Macro Snapshot – Chief Economist Jean Ergas

February 1, 2016

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US GDP fourth quarter 2015 comes in at 0.7 per cent – not breathtaking but at least world's largest economy not in recession.

Japan throws in towel and moves towards negative interest rates fueling stocks, top rated sovereign fixed income and oil. We remain cautious on global growth and see the Japanese step as regressive and indicating that we are back to square one.

We are leaving behind us a week dominated by continued financial turbulence and an attempt at recovery by risk assets. We see no change in the economic fundamentals and expect further downgrades to global growth.

We remain of the view that we are witnessing a massive asset allocation shift across asset classes, currencies, credit risk and geography.

Bank of Japan step not encouraging! Not buying stock bounce!

We see last week's recovery in stock prices as driven by expectations of further non – US central bank easing and by a pause in US Federal Reserve interest rate tightening. The unexpected "shock" announcement by the Bank of Japan of a move to negative rates was a key catalyst.

Eight years of monetary policy and government support insufficient to restore cyclicality

These actions are being driven by concerns as to growth and - closely intertwined - the flagging battle against deflation. Markets are regressing from a focus on an incipient recovery to a "state of emergency" monetary policy. Eight years of extraordinary measures have failed to restore a semblance of cyclicality to the major economies.

US economy facing a dual challenge

US durable goods and GDP data are highlighting the dual challenge to the US economy. Manufacturing is being impacted by global slowing, while GDP at 0.7 per cent reflects the decline in business capital investment and retail consumption.

Federal Reserve strikes a cautious tone – will financial turmoil stay its hand?

We have had the first Federal Reserve meeting of the "New era" following the rate increase in December 2015. The US central bank has now struck a cautious tone in the light of the recent financial turmoil and disappointing economic data.

Split between Federal Reserve and traders widening

This has now further widened the divergence between the Federal Reserve and traders / investors. We are now hearing views that the US central bank may desist from raising rates until late 2016.

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.

We see the relevance of formal steps by the Federal Reserve as largely superseded by the progressive widening of credit spreads and falls in the equity markets.

Today's markets

Markets starting on a cautious note – Where is the economic boom in China

Markets are starting the new month on a cautious footing, with equity indexes weakening and oil and commodities coming off the boil. The catalyst is the – once again – disappointing data from China with a continued contraction in the manufacturing sector. We are predictably hearing less from the "China fellow travelers" as to the wonders of the Chinese economy.

Are we seeing the limits to growth?

What we are seeing may well be the limits to growth. The Chinese economy has been kept moving by government intervention and stimulus which would be deemed unacceptable in any economy on nodding terms with the free market. We are hearing renewed reports that the government wishes to reduce excess capacity – no comment.

Euro Zone economy continues to chug along!

On the European front, we are seeing the Euro Zone economy continuing to chug along, with manufacturing still expanding. Notwithstanding, markets are down on the Chinese news reflecting the dependence of the European economy on the "central bank of growth" and the overall EM complex.

EU companies unable to leverage bounty of blessings

We are continuing to see disappointing earnings from the large Euro Zone groups, who have proven incapable of leveraging lower input costs, wage stagnation and zero interest rates to enhance profitability.

When shall global corporates do the necessary write offs?

The focal issue remains when these corporates shall "bite the bullet" and write- off an immense amount of redundant capital investment. Global growth remains the key issue with the large players having bet the house on an EM story which is busting in front of our eyes.

Brazil – a potential longer run bright spot

Within the emerging markets, we see the major potential longer term bright spot as being – notwithstanding the current difficult situation – Brazil. We have always adhered to the view that the key to understanding emerging markets is to watch what the big money foreign direct investors are doing. In Brazil, they are seizing the opportunity to buy out their local minority shareholders.

This house votes to not spend the oil dividend!

We are waiting for a massive amount of US data this week - covering incomes, spending, manufacturing and services. The climax shall be the employment data. The GDP data last week should now have put a charitable end to the triumphalist prattling we have been subjected to.

Manufacturing shall continue to contract and we continue to see the consumers voting yes to the debate motion" This house shall not spend the oil dividend"!

Contacts

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

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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