Tigress Financial Partners

Macro Snapshot – Chief Economist Jean Ergas

June 20, 2016

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1 In a nutshell!

Have we seen the turning point in the UK-EU drama following brutal member of UK MP? Equities signal lower risk but investors continue to focus on top rated sovereign debt — Remain centered on economics but poll rooted in emotions – IMF launches another warning!

As expected, Federal Reserve cautious as to both US economy and international situation – Stands by call on higher rates but does not say when! UK-poll cited as a key factor – UK leave victory seen as de-stabilizing

Central banks rally around and confirm contingency plans in the event of a "leave" victory – widespread turmoil expected across asset classes and currencies – central banks focused on maintaining interbank liquidity – Finland Minister of Finance describes Leave victory as European Lehman moment!

2 Today's action

Shall common sense triumph or are we back to the 1930's?

Shall common sense triumph or shall we start putting up the drawbridges all over the world – with "going it alone" the modern day equivalent of the competitive devaluations of the 1930's? Was the brutal murder of the UK MP the turning point – swinging the pendulum from politics centered on demonizing "the other"?

Despite some relief safe haven asset bond yields still rock bottom

We are seeing some tensions easing in the fixed income markets, with German 10 year government bonds now above the zero mark. This is paralleled by a fall in peripheral bond yields –signaling short term relief. What is remarkable is that rates are still near record lows.

Key macro concerns remain firmly in place

We see the slight improvement as reflecting only one of the two pillars spurring flight to safety instincts. Investors are focusing on the "systemic" aspect – the macro concerns centered on growth and deflation – remain firmly in place.

Do not count chickens before they hatch!

This morning markets are taking the view that reason shall carry the day forecasting a victory by the "remain" camp in the UK. The pound is surging and stock markets are on a tear. Can we sound the all clear? We see the following as in the short term key:

Will the "remain" camp margin widen?

The vote has not taken place
The remain margin remains thin and within a margin of error
There is the risk of a "silent majority" emerging

This tends to confirm our view that there is a roughly 40-45 per cent hard core anti –EU camp and that the vote shall play out on a relatively small part of the electorate.

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"Remain" camp has not addressed fundamental fears of secessionists!

The polls turned on an event as opposed to any concrete proposals by the "remain" camp to address the fears of the disaffected. Longer term – strains within the European Union on major policy issues shall persist and the structural problems besetting the Euro Zone shall not abate.

Remain victory shall do little to attenuate desire to "split" of many others!

We will see break-up pressures regardless of who wins!

Some are saying that if the "leave" camp wins, others shall also want to leave. They shall in any case want to leave – regardless of the result of the UK poll. We are already seeing a steady rise in anti-EU populism – with Italy and France in "pole position" in this regard.

The "unionist" camp must in addition to the populists also contend with separatism – which long quiescent is now roaring back.

UK Poll like the "Arab Spring" not an end but a beginning!

We see a "remain" victory as possibly delaying but not materially changing the push toward less austerity and greater leeway with regard to a wide swathe of regulations. We may well see the UK poll – like the Arab Spring – whatever the result, not as an end point but as the start of even greater convulsions.

Watch the elections in Italy and Spain – populists and hard left uniting?

The first test shall be the Spanish elections on June 26th – centered on the extent to which the "hard left" and populists can succeed in shifting the political axis. In Italy the populists have seized the mayor position in the capital presaging a rough ride ahead for the Renzi government.

With a total outstanding Spain and Italy debt of Euro 3 trillion- and a Euro Zone rescue fund of Euro 500 billion effective firepower- this is food for thought.

3 Global growth and what's next?

Sentiment regarding global growth worsening

We are revising our overall sentiment for global growth downwards. This is based primarily on a slower for longer outlook for the US economy – beset by slowing exports and cash strapped consumers - and a still struggling Euro Zone.

See little chance of relief from the emerging markets

We see little hope for relief from the emerging markets – whose prospects are on the solvency front largely hostage to fluctuations in the US Dollar – and as regards growth to China.
Should the "leave" camp carry the day, we expect a continued shift towards safe haven assets limiting asset allocation shifts away from Europe.

Political risk increasing and shifting to the advanced economies

We view political risk as both increasing and shifting towards the advanced economies. The coming week the UK-EU poll shall dominate decisions. This shall be followed on June 26th by the Spanish political elections, where a strong showing of the hard left is expected.

Strong populist advance in Italy

The populist advance in Italy has materialized. This shall place considerable pressure on the Renzi government, which is struggling to put through major economic and institutional reforms.

The attack on globalization continues and we are seeing a move away from economic and political integration. An increasing number of countries seem to be prioritizing "sovereignty" over unfettered access to foreign markets.

Rise in oil prices shall not be a trigger for major increase in global growth

We do not see the recent recovery in oil prices as acting as a catalyst for a recovery in growth. Its principal impact shall be to limit systemic risk - producer or trader insolvency. It however shall not be sufficient to make oil producers backtrack on their plans to cut capital investment.

4 Systemic risk - Brexit emergency

IMF sounds warning – is anybody listening?

IMF once again warns on UK poll – are they barking up the wrong tree?

The IMF has once again chimed in foreseeing a substantial and longer term contraction in the UK economy. This shall be due to both the lengthy "divorce" proceedings creating uncertainty and scant prospects for replicating on a "stand alone" basis the current trading agreements.

Continued leads and lags between the cash and derivatives markets

With regard to the short term outlook, we are continuing to see "leads and lags" with regard to the cash and derivatives markets. While the pound has staged a comeback in the cash market –FX options are closing in on levels last seen at the peak of the financial crisis.

This is a sobering thought when we consider that at the height of the debacle ATM were a week away from being shut down!

Concerned by the extension of risk perception from "step function" FX to solvency

We are concerned by the extension in investor attention from currency and equity risk to credit as reflected to the escalation of volumes in the CDS market. This reflects a "sea change" in risk assessment. Markets are now deeming the potential "aftershocks" as sufficient to trigger insolvencies, as well as other credit events.

"Heart of the matter" first 24 hours!

Market participants are now rapidly realizing that the "heart of the matter" is not the long term consequences of an exit but the financial turmoil in the first 24 hours! The global financial system may need to absorb and fend off systemic risk while still struggling with the aftermath of the financial crisis.

Central banks are focusing on providing liquidity – Lessons from Lehman?

Global central banks have confirmed that they are preparing contingency plans for the "Day After". Efforts shall be focused on ensuring sufficient liquidity to the banking system. The objective is to avoid a freeze of interbank lending, which ultimately was the key factor in the "forest fire" speed spread of the Lehman crisis.

We reiterate our view that liquidity shall not necessarily be sufficient to support asset prices and expect "step function" adjustments across all asset classes.

5 – Macro - All quiet on the US front?

No major surprises from the Federal Reserve

The Federal Reserve meeting while producing no surprises with regard to monetary policy revealed incipient doubts as to the underlying strength of the US economy. Was the labor market collapse in hiring a blip or the start of a trend?

US employment levels belie structural weakness – who is working?

We remain skeptical as to apparent enthusiasm as to employment levels when set against the low labor force participation rate and "shadow unemployment" at close to 10 per cent. There is still an apparent disconnect between alleged "full employment" and wage driven inflation.

Do not see US housing as the key to a turnaround in US growth prospects

One hears growing enthusiasm regarding the housing market. While this is positive, we do not view a recovery in housing as a prelude to a significant shift in US growth prospects. The housing market has come back from the Depression levels of the first phase of the financial crisis.

However it is still on both an absolute and relative basis still well below levels seen pre-crisis or at the height of the 1960's boom! The US economy was one half the size and housing starts were higher!

Federal Reserve focused on limiting de-stabilization and not on managing through the business cycle

We are also seeing a Federal Reserve increasingly focused on limiting the risk of de-stabilization as contrasted with cyclical management. While the UK-EU poll is viewed as a possible immediate proximate cause of bedlam, we discern continued fears of triggering a massive "weight of money" shift out of the emerging markets.

6- Oil is this still a macro wild card?

Oil coming off the boil! Need to separate "noise" from "signal"

With regard to the oil market, oil came off the boil last week. We see the key long term drivers as the rise in the US oil rig count, increasing concerns as to global growth and no let-up in Iranian exports. While some have focused on the easing of disruptions, we view these as contributing to short term "noise – volatility" and not impacting at the long end of the curve.

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See carnage in US shale sector as largely over

We confirm our view that the worst of the carnage in the US shale sector is over for two reasons. The first is that the recent spike in prices has allowed producers to hedge forward sales. The second is that the recent travails shall prompt a re-structuring of the sector, with M+A acting as a capital provider.

Scope for concerted action in oil limited

We continue to see two factors constraining concerted action:
While prices are moving higher, we consider that Saudi Arabia shall be remiss to tip the boat over at what might be a turning point for global growth prospects. Any action without Iran is likely to be ineffectual.

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