Money, Macro & Markets Monitor

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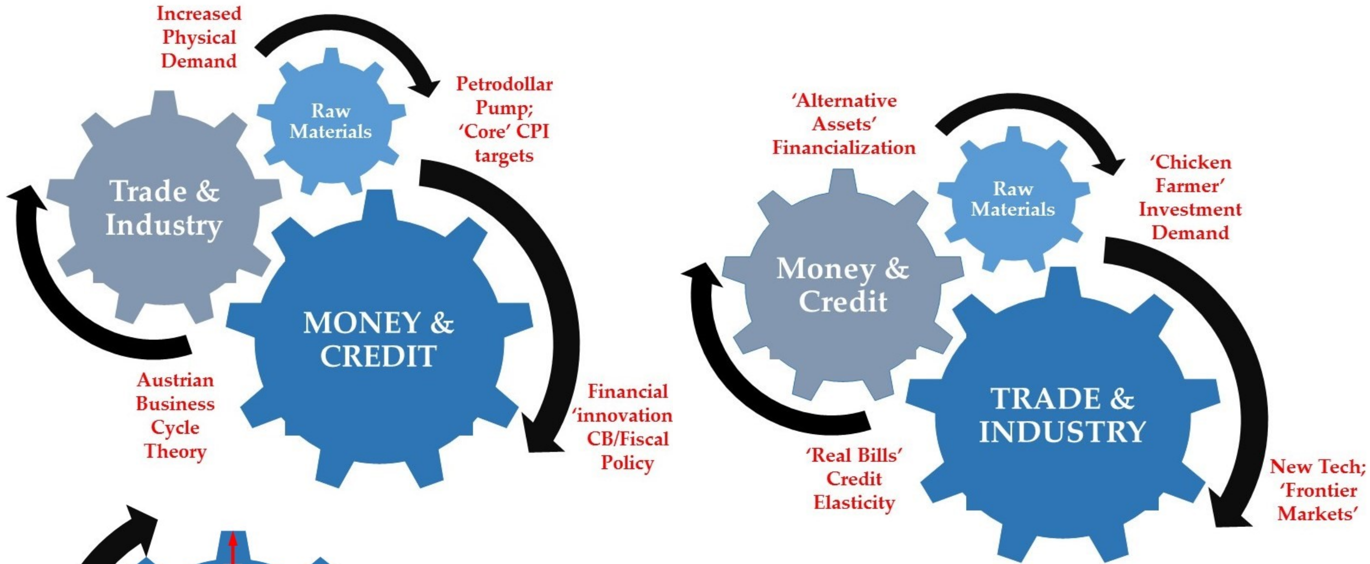
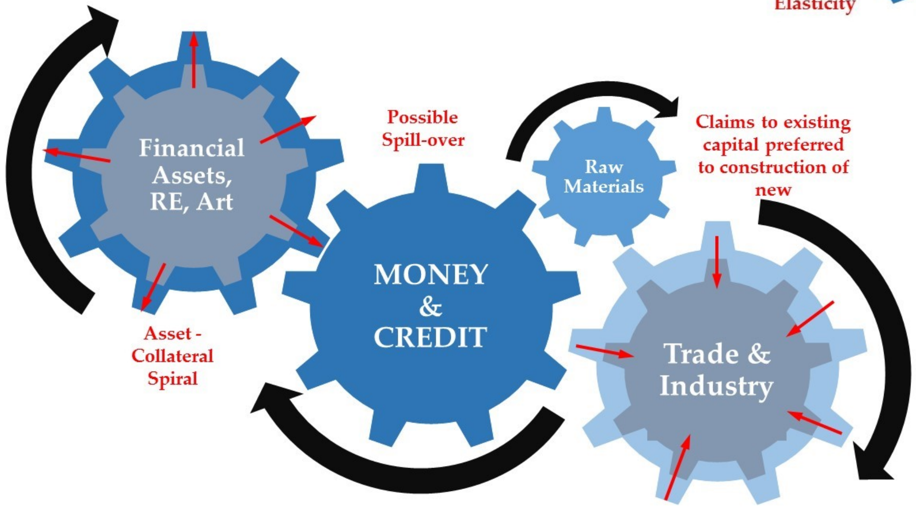




Money makes the World go round, makes the Money go round, makes the World go round...

Volume II, Issue III

A tide in the affairs of men

Sixteen months on from the political earthquake which unleashed the extraordinary Trump Bump of smartly rising asset prices and strengthening macro-economic numbers, we have lately begun to ask ourselves whether we are about to witness the appearance instead of its mirror-image – of a period of at least partial reversal which we might come to christen the Trump *Dump*.

Since overturning the psephologists' calculations, along with much of what passed for conventional wisdom, Mr Abrasive – for all his seeming caprice and in spite of his inexhaustible penchant for playground point-scoring – does seem to have invigorated many of the Forgotten Men and Women outside of America's pampered littoral elites. Though far from unblemished in its record of attainment, his regime has also delivered some welcome respite from the regulatory kudzu which was undeniably strangling the country's native crop of own-two-feet self-reliance. On top of that, we have seen what is, thus far, the crowning glory of his term in office – the tax package – entered into the statue books, all to the utter chagrin of Mr. T's many detractors.

He has even largely managed to avoid too debilitating an addiction to the sort of head-first, drones-away foreign policy adventurism which has been the bane of so many of his predecessors in the Oval Office – if only by means of what seems to have been a wilful, almost programmatic disruption of the career ambitions of the various sinister apparatchiks and would-be Strangeloves who inhabit the dingy recesses of the Departments of State and Defense, as well as of the Edge-of-the-Map monstrosities who swim amid the toxic alphabet soup of the national security hierarchy.

We, at the height, are ready to decline

Of late, however, the question keeps thrusting itself unbidden into our mind about whether our presidential fireball has already reached its zenith, its flaming course through the political heavens about to turn decisively lower at last.

The first source of concern is that, after the undoubted boon of lighter regulation and lowered taxes (a blessing only sullied by the accompanying loss of what little sense of fiscal restraint there might have existed in Washington), we now seem to be locked into the destructive issue of tariffs, quotas, and crass bilateralism on the trade front – in other words, to be embarking on a course which will add to both the difficulty and the cost of doing business in place of reducing them both.

The one, faint flicker of hope here is that Trump is after what he often seems to do best: namely, to bully those he paints as his antagonists into doing something half-way sensible, despite themselves. For example, the seemingly pointless irritation of steel and aluminium duties has already served to highlight the various restrictive practices – as well as the obvious cant - of both the Europeans and the Chinese, when it comes to matters of trade. If the Donald is merely manoeuvring therefore to achieve some sort of mutual *decrease* in impediments to commerce, rather than ostensibly seeking to *raise* them, our forebodings might yet be unrealised.

It is, however, far too flimsy a chain of supposition to be relied upon at this stage of the game, meaning that we must first treat the loud Protectionist quacking as the call of a full-fledged Protectionist duck.

Our legions are brim-full, our cause is ripe

Beyond that, the dark spectre of 'geopolitics' (aka: armchair generalship) seems to be stirring in its grave, with Trump's latest, abrupt appointments to the relevant positions being men of a reflexively, if not an irrationally, hawkish mien when it comes to both Russia and Iran. Further hostile intent toward the first could risk a confrontation too terrible almost to contemplate, while an abrogation of the accord reached with the second would not only further inflame that cockpit of horrors which is the Middle East, but potentially destabilize energy markets and hence undermine the wider economic framework, into the bargain.

Finally, there can surely only be downside risk in the shape of the coming US mid-term elections. One must suppose that even a Ballot-box Barnum like Trump cannot surprise us twice in the same manner and so will lose some good measure of command over the levers of government this autumn. This should be a matter of broad indifference to those of us who live outside the US of A, as well as a matter of some comfort to the valiant Constitutionalists who do; those virtuous souls who believe that the separation of powers is to be cherished even if it is *their* side's imperial presidency which is this time frustrated in its ambitions.

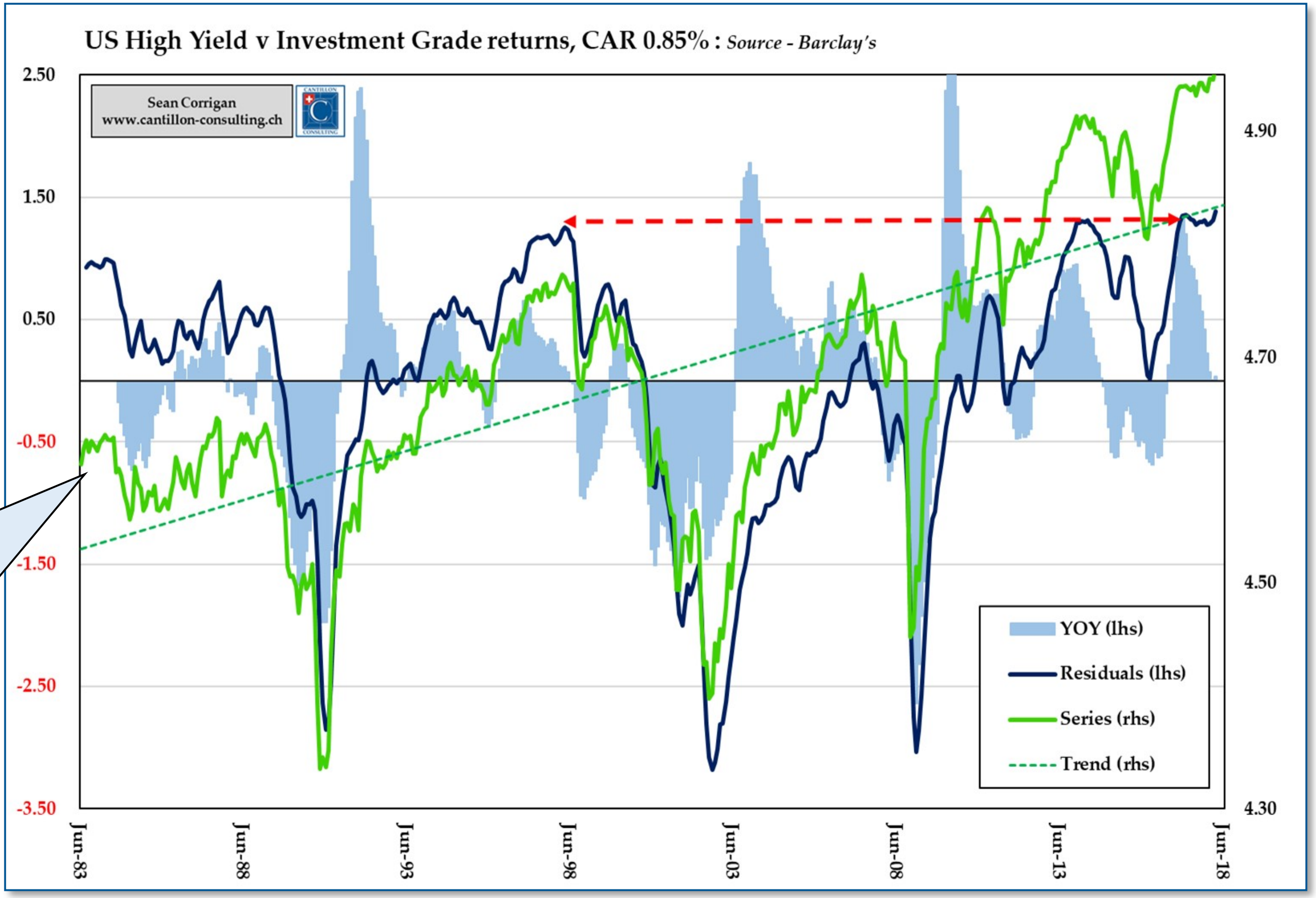
However, so factious and so over-heated is the temper inside the Beltway that one shudders to think what might be unleashed were the Republicans to fare badly in the Congressional vote. Not only would we then have the grim prospect of impeachment proceedings being launched from without, but also the likelihood of revolt and treachery from within, as those establishment types who view their outsider Chief with barely less horror than do the Democrats for the threat he poses to their shadow-boxing lives of mutual self-enrichment and cosy, bipartisan boondoggling.

Few from either side of the aisle can, after all, be happy that Trump's apotheosis has threatened to turn their carefully stage-managed, Washington WWE pantomime into the no-holds-barred smackdown of a UFC cage fight. The temptation to play Brutus – especially for those with an eye to a possible candidacy in future elections – might therefore prove all too irresistible, should Trump stumble at the hustings this fall.

Whatever your feelings about the tenor of the present Administration, it is hard to see how such a descent into internecine strife could be conducive to a continuation of the past several quarters' mostly serene inflation of asset valuations. Add in the threat of nuclear-tipped eyeballing across the battle lines in Syria and Eastern Europe; the affront which the newly elevated Xi might take at recent US overtures to Taiwan; the fear of tit-for-tat trade restrictions and the odd 25 basis points here and there from the Fed suddenly looks like the least of the worries to be felt by such a highly-valued, long-in-the-tooth bull market.

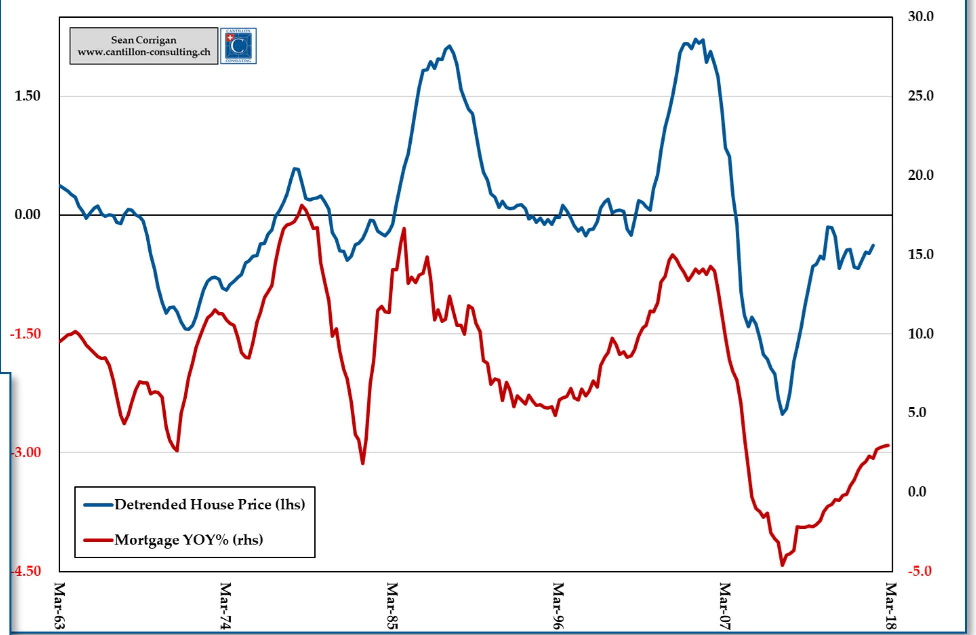
Relative to investment grade, junk bonds have hit their highest ever levels, both as a simple ratio and relative to their long-term trend. The climb, however, has stalled for the first time since the 'Hidden Recession' ended in 2016 while the consequent deceleration is the worst experienced since the post-LEH reflation failed in the spring of 2011.

The auguries are not overly promising, therefore.

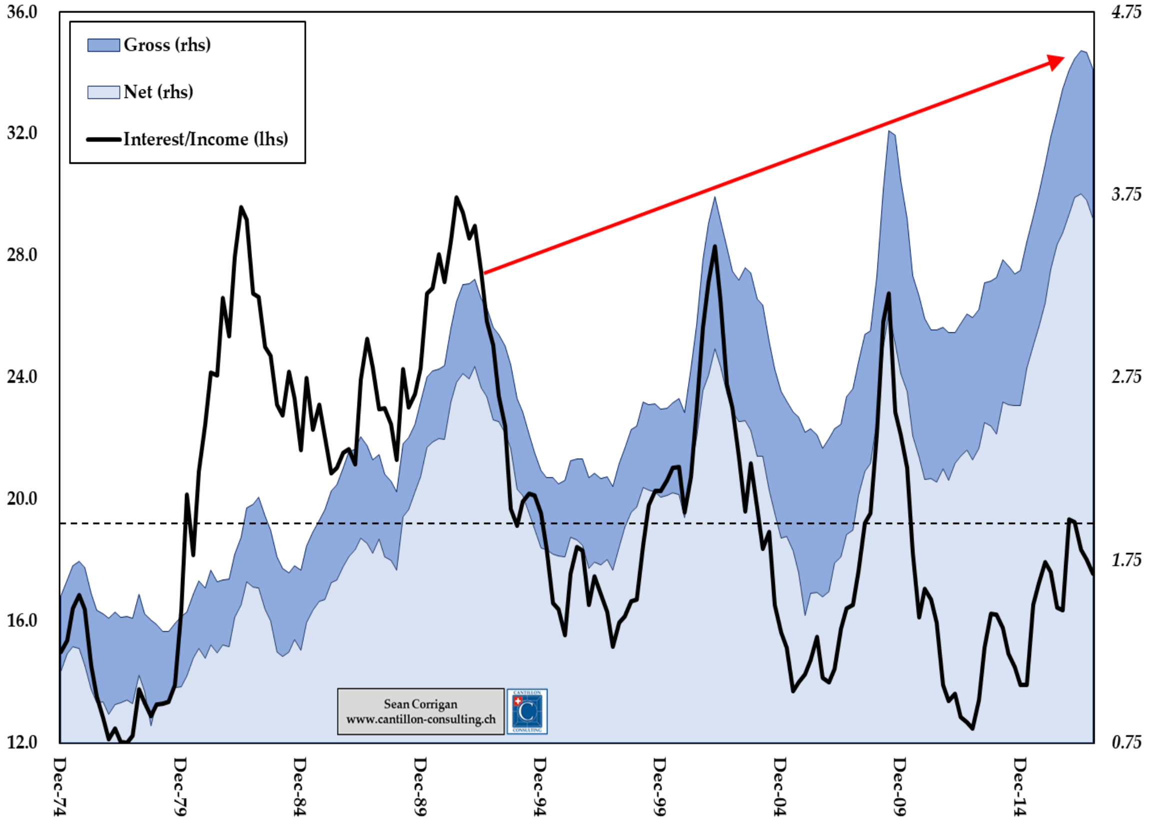


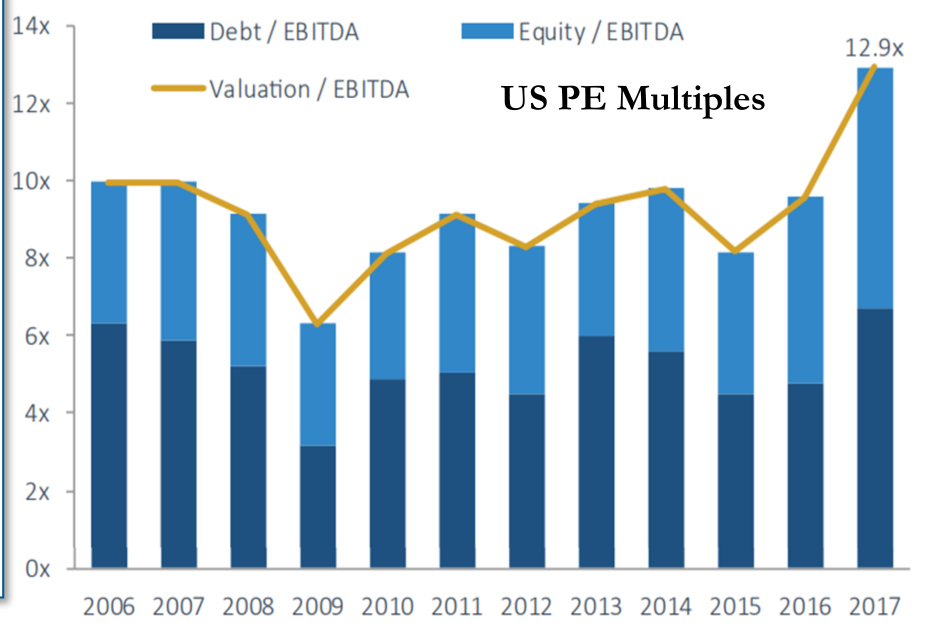
If we *are* about to enter a world where the porridge is at last either too hot or too cold, be aware that the prolonged period of abnormally—that is to say, *artificially*—low interest rates have worked their usual malign magic; turning companies, householders, and investors into renters, not owners.
Corporate leverage is high (and ROIC accordingly lowered) because debt is cheap. Mortgage markets are overcooked in many lands and are now warming in the States, too. The corporate finance Barbarians have never found it so easy to break down the Gates

US Wage-Deflated House Prices v Mortgage Debt YOY%, (t-4): *Source - FRED*



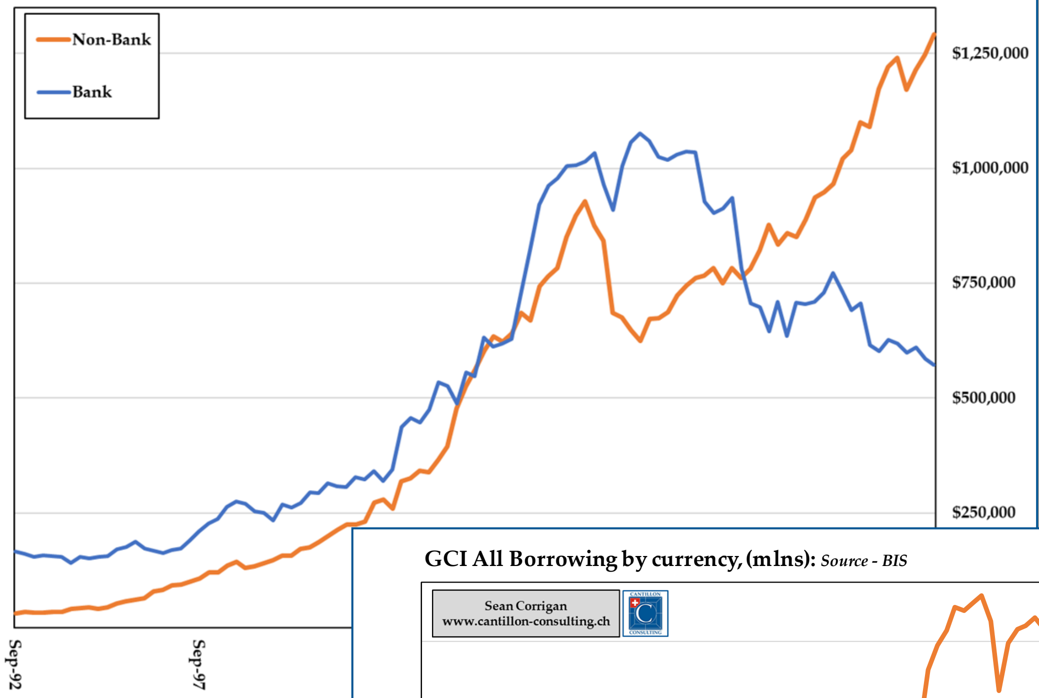
US Manufacturing Corps, Gross & Net Debt, L-T Funding Cost v EBITDA: *Source - Census*



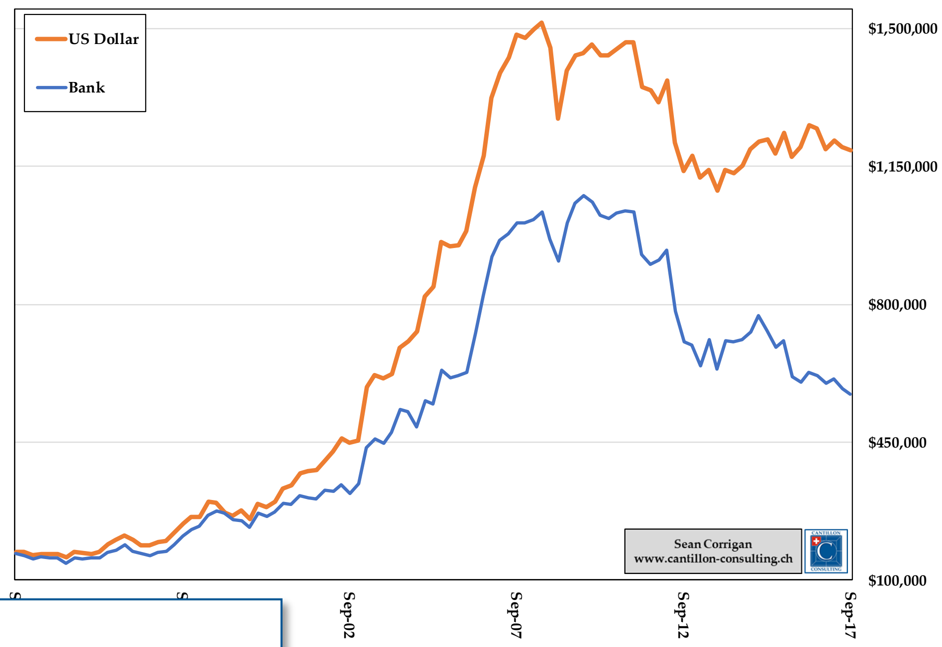


Source: PitchBook. *As of 12/31/2017

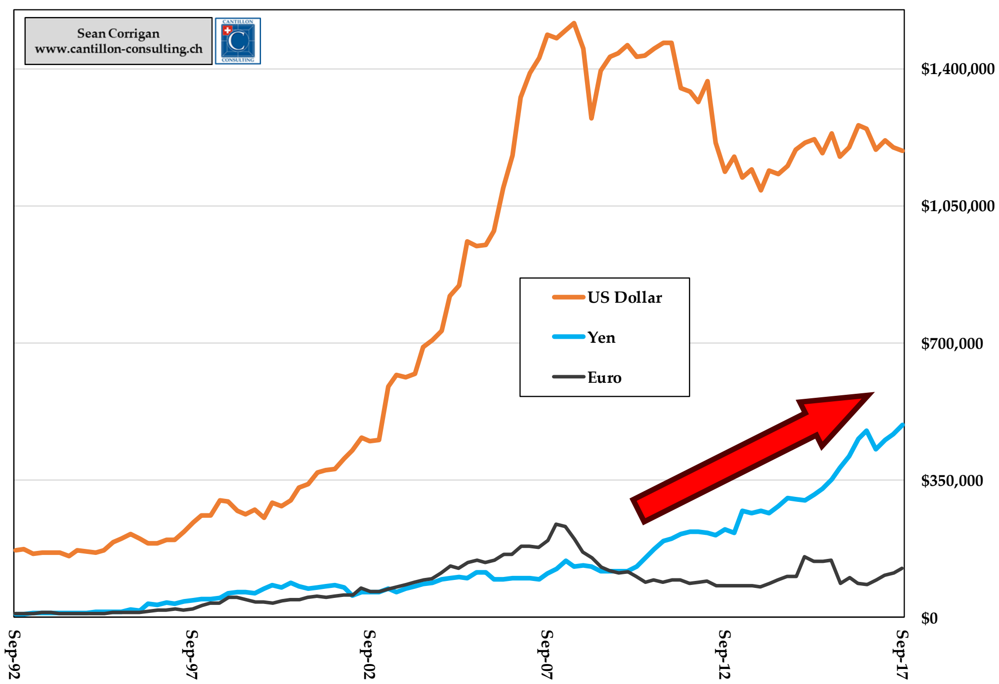
GCI Bank & Non-Bank Borrowing, (mlns): *Source - BIS*



GCI Bank Borrowing, (mlns): *Source - BIS*



GCI All Borrowing by currency, (mlns): *Source - BIS*



In the past four years—since Abenomics started shooting its principal arrow—BIS bank cross-border claims on non-banks in the Caymans (read: hedge funds and their ilk) have risen by $430 billion or 50%, accounting for 70% of all ex-HK borrowing by offshore centres.

Over that stretch, total GCI liabilities in USD have risen 10% ($106bln) while JPY ones have soared by over 80% for twice the increment ($217) billion. Given (a) that GCI bank borrowing has actually fallen by $62 billion over this period and (b) the suspiciously similar paths traced out by that sector and the USD component of loans, one can begin to see how big Kuroda's contribution to global leverage may have been.

ERGO, RISK OFF = DOUBLE WHAMMY

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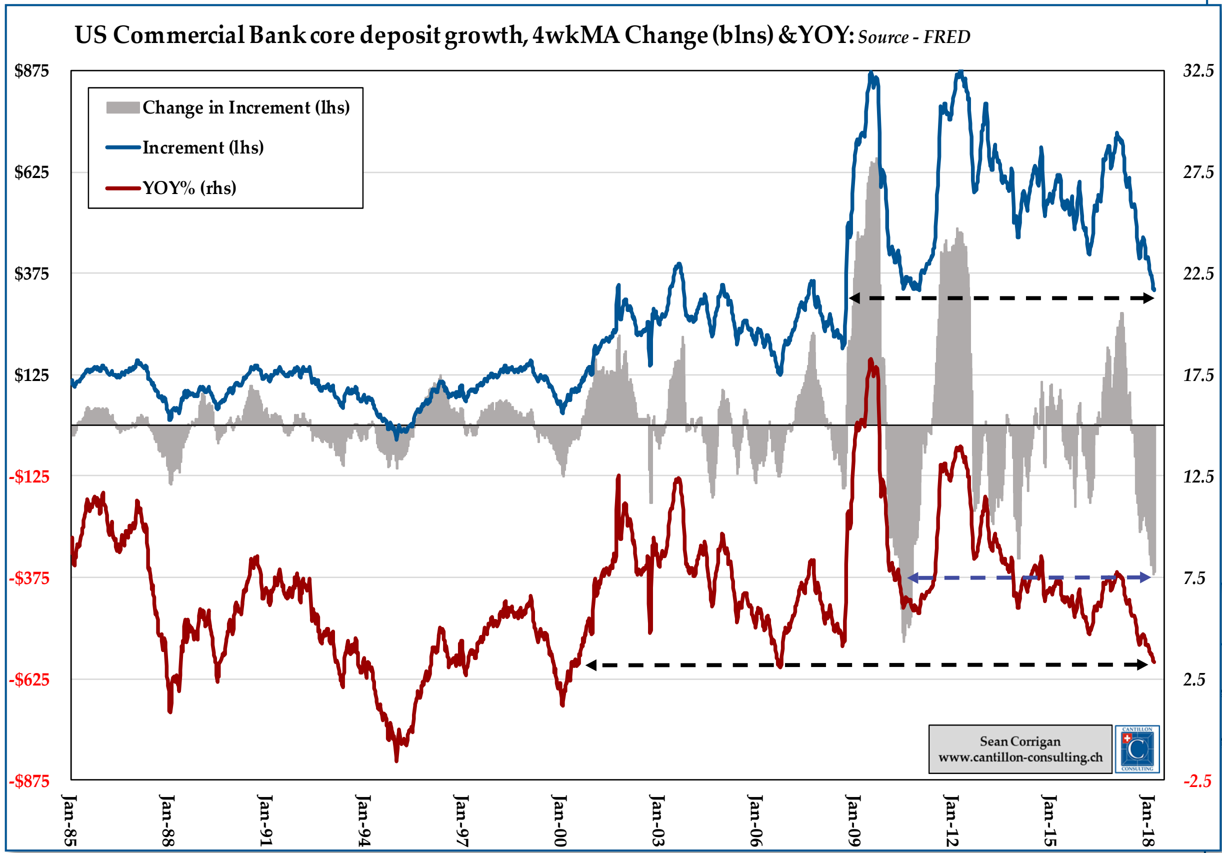
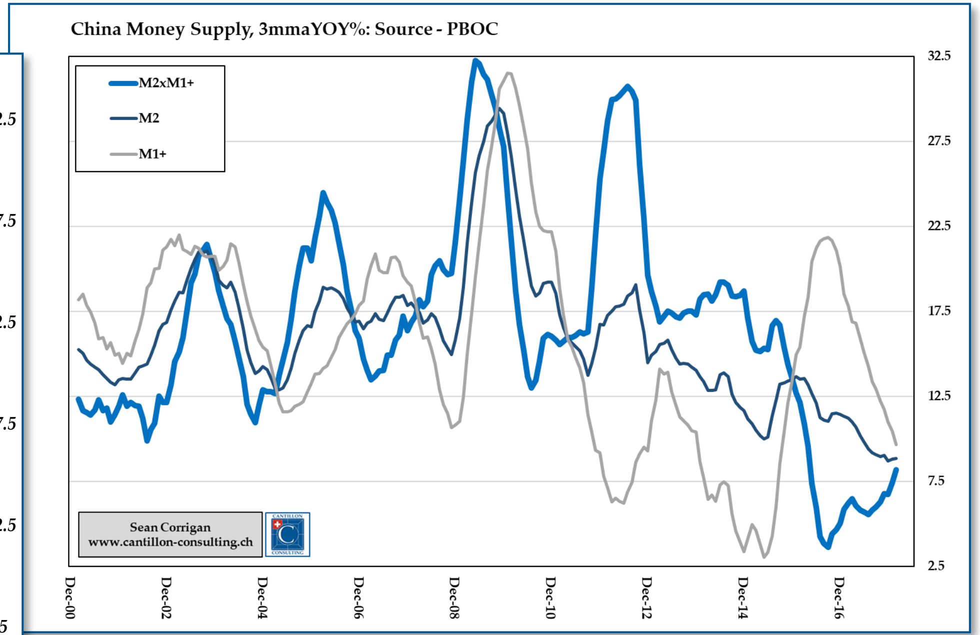
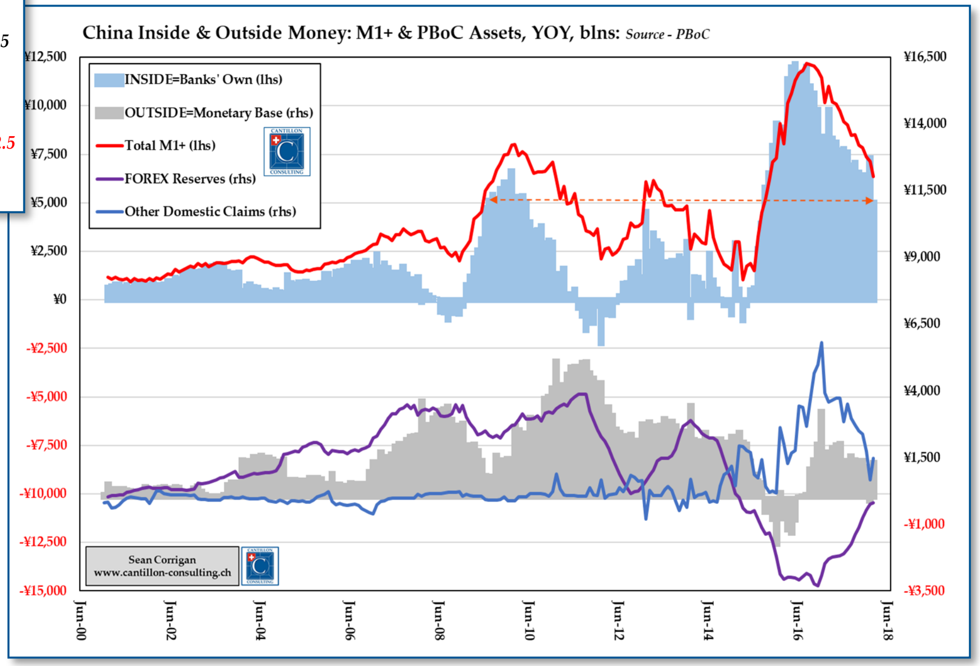
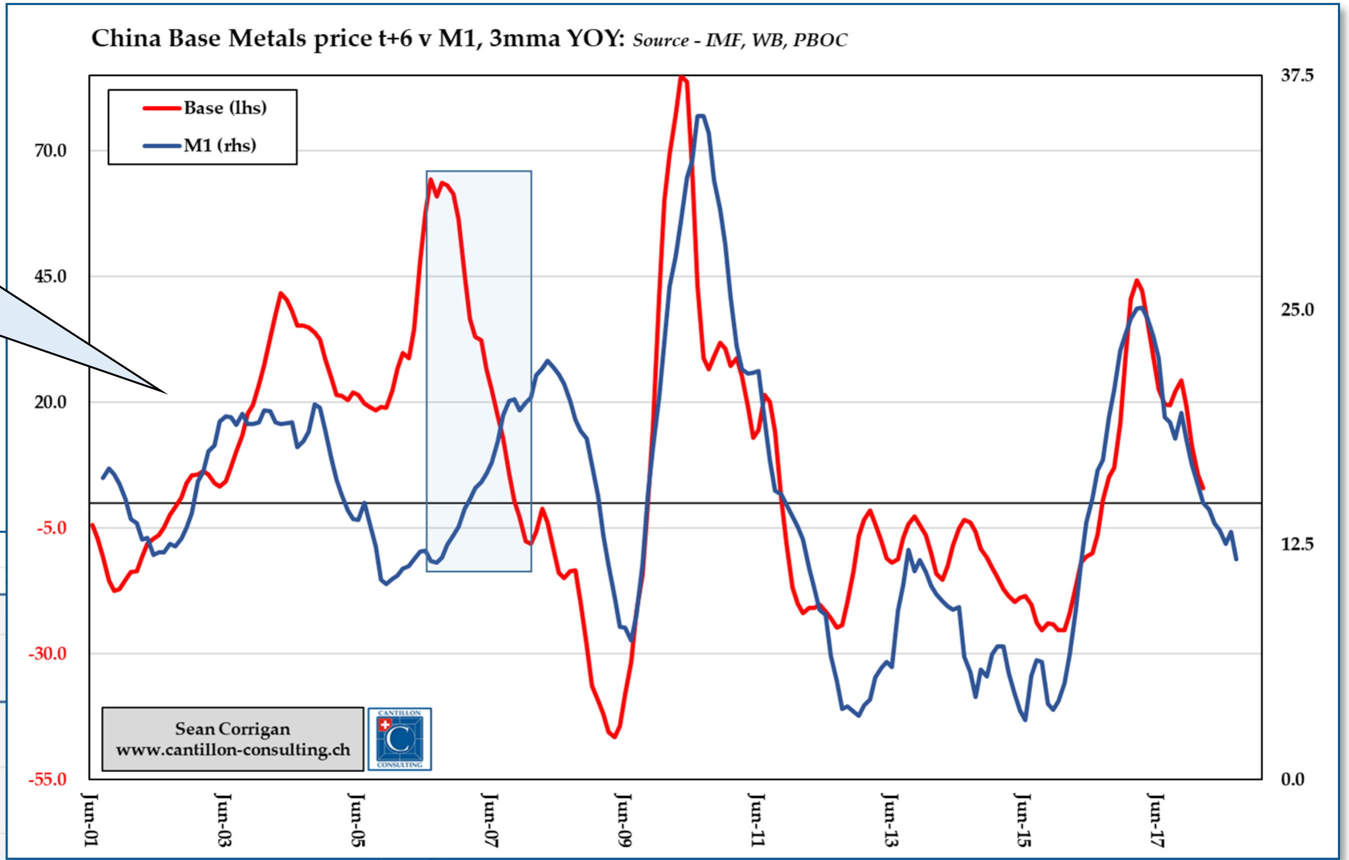






We first began pointing out that the retro-rockets were firing in Chinese credit markets in the middle of last year. Deposit growth was fading, taking money supply with it and pushing LTD ratios through the roof. As the two graphs to the right will illustrate, nothing material has changed there, with single digit increases seemingly baked in for now. Indeed, the new PBOC governor, Yi Gang has already hinted that M2 will be de-emphasised as a monetary target in favour of something called, 'elastic moderation'. What is more intriguing is that a similar dynamic seems to be at work in the US, too. Core deposit growth (above) has halved in the space of just a few months, limiting increases to a scale first seen in the aftermath of 9/11. Those fretting on the widening Libor-OIS spread need look no further for a cause.

As shown before, Chinese slowdowns are unequivocally influential on metals prices, as well as in regard to those of energy, real estate, and even agricultural commodities.



Having rallied nearly 60% to a 4-year high and a 50% retracement of the 2011-16 slump, Dr Copper is starting to look a little peaky himself. Hereabouts—at \$6775/t or 305¢/lb—there is evident risk to the downside.

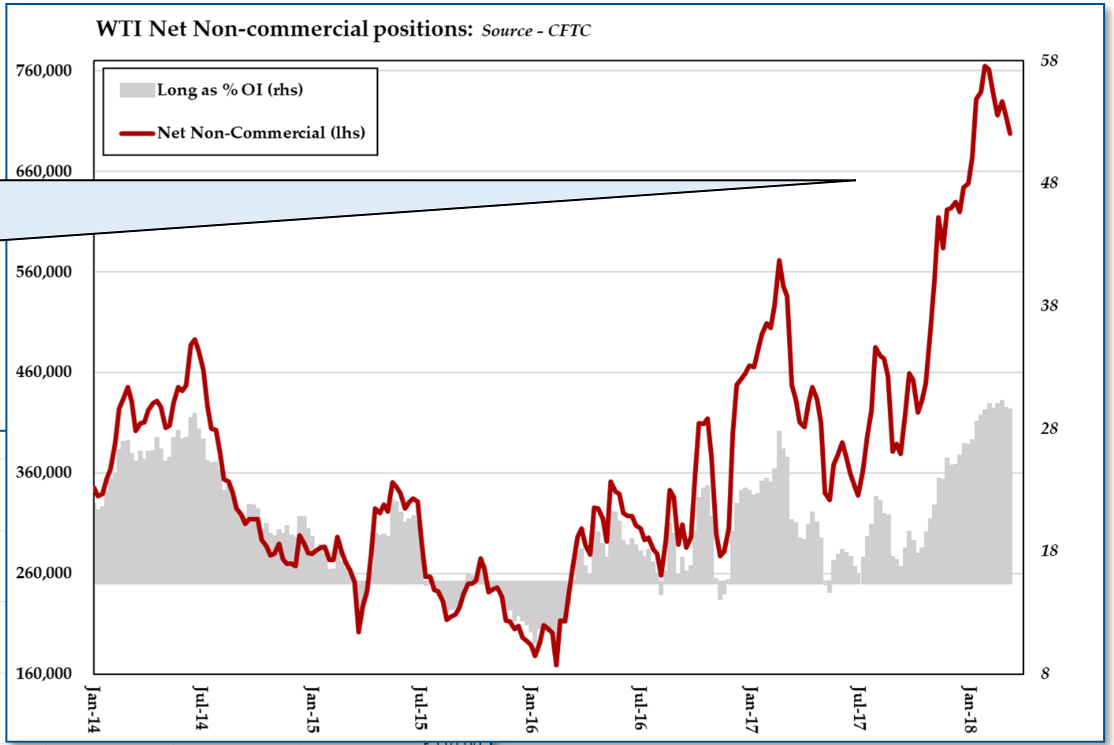
Gold really should be doing better here, given dollar weakness and a remission in the rise in bond yields. Yet, $1370 has recently proved insurmountable, leaving the dreadful gravity of $1300 to come into play instead.

ON a TWI basis, the succession of lower highs since July-16's local maximum has left gold jammed in against THE key rising trendline, the one which stretches way back to the first bull market breakout in late 2005. Gold bugs will not wish to see THAT give way.

Bitcoin, meanwhile (here plotted on a log scale), seems destined to retest the spike lows from early Feb around the $6000 mark and even—to your author's jaundiced, 'No-Coiner' eye—to conduct a full, Retreat-from-Moscow return to the geometric mid at $4175

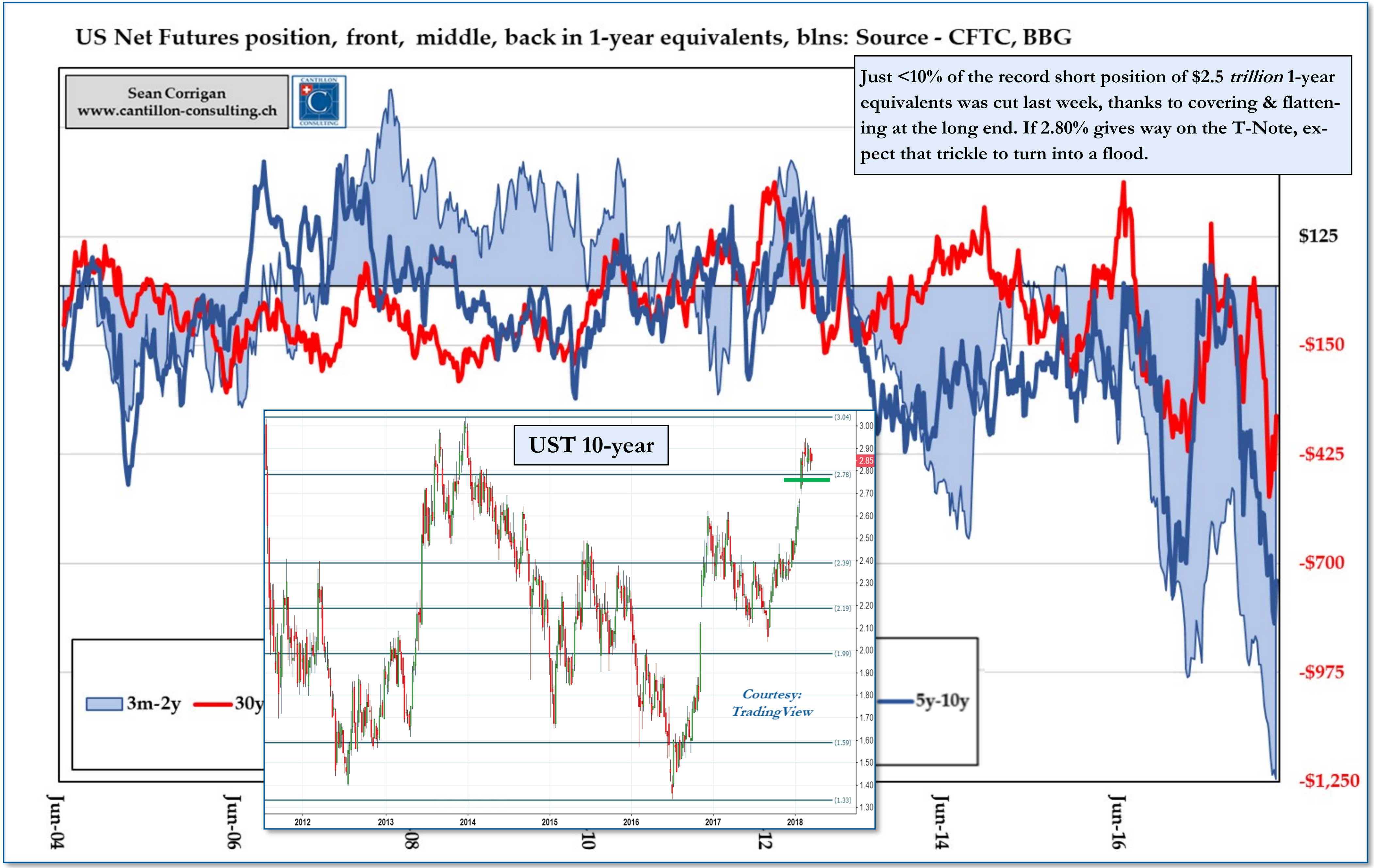
'For dust thou art, and unto dust shalt thou return '

WTI has also effected a 50% recovery from the shale oil debacle of 2014-16 with returns further helped by the welcome degree of backwardation which has prevailed, largely thanks to the avidity with which the once-bitten-twice-shy US fraccers are now hedging their production.
More ominously, there are signs that some members of that extraordinary concentration of spec longs are beginning to bail out of their positions.

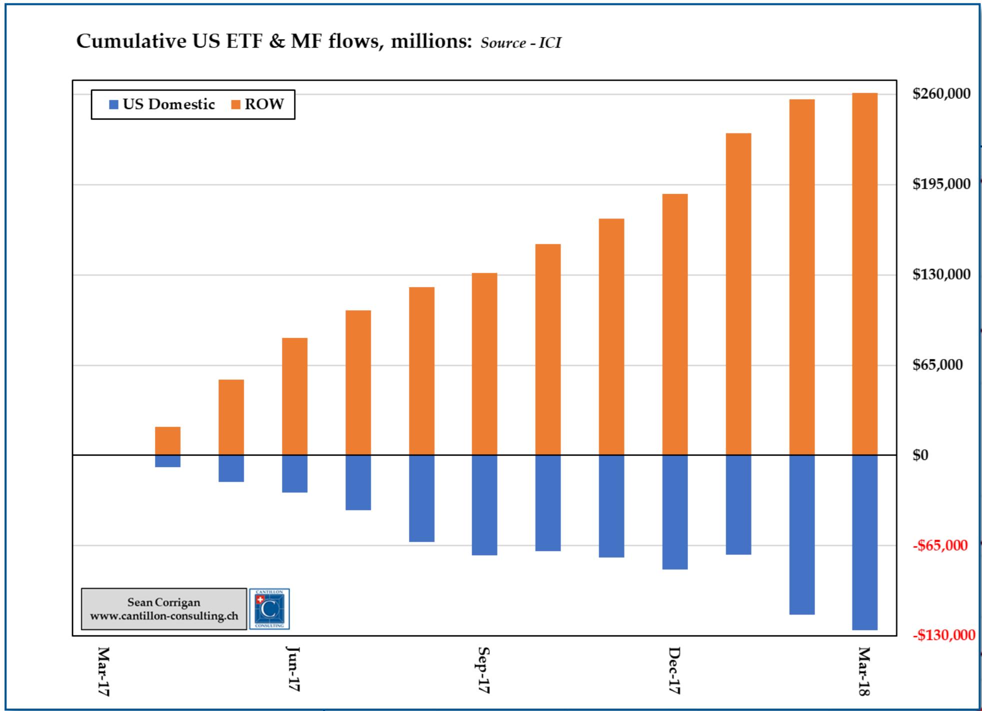


The past 8 weeks or so has seen the laying down of a neat pennon formation, centred on $61.50.
Trade the breakout from this, as and when it happens

US Net Futures position, front, middle, back in 1-year equivalents, blns: Source - CFTC, BBG



Conversely, the pain trade for equities is a sell off—one not made any less probable by the distinct lack of appetite for domestic stocks, as evidence by combined ETF & mutual fund flows. Let's see if that island reversal & rejected high in NDX attracts any follow-on selling.



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