The Weekly Market View

Feb 1 2016

Central banks more dovish again, commodities rally, so do Treasuries

The US Federal Reserve press statement reflected implicitly a more prudent stance towards further rate hikes, thereby somehow endorsing the markets' concerns regarding growth in the United States, as well as globally. But the true surprise probably came from the BoJ's Kuroda who kept QQE at 80 trillion Japanese yen per month, but further reduced interest rates on bank deposits to negative territory, Those negative rates will hold on excess deposits that commercial banks hold with the BoJ. Currently there are no such excesses but, as they will materialize going forward, the decision will likely impact overall credit in Japan. The yen immediately lost some of the gains it had made over the last month because of the increase in global risk aversion. The BoJ certainly has the power to provide more liquidity and depress interest rates, and it is likely to continue to do so. The question is how positive will global markets judge this? The weaker yen facilitates growth in Japan only at the expense of the country's trading partners. As such it does not alter the current deflationary dynamics of a global slowdown. The downswing in yields tells us that last week's violent commodity rally, even from very low levels, might be short lived.

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US ISM and labour markets in focus as markets verify US health

After the disappointing figure for fourth quarter 2015 US GDP growth, markets will pay close attention to the growth outlook in the United States, in particular the ISM indicator and the job market data for January. Weaker growth in the United States might temporarily be beneficial for equity markets as it implies a delay (or possibly a reversal) of Fed rate hikes. Yet, much of this is by now anticipated by financial markets and – to the extent that the ECB and BoJ's loosening is keeping the euro and the yen weak – it is not really clear that central banks are still able to stimulate overall global growth. As such we remain cautious on global equities.

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	1,940.2	1.7	-5.1
Dow Jones	16,466.3	2.3	-5.5
Nasdaq	4,614.0	0.5	-7.9
DAX	9,798.1	0.3	-8.8
Nikkei 225	17,518.3	3.3	-8.0
FTSE 100	6,083.8	3.1	-2.5
Sensex	24,870.7	1.8	-4.8
Hang Seng	19683.1	3.2	-10.2
Regional Markets (Sunday to Thursday)			
ADX	3910.4	4.6	-9.2
DFM	2857.2	9.0	-9.3
Tadawul	5880.0	7.6	-14.9
DSM	9272.0	8.0	-11.1
MSM30	5016.51	3.1	-7.2
BHSE	1171.6	0.5	-3.6
KWSE	5010.4	1.3	-10.8
MSCI			
MSCI World	1,562.2	1.7	-6.1
MSCI EM	742.4	4.5	-6.5

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	36.0	8.0	-3.5
Nymex WTI USD/bbl	33.6	4.4	-9.2
OPEC Baskt USD/bbl	28.3	10.9	-9.6
Gold 100 oz USD/t oz	1118.2	1.8	5.4
Platinum USD/t oz	871.5	4.7	-2.3
Copper USD/MT	4541.5	1.6	-3.4
Alluminium	1520.75	2.4	1.0
Currencies			
EUR	1.0831	0.3	-0.3
GBP	1.4244	-0.1	-3.3
JPY	121.14	2.0	-0.8
CHF	1.0231	0.7	-2.1
Rates			
USD Libor 3m	0.6126	-1.0	-0.0
USD Libor 12m	1.1398	-1.4	-3.2
UAE Eibor 3m	1.0559	-0.0	0.1
UAE Eibor 12m	1.5473	-0.1	4.9
US 3m Bills	0.3103	5.2	90.7
US 10yr Treasury	1.9209	-6.4	-15.4

Please refer to the disclaimer at the end of this publication

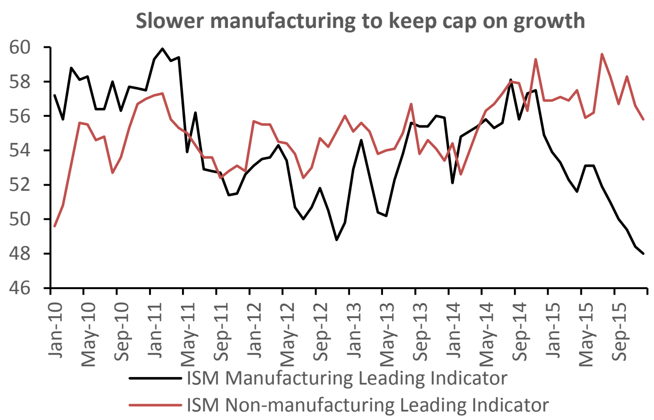
Assessing US growth and China capital outflows

Going beyond the dismal growth of the 2015 last quarter

The very weak (0.7% annualized) growth figure for the last quarter of 2015 has confirmed our doubts about the strength of the US economy. Now that it is less clear how much central banks are willing, and able, to support financial markets, the latter are becoming more sensitive to economic data than they have been during most of the QE era. They are therefore also likely to remain more volatile as economic data surprised either on the upside or on the downside.

US manufacturing ISM and job data to be in the focus

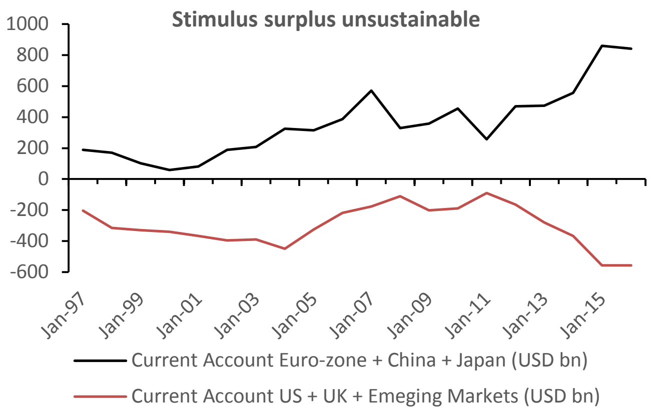
Whilst US job data have kept surprising on the upside, the ISM manufacturing leading indicator has kept deteriorating over the last months. The latter is a better indicator for future GDP growth such that it will be closely watched by the markets. The former, however, is unfortunately very important too as it has been a key parameter for the Federal Reserve as it assess the opportunity to hike rates. Specifically the Federal Reserve has indicated that continuing job creation would be inflationary for the economy and warrant higher rates. Thus the worst outcome from the viewpoint of the markets would be a further deterioration of the ISM leading indicator together with continuing robust job creation. This would determine that the markets would remain concerned about growth troubles and the risk of a premature Fed hiking cycle. We believe that the Federal Reserve will soon realize that it is better advised halting hikes for the foreseeable future. As such, yields will remain subdued. It will thus not be monetary policy, but continuing growth concerns, globally and within the US, that will keep global equity markets under pressure.



Source: Bloomberg

Global growth at risk as imbalances are rising

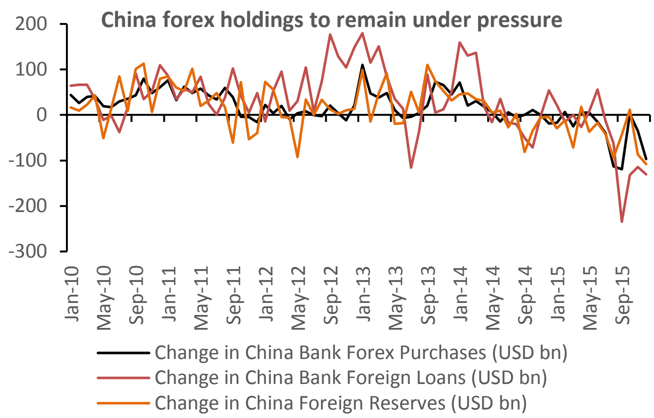
Markets reserved a warm welcome for Mr. Draghi's and Mr. Kuroda's most recent efforts to indicate that more stimulus would be in the pipeline if growth and inflation were to remain subdued. The crucial questions investors have to ask themselves is how much global growth ECB and BoJ stimulus can achieve to the extent that such stimulus will once more result in exchange rate devaluations. The question has become more critical precisely because also China is bound to depress the external value of the renminbi. The combined current account surplus of the Euro, China and Japan has now reached a new record level. One can truly put some question marks regarding the possibility to sustain such surplus without seriously impairing the growth prospects of the rest of the world.



Source: Bloomberg

China's balance of payments issues are not over

Doubts about the sustainability of economic growth are nowhere as obvious as in China where citizens continue to try – with a considerable degree of success – to circumvent capital controls and move money out of the country. These outflows are unlikely to cool down soon unless the authorities allow for a significant devaluation of the currency. Such devaluation would, however, by itself trigger more global growth concerns, first and foremost in emerging markets, but at some point also in the more advanced economies of the United States, Europe and Japan.



Source: Bloomberg

Summary market outlook

Global Yields

US Treasury yields continued to trend down on dovish central banks, despite the easing risk-off environment. They are likely to remain under pressure, especially if important economic data - scheduled to release this week - disappoint. Euro-zone sovereign yields are likely to move further lower as well.

Stress and Risk Indicators

The VIX index eased late last week on the BoJ surprise move that supported risk assets. Despite some decline the index remains well above its low levels of past months. Sovereign CDS spreads, especially in Asian countries, also eased due to dovish major central banks.

Precious Metals

The gold price continued to have an upward momentum last week. However, we believe that the deflationary forces and lower external surpluses of EMs will keep the price in check.

Local Equity Markets

A sustained recovery in the oil price last week is expected to be positive for the local equities to start with. However, given the high volatility we have witnessed in the oil price over the last one year, we advise caution for investors.

Global Equity Markets

After Mr. Draghi, a dovish FOMC statement and a surprise rate cut by the BoJ supported global equities last week. Such monetary supports could possibly reduce the risk-off environment in the near term. But the global growth environment seems to be getting more difficult, and it is not clear how much central banks can really do about it. We remain very cautious on equity markets.

Energy

The oil price not only sustained the prior week's rebound but gained further last week. We have seen similar rebounds in recent months. The current rebound does not convince us for a bottoming out. We remain cautious.

Industrial Metals

Industrial metals prices were relatively stable during the week, and continue to lack an identifiable catalyst in our view.

Currencies

	Commentary	Critical levels
EURUSD	Draghi's effect on the currency market was rather short lived as the euro turned around and appreciated over the last week. We continue with our view that the currency is likely to remain range bound around the current level in the near term.	R2 - 1.1041 R1 - 1.0936 S1 - 1.0758 S2 - 1.0685
GBPUSD	The pound closed the week flat after earlier strength against the US dollar. The economy continues to exhibit strength which should be positive for the currency. However, the ongoing referendum issue (with the possibility that the UK might leave the EU) will keep the currency volatile.	R2 - 1.4532 R1 - 1.4388 S1 - 1.4269 S2 - 1.4006
USDJPY	The BoJ surprise move pushed the currency lower. It could trend further lower towards 124-125 level in the coming weeks. However, any rise in the global risk-off environment will determine a reversal and strengthen the currency.	R2 – 124.19 R1 – 122.67 S1 – 118.64 S2 – 116.13

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
02/01/2016	Personal Income	Dec	0.2%	0.3%	
02/01/2016	Personal Spending	Dec	0.1%	0.3%	
02/01/2016	PCE Core YoY	Dec	1.4%	1.3%	A set of important data this week ranging from ISM to job markets are expected to show further moderation.
02/01/2016	ISM Manufacturing	Jan	48.5	48.0	
02/03/2016	ISM Non-Mfg Composite	Jan	55.2	55.8	
02/04/2016	Factory Orders	Dec	-2.8%	-0.2%	
02/04/2016	Change in Nonfram Payrolls	Jan	190k	292k	
02/04/2016	Unemployment Rate	Jan	5.0%	5.0%	
02/04/2016	Avg Hourly Earnings YoY	Jan	2.2%	2.5%	

Japan

	Indicator	Period	Expected	Prior	Comments
02/05/2016	Nikkei Mfg PMI	Jan F	NA	52.4	
02/03/2016	Nikkei Service PMI	Jan	NA	51.5	Bloomberg consensus expects some moderation in economic indicators to be released this week.
02/05/2016	Leading Index	Dec P	102.7	103.5	
02/05/2016	Coinciding Index	Dec P	111.0	111.9	

Eurozone

	Indicator	Period	Expected	Prior	Comments
02/01/2016	Markit Mfg PMI	Jan F	52.3	52.3	Economic indicators are likely to confirm the moderate pace of growth continuing in the common currency zone.
02/02/2016	Unemployment Rate	Dec	10.5%	10.5%	
02/03/2016	Markit Services PMI	Jan F	53.6	53.6	
02/03/2016	Retail Sales MoM	Dec	0.3%	-0.3%	
02/05/2016	Factory Orders MoM (GE)	Dec	-0.5%	1.5%	

China and India

	Indicators	Period	Expected	Prior	Comments
02/01/2016	Mfg PMI (CH)	Jan	49.6	49.7	
02/01/2016	Caixin Mfg PMI (CH)	Jan	48.1	48.2	
02/07/2016	Foreign Reserves (CH)	Jan	NA	$3330B	Manufacturing PMIs from China and India and foreign reserves data for China will be looked at closely by the market.
02/02/2016	Nikkei Mfg PMI (IN)	Jan	NA	49.1	
02/02/2016	RBI Policy Meeting	Feb 2	No Change		
02/03/2016	Nikkei Services PMI	Jan	NA	53.6	

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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