The Weekly Market View

March 20 2017

Markets welcome Yellen cautious tone with continuining rally

As expected, the Fed hiked rates up 25 basis points, positioning its reference rate in the 0.75-1.00 interval. Markets interpreted the Fed's official statement, and Chairwoman's Yellen's press conference as dovish, the US dollar weakened against most currencies and equity markets got a boost. Emerging equities staged an impressive rally. US dollar long term yields declined markedly, producing a flattening of the yield curve, as we had anticipated in last week's issue. Whilst this is a normal feature of Fed rate hike phases, it would not be the first time that the flattening of the curve turns into an inversion, traditionally the best warning sign of an imminent recession. We do not think that a recession is around the corner, but some stabilization of growth is in the cards, at a time that inflation remains a non-threat. Dissenting member Neel Kashkari's vote against the rate hike combined with Mrs. Yellen's prudent words probably confirm that the Federal Reserve will go slow even if the dot plots have not changed and, in principle, indicate rates at 2% by the end of this year, and at 3% by the end of 2018. Speculation about fiscal policy stimulus combined with the sense of an increasingly prudent Fed (again) is keeping markets in a sweet spot.

Dollar to stabilize rather than weaken further

The weakening of the US dollar should be taken with caution. If currencies would be entirely driven by central banks some more weakening might be in the cards since most of the hiking cycle is by now priced in the markets. But currencies are increasingly driven by politics and the ramifications of fiscal stimulus in the United States won't be fully worked out and clear for most of 2017. It is also reasonable to expect less of a slowdown in the US economy than in the global economy. With the pound sterling we similarly have seen the markets attributing a lot of importance to the dissenting vote in the Bank of England's decision not to hike rates, and less importance to the ramifications of the UK government triggering article 50. Thus, just as the dollar should regain strength because of general political reasons, and in spite of the Fed appearing more dovish than expected, the pound should weaken when the reality of Brexit sinks in and the BoE will become more convinced to maintain a very accommodative policy stance.

Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,378.3	0.2	6.2
Dow Jones	20,914.6	0.1	5.8
Nasdaq	5,901.0	0.7	9.6
DAX	12,095.2	1.1	5.3
Nikkei 225	19,521.6	-0.4	2.1
FTSE 100	7,425.0	1.1	3.9
Sensex	29,649.0	2.4	11.4
Hang Seng	24309.9	3.1	10.5
Regional Markets (Sunday to Thursday)			
ADX	4424.9	-0.7	-2.7
DFM	3521.3	0.0	-0.3
Tadawul	6921.6	0.1	-4.0
DSM	10361.0	-1.0	-0.7
MSM30	5668.33	-2.1	-2.0
BHSE	1374.6	1.6	12.6
KWSE	6810.7	1.5	18.5
MSCI			
MSCI World	1,863.1	0.9	6.4
MSCI EM	965.6	4.3	12.0

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	51.8	0.8	-8.9
Nymex WTI USD/bbl	48.8	0.6	-9.2
Gold USD/t oz	1229.3	2.0	7.1
Silver USD/t oz	17.4	2.1	9.3
Platinum USD/t oz	965.0	2.4	6.9
Copper USD/MT	5889.0	3.1	7.1
Alluminium	1908.5	2.2	12.7
Currencies			
EUR USD	1.0738	0.6	2.1
GBP USD	1.2396	1.9	0.5
USD JPY	112.70	-1.8	3.8
CHF USD	0.9982	-1.3	2.1
Rates			
USD Libor 3m	1.1518	2.7	15.4
USD Libor 12m	1.8132	-0.3	7.6
UAE Eibor 3m	1.4620	4.3	-0.9
UAE Eibor 12m	2.1424	1.9	2.3
US 3m Bills	0.7262	-2.1	46.0
US 10yr Treasury	2.5005	-2.9	2.3

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Prudent Fed and fading Europe risk are likely to keep markets in a sweet spot

Animal spirits still roaring bullish

We keep on stressing that the new Trump administration will take time to enact fiscal reforms, but – based on historical precedent – it is very likely that Mr. Trump will be able to push through both fiscal stimulus and reduced corporate costs through deregulation. If one adds to that an ever so prudent Fed, for the moment expected to keep on ignoring its own "dot plot" reference rate forecasts in the same fashion as it has done over the last years, and less – rather than more political risk in Europe – than it is clear why the markets' animal spirits keep on roaring bullish.

US yields to remain stable

As we had pointed out last week, the US treasury yield curve typically flattens during the rate hike cycle, since short-dated Treasury bonds are in general more sensitive to any re-pricing of rate hike expectations. In addition, it is important to stress that inflationary expectation have, yes, surged but have remained relatively stable. Not entirely surprisingly, Neel Kashkari, the President of the Minneapolis Federal Reserve Bank dissented against last week's rate hike.

USD – EUR spreads to narrow

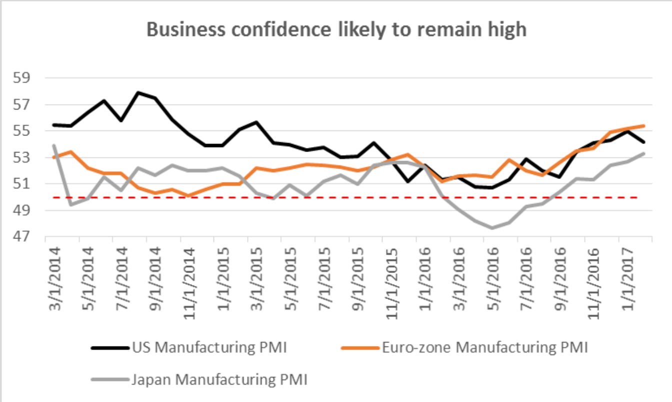
Another good reason for expecting US dollar yields to remain contained is, of course, also the fact that they still command a considerable premium over other global yields. Last week we argued that the spread between Bunds and Treasuries should further narrow as, at the margin, monetary policy normalization (and thus some yield normalization) is more likely to surprise to the upside in Europe than in the United States. We saw again a bit more of that with the German bund yields hardly coming down.

US dollar unlikely to weaken significantly

An obvious corollary of a more hawkish than expected ECB, and more dovish than expected Federal Reserve would of course be a continuing depreciation of the US dollar. We are less convinced about that because it is increasingly "general politics" driving currencies, rather than central banks. It will take time for the new administration to push through Congress fiscal stimulus and deregulation. Until then markets will speculate on the goodness of the new policies, and will continue to give the new administration the benefit of the doubt. The larger deficit, in particular will keep upward pressure on the currency.

Upcoming data unlikely to disappoint

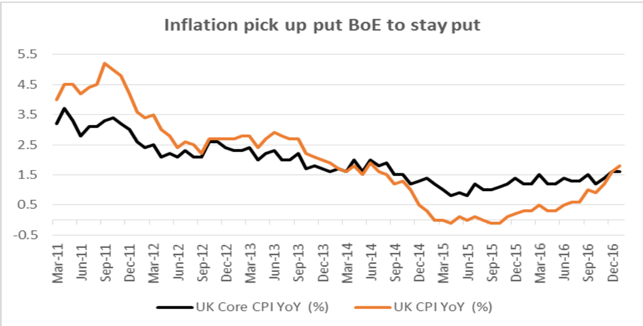
On the data front we are going to have a relatively poor week. The biggest scope for disappointment could come from less than buoyant manufacturing confidence indicators. Again, as long as there remains a good indication that the new US administration will be able to pull off meaningful business friendly policies by the end of the summer, chances are that the current upturn will remain sustained. The increasingly likely absence of a massive US dollar rally (we expect the US dollar not to weaken and at the margin to strengthen, but in a moderate fashion only) will allow China to maintain stimulus at least until the 19th National Party Congress is over in fall this year. In sum, favourable policies in both the US and China will keep confidence sustained.



Source: Bloomberg

Dutch election risk archived, Brexit ahoy

As we have been repeating for some time now, the political risks in the Euro-zone are currently overstated, at least as far as possible developments in 2017 are concerned. The failure of Mr. Wilders' populist movement to gain a significant footing in Netherlands will somehow repeat itself in May when Mrs. Pen is likely to not win the French presidential elections. This is of course, also important for global equity markets to continue to make gains. Prime Minister May is likely to trigger article 50 this week. The pound sterling has been very volatile lately, appreciating towards the end of the week as one member of the Monetary Policy Committee dissented from the decision not to hike rates. Whilst we understand policy-makers unease at not hiking rates, we believe that the BoE will stay its course and stay accommodative as the Brexit reality kicks in. This means further weakening of the pound sterling and is good for UK equities.



Source: Bloomberg

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Summary market outlook

Bonds	
Global Yields	Even though the Fed raised policy rates last week, the 10yr Treasury yields declined as the Fed maintained the forecasts for additional rate hikes, opposed to the market expectations which was signaling a faster pace of hikes. We expect the US Treasuries to remain contained within the 2.3-2.5% range due to the lack of US fiscal policy clarity. In UK, gilt yields ended the week flat in reaction to slightly hawkish tilt by the Bank of England. While “Brexit” risks and election uncertainty in Europe should support gilts for now, we caution against the rising inflation pressures.
Stress and Risk Indicators	The VIX levels dropped this week as the Fed decision eased expectations of faster rate hikes. Current low levels of volatility don’t look reasonable amidst the rising geopolitical risks and we expect volatility to rise.
Equity Markets	
Local Equity Markets	GCC equity markets were mixed in spite of the weakness in dollar as oil prices were little changed. We remain neutral on GCC equities given the potential for further dollar strength and limited upside in oil prices.
Global Equity Markets	Global equities ended the week slightly higher on the “dovish” Fed rate hike decision. Emerging markets rose the most on the Fed announcement, now the best performer on a year-to-date basis. The S&P 500 and Dow Jones both were flattish as the midweek rally post the FOMC decision erased the losses made before the FOMC meeting. In contrast, Japanese equities fell due to yen strengthening versus the dollar. With a less hawkish Fed and ease in political risk in Europe after positive Dutch election results, we expect the equity rally to remain supported.
Commodities	
Precious Metals	Gold prices advanced last week as demand for safe-haven assets rose after the Fed tone was less hawkish than expected. We stick to gold as a risk hedge against the ongoing political and inflationary risks.
Energy	Oil prices were little changed as uncertainty about the extension of oil supply cuts into the second half of the year rattled investors. WTI crude stayed below USD50bbl even though US crude inventories slid last week. We argue against any significant jump in oil prices as rising US rig counts and downbeat China demand should weigh on energy prices.
Industrial Metals	Industrial metals performed well with the help from weak dollar appetite. We do not expect this trend to continue given the ongoing concerns on China demand.

Currencies								
EURUSD	The euro strengthened against the greenback as the dollar index fell post the Fed meeting. We expect the euro to remain under pressure given the upcoming election calendar in key Eurozone countries.							
Critical levels	R2	1.0804	R1	1.0771	S1	1.0716	S2	1.0695
GBPUSD	The pound gained versus the dollar due to BoE’s hawkish tone and broad dollar weakness. However, this is likely to correct as the pound could weaken with the “Article 50” due to be triggered by end of this month.							
Critical levels	R2	1.2456	R1	1.2426	S1	1.2345	S2	1.2294
USDJPY	The Japanese yen strengthened versus the dollar due to decline in dollar demand. This trend is not sustainable given the potential for dollar strength.							
Critical levels	R2	113.85	R1	113.27	S1	112.35	S2	111.99

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
3/22/2017	Existing Home Sales	Feb	5.56m	5.69m	
3/23/2017	New Home Sales	Feb	565k	555k	PMI release and home sales data will be closely tracked by the market.
3/24/2017	Durable Goods Orders	Feb P	1.20%	2.00%	
3/24/2017	Markit US Manufacturing PMI	Mar P	54.7	54.2	

Japan

	Indicator	Period	Expected	Prior	Comments
3/22/2017	Trade Balance	Feb	¥807.2b	-¥1087.6b	
3/22/2017	Exports YoY	Feb	10.1%	1.3%	
3/22/2017	All Industry Activity Index MoM	Jan	0.00%	-0.30%	Attention will be on the trade data.
3/24/2017	Nikkei Japan PMI Mfg	Mar P	-	53.3	

Eurozone

	Indicator	Period	Expected	Prior	Comments
3/23/2017	Consumer Confidence	Mar A	-5.8	-6.2	PMI will be the main focus this week.
3/24/2017	Markit Manufacturing PMI	Mar P	55.3	55.4	
3/24/2017	Markit Composite PMI	Mar P	55.8	56	

United Kingdom

	Indicator	Period	Expected	Prior	Comments
3/20/2017	Rightmove House Prices MoM	Mar	-	2.00%	
3/21/2017	CPI YoY	Feb	2.10%	1.80%	
3/21/2017	CPI Core YoY	Feb	1.70%	1.60%	
3/21/2017	RPI YoY	Feb	2.90%	2.60%	Inflation data will be important.
3/21/2017	Public Sector Net Borrowing	Feb	2.8b	-9.8b	
3/23/2017	Retail Sales Inc Auto Fuel YoY	Feb	2.60%	1.50%	

China and India

Indicator	Period	Expected	Prior	Comments
				No major releases scheduled this week.

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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