Creative Global Investments

Morning market commentary & charts

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Objectivity

Integrity

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As the table below shows, the interest rate differential between the US and other economies of higher growth have been narrowing.

Economies like Russia, Germany and Japan, all having significant trade surpluses and also current account surpluses, have had a compression in interest rates over the past 4 months, however, US interest rates despite a lower growth rate and also despite a widening trade deficit and a growing current account surplus has seen its interest rates rise significantly more than those other economies.

ALL	Trade balance	Current-account balance		Currency units		Budget balance	Interest rates	
Country	latest 12 months, $bn	latest 12 months, $bn	% of GDP, 2017*	Jan 2nd, per $	year ago, per $	% of GDP 2017*	3-month latest	10-year government bonds, latest
Turkey	-56.0 Dec	-33.8 Oct	-5.2	3.52	2.92	+	+10.17	11.0
Brazil	+47.7 Dec	-20.3 Nov	-1.3	3.25	4.00	+	+12.94	11.0
Venezuela	-36.2 Oct*	-17.8 Q3*	+	10.0	6.31	+	+14.76	10.0
South Africa	-0.5 Nov	-12.3 Q3	-3.9	13.0	15.0	+	+7.36	8.93
Russia	+89.7 Oct	+29.0 Q3	+2.8	61.0	73.0	+	+11.28	8.46
Pakistan	-26.0 Nov	-4.1 Q3	+	104	104	+	+6.12	8.03*
Indonesia	+7.6 Nov	-19.2 Q3	-2.4	13,472	13,785	+	+7.46	7.85
Mexico	-13.9 Nov	-30.6 Q3	-3.0	20.0	17.0	+	+6.11	7.44
Colombia	-15.2 Oct	-13.7 Q3	+	3,002	3,174	+	+6.86	7.11
Greece	-18.0 Oct	-1.0 Oct	+	0.95	0.92	+	-0.32	7.09
India	-96.4 Nov	-11.1 Q3	-1.0	67.0	66.0	+	+6.1	6.41
Vietnam	+2.7 Dec	+2.0 2015	+	22,771	22,485	+	+4.8	6.10
Philippines	-22.5 Oct	+3.1 Sep	+	49.0	47.0	+	+2.08	4.63
Chile	+3.4 Nov	-4.8 Q3	+	669	708	+	+0.47	4.29
Malaysia	+21.3 Oct	+5.6 Q3	+	4.49	4.29	+	+3.41	4.24
Portugal	-11.6 Oct	+0.8 Oct	+	0.95	0.92	+	-0.32	3.71
Poland	+5.8 Oct	-2.4 Oct	+	4.17	3.95	+	+1.53	3.68
New Zealand	-2.4 Nov	-5.3 Q3	+	1.43	1.46	+	+2.0	3.37
Hungary	+11.0 Oct	+5.5 Q3	+	292	290	+	+0.36	3.20
China	+531.7 Nov	+264.6 Q3	+2.2	6.95	6.49	+	+3.28	2.88*
Australia	-9.8 Oct	-47.9 Q3	-3.0	1.38	1.37	+	+2.21	2.76
Thailand	+21.2 Nov	+47.9 Q3	+	35.0	35.0	+	+1.09	2.71
Singapore	+46.8 Nov	+63.0 Q3	+	1.44	1.42	+	*na*	2.49
United States	-739.7 Oct	-476.5 Q3	-2.8	-	-	+	+1.0	2.45
South Korea	+89.8 Dec	+99.9 Oct	+6.9	1,207	1,172	+	+1.46	2.05
Israel	-13.0 Nov	+13.3 Q3	+	3.85	3.89	+	+0.11	2.02
Hong Kong	-54.5 Nov	+13.3 Q3	+	7.75	7.75	+	+1.03	1.90
Italy	+56.8 Oct	+49.5 Oct	+2.2	0.95	0.92	+	-0.32	1.74
Canada	-23.8 Oct	-53.6 Q3	-2.9	1.34	1.39	+	+0.9	1.71
Norway	+15.7 Nov	+18.0 Q3	+	8.61	8.85	+	+1.16	1.66
Spain	-20.8 Oct	+23.0 Oct	+1.4	0.95	0.92	+	-0.32	1.32
Britain	-178.6 Oct	-138.1 Q3	-4.4	0.81	0.68	+	+0.37	1.27
Taiwan	+15.8 Nov	+74.7 Q3	+	32.0	32.0	+	+0.66	1.21
Slovakia	+4.1 Oct	+0.1 Oct	+	0.95	0.92	+	-0.32	0.91
Lithuania	-2.3 Oct	*nil* Q3	+	0.95	0.92	+	-0.32	0.80
Ireland	+51.0 Oct	+34.2 Q3	+	0.95	0.92	+	-0.32	0.79
France	-55.3 Oct	-40.0 Oct*	-1.1	0.95	0.92	+	-0.32	0.66
Sweden	-0.4 Nov	+22.2 Q3	+4.9	9.08	8.43	+	-0.6	0.53
Czech Republic	+20.4 Oct	+3.7 Q3	+	25.0	24.0	+	+0.28	0.48
Belgium	+29.4 Oct	+3.4 Sep	+0.7	0.95	0.92	+	-0.32	0.47
Austria	-2.8 Sep	+8.0 Q3	+2.3	0.95	0.92	+	-0.32	0.41
Finland	-2.9 Oct	-1.7 Oct	+	0.95	0.92	+	-0.32	0.34
Netherlands	+55.1 Oct	+57.1 Q3	+8.4	0.95	0.92	+	-0.32	0.33
Denmark	+8.7 Oct	+23.2 Oct	+6.8	7.05	6.87	+	-0.22	0.32
Euro area	+296.2 Oct	+380.4 Oct	+3.0	0.95	0.92	+	-0.32	0.19
Germany	+278.7 Oct	+296.2 Oct	+8.1	0.95	0.92	+	-0.32	0.19
Japan	+41.0 Oct	+184.2 Oct	+3.5	116	120	+	-0.05	0.04
Switzerland	+38.5 Nov	+68.2 Q3	+9.0	1.02	1.00	+	-0.73	0.0
Iceland	-0.9 Nov	+1.3 Q3	+	112	130	+	+5.6	*na*
Peru	*nil* Oct	-6.9 Q3	+	3.35	3.41	+	+1.16	*na*
Argentina	+1.0 Nov	-15.7 Q3	-2.5	15.0	12.0	+	+18.88	*na*
Latvia	-2.1 Oct	+0.3 Oct	+	0.95	0.92	+	-0.32	*na*
Slovenia	*nil* Sep	+3.1 Oct	+	0.95	0.92	+	-0.32	*na*
Estonia	-1.8 Oct	+0.5 Oct	+	0.95	0.92	+	-0.32	*na*
Luxembourg	-6.2 Oct	+3.2 Q3	+	0.95	0.92	+	-0.32	*na*

How long can credit diverge, without paying attention to macro fundamentals supporting such abnormalities?

Additionally, how long can the US benefit from capital inflows from abroad, purely on hope and hype, without the fundamental momentum relatively improving, in order to back such capital flows?

There are quite some "Keynesians" who believe that capital deficits and current account and trade deficits constitute any substantial risk matters any longer, but we tend to differ in opinion.

We see it hard for foreign investors at this point see need to allocate more assets to any US asset classes currently when their purchasing power is so dramatically reduced due to the past two years of an irrational +35% rise of the US$!

If the dollar at EUR/US$ 1,28 in 2014 was not enabling the US to become more competitive, so how can investors believe that current political and macro conditions can help US corporate profitability and productivity keeping up with the rest of the world?

It is obvious that the US has had a growing trade deficit since the late 1980's, from when the monthly trade deficit was under US$1BN, and when the US economy was growing at almost double the annual growth rate than in the past 5 years.

Today, US's trade deficit measures a whopping +US$ 45BN per month, (a total of $739.7 BN for 2016), and the current account deficit accounts for $476.5 BN or -2,9% of GDP.

And for all that we know, Mr. Trump will re-start the printing presses and try to halt the inevitable recession by spending increases in defense, public infrastructure, but simultaneously give corporate tax breaks and reduce the income taxes to the super wealthy. Come again?

For any foreign asset allocators to add more money to US assets seems a bit of a stretch at this point, as the political risks of the current US reality show outweigh those well publicized break up fears of the EU and those geo-political concerns hovering over the rest of the world.

We are anticipating the US economy will soon slip over to the dark side. Our outlook for 2017 and beyond is that the US economy will likely enter another recession, not only because of trouble brewing via Donald Trump's election win & "idle and unrealistic" promises and so far announced policy changes.

History shows that the election of a Republican generally, any Republican, has been a proven recipe for recessions. There is a 100% correlation of cause and effect between presidents who hail from a political party that begins with the letter "R" and economic downturns.

Each of the six Republican presidents since the WWII presided shortly into a recession, and some more than one, such as three under Trump's self-declared idol, Dwight 'Ike' Eisenhower, and two each under Richard Nixon and George W. Bush.

Risks have substantially increased for a new recession because a new occupant of the Republican persuasion is set to move into the Oval Office. The probability of a recession in 2017 is certainly higher than zero and so it's possible that a new slump is fate at some point between now and December 31.

The reality is that predicting recessions is a fool's errand, as history clearly and continuously reminds. The next best thing is now casting the business cycle, which is essentially crunching a wide and representative sample of economic and financial data and modeling the numbers in search of clear signals of cyclical change. History also shows that such efforts offer a substantially higher level of reliability vs. warm and fuzzy approaches that are data independent and instead rely on theory, intuition and cherry-picking data sets to rationalize a dark forecast.

Even if we can do a better job of estimating recession probability, is the effort worthwhile from an investment perspective? Yes, or at least it has been in recent history. For example, the track record looks encouraging for using the monthly reports of the Chicago Fed National Activity Index (3-months average) as the basis for a tactical asset allocation model. By analyzing various combinations of our macro trend in conjunction with leading indicators, we managed to reliably anticipate the signals for contracting benchmarks by a week or two.

In other words, there are relatively robust methodologies for estimating recession risk in real time. On that note, the probability is currently close to zero that the US economy is contracting or is at risk of contracting. However, parts of our research are starting to show that parts of that analytical outlook are starting to change.

The good news is that real-time analysis, if done right, can reveal a lot about the odds of a cyclical shift. But predicting that date, in advance with a reasonable degree of reliability is only slightly tougher than turning water into wine.

But let's look at the bond and forex markets for further clues. Yields fell sharply lower, the US Dollar Index also declined; the $USD was losing -1.15%, moving back towards previous resistance, now support, at 100.

Moves were pronounced across the currency market, in part due to a crackdown by the Peoples Bank of China, which fuelled the largest ever two-day gain versus the US$.

The Chinese central bank tightened liquidity in Hong Kong on Thursday by instructing the nation's banks to withhold funds from other banks, a move that drove the Yuan in offshore trading to its highest level since early November. The rate that banks charge each other in Hong Kong's overnight lending market rose from 17% to 38%, the highest in a year.

The currency shift was also felt in the Japanese Yen, disrupting a popular carry trade that involves borrowing the low yield currency (the Yen) and buying the high yield currency (USD). The flow of assets typically has positive benefits for the S&P 500 Index. With the 10-Year Yield in Japan hovering close to 0%, it is easily apparent why the popular strategy has been so successful as yields in the US stretch above 2%. The yen gapped higher during Thursday's session, closing above its 20-day moving average with a gain of 1.64%. Variable resistance would be expected at the 50-day moving average, now around 90 on the Philadelphia Yen Index.

While declines in the Yen are typically conducive to gains in the S&P 500 Index, the opposite holds true when the Yen rises, as a result of the carry trade mentioned above.

Seasonally, the Yen typically declines through Q1, moving opposite to the US$.

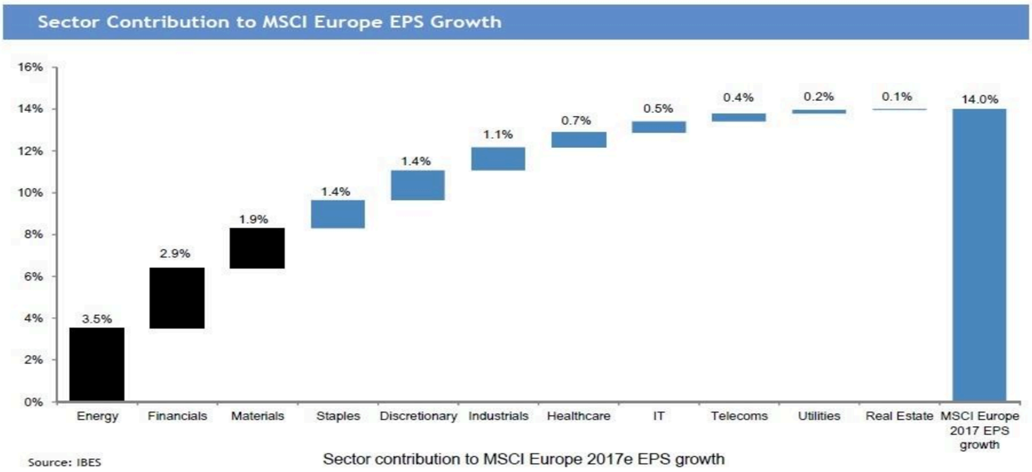
Stocks closed mixed on Thursday as investors reacted to the drift lower in treasury yields, which impacted stocks in the financial sector. The S&P 500 Index ended lower by a mere eight basis points.

Both the S&P 500 and Dow Jones Industrial Average remain stalled at short-term resistance with a major catalyst ahead by way of the monthly employment report.

Over in Europe, a direct beneficiary of the strong US$, the EU’s mini earnings recession seems to be ending.

Although, 2017 EPS projections appear elevated at face value, the recent weakness in the EUR/US$, leads us to believe that analysts’ consensus earnings are too low, and will have to forecast higher EPS for 2017.

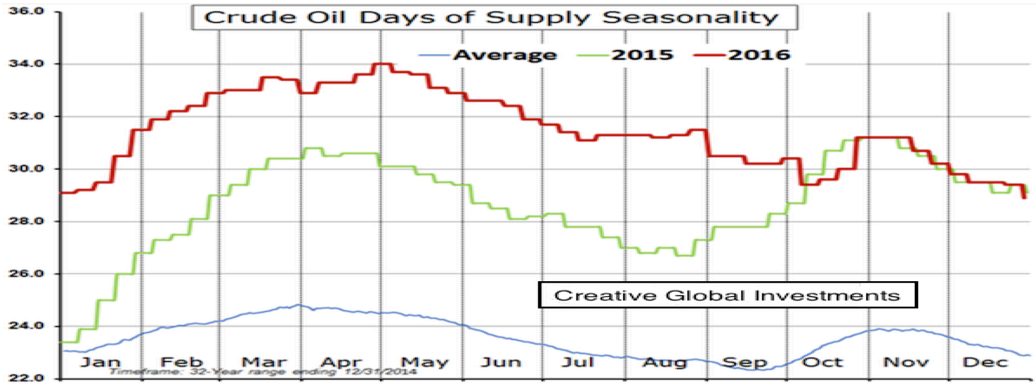
The prospective rebound in earnings is not a surprise to us, and we would again like to point out to investors that European equity valuations are significantly lower than in the US. As equities are a real asset class, they ultimately benefit from reflation, and current bond/equity correlation is starting to drop.



Sector contribution to MSCI Europe 2017e EPS growth

European equities currently present the better investment opportunity for investors, with the EUR/USD at 1.06, European companies are very competitive and will continue to take market share at higher margins against US rivals. As we had been predicting, European equity markets, stocks and related ETFs have record positive real and relative returns during the past 6 weeks, as they have entered their period of seasonal strength, until the late April/May time (when most annual dividends will be paid out)

Oil prices slipped a touch despite the start of supply cuts by Saudi Arabia and Abu Dhabi. West Texas Intermediate was down -0.2% to $53.64 a barrel and Brent crude was off -0.3% at $56.71. Yesterday, the EIA petroleum status report for the last week of 2016 caught some analysts off-guard, that oil inventories declined by 7.1MN barrels, while product inventories swelled with 8.3MN barrels of gasoline added and 10.1MN barrels of distillates.



The result had a greater impact on the days of supply of gasoline, which jumped by a full day to 26.2, almost two days above the norm for this time of year. Typically, the days of supply of the refined product holds within a day of its seasonal norm. The result follows a drop in production to year-end, mirroring the decline in the product supplied, a gauge of demand; both production and demand seasonally decline into February. While the initial reaction to the report was negative, the drop in the US$ helped to fuel a rebound in the price of both commodities into the close. The price of oil ended higher by nearly 1%, maintaining support at $52.

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