



## ECOGNOSIS ADVISORY LTD

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### The investment outlook for 2016 and similar blah, blah, blah....

#### Summary

In this time of the year investment advisors come forth with their outlook for the new year. Econote will resist this, not because we have nothing to contribute, but because a review of what has happened in 2015 is redundant, everyone knows what happened, and a list of suggestions will simply add one more list to your desk. Instead we will play it safe but, in a peculiar way, by pointing out to some trends which are so well established that the likelihood of a reversal is very small, and then outline their logical investment implications. This may sound like telling you where to invest in 2016 by looking at market trends. It is for you to judge whether we have added some more seasonal blah blah to your desk!

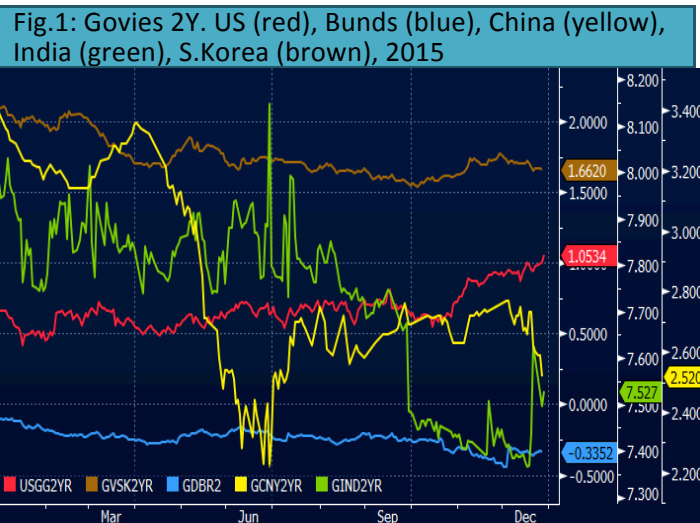
#### Investment Conclusions

Total divergence in global interest rates in 2016, with the US hiking and EU and Japan staying at zero thus offering clear, but well exploited, differentials and currency bets. EMK rates are not linked to the USD rates and hence the "anchoring" effect of higher USD will also offer differential opportunities as these rates will not move together. In equities, the EU will offer better macros than Japan, with loose monetary policy and fiscal policies also helping to keep rates down. Japan's performance will depend on third arrow policies, which will never come. China is bottoming and Hong Kong is a shorters' paradise. Argentina, with the new president, is promising

### The global economy which ain't

More than ever there are no global trends. There are market trends, such as the falling hard and soft commodity prices partially driven by China, but oil is driven by a multiplicity of factors little connected to cyclical. Some EMKs are doing well both in absolute and relative sense, such as China (believe it or not), while others are spiraling into recession because of man-made factors such as Brazil. Argentina might just do it this time and break out of a 16-year bind but thanks to policy decisions and not to cyclical. The pace of hikes in US rates in 2016 will not really matter, while the certainty of hikes will. The likelihood of a US policy reversal, ECB style in 2011, is minimal and, if it comes, it will require a big reversal in US macros and hence will not occur till the end of 2016. It is just not true that higher USD rates will be the death of most EMKs! Most of the major and minor EMKs had been cutting rates for months now, fully aware of the likelihood of the Fed move. (China, India, Taiwan, S.Korea's to mention but a few, see Fig. 1 for the widely divergent trends in 2015). It will also now follow that, while the USD will have a forex advantage in terms of actual and expected differentials, the size of these differentials will vary widely. Some EMKs, such as India, will be unlikely to cut rates in 2016 (inflation pressures) while others may have bottomed in terms of cuts, such as China, as incipient recovery sets in. In the context of this disjointed per

background it would follow that bottoming cyclical would offer equity opportunities. The EU stands out, given that Greece is now under control, while Japan will continue to require structural changes which will not come, while monetary policy did not generate inflation. Allowing only one look backwards, the year ended with "Asian" equities (Japan and China) outperforming the US and EU. Look to Asia, minus Japan, in 2016 for better performance



Source: Bloomberg

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EMKs, and Asians in particular

Mercifully 2015 killed off that unfortunate BRIC combination, a combination which Econotes always suspected as the bundling together of utterly different economies, whose similarities were, in fact, their striking differences. **India** will struggle with macros rather than policies as the Modi experiment is effectively over given that there is no political stomach for the type of reforms which will propel India's growth rate to double digits for a decade or more, just as China did. **Brazil** is a man-made disaster and hence, like **Argentina**, it can be reformed by men and not just by commodity prices. Argentina is worth investing purely on the basis that there is political will (albeit not congress majority) to get a few things right. Concerns over **China's** credit system are exaggerated as the government owns the banking system and has the ability to run fiscal deficits as necessary. However as the government is also the major shareholder of the stock

**FACT BOX: Why "globals" don't matter any more**

The notion of globality signifies a unity of influences in various and very different economies. In which way one can say that USD rates are of "global" importance if the G2 of the G3 are purposefully moving in a completely opposite direction to that if the US? Did oil prices fall because of "global" factors or because of the shale revolution in the US and a dangerous game of chicken by the Saudis? The rest of us enjoy low oil prices irrespective of the phase of our cycles. China's cyclical slowdown impacted the prices of hard commodities but this has no direct sectoral effect on the G3, the G2 of which are not even remotely commodity exporters! Australia and Brazil felt the blow, but they are a small part of the global economy. The list goes on....

market after the intervention in the summer-autumn of 2015. Hence the equity market will remain jumpy. Cyclical stocks could come in favor again. **Hong Kong's** golden age of negative real interest rates has ended, and with it, nearly 6 years of a bull property market. (See Fig.2). The adjustment will be long and grim and will last till the Fed has decided that it hiked enough, or the peg is abandoned. Hong Kong offers a classical illustration of our approach of taking trends most unlikely to change (USD rate hikes, peg stays) and seeking the obvious investment implications: short Hong Kong property and equities.

Fig 2: HK composite int. rates less inflation, 2004-15



Source : Bloomberg

And so some conclusions ( blah blah ??)

The USD will stay strong but not uniformly, especially in EMKs where the interest cycle of rate cuts might be ending. Equities in the EU preferred to Japan, and even to US, where the new uncertainty of the speed of the hikes may impact valuations. EMKs are very variable. Argentina sticks out while Brazil sinks in. China on a slow boat recovery, but still in absolute standing out, except the equities which will remain jittery under the heavy hand of government staying in. India can only be bought on macros and not on reform expectations as, perversely, is now Japan with one arrow missing and the other two having the consistency of ping pong balls hitting a wet mattress. Interesting but not exciting. What can go wrong, is now the "plat du jour", namely why the Fed got it wrong and will need to reverse as the economy goes into recession. The ECB did so, and so why not the Fed? If it happens it will take time, possibly 9 months or more in which case it will be time for the 2017 blah blah period. And, oh, almost forgot, oil price stays low in 2016, no change in the state of the game.

**Eutyhismenos o Kainourgios Hronos**, or to the classics challenged, Happy New Year.

Andrew Freris, in Montevideo, where Xmas is called "bikini Xmas" as the temperature is in the high 30s, the shops are decorated with artificial snow... nothing in this world is what it seems. (Writing completed on 29/12/15)