WEEKLY MARKET OUTLOOK

19 - 25 January 2015

DISCLAIMER & DISCLOSURES

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

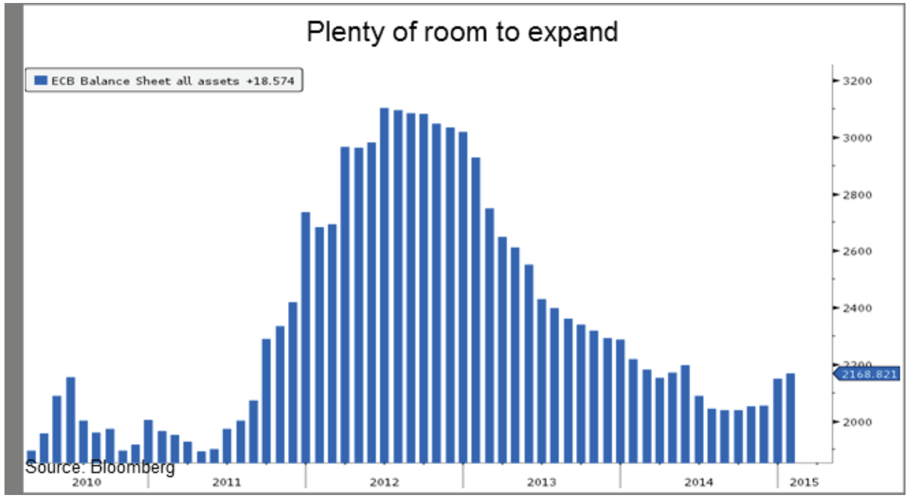
Economics | Signals in the SNBs Move

Not so much "currency wars" but "policy assassination". FX markets claimed its second victim in less than four months. And there will definitely be more in 2015. The EUR is unmistakably on our radar. One thing is curtain, in FX markets that volatility always return, and this wave of volatility is back with a vengeance.

One thing is clear, regarding yesterday's SNB action, something was said or hinted in conversation between the SNB and ECB that spooked the SNB (we are confident policy management occurs). Scared them so much that abandoning the minimum exchange rate, allow the EURCHF to free-fall, was the chosen policy path. The SNB could have selected to managing the EURCHF decline with the still significant room in the SNB balances sheet (estimated by us at least chf200-300bn). Yet, something Draghi said worried Jordon so much that the SNB abandon the strategy rather than attempt further balance sheet expansion to endure current pressure.

Don't expect to be disappointed

While EURCHF floor is "done-and-dusted" we now must position for ECB ultra-expansionary monetary stance. In our view the market has not fully priced in what the ECB is planning. If it had the SNB would have never have abandoned the floor so unceremoniously. Currently markets are expecting the ECB to announce sovereign QE totaling €400-500bn on January 22nd. By authorizing broad-based government bond purchases the EUR can expected to depreciate further. We suspect the ECB suffers from the same credibility issue haunting the pre-Karuda's BoJ. The market is expecting to be disappointed. Markets anticipate the ECB will be too timid and cautions in the size and scope of any addition stimulus that net effect will be marginal. However, like the empowered BoJ under Koruda we believe Draghi's ECB is planning a much larger strike then traders are expecting. Clearly the impending ECB strategy scared the SNB. We remain short in the EUR verse all G10 ahead of the QE announce and due to mounting political uncertainty in Greece.



FX Markets

Swiss franc squeezed on surprise SNB decision

The SNB removes the 1.20 floor on EUR/CHF

The surprise SNB intervention on January 15th triggered sizeable volatilities on the FX markets. The EUR/CHF plunged to 0.85172, the record low, in a single move as soon as the SNB officially announced the removal of the 1.20 floor. The price discontinuities, lack of liquidity has been a major issue on the trading. The EUR/CHF realized volatility spiked to 75%, a record high following the SNB announcement. USD/CHF tumbled down to 0.7406 in similar fashion. At this point, it is still too early to give a target level given that the pair has not traded free-float for the past three years yet there is talk that 1.10 would be acceptable level, fair value on the EUR/CHF. The SNB credibility, however, got a serious hit on this action, which should keep traders, companies, funds and real money names alert in the coming weeks. Next week's ECB decision gains sizeable importance as a consequence. The selling pressures on the EUR/CHF are expected to remain tight.

Surprise decision hit the Swiss market

The SNB decision was much unexpected and fully surprising given the Swiss policymakers' latest comments on their "utmost determination" to defend the EUR/CHF floor at 1.20. The credibility of the SNB certainly took a big hit at this point amid the damage it caused to the real economy; the loss in market value is estimated at roughly 105 billion francs! The banks and exporters will certainly be the most hit by the free float franc as the CHF appreciation will decrease the competitive advantage of Swiss products on international markets. Swatch Group and Richmond took the biggest losses among the Swiss exporters post-announcement. Beyond the first hit, the cash flow management strategies and the FX hedges should be revised in order to adopt to the new normal: the free-floating Swissy verse euro.

FX Markets

RBI's cut increases speculations for potential CBT action

RBI unexpectedly cuts rates

By a surprise action, Reserve Bank of India cut both the repo and the reverse repo rate by 25 basis points down to 7.75% and 6.75% respectively. The inflation print below the RBI's target for the third straight month is seen as the major trigger for the move. As Governor Rajan sees cool-off in inflation below 6% in a year from now, his colleague Virmani from RBI's advisory panel, had already said it was "time to cut rates" on January 13th. The rate action aims to boost investments and economic recovery at a period favorable due to low commodity and energy prices. This is the first rate cut since May 2013 and further cuts are expected within the Q1 at this point, should the disinflationary pressures continue, according to Rajan. He also highlights the importance of a well sustained "fiscal consolidation" and the importance "to overcome supply constraints and assure availability" of resources to make sure the lower rates will translate into growth.
USD/INR eased to 61.4825 post decision, yet rapidly bounced back above the100-dma (61.7016) support, broken for the first time since July 2014. The expectations for more policy action should keep the INR longs limited. We see solid support pre-200 dma (60.8880).

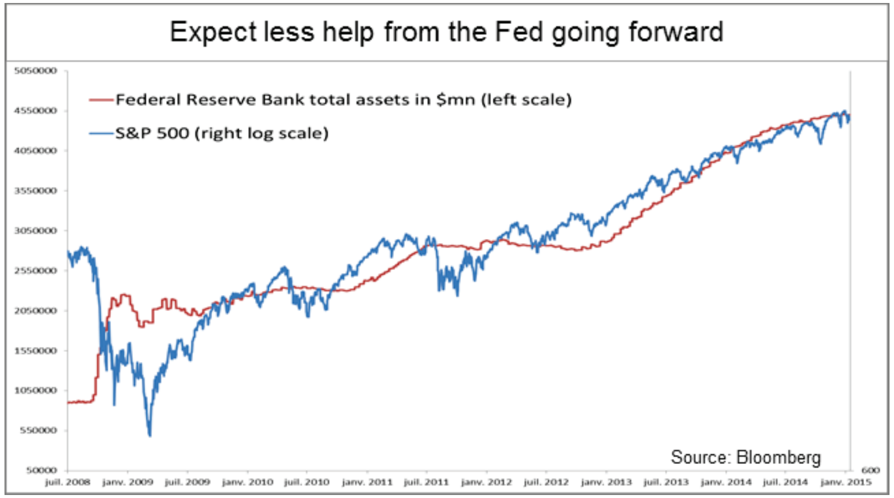
Turkish President Erdogan calls for rate cut

A related question is whether the RBI move would trigger a contagion effect in Turkey, where the pressures for lower rates mount as inflation eases and the ECB walks into a full-blown QE. The lira shows mixed performance against USD and EUR. While the USD/TRY longs remain solid at 1.2382/1.2550 (Fibonacci 50% on May-Dec lift / 100-dma), we see room for an advance toward 2.60s on EUR/TRY (resistance pre- Aug 2013 turned support). The lower oil and commodity prices, the expectations for further cool-off in inflation, the negative rates in Switzerland, the anticipations for further expansion in the Euro-zone, the surprise action in India (based on similar motives), combined to political pressures should lead to lower CBT rates to take advantage of the situation. We expect 25 basis points cut in benchmark repo rate on January 20th MPC meeting.

Stock Markets | US stock market without QE's support

No QE in 2015 to push US market higher

Liquidity injections from the US Federal Reserve (Fed) has been a key drivers in the positive performance of the US stock market. However, as the Fed has fully tapered its asset buying programme and with the probable beginning of its tightening cycle this year, US monetary policy should be less favourable for stocks. However, the fact that the Fed wants to raise rates indicates that the US economy is judged strong enough to withstand more normal rates conditions. Furthermore, even after the Fed start raising, rates will remain significantly lower than their neutral levels for an extended period of time. Nevertheless, with the Fed reducing its supportive monetary policy, US stock outlook will be more dependant on economic data like US growth. However, with headwinds like a stronger dollar and a weak growth outlook outside of the US, the expansion of the US economy is unlikely to be a smooth ride, suggesting increasing volatility in the stock market.



The Russell 200 needs to break out of its 2014 consolidation

In this context, the behaviour of US smaller caps should offer valuable insights. Indeed, smaller caps are usually more sensitive to the US growth outlook and tend to turn before larger caps index. As the US recovery should improved further and given that smaller caps are usually more exposed to the health of the domestic market (i.e. less exposed to global weak growth and a stronger USD), the outlook for small caps is rather positive. From a technical analysis standpoint, the relative performance of the Russell 2000 (small caps) against the S&P 500 (large caps) has indeed invalided their underperformance of 2014. However, given the sideways move in 2014 in absolute price, a decisive break of the March and April tops around $1214 is needed to confirm an improving growth outlook.

FX Markets | Riksbank to deliver more dovish monetary policy

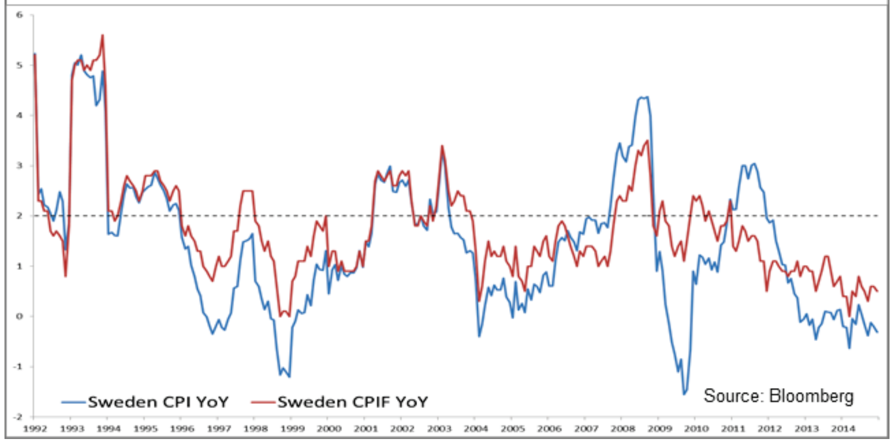
Upside surprise in Swedish CPI

Despite increasing global disinflationary pressures, Swedish December inflation surprised to the upside, coming at 0.2% on month to month basis (versus a consensus at -0.1%). However, as the higher-than-expected print was mostly coming from seasonal segments like transport and recreation, it would be wrong to think that the disinflationary pressures have receded in Sweden. Furthermore, the probable announcement of an expansion of the ECB's QE on 22 January is expected to increase the pressures on the Riksbank. Indeed, any Euro weakness, if not mimicked by the Swedish krona, would lead to imported disinflationary pressures. As a result, the Riksbank is expected to adapt its monetary policy to curb any significant strengthening of the krona compared to the Euro. As a result, the 12 February Riksbank meeting is likely to signal a more dovish monetary policy.

USD/SEK is near its strong resistance at 8.1372

Looking at the chart of USD/SEK, prices are challenging the strong resistance at 8.1372. However, the ECB and Riksbank meetings are expected to support a higher USD/SEK. Indeed, SNB's recent capitulation, a week before the ECB's monetary policy meeting, suggests that the Mr Draghi will deliver and likely above market expectations. Therefore, we favour a further rise towards the strong resistance at 8.7407 (21/04/2009 high). However, given the current overextended move, the strong resistance at 9.3309 (05/03/2009 high) is likely to cap prices appreciation. A break of the support at 7.8789 (06/01/2015 low) would signal a weakening bullish momentum.

Swedish inflation remains close to zero levels



Further strength in USD/SEK remains likely

FX Markets

Net short AUD positions near record levels

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 6 January 2015.

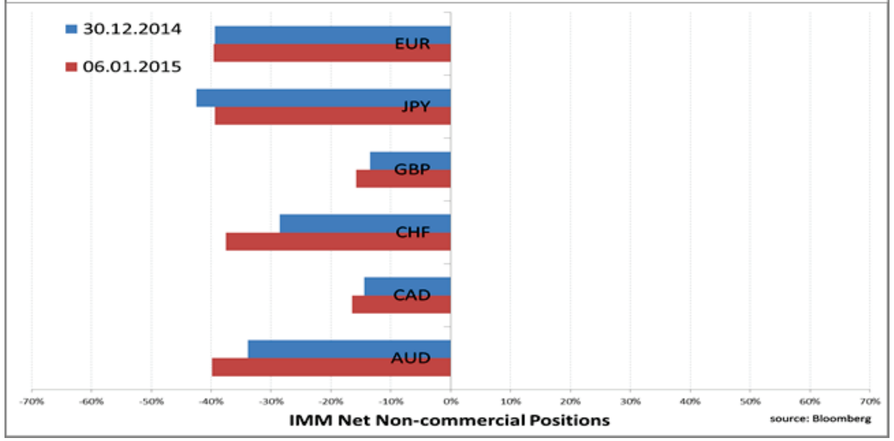
Given the continuous strength of the US dollar, it is not so surprising to see all currencies short against it, with even some of them near record levels. However, when a currency is near extreme levels in terms of short positions, it becomes very sensitive to any news that do not support its bearish outlook.

In the case of the EUR/USD, we suspect that the ECB will surprise the market by the size of its asset programme, resulting to a lower Euro.

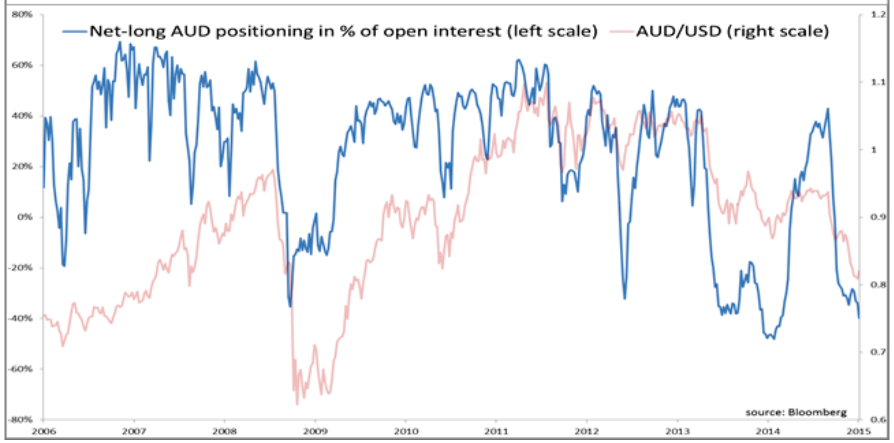
The Japanese yen has seen some short JPY covering as the Bank of Japan is perceived to be less active this year. The resulting decline in USD/JPY is likely to generate some attractive entry points for a long position.

Net short AUD positions are approaching record levels. As a result, the risks to see sharp temporary rebounds in AUD/USD are increasing. We would favour a sell on strength strategy on this FX pair.

Long USD bets continue to increase except against JPY



Net short AUD positions are near record levels



DISCLAIMER

While every effort has been made to ensure that the data quoted and used for the research behind this document is reliable, there is no guarantee that it is correct, and Swissquote Bank and its subsidiaries can accept no liability whatsoever in respect of any errors or omissions, or regarding the accuracy, completeness or reliability of the information contained herein. This document does not constitute a recommendation to sell and/or buy any financial products and is not to be considered as a solicitation and/or an offer to enter into any transaction. This document is a piece of economic research and is not intended to constitute investment advice, nor to solicit dealing in securities or in any other kind of investments.

Although every investment involves some degree of risk, the risk of loss trading off-exchange forex contracts can be substantial. Therefore if you are considering trading in this market, you should be aware of the risks associated with this product so you can make an informed decision prior to investing. The material presented here is not to be construed as trading advice or strategy. Swissquote Bank makes a strong effort to use reliable, expansive information, but we make no representation that it is accurate or complete. In addition, we have no obligation to notify you when opinions or data in this material change. Any prices stated in this report are for information purposes only and do not represent valuations for individual securities or other instruments.

This report is for distribution only under such circumstances as may be permitted by applicable law. Nothing in this report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances or otherwise constitutes a personal recommendation. It is published solely for information purposes, it does not constitute an advertisement and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments in any jurisdiction. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein, except with respect to information concerning Swissquote Bank, its subsidiaries and affiliates, nor is it intended to be a complete statement or summary of the securities, markets or developments referred to in the report. Swissquote Bank does not undertake that investors will obtain profits, nor will it share with investors any investment profits nor accept any liability for any investment losses. Investments involve risks and investors should exercise prudence in making their investment decisions. The report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are for information purpose only and are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or groups of Swissquote Bank as a result of using different assumptions and criteria. Swissquote Bank shall not be bound or liable for any transaction, result, gain or loss, based on this report, in whole or in part.

Research will initiate, update and cease coverage solely at the discretion of Swissquote Bank Strategy Desk. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. Swissquote Bank is under no obligation to update or keep current the information contained herein and not liable for any result, gain or loss, based on this information, in whole or in part.

Swissquote Bank specifically prohibits the redistribution of this material in whole or in part without the written permission of Swissquote Bank and Swissquote Bank accepts no liability whatsoever for the actions of third parties in this respect.