Weekly Market Summary

07th of July 2017

Nothing Major To Report This Week .... All News is Rosy & Uplifting !! N O T
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There are times when one wishes things could be different and world leaders behave more maturely. This week was no exception!

Take for example US President Trump's attack on North Korean leader Kim Jong-un on Tuesday – via Twitter - after Pyongyang's latest missile test, asking, "*Does this guy have anything better to do with his life?*" Few days prior to that, Donald Trump sent out a tweet with the hashtag "#FraudNewsCNN # containing a video in which he trashes a person with a CNN logo as its head (the original footage refers to an appearance Trump made in 2007 on the pro wrestling fake and scripted television show "WWE"), prompting the news network to wonder whether the US president had better things to do. "*Instead of preparing for his overseas trip, his first meeting with Vladimir Putin, dealing with North Korea and working on his health care bill, he is instead involved in juvenile behavior far below the dignity of his office. We will keep doing our jobs. He should start doing his*", the CNN statement read, calling it a "*sad day when the President of the United States encourages violence against reporters.*"

Anyone who has followed Trump's earlier career in business and Kim Jong-un's past in politics knows that there aren't more attentive media consumers than those 2 chaps. They watch TV constantly – mostly FOX news for Trump, cartoon shows, Chicago Bulls & Manchester United games for Kim – and do enjoy being constantly the center of attention on major news outlets. In fact, President Trump raised eyebrows in a Reuters interview last April, when he threatened a "*major, major*" conflict with North Korea but later went on to say that he empathized with the supreme leader of this nuclear power Republic. Trump, who tried to escape his own father's shadow by going into business for himself at 27, found some similarities between his biography and Kim Jong-un's: "*He is 27 years old. His father dies, took over a regime. So say what you want, but that is not easy, especially at that age*," Trump told Reuters. "*I'm not giving him credit,*" Trump continued. *"I'm just saying that's a very hard thing to do. As to whether or not he is rational, I have no opinion on it. I hope he is rational*."

The danger of the current standoff is that the psychology of the protagonists – two leaders with large egos, thin skins, wild hairstyles and a preference for maximalist solutions (extreme and excessive decisions) – will encourage them to keep tightening the knot with potentially devastating consequences. Rationally, U.S. military pre-emption makes little sense given the low probability of removing all of Kim's WMD assets and the high probability that the North will launch a crippling conventional assault on Seoul and possibly Tokyo. While the U.S. and its South Korean ally would almost certainly prevail in a war with the North, a devastated North would pose its own challenge given the risk that hidden fissile material might fall into the hands of extremist organizations or other rogue regimes - i.e. the "*loose nukes*" scenario. As such, the U.S. has few options apart from tougher economic sanctions, which are only likely to have substantial impact on the North if backed by China. However, Beijing (& Moscow) has made it clear that sanctions alone are not enough and is pushing for renewed talks, be it formal or informal, between the U.S. and North Korea. Ultimately, those will require concessions from both sides: At the very least a freeze by Kim of his missile and nuclear weapons tests could be met in return by a suspension of joint U.S.-South Korea military exercises. This in turn would lead to an expansion of diplomatic ties between Washington and Pyongyang and eventually a peace settlement on the peninsula. For now, cool heads seem to be prevailing, and yesterday's confirmation by US Defense Secretary James Mattis that North Korea's launch of an intercontinental ballistic missile capable of reaching the U.S. does not necessarily bring the two nations closer to war is a move in the right direction (President Trump had suggested during his stop in Poland that "*It is a shame North Korea is behaving this way, and they're behaving in a very dangerous manner, and something will have to be done about it*").

Moving to regional news, the four Arab states that had imposed an earlier embargo on Qatar, have recently attacked Doha for its negative response to their demands in a sign that the month-long diplomatic crisis is deepening. After meeting in Cairo on Wednesday to discuss the dispute, the foreign ministers of Saudi Arabia, the United Arab Emirates, Bahrain and Egypt said Qatar's response showed "*a lack of seriousness in dealing with the roots of the problem*" and a "*failure to appreciate the dangers in the situation*". Adel al-Jubeir, Saudi Arabia's foreign minister, warned that additional steps against Doha could be taken at the appropriate time. This morning – in a new statement - Saudi Arabia, the United Arab Emirates, Bahrain and Egypt expressed their "*deep surprise*" that Qatar rejected the 13 demands, saying that they were now "*null and void*." They pledged new political, economic and legal measures against the Gulf nation. As a reminder, the crisis erupted on June 5th when Riyadh and its allies cut diplomatic and transport links with Qatar, accusing the gas-rich state of sponsoring terrorism. Doha was given until last Wednesday to respond to a list of 13 demands, including that it pay reparations, cease all support for the Muslim Brotherhood and close Al Jazeera, the satellite television channel. Qatar's foreign minister has said his country is willing to discuss legitimate grievances but will not be dictated to by its neighbours. Speaking in London, Sheikh Mohammed bin Abdulrahman Al-Thani, said Doha "*continues to call for dialogue*" despite what he described as "*clear aggression*" against his country. Kuwait is mediating the dispute, and Donald Trump has called on all parties "*to negotiate constructively to resolve the dispute*" during a phone conversation with Abdel Fattah al-Sisi, his Egyptian counterpart, according to a White House statement on the call.

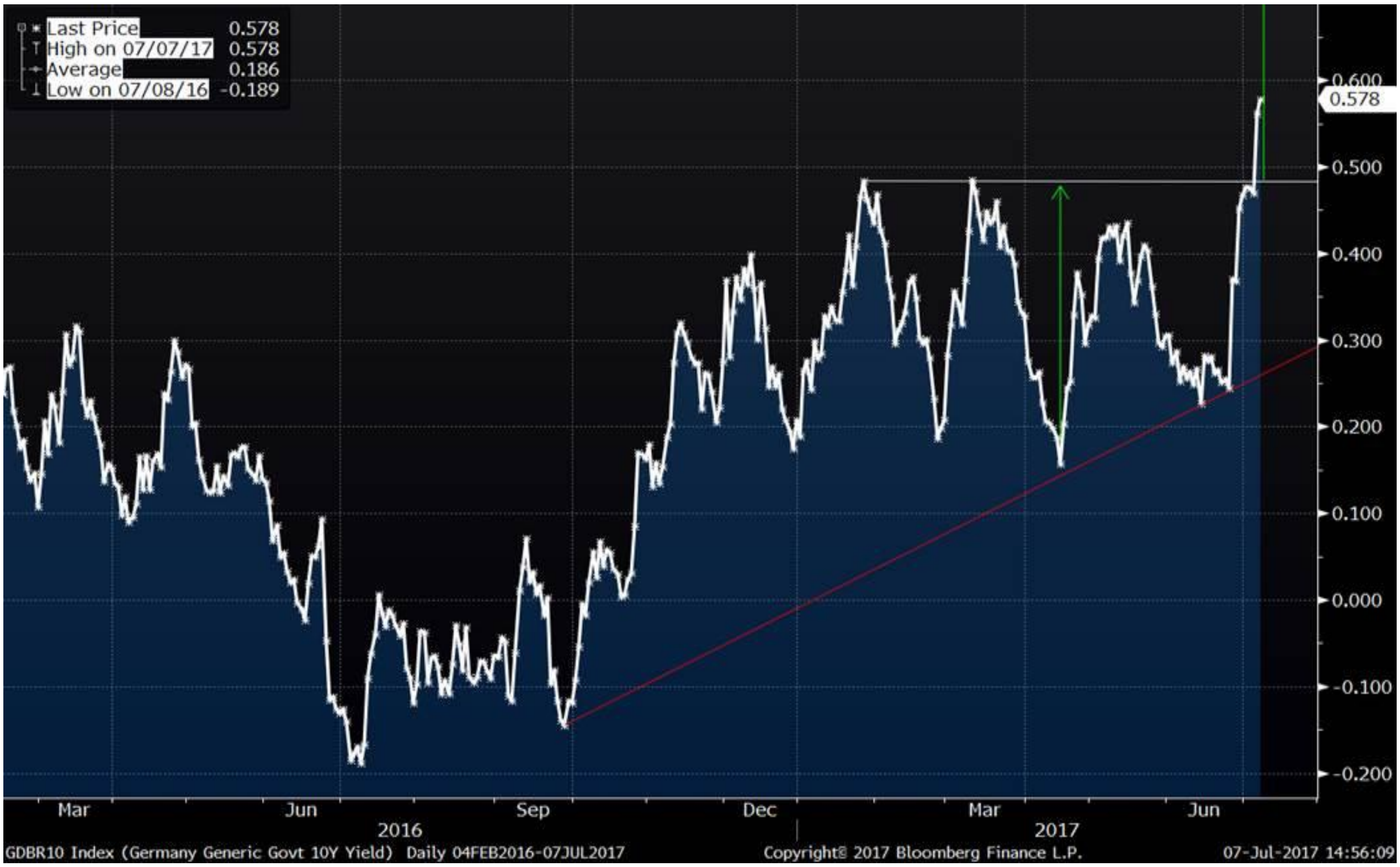
Last - but not least – a quick update on a major market developing story making the headlines in past hours/days:

As recently as the start of last week, it looked like the U.S. Treasury and German bond markets were primed for an historic bullish breakout (i.e. higher prices & lower yields), with analysts forecasting a quick march lower in US 10-year note and German 10-year bund yields to the 2% and 15 bps respective yield markers, as inflation measures sagged, oil prices entered a bear market, and disarray in Washington trashed all hopes for the Trump administration's economic agenda. Although that bullish landscape has not changed much – notwithstanding few solid US and European data releases in past days - the market has surprisingly traced out a significant 28 to 33 basis-point reversal in yields to the 2.38% area in the US and 0.57% in Germany, making the bears firmly in charge as we head into this afternoon US payroll data ** (release at 3:30 pm Bahrain time. Bloomberg consensus is for 178,000 new non-farm jobs created during June, unemployment steady at 4.3%, average hourly earnings – a gauge of inflation – up 0.3% month-on-month, and 2.6% YoY).

***Strong US employment figures with little wage growth has been a recurring theme in US payrolls releases for a number of years now, and it happened again this June! Employment rose by 222,000, with a 47,000 cumulative upward revision to the prior two months. However, an only modest 0.2% gain in average hourly earnings was good enough for a 2.5% annual rate – noticeably below the almost 3% pace reached in late 2016 /early 2017. The unemployment rate, derived from a separate survey of households, rose slightly to 4.4% (from a 16-year low of 4.3% the previous month). The average workweek for all workers rose to a strong 34.5 hours (from 34.4 hours in May). As such there is something for hawks and doves alike on the FOMC, and today's figures should do little to alter policy expectations. Market reaction so far has been muted, with the USD stronger on the day (EUR/USD and USD/JPY last at 1.1390 and 113.85 respectively). 10-year US yields hardly changed at 2.38%.*

European Central Bank President Mario Draghi was the initial trigger for the reversal in bond sentiment when he hinted on June 27th that faster growth in Europe could allow for both interest-rate hikes and some slowing in the pace of bond purchases mapped out by the central bank. While his comments were quickly walked back by insiders maintaining that he was misinterpreted (that is at odds with yesterday's release of the June 7-8th ECB meeting account, which clearly confirmed that the European Governing Council discussed removing the easing bias in their last policy communication as European economic growth continues unabated), the damage was done: Bond markets globally were hit as investors realized they faced the beginning of the end of aggressive quantitative easing programs - that have kept high-quality government debt in short supply – whilst traders with long bond bets capitulated as the technical outlook (interest rate charts) took a turn for the worst with Thursday's significant breakout of 10-year German yields above their 18-month range top at 50 basis points (**The beauty of herd mentality traders: Buying the highs and selling the lows!**).

German Bund 10-year yield (Daily Chart)



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