The Weekly Market View

March 21 2016

بنك أبوظبي التجاري ADCB

2-0 to the doves

Just over a week ago Mario Draghi scored the first goal for the doves as the ECB introduced much larger than expected monetary easing measures. A week later Janet Yellen added to the scoreline by delivering a surprisingly dovish message from the Federal Reserve. The net effect was that global equities ground a little higher again. Last week we asked the question whether the rally was running out of steam, the reaction to the FOMC decision on Wednesday suggests that this is indeed the case. One could ordinarily have expected a sharp rally following such a dovish statement from the Fed, instead markets finished the week only slightly higher. The biggest move came in the dollar, which weakened against most trading partners. This pushed the Japanese yen back into an uncomfortably strong level (from the point of view of the BoJ) while the euro also gained. Oil prices reversed sharp losses from earlier in the week to finish up while the weaker dollar also boosted other commodities. Treasuries ignored the hype, striking a more cautious tone with 10-year yields falling to 1.87%.

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The Fed is putting itself between a rock and a hard place

During the Q&A session which followed Fed Chair Yellen's statement, a number of questions centred on the Fed's credibility. Specifically because the Fed has long stressed its twin goals of full employment and price stability (which it defines as inflation around 2%). The Fed has achieved full employment and seems very close to its inflation objective as well, nevertheless interest rates remain near rock bottom. February core inflation came in at 2.3% y-o-y in the hours leading up to the FOMC decision; granted the Fed's preferred measures of inflation is core PCE which is running at 1.7% y-o-y. However, it looks like they rather see an overshoot of their goals before tightening further. This risks putting them between a rock and a hard place: if they fall behind the curve they will need to turn more hawkish and raise rates more quickly, or if they don't deliver even the two hikes they now project, they signal that the economy is in worse shape than what markets have priced in over the past month. Neither outcome seems likely to be received particularly well by investors.

Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,049.6	1.4	0.3
Dow Jones	17,602.3	2.3	1.0
Nasdaq	4,795.6	1.0	-4.2
DAX	9,950.8	1.2	-7.4
Nikkei 225	16,724.8	-1.3	-12.1
FTSE 100	6,189.6	0.8	-0.8
Sensex	24,952.7	0.9	-4.5
Hang Seng	20671.6	2.3	-5.7
Regional Markets (Sunday to Thursday)			
ADX	4380.7	-0.5	1.7
DFM	3357.3	0.9	6.5
Tadawul	6394.7	0.6	-7.5
DSM	10426.0	0.4	-0.0
MSM30	5335.25	0.7	-1.3
BHSE	1162.8	0.7	-4.4
KWSE	5271.5	-0.4	-6.1
MSCI			
MSCI World	1,645.6	1.2	-1.0
MSCI EM	826.8	3.2	4.1

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	41.2	2.0	10.5
Nymex WTI USD/bbl	39.4	2.4	6.5
OPEC Baskt USD/bbl	36.4	2.1	16.3
Gold 100 oz USD/t oz	1255.4	0.5	18.3
Platinum USD/t oz	972.5	1.1	9.1
Copper USD/MT	5103.0	3.3	8.5
Alluminium	1509.5	-2.7	0.3
Currencies			
EUR	1.1270	1.0	3.8
GBP	1.4476	0.7	-1.8
JPY	111.55	2.0	7.8
CHF	0.9695	-1.3	3.4
Rates			
USD Libor 3m	0.6243	-1.5	1.9
USD Libor 12m	1.2115	-1.1	2.8
UAE Eibor 3m	1.0261	0.1	-2.7
UAE Eibor 12m	1.5690	-0.7	6.4
US 3m Bills	0.2849	-9.7	75.1
US 10yr Treasury	1.8732	-5.6	-17.5

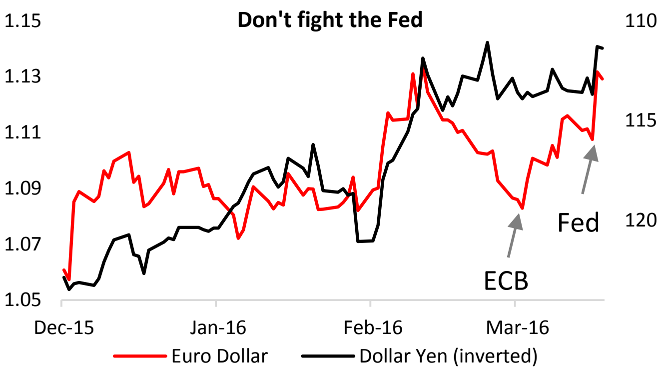
With the G3 central bank meetings behind us, markets should re-focus on fundamentals

Is the Fed targeting an inflation overshoot?

Despite US data improving quite significantly since the Fed's end of January FOMC policy meeting and financial markets being in a much stronger position, the Fed downgraded its assessment of the economy and cut back its projection for rate increases in 2016 to 2 (from 4 previously). With inflation ticking up and the economy at full employment it raises the question if the Fed is trying to generate an inflation overshoot before tightening further; i.e. the Fed may deliberately be behind the curve. This is a dangerous game as it risks needing sharper tightening down the line. Inflation expectations in the US which have already been rising on the back of the rebound in energy prices shot up in the aftermath of the Fed's decision. From this point onwards the picture for financial markets is increasingly difficult. Either the Fed will turn more hawkish and raise rates in response to better economic data, or projected interest rate hikes will get pushed out even further, thereby signalling a much weaker economy. Neither will likely be received particularly well by investors.

Draghi and Kuroda learn their lesson

In January both the ECB and the Bank of Japan intervened to weaken their respective currencies only for their efforts to be reversed within a matter of days, damaging their credibility in the process. Using the past two weeks as a guide, it seems that both Mr. Draghi and Mr. Kuroda have learned not to fight the Fed. Both central banks held their policy meetings during the last 2 weeks, ahead of the Fed's own rate setting meeting on March 16. It was notable that the ECB in particular introduced a range of new measures designed to boost lending growth (and ultimately inflation) without targeting further euro weakness. The BoJ remained on hold, and both proved wise decisions as days later the Fed's dovish FOMC statement saw a significant weakening of the US dollar. Despite recent dollar weakness, the fact remains that the Eurozone and Japanese economies are much weaker than that of the US. Therefore we continue to expect both the euro and the yen to trade within the same ranges that we have been seeing for some time now (€1.05-1.15 and ¥110-120).



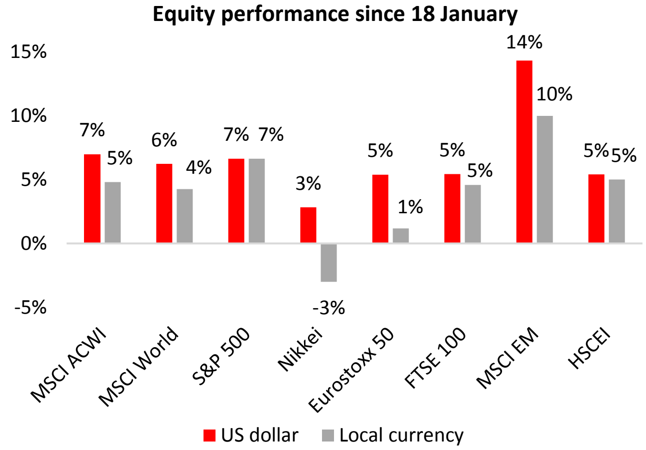
Source: Thomson Reuters Datastream

Time again to focus on fundamentals

With the G3 central bank meetings out of the way, and Friday's monthly option expiry also behind us, markets will once again be forced to look at fundamentals. Both bottom-up and top-down fundamentals remain very weak, as highlighted by a dreadful Q4 15 earnings season in the US, which marked the third consecutive quarter of negative earnings growth. Our view has been, and remains that unless we see improvement in fundamentals such as earnings that we will remain underweight equities in our asset allocation. Top-down fundamentals will be mostly in focus in this shortened trading week (markets closed for Good Friday on the 25th), with the German IFO and ZEW surveys, preliminary PMI releases and the final reading of Q4 US GDP growth providing the focal points.

Update of our key equity calls

On January 18th we decided to shift our equity focus in a more defensive direction by going overweight US equities and underweight all other major countries and regions. The rationale behind this move had nothing to do with fundamentals, which are admittedly poor for US equities, but more to do with limiting exposure to higher beta equity markets (Europe, EM) as well as benefitting from US equities as a relative "safe haven". During the major equity market sell-off which ensued, US equities meaningfully outperformed, behaving precisely as one would have expected in a difficult environment for risk assets. Since markets bottomed on February 11, however, the US has slightly underperformed. Taken as a whole, since implementation the strategy has still outperformed. More importantly however, and recent rally aside, we continue to expect equities to remain in a broadly downward trajectory. This means that within an equity only portfolio US equities will likely outperform again if and when the environment becomes more challenging.



Source: Thomson Reuters Datastream

Summary market outlook

Bonds	
Global Yields	The US 10yr Treasury yield came back down last week to 1.87% from close to 2%. This was driven by the very dovish FOMC statement in which the Fed downgraded its assessment of the economy and scaled back the number of rate hikes this year to just 2, from 4 previously. Elsewhere, additional stimulus from the ECB and negative rates in Japan are likely to continue to keep a ceiling on Eurozone and Japanese yields.
Stress and Risk Indicators	Expectations for volatility in US equities over the next month (as measured by the VIX) have fallen to the lowest level since November, underscoring the more positive sentiment which has prevailed. With no major central bank meetings on the agenda, and with equity markets and oil prices having rallied strongly of late, a change in sentiment could see the VIX rise once more.

Equity Markets	
Local Equity Markets	Oil prices hit the $40/bbl mark last week, finishing at the highest level of the year, thereby offering support to GCC equity markets. However, at some point volatility will likely return which given regional equities' strong run over the past month is likely to translate into a choppier environment for local markets.
Global Equity Markets	With Mrs Yellen joining Mr Draghi in offering a dovish outlook on monetary policy the global risk rally continued last week, albeit at a slower pace. Investors chose not to focus on the Fed's downgraded assessment of the health of the US economy, but rather on the fact that committee members now expect just 2 rate hikes in 2016, from 4 previously.

Commodities	
Precious Metals	The gold price stayed range bound during the week, trading between $1,240/oz and $1,280/oz. The metal remains one of the best performing assets year-to-date. Long-term we remain cautious on gold, as global pressures are by and large deflationary.
Energy	The momentum continued in oil last week as prices gained 2%. A large part of the gains of late can be explained by short covering on hopes of a broader output agreement at a meeting of key producers in Doha on April 17. However, given the recent volatility in the price, we caution investors against massive entries.
Industrial Metals	Industrial metals prices gained again last week. We believe that the gains have come mostly from dollar weakness rather than any improvement in the fundamental outlook for metals, which remains bleak in our view.

Currencies								
EURUSD	The euro strengthened further against the US dollar driven by the FOMC's decision to not hike interest rates at its March meeting, as well as its decision to scale back the number of projected rate hikes this year to 2 from 4 previously. The EURUSD is now hovering close to the upper end of 1.05-1.15 range. However, the weaker state of the Eurozone economy will likely keep a cap on euro strength in our view.							
Critical levels	R2	1.1461	R1	1.1309	S1	1.0913	S2	1.0669
GBPUSD	Cable was volatile during the week, but overall continued its recent strengthening trajectory following the Fed's policy meeting. It has rebounded sharply from the height of its Brexit induced jitters (1.38) at the end of February to finish the week just shy of the 1.45 mark.							
Critical levels	R2	1.4631	R1	1.4507	S1	1.4188	S2	1.3993
USDJPY	The Japanese yen strengthened further, breaking back towards the lower end of its recent range (111-114). The BoJ will be especially concerned by this given that it has occurred in the backdrop of strong risk sentiment in market. If and when sentiment reverses, the yen may rally further as a safe haven currency.							
Critical levels	R2	115.73	R1	114.80	S1	112.58	S2	111.29

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
3/21/2016	Existing Home Sales	Feb	5.31m	5.47m	The most closely watched US data releases this week will likely be final Q4 GDP growth as well as PMI data.
3/22/2016	Markit US Manufacturing PMI	Mar P	51.9	51.3	
3/22/2016	Richmond Fed Manufact. Index	Mar	0	-4	
3/23/2016	New Home Sales	Feb	510k	494k	
3/24/2016	Initial Jobless Claims	Week 19 Mar	268k	265k	
3/24/2016	Durable Goods Orders	Feb P	-3.0%	4.7%	
3/24/2016	Markit US Services PMI	Mar P	51.4	49.7	
3/24/2016	Markit US Composite PMI	Mar P	--	50	
3/25/2016	GDP Annualized QoQ	4Q T	1.0%	1.0%	

Japan

	Indicator	Period	Expected	Prior	Comments
3/21/2016	Nikkei Japan PMI Mfg	Mar P	50.5	50.1	PMI and CPI data the most important data from Japan.
3/22/2016	All Industry Activity Index MoM	Jan	1.9%	-1.0%	
3/24/2016	Natl CPI YoY	Feb	0.3%	0.0%	
3/24/2016	Natl CPI Ex Food, Energy YoY	Feb	0.8%	0.7%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
3/21/2016	ECB Current Account SA	Jan	--	25.5b	German IFO data and PMI form the focus of the week ahead in the Eurozone.
3/21/2016	Current Account NSA	Jan	--	41.4b	
3/22/2016	Markit Eurozone Manufacturing PMI	Mar P	51.4	51.2	
3/22/2016	Markit Eurozone Services PMI	Mar P	53.3	53.3	
3/22/2016	Markit Eurozone Composite PMI	Mar P	53.0	53.0	
3/23/2016	Consumer Confidence	Mar A	-8.3	-8.8	
3/22/2016	IFO Business Climate (Germany)	Mar	106	105.7	
3/24/2016	Import Price Index YoY (Germany)	Feb	-5.1%	-4.0%	

China and India

	Indicators	Period	Expected	Prior	Comments
					No major releases from China or India this week

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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