Weekly Market Summary

19th of Feb. 2016

Don't Be Fooled by a Week or Two of Market Stability … Heightened Uncertainties To Persist Throughout 2016!! Fadi Nasser (SVP – Head of Treasury Sales)

This week has witnessed stability in risk assets, though "realistically" the backdrop has not really changed. Oil and equity markets have managed to bounce back in past days (moves explained later), whilst G7 government bond prices dropped slightly (higher yields). Meanwhile, economic data in the US continues showing resilience and remains at odds with the narrative about an imminent recession.

Still, Money / Hedge Fund managers do not appear to be persuaded with recent assets' steady performance. The US$ 1.4 trillion money manager Capital Group Co. (the world's 7th largest asset manager at the end of 2014) is warning investors that more volatility in markets will emerge as the global economy slows and central banks experiment the dangerous world of negative interest rates. "*Turbulence will probably persist as rates below zero and deflation poses a "real threat" in Japan and Europe*", Capital Group wrote in a note to clients earlier this week. They also added that the risk of a U.S. recession has increased, which means the Federal Reserve probably will not increase borrowing costs in 2016, a view now widely shared by various market strategists / traders (needless to reiterate that we strongly believe such market stance/assumption is quite premature!).

Since the start of 2016, investors have found few places to profit as a rout in stocks that started with concerns about China's economy and the tumbling price of oil spread to global bank shares, emerging-market currencies and high-yield bonds. Despite three days of gains of more than 1% in four sessions, the Standard & Poor's 500 Index is still down 6.2% year-to-date, and earnings by its companies are set to drop for a third quarter. "*The big question is whether the U.S. economy gets overwhelmed by problems overseas; we will have to see,*" the report cited Capital Group fund manager Jim Lovelace as saying. "*Additionally, it is not clear whether central banks will succeed in preventing a sharp economic slowdown, and their actions may cause unexpected side-effects*" (according to the same report). Despite all the risks, Capital Group is far from alarmist in its outlook, and says the chance of a repeat of the 2008 financial crisis remains low. The U.S. economy will "*muddle through*," Lovelace says.

"*Do not be fooled into thinking the rebound in stocks means we have reached the bottom*", says Marcella Chow, the global strategist for the $1.7 trillion JPMorgan Asset Management Unit (beat that Capital Group!). She says she is on edge, her clients are panicky and Chow is telling them to increase their exposure to bonds while being selective on equities (Wow! Do investors pay a fee for this superior advise?). She is personally stashing as much as 70% of her own portfolio in bonds including U.S. Treasuries. Calm will not return to markets until China's economy improves and central banks regain credibility with investors, Chow believes. Investors are worried oil may fall to as low as $22 a barrel, so for now keep a low profile and try to avoid volatility.

Treasuries are the best haven from a rout that wiped almost $7 trillion from global shares this year, said Chow, because the Federal Reserve is unlikely to rush to raise interest rates again soon (a measure of U.S. government bonds has gained 2.3% this year). Central banks are running out of ammo, according to Chow, who says she has lost faith in their ability to calm markets. She points to how quickly the yen reversed declines after the Bank of Japan adopted negative interest rates. That move itself shows the BOJ is running out of options, Chow added.

Below is a summary of major news stories/developments that shaped markets in the past few days / week:

Gold Bulls Feast as More central Banks Drive Rates To or Below Zero: Gold bears for years fed off the prospects for higher borrowing costs. Now bulls are thriving in a world where negative rates are becoming commonplace. The Bank of Japan adopted negative rates last month to spur growth, joining central banks in Denmark, the euro area, Sweden and Switzerland. With about a quarter of the world economy facing negative rates in some form and growth faltering, gold has become one of this year's best investments. It is a big turnaround for the yellow metal which slid to a five-year low in December as the Federal Reserve readied for its first rate increase in almost a decade. With China's slowdown roiling markets, markets do not believe the Fed will move again until next year. Negative rates mean depositing cash would leave investors with less than when they started, making traditional stores of value such as gold more appealing. "*Leave a million dollars with a bank, and in a year, you get only something like $990,000 back*," Marc Faber, the publisher of the Gloom, Boom & Doom Report, said by phone. "*I would rather want to own some solid currency, in other words gold*." Gold has rallied 19% percent to $1,264 an ounce this year (last at $1221), beating other commodities, sovereign bonds, major currencies and most stock indices. Investors are buying gold through funds at the fastest pace since 2009. Prices are still down a third from their record in 2011 ($ 1921 on September 6th 2011!), when monetary stimulus boosted demand for an alternative to currencies.

China's Stocks Complete Their Biggest Weekly Advance in Two Months: China's stocks capped their steepest weekly gain in two months after the government signaled increased support for the economy through higher spending and new measures to boost bank lending. The Shanghai Composite Index advanced 3.5% this week, with technology companies leading the gains. Policy makers have accelerated measures to bolster the economy after earlier data showed a decline in exports and a pickup in inflation. In moves that could support lending after a record surge in new yuan loans last month, the PBOC also loosened restrictions on what banks could pay on deposits and charge for loans, while the nation's cabinet has discussed lowering the minimum ratio of provisions that banks must set aside for bad loans. Even with this week's advance, the Shanghai gauge is the world's worst performer this year after Greek and Italian equities, plunging 19% YTD!

OECD Cuts Global Growth Forecast and Warns of Growing Risks: The Organization for Economic Cooperation and Development (OECD) cut its global growth forecasts yesterday (shocking -to say the least- after the market rout in past weeks! J), saying the economies of Brazil, Germany and the U.S. are slowing and warning that some emerging markets are at risk of exchange-rate volatility. Global gross domestic product will expand 3.0% in 2016, the same pace as in 2015 and 0.3% percentage point less than predicted in November, the Organization for Economic Cooperation and Development said in its quarterly report. "*Financial stability risks are substantial*," the Paris-based organization said. "*Some emerging markets are particularly vulnerable to sharp exchange-rate movements and the effects of high domestic debt*." With Group of 20 Finance Ministers and central bankers gathering in Shanghai next week to grapple with the slowdown, the OECD urged them to consider offering more fiscal stimulus to support monetary efforts already underway. "*A stronger collective policy response is needed to strengthen demand,*" the OECD said.

"*Monetary policy cannot work alone. Fiscal policy is now contractionary in many major economies. Structural reform momentum has slowed. All three levers must be deployed more actively to create stronger and sustained growth.*"

Saudi Arabia, Russia Agree to Freeze oil Output: Saudi Arabia and Russian oil ministers agreed earlier this week to freeze - but not cut - crude oil output at near-record January levels, a highly unusual pact between the world's leading OPEC and non-OPEC petroleum producers. Qatari and Venezuelan oil ministers also joined the agreement in a meeting Tuesday in Doha, but the accord did not include Iran, which is seeking to ramp up oil output after the lifting of sanctions related to its nuclear program, nor Iraq, which has been boosting production to finance its economy and war against the Islamic State. Moreover, January levels of oil output would most likely keep global supplies running faster than demand for months to come, if not longer. That would be bad news for oil exporting countries, but good news for consumers in oil importing nations badly in need of financial stimulus and happy to have more money in their pockets. Few market participants have put high credence to those headlines as it merely perpetuates the status quo and keeps markets oversupplied ! In order to produce a swift rebound in prices, one needs both producers to agree on production cuts, with the support of other OPEC and non-OPEC countries. WTI oil for April 16 delivery is last trading at $ 32.35, after reaching a high of $ 34.21 yesterday morning.

"Brexit" – Myth or Reality? French Prime Minister Manuel Valls has confirmed in the past 48 hours that Britain's exit from the European Union would be "*a shock*" for Europe but that members could not pick and choose rules that suit them. "*We believe and we hope*" that a deal is possible to keep Britain in the EU," Valls told France's parliament. "*Because the departure of Britain would signify a shock for Europe, but more importantly a shock to the way the world sees Europe, which is already in crisis*." A summit of all 28 EU leaders is currently taking place in Brussels (Thursday 18th/Friday 19th), at which British Prime Minister David Cameron hopes to win backing for a package of reforms to his country's relationship with the bloc (to appease British voters' concern over EU laws on immigration and subsidies). Cameron says the reforms are necessary to convince Britons to vote to stay in the EU in a referendum that could take place as soon as next June. Policymakers at the Bank of England have suggested that fears over a potential "Brexit" are starting to weigh on the pound. The UK's large current account deficit could become a "*source of vulnerability*" in the event of a vote in favor of leaving the EU, according to Goldman Sachs. At 3.7%, the deficit reflects the economy's reliance on inflows of foreign capital. George Cole, an economist at GS, said leaving the EU would "*increase uncertainty, weigh on the UK outlook and raise concerns of foreign investors*", resulting in "*an abrupt and total interruption to incoming capital flows*". UK Sterling is last trading at 1.4300 versus the USD, down from a high of 1.5240 just 2 months back!!

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.