WEEKLY MARKET OUTLOOK

1 - 7 February 2016

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WEEKLY MARKET OUTLOOK - An Overview

Economics

SNB Relieved At Falling Franc

The new sight deposit data that came earlier last week showed that the SNB is clearly not intervening to maintain a stronger EURCHF despite dovish performance from Mario Draghi a week earlier. The domestic sight deposit declined slightly to CHF 403.1 billion from CHF 403.8 billion even though the amount of deposit trend remains positive since the abandoning of the floor just over one year ago. We assume from Draghi's statements that ECB March's meeting will be more significant with bets on for a review of the current monetary policy and an increase in stimulus (currently €60 billion per month).

Over the past months, the EURCHF has been slightly grown and is now currently trading well above 1.1000 for the first time since September last year. The Helvetic currency is still feeling the effects of upside risks due to its safe haven status and current global uncertainties, namely lingering low commodity prices and high geopolitical risks.

In a world where actual returns are very difficult to grasp, the Swiss currency is more and more used as a funding currency. This is of course providing some relief to the Swiss National Bank which is still concerned about the overvaluation of the currency. The continued weakening of the Helvetic currency against the single currency is also proving the market confidence in the European Central Bank's policy despite continued announcement that the institution will do “whatever it takes” to drive up inflation.

It also seems that we are not in a full risk-off environment. The Global turmoil, the Chinese slowdown and current equities losses are not yet sufficient to give back the safe haven status to Switzerland. For the time being, the yen looked much more attractive attractive due to the fact that the overnight rate, even though very low, was positive. A long position in the Japanese currency provided interests until last Friday when the BoJ cu -t rates. Anyway, investors will favour the yen as long as their interest rates will remain higher than those of Switzerland. Last but not least, the Swiss economy is at stake, for example December Trade Balance has been released this morning well below expectations are CHF 2.54 billion vs CHF 3.14b and the exports are also suffering with a continued declined to -1.4% m/m vs a prior revised data of -3.3% m/m for November.

Anyway, we believe that there is a threshold for which a too strong risk-off environment will drives inflows of capital toward Switzerland. For the time being, confidence is still there, monetary policies around the globe are still believed to be efficient to help countries to recover from current economic slowdown.

As a result, we think that the EURCHF may go up to 1.1200 but not above. Downside pressures will then be too strong.

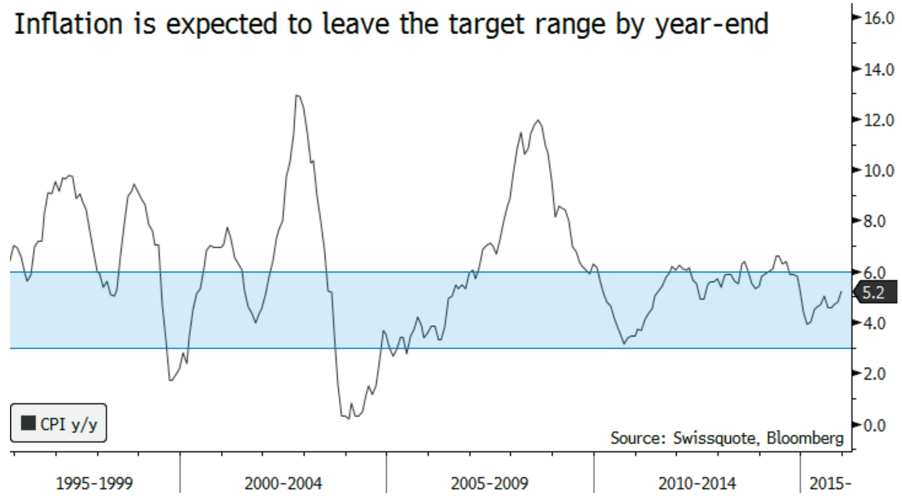
Economics

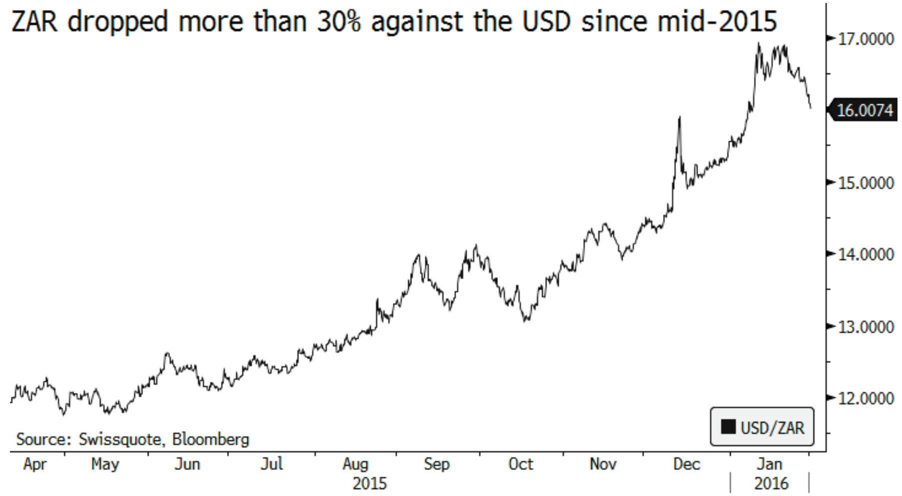
After Brazil, South Africa?

As broadly expected the South African Reserve Bank hiked interest rates last Thursday in reaction of a deteriorating inflation outlook. The Bank increased its benchmark rate by 50bps to 6.75% as the de-anchoring of inflation expectations, together with renewed pressure on the rand have left the SARB with little choice. CPI inflation rose to 5.20% in December from 4.80% in November as food prices kept ballooning due to a worsening drought while the rand fell to an all-time low against the US dollar - USD/ZAR reached 17.91 on January 10th. Bad news never travel alone - the latest inflation forecast showed a clear deterioration of inflation. Inflation is expected to average 6.8% in 2016 and 7.0% in 2017 versus 6.0% and 5.8% previous estimate, respectively. On the growth side, the GDP forecast was also revised lower from 1.5% to 0.9% in 2016 and from 2.1% to 1.6% in 2017.

Looking beyond, Governor Kganyago will find himself in a similar situation to Governor Tombini where he will have to choose between trying to anchor inflation expectations, at the risk of accelerating the recession, and supporting the economy by staying sidelined. In addition, South Africa is already on the edge of losing its investment grade credit rating - currently at Baa2/BBB-. In our opinion a downgrade is inevitable and it will be rather sooner than later as the higher interest rate environment will damage further the growth outlook.

On the currency side, we think that despite the SARB's best efforts to curb inflation, rand weakness will likely persist in 2016. The main reason being that the central bank will eventually run out of options and just like the BCB, it will have to give up on containing inflation in order to let the economy breathe. On Friday, USD/ZAR was trading around 16.05, down 1.50% amid the SARB decision.





Economics

New Zealand: Monetary Policy Divergence Back On

RBNZ cut interest rates

As expected by the market, the Reserve Bank of New Zealand has kept its Official Cash Rate unchanged at 2.50% last week. This follows the rate cut of 25 basis points at last December's meeting. The central bank is in a dovish mood and hinted that the door is wide open for further easing. Markets now expect the central bank to cut again interest rates at next meeting in March. This would make the OCR at record lows.

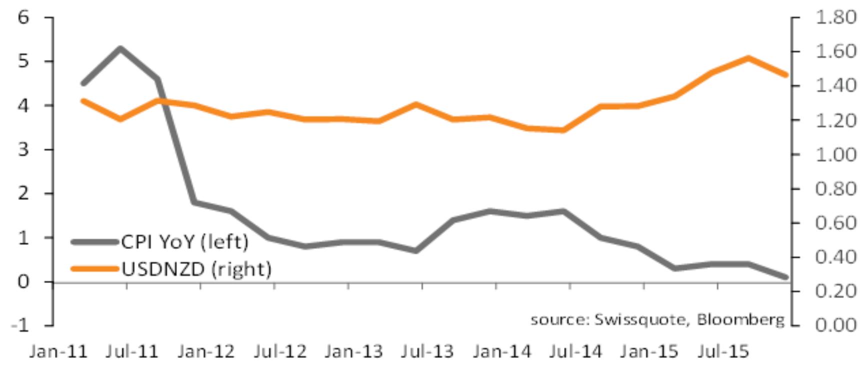
The current low inflation is weighing on the RBNZ monetary policy, which printed for the fourth quarter 2015 well below forecasts (0.1% y/y vs 0.4 y/y). The central bank expects inflation to increase in 2016. Yet, recent core inflation date (excluding food and energy) is in line with the target. It increased by 0.35 in the last quarter. Nonetheless, we remain suspicious regarding the inflation expectations. By the way, Governor Graeme Wheeler looks now way more dovish than in December when he stated that the inflation should be soon back in the middle of its 1%-3% range.

Global uncertainties threat NZ monetary policy

Therefore, global turmoil is also largely affecting the New Zealand economy, especially China's slowdown. Boosting exports for New Zealand is a key goal and we should see continued weakness in the Kiwi despite policymakers being optimistic regarding the domestic economy and growth in tourism and construction (amongst others). Other than the expectations that the economic growth will pick up next year, there is the increasing risk of rising houses prices and a weaker dollar that fully support a further rate cut.

The next rate decision is due March 10th. In the meanwhile we assume that the central bank will be gathering more data in order to try to remove the dovish stance towards further easing. It is obvious that inflation will be the key driver for another rate cut in 2016. Over the medium term we remain bullish on the USDNZD and target 1.6000.

New Zealand: Currency weakens slightly amid threats of deflation



Economists

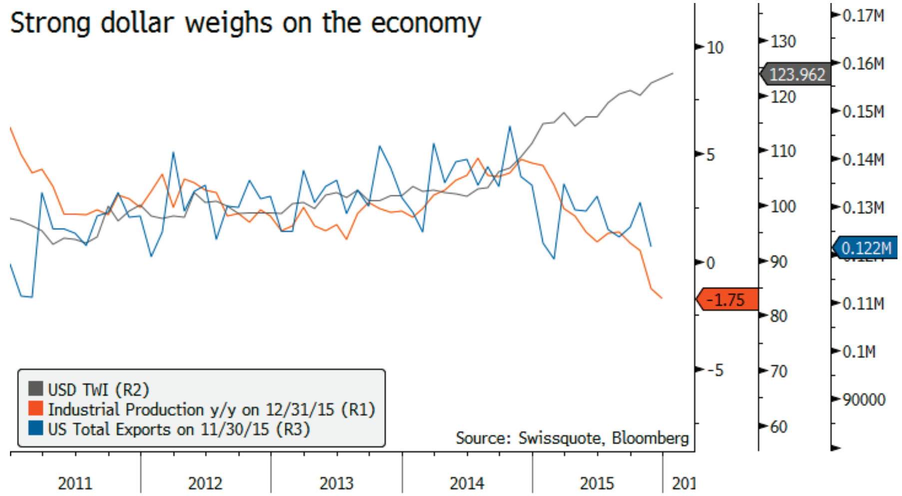
The Fed Is Skating On Thin Ice

So far, the year 2016 has been a tough one for the world's biggest economy. In the wake of the first rate hike in almost a decade the US economy kept on sending mixed signal, especially from the inflation side and the export industry.

After clear evidence of subdued inflation pressure in December - headline CPI contracted 0.1%m/m, while the core gauge rose 0.1%m/m, missing estimates of 0.2%. New orders for long-lasting manufactured goods, released last Thursday, saw their biggest drop since August 2014, contracting -5.1%m/m, while inventories of durable goods climbed 0.52% as manufacturers struggle to export their goods in a strong dollar, low oil price and weak global demand environment. Finally, US 4Q GDP released on Friday missed estimates as it came in at 0.7%q/q annualized versus 0.8% expected and 2.0% previous reading.

The cherry on the cake, the monetary policy divergence between the Fed and the rest of the world bumped up a notch on Friday as Japan switched to negative interest rates. This decision will prevent the JPY from gaining more ground against the US dollar. Moreover, the BoJ's move created another incentive for the ECB to proceed with further monetary easing which would add pressure on EUR/USD. All in all, it will become increasingly difficult for the Federal Reserve to push ahead with its tightening process with everybody else heading in the opposite direction. The dovish tone used in the last FOMC meeting's statement suggests that Fed members are fully aware of that.

On the currency side, we expect the greenback to regain some ground lost recently, especially against the yen. After hitting the top of its multi-day range, EUR/USD is heading south. A first resistance can be found at 1.08, then 1.0711 and finally 1.0524.

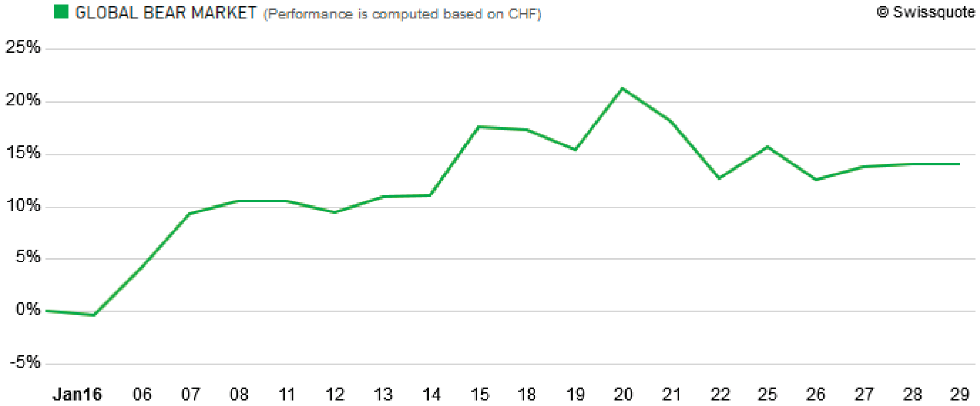


Themes Trading | Global Bear Market

Global equity markets have not reacted well to the advent of 2016, with volatility expected to become the new “normal” for stock markets and central banks shifting monetary policy. The lack of corporate profit growth, the scary decline in oil, China's sharp economic slowdown, high multiples and weakness in credit markets all suggest that further downside in stock markets is a distinct probability. Perhaps the strongest argument is that the current bull market has been fueled by the Federal Reserve's massive bond-buying programs, which have propped up equity market prices and stimulated growth in emerging markets. With the Fed on course toward normalization, artificial growth in asset prices will unwind.

With US interest rates rising, investors are increasingly likely to rotate out of risky emerging market assets and into safe havens. In addition, the Chinese manufacturing sector is struggling with overcapacity after years of over-investment; its only option is to slash prices and flood the global marketplace. This disinflationary dynamic will hurt earnings and create a spillover effect for consumers, further weighing on stock prices. We are unsure whether this is the “big one,” but having a bit of protection in your portfolio never hurts.

We have built this theme using ETFs (Exchange-Traded Funds) with a broad sampling of large cap stocks globally. Using ETFs allows us to effectively short (or sell) stocks in order to benefit from price depreciation.



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