SWISSQUOTE

# WEEKLY MARKET OUTLOOK

**27 June - 3 July 2016**

DISCLAIMER & DISCLOSURES

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

# WEEKLY MARKET OUTLOOK - An Overview

# Economics

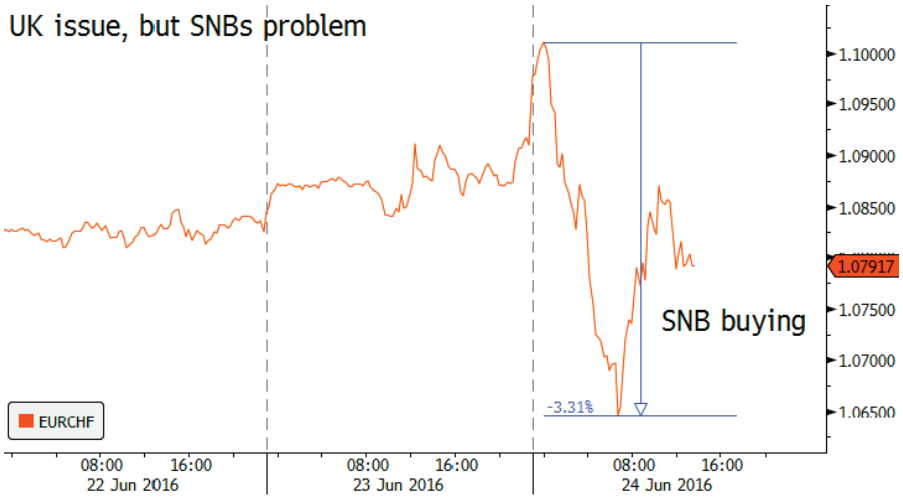
## "Brexit" Bombshell

**SNB on red alert**

The expected impact of the "brexit" vote will be massive for the franc. As expected the CHF has been a primary tool for hedging the risk of a "leave" vote. EURCHF dropped to 1.06237 low in reaction, however the pair bounced to 1.0723 despite the lack of EURUSD strength, suggesting SNB intervention. Direct FX intervention has just now been confirmed by the SNB, who in an email stated that they are entering the markets. Clearly the SNB is on tenterhooks as they scrutinize unfolding developments with wariness. The EURCHF has become the darling of "Brexit" hedges in investment communities. The correlation between EURCHF and referendum polls has become tight in recent weeks. The popularity of CHF safe-haven trades for European/UK risk will only increase with this morning's shockwave.

Unfortunately for the SNB, which actively encourages a weaker CHF, "Brexit "will likely trigger additional regional risks. Outside the general uncertainty, projected referendum votes in Northern Ireland and Scotland will threaten the UK's existence, while Eurosceptics will be emboldened in the Spanish election on Sunday. We can anticipate rolling European-centric risk-off environment for the foreseeable future, suggesting a sustained period of CHF strengthening. This will put the SNB on defensive stance. The SNB has taken the correct view to remain quiet on policy in order to preserve total flexibility in defending the CHF from further overvaluations, with whatever tools are necessary. Expansion of the SNB balance sheet indicates that the central bank has been actively intervening in the market however, with total reserves now over 95% of Swiss annual GDP, further expansion could be destabilizing. The next level would be tightening of exemption on negative rates and/or deep negative rates.

Yet, with the Swiss sovereign yield curves in negative territory out 20 years, yet demand remaining, it's unlikely that more negative rates will provide a significant deterrent to risk adverse investors. Finally, the experiment of negative rates is young and long-term consequences are unknown. There is nonnegotiable worry that negative rates will erode bank profits and balance sheets while consumers could become spending adverse opting instead to hoard cash rather than depositing. All in all, it is unlikely that the SNB has the tools to protect the CHF from an extended period of demand.



## Economics

## What's Next For Scotland And Northern Ireland?

**An unexpected result**

The Brexit result was somewhat unexpected and the results have definitely taken financial markets by surprise. Bookmakers, whose odds were largely in favour of a "remain" vote yesterday, changed their quotes as soon as first results started to come in very early during the night. The consequences of this historical event will remain unknown for some time, particularly for the United Kingdom whose separation may have been triggered by yesterday's vote.

**Scotland dreams again about its independence**

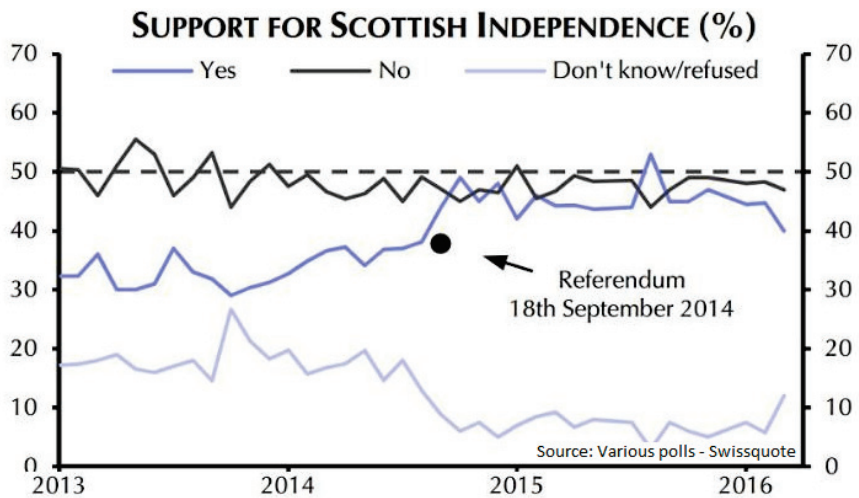
England voted to leave the union by a wider than expected margin, while the "remain" vote in Scotland was largely favoured by 62% to 38%. Scotland officials, who have often called to stay in the European Union, should now try to organize another referendum in order to become an independent sovereign state. Alex Salmond, former Scottish prime minister until 2014, is now expected to take the lead of this call for an independent Scottish state.

**A reunited Ireland may be possible**

Northern Ireland also voted in favour of the EU by a majority of 56% to 44%. As for Ireland, it is likely that the idea of a unified country will come back on the table. The leader of the left-wing Sinn Féin party has declared that the whole island should be allowed to vote on unification. This offer is attractive as it would allow Northern Ireland to stay in the European Union.

**Financial turmoil are not over**

Shockwaves in the financial markets are, from our vantage point, far from being over, this is just the beginning. The pound should continue to further suffer as long as developments unfold. It has lost around 7% against the dollar for the time being. It is important to remain aware that any further declaration during this 2-year window where the exit will be negotiated will drive the currency.



## Economics

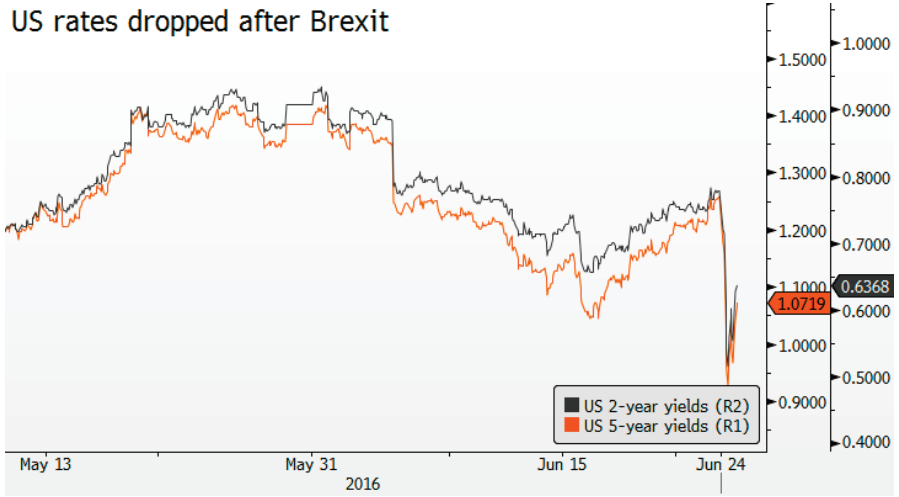
# Fed's Rate Path Challenged By Brexit Vote

Financial markets woke up with a massive hangover last Friday amid the decision of the United Kingdom to leave the European Union. The decision will have major consequences on this side of the Atlantic, but not only. The global level of uncertainty increased by another notch, adding concern about the slowing global economy and potential spillover from the Brexit situation at the international level.

Obviously, on the frontline, there are the SNB and the BoJ, both worried that the deteriorating risk sentiment, which made investors fled risky assets for safer ones, will boost the demand for their respective currency. However those are not the only central banks that will have to have adjust their monetary policy in the aftermath of UK's vote. The Federal Reserve will also have to adjust its plans to the new international situation.

Back in December last year the Fed has planned to increase the federal funds rate four times this year. However, the poor performances of the US economy during the first half of the year has forced Fed members to review their growth forecast to the downside but also to postpone the next rate hike to… well. According to fed futures, the market is now pricing out any rate hike in 2016. But most surprisingly, the market has also started to price in a… rate cut, with 12% chance. We have always been very dovish regarding the US rate path even though the market was constantly supporting the hawkish view. It seems now that the Fed will have to wait for the smoke to clear, just like everybody else.

As expected EUR/USD took a hit amid the result, falling as much as 4.50% before consolidating slightly below 1.11. It is still hard to tell whether the sell-off in pound and the euro should worsen but given the panic reaction on Friday, we won't be surprise to see certain asset reversing Friday's losses.



## Economics | "Brexit"

In a historic EU referendum, the UK people voted 51.9% leave vs. 48.1% remain.

For the Themes Trading Brexit portfolio, we analyzed the global investment landscape across all asset classes to build a basket that would perform well under the stress of a "leave" vote. On the equity side, we anticipate that FTSE constituents exposed to domestic and non-EU-related trade will retain value (a sharp decline in sterling should support terms of trade), while companies with deep exposure to the EU – especially global financial – will decline. In Europe, German companies highly exposed to the UK will likely suffer. However, SMI value plays with solid dividend yields should benefit as a safe haven trade. On the currency front, we expect EUR/CHF to decline as investors flee the euro into a currency with a solid current account surplus, a triple-A sovereign rating and reserves of gold. Finally, we foresee a marginal short-term decline in global demand suggesting that base metals, which are an indicator of economic health, are likely to decline. Investors expecting a "remain" vote should simply reverse the basket trade.

Analysis & Portfolio - Swissquote Bank Strategy Desk


| | |
|---|---|
| Since inception | ▲ 4.99% |
| 1-month return | -1.88% |
| Return day | 0.57% |
| Est. dividend yield | 1.32% |
| Inception date | 01/04/16 |

# FX Markets

## IMM Non-Commercial Positioning

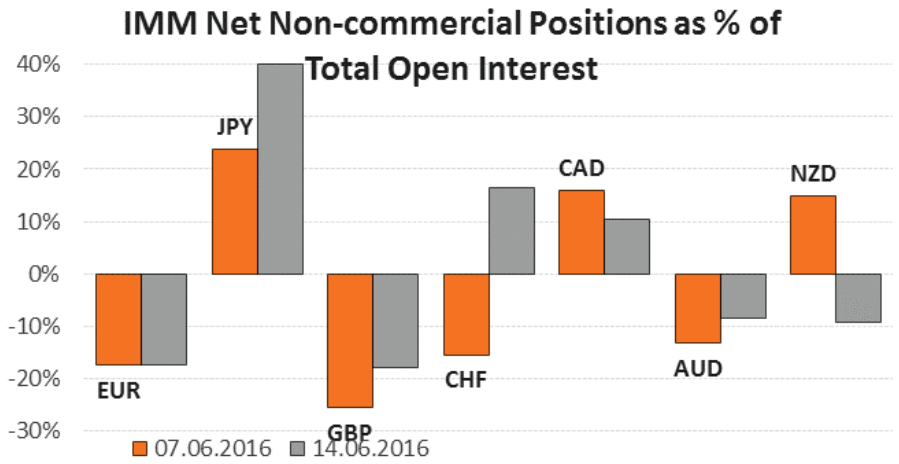
**The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.**

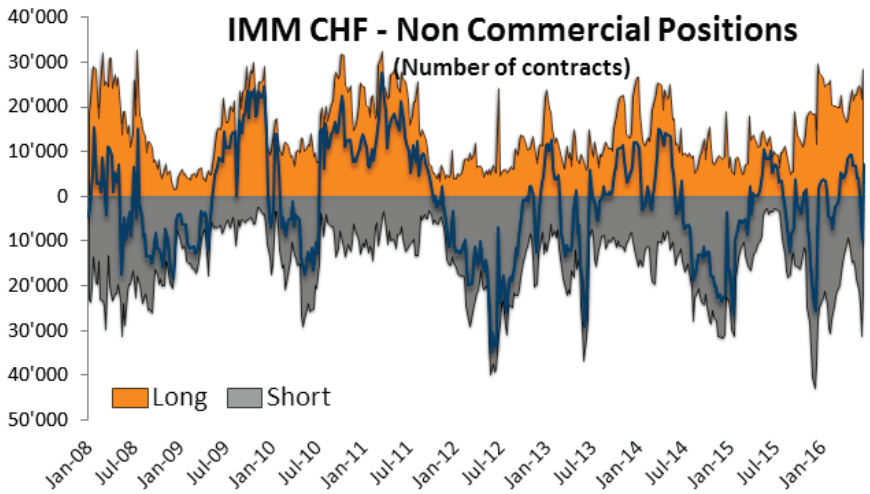
The IMM data covers investors' positions for the week ending June 14th 2016.

The EUR net position remained as the Brexit approached. The risk-off sentiment still dominated. The net short position for the GBP had diminished last week on expected "remain" result of the Brexit. Yet, the swiss franc has found back its safe haven status function under ongoing uncertainties (European and global).

Despite verbal intervention from the BoJ which may add further stimulus before the end of the year, the JPY currency still serves as safe haven in this risk environment. The net position is even longer.

Speculators have decreased their long position in CAD as oil price has, for the time being, stopped its medium-term bullish move.



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