WEEKLY MARKET OUTLOOK

11 - 17 April 2016

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WEEKLY MARKET OUTLOOK - An Overview

Economics

JPY And The Global Currency Wars

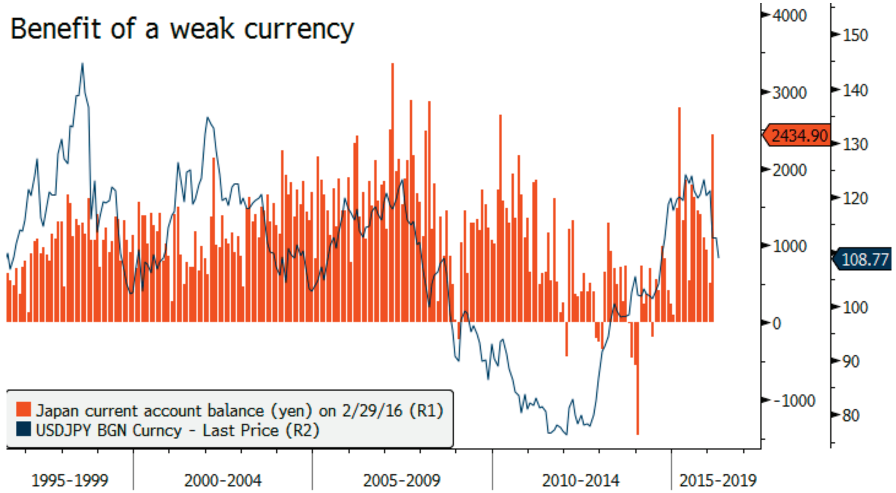
JPY moves "undesirable"

The dominate story in FX markets has been the unrelenting JPY appreciation. Yen strength has reasonable triggered a rash of verbal intervention from Japanese officials (something Japan is familiar with). Finance Minister Aso reiterated earlier calls to take necessary steps against FX moves suggesting that sudden JPY moves "undesirable". Chief Cabinet Secretary Suga step into the fray stated that JPY moves were not based on fundamentals and would act if necessary. The USDJPY was able to stabilize above the 108.00 handle however further downside looks interesting.

Japanese February MoF March flow data indicated that Japan's current account surplus improved in February. Within the data are indications that Japanese domestic investor demand for foreign assets according to weekly portfolio flow data has been increasing. March data indicated that Japanese investors purchased ¥5.47trn in foreign securities after the previous massive month's ¥4.91trn (Investors bought a ¥5.2trn in foreign bonds). However, despite the outflow demand for JPY as investors unwind carry trades (not corporate hedging as speculated). We anticipated that official Japanese rhetoric is likely to increase the close we get to 105.00. The clear spillover effect of strong JPY on import prices all but kills Japanese policymaker's ability to fight disinflation.

Next phase in currency war

While predicting central bank inventions have left many a good analyst bloodied, we believe that the pain threshold of the BoJ in USDJPY is closer to 100-104. First of all PM Abe's statement this week suggested that policy should "refrain from arbitrary interventions in FX markets" and second the broad credibility of the BoJ is already in doubt. Specifically in regards to managing the yen price, we believe that the BoJ lacks real tools to effectively weaken the JPY for extended period of time. Given the deteriorated BoJ credibility verbal interventions have has limited market impact while ineffective direct FX intervention will only further damage the central banks reputation.



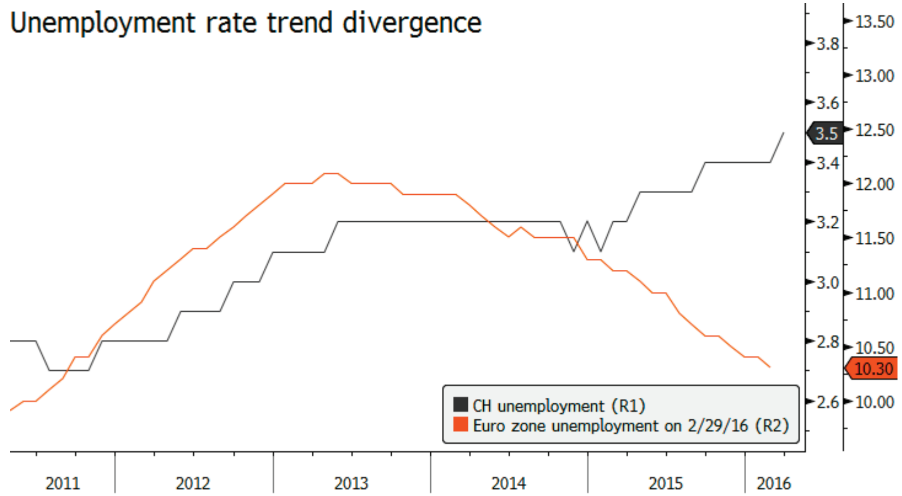
Economics

Swiss Economy Under Constant Pressure

The latest batch of Swiss data suggests that the situation has in fact remained largely unchanged over the past few months as the country continues to suffer as a direct consequence of its safe-haven status. The consumer price index rose 0.3%m/m in March, matching consensus, up from 0.2% in February. On a year-over-year basis, the gauge contracted 0.9%, also matching the median forecast, down from -0.8% in February. The improvement of the monthly increase coincides with the end of February's sales in the clothing sector (prices surged 4.8%m/m) and therefore the effect will be limited and short-lived. Overall, inflationary pressures remain subdued in Switzerland against the backdrop of low commodity prices and a strong Swiss franc. We therefore expect the SNB to revise down its CPI forecast for 2016 (currently at -0.40%y/y at year-end) at its next quarterly meeting on June 16th, as the economy continues to adjust to the strong CHF environment.

Jobs data, which came in on Friday painted a mixed picture of the Swiss job market. Even though unemployment decreased to 3.6% in March from 3.7% in February, the seasonally adjusted measure rose to 3.5% from 3.4% in the previous month, suggesting that the underlying trend in unemployment is not about to reverse just yet. In addition, when comparing the developments in the job market between the euro zone and Switzerland, one notices that Swiss unemployment has in fact risen continuously since 2013, while in the euro zone the measure has started to reverse the trend, falling from 12.10% to 10.30%. Overall, economic conditions should continue to deteriorate further in Switzerland as the country continues to adapt to the strong Swiss franc environment. This process is not yet complete.

On Thursday data showed that the SNB's foreign currency reserves rose 5bn to CHF575.8bn from CHF571.1bn, suggesting that the central bank may have intervened in the foreign exchange market to defend EUR/CHF. This is confirmed by the steady increase of SNB's sight deposits since the beginning of year. Even though the increase remains modest, it highlights the fact that there is no respite for the SNB. Indeed, the central bank cannot lower its guard as speculators would take advantage of the situation at the first sign of weakness. The data suggests that the SNB is moderately intervening in the FX market, just to remind traders not to play around with EUR/CHF.



Economics

Is It Really The Time To Buy Gold

Since December the yellow metal has sharply increased and is now trading between 1200 and 1250 dollars per ounce. For many people, physical gold is useless as it does not provide dividends and has storage costs that can be very high. However, in the last four years, gold has lost more than 30% of its value and a lower gold price indicates confidence in central bank actions. Ironically despite massive and never-ending intervention by policymakers around the world (QEs and low rates) and a risk-off sentiment that dominates, gold has been in constant decline. With regards to the US rate hike, the price of gold in US dollar should have gone down but instead the opposite has happened. Gold has sharply increased since the beginning of the year and the global economic slowdown sustain this trend. In particular, the American economy is under pressure, domestic data are released mixed while a decade of low interest rates should have been sufficient to trigger a sustainable recovery.

The price of gold is low because it does not only represent the state of the physical market. The paper market is a great component of the gold price and while the underlying asset is physical gold itself, the paper market is far larger compared to the physical market. The ratio is an astonishing 200 vs 1. Most banks issue mainly paper ounces driving down the price of gold, resulting in a major counterparty risk. In the result of difficulties in the banking sector due for example as the era of low interest rates, the price of paper gold is set to decrease. However, as physical gold is also included in the overall price, this legitimises the purchase of physical gold which is undervalued. Banks are also experiencing massive exposure to derivatives. When we look at the balance sheet of Deutsche Bank for instance, one can guess how it is possible to be exposed as much as up to 25 times the German GDP. Another important issue is the premium paid for gold on the physical market and this has never been so high due to scarcity.

Economics

Growing Divisions Among Fed Members

It has been a couple of months now that the market has understood that the Federal Reserve had switch towards a more cautious stance, preferring to remain constantly dovish - with the exception of Bullard, the ultimate hawk - in order to avoid to reiterate last December's unpleasant experience when the Fed had no choice but to hike rate to preserve its credibility. The statement of the last FOMC meeting, back in mid-March, was a clear reminder of this new mind-set as it revealed that only two rate hikes were expected throughout 2016, compared to four at the December meeting. Finally, the minutes of the March FOMC, which were released last Wednesday, have confirmed the Fed's cautious approach against the backdrop of weak global economic developments and volatile financial markets. Looking at most USD crosses, it seems that Janet Yellen did a good job preparing the market for the minutes. No sharp move. However, in our opinion, the minutes were actually substantially more dovish than anticipated as it highlighted a greater division among Fed members.

Indeed, the minutes revealed that the Committee expressed diverging views while assessing the US outlook, failing to provide clear forward guidance to market participants. Firstly, the members are split regarding the inflation outlook as "some participants saw the [recent] increase in inflation as consistent with a firming trend in inflation", while others "expressed the view that the increase was unlikely to be sustained" as it was due, to a certain extent, to an increase in historically volatile prices.

Secondly, the committee appeared to be also split regarding the implication of the global economic and financial developments as most participants expressed their concerned that it poses downside risk to the US economic outlook. However, some of them thinks that the actions taken by most foreign central banks to improve monetary conditions helped to mitigate the risk, while others expressed their concerns about the ability of central bankers to limit this risk.

All in all, the minutes shed light on the Fed's internal divergence, suggesting that it is still a struggle to find a common ground among Fed members, especially about the inflation outlook, which is determinant for monetary policy. This lack of consensus is interpreted as a very strong dovish signal by the market as the Fed will not hike rates while its members are not even able to agree on the outlook. We do not expect the central bank to increase the federal fund rate anytime soon. In our opinion, even June is too early as we believe Yellen will wait to see a clear pick-up in the inflation and growth outlook before making the smallest move. The US dollar is therefore not yet close to recover.

Economics

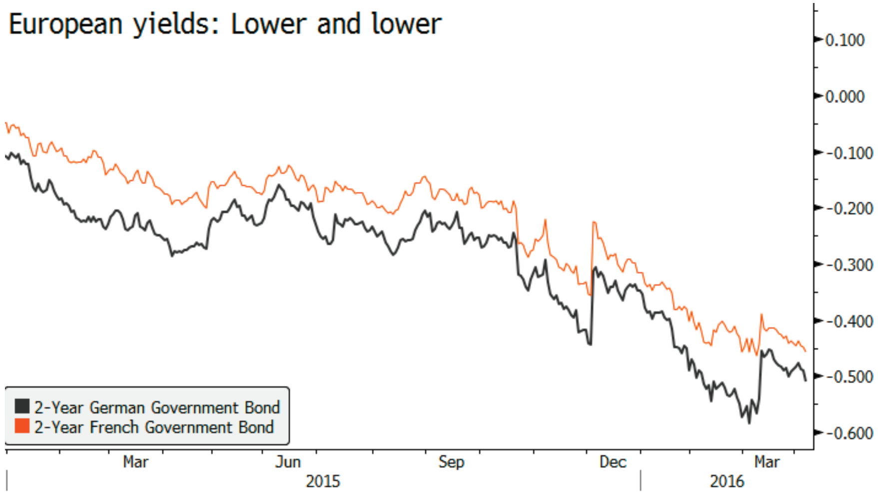
ECB Is Facing Criticism Over Its Monetary Policy

Eurozone fundamentals remain weak. Last week, March final retail sales printed at 0.2% m/m lower than the February release at 0.4% m/m. Consumer sentiment has also dropped as indicated in a recent survey carried out before the recent events in Brussels. It is clear that the European economy is contracting and all the pressures are now on the ECB's shoulders. Current monetary policy has failed so far to deliver the expected results. Economic conditions are also worsened because of lingering low oil prices, despite recent rebound, which are threatening the inflation outlook.

However, we believe that financial markets have already priced in current European difficulties. The euro should not weaken further as results should be appraised on a mid-term horizon. We consider that only internal difficulties such as Greek debt coming back in the picture and sovereignty issues can drive the single currency lower. We are maintaining our bullish position on the Euro against the greenback and we target 1.1500 over the next few weeks. The next ECB meeting on the 21st April should not trigger major moves of the EUR as the central bank is already all-in.

The current monetary policy inefficiency is annoying Germany which economy remains solid. Indeed, after the strongest jump in more than six years in February at +3.3% m/m, Germany Industrial Production growth did not collapse despite markets expecting a very weak read. The data printed earlier last week at -0.5% m/m for March. Domestic demand is definitely helping the German economy as the overall weaker demand adds downside pressures to exports. The country, along with solid economic data, is one of the few, if not the only one, to have a sustainable debt. Servicing its debt is not as heavy as it is the case with other European countries and only represents 71.70% of the GDP.

Hence, despite its other fundamentals being on the right path, inflation, as in the rest of Europe, is not picking up - currently stalling below 0%. And it seems that Wolfgang Schauble is holding the ECB responsible for this situation. The German finance minister considers that only other European countries benefit from the current monetary policy. From our standpoint, we believe that Germany is not the one footing the bill for other countries. It would rather be the entire European population. Austerity policies are the new normal in the continent. While recession in Europe is far from being over, a brief look at debt and revenues from most of the European countries would be enough to convince anyone. Yet, we do recognize that Germany's competitiveness is definitely limited by its neighbours. The first European economy is now blaming Europe. This sounds ironic when we ask ourselves: Is anyone in Switzerland disappointed about not being in the Eurozone…? No.



Economics

Amexit

What keeps us up at night?

Clearly we are concerned about Brexit, the breakdown of Greek/Troika debt negotiation, China's soft landing etc. Aside from these things, there remains one tail risk which really unnerves us. We are calling it "Amexit" and are viewing the series of events which may trigger are to be well within the realm of possibility. We believe that we have a beat on current outlook for Fed policy path and have therefore been correct in forecasting the steady downsizing of 2016 interest rate hikes. Our base scenario is that the healthy US domestic growth has not been able to offset disinflationary pressures leaving uncertainty of international outlook. In this scenario, we anticipate a single 25bp hike in December.

However even the cautious Fed has made it clear that the policy path is data depended. At the fringes there are signals of stabilization / recovery within the Chinese economic data and the potential for an oil production agreement in Doha which could quickly flip our base case. So what happens if the timing of the next rate hike convincingly refocuses on the Fed June meeting? We suspect some chilling consequences.

A series of events which would make us cringe

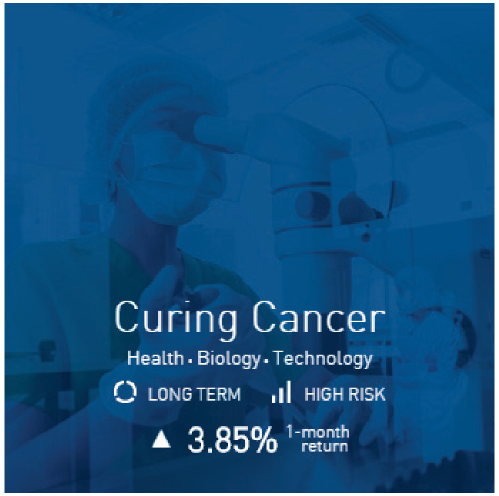
Should Fed Fund futures increase pricing from current 20% to a meaningful above 70% probability, its likely once again that the markets would suffer through another "taper tantrum". The reaction to higher US rates can be exemplified by the rotation of capital into safe-haven assets specifically a sell-off in global equities. A correction in equities will make republican candidate Trump sound prophetic (remember his amateurish sounding call on bubble and recession?). With things then being emboldened by a Fed induced equity correction, Donald J. Trump would likely gain significant political capital heading into a contested Republican Republican convention in July. According to campaign trail promises, Trumps goal is to redefine nearly every social, political and economic pact America has made both domestically and international. Markets will need to begin pricing in America's removal from the international stage or what we call "Amexit".

Themes Trading | Curing Cancer

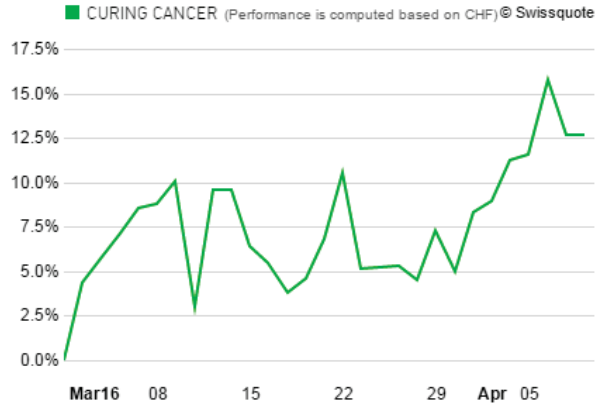
According to cancer.org, it is estimated that 21.7 million new cases of cancer will be diagnosed in 2030. Thirteen million cancer deaths are forecast that same year. And with new lifestyles already suspected to increase cancer risk, these figures are likely to be underestimated. As a result, there are important discoveries to be made, and many companies – including start-ups – are investing time and money to find treatments.

Of course, finding a cure for cancer takes time, dedication and knowledge. Today's investment is tomorrow's cure. It is also difficult to know just what research is being done: findings often appear in confidential reviews. We have therefore selected 12 stocks where research and development is focused on a wide range of medications. Our main diversification is between start-ups and revenue-generating companies.

We have selected five recent start-ups that completed IPOs in 2015 but have yet to release any products. These companies are candidates to become future pharmaceutical blue chips. Beigene and Syndax are focusing their research on developing cancer treatment drugs, while Editas and Avexis are focusing on the gene editing and therapy side. Meanwhile, Proteostasis is in a niche market, focusing on drugs to treat cystic fibrosis. As well as these start-ups, we consider that well-established anti-cancer pharmaceutical companies such as Juno Therapeutics and the very old Bristol-Myers Squibb (founded in 1887) represent a safe bet. As such, we have overweighted revenue-generating companies. However, alpha (outperformance) is likely to come from start-ups.



Since inception	▲ 12.69%
1-month return	3.85%
Return day	0.01%
Est. dividend yield	0.00%
Inception date	01/03/16



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