Weekly Market Focus

HINDUJA BANK SWITZERLAND

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ASSET CLASS REVIEW

Anticipating China-US trade discussions

Last week, PMI figures in Europe and Japan have again showed signs of slowing growth with reading of 49.2 and 50 respectively. Below 50, PMI indicates a contraction of the activity. Because exports represent 19% of European GDP and 14% of Japanese GDP, the global trade war has negatively affected the manufacturing and services sectors. The US, in the contrary, showed a good reading of 53.7. Caution is required especially in Europe.

For the time being, markets are calm and slightly bullish, waiting for news about China-US trade discussions; President Trump has so far delayed to March 1 the imposition of tariffs on Chinese goods. It should not be forgotten that EU and US are also in talks to find a solution on Trump's threat to impose a 25% tariff on European car Imports.

Interesting to note that mainly two factors have fuelled the market rally: the increasing dovishness from central banks and the anticipation of a positive issue on US-China negotiations. The market bets on two positive issues when, in fact, they are contradictory: reaching a deal on the trade war means that central banks will be inclined to raise interest rates. In fact, stocks and bonds are not sending an identical signal. Upward movement in stocks implies that the recent lower growth rate will not persist for long. Bond rates have clearly declined and the yield curve has flattened considerably which suggest further weakness.

As long as prices do not align with recent macroeconomic data, we consider the stock market rebound as technical, following the strong correction at the end of last year. The actual rebound can therefore be used to gradually reduce the riskiest positions.

FOREX

USD

Don’t be surprised if important issues such as the debt ceiling, the suspension of which is coming to an end tomorrow, hardly seem to be an issue any longer, neither for the market nor for US Congress. First of all there seem to be more important subjects in US politics at present, such as the trade negotiations with China, the wall on the Mexican border or the Cohen affair. Secondly the subject of the debt limit is not so pressing at the moment. The US administration can continue to finance itself with the help of extraordinary measures until the summer. As a result it may not be until the summer that budget and debt ceiling combined will be hotly debated in Congress again causing trouble for the dollar. Having refused to clarify the future direction of the key rate in front of the Senate, Fed chair Jerome Powell remained just as reserved in front of the House of Representatives Financial Committee yesterday, refusing to provide any new information, so that the dollar is also lacking momentum on the monetary policy front. There is no substantial news on the trade conflict front either; but perhaps a surprisingly low GDP result today might be able to wake the market from its lethargy as growth in the US is likely to have slowed considerably in Q4. If the ISM index tomorrow were also to disappoint, the market might be affected by economic concerns again, allowing EUR-USD to rise above 1.14. However, we urge caution: despite slowing growth and a fall of the ISM the economic situation in the US is solid, in addition to inflation at inflation target, which means there is no reason to justify rate cut considerations. Only an external shock is likely to lead to that - a view shared by the Fed - but that seems unlikely at present. In other words: the market can remain in standby mode so that volatilities and the dollar continue to ease off only very, very slowly.

GBP

Sterling is in high spirits. It is trading at almost the same levels against the euro as seen in May 2017. The reason is the very real hope of a happy end, i.e. a Brexit with a deal, even if it was to come after a delay. So how will things move on from here? Until 12th March Prime Minister Theresa May will have to present a (possibly slightly modified) deal that has been agreed with the EU. If Parliament passes it, we have reached a happy end and we will just wait for the final credits. If Parliament rejects the proposals, there will be a vote on 13th March as to whether the House of Commons supports a Brexit without deal. If the answer is yes then on 29th March we will see what almost everyone is terrified of: the jump over the cliff edge into the no deal abyss with Sterling following suit. If Parliament insists on a deal, the more likely outcome, there will be a vote on a postponement of article 50 on March 14th, which the EU could then ratify at the summit on 21st/22nd March. In that case the happy end would be within grasp but once again all the details would remain open. The disagreement about how long Brexit would be delayed by (3 months or until the end of 2020) as well as the details of the agreement (e.g. Irish backstop) would resume. At least May caving in this week means that the likelihood of a happy end has risen and the risks for Sterling have fallen.

INR

Tensions between India and Pakistan so far did not impact the FX market. For USD-INR, it closed modestly higher yesterday by 0.2% to 71.24 but fears of a further escalation are likely to keep the market nervous. USD-INR has held mostly within the 69-72 range over the past three months or so and a move out of this range should provide a clearer direction. On the data front, we get Q4 GDP today with consensus at 6.8% y/y. This will imply growth in 2018 of 7.4% and above the government’s conservative estimate of 7.2%.

CNY

A further step towards the final agreement! US Trade Representative Robert Lighthizer testified in the Congress stating that an enforcement mechanism has been reached to ensure that China will follow through on the promises, if a final deal could be reached. Certainly, the paves ways for the final pact as the enforcement is one of the biggest concerns from the US’ perspective. Specifically, a “compliant” mechanism will be utilised and the US has the power to take actions to punish China unilaterally. However, Mr Lighthizer also mentioned that much work is needed to reach the final deal, indicating that the market will still need some more time to get more concrete results. Separately, China’s official manufacturing PMI came in at 49.2 for February, well below market expectations, reinforcing a challenging outlook. USD-CNY remains sideways due to the mixed news.

VIEWS FROM THE TRADING FLOOR

Equity

S&P was up 0.51% last week, with a flat volatility, the VIX index moving from 14.88 to 15.17. On the upside, we have consumer electronics up 17% and hotel& resorts 6%. On the downside, we find healthcare services down 12%, alternative carriers down 8% and oil & gas drillers down 7% on the week.

Stocks moved modestly higher, helping the Dow Jones Industrial Average mark its longest streak of weekly gains in nearly a quarter of a century.

One driver of the week's gains appeared to be the release of the minutes from the Federal Reserve's last policy meeting, which highlighted a continued "wait and see" approach for future rate hikes. Policymakers also indicated that they would stop shrinking the central bank's balance sheet by the end of the year, a drawdown that has slowly been removing liquidity from the financial system since late 2017.

S&P 500: The has nearly reached its 2816 target and corrected a little. On the downside, the first significant support is at 2703 before 2635. On the upside, if 2816 is broken then, the next target will be 2910.

Eurostoxx 50: the index has reached and overtaken its 3260 target. On the upside, if 3300 is broken, the next target stands at 3340. On the downside, the first significant supports are at 3260and 3156.

EQUITY

Developed countries

		Total return - 1 Week
SMI	⬆	0.4%
Euro Stoxx 50	⬆	0.7%
DAX	⬆	0.5%
FTSE 100	⬇	-1.2%
S&P 500	⬆	0.7%
Dow Jones	⬆	0.6%
Nikkei 225	⬇	-0.3%

Developing countries

Russia/Micex	⬆	0.5%
India/Nifty 50	⬆	0.1%
China (HK)	⬆	0.0%

⬆ - Upward move ⬇ - Downward move

FIXED INCOME

Developed countries

	2-year Yield	10-year Yield
USA	2.5%	2.7%
UK	0.8%	1.3%
Germany	-0.5%	0.2%
France	-0.5%	0.6%
Italy	0.4%	2.8%
Spain	-0.3%	1.2%
Switzerland	-0.8%	-0.3%

Developing countries

	2-year Yield	10-year Yield
Russia	3.3%	4.6%

COMMODITIES

		Total return - 1 Week
Crude Oil	⬆	0.14%
Gold	⬇	-0.08%

CALENDARS

Economic Events

Date of release	Domicile	Event	Period	Actual	Estimated
21 Feb 2019	US	Initial Jobless	Feb	216k	228k
21 Feb 2019	US	Existing Home	Jan	-1.2%	0.2%
26 Feb 2019	US	Housing Start MoM	Jan	-11.2%	3.2%
22 Feb 2019	Germany	IFO	Feb	93.3	94.3

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