The Weekly Market View

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بنك أبوظبي التجاري
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ECB surprises on the upside, confirming our euro equity trade

Draghi has maintained his pledge to bring the ECB's balance sheet to more than 3 trillion euros. He has even done more because – if inflation indicators remain unsatisfactory - purchases will go beyond the 1.1 trillion euros to be reached by September 2016. The fact that the bulk of government bond acquisitions will not be mutualized but kept on the balance sheets of the member-state central banks, is not relevant. First, because in the benign scenario of no capital losses, mutualisation would have resulted in a transfer of wealth to Germany as the Bundesbank receives the bulk of interest rate payments on ECB-held assets. Second, because in the negative scenario Spain or Italy would probably apply to the OMT program, whereby the ECB will buy their paper directly, i.e. mutualize!

US economic resilience key to current bullishness

The ECB surprise has triggered an additional sharp depreciation of the euro, and further compression of euro yields and spreads: European equities continue to do better than US equities (not adjusting for the currency effect). This trend can continue if and only if US growth remains resilient. A significant disappointment in this week's US GDP data, or the FOMC expressing concerns about US dollar strength, would thus be the potential party-poopers. We don't expect that to happen, at least not yet.

Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,051.8	1.6	-0.3
Dow Jones	17,672.6	0.9	-0.8
Nasdaq	4,757.9	2.7	0.5
DAX 40	10,649.6	4.7	8.6
Nikkei 225	17,511.8	3.8	0.3
FTSE 100	6,832.8	4.3	4.1
Sensex	29,278.8	4.1	6.5
Hang Seng	24850.5	3.1	5.3
Regional Markets (Sunday to Thursday)			
ADX	4570.2	1.0	0.9
DFM	3862.3	1.0	2.3
Tadawul	8421.7	-0.4	1.1
DSM	11847.5	-1.4	-3.6
MSM30	6644.51	1.9	4.7
BHSE	1428.6	0.0	0.1
KWSE	6662.8	1.0	1.9
MSCI			
MSCI World	1,707.7	2.1	-0.1
MSCI EM	990.9	2.7	3.6

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	48.8	-2.8	-14.9
Nymex WTI USD/bbl	45.6	-6.4	-14.4
OPEC Baskt USD/bbl	43.1	-0.8	-17.2
Gold 100 oz USD/t oz	1294.1	1.1	9.3
Platimum USD/t oz	1268.8	0.1	5.0
Copper USD/MT	250.2	-4.4	-11.5
Alluminium	1820.5	-1.1	-0.7
Currencies			
EUR	1.1204	-3.1	-7.4
GBP	1.4989	-1.1	-3.8
JPY	117.77	0.2	1.7
CHF	0.8801	2.5	13.0
Rates			
USD Libor 3m	0.2561	-0.2	0.2
USD Libor 12m	0.6219	2.0	-1.1
UAE Eibor 3m	0.6771	0.0	0.0
UAE Eibor 12m	1.0157	0.0	0.0
US 3m Bills	0.0152	-42.0	-57.2
US 10yr Treasury	1.7968	-2.2	-17.2

Please refer to the disclaimer at the end of this publication.

For the moment we stick to our European equity call

ECB QE program entails bargaining chip versus Greece, whatever its government

Currently ECB Greek government bond holdings of 27 billion euro stand at 40% of its total outstanding market capitalization of 67.5 billion euros. As such Greek government bonds do not qualify for the ECB's recently announced QE program which states that the ECB's holdings should not exceed 33% of outstanding debt. By July, however, 6.6 billion euro should be repaid to the ECB, reducing its holdings to slightly more than 20 billion euros over slightly more than 60 billion of outstanding issues, still roughly 34%. If, however, outstanding bills are included in the calculation the share would drop to 30% by July, and 27% by the end of the year. This is, of course, provided that Greece does not increase its outstanding debt, an unlikely development given that Greece is currently running a primary surplus and would have to raise such additional debt at very unfavourable market conditions.

Curiously, the ECB has not yet fully stated if Government bills are to be included in the calculation of total outstanding debt. If they are, then – based upon Greece's 2.9% capital share – the ECB would be able to buy, for a limited period of time, an analogous share of the 45 billion governments it intends to buy on a monthly basis, i.e. 1.3 billion euro per month.

Greece's bargaining power appears limited

It is of course too early to predict what kind of agreement the new government will try to strike with its official creditors, represented by the European Commission, the European Central Bank and the International Monetary Fund. It is clear, however, that any support is unlikely to consist of a significant debt reduction that has to be directly shouldered by the taxpayers in other countries of the Euro-zone.

Syriza does not want to exit the euro, nor unilaterally reduce its debt burden. By making such declarations it has already weakened its bargaining position. Draghi's most recent move has pushed the Eurozone a step further towards federalization. It finds itself as such in a much stronger capacity to withstand the contagion risk from an eventual Grexit, however undesirable. The reduction in Greek yields seems a confirmation that the market sees the Greek bluff, and that the new government might have to settle with some face-saving solution combined with (limited) purchases of Greek bonds under the new ECB QE program.

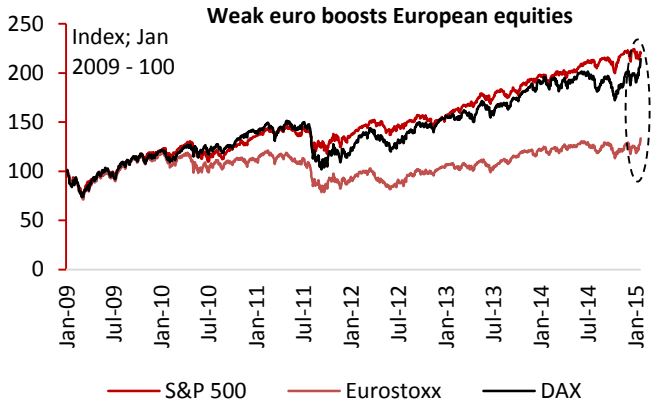
This week's focus will be on the US, not Europe

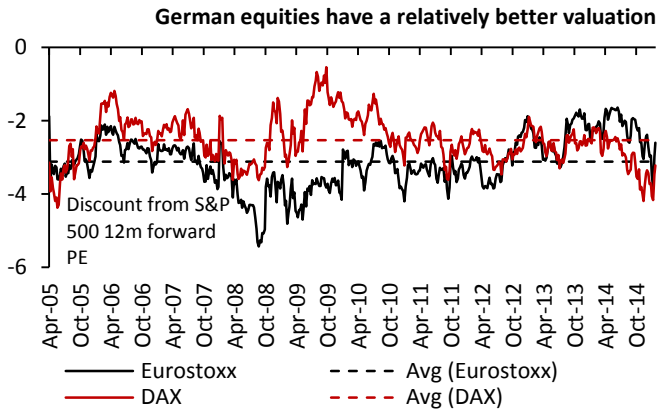
If global economic growth will not be derailed, US equity markets are likely to maintain their current levels. If not, then current valuations are no longer warranted and some correction is inevitable. Small wonder, therefore, if all eyes will be on the US this week as the first estimate for GDP growth in the last quarter of 2014 is released on Thursday, and the Federal Reserve Open Market Committee is to release on Wednesday its first policy statement.

Consumption growth is expected to have grown by 4% on a year over year basis. This is a high figure, and risks to be beaten. Provided the disappointment – if any – will not be too big, and assuming the Federal Reserve is not yet to formally express any concern about the strong appreciation of the US dollar, we would expect markets to remain bullish on the back of the ECB's QE program, and the euro to remain under pressure. The continuing stabilization of the oil price should also help.

European, and in particular German, equities to continue to outperform in the weak euro scenario

Below chart confirms our current call on European equities, on the back of a weaker euro. Indeed, the German Dax index has a proportionally higher share of export-oriented companies than other European indices. The second chart, shows that it's continuing outperformance is still warranted on valuation considerations.





Source: Bloomberg

Summary market outlook

Global Yields	QE announcement by the ECB has pushed sovereign yields further low in the Eurozone and the euro sharply lower. This pushed even US Treasury 10-yr yield lower as investors moved to a relatively higher yielding US Treasury and in an appreciating currency. US long term yields are much higher than its peers in the developed world which makes it an attractive investment option. Moreover, dollar strength and sliding inflation are pushing market expectations of Fed rate hike further lower. This is likely to keep the yield low in the very near term.
Stress and Risk Indicators	The VIX index might further come down if US GDP data proves to be solid. Sovereign CDS spreads likely to further come down in the wake of ECB QE.
Precious Metals	Will remain volatile as long as Federal Reserve will not become more explicit about rate hikes.
Local Equity Markets	Local markets will continue to stabilize provided no further significant oil price corrections occur.
Global Equity Markets	ECB QE and Flash PMIs from major developed markets have provided a significant boost to equity markets. This is likely to continue through the week, especially if Q4 GDP data for the US will prove to be solid.
Energy	Crude oil price stabilization still in the cards for the medium term. Short term volatility cannot be excluded.
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	Positive surprise from the ECB pushed the euro rather sharply lower towards the end of the last week. The yield differential between the US and the Eurozone core countries has also widened in favour of the US dollar. This is likely to keep pressure on the euro in the near term. However, the FOMC statement must be watched carefully for any mentioning of dollar strength as a risk to the US economic outlook.	R2 - 1.1897 R1 - 1.1550 S1 - 1.0986 S2 - 1.0769
GBPUSD	GBP breached 1.50 level as the MPC minutes showed that the decision of no rate hike was unanimous as compared to the previous minutes that had showed two MPC members voting in favour of a rate hike. Relative strength of fourth quarter GDP releases in both countries and the FOMC statement are likely to influence the currency pair this week.	R2 - 1.5312 R1 - 1.5151 S1 - 1.4890 S2 - 1.4790
USDJPY	JPY has been trading in a range for the last few sessions, unlike EUR and GBP. It is likely to continue the same way in the very near term. The trade balance and inflation data in Japan could have some influence on the pair. Any mention of USD appreciation by the Fed in FOMC statement will also influence the currency.	R2 – 119.80 R1 – 118.78 S1 – 116.84 S2 – 115.92

Forthcoming important economic data

United States

	Indicators	Period	Expected	Prior	Comments
01/27/2015	Durables ex Transportation	Dec	0.4%	-0.9%	A string of important economic data and FOMC statement will influence the global market.
01/27/2015	Capital goods orders (nondefense)	Dec	0.5%	-0.5%	
01/27/2015	S&P/CaseShiller 20-City Index	Nov	4.32%	4.5%	
01/27/2015	New Home Sales	Dec	450k	438k	
01/27/2015	Consumer Confidence Index	Jan	95.5	92.6	
01/28/2015	FOMC Meeting	Jan			
01/30/2015	GDP Annualized QoQ	4Q	3.1%	5%	
01/30/2015	Personal Consumption	4Q	4%	3.2%	
01/30/2015	Univ. of Mich. Sentiment	Jan F	98.2	98.2	

Japan

	Indicators	Period	Expected	Prior	Comments
01/26/2015	Trade Balance	Dec	-¥ 735bn	-¥ 892bn	Economic data in Japan are expected to show improvement in outlook
01/26/2015	Exports YoY	Dec	11.2%	4.9%	
01/26/2015	Imports YoY	Dec	2%	-1.7%	
01/29/2015	CPI YoY	Dec	2.3%	2.4%	
01/29/2015	Industrial Production YoY	Dec P	0.3%	-3.7%	

Euro zone

	Indicators	Period	Expected	Prior	Comments
01/26/2015	IFO Business Climate (Germany)	Jan	106.5	105.5	Headline inflation in the Eurozone is expected to go further down in the negative territory. IFO in Germany is expected to be better.
01/26/2015	IFO Current Assessment (Germany)	Jan	110.8	109.8	
01/26/2015	IFO Expectations (Germany)	Jan	102.5	101.4	
01/29/2015	Business Climate Indicators	Jan	0.12	0.04	
01/29/2015	Unemployment Rate	Dec	11.5%	11.5%	
01/30/2015	CPI Estimates YoY	Jan	-0.5%	-0.2%	
01/30/2015	CPI Core YoY	Jan A	0.7%	0.7%	

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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