It Beggars Belief

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- **Fed and Bank of Japan continue to fail to deliver**
- **Risk asset rally remains on flaky ground**
- **Gold leads returns +2.1% on the week**
- **International energy forum unlikely sufficiently good news to drive oil prices higher**
- **We continue to encourage investment in bonds, gold and emerging market assets**

It beggars belief that many in the markets still believe in the major central banks to deliver on their promises of growth and inflation. Last week Federal Reserve indecision continued against the backdrop of more cuts to their forecasts for long-term growth. Meanwhile, we are expected to take as a positive that the Bank of Japan announces a policy to manipulate every aspect of the government bond market. It truly beggars belief.

From market performances last week it was telling that gold was the best performer and although equities rallied as some investors still have the blind faith in central bankers, the US 10-year yield fell suggesting some investors expect trouble ahead. They are likely to be right.

The much anticipated Bank of Japan and Federal Reserve meetings had a headline message that helped risk assets rally, but the underlying picture looks much more fragile. On the surface, the Federal Reserve left interest rates unchanged but signaled that they would likely raise rates before the year-end. However, in the background, they cut their assumption for the long-term growth of the US economy to just 1.8% versus a previous forecast of 2.0% and reduced the likely future increases in interest rates. So in 2017 the committee now expects only two increases in rates compared to three before. They also cut their assumption of long-term interest rates by 23 basis points to 2.91% - the largest downward revision in history.

The Bank of Japan (BoJ) talked about taking control of the yield curve and targeting an inflation rate of above 2%. The latter is ironic given that the BoJ has abjectly failed to get anywhere near its current inflation target of 2%. Indeed deflationary pressures appear to be building again with core inflation measures pointing to deflation.

Our strategic advice to clients is to remain cautiously invested with an emphasis on bonds and gold. Within equities, we favour emerging markets over developed markets.

Emerging market assets continue to do well. Last week, emerging market equities rose 3.6% while the emerging market bond index returned 1.3% with the sovereign bond market returning 1.8%. Some countries are starting to provide a persistent feel-good factor with better control over inflation and hence with room for easing.

There are signs of improvement in South Africa. The South Africa Reserve Bank in their meeting last week kept policy rates unchanged at 7%. However, some of the comments from policy makers were optimistic citing improvement in both growth and a dampening of inflation. However, this could also mean that there is an end in sight to the rate hiking cycle if upcoming economic data keeps up with policy-makers expectations.

The Central Bank of Turkey lowered overnight lending rates by 25bps to 8.25%. Rates on 1-week repo and overnight borrowing remained unchanged at 7.50% and 7.25% respectively. Turkey lost their lowest investment grade status after Moody's concluded their post-military coup review. Moody's lowered Turkey's Sovereign ratings from Baa3 to Ba1. Currently, only Fitch rates Turkey at Investment grade status. We do not expect any material widening of credit spreads from current levels for either sovereign or corporate bonds.

In Russia, The Federation acting through the ministry of finance successfully returned to international capital markets with a tap of US$ 1.5Bn on their 4.75% May 2026 sovereign bond maturity. We continue to see value in some of the corporate US-dollar denominated Russian debt, particularly in the pre-sanction issued bonds.

Asian Development Bank, rated AAA by all three major agencies have returned to capital markets with an offshore Indian rupee bond also commonly known as "Masala bond". This time, ADB returned to the market via their 10-year maturity, with an issue size of INR 9 billion, priced to yield 6.23%. ADB is a regular borrower on international capital markets helping develop primary issuance in emerging Asian countries for the purpose of reducing funding stress on some of the domestic banks. ADB has announced previously the intention to raise around US$20 billion from capital markets in 2016.

We continue to have the conviction that emerging market equities should outperform developed market equities. The case for emerging markets has been reinforced by the improvement in corporate earnings revisions seen over recent months. Indeed, over the last three months analysts have consistently upgraded their corporate profit forecasts, something that has not been seen since 2013 and not consistently since 2009-11.

Gold continues to consolidate in a narrow band above $1300. Uncertainty building in the run-up to the US elections could be another driver of upside risk. Last week gold rose 2.1% moving to the higher end of its recent trading range at $1338. The most recent high was $1366, which is probably marking the limit of near-term upside. There is technical resistance at $1342 and support at $1324. We remain long-term positive, but prefer to be price sensitive when topping up holdings.

The upcoming International Energy Forum in Algiers on September 26-28 will be the focus of GCC markets this week. The meeting will bring together the full breadth of oil producers not just OPEC. The consensus view is that the meeting is unlikely to achieve an outcome that would lead to higher oil prices. Indeed with the WTI oil price at $44.5, almost the middle of the recent trading range, the market is not pricing a materially positive or negative outcome from the meeting. Any "freeze" in production is likely to be with quotas close to recent production highs. There may be an agreement based on words rather than actions, which commit the group to stabilising the oil price over the coming year.

Within the GCC, Union National Bank rated investment grade, owned 50% by the Government of Abu Dhabi and 10% by the Government of Dubai, has mandated banks to arrange a series of fixed-income meetings across Asia, Europe and the Middle-East commencing 25th of September. Subject to favourable market conditions, a 5-year, plain-vanilla, senior-unsecured bond structure would be on offer. Being a rare issuer in the GCC bond market, we expect to see good interest from investors seeking exposure to the 5-year investment grade segment.

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