WEEKLY MARKET OUTLOOK

31 October - 6 November 2016

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WEEKLY MARKET OUTLOOK - An Overview

Economics

SNB Monetary Policy To Remain Ultra-Loose

An unclear communication

Last Monday, Thomas Jordan, the SNB Chairman, held a press conference in Bern. Investors are often looking for further hints about what the SNB is going to do. Unfortunately, the Swiss central bank's communication is often unclear and the banking institution is not very likely to disclose its strategy to defend the CHF.

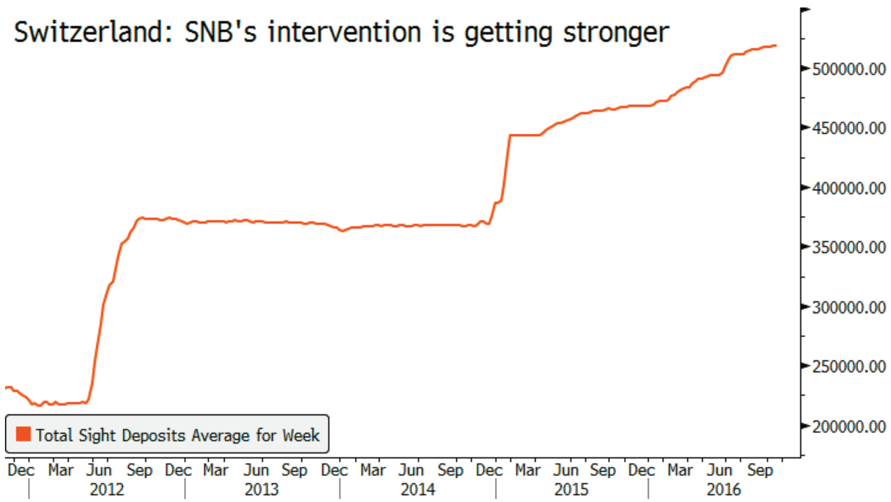
What is certain, anyway, is the ongoing inability of the SNB to stimulate the growth of the Helvetic economy as the safe-haven status of the country is making very difficult the SNB actions. It is well reflected in the bonds markets. The Swiss govies are very attractive due to the ever-lower cost of money along the strong franc. Short-term and even long-term yields (until a maturity of twenty years) are negative. In our view, sky is definitely not the limit for the bonds market and while the consequences of such a monetary policy are not exactly known, the impact on banks and investors must be assessed.

Nothing new... at the moment

Jordan stated that "The cost associated with negative interest is lower than the cost of holding cash", which we do not believe knowing that from our perspective, the cost of negative interest rate will be always higher than the cost of holding cash, especially if inflation comes back. Further decreasing interest rates may trigger a bank run or a least a flight to cash that would be damaging to the economy.

Jordan also mentioned that the SNB is not willing to limit or abolish cash in order to prevent such adverse effects and other monetary tools such as helicopter money. At this point, the SNB has expanded its balance sheet to 110% of its GDP and we believe that there is still more room for further expansion, especially when looking at other countries with significantly higher debt-to-GDP ratio such as Japan or the United States.

Downside pressures are still weighing on the EURCHF despite the SNB's massive intervention. We naturally remain bearish on the pair. The main driver of the pair is, at the moment, clearly the ECB and the December meeting is highly anticipated by financial markets. Volatility should come back then knowing that the end of the European QE program looms.

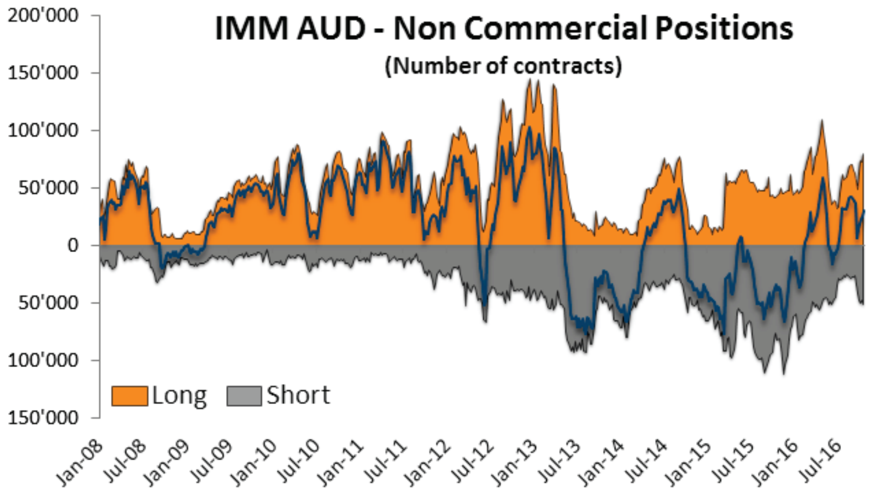


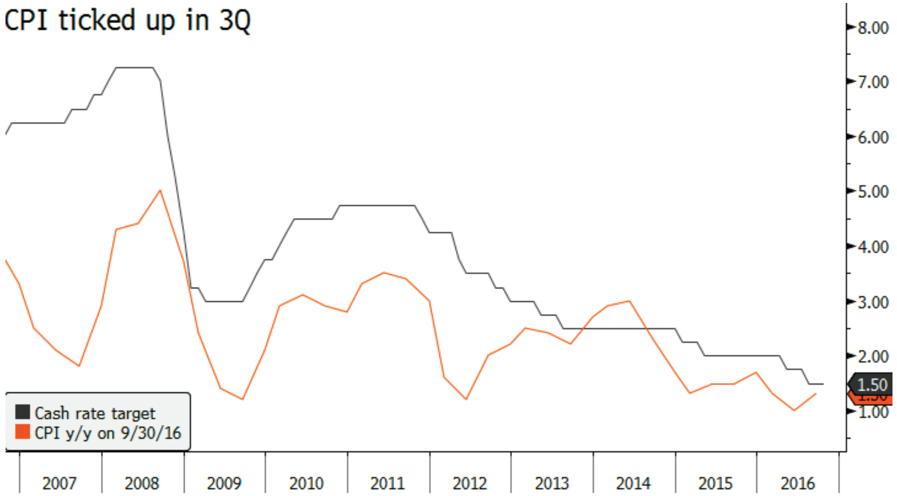
Economics

Australian CPI Surprised To The Upside

The last CPI report from Australia surprised substantially to the upside with the headline measure printing at 1.3% in the third quarter versus 1.1% median forecast. The sharp increase was mostly due to an important rise in fruit (+19.5%), vegetables (+5.9%), electricity (+5.4%) and tobacco (+2.3%) prices. On the other hand, automotive fuel (-2.9%) and telecommunication equipment & services prices (-2.5%) dragged the gauge down. In spite of this good news, the core figures were left unchanged with the trimmed mean stable at 1.7%y/y, while the weighted median mean eased and came in slightly below median forecast as it printed at 1.3%y/y versus 1.4% expected.

All in all, this inflation report does not change the big picture, especially for the Reserve Bank of Australia, as core inflation remains subdued meaning that the door is still open for another rate cut. However we expect the central bank will remain on hold next week, waiting for further clarity - especially from the US where the Fed and presidential election could impact markets significantly - before cutting the cash rate target another 25bps. The Australian dollar surged 0.64% after the release and consolidated those gains afterwards. Over the end of the week, the Aussie went under significant pressure as speculators closed their long AUD position. Indeed, CFTC AUD net long speculative positioning reached 25% of total open interest last week as investors desperately seek higher returns. The Aussie stands amongst the few currencies that did not lose ground against the dollar as market participants started to price in a December rate hike in the US. Therefore, there is still upside potential, especially should the Fed delay further any tightening move. However, the BRA will likely emphasized the need for a weaker Aussie, which could prevent further AUD gains in the short-term.





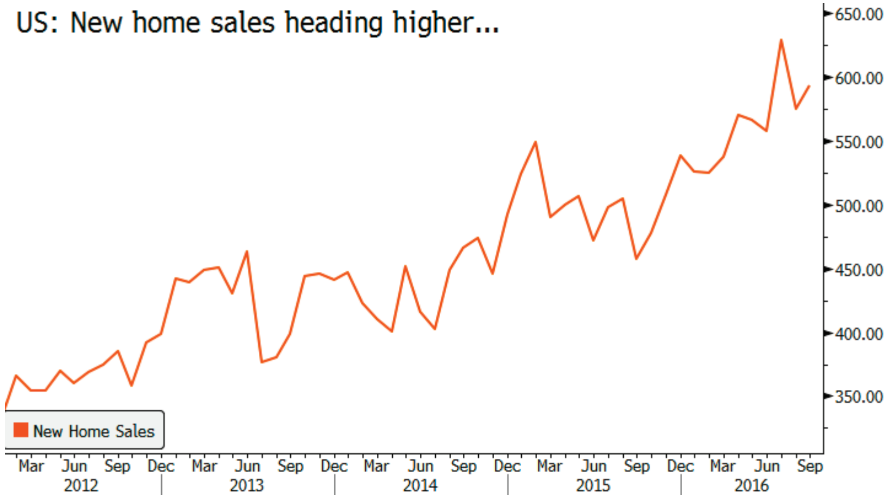
Economics

Real Estate Data Set To Reflect Underlying US Difficulties

US new home sales rarely decline twice in a row. Over the last two and a half years this has only happened once - at the beginning of this year. In addition, the downside move was somewhat limited with new home sales declining from 538k to 525k from December 2015 to February 2016. Last August, new homes sales declined by -7.6% from 650k to 609k, which represented the biggest monthly decline in 11 months. Finally, September new homes sales printed to 593k but August release has been revised upward at 575k which results in an increase.

The trend in home sales remains nonetheless positive over a 5-year period. The bottom was touched in February 2011 three years after the subprime crises exploded. The era of free cash has pushed real estate massively higher and while markets are now pricing a decent likelihood of a December rate hike, we should see the start of a slight correction in the housing market. In our view, this will remain temporary as no more rate hike should happen in 2017. We believe that the Fed will keep interest low while inflation starts running higher. This move will mostly be aimed at killing the massive US debt and taking back control of the economy as monetary policy becomes increasingly inefficient the more debt continues to rise.

As a result, the US middle class is certainly going to suffer in the coming few months/years. The demand for dollar is set to continue and we maintain our bearish view on the currency. Yet, there is no big upside on the green note at the moment as a Fed rate hike in December is well priced in.



Economics

Brazil Goes For Austerity

After rallying in the first part of last week, the Brazilian real came quickly under pressure as the positive effects stemming from the approval by the lower house of the constitutional amendment to cap spending on social welfare faded away. The unelected and very unpopular president, Michel Temer, was able to count on support from the entire political class to pass the PEC 241 at the Chamber of Deputies. The measure, aimed at limiting the growth of public spending to the rate of inflation of the previous twelve months will likely hurt the most disadvantaged Brazilian citizens as it will significantly reduce health and education programs, from school funding to disease prevention.

Temer's manoeuvre will likely please financial markets in the short to medium-term as it will help to shore up Brazil's finances. However, on the longer term, these public spending cuts could be seen as a cut in investment, which would eventually weigh on the potential growth outlook.

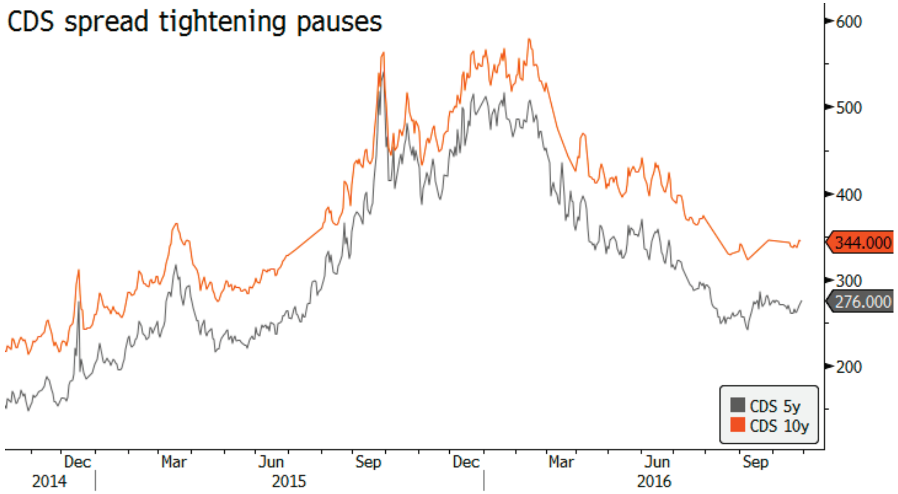
Cautious BCB

On the data front, the last mid-month inflation report showed that inflationary pressures have eased slightly in October, softening from 8.78%y/y in September to 8.27% in October and beating the median forecast of 8.29%. In the COPOM minutes released last Tuesday, in which its trim interest rate by 25bps, bringing the Selic rate down to 14%, the Brazilian Central Bank (BCB) emphasized the need for caution in monetary easing as inflationary pressures remain strong. The easing will likely be slow and gradual, which will provide the BRL with solid demand as traders ride the carry trade. The Brazilian real fell almost 2% against the greenback since last Wednesday on broad dollar strength.

CDS spreads stabilised

Dilma Rousseff's removal and hopes that the new government would be able to tackle the country's economic woes led to a sharp tightening in CDS spread, with 5-yr CDS spread tightening 255bps to 323bps. However, recently long-term CDS spread ticked up, with the 10-year rising more than 20bps to 344bps.

CDS spread tightening pauses



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