STOXX

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"Choose always the way that seems the best, however rough it may be; custom will soon render it easy and agreeable."

– Pythagoras (c. 570 BC–c. 495 BC)

A HIGHER VOLATILITY SCENARIO MATERIALIZES IN GLOBAL MARKETS AMID THE "FRANCOGEDDON" MOVE AND EXPECTATIONS OF AN AGGRESSIVE ECB BOND BUYING

U.S. stock markets declined for a fifth trading session in a row on Jan. 15 amid disappointing banks results and investors' concerns about the potential impact of a scenario of global faltering economic growth on U.S. corporate earnings.

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In a move that social media dubbed "Francogeddon", the Swiss National Bank (SNB) on Jan. 15 unexpectedly discontinued the 1.20 floor on the euro/Swiss franc exchange rate that was introduced in September 2011. At the same time, after sending the interest rate on cash deposits held by commercial banks and other financial institutions into negative territory for the first time since the 1970s in December last year, the SNB also cut another 50 basis points to -0.75%. In addition to lowering the sight deposit rate, the SNB announced it would move the target range for the three-month Libor further into negative territory, to between –1.25% and -0.25%, from the current range of between -0.75% and 0.25%. The move pre-empted one week earlier the ECB expected announcement of a massive bond-buying program and aimed at weakening an appreciation pattern of the Swiss franc by enforcing disincentives on safe haven flows. Nonetheless, on the same day it triggered a tsunami in global markets as it sent the safe haven currency to climb against both the euro and the US dollar, and Swiss stocks to capitulate in the largest one-day market drop in at least 25 years (-8.67% for the Swiss Market Index).
With Eurozone accounting for about 46% of Swiss overall foreign trade, export oriented Swiss firms, as well as Swiss banks, tumbled on the same day. Among Swiss watchmakers, on Dec. 15 close compared with previous day's, shares of the Swatch Group plunged 16.35%, while Compagnie Financière Richemont dipped 15.5%. Similarly, on the same day UBS, Julius Baer, and Credit Suisse dropped 11.74%, 11.46%, and 10.99%, respectively. Large speculators, namely macro hedge funds, remained caught in a trap as they awoke to one of the major daily shocks in the FX markets in years. In fact, according to the Commodity Futures Trading Commission (CFTC) Commitment of Reports data available as of Jan. 15, 2015 market close, large speculators net-short positions outstanding in the Swiss franc FX delta-adjusted options and futures combined totaled to 24,833 contracts (corresponding to an overall notional value of CHF3.10 bn on Jan. 6, 2014).

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On Feb. 7, 2014 Germany's Constitutional Court announced its decision to refer a complaint against the European Central Bank's Outright Monetary Transactions (OMT) program to the European Court of Justice, saying that the plan exceeded the ECB's mandate and violated a ban on it funding governments. The German court affirmed: "Subject to the interpretation by the Court of Justice of the European Union, the Federal Constitutional Court considers the OMT decision incompatible with primary law". Given the Germany's Constitutional Court did not declare the OMT program illegal under the German law, it deferred to Europe's top court, as the matter pertain to European law. On Jan. 14, a favorable pronunciation of the European Court of Justice, which affirmed that the ECB's pledge to do "whatever it takes" to save the single currency and reignite a pattern of economic growth was compatible with EU law, paved the way for a more aggressive ECB bond-buying program next week. Nonetheless, it will be interesting to monitor the magnitude of the bond-buying program that will be announced at the ECB Governing Council meeting next week, just three days ahead of a critical election in Greece.

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Political elections in Greece and the Grexit argument took the center stage at the beginning of the week in Europe. Syriza, the leftist anti-bailout party that is on top of polls ahead of Greek general elections, has urged a write-down on some of the national debt of about 180 percent of GDP. Greece,

which has already been granted better conditions on repayment terms on emergency loans, is expected to take advantage of "*further measures and assistance*" to relieve its debt burden. Opinions on a Grexit argument differed, though. According to the German newspaper Der Spiegel, German Chancellor Angela Merkel and the finance minister Wolfgang Schäuble believed that the Eurozone has implemented sufficient buffers to withstand the exit of Greece. On the opposite side, recent comments by Olli Rehn, a former European Union economic and monetary affairs commissioner, stressed how Greece is unlikely to win any write-down on outstanding debt owed to the Eurozone and should instead focus on possible relief in the form of longer repayment periods.
On a similar position, Finland's prime minister tough stance stressed his "resounding no" to a debt write-down and his reluctance to back another extension of the 172 billion euro bailout deal.
Despite emerging in 2014 from a six-year recession and returning to bond markets for the first time since 2010, Greece remains the weakest link in the Eurozone. Greek bond yield curve inverted on Dec. 9, 2014 factoring in additional debt write-downs as the Greek prime minister Antonis Samaras brought forward a presidential vote.
We believe that a Grexit scenario will not materialize as a result of Syriza winning Greece's elections on Jan. 25. Rather, a renegotiation of repayment terms and a potential new bailout deal on outstanding debt is the most likely scenario. The Eurozone has a vested interest to avoid any potential contagion effect arising from a Grexit argument ahead of a critical election in Spain later this year. Podemos, a new anti-establishment movement that was founded at the beginning of 2014 by a group of Complutense University academics in Madrid, surprised analysts by gaining 8% of the national vote in European Parliament elections in May last year. Currently, Podemos is on top of political party polls in Spain and will capitalize on the political elections in Greece. Pablo Iglesias, the Podemos leader, is expected to appear at a Syriza electoral talk next week and reap benefits from a mutual support.

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Confirming the outlook forecast published by STOXX in October last year in the research paper "*A Tale of German Economic Success and Superior Competitiveness*" the price-adjusted GDP for Germany rose by 1.5% for 2014, well above the average of the last ten years of 1.2%. Employment levels along with real wage increases sustained economic growth in Germany as disposable household income boosted consumption growth. "Obviously, the German economy turned out to be strong in a difficult global economic environment, benefiting especially from a strong domestic demand", said Roderich Egeler, President of the German Federal Statistical Office (Destatis) at a press conference in Berlin on Jan. 15.
According to preliminary readings published by Destatis, on the use side of the GDP, final consumption expenditure was the main driver of German economic growth. Household final consumption expenditure rose a price-adjusted 1.1% for 2014, while government final consumption expenditure increased 1.0%. Capital formation rose, too. In the domestic territory, gross fixed capital formation in machinery and equipment by businesses and general government together was up 3.7% on a year earlier. Also, price-adjusted gross fixed capital formation in construction increased remarkably by 3.4%. Gross fixed capital formation in other products – which includes expenditure on research and development since the major revision of national accounts of summer 2014 – rose 1.2% year on year. Despite a continuing difficult external economic environment, German foreign trade was slightly more dynamic on an annual average in 2014. German exports of goods and services rose a price-adjusted 3.7% compared to a year earlier. However, imports rose almost as strongly (+3.3%). The balance of exports and imports thus made a relatively small contribution of +0.4 percentage points to GDP growth for 2014.

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Just one week after consumer price data for the Eurozone confirmed the euro area slipped into the dangerous territory of deflation, Destatis data on German consumer prices showed an easing pattern at the end of the year.

In December 2014, as energy prices stayed on a sliding pattern, consumer prices were flat compared to the previous month's reading. As reported by Destatis, it is worth noting the seasonal price increase for package holidays (+12.2%) and the rise in prices of information processing equipment (+5.6%). Due to the annual changes in fares, rail fares were up towards the end of 2014 (+0.7%; of which long-distance rail transport: +0.3%; short-distance rail transport: +2.9%). Modest price increases were also observed for food as a whole (+0.4%, including fruit: +3.3%). Price decreases were observed for clothing and footwear (–0.9%, including footwear and accessories: -2.8%). A favorable development for consumers was the continued decline in prices of mineral oil products (–8.6%, of which heating oil: -14.2%, motor fuels: -7.0%). The price of energy as a whole dropped by 3.9% compared with November 2014.

Year on year, in December 2014, the inflation rate was +0.2%, after +0.6% in November and +0.8% between July and October.

A stronger decline was observed in the prices of energy products at the end of the year. The price of energy as a whole dropped by 6.6% compared with Dec. 2013. Considerable price decreases were observed for heating oil (–22.8%) and motor fuels (–12.1%). The prices of other household energy products declined to a lower extent (amongst others, gas: –1.4%), while electricity prices showed an increase (+1.9%). As a result, energy prices as a whole had a considerable effect on the inflation rate in December 2014. In fact, excluding energy prices, the inflation rate in December 2014 was +1.0%.

The prices of food and non-alcoholic beverages were slightly down in December 2014 from the same month a year earlier (–0.6%, including food: -1.2%). The prices of edible fats and oils (–10.7%) and of vegetables (–7.9%) posted a particularly strong decline. Compared with December 2013, consumers also paid less for dairy products and eggs (–0.9%) and for meat and meat products (–0.6%). However, marked price increases were recorded for coffee, tea and cocoa (+11.1%).

As noted by Destatis, particularly striking were the opposite price developments observed for goods (–1.2%) and services (+1.4%) year on year in December 2014. Prices of goods declined mainly as a result of decreasing energy and food prices. A ecline in prices was also recorded for consumer electronics (–7.1%) and telephones (–6.4%). Marked price rises were observed only for few goods like pharmaceutical products (+4.9%) and newspapers and periodicals (+4.2%). Prices of services increased mainly as a result of higher net rents exclusive of heating expenses (+1.4%). Other price increases were observed for services of social facilities (+4.0%) and hairdresser services and other services for personal care (+3.0%), while telecommunication services were slightly cheaper (–1.0%).

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According to estimates published from Eurostat on January 14, in November 2014 compared with the previous month, seasonally adjusted industrial production rose by 0.2% in both the Eurozone (EA18) and the broader European Union (EU28). In Oct. 2014 industrial production rose by 0.3% in both areas.

In November 2014 compared with the reading a year earlier, industrial production decreased by 0.4% in the Eurozone and by 0.1% in the broader European Union.

The increase of 0.2% in industrial production in the Eurozone in November 2014, compared with October 2014, was attributable to production of durable consumer goods rising by 1.9%, non-durable consumer goods by 0.5% and intermediate goods by 0.3%, while capital goods declined by 0.2% and energy by 0.9%.

In the EU28, the increase of 0.2% was attributable to production of durable consumer goods rising by 1.7%, non-durable consumer goods by 0.5% and intermediate goods by 0.4%, while capital goods dropped by 0.1% and energy by 1.0%.

The highest increases in industrial production were observed in Ireland (+4.6%), Hungary (+3.3%) and Croatia (+2.7%), while the largest decreases in Lithuania (-2.0%), Latvia (-1.7%) and Malta (-1.4%).

The decrease of 0.4% in industrial production in the Eurozone in November 2014, compared with the same reading a year earlier, was attributable to production of energy falling by 4.8%, capital goods by 0.9% and intermediate goods by 0.6%, while durable consumer goods rose by 0.4% and non-durable consumer goods by 3.2%. In the broader European Union, the decrease of 0.1% was attributable to production of energy declining by 4.4% and capital goods by 0.4%. Intermediate goods remained stable, while durable consumer goods rose by 2.4% and non-durable consumer goods increased by 2.5%. Year on year, the largest decreases in industrial production were observed in Sweden (-3.9%), the Netherlands (-3.5%), Slovakia (-3.3%) and France (-2.9%), while the largest increases were posted by Ireland (+35.8%), Hungary (+5.8%), Estonia (+4.9%) and the Czech Republic (+4.7%).

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According to data published by Eurostat, Eurozone annual inflation came in -0.2% in December 2014, down from 0.3% in November. This was the lowest rate recorded since September 2009. In December 2013 the rate was 0.8%. The broader European Union annual inflation was -0.1% in December 2014, down from 0.3% in November. A year earlier the rate was 1.0%. In December 2014, negative inflation annual rates were observed in sixteen Member States. The lowest annual rates were recorded in Greece (-2.5%), Bulgaria (-2.0%), Spain (-1.1%) and Cyprus (-1.0%). Conversely, the highest annual rates were observed in Romania (1.0%), Austria (0.8%) and Finland (0.6%). Month on month, annual inflation fell in twenty-six member states, remained stable in Sweden and rose in Estonia.
The biggest downward impacts on euro area annual inflation came from fuels for transport (-0.53 percentage points), heating oil (-0.17 percentage points) and telecommunications (-0.08 percentage points), while restaurants & cafés and rents (+0.11 percentage points each) and tobacco (+0.07 percentage points) had the largest upward impacts.

LIGHT AND SHADOWS – DAX CONSTITUENTS

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According to figures published at the beginning of the year by Deutsche Börse, in 2014 turnover at the cash markets of Deutsche Börse stood at EUR1.28 tn, up from a 2013 reading of EUR1.16 tn.
Order book turnover on Xetra, Börse Frankfurt and Tradegate stood at EUR108.9 bn in December (up from a December 2013 reading of EUR85.4 bn). Of the EUR108.9 bn for December 2014, EUR100.7 bn were attributable to Xetra (the corresponding reading for December 2013 was EUR77.2 bn), while EUR4.0 bn were attributable to Börse Frankfurt (the corresponding figure for December 2013 was EUR4.2 bn). Order book turnover on Tradegate Exchange amounted to approximately EUR4.3 bn in December (up from a December 2013 reading of EUR4.0 bn).
In equities, the turnover reached about EUR91.4 bn on Deutsche Börse's cash markets (Xetra: EUR85.6 bn, Börse Frankfurt: EUR1.9 bn, Tradegate Exchange: EUR3.9 bn). The turnover in bonds was EUR0.7 bn, and in structured products EUR1.3 bn. Order book turnover in ETFs/ETCs/ETNs amounted to EUR15.4 bn.

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The maker of Nivea skin cream Beiersdorf reported an expected increase in 2014 sales on Jan. 15 and confirmed its full-year profit target.

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As reported by Reuters news, an arbitration panel has denied U.S. brokerage firm Oppenheimer & Co's attempt to collect more than USD30 mn from Deutsche Bank AG related to the sale of auction-rate securities that the bank created.

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The Pimco Total Return Fund, one of the world's largest bond funds, part of the German multinational financial services company Allianz SE, closed December with an increase in U.S. government-related holdings and nearly get rid of

all its holdings of developed countries' foreign currencies-denominated government bonds. According to the firm's website, the Pimco Total Return Fund had 43.19% exposure in U.S. government-related securities in December, up from 37% the previous month.
In September last year, one of the firm's cofounder Bill Gross shocked markets by leaving Pimco for smaller rival Janus Capital. The move prompted massive outflows from the fund. Pimco reported at the beginning of January that its flagship Total Return Fund posted a 20th straight month of outflows in December to the tune of US dollar 19.4 bn. The fund's assets stood at US dollar 143.4 bn at the end of December, less than half the peak of nearly US dollar 293 bn recorded in 2013.

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According to the German financial regulator Bafin, low interest rates may lead some banks to take on unwarranted risks and lenders must sharpen their focus on business models and costs in a tough environment. Bafin president Elke Koenig said in the text of a speech that "There is the danger that banks go too far in terms of short-term profit seeking and build up long-term, massive risk positions that are out of proportion to their short-term gains." And she added "Mergers could help but are not a panacea."

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As reported by the German newspaper Handelsblatt, the Porsche division of the automaker Volkswagen is facing demands by Chinese dealerships for compensation payments for overstocked showrooms.
At a recent reception in Detroit Volkswagen Chief Executive Martin Winterkorn, admitted it may be tough for the German automaker to more than double VW brand sales to 800,000 cars by 2018. The carmaker recently announced that December sales rose 2.7% to 881,000 vehicles as sales across VW's multi-brand group rose at a higher growth pace in China and Europe, offsetting declining sales in the United States and Latin America. VW increased full-year deliveries by 4.2% to 10.14 million autos, meeting a 2007 target four years earlier than originally planned. Group sales in China rose 12.4% in 2014 to 3.67 mn cars, outpacing market growth and projected expectations for its largest single market.

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Daimler sees global demand for passenger cars rising around 4% in 2015. The automaker of Mercedes-Benz luxury brand aims to outgrow the market thanks to continued demand in China where momentum remains strong. As announced at the beginning of the week, the group's CEO Dieter Zetsche said he saw no signs of a significant slump in sales for Mercedes-Benz luxury cars in China.

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Moody's changed the outlook to stable from negative on Fresenius SE & Co. KGaA's Ba1 corporate family rating and Ba1-PD Probability of Default rating. Moody's also confirmed the ratings of Fresenius SE & Co. KGaA and of its guaranteed subsidiaries. The outlook on all ratings remained stable.

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In light of the recent slide in the price of oil, German airline Lufthansa said it expects its fuel bill for 2015 to drop to EUR5.8 bn from EUR6.7 bn in 2014. The company also confirmed its expectations of an operating profit for 2014 of around EUR1 bn, with 2015 earnings to be significantly above that reading.

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– Pythagoras (c. 570 BC–c. 495 BC)

The report was closed with information available as of the market close on Jan. 15, 2015.

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