Weekly Market Summary

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2016 Starts With a Bang!!
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2015 already feels like history and 2016 has started with a big bang! That was the new reality I faced upon returning to office middle this week, following a stress free two-weeks break! From China's weakening currency to the rout in oil to the withdrawal of Federal Reserve stimulus and gains in the cost of financing business, things that keep investors up at night are climbing out from under the bed again this year. While little of it is new, the persistence is troubling, especially when buffers such as valuations and central bank support are turning against the market bulls.

Indeed, renewed China fears - following further contraction in its PMI Manufacturing, repeated heavy selloff in its stock market and further depreciation in the value of the Chinese Yuan – coupled with a lowering in 2016 global growth prospects by the Washington-based World Bank have conspired to create a risk-off environment [refers to trader's worry to hold equities and commodity currencies for fear of lower growth and higher volatility; The Swiss Franc & Japanese Yen both rally while G-7 bond yields tend to fall in a risk-off environment, as investors move out of high yielding bonds into the safety of "low risk" government paper "flight to quality"] and led billionaire George Soros to conclude at a recent economic forum in Colombo -Sri Lanka that "*the current environment reminds me of the crisis we had in 2008!*".

Whilst I personally feel it is premature to jump to such tormenting conclusions (surely the big market meltdown can wait for another year or two until inflation shows its ugly head and market yields jump markedly from current depressed levels!) and did warn in my last economic write-up for 2015 against holding mainstream views on financial markets – adding that what "everyone knows or assume to know" is usually unhelpful at best and wrong at worst – market traders/asset managers for their part seem to have opted for an extension in their bets on those late 2015 trends, at least for now, rather than take profits or focus on potential new themes/ trend reversals in 2016.

Over the past few days, more than $2 trillion has been wiped from the value of global equities, volatility in the broadest stock gauges has jumped 15% or more, and 10% was shed from the price of oil. Almost everything - from junk bonds to coffee - has tumbled.

Below is a summary of major financial events that have impacted markets in the first week of 2016:

- **Purchasing Managers Indices Disappoint Globally**: Chinese, US and UK manufacturing PMIs – released in the first few days of 2016 - were unanimously weaker-than-expected, reviving fears of a possible growth slowdown and leading to a global equity selloff.

- **Chinese Stocks Crash:** Chinese stocks sold off aggressively in the first week of 2016 (in excess of 13% at one point!), forcing local exchanges to close for two days following automatic shutdowns. The nation's market circuit breakers, which halt exchanges for 15 minutes after a 5% drop in the CSI 300 and for the rest of the day after a 7% retreat, have been criticized by analysts for exacerbating losses as investors scramble to exit positions before getting locked in. However, those circuit were suspended this morning by China's securities regulator.
- **Oil Prices Continue Tumbling:** Oil prices have extended their losses in early 2016 (WTI closed 2015 at $ 37.73, a 7-year low), dropping to a low of $ 33.16 yesterday (last at $ 33.92 for February West Texas Intermediate) as major oil suppliers (Russia, OPEC, US) resist production cuts / pump at record capacity despite a global supply glut estimated at close to 2.5 million barrels a day. Heading into this year, oil market will face various uncertainties - including the pace and volume at which Iranian oil will re-enters market, oil consumption growth, and the responsiveness of US shale and other non-OPEC production to low prices.
- **World Bank Sees Global Growth Sputtering Along:** The Washington-based development bank lowered this week its forecast for 2016 global growth to 2.9%, from a 3.3% projection in June. The world economy advanced 2.4% last year, less than a forecast of 2.8% in June and slower than the 2.6% expansion in 2014, the Bank said. The deteriorating picture in emerging markets is a big reason for a fifth straight year of global growth below 3%. The World Bank cut its outlook for China's growth in 2016 to 6.7%, from 7% in June, and a 6.5% increase is estimated for next year. Brazil's economy will shrink 2.5% this year, while Russia's will contract 0.7% percent, the lender predicted.
- **German and Eurozone Consumer Prices ("CPI") Print Weaker-than-Expected**: Eurozone annual inflation rose an annual 0.2% in December, compared to a median estimate for a +0.3%. For the ECB governing council, who has opened the money tap ("QE") since early 2015 to boost price pressure (I still remain puzzled why central bankers desperately want inflation to rise at a time wages are hardly growing!), such data is a reminder that the ECB medium-term inflation goal of just under 2% keeps moving further away. Earlier in the week, the German statistics office said inflation in Europe's largest economy was +0.3% YoY, missing economist estimates for a 0.4% increase.
- **Fed Releases Minutes of its December 15-16th FOMC Meeting**: The Federal Reserve confirmed that it is likely to move cautiously and "*gradually*" as it looks toward further withdrawing support for the US economy, following its first 25 bps hike in the overnight Fed fund rate. The minutes also showed that "*some Fed members said that their decision to raise the target range was a close call, particularly given the uncertainty about inflation dynamics*". "*In determining the size and timing of further adjustments to monetary policy, some members emphasized the importance of confirming that inflation would rise as projected and of maintaining the credibility of the Committee's inflation objective,*" the minutes added.
- **Geopolitical Risks Escalate:** With North Korea conducting a nuclear test, tensions noticeably growing between Saudi Arabia and Iran, and Britain threatening to leave the European Union.

Whilst 2016 could look different, the general theme of strong US job gains but still tame wage pressures remains. Payrolls were well ahead of consensus expectations at +292,000 in December, with a net upward revision of 50K to the previous two months. Construction and service sector hiring once again drove the increase in payrolls. However, despite the continued sharp intake of jobs, wage inflation remains largely subdued. The annual rate of average earnings may have accelerated to 2.5% from 2.3% in the prior month, but that was largely due to favorable base effects (December 2015 month/month change in average earnings was -0.2%), rather than any real strength in the current month. Indeed, wages were flat on the month this December.

Elsewhere in the report the unemployment rate was unchanged at 5.0%, and the wider U6 measure was also unchanged at 9.90%

The strength of the job gains – if supported by healthy retail sales data next week - should keep the Fed on track for one more hike in interest rates at the March 16th FOMC meeting, should financial market volatility subside. However, signs of inflation picking up will likely be needed to convince more dovish members to support further hikes beyond that point!!

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