Weekly Market Summary

7th of October 2016

Top Market Themes

Fadi Nasser - Head of Treasury Sales

Several themes have been driving markets in past days. The most important and solid one seems to be **investors' renewed appetite for USD** on the back of growing rate hike expectations and re-steepening of the US yield curve. Unless today's non-farm payrolls release disappoints significantly and Donald Trump decisively wins the second presidential debate on October 9th, the constructive USD view should most likely remain in place for now. Next week's US data (retail sales, business inventories, consumer confidence) should further confirm that domestic demand is in a good shape while the Fed minutes should point at broad support for a rate hike later this year. Markets will also focus on Fed Chair Yellen's speech next week (scheduled for October 14th) for more clues as to the near-term outlook for policy.

Other important themes closely tracked by fund managers and traders:

- **An overnight Flash Crash of the Sterling Pound:** 2 minutes of chaos in Asian trading this morning sparked the biggest plunge in the pound since the Brexit referendum! Whether that was the result of a so called fat finger trade fuelled further by computer controlled algorithms that caused the temporary collapse of Sterling remains unknown? The reference alone that the French President Hollande insisted on a tough approach towards Great Britain so as to avoid a contagion effect is clearly not enough to explain the 9 big figure collapse in the value of the pound against the US dollar (from 1.2650 to 1.1750). After all, there was sufficient bad news over the past few days that did not cause Sterling to ease much in the space of a few seconds. EUR-GBP jumped to 0.93, while GBP-USD fell below slightly 1.18 before quickly trading back up to 1.2375. This immediate recovery also points towards a technical glitch. Error or not, the reaction illustrates that the British exit from the EU has the potential to create considerable disruption on the markets, in particular if no sensible deal can be reached between the UK and the EU.

- **A rebound in oil prices on the back of expectations of an OPEC output cut and evidence of growing US demand**: WTI oil held above $50 a barrel for a second day after U.S. inventories fell a fifth consecutive week and as OPEC's pledge to reduce output sparked speculation a global glut may ease. Data this week showed US stock piles shrinking below 500 million barrels for the first time since January, whilst OPEC pledged in Algiers last week to reduce the group's production to 32.5 to 33 million barrels a day in a bid to shrink the world's bloated crude supplies and boost prices. Oil has gained about 13% since the Organization of Petroleum Exporting Countries agreed on September 28th to cut production for the first time in eight years. OPEC - which pumped at a record in September - will decide on quotas at an official meeting of the group in Vienna on November 30th.

- **Deutsche Bank's $ 14 Billion Scare:** This summer, U.S. Justice Department officials working on a mortgage securities investigation of Deutsche Bank AG expected the bank to settle the matter for $2 billion to $3 billion, according to people with knowledge of the matter. Then came last month's news that the US government had opened settlement talks by asking for $14 billion, a figure that Deutsche Bank said it would not pay.

That September surprise roiled markets and pushed the German lender's shares to a record low (EUR 9.89 on 30/09 and last at EUR 12.25) as investors asked whether it would have to raise capital to meet the U.S. demand, even as it faces other potentially costly investigations. It is not unusual for the Justice Department to begin settlement negotiations with a number higher than the ultimate penalty. The sides may also bargain over what behaviors will be admitted, if any, whether individuals will be held to account, and how much of the top-line total may include items besides cash penalties, such as credit for modifying loans. However, it is less common for such figures to spill into the open while talks proceed, as happened on September 15th when the Wall Street Journal reported the $14 billion figure. With negotiations now taking place out of the spotlight, analysts have been evaluating what the possible penalty might be. The bank has set aside 5.5 billion euros ($6.1 billion) for litigation. A settlement above that amount would leave the German lender no room to settle other legal issues without increasing capital, JPMorgan analysts have written.

- **A Sharp Selloff in Gold Prices:** The sell-off in gold prices has accelerated in past week as US bond yields continue to rise in response to solid economic data and market speculation of a possible Fed rate rise at the November or December FOMC meeting. Gold has been pressed lower not just because US yields turned higher, but because rising yields played a key role in boosting the USD. And with no sizable purchasers coming forward - China is out of the market due to the Golden Week national holidays - gold has traded down to $ 1,250 per ounce, breaking below the 200-day moving average (at USD1,259) and triggering further technical and momentum selling.

- **Hurricane Mathew:** Millions of people in the U.S. southeast have been ordered in past days to flee as Hurricane Matthew, set to become the strongest storm to hit the country since 2005, headed toward Florida's East Coast after leaving hundreds dead in Haiti. The storm was downgraded to Category 3, with winds of 120 miles (195 kilometers) an hour, and was expected to make landfall this morning near Cape Canaveral and then track along the Atlantic coast, resulting in as much as $50 billion in economic losses. At least 2 million people have been ordered to flee its path, with evacuations under way in Georgia and South Carolina. In one part of Haiti's southwest region, more than 300 people have died and authorities expect the nationwide death toll to rise further. The U.S. has not been hit by a major hurricane with winds of 111 miles per hour or more since Wilma struck Florida in October 2005. Katrina, also in 2005, caused about $154 billion in damage, adjusted for inflation, making it the costliest in U.S. history, according to the National Oceanic and Atmospheric Administration.

Traders will shift focus this afternoon to the all- important US payroll release* (3:30 pm Bahrain time). Economists are looking for US payrolls growth to return in September to its 2016 average following a flip & flop picture in the past 2 months (July was very strong at +275,000 versus a "low" +151,000 number for the month of August). Should the September number print relatively strong, the conclusion that traders will draw is that maybe the Fed would have been better off raising rates by 25 bps at its September 21st meeting! Bloomberg consensus is for September payrolls rising by 175,000 (versus an average 181,000 a month gain in the first eight months of 2016). As always, it will also be worth keeping a close eye on the other important elements of the report, including the unemployment rate (expected to stay unchanged or decline one-tenth to 4.8%), average hourly earnings (+0.3% mom / +2.6% yoy is anticipated there), the participation rate (last at 62.8%) and average weekly hours.

**Disappointing data for US economic activity in August has given way to brighter news for September, and this afternoon's payrolls report continued that pattern, even if the numbers were a shade weaker than expected. The payrolls gain of 156,000, coupled with a slight downward revision for the prior 2 month total, was a modest miss versus forecasts, as was the 0.2% rise in average hourly earnings. That still left the latter up a reasonable 2.6% Year-on-Year, edging closer to the 3% pace the Fed would like to see. One important improvement was in average weekly hours, up one tick to 34.4. The jobless rate moved up a tick to 5.0%, but that came from a rise in participation. Job gains were seen across the service sector, with goods seeing factory work down but construction up strongly. Overall, slightly on the soft side versus high hopes, but still in the range that the Fed needs to see to carry through with a rate hike in December.*

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.