The Weekly Market View

February 27 2017

What do US equities know that Treasuries, gold & other safe havens don't?

US equity markets closed at record highs for their 11th consecutive session on Friday and are now up between 11-14% since the US Presidential elections on November 8 last year. The largest pull-back in US markets during this time has been little over 1%. Investors in US equities continue to position for very positive outcomes in terms of deregulation, tax cuts and infrastructure spending. European markets on the other hand have fared less well. They have also rallied post US elections (+9%) but have underperformed considerably since the turn of the year (+0.4% vs. +5.7% for the S&P 500). Treasury yields on the other hand are trading more cautiously, the 10-year yield dipped to 2.31% from 2.41% a week earlier. Other safe haven assets such as gold and the Japanese yen also rallied during the week, suggesting that the exuberance in US equities is not spilling over to other risk assets.

To raise or not to raise rates

Following just one rate hike in each of the past two years, this year will likely see multiple rate hikes. Following the release of the minutes from the Fed's most recent meeting, expectations of a March interest rate hike have increased. Fed officials cited potential for reflationary policies from the new US administration as a reason that rates may need to rise soon in order to keep inflation in check. We remain unconvinced by the prospect of three quarter-point rate hikes this year as signalled by Fed officials. Using inflation as a guide, the recent uptick in inflation has been driven mainly by rising energy prices and not a structural improvement in underlying inflation dynamics which would be required to justify three rate hikes in our view. Given the fragility of the global economy and political uncertainties associated with European elections the Fed will remain cautious in hiking too aggressively in our view. President Trump will address Congress on February 28, he will hopefully provide more detail on the promised expansionary fiscal policies, expectations of which have fuelled the rally in US equities.

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,367.3	0.7	5.7
Dow Jones	20,821.8	1.0	5.4
Nasdaq	5,845.3	0.1	8.6
DAX	11,804.0	0.4	2.8
Nikkei 225	19,283.5	0.3	0.9
FTSE 100	7,243.7	-0.8	1.4
Sensex	28,893.0	1.5	8.5
Hang Seng	23965.7	-0.3	8.9
Regional Markets (Sunday to Thursday)			
ADX	4653.4	0.2	2.4
DFM	3633.9	-0.5	2.9
Tadawul	7046.2	-1.2	-2.3
DSM	10925.4	1.0	4.7
MSM30	5849.52	0.1	1.2
BHSE	1349.3	1.9	10.6
KWSE	6809.8	-0.2	18.5
MSCI			
MSCI World	1,840.8	0.2	5.1
MSCI EM	943.5	0.5	9.4

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	56.0	0.3	-1.5
Nymex WTI USD/bbl	54.0	1.1	0.5
Gold USD/t oz	1257.2	1.8	9.6
Silver USD/t oz	18.4	2.1	15.3
Platinum USD/t oz	1027.5	2.4	13.8
Copper USD/MT	5881.0	-1.0	6.9
Alluminium	1884.75	0.7	11.3
Currencies			
EUR USD	1.0563	-0.5	0.4
GBP USD	1.2462	0.4	1.0
USD JPY	112.12	-0.6	4.3
CHF USD	1.0075	0.5	1.1
Rates			
USD Libor 3m	1.0540	0.2	5.6
USD Libor 12m	1.7396	0.2	3.2
UAE Eibor 3m	1.3896	0.9	-5.8
UAE Eibor 12m	2.0803	1.2	-0.7
US 3m Bills	0.5025	-2.0	1.0
US 10yr Treasury	2.3117	-4.3	-5.4

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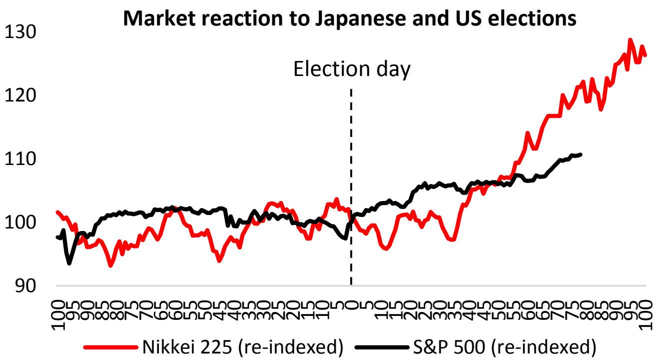
Global financial markets still very much driven by politics

Honeymoon intact, will Mr Trump's address to Congress confirm or undermine the recent rally?

In previous weekly notes we have talked about the honeymoon period that US presidents tend to enjoy and that Mr Trump was clearly benefitting from the same. The fact that US equity markets closed at record highs for 11 consecutive sessions confirms that Mr Trump's honeymoon period remains intact. However, there is a clear risk that markets could end up being disappointed by the composition and timeline of reforms. So far, however, 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 on these issues. All the while they are ignoring more negative policies such as protectionism and immigration issues on which there has been real progress. So far, even delays in implementation are being shrugged off. Earlier in February Mr Trump announced that a "phenomenal" tax plan would be delivered within several weeks. However last week Treasury secretary Steven Mnuchin pushed this timeline back to the summer. Markets did not seem to care. The President's address to Congress on February 28 provides the ideal platform to expand on the new US administration's fiscal policy plans, this could either confirm the recent rally in US equities, or undermine it.

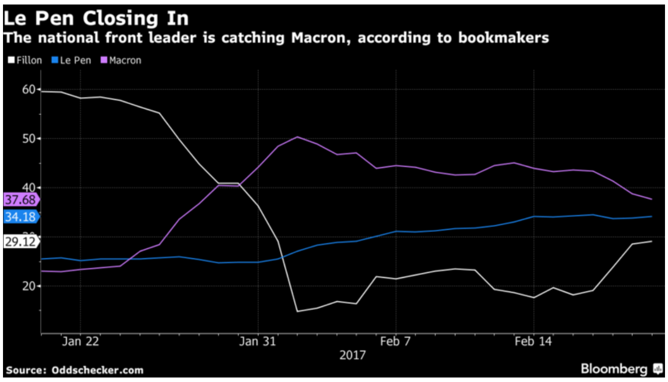


Source: Thomson Reuters, HSBC

To illustrate this honeymoon period the President is enjoying, we have updated the above chart which shows the behaviour of the Japanese equity market in the 100 days prior and after the election of Prime Minister Abe in 2012 as well as that of the S&P 500 around the election of Mr Trump. US performance has been less impressive but it also comes from a much higher starting point (US equities were already close to record highs at the time of the US presidential election). The point we wish to illustrate however is that even if Mr Trump is unable to have any meaningful impact in the 100 days post his election (just like PM Abe) markets continue to perform well regardless, boosted by promises of deregulation, tax cuts and infrastructure spending.

In Europe the French election appears to be the focal point for the euro and spreads

The fact that politics is the predominant driver of financial markets is by now well known. Investors find it more difficult to predict political outcomes than for example, economic growth. Opinion polls anticipating market friendly outcomes have become less reliable in the post-Brexit and post-Trump world. With this in mind, investors are even more concerned by the rise in the polls of National Front leader Marine Le Pen in the French elections. The expectation for some time had been that Mr Macron would comfortably defeat Ms Le Pen in a presidential run-off on May 7th. However, Mr Macron's lead has steadily declined in February while Ms Le Pen has been gaining (see chart below). The other thing which needs to be considered is the so called "hidden vote". That is a portion of the vote which a populist candidate like Ms Le Pen will likely capture but is not being reflected in polls because poll participants are afraid to admit that they will vote for that candidate. The same happened in Brexit and the US presidential elections.



Source: Bloomberg

The uncertainty around the outcome of the French elections is impacting the euro which has started weakening in February. At the same time the spread of French government bonds over German Bunds risen to their widest levels in 4 years (at the 10-year segment of the curve). It is likely that political risk will continue to weigh on European assets in the coming months as investors respond to every change in opinion polls.

This uncertainty, we think, will also be sufficient to prevent the Federal Reserve from hiking interest rates in March. The Fed wisely waited last year for the outcome of the UK's referendum before hiking interest rates and it is likely they will do the same this time around.

Summary market outlook

Bonds	
Global Yields	10-year US Treasury yields closed at their lowest level since November, mainly boosted by safe-haven demand. We expect US treasury yields to remain range bound as market participants will closely look for any details on promised tax reform at Mr. Trump's congress address this week. In Europe, French OATs experienced some relief rally on news that centrist politician Francois Bayrou decided to form alliance with presidential candidate Emmanuel Macron. However, rising support for Le Pen in the polls should weigh on the French bonds. We expect French OATs spreads to widen versus the safe-haven German Bunds.
Stress and Risk Indicators	The VIX was flattish last week in the absence of any major economic data surprise. The current levels of volatility are too low given ongoing geopolitical risks and a move higher is likely.
Equity Markets	
Local Equity Markets	GCC equity markets were mixed last week in spite of the increase in oil prices and a stable dollar. The Saudi market underperformed, followed by the DFM and Kuwait. We remain neutral on GCC equities given the potential for further dollar strength and limited upside in oil prices.
Global Equity Markets	Global equities continued to rally for another week, led by US equities. The S&P 500 and Dow Jones ended the week close to record highs, suggesting that investors are pricing in a positive outcome on tax reforms at Mr. Trump's address to Congress this week. In contrast, European stocks ended the week lower, weighed by weak earnings reports and election uncertainty. Mr. Trump's address to Congress could make or break the rally in US equities as investors hope to receive clarity on his fiscal policy plans.
Commodities	
Precious Metals	Gold prices moved higher last week, in line with the rise in demand for safe-haven assets. We stick to gold as a risk hedge against ongoing political risks.
Energy	Oil prices rose last week helped by a smaller than expected increase in US crude oil stockpiles. However, further upside is limited given the rising US rig count and OPEC cuts already being priced in by the market.
Industrial Metals	Industrial metals ended the week higher, tracking precious metals and benefitting from stable dollar. We argue against any sustainable increase as weak China demand will eventually weigh on metal prices

Currencies								
EURUSD	The euro continued to weaken versus the dollar, adding to its previous losses. 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	1.0640	R1	1.0602	S1	1.0541	S2	1.0518
GBPUSD	The pound strengthened versus the greenback, boosted by a robust GDP print. However, the recent strength is likely to be short-lived as "Brexit" concerns pose risks for cable.							
Critical levels	R2	1.2615	R1	1.2539	S1	1.2417	S2	1.2371
USDJPY	The Japanese yen strengthened versus the dollar, adding to its previous week's gain. However, we expect the yen to weaken given the potential for dollar strength.							
Critical levels	R2	113.36	R1	112.74	S1	111.72	S2	111.32

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
02/27/2017	Durable Goods Orders	Jan P	1.7%	-0.5%	Focus will be on GDP, core PCE and ISM Manufacturing.
02/28/2017	GDP Annualized QoQ	4Q S	2.1%	1.9%	
02/28/2017	Wholesale Inventories MoM	Jan P	0.4%	1.0%	
03/01/2017	Personal Income	Jan	0.3%	0.3%	
03/01/2017	Personal Spending	Jan	0.3%	0.5%	
03/01/2017	PCE Core YoY	Jan	1.7%	1.7%	
03/01/2017	ISM Manufacturing	Feb	56	56	

Japan

	Indicator	Period	Expected	Prior	Comments
02/28/2017	Industrial Production YoY	Jan P	4.4%	3.2%	Job market and inflation data likely to be tracked by the market.
02/28/2017	Retail Trade YoY	Jan	1.0%	0.7%	
03/03/2017	Jobless Rate	Jan	3.0%	3.1%	
03/03/2017	CPI YoY	Jan	0.4%	0.3%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
02/27/2017	Consumer Confidence	Feb F	-6.2%	-6.2%	Inflation and PMI will be the main focus.
03/01/2017	Markit Manufacturing PMI	Feb F	55.5	55.5	
03/02/2017	Unemployment Rate	Jan	9.6%	9.6%	
03/02/2017	CPI Estimate YoY	Feb	1.9%	1.8%	
03/03/2017	Market Eurozone PMI	Feb F	56	56	

United Kingdom

	Indicator	Period	Expected	Prior	Comments
02/28/2017	Nationwide House PX MoM	Feb	0.2%	0.2%	No major indicators are scheduled to be released this week.
03/01/2017	Markit UK PMI Manufacturing SA	Feb	55.7	55.9	

China and India

	Indicator	Period	Expected	Prior	Comments
02/28/2017	Fiscal Deficit INR Crore (IN)	Jan	-	43254	Attention will be on India GDP release and China PMI data.
02/28/2017	GDP YoY (IN)	4Q	-	7.3%	
02/28/2017	GDP Annual Estimate YoY (IN)	2017	-	7.9%	
03/01/2017	Manufacturing PMI (CH)	Feb	51.2	51.3	
03/01/2017	Caixin China PMI Composite (CH)	Feb	-	52.2	

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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