WEEKLY MARKET OUTLOOK

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WEEKLY MARKET OUTLOOK - An Overview

Economics

Trump Reignites Bond Sell-Off

Fixed income selling pressures continue to mount as the President-elect suggests significant fiscal expansion. Sovereign bonds took a hit with yields on 10-year treasuries surging to 2.092% while the 30-year US bond rose to 2.887%. President-elect Trump has provided only the vaguest of details of his sweeping policy on the campaign trail.

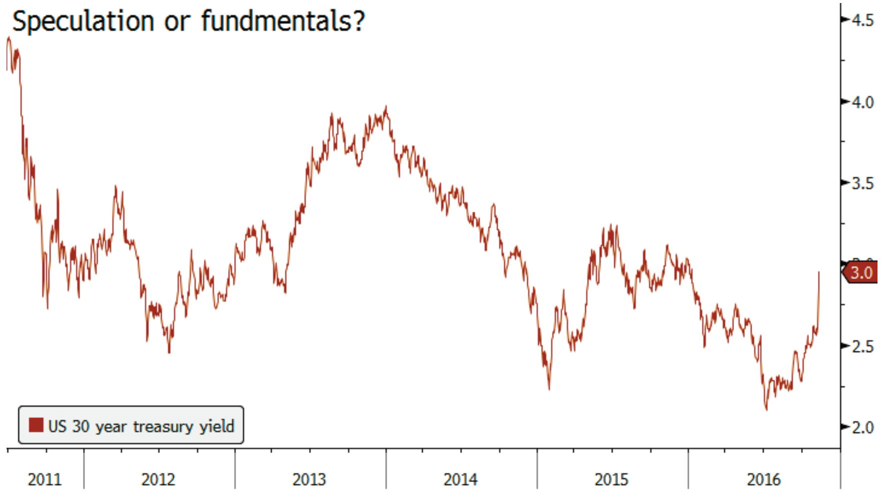
Yet at this acceptance speech he provided assurance that a potentially massive $600bn+ infrastructure spend is likely on the way. "We are going to fix our inner cities and rebuild our highways, bridges, tunnels, airports, schools, hospitals", Mr. Trump stated. Without much more clarity, specifically how this would be funded, why wouldn't Trump go for the quick win by fiscally stimulating a sub-growth economy on a cyclical downturn.

Even fiscally conservative republicans are showing exhaustion from spending constraint. It is unlikely that Trump will find much resistance, considering the republican viewed mandate forcing the majority run House and Senate will fall in line.

This new "Trumpflation" is pressuring yields already on the run under a tight labor market and rising inflation is pressuring wages. Increasing speculation that the Fed will raise rates 25bp in December and two to three times in 2017. Long term inflation expectations are rising and with it US bond yields. Widening US spread differentials against high yielding EM currencies should come under further selling pressure.

In the near term, we anticipate continued USD strength best seen through long USDJPY positions. AUDUSD also remains vulnerable as a proxy trade of weak Asian EM currencies (especially as more details on President Trump's policy are released).

However in the mid-term, we are dubious of how much inflation, even a fiscal expansion the US economy can generate. Trump's infrastructure plan should add 0.2% to GDP yet stronger USD and low energy costs will keep a lid on prices. In addition, as the external demand environment struggles, the US will continue to import deflation. We see it more likely that the Fed will raise once by 25bp in late 2017.



Economics

US Election's Epillovers En China's Trade Partners

The Australian and New Zealand dollar as well the Korean won bore the brunt of the sell-off that hit financial markets amid the election of Donald Trump as 45th president of the United States. Indeed the upcoming US president has promised he would support a 45% tariff on Chinese product to help reversing the trade imbalance. Such strong measure would definitely impact global growth in a negative manner and would more specifically accentuate China's economic slowdown. Indeed, even if China has already started the process to shifting its economy toward a domestic generated growth from an export driven one, the world's second largest economy is still heavily export dependent. Therefore a weaker Chinese outlook could only translate into bad news for the countries that are heavily sensitive to the Chinese demand. More than 30% of South Korea's exports are going to China, while 32% of Australia's exports are sent to China. For New Zealand the picture is a bit different as the country as a negative trade balance with China, meaning that it importing more than it exports. However the economy of New Zealand depends greatly on international trade and is particularly exposed to demand from Australia and China, its two biggest trading partners.

Central Bank cut

The Reserve Bank of New Zealand eased further its monetary condition last week on fears the strong Kiwi would dampen inflation expectations and rising uncertainty after the election of Donald Trump. The central was also more comfortable to cut rates further after the implementation of a tougher LVR rules that requires buyers to put down a deposit 40% on investment properties. The institution is also keen to continue improving macro-prudential measures to ease inflationary pressure on the housing market. Indeed it will allow Governor Wheeler to ease further without feeding the housing bubble. The Kiwi was one of the worst performers amongst the G10 complex last week as it slid to $0.7180 after hitting 0.74 in the immediate aftermath of the US election.

In spite of a solid year on the growth side, we believe that the central bank cannot stand idle on the inflation front as the strong Kiwi is making the country exporting inflation, especially tradable inflation that remained flat in the third quarter compared to the previous one, while on a year-over-year basis the measure contracted 2.1%. The trimmed mean measures rose 0.8%y/y in the September quarter. The RBNZ did not signal further rate cut for now but warn investors that it would not hesitate should inflation expectations come under renewed downside pressures. The Kiwi fell on another 1% against the greenback on Friday. The 0.70 key support area is not that far after all. A break of the latter would open the road towards the next support area at around 0.67.

Economics

Stocks Rallied After Trump's Elections

The day after the election was one of those days where a massive sell-off was expected after the Trump's surprise win. It is the second time this year that pollsters get it wrong after the Brexit vote.

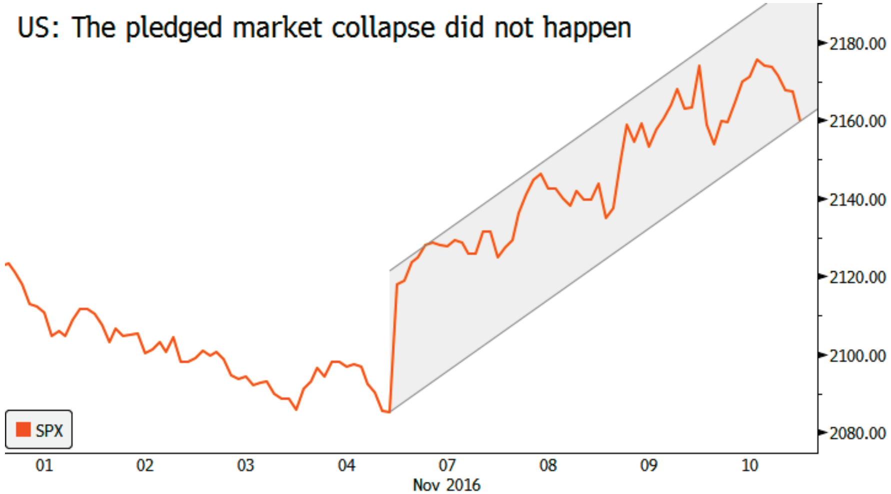
Upon Trump's election, S&P futures even crashed to a 4-month low. A black day loomed. However, eventually, when the US markets opened, losses were already largely offset and the US markets even finished on a higher note. However in Mexico, the stocks market keeps on suffering losing around 6% three days after the elections result on renewed declaration that the wall is one of the first thing that should be achieved during Trump Presidency. Controlling immigration is

It seems that Trump's victory speech cooled market anxiety as investors realised that it is only when Trump begins his presidency that markets will truly understand what he intends to do. For the time being, Obama remains president until the 20th of January.

Nonetheless, we believe that markets expect that a large fiscal stimulus package will be among Trump's first measures. On top of that, there is the widespread idea that Trump will do whatever possible to reduce regulations, which actually works in favour of the markets and implement protectionist measures to stimulate the US economy. The latter idea is widely supported by the fact that Republicans now hold power over the White House and congress.

We also believe that the tough words spoken against the Fed on the campaign trail will subside now that the election is over. In the short-run, the Fed will soon be back in the spotlight, US government bond markets are supporting a normalization of monetary policy. Markets are pricing a rate hike likelihood for December at 85%. We maintain our view that the Fed must deliver to keep its credibility.

The Fed is still having their hands free until then despite multiple statements from the new US president. For us it is an eventuality that Donald Trump will try to diminish the Fed control. Volatility which has collapsed amid the relief rally after the election is expected to grow again in December.



Economics

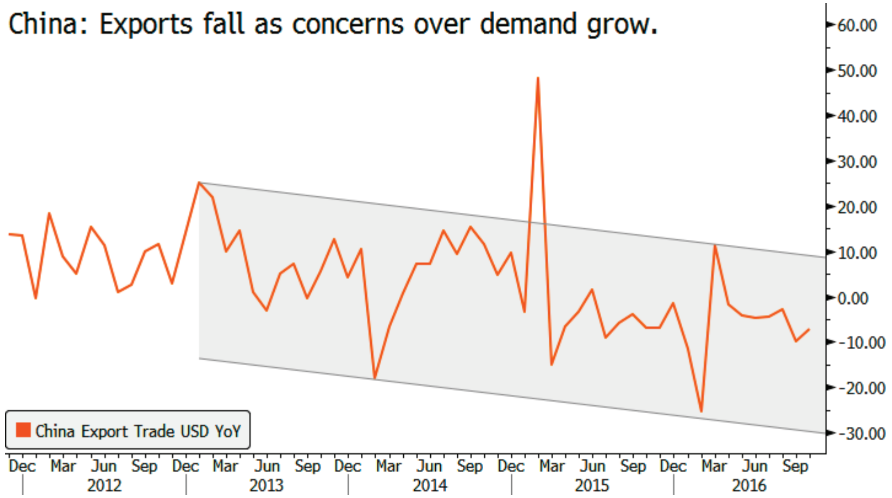
China: Exports Tumble Despite Weaker Yuan

China's economy is facing difficult moments. Earlier last week, exports collapsed to -7.3% y/y representing the seventh consecutive month of decline. Overall, global demand is on the soft side and it is clear that the Chinese economy is well into a shifting process from international to domestic growth.

The weaker yuan has not brought sufficient fuel to spur exports. The Chinese currency has nonetheless lost 1.5% in October against the dollar and 9% since last year. The country's imports fell 1.4% amid weakening demand, nonetheless driven by an increased call for commodities. As a result, the trade surplus fell to $49.1 billion for October which is still largely positive. In our view, this trend is likely to continue. One indictor which we closely monitor is the Baltic Dry Index which represents the cost of freight. This index is still at a very low level (870) compared to levels reached in the first decade of this century (between 2500 and 10000). The slight pick-up in the index is not sufficient to justify a global recovery.

Moreover, as Chinese consumer and producer prices rise at a quicker than expected pace, this tends to offset the lower currency. We believe that sooner than later China will export inflation. This is why in our view, we maintain our bullish view on commodities despite an already announced December rate hike, which should be the only one for at least a year.

Trump's policy will also be very important. The new President-elect declared that he would like to put the China into the list of manipulating currency. In other words, Trump is very likely to push China to strengthen its currency even though we consider that a weaker yuan would help the US to import inflation, necessary to kill the massive debt.



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