Weekly Market Summary

5th of Feb. 2016

Tired of Receiving Gloom, Boom and Doom Reports.... Join the Club!!
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Marc Faber is a Swiss investor based in Thailand who also serves as a director, advisor and shareholder of a number of investment funds that mainly focus on emerging and frontier markets. Born in Zurich and schooled in Geneva, he studied Economics at the University of Zurich and, at the age of 24, earned a Ph.D in Economics! Faber shot to fame -early in his career- when he advised clients to get out of the stock market before the October 1987 crash. In addition, he rightly predicted the rise of oil, precious metals and other commodities, emerging markets, and especially China in his 2002 book entitled *Tomorrow's Gold: Asia's Age of Discovery.* Faber also expressed bullishness for the US dollar in mid-2008 before it dramatically recovered and showed positive expectations for holding the Japanese Yen. Marc Faber is the author of the monthly investment newsletter ***"The Gloom, Boom & Doom"***, an in-depth economic and financial publication which highlights unusual investment opportunities around the world. His latest posting (February 3rd, 2016) refers to **stock markets crashing further like the Titanic!**

However, Faber's predictions have not always been correct! In 2009, he predicted with full confidence that the Federal Reserve's policy of keeping interest rates near zero would lead to hyperinflation approaching levels seen in Zimbabwe (peaked at 79.6 billion percent in mid-November 2008!). Most recently, Faber projected a 30% rise in gold prices in 20015 (versus an actual drop of 11% over that year). His latest forecasts include the developing "nowhere-to-hide bubbles" fueled by US Federal Reserve policies in past 4 years (I fully agree with this one) and the need for investors to hold cash for better buying opportunities after big market corrections.

Going back to major developments that shaped markets in the first week of February (2016), we can point out to the following major trends:

Lower Yields Keep on Coming, in Defiance to Economists' Forecasts: Investor demand for bonds is proving voracious as oil and stocks tumble, defying the consensus forecast for yields to rise this quarter and for the rest of the year. Two-year yields fell to - 0.5% in Germany and -0.2% in Japan, where the 10-year yield traded down to +0.01% -- all record lows. Benchmark 10-year US Treasury yields touched 1.79% earlier this week – within half a percentage point of the record low of 1.38% set in 2012 - before settling last at 1.85%. The rally is defying economists who said yields would climb after the Federal Reserve raised interest rates in December. Uneven U.S. economic growth is leading investors to scale back forecasts for further increases. Bloomberg surveys of economists still project the U.S. 10-year yield will rise to 2.25% by March 31st and to 2.68% by year-end, with the most recent forecasts given the heaviest weightings. As to the future of US monetary policy, NY Fed President William C. Dudley confirmed in an interview this week that Fed policy makers are "*acknowledging that things have happened in financial markets and in the flow of the economic data that may be in the process of altering the outlook for growth and the risk to the Fed outlook for growth going forward*."

US Dollar Posts Biggest 2-Day Drop in 7 Years: The dollar posted its biggest two-day drop since March 2009, extending a decline that wiped out its rally at the start of the year. The greenback fell against all of its 16 major peers. Signs of a slowing U.S economy have hurt the dollar by derailing wagers on diverging policies between central banks. Currency traders are catching up to the bond market, where interest rate futures sent the strongest signal yet that traders expect the Federal Reserve to stand pat on rates in 2016. The dollar's pullback this week has reversed all the yen's decline against the greenback last Friday when the Bank of Japan introduced negative interest rates to revive inflation, which is stuck near zero. The Dollar Index, which tracks the U.S. currency against major global peers, has fallen 3.50% this week to its lowest level since mid-October 2015.

Citibank Warning - We Should All Fear "Oilmageddon": Markets are currently in a well-oiled "*death spiral*," according to Citigroup Inc. analysts led by Jonathan Stubbs. "*It appears that four inter-linked phenomena are driving a negative feedback loop in the global economy and across financial markets*," the analysts write, citing the resilient U.S. dollar, lower commodities prices, weaker trade and capital flows, and declining emerging market growth. "*It seems reasonable to assume that another year of extreme moves in U.S. dollar (higher) and oil/commodity prices (lower) would likely continue to drive this negative feedback loop and make it very difficult for policy makers in emerging markets and developing markets to fight disinflationary forces and intercept downside risks*," the analysts add. "*Corporate profits and equity markets would also likely suffer further downside risk in this scenario of Oilmageddon*". Their case is bolstered by a collection of charts showing the linkages between these four factors, including the importance of lofty oil prices to the ready supply of petrodollars circulating in the world economy and flowing to financial assets. However, should Citi's base case of a stabilizing USD and improving commodities markets (oil above $50 by year-end) materialize, financial assets should respond accordingly and recover.

BOE Leaves Rates Unchanged, Lower Growth and Inflation Forecasts: The Bank of England Monetary Policy Committee (MPC) voted 9-0 to keep the benchmark UK base rate unchanged at 0.50%, with Ian McCafferty unexpectedly abandoning the call for higher borrowing costs that he had held since August. "*The MPC judges the risks to the central projection to be skewed a little to the downside in the near term, reflecting the possibility of greater persistence of low inflation,*" the Committee said yesterday. "*Low realized inflation will continue to moderate the increase in wage pressure in the near term*." Additionally, the BOE governor said inflation will average just 0.8% this year, climbing to the 2% target in 2018 and signaled that a rate increase is still some way off.

China Foreign Reserves Alert: China's foreign-exchange reserves, already at a three-year low, are poised to post a second consecutive record monthly drop as policy makers intervene to support the Yuan. The central bank will most likely confirm this Sunday that the currency reserves fell by $118 billion to $3.2 trillion in January, according to economists' estimates in a Bloomberg survey. That would exceed a record $108 billion decline in December, which brought last year's total draw-down to more than half a trillion dollars and capped the first annual decrease in the reserves since 1992. Policy makers are burning through billions of dollars to hold up a weakening currency amid flagging growth and $ 1 trillion in capital outflows last year. The draw-down has accelerated since the Central Bank's (PBOC) surprise devaluation of the currency in August 2015. Reserves tumbled $94 billion that month, a record at the time. Another cut to the Yuan's reference rate last month spurred a stock sell-off that has helped push the Shanghai Composite Index down 21% this year and into a bear market. Beijing's foreign-exchange reserves surged almost 200-fold from $21.2 billion in 1993 to a peak of almost $4 trillion in 2014. Even after falling 17% since then, the reserves remain the world's largest and are almost triple the level held by No. 2 Japan.

This afternoon - the first Friday of February - market focus will shift to the US January job release (4:30 pm Bahrain time). As always, welcome to random number generator, also known as US Non-Farm payrolls: Bloomberg's consensus is for a 190,000 increase in jobs on the month (although the whisper number is much lower at 165,000 following weaker-than-expected US data in past 2 weeks), an unchanged unemployment rate and average workweek (at 5.0% and 34.5 hours respectively), as well as a nice pickup in wages (+0.3% MoM/ +2.3% YoY).

With Federal Reserve policy makers having already moved forward with their first interest-rate increase in almost a decade, today's jobs report takes on elevated importance for a different reason: In the face of crumbling financial markets and plunging commodity prices, the January employment data will help better define the current strength of the US economy. Payroll gains at or near 170,000 would probably provide some reassurance about growth prospects. Conversely, a lackluster report will almost certainly add to the wall of worry that has washed over financial markets this week and lead to further market erosion in weeks to come, whilst also possibly confirming that the Fed's December 25 bps hike in rates was a miscalculated move by US central bankers.

**Payroll Release commentary (late on Friday afternoon): One observation does not make a trend and this afternoon's slightly below consensus payroll figure does not change the fact that jobs have been growing at a solid pace recently. US Non-farm payrolls (NFP) grew 151K in January, a deceleration from the downwardly revised 262K in December (previously 292K). However, all other details contained in the report were surely more positive than anticipated. Average hours worked increased on the month to 34.6 hours from 34.5. Average earnings also came in ahead of expectations at 0.5% MoM, leaving the annual rate at 2.5% (although that is down from an upwardly revised 2.7% in the prior month). And despite the slower than expected gain in payrolls, the unemployment rate edged down to 4.9% (finally breaking the psychological 5.0% threshold!). Today's US job data appears to offer something for Fed doves and hawks alike. As a result, market reaction should be somewhat mixed. Our call is that it will be mildly more positive for stocks and commodities and surely quite bearish for US bonds (lower prices / higher yields).*

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