WEEKLY MARKET OUTLOOK

13 - 19 July 2015

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WEEKLY MARKET OUTLOOK - An Overview

Economics

Odds Of September Rate Hike Decrease

Dovish minutes

The FOMC minutes of the June 16-17 meeting didn't provide support to US bulls as Federal Reserve officials remained cautiously optimistic about the outlook of the world's biggest economy. Most committee member acknowledged that the economy didn't gain momentum as certain sectors of the economy are still struggling to show substantial signs of improvement. More specifically, the committee emphasised that a strong dollar and low crude oil prices weigh on both manufacturing and mining sectors. Members also noticed that inflation pressure remained subdued as labour compensation rose at a moderate pace together with low energy prices. Despite those drawbacks and the very cautious tone of the minutes, policy makers "saw economic conditions as continuing to approach those consistent with warranting a start to the normalization of the stance of monetary policy". The minutes also revealed that some Committee members acknowledged that the Greek crisis and the slowdown of the Chinese economy impacted negatively the economic recovery in the US. Market participants are now eager to obtain further insight on the extent to which developments in those countries will impact the timing of rate tightening. Initially, Federal Reserve policy makers were more focus on local developments as they want to see further evidence that the US economy is strong enough to stand a rate hike and it appears now that they are also looking abroad to adjust the timing.

September rate hike ?

As a result, market participants will also start to assess the global economic outlook instead of focusing only on US economic indicators. Therefore, they will be monitoring closely the wording and the view on the global economy of Fed members in an attempt to determine whether a September rate hike is still on the table or not. In our view, a rate hike in 2015 is a little bit too ambitious as the global economic environment (China's economic slowdown, Greek crisis, most central banks in easing mode, low commodity prices) coupled with the lack of dynamism of the US economy will prevent the Fed to start tightening monetary policy, even at a gradual pace, before 2016.

Economics

The Greeks Say No

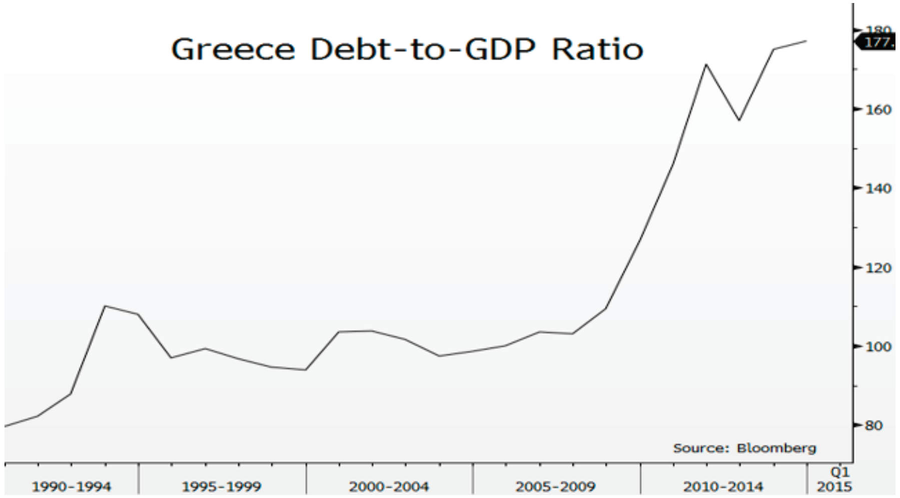
Last Sunday the Greeks voted massively, at 61.3%, for the "no" against latest bailout terms from creditors. This is a major victory for Alexis Tsipras and its government.

We now wonder what will be the real impact of this outcome. Yanis Varoufakis, the Greek Finance Minister announced last Monday that an agreement with lenders may still be reached. However the Greek finance minister resigned by saying in a note in his blog that most of the Eurogroup officials were reluctant to negotiate further with him. Euclid Tsakalotos is now Greece's new finance minister.

In addition, despite Tsipras declared that Greece wants to stay in the Eurozone and that negotiations will continue, we remain suspicious that a deal will be settled. Greece is heading toward the EU exit door. Let's recall that in 2012, the overall debt had already been restructured. Three years later, the Greek debt to GDP ratio is higher than ever. At some point we think that an official default will come.

For the time being, Greek banks remain closed and the cash withdrawal of €60 per day per person will likely be cut. Greek banks are still at stake and this is why Greece's central bank is now requesting the emergency funding to be raised. Greece's creditors have more pressures on the shoulders and therefore they will be more willing to provide significant debt relief measures. Even the US and the IMF call for Greek debt relief. The next payment is due to the ECB on July 20th. Consequently negotiations are set to be tense until there.

EUR/USD is now trading below 1.10 and it should remain than below this level. Yet, the currency may go up on Greek declarations that "an agreement is reached". European equities are likely to suffer on Greece uncertainties.



Economics

Is This Light At The End Of The Tunnel?

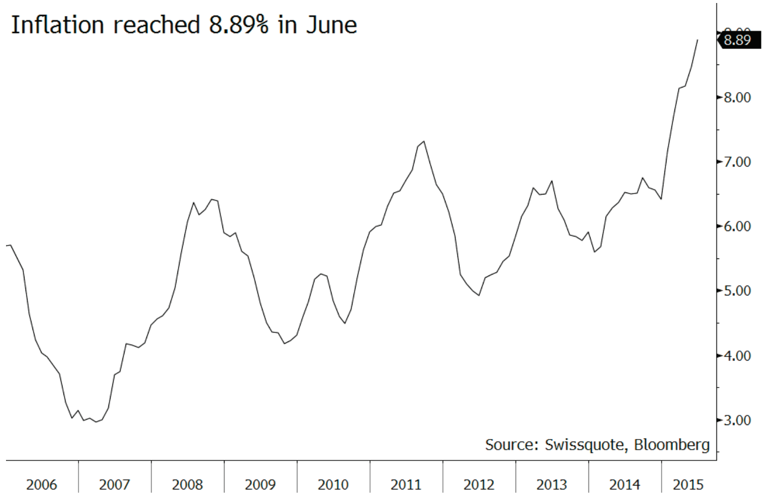
Last week, the BCB released its weekly survey. And the report showed that even though analysts raised again their inflation anticipation for the end of 2015 to 9.04% from 9% a week earlier, they also reduced their estimates for 2016 for the first time in seven weeks- closer to the 4.5% target - to 5.45% from 5.5% a week earlier. It's a small step but it may be the beginning of a trend reversal as it suggests that the Central Bank's efforts to restore its credibility have finally paid off, even though the BCB is still struggling to anchor lower inflation anticipation in the short-term. The latest inflation report indicates that inflation pressure remain strong in Brazil with IPCA rising to 8.89%y/y in June from 8.47% a month earlier.

All in all, the future doesn't look that bright for the Brazilian economy according to median forecast. The report shows that economists lowered their estimates for 2015 GDP to -1.50% from -1.30% a month ago while they anticipate industrial production to contract 4.72% during the same year. We think that the Brazilian economy will suffer more than previously anticipated as the BCB still need to anchor its renewed credibility while fighting elevated inflation. Moreover, the recent fall in iron ore prices adds pressure on the real, with USD/BRL appreciating more than 4% as Chinese equity suffered wild sell-off.

In the long-term, we remain constructive on the real. However, we expect the Brazilian currency to remain under pressure in the short and medium-term as the fiscal adjustment process is not a done deal yet. However, the recent sharp depreciation of the BRL will likely reverse momentum with USD/BRL moving lower after an overreaction due to the panic sell-off in Chinese equity markets.

USD/BRL remains in a bullish channel

Inflation reached 8.89% in June



Economics

How Do You Say "Sell in May And Go Away" In Chinese ?

It is a very difficult time for China at the moment. The Shanghai composite index had fell over 25% since mid-June when it reached a seven-year high at 5166 points. Chinese stocks climbed by a massive 162% from the lowest 2014 level. Last Thursday, the Chinese market opens at more than 2% lower, with 400 stocks that went immediately down by 10 %. In addition, around 1'400 stocks were suspended from trading.

Chinese stock markets are now playing a large role in the Chinese society as more and more person decided to invest in their savings. However, it is worth adding that China's equity markets represent less than 15% of household financial assets.

The People's Bank of China, in order to stop the decline, rushed to intervene by easing money supply for fuelling the stock markets. In addition, China's central bank can be seen as changing the rules at it forbids large investors owning more than a 5% stake to sell their shares over the next six months.

Despite the fact that China and the PBoC are still trying to keep control of the markets, shares prices are clearly heading south. Over the last month regulations on margin financing, equity transactions have been eased. Even the reduction of IPO's to support current stocks had only a medication effect. Yet, the disease is still there.

The main issue now is to remain confident while investing in China as rules may change overtime. Furthermore China is now paying the fact that liquidity flowed on the stock markets and therefore made shares largely overvalued. China's credit market debt outstanding is about $1 trillion. Their economy is clearly at stake as it may only be the start of a bursting credit bubble.

FX Markets

IMM Non-Commercial Positioning

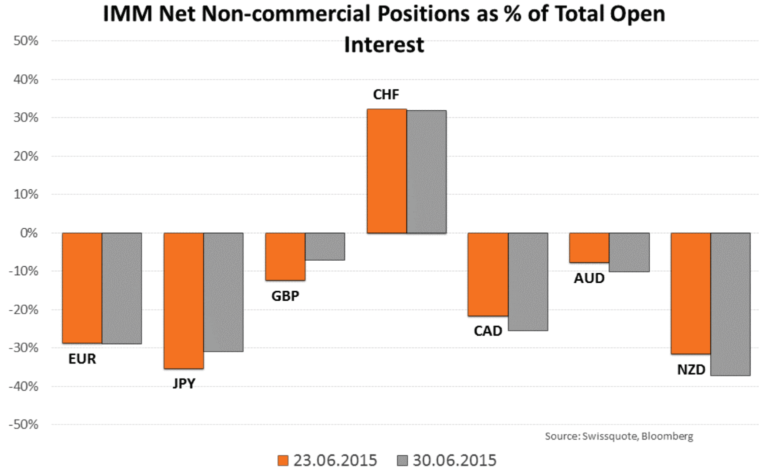
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

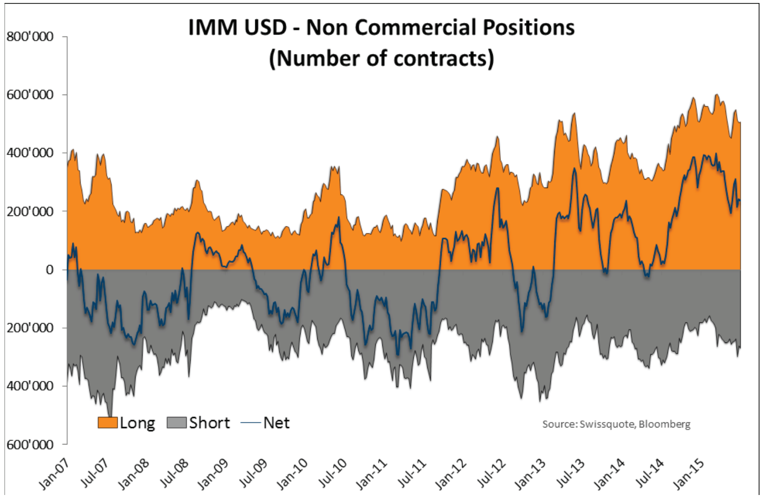
The IMM data covers investors' positions for the week ending 30 June 2015.

The USD net long positions have decreased over the past few months as expectations of a September rate hike fade away. Even a December rate hike looks more and more uncertain. Hence, long positions are decreasing.

In addition, most currencies have seen a decrease in their net short position. The Swiss Franc remains stable.

Net short positions in EUR and JPY are already elevated. As a result, we suspect a limited downside potential in the next few weeks.





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