Draghi disappointment shifts attention to the Fed

Last Thursday markets were expecting Mr. Draghi to do again what he always does, i.e. surprise on the upside. Instead he took a series of measures the market was already expecting, such as the extension of the program of monthly purchases from September 2016 to March 2017 (at the earliest) and the reduction of the deposit rate from -0.2 to -0.3%. Also the statement that the ECB will keep liquidity constant (i.e. repurchase bonds with the proceeds from expiring securities), whilst for the first time explicitly announced, was hardly enough to impress the markets as it was assumed that the ECB would anyway – also in this sense – follow in the footsteps of the Fed (which, for all the talk of rate hikes, has kept the size of its balance sheet constant after finishing QE). The spike in the euro – combined with the sharp decline in Euro-zone equities – confirmed that in Europe at least the old mantra "bad news is good news" still holds: the markets were expecting news to be sufficiently bad for the ECB to take more resolute action.

Monetary policy divergence prospects now less pronounced

The same mantra, however, might lose some validity in the United States. This is so because markets are right now pricing in a series of modest rate hikes through 2016. The Federal Reserve is steering its communication in such a way that long-term yields will remain well contained, and the US dollar will remain relatively stable versus other currencies. A stable US dollar – euro exchange rate is, of course, a good thing for global capital markets. For one thing it stabilizes commodity and energy prices, and - critically – might help in stemming further outflows from emerging markets. Stable commodity prices will also help in anchoring inflation expectations. Precisely because the Federal Reserve is now not expected to hike rates significantly, any disappointment on this front – for instance the decision to not enact any further hike in 2016 - might be interpreted as a lack of confidence in the US economy, with consequent fears for companies' earnings. Thus for the US at least, bad news is still simply bad news, and good news is good news!

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,091.7	0.1	1.6
Dow Jones	17,847.6	0.3	0.1
Nasdaq	5,142.3	0.3	8.6
DAX	10,752.1	-4.8	9.7
Nikkei 225	19,504.5	-1.9	11.8
FTSE 100	6,238.3	-2.1	-5.0
Sensex	25,638.1	-1.9	-6.8
Hang Seng	22235.9	0.8	-5.8
Regional Markets (Sunday to Thursday)			
ADX	4220.1	0.4	-6.8
DFM	3149.9	0.0	-16.5
Tadaw ul	7268.0	0.4	-12.8
DSM	10489.8	-0.4	-14.6
MSM30	5556.67	-2.0	-12.4
BHSE	1227.7	-0.5	-13.9
KWSE	5785.5	-0.1	-11.5
MSCI			
MSCI World	1,694.8	-0.3	-0.9
MSCI EM	812.3	-1.7	-15.1

Global Commodities, Currencies and Rates

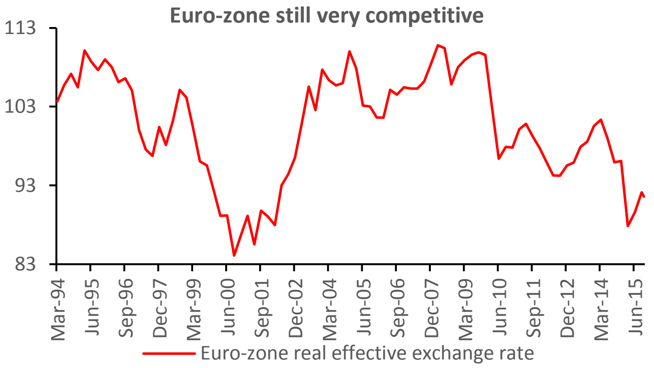
Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	43.0	-4.1	-25.0
Nymex WTI USD/bbl	40.0	-4.2	-25.0
OPEC Baskt USD/bbl	37.9	-3.1	-27.1
Gold 100 oz USD/t oz	1086.4	2.7	-8.3
Platinum USD/t oz	879.5	5.2	-27.2
Copper USD/MT	4637.0	0.0	-27.1
Alluminium	1509.5	3.6	-17.7
Currencies			
EUR	1.0881	2.7	-10.1
GBP	1.5112	0.5	-3.0
JPY	123.11	0.3	-2.7
CHF	0.9964	-3.3	-0.2
Rates			
USD Libor 3m	0.4620	11.5	80.8
USD Libor 12m	1.0177	4.5	61.8
UAE Eibor 3m	0.9474	1.7	39.9
UAE Eibor 12m	1.3214	0.0	30.1
US 3m Bills	0.2136	27.3	501.7
US 10yr Treasury	2.2693	2.2	4.5

Please refer to the disclaimer at the end of this publication

In 2016 the real issue will be growth rather than (the lack of supportive) monetary policy

Draghi no longer surprises, but is still equity-friendly

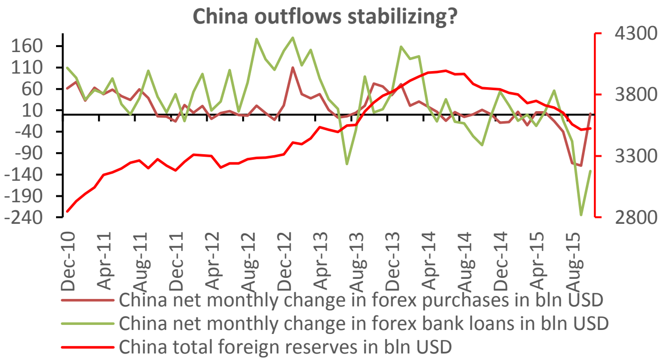
As mentioned on the first page of this weekly, yes, Mr. Draghi disappointed his audience. As we will outline below, the ECB's reluctance makes it easier for the Federal Reserve to hike rates without triggering excessive upward speculation on the US dollar. Critically, less upward pressure on the US dollar will make it easier for China and other emerging markets to prevent excessive capital outflows. Before analysing implications beyond the Euro-zone, it makes sense to put things in perspective. A slightly stronger euro does not alter the fact that Europe has gained in competitiveness over the last years. The euro might not depreciate further, however, neither should it massively appreciate. European equities continue to benefit from a monetary environment that is relatively friendlier than that of most other equity markets.



Source: Bloomberg

USD stabilization good for China and emerging markets

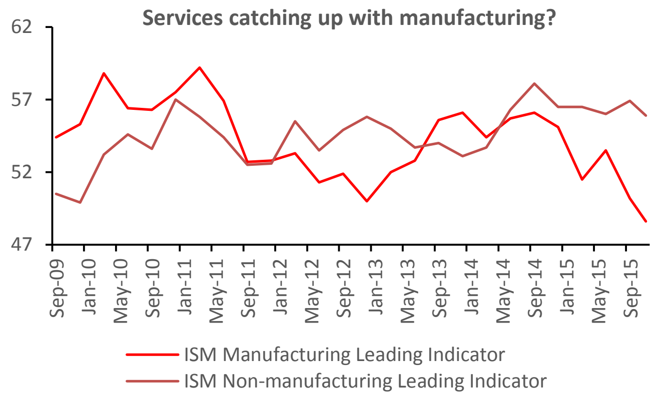
In our earlier weekly we were still contemplating a temporary overshoot of the US dollar, because the market – while already having internalized a shallow path of rate hikes come 2016 – was still contemplating more aggressive easing by the ECB. It is, of course, difficult to forecast exchange rates over a short horizon. Last week's ECB event, however, confirms our view that 2016 is going to be a year of relative exchange stability, with the EURUSD largely confined in the 1.05-1.15 trading range. This should provide some critical support to emerging markets, and in particular China, containing its capital flows.



Source: Bloomberg

Economic growth, not restrictive policy, the real risk

As we move into 2016, it appears clear that the world's major central banks are increasingly at pains to significantly steer the course of events. The European Central Bank has a hard time to significantly increase its expansionary monetary stance. Similarly, the Federal Reserve will have a hard time to hike rates at a pace comparable to what happened in other rate hiking cycles. As things stand now, growth in the United States is likely to remain sluggish. It is true that the labour marketing remains relatively buoyant. It is also true that third quarter growth surprised on the upside. The real estate sector, however, is not extremely strong. The manufacturing sector is in recession, and investments in the energy sector have collapsed. The uptick in unit labour costs, while not sufficient to significantly alter the price dynamics (i.e. decisively bring the Fed closer to its inflation target), risks negatively impacting earnings. It has been argued that the service sector, which constitutes 88% of the country's economy, will be resilient to the downturn in manufacturing. We had warned against this assumption, as the manufacturing sector historically tends to lead the economic cycle, and thus also the service sector. Last week, we saw the first sign of that.



Source: Bloomberg

What if we are wrong?

We could be wrong, of course. Growth in the United States might turn out to be much stronger than we expect. In that case our underweight in US equities and our US Treasury positions would not be warranted. Under the assumption that growth would be better, however, we would still see upside on our other equity calls in Europe, India and China, such that our US equity underweight would be an opportunity cost, rather than an effective loss. We admit that we are running some risks by our long call on US Treasuries. We remain adamant, however, that Treasuries remain the best risk hedge in a world of low inflation and deleveraging. As such we could – within a well-diversified portfolio - take some prospective losses on that side. A massive hike in long term yields seems to us still unlikely in view of the dependence of the economy on real estate. And the Fed probably shares our opinion in that regard.

Summary market outlook

Global Yields	US 10-year Treasury yields twice breached 2.30% during the week, once during Thursday's ECB meeting and again after Friday's US non-farm payrolls data, eventually settling at 2.27%. Like Eurozone equities, European sovereign bond yields had been positioning for significantly greater ECB stimulus but were left disappointed. 10-year German bunds for example rose from around the 0.52% level to 0.75%.
Stress and Risk Indicators	The VIX index settled below 17 after reaching 19 during Thursday's ECB related market turbulence.
Precious Metals	The gold price benefitted from dollar weakness during the week, rallying 2.7% to $1,086/oz. Overall, we remain cautious on the precious metal price.
Local Equity Markets	Local markets have a lot to catch up on as most of the action (ECB and US non-farm payrolls) happened after Thursday's market close. Expect some downward pressure following oil's move lower and European equities' sell-off.
Global Equity Markets	A terrible week for global equities. European markets took the bulk of the hit, finishing strongly lower on Thursday after ECB stimulus did not live up to expectations. Elsewhere Japanese and EM equities also did not manage to escape the sell-off, but held-up better than Eurozone equity markets. US equities on the other finished a very bumpy week moderately up, a good non-farm payrolls number (+211k) and big revisions to previous months' data did nothing to derail US equities.
Energy	Despite the weaker US dollar, energy prices were unable to capitalise last week as OPEC decided to maintain its strategy and not cut its production quotas. WTI finished at $40/bbl and Brent at $43/bbl. Medium-term a less strong dollar should help to remove some of the downward pressure on energy prices.
Industrial Metals	Industrial metals prices stabilised during the week but continue to lack an identifiable catalyst in our view.

Currencies	Commentary	Critical levels
EURUSD	A big jump in the Euro on Thursday as Mario Draghi underwhelmed the market with the changes to the Eurozone's asset purchase programme. Markets had positioned for significantly further easing which was not forthcoming.	R2 - 1.1252 R1 - 1.1067 S1 - 1.0610 S2 - 1.0338
GBPUSD	A fairly steady week for sterling, appreciating modestly against the dollar. The Fed is likely to hike before the BOE which could result in some near term weakening. Medium to longer-term the UK's weak external position also adds to moderate downward pressure against the greenback.	R2 - 1.5319 R1 - 1.5216 S1 - 1.4952 S2 - 1.4791
USDJPY	The Yen was flat over the course the week. We expect that the currency is unlikely to move significantly in either direction from the current level/range.	R2 – 124.40 R1 – 123.75 S1 – 122.38 S2 – 121.66

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
12/10/2015	Initial Jobless Claims	5-Dec	268k	269k	Following Friday's non-farm payrolls release there are no major data releases this week. Retail sales the one to watch.
12/11/2015	Retail Sales Advance MoM	Nov	0.30%	0.10%	
12/11/2015	U. of Mich. Sentiment	Dec P	92	91.3	

Japan

	Indicator	Period	Expected	Prior	Comments
12/7/2015	GDP SA QoQ	3Q F	0.10%	-0.20%	Final Q3 GDP the only major data release from Japan this week.
12/7/2015	GDP Annualized SA QoQ	3Q F	0.20%	-0.80%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
12/8/2015	GDP SA QoQ	3Q P	0.30%	0.30%	The Swiss National Bank rate decision is arguably the most interesting to watch following the excitement around the ECB's meeting last Thursday.
12/8/2015	GDP SA YoY	3Q P	1.60%	1.60%	
12/8/2015	Household Cons QoQ	3Q	0.50%	0.40%	
12/10/2015	SNB rate decision (CH)	10-Dec	-0.75%	-0.75%	

China and India

	Indicators	Period	Expected	Prior	Comments
12/6/2015	Foreign Reserves (CH)	Nov	$3492.5b	$3525.5b	China releases key data this week, to watch closely are foreign reserves, inflation, industrial production and trade numbers.
12/7/2015	Trade Balance (CH)	Nov	$64.15b	$61.64b	
12/7/2015	Exports YoY (CH)	Nov	-5.00%	-6.90%	
12/7/2015	Imports YoY (CH)	Nov	-11.80%	-18.80%	
12/8/2015	CPI YoY (CH)	Nov	1.40%	1.30%	
12/12/2015	Retail Sales YoY (CH)	Nov	11.10%	11.00%	
12/12/2015	Industrial Production YoY (CH)	Nov	5.70%	5.60%	
12/6/2015	BoP Current Account Balance (IN)	3Q	-$7.80b	-$6.20b	
12/9/2015	Exports YoY (IN)	Nov	--	-17.50%	
12/9/2015	Imports YoY (IN)	Nov	--	-21.20%	
12/11/2015	Industrial Production YoY (IN)	Oct	--	3.60%	

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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