WEEKLY MARKET OUTLOOK

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WEEKLY MARKET OUTLOOK - An Overview

Economics

Swiss Economy Feels The Heat

According to the report released by the Swiss customs, exports contracted for a third straight month in January as the weak global outlook continues to weigh on the sale of high value-added Swiss products. Export contracted 1.1% m/m (s.a.) in January or -3.9% y/y, following a downwardly revised contraction of 1.5% m/m in the previous month (or -0.9%y/y). The fall in exports was mainly driven by the sharp contraction in machinery and electronic products and watches exports, which contracted -11%y/y and -8%y/y respectively. Exports to most continents have also decreased substantially (Latin America: -16%; Asia: -5%) in response to a worsening global outlook and fears over China's growth prospect. However, thanks to a strong greenback, exports to the United States rose 3%, while the incipient upturn in the euro zone economy boosted exports to member countries (euro zone: +2.3%; France: +10.8%; Spain +14%). On the imports side, the long-term effects of the strong Swiss franc continue to weigh more heavily on Swiss companies' growth prospects; however the current weakness in crude oil prices provided some respite as imports rose 2.5%m/m (s.a.). Overall, the trade balance reached CHF3.51bn in January, up from 2.59bn in the previous month.

The SNB's decision to remove the EUR/CHF floor in January 2015 has forced Swiss companies to reduce their margins to increase competitiveness. Even though Swiss companies have made significant efforts to adjust to this strong CHF environment, the process is not over yet as more efforts are still required to ensure the viability of Swiss companies over the long-term. Unfortunately, companies have little freedom left to adjust their margins further.

Job market under pressure

The latest job report showed that the ILO unemployment measure (International Labour Organisation: it allows international comparison between unemployment measures) rose to 4.7% (not seasonally adjusted) in the last quarter of 2015 from 4.1% a year earlier. On the other hand, the job situation improved substantially in the European Union with the unemployment rate falling to 9.1% from 10%, while in the euro zone the gauge fell to 10.6% from 11.5% in 4Q 2014.

Overall, we expect the Swiss economy to continue to suffer the consequences of the removal of the EUR/CHF floor by the SNB a year ago. We therefore expect the job market to come under renewed pressure over the next few months. On Friday, EUR/CHF was stabilising above the 1.10 threshold as the EU summit was about to end without any EU/UK agreement.

Economics

Markets Fear Deutsche Bank Is The Next Lehman

A very concerning balance sheet

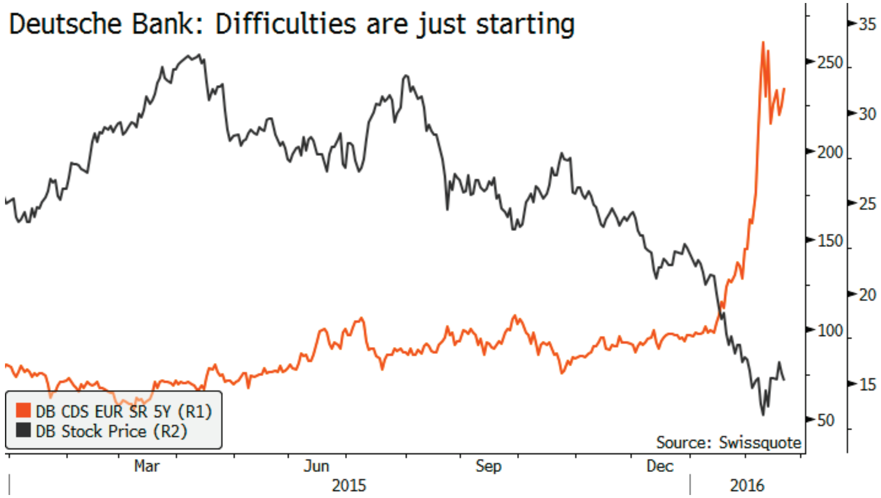
There is volatility in the market and risk sentiment is largely increasing. The JP Morgan Volatility index is now around its highest level in twelve months. In particular, there are huge concerns that Deutsche Bank may be in a very difficult situation. Its stock price has lost more than 50% in less than a year. The share is currently trading above €15, increasing only because of buyback news. This bank is well known to have the biggest derivatives exposure in the world - currently estimated at around €55 trillion, compared to German GDP which tops around €3 trillion -. In addition, the amount of deposit is around €532 billion, representing less than 1% of the overall derivatives exposure.

However, markets do not clearly fear, at the moment, the derivatives exposure but more a fixed income product whose name is CoCo. This product is almost unknown from the general public. DB has €1.75 billion worth of CoCo bonds which trading price fell below 75 cents. The issue is that CoCos are kind of perpetual bonds which may only be redeemed from the bank's decision. Investors chose those kind of instrument under the assumption that these securities could be converted to equity. Yet, Deutsche Bank stock price has declined 25% since the beginning of the year. Last but not least, Cocos belong to the high-yield securities class which allows bank to skip interest on them in case of the bank is running with difficulties.

Future looks uncertain

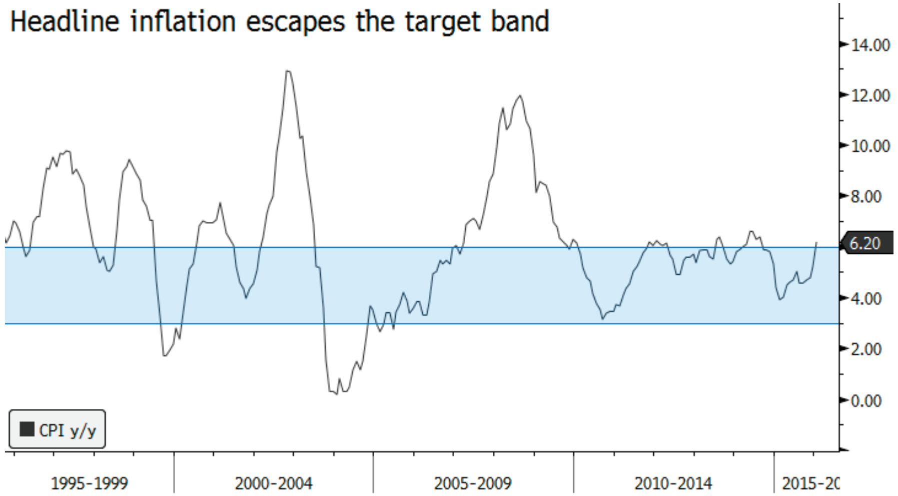
Those uncertainties brought German Finance Minister Wolfgang Schauble to declare that he is not worried about Deutsche Bank's solidity in order to prevent any fears that would result from ongoing uncertainties. Yet, we remain suspicious regarding the bank's ability to meet its CoCo obligations. The bank also needs to meet Tier 1 capital ratio of 10.75% this year.

The bank's situation is definitely very concerning. For example, last October, CEO John Cryan had announced two years of dividend cuts and in January it is no more than 15'000 jobs that will be sacrificed. As a result CDS on DB (a contract that gives protection against the default risk of the German bank) is currently largely increasing. We also consider that the German bank's issues are a reflection of the overall banking situation. This certainly justifies the huge increase in demand for physical gold in London over the past week.



Economics

Market Awaits South Africa's Budget Presentation



According to the latest CPI report from South Africa, inflation accelerated substantially during the month of January. After having accelerated to 5.2%y/y in December, headline CPI broke the upper band of the target range (3%-6%) as it surged 6.2% in January, beating the median forecast of 6.0%. The constant pressure on the rand together with the sharp increase in food prices, mainly due to a worsening drought, have exacerbated inflationary fears as both the economic and inflation outlook have deteriorated further over the past few months. Unfortunately for Governor Kganyago, the weakness of the domestic situation, coupled with the global risk-off sentiment will put the SARB in a tough situation. The South African Reserve Bank already increased its benchmark interest rate by 0.50% to 6.75% in late January in an attempt to re-anchor inflation expectations. However, given these exceptional market circumstances, the SARB will have no choice but to proceed with another rate hike at its next meeting in mid-March.

On the political side, the deteriorating growth outlook, which could be exacerbated by further interest rate hike by the SARB, has put the country's investment-grade credit rating at stack. The pressure on the government has increased another notch as the market expects officials to step in to curb budget deficits. South Africa's budget presentation for 2106/2017 is due on February 2016 and will likely drag the market's attention. USD/ZAR ended last week treading water at around 15.45 as the risk environment was slow to improve. External developments will likely remain the main drivers ahead of next Wednesday's budget presentation. With US CPI beating market consensus and renewed pressure on commodity prices, the risk will most likely remains on the downside for the South African rand.

Economics

U.S.: Economic Fundamentals Remain Soft

Markets too optimistic on housing starts

Housing starts and building permits were on last week's calendar. Economists forecast an increase of 2% m/m of new constructions increasing from the December data where new housing declined by 2.5%. Yet, data has shown a decrease of new housing at 3.8% m/m for January. In the same time, building permits decreased 0.3% m/m. It is important to notice that the current housing starts number is well below the allowed building permits data (1099k vs 1202k) which reflects the continuing weakness of the U.S. economy. Yet, January was the tenth straight month that housing starts are above a million units.

Also of note is that better labour markets as well as a growing trend in wages should normally boost housing market. Yet, we consider that recent housing data are still not sufficient to trigger a Fed rate hike in March. For the time being, markets are excluding any Fed action next month as inflation currently lies far away from the Fed's target range of 2%.

Consequently, it is also clear that better labour markets have not spurred inflation as we believe that the reserved army of workers on the sideline is way too big to boost wage growth sustainably. As a result, we expect that the current increase in housing starts should further slow. It is then likely that the greenback should weaken against the euro.

Minutes shows that the Fed is backing off

The U.S central bank has released its minutes from January's FOMC meeting. As expected, the discussions revolved around global financial conditions. Indeed, policymakers are concerned that the fall-out could hit the U.S. economy. Significantly, the Fed discussed changing the central bank's rate path for this year.

What is clear is that we should not see four rate hikes this year. We maintain the same view we had before December's rate hike that such a move had only be made in order to ensure confidence in the central bank as financial markets were more than expecting a rate hike. Economic conditions were in any case insufficient for triggering a rate hike and we can evidently see that we are not even close to seeing a new raise.

Geopolitical risks are also of major concern for the Fed. Indeed, there is an urgent need for the U.S. to ensure confidence in the dollar. The many global conflicts the U.S. is involved in may provide the start of an answer. Many countries are now trying to get rid of the dollar from their exchange. The latest country to do this is Iran which claims that it is paid in euro for its oil.

As a result we strongly believe that the Fed's monetary policy does not only depend on economic data in the U.S. but also on geopolitical risks. The Fed for now is definitely backing off.

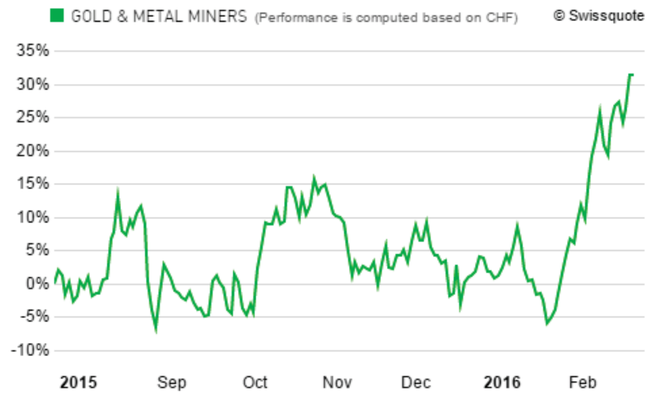
Themes Trading

Gold & Metal Miners

The sudden collapse in commodity prices in 2014 sent mining stocks into free fall. In the long term, however, precious metals – and gold in particular – are the perennial go-to sources of protection against inflation and economic downturns, something investors should be looking out for. The gold market is dynamic, and there are compelling reasons why gold producers could rally. Consumer demand remains solid, with around 2,500 tons of gold mined worldwide every year. Over the long haul, gold as a commodity has appreciated by more than 287% over the past 15 years; by comparison, the S&P 500 has gained less than 44% over the same period. In a period of central bank policy shifts, it is reasonable to envisage a rebound in metal prices – something mining stocks will benefit from. Gold miners are a good way to tap into the benefits of precious metals without paying storage costs.

Analysis & Portfolio - Swissquote Bank Strategy Desk

Since inception	▲ 31.33%
1-month return	34.52%
Return day	0.01%
Est. dividend yield	0.03%
Inception date	20/07/15



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