WEEKLY MARKET OUTLOOK

21 - 27 November 2016

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WEEKLY MARKET OUTLOOK - An Overview

Economics

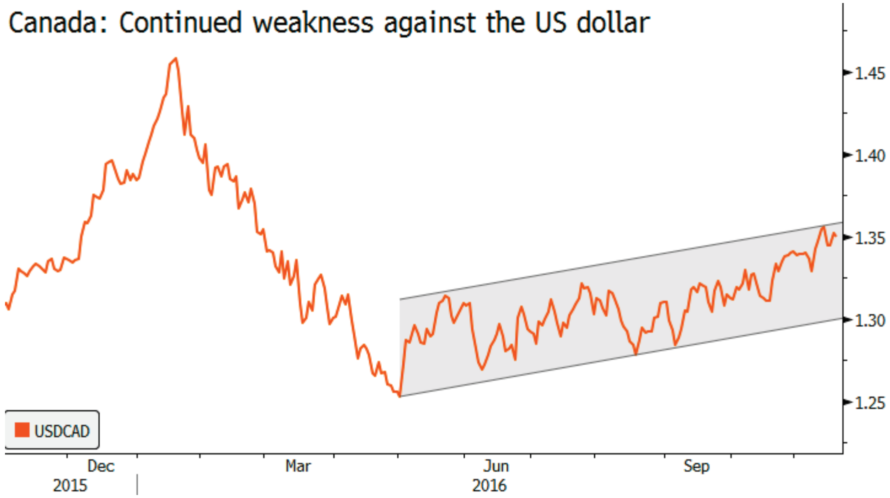
Trump Effect Hits Commodity Prices

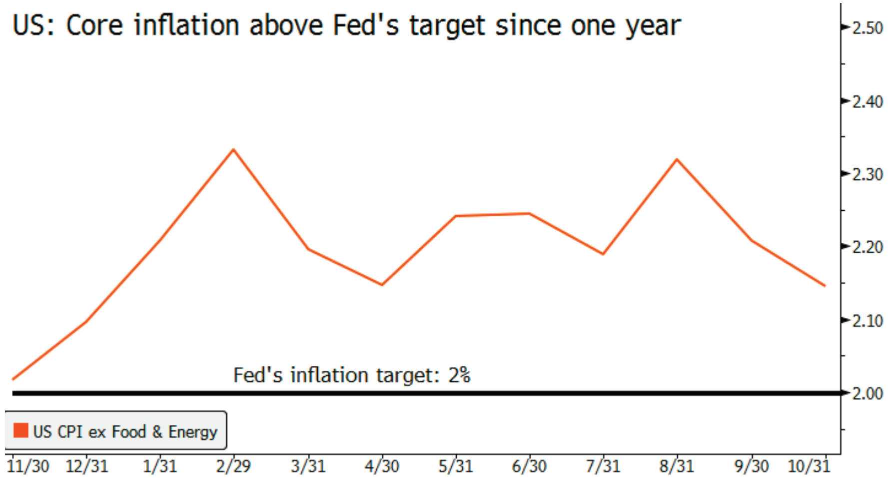
Uncertainties around the US elections have been significant. Gold prices have gone down over the past two weeks from $1305 an ounce to around $1215. Silver also went much lower flirting with prices unseen in the last six months. The stocks markets have rallied with the realisation that Trump is highly in favour of further deregulation. Safe havens have therefore been left behind. On top of that, there is now a strong sentiment that the Fed is going to raise rates in December with markets currently pricing a likelihood of 94%.

The Fed is now the main topic as we know that President-elect Trump has been very critical regarding the Central Bank, blaming them for underpinning asset bubbles. However, Last Thursday, Fed Chair Yellen confirmed that she intends to serve out her full term until 2018. Trump's politics will gear towards a higher inflationary environment, which is why no one should be concerned about gold and silver rising again in the medium-term. Indeed, we already expect protectionist measures to add important upside pressures on the US inflation.

Even if, theoretically, a rate hike from the Fed should send commodities lower, we remain confident that the US central bank will leave some inflation running to kill the country's massive debt. Under the Obama's presidency, the debt has increased to $18 trillion from $9 trillion. Fed's Bullard also mentioned that only rate hike should happen next year.

Commodity currencies are also weakening. The USDCAD is testing 1-year high levels while AUDUSD has finally broken a range in which it was trading for the last 4 months. In our view we expect a lower AUDUSD and a higher USDCAD in the short-term as we expect inflation to hit soon western economies. This is why we consider the current weakness of these currencies as a great entry point as inflation is already at our doorstep.





Economics

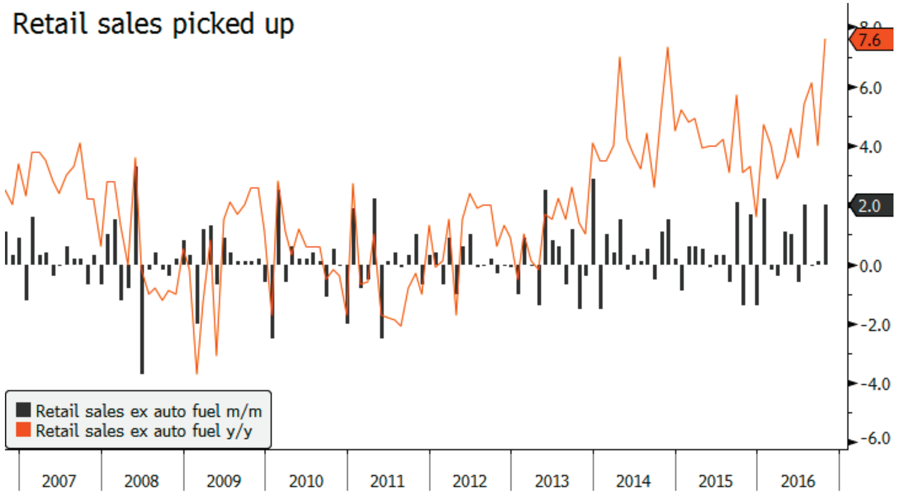
UK Economy Solid So Far

Market to focus on EU political agenda

In the wake of the election of Donald Trump as 45th president of the United States, the pound sterling was the sole currency within the G10 complex to extend gains versus the US dollar. It seems that the pound is taking advantage of the broader EUR weakness that is stemming from the increasing political risk as we head into 2017. Indeed, the UK's decision to leave the European Union has raised questions regarding the future of the union, especially since the escalation of nationalist fervour and rise of populism across members. In fact, the heightening political risk remains the more probable cause of the recent EUR weakness. Indeed, the next 13 months will be a veritable minefield for the European Union with several major risk events on the programme, including the Italian referendum, the Spanish general election, both general and presidential election in France, the Dutch national election and the German federal election. The market is therefore anticipating a darker outlook for the euro zone, especially now that inflation expectations have risen across the Atlantic.

Brexit negotiations

Therefore, the fact that the UK is trying to distance itself from the EU is having a positive impact on the GBP, at least in the short-term. Moreover, UK economic data has surprised to the upside last week. The unemployment rate eased to 4.8% in October versus 4.9% median forecast and previous reading. Retail sales surged unexpectedly in October, with the main measure rising 7.4%y/y versus 5.3% expected. The one excluding auto fuel surged 7.6%y/y versus 5.4% consensus. However we think it is important to keep calm and put things in perspective as the potential effects of Brexit, either soft or hard, did not kick in yet. In the longer term it will be a different story as it will depend on the terms of the new relationship between UK and the EU. After hitting 1.2674 in the days following the US election, the cable lost some ground and stabilised at around 1.24-1.2450 amid a broad-based USD rally. In the short-term, we believe the risk is skew to the upside, while on the longer term, the upcoming Brexit negotiation may increase the pressure on the pound.



Economics

Markets Expecting ECB Hints For 2017

What's next after March

Earlier last week, the ECB has published its account regarding the October policy meeting. Policymakers have decided that it is still too soon to have a clear assessment of the monetary policy especially regarding the asset-purchase program due next March.

Financial markets are still trying to spot any new hints about the future of the monetary policy. Yet, markets have already priced in that the current program should be extended beyond March. ECB President Mario Draghi has refused so far to announce any change as he certainly believes that a December Fed rate hike would provide further relief to the single currency and add upside inflation pressures. He definitely wants to be as flexible as possible until the next ECB meeting which will be held in December and which will then be very significant.

Some structural concerns

For the time being, Eurozone inflation is close to 0% and the asset-purchase program should remain around 80 billion euros per month. But there is one major issue at the moment: markets are concerned about the feasibility of such a decision as the scarcity of bonds remains a growing issue. The deposit facility rate is currently at -0.4% and the European institution is obliged to buy bonds yielding less than this level. This is why it would definitely help the ECB by removing this rule. On top of that the QE program also restricts the European institution to buy more than 33% of a country's debt. We believe that the ECB is too far to stop its QE program now and we believe that this alternative solution is becoming more likely to improve the scarcity of bonds.

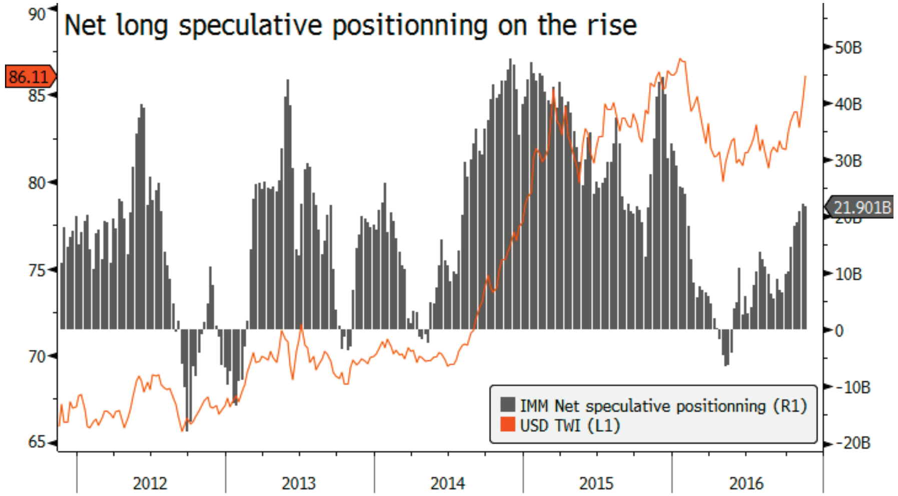
Economics

USD Risk Is Skewed To The Downside

It is almost a done deal. The Federal Reserve should increase its interest rate target band by 25bps at the December FOMC meeting. James Bullard, the President of the Fed bank of St. Louis, said last Tuesday that the case for an interest rate hike has strengthened recently but he suggested to keep them stable the following months as the US economy has been struggling with low growth and faltering inflationary pressures. It is not every day that we agree with a Fed member regarding the outlook of the US monetary policy as they have the tendency to always be overly optimistic, even the most dovish ones. Last Thursday, Janet Yellen's comments before the Congress Joint Economic Committee followed the same strain as she signalled that a tightening move was imminent.

We believe that the Fed is willing to let inflation run above the 2% target. Moreover, whether the Fed wanted it or not, the election of Donald Trump has created more uncertainty, especially concerning the growth and inflation outlook. Therefore, even if the Fed is saying that Trump's election will not alter its monetary policy, it will indirectly. We believe that the Fed will take the time to assess the new environment. We maintain our view that the Fed will remain sidelined next year, possibly raising rates just once at the end of the year, just to reaffirm its confidence in the strength of the US economy and to reassure markets. Again this is also the reason why the central bank will most likely push the button on December 14th.

According to the Fed funds futures, the probability of a rate hike at the December meeting has reached 94%. A tightening in monetary conditions in the US is therefore a done deal now and this is already fully priced in financial markets. That is why risk is essentially on the downside for the USD as a dovish surprise from the Fed on December 14th could trigger a sell-off in the USD. I am not convinced about a decision to stand idle but if the dot plots show that Fed members revised their rate hike expectations massively to the downside, it could send a negative signal to investors as it will show the Fed is becoming less optimistic about the US outlook.



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