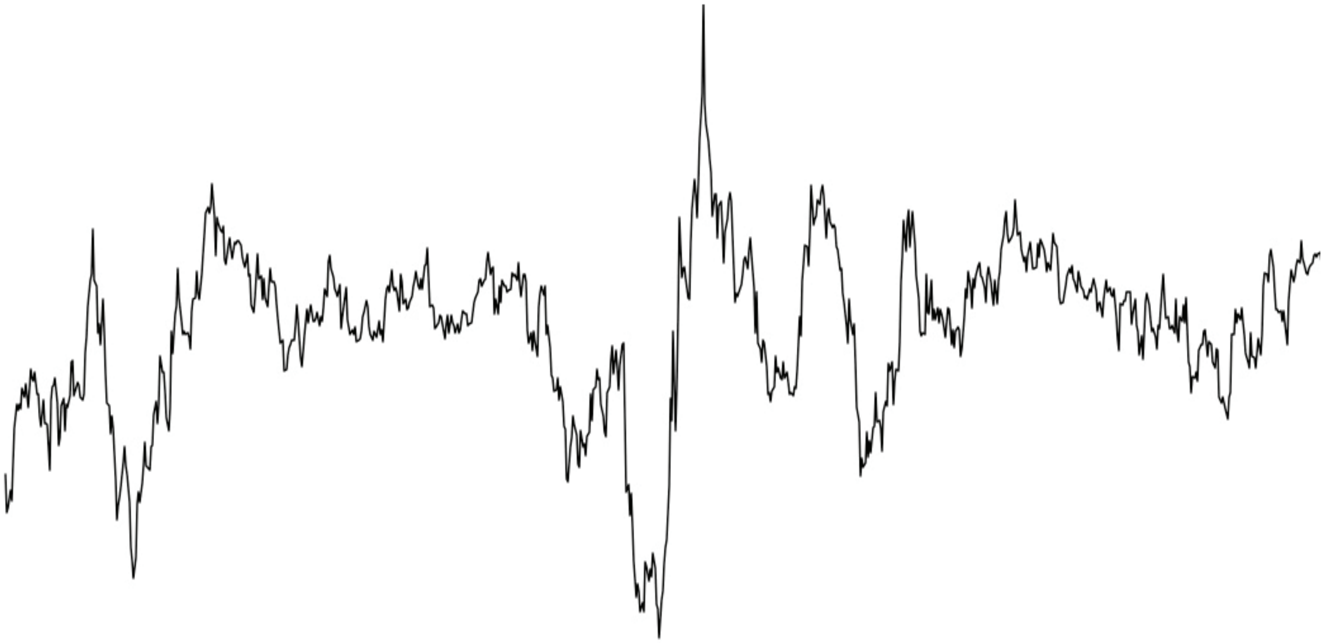
ALPHA SOURCES

JANUARY 7, 2019



IS IT OVER YET?

The new year has started like the old one ended; volatile and with confusion among punters and analysts with respect to the notional Narrative™. The volte-face in expectations for U.S. interest rates is a good example. In October, eurodollars were implying a Fed funds rate of just under 3.3% in December 2019 and 2020. At the beginning of the year, they had collapsed to 2.6% and 2.4%, respectively, effectively pricing in an imminent recession, and Fed rate cuts in 2020 to counteract that. Indeed, at some point, the Fed fund futures were even pricing cuts *this year*, a position that was stung badly on Friday by the hilariously bullish NFP report.

Although neither the Fed nor markets know where the terminal/neutral rate—not to mention that this is a moving target—I reckon that the past six months have given us a decent clue. Anything close to 3.5% probably is too high, while sub-2.5% is too low, at least as long as the economy remains in a more-or-less stable expansion.

Looking beyond the navel-gazing that is U.S. monetary policy, I am warming to the idea that (equity) markets will pivot towards cyclicals at some point this year, but we are not there yet. Over Christmas, I toyed with the idea that the next shoe to drop would be a downturn in the (hard) global economic data.

* / See additional charts on final page.

** / Data for charts are sourced from FRED, OECD, Eurostat, IMF, BIS, Market Watch, Yahoo/Google Finance, COT, Bloomberg, Investing.com or Quandl, unless otherwise stated.

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The numbers have already deteriorated, but I reckon that they could slip further. The first chart below shows that the CBP's global industrial production index was rising just under 3% year-over-year at the start of Q4, but my diffusion of leading indicators suggest that growth will fall further in coming months.

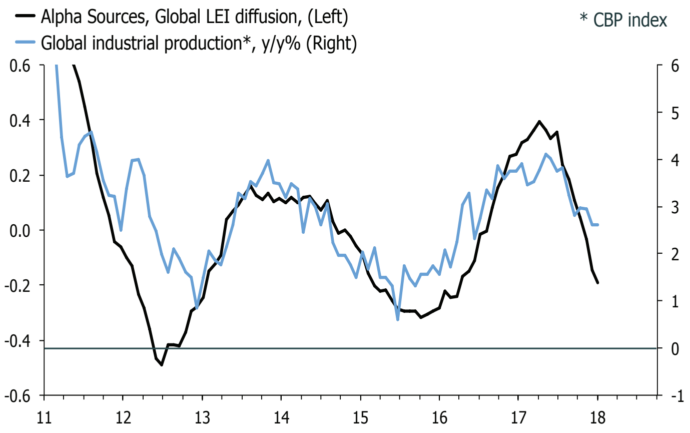
Data in Europe and EMs already have rolled over, so the key in the short run is the U.S. Here, I think last week's downbeat ISM is more important than the employment report, but don't let that get in the way of a good story. Just to be clear, though, I call dibs on revisions being the key story next month.

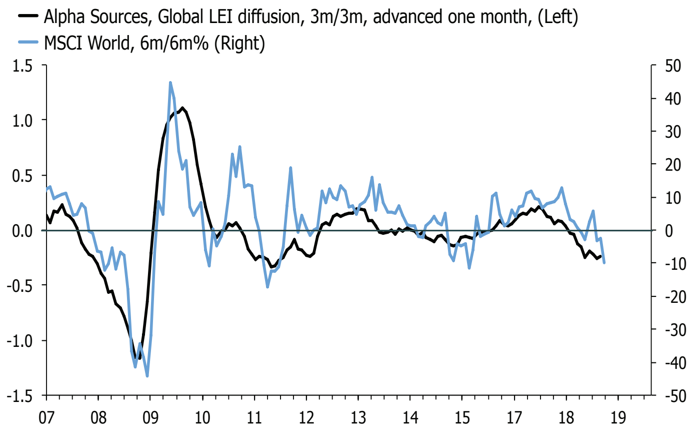
In any case, all the hard data will tell us in the next few weeks is whether growth slowed further in *Q4*, which is why the incoming Q1 survey data will be at least as important. The same is the case for the next earnings reports. Anyone not living under a rock will, by now, have incorporated a significant slowdown in *growth*, but the question is whether expectations have come down enough for the big bellwethers to "surprise" to the upside, I have my doubts.

The upshot amid all the gloom is that the last few months have been astonishingly poor, even by historical standards. In other words; a lot of pain has already been priced-in. My final chart plots the change in my leading indicator alongside the six-month return of the MSCI World. According to that view, the downside to equities is limited, though as I have showed recently, the message from global liquidity indicators remains uniformly bearish across the board.

I am fine with the idea that equities put in a good January after the horrible Q4, but beyond that, I can't get excited until we see a more meaningful pickup in global liquidity and money growth. My sense is that policymakers are edging towards a response, especially in China were the recent RRR cut is a statement of intent. But they won't be donning the bazookas anytime soon. Pausing the hiking cycle and QT is the best we can hope for in the U.S. And in Europe and Japan, I also see a high bar for anything approximating additional easing at this point; they'll simply *not tighten*, much.

fig. 01 / Global growth is rolling over... — fig. 02 / ...But have equities already priced it in?





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