The Weekly Market View

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Currencies leading equities

In an otherwise lacklustre week, currency movement was leading other parts of financial markets. Equity markets with depreciating currencies gained while opposite was true for markets with stronger currencies. Largely positive surprises in US economic data pushed the US Treasury yield higher along with the dollar index that weighed on the country's equities. On the other hand, dollar strength, mainly coming on the back of the British pound and to some extent the Japanese yen helped the two equity markets. As we argue in this report the structural factors likely to continue exerting downward pressure on cable in the near to medium term, the further potential gains for UK equities remains. On the other hand, we have seen since the beginning of the year, the BoJ has been finding it difficult to weaken the currency in the absence of dollar strength. Given our baseline view does not envisage any significant dollar strength from current levels, rather a range bound scenario, the Japanese yen is unlikely to depreciate on a sustainable basis which will keep the potential for its equity market capped.

Reality check for equities as third quarter earnings season kicks-in

Since the release of most important economic data is behind us for the moment, equity markets will start focusing on earnings announcements for the third quarter. Market consensus expects a strong rebound in earnings (c.15% QoQ) for S&P 500 companies, with earnings estimates over the last four weeks rising by almost 5%. We have our doubts for such an optimistic expectation given that economic growth in the last few quarters has been soft. Besides earnings announcements, political developments, particularly in the US, will also be of interest for the market as the voting day draw closer.

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,153.7	-0.7	5.4
Dow Jones	18,240.5	-0.4	4.7
Nasdaq	5,292.4	-0.4	5.7
DAX	10,490.9	-0.2	-2.3
Nikkei 225	16,860.1	2.5	-11.4
FTSE 100	7,044.4	2.1	12.8
Sensex	28,061.1	0.7	7.4
Hang Seng	23851.8	2.4	8.8
Regional Markets (Sunday to Thursday)			
ADX	4389.6	-1.9	1.9
DFM	3354.6	-3.4	6.5
Tadawul	5631.3	0.1	-18.5
DSM	10357.3	-0.7	-0.7
MSM30	5609.97	-2.0	3.8
BHSE	1137.1	-1.1	-6.5
KWSE	5320.2	-1.4	-5.3
MSCI			
MSCI World	1,712.4	-0.8	3.0
MSCI EM	914.8	1.3	15.2

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	51.9	5.8	39.3
Nymex WTI USD/bbl	49.8	3.3	34.5
OPEC Baskt* USD/bbl	47.8	7.2	53.0
Gold 100 oz USD/t oz	1257.1	-4.5	18.5
Platinum USD/t oz	968.0	-5.8	8.6
Copper USD/MT	4742.0	-1.9	0.9
Alluminium	1667.25	0.2	10.7
Currencies			
EUR	1.1201	-0.3	3.1
GBP	1.2434	-4.1	-15.6
JPY	102.98	1.6	16.7
CHF	0.9775	0.6	2.5
Rates			
USD Libor 3m	0.8761	2.6	43.0
USD Libor 12m	1.5871	2.3	34.7
UAE Eibor 3m	1.2714	0.0	20.5
UAE Eibor 12m	1.8101	0.2	22.8
US 3m Bills	0.3154	15.1	93.9
US 10yr Treasury	1.7181	7.8	-24.3

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There is a limit for the yield and dollar to move up

Positive economic surprises boost Fed hike probability

The first set of important economic releases for the month of September from the US have largely been positive as cyclical indicators such as ISM – both manufacturing and services – surprised positively. ISM manufacturing jumped two points from its contractionary territory in August, while ISM services leaped more than six points, reflecting a strong cyclical revival in September from August lows. Growth in factory orders and capital goods orders further supported the belief that cyclical rebound is underway. Despite being slightly less than market expectations, job market data did not raise any red flag for the moment. Thus, largely positive surprises in economic releases boosted the market implied probability of the Fed hike in December, which in turn pushed US Treasury yields and the dollar index higher. The DXY index touched the highest level since July before it eased a bit.

Upside move in yields and the dollar to be limited

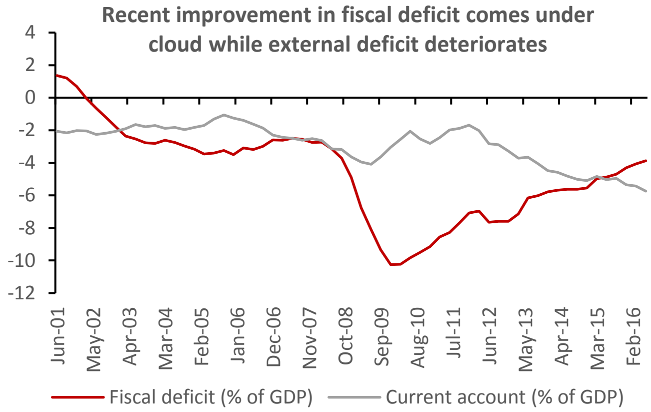
Notwithstanding the improved cyclical indicators, we believe that US economic growth is unlikely to move to a higher trajectory. Growth expectations for the year 2016 were in excess of 2.5% at the beginning of the year, which has come down to a mere 1.5%. Under such a growth environment, we have our doubts of the possibility of rate hikes by the Fed. If anything, the central bank is likely to lower its rate trajectory rather than taking it higher. This coupled with contained inflationary momentum will keep the long term Treasury yield from rising significantly.

On the other hand, major central banks (ECB, BoJ, SNB) seem to have reached close to the limit of the Quantitative Easing. Bank of Japan could be a prime example as its incremental steps to depreciate the yen have yielded little result since the beginning of the year. The only probable candidate for significant further easing seems to be the Bank of England in the wake of Brexit. That is reflected through the movement in the British pound in recent weeks. If we look closely the recent gains in the dollar index, the major contributor to this gain has been the pound. Therefore, broadly the dollar index is unlikely to move much higher from here.

Pound crash was technical but fundamentals also not bright as Brexit weighs

Despite the fact that economic indicators have been strong over the last two months, the reality of Brexit has not changed. A clear timeline now already announced for the Brexit process to start, the impact of divorce between the UK and the European Union is likely to start playing through economic sentiments. Note that the Brexit will result into the UK producers losing access to the single EU market which imports almost half of the country's total exports. Depending on the exact impact, it could significantly deteriorate the current account deficit, which is already in a bad shape. It will also lose the benefits of immigration of relatively cheap labour from Eastern Europe. Once the process of separation begins, it is likely to create uncertainty that will feed through into a deterioration in the investment environment which ultimately will affect consumption as well.

On a medium term basis, Brexit has also jeopardized the UK's fiscal consolidation path as the government has deferred tax reforms which could have enhanced revenue. With public debt close to 100% of GDP and a fiscal deficit running around 4% of annual output, the government will not be in a position to provide a meaningful fiscal stimulus during a downturn. Such structural factors will continue to exert downward pressure on the cable in coming quarters.



Source: Bloomberg

A new thought process at RBI

Contrary to market as well as our expectations, Reserve Bank of India under a new leadership and a new monetary policy decision making body reduced the main policy interest rate by 25bps. It also revised down its earlier guidance for the real interest rate from 1.5-2% to 1.25%. The central bank tone was largely dovish as it underlined the moderation in inflation while highlighting the risk to growth, especially in the next fiscal year. This is a complete reversal in the central bank's assessment of the economy as compared to its previous one where it highlighted upside risk to inflation while being confident about growth. However, we believe that growth momentum will continue with consumption being in the leading role as many consumption boosting factors such as rise in government employees' salary and a good monsoon boost household income. We remain cautious on the inflationary dynamics beyond a few months when the impact of lower food prices will fade away, mainly due to the consumption driven growth.

Summary market outlook

Bonds	
Global Yields	Largely positive economic surprises and rising probability of the Fed rate hike in December pushed the US Treasury 10yr yield higher. Strong retail sales data could further push the yield slightly higher. However, we believe that the yield is unlikely to move up significantly from here.
Stress and Risk Indicators	The VIX index traded largely sideways last week same as the US equity market. We see a possibility of a sideways movement in the index in the very near term with the upward bias as we see lower equities. The resulting dollar stability is likely to keep the EM sovereign CDS spreads stable in the near term.

Equity Markets	
Local Equity Markets	Despite the gain in the oil price, GCC markets were mostly down last week, led by the UAE markets as quarterly earnings season kicks-in. Regional markets will be strongly influenced by the earnings news in the next couple of weeks which we believe is unlikely to be great.
Global Equity Markets	Putting aside the macro theme and central banks' actions, global equity market will start focusing on the actual earnings for the third quarter. We believe that reported numbers are likely to reflect subdued earnings growth on aggregate level.

Commodities	
Precious Metals	Positive surprises in global economic data and rising probability of a Fed rate hike in December caused a sharp correction in precious metal prices. We believe that the price will benefit more significantly when the risk-off mood will re-emerge more strongly.
Energy	The oil price carried its momentum from the prior week even last week. However, we believe that the price has run its course on the talk of production freeze and see limited upside from the current level. A sideways movement is likely in the near term.
Industrial Metals	Industrial metals were flattish last week. Long term prospects remain negative with China pushing in the direction of less rather than more consumption of industrial metals.

Currencies								
EURUSD	Stronger set of economic releases from the US and rising probability of the Fed rate hike in December pushed the dollar higher against the euro. The later could go further down in the very near term as dollar gained some momentum on the expected Fed action. However, we see limited upside move in the dollar and by consequence limited downside in the euro.							
Critical levels	R2	1.1323	R1	1.1262	S1	1.1122	S2	1.1043
GBPUSD	Notwithstanding the flash crash in cable on early Friday, the currency trended lower. We believe that the Brexit will continue to hang over the economic outlook (notwithstanding improvement in economic data for the two months) and the currency.							
Critical levels	R2	1.3521	R1	1.2978	S1	1.1866	S2	1.1297
USDJPY	A general dollar strength is helping the BoJ as it has taken the pressure off from the yen to appreciate. The currency, in fact, lost 1.6% last week. We believe that in the absence of more dollar strength, the Japanese yen will trend slightly higher.							
Critical levels	R2	105.75	R1	104.37	S1	101.39	S2	99.79

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
10/11/2016	NFIB Small Business Optimism	Sep	95.0	94.4	Retail sales numbers will be important for the financial market.
10/13/2016	Retail Sales Advance MoM	Sep	0.6%	-0.3%	
10/13/2016	Retail Sales Ex Auto & Gas	Sep	0.3%	-0.1%	
10/14/2016	PPI Final Demand YoY	Sep	0.6%	0.0%	
10/14/2016	Univ. of Mich. Sentiment	Oct P	92	91.2	

Japan

	Indicator	Period	Expected	Prior	Comments
10/11/2016	Eco Watchers Survey Current	Sep	45.8	45.6	Machine orders and tertiary industry index will be important for markets.
10/12/2016	Machine Orders MoM	Aug	-4.6%	4.9%	
10/13/2016	Tertiary industry Index MoM	Aug	-0.2%	0.3%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
10/11/2016	ZEW Survey Expectations	Oct	--	5.4	ZEW surveys will looked at by the market.
10/12/2016	Industrial Production SA	Aug	1.5%	-1.1%	
10/11/2016	ZEW Surveys expectations (GE)	Oct	4.0	0.5	

United Kingdom

	Indicator	Period	Expected	Prior	Comments
10/13/2016	RICS House Price Balance	Sep	14%	12%	Not many important indicators are scheduled to be released
10/14/2016	Construction Output MoM	Aug	0.0%	0.0%	

China and India

	Indicator	Period	Expected	Prior	Comments
This Week	New Yuan Loans (CH)	Sep	1000B	948B	A large set of important economic data, including foreign trade and inflation will be important for markets.
This Week	Money Supply M2 YoY (CH)	Sep	11.6%	11.4%	
10/13/2016	Trade Balance (CH)	Sep	$53B	$52B	
10/13/2016	Exports YoY (CH)	Sep	-3.3%	-2.8%	
10/13/2016	Imports YoY (CH)	Sep	0.7%	1.5%	
10/14/2016	CPI YoY (CH)	Sep	1.6%	1.3%	
10/10/2016	Industrial Production YoY (IN)	Aug	-0.3%	-2.4%	
10/13/2016	CPI YoY (IN)	Sep	4.7%	5.05%	
This Week	Imports YoY (IN)	Sep	--	-14.1%	
This Week	Exports YoY (IN)	Sep	--	-0.3%	
10/14/2016	Wholesale Price YoY	Sep	3.85%	3.74%	

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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