The Weekly Market View

May 2 2016

بنك أبوظبي التجاري ADCB

Markets recede, as BoJ (and ECB) dilemma re-emerges

Global equities ended the week with losses, even if the bulk of those losses materialized at the end of the week only, with most markets managing to struggle sideward through the first days of the week. Treasury yields came again down quite significantly and gold got a boost together with the Swiss franc and the Japanese yen, an indication that markets are once more flirting with a return to the risk-off mood. The strengthening of the Japanese yen is perhaps the most noteworthy as it reveals the dilemma the BoJ (and similarly the ECB) finds itself in. QE without currency devaluation seems to have little lasting positive impact on the Japanese economy. Yet, a renewed slide of the yen (and more importantly the euro), would reignite problems in emerging markets and specifically in China, something that the world economy can hardly afford. From this perspective one should not have too many illusions as to the Europeans holding up forever. True, first quarter GDP was better than expected, but the receding IFO – Germany's most important leading business indicator – sheds some doubts as to the continent's capacity to absorb the US dollar's recent slide.

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Global manufacturing indicators and US labour market to set the tone

After a week during which macro-economic data was generally bad and US Q1 earnings stayed on track for their weakest quarter since the global financial crisis (-9% y-o-y so far), markets will most closely watch the development of the leading manufacturing data of the largest economies, especially as we have already seen some slippage in German and Chinese leading indicators. Other important factors – but they will be released only at the end of the week will be China forex reserves and US labour market data. As for the former, they should be less important in the aftermath of continuous US dollar weakening. US labour market data might also remain strong for some months. Thus markets might still somewhat stabilize this week, even though over a longer period downward pressures are most likely to persist.

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,065.3	-1.3	1.0
Dow Jones	17,773.6	-1.3	2.0
Nasdaq	4,775.4	-2.7	-4.6
DAX	10,039.0	-3.2	-6.6
Nikkei 225	16,666.1	-5.2	-12.4
FTSE 100	6,241.9	-1.1	-0.0
Sensex	25,606.6	-0.9	-2.0
Hang Seng	21067.1	-1.9	-3.9
Regional Markets (Sunday to Thursday)			
ADX	4543.5	-2.0	5.5
DFM	3491.9	-2.6	10.8
Tadawul	6805.8	3.3	-1.5
DSM	10186.2	-2.0	-2.3
MSM30	5942.72	2.2	9.9
BHSE	1110.5	-1.0	-8.7
KWSE	5391.8	0.8	-4.0
MSCI			
MSCI World	1,670.8	-0.9	0.5
MSCI EM	840.2	-0.6	5.8

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	47.4	6.7	27.1
Nymex WTI USD/bbl	45.9	5.0	24.0
OPEC Baskt* USD/bbl	42.0	5.6	34.4
Gold 100 oz USD/t oz	1293.5	4.9	21.9
Platinum USD/t oz	1076.4	6.7	20.7
Copper USD/MT	5045.0	0.6	7.3
Alluminium	1673.75	1.5	11.2
Currencies			
EUR	1.1451	2.0	5.4
GBP	1.4612	1.5	-0.8
JPY	106.50	-4.7	12.9
CHF	0.9599	-1.9	4.4
Rates			
USD Libor 3m	0.6366	0.1	3.9
USD Libor 12m	1.2295	-0.6	4.4
UAE Eibor 3m	1.0636	2.1	0.8
UAE Eibor 12m	1.6160	1.1	9.6
US 3m Bills	0.2085	-8.9	28.2
US 10yr Treasury	1.8333	-2.9	-19.2

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Q1 earnings season highlights the dislocation between fundamentals and the recent rally

So far companies are beating very low expectations

With well over half of US companies now having reported Q1 2016 earnings, it is a good moment to get a snapshot of the health of corporate America. On the surface it looks to have been a very strong earnings season with 76% of S&P 500 companies beating EPS estimates by an aggregate 3.6%. The below table shows the S&P 500 sector by sector earnings beats/misses so far this quarter. 9 out of 10 sectors have beaten analyst expectations, technology being the only sector to disappoint so far.

S&P 500 Q1 2016 earnings surprises

		Earnings Surprise			
	Reported	Positive	Inline	Negative	%
Overall S&P 500	**310 / 499**	**237**	**1**	**72**	**3.6%**
Oil & Gas	17 / 38	12	0	5	262.4%
Basic Materials	13 / 19	12	0	1	12.9%
Industrials	60 / 77	44	0	16	4.5%
Consumer Goods	42 / 62	37	0	5	9.0%
Health Care	32 / 51	28	0	4	2.9%
Consumer Svs	31 / 74	26	1	4	6.0%
Telecoms	3 / 5	2	0	1	1.9%
Utilities	11 / 30	7	0	4	2.6%
Financials	72 / 92	48	0	24	3.2%
Technology	29 / 51	21	0	8	-1.6%

Source: Bloomberg

However, all is not as well as it seems. US corporates are very good at managing (down) analysts' expectations, in the past 10 years the share of earnings beats has consistently been well above 50%, averaging >70% in the long-run. The share of beats therefore tells us little about the underlying health of the corporate sector. Actual earnings growth is a far better indicator, and here the signs are fall more troubling. Actual Q1 earnings growth is running at -9% y-o-y so far, the weakest since 2009. Only 4 out of the 10 sectors have managed to generate positive earnings growth in Q1.

S&P 500 Q1 2016 earnings growth (so far)

		Earnings Growth			
	Reported	Positive	Flat	Negative	%
Overall S&P 500	**310 / 499**	**182**	**7**	**120**	**-9.0%**
Oil & Gas	17 / 38	2	0	15	-95.4%
Basic Materials	13 / 19	5	0	8	-12.9%
Industrials	60 / 77	38	1	21	-7.4%
Consumer Goods	42 / 62	29	1	12	11.6%
Health Care	32 / 51	26	0	6	6.3%
Consumer Svs	31 / 74	22	0	8	7.1%
Telecoms	3 / 5	2	0	1	17.0%
Utilities	11 / 30	3	0	8	-5.3%
Financials	72 / 92	40	4	28	-13.1%
Technology	29 / 51	15	1	13	-10.2%

Source: Bloomberg

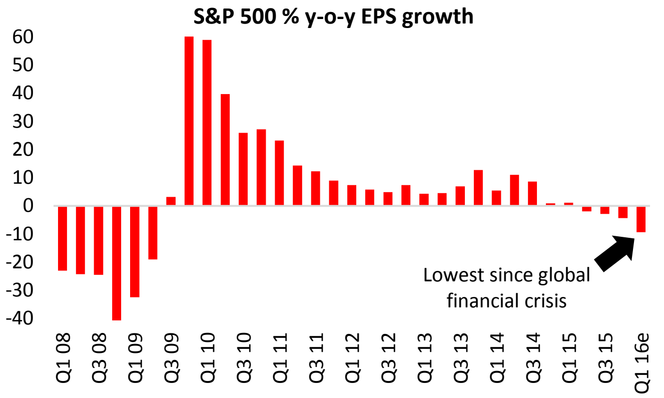
We have been arguing for some time that US earnings are at risk longer-term with record high margins and falling top-line growth. Top-line growth numbers in Q1 have fallen 2.4% y-o-y so far in aggregate.

S&P 500 Q1 2016 sales growth (so far)

		Sales Growth			
	Reported	Positive	Flat	Negative	%
Overall S&P 500	**310 / 499**	**174**	**0**	**135**	**-2.4%**
Oil & Gas	17 / 38	2	0	15	-29.1%
Basic Materials	13 / 19	2	0	11	-12.5%
Industrials	60 / 77	31	0	29	-1.1%
Consumer Goods	42 / 62	23	0	19	0.3%
Health Care	32 / 51	28	0	4	9.6%
Consumer Svs	31 / 74	22	0	9	8.2%
Telecoms	3 / 5	2	0	1	12.2%
Utilities	11 / 30	1	0	9	-12.0%
Financials	72 / 92	48	0	24	-2.2%
Technology	29 / 51	15	0	14	-4.0%

Source: Bloomberg

The overall picture is therefore one of concern. The below chart shows S&P 500 y-o-y EPS growth by quarter going to back to the global financial crisis of 2008/09, the earnings malaise of the past four quarters clearly sits uneasily with close to record high equity markets and expensive valuations.



Source: Bloomberg

In Europe the earnings season is not as advanced as in the US. So far although 59% of Eurozone companies have beaten earnings estimates, actual Q1 growth in earnings is -6% y-o-y, although it jumps to +2% y-o-y excluding energy. In fact, the Eurozone is the only region delivering positive earnings growth this quarter when excluding energy. Japan is too early in its reporting season to make any meaningful assessment, although it has not started well, earnings growth for the companies which have reported is -11% y-o-y so far in aggregate.

Summary market outlook

Bonds	
Global Yields	US Treasury 10yr yields eased on the dovish tone in the FOMC statement and negative surprises in economic data releases. We do not expect any sharp run-up in the yields in the short term, however, a further uptick is possible if economic data surprises to the upside. The European Periphery Sovereign yields' movement was largely flattish. ECB purchases should keep yields contained.
Stress and Risk Indicators	The VIX index moved up last week as US equity markets gave up some of their gains. We have an upward bias for the index as global equities including US equities are unlikely to move much higher in the near term. Sovereign CDS Spreads, especially in the Asian EMs ticked up a bit with volatility in global risk assets. However, with the softening in the dollar, they could improve in the very near term.

Equity Markets	
Local Equity Markets	GCC equity markets were mixed with Saudi markets performing well on the National Transformation Plan revealed last week. However, disappointing results were reasons for decline in the UAE markets. A solid gain in the oil price should provide support to the market, given also lower valuations.
Global Equity Markets	A combination of factors, including disappointing first quarter US GDP and some disappointing earnings from large companies in the US, and more importantly the BoJ's surprise status quo announcement were the cause of the equity market correction at the end of the week. We expect downward pressure to continue in the near term.

Commodities	
Precious Metals	The BoJ's suspension of additional stimulus reignited currency and equity volatility which caused strong gains in the gold price. Similar developments can re-occur each time risk aversion re-emerges.
Energy	Energy prices continued to build up to the close of the month (April) with a solid gain of 22%. After significant gains over the past weeks, we do not rule out some volatility in the near term.
Industrial Metals	Industrial metals prices witnessed further gains last week. We don't see any fundamental factor supporting industrial metals prices in the medium term.

Currencies								
EURUSD	A dovish Fed as well as disappointing economic releases from the US pushed the euro higher last week. However, it has moved up close to its upper trading range. At the same time, important ISM and job data this week could push the euro lower.							
Critical levels	R2	1.1618	R1	1.1534	S1	1.1292	S2	1.1134
GBPUSD	The cable continued to gain last week as a dovish Fed and disappointing US data softened the dollar. However, we believe that the currency pair will remain volatile with a potential upward bias, largely news-driven on the "Brexit".							
Critical levels	R2	1.4829	R1	1.4720	S1	1.4453	S2	1.4295
USDJPY	A surprise move by the BoJ (by not moving on further stimulus) caused sharp gains in the yen. At such a level, it is likely that the currency will have more volatility with downward bias (yen depreciation).							
Critical levels	R2	113.86	R1	110.18	S1	104.55	S2	102.60

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
5/02/2016	ISM Manufacturing	Apr	51.4	51.8	Important set of data this week to provide a sense of how the second quarter started after poor first quarter growth numbers.
5/04/2016	ISM Non-manufacturing	Apr	54.7	54.5	
5/04/2016	Factory Orders	Mar	0.6%	-1.7%	
5/04/2016	Durable Goods Orders	Mar F	0.8%	0.8%	
5/06/2016	Change in Nonfarm Payroll	Apr	200k	215k	
5/06/2016	Unemployment Rate	Apr	5.0%	5.0%	
5/06/2016	Average Hourly Earnings YoY	Apr	2.4%	2.3%	
5/06/2016	Labour Force Participation Rate	Apr	63.0%	63.0%	

Japan

	Indicator	Period	Expected	Prior	Comments
5/02/2016	Nikkei Mfg PMI	Apr F	--	48.0	PMIs will be looked at by the market.
5/06/2016	Nikkei Services PMI	Apr	--	50.0	

Eurozone

	Indicator	Period	Expected	Prior	Comments
5/02/2016	Markit Mfg PMI	Apr F	51.5	51.5	PMIs will be in focus this week.
5/04/2016	Markit Services PMI	Apr F	53.2	53.2	
5/04/2016	Retail Sales MoM	Mar	-0.1%	0.2%	
5/02/2016	Markit/BME Mfg PMI (GE)	Apr F	51.9	51.9	

China and India

	Indicators	Period	Expected	Prior	Comments
05/03/2016	Caixin Mfg PMI (CH)	Apr	49.8	49.7	PMIs from China and India will be looked at by the market.
05/07/2016	Foreign Reserves (CH)	Apr	$3200B	$3212B	
05/02/2016	Nikkei Mfg PMI (IN)	Apr	--	52.4	
This week	Eight Infrastructure Industries (IN)	Mar	--	5.7%	

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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