Tigress Financial Partners

Macro Snapshot – Chief Economist Jean Ergas

April 11, 2016

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Today's action

Surf is up – but waves small. We are not holding our breath as to oil meeting in Qatar. US revving up for the earnings season – this shall be about the banks! Italian banking system solution a good step but shall not ignite European economies.

Markets starting week on positive note

Markets are starting the week on a slightly firmer footing, with European stocks buoyed by more positive noises regarding the restructuring of the Italian banking system. A further short term contributing factor is a steady oil price, with some investors pinning their hopes on an agreement at the upcoming Qatar conference.

Fixing Italian banking system shall not cause an economic boom!

While placing the Italian banking system on a stronger basis is a step forward, we do not see this as a panacea for the Italian economy. The news flow continues to be disappointing with industrial production data coming in well below forecasts and continued downward revisions to growth. We view the market rising on the prospect of a government backed capital injection as reflecting that systemic concerns have not vanished.

Oil meeting – is this the League of Nations?

As concerns the oil price, we see investors already discounting a positive outcome to a meeting which is starting to increasingly resemble the League of Nations. We do not see it as realistic to assume a lasting and effective agreement without the participation of Iran.

US focus is on the start of the earnings season

In the US, the focus is on the start of the earnings season. Alcoa seen as a cyclical bellwether shall be the opening act, releasing its results today. However, we see investors more focused on banking stocks seen as an indicator of long term support to an economy which is still mired in a – by any standard – weak recovery.

The banks shall need to in the short term navigate the impact of lower oil prices. Longer term the critical issue shall be low interest rates and regulatory constraints.

Bank net interest margins under pressure

We are informed that the net interest margin is at its lowest for 20 years. With capital constraints preventing a "volume" strategy to boost income and restrictions on proprietary trading, in the absence of the Federal Reserve getting on with it, the outlook looks bleak.

Waiting for massive arrival of packaged busted oil loans!

Some banks are expected to need to write down their energy loan book by 10-15 per cent for the energy sector. It is only a matter of time before busted oil loans shall be packaged and sold to yield starved investors.

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Global overview

Global growth slowing – ECB pulls out all the stops – Will it make a difference? Oil, hope springs eternal! Europe multiple crises – where does one start? European banks, this will get worse!

US earnings season starts – fasten your seat belts!

With regard to the coming week, we shall be seeing the start to the US earnings season. Alcoa shall be leading the pack and will be looked at as a global cyclical marker. We are not holding our breath and view both the US domestic and global cyclical outlook as weak and expect further downward revisions to growth.

Gap between risk assets and economic data still firmly in place

We see the gap between "risk assets" and economic data firmly in place and we see investors still looking to the twin saviors of low interest rates and multiple expansion. With EBIT and EBT practically synonymous and earnings falling for many companies, there are scant bolt holes left.

Political risk is not abating – Panama scandal may have massive impact!

Political risk is not abating, with the UK- EU quandary now compounded by the widening scandal of the Panama trusts and accounts. This has already led to the resignation of Iceland's Prime minister and the UK PM Cameron struggling to explain his benefiting from one of the vehicles identified. We view this scandal as key for three reasons:

It is raising the issue of the difference between the letter of the law and the spirit of the law. The elites, while not breaking the law can access tax avoidance mechanisms precluded t the others!

Tax schemes by powerful shall limit capacity to ask for sacrifices from the rest of us

Due to the above, it shall become increasingly difficult to ask the already cash strapped bulk of the population to make further sacrifices. This shall increase pressure to moderate austerity policies, putting upward pressure on deficits.

Global groups shall get squeezed as tax loopholes close

This shall be a further inducement to clamp down on corporate tax avoidance. With global growth slowing and deflationary pressures smashing pricing power transfer pricing and/ or the creative use of cash management vehicles have been among the last means to expand margins.

Powerful grist to mill of Brexit supporters

The Panama scandal shall provide powerful grist to the mill of the Brexit supporters. The debate is rapidly mutating into a morality play and extension of class warfare. The bulk of the population – who cannot afford lunch in central London – pitted against the global elites.

No to a bigger EU!

A further punch to the European ideal and the capacity of the world's largest trading block to act effectively was the rejection in the Netherlands of an association treaty with the EU. This reflects both a move away from the expansion doctrine underpinning the benefits of free trade and security concerns.

We are already reading proposals to create a two track European Union – with associated members and full members. Broader ambitions aimed at political union are giving ground to a narrower, NAFTA type focus.

Oil price volatility a constant

With regard to the oil price, we have seen continued volatility. Prices have now rebounded towards the WTI US Dollars 40 level. This was spurred by renewed hopes as to success of the upcoming conference in Qatar on April 17th, a drop in US rigs and oil inventories and some upbeat comments about the US economy by the head of the US Federal Reserve.

Are we already in the second phase of the oil crisis?

We are starting to read reports that the first phase of the oil conflict has ended and that the second is about to begin. The first phase played out in two phases, elimination pricing followed by slashing of future production capacity.

Return of Saudi Arabia as the swing producer?

With massive capital investment reductions having broken the back of future oil flow, in the second round, Saudi Arabia shall reposition itself as the "swing producer" to prevent supply outages in a rising market. The focus has shifted from attempting to enlist Iran in an agreement to creating the premises for shortages going forward.

We remain skeptical of these efforts and continue to see the US shale producers as "waiting in the wings" and slowing demand growth as acting as a catalyst for further market share wars.

We move from market prices to asset sales – Changing of the guard

As concerns non-oil commodities, the focus has shifted from market prices to asset sales. We are seeing a "changing of the guard". The traditional players are seeking to sell to China, whose focus is on reliability of supply as opposed to calling the bottom in asset prices.

Limits solvency risk via cash injection – capacity shifted but not eliminated

While this may limit the solvency risk for the commodity traders and mining houses, it does not eliminate capacity but merely shifts its ownership. The general mood remains cautious with the Chilean copper giant Codelco not seeing a turnaround before 2020.

European banking - swimming dangerous!

With regard to the European banking sector, as we predicted, equity weakness has not abated. Stock prices are now once again inching close to the levels seen at the peak of the recent Deutsche Bank scare, a key driver in global stock market volatility.

Banks do not like negative interest rates!

Short term Stock declines are now being driven by renewed concerns as to negative interest rates globally, including in the ECB. This disquiet is increased by continued government sponsored attempts to patch together a semblance of order and solidity in the Italian banking sector. With bad debts equal to 17 per cent of GDP and growth forecasts being lowered, this is a major concern.

Italy – need for more draconian measures

A series of mergers not having been sufficient to bolster investor confidence, the focus is now on injecting capital via the involvement of government controlled entities. Banks are an important part of Italy's stock market capitalization. A further fall would seriously damage ECB attempts at engineering a "wealth effect" via a move to risk assets.

Emerging market bounce not based on economic fundamentals

Turning to the emerging markets, we are seeing a renewed bounce in financial asset prices and currencies. This has been largely predicated on continued moderation by the US central bank and consequently, a limited upside risk for the US Dollar.

The key factor is no longer increasing growth but avoiding debt defaults. A stable to slightly stronger US currency acts as a "cap" on debt servicing costs for companies struggling with both revenue stagnation and currency mismatched liabilities.

We continue to see the "heart of the matter" in the emerging markets as the need to implement structural reforms to boost productivity and reduce current account deficits. The weaker US Dollar shall induce procrastination – which as Dickens immortally stated in "David Copperfield" – is the thief of time!

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