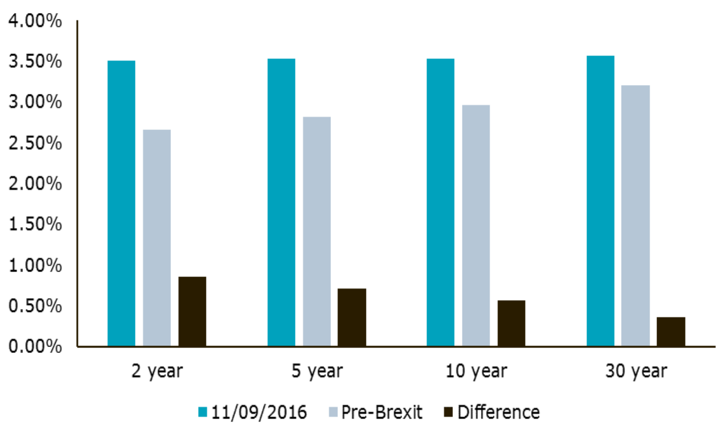
- Rising yields is also what October brought us. As always, it is difficult to determine the exact trigger for this move higher. One thing we think played a part was the general improvement in growth numbers. Producer confidence numbers have rebounded, and even though third-quarter growth was not overly solid, the rise in US wages is inflationary, as well as a sign that domestic demand will remain solid moving forward.

AAA Bonds(II)

1-month changes of European 10-year swap rates dissected



After Brexit, inflationary pressures are building in the UK



Source Bloomberg

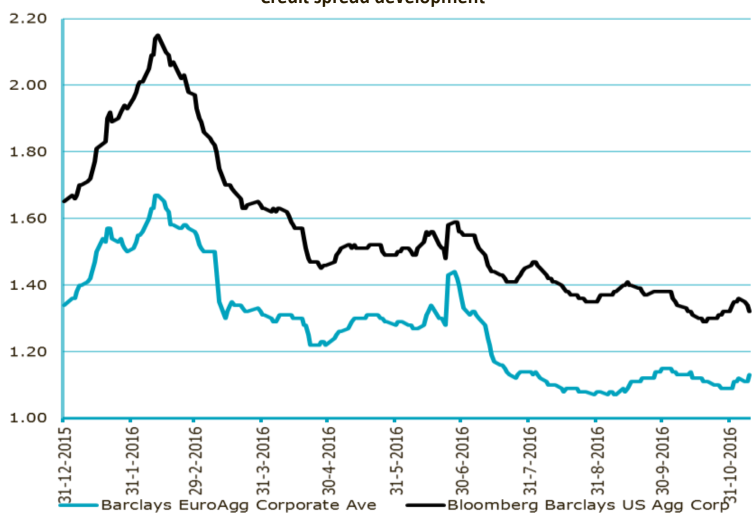
- The deflationary risk has firmly diminished, but we remain far away from inflation levels that would be a concern for central banks.

- While yields in general moved up in October, not all yield rises were equal. In the UK and the US, the driver of nominals yields was rising inflation expectations, reflecting the inflationary pressures that are building in these regions. In the Eurozone and Japan, the driver of the yield rises was real yields, and is more related to a possible change in the respective central bank policy.

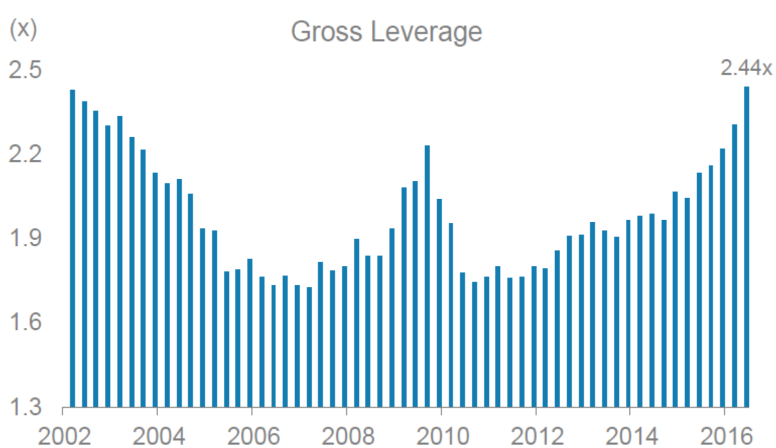
- Before the US election result, we would have been more confident that the Fed would raise rates in December; we are less so now. It's not that we think that a rate hike is no longer warranted, but we think the Fed will want to keep its powder dry until there is more visibility of the policy priorities of the president-elect. Although we think that ECB President Draghi will seize the opportunity to push through an extension of the asset purchasing program, we still think the window remains open to be underweight European bonds. The policy outlook in the US will have an upward pressure on US yields, and we don't think that European rates will decouple from what happens with US yields.

Investment Grade Credits (I)

Credit spread development



Leverage of US corporates at historically high levels



Source: Morgan Stanley, Bloomberg

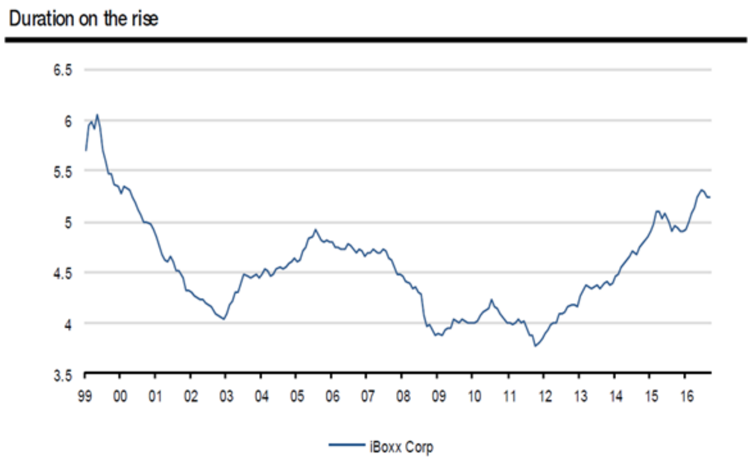
– The spread movement in the US moved along with the polls of the presidential election. In absolute terms they were hardly moving, and they showed the same volatility as the sovereign bond market, both before and after the election results, ending just below the end of September levels on 9 November.

– The relative non-movement in spreads is remarkable, as the volatility in financial markets around the election day was significantly higher than in the months before, but apparently other rules and laws apply for this part of the financial markets. And yet, the risks for US credits are out there: at a macro level, a possible rate hike was and is looming, the election of Trump will cause volatility by itself, and on corporate level, balance sheet leverage is above 2009's levels.

– The latter is no surprise given the low interest rates we have seen for years. Besides the higher leverage, corporates are issuing bonds with longer maturities. The average duration of credit indices is now well above 5 years (see the next page). This makes the total return on credits as a group more vulnerable to changes in overall interest rate levels. And indeed, we have seen in recent months that returns in the credit markets were mostly due to changes in the sovereign markets.

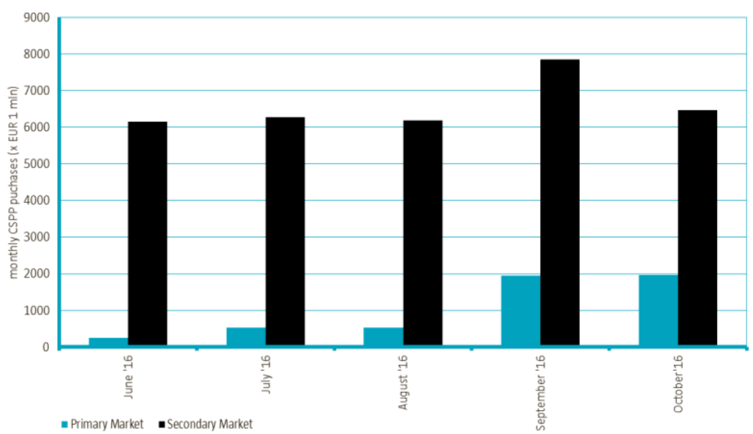
Investment Grade Credits (II)

Credit duration above 5 years



Source: SG Cross Asset Research/Credit

The ECB already bought EUR 38 bln in corporate bonds

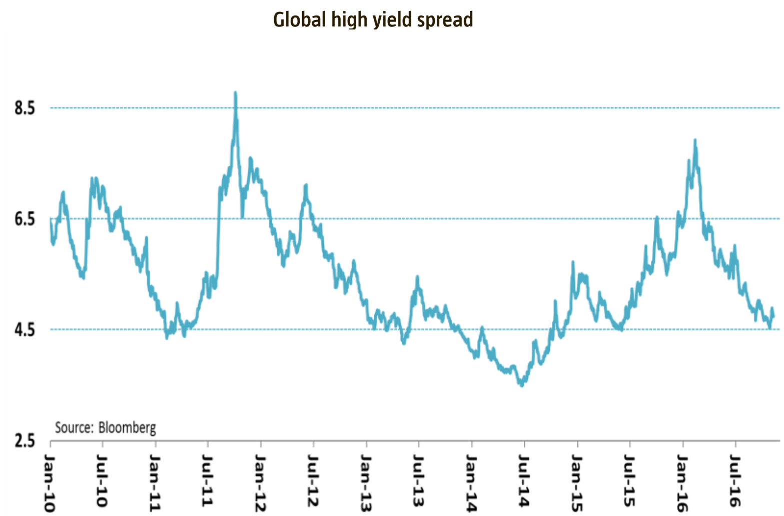


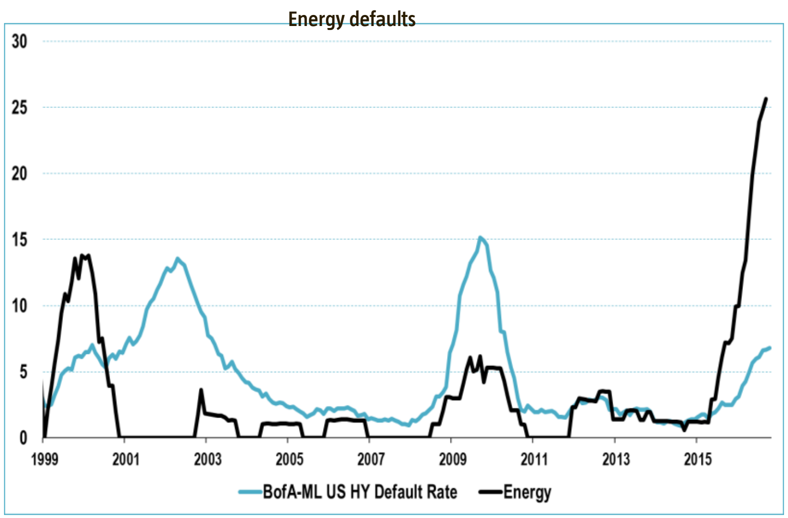
- European credit spreads seemed to be unaffected by the election news storm and tightened just several basis points below their end-of-September levels. The Corporate Sector Purchase Program (CSPP) in the Eurozone is still running until March 2017 at least. At the last ECB meeting, Draghi didn't discuss a possible extension of the program after March, or a possible tapering. We expect however that the ECB's December meeting will choose to extend the program by six months. This still gives enough backing for European credits to withstand rising interest rates and the aftermath of the Italian referendum on 4 December.

- The Bank of England's Corporate Bond Purchase Scheme (CBPS) has the same effect on credit spreads in the UK as the CSPP has in Continental Europe: nothing else matters. In a month when that the British High Court ruled that a vote on triggering Article 50 needs to be taken by Parliament, spreads didn't show any signs of a change in risk attitude.

- We have an overweight position in European credits as the ECB will be in the market as the 'ultimate buyer' for the coming period. We are more cautious on US credits, as the risks are increasing there on multiple levels. The higher credit spread than in Europe doesn't compensate for that.

High Yield (I)





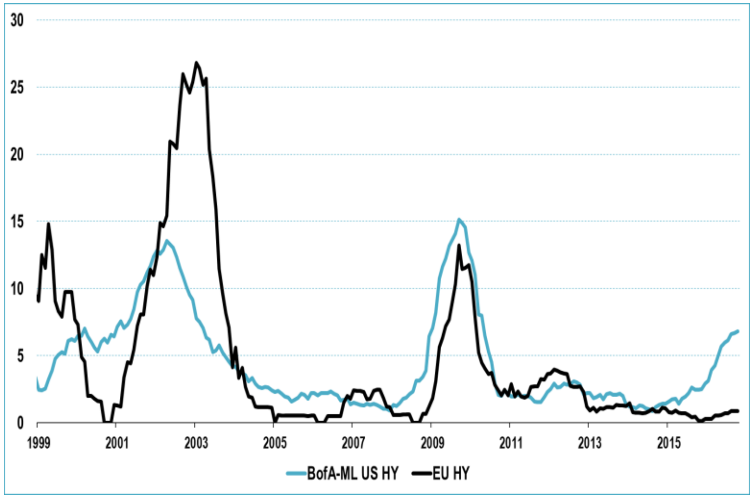
- During October, the global high yield spread hardly changed. Initially, spreads contracted as investors kept looking for yield, and commodity prices stood their ground. Towards the end of the month, however, as Trump emerged as the potential victor in the US presidential race, spreads began to widen.

- With Trump elected President, the outlook for high yield bonds has become murky. On the one hand, the uncertainty it brings isn't good news for risky assets, as it means both producer and investor sentiment deteriorates, which could hamper growth. Slower growth could, in turn, negatively impact commodity prices, which would cause spreads to wider further, as was seen at the beginning of the year. OPEC seems to be a wildcard at this point, as any tangible decisions on production cuts remain idle.

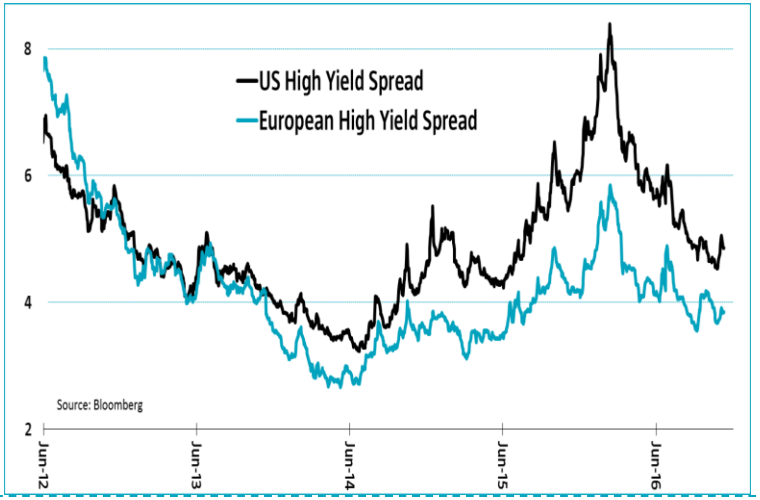
- On the other hand, Trump has declared that he would reduce regulations that restrict the production and use of fossil fuels, and withdraw support for international Climate Change agreements. This should be considered a positive for US high yield energy companies. In addition, infrastructure investment is one of the showpieces of Trump's economic plan, hence industrial companies, especially locally operating ones, could also benefit.

High Yield (II)

US and European default rates



US and European spreads



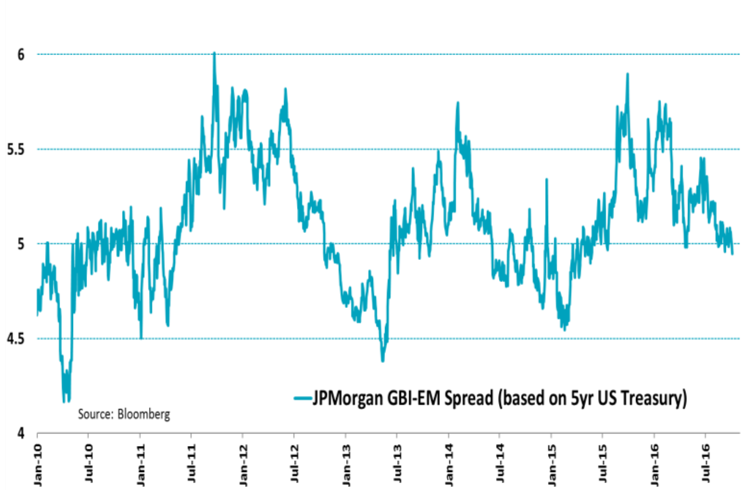
- Before the elections, US high yield companies were working through a commodity-led default cycle, and there was some light at the end of the tunnel. But the lack of visibility makes it hard to judge how this will now proceed. In Europe, defaults have start to pick up, albeit at a very moderate pace.

- For European high yield bonds, the bond-buying program by the ECB remains a positive, as it pushes investors higher up the risk curve. In addition, with recent events, the chances of tapering have been greatly reduced. We expect the ECB to extend its bond-buying program until September 2017. With reasonable growth in the Eurozone in the next few quarters, we think the risk of a severe spread widening remains slim.

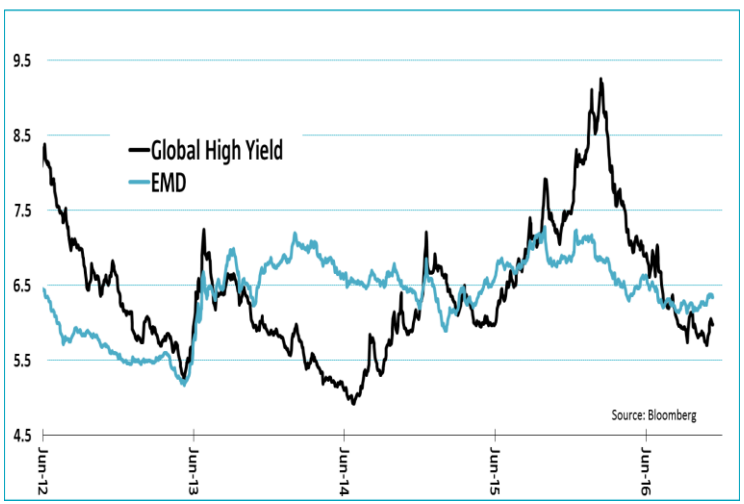
- We have argued before that in recent months, valuations of high yields bonds have become less attractive as spreads have tightened. With Trump's unexpected victory, political uncertainty has increased, and risk has to be repriced. However, as some important sectors within in the high yield universe could benefit from Trump's economic agenda, and the ECB will continue buying bonds in Europe, we keep a neutral weight in the portfolio.

Emerging Market Debt (I)

Emerging Market Debt spread based on the 5-year US Treasury yield



Yield to Maturity: emerging market debt v high yield



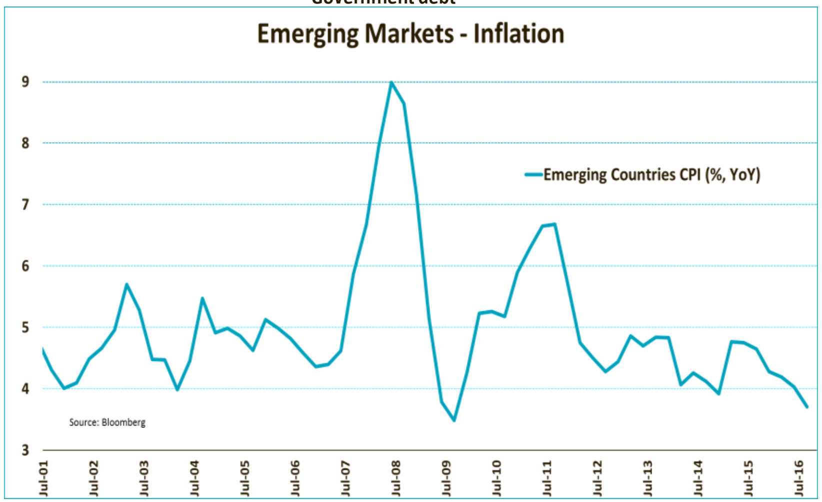
- Until early November, local currency emerging market debt continued to perform strongly. The average spread fell back below 500 basis points, helping emerging debt to top the list of best-performing asset classes in October, with a monthly gain of 1.2%.

- A number of factors have benefited emerging market debt. First, due to the ongoing stimulus by central banks, the search for yield continues. Since the yield on emerging debt surpassed that on high yield bonds a couple of months ago, the asset now ranks first. Second, the recovery in commodity prices has helped currencies stabilize on average. Third, both global and emerging manufacturing PMIs have been trending up lately, signally firming growth.

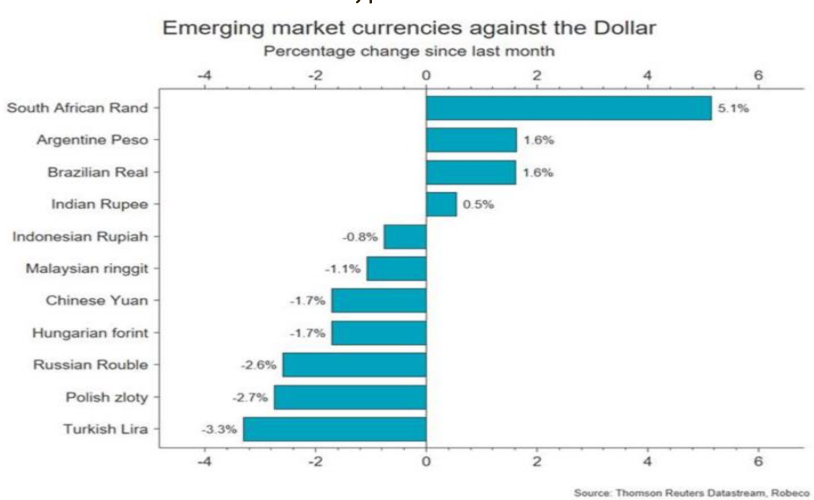
- Brazil and Russia are two important countries within the emerging debt universe that have profited from these developments. While political issues remain abundant in both countries, the growth outlook has significantly improved. The Brazilian central bank lowered its reference rate for the first time since September 2009. In contrast, South Africa and Turkey remain vulnerable, especially because of political developments. As group the growth outlook for emerging countries has improved marginally.

Emerging Market Debt (II)

Government debt



Currency performance



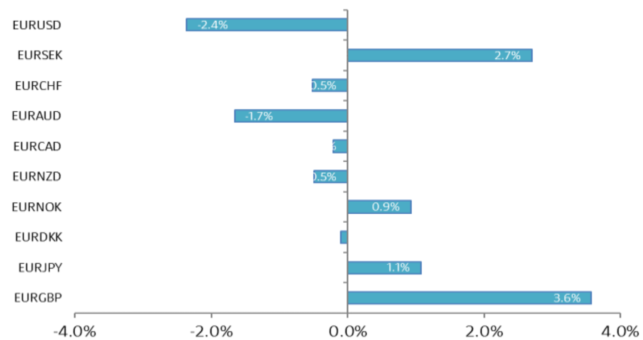
- While troublesomely low in developed markets, inflation in emerging countries is just low, pushing down yields. Inflationary pressures are benign, but will increase somewhat going forward. Chinese CPI and PPI readings are moving up together with commodity prices apart from oil. This will have a noticeable impact on global inflation numbers. However, we don't see any immediate inflation scares.

- What about the Trump factor here? Trump's foreign policy is likely to involve global trade, which could be negative for emerging market companies. For government debt however, the effect is less clear cut. In addition, while we still believe a December Fed rate hike is possible, the chances of it have decreased. This implies that the potential upside for the US dollar has decreased, although it remains there. That said, as the chart on the bottom left shows, currency movements remain pretty erratic. As a group, we don't expect a massive sell-off like the one we saw earlier this year, but much depends on the future US trade policy.

- Uncertainty has risen due to Trump's victory. Although we expect this to be more negative for equities than for bonds, we prefer to get a bit more confirmation about the actual policy measures that the Trump administration will pursue. We remain neutral for now.

FX (I)

Monthly returns for G10



Source: Bloomberg

The market has made up its mind that a hike is coming…but we doubt the Fed has

Source: Bloomberg

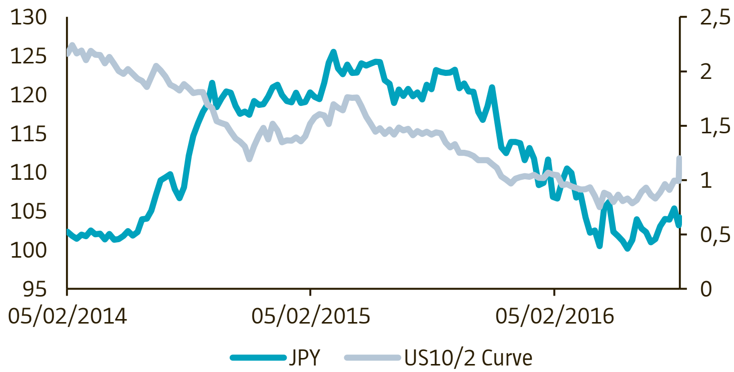
- Within the G10 currencies the US dollar was the strongest and sterling the weakest in October. The weakness in sterling was triggered by UK Prime Minister Theresa May, who provided more clarity on her intentions with respect to the Brexit process, stating that she would trigger the by now famous Article 50 in March 2017. The tone she struck increased fears that the government was considering a hard Brexit. Currently it remains unclear what the future relationship between the EU and UK will look like.

- On a positive note, the macroeconomic numbers out of the UK up until now remain resilient. The depreciation of the currency however is starting to have an impact on inflation expectations, and this is already effecting the policy of the Bank of England. We continue to think that ultimately sterling will weaken further, but in the near term we think that sterling will consolidate and creep higher. We will be looking for a compelling level to re-enter an underweight position in sterling.

- The big news has of course been the unexpected Trump victory in the US election race. What was even more unexpected was the stock market's reaction to this; after the initial sell-off, equities regained their footing.

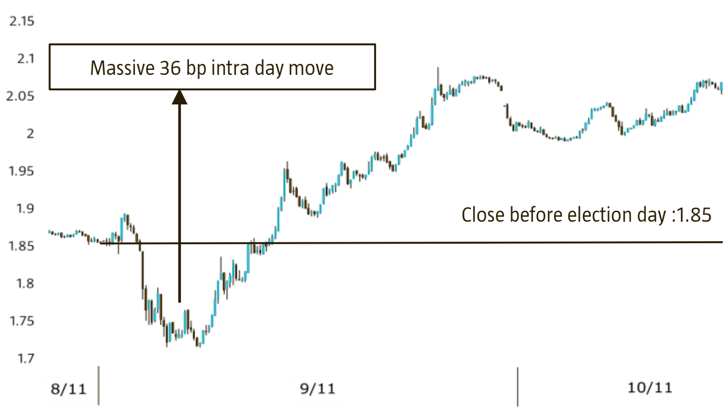
FX (II)

Since 2014 a steeper 1/10 US curve has been a support for USD/JPY



Source: Bloomberg

The rise in US yields helped propel the US dollar higher



Source: Bloomberg

- While equities closed slightly higher after the US election verdict compared to the previous day, bond yields ended up substantially higher. We think this upward move in yields propelled the US dollar higher.

- The market seems to have opted for a pretty one-sided interpretation that Trump will be successful in launching a reflationary policy package, which explains why stocks and rates have been rising together. We expect central bankers to tread a bit more carefully amid the current policy uncertainty. We therefore think that while the circumstances might warrant a hike in December, a more cautious approach might be adopted by the Fed. In December, the ECB will finally give some clarity on the future of its asset purchasing program. Given that inflation is still low relative to the ECB's target, we think that a continuation of the current program is highly likely. This will keep downward pressure on the euro.

- We think that the US dollar will strengthen further. We have therefore increased our overweight in the US dollar by adding a long USD/JPY position to our current long USD/EUR position.

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Important information

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