



## 1 MONTH IN 10 SNAPSHOTS

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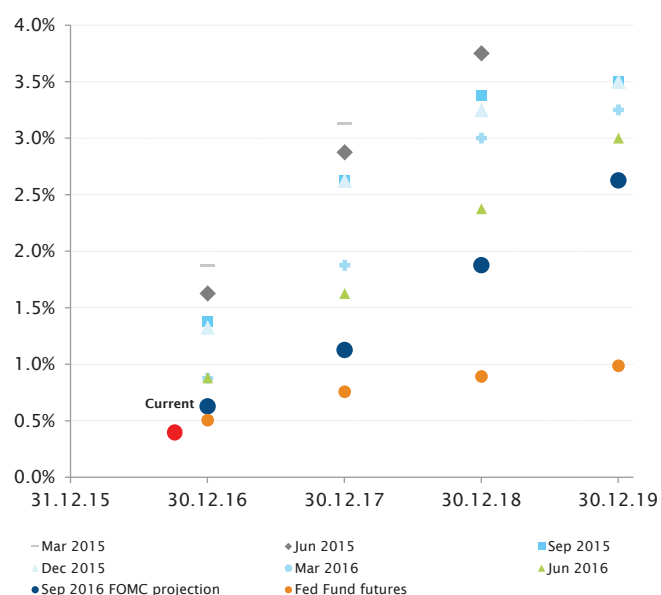
### INDEX

- |   |   |   |   |
|---|---|---|---|
| 1. The Fed once again backs off .....           | 1 | 7. Credit - China still in red territory .....          | 4 |
| 2. US activity bounces up in September.....     | 2 | 8. FX - Evolution of the Mexican peso                   |   |
| 3. A mid-cycle slowdown in the Euro area .....  | 2 | in the run up of the US election .....                  | 5 |
| 4. The ECB refrains from extending QE yet ..... | 3 | 9. Gold - The yellow metal became less attractive ..... | 5 |
| 5. Japanese growth remains stuck .....          | 3 | 10. Equity - Buying the Swiss National Bank? .....      | 6 |
| 6. Capital flows out of China have slowed       |   |   |   |
| but not reversed .....                          | 4 |   |   |

### 1. The Fed once again backs off

- After a first rate hike in December 2015, the Fed expected to raise rates four times in 2016 but has not been able to move again so far. Market conditions and the economic backdrop have led the central bank to postpone any move.
- In September, the Fed Fund rate was once again left unchanged at 0.5%. The press release hinted to one rate hike before year-end, probably in December.
- Such a move is currently partially priced by future markets and would allow the Fed to save face by formally extending the “normalization process”. But it will not hide the plain fact that the Fed has constantly been overly optimistic in the past years. FOMC members have had to revise lower their rate and growth projections at almost every meeting, effectively validating ex post much softer market expectations. A feature that may be repeated in 2017, when the Fed currently expects to hike twice...

#### Fed projections of Fed Fund rate levels and market pricing



Source: Federal Reserve, Bloomberg

## 2. US activity bounces up in September

- After an unexpected drop in August, the ISM non-manufacturing index of activity in the service sector bounced up even more spectacularly in September. It therefore dissipated potential worries on a loss of steam of the largest sector of the US economy and its main growth driver.
- In September, the ISM manufacturing also rose after a weak August datapoint, and climbed back into expansion territory. This confirms the stabilization in the US industrial sector witnessed since the spring, after the pronounced decline of 2015 resulting from lower oil prices and a stronger dollar.
- As a consequence, the ISM composite (GDP-weighted index of the two aforementioned ISMs) rose in September to its highest level of the year. It suggests that GDP growth is likely to have rebounded in Q3 (after a weak Q2 at +1.4% annualized) and might remain close to 2% for the second half of 2016.

*US ISM composite index and real GDP YoY %*

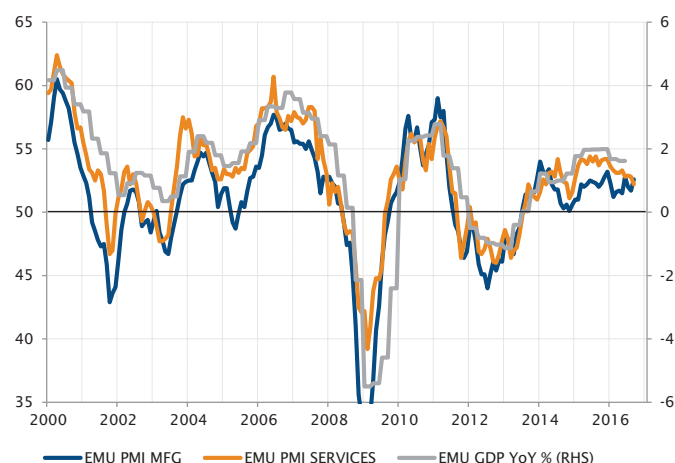


Source: Datastream, SYZ Asset Management

## 3. A mid-cycle slowdown in the Euro area

- The euro area is entering a mid-cycle stabilization of its growth rate, after two years of recovery post-recession. The combination of favorable factors which fueled growth in 2015 is gradually dissipating: oil prices are rebounding, the euro is not getting weaker anymore, interest rates can hardly get much lower and pent-up demand has faded.
- As a result, growth dynamic is losing steam, as pictured by the regular decline of the service sector activity index, a good gauge of domestic demand dynamic. In September, it fell to its lowest level since late 2014 after a 6th decline in 9 months. It has now converged toward the level of the manufacturing index, itself relatively steady over the past 18 months.
- Those indices suggest that growth is further losing steam in Europe during the second half of the year and might be closer to 1% in annualized terms than the 2% experienced in 2015.

*Euro area PMI indices (manufacturing and services) and GDP YoY*

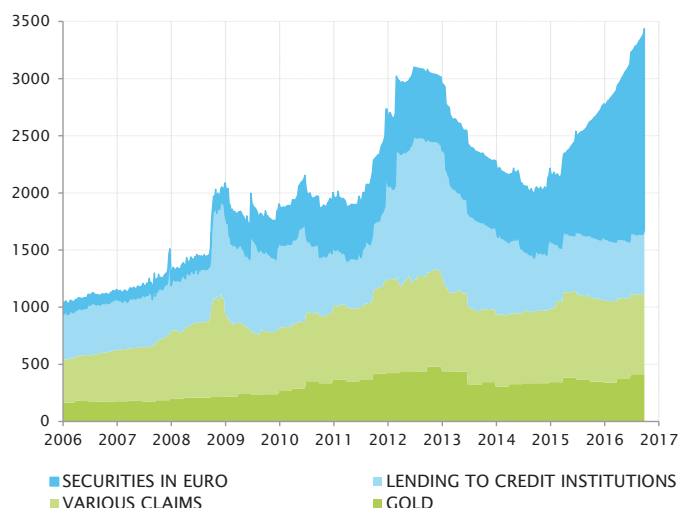


Source: Markit PMI, Datastream, SYZ Asset Management

#### 4. The ECB refrains from extending QE yet

- Financial markets were unsettled after the latest ECB meeting when Mr Draghi declared extending the QE beyond March 2017 has not even been discussed. With the end of the asset purchase program due in six months, it brought up bad memories from the US Fed's QE taper in 2013.
- The ECB is currently running a very accommodative monetary policy, with an ongoing bond purchase program of EUR 80 bn per month. Its balance sheet is reaching record levels (almost EUR 3'500 bn, 32% of the euro area GDP). It has therefore not much room to ease further its policy.
- As long as economic growth is OK and inflation is moving away from the deflation "danger zone", the ECB has no need to precommit to any additional action. Ultimately, it may have to extend its QE program to keep away deflationary forces. But there is no need to hurry for that.

**ECB balance sheet breakdown by main categories (EUR bn)**

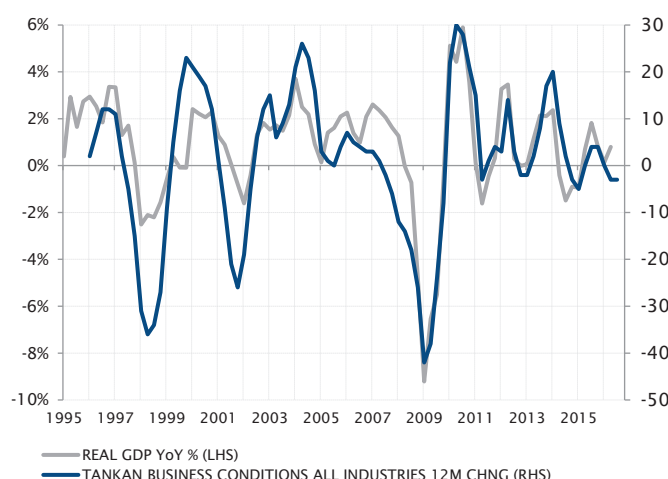


Source: ECB, SYZ Asset Management

#### 5. Japanese growth remains stuck

- The Japanese economy is struggling to resume the positive dynamic briefly witnessed in 2013. The VAT hike in 2014 caused a blow to domestic demand that has hardly been digested yet: GDP growth has been almost nonexistent since then and inflation has slowed down back toward zero.
- The strengthening of the yen this year and the inability of the Bank of Japan to slow it down have only added to Japan economy's woes. Projected growth and inflation are barely positive for the year ahead.
- The latest Tankan survey has provided no real ground for hope: the lack of improvement leaves little room for a short term growth acceleration. Inflation expectations have again edged lower and the current yen strength threatens corporate profits. Japan can only rely on external developments (stronger USD triggered by the Fed, acceleration in global GDP) to hope for higher growth and inflation.

**Real GDP and Tankan business condition index annual change**

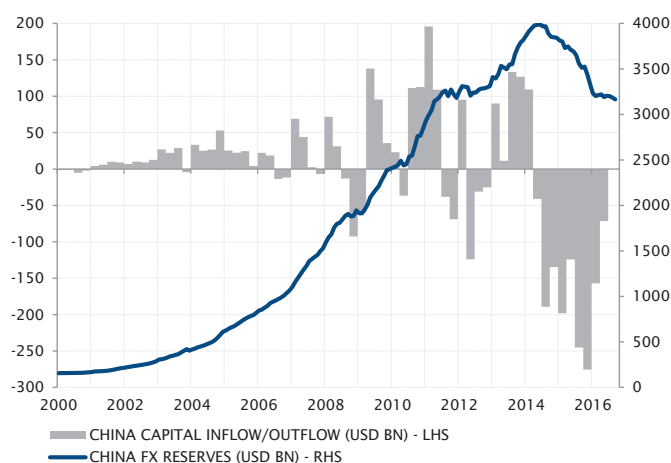


Source: Datastream, SYZ Asset Management

## 6. Capital flows out of China have slowed but not reversed

- The newsflow on China has been significantly quieter in the past few months than it had been from mid-2015 to the beginning of 2016. Still, if most of the worries appeared last year have lost some intensity, they have not faded away or reversed. The yuan continues to depreciate and is down -7% this year versus a trade weighted currency basket (more than in 2015!). Capital outflows have slowed down but have not reversed. FX reserves are declining less rapidly but are still declining.
- What has changed is the stabilization of economic activity, after the pronounced slowdown experienced in 2015. Better communication from Chinese authorities may have also helped to reassure and provide visibility for international investors.
- However, with a currency still on a depreciating trend and less attractive growth prospects, the trend of capital flows remains broadly outward. It doesn't make headlines anymore but it is still there...

*China FX reserves and quarterly capital flows (USD bn)*

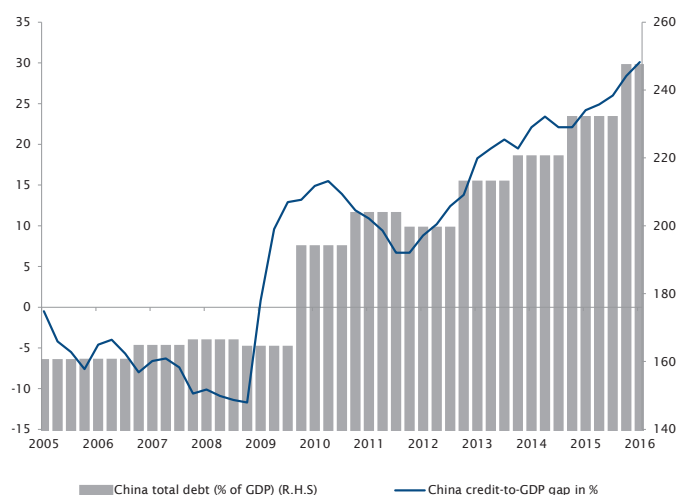


Source: Datastream, SYZ Asset Management

## 7. Credit - China still in red territory

- The growth of debt in China continues to be a source of worries for the country, as well as abroad due to its links to global financial markets. The problem is not new, but concerns are rising as China's total borrowing has escalated further at an alarming speed to reach 247% to GDP.
- The fear of another 2008 debt crisis is legitimate and warnings are taken seriously by the Chinese Authorities. Recently, credit-to-GDP gap came out at 30.1, signaling an excessive credit growth. Although the situation is not new, Chinese authorities appear now to be allowing more defaults from corporate and a prominent Communist Party newspaper declared in May that high leverage was China's "original sin" and the country could not borrow its way to long-term economic health.
- In a move to tackle the debt issue, China authorized in September the first CDS to trade, allowing investors to hedge credit risk.

*China's rising debt*



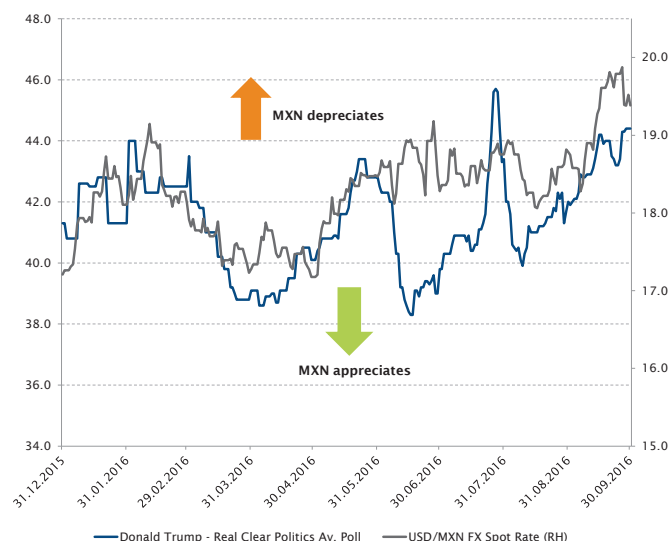
Source: Bloomberg



## 8. FX - Evolution of the Mexican peso in the run up of the US election

- The US presidential election has arguably been one of the dominant drivers of the Mexican peso recent volatility. Last month, the Mexican currency was down -2.5% against the Greenback (-10.9% YTD). The "Trump effect" has been influencing the direction of the Mexican peso since the beginning of August. The MXN has recently been under pressure and closely tracking (in the opposite direction) Donald Trump's poll numbers. As Trump's poll numbers are improving, the value of Mexico's peso is falling.
- At the end of the month, RCP Average polls stand at 44.4 for Donald Trump and at 47.5 for Hillary Clinton vs. at the end of March respectively 39.1 and 49.7.
- The peso's weakness undermines fears that the political and economic relationship between Mexico and the United States could seriously be put under pressure if Trump was to succeed to Obama to the White House on the 8th of November.

**USD/MXN FX Spot Rate and Donald Trump Real Clear Politics Average Poll**

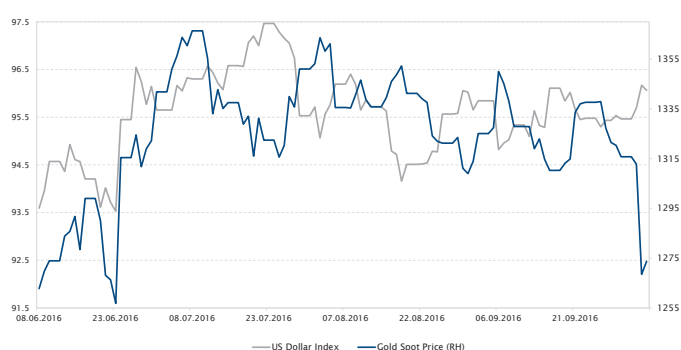


Source: Bloomberg

## 9. Gold - The yellow metal became less attractive

- Gold played its part as a safe haven during the steep downturn on the equity markets in the beginning of the year and continued to go higher until the Brexit vote. Moreover, at that time, the Fed's more cautious approach with respect to increasing its key rates, which reduced upward pressure on the dollar, also helped the recovery of gold prices.
- Since then, the precious metal has been trading range bounded between circa USD 1310 and 1360 per Troy Ounce before falling below 1300 levels after September FOMC meeting.
- Compared with low and even more and more negative interest rates, precious metals were offering an alternative to investors, above all when some countries let their currencies slide. The recent, less accommodative statements from some members of the Fed but also some rumours from a possible ECB tapering before than anticipated, coupled with a stronger dollar is suggesting that monetary policy will become more restrictive which has automatically weighted on gold prices.

**Gold price evolution and US Dollar index**



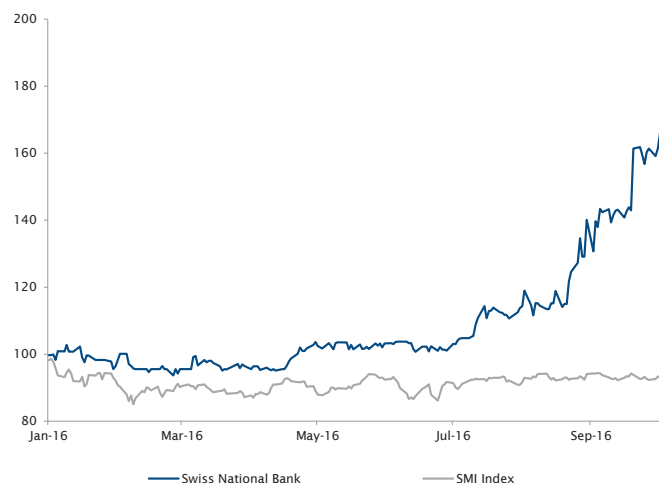
Source: Bloomberg



## 10. Equity - Buying the Swiss National Bank?

- Probably not all investors know this fact, but a number of Central Banks trade on a stock market. Switzerland is part of the group of countries that have their Central Bank a tradable security. Current holding of the stock is split between Canton for 45%, cantonal banks 15% and 40% by private investors and corporates. Unlike traditional equities, shareholders of the SNB are entitled to a capped fixed dividend of approximately 1%, while the bulk of the profits of the SNB are being distributed to the Cantons and the Federal government.
- As of late, price action of the SNB has gone parabolic with a 59% performance from end of June until end of September. The last time that stock had a similar pattern was in 1997 when it was rumored that the SNB would mark-to-market its stock of gold. The rise observed lately remains completely unanswered and up for speculation.

**Performance of the Swiss National Bank stock vs. the Swiss market index (Dec 2015=100)**



Source: Bloomberg