The Weekly Market View

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The dollar takes a breather

The surge in the strength of the US dollar which received new impetus following the US presidential elections moderated for the second week running last week, allowing emerging market equities to outperform developed markets. Earnings season kicked off in the US and some of the banks reported strong numbers. The outperformance of banks and the softer dollar was not sufficient to drive US equities higher, which finished flat to slightly down. Gold as well as other metals were able to take advantage of the weaker greenback, rising between 1.7% and 5.5%. Oil, which typically would also have rallied along with the other commodities fell around 3% on the back of weak Chinese data, rising US production data and concerns about the implementation of the agreed OPEC and non-OPEC production cuts. GCC markets performed well despite the drop in oil, with the exception being the Saudi market where news that the government was considering cutting $13bn-$20bn of projects in order to narrow its budget deficit.

Markets have gone a long way on little news, a pull-back now seems likely

*Following 2 months of very strong performance in equities and the dollar as well as a sharp retracement in US Treasuries we believe it is quite likely that we will see a pull-back in the coming weeks (**see last week's strategy note**). Having said so, global financial markets are now driven by political developments; think Brexit, US elections, Brazil political scandal, developments in Turkey, Mr. Modi in India, etc. This will likely remain, meaning that what Mr. Trump delivers in terms of policies will also determine the direction of markets over the coming months, if not longer. Although we believe that the outcome of the Trump-reflation story is likely to disappoint, we believe that the market will continue to give the president the benefit of the doubt for a little while longer. So, the reflation trade still has legs, but a near-term pause or pull-back should be expected.*

Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,274.6	-0.1	1.6
Dow Jones	19,885.7	-0.4	0.6
Nasdaq	5,574.1	1.0	3.5
DAX	11,629.2	0.3	1.3
Nikkei 225	19,287.3	-0.9	0.9
FTSE 100	7,337.8	1.8	2.7
Sensex	27,238.1	1.8	2.3
Hang Seng	22937.4	1.9	4.3
Regional Markets (Sunday to Thursday)			
ADX	4681.3	1.7	3.0
DFM	3720.6	2.6	5.4
Tadawul	6921.8	-3.8	-4.0
DSM	10709.5	-0.1	2.6
MSM30	5762.48	-0.5	-0.3
BHSE	1211.7	0.4	-0.7
KWSE	6107.7	4.7	6.3
MSCI			
MSCI World	1,788.2	0.3	2.1
MSCI EM	896.0	1.7	3.9

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	55.5	-2.9	-2.4
Nymex WTI USD/bbl	52.4	-3.0	-2.5
OPEC Baskt* USD/bbl	52.3	-2.2	-1.9
Gold 100 oz USD/t oz	1197.3	2.1	4.3
Platinum USD/t oz	984.9	1.7	9.1
Copper USD/MT	5797.0	4.5	5.4
Alluminium	1809	5.5	6.8
Currencies			
EUR	1.0643	1.1	1.2
GBP	1.2182	-0.9	-1.3
JPY	114.49	-2.2	2.2
CHF	1.0084	-0.9	1.1
Rates			
USD Libor 3m	1.0232	1.3	2.5
USD Libor 12m	1.6984	0.8	0.8
UAE Eibor 3m	1.4021	2.2	-5.0
UAE Eibor 12m	2.0281	-1.6	-3.2
US 3m Bills	0.5228	2.0	5.1
US 10yr Treasury	2.3964	-0.9	-2.0

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Pause for breath

Equity investors as always the most optimistic bunch

The sharp moves in global financial markets post the US presidential elections have been well-documented. Investors have re-positioned for the US reflation trade en-masse. However, given the scale of the moves and the fact that these have taken place in anticipation of policy changes which in many cases could take a year or longer to be enacted, means that a near-term pull-back has become increasingly likely.

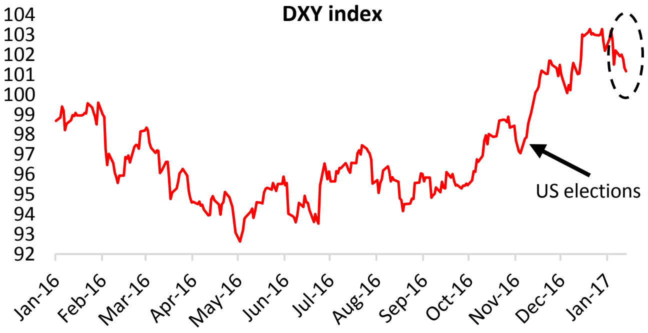
In fact, it is really just in equities where the pull-back is not yet underway, US Treasury yields and the US dollar have both fallen over the past few weeks. The below table shows the level of the US dollar index (DXY), the MSCI global equities index (ACWI) as well as the yield on 10-year USTs on the day of the US elections (Nov 8) and currently. The DXY had risen >5% before giving back some of the gains, 10-year Treasury yields had spiked from 1.85% to 2.64% before rallying back to 2.39% (even hitting 2.32% at one stage). Equities, on the hand are currently at their highest level since the US elections.

US dollar, 10-year Treasury yield and global equities

	DXY	US 10Y	ACWI
8 Nov 2016 close	98	1.85%	411
Current	101	2.40%	432
8 Nov 16 – Current peak	103	2.64%	432
Since 8 Nov 2016	3.4%	29.2%	5.0%
% from peak	-2.0%	-9.2%	0.0%

Source: Bloomberg, Thomson Reuters

This is not unusual given that equity markets tend to be the worst at anticipating changes in the overall environment, preferring to price in optimistic scenarios and adjusting later. Equity sentiment indicators are unsurprisingly elevated, reaching levels where they normally top. From these levels the chance of disappointment is high and investors will scrutinise every word from the incoming US president regarding prospective policies and their timing. Should they not quite match expectations, equities, more than the dollar or Treasuries are likely to bear the brunt of the disappointment.



Source: Bloomberg

From our point of view therefore, a pull-back in the coming weeks is increasingly likely, especially in equities. Beyond this although we are very sceptical as to what can realistically be delivered in terms of infrastructure spending in the US, we believe that there is still some momentum left in the Trump reflation trade. In our note last week (**link**) we drew comparisons to the election of Prime Minister Shinzo Abe in Japan in 2012 who rose to power promising a wave of stimulus. Investors bought into it even though for a long time results were very disappointing.

The difficulty at the moment is that political events are dictating asset class performance, and 2016 has taught us that political outcomes are notoriously difficult to predict. However, we should not disregard other more traditional events influencing markets. The Q4 earnings season is such an event, and it kicked off in the US last week.

Banks shine early on during earnings season

Expectations for US (and indeed global) earnings growth in 2017 is high. Following several years of hardly any growth, analysts expect 12% in 2017. This is nothing new, expectations for earnings typically start around 10-15% only to be revised lower throughout the year. This year, however, expectations have remained elevated for longer based on the hope that President-elect Donald Trump is able to give the US economy a nudge higher.

The US elections took place roughly half way through the fourth quarter of last year. Q4 2016 earnings season kicked off last week and should therefore give us a reading on whether or not the high 2017 expectations are warranted. It is still very early on in terms of reporting with only 29 out of 499 S&P 500 companies releasing numbers, however, so far all 5 of the financials to have reported have beaten expectations. It should give us a decent guide for the financials sector given these 5 companies account for more than a quarter of the sector's total market capitalization. For the market as a whole, the consensus is expecting earnings growth of 4.2% relative to the same period last year. Energy sector earnings should contribute positively for the first time in 8 quarters and will need to play a large role in driving overall earnings growth.

We are concerned that 2017 earnings growth expectations are too high and will need to come down, especially in the US where the strong dollar and rising wages are simultaneously weighing on top line growth and pushing up costs.

In the upcoming shortened US trading week (Martin Luther King Day is on Monday) there are a further 34 S&P 500 companies reporting.

Summary market outlook

Bonds	
Global Yields	The 10yr US Treasury yields traded near their six week lows on an intraday basis, but ended the week marginally higher at 2.4%. Decent retail sales and producer prices data helped push bond yields up. However, bond yields should remain range bound in the near term as policy uncertainty is likely to prevail even after Mr. Trump formally takes office.
Stress and Risk Indicators	Muted equity market volatility dragged the VIX index to its two-year low. However, a spike in volatility cannot be ruled out given the lack of clarity on the policy making front.
Equity Markets	
Local Equity Markets	GCC equity markets performed better in spite of the volatility in oil prices. The weaker dollar proved supportive for KWSE, ADX and DFM which posted weekly gains. In contrast, the Saudi market was negatively impacted by news the Saudi government is looking at cutting $13bn-$20bn in projects.
Global Equity Markets	Global equity markets were mixed as Mr.Trump's first press conference failed to provide any clarity on his policy making. US stocks pulled back from their near record highs with the S&P500 and Dow Jones ending flat. In contrast, the FTSE 100 continued its historic run, touching an all-time high due to sustained pound weakness. Similarly, emerging equity markets held up well, posting a weekly gain likely on account of the weaker dollar. Market sentiment is likely to remain muted as investors look for cues ahead of Mr.Trump's inauguration speech this week.

Commodities	
Precious Metals	Increase in US policy uncertainty positively impacted gold prices as investors flocked to safe-haven assets. Weaker dollar also pushed the gold prices higher. Given the geopolitical risks and economic policy uncertainty, we maintain our positive stance on gold prices.
Energy	Oil prices retreated this week, after touching the highest level since July 2015 (USD57/bbl). Concerns over the implementation of OPEC's plan of production cuts dented investor sentiment. We do not expect any potential jump in oil prices as the latest OPEC's agreement is likely to have been priced in.
Industrial Metals	Industrial metals jumped higher this week mainly on account of weaker dollar. However, this upward trend is not sustainable given the subdued demand from China.

Currencies								
EURUSD	The euro continued to strengthen against the greenback for another week. Lack of clarity on Trump's economic policies is likely to have spurred demand for the euro.							
Critical levels	R2	1.07	R1	1.0679	S1	1.0602	S2	1.0561
GBPUSD	Sterling weakened versus the dollar during the week on renewed hard Brexit concerns. Further weakness is expected in the near term given the growing uncertainty on the government's Brexit plans.							
Critical levels	R2	1.2290	R1	1.2236	S1	1.2125	S2	1.2068
USDJPY	The yen strengthened further versus the dollar, marking its second weekly gain. However, recent yen strength versus the dollar appears excessive and a pullback cannot be ruled out.							
Critical levels	R2	115.96	R1	115.23	S1	113.97	S2	113.46

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Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
01/18/2017	CPI YoY	Dec	2.1%	1.7%	Market attention will be mainly on Mr. Trump's inauguration speech. Focus will also be on the inflation and industrial production print.
01/18/2017	Industrial Production MoM	Dec	0.6%	-0.4%	
01/18/2017	Capacity Utilization	Dec	75.4%	75.0%	
01/18/2017	NAHB Housing Market Index	Jan	69	70	
01/19/2017	Housing Starts	Dec	1184k	1090k	
01/19/2017	Building Permits	Dec	1225k	1212k	
01/19/2017	Initial Jobless Claims	14-Jan	251k	247k	

Japan

	Indicator	Period	Expected	Prior	Comments
01/16/2017	Machine Orders YoY	Nov	8.1%	-5.6%	Producer Price Index and Industrial Production data will be closely watched.
01/16/2017	PPI YoY	Dec	-1.4%	-2.2%	
01/16/2017	Tertiary Industry Index MoM	Nov	0.2%	0.2%	
01/17/2017	Industrial Production YoY	Nov F		4.6%	
01/17/2017	Capacity Utilization MoM	Nov		1.4%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
01/16/2017	Trade Balance SA	Nov	20.8bn	19.7bn	ECB meeting will be the main highlight for the week. Attention will also be on the CPI print.
01/18/2017	CPI YoY	Dec F	1.1%	0.6%	
01/18/2017	CPI Core YoY	Dec F	0.9%	0.9%	
01/19/2017	ECB meeting		No change		

United Kingdom

	Indicator	Period	Expected	Prior	Comments
01/17/2017	CPI YoY	Dec	1.4%	1.2%	PM Theresa May's Brexit speech will be the key focus. Markets will also closely track the inflation data.
01/17/2017	Retail Price Index	Dec	266.7	265.5	
01/17/2017	House Price Index YoY	Nov	6.1%	6.9%	

China and India

	Indicator	Period	Expected	Prior	Comments
01/16/2017	WPI YoY	Dec	3.50%	3.15%	Market attention will be mainly of China GDP print for 4Q 2016. India WPI data will also be closely watched.
01/20/2017	GDP YoY (CH)	4Q 2016	6.7%	6.7%	
01/20/2017	Industrial Production YoY (CH)	Dec	6.1%	6.2%	
01/20/2017	Retail Sales YoY (CH)	Dec	10.7%	10.8%	
01/20/2017	Fixed Assets Ex Rural YTD YoY (CH)	Dec	8.3%	8.3%	

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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