MARKET OUTLOOK 2015
A YEAR OF OPPORTUNITY
2015 OUTLOOK

1 GLOBAL GROWTH OUTLOOK:
   With Europe, China and the UK all showing signs of slowing down, we assess whether the US can prop up global growth singlehandedly. We also look at what this means for global monetary policy and ask whether the Fed will bite the bullet and hike rates mid 2015. We also look at the prospect of QE from the ECB, and what the Europeans can do if deflation takes hold.

2 STOCKS: MAJOR INDICES OUTLOOK
   2014 has been another stunning year for US equities. We assess whether the market can make it a hat-trick and give you our view on whether the S&P 500 can make another record year.
   European markets have lagged behind their US peers, but some markets are starting to look like a good value. Get our take on whether Europe can steal the limelight from the US.

3 COMMODITIES: GOLD AND OIL
   Oil has fallen more than 30% in the second half of 2014 with OPEC looking unlikely to cut production. We ask whether oil has fallen far enough that it could be due a recovery this year.

4 EMERGING MARKETS OUTLOOK
   In 2013 we had the taper-tantrum: could we get rate-rage in 2015? We assess the impact of a US rate hike on emerging economies and look at what countries are most at risk in 2015.

5 VOLATILITY OUTLOOK 2015
   What could cause volatility to spike this year? Should we be on our guard, or will volatility fall back to 2014’s record lows? What are the most volatile currencies to keep an eye on and how does a strong dollar create market fear?

6 ELECTION WATCH: UK
   This is one of the most important elections in years. If UKIP’s star continues to ascend could it disrupt the UK political system? We assess potential outcomes of the election and discuss what this means for the UK’s position within the EU and the impact on the pound and UK-based assets.

7 FX FORECASTS

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9 EXCLUSIVE: TOP TAIL RISKS FOR 2015
   We give you our most outrageous predictions for 2015, from the prospect of UKIP taking power in the US, a collapse in the oil price, the return of Berlusconi to front-line Italian politics and the prospect of the USD/JPY reaching 180.
GLOBAL GROWTH OUTLOOK

US: Growth via Tangential Quantitative Easing

The US economy had been in recovery mode in 2014 with big improvements in GDP and the unemployment rate, which fell to its lowest level since 2008. Inflation was the one weak spot, as it was stubbornly lower than the Fed may have desired; however, it remains stable as we move into 2015. Those who were expecting the US economy to fail miserably once monthly stimulus from the Federal Reserve ended in October were briefly validated as stocks tumbled in the immediate days following the announcement, but rebounded thereafter and appear strong heading in to the end of 2014.

Despite the dangers of weakness in the economies of Europe and Asia to the US, the measures taken by those other nations could actually help the US maintain its current level of strength, especially if we see the ECB embark on QE at some stage in 2015. All in all, the future looks bright for the world's largest economy, and if oil prices continue to decline as they have in the latter half of 2014, the US may keep this momentum going even if the Fed starts to increase rates to a more historically normal level at some stage this year.

Figure 1

The US non-manufacturing sector has decoupled from the global trend

Source: FOREX.com
Federal Reserve: Committed to Hawkish Policy?

The Federal Reserve is expected to take its first steps towards normalizing monetary policy in the middle of 2015, with the market anticipating a rate rise sometime in June or July. The US is in a position of cyclical leadership with the economy doing well, particularly the jobs market, and the US managing to buck the global disinflation trend. The US created over 300,000 jobs in November, but more important to Fed policy was the 0.4% rise in hourly earnings for November, which was the largest monthly rise since October 2011.

The expected rate rise from the Fed has been one of the major factors behind dollar strength in 2014. The greenback has outperformed all of the major currencies and all of the emerging market currencies bar the Indian rupee (INR) and the Hong Kong dollar (HKD). Due to the divergent monetary policy paths between the Fed and other major central banks, the dollar is in a good position to continue to outperform in 2015, at least for the first half of the year.

In the first few months of 2015 we think that the focus will shift towards what the Fed will do after the first rate hike. Right now the market is looking for two further hikes for the rest of the year, which has been supported by the economic data; however, the bigger risk in our view is that the Fed is not as hawkish as some expect.

The Fed may have adopted a hawkish tone at its October meeting, but it could change its tune if the economic data starts to deteriorate or if the US catches the disinflation bug from the steep drop in oil prices. The other major risk to the Fed outlook is the dollar. So far the Fed has been remarkably tolerant of a strengthening greenback while other major central banks have been happy to see their currencies depreciate, including the Bank of Japan and the ECB. If the strong dollar trend continues in the first half of next year, the Fed may decide that it no longer wants to lose the race to the bottom. If the Fed starts to talk down the prospect of multiple rate hikes next year then we could see a sharp reversal in the dollar, and some respite for emerging market currencies that have fallen sharply against the greenback including the Brazilian real, South African rand and Russian ruble.

While we expect the dollar to reign supreme in Q1 2015, its performance for the second half of the year could be tricky depending on the Fed’s tolerance of dollar strength. FX markets could face another year trying to parse Fed statements to see if Fed members are happy with the level of the buck. Thus, 2015 could be a year of two halves for the Fed: the first half could be about making the long-awaited rate hike, while the second half could be a more cautious Fed who tempers its rate-hike talk to limit dollar upside.

Eurozone: To QE or Not To QE, That Is the Question...

Big things are expected of the European Central Bank in 2015. After the Fed ended its quantitative easing program in October, the market has been waiting for the ECB, along with the BOJ, to take its place by providing the global financial system with Fed-style liquidity. But while the BOJ have been willing to step into the Fed’s shoes by announcing a second round of QE late last year, the same may not be true for the ECB.

The ECB held steady at its December meeting; however, ECB President Draghi has sounded more supportive about the prospect of further easing and potential QE in recent weeks. As we move into 2015 we continue to think that the bar to QE remains high. According to German press reports after the December ECB meeting, three members of the ECB’s six-strong executive board refused to sign off Mr. Draghgi’s statement. Considering there is still a legal challenge outstanding on the ECB’s OMT program, don’t expect the opposition to QE to soften by the time of the first ECB meeting of 2015 on January 22nd.
A caveat to our theory that the ECB will not embark on QE would kick in if inflation falls below 0% in December. If this happens then we could see the ECB take some action, but we doubt that the ECB will fill the Fed’s shoes when it comes to QE, or even match Draghi’s pledge to boost the ECB balance sheet by EUR 1 trillion. Draghi talked about this six months ago and said a larger balance sheet was needed to ward off deflation fears. But since then nothing has happened and the ECB’s balance sheet has shrunk by EUR 100 billion.

But will an ECB QE program actually work? Unfortunately for the ECB, the answer isn’t as clear as it may hope. The two most recent large-scale versions of QE were the US version (QE3) and the Japanese version (QQE); one has been a resounding success so far, the other not so much. As the US enjoys accelerated job growth, healthy GDP growth and inflation on the lower end of acceptability, Japan has experienced a worsening economy and still too low inflation despite the enormous size of stimulus in terms of the size of their economy.

What Europe needs to find is at least some semblance of what the Fed has done with its version of QE. However, you will notice that there is a “3” next to the Fed’s QE which means that this was the third time around for the world’s most influential central bank, so getting it right isn’t easy.

The easiest outcome for Mario Draghi would be a large take-up of its longer-term refinancing operations (known as TLTRO). Back in September the Bank only managed to attract bids to the value of EUR 82.6 billion for its cheap loans. The market will be looking for take-up around the EUR 150 billion mark at future auctions. If this happens then QE may not be deemed necessary, which could save Draghi a fight with his German colleagues.

Apart from QE, the ECB could have more pressing problems to deal with in 2015. Greece is expected to have a general election sometime in spring, which could see a win for the anti-euro SYRIZA party. This may widen sovereign credit spreads, and could make it hard for Greece to remain in the currency bloc if its new government does not adhere to the strict terms of its 2010 bailout.

The impact on the EUR is likely to be negative. Widening sovereign spreads combined with QE could trigger another leg lower to below 1.20 vs. the USD. However, even though deflation fears and Greek political risks could prove toxic for the EUR, bears need to be careful. Firstly, the EUR has already had a sharp fall vs. the USD. Secondly, the market is already short the EUR which leaves the single currency at risk of a reversal. Lastly, as we mention above, the Fed may not be comfortable with dollar strength and could adjust its policy towards the middle of 2015 to limit upside in the greenback. Overall, the outlook is negative for the EUR, albeit with a potential slowdown in the pace of depreciation in the second half of 2015.

**Japan: Sowing the Seeds of Hyperinflation**

Do a quick Google search on “Japan” and “hyperinflation” and you’ll likely come across a litany of articles and prophecies declaring that The Land of the Rising Sun has already pulled a Wile E. Coyote; namely that they’ve already run off the inflationary cliff, but we’re just waiting for them to realize it and plummet to the earth. Granted, some of those doomsayers were saying the same thing back in 2010 or 2013 or probably even before then if you dig deep enough. The problem for these prognosticators is that it hasn’t come to fruition despite all the warning signs blinking red across the board. In fact, for years Japan has been adding to situations that historically help trigger a hyperinflationary event.
One of the most frequently quoted metrics for determining the future fate of Japanese inflation is their debt-to-GDP ratio, or gross government debt as a percentage of GDP. In this category, Japan is at the top of the world at 237.92%, and they really shouldn’t want to be there. The list of nations that are actually doing BETTER than Japan in this category is a who’s who of economic strife: Zimbabwe, Greece, Portugal, Italy, Iceland, Ireland, and Lebanon, just to name a few.

In its defense, Japan does have plans to try to lower that debt-to-GDP burden as a consequence of Prime Minister Shinzo Abe’s economic stimulus program (lovingly dubbed “Abenomics”), but it hasn’t gone according to plan so far. In an effort to bring budgets closer to actual revenue there was a consumption tax hike back on April 1st 2014 (that wasn’t an April Fool’s joke), which was supposed to be followed by another hike in 2015 that has now been delayed for 18 months due to a struggling economy. In addition, the Bank of Japan has increased Quantitative Easing in an effort to get interest rates so low that Japanese investors stop buying Japanese Government Bonds.

Past hyperinflationary episodes were largely caused by an increase in money supply to help pay off debts, the most well-known being the Weimar Republic in Germany in the 1920s. In an effort to bring Germany out of recession and pay off reparation debts from WWI, the German Papiermark was devalued by 50% in 1919 which kicked off the inflationary episode economists love to reference. Eventually, the Papiermark was replaced by the Rentenmark at a conversion of 1 trillion to 1 in 1923, which is utterly ridiculous when you think about it. However, it wasn’t just debt that helped trigger hyperinflation; there was also political uncertainty and overall loss of confidence as the Great Depression was felt especially hard in Germany.

While Japan hasn’t outright devalued their currency in one fell swoop like Germany did back in 1919, they have devalued it by over 50% in the last two years as the USD/JPY has risen from sub 80 to over 120 at the time of this writing. In addition, the Bank of Japan has pledged to add to their already large QE (15% of GDP per annum) by double if the economy doesn’t start to recover, which would take that already burdensome debt-to-GDP ratio even higher. When Germany started experiencing hyperinflation, their debt-to-GDP ratio was just under 300%. Also Japanese politics are in flux as Abe has called for new elections and Japanese consumer confidence has declined in the latter half of 2014.

When perceived as a whole, it appears that Japan has sown all the necessary seeds to bring about hyperinflation in the struggling state. However, once again, these seeds have been sown for many years now as doomsayers have been keen to point out. So will 2015 be the year that Japan finally falls down the rabbit hole? Whether hyperinflation is the ultimate result or not, it appears that the JPY might be losing even more value as the hyperinflationary seeds continue to germinate.

**Bank of England: Shifting to a Dovish Stance**

The last weeks of 2014 saw a sharp reduction in expectations around the timing of the first rate hike from the Bank of England. In the middle of 2014 the market had expected the BOE to hike rates at the end of Q1 2015; however, after a sharp fall in inflation and a deterioration in the UK’s growth outlook, expectations for the first rate hike have been pushed back to August 2015.

This recalibration of rate expectations for the UK has been reflected in the pound, which has fallen more than 3% versus the USD since the start of the fourth quarter. The outlook remains bleak for the pound as we start the new year on the back of falling inflation expectations and monetary policy divergence with the Federal Reserve in the US.

Falling inflation is a big risk for the pound this year, as the BOE may find it tough to hike interest rates if prices continue to fall. The Bank of England’s 12-month inflation expectations survey for November saw expectations fall to their lowest level since February 2010 (see the chart below). This is problematic for the Bank as maintaining price stability is its only mandate, yet inflation is falling sharply and could drop below 1% early next year.
If inflation continues to miss the BOE’s 2% target rate then we would expect some more dovish talk from the MPC. While we don’t think that they will boost policy action to try and stem the disinflationary trend, we do think that they will be happy to push back market rate expectations until late 2015.

From a currency perspective this is pound negative, but economic fundamentals may also weigh on the pound next year. The UK’s current account deficit is still a large 5.17% of GDP; this compares with a deficit of 2.25% of GDP in the US and a 2.41% surplus in the Eurozone. We think that the market will be less forgiving of the UK’s economic imbalances, especially as the other major economies have made large improvements. Added to this, political risk is back to the fore with the General Election in May (see our election preview for more).

The pound’s performance next year could be somewhere in the middle between the US dollar and the Euro. We think it will continue to fall versus the USD due to political risk, a deteriorating growth outlook and divergent monetary policy paths for the Fed and the BOE, while it may continue to rise versus the EUR, especially if the ECB embarks on QE at some stage this year.

**Figure 2:**

![Graph showing BOE inflation expectations have fallen to their lowest levels since 2009](source: FOREX.com)
Australia and New Zealand Continue to Head in Different Directions

It’s going to be a very important year for Australia and New Zealand. Both economies face many trials in the year ahead, but New Zealand may emerge as the victor in the Trans-Tasman battle for growth.

In Australia during 2013-14 a strong property market showed potential to spur economic growth in the broader economy, but the rest of the economy failed to respond and activity at the ground level remains restrained. This is set against a backdrop of retreating mining investment and falling key commodity prices, which doesn’t bode well for Australia’s all-important resources sector.

It’s not all doom and gloom Down Under, however. There is some hope that a falling exchange rate and accommodative monetary policy will carry the economy through 2015. Since September 2014 the Australian dollar has taken a mauling, with AUDUSD down over 10% at the time of writing (this report was written in early December). The onus is on policymakers to help support the economy and foster sustainable economic growth. Further monetary policy loosening by the RBA next year should keep the economy from stalling, but GDP growth may fall to around 2.5% in 2015. This assumes the exchange rate remains in the low 0.8000’s and commodity prices don’t fall off another cliff.

In NZ, the economy is much better situated to deal with threats to growth originating from falling commodity prices and even lackluster global commodity demand. NZ is heavily reliant on certain commodity exports, particularly dairy products. However, NZ has other avenues of growth to fall back on.

Rebuilding efforts in Canterbury, a generally solid construction market and strong net immigration are expected to augment domestic demand in 2015. These reliable sources will provide a solid platform for growth this year. At the same time, the economy is dealing very efficiently with high levels of growth. In other words, it can sustain a high growth rate without booming inflation, which in turn gives the RBNZ more room to keep monetary policy at a more accommodative level for longer.

The differing economic conditions and tolerances between Australia and NZ are expected to widen the interest-rate gap between the two nations. In Australia, the threat of a strong housing market is always going to be in the back of the RBA’s mind, but it can use macro-prudential tools to limit price pressures in the housing market. This will free up the RBA to use traditional monetary policy to support the broader economy. As such, we expect the RBA will cut the official cash rate next year. We believe that the RBA may hike rates twice next year, which would bring the cash rate to 2.00% by the end of 2015.

Across the Tasman, the RBNZ is expected to begin tightening monetary policy next year, but not until Q3 or Q4. Easing price pressures in the housing market and only mild inflationary forces in the rest of the economy, largely due to falling commodity prices, mean that the RBNZ can maintain looser monetary policy for longer than would be possible if inflationary pressures were stronger. We see the RBNZ raising the cash rate to 3.75% late in the third quarter or early in Q4 2015.
The widening gap between monetary policy expectations in Australia and NZ is already playing out in the FX market. AUDNZD was assaulted by the bears in the final quarter of 2014 and we expect it will continue to broadly weaken in 2015. In fact, we put AUDNZD below 1.0500 by the end of year with a 50% chance it will break parity. Looking at figure 4 we can see that AUDNZD still has further to fall based on the current divergent monetary policies of NZ and Australia.
RBA policy action next year may also keep AUDUSD depressed, although this is largely dependent on the outlook for US interest rates which is in turn dependent on the US labor market and inflation numbers. NZDUSD is also susceptible to widespread USD strength and possible central bank intervention on the part of the RBNZ.

**China’s Slow Descent Continues**

Beijing has been forced to reconsider its position regarding the use of broad-based stimulus measures to support China’s decelerating economy as more threats emerge both externally and internally. At the end of 2014 the PBoC shocked the market by cutting interest rates for the first time since July 2012. Despite some initial comments from the PBoC suggesting that this move shouldn’t have signaled a change in policy, the move was unquestionably more aggressive than the targeted stimulus measures we witnessed earlier in the year. The door is now open for further easing from Beijing as it attempts to prevent its economy from stalling this year, but we still suspect real GDP will slow to 7.0% by year-end, from an estimated 7.4% in 2014.

The mixture of lackluster global growth, falling property prices and stagnant domestic demand is weighing on China’s growth outlook. Early in 2014 Beijing was attempting to support the economy without stoking China’s red-hot property market. This was done by introducing a raft of measures aimed at cooling the booming market. Later in the year most of these tools were slowly withdrawn as property prices began to tumble across the board. In fact, property prices were falling so precipitously that it raised concerns about a possible crash and despite the relaxation of property curbs these concerns haven’t been entirely alleviated (out of the 70 cities surveyed, 69 are still experiencing falling property prices – see figure 5).

**Figure 5:**

No. of Chinese cities experiencing falling property prices

Source: FOREX.com
At the same time Beijing must addresses other weaknesses emerging from China's economy. There are two main sources for growth in a modern economy: domestic demand and global demand. China has historically been an export-based economy, but it is attempting to transition towards a more effective growth model that takes advantage of China's massive population. As urbanization continues to transform China into a more developed economy, it can tap into more reliable and sustainable growth conduits from within its own economy.

However, the near-term outlook for domestic demand isn’t good, particularly given recent soft import data, stagnant inflation numbers and persistent disinflation in producer prices. While China can still largely rely on its robust export market for growth, it cannot seek long-term sustainable growth from this area. This puts even more focus on the strength of domestic demand in China. As is evident from figure 6, consumer price growth has flatlined and imports are declining; some of the weak import data can be attributed to falling commodity prices but some is clearly the result of softening domestic demand.

**Figure 6:**

![Figure 6](source: FOREX.com)

**What Kind of Response Can We Expect from Beijing?**

Beijing has been carefully managing China’s slowdown since it began, and nothing is expected to change in this regard. Throughout 2014 the PBoC was using targeted stimulus to support the financial sector by injecting liquidity into the nation’s biggest banks and small lenders, either through direct injections or by lowering funding costs. Later in the year China’s central bank cut its one-year lending rate by 40 bps to 5.6% and its one-year saving rate by 25 bps to 2.75%. As
we stated earlier, this signaled to the market that the PBoC is primed to use its big guns once more to spur demand. Yet more monetary easing may be needed in China, although the decision to ease further must be weighed against the advancement of structural reforms and local government debt management. Deposits at China’s major banks are suffering as people seek out other investment alternatives, so now these banks are pressuring the PBoC to cut its 20% RRR, thereby allowing them to lend more of their deposits. Given the ineffectiveness of the first interest-rate cut in two years, the threats to growth, the fact that inflation is well below target and the PBoC’s apparent alacrity to pull out its big guns, we believe the bank may cut interest rates again as well as banks’ Reserve Requirement Ratio (RRR).

**Figure 7:**

![Graph showing Central Bank Rate and RRR over time](Source: FOREX.com)

### The Yuan May Soften again in 2015

Part of the attractiveness of CNY-denominated assets are the generally high yields on offer as well as the safety that comes from the guarantees that Beijing has placed on some assets. The fact that the yuan was thought of as a one-way bet only encouraged more hot money into China, thereby compounding the upward pressure on the exchange rate. While the idea that the renminbi could only strengthen was mostly dispelled earlier this year by the PBoC as they engineered a decline in the exchange rate, the aforementioned attractiveness of the yuan couldn’t be ignored.

However, the severity of the economic issues facing China may see the yuan weaken for its second year in a row against the US dollar. The prospect of further interest rate or RRR cuts on the back of softening economic conditions in China make the renminbi less attractive and increase the PBoC’s motivation to engineer a fall in the exchange rate to support exporters. Further policy loosening could flood the market with renminbi, especially if the PBoC elects to cut the RRR. This may see USDCNY push towards 6.35 by the end of 2015.
2015 EQUITIES OUTLOOK

2014 has been another great year for US equities and a mixed one for Europe. As of early December, the S&P 500 was up 13% year to date, Nasdaq 100 up 22% and Dow Jones was 9% higher. In contrast, Germany’s DAX index was ‘only’ up 7% while Britain’s FTSE was literally flat year to date. Despite the geopolitical tensions in Ukraine and the Middle East and the slump in oil prices, investors’ appetite for equities has been strong as global central banks stick to their accommodative monetary policies.

Some of the themes from 2014 are likely to remain in place in 2015 for stocks, especially the support from central banks. The ECB for example may move to expand its asset purchases program to include government debt as it fights deflationary threats from falling oil prices and weaker wage growth. This could be a boon to German stocks in particular. The US is again likely to lead the global economic recovery while the weaker commodity prices could alleviate the pressure on emerging markets. But weaker oil and metal prices could also mean the FTSE, a commodity-heavy index, could underperform once again. As monetary policy in the US is heading towards the path of normalization, we envisage only moderate further gains for US stocks, at least compared to recent years. But from a technical point of view, the major US indices are still not in the parabolic phase of the bubble, assuming one is forming. So, there could be further sharp gains to come before the bubble potentially bursts, perhaps toward the end of 2015.

DAX Could Outperform in 2015

Although we think that the economic outlook for the Eurozone is fairly bleak for 2015, we think Germany will lead growth in the Eurozone and we are therefore bullish on the DAX. After consistent falls in the German Ifo Business Climate index throughout 2014, there was an upward surprise in the November reading. Though one month’s worth of data may not be a game changer, we think the Ifo will continue to improve in 2015. The lower oil prices will likely help lower the production costs for German manufacturers and builders, which could in turn boost their bottom lines. Traders should watch the “Business Expectations” sub-index of the Ifo very closely this year as it tends to lead the Business Climate.
If the Ifo does improve as we expect it to, the DAX index could potentially outperform the US indices, for it may also have the added support of the European Central Bank who may embark on QE (see our euro section for more). If introduced, this could provide further support for stocks as the ultra-loose monetary policy from the ECB will hopefully encourage households and businesses to spend more. A weaker euro may also be positive for the export-oriented German economy.

**Technical Outlook: DAX**

At the time of this writing the DAX was just shy of the 10,000 mark. This level had provided significant resistance earlier in 2014 and so there is a chance the index may hesitate again around this psychological area as the buyers continue to take profit going into year-end. Nevertheless, the long-term technicals are still supportive, which bodes well for at least the early part of 2015. The DAX is clearly in an upward trend, as pointed out, for example, by the still-rising 50-week moving average. Indeed, the momentum indicators are trending higher too: the weekly MACD has just created a bullish crossover while the RSI has broken its downward trend. We think that there is further momentum left in this rally that started in mid October. Thus, a decisive break above the 10k mark, which would be a very bullish development from a technical point of view, may be on the cards.

As the DAX is trading near the record high it had achieved earlier in 2014, Fibonacci extension levels can be handy to give us a view of where this index could go next if we are to expect further upside. As you can see on the chart below, we have plotted the extension levels of the most recent sell-off from the previous record high of about 10050 to a low of 8350. The 127.2% extension level of this move comes in at 10510 while the 161.8% is just shy of 11100. Also, in between these levels is 10985; this level corresponds with the 161.8% Fibonacci extension of the entire 2007-2009 crash. So, our key bullish targets for 2015 are 10510, 10985 and 11100. Meanwhile, some of the key supports we are watching for 2015 include 9800, 9465 and 9000, levels that were formerly resistance. We will be paying particularly close attention to the bullish trend line that has been derived from connecting the low point of 2011 with that of 2014. If and when the DAX breaks below this trend, we could easily see a sharp correction. An even more bearish outcome would be a decisive break below the October 2014 low of 8350. But our base case is that the DAX could continue to appreciate while expectations for further ECB action run still high. Thus, we expect a couple of our bullish targets could be reached in the first quarter of 2015.

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**Figure 9:**

Source: FOREX.com. Please note this product is not available to US clients.
Commodity-Heavy FTSE 100 May Struggle Again

The UK’s FTSE 100 could be among the European indices which may underperform in 2015, not least because, unlike the ECB, the Bank of England is unlikely to ease policy further. The relatively higher interest rates in the UK may put further upward pressure on the pound against the euro which could weigh on exports to the Eurozone – the UK’s largest trading partner. Meanwhile, miners and energy stocks could remain under pressure if commodity prices stay weak in 2015, which we think will be the case. The energy sector makes up 14% of the FTSE 100, with BP and Shell alone accounting for more than 10% of the index. Thus, if the weaker oil prices persist in 2015, these companies could weigh heavily on the FTSE 100 as they have done towards the end of 2014. Another factor that could weigh on the FTSE 100 is uncertainty ahead of the May 2015 general election and financial shocks due to increased regulations. In the Autumn Statement, Chancellor George Osborne announced plans to raise £4bn by limiting banks’ ability to use losses suffered during the global financial crisis to cut taxes on current profits. However, Mr. Osborne also unveiled new stamp duty rates that could save 98% of UK homebuyers money. In theory, this should help to increase demand for mortgages and also homebuilding, thus providing support for both banks and homebuilders. Support for the FTSE could also come in the form of increased M&A deals. The stronger US dollar was partly responsible for the M&A boom in 2014 and if this trend continues then so too could the number of deals. A weaker GBP/USD in 2015 could make British companies attractive takeover targets for US firms.

The Technical View: FTSE 100

The FTSE has had many unsuccessful attempts to break above 6900 over the past two years. The last time they tried to break above 6900 was in September of 2014 when the index hit a fresh multi-year peak of 6905; but here, the rally once again stalled and the pace of the selling accelerated soon after. From that peak, the index went on to drop by 835 points to a low of 6070 by mid-October when the markets bottomed out. The bears were thus unable to break the major support area between 6000 and 6100 for the second time. This is potentially a very bullish outcome and we think that if the FTSE were to make a few more attempts at 6900 it may break decidedly higher.

On a side note, it is worth pointing out that the long period of consolidation below 6900 suggests that an eventual breakout could potentially be quite significant in terms of magnitude. This would not only deliver a hammer blow to the existing sellers but also encourage fresh buyers to enter the market – particularly those who have so far been discouraged by the index’s lacklustre performance in recent years.

A decisive break above the 6900 level on the FTSE could pave the way for a move towards the Fibonacci extension levels around 7130/5 (127.2%) and then 7420/5 (161.8). The latter also corresponds with the upper resistance trend of the bullish channel. The intra-day record high of 6950, achieved in December 1999, should also be paid some attention should we get there. Meanwhile on the downside, the key supports that we will be watching in 2015 include the abovementioned 6000/6100 range, as well as the long-term Fibonacci retracement levels. Ahead of these are some near-term support levels, including 6525 and 6400.
Stronger Dollar = Bad News for Earnings

In 2014, US companies continued to surprise with their earnings results as the economy expanded at a moderate pace. According to research from FactSet, the telecoms, financials, material and healthcare sectors did particularly well in the third quarter while consumer discretionary was the only sector which reported a year-over-year decline in earnings. Compared to a year earlier, the overall S&P 500 earnings growth rate was a healthy 8% while the revenue growth was 4% in Q3. Some 77% of the S&P companies managed to beat profit expectations, making this the best quarterly performance since the second quarter of 2010 when 79% of the companies beat earnings estimates.

As you can see in the chart below, US stocks and the dollar moved together for sustained periods in 2014. If the dollar continues to push higher in 2015 then this could be bad news for US exports. Clothing retailers and automakers could be among the worst hit, particularly in Europe where the euro may weaken further amid continued ECB intervention and lackluster growth.

Source: FOREX.com. Please note this product is not available to US clients.
A slowing global economy could start to hurt US corporate profits in Q4 2014. During the first two months of the quarter, analysts have lowered their Q4 earnings estimates by 3.9%. Unsurprisingly, the estimate reductions were led by the commodity-based sectors following the declines in crude and metal prices. Analysts have also trimmed their estimates for Q1 and Q2 of 2015, although this is subject to change closer to the time.

Meanwhile companies themselves have been lowering their forecasts, with 76 out of 95 (80%) already issuing negative earnings guidance for Q4. So far, however, the markets have ignored these fundamental developments with the S&P trading at a record high at the time of this writing. The divergence between the index and the Q4 earnings estimates therefore increases the probability for a correction at some point in early 2015.

But despite our slightly negative view on earnings, we are still overall bullish on stocks at the start of 2015. Some of the key risks to our outlook in 2015 include among other things the deterioration in emerging market economies, stagnation in the Eurozone and central banks’ inability to defeat deflation or at least create inflation (e.g. in Japan and now the Eurozone). The ongoing geopolitical tensions in Ukraine and to a lesser degree in the Middle East are also a concern. Meanwhile the Volatility Index (VIX) continues to trade near historic lows which suggests that the bullish complacency is extremely high.
Technical View: S&P 500

The S&P 500 has been trending consistently higher in recent years. The recent acceleration in the trend suggests that the index could smash through this barrier and embark on a vicious rally. If it does that, then one should proceed with extra caution for we will have potentially entered the parabolic phase of the stock market bubble. Even then, the rally could extend far beyond most people’s imagination and in a very short period of time, too. But eventually the bubble will burst – the same way, for example, that silver’s did in 2011 – and we could then see a large unwinding of longs and the start of a major downward trend. When this will happen is a million-dollar question, but a good clue will be the first sharp pullback following an extensive parabolic-like rally. But until that happens, the “trend is your friend.”

As the S&P is trading in uncharted territories, Fibonacci extensions and psychological levels are tools we can use as projections for potential turning points or bullish targets. The first such area is between 2137 and 2147: the lower end of this range corresponds with the 161.8% Fibonacci extension of the entire 2007 to 2009 crash while the upper end is the 161.8% extension of the correction we saw around September/October of 2014. We envisage that the S&P will at least pause for breath around this area if and when it gets there. Beyond this area are the psychological levels of 2200 and 2300 and further out still is the 261.8% Fibonacci extension at 2350. The latter looks like an extremely ambitious target, but we could get there in the event of a parabolic-like rally. Meanwhile old resistance levels are likely to turn into support. In this regard, the area around 2000/22 should be watched carefully. If the index breaks below here then a move towards the 50-week moving average or the support trend of the bullish channel could be next. A break below the latter would be a particularly bearish development.

Figure 12:

Source: FOREX.com. Please note this product is not available to US clients.
2015 COMMODITIES OUTLOOK

Crude Oil

2014 was a wild ride for crude oil traders. After initially moving sideways in a relatively narrow range, prices embarked on a surprise rally at the start of the summer as traders put the excessive supply and weaker demand worries behind them and concentrated on the geopolitical risks in the Middle East and, to a lesser degree, Ukraine. In particular it was the advance of the terrorist group ISIS in Iraq that unnerved oil speculators the most. However, once traders realized that most of the fighting was taking place in the country’s north, well away from the oil export terminals in the south, they quickly unwound their speculative long positions. This caused the price of oil to fall viciously in the space of just a few weeks, leading to the breakdown of a long-term bullish trend line on the Brent contract which encouraged further followup technical selling. Meanwhile the selling was exacerbated by the return of Libyan oil production towards normal levels following several months of rebel occupation of major oil terminals in the country. At the same time Iran was allowed to sell more oil as the country succumbed to western pressures and agreed to lower its uranium enrichment levels. The US and other non-OPEC oil producers were also contributing towards the supply glut, thanks mainly to the boom in shale oil output. As the world’s supply of oil increased dramatically and the growth in demand remained weak, prices took a huge drop in the second half of the year. The sell-off was made worse in November after the OPEC refused to concede more ground to shale producers by maintaining its production quota of 30 million barrels per day (mbpd) intact.

Not only did the OPEC refuse to lower its production target, the cartel’s most important member, Saudi, has been selling oil cheaper than international benchmarks to its customers in Asia and the US. In other words, Saudi has potentially started a price war as it seeks to defend its market share against the rising US shale output. If this trend continues, there could well be further falls in the price of oil in early 2015. Whether or not US shale producers will be able to weather Saudi’s proverbial counterattack in excessive oil production is difficult to say, but one thing for certain is that the weaker oil prices are undoubtedly chipping away at their margins. This is reflected in the huge drops in share prices of the three large US companies that are involved in the fracking business: Halliburton, Baker Hughes and Weatherford. Since the summer of 2014, these stocks have lost between 25 to 50 percent of their value.

The apparent desire of US shale producers to scale back their operations, combined with the very weak oil prices, suggest that the supply of US oil may now turn out to be a lot less in 2015 than it would have been the case under calmer market conditions. The major oil forecasters such as the OPEC, EIA and IEA may therefore have to cut their already-optimistic non-OPEC production estimates. The prospects of a tighter oil market therefore means prices could well stabilize very soon, particularly given the market’s exaggerated response to the OPEC news in late 2014. Still, with Saudi Arabia unwilling to cut back its production levels, and this combined with the threat of oil supply continuing to rise from other OPEC countries such as Iran, Iraq and Libya, concerns over excessive supply are unlikely to go away any time soon. With the OPEC being responsible for about 40% of global oil supply, further increases in production from this group may keep a lid on prices for the foreseeable future. A weak global economic recovery also argues against a major price recovery in 2015.

Taking the supply and demand forces into consideration, it is really difficult to be bullish on crude oil going into 2015. At the same time, the extent of the price plunge makes us think that further sharp losses will be limited. So, overall, we envisage only moderate further losses in 2015 and expect prices to be a lot less volatile compared to 2014. We think that if prices were to stage a meaningful recovery, it would more likely be towards the end rather than start of 2015 when the global economy will hopefully be on a more stable and sustainable path of recovery. The main risk to our moderately bearish 2015 oil outlook is the escalation of geopolitical risks in the Middle East and North Africa (MENA) regions; we strongly believe that the market is under-pricing these risks at the moment. Meanwhile uncertainty over the direction of the US monetary policy and its impact on the dollar poses an additional risk to our forecast. A stronger dollar should undermine buck-denominated commodities, all else being equal.
Crude Oil Technical View
Brent

Even from a technical point of view it is extremely difficult, if not impossible, to predict when oil prices may bottom out. But the speed of the drop since mid-2014 suggests that a recovery may not be too far out. On top of this, the weekly RSI – at just above 10 – has drifted further into the extreme oversold territory. Meanwhile prices have now fallen about $40 since the last major reversal pattern occurred i.e. the break of the long-term bullish trend line. The last time a major reversal pattern came about was in early 2012 when a double top/false breakout pattern drove prices down viciously. Then, too, oil prices dropped about $40 from a high of above $128 to around $88, in a similar, parabolic-like, manner. Thus if history were to repeat itself, Brent oil prices could find a base around or just below $67/$68. That said, the fundamental drivers are different this time around and there has been a clear shift in paradigm, so prices could take another or additional legs lower before stabilizing in early 2015.

A key support level to watch out for is $68. This is where Brent had previously formed a double bottom reversal back in 2010. In addition, oil has now achieved at least a 61.8% retracement from its peak in 2012. But that’s not to say prices will necessarily bottom out here. Indeed, if the bears manage to push prices lower then that could give rise to further followup technical selling towards the next psychological round handles at $65 followed by $60. The long-term 78.6% Fibonacci retracement level comes in around $56, and below that is the next psychological level at $50. At this stage, the major long-term resistance levels that we will be watching are $80 and $88.50 – levels that were formerly support.

Figure 13:

Source: FOREX.com. Please note this product is not available to US clients.
WTI

Like Brent, WTI (or US) crude was also testing a major support area when we were putting this report together: around $65. As well as a major psychological level, this is also where a long-term bullish trend line comes into play. In addition, the 61.8% Fibonacci retracement level of the 2008-11 bull trend is also just below this $65 mark. So, while a bounce back here is possible, another potential break lower could pave the way for fresh selling pressure towards $60 and potentially even $50 at some point in 2015.

Given the abovementioned fundamental drivers, we are only expecting moderate price recoveries throughout 2015. In our view, the buyers would do very well to push WTI prices above the $90 handle, let alone $100, at any point in 2015. But a counter-trend move towards $80 is more plausible particularly given that prices are already oversold.

Source: FOREX.com. Please note this product is not available to US clients.
Precious Metals

Gold had a quiet year in 2014 as it traded inside a $260 range in a sideways trend. In fact, at the time of this writing in early December, the shiny metal was hovering around the flat line for the year – albeit near the lower end of its yearly range. But given that the US dollar and equities have both risen considerably, gold has held its own remarkably well as it can move in the opposite direction of these two assets (see the chart below). The yellow metal’s performance as an asset that pays no interest or dividend becomes even more impressive when you consider the fact that inflation has been virtually nonexistent in the major global economies. Nevertheless, the general bias and market sentiment was bearish towards gold and generally many market participants expect this theme to continue in 2015.

Something historic could be happening to the gold price. If the greenback continues in its upward trajectory, but gold fails to head in the opposite direction (or at least by a similar magnitude), then that would suggest investors are finally starting to treat gold as an independent asset, not a USD-denominated FX pair.

Physical Demand could Increase in Early 2015

There was actually a good reason for gold to have climbed higher in November, which was driven by news from the
physical market; in a surprise move at the end of that month, India lifted some of the gold import restrictions. The so-called 80:20 rule, requiring importers to sell 20% of their shipments to jewelers for re-export, was abolished with immediate effect. Although the 10% import tax is still there and likely to remain in place throughout 2015, the removal of the 80:20 rule may help to shore up the physical demand in the former top gold consumer nation.

Meanwhile the main wedding season in India is now underway and will last until about late January. During this time, large amounts of gold jewelry can be purchased by the Indians. Then it will be over to China where jewelry purchases are likely to increase ahead of their Lunar New Year on February 19. Indeed, we think that the main source of support for gold will probably come from the physical rather than the paper market in 2015 because, as mentioned, speculators are more likely to hold stocks rather than gold amid the record-low interest and inflation rates.

### Technical Outlook

#### Gold

The pace of gold’s decline slowed down towards the end of 2014 as the sellers once again struggled to hold their ground below the key $1180 level. As can be seen on the chart, the yellow precious metal has shown relative strength around this area for the best part of two years now. This has caused the Relative Strength Index (RSI) to create several instances of positive divergence, confirming that the bearish trend has weakened. In addition to horizontal support at $1180, gold has also found some support from its long-term 61.8% Fibonacci level at $1155. What the bulls would like to see now is a break above the long-term bearish trend and resistance around $1240. If seen, this could lead to the unwinding of further bearish positions which could thus add to the bullish momentum. The next significant levels beyond $1240 are $1345, $1390 and $1435. These are among our bullish targets for 2015 (subject to price breaking decisively above $1240 first).

However as things stand, the long-term trend is still technically bearish for gold, so the vast majority of the market may still be positioned short. Therefore the possibility for further losses is there. If gold breaks below the 61.8% Fibonacci level, there is little support seen until the next psychological barrier at $1000.

![Gold weekly chart](source:FOREX.com)
Silver

The price action in silver suggests that the end of the four-year bearish trend in approaching, with the monthly chart below showing an almost perfect example of how the different phases of a bubble form. Although the grey metal has bounced off the key psychological $15 mark, there is still the possibility for perhaps one more vicious sell-off that could push its price momentarily below the long-term bullish trend line before it stages a recovery as it returns to the mean. In other words, we probably haven’t seen the “despair” part of the “blow off” phase yet. If we do witness that in 2015, the price of silver could potentially fall to around $10 before the bubble deflates fully. But whether or not it will get to $10 is anyone’s guess. Instead, traders should watch closely what silver may do if it rises towards the old key support around $19; only a decisive break above here will signal that the long-term downward trend is over. Until then the trend will remain bearish for silver.

Figure 17:

Source: FOREX.com.
4 EMERGING MARKETS OUTLOOK: THE IMPACT OF COLLAPSING COMMODITIES

As of writing in early December, emerging market currencies are on in the midst of a painful plunge. According to JPMorgan’s Emerging Market Currency Index, which measures the strength of a number of developing country’s currencies against the US dollar, EM currencies are at their lowest level since at least 2000.

Figure 18:

Of course, the recent broad-based strength in the dollar has driven all currencies lower on a relative basis, but the dollar’s strength has also impacted EM FX indirectly, through its impact on commodities. As we go to press, the S&P Goldman Sachs Commodity Index (GSCI, not shown) is down over 20% on the year, and certain widely followed commodities including oil have fallen even more. This big drop in commodity prices will have a major impact on growth, inflation, and monetary policy throughout the emerging market world.

What Could Falling Commodity Prices Mean for EM FX?

The most obvious impact of falling commodity prices is that the inflation should continue to fall heading into 2015. Emerging markets are particularly leveraged to commodity prices through consumption of food and energy, and the...
corresponding drop in inflation could cause EM central banks to push back rate hikes or ease monetary policy in 2015. This impact may be particularly strong in economies that are struggling with relatively high inflation rates already, such as Turkey, South Africa and Russia.

Likewise, major EM commodity producers may see a hit to growth as the beneficial impact of lower import prices is overwhelmed by the deleterious effect of lower export prices. As a result, fundamental traders should closely monitor each country’s terms of trade, or the price ratio between a country’s exports and imports, to evaluate whether falling commodity prices are benefiting or hurting each country.

Below, we discuss a number of emerging countries (and their currencies) individually, but readers would be wise to note that emerging markets can be interrelated and the market’s attitude about one country can spread to other countries at a moment’s notice, as we saw in early 2014.

**USDMXN: Mexico Taking a Cue from its Northern Neighbor**

More than any other EM economy, Mexico is closely linked to its neighbor to the north. The relative outperformance of the US economy has spilled across the 30th parallel, and as a result, Mexico’s economy and currency are projected to hold up relatively well in 2015. Referring back to our commodity theme, Mexico is actually a net exporter of oil, so the recent collapse in crude prices does serve as a possible headwind for growth. That said, major structural reforms in recent years, along with projected strong growth in the US in 2015, should allow Mexico’s Banxico to hike interest rates later in 2015.

On a technical basis, USDMXN consolidated around 13.00 for most of last year before the peso finally gave in to the dollar rally in December. Moving forward, a break of the five-year high at 14.60 may open the door for a continuation all the way toward the 2009 high near 15.55, though we anticipate that the peso may hold up better than some of its EM brethren against the greenback this year.

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**Figure 19:**

Source: FOREX.com.
USDRUB: Could Ruble’s Collapse Continue in 2015?

Of course, it’s impossible to discuss EM FX without checking in on 2014’s resident basket case, the Russian ruble. The RUB was sold throughout the year on geopolitical risk from military incursions into Ukraine, the related economic sanctions from Western countries, falling oil prices and generally poor economic performance in the Mother Country. As we roll into 2015, the outlook for Russia’s economy remains weak, with the country struggling with a classic stagflation dynamic, as GDP growth is hovering below 0.5% and inflation is rising at more than 9% per year. The ongoing collapse in the ruble will only exacerbate price pressures in 2015, though the currency’s drop may provide some support to GDP growth.

Speaking of the ruble, USDRUB has exploded all the way up to trade above 50 as of writing after the Central Bank of Russia (CBR) was forced to allow it to float freely in Q4. The efficacy of technical analysis is limited in such a parabolic, emotion-driven surge, but traders’ first impulse will be to buy dips in USDRUB in 2015 until the ruble can show signs of stabilizing.

Figure 20:

Source: FOREX.com
USDZAR: Economy Poised to Rebound, but ZAR Still Struggling

A prolonged mining strike derailed South Africa’s economy in 2014, but the country’s economy could see substantial improvement this year. Moving forward, the expected normalization of activity in the mining and manufacturing sectors should contribute positively to growth, especially in the first half of the year. Meanwhile, the drop in oil prices should reduce the country’s elevated inflation rate, though this impact may be partially offset by the sustained decline in the rand over the last few years. Given this economic backdrop, the South African Reserve Bank (SARB) is likely to remain on hold for the first half of the year and we anticipate that the rand will track EM FX as a whole next year.

While the fundamental picture is cautiously optimistic for South Africa, the technical perspective is decidedly bearish. The pair has just broken out from a multi-month cup-and-handle pattern, hinting that the rally may accelerate heading into 2015. To the topside, the next level of resistance will be the Great Financial Crisis high at 11.84, followed round handle resistance at 12.00. Only a break below the established uptrend would shift the near-term bias back to neutral at this point.

Figure 21:

Source: FOREX.com
USDTRY:

Objectively, Turkey’s economy is doing poorly heading into 2015. The country saw a negative 0.5% q/q Q3 2014 GDP reading, bringing the country’s annualized GDP growth down to just 2.1%. Meanwhile, the country is struggling with an unemployment rate above 10%, inflation at 9%, and a current account deficit equal to nearly 8% of GDP. That said, markets are always forward looking, and like its EM rival South Africa, Turkey’s economy is poised for improvement in 2015. The biggest risk to Turkey’s economy in the coming year will be its dependence on external sources to finance its current account deficit, but anticipated further easing in the Eurozone should help in that regard.

Turning our attention to the chart, the Turkish lira (TRY) held up relatively well against the dollar in 2014 beyond the brief EM panic in January. USDTRY is currently pressing a short-term bearish trend line off the January high, and if that barrier is eclipsed, a continuation toward the previous highs at 2.30 or 2.40 will be on the radar for 2015. Of course, a pullback in the dollar would leave plenty of room for weakness in USDTRY, with support initially at 2.20, followed by all the way down at 2014’s low near 2.0750.

Figure 22:

Source: FOREX.com
VOLATILITY OUTLOOK 2015: DID 2014 MARK A SECULAR LOW IN VOLATILITY?

Volatility is always a sticky subject for traders. By definition, some volatility is required to make profitable trades, but too much volatility can lead to erratic markets and unexpected losses. Lately though, traders have been having far more issues with the former than the latter: according to JP Morgan’s G7 Volatility Index, last summer’s doldrums marked an all-time low in currency market volatility, with the index dropping below its pre-Great Financial Crisis trough of six before volatility picked up heading into the end of the year.

Figure 22:

Source: Bloomberg, FOREX.com
Naturally, the question on every trader’s mind is, “Will volatility finally rise this year or will it fall back to 2014’s record lows?” To answer this question, let’s analyze the primary catalyst that has pushed volatility consistently lower since 2009’s peak: easy monetary policy.

Above all, the decline in currency market volatility since 2009 has been driven by unprecedented liquidity injections from global central banks. Beyond keeping interest rates at historically low levels, the Federal Reserve has enacted three separate iterations of QE (not to mention its Operation Twist program), while the Bank of Japan and the Bank of England have both maintained large asset purchase programs of their own over the past few years. While the Fed finally wound down its QE program in October, the BOJ recently expanded asset purchases, and there is a high likelihood that the ECB will also have to jump on the QE bandwagon in the first quarter of this year. As a result, some traders suggest that other central banks will simply pick up the Fed’s slack and that the prolonged five-year decline in volatility will stretch into 2015.

Color us skeptical. Though the spigots of global liquidity remain wide open, another factor driving volatility lower has been the uniformity of monetary policy. That is, nearly every major central bank has been in easing mode for years (barring last year’s short-lived tightening cycle from the RBNZ), leaving little reason for long-term traders to shift their positions. Of course, many central banks will remain accommodative throughout 2015, but futures markets are still pricing in interest rate hikes from the Federal Reserve, BOE, and RBNZ later in the year. With incoming economic data likely to have a more direct and immediate impact on monetary policy this year, volatility is unlikely to revisit last year’s snore-inducing lows, in our view.

Extending the above line of thought, volatility is likely to be highest in currencies with central banks that are on the verge of making changes to monetary policy. As of writing in late November, pressure is growing on the European Central Bank to start a sovereign QE program to stimulate its moribund economy, so volatility may be centered on the euro early in the year. As the year develops, volatility should start to increase in the US dollar, New Zealand dollar, and British pound (as their respective central banks grow more serious about raising interest rates), as well as the Australian dollar, which could even see the RBA cut rates later in the year.

Of course, markets don’t always play out exactly as expected, but for now, the markets’ New Year Resolution may be to offer more volatility to traders.
UK: A DRAMATIC SHIFT IN THE UK’S POLITICAL LANDSCAPE

At this early stage the outcome of the UK’s general election, which will take place on 7th May 2015, is uncertain. We are too far away from the election to be able to derive much from the latest political polls; however, there have been some interesting developments in the last year. YouGov, the market research firm, found that November was the first month when more voters would vote for some other party than pick either the Conservatives or Labour party on their own.

Digging a bit deeper into the YouGov poll, we found that Labour were just about in the lead with 33% of votes and 32% of people said they would vote for the Conservatives, which would leave 35% who would vote for some other party. But while the share of the Tory and Labour vote has been falling in recent years, it is the Liberal Democrats (currently in a coalition with the Conservatives) who have seen the share of their vote dwindle to just 7%, the lowest level in this parliament.

As the Lib Dems have faded in recent years, the three other remaining parties had some of their best results in their history. For example, UKIP, the anti-EU UK Independence Party, received 16% of the votes, an all-time high. The Scottish Nationalist Party reached 5% for the first time, and the Greens reached 6%. This is a sea change for British politics, and if current trends play out then we could see a radically different Parliament after this election.

These polls suggest that the UK is likely to have another coalition government, so what outcome could we expect? At this stage it is worth pointing out that many voters could change their mind come election day and “go home” to the main parties, according to YouGov. However, we continue to believe that a coalition is likely and with the Lib Dems star descending, we thought it was worth looking at some potential outcomes:

1, Conservative and UKIP

This would push the UK towards the right on issues like tax and immigration, but the biggest concern for the financial markets would be Britain’s position in Europe. UKIP want the UK out of the EU, while British PM David Cameron has promised an in/out referendum on the UK’s membership of the EU in 2017. This referendum could be brought forward if UKIP are involved in a coalition.

2, Labour and the Greens

This pairing would trigger a shift to the left for the UK, with the Greens pushing for an environmentally friendly agenda that could be deemed unfriendly to business. Labour has promised to end austerity, increase taxes and boost public sector spending that could aggravate the UK’s deficit over the coming years, causing bond yields to rise.

Overall, the two examples above would be a shift for British politics from the center either the left or the right. If this happens then it could trigger market panic as investors remain concerned about political uncertainty. This could trigger a sharp fall in the pound, a rise in Gilt yields, and a decline for the FTSE 100, as markets tend to react badly to uncertainty.
Although the Labour party is traditionally considered bad for UK business and UK assets, we think that a Tory/UKIP coalition could also trigger market panic and economic weakness as it would leave the UK’s position in the EU on shaky ground. At this stage the international community and some powerful figures in the business sector still see a UK exit (or Brexit) from the EU as a bad economic move that could hurt the UK’s major industries including finance and exports.

Thus, as we move into January there are plenty of uncertainties to digest, which could weigh on the pound and other UK-based assets in the first half of the year.
## FX RATE EXPECTATIONS:

<table>
<thead>
<tr>
<th>Cross</th>
<th>Previous Ranges</th>
<th>Predicted Range</th>
<th>Bullsish/Bearish</th>
<th>Comments</th>
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<tbody>
<tr>
<td>EUR/USD</td>
<td>1.3476 – 1.3966 490 pips</td>
<td>1.2627 – 1.3699 1072 pips</td>
<td>1.18 – 1.26 800 pips</td>
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<tr>
<td>EUR/JPY</td>
<td>136.22 – 145.11 889 pips</td>
<td>135.72 – 141.21 549 pips</td>
<td>145.00 – 155.00 1000 pips</td>
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<tr>
<td>EUR/CHF</td>
<td>1.2103 – 1.2393 290 pips</td>
<td>1.2043 – 1.2176 133 pips</td>
<td>1.20 – 1.2150 150 pips</td>
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<tr>
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<tr>
<td>Cross</td>
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<td>Predicted Range</td>
<td>Bullish/Bearish</td>
<td>Comments</td>
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<td>618 pips</td>
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<td>169.33 – 180.70</td>
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<td>1.0642 – 1.1033</td>
<td>1.0621 – 1.1294</td>
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<td>391 pips</td>
<td>673 pips</td>
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<td></td>
<td>2029 pips</td>
<td>857 pips</td>
<td>885 pips</td>
<td>900 pips</td>
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January 22 – European Central Bank Meeting and Press Conference

Back in July of last year, the ECB surprised traders by opting to change its meeting frequency to every six weeks, like the Fed, instead of its previous schedule of every four weeks. This change, along with the decision to start publishing the minutes from its meetings, will go into effect in January 2015 and will increase the importance of each ECB meeting. As of writing, the central bank is debating a possible sovereign QE program to combat entrenched deflationary pressures, so traders should keep a close eye on the central bank’s meetings for potentially big monetary policy changes in 2015.

February 11 – Bank of England Quarterly Inflation Report

While the regular rank-and-file Bank of England meetings have hardly been exciting over the last few years, the central bank’s Quarterly Inflation Reports have been far more informative for traders. The BOE typically uses this publication to outline its longer-term views for the UK economy and monetary policy. With inflation at a low (and falling) level heading into 2015, traders will eagerly devour these reports for hints about economic expectations and any potential changes to monetary policy.
March 5 – European Central Bank Meeting and Press Conference

Back in July of last year, the ECB surprised traders by opting to change its meeting frequency to every six weeks, like the Fed, instead of its previous schedule of every four weeks. This change, along with the decision to start publishing the minutes from its meetings, will go into effect in January 2015 and will increase the importance of each ECB meeting. As of writing, the central bank is debating a possible sovereign QE program to combat entrenched deflationary pressures, so traders should keep a close eye on the central bank’s meetings for potentially big monetary policy changes in 2015.

March 18 – Federal Reserve Monetary Policy Meeting, Summary of Economic Projections and Press Conference

Over the past couple of years, the Fed has reserved major monetary policy meetings for its quarterly meetings that also feature the release of the central bank’s Summary of Economic Projections (including the so-called “dot chart”) and press conferences so it can fully explain the decision. This year, these supercharged Fed meetings take place in March, June, September, and December, so readers should be prepared for a possible spike in volatility around those releases as traders look for more insight from the notoriously inscrutable central bank. As we go to press, futures markets are pricing in an interest rate hike by the Federal Reserve midway through 2015, but that expectation will undoubtedly fluctuate based on incoming economic data.

March 22 – Sweden General Election

As we go to press, the ruling Social Democrat-led government in Sweden has called for snap elections after surprisingly losing a budget vote. By law, this poll cannot be made official until December 29th, but assuming it is called as expected, the Swedish krone may face headwinds from political uncertainty in the first quarter of the year.

April 15 – European Central Bank Meeting and Press Conference

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May 7 – United Kingdom General Election

For information on the general election, see section 6 - UK: A Dramatic Shift in the UK’s Political Landscape.

May 13 – Bank of England Quarterly Inflation Report

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into 2015, traders will eagerly devour these reports for hints about economic expectations and any potential changes to monetary policy.

**June 3 – European Central Bank Meeting and Press Conference**

Back in July of last year, the ECB surprised traders by opting to change its meeting frequency to every six weeks, like the Fed, instead of its previous schedule of every four weeks. This change, along with the decision to start publishing the minutes from its meetings, will go into effect in January 2015 and will increase the importance of each ECB meeting. As of writing, the central bank is debating a possible sovereign QE program to combat entrenched deflationary pressures, so traders should keep a close eye on the central bank’s meetings for potentially big monetary policy changes in 2015.

**June 17 – Federal Reserve Monetary Policy Meeting, Summary of Economic Projections and Press Conference**

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**July 16 – European Central Bank Meeting and Press Conference**

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**August 12 – Bank of England Quarterly Inflation Report**

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**September 3 – European Central Bank Meeting and Press Conference**

Back in July of last year, the ECB surprised traders by opting to change its meeting frequency to every six weeks, like the Fed, instead of its previous schedule of every four weeks. This change, along with the decision to start publishing the minutes from its meetings, will go into effect in January 2015 and will increase the importance of each ECB
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**September 17 – Federal Reserve Monetary Policy Meeting, Summary of Economic Projections and Press Conference**

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**October 19 – Canadian Federal Election**

**October 22 – European Central Bank Meeting and Press Conference**

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**November 11 – Bank of England Quarterly Inflation Report**

While the regular rank-and-file Bank of England meetings have hardly been exciting over the last few years, the central bank’s Quarterly Inflation Reports have been far more informative for traders. The BOE typically uses this publication to outline its longer-term views for the UK economy and monetary policy. With inflation at a low (and falling) level heading into 2015, traders will eagerly devour these reports for hints about economic expectations and any potential changes to monetary policy.

**December 3 – European Central Bank Meeting and Press Conference**

Back in July of last year, the ECB surprised traders by opting to change its meeting frequency to every six weeks, like the Fed, instead of its previous schedule of every four weeks. This change, along with the decision to start publishing the minutes from its meetings, will go into effect in January 2015 and will increase the importance of each ECB meeting. As of writing, the central bank is debating a possible sovereign QE program to combat entrenched deflationary pressures, so traders should keep a close eye on the central bank’s meetings for potentially big monetary policy changes in 2015.
December 16 – Federal Reserve Monetary Policy Meeting, Summary of Economic Projections and Press Conference

Over the past couple of years, the Fed has reserved major monetary policy meetings for its quarterly meetings that also feature the release of the central bank’s Summary of Economic Projections (including the so-called “dot chart”) and press conferences so it can fully explain the decision. This year, these supercharged Fed meetings take place in March, June, September, and December, so readers should be prepared for a possible spike in volatility around those releases as traders look for more insight from the notoriously inscrutable central bank. As we go to press, futures markets are pricing in an interest rate hike by the Federal Reserve midway through 2015, but that expectation will undoubtedly fluctuate based on incoming economic data.

No date set – Major IPOs

A number of major private companies are mulling over Initial Public Offerings (IPOs) in 2015, including the UK’s Everything Everywhere mobile phone operator and Ferrari, the Italian luxury auto maker. Expect global equity markets to exhibit elevated volatility and volume on these days.
EXCLUSIVE: TOP TAIL RISKS FOR 2015

UKIP Get into Power in the UK

We have included a section on the UK election elsewhere in this report, but in the spirit of outrageous predictions for 2015 we thought we would try and predict what would happen if UKIP get into power next May. UKIP get into a power-sharing collation with the Conservatives in May, but don’t expect Nigel Farage and David Cameron to have a bromance in the garden of Number 10; instead the focus will be on the EU in/out referendum in 2017. If Farage gets his way then this will happen a lot sooner than 2017. The uncertainty about the UK’s position in the EU sees traders ditching the pound and the FTSE, leading to GBPUSD falling further than it did in 2008 when it touched 1.3500, and the FTSE 100 falling below 3,500.

Italy Leaves the Eurozone – Berlusconi Makes a Comeback

The Italian public gets fed up of Matteo Renzi telling them what to do and why they have to work until they are 65 to get a pension; they ditch him and call for Berlusconi to come back and lead their nation. The former Italian PM is pardoned from all previous and future investigations over his private life and tax affairs and, after a snap election, comes back into power in a blaze of glory. This is Germany’s Angela Merkel’s worst nightmare. She decides she can’t survive another EU summit with Italy’s PM, so she makes a push to oust Italy from the Eurozone. The German chancellor manages to force Italy out; Merkel makes a pledge to keep the rest of the Eurozone together and EURUSD rallies to 1.50.

Russia Declares War on the US and EU – Cold War 2.0

The spat between Russia and the West elevates even further in 2015 with Russia declaring a Cold War on the West, and cutting off diplomatic ties. Russia solidifies its position in Ukraine even further and Putin threatens to continue to expand further into Eastern Europe. This invokes the ire of the West who installs troops in Poland, Slovakia and Hungary to avoid further Russian expansion. This triggers a harsh response from Russia, who cuts off the gas supply to Europe. The result is a dramatic rise in the oil price, which saves the fracking and shale oil industry in the US, while also helping the Russian economy. The boon to both the US oil industry and to Russia’s economy dampens tensions between Russia and the West and by early 2016 the shortest Cold War in history is a thing of the past.

Oil falls to $40

In an effort to encourage Iran to dismantle large parts of its nuclear infrastructure, the US and its allies rescind embargoes and sanctions on Iranian oil and make it universally available on world markets. Despite having the world’s fourth largest proven crude oil reserves, Iran has substantially reduced its oil production over the past few years as sanctions had a profound effect. The new freedom to trade encourages Iranian oil fields to ramp up production exponentially and essentially floods the market with even more supply, which causes oil to fall to $40/barrel. This triggers a default in Russia, sharp rate cuts in Norway and a record decline in the Norwegian krone. The Aussie also gets hit, while Europe falls deep into deflation causing the ECB to embarks on the world’s largest QE programme.
The Swiss Get Serious with the Peg

Since the Swiss National Bank enacted a floor on EURCHF at 1.20 back in September 2011, volatility in EURCHF has been non-existent with weekly closes in the previously volatile pair being contained to a 500-pip range over the last three years. But as pressure builds on the EUR the SNB will be forced to raise its seemingly immovable floor on EURCHF up to at least 1.30 to stimulate its moribund economy, injecting some volatility into EURCHF. Both GDP and Inflation in Switzerland have essentially ground to a halt, and if economic activity in the Eurozone falls further, the SNB will have no choice but to raise the floor in a regional trading war with its largest trading partner. Then again, that may be just my desire for cheaper Swiss chocolate speaking!

USDJPY to 150 in 2015!

USDJPY is being propelled higher by the divergence of monetary policies between the US and Japan. While the Bank of Japan floods the market with liquidity, the US Fed has ended its own quantitative easing program and is preparing to begin raising interest rates. The prospect of even more stimulus from the BoJ and a stronger-than-expected economic recovery in the US threatens to send USDJPY to heights not seen in decades. Tokyo’s efforts thus far to stoke inflation and boost growth have largely been unsuccessful and the BoJ may be forced to boost QQE if we don’t see a significant pickup in economic activity, especially if energy prices continue to fall, domestic demand remains subdued and trade-exposed sectors fail to materially respond positively to a weaker yen. In the US, inflation forecasts remain somewhat subdued, but a strengthening inflation outlook alongside an already solid recovery in the labor market would encourage the Fed to begin hiking interest rates sooner than presently expected. If this scenario begins to play out early next year, it may prompt a rally in USDJPY through 2007’s high around 125.00 and then on towards further resistance around 135.00 and then 150.00.

Parity in EUR/USD

At the start of 2014, virtually no one had predicted the oil plunge, the extent of the US stock market rally or that global interest rates would have remained low for this long. While parity for EUR/USD may sound outrageous now, it may not towards the end of 2015. The reason is simple: disparity between the ECB and Fed monetary policy stances. While the latter is expected to hike rates in response to an improving economy, the former may even unleash a full-scale QE program to fight off deflation threats in the Eurozone.
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