SWISSQUOTE

# WEEKLY MARKET OUTLOOK

## 1 - 7 December 2014

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Swissquote Bank SA | Ch. de la Crétaux 33, CP 319 | CH-1196 Gland | Switzerland
Tel +41 22 999 94 11 | Fax +41 22 999 94 12 | forex.analysis@swissquote.ch | www.swissquote.com/fx

# WEEKLY MARKET OUTLOOK - An overview


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# Economics

## USD/JPY to head higher

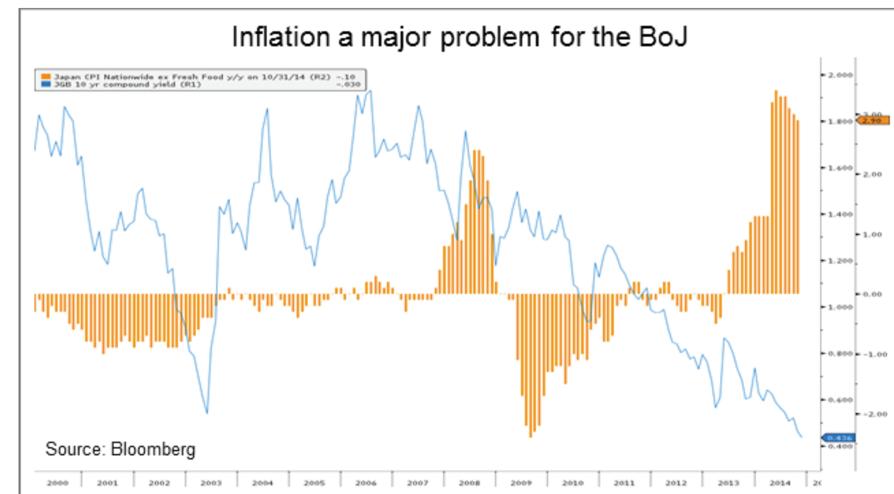
USD appreciation is consensus for 2015, yet this theme will be especially apparent in JPY. Two important factors will contribute to the yen decline. First is the pace of the widening between the Fed and BoJ monetary policies and second investors rotation out of Japan.

### US – JP Yield Spread

Despite some dovish rhetoric from certain members of the Fed and choppy economic data, the Fed is on a path toward normalization, which should transpire mid-2015. All the while, the BoJ stands ready and able to increase its quantitative and qualitative easing program. True, the thin 5-4 margin of the latest round plus the year and half delay since the launch of QQE indicate that no action is currently on the table. However, the BoJ has not signaled that they have done enough to reverse deflationary forces as in the Oct 31 policy statement, "the Bank will continue with the QQE aiming to achieve the price stability target of 2% as long as it is necessary for maintaining that target in a stable manner." QQE is an open-ended policy which uses bazooka-like effect to shift the market perception. Given the global dynamics of price deflation, it's unlikely that current Japanese economic fundamentals will be able to stop Japan from undershooting the bank's inflation forecasts. The mere prospects of missing the BoJ targets will undoubtedly keep speculation of further policy action alive. Therefore given the BoJ's indefinite ultra-lose policy, FX traders will continue to use JPY fuel for policy divergence carry trades.

### Investment Rotation

The structural change which triggered GPIF diversification will also support domestic investors' portfolio rotation to foreign stock and bonds. The principle change in GPIF allocation to foreign securities from 23% to 40% in a portfolio valued at ¥127trn is too large to discount. We don't expect a wave of capital flooding the market but rather a steady flow of pension money reallocating overseas. In addition, as the BoJ conducts QQE through JGBs, domestic yields will remain suppressed, giving Japanese investors no other choice but to seek higher returns overseas. And these domestic investors tend to be less likely to have currency hedges in place; especially should volatility increase hedging costs. Given historical preferences combined with positive US fundamentals, we suspect Japanese investors to have a bias towards USD assets.



# Economics

# OPEC refrains from cutting the supply, oil tumbles

OPEC refrained from taking action in November 27th meeting. The 12-country group kept the daily production ceiling unchanged at 30 million barrels, despite calls from some members to adjust production to sustain oil prices. The decision was highly strategic. Given that the US expanding production to record highs at sustainable speed, an outcome cut from the OPEC would mainly hit the group's market share. While the higher cost of US shale oil will certainly weigh on the US, the immediate victims have been the oil producer currencies (NOK, CAD and RUB), as well as the EUR, where the developing bear market in oil can only weigh heavier on inflation expectations moving into 2015. The Euro-zone November CPI y/y estimate retreated to 0.3% as expected from 0.4% a month ago.
The WTI crude traded down to $67.75 for the first time since September 2009. Last week's bullish consolidation leaves its place to deeper bear market. The RSI falls to 23%, as warning that the oil contracts were sold too fast in a too short period of time and suggesting that short-term correction would only be healthy at these levels. Yet trend and momentum indicators turned sharply negative. This aggressive fight for market share should lead to deeper sell-off as markets will decide on prices until the next OPEC meeting due on June 5th in Vienna.

**OPEC inaction hits NOK, CAD and RUB**

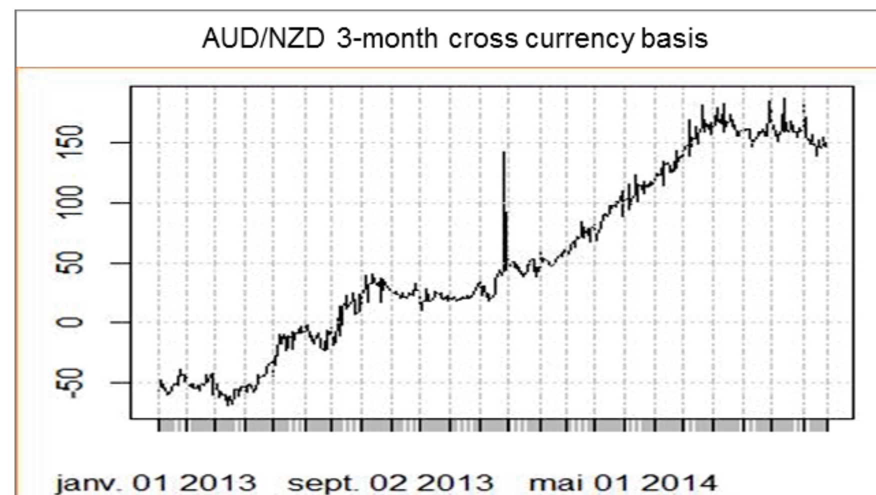
The most hit currencies were certainly NOK, CAD and RUB following OPEC's decision to stay on hold. Norway made clear that it won't adjust oil sector spending following the oil decline, which "may turn out to be a temporary shock "according to Finance Minister Siv Jensen. USD/NOK tests 7.00 offers for the first time since March 2009. If cleared, we should see sustained advance. Moving forward, the lower NOK should partially temper the price shock therefore should give some flexibility to Norwegian policymakers before making any decision. The key resistance stands at 7.3133/45 (end-2009/beginning 2009 resistance).

The OPEC-related bullish reversal was widely anticipated on USD/CAD. The pair broke above its November descending channel to enter fresh bull market. The key resistance stands at year-high 1.1469, we believe it is just a matter of time before we cross over. The lower Loonie is certainly not positive for Canadian inflation, already accelerating above the BoC target of 2%. The macro conditions should push the BoC to tighten its stance in next week's BoC meeting (December 3rd) and cool-off the CAD-bears.
Ruble rallied 7% against USD post-OPEC. USD/RUB hit 50-offers on Friday November 28th. The aggressive RUB sell-off pushed USD/RUB technicals in green zone suggesting a break above strong 50-resistance. The Ruble is the most beta-sensitive currency to oil markets according to our monthly regression study. Deeper bearish trend in oil should unavoidably push the Ruble lower. The stress in the Ruble markets have been translated in sizeable volatilities. The 1-month implied vol spiked to 35% on week to Nov 28th. The USD/RUB 3-month 25-delta risk reversal spiked to 10 bps, levels last seen in beginning 2009. The higher preference in USD/RUB calls confirm mid-term pressures in derivative markets.

# FX Markets

## Stevens' 85 cents-dream becomes true

The Aussie complex had yet well started the week. AUD-bulls boosted by Chinese rate cuts remained short-lived however. AUD-complex sold-off aggressively from the moment the RBA Deputy Governor Lowe talked down the Aussie in his speech at the Australian Business Economics Annual Dinner. "The RBA has been saying for a while now that a lower value of the Australian dollar would be helpful from an overall macroeconomic perspective. If the exchange rate is to play its important stabilizing role, it needs to go down when the terms of trade and investment are declining, just as it went up when the terms of trade and investment were rising. To date, as we expected, we have seen some adjustment, but if our assessment of the fundamentals is correct we would expect to see more in time" said Lowe. The Aussie took a dive.
The following release of 2.2% contraction in 3Q construction output finalized the move below 0.85. AUD/USD rallied to 0.8480 on sub-0.85 stops. Decent option barriers trail below 0.8500/50 for the week ahead and should keep the pressure heavy on AUD/USD. In the mid-run, a significant break of Fib 50% on 2008-2011 (0.8542) will shift support at 0.7944/0.8000 (Fib 38.2% / psychological level).




**AUD weakens past 200-dma against EUR and NZD**

EUR/AUD significantly broke above the 200-dma for the first time since 6-months, AUD/NZD left its 200-dma (1.0916) and Fib 38.2% on Jul-Aug (1.0884) far behind. The antipodean pair is now at oversold territories (RSI at 29%), resistance is building at 200-dma despite the worse-than-expected New Zealand trade terms. The 3-month cross currency basis shows preference for AUD has recently topped, further downside in AUD/NZD should develop. The strengthening bearish momentum suggests the extension of weakness to 1.0784 (Fib 23.6%), 1.0624 (Jul 10th low) and 1.0493 (Jan 24th low).

# FX Markets

# Further patience likely required for EUR/USD bear

**Further consolidation likely for EUR/USD**

The increasing monetary divergences between the Fed and the ECB is expected to remain a key catalyst for further declines in EUR/USD. However, in the short-term, we see scope for further consolidation in EUR/USD. Indeed, the aggregate net long USD positions is at record highs (see page 8) with a significant net short EUR positioning. As a result, any news that could support a higher EUR/USD could be magnified as the market is broadly exposed to the short side. In that respect, the recent weaker-than-expected US data (US home sales, US consumer confidence) could sow the seeds of a weaker Q4 GDP and lift expectations of a later Fed's rate hike, as the next FOMC meeting should further stress that the timing of the first rate hike is highly data dependent. On the other hand, the very gradual stabilisation of bank lending and the subdued money growth in the Euro-zone coupled with the persistent decline in oil prices support a full-scale QE from the ECB. However, even if we do not want to underestimate Mr Draghi's resolve to do more to respect the ECB's remit, the 4 December meeting seems too early for further easing, especially as the second TLTRO auction will take place on the 11 December.

**Selling rallies remained our preferred strategy**

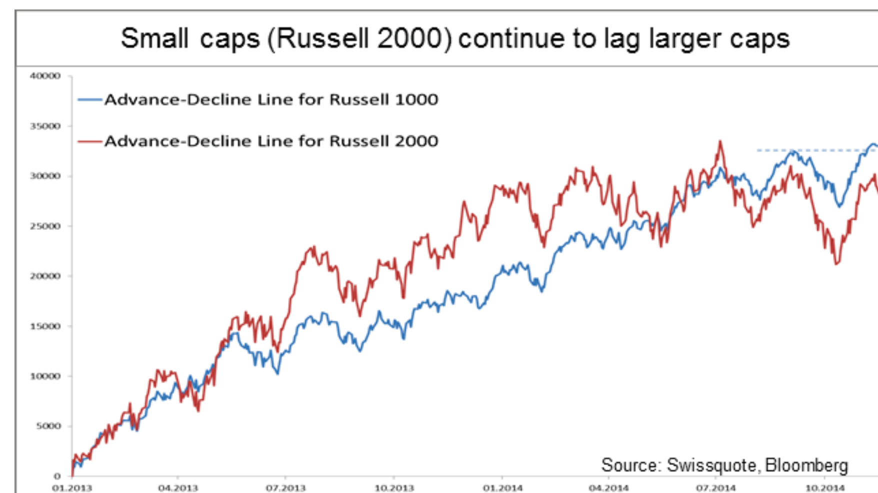
Even if a cautious Fed and some resistances among ECB members for a large scale QE could temporarily hurt short EUR/USD investors, it is unlikely to disrupt the underlying bearish trend in EUR/USD and the expected medium-term move towards 1.2043. Selling rallies in EUR/USD remains therefore our preferred strategy. Looking at the chart, the pair is moving sideways between the support at 1.2358 and the resistance at 1.2600. An attractive entry point is therefore given by the top of this horizontal range. However, in the light of the aforementioned reasons, should this resistance fail to hold, any move towards 1.2771 would be seen as another attractive entry point for a short EUR/USD position.

# Stock market

## Seasonality favours a stronger stock market

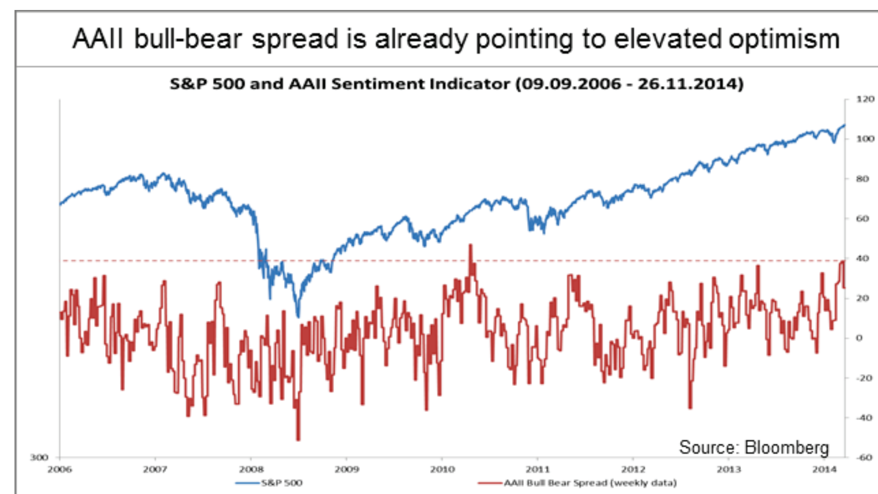
### US mid caps are confirming the new highs in S&P 500

For the time being, seasonality has been very helpful to navigate through the US stock market: September has been weak, October has been very volatile but ended up positively and November was strong. Looking forward, the confirmation of the all-time highs of the S&P 500 (large caps) by the S&P Midcap 400 is positive as it indicates reduced selectivity within the US stock market. However, small caps continue to lag as can be seen by the lack of new highs in the S&P Smallcap 600 and in its breadth measures. Based on seasonality, the S&P 500 is likely to appreciate further in December. However, without further improvements in the broad market participation, 2015 could start with persistent selectivity, overbought prices and high levels of optimism among investors, which would not bode well for short-term bullish investors.




### Cyclical sectors need to improve

Looking at the US sectors, IT and Healthcare (with its Biotech sub-segment) remain the best performers. Although they have recently outperformed, Industrials and Consumer Discretionary need to further improve to strengthen the stock market outlook. Indeed, sustained outperformance in these cyclical sectors would likely stem from a stronger economic outlook. Overall, given the recent general weakness in defensive sectors, like Consumer Staples or Telecom, the sectorial behaviour favours a mild bullish bias on the stock market.




### Risks of a short-term consolidations are increasing

Even if we expect a positive month of December, it doesn't necessarily means that the performance will be spectacular. Indeed, given the overextended rise since October and the high levels of optimism, the odds to see a short-term consolidation are elevated. Supports can be found at 2030 (13/11/2014 low) and 2001 (04/11/2014 low).

## FX Markets

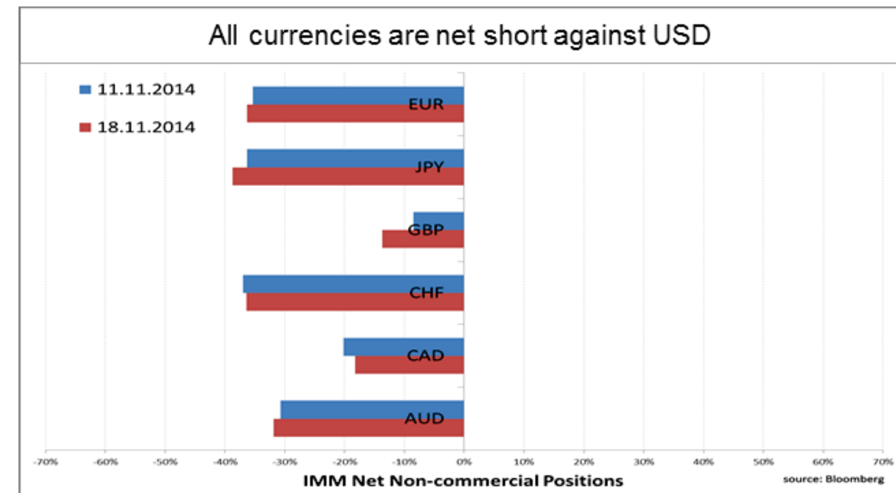
## Aggregate net long USD positions at record high

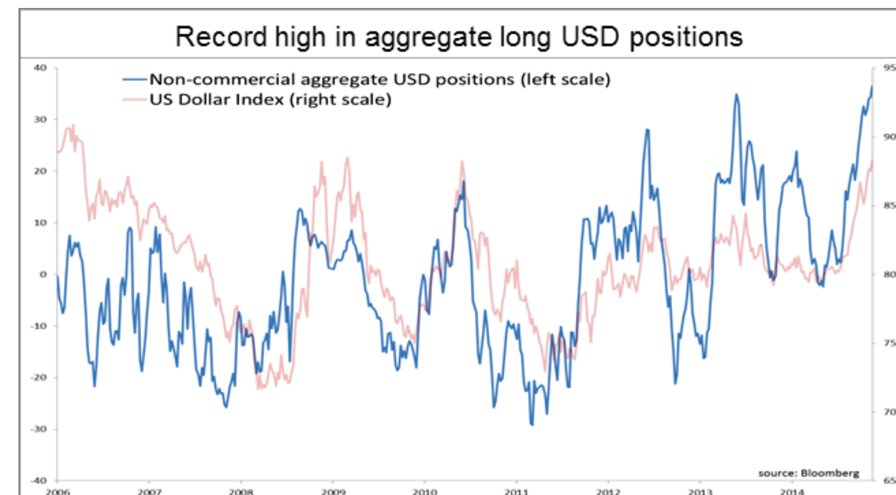
**The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.**

The IMM data covers investors' positions for the week ending 18 November 2014.

The record high in aggregate net long USD positions reflects the attractiveness of the greenback thanks notably to a supportive relative monetary policy and a robust US growth outlook. Despite the fact that these drivers are likely to support an even higher USD value, the large long USD exposure in the market makes it vulnerable to any negative news.

The building of short JPY positions continues, backed by a significant expansive monetary policy from the Bank of Japan and diversification outflows. As the net short JPY positioning is not extreme, it seems to be too early to be contrarian in USD/JPY.



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