The Weekly Market View

September 19 2016

Equities and bonds correct as markets fear higher rates, lower growth

The indication by the BoJ that it would rather see a steeper yield curve, and thus stem purchases of longer maturity paper came at a moment that the market was already fretting over the "when" rather than the "if" of a new Fed hike. Mr. Draghi's "do nothing new, say nothing new" press conference added to the concerns that an exceptionally long period of a very accommodating global monetary environment is finally drawing to an end. Whilst it is true that the BoJ move triggered a globally upward move in bond yields, including US Treasuries, we are not convinced that a major shift in global yields is the true concern. Rather, whilst markets have not yet priced in a full-blown recession, they are aware that the risks of a significant slowdown have risen. As such they perceive the recent announcements (or lack thereof) by central bank officials at best misguided (the case of the Fed), at worst the result of policy paralysis with few options for manoeuvre (the case of the ECB and the BoJ).

Crucial week ahead as markets assess possible Fed and BoJ moves amidst low growth concerns

Both the Fed and the BoJ will announce their policy stance on Wednesday. We would expect the Fed to be rather cautious as recent economic data have not been as good as expected. Mrs. Yellen will probably stick to the "data dependent" script, whilst also confirming that the Fed is still on track for a rate hike. It remains more difficult to guess what the BoJ will do or say. A further cut into negative territory is a distinct possibility as the authorities now feel that they are somehow compensating the banks for short-term negative yields by pushing up the yields on higher maturities. We see this, however, as a first sign that Japan's heavy version of quantitative easing – an essential pillar of so-called Abenomics – is no longer able to deliver. The stronger yen is also killing inflationary expectations. Add to that that important US housing data, as well as the release (albeit only on Friday) of the global PMIs might also confirm a scenario of less, rather than more growth, and it becomes clear that markets are likely to remain under downward pressure.

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,139.2	0.5	4.7
Dow Jones	18,123.8	0.2	4.0
Nasdaq	5,244.6	2.3	4.7
DAX	10,276.2	-2.8	-4.3
Nikkei 225	16,519.3	-2.6	-13.2
FTSE 100	6,710.3	-1.0	7.5
Sensex	28,599.0	-0.7	9.5
Hang Seng	23335.6	-3.2	6.5
Regional Markets (Sunday to Thursday)			
ADX	4499.3	-0.4	4.5
DFM	3482.3	-1.1	10.5
Tadawul	6176.5	Closed	-10.6
DSM	10534.1	Closed	1.0
MSM30	5777.66	Closed	6.9
BHSE	1125.1	0.4	-7.5
KWSE	5429.4	Closed	-3.3
MSCI			
MSCI World	1,696.3	-0.7	2.0
MSCI EM	885.5	-2.6	11.5

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	45.8	-4.7	22.8
Nymex WTI USD/bbl	43.0	-6.2	16.2
OPEC Baskt* USD/bbl	41.7	-6.5	33.3
Gold 100 oz USD/t oz	1310.4	-1.3	23.5
Platinum USD/t oz	1016.2	-4.3	14.0
Copper USD/MT	4733.5	2.4	0.7
Alluminium	1561.5	0.1	3.7
Currencies			
EUR	1.1155	-0.7	2.7
GBP	1.3002	-2.0	-11.8
JPY	102.29	-0.4	17.5
CHF	0.9804	0.5	2.2
Rates			
USD Libor 3m	0.8571	0.6	39.9
USD Libor 12m	1.5449	-0.8	31.1
UAE Eibor 3m	1.2046	-0.2	14.2
UAE Eibor 12m	1.7814	0.1	20.8
US 3m Bills	0.2790	-16.9	71.5
US 10yr Treasury	1.6926	1.1	-25.4

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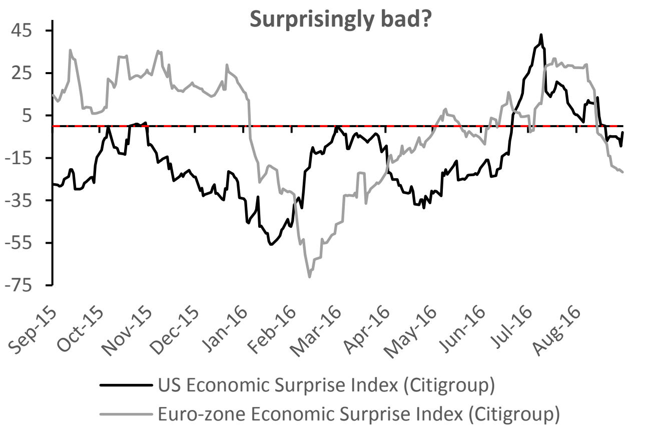
Growth doubts persist, all eyes on the Fed and the BoJ

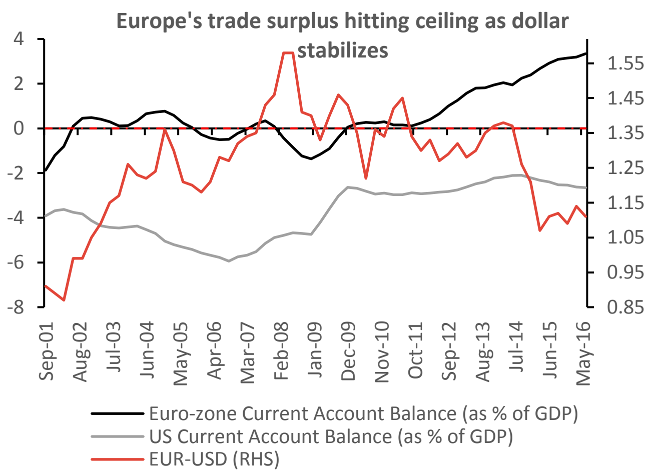
China slowdown continues, US and Euro-zone growth doubts on the rise

Markets cheered when China reported better than expected industrial and trade data for the month of August. On our side we would not take part in the celebrations as the spending mixture in China remains heavily tilted in favour of (inefficient state) investing rather than consuming. In the meanwhile in the United States the drop in the ISM leading manufacturing indicator has now been followed by less good industrial production and retail sales figures. Industrial production in the Euro-zone also came down. As we have been stressed before, growth in the US is too much titled towards consumption, and the lack of investments will at some point lead to a halt in the hitherto robust consumption figures. Across both sides of the Atlantic negative economic surprises are outweighing positive ones as is clear from the Citigroup Economic Surprise Index which is now in negative territory for both economic areas.



Source: Bloomberg

The 2014 euro devaluation has been key in increasing the Euro-zone's trade surplus (and thus GDP). This seems over now.



Source: Bloomberg

But central banks stay their course ....

Against this background of growing economic doubts, one might doubt why all three major central banks are increasingly less enthusiastic about continuing monetary accommodation, especially in consideration that – even in the United States – there is no real threat of inflation.

Policy failure a growing concern

This answer to that question is not really comforting to markets. The point is that massive unconventional monetary accommodation has, yes, been able to prevent the global economy from falling into a permanent, and massive, recession after the Global Financial Crisis. Yet, it has not been able to lift it out of stagnating low growth and low productivity. The BoJ and the ECB are increasingly wary about continuing to increase their balance sheets, without obtaining significant additional benefits from it. They would probably prefer to revert to the Fed's current constant balance sheet policy (i.e. purchase only new bonds to compensate for expiring paper).The Fed, on the other hand, would like to hike rates but is aware that it can do so in an only very gradual manner (lest it derails already weak domestic growth and destabilizes global markets, and in particular emerging markets).

Policy paralysis and mistakes cannot be ruled out

We cannot rule out that the Fed might try to impose a rate hike this week, although we consider it unlikely. The biggest risk remains a negative growth surprise. As such, if the Fed would hike this week, the markets would no longer consider that as a confidence booster, but as a development that could in fact trigger lower growth.

Some temporary upside movement would not alter our largely cautious stance: we undo our emerging equity overweight

Of course, one cannot exclude further temporary upside movements. A relatively dovish Fed might still give some boost to equity markets, in particular emerging equity markets. The reality of lower global growth, high valuations in US equities, and growing concern about the sustainability of today's global monetary stance, however, tells us that it is better to reduce risks. We have, therefore, decided to take profit on our emerging equities overweight and to stick to our overall global equity overweight.

Summary market outlook

Bonds	
Global Yields	Disappointment from the ECB spilled over to most sovereign bond markets, including the US where the yield curve steepened. We believe that the US 10yr yield is unlikely to run significantly higher as we expect a dovish FOMC statement due to softer US economic data recently.
Stress and Risk Indicators	The VIX index, after jumping above 20, has moved lower. We see a possibility of an up move in the index in the very near term as the equity market is likely to see volatility in the wake of the FOMC and BoJ meetings. The dollar strength further pushed EM sovereign CDS a bit higher. However, we do not expect too much of a run-up in these spreads in the near term.

Equity Markets	
Local Equity Markets	GCC markets were mostly closed last week on Eid holidays. A renewed decline in the oil price is likely to put downward pressure on regional equities in the near term.
Global Equity Markets	Global equity markets continued to feel the pressure from the stronger dollar last week as EM equities were further down. European and Japanese equities also joined the decline as the ECB disappointed the market with no additional stimulus. The pressure on the broader global equity market will remain in the near term.

Commodities	
Precious Metals	The gold price declined as the US dollar gained against most currencies. We believe that the price will benefit when the risk-off mood will emerge more strongly.
Energy	The oil price declined last week as gains in the dollar and the talk of supply increase from Libya and Nigeria played their roles. However, we believe that the oil price is likely to remain range bound in the medium term.
Industrial Metals	Industrial metals were mixed last week. Long term prospects remain negative with China pushing in the direction of less rather than more consumption of industrial metals.

Currencies								
EURUSD	The euro gave up its gains as the US dollar rallied broadly. The pair is likely to be volatile before the FOMC statement which we believe is likely to be dovish/less hawkish in the wake of softer economic releases. This could provide some support to the euro.							
Critical levels	R2	1.1330	R1	1.1243	S1	1.1109	S2	1.1062
GBPUSD	A broader US dollar rally pushed the cable lower despite the BoE staying put. We see the cable trading in a range around current levels in the near term.							
Critical levels	R2	1.3465	R1	1.3233	S1	1.2884	S2	1.2767
USDJPY	The next move in the Japanese yen will come after the BoJ meeting on 21st Sep. The BoJ officials have talked about the possibility of a revamp of the stimulus measures. Markets seem not to be very clear about the next move by the central bank which creates possibility of a high volatility after the meeting.							
Critical levels	R2	104.30	R1	103.29	S1	101.35	S2	100.42

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
9/19/2016	NAHB Housing Index	Sep	60	60	All eyes will be on the FOMC statement. We don't expect any action this time.
9/20/2016	Housing Starts	Aug	1190k	1211K	
9/20/2016	Building Permits	Aug	1164k	1144k	
9/21/2016	FOMC Rate Decision	Sep	No Change		
9/22/2016	Existing Home Sales	Aug	5.45m	5.39m	
9/23/2016	Markit Mfg PMI	Sep P	52.0	52.0	

Japan

	Indicator	Period	Expected	Prior	Comments
9/21/2016	Trade Balance	Aug	¥195.5b	¥513.5b	BoJ policy decision meeting is the main event where members of the bank have spoken about possibility of more stimulus.
9/21/2016	Exports YoY	Aug	-4.5	-14.0	
9/21/2016	BoJ Policy Decision	Sep	--		
9/23/2016	Nikkei Mfg PMI	Sep P	--	49.5	
9/23/2016	All Industry Activity Index MoM	Jul	0.2%	1.0%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
9/22/2016	Consumer Confidence	Sep A	-8.2	-8.5	PMIs are to be the main focus of the market.
9/23/2016	Markit Mfg PMI	Sep P	51.5	51.7	
9/23/2016	Markit/BME Mfg PMI	Sep P	53.1	53.6	

United Kingdom

	Indicator	Period	Expected	Prior	Comments
9/19/2016	Rightmove House Price MoM	Sep	--	-1.2%	Not many important indicators are scheduled to be released
9/21/2016	Public Sector Net Borrowing	Aug	10.4b	-1.5b	

China and India

Indicator	Period	Expected	Prior	Comments
				No major economic data are scheduled to be released

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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