



Update December 15th 2015

First day of the vigil – Oil has not bottomed – High yield – is this the return of 2008 or an isolated storm? – Europeans take to the steering wheel – Euro Zone like US 2010- 2011?

Good day sunshine? Europeans in driver's seat as car sales rise

We are seeing greater optimism this morning as European investors are reacting to higher auto sales, increased German business confidence and a stabilization of oil prices. We are even once again hearing talk of a Santa Claus rally – albeit muted.

Euro Zone shall not be a major growth driver

As regards the Euro Zone, the brutal truth remains that the recovery remains weak, uneven and showing little response to the massive stimulus by the ECB. Those seeking the growth drivers of tomorrow are better advised to look elsewhere.

Not wild about oil – US Dollars 37 WTI is not good news

We are not wild about oil and see a rise to about US Dollars 37 nothing to cheer about. At these levels, a large part of global production remains unprofitable and cash flow negative. Pressure on sovereign finances of the marginal producers shall not be alleviated, forcing them paradoxically, to increase production further in a desperate attempt to raise cash.

While the focus continues to be on the re-entry of Iran, we continue to see the major pressure stemming from increased production from the big producers.

Will natural resources debt lead to massive bank loan losses?

A key concern is the massive amount of bank debt which has been extended globally to the natural resources sector. We expect credit to start being curtailed due to:

The difficult trading position of several of the leading companies

The steadily increasing capital requirements imposed on banks

The limited capacity of the “shadow banking” system to replace the banks

While up to now, the brunt of the losses has been borne by shareholders and bondholders, we see the banks as next in line.

Expect further turbulence in US high yield

As concerns the US high yield market, the better market picture this morning is doing little to improve the overall tone. Further selling is expected as many investors liquidate positions ahead of the Federal Reserve meeting and the risk of a harsher tone than expected.

Any considerations as to a divergence between prices and credit fundamentals are being caste to the wind as the good, the bad and the ugly are being treated as an asset class.

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Federal Reserve meeting – new Bretton Woods?

In the US, the Federal Reserve meeting starts today, with the Oracles of Delphi announcing their verdict tomorrow to a financial world which shall be waiting with bated breath. We do not see turmoil in the high yield market and the morose outlook for the global economy as likely to influence the Federal Reserve.

Is distressed high yield a “niche” as the sub-prime sector was?

As regards junk bonds, the tendency shall be to view the current chaos as focused on a “niche” within a risky sector – shades of sub-prime containment? The global economy is seen as relevant in terms of systemic shock potential and not in terms of growth within a cyclical pattern.

Speed of tightening focus of debate – Shall this turn into one step forward and one step back?

The focus remains on the speed at which the Federal Reserve shall tighten. Some of the bolder are predicting that the US central bank shall be forced to beat an ignominious retreat and reduce rates, as the debacle of slow growth and deflation takes hold. We see the point not as whether the Federal Reserve take a step back but what impact this might have on the problems to be tackled.

Monetary policy has proven to be of little use in a context of massive changes in the world economy. We are attempting to correct today’s weaknesses with the methods of another age, when the developed economies were shielded from the global economies full production and labor potential.

US inflation low – absence of wage increases

With regard to US economic data – consumer price inflation in the US is trading water. While this is largely attributed to the influence of energy prices, we see this as reflecting a changed and atomized labor market reducing wage pressures.

We stand by our view that this shall not impede the Federal Reserve from raising rates, with the US central bank seeing inflation “around the corner”. The key risk to the non-energy high yield issuers is not the rise in rates- they cannot borrow anyway – but that:

Most of them are in commodity type sectors with little pricing power

Pricing power is enhanced by inflation

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