WEEKLY MARKET OUTLOOK

29 August - 4 September 2016

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WEEKLY MARKET OUTLOOK - An Overview

Economics

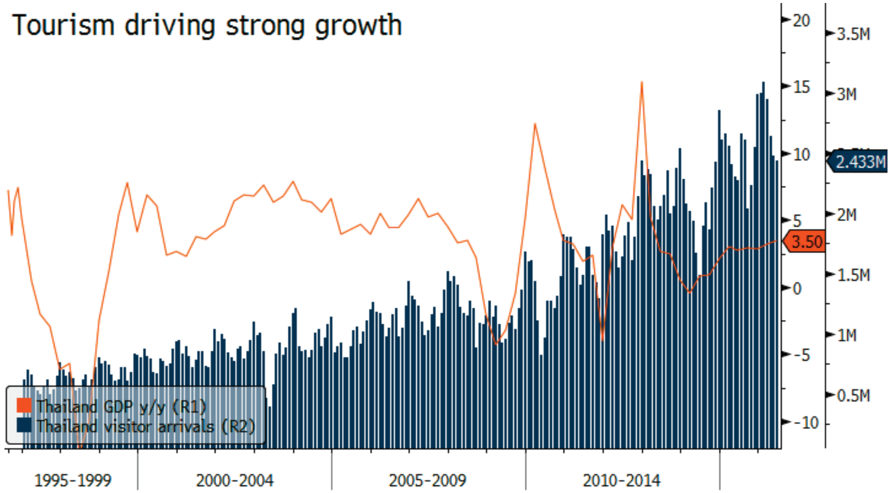
Thai Economy Resists The Odds

With the market continuing to flood into risky assets including EM FX, the Thai baht will remain on the investor's radar for long carry opportunities. Thailand's economic GDP growth was healthier than expected, expanding at a notable 3.5% y/y in Q2 from 3.2% in Q1. This is the fastest pace in over three years despite lingering political concerns. Growth was driven by the tourism sector and government spending which offset softness in exports and private investment. With scant evidence that inflation might accelerate from a benign 0.10% y/y, the BoT will remain accommodative, yet sidelined, while monitoring unwarranted THB appreciation. The BoT will preserve their firepower for a shock either from domestic factors or potentially in reaction to the Fed's monetary policy.

Tourism remains the bedrock for impressive expansion despite worries that terrorism could damage this sector. Tourist arrival increased 8.0% y/y in Q2 to 7.6mn from 9mn in Q1. Given the current pace, 2016 is expected to outpace the prior year of 30mn arrivals by 3mn. The spill-over effect of the increased demand can be felt across the domestic economy. The wealth factor was evident in private consumption, which expanded 3.8% y/y against 2.3% in Q1. Stronger farm income and new vehicle sales, which jumped 13%, contributed to the strong read. Finally, public investment provided a solid support for the recovery as the ongoing construction of the Water Resource Management provide stimulus.

The identifiable soft spots to growth dynamics are private investment growth and exports. Private investment growth slowed to 2.7% y/y from a brisk 4.9% in Q1. Tightening lending standards and general business uncertainty due to the domestic political situation and macro-environment has kept investments restrained. Custom trade balance declined to $1213, from $1965 with a big drop in rice export volumes of -39.6%.

Finally, the political ambiguity has begun to thaw with the 8th August referendum on constitution changes gaining broad approval. The new constitution gives the military a greater political role with the ability of an unelected senate to choose a Prime Minister in the case of a no majority. However, the changes seem to clear the way for civilian elections by mid-2017, which should be viewed by investors as a positive development. The odds defying the Thai economy have decreased the outlook for the likelihood of a 25bp rate cut this year. The BoT MPC sounded dovish at the recent policy meeting but with a gradual improvement in growth, the sense of urgency has decreased. With the BoT sidelined and demand for Thai yield watch USDTHB to steadily decline to 34. A manageable level that will not trigger a BoT response.



Economics

Central Bank Credibility At Stake

Should we really expect something big to come from Jackson Hole Policy Symposium? At the time we write this report, The Jackson Hole meeting had not started yet. Yet, we believe that the Fed is still under the same strategy to provide markets with hawkish comments and hints that "a possible rate hike" before year-end is possible. The odds that a September rate hike occurs had increased to pre-Brexit levels around 32% later last Friday. The major issue is that the US central bank needs inflation to kill its massive debt, currently above $18 trillion, before raising rates as well as a strong labour market. But, our view is that US economic health is overestimated. Indeed, unemployment tax receipts, aimed at funding the state workforce agencies by companies, have fallen over the past 4 years. This contradicts the notion that the US economy is actually creating jobs.

Currency-wise, the dollar should remain strong as long as there are still hopes about a rate hike this year. The Fed's credibility is clearly at stake and we believe that a small increase in interest rates is possible if only for the sake of saving its integrity. This is why investors are growing very suspicious of the Fed and the normalization of interest rates. Indeed, repeating over and over that a rate hike will happen and not doing anything is strongly damaging for the confidence in the central bank. As a result, it is clear that the dollar may have further downside potential and which would also weighs on US yields. We are definitely not in a period of rate normalisation but rather in a fight for credibility.

Equity markets are also sidelined, as the S&P 500 closed in negative territory for two consecutive days before Yellen's speech. Yet, bearish moves were very light, indicating that markets refuse to go further lower. The patient stance is clearly preferred and also wait any signal from the Fed, to pursue their path to new record-highs. We clearly believe that there is strong likelihood that this will happen. The bonds markets are also impatient for Yellen's address as, for example, the generic 10-year US Government Bond yield has increased again over the last months and is now not far from 1.6%.

In Europe, the ECB is conducting a very aggressive monetary policy, spending at the pace of around €1 trillion per year to stimulate the economy when recent data came in at a decent level. Inflation has risen 0.4% in the last four months and PMI is still above 50 (signalling expansion) for August. The ECB is all-in while according to data, the Eurozone economy is not in a recession.

Looking to Japan, it is hard to see how things can end well for the BoJ. The central bank is now a major shareholder for one third of all companies trading on Japan's major index, the Nikkei 225. On top of that, according to data, Japan is not even in a recession cycle but its monetary policy is simply huge and markets have already started to price an increase in the annual bond-purchase target from yen 80t to 90t. On the USD/JPY, we are clearly bearish as from our point of view, the BoJ will lose all the gains it had during the era of Abenomics. A target of yen 90 for one single dollar note within the medium-term is likely.

Economics

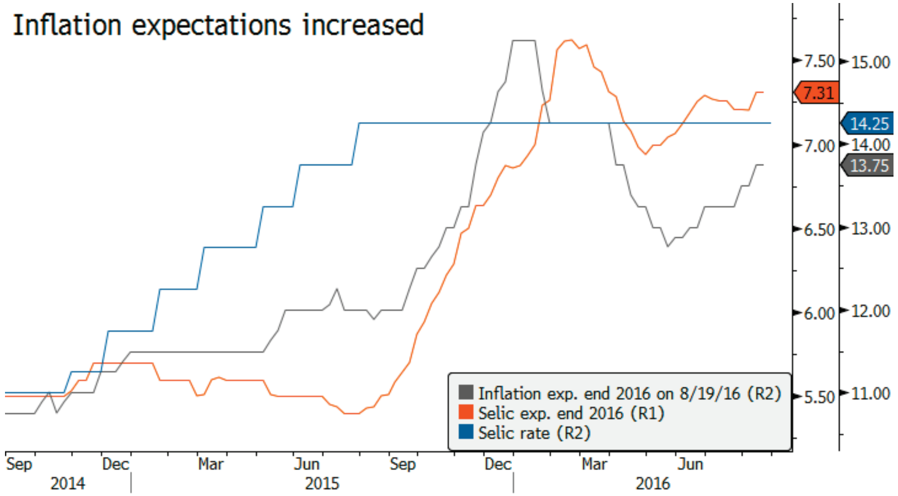
BCB To Wait Until Year-End Before Cutting Rates

It has been nine months that Eduardo Cunha's impeachment request against Dilma Rousseff was accepted by the lower house of the National Congress. Nine months that the country is waiting for this process to end to move on. The impeachment trial started yesterday and was marked by the lack of any sort of relief, enthusiasm or even anger; suggesting that Brazilian people are just tired of the entire process as Dilma's removal is seen as inevitable now. It has been more than three months now that Michel Temer took over as Brazil's head of government. The market had more than welcomed his arrival, hoping for Temer to restore confidence and trim a massive budget deficit. Since Temer took over, the Brazilian real rose more 8% against the USD dollar, with USD/BRL falling from 3.5225 to 3.23, while the iBovespa rose more 7% to 57,720 points.

Even though it seems clear that Rousseff's removal boosted investors' confidence, it would be wrong to attribute this sharp improvement of Brazilian assets solely to Temer's rise to power. Indeed, the entire EM complex has seen strong inflow of money as investors across the globe were desperately chasing higher returns. A weak US dollar also helped emerging market to attract money and this in spite of various negative local political developments. The Fed dovishness was indeed of a great help. But this auspicious period may come to an end as several Fed members already started to signal a possible rate hike this year that may cause a return of investors to the greenback. Writing on Friday morning, the market is still waiting for Janet Yellen to provide more clarity at Jackson Hole Symposium.

Next week, the BCB is expected to leave the Selic rate unchanged at 14.25% as inflationary pressure continued to decrease over the last few weeks. Nevertheless, since the beginning of August the market has been revising its year-end forecast for the Selic rate to the upside, to 13.75% compared to 12.25% in early June as inflation expectation ticked-up slightly. Indeed, the market is now expecting IPCA inflation to ease to 7.31% by year-end compared to 8.74% in July. We expect the central bank to start cutting the Selic in the latter part of the year. It should therefore reduce the BRL's attractiveness for carry traders, especially if the Federal Reserve starts to tighten its monetary policy.

Inflation expectations increased



Economics

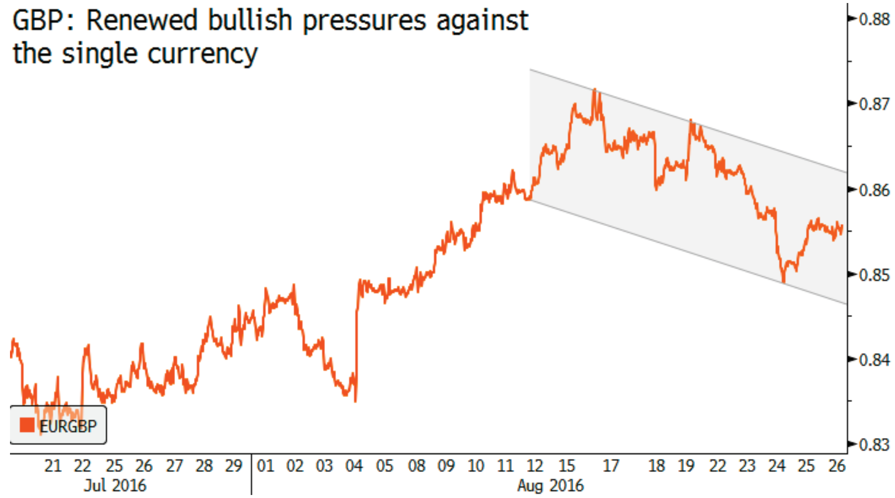
GBP Keeps On Strengthening

Over the last week, the pound has appreciated against the dollar and the pound. The cable is targeting $1.33 while the euro is trading lower towards £0.85. Financial markets have clearly priced in a strong devaluation of the pound on the wake of the Brexit vote. We now think that there has some room for further improvement of the UK Currency and that markets start to realize it.

Recent UK data did not come in as soft as it was expected by markets. Tourism is increasing due to the current pound weakness. The unemployment benefits have also declined, the unemployment rate is at its lowest level since 2005 at 4.9% and even if consumer confidence has dropped, this does not really reflect in the economy. Indeed retail sales jumped 5.9% y/y in July. On top of that UK stocks are on the rise. This last point must nonetheless be qualified as the BoE is massively injecting liquidities.

What we do know for sure two months after the 23rd of June referendum is that investments have not sharply declined as it was promised. The fear of the Brexit consequences has generated some outflows but this remains somewhat limited.

If UK is better off without the EU, there is no reason why other countries should not ask to leave or at least ask for specific conditions within the EU. The truth is that elites are very reluctant to give that possibility to their people. For example there is no way such a referendum would take place in France. To conclude, it must also be said that the UK has not left yet. UK new Prime Minister Theresa May is already postponing the triggering of the article 50 that will start the exit process. Finally this is maybe what is still weighing on the pound.



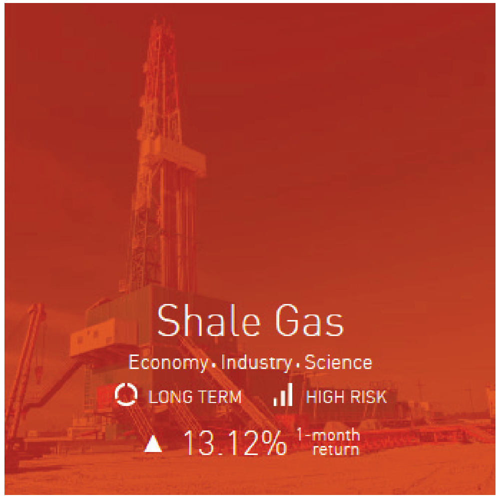
Themes Trading — Shale Gas

Shale gas burst onto the energy scene around 2000 with advances in hydraulic fracturing and horizontal completions and changes in the regulatory environment. By 2010, with the "shale revolution" in full swing, 20% of US natural gas production was from hydraulic fracturing.

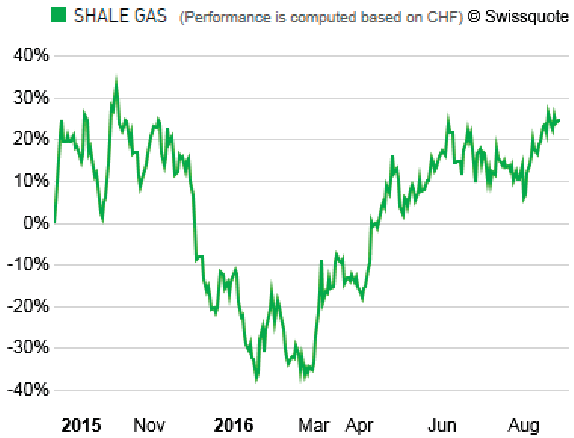
Shale gas refers to natural gas confined within shale formations. The appeal is simple: natural gas is a cleaner source of energy than traditional fossil fuel, and there is a plentiful supply. Capital poured into the industry and wells ballooned, producing over 4.5trn cubic feet of gas per year. In his 2012 State of the Union address, President Obama stated, "We have a supply of natural gas that can last America nearly a hundred years." Valuations in the shale gas segment went ballistic. However, the total collapse of oil prices caused natural gas prices to fall and producers to stop frackin.

While questions remain as to the actual breakeven cost of shale gas, its environmental impacts and the real size of reserves, there has been a real shift towards natural gas. The plentiful supply of domestic oil and natural gas provides a rationale for ending the oil export ban and fast-tracking support for liquefied natural gas (LNG) export terminals. Global nations are looking to US firms' expertise to help harness their natural gas reserves (China is estimated to have the world's largest shale gas reserves). In the US, retooling has begun.

Electricity generated by gas-fired plants has risen by more than 50% over the past decade, while coal-fired generation has declined. With valuations of shale gas producers at significantly low levels, even a slight increase in natural gas prices will have a big impact. We built this theme based on the US shale gas pure-play exploration and production based in Barnett, Fayetteville, Haynesville, Marcellus, and Eagle Ford fields and market capitalization above $1bn.



Since inception	▲ 24.50%
1-month return	13.12%
Return day	0.07%
Est. dividend yield	0.22%
Inception date	25/08/15



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