Money, Macro & Markets Monitor

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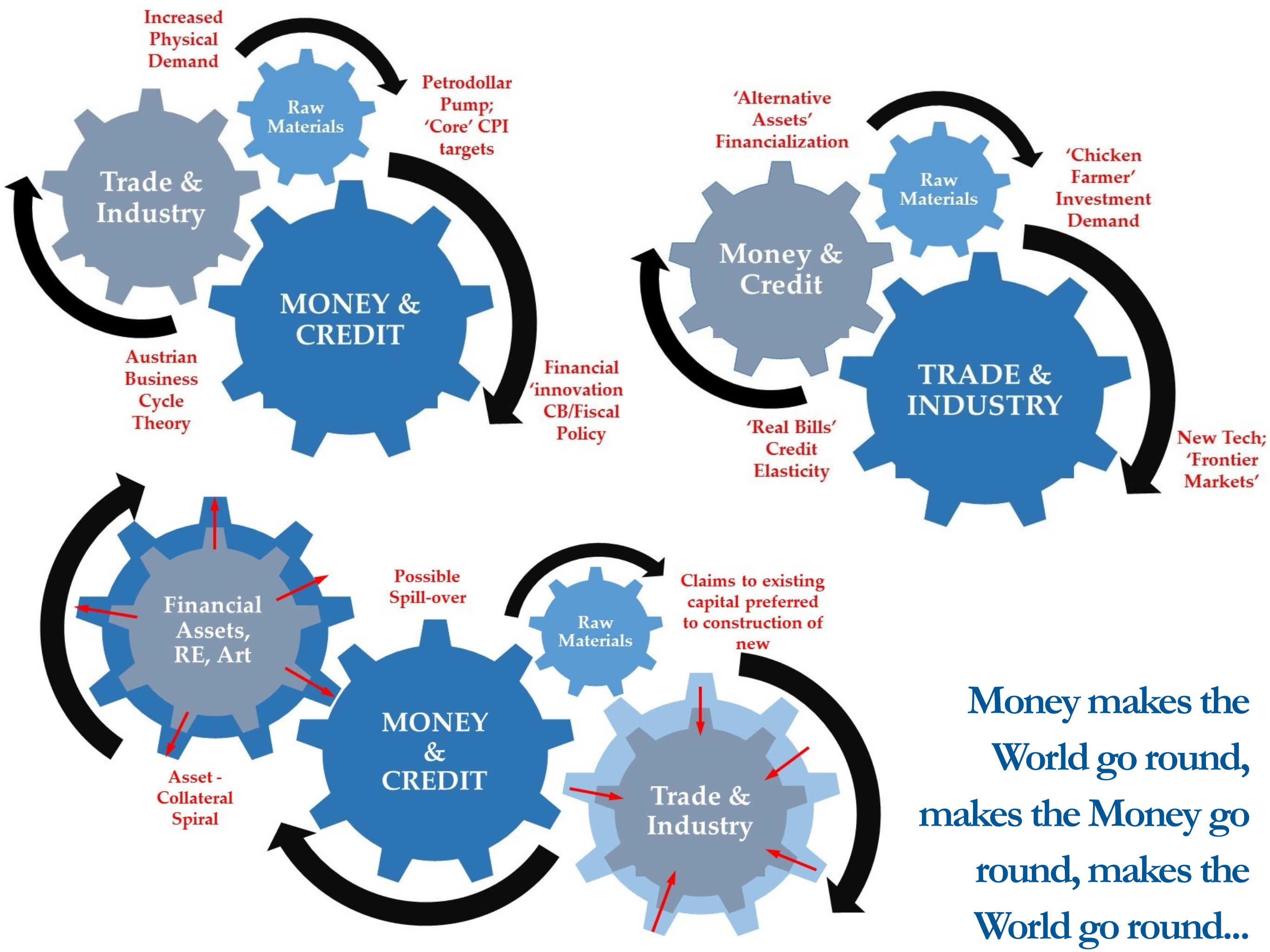
July 2018



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

IN THIS ISSUE:-

Trade Wars: Those damn'd torpedoes are ours!

China: Airing one's dirty washing in public

Tip-toeing with tight stops: SHCOMP oversold?

Yesterday & today suggest more Fed hikes to-morrow

Are stocks again about to break out?

JPY: 'Carry me Home' or carry me out?

EMs: What's the incentive?

Gold still weak, copper to consolidate, oil may yet rally.

Volume II, Issue VI

Blue on Blue

For many an age, a principal element of Britain's strategy in its frequent wars with its Continental rivals was that of the naval blockade.

Throughout the long years of increasing mastery of the High Seas, the nation's fleet admirals, frigate captains and often forcibly-impressed jack tars were frequently to be found, hovering just beyond the enemy's horizon in order to deny their French, Dutch, or Spanish adversaries any freedom of navigation, whether for commercial or military purposes. Thus they aimed to limit their foes' operational reach and slowly to bleed their economies dry.

Indeed, the one great defeat suffered by the British in a quarter of a millennium of oceanic predominance was partly the result of the fleet's rare inability to secure its grip on the coastline of the Crown's rebellious subjects in the American colonies – a failure partly due to sheer logistical difficulties and partly to the confusion of purpose which the simultaneous defence of the then more highly-prized Caribbean sugar islands entailed.

Nor was the lesson left unheeded by the newly-independent Americans whose Union forces employed the same approach to great effect during the bloody strife loosed by Southern attempts at secession, two generations after. Likewise, later still, Britain's controversial 'Hunger Blockade' of Imperial Germany fostered - through its awful effects on a starving and disease-prone civilian populace - much of the latent ill-feeling which would erupt so horribly into a second, even less humane conflict, twenty-one years after the cessation of the first.

Indeed, such was the potency of this practice, that the very declaration of intent to apply it was to be taken as an overt act of war, a status which it retains to this day, even as the denial of international access has moved far beyond the merely physical and into the realms of the financial (and possibly the informational), as with present-day America's aggression towards the likes of Russia and Iran.

Given all this, how is it then that that same America which is so quick to deny its designated 'pariah states' the fruits of open exchange is also so ready to blockade its *own* harbours and to sink (metaphorically, at least) not ships heading *for*, but coming *from*, a foreign port? For this is exactly what is implied by the current effort to exclude – or at least to seriously disadvantage – the import of those goods whose purchase its 328 million consumers and 34 million businesses had otherwise freely decided were advantageous to them to make, often on a daily basis.

Here, the parallel is perhaps best drawn with the truculent little Corsican whose spectacular series of battlefield triumphs, three centuries ago, had made him temporary master of all Europe. Frustrated that he could not come directly to grips with his inveterate British enemy, he thought to harm the interests of what he dismissed as 'a nation of shopkeepers' by interdicting their trade from the landward side, by means of the universal embargo he named his 'Continental System'.

It is only a slight exaggeration to say that this monumental act of folly was a major contributor to his eventual overthrow, for the commercial classes who most keenly felt its thrust were both his own and those of the subject nations who were already rankling beneath the local misrule of Bonaparte's sprawling, corrupt, and largely undistinguished kin and cronies.

Whole industries failed; time-honoured trading houses were ruined; ancient entrepots fell into windswept decay. Smuggling was rife and so suppression became ever more severe. Corruption was endemic and so respect for authority quickly evaporated. Already unpopular, economic contractions made requisitions and tax burdens even more insupportable while many an entrepreneur, banker and industrialist simply upped sticks and moved to the flourishing City of London. It has been calculated that French trade fell from its peak in 1806 – one attained just before the notorious Berlin Decrees promulgated the 'System' - to such a nadir that it was 1825 before it again reached the levels first seen in the last years of the Ancien Régime, way back in the late 1780s.

Worse yet, domestic discontent led the Russian Tsar to shake off his former personal infatuation with Napoleon and so take the first steps down the road to Borodino and beyond, a *Via Dolorosa* which would see the Corsican's grandest of *Grande Armées* left shattered amid the icy blasts of the pitiless steppe winter – and all of Bonaparte's vaulting ambitions along with it.

Setting aside the sweeping historical parallels, there seems little to be said in favour of the Trump Administration's policies in this regard, in marked contrast to the positive, if tentative, steps it has taken toward deregulation and to the major lightening of the burden of taxation recently enacted.

Given that there can be no credible economist anywhere in the world who is in favour of the tariffs, there can only be two real motivations for what one might best greet – in a further nod to Imperial France - with the dismissal, '*C'est pire qu'un crime: c'est une faute*' ('It is worse than a crime: it is a blunder.')

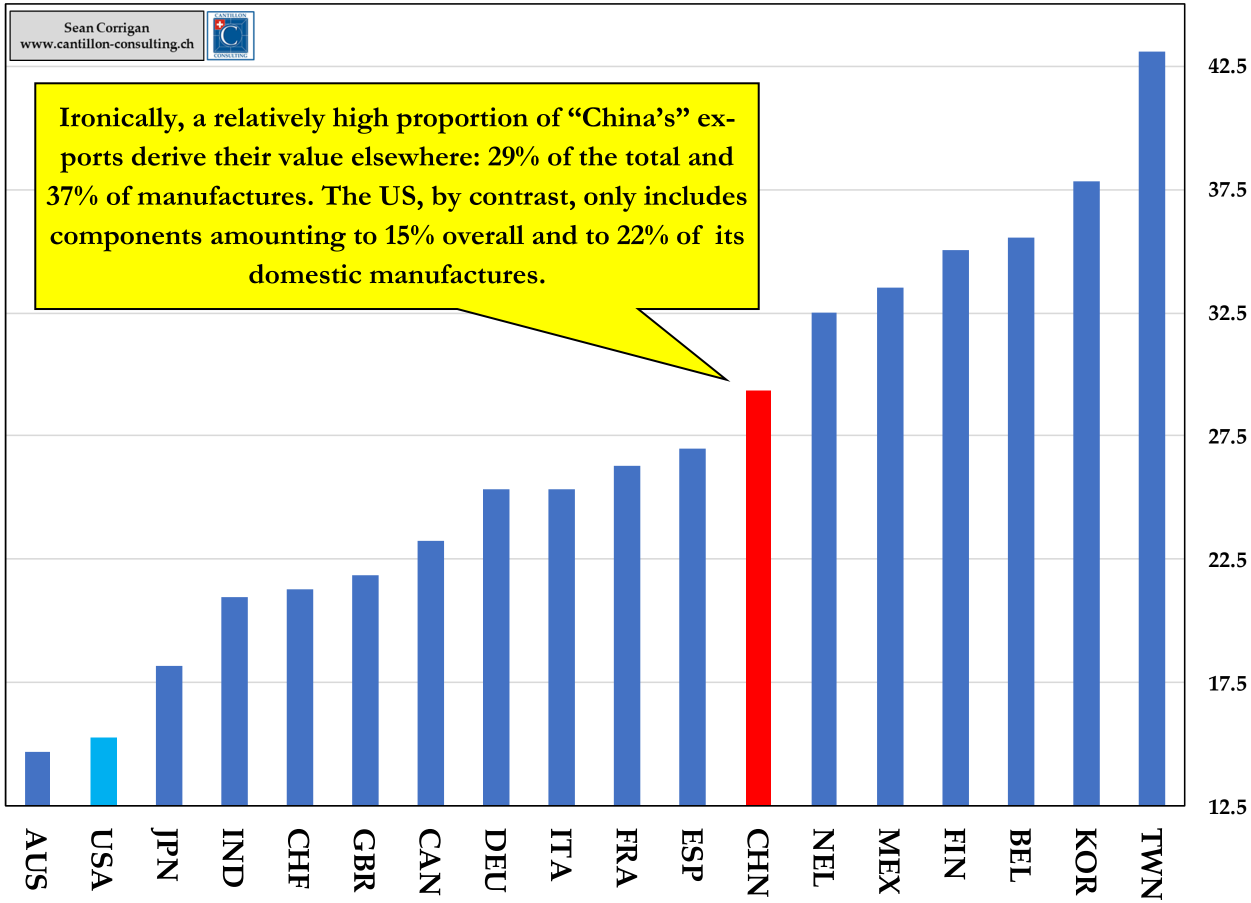
The first of these – by some way the more alarming of them – is that this is a manifestation of what the Chinese themselves have taken as referring to the 'Thucydides Trap': the concept that the existing hegemon will not in any way tolerate the emergence of a potential rival for its supremacy but will rather seek to eradicate it at the earliest juncture.

With China now in a position to pose just such a threat (as Beijing likes to flatter itself it does, to the avid endorsement of the Neocon armchair Attila's who infest the Beltway), the US – some imagine – has therefore embarked upon the first phases of a prolonged attempt at containing, if not actually humbling, the Middle Kingdom.

For all our sakes – whether in terms of material prosperity or physical security – we must pray that those with their hands on the levers of powers (and their fingers on the Button) do not indulge in such rabid, think-tank paranoia or, just as bad, do not succumb to the temptation to harness it for short-term political ends.

The second possibility – one which we can perhaps too readily persuade ourselves carries a small kernel of sense within it – is that all Trump is doing is drawing attention to the iniquities of the present system of 'managed trade' in the hope of provoking a bonfire of the rule-books and thus – somewhere in the not too distant future – to lower tariffs and lessened *non*-tariff impediments to trade in general.

Share of Foreign Value-Added in 2014 Exports: *Source - OECD*



Indeed, a sentiment of the sort was offered to us by the President himself at the beginning of his spat with those running that Continental System Mark II which is the European Union – a body whose hypocritical lip-service to the concept of 'free trade' is readily given the lie by the dire consequences which it and its many British hirelings warn will ensue for Perfidious Albion should she finally reject its smothering embrace and actually consummate the process of 'Brexit' after two long years of naked manoeuvring and determined obfuscation.

Here, however, we must be careful not to let the wish become father to the thought. Mr. Trump – as we have come to know – is not a statesman to whom we should look for much consistency of expression. His *modus operandi* is provocation and the off-the-cuff pronouncements through which he prosecutes it may sometimes be highly pertinent but are just as readily rejected in full, mere moments later, with his own self-contradiction being lost amid that thorny tangle of accusations of 'Fake News' which he has been so careful to construct as a cover for himself.

Is this, then, all merely a gambit? Is it just an attempt to call a spade a spade; to point out the cant and deceptive practices of the current order and hence to begin a move towards ameliorating some of its greater failings? Some small hint of that came when Secretary Mnuchin proposed a general abolition of all manner of barriers at the Buenos Aires G20.

One would dearly love to think this is indicative of the underlying aim, but long years of vindicated scepticism about politicians' perceptions and priorities, both, make us hesitant to espouse such a view. And even if one *were* to suspend disbelief and temporarily to give the Devil his due in this context, the problem remains that such a policy of confrontation can all too easily escalate into something irretrievably counter-productive.

With paint-brushes everywhere moving firmly in the direction of corners, one must recall the feted aphorism of that most world-weary of political philosophers, Thucydides himself. The principle motives for conflict he says, in the stark *Realpolitik* of the infamous Melian dialogue, are '*times kai deous kai ophelias*' – 'Fear, Honour and Self-interest'.

In the modern world, the first we can allow to stand. For the second – not a word one might find wholly consonant with the holding of public office – we can substitute the loose synonym, 'face-saving'. The third we can render as, 'self-preservation' – a skill at which such holders are usually most adept – or, worse, 'self-advancement', even 'self-enrichment' – also attributes not entirely foreign to those frequenting the corridors of power.

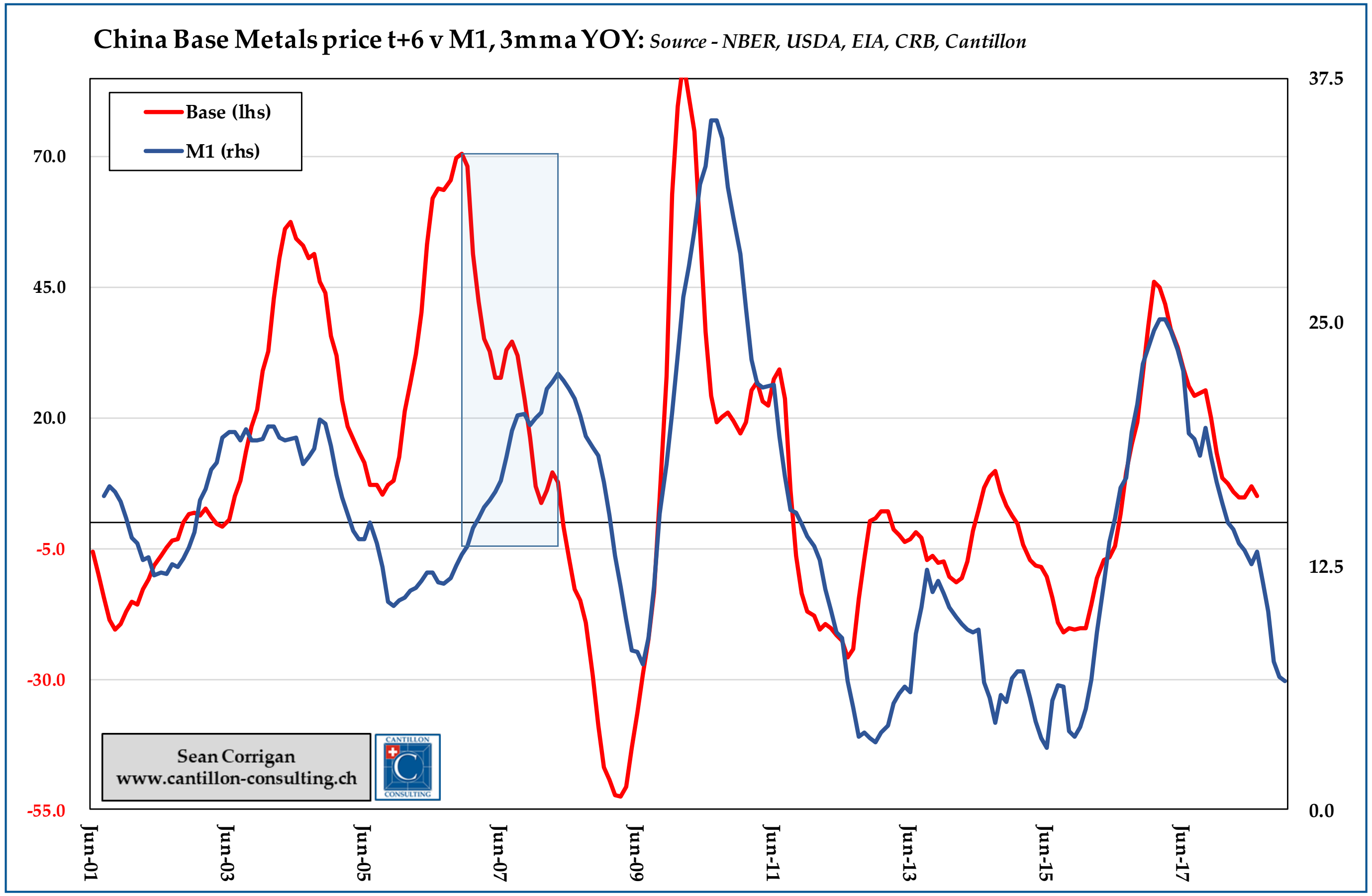
Given such observations, we can argue that President Trump's approach risks triggering all three of these emotions among the targets of his attack, as well as aggravating the entrenched vested interests whom they affect to represent. Even if they have been launched with the best of intentions, therefore, his rockets' red glare could all too easily set a spark in the powder-room and so ignite a conflagration it will prove very hard indeed to extinguish, once started in this way.

Let us hope cooler heads and more considered tactics soon prevail.

As the fears have mounted regarding the 'Trade War', China has naturally come under scrutiny, if not exactly into focus. As ever, the problem is not so much one of too many moving parts, but the fact that not all their motions are being correctly recorded and that certain unreported changes to the spec are also being made, just at the moment when a modicum of consistency would be helpful in trying o disentangle domestic from overseas factors.

Some months back, we pointed out the glaring inconsistency in the NBS numbers for sales and earnings at 'above scale industrial enterprises' and—worse still—in said enterprises' assets, liabilities and net worth. As awareness of this spread and questions mounted, the Agency grudgingly admitted that they had changed the sample and had moved to 'eliminate double counting'! As the Nikkei Asian Review has since pointed out, much the same discontinuities are evident in data for retail sales, industrial output and fixed investment. GDP, of course, came in where it always does, showing what an official spokesman described—presumably with a straight face—as a 'stable operation in the mid-high speed range of 6.7% to 6.9% for twelve consecutive quarters'. It's amazing to realize just how closely 1.38 billion people can co-ordinate their efforts, isn't it?

While traders and commentators have recently begun to chatter about the inverse movement of, say, copper, and the renminbi, our readers will be aware that we have been showing successively update versions of the somewhat minatory relationship to the right. Slowing money supply—which we have also been at pains to explain—as the seeming inability of banks to generate the right kind of deposits has been a notable feature of the past year or so, together with the inordinate, if inevitable, climb on prudential loan-to-deposit ratios which this has entailed.



Given both the plunge in the currency and various comments and policy announcements from the central bank, the pat response is to say that the PBOC has 'eased'. MPC member Liu Wei made perhaps the least equivocal expression of this by saying that 'further measures to introduce liquidity' may constitute a 'short-term contradiction' (sic) with the avowed intent to 'deleverage;, but that it was somehow 'consistent in the long run'.

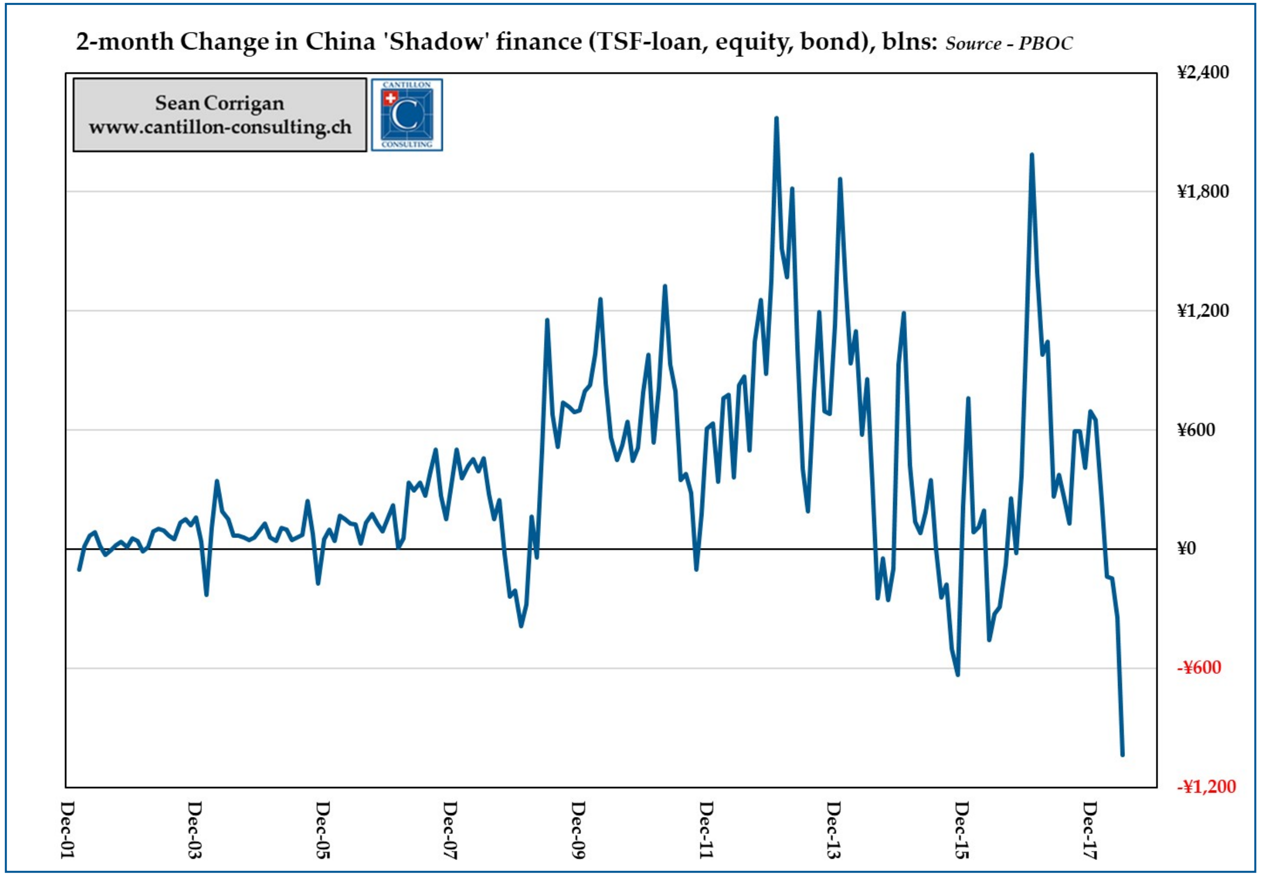
Having already cut RRR's for a range of lenders and told banks to convert a proportion of the newly-freed MLF backed loans to equity, the Bank has also moved to squash competition from the Fintech brigade by insisting their customers' cash balances must be fully redeposited with bona fide banks; has issued directives—emanating straight from the highest levels of the CPC—to reduce costs for and concentrate resources on SMEs; regulations regarding 'asset management' have been clarified but their implementation also softened, in a parallel move; and banks have been directed to buy more bonds with ratings inferior to the AA+ grade. In taking this latter step, the PBOC has promised MLF funding of up to 50% of the consideration with which to comply with the instruction. It should also be noted that, according to a study the Bank itself published last year, the disparity between Chinese and international ratings standards means that AA– there corresponds to BBB– elsewhere, meaning that, with private sector borrowers being scared off by rising defaults and with the effective closure of alternative sources of finance, the PBOC has essentially become a junk bond fund by proxy. How envious must Draghi and Kuroda be of Yi Gang, now?

The proximate reason for this activity can be seen in the graph feature here showing that the moves to contain 'shadow' financing have been, if anything, too successful, with a full CNY1 trillion falling out of the market in just the past two months in what is an unprecedented jolt to the nation's creaking financial networks. No wonder rumours abound of large distress selling on the metals markets in Shanghai!

More worryingly, a remarkably open spat has being fought out between the central bank—whose new management appears to feel too many conflicting demands are being made of it—and the Ministry of Finance. Sina Finance ran the exchange at some length, helpfully interspersing it with its own, highly barbed glosses. Even allowing for the vagaries of Google's translation, the exchange seemed extraordinarily brusque with insults being bandied about regarding the mistakes made ever since Zhu Rongji's reform programme, twenty years ago. The invective employed was uniquely revealing abut the degree to which the authorities admit China's problems are deep-seated—if not actively intractable. The State Council has since seemingly backed the Bank—but not before it undertook a record $78bln, one-day, cash injection.

Commentators can be heard talking of the 'Breaking of the Big Mother' (the Bank) and muttering about that hoary, old Keynesian chimera, the 'liquidity trap' as well as 'Minsky moments'. There has even emerged a background susurration of speculation that Xi Jinping himself might be starting to meet with some untoward criticism in the secret recesses of the party though whether this is any more than US think-tanker wishfulness at work is anyone's guess.

It would not pay to ignore developments here in coming months.



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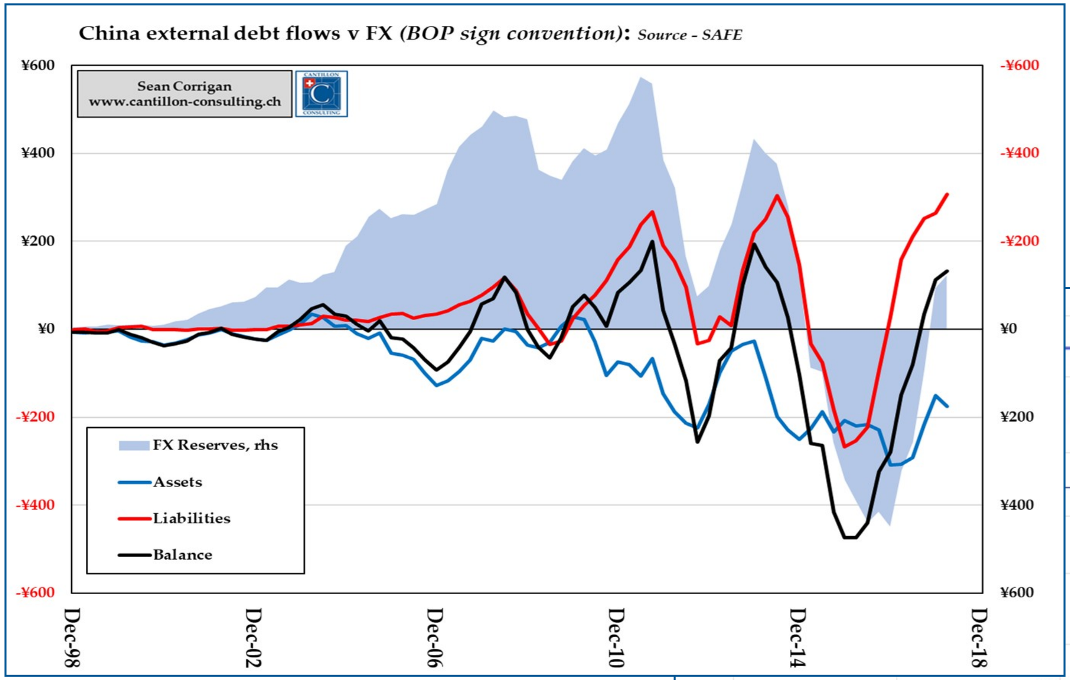

Note that the domestic funding squeeze appears to have encouraged some bad, old habits to resurface with the BOP numbers revealing the highest 4Q total of gross external borrowing (a 4-year high in net terms)

Those stabilized FX reserves might not be all they're cracked up to be!

Nevertheless, a brave punter might just want to have a tickle here, with the Chinese stock market bouncing back from key long– and short-term support levels, both in local currency and US dollars. Investors, on the other hand, might still want to be cautious given the evident signs of panic emanating from the country.


Courtesy:
TradingView
USDCNH
We called the 50% retracement in an earlier issue, but, as things stand, we could be looking at doing a Full Monty
(6.99)
(6.87)
(6.69)
(6.60)
(6.51)
(6.33)
(6.21)
Oct
2016
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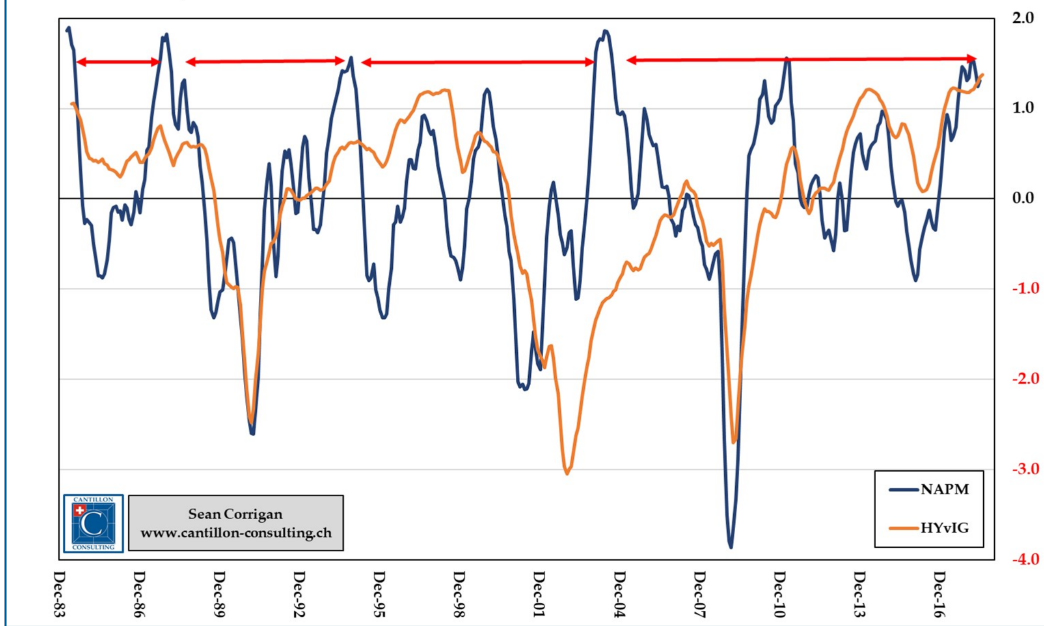
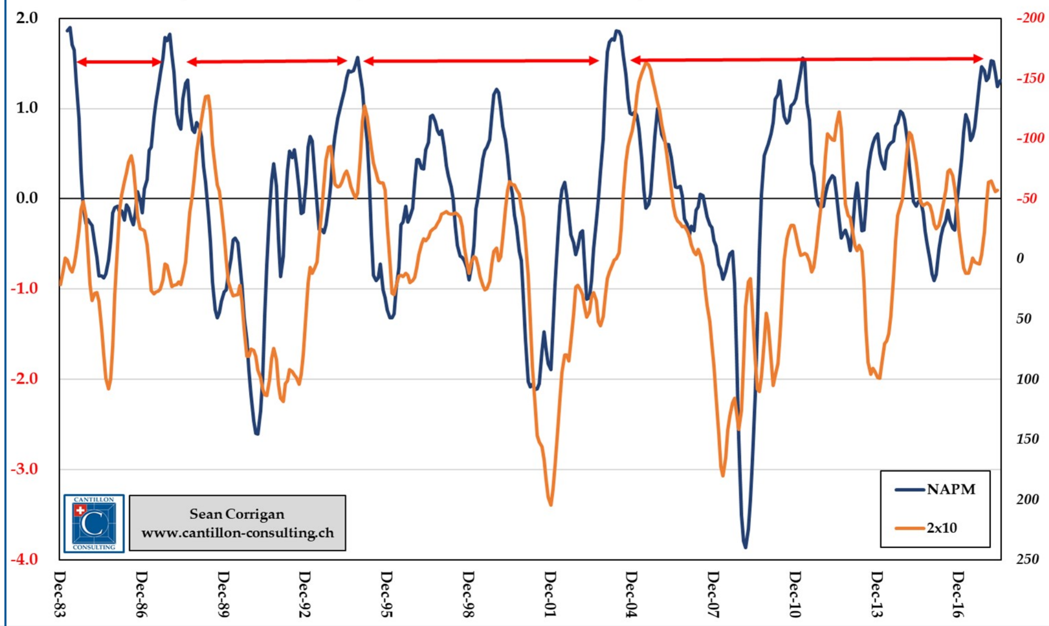
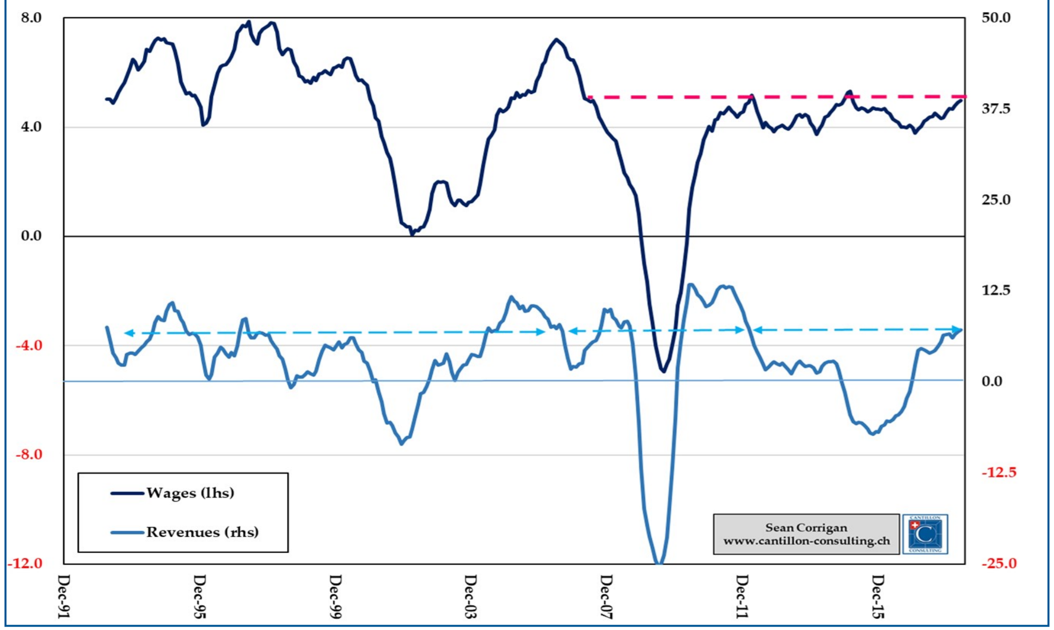
NAPM Index, 3mma normalized: *Source - ISM*



NAPM Index, 3mma normalized, v UST2x10 inverted: *Source - ISM, FRED*



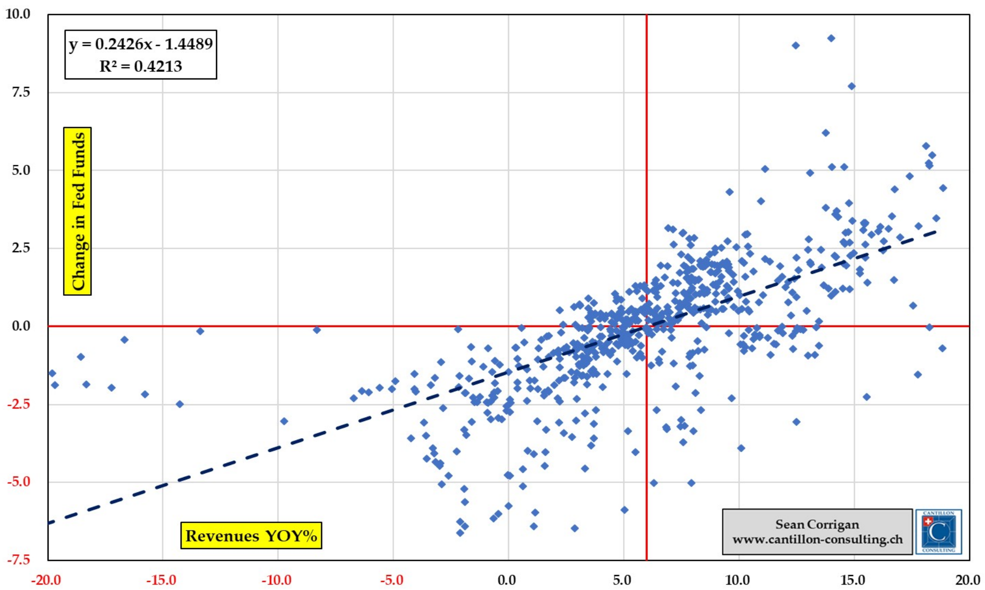
Private NFP Wages Earned & MFG/Trade Sales , 3mmaYOY: *Source - BLS, Census*



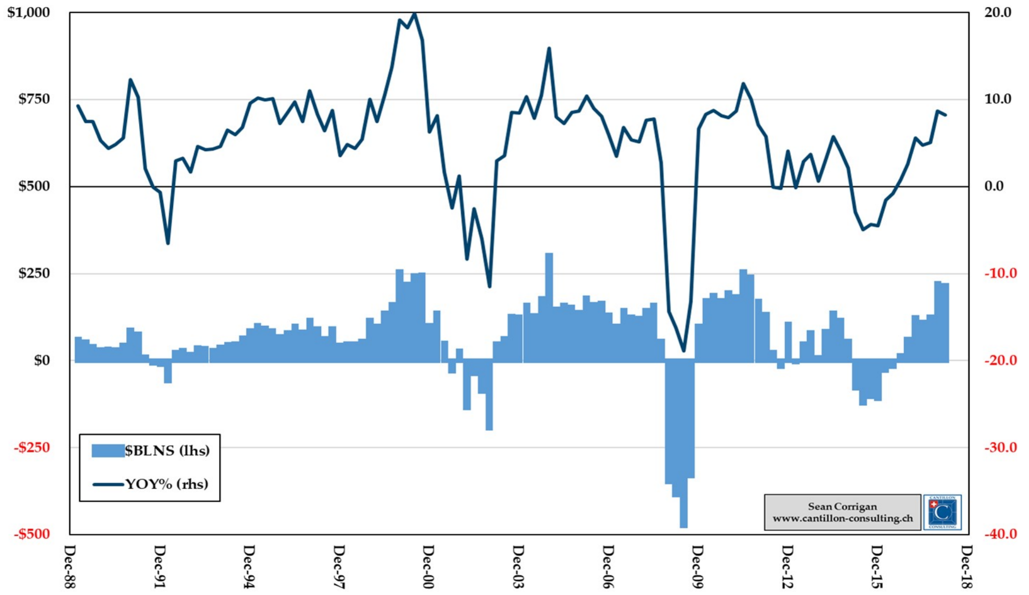
Back in Jerome Powell's America, things are still ticking along nicely—whatever the (justifiable) concerns to which Trump's tariff policies are giving rise. Revenues are still rising smartly; profits seem to be coming in strong so far again this quarter; the increase in earned wages is pushing the top of the post-Crisis range. Despite all the hot air being expended over the yield curve, credit conditions are anything but onerous, as one might expect against this positive, real-side backdrop. The one caveat is the continued slowing of growth in money proper which cannot indefinitely be made up by its more rapid passage from buyer to seller.

On top of that, we are ever on alert for signs of financial stress and/or trouble amid the malinvestments to which loose credit always gives rise but there is little hard evidence of this, to date.

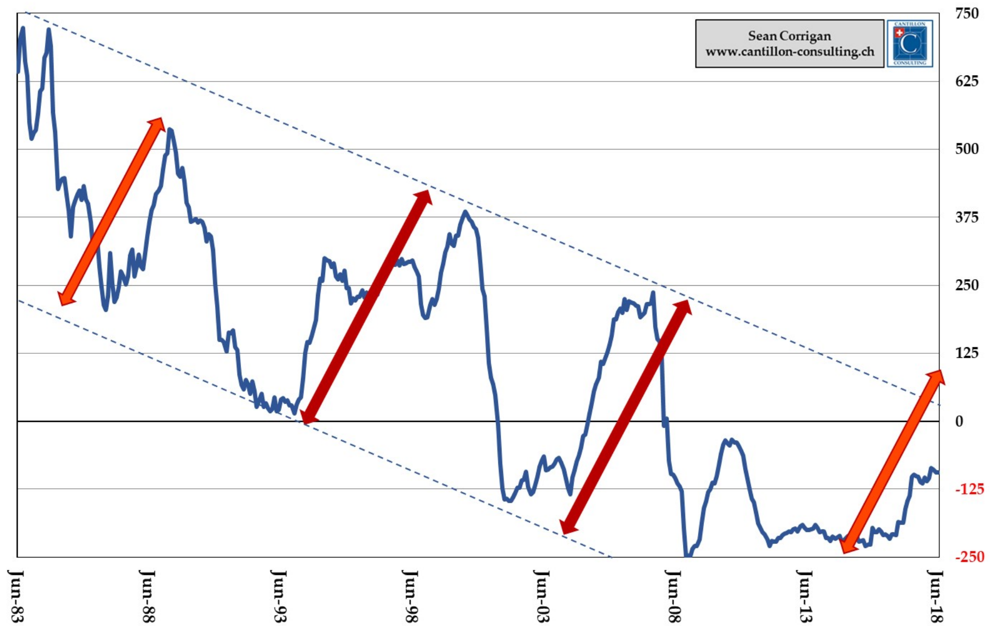
US Business Revenues, 3mmaYOY% v d[Fed funds], t+3, 1955-2010: *Source - Census, FRED*



S&P500 YOY Revenue Growth: *Source - S&P*



US Median CPI v Real Fed Funds: *Source - Cleveland Fed*



Given the rise in business turnover is comfortably north of 6%, there is little yet to prevent the Fed from continuing to remove its emergency levels of accommodation—as, in fact, its Chairman keeps telling us.

For the historically minded, the past three tightening cycles ran, in real terms, to between 310 and 350 bps (and were much more swingeing again in the prior few). Similarly—if not with such compelling underlying logic—the previous peaks and troughs have moved successively lower by around ~160bps.

An adherence to those two sets of precedents would mean the Funds rate peaking at positive 50-75 bps; so six to seven rate hikes beyond where we sit now. All of you betting on that 3% nominal ceiling may wish to take note.

Financial account of the euro area

(EUR billions unless otherwise indicated; transactions; non-working day and non-seasonally adjusted data)

	Cumulated figures for the 12-month period ending in					
	May 2017			May 2018		
	Net	Assets	Liabilities	Net	Assets	Liabilities
Financial account	342	1,271	928	466	800	334
Direct investment	217	450	233	152	-14	-166
Portfolio investment	287	476	189	332	548	216
Equity	-230	104	334	-233	163	396
Debt securities	517	373	-145	565	385	-181

Twos and Fives have each retraced half the range from the 2007, pre-Lehman highs to 2016s lows, with the latter consolidating for now just below a key trend line drawn through there from the height of the 1994 (Ahh! I remember it well!). If Tens are to get there, they would need a ~50bp rise to 3.35%; likewise the Bond would need to decisively break 3.25% to hope of stretching to 3.75%.

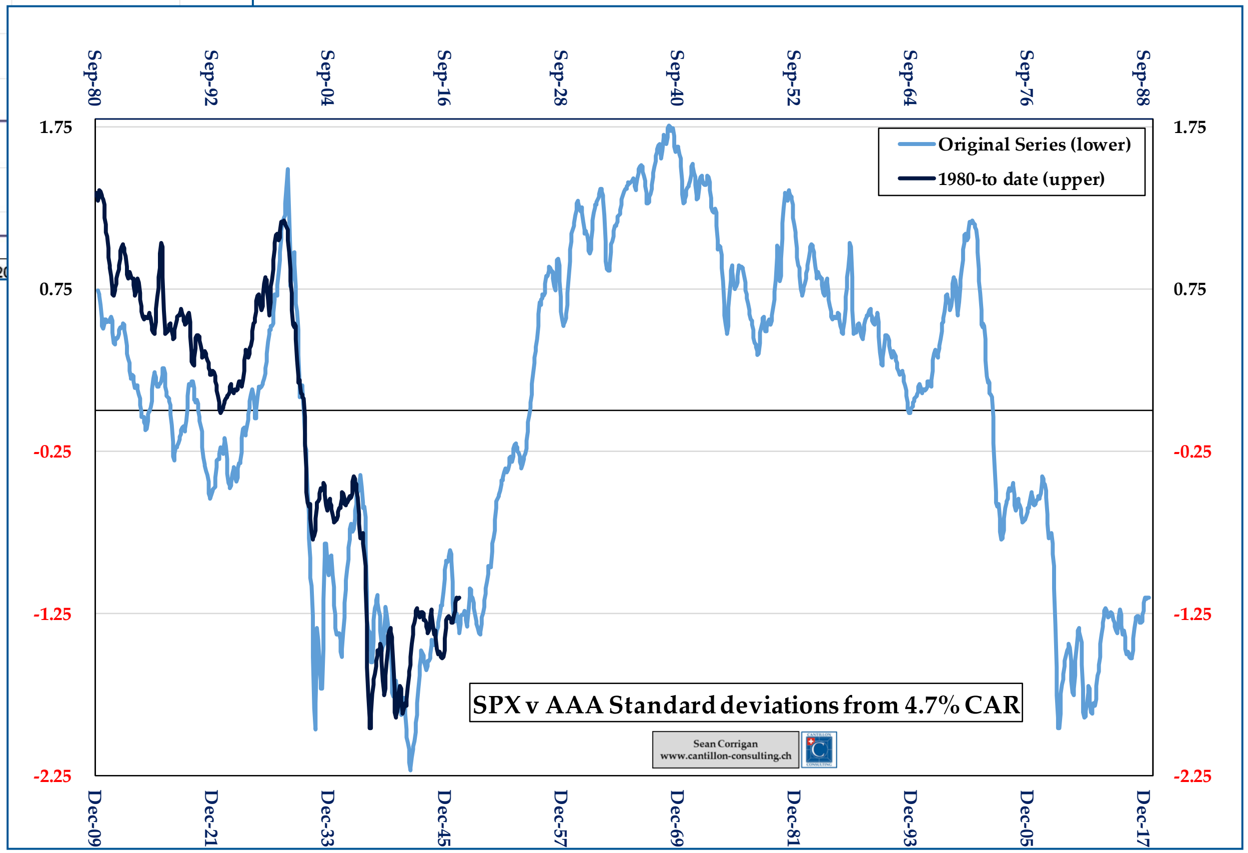
Hard to see that happening while Snr Draghi continues to suck duration out of the world, with a little help from Kuroda-san, over in Japan. Don't fear the flattening yet!

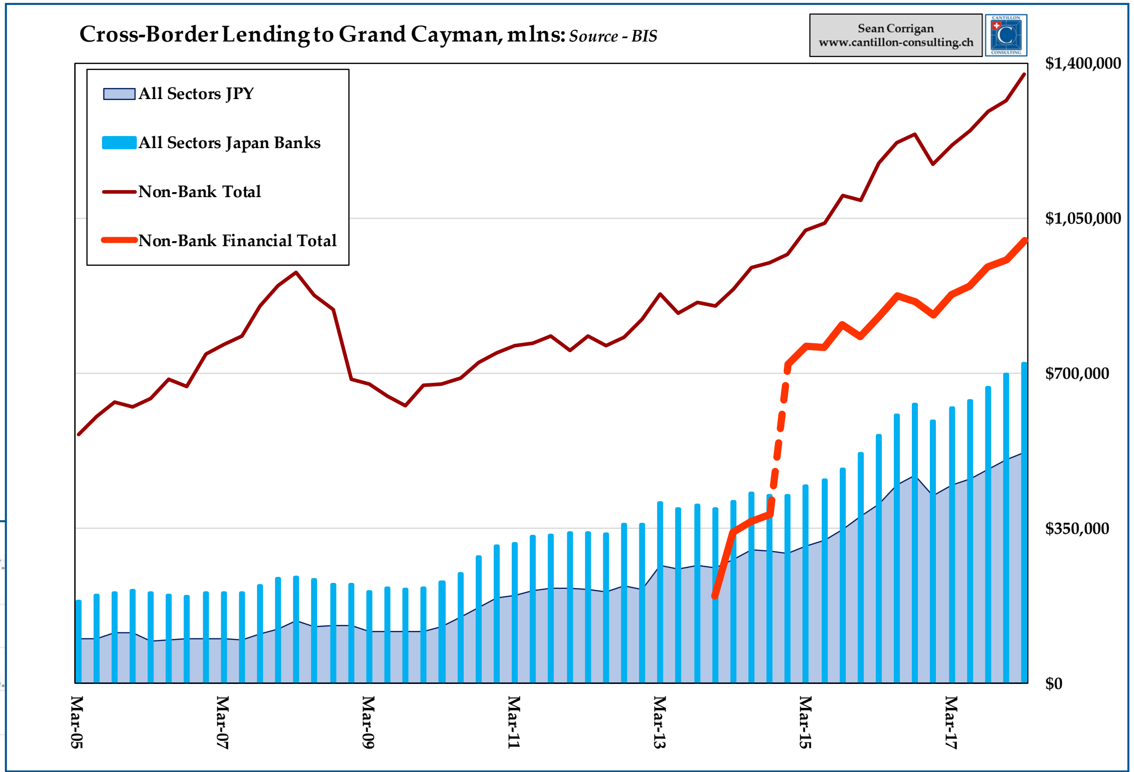
Whisper it, but it's not just about the FAANG stocks, however overblown their valuations may be. Small-caps, mid-caps, the Value Line (see left), the A/D lines—all are at or near new highs, too. Whisper it, but this might just be a break out, coming after the last six months consolidation.

Too late in an 'old' expansion for that to occur, you say? Well, we would argue that's not strictly true and that the setback of 2014-16 which we call the 'Hidden Recession'—unrecognised as it may be by the supposedly oracular NBER—was what cleared the decks for action.

Note, too, the fascinating parallels with the developments of seventy years ago in a plot which takes the log of the relative returns of stocks and bonds and detrends the resulting series.

The Tech Bubble as a rerun of the Roaring Twenties? The subprime boom as the Crash of '37? And now, the end of QE (well, the end in the more level-headed parts of the world) as analogous to the 1951 Treasury-Fed accord which finally uncapped bond yields and saw stocks soar all the way to the start of the Great Inflation?





With the yen narrowing in to a level smack, bang in the middle of the Sakakibara (numerical highs) and the pre-Abenomics lows, the issue for currency traders will be which way it breaks out of the large-scale pennant it has been slowly, but surely forming these past three years.

The wider import comes when we look at what Kuroda's destruction of domestic yield and capital markets has inspired—namely, the restoration of the yen as carry-trade vehicle of choice. Worryingly, some substantial fraction of all those monies pouring into GCI are said to be financing CLO structures for onward sale from those same regional Japanese banks and small insurers who are also such avid buyers of the Samurais being copiously issued by the likes of Australia's cash-strapped banks.

Have we found this cycles defining 'dumb Germans from Dusseldorf'?

MSCI EM Equity TR v S&P GSCI ER: *Source - MSCI, S&P*

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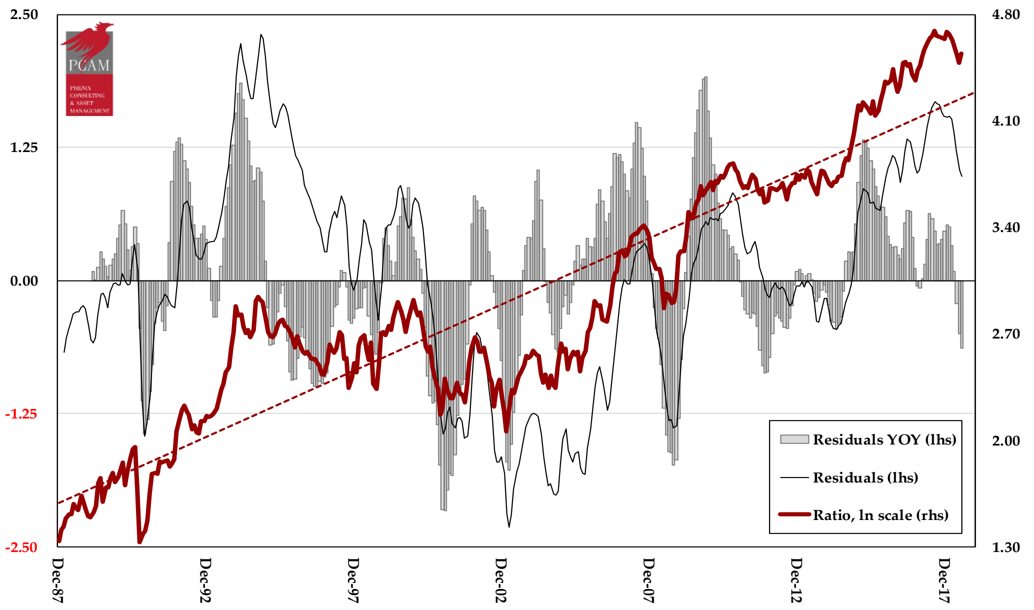
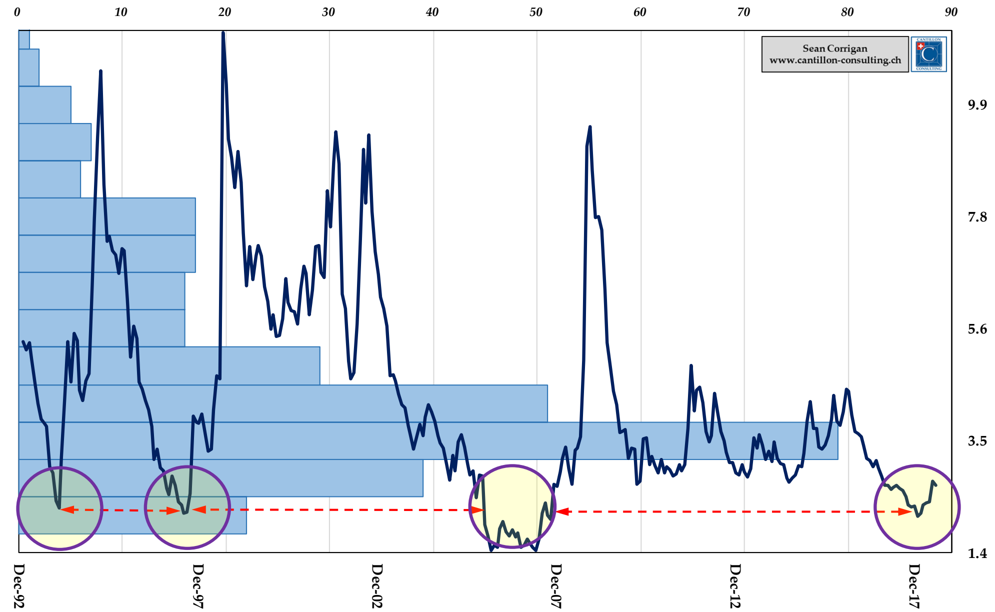
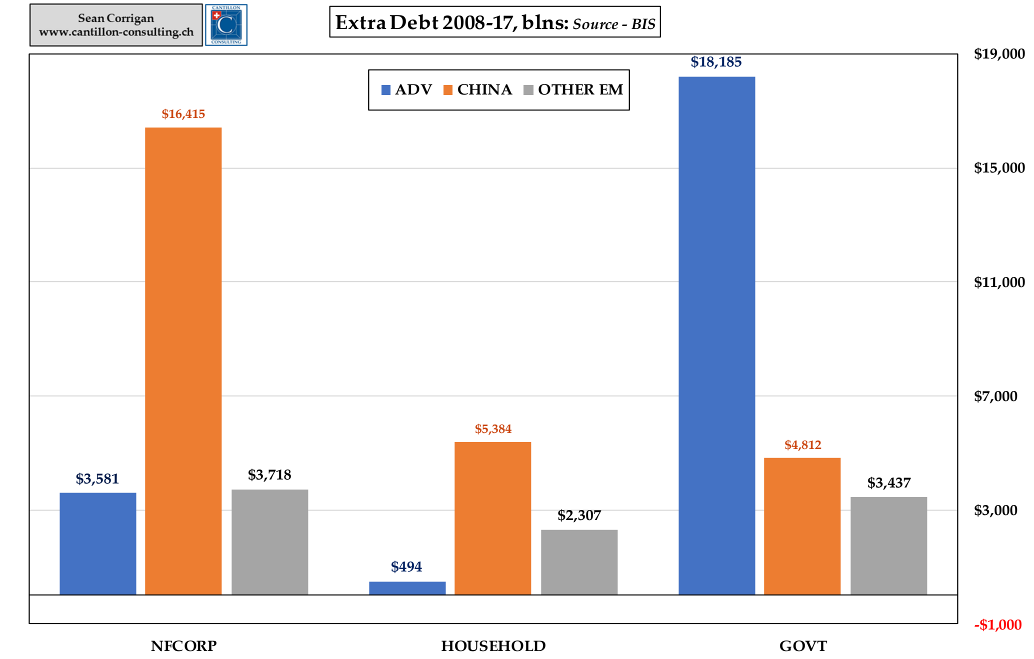


EM Bond Spreads, Log Scale: *Source - Barclay's*



Extra Debt 2008-17, blns: *Source - BIS*



Emerging Markets do not currently offer the most compelling of cases for sponsorship. The usual suspects in Latam and South East Asia are all under pressure; Turkey is teetering on the brink of atypical authoritarian melt-down; South Africa is itching to expropriate whatever capital does not flee in time. News—and rumour—of currency interventions to cushion the flipside of the dollar's rise are rife.

The long years of easy money have yet again tempted too many into borrowing too much foreign currency in the pursuit of unsustainable domestic returns. Bonds are again rising away from levels which have proven all too ephemeral in past cycles; equities are not only underperforming their DM peers, but also the highly-correlated commodity market (and which therefore may offer a better alternative). Not for us, thank you!

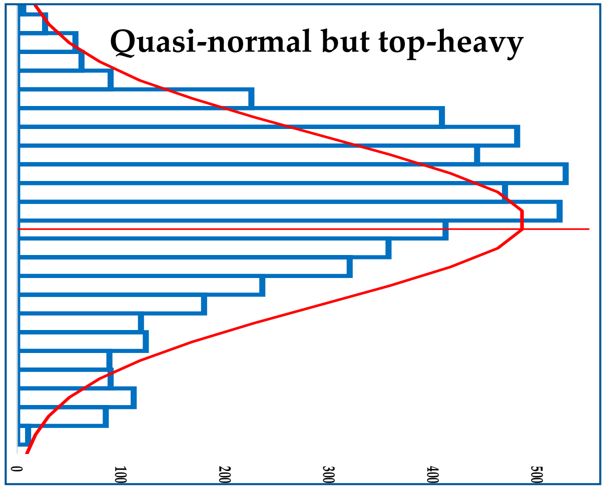
This has been one wild market of late. Brent-WTI shot from a $3 premium to almost $12 then collapsed back to $3 again. Meanwhile the former's front two months crashed from a 60c backwardation to a 10c contango, before struggling back to zero while the WTI back managed a run from 20c to $2.55 then 90c and now $1.40.

Shale pipelines, Canadian outages, Libya, OPEC, Iran, Russian sanctions - PHEW!

The pullback itself broke the 13-month channel in Brent, not in WTI. Both stopped above the Jan peak, midpoint of the 2014/16 slump, at a level which marked the temporary spring 2010 spike high and summer 2012 spike low. If the bulls can summon the nerve to re-enter, this could still see $80 (WTI) to $89 (Brent) before we're done.

We were recently amused to read one die-hard gold bug's tweet, as he forlornly attempted to rally the faithful, one more time, in the face of the metal's steep decline. 'Investors are increasingly coming to see old as undervalued,' he offered when, the sell-off rather seems to prove the contrary, of course! Our objectives met and a tad oversold, so no big conviction at present. Needs to build back above the $1240/5 mid for comfort, otherwise, $1175, $1125, and ultimately $1050 lie in prospect.

Up by the stairs: down by the elevator. Copper has been Shanghai'd back to the 2014/16 mid point and could well now wash between $2.40/lb and $2.80'lb until a new story emerges to move it.



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