

FFTW Weekly Commentary

FOR PROFESSIONAL INVESTORS

Don't make investment decisions on "likely outcome of elections"

May 1, 2017

Key takeaways

- It's all about fundamentals; don't focus solely on "likely outcome of elections"
- The European Central Bank and Bank of England remain dovish
- Euro and sterling enjoyed an early spring, but May is likely to be less favorable

Full commentary

Sterling and the euro were the best performing Group of Ten (G10) currencies in April. Sterling rallied after the announcement from Prime Minister, Theresa May, of a snap general election on June 8 and the euro benefited after the results of the first round of the French presidential election on April 23.

The market believed that a larger government majority should reduce Brexit-related downside risks for sterling. The prospect of a strong conservative victory and a large government majority at the forthcoming election benefited the British pound. The idea is that Prime Minister May would be in a stronger position to make necessary compromises with the European Union.

The results of the first round of the French presidential election benefited the euro. Two of the four candidates who had a plausible chance of making it through to the second round, Le Pen and Jean-Luc Mélenchon, were both perceived in favor of France leaving the Eurozone. Emmanuel Macron made it to the second round and polls give him a significant lead over Le Pen for the second round.

We believe that the market reaction over the last weeks creates an opportunity to establish short sterling and euro positions. Politics will cease to be the only dominant driver of sterling and of the euro and fundamentals which are far from bullish will matter more. Both currencies continue to suffer from dovish central banks.

In the case for the Bank of England, the market is currently not penciling in a hike until the end of 2019. Based on two year rate differentials, GBP/USD therefore already looks very expensive at 1.29 and should drift down to around 1.15 next year if the forwards are realized. Importantly, the external balance of the United Kingdom remains weak. Despite upward revisions to the current account, the deficit remains above sustainable levels. A weak currency would help.

In the case of the European Central Bank (ECB), President Mario Draghi continues to stay dovish and reasserted the sequencing on exit. Our expectations remain unchanged after the ECB meeting on April 25. We expect forward guidance to be adjusted in June, tapering to be pre-announced in September and a one-off deposit rate hike in December. Importantly, President Draghi was pretty dismissive when asked whether Emmanuel Macron winning the French presidential election would have an impact on monetary policy, arguing that the council doesn't 'do monetary policy on the likely outcome of election'. We agree. The surge in sterling and euro based on "likely outcome of elections" are likely to reverse in May.

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This week's market developments

Monday, April 24

- Japan PPI services growth increased to 0.8% y.o.y. for March

Tuesday, April 25

- US FHFA House Price Index increased to 0.8% m.o.m. for February
- US new home sales increased to 621,000 for March
- US Conference Board Consumer Confidence Index decreased to 120.3 for April (s.a.)

Wednesday, April 26

- Japan All Industry Activity Index increased to 0.7% m.o.m. for February

Thursday, April 27

- Eurozone Consumer Confidence Index remained at -3.6% for April (final estimate)
- US Wholesale Inventories Index (preliminary estimate) decreased to -0.1% m.o.m. for March
- US durable Goods Orders growth (preliminary estimate) decreased to 0.7% for March

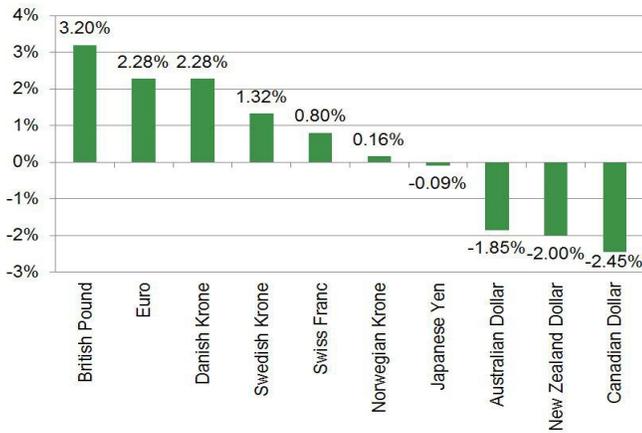
Friday, April 28

- UK GDP (advance estimate) decreased to 0.3% q.o.q. for Q1
- US Annualized GDP (advance estimate) decreased to 0.7% q.o.q. for Q1
- Chicago Purchasing Manager Index increased to 58.3 for April (s.a.)
- University of Michigan Consumer Sentiment (final estimate) decreased to 97.0 for April
- UK Nationwide House Price Index decreased to -0.4% m.o.m. for April

Source: Bloomberg, as of May 1, 2017



Chart of the Week
Performance of G10 Currencies in April 2017



Sources: Bloomberg, as of April 30, 2017



Next week's market developments

Monday, May 1

- US personal income growth is expected to decrease to 0.3% m.o.m. for March
- US personal spending growth is expected to increase to 0.2% m.o.m. for March
- US ISM manufacturing growth is expected to decrease to 56.5 for April
- US construction spending growth is expected to decrease to 0.4% m.o.m. for March

Tuesday, May 2

- Markit UK PMI Manufacturing is expected to decrease to 54.0 for April

Wednesday, May 3

- Eurozone 1st Quarter GDP growth (advance estimate) is expected to increase to 0.5% q.o.q.
- US ADP Employment Change is expected to decrease to 178,000 for April
- US ISM Non-Manufacturing Composite is expected to increase to 55.8 for April

Thursday, May 4

- Markit/CIPS UK Services PMI is expected to decrease to 54.5 for April
- Markit/CIPS UK Composite PMI is expected to decrease to 54.5 for April
- US Factory Orders growth is expected to decrease to 0.5% m.o.m. for March

Friday, May 5

- US Change in Nonfarm Payrolls is expected to increase to 190,000 for April
- US unemployment rate is expected to increase to 4.6% for April

Source: Bloomberg, as of May 1, 2017



Central Bank Watch

| | Last move | Date of move | Current policy rate | Implied 3-Month Rate on March 2017 Interest Rate Futures Contract | Next meeting |
|-----|------------------|-------------------|---------------------|---|---------------|
| Fed | +25 basis points | March 15, 2017 | 0.75% - 1.00% | 1.00% | May 3, 2017 |
| ECB | -5 basis points | March 10, 2016 | 0.00 % | -0.18% | June 8, 2017 |
| BoJ | -20 basis points | February 16, 2016 | -0.10 % - 0.00% | 0.06% | June 16, 2017 |
| BoE | -25 basis points | August 4, 2016 | 0.25% | 0.33% | May 11, 2017 |

Sources: Bloomberg, as of May 1, 2017

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