MORABANC
asset management

MARKETS AND STRATEGIES

> NOVEMBER2016

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Keeping ahead of events

Once again, the polls failed to predict the correct outcome to a political event. And of course the investment world has turned a cold shoulder on economists in an attempt to anticipate the implications of this latest change to the world order.

So, what has been the initial reaction to the Republican victory in the US? An increase in global interest rates, stock markets in developed countries pretty much holding their own, a firmer dollar, and weaker emerging market assets.

And what should we expect looking forward? That the market is right about the increased growth outlook triggered by the change. Because, if this were not the case, we would be digging what is effectively the grave in terms of growth.

> We believe the economy will in the short term withstand these new pressures.

As we all know, the market is always right! And the market says that rates should rise. As we have been saying for months, the big distorting factor right now is the current low cost of money. As and when this situation normalises, we ought to return to a new expansionary phase.

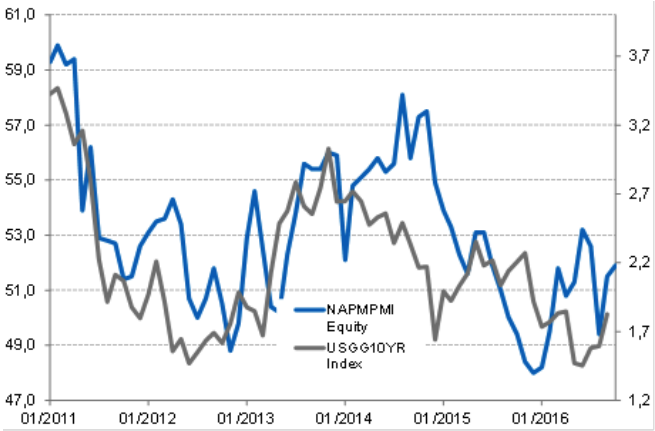
But this opens up a chicken-and-egg debate. If the market is captivated by the sirens' call of Trump's expansionary policy but is then left "stranded", what will happen? Surely, the higher financial costs that we are now moving towards short term will only accentuate low costs and low growth rates moving forward.

At MoraBanc, we have been likening global growth to the super-hero chased by "baddies", who is brilliantly dodging the various obstacles and waiting for help to arrive. The global economy has picked up over the last few months. Fear of a meltdown in China has diminished and growth is stable. We have just witnessed an upbeat results season that suggests that earnings may have bottomed out. And fears that Theresa May may push for a hard Brexit have also diminished, following the High Court ruling. For the time being, monetary conditions are lax, due to the fact that the ECB, the BoJ, and the BoE all continue to expand their balance sheets.

This said, we believe the economy will in the short term withstand these new pressures. And this should be positive for all assets linked to the real economy. Another important reason is the level of divestment in general. Since the beginning of the year, and the world over, the trend has been to sell equities in favour of fixed income. The reversal of this position is likely to be the new driving factor.

One of the best leading indicators are currencies. The recent trend in the main currencies and their correlation with equity markets means that we are optimistic for share prices. But at the same time, it is unlikely to be a smoothe ride, with several political events in Europe that may at least rock the apple cart in 2017.

Chart 1. Leading ISM Manufacturing Index in the US & US 10-year rate



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Risk map

As in July, we have withdrawn Brexit risk; and this time we have also withdrawn electoral risk in the US. Up until now, Donald Trump was not the markets' preferred candidate; but now that the uncertainty over the direction of US politics has lifted and the risk outlook for the remainder of the year cannot really include anything new, we sense relief in equity markets and there appears to be further upside through to the end of the year. Following Trumps' victory, we are reducing the risk of a slowdown in the US: the increase in fiscal spending and the tax cuts promised by the President-elect should provide a boost for the American economy.

Strategy: post the Trump victory

Macro scenario. We continue to believe that the Fed will raise rates in December, given the upbeat macro data: GDP growth of 2.9% q/q, ISMs above 50, job creation at acceptable levels (above 150,000) and, most importantly, a certain increase in inflationary pressure via salaries. The Trump victory implies greater fiscal stimulus, which is another argument in favour of Janet Yellen making a move.

Meanwhile, the fundamentals in Europe appear to be improving, particularly the manufacturing PMI, which at 53.5 is now at its highest level since 2014. We also draw attention to the unemployment rate, which is receding gradually (now at 10.0%). In China, the PMIs are now above 51, and in Brazil too indicators are bouncing, which leads us to believe that the worst may well be over for the emerging economies.

Equity. Trumps' economic programme appears to favour cyclicals (banks, energy, infrastructure, defense), and this should be good for share prices. The probability of a rate rise in December remains extremely high (90%), so the move, assuming it takes place, will not take investors by surprise this time. The main risks for 2016 (Brexit and Trump) have in the end become reality, which means that there are now no real impediments to markets moving higher in the final quarter. We are raising equities to a strong OW and we are once again buying the S&P, which, following the election is back below the level at which we took profits in September.

Fixed Income. We are gaining protection ahead of a tightening at the long end of the curve by overweighting credit and inflation. We are maintaining our exposure to the periphery and the short end.

EURUSD. We maintain our forecast range for the EURUSD of 1.05-1.10, ahead of an inevitable US rate rise over the coming months.

Commodities. We maintain our exposure to oil, ahead of a likely OPEC agreement on production cuts. We remain bearish on gold, consistent with our more bullish stance on risk assets.

Chart 2. Risk map

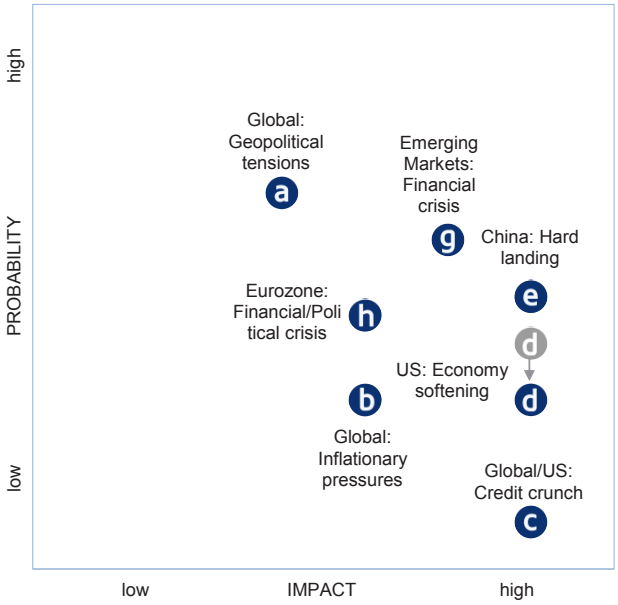


Chart 3. Total returns October 2016*

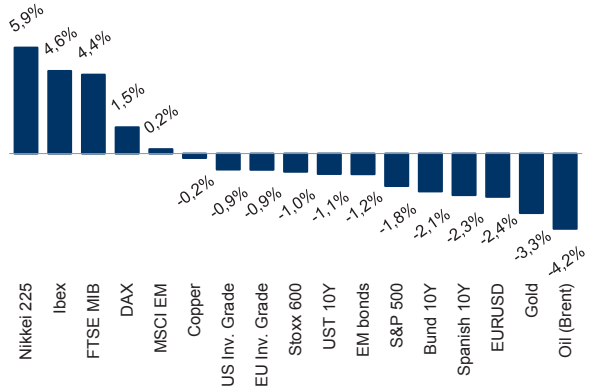
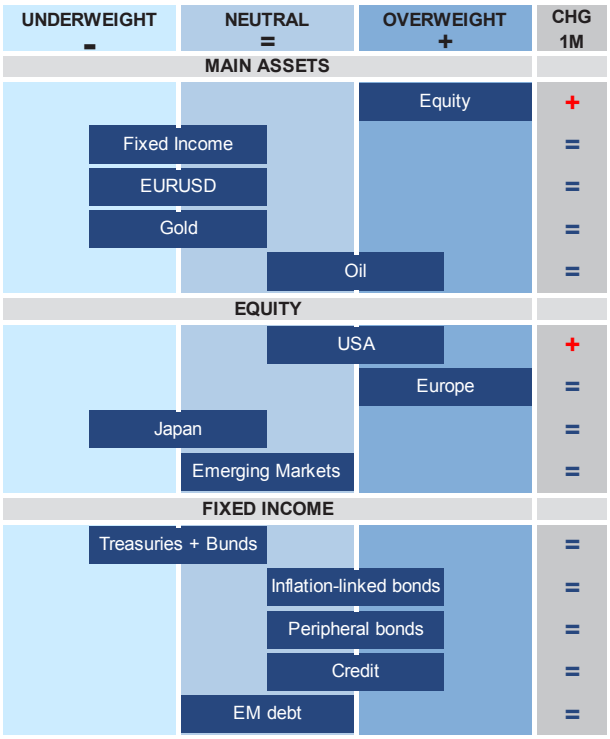


Chart 4. Positioning on the main asset classes



*USD returns on MSCI EM index and EM bonds

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macroeconomy

The people have spoken! And they have made it loud and clear...

It has certainly been an unusual year, particularly at the political level. Magnate Donald Trump became US President in what was a historical and record election (128 million of the 146 million people registered voted: a massive 88%!). And never in its 150-year history had the Republican party won such a clear majority across the board: President, Congress, and Senate.

As for the markets' surprise move, the **Trump Reflation Trade**, I would be taking care and time. There are several trends and factors producing deflationary pressures globally, and they are structural (i.e. long-term). Among them, demographics, new technologies, international trade barriers...over which the new American president will in principle have little or no significant control, for the moment.

At the macroeconomic level, the figures remain good and continue to improve. Slowly? Yes. But surely! Economic surprise indicators are moving into positive territory globally, and those in the US and China are almost there too. Even so, and although I am now more comfortable saying that "the figures are promising", it is never amiss to point out that long-term investing must always involve some caution.

R. Giménez

News	Events
Surprising election result in the US, with the Republicans controlling the Presidency, Congress, and the Senate	23/NOVEMBER/16. Publication of the minutes from the latest FED/FOMC meeting
Mariano Rajoy returns to power after the socialist debacle in Spain	24-30/NOVEMBER/16. Revised 3Q16 GDP figures for the main economies: USA, GER, FRA, UK, CA
Negative yielding bonds sink -14% over the last week (-$1.4Trn)	3/DECEMBER/16. Italian referendum. Repeating of Austrian elections
China warns of the negative repercussions of a potential trade war with the US	13-14/DECEMBER/16. Last FOMC (Fed) meeting of 2016 on US interest rates

Chart 5. Bonds post-shock: interest rates still depressed, despite everything

Sovereign Yields

November 16th, 2016	2 Years	3 Years	5 Years	7 Years	10 Years	15 Years	30 Years
Switzerland	-1,16%	-0,96%	-0,70%	-0,46%	-0,17%	0,07%	0,32%
Japan	-0,11%	-0,09%	-0,06%	-0,04%	0,01%	0,16%	0,57%
Germany	-0,63%	-0,59%	-0,32%	-0,13%	0,33%	0,52%	0,96%
Austria	-0,58%	-0,47%	-0,19%	0,08%	0,59%	0,96%	1,33%
Denmark	-0,61%		-0,18%		0,41%		0,94%
Sweden	-0,69%		-0,13%	0,07%	0,52%		
Netherlands	-0,66%	-0,58%	-0,20%	-0,01%	0,48%	0,74%	1,04%
Finland	-0,61%	-0,54%	-0,27%	0,03%	0,51%	0,86%	1,04%
Belgium	-0,61%	-0,44%	-0,18%	0,07%	0,69%	1,08%	1,61%
France	-0,60%	-0,49%	-0,13%	0,17%	0,76%	1,06%	1,54%
Ireland	-0,39%	-0,28%		0,26%	0,95%	1,29%	1,84%
Italy	0,06%	0,29%	0,90%	1,42%	2,04%	2,31%	3,08%
Spain	-0,13%	0,04%	0,45%	0,94%	1,52%	1,88%	2,69%
Canada	0,66%	0,72%	0,94%	1,18%	1,53%		2,16%
Norway		0,74%	1,13%	1,35%	1,58%		
United Kingdom	0,21%	0,33%	0,66%	1,00%	1,42%	1,77%	2,05%
United States	1,00%	1,29%	1,70%	2,05%	2,26%		2,98%
Singapore	1,05%		1,65%		2,27%	2,63%	2,71%
Australia	1,74%	1,81%	2,13%	2,42%	2,64%	3,06%	3,62%

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fixed income

Elections and volatility in debt markets

The start of the fourth quarter has brought high levels of volatility on the different European and American debt markets. Rumours of a potential start to tapering in the ECB's purchase programme, the toing and froing of expectations about the Fed's 25bp rise at its December 14 meeting and, above all, the tension of election week in the US and Trump's "surprise" (but indisputable) victory have left markets exposed to all kinds of rumours. As a result, volatility levels have risen across the board (debt, credit, currencies, and equities). As long as in Europe the distant drum of the start of tapering is heard, and in the US the new president's economic plan remains a mystery, uncertainty will continue to rise.

And it is this uncertainty that has driven up the long end of interest rate curves on both sides of the Atlantic. The German 10-year rate is very close to 0.40%, with the US equivalent at 2.30%, level not seen since the end of December 2015. European credit indices have also seen a bit of a rebound, with the ITRAXX Xover at 350bp and the ITRAXX Europe at 80bp. As for emerging debt, LatAm debt has been one of the asset classes hardest hit by the US election result so far. The EMBI Global index has bounced more than 50bp to 405bp.

M. Soca

Chart 6. Ideas for 2016

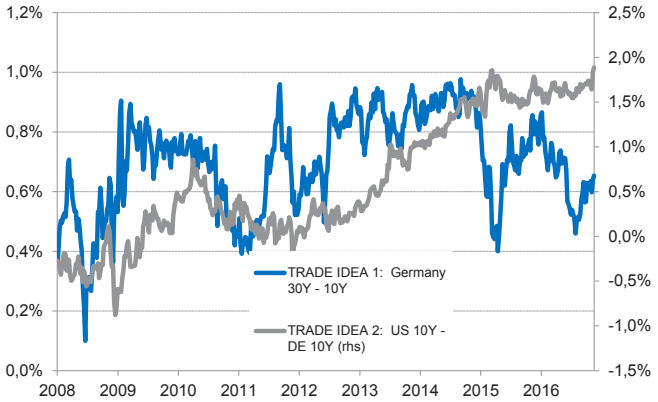
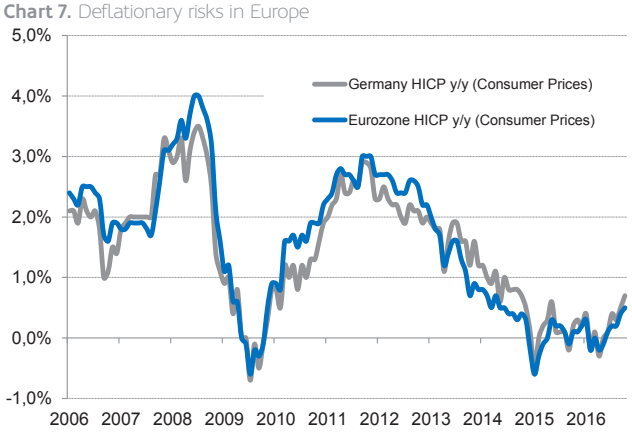


Chart 7. Deflationary risks in Europe



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equity

Ready for the Christmas rally?

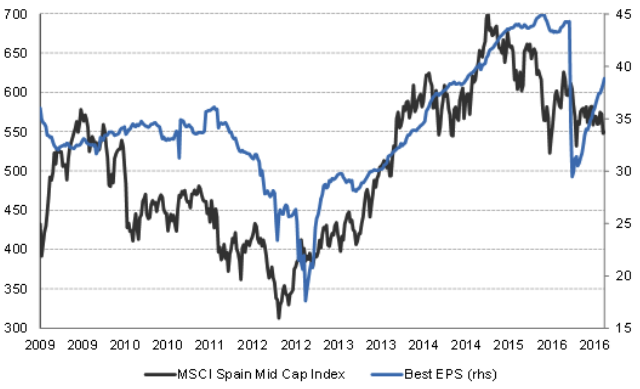
As I commented last month, the key to the market's performance could lie with the banks. It looks as though the markets were listening; and thanks to the "Trump effect" and the steepening of the yield curve, this has indeed been the case. All we need now are some positive earnings revisions for the sector. This process has started in the Spanish small-cap index, MSCI Spain Mid Cap Index (Chart 2). And most of revisions are focused on two sectors: materials and industrials. So, if forecasts continue to be raised, share prices are likely to continue their positive trend. At the same time, and having seen how the gloomiest forecasts for the Spanish market were not met (in fact quite the contrary), it seems reasonable to expect that the market will get back close to its year-end 2015 level. What we are seeing is a rotation towards more cyclical stocks, where valuations are far more attractive, and away from the more defensive plays, which in my view are now trading on very demanding multiples.

So, we should get ready to join the Christmas rally....at least until Thanksgiving.

X. Torres

Chart 8. SP500 vs. earnings

Chart 9. Performance of the MSCI Spain Mid Cap and its earnings



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equity / technical analysis

Market clean-up

Over the last month, we have witnessed, dumbfounded, the election of America's 45th president. Once again, opinion polls failed to predict the correct outcome and analysts failed with their market forecasts. The Trump victory was supposed to set markets back by around 10%; but the main indices held their ground. Not without triggering most traders' stop-losses that is; a thorough market clean-up! It is important to point out that such dramatic movements usually usher in a new defined trend. And for the coming months we see a greater possibility of higher prices than lower ones. This said, it will be important to have a stop-loss in place, which in the case of the Stoxx 50 should be the low registered on US election day: 2,874 points. As for the Ibex 35, we still see it a little weak. The 200-day moving average has provided support, and we expect to see a bounce from these levels and an attempt at a return to the top end of the bull channel. In terms of the SP 500, we are back close to the all-time highs; and if these are broken, there is the chance of a move up to 2,380.

G. Apodaca

Chart 10. Eurostoxx future (daily chart)

Chart 11. Ibex future (daily chart)

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FX

Trump Reflation Trade

Reflation can mean an increase in public spending or a reduction in taxes accompanied by flexible monetary policy that ends up driving inflation higher. The Trump victory has triggered an asset and sector rotation, now called The Trump Reflation Trade, in order to hedge against this phenomenon.

Currencies were by no means unaffected; in fact, they have played an important part in the move. As with other assets, the FX reflation trade has involved the search for protection against the interest rate rise that would be triggered by a wider deficit and higher inflation.

The USD (trade-weighted) has broken through the year's high and is now at its highest level since 2003, movement that has been further boosted by the closing of carry trade positions. As a result, the dollar has been particularly strong against emerging currencies. Against the EUR, it sits in the middle of the range we are forecasting through to the end of the year (1.05-1.10).

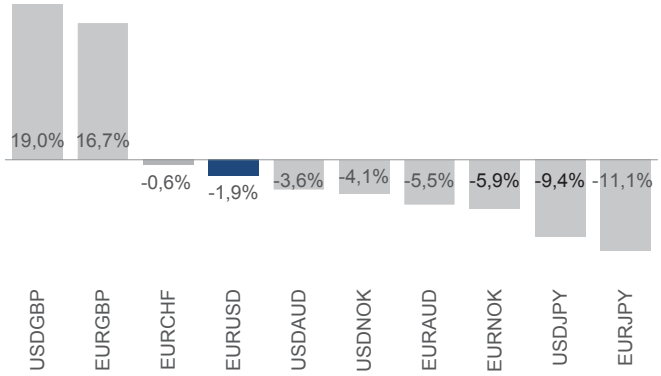
Of the emerging currencies, we would highlight the slide of the renminbi and the Mexican peso, which have moved in tune with the political situation in the US.

The JPY has also lost ground. The yen is considered a safe-haven currency, with negative or extremely low interest rates. A pick-up in rates would diminish its attractions.

T. García-Purriños

Chart 12. US Trade-Weighted Dollar

Chart 13. Performances of main currencies in 2016 (YTD)



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commodities

Waiting for the OPEC meeting

USD strength has weighed heavily on commodities. In the case of the oil price (the focus of the entire section this month), there are also then seasonal factors and the pullback to the 200-day moving average.

There is uncertainty surrounding US energy policy following the election of Trump, and particularly surrounding the obstacles to crude exports, the new energy mix, and sanctions on Iran. But at the same time, the indirect impact of other policies, such as infrastructure investment, is likely to be increased demand for oil.

This unexpected increase in demand would coincide with OPEC countries producing maximum amounts and non-Opec countries reducing CAPEX to below the level required for maintaining current production.

Overall, it looks as though the market is more concerned about the OPEC meeting than about the fundamentals. Here, our view is distanced from that of the consensus in so far that we expect the organisation to reach an agreement. We believe this for three reasons: at the geopolitical level, the rhetoric towards the Russian government and its OPEC allies has been toned down; the significant difference between official production figures and those of secondary sources suggests that some countries are trying to take the highest possible figures into the Meeting; and finally, OPEC needs to make a statement in order to demonstrate that it still has a relevant role.

Based on all of this, we are leaving our target price unchanged at USD 55 (Brent) and the stop-loss at USD 43.

T. García-Purriños

Chart 14. Excess supply and the Brent price (USD/barrel)

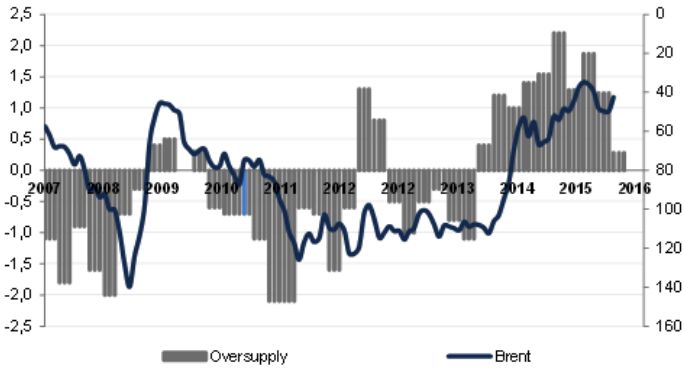
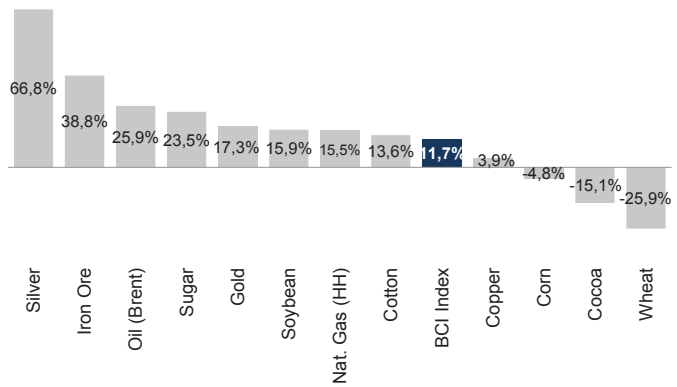


Chart 15. Performance of the main commodities in 2016 (YTD)



It is now official: we are experiencing a regime change!

The fact that the people in the UK and the US, two countries that have been at the forefront of liberalism – intellectually and politically speaking – have now spoken out so loudly against the status quo, is an indication of how exhausted the current regime is. It is also not coincidental that the pioneers who enjoyed the benefits of globalization earlier are the ones that have hit the end of the road first.

What will this imply from a world order perspective? Probably that domestic politics will overturn supra-national coordination efforts in the years to come. Forget about the Fed looking after the global economy, the US Treasury rescuing foreign countries, not to mention funding the IMF or the World Bank.

Revolving against the global order on your own is not a clever thing to do, but once the Hegemon retreats, other countries will start to follow suit. The next cracks will probably occur within the EU, which is starting to look like a vestige of a bygone era. Sooner or later another core country will leave, and it is just a matter of time until an exit strategy is commonly agreed. Political risk is hence on the rise, and with the referendum in Italy and elections in the coming months in Austria, France, Netherlands and Germany, betting for a mean-reversion to normal times is a risky strategy.

What will this mean for investments? Probably the end of the great moderation period, inflation on the rise due to both the reintroduction of trade barriers, and the promotion of local industry, accompanied with larger fiscal deficits to finance the transition into the new economic model. It is also likely that we will witness another metamorphosis of the exchange-rates regime, putting and end to the era of free-floating currencies that replaced the Bretton Woods system. This may actually be the area where most efforts for international coordination will be spent, and as a result the attractiveness of gold as a market-driven alternative currency will probably be restored.

In the long run, all these structural changes will translate into higher interest rates, and a lower return on equity, as labor costs and financing costs will both increase, whilst global economic growth – in real terms – will decrease. This will be detrimental for equities, credit and long-duration bonds, and also bad news to emerging economies – one of the biggest winners of globalization.

In the short term on the contrary, Trump's expected fiscal stimulus via tax cuts and infrastructure investments, will dramatically reduce the likelihood of a recession in the US in the coming years, which will be supportive for credit and equities, at least until financing costs start to rise. Likely winners will be domestic industries in the US, the more protected they are, the better. Examples of these are local companies in strategic sectors like energy, finance, utilities, defense and construction.

In conclusion, we need to be aware that we are going to be living in a restructuring phase, and similar to what happens in every corporate turnaround, there will be a cost associated to it.

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Equity

17/11/2016	LAST PRICE	CHANGE 1M	CHANGE YTD
INDEXES			
MSCI World	1.698	0,6%	2,1%
MSCI Emerging Markets	847,2	-5,3%	6,7%
S&P 500	2.182	2,6%	6,8%
Nikkei 225	17.863	5,7%	-6,2%
EuroStoxx 50	3.041	1,1%	-6,9%
FTSE 100	6.795	-2,2%	8,9%
DAX	10.685	1,7%	-0,5%
Ibex 35	8.710	-0,4%	-8,7%
CAC 40	4.525	1,7%	-2,4%
FTSE MIB	16.536	-0,6%	-22,8%
PSI 20	4.415	-4,0%	-16,9%
Athex	601	2,6%	-4,8%
Hang Seng	22.262,9	-3,4%	1,6%
Bovespa	60.815	-3,0%	40,3%
Micex	2.043	4,4%	16,0%
SECTORS			
Consumer Discretionary	191,1	0,7%	-1,3%
Consumer Staples	202,5	-5,2%	-2,8%
Energy	203,8	-0,1%	14,2%
Financials	100,9	8,7%	3,9%
Industry	208,3	2,2%	8,6%
Materials	215,5	2,7%	16,7%
Health Care	194,3	-0,9%	-7,6%
Technology	158,3	-0,4%	8,1%
Telecommunication	64,6	-5,9%	-4,9%
Utilities	109,4	-5,1%	-2,0%

17/11/2016	LAST PRICE	CHANGE 1M	CHANGE YTD
IBEX-5			
BBVA	6,0	4,9%	-10,9%
Inditex	31,5	-1,4%	-0,3%
Repsol	12,4	-0,2%	23,0%
Santander	4,3	7,5%	-4,8%
Telefónica	8,1	-7,5%	-20,6%
BLUE CHIPS EUROPE			
BASF	81,3	3,8%	14,9%
Daimler	65,4	2,3%	-15,7%
E.ON	6,1	-8,2%	-22,1%
HSBC	631,7	2,9%	17,8%
Nestle	69,0	-7,4%	-7,4%
Roche	234,3	0,7%	-15,2%
Royal Dutch Shell	23,3	2,5%	10,6%
Siemens	107,3	2,7%	19,3%
Vodafone	205,9	-8,3%	-6,9%
BLUE CHIPS US			
Apple	109,3	-7,0%	3,8%
Bank Of America	20,1	25,4%	19,5%
Coca-Cola	41,0	-1,4%	-4,5%
Exxon Mobil	85,9	-0,7%	10,2%
Mc Donald's	119,0	5,8%	0,7%
Microsoft	60,5	5,7%	9,0%
Procter & Gamble	83,0	-5,5%	4,5%
Walt Disney	98,7	8,7%	-6,1%

Fixed Income

17/11/2016	LAST PRICE	CHANGE 1M	CHANGE YTD
GOVERNMENT BONDS	YTM	bp	bp
Treasury 2y USD	1,02%	20,3	-3,0
Treasury 5y USD	1,68%	42,5	-8,1
Treasury 10y USD	2,24%	47,6	-2,7
Bund 2y EUR	-0,64%	1,8	-29,4
Bund 5y EUR	-0,35%	14,1	-30,2
Bund 10y EUR	0,27%	21,9	-35,5
CDS	Spread	bp	bp
ITRAX EUROPE 5Y	79,5	6,1	2,2
ITRAX EUROPE 10Y	117,6	7,5	3,8
ITRAX EUROPE SR FIN 5Y	105,4	6,1	28,6
ITRAX EUROPE SUB FIN 5	240,9	10,0	87,6
CDX USA 5Y	75,1	-0,8	-13,3
SOVEREIGN SPREADS	Spread	bp	bp
Spain / Germany 10y	131,5	25,9	17,7
France / Germany 10y	46,5	18,1	10,7
Italy / Germany 10y	181,8	47,3	85,3
Ireland / Germany 10y	50,1	19,9	-1,6
Portugal / Germany 10y	346,8	26,9	157,9
BREAKEVENS	Rate	bp	bp
Germany Breakeven 10Y	1,06%	4,0	4,0
US Breakeven 10Y	1,91%	21,2	33,3
UK Breakeven 10Y	3,02%	9,8	66,5
HY & EM SPREADS	Spread	bp	bp
BarCap US Corp HY	483,0	18,0	-177,0
JPM EM Sovereign spread	387,5	30,1	-58,1
CS EM Corp Spread vs. BM	297,2	1,5	-114,2

17/11/2016	LAST PRICE	CHANGE 1M	CHANGE YTD
IBEX-5 CDS 5Y		bp	bp
BBVA	141,8	13,6	12,5
Iberdrola	78,5	4,9	-4,3
Repsol	150,0	2,4	-110,6
Santander	140,4	11,0	4,6
Telefónica	130,9	16,4	11,3
BLUE CHIPS EUROPE		bp	bp
BASF	41,3	-6,8	1,1
Daimler	59,9	8,6	-2,5
E.ON	78,0	2,3	-20,0
HSBC	75,1	-6,3	4,2
Nestle	30,4	4,7	-0,7
Roche	33,0	-0,5	2,0
Royal Dutch Shell	n.a.	n.a.	-12,1
Siemens	42,4	-2,0	2,2
Vodafone	89,8	-1,6	-4,9
BLUE CHIPS US		bp	bp
General Electric	38,5	1,3	0,4
Bank Of America	72,9	-8,1	0,6
Coca-Cola	27,6	2,1	2,1
Chevron	85,0	-15,0	16,7
Mc Donald's	35,8	-5,0	-1,4
Microsoft	34,4	0,1	2,2
Pfizer	36,8	3,5	18,2
Walt Disney	29,3	2,2	12,9

FX

17/11/2016	LAST PRICE	CHANGE 1M	CHANGE YTD
EURUSD	1,0662	-3,1%	-1,8%
EURCHF	1,0714	1,5%	1,6%
USDJPY	109,4400	-5,1%	9,9%
GBPEUR	1,1682	-5,2%	16,2%
AUDJPY	81,6820	3,1%	7,2%

Commodities

17/11/2016	LAST PRICE	CHANGE 1M	CHANGE YTD
Gold (USD/oz)	1.227,5	-2,3%	15,7%
Copper (USD/t)	5.433,0	16,2%	15,5%
Crude Brent (USD/bbl)	46,9	-10,2%	4,4%
Corn (USD/bushel)	340,0	-4,0%	-5,2%
GSCI Commodity Index	357,6	-4,6%	14,7%

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