

Update October 12th 2015

Economic fundamentals remain unchanged

This coming week markets shall be partially shifting gears as the earnings season starts in earnest with the banking sector at the forefront. While recognizing the importance of corporate results, we continue to see investors focused on:

- 1- Central bank action
- 2- (1) being driven by global considerations
- 3 –(2) focusing mainly on the desire to avoid systemic risks

Base case scenario remains slow growth – Federal Reserve lives in terror of EM sourced systemic risk

Our base case scenario continues to be slow growth- with an increasing disconnect between the financial economy and the “real economy”. Financial assets are rallying on a momentary “all clear” by a Federal Reserve which lives in terror of unleashing an EM sourced systemic episode.

EM enjoying a respite driven by Federal Reserve non-action

We are cautious EM and expect more turbulence regardless of any Federal Reserve decision – problems are structural and not cyclical. The great capital and flight money exodus has not yet begun! The upswing in currencies is being driven by a temporary postponement of the “Day of Reckoning” – for how long remains unclear.

Sentiment steadied by hopes of new Chinese government stimulus – overcapacity problem remains unsolved

Sentiment in the Asian markets appears to have been steadied by new indications and / or hopes that the Chinese government shall embark on new stimulus plans. Whether this shall be sufficient to stem the decline in industrial production or solve the overcapacity problem is doubtful. This is the application of stop-gap measures to a structural problem and we see the key point – persistence of deflationary pressures – not abating.

Remain cautious on demand for commodities – Chilean government reviewing its financial strategy

As regards commodities, the China story is filtering through and providing a modest boost. Will this herald another commodity boom or “boomlet” We remain cautious on a sector where demand is expected to fall, this is reflected in a change in government financial strategy in Chile, whose peso is known as the “copper currency”.

Disappointed at impact of “oil dividend”

We are now reading that US consumers are spending the “oil dividend” – should this be the case, we can expect a limited benefit going forward.

We reiterate our view that a wage increase is bankable and can be used to access credit and boost consumption. This is not the case with a reduction in expenses, which may prove fickle.

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Are bank reserves anticipating a turn in the business cycle?

We are starting to see reports that the US banks are starting to both slow the draw-down of their reserves and may soon start restocking them. Loss reserves to gross loans are now below their historical average.

Is this strictly a reaction to an anticipated rise in energy loans losses or are the banks hunkering down for a recession? Will the economy not be able to divorce from the repercussions on capital asset investment of the energy retreat?

OPEC – Oil day of reckoning is near – again ?

As regards oil, we are continuing to hear reports from the camp of the producers that the day of reckoning is near. OPEC's secretary general views the "elimination pricing" strategy as successful with the market in balance by the third quarter of 2016. This shall be brought about primarily by an increase in demand.

The market remains oversupplied and the CEO of BP sees oil demand increasing slowly, by one third over 2 decades. With the drop in energy prices reducing costs, the shale oil producers shall "hang in there"!

Turkey – Risky business - where is the army?

We are continuing to focus on the situation in Turkey following a terrorist attack which has killed 95 people. Turkey remains a wild card with regard to the Middle East political chessboard. The army has traditionally been the guarantor of order in Turkey. Are they waiting in the wings?

With regard to emerging markets, we are hearing that an increase in US interest rates might prove positive for emerging markets. This would dispel the uncertainty. We might add that less uncertainty does not mean immediate massive inflows and still see US monetary policy as only one part of a much vaster mosaic

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