WEEKLY MARKET OUTLOOK

7 - 13 March 2016

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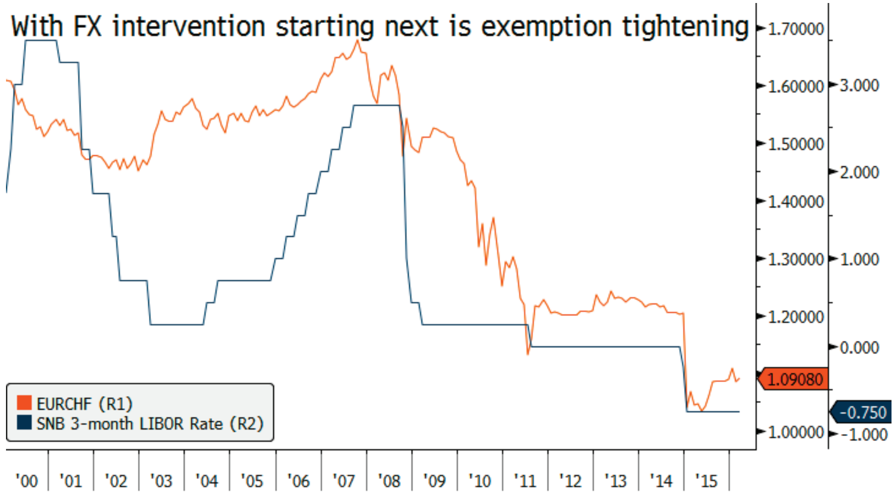
WEEKLY MARKET OUTLOOK - An Overview

Economics

Intervention Threats Fall On Deaf Ears

Clearly the macro risks for continued CHF strength against the EUR are building. Expectation for the ECB to push rates in more negative territory (which limits the effectiveness of the SNB own negative rates strategy) combined with global risk aversion (including Brexit) have sent traders back into the traditional safe-haven CHF trade. Yesterday, EURCHF traded down to 1.08104 (1-month low) before unforeseen demand sent the cross higher. SNB president Thomas Jordon's strongly worded remarks this weekend, which confirmed for the first time the possible use of reducing exemptions on the majority of domestic banks' reserves from negative deposit rates, have renewed speculation of coming intervention. The signal was a public indication the SNB is worried about the direction of EURCHF. This has put traders experience with the SNB on high alert. While the SNB has a history of devastating proactive policy, in our view, we need a break below 1.0700 before the SNB would risk aggressive action (lack of change in option prices support this).

The wait-and-see approach (supported by expanded aggressive verbal intervention) is primarily based on the limited effectiveness of the SNB primary policy tools; direct FX intervention and negative deposit rates. The most powerful tool a central bank has is credibility and launching policy that is ineffective erodes credibility. The SNB has suffered in recent years unable to sustain weakness in the CHF. The SNB probably have conducted small FX intervention as suggested by this week's sight deposits and January reserves data, yet the SNB's bloated balance sheet restricts the awe-inducing influence of intervention. That said it's an easy tool and suspect less hidden direct intervention will be seen before tighten exemptions. However, should intervention fail to halt CHF appreciation and the ECB looks to cut rates further, the SNB is highly likely to tighten negative rate exemptions. Should these conditions be met, the period around the ECB meeting on March 10th and SNB scheduled March 17th policy meeting, looks prime for further SNB action.



Economics

China Long Adjustment Process Toward Stabilisation

It's been a while already since China lost its title as the world's main growth driver as the economy continues to adapt to the "new normal" of slower growth, shifting toward a domestic generated growth from an export driven one. Since mid-2015, the yuan has been under increasing pressure - falling almost 6% against the US dollar - as the PBoC stepped in to try to manage a soft landing for the economy. Since January 2015, the People's Bank of China has cut rates five times, which brought the 1-year lending rate down to 4.35% from 5.60%, while lowering the reserve requirement ratio for major banks also 5 times, bringing the ratio down to 17% from 20%. However, as the market expects further downside to the Chinese economy and anticipates the PBoC will provide further support to the economy, which would over the medium to long-term further weaken the yuan, this creates a situation in which investors have started to cash in rapidly. As a result, China has experienced massive capital outflow over the last few months, which made its forex reserves melt like snow in the sun.

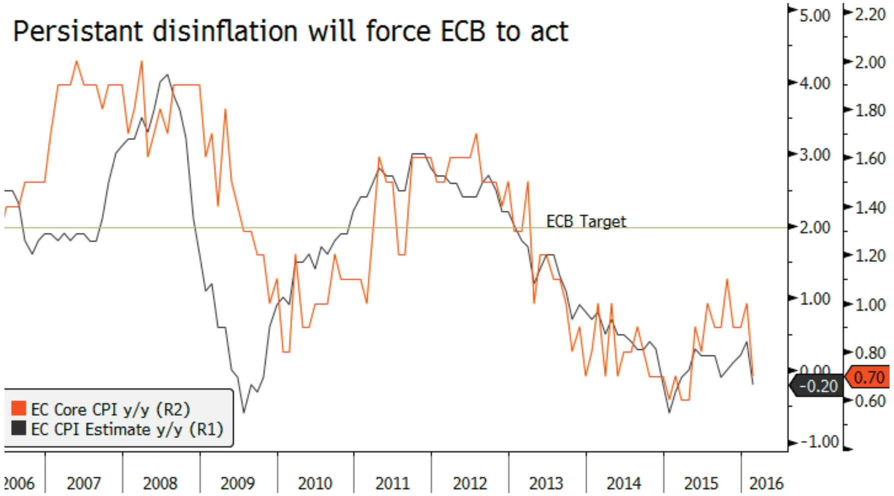
In such an environment - and we didn't talk about the state-owned zombie economy yet - Moody's decision to lower the outlook on China's credit rating to negative from stable - but maintain the Aa3 investment grade - wasn't a big surprise. The rating agency argued that the rapid depletion of FX reserves and rising concerns about China's ability to make the required fiscal adjustments to face the new weak global demand environment justify the negative outlook. In our opinion, given China's gloomy economic outlook, it would make sense to see a credit rating downgrade as early as this year. On the currency side, we expect further yuan weakness as the PBoC will have no choice to further ease its monetary policy as the government starts to implement tighter fiscal conditions. China is therefore not yet done with capital outflow.

During the weekend, Chinese leaders will meet in Beijing for the National People's Congress (NPC). China's biggest political event will allow the market to take note of the party annual GDP target among other government reports. However the market is also expecting to get some answers regarding how the government is going to address China's problem of overcapacity. Nevertheless, the expectations are relatively low, especially given the tentative steps taken by officials so far.

Economics

Waiting For The ECB

EURUSD continues to trade in thin volumes making price action choppy and directionless. Ahead of the ECB rate decision on 10th March, traders are increasingly cautious about Euro positioning. With crude prices dipping lower and further deterioration in Europe's economic outlook, the ECB will be forced to act. Against this backdrop we anticipate that the ECB will lower its inflation forecasts for 2016 from 1.0% to 0.5%, well below the 2% target. With the inflation outlook heading in the wrong direction, and a majority of ECB members demanding a proactive strategy, markets are anticipating more stimulus. Yet for traders, the exact make-up of the easing will define the near term direction of FX. Another important factor will be the disappointment felt by traders in December as monetary stimulus failed to live up to the hype. The lack of aggressive action sparked a sell-off in government bonds in Europe and US. We expect the ECB to cut the deposit rate by 10bp (to -50bp, below expectations for 12bp) and increase its monthly assets purchased by €10bn (to €70bn currently). Given the lack of liquidity it's likely that the ECB will adjust the composition of QE to include 'semi-public' debt (50% or more owned by EU governments) in its purchase program but will limit the rating threshold. There is also the probably that the duration will be extended (however, not our baseline view). We do see scope for additional depo rate cuts yet the ECB will opt to keep its powder dry given the near-term event risk ahead (Brexit and Spanish's general elections). Given the damaging effect the ECB negative rate policy is likely to have on banks in this high excess liquidity environment, we expect that the ECB will launch a multi-tiered system to protect at-risk participants. Should the result come in close to our baseline scenario we anticipate a rally in EURSD as the strategy is broadly priced into. Finally, this micro-tuning of ECB current policy indicates an exhaustion of monetary policy ideas, potentially a loftier driver of long-term FX pricing.



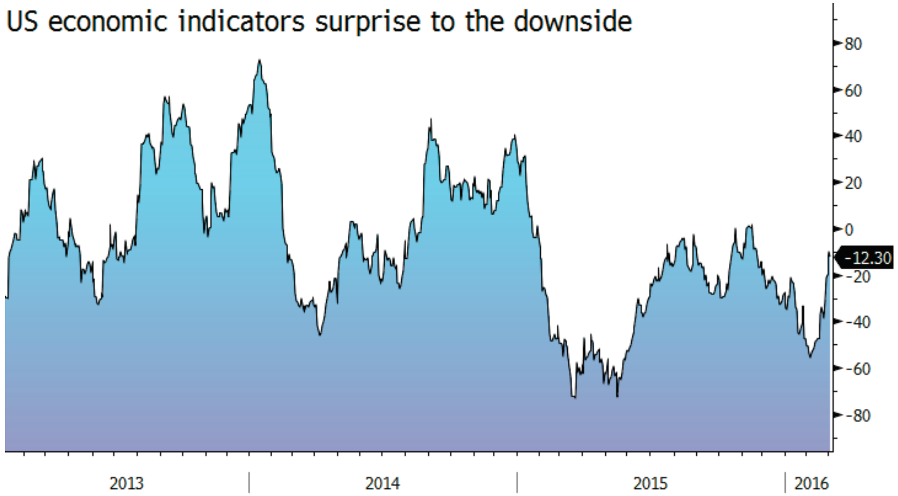
Economics

US Economy Keeps Sending Mixed Signals

The US economy seemed to have started the New Year on a firmer footing. Indeed, during the past year the world's biggest economy has kept sending mixed signal, forcing the Federal Reserve to delay the start of its tightening cycle to December. However, we are only two months into 2016 and the picture already looked a little bit brighter as most economic indicators stopped printing systematically below market's expectations. As a reminder, only the job market showed continuous improvement throughout the year, while on the inflation front the situation seemed desperate.

2015 is over and 2016 may prove to be a turning point in the US economy. For now, certain indicators are pointing toward a reversal, which may suggest that the US economy should not fall into recession, while other indicators are having a hard time to take off. Friday's NFP report - the last one before the much awaited March FOMC meeting - came in widely above market expectations, printing at a solid 242k versus 195k median forecast, while previous month reading was revised higher to 172k from 151k. However, it seems that the NFPs have lost the influence it once had on market participants' mood as the broader economic picture does not allow any room for excess optimism. The US dollar was trading broadly lower after the release of the figure as traders would rather focus - for once - on the broader picture and more specifically on the wage figures, which came on the soft side. Average hourly earnings contracted 0.1%m/m in February, while economists were looking a figure closer to +0.2%. This will definitely not help inflation to move toward the Fed's target of +2%. However, one should not put the cart before the horse by concluding that the Fed won't be able to raise rates this year. Even the most hawkish Fed members have stopped giving overly optimistic speeches, instead becoming more cautious about the US outlook. More and more market participants are wondering if the US economy is on the edge of a recession or whether this is just a temporary setback (apparently the temporary setback has become seasonal since last year…). In our opinion, it is still too early to ring alarm bells. On the currency side, we expect the greenback to weaken further in the short-term as the trend reverse. However, next week ECB meeting will reshuffle the card as the expectations for a rate cut continue to build up.

US economic indicators surprise to the downside

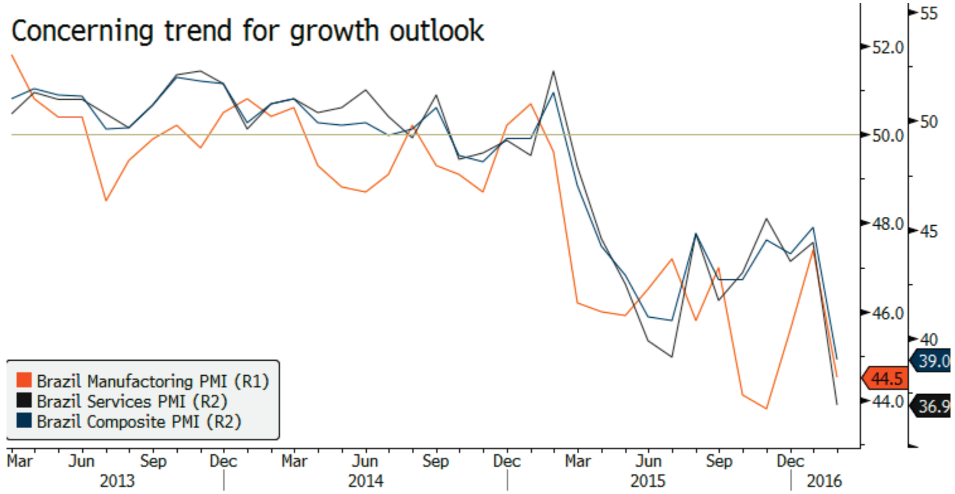


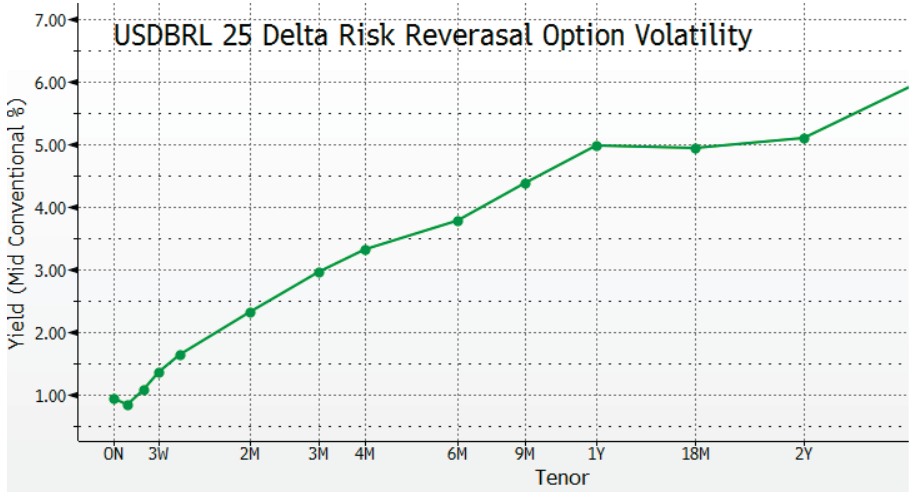
Economics

Brazil: Deeper In Recession But Rate Cuts Distant

As was widely expected the central bank of Brazil voted to hold the Selic rate at 14.25%. However, in a minor plot twist, two Copom members (Tony Volpon and Sidnei Marques) continued to vote for a rate hike of 50bp. Markets had anticipated that the more hawkish members would vote to maintain the Selic rate, thus starting the process towards a rate cut. The post meeting communique provided scant new insight into the thinking of the board members. The statement, which repeated the decision, was based on the evaluation of the balance of risks for inflation, deterioration of external conditions but less erosion on the domestic side and general uncertainty around the macro environment. While the specific rationale for the persistent votes for tightening was not provided at this meeting (as in prior meeting minutes), the higher than expected underlying inflation in February's IPCA-15 print (y/y 10.71% vs. 10.52% exp and 10.67% prior read) combined with rising inflation outlook remains the primary culprit. The board remains skewed to the conservative side, likely to be waiting for a steady inflation slowdown before discussing any policy easing.

In our view, the split vote will not drive the market to price in near-term rate hikes but rather push out policy easing. Expectations for Copom to begin monetary policy easing in August feel unlikely given the sustained momentum of inflation. However, deeper deterioration in incoming data based on deceleration of macro trade and domestically, significant weakness in labor markets, which would lessen upside surprise in inflation and quicken the pace of downward inflation expectations, could shift our view on the timing of BCB's first rate cut. In recent weeks, PMI composite and service both collapsed adding to the growing pessimistic growth outlook. Meeting minutes released on 10th March will help provide guidance on the BCB's next move. We remain short USDBRL as near term macro risks fade and yield starve investors pile back into carry trades.



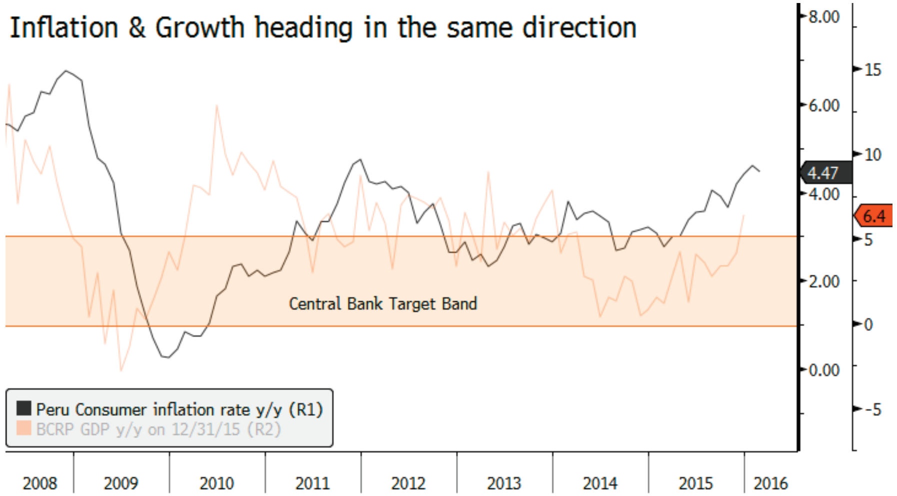


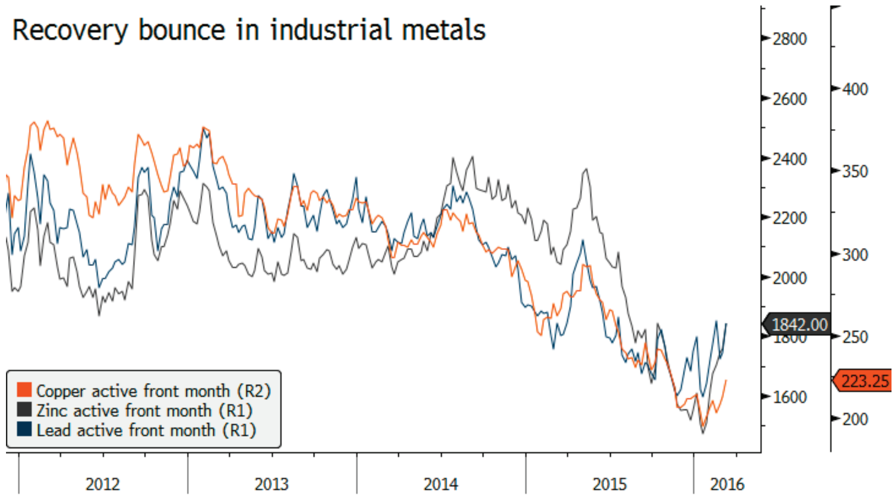
Economics

Higher Copper Prices Should Benefit Peru

Steady positive price development in industrial commodities highlights the potential FX opportunities that a sustained price recovery story could uncover. Peru, with the highest Latam GDP growth rate in 2015 at 3.26%, should see further economic improvement, outpacing market expectations. Heavy investment in copper output is showing returns as production increased 68% m/m in December-a timely development as copper prices have rallied 15% to $224. Price improvement in lead, zinc and iron has resulted in outpaced economic expansion. Our expectations of quicker GDP growth at 3.7% for 2016, a rebound in energy prices and sol's deprecation suggest that inflation will remain above the Banco Central de Reserva del Perú (BCRP) comfort level. A hawkish central bank and expectations for higher interest rates alongside stability in growth outlook will allow the sol to further appreciate.

Despite a breather in January, core inflation (excluding food and energy) picked up in February by rising 0.52% m/m. This pushed the annual read to 3.79%, the strongest pace since July 2009 and well above the BCRP's 1.0% to 3.0% target range. As inflation remains persistently above target, the BCRP will keep its hawkish policy stance by continuing a rate hiking cycle, which began back in September 2015. After three 25bps rate hikes, which brought the BCRP's policy rate to 4.00%, we now expect a further 50bps of hikes to 4.50% by end-2016. With inflation remaining an issue for the BCRP and growth outlook driving demand side price pressure, the undervalued sol should continue to reverse 15% depreciation against the USD. Technically in USDPEN we don't see much demand until 3.3676 and would see rallies as short-term and opportunity to reload shorts for the mid-term trade.



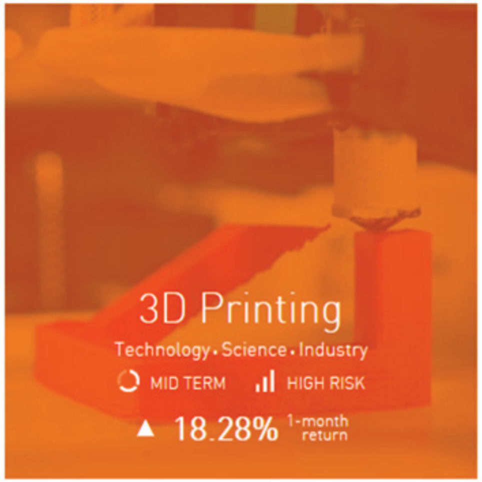


Themes Trading — 3D Printing

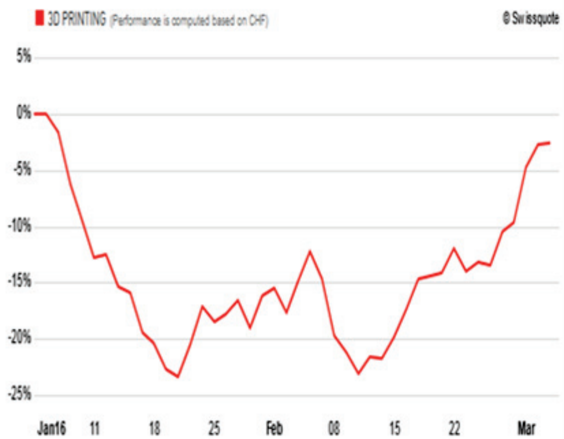
Few inventions in the last five years have grabbed the popular imagination more than 3D printing. 3D printing, or additive manufacturing, invented in 1986 by Charles Hull, is a process of forming a three-dimensional object from a digital model. The additive process consists of laying down successive layers of materials. There are many printing techniques and numerous substances that can be used as additives. 3D printers have quickly moved out of the hobby arena into commercial usage. Peter Sander, Head of Emerging Technologies and Concepts at Airbus, has said the company is now at "readiness level 6 for ALM (Additive Layer Manufacturing) industrialization". Applications are as limitless as your imagination. The technology has already found uses in the medical, aerospace and automotive sectors, and the worldwide 3D printing industry is projected to grow global revenue from $3.07 billion in 2013 to $21 billion in 2020. Despite current limitations in market size, transparency and volatility, investors have still seen the potential in this revolutionary technology.

To build this theme, we screened for companies that generate the majority of their revenue from 3D printing, with no minimum on market capitalization, and with daily trading volumes to ensure tradability so as to access the most groundbreaking names available.

Analysis & Portfolio - Swissquote Bank Strategy Desk



Since inception	▼ -2.57%
1-month return	18.28%
Return day	0.11%
Est. dividend yield	0.00%
Inception date	04/01/16



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