CITYINDEX

THE ALTERNATIVE 2017 MARKET OUTLOOK

Forget the boring old investment bank research for 2017; find out what the greatest minds of City Index think are the best trading opportunities for the year ahead!

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KING DOLLAR

We expect the dollar to be the best performer in 2017. EUR/USD parity is on the cards, we could see back to 120.00 in USD/JPY, and potentially back to 1.18 in GBPUSD. The driver of this move in the dollar include: US rates continue to rise, a banking crisis in Europe, along with rising political risk and a narrow loss for Marine Le Pen in France's Presidential election in May, which boosts Europe's hard right movements and threatens the future of the EU. As US yields rise to 4%, it looks like nothing can stop the US currency. The only problem: the US trade deficit has exploded, at the same time as fiscal largesse is pushing up US government borrowing to unsustainable levels, leading some, including China, to start questioning the benefit of buying US Treasuries. The dollar rallies until Trump gets in the way, refer below.

10-year US Treasury yields rise to 4%

Equities get slammed as the end of the bond bull run starts to bite. Rising yields leads to a very uncomfortable year for some emerging markets, including Turkey, which has an unsustainable US dollar debt position. The EU comes to its rescue with a loan, leading to a rekindling of EU/ Turkish relations, by the end of 2017 Turkey is on track to join the EU. Political upheaval in Turkey leads to the ousting of as President Erdogan, this time without the need of a coup, as economic conditions in the country deteriorate.

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OIL FALLS TO $15 PER BARREL:

Iran and Saudi both renege on their plans to cut oil production in 2017, which in turn leads to the break down of the Opec consortium. Russia distances itself from its previous plan to cut production by 600,000 barrels, leading to a massive oil glut. President Trump steps in to protect the US's oil and shale gas industry, as the US becomes the first oil producer to guarantee oil companies a minimum price for a barrel of oil, thus increasing the size of the US's balance sheet even more.

US financial stocks are best performers on the Dow.

The first half of 2017 is positive for US banks as they continue to retrace their financial crisis losses on the back of the 'Trump effect'. Plans to scrap the Dodd Frank rule, easing regulation for the banking sector, along with an uptick in the US economy, are powerful drivers for the US banking sector, which continues to look in far better health than its European counterpart.

At some point in H1 2017 we expect the Dow Jones banking sector to return to its 2014 highs. However, the second half of 2017 is a trickier time for financials as the markets question whether Trump's policies can deliver the long-run growth he has promised.

Trump impeachment by end of 2017:

One tweet too far from President Trump leads to him being ousted by an angry Congress, representing both sides of the political isle. Don't rule this one out; after all, 2016 delivered some of the biggest political shocks in a couple of generations. Teflon Trump comes unstuck after one controversy too many, which leads him to impeachment. The US political system is thrown into disarray, as Vice Pence takes the reigns of power.
With Trump out of the frame, fiscal largesse takes a back seat, leading to reduced expectations for US growth in 2018 and 2019, and the end of the global rally in equities.

A BREAK UP OF RBS

Having followed RBS for almost a decade, I now agree with an authoritative minority that believes it is impossible to turn the bank around, and that it should be broken up instead.

Liquidating RBS won't be easy. But it will be preferable to further consecutive annual multimillion losses. How the bank is broken up is less important than marshalling the political will to do it. Right now, political expediency, rather than Britain's best interests seems to be the main reason why two Chancellors have opted to let RBS battle on.
George Osborne got closest to biting the bullet. In the end he decided on an 'internal bad bank'. The "effort, risk and expense involved in the creation of an external bad bank is not justified", to quote from the outcome of the review he commissioned. The problem for RBS is that its problems keep mounting. On the legal front alone, a rough tally of penalties, settlement costs, and, where known, provisions, for litigation coming to a head over the next two years, comes to around £20bn. And that's barely scratching the surface.

On top of that, RBS failed the Bank of England's latest simulation, partly because risk regimes are converging towards international norms like "Basel III". Under these, provision requirements could revert closer to RBS's previous five-year rate of 2% per Risk-Weighted Assets (RWAs), than 0.1%-0.2% currently. With RWAs forecast at £275bn this fiscal year, in theory provisions would be £5.5bn at the higher rate. Yet, in an era of bank decapitalisation, RBS's RWA reduction will remain slow.

A break-up doesn't have to be a wholesale slaughter. Economically enhancing solutions abound. One proposed by the New Economics Foundation in 2014 foresaw the creation of a network of 130 locally run banks, saving costs by using RBS's centralised back-office systems. Another full-year report underlying RBS's dearth of progress will lift the matter higher up the political agenda. The breakup of RBS could begin sooner than later, Chancellor Philip Hammond may even begin to signal his views as soon as his Spring Statement.

TESCO CLAWS BACK MARKET SHARE FROM ALDI AND LIDL

Tesco is about to flex its muscles and remind discounters that low-low prices aren't everything in Britain's grocery world.
The latest independent industry data shows Tesco, still Britain's biggest supermarket, pulling ahead of rivals again by means of both lower prices and finely calibrated store refinements. This led to Tesco volumes rising 2.2% year-on-year over 12 weeks to 6th November, the fastest pace for three years, according to researcher Kantar Worldpanel. It comes after Tesco reported three straight quarters of underlying sales growth in its main British market. October's Kantar report also showed Tesco growing UK market share for the first time in five years.

The revamped Tesco under CEO David Lewis is riding back to strength on a strategic shift towards more of its own label products. Cheaper "Farm Brands", launched in March, are encouraging shoppers to return from discounters Aldi and Lidl, as is the more upmarket "Finest" range. Kantar noted more affluent shoppers returning to Tesco, from Waitrose and Marks & Spencer. By contrast, last month, sales growth at the discount upstarts continued to stall and hit the slowest rate since 2011, partly due to pressure from a slowdown in food price deflation. Tesco's improving supplier relationships are another key strength. Improved sales have brought about a "virtuous circle" says Lewis: better deals with suppliers, driving more price cuts and further volume growth - and consequently even better deals with suppliers. Additionally, despite 'Marmite-gate', overall, it appears Tesco does recognise some suppliers face legitimate cost pressures, particularly from sterling's devaluation. Under such circumstances, it has made it clear that it will try to offset them by, for example, changing recipes or finding cost savings.

Tesco's goal is to earn between 3.5 pence and 4 pence of operating profit for every 1 pound spent by shoppers, up from 2.18 pence currently. That achievement, despite the reduction of some 10 million square feet of store space since 2014, would make a return to a 30% UK market share from 28.2% not particularly punchy call, and an interesting trade call for 2017.

More Blockbuster IPOs:

A rise in IPO volumes in the third quarter of the year, after a big slowdown overall in 2016 points to a big rebound in share listings in the New Year, with icing on top. Not that 2016 was exactly quiet for IPOs. But at, US$79.4bn, January-September global IPO proceeds were 39% lower than in the same period in 2015 and deal volumes (704) were down by 23%, says Ernst & Young. Quarter-over-quarter in Q3 the rise was 16% compared to 2Q16 to US$35.4bn, and also strong compared with 3Q15—up 84% with the number of deals rising by 21%.

The outlook for 2017 is better, given improving economic fundamentals, chiefly in the U.S. While a return to the record levels of activity in 2014 may be a stretch, the IPO activity for 2017 is expected to surpass 2016, and could even beat proceeds in both due to the return of the kind of blockbuster IPOs that 2016 lacked. Whilst investors will now have to wait another year for the biggest IPO of all time (Aramco) we believe Snap Interactive Inc. (Snapchat) is planning to launch on the stock market in the first or second quarter of 2017.

With a current valuation of $18bn, timed right, the group could match the last big tech IPO, in 2014, when Alibaba raised $22bn. 2018 is sorted too: Aramco's IPO just keeps growing. Saudi's oil production vehicle now plans to include all of its businesses in the float, having initially outlined plans to sell just downstream operations.

And whilst officially, the Kingdom has indicated an approximate 5% stake would be floated, it has not ruled out expanding the size of the portion given the wider number of assets, and demand. From initial market soundings of around $1 trillion, Saudi has not sought to downplay more recent consensus for a float of at least $2 trillion.

Even that would be a fraction of the worth of the group, which has 12 times the reserve of ExxonMobil. Advisers to the Saudi oil ministry estimate its total value at $10 trillion. Of course, if our previous prediction comes true and the oil price falls to $15 per barrel, then we could see the Aramco float delayed for another year.

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