The Weekly Market View

January 10 2021

ADCB ASSET MANAGEMENT LIMITED

New year optimism..

Markets kick-started the new year with renewed optimism as Democrats secured the Senate majority in Georgia. The optimism remain undeterred in spite of the unprecedented attack by Trump's supporters on the US Capitol. Democrat control of Senate spurred the prospects of more fiscal stimulus, fuelling the reflation trade. The jump in oil prices, after Saudi Arabia announcing a surprise production cut, also added to the positive sentiment. In terms of economic releases, data was a mixed bag. The ISM Manufacturing rose to the highest level since August 2018 and ISM services also surprised on the upside. In Europe, German economic data including industrial production, exports and factory orders came in better than expected. On the other hand, US non-farm payrolls declined by 140k for the first since April, signalling slowdown in labour market amidst renewed lockdown measures. In contrast to the reflation narrative, European inflation figures signalled a continuation of deflation trend for the fifth straight month. The Treasury market ignored the labour market data with the 10yr UST yield jumping above 1%, the highest level since March 2020, boosted by the reflation trade. European core bond yields also rose higher, but the rise was offset by the inflation data. In equities, EM outperformed DM, with strong performances from South Korea, Taiwan, Russia and Mexico contributing to the outperformance. In the DM space, UK equities were the best performers. In currency market, the dollar index rose slightly with the greenback strengthening versus Japanese yen and the pound sterling, but flat versus the euro. In commodities, gold prices fell while Brent crude rose by 8%, helped by Saudi's surprise cut.

..but old reflation trade

The main theme of the first week of 2021 was the revival of the reflation trade, driven by fiscal stimulus hopes with the Democrat-led Senate. Boost in inflation expectations pushed the 10yr breakeven rate to cross the 2% level for the first time since 2018.The reflation trade remains the biggest risk to our overweight duration stance on US Treasuries. However, at this stage, the question is how much higher can the 10yr UST yields go? This is where the Fed's possible action/inaction comes in context. Though actual inflation figures are yet to reflect the recent surge in expectations, some pick-up in inflation is valid, mainly due to the base-effects. However, even if the inflation indicators surpass the 2% level, the Fed has made it clear it is unwilling to hike policy rate through a) forward guidance- policy rates unchanged until 2023 b) average inflation targeting. Moreover, the Fed is likely to focus on bringing the unemployment rate down instead, prioritizing their new mandate of "maximum employment is broad based and inclusive goal". Note that the unemployment rate is still almost twice the time higher than 2019 levels. As a result, it seems unlikely for now that the Fed will alter its forward guidance anytime soon. Investment into inflation-linked bonds is an option to consider, to protect against any potential inflation surprises. However, the current 10yr breakeven rate is already above the Fed's 2% inflation target and in absolute basis, the 10yr TIP yield is at record low, in the negative territory. Inflation-linked bonds' valuation do not look attractive, unless one expects inflation to sustain above 2% level, which given the low-growth trending environment looks implausible.

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Index Snapshot (World Indices)*

Index	Latest	Weekly %	YTD %
S&P 500	3,825	1.8	1.8
Dow Jones	31,098	1.6	1.6
Nasdaq	13,202	2.4	2.4
DAX	14,050	2.4	2.4
Nikkei 225	28,139	2.5	2.5
FTSE 100	6,873	6.4	6.4
Sensex	48,783	1.9	2.2
Hang Seng	27,878	2.4	2.4
Regional Markets (Sunday to Thursday)**			
ADX	5,164	2.3	2.3
DFM	2,626	5.4	5.4
Tadawul	8,737	0.5	0.5
DSM*	10,678	2.3	2.3
MSM30	3,699	1.1	1.1
BHSE**	1,451	-2.6	-2.6
KWSE	5,537	-0.2	-0.2
MSCI			
MSCI World	2,753	2.4	2.4
MSCI EM	1,354	4.8	4.8

Global Commodities, Currencies and Rates*

Commodity	Latest	Weekly %	YTD %
ICE Brent USD/bbl	56.0	8.1	8.1
Nymex WTI USD/bbl	52.2	7.7	7.7
Gold USD/t oz	1,849.0	-2.6	-2.6
Silver USD/t oz	25.4	-3.7	-3.7
Platinum USD/t oz	1,069.3	-0.3	-0.3
Copper USD/MT	8,146.0	5.2	5.2
Alluminium	2,018.0	2.0	2.0
Currencies			
EUR USD	1.22	0.0	0.0
GBP USD	1.36	-0.8	-0.7
USD JPY	103.94	0.7	-0.7
CHF USD	0.89	-0.1	-0.0
Rates			
USD Libor 3m	0.22	-5.7	-5.7
USD Libor 12m	0.33	-3.7	-3.7
UAE Eibor 3m	0.42	-17.3	-17.3
UAE Eibor 12m	0.57	-12.4	-12.4
US 3m Bills	0.07	21.7	21.8
US 10yr Treasury	1.12	22.1	22.1

Notes: *Data as of January 8 2021; **Data as of January 7 2021

Summary market outlook

Global Yields	US Treasury (USTs) yields jumped past 1%, highest level since March 2020, driven by the jump in inflation expectations after the Democrats won Senate seats in Georgia. In Europe, core bond yields rose, tracking the risk-on sentiment, but the rise was offset by disappointing inflation data. US HY spreads tightened, with the rally in global equities. We remain long duration on USTs as overall economic outlook remains mixed and is likely to remain so with rising COVID-19 infection rates. In US credit, we remain neutral on US IG and underweight on US HY, both trading at rich levels.
Stress and Risk Indicators	VIX index declined with the improved risk sentiment. We expect the VIX index to continue to stabilize over the next weeks and months.
Equity Markets	
Local Equity Markets	GCC equities registered positive gains over the week but underperformed broader equity indices. Within GCC, UAE and Qatar equities outperformed. We remain neutral GCC equities within our global equity framework. Stable to higher oil prices, potential for revival in growth and recent underperformance are all balanced by lack of structural growth plays in the equity market.
Global Equity Markets	Equity markets started the year on a strong footing. Optimism was helped by the outcome of Georgia senate run-off election results which pointed to a Democrat-led senate in the US. Markets were quick enough to reprice associated reflation trades. Over the week, EM outperformed DM. Within EM, strong performances from South Korea, Taiwan, Russia and Mexico helped. In the DM space, UK outperformed. We are constructive on the outlook over the 12-month horizon but we remain watchful of near-term risks including technical overbought conditions and rampant virus. Our equity strategy is to overweight US and UK, and underweight Eurozone and EM outside Asia. We are neutral Asia and prefer structural growth opportunities there. By sector we prefer IT and Communication services as long-term plays and energy as a cyclical play. We have also identified industry level opportunities to play the vaccine availability in the medium-term. Our strategic preference is for large cap non-cyclical growth with focus on quality. 'Build back better' themes including green recovery, digitalization and health care innovation are likely to do well.
Commodities	
Precious Metals	Precious metals posted weekly loss with the dollar strengthening. We remain overweight gold as a hedge against general risks, but we are not particularly bullish over the near-term.
Energy	Oil prices rose after Saudi announced surprise output cuts. Oil prices are likely to remain sustained as the market is roughly balanced in terms of demand versus supply.
Industrial Metals	Industrial prices rose strongly, amidst the risk on sentiment. We do not recommend industrial metals exposure as China structurally reigns in demand.

Currencies

EURUSD	The euro ended the week flat versus the dollar. We expect the EUR to remain stable.							
Critical levels	R2	1.2589	R1	1.2403	S1	1.1978	S2	1.1739
GBPUSD	The pound sterling weakened against the dollar. Looking ahead, GBP is likely to be influenced by global cyclical conditions – an improvement there would mean cable strength.							
Critical levels	R2	1.4038	R1	1.3803	S1	1.3234	S2	1.29
USDJPY	The Japanese yen lost value against the greenback amidst the risk-on sentiment. The risk-on context is not favourable for the JPY, which will facilitate BoJ's intention to keep it weak if necessary through further yield curve targeting.							
Critical levels	R2	105.92	R1	104.93	S1	102.77	S2	101.6

Note: R2, R1, S2 and S1 refer to Bloomberg calculated weekly technical resistance and support levels.

Forthcoming important economic data/events

United States

	Indicator	Period	Expected	Prior	Comments
01/12/21	JOLTS Job Openings	Nov	-	6652	Inflation data will be particularly important as reality check of actual inflation amidst the rise in inflation expectations. Retail sales and Michigan sentiment index will highlight the prospects of consumer spending.
01/13/21	**CPI YoY**	**Dec**	**1.30%**	**1.20%**	
01/13/21	**CPI Ex Food and Energy YoY**	**Dec**	**1.60%**	**1.60%**	
01/14/21	**Initial Jobless Claims**	**9-Jan**	**--**	**--**	
01/14/21	**Continuing Claims**	**2-Jan**	**--**	**--**	
01/15/21	**Retail Sales Advance MoM**	**Dec**	**-0.3%**	**-1.1%**	
01/15/21	Industrial Production MoM	Dec	0.3%	0.4%	
01/15/21	**U. of Mich. Sentiment**	**Jan-P**	**79.5**	**80.7**	

Japan

	Indicator	Period	Expected	Prior	Comments
01/12/21	BoP Current Account Balance	Nov	¥1586.5b	¥2144.7b	Machine Tool Orders and Tertiary Industry Index data will be provide an update on the status of industrial sector.
01/13/21	**Machine Tool Orders YoY**	**Dec P**	**--**	**8.6%**	
01/14/21	PPI YoY	Dec	-2.2%	-2.2%	
01/15/21	**Tertiary Industry Index MoM**	**Nov**	**0.4%**	**1%**	

Eurozone

	Indicator	Period	Expected	Prior	Comments
01/11/21	Sentix Investor Confidence	Jan	--	-2.7	Industrial Production and Germany GDP will throw light on the economic damage.
01/13/21	**Industrial Production WDA YoY**	**Nov**	**--**	**-3.8%**	
01/14/21	**Germany GDP NSA YoY**	**2020**	**-5.1%**	**0.6%**	
01/15/21	Trade Balance SA	Nov	--	25.9bn	
01/15/21	France CPI YoY	Dec F	--	0.0%	

United Kingdom

	Indicator	Period	Expected	Prior	Comments
01/15/21	Industrial Production YoY	Nov	--	-5.5%	Industrial production and manufacturing production will be important.
01/15/21	Manufacturing Production YoY	Nov	--	-7.1%	

China and India

	Indicator	Period	Expected	Prior	Comments
01/11/21	**China CPI YoY**	**Dec**	**0.0%**	**-0.5%**	China CPI is expected to remain in deflation territory while China exports are likely to have continued to grow amidst pandemic-related buying elsewhere. In India, CPI data is expected to show moderation in inflation.
01/12/21	India Industrial Production YoY	Nov	-1.4%	3.6%	
01/12/21	**India CPI YoY**	**Dec**	**5.00%**	**6.93%**	
01/14/21	**China Exports YoY**	**Dec**	**15%**	**21.1%**	
01/14/21	India WPI YoY	Dec	0.85%	1.55%	
01/09-01/15	China Money Supply M2 YoY	Dec	10.70%	10.70%	
01/09-01/15	China Aggregate Financing CNY	Dec	2165bn	2,134.3b	
01/09-01/15	China New Yuan Loans CNY	Dec	1250.0b	1430.0b	

Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTT News
4. Reuters
5. Gulfbase
6. Zawya

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