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The Context

February 12th 2018

The Context

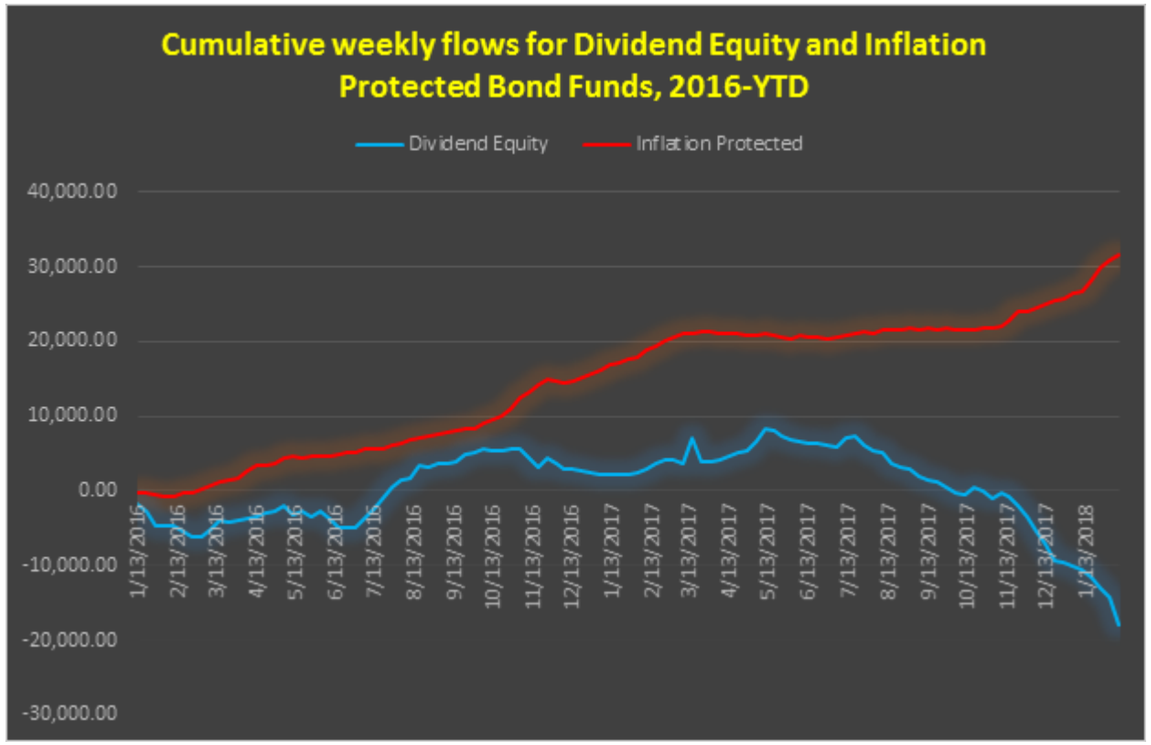
Published weekly

Inside this week's edition:

Know the Flows

By Cameron Brandt, Director of Research

The tide of fresh money flowing into **Equity Funds** turned sharply in early February as fears that 2018 is the year when inflation finally takes off, thereby forcing the hands of previously accommodative central banks, sparked a major sell-off around the globe. Having set a new monthly inflow record in January, those **Equity Funds** started February by posting their biggest weekly outflow since EPFR started tracking them with **Global Equity Funds** experiencing net redemptions for only the second time in the past 15 months and **US Equity Funds** setting a new outflow record.



Inflation Protected Bond and **Dividend Equity Fund** flows, which have been flagging investors' unease about the outlook for US interest rates since late October, extended their respective inflow and outflow streaks during the week ending February 7 while redemptions from **High Yield Bond Funds** climbed to a seven-week high.

The prospect of higher wages driving up consumer demand and prices in Europe and the US, thereby accelerating the pace of monetary tightening and propping up the US dollar, did help funds dedicated to Asian exporters. Both **Korea** and **China Equity Funds** attracted over $500 million during the week and **Japan Equity Funds** recorded their biggest inflow since mid-4Q16.

Overall, investors pulled a net $30.6 billion out of EPFR-tracked **Equity Funds** during the first week of February and $825 million from **Alternative Funds** while steering $3.7 billion into **Bond Funds** and over $45 billion into **Money Market Funds**.

At the asset class and single country fund levels, **Municipal Bond Funds** posted consecutive weekly outflows for the first time since late 1Q17, **Bank Loan Bond Funds** took in fresh money for the sixth week running and **Total Return Bond Funds** absorbed over $900 million for the fifth time in the past six weeks. Among **Emerging Markets Country Fund** groups **Brazil Equity Funds** posted their first weekly inflow since late December, **Chile Equity Funds** recorded their biggest outflow since late 3Q15 and flows into **Saudi Arabia Equity Funds** were the largest in over nine years.

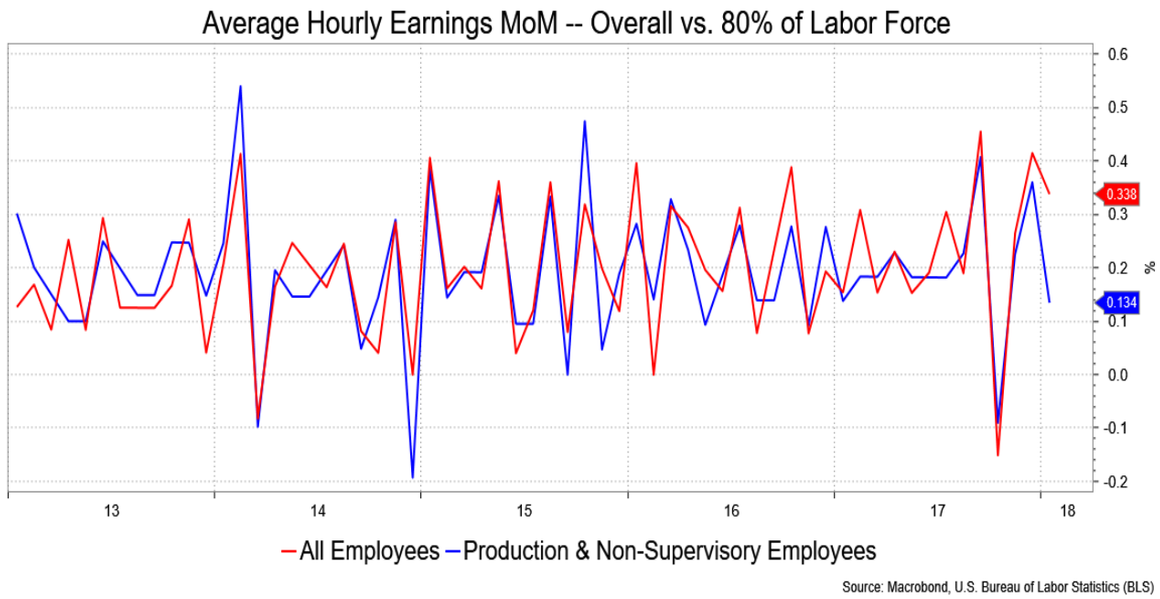
The shares of technology plays, meanwhile, were heading in the other direction. With investors suddenly leery of stocks routinely described as expensive, EPFR-tracked **Technology Sector Funds** posted their biggest outflow since mid-3Q15.

Abby Someone. Who? Abby Normal

By David Ader, Chief Macro Strategist

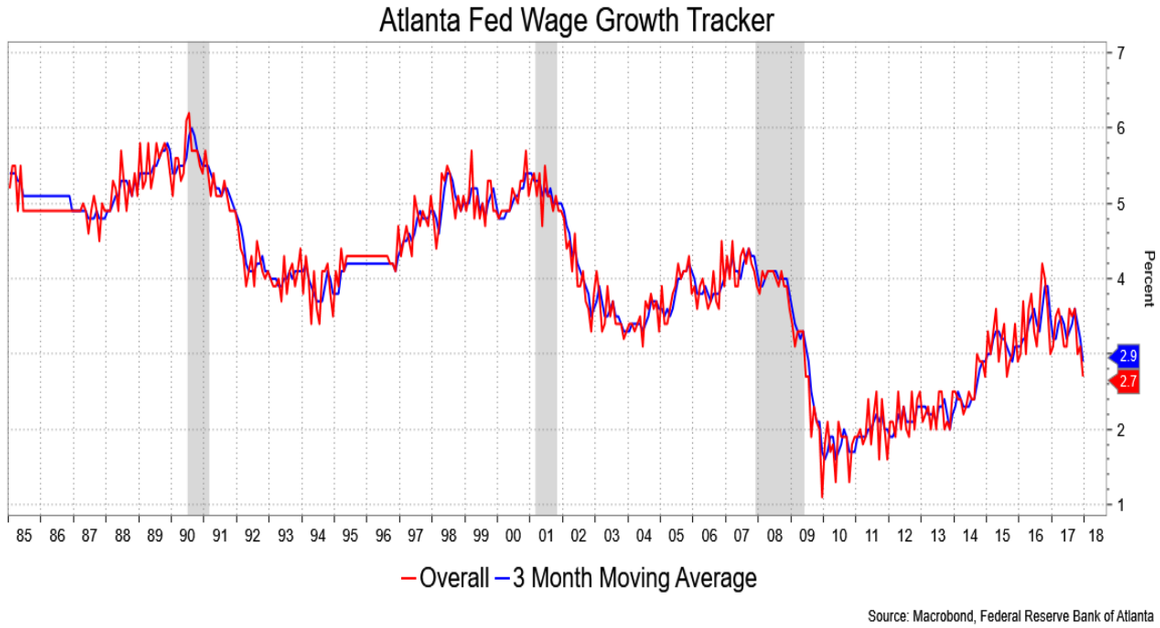
I was all set to go over some of the quirks in the NFP report in an attempt to dilute the initial bearish response that wage inflation was at hand when I came across a lot of others beating me to the punch. Still, I'm going to do it at the risk of flogging a dead horse because it did take some time for the view I'm about to share to filter out.

To wit, yes, there were some quirks. First, cutting to the chase of the wage component the news that was eye-popping before anyone had a chance to hear the professional economists opine was the 0.3% gain to AHE on top of December's 0.4% gain. Stellar and inflationary, no doubt, if they were steady. Alas, the issue here is that the AHE gain to the bulk of workers, the production and non-supervisory workers, was only up 0.1%. In the spirit of raining on the parade, combining that with YoY CPI figures, 2.1% at the headline level in Dec, you have a pretty paltry 0.3% REAL gain in AHE for these workers and 0.8% when adding the better-paid folks. That's an improvement, by the way, over the milquetoast gains of 2017, but not grand by any stretch.



Another quirk, you've probably heard this, was in the weather component. The number of people not-at-work- due-to-bad-weather was 496K vs. an average for a January over the last 10 years of about 171k. When you see an outsized increase to this category it tends to boost AHE only to revert when people get back to work. Why? Lower-paid workers are the ones that tend to miss work due to bad weather. I ponder whether the flu season had anything to do with this January's phenomenon, and the gain to minimum wages in many locales. This is not to say the overall gains were bad and it was a weak report, just that the evidence for wage inflation remains somewhat skimpy.

Also, there was the oddity of wages gain against the backdrop of a slip in the hours worked - 34.3 hours from 34.5. Again, it seems a weather influence suggesting the undertow of wage inflation is on somewhat thin ice.



I won't say this next chart is the end all and be all of the story, but it's another angle. This is the Atlanta Fed's Wage Growth Tracker which is hardly in a growth mode. This measure looks at median vs. mean growth in wages, suggesting wages gains are not widespread.

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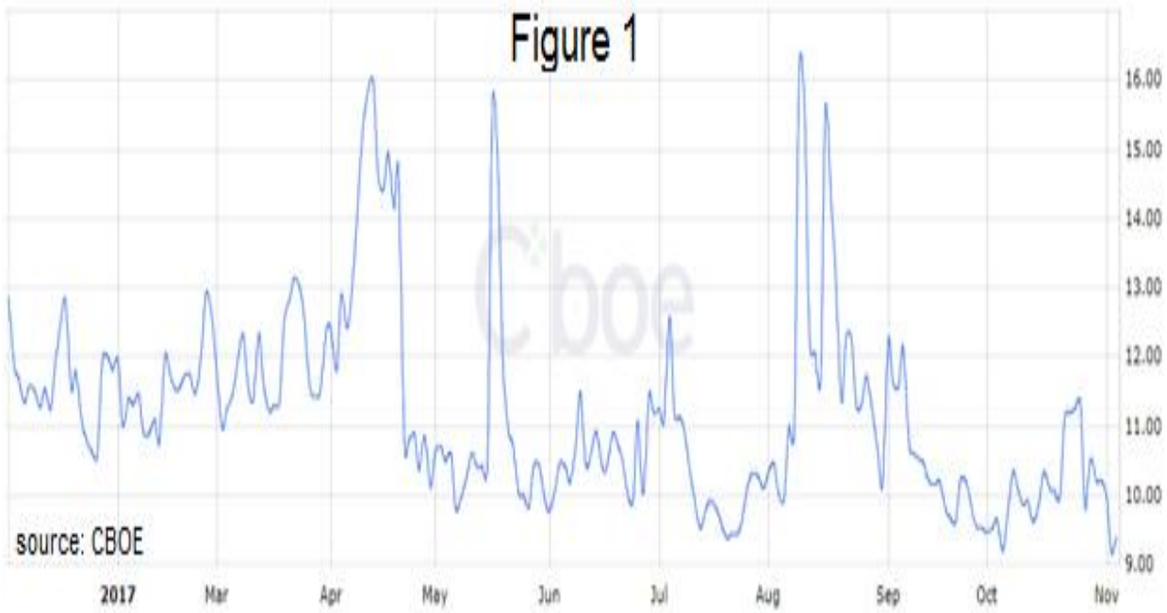
This is an excerpt from Ader's Musings. For the full article, please click HERE.

Active Management Outperforms in 2017

By Ryan Nauman, IIS

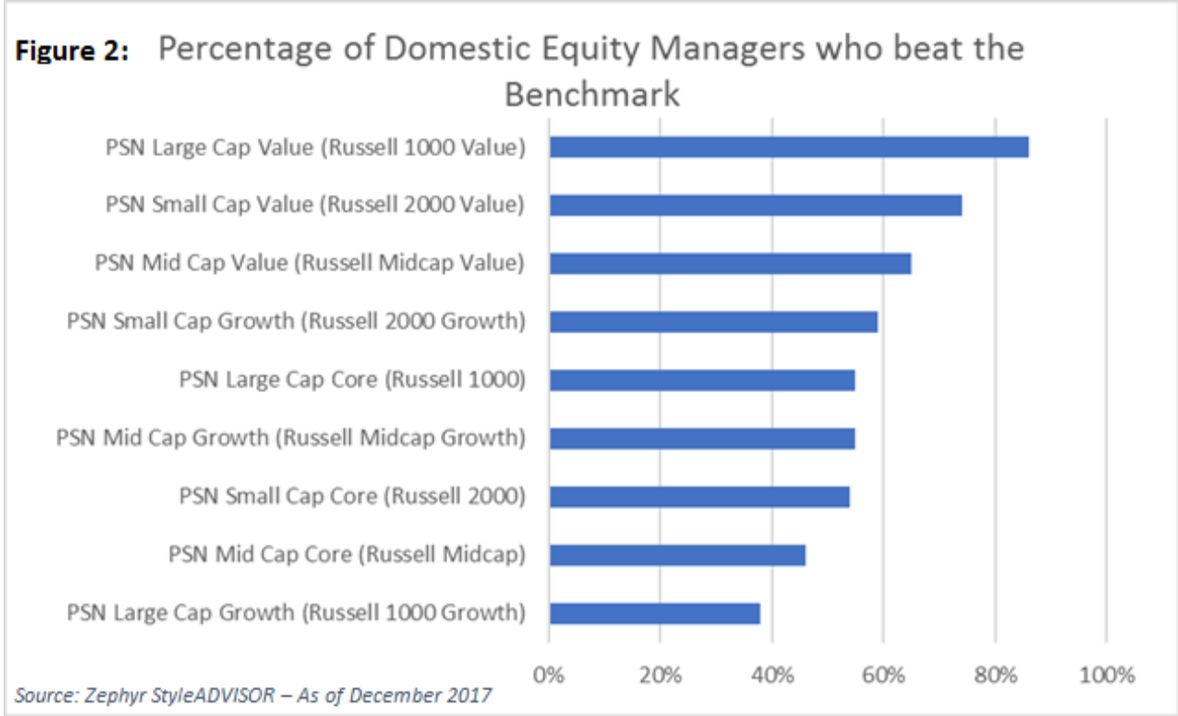
The active versus passive investment argument has been one of the hottest debates in the investment management space over the past few years. Many observers, myself included, believed 2017 would be a stock picker's year, due to an increase in market volatility.

Market volatility, measured by CBOE's VIX index, started to decline at the end of 2016, which was surprising, given the uncertainty surrounding fiscal policy. This uncertainty led me to believe that volatility would increase during 2017, but as you can see in figure 1, I am not clairvoyant and the VIX index hit all-time lows throughout the year. Another factor contributing to my beginning of the year prediction, was the low correlations amongst the 50 largest S&P 500 stocks, which presents opportunities for stock pickers.



With 2017 in the rear-view mirror, we look back to determine if active managers outperformed, and if so, which asset classes provided opportunities for financial advisors to find outperformance.

Focusing on the different PSN universes, we can see the percentage of managers who outperformed the appropriate benchmark for each major universe. Historically, efficient asset classes such as large cap equities and investment-grade fixed income have favored passive investments, compared to less efficient asset classes such as small cap equities and emerging markets.



In Figure 2, we take a closer look at the nine broad PSN domestic equity universes. As one can expect, the less efficient, PSN Small Cap Value universe offered numerous opportunities to find outperforming strategies, as 74% of the strategies within the universe beat the Russell 2000 Value index. Financial advisors were also able to find a high percentage of outperforming managers in the PSN Large Cap Value universe, which is traditionally viewed as an efficient asset class, as 86% of the strategies outperformed the Russell 1000 Value index. There were only two universes where the index ranked in the top 50th percentile – PSN large cap growth (38%) and PSN mid cap core (46%).

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This is an excerpt from Ryan's piece . For the full article, please click HERE.

Is This The Perfect Recipe For An EM Sell-Off?

By Chris Shiells, EM Managing Analyst

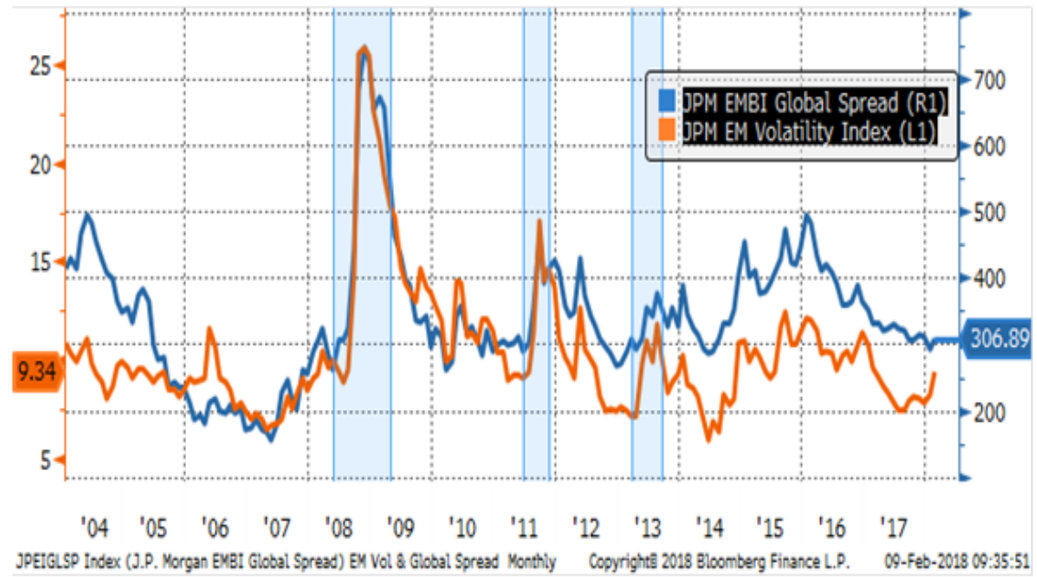
After a record breaking January, the question now being asked is if the amount of cash flowing into Emerging Markets can be sustained.

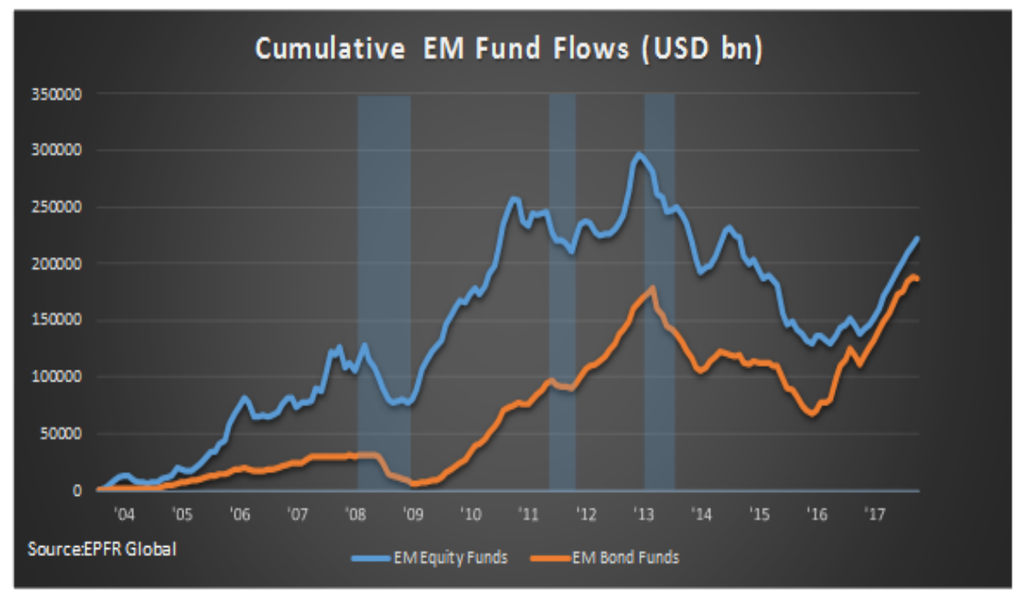
This year EM local currency government bonds have returned 4.4% in the year to date — the best return in global fixed income — while EM hard currency sovereigns have been flat. Will the rise in volatility change this?

Last October we explored the relationship between rising EM FX Volatility and Flows, when the JPM Emerging Market Volatility Index (for FX) had climbed above 8. It has once again spiked this week, hitting 8.86, the highest since May last year. As we highlighted then, and as the first shows, during periods when EM FX volatility has spiked (Aug 2008 to Nov 2008/Jul-2011 to Sep-2011/Apr-2013 to Aug-2013), credit spreads have also spiked and correlation has been at its highest.

We noted back in October that the JPM EMBI Index spread was at wide levels for such low volatility, which suggested there was room for EM Credit Spreads to narrow further. This proved to be the case with the spread hitting 288.53 before the spike to 306.53 this week, as the JPM EM Vol index moved to 8.95.

However, on a historical basis the index remains near record lows and well off this year's peaks of 11.34, so the latest up tick is still not yet significant.





Are rising global yields the real issue?

Underlying all of this is a debate over the outlook for Fed policy, and now there are two additional uncertainties; 1) will the global equity sell-off be factored into the Fed's decision-making process, 2) will new Fed Chair Powell mark a change in current policy.

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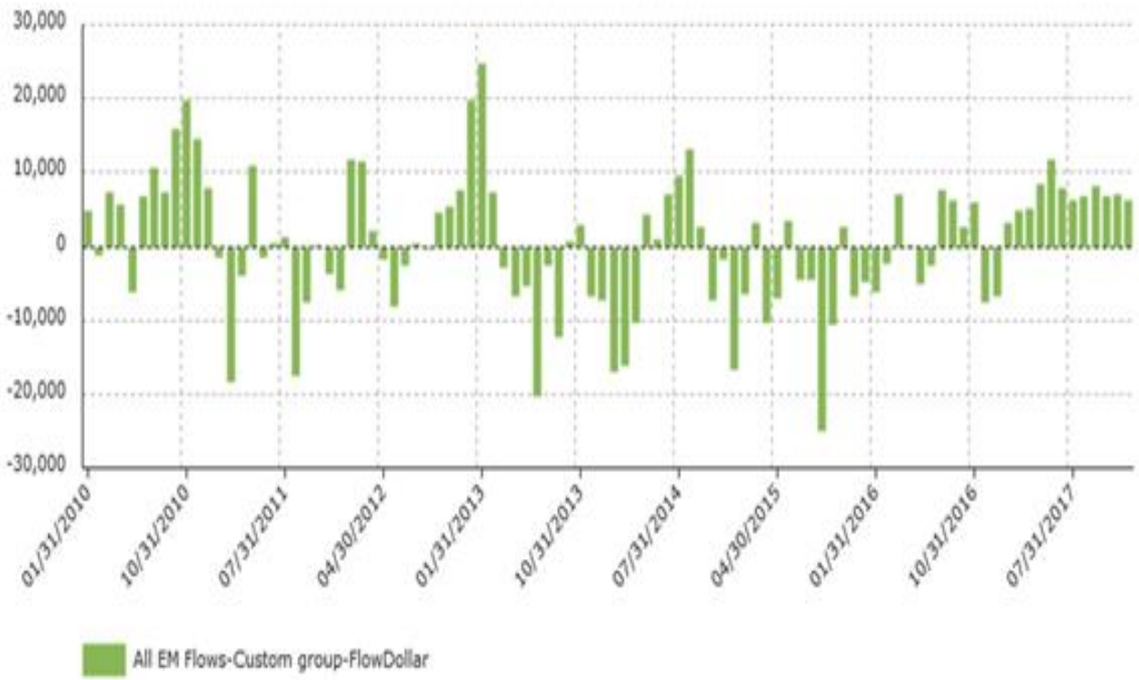
Is This The Perfect Recipe For An EM Sell-Off? … cont



The recent rise in UST and Bund yields had not sparked any major outflows from EM Funds, (graph to the left shows monthly net flows into EM Bond & Equity Funds) until this week, and in fact only during the 2013 taper tantrum was there a sustained outflow from EM Funds as yields rose.

We argue that if it is just about Fed rate hikes then Emerging Markets have little to fear. This is due to the below factors:

- US and global growth fundamentals remain strong - against this backdrop we expect EM central banks will not take risks with inflation and lead, not follow the tightening cycle, further enhancing the attractiveness of EM currencies and equities.

- Positioning and valuations in Emerging Markets – both of these remain low/cheap vs historical averages. EM currencies are about 5 per cent undervalued. Again, valuations have room to stretch before they come under pressure.

- Reduced vulnerabilities – it has been well reported that during previous episodes of rising UST yields and USD strength emerging markets that had become reliant on foreign flows to cover deficits, has left them vulnerable. During the 2013 taper tantrum this led to the 'Fragile 5' moniker. However since then EMs have undergone significant structural reforms - external imbalances have been reduced, balance sheets cleaned up, and thus reliance on FX funds reduced.

So do not expect a repeat of 2007 of the 2013 taper tantrum. Fundamentals are still strong.

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Asia Credit Strategy: A Three-Dimensional Threat Looms Large

By Tim Cheung, IGM Head Of China, Riki Zhang, Analyst

The recent plunge of US equities has spurred risk-off sentiment towards EM assets across the globe. In EM Asia, equities saw panic selling first. As far as the credit market is concerned, investors here are turning more cautious though they have not yet panicked.

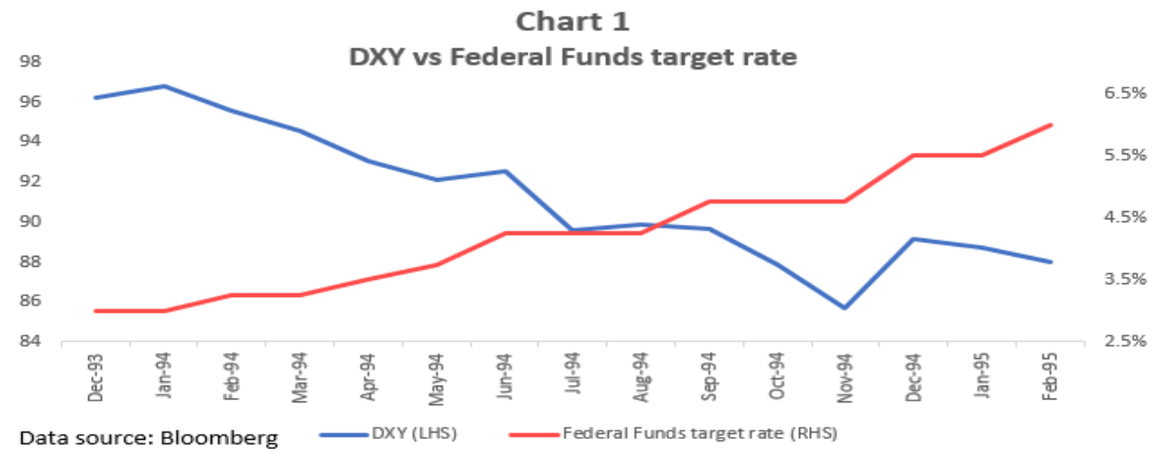
Let's have a look at the performance of JP Morgan JACI indices year-to-date and month-to-date:

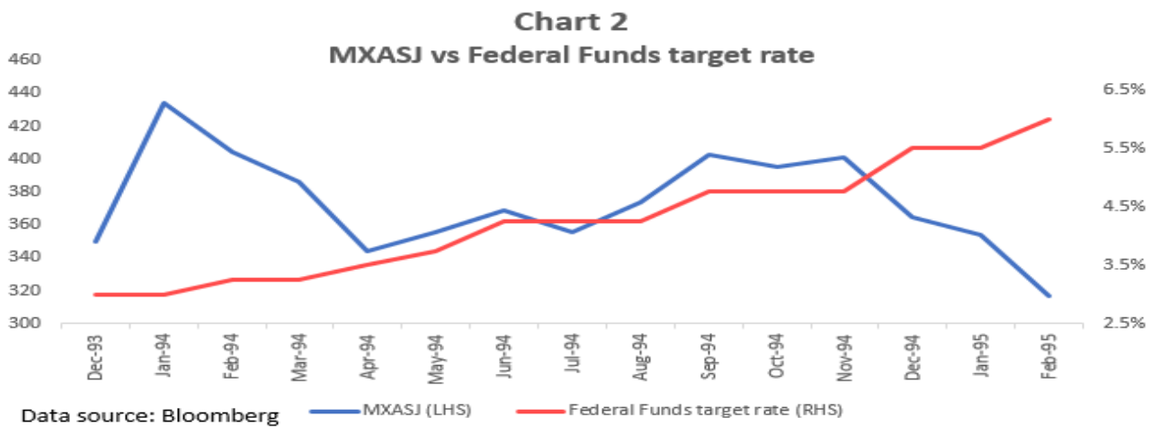
JACI index	vs 2017 Dec-end	vs 2018 Jan-end
Aggregate	-0.7%	-0.2%
IG	-0.9%	-0.1%
HY	-0.2%	-0.4%

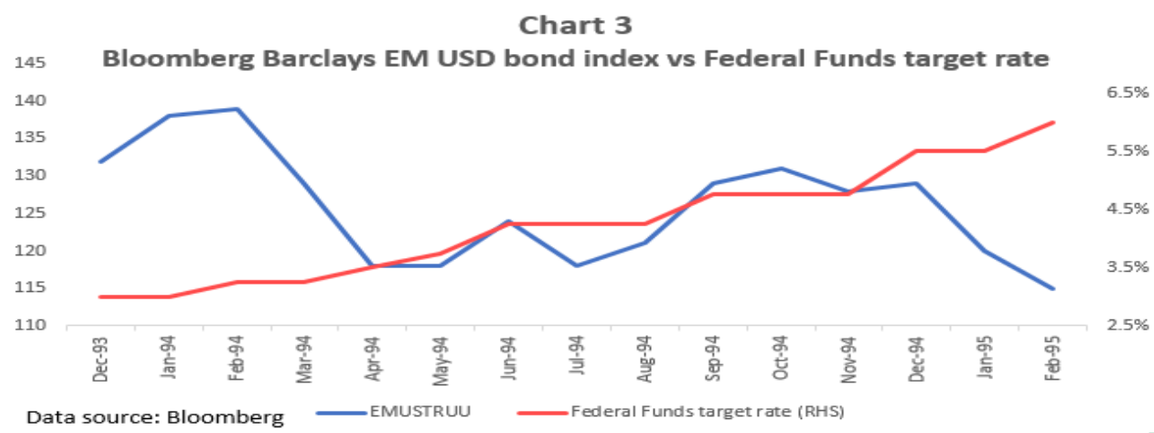
Despite January 2018 being the busiest January on record for Asia ex-Japan G3 new issuance, February's first week saw a notable fall in activity levels in the primary market, indicating a change in sentiment. The near-term technicals will be turning more challenging until we see stabilization in equities, rates and FX rates space. After experiencing a number of market turmoils in the region since the GFC ended 2009, we all know how negatively a global equity market slump would impact the credit spreads.

What about the roles played by interest rates and FX rates? The answer is rising US interest rates combined with USD weakness is dampening Asian local investors' sentiment towards USD-denominated Asian bonds because it has led to a noticeable increase in hedging costs for investors that are looking to invest in USD credit and hedge back into local currencies.

Back in 1994, the EM credit market suffered a setback because of the above-said three-dimensional threat i.e. equity market weakness combined with rising US interest rates and falling USD (see charts 1-3).







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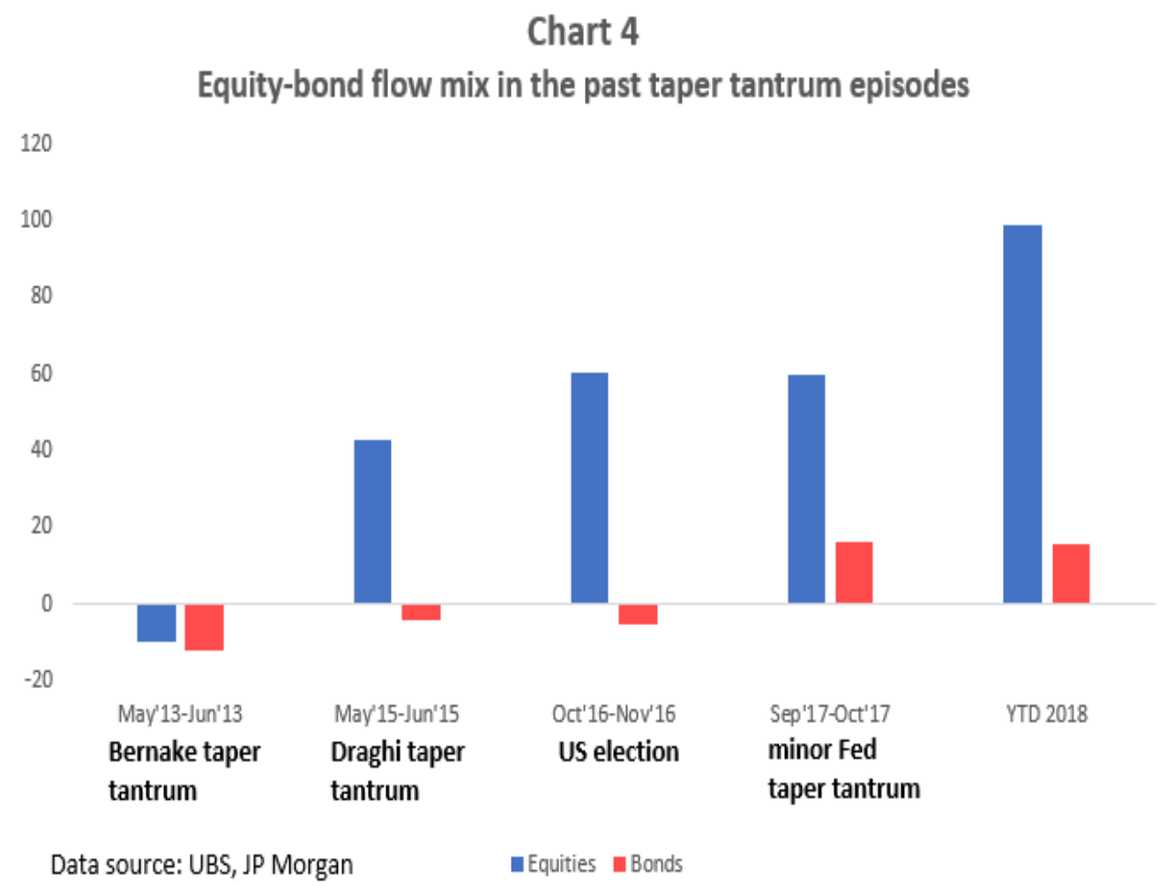
Asia Credit Strategy: A three-dimensional threat looms large cont'd

Apparently, once a three-dimensional threat arises, we should pay extra attention to equities because they have always been the driving force behind the selloff in other risk asset classes.

With reference to the taper tantrum episodes over the recent years (chart 4), we find that bond ETFs saw outflows more frequently than inflows. In contrast, equities, despite always seeing a big selloff in reaction to the taper tantrum, surprisingly enjoyed inflows more frequently than outflows. This difference should be attributed to the behavior of the retail investors. Simply speaking, retail investors, who are noted to be less savvy than institutional asset managers and habitually fond of catching a falling knife, have always been playing a more prominent role in equity funds than in bond funds. That's why inflows happened more frequently to equities than to bonds in taper tantrum episodes, in our view.

YTD, both equity ETFs and bond ETFs have registered inflows. We doubt this trend will go on if market sentiment worsens much further. Perhaps, we will eventually see an equity-bond flow mix like the one seen in the 2013, 2015 or 2016 episodes.

To play safe, we think it is time for EM Asia credit investors to shorten the duration of their EM Asia credit portfolio and move up along the credit quality ladder. Rising interest rates accompanied with stable/bullish equities have historically been positive for HY, rather than IG. We have no doubt about that. However, once the "stable/bullish equities" picture fails to work out, HY is likely to be more vulnerable than IG.



Asia FX Strategy: Why Equity Positioning Counts In This Risk Off Market

By Tim Cheung, IGM Head Of China; Riki Zhang, Analyst

The recent selloff in global equities has spurred demand for safe haven asset(s). As a result, on Wednesday during the Asia morning we saw a surge of demand for CNY which is already widely believed to be free from depreciation risk.

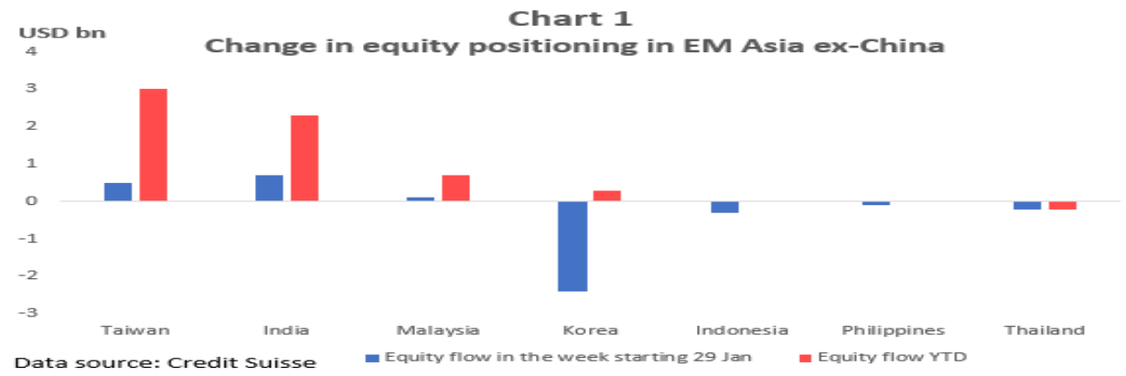
Fundamentally, sustained improvement in China's FX reserves (note: it increased by another USD21.5bn to stand at USD3.16tn at the end of January) combined with government curtailment of capital outflows strengthens the country's basic balance. Likewise, both Malaysia and Thailand are also equipped with strong basic balance as they see rising trade surplus relative to portfolio flows.

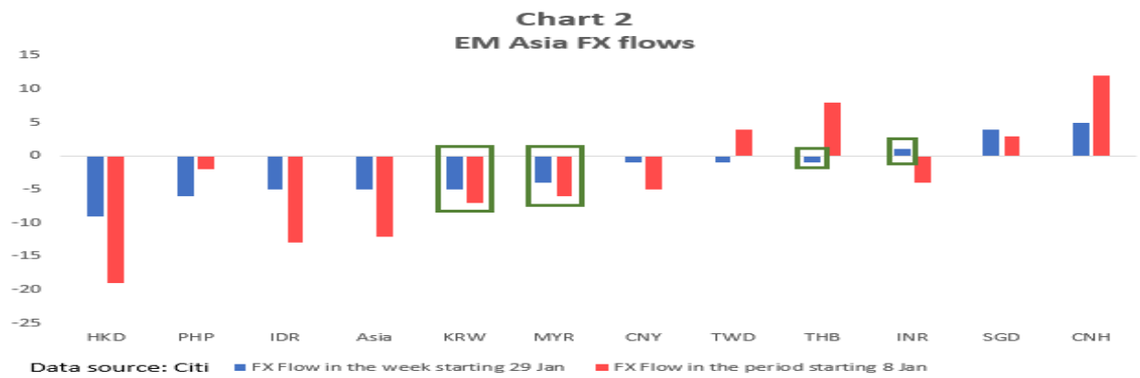
As investors turn highly concerned about the global equities, there is no reason why we should just focus on the fundamentals. In fact, rather than that, equity positioning perhaps is going to have more impact on FX rates as long as the equity market sentiment remains fragile.

We think for now it is necessary to have a quick scan of the equity positions in the region before telling which currencies might be less vulnerable in case of a further deterioration in the global equity market outlook over the near term.

In our view, any further plunge in equities will spark a squeeze of equity positions, in turn forcing foreign investors to withdraw and sell the currencies concerned.

Chart 1 shows both Taiwan and India have the largest increase in equity position in money terms YTD and in the week starting 29 January.





How do we know how much of the equity position increase is contributed to by foreign flows? We can tell this by comparing the equity position change in a country with its currency flows.

Chart 2 shows that India is the only country that saw notable FX inflows in the week starting 29 Jan. Based on the Charts, we can deduce that INR probably will be under more pressure than other currencies in the region if equities head south further.

In contrast, MYR and THB are likely to be relatively less vulnerable in response to a near-term worsening of the equity market outlook. By making reference to FX flows and equity positional changes, without considering fundamentals, we deduce that KRW is also likely to be a less vulnerable candidate in the region.

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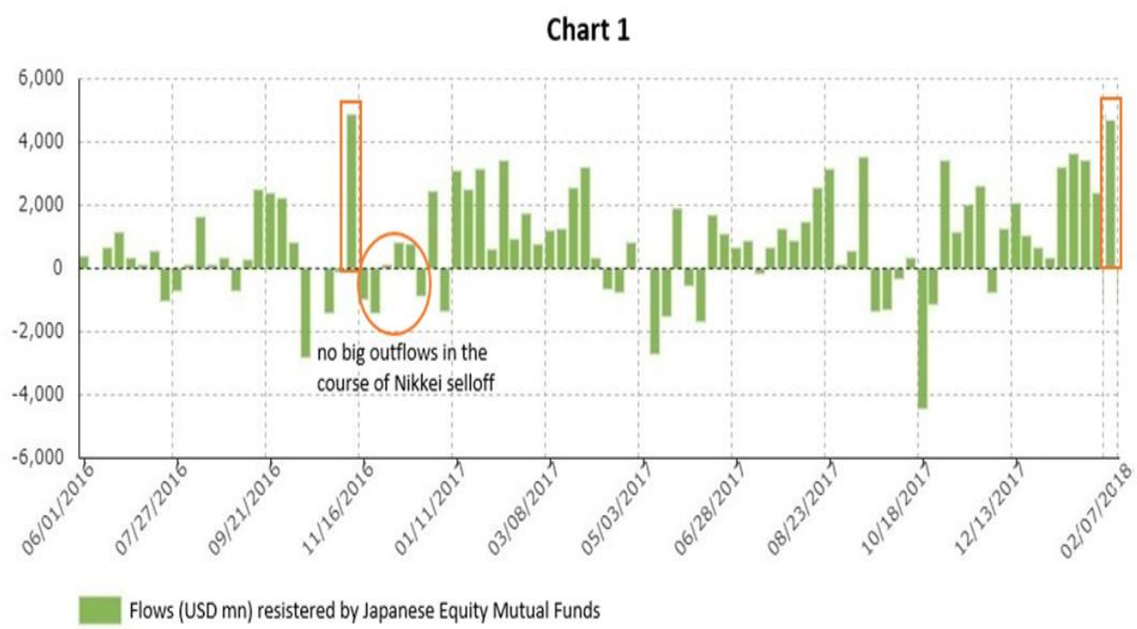
Japanese Equity Funds: Leveraged ETFs Look In Better Shape

By Tim Cheung, IGM Head 0f China; Riki Zhang, Analyst

Looking at Japanese equity funds in the current risk-off market, it is interesting to consider what happened in early-November 2016, just before the Nikkei 225 topped out at 17,400, before starting to dive towards 16,200 in the week ended 9 November 2016.

According to fund flow data from EPFR, Japanese equity mutual funds (chart 1) received USD4846.44mn (largest inflow since mid-Sep 2015) during this period. Coincidentally, last week they received as much as USD4732,92mn, the largest weekly inflow since 9 November 2016, when the Nikkei was starting to plunge.

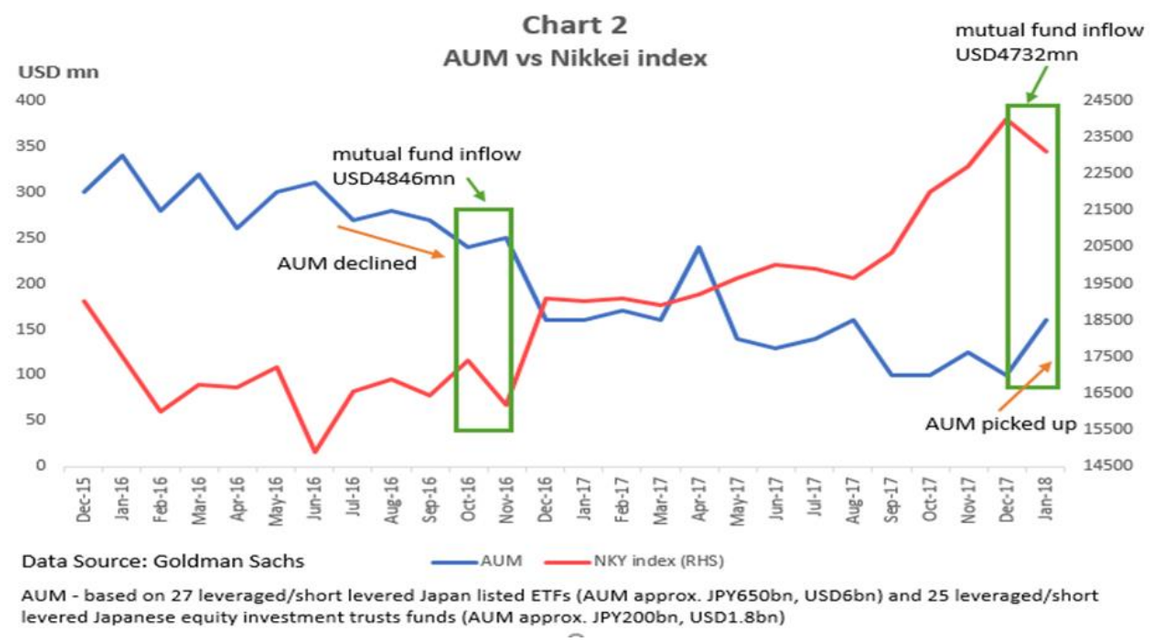
Both events suggest Japanese equity mutual funds always draw heavy subscriptions before/when the Nikkei 225 makes an inverted V-shaped about turn.



More interesting are leveraged/short levered Japan listed ETFs.

Here we find a very meaningful picture developing, which suggests these funds saw an increase in AUM (chart 2) in the course of the Nikkei selloff on the aforementioned two occasions.

In Japan, leveraged/short levered ETFs generally amplify 2x and 3x or negative 2x and 3x the returns of an underlying index by using financial derivatives or equity-borrowing in the case of short levered funds. A leveraged/short levered ETF here typically uses futures contracts to magnify the exposure to an underlying index, and typically follows the daily price changes.



In our view, there is a group of players particularly interested in making bets on a Nikkei plunge whenever Japanese equity mutual funds see unusually huge inflows (namely retail flows) in an environment where the Nikkei's exhaustion rally is about to end.

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Japanese Equity Funds: Leveraged ETFs look in better shape cont'd

If we look at retail flows in the November 2016 plunge carefully, we find that no huge outflows (chart 1) occurred when the Nikkei was diving. That might be one of the reasons why the November 2016 selloff was so short-lived. Another reason for the selloff being short-lived is that leveraged funds did not see a notable increase in AUM in the weeks before the November 2016 plunge occurred. In other words, no huge bets were placed on the table by these funds at the time.

In contrast, leveraged/short levered ETFs this time round have seen a sustained increase in AUM since early-January. This suggests they are now already equipped with much bigger bearish positions. Bigger bets understandably have a better chance of triggering sharper moves. As such, the ongoing selloff might not be as short-lived as the one in November 2016.

If bigger outflows (say USD1500mn on weekly basis) happen in the following weeks, then we can conclude retail investors trapped in mutual funds might be fleeing for their lives. As a result, there is a risk of a selloff far more severe than that experienced in November 2016.

Riksbank Outlook: Meeting Marred By Latest Equity Rout

By Rachel Bex, Senior FX Analyst

The Riksbank's next policy decision is due on the 14th February, and while tentative calls for a more hawkish statement had filtered through during January, latest risks to global growth emanating from huge equity fall outs suggest caution will be more readily exercised from Ingves and Co.

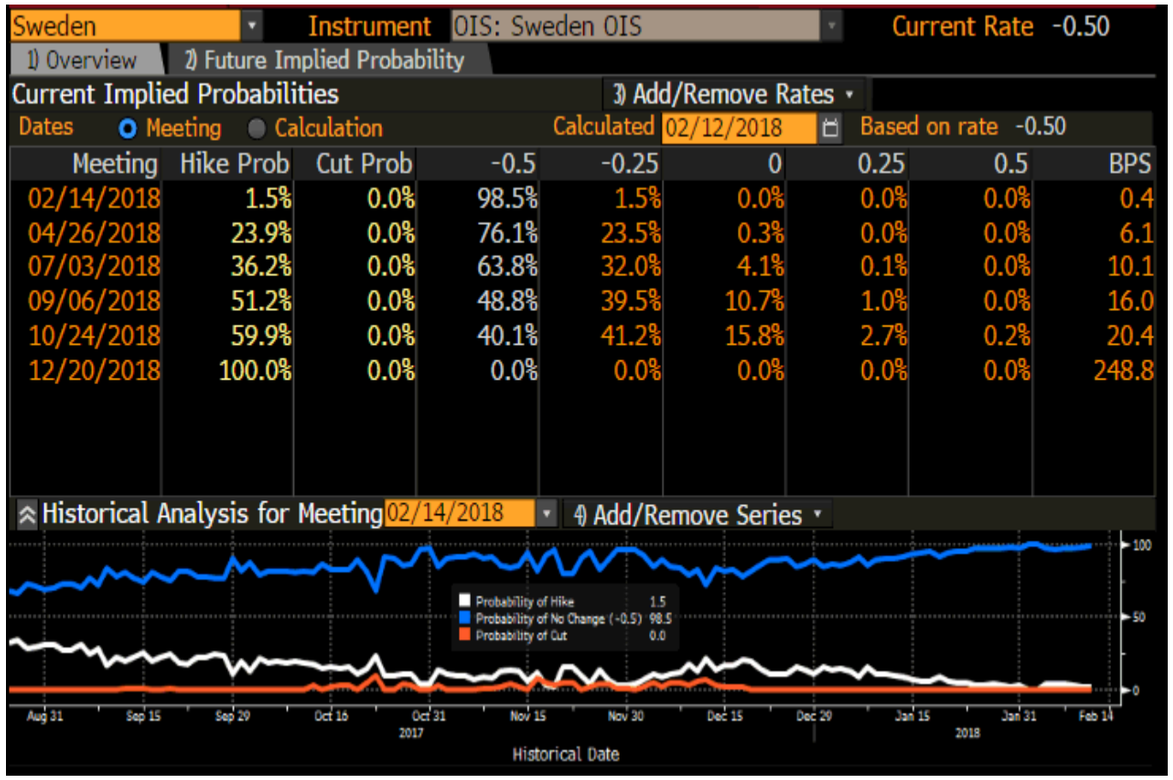
At the last meeting, the Riksbank continued to project its first rate hike to come mid-2018, and has conceded that tightening will likely begin before the ECB starts hiking. CB members continued to exercise caution over policy, however, warning that housing will become a worry if it affects inflation, while low wages pressure are also envisaged going forward. The inflation developments have been broadly in line with estimates, but members want to see inflation stabilize around 2% before tightening can begin. Note, CPIF for December came in at 1.9% y/y as forecast.

Since the December meeting, fairly hawkish comments from various CB members have been heard. The Riksbank's first Deputy Governor af Jochnick has highlighted the “very hot" labor market (perhaps suggesting that too much dovishness is priced into markets), while Ingves has conceded that inflation is now at the CB's target.

With housing market risks also being largely played down and the problem of unwanted Sek strength (to some extent) taken care of in recent sessions as the Krona gets linked to global growth concerns (Eur/Sek hitting 10.00 in recent exchanges), surely all the Riksbank's boxes have now been ticked?

Nonetheless, with January's inflation figures coming hot on the tails of the decision (data due February 20th), we suspect a relatively balanced, neutral statement will be published, with the CB no doubt wanting to see a few more months of near-target CPIF figures before pulling the trigger on rates.

Market pricing (via Bbg – see graphic) currently sees just over a 50% chance of a hike in September, 60% priced for October, and 100% priced for December.



Meeting	Hike Prob	Cut Prob	-0.5	-0.25	0	0.25	0.5	BPS
02/14/2018	1.5%	0.0%	98.5%	1.5%	0.0%	0.0%	0.0%	0.4
04/26/2018	23.9%	0.0%	76.1%	23.5%	0.3%	0.0%	0.0%	6.1
07/03/2018	36.2%	0.0%	63.8%	32.0%	4.1%	0.1%	0.0%	10.1
09/06/2018	51.2%	0.0%	48.8%	39.5%	10.7%	1.0%	0.0%	16.0
10/24/2018	59.9%	0.0%	40.1%	41.2%	15.8%	2.7%	0.2%	20.4
12/20/2018	100.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	248.8

Meanwhile, Eur/Sek has rallied around 2.5% on the month so far as risk aversion gets the better of price action. The strong growth story in Europe and expectations for the ECB to start normalising policy this year have also bolstered the single currency in its own right - particularly as players look for alternatives to long the Eur as Eur/Yen and Eur/Usd falter. Unless the Riksbank offers a strong signals for a September hike, so bias in the pair looks skewed higher.

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EUR/SEK – Rebound Near 50% Retrace Suggests Fresh Highs Ahead

Technical Analysis by Andrew Dowdell

Bulls re-established a foothold at 9.7458, near the 50% retracement of the Aug-Dec 2017 rally at 9.7428.

Weekly Stochastics have unwound from overbought levels and are now on the verge of crossing higher.

Scope is seen for a renewed attempt on the 2017/2016 peaks at 10.0333 and 10.0833 respectively.

Above there would target an equality projection at 10.3268, possibly 61.8% of the 2009-2012 fall at 10.4096.

Below 9.8255 threatens further congestion, but bears need to breach the 9.7067/9.6678 area to weaken

Resistance Levels		
R5	**10.4096**	61.8% of the March 2009-August 2012 (11.7896-8.1771) fall
R4	**10.3268**	1x 9.4523-10.0333 projected off 9.7458
R3	**10.0833**	9 November 2016 high
R2	**10.0333**	11/12 December 2017 high
R1	**9.9792**	25 December 2017 high
Support Levels		
S1	**9.8255**	5 February 2018 low
S2	**9.7458**	31 January 2018 low, near 50% of 9.4523-10.0333 rally at 9.7428
S3	**9.7067**	9 November 2017 low
S4	**9.6742**	61.8% of 9.4523-10.0333 rally, near the 29 September 2017 high at 9.6678
S5	**9.4523**	31 August 2017 low

STRATEGY SUMMARY

Look to buy for gains to 10.3268. Place stop below 9.8255.

IFI Research's global team of Technical Analysts constantly look for interesting patterns in prevailing price action of a broad range of currency pairs, fixed income and commodity products. We will highlight the most compelling on these pages. For information on the full spectrum covered, please contact your Account Manager.

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Swedish 10-Year Yield – Poised For Yield Strength Targeting 1.142-1.177

Technical Analysis by Ed Blake

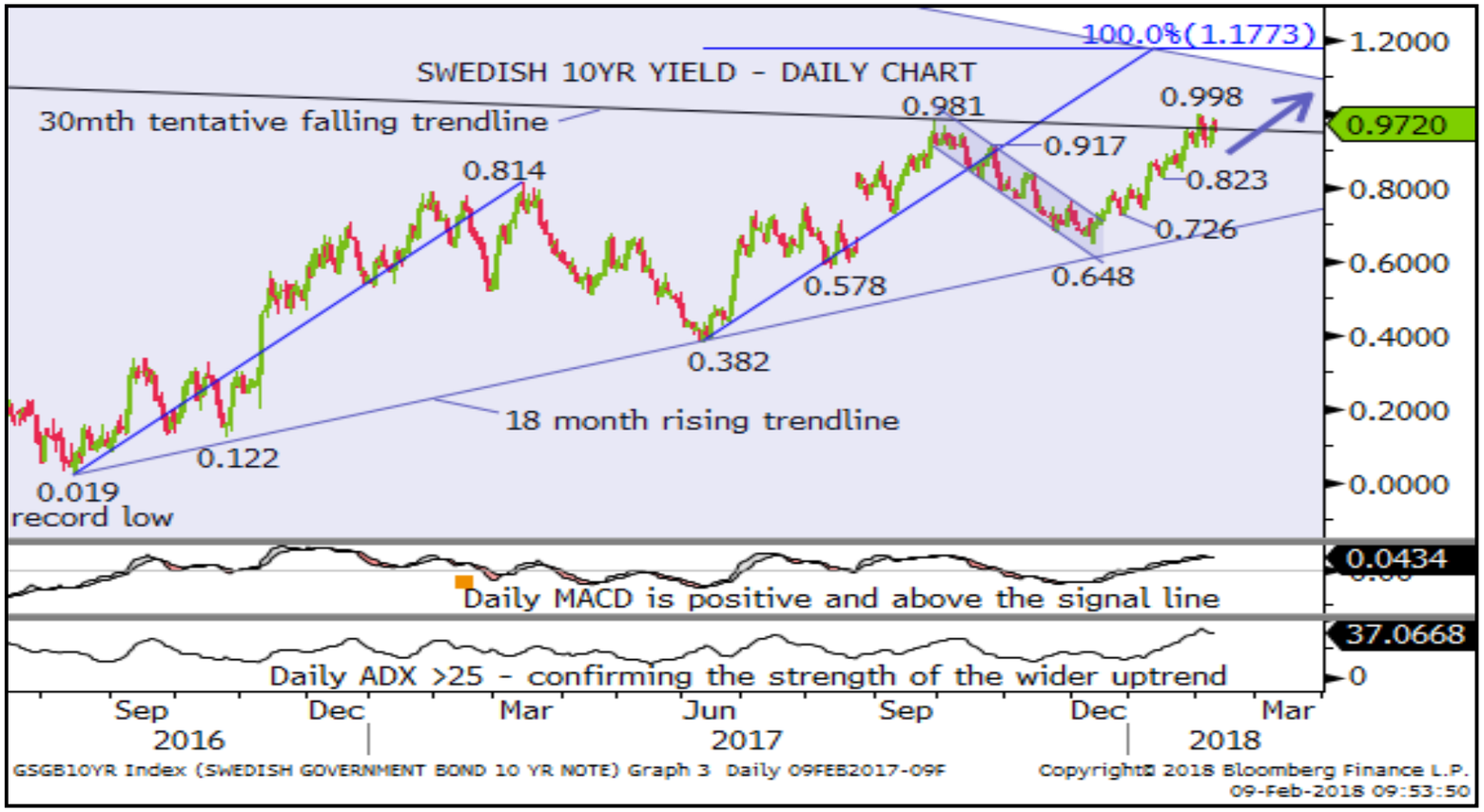
Extended the l-term uptrend over a 30mth tentative falling trendline at 0.950 to reach 0.998, before ranging.

Daily-monthly studies remain constructive and should underpin an upside extension to new 25 month highs.

Initial resistance is pegged at 1.076, beyond which opens strong clustered resistance between 1.142-1.177.

This marks 9½yr bear channel resis (1.142), 11 June 15 peak (1.145) and an equality projection off 0.382 (1.177).

Near term corrective dips remain possible but only under 0.823 (17 Jan low) would caution for the 0.648-0.726 support zone



Resistance Levels		
R5	1.383	50% retrace of 2.749/0.019, near 1.236 projection of 0.019/0.814 from 0.382 at 1.365
R4	1.294	23 October 2014 lower high
R3	1.145	2015 top - 11 June, nr 9½yr bear channel top (1.142) and 1x 0.019/0.814 from 0.382 (1.177)
R2	1.076	28 December 2015 lower high, near 38.2% of 2.749/0.019 fall at 1.061
R1	0.998	2018 high - 2 February, near .764 projection of 0.019/0.814 from 0.382 at 0.990
Support Levels		
S1	0.906	6 February 2018 low
S2	0.823	17 January 2018 low
S3	0.726	27 December 2017 low
S4	0.648	12 December 2017 higher low, near an 18mth rising trendline at 0.674
S5	0.578	11 August 2017 higher low

STRATEGY SUMMARY

Buy into any near term corrective dips as we await an extension of the long term uptrend targeting 1.076 and then the 1.142-1.177 cluster. Place a projective stop under support at 0.823.

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