SWISSQUOTE

WEEKLY MARKET OUTLOOK

24 - 30 August 2015

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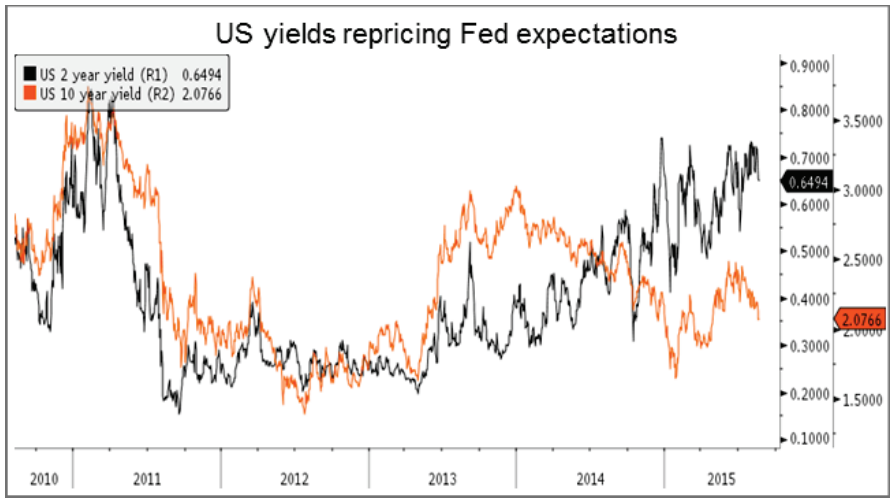
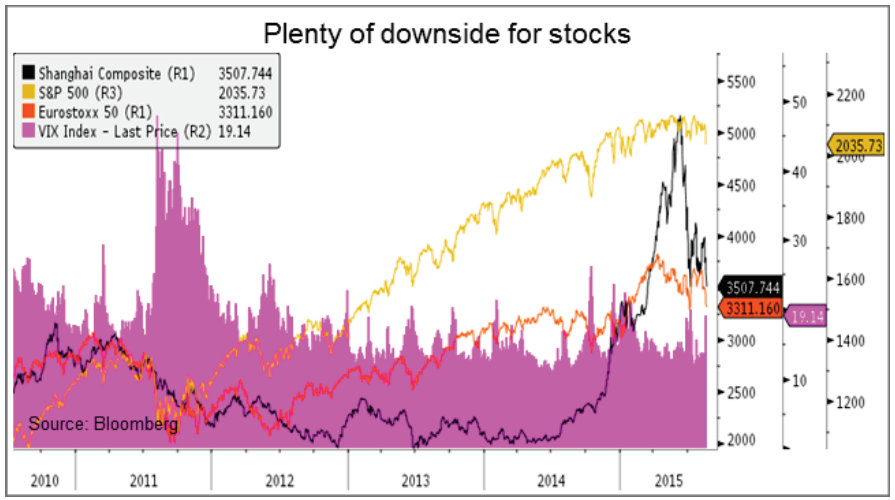
WEEKLY MARKET OUTLOOK - An Overview

Economics

Pressure On Stocks Build

Global risk sentiment remains under significant selling pressure. Most major equity indices are trading below their 200d MA while the VIX has spiked to 19.4. The last five years of bullish asset pricing have been predicated on three key issues (not solely global loose monetary policy). US monetary policy, growth in China and political stability of the EU. When all three are positive (plenty of US monetary stimulus, solid growth data in China and when Greece and Brussels are in relative harmony), global risk appetite surges. Yet when the three are not in-synch, investors risk-taking behavior suffers. While each driver affects segments differently, in whole high correlations levels cultivates the customary risk-on & off pattern. We are in a current environment where all three drivers have turned negative for risk seekers. From the US, incoming economic data and matching Fed speak (via minutes and comments) until recently supported a rate hike in 2015. While, China's deceleration in growth, including flash manufacturing PMI falling to 47.1, indicates Chinese economic slowdown is deeper than anticipated. The final nail arose with news that Greek PM Tsipras resigned, triggering renewed political uncertainty in Europe. Interestingly, this development came right after Greece made an €3.2bn debt repayment to the ECB and central banks of EZ nations, satisfy Athens obligations towards these critical creditors for the next 11 months. The lack of repayment pressure will give whatever new government is fashioned (either through a snap election or opposition forming a new government) additional room to negotiate with creditors. Therefore conceivably taking investors on another typical Greek crisis roller coaster ride. After an unprecedented six year bull run the downside in equity prices is worryingly distant. In our view, it will take a reversal in markets perception of one of these drivers to halt the current selling pressure and convince investors to become risk seekers again.





Economics

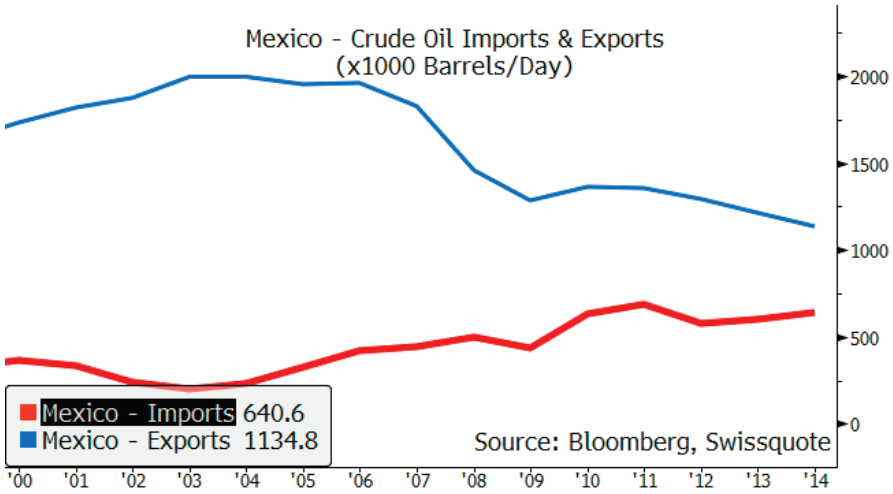
Mexico On The Fed's Path

The Mexican Q2 GDP has been released last week and came in at be released today. It is expected to come in at 2.2% year-on-year, down from the first quarter which was revised slightly up at 2.5%. The Mexican peso is now at its lowest level ever against the greenback. It is currently trading at an average of 16.50 and we think that USDMXN will head further north.

The major issue is that Mexico is struggling to find investors for exploiting its huge oil reserves. Over the past twenty years, the country did not have the ability to invest in its own infrastructures. Therefore the country has been forced to open up its petroleum business to private and foreign investors. Unfortunately the country is hit by the lingering oil commodity prices. The WTI crude oil is now ready to hit $40 a barrel. While demand for oil remains high, exports have decreased and therefore Mexico had to import even more natural gas from the United States in order to support, ironically, all the oil and electricity production. The market reality is now pushing Mexico to liberalizing its energy markets, in particular infrastructure investments are highly requested.

The peso has been constantly dropping against the dollar for four years. Then Banxico is trying to stabilize the currency. For example it auctioned $233 million last week in order to prevent the currency to go even lower but for the time being the downside momentum on the peso seems way too strong. It is also worth adding that the current strong demand for dollars lowers the Mexican currency as expectations about a rise in U.S. interest rate increase day after day. However we remain suspicious on a September rate hike. If it does not happen this would provide some relief to the peso. However, this would only be temporary as expectations for December will grow. Mexico is not only struggling with its own economy but also with the high expectations that markets expect from the first world economy.

Banxico will decide about the overnight rate the 21st of September few days after the FOMC rate decision on the 17th. We think that the Central Bank of Mexico will act accordingly to what the Fed decides. However Mexico has to prevent its currency to go lower as the Mexican Economy is really at stake. Nowadays, the primary issue for Mexico. We remain highly bullish on the USDMXN that should reach 17 within the next few weeks.



Economics

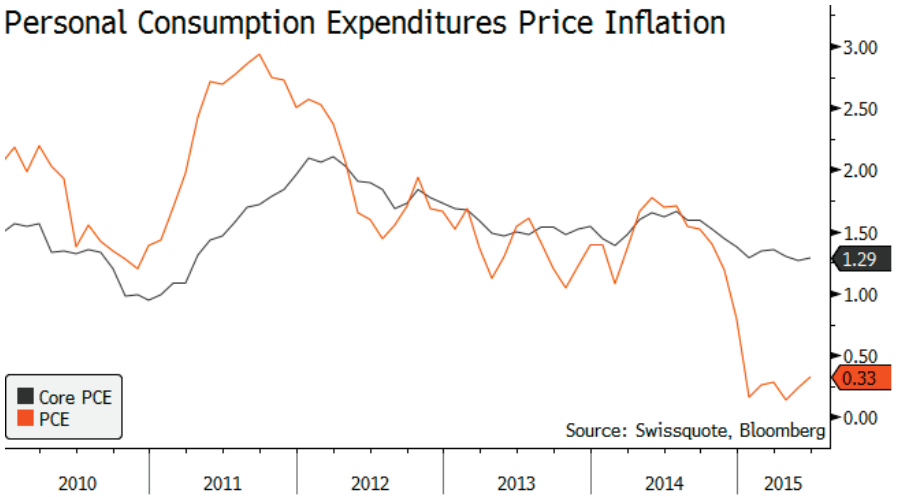
Inflation Pressures Remain Subdued

Even though the last FOMC minutes are seen as more dovish than expected by the market, we cannot rule out a September rate hike… and definitely not a December one. However, in our opinion, the odds are now skewed toward December rather than September. Let's quickly review the Fed's thinking about inflation and the job market.

Let's start with the good news, Fed members "agreed that labour market conditions had improved further" as unemployment rate reached 5.3% in June. However, several members are still concerned about the high number of workers not actively searching for jobs, together with a decline in the participation rate. In addition, increase in wage gains remained subdued. All in all, participants are confident that market labour slack will continue to diminish but the real threat to a September rate hike is inflation outlook.

Inflation is the major concern to Fed members and unfortunately the outlook does not look great. The minutes say that "Some participants expressed the view that the incoming information had not yet provided grounds for reasonable confidence that inflation would move back to 2 percent over the medium term" while "Some participants, however, emphasized that the economy had made significant progress over the past few years and viewed the economic conditions for beginning to increase the target range for the federal funds rate as having been met or were confident that they would be met shortly", meaning that inflation outlook is strong enough. As you can see, Fed members are divided and do not have the same view about inflation outlook. Looking at the latest figures, July core inflation came in below expectations with a reading at 0.1%m/m versus 0.2% consensus and previous read (stable at 1.8y/y). Fed's favourite measure, the PCE deflator, printed stable at 0.3%y/y while the core indicators came in at 1.3%y/y for June, flat compared to May. In our opinion, weak inflation outlook will retain the Fed from raising rate in September, we therefore favours a December rate hike. As Fed members put it: "Most judged that the conditions for policy firming had not yet been achieved, but they noted that conditions were approaching that point".

Personal consumption expenditure figures for July are due on Friday and are expected stable at 0.3%y/y for the headline and 1.3%y/y for the core measure. A higher reading will skew the odds toward September, triggering a dollar rally.



Economics

Tsipras Resigns And Stock Markets Fall Sharply

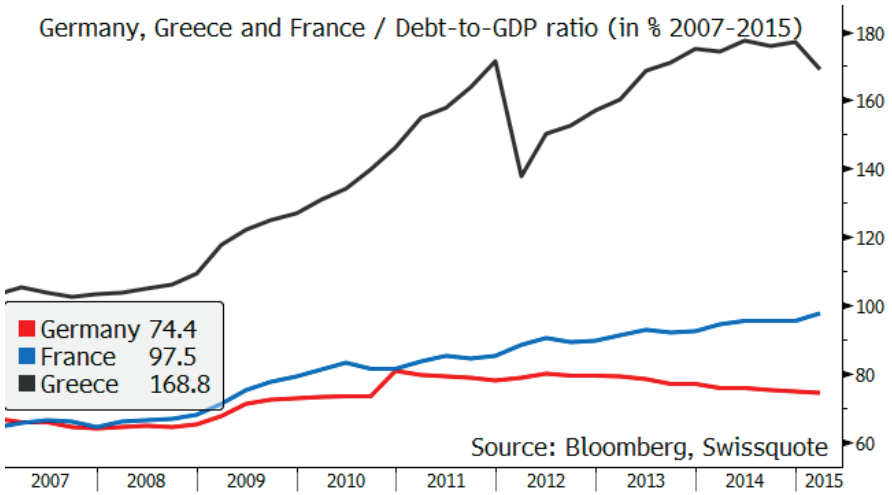
Last week, after a nine-month mandate which has seen an agreement on a €86bn bailout, Greek PM Tsipras resigned. He then called for new elections. Earlier reports suggest that these will likely take place around the 20th of September.

Tsipras negotiated strongly with Greece's creditors but against all odds and after a referendum where the "No" vote won, he decided to comply with the creditors. Furthermore the agreed plan was even worse than the one that was decided before the referendum. Ironically, despite the "No" vote won, Greek think that the Eurozone can only be a chance for their future. Following this logic, massive austerity measures should also be seen as a great opportunity.

Over the medium-term. We think that the Greek case is only the start of more massive austerity policies in Europe. Most countries, since they joined the European Union club, have seen their debt-to-GDP increase massively. Indeed, the impossibility to debase its local currency gives only one solution: austerity. We think that Greek parliament members should not have congratulated on the bailout. Compromises aside, Greece is now privatising numbers of companies which are now sold. For example, Greece has just recently sold airports to… Germany.

Global stock markets reacted sharply at the Tsipras's resignation as most markets ended up very negative. We still remain suspicious on the so called austerity measures as we think that most European countries will not be able to reimburse their debt. In addition the situation in the U.S. is concerning as we consider that mixed data do not support a September rate hike. Last but not least, Chinese stock markets follow its decline. The bottom line is that we wonder on what extent central banks are able to regulate efficiently the economy.

As we expected, the EURUSD resistance at 1.1278 has been broken on the Greek bailout settlement. Now, the key driver will be any announcement by Janet Yellen or Fed's member. At some point we judge that a Fed statement saying that no September rate hike will happen as likely. The surge of euro is not over yet.

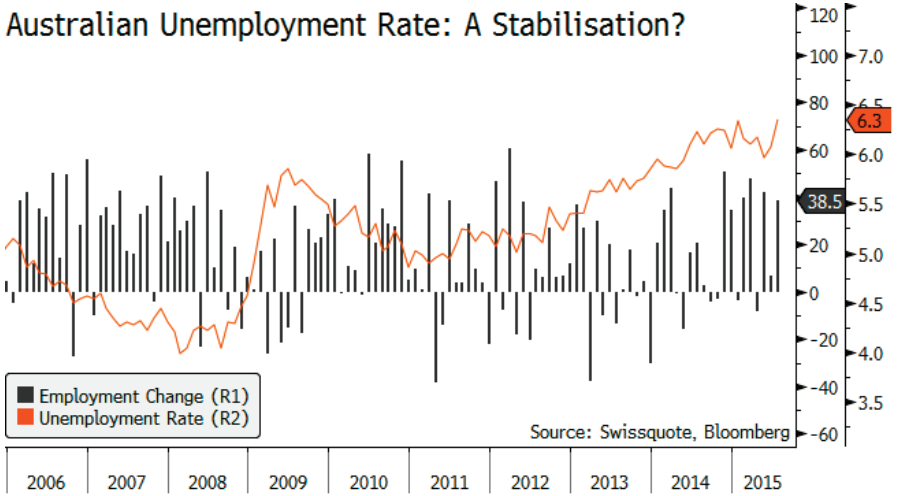


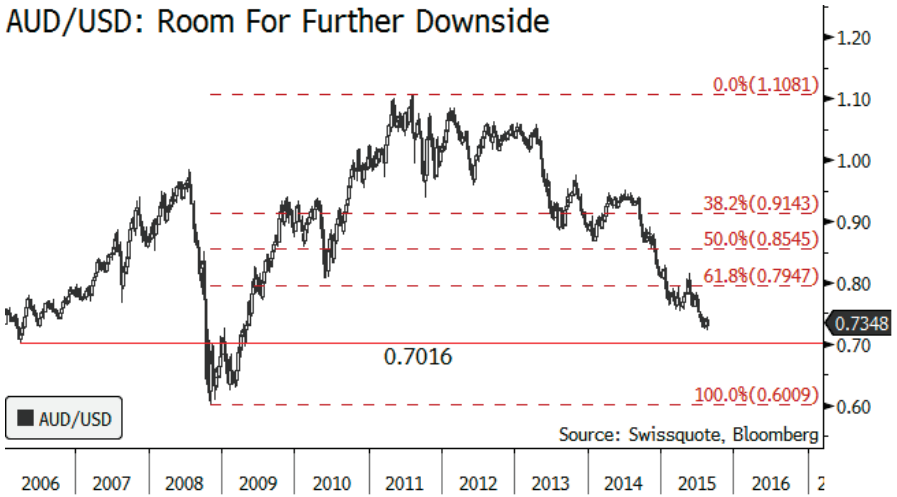
FX Markets

Commodity Currencies Under Pressure

The minutes from the August RBA meeting were roughly in line with market expectations. Even though the minutes didn't indicate clearly any policy bias, we think the overall tone was less dovish than expected as the Reserve Bank seemed pretty comfortable with the current monetary policy settings. On the domestic economic conditions, RBA's members highlighted "that labour market conditions had been a little bit better than expected", contrasting with previous expectations of a unemployment rate drifting higher. Still on the bright side, RBA's officials stated that "Domestically, economic activity had generally been more positive over recent months" as both consumption and net exports are taking advantage of a weaker Australian dollar. We therefore think that the RBA will maintain the status quo for now as the AUD/USD is trading at low level, thanks to a US dollar strengthen by lift-off expectations.

The minutes also indicates that the central bank was quite confident that the downside risk to the outlook for Chinese growth had abated somewhat. However, at that time, the PBoC had not yet devaluated its currency and according to the latest developments - such as the recent sell-off in equity markets, concern about global growth and global risk-off sentiment - China's outlook may not be as bright as expected. Australian exports will likely feel the consequences of a weaker yuan, undermining growth outlook in Australia. We maintain our downside bias on the AUD/USD, even though the pair may take a breather for some time. On the downside, the 0.7016 threshold will act as a strong support while on the upside, the pair will find a resistance around 0.7947 (Fib 61.8% on 2008 - 2011 rally).





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