SWISSQUOTE

WEEKLY MARKET OUTLOOK

9 - 15 May 2016

Swissquote Bank SA | Ch. de la Crétaux 33, CP 319 | CH-1196 Gland | Switzerland
Tel +41 22 999 94 11 | Fax +41 22 999 94 12 | forex.analysis@swissquote.ch | www.swissquote.com/fx

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WEEKLY MARKET OUTLOOK - An Overview

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Economics

Trump Victory Hurts MXN

There are growing geopolitical and domestic economic reasons for taking a short MXN position. After the landslide victory in Indiana, Donald Trump has gone from the long-shot challenger to the Republican Party's presumptive nominee for president. With this shift of events comes the natural inclination to speculate about what a Trump presidential term might actually look like. While we view him as a pathological liar and unlikely to execute many of his blithering campaign pledges, he has so far not backed away from one promise. A President Trump would undoubtedly build a "great, great wall" and make Mexico pay for it. Such an aggressive act of international diplomacy would immediately trigger retaliatory trade barriers. Starting from a day prior to the Indiana primary USDMXN implied volatility jumped, outpacing regional EM peers. Assigning MXN risk premium directly to the US elections is difficult however we see increasing evidence of asymmetric pressure on the currency.

Banxico held its overnight rate unchanged at 3.75% as was widely expected. With inflationary pressure benign and the Fed unlikely to raise rates in June, the central bank does not feel the pressure to tighten. Mexico's GDP growth has been hampered by weak production at Pemex, which has also damaged fiscal conditions. As oil prices linger at low levels the central bank must factor in additional growth deceleration. The accompanying statement was naturally suggesting that financial market volatility was the primary concern to members. Banxico will remain focused on MXN stability and take a proactive approach to declining with the Fed policy path. Should a Fed-inspired EM sell-off threaten inflation conditions we will see Banxico react with further defensive rate hikes.

We suspect that a combination of both issues will weigh on the MXN. With a Fed meeting in June and the Republic national convention in July, appetite for MXN risk is unlikely to return. We short MXN against the USD, JPY and for a regional play, BRL. Only in the event of MXN depreciation becoming unruly will we see FX intervention. An MXN collapse could certainly be triggered by the Republic nomination of Donald Trump as candidate for the 2016 president election.

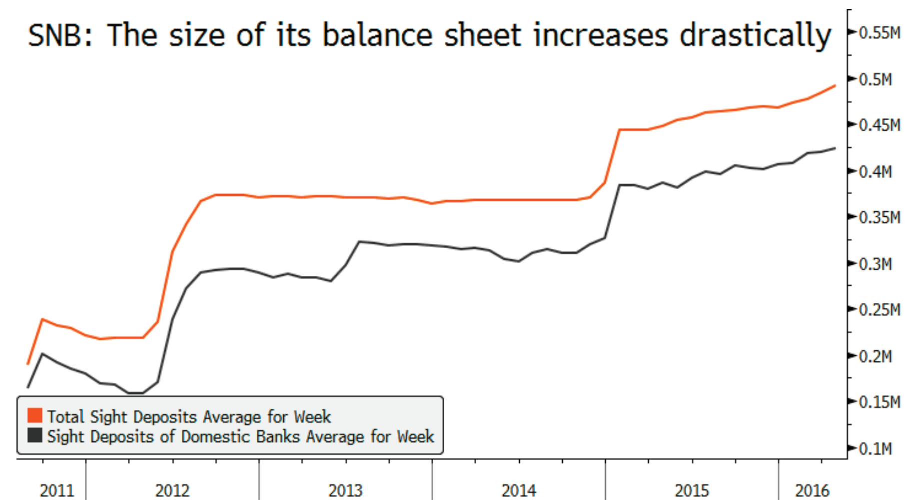
Economics

The SNB Intervenes Slightly To Weaken The CHF

Data released earlier last week are showing that Swiss Total Sight Deposits continue to grow higher, rising from CHF 490.9 billion for the week ending 22nd April to CHF 491.2 billion a week before. We believe that there are growing evidence, that the SNB is intervening in an attempt to further weaken the domestic currency. We also do think that there is the willingness not to communicate on this intervention in order to avoid any adverse bet from financial markets. Since the end of January 2015, total deposits have increased drastically - by more than CHF 50 billion and should continue to expand.

The SNB is closely scrutinising any comment or action from the ECB that could result in further appreciation of the CHF. At the moment, the ECB's monetary policy has not proven its ability to deliver the necessary results. Two weeks ago, Draghi announced that European "inflation should go more negative before bouncing back". The Helvetic currency has been appreciating since, also due to its safe haven status and global uncertainties, namely lingering low commodity prices and high geopolitical risks such as Brexit. Fears of a dismantled European Union is pushing the EURCHF lower and driving the SNB to intervene, even though very slightly, on the FX markets.

Over the past months, the EUR/CHF has grown slightly. Recently the pair has finally erased the strong resistance area located at 1.100 and keeps on bouncing back which confirms underlying selling pressures. Our view on the pair remains bearish but we are also vigilant of any surprise action from the SNB. We do not consider that a new peg is something possible but Switzerland may be forced to use quantitative easing to counter deflation pressures and to defend the currency against a too important appreciation. It is still very unlikely for the time being but a EUR/CHF around 1.05 should force the SNB to anticipate against a larger downside move.



Economics

BoE Rate Decision Unlikely To Influence GBP

Traders continue to search for trigger points to GBP weakness ahead of the UK referendum on the EU, after reduction in "Brexit" uncertainty last week. This week will provide two such events. The market, still short sterling, will get the BoE rate announcement and Inflation Report, is hoping new information will support positioning. The BoE rate decision should be a non-event as the rate markets have priced out interest rate hikes till 2017and therefore its dubious the BoE could sound even more dovish (baring complete reversal of policy direction). The preliminary UK 1Q GDP release and incoming data, such as industrial production and construction (services remain a bright spot), have confirmed a decelerating economy, largely reflecting increase EU referendum concerns. Economic weakness underpins the BoE dovish stance.

The focus of the Inflation Report will be extent of the BoE adjustment of forecasts and contingency plans after the "Brexit" vote. We would expect that any mention of the event will be limited due to the Banks effort to appear neutral. Yet, it will be difficult for BoE`s Carney to stay balanced as his prior views suggest "Brexit" poses a massive economic risk to the UK. Currently the BoE forecasts just gaze over the vote without pricing in either scenario. Yet, regardless of the outcome we suspect extreme economic reaction which is expected to render current BoE forecasts obsolete. Given the binary aspect of the vote it's unlikely that the BoE symmetrical risk in growth and inflation forecasts will provide much insight. Outside the politically correct BoE, its commonly viewed that Brexit will produce a significant growth shock in the UK economy, which is not being accounted for in current forecasts. In order to stay impartial there is chatter that the BoE might provide two forecasts ("remain" and "leave" projections) to handle the event.

The sterling is now up against headwinds in political & event uncertainty and high sensitivity to risk aversion. GBPUSD false breakout above 1.4700, running into resistance at 1.4800 supply area, indicates a reversal in bullish momentum. We anticipate a bearish correction to 1.4298.

Economics

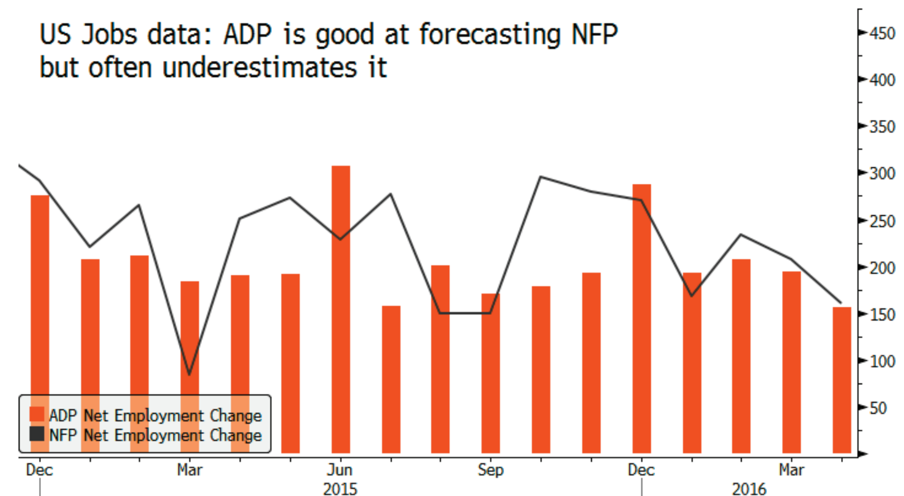
Weak Jobs Data Put An End To Fed Hopes

Earlier last Tuesday marked the starting day of US jobs data with the ADP release ahead of Friday's NFP data. The April ADP Employment change, expected at 195k new jobs vs 200k in March, has printed very weak with only 156k jobs created. We firmly believed that US soft data would one day or another be reflected in some way in the job market and a weaker number was clearly on the table. Last Friday, the change in Nonfarm Payrolls, which was expected to come in today at 200k new jobs, despite being lower than the March prior data, +215k printed also very weakly with only 160k jobs. Our research leads us to believe that despite the current job market momentum seems positive, the health of the U.S economy, and especially of its job market, is overestimated.

Financial markets are still looking for evidence that the Fed will raise rates this year and are unconcerned about their dovish stance especially as a loose monetary policy benefits the stock markets. However, in the long run, the resulting bubble could burst very strongly. The labour market was perhaps one of the best performing US fundamentals (if not the only one) with unemployment at almost 5%. On top of that, even with jobs conditions improving, inflation had not clearly picked up and the March release stood below 0.9% y/y. Retail sales growth declines month after month and the last March print was below 2% y/y.

Recent data are definitely much more on the soft side. It sounds contradictory to us that the job market conditions improve while consumption hardly increases. A lower-than-expected NFP last Friday have put a definitive end to the possibility of the Fed hiking for the second time since December 2015. Markets seemed already resigned to the possibility of a June hike as the probability of any tightening was not anyway higher than 10%. There was maybe only Fed members to still believe that they would hike rate at June's meeting.

Now, the US needs inflation more than ever, at the very least to kill its massive debt ($18 trillion) but the Fed does not seem able to spur it and it will not make any moves that may increase deflationary risks. This is also why we will need to closely monitor wage growth which seems to have nonetheless picked up slightly since the start of the year. In our view, this is not a significant indicators as there are too many workers on the sidelines waiting for work as the average weekly hours per employee is still around 35 hours. We interpret this as meaning that many US employees have part-time jobs. Currency-wise, the EURUSD should continue to go higher towards 1.2000 over the medium-term.



FX Markets

IMM Non-Commercial Positioning

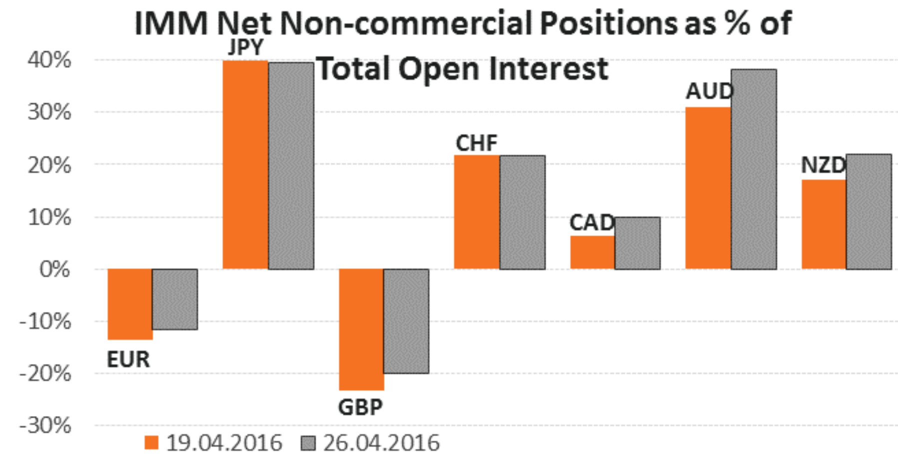
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

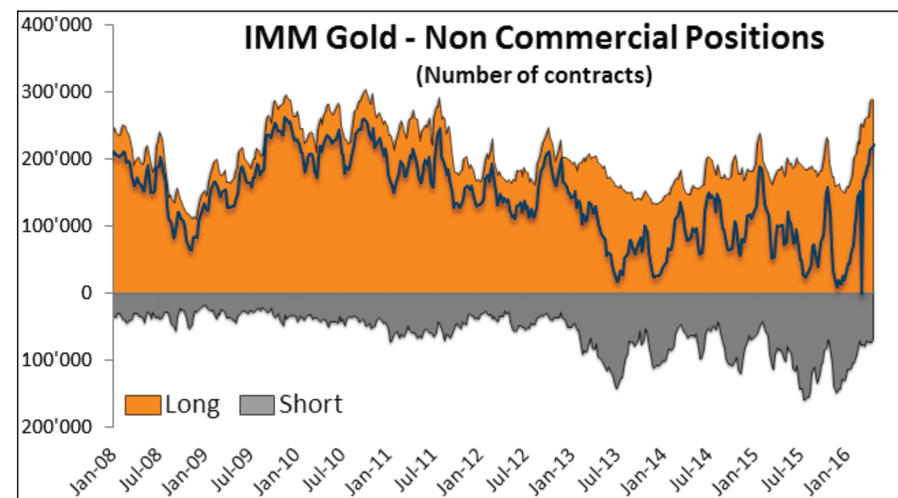
The IMM data covers investors' positions for the week ending April 26th 2016.

The EUR net position remains short for the sixth consecutive week. However, speculators have reduced their short positions despite the ECB is on the dovish side.

The CHF net position is also long this week. There is still the threat that the SNB may intervene to offset any further appreciation of the Swiss currency. For the time being, demand for the CHF should continue to grow as long as European uncertainties linger.

The AUD net long position is increasing again despite recent rate cut from the RBA. This is mostly due because of the current optimism on the economic outlook and the recent surge in gold and silver prices.





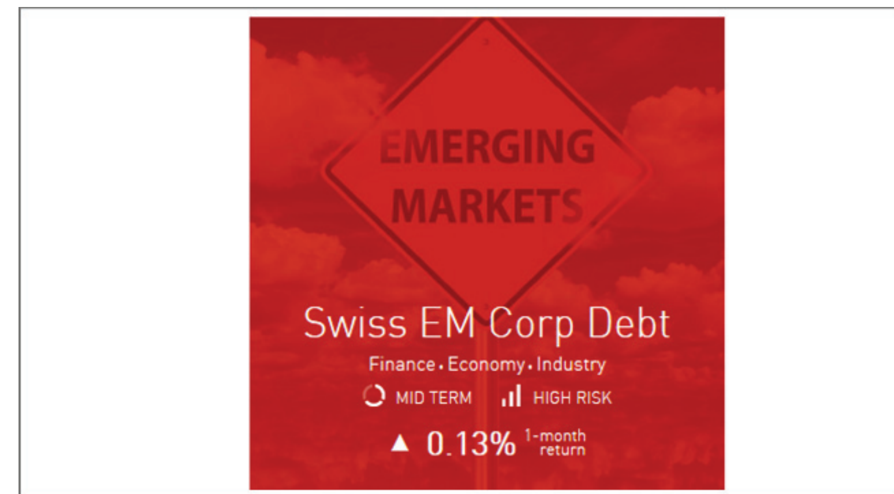
Themes Trading — Swiss EM Corp Debt

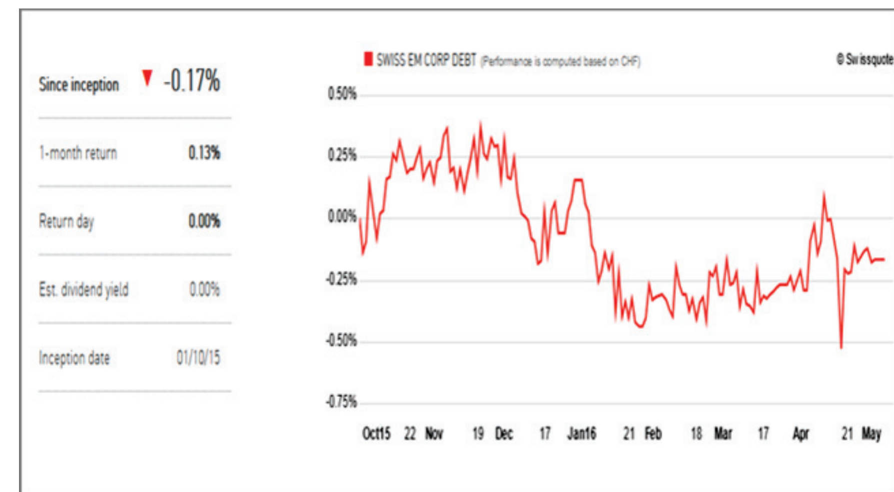
For income-hungry investors, corporate bonds are often the answer. With western interest rates significantly low on both sovereign and corporate debt, savvy investors are looking for opportunities in emerging markets. Bonds have traditionally been used in portfolios as a source of stability, to generate income, and to preserve capital.

With signs that the worst is over in emerging markets, bonds issued by companies based in such markets are an increasingly attractive source of substantial investor payouts. Recent concerns over US interest rate rises have sent prices lower, creating an opportunity for those willing to accept a degree of risk. Interestingly, the default rate among high-yield issuers has fallen dramatically in recent years, suggesting that markets are overpricing the risk premium.

We built this theme with the goal of generating high yields but without incurring domestic market currency risk. All bonds are short duration and denominated in Swiss francs.

Please note that the below prices are expressed as a percentage of par value. Example: a bond with a par value of 100 that is priced 85 is actually trading at 85% of its par value.





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