Tigress Financial Partners

Macro Snapshot – Chief Economist Jean Ergas

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Update December 14th 2015

Waiting for the Federal Reserve – Investor's feet getting colder – Expect further weakness in oil and commodities to unsettle markets - Is high yield albatross as per Ancient Mariner?

In a nutshell: Are we about to see the perfect storm?

We are seeing a confluence of the Federal Reserve meeting, further slides in oil and commodities, the bursting of the high yield bubble – for now focused on energy and leveraged distressed – and Chinese devaluation via benign neglect.

Expect volatility to keep building – this could be bumpy!

We expect volatility to keep building across asset classes as investors and traders ready themselves for a variety of scenarios. See systemic risk building in commodities and expect consequences at both the corporate and sovereign rating level.

What level of turmoil is necessary to stop the Federal Reserve?

The key issue remains what level of turmoil shall be necessary for the US central bank to step back from the brink. We see the Federal Reserve as facing a choice between the bad and the worse should instability persist. If no action is taken does this mean that situation even worse than assumed?

The week ahead

Gains turning to losses – oil continues to fall, Iran unstoppable

We are easing into the week cautiously with initial strength in European markets and US futures fading into losses. Investors – already unnerved by the upcoming Federal Reserve meeting, are getting cold feet as oil continues to slide. We are hearing little cheer leading as to the long run positive impact of lower oil prices on the global economy.

Wells Fargo – considered one of the sharpest of US lenders – is now warning of stresses in its energy portfolio – heaven help us as to what the less expert must have on their books.

Keeping your money in copper in a warehouse may be hazardous to your health!

As regards non-oil commodities, we are continuing to see them march in lockstep with oil, with copper plumbing new depths. There has been scarce succor from the better than expected Chinese data. Investors have realized that in an environment of slowing global growth and prospective increasing returns on interest bearing investments – locking your money up in copper in a warehouse may be hazardous to your health.

Commodities – we are at the start of a complex and long drawn out process – This is about repaying debt not dividends

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We remain cautious on commodities and see the rout as not over, with the Anglo-American restructuring the beginning of a series of measures focused on a structural and not cyclical change. There is a continued shift up the value chain from the traders to the major integrated groups, with the emphasis shifting from earnings and dividends to debt repayment.

Euro Zone industrial production increases – will it be enough?

Turning to the Euro Zone, industrial production rose 1.9 per cent year on year through October, and was broad based. While positive, this shall still not be sufficient to significantly boost growth or inflation. We continue to see deflationary pressures as strong – with the Chinese currency continuing to depreciate, commodity prices falling and labor markets in the Euro Zone still difficult.

Bank of England warns against complacency

Will the Federal Reserve be the "Lone Ranger" in raising interest rates? In a speech an official of the Bank of England warned that should the downside risks to the economy not materialize, the central bank might raise interest rates faster than expected by financial markets. Considering that the UK consumption model still rests heavily on bank overdrafts collateralized by housing, this is a sobering comment.

Wither US high yield – will we see many further collapses?

Shall US high yield be the albatross as per "Rime of the Ancient Mariner"? We are seeing less hysteria this morning, as the peculiarities of the Third Avenue fund are being advanced to buttress the view that this is an exception and not the rule. While it is true that the fund was both leveraged and at the frontier of credit strength, the least that can be said is that liquidity and consequently, spread risk is increasing.

US credit cycle has peaked – look forward to more pricing power for stronger companies

We have commented that the credit cycle – which may or may not be synchronous with the business cycle – in the US has peaked.

However, if this means that inefficient companies are taken out of the market, this may result in less overcapacity and increased pricing power for the stronger players.

Focus on FX

FX market divided into two segments – developed economy interest rate divergence and commodity currencies

See FX market as divided into segments – US Dollar versus non-commodity currencies and developed economies – where the key factor is the prospective interest rate divergence, with the Federal Reserve expected to increase rates. We continue to see moderate US Dollar strength versus the Euro and the yen, and remain skeptical on the pound.

Continue to not like commodity currencies – Impact of oil price fall on Mexican peso increasing

The second segment is the US Dollar versus commodity currencies and commodity economies, which are crumbling under the weight of falling natural resource prices and slowing Chinese growth. We remain negative on the Canadian Dollar and to a lesser extent the Australian Dollar. With oil prices continuing to fall, we see the brief respite granted to the Mexican peso as finishing.

ECB concerned by bounce in Euro - risk that super moderate Federal Reserve announcement may mute impact of a possible rate increase

We see the ECB as concerned as to the bounce in the Euro and renewed weakness in oil and commodities. While an interest in US interest rates is likely to lower the Euro – US Dollar rate – creating the scope for limited imported inflation – this effect may be muted by a very moderate Federal Reserve statement.

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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.

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