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Newsclips/Daily Commentary

March 11th, 2016

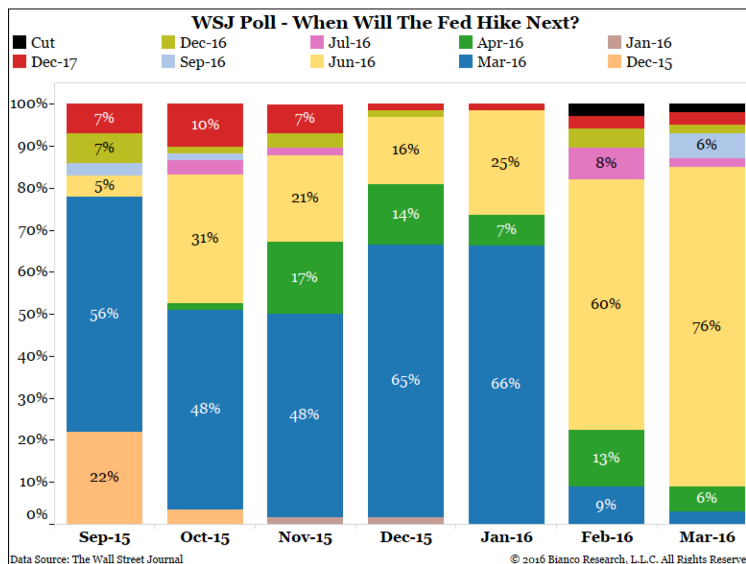
The Next Fed Move, Economists vs Markets

- The Wall Street Journal - WSJ Survey: More Economists See Fed Waiting Until June to Raise Rates
Just 3% see central bank acting at March meeting, down from 9% in last poll Most economists surveyed by The Wall Street Journal expect the Federal Reserve to leave short-term interest rates unchanged at its next two policy meetings, and next raise them in June. About 76% of business and academic economists polled in recent days said the Fed would next raise its benchmark federal-funds rate at its June 14-15 policy meeting, up from 60% in the February survey. Just 3% of forecasters predicted Fed officials would lift rates at the March 15-16 meeting, down from 9% in the last survey. Asked to gauge the probability of a March rate increase, on average economists said 12%.

Comment

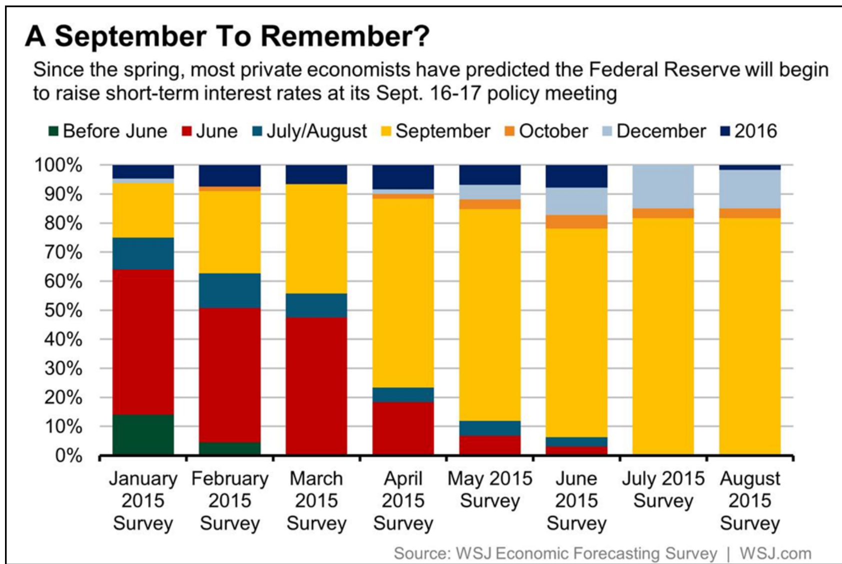
The next chart shows the results of this month's *Wall Street Journal* survey. Respondents are asked when the Fed will move next.

- From September 2015 to January 2016 the blue bars dominated. Economists largely thought the second Fed hike would be at the March FOMC meeting.
- The February and March surveys are dominated by the yellow bars, meaning economists now largely think the next hike will come at the June meeting.



<Click on chart for larger image>

The chart above highlights a common pattern. Economists always think the next hike will occur at the next quarterly meeting. This same pattern can be observed when respondents were asked about the first hike below. Economists initially thought the first hike would come in June 2015 (red), then they thought September (yellow). The first hike actually came in December.



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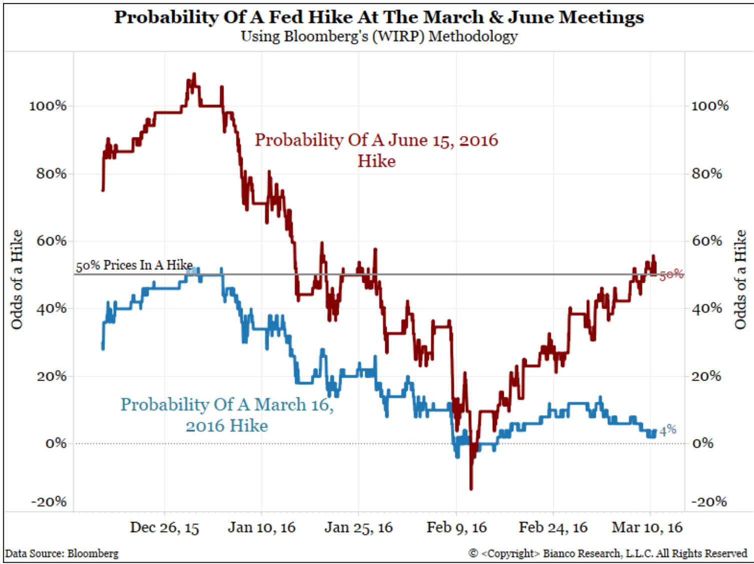
As the next two charts show, the markets do not hold the same opinion as economists. They have the probability of a hike in June at 50/50. As we detailed last month:

> Since 1994 the Fed has never forced a rate hike on the markets unexpectedly. While the Fed and sympathetic economists will try to convince the market that a rate hike is coming, such a move would be unprecedented without the market's consent. Recall that the Fed caved to market pricing and did not hike in September 2015
> .



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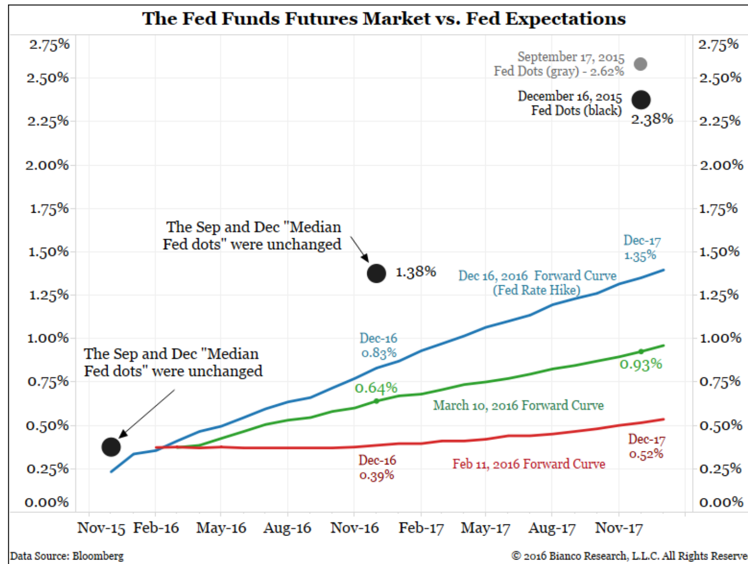

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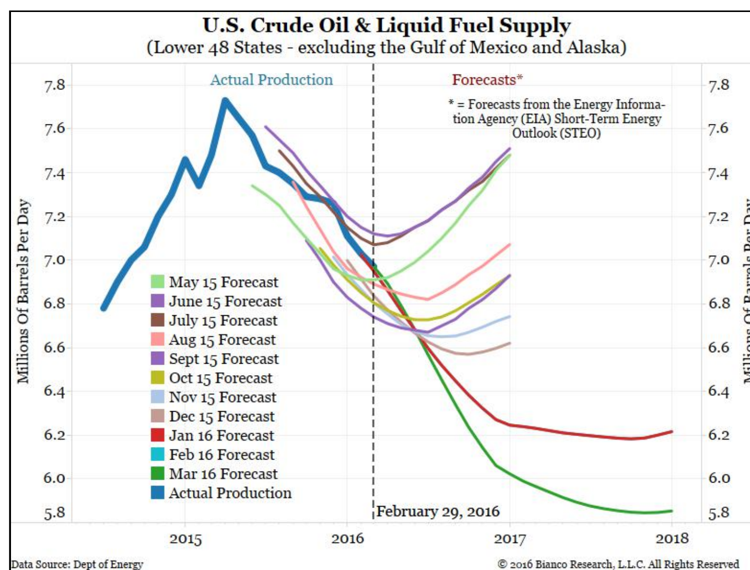
- Reuters - Calmer markets, positive data prime Fed to push ahead with rate rises Barely a month ago Federal Reserve Chair Janet Yellen cut an isolated figure in her semi-annual testimony to Congress, forced to defend the U.S. central bank's data-dependent approach while around her stocks plunged and oil prices sagged. But a recent string of positive economic news has dragged markets back closer to the Fed's overall outlook, allaying recession fears and suggesting the Fed will have more credibility at its meeting next week when it says further rate hikes this year remain firmly on the table. "Financial markets for a while were completely out in the weeds, running around looking at things that turned out not to be real risk," said Torsten Slok, chief international economist at Deutsche Bank. When the Fed raised its benchmark interest rate in December for the first time in a decade from near zero, its so-called "dot plot" of policymakers' forecasts penciled in four quarter-point hikes this year. Markets at the time priced in three increases.

Is The Oil Glut Over?



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- Bloomberg.com - IEA Says Oil Price May Have Bottomed as High-Cost Producers Cut **Non-OPEC supply will decline 750,000 b/d as U.S. falters OPEC-Russia output freeze to have little impact in first half** Oil prices may have passed their lowest point as shrinking supplies outside OPEC and disruptions inside the group erode the global surplus, the International Energy Agency said. Production outside the Organization of Petroleum Exporting Countries will decline by 750,000 barrels a day this year, or 150,000 barrels a day more than estimated last month, the agency said. Markets are also being supported by output losses in Iraq and Nigeria, and as Iran restores production more slowly than planned following the end of international sanctions, it said.
- The Wall Street Journal - Oil Prices Rise on Hopes Glut Will Ease **International Energy Agency report suggests prices may have bottomed** The International Energy Agency said that prices have been supported by easing supply around the globe but cautioned that the recent rally might not be sustainable as the demand outlook remains uncertain. Crude prices have rebounded by around 40% since their lows last month. "For prices there may be light at the end of what has been a long, dark tunnel," the Paris-based agency said in its closely watched monthly report. "But we cannot be precisely sure when in 2017 the oil market will achieve the much-desired balance."

Comment

So the glut is now over according to the IEA. They were singing a far different tune just three weeks ago:

- The Wall Street Journal - (February 22, 2016) Crude Glut Could Take Years to Disappear, IEA Data Show OPEC official won't rule out additional steps to stabilize the market
- Reuters – (February 10, 2016) IEA sees global oil glut worsening, OPEC deal unlikely
- The Wall Street Journal – (January 19, 2016) IEA Says Oil Market Could 'Drown in Oversupply'

Check back after the next correction in prices to see if we are again "drowning in oversupply" or if "the glut is over."

In the meantime, maybe this low is a good old-fashioned contrarian bounce. Below is the Barron's cover from February 8, 2016, three days before the low in prices.

Market Week Pullout

Dow Off 1.6% on Week on Poor Jobs News; Nasdaq Plunges 5.4% Page M3

BARRON'S

UP & DOWN WALL ST. • 7
Petrodollar recycling in reverse

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GILEAD, CELGENE • 25
2 beat-up biotechs with 30% upside

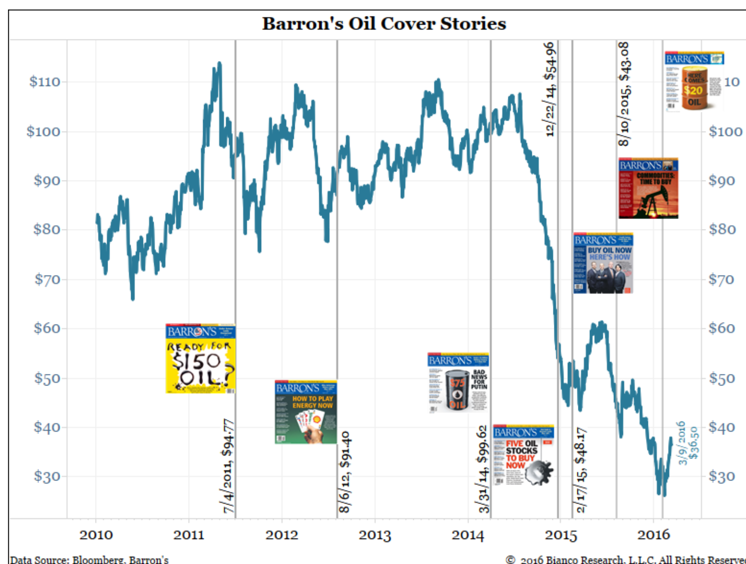
AVOIDING RECESSION • 30
Despite turmoil, Yardeni is optimistic

HERE COMES $20 OIL

Oil prices will bottom at $20 soon. So says an indicator that has been correct for the past two years. Why oil should move back up to around $55 late this year.

<Click on graphic for larger image>

The next chart shows all the Barron's oil cover stories over the last few years. They predicted $150 oil in July 2011 and followed this up with a series of bullish covers throughout the collapse in prices. They finally threw in the towel on the bullish stories with the cover above right at the low.



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- RT.com - Russia may be running out of oil Oil production in Russia will inevitably decline by 2035 according to an Energy Ministry report seen by the Vedomosti business daily. The different scenarios predict an output drop from 1.2 percent up to 46 percent two decades from now. The document, obtained by the newspaper and confirmed by a source in the ministry, says by 2035 existing oil fields will be able to provide Russia with less than half of today's production of about 10.1 million barrels per day. The shortfall should be met by increased production from proven reserves, according to projections by the Energy Ministry. In the best case for oil producers, short-term growth remains possible only until 2020, according to the report. After that, production will contract. The figures vary from 1.2 percent to 46 percent, depending on prices, taxation and whether or not anti-Russian sanctions will be in force.

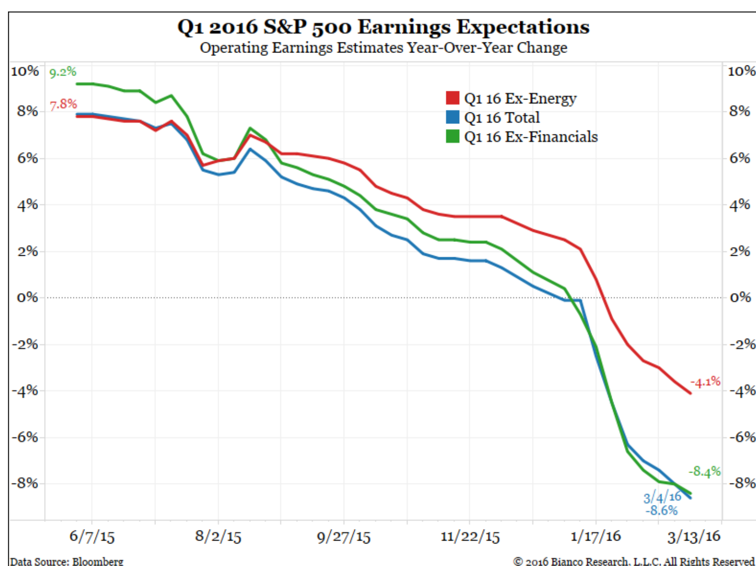
Discussing The ECB

Comment

Jim Bianco was on Bloomberg TV this morning talking about the ECB move yesterday. To view the interview, click on the image above. To view any of our recent interviews, click here.

- The Financial Times - ECB bazooka blasts stocks higher Following an ultimately upbeat Asia session, the pan-European Stoxx 600 equity index is up 2.2 per cent — powered by bouncing banks — as US index futures suggest the S&P 500 will gain 0.9 per cent to 2,008. Better risk appetite is boosting growth-focused assets like industrial commodities. Brent crude is gaining 1.7 per cent to $40.74 a barrel after the International Energy Agency said oil prices may have “bottomed out”, and copper is up 0.6 per cent to $4,926 a tonne. The chipper mood is curtailing demand for US government bonds, pushing 10-year Treasury yields up 2 basis points to 1.95 per cent, and haven currencies like the yen, which is 0.5 per cent softer at Y113.71.
- The Financial Times - ECB cuts rates to new low and expands QE The European Central Bank has unleashed a bigger than expected package of measures to stimulate the eurozone economy, with expanded quantitative easing, incentives to banks to increase lending and further interest rate cuts. The ECB cut its deposit rate on Thursday by 10 basis points to minus 0.4 per cent but eased the impact on banks with cheaper short-term loans and longer-term liquidity at negative interest rates — essentially, paying eurozone lenders to increase credit to households and companies. Mario Draghi, the ECB president, said interest rates would stay low for “an extended period” and he kept open the option of a further cut. But he added his voice to growing unease about negative rates among top central bankers, saying he did not anticipate pushing deeper into negative territory, partly because of the impact on banks. “Does it mean we can go as low as we want without having any consequences on the banking system? The answer is no,” the ECB president said. His comments on rates triggered a surge in the euro to $1.12, a near 2 per cent rise on the day, after it earlier plunged on the news of the ECB’s measures. Analysts intepreted the measures as a recalibration of the ECB’s armoury, putting more ammunition into reinforcing the eurozone’s economy and less into weakening the currency. The ECB raised the amount of bonds the eurozone’s central bankers buy each month under QE from €60bn to €80bn — a greater sum than many analysts had expected. It also expanded the range of assets it will buy to include high-quality corporate bonds. To help banks, it will provide liquidity through so-called targeted longer-term refinancing operations, with rates as low as minus 0.4 per cent — in effect paying them to borrow money.

Another Bad Earnings Quarter?



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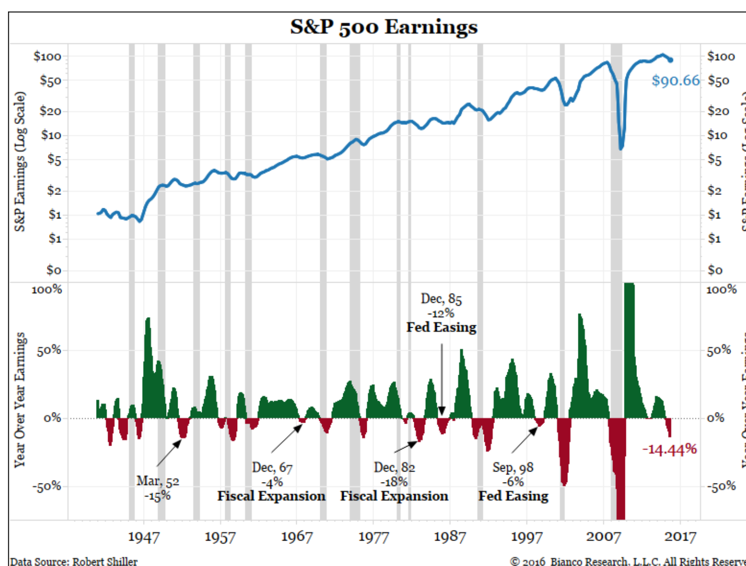
- MarketWatch - Earnings decline looms large over U.S. stocks Every once in a while even the most rehearsed game of earnings expectations on Wall Street doesn't go according to the plan. Downward revisions to first-quarter earnings estimates are a case in point. Over the past two months, sell-side analysts cut their estimates for first-quarter earnings per share by 8.4%, according to FactSet. As a result, analysts now expect earnings for the quarter to fall 8% from the same period a year earlier; on Dec 31, they were penciling in growth of 0.3%. Unsurprisingly, the analysts aren't acting alone. Negative guidance issued by reporting companies was also higher than average. Of the 115 companies issuing guidance, 91 steered expectations lower. In other words, 79% of companies guided expectations lower, compared with the average of 72%, according to FactSet.
- Bloomberg.com - Barry Ritholtz: Falling Earnings, Recession Warning One of the big concerns for investors is the health of corporate profits, which have declined in the three of the past four quarters (the last quarter with full data ended Sept. 30, 2015, though forecasters have predicted a decline in fourth-quarter profits as well). The natural question is whether falling earnings point to a recession. I put that question and a few others to James Bianco, president of Bianco Research LLC, an institutional research firm servicing many of the world's largest mutual funds, hedge funds and sovereign-wealth funds. Below is our exchange: BR: A recent research report by JPMorgan found that when markets see consecutive quarters of earnings declines, the economy slips into a recession 81 percent of the time. What do you make of this? JB: Our chart below starts in 1940 and shows Standard & Poor's 500 Index earnings in the top panel and their year-over-year change in the bottom panel. The shaded areas highlight the 12 recessions over this period. Earnings turned negative either during or just after all 12 of these recessions. This should come as no surprise. Also noted on the chart are the five instances when earnings turned lower (at least two consecutive quarters) without a recession. The last time earnings went negative without a recession was September 1998.



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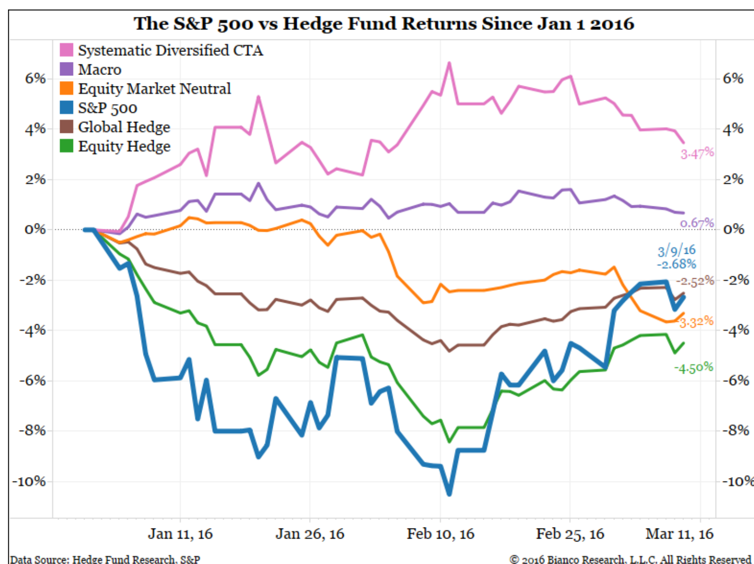
Stock Exchanges

- The Financial Times - The death and rebirth of the stock exchange **Trading venues have grown in value despite regulatory, technological and competitive disruption** One of its biggest operations is clearing — taking care of the contracts after trades are done. Its SwapClear division now clears 95 per cent of the global market in over-the-counter interest rate swaps (private interest rate contracts reached by banks). This is less exciting or visible than equity trading but bigger and more profitable; SwapClear often clears $1tn of swaps daily. Derivatives clearing has another advantage over share trading: it takes a long time. A clearing house holds cash to cover the moves in the value of a contract over weeks or months. It is a steady money-earner that is far less exposed to competition than a stock exchange. Fees such as these, from derivatives clearing, data and financial indices, are valuable. The transformation of exchanges offers three lessons. First, regulation works. It does not always work as intended but it affects behaviour. US and European regulators encouraged stock exchange competition and, after the 2008 crisis, pushed banks to use clearing houses to curb risk. Exchanges altered course as their old business grew tougher and another one expanded. Second, capitalism is highly adaptable. The world of stock exchanges was dominated for decades by entrenched institutions, particularly those in global financial centres such as London and New York. Changes in regulation and financial markets undermined that position so they adapted. In some cases, such as the LSE's, stock exchanges remodelled themselves behind the scenes into clearing and data operators. In others, futures exchanges such as the Chicago Mercantile Exchange outstripped stock exchanges in value or acquired them, as ICE has done. Within a decade, stock exchanges were absorbed into exchange groups that mostly do other things. Last, traditions endure. Exchanges are largely but not wholly unrecognisable from the days of the buttonwood tree. Networks remain powerful — exchanging contracts through a hub rather making a multitude of bilateral deals creates economies of scale. This applies as much to the central clearing of interest rate swaps as to exchange-based share trading. Stock exchanges remain exchanges, despite all the fragmentation and upheaval. Unlikely as it once seemed, they are still in business.

Hedge Funds Still Struggling



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- DealB%k - For Hedge Funds, Start of 2016 Offers Little Relief From 2015 The hedge fund titan Larry Robbins did something out of character last year. He apologized to investors for losing their money and pledged to “right the ship as quickly as possible.” Then he solicited more money from them, raising $1 billion for a new fund and promised to waive the fees. But he keeps on losing money. Over the first two months of this year, his $9.2 billion Glenview Capital Management’s flagship portfolio lost 15 percent. The new fund — called GCM Equity Partners — is down 5.2 percent. Even worse, the Glenview Capital Opportunity fund, a $1.7 billion portfolio that uses leverage or borrowed money to enhance its bets, has lost 22.4 percent through the end of February. Mr. Robbins is not the only one. William A. Ackman, another big-name investor, is also nursing double-digit losses this year.

Comment

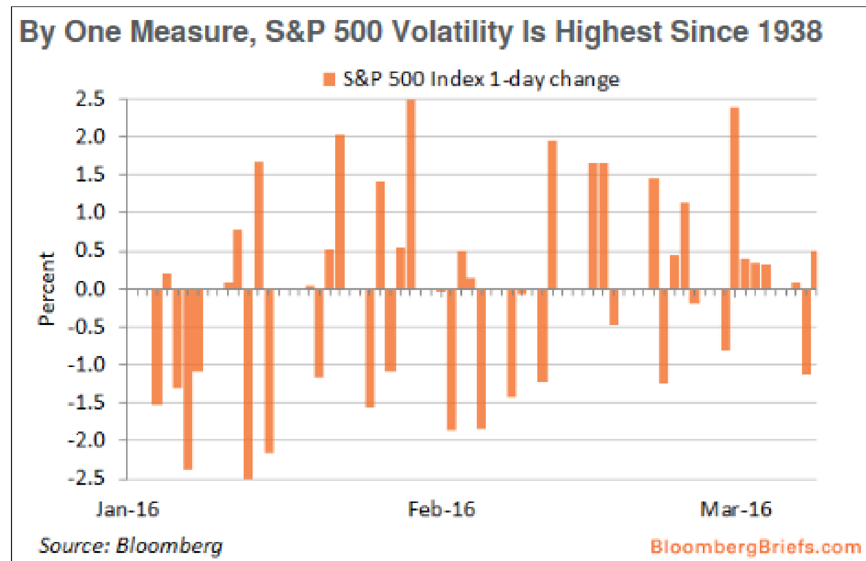
The chart above shows year-to-date returns for hedge funds. Most styles are again underperforming the S&P 500. Earlier this week we noted that Systematic Diversified CTAs (pink line), which are a bunch of trading machines, are doing well. Humans are not doing well. This is the opposite of the last several years when the machines offered the worst returns while humans performed better. However, both still terribly underperformed the S&P 500.

NIRP Forever!

- Reuters - Markets betting on near-zero interest rates for another decade World markets may have recovered their poise from a torrid start to the year, but their outlook for global growth and inflation is now so bleak they are betting on developed world interest rates remaining near zero for up to another decade. Even though the U.S. Federal Reserve has already started what it expects will be a series of interest rate rises, markets appear to have bought into a "secular stagnation" thesis floated by former U.S. Treasury Secretary Larry Summers. The idea posits that the world is entering a peculiarly prolonged period in which structurally low inflation and wage growth - hampered by aging populations and slowing productivity growth - means the inflation-adjusted interest rate needed to stimulate economic demand may be far below zero. As there's likely a lower limit to nominal interest rates just below zero - because it's cheaper to hold physical cash and bank profitability starts to ebb - then even these zero rates do not gain traction on

demand. For all the debate about the accuracy of that view, it's already playing out in world markets, with long-term projections from the interest rate swaps market showing developed world interest rates stuck near zero for several years.

Most Volatile Markets Since 1938?



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- Bloomberg - By One Measure, S&P 500 Volatility Is Highest Since 1938 Violent swings are whipsawing stock investors more frequently than any year since the Great Depression. The Standard & Poor's 500 Index has moved at least 1 percent in either direction in 25 of 45 trading sessions so far this year. That rate of 56 percent puts 2016 on track to exceed the 53 percent experienced during the full year of 2008 and would mark a level not seen since 1938, data compiled by Bloomberg show.

How To Look At The Economy

- MarketWatch - Caroline Baum: How's the economy? Depends on your political leanings The state of the U.S. economy is always an important consideration when voters go to the polls every four years to elect a president. Even in this bizarrest of bizarre campaigns, characterized by name-calling, mud-slinging and not-so-subtle references to male genitalia, the American public ultimately votes its pocketbook. Candidates from both parties use the current state of affairs as a jumping off point to promise something better. It's their assessment of how things now stand that differs. This time around, Republicans have an easier time formulating a coherent view of the economy than Democrats. For Republican candidates, the economy stinks, and it's all President Barack Obama's fault. Heck, the Democrats are still blaming President George W. Bush for bequeathing a mess to Obama. They seem to forget that Obama had a Democratically controlled Congress, both House and Senate, for the first two years of his administration. The House went Republican in 2010 while Senate control shifted to the GOP in 2014.

Stressed Markets

- The Financial Times - US Treasury market shows signs of stress Dislocation in the world's biggest government bond market is sending warning signs of stress in the system, with dealers and hedge funds

blaming tougher bank capital rules as they choose not to exploit the arbitrage opportunity. Investors are increasingly choosing to hold derivatives contracts rooted in US sovereign debt rather than cash Treasuries, resulting in a big price difference between the two closely-related products. As recently as July, it remained slightly cheaper to buy cash Treasury paper rather than the futures. But banks and hedge funds say they are unable to close the gap, blaming a tougher regulatory regime that has increased the cost of trading in the US sovereign debt market. In theory, institutional investors should seek to profit from the price difference by selling futures and buying cash Treasuries. However, the cost of such trades stemming from constraints on balance sheets among the big dealers makes the strategy less appealing. Regulatory changes have made it harder to fund trades via the repurchase, or "repo" market, in which banks can borrow cash to buy Treasuries with a fixed rate of interest and a pre-agreed time to exchange the assets back. Hedge funds also struggle because they rely on banks giving them access to repo markets, which means a lot of the capital cost of doing so gets passed on. "It's a measure of balance sheet stress in the system," said Jason Prest, a trader at III Capital Management. "Historically Treasuries would have easily been funded and this arbitrage would have easily closed. But guys like me, after going to repo, can't justify it now."

Inflation Expectations

- MoneyBeat (WSJ Blog) - This Market Is Wacky: Oil at $0, And Other Unlikely Inflation Expectations Look too hard at certain measures of U.S. inflation expectations and you might come away with unlikely conclusions. For example, that crude oil will be worth zero dollars a barrel in a few years' time. Or that some prices are due to start falling soon, even as the Federal Reserve says they're increasing toward the central bank's target. Or that there's a torrent of global risk...As breakeven prices slumped earlier this year, the predictor was highly correlated with a composite index of global risk that includes Chinese, emerging market, and other high yield returns, according to Arbor Research & Trading LLC. That correlation only began to detach as investor fears subsided in mid-February. The firm concluded: "Breakevens are as much a reflection of financial stress as they are inflation expectations."

A Tale Of Two Bond Markets: Government Debt vs. High Yield

- Bloomberg.com - Clash of the Bond Titans A fight is brewing between two types of debt that serve as guideposts for assets around the world. On one side, there's the $13 trillion U.S. government debt market, which seems to be sending a steady message that growth is slowing and not picking up anytime soon. On the other is the $1.4 trillion U.S. high-yield bond market, which had been saying that things looked gloomy but reversed course quickly and now sees sunshine and rainbows. Both markets matter. The government debt sets the benchmark borrowing costs on everything from mortgages to auto loans, while junk bonds have historically been a leading indicator for recessions and stock market selloffs. But both can't be right at the moment. Determining the reality between the pessimism of government-debt traders and sudden optimism of credit buyers is difficult, but the edge probably goes to the U.S. government debt market, which has a clearer, more compelling message.

Credit Rating Agencies Are Back

- The Wall Street Journal - What Crisis? Big Ratings Firms Stronger Than Ever **S&P, Moody's and Fitch issue more than 95% of global bond ratings, and profits are nearing all-time highs** The three big ratings firms that played a central role in the last financial crisis never got a downgrade of their own. Investors still overwhelmingly rely on Standard & Poor's Ratings Services, Moody's Investors Service and Fitch Ratings when deciding whether to buy bonds. The three issue more than 95% of global bond ratings,

a total virtually unchanged from the pre-2008 period. Profits also are nearing all-time highs as they ride a recent wave of debt sales and push into new lines of business. The resilience of the industry's largest players was on display again this week as Moody's, a unit of Moody's Corp. , agreed to a $130 million settlement with a California pension fund. The pact resolved one of the industry's last remaining major crisis-related legal headaches and brought the total of fines and settlements to $1.9 billion, a fraction of the amount paid by U.S. banks for missteps during the same period.

Cartoons

<Click on cartoon for larger image>

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