SWISSQUOTE

WEEKLY MARKET OUTLOOK

19 - 25 September 2016

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WEEKLY MARKET OUTLOOK - An Overview

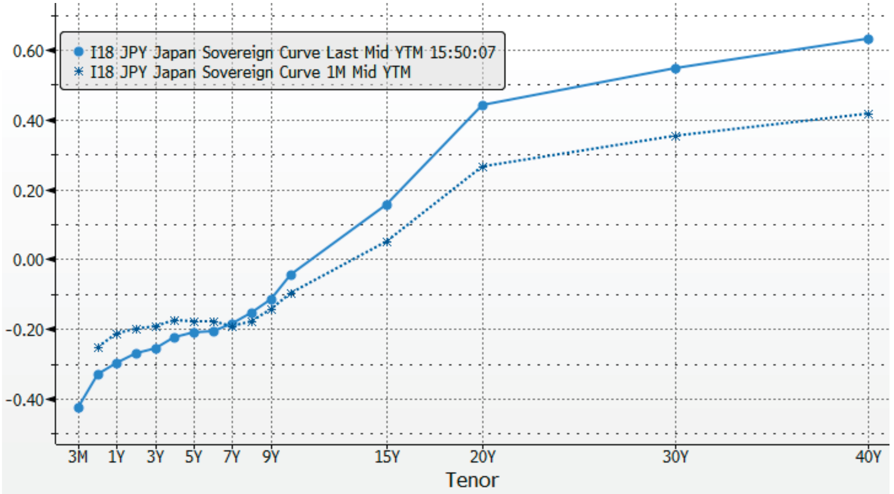
Economics

Limited Options For The BoJ

Looking forward to next week's central bank meeting packed schedule, it is potentially the BoJ that will have the most profound effect on financial markets. We expect no change in the bank's deposit rate and no noteworthy shift in its QE program. The flat yields curve, which the market has grown increasingly accustomed to, is now steepening. Interest rates, specifically, long term rates have been steadily climbing as hopes of further significant monetary policy easing have been damaged. The direction of the BoJ's aggressive QE strategy has been critical in restraining global yields. Should the BoJ's comprehensive assessment of its unconventional monetary policy indicate an end to asset purchases, yields will react violently. Yet with current policy efforts fading and the BoJ owning more than a third of all JGB, there is a clear limit on expansion.

The effectiveness of the monetary part of "abenomics" is being openly challenged. Inflation, which was forecasted to hit 2.0% by mid-2015 is now closer to -0.5%. Growth has stalled with GDP 2Q printing a negligible 0.2% rise, while a weakened JPY - key to any Japanese recovery, has completely reversed course. There is a realization within Japan that the current strategy is not working and doing more of the same is likely to have a similarly disappointing ending. In fact, as discussed on CNBC yesterday, we believe that the BoJ will be the first central bank to "hit the wall". Once this happens, the BoJ will lose control of the wheel as its monetary policy mix becomes ineffective in enforcing a credible strategy. The primary policy measures in negative interest rates, namely, quantitative easing and purchasing private sector assets are no longer having the desired impact, more specifically to weaken the JPY.

We do not expect any change, including more negative interest rates. Should the Fed also hold rates unchanged, as we expect it will, then the combo effect will be USDJPY breaking below 100.



Economics

Hawkish One Day, Dovish The Next

The US equities market declined sharply on Friday the 9th on the back of Fed Rosengren's very hawkish comments. We consider this move was a mistake. In our view, the American central bank does not have the ability to raise rates as its massive debt holds it back. Its credibility will continue to deteriorate as long as a rate hike normalization period is not delivered. Last December's small hike was merely an attempt to smooth over the cracks.

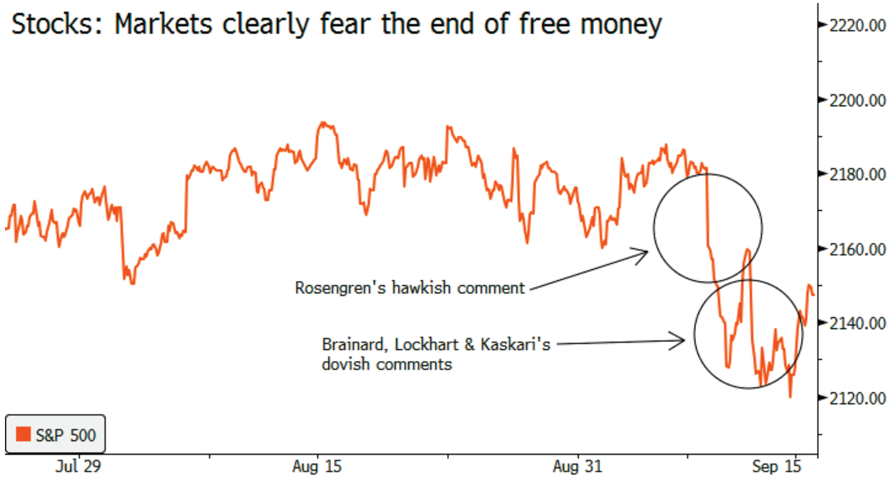
Rosengren's hawkish declarations triggered a significant equity sell-off. Earlier last week, Fed's Brainard, Lockhart and Kashkari all played the role of firemen, repeating over and over that patience is the key word and that the job market is not yet strong enough. Ordinarily, a 4.9% unemployment rate would be looked on very favourably, but with the absence of wage growth, the figures contradict each other. This is why we believe that the jobs market is in fact largely overestimated.

Unsurprisingly, equity markets is now consolidating amid the comments that there is “no hurry” to raise interest rates. The free money tap continues flow with no end in sight at present and markets are now pricing a September rate hike at 18%. Fed communication is mixed, contributing to market volatility while it should be working to ensure price stability. This sounds like another failure from the American Central Bank.

The data are also clearly not supporting a rate hike. August American consumption continues to declined and printed in negative territory at -0.1% excluding Auto & gas. This adverse outcome is supporting the stocks as financial markets will likely adjust lower a Fed rate hike possibility before year-end. Indeed, investors are looking for yields and the stock markets represent a great opportunity as the cost of money is very weak.

In our view, we maintain the US economy is fragile and that there is no actual recovery. Economic data remains either soft or subdued. Industrial Production declined 0.4% in August. It has been more than two years that this indicator has not released three monthly consecutive increases.

Currency-wise, the dollar should then weaken over the next few weeks as a Fed rate hike will be repriced. A great FX strategy is to buy/sell dollars when the probability of a hike is reaching a bottom/top. For December we would sell the dollar as a Fed rate hike looks too awaited.



Economics

SNB In "Wait And See" Mode

As expected, the Swiss National Bank did not modify its monetary policy stance and reiterated that it will remain active in the foreign exchange market to prevent further Swiss franc appreciation. The central bank also left its interest rate on sight deposits unchanged at -0.75% and the target for the three-month Libor at between -1.25% and -0.25%. On the growth and inflation sides, as expected the SNB revised its growth and inflation forecast slightly lower. The SNB projects that inflation will move above the 1% threshold during the first quarter of 2019, compared to the third quarter of 2018 as estimated in June. In the short-term, inflation should barely reach the neutral threshold by year-end in reaction to a "slightly less favourable global economic outlook".

On the growth side, the central bank acknowledged the surprisingly solid recovery in the second quarter as GNP grew +2%y/y. However, it expects more modest growth in the second half of the year as Europe slows down. Overall, it was rather an optimistic statement even though the Swiss institution did not pass up on the occasion to point out its commitment to defending the CHF.

In the long-term, the picture has much changed. The SNB will remain in "wait and see" mode. In this regard, development in Europe is being monitored. The ECB holds policy steady, opting to conserve firepower. However, the issues from Brexit are only now beginning to materialize both on the economic and political front and may turn up the heat on the Swiss franc in the coming months.

Moving forward, direct FX intervention and interest rates will remain the policy tools of choice of the SNB. Price stability is the bank's mandate with a focus on the overvalued CHF. Intervention effectiveness has proven difficult to sustain over a long period but highly effective in the short-term to discourage speculators.

In the longer term, negative interest rates seem to be the SNB members' option of choice. It's a simple way of maintaining the interest rate differential with the euro, making the CHF less attractive. Given the current environment, the SNB will be comfortable to stay on the sidelines indefinitely. Only if a "shock" threatens the EURCHF exchanges rate will the SNB jump back with a policy response.

Economics

BoE On Hold Until November

As widely expected and as we surmised, the Bank of England has kept rates unchanged at 0.25%. The meeting minutes show that policymakers voted unanimously to hold the bank rate at 0.25%. In addition, there were no changes made to monetary policy and the UK government bond purchases of £60 billion will continue.

There was no urgency for BoE officials to decrease rates as we believe that policymakers have ironically gained some time with the Brexit referendum. Indeed, the market's reaction has sent the pound very low, it having lost 15% of its value against the dollar, which has boosted the UK economy, particularly exports. The latest data shows that UK goods exports rose 3.4% in June. In particular, exports towards the EU have risen 9.1%, representing the biggest increase since October 2010. In our view, financial markets have largely overpriced the Brexit consequences. By the way, retail sales continue increasing albeit at a slower pace and UK tourist spending saw a sharp increase of 7% for July.

Besides, Brexit is still not a complete certainty. As long as article 50 has not been triggered there is no guarantee that this will be the case. For now, the UK has time to plan its exit strategy. Lingering uncertainties on the future of the UK is only beneficial for the BoE.

For the time being, the BoE is very satisfied with the immediate results of its monetary policy and is not really concerned by the upside pressures on UK asset prices due to the current QE. In our view, the recent positive data is most likely a result of Brexit. The devalued pound is helping the country to increase its attractiveness and the lowering rate is of course stimulating the stock markets as the era of free money continues. The fact is that Brexit provided a fresh boost to the BoE even if it will never be admitted officially.

In terms of key data, inflation is lower than the inflation target setting at 0.6% vs. 2%. The BoE expects that the Brexit will push prices of goods and that the CPI target will be reached by the end of 2017. On top of that the BoE Monetary Policy Committee is still expecting decelerated growth for the second half of this year. As a result, we anticipate that the BoE will likely cut rates at the next meeting on 3rd of November in order to provide some fresh stimulus to growth. What is sure at this point is that in most developed countries, massive stimulus and the road towards negative interest rates will continue. The current bounce in UK bond yields is simply due to renewed market expectations on monetary policy success which we are very sceptical about.

To conclude, oil prices - which remain between $45 and $50 - should normally add some inflation pressures. The UK is the largest producer of oil and the second-largest producer of natural gas in the European Union. There are however growing concerns that the oil oversupply is not yet and that the current rebound might actually be temporary.

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FX Markets

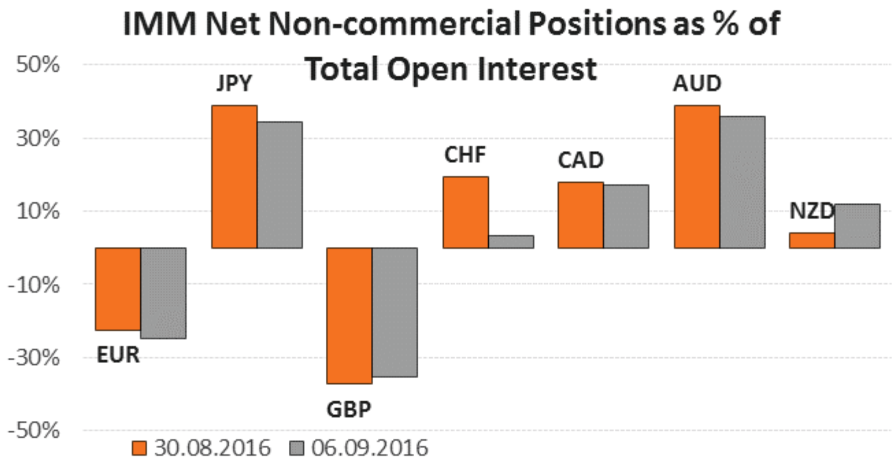
IMM Non-Commercial Positioning

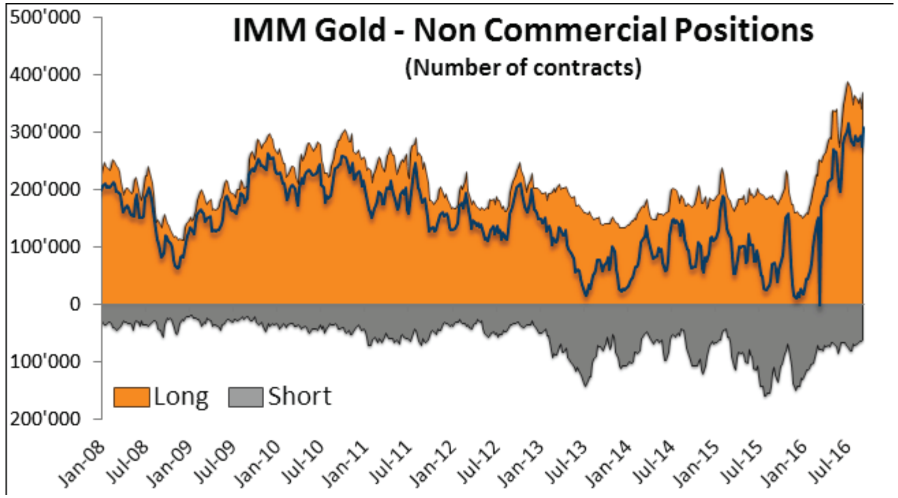
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

The IMM data covers investors' positions for the week ending September 6th 2016.

Net long gold positions reached the highest level since early July this year as the global uncertainty stays elevated. The net number of long contracts hit 307,860 contracts in the week ending September 6th. Given the extreme in long positioning, the risk is skewed to the downside.

The GBP short positions have remained at very high levels as investors bet the pound sterling still has substantial downside potential. Since the UK referendum, short positions have increased steadily and did not show any sign of easing as the long-term consequence





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