SWISSQUOTE

WEEKLY MARKET OUTLOOK

2 - 8 March 2015

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WEEKLY MARKET OUTLOOK - An overview

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Economics | RBA to Cut Further

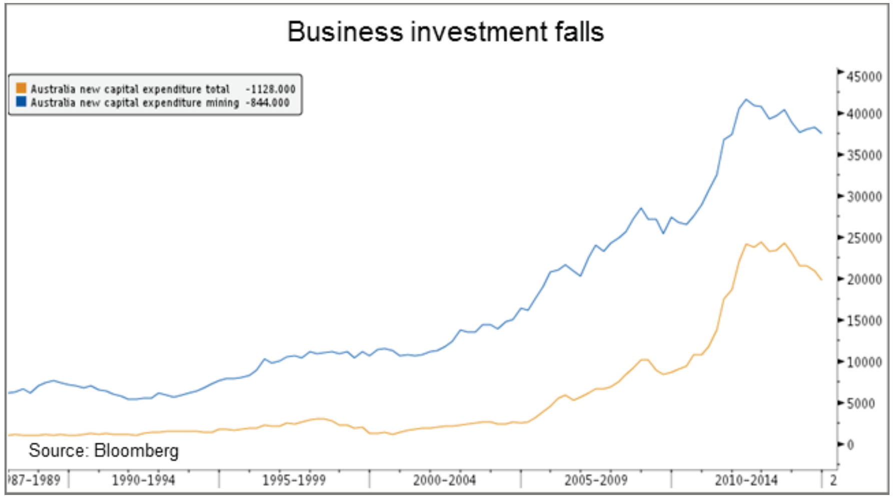
Weak economic data

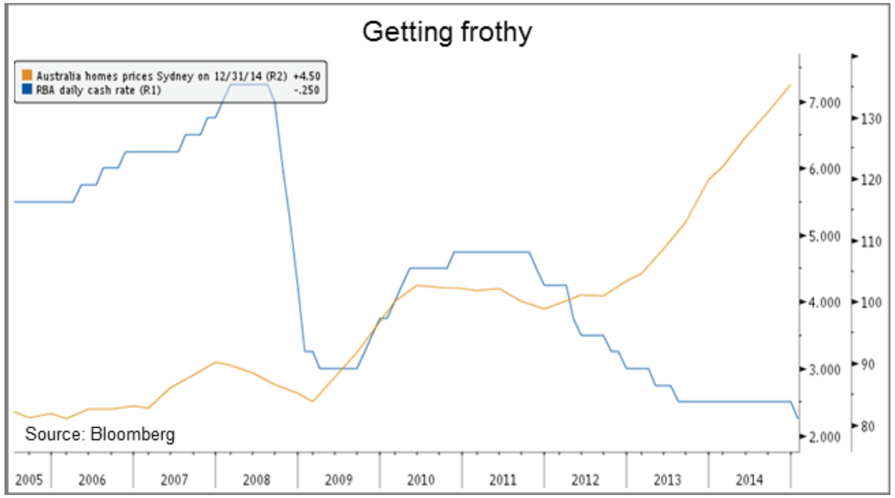
The RBA has recently triggered an new easing cycle by cutting interest rates to 2.25% a record low. The central bank has also signaled that additional easing was possible. Expectations for a rate cut that this week's policy meeting crossed the 50% threshold. A key driver was the collapse of Australia's private capital expenditure. CAPEX for Q4 2014 declined -2.2%Y against expected -1.6%Y fall. This is the critical first read of capital expenditures for 2015-2016 since its sets the tone for the rest of the year. The estimates came in at AUD109.8 billion against the market consensus for AUD119 billion. A sizeable deceleration in spending expectation. As expected the biggest hit was the mining sector yet there were cuts in non-mining sectors recovery, dimming forward outlook, and suggesting broad-based economic weakness.

The rates market were quick to react sending expectations for a RBA OCR cut to 52% from 38%. Interestingly, by commencing additional easing the RBA indicates that current strong houses prices and frothiness in the real-estate market is not at perilous levels yet. The RBA seems to be willing to lets APRA macro-prudential measure work to help pull in risky lending and lessen investor demand.

One more cut

Finally, given the FOMC slightly dovish turn, the RBA now has more room to cut without any geopolitical backlash (accusations of targeting FX). We now expect the RBA to cut 25bp to 2.00% at next week's rate decision meeting as signs of slowing growth has increased. As a results we anticipate further weakness in AUD despite being near to fair-value. AUDUSD recent recovery nearing 0.7942 downtrend provide opportunity to reload short positions. In the longer term, a weak currency and lower oil prices should support Australia growth.





FX Markets

How patient is the Fed?

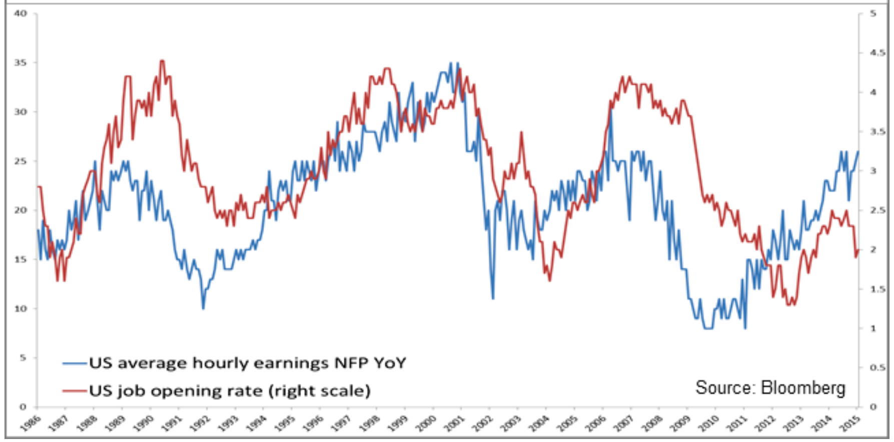
Yellen is paving the way for a change in forward guidance

Even if Fed Chair Yellen reassured the market that no rate hike will occur "at least in the next couple of FOMC meetings" (usually understood as two meetings), she however carefully explained what would be the next steps from the Fed should economic data support the start of the tightening cycle. A change in the forward guidance about the "patient" stance must occur first. Such modification would then indicate that economic conditions have improved to the point where it will soon be the case for the Fed to consider a rate hike at any meeting.

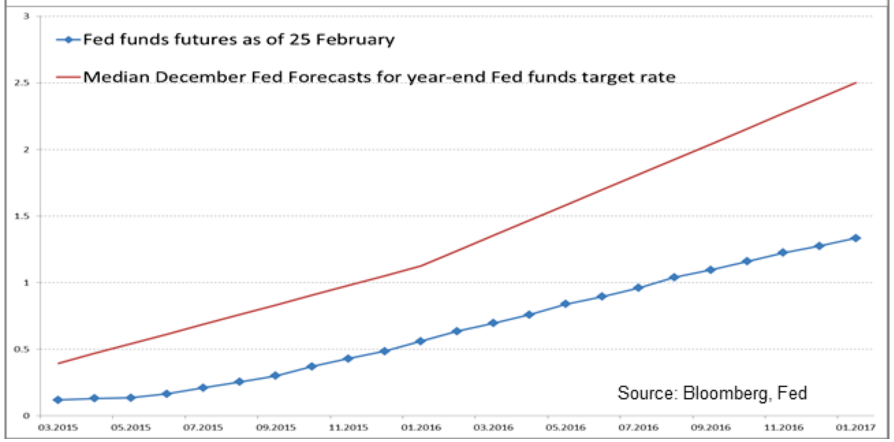
Yellen's take on the economy is constructive

Listening to Yellen's testimony, her view on the economic outlook is rather constructive: the job market has been improving "along many dimensions", long-term inflation expectations remain anchored and foreign risks do not only reflect downside risks. Furthermore, oil prices have started to stabilise and wage growth is expected to improve in the next months, which should confirm an improving labour market and strengthen the inflation outlook. As a result, as we suspect that the 6 March payrolls numbers will continue to point to a stronger labour market, the Fed is likely to change its forward guidance on its March FOMC meeting to prepare the market for a potential June hike (hence supporting some upwards realignments of market expectations towards the Fed's own median rates forecasts). It has to be noted that the timing of the rate hike will depend on upcoming data. However, the expected improvement on wages growth, the potential stabilisation in oil prices, the upside risks stemming from recent numerous non-US monetary stimuli and Yellen's constructive description of the economic outlook continue to point for a rate hike early in the second half of 2015. Overall, USD weakness following Yellen's testimony should likely be temporary.

Increasing job openings support higher wage growth



Early change in forward guidance to lift market expectations



FX Markets

What do FX long-term valuations say?

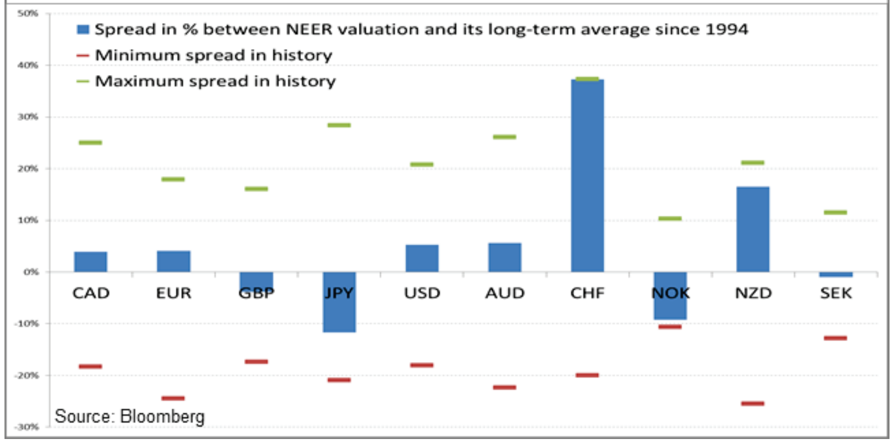
Introducing NEER FX valuations

Among fundamental FX valuations, the nominal effective exchange rate (NEER) is useful to have an idea of the overall value of a currency compared to its peer. Indeed, the purchasing power parity estimates the amount of adjustment needed on the exchange rate between two countries to make their respective currency's purchasing power equal. On the other hand, the NEER of a currency is measured by the weighted average of the nominal exchange rate against the country's trading partners based on their share in the country's trade. As a result, NEER gives us clues about the valuation of a currency against a basket of currencies.

NEER valuations suggest extremes in CHF and NOK

Looking at the spread between the NEER value and its long-term average and comparing it to historical extremes, we find that CHF and NZD are significantly overvalued, while NOK is significantly undervalued. Even though NEER valuations do not take into account safe haven flows (which is a key driver in CHF), the Swiss franc seems too expensive to be bought for a long-term horizon. As a result, a long USD/CHF seems interesting especially as rising US yields could attract risk-averse flows out of CHF into USD. The undervaluation of NOK is also quite interesting as it appears to be the most undervalued currency in Europe. As we suspect that oil is starting to stabilise, shorting EUR/NOK seems an attractive long-term position especially as the Norwegian economy is holding well despite the oil decline, suggesting that rates expectations by the market (more than two rate cuts in 2015) are too dovish.
Looking at other currencies, it is interesting to note that the US dollar is far from overvalued levels. This observation seems shared by the Fed given the absence of any reference on the valuation of the greenback. As a result, USD is unlikely to be a factor to derail the Fed in its tightening cycle.

Extremes valuations apparent in CHF, NOK and NZD



Norwegian economy is holding well despite declining oil prices

Stock Markets | STOXX Europe 600 is approaching major resistances

DAX soars to new all-time highs

As the ECB's QE is about to start, European indices have already risen sharply, as can be seen by the persistent all-time highs made by the DAX. As explained in our last week's report, we favour further strength throughout 2015, even though the rise is quite overextended in the short-term. Such positive outlook is confirmed by the the long-term bullish technical structure visible in the DAX. Indeed, prices have broken the major resistance at 8136 (implied by the 2000 and 2007 peaks), rebounded on it (the broken resistance is now acting as a support) and then made new highs, which indicates a healthy technical structure.

The STOXX Europe 600 is approaching its all-time highs

Given the all-time highs in DAX, it is difficult to find potential resistance levels where the index may stalled temporarily. However, looking at the STOXX Europe 600, prices are close to a major resistances area between 401 and 408 (implied by the 2000 and 2007 peaks). Given the short-term deep overbought conditions, the odds to see a short-term correction in the next few weeks are elevated. As a result, the short-term risk/reward to initiate a long position in the DAX is currently not attractive. Supports for the German index can be found at 11013 (13/02/2015 high) and 10765 (17/02/2015 low).

FX Markets

Net short GBP positions continue to be unwound

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 17 February 2015.

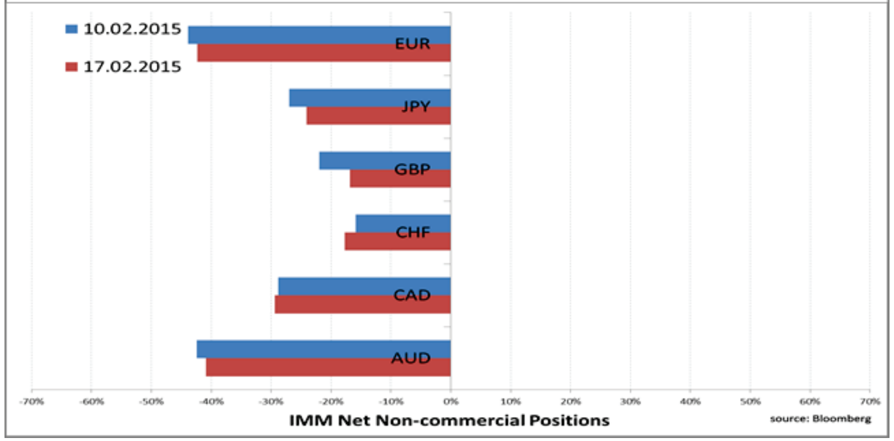
The most notable change comes from the persistent reduction in net short GBP positions, highlighting a re-pricing of the timing for the first BoE rates hike. In the short-term, we continue to favour further GBP strength as market expectations on the BoE stance is too dovish in our view. However, we suspect that renewed GBP selling pressures will occur as the UK general elections will start to grab the headlines. Indeed, the high uncertainties linked to this event should reduce GBP buying interest.

For the first time since 2 December 2014, the net short EUR positions have decreased, suggesting reduced interest in selling the euro. This could pave the way for a short-term rally in EUR/USD.

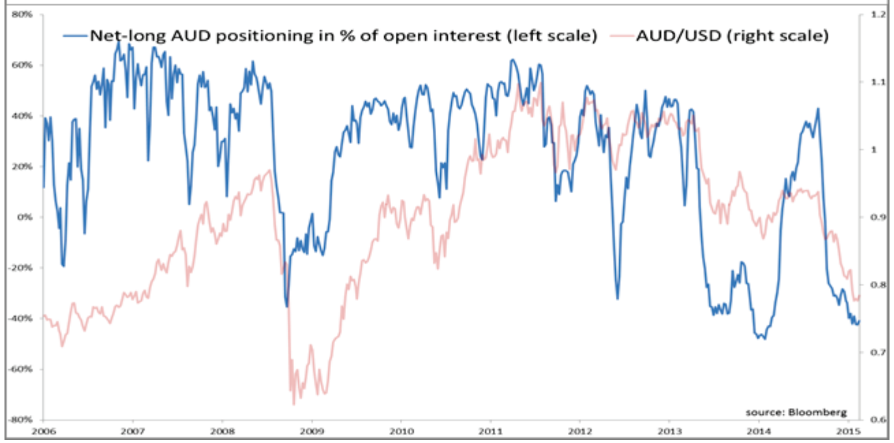
We favour further decline in short JPY bets as the BoJ will likely remain on the sidelines in the first half of 2015. Should we be right, it would then offer attractive entry points in USD/JPY to be exposed to further easing from the BoJ and a tightening from the Fed in the second half of the year.

As the net short AUD positions are near historical extremes, any decline in AUD/USD will likely be hampered by the market positioning.

Net short EUR positions have been reduced



Net short AUD positions are near extreme levels



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