FXTM

QUARTERLY **MARKET** FORECAST

2017

Q1

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Introduction

2016 has been a remarkable year for the financial markets. It was the year that Donald Trump was elected the 45th president of the United States, the year the United Kingdom voted to leave the European Union and the year the Federal Reserve raised interest rates in the US for the second time in the last 10 years.

These events, along with others, shook the markets and took both Market Analysts and traders on a rollercoaster ride.

One thing is certain, the markets will never cease to surprise. Therefore understanding the impact these events have can boost any trader's potential as well as help limit their exposure to risks. By preparing for what's to come you can adjust and strengthen the trading strategy that could potentially yield the most profits.

FXTM's Quarterly Market Forecast will guide you through the most exclusive insights on all major instruments, straight from our team of Market Analysts, and put you one step ahead on how the markets are expected to move in the coming months.

01

EURUSD:

Upside capped to USD weakness once again

Are we finally going to meet parity? That is the question on everyone's mind for the past two years following persistent speculation around Eurodollar parity.

The acceleration of selling momentum during the final two months of 2016 and the upcoming political risks edging towards Europe over the course of 2017 have encouraged a general consensus that if the Eurodollar is bound for parity, 2017 is the time. That is the view if you are attracted to the market headlines, but sceptics will remain, and arguably rightly so, considering we have been speaking about Eurodollar parity for the past two years!

Aside from the political risks heading towards Europe with major elections in both France and Germany in 2017, growth and monetary policy divergence is seen as the reason for the Euro remaining at a clear disadvantage to the USD. With that being said, the threat of further populism should not be understated, as there

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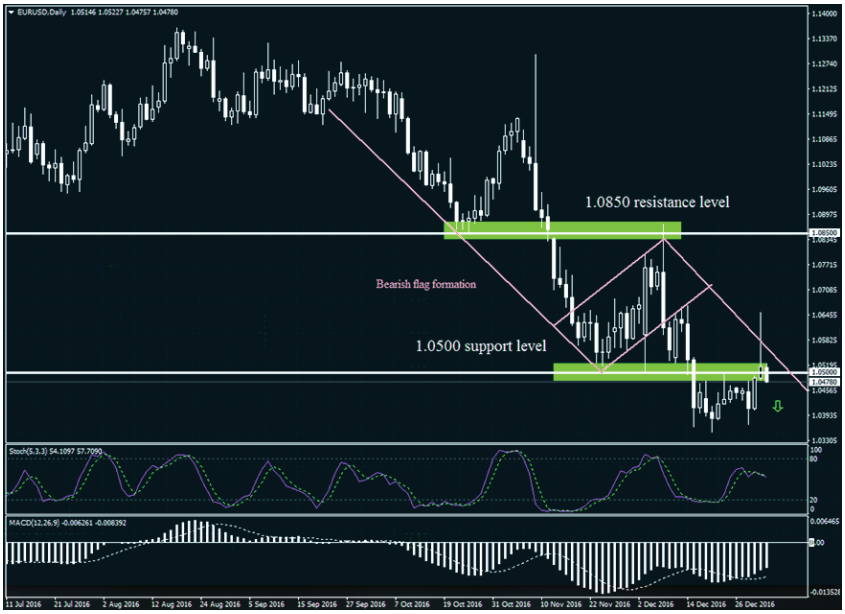

are political risks in Europe next year threatening further moves towards the anti-establishment; following the recent victories in both the United Kingdom and the United States providing an eye-opener to everyone over the past seven months.

Ultimately, what this means if you are trading the Eurodollar is that, for the second year in a row, buyers are going to find upside gains in the pair capped to USD weakness. This is exactly where traders need to be careful because, as we have seen on countless occasions in the past, if there is a round of unwinding in USD positions it can lead to spectacular bounces higher in the Euro.

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This is also why it should be pointed out that the market reaction to the official inauguration of Donald Trump could be used as a major catalyst towards whether the long-talked about move to parity is actually on the horizon.

The markets basically need reassurance that Trump will introduce the expected business friendly policies as soon as possible after he takes over office, and that the US interest rate outlook will include at least two interest rate increases to hang onto USD positions. Both of these factors occurring would help push the Eurodollar over the finish line and the looming political risks in Europe should encourage investors to refuse the temptation to purchase the Euro at weak levels.

When you factor all of the above together, there is no doubting that the fundamental picture for the Eurodollar is bleak, but technical traders will be more than aware that there are still some barriers of defence left for the pair before the long-talked about move to 1:1 can be encouraged. A look at the charts shows that 1.05 has acted as a line of psychological support on a

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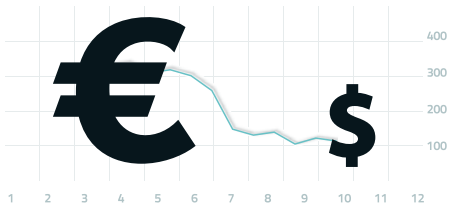

number of different occasions throughout the final months of 2016, and that a failure to close below this level had previously encouraged a retracement higher on each occasion. While 1.05 was finally breached late in December, I still believe that we need to conclude trading for 2016 below this level to avoid the risk of being caught off-guard with another sudden retracement.

Moreover, and if you look even deeper at the technical picture, severely strong psychological support is seen at 1.0460 and we might even need to conclude trading on a monthly basis below this level for encouragement to arise that investors will continue pricing in further declines towards parity. Where is the upside capped? It's difficult to say considering the Euro is extremely sensitive to sudden USD weakness, but it is likely to find tough resistance between 1.0750 – 1.08. You would need a successful close above these levels in order to expect a correction around 1.10-1.11, but considering the imminent political risks heading towards Europe and the current support in the Dollar, I would personally say this would be ambitious to expect.

02

GBPUSD:

Brexit woes continue to limit attraction

Uncertainty is **expected to continue playing out** as the name of the game when it comes to the **British Sterling**, with uncertainty being used as the reason behind investors continuing to install rounds of selling onto the GBPUSD over the past seven months.

The currency is expected to stumble into 2017 under pressure, especially with it being known that UK Prime Minister Theresa May is currently expected to invoke the long-awaited Article 50, as we approach the end of March 2017.

Much has been made about the resilience of the UK economy since the unexpected events of June 23, however, what investors must realise is that all that has been priced into the currency so far is the EU referendum vote outcome and that the UK has not officially commenced negotiations to leave the European Union at this stage. The opening quarter of 2017 is viewed as a critical period because this is when the process to officially begin leaving the European Union is set to

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begin, which could play a role in dictating how the Sterling performs over the remainder of the year, at the very least.

The argument over whether the Sterling could be undervalued will remain in the headlines, taking into account that the UK economy is consistently performing as one of the strongest in the G10, but this is unlikely to deter investors away from the current trend to sell on rallies. Article 50 in itself is seen as a major event risk and when it is finally invoked, it could provide the catalyst to the Pound facing another leg lower.

Upside gains are seen limited to brief recoveries, but meaningful gains in the Pound could be limited to Dollar weakness, meaning investors should keep an eye towards how the Pound performs after Donald Trump is officially inaugurated as President of the United States later in January. Another hope for the Pound could arise if the looming political risks in Europe, with major elections set to take place in France and Germany, encourage investors to divert their attention away from the ongoing Brexit saga.

While the outlook for the Pound seems to be currently pinned heavily towards the direction of further pressure, what provides support for the currency is the ability for the UK Government to vote on the Brexit strategy. This has played a major role behind the Pound failing to return to its flash-crash lows below 1.20, when hard-Brexit fears hit their peak.

In regards to the technicals, the Sterling is bearish on both the Weekly and Monthly timeframes, with the GBPUSD meeting the prerequisites of a bearish trend through a consistent run

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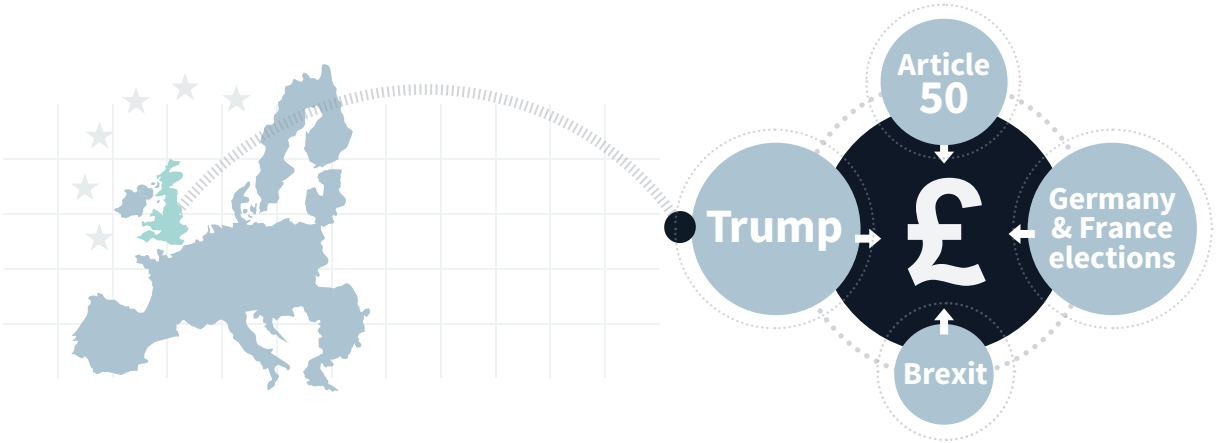

of lower lows and lower highs. The weekly charts continue to be dominated by sellers, with a decisive break down below the psychological 1.230 level, encouraging a further selloff towards 1.200. While bears are clearly in control on the daily timeframe, bulls could receive some inspiration for a small recovery if the GBPUSD manages to close back above 1.2350.

If you are looking for a significant correction in the British Pound, 1.2350 is a hurdle that could open the gates for another retest of the high before the flash crash at 1.2775. Either way, 1.30 represents the historical low that was reached on the night of the EU referendum and will be used as the psychological pivot to escape the overall bearish bias that has limited the GBPUSD to short-term recoveries throughout the second half of 2016.

03 AUDUSD:

Australia at risk to a technical recession?

Headlines late into 2016 around the **Australian economy made for a disappointing read with a quarterly GDP contraction igniting fears over the possibility of entering a technical recession**, something that, if occurred, would spell the end to a remarkable **25 years** recession free for Australia.

There have, in all honesty, been concerns over the underlying momentum of the economy for some time, including a reliance on part-time job creation and an overheated housing market. With Australia remaining under pressure to rebalance towards domestic consumption the reports late in 2016 that wage growth reached record low levels, will add pressure on consumer spending and any signs of muted domestic demand will likely lead to the Reserve Bank of Australia (RBA) being in favour of another interest rate cut before the second half of 2017.

What needs to be pointed out when it comes to the slowdown in growth for the Australian economy is that monetary policy has been regularly active since early 2015, with various

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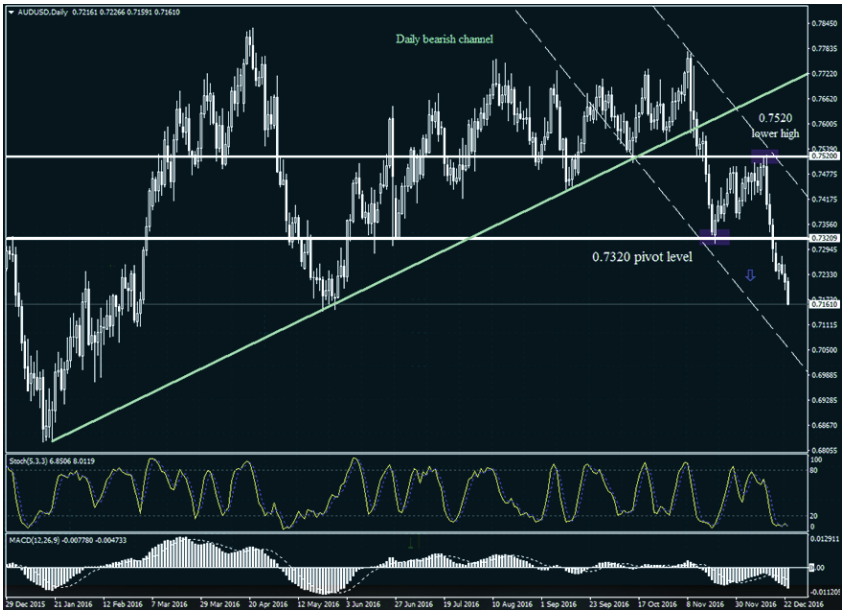

interest rate cuts - aimed to boost domestic spending - not having the desired impact but encouraging house price risks.

As spectators realise that further stimulus is not the only answer to help the economic downturn in Australia, the focus will shift away from the RBA and towards the government needing to continue passing reforms to drive investment and spending. While the above does not paint the most favourable picture for Australia, the risks of falling into a technical recession are seen as unlikely. The recent end to the five-year downturn in commodity prices has not yet been factored into the economy and could be used as a game-changer for Australia. The current expectations for an infrastructure spending push from Donald Trump have been pivotal towards the rally in some commodities, with Copper being seen as one of the clear winners and the rally in commodities should support the mining industry for a little while longer.

Signals of stable growth in China should also support the outlook for the Australian economy as the nation is known on a global scale as China's main trading partner. What should be kept in mind however, is that any signs of the Chinese property sector cooling down will run the risk of pressuring demand for Australia's exports.

In regards to the foreign exchange outlook, the market expectations for the AUDUSD remain tilted towards further pullbacks at this stage.

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A return to 70 cents, and possibly below, would not be negative for the Australian economy; considering the pressure the Dollar strength has had on the global currency markets over the final months of 2016. The overall expectations that the RBA will remain under pressure to ease further will limit buying attraction. A rebound towards the end of Q1 should not be ruled out if investor attention shifts back to Europe, with the UK invoking Article 50 and the upcoming elections in France seen as major political risks.

Technically speaking, a return towards 0.77 is not expected and unlikely to occur unless there is a major unwinding in USD positions. The current bias is still edged towards the lower 0.70's for as long as the peak slightly below 0.75 remains in place, and a weekly close above 0.75 is required for the AUDUSD to return to higher levels. Traders in the meantime will remain encouraged to target pullbacks, with support around the 0.7320 area seen as the catalyst for igniting selling momentum towards the lower 0.70's and possibly even lower.

Once support at 0.7320 is breached, traders can begin to target 0.70, but a weekly close below 0.70 is needed for the AUDUSD to return to milestone lows, last seen early in 2016. The Weekly and Monthly charts still signify that the pair remains in a clear downtrend and the bottom line is that the AUDUSD will remain under pressure while the peak slightly below 0.75 remains in place.

04 USDJPY:

Further rally ahead, or risk of exhaustion?

The volatility experienced in the USDJPY over the course of 2016 was simply remarkable. To think that the USDJPY could decline close to 20% is serious business and would, in most cases, represent a bear market for investors. To then consider that the pair could later reverse over half of those losses at around 15% in less than two months is unreal, but this is the story of the USDJPY over the course of 2016!

This is the toughest projection to make and there are reasons to believe the pair can continue to trade higher, but I am overall siding towards the view that the USDJPY is now exhausted with the possibility of a pullback below 115, something that can't be fully ruled out over the course of Q1.

For those who would prefer further gains in the USDJPY and potentially above 120, you have interest rate differentials between the United States and Japan as well as the ongoing desire for prolonged weakness in the Yen from the Bank of Japan (BoJ) on your side. In essence, the requirement for another overshoot in the USDJPY is likely to rest behind whether Donald Trump can assure spectators

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during his inauguration ceremony that he can realistically deliver on macro policy. At the moment, and regardless of how positive of an impact his campaign promises to have on the US economy, they are still at this point hypothetical and need to be confirmed in order to encourage further milestone highs in the Dollar, and consequently, a meaningful return above 120 for the USDJPY.

There are a couple of valid reasons why you would side with the bears, which is what I am leaning towards at the time of writing. Even if Trump is able to deliver on macro policy it will still take some time for measures to be passed through the legal system, if it is passed through at all, and this could encourage investors to take profit on some very healthy returns. The low risk profile of Japan that leaves the Yen as the most desirable asset of choice for safe-haven drives can't be ignored, and we witnessed this on countless occasions throughout 2016. Japan itself remains isolated away from the current anti-globalisation and anti-establishment emergence that has driven politics in Europe and the United States, which could result in some attraction towards the Yen if political risks emerge again.

Traders need to be careful when monitoring the technical picture, because the moves over the past two months have been encouraged by an extreme shift in fundamentals, and the technicals have basically lost complete control. After a rally at around 15% in under two months, all of the indicators are likely to show overbought levels and possible signs of exhaustion but this will not matter if Trump is able to reassure spectators during his inauguration that he can deliver on his campaign pledges.

While the weekly chart does suggest that we are in a correction phase after the previous downtrend, the monthly chart suggests the rally might be running out of steam over the near term. A simple look at how fast this pair has recovered on the daily chart is enough to see why there is a valid argument that the USDJPY is at risk to severe levels of exhaustion.

Overall this is a tough projection to make with valid points on either side of the debate. I would conclude by saying that if you are confident that Donald Trump can encourage further confidence in the US economic outlook and inspire additional gains in the Dollar, 120 is the psychological target. A close above this level on either the Weekly, or even better Monthly, timeframe represents what is required if you are hoping for the USDJPY to return to its milestone highs - last seen in late 2015 near 124.

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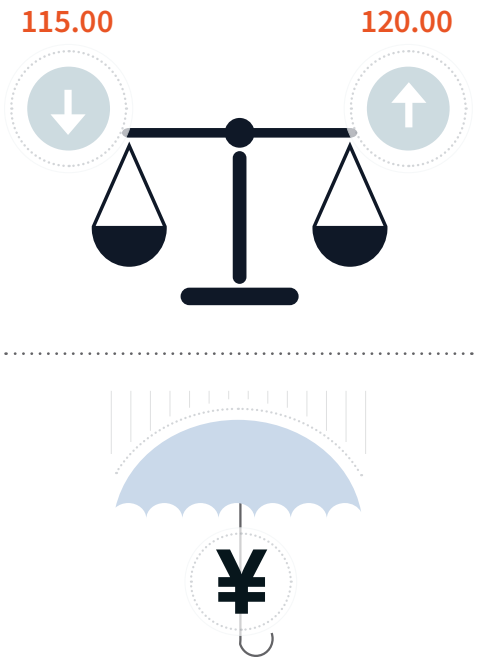

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05
GOLD:

Could Gold be oversold or under bought given political risks?

Gold concluded 2016 under heavy pressure with the precious metal declining by $200 over the final eight weeks of the calendar year. Essentially, the story of Gold throughout the closing period of 2016, is a suffering of losses following the spectacular Dollar drive in reaction to Trump winning the US election, and the metal ended up concluding the year at roughly the same levels to where it was trading in the final weeks of January 2016.

With Gold trading at depressed levels, only a little over $100 away from the milestone $1000 level, there is temptation to traders and an ongoing question is being asked as to whether Gold could possibly be oversold or undervalued at these levels. While it will read like sitting on a fence, the truth is that this is a difficult question to answer and there are arguments for both sides of the debate.

The combination of external uncertainty and political risks in the global headlines is a reasonable consideration for investors, however, the continued drive in the Dollar and optimism over what impact expected Trump policies can have on the US economy should encourage the near-term selling bias to remain. The Donald Trump inauguration

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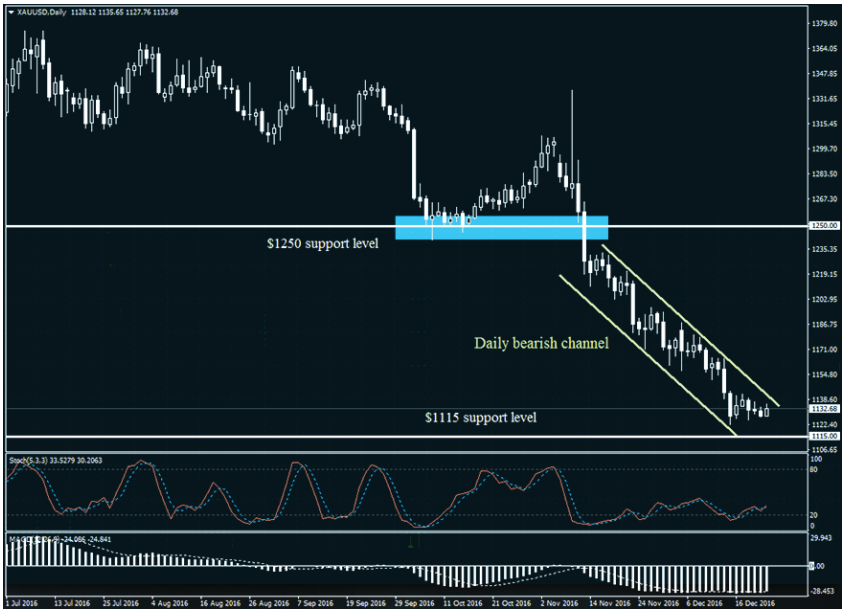

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will represent a major event risk for investors, one that traders of Gold must be careful towards, because the market reaction to Trump officially becoming President of the United States will play a major factor behind how Gold trades for the remainder of Q1.

While the concerns over populism and the rise of the anti-establishment with elections in Europe next year are understandably making investors second guess whether we might be in for a correction sometime soon, I ultimately believe that the reaction to the Trump inauguration will set the overall tone for Q1, and concerns over political risks in Europe might encourage a correction on headline as we approach the latter parts of Q1 and head into Q2.

Ultimately, investors have shown of late that they are more than capable of ignoring bad news. If you think back to the rallies in the equity markets, there is no real reason to expect that to change with ongoing global debt and upcoming European elections in mind; considering how the markets have priced in the shocks to both the United Kingdom and the United States over the past eight months.

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In regards to the technicals, all of the charts show that Gold is in a clear downtrend, with the Weekly chart in particular, showing that the metal is actually in freefall. Sticking with the Weekly chart, there has been a series of consecutive lower highs since week commencing on the 6th November and that pattern will need to stop if we are to expect Gold to at least attempt a consolidation phase early in 2017. The Monthly chart suggests that a close below the zone between $1130 and $1115 is required for another leg lower. In the meantime, it is possible that Gold will attempt a consolidation phase.

I overall believe that investors will decide to play the correlation game and hold fire when it comes to pricing in a meanwhile correction into the price of Gold, with a consolidation phase being the best hope for the metal to find support at this stage. What would provide encouragement to traders that Gold could make a meanwhile correction? Investors taking profit on the Dollar after the Greenback concluded 2016 reaching levels not seen since around 2003.

06
OIL

Can the production cut support a meanwhile rebound?

The Oil markets received a welcome boost in the final quarter of 2016 following the **unexpected agreement to cut production between OPEC and Non-OPEC** members providing some relief to the ongoing oversupply concerns. The prospects of major oil producers trimming output by around 1.76 million barrels a day in the New Year propelled WTI Crude to fresh 2016 highs above $54, however, gains from this point could be limited if anxiety arises from the compliance side of the market shaking deal.

With the settlement between OPEC and Non-OPEC not legally binding, and no punishments in place for going against the arrangement, there is a question of trust between oil producers that remains in the air and is leading to scepticism over whether those who agreed to a production cut will actually respect it.

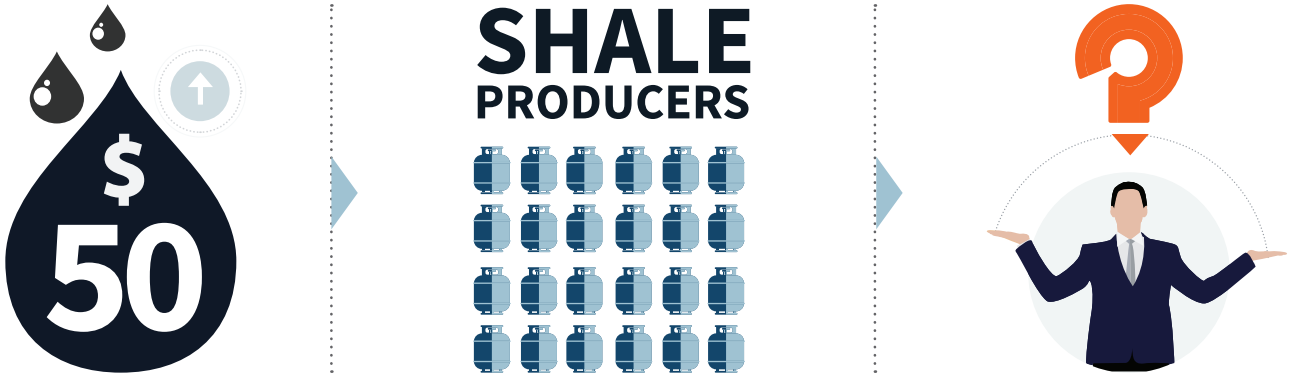
As we enter 2017, the above question will remain under the spotlight and Donald Trump will also be viewed as a major unknown to the oil markets. The President-elect has previously shared negative views on OPEC in the past while his current views on the price of oil are unknown. With Trump stating in the past that the cartel was trying to artificially control the price of oil, investors may keep a close eye on whether he repeats these claims and if he tries to support the US shale industry through deregulation, encouraging further output. It is already speculated that the price of Oil rebounding above $50 might encourage Shale producers to turn the taps back on when it comes to production, and this could alert concerns over the oversupply increasing once again.

In order for WTI Crude to maintain gains in the New Year there must be signs of OPEC and Non-OPEC members respecting their pledge to cut production.

1.76
MILLION
BARELLS A DAY

OPEC VS **Non-OPEC**

Recent history has often shown that rallies in the price of oil can fall like a house of cards and this is why many still remain sceptical about the recent recovery. With variables such as Trump, a resurgent Dollar and repeated warnings of slowing growth sparking concerns over a fall in demand for the commodity, oil could be in store for another chaotic year filled with explosive levels of volatility.



In regards to the technical outlook, WTI Crude on the monthly chart may be on route to challenging the previous lower high at $60, which is also seen a strong psychological resistance. Despite the initial chaos created from the fluctuating expectations of an OPEC deal earlier in the year, monthly bulls seem to be in control with the break above $52 opening a path to $60. There have been consistently higher highs and higher lows on the weekly timeframe, while lagging indicators such as the MACD are in favour of further upside. Daily traders may pay extra attention to how prices respect the daily ascending triangle pattern, with a breakout above $54.50 providing the permission needed for bullish investors to install another round of buying between $56 and $60 respectively. While the technicals clearly signal that bulls are currently in control on the daily and weekly charts, investors should keep diligent as bearish fundamentals could spark a sharp selloff and the oil markets are known to be overly sensitive to speculation over shifting fundamentals.

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MARKET FORECAST SUMMARY FOR Q1 2017, BY HUSSEIN AL SAYED

FXTM Chief Market Strategist and CNBC Arabia host

Whether you consider 2016 a good or bad year, it was by no doubt the year of surprises. Not just because Donald Trump was elected the 45th president of the United States nor because the UK decided to leave the EU, but because the markets' reactions to these events were even more surprising and most forecasters got it wrong.

A new year has begun and many questions remain to be answered in 2017: Will the Trump rally carry on? How many rate hikes will the Fed deliver? What is the future of the UK and the EU? Will OPEC finally balance the oil markets?

Will the Trump rally carry on?

Following the election of Donald Trump on November 8, all U.S. major indices recorded new highs. The Dow Jones industrial average rose 8%, S&P 500 and Nasdaq composite gained 5%, and the small-cap stock market index Russell 2000 outperformed its peers rising by more than 13%.

From a market valuation perspective, very few may disagree that stocks are expensive, but the expected combination of fiscal stimulus and deregulation for some sectors under Trump's presidency were the main catalysts for the rally. Of course, financial markets tend to price in events before they occur, but this time I believe investors have priced in most of the good news, and it requires very strong corporate profit growth to keep this bull market alive. Predicting the end of the bull market is a tough call, but the downside risk in 2017 is likely to be larger than the upside potential. If U.S. policy makers succeed in delivering the anticipated growth, we can see another 5 – 10% gains in U.S. stocks, but failure to do so will cause a steep selloff that could exceed 20%.

Day traders may be luckier than investors in 2017, as a new indicator has been added to their watch list: Trump's twitter account. On December 6, Trump tweeted "Boeing is building a brand new 747 Air Force One for future presidents, but costs are out of control, more than $4 billion. Cancel order!", few seconds later the Boeing stock wiped almost $1 billion from its market cap. We expect to see more of these tweets in 2017 and algorithms will probably require long time to put them into play, leaving retail traders with opportunities to profit from such market disruptions.

How many rate hikes will the Fed deliver?

2016 kicked off with the expectation that four rate hikes would occur, but only one was delivered in December. Although it was anticipated that the Federal Reserve will be more cautious in their forward guidance for 2017, December's meeting took many economists by surprise as they hinted for three rate hikes.

Since the financial crisis in 2008 the Fed has got many things wrong, whether it is forecasting rate hikes, economic growth and inflation levels, and now with a new administration to take office on January 20, this could make the Fed's projections even more complicated.

Inflation has always been the main justification for low interest rates, but now, even before Trump takes office, a couple of inflation gauges are running above 2%. The Fed did not account for any fiscal stimulus measures in their most recent projections, suggesting that huge shifts in expectations may be seen.

The rising U.S. dollar which is currently at a 14-year high is another source of worry for the Fed, and tightening too fast will lead to an even stronger dollar hitting U.S. exports and multinational companies' profits.

If Trump's measures were passed and economic growth picked up, the Fed will have few options, either tightening monetary policy more aggressively, or to fall behind the curve and let the fixed income market lead the way, but three rate hikes in 2017 is my base case. Either way the dollar is likely to remain strong as divergence in monetary policies will continue to widen.

Future of the UK and the EU?

Hard, Soft or Grey Brexit. This was the most argued topic in the past six months, and until now there's no clear path on what direction the UK will move. The pound ended 2016 17.5% lower against the US dollar since June 23, and there's lot of speculation on how it will end in 2017. Of course, much will depend on the path Britain will choose. Theresa May promised to trigger Article 50 by the end of March, but we still need to hear from the Supreme Court on whether the UK government needs parliamentary approval before starting the withdrawal from the EU.

The delay in triggering Article 50 will be positive in the short term for the sterling, and negotiations may last well beyond 2017 on the terms of Brexit. Meanwhile, investors will be focusing on the economic developments and the direction of the Bank of England's monetary policy, which will probably be the second major central bank to raise rates after the Fed.

Politics within the EU will rule investment decisions in 2017. Germany and France, the two largest economies, will hold elections amid the rise of Eurosceptic candidates. Italy is likely to see an early vote, after the resignation of Matteo Renzi last month, and the Five Star Movement has vowed that; if it wins power, it will hold a referendum on whether Italy should leave the Eurozone.

Although many polls indicate that far right candidates are still behind, nothing should be taken for granted after Trump won the U.S. presidency and Britain voted to leave the EU. Expect to see more pressure on the Euro and look out for parity against the dollar in the first six months.

Will OPEC finally balance the oil market?

After hitting a low of $27 a barrel in February 2016, Brent prices more than doubled by the end of the year and many investment banks still see further increase in prices for 2017.

OPEC's decision to cut its output by 1.2 million barrels a day starting January, and non-OPEC producers to cut 558K barrels for the next six months to drain record global oil inventories led to Brent prices posting their first yearly increase since 2012.

Whether more appreciation is to be seen in 2017 will depend on multiple factors, and the biggest one currently looming is compliance to production cuts. It's in no one's interest not to comply, but historic figures show that delivering on previous production cuts has been poor.

U.S. producers are another element to focus on, how fast shale may come back is a key component to be considered in the price equation. Although Trump has made the energy sector part of his economic growth plan, I believe it won't have a lot of impact if prices don't hold up. The dollar strength will likely impact the demand side, as continued strength will make oil more expensive in other currencies.

With all these unknows we will likely see prices moving in tight ranges in the first quarter until we get a clearer picture.

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IT'S FOREX TIME