

July 7th 2016

***Are markets stabilizing? – Cannot believe that commercial property funds in UK a non- issue! – Pound rebounds to 1.30, noise or signal? – Should several European banks be liquidated?
- Expect “A not so silent TARP” in Italy***

Are we seeing “A Tale of Two Markets”?

Are we starting to see “A tale of two markets”? Europe wobbles and US rises –or shall the “Old world” tomorrow rise like the Phoenix? European stocks continue to be in the thrall of the “Adventures of Brexit” – with little clarity as to how the motley crew wishes to move forward.

UK politics focus remains on the “immigrant issue” – now more generally centered on foreigners in the UK

Are markets stabilizing?

Are we seeing stabilization in the financial markets or is this hope that central banks can endlessly correct massive imbalances in economies and balance sheets? Europe is posting a mild advance this morning – boosted by a clement tone from the Federal Reserve, good services data out of the US and a stronger tone in oil.

And yet more attempts to minimize the property fund crisis!

The flip side of the coin is that UK sterling’s “rebound” is still leaving it at levels dreamed unthinkable by many 1 month ago and that the halting of withdrawals from UK commercial property funds seems unstoppable. We are somewhat perplexed by the desperate attempts we are seeing to minimize the importance of the property fund shuttering.

Like night follows day – there shall be pain in the residential property sector

One cannot but be astounded to read that only a small part of commercial property is held by these funds. It may be useful to seriously start to mark the rest to market. Like night follows day a bust in commercial property shall not leave the residential sector unscathed.

Large property investors “marking to market” – this is not done lightly!

We are already reading of large property investors “marking to market” – this is not something you do lightly on non-tradable assets held supposedly for the long term. The change in asset values is not cyclical but structural. With the foreign investors and domestic insurance companies hesitant to take the plunge – loss of liquidity is translating into a “sticky” market coming unstuck!

Why can office blocks not be sold? Could there be a passing correlation to the “state of the nation” of the UK economy?

There is no good exit strategy!

We reiterate our view that the crisis is shifting rapidly from a “long run” new economic structure perspective - to a growing view that there is no good exit! This is placing massive pressure on the pound – further jolting the confidence of the “long run” brigade.

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Dominant strategy to avoid currency losses – formerly long term investors become spot traders

The dominant strategy is to avoid currency losses! The collapse in sterling over the last 18 months has wiped out the equity of many investors who accessed the market in the last 5 years. For the foreign direct investors – who considered spot FX rate fluctuations as secondary to prospective benefits from the single market – this is devastating.

UK likely to go for “bare bones” trade solution

The IMF warns that a best case EEA – Norway solution for the UK shall take 1.5 per cent off growth by 2020. The in our view more probable “bare bones” WTO scheme shall reduce it by 4.5 per cent. We do not exclude a greater drop should foreign direct investment – a massive jobs creator in the UK – start to ebb.

We are witnessing the triumph of nationalism over economic rationality

The key to the sovereignty debate was immigration and the EEA shall require labor mobility. What continues to be underestimated is the triumph of nationalism over economic rationality. This shall not be overturned by a decline in living standards.

Can there be a successful pivot to the emerging markets?

One of the major arguments buttressing the “leave” argument has been the UK pivot to the emerging markets – seen as the hope of the morrow. This seems based on a twin axis:

1 – Exports are fungible – what shall not be sold in the EU can be sold to the EM

2 - In the former UK colonies, there is still a strong sentimental attachment to Britain – this shall give the UK the “edge”

What about political and credit risk?

As to the first point exports may involve large “big ticket” contracts with elevated political risk and credit risk and “lumpy” cash flows. We might also mention the minor factor of dealing with corruption.

This is not the 1960’s!

With regard to the second issue, this is not the 1960’s when the former UK colonies were ruled by UK trained – and in some cases – jailed elites. The new and upcoming business elites are more likely to not be from the historic and dynastic founding families of the post-colonial era and are more likely to be looking towards the US.

19th century is over! Tea at governor’s house no longer key aspiration

The era of “more British than the British” is over. New generations are not in an “identity fog” and no longer dream of being invited to the governor’s house for tea! When asked what the lesson of the 1956 Suez crisis was – the Egyptian leader Nasser answered – that the 19th century is over. Some have not understood this.

Is the best solution for a large part of European banking orderly liquidation?

As concerns the European banks, stock prices continue to reflect a scenario spelling “The end of credit” – with prices indicating negative value and the most compassionate option for shareholders being liquidation! Deutsche Bank continues to hit new lows and the UK lenders are still trading well below book.

We see the shift in investor perception now going beyond cyclical and starting to contemplate lower – if any – profits – for longer.

We are building up to “A not so silent TARP” in Italy

“A not so silent TARP” is to be expected in Italy with the government presenting a de-facto ultimatum to the European Union: State bailouts or systemic banking crisis! The Renzi government’s staunchest “ally” in this battle is the populist 5 star movement. The stronger their position in the polls and the greater the wish to not add a political crisis to a bank bust.

Careful as to enthusiasm over the US economy!

Following the publication yesterday of the Federal Reserve minutes there has been some enthusiasm that the US economy is about to roar ahead. While welcoming the services data, we see this jubilation as somewhat pre-mature. Wage growth – for the “happy few” remains constrained and the march of technology – independent of global concerns – continues unabated.

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