Tigress Financial Partners

Macro Snapshot – Chief Economist Jean Ergas

June 30, 2016

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Are markets in a more reflective mood? Boris Johnson calls it quits – we shall all breathe a sigh of relief! Are UK large caps a safe haven asset? – Banking charade not yet over! – Euro Zone hits hyper- inflation - +0.1 per cent!

Are markets in a more reflective mode?

Are the markets in a more reflective mode? We are seeing some modest advances but the "Great Leap Forward" of the last two sessions seems to be ebbing. Markets had once again steamed forward buoyed primarily by further reassurances by central banks that they stood ready to intervene if necessary.

Whether this would go as far as supporting asset prices at these levels was not clear but with investors most concerned about markets freezing up, this was considered a start.

Political situation remains confused – will Boris Johnson's pulling out of race make for a smoother transition?

Investors are now gradually realizing that the situation is in terms of "the real economy" no clearer than previously. The UK political context remains confused. Who among the "leave" camp shall be the next prime minister and shall they be able to put forth a concrete strategy on both the internal and external fronts?

Boris Johnson's withdrawing from the race may help the "separatists" distance themselves from the more controversial issues which dominated the campaign.

EU says no to EU lite with immigration restrictions!

In what could be a significant obstacle for the UK's endeavors to "have your cake and it" the EU leaders have put their foot down on the immigration issue. There shall be no "most favored nation status" without unrestricted EU immigration, scuttling the much discussed Norwegian model.

Leave camp are in a bind!

The Leave camp - having won - is now in a bind. How to deliver on its key election promise, without slamming the door on the key UK market for growth companies and high value added services. While much breath is expended on the banking sector – a large swathe of the "knowledge economy "in England's south east could be "knocked for six".

The key to analyzing economic prospects shall be to assess the damage to sectors where UK companies are building market share and pricing power.

What is the gap between large and mid-caps in the UK telling us?

Turning to the "epicenter" of the quake, the UK market now appears to have a dual nature. The FTSE 100 has recovered ground since the detonation while the small and mid-cap 250 is still down almost 8 per cent. Some see this as signaling that all is well in the global economy as distinct from the UK domestic market.

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Can we split domestic from the global economy?

We see this stance as brittle on several fronts. The first is that we do not see how we can have interconnection between the financial markets while "The global" and domestic "real economies" remain distinct.

"Recession in one country"?

With a growing risk of US recession and knock on effects – in particular the Euro Zone – we should avoid pernicious doctrines of "recession in one country".

Are large caps safe haven assets?

The second is that we see investors now seeing some global companies as a "safe haven" asset. This leads us to believe that the valuation gap between the two indices is a harbinger of tough times for the UK economy.

Global economy not firing on all cylinders

Lastly, we question the assertion that "all is fine" with the global economy. What we may – at the very best – see is a return to the status quo which was nothing to write home about!

UK advanced economy with an emerging market current account deficit!

Meanwhile the UK current account deficit at almost seven per cent, the "Kindness of stranger" may be getting stretched! While we expect imported inflation to take off, we see the Bank of England as staving off interest rate increases.

Do not buy mild recession speech!

They shall prefer to not deal a further blow to the already wobbly underpinnings of the economy – consumer demand and housing prices. We do not share the Polly Anna view of the UK economy of a "mild recession" and see longer lasting consequences as domestic and capital investment comes to a screeching halt.

Why are the banks and homebuilders on the floor?

We see this as reflected in the stalling of the recovery in the UK banking and home builders sector – with the former adding economic weakness to a litany of woes and the latter reflecting concerns of gross overvaluation. When the immigrants – seen by the leave camp as the "root of all evil" and the rich EU expats start to de-camp, who shall buy all of these houses?

No rest for the Italian banks – is this Spain?

The Italian banking sector continues to show signs of fragility, with the request for a waiver from the new re-structuring rules having been rejected. There are now rumors of a Euro 40 billion bail-out of the distressed banks – to be implemented via a re-stocked Atlas fund.

Banks will need to manage both legacy and here and now!

This is starting to look ominously like the financing extended to Spain at the height of the Euro Zone sovereign crisis. Are we seeing a re-play? With the prospect that uncertainty shall continue to undermine the European recovery, we expect that the banking problem shall increasingly shift from managing "legacy" to the here and now!

Three cheers for Euro Zone inflation!

We were cheered to read that inflation in the Euro Zone turned positive at 0.1 per cent and that "core" inflation has reached the dizzying level of 0.9 per cent. This remains "noise" and not signal and highlights the brittle constitution of domestic demand. Companies dispose of scant pricing power and for many real wages continue to fall.

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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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