The Weekly Market View

4 May 2015

بنك أبوظبي التجاري
ADCB

Strong euro and yield reversal as investors get out of crowded trades

We have seen a significant correction in Euro-zone equity markets whilst global equity markets - albeit amidst significant volatility - managed to keep up. The US equity market, in particular is still at record levels. GCC markets did very well. The correction in European equity markets has gone together with a jump in the euro and in government bond yields, in particular in Europe, but also in the US. Critically, Greek yields came down, confirming that the market continues to believe in a negotiated debt solution. Option prices also remained low. Unfortunately, however, the jump in the euro seems to come more from growth concerns in the US and China, then from a tangibly improved outlook for the euro-zone. Investors have temporarily moved out of two very crowded trades: the stronger weaker euro, as well as advanced economies government bonds. If one excludes its value against the euro, the US dollar has remained strong. The euro and government bond yields are bound to stabilize over the next months.

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US payroll data and factory orders might deliver more negative surprises

US payroll data and factory orders are expected to be good, but not exceptional. If expectations are confirmed we could see some stabilization across global financial markets. If payroll data will disappoint, we are likely to see pressure on equity markets, globally. The recent euro strength and, above all, the rise in government bond yields should, however, abide under all scenarios.

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Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,108.3	-0.4	2.4
Dow Jones	18,024.1	-0.3	1.1
Nasdaq	5,005.4	-1.7	5.7
DAX 40	11,454.4	-3.0	16.8
Nikkei 225	19,531.6	-2.4	11.9
FTSE 100	6,986.0	-1.2	6.4
Sensex	27,344.3	-1.6	-0.6
Hang Seng	4618.9	0.3	2.0
Regional Markets (Sunday to Thursday)			
ADX	4132.5	3.4	9.5
DFM	9764.2	2.3	17.2
Tadawul	12195.0	1.0	-0.7
DSM	6318.3	-0.6	-0.4
MSM30	1390.615	-0.5	-2.5
BHSE	6389.5	0.7	-2.2
KWSE	1787.4	-0.7	4.5
MSCI			
MSCI World	1,046.0	-1.4	9.4
MSCI EM	1,060.5	1.7	10.9

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	66.4	1.8	15.9
Nymex WTI USD/bbl	59.1	3.5	11.0
OPEC Baskt USD/bbl	60.9	-0.1	17.2
Gold 100 oz USD/t oz	1184.8	-0.0	0.0
Platimum USD/t oz	1134.3	0.7	-6.1
Copper USD/MT	290.5	6.7	2.8
Alluminium	1897.25	4.6	3.5
Currencies			
EUR	1.1213	3.0	-7.3
GBP	1.5166	-0.3	-2.6
JPY	120.04	1.0	-0.2
CHF	0.9332	-2.3	6.5
Rates			
USD Libor 3m	0.2798	0.3	9.4
USD Libor 12m	0.7176	1.7	14.1
UAE Eibor 3m	0.7386	0.0	9.1
UAE Eibor 12m	1.0671	0.0	5.1
US 3m Bills	0.0000	-99.9	-100.0
US 10yr Treasury	2.1100	10.7	-2.8

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US factory orders and payroll data to take centre-stage

Weak US data pushed the US dollar lower as the Federal Reserve stay in "wait and see" mood

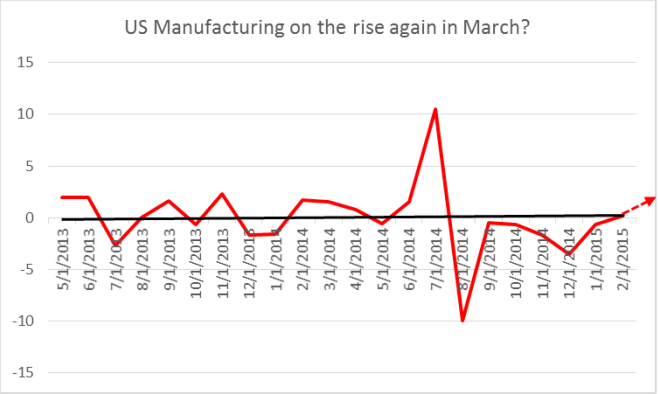
Investors have been caught by surprise by the surge of the euro against the US dollar, as well as the spike in government bond yields, in particular yields on German bunds and bonds of other core countries of the Euro-zone. In truth a bounce-back from these overly crowded trades was at some point inevitable.

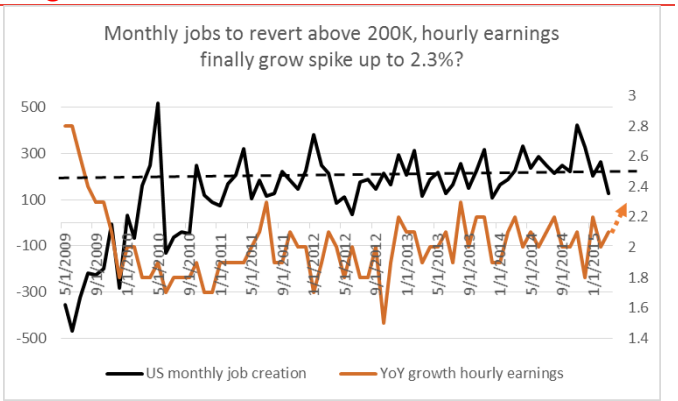
A rise in yields of Government bonds usually is an indication that economic growth and inflation are picking up. Unfortunately, this is occurring only very gradually in Europe and last week there was no clear sign of a dramatic turn-around in this regard: the stronger euro seems to be more a consequence of the weakening US and China economies – and the reluctance of the Fed to initiate rate hikes - rather than of stronger growth in the Euro-zone.

Thus the key risk ahead is a further deterioration of growth news coming out of the United States. This would certainly renew pressure on equity markets, and this time not only Euro-zone equity markets. It would halt the rise of bond yields across all advanced economies. It might paradoxically lead to a strengthening of the US dollar, as the greenback remains an important safe haven currency compared to the euro.

US new manufacturing orders and labor data to provide some relief?

In March manufacturing orders are expected to grow for the first time in 6 months. At the same time the markets expect monthly job creation to pick-up in April again above the 200'000 figure it has maintained over the prior 12 months. If both indicators will confirm market expectations, respectively on Monday and Friday, we would expect markets to subscribe to the consensus view that the US economy should whither the winter and improve upon the very weak first quarter of the year.





Of course, a really good *overall* job report would come together with a spike in year–over–year hourly earnings as higher wages defuse the deflation scare and provide the most solid underpinning for continuous economic growth. Such a development would be the one single most important factor justifying higher bond yields. Unfortunately, the expected 2.3% growth rate for hourly earnings is positive yet not enough to trigger such confidence.

We therefore expect bond yields to stabilize. If the job report and factory orders disappoint we expect equity markets to remain under pressure and bond yields to come down again. Very bad news would paradoxically determine a strengthening of the US dollar, as markets re-appreciate its safe haven role.

Greek concerns are not over

On May 12 Greece is to repay close to 800 million euro to the IMF. Following the removal by the Greek Prime Minister of Finance Minister Yanis Varoufakis from the negotiation team, markets seem to bet on a positive solution to be agreed upon at the Summit of Finance Ministers of the Euro-zone on May 11.

We would like to suggest that such positive solution is anything but a foregone solution as there are still huge differences on very crucial issues such as pension reform and labor market reform. Whilst we see a definitive solution sometime in May, we would argue that Greece will be granted some temporary bridge financing based on some preliminary framework or letter of intent which would then have to be approved by the Greek parliament or a national referendum. Greece's financial markets are thus to remain volatile, although for now they seem unable to negatively affect the other markets of the Euro-zone.

Summary market outlook

Global Yields	The US Treasury 10yr surged above the 2% yield in spite of weak economic data. We expect this surge to be technically driven, as well as being related to the weaker US dollar. Yields should stabilize and might as well come down.
Stress and Risk Indicators	The VIX index ticked remained stable in spite of the volatile equity markets and the weak growth figures. Markets seem also to bet on a solution of the Greek issue, which resulted in a reduction in intra-Eurozone spreads as well as sovereign CDS spreads. These risk indicators could be derailed if US growth figures disappoint, and also negotiations on the Greek debt continue to stumble. Otherwise we would expect them to remain stable.
Precious Metals	The gold price remains under pressure in spite of the weakening US dollar and signs that inflation is picking up. It would look like the gold market does not believe that euro strength will lead to generalized US dollar weakness, or a surge in global inflation.
Local Equity Markets	GCC equities were strong as the oil price remained resilient. We might see some consolidation in the near term.
Global Equity Markets	Global equity markets came under pressure as US growth appeared to slip, but yields at the same time surged. In the end, equities proved resilient, except for the European equities which continued to suffer because the euro strengthened against the US dollar. We expect volatility to continue as further disappoints from the US economy cannot be excluded.
Energy	We remain cautious on energy prices, as the demand- and supply dynamics do not support further significant near term gains.
Industrial Metals	The China-driven secular downward trend will continue, but the pace might stall to the extent that US dollar strengthening might have a “technical” pause.

Currencies	**Commentary**	**Critical levels**
EURUSD	Relative weakness in economic data from the US continues to weigh on the currency as markets adjust rate hike expectations. The euro strengthened as US economic data were disappointing. Even if next week’s US data might disappoint again, we would expect the US dollar to stabilize as markets are now fully pricing in a postponement of rate hikes by the Fed.	R2 - 1.1573 R1 - 1.1386 S1 - 1.0916 S2 - 1.0633
GBPUSD	The Pound Sterling unexpectedly declined against the US dollar as pessimism about the UK economy was compounded by uncertainty on the outcome of the elections. Volatility might well continue after the elections if they fail to yield a clear majority. Yet, we would expect the Pound Sterling to recover some of the losses of last week.	R2 - 1.5642 R1 - 1.5395 S1 - 1.5004 S2 - 1.4860
USDJPY	The Japanese yen marginally broke out of its range of 118-120 per US dollar. The Fed statement is likely to continue to have less impact on this pair as compared to the above two, as the BoJ seems to be comfortable with this range for the moment.	R2 – 121.44 R1 – 120.79 S1 – 119.00 S2 – 117.86

Forthcoming important economic data

United States

	Indicators	Period	Expected	Prior	Comments
05/04/2015	Factory Orders	Mar	2%	0.2%	
05/05/2015	Trade Balance	Mar	-43.3B	-35.4B	
05/08/2015	Change in Nonfarm Payrolls	Apr	225k	129k	Market will focus on labour market data
05/08/2015	Average Hourly Earnings YoY	Apr	2.3%	2.1%	
05/08/2015	Unemployment Rate	Apr	5.4%	5.5%	

Japan

Indicators	Period	Expected	Prior	Comments
				No significant data from Japan

Europe

	Indicators	Period	Expected	Prior	Comments
04/05/2015	Markit Eurozone PMI (EC)	Apr F	51.9	51.9	
05/05/2015	PPI YoY (EC)	Mar	0.3%	0.5%	Focus will be on Markit PMI
06/05/2015	Retail Sales YoY (EC)	Mar	2.4%	3.0%	
05/01/2015	Bank of England Rate	May 11	0.5%	0.5%	

China and India

	Indicators	Period	Expected	Prior	Comments
05/07/2015	Exports (China)	Apr	2.6%	-15%	China exports to provide insight into sustainability global growth and commodity price recovery
05/07/2015	Imports (China)	Apr	-10.3%	-12.7%	

Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTTNews
4. Reuters
5. Gulfbase
6. Zawya

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