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Markets bet on resilient US growth

The recent equity surge stems from the conviction that the US economy will be able to avoid recession. The fall of the VIX Index – a measure for the price investors are willing to pay against equity price drops – is also confirming that conviction. On the fixed income side, it is less clear. Yes, CDS spreads have eased and Treasury yields have backed up. However, they have not done so in a spectacular way. Futures are still expecting the Federal Reserve to stay on hold until September 2016.

We stick to our scenario of positive but sluggish US growth. Job creation is still strong but is a lagging indicator and the US will be unlikely to grow strongly whilst Japan, Europe, China and most markets are slowing down. The US dollar will not strengthen significantly as the Federal Reserve will be unable to hike significantly, notwithstanding last week's spike in inflation. This should be enough to keep growth in positive territory. Not enough to significantly boost equities.

All eyes on Mr. Draghi and China numbers

Whilst inflation in the United States rose, it came further down in Europe. This should give Mr. Draghi some leeway to surprise markets, possibly by adding an addition 10 billion per month QE to the expected further reduction in the ECB deposit rate. Whatever he does, however, he will not be able to significantly alter the exchange rate of the euro versus other major currencies. Since the euro depreciation has been the major factor boosting European equities, we are therefore not likely to see any boost there. Rather, to the extent that Mr. Draghi is "bound" to disappoint we could see some consolidation of equity prices that have now reached again reasonable valuations. Another risk factor will be China data. Markets will pay particular attention to the data on foreign reserves to assess whether capital outflows continued or abated in February.

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,000.0	2.7	-2.2
Dow Jones	17,006.8	2.2	-2.4
Nasdaq	4,717.0	2.8	-5.8
DAX	9,824.2	3.3	-8.6
Nikkei 225	17,014.8	5.1	-10.6
FTSE 100	6,199.4	1.7	-0.7
Sensex	24,646.5	6.4	-5.6
Hang Seng	20176.7	4.2	-7.9
Regional Markets (Sunday to Thursday)			
ADX	4420.5	4.0	2.6
DFM	3250.2	4.0	3.1
Tadawul	6216.3	4.0	-10.1
DSM	10136.6	2.9	-2.8
MSM30	5404.51	0.3	-0.0
BHSE	1174.3	-0.7	-3.4
KWSE	5244.0	1.3	-6.6
MSCI			
MSCI World	1,608.0	3.4	-3.3
MSCI EM	791.0	6.9	-0.4

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	38.7	10.3	3.9
Nymex WTI USD/bbl	35.9	9.6	-3.0
OPEC Baskt USD/bbl	31.6	2.8	1.1
Gold 100 oz USD/t oz	1259.0	2.9	18.6
Platinum USD/t oz	978.8	7.1	9.8
Copper USD/MT	4918.0	5.1	4.6
Alluminium	1583.25	1.5	5.2
Currencies			
EUR	1.1005	0.6	1.3
GBP	1.4229	2.6	-3.4
JPY	113.74	-0.2	5.7
CHF	0.9927	-0.4	0.9
Rates			
USD Libor 3m	0.6335	-0.3	3.4
USD Libor 12m	1.1940	2.8	1.4
UAE Eibor 3m	1.0317	-1.1	-2.2
UAE Eibor 12m	1.5781	0.1	7.0
US 3m Bills	0.2645	-14.8	62.6
US 10yr Treasury	1.8741	6.3	-17.4

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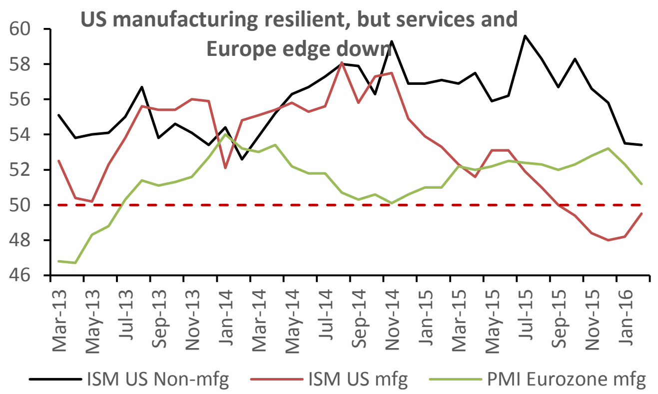
Markets bet on US avoiding recession

Markets take heart from some improvements

Last week markets took heart from some moderate indications that the US economy would not go into recession any time soon. Whilst we have said earlier in 2015 that a recession in the US had a meaningful probability, our own base case scenario has been throughout a scenario of positive, yet sluggish and below potential growth. More specifically we still think that annualized growth should stabilize between 1% and 2%. Whether such growth is enough to significantly propel the value of risky assets – in particular equities – is altogether another issue.

US manufacturing seems to stabilize

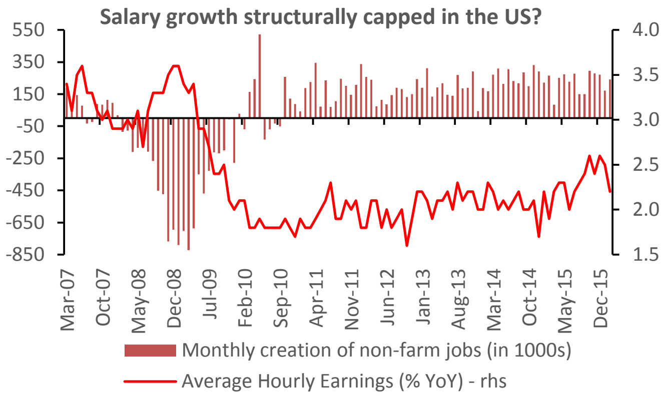
The ISM Manufacturing Index edged up in the month of February, even if – at 49.5 – it is still below the 50 threshold level, i.e. it is still in contractionary territory. We might of course see some further moderation in the manufacturing slowdown. This should then also spill-over to the service sector which lately had also been slowing down. It is important, however, to note that the US manufacturers' inventories over shipments ratio has barely budged from its December 2015 level, which was the highest level since the Global Financial Crisis. As such, we see little scope for a massive jump in manufacturing activity, at the same time that everywhere else – and now also in Europe – activity is slowing.



Source: Bloomberg

US labour markets rolls on, but not wages

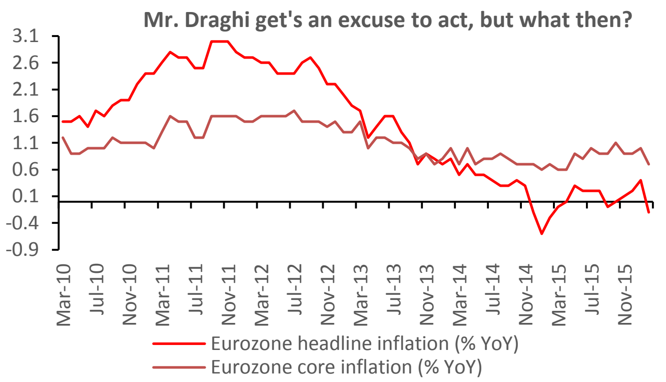
Whilst the US labour market continues to impress us with the creation of jobs at a monthly average above 200'000, it is ever so remarkable that wage growth is unable to catch up at rates that one would have expected at this stage of the business cycle. More specifically, with the economy approaching full employment one would have expected salaries to grow at close to 3% YoY. Instead, they are unable to significantly break away from the 2% YoY growth rate. The reasons for this compensation hysteresis are well-known and we have discussed them at length on earlies occasions. The recovery has not determined an increase in productivity, on the contrary, and companies are unwilling to invest as they remain uncertain about future demand. Thus most jobs being created are not high skilled jobs, they might well be temporary, and they do not generate the type of income certainty that would give a permanent boost to consumption spending. On the flip side this means that inflation is not an imminent threat and the Fed has no specific urgency to hike rate.



Source: Bloomberg

Mr. Draghi to steer market expectations

By Thursday afternoon we will know if Mr. Draghi will do something more in addition to the already expected reduction of already negative deposit rates. It is becoming increasingly difficult for Mr. Draghi to surprise on the upside, but after last week's disappointing inflation number, he has extra arguments to overrule the hawks in the ECB.



Source: Bloomberg

How effective can monetary policy be?

The key problem with further QE from the ECB – or from the BoJ – is that it is unlikely to further affect the exchange rate. Yes, the US dollar is likely further strengthen against bothe the euro and the yen. Yet it will not be the type of significant appreciation that occurred when the ECB and the BoJ first unleashed QE. Since it was the exchange rate that provided a major boost to European and Japanese equities, it is reasonable to expect disappointment rather than euphoria after Mr. Draghi has spoken.

Summary market outlook

Global Yields	Bond markets remained cautious despite the continuing risk rally. The US Treasury 10yr yield ticked up only 10bps amid better than expected growth indicators. With some economic data coming this week only from China, yield will largely be guided by the sentiment in equity market which in turn will be dependent on the ECB action this week. The same is the case for European sovereign yields.
Stress and Risk Indicators	VIX indicator moved to touch the lowest level of this year. We believe that the indicator is unlikely to go further lower from the current levels as we see limited potential for S&P 500 to move significantly upward. Sovereign CDS spreads also eased a bit which corroborates the global risk rally.
Precious Metals	Amid risk-rally, gold prices also gained significantly last week which is sort of counterintuitive. Long-term we remain cautious on gold, as global pressures are by and large deflationary.
Local Equity Markets	GCC equity markets closed with strong gains last week, taking UAE markets into positive territory on a year-to-date basis. A decent pick-up in the oil price, if sustained, is likely to be positive for the local markets in the near term.
Global Equity Markets	Global equities continued their upward trend last week, getting support from the better than expected US economic releases. We see capped upward potential for the equity market especially after the sharp rebounds. ECB decision will be crucial for global equities this week.
Energy	Oil prices also continued to move up last week like equities. We could see some stabilization at these levels as the markets bet in stable domestic demand and a gradual reduction of US shale output.
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	After trading largely on the softer side for most part of the week, the euro gained strength towards end of the week despite strong US job market data. This is probably a cautious approach by the currency market towards the ECB meeting this week.	R2 - 1.1175 R1 - 1.1090 S1 - 1.0873 S2 - 1.0741
GBPUSD	With relatively less focus on “Brexit”, the pound movement was dictated by the economic reality as it strengthened last week. We believe that the currency could continue regaining its lost ground but remains susceptible to “Brexit” concerns.	R2 - 1.4516 R1 - 1.4373 S1 - 1.3961 S2 - 1.3692
USDJPY	The Japanese yen seems to have found a new trading range of 112-114. It is likely to remain in the range in the near term.	R2 – 115.89 R1 – 114.81 S1 – 112.41 S2 – 111.09

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
3/07/2016	Consumer Credit	Jan	$16.5B	$21.3B	After a set of important economic releases last week, there is hardly any market moving data scheduled to be released this week.
3/08/2016	NFIB Small Business Optimism	Feb	94.1	93.9	
3/09/2016	Wholesale Inventories MoM	Jan	-0.2%	-0.1%	
3/10/2016	Initial Jobless Claims	05-Mar	275K	278K	
3/10/2016	Household Change in Net Worth	4Q	NA	$1232B	
3/10/2016	Monthly Budget Statement	Feb	-$200B	-$192B	
3/11/2016	Import Prices YoY	Feb	-6.6%	-6.2%	

Japan

	Indicator	Period	Expected	Prior	Comments
3/07/2016	Leading Index CI	Jan P	101.6	102.1	Markets would look at how much downward revision Q4 GDP underwent.
3/08/2016	GDP Annualized QoQ	4Q F	-1.6%	-1.4%	
3/08/2016	Current Account Balance	Jan	¥700B	¥960.7B	
3/08/2016	Eco Watchers Survey Outlook	Feb	49.3	49.5	

Eurozone

	Indicator	Period	Expected	Prior	Comments
3/08/2016	GDP SA QoQ	4Q P	0.3%	0.3%	Markets will focus on ECB meeting as it expects at least a cut in the central bank's deposit facility rate.
3/08/2016	Gross Fixed Cap QoQ	4Q	0.6%	0.0%	
3/08/2016	Govt. Expenditure QoQ	4Q	0.4%	0.6%	
3/08/2016	Household Cons QoQ	4Q	0.3%	0.4%	
3/08/2016	ECB Deposit Facility Rate	10-Mar	-0.4%	-0.3%	
3/08/2016	ECB Marginal Lending Rate	10-Mar	0.3%	0.3%	

China and India

	Indicators	Period	Expected	Prior	Comments
3/07/2016	Foreign Reserves (CH)	Feb	$3190B	$3230B	A large set of important economic data will be watched closely by the market this week along with trade and IP data from India.
3/08/2016	Trade Balance (CH)	Feb	$50.75B	$63.3B	
3/08/2016	Exports YoY (CH)	Feb	-15%	-11.2%	
3/08/2016	Imports YoY (CH)	Feb	-10.2%	-18.8%	
3/08/2016	CPI YoY (CH)	Feb	1.8%	1.8%	
This week	New Yuan Loans (CH)	Feb	1200B	2510B	
This week	Money Supply M2 YoY (CH)	Feb	13.7%	14.0%	
3/08/2016	Industrial Production YTD YoY (CH)	Feb	5.6%	6.1%	
3/08/2016	Retail Sales YTD YoY (CH)	Feb	10.9%	10.7%	
3/08/2016	Fixed Assets Ex- Rural YoY (CH)	Feb	9.4%	10.0%	
3/10/2016	Local Car Sales (IN)	Feb	NA	168303	
3/10/2016	Trade Balance	Feb	NA	$7.6B	
3/10/2016	Exports YoY (IN)	Feb	NA	-13.6%	
3/10/2016	Industrial Production	Jan	NA	-1.3%	

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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