The Weekly Market View

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Lacking direction

Global equities finished the week lower, with Europe and Japan leading the way. There has been a lack of direction in markets ever since the Brexit referendum at the end of June. Three weeks into the month and most markets have given up the majority of their August gains. At one point European equities were up 5% and Japanese equities up over 3%. Currently for August these numbers read 2% and <1% respectively. Still not bad, but neither market has been in positive territory at any point this year, while on a year-to-date basis both are still heavily down in local currency terms. This does of course mask big moves in exchange rates as the US dollar figures differ greatly. The only major markets/geographies which have performed well this year are the US (+7%) and Emerging Markets (+10%, +15% in USD). The lack of direction is also visible in other asset classes, the 10-year US Treasury has been range-bound of late, and so too gold prices. It appears that the market is awaiting a catalyst to firmly choose a direction.

A quiet summer, but upside down world persists

As market participants return from their summer holidays, they will be happy to have found relatively stable markets during July and August. Although equities experienced a mini-rally earlier this month, which has now mostly unwound, this is nothing compared to the wild swings seen during H1 of this year. Overall over the past weeks nothing has materially changed, investors are still buying bonds in the hope for capital appreciation and equities for future yield. Of course this cannot be a sustainable strategy in the longer-term. Bond yields have been compressed to such an extent that there is little alternative but to invest in equities. This has kept markets afloat for now, but volumes continue to be very weak suggesting investors are (rightfully) extremely pessimistic about the foundation and durability of any risk rallies. As a result we maintain our conservative asset allocation and equity strategy. We favour bonds over equities in our asset allocation and overweight US and EM equities vs. European and Japanese equities in our equity allocation.

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,183.9	-0.0	6.8
Dow Jones	18,552.6	-0.1	6.5
Nasdaq	5,238.4	0.1	4.6
DAX	10,544.4	-1.6	-1.8
Nikkei 225	16,545.8	-2.2	-13.1
FTSE 100	6,859.0	-0.8	9.9
Sensex	28,077.0	-0.3	7.5
Hang Seng	22937.2	0.7	4.7
Regional Markets (Sunday to Thursday)			
ADX	4518.5	-0.2	4.9
DFM	3572.4	1.4	13.4
Tadawul	6227.0	-1.6	-9.9
DSM	11320.4	3.3	8.5
MSM30	5894.46	-0.0	9.0
BHSE	1149.0	-0.6	-5.5
KWSE	5471.9	-0.5	-2.6
MSCI			
MSCI World	1,731.9	-0.2	4.2
MSCI EM	910.3	0.0	14.6

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	50.9	8.3	36.5
Nymex WTI USD/bbl	48.5	9.1	31.0
OPEC Baskt* USD/bbl	46.5	9.2	48.7
Gold 100 oz USD/t oz	1341.5	0.4	26.4
Platinum USD/t oz	1114.3	-0.8	25.0
Copper USD/MT	4774.0	0.6	1.5
Alluminium	1659.25	1.0	10.2
Currencies			
EUR	1.1325	1.5	4.3
GBP	1.3075	1.2	-11.3
JPY	100.22	-1.1	20.0
CHF	0.9605	-1.4	4.3
Rates			
USD Libor 3m	0.8171	-0.1	33.4
USD Libor 12m	1.5232	-0.2	29.3
UAE Eibor 3m	1.1727	-0.7	11.2
UAE Eibor 12m	1.7596	-0.2	19.3
US 3m Bills	0.2993	9.0	84.0
US 10yr Treasury	1.5781	4.3	-30.5

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Markets rudderless without Central Bank direction, but EM benefits

Investors waiting for a signal

The dominant driver for global markets this year has been central bank action, or at times, inaction. Over the last month or so there has been little noteworthy to come from the major central banks; the BoJ disappointed by not delivering the degree of additional stimulus which investors had anticipated, this saw the yen rally and Japanese equities correct somewhat. However expectations for further intervention remain and this keeps a floor under the market for now. There have been half-hearted attempts by Fed officials to prime the market for a US rate hike again, but these have been shrugged off by investors given mixed economic data. All the while Mr Draghi of the ECB has been silent. Given the market's degree of monetary policy addiction recently it should come as no great surprise that without a firm central bank cue markets have been directionless over the past month or so. This could remain the case for a while until the next catalyst pushes markets higher or lower. When that happens it will again be central banks reaction function that will be most important for investors. However, given soft global economic data and policymakers starting point, a turn lower, rather than higher still appears to most likely scenario.

Europe and Japan underperforming US and EM

	YTD low	% from low	Current	YTD high	% from high
Euro Stoxx 50	2,680	11%	2,968	3,268	-9%
Nikkei 225	14,952	11%	16,546	19,033	-13%
S&P 500	1,829	19%	2,184	2,190	0%
EM $	689	32%	910	916	-1%

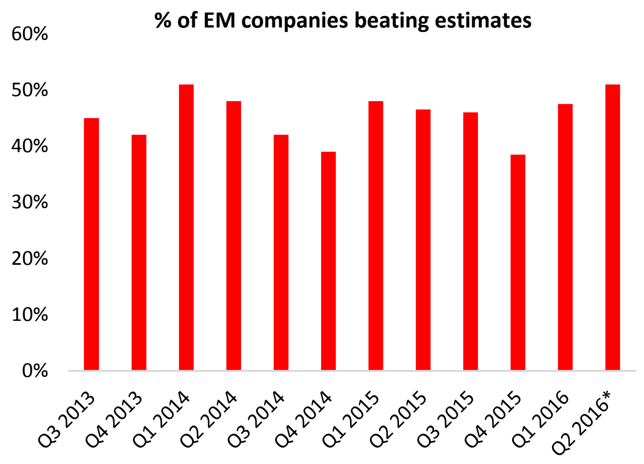
Source: Thomson Reuters Datastream

EM remains flavour of the month/year

While developed markets are struggling to move higher, emerging markets are benefitting from the stability of recent weeks. EM equities are up close to 4% in August. Not only that, the table above shows that EM (as well as US) equities are trading towards the top of their YTD range, rallying 15%. This represents and outperformance over developed markets of 10% in US$ terms. Most of this outperformance has occurred since the Brexit referendum, the result of which added to the already lukewarm global backdrop, thereby reinforcing low developed world interest rates. **We moved overweight EM equities in the days following the referendum** (see link), arguing that while macro fundamentals in EM remain challenging, the asset class has scope to benefit from flows out of Europe and cheap valuations in the context of a stable dollar. So far this has more or less played out as expected. Although we are not optimistic on the long-term prospects for EM at this point in time, we are seeing signs which suggest that the EM rally can go further.

EM rally is growing legs

The EM earnings season has been a positive one. With around 90% of companies having reported earnings, the number of beats has exceeded 50% for the first time in two years, see chart below.



*As of 18 August 2016

Source: MSCI, Thomson Reuters Datastream

There are reasons to believe EM's outperformance can continue, especially given the current extremely favourable macro backdrop, namely:

- Continued loose developed world monetary policy…
- …leading stable US dollar…
- …as well as stable to stronger commodity prices
- Dovish domestic EM monetary policy
- Relative improvement in the macro cycle of EM relative to DM
- Cheap valuations

To the extent these conditions remain in place EM should continue to do well, especially given it is still coming from a very low base. Not only is the current earnings season showing improvement, but forward looking earnings estimates are also being upgraded by consensus. For example, 3-month revisions to forward earnings estimates are the highest in 5 years, marking a clear inflection point in early 2016.

Of course risks remain aplenty and we will continue to monitor these closely. Foremost is a re-strengthening of the US dollar, this can be initiated by sharply higher expectations of US monetary policy (which we think is unlikely) as well as a flight to quality. Another risk relates to China, in particular its FX regime. For now, however, we believe the pieces remain in place for EM to attract further flows out of the developed world, thereby we maintain our overweight recommendation on EM equities.

Summary market outlook

Bonds	
Global Yields	US Treasury 10yr yield remained contained and below 1.6%. Despite relatively hawkish statements from a couple of FOMC members, yields have barely budged. We remain of the view that yields are unlikely to move up significantly.
Stress and Risk Indicators	Risk indicators such as the VIX index fell as equities sustained their gains. The index is currently close to its lower limit, and it has, therefore, limited room on the lower side. Sovereign CDS Spreads for EMs also eased further.

Equity Markets	
Local Equity Markets	Despite strong rally in the oil price, GCC equity markets were mixed as they seem to have been constrained by earnings slowdown. In the very near term, markets are likely to move sideways if oil price sustains the current level.
Global Equity Markets	Global equity markets took a breather last week after strong performance in the prior weeks. With earning seasons almost close to the end, markets will start focusing on the economic fundamentals. We see sideways movement in the very near term before important central banks' meetings next month.

Commodities	
Precious Metals	The gold price were largely flattish last week. However, we believe that the price will benefit when the markets' attention refocuses on economic fundamentals.
Energy	After a strong rally in the past weeks, oil price is likely to stabilize in the very near term.
Industrial Metals	Industrials metals were mixed last week. Long term prospects remain negative with China pushing in the direction of less rather than more consumption of industrial metals.

Currencies								
EURUSD	Euro continued its upward move against the dollar last week. However, we believe that it has run its course and likely to move lower in coming days.							
Critical levels	R2	1.1494	R1	1.1409	S1	1.1197	S2	1.1070
GBPUSD	Cable regained some of it's loses last week as broader dollar weakness persisted. However, we believe that the trend for the currency is still downward.							
Critical levels	R2	1.3361	R1	1.3218	S1	1.2899	S2	1.2723
USDJPY	The Japanese yen gained further, breaching the 100 mark against the US dollar during the week. We believe that the currency will largely react on the expectations of BoJ's action. Therefore, until the next month's BoJ meeting, its likely to remain range bound (below) with relatively higher volatility.							
Critical levels	R2	102.31	R1	101.27	S1	99.36	S2	98.49

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
8/23/2016	Markit Mfg PMI	Aug P	52.7	52.9	Housing data and revision in the second quarter GDP will be looked at closely by the market.
8/23/2016	New Home Sales	Jul	580k	592k	
8/24/2016	Existing Home Sales	Jul	5.51m	5.57m	
8/25/2016	Durable Goods Ex Trans	Jul P	0.4%	-0.4%	
8/26/2016	GDP Annualized QoQ	2Q S	1.1%	1.2%	
8/26/2016	Univ. of Mich. Sentiment	Aug F	90.7	90.4	

Japan

	Indicator	Period	Expected	Prior	Comments
8/23/2016	Nikkei Mfg PMI	Aug P	--	49.3	Market will look for clues for BoJ's action in PMI and inflation data.
8/26/2016	CPI YoY	Jul	-0.4%	-0.4%	
8/26/2016	Core CPI YoY	Jul	0.4%	0.5%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
8/23/2016	Markit Mfg PMI	Aug P	52.0	52.0	PMIs are to be the main focus of the market.
8/23/2016	Markit Services PMI	Aug P	52.8	52.9	
8/24/2016	GDP SA QoQ (GE)	2Q F	0.4%	0.4%	
8/25/2016	IFO Business Climate (GE)	Aug	108.5	108.3	

China and India

Indicator	Period	Expected	Prior	Comments
				No important economic data from China and India

Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTTNews
4. Reuters
5. Gulfbase
6. Zawya

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