Money, Macro & Markets Monitor

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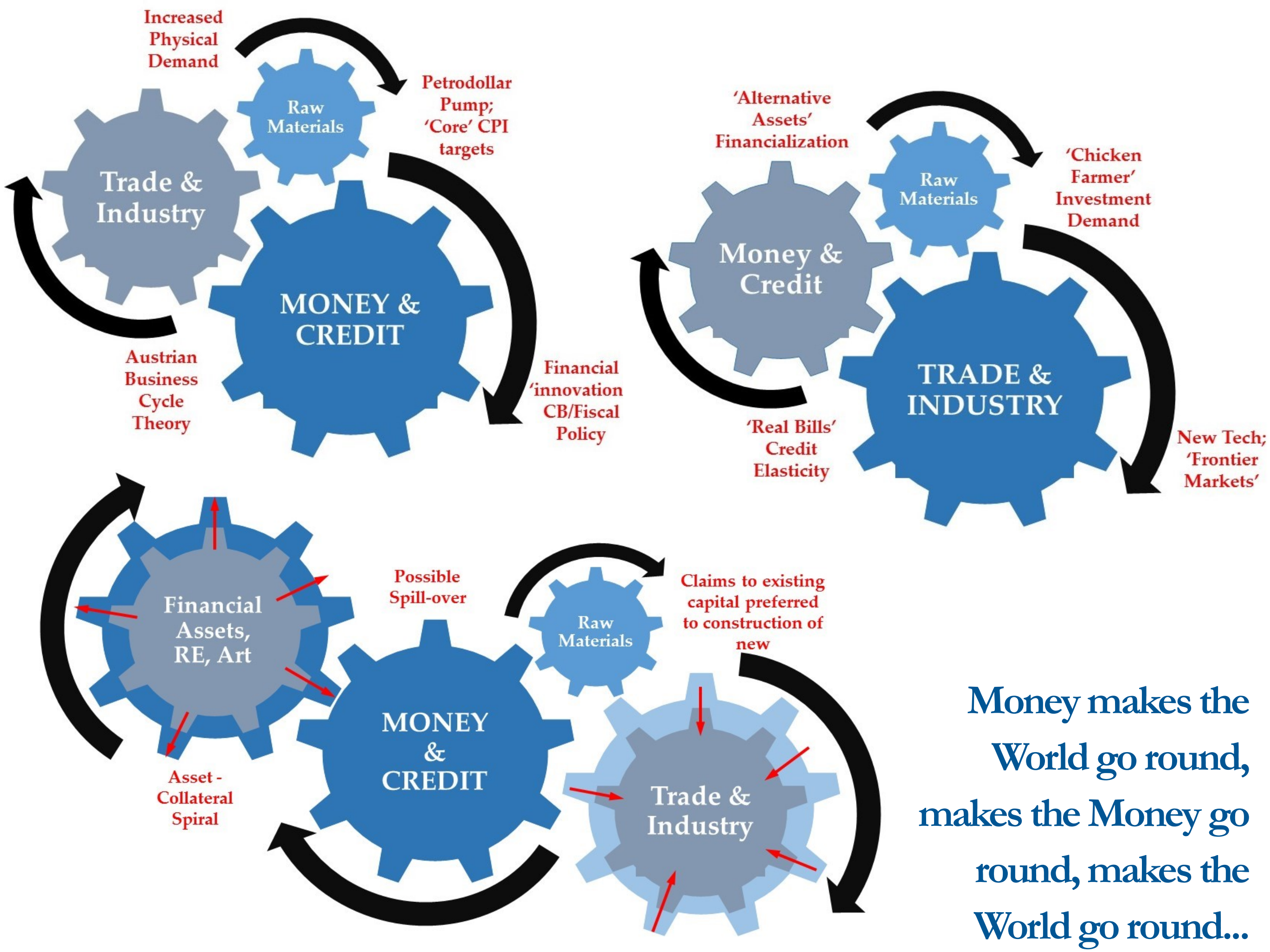

Money makes the World go round, makes the Money go round, makes the World go round...

IN THIS ISSUE:-

CENTRAL BANKERS:

Troubling Plato's ghost.

BRITAIN:

Bad diagnosis offers no cure

FIXED INCOME:

Return of the bond bears

EQUITIES:

No longer quite so cheap (relatively)

GOLD & ENERGY

Mean reversion

Volume I, Issue 7

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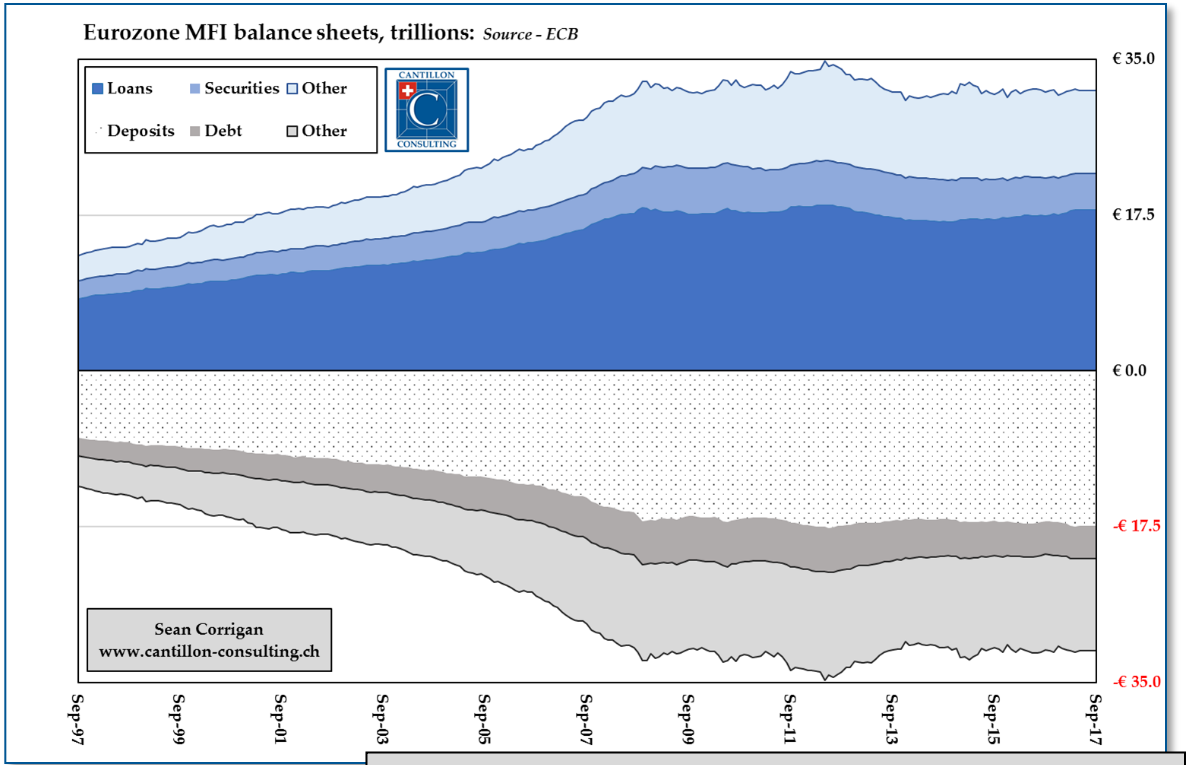


Eurozone Banking: a €32 trillion 'signal' according to the ECB

Somewhere down there, in the Stygian gloom, one hopes that Plato's shade is displaying a suitable degree of contrition for his earthly advocacy of the role of Philosopher Kings in the governance of his theoretical Republic. For surely, when he looks at the latter-day incarnation of his ideal, he cannot fail to despair of a world left largely at the mercy of the self-reinforcing hubris and intellectual vanity of our Philosopher-Central bankers.

Let us take a few quick examples, none of which will involve Janet Yellen's ringing declaration of the abolition of the business cycle.

In seeking to elaborate upon – if not, in fact, entirely explain away - what his boss, Marion Draghi meant by his recent, market-moving speech in Portugal, the ECB's chief economist, Peter Praet, started off with the following, rather startling assertion:-

'Well-functioning fixed income markets are at the heart of modern market economies. There are several reasons for this: they provide information to market participants and policymakers concerning the state of the economy and how it is expected to develop; they signal monetary policy expectations and investors' expectations regarding future inflation; they offer benchmarks for pricing other assets."

Aha! *Now* I get it!

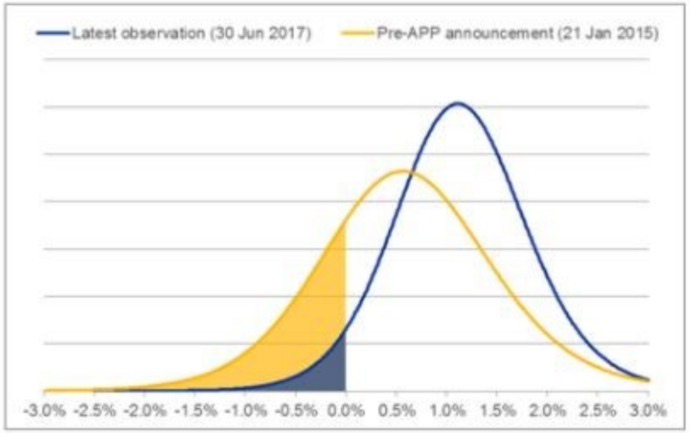
There I was, foolishly thinking that, whenever I put some savings aside or, conversely, took out a loan, I was actually altering the timing between my effort to produce something of exchangeable economic value and the point at which I decided to enjoy its fruits. In short, that I was changing the intertemporal distribution of my indissoluble, twin activities as both maker and consumer by interacting voluntarily with someone who - at that same moment – happened to display needs and intentions opposite to, but complementary with, mine.

But, no. To the idiot savants among us, I am clearly *not* putting a little something aside for a rainy day and you are *not* agreeing to give me back my umbrella when the heavens do open. You are *not* paying me interest to do this in order to have use of my brolly now – possibly as a means of giving employment to others while engaging in the creation of an additional increment of wealth. No, what we two are doing instead is '*signalling*' to a mathematically-gifted, but understanding-free Philosopher King how well *he* has succeeded in using blunt force monetary policy to swamp our individual schedules of preference in the one he would impose.

Worse still, in some strange sort of Cheshire Cat way, where all is smile and none is substance, I am helping price other 'assets' – i.e., I am attaching a value to other embodiments of that exact same process of trading a little of today for a small slice of tomorrow but only for its own sake so it fits in one of M. Praet's models.

Risk-neutral probability density function of euro area inflation over the next five years

Can anyone here spell 'pseudo-science'?



Sources: Bloomberg, Reuters and ECB calculations.
Notes: This chart shows the risk-neutral probability distribution function implied by five-year zero-coupon inflation options. These risk-neutral probabilities may differ significantly from physical, or true, probabilities. They are estimated on the basis of call ("caplets") and put ("floorlets") options, with different strike rates on the (three-month lagged) euro area harmonised index of consumer prices (excluding tobacco), assuming Black-Scholes option pricing and implied volatilities that vary across strike rates ("volatility smile"). Shaded areas indicate the risk-neutral probability mass assigned to an inflation rate below 0.0%.

Towards the end of his speech, Monsieur Praet graciously lifted a little corner of the curtain behind which he and the other Oz's sit to show us how he knows to what degree we *hoi polloi* are indeed following his strictures about how rapidly we estimate our money will depreciate and hence how close he is to achieving the economic perfection of which only a mind such as his can have full comprehension.

Here it is in all its glory (see opposite):-

And on such flimsy foundations does our modern-day Plato take decisions involving trillions of euros which affect the lives of hundreds of millions of people of whose unique, individual 'caplet'– and 'floorlet'-free circumstances he can know precisely nothing!

Mr Godwin, meet Mr. Phillips.

An even more risible pronouncement was delivered last week by the BOJ's Yutaka Harada who got himself into hot water by indulging in a little *'…yes, but at least Hitler got the trains to run on time'* stupidity, saying that, had the world done as Herr Schicklgruber and followed the tenets of Keynes, then *we'd* have had the *Autobahnen* and the VW and not *them*.

The howls of outrage were as predictable as they were misdirected. It was the man's grasp of history to which they should have been addressed, not least because he seems to have overlooked the local, proto-Abenomics example of Takahashi Korekiyo - a man who helped finance a similarly unfortunate phase of Japanese history through a policy of devaluation and monetized deficit-spending, enacted very much then as today.

No, the 'wonderful' fiscal and monetary policy which Harada praised did *not* see the Nazis come to power in 1933: they were enacted *afterwards* - largely under the guidance of Reichsbank president, Hjalmar Schlacht. Keynes, meanwhile – despite his notorious encomium to Germany's nascent totalitarianism in the local edition of '*The General Theory*' – did not publish that flawed *Meisterwerk* until three years later, in 1936.

Great Scott, Marty! Charge the flux capacitors! 88mph, here we come! For here, it seems, we have a rare case of 'backward guidance' to add to the more familiar, if equally fatuous, 'forward' version so beloved of the MIT macromancers of today.

To paraphrase Keynes himself: *'Practical men who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some* yet-to-be-born *economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years* hence.*'*

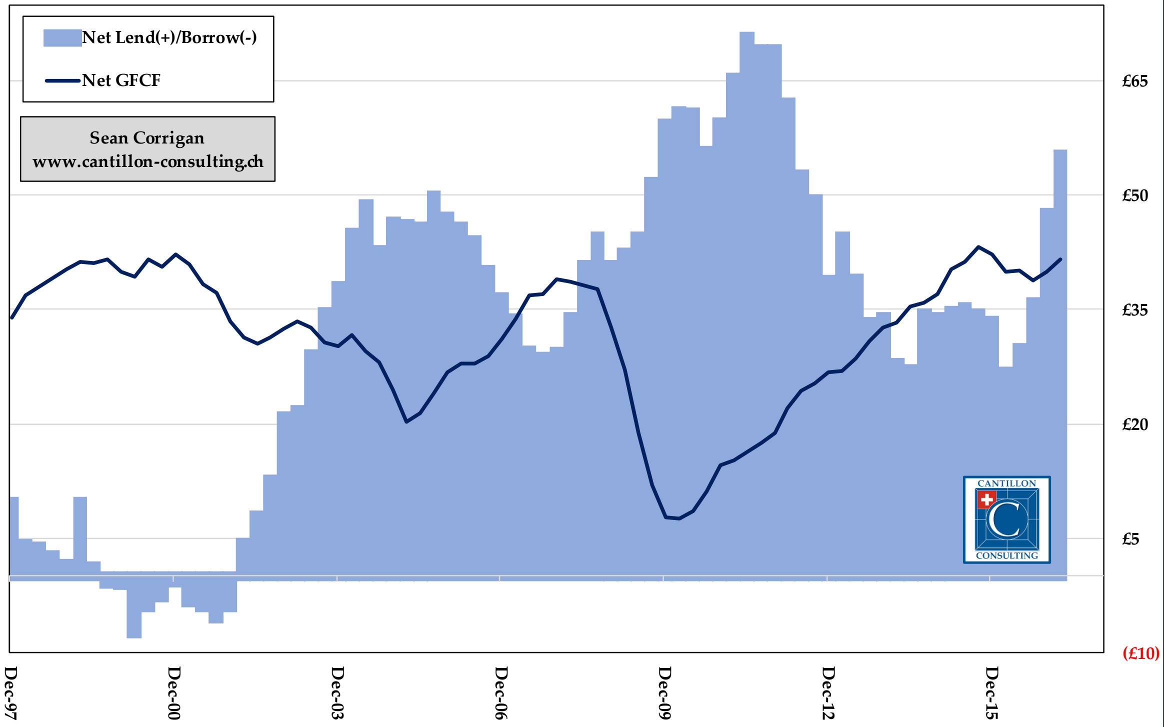
We could carry on at length here about how the policies that *retrospectively* came to be associated with the Bloomsbury sage - deficit spending, tariff barriers, loose money, etc. - were the ones largely responsible for tipping the world over the edge in the 20s and 30s and not the converse, but let us just point out that there are sufficient examples of such pre-Keynes 'Keynesians' as Schlacht and Takahashi to show that he was scarcely as original in his crankdom as his vanity allowed him to pretend to himself he was.

The Insufferable in pursuit of the Intangible

Over in the UK, Divus Marcus Carney firstly managed to deliver a treatment of the UK's yawning current account deficit which nowhere mentioned the fact that his ludicrously lax monetary policy – coupled with a fiscal approach, the reverse of true 'austerity', which this has enabled – has led households to join Her Majesty's Treasury in consuming capital on an unprecedented scale.

Already sucking up £10s of billions of company funds which could be better used to invest in productive adaptation and advance, the hole in the accounts has had, perforce, to be made up by the same foreigners (the Germans to the forefront) whom Carney seeks to blame for their signal success in satisfying the over-eager desires for their goods of Britain's swelling army of euthanised rentiers.

UK Private Non-Fin Corporates, Net Capital Formation & Lending, blns: *Source - ONS*



Instead of investing, UK corporates are financing consumption

As for his excuse for why capital investment is too slow for his liking, he ignores this dwindling pool of savings and the accompanying inflationary fall in the cost of labour - phenomena which are both his godchildren - and instead reaches for the following:-

"… A wide range of analysis suggests that the shift [in investing] towards intangibles has… dampened this [accelerator] effect, perhaps because [they] assets are less suitable for use as collateral than physical assets, such as property. The weakness in investment is of course linked to weak productivity. In the UK, while the most productive companies have continued to innovate, others have become slower at adopting those innovations"

So, if UK firms invest in unwieldly, illiquid, lumps of slow/zero-payback real estate, they can borrow against it (at helpfully BOE-depressed rates, one infers) to make *further* investments? But this just begs the question of why they do not just spend the cash being devoted to property on these other things in the first place. After all, if I want a new suit, I don't first buy an expensive pair of shoes, then hand them over to the local pawnbroker to raise the money with which to buy my threads.

Moreover, it is painfully inconsistent to say that firms are shifting so much investment to these 'intangibles' (which, by implication, businessmen must judge are likely to return *more* than the now-neglected 'tangibles') that the aggregates are falling - and to argue in the very next breath that not enough of them are doing so!

The clincher however, is the ill-concealed contempt which the no-skin-in-the-game Governor concludes by expressing for those mere commercial-types not spending the money he is throwing at them in the manner which he, from his Olympian perspective, intended:

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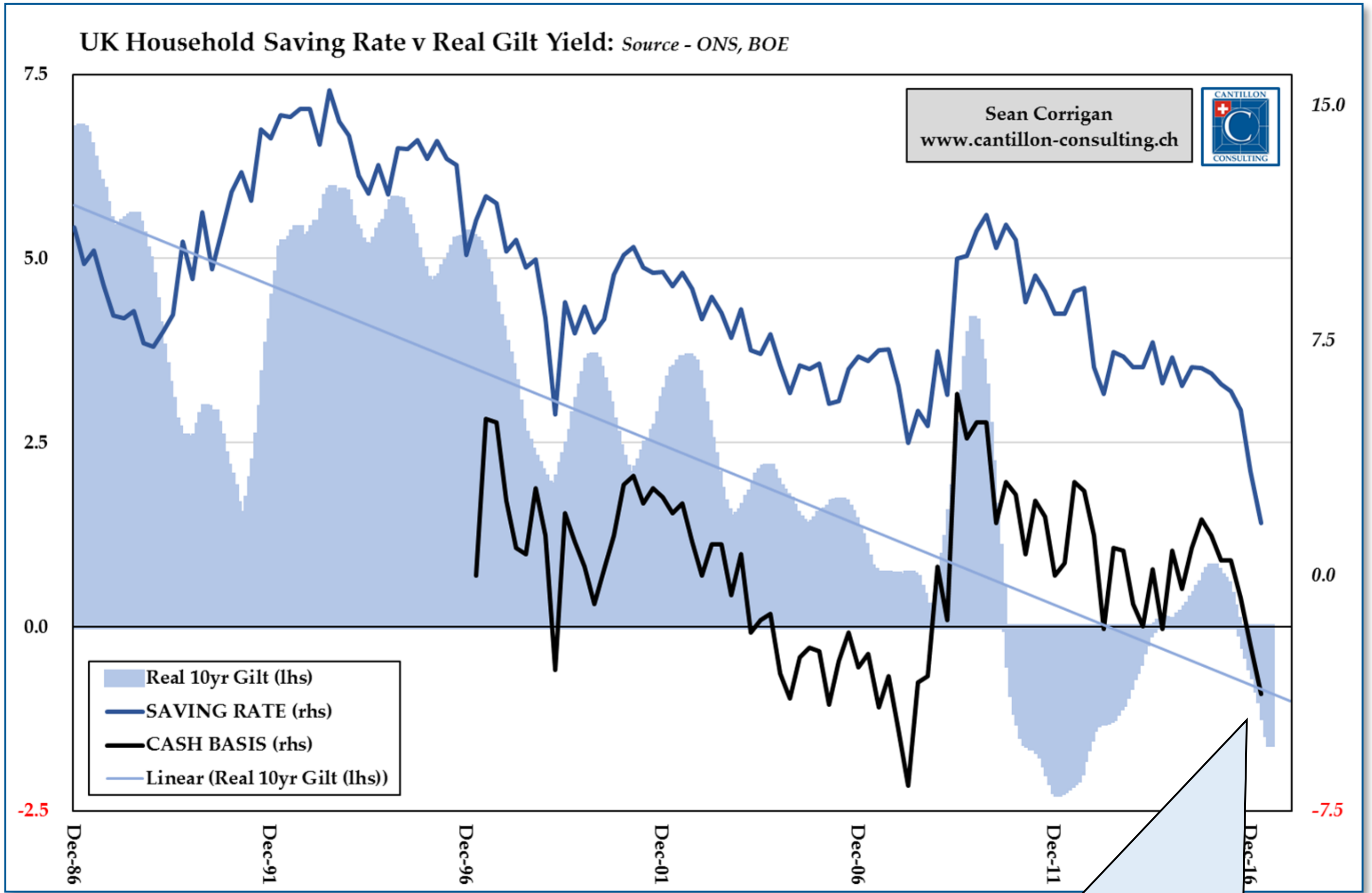


"…That has stalled diffusion of productivity gains through the economy. This shortfall in investment could reflect deeper causes such as …sub-optimal managerial practices."

Truly insufferable!

To round off this week's visit Platonic Hall of Shame, consider Carney's chief familiar, Andy Haldane – another believer in the Tooth Fairy of 'expectations' - who, in seeking to justify his sudden, Road to Damascus conversion from perma-dove to fledgling hawk, a few days ago, offered us this little gem:-

"…I do think that beginning the process of withdrawing some of the incremental stimulus provided last August would be prudent… When the MPC begins this process of normalising monetary policy… far from being a cause for concern, starting the process of withdrawing some monetary policy insurance should serve as a signal of the MPC's confidence in the UK economy's resilience…"

Hmmm. I wonder why savings have fallen into the red?

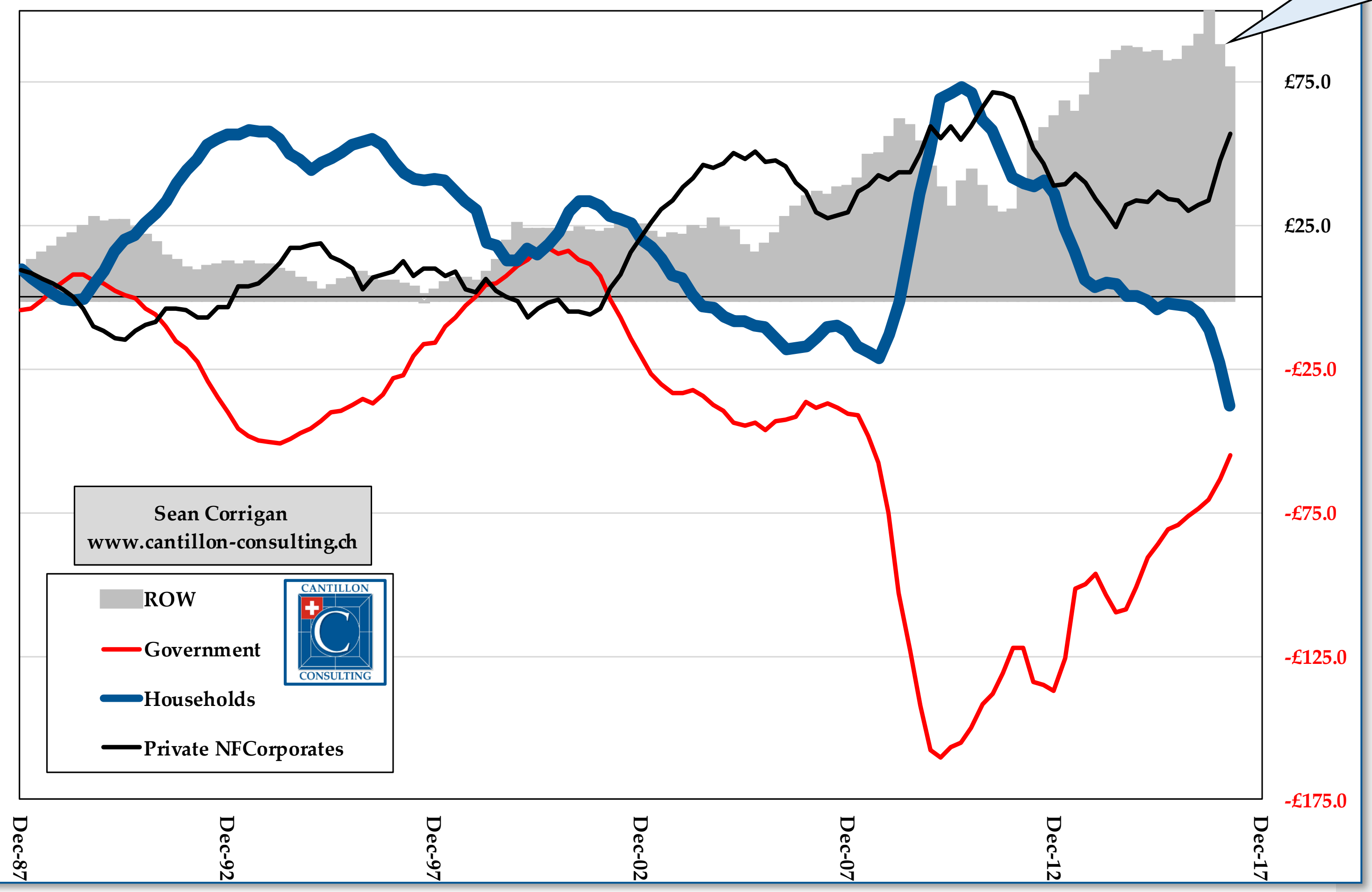
So, by implication, the whole business of *adding* 'incremental monetary policy insurance' (i.e., of promoting inflation, by hook or by crook), as practised throughout this past decade, cannot have failed to have 'served as a signal' (there's that word again!) of the *lack* of such confidence.

Thus, we must conclude, those grubby tradesmen truculently refusing to abandon their 'sub-optimal managerial practices' and to strike boldly out on a programme of 'tangible investment'-led expansion have all along been paralysed by the 'uncertainty' arising from the suspicion that the Philosopher Kings of Threadneedle Street knew something they didn't about how ill-advised to embark upon such a course would have been.

Thanks for nothing, Mark and Andy!

Roughly, the current account gap is equal and opposite to this Rest of the World (ROW) component.

UK Sectoral Net Lending/Borrowing, 4Q sum, blns: *Source - ONS*



Even the headline that the UK household savings rate hit a record low +1.7% does not reveal the true horror of what Carney's BOE & successive Chancellors have done to Britain's economy.

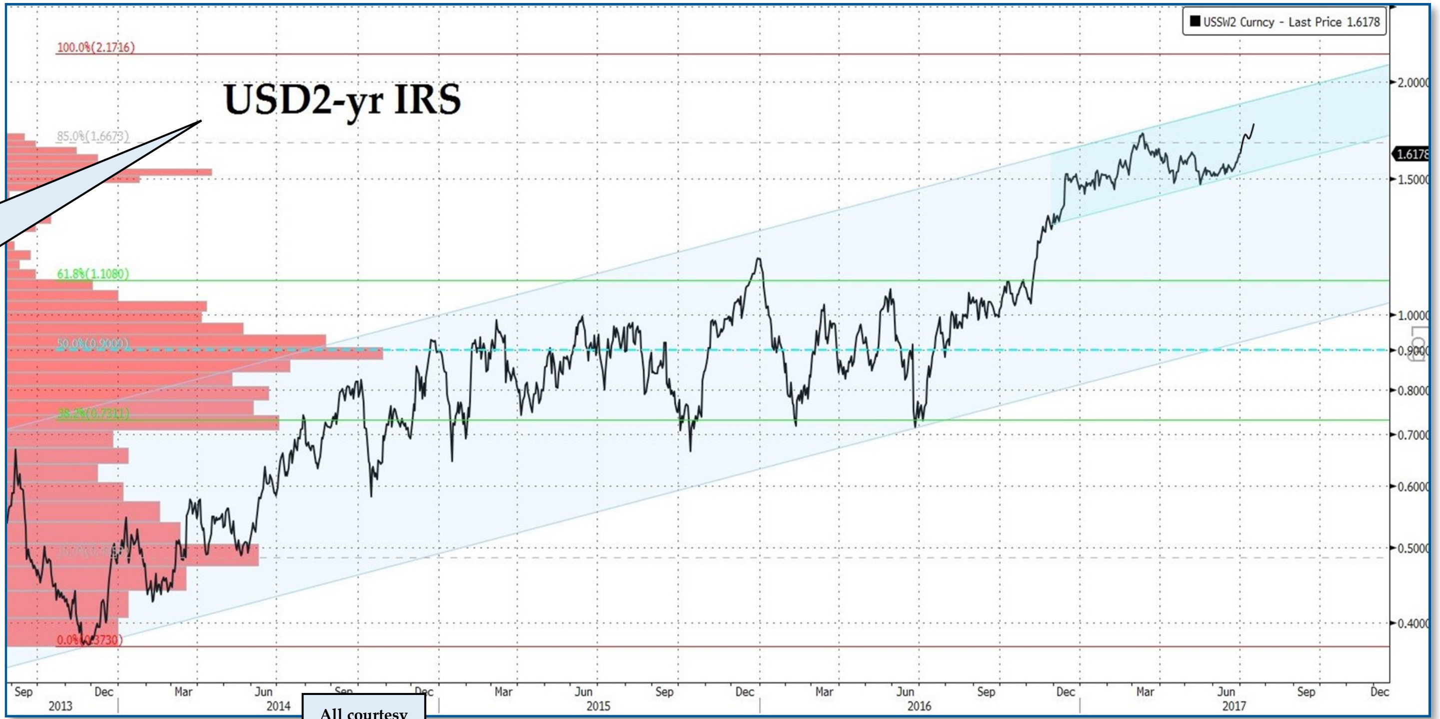
Strip out various non-cash 'imputations' such as pension entitlements (themselves £230 Billion in the red) and even the ONS admits one needs to knock 5-6% off that number, as our earlier graph shows.

The graph to the left shows that government finances are currently improving at the expense of householders who, as a group, have been net borrowers (i.e. dissavers) of a record £38bln this past 4 quarters.

Between the two of them, their chronic overspend (technically known as 'austerity'!) has sucked in £75 billion from abroad *and* used up £55bln of corporate saving – a sum comfortably in excess of NFC net investment.

No wonder real, per capita household income is reckoned to be unchanged from as far back as a decade ago.

With most of the damage being Fed-driven at the front end, 2-years looks like it could be headed for the 2.15/20 area



All courtesy

For now, the long end still remains in the lower half of the post-GFC (log) range, but a further 10-15bps rise seems the most likely progression

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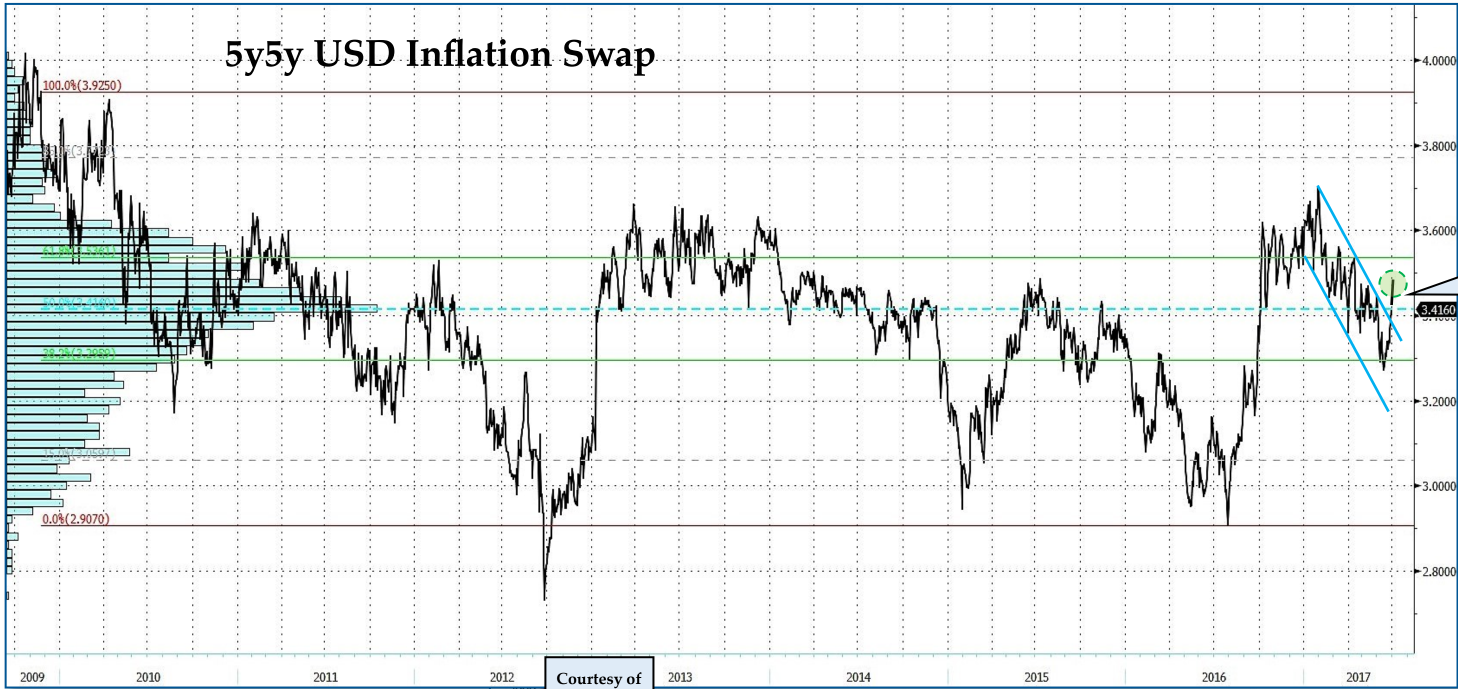

The latest uptick has involved a back up in the forward inflation component…

But the move in real yields (entailed by its prior decline), being mirrored by a climb in average equity prices back to the highs, should shut the 'secular stagnationists' up *and* keep the Fed in play

Courtesy of Bloomberg

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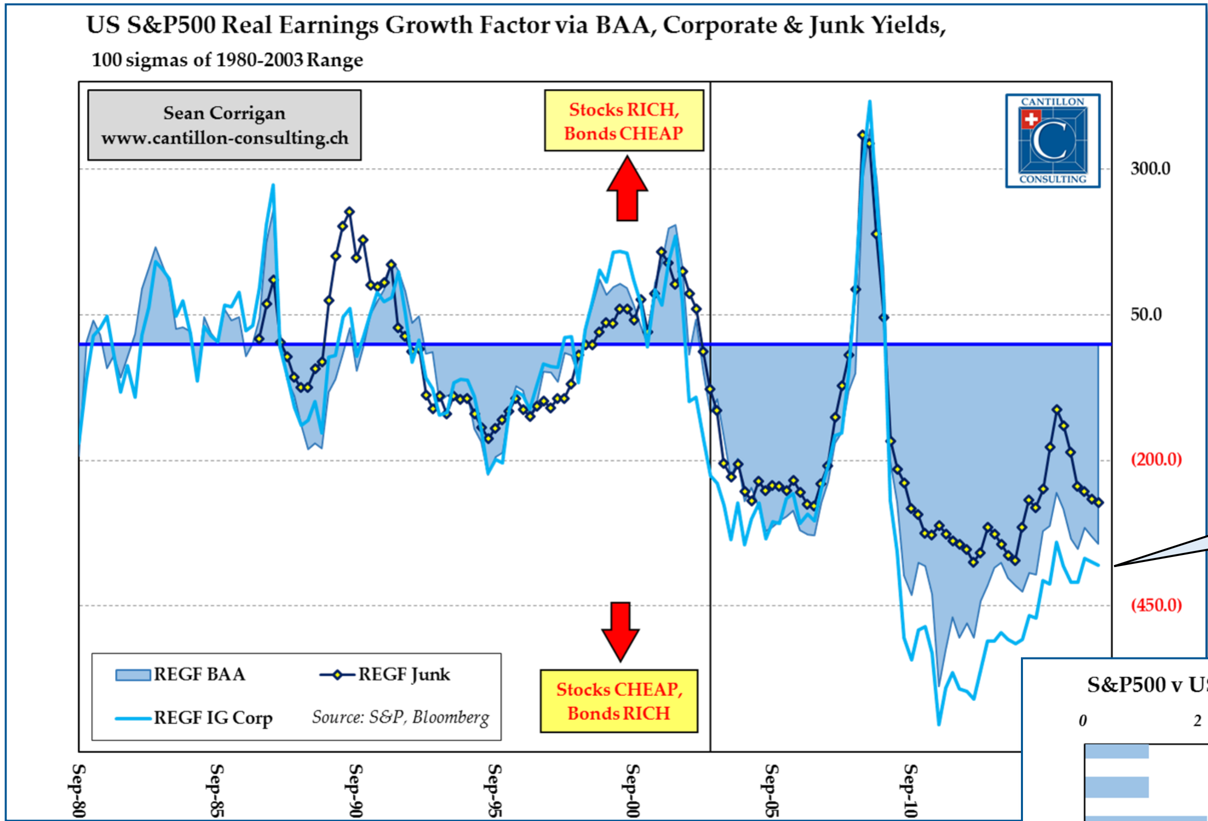
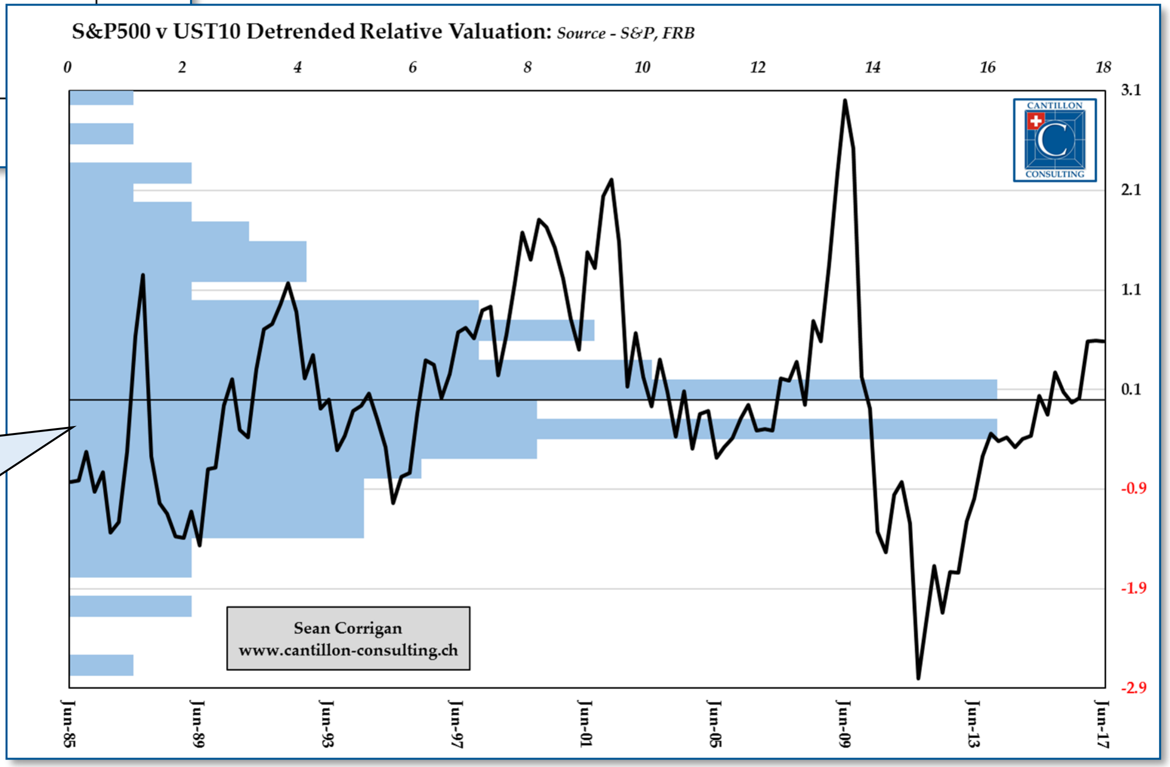


For some years now, it has been easy to argue that stocks were only expensive because bonds were even *more* pricey—thanks to the likes of M. Praet, of course! But, at least in terms of the post-Tech Bubble norms, that is no longer quite so evident, as this chart (which essentially compares earnings yields with a range of corporate bond yields) illustrates.



On a similar basis—this time abstracting the evident downward slope of the relation these past 30 years—equities are undeniably to the rich side of US Treasury yields for the first time this decade. Though by no means extreme, they only tend to get richer in either a full-blown stock bubble (1987, 2000—arguably 2007) or, conversely, when multiples expand during a recessionary earnings collapse (1991, 2002, 2009).

Conclusion: the margin within which to absorb the effect of higher yields is slowly beginning to narrow.

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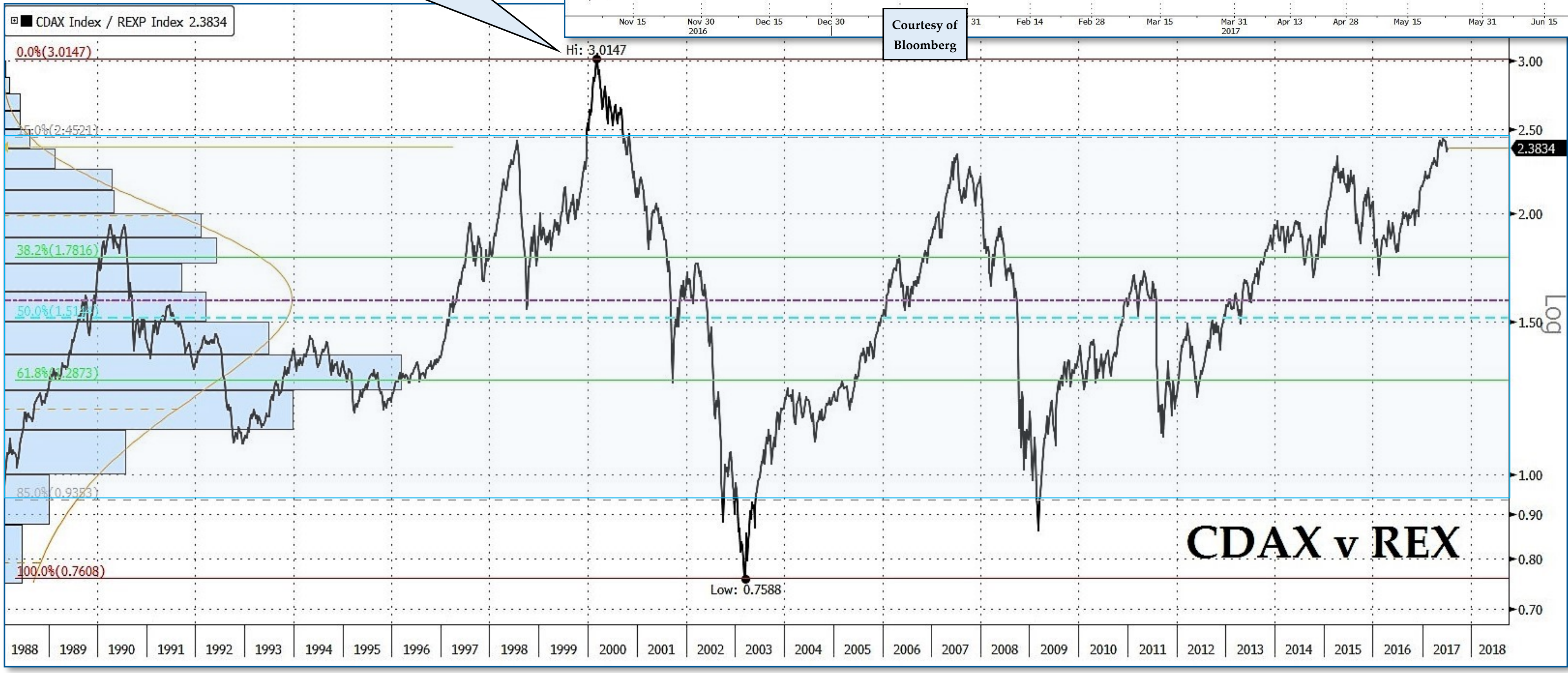
Unsurprisingly, therefore, cracks are beginning to appear in equities themselves, not helped by a stronger euro.

The Reunified German stock market is another bumping up against the constraints of a bearish fixed income market. The broad CDAX has only ever done better v bonds at the very pinnacle of the Neuer Markt madness in 2000



For all the sound & fury, crude is effectively washing back and for in a +/-10% TWI-based range right in the middle of the post Shale-bust pattern. Buy cheap, sell dear against it.

Courtesy of Bloomberg

As suspected, that nasty little H&S on the Gold-TWI (world value proxy) chart broke down. Can the pattern of higher lows hold or will we lose all the Trump Bump?

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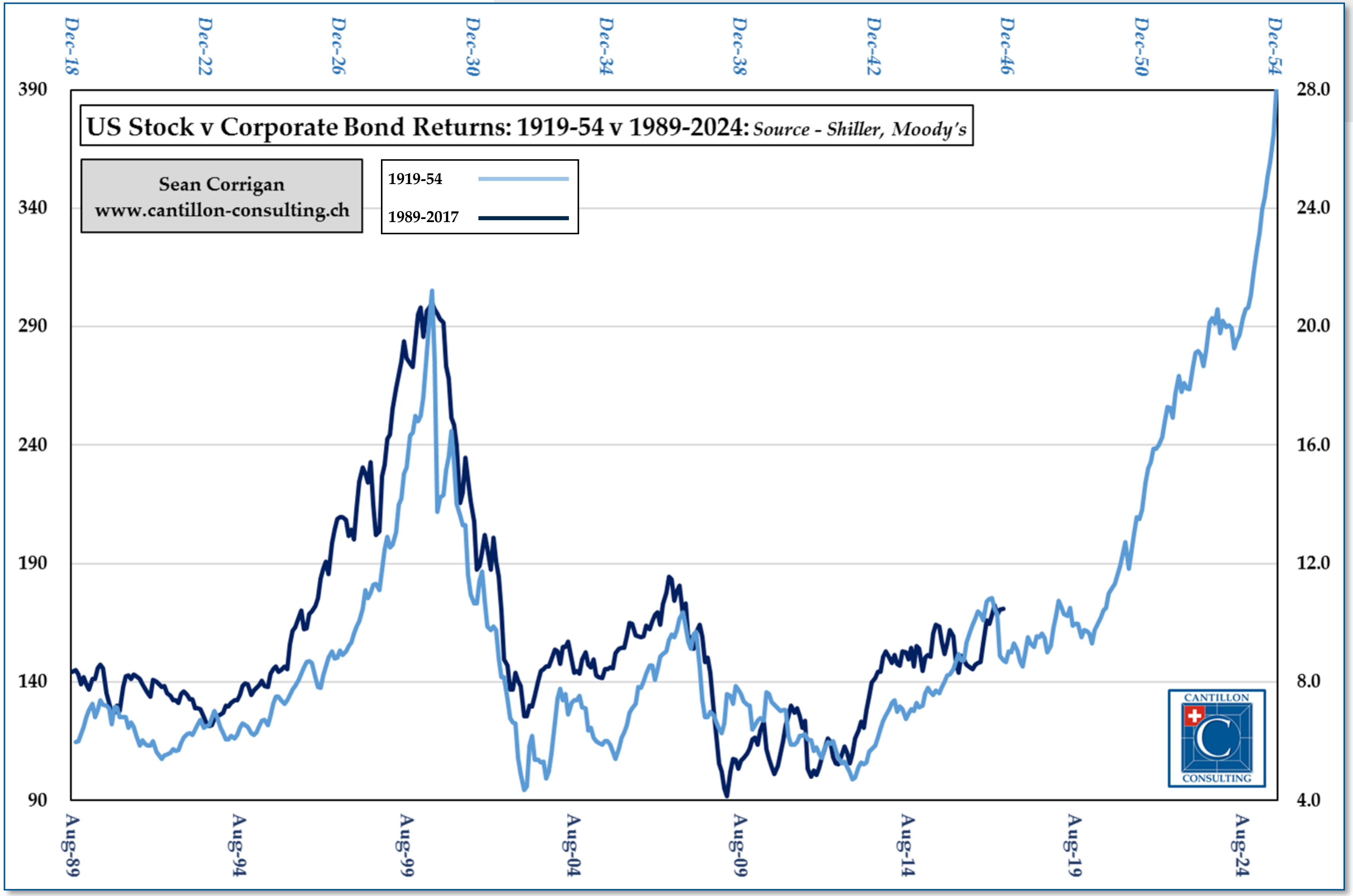
BONUS CHART OF THE WEEK

Above, we discussed the relationship between of US equities and fixed income. But here is an intriguing little chart. If we superimpose the pattern from WWI to the end of WWII on the post-Berlin Wall data, we get a near perfect overlap with the Crash of '29 corresponding to the Tech bust and the '37 slump to the GFC. Were the somewhat spooky parallels to continue, 2020 would usher in a two-decade, 13% CAR stock outperformance as enjoyed in the 50s and 60s.

Now THAT would be something to behold!



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