Tigress Financial Partners

Macro Snapshot – Chief Economist Jean Ergas

February 8, 2016

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We see continuing volatility and do not expect Yellen conference to usher in a "sea of tranquility". Global growth prospects are being downgraded, China remains a mystery and the US economy is going nowhere. Oil shall fall further and we see commodities as muted – absence of large buyer. The banking crisis in Europe shall force government action - forced mergers – and put pressure on equity markets

Do not take off your helmet – this is the Tet offensive!

Do not take off your helmet! Market volatility has picked up with a bang and is unlikely to subside in the short term. Investors are being buffeted by multiple forces as the economy attempts to squeeze through the Cape Horn of weakening global growth, collapsing commodities and oil which stubbornly refuses to rise. On the foreign front, Europe continues to disappoint and the "out of the EU" camp is in the lead in the UK.

Fight against migrants starting to look like Cold War

Turning to political risk, we are continuing to see the migrant crisis in Europe as superseding conventional economic arguments. As we have often commented, the fight is now being extended to outside of the confines of the European Union, recruiting the hapless Macedonians to stem the onslaught.

Migrant crisis shall get worse

There is now talk of sending troops – we see the migrant situation as becoming increasingly fraught with risk due to two factors:

The rapid advance of the Assad forces in Syria- triggering further departures
The coming of the summer and warmer weather making the trek easier

There shall be as the British might say, be some unpleasantness.

This is starting to look increasingly like the Cold War, where Greece and the former Yugoslavia, were the front line in the anti-Soviet struggle.

Syrian war – we shall let Assad advance – who are the opposition?

The Syrian crisis seems to now know no end – with the advance of the Assad forces leading to a pause in the negotiations. We see the chances of the coalition members coming to the rescue of the Syrian opposition as slim. The fight against ISIS shall make for tacit alliances.

UK under Brexit pressure – will they leave the EU?

Straddling political risk and financial markets, we are following the adventures of the UK pound. The key concern is the upcoming referendum on UK membership in the EU. With the latest polls showing the Brexit camp in the lead, this is causing considerable uncertainty.

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Together with disappointing UK economic data - slowing growth and zero inflation – this is placing renewed pressure on the pound.

Today's markets

No end of a lesson! Bulls take it on the snout!

A rude awakening for the bulls! Stock markets are taking it on the snout globally. Investors are now confronting the grim truth that there is little growth to be seen, that company earnings have been disappointing – with scant efficiencies to be wrung out of operations and that political risk is on the rise. We expect further pressure on markets this morning as investors opt for discretion over valor.

Not surprised by the carnage in Europe – likely to continue – Europe a bet on emerging markets middle class surge

We are seeing more carnage in Europe and are not surprised. The EU and Euro Zone markets and economies are heavily geared towards exports, seen as the growth component. The key point is that a lower Euro and cheap financing have proven insufficient to offset lower demand across a wide range of goods. We are concerned at the continued drop in auto stocks – seen as a harbinger of an increase in the middle class.

European bond market – harbinger of grim news?

The European bond market is not signaling recession but a Depression! Germany 2 year bond yield are hitting a record low and the divergence between the top rated countries and the periphery is increasing. The ECB's efforts to lower financing costs have not been sufficient to dispel credit risk concerns.

Good domestic news insufficient to lift German market

Increasing domestic demand and low unemployment – traditionally optimistic indicators- have failed to stop the German DAX index from falling almost three per cent. France is little better and continues to hover around its 1998 level ***. We see continued further weakness in Europe as a combination of weak growth – continental markets – and stumbling natural resources, UK, point to disappointed expectations.***

European banking sector has not bottomed

European woes are being compounded by continuing drops in the banking sector. We are seeing price collapses reminiscent of the financial crisis and systemic risk. The debacle is now squarely centered on the heavyweights, with Commerzbank – rescued during the financial crisis – falling by more than 4 per cent and Deutsche Bank senior debt CDS above the 200 mark. We see as key that the selling is assuming a lower level of implicit government support.

We are seeing the rot in the European banking sector spreading from the usual suspects - for example, Monte dei Paschi – to market leaders. What is being put in doubt is not exposure to a specific asset class but the sustainability of the current business model.

Emerging markets are not cheap – hold your fire!

Turning to the emerging markets, we are seeing a decline in those markets not closed for the Chinese New Year or other festivities. We see the MSCI PE index close to 11 as still not indicative of a major buying opportunity and not sufficiently discounting the growth uncertainty or the "Gathering Storm" on the sovereign risk front.

China shall attempt a "strategic retreat" on the currency front – there may be some unpleasantness

We were not surprised to see a further drop in Chinese FX reserves. While still robust at over US Dollars three trillion, the cash burn rate has not been commensurate with any success at soothing market anxieties. We expect that the Chinese government – having burned through about ½ of the liquid reserves – shall now opt to play from backfield and attempt a strategic retreat.

This shall be easier said than done and we expect further havoc in the markets. The buy signal shall be a cathartic shake-out triggered by a one-off sharp fall in the yuan.

Investors desperately seeking comfort from Federal Reserve – crossing our fingers

As concerns the US, we shall not be seeing major economic data today. However, besides the Yellen testimony, we shall be later in the week seeing retail sales. The key question shall be the extent to which the US consumer shall be able to provide "air support" to a US economy which is not booming. We continue to see the US economy as likely to post lower than expected growth.

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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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