The Weekly Market View

Dec 14 2015

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Déjà vu or is this time different?

Hardly the backdrop the Fed would have liked going into the final policy-setting meeting of 2015. Last week risk-off sentiment returned to markets in a big way. US equities suffered their worst week since August, with the S&P500 sliding 3.8%. European and Emerging Market equities fared even worse, developed market bond yields rallied and oil prices slumped further, Brent and WTI ending the week at $38/bbl and $35/bbl respectively, hitting levels not seen since 2009. Volatility soared as reflected in the VIX which jumped 30% on Friday.

The timing of the latest slump in financial markets once again coincides with one of the Fed's key policy meetings, just as was the case before the September FOMC meeting. While China-related worries were the main source of risk then, this time around they also had a role to play. On Friday the People's Bank of China paved the way for further weakening of the currency by announcing that it plans to measure the level of the RMB against a basket of currencies rather than just the US dollar. Market turmoil in August/September was then enough for the Fed to delay "lift-off", stressing that it was concerned about external developments. ***This time around, however, we expect that the Fed will remain resolute in its apparent determination to raise interest rate for the first time since 2006.***

Only one thing to watch this week

On Wednesday 2pm Eastern US time (11pm local time) investors will finally find out if 2015 will be the year when US monetary policy finally tightens once again. The press conference which will follow will explain the rationale for the FOMC's decision. Markets are expecting a "dovish rate hike", insofar this is possible, with Fed Chair Janet Yellen likely emphasizing that there is no set commitment to future rate hikes and that the path of tightening will be dependent on the data coming in. The success or failure of the Fed's communication will determine whether risk remains off, or comes back strong.

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Past week global markets' performance

Index Snapshot (World Indices)			
Index	Latest	Weekly Chg %	YTD %
S&P 500	2,012.4	-3.8	-2.3
Dow Jones	17,265.2	-3.3	-3.1
Nasdaq	4,933.5	-4.1	4.2
DAX	10,340.1	-3.8	5.5
Nikkei 225	19,230.5	-1.4	10.2
FTSE 100	5,952.8	-4.6	-9.3
Sensex	25,044.4	-2.3	-8.9
Hang Seng	21464.1	-3.5	-9.1
Regional Markets (Sunday to Thursday)			
ADX	4086.3	-3.5	-9.8
DFM	2944.7	-8.1	-22.0
Tadawul	6949.0	-4.4	-16.6
DSM	10014.8	-4.4	-18.5
MSM30	5451.21	-1.9	-14.1
BHSE	1213.7	-1.1	-14.9
KWSE	5686.2	-1.8	-13.0
MSCI			
MSCI World	1,637.8	-3.4	-4.2
MSCI EM	773.6	-4.8	-19.1

Global Commodities, Currencies and Rates			
Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	37.9	-11.8	-33.8
Nymex WTI USD/bbl	35.6	-10.9	-33.1
OPEC Baskt USD/bbl	34.7	-8.9	-33.3
Gold 100 oz USD/t oz	1074.8	-1.1	-9.3
Platinum USD/t oz	840.3	-4.5	-30.4
Copper USD/MT	4667.0	0.6	-26.6
Alluminium	1486.5	-1.5	-18.9
Currencies			
EUR	1.0986	1.0	-9.2
GBP	1.5213	0.7	-2.3
JPY	121.01	-1.7	-1.0
CHF	0.9826	-1.4	1.2
Rates			
USD Libor 3m	0.5120	10.8	100.3
USD Libor 12m	1.0668	4.8	69.6
UAE Eibor 3m	0.9749	2.2	44.0
UAE Eibor 12m	1.3357	2.2	31.5
US 3m Bills	0.2187	2.4	516.1
US 10yr Treasury	2.1270	-6.3	-2.0

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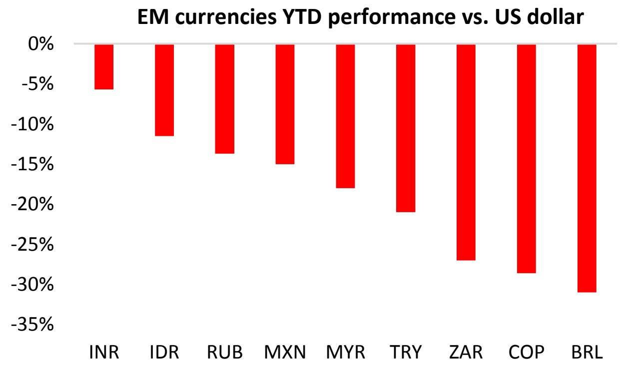
Market reaction points to global fragility

Another reminder of the fragile global environment

Last week investors received the latest reminder that the global economic backdrop remains extremely fragile. The moves in oil prices, EM currencies, the VIX and broader financial assets signal deep underlying concerns about the ability of the global economy to sustainably improve.

EM currencies – (almost) nowhere to hide

Within our equity allocation we remain very selective on Emerging Markets equities. A key reason for this relates to EM currencies which have sold off aggressively this year. The chart below gives a snapshot of the year-to-date performance of some key EM currencies against the US dollar, it is clear that there has been very little respite. Last week brought with it another large wave of selling pressure. Some of this can be attributed to the impending rate hike in the US, but more can probably be explained by country specific factors, the political and economic turmoil in Brazil for example, as well as President Jacob Zuma's decision to fire a well respected finance minister and replace him with an unknown quantity. The South African rand shed 10% last week alone. Another example is Turkey, where minimum wages were raised by 30% last week as part of a reform program, a move not well received by the market as it will likely eat into corporate margins.

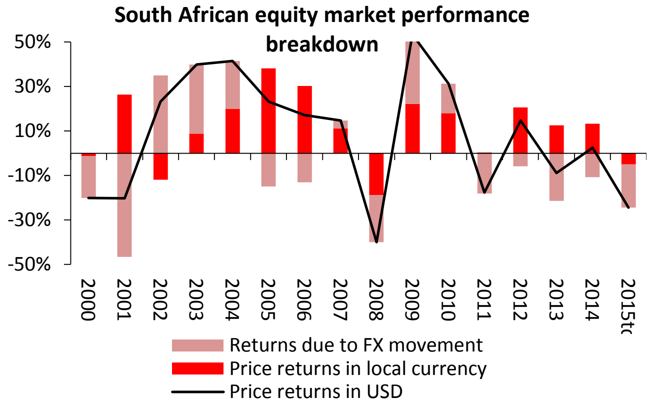


Source: Bloomberg

In aggregate though, these developments in Emerging Markets highlight the policy difficulties facing many parts of the EM world right now. This should continue to help those EM countries which are following more orthodox monetary and fiscal policy, India for example where the depreciation of the INR has been much more muted.

Although it is quite possible that some EM markets will enjoy a near-term rebound after aggressive selling, in the absence of any readily identifiable catalysts it is difficult to become constructive on EM equities in the medium-term. Unless EM currencies are able to stabilise, and begin to move higher, it seems unlikely that equity markets in most EM countries will be able to outperform.

To illustrate this point we have put together the below chart showing the breakdown of FX and price movement (for US dollar investors) over time for the South African equity market. The chart clearly depicts that the bulk of returns come from FX movement. The chart for Brazil, Turkey, Russia, etc looks very similar.



Source: MSCI, Thomson Reuters Datastream, HSBC Calculations

Oil slump shows no signs of abating

Despite data from Baker Hughes on Friday which showed that the US oil rig count dropped to 524 last week, from a peak of 1,609 in October 2014, oil prices saw another >10% drop. The US rig count is widely used as a proxy for oil industry activity, nevertheless, the sell-off in crude oil shows no sign of abating and signals the deep underlying concerns about the health of the global economy. Without stabilisation in oil prices, it will not be possible for the bulk of EM currencies to rebound meaningfully either.

RMB headlines refuse to go away

Finally, no weekly comment would be complete without something on China. Late on Friday the People's Bank of China posted an article on the Central Bank's website detailing changes to how it measures the RMB's value. Going forward the RMB will be measured against a basket of currencies rather than only against the US dollar. The announcement didn't have the catastrophic impact that the August change in the currency mechanism had, nevertheless, it will hardly have helped investor confidence. The latest PBoC move is another step on the way to full liberalisation of the RMB, and was recommended by the IMF, as such it was not such a surprise. However, given market reaction to the August FX regime change in China, investors remain understandably nervous. It is likely that this latest move is designed to more easily devalue the RMB. Indeed in the context of a Fed rate hike it makes increasingly less sense to value the RMB solely against the US dollar.

Summary market outlook

Global Yields	The global risk-off environment helped sovereign bonds in the developed countries as US Treasury 10yr yields eased almost 18 bps. Even European sovereigns yields largely eased a bit. With FOMC decision this week, the next move in the US sovereign yields will depend on the language of the statement. We expect a dovish statement which will keep the yield well contained despite rate hike. European sovereigns are likely to continue to benefit from the global risk-off conditions.
Stress and Risk Indicators	The VIX index jumped 65% last week, fifth largest jump in a week. Major sovereign CDS also moved up. They are likely to remain elevated until the Fed decision and then will depend on the language of the FOMC statement. We expect the language to be extremely dovish, meaning the risk indicators could ease a bit.
Precious Metals	Despite global risk-off conditions, the gold price declined last week, reflecting underlying weakness in the commodity. We remain cautious on the precious commodity prices.
Local Equity Markets	GCC equity markets remained under pressure due to weakening oil prices. With no respite in the downward movement in the oil price, we see further downward pressure on the regional equity prices in the near term.
Global Equity Markets	Global equity markets remained under pressure for the second consecutive week as risk-off conditions deepened. With the impending Fed hike and China currency issues lingering, we expect volatility to continue in the very near term. However, a rate hike with sufficiently dovish FOMC statement could soothe market nerves.
Energy	Another week of a sharp decline in the oil price presumably caused by the OPEC decision to continue with the existing policy of supply. The oil market seems to be extremely volatile which warrants caution even though prices have come down close to the 2008-09 lows.
Industrial Metals	Industrial metals prices were relatively stable during the week but continue to lack an identifiable catalyst in our view.

Currencies	**Commentary**	**Critical levels**
EURUSD	The Euro strengthened for the second consecutive week after the ECB decision. This re-confirms its relationship with the global risk-off conditions. We expect the currency to move lower especially after the Fed decision when at least some part of uncertainty from the global financial markets is removed.	R2 - 1.1189 R1 - 1.1087 S1 - 1.0840 S2 - 1.0695
GBPUSD	The British pound was largely stable with small appreciating bias over the last week. The currency pair is likely to move in its trading range for the last two months or so. However, its making lower lows and lower highs since July this year.	R2 - 1.5420 R1 - 1.5316 S1 - 1.5033 S2 - 1.4854
USDJPY	The Yen tended to strengthen last week slightly. However, the currency remained within the range it has been trading for some time now. Its likely to remain within a smaller range in the near term.	R2 – 124.59 R1 – 122.80 S1 – 119.90 S2 – 118.79

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
12/15/2015	CPI MoM	Nov	0.0%	0.2%	Besides the overwhelming focus on the FOMC rate decision, market will also look at the inflation and housing sector data.
12/15/2015	CPI Ex Food and Energy YoY	Nov	2.0%	1.9%	
12/15/2015	NAHB Housing Market Index	Dec	63	62	
12/16/2015	Housing Starts	Nov	1135k	1060k	
12/16/2015	Building Permits	Nov	1150k	1161k	
12/16/2015	Industrial Production MoM	Nov	-0.1%	-0.2%	
12/16/2015	FOMC Rate Decision	16-Dec	.25%-.5%	.0%-.25%	

Japan

	Indicator	Period	Expected	Prior	Comments
12/14/2015	Tankan Surveys	4Q	--	--	Tankan Surveys, conducted by the BoJ, would crucial indicators this week from Japan.
12/14/2015	Industrial Production MoM	Oct F	NA	1.4%	
12/17/2015	Tertiary Industry Index MoM	Oct	0.5%	-0.4%	
12/17/2015	Exports YoY	Nov	-1.6%	-2.2%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
12/14/2015	Industrial Production SA	Oct	0.3%	-0.3%	Industrial data are important to gauge the fourth quarter growth.
12/16/2015	Markit Mfg PMI	Dec P	52.8	52.8	
12/16/2015	CPI MoM	Nov	-0.2%	0.1%	
12/16/2015	CPI Core YoY	Nov F	0.9%	0.9%	
12/15/2015	ZEW Surveys Expectations (GE)	Dec	54.2	54.4	
12/17/2015	IFO Expectations (GE)	Dec	105.0	104.7	

China and India

	Indicators	Period	Expected	Prior	Comments
12/14/2015	Exports YoY (IN)	Nov	--	-17.5%	With no economic releases from China, market will focus on foreign trade and inflation data from India.
12/14/2015	Imports YoY (IN)	Nov	--	-21.1%	
12/14/2015	Trade Balance (IN)	Nov	-$10.2bn	-$9.77bn	
This week	BoP Current Account Balance (IN)	3Q	-$7.80b	-$6.20b	
12/14/2015	Wholesale Price YoY (IN)	Nov	-2.48%	-3.81%	
12/14/2015	CPI YoY (IN)	Nov	5.33%	5.0%	

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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