



*Update December 21st 2015*

### **Markets shrugging off fall in oil price – Spain election earthquake**

*Markets are shrugging off a further fall in the oil price and seeing the immediate impact of the lack of a majority for the leading party in Spain as having a limited impact on other European markets. The damage from the Spanish election, with a distant second best coalition government as the most likely outcome, has been restricted mostly to the local market with a sharp increase in the 10 year yield and a falling stock market.*

### **Do not underestimate Podemos result**

*The lack of a clear majority – which has allowed Spain to pursue a reform policy unencumbered by needing to make compromises – is important. However, the key shift is the seismic advance of the anti-austerity party Podemos. We view the key problem in the European periphery as rising expectations – with consumers frustrated by the pass-through of improved macro fundamentals to consumer living standards. There may be more storms ahead.*

### **No short term relief in sight for oil prices**

*Turning to the oil price – we are now nearing the lows set by WTI at the wretched depths of the financial crisis. At the cost of sounding monotonous, we see no short term turnaround in the market. Saudi Arabia is pumping like there was no tomorrow and the Russians are at their post – Soviet era peak. The prospect of US oil exports is not helping, but is not the major trigger.*

### **Getting real about the oil dividend**

*We are also seeing a greater realism as to the hallowed “oil dividend” in the US. We need to bear in mind that an extra payment of approximately US Dollars 550 to every US consumer is not the game changer for the US economy. With US consumers, despite the good augurs of the head of the Federal Reserve not yet receiving the munificence of higher wages and still mired in de-leveraging, the impact shall be limited. You can borrow against a pay rise – try borrowing against a lower oil price.*

### **Mining companies – from eternal growth to scrounging for value in restructuring stories**

*With regard to commodities, we are seeing some relief for the sector from a plateauing of US Dollar strength. Investor interest appears to now be focusing no longer on eternal Chinese growth but scrounging for value in turnaround stories. This sentiment is abetted by rumors of Chinese copper price support – a form of commodities QE.*

*We remain unimpressed and see these markets as offering a possible playing space for short term trading but unsuited for investors not having the stomach of an ox.*

### **The coming week**

*We shall be seeing key US data, which inaugurates the first week of the PRR – Post rate rise era. Will the data confirm the rate increase skeptics or lend ammunition to the FOMC? We continue to see pressure on commodities, oil and higher market volatility as investors square positions while there is still a modicum of liquidity.*

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***In a nutshell!***

***Honeymoon investors Federal Reserve over – continued US economic weakness – oil and commodities shall rock the boat – high yield will remain an issue – China shall continue to let currency slip – devaluation via benign neglect***

*We expect volatility to not abate, as investors contend with the need to focus on a plethora of risk factors – not all of which are moving in synch with monetary policy. See in this regard the fall in the oil price – an undertow which began last year – and the fall in commodities, reflecting the end of the Chinese “development block” super-cycle.*

***Are we at the beginning of the turmoil?***

***Last week we saw an initially relatively smooth reaction to the Federal Reserve’s “epochal” move. The honeymoon seems to now be over clouded by:***

***We re-read the Federal Reserve statement – the meaning of “gradual”***

- (1) A re-reading of the Federal Reserve’s statement in a more dispassionate key – the US central bank is not focused on a Dieppe 1942 style commando raid but is resolved to plow ahead – albeit possibly at a “gradual” pace – with the tightening cycle.*

***Weakness on the export front may not be offset by a domestic recovery***

- (2) US economic data indicating continued weakness in the manufacturing and industrial sector. This was compounded by slowing growth in the services sector – which is domestically focused. The key point is that weakness on the foreign front may not be offset by domestic strength.*

***Theorists of oil market bottom confounded***

- (3) Renewed turmoil in oil as the price action continues to confound the theorists of the market bottom. Despite falling prices the US rig count has increased and global production shows scant sign of subsiding.*

***Realization that high yield debt is debt and not equity***

- (4) Fears about the US high yield market have not been completely dissipated, with concerns as to both credit and liquidity now also being directed towards the investment grade sector. Investors are realizing that debt, however - low the interest rate – needs to be repaid!*

***Chinese currency shall continue sliding – we are on the verge of new round of competitive devaluations***

- (5) Last but not least, we are seeing a further slide in the Chinese currency, reflecting a policy of benign neglect by the Bank of China. This may set off a further round of competitive devaluations in the emerging markets. While geared to lower export costs, this shall increase the cost of repaying US Dollar denominated debt.*

***We see multiple factors contributing to higher volatility***

*We expect volatility to not abate, as investors contend with the need to focus on a plethora of risk factors – not all of which are moving in synch with monetary policy. See in this regard the fall in the oil price – an undertow which began last year – and the fall in commodities, reflecting the end of the Chinese “development block” super-cycle.*

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