Weekly Market Summary

13th of Nov 2015

A December to Remember…30 Days and Counting Till The US Federal Reserve's First Rate Liftoff in 9-1/2 Years ! Fadi Nasser (SVP – Head of Treasury Sales)

In the absence of major economic data releases in the early part of this week (that will change later this afternoon with the publication of the all-important October U.S. Retail Sales and Producer Price Index reports as well as that of the preliminary November US Consumer Confidence report known as the University of Michigan Sentiment), market attention has turned to appearances/speeches made by various Federal Reserve officials, with the latter reiterating for the second week in a row that conditions for the first rate liftoff since June 2006 "*could soon be satisfied*" (NY Fed President William Dudley – permanent voting member) and stressing that policy should be tightened only gradually after that first rate increase.

Though Dudley declined to say if he expected rates to rise at next month's meeting of the policy-setting Federal Open Market Committee (December 16th), he devoted considerable space in his speech to the Economic Club of New York to explaining why the central bank should proceed with caution as it raises rates above zero. "*After liftoff commences, I expect that the pace of tightening will be quite gradual*," Dudley said. "*In part, that is because monetary policy is not as stimulative as the low level of the Federal funds rate might suggest.*"

Dudley's speech followed comments by the Chicago Fed's Charles Evans (voting member), Richmond's Jeffrey Lacker (voting member) and St. Louis Fed chief James Bullard (non-voting member). Charles Evans, speaking in Chicago on Wednesday, stressed the need to tighten policy slowly and for officials to spell out this strategy as clearly as possible. "*It is critically important to me that when we first raise rates the FOMC also strongly and effectively communicates its plan for a gradual path for future rate increases*," Evans told a National Communities Council leadership forum.

St. Louis's Bullard, in contrast, was very vocal in his push for higher US rates at upcoming Fed meetings. "*Prudence alone suggests that, since the goals of policy have been met, we should be edging the policy rate and the balance sheet back toward more normal settings*," said Bullard, who called the Fed's current policy settings "*as extreme as they have been at any time since the recession ended*." Richmond Fed's Lacker, speaking at the same Fed policy conference, said the central bank had not lost its ability to guide inflation, but had more limited scope to use monetary policy to lift real economic performance over the longer term. He said that his projected path for future rate increases was steeper than the median of forecast of policy makers (a remark echoed by Bullard). Jeffrey Lacker votes on the FOMC this year and dissented in September and October in favor of a 25 basis-point rate increase. Bullard will be an FOMC voter in 2016.

Elsewhere, commodity markets took another pounding this week, sending gold to a five-year low, oil to its the lowest level in two months and copper to the cheapest since 2009. Investors are fleeing, withdrawing more than

a $1 billion from exchange-traded funds tracking industrial and precious metals just this month, data compiled by Bloomberg show. Platinum dropped yesterday in the worst losing streak since 2002, while silver posted its longest slump since March 2014. Gold futures for December delivery was last at $1,083 an ounce, after touching $1,073, the lowest since February 2010. Copper futures slumped as much as 2.7% to $2.1585, the lowest since July 2009.

Oil too was a big loser on the week, with prices for December WTI last at $ 41.80 a barrel from $44.30 on Monday. According to the International Energy Agency (IEA), oil stockpiles have swollen to a record of almost 3 billion barrels because of strong production in OPEC and elsewhere, potentially deepening the rout in prices. This "*massive cushion has inflated*" on record supplies from Iraq, Russia and Saudi Arabia, even as world fuel demand grows at the fastest pace in five years, the agency added. Still, the IEA predicts that supplies outside OPEC will decline next year by the most since 1992 as low crude prices take their toll on the U.S. shale oil industry. "*Brimming* (full) *crude oil stocks*" offer "an unprecedented buffer against geopolitical shocks or unexpected supply disruptions," the Paris-based agency said in its monthly market report. Global oil demand will climb by 1.8 million barrels a day this year to 94.6 million amid the strongest growth in India's consumption in more than a decade, according to the Agency, though demand growth could ease next year to 1.2 million barrels a day as the stimulus from cheap fuel fades and China's economy remains "*problematic*."

Whilst China's slowing growth has pressured prices in past year, the country is not all to blame for an acceleration of the metals and energy meltdown. The latest catalyst for the collapse is the rapid shift in investors' expectations for higher U.S. interest rates, which in turn boost the value of the US dollar, raise the probability of slower US & global growth and make commodities – especially metals - less competitive against assets that pay interest or offer dividends (needless to stress that we disagree with this general market thinking/consensus as fears/obsessions over the Fed's upcoming 25 bps hike appear fully overblown! And while a brief drop in gold prices below the $1,000 psychological mark would not come as a big surprise after 2 or three 25 bps hikes by the Fed, our bias remains in favor of a "buy on dip" whenever oil prices trade close to or slightly below the $40 mark).

Last, but not least, a great piece of news from early this week for conspiracy theorists (yours truly!): Neel Kashkari, 42, a former financier who managed the U.S. Treasury's $700 billion rescue of banks in the 2008 crisis (the Troubled Asset Relief Program, or TARP, which till date remains one of the more controversial measures adopted during the financial crisis as its mandate was unexpectedly altered from allowing the US government to purchase the bank's troubled assets at "fair" market prices to bailing out AIG, automakers and stabilizing financial institutions), was named the next president of the Federal Reserve Bank of Minneapolis. Kashkari's resume includes a failed run for governor of California last year and great involvement at the US Treasury during the peak of the 2007/2009 financial crisis, where he was Secretary Henry Paulson's key aide in overseeing TARP. Kashkari will take over from Narayana Kocherlakota on January 1st 2016, according to a statement Tuesday from the Minneapolis Fed.

However, it is Kashkari's stop at Goldman Sacks in the early 2000s - before accepting the Treasury post in 2006 - that is now giving Goldman Sachs conspiracy believers a field day! Neel Kashkari's appointment places another ex-Goldman Sachs banker at the helm of a regional Fed bank. Robert Steven Kaplan (who took over the Dallas Fed in September 2015) and William C. Dudley (has been in charge of the New York Fed for almost seven years) are Goldman alumni. Philadelphia Fed chief Patrick Harker previously served as a trustee at Goldman Sachs Trust and as a member of the board of managers of Goldman Sachs Hedge Fund Partners Registered Fund.

The Kashkari appointment is therefore great news for anyone seeking evidence of a system in thrall to Wall Street, especially as it comes fresh on the heels of Goldman paying a US$ 50 million fine to settle a case involving the leak of Fed documents that speaks to the revolving-door problem. "*We are disappointed that yet another former Goldman Sachs insider has been elevated to a regional president position,*" said Jordan Haedtler at the Center for Popular Democracy in Washington and a deputy campaign manager at Fed Up, a national coalition that is calling for changes at the central bank. Such appointments need "*more transparency and public input,*" Headtler added.

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