WEEKLY MARKET OUTLOOK

21 - 27 December 2015

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WEEKLY MARKET OUTLOOK - An Overview

Economics

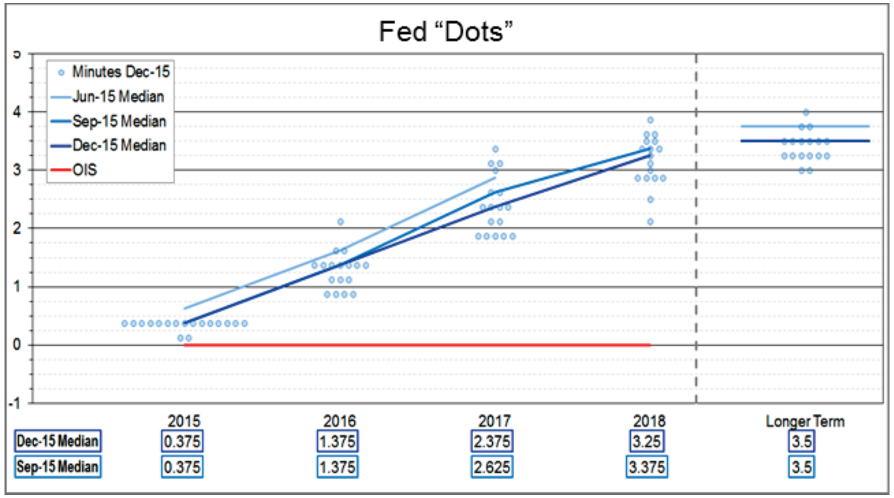
Fed Finally Hikes

In what turned out to be a central banker master-class in communication the Fed increased policy rates by 25bp, to 25-50bp, for the first time in a nearly a decade. And the market's reaction was negligible. Fed Chair Yellen was deftly able to balance hawkish "dots" accompanied with a dovish statement. The net result was that risk appetite has remained firm as equity markets continued to trade higher. Emerging markets, a potential flashpoint, have absorbed the hike well as local yields and currencies have remained subdued.

In a unanimous vote the FOMC communicated their belief that the pace of rate hikes would be "gradual", but at a steady pace, whilst keeping Fed fund rates low for an extended period of time. The committee indicated that each meeting would be "live" and "assess realized and expected economic conditions" indicating the data dependent nature of further policy action. Currently, the projection for Fed fund rates stands around 1.4% by end-2016, which is 50bp above what the rates futures are showing. The Fed emphasized the importance of exchange rates risks indicating that policy expectations could weigh on USD bullish momentum. Our optimistic view is for the Fed to hike rates 75bp (3 rate hikes) in 2016, which is more than currently priced in to the futures (but only marginally). Our sluggish inflation expectations is based on strong USD, low oil and imported deflationary pressure indicates fed "dots" are overly optimistic.

What's next for the USD?

The developed market divergence theme has cooled after less dovish ECB easing and dovish Fed rate hike. Economic data in Europe has recovered while the effectiveness of additional QE has been called into question, indicating further policy easing is less likely. While the Feds expectations for restricted inflationary pressures will keep the "dots" curve shallow. The interest differential is likely to spread only marginally in 2016 indicated the significant downside (parity unlikely) in EURUSD is unlikely. We could see early improvement in the USD as investors rotate from EM into developed market currencies. Yet once sided buying in USD is dubious. It's likely we see the bottom of EURUSD in 2Q 2016.



Economics

Mexico: On The Fed's Path

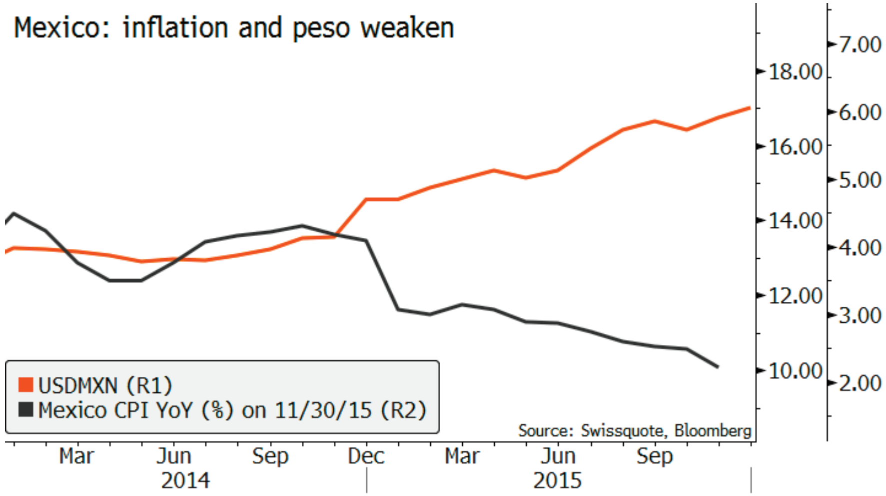
The whole world had awaited the U.S FOMC decision regarding the first rate hike. This decision has ended a seven-year period of zero interest-rate policy. In particular, Mexico, which economic situation has to be appraised regarding the extreme dependency to the U.S., had for sure a close look to the Fed lift-off. Indeed, Banxico, the Mexican central bank has the habit to adjust its monetary policy to the decision of the Federal Reserve. In July it even changed its meeting schedule to be able to react more efficiently to any Fed decision.

Hence, it was then clear, after the Fed rate hike, that Banxico would increase rates by 25 basis points to 3.25%. Overall, the move may appear early or even dangerous as the current inflation fell at 2.21% year-on-year, lowest level since 1968 and below the central bank's 3% target. Yet, the necessity to preserve the Mexican currency against the dollar has obliged Banxico to increase its rates in order to avoid the narrowing of the gap between the two countries' benchmark rates as U.S. treasury yields are moving higher. A predictable capital outflow would have resulted from any inaction of the Mexican central bank.

We remain suspicious as this decision is in nature to impact negatively the domestic economy. For the time being, the current state of the Mexican economy looks better with GDP for the first three quarters of 2015 averaging at 2.35% year-on-year. In the same time, the peso has lost almost 14% against the greenback this year. The currency weakness has affected durable goods price and increased downside pressures on inflation.

The major issue is that Mexico keeps 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 as an important part of its revenues are from the oil export. And this is not likely to stop as the WTI crude oil futures are trading around their 6 year-lows below $35 in a context of global oversupply.

Mexico is then on a difficult situation and the fact that the peso has been constantly dropping against the dollar for four years does not help. Even worse, the Fed rate hike will push up the demand for dollars. As a result, Mexico is not only struggling with its own economy but also with high expectations from financial markets towards the first world economy.



Economics

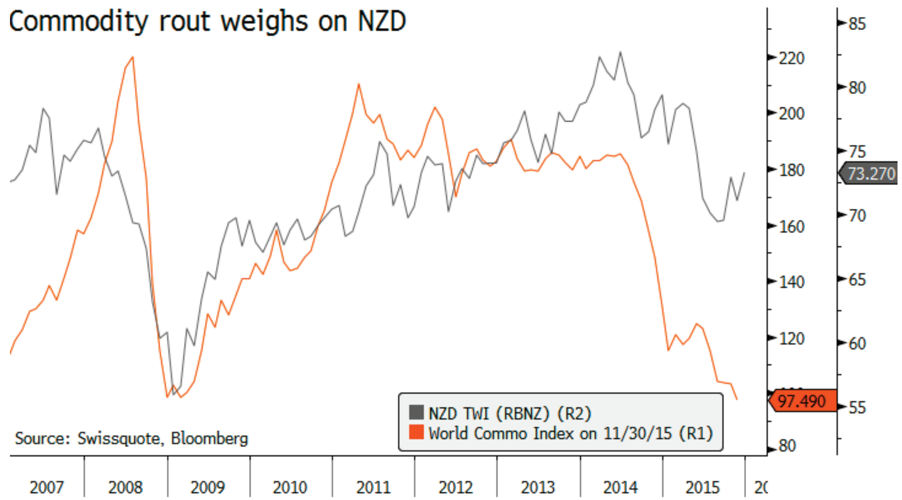
NZD Exposed To Downside Risk

A few central bankers across the globe counted on the Federal Reserve to help them deal with weak global growth and lingering disinflationary pressures. They feel relieved now. Countries such as Canada, Australia and New Zealand should take advantage of this decision as it would maintain the greenback at a high level against their respective currency. This dollar strength should help them to reach their inflation target and support growth through an increase in exports volume. On the other hand, emerging-market countries that have a substantial part of debt denominated in US dollar - such as Indonesia, Mexico, South Africa, Turkey or Brazil - will likely feel the blow due to higher debt-servicing costs and renewed inflation pressure (for some of them).

The Reserve Bank of New Zealand definitely stands among the lucky ones as Janet Yellen took weight off of the RBNZ's back by increasing the federal fund rate last Wednesday. Indeed, the move will prevent Governor Wheeler to lower the official cash rate further. As a reminder, the OCR was trimmed four times over the past eight months (from 3.50% to 2.50% on December 10th) in an attempt to boost exports and to bring inflation back within the 1%-3% target range. Looking at the latest projections, the RBNZ pushed back the timeframe for reaching the inflation target by roughly one year compared to the previous forecast on falling crude oil prices. In its MPS from December, the RBNZ expects headline CPI to reach the bottom of the target range in early 2016 and to move toward the mid-point at the very end of 2017.

In spite of this drawback, the RBNZ is more optimistic on growth as it revised higher its forecast. Despite a fall in dairy prices and, to some extent, a decline of prices foe forestry and meat products, the central bank increases its GDP forecast for 2016 from 2.1% to 2.2% and from 2.5% to 2.9% for 2017, compared to September's estimates, as the central bank expect a pick-up in export prices and strong population growth.

Overall, we expect commodity currencies to remain under pressure in the foreseeable future as the slowdown of the Chinese economy will continue to weigh on global demand, and therefore prices. In the wake of the Fed historic decision, the Kiwi fell roughly 1.50% in a couple of days, down to $0.67. The NZD remains exposed to selling pressure, especially since the commodity rout is not done yet.



FX Markets

IMM Non-Commercial Positioning

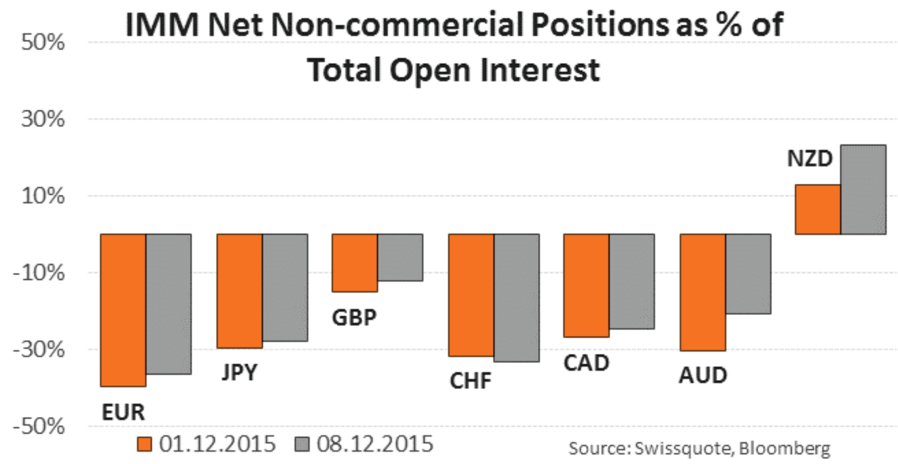
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

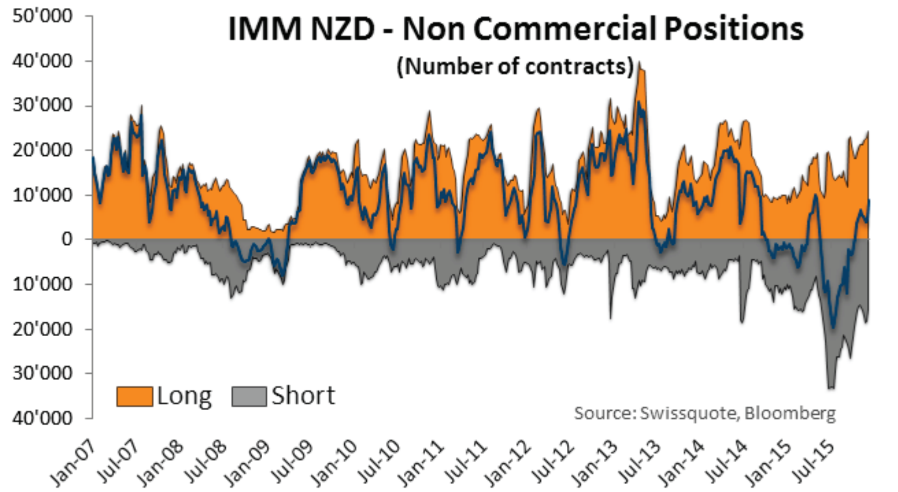
The IMM data covers investors' positions for the week ending December 8th 2015.

The data suggests that investors reduced their long USD position ahead of the FOMC meeting. Investors did not want to overprice the effect of a rate cut on the USD and preferred to reduce long USD positions.

NZD longs increased substantially over the week and reached more than 23% of total open interest as investors became more optimistic on the growth outlook. However, the rapid acceleration of long positioning increases the probability of reversal.

In Australia, short positions have decreased for the third consecutive week as the Reserve Bank seems reluctant to cut rate further. However, concerns over China's growth outlook should prevent traders to add long positions.



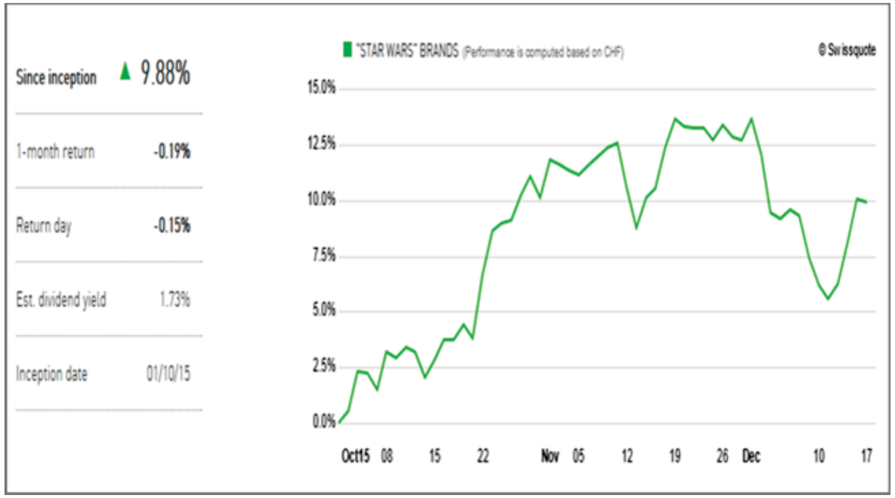


Themes Trading — "Star Wars" Brands

The wait is finally over – "Star Wars: The Force Awakens" was released worldwide on December 16th, to unprecedented fanfare and global earnings expectations. Early reviews have been significantly positive. According to Variety magazine, the seventh film in the franchise has become the all-time record breaking pre-seller of tickets, generating more than $50 million in advance sales. Demand has been so high that extra show times have been added during the opening weekend. Forecasts anticipate that over $200 million will be generated on the opening weekend alone.

With an estimated production budget of $200 million ($190 million more than the 1977 title "Star Wars: A New Hope"), plus the $4 billion paid to acquire Lucasfilm, franchise owner Walt Disney cannot simply count on legions of fans: it must also generate lucrative revenue through sponsorship deals. Disney has therefore sold significant promotional and merchandise licensing rights. From automotive manufacturers to video game makers, a range of companies are expected to exploit the global phenomenon. One major US bank has estimated that Disney will see a 200% increase in merchandise sales (approximately $500 million) because of Star Wars. In addition, with new movie releases due every year between now and 2019, companies who board the train early should continue to see enhanced revenues.

This theme was built using companies that have direct deals and/or revenues directly related to the Star Wars franchise.



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