

Ten Seconds Into The Future. 2016 Will Be Guerrilla Trading

Last week the FOMC finally raised interest rates, the first time in 9 years. Risk markets rallied in relief before falling back on concerns in commodities and credit markets.

Equities

Year to date MSCI World is -3.45%. The S&P is -2.6%, FTSE is -7.8%, MXAPJ is -13.6% and MSCI Emerging Markets is -15.3%. In China, H shares are -19.6% and Shanghai Comp is +10.6%. In positive territory, the Eurostoxx is +3.63% with CAC and DAX both up over 8%. The Nikkei is +8.8% and Topix +9.2%. A cursory glance observes that the weakest economies have the strongest stock markets.

Fixed Income

The Barclays Agg is -0.5%. On the positive side, Euro sovereigns are +2.25%, China corporates are up, local IG and HY +2.95% and +6.83%. USD IG and HY are +3.45% and +10.55%. US Non Agency RMBS is +9.55%. On the negative side, US and EUR IG are -0.59% and -0.27%. US HY and loans are -6.17% and -0.94%.

FX

JPY traded within 116 – 125 in the year before settling at 121.33, or -1.30% YTD, largely flat despite weak data, as the BoJ holds firm.

EUR is -10.2% YTD, depressed by QE and the ECB's inflationary efforts.

JP Morgan's Emerging Market FX Index is -15.2% YTD.

Gold traded in a +-10% range YTD most recently trading at -10% YTD at 1065.

Commodities

Crude oil is -35% as supply continues to outstrip demand.

Nat Gas is -36%.

Industrial metals are broadly -30+% YTD.

Looking forward:

There is not much to look forward to really. One bright spot is the **Eurozone** where QE is young and PMIs are still buoyant. Still there is much uncertainty as flash PMIs have weakened, Spain will have a new government but it is not clear of what composition, Greece is still running a significant budget deficit and has signaled reluctance at further IMF support and the UK considers exiting the European Union. Fortunately the ECB's last expansion of QE was sufficiently half-hearted to warrant a further augmentation.

The US was slowing already ahead of the rate hike. The Fed says 4 hikes in 2016 the market 3, so investors are already more optimistic about markets and less optimistic about the economy than the Fed. Without an expansionary Fed, equity markets will have to rely on earnings growth, which has been weak and hitting peak in recent quarters. At least the Americans are repacking their parachute back into the bag.

China continues to slow at a steady rate and has dragged its entire Emerging Market supply chain with it. The rebalance towards consumption and services looks to be on track, at the expense of the old economy industrial machine. The PBOC will continue to send liquidity where it is needed in copious quantities but will be careful that it does not drive asset bubbles. The H share market, already cheap keeps getting cheaper as fundamentals catch up to valuations.

Emerging markets have been in a 5 year bear market and valuations are approaching attractive levels. The problems they face are, however, not high valuations or rising interest rates or strong or weak currencies. Supplying China and the US or standing between them is no longer a viable business model when the two giants turn from one another.

Commodities' current cycle is already very mature. However, it takes a catalyst to reverse the 5 year bear market. Such a catalyst could be a supply side shock, new legislation, previously

unidentified demand.

A few spots of value may be exploitable.

Energy is evidently distressed and will soon present opportunities for restructuring. It's probably too early and buying performing debt is probably ill advised but swaths of the industry will be headed into Chapter 11.

US high yield was overvalued but the tide has turned and not so much on credit quality than on concerns over liquidity. The HY bond market and the leveraged loan market already presents good value. However, the very nature of the mis-pricing, that is concerns over illiquidity, portend a volatile market. Risk management will be important.