# The Weekly Market View

September 26 2016

بنك أبوظبي التجاري ADCB

## Equities and bonds rebound as Fed stays pat, BoJ targets yield curve

*A highly divided Federal Reserve decided not to raise its reference rate, preferring to wait until December. The Bank of Japan did not add stimulus, but indicated that it would work on keeping the country's yield curve steep. Although the Fed's move can be interpreted as a "hawkish hold", markets took it as an indication that the Fed would continue to err on the side of caution, rather than precipitating an unnecessary slowdown of the economy, let alone a recession. Thus the US dollar weakened against all major currencies, allowing global equities to rally, and government bond yields to come down. The strengthening of the yen complicates matters for the BoJ. It remains to be seen if the country's central bank will manage to keep the yield curve steep if inflation expectations do not pick up. For the moment, such steepening has improved the profit outlook for the country's banks, whose shares have rallied. Not surprisingly, however, the overall Japanese equity market fared worse than its global peers, confirming that Japan's monetary policy remains cornered.*

## Germany IFO, US services PMI, China PMIs to clarify growth outlook

*Caution on the side of the world's most important central bank has alleviated markets' fears that an excessively hawkish Fed would push the cooling US economy into a recession. Critically, the scenario of a continuing weak US dollar, is again good for emerging markets. It also allows China's imbalances to persist, and its debt burden to continue to grow. In such circumstances, the biggest risk remains that the situation of low growth in the United States tilts into recession. Such news would rapidly determine global growth concerns, and trigger a flight for quality away from Europe to the United States, that would result in a massive appreciation of the US dollar. This time, it would be difficult for China not to allow its currency to devalue, thereby unleashing a massive deflationary hit to the global economy. These concerns are unlikely to disappear soon. As a result markets will keep a close eye as this week we will see a myriad of confidence indicators coming from the US, Germany and China, as well as further housing data from the US.*


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## Past week global markets' performance

**Index Snapshot (World Indices)**

| Index | Latest | Weekly Chg % | YTD % |
|---|---|---|---|
| S&P 500 | 2,164.7 | 1.2 | 5.9 |
| Dow Jones | 18,261.5 | 0.8 | 4.8 |
| Nasdaq | 5,305.7 | 1.2 | 6.0 |
| DAX | 10,627.0 | 3.4 | -1.1 |
| Nikkei 225 | 16,754.0 | 1.4 | -12.0 |
| FTSE 100 | 6,909.4 | 3.0 | 10.7 |
| Sensex | 28,668.2 | 0.2 | 9.8 |
| Hang Seng | 23686.5 | 1.5 | 8.1 |
| **Regional Markets (Sunday to Thursday)** | | | |
| ADX | 4515.2 | 0.4 | 4.8 |
| DFM | 3513.6 | 0.9 | 11.5 |
| Tadawul | 5948.9 | -3.7 | -13.9 |
| DSM | 10412.5 | -1.2 | -0.2 |
| MSM30 | 5766.14 | -0.2 | 6.7 |
| BHSE | 1134.5 | 0.8 | -6.7 |
| KWSE | 5405.8 | -0.4 | -3.7 |
| **MSCI** | | | |
| MSCI World | 1,729.7 | 2.0 | 4.0 |
| MSCI EM | 917.5 | 3.6 | 15.5 |

**Global Commodities, Currencies and Rates**

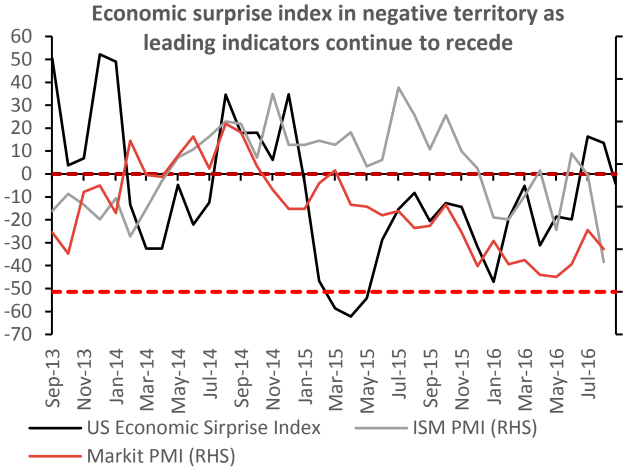
| Commodity | Latest | Weekly Chg % | YTD % |
|---|---|---|---|
| ICE Brent USD/bbl | 45.9 | 0.3 | 23.1 |
| Nymex WTI USD/bbl | 44.5 | 3.4 | 20.1 |
| OPEC Baskt* USD/bbl | 43.3 | 3.7 | 38.4 |
| Gold 100 oz USD/t oz | 1337.6 | 2.1 | 26.1 |
| Platinum USD/t oz | 1054.0 | 3.7 | 18.2 |
| Copper USD/MT | 4815.0 | 1.7 | 2.4 |
| Alluminium | 1630.25 | 4.4 | 8.3 |
| **Currencies** | | | |
| EUR | 1.1226 | 0.6 | 3.4 |
| GBP | 1.2966 | -0.3 | -12.0 |
| JPY | 101.02 | -1.2 | 19.0 |
| CHF | 0.9704 | -1.0 | 3.3 |
| **Rates** | | | |
| USD Libor 3m | 0.8529 | -0.5 | 39.2 |
| USD Libor 12m | 1.5574 | 0.8 | 32.2 |
| UAE Eibor 3m | 1.2707 | 3.2 | 20.5 |
| UAE Eibor 12m | 1.7860 | 0.1 | 21.1 |
| US 3m Bills | 0.1674 | -40.0 | 2.9 |
| US 10yr Treasury | 1.6184 | -4.4 | -28.7 |

*Please refer to the disclaimer at the end of this publication*

# Fed's "hawkish" hold not that hawkish after all

## Fed's dot plot catching up with the markets

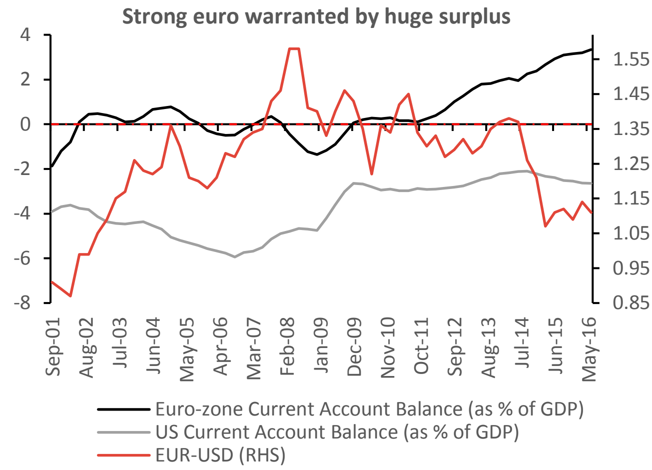
Whilst the Fed Funds Futures are now pricing in a 55% chance of a rate hike in December, the FOMC – through the publication of the well-known "dot plot chart" - has now indicated that the path of rate hikes will be more gradual going forward, with plausibly only two more hikes in 2017. We would argue that the "dot plot" has already been revised downward before: the bottom line is that markets remain very doubtful about a continuing tightening of monetary conditions in the United States. This should not come as a surprise as leading indicators continue to point to a cooling down of the US economy, and bad data surprises have been at least as frequent as good data surprises.




Source: Bloomberg

## Currency implications of central banks' limits are good news for markets

Paradoxically central banks are now exercising a stabilizing influence on financial markets because they are no longer able to pursue their intended policies. The Bank of Japan is concerned about the implications of negative yields for banks, yes, but underneath it is also coming to the realization that it will not be able to continue its massive QE purchases, lest it would end up owning a too large share of the Japanese government Bond market. With the European Central Bank things are not that clear cut as its balance sheet currently stands "only" at approximately 30% of GDP, slightly more than is the case for the Federal Reserve, but just one third of the same ratio for the BoJ. Yet, also the ECB is likely to tread more carefully going forward: not only is it not allowed to own a too large share of negative yielding debt, but more importantly – like for Japan – it is increasingly less clear that quantitative easing is having a positive impact in terms of building higher inflation expectations, or boosting private credit. Thus political support for it might fade over time. Whilst the BoJ and the ECB are hitting a limit in terms of how accommodative they can be, the Federal Reserve is hitting a limit in terms of how much more they can tighten their policy, as US growth remains subdued and inflationary expectations are by and large contained. Thus the Fed's unintendedly more accommodating stance, and the ECB's and BoJ's unintendedly more restrictive stance is effectively putting a ceiling on the greenbacks' external value: this is stabilizing for financial markets in general, and good for emerging markets and China. Some strengthening of the euro, furthermore, would be in line with fundamentals as the euro's current account surplus has swollen over the last five years.




Source: Bloomberg

## But China's fundamentals further distorted

The problem is that a persistently weak US dollar is determining more and more state enterprise investment and bad debt accumulation in China, rather than a progressive shift towards a more balanced and more consumer driven economy. At the same time, US economic data remains bad, whilst the US equity market – the world's equity market or reference – is clearly overvalued.

## Better to go for UK equities

We would therefore caution to further buy into the current emerging markets rally. We maintain our global equity underweight, and – as a way to maintain exposure to what we consider a possible, but soon to be fading, rally – we are now suggesting to buy into a **currency hedged UK equity position**, as we believe that further pound sterling weakness can insulate the bulk of the FTSE 100 stocks from most of the prospective global equity weakness, whilst giving it very attractive return prospects, if the global rally continues. As such we think that this investment has an interesting asymmetric risk profile.

## Summary market outlook

| Bonds | |
|---|---|
| **Global Yields** | Fed dovishness pushed the US yield lower. With most economic data remaining soft, we expect the yield to trend lower in the near term. |
| **Stress and Risk Indicators** | Fed dovishness also improved risk sentiment improved which pushed the VIX index lower. We see a possibility of a sideways movement in the index in the very near term as soft economic data will keep the rate fear low. The resulting dollar stability is likely to keep the EM sovereign CDS spreads stable in the near term. |

| Equity Markets | |
|---|---|
| **Local Equity Markets** | GCC markets were mostly down last week, led by the Saudi market. The oil price coming under pressure towards the end of last week is likely to create further pressure on the regional markets this week. |
| **Global Equity Markets** | A change in tactics by the Bank of Japan and Fed's continuous scaling back its rate trajectory are likely to be positive to global equity markets until they realize the risk on the growth side. Thus, whilst there is a chance for some continuing short-term momentum, we remain very cautious. |

| Commodities | |
|---|---|
| **Precious Metals** | Despite the easing in the global risk environment, the gold price gained last week. We believe that the price will benefit more significantly when the risk-off mood will re-emerge more strongly. |
| **Energy** | The oil price was on an uptrend for almost the entire week before it gave up all the gains on Friday due to developments on the OPEC meeting scheduled week. It is likely to remain volatile in the very near term. |
| **Industrial Metals** | Industrial metals were strong 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 gained a bit after the Fed meeting and its relatively dovish outcome. The pair is likely to be range bound in the near term with no specific catalyst in the sight. | | | | | | | |
| **Critical levels** | R2 | 1.1336 | R1 | 1.1281 | S1 | 1.1147 | S2 | 1.1068 |
| **GBPUSD** | The cable traded largely flat with a small downward bias. The currency will largely react on dollar movements in the near term and remain range bound. However, for the medium term we believe that the cable will trend downward, given the country external imbalances and the fact that the BoE has relatively more room for manoeuvre. | | | | | | | |
| **Critical levels** | R2 | 1.3207 | R1 | 1.3086 | S1 | 1.2880 | S2 | 1.2795 |
| **USDJPY** | The BoJ seems increasingly unable to influence the exchange rate. This makes the near term outlook tricky. Having said so, we believe that the currency has run its course of appreciation and likely to trend lower against the dollar over the medium term. | | | | | | | |
| **Critical levels** | R2 | 103.99 | R1 | 102.51 | S1 | 99.82 | S2 | 98.61 |

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## Forthcoming important economic data

### United States

| | Indicator | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 9/26/2016 | New Home Sales | Aug | 600k | 654k | Details of the second quarter GDP number will be important for the market as expectations for overall growth are subdued. |
| 9/27/2016 | Consumer Confidence Index | Sep | 98.8 | 101.1 | |
| 9/28/2016 | Durable Goods Orders | Aug P | -1.5% | 4.4% | |
| 9/29/2016 | Wholesale Inventories MoM | Aug P | 0.1% | 0.0% | |
| 9/29/2016 | GDP Annualized QoQ | 2Q T | 1.3% | 1.1% | |
| 9/30/2016 | Personal Income | Aug | 0.2% | 0.4% | |
| 9/30/2016 | Personal Spending | Aug | 0.1% | 0.3% | |
| 9/30/2016 | Univ. of Mich. Sentiment | Sep F | 90.0 | 89.8 | |

### Japan

| | Indicator | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 9/28/2016 | Retail Trade | Aug | -1.7% | -0.2% | Job market and inflation data are likely to be looked at by the market. |
| 9/30/2016 | Jobless Rate | Aug | 3.0% | 3.0% | |
| 9/30/2016 | CPI YoY | Aug | -0.5% | -0.4% | |
| 9/30/2016 | Industrial Production MoM | Aug P | 0.5% | -0.4% | |

### Eurozone

| | Indicator | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 9/29/2016 | Unemployment Rate | Aug | 10.0% | 10.1% | Inflation in the Eurozone and IFO indicators in Germany are important for the market. |
| 9/29/2016 | CPI Estimate YoY | Sep | 0.4% | -- | |
| 9/26/2016 | IFO Business Climate (GE) | Sep | 106.3 | 106.2 | |

### United Kingdom

| | Indicator | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 9/30/2016 | Nationwide House Price MoM | Sep | 0.3% | 0.6% | Not many important indicators are scheduled to be released |
| 9/30/2016 | GDP QoQ | 2Q F | 0.6% | 0.6% | |

### China and India

| | Indicator | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 9/30/2016 | Caixin Mfg PMI (CH) | Sep | 50.1 | 50.0 | China's PMI data are important for the market. |
| 10/01/2016 | Mfg PMI (CH) | Sep | 50.5 | 50.4 | |
| 9/30/2016 | Fiscal Deficit INR (IN) | Aug | -- | 671B | |

## 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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