SWISSQUOTE

WEEKLY MARKET OUTLOOK

13 - 19 June 2016

DISCLAIMER & DISCLOSURES

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WEEKLY MARKET OUTLOOK - An Overview

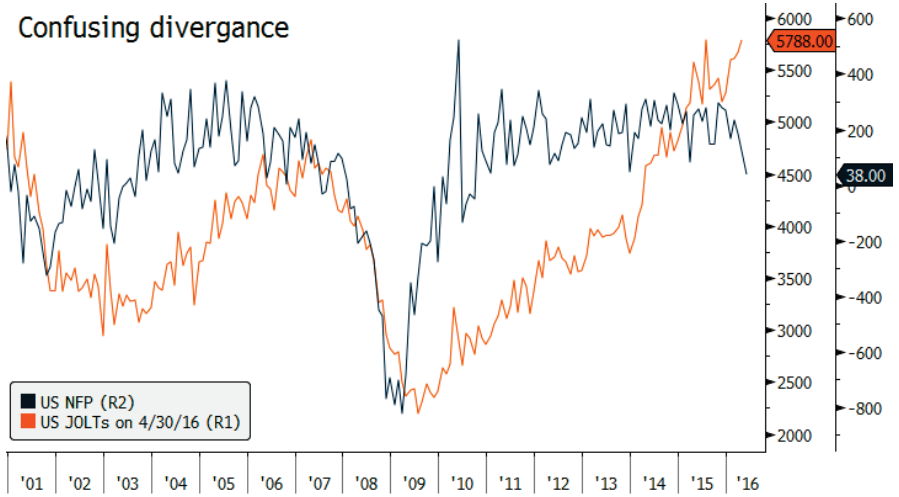
Economics

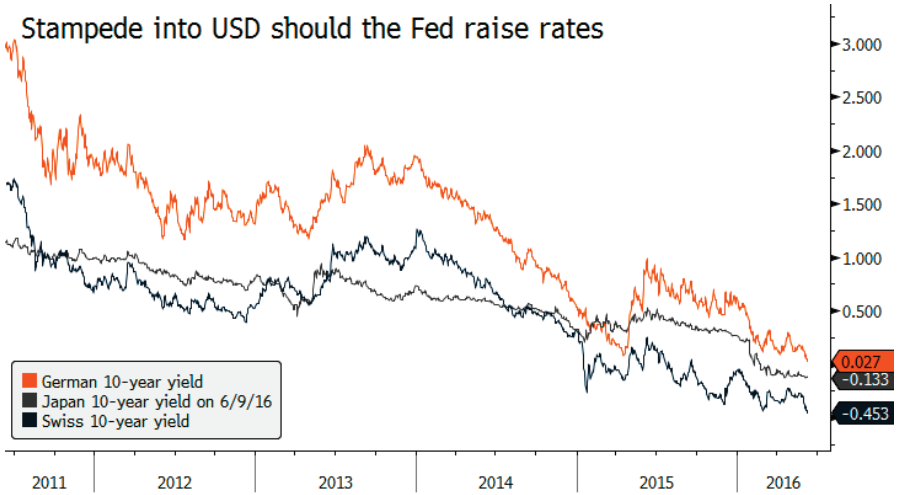
Reflection Point In US Labor Markets

Weak labor market report has nearly taken the probably of an interest rate hike completely off the table. According to Fed fund futures expectations for the Fed to raise rates is less than 5%. Next week will bring a rush of US economic data release which will help resolve critical questions around the direction of the US economy.

The markets have been trading on the theory that weakness in labor reports, specifically NFP, is an indication of a cyclical slowdown. However, yesterday JOLTs report throws a wrench in this theory. JOLTs total job openings increased to 5.788mn in April from 5.67mn in the prior month, a record high. An economic slowdown should be reflected with a decrease in job openings, however the reverse was realized. This could indicate that tightness in participation has thinned the pool of qualified applicants. If US labor markets have breached the non-accelerated inflation rate of unemployment (NAIRU), then the pace of wage growth should quicken as companies compete to outbid one another for qualified candidates. Should the labor market data reflect weakness in the US economy, then the Fed might hold back new hikes until 2017. However, should the issue supply constraints then the threat of inflation will push Fed rate hike expectations aggressively higher.

Our view is that weakness in NFP is indicative of a broader slowdown, spreading from a strong USD and sluggish global demand. We anticipate moderate pace of expansion and slightly higher inflation pressure which will keep the Yellen cautious at Monday speech (our view Nov rate hike). With the Fed on the sidelines, BoJ preparing to stimulate further and the ECB decidedly dovish, global loose momentary policy should encourage risk taking in high beta currencies. USD will depend of shifting views on the shape of the Fed rate path, yet despite gains due to Brexit event risk we expect the USD to weaken.





Economics

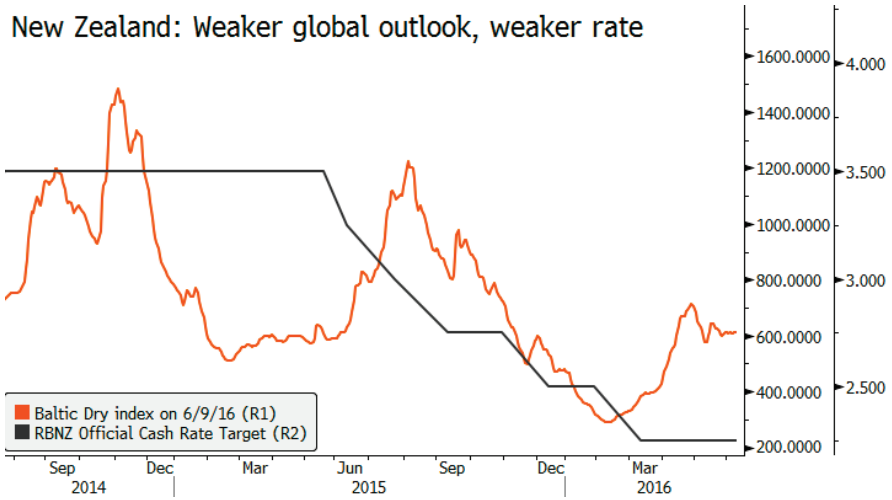
RBNZ Willing To Weaken The Kiwi

Some central bank decisions were much awaited last week. Amongst these, the Reserve Bank of New Zealand announced its Official Cash Rate decision last Thursday. Rates are being kept unchanged at 2.25% for the time being. Currently, the country's rates are the highest amongst the G10 in which two countries (Switzerland and Japan) have negative interest rates.

At March meeting, the central bank took financial markets by surprise by cutting rates to 2.25% (record low).The RBNZ, concerned by the global economic outlook, preferred to weaken its currency. A few months after, it cannot be said that the global conditions will improve by the end of this year. The Baltic Dry Index, an economic indicator, which shows an estimation of the cost of moving raw commodities by sea, is very close from its all-time low which was recorded in February. The index is currently standing at 610 while it was at 290 four months ago. This reflects the ongoing weakness of the global economy and in particular the weaker industrial demand. We consider that a rebound in commodities is not sufficient and we firmly believe that those global economic conditions will weigh on New Zealand' revenues this year. Indeed exports are driving around 30% of the countries' GDP.

Fundamentals of the New Zealand economy are clearly heading towards the soft side. Inflation is below the target band of 1% to 3% over the medium term and is currently running at 0.4% y/y. We do not believe that inflation will pick up within the next year despite the recent rebound in commodity prices even though this rebound is currently providing some relief to the country in terms of revenues. Indeed the kiwi should strengthen on those increasing revenues and add some downside pressures on inflation. That would certainly push the RBNZ to further cut rate this year.

A major key issue that the RBNZ will need to deal with is the housing bubble that it does not want to feed against its will, which is particularly significant in Auckland. Unfortunately a global currency war on competitive devaluation continues to rage (the dovish stance is the new normal) and New Zealand is unfortunately obliged to participate. Weakening the kiwi is necessary and the RBNZ still has room to do so without affecting too much the credibility of the institution.

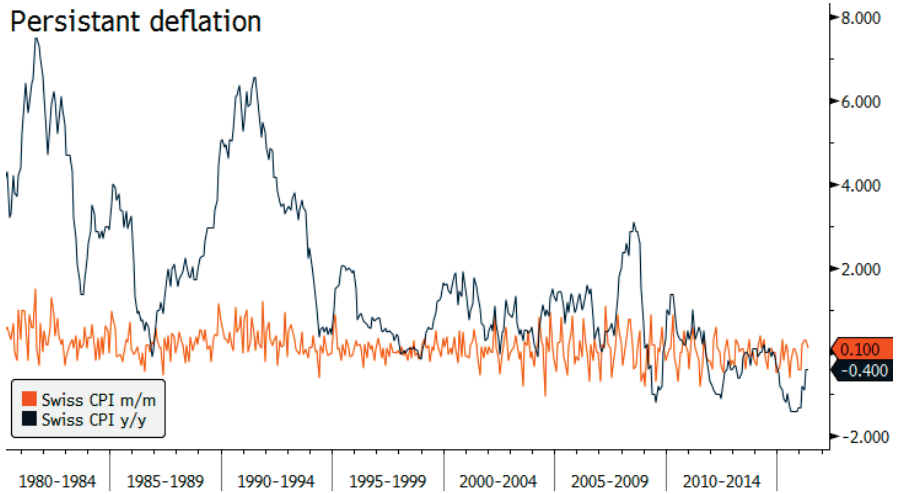


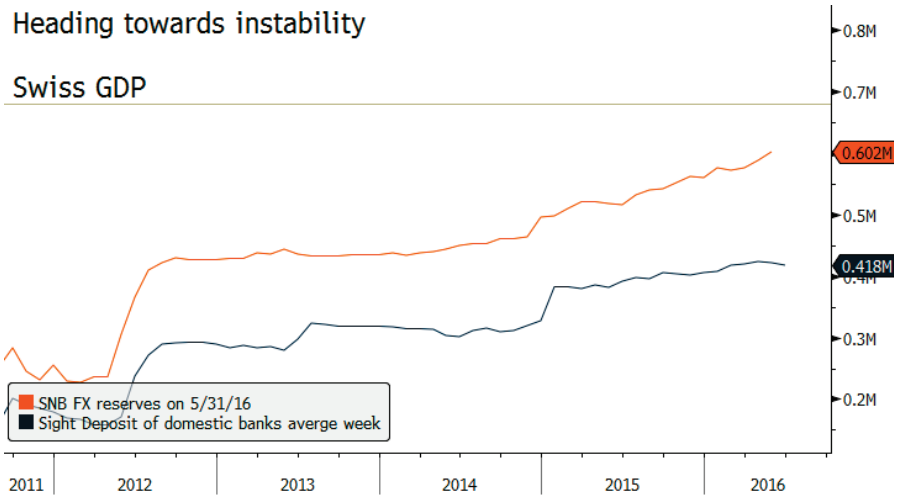
Economics

Swiss Inflation Falls But Policy Action Unlikely

Swiss data release today indicated that deflations remain a significant concern, especially in light of a stubbornly overvalued CHF and soft domestic consumption and external demand environment. Consumer inflation reversed positive trend rising a meager 0.1% in May against 0.3% April read, the annual number stagnated at -0.4%. Despite the overall weak tone of Swiss domestic growth and inflation data, punctuated by retail sales contracting -1.9% y/y, it is unlikely that the SNB will overtly act. We have limited expectations for the SNB policy meeting on the 16th June, with no adjustment in negative rates anticipated. Given the event risks created by the FOMC meeting and UK referendum of EU membership, the SNB will likely keep their powder dry and retain total policy flexibility. Yet, while the SNB remains silent, there is increasing evidence of behind the scenes activity. SNB foreign exchange reserves data for May increased to CHF 602.1bn from 587.9bn.

Meanwhile Swiss foreign FX reserves are close to breaching the 95% threshold of annual GDP level, a potentially worrying development for the economic conservative Swiss—remember the recent referendum to link central bank policy to gold reserves? A portion of the increase in FX reserves can be attributed to valuation effects, which then leaves around chf5bn of unaccounted for accumulation. This suggests that the SNB has been discretely, but considerably intervening as we had suspected. Given the recent EUR strength, the lack of EURCHF appreciation indicates that inflows into CHF remains significant. A portion can be attributed to the immediate risk of destabilization of a Brexit and flight to safety, while the longer term trades indicates with falling global inflation expectations, that real yields in Switzerland remains attractive. The SNB will reiterate their commitment to defending the CHF from excessive appreciation however, the closer we get to 23rd June, the increased probability of heavy CHF buying.



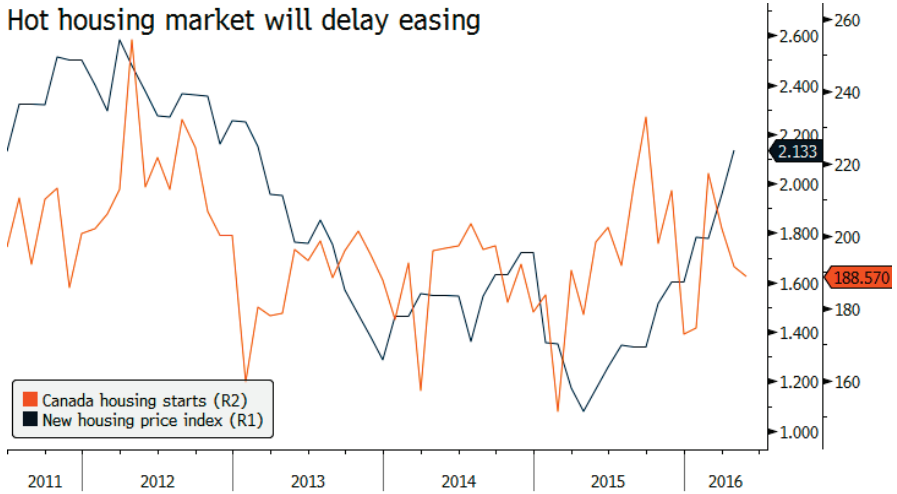


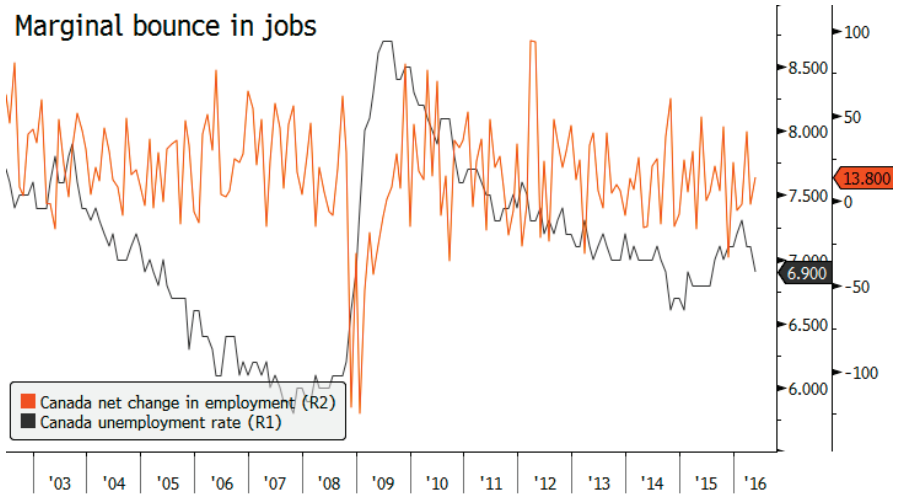
Economics

CAD Looks Vulnerable On Underpriced Easing

Commodities continued to weaken despite indications of solid demand from China. Metals and oil prices have reversed recent highs as uncertainty worries emulate from the Fed's monetary policy path and Brexit weighs on investor sentiment. In the short term risk aversion should dominate, yet in the mid-term, loose monetary policy and historic lows in developed markets interest rates should provide risky assets with a boost. EM Asian nations that are non-commodity dependent economies and are running a current account surplus should outperform. In the short term, this backdrop should be negative for the CAD. With crude prices hitting $50, select shale producers are near/at break even, increasing the likelihood of increasing supplies. Therefore, while higher crude prices are good for Canadians the outlook spillovers into a domestic recovery feel limited. With sluggish domestic economic data and growing expectations for additional Bank of Canada easing, we should see further selling pressure on CAD.

On Friday Canada's May employment report provided a lethargic bounce, adding only 13.8k jobs after a -2.1k contraction in April. The unemployment rate dipped to 6.9% from 7.1%. Canadian 1Q economic growth was poor as weak investment and a drop in oil production hampered export and consumption gains. Bank of Canada Governor Poloz's comments indicate that further policy measures are on the table, as policy makers suggest that wildfires might reduce 2Q GDP by 1.25% and shrink annual GDP by 0.25%. Yet, concern over domestic housing markets, uncertainty over the Fed path and the direction of the US economy is likely to keep the BoC on hold. However, we still anticipate another 25bp cut in 2016 to support domestic weakness. With the Canadian yield curve underpricing additional rate cuts, our USDCAD target remains 1.3188 range resistance.





FX Markets

IMM Non-Commercial Positioning

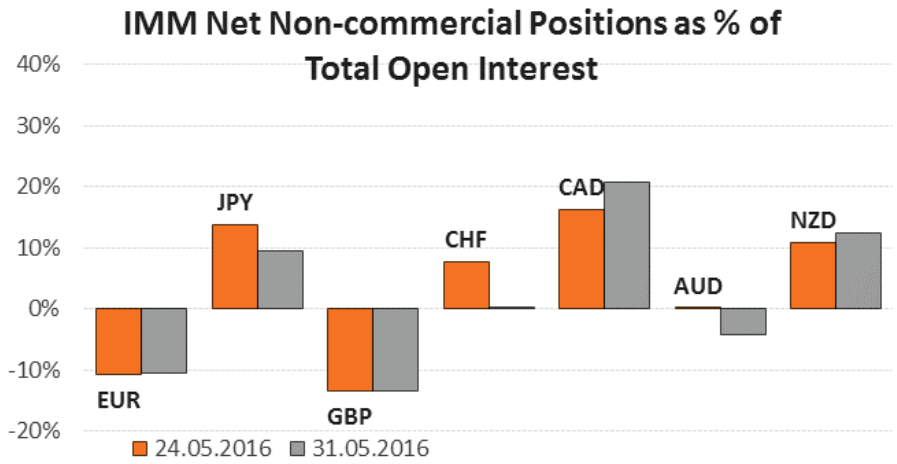
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

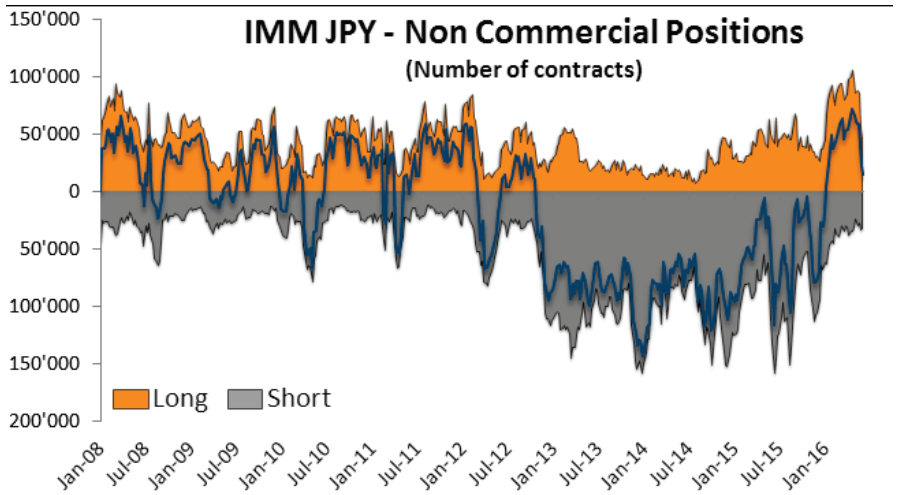
The IMM data covers investors' positions for the week ending May 31st 2016.

The EUR net position remains short as traders are focused on the "Brexit" referendum. The ECB is expected to increase its stimulus within the next few months and while it has upgraded its inflation and growth forecasts, the future of the European union is still uncertain.

Traders also increased their long kiwi position as the oil prices rebound is still on. Compared to others members of the G10, the fundamentals of New Zealand are still correct. Any adverse move in commodities would push traders to unload their long position.

Traders decreased their long JPY position on renewed increasing likelihood of a June Fed rate hike. Now that Fed members, through their multiple declaration, almost ruled out an intervention in June, we believe that traders should increase again their long position. The yen is an indicator of the market risk sentiment and while the BoJ credibility is at stake, with its infinite monetary intervention, investors are more and more looking for the Japanese stability.





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