Weekly Market Summary

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China, Oil & Cautious Central Bankers
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Economic data releases are no longer the main driver for the price action in equity and bond markets. That is surely noticeable two weeks into the new year, with eyes rather focused on developments in China and the oil market.

Concerns about the state of the Chinese economy are dominating global markets in 2016, helping trigger a $5+ trillion (numbers keep ballooning!) equity selloff since the start of the year and weighing on currencies in commodity-producing nations from Australia to Canada. Those fears have also helped push countries like Brazil into a severe recession and cast a doubt over U.S. and other financial markets as investors grow increasingly worried about the health of the Asian giant.

And whilst US equity indices did manage a nice bounce on Thursday evening, this morning's price action in Asian markets is disturbing to say the least. The Shanghai Composite Index sank 3.55% at the close, falling more than 20% from its December high (the threshold for defining a solid bear market) and sinking below its low during the depths of the market rout in August 2015 (which followed a small 2% devaluation in the value of the Chinese currency). Today's decline has been attributed to persistent investor concerns over volatility in the Yuan and a report that some banks in Shanghai have halted accepting shares of smaller listed companies as collateral for loans.

The selloff is clearly a setback for Chinese authorities, who have been intervening to support both stocks and the Yuan after the worst start to a year for mainland markets in at least two decades. As policy makers in Beijing manage (or "mismanage") an unprecedented state rescue campaign and fight to prevent a vicious cycle of capital outflows and a weakening currency, the resulting financial-market volatility has undermined confidence in their ability to manage the deepest economic slowdown since 1990. Moreover, policy zig-zags (backtracking on pledges to make its management of the Yuan more market driven and provide circuit breakers or price supports for its ailing equity market) have left investors divided over how committed President Xi Jinping and Premier Li Keqiang are to financial sector reform and shifting their $10 trillion-plus economy from one powered by investment and exports to one more focused on consumption and services.

"A rebound in equities isn't going to be sustainable until volatility comes down and until we get a sense that the Chinese economy is doing better or at least is moving in the right direction," Herald van der Linde, Hong Kong-based head of equity strategy for the Asia Pacific at HSBC Holdings Plc, said in an interview from Singapore. "*China's economy is struggling to turn around*."

My personal take: China's slowdown, after years of double-digit annual growth, reflects the nation's attempt to create a more diversified and sustainable economy. It was a weakening of China's manufacturing data early this year that largely set many global investors on edge, but this ignores the relatively strong services sector, which has been the main engine of Chinese growth for the last three years and now accounts for more than half of the country's economy. Additionally, China is a great big domestic economy with too much wealth behind it and therefore is better positioned to make the difficult transition away from exports and investments and into a consumer-driven service economy than other Asian tiger economies that have attempted to do so!

Oil

Oil is headed for its third weekly decline as Brent crude's discount to U.S. prices increased on signs Iran is moving closer to boosting exports. West Texas Intermediate futures dropped as much as 5.5% this morning (US$ 30.50 last on the March contract) and are down 8.4% for the week! Brent for March settlement was $ 1 lower, or 4.0%, at $29.60 a barrel on the London-based ICE Futures Europe exchange. The European benchmark discount widened to as much as $1.07 to WTI for March, the biggest intraday gap since July 2010.
International sanctions on Iran may be lifted Monday, allowing for a boost in oil shipments from the fifth-biggest member of the Organization of Petroleum Exporting Countries. "*Lower oil prices have been a sentiment leader for the recent market selloff and will again be in focus with Iranian sanctions expected to be lifted next week*," Ric Spooner, a chief analyst at CMC Markets in Sydney, said in a note Friday. "*How fast Iran can put oil back on the market will now be a key issue for oil markets, with many skeptical that it will be able to do this nearly as fast as it has forecas*t." "*Iran is trying to regain lost market share and does not intend to pressure prices with an export increase once sanctions are removed*", officials from its petroleum ministry and national oil company have said this month. The nation's output will increase by 100,000 barrels a day, or 3.7%, a month after sanctions are lifted and by 400,000 in six months, according to the median estimate of 12 analysts and economists surveyed by Bloomberg.

The persistent price decline is affecting producers with BHP Billiton Ltd. expecting to book a $4.9 billion write-down on its U.S. shale assets, BP Plc planning to cut 4,000 jobs and Petroleo Brasileiro SA slashing its spending plan. Additionally, while low oil and gas prices might be good for consumers, really low oil prices have historically been a harbinger of terrible outcomes for the stock market - and the economy – as they could signal that lower growth is on the horizon and businesses will not be expanding as quickly. Past accounts show that sometimes they can even foretell the beginnings of a major stock market crash.

My personal take: I don't claim to be an expert on oil prices (FAR from that!), but surely the bulk of the bearish news is by now fully valued/priced in current depressed levels, whilst little regional/international political & geopolitical risks (or black swans) are being anticipated.

Cautious Central Bankers

- **Europe:** Some European Central Bank policy makers argued in favor of making a deeper cut to the deposit rate and stepping up the monthly pace of bond-buying while others called for no action at all, an account of the December 3rd Governing Council meeting showed yesterday. "*Some members expressed a preference for a 20-basis-point cut in the deposit-facility rate at the current meeting, mainly with a view to strengthening the easing impact of this measure*. *The possibility was also raised of expanding the monthly volume of purchases*", a summary of the policy meeting revealed. Back then, the ECB cut its deposit rate to minus 0.3% (from -0.20%), extended its quantitative-easing program to at least March 2017 and pledged to reinvest the principal of the bonds it bought. Whilst President Mario Draghi argued that this re-calibration of monetary stimulus was "*adequate*" to return inflation near its goal of just under 2%, the continued fall in oil and equity prices since then may pose fresh challenges to his outlook. The next ECB policy meeting is scheduled for January 21st . ECB policy makers have expressed a broad agreement that a "*reassessment could be made in the future*" about the option of increasing monthly QE purchases beyond the current 60 billion euros ($66 billion) a month.

- **US:** Minutes of the December 15-16th Federal Open Market Committee (FOMC) - released last week – showed some Fed governors were on the fence about the rate hike decision and were swayed by strong job data. "*Some members said that their decision to raise the target range was a close call, particularly given the uncertainty about inflation dynamics*," the minutes said. Similarly, signals from Fed officials this week have been mixed. On Monday, Atlanta Fed President Dennis Lockhart said the global selloff in stocks is unlikely to affect the U.S. economy, but added he could change his view if the turmoil persists. Boston Fed President Eric Rosengren said Wednesday there is a risk that weakening U.S. growth forecasts could prompt the central bank to take a slower approach. Last, St. Louis Fed President James Bullard said the recent decline in oil prices may delay the return of inflation to the central bank's 2%. That has prompted investors to cut wagers on how higher the Federal Reserve will raise its policy rate this year, with current pricing for 1 rate hike between now and year-end (versus the 2 rate hikes priced just a while back and Fed projections for 4 rate hikes in 2016!).

My personal take: In this current unpredictable and wild market environment, it is no time to be a hero and take big market risks or long-term market bets! Hedge your exposures & protect your capital

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