The Weekly Market View

Feb 29 2016

Mixed messages from the US, but clear signals from Europe

The week provided investors a mixed message in terms of the health of the global economy. On the positive side, US annualised Q4 GDP growth came in stronger than expected, as did core PCE inflation which is the Feds preferred measure of US inflation. Both point to a relatively resilient US economy and at the margin, increase the chances of further rate hikes in the US this year. Other data however, suggested further weakening of the cycle; for example the preliminary US services PMI fell sharply (below the 50 figure which separates expansion from contraction). In Europe preliminary PMIs for February also signalled further economic weakness; the Eurozone composite flash PMI hit a 13-month low of 52.7 (but remains in expansionary territory). Staying in Europe, the German Ifo survey, regarded as the best gauge of business sentiment in the Eurozone's largest economy fell more than expected.

Despite the confusing global macro picture, equity markets managed to move higher during the week. One factor supporting markets is likely to have been the meeting of G20 finance ministers and central bank governors which took place over the weekend in Shanghai. Meetings such as these rarely produce actions of note, nevertheless expectations this time around seemed to be higher than usual. Much has been made of potential monetary policy paralysis among the major central banks of the world, as such, there were hopes (and media speculation) of a potential global coordinated fiscal package. However, the gathering finished with policy makers unable to agree on fresh stimulus, and will likely come as a disappointment to investors speculating on something concrete.

Luciano Jannelli, Ph.D., CFA
Head Investment Strategy
Tel: +971 (0)2 696 2340
luciano.jannelli@adcb.com

Wietse Nijenhuis
Equity Strategist
Tel: +971 (0)2 205 4923
wietse.nijenhuis@adcb.com

Rahmatullah Khan
Economist
Tel: +971 (0)2 696 2843
rahmatullah.khan@adcb.com

Visit Investment Strategy Webpage to read our other reports.

All eyes on US jobs numbers and ISM surveys

The most important data this week comes from the US, markets will closely watch non-farm payrolls data on Friday, focussing not only on the headline jobs created, but also if wage growth strengthened further from the 2.5% y-o-y in January. The other key data will be the ISM survey, in particular it will be interesting to see if the non-manufacturing ISM reflects the same weakness in the services sector as suggested by the preliminary US services PMI. The divergence between the relative weakness of manufacturing and strength of services has long been something which we have expected to narrow.

Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	1,948.1	1.6	-4.7
Dow Jones	16,640.0	1.5	-4.5
Nasdaq	4,590.5	1.9	-8.3
DAX	9,513.3	1.3	-11.4
Nikkei 225	16,188.4	1.4	-14.9
FTSE 100	6,096.0	2.4	-2.3
Sensex	23,154.3	-2.3	-11.3
Hang Seng	19364.2	0.4	-11.6
Regional Markets (Sunday to Thursday)			
ADX	4277.5	0.9	-0.7
DFM	3158.2	1.0	0.2
Tadawul	5975.9	1.6	-13.5
DSM	9929.1	-1.2	-4.8
MSM30	5388.9	-0.6	-0.3
BHSE	1182.3	0.8	-2.8
KWSE	5192.0	0.7	-7.5
MSCI			
MSCI World	1,554.5	1.1	-6.5
MSCI EM	740.0	-0.1	-6.8

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	35.1	6.3	-5.8
Nymex WTI USD/bbl	32.8	10.6	-11.5
OPEC Baskt USD/bbl	29.2	0.1	-6.7
Gold 100 oz USD/t oz	1223.5	-0.3	15.3
Platinum USD/t oz	914.3	-2.7	2.5
Copper USD/MT	4681.0	2.0	-0.4
Alluminium	1560	0.5	3.6
Currencies			
EUR	1.0934	-1.8	0.7
GBP	1.3871	-3.7	-5.9
JPY	114.00	1.2	5.5
CHF	0.9968	0.6	0.5
Rates			
USD Libor 3m	0.6351	2.7	3.7
USD Libor 12m	1.1610	1.9	-1.4
UAE Eibor 3m	1.0467	1.6	-0.8
UAE Eibor 12m	1.5710	2.2	6.5
US 3m Bills	0.3103	7.0	90.7
US 10yr Treasury	1.7623	1.0	-22.3

Please refer to the disclaimer at the end of this publication

US growth stabilizing at sluggish rate

US fourth quarter growth revised upward

Markets were expecting annualized 2015 fourth quarter US GDP growth to be revised downward. Instead it received an upward revision from 0.7% to 1 %. The utility of looking at backward data is, of course, always limited. We have argued that continuing sluggish growth in the United States is not the same as a full-blown recession. More specifically we think that annualized growth should stabilize between 1% and 2%. As such the upward revision for the further quarter is not surprising. It is also not particularly meaningful.

Inflation data also surprises to the upside

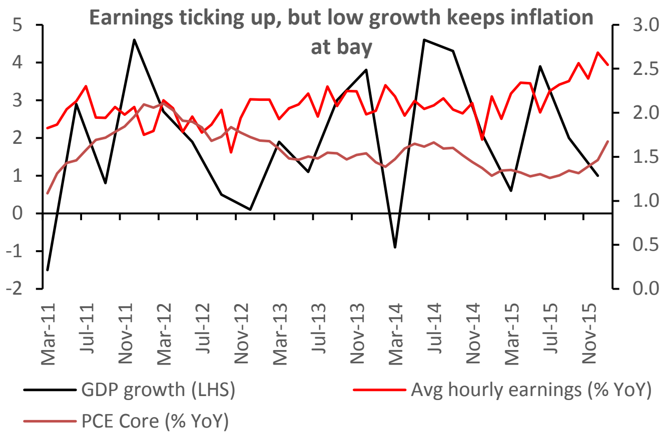
Arguably more surprising was the uptick in the Personal Consumption Expenditure (PCE) Core Price Index which – in January – posted a year-over-year gain of 1.7%, The PCE Core Price Index is – together with the job market data - closely watched by the Federal Reserve. Whilst it is currently not at a particularly high level, it has been creeping up consistently over the last months, thus confirming the inflation concerns of some members of the interest rate-setting of the Federal Open Market Committee. We are not that convinced that such concerns are warranted from a long term perspective. Inflation is a lagging indicator. Specifically it follows GDP growth which has been coming down since last summer. At some point in time we expect inflation to fall in line with the reduction in growth that occurred in the latter half of 2015.

But bond markets are yet unconvinced

This probably also explains why fixed income markets did not react particularly sharply to the increase in the PCE Core Index and the revision of fourth quarter growth. True, long term yields rose by four basis points and also Fed rate hike probabilities – as reflected by future prices on the Federal Reserve Funds – did somewhat move up. Treasury yields remain however at low levels, and the market is still forecasting a hike only in December of this year.

Labour market report to steer rate expectations

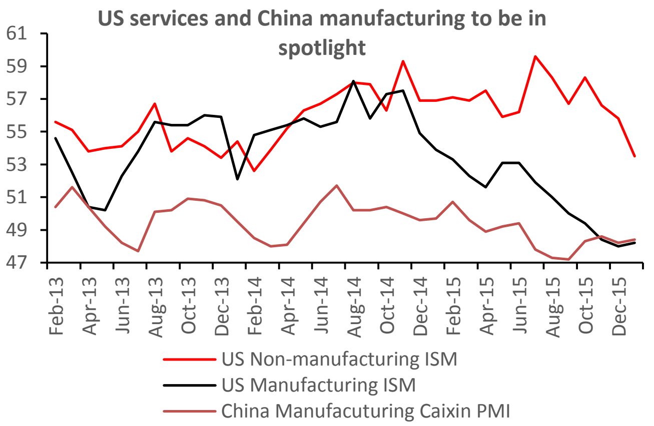
This Friday's labour market report might however – at least short term – determine a further pick up in yields and rate expectations. This could specifically be triggered by a continuing increase in jobs being created and, critically, average hourly earnings maintaining a year over year growth rate at 2.5% or higher. Our short-term concerns for the rate outlook, in fact, simply reflect the awareness that the Federal Reserve's preferred indicators are simply the PCE Core Index and the monthly labour data. Now that the first has surprised on the upside, we have to carefully watch if the latter will confirm or deny potential inflation concerns by the Fed. Over the longer period we are less concerned. We consider growth to remain sluggish, and inflation at any rate contained. The real concern of the markets remains growth seriously disappointing, rather than the Fed hiking rates. In the short-term, however, rate hike concerns might temporarily resurge.



Source: Bloomberg

PMIs for major economies to confirm slowdown?

This week we will receive the leading business confidence indicators for all major economies. We will have to watch particularly close the China Caixin Manufacturing PMI for which no preliminary release was published last week. Likewise it will be important to see whether the most watched US Manufacturing ISM will marginally improve, and the US non-manufacturing ISM will only marginally deteriorate, as expected by the consensus. This relatively stable consensus outlook would keep the growth outlook rather sluggish. This we believe provides the anchor to excessive rate increase expectations. It is also likely to keep a lid on the upside for equity markets.



Source: Bloomberg

Political risk might take a backseat

This weekend's G-20 has taken a markedly hands-off approach. Thus economic data is going to remain very important as markets digest less pro-active, and thus less supportive, central banks. Political risk, on the other hand, might well take a backseat this week as the Brexit vote is still 4 months away, and chances are Hillary Clinton emerges out of Super-Tuesday as the clear democratic frontrunner, as well a national favourite, for the US Presidency.

Summary market outlook

Global Yields	US Treasury 10yr yields rose slightly following better than expected US macro data. US Q4 2015 GDP was revised up from an annualised 0.7% to 1.0%. The consensus had expected a downward revision to 0.4%. In addition, the Fed's preferred measure of US inflation also exceeded estimates, rising 1.7% year-on-year in January and reaching the highest level in 3-years. We remain of the view that the yield is unlikely to cross 2% in the very near term.
Stress and Risk Indicators	The VIX index finished marginally lower on a week-on-week basis. We expect volatility to remain high for the foreseeable future as the market switches between risk on and risk off modes.
Precious Metals	The gold price was a little down, but range bound during the week, trading between \$1,200/oz and \$1,250/oz. Long-term we remain cautious on gold, as global pressures are by and large deflationary.
Local Equity Markets	GCC equity markets closed with moderate gains last week as oil prices rallied. The DFM is now positive for the year (+0.2%) having rallied strongly over the past few weeks.
Global Equity Markets	Global equity markets moved higher last week, building on gains from the previous week. Investors may have been anticipating positive news to come out of the meeting of G20 finance ministers and central bank governors in Shanghai over the weekend. We remain cautious on global equities for the time being and expect big swings in markets to continue.
Energy	Both Brent and WTI enjoyed strong gains during the week. It is difficult to assign a specific reason to this given that like equities, oil prices have been very volatile this year. Perhaps stronger than expected US growth numbers and hopes of a coordinated fiscal policy by G20 countries to support global growth boosted oil prices.
Industrial Metals	Industrial metals prices were also up, likely helped by some of the same factors that helped oil prices rally sharply.

Currencies	**Commentary**	**Critical levels**
EURUSD	The euro weakened last week. Poor economic data out of the Eurozone has increased the chances of further easing at the next ECB meeting in March.	R2 - 1.1217 R1 - 1.1075 S1 - 1.0852 S2 - 1.0771
GBPUSD	Weakness in Sterling (mainly relative to the dollar) was one of the main talking points last week and comes on the back of uncertainty surrounding the Brexit Referendum. It seems unlikely that the pound will be able to strengthen until the outcome of the referendum in June becomes clear.	R2 - 1.4497 R1 - 1.4184 S1 - 1.3706 S2 - 1.3541
USDJPY	The Japanese yen lost a bit of ground last week, weakening to 114 against the dollar. This is of course the direction that Japanese policy makers want to see the currency traveling in. So long as the mood in global markets remains positive the yen, which acts as a safe haven currency will remain soft, but range bound.	R2 – 115.97 R1 – 114.99 S1 – 112.03 S2 – 110.05

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
2/29/2016	Pending Home Sales NSA YoY	Jan	4.10%	3.10%	A plethora of key economic releases out of the US this week, the ISM and non-farm payrolls data will be most closely watched by investors hoping to get more clues as to the likely direction of the US business cycle and monetary policy.
3/1/2016	Markit US Manufacturing PMI	Feb F	51.2	51	
3/1/2016	ISM Manufacturing	Feb	48.5	48.2	
3/3/2016	ISM Non-Manf. Composite	Feb	53	53.5	
3/2/2016	ADP Employment Change	Feb	185k	205k	
3/3/2016	Initial Jobless Claims	27-Feb	270k	272k	
3/3/2016	Factory Orders	Jan	2.10%	-2.90%	
3/4/2016	Trade Balance	Jan	-$43.80b	-$43.36b	
3/4/2016	Change in Nonfarm Payrolls	Feb	193k	151k	
3/4/2016	Unemployment Rate	Feb	4.90%	4.90%	
3/4/2016	Average Hourly Earnings YoY	Feb	2.50%	2.50%	

Japan

	Indicator	Period	Expected	Prior	Comments
2/28/2016	Industrial Production YoY	Jan P	-3.80%	-1.90%	The BoJ will look closely at earnings, hoping they rise thereby potentially boosting inflation.
2/28/2016	Retail Sales MoM	Jan	0.10%	-0.20%	
3/3/2016	Labor Cash Earnings YoY	Jan	0.40%	0.10%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
2/29/2016	CPI Estimate YoY	Feb	0.00%	0.30%	PMI and inflation are likely to be the focus of the market.
2/29/2016	CPI Core YoY	Feb A	0.90%	1.00%	
3/1/2016	Markit Eurozone Man. PMI	Feb F	51	51	
3/3/2016	Markit Eurozone Services PMI	Feb F	53	53	
3/3/2016	Markit Eurozone Composite PMI	Feb F	52.7	52.7	
3/3/2016	Retail Sales YoY	Jan	1.30%	1.40%	

China and India

	Indicators	Period	Expected	Prior	Comments
2/29/2016	Manufacturing PMI	Feb	49.4	49.4	China Caixin as well as official PMI data releases will give an indication as to the strength of the Chinese economy.
2/29/2016	Non-manufacturing PMI	Feb	--	53.5	
2/29/2016	Caixin China PMI Mfg	Feb	48.4	48.4	
3/2/2016	Caixin China PMI Services	Feb	--	52.4	
3/2/2016	Caixin China PMI Composite	Feb	--	50.1	

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

Disclaimer