



Update December 15th 2015

First day of the vigil – Oil has not bottomed – High yield – is this the return of 2008 or an isolated storm? – Europeans take to the steering wheel – Euro Zone like US 2010- 2011?

Good day sunshine? Europeans in driver's seat as car sales rise

We are seeing greater optimism this morning as European investors are reacting to higher auto sales, increased German business confidence and a stabilization of oil prices. We are even once again hearing talk of a Santa Claus rally – albeit muted.

Euro Zone shall not be a major growth driver

As regards the Euro Zone, the brutal truth remains that the recovery remains weak, uneven and showing little response to the massive stimulus by the ECB. Those seeking the growth drivers of tomorrow are better advised to look elsewhere.

Not wild about oil – US Dollars 37 WTI is not good news

We are not wild about oil and see a rise to about US Dollars 37 nothing to cheer about. At these levels, a large part of global production remains unprofitable and cash flow negative. Pressure on sovereign finances of the marginal producers shall not be alleviated, forcing them paradoxically, to increase production further in a desperate attempt to raise cash.

While the focus continues to be on the re-entry of Iran, we continue to see the major pressure stemming from increased production from the big producers.

Will natural resources debt lead to massive bank loan losses?

A key concern is the massive amount of bank debt which has been extended globally to the natural resources sector. We expect credit to start being curtailed due to:

The difficult trading position of several of the leading companies

The steadily increasing capital requirements imposed on banks

The limited capacity of the “shadow banking” system to replace the banks

While up to now, the brunt of the losses has been borne by shareholders and bondholders, we see the banks as next in line.

Expect further turbulence in US high yield

As concerns the US high yield market, the better market picture this morning is doing little to improve the overall tone. Further selling is expected as many investors liquidate positions ahead of the Federal Reserve meeting and the risk of a harsher tone than expected.

Any considerations as to a divergence between prices and credit fundamentals are being caste to the wind as the good, the bad and the ugly are being treated as an asset class.

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

To subscribe to Jean's Global Macro Overview, order customized reports, or gain direct access to Jean, contact research@tigressfp.com.

Federal Reserve meeting – new Bretton Woods?

In the US, the Federal Reserve meeting starts today, with the Oracles of Delphi announcing their verdict tomorrow to a financial world which shall be waiting with bated breath. We do not see turmoil in the high yield market and the morose outlook for the global economy as likely to influence the Federal Reserve.

Is distressed high yield a “niche” as the sub-prime sector was?

As regards junk bonds, the tendency shall be to view the current chaos as focused on a “niche” within a risky sector – shades of sub-prime containment? The global economy is seen as relevant in terms of systemic shock potential and not in terms of growth within a cyclical pattern.

Speed of tightening focus of debate – Shall this turn into one step forward and one step back?

The focus remains on the speed at which the Federal Reserve shall tighten. Some of the bolder are predicting that the US central bank shall be forced to beat an ignominious retreat and reduce rates, as the debacle of slow growth and deflation takes hold. We see the point not as whether the Federal Reserve take a step back but what impact this might have on the problems to be tackled.

Monetary policy has proven to be of little use in a context of massive changes in the world economy. We are attempting to correct today’s weaknesses with the methods of another age, when the developed economies were shielded from the global economies full production and labor potential.

US inflation low – absence of wage increases

With regard to US economic data – consumer price inflation in the US is treading water. While this is largely attributed to the influence of energy prices, we see this as reflecting a changed and atomized labor market reducing wage pressures.

We stand by our view that this shall not impede the Federal Reserve from raising rates, with the US central bank seeing inflation “around the corner”. The key risk to the non-energy high yield issuers is not the rise in rates- they cannot borrow anyway – but that:

Most of them are in commodity type sectors with little pricing power

Pricing power is enhanced by inflation

Contacts

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

Ivan Feinseth
Chief Investment Officer
(646) 780-8901 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

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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