Tigress Financial Partners

Macro Snapshot – Chief Economist Jean Ergas

April 6, 2016

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Allergan – Pfizer goodbye! Some still harbor illusions about oil market. China services put option against hard landing. Welcome to the "Age of Deflation". Are we seeing a rerun of Japan in the US debt markets?

Merger of the century now history

The merger of the century is now history – Allergan + Pfizer are now off. Was this attempted mega deal a bridge too far and / or a signal that the M &A wave is starting to ebb? These humble lines are not focused on companies. However, we see these micro developments as reflecting an ever stronger government drive to scoop up cash today, irrespective of global growth tomorrow.

The thin line between tax avoidance and tax evasion is becoming ever thinner. In a context of shrinking margins and slow growth higher tax bills shall have a disproportionate impact on profits and cash flow distributions.

Shall we see the sunshine?

After the rain - a ray of sun? This seems to be the mood this morning among stock market investors. European markets are up, following yesterday's sharp declines and US futures are edging higher. We are however seeing a "Tale of two markets" with German sovereign risk bond yields at record lows indicating scant confidence in a return of inflation anytime soon.

Oil and China holding up stocks today

Stocks are being supported by an increase in oil prices and by expansion in the Chinese services sector. Commodities have also put in a sign of life. The major factor behind the oil price is optimism by Kuwait's OPEC representative that the upcoming meeting shall result in a production freeze.

Skeptical as to oil conclave

We do not see freezing output at current levels – in a situation of excess supply – as likely to reverse the sector's fortunes. Without Iranian participation and Russia and Saudi Arabia ramping up output to arrive at the negotiating table with stronger cards, the impact of any agreement shall be mitigated.

Weight of money not friend of Europe stocks

Turning to Europe, we are seeing range trading on a broad front. Investors are still somewhat skittish, with withdrawals from equity funds continuing at a strong pace. The "weight of money" argument appears to be moving into reverse, highlighting the lack of success of QE to move funds into risk assets.

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New seminal work in economic history "Age of Deflation"

Hitherto, the major impact of bond buying and record low rates has been to spur almost panic level bond buying. Whether this heralds the beginning of "The Age of Deflation" or the hope of realizing capital gains in the expectation of yet more rate cutting, remains unclear. What is clear is that we are seeing a parting of the ways between the financial markets and the "real economy".

Europe pricing power kaput!

This is reflected in repeated reductions of earnings forecasts for European companies despite record low interest rates and a relatively weak Euro. Deflationary pressures and a reliance on domestic demand have pulverized pricing power forcing a re-assessment of operating margins.

Considering that at current rates, the distinction between EBIT and EBT is quasi nil, this is disconcerting.

Chinese services out of money put option for investors

Improved services data from China has also lifted spirits. While this is a welcome development, we do not see this as justifying a reappraisal of growth prospects. Investor relief is not driven by hopes of expansion but in terms of service growth providing a worst case put option with regard to the risk of a "hard landing".

Service data not sufficient to dispel pessimism

Turning to the US economy, we are seeing further revisions to first quarter growth. These are driven by the trade drag – see the widening of the trade deficit. Stronger than expected US service data has not been sufficient to dispel the ambient gloom regarding global growth prospects, highlighting the rift between the relatively closed US economy and the "global" S+P 500.

Fight of the century- manufacturing versus services!

Whether the impact of foreign slowing shall be offset by a "modestly steady as she tiptoes" US domestic economy remains the key issue. At the end of the day, this is shaping up as manufacturing versus services – may the best sector win!

Investors now focusing on concrete cash flow and not on buybacks

We find interesting that a global slowing is not engendering hopes of further Federal Reserve easing. Instead it is seen as further impacting earnings and revenue. We are now talking concrete cash flow and not buybacks.

Decapitalization impact looms!

This is tallying closely with increasing focus on the vexing issue of the de-capitalization of US companies fueled by inexpensive and plentiful capital markets financing. Those of us born before cell phones remember the travails of Japanese companies which took on massive amounts of bond debt in the late 1980's.

Is this Japan redux?

This binge was driven by:
1 - The hope that the Japanese economy would continue to be the poster child for the less fortunate!
2 - Following on the above, that a combination of growth, inflation and conversion into equity would ease the financing strain.

Are we seeing our own version of the Japanese 1980's fixed income markets in the US?

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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.

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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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