WEEKLY MARKET OUTLOOK

25 September - 1 October 2017

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WEEKLY MARKET OUTLOOK - An Overview

FX Market

Inflation Key To EURUSD

EU inflation data will be critical for the near-term EURUSD direction. Last week the Fed took another significant step towards policy normalization by announcing the start of balance sheet reduction in October. In addition, despite lacking a upwards trend in inflation data Fed members indicated that a December hike, then three more 25bp increase in 2018 was the base senario. The net result was a marginal and short lived USD rally. For EURUSD traders the Fed played their hand, so the next move will be the ECBs.

Strong improvement in EU growth outlook, led by domestic consumption, and improving backdrop for inflation has encouraged ECB policy makers to suggest the removal of emergence measures. However, further evidence that inflation trajectory will continue would provide the basic justification for a reduction in asset purchases. The most recent print of August core inflation was 1.2% y/y, above expectations. Yet the rise has not been broad-based, depending primary on the tourism trade in southern nations. Spillover from the summer holiday season into September is not expected while the strong Euro probably damped demand for industrial goods. We anticipate that September core inflation will stall at 1.2% y/y (1.2% y/y exp). However, consumer spending, supported by the strong gain in labour markets, is expected to drive the September headline read to 1.6% y/y from 1.5% (1.5% y/y exp).

The initial reaction to an unchanged core inflation read will likely be disappointment with traders unwinding speculative Euro longs. However, the sentiment around the EU is positive, supported by Merkel winning a historic 4th term as German chancellor and UK “Brexit Bill” concessions. In addition, on a technicality, the ECB will have to reduce its bond purchased in 2018 since they are restricted to hold no more than 33% of nations sovereign debt (German debt will be first to hit that threshold). In the US, traders are sceptical of the Fed optimistic forecast, while in the EU, traders have accepted that the next move for Draghi will be tighter policy. We view any dip in EURUSD as an opportunity to reload EURUSD longs.

Economics

Investors To Focus On ECB Amid Boring FOMC

As widely expected, the FOMC triggered the process to reduce the size of its $4.5tn balance sheet. Although the normalization process will start in October, which could be seen as a bit rushed, the pace of disinvestment will be very slow and has already been well telegraphed as described in the Addendum to the Policy Normalization Principles and Plans released in June.

As a first step, the Federal Reserve will reinvest principal payments it receives from maturing Treasury securities only if it exceed $6 billion per month, then this “cap” will be increased by $6bn every three months until it reaches $30bn a month. Regarding principal payments from agency debt and mortgage-backed securities, the process is the same except that the initial “cap” is set at $4bn a month, while the “cap” will increase by $4bn every three month until it reaches $20bn a month.

The reaction of investors was quite mixed as the US dollar was unable to maintain its gains and returned slowly towards its pre-FOMC meeting levels. Initially, high quality commodity currencies such as the CAD, NZD and AUD experienced a more acute sell-off, mostly due to the substantial proportion of long speculative position in those currencies against the USD. However, by Friday afternoon, even the Japanese yen retraced against the greenback with USD/JPY easing towards 112.

It must be noted that all in all, it wasn’t a hawkish meeting with both the statement and Yellen’s speech being cautious, especially about the inflation forecast. Speaking of which, the Fed revised downwardly its inflation forecast. Now, FOMC members don’t expect core inflation to reach the 2% target percent until 2019. However, the growth forecast was moderately revised to the upside as the real GDP growth forecast has been lifted to 2.4% for 2017 compared to 2.2% previously. Finally, Fed officials cut the forecast for the official rate down to 2.8% in the long-term from 3%, suggesting a stabilisation of the economy.

Considering the market’s reaction, with both the greenback and US treasury yields reversing quickly Thursday’s gains, it appears that investors are not too quick to believe the Fed will increase interest rate according to the announced pace. In addition, according to the Fed Funds Futures, the probability that the Fed raises rates in December barely reached 63% on Friday. Therefore, there is no rush to take long USD position, especially knowing that the ECB is on the cusp to scale down significantly it quantitative easing programme.

Economics

Bank Of Japan Still On The Accommodative Side

Last Thursday night, the Bank of Japan has announced after an 8-1 vote that its benchmark interest rate will remain on hold at -0.1%. It is certain that the Bank of Japan was also closely looking towards the Fed which had its meeting few hours earlier. Indeed, the US central bank has announced a reduction of its balance sheet which is providing some relief to the USDJP which has surged above 112 and is now consolidating around this level.

The BoJ stands ready to continue its all-in monetary policy by buying assets at around yen 80 trillion a year in order to maintain the 10-year Japanese Government Bonds at its 0% target. This can definitely not end well. We recall that the Japanese debt-to-GDP ratio is above 230% and deflation threat is still very important. On top of that some BoJ members believe that the inflation target of 2% is too high for the current monetary policy which is, in definite, not loose enough. This is something that we need to underline, in particular since the Bank of Japan has recently postponed its deadline for reaching the inflation target for six consecutive times.

It is nonetheless important to note that the overall economic fundamentals are improving with Japan recording a positive growth period of around a decade. Q2 GDP came at 0.6% q/q. A strengthening domestic demand and the recent boost in Japanese exports are the main reasons for this continuous period of growth.

Globally, markets are pricing in the end of the US Quantitative Easing, at least further tightening. The big unknown is how will react the global bond markets as higher yields would likely trigger a sell-off which can be massive as free money kept flowing into this market during the last decade. Against the backdrop of the US balance sheet reduction, we consider that the USDJPY is set to appreciate towards 114 within the short-term.

Themes Trading

Online Gaming

Much ground has been covered since the first video game consoles of the early 1970s, which offered only 2D games in black and white with no sound. Since then, the video games industry has grown exponentially as computer technology has advanced. Nowadays, blockbuster video games enjoy massive budgets, easily surpassing those of Hollywood movies: budgets in excess of $100 million are not uncommon. According to ESAF (the Entertainment Software Association Foundation), over the last five years total consumer spending on the video games industry in the US grew by an average of $1.38 billion a year to reach $30.4 billion in 2016. Video game content accounts for more than 80% of this amount, putting video game makers in a strong position to take advantage of this trend. Moreover, the fastest growth is in social network gaming, mobile apps and online gaming, which together account for over 65% of total revenue.

The video games industry is evolving faster than any other, constantly adapting to the latest technological breakthrough. The industry has already embarked on its latest transformation. However, it is not too late to be part of it. We built this theme with the aim of offering exposure to the entire video games market, from traditional physical media distribution and console builders to new market entrants. We have overweighted the fastest-growing part of the industry: companies active in

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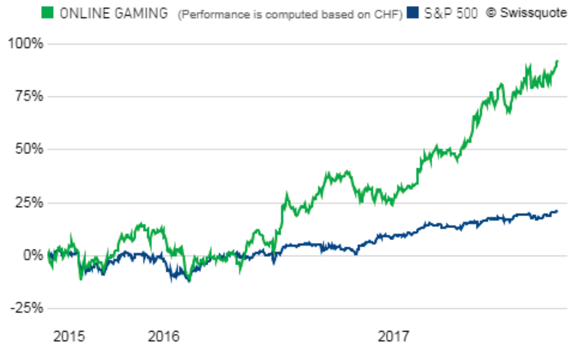

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