WEEKLY MARKET OUTLOOK

17 - 23 October 2016

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WEEKLY MARKET OUTLOOK - An Overview

Economics

Unsurprising Fed Minutes & Strong Retail Sales

No less than seven Fed members have spoken this second week of September, including Janet Yellen on Friday. Policymakers hinted more strongly about a December rate hike, which is now priced at around 68%. Last year's scenario, a December hike, is repeating. In terms of data, the week had been well loaded with some major events in particular the September FOMC meeting minutes which had been released. There was not any surprise on that front and the tone remains hawkish.

The minutes served also to highlight the growing division amongst policymakers. It is said that the decision to hold off rates was finally made by Janet Yellen. It appears that several policymakers indicated that raising rates "relatively soon" would be a good thing.

We maintain our view that the quest for credibility will be the catalyst behind the Fed raising rates despite the state of the US economy is overestimated. This is why the Fed should remain on hold next year. Indeed, normalization rates are several years overdue. We remember the Fed claiming that it would raise rates when unemployment fell 6.5%. This level was reached in April 2014. On top of that, US core inflation has been above the 2% inflation target for almost a year. Actions speak louder than words and we cannot qualify Fed's actions as hawkish.

What remains concerning and what the Fed will be questioned on, is why has it decided to now raise rates while inflation expectations are getting lower. On top of that, labour data has often been a strong point in the Fed's arguments to raise rates. Last September NFP is only hiding the fact that despite it coming in around the August release figure, 156k vs 151k, the unemployment rate increased to 5% and wage growth keeps on declining. The Fed's dual mandate, low unemployment and price stability, looks at stake. Uncertainties remain as the Fed now does not seem as data dependent as it was.

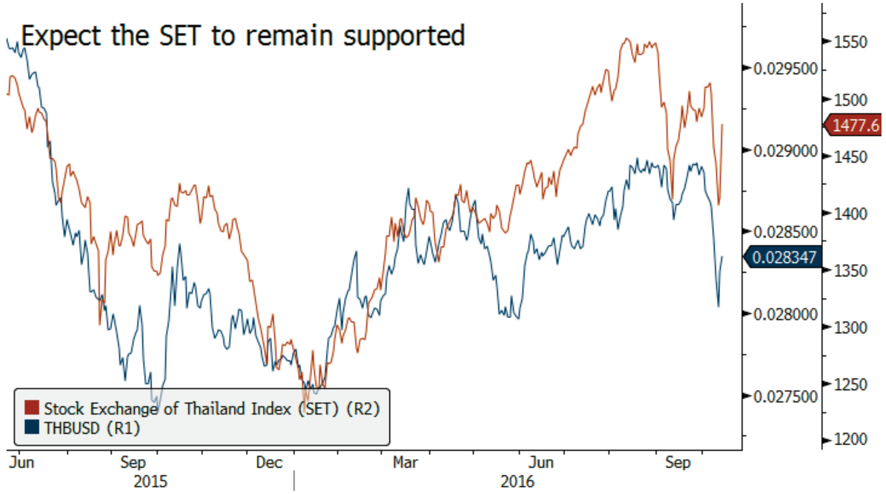
Currency-wise, the EURUSD is trading at its lowest level in three months and there is definitely some room for further upside caused by soft economic data or mixed Fed member declarations. For the time being, the demand for dollar remains strong and the green note is also climbing with oil prices. Usually when the dollar is getting stronger, oil prices would fall. We nonetheless believe that the barrel remains relatively low at around $51 and that the black commodity prices are actually pushing the stocks market. We nonetheless consider that a stronger oil price is needed before triggering any downside pressures on the dollar.

Economics

A Very Thai Reaction

Currently Thailand is in shock following the passing of King Bhumibol Adulyadej, the world's longest-reigning and most beloved monarch. Thais are now waiting to hear how the period of mourning will be organized. Most likely, exchanges will be closed tomorrow so traders will have to wait and see the effect his passing will have. We doubt any political party will take advantage of the situation out of respect and reverence to the monarch. Despite international anxiety concerning the transition, presenting a challenge for his only son and named heir, Maha Vajiralongkorn, we anticipate that the event will go smoother than Thailand's traumatic decade would suggest. The government, led by the military since the coup d'état of May 22, 2014, will likely maintain strong domestic control.

Should outflows become destabilizing, we anticipate that the BoT will step in to maintain order. Mr Veerathai has stated in the past that the BoT stands ready to use tools if the BoT finds FX movement to be incompatible with Thailand's financial stability or indeed the country's economic recovery. Capital flows are likely to marginally slow until the transition strategy has been clarified. We anticipate some degree of weakness in THB, however nothing drastic as Thailand works through this transitional period. Markets are now bracing for a potential sell-off in Thai stocks. However, we suspect the opposite to be the more likely outcome. We anticipate the SET to rally in the next week. The passing of the revered monarch is more than the loss of a leader, but rather the father and guardian of a kingdom. International analysts have been focused on the decade of chaos and extrapolate the king's death as the next trigger of social disorder as political factions again splinter. We expect Thai domestic investors to defend the traditional cut and run by international investors with significant buying. For the Thai's, supporting the stock market at this historical moment of transitions, is not about financial gains but cultural pride.



Economics

BoE Could Praise The Devalued Pound

The Pound flash crash has not been really explained

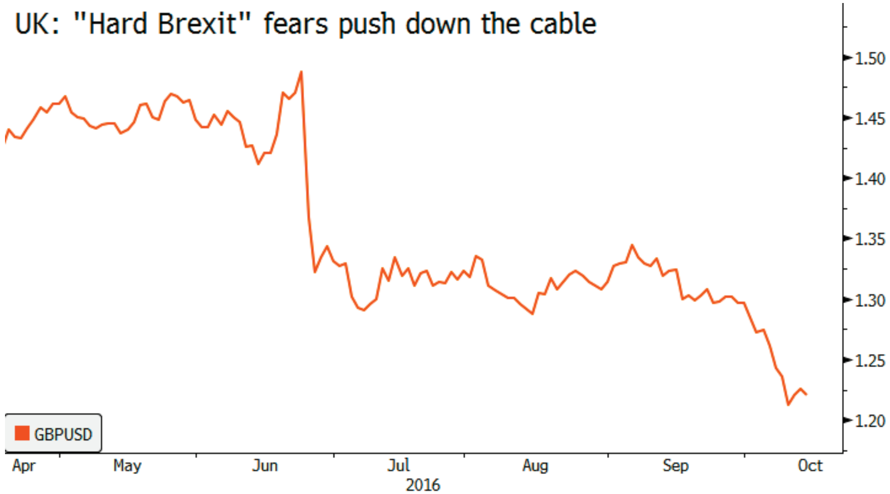
A week after the flash crash which sent the GPBUSD below 1.2000 before bouncing back slightly, it is concerning that no actual reasons have been found out. We may accuse algos but on what would be the rationale that would justify such sell-off during the Asian session. Some rumours also say that it is a fat finger order that could have possibly triggered the brutal move.

It does not change our fundamental view on the pound, plus it is a good occasion for investors to reload their long position. The Brexit consequences are overly exaggerated and the nightmare that was promised out of the Brexit referendum did not exactly happen. We may even see now that a "Hard Brexit" in other words an abandon from the single market is a possibility.

UK is not going to collapse

A Brexit is definitely not the end of the world. On top of that, it is interesting for the BoE to have such a weak pound at the moment. It is definitely helping the country. It is also worth noting that since the Brexit, the house-price growth is at the lowest in three years. Fears of "Hard Brexit" maintain the pound at a very low level and investing on the fact that the UK economy is not going to collapse seems a good macro trade.

We remain nonetheless cautious as a more-than-expected hawkish Fed could send the cable lower. This has not happened in recent decades but the quest of credibility from the American central bank may surprise markets. However, the Fed has disappointed markets on several occasions. This is another good reason to reload longs.



FX Markets

IMM Non-Commercial Positioning

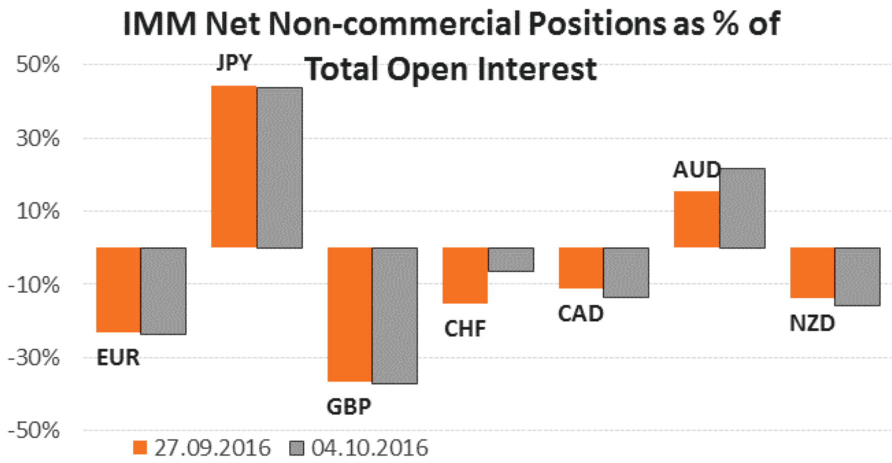
The International Monetary Market (IMM) non-commercial positioning is used to visualise the flow of funds from one currency to another. It is usually viewed as a contrarian indicator when it reaches an extreme in positioning.

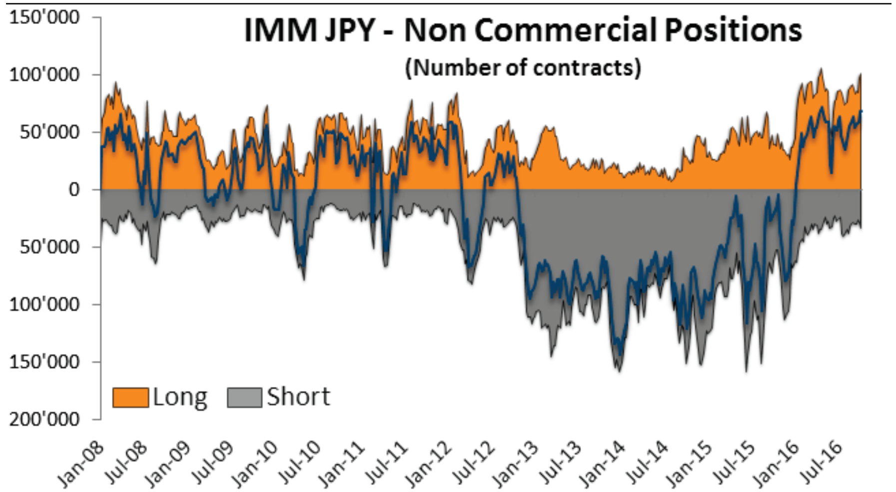
The IMM data covers investors' positions for the week ending October 4th 2016.

Speculators remain largely long JPY. The Japan's safe haven status is still very attractive despite the fact that ultra-loose monetary policy keeps going.

Net short CHF positions have been reduced. The US Elections is bringing a lot of uncertainties in the market and we should see investors moving back towards safe haven.

The GBP net position is still largely short which may explain why the flash crash was so intense a week ago. We believe that the Brexit is not going to be a nightmare and that investors will slowly reverse their positions.





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