UBS House View

US Daily

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Market update

IBEX 35 +0.8%, offering some relief amid Catalonia tensions.

GBPEUR –0.4%, following a poorly received Theresa May speech.

AUDCAD –0.6%, as Australian retail spending disappoints.

What to watch

6 October 2017

- German factory orders for August
- US jobs report for September
- US wholesale inventories/trade sales for August
- US consumer credit for August

Thought of the day

Are markets prepared for a hawkish Fed chair?

Among possible candidates as the next head of the Federal Reserve, President Donald Trump has reportedly talked with Kevin Warsh, a former Fed governor. Warsh, who shares Trump's views on reducing regulation, is considered a hawk. In January he asked "why interest rates seem to be so far away" from their long-term target, when the Fed is close to achieving its goals of maximum employment and price stability.

But while a Warsh nomination would be viewed as taking the Fed in a more hawkish direction, we believe that even with the current composition of the Federal Open Market Committee, the market is underestimating the likely trajectory of interest rates:

- Yellen has strongly hinted at another rate hike this year, saying it would be imprudent to keep monetary policy on hold until inflation is back to 2%.
- The Fed has prepared the market for the next step in withdrawing monetary accommodation, announcing that it will start shrinking its balance sheet this month.
- Macroeconomic data support the need for further tightening. The ISM manufacturing index reached a 13-year high in September and unemployment is close to 16-year lows.

So while market expectations have started to adjust, with the probability of a December rate hike based on Federal Funds futures having increased to 70% now from 22% on September 8, longer-term market underpricing remains. We expect two rate hikes in both 2018 and 2019, and two-year US Treasury yields to rise to 1.8% in six months compared with 1.47% currently.

Caught our attention

- **S&P on best run since May**
  The S&P 500 closed up for the seventh consecutive session at yet another record high on October 4, its longest positive run since May 17. The index has now risen 15 times in the last 18 sessions. *We expect stock markets to continue to grind higher and are overweight global equities.*

- **Swiss inflation strength**
  Swiss inflation rose at its fastest pace since March 2011, coming in at an annualized 0.7%, supported by recent substantial CHF depreciation. The SNB remains unlikely to change its ultra-accommodative monetary policy, as tightening would strengthen CHF, which the central bank already classifies as "highly valued." *The Swiss franc has fallen 8% against the Swedish krona since mid-June, and we expect a further fall to our six-month forecast of 7.89 (8.30 currently).*

- **Eurozone equities resilient**
  Spanish equities have fallen around 3.5% since the start of the week, amid political uncertainty due to the Catalonia crisis. Still, the Euro Stoxx 600 experienced a nine-day streak of gains, ending on 4 October with a mere –0.08% fall. *We believe the Catalonia crisis won't end the Eurozone stocks rally, and prefer the asset class to UK stocks within Europe.*

Appendix

Disclaimer

Version as per September 2017.