The Weekly Market View

May 16 2016

Global equity markets remain under pressure, yields down

In spite of better-than-expected retail sales in the US, as well as signs of resilience of the German economy, global economic growth prospects remain subdued. A clear indicator of increased growth concerns is the yield on 10- year US Treasuries which is again at the minimum it reached last year. US equity markets reversed on Friday, thereby registering a loss for the week. The fact that Japan and European equity markets fared better, should be seen in the context of the fact that both the yen and the euro lost ground against the US dollar. More encouraging is the apparent decoupling of the oil price from its negative relationship with the US dollar, as it also managed to strengthen last week. The decoupling between the US dollar and the oil price can be explained on the basis of fundamentals, such as lower US oil production and inventories, and it is clearly a plus for local GCC markets. Having said so, a massive rise of the US dollar would be problematic for China and Emerging markets. Last week's data clearly confirmed that China's growth continues to decelerate more significantly than many are still expecting. And Brazil's problems seem to be far from over.

Markets will focus on US data, China weekend data still to be digested

Markets might, however, kick of nervously as the will be concerned about China's economy slowing down more than expected, as we had anticipated in last week's edition. And of course, any news on China needs to be carefully watched in conjunction with the US dollar: if the US dollar stabilizes at current levels, fears about China might subside. If, on the other hand, concerns mount that "currency war truce" between the Euro-zone and Japan on one hand, and the United States, on the other hand, is over, we are likely to see again downward pressure on China and emerging markets, and a as result also on commodity markets, although it is starting to be less clear how much oil will be impacted this time. Given continuing concerns about US growth, markets are also likely to watch carefully US data, in particular the upcoming figures for the housing market.

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,046.6	-0.5	0.1
Dow Jones	17,535.3	-1.2	0.6
Nasdaq	4,717.7	-0.4	-5.8
DAX	9,952.9	0.8	-7.4
Nikkei 225	16,412.2	1.9	-13.8
FTSE 100	6,138.5	0.2	-1.7
Sensex	25,489.6	1.0	-2.4
Hang Seng	19719.3	-1.9	-10.0
Regional Markets (Sunday to Thursday)			
ADX	4383.1	-0.9	1.8
DFM	3339.4	1.1	6.0
Tadawul	6694.8	0.6	-3.1
DSM	9955.1	2.0	-4.5
MSM30	5980.21	-0.2	10.6
BHSE	1111.5	-0.1	-8.6
KWSE	5390.6	0.4	-4.0
MSCI			
MSCI World	1,635.9	-0.4	-1.6
MSCI EM	796.1	-1.2	0.2

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	47.8	5.4	28.3
Nymex WTI USD/bbl	46.2	3.5	24.8
OPEC Baskt* USD/bbl	43.3	6.8	38.5
Gold 100 oz USD/t oz	1273.5	-1.2	20.0
Platinum USD/t oz	1051.7	-2.6	18.0
Copper USD/MT	4660.0	-3.1	-0.9
Alluminium	1517.25	-4.3	0.8
Currencies			
EUR	1.1309	-0.8	4.1
GBP	1.4365	-0.4	-2.5
JPY	108.63	1.4	10.7
CHF	0.9755	0.3	2.7
Rates			
USD Libor 3m	0.6276	-0.3	2.4
USD Libor 12m	1.2289	0.4	4.3
UAE Eibor 3m	1.0770	2.5	2.1
UAE Eibor 12m	1.6213	-1.8	10.0
US 3m Bills	0.2645	36.9	62.6
US 10yr Treasury	1.7001	-4.4	-25.1

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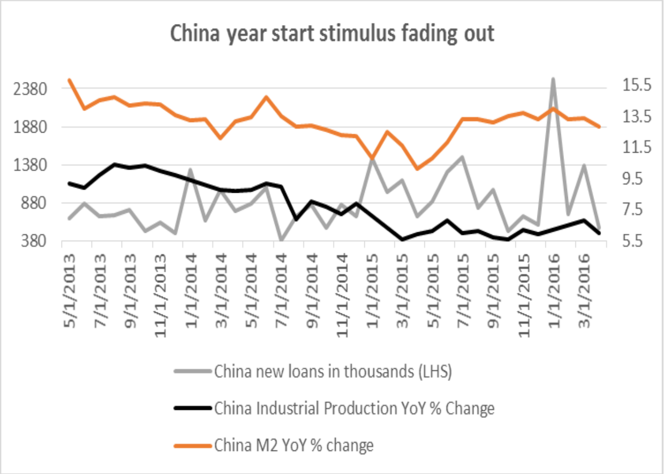
China troubles re-emerging

Industrial production, investments and retail sales down in China

The title of our last edition was "China troubles to re-emerge sooner rather than later". Our readers will forgive us if this week we will not be particularly innovative, at least not in terms of changing the title. This weekend, in fact, we have seen a batch of data coming out of China which seems to indicate that the stimulus impact is already petering out. Most importantly Industrial Production, but also retail sales and investments surprised on the downside. In fact, loans and the broader monetary base grew less than expected, a sign that economic agent are not picking up on government stimulus.



Source: Bloomberg

We would once more like to stress that the stimulus during the first months of this year – and its initial beneficial effects – would not have been possible without the substantial weakening of the US dollar, and the more dovish Federal Reserve policy that was at least partly behind it.

Likewise we have been arguing that the recent reversal of US dollar weakness – while not necessarily a prelude to a massive strengthening of the greenback – is likely to indicate a stabilization of the US dollar at current levels. Now if one considers that – in fact – the weakening of the US dollar has had only a marginal impact on China's Real Effective Exchange Rate, then it becomes clear that further deceleration in growth and output cannot but reignite market fears and the foreign reserve outflows that come with it.

Source: Bloomberg

Also Brazil has to be put in the context of decelerating China growth

It is probably worthwhile to spend a few words on Brazil as the impeachment of Dilma Rouseff and the confirmation of her erstwhile deputy Michel Temer as acting president, has raised hopes that a technocratic government would undertake the needed fiscal and economic reforms. First of all, it is worthwhile to observe that the magnitude of Brazil's problems – a fiscal deficit at 10% of GDP and a primary fiscal deficit at 2% of GDP – require a high order of fiscal reforms to be taken by the government. Now, whilst such reforms seem already to be discounted by the recent rally in Brazilian assets, they are less likely to be implemented by a government that is in fact less technocratic than the market might be hoping for. Many of its members are presidential hopefuls for an election that is only a couple of years away.

Now a lot of the recent pick-up in Brazilian assets has undoubtedly also been favoured by the weakness in the US dollar, which has stabilized China, Brazil's biggest client, and commodities, Brazil's main output.

We continue therefore to caution against jumping on the bandwagon of a rally that is likely petering out, whether that is in Brazil (arguably the extreme case), or in other commodity exporting emerging markets.

Summary market outlook

Bonds	
Global Yields	10-year US Treasury yields came down to 1.70% last week in spite of slightly better than expected retail sales figures. Treasury yields continue to paint a picture of concern on behalf of investors, something which is not squaring well with global equities.
Stress and Risk Indicators	Despite declines in US equity markets, the VIX index eased on a weekly basis. However, we do not expect it go much lower from the current levels.

Equity Markets	
Local Equity Markets	The strength in oil prices last week was not reflected in local equity markets, which displayed diverging performance. The Abu Dhabi market fell over the course of the week dragged down by banking stocks while Dubai rose. We are cautious in the very near term, but markets should benefit from oil stability.
Global Equity Markets	Global equities were small down as data out of China disappointed. Emerging Markets continued their slide with the strengthening of the dollar potentially creating problems in those markets. We continue to believe that equities are mispriced given weak top-down and bottom-up fundamentals.

Commodities	
Precious Metals	Gold was down over 1% during the week but remained range bound between $1250-$1300/oz. The metal has made strong gains this year, albeit virtually all the gains came in Q1. Risks to the global economy remain aplenty, this will continue to support precious metals in the near term. However, long-term we remain cautious on gold, as global pressures are by and large deflationary.
Energy	Oil prices enjoyed a rebound of between 3-7% as the International Energy Agency said global crude inventories will experience a "dramatic reduction" in the second half of the year on the back of strong demand and falling supplies.
Industrial Metals	Industrial metals prices continued their retreat last week on the back of concerns over the global, and especially China's economic growth.

Currencies								
EURUSD	After going through a sustained period of strength the major currencies appear to have taken a turn against the dollar of late. The euro is back to its range of 1.05-1.15 and likely to move lower still after its recent strength, primarily because we believe that the US dollar weakness is more or less done.							
Critical levels	R2	1.1510	R1	1.1410	S1	1.1246	S2	1.1182
GBPUSD	The British pound weakened a touch against the dollar last week, but should be viewed in the context of a very strong preceding couple of weeks. The currency pair is likely to be volatile with a downward bias (GBP) due to the overhang of "Brexit" referendum in just over a month time.							
Critical levels	R2	1.4602	R1	1.4484	S1	1.4294	S2	1.4222
USDJPY	The Japanese yen weakened by 1.4% during the week. This buoyed Japanese equities which had come under severe pressure due to yen strength during previous weeks. The problem for the yen is that huge stimulus has weakened it greatly already. The scope for further stimulus is now very low which suggests some of this weakness should unwind. On the flipside, Japanese macro fundamentals are extremely weak.							
Critical levels	R2	110.94	R1	109.78	S1	107.25	S2	105.88

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
5/16/2016	Empire Manufacturing	May	6.5	9.56	FOMC minutes will likely be the most closely scrutinized release in the US as investors look for clues as to the Fed's next increase in interest rates
5/17/2016	Housing Starts	Apr	1125k	1089k	
5/17/2016	CPI YoY	Apr	1.10%	0.90%	
5/17/2016	CPI Ex Food and Energy YoY	Apr	2.10%	2.20%	
5/17/2016	Industrial Production MoM	Apr	0.30%	-0.60%	
5/18/2016	FOMC Meeting Minutes	27-Apr	--	--	
5/19/2016	Initial Jobless Claims	14-May	275k	294k	
5/19/2016	Continuing Claims	7-May	2165k	2161k	
5/19/2016	Leading Index	Apr	0.40%	0.20%	
5/20/2016	Existing Home Sales	Apr	5.40m	5.33m	

Japan

	Indicator	Period	Expected	Prior	Comments
5/15/2016	PPI MoM	Apr	0.20%	-0.10%	Data releases, including Q1 GDP are expected to continue to show lacklustre economic performance despite massive stimulus
5/15/2016	PPI YoY	Apr	-3.70%	-3.80%	
5/17/2016	Industrial Production YoY	Mar F	--	0.10%	
5/17/2016	GDP SA QoQ	1Q P	0.10%	-0.30%	
5/17/2016	GDP Annualized SA QoQ	1Q P	0.30%	-1.10%	
5/18/2016	Machine Orders MoM	Mar	-1.90%	-9.20%	
5/18/2016	Machine Orders YoY	Mar	0.80%	-0.70%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
5/17/2016	Trade Balance SA	Mar	22.0b	20.2b	Headline inflation for the month of April is expected to disappoint
5/18/2016	CPI MoM	Apr	0.00%	1.20%	
5/18/2016	CPI YoY	Apr F	-0.20%	-0.20%	
5/18/2016	CPI Core YoY	Apr F	0.70%	0.70%	

China and India

	Indicators	Period	Expected	Prior	Comments
5/16/2016	Wholesale Prices YoY	Apr	-0.23%	-0.85%	A quiet week for data in two of the largest Emerging Markets

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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