

FINANCIAL MARKET ANALYSIS

Volume 13, Issue 40 **October 28, 2013**

QE tapering expectations delayed on softer data

Last Week's Highlights

The postponed September employment report was released last week. Job creation in the US slowed with September payrolls increased by 148K (vs. 180k of consensus), while the recent ongoing job gains have helped bring the rate of unemployment down to 7.2% to its lowest since November 2008. Sales of existing US homes fell 1.9% to 5.29mn in September for the first time in three months as mortgage purchase applications have been falling since June due to rising mortgage rates. The NAR also mentioned that the government shutdown could cause further delays in mortgage application processing. Following the softer payroll print that signals a faltering job market, Citi analysts have pushed out the most likely date for the start of Fed tapering of QE to March next year.

Performance

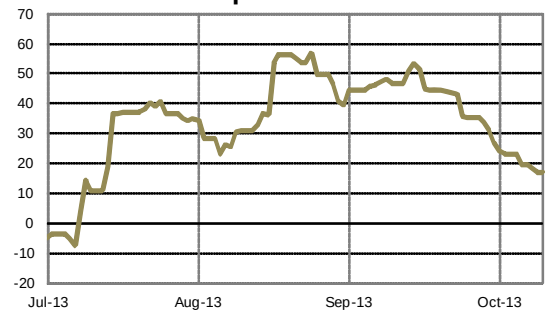
US equities hit new all-time highs with The Dow Jones Industrial Average up 1.1% and the S&P 500 Index gaining a weekly return of 0.88% last week after a peak earnings week. On the surface, results from the biggest US companies appear relatively strong, and that has helped support stock gains. The Euro Stoxx600 rose 0.51% last week pushing the index to 320.09. Meanwhile, Asian stocks fell with the MSCI Asia ex Japan Index sliding 1.73%, on concerns that earnings may falter. Largest losers include Offshore China (HSCEI -4.38%), Onshore China (Shanghai Composite -2.77%) and Hang Seng (-2.75%).

The Week Ahead

In the US, focus will be on the FOMC meeting this week and the committee's policy statement. On macro releases, Consumer and Business surveys, Vehicle sales, Retail sales, Industrial production, Pending home sales, CPI and PPI inflation prints are due out this week. In the euro area, inflation and economic confidence indicators will be in focus while UK's house price data, money and credit statistics, and the manufacturing PMI will be released this week. Japan will see industrial production and unemployment rate this week. In emerging Asia, China's official manufacturing PMI is in focus, along with Korea's industrial production and exports data. The BoJ and the Reserve Bank of India will decide key policy rates this week.

	Oct 25 Close	Last week's return	YTD Return	YTD return (USD)
S&P 500:	1759.77	+0.88%	+23.39%	+23.39%
Stoxx Europe:	320.09	+0.51%	+14.45%	+19.63%
Topix:	1178.28	-2.26%	+37.04%	+21.03%
MSCI Asia ex Japan:	550.72	-1.73%	+0.55%	+0.55%

Citi Economic Surprise Index - US



Source: Bloomberg

Economic Outlook

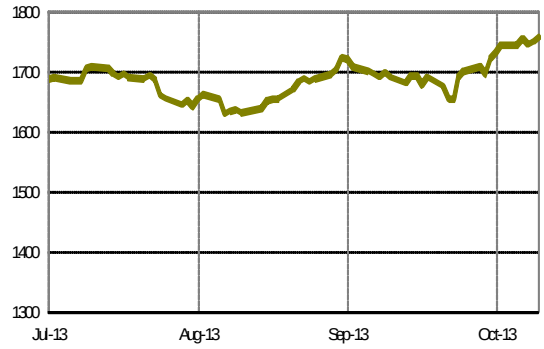
Blackout Ends Without Clarity

Uncertainties in the immediate outlook are expected to keep the FOMC on hold this week. The resumption of hard economic data last week fell mostly in line with estimates that growth is on a moderate track around 2%. Given officials' reduced confidence in labour market improvement last month, the latest employment figures are unlikely to sway them in a new direction. The base case expects March tapering.

The updated economic forecast still anticipates a modest acceleration in growth to 3% next year, reflecting underlying cyclical forces, much diminished fiscal headwinds and continued Fed accommodation. Although the Fed's hesitancy to taper amid easy financial conditions is risking a policy mistake in our judgment, Citi analysts expect a resumption of stronger job gains in the first half of next year may steer them back on course, halting QE altogether by September.

Despite the headline disappointment in September payrolls, the gain was well inside of confidence intervals consistent with the 185,000 trend. Weak summertime payrolls have been a recurring theme in first-reported data. But on that basis, both August and September first prints this year have been the strongest in more than a decade. Gains in construction outlays show signs of rebound in depressed state and local activity, while rising backlogs of capital goods orders point to stronger readings on factory output ahead.

S&P 500 (25/7/2013 to 25/10/2013)



Source: Bloomberg

Equities

Unsettling disconnects

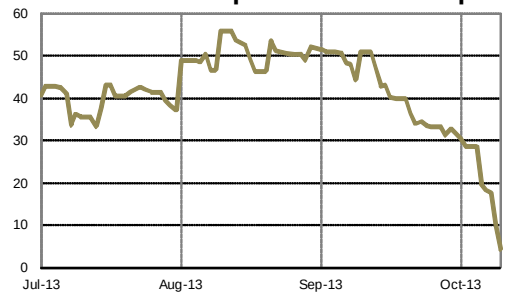
While roughly 70% of companies have again beaten 3Q13 estimates thus far (with approximately 45% having posted results), one needs to recognize that the numbers came down from near 6% year-over-year expected EPS growth back in late June to less than 1% by the time earnings began to get reported. Moreover, a good number have made or topped forecasts on lower than expected tax rates or one-time items, suggesting that results were not necessarily comprised of high quality beats. Accordingly, it is challenging to argue that the reporting season has been all that good when some detailed insight is applied.

Many investors monitor the Citi Economic Surprise Index (CESI) and there is coincident correlation with stock prices. Hence, it is a bit disturbing that the European, US, Japanese and G-10 indices have all dipped from recent highs, suggesting further weakening in many of the regions potentially acting as a drag on equity markets. While many within the investment community are hoping for a strong rally into year-end, Citi analysts believe that there is the distinct possibility that it has happened already and some modest correction is more likely.

	Last week's close	Last week's return	YTD return
S&P 500	1759.77	+0.88%	+23.39%
DJIA	15570.28	+1.11%	+18.82%
Nasdaq	3943.36	+0.74%	+30.60%

- **End-2013 S&P500 Index Target: 1650**

Citi Economic Surprise Index - Europe



Source: Bloomberg

Economic Outlook

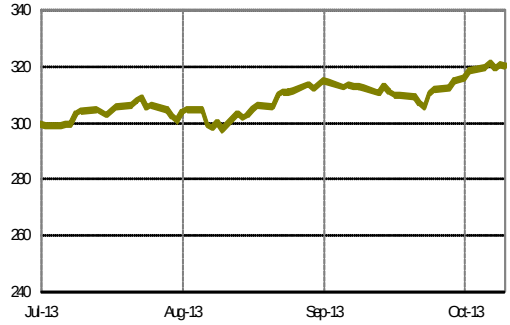
Italy and Spain Look Well Positioned For Job Growth

As sentiment surveys are continuing to recover across the euro area, some improvement in employment expectations suggests that job creation will become a feature of the economic landscape once again. Most member states have made some significant efforts to reform labour markets and lower the cost of labour, attempting to lower the threshold of GDP growth at which job creation becomes positive.

However, Citi analysts argue that the improvement in demand forecasts may likely be the key determinant of job creation in the coming quarters, especially in member states where an important gap is opening up between demand and job expectation. Italy and Spain are our top picks from the periphery, assuming that the recovery continues.

The jobs recovery may nevertheless be modest and uneven, with a significant likelihood of high unemployment becoming a permanent feature of the euro area in Citi's view.

STOXX (25/7/2013 to 25/10/2013)



Source: Bloomberg

	Last week's close	Last week's return	YTD return
STOXX	320.09	+0.51%	+14.45%
FTSE 100	6721.34	+1.49%	+13.96%
DAX	8985.74	+1.36%	+18.04%

Equities

Mega-Caps: Value Traps or Opportunity?

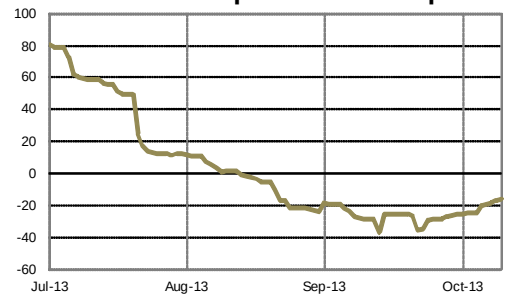
Despite decent fundamentals, strong balance sheets & attractive valuation, poor performance from UK/European mega-caps has been driven by: 1) lack of flows to equities, 2) lack of self-help/restructuring, 3) less leverage/growth, 4) wrong time/wrong place. Mega-caps have lagged mid-caps by 50%+ since 2000.

Following more than a decade of underperformance, UK and European mega-caps are now trading at/close to multi-decade valuation lows. In a market where investors are looking for value, mega-caps should look attractive. But, mega-caps have been cheap for some time = value trap or value opportunity?

Citi analysts think 'top-down' mega-cap outperformance is unlikely unless: 1) the group displays a synchronised pick-up in growth relative to the market, 2) there is a significant increase in CEO-led self-help/de-equitisation/de-megatisation, or 3) there is a return of mid-to-late 1990s flows to equities. All three are unlikely in the nearterm in Citi's view. However, there are also signs of encouragement on all counts. This suggests that UK and European mega-caps can, at least, close some of the performance gap with the rest of the market over the coming 1-2 years.

- **End-2013 Stoxx Index Target: 330**

Citi Economic Surprise Index - Japan



Source: Bloomberg

Economic Outlook

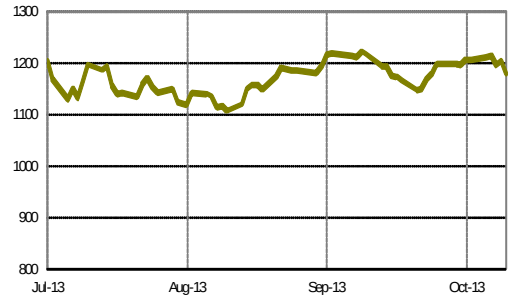
Deflation Pressure Is Steadily Waning

Citi analysts believe deflation pressure is waning steadily. However, they continue to see most of price increases in a small group of items such as food and energy and those that are directly impacted by a cheaper yen/rising costs.

The nationwide core CPI (the CPI excluding fresh food) climbed 0.7% YoY in September, slightly slowing from the 0.8% YoY rise in August. However, this was caused by weaker upward pressure from energy prices. Meanwhile, the CPI excluding food and energy stayed unchanged YoY in September, escaping negative territory for the first time since December 2008.

Meanwhile, service prices have been hovering around 0% YoY with little notable improvement. Service prices look unlikely to pick up clearly in FY2014 (starting in April 2014) as a consumption tax hike in next April could likely take a toll on consumer spending on services, in Citi's view. Furthermore, in the rent category which has a high share in services, private house rent and imputed rent declined 0.6% YoY and 0.4% YoY, respectively in the month. Unless these items turn around, service prices are unlikely to pick up in a meaningful manner.

Topix (25/7/2013 to 25/10/2013)



Source: Bloomberg

	Last week's close	Last week's return	YTD return
Nikkei	14088.19	-3.25%	+35.53%
Topix	1178.28	-2.26%	+37.04%

Equities

Anticipating a stock picker's market

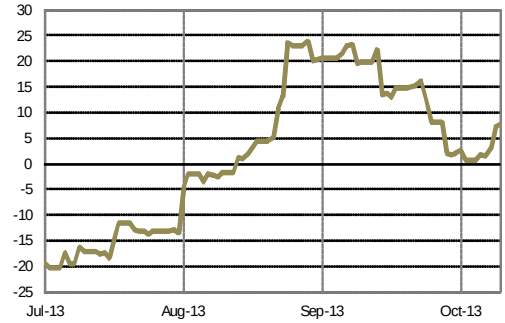
In a recent client survey, investors believed that yen depreciation would be required for Japanese stocks to appreciate, but they think the prospects for yen depreciation have weakened given the low immediate likelihood of further monetary easing by Governor Haruhiko Kuroda's BoJ, and the growing speculation that the Fed's monetary easing may persist. Thus many investors think that a stock picker's market is approaching, in which individual company factors could be more important than macroeconomic factors.

Citi analysts are concerned that overseas investors may also start selling to take profit, due mainly to a lack of substantial macroeconomic factors up to end-2013, and profit-taking sales by individual investors gaining momentum toward end-2013 in response to the ending of tax reductions. Citi analysts think that the ending of tax reductions in particular could prompt selling, since some investors are not very aware of this matter.

Some investors have expressed interest in the Nippon Individual Savings Accounts (NISA) scheme, but few seemed to expect it to become a powerful factor for Japanese stock appreciation. Some investors think that defensive stocks with high dividend yields and J-REITs could be appealing, if the Japanese stock market sees an influx of risk-averse investors who previously avoided investment in stocks and investment trusts.

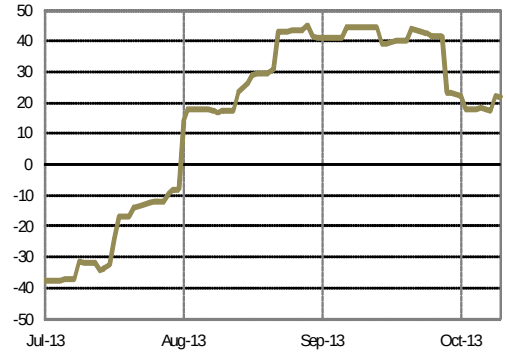
- **End-2013 Topix Index Target: 1300**

Citi Economic Surprise Index – Asia Pac Ex Japan



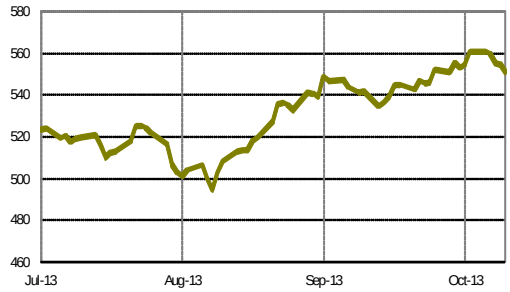
Source: Bloomberg

Citi Economic Surprise Index – China



Source: Bloomberg

MSCI AC Asia ex Japan (25/7/2013 to 25/10/2013)



Source: Bloomberg

	Last week's close	Last week's return	YTD return
MSCI AC Asia ex Japan	550.72	-1.73%	+0.55%

Economic Outlook

Is the Emerging Asia Growth Story Losing Its Luster?

There is a growing sense of malaise that Asia's growth story is running out of steam given that short-term cyclical outlook looks weaker than before. Financial conditions have meaningfully tightened vis-a-vis history for China, India and Indonesia. Also slower short-term US growth outlook could be a drag to earlier expectations about the strength of Asia's export rebound.

However, Citi analysts believe that some of the bearish growth views on Asia look exaggerated and longer-term growth prospects still remain intact for some countries. They think import-lite nature of recent US recovery is due to the still historically weak and narrow nature of US domestic demand recovery, rather than the fears that Asia is meaningfully losing export competitiveness. If taper eventually comes along with recovery in Advanced Economies, Asia could benefit, in Citi's view. The story of capital accumulation and productivity gains, particularly in the South and Southeast Asian countries, has a long way to go, although India and Indonesia are constrained by low domestic savings (among other things) that policymakers are trying to address.

The concern on China's slowdown seems to be the most valid one, in Citi's view, but there are some policy/growth offsets still available to Chinese policymakers that argue a hard landing is not a foregone conclusion.

Equities

Fears Of Another Round Of Liquidity Crunch

After a 4-day losing streak last week, Chinese equities plummeted with onshore (Shanghai Composite) and offshore (HSCEI) index falling 2.77% and 4.38% respectively as fears of a liquidity crunch dominated in the market.

PBOC's suspension of injecting liquidity into the market pushed the inter-bank rate higher, and the 7-day repo rate increased to over 5%. Tight liquidity conditions caused heavy profit-taking pressure in both markets amid a positive macro surprise of Preliminary HSBC PMI reading. The flash manufacturing (Mfg) PMI rose to a seven-month high of 50.9 in Oct (50.2 in Sep), beating market expectation (50.4) while indicating continued expansion of production.

While the climbing interbank rate has dampened sentiment, Citi analysts do not expect a replay of the June liquidity crunch episode. Reasonable reform progress and resilient external demand may provide some buffers to large selloffs. That being said, Citi analysts remain cautious about near term profit-taking risk given that there are signs of a further modest slowdown for Q4.

- **End-2013 MSCI AC Asia ex Japan Index Target: 625**

Developed Markets

28 October (Monday)

- **US** — Industrial production likely jumped in September (0.5%), due to a sharp rebound in utilities output.
- **Europe** — Retail sales in Sweden likely saw a positive gain in September (0.2% MoM).

29 October (Tuesday)

- **US** — Citi analysts look for a flat Producer Price Index in September (0.1%).
- **US** — September retail sales likely were dampened by a sharp drop in motor vehicle sales and a decline in gasoline prices (-0.1%).
- **US** — Business inventories probably continued to grow in August (0.4%).
- **US** — Citi analysts look for a large drop in consumer confidence in October to 73.0.
- **Europe** — Citi analysts look for a 2-point increase in the French consumer confidence indicator in October to 87.
- **Japan —** Citi expects to see moderately better readings for unemployment (4.0%) and the effective job-offers-to-seekers ratio 0.96 in September.
- **Japan —** Real spending of all households likely increased 0.7% YoY and 0.5% MoM in September.
- **Japan —** September retail sales likely rose 2.6% YoY.

30 October (Wednesday)

- **US** — Citi analysts look for another modest reading on consumer prices in September (0.2%).
- **Europe** — Economic sentiment likely posted another gain in October, albeit a smaller one relative to previous months (97.2).
- **Japan —** September industrial production likely increased 1.6% MoM.

31 October (Thursday)

- **US** — Initial jobless claims for the week ending October 19 likely remained unchanged at 350K.
- **US** — Citi analysts look for the Chicago purchasing managers' index to remain roughly unchanged in October, in a relatively solid range at 56.0.
- **Europe** — In September, Citi analysts expect a modest rise in German retail sales (0.4% MoM, 0.9% YoY) after a fall in August amid high consumer confidence, and low unemployment.
- **Europe** — Italian Unemployment rate has stabilised at around 12.2% in the past four months, and Citi analysts expect a small uptick for September (12.3%), at the end of the summer hiring season.
- **Japan —** September housing starts may come to 973k on a seasonally adjusted annualized basis.

1 November (Friday)

- **US** — The manufacturing activity index likely held its September gains in the face of the government shutdown (56.0).
- **Europe** — Citi analysts expect another high figure in UK manufacturing PMI in October (56.5), consistent with other signs that manufacturing output growth is buoyant.

Asia ex-Japan

28 October (Monday)

- **Thailand —** Manufacturing output is likely to post the last positive growth in September of 1.7% YoY.

29 October (Tuesday)

- **India —** RBI is likely to hike repo by another 25bps to contain inflationary pressures.

30 October (Wednesday)

- **Korea —** September IP growth likely slowed to 2.1% YoY, on sluggish exports, fewer working days due to Chuseok holidays, and strike in the auto sector.

31 October (Thursday)

- **Hong Kong —** September retail sales value growth likely moderated again (val.: 7.3%YoY; vol.: 6.5%YoY).
- **Taiwan —** 3Q13 GDP may come in at 2.6% YoY as widening trade surplus translates to a modest net exports contribution to growth.
- **Singapore —** 3Q13 jobless rate probably remained stable at 2.1% s.a. as the economy saw only a small sequential contraction even as labour supply tightened.

1 November (Friday)

- **China —** Citi expects a marginal increase in October manufacturing PMI (CFLP) to 51.2 given that sequential growth momentum is likely to be on sideways and then softening by year end.
- **Indonesia —** October headline inflation may edge up to 8.43% YoY due to rising prices of non-foods (driven by exchange rate pass through).
- **Indonesia —** Import growth may rebound in September (-1.6% YoY) after a drop in August, with a trade deficit of US$0.19bn.
- **Korea —** Headline inflation likely inched up further to 1.1% YoY in October due to low-base effects.
- **Korea —** October export growth is expected to rebound (4.9% YoY) on continued upswing in semi-con, shipbuilding and auto parts.
- **Thailand —** The core disinflation cycle likely ended in October as the base effect eased, implying headline inflation stayed flat at 1.4%YoY.

WORLD MARKETS AT A GLANCE

	Previous Week's Close	52-Week High	52-Week Low	Weekly Return	YTD Return	YTD Return (USD)
UNITED STATES						
Dow Jones Industrial Average	15570.28	15709.58	12471.49	+1.11%	+18.82%	+18.82%
S&P 500	1759.77	1759.82	1343.35	+0.88%	+23.39%	+23.39%
Nasdaq	3943.36	3961.10	2810.80	+0.74%	+30.60%	+30.60%
EUROPE						
DJ Euro STOXX	320.09	321.92	262.86	+0.51%	+14.45%	+19.63%
FTSE 100	6721.34	6875.62	5605.59	+1.49%	+13.96%	+13.42%
DAX	8985.74	9010.65	6950.53	+1.36%	+18.04%	+23.16%
JAPAN						
Nikkei 225	14088.19	15942.60	8619.45	-3.25%	+35.53%	+19.69%
TOPIX	1178.28	1289.77	718.36	-2.26%	+37.04%	+21.03%
ASIA						
MSCI Asia ex Japan	550.72	566.88	475.70	-1.73%	+0.55%	+0.55%
Hong Kong Hang Seng	22698.34	23944.74	19426.36	-2.75%	+0.18%	+0.15%
Shanghai Composite Index	2132.96	2444.80	1849.65	-2.77%	-6.00%	-3.68%
Taiwan Weighted Index	8346.62	8459.30	7050.05	-1.12%	+8.40%	+7.16%
Korea KOSPI	2034.39	2063.28	1770.53	-0.88%	+1.87%	+2.29%
Mumbai Sensex	20683.52	21039.42	17448.71	-0.95%	+6.47%	-5.11%
Singapore Straits Times Index	3205.24	3464.79	2931.60	+0.39%	+1.20%	-0.02%
Kuala Lumpur Composite	1817.57	1826.22	1590.67	+1.00%	+7.62%	+5.16%
Thai Stock Exchange	1454.88	1649.77	1260.08	-2.01%	+4.52%	+3.02%
Jakarta Composite Index	4580.85	5251.30	3837.74	+0.75%	+6.12%	-7.15%
Philippines Stock Exchange Index	6539.81	7403.65	5383.90	-1.03%	+12.51%	+7.32%
Australia All Ordinaries	5385.71	5453.10	4355.90	+1.22%	+15.46%	+6.51%
EMEA						
Russia MICEX Index	1504.48	1566.42	1271.48	-1.88%	+2.02%	-2.63%
South Africa JSE All Shares Index	45124.04	45486.01	36663.38	+0.97%	+14.97%	-0.56%
Turkey ISE National 100 Index	79271.50	93398.33	63887.70	+3.98%	+1.36%	-8.83%
LATIN AMERICA						
Mexico Bolsa Index	40671.61	46075.04	37034.30	+0.64%	-6.94%	-6.56%
Brazil Bovespa Index	54154.15	63472.55	44107.06	-2.21%	-11.15%	-16.97%
COMMODITIES						
Gold	1350.80	1754.65	1180.50	+2.62%	-19.37%	-19.37%
Oil	97.85	112.24	84.05	-2.94%	+6.57%	+6.57%
FIXED INCOME						
Citigroup World Government Bond Index	641.15	650.43	627.83	+0.30%	+0.75%	+0.75%

Source: Bloomberg (As at October 25, 2013)

CURRENCY FORECASTS

Currency		28-Oct-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
G10											
Euro	EURUSD	1.38	1.38	1.39	1.40	1.40	1.40	1.4	1.4	1.4	1.4
Japanese yen	USDJPY	98	99	102	104	105	105	105	105	105	105
British Pound	GBPUSD	1.62	1.67	1.69	1.70	1.71	1.72	1.73	1.74	1.75	1.75
Swiss Franc	USDCHF	0.89	0.90	0.90	0.89	0.90	0.90	0.91	0.91	0.92	0.92
Australian Dollar	AUDUSD	0.96	0.97	0.96	0.95	0.95	0.94	0.94	0.93	0.93	0.93
New Zealand	NZDUSD	0.83	0.87	0.86	0.85	0.84	0.84	0.83	0.82	0.81	0.81
Canadian Dollar	USDCAD	1.04	1.04	1.05	1.06	1.06	1.07	1.07	1.08	1.08	1.08
Swedish Krona	USDSEK	6.32	6.41	6.40	6.39	6.37	6.34	6.31	6.28	6.26	6.22
Norwegian Krone	USDNOK	5.89	5.84	5.78	5.73	5.66	5.58	5.51	5.44	5.37	5.33
EM Asia											
Chinese Renminbi	USDCNY	6.09	6.08	6.09	6.10	6.08	6.06	6.04	6.02	6.00	6.00
Hong Kong	USDHKD	7.75	7.76	7.76	7.76	7.76	7.76	7.75	7.75	7.75	7.75
Indonesian Rupiah	USDIDR	11111	11207	11430	11655	11587	11446	11308	11168	11028	10899
Indian Rupee	USDINR	61.5	61.40	62.10	62.90	62.20	61.20	60.20	59.20	58.20	57.70
Korean Won	USDKRW	1061	1051	1041	1032	1024	1017	1010	1003	996	995
Malaysian Ringgit	USDMYR	3.14	3.15	3.15	3.15	3.13	3.11	3.09	3.07	3.05	3.04
Philippine Peso	USDPHP	43.0	41.90	41.60	41.30	41.10	41.10	41.00	40.90	40.80	40.70
Singapore Dollar	USDSGD	1.24	1.24	1.24	1.24	1.23	1.22	1.21	1.20	1.19	1.19
Thai Baht	USDTHB	31.1	31.00	31.10	31.20	31.00	30.70	30.50	30.20	30.00	29.80
Taiwan Dollar	USDTWD	29.4	29.20	29.10	29.00	29.00	29.00	29.00	29.00	29.00	28.90
EM Europe											
Czech Koruna	USDCZK	18.63	18.75	18.57	18.39	18.17	17.94	17.72	17.49	17.26	17.15
Hungarian Forint	USDHUF	212	217	218	218	218	219	220	221	221	222
Polish Zloty	EURPLN	3.03	2.99	2.96	2.93	2.92	2.9	2.89	2.87	2.86	2.85
Israeli Shekel	USDILS	3.53	3.53	3.58	3.64	3.67	3.69	3.71	3.73	3.75	3.73
Russian Ruble	USDRUB	31.8	31.8	32.2	32.6	32.6	32.6	32.6	32.6	32.6	32.6
Turkish Lira	USDTRY	1.98	1.99	2.02	2.04	2.05	2.06	2.06	2.07	2.07	2.07
South African Rand	USDZAR	9.82	9.92	9.95	9.99	10.08	10.18	10.28	10.38	10.48	10.51
EM Latam											
Brazilian Real	USDBRL	2.19	2.22	2.25	2.29	2.31	2.32	2.33	2.34	2.35	2.34
Chilean Peso	USDCLP	506	495	502	509	508	506	504	502	500	499
Mexican Peso	USDMXN	12.9	12.60	12.50	12.40	12.40	12.40	12.30	12.30	12.30	12.30
Colombian Peso	USDCOP	1883	1879	1897	1916	1929	1940	1951	1962	1973	1963

Source: CR, Bloomberg (As of October 28, 2013; Forecasts as of October 18, 2013)

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