MONTHLY INVESTMENT OVERVIEW

بنك الامارات للاستثمار

EMIRATES INVESTMENT BANK

Asset Class	View
Equities	Cautious
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

MAY 2017

- Although major stock markets continued to grind upwards in May with monthly performances ranging from 1.4% for the S&P500 to 4.9% for the FTSE100, we downgrade US equities to Cautious as valuations are not fully pricing in policy implementation risk that could potentially delay Trump's fiscal reform agenda.
- As monetary policy becomes less accommodative in the US and China, current equity market valuations can only be justified by successful expansionary fiscal policy implementation, which should not be taken for granted.
- The US Dollar Index fell for a third consecutive month, dropping by 2.1% in May on concerns over free trade, lacklustre economic data and ad-hoc protectionist commentary from the Trump administration.
- Overall, economic readings in Europe continue to show signs of improvement with hard data such as unemployment falling from 9.4% to 9.3% in April, an eight-year low.
- PM May's Conservative Party which lost its majority, announced that it would form a new minority government with support from a smaller party. This result potentially puts the UK in a weaker bargaining position with the EU and the decision to call for early elections is now seen as a big miscalculation by Theresa May.
- OPEC's extension of production cuts to March 2018 failed to boost crude prices, as the cartel's position as a global swing producer is under question with the rise of US shale production.
- In the MENA, a group of Gulf nations and Egypt severed diplomatic ties and transport links with Qatar on June 5. Political uncertainty in the region will remain elevated until the situation is resolved.

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Although major stock markets continued to grind upwards in May with monthly performances ranging from 1.4% for the S&P500 to 4.9% for the FTSE100, we downgrade US equities to Cautious as valuations are not fully pricing in policy implementation risk that could potentially delay Trump's fiscal reform agenda. The S&P500 shrugged off political tensions on allegations that Trump sought to interfere with an FBI probe into his administration's ties with Russia while the FTSE100 performed well on the hope that PM May would secure a majority in parliament in the elections held on June 8. Emerging markets continued to perform well in May, gaining 3%, despite Russia and Brazil losing 5.6% and 4.1%, respectively. Overall, global manufacturing PMIs held up well above the expansionary threshold at 52.6 in May, Europe being the best performer with the Eurozone PMI at a six-year high. China's manufacturing PMI dipped below 50 after ten months of expansion, due to the deleveraging drive by authorities, which cooled down growth.

In the US, treasuries rallied over the month, assisted by shifting expectations that the Fed might have to slow down its pace of tightening, leading the US 10-year Treasury yield 8bps lower to 2.2%. Despite disappointment over the May jobs report, with employment growth falling to the lowest level since mid-2012, markets continued to price in a 25bps rate hike at the upcoming June 13-14 FOMC meeting, albeit with lingering doubts as to whether the US economy is capable of handling the Fed's desired pace of policy-normalization. As monetary policy becomes less accommodative in the US and China, current equity market valuations can only be justified by successful expansionary fiscal policy implementation, which should not be taken for granted. The US Dollar Index fell for a third consecutive month, dropping by 2.1% in May on concerns over free trade, lacklustre economic data and ad-hoc protectionist commentary from the Trump administration. On the earnings front, continued growth in consumption and wages are beginning to reflect in upbeat corporate earnings with the S&P500 companies clocking an average earnings and revenue growth of 15% and 8%, respectively. The ECB is coming under some pressure to taper its QE program on an improving political and economic climate while the Fed looks to normalize its rate outlook and its balance sheet.

The European stock markets had a good month managing to close near their monthly highs. Encouraging economic data from various parts of the Eurozone helped the EuroStoxx50 record a total return of 1.3% in May. Meanwhile, headline inflation in the Eurozone fell sharply to 1.4% in May after spiking to close to the ECB's target of 2.0% in April, easing pressure on the Bank to curtail its monetary stimulus. Overall, economic readings in Europe continue to show signs of improvement with hard data such as unemployment falling from 9.4% to 9.3% in April, an eight-year low. Increased spending power among households is adding to improving profit margins and revenue growth, reflected in the recently concluded Q1 earnings season. With political risks abating and growth in the region above trend, Germany's DAX gained 1.4% over the month, while France's CAC40 benefitted from the Macron win and surged 1.9%.

In the UK, the Bank of England (BoE) left rates unchanged at 0.25%, cut its 2017 growth forecast for the economy from 2.0% to 1.9%, and increased its inflation target for this year to 2.7% from 2.4% previously forecast. The BoE warned of a spending squeeze as a weak GBP induced inflation and undercut real wages. The Bank also warned that these forecasts were based on the assumption of smooth Brexit negotiations. At the time of this writing, the UK elections resulted in a "hung" parliament, in which no single political party managed to secure a majority in the House of Commons. PM May's Conservative Party which lost its majority, announced that it would form a new minority government with support from a smaller party. This result potentially puts the UK in a weaker bargaining position with the EU and the decision to call for early elections is now seen as a big miscalculation by Theresa May.

" PM May's Conservative Party which lost its majority, announced that it would form a new minority government with support from a smaller party "

Meanwhile in Japan, capital spending rose 4.5% year-over-year (YoY) in Q1, its highest level in nine years, signalling the on-going pickup in momentum. The economy recorded a fifth consecutive quarter of growth, albeit at a relatively muted rate of 0.3% QoQ in Q1, aided by strong global demand and an uptick in capital expenditure. For April, Japanese exports grew for the fifth consecutive month and core CPI (ex-food) also rose and reached a two-

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year high. However, the 0.3% YoY increase (in core CPI) was well below the Central Bank's 2.0% target. Meanwhile, the ex-food and energy CPI improved marginally from -0.1% to 0.0%, highlighting the difficulties faced by authorities to revive moribund inflation and leaving little chance for the Bank of Japan (BoJ) to change its easy monetary policy stance at this stage. Meanwhile, the World Bank raised its GDP growth forecast for Japan to 1.5% for 2017, up from its 0.9% estimate in January, citing rising exports and a pickup in capital spending for the 2020 Tokyo Olympics.

China suffered its first downgrade since 1989, as Moody's lowered China's long-term local currency and foreign currency issuer ratings by one notch to A1 from Aa3, warning that economy-wide debt is expected to rise as potential economic growth slows over the coming years. The agency also revised its outlook from "negative" to "stable", while China's finance ministry dismissed the downgrade as "groundless". Meanwhile, China's Producer Price Index (PPI) slowed to 5.5% YoY in May, from 6.4% in April, marking a third consecutive month of deceleration.

" China's positive growth momentum is holding up well despite the government's targeted efforts to curb excessive leverage in the economy "

Although lower producer prices in China can potentially export deflation globally, China's trade data was encouraging last month. China's May exports rose 8.7% from a year ago, lifted by robust demand from the US and Europe, while imports also surged 14.8%, as domestic consumption stayed strong and in line with a stable CNY. So far, the CNY has gained almost 2.0% against the USD this year. Additionally, China's forex reserves rose in May for a fourth straight month, by a significant USD 24 billion to USD 3.05 trillion, their highest level this year. This strong set of data shows China's positive growth momentum is holding up well despite the government's targeted efforts to curb excessive leverage in the economy.

Within EM, both Russia and Brazil had a poor month. The Russian stock market fell 5.6% in May, down by nearly 15% for the year as the oil-reliant economy struggles to shrug off US shale resilience and international sanctions. Meanwhile, Brazil plunged into another political crisis following reports that President Temer was involved in an alleged cover-up concerning the former speaker of the Lower House of Congress. The latest scandal calls into question the investor-friendly reform agenda of the Temer administration as Brazil stocks sold off with the IBOV losing 4.1% in May. President Temer has since been acquitted of any illegal financing charges by Brazil's top electoral court. Meanwhile, the Central Bank of Brazil cut interest rates by 100 bps to 10.25% and signalled another reduction of 75 bps in July. In India, GDP for Q1 grew by 6.1%, well below the consensus expectation of 7.1%, suggesting a slowdown due to lag effects of the demonetization drive announced on Nov 8 last year. However, the recent strengthening in the INR, lower inflation and a slowing economy should allow the RBI to tone down its neutral stance in its upcoming policy meeting and become more accomodative.

OPEC's extension of production cuts to March 2018 failed to boost crude prices, as the cartel's position as a global swing producer is under question with the rise of US shale production. OPEC's extension may not be enough to bolster prices, as shale producers continue to ramp up production and US crude inventories remain at elevated levels, while Brent hovers in the USD 50-55/barrel range. Brent was extremely volatile but managed to hold on to the psychological USD 50 mark, ending the month lower by 2.7%.

As for the MENA, a group of Gulf nations and Egypt severed diplomatic ties and transport links with Qatar on June 5. Political uncertainty in the region will remain elevated until the situation is resolved. The S&P Pan Arab Composite Index closed almost 1% lower in May, while Saudi recorded a monthly drop of 1.1%, despite the USD 200bn+ worth of deals announced following Trump's visit to the Kingdom. Egypt was the best performer in the region with its main index gaining 7.3% over the month following the successful issuance of a USD 3bn bond programme across 3 tranches with a 5-year, 10-year and 30-year deal. Meanwhile, in the UAE, Moody's upgraded its outlook on Abu Dhabi's credit rating to stable from negative, citing the government's "rapid, effective and broad policy response to the lower oil price environment". The government has cut spending by almost 25% over the last two years and has moved swiftly to reduce subsidies by raising prices of fuel, electricity, and water.

Asset Class Views

Asset Class	April	May	View / Rationale
Equities	↔	↘	
US	↔	↘	Downgrade to Cautious as valuations not fully pricing in policy implementation risk that could potentially delay Trump's fiscal reform agenda.
Europe	↔	↔	Series of strong economic data and a fairly dovish ECB bode well for European equities.
UK	↘	↘	A hung parliament weakens the UK's bargaining capacity in the Brexit negotiations.
Japan	↗	↗	Record low unemployment expected to work its way through to higher wages and inflation.
China	↔	↔	Resilient macro data and PMI figures point to a gradual stabilization of the economy.
India	↔	↔	Lower than expected Q1 GDP and recent strength in INR leaves room for a more accommodative RBI.
Brazil	↘	↘	Political and macro environment still uncertain despite recent acquittal of President Temer of any wrongdoing in the 2014 Presidential elections.
Russia	↔	↔	Economy slowly emerging from recession but international sanctions and low oil price remain major headwinds.
MENA	↘	↘	The Qatar situation is creating an aura of uncertainty and, if unresolved, will weigh on the region's growth prospects.

Asset Class	April	May	View / Rationale
Fixed Income	↘	↘	
US	↔	↔	Credit spreads selectively attractive as the Fed continues to normalize its rate outlook and its balance sheet.
Europe	↘	↘	The ECB is coming under some pressure to taper its QE program on an improving political and economic climate.
UK	↘	↘	Unexpected election result to weaken the UK's position in Brexit talks.
Japan	↘	↘	Corporate and government bonds already pricing in an accommodative BoJ.
China	↔	↔	Downgrade of China's sovereign debt by S&P will increase borrowing costs for Chinese companies. Selectivity remains key for corporate bonds.
India	↔	↔	RBI has room to be more accommodative with benign inflation and lower than expected GDP growth.
Brazil	↔	↔	Central Bank to continue easing cycle in an effort to boost the economy, which emerged from recession in Q1 after 8 consecutive quarters of contraction.
Russia	↔	↔	Inflation at a 5-year low to allow the Central Bank to remain accommodative.
MENA	↔	↔	If persistent, increased geopolitical tensions to weigh on the region's growth prospects.

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

Asset Class Views

Asset Class	April	May	View / Rationale *
Currencies	NM	NM	
USD / EUR	↗	↗	Potential balance sheet reduction and continued rate normalization to be positive for the USD.
USD / CHF	↗	↗	Potential balance sheet reduction and continued rate normalization to be positive for the USD.
USD / GBP	↗	↗	Political uncertainty and a hung parliament to weigh on the UK economy and GBP relative to the dollar.
USD / JPY	↗	↗	Continue to favour the USD as BoJ is expected to remain accommodative as recovery remains fragile.
EUR / CHF	↔	↔	Improved economic data and lowered political risk to increase pressure on the ECB to start to taper talks.
EUR / GBP	↗	↗	Favour the EUR over the GBP as EU negotiates from a position of strength after reduced mandate for PM May.
EUR / JPY	↗	↗	Favour the EUR over the JPY amid improving economic data in the Eurozone and fragile recovery in Japan.
CHF / GBP	↗	↗	Favour the CHF vs the GBP as UK election result increases political uncertainty.
CHF / JPY	↗	↗	Favour the CHF as BoJ expected to remain accommodative as recovery remains fragile.
GBP / JPY	↗	↔	GBP and JPY have driving forces that could potentially weaken both currencies.

* Reference currency is the USD

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

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