

From West to East

Weekly Investment View
 3rd March, 2019

The run has been so good that it may be time to take a breath

It has been a great quarter for risk assets so far. So good, indeed, that it could be wise to take some profits. With most stock markets having offered double-digit returns this year to date and a growing chorus of uncertainties mounting, the balance of risks has started to look skewed to the downside. Taking that into account, the FAB Asset Allocation Committee (AAC) last week voted to reduce its model portfolio's exposure to US equities to neutral from overweight.

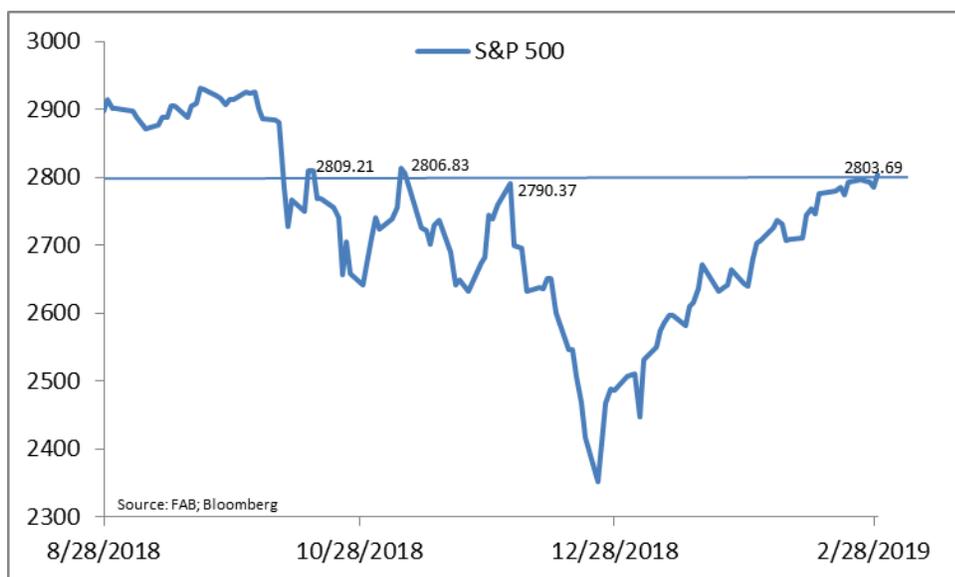
The decision was tactical, though, as AAC members continue to believe that 2019 will be a good year for American stocks, and risk assets in general. In simple terms, the AAC plans to reinstate its overweight position later this year after members become more confident of the economic outlook and the political backdrop. For now, however, it made sense to take a small step back.

On Friday, the S&P 500 ended at 2,803. It was the first time it finished above 2,800 since early November. Since October, the index retreated every time it hit that level. The figure has, therefore, become what technical analysts call a 'resistance'. That means there could be upside momentum if the index holds above that level for a while, but also that it is more difficult for that to happen because people see the number as a signal to take profits.

Even if the index managed to keep the momentum, however, the next so-called 'resistance' would be around 2,900, implying potential gains of 3.5%.

"The risks of an overweight position in US equities are now skewed downwards."

Beyond that, if the S&P 500 reaches its all-time high of 2,930 in the near-term, that would still only be 4.6% higher than current levels. Meanwhile, if the index were to revisit its recent low of 2,344, hit on 24th December, it would drop almost



17%. That is a classic downward skew and helps explain why the AAC found it fit to reduce exposure to US equities. It also probably provides arguments for many other investors, including active money manager and hedge funds, to rethink their positions and lock in the gains of the first two months of the year. Again, psychology is key here. The last time the S&P 500 gained more than 10% in the first two months of the year was in 1991, a year when the index gained 26.3%. Unlike this year, however, US equities had just rallied almost 8.5% in the last two months of 1990.

The memory of the 14% fall in the fourth quarter, meanwhile, is very fresh for active managers. Therefore, they are likely to favour taking profits before the end of the quarter, and that movement in itself could create negative momentum for US equities and was one of the factors the AAC considered in reducing its exposure to the asset class to neutral. Finally, the internal political situation in the US is about to get a lot more complicated, which could affect risk appetite. The US House of Representatives last week voted to block President Donald Trump's declaration of a national emergency to build a wall at

the Mexican border and the Senate has two weeks to assess that bill. It would take only four Republican senators siding with Democrats to pass the bill and reverse the president's ability to use extraordinary powers and reallocate military funds. While the Senate is Republican, this is about more than the wall, it is about the power of the purse, so there is a significant chance the Senate backs the House.

Amid all that, the debt ceiling kicked in on Friday. According to the US budget, the country will spend about US\$985 billion more than it expects to receive this fiscal year, which ends in September. That means it will have to incur more debt on top of the US\$22 trillion it had as of 11th February. To borrow more, Congress has to increase the debt ceiling.

Last year, when Republicans controlled both the House of Representatives and the Senate, they suspended the debt ceiling until 1st March, 2019, at President Donald Trump's request. However, for the US to continue borrowing, the now Democratic House would have to either increase the debt ceiling, or suspend it again. Given the animosity between the White House

From West to East

Weekly Investment View
3rd March, 2019

and the House of Representatives, it looks like the problem will be difficult to resolve. **To be sure, there is also potential good news ahead, which could help boost risk assets everywhere.** Two of the issues which most concerned global investors seem to be nearing some form of positive resolution. The trade war between the US and China seems close to a conclusion, with Chinese and American officials signalling progress. Reports indicate that both countries have already started to work on a memorandum of understanding which would pave the way for the broader agreement. Some of the key issues, such as subsidies and intellectual property rules, may be left out as a solution for them could take years of negotiations. A preliminary agreement, however, could surface soon, probably after the annual meeting of the Chinese People's Political Consultative Conference, the country's parliament, which finishes late next week. President Trump probably wants that victory too, after his second summit with North Korean Communist Party Chairman Kim Jong Un last week ended abruptly, without a denuclearization agreement. Mr. Trump walked out of the meeting saying Kim had asked for an immediate end to all US sanctions on the nation, something the US was not prepared to offer yet.

“President Trump probably wants to strike a trade deal with China soon, as he gears up for the 2020 elections.”

Brexit, another major issue last year, seems to be progressing to a better outcome as well. Last week, a group of pro-Brexit members of Prime Minister Theresa May's Conservative Party in Parliament suggested they would be willing to vote in favor of her exit plan if she makes some changes to the deal agreed with the European Union last year. Essentially, they want clear language ensuring the so-called Irish backstop is only temporary. That suggests that Mrs. May's agreement has a chance of being approved in Parliament when it comes up to a vote on 12th March. In any event, she has indicated that she will allow for an extension to the 29th March deadline for Brexit in case Parliament fails to approve her deal.

Markets have reacted to the recent news by pushing the British pound up by 1.1% to 1.3202 last week. That is 5.7% higher than the currency's recent low of 1.2487 on 11th December.

“A Brexit deal is starting to seem more likely, though the risk of a hard exit remains.”

If Brexit were out of the picture, the strength of the UK economy suggests the currency could be even stronger. Loans grew 4.2% in January, just as house price inflation and new mortgages surprised to the upside. Unemployment remains low and interest rates are effectively negative, as one-year gilts are yielding less than 0.8% while UK inflation came in at 1.8% year-over-year in January. That suggests that the Bank of England could have to increase benchmark rates after the uncertainty of Brexit is removed, particularly if an orderly exit is achieved, which could further boost the pound. Furthermore, President Trump indicated clearly that he wants the US dollar to be weaker, which would also support a stronger British pound. Mr. Trump told a crowd of conservatives on Saturday that he did not want “a dollar that's so strong that it makes it prohibitive (...) to do business with other nations.” The rhetoric confirms the expectations professed in the FAB Global Investment Outlook 2019 of a weakening trend for the dollar in the second half of the year. It also further confirms the FAB AAC's decision in early January to increase exposure to emerging markets, a position the AAC kept even as it trimmed US equities exposure last week.

“Mr. Trump has started to talk down the dollar, which favours emerging markets.”

That position is mostly focused on Chinese stocks and bonds, which are largely driven by local investors and tend to move more independently of US markets. Stocks in Shanghai and Shenzhen have started to reflect the diffusing currency and trade risks and rallied last week. However, not all emerging markets are likely to benefit equally of President Trump talking down the dollar. India, for instance,

is currently facing its own idiosyncratic issues and could see more volatility than other developing nations in the coming months.

The situation was underlined last week, when the country was on the verge of a war with its northern neighbor, Pakistan. Both nations claimed to have downed a jet from each other, with Pakistan capturing an Indian pilot as a result of the worst escalation of the Kashmir border dispute since 1971. Tensions had subsided by the weekend as Pakistani Prime Minister Imran Khan returned the pilot in what he called a “gesture of peace”.

“Upcoming elections in India suggest caution about the country's assets.”

While the Kashmir conflict seems to have simmered down after that, the event was a reminder that India is in election mode. Prime Minister Narendra Modi probably weighed his dwindling popular support when he was making a decision on whether to attack terrorist camps in Pakistan following a deadly terror attack on Indian troops in Kashmir in February. Such considerations could run policy afoul of what investors would expect and promises to increase the volatility of Indian assets in the next couple of months, which is why investors should approach them carefully.

For inquiries related to this article, please contact:

***Alain.Marckus@bankfab.com or
Christofer.Langner@bankfab.com***

From West to East

Weekly Investment View

3rd March, 2019

Disclaimer:

This report has been prepared and issued by Products & Services - Elite & Private Banking ("P&S-EPB") of First Abu Dhabi Bank PJSC ("FAB") outlining particular services provided by P&S-EPB and does not constitute or form part of any offer or invitation to sell, or any solicitation of any offer to purchase or subscribe for, any shares in FAB or otherwise or a recommendation for a particular person to enter into any transaction or to adopt any strategy nor shall it or any part of it form the basis of or be relied on in connection with any contract therefore. This report is incomplete without reference to, and should be viewed solely in conjunction with the associated oral briefing provided by P&S-EPB. The report is proprietary to P&S-EPB and may not be disclosed to any third party or used for any other purpose without the prior written consent of P&S-EPB. The information in this report reflects prevailing conditions and our views as of this date, which are accordingly subject to change. In preparing this report, we have relied upon and assumed, without independent verification, the accuracy and completeness of all the information available from public sources or which was otherwise reviewed by us. In addition, our analysis are not and do not purport to be appraisals of the assets, stock or business of the recipient. Even when this presentation contains a kind of appraisal, it should be considered preliminary, suitable only for the purpose described herein and not be disclosed or otherwise used without the prior written consent of P&S-EPB. FAB clients may already hold positions in the assets subject to this report and may accordingly benefit from the buying or selling of such assets as referred to in this report. This document does not purport to set out any advice, recommendation or representation on the suitability of any investment, transaction or product (as referred to in this document or otherwise), for potential purchasers. Potential purchasers should determine for themselves the relevance of the information contained in this document and the decision to purchase any investment contained herein should be based on such investigation and analysis as they themselves deem necessary. Before entering into any transaction potential purchasers should ensure that they fully understand the potential risks and rewards of that transaction (including, without limitation, all financial, legal, regulatory, tax and accounting consequences of entering into the transaction and an understanding as to how the transaction will perform under changing conditions) and that they independently determine that the transaction is appropriate for them given their objectives, experience, financial and operational resources and other relevant circumstances. Potential purchasers should consider consulting with such advisers and experts as they deem necessary to assist them in making these determinations and should not rely on FAB for such purposes. FAB is acting solely in the capacity of a potential arm's-length contractual counterparty and not as a financial adviser or fiduciary in any transaction unless we have otherwise expressly agreed so to act in writing. FAB does not provide any accounting, tax, regulatory or legal advice. FAB is licensed by the Central Bank of the UAE.

London: FAB London Branch is Authorized by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from FAB London branch on request. Registered in England & Wales: Company No: FC009142: VAT No: GB245 3301 91.

Paris: FAB Paris Branch is licensed by the French Prudential Control Authority as a credit institution. FAB Paris is registered in France under the company number: RCS Paris B 314 939 547.

Switzerland: This publication is for your information only and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. Certain services and products are subject to legal restrictions and cannot be offered worldwide on an unrestricted basis and/or may not be eligible for sale to all investors. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness. All information and opinions as well as any prices indicated are currently as of the date of this report, and are subject to change without notice. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. At any time the First Abu Dhabi Bank PJSC and/or FAB Private Bank (Suisse) SA may have a long or short position, or deal as principal or agent, in relevant securities or provide advisory or other services to the issuer of relevant securities or to a company connected with an issuer. Some investments may not be readily realizable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. Futures and options trading is considered risky. Past performance of an investment is no guarantee for its future performance. Some investments may be subject to sudden and large falls in value and on realization you may receive back less than you invested or may be required to pay more. Changes in foreign exchange rates may have an adverse effect on the price, value or income of an investment. First Abu Dhabi Bank PJSC expressly prohibits the distribution and transfer of this document to third parties for any reason. First Abu Dhabi Bank PJSC and/or FAB Private Bank (Suisse) SA will not be liable for any claims or lawsuits from any third parties arising from the use or distribution of this document. This report is for distribution only under such circumstances as may be permitted by applicable law. The "Directives on the Independence of Financial Research", issued by the Board of Directors of the Swiss Bankers Association (SBA) do not apply.

Singapore: First Abu Dhabi Bank P.J.S.C., Singapore Branch is regulated by the Monetary Authority of Singapore and holds a Wholesale Bank license.