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Newsclips/Daily Commentary

February 8th, 2016

Oil Capitulation Talk?

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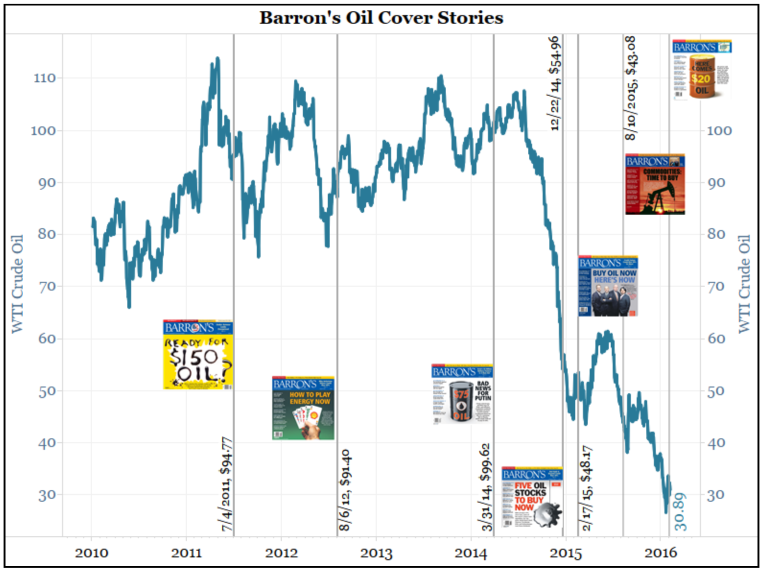
- Barron's - Here Comes $20 Oil **Oil could fall as low as $20 a barrel in the first half of this year, recovering to $55 by year end. That could help drive stocks, which have closely followed oil prices, much higher.** Oil bulls, take heart. The last leg of the bear market that began in mid-2014 is probably in sight, as marginal producers fall by the wayside. Supply cutbacks should bring a rebound in the price of crude by the second half of 2016. But before a rebound, West Texas Intermediate crude will probably continue to fall, perhaps as low as $20 a barrel, before vaulting to the mid-$50s by year end. Stock market investors can also take heart. The stock indexes have been closely correlated with oil of late, moving up or (mostly) down, as the price of crude has gyrated. This perverse pattern has persisted even though the overwhelming majority of global companies benefit from cheaper crude, since they buy the refined products to help run their operations.
- Bloomberg.com - World's Largest Energy Trader Sees a Decade of Low Oil Prices Oil prices will stay low for as long as 10 years as Chinese economic growth slows and the U.S. shale industry acts as a cap on any rally, according to the world’s largest independent oil-trading house. "It’s hard to see a dramatic price increase," Vitol Group BV Chief Executive Officer Ian Taylor told Bloomberg in an interview, saying prices were likely to bounce around a band with a midpoint of $50 a barrel for the next decade. "We really do imagine a band,” probably between $40 and $60 a barrel, he said. "I can see that band lasting for five to ten years. I think it’s fundamentally different."..."You have to believe that there is a possibility that you will not necessarily go back above $100, you know, ever," he said. The problem is that "there is so much more supply" while the global economy is more efficient in consuming crude. On top of that, Iran is returning to the market and growth in emerging markets, the biggest engine of oil demand, is slowing.

Comment

Here is a short history of Barron's covers on oil:

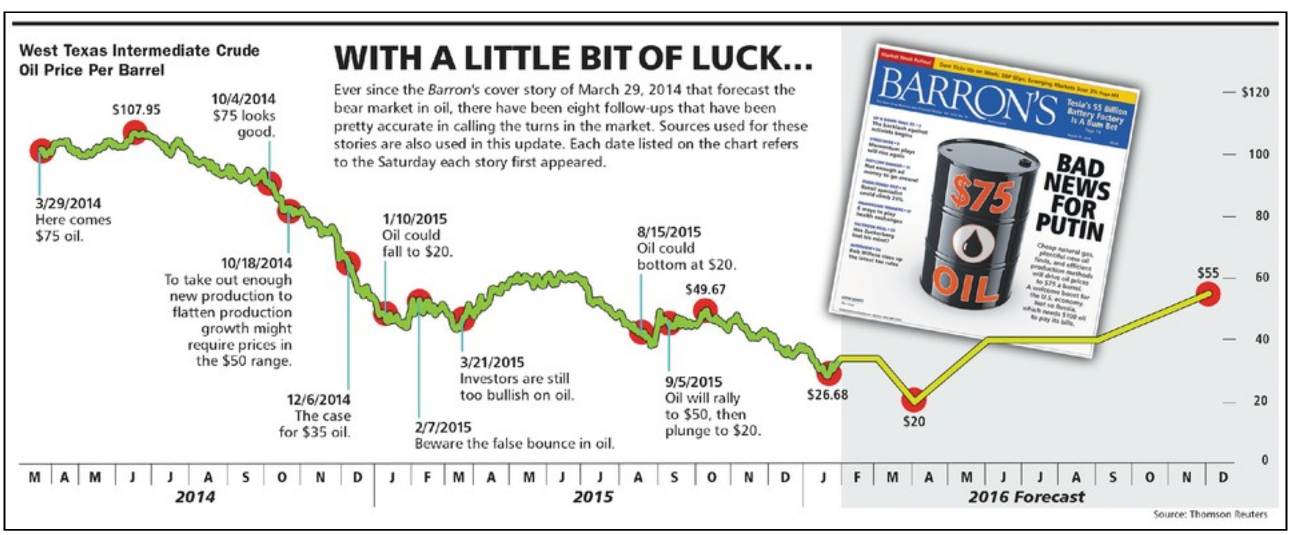


<Click on chart for larger image>

<Click on any cover for larger image and story>

Note that Barron's record on cover story calls has been similar to the general public's. They have been bullish throughout one of the largest declines in history. Given this, today's $20 cover smacks as a contrarian low.

Barron's highlights their correct bearish call in the graphic below while ignoring all the incorrect bullish covers.



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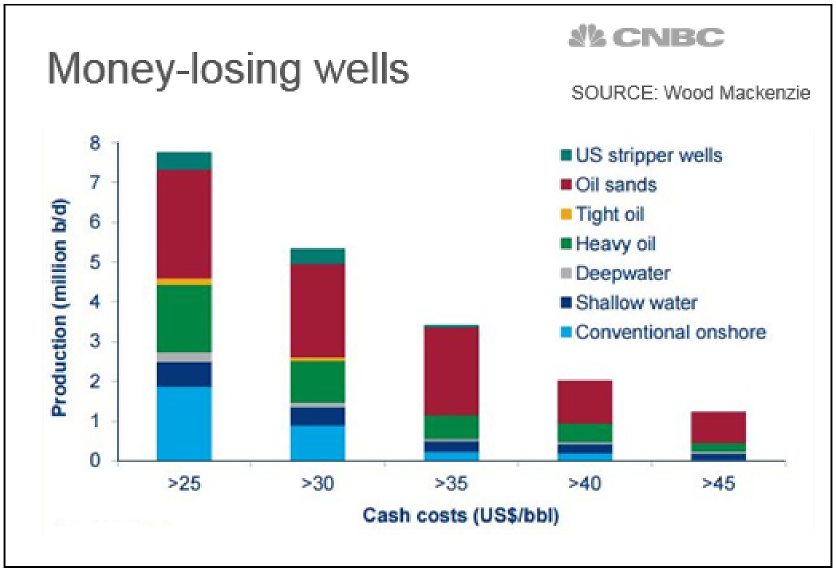
- Bloomberg.com - Citi: 'We Should All Fear Oilmageddon' **A feedback loop of the U.S. dollar, crude, capital flows, and emerging markets.** Markets are currently in a well-oiled "death spiral," according to Citigroup Inc. analysts led by Jonathan Stubbs. "It appears that four inter-linked phenomena are driving a negative feedback loop in the global economy and across financial markets," the analysts write, citing the resilient U.S. dollar, lower commodities prices, weaker trade and capital flows, and declining emerging market growth. "It seems reasonable to assume that another year of extreme moves in U.S. dollar (higher) and oil/commodity prices (lower) would likely continue to drive this negative feedback loop and make it very difficult for policy makers in emerging markets and developing markets to fight disinflationary forces and intercept downside risks," the analysts add. "Corporate profits and equity markets would also likely suffer further downside risk in this scenario of Oilmageddon."

Crude Oil Supply/Demand



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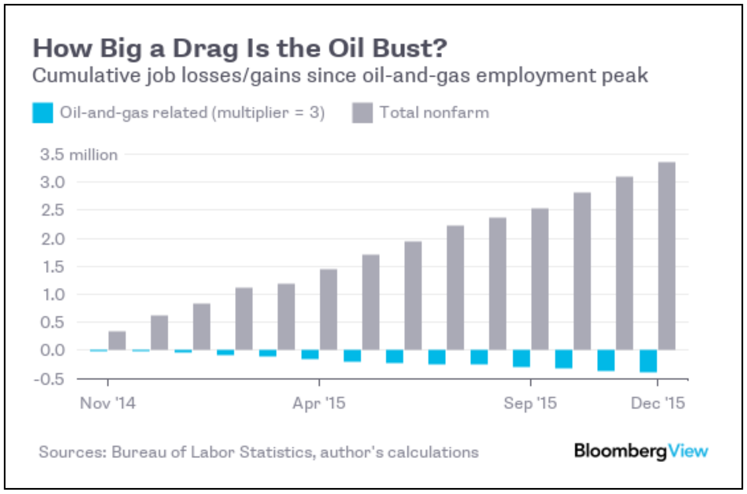
- CNBC - Producers keep pumping, even with oil prices falling When a commodity costs more to produce than the current market price, producers usually stop producing it. When it comes to U.S. crude oil, that's not happening, according to an analysis of global oil production by Wood Mackenzie, a commodities market research firm. The oil glut continues to weigh on crude prices, but the decision to stop pumping when prices fall is not as simple as it may seem. For starters, the cost of producing a barrel of oil varies widely from one well to another, based on the initial cost of finding and developing the oilfield, along with such costs as borrowing, current operations and maintenance. Some of the recent expansion of U.S. crude production, for example, has come from so-called "stripper" wells — once abandoned finds that are seeing new life thanks to advanced production techniques. Many of these are profitable even at current market prices. But at $35 a barrel, roughly 3.5 million barrels a day of current global crude output costs more to pull out of the ground than it's worth, according to Wood Mackenzie's analysis. So why do the operators of those wells keep pumping? "The operator's first response is usually to store production in the hope that the oil can be sold when the price recovers," said Wood Mackenzie analyst Robert Plummer.



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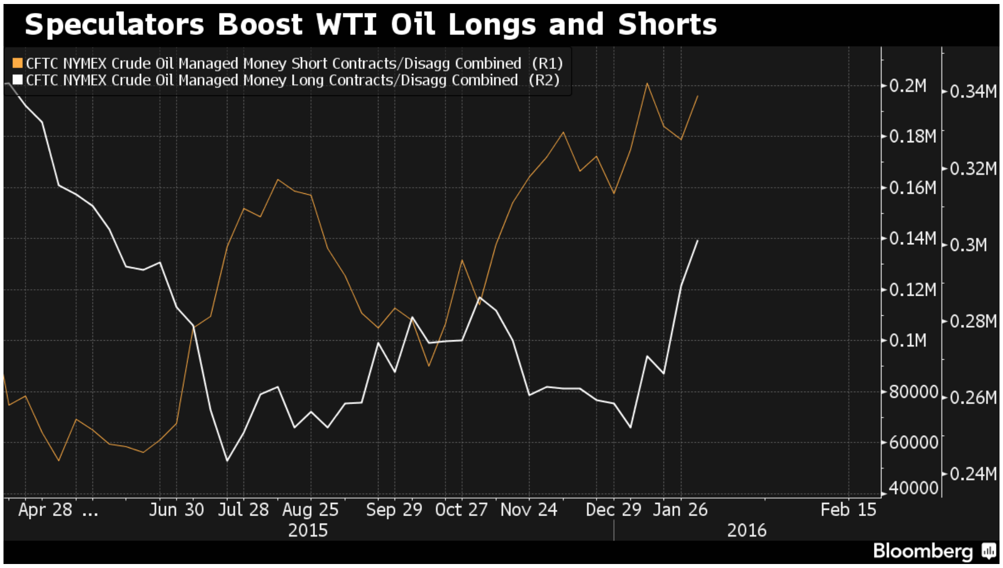
- Bloomberg Business - How Much Oil Output Halted Due to Low Prices? Just 0.1% After a year of low oil prices, only 0.1 percent of global production has been curtailed because it's unprofitable, according to a report from consultants Wood Mackenzie Ltd. that highlights the industry's resilience. The analysis, published ahead of an annual oil-industry gathering in London next week, suggests that oil prices will need to drop even more -- or stay low for a lot longer -- to meaningfully reduce global production. OPEC and major oil companies like BP Plc and Occidental Petroleum Corp. are betting that low oil prices will drive production down, eventually lifting prices. That's taking longer than expected, in part due to the resilience of the U.S. shale industry and slumping currencies in oil-rich countries, which have lowered production costs in nations from Russia to Brazil. The Wood Mackenzie analysis provides an estimate for the amount directly impacted by low prices -- to the tune of 100,000 barrels a day since the beginning of 2015 -- rather than output affected as new projects build up and aging fields decline. Canada, the U.S. and the North Sea have been affected the most by closures related to low prices.
- Bloomberg.com - Lost Oil Jobs Are a Drag Still, the charts at least give a rough sense of the jobs impact of the oil-and-gas boom and bust. In the early months of the recovery in 2010, the industry appears to have played a significant role in keeping the economy going. Through September 2010 it had accounted for 17 percent of the cumulative job gains (that's including the multiplier) since overall employment began growing in March of that year; through July 2011 that share was still 15 percent. Since then, though, its impact has been much more modest on both the upside and the downside. It could be that the oil-and-gas industry's troubles will affect the economy in some other way. Oil-and-gas producers sold lots of high-yield bonds to finance their drilling, and there are those who worry that a wave of bond defaults could bring a credit crunch. And of course oil-and-gas employment is extremely important to some local economies. On a national scale, though, oil-and-gas employment looks like it's big enough to matter, but not big enough to determine the economy's fate.

Betting On Crude



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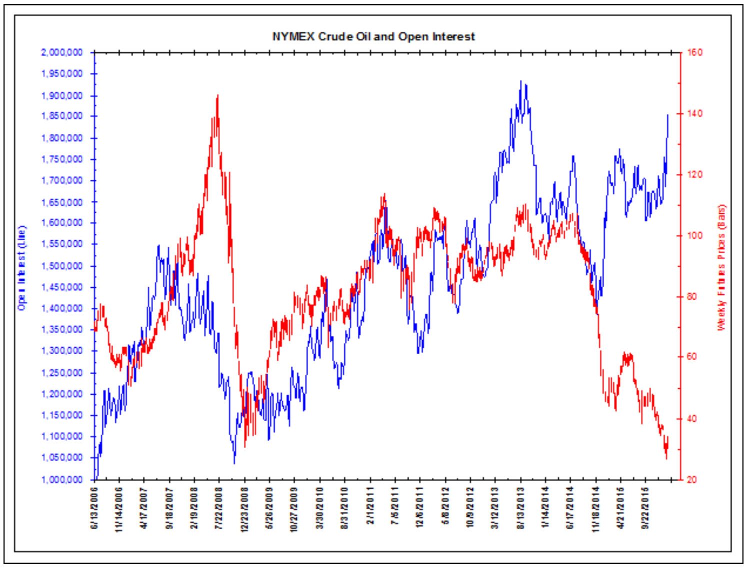
- Bloomberg.com - A Record Number of Investors Are Piling Into Oil Money managers may not agree where oil prices are headed, but they are increasingly eager to place their bets. Total wagers on the price of crude climbed to the highest since the U.S. Commodity Futures Trading Commission began tracking the data in 2006. Speculators' combined short and long positions in West Texas Intermediate crude, the U.S. benchmark, rose to 497,280 futures and options contracts in the week ended Feb. 2...“This is a reflection of a lot of conviction on both sides,” said John Kilduff, a partner at Again Capital LLC, a New York-based hedge fund that focuses on energy. “We're seeing a battle royal between those who think a bottom has been put in and those who think we have lower to go.”

Comment

The story above highlights the combined long and short positions of money managers in WTI crude oil. Total open interest, which also includes the open contracts of producers, swap dealers and other reportables, is shown in blue in the chart below. Total open interest in WTI crude futures has rocketed higher in the past few weeks, although it is still a bit off the high set in August 2013. Regardless of which measure you prefer, the message is largely the same. Bets on crude prices are reaching a fever pitch.



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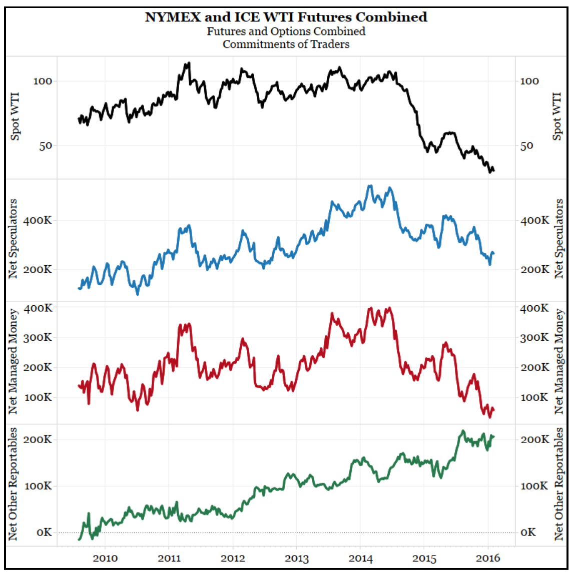

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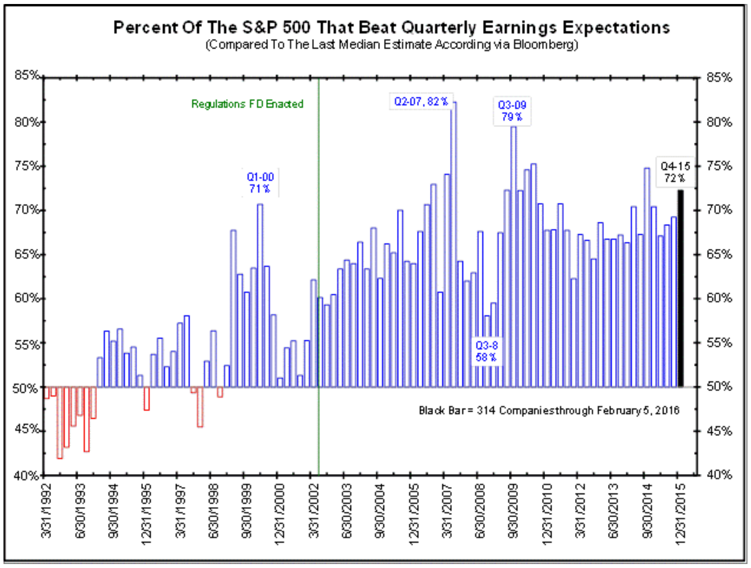
An Earnings Update

- CNBC - America's earnings recession deepens Corporate America, we have a problem. The fourth quarter of 2015 looks to be the third straight quarter in which S&P 500 companies' profits fell versus the year prior. This would be the first time this has happened since 2009 (when profits fell in Q1, Q2 and Q3). The official numbers aren't out yet, since not every S&P 500 company has reported results for the period. However, a combination of the results from the first 63 percent that have reported, and the expected results from those companies yet to report, yields a combined earnings decline of 3.8 percent, according to FactSet. (Note that this number should rise a bit as results are released, as the average company beats expectations.) To be sure, the low-oil-plagued energy sector, and its 74 percent earnings decline, has been a big contributor to the overall drop. But it's worth noting that six of the ten S&P 500 sectors are seeing their earnings fall compared with fourth quarter of 2014.

Comment

Through Friday, 314 of the 500 of the S&P 500 companies have reported Q4 2015 earnings. As the black bar in the first chart below shows, the current Q4 earnings beat rate is above that of recent quarters. The second chart shows the Q4 revenue beat rate is below the average of recent quarters.



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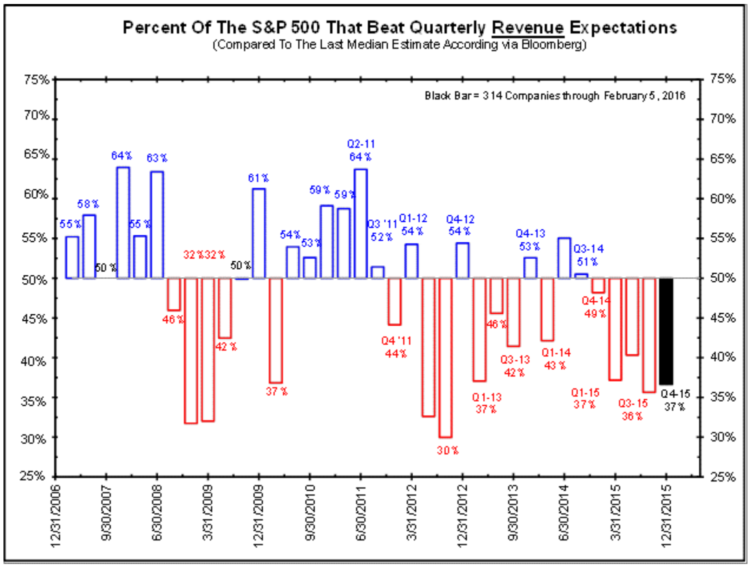

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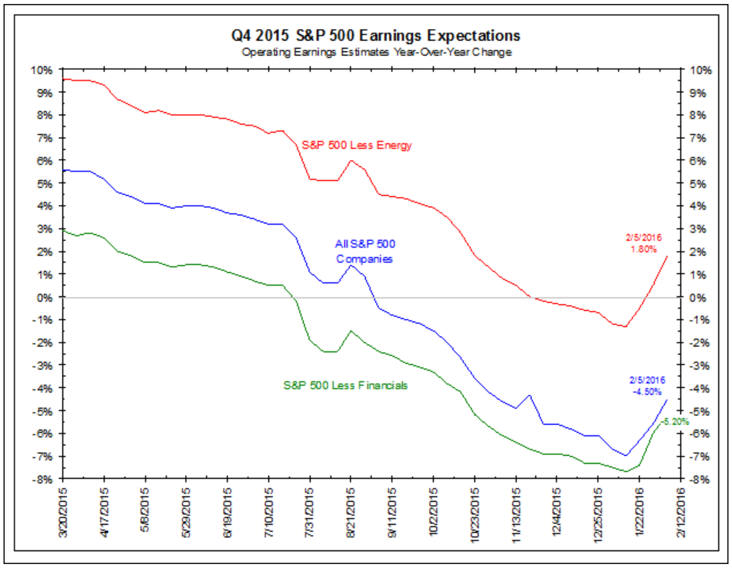
The next set of charts show forecasted earnings and revenues for Q4 2015, Q1 2016 and 2016. Quite simply, Q4 is not expected to be good. Note that these charts combine the results of the 314 companies that have already reported to the 186 median forecasts for those that have not reported.

The Q1 and all 2016 earnings and revenues charts are being marked down hard. A few weeks ago 2016 forecasts were much more optimistic. If history is any indicator, these forecasts will likely be reduced even further.



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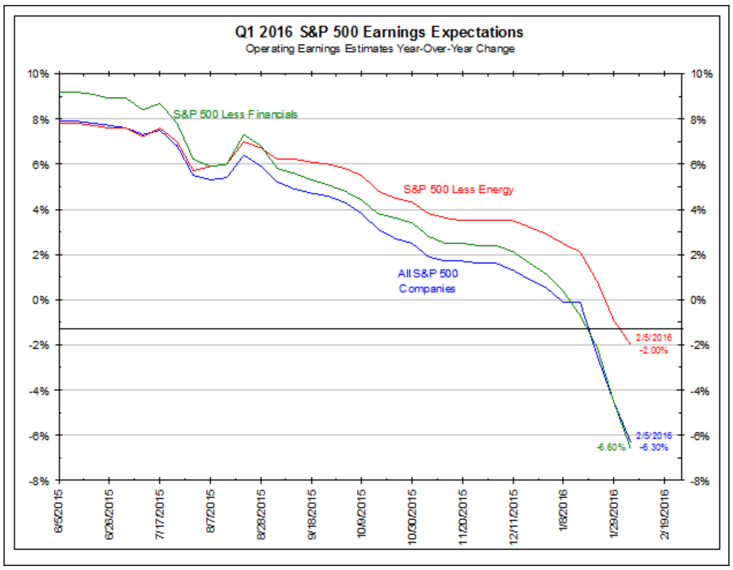

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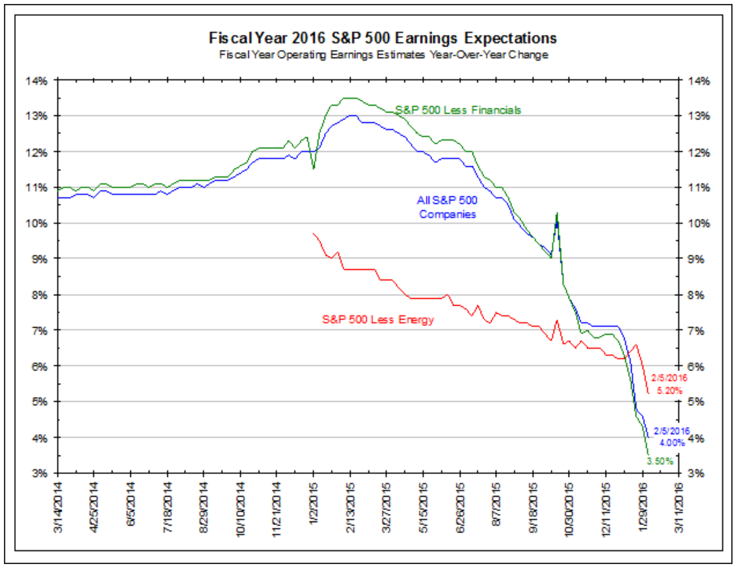

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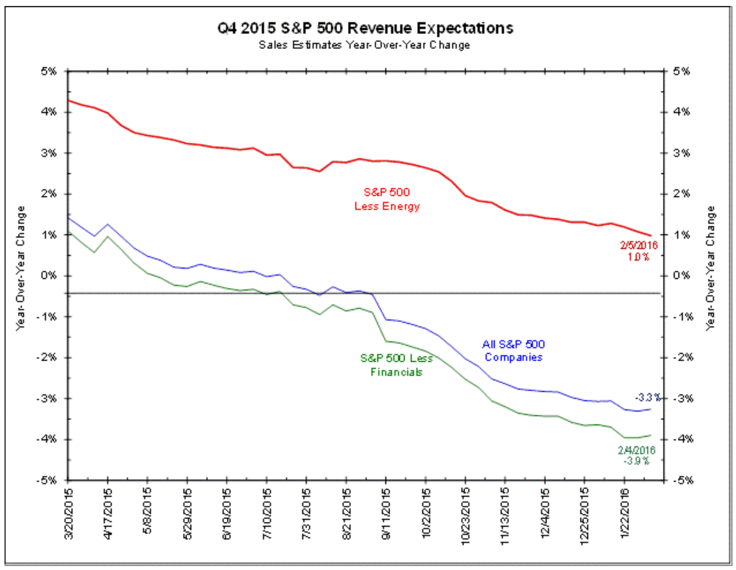

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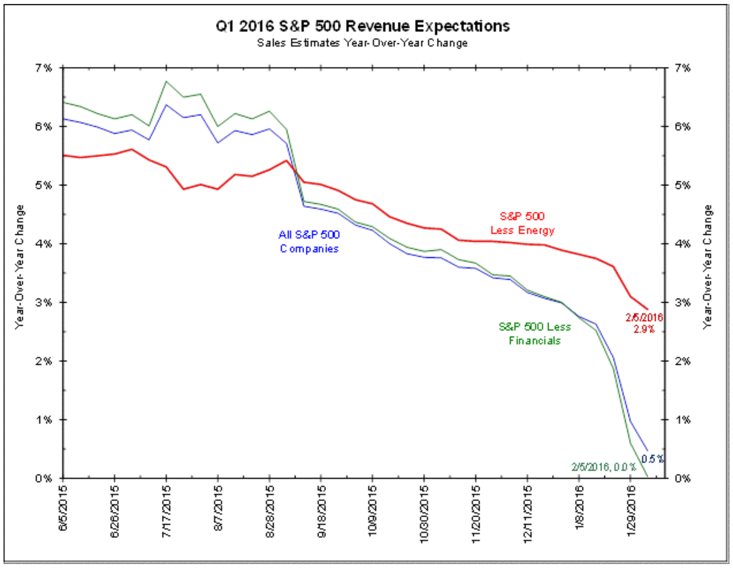

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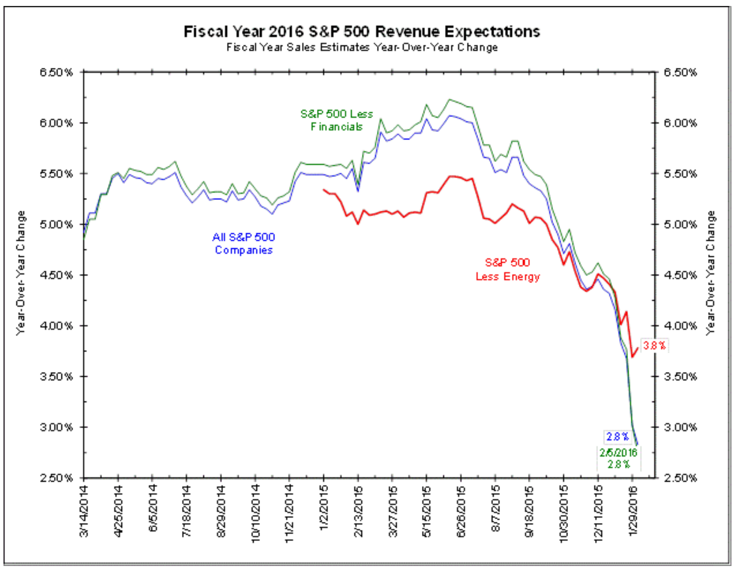

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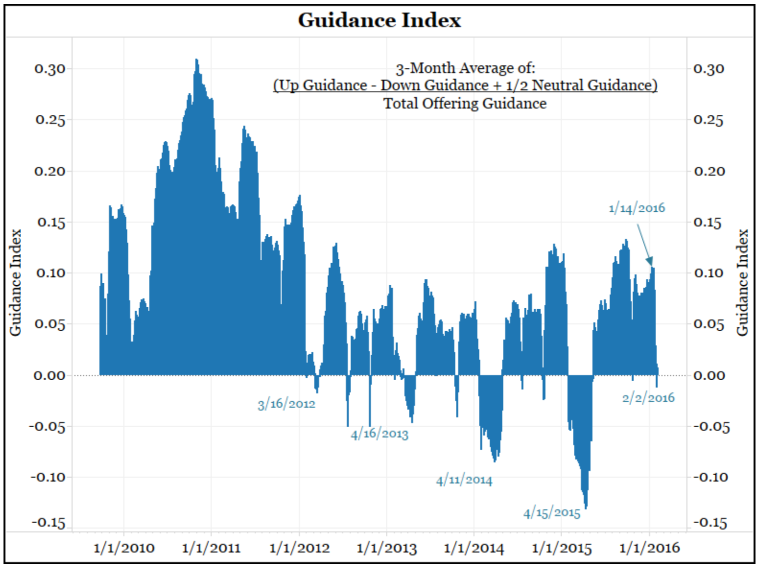
The final two charts below detail the trends in company guidance. The first chart shows the Guidance Index. Its construction is noted on the chart. It is a rolling 3-month average as the typical company offers guidance once a quarter. The second chart notes the trends used in constructing the Guidance Index. Note the seasonal pattern that is emerging in the Guidance Index. After a strong period in January (reflecting guidance with Q4 results), the spring guidance around April (reflecting guidance with Q1 results) is not that good and the Guidance Index turns negative. As the second chart shows, negative guidance (red line) spikes in the spring. Why is this? Does the optimism that comes with the beginning of the year give way to reality by spring? Are companies talking up their stock options during bonus season to maximize personal profits? Is this all a coincidence? Whatever the reason, the Guidance Index is likely to turn lower if this seasonal trend holds. The big markdown in 2016 forecasts above suggests this is already unfolding.



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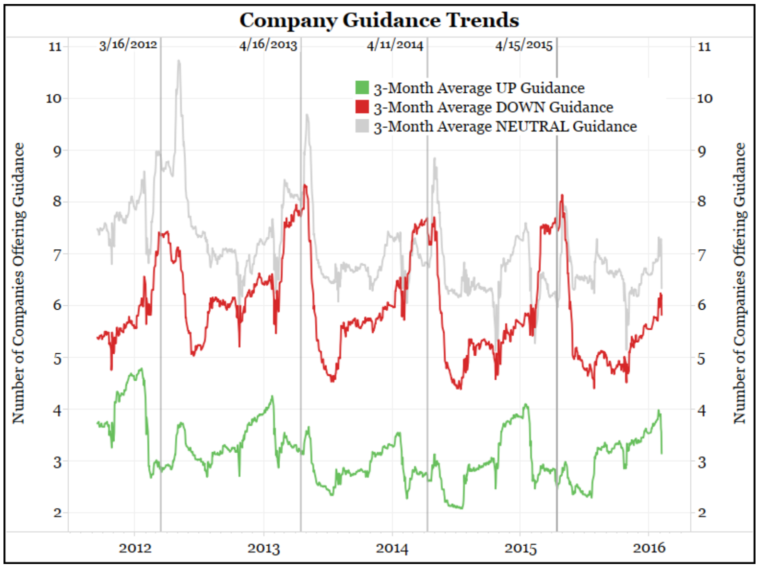

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Did Rubio Blow It Saturday Night?

- Bloomberg.com - Rubio's Stumble Opens Door to Underdogs in Final New Hampshire Sprint **The Florida senator's poor performance in Saturday night's Republican debate has energized his rivals.** The final weekend before New Hampshire's first-in-the-nation presidential primary was a steady one for long-time front-runners Donald Trump and Bernie Sanders. But a trio of governors who need strong showings Tuesday to revive their campaigns have one big reason to feel bullish: Marco Rubio. The Florida senator, who surged to second place in polls after a coming in third in the Iowa caucuses, spent Sunday trying to extinguish a political brushfire after he delivered the same canned answer three times within a matter of minutes at Saturday's presidential debate. Standing to gain most would appear to be New Jersey Governor Chris Christie, who initiated the line of questioning that stumped Rubio and who has held more New Hampshire events than any other Republican, according to a tally from the New England Cable Network.

Comment

As we detailed last month:

> We view election betting markets as real-time polls. They aggregate all known information (or consensus thinking) in a format that can instantly change to new information. Poll aggregation does the same thing, but takes more time and effort. We do not view election betting as having a special ability to predict the future, but it can tell us which events matter and which events do not.

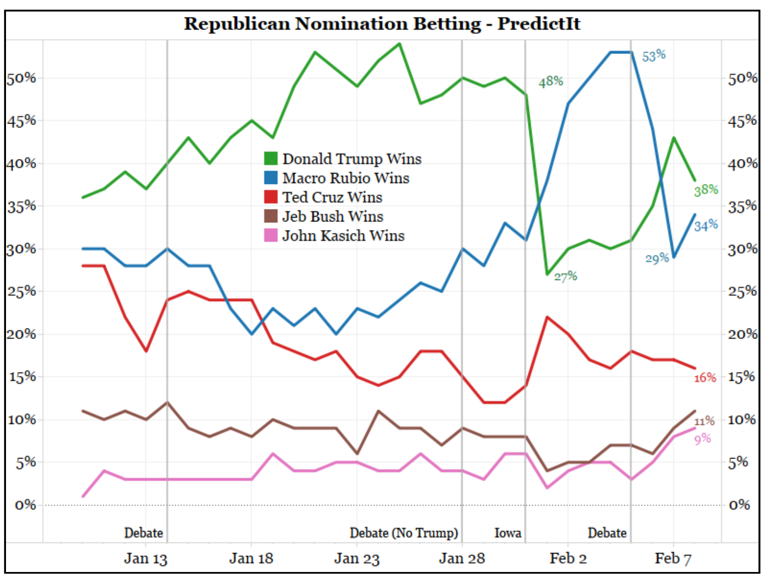
Note this does not mean the markets will always be correct. These markets simply represent what everyone thinks at a given moment.

The chart below offers a good example of using these political markets to see what the consensus thinks. Saturday night the Republicans had a debate. As the story above points out, Marco Rubio was not perceived to have done well. The betting markets support this idea.

First, note how much Donald Trump's odds (green) dove in the wake of his second place finish in the Iowa caucus. Rubio's odds (blue) were the main beneficiary.

In the wake of Saturday's debate, Rubio's odds fell from 53% to 29% in less than 24 hours. Trump was the main beneficiary, but the other two "establishment candidates," Bush (brown) and Kasich (pink), also benefited.

While not shown, the betting on the New Hampshire primary is also interesting. Trump is trading 89% to win. There is also a market for the New Hampshire runner-up. Rubio is trading 37%, Kasich 34%, Cruz 16% and Bush 14%. Many believe Rubio needs a second place finish in New Hampshire or his candidacy takes a big hit. According to these markets, however, Kasich has a real chance to finish second.



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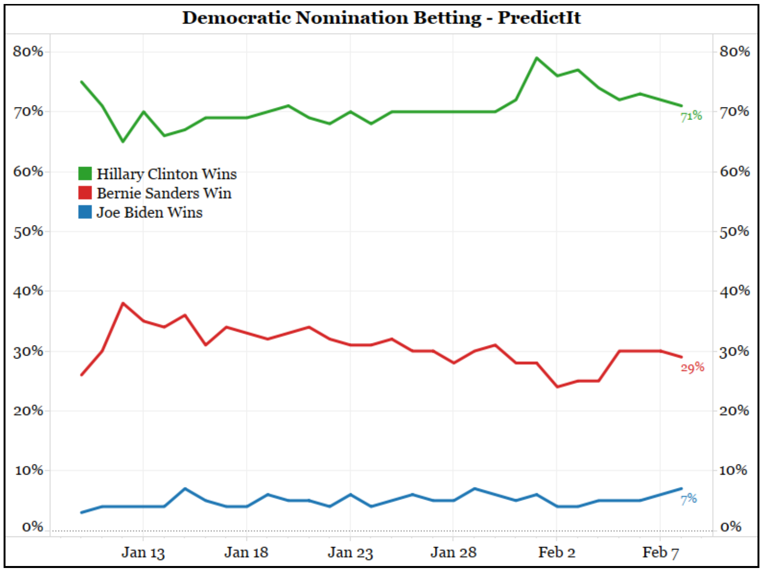
The chart above shows tremendous volatility, reflecting the uncertainty in the Republican race. This is not the case in the Democratic race. The chart below, which shows the same period as the chart above, shows very stable odds. Not even the Iowa Caucus changed the odds much. Bernie Sanders is leading the market for Democrat to win New Hampshire at 94%

. However, this has not changed bettors' opinion on who will eventually win the nomination.

For the conspiracy theorists we also include Biden (blue). He is trading at 7%, a one-month high and not much different than Kasich and Bush in the republican nomination market. Many bettors view a Biden to win bet as a Hillary indictment play over the current FBI investigation into her State Department emails. They are not looking for Biden to necessarily win outright, but to have a meaningful pop higher on any news to suggest Clinton's legal trouble is worsening.



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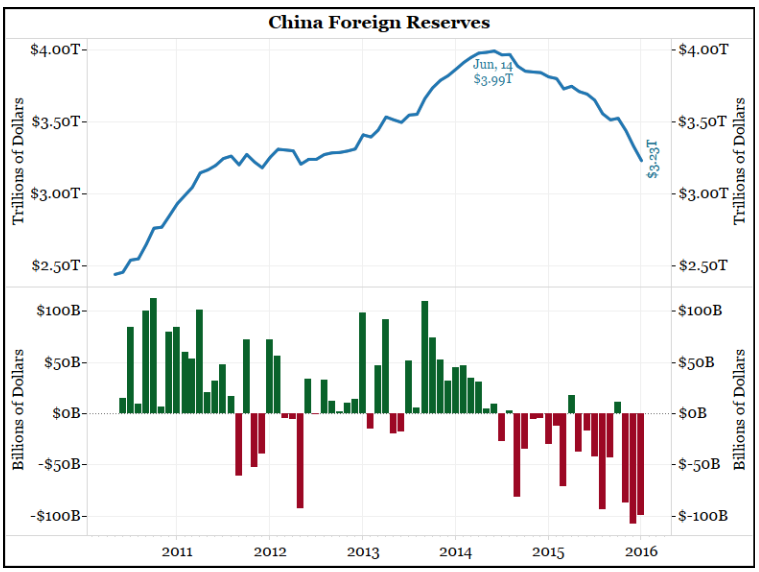
China Capital Outflows Continue At $100 Billion/Month



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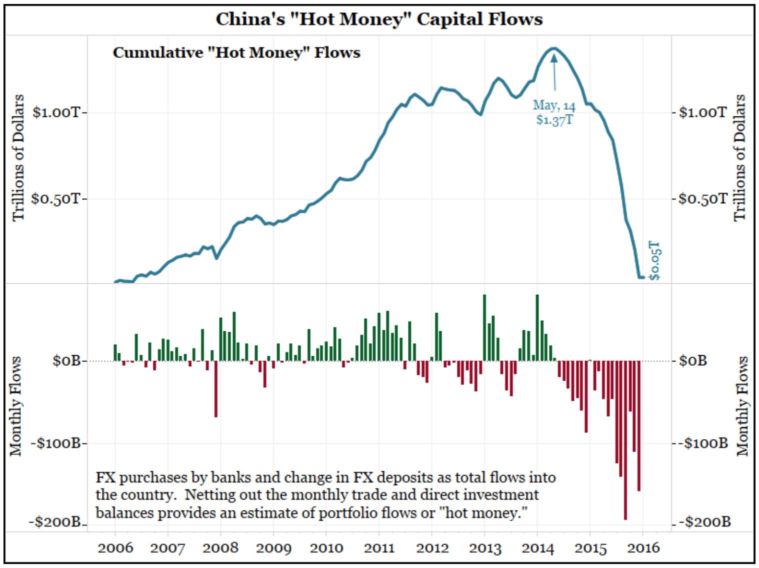

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- The Wall Street Journal - China's Forex Reserves Plunge to More-Than-Three-Year Low China's foreign-exchange reserves fell to the lowest level in more than three years in January, raising questions about how long Beijing can keep burning through the rainy-day funds to defend the yuan without triggering a huge flight of capital. The People's Bank of China said Sunday that the world's largest stockpile of foreign currency plunged by $99.5 billion last month, to $3.23 trillion. The drop follows a record $107.9 billion plunge in December and continues a decline that picked up speed in August, as China's exchange-rate policies started to appear to be in flux. In mid-August, the central bank unexpectedly devalued the yuan, saying it wanted to bring its value more in line with market forces. But the action backfired, as investors sold the currency in panic fashion, forcing the Chinese central bank to dig into the reserves to stabilize it. Last month, the central bank again had to draw on the reserves in the wake of a botched effort to guide the yuan weaker, a move that sparked fears of a deeper-than-expected slowdown in China's economy, setting off a sharp selloff in global markets for stocks and commodities. Many investors and analysts are questioning the central bank's ability to continue such interventions. Already, the central bank is finding itself in a vicious cycle: As it repeatedly draws on the reserves to prop up the yuan, doubts grow about its ability to keep the currency stable, which then causes more money to leave the country, eroding the reserves further.

Central Bank Policy Around The World

- Bloomberg Business - Here Comes the New Divergence as Central Banks Amend Hike Plans **Fed, BOE seen less likely to increase rates this year** The divergence among global central banks that was supposed to drive financial markets in 2016 barely lasted a month. Coming into the year, investors were figuring out how they would trade between two paths set on one side by monetary tightening from the Federal Reserve and, eventually, the Bank of England, and on the other by Bank of Japan and European Central Bank easing. Now, those investors are rethinking that divide as the U.S. and U.K. economies succumb to signs of a worsening global slowdown, forcing their central banks to rethink the interest-rate outlook. Any split now will be led by how much euro-area and Japanese authorities press ahead with looser policy. The reassessment following a volatile start to the year suggests a world economy still in need of synchronous and easy monetary policy if it is to escape the threats of low inflation and slowing Chinese demand. It also means a review of the trade that propelled the U.S. dollar higher. "We're having peak divergence," said

Torsten Slok, chief international economist at Deutsche Bank AG in New York.

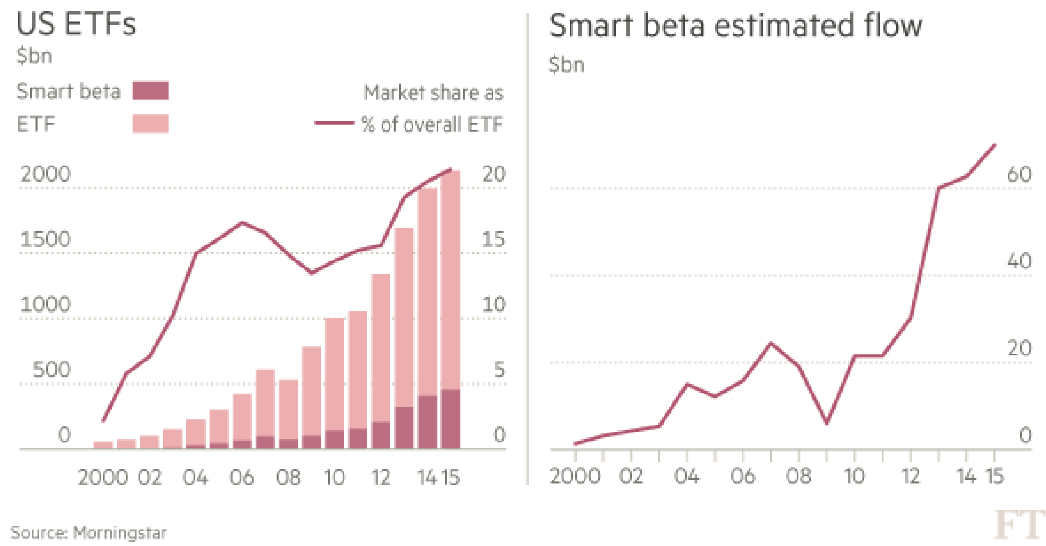
Arguing The Yield Curve's Predictive Ability

- The Wall Street Journal - Ben Eisen: Why a Recession Could Arrive Without a Yield Curve Warning Investors may not be able to count on a once-reliable economic warning bell to ring before the next recession...with short-term rates already so low, long-term rates would have to go very close to zero for the yield curve to invert. Since that seems highly unlikely, the inversion indicator may be broken. Some investors and analysts believe the slope remains positive only because of extensive central bank easing, which tends to push harder on short-term rates. Mark Yusko, chief executive of Morgan Creek Capital Management, said last week that he believes the curve would already be inverted if not for the relentless pressure on short-term rates. "Historically, it has been a predictor," said Gemma Wright-Casparius, a senior portfolio manager at Vanguard. "We are looking to other factors at this juncture." Not everyone is convinced. Banks including Royal Bank of Canada and UBS Group AG have pointed to the yield curve amid the market turbulence to dispel fears of a coming recession. Japan's experience with ultralow rates may be instructive. During each of its past four recessions, the yield curve didn't invert. Analysts at Deutsche Bank AG argue this indicates the yield curve won't invert when short-term rates are below 1%.

U.S. Economic Growth

- The Financial Times - John Authers: Why nobody is happy with the US economy **Wall Street is in line with Main Street over the outlook for growth** Nobody is happy about the US economy. You do not need to read the business sections to know that; the political section should make it amply obvious. But on Wall Street, at least, there had been a cosy belief that the economy was recovering, albeit with a shocking level of inequality, and that this could be counted on to continue. By the end of January, they were reconsidering. This week, which brought a welter of data, has seen recession fears resurgent. Bond markets show the depth of concern. Bond yields are sliding down, suggesting no great optimism for growth, implicit inflation forecasts from the bond market suggest the most deflationary outlook since the crisis, and the extra yield that "junk"-calibre companies must pay has risen to levels that suggest stress is coming. The extra yield available for buying longer bonds is falling, suggesting a belief in low growth and interest rates long into the future. The Fed Funds futures market, in which investors hedge against changes in rates, says it is roughly a fifty-fifty shot whether the Federal Reserve raises rates even once this year; the official guidance is for rate rises. Equities have fallen and boring defensive companies are besting the tech companies that recently dominated. Gold has gained some 10 per cent in the last two months, showing fear that central banks no longer have control. In all of this, Wall Street is in line with Main Street, which evidently also believes the economy to be in a bad way. This week, three strands of data were important. First came supply manager surveys for manufacturing and services. The manufacturing survey has been a great leading indicator for growth in the economy as a whole, and it is holding at a level, below 50, that portends contraction. It has been there for four months. Manufacturing is a dwindling share of the US economy — but the services measure, which had been holding up, also dipped this week.

Smart Beta



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- The Financial Times - Fund managers ready for 'smart beta' wars The swelling popularity of cheap, index-tracking funds has been a mounting concern for traditional asset managers. But many have decided to launch a fightback, betting that they can capture business in the more innovative edges of the passive investment world...Many of the biggest active fund management companies have therefore reluctantly conceded defeat in ETFs, but have resolved to do battle in a hot new niche called "smart beta" — passive investment with a twist. The battle lines have been drawn by a slew of acquisitions and fund launches over the past year, and analysts and industry insiders expect the initial skirmishes to escalate into a full-scale "smart beta war" in the coming years...Encouragingly for active asset managers who have had their lunch eaten by ETFs in recent years, the smart beta industry is far smaller and more splintered and therefore remains wide open. The total US ETF industry stands at about $1.7tn and smart beta products now account for well over a fifth of that — up from 14 per cent five years ago — after three straight years of $60bn plus inflows, according to Morningstar. And there are only 11 smart beta ETFs with assets of over $10bn.

Cartoons

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Bianco Research, L.L.C.

Clybourn Galleria
1731 N. Marcey Street
Suite 500
Chicago, IL 60614

Phone: (847) 304-1511
Fax: (847) 304-1749
E-mail: Research@biancoresearch.com
www.biancoresearch.com

For more information about the contents/opinions contained in these reports:

President (847) 756-3599
James A. Bianco

Strategists/Analysts
Greg Blaha
Ryan Malo

For subscription/service information:

Arbor Research & Trading, LLC
Director of Sales & Marketing (800) 606-1872
Max Konzelman

Arbor Research & Trading, LLC

1000 Hart Road
Suite 260
Barrington, IL 60010

Phone: (847) 304-1550
Fax: (847) 304-1569
E-mail: InfoRequest@arborresearch.com
www.arborresearch.com

Domestic - For more information about Arbor Research & Trading and its services:

New York Sales Office
The Chrysler Building
405 Lexington Ave
New York, NY 10174
Edward T. McElwreath
Phone: (212) 867-5326
Fax: (212) 370-1218

International - For more information about Arbor Research & Trading and its services:

London Sales Office
Room 303
New Broad Street House
35 New Broad Street
London
EC2M 1NH
Phone: 44-207-100-1051
Neil Tritton
Ben Gibson

Chicago Sales Office
Jim Perry
Phone: (847) 304-1560
Fax: (847) 304-1569

Geneva Sales Office
Rich Kleinbauer
Phone: 41-22-565-2480