

Weekly Market Focus

14 June 2017

HINDUJA BANK
SWITZERLAND

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ASSET CLASS REVIEW

The UK election resulted in a hung parliament, with no party winning an outright majority in an outcome that will create uncertainty about the path ahead for Brexit negotiations.

UK Politics

This is only the second hung parliament since 1974. The Conservatives look to have won enough seats to form a minority government with some smaller groups. One should expect a new Conservative leadership race as likely at some point to replace Prime Minister Theresa May, who called the election on hopes of securing a bigger majority for a freer hand in Brexit negotiations. The winner of that leadership race will shape the UK's negotiating stance with the European Union (EU) unless a new election is called. A new election is possible but would require two-thirds of parliament to approve.

This as a mild short-term negative for UK domestic assets due to the uncertainty and prospect of a weak government vulnerable to losing votes in parliament. We expect the Bank of England to keep its accommodative policies in place to support the economy through the uncertain negotiation period, looking beyond any short-term inflation spikes unless price pressures become sticky.

There could be risks of an economically disruptive "no deal" Brexit—one that leaves the UK without existing trade or security agreements by the hard March 30, 2019 deadline. A minority government may be hostage to euro sceptics and others hostile to making concessions to the EU. But one can now also see a wider range of potential outcomes, including a softer Brexit in light of parliament's new makeup.

One market positive from the election is the reduced risk of another Scottish independence referendum. Analysts consider the election outcome as a UK domestic issue and don't expect broader ramifications for global markets.

The EU is willing to do a deal, but wants to draw a clear line between the benefits and responsibilities of members versus non-members. The EU has other priorities. New French President Emmanuel Macron looks poised to build on his win with a parliamentary majority that may make it easier to pass business-friendly reforms. Macron and German Chancellor Angela Merkel are leading a revived drive to reform the EU, a bigger priority than spending energy haggling over Brexit terms.

The big question is whether an outline agreement can be reached by the hard March 2019 deadline. The main two sticking points: the size of the UK's exit bill—reported to be €60-100 billion—and a deal on citizens' rights on both sides, including any ongoing role for the European Court of Justice. The EU wants to settle these issues before discussing any future relationship. The EU is likely to give the UK some time before beginning any formal discussions, originally scheduled for later this month. One can foresee that the UK's uncertain political outlook means the timetable for reaching an agreement is even more compressed, with the clock already ticking.

FOREX

Now that we have the ECB and the UK elections behind us the focus this week is the Fed, BoE, SNB and BoJ. The FOMC meet this week where the market widely expects another 25 bps interest rate hike. Little else is expected from the Fed with little market reaction foreseen. The BoE meet Wednesday to discuss monetary policy, however following the election results few expect any change. The SNB meet, but little is also expected apart from the run of the mill comments regarding an overvalued currency and low growth environment. Finally, the BOJ is expected to leave monetary policy unchanged this week, and maintain the outlook that the nation's economy is "turning toward a moderate expansion". In summary, the USD index remains weak but seems to be forming an interim base just above the 61.8 % Fibonacci area at 96.60. FX markets have witnessed a fall in volatility recently, apart from event risks where we see a spike. This can probably be attributed to lower inflation expectations. This is frustrating for market investors as many currency pairs remain within ranges.

EUR

The Euro continues to struggle at and below 1.1300 against the USD, this level marks the Nov 2016 high. While we remain below 1.1300, risk leans toward a correction lower to 1.1100, the Feb 2016 upswing. ECB's Draghi last week threw cold water on Euro bulls with his omission to signal an exit to QE. Instead he highlighted the recent spike in inflation as transitory and highlighted concerns for growth trajectory in the Eurozone. The market unwound long positions but quickly found demand below 1.1160 under speculation that tapering of QE will inevitably arrive before year end.

Technically buying the Euro at current levels does not seem attractive as caution is warranted here, (1.1190/1.1210) due to the negative divergence of the daily RSI suggesting weakness or near term correction is due. Late last week into this week trading has been light and stuck in a 1.1235/1.1165 range. We continue to see the next move in EURUSD to the upside but patience is needed. Wait for dips towards 1.1110/30 before assuming bullish strategies. A sustained move below 1.1100 should be respected however as this guards further weakness towards 1.1030 and below to the 55 mda at 1.0960 (76% retracement from the French Election rally). Ultimate support rests at the 200 mda, 1.0825 and election gap at 1.0775. To the topside we need to see prices extend through 1.1285/1.1300 before targeting further upswings to 1.1367 and 1.1425.

GBP

What can only be described as a disaster for PM May and her Tory party, the pound naturally has suffered in the wake of uncertainty. Comments from May since the election seem to indicate she is softening her hard stance with regards to Brexit. What Theresa May needs to focus on is that a soft Brexit would mean that Great Britain maintains access to the EU single market or at least remains part of the European customs union, therefore lowering the costs of Brexit for the UK economy. This should be positive for the pound however uncertainty however questions still remain whether May will remain in office to see the end of the Brexit. Her dependence on the Northern Irish DUP also has negative outcomes for sterling.

The BOE is unlikely to change its policy this week. Poorer economic data and the disastrous UK election will likely prevent the central bank from acting. Future interest rate hikes for 2018 too have slid from a 50% to a 33% probability. We do not expect any minutes to be released with the decision. This week saw UK inflation resume its upward trend from last month, accelerating more than forecast to the fastest pace in four years. An increase in prices for computer games, laptops and package holidays and also partly reflecting the impact of the weaker pound lifted the inflation rate to 2.9%, the highest since June 2013. BOE Mark Carney expects inflation to keep accelerating this year before falling back slightly from 2018.

GBPUSD is negative over the near term while prices remain under 1.2775/85. Cable remains under pressure following the political chaos that has ensued following the UK general election last week. The market broke down from the 1.2775-1.3060 range and this is now acting as formidable nearby resistance. Further losses cannot be ruled out if 1.2785 resistance is not overcome. Ultimate support waits at the 200 day ma at 1.2570/75. We have seen a bounce off then lows however less than 50 % of the election loss from 1.2978/1.2636. Best to watch this unfold from the side lines.

CHF

The SNB meet this week but little is expected from the central bank. Usual references to the currency as “significantly overvalued,” are expected with the accustomed threats to currency intervention. Markets expect no adjustments to interest rates or key policy pronouncements at this meeting. This means the deposit rate of minus 0.75% and the aforementioned pledge to intervene if needed to keep the franc in check will remain. Recent data from sight deposits suggest the SNB intervened this year to curb the franc’s rise. The tail risk surrounding elections in Europe have seen a fall in the Swiss franc which will be welcomed by the SNB, however they are still far from changing its monetary policy. USDCHF threads water under 0.9700 handle and remains in a bearish move below 0.9810/15. We see this cross moving in sympathy with EURUSD over the near term.

JPY

This week the BOJ meet on monetary policy. Following rhetoric from BOJ member, Amamiya who was cited as saying “[The BOJ] will continue necessary monetary policy steps to achieve stable prices, with an eye on how they affect BoJ financial health”. The recent slowdown in JGB purchases can be attributed to the fact that UST yields have stabilized and are exerting less upward pressure on Japanese Long term rates. This has placed an interim floor for USDJPY around 109.80/110.00. Considering this we can assume that USDJPY direction will be the result of movements in US T-Notes and geopolitical noise. We continue to favour buying dips for the cross but caution is needed for any sell off through 109.10. First resistance is seen at 110.60, the 200 mda.

CAD

Weaker oil prices have put pressure on the Canadian dollar until recently. Nevertheless the economy is printing decent growth rates and inflation is picking up too. Even though inflation has principally fallen recently, in view of stronger economic growth the BoC seems to be relaxed about this, their main concern being weak growth. CAD has been pushed and pulled in line with other commodity currencies recently, however early this week, the CAD strengthened considerably following comments from both BoC Senior Deputy Governor Wilkins and Governor Poloz, who questioned whether “all of the considerable monetary policy stimulus presently in place is still required”. Poloz went further to say that that Interest Rates have been extraordinarily low. These are relatively hawkish comments from the central bank which consequently saw a 2% fall in USDCAD. Remember in April, the BoC moved to a neutral stance, saying the possibility of a cut wasn’t discussed at that meeting. The Bank Bill futures have taken this to be a move to a decidedly hawkish stance and immediately priced in a further 60% chance of a hike in December.

We see this move as transitory for FX markets and a buying opportunity for USDCAD. We should not forget that momentum in the oil price is still to the downside and that the forthcoming NAFTA negotiations will weigh on the Loonie over the medium term. Technically, USDCAD having broken the Jan-June trendline at 1.3448, the market has liquidated stale short CAD positions. The slide has easily taken out the 200 mda support area to now test the longer trendline line at 1.3200/20. We see this fall as an opportunity to build fresh long positions targeting 1.3440 risking a close below 1.3165.

Gold

Gold having failed to successfully remain above the July 2016 trendline at 1280 and the YTD high at 1295 has since fallen rapidly back towards the uptrend from Dec 2016. In the near term, prices have now a focus on the 55 mda at 1260/59 having bounced off there on Tuesday. The shiny metal, having paused its move lower at the beginning of the week has again picked up momentum to the downside.

We see this correction continuing towards the 100mda and 200 mda support at 1245/1240. Just to note. In the last three phases of this Dec 2016 June 2017 uptrend, three out of the four upswings have retraced lower by 78 % of said phase. Past history doesn’t dictate future movements but this does indicate a potential move back to 1233.

VIEWS FROM THE TRADING FLOOR

Equity

The Nasdaq having printed a new year to date high at 6341 has as expected fallen from this overbought level. There remains ample room for further technical correction and the Nasdaq could go back to test its breakout level at 5450. Volatility remains historically low so we suggest buy some protection against such a move.

In Europe, Equities have remained on their highs consolidating above the previous upswing from March 2016. The banking index has been the key driver for European Equity performance in recent weeks. It is now coming off from an overbought level.

The Eurostoxx 50 has failed to cross a key monthly resistance and the index retrace as low as 3400 before resuming its uptrend. We would recommend to reduce longs at this juncture.

For US equities, the market continues to see sector rotation.

There was further buying in US Energy (+\$403mm) and Financials (+\$354mm), offset by selling in Tech, seen largely through selling in NASDAQ ETFs, with the largest NASDAQ ETF losing an impressive \$1.8bn of assets.

US Financials have now received \$1.7bn of new assets in just 4 days, which represents 3.14% of current AUM.

EQUITY

Developed countries

Total return - 1 Week

SMI	↑	0.3%
Euro Stoxx 50	↑	1.0%
DAX	↑	1.8%
FTSE 100	↑	1.0%
S&P 500	↑	0.3%
Dow Jones	↑	0.8%
Nikkei 225	↓	-0.5%

Developing countries

Russia/Micex	↓	-0.3%
India/Nifty 50	↓	-0.4%
China (HK)	↓	-0.2%

↑ - Upward move ↓ - Downward move

FIXED INCOME

Developed countries

	2-year Yield	10-year Yield
USA	1.3%	2.1%
UK	0.1%	1.0%
Germany	-0.7%	0.2%
France	-0.5%	0.6%
Italy	-0.3%	1.9%
Spain	-0.3%	1.4%
Switzerland	-0.9%	-0.2%

Developing countries

	2-year Yield	10-year Yield
Russia	2.0%	4.0%

COMMODITIES

Total return - 1 Week

Crude Oil	↓	-3.6%
Gold	↑	3.4%

CALENDARS

Economic Events

Date of release	Domicile	Event	Period	Actual	Estimated
14 June 2017	US	CPI YoY	May	1.90%	2.00%
14 June 2017	US	Retail Sales Ex Auto	May	-0.3%	0.10%
14 June 2017	EU	Employment YoY	1Q	1.5%	1.4%
16 June 2017	EU	CPI YoY	May	1.40%	1.90%
14 June 2017	DE	CPI YoY	May	1.50%	1.50%
15 June 2017	JP	Industrial Production YoY	April	4.00%	4.00%

Company Earnings

Date of release	Domicile	Company Name	Period	Estimate EPS
14 June 2017	SP	Industria de Diseno Textil SA	Q1 18	0.21

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