# Weekly Market Focus

**31 May 2017**

HINDUJA BANK

SWITZERLAND

**CONTENTS**



Follow us on
LinkedIn

# ASSET CLASS REVIEW

The market is currently assuming that the Conservatives will win a large majority and eventually deliver a relatively hard Brexit, but that the election will make it easier for them to agree to transitional arrangement, prolonging single market access for two or three more years after March 2019.

## UK Politics

If the Conservatives win the election, but fail to meaningfully increase their majority, then markets would likely price a reduced probability of a transitional deal and a higher probability of a “no deal” outcome, as well as a more uncertain outlook. In this scenario, the gain in the pound since the election was announced would probably be reversed. The lower pound would probably support companies who get most of their sales from abroad, helping the FTSE 100. Mid- and small-cap equities might underperform though, as the potential for a “no deal” Brexit increased. Based on the same logic, UK corporate credit spreads could widen. The outlook for gilts would be hard to predict, given that they have been driven more by the outlook for global government bonds recently, than by UK specific factors. A similar outcome could play out, over time, even if the Conservatives win a large majority, but it later becomes clear that the newly elected MPs are willing to contemplate a “no deal” Brexit in 2019, rather than supporting a transitional deal.

If Labour wins a majority, markets would have to digest Corbyn’s plan for higher corporate tax, higher government spending and the nationalisation of various companies. Those companies that he wants to nationalise would most likely fall in value perhaps quite sharply, due to uncertainty over the price shareholders would get from the government. Higher corporate tax would also clearly be negative for all equities after tax profits. Those companies who pay the highest percentage of their tax in the UK are most exposed to this risk. Government bond yields would likely rise, on the assumption that Labour’s plans will lead to higher government borrowing. Markets would be concerned by Labour’s Fiscal Credibility Rule focusing only on current expenditures; they would also be sceptical of the party’s ability to raise as much tax as hoped from its proposed tax measures. Credit spreads would probably widen too.

When it comes to Brexit, Labour’s position is unclear, as its manifesto states that it will “have a strong emphasis on retaining the benefits of the Single Market” (soft Brexit), while also claiming that “Freedom of movement will end when we leave the European Union” (hard Brexit). It is the incompatibility between these two statements that is at the very heart of the Brexit debate. As such, the pound would probably be torn between a slightly higher probability of a soft Brexit and concerns over higher borrowing and a government perceived as less business-friendly. Under this uncertain outlook for sterling, the pound would probably fall, although that could later be reversed.

What happens to the pound would be key for equities. If the pound were flat, equities would be expected to fall, with domestic-focused companies underperforming more internationally exposed companies. A fall in the pound would exacerbate that relative performance, but could support internationally exposed companies and even cause them to rise in value, as we saw after the Brexit referendum. However, if sterling rallied sharply on hopes for a soft Brexit, large-cap equities with international exposure could come under pressure.

Overall, even a large majority win by the Conservative Party would not dramatically reduce the uncertainty over the type of deal the UK will eventually get, although the market reaction on the day would likely be limited. While we have examined the most likely outcomes if the election delivers a surprise result, the market’s reaction to unexpected outcomes could easily be unexpected too, given the large uncertainties involved.

# FOREX

## Overview

The normal focus this week for markets would look to Friday's US labour data, however key inflation numbers in the US and Europe should warrant close attention. Inflation currently is a key factor for both the Fed and ECB. Inflation in the Eurozone saw a significant jump higher last month due to Easter seasonal distortions. Already this week we have seen a mild negative correction in some German states, and Spain. It is important to watch closely these pullbacks in inflation to better measure the underlying trend. In the US recent inflation data has erred on the weak side. The release of the core PCE numbers remained unchanged in April. The market will be equally sensitive to higher and lower numbers. Looking forward, a surprise to the downside will question the pricing of the market's expected interest rate path and if the Fed will indeed raise rates twice more in 2017.

Month end adjustments for FX should see a passive rebalancing indicating a modest selling of USD verses GBP, CAD and AUD, and modest USD buying against the EUR. Equity and bond markets printed gains in dollar terms. The strong USD eased during May as uncertainty over US politics increased. US yields also pared recent gains, the yield on the US 10 year stuck under the pivot 2.35%. This weighs on USDJPY. European assets benefited from reduced political risk premia following Macron's election and supportive economic data, while GBP underperformed as the UK snap elections near. The broad softness of the USD combined with the better performance of European assets indicates a mild EURUSD selling signal.

## EUR

Monday was a bank holiday in the UK and US, EURUSD containing itself to trade within Friday's range. It wasn't until the Asian session on Tuesday that saw prices trade lower through the 1.1160 support are to test 1.1110/00 support.

Headwinds for the Euro have increased. Technically the failure to significantly test 1.1300 resulted in weak bulls to unwind positions into the bank holiday weekend.

The political risk for the Eurozone is not completely behind us in the wake of the ve+ results in France and Holland. A couple of key factors will prevent the Euro from trading outside a consolidation range over the summer. First, the elections in Italy and Germany will prevent the Euro from appreciating beyond 1.1350/1.1400 and the markets anticipation of the ECB signalling an taper to QE by year end will provide support to the downside providing an ultimate floor around the 1.1000 pivot point. Second, monetary policy remains to be a key factor in the euro exchange rate. The USD side of the prices leaves little room for surprise bar a U-Turn from the Fed for a June meeting.

Looking to the EUR side of the cross, Mario Draghi spoke to the European Parliament on Monday throwing water on the hawkish tapering argument. The ECB meeting on Thursday is unlikely to result in a signal to reduce QE, with the ECB probably preferring to wait until the release of the June ECB Economics forecast before a decision is to be made. Draghi did highlight that the ECB continues to believe that an extraordinary amount of monetary policy support is still necessary and emphasised the importance of the forward guidance once again. Underlying inflation pressures are still subdued, despite the favourable growth outlook. The market should read this as a central bank willing to wait a little longer before normalising its monetary policy.

While prices for EURUSD remain under 1.1175 in the near term. The path of least resistance is to the downside to test trend line and pivot support at 1.1025/00 where good demand is expected. Extensions higher towards 1.1350/1.1400 should meet decent supply and be treated as decent selling opportunities. The past few sessions have seen EURUSD is correcting lower: Having failed to touch 1.1300, Nov 2016 high some further weakness over the near term cannot be ruled out. First support is seen at 1.1100, 1.1075 which marks the bottom of the bull flag formation. Broader picture, while dips lower hold over the near term uptrend at 1.1010, the market remains in a longer term bull trend and will need to close below here to question that. Rallies will find interim resistance at 1.1235 ahead of 1.1268 and 1.1300. Above 1.1300, the market has potential to reach the highs from mid-2016 circa 1.1400, however we believe it will struggle here from a longer term perspective. Note the 78.6% retracement awaits at 1.1343. Look to buy dips towards 1.1010.

## GBP

Sterling is weakening. Recently EURGBP temporarily traded around 0.8750 and GBPUSD below 1.2780. Cable has found support on the trend line from March but the weakness will persists a little lower to 1.2740 pivot and 1.2720 55 mda support. The Pound's weakness can be attributed to Labour's recent surge in the polls for the June general election. At the moment, Theresa May's Tories are considerably less sure of a clear electoral victory than when the elections were announced. When the early elections were called, sterling gained because the market expected a clear Tory victory. This probability is now being pared back. We know that the Labour party has only a very small chance of winning the election however the surveys place a concern that the Conservative party may only win by a tight margin. This potential outcome would be troublesome for PM May as she would struggle with Brexit policies without a strong majority in parliament. Cable, as mentioned is drifting lower with targets on the recent low of 1.2776, the December high, having recently failed just ahead of 1.3060 the 29th September high. As we approach the UK election ranges are likely to remain narrow, confined to 1.2710/1.2980. We still favour being long sterling against the USD respecting the bullish trendline form September 2016. We look to buy dips towards the pivot at 1.2700/1.2690 risking a close below the 200 mda. Prices need to recover above 1.3040 to target the 1.3440/50 Sept 2016 high.

## USD

Economic data from the US remains supportive for the price. GDP was revised higher, Durable goods orders, albeit a volatile indicator did not disappoint. USD strengthened following the release. It seems that the FX market continues to follow traditional patterns. "Growth, inflation, higher interest.

## GOLD

Gold has made gains recently to a new interim high at USD 1,270oz. The move has surprised many with investors looking to Asia for clues to the renewed demand. Gold has probably found support from a weaker USD, a fall in long term yields and the high probability attached to the June FOMC meeting for a further 25 bps hike. The heightened differences between the US and Europe has resulted in a mild safe haven buying.

This week the main focus will the monthly US NFP releases. There is however little in the number that can prevent the Fed form increasing rates at the June meeting. Looking to positioning, the CFTC's statistics reflect net long positions in gold and silver increased considerably in the week to 23 May. Technically Gold is approaching a important crossroads as we near multiyear trend line resistance at 1283. Momentum may take the price higher leaving room to the upside towards the 2016 high at 1375. Failure to trade through 1283/85 would result in lower prices within the consolidation triangle to the 200 mda support at 1242/41 and below to the Jan-May bull trend line at 1226/1228 (see chart). We favour lower prices over the near term as the charts suggest a reversal following the failure to trade through 1270. The three day Evening star pattern suggests lower prices are in store. Near term targets rest at 1254.50 and 1242.

# VIEWS FROM THE TRADING FLOOR

## Equity

S&P was up 0.8 on the last week, VIX has also slightly decreased to 10.38 from 10.50. The only significant rise was for computer and electronics retail sector up nearly 15%. On the down side we find oil & gas drillers down 12% and oil & gas storage & transportation, equipment & services and exploration & production all three sectors down 5%.

In the US, the focus this week will be on the change in non-farm payrolls released on Friday. According to Raiffeisen, the labour market appears to have developed very positively in May. They assume that more than 200,000 new jobs have been created. There is here a potential for a positive surprise as the consensus is expecting 185k new jobs. Data by the Federal Reserve Bank of San Francisco, which analyses the influence of weather conditions on the creation of jobs, suggests the creation of more than 250,000 new jobs. According to the data, a plus of about 300,000 new jobs would have been expected in April in light of the dominant weather conditions – i.e. the temperatures and precipitation. However, according to the Bureau of Labor Statistics, 'merely' 211,000 new jobs were actually created. Typically, such discrepancies tend to level out in the subsequent months, at least to some extent. We set our estimate for the job creation slightly lower at 210,000, as it is quite possible that the previous month's figures will be revised upward.

S&P 500: The index managed to push above the 2400 resistance and it is now struggling to reach the first target area 2484-2500. The next one being 2600. On the downside 2350 remains the first support before 2325, below this level 2300 is the most probable target of any downward move.

Eurostoxx 50: The index has not managed to regain momentum and move above 3600. It is currently moving in a broad trading range between 3525 and 3600.A new break above 3600 will lead to a test of the recent high at 3666 before 3690 and a potential extension toward 3836.The first strong support remains 3525 any close below this level will lead to a test of 3450 support.

### EQUITY

**Developed countries**

| | | Total return - 1 Week |
|---|---|---|
| SMI | ↑ | 0.1% |
| Euro Stoxx 50 | ↑ | 0.1% |
| DAX | ↑ | 0.4% |
| FTSE 100 | ↑ | 1.3% |
| S&P 500 | ↑ | 0.7% |
| Dow Jones | ↑ | 0.5% |
| Nikkei 225 | ↓ | -0.5% |

**Developing countries**

| | | |
|---|---|---|
| Russia/Micex | ↓ | -2.2% |
| India/Nifty 50 | ↑ | 2.8% |
| China (HK) | ↑ | 1.0% |

↑ - Upward move ↓ - Downward move

### FIXED INCOME

**Developed countries**

| | 2-year Yield | 10-year Yield |
|---|---|---|
| USA | 1.3% | 2.2% |
| UK | 0.1% | 1.0% |
| Germany | -0.7% | 0.3% |
| France | -0.5% | 0.7% |
| Italy | -0.2% | 2.1% |
| Spain | -0.3% | 1.5% |
| 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 | ↓ | -2.0% |
| Gold | ↓ | -0.3% |

# CALENDARS

## Economic Events

| Date of release | Domicile | Event | Period | Actual | Estimated |
|---|---|---|---|---|---|
| 31 May 2017 | US | MBA Mortgage App. | May 26 | -3.4% | 4.4% |
| 31 May 2017 | US | Chicago Purchasing Manager | May 2017 | 55.2 | 232k |
| 1 June 2017 | US | ISM Manufacturing | May 2017 | 54.7 | 54.8 |
| 1 June 2017 | US | Construction Spending | April 2017 | 0.50% | -0.20% |
| 1 June 2017 | US | Change in Nonfarm Payrolls | May | 180k | 211k |
| 1 June 2017 | EU | Eurozone Manufacturing | May F | 57.0 | 57.0 |

## Company Earnings

| Date of release | Domicile | Company Name | Period | Estimate EPS |
|---|---|---|---|---|
| 25 May 2017 | US | Medtronic PLC | Q4 17 | 1.31 |
| 25 May 2017 | US | Costco Wholesale Corp | Q3 17 | 1.31 |

# Contacts

## Geneva – Headquarters

**Hinduja Bank (Switzerland) Ltd**

Place de la Fusterie 3bis

1204 Geneva, Switzerland

Tel. +41 58 906 08 08

Fax +41 58 906 08 00

## Branches

**Zurich**

Florastrasse 7

8008 Zurich, Switzerland

Tel. +41 58 906 05 05

Fax +41 58 906 05 06

**Lugano**

Viale Serafino Balestra 5

6900 Lugano, Switzerland

Tel. +41 91 910 43 43

Fax +41 91 923 55 73

## Representative Offices

**London**

New Zealand House, 80 Haymarket

London, SW1Y 4TE, United Kingdom

Tel. +44 20 7839 2366

Fax +44 20 7839 4959

**Paris**

Rue Galilée 33

75116 Paris, France

Tel. +33 1 44 43 52 36

Fax +33 1 40 70 03 79

## Subsidiaries

**Switzerland**

Berafina AG

Münchensteinerstrasse 43

4001 Basle, Switzerland

Tel. +41 61 225 45 45

Fax +41 61 225 45 25

Rowena AG

Grenzstrasse 24

9430 St Margrethen, Switzerland

Tel. +41 71 747 49 59

Fax +41 71 747 49 51

**Dubai**

Hinduja Bank (Middle East) Ltd

Dubai International Financial Centre

Building GV 10, 2nd Floor, Unit 5

Dubai, UAE

Tel. +97 14 436 65 88

**Mauritius**

Hinduja India Mauritius Holdings (Mauritius) Ltd

HBS India Investments (Mauritius) Ltd

HBS Trust Services (Mauritius) Ltd

1st Floor, Manor House Cr. St. James

Chazal Street Port Louis, Mauritius

Tel. +230 208 75 75

Fax +230 208 75 74

**USA**

Hinduja Capital Advisors Inc

520 Madison Ave., 34th Floor

New York, 10022, USA

Tel. +1 212 355 07 55

Fax +1 212 752 73 12

**UK**

Amas Investment & Project Services Ltd

New Zealand House

Haymarket 80

London, SW1Y 4TE, United Kingdom

Tel. +44 20 7839 4661

Fax +44 20 7839 5992

**India**

Paterson Securities Pvt Ltd

#3, Bhavani Mansion, 4th Lane

Nungambakkam High Road

Chennai - 34

India

**Cayman Island**

Hinduja Bank & Trust (Cayman) Ltd

c/o P.O. Box 2407GT

Grand Cayman

Cayman Islands

## Publisher

**Hinduja Bank (Switzerland) Ltd**

Place de la Fusterie 3 bis

1204 Geneva, Switzerland

Tel.  +41 22 906 08 08

Fax  +41 22 906 08 00

www.hindujabank.com

info@hindujabank.com

HINDUJA BANK

SWITZERLAND

## Disclaimer