MACRO HIGHLIGHTS & STRATEGY

DECEMBER 7TH 2015

OUR ROUNDUP:

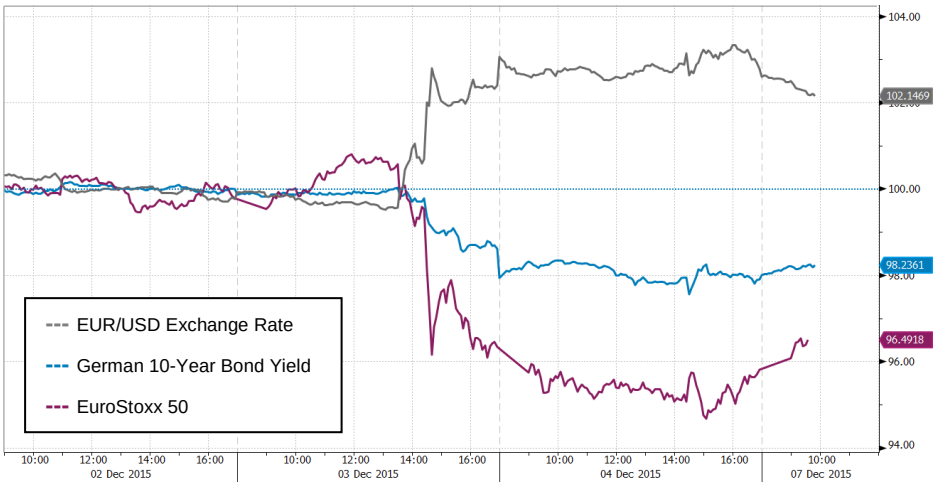
- Investors sold the news
- Should we worry about the decline in Swiss GDP?
- How will the next Fed Day affect emerging markets?

MARKETS

INVESTORS SOLD THE NEWS

The highly (overly) anticipated monetary support measures promised by the European Central Bank (ECB) deeply disappointed investors around the world on Thursday 3 December **when they were finally announced.** The yield on German 10-year bonds rose from 0.46% to 0.71%, with bond prices down 2%. Equity indexes in the Euro Zone shed more than 5%. The euro recorded one of its largest daily jumps in its history, going from 1.053 against the dollar to 1.098. Investors *"bought the rumour and sold the news"*.

Financial market performances (%)



Yet, for the most part, Mario Draghi delivered on what he promised. The ECB extended quantitative easing beyond the original end date and lowered deposit rates for commercial banks. The only thing missing was an increase in the monthly asset purchase programme, which will remain at 60 billion euros.

The following day in New York, the ECB president carefully clarified his message. Using one of those reassuring sentences that he has the knack for delivering, he promised that *"if we had to intensify the use of our instruments to ensure that we achieve our price stability mandate, we would."* This leaves the door open to further monetary stimulus.

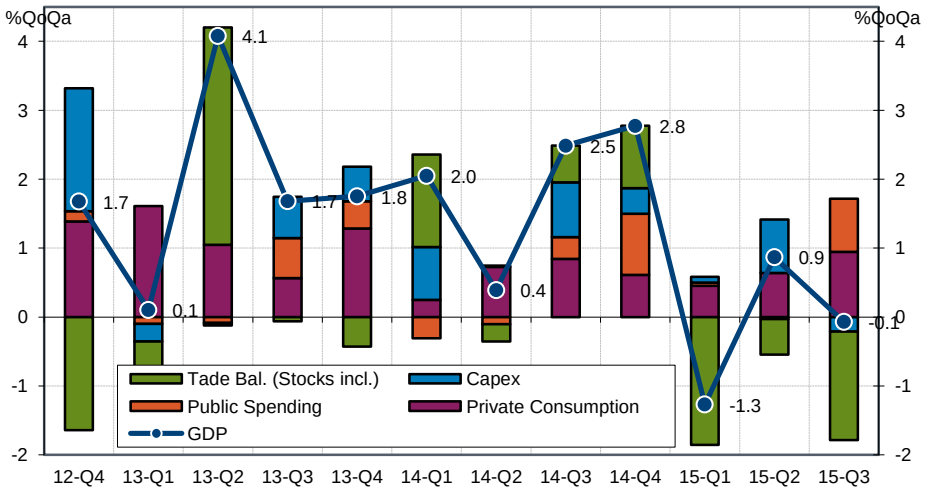
The tumult over the past few days provided unexpected respite to the Swiss National Bank (SNB). The franc slipped to more than 1.09 per euro from around 1.08 before Draghi's announcement. SNB President Thomas Jordan's turn to communicate on monetary policy comes on Thursday, December 10th. **Interest rates are very likely to be pushed further into negative territory** in the effort to dissuade speculators from buying the already overvalued Swiss franc. The Swiss economy dearly needs a less expensive franc (see the next article).

SWITZERLAND

SHOULD WE WORRY ABOUT THE DECLINE IN SWISS GDP?

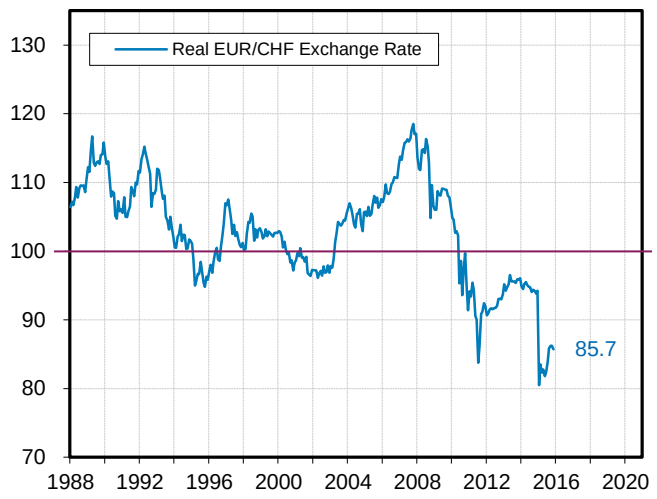
Switzerland's GDP declined ever so slightly (-0.1% QoQ annualised) between July and September (see chart). Growth was held back by a contraction in the balance of trade in services, a slowdown in construction spending, and destocking.

Switzerland: contribution to GDP growth (% QoQa)

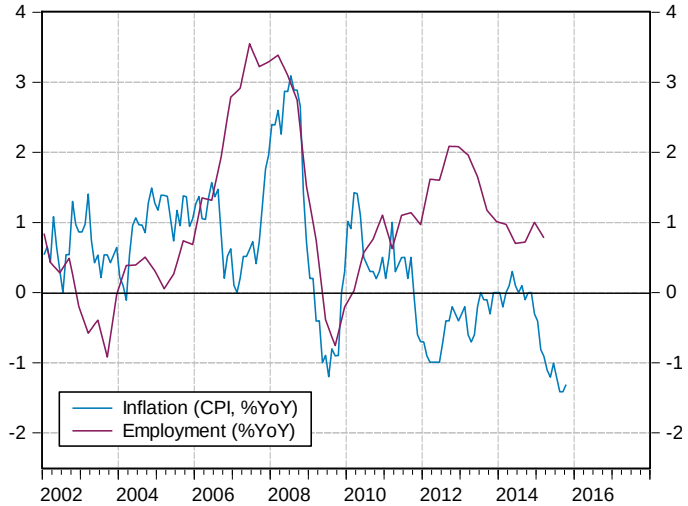


The trade balance is directly linked to the excessive strength of the franc. Following the SNB's decision to scrap the exchange rate floor at the start of the year, the franc is now overvalued relative to the euro by some 15% (see left-hand chart). Although the franc has not gained ground on the dollar in 2015, Swiss companies have clearly lost in terms of competitiveness in the Euro Zone.

EUR/CHF: deviation from the fair value (PPP approach)

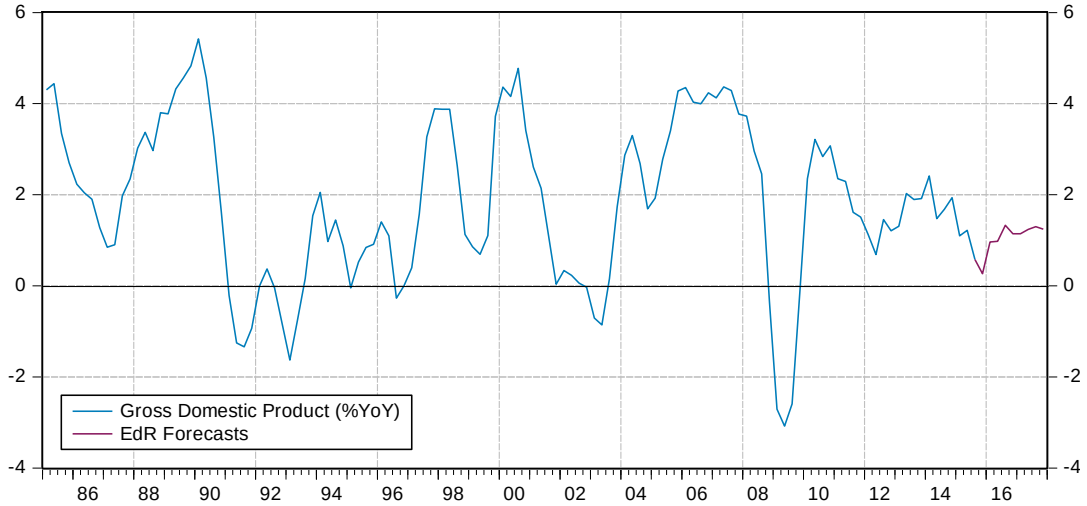


Inflation and employment in Switzerland



Switzerland's weak Q3 performance is nothing to lose sleep over. First, economic activity was up on a year-on-year basis (+0.6%). Second, growth in consumer spending was extremely promising, underpinned by the sharp decline in prices and the firm labour market (see right-hand chart above). Finally, government spending showed an unexpected counter-cyclical jump. In theory, fiscal policy should give the economy a boost when things are slow. This is what happened in the third quarter.

Switzerland: GDP forecasts (% YoY)



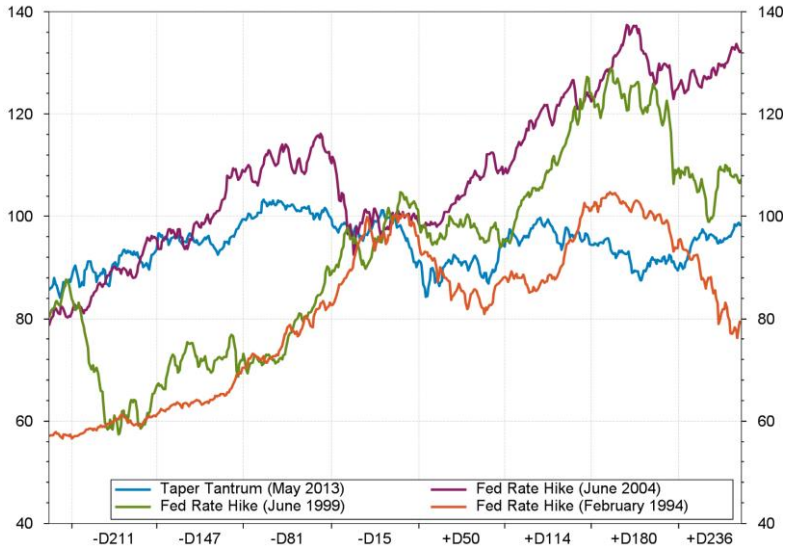
Based on our econometric models, we expect growth of +0.8% in 2015, +1.1% in 2016 and +1.2% in 2017 (see chart). These figures are not remarkable but, in the current climate, **can still be considered a solid performance.** Zurich Cantonal Bank (ZKB), which also prepares estimates, has just raised its forecast for the current year from +0.5% to +0.7%. The chief economist at ZKB attributes this upgrade to the Swiss economy's Q3 performance – further proof that the latest figures should not be so alarming. ZKB expects growth to reach +1.2% in 2016 and +1.5% in 2017, which is in line with the consensus estimates of economists surveyed by Bloomberg. **Nothing to worry about, in other words.**

EMERGING MARKETS

HOW WILL THE NEXT FED DAY AFFECT EMERGING MARKETS?

May 2013: the Fed's announcement that it would taper its monthly bond purchases as part of the quantitative easing programme delivered a blow to emerging markets, which shed nearly 20% in just two months. This effect – dubbed the taper tantrum – continues to weigh on emerging markets, which are highly sensitive to international capital flows. Indeed, the looming rise in US interest rates suggests a reprise of the May 2013 episode.

Emerging markets: before and after a US interest-rate hike

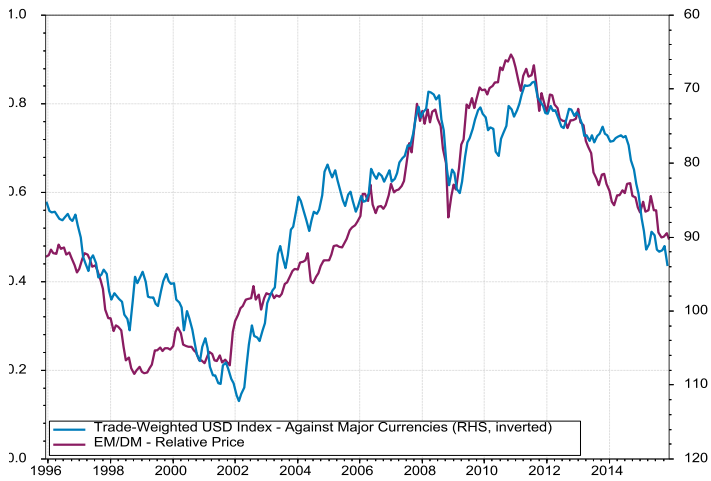


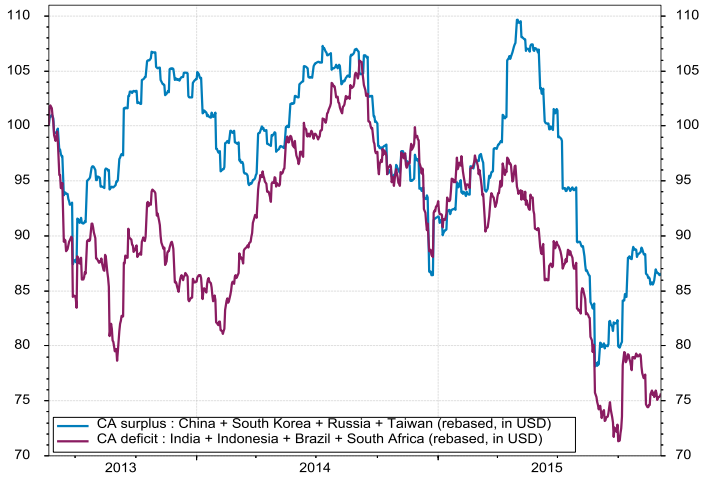
In USD, base=100 on the date of the rate hike, 1 year before and 1 year after.

For emerging-market economies, the normalisation of US monetary policy highlights the need for a stable financial base capable of meeting their financing needs. This means keeping their interest rates attractive enough to maintain a positive spread relative to the USA, which is to their advantage. But their interest rates must remain low enough to support growth through affordable lending terms for domestic economic agents.

Will US monetary tightening harm emerging markets as it did in May 2013? Just as it is impossible to predict the market's behaviour, this question cannot be answered with any certainty (see chart). The unique nature of interest-rate hikes, which are rooted in a specific economic environment, suggests that historical comparisons are of limited use. A number of points do seem clear, however.

- **The impact of US monetary tightening will be transmitted through exchange rates** rather than in the form of domestic asset price corrections. The rise in the dollar that follows an interest-rate hike usually hurts emerging-market currencies owing to the link with commodities and with domestic debt that is partly dollar-denominated (see left-hand chart below).
  While most emerging-market currencies have largely corrected against the dollar in recent years – reducing their downside accordingly – others face the possibility of a steeper decline. **The rise in US interest rates will affect emerging markets unevenly**.





- For the first time, **the Fed will raise interest rates at a time when global growth is less firm than previously**. Apart from the question of the resilience of the global economy, it would be fair to assume that, after waiting for so long, the Fed will only raise rates if it feels comfortable with the growth level of the world's largest economy.

- This time around, **the US interest-rate hike will not be a surprise at all**. Hot money has largely deserted emerging markets and should only play a minor role as their economies adjust. The risk of a massive currency depreciation is thus quite low.

- **The risk seems to lie more in the pace of the interest-rate hikes** than in the fact of the hikes themselves. Gradual increases would confirm that the US economy is in good shape, whereas hasty ones would suggest the Fed is out of sync with the economic cycle and inflation. This latter scenario would be very detrimental to emerging markets.

In May 2013, **the market distinguished between emerging-market countries in accordance with their international strength as measured by their current account**. Countries showing a surplus made out relatively well. It is interesting to note that this distinction is again at work (see right-hand chart above). These economies could be worth favouring, provided they show some sort of growth momentum. Most

Asian economies – China, South Korea, Taiwan and even India in terms of quality of growth – meet these two conditions.

ECONOMIC FORECASTS

Contributions to global GDP growth

Economic Activity	GDP 2014	GDP 2015 Economist Estimates	GDP 2016 Economist Estimates	Country Weights	Contribution 2016
United States	2.4%	2.5%	2.5%	23.2%	0.58%
Canada	2.4%	1.2%	2.0%	2.0%	0.04%
Euro Area	0.9%	1.5%	1.7%	14.5%	0.24%
United Kingdom	2.6%	2.4%	2.3%	4.0%	0.09%
Switzerland	1.9%	0.9%	1.2%	0.8%	0.01%
Russia	0.5%	-3.8%	0.0%	1.9%	0.00%
Japan	0.2%	0.6%	1.1%	4.9%	0.05%
China	7.4%	6.9%	6.5%	17.8%	1.16%
India	4.7%	7.4%	7.4%	3.6%	0.26%
Brazil	0.1%	-3.0%	-1.2%	2.1%	-0.03%
Mexico	2.1%	2.4%	2.8%	1.6%	0.04%
Others	4.4%	3.3%	4.7%	23.6%	1.11%
WORLD	**3.4%**	**3.1%**	**3.6%**	**100%**	**3.6%**

Source : Bloomberg Momentum (vs Last Estimates) Performance (Over \ Under)

Comments

- The GDP growth rates shown above are actual for 2014 and projections for 2015 and 2016.
- Each country's weighting is based on its GDP in US dollars as calculated by the World Bank.
- Contributions to global expansion are calculated by multiplying the GDP growth of each country by its weight. The sum of the contributions works out to 3.6% for 2016, a good estimate of next year's global GDP growth.

RETURNS ON FINANCIAL ASSETS

Major benchmarks and currencies

Markets Performances (local currencies)	Last Price	1-Week (%)	1-Month (%)	Year-to-Date (%)	Last Year (%)
Equities					
World (MSCI)	407	-0.4%	-1.4%	0.0%	4.8%
United States (S&P 500)	2'092	0.1%	-0.3%	3.6%	13.7%
Euro Area (DJ EuroStoxx)	355	-3.7%	-2.0%	12.7%	5.0%
United Kingdom (FTSE 100)	6'273	-2.1%	-2.3%	-1.2%	1.0%
Switzerland (SMI)	8'901	-2.2%	-1.7%	1.0%	12.9%
Japan (NIKKEI)	19'698	-1.9%	3.1%	13.6%	9.0%
Emerging (MSCI)	812	-1.7%	-6.4%	-13.0%	-2.0%
Bonds (Bloomberg/EFFAS)					
United States (7-10 Yr)	2.27%	-0.4%	-0.2%	2.0%	8.9%
Euro Area (7-10 Yr)	1.52%	-1.6%	-0.3%	0.7%	14.0%
Germany (7-10 Yr)	0.65%	-1.9%	-0.6%	0.4%	12.0%
United Kingdom (7-10 Yr)	1.91%	-0.7%	0.7%	0.8%	11.7%
Switzerland (7-10 Yr)	-0.25%	-1.2%	-0.4%	5.3%	7.2%
Japan (7-10 Yr)	0.33%	-0.1%	0.1%	0.9%	5.0%
Emerging (5-10 Yr)	4.99%	-0.7%	-1.5%	2.4%	7.7%
United States (IG Corp.)	3.50%	-0.3%	-0.3%	-0.3%	7.6%
Euro Area (IG Corp.)	1.21%	-0.8%	-0.1%	-0.5%	8.1%
Emerging (IG Corp.)	4.53%	-0.7%	-1.6%	-1.4%	5.7%
United States (HY Corp.)	8.27%	-0.2%	-2.5%	-0.9%	1.6%
Euro Area (HY Corp.)	4.48%	-0.5%	-0.6%	2.4%	5.5%
Emerging (HY Corp.)	9.93%	-1.4%	-2.0%	6.2%	-2.6%
United States (Convert. Barclays)	46	-0.5%	-1.8%	0.2%	7.7%
Euro Area (Convert. Exane)	7'507	-1.4%	-1.0%	7.7%	4.5%
Real Estate					
World (MSCI)	189	-0.6%	-1.3%	0.3%	15.2%
United States (MSCI)	198	-0.8%	-1.0%	2.8%	28.1%
Euro Area (MSCI)	208	-4.8%	-4.7%	14.9%	19.1%
United Kingdom (FTSE)	6'585	0.4%	0.1%	9.3%	19.7%
Switzerland (DBRB)	3'549	1.3%	0.7%	3.3%	14.6%
Japan (MSCI)	272	-2.0%	3.6%	1.6%	-6.3%
Emerging (MSCI)	100	1.0%	-3.7%	-6.4%	-3.4%
Hedge Funds (Dow Jones)					
Hedge Funds Industry	554	n.a.	0.5%	-0.1%	4.1%
Distressed	738	n.a.	-0.3%	-3.9%	2.6%
Event Driven	608	n.a.	0.1%	-3.9%	1.6%
Fixed Income	302	n.a.	-0.2%	0.4%	4.4%
Global Macro	891	n.a.	1.3%	0.9%	3.1%
Long/Short	678	n.a.	1.7%	3.7%	5.5%
Managed Futures (CTA's)	312	n.a.	-2.5%	-2.4%	18.4%
Market Neutral	268	n.a.	-0.6%	1.1%	-1.2%
Multi-Strategy	519	n.a.	0.1%	3.4%	6.1%
Short Bias	31	n.a.	-5.6%	1.0%	-5.6%
Commodities					
Commodities (CRB)	387	1.5%	-2.6%	-13.6%	-11.9%
Gold (Troy Ounce)	1'084	1.8%	-0.6%	-8.8%	-1.1%
Oil (Brent, Barrel)	42	-2.4%	-11.7%	-24.6%	-49.7%
Currencies					
USD	98.7	-1.4%	-0.4%	9.4%	12.8%
EUR	1.08	2.4%	0.7%	-10.5%	-12.0%
GBP	1.51	0.1%	-0.3%	-3.2%	-5.9%
CHF	1.00	2.7%	0.2%	-0.8%	-10.2%
JPY	123.4	-0.2%	-0.2%	-2.9%	-12.1%

Source : Bloomberg Momentum (1-week / 1-month / 3-month) Performance (Negative \ Positive)

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