The Weekly Market View

October 31 2016

بنك أبوظبي التجاري
ADCB

Better than expected US Q3 GDP overshadowed by renewed political risk

A topsy-turvy day on Friday as US Q3 GDP surprised to the upside, coming in at 2.9% y-o-y vs. an expectation of 2.6%. The data release failed to push markets meaningfully higher, given that GDP data is backward looking and the stronger number increases the likelihood the Federal Reserve will raise rates before year-end. US equities had been on track for a small up day before the news broke that the FBI was reopening its investigation into Presidential candidate Hillary Clinton for her use of a private email server during her time as secretary of state. The VIX, a measure of expected volatility in US equities shot up 10% on the news, while the Mexican Peso, viewed by many as the best way to gauge the likelihood of a Donald Trump victory weakened from $18.70 to above $19, a level not seen since mid-October. Elsewhere, oil prices fell sharply as OPEC failed to finalise a proposal to implement a previously mooted production cut.

Inverse relationship between macro data and market performance holds

*One of the features of the summer months was that economic data surprised mostly to the downside. This fed through to expectations of monetary policy in the developed world remaining ultra-accommodative, supporting a post-Brexit referendum rally in risk assets. However, with economic data now stronger once again, expectations of more hawkish policies from central banks have stunted risk assets. In the 10 weeks following the Brexit referendum, global equities rallied 12%, peaking in early September. Over the subsequent 7 weeks equities retreated 3%. In other words, markets have been driven by liquidity expectations more than anything else. Once removed, this leaves little fundamental reason for equities extend their strong summer performance. Of course, with bond yields also rising on the back of better economic data, investors are left with a difficult decision in terms of their asset allocation. For this reason, to generate alpha we believe it makes sense to try to pick out individual themes such as our **currency-hedged large cap UK equity call** as well as our **Mexican equity overweight** (see links for details).*

Wietse Nijenhuis
Equity Strategist
Tel: +971 (0)2 205 4923
wietse.nijenhuis@adcb.com

Rahmatullah Khan
Economist
Tel: +971 (0)2 696 2843
rahmatullah.khan@adcb.com

Luciano Jannelli, Ph.D., CFA
Head Investment Strategy
Tel: +971 (0)2 696 2340
luciano.jannelli@adcb.com

Prerana Seth
Fixed Income Strategist
Tel: +971 (0)2 696 2878
prerana.seth@adcb.com

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,126.4	-0.7	4.0
Dow Jones	18,161.2	0.1	4.2
Nasdaq	5,190.1	-1.3	3.6
DAX	10,696.2	-0.1	-0.4
Nikkei 225	17,446.4	1.5	-8.3
FTSE 100	6,996.3	-0.3	12.1
Sensex	27,941.5	-0.5	7.0
Hang Seng	22954.8	-1.8	4.7
Regional Markets (Sunday to Thursday)			
ADX	4292.5	-0.0	-0.3
DFM	3318.4	-0.7	5.3
Tadawul	5936.3	5.0	-14.1
DSM	10371.2	-0.6	-0.6
MSM30	5497.05	-1.2	1.7
BHSE	1148.2	-0.3	-5.6
KWSE	5397.9	1.4	-3.9
MSCI			
MSCI World	1,691.0	-0.6	1.7
MSCI EM	903.5	-0.8	13.8

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	49.7	-4.0	33.3
Nymex WTI USD/bbl	48.7	-4.2	31.5
OPEC Baskt* USD/bbl	47.2	-1.8	51.0
Gold 100 oz USD/t oz	1275.5	0.7	20.2
Platinum USD/t oz	980.6	5.0	10.0
Copper USD/MT	4787.0	3.2	1.8
Alluminium	1718.75	6.1	14.2
Currencies			
EUR	1.0985	0.9	1.1
GBP	1.2185	-0.4	-17.3
JPY	104.74	0.9	14.8
CHF	0.9881	-0.6	1.4
Rates			
USD Libor 3m	0.8859	0.5	44.6
USD Libor 12m	1.5823	0.7	34.3
UAE Eibor 3m	1.2977	2.6	23.0
UAE Eibor 12m	1.8351	0.4	24.5
US 3m Bills	0.2790	-14.1	71.5
US 10yr Treasury	1.8468	6.5	-18.6

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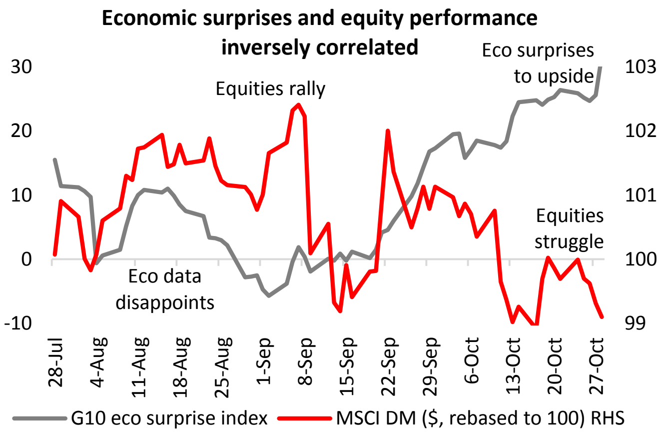
Stronger economic data reveals weak foundation for risk assets

Weak macro data during the summer fuelled risk assets

The relationship between economic data and risk assets has for a good while been an inverse one. That is to say, bad economic data was perceived to be good for risk assets (given it supports the case for easy monetary policy), and vice versa. The summer months saw equities rally as economic data surprised on the downside (see chart below). Equities peaked on September 7th, around the same time as economic data ceased surprising to the downside. From this point onwards equities have retreated. This tells us a great deal about the true driver for risk assets, namely liquidity expectations. If the trend of the past month continues, and economic data carries on surprising to the upside, it will likely weigh on expectations of easy monetary policy (read interest rate hikes in the US and potential asset purchase tapering in Europe).



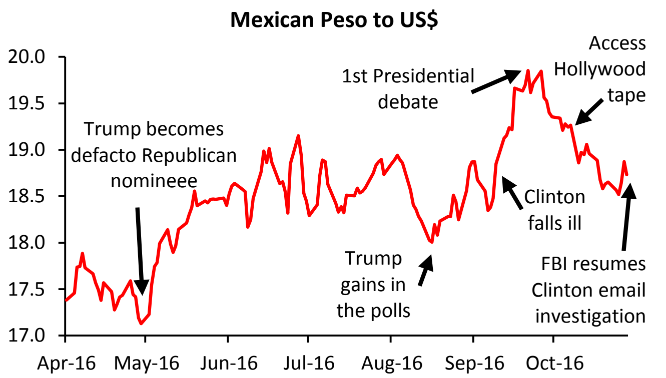
Source: Bloomberg, Citigroup

On Friday the first reading of US Q3 GDP surprised positively, coming in at an annualised rate of 2.9% vs. an expectation of 2.6%. The data is a significant improvement from the first half of the year (average 1.1%) and the best quarterly advance in two years. Looking more into the detail of the release suggests the bounce in growth will struggle to continue at the same pace in upcoming quarters. Net exports (mostly a surge in soybean exports) added 0.8% to growth while the reversal of the recent de-stocking cycle contributed 0.6%. One area of concern was consumption, which grew just 2.1%, having grown 4.3% in the preceding quarter. Overall, the headline was a beat while the detail suggests some caution.

Elsewhere economic data also surprised positively last week. UK GDP beat expectations, although this did little to boost sterling, Germany's gauge of business confidence, the Ifo index jumped to a two-and-a-half year high and the Eurozone manufacturing PMI rose to a 30-month high. German inflation ticked up while Eurozone confidence hit the highest level of the year. It wasn't all good news though, core inflation in Japan fell to zero for the first time since 2013, undermining the efficacy of Prime Minister Shinzo Abe's efforts at reviving the Japanese economy. To see if the overall trend of positively surprising economic releases continues, the week upcoming has a plethora of important data on the agenda. Most importantly investors will focus on Eurozone Q3 GDP and inflation, PMIs across the globe along with US ISM data and non-farm payrolls for October. The Fed, Bank of Japan and Bank of England meetings are also on the agenda.

A week is a long time in politics

Financial markets are constantly pricing risk, whether it be from potential earnings disappointments, misses to growth or inflation, even weather patterns, an entire industry is built on it. One thing markets struggle with more than anything, however, is pricing political risk. Brexit is a powerful recent reminder of this. Friday's news that the FBI in the US is examining a new raft of emails relating to Presidential candidate Hillary Clinton use of a private email server during her time as secretary of state resulted in a swift re-pricing of risk. Betting exchanges had assigned a roughly 85% likelihood of a Clinton victory on November 8, which dipped to around 75% following the news. For reference these same betting exchanges put the likelihood of a 'remain' victory in the UK referendum at about 90%. Safe havens such as the Japanese yen and gold both climbed on the news while the Mexican peso, a gauge as to the likelihood of a Donald Trump victory fell back to levels last seen in Mid-October. Details around the FBI's re-opening of the investigation are very vague, however, even if Mr Trump is still well behind Mrs Clinton in most polls, investors should caution against another Brexit-style "surprise". Most markets (Mexican peso aside) appear to be assigning too little chance of a Trump victory. With 8 full days until the election, Friday's news was a reminder that a week is a very long time in politics.



Source: Thomson Reuters

OPEC disappoints expectations

A weekend of intense talks among OPEC members in Vienna failed to result in a plan on how to implement last month's agreed production cut. The plan had been to finalise a proposal to be presented to OPEC's 14 member nations on November 30. Oil prices fell 4%, back below $50/bbl on the news.

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Summary market outlook

Bonds	
Global Yields	Largely positive surprises in economic data last week pushed US Treasury yields higher, boosting the probability of a December rate hike. Notwithstanding renewed political risk in the US as the country moves closer to the November 8 Presidential election, any positive surprise in the important economic data this week is likely to push yields higher still.
Stress and Risk Indicators	Rising fear of a Fed rate hike was a factor for the higher VIX index all through the week before Mrs. Clinton's email issue further pushed up the index. Notwithstanding the political issue, rising probability of the Fed rate hike is likely to keep the index elevated.

Equity Markets	
Local Equity Markets	GCC equity markets were resilient last week in spite of correction in the oil price. This is mainly due to positive sentiment created by the Saudi government bond issuance. However, disappointing earnings for the third quarter will keep a cap on regional markets in the near term.
Global Equity Markets	Major global equity markets were under pressure last week as rising global bond yields reflected a risk-off mood. Important economic data this week from major economies along with central banks' (Fed, BoJ and BoE) statement will provide direction to the market.

Commodities	
Precious Metals	Political development in the US on Friday helped the gold price to close the week with some gain. We believe precious metals prices will benefit more significantly when the risk-off mood re-emerges.
Energy	Energy prices corrected due to reports that OPEC members were finding it difficult to arrive at a plan for the proposed freeze/cut during the organization's meeting in November. We believe that such news flows will create volatility in the near term.
Industrial Metals	Industrial metals performed strongly last week on relatively better economic data from China earlier. However, long term prospects remain negative with China pushing in the direction of less rather than more consumption of industrial metals.

Currencies								
EURUSD	Despite a stronger US GDP print last Friday, the euro gained on comments from the ECB's MPC members. Those comments reflected the ECB's commitment to ongoing QE but were not very clear on the extension of the asset purchase program. As the market is more or less sure about a December Fed rate hike, euro traders will be cautious on the ECB's move and, therefore, unlikely push the euro lower.							
Critical levels	R2	1.1084	R1	1.1034	S1	1.0893	S2	1.0802
GBPUSD	Despite stronger economic releases from the UK, currency market continues to test GBPUSD on the lower side. Bank of England statement will provide guidance this week which, we suspect, could be slightly less dovish due to positive surprises in economic releases.							
Critical levels	R2	1.2369	R1	1.2277	S1	1.2088	S2	1.1991
USDJPY	Disappointing inflation data in Japan and general dollar strength continue to help the yen move lower. We see largely sideways movement in the near term. However, we expect that in the absence of significant dollar strength, the Japanese yen will trend slightly higher in the medium term.							
Critical levels	R2	106.47	R1	105.61	S1	103.80	S2	102.85

Forthcoming important economic data

United States

Date	Indicator	Period	Expected	Prior	Comments
10/31/2016	Personal Income	Sep	0.4%	0.2%	Market will focus on most economic indicators this week along with the FOMC statement.
10/31/2016	PCE Core YoY	Sep	1.7%	1.7%	
11/01/2016	ISM Manufacturing	Oct	51.7	51.5	
11/02/2016	FOMC Rate Decision	Nov-2	No change		
11/03/2016	ISM Non-Mfg Composite	Oct	56	57.1	
11/03/2016	Factory Orders	Sep	0.2%	0.2%	
11/04/2016	Change in Nonfarm Payroll	Oct	175k	156k	
11/04/2016	Unemployment Rate	Oct	4.9%	5.0%	
11/04/2016	Average Hourly Earnings YoY	Oct	2.6%	2.6%	

Japan

Date	Indicator	Period	Expected	Prior	Comments
10/31/2016	Industrial Production MoM	Sep P	0.9%	1.3%	Market will look into what BoJ says after the meeting.
11/01/2016	Nikkei Mfg PMI	Oct F	--	51.7	
11/01/2016	BoJ Policy Rate	Nov-1	No change		

Eurozone

Date	Indicator	Period	Expected	Prior	Comments
10/31/2016	CPI Core YoY	Oct A	0.8%	0.8%	Third quarter growth figure and inflation will be scrutinized by the market.
10/31/2016	GDP SA QoQ	3Q A	0.3%	0.3%	
11/02/2016	Markit Mfg PMI	Oct F	53.3	53.3	

United Kingdom

Date	Indicator	Period	Expected	Prior	Comments
11/02/2016	Markit Mfg PMI	Oct	54.5	55.4	Market will look for BoE's statement as what it says about strong recent economic data.
11/03/2016	Bank of England Rate Decision	Nov-3	No change		

China and India

Date	Indicator	Period	Expected	Prior	Comments
11/01/2016	Mfg PMI (CH)	Oct	50.3	50.4	PMIs will be in focus in both China and India.
11/01/2016	Caixin Mfg PMI (CH)	Oct	50.1	50.1	
10/31/2016	Fiscal Deficit INR cr. (IN)	Sep	--	14333	
11/01/2016	Nikkei Mfg PMI (IN)	Oct	--	52.1	

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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