



June 8th 2016

US stock market edging up – where are the growth “locomotives”? Outlook for deflation not brilliant! Oil rise easing fears of systemic collapse - ECB starts bond buying – Show me the real economy!

US stocks positively inclined – a lucky line-up of coincidences?

US stocks are pointing to an advance taking the Chinese export data, concerns as to global growth and the UK-EU referendum in their stride. The mood is being supported by a continuing firming in oil prices. Due to the large weighting of energy in the US economy is seen as limiting defaults, reducing pressure on the high yield sector and prospectively boosting investment.

Risk of a commodity induced shock is receding but World Bank lowers its global 2016 growth forecasts

We are looking at a situation where money shall remain inexpensive and the risk of oil or commodity shocks is receding. This in no way implies that growth is robust. Growth remains a delicate subject with the World Bank lowering its 2016 global forecast to 2.4 per cent from 2.9 per cent in January.

There are no more locomotives!

Multiplied out by a global GDP approaching US Dollars 60 trillion, this is a massive adjustment. We see as significant that the downward revisions have fallen across both the developing and advanced economies. There are no “locomotives” and we see our “stand alone” view of economic analysis as vindicated.

Could it be a “minimalist” explanation?

A further - somewhat “minimalist” explanation is that with a firmer oil price the risk of defaults along the global oil value chain is receding. An added boost could be the lesser need by sovereign wealth funds to sell down investments, attenuating pressures on market liquidity.

Cyclical recoveries are not forever!

As concerns the Federal Reserve we do not see Yellen’s declarations as no further rate increases ever. The US central bank shall need to at some point face the risk that – unlike diamonds – a cyclical recovery is not forever.

Need to stock up a reserve for a “rainy day”!

There is therefore the need to “stock up” for a rainy day! The Federal Reserve needs to have some powder in its arsenal to lower interest rates if necessary, without pushing into negative rates.

Not surprised by Chinese data – once an exporter always an exporter!

With regard to Chinese export data – we are not surprised. The Chinese economy shall take decades – should it ever succeed in doing so – from its export focus. We do not share the view that the transition to higher standards of living necessarily implies a reduction in the export share of GDP.

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Outlook for deflation in the advanced economies not brilliant!

Japan and Germany both have high living standards and remain beholden to exports for close to 50 per cent of GDP. China shall continue to be export driven with the peculiarity that state support and lower trade barriers shall result in cost or below cost selling. The outlook for inflation in the advanced economies is not brilliant!

We are in “The Age of Re-leveraging”

With regard to the vexing issue of deflation which is leading us into the “Age of Re-leveraging” Euro Zone bond markets are sending out a grim message. Some see the precipitous decline in Euro Zone bond yields as a reaction to the ECB’s announced bond buying program. This does not explain the willingness of institutional investors to buy negative yield paper.

ECB cannot buy bonds forever! Deflation has resisted everything!

The key assumption is that the ECB cannot buy bonds forever. If inflation has not taken off following the massive liquidity inflows – when will it? Deflation has resisted the “weight of money”, a rising oil price, a bounce back for commodities and a Euro off its peaks. No wonder expectations of falling prices remain strong!

Brexit fever going strong! Comparing apples and pears?

As regards the prospects across the Atlantic – Brexit fever shows little signs of abating. The former UK PM Blair sees the race as close. A fiery debate yesterday between Cameron and the leader of the United Kingdom Independence Party confirmed that the two sides are arguing from completely different standpoints.

This is not about Scottish separatism – This is about lower income wage earners not interested in “The Long Run”!

The “quitters” are focusing on the immigration issue while the “remain” camp is centered on economic issues. An added twist in the saga is that in the event of a “leave” vote the Scottish separatist issue would roar back. This does not seem to have much traction with the “leave” base – which is more concerned with maintaining access to social services and a further “squeeze” on wages.

Sentiment remains fickle and we have not heard of anybody who is going overweight sterling or UK assets.

European stocks have not factored in a “leave” victory

We read that European equity markets based on a “discount” to US stocks have already built in a “leave” vote. We do not agree. The book to value and P/E differentials represent long term divergences stemming from “embedded” structural obstacles and closer correlation to global growth. The “step function” impact of a “leave” vote and the ensuing financial turmoil are not reflected.

Always wanted to be an oil tycoon? Some giving it a shot!

Turning to the oil market, prices are continuing to firm on US supplies and the continued disruption in Nigeria. What we see as significant is the continued resilience of the US shale sector – which has resisted multiple challenges. Bargain hunting is picking up steam as prices edge back up to profitability or in many cases “cash flow” breakeven.

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