Tigress Financial Partners

Macro Snapshot – Chief Economist Jean Ergas

July 27, 2016

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Today is another day! – US economy ambling along? – Federal Reserve shall follow "Monroe Doctrine" – UK this is the beginning not the end – Banking crisis in Europe will get physical!

We paraphrase "Gone with the wind" – Today is another day!

We might paraphrase "Gone with the wind" and say that "today is another day"! Investors appear to be looking at the sunny side of the street and concluding that macro data and central banks shall provide a firm underpinning. Stability and "capitalism in one country" are the new tenets and the absence of further shocks is seen as confidence building.

US investors sitting on their hands before the Federal Reserve announcement!

The US stock market yesterday once again chose discretion over valor, with investors hedging their bets before "The Day" tomorrow – Federal Reserve announcement. US economic data has been reasonable – indicating an economy which is continuing to grow at an - albeit – very moderate – pace.

Services expanding but increase minimal – we are worried by the lack of pricing power

Services - which comprise the bulk of the US economy – are still expanding but a very moderate pace. We view as significant not the absolute growth but the continuing lack of pricing power. It shall not behoove the economy for companies to be basically "swapping dollars" with their customers.

We shall look to comments – can we expect action?

Expectations for the Federal Reserve meeting remain centered on comments and not action. No measures are expected but with immediate external turmoil decreasing and the US economy still extant – "Olympus" may opine that interest rates should rise. We see the US central bank as reverting to its "Monroe Doctrine" stance – America to the Americans!

Arigato Mr. Abe!

Investor spirits are being lifted by the announcement of a stimulus package from Japan. We see two caveats: The first is the extent to which the roots of internal stagnation can be overcome by government assistance. The Japanese economy remains hobbled by demographics and by increasing competition as China and the EM go up the value chain.

Japan problem not growth but finding new buyers for debt!

The second is the ultimate impact on the global economy. We see the Japanese conundrum not as centered on immediate growth but on the risk of its massive government debt needing to be "externalized". Markets are confusing GDP growth with a long term pressure to find other financing sources for the massive sovereign debt.

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Focus on the UK

UK battle between optimists and pessimists rages on!

In the UK the battle of the economic data continues unabated with the optimists pointing to stronger than forecast growth before "The Schism". The realists are highlighting the collapse in manufacturing confidence, panic in the commercial property market and kaput retail sales post break.

We see hesitation ruling the roost!

We reiterate our view that the UK economy is at the start of a lengthy period of adjustment. Uncertainty shall place a brake on capital spending as companies stow away cash and foreign investors shall continue to scale down their UK exposure.

The "terms of trade" are far from being agreed and the UK government is relying on a depreciated pound as its principal support. We doubt that this shall be sufficient.

Do not see mammoth M+A deal as the solution

Much is being made of the US Dollar 30 billion + ARM – Softbank deal and that the inflow is sufficient to cover 3 months of the current account deficit. In our view this is a one – off driven by global tech sales and not a vote of confidence in more mainstream sectors.

Is this about a chronically weak pound and imported inflation?

UK government debt still in demand!

*The UK drama continues to play out with the sale of a 50
year government bond indexed to inflation. The issue was oversubscribed and snapped up by pension funds and insurance companies – seeking to match long term liabilities.*

Key driver not maturity but inflation link – can we "back into" a chronically weak pound?

We see the key driver as not being maturity but the inflation link reflecting investor expectations that a weak currency shall likely stay weak! Prices shall receive a boost as imports rise in price – a trend that shall be abetted by the UK central bank's proclivity to weaken the pound to boost exports to offset wobbly domestic demand.

Battle of the giants - A tale of two macro indicators – McDonalds and Apple

Apple short on sales but long on spin!

Straddling micro – tech – and macro, investor spirits are being buoyed by Apple's not stellar results but excellent spin on prospects. We continue – with technology the iron and coal of the present industrial revolution – to see Apple as a bellwether for the global economy.

Where have the first time buyers gone? Are I phones now the bait for service contracts?

Does Apple signal that not all is lost globally? While revenues have fallen, we are seeing a larger part of revenues coming from service contracts. We see this indicating that the cash shall come increasingly from existing "holders" and not from first time buyers.

Does this validate the hypothesis of slower growth in the EM middle class? We have seen cell phone and IT expansion as closely correlated to economic growth. Has the first development block run its course?

Are we eating our way to a US recession?

Much attention is being given to the debacle in the restaurant sector and the disappointing results from McDonald's. Some view this US icon as "The Apple" or barometer of the "constitution" of the American consumer. Is this a leading indicator of recession or of a rapidly slowing economy?

Focus on the European banking crisis

Euro Zone banking crisis hitting a crescendo

Turning to the Euro Zone, the issue of the banks is reaching a crescendo. The Italian government is now feverishly trying to patch together a private sector solution for MPS prior to the release of the stress test results on July 29th. We view these concerns as in the larger picture irrelevant.

A private sector solution in name only!

Any "private sector" solution shall be the result of extensive pressure applied by the government. It shall in no way solve the challenges of more constraining capital requirements and certainly not alleviate further likely increases in non-performing loans.

We shall abandon the doctrine of "The separation of risks"

It is now increasingly clear that the "separation of risks" between sovereign and banking risk is not attainable. Should the EU not bend on the issue of a TARP like solution, we may not have seen the last of bank nationalizations. With a market capitalization below that of several IT start-ups the state can snap it up on the cheap!

We are seeing a two plane banking crisis – shall they converge?

The banking crisis in Europe far from fading from the picture is now coming more clearly into focus on two different planes:
Banks which are fundamentally insolvent – should honesty prevail and non-performing loans be properly accounted for

Banks whose capital position is not in line with current or prospective requirements

We expect the negative news from the banking conundrum to keep coming and to act as a brake on significant upside in the equity markets.

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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.

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