WEEKLY MARKET OUTLOOK

28 September - 4 October 2015

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WEEKLY MARKET OUTLOOK - An Overview

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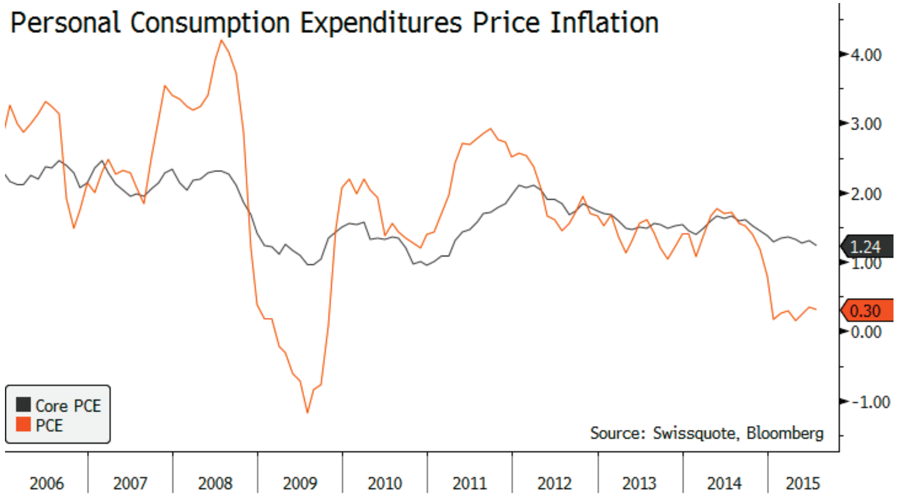
Economics

US Rate Hike : Here We Go Again

One after another, Federal Reserve members continue to breathe life into the notion of a rate hike this year. We now wonder whether the Fed really believes that the Committee will be able to deliver a rate hike before 2016, given that the market is pricing in a 22% probability of such a move in October and 44% in December and that inflation is still well below the 2% target, or whether they are trying to spread its buoyant optimism to market participants. Following in the footsteps of San Francisco's Williams, St. Louis' Bullard and Richmond's Lacker, Atlanta's Lockhart also declared that he was "confident the much-used phrase 'later this year' is still operative", adding that "As things settle down, I will be ready for the first policy move on the path to a normal interest-rate environment". No later than last Friday, Janet Yellen, Federal Reserve Chairwoman, added her voice to that of her colleagues as she reiterated her call for a rate hike before the end of the year. To support her view she argued that the recent weakness in US inflation levels comes down to low energy prices and weak import prices due to a strong dollar, adding that she was confident that the gauge will return to 2% over the next few years and that, therefore, the prudent strategy is to start increasing rates gradually before reaching the Fed's target. However, she warned that the Fed could change its strategy if there were some economic surprises.

The bottom is line that, despite the Fed's members' strong commitment to raising rate, the central bank is at the mercy of external factors. It seems that another round of "transitory factors" will likely thwart the Fed's plans. In our opinion, the current weak inflation environment will prevent the Fed to raising rates this year. However, we do not rule out an extremely small increase of the federal fund rate as the Fed may to save what is left of its credibility.



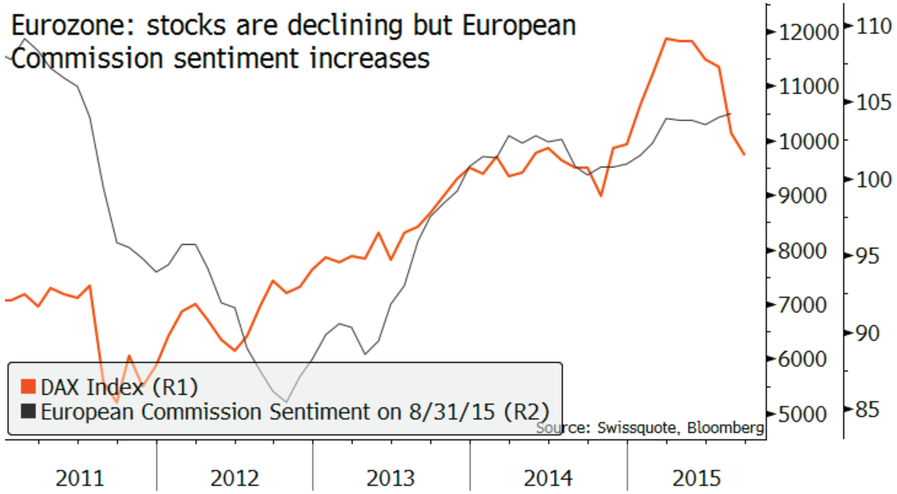
Economics

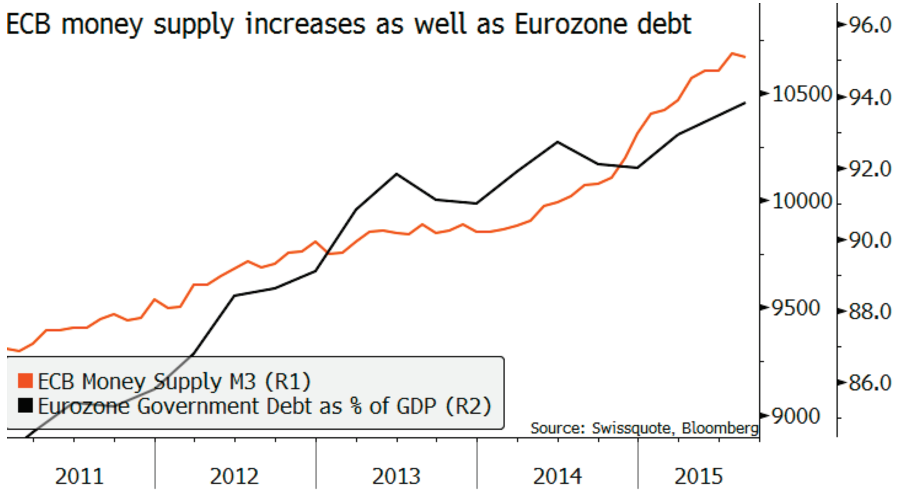
The European Central Bank Is Willing To Expand The QE

At last week's ECB meeting, President Draghi appeared worried. He stated that some more time was needed to appraise the risks which would trigger an increase in the current quantitative easing program. This is the second time of late that Draghi has hinted about the possibility of monetary easing being stepped up. Of course it is not the current recession and the global Eurozone labour market that keep Mario Draghi awake, but rather the lingering low oil prices and the recent turmoil in the global markets. These outside conditions have the potential of increasing downside pressure to both Eurozone inflation and growth. This would provoke an expansion of the asset program.

In addition, there are growing concerns about the efficiency of using quantitative easing to boost the economy. The Japan and the U.S. examples are still struggling to stabilize their economies despite the massive stimulus programs of the past years. There is in fact no substantial evidence that proves the validity of such a monetary tool. However, it seems that it was the last solution for the European Central Bank to get back on path to growth. We consider that the only thing QE does is that it brings the illusion of a strong economy through overvalued equity markets.

The inflation and growth forecasts have already been lowered this month as the odds increase of an official announcement of a QE increase. In spite of that, the ECB remains very optimistic about the future success of quantitative easing as was the case with U.S. and Japan. Many European countries have massive debt-to-GDP ratio whose debt, in most cases is unsustainable. Before being able to grow, reimbursing debt should be the first priority. We anticipate the EURUSD to weaken in the medium term as markets are still expecting a Fed rate hike amid the fact that the European economy is not providing sustainable signs that growth will accelerate.





Economics

Potential For Further China Weakness

There is a growing acceptance that China's economic deceleration is more than just a slowdown. The steady reduction of built-up imbalances is likely to generate a lower growth trend moving forward. While dire economic collapse is not the primary scenario, 2015 GDP should linger around 6.7% with further downside risks. Worryingly, the pull-back in domestic markets and globally weaker economic outlook has not been fully priced in China's asset prices. Our view for a soft landing in this secular slowdown is based on the presumption that the government's massive new infrastructure investments, the PBoC monetary stimulus and stable unleveraged consumer spending should keep China from spiralling lower.

Commodity currencies to suffer

The real unknown is the true effect of the yuan devaluation. The general thinking is that a 10% CNY devaluation will only produce a small GDP bump (less than .5%). Yet there is significant risk that trading competitors will respond in the same fashion, negating any expected benefit. In fact, we have seen a worrying trend of contraction in international trades. Post the financial crisis, global trade has lagged behind historical expansion periods. Meanwhile the increased number of trade barriers, regional treaties and the frequency of neo protectionism activities (i.e. competitive devaluations) has clearly damaged free cooperation among trading partners. Without the free flow of global trade, this weaker currency does little to stimulate growth and with this backdrop, regional commodities currency will continue to underperform. With serious sensitivity to Chinese growth, the new normal growth trend will directly impact NZD and AUD. While the NZD and AUD have already deprecated, years of overvaluation in mining, lack of commodity demand and deterioration in manufacturing sectors suggests an extension of the current economic weakness.

Economics

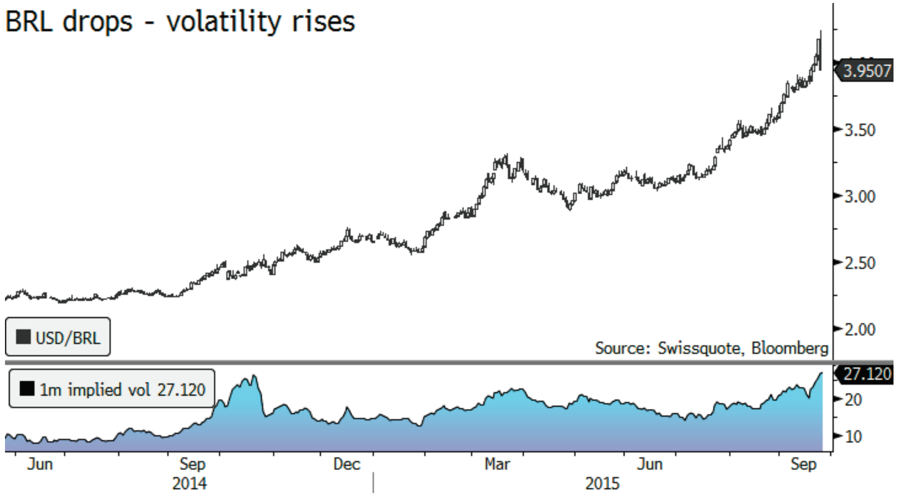
BCB Ready To Intervene

During yesterday's surprise press conference, Brazil central bank governor Tombini, announced that he stands ready to use "all the instruments" at hand to guarantee that the foreign exchange market works efficiently - even though he reaffirmed that interest rates will be maintained at current levels for an extended period of time - after the Brazilian real lost almost half of its value against the US dollar over the last 12 months. In addition, the BCB's governor suggested that Brazil's FX reserves could be used to support the falling currency, a view supported by Finance Minister Joachim Levy. USD/BRL fell 5.76% in São Paulo yesterday, reaching 3.9507. Unfortunately for Governor Tombini, a political crisis requires a political solution; the BCB's good faith can only offer some temporary respite to the BRL.

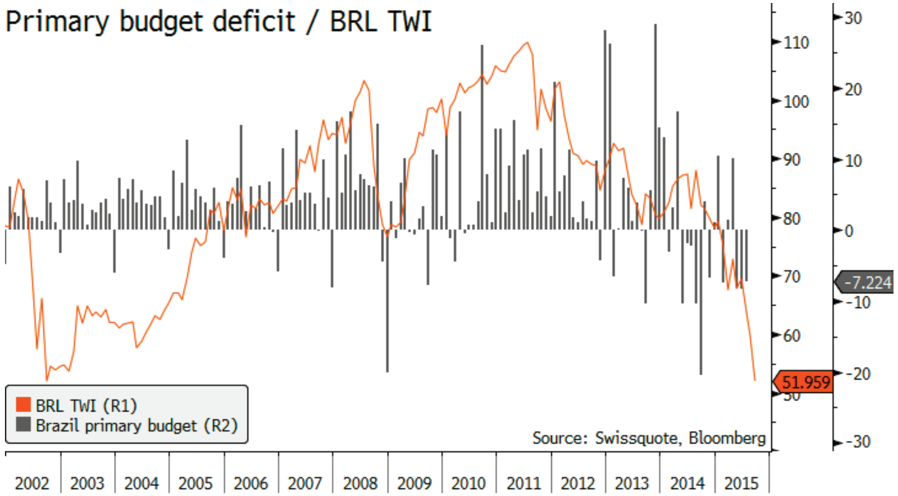
The only way of offering some sustainable respite to the BRL is to restore investor confidence in the government's ability to shore up support for austerity measures. For months, Dilma Rousseff's government has been facing tough opposition in congress against austerity measures, which would see a cut in spending and an increase in taxes. Opposition lawmakers say Dilma Rousseff's package of fiscal measures will badly hurt Brazil's middle class, but have they even considered the fact that the highly uncertain environment stemming from the status quo could also be as harmful for Brazilian people? Unemployment rates reached 7.6% in August from 7.5% a month ago while the central bank raised its 2016 inflation forecast to 5.3% from 4.8% in June, according to the quarterly inflation report released yesterday. Even though the BCB is reluctant to raise the Selic rate further, we believe the market will force them to act as the BCB has been unable to definitively anchor inflation expectations."

We may see a stronger BRL in the short-term but we stick to our view that the BRL will continue to suffer from the highly uncertain political environment.

BRL drops - volatility rises



Primary budget deficit / BRL TWI



FX Markets

IMM Non-Commercial Positioning

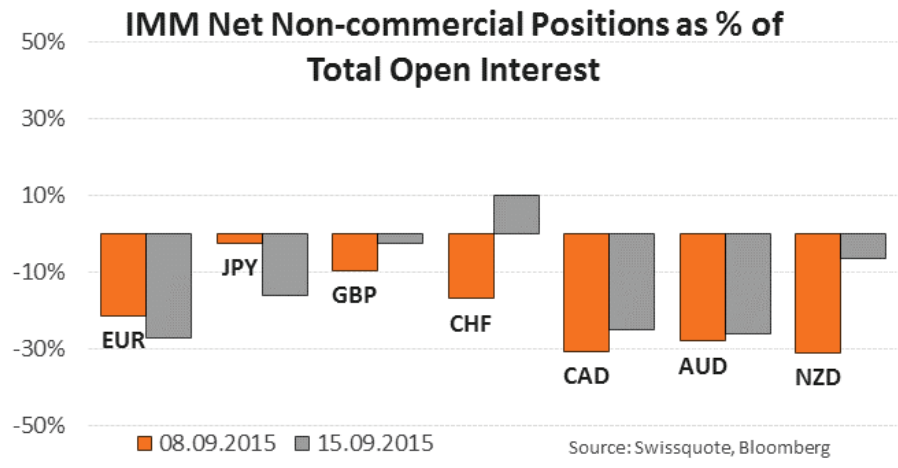
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

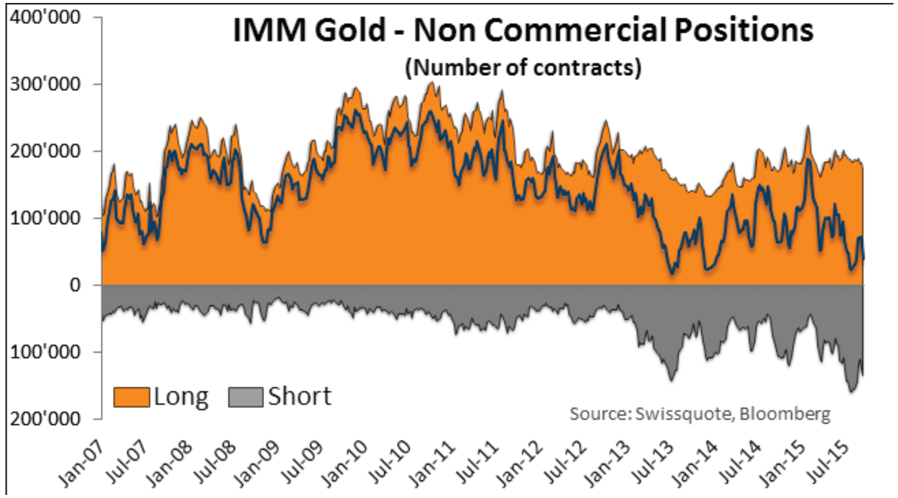
The IMM data covers investors' positions for the week ending September 15th 2015.

Swiss franc net position has reversed to long last week. It has ended a 6-week period where the CHF net position was short. Swiss Franc certainly benefits from the safe haven effect as U.S. Fed rate hike did not occur and uncertainties on the global markets remain lively. In addition long USD positions are declining. Markets are pricing a 2016 Fed rate hike.

It has been now three years that the net JPY position is short. The Bank of Japan is struggling to enter into a recovery path and the deflation is still there. The trend is not going to stop any time soon. Indeed, in October, the BoJ is likely to step-up its stimulus of its quantitative easing program.

Gold net position is still long. It is likely that this figure is undervalued as the ratio between paper and physical have reached an astonishing 200 ounces of paper gold for one single ounce of physical gold. In addition the physical gold demand is very high.





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