MONTHLY INVESTMENT OVERVIEW

EMIRATES INVESTMENT BANK

Asset Class	View
Equities	Neutral
Fixed Income	Cautious
Real Estate	Neutral
Commodities	Neutral
Low Vol / Alternatives	Overweight
Cash	Favour

Overweight, Favour, Neutral, Cautious, Underweight

About Emirates Investment Bank

EIBank is a Dubai-based boutique dedicated to the service of an exclusive group of private and institutional clients. Private banking and investment banking needs are approached holistically.

In private banking, the bank prides itself on offering highly personalised investment solutions and one-on-one servicing by a professional team of wealth management specialists. EIBank's open platform provides clients with access to markets globally.

In investment banking, the bank provides clients with advice on mergers & acquisitions, access to capital markets and other corporate finance matters.

MONTH IN BRIEF

JAN 2017

- Most markets around the world continued to rise in the first month of 2017, building on last year's broadly positive close. Leading the way higher, the MSCI Emerging Markets Index gained 5.5% on a total return basis in January, its best monthly gain since April 2016.
- While most recent forecasts are predicting an uptick in growth, the global economy is being tugged by two opposing forces. Pro-growth fiscal policies can act as a positive contributor to growth, while protectionist policies – which are currently playing out in the currency markets – have the potential to derail growth.
- In Europe, the outlook for growth has improved recently with better than expected economic data. January's manufacturing PMI for Italy, France and Germany all reported strong performances with the overall Eurozone PMI higher than initial estimates at 55.2, with job creation hitting its highest level since early 2011.
- The Bank of England decided to leave its current monetary policy unchanged and while it warned the decision to leave the EU would continue to create uncertainty, it upgraded its growth forecast for 2017 for the second time since the Brexit vote.
- Chinese policymakers stepped up efforts in the new year to stem capital flight and stabilize the CNY amid threats from the Trump administration to label China a currency manipulator and take punitive measures on the country's exports to the US.
- In the MENA, the Saudi market recorded a 1.5% monthly drop as corporate earnings growth contracted by 10.1% QoQ in the last quarter of last year while the S&P Pan Arab Total Return Index gained 1.6% over the month.

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Most markets around the world continued to rise in the first month of 2017, building on last year's broadly positive close. Leading the way higher, the MSCI Emerging Markets Index gained 5.5% on a total return basis in January, its best monthly gain since April 2016. Amid a continuation of Trump's reflation trade and better-than-expected growth prospects in the Eurozone, sovereign bond yields continued to rise with the 10Y German yield increasing by 23bps to close at 0.44%, its highest level since January 2016, while the US 10Y yield rallied 13bps from its January lows to close just 1bps higher. Meanwhile, commodities had a fairly mixed start to the year with gold rallying 5.5%, while oil lost some ground amid concerns that an increase in US shale output would undermine OPEC's production cut agreement.

"Most recent forecasts are predicting an uptick in global economic activity"

In terms of macroeconomics, most recent forecasts are predicting an uptick in global economic activity. As per the World Bank's latest global economic outlook, global growth is expected to accelerate to 2.7% in 2017, from the 2.3% achieved in 2016, despite stagnant global trade and heightened policy uncertainty. In a Twitter-happy, Trump era, it's important to separate the wheat from the chaff and to continue focusing on fundamentals that will both positively and negatively affect the global economy. On the one-end, accommodative monetary policy is slowly giving way to fiscal policy with the US leading the way in this multi-year shift that should help boost growth. On the other end, expansionary fiscal policy may have its limitations due to two main factors. Governments are still highly-indebted and will need to strike a balance between promoting pro-growth fiscal policies and finding the means to fund such policies. The second factor stems from the fact that Trump seems to be keeping true to some of his campaign promises, pushing for protectionist trade policies that could be countered by other nations. A tit-for-tat trade policy framework would undoubtedly hurt global growth and will need to be monitored closely.

Some of this protectionism is already playing out in the currency markets where many government authorities are trying to weaken their respective currencies to boost their export sectors. Countries with large current account surpluses will have more to lose should protectionist policies override cooperative measures to boost global trade. Since taking office on January 20th, Trump and his team have criticized several leaders, including Japan, Germany and China for their allegedly lopsided trade and currency policies, signaling a more disruptive approach to bilateral relationships with long-term allies. In his first week as President, Trump signed an order to withdraw the US from the Trans-Pacific Partnership (TPP), a trade agreement with 11 pacific nations, and said he would renegotiate the North American Free Trade Agreement (NAFTA) with Canada and Mexico. The Trump reflation trade that had dominated financial markets since November underwent a subtle shift, with sectors that would benefit from infrastructure spending and higher inflation leading the way for S&P 500, which closed January with a total monthly return of 1.9%. The dollar index slipped by 2.6%, as investors parsed mixed economic data and remained anxious of the policies of the Trump administration. On the corporate earnings front, at the time of this writing, 326 of the S&P 500 companies finished reporting Q4 results with average sales and profit growth of 4.3% and 4.9%, respectively. US corporate earnings seemed to be recovering well, allowing stock prices to continue their steady, upward trend.

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In Europe, the outlook for growth has improved recently with better than expected economic data. January's manufacturing PMI for Italy, France and Germany all reported strong performances with the overall Eurozone PMI higher than initial estimates at 55.2, with job creation hitting its highest level since early 2011. GDP data also beat analyst expectations and showed the Eurozone expanded 0.5% in Q4 2016, taking growth to a relatively strong 1.8% for 2016 as a whole. Germany, the Eurozone's largest economy, expanded 1.9% in 2016, the fastest pace in five years and 0.2% faster than in 2015, fueled by a rise in private consumption, wages, and record exports, pushing ECB officials to urge Germany to help boost growth in the rest of the Eurozone via fiscal stimulus, as some countries are still struggling to revive their own economies. Earlier in the month and despite a strong rise in the Eurozone's headline inflation to 1.8% YoY in January, from 1.1% YoY in December, the ECB decided to leave its monetary policy and bond buying program unchanged. ECB officials stated that policymakers would need to see a "sustained adjustment in inflation" before any discussion of tapering could take place and attributed the spike in inflation mainly to higher energy prices as evidenced by the core inflation (ex. food & energy) reading, which printed at 0.9% in January, 0.1% lower than in January 2016. We expect the ECB to remain dovish over elevated political event risk in the first half of the year and also as a result of accusations by the Trump administration that Germany was using a "grossly undervalued" EUR to exploit the US and its partners.

> "Japanese manufacturing expanded for a fourth consecutive month in December"

Within the UK, although the services PMI, which accounts for more than three-quarters of the UK economy, dropped to 54.5 in January, from 56.2 in December, it remains well anchored in expansionary territory, signaling the current resilience of the economy amid uncertainty surrounding the impending Brexit negotiations. Also bucking the uncertainty surrounding Brexit, UK GDP grew by 0.6% in Q4, driven almost entirely by services, helped by consumer spending, taking the full year 2016 growth figure to 2.0%. Meanwhile, the Bank of England decided to leave its current monetary policy unchanged and while it warned the decision to leave the EU would continue to create uncertainty, it upgraded its growth forecast for 2017 for the second time since the Brexit vote and sees the UK economy expand by 2.0% this year, from its previous forecast of 1.4% in November. On Brexit, the UK Supreme Court ruled that the triggering of Article 50 will require Parliamentary approval. At the time of this writing, the House of Commons gave an initial approval to a bill authorizing PM May to trigger exit talks. This means she can now meet the end-of-March timeline initially envisaged, starting a 2-year divorce process from the EU. The progress of these negotiations will keep the GBP volatile, and is bound to have an impact on the current account deficit, the credit and the commercial property markets, depending on how the negotiations play out. In light of these developments, the GBP managed to recover some its losses and gained 1.9% over the month, while the FTSE100 closed 0.6% lower.

In Asia, the Bank of Japan (BoJ) made no change to policy, saying it would keep interest rates at -0.1%, capping 10-year bond yields at or near zero. The BoJ hopes that shortages of labour will eventually feed through into rising wages, fuelling higher consumption, and pushing up inflation towards its 2.0% objective. It also revised its 2017 and 2018 growth expectations higher to 1.5% and 1.1%, respectively, from 1.3% and 0.9% previously. Japanese manufacturing expanded for a fourth consecutive month in December, while the services PMI clocked an 11-month high in December, suggesting economic momentum is gaining

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strength, driven by strong US auto sales, improving global demand and a surge in exports to China. However, inflation remains well below target, with core CPI falling 0.1% in December back to 0.0% as weak household spending and meagre wage hikes keep a lid on inflation. Overall, encouraging economic data and a flight-to-safety trade on concerns over Trump's policies sent the JPY higher by 3.6% against the USD in January.

Meanwhile, Chinese policymakers stepped up efforts in the new year to stem capital flight and stabilize the CNY amid threats from the Trump administration to label China a currency manipulator and take punitive measures on the country's exports to the US. The CNY gained 0.9% versus the USD in January, as Chinese authorities have been burning through forex reserves to support the beleaguered currency amid an economic slowdown and capital outflows. The economy clocked a 6.8% YoY growth in Q4, taking the growth rate for the full year 2016 to 6.7% and although this represents the slowest rate since 1990, it is right in the middle of the official target range of 6.5% to 7.0%. Despite a somewhat softer set of PMIs in January, the manufacturing PMI seems to have stabilized in expansionary territory by closing above 51 for a fourth consecutive month, while the services PMI printed at 54.6, 0.1% higher than in December. Heavy government spending, real estate sales and growth in bank lending helped counter the slowdown to some extent.

In Emerging Markets, Brazil posted a trade surplus of USD 47.7bn in 2016 compared to USD 19.7bn in 2015, as a recession there smothered domestic demand. Brazil's central bank had cut interest rates by a larger-than-expected 75bps in January to 13%, as policymakers attempt to jumpstart the struggling economy. This decision marked a strong signal to start 2017, highlighting the Central Bank of Brazil's desire to revive the economy, as inflation concerns fade. In Turkey, the TRY reached record lows against the USD at the start of 2017 following a terrorist attack in an Istanbul nightclub over the New Year's holiday. The Central Bank of Turkey's reluctance to raise interest rates aggressively to combat runaway inflation amid prevailing political turmoil is further damaging FX market sentiment. The currency reached unprecedented lows at the start of 2017 and fell 7.1% in January alone.

> " Data towards the end of the month suggested that drilling is ramping up in the US, somewhat offsetting efforts by OPEC and other producers to support prices "

In the MENA, the Saudi market recorded a 1.5% monthly drop as corporate earnings growth contracted by 10.1% QoQ in the last quarter of last year while the S&P Pan Arab Total Return Index gained 1.6% over the month. Meanwhile, OPEC, along with non-member oil producers led by Russia, have managed to largely adhere to the agreement to cut oil production so far. Data towards the end of the month suggested that drilling is ramping up in the US, somewhat offsetting efforts by OPEC and other producers to support prices. Rigs targeting crude oil in the US rose last week by 17 to 583, according to Baker Hughes, triggering a 2.0% decline in the price of crude oil in January. According to the International Energy Agency (IEA), demand and supply numbers suggest the market would re-balance by the end of 2017.

Asset Class Views

Asset Class	January	December	View / Rationale
Equities	↔	↔	
US	↔	↔	Pickup in earnings growth in Q4 is already priced into the equity market. Trade policy framework to be a key deciding factor on where the market heads from here.
Europe	↔	↔	Better than anticipated recent GDP and PMI figures but political event risk remains elevated in H1 2017.
UK	↘	↘	Triggering Article 50 earlier rather than later is a positive step forward and will help remove some uncertainty sooner.
Japan	↗	↗	An uptick in growth with an economy close to full employment is expected to lead to higher wages and stronger consumer spending.
China	↔	↔	Strong retail spending as China gradually shifts towards a more consumer-driven economy.
India	↔	↔	Positive effects of demonetization in the medium/long term but is having an adverse short term impact.
Brazil	↘	↘	A larger than expected 75bps interest rate cut in January highlighted the Brazilian authorities' desire to revive the economy.
Russia	↔	↔	A potentially better relationship with the US, higher oil prices, and a stabilizing currency should help economic growth after two years of deep recession.
MENA	↘	↘	Establishment of a parallel stock market in Saudi to benefit the real economy by providing investors access to new opportunities including SMEs.
Asset Class	**January**	**December**	**View / Rationale**
Fixed Income	↘	↘	
US	↔	↔	USD strength may cap Fed's 2017 rate increases to two.
Europe	↘	↘	ECB to remain dovish as temporary cyclical forces could be behind higher headline inflation figures. Subdued core inflation figures could delay taper talks.
UK	↘	↘	Triggering Article 50 earlier rather than later is a positive step forward and will help remove some uncertainty sooner.
Japan	↘	↘	BoJ made no change to policy, maintaining interest rates at -0.1% and capping 10Y bond yields at or near zero.
China	↔	↔	USD 3trn corporate debt market remains highly volatile and selectivity is key.
India	↔	↔	Easing cycle might come to an end as the Reserve Bank of India changed its stance to neutral, from being accomodative since December 2014.
Brazil	↔	↔	A larger than expected 75bps interest rate cut in January highlighted the Brazilian authorities' desire to revive the economy.
Russia	↔	↔	A potentially better relationship with the US, higher oil prices, and a stabilizing currency should help economic growth after two years of deep recession.
MENA	↔	↔	Oil market rebalancing is improving credit quality metrics.

↑ Overweight, ↗ Favour, ↔ Neutral, ↘ Cautious, ↓ Underweight

Asset Class Views

Asset Class	January	December	View / Rationale *
Currencies	NM	NM	
USD / EUR	Favour	Favour	USD strength may cap Fed's 2017 rate increases to two.
USD / CHF	Favour	Favour	USD strength may cap Fed's 2017 rate increases to two.
USD / GBP	Favour	Favour	Triggering Article 50 expected to give some clarity on the country's future ties with the EU.
USD / JPY	Favour	Favour	Continue to Favour the USD in light of BoJ's resolve to revive inflation via devaluation.
EUR / CHF	Cautious	Cautious	ECB officials looking for sustained inflation to start tapering.
EUR / GBP	Neutral	Neutral	Valid reasons have weakened both currencies as both start to approach attractive levels.
EUR / JPY	Favour	Favour	Favour the EUR over the JPY as the EUR has more room to strengthen.
CHF / GBP	Neutral	Neutral	GBP may pose more upside potential but not without potential associated risks.
CHF / JPY	Favour	Favour	Favour the CHF over the JPY but the risk/return payoff is not as attractive as before.
GBP / JPY	Overweight	Overweight	GBP has more room to strengthen against the JPY.

* Reference currency is the USD

Overweight, Favour, Neutral, Cautious, Underweight

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