Weekly Market Summary

2nd of September 2016

A Well Telegraphed 25 bps US Rate Hike in Less Than 20 Days … Markets Still In Full Denial!!
Fadi Nasser (SVP – Head of Treasury Sales)

One is always very anxious and concerned formulating strong directional views ahead of a big payrolls report that could result in large market movements and set the trend for upcoming changes in US and global yields!

The job surely doesn't get easier when the latest US manufacturing release is taken into consideration (the ISM index fell yesterday by 3.2 points to 49.4 in August, the biggest drop in more than 2 years and signaling contraction for the first time in six months), nor when a large majority of economists and market pundits still argue strongly for US rates being left unchanged – at least until December this year and/or possibly well into 2017. Some of those bearish views/headlines - expressed over the past 72 hours - are reproduced below:

- *'Ugly' US manufacturing data add to Federal Reserve dilemma* - Financial Times
- *ISM Ends 'Slim to None'* September Fed Hike Chance – Bloomberg Intelligence
- *Fed May Stay Cool on September Hike Even if Job market Glows Hot* – Reuters News
- *Morgan Stanley Vindicated on Their 5-year Treasury bet as Treasury Rallies & Yields Fall Before the Jobs Report*
- *Labor Data is a Noisy Distraction, Won't Work for September Hike* – Mark Cudmore , FX trader writing for Bloomberg

Markets remain quiet this morning – and risk sentiment is generally stable - ahead of this afternoon US Non-Farm Payrolls release (3:30 pm Bahrain time), which will be followed by the G-20 meeting over the weekend and the US Labor Day holiday on Monday. Traders' strong belief is that the Federal Reserve's interest rate decision on whether to keep rates on hold or raise them at its upcoming September 21st FOMC meeting hinges in large part on this ONE crucial economic indicator (Seriously?! Seven years into a US recovery and the Fed/markets want us to believe that a single data release will determine/shape future US monetary policy?). If the U.S. economy added a ton of jobs in August (in excess of 180,000 newly created jobs for the month) and displayed a steady rate of growth in wages (in excess of 2.5% YoY), the promised Fed increase in borrowing costs will be seen as a done deal for this month. If employment falters, the soothsayers of finance will scribble that the Fed stays on hold for a while longer (at least till the December 14th FOMC meeting).

Still, a major issue at hand is that the August report is the least trustworthy of the monthly jobs figures! So it should not be a surprise if it turns out that the economy did not add the forecast 180,000 jobs last month after all; especially that July has already witnessed a robust nonfarm payrolls gain of 255,000, whilst June too was solid at 292,000.

Of the seven August reports since the end of the 2007-2009 recession, payrolls have disappointed five times, missing the market's median estimate by more than 50,000. Even more surprising, once the Bureau of Labor & Statistics (BLS) gets around to revising its numbers, August typically gets a massive 90,000 boost, more than double what the other 11 months receive on average. That clearly makes August the most unreliable month for taking the temperature of the U.S. economy!

Fed Chair (alias "General" or "Grandma") Janet Yellen has blown the whistle at last Friday's Jackson Hole Symposium, whilst her lieutenants have come out in force - in past weeks - stressing/reminding markets that the Federal Reserve remains in a tightening mode. As of now, Bloomberg's world interest-rate probability calculator says traders and investors only see a 34% chance of the Fed raising rates this month, up from 25% a week ago!

History would suggest that relying on such low market probabilities or even Friday's economic report to gauge whether the Fed should move would be a mistake -- both for traders and for policy makers! And unless we see a major disturbing development unfolding in coming days, a September rate hike by the Fed certainly remains my base case scenario!!

**August Payroll Summary:*

The Fed needed a stellar payrolls report to hike as early as September 21st, and this afternoon data did not measure up to that task!
August payrolls were up a more moderate – but still healthy - 151,000, shy of the 180,000 consensus call. Other details also were disappointing, with wages up only 0.1% in the month (and 2.4% year-on-year), the jobless rate remaining at 4.9% against expectations of an improvement to 4.8%, and average hours quite soft at 34.3, implying a weak month for total hours worked.
Overall the number should be bullish (positive) for US Treasuries (higher prices, lower yields) and stocks (due to lower chances for an imminent rate hike), bearish for the US$.
Still, the current rate of job gains is very encouraging given the tight US labor market, while the average increase over the past 3-months remains elevated at 232,000 per month! As such, we maintain our call for a potential 25 basis point hike at the September FOMC meeting, though point out that the Fed's final decision will most likely be sealed on September 15th (following the release of many important economic indicators, including Retail Sales, Producer Price Index, Philadelphia Fed Business Survey, NY Manufacturing Survey, Industrial Production & Capacity Utilization and weekly Initial Claims).

Disclaimer

It is important that you only use this report if you are the intended recipient of this report and you have satisfied yourself that you are eligible to receive such information. This report is provided to you because you are one of our esteemed customers and have previously shown interest in receiving the type of information contained in this report.

The Treasury and Investment Management department of Gulf International Bank B.S.C. ("GIB") have compiled the information in this report. GIB is incorporated in the Kingdom of Bahrain and is licensed by the Central Bank of Bahrain (the "CBB") as a conventional wholesale bank. GIB's head office is located at Al-Dowali Building, P.O. Box 1017, 3 Palace Avenue, Manama, Kingdom of Bahrain.

This report is intended for the accredited investors, as defined in the Investment Business Code of Conduct published by the CBB. This information has not been reviewed by the CBB or any other regulatory authority in any jurisdiction and neither CBB nor any other regulatory takes any responsibility for the correctness or accuracy for the information contained in this report.

The information contained herein is not directed at or intended for use by any person resident or located in any jurisdiction where (1) the distribution of such information is contrary to the laws of such jurisdiction or (2) such distribution is prohibited without obtaining the necessary licenses or authorizations by the relevant branch, subsidiary or affiliate office of GIB and such licenses or authorizations have not been obtained. The recipient of such information is responsible for ensuring that this information has not been received by it in breach of laws and regulations of any jurisdiction.

This report contains publicly available information only, which has only been complied by GIB. The information provided herein is on "as is" and "as available" basis and without representation or warranty of any kind. GIB hereby disclaims any representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability, fitness for any particular purpose or non-infringement of any of such information. In no event shall GIB or its subsidiaries, affiliates, shareholders or their directors, officers, employees, independent contractors, agents and representatives (collectively, "GIB Representatives") be liable (1) for any inaccuracy, delay, loss of data, interruption in service, error or omission or for any damages resulting there from, or (2) for any direct, indirect, incidental, special, compensatory or consequential damages arising from any use of information or arising from any error (negligent or otherwise) or other circumstance or contingency within or outside the control of GIB or any GIB Representative, in connection with or related to obtaining, collecting, compiling, analyzing, interpreting, communicating, publishing or delivering any such information. The information here is, and must be construed solely as, compilation of information (unless expressly stated otherwise) and not statements of fact as to credit worthiness or recommendations or opinions of GIB.

This report does not provide individually tailored investment advice. Any materials contained herein have no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. The document is provided for information purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. GIB makes every effort to use reliable, comprehensive information, but we do not represent that it is accurate or complete. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the materials, nor are they a complete statement of the securities, markets or developments referred to herein. Recipients should not regard the materials as a substitute for the exercise of their own judgement. Any opinions are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or groups of GIB as a result of using different assumptions and criteria. GIB is not under any obligation to update or keep current the information contained herein.

The value of, and income from, your investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realised.

The information contained in this report is just for informational purposes. Information does not constitute a solicitation, an offer, or a recommendation to buy or sell any investment instruments, to effect any transactions, or to conclude any legal act of any kind whatsoever. GIB does not intend to provide investment, legal or tax advice through this report and does not represent that any securities or services discussed are suitable for any investor. When making a decision about your investments and business, you should seek the advice of professional advisors.

The report may contain statements that constitute "forward looking statements". While these forward looking statements may represent GIB's judgment and future expectations, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from GIB's expectations. GIB is under no obligation to (and expressly disclaims any such obligation to) update or alter its forward-looking statements whether as a result of new information, future events, or otherwise. The historical information is provided for information purposes only. Performance figures are calculated before tax (if any) and after deducting ongoing fees and expenses. The performance figures are historical and past performance is not necessarily an indication of future results. Certain amounts (including %ages) included in this document may have been subject to rounding adjustments. Accordingly, figures may not be an exact arithmetic aggregation of the figures to which they relate. The values and forecasts shown represent our current indicative valuations and forecasts of the relevant transactions, currencies, interest rates, commodities or securities as at the date shown. Any value or forecast shown herein is not an indicative price quotation. We expressly disclaim any responsibility for the accuracy of the values or forecasts shown, any errors or omissions in the report

With the exception of information regarding GIB and save as otherwise specifically indicated, the information set out in this report is based on public information. We have, where possible, indicated the primary source of information. We strongly recommend the recipients consult the primary source of information. Facts and views in this report have not been reviewed by, and may not reflect information known to, professionals in other GIB business areas.

This Report, and the information contained herein (save to the extent that such information is publicly available) is confidential and may not be disclosed by you to any other person outside of your organization without our consent.