Tigress Financial Partners

Macro Snapshot – Chief Economist Jean Ergas

June 6, 2016

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UK – EU poll ever more dramatic – is this the dress rehearsal for the rest of Europe? Shall markets hold the line this week? – Tired of excuses from the Federal Reserve! – Not impressed by low interest rates!

Investors remain cautious – await Yellen speech and hedge against a UK exit from EU – US Dollar stable following fall after jobs data – Do job numbers count?

Is it all about Brexit?

So – is it all about Brexit? The UK-EU referendum long dismissed as a sop offered by Cameron to a disgruntled electorate now appears to be turning into a Pandora's Box. A series of opinion polls places the "quitters" in the lead as the excess immigration argument trumps – no pun intended- economic arguments as to the long run benefits.

UK economy unbalanced – shall not be solved by a "remain" vote!

We stand by our view that the UK economy remains unbalanced. A massive current account deficit and a dependence on consumption fueled by the spending of unrealized real estate gains do not bode well for the future. Whatever happens on June 23rd, the problems are structural and shall not be resolved by a relief rally in the financial markets.

Leave supports latter day Keynesians – not interested in the "long run"!

For what it counts in their reasoning, we see the leave partisans as being latter – day Keynesians, echoing the great economist's admonishment, "in the long run we are all dead"!
We are seeing a groundswell in the UK that regardless of the ultimate result shall be a warning to Europe and the world's elites.

It is often said that the Spanish Civil War from 1936 to 1939 was the dress rehearsal for the Second World War.

Will the June 23rd vote be the summons for a re-drawing of the European political system?

Old enough to remember speech by Enoch Powell "rivers of blood" speech!

A poll by the highly respected "Observer" places the exit camp in the lead 43 per cent versus 41 per cent as the "separatists" wage their extremely effective battle centered on immigration. Are we seeing echoes of Enoch Powell's controversial speech in the UK in 1968 warning of "Rivers of blood" should immigration not be scaled back?

UK poll shoot-out between "winners" and "losers" of globalization

The key point remains that the poll is rapidly becoming a confrontation between globalization's "winners" – the highly paid and / or owners of "capital" and the "losers" – those who have not had the good fortune of inventing a "killer app" and who do not believe in the great statistical fallacy – averages.

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We are seeing a shoot-out between capital accretion fed by global capital flows and the last cavalry charge of the mass of the unskilled.

Is this "Tales from the Vienna Woods"? Beware of the de-classed European middle classes!

We are seeing a race against time between the speed at which the ECB can engineer a stronger cyclical recovery and the mounting frustration of a large part of the electorates, who are starting to fear being de-classed. Are we seeing the prescient play "Tales from the Vienna Woods" which foresaw the rise of Nazism?

Populist tsunami makes landfall in author's hometown!

The populist "tsunami" has now made landfall in the author of these lines hometown – Rome – The Eternal City. Years of mismanagement and corruption appear to be catapulting a candidate of the 5 star Movement into the mayor's seat.

Is this the end of "transformist" politics in Europe?

The movement is anti-Euro and opposed to the austerity measures imposed on the country. A victory in the second round ballot will create serious difficulties for the Prime Minister Renzi- whose left wing government is attempting to put through a right wing program. We may be seeing the end of "transformist" politics in Europe.

Populist movement echoes non-aligned of 1950's and 1960's?
What shall be their Aswan Dam?

Like the non-aligned movement in the 1950's and 1960's gave a voice to the countries recently free of the colonial yoke, today's populists are appealing the downtrodden at home!
A nirvana down the road shall do little to assuage the pain of those who cannot afford to go for the private option in health care and education.

Focus on the US

Will equity markets continue to hold the line this week? Does the job number count?

Will markets continue to hold the line this week after a strong show of resilience following the "shock" jobs number last week? Are markets taking the view that employment and economic growth are now completely divorced? Low wages reduce incremental purchasing power and pricing power is increasingly weighted towards capital – technology intensive sectors?

We may believe in miracles but not in "flukes"!

Or are they hoping that this was a "fluke" – a term which we consider has no place in rational discourse among sentient beings! We find it hard to accept that "The number" can be solely placed squarely on the shoulders of the Verizon strike or that the job market is so "tight" that there is nobody left to hire? Common sense and decency preclude any further comment.

Are we seeing cracks in the Federal Reserve's "united front"?

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"Hot off the press" we are seeing a glimmer of a crack in the Federal Reserve hitherto "US economy full steam ahead" united front. While the head of the Cleveland Federal Reserve continues to see an "American Graffiti" US economy – central bank governor Lael Brainard rightly sees the data as a warning shot.

Can the "Great Displaced" survive fifteen rounds?

We stand by our basic view that the US labor market has mutated from that of an advanced economy to more closely approaching the duality common in emerging markets. In one corner the highly skilled able to wring a living wage from employers.

Strongly recommend Arthur Lewis's essay on "unlimited supplies of labor" – is this a plantation economy?

In the other, ever more numerous – "The Great Displaced" casualties of outsourcing and technology struggling to make ends meet. We refer readers to Arthur Lewis's excellent essay on unlimited supplies of labor to understand why wage increases are scant and unevenly distributed.

We may well ask – are we mutating into a plantation economy for those not endowed with extraordinary skills? Can this trend be reversed or shall the social compact be ripped into shreds?

Focus on interest rates heading for bottom of Marianna's trench!

Do not see positive impact to "real economy" from ever lower interest rates

With regard to the fixed income markets, the jobs data has led to a further fall in US and safe haven yields abroad. Speculation is rife that the German 10 year bund might fall into negative territory.

Low interest rates shall not trigger a boom in capital investment

While this shall force investors further out on both the credit risk and maturity curve, we continue to see little impact on the "real economy" which has hitherto shown scant reaction to the appeal of low financing costs.

The "discount rate" for investment assessment is composed of both the cost of financing and a risk premium. We shall need to see a decrease in the European risk premium for a recovery in capital spending.

1 - Key issues - In a nutshell!

UK-EU poll seen as key "event risk" – focus now shifting to hedging short term turmoil – Federal Reserve meeting downgraded following disappointing jobs data – Oil stabilizing - will it hold at these levels?

Fasten your seat belts!

We see political risk in the form of the UK – EU referendum as being the focal point for investors - with the key objective to build a buffer against potential market turmoil.
Longer term concerns linked to global growth are being subordinated to avoiding losses in the event of a "leave" outcome.

Continued dissonance between the Federal Reserve and Wall Street?

We see the upcoming Federal Reserve meeting as having been relegated to second place following the disappointing jobs data. This is seen – whether rightly or wrongly – as limiting the chances of rate increases. This appears to reflect the basic dissonance between financial markets and the central bank – with the latter increasingly focused on US internal dynamics.

Oil market remains oversupplied – are supply disruptions permanent?

Oil prices have continued to hover around the US Dollar 48- 49 mark deemed sufficient to ward off short term systemic risk, while still insufficient to reverse a decline in profitability.
We are continuing to see prices supported by disruptions and seasonal factors – while the market remains oversupplied.

2 - Overview and the coming weeks!

Markets shall continue to be driven by political risk and central banks

We are leaving behind us another action packed week with investors reflecting on the OPEC conference, the ECB meeting and the US jobs data. With the Federal Reserve meeting and the UK – EU poll up ahead, we see little reason to see an attenuation of tensions and expect market participants to keep their "finger on the trigger"!

OPEC meeting as expected – "natural re-balancing" the way forward!

The OPEC meeting – as expected – did not signal any change in the Saudi Arabia laissez – faire policy. The market is seen as re-balancing by natural means limiting the need for external intervention. Oil is now deemed by market participants to be at a level still pressuring marginal producers but as having recovered from the depths which might have triggered a systemic event.

ECB holds to trusted adage – When in doubt abstain!

The ECB meeting confirmed the adage - when in doubt abstain! The single currency area central bank has opted to await the outcome of the measures adopted while remaining to intervene further if necessary. The need to attenuate systemic risk in the form of a persistence of deflationary pressures – as opposed to "re-entering" the economic cycle – remains the key priority.

Markets are awaiting the launch of the ECB program of corporate bond purchases. We see this as having little impact on the "real economy" with capital investment decisions remaining largely independent of interest rates.

Will the Federal Reserve opt for the "long view" or shall they see jobs data as trend?

The US jobs data was a powerful wake-up call with regard to the prospects for the US economy for domestic investors and for foreign investors, the direction of US monetary policy. Shall the US Federal Reserve reverse course and refrain from raising rates or shall they take the "long view"? We expect to learn more on June 6th from a speech by the head of the Federal Reserve.

UK–EU poll bellwether consultation on economic and political integration – increasing concerns as to power of concerted EU political action without UK

The UK-EU poll on June 23rd remains the key short term political event seen as a potential watershed longer term for the EU, Euro Zone and moves towards global economic and political integration.

We are seeing concerns shifting from the economic to the security sphere – can the EU stand up to Putin without the UK?

3 Global survey

US markets stabilize at upper end of trading range – Europe remains pressured by macro data and slowing global economy – China still in pre-transition economic mode – Brazil internal factors dominate – Commodities in "short cycle" within longer cycle of lower prices

Global growth

Global growth is once again a key topic. Disappointing data out of the US and Europe is tempering expectations of either an economic acceleration or a recovery in earnings. We see central banks at the end of their tether and see "organic" domestic demand as the key determinant of expansion moving forward.

US stocks surprisingly resilient – is this a head fake?

US stocks have proven remarkably resilient despite disappointing data across a broad spectrum of metrics. We see the key as being weakness across both manufacturing and services. This is limiting expectations as to the potential for the domestic economy - centered on services - to offset weakness in the export heavy manufacturing segment.

Is the "tightening" labor market argument still valid?

The "optimist" case continues to rest on US internal dynamics – with the US marching to a different beat. A key support has been the conviction that a "tightening" labor market shall boost both employment and wages. Whether these assumptions shall hold in the context of an increasingly dual labor market appears doubtful.

ECB remains principal economic arbiter – major challenge stopping deflation

With regard to the "Old World" the ECB – in the absence of structural reforms – remains the principal economic arbiter. The focus remains on reversing deflationary pressures, with prices falling despite an increase in oil and commodity prices. Growth is being driven by a recovery in domestic consumption with consumers cashing a "one off" deflation dividend.

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