SWISSQUOTE

WEEKLY MARKET OUTLOOK

10 - 16 July 2017

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WEEKLY MARKET OUTLOOK - An Overview

Economics

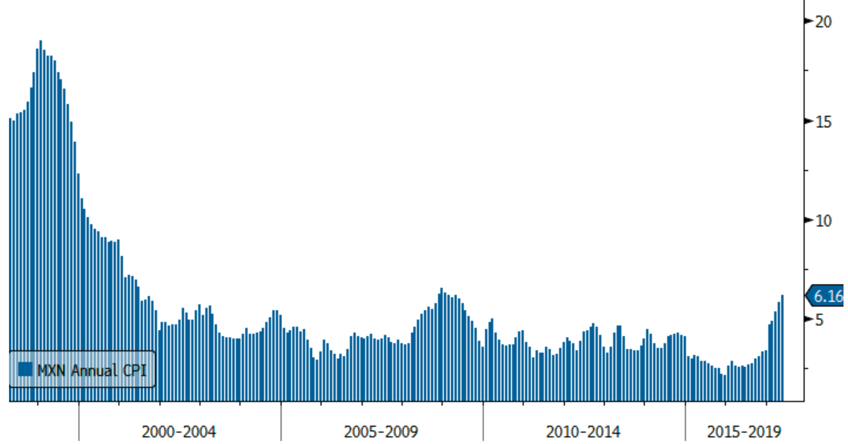
Global Bond Rally Threatens EM

Developed markets bond yields continue to rally, slowing investors rush into EM assets. Banks and data from ETFs are reporting the slowest EM inflows since the start of 2017. With rates driving currencies, last week saw steady depreciation in most EM currencies against G10. High beta currencies like TRY, RUB and ZAR lost over 2% as yields differentials widened. The root cause is the growing expectations of policy regime shift in central banks. Led by the Fed, ECB and BoE investors can finally see a light, abet distant, at the end of the ultra-accommodating monetary policy tunnel which dominated the last 10 years. In the FOMC meeting minutes members continued to highlight that a combination of interest rate hikes and reduction of balance sheet will utilized to prevent the economy from overheating. At the ECB Draghi attempted to back track from his hawkish comments, yet optimistic economic outlook suggests that the days of emergency measures in Europe are numbered. So far, the shift out of EM has been orderly yet as we have seen with the taper tantrum, sentiment can change in a moment.

Lower oil prices and protectionisms Trump behaviors towards China has once again put the spotlight on Mexico. Banxico meeting minutes signaled a cautious stance towards policy setting. Inflation outlook remains skewed to the upside, which is problematic for the central bank that would like to pause hiking cycle with overnight rate at 7.00%. With the Mexican economy mired down in weak oil prices, soft consumer demand and stalled industrial production, higher funding cost would not help. Annual consumer price inflations has gone ballistic now standing at 6.15% from 2% in December. Markets are already expecting a reversal and have two cuts priced in for the end of 2018. Yet in the short term this feel optimistic. Baring orderly rise in US yields, break down in Pena Nieto & Trump communication or a panic exodus from EM, MXN should continue to rally.

USDMXN bearish monument should continue with a test of near term support at 17.80.

Rising inflation will Banixco hawkish



Economics

Fed Minutes Leave Markets Hopeless

Beside the start of the G20 meeting in Hamburg, the release of the June FOMC meeting minutes was the highlight of last week. Investors were impatiently waiting for clues about the Fed's thinking and expectations were quite high. There was considerable disappointment when they realised that the minutes showed a highly-divided committee, increasing the overall uncertainty about the timing of the next interest rate hike and the beginning of balance sheet unwinding programme.

The committee noticed that the labour market continued to strengthen together with the economic activity, the latter improving at a moderate pace though. FOMC members acknowledged both headline and core inflation measures came in below their anticipation but "viewed the recent softness in these price data as largely reflecting idiosyncratic factors" and added that it will have little bearing effect on the medium-term. However, some participants appeared quite concerned about the downside risk in inflation and raised doubts about reaching the 2% target, suggesting that dissent started to appear within Fed presidents.

Regarding the asset-reduction plan, the minutes did provide clarity regarding the game plan and the timing of the announcement, revealing that several participants prefer to announce the start of the process within a couple of months, which puts the September meeting right in target. Indeed, we do not believe the Fed will do this at its July meeting.

We reiterate our view that the weakness in inflationary pressures that has emerged at the beginning of the year will force the Fed to slow down the pace of monetary tightening. Therefore, we expect only one other rate hike this year, most likely in December. We also anticipate that the Fed will wait until at least until September to announce the timing of the balance sheet reduction, which will most likely start at the earliest in the second half of 2018. However, given the disappointing reading in average hourly earnings last Friday (2.5%y/y versus 2.6% exp. and a downwardly revised figure of 2.4% in the previous month), we won't be surprise should the Fed delay further the announcement.

Given the lack of new information provided by the minutes, the USD extended losses starting on Thursday. On Friday, EUR/USD was on its way to test the 1.1445 resistance.

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Economics

Switzerland Retail Sales Declined Less Than Expected

The CHF is still trading below 1.10 against the single currency despite short-term bullish pressures on the pair. We believe that there are at the moment two major reasons that are pushing the euro against the Helvetic currency.

The French Presidential election and the start of the "Brexit" negotiations have removed - at least reduced - the political and geopolitical uncertainties, markets are clearly shifting towards risk-on and which is why we see the EURCHF pair moving up.

In addition, Mario Draghi's recent comments pushed the euro higher by stating that the Eurozone recovery is progressing and that the ECB monetary policy stance must accompany this recovery. Markets interpreted those declarations from the ECB as hawkish.

Overall, we may judge that the economic fundamentals of Switzerland are now better than what could have been expected after January 2015 despite the constant overvaluation of the CHF pushed by the extreme monetary policy of the European Central Bank. It has been now two years and a half since the removal from the floor and upside pressures on the Swiss franc are still strong.

For the time being, the situation looks under control. The trade balance remains largely positive, unemployment rate is still very low (3%) and the GDP growth, even though low is decent (Q1 at 0.3% q/q). The one major issue is inflation which is not picking up and this should, at some point, have a negative impact on growth. Hence, we may assess that the Swiss economy still has some room to resist, in case larger weaknesses of the single currency drive the CHF higher.

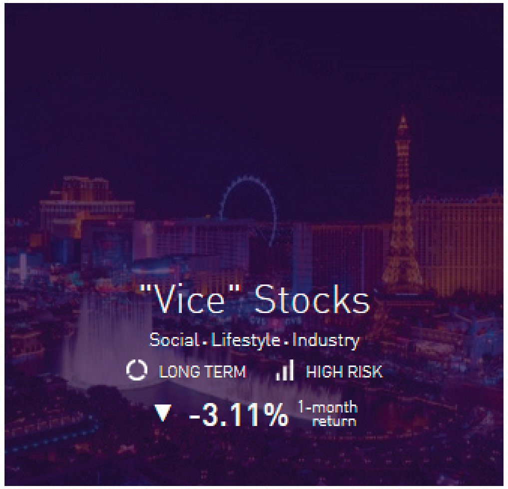
It is worth noting the CHF is valued under its political and economic stability rather than on its economic data. By the way markets barely reacted on the release of retail sales growth which came in negative for the 2nd month in a row at -0.3% y/y. Swiss safe haven status is what makes the country attractive and we see the EURCHF pair showing a short-term continued bullish move towards 1.1000.

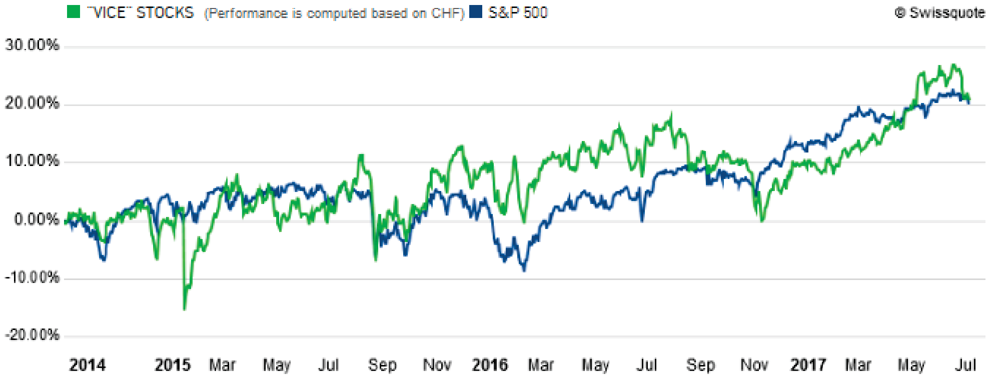
The SNB must still hold tight to defend the Swiss franc but we are concerned about the level of FX reserves which continues their massive increase. This has enabled the Swiss central bank to become the eighth most important investor in the world with $80 billion dollar invested In the US market.

Themes Trading "Vice" Stocks

Investing in vice (or "sin") companies isn't for everyone. But it has been shown to significantly outperform more conventional stocks. The economic rationale for investing in socially irresponsible companies is clear. "Politically incorrect" industries --such as alcohol, tobacco, gambling and military (heck, we'll even throw in fast food and big oil for good measure) --generally outperform in bull markets and are more resilient in bear markets. That's because earnings growth and dividend yields tend to remain stable, no matter what the state of the economy.

Many vice stocks even exhibit countercyclical behaviour, performing better as the economy worsens. Some people find this type of investment questionable for moral reasons. But make no mistake: this is big business with big opportunities. The US alcoholic-beverage market was worth a whopping $211.6 billion in 2016, with a growth rate of 7% between 2000 and 2016. This Theme will focus on companies that generate most of their revenue from alcohol, tobacco, guns, fast food, adult entertainment and gambling.





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