ECOGNOSIS ADVISORY LTD

From the Greek: ΟΙΚΟΝΟΜΙΚΗ ΓΝΩΣΙΣ (Ekonomiki Gnosis, Knowledge of Economics). Ecognosis is a global financial, economic advisory and information service, covering economic and financial developments, equities, fixed income, forex, commodities and other assets. Econotes is a research publication available free on our internet site and to the public in Hong Kong. It is not a solicitation for business and neither does it contain investment suggestions on specific and named securities including any buy, sell or hold advice. It is written by Dr. Andrew F. Freris based on 50 years of market experience which includes senior positions with GT Capital, Salomon Brothers, Bank of America and BNP Paribas as well as senior academic posts with universities in London and in Hong Kong

Level 20,One IFC,1 Harbour View Street, Central, Hong Kong. Tel: 852 3167 4591, Mob 852 9738 0944
Email: afreris@ecognosisadvisory.com, Website: www.ecognosisadvisory.com, Facebook: @ecognosis

ECONOTE No. 79: This is NOT a "Global Outlook for 2019 "!

31/12/2018

Summary

Econotes traditionally detested yearend and yearstart blah-blah investment research, and we are not going to change now. These types of strategy pieces have the same life span of a Trump cabinet member, and just about the same impact. We stick here to what we have always done, and that is a series of points and observations, which have some investment implications. Looking back is useless, as we all know what happened, although we all disagree why and how it happened. Looking forward is equally pointless as the chance of getting a forecast right in terms of direction, quantity and timing is highly unlikely. Our experience is that investors listen to interesting angles and approaches, like tight and short summaries and then proceed to make their own mistakes! Is 2019 likely to be different from 2018? Yes, to the extent that it will contain unexpected surprises, as Rumsfeld would have said.

Investment Conclusions

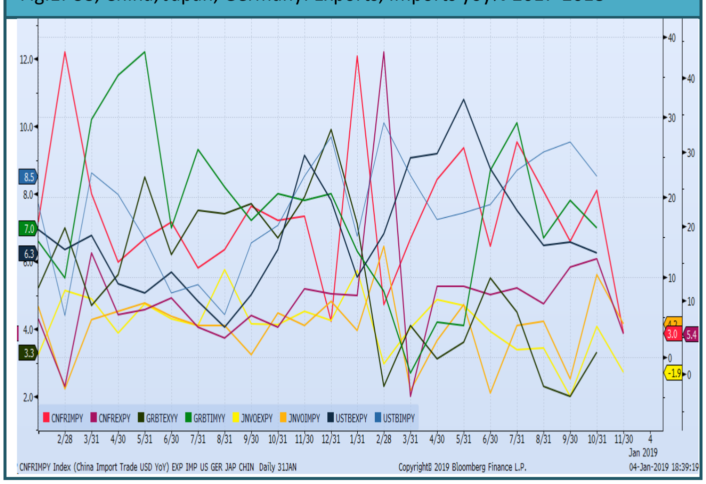
The key characteristic of 2018 was the perceived falling apart of components of the international economy, such as multilateralism and freedom of trade, the growing use and the acceptability of crude power politics and of force, and in general, the collapse of moral values. In seeking the causes of these perceptions the name "Trump" springs to mind. However the word "perception of " is crucial here as closer examination of these perceptions can lead to different conclusions. The collapse of any form of coordination among G3, or G20 for that mater, central banks, predates the presidency of Trump. Brexit was in the offing since June 2016 while Trump was still a glint in the eye of the US electorate (Nov. 2016). Investment ideas can be structured around the degree of unrealism of these perceptions!

The global economy which wasn't , isn't and won't be global

The so-called **trade war** instigated by Trump was, in essence, neither a trade nor a war.It had three components.First an attack on the bilateral surplus of China with the US which did involve "war" tactics, such as hikes of tariffs or threats thereof.Second a brief blackmailing period with NAFTA which ended up with some opening of markets to US products by Mexico and Canada, and tougher rules on car imports depending on the use of US components, and the possibiity of revisiting the agreement at regular intervals.Third, the imposition of tariffs on steel, aluminun, washing machines an solar panels irrespective of country of origin, although in the case of steel, there were several exemptions and modifications involving, among others, Brazi and S.Korea.So entering 2019 the only war is that with China and with a small number of countries producing steel, solar panels etc. Fig. 1 shows the exports and imports growth since 2017 of major global traders, such as US, China, Japan and Germany.There are no obvious conclusions if the "war" has had a clear impact "globally".The most recent trends of US exports and imports (blue) indicate a deceleration, while China's trends (red), not surprisingly, have a taken a steep drop, while Japan's trends (yellow) may be bottoming as are Germany's (green).Which bring us next to **interest rates.** The **Fed,** will likely hike again perhaps finaly once, with growing expectations by the markets that it might even cut in 2019.The **ECB** has reconfirmed its 0.25% to -0.40% policy rates till ,at least ,summer 2019, but assets purchases (QE) ceased in December although maturing holdings will be re-invested.**BoJ** confirmed its -0.1% policy rate, its policy of keeping 10Y JGB yields to zero and continuing asset purchases.So, here we are, three years after supposedly zero rates ended in the US, and hence in the world, with two out of three G3 central banks having no just zero rates, but **negative** ones. "Go figure" as the saying goes !

Consider, however, this exception to global links**.** All major equity markets ended 2018 ytd in USD terms in the red, with top prize going to SHCOMP at nearly 30.0% down, Nikkei at about -15.0% and S&P 500 at -7.0%.The October presssures remained unabated and will not go away in 2019. Equity markets, as they are unconnected to basic macros (witness the US with the best G20 growth track record in 2018) will need "expecational boosts" such as prospects of an end of the trade war, return to low rates, etc all of which will not happen anytime soon .in 2019.China is not really special here (Factbox)

Fig.1: US, China, Japan, Germany: Exports, Imports yoy% 2017-2018



Source: Bloomberg, See text

Investment suggestions:From sense to complete insensibility

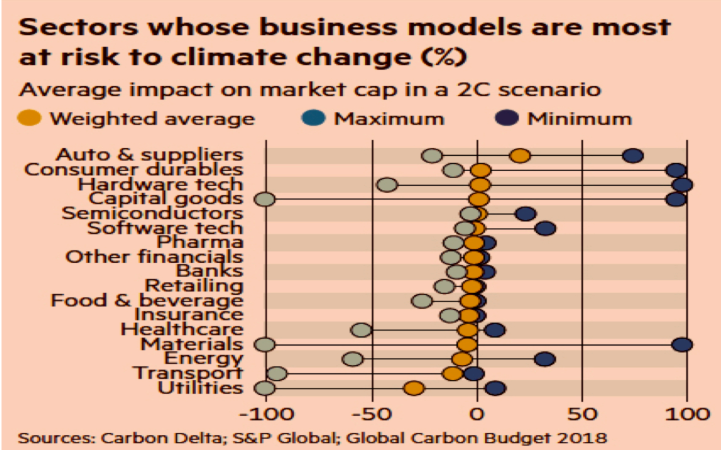
Brexit was mentioned briefly at the introduction but it merrits more than one line.Econotes has been steadfastly espousing the position that Brexit will simply not happen at all (no “No Deal”, no “May deal” etc) but with the UK staying in the EU.How this will be happen may involve a referendum or new elections.It would now follow that the “no Brexit” will be bullish for the UK stock market and GBP with supporting a renewed interest in the EUR given that the EU passed with flying colours the first effort by a member to leave ! **Enviromental investment opportunities.**This is not just about hugging trees and corporate emissions responsibility, but a profitable reality. With the world reaching the edge of the start of an uncontrolled climate deterioration, there are very large risks and gains to be faced and had.The IPCC 2018 report was extremely blunt as to the risks faced if global warming was not stopped at 1.5 C let alone to, on basic trends continuing, 2.0C.Figure 2 shows the expected impact on market caps of various sectors of climate change should the 2C warming is reached.Sectors such as utilities and transport are, potentially, the worst hit, with materials and capital goods spanning the extreme of “gains and losses”.

Fact Box: China, a champion of shorts

With an economy growing at near 6.5% one wonders what do investors want in order to price China back. The simple answers include a stock markets less poorly handled by the authorities as it was during most of 2018, a settled exports sector which also includes the key electronics goods, but this will involve assuaging global political and security concerns and not just settling with Trump. The efforts to substitute the US as the main engine of multilaterally driven trade, seems to be having problem with the very poor press received by the Belt and Road initiative. A renewed thrust at Taiwan will not help and neither will the N.Korean initiative petering out. One area of positive global policies has been China’s enthusiastic participation in the Paris and COP24 emission controls initiative. Skeptics will point that China is now the major CO2 emitter and it has been accelerating so.

These forecasts can be used as a guide as to which of these sectors to invest as the gains/losses vary from neutral possibilities to the extremes. As all scenarios go, this is no different in terms of its likelihood to come true than all others, but at least it quantifies the risks of doing something or nothing. The follow up to the Paris 2016 agreement, COP 24 in December 2018, was encouraging in terms of redefining and setting out clear rules concerning state commitments to reducing emissions, but then the road to perdition is paved with good intentions, notwithstanding the still ambivalent position of the US to the Paris commitments.

Fig.2: Climate change, Paris and IPCC: Corporate impact



Source: FT

And so back to portfolios

It will take a brave analyst to claim that , at the very least, the first half of 2019 will be good for **equities** while the uncertainty-generating factors persist.The **USD** will continue to be supported by the higher USD interest rates, at least till 2H.19, while the close-down of the US government and its eventual re-opening, with a widening deficit, will push **UST** yields up.The performance of **Emerging markets equities** was all negative but highly differentiated in terms of the size of the losses, and this may give some high/low base starting point for braver investors.**No Brexit** is our “sticking neck out” call with a strong potential for the GBP, FT100 Eurostox and the EUR.

As for the crazies, cryptocurrencies made a zombie reappearance on the basis that they will make a spectacular recovery in 2019.Yeah, so will the Titanic for a fully sold -out Caribbean cruise !

Andrew Freris (writing compleed 31/11/2018)