SWISSQUOTE

WEEKLY MARKET OUTLOOK

6 - 12 March 2017

DISCLAIMER & DISCLOSURES

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WEEKLY MARKET OUTLOOK - An Overview

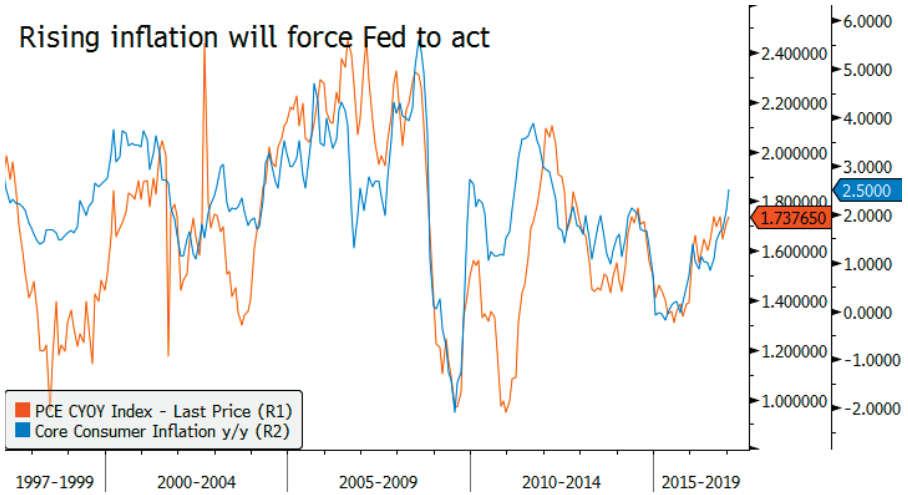
Economics

Fed Takes Back Center Stage

In our view the last straw fell this week as FOMC committee member Brainard seemingly reversed her long standing skepticism of a near term rate hike. We now expect the US policy path to include a hike in March and September. Brainard pointed to lowered concern over the growth outlook in Europe and China. Given Brainards long-standing dovish bias support of tightening should be view as an important step. Markets have rapidly pulled forward the Fed next rate hike from 20% probability of a 25bp hike just two weeks against over 90% today. US front end yields reinforced expectations and have support the USD rally.

First, US economic data has improved along the line with momentum in global growth. China factory active expanded faster than expect at manufacturing PMI rose to 51.6. While South Korea exports grew at the fastest pace in five years with shipments to China increasing 28.7% y/y. Domestically, the US manufacturing sector grew for a sixth consecutive month as Purchasing manager index surged to 57.7 and factory orders climbed 1.3%. Second, inflation including core pace has quickened more than expected. Annual core PCE, the Fed favorite measure of price pressures, remains elevated at 1.7% while core CPI has climbed to 2.3%. Third, the rhetoric from Fed members including history dovish members increasingly sounds hawkish, suggesting a bit of urgency in policy setting. Finally, President Trump's conciliatory address to congress has lowered the potential political risk that was obscuring Feds policy pricing. With the markets principally focused on economic fundamental and monetary policy, and not political noise, the reality of data indicted Fed need to act. Our expectation of only two hikes in 2017 is based on the fact that real wage growth remains subdued.

If we are correct, a majority of USD buying has already been priced in (judging from vol) but USD remains underpriced for additional tightening to continue through 2017. In the mid-term, given the mounting political risk in European we continued to see EURUSD grinding lower.



Economics

No Wage Growth Environment

Since reaching its lowest level in a year against the dollar in December, the yen continues to strengthen. However, the BoJ still appears to be unable to stimulate the economy and fundamental data are somewhat lukewarm. Industrial production came in earlier last week at -0.8% m/m for January after financial markets were expecting a positive read. Retail data are also concerning, household spending is on its way down, 1.2% in January. Ironically, upside pressures on the yen continues despite its economy being out of control. Japan's economy is clearly a market risk indicator.

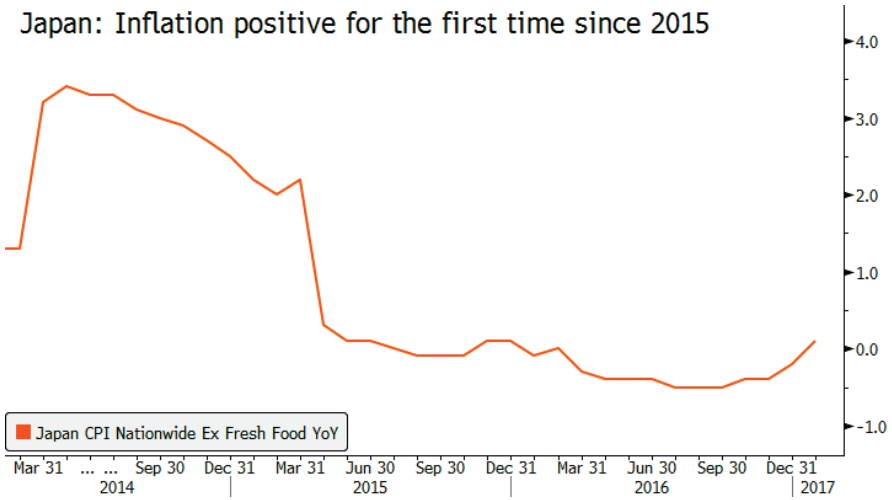
For the first time since 2015, Japanese inflation has become positive. This may be seen as positive for Shinzo Abe and the Bank of Japan but the print is only of 0.1% y/y. The inflation target of 2% still seems far off. Of course, the most likely cause are petrol prices which have jumped since last year.

Indeed, since Trump's election last November there were hopes that Japan's inflation will eventually start picking up. The yen has weakened in the last few months. We recall that Japan has battled with inflation for the past two decades and the ultra-loose monetary policy has not worked yet. The BoJ's strategy to control Japan's yield curve may be a more sustainable strategy in the medium-term.

Japanese policymakers are still expecting the Fed to raise rates in order to hold off some pressures from the economy. However, there are still important uncertainties on the Fed rate path tightening. This is why we remain cautious as there are definitely room for further disappointment. Uncertainties over Trump's economic policies loom large.

It is also worth noting that retail sales have increased for the third consecutive month with a 0.5% m/m for January (1% increase annualized). Furthermore, wage growth slowed in December, which should reflect at some point in the retail sales. The truth is that wages are not at a sufficient level to support the economic recovery especially knowing that, once inflation is stripped away, wage growth for 2016 will in fact be negative.

Other fundamental data is positive, unemployment is very low, 3% and the number of jobs per applicant is lying at an amazing 26-year high. Yet, companies are still reluctant to increase wages, which would support the economic recovery

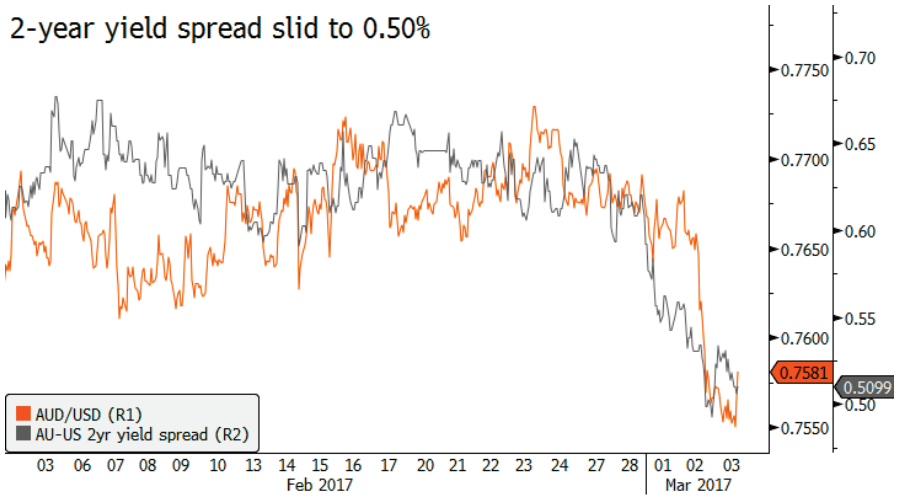


Economics

AUD Set To Decline Further

The Australian dollar has been the best performing currency among the G10 complex during the two first months of the year. The Aussie rose more 6% against the greenback and recovered from around $0.72 to around $0.77. This sustainable appreciation of the Aussie is mostly the results of two factors: Firstly, the broad dollar depreciation was especially marked against high-yielding currencies such as the Aussie and the Kiwi but also against safe haven currencies such as the Japanese yen and the Swiss franc. This move was due in large part to growing impatience of investors about the lack of details regarding Trump's stimulus plan. Secondly, the sharp increase in iron prices - together with the broad-based recovery in commodity prices - has helped boost expectations for the country's growth outlook. Indeed, the Aussie economy is highly dependent on exports (around 20% of GDP) and its dependence on China's health is also very high as roughly 34% (12-month average) of its exports go to the "Middle Kingdom".

Despite this encouraging note, dark clouds are gathering on the horizon as the two factors mentioned above are losing momentum. Indeed, China's iron ore port inventory rose dramatically this year and reached almost 130 million tons as of February 24th. On the other hand, over the same period, steel production continued to inch lower, suggesting that there is a strong imbalance between demand and supply. Finally, on a trade-weighted basis the Aussie is back to levels last seen in summer 2015, which makes the RBA very unhappy with the situation. Indeed, the central bank has reiterated many times that the Aussie is overvalued and may be ready to take some action to adjust this situation. Taking into account the two factors exposed above, we believe that the Aussie rally is definitely over and that the ongoing correction has some legs. We do not exclude the RBA to cut rates next Tuesday but in our opinion it appears very unlikely as the AU-US yield spread continues narrow. We anticipate AUD/USD to return quickly toward $0.75 and do not rule out further weakness for the pair should the dollar rally continue with $0.74 as the next target.



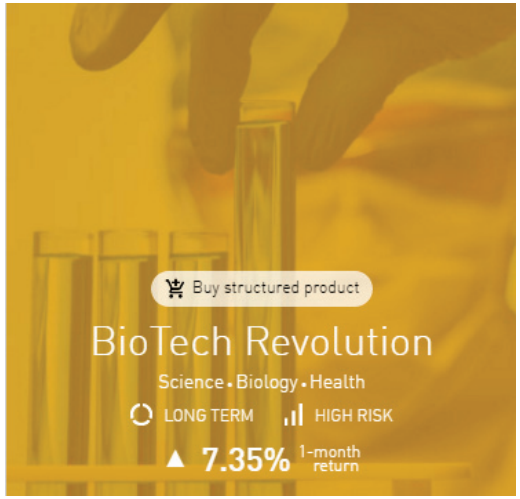
Themes Trading

BioTech Revolution

Trump negative comments over the pharma industry has now died down allowing Biotech stocks to recover. The pharmaceutical industry is going through a minor revolution. Biotechnology has a broad mandate, covering a wide range of processes for transforming living organisms for human purposes. However, this theme focuses on a new breed of companies that have joined the race to use modern technology to create healthcare products. These companies harness cellular and bio-molecular processes to develop technologies and products to fight disease. Exploding R&D costs have forced traditional pharma companies to look to smaller, more agile, technology-driven firms as the primary pipeline for innovation. With public and private investors and big pharma all expecting the next big breakthrough to come from this dynamic sector, valuations are on the rise.

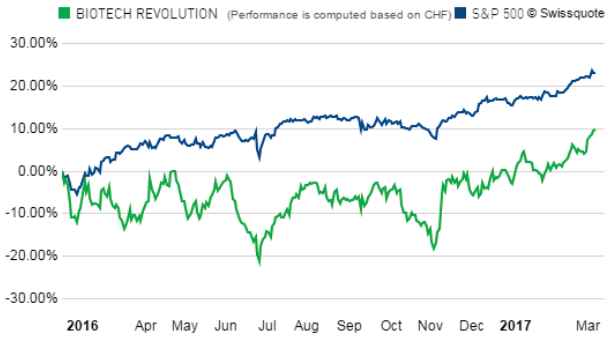
We built this theme by filtering on firms with a market capitalization of over $1 billion and positive sales growth over the past two years, ensuring that they have sufficient cash flow to fund the next blockbuster.

https://www.swissquote.ch/url/investment-ideas/themes-trading



Since inception	▲ 9.25%
1-month return	7.35%
Return day	0.65%
Est. dividend yield	0.00%
Inception date	01/02/16

See portfolio details | Buy structured product



Themes Trading

Swiss Smart Beta

Swiss stocks have a reputation of being high quality and tend to provide stable returns during times of geopolitical uncertainty. With President Trump, Brexit, European elections and global protectionism, the world has become significantly more unpredictable. This portfolio sources high-dividend Swiss stocks and provides an active quantitative overlay to optimize risk/reward potential.

The Swiss Smart Beta theme consists exclusively of stocks from the Swiss Performance Index (SPI). The selection process identifies stocks with a high dividend yield and a market capitalization in excess of CHF 100 million. Illiquid stocks are screened for constant bid-ask spread and daily average dollar volume traded. To enhance risk diversification, the portfolio is weighted using an equally-weighted risk contribution approach. In summary, this means the allocation is calculated in such a way that each stock contributes on an equal basis to the total risk of the portfolio. This approach allows for low volatility and, in so doing, increases the risk/reward ratio.

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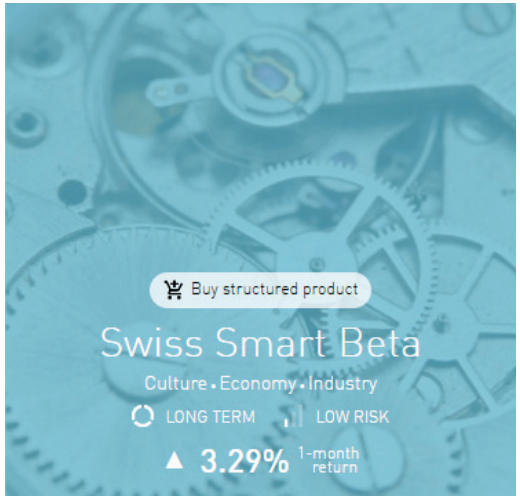
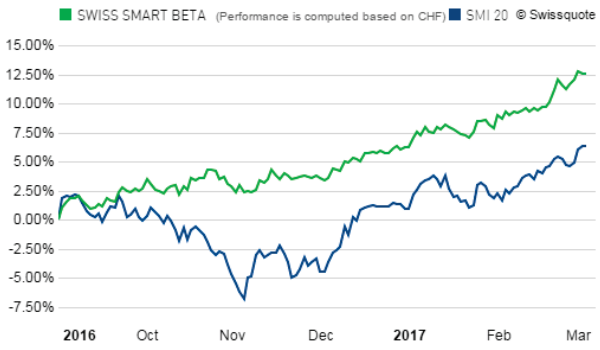


Since inception	▲ 12.56%
1-month return	3.29%
Return day	-0.20%
Est. dividend yield	0.00%
Inception date	01/09/16

See portfolio details | Buy structured product



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