# The Weekly Market View

Jan 25 2016

## Draghi gets his mojo back, but for how long?

*ECB chief Mario Draghi did at the January ECB meeting what he was unable to do at the December meeting that is positively surprise the markets. Relieved investors lapped it up following a nightmare start to 2016. Expectations for what Mr Draghi had to say were much lower this time around, correspondingly he found it easy to surprise positively. So how much can we read into the latest bounce in risk assets? We think very little, and remain cautious. There has been speculation for a while now about developed equity markets falling into a "bear market". A better way of defining a bear market we think is whether we are seeing a sustained pattern of lower highs and lower lows. This is what is happening in most major equity markets, including the MSCI World, S&P500, Eurostoxx 600 and Nikkei 225. Each of these markets reached their respective peaks around April/May last year, and have fallen back further and further whilst setting lower and lower peaks. Can Mr Draghi with what he said last week really prevent this? We think not, in fact it is easy for Mr Draghi to be bullish and talk markets up when he is not expected to deliver. The real constraints to ECB monetary policy are more evident in the minutes from the December meeting which highlight that the debate within the ECB governing council is firmly focused on the increasing risks to sustained unconventional monetary easing, as well as its diminishing returns. In this environment, short squeezes and relief rallies will take place regularly, but the trend of lower highs and lower lows will likely remain in place.*


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## Important to see FOMC statement and the US fourth quarter growth

*It will be important to see this week whether the FOMC statement tampers its economic assessment and includes higher downside risk to US growth, especially in the context of a series of disappointing data in recent weeks. The market mean consensus estimate for fourth quarter US GDP growth, scheduled to be released on 29th January, is only 0.8%. Any such print on the growth number will further increase global growth concerns, and lead to adjustments in Fed rate hike expectations.*

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## Past week global markets' performance

**Index Snapshot (World Indices)**

| Index | Latest | Weekly Chg % | YTD % |
|---|---|---|---|
| S&P 500 | 1,906.9 | 1.4 | -6.7 |
| Dow Jones | 16,093.5 | 0.7 | -7.6 |
| Nasdaq | 4,591.2 | 2.3 | -8.3 |
| DAX | 9,764.9 | 2.3 | -9.1 |
| Nikkei 225 | 16,958.5 | -1.1 | -10.9 |
| FTSE 100 | 5,900.0 | 1.7 | -5.5 |
| Sensex | 24,435.7 | -0.1 | -6.4 |
| Hang Seng | 19080.5 | -2.3 | -12.9 |
| **Regional Markets (Sunday to Thursday)** | | | |
| ADX | 3737.0 | -5.5 | -13.2 |
| DFM | 2622.0 | -6.9 | -16.8 |
| Tadawul | 5463.6 | -6.4 | -21.0 |
| DSM | 8584.0 | -6.5 | -17.7 |
| MSM30 | 4867 | -4.8 | -10.0 |
| BHSE | 1165.5 | -2.9 | -4.1 |
| KWSE | 4946.3 | -6.1 | -11.9 |
| **MSCI** | | | |
| MSCI World | 1,536.8 | 1.0 | -7.6 |
| MSCI EM | 710.7 | 0.2 | -10.5 |

**Global Commodities, Currencies and Rates**

| Commodity | Latest | Weekly Chg % | YTD % |
|---|---|---|---|
| ICE Brent USD/bbl | 32.2 | 11.2 | -13.7 |
| Nymex WTI USD/bbl | 32.2 | 9.4 | -13.1 |
| OPEC Baskt USD/bbl | 22.9 | -7.5 | -26.8 |
| Gold 100 oz USD/t oz | 1098.0 | 0.8 | 3.5 |
| Platinum USD/t oz | 832.5 | 0.4 | -6.6 |
| Copper USD/MT | 4468.0 | 3.7 | -5.0 |
| Alluminium | 1484.75 | 0.6 | -1.4 |
| **Currencies** | | | |
| EUR | 1.0796 | -1.1 | -0.6 |
| GBP | 1.4265 | 0.0 | -3.2 |
| JPY | 118.78 | 1.5 | 1.2 |
| CHF | 1.0161 | 1.5 | -1.4 |
| **Rates** | | | |
| USD Libor 3m | 0.6191 | -0.1 | 1.0 |
| USD Libor 12m | 1.1560 | 0.9 | -1.9 |
| UAE Eibor 3m | 1.0563 | 0.2 | 0.1 |
| UAE Eibor 12m | 1.5481 | 1.2 | 5.0 |
| US 3m Bills | 0.2950 | 28.9 | 81.3 |
| US 10yr Treasury | 2.0519 | 0.8 | -9.6 |

*Please refer to the disclaimer at the end of this publication*

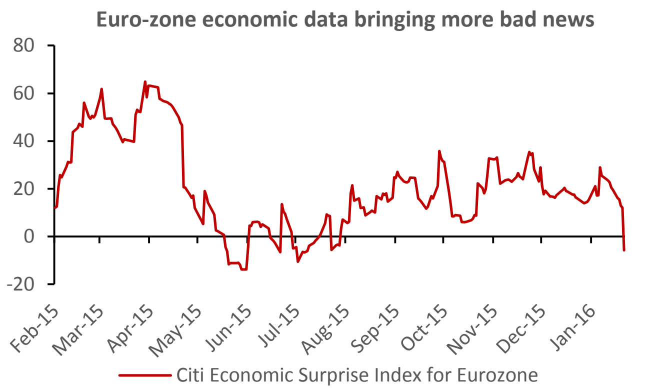
## Markets take solace from possibility of ECB QE, set to come back to growth reality

### Mr. Draghi does it again

European Central Bank chief Mario Draghi does it again, and cheers the market with a possibility of more QE in March. The MSCI World index jumped up almost 3.5% since his statement while the turnaround in commodity prices was even sharper. We think that the market took the statement as a catalyst for a technical rebound as many believed that the risky assets were oversold after a sharp selloff in recent weeks.

For us, markets seem to have ignored the other portion of the statement where Mr. Draghi highlights the rise in downside risks, largely coming through heightened uncertainty about emerging markets' growth prospects, volatility in financial and commodity markets and geopolitical risks. We think that the possibility of more QE does not change the global real growth dynamics. Rather, QE leading to further US dollar appreciation would act as counter-productive for global growth for two reasons. First, it will further increase the US dollar debt burden on EM corporates, and second, it will strangle US growth prospects as exports become more expensive, and imports cheaper, because of the strong currency.

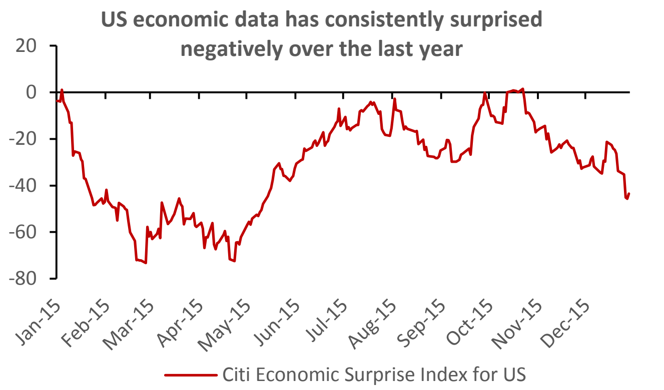
Moreover, Mr. Draghi's statement should be read in a context where not only there are potential downside risks to growth, but also, some of those potential risks seem to have started materializing. Eurozone growth indicators, after holding up well in the last quarter, have clearly turned for the worse. The pace of deterioration seems to be accelerating as reflected in the Citi Economic Surprise Index.




Source: Bloomberg

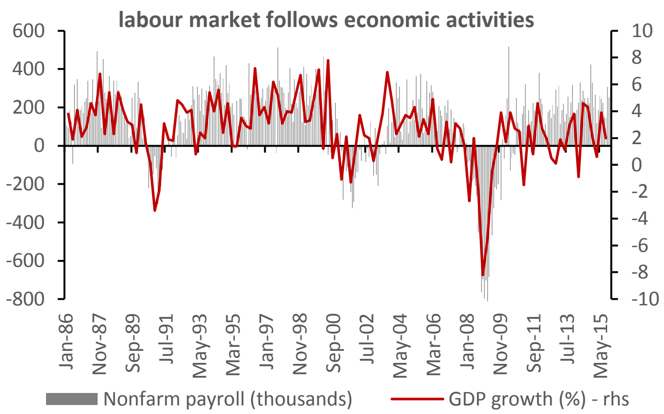
### Further signs of the US growth slowdown

It's not only the Eurozone where fragile economic growth has come under stress but also elsewhere. Economic indicators have been confirming more and more strongly that the US will find it difficult to escape from the 2% growth dynamics. The Citi bank economic surprise index for the country has consistently been in negative territory over the last one year, suggesting that the market has largely been disappointed with growth expectations. With the index further going south in recent months, markets are now expecting fourth quarter GDP growth to be as low as 0.8%, (annualized QoQ), which takes the average growth in the last four quarters (2015) at 1.8%.




Source: Bloomberg

With moderating activities, it is hard to believe that the job market will keep its mojo of throwing monthly job additions in excess of 200k. With slower growth in the fourth quarter and typically seasonally weaker first quarter, we expect job additions to moderate significantly in coming months, keeping wage growth at bay. Historically as well, job data, have always lagged economic activity. For instance, on the downside, change in nonfarm payrolls was positive until January 2008 while the recession had already started in December 2007. It turned negative only in February 2008. On the upside, GDP growth turned positive in the third quarter of 2009 while the uptick in nonfarm payrolls started only in January 2010.




Source: Bloomberg

Therefore, global growth concerns have rather increased confirming our prudent call on risk assets. In such an environment, the Fed will find it difficult to raise interest rates, which might lead to rallies that we expect to be temporary.

## Summary market outlook

| | |
|---|---|
| **Global Yields** | The global risk-off environment helped the US Treasury 10yr yield to trade below 2% last week before Draghi's statement calmed the market and pushed the yield slightly above 2%. We believe that the yield is likely to trade around the current level even if the risk-off environment fades in the very near term. |
| **Stress and Risk Indicators** | The VIX index eased on Friday as sentiment finally approved following Mr. Draghi's press conference. We do not see a significant let-up in risk taking in the near term, and expect the VIX index to remain elevated. |
| **Precious Metals** | Gold price gains have been muted in spite of the risk-off mood, as the precious metal is up by only 3.5% YTD. Deflationary forces and lower external surpluses for EMs will continue to put downward pressure on gold. |
| **Local Equity Markets** | A rebound in the oil price late last week would give a positive start to local equities, the sustainability of which will depend on how the oil price behaves over the week. |
| **Global Equity Markets** | ECB's Mr. Draghi calmed financial markets on Thursday with his promise of more QE in March. Global markets could extend gains this week as many believe that markets were oversold. However, we believe that markets have less upside on deteriorating fundamentals. |
| **Energy** | A sharp technical rebound in the oil price late last week was not the result of any fundamental change in the oil market. Despite such rebounds and possibility of further upticks, we continue to caution investors on investing in the energy space. |
| **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** | Mr Draghi's statement pushed the euro lower against the US dollar which otherwise was moving sideways. We do not see a much lower level for the currency in the near term, as US rate expectations are likely to adjust further lower. | R2 - 1.1048<br>R1 - 1.0922<br>S1 - 1.0724<br>S2 - 1.0652 |
| **GBPUSD** | The pound closed the week flat after earlier weakness against the US dollar. Political issues (EU in-or-out) will keep the currency volatile, but we see some positive bias for the Cable in the near term. | R2 - 1.4419<br>R1 - 1.4392<br>S1 - 1.4109<br>S2 - 1.3953 |
| **USDJPY** | The yen gave up all of its earlier gains as the risk-off environment eased a bit in the latter half of the last week. The currency is likely to move a bit further lower if this environment persists this week. | R2 – 120.78<br>R1 – 119.78<br>S1 – 116.88<br>S2 – 114.98 |

# Forthcoming important economic data

## United States

| | Indicator | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 01/25/2016 | S&P/CS Composite House Price | Nov | 5.64% | 5.54% | Important set of economic indicators this week along with FOMC meeting |
| 01/26/2016 | Markit Service PMI | Jan P | 53.9 | 54.3 | |
| 01/27/2016 | New Home Sales | Dec | 500k | 490k | |
| 01/27/2016 | FOMC Meeting | Jan | | No change | |
| 01/28/2016 | Durable Goods Orders | Dec P | -0.5% | 0.0% | |
| 01/29/2016 | GDP Annualized QoQ | 4Q A | 0.8% | 2.0% | |
| 01/29/2016 | Univ. of Mich. Sentiment | Jan F | 93.0 | 93.3 | |

## Japan

| | Indicator | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 01/25/2016 | Trade Balance | Dec | ¥117B | -¥379B | Foreign trade and Inflation data would be looked at closely by the market. |
| 01/25/2016 | Exports YoY | Dec | -7% | -3.3% | |
| 01/25/2016 | Imports YoY | Dec | -16.4% | -10.2% | |
| 01/29/2016 | Jobless Rate | Dec | 3.3% | 3.3% | |
| 01/29/2016 | Core CPI YoY | Dec | 0.9% | 0.9% | |
| 01/29/2016 | Industrial Production MoM | Dec P | -0.3% | -0.9% | |

## Eurozone

| | Indicator | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 01/25/2016 | IFO Expectations (GE) | Jan | 104.1 | 104.7 | Germany's IFO and Eurozone's money supply and inflation data will be the focus of attention. |
| 01/28/2016 | M3 Money Supply YoY | Dec | 5.2% | 5.1% | |
| 01/29/2016 | CPI Estimate YoY | Jan | 0.4% | 0.2% | |
| 01/29/2016 | CPI Core YoY | Jan A | 0.9% | 0.9% | |

## China and India

| | Indicators | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 01/26/2016 | Industrial Profits YoY (CH) | Dec | NA | -1.4% | No major economic data expected from the two large EMs. |
| 01/28/2016 | Leading Index (CH) | Dec | NA | 98.11 | |
| This week | Infra Industries Growth YoY (IN) | Dec | NA | -1.3% | |
| 01/29/2016 | Fiscal Deficit INR Crore (IN) | Dec | NA | 72277 | |

## 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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