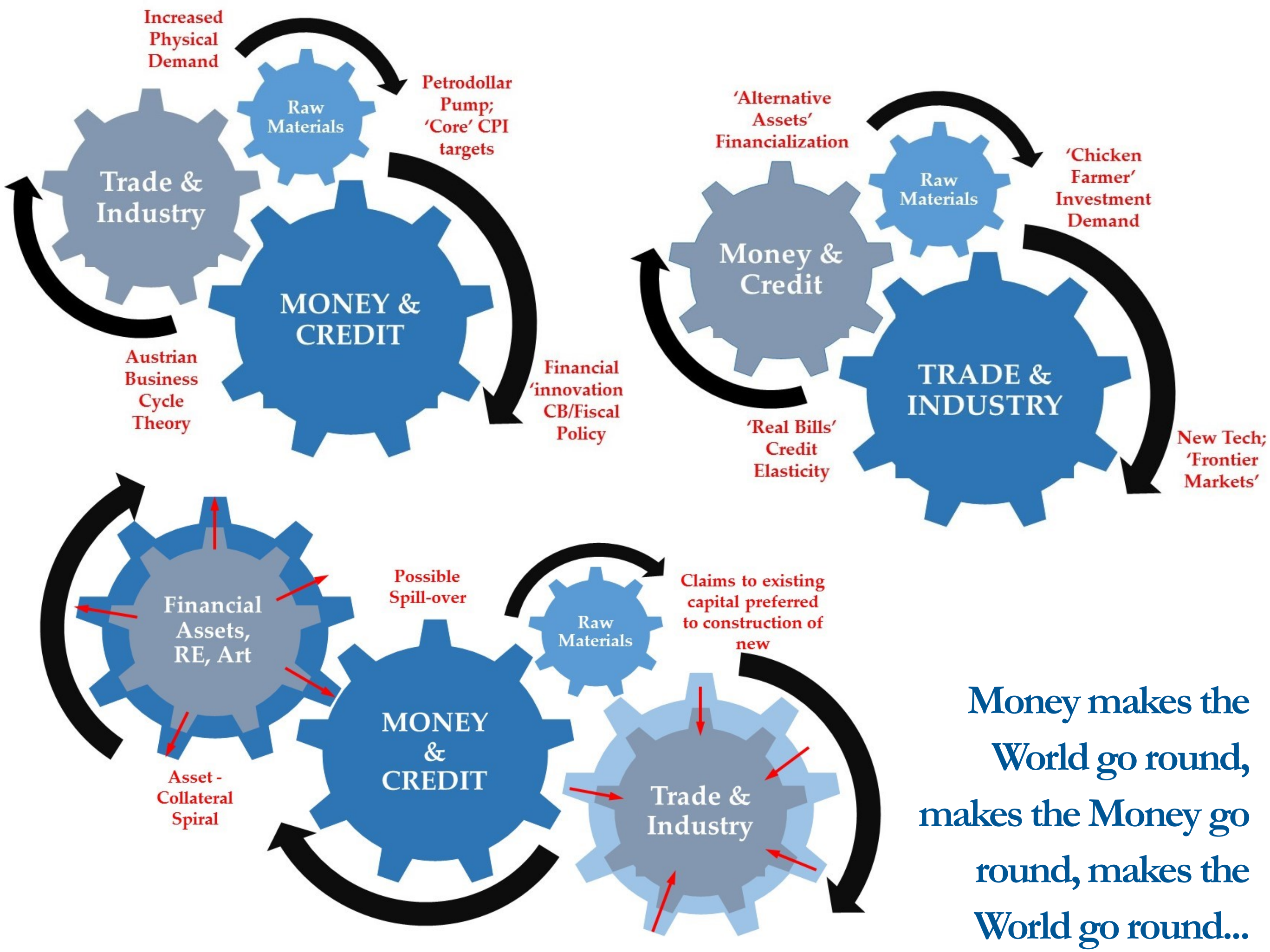
Insight & Support for the Managers of Wealth

Money, Macro & Markets Monitor

www.cantillon-consulting.ch

August 2018



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

IN THIS ISSUE:-

Don't Panic with Chinese characteristics

Stronger USD = lower global liquid money

High yield holds in: hedges & higher earnings

Real side rockin' - money measures mingin'

Upside for US stocks but watch the reversion

Bond bears ahead: might shoulder arms

Crude could test $60.bbl

Gold: finally a bounce?

Tesla: short of the 1.21 Gigawatts

Volume II, Issue VII

The Hitch-hiker's Guide to The Middle Kingdom

Were the late Douglas Adams still around to oversee the production of a digital *vade mecum* for the visitor to today's China, he would very rightly insist upon the characters 不要惊慌！ being emblazoned in 'large friendly letters' on the cover—this being what we rather trustingly find to be the way Google would have us write, 'Don't Panic!', in the local script.

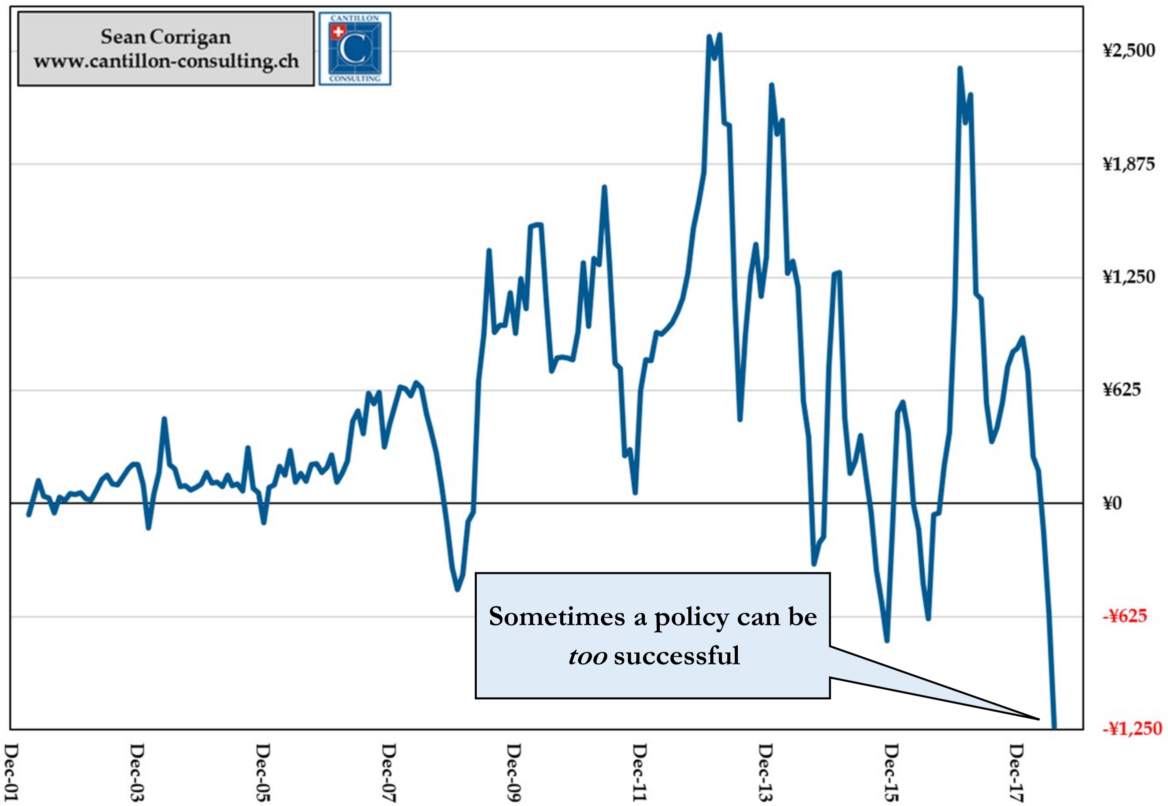
China has, of course, continued to '*remain within a reasonable range, continuing the overall and positive trend*,' as the official formulation has it, and there is therefore absolutely no need for the central bank to do more than engage in '*fine-tuning*' of the monetary system, while providing '*adequate liquidity*' and certainly not engaging in any concerted push to expand credit.

But, if that is the case, why does barely a day go by without news of some new initiative to channel money to some sector or other, or without yet another exhortation to the banks to lend to this or that worthy cause of the day?

The regulators, for example, have vouchsafed more funds for construction and infrastructure projects, while hinting that the risk-weightings applicable for the oft-promoted debt-for-equity swaps will be—shall we say—'sympathetically' crafted. Banks and insurers also stand under instruction to '*have an accurate understanding of the relations between promoting economic growth and containing* risks' (guess which side of the scales is currently expected to weigh more heavily).

Adding its considerable heft to such initiatives—and perhaps still smarting at the PBOC's impertinent suggestion that it was not doing enough to help, the Ministry of Finance has also come out with all guns blazing. As Ning Jiwei of the NBS recently declared to Xinhua News, it is imperative that the 165 major projects (sic) identified in the 13th Five Year Plan be '*implemented as soon as possible*'. Even more emphatic was the MOF's insistence that no less than 80% of the CNY1.3 trillion in newly-permitted local government infrastructure bonds—should be issued by the end of September: a demanding schedule which amounts to CNY1 billion *an hour* between now and the end of the summer, all of it allotted calmly and rationally to only the most socially-remunerative undertakings, of course.

3-month Change in China 'Shadow' finance (TSF-loan, equity, bond), blns: *Source - PBOC*



Newswires have also carried stories that banks are being urged to provide financing for Trade War-afflicted exporters, too—presumably with a view to preventing any (further) distress sales of inventories of raw materials inputs or stocks of finished goods. Meanwhile the four creaking, toxic waste dumps of the radioactive remains of Booms of yore, the ironically-named Asset Management Companies, have been called upon to bail out the nation's crumbling P2P networks of which 165 denied their investors access to funds in the month of June alone, a wave of defalcation which sparked a heavily-suppressed series of street protests in the wake of the embargo.

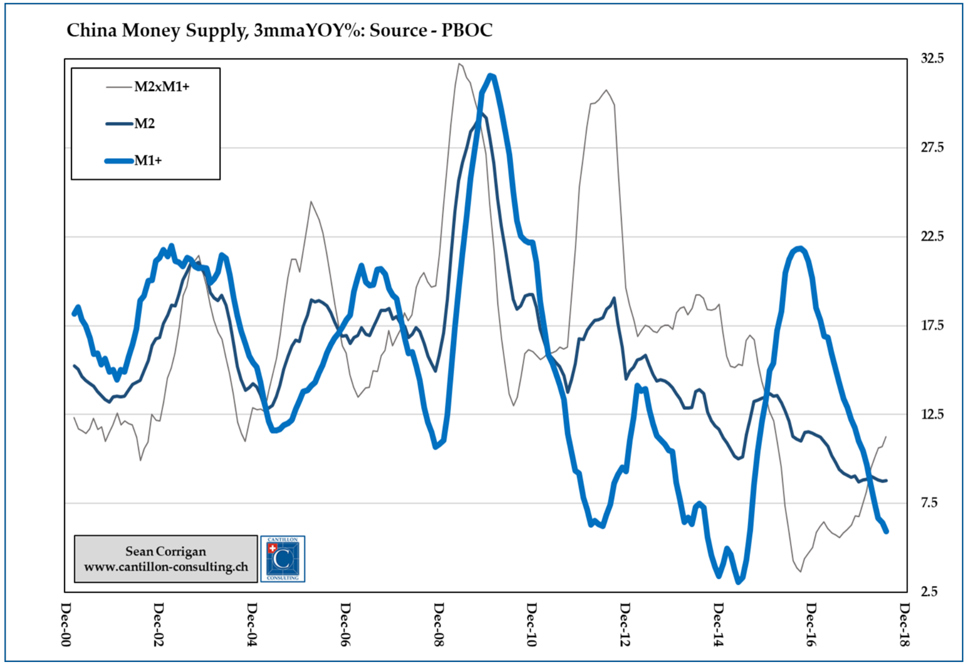
As all this frantic, political dog-paddling goes on, some glimpses are also being given of the dangerous shoals of large-scale malinvestment which lurk menacingly below the fragile keel of the Chinese ship of state. Amid reports that the count of the over-60s has risen to one in six of the population and that both marriages and registered births were off by double-digit percentages in the first few months of 2018, there were also tales of how the 'Moonlight Clan' millennials were funding their conspicuous consumption mainly on debt and were accordingly responsible for much of the 40% increase in consumer defaults suffered this year. Simultaneously, there has been much angst over the parlous state of the national pension fund and its unenviable actuarial prospects.

No wonder the 'National Team'—having vehemently denied any such intention over the weekend—sprang into action on Monday, at the very same moment that the nation's insurers collectively decided that the stock market had finally fallen to a point where it now offered an unmissable opportunity to buy! 'Don't Panic', indeed!

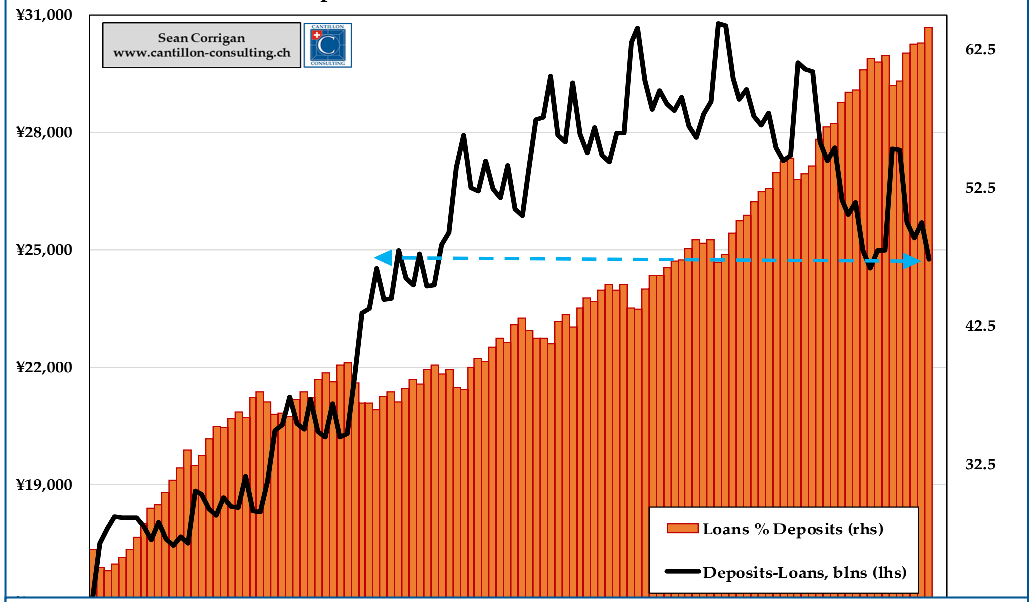
Taken in the round, such a backdrop should raise the vexed question of how a nation running up so much debt and building so few obviously productive, much less self-amortizing, assets can be said, in any meaningful sense, to be 'saving too much'? Even the contentious current account surplus which once appeared to point that way has dwindled into insignificance of late as increasing numbers of eager Chinese travellers pass their very own Grand Tour of the West diligently redistributing the earnings made in their countrymen's humming factories.

And then there is that already creaking act of Open Door imperialism, the Belt and Road Initiative—a vast project already arousing disquiet about the viability of many of its works and exciting outright fear about the incidental financial burdens it threatens to impose. While usefully supportive of the demand for heavy plant and industrial commodities in the short term, this could well prove to be one of those monumental acts of folly to rival the mad-cap canal and railway booms of the 19th century which routinely erupted to shatter the peace and dislocate the otherwise impressive upward progress of that era's spreading material prosperity.

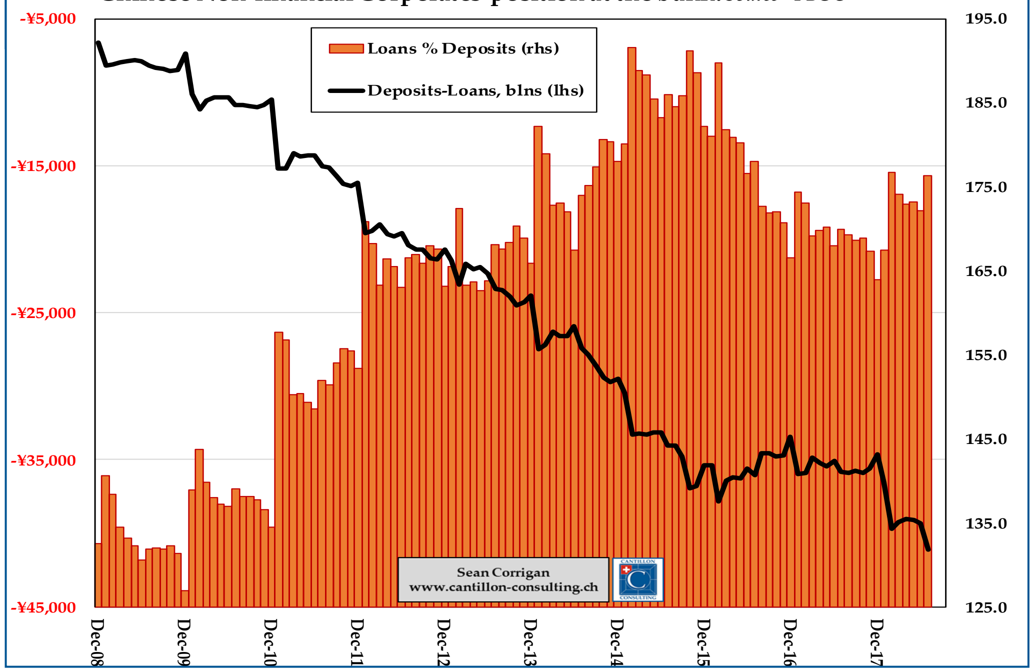
All in all, an unenviable array of problems seems to be confronting the Chinese leadership—a Gordian knot of conflicting priorities into which the forcible insertion of the Stars'n'Stripes might almost be seen as affording some measure of political relief. To distract from his difficulties at home, Xi Jinping would seem to require one of two things abroad: either a marketable diplomatic triumph in dealing with the Trump Administration's demands on trade or, conversely, a spinnable tale of foreign perfidy around which to unite the populace in order to avoid the imagined ignominy of what would be sold as the equivalent of a Third Opium War. ***Let us hope it is the first.***



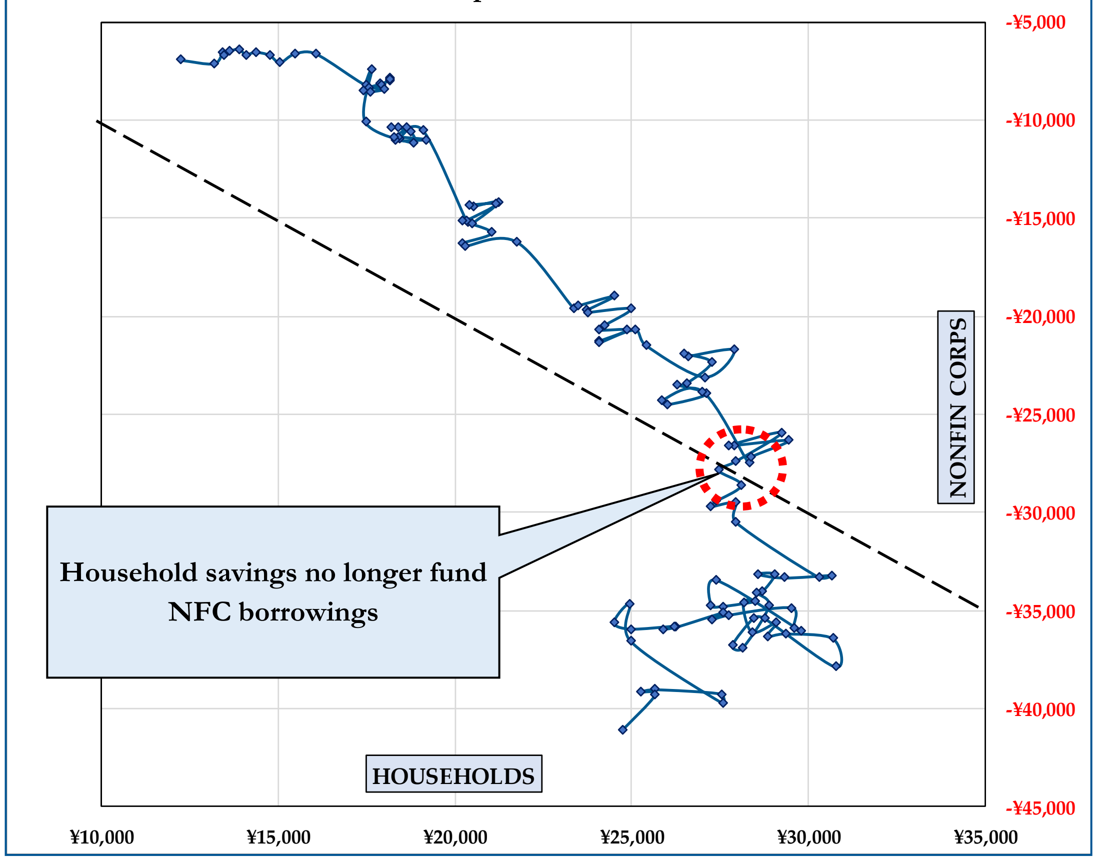
Chinese Households' position at the bank: *Source - PBOC*



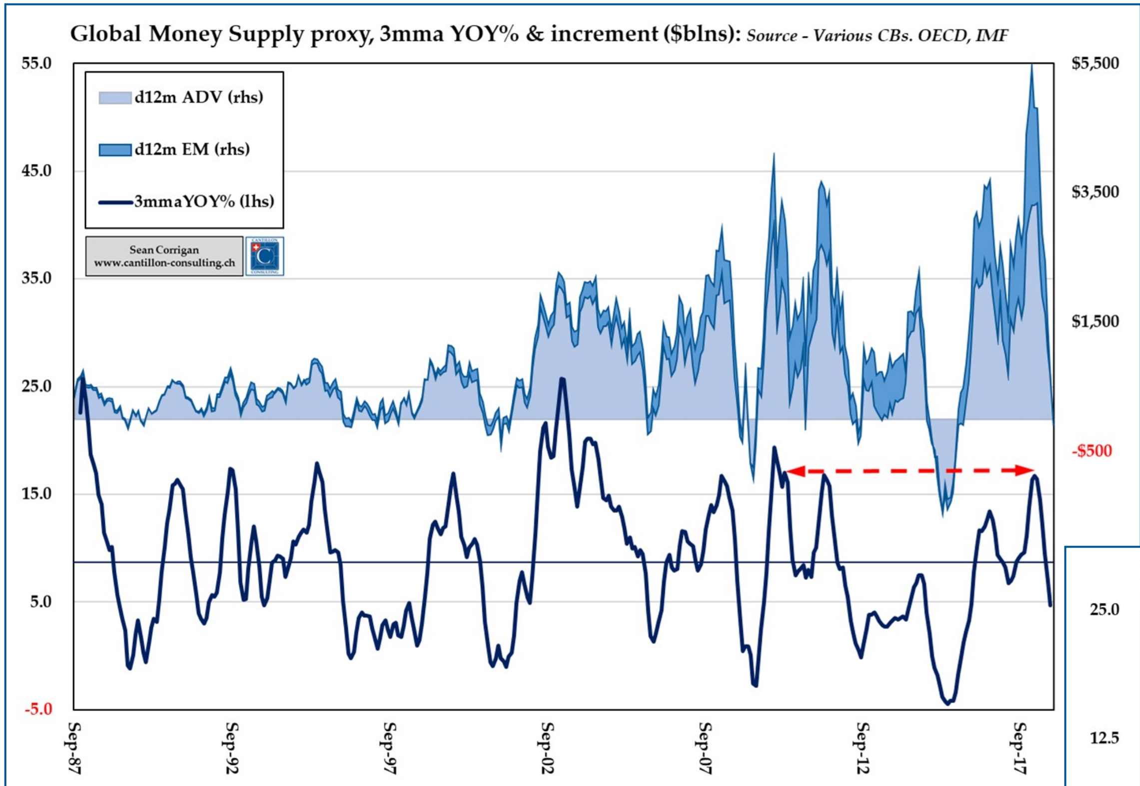
Chinese Non-financial Corporates' position at the bank: *Source - PBOC*



China NFC & Households' Deposits - Bank Loans Combined. blns: *Source -PBOC*



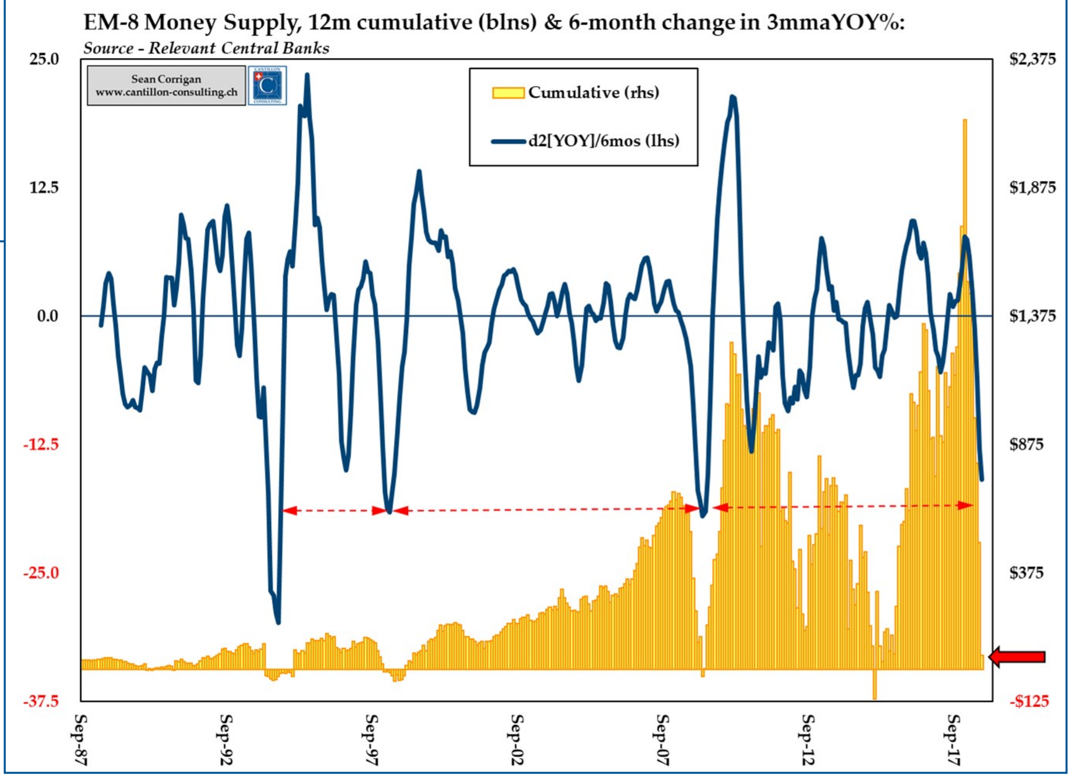
The fabled 'Chinese Saver' is fast passing from reality and into the pages of legend, putting ever more stress on bank balance sheets. This lead one senior insider to tell the regulator this week that a capital boost of CNY2 trillion should be considered if all the grand schemes of 'fine-tuned' and 'targeted' support were ever to be met.



The slower pace of monetary additions in the US, UK, China—and to a lesser contributory degree, Australia—have slowed the new *flow* of monies at the same time that the rise in the dollar has shrunk their combined, common-currency *stock*.

If the last months' trends persist through the current month (and if FX parities remain unchanged), we would continue the descent from a 6 1/2 year high rate of growth (and, ex-GFC response, the quickest seen since the 9/11 emergency boost) to a 2 1/2 year low (which last nadir marked the end of the 2014-16 'Hidden Recession').

That sort of deceleration accompanied each of the past three recessions.



The EM deceleration over the past six months (aggravated by the local currency plunge) has stretched to –16.9%. That matches the magnitude of braking experienced in the wake of Lehman's collapse; in the Asian Contagion or 1997-8, and during the Tequila Crisis of 1994/5

WHAT THE FIRM OFFERS

The fruits of a lengthy exercise of full intellectual independence, trading in, commenting upon, and analysing markets, placed fully at your disposal to help enhance your investment process.

Dedicated personal interaction, as well as written assessments, to enliven the debate and to mitigate risks by broadening the circle of opinion.

Detailed macro/market research with the possibility of undertaking special commissions upon request.

Ideas and arguments to incorporate into your existing framework of client communication either as 'white-labelled' material or, if you wish, to present as the stand-alone opinion of one of your firm's expert counsellors.

Assistance with content for reporting, proposals, marketing, etc.

Education and training.

Public speaking to entertain and inform you and your invited guests.

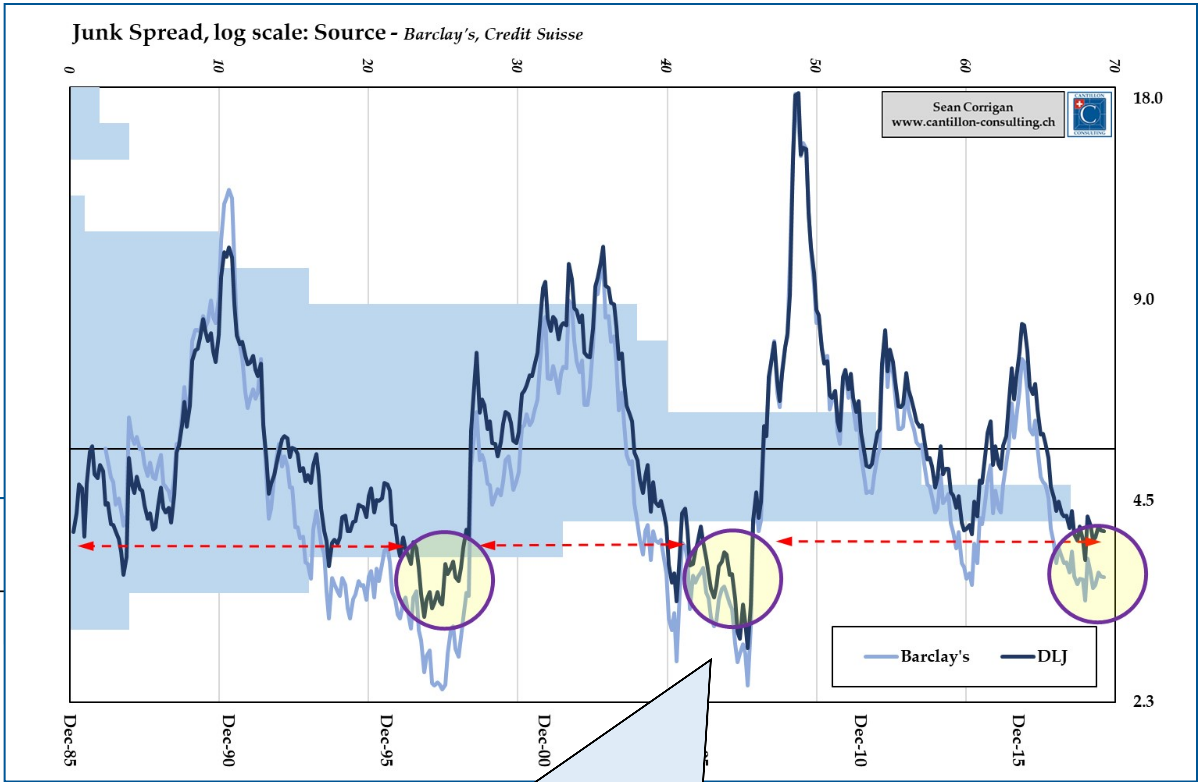
For more information and to discuss the specifics of what we can offer, please write to

info[at]cantillon-consulting.ch

'Silver alone is the True Sinews of the Circulation' - *Essai sur la Nature du Commerce en général*

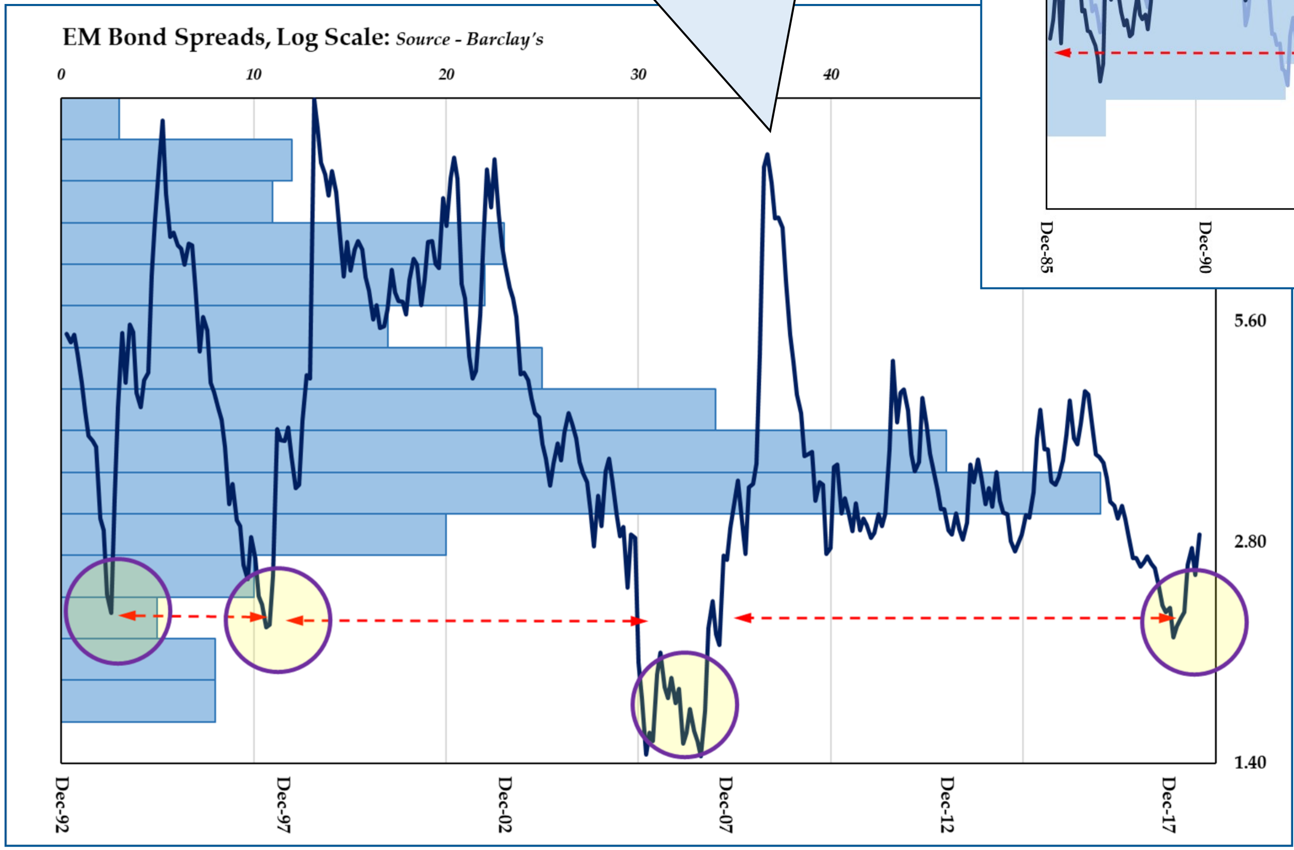
For much more, please visit the blog: www.truesinews.com

Unsurprisingly, EM bonds have been the hardest hit, though it cannot be emphasized strongly enough that, so far, this has only meant a movement *away* from the sorts of excessively easy conditions which have been conducive to previous episodes of perilous overborrowing and *toward* the mode of a skewed, long-term distribution. Keep your fingers crossed that the sort of corrective overshoot which succeeded previous periods of blithe over-optimism is not repeated this time, too.



Junk, meanwhile, though similarly priced at levels which have proven ultimately unsustainable, remains impervious to the wider rumblings of disruption—possibly because US revenues and earnings trends also remain so far untroubled and stock markets resilient.

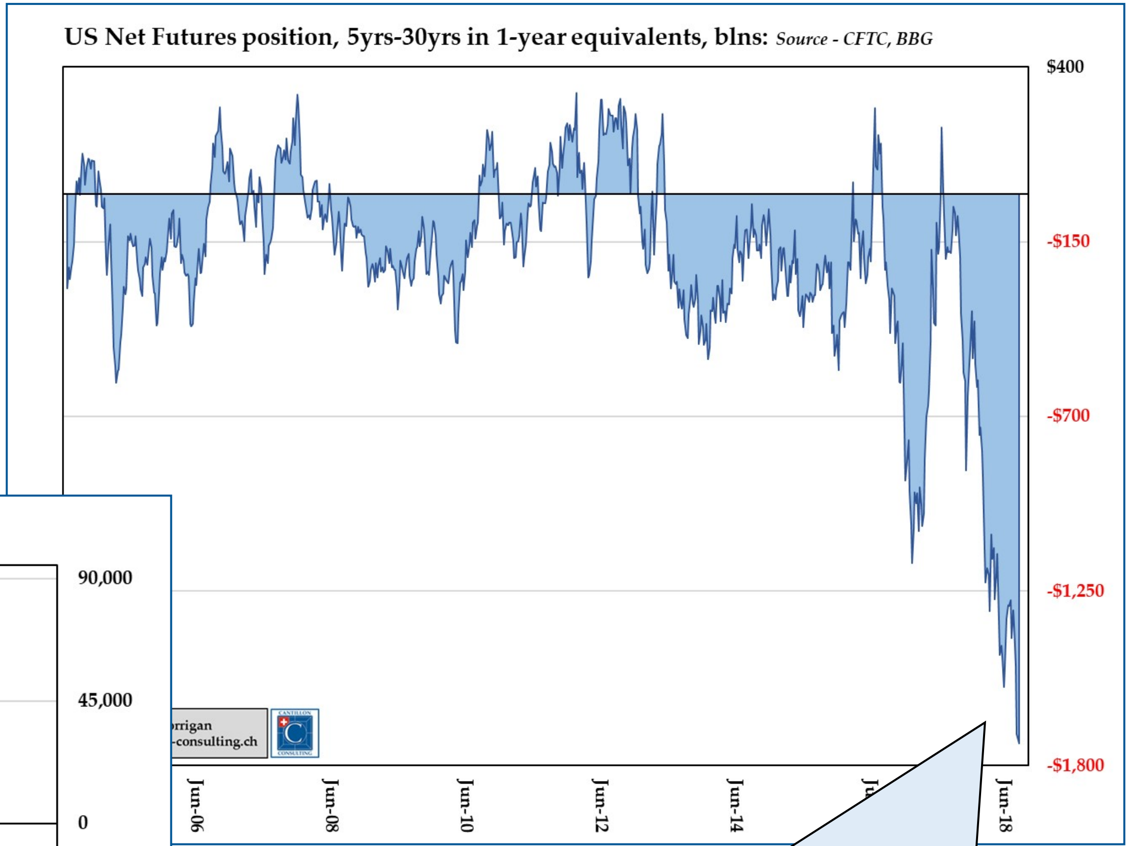
You may be enjoying an Indian Summer here, but don't be tardy in selling out once that happy confluence starts to be dispelled.

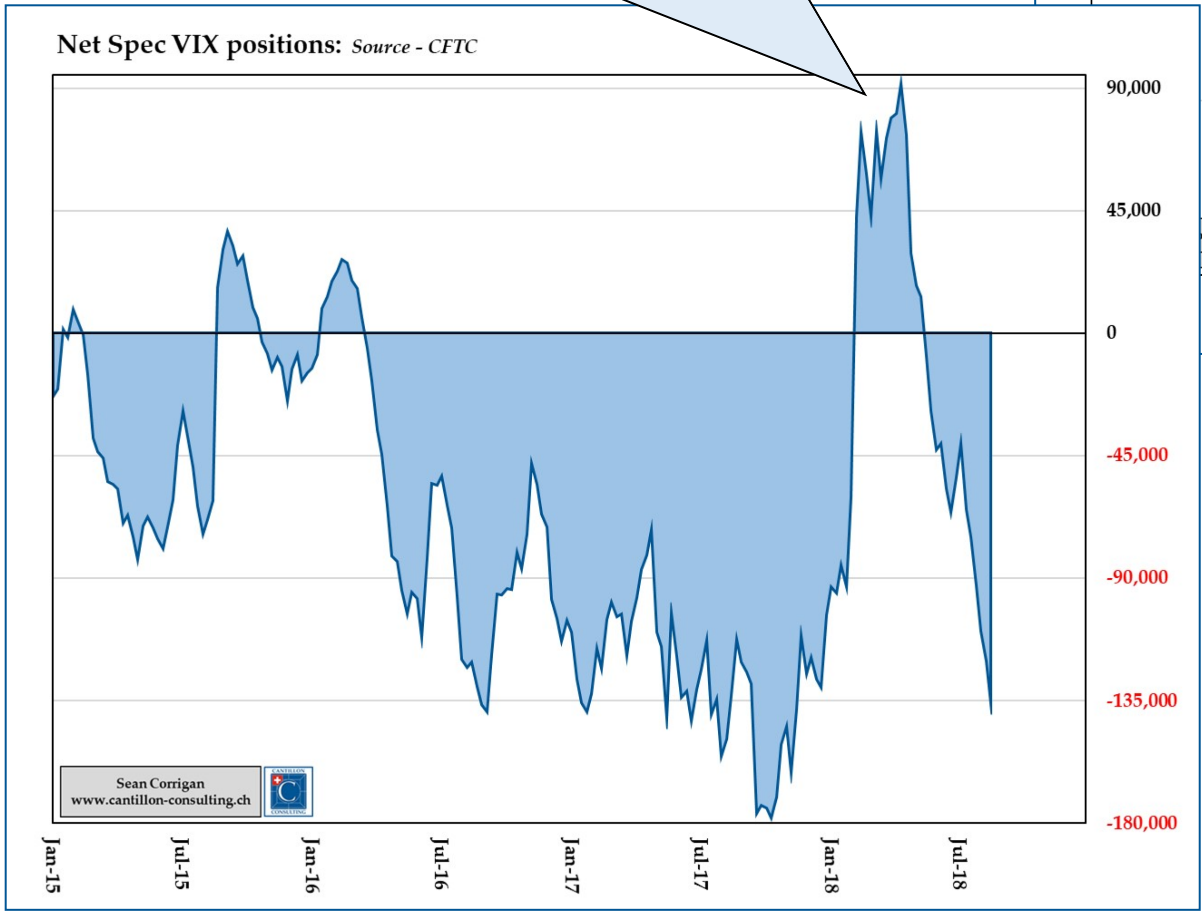


Remember that brief 'Vol-canic' eruption panic, back at the end of the winter?

Well, even third-degree singed digits can heal, it appears. Short VIX positions are now almost as stretched as they were back then.

The whole world is short convexity, one way or another.

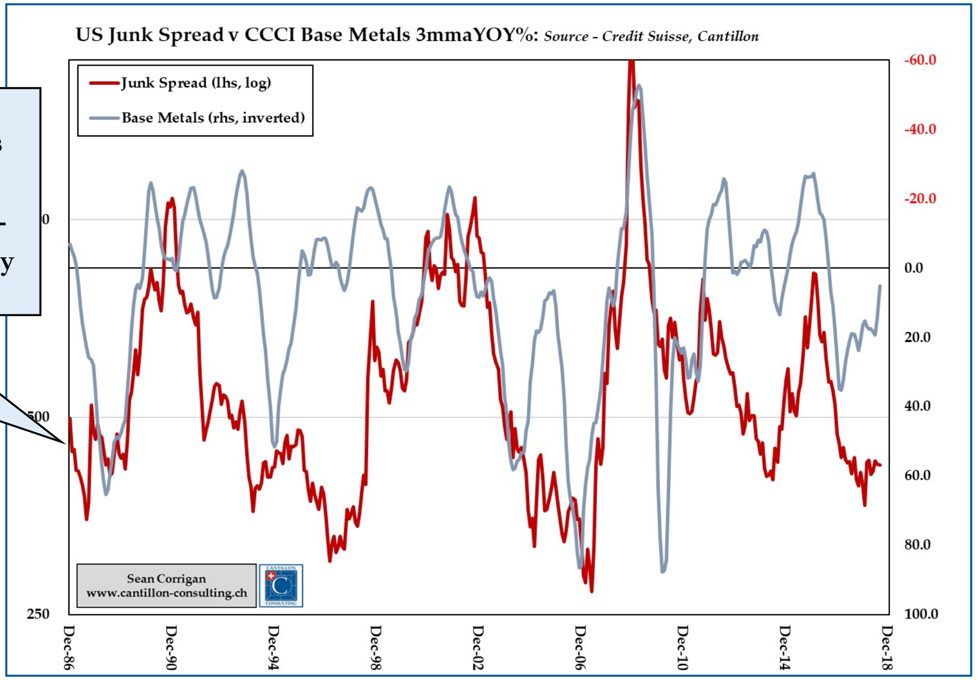


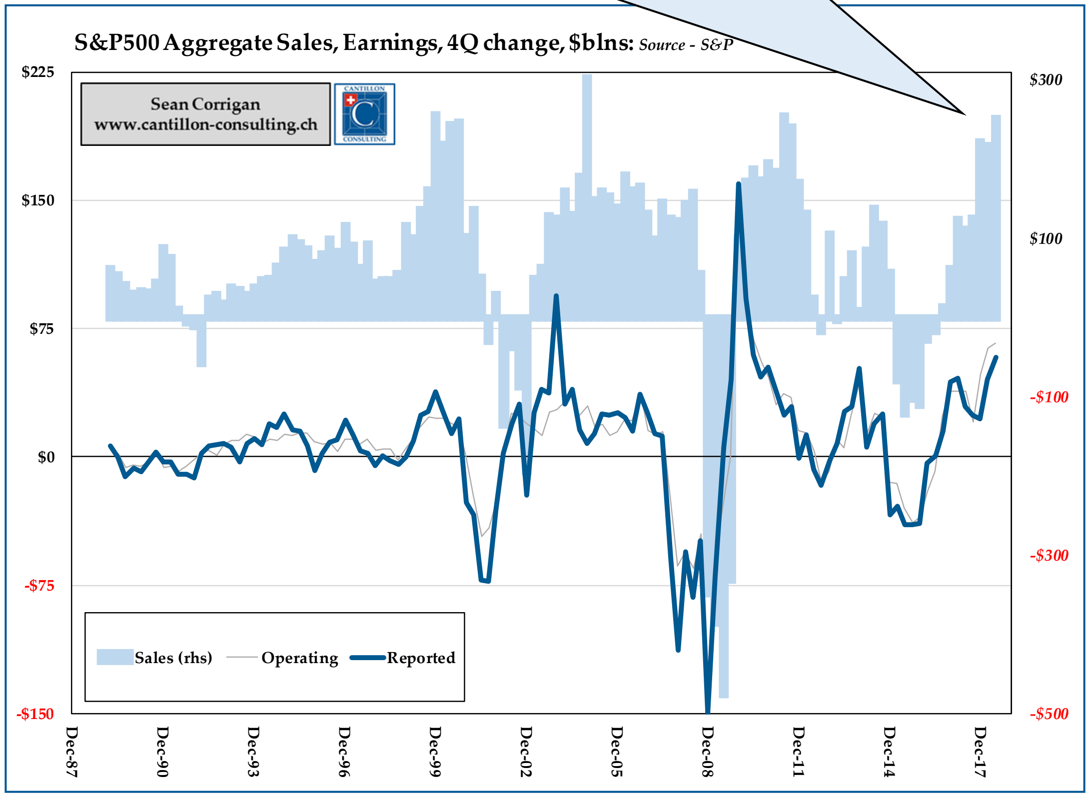


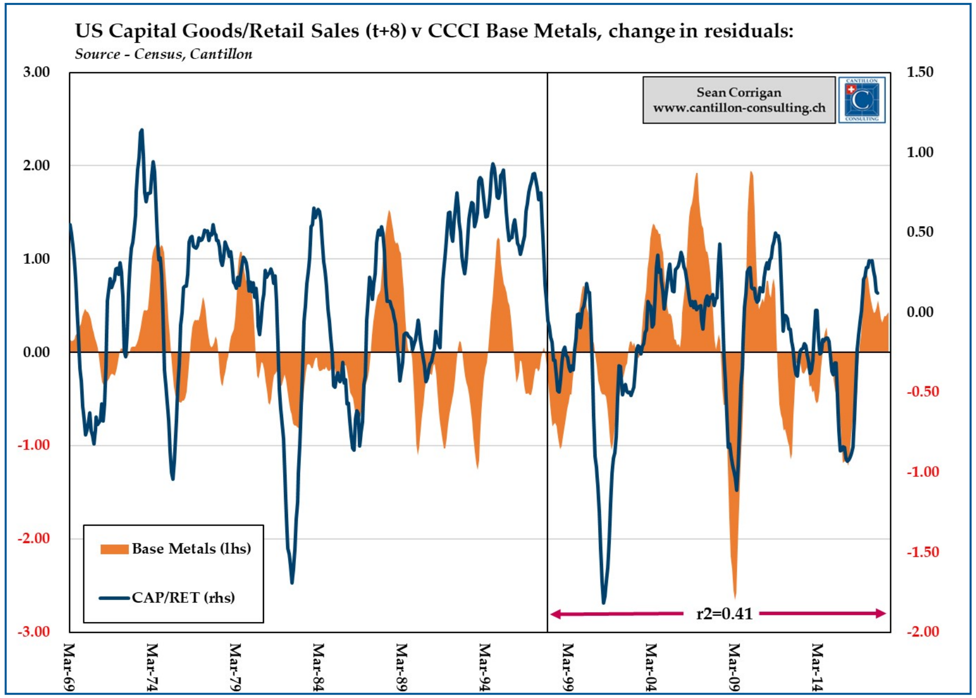
Perhaps some of that complacency with regard to credit is reflected in the fact that its buyers among the leveraged crowd are well short duration via their positions in T-bonds and T-notes. Presumably, the corresponding heavy longs among the asset management community are happy just to pick up yield and watch their pension shortfalls dwindle via higher returns and bigger discount rates.

One thing which might make the antenna twitch is the weakness in industrial metals. This tends to take place under conditions which see credit spreads widen and that movement, in turn, is related to our Austrian conception of 'higher-order' goods' cylicality

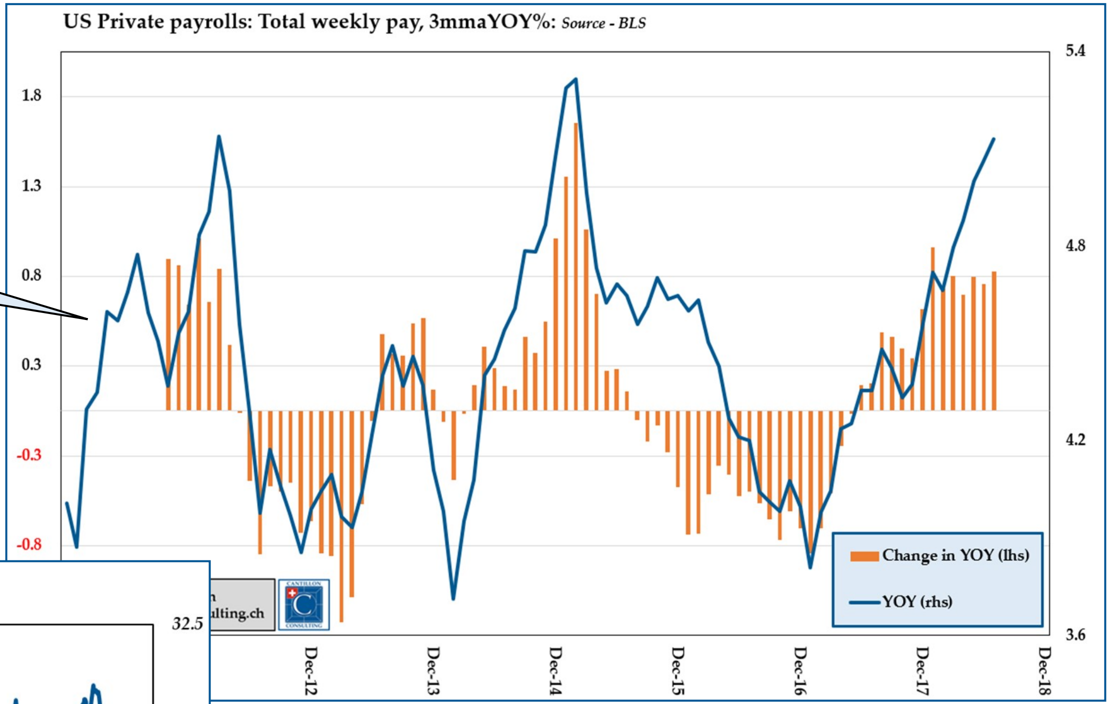
Yet, QII earnings look like they will come in some 25% ahead of the like quarter last year and sales are making close to double-digit gains, something only exceeded a handful of times since the Tech Boom at the turn of the millennium. Hence why credit remains underpinned—*for now*

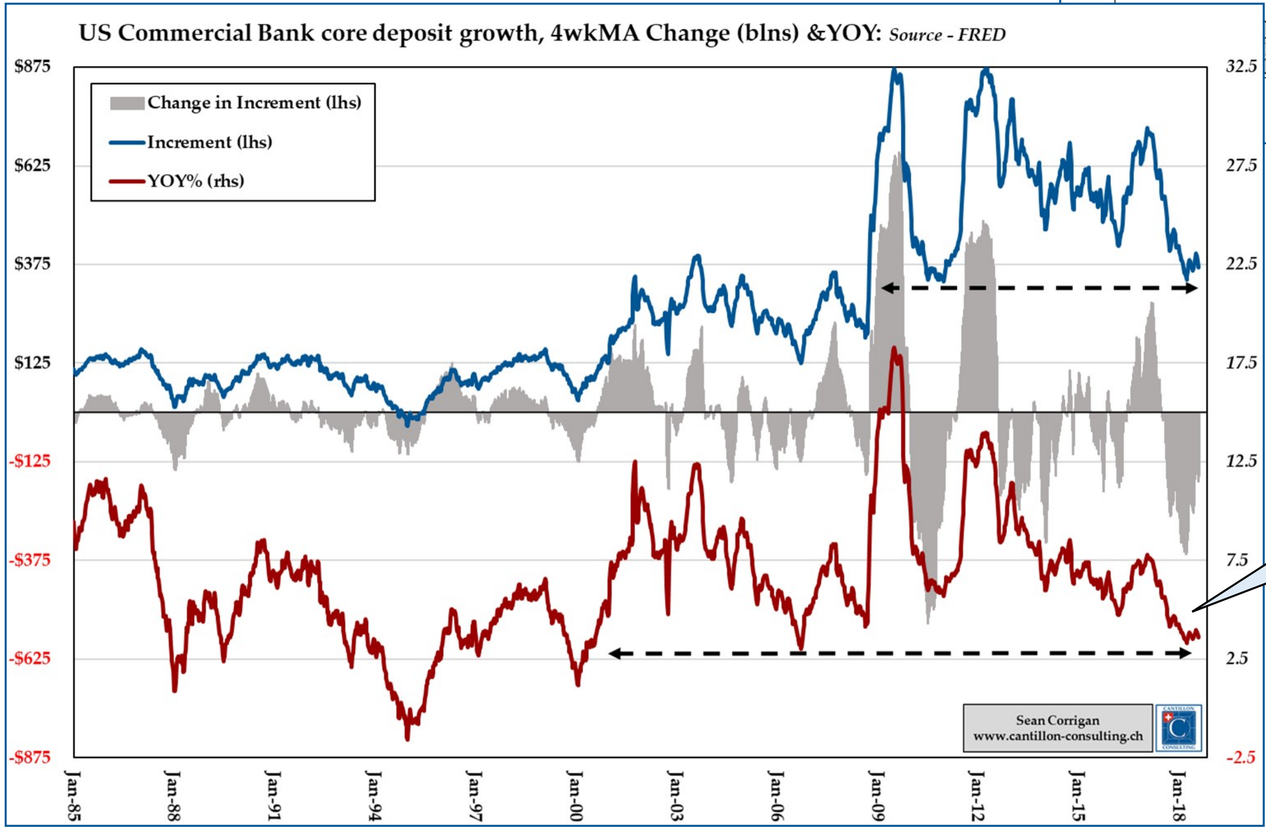






The sort of real-side factor which keeps Fed Chairman Powell in the game...

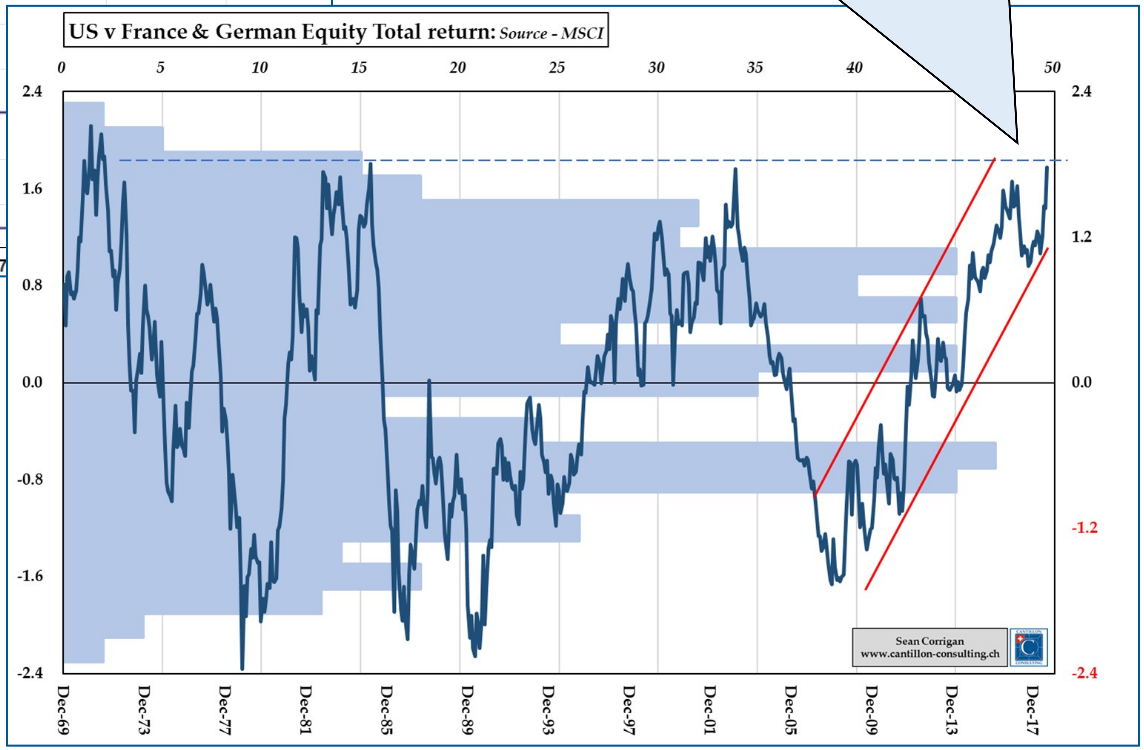




...and the monetary one he seems happy for now to ignore.

Hard to argue with the new highs being made here in the face of all the adverse news from around the world...

...but at some point this well-defined, stationary distribution—which of course, partly reflects currency moves, ought to start to revert to the mean. Earnings trends are unhelpful at the moment; politics, too, but—hey—who knows what Dame Tyche has tucked up her chiton?

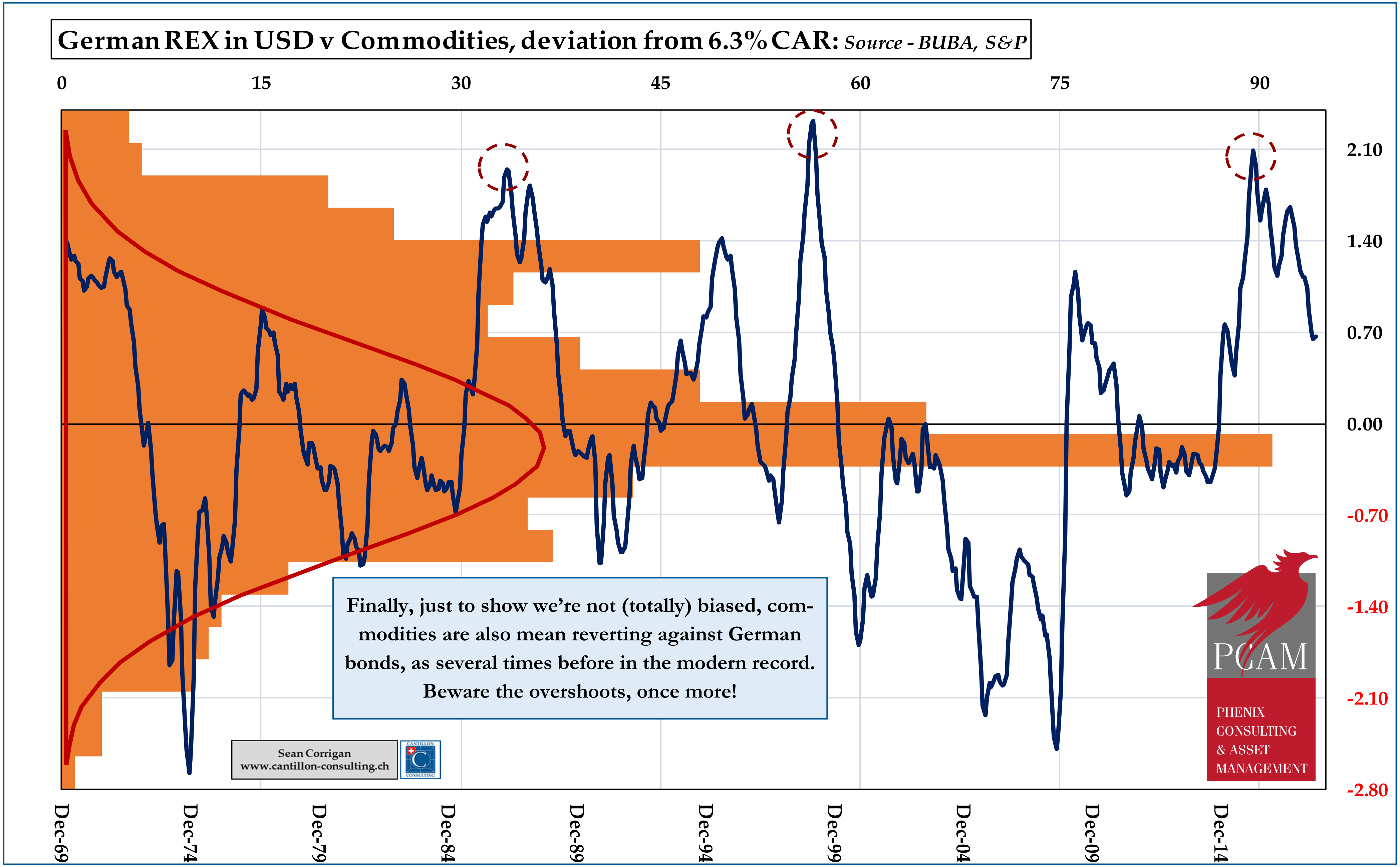



We at Cantillon would like to think rates could continue to make some further token effort at normalization—not least in REAL terms—before the tide finally turns but, given the Managed Money net short of 1,162,168 contracts here, if the H&S neckline gives way, a rally to 2.30/35% would have to be endured first
UST 5-year
Courtesy: TradingView
(52.3)
(51.2)
(45.3)
(42.4)
(34.4)
(33.7)
(28.9)
(23.3)
(16.5)
(12.5)
(5.4)
(5.4)
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020


Not yet an end to the bull market, *per se*, in Crude, but the still-heavy phalanx of longs must be getting stale—and more than a little concerned. With the past year's channel clearly no longer in play, look for a rotation to mid-2015 highs around $60/61 a barrel and watch what happens there
WTI
(107.8)
(95.5)
(76.5)
(66.9)
(57.2)
(38.2)
(26.0)
(66.6)
(60.6)
(51.2)
(46.4)
(41.6)
(32.2)
(26.1)
(75.4)
(71.0)
(64.3)
(60.9)
(57.5)
(50.8)
(46.4)
Courtesy: TradingView
2014
Jun
2015
Jun
2016
Jun
2017
Jun
2018
Jun


Regular readers will know we have been bearish most of the way down this move but the selling excess left behind—plus a record leveraged short—makes us rather fancy a rotation back to the mean at $1240. Tactical only: no goldbugs here!!
GOLD
(1435.1)
(1376.7)
(1286.3)
(1240.3)
(1194.3)
(1103.9)
(1045.5)
Courtesy: TradingView
Jun
2014
Jun
2015
Jun
2016
Jun
2017
Jun
2018
Jun

In the grand scheme of things, the fate of this egregious chancer's company is nether here nor there, but *erwartete Schadenfreude* compels the observation that a break of 280/5 sees mean reversion to 212—and who knows if either company or hysterical CEO could survive THAT!?


German REX in USD v Commodities, deviation from 6.3% CAR: Source - BUBA, S&P
0
15
30
45
60
75
90
2.10
1.40
0.70
0.00
-0.70
-1.40
-2.10
-2.80
Dec-69
Dec-74
Dec-79
Dec-84
Dec-89
Dec-94
Dec-99
Dec-04
Dec-09
Dec-14
Finally, just to show we're not (totally) biased, commodities are also mean reverting against German bonds, as several times before in the modern record. Beware the overshoots, once more!
Sean Corrigan
www.cantillon-consulting.ch
PCAM
PHENIX CONSULTING & ASSET MANAGEMENT

Disclaimer

All content is intended to give general advice only. The investments and instruments mentioned therein are not necessarily suitable for every individual and you should use this information in conjunction with other advice and research to determine its suitability for your own circumstances and risk preferences. The value of all securities and investments, as well as the income derived from them, can fall as well as rise. Your investments August be subject to sudden, often substantial, declines in value which August not be recoverable; others August expire worthless after a specified period. You should not buy any of the securities or other investments mentioned with money you cannot afford to lose. In some cases there August be significant charges which August reduce the value of your investment. You run an extra risk of losing money when you buy shares in certain securities where there is a large difference or 'spread' between the buying price and the selling price, a circumstance which means that, should you sell them immediately, you August get back much less than you paid for them. In the case of investment trusts and certain other funds, these August use or propose to use the borrowing of money in order to increase the size of their exposures and/or invest in other securities with a similar strategy. As a result, movements in the price of the securities August be more volatile than the movements in the prices of those underlying investments. Some investments August involve a high degree of such borrowing (often referred to as 'gearing' or 'leverage') This means that a small movement in the price of the underlying asset August have a disproportionately large effect on that of your investment. Accordingly, a relatively small adverse movement in the price of the underlying asset can result in the loss of the entirety of your original investment. Changes in rates of exchange August have an adverse effect on the value or price of the investment and you should be aware that additional dealing, transaction, and custody charges for certain instruments August result when these are not traded in your home currency. Some investments August not be quoted on a recognised investment exchange and, as a result, you August find them to be 'illiquid'. You August not easily be able to trade your illiquid investments and, in certain circumstances, it August become difficult, if not impossible to sell the investment in a timely manner and/or at its indicative price. Investment in any of the assets mentioned August have tax consequences regarding which you should consult your tax adviser. All reasonable care has been taken to ensure that all statements of fact and opinion contained in the either written or spoken form are fair and accurate in all material respects. All data is from sources considered to be reliable but its accuracy cannot be guaranteed. Investors should seek appropriate professional advice if any points are unclear.