



Update December 1st 2015

Stock markets mixed – Chinese data on the weak side – Euro Zone economy inching forward – BTG Pactual, expect some waves – Concerned as to US credit cycle

Stock markets

Stock markets are mixed this morning, with European stocks welcoming a Euro Zone economy which appears to combine the best of both worlds – while concerned about the mixed Chinese data. The Euro Zone economy is continuing to show signs of improvement – manufacturing firming and unemployment falling. However, while not at a pace which suggests any hint of capacity constraints and would cause prices to start rising

This leaves the road open to further easing by the ECB – giving a push to a car which seems to be already very slowly revving up. There is scope for betting on an intra-Euro Zone firming – “real economy” – while being able to continue the stock market “carry trade”.

Will European earnings post a dramatic recovery?

We are also seeing increasing calls as to a recovery in EU earnings after multiple disappointments. We do not see this as investors’ primary motivation. The key focus remains the possibility of financing “cash and carry trades” at a low cost. With borrowing rates often lower than dividend yields, this may prove hard to resist.

Chinese economy – parting of the ways

Turning to the emerging markets, the data out of China continues to point to a parting of the ways in the economy. While manufacturing continues to weaken, the service sector is advancing.

Some see manufacturing weakness as good news – we do not agree

While the improvement in services is welcome, we continue to see the Chinese economy as an economy which is far from having transitioned. The manufacturing data shall – in the eyes of the optimists – trigger further government stimulus programs.

Scarce success of measures so far

The fact remains that global demand continues to weaken, deflationary pressures are vibrant and that an avalanche of measures has yet to achieve any real degree of success. China is becoming an economy where services are becoming more important but it is not a service economy.

BTG Pactual saga – may not end peacefully

We are continuing to follow the BTG Pactual saga in Brazil and are not reassured by the continued run on the investment funds they manage. Whether this is going to start being the prelude to a reduction in financing access and the need for government help remains uncertain. However, history shows that these crises generally result in major changes – not always by peaceful means.

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Sovereign wealth funds busy raising cash

We read with interests as to massive redemption from emerging market funds by sovereign wealth funds. This reflects both the running down of FX reserves in the wake of slower growth and a likely shift in diversification in the direction of the developed economies, in particular the US.

We expect the sovereign wealth funds to continue to sell off and draw down on their holdings, reducing “weight of money” and – in certain asset classes – liquidity.

Focus on the US***Awaiting US manufacturing data – car sales speeding***

With regard to the US, we shall be seeing US manufacturing data and vehicle sales. US manufacturing, which is being impacted by the slowing in the global economy, shall at best post a slight increase. The bright spot remains auto sales. While the 2011 – 2012 boom reflected pent up demand from the dog years of the recession, the current boom rests on lower oil prices, continued low financing costs and greater confidence among the employed.

Credit cycle peaking in the US – usual suspects named!

There are increasing reports as to the peaking of the credit cycle in the US. The usual suspects are being named, with investors becoming increasingly skittish as to leveraged loan funds.

Leveraged loan market contracts – less M+A – what happens to the stock market?

This is in turn making it more problematic for investment banks to cobble together the financing which has underpinned a substantial amount of mergers and acquisitions activity. We are seeing the first phase – difficulty in raising finance – like night follows day, we shall not be spared Act 2 – defaults.

Not convinced that US high yield has priced in everything

As concerns the US high yield market. Some believe that it is more realistically priced in relation to investment grade benchmarks than in the Euro Zone. There is however a major caveat.

We are seeing a combination of potentially rising reference rates and a market which has still to digest the inevitable excesses spawned by Depression era rates + sophisticated capital markets.

Federal Reserve concerned about asset bubbles – there are many of them!

While not foreseeing a repeat of the great US deflation of the post - civil war period:

We see no significant inflation surge on the immediate horizon.

We see the US central bank’s concern as to minimize the expansion of further asset bubbles.

While CPI remains low – several “hard asset” markets appear by any reasonable standard overpriced.

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