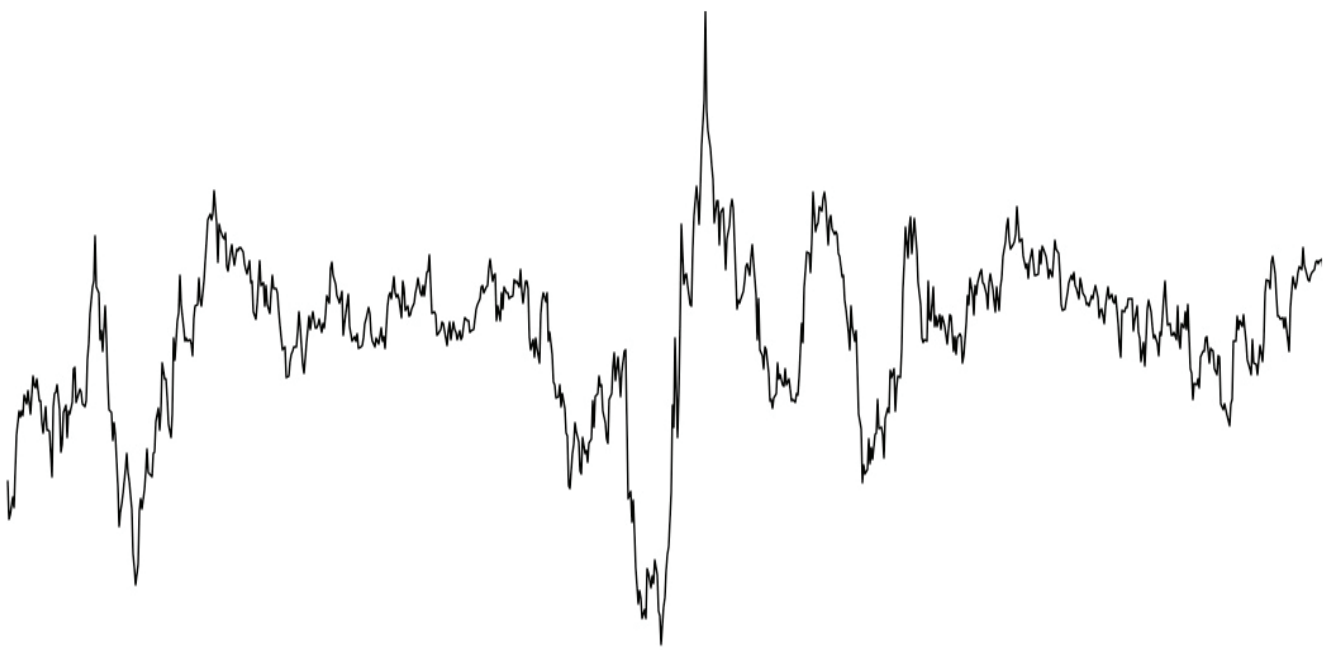
ALPHA SOURCES

DECEMBER 16, 2019



IS GLOBAL GROWTH PICKING UP?

It's been a while since my latest market dispatch, mainly because nothing much seems to have changed. Equities are still doing great, and vol-sellers remain in charge, driving the VIX steadily towards single-digit territory. In fixed income, a war of attrition is at play. The front-end is locked, but the long end can't decide whether to sell-off. **In preview, I think it will in due course, delivering the bear-steepener needed to sustain the burgeoning outperformance of value over growth—and cyclicals versus defensives—in equities.** HSBC's bond bull extraordinaire, Steven Major, is sceptical, but even he admits that the long bond might be in for a bit of pain in the near term. I'll take that insofar as goes an endorsement for a self-proclaimed perma bond-bull.

The devil as ever, however, is in the detail. Markets can probably be fairly certain that they have central banks exactly where they want them. Last week's performance by Powell suggests that the Fed is kicking back from the table, with a dovish bias. Apparently, the Fed now wants to see a "persistent" and "significant" increase in inflation before hiking rates. This sounds an awful lot like the message from the ECB and the BOJ, and while I concede the BOE is in a different situation, but I'd imagine

* / 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.

that Carney's response to the facing the economy next year will be to do nothing. He seems to be quite good at that.

The picture is even rosier if we consider that the U.S. and China appear to have struck a phase-one trade deal and that the Tories have just won a huge majority in the U.K., in doing so vanquishing the ghost of Lenin and Marx in the form of Jeremy Corbyn. Of course, I am quietly passing by the fact that Mr. Trump could be about to open a new front in the trade war with Europe, and that the new conservative U.K. government ostensibly was elected on pushing through a hard Brexit. In any case, I reckon that Cameron Crise is right when he says that: *"Over the past 48 hours three of the major headwinds of the last several years --the trade war, Brexit, and the threat of higher interest rates -- appear to have been safely put to bed, if only for the time being."*

One condition for my bond market story—and its associated shift in the relative performance of equity sectors—to play out is that the global economy regains cyclical momentum. The evidence to support is *slowly* building. [Teis Knuthsen, CEO at Kirk Capital, notes] that the OECD's leading indicator made a positive reversal in October, halting a period of deceleration in the past 21 months. More evidence is needed to confirm the upturn, but it's fair to say that it's a good start.

My own home-cooked leading indicators are just about in line with this story. The first chart below shows that my diffusion index of 24 global leading indices is showing tentative signs of stabilisation. If sustained, history suggests that it will lead the global composite PMI up starting next year. Unlike in the case of the OECD index, however, takes a bit more than one month's rise to get the ball rolling. Indeed, using a month-to-month increase as the yardstick for success, this diffusion index has provided several false-positive signals recently, so I need to see a few more months' worth of an upturn to get excited.

Taking a cross-sectional view, ten out of the 24 economies included in my sample now are enjoying slightly improving leading indicators of a three-

fig. 03 / Stabilising, at best…

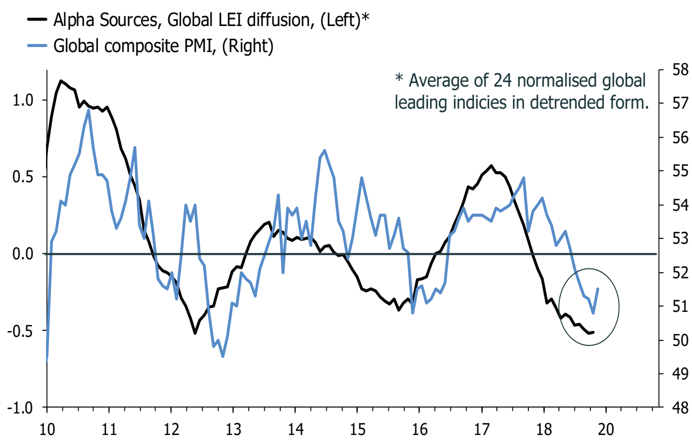
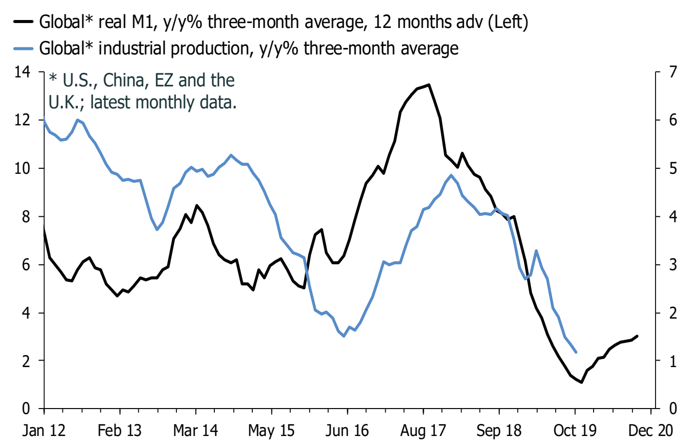


fig. 04 / …but the picture is better in the real M1 data



month basis. The most notable of these from the point of view of a gauging something for the global economy as a whole are: the U.K., Brazil, Mexico, South Korea and China.

If my aggregate LEI diffusion index is still a bit indecisive, the upturn in global real M1 growth looks more sustainable, pointing to a clear bottom in global industrial production growth in Q4, and an upturn in the first half of next year.

AND THE BAD NEWS?

It doesn't take a lot of digging to qualify the rosy story above. For starters, the upturn in real global M1 looks great, but it hides an uncomfortable detail. Real money growth *in China* is still decelerating; indeed, it has slipped back below zero in the past few months, which is not usually a good sign, neither for the Chinese nor the global economy.

At the very least, this challenges the increasingly popular idea that investors should be overweight EM next year, at least in terms of holding the market. The idea of stationary U.S. rates, and perhaps even a weaker dollar, is positive, but it's difficult to see how the MSCI EM can outperform anything without better data out of China. We keep hearing stories about the more stimulus by the PBoC, but the truth is that Chinese authorities have been locked-in through the trade negotiations. Will that change now that the pressure in the trade wars is *easing* slightly? I am not holding my breath.

Finally, it's difficult for investors in risk assets to double down on their longs based on the idea of an upturn in global growth. My final chart shows that equity returns are running well ahead of the macro data. As I showed in [my last entry](), it is a similar picture if we compare with fundamentals in other assets. I am trying not to fiddle too much with my equity exposure at the moment. After all, it's doing great, but the market feels like a ruse. Valuations are high, and rising, and vol is collapsing. This is a fantastic environment for being long risk, but we also know how it ends; with an out-of-the-blue gut wrenching correction, regardless of whether global growth is indeed picking up or not.

fig. 03 / What's happening in China?

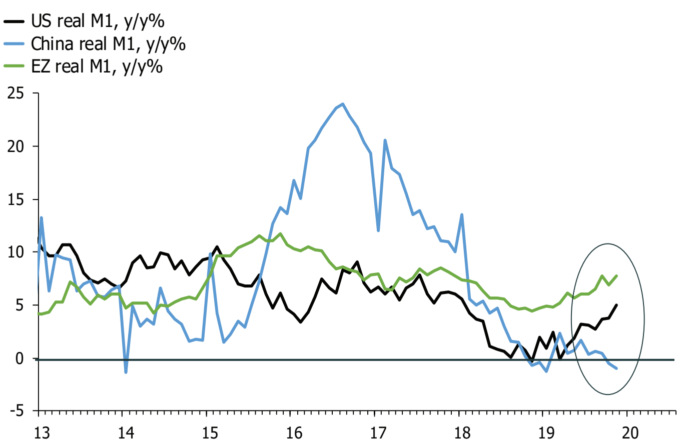


fig. 04 / Equities are way ahead of the macro data