



April 18th 2016

Stock markets holding the line – will this last? Global growth forecasts keep being revised downwards – US not brilliant. Not surprised at lack of agreement in Qatar - Saudi Arabia can tough it out! Europe – can the EU disintegrate? ECB shall hint at further easing and “total war”

Equity markets broadly holding the line – combination of micro and macro data

Last week markets broadly held the line on a combination of micro and macro data. We reiterate our view that the gap between “risk assets” and economic data is still firmly in place and do not see a slight attenuation of systemic risk as justifying current valuations.

Monetary policy set – with the exception of the US – on further rate reductions

With regard to monetary policy several major central banks have reiterated their willingness to implement further monetary easing. This shall extend to negative interest rates, with the danger to bank solvency seen as attenuated by pricing power – imperfect competition – in the banking sector.

Market imperfections are in the eye of the beholder and see this as a declaration of hostilities by the central banks.

No deal in Doha – No surprise

Not surprisingly the Qatar conference has ended without an agreement. The stumbling block was the role or rather non-participation of Iran, which is now viewed as the swing factor. Whether this shall force participants from OPEC to focus on a solution in June or unleash a free for all, cannot be determined.

We may well see an increase in financial markets volatility

What is likely is that we shall be seeing an increase in oil and financial markets volatility. Oil prices are down below the US Dollar 40 benchmark and may give more ground as hopes of disruptions providing a long term support fade.

Impact may be slow motion!

Should this be the case, we may see a wider impact when the European and US markets on a wide swathe of assets, currencies and sovereign risks. The reaction has hitherto been moderate, with the US futures down ¼ per cent.

The lack of an agreement, even when expectations had been scaled down, removes one of the key planks for an attempted stabilization of financial markets.

Focus shall now shift to the US shale industry

The supply side focus shall now shift to the US shale industry, whose reaction will be key. Should hopes for a partial agreement in June as to a freeze or a production cut materialize, this could encourage the shale producers to “hang in there”.

Lack of enforcement mechanism flaw in a potential agreement

The critical flaw in any agreement shall be the lack of a formal enforcement mechanism. We see this as prejudicing the success of any “handshake” understandings reached and consider that the Doha conference was more about optics than substance. The heavy lifting shall be postponed to the OPEC conference in June.

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

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research@tigressfp.com.



Oil price stabilization is seen as the key swing factor

Investor hopes rest increasingly on a rise or stabilization in the oil price as reducing pressure for large scale asset liquidation by sovereign wealth funds. This is seen as reducing volatility and improving market liquidity.

The dominant strategy has changed from seeking to spot asset under-valuation to having a “comfort zone” of being able to exit.

US growth – if any - modest – optimists placing their hopes on US GDP “transition” from manufacturing to consumption

Weakening US economic growth – if any – and persistent deflationary pressures globally are shifting focus from finding a locomotive to “capitalism in one country”. With regard to the domestic US market, optimists are pinning their hopes on a short term transition from manufacturing to consumption.

Which is the right metric for Chinese growth – top down or bottom up?

While systemic concerns may be slightly reduced by Chinese top down data – 6.7 per cent growth - a bottom up analysis backs into 4 – 4 ½ per cent maximum. Stimulus measures are now mired in diminishing returns.

Chinese government policy has accepted the trade-off between spurts of economic recovery and further wreckage in the banking system.

Political risk shows no sign of abating

Political risk shows no signs of abating, with the Brexit debate rapidly fusing with the Panama tax scandal. We see massive shifts in corporate strategy on the horizon, with a significant impact on the global economy.

Greek cauldron about to boil over!

The Greek cauldron is once again about to boil over. Demands for debt reduction as a pre-requisite for continued IMF participation are once again on the table. Are we about to revisit the crisis levels of last year?

Refugee crisis reaching tipping point

With regard to the migrants – refugee crisis there are increasing reports of violence in the camps in Greece. Will the EU countries abide by their resolution to – if necessary – forcibly repatriate the migrants to Turkey, under the spotlight of the international media?

The boat is full- shades off the 1930's

We expect there to be harrowing scenes when the transfers to Turkey get underway. Will the EU countries have the stomach to countenance these measures and use maximum force? Global extensive media coverage may cast events in a very unfavorable light for the western democracies.

Focus on the US

US bank earnings cast recession as a lesser threat with China data taking the edge off systemic concerns

We are leaving behind us a week when the first intimations of US earnings buoyed investors and possibly dissipated their worst fears as to the economy sliding into recession. On the global macro front concerns were allayed by trade and GDP data from China indicating less risk of a hard landing and systemic risk.

This was deemed sufficient to offset disappointing US macro data, including retail data, industrial production and inflation.

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Research: (646) 780-8880 research@tigressfp.com

500 Fifth Avenue New York, NY 10110 (212) 430-8700 www.tigressfinancialpartners.com



Markets weathering disappointing US data on both the consumer and the industrial front

These factors were deemed sufficient to partially offset a string of disappointing US specific data, hinting at a broad weakness on a broad front. Retail data highlighted the continued reluctance of US consumers to open their wallets – with the majority still intent on reducing their leverage.

Rise in oil price insufficient to stoke inflation at either core or non-core level

The above cheerless numbers were accompanied by disappointing inflation data – even when assessed on a “core” basis. The rise in the oil price and second round effects on goods and services, has been offset by the continued whittling away of corporate pricing power.

US economy at risk of missing its “appointment with history” as regards hand over from manufacturing to consumption

We see the US economy at risk of missing its “appointment with history” as regards our domestic version of transition – consumption stepping into the breach for manufacturing which remains weak. In the US we are seeing the last act of the auto “catch up” buying and fallign consumer confidence discouraging buying of big ticket items.

Manufacturing exports not a strict function of the US Dollar

While much has been made of the relative strengthening of the US Dollar, we see manufacturing as reflecting the slowing of the global economy. Were it the FX, the US lost sales would be picked up by Germany – this has not been the case. This is not an issue of the reapportioning of capital investment but of its absolute decline.

This slippage is already prompting substantial downgrades to first quarter US GDP, with the expansion foreseen by the more optimistic members of the Federal Reserve backloaded.

Focus on oil

Qatar oil conference disappoints – was seen as a put option on the oil price – we are once again seeing buying of high yield energy debt

Markets were also buoyed by continued hopes that the upcoming Qatar oil conference might at a bare minimum create a floor under oil prices. This was seen as reducing a broad slew of cyclical, systemic and sector specific risks. This is reflected in strong buying of energy high yield debt in the US, including distressed. Was this pre-mature?

Widening split between producers focused on immediate cash flow and those pursuing a longer term marketing strategy

We reiterate our view that we are seeing a fundamental rift based on the relative financial resilience between the sovereign producers. The longer low prices persist the greater shall be the negotiating power of the stronger players. Saudi Arabia's declarations that current prices are sufficient to cover social programs, seen as ensuring social cohesion, are critical.

Focus on the Panama tax shelters

Brexit referendum and Panama tax haven scandal increasingly intertwined

With the June 23rd UK – EU referendum approaching, concerns over the consequences of a UK exit from the EU have increased. These concerns have been further fueled by the Panama tax scandal and the use by the UK Prime minister of these vehicles. The discussion is now more and more resembling a latter day morality play centered on ethics as opposed to legality.

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500 Fifth Avenue New York, NY 10110 (212) 430-8700 www.tigressfinancialpartners.com



This shall lend a powerful boost to the EU separatists – will the EU turn into an “Old World” version of the Transpacific Partnership?

We view the immediate political impact of this controversy as two-fold; Contributing to shifting UK opinion towards opting to leave the European Union; Providing grist to the mill of “separatist” sentiment in the other EU countries

Risk of tax recapture clawbacks risks causing havoc with corporate investment plans – where does tax planning stop and tax avoidance begin?

With regard to longer term macro consequences, the Panama polemic shall likely create massive uncertainty among global companies as to reputational risk attaching to the use of tax planning – tax avoidance strategies.

What share of aggregate global corporate cash flow is at risk?

This may determine substantial changes in investment strategy as the availability of hitherto “sheltered” cash resources is re-assessed. While in the short term increasing government tax revenue and assisting in re-balancing deficits this shall not be conducive to boosting capital investment.

Tax planning a key pillar of corporate strategy with regard to supply chains, cash management and pricing power. Will we see a massive shift?

The focus has hitherto been on prominent personalities. However the key impact shall be to force a massive re-appraisal by multinational groups of the tax strategies which have hitherto underpinned their internal and external financial structure.

Focus on Europe

Euro Zone – waiting for the ECB and PMI data

With regard to the Euro Zone, this week’s ECB meeting shall likely weave the familiar refrain of downside risks and willingness to wage “total war”. PMI data at the end of the week are expected to show a gradual improvement in both manufacturing and services. The improvement is expected to be driven from a fall in unemployment and low interest rates boosting consumption.

No oil deal complicates ECB efforts to rekindle inflation

However we see the failure of the Qatar meeting as removing one of the key supports to the ECB’s desperate attempts to boost inflation. The uncertainty generated by the lack of success of the Qatar meeting may impact capital goods exports, critical to several Euro Zone economies.

Pricing power weakening – is it all about generating cash? US shale oil model extended to industry

We see the Euro Zone economy as continuing its slow advance. It is however still brittle and on the corporate side predicated on extensive discounting. Weakening pricing power and lower margins might temper the enthusiasm of the banks to extend credit. With regard to bad loans, the EU banks have not yet begun to fight!

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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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