

Update January 14th 2016

We are seeing further weakness in overseas stock markets with investors unsettled by global growth, attacks in Indonesia, low oil prices and a new VW type scandal on the horizon. DAX not lifted by German exception status within EU. European economies getting modest boost from domestic demand but financial markets priced on exports.

Punches just keep coming!

We are almost at the close of an exciting first two weeks of 2016 and the punches just keep coming! Investors are becoming –rightly – increasingly nervous as to growth prospects globally.

This has led to two reactions:

A continuing shift out of the emerging markets, deemed call options on global expansion

A flight towards the US Dollar – we believe that Euro strength results from the unwinding of EM carry trades. Bouts of single currency strength are excellent leading indicators of weakness in EM.

We are struck by the fact that currency shifts are increasingly US Dollar based with selling not only of EM but also of developed economy currencies.

Commodities echoing Charles Dickens – “Bleak House”!

Commodities are continuing to weaken. Copper which is an excellent indicator of industrial activity is near a six year low. We see this as further pressuring the balance sheets of the large mining groups and expect to see new stock lows.

We are hearing once again from the Chinese fellow travelers

The China “fellow travelers” having realized the utter futility of peddling the de-coupling story, are now resorting to emphasizing the strength of the services sector and income growth.

What about the debt in China?

While this is certainly positive, this is not enough to alter the current economic slowdown, the massive amount of local currency and foreign currency debt and the fact that the global economy shall not be saved by the sale of I-phones in Shanghai.

Expect more terrorism in Asia – Indonesia – the new Afghanistan?

Asian markets have also been unsettled by terrorist acts in Indonesia. We are not surprised and continue to see Indonesia as the politically most strategic and risk fraught country in the region. A large population, substantial natural resources and sprawling difficult to patrol land mass makes this an ideal target and operational base for terrorists.

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Problems with the ignition – is this another VW scandal?

Are we on the cusp of another VW scandal? With Renault shares down 20 per cent in one day, investors seem to think so! Once again, this is about emissions controls and may result in massive monetary fines, costly recalls and considerable economic exposure in terms of market share loss.

We are concerned as the auto sector shares due to the spreading scandals, may not be able to reap the full benefits of lower oil prices and the munificence of the ECB.

German exception - where are you?

What about the German exception? Notwithstanding a relatively strong economy – compared to their major Euro Zone counterparts – the DAX is tanking. Global growth jitters are taking their toll, despite stronger domestic demand, low unemployment and lower fuel prices.

We reiterate our view that German equity markets remain largely a leveraged bet on the EM sphere – notwithstanding hopes of offsetting China with the US.

Bank of England plays it safe

As we expected, the Bank of England left rates unchanged. With a slowing expansion in the services sector, weak manufacturing, Depression level inflation and flat wages, this was a logical decision. To this litany of woes are added a weakening global growth outlook – with EM focus – and the uncertainty from the EU referendum.

We see a rate increase not on the horizon and continue to see further UK sterling weakness. This shall be abetted by the Bank of England as competitive devaluation becomes acceptable within the EU.

US banks – key is capital strength

Turning back to the US, investors are continuing to focus on earnings, which so far have not shone by their brilliance. Whether financials shall provide some relief is uncertain. While some are focusing on net interest margin, we deem the capital strength issue as the lynch pin.

Boring shall be beautiful

The concern is less with earnings this quarter but on the capacity to expand your balance sheet and refocus on traditional banking business. With ever greater constraints on proprietary trading and market making – boring credit shall increase in importance.

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