SWISSQUOTE

WEEKLY MARKET OUTLOOK

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WEEKLY MARKET OUTLOOK - An Overview

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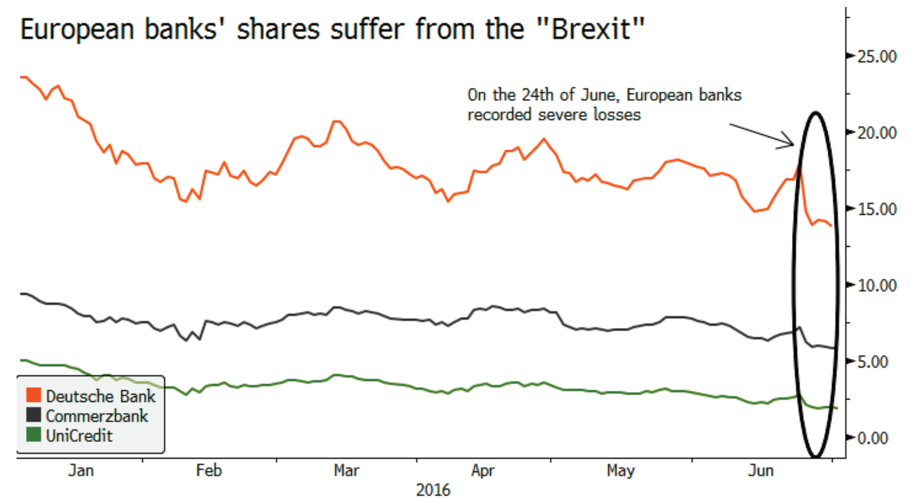
Economics

Fraught Banks Bearing The Brunt Of Brexit Uncertainty



Turmoil in the banking sector

Banks have definitely been the biggest losers since the Brexit vote. Other than British banks, European banks are still in the eye of the storm. Some German and many Italian banks have experienced sharp declines in their market capital since the vote. Deutsche Bank and Commerzbank took a beating on Friday but not as much as UniCredit, which has so far lost around 30%. Some banks lost due to their heavy involvement and presence in the UK, while for others it is a direct result of the growing uncertainty surrounding the future of the EU.

A future bailout for Italian banks?

Even if it remains an unlikely prospect at the moment we believe that the market has already begun to price in a potential dislocation of the EU. This is particularly true for Italy, where the ongoing underlying difficulties faced by its banking sector would not be sustainable without EU support. The true nature of the Italian banking system risks being exposed, revealing that it may in fact be bankrupt. For the time being, a bailout from the EU seems absolutely necessary.

For banks, further ECB stimulus to bring relief

Italian banks are far from being the only ones to suffer. German banks are also facing major difficulties. Over the last few days, George Soros took a massive bet against Deutsche Bank as did some hedge funds. As a result, the ongoing market uncertainties are reflected by the banks share price and we believe that further stimulus will be added by the ECB in an attempt to mitigate these uncertainties. For the foreseeable future the currency war will rage on spelling eventual upside pressures for the Swiss franc.

Economics — Brexit: And Now What ?

A week after

It has been more than a week now that British people voted their way out of the European Union. The market's initial reaction was to sell everything, from equities to emerging market currencies and in a panic-stricken mood, investors rushed into bonds and safe haven currencies. Starting last Monday, the situation stabilised as traders realise that they overreacted to the news. Of course, who can blame them? After all, there is no historic precedent, no benchmark that could have helped them to assess the immediate and long-term consequences of such an event.

Uncertainty to last until autumn

Of course, the uncertainty stemming from the Brexit vote will likely persist over an extended period of time. However, as the smoke begins to clear somewhat, a few elements are becoming clear. Since the decision has no short-term consequences - the UK will likely not trigger article 50 before the end of the summer at the earliest. In the meanwhile, there is plenty of room for a momentary rally. Secondly, it is still not 100% sure that the UK will in fact leave the EU. Indeed, the result of the referendum is not legally binding for the parliament. They could therefore in theory chose to ignore the people's decision - just like France and the Netherlands did with the Lisbon treaty. Indeed, in 2005 both French and Dutch peoples rejected by referendum the Treaty establishing a Constitution for Europe. A few years later, the French (in 2007) and Dutch (in 2008) parliaments ratified the Lisbon Treaty, which takes up the substance of the treaty rejected by both peoples back in 2005. There is thus every reason to think that the British parliament, which is largely composed of Europhiles, will try to maintain the UK within European Union.

For now the pound sterling remained under substantially pressure, treading water at around 1.33 against the greenback. The medium/long-term uncertainty surrounding the potential effectiveness of a Brexit should prevent the currency to extent gains, especially after BoE's Carney suggested last Thursday that a summer rate cut will be needed in response to a weaker growth prospect amid the Brexit vote.

In the FX market, EUR/CHF moved back at around 1.09 as the SNB intervened in the FX market to protect the Swiss franc. The Footsie 100 returned to its pre-Brexit level and EM currencies continue to trade higher on the outlook of low interest rates in the US. While the market will of course continue to keep a watchful eye over Brexit developments, we expect attention to now largely drift back to the Fed and the upcoming release of several economic indicators.

Economics

JPY Feeling The Brexit Burn

Upside pressures

The Brexit vote has had the obvious consequence of increasing safe haven demand and in particular the yen. The Japanese currency is now trading very close to 101 against the green note, its lowest level since 2014. BoJ policymakers were indeed clearly aback by this result, which is now threatening the efficiency of the island's current monetary policy.

In fact, things just seem to be going from bad to worse for Japan, especially as the UK vote will have consequences for the US, which in turn will likely weigh on Japanese exports. The Fed rate path for normalization, despite being widely expected by markets, is now decelerating. Fund Fed futures also indicate that negative rates, even though the probability is small, are possible. The so-called monetary policy divergence between the US and other main central banks has been a key point for markets, however we have maintained that monetary policies are actually converging. This has now turned out to be true. Upside pressures on the JPY should then continue.

Soft data

In terms of Japanese data, the May National CPI and the June Tokyo CPI are still negative on an annualized basis at respectively -0.4% y/y and -0.5% y/y mostly weighed down by food and energy. The BoJ target on inflation of 2% looks further and further away. In addition, consumer spending keeps on declining despite a better labour market. Indeed overall household spending has shrunk -1.1% m/m in May from -0.4% m/m a month before. Rare positive aspect, the manufacturer's confidence, given by the Tankan Survey, is steady from the previous report. Yet, the survey was already completed before the Brexit results.

Easing, as usual

So, what's next? Markets are now waiting for a response from BoJ policymakers. Markets expect that further stimulus will be added in another attempt to weaken the currency. From our vantage point, we believe that global uncertainties are not likely to subside and will continue to threaten Japan's stability. The next BoJ meeting will be held at the end of July and we consider that the central bank is very likely to ease and reduce to more negative rates.

Politically speaking, next July 10, election for the Japanese upper house of Parliament will take place. First polls are already showing that Abe should maintain its majority despite that his measures to reflate the economy is a failure. There is too few growth and no inflation. The confidence in the Abenomics still seems to prevail and it is clear for us that nothing new has to be expected out of those elections.

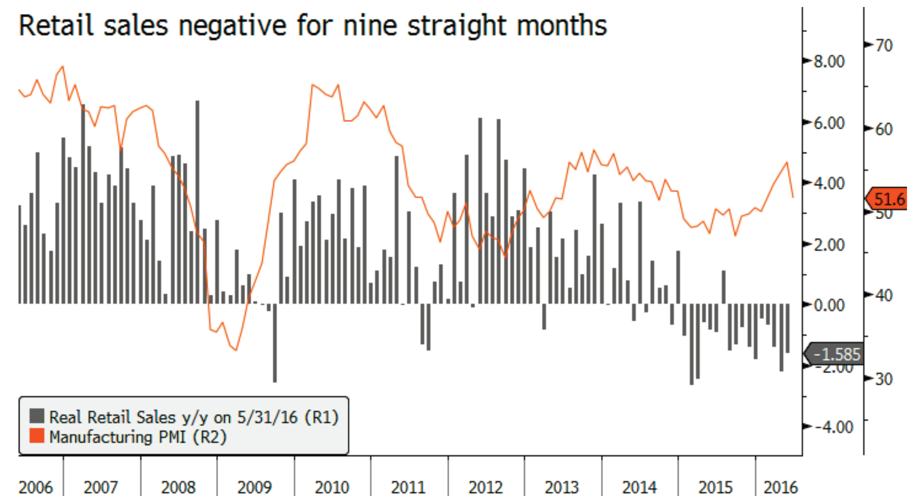
Economics

Swiss Economy Under Constant Pressure

Last Friday, the last batch economic data from Switzerland reminded the market that the strength of the CHF continued to weigh heavily on the economy. Switzerland's real retail sales fell 1.6%y/y in May, while the previous month's figure was downwardly revised to -2.2%y/y from -1.9% first estimate, according to FSO data. Sales have been falling since August 2015 and the trend seems to have accelerated over the last few months. Even though the gloomy global economic outlook and the strong franc are the main drivers, the unfavourable weather conditions have also taken their toll on consumer spending. The combined effects of global uncertainty and the strong Swiss franc are also making Switzerland less attractive to foreigners, which is impacting retail sales figures also.

The straw breaking the camel's back however, is the Swiss manufacturing PMI, which fell to 51.6 in June from 55.8 in May, missing estimates of 55.3. The weak reading came on the back of a collapse in production, which fell to 53.8 from 57.2 in May, and purchase volume, which fell to 51.1 from 60.2. Finally, the price component dropped to 46.8 June from 51.9 in May. All in all, the gloomy report showed that the Swiss manufacturing sector would suffer greatly from the potential dislocation of the European Union and the reintroduction of customs tariffs. Even though the consequences of Brexit remain unclear, it has already taken its toll on business and business confidence. Uncertainty has never been a business booster.

On the currency side, the Swiss franc did not react to the news with the EUR/CHF continuing to trade sideways at around 1.0830. Data released earlier last week showed that the SNB intervened by roughly CHF 5bn in the FX market. We expect sight deposits will show that the SNB also intervened during the last week of June to stabilise the currency pair. EUR/CHF will nevertheless remain sensitive to Brexit developments but as current uncertainty is likely to drag out over a longer timeframe, the short-term effects should be less significant.



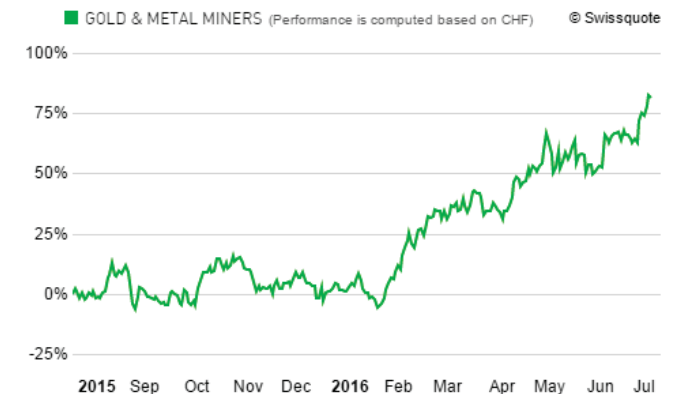
Themes Trading

Gold & Metal Miners

The sudden collapse in commodity prices in 2014 sent mining stocks into free fall. In the long term, however, precious metals – and gold in particular – are the perennial go-to sources of protection against inflation and economic downturns, something investors should be looking out for. The gold market is dynamic, and there are compelling reasons why gold producers could rally. Consumer demand remains solid, with around 2,500 tons of gold mined worldwide every year. Over the long haul, gold as a commodity has appreciated by more than 287% over the past 15 years; by comparison, the S&P 500 has gained less than 44% over the same period. In a period of central bank policy shifts, it is reasonable to envisage a rebound in metal prices – something mining stocks will benefit from. Gold miners are a good way to tap into the benefits of precious metals without paying storage costs.

Analysis & Portfolio - Swissquote Bank Strategy Desk

Since inception	▲ 81.51%
1-month return	19.22%
Return day	-0.46%
Est. dividend yield	0.17%
Inception date	20/07/15



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