Weekly Market Summary

1st of July 2016

One Week After Brexit Vote .... Uncertainties Remain !!
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The first six months of the year are turning out to be a period traders and hedge fund managers would surely want to forget. With China's currency causing global market turmoil in January/early February and the U.K. vote to quit the European Union doing the same in late June, risks to financial markets remain elevated and the US$2.9 trillion hedge fund industry seems to be headed for its worst first-half performance since 2011.

"*There have been a lot of intrinsic shocks this year, especially after managers got relatively comfortable with betting on rising markets for the last several years*," said Ronan Cosgrave of Pacific Alternative Asset Management, an Irvine, California-based firm that invests client money in hedge funds. Market players are now struggling to navigate markets marked by wide stock swings, a commodity selloff and divergent monetary policies. Trillions of dollars have already been lost and it appears that worries over the UK vote to leave the European last Thursday – and the ensuing market turmoil and political carnage in past days – will stay around for some time (very low visibility to say the least!).

Brexit's real lesson is that there is a consequential divide between cosmopolitans who view the future with hope and those who have been left behind and have seen their economic situations and ways of life deteriorate. The risk is that the same story could well play out in the United States and elsewhere, with important electoral effects and market impact! But the Brexit story also speaks to the uniqueness of the EU as a new kind of political power with a profound impact on the lives of all within it. History has shown that the development of new political formulations rarely goes smoothly. The divisions between those who can imagine a better life in the new system and those who cannot will likely continue to drive politics in the EU and elsewhere for years to come.

Elsewhere – and as we had into the summer break - the following developing stories deserve some attention given their potential large ramifications on financial markets for the remainder of 2016:

1. ***George Soros Says Brexit Has "Unleashed" a Financial Markets Crisis***: Britain's decision to leave the European Union has "*unleashed*" a crisis in financial markets similar to the global financial crisis of 2007 and 2008, George Soros told the European Parliament in Brussels yesterday. "*This has been unfolding in slow motion, but Brexit will accelerate it. It is likely to reinforce the deflationary trends that were already prevalent*," the billionaire investor said. Soros rose to fame as the money manager who broke the Bank of England in 1992, netting a profit of US$1 billion with a wager that the U.K. would be forced to devalue the pound and pull it from the European Exchange Rate Mechanism.
2. ***Fed is Done Hiking Until 2018***: Traders, who have consistently been better at projecting the path of interest rates than the Fed itself, are now pricing in a greater probability that policy makers will cut rates

in upcoming meetings than raise them. They do not assign more than a 50% chance of an increase until the beginning of 2018, and don't price in a full rate hike until the final quarter of the year. The sea change in outlook for central bank policy comes after global equities and commodities plunged while government bonds and the dollar surged following Britain's vote to quit the European Union.

3. ***EU Calls for "Orderly" Brexit at Historic Meeting (Excluding UK):*** European Union leaders called for an orderly British withdrawal from the bloc to minimize instability as they pledged to learn lessons from the U.K.'s political earthquake and do better at serving their citizens. As EU government chiefs took the historic step of meeting without one of the bloc's members for the first time, they lamented the British decision to part ways then began to lay plans for a new union minus its second-largest economy. That included setting the parameters of Britain's future relationship with the EU, and insisting that negotiations to finalize secession won't be started until the U.K. gives official notification of departure. In their final statement released Wednesday evening, leaders of the 27 other nations said "*there is a need to organize the withdrawal of the U.K. from the EU in an orderly fashion*." While the decision to trigger secession talks lies with Britain, and they can wait until a new prime minister is in place, "*this should be done as quickly as possible*."
4. ***Carney Signals Rate Cuts as Brexit Chaos Engulfs Political Class*:** Bank of England Governor Mark Carney signaled yesterday that the Bank of England could cut interest rates within months as the central bank tries to shield an economy rattled by the shock of Brexit and the chaos engulfing Britain's political classes. In his second televised address since the country voted to leave the European Union, Carney signaled that officials would not hesitate to act when it comes to safeguarding the economy or the resilience of the financial system. The BOE will also continue its liquidity auctions for banks on a weekly, rather than monthly, basis and consider a "*host of other measures*". The pound slumped and bond yields dropped as investors increased bets on a rate cut by August.

Government Bond Yields Fall to Fresh Record Lows: Global government bond markets began the second half of the year extending their record-setting run, led by the UK and Japan, while the US Treasury benchmark yield also approached a fresh all-time low. The prospect of global central banks keeping interest rates lower for an extended period, led by a likely easing from the Bank of England as early as July 14th, has spurred strong buying of top-tier sovereign debt by investors. Against a backdrop of UK political turmoil and with economists expecting a recession in the coming months, the 10-year gilt yield fell to a record low of 0.81% earlier today (German 10-years bund yields dropped to -0.15%!). The rally in Gilts was accompanied by firmer US Treasury prices; with investors concerned that Brexit will slow global growth prospects and spark bouts of financial market volatility over the summer. The 10-year Treasury yield fell 12bp to 1.385%, almost matching the July 2012's record low of 1.38%.

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