XTB Limited

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Trading ideas for 2017

Analysis and outlook

XTB Research

Key takeaways

2016 will be remembered as a year where economics took a backseat to politics in being the main driving force for the financial markets

2017 is a different story, though. Firstly, the ongoing political uncertainty is not going anywhere any time soon

GBP is one of the very few currencies that has dodged the latest phase of the global appreciation of the US dollar. It does not mean that the British pound is expensive or overvalued

2016 will be remembered as a year where economics took a backseat to politics in being the main driving force for the financial markets, with Brexit and Trump's unexpected victories causing shockwaves from London to New York. The pound plunged, stock markets around the globe have soared and Gold has endured a rollercoaster ride. But with 2017 on the horizon and higher rates in the US looming while the threat of political turmoil in Europe lingers with French and German general elections, how will 2017 shape up and how could you trade it?

We've listed 6 trade idea's for you to consider as part of your 2017 trading portfolio.

1. **DE30**
2. **AUDUSD**
3. **PLATINUM-GOLD**
4. **WHEAT**
5. **MXNHUF**
6. **GBPUSD**

Trade 1

DE30

2017 is a different story for the DAX

The German blue-chip index DE30 (DAX underlying) has been one of the strongest indices on the market for the second half of 2016. Firstly, the ongoing political uncertainty is not going anywhere any time soon. Monetary policy is also another factor to watch

The German blue-chip index DE30 (DAX underlying) has been one of the strongest indices on the market for the second half of 2016. It dodged all the potentially lethal bullets - like the Brexit vote, Italian referendum or the US elections - and even a slightly less accommodative monetary policy in Europe combined with US interest rate increases failed to discourage investors from piling up German shares.

2017 is a different story, though. Firstly, the ongoing political uncertainty is not going anywhere any time soon. The markets might have digested the potentially destabilising choices from the UK and Italy in 2016, but worries may begin to mount once more at some point; we're facing presidential elections in France in the spring, snap elections in Italy over the summer and parliamentary elections in Germany in the autumn. In all three cases, the concept of a united Europe might be tested as the 'populist' movement seems to be on the rise across the continent.

Monetary policy is also another factor to watch. Yes, the ECB maintains a highly accommodative approach to monetary policy, yet asset purchases will be conducted at a reduced pace from April. Do notice that the DE30 surged the most between September 2014 and March 2015 in anticipation of this large government bond purchasing program. While a modest recovery in Europe is generally a positive thing, investors might become concerned about the tapering of this program at some point. Looking at valuations, the DE30 is not cheap. With a price to earnings ratio (P/E) above 17, it could be considered by investors as overvalued.

Technically, the DE30 does not currently look bearish but there will be four key resistance zones ahead: 11440, 11735, 12000 and 12440. On a D1 or W1 intervals at that point (bearish engulfment, shooting star, outside bar) could provide interesting selling opportunities for traders.

Trade 2

AUDUSD

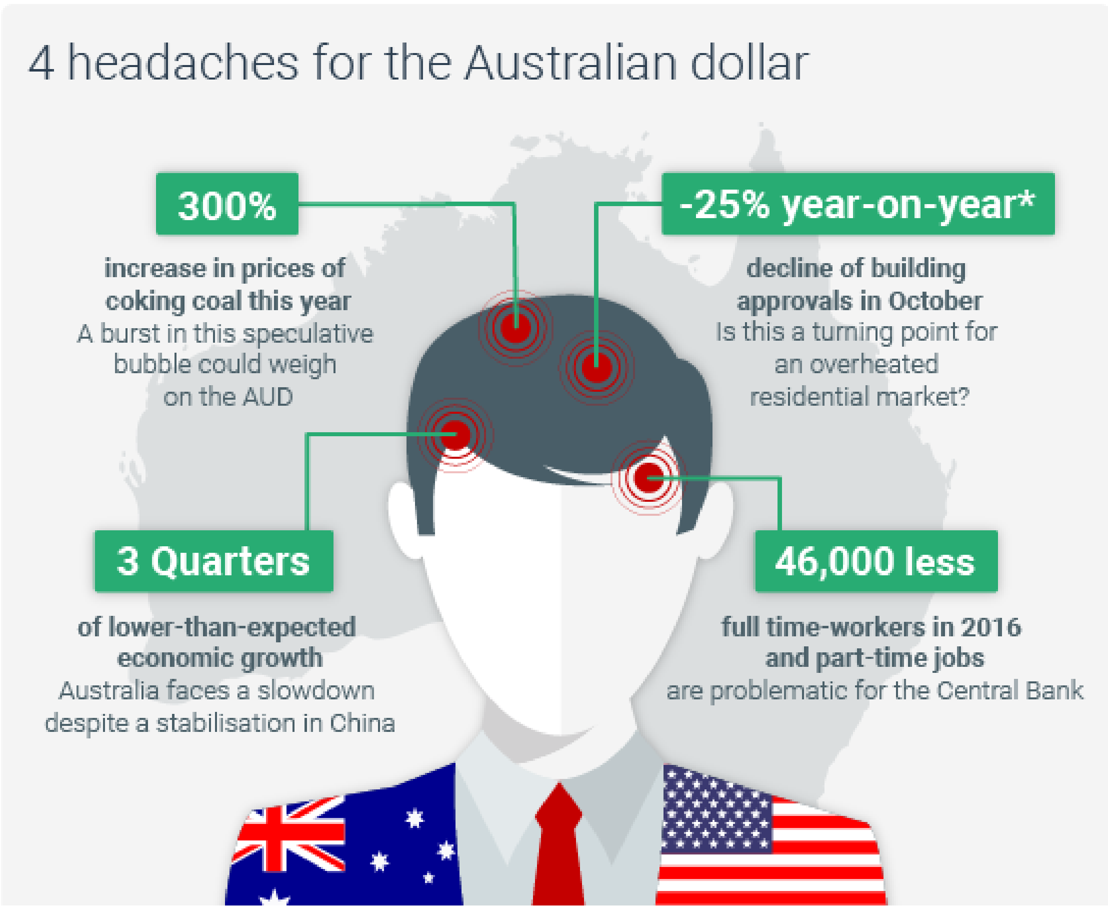
Balance of risks for the Aussie seems to be negative

Commodities like iron ore and coking coal, whose prices surged in recent months, could see a significant correction at some point and this could weigh on AUD. The Australian economic outlook is also deteriorating.

The AUDUSD currency pair is trading relatively high despite the US dollar following the US elections. While USD remained strong and the US dollar index soared to multiyear highs, equities and industrial commodities (of which Australia is an important global supplier) advanced as well, supporting the Australian currency. Nevertheless, a balance of risks for the Aussie seems to be negative.

Commodities like iron ore and coking coal, whose prices surged in recent months, could see a significant correction at some point and this could weigh on AUD. In the case of both commodities, a rally is a result of speculative trading fuelled by a rapid credit expansion in China. Let us recall that China avoided a deeper slowdown in 2016 but it came at the cost of a credit expansion considered unsustainable by many. A significant amount of new credit found its way to a real estate market, causing both a direct and indirect speculative rally on industrial metals. China would need to curb credit expansion at some point. Obviously a major slowdown in the Chinese economy, which remains a risk, would be the worst-case scenario for industrial metals and the Aussie.

The Australian economic outlook is also deteriorating. Recent negative surprises include worse-than-expected GDP growth in Q3, a lack of rebound of business investment, as well as declining industrial output, full-time employment and consumer sentiment. What's more, the housing sector is showing some fragility, as evidenced by a huge decline in building approvals. Higher expectations for future rates in the US could push USD higher and at the same time a relatively weak economic outlook should limit such moves in Australia. As a result, bond yield spreads could change in favour of the US dollar which could be negative for AUDUSD.



* October 2016

Source: Bloomberg, Macrobond, XTB Research

Trade 3

Platinum - Gold

Platinum may perform better than gold in 2017

Prices of platinum and gold exhibit a relatively high correlation. Both are precious metals and therefore both are affected by a range of similar factors. However, they are not entirely similar..

In our previous report on gold released in November, we pointed out that gold prices may decline another 10% in a relatively short timeframe – they are more than halfway to that target at time of writing. Rising market interest rates in the US are negative for gold prices, a tendency that could be extended into 2017 - but given a relatively optimistic picture that has been already discounted by US bond yields. Platinum may perform better than gold in 2017.

Prices of platinum and gold exhibit a relatively high correlation. Both are precious metals and therefore both are affected by a range of similar factors. However, they are not entirely similar. Gold has a traditional 'safe-haven' status and therefore risk appetite plays a relatively more important role in its pricing. Platinum, like gold, is used for jewellery production and as an investment, but has a relatively high share of industrial demand. This may act in its favour. As investment demand for precious metals declines amid higher interest rates, metals will need other sources of demand. Gold could be in trouble here, because jewellery demand has been in a long-term decline. A demand for platinum from the car industry is relatively stable and may act as a buffer here. Moreover, we have seen a revival of jewellery demand for this metal recently.

Finally, one needs to notice that a ratio of platinum and gold prices is at multi-decade lows. Platinum output is much more concentrated geographically in comparison to gold, so any disruption may have a relatively bigger impact on prices. Looking from a reward to risk perspective, this "precious relationship" looks very attractive.

Source: Macrobond, XTB Research

Trade 4

Wheat

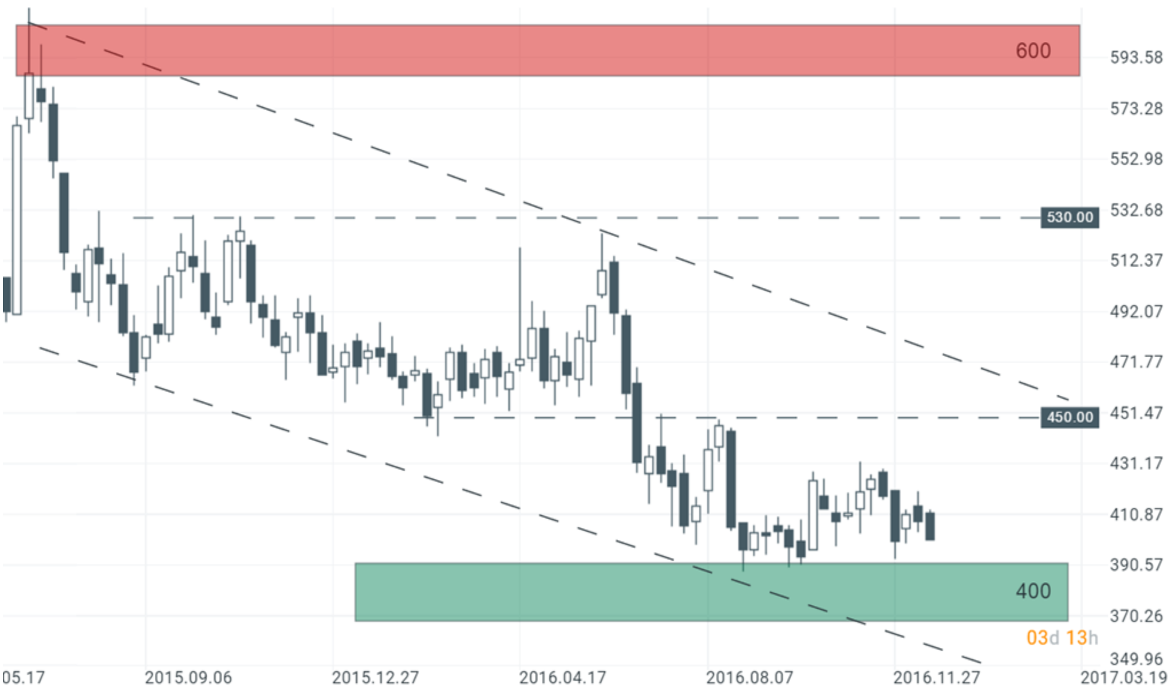
Consensus view is that wheat prices may remain depressed

The commodity was unable to replicate price recoveries on highly correlated corn and soybean amid a supply glut that eventually pushed prices to multi-year lows.

Wheat prices struggled throughout most of 2016. The commodity was unable to replicate price recoveries on highly correlated corn and soybean amid a supply glut that eventually pushed prices to multi-year lows. A bushel of wheat hovered around 400 cents in the second half of 2016, price levels not seen in a decade. While the consensus view is that wheat prices may remain depressed, we might see a good chance for them to recover.

The majority of wheat output, especially in the United States, comes from a winter grain. This means that wheat is sowed in the autumn and harvested in the spring. When the last winter grain was sowed in late 2015 prices were close to 600 cents per bushel. Now with prices 30% lower, many farmers in the US may find wheat output unprofitable, even after subsidies, and could have shifted to soybean or corn. There are some early signs of this process already happening although more precise data will not be available until March. Furthermore, price developments made cotton more profitable and while it's not a natural substitute, some farmers may decide to change their production profile given the persistence of low prices.

While appreciation of the US dollar has exerted a downward pressure on USD-denominated wheat prices, we expect the US dollar to make only modest gains in 2017 so this factor should no longer be a major obstacle to price advances. Despite currency strength, the wheat export outlook (according to United States Department of Agriculture or USDA) has not been that good since 2014. Last but not least, agricultural commodities are prone to weather disruptions. These were largely absent in recent years which resulted in a high supply and low prices. This is a factor which cannot be forecasted precisely but we could make a case that current prices do not reflect a risk of such disturbances. Therefore the relationship of reward to risk could be very attractive on this market and we could see higher wheat prices in 2017.



Trade 5

MXNHUF (USDHUF and USDMXN)

Emerging market currencies are becoming increasingly popular in the FX market

This trade idea is based on a combination of an extremely low valuation of the peso versus the forint (based on historical levels) and expectations that many threats from the US presidential campaign will not become reality.

This trade may look exotic, but the truth is that emerging market currencies are becoming increasingly popular in the FX market and may offer interesting and potentially lucrative opportunities. The Mexican peso has been one of the biggest losers of 2016 on the back of Donald Trump's aggressive rhetoric towards Mexico during the campaign and his eventual victory in the presidential elections. Meanwhile, the Hungarian forint has managed to dodge the bulk of global USD appreciation and is down only some 3% against the US dollar in 2016 at time of writing. As a result, the MXNHUF has revisited a multi-year low from a financial crisis in which we also witnessed extremely low oil prices.

From a fundamental perspective, both Mexico and Hungary have ups and downs. Growth of the Mexican economy has been decelerating recently and yet the central bank had to increase interest rates to prevent a build-up of inflationary pressures. We have seen a significant growth slowdown in Hungary as well but in this case, the central bank has kept rates very low and has actually introduced some non-standard measures to promote growth. Although inflation is two percentage points lower in Hungary, inflation adjusted interest rates are much higher in Mexico, making the MXN more attractive for investors. Hungary stands out when it comes to external balances, exhibiting current account surplus equal to ca. 6% of the GDP while Mexico has a modest deficit of 3% GDP. However, the external position of Hungary is set to deteriorate as a result of higher energy prices, a tendency that should support oil industry in Mexico. Looking forward, Mexico could benefit more from a recovery in the United States.

This trade idea is based on a combination of an extremely low valuation of the peso versus the forint (based on historical levels) and expectations that many threats from the US presidential campaign will not become reality. Looking at real exchange rates over the past 15 years the peso is the most undervalued and the forint the most overvalued in a group consisting of BRL, HUF, MXN, PLN, TRY and ZAR. If president Donald Trump turns out to be more pragmatic than his presidential candidate suggested, those valuations could be corrected and the MXN could gain versus the HUF in 2017.

MXN 2nd most popular emerging market currency in the world		HUF 3rd most popular emerging market currency in Europe
2%	GDP growth*	1.6%
3.3%	Inflation rate**	1%
5.25%	Central bank rate**	0.9%
-15.1%	Change vs USD***	-2.1%

* for Q3'16, in y/y terms
** November 2016
*** between 2016.01.04 and 2016.12.14

Source: BIS, Macrobond, XTB Research

Trade 6

GBPUSD

The UK economy has done relatively well since the Brexit vote

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GBP is one of the very few currencies that has dodged the latest phase of the global appreciation of the US dollar. It does not mean that the British pound is expensive or overvalued. Actually the GBPUSD currency pair is down over 18% since the Brexit vote. While the British currency has recovered some of the losses, a further significant appreciation vs the US dollar would be unjustified, and could create a trading opportunity.

The UK economy has done relatively well since the Brexit vote, given dreadful expectations. We saw a short-lived plunge in sentiment but generally business surveys improved, even above pre-referendum levels in some cases, and consumer spending remained strong. We are yet to see a significant negative impact on the labour market. However, the pound collapsed in October despite these signs amid the “Hard Brexit” talk from UK politicians. As both the UK and Europe prepare themselves for tough negotiations, the UK government continues to send signals that it may introduce stringent controls on immigration even at risk of losing access to a single European market. As political climate warmed up on both sides of the English channel the pound was able to recover quite substantially.

While the worst-case scenario of a “Hard Brexit” may not materialize, the scope for further advances in the GBPUSD could be limited. Even if the UK economy avoids a sharp slowdown next year, the Bank of England is unlikely to depart from its expansionary policy any time soon as the negative impact of Brexit related uncertainty may linger for years. The 10-year bond market yield spread suggests that in fact the GBPUSD rate could be below 1.20. Therefore any rallies could be seen as potential selling opportunities. The technical level of 1.2850 should be watched carefully in the coming months as an important and strong resistance level.

About the author

David began his career trading Brent futures on a prop desk, after completing an MSc in Banking and Finance at Newcastle University. Whilst David's approach is predominantly technical he is well aware of fundamental drivers impacting markets and uses a combination of both when selecting his trades. David is the chief architect of XTB's Chart of the Week and can be seen at XTB's Trading Club each week at our London HQ.

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