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Are we at the turning point? Glass half full better than nothing!

A bit too early for “hark the herald angels sing” but a ray of sunlight in the cold water - quote courtesy of the French writer Françoise Sagan – appears to be making a timid appearance in the financial markets. Dividing the proverbial glass into two parts – bottom half lower level of systemic risk and top half growth – investors have decided that a glass half full is good news.

Markets are seen as holding the line, with a possible victory in the offing. We are seeing the stabilization scenario continuing to play out – cyclical fluctuations are manageable and as long as US does not collapse, we shall be OK.

Key driver remains monetary policy – structural reforms sparse on the ground – deflation danger ever present

In our view, the principal factor driving the markets remains an overall generous monetary policy in the face of dismal growth prospects and continued deflationary pressures. Despite solemn pledges to the contrary – many central banks are venturing ever further into zero or negative yield territory.

Policy makers, having all but given up on top line growth are now focusing improving margins via the elimination of financing expense for the “happy few”.

ECB facing El Alamein moment – can the line hold?

That deflation remains a concern was highlighted by a speech by the head of the ECB yesterday – who reiterated view that ECB stands ready to review all measures. Deflation shall prove extremely difficult to fight for two reasons:

Overcapacity shall continue and labor force is being feudalized – this is the Nile Delta before the 1952 Revolution!

1- With China seeking 6 1/2 per cent growth, overcapacity shall not be throttled back overnight

2- In the developed economies there has been a massive re-casting of the labor market – where the rise of services – low paid positions and automation have crushed the bargaining power of the workers. Atomized labor is therefore resulting in a longer lag time in re-balancing wages and profit shares of GDP.

These forces have re-cast the developed economy labor force from the wage earner + benefits model to relationships like those prevailing in the Nile Delta before 1952 – feudalism.

Jean Ergas
(646) 780-8880
jergas@tigressfp.com
Twitter: @jean_ergas

Tigress Financial Partners
Member of FINRA / MSRB /
SIPC

500 Fifth Avenue
New York, NY 10110
(212) 430-8700

www.tigressfinancialpartners.com

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direct access to Jean, contact
research@tigressfp.com.

We keep looking at previous economic cycles as signposts for the future. This is like studying stock market cycles and PE ratios without tech.

US recovery does not deserve a consolation prize for showing up!

Moving from a brief historical analysis to today's data flow, US ADP data shows a still moderate pace of hiring. Whether this is a useful metric for the official release on November 6th, is in our view totally irrelevant. What is relevant is the snail's pace of the recovery – which does not even merit a consolation prize for showing up!

We need to reassess the relationship between employment and living standards - in the middle ages there was full employment – lives were nasty, brutish and short. There are several developed economies where the unemployed are living better than those with three jobs in the US!

The absorption of excess labor at lower real wages with scant prospect of redressing wage – profit imbalances does not bode well for the prosperous who wish to sleep comfortably.

Are we in a “Sixteen tons” economy?

We shall also be seeing data on US services, which provide the lion's share of the US economy and are domestically driven. Wither the US consumer in a social structure which is ominously inching closer to the “company store” in the immortal song “Sixteen tons”?

The service economy, which is the desperate buying often from the desperate – low wage buys from low wage – tends to have a fast pass-through of any incremental income. We are wary of deflation in services – internally generated.

Contacts

Jean Ergas
Chief Economist
(917) 551-6533 Direct
jergas@tigressfp.com

Ivan Feinseth
Chief Investment Officer
(212) 430-8730 Direct
ifeinseth@tigressfp.com

Philip Van Deusen
Director of Research
(646) 862-2909 Direct
pvandeusen@tigressfp.com

Brian O'Sullivan
Managing Director, Trading
(646) 798-8453 Direct
bosullivan@tigressfp.com

Ernest Williams
Institutional Sales & Trading
(646) 862-2912 Direct
ewilliams@tigressfp.com

Chris DeCarolis
Research Associate
(646) 402-6695 Direct
cdecarolis@tigressfp.com

About Jean:

Jean Ergas is the Chief Economist for Tigress Financial Partners LLC (Member FINRA, MSRB, SIPC) based in New York City.

He is an Adjunct Assistant Professor at New York University's School of Professional Studies and an Adjunct Faculty member at Manhattanville College. In 2014 he received the award for teaching excellence from NYU School of Professional Studies.

He is fluent in English, French, German, Italian, Spanish and Portuguese. He also has a certificate in Arabic – from NYU School of Professional Studies.

His career has spanned the complete range of macro risk analysis - energy / commodities with ENI - Global Fortune 500 17 - leading global natural resources group, capital markets with Swiss Bank Corporation (now UBS) and insurance / reinsurance with the A.M. Best Company. Jean contributes regularly to international media commenting on key macro-economic issues.

Jean is a member of the American Institute of Certified Public Accountants and has an MBA and an Advanced Professional Certificate in Accounting from New York University's Stern School. He has also passed the FINRA Series 7 examination.

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Research: (646) 780-8880 research@tigressfp.com

500 Fifth Avenue New York, NY 10110 (212) 430-8700 www.tigressfinancialpartners.com

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500 Fifth Avenue New York, NY 10110 (212) 430-8700 www.tigressfinancialpartners.com