# The Weekly Market View

February 13 2017

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## A week of two halves

*Having started on the back foot, global equities finished the week very much on the front foot. Gains were led by the US where President Trump's promises of a "phenomenal" tax plan drove all three major US equity indices to new record highs. Despite the fact that the US dollar index (DXY) has rebounded 1.6% from its February low, emerging markets extended their outperformance over developed markets to 4.3% year-to-date. Commodity prices also defied dollar strength with oil prices remaining stable and metals gaining between 0.5% - 2.5%. Investors' concerns over the new US administration's brand of diplomacy which weighed on markets over the past few weeks appears to have vanished. This was reflected in the CBOE Volatility Index (VIX) which fell to 10.9. 10-year US Treasury yields fell slightly to 2.41%.*

## "Phenomenal" tax plan reignites stalled equity markets

*US equities are quite remarkable. Despite the plethora of reasons why market performance should slow (weak earnings, compressing margins, high valuations, etc.) the market keeps finding new impetus, most recently from the announcement by President Trump that his administration will present a "phenomenal" tax plan in the coming weeks. No further detail was provided, but it was sufficient for investors to push US equities to new all-time highs. We have been calling for a pull-back in equities and it is possible that it has now occurred, not in the US, but in other developed markets. From the January highs to February lows Japanese, Eurozone and UK equities all corrected c4% before being dragged up by the US at the tail-end of last week. Although we are unconvinced by the nature of the rebound, it is clear that market participants continue to give the new US administration the benefit of the doubt without receiving any details on policy. This of course creates the risk that eventual reality does not stack up to investors' lofty expectations.*


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## Past week global markets' performance

**Index Snapshot (World Indices)**

| Index | Latest | Weekly Chg % | YTD % |
|---|---|---|---|
| S&P 500 | 2,316.1 | 0.8 | 3.5 |
| Dow Jones | 20,269.4 | 1.0 | 2.6 |
| Nasdaq | 5,734.1 | 1.2 | 6.5 |
| DAX | 11,667.0 | 0.1 | 1.6 |
| Nikkei 225 | 19,378.9 | 2.4 | 1.4 |
| FTSE 100 | 7,258.8 | 1.0 | 1.6 |
| Sensex | 28,334.3 | 0.3 | 6.4 |
| Hang Seng | 23575.0 | 1.9 | 7.2 |
| **Regional Markets (Sunday to Thursday)** | | | |
| ADX | 4569.5 | 2.8 | 0.5 |
| DFM | 3682.8 | 1.6 | 4.3 |
| Tadawul | 6969.3 | -1.8 | -3.3 |
| DSM | 10629.1 | 0.6 | 1.8 |
| MSM30 | 5819.52 | 0.3 | 0.6 |
| BHSE | 1306.8 | -0.1 | 7.1 |
| KWSE | 6582.8 | -3.8 | 14.5 |
| **MSCI** | | | |
| MSCI World | 1,814.7 | 0.5 | 3.6 |
| MSCI EM | 930.2 | 1.2 | 7.9 |

**Global Commodities, Currencies and Rates**

| Commodity | Latest | Weekly Chg % | YTD % |
|---|---|---|---|
| ICE Brent USD/bbl | 56.7 | -0.2 | -0.2 |
| Nymex WTI USD/bbl | 53.9 | 0.1 | 0.3 |
| Gold USD/t oz | 1233.6 | 1.1 | 7.5 |
| Silver USD/t oz | 17.9 | 2.5 | 12.7 |
| Platinum USD/t oz | 1011.5 | 0.7 | 12.0 |
| Copper USD/MT | 5872.0 | 0.6 | 6.7 |
| Alluminium | 1866.5 | 2.6 | 10.2 |
| **Currencies** | | | |
| EUR USD | 1.0643 | -1.3 | 1.2 |
| GBP USD | 1.2491 | 0.1 | 1.2 |
| USD JPY | 113.22 | 0.5 | 3.3 |
| CHF USD | 1.0024 | 0.9 | 1.7 |
| **Rates** | | | |
| USD Libor 3m | 1.0362 | 0.2 | 3.8 |
| USD Libor 12m | 1.7026 | -0.6 | 1.0 |
| UAE Eibor 3m | 1.3866 | -0.2 | -6.0 |
| UAE Eibor 12m | 2.0933 | 0.0 | -0.1 |
| US 3m Bills | 0.5330 | 7.2 | 7.2 |
| US 10yr Treasury | 2.4073 | -2.3 | -1.5 |

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

## Rally now, ask questions later

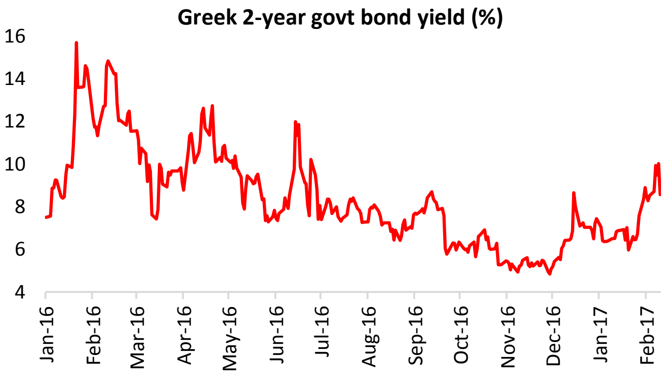
### Honeymoon period resumes

The Trump "reflation" theme continues to be headline heavy and detail light. Last week was no exception as markets rebounded strongly mid-week on the back of President Trump's announcement of a "phenomenal" tax plan. There was no detail other than that it would arrive in two to three weeks' time. This is a very risky announcement as typically tax reform is very time consuming to enact. Markets could end up being disappointed by the composition and timeline of the reform. What is clear however, is that investors are choosing to focus on positive Trump policies such as tax reform, deregulation and infrastructure spending even though there has been no tangible progress whatsoever. All the while they are ignoring more negative policies such as protectionism and immigration issues on which there has been real progress.

### Eurozone leaders wish they too could have a honeymoon

On the other side of the Atlantic trouble is brewing once again in the Eurozone (not that it had ever gone away). We are not talking so much about risks associated to elections in France, Germany and the Netherlands between now and the end of September, but more about Greek debt talks (as well as problems in Italy).

For what it is worth, we expect the elections in these countries to have market friendly outcomes. In France it is unlikely that populist candidate Marine Le Pen will be able to broaden her appeal sufficiently to win the presidential election in April. In Germany Ms Merkel's CDU party remains the biggest (c33%), with the other establishment party, the SPD of Sigmar Gabriel (c29%). However, the right-wing Alternative fűr Deutschland party (c12%) seems much less of a threat. In the Netherlands Geert Wilders' Freedom party will likely win the majority of the votes in March, but he is unlikely to be able to form a government with any of the other parties. All in all, taken in isolation we believe political risk in these countries is overstated.




Source: Thomson Reuters

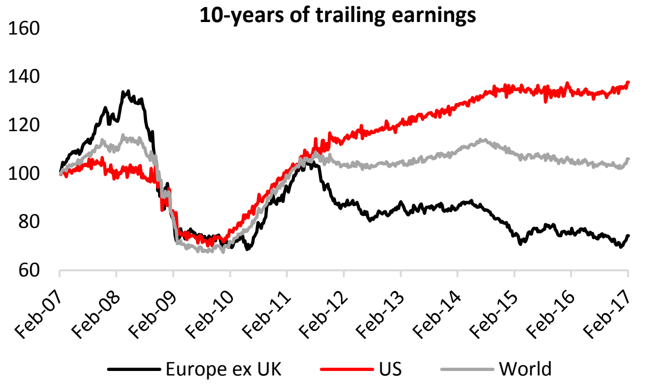
The bigger threat is good ol' Greece again. Greek debt talks rear their head every 6-12 months. The problem now is that this issue is coming at a time when some of the main creditors are holding elections and the last thing the incumbent leaders of Germany, France and the Netherlands want to be seen to be doing going into election, is give Greece a "free-ride" and thereby inadvertently handing the populist parties in their countries further ammunition.

Greek bond yields have moved sharply higher in recent months (see chart). The yield on 2-year Greek government bonds has jumped from below 5% at the end of November to 10% last week. The most recent impasse between creditors and the Greek government is again related to the implementation of austerity measures agreed as part of the country's three-year bailout program. The IMF, as one of the creditors believes Greece's debt is unsustainable arguing for debt relief in order to participate further in the program whilst creditor countries such as Germany, the Netherlands and Finland insist their own participation is contingent on IMF involvement.

Eurozone finance ministers meet in Brussels on 20 February in what will be the final (scheduled) gathering before elections in the Netherlands. So far, the risk that negotiations get dragged out are being ignored by the market.

### Reiterating our US overweight and Eurozone underweight equity positions

In spite of the above mentioned risks there has been a pick-up in Eurozone corporate earnings of late, boosted by a rebound in commodity earnings, a trough in financials earnings, rising margins and improving global growth. Expectations are for earnings to grow 13% this year, which would represent the first year of positive earnings growth after 5 consecutive years of declines. We are sceptical that the positive earnings momentum in the Eurozone can continue. If we are correct that political risk ends up being overstated, the euro will likely strengthen which will impede Eurozone corporate earnings momentum, while an ECB which is likely to taper towards the end of 2017 will also put upward pressure on the currency.




Source: MSCI, IBES, Thomson Reuters

## Summary market outlook

| | |
|---|---|
| **Bonds** | |
| **Global Yields** | 10-year US Treasury yields dropped this week despite the reflation trade gaining traction after President Trump hinted at revealing the details of new tax reforms. On the other hand, European bonds continued to remain under pressure, pricing in higher risk premium ahead of the upcoming elections. We expect global yields to remain stable, however, in Europe spreads could widen further given lingering issues in periphery countries as well as Brexit. |
| **Stress and Risk Indicators** | The equity rally and improved risk sentiment pushed the VIX lower. However, a spike in volatility is likely as the VIX continues to trade near the record low levels amidst the ongoing global uncertainty. |
| **Equity Markets** | |
| **Local Equity Markets** | GCC equity markets ended the week on a mixed note in spite of stability in oil prices. Kuwaiti stocks retreated on profit taking amidst the rise in political tension. In contrast, ADX and DFM were the best performers, boosted by the rally in bank stocks. We are neutral GCC equities which are helped by oil price resilience but hurt by potential for further dollar strength. |
| **Global Equity Markets** | Global equities performed well this week, led by a surge in US equities. The S&P 500 rose to an all-time high thanks to President Trump's announcement that details on his new "phenomenal" tax reforms will be unveiled in the coming weeks. We expect investors will continue to give the new US administration the benefit of the doubt, even if we are unconvinced by the impact of the mooted policies. This means that equity markets can continue to move a little higher, however risks are building given lofty expectations. |
| **Commodities** | |
| **Precious Metals** | Gold continued to rally in spite of stronger dollar, hinting at cautious market sentiment. We continue to favour gold as a risk hedge against ongoing political risks. |
| **Energy** | Oil prices remained fairly stable and resilient to the surge in dollar. The International Energy Agency indicated that the OPEC members have implemented 90% of their pledged production cuts, proving supportive for oil prices. Nevertheless, a continuous rise in US crude stockpile should limit the upside in oil prices. |
| **Industrial Metals** | Industrial metals performed well, tracking higher gold prices and in spite of the stronger dollar. However, this upward trend is not sustainable as weak China demand will eventually weigh on metal prices. |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Currencies** | | | | | | | | |
| **EURUSD** | The euro weakened versus the dollar, reversing its previous gains. Political uncertainty in Europe ahead of the elections and broad dollar strength could lead to further euro weakness in the near term. | | | | | | | |
| **Critical levels** | R2 | 1.0760 | R1 | 1.0671 | S1 | 1.0611 | S2 | 1.0580 |
| **GBPUSD** | The pound strengthened versus the dollar on the back of decent industrial production data. However, we expect cable to come under pressure on "Brexit" concerns ahead of the Article 50 being triggered. | | | | | | | |
| **Critical levels** | R2 | 1.2566 | R1 | 1.2529 | S1 | 1.2447 | S2 | 1.2403 |
| **USDJPY** | The Japanese yen declined versus the dollar ahead of the meeting between President Trump and Japanese Prime Minister Abe. Further weakness is expected with the rebound in dollar strength. | | | | | | | |
| **Critical levels** | R2 | 114.30 | R1 | 113.76 | S1 | 112.77 | S2 | 112.32 |

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## Forthcoming important economic data

### United States

| | Indicator | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 02/15/2017 | CPI YoY | Jan | 2.4% | 2.1% | Retail sales, industrial production along with the inflation numbers will be closely watched this week |
| 02/15/2017 | Core CPI YoY | Jan | 2.1% | 2.2% | |
| 02/15/2017 | Retail Sales Advance MoM | Jan | 0.1% | 0.6% | |
| 02/15/2017 | Industrial Production MoM | Jan | 0.0% | 0.8% | |
| 02/15/2017 | Capacity Utilization | Jan | 75.5% | 75.5% | |
| 02/15/2017 | NAHB Housing Market Index | Feb | 67 | 67 | |
| 02/16/2017 | Housing Starts | Jan | 1226k | 1226k | |
| 02/16/2017 | Building Permits | Jan | 1230k | 1228k | |

### Japan

| | Indicator | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 02/13/2017 | GDP SA QoQ | 4Q P | 0.3% | 0.3% | GDP print will be the main focus this week |
| 02/14/2017 | Industrial Production YoY | Dec F | - | 3.0% | |
| 02/14/2017 | Capacity Utilization MoM | Dec | - | 3.0% | |

### Eurozone

| | Indicator | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 02/14/2017 | Industrial Production SA MoM | Dec | -1.5% | 1.5% | Attention will be on the GDP print. |
| 02/14/2017 | GDP SA YoY | 4Q P | 1.8% | 1.8% | |
| 02/14/2017 | CPI YoY (GE) | Jan F | 1.9% | 1.9% | |

### United Kingdom

| | Indicator | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 02/14/2017 | CPI YoY | Jan | 1.9% | 1.6% | . Inflation numbers will be important this week. |
| 02/14/2017 | Core CPI YoY | Jan | 1.7% | 1.6% | |
| 02/17/2017 | Retail Sales Inc Auto Fuel YoY | Jan | 3.4% | 4.3% | |

### China and India

| | Indicator | Period | Expected | Prior | Comments |
|---|---|---|---|---|---|
| 02/13/2017 | CPI YoY (IN) | Jan | 3.24% | 3.41% | Focus will be on China and India inflation numbers |
| 02/14/2017 | CPI YoY (CH) | Jan | 2.4% | 2.1% | |
| 02/14/2017 | WPI YoY (IN) | Jan | 4.34% | 3.39% | |
| 02/13-02/15 | Exports YoY (IN) | | | 5.7% | |
| 02/10-02/15 | New Yuan Loans CNY (CH) | Jan | 2440bn | 1040bn | |
| 02/10-02/15 | Aggregate Financing CNY (CH) | Jan | 3000bn | 1626bn | |

## 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

## Disclaimer