The Weekly Market View

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ADCB

Markets slow down ahead of Italy referendum and ECB decision

As we had mentioned last week, after a three week long post-Trump election surge, equity markets were poised for some correction. Interestingly, Friday's US labour market data was not too strong, such that the shorter end of the US yield curve came down together with longer yields. Yet, the anticipation of a continuing relatively accommodating Fed (after the priced-in hike of December) was not able to induce equity markets to recover their weekly loss. At the same time, however, it is important to point out that the Italian equity market recovered strongly, Italian bond spreads tightened and the euro gained somewhat against the Swiss franc, confirming our view that the Italian referendum risk is overstated. Global manufacturing confidence showed resilience in the US, Europe and China.

Profit-taking might continue in anticipation of ECB and Fed meetings

Last week's correction seems clearly inspired by investors' desire to take some money off the table ahead of some anticipated uncertainty, and thus volatility, even if the macro-economic outlook (low growth and low inflation) remains relatively benign. We believe that implications of the Italian landslide "no" referendum vote are vastly overstated and that, instead, it would be better to focus on the ECB rate decision of December 8th and the Fed rate decision of December 14th. It will be particularly important to see if Mr. Draghi will start giving some indication of tapering. Such an indication would lead to a further rise in European yields, and to a lesser extent global yields. It would also determine some weakening of the US dollar. Regardless, we expect equity markets over the next week to move sideward with some bias for a further minor correction.

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,192.0	-1.0	7.2
Dow Jones	19,170.4	0.1	10.0
Nasdaq	5,255.7	-2.7	5.0
DAX	10,513.4	-1.7	-2.1
Nikkei 225	18,426.1	0.2	-3.2
FTSE 100	6,730.7	-1.6	7.8
Sensex	26,230.7	-0.3	0.4
Hang Seng	22564.8	-0.7	3.0
Regional Markets (Sunday to Thursday)			
ADX	4308.8	0.8	0.0
DFM	3360.9	1.1	6.7
Tadawul	7093.7	4.4	2.6
DSM	9913.8	2.0	-4.9
MSM30	5590.16	1.2	3.4
BHSE	1177.7	-0.7	-3.1
KWSE	5569.0	0.9	-0.8
MSCI			
MSCI World	1,708.9	-0.7	2.8
MSCI EM	853.1	-0.3	7.4

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	54.5	15.3	46.1
Nymex WTI USD/bbl	51.7	12.2	39.5
OPEC Baskt* USD/bbl	49.4	10.0	57.8
Gold 100 oz USD/t oz	1177.4	-0.5	11.0
Platinum USD/t oz	929.2	2.3	4.2
Copper USD/MT	5736.0	-1.5	22.0
Alluminium	1716.5	-2.4	14.0
Currencies			
EUR	1.0664	0.7	-1.8
GBP	1.2729	2.0	-13.6
JPY	113.51	0.3	5.9
CHF	1.0111	-0.3	-0.9
Rates			
USD Libor 3m	0.9464	1.0	54.5
USD Libor 12m	1.6446	-0.0	39.6
UAE Eibor 3m	1.4127	0.4	33.9
UAE Eibor 12m	2.1019	2.9	42.5
US 3m Bills	0.4618	-6.2	183.8
US 10yr Treasury	2.3831	1.1	5.0

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Italy "no vote" risk overstated while positive implications of Austrian elections understated

Markets likely to remain under some pressure

Over the next days markets will have to digest significant news, starting with the Italian "no vote", then the ECB rate decision, and then finally the Fed decision on December 14th. It is only normal that some profit making would occur, especially after the tremendous three week stretch of gains that followed Mr Trump's election. If, as we believe, the Italian "no vote" risk is overstated and both the ECB and Federal Reserve will remain broadly constructive, it makes sense to expect corrections to be moderate.

Labor market data good for US financial conditions

The not-so-inflationary wage growth indications will ultimately not change much as far as the effective course of US monetary policy is concerned. Having said so, the fact that wage growth remains moderate in the United States, will allow the Federal Reserve to avoid a too hawkish language when, come December 14th, it will hike rates. The Federal Reserve is in fact keen on keeping its options open until the new administration comes to power and starts elaborating its policies in January. This means that the US dollar will stabilize, along with yields. That is a positive, and as important for the global economy as it is for the US economy, and global equity markets.

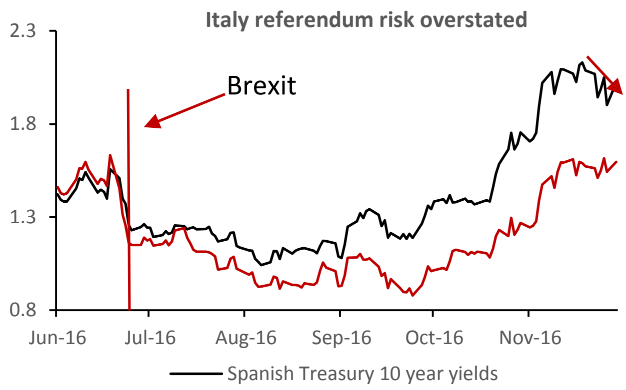
Sector rotation still key

Thus, whilst we remain neutral on global equities, we have over the last weeks stressed the importance of sector rotation (**see link**), also as a key factor preventing a too significant correction, in particular the US equity market. Our assessment that the technology sector will be the main victim of Trumponomics to the benefit of more cyclical sectors and traditional industrial sectors was confirmed with the Nasdaq suffering significantly more than the other two major indices.

Italian "no vote" risk likely overstated

The landslide vote whereby Italians rejected the constitutional reforms promoted by the government has, in our view, been taken out of context. It is not that much a victory of populism as the "no coalition" was heterogeneous and included also traditional establishment parties and figures. And even if one would like to see behind the "no vote" a populist protest movement, it is quite important to point out that the "no vote" implies no change which is a stark contrast with Brexit and Trump!

In Italy political stability has always gone hand in hand with government instability. We expect a new government to be sustained by the same majority as the one supporting Mr. Renzi, possibly somewhat enlarged by right-wing establishment politicians. We expect the government to pursue electoral reform, so as to ensure that the next elections will be held with a relatively proportional voting system. This way the post-election government will likely be formed by a coalition of relatively moderate parties. We don't expect these elections to take place before the summer, they might well only take place in early 2018 when the parliament comes to the natural end of the legislature. Critically, we don't see a populist government on the immediate horizon. More importantly, we don't see an EU in-out referendum on the horizon.



Source: Bloomberg

ECB to stand by, will still try to announce some tapering down the road.

The ECB has ample ammunition to support Italian government bonds and provide liquidity to Italian banks. Italy will soon have a new government that will continue to support a market based solutions for *Monte dei Paschi di Siena*, although a forced equity conversion of subordinated paper is now more likely, it looks likely that plans for recapitalization of Italy's more troubled banks will work out as soon as markets stabilize. We still see a good chance that this Thursday Mr. Draghi will announce a 6-month extension of the QE program combined with some form of tapering by the end of 2017. This would mean higher Euro-zone yields, a stabilization of USD strength, and still some upside for US yields (albeit contained).

Global backdrop at the margin has improved

The defeat, by a wide margin, of the populist, anti-immigration, extreme right Austrian presidential candidate is not yet fully appreciated. The defeat of this candidate in one of Europe's most socially conservative countries is a good omen for the French presidential election, where a candidate from the extreme right will likely stand for election in the final round, come May. We consider the French election to be the biggest political risk in Europe in 2017. This together with a stabilization of the US dollar and global yields, should stabilize global capital markets.

Summary market outlook

Bonds	
Global Yields	Yields rose again on the back of stronger economic data last week. Whilst it is likely that they will remain in a higher range, for now we think that lower foreign yields and US dollar appreciation should prevent them from shooting significantly above 2.5%.
Stress and Risk Indicators	Equity market volatility pushed the VIX index higher. We see potential for the index to move higher as the strong dollar could weigh on equities in the very near term.
Equity Markets	
Local Equity Markets	GCC equity markets were strong last week in anticipation of an OPEC production deal. The deal materialised, boosting oil prices over the weekend, it is likely to support regional equity markets further this week.
Global Equity Markets	Global equity markets witnessed their first weekly decline since the US election result, most likely on profit booking. The coming weeks could be volatile for global equity markets as the major central banks are due to meet, most notable the ECB this week and the Fed next week.

Commodities	
Precious Metals	Rising US yields and the strong dollar continue to pressure precious metals prices. However, geopolitical risks and economic risks are here to stay, we therefore stick to our positive view on the gold price.
Energy	A production cut by OPEC boosted oil prices significantly. Near-term sentiment still seems positive for oil, however, we caution against positioning for a further significant rise from here.
Industrial Metals	Industrial metals declined last week, again seems to be a profit booking event. Moreover, we have strong doubts about the resilience of industrial metals since most of the demand comes from China and not the United States.

Currencies								
EURUSD	The euro gained against the greenback last week as inflation data was relatively positive. The pair is likely to move sideways until the ECB meeting this Thursday. Any hint of QE tapering by the central bank could push the euro higher.							
Critical levels	R2	1.0773	R1	1.0718	S1	1.0581	S2	1.0499
GBPUSD	The pound sterling recovered strongly against the greenback as economic data are yet to reflect the impact of Brexit on economic activity. However, we expect downward movement in the currency in the near term.							
Critical levels	R2	1.2970	R1	1.2849	S1	1.2497	S2	1.2266
USDJPY	The yen continued its depreciating trend. The one sided movement in the currency has been sharp over the last few weeks, meaning that a pullback cannot be ruled out.							
Critical levels	R2	116.70	R1	115.11	S1	111.64	S2	109.76

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
12/05/2016	ISM Non-mfg Composite	Nov	55.5	54.8	ISM non-manufacturing and durable goods data will be important for markets.
12/06/2016	Nonfarm productivity	3Q F	3.3%	3.1%	
12/06/2016	Unit Labor Costs	3Q F	0.3%	0.3%	
12/06/2016	Factory Orders	Oct	2.5%	0.3%	
12/06/2016	Durable Goods Orders	Oct F	0.5%	1.0%	
12/09/2016	Wholesale Inventories MoM	Oct 4	-0.4%	-0.4%	
12/09/2016	Univ. of Mich. Sentiment	Dec P	94.4	93.8	

Japan

	Indicator	Period	Expected	Prior	Comments
12/06/2016	Labor Cash Earnings YoY	Oct	0.2%	0.0%	Markets will look at the second read of third quarter GDP.
12/08/2016	GDP SA QoQ	3Q F	0.6%	0.5%	
12/08/2016	GDP Deflator YoY	3Q F	-0.1%	-0.1%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
12/05/2016	Markit Composite PMI	Nov F	54.1	54.1	All eyes will be on the ECB's monetary policy meeting
12/06/2016	GDP SA QoQ	3Q F	0.3%	0.3%	
12/08/2016	ECB Policy Decision Meeting		No change		

United Kingdom

	Indicator	Period	Expected	Prior	Comments
12/07/2016	Industrial Production MoM	Oct	0.2%	-0.4%	Industrial production and foreign trade data will be important for the market.
12/09/2016	Trade Balance	Oct	-£4.3B	-£5.2B	

China and India

	Indicator	Period	Expected	Prior	Comments
12/05/2016	Caixin PMI Composite (CH)	Nov	--	52.9	China's foreign reserves and foreign trade data along with India's central bank's action will be the focus this week.
12/07/2016	Foreign Reserves (CH)	Nov	$3065B	$3120B	
12/08/2016	Exports YoY (CH)	Nov	-5.0%	-7.3%	
12/08/2016	Imports YoY (CH)	Nov	-1.8%	-1.4%	
12/09/2016	CPI YoY (CH)	Nov	2.2%	2.1%	
12/07/2016	RBI Policy Decision (IN)	7th Dec	--	6.25%	
This Week	Exports YoY (IN)	Nov	--	9.6%	

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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