Tigress Financial Partners

Macro Snapshot – Chief Economist Jean Ergas

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Update November 19th 2015

Federal Reserve may well raise rates in December – will be "Lone Ranger" – increases shall likely be small – This is not the pre-internet tightening cycle, extensive systemic and political risk

Markets appear to be looking up with the prospect of higher US rates tempered by a gradual and limited rise thereafter. The US central bank has succeeded in quelling – at least for the moment – fears of a shock as money domiciled in the emerging markets was returned to sender.

With EM up on the news, we still discern that the key driver behind these markets is not growth but stability of fund flows. The new paradigm appears to be do not rock the slowing boat!

US economy–steady as it goes?

The US labor market continues – on the basis of jobless claims – to power ahead. As for manufacturing, the Philadelphia index has come in stronger than expected, indicating that manufacturing is holding up despite a slowing global economy and strong US Dollar.

Focus on the Federal Reserve

FOMC minutes reveal little of new

The FOMC minutes reveal little that was not known regarding the likelihood of a rate increase in December, with most participants comfortable with raising interest rates. After hearing that the intensity of fire in Paris yesterday was reminiscent of Saigon during the 1968 Tet offensive, we need to look at new metrics.

With the de-stabilization focus veering from an EM driven economic pullback to the prospect of a 100 year war against terrorism, we see conflict escalation as the wild card.

Equilibrium interest rate, low rates ahead?

Shrouded in an academic discussion as to the equilibrium interest rate, the probability is mooted of low rates as a constant. Rates will rise but remain within a fairly tight band. Has the Federal Reserve given the green light for "speculation – light" and the continuation of asset bubbles?

Will we start to see the deflation – monetary easing – asset bubble – crisis and start all over again cycle?

Central banks shall be reluctant to do a conventional lift – off

Which central banks will do a conventional lift – off in the light of the fact that:

Many corporates have gorged on cheap debt
Many corporates consider this debt – due to its low cost in terms of cash outflows almost akin to equity

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Raising interest rates akin to decapitalizing weakest borrowers

The strongest companies borrowed to do buy backs
The strong companies issued stock
The weaker companies issued high yield debt at absolute rates close to the financing costs of AAA issuers 5 years earlier + very light covenants

Any reluctance to raise rates drastically and quickly may be tempered by the risk of triggering panic reactions in emerging markets. However, when and if rates rise, we shall likely see further weakness in EM currencies and assets.

Others shall do the Federal Reserve's work – BOE has talked and not moved

We remain of the view that the other central banks shall be delighted to do the Federal Reserve's work for it. Even the most "hawkish" of the big money center banks – the Bank of England – has talked a lot and done nothing. Those upon whom growing economies have not been bestowed, will be in no rush.

Economic long run considerations are tempered by the concern that missteps may be difficult to correct and that not all "fault lines" have been identified.

Focus on commodities

Oil weakness continues – Oil bulls have broken their horns!

Oil WTI has broken briefly below US Dollars 40, with political risk offset by a world awash in supply. We continue to see forecasts as to a "turning point" as being regularly postponed. Calls to cooperation from within the OPEC camp to "stabilize" the oil market appear to be having little effect.

Arab countries control 57 per cent of the globe's oil reserves – the oil cycle has gone full circle with the industry returning to its post – 1945 stronghold.

Is the oil market looking ahead to the chance of a US recession in 2017?

We reiterate our view that the oil market axis is shifting towards demand as opposed to supply, with slowing global growth providing little solace. Probabilities of a US recession in 2017 are being marked up.

BHP aims to safeguard its balance sheet

With regard to commodities and mining – we are seeing more evidence of the acceptance that the price downturn may be prolonged. BHP has announced – with regard to its hitherto generous dividend policy – that its first priority shall be to protect its balance sheet. This is code for reducing dividends.

We see this as significant, with BHP as one of the leaders in the "elimination pricing" strategy in iron ore – accepting that the demand issue is greater than initially believed.

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He is fluent in English, French, German, Italian, Spanish and Portuguese. He also has a certificate in Arabic – from NYU School of Professional Studies.

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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