The Weekly Market View

August 29 2016

بنك أبوظبي التجاري ADCB

Jackson Hole speech strengthens dollar and curtails EM rally

Equities finished the week slightly lower as US Federal Reserve Chair Janet Yellen talked up the prospects of a hike in interest rates before the end of the year. Markets' implied probability of a September and December rate hikes increased, sending the dollar and bond yields up and commodities and equities, particularly EM equities down (the latter fell for the first time in 7 weeks). Global data was mixed during the week, US Q2 GDP growth was revised down to a mere 1.1% QoQ annualized (from 1.2%), however, new home sales in the US surged 12.4% in July to their highest level since October 2007. In Europe German business confidence took a major hit as the Ifo survey fell by the most in over 4 years.

Fed déjà vu

As was to be expected recent weakness in the dollar coupled with the strength in US equity markets afforded the Fed the space to once again talk up the prospect of another rate increase, the first of 2016. Markets were not surprised by the more hawkish tone to Mrs Yellen's words given that each time markets are strong and the dollar weak, talk of tighter monetary policy in the US intensifies. With equities only small down, the biggest move came in the dollar. It seems reasonable to assume that Mrs Yellen's Jackson Hole speech likely marks the end of the mini dollar-weakening cycle which has been in place since the end of July. This period has been characterized by calm markets and limited (major) central bank intervention which has allowed Emerging Markets (both equities and bonds) to perform very strongly. If this is correct, and dollar weakness has now been capped again, we can expect a pull-back in risk assets, in particular EM assets which have performed very strongly of late. Some profit taking is natural but we would expect any weakness in EM assets to prove temporary as we remain doubtful of the Fed's ability to tighten at a faster rate than what they have done thus far, i.e. roughly one 25bps rate hike every 9-12 months.

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,169.0	-0.7	6.1
Dow Jones	18,395.4	-0.8	5.6
Nasdaq	5,218.9	-0.4	4.2
DAX	10,587.8	0.4	-1.4
Nikkei 225	16,360.7	-1.1	-14.0
FTSE 100	6,838.1	-0.3	9.5
Sensex	27,782.3	-1.0	6.4
Hang Seng	22909.5	-0.1	4.5
Regional Markets (Sunday to Thursday)			
ADX	4519.8	0.0	4.9
DFM	3492.2	-2.2	10.8
Tadawul	5976.9	-4.0	-13.5
DSM	11134.8	-1.6	6.8
MSM30	5823.06	-1.2	7.7
BHSE	1146.4	-0.2	-5.7
KWSE	5428.9	-0.8	-3.3
MSCI			
MSCI World	1,726.1	-0.3	3.8
MSCI EM	901.4	-1.0	13.5

Global Commodities, Currencies and Rates

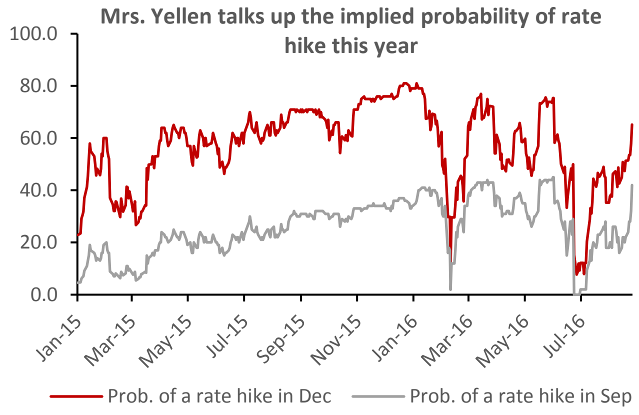
Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	49.9	-1.9	33.9
Nymex WTI USD/bbl	47.6	-1.8	28.6
OPEC Baskt* USD/bbl	45.3	-3.3	44.8
Gold 100 oz USD/t oz	1321.2	-1.5	24.5
Platinum USD/t oz	1073.8	-3.6	20.4
Copper USD/MT	4622.0	-3.2	-1.7
Alluminium	1632.5	-1.6	8.4
Currencies			
EUR	1.1198	-1.1	3.1
GBP	1.3137	0.5	-10.9
JPY	101.84	1.6	18.0
CHF	0.9782	1.8	2.4
Rates			
USD Libor 3m	0.8334	2.0	36.0
USD Libor 12m	1.5366	0.9	30.4
UAE Eibor 3m	1.1807	0.7	11.9
UAE Eibor 12m	1.7636	-0.1	19.6
US 3m Bills	0.3145	5.1	93.3
US 10yr Treasury	1.6296	3.3	-28.2

Please refer to the disclaimer at the end of this publication

Mrs. Yellen talks up the prospect of rate hikes; we have our doubts

Jackson Hole used by the Fed chair to push market probability of a rate hike this year

As has been the case in the past, Fed officials used the Jackson Hole symposium to guide financial markets on monetary policy. Federal Reserve Chair Janet Yellen took the opportunity to provide a hawkish signal, according to her statement economic conditions, especially the labour market situation as well as consumer spending have improved in recent months, thereby strengthening the case for an increase in the federal funds rate. Since the Brexit vote, financial markets have been attaching a very low probability to a Fed rate hike this year, which some FOMC members have termed “market complacency”. We believe that Mrs. Yellen’s statement was an attempt by the Fed to address this complacency. Before her statement last Friday, several other FOMC members in recent weeks had also argued in favour of rate hikes this year. However, market reaction to Mrs Yellen’s statement was, as expected, more pronounced. The market probability of a rate hike even in September jumped by 10% to 42% while the December rate hike probability moved to 65%.



Source: Bloomberg

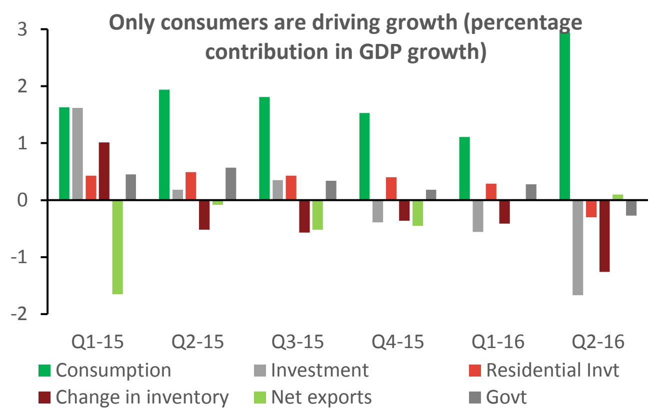
Near-term strong economic releases will push up market probability of a rate hike further

In her assessment of the economic situation, Mrs Yellen focused on the solid growth in household spending and job gains. This has brought the focus back on this week’s job market data release. The Bloomberg consensus expects another solid month of job gains which is based on the fact that jobless claims have trended lower through August. In our view, the job data is unlikely to disappoint the market this month which will further boost the market expectations of a rate hike. However, there are other important data points such as ISM manufacturing which are scheduled to be released this week which will also potentially have an impact on the market’s assessment of the economy.

Any robust economic release in the near-term will likely boost the dollar which in turn could bring back some pressure on Emerging Market currencies. However, as we argue in the next segment, US economic conditions are not strong enough to provide conditions for rate hike by the Fed. Therefore, it is possible that coming economic releases could lead to volatility in EM asset classes in the very near-term, possibly even until the next Fed meeting on 21st September.

Notwithstanding near-term data releases, we believe that the Fed’s assessment is too optimistic

Economic growth has largely been driven by consumer spending in the last few quarters. More specifically in the last quarter, consumer spending was the only positive contributor while other sectors dragged growth lower. Private fixed investments have been contracting for the last three quarters, and was joined by residential investment last quarter. Most recent indicators do not provide a strong signal of any revival in investments. On top of that, the presidential election in November will act as an overhang to the investment environment, especially given the radically different economic policies proposed by the candidates. On the Republican side, talks of renegotiating international trade treaties along with a radical rethinking of immigration policy do not bode well for investments. Moreover, due to anaemic global growth and the large dollar appreciation since 2014, net exports have hardly contributed to growth. Note that the impact of the Brexit vote is yet to play out fully which will further weaken growth dynamics in Europe, thereby also negatively affecting US exports.



Source: Bureau of Economic Analysis

In an environment where growth is mainly coming from one sector and the investment backdrop looks less than satisfactory, the Fed will have limited room to move on the policy front in the very near-term.

Summary market outlook

Bonds	
Global Yields	US Treasury 10yr yield, after remaining largely stable during earlier days of the week, jumped up Friday on Mrs. Yellen's hawkish statement. It moved to highest since Brexit vote. However, we remain cautious on the significant upward move in the US yields as economic data continues to suggest a slower growth.
Stress and Risk Indicators	Risk indicators such as the VIX index moved up as hawkish statement by the Fed chair induced a retreat in the stock market from its record levels. We see further possibility of up move in the index in the very near term. The Fed chair induced near term marginal dollar rally would also be pushing EMs CDS spreads a bit higher.

Equity Markets	
Local Equity Markets	The GCC equity markets continue to adjust the new earnings reality, especially after the second quarter earnings disappointments. In the very near term, retreat in the oil price will also have some impact on the regional markets.
Global Equity Markets	Global equity markets retreated a bit last week on the expected hawkish Fed. Now the event has actually played out as expected, there is further possibility of downside move in the very near term in the global equities, particularly in EM equities on the US dollar strength.

Commodities	
Precious Metals	The prospect of Fed rate hike and strong dollar had a negative impact on the gold price. 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	Industrial metals joined the decline in other asset classes last week. Long term prospects remain negative with China pushing in the direction of less rather than more consumption of industrial metals.

Currencies								
EURUSD	The euro gave up some of its recent gains on the hawkish Fed chair statement. We believe that it still has further downward room in the very near term.							
Critical levels	R2	1.1419	R1	1.1308	S1	1.1134	S2	1.1071
GBPUSD	Cable benefitted on better than expected economic releases last week. However, we believe that the trend in the currency is downward on diverging monetary policy stance, BoE remaining dovish while the Fed trying to talk up the prospect of rate hike this year.							
Critical levels	R2	1.3394	R1	1.3266	S1	1.3022	S2	1.2906
USDJPY	The Japanese yen weakened a bit against the US dollar during the week, mainly on the Mrs. Yellen statement. 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	103.24	R1	102.54	S1	100.54	S2	99.24

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
8/29/2016	Personal Income	Jul	0.4%	0.2%	Personal income & spending and ISM manufacturing will be key focus point this week, before all Important job market are released on Friday.
8/29/2016	Personal Spending	Jul	0.3%	0.4%	
8/29/2016	PCE Deflator YoY	Jul	0.8%	0.9%	
8/29/2016	Core PCE Deflator YoY	Jul	1.5%	1.6%	
8/31/2016	ADP Employment Change	Aug	165k	179k	
9/01/2016	ISM Manufacturing	Aug	52.0	52.6	
9/02/2016	Change in Nonfarm Payroll	Aug	180k	217K	
9/02/2016	Unemployment Rate	Aug	4.8%	4.9%	
9/02/2016	Average Hourly Earnings YoY	Aug	2.5%	2.6%	
9/02/2016	Factory Orders	Jul	2.0%	-1.5%	

Japan

	Indicator	Period	Expected	Prior	Comments
8/30/2016	Jobless Rate	Jul	3.1%	3.1%	Job market data and PMI are going be important.
8/30/2016	Job-To-Applicant Ratio	Jul	1.37	1.37	
8/31/2016	Industrial Production MoM	Jul P	0.8%	2.3%	
9/01/2016	Nikkei Mfg PMI	Aug F	--	49.6	

Eurozone

	Indicator	Period	Expected	Prior	Comments
8/30/2016	Consumer Confidence	Aug F	--	-8.5	PMIs are to be the main focus of the market.
8/31/2016	Unemployment Rate	Jul	--	10.1%	
8/31/2016	CPI Estimate YoY	Aug	--	0.2%	
8/31/2016	Core CPI YoY	Aug A	--	0.9%	
9/01/2016	Markit Mfg PMI	Aug F	--	51.8	

China and India

	Indicator	Period	Expected	Prior	Comments
9/01/2016	Manufacturing PMI (CH)	Aug	49.9	49.9	China's PMIs and India's second quarter growth figure are important for market.
9/01/2016	Non-manufacturing PMI (CH)	Aug	--	53.9	
9/01/2016	Caixin Mfg PMI (CH)	Aug	50.2	50.6	
This Week	Infrastructure Industries growth (IN)	Jul	--	5.2%	
08/31/2016	GDP YoY (IN)	2Q	7.6%	7.9%	
09/01/2016	Nikkei Mfg PMI (IN)	Aug	--	51.8	

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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