



Independent
Investment Research
Since 1949

The End Of An Era

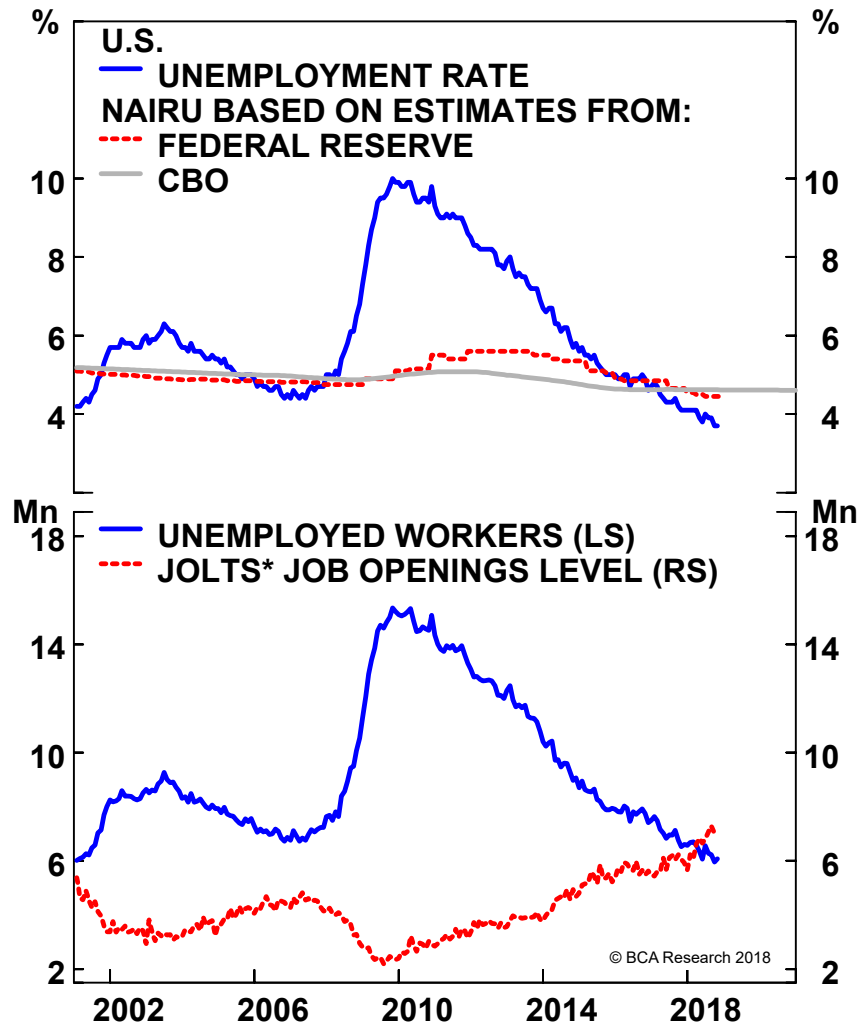
November 2018

Mathieu Savary
Chief FX Strategist
Foreign Exchange Strategy

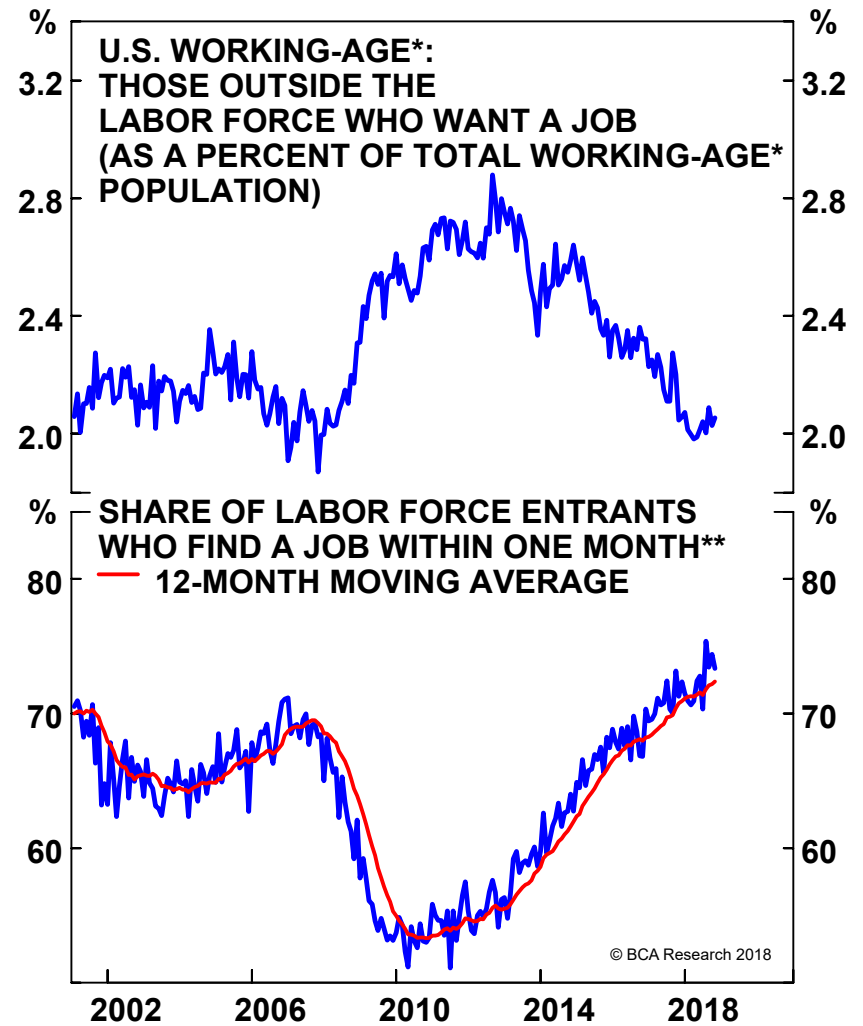
Three macro “policy puts” are in jeopardy of disappearing or, at the very least, being repriced

- *Fed Put*: Rising inflation has made the Fed more reluctant to back off from rate hikes at the first hint of slower growth or falling asset prices.
- *China Put*: Worries about high debt levels, overcapacity, and pollution all mean that the bar for fresh Chinese stimulus is higher than in the past.
- *Draghi Put*: Bailing out Italy was a no-brainer in 2012 when the country was the victim of contagion from the Greek crisis. But now that Italy is the source of the disease, the rationale for intervention has weakened.

The U.S. Is Back To Full Employment

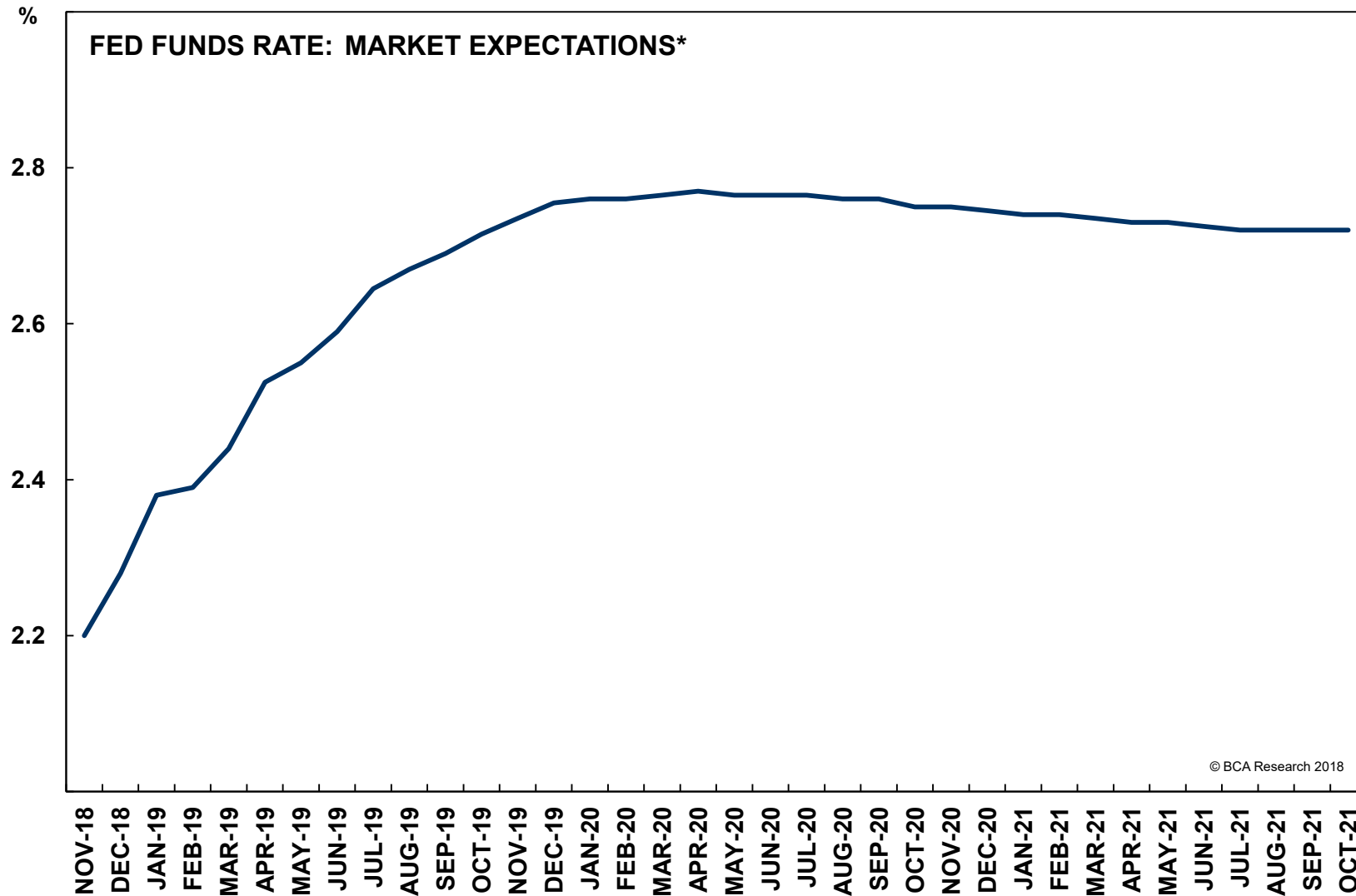


* JOB OPENINGS AND LABOR TURNOVER SURVEY.
 SOURCE: BUREAU OF LABOR STATISTICS.



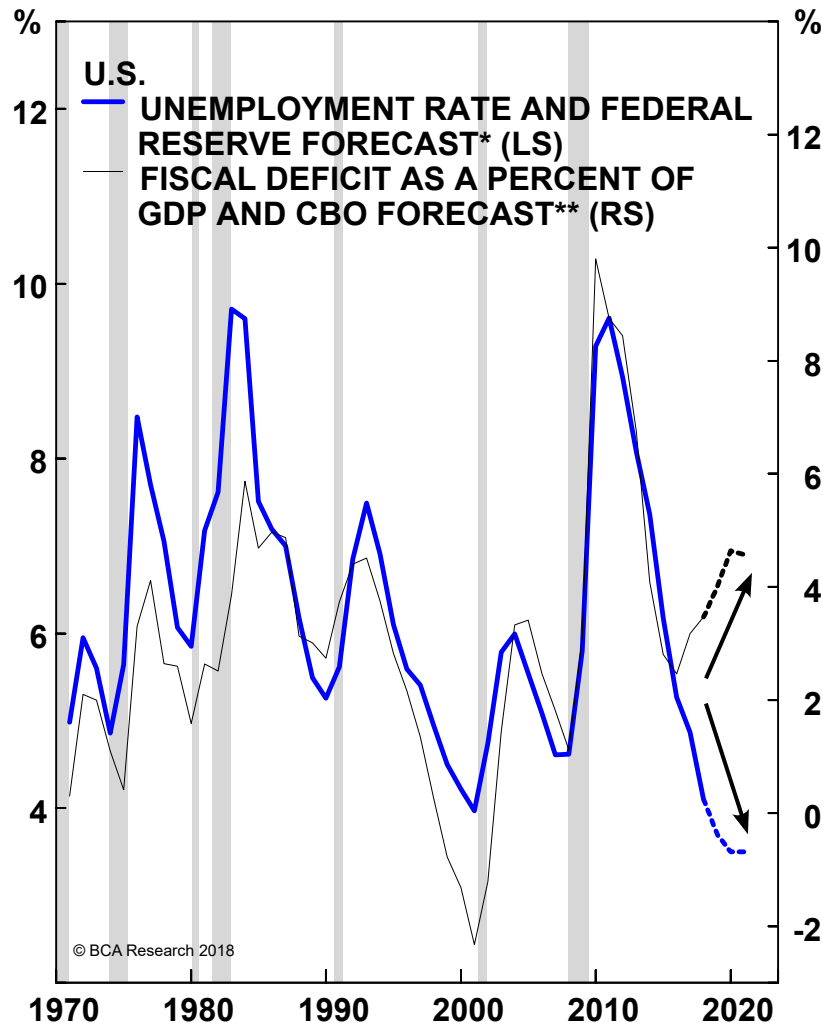
* THOSE AGED 16 YEARS AND OVER.
 ** CALCULATED AS THE FLOW OF NOT IN LABOR FORCE (PREVIOUS MONTH)
 TO EMPLOYED (CURRENT MONTH) AS A SHARE OF THE FLOW OF
 NOT IN LABOR FORCE (PREVIOUS MONTH) TO EMPLOYED AND UNEMPLOYED
 (CURRENT MONTH). SOURCE: BLS.

Markets Expect No Fed Hikes Beyond Next Year

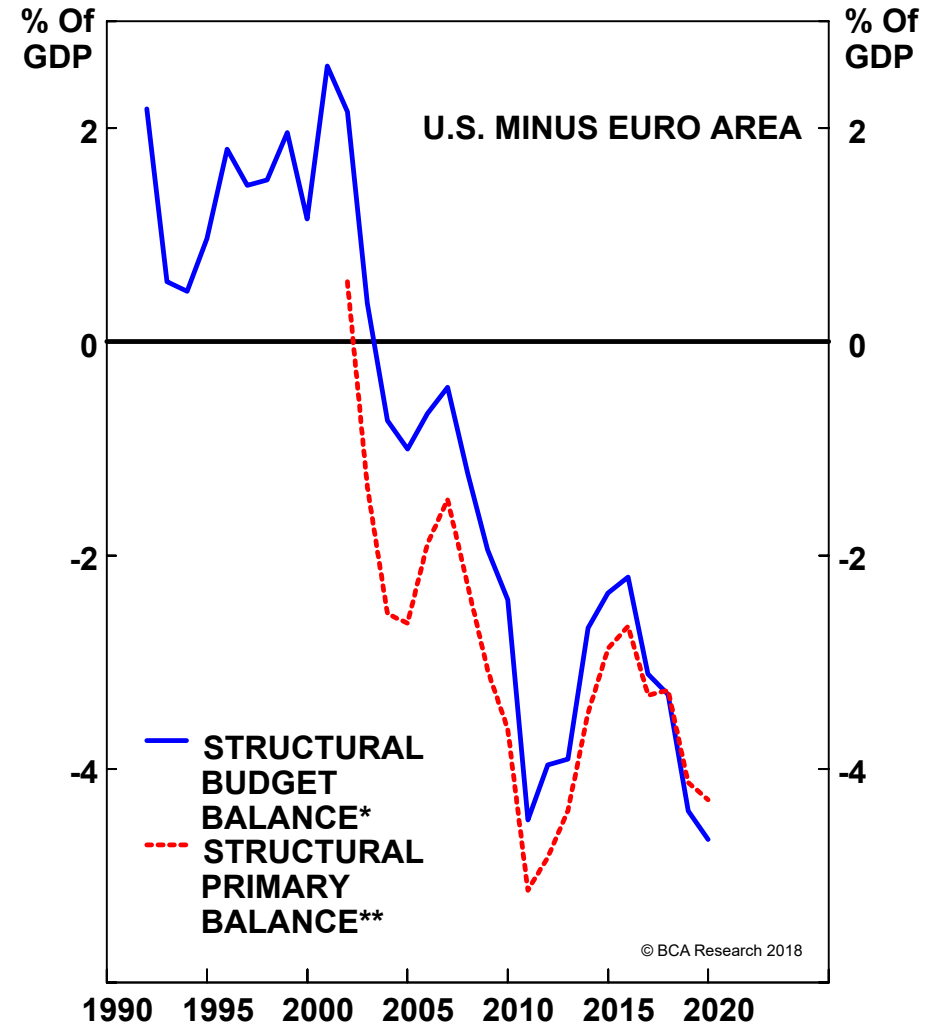


* REFERS TO EXPECTATIONS OF THE AVERAGE DAILY FED FUNDS RATE DURING THE MONTH AS DISCOUNTED BY THE FED FUNDS FUTURES MARKET.

This Is Not The Time For U.S. Fiscal Stimulus

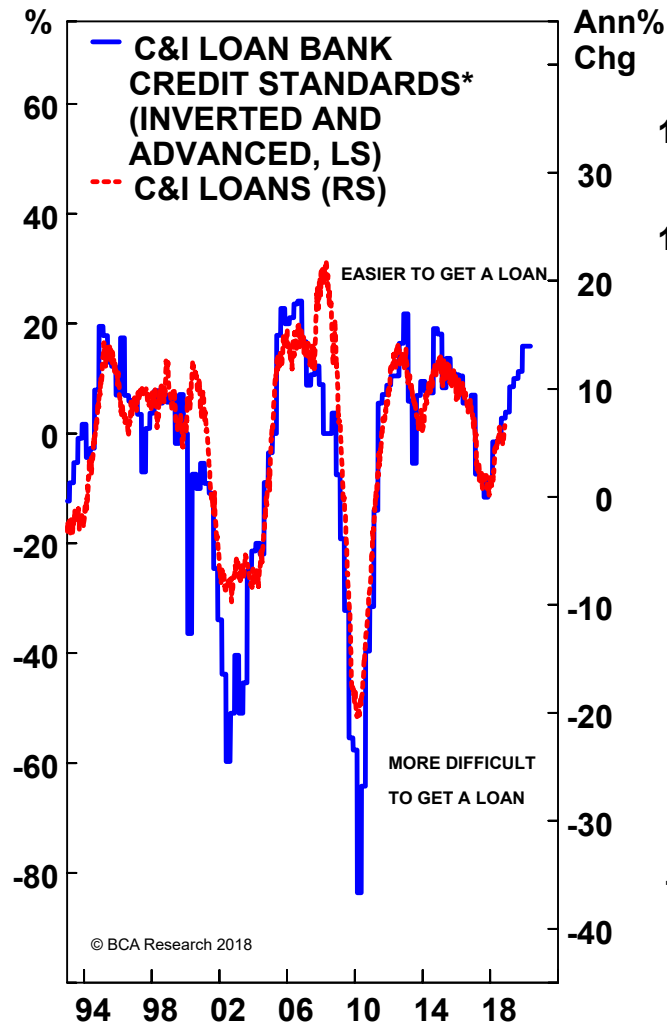
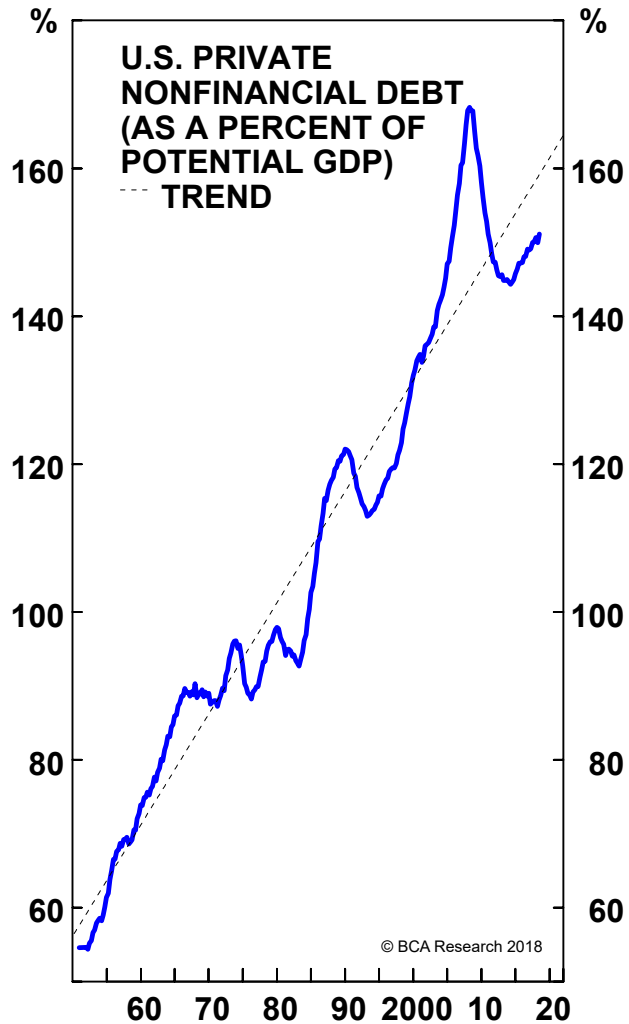


* SOURCE: FEDERAL RESERVE SUMMARY OF ECONOMIC PROJECTIONS.
 ** SOURCE: CONGRESSIONAL BUDGET OFFICE.
 NOTE: SHADED AREAS DENOTE NBER-DESIGNATED RECESSIONS.

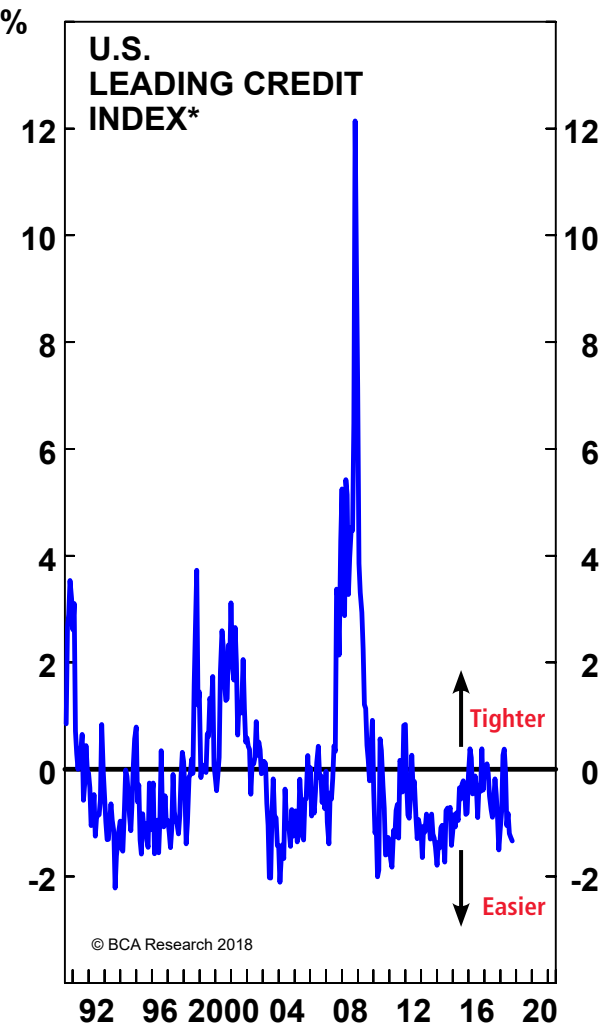


* THE STRUCTURAL (CYCLICALLY-ADJUSTED) BUDGET BALANCE IS THE GOVERNMENT'S ACTUAL FISCAL POSITION EXCLUDING THE ESTIMATED BUDGETARY CONSEQUENCES OF THE BUSINESS CYCLE. IT IS DESIGNED IN PART TO PROVIDE AN INDICATION OF THE MEDIUM-TERM ORIENTATION OF FISCAL POLICY.
 ** THE STRUCTURAL PRIMARY BALANCE IS THE STRUCTURAL BALANCE EXCLUDING NET INTEREST PAYMENTS (INTEREST EXPENDITURE MINUS INTEREST REVENUE).
 SOURCE: IMF

Private Credit Growing Again

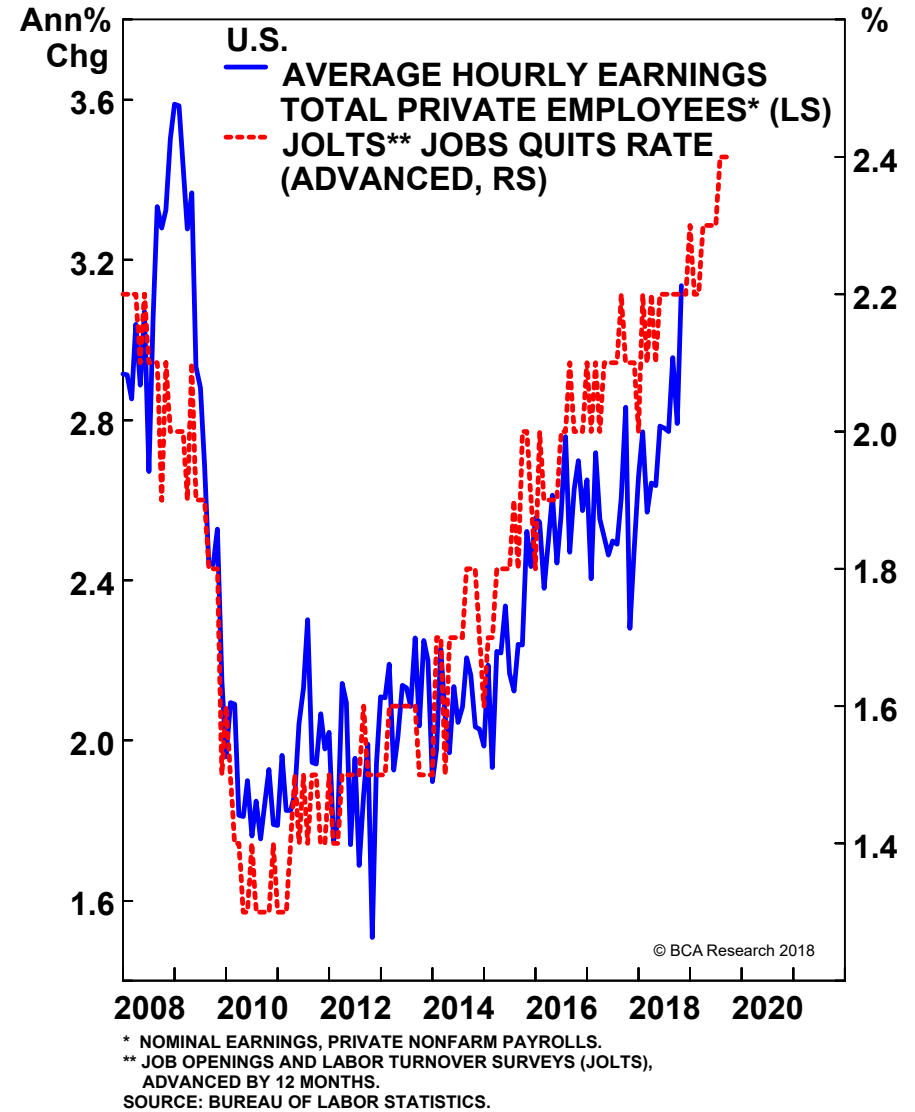
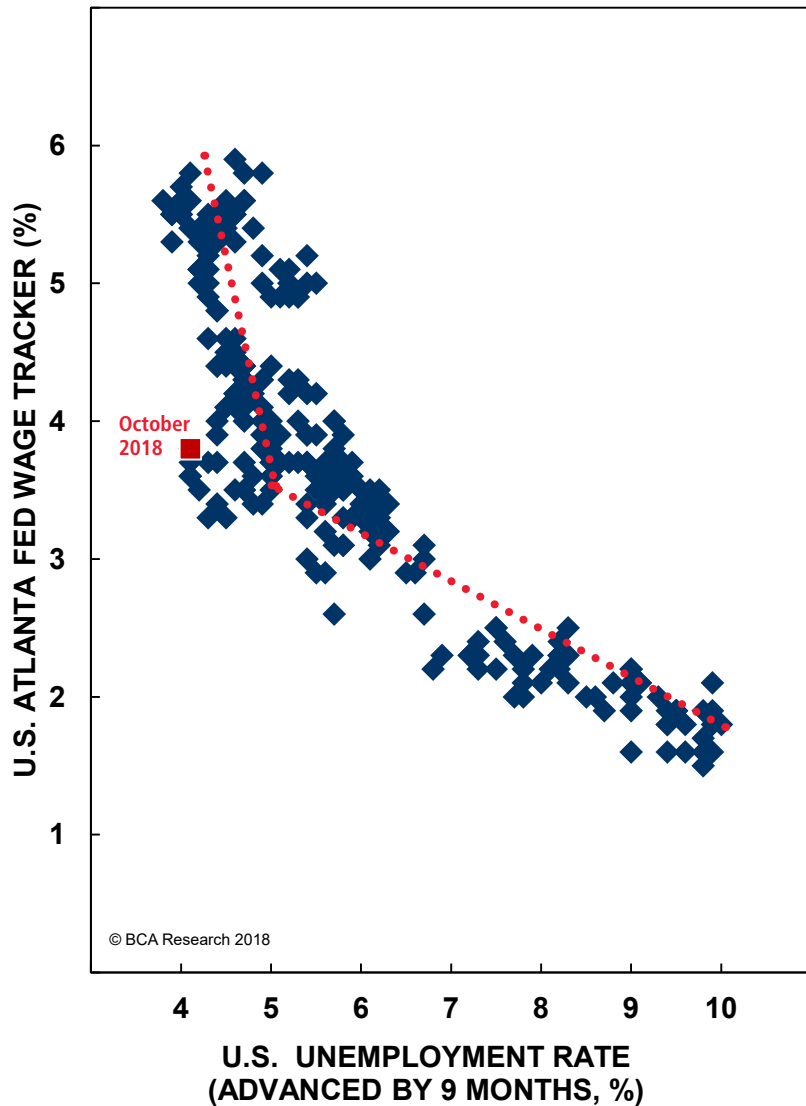


* COMMERCIAL AND INDUSTRIAL LOANS (LARGE FIRMS). NET PERCENTAGE OF RESPONDENTS TIGHTENING STANDARDS. SOURCE: FEDERAL RESERVE SENIOR LOAN OFFICER SURVEY.



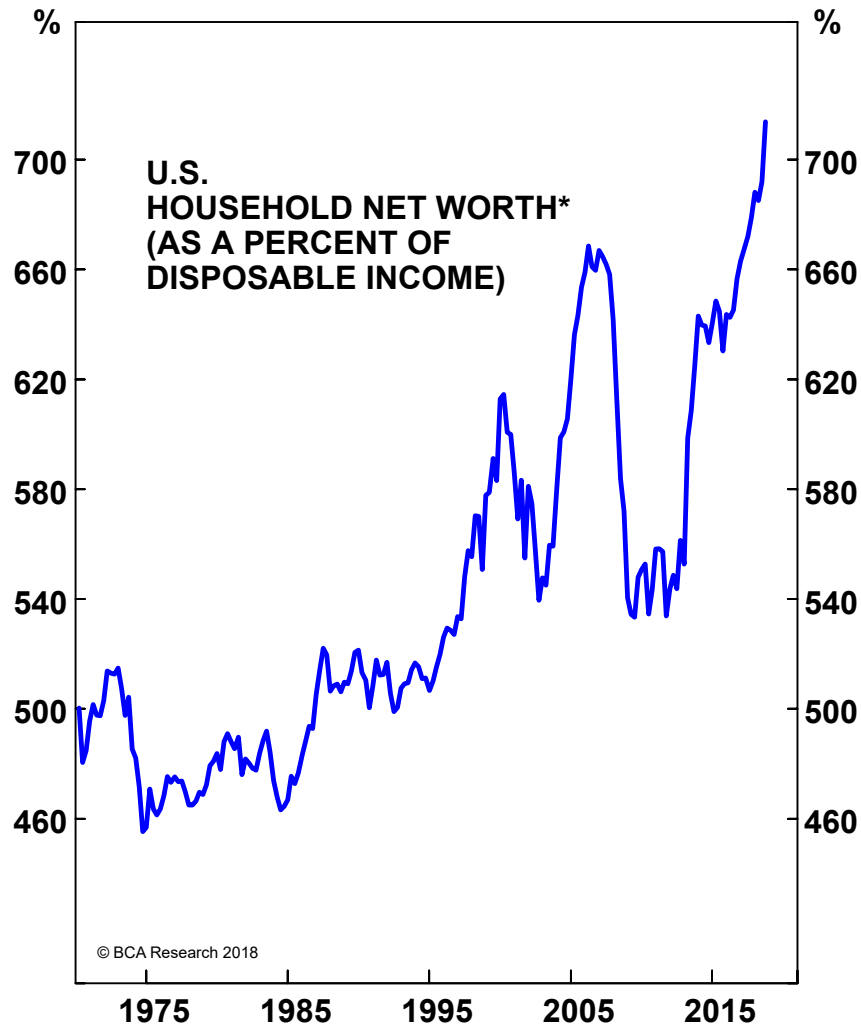
* BASED ON THE FOLLOWING SIX FINANCIAL INDICATORS: 2-YEAR SWAP SPREADS, 3-MONTH LIBOR MINUS 3-MONTH TREASURY-BILL YIELD SPREAD, DEBIT BALANCES AT MARGIN ACCOUNTS, INVESTOR SENTIMENT (BULLISH LESS BEARISH), SENIOR LOAN OFFICER C&I LOAN SURVEY: BANK TIGHTENING CREDIT TO LARGE AND MEDIUM FIRMS, AND SECURITY REPURCHASES FROM THE TOTAL FINANCE- LIABILITIES SECTION OF FEDERAL RESERVE FLOW OF FUNDS REPORT. SOURCE: THE CONFERENCE BOARD.

Wage Growth Will Pick Up

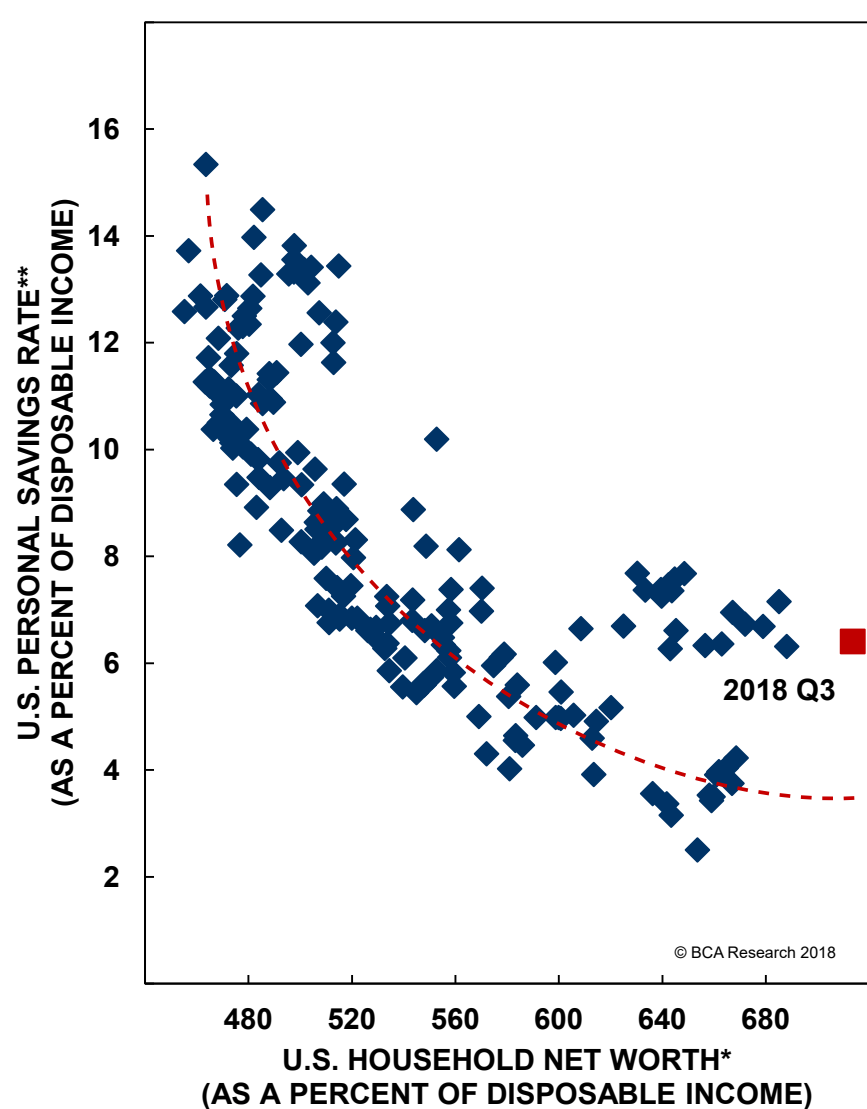


* BASED ON MONTHLY DATA FROM 1997 TO PRESENT.

The Savings Rate Has Room To Fall



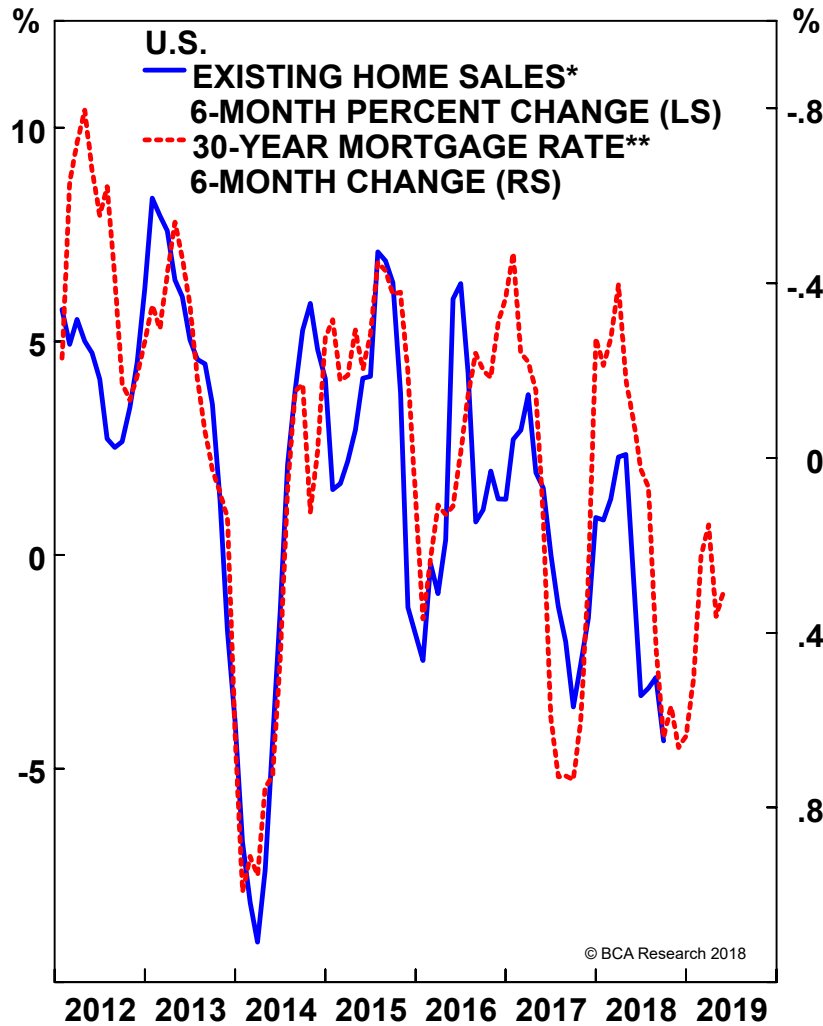
* BASED ON FLOW OF FUNDS DATA.



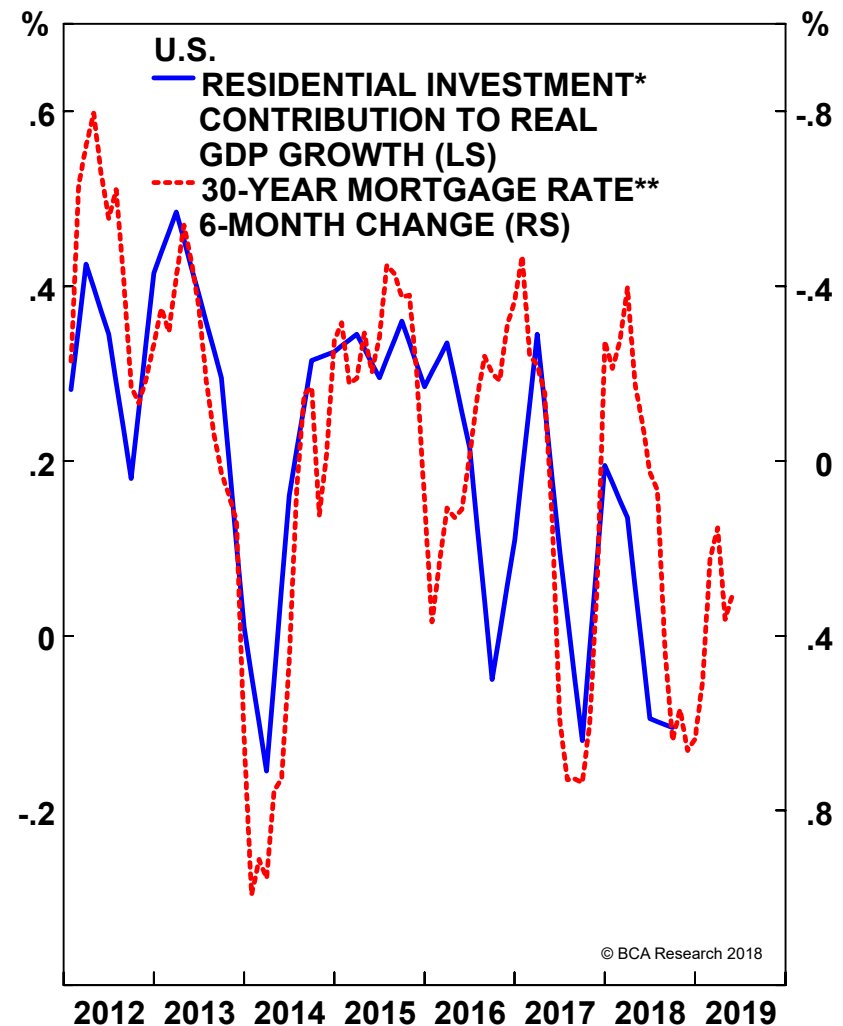
* BASED ON FLOW OF FUNDS DATA. LATEST DATAPPOINT IS BCA ESTIMATE.

** BASED ON BUREAU OF ECONOMIC ANALYSIS (BEA) DATA.

No Mystery Why U.S. Housing Has Been Weak...

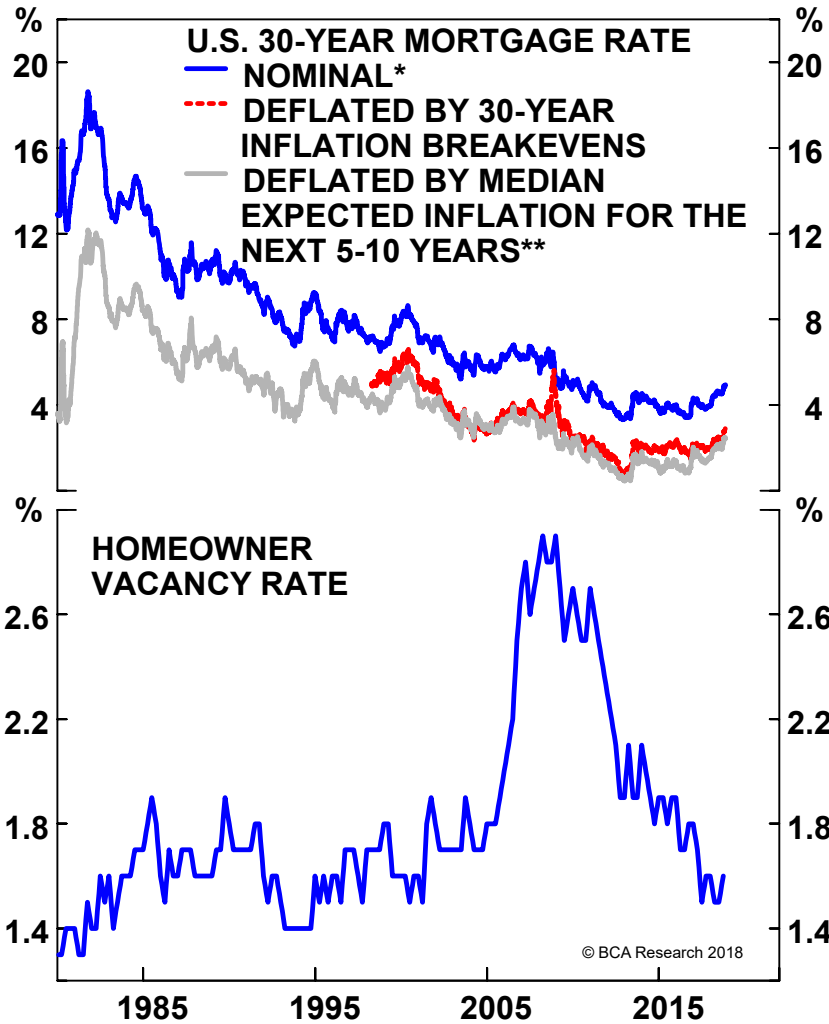


* SHOWN AS A 3-MONTH MOVING AVERAGE.
 ** SHOWN INVERTED AND ADVANCED BY 6 MONTHS.

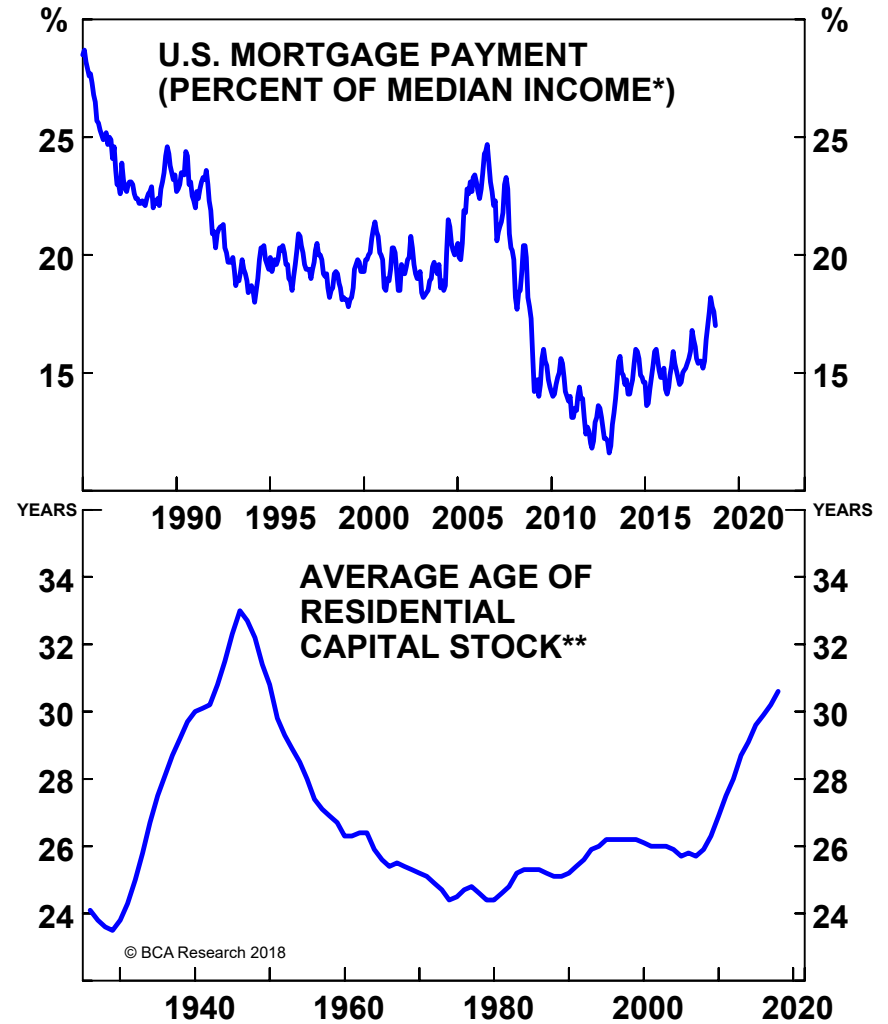


* SHOWN AS A 2-QUARTER MOVING AVERAGE.
 ** SHOWN INVERTED AND ADVANCED BY 6 MONTHS.

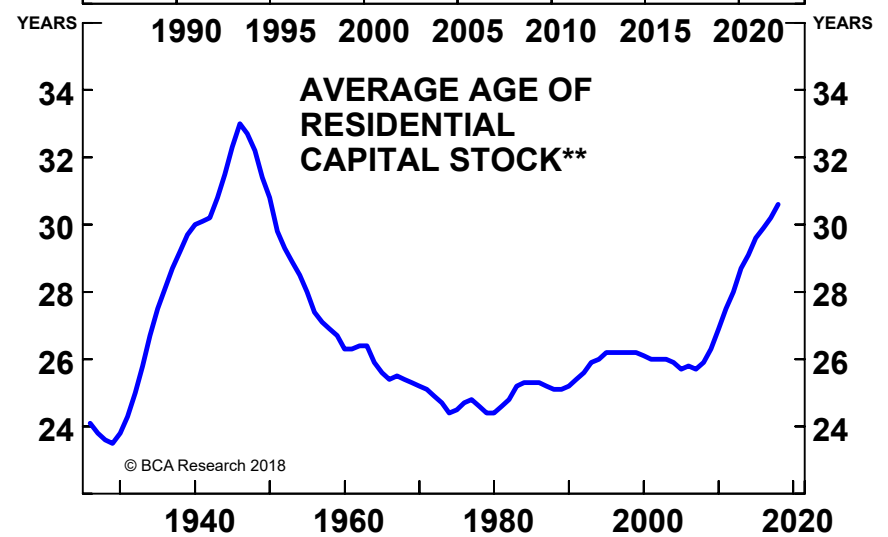
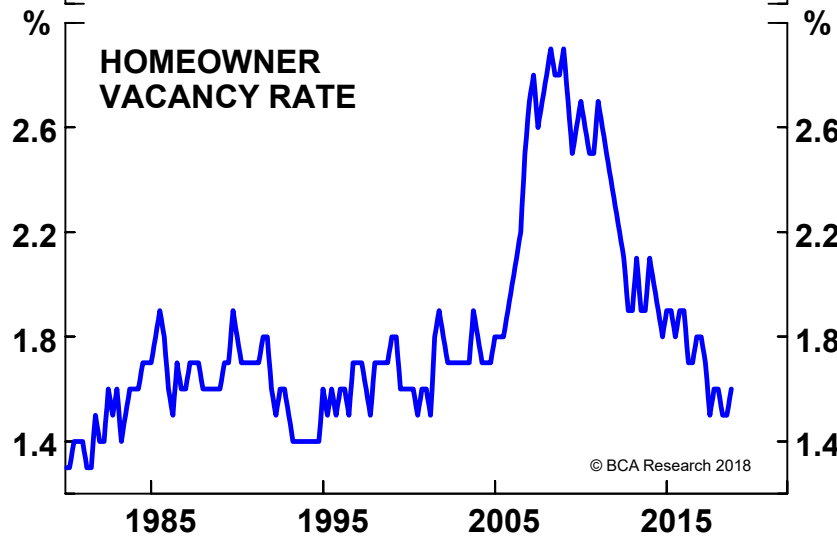
...But Housing Fundamentals Are Still In Good Shape



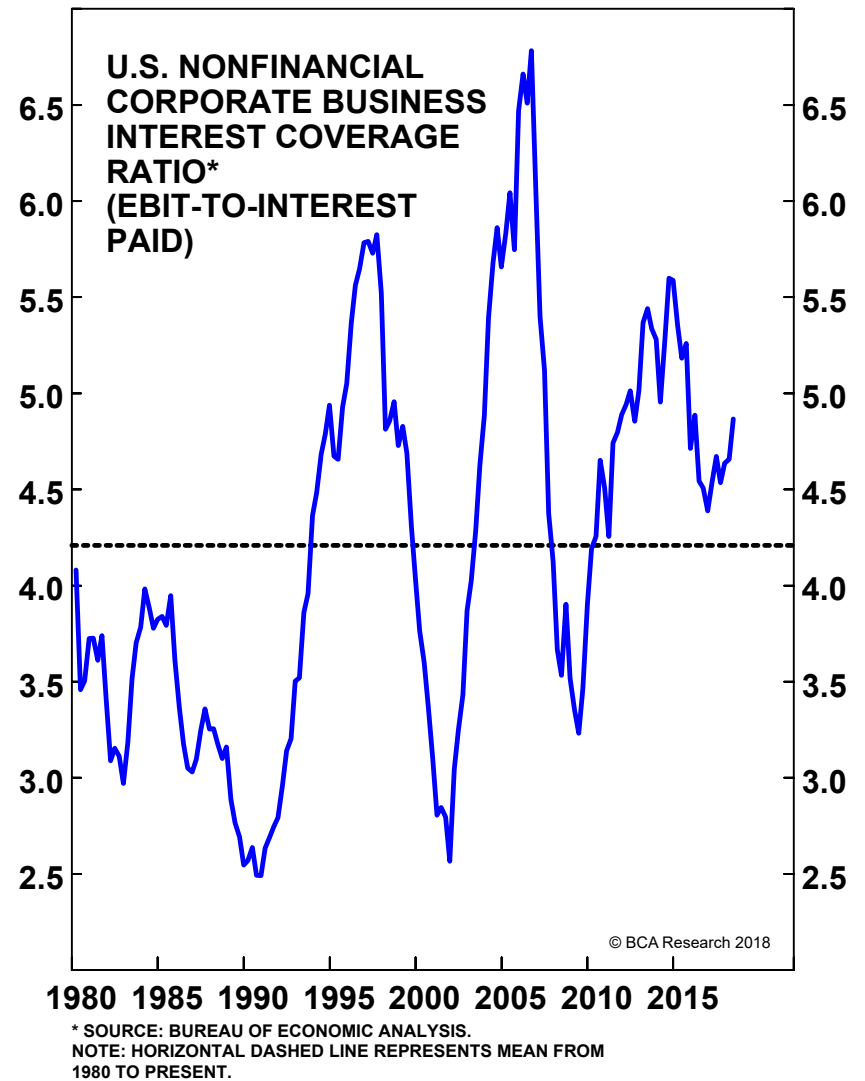
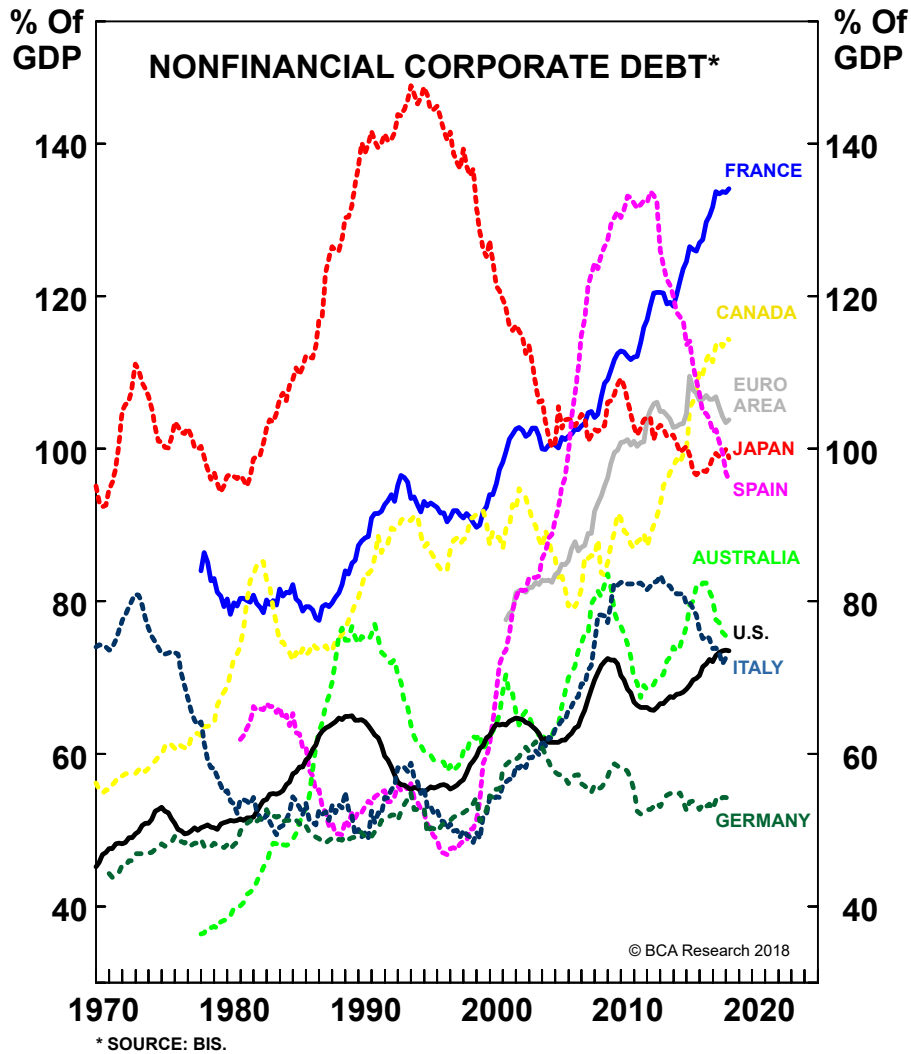
* SOURCE: FREDDIE MAC / FEDERAL RESERVE.
 ** UNIVERSITY OF MICHIGAN CONSUMER SENTIMENT SURVEY.



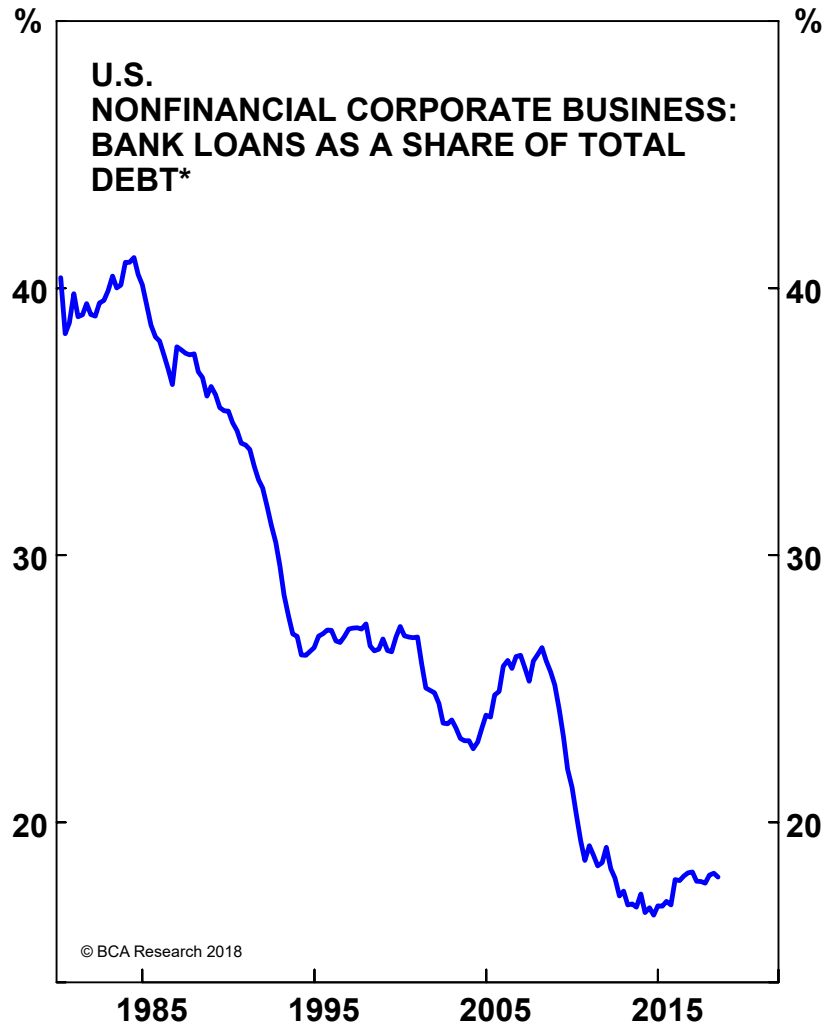
* SOURCE: NATIONAL ASSOCIATION OF REALTORS.
 ** CURRENT-COST AVERAGE AGE AT YEAR-END.



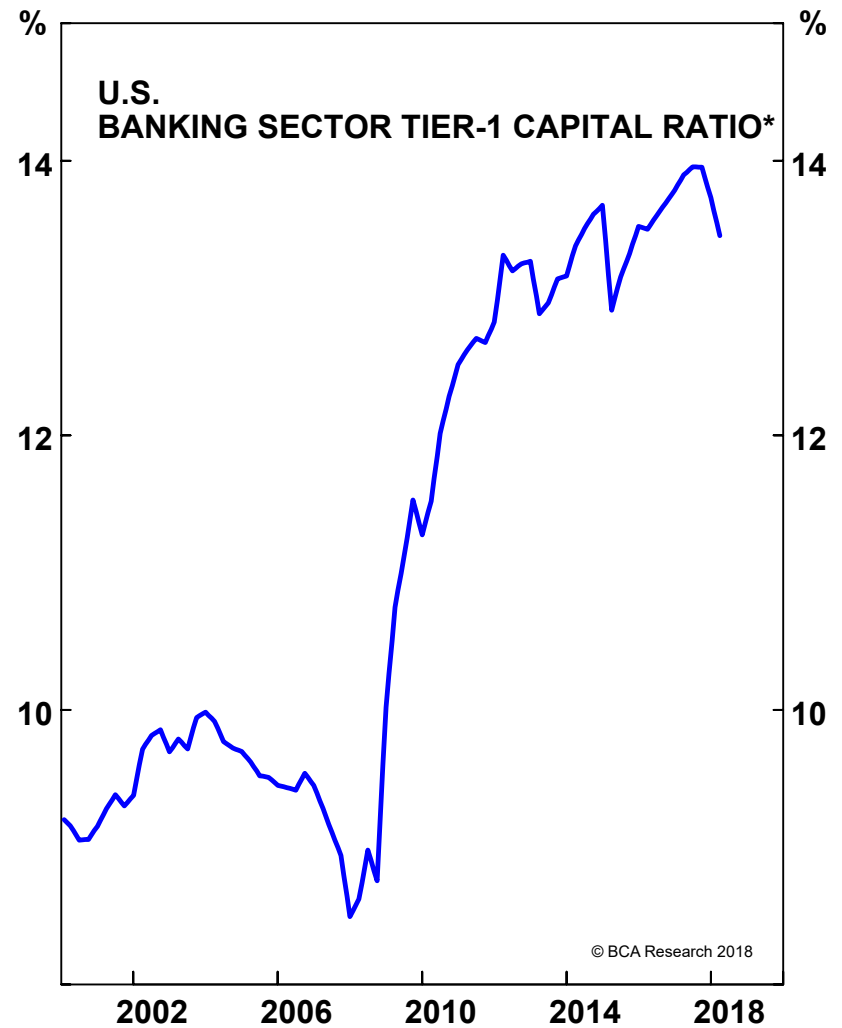
Corporate Debt Market: More Resilient Than Widely Believed?



Banks Are Better Capitalized And Less Exposed To The Corporate Sector

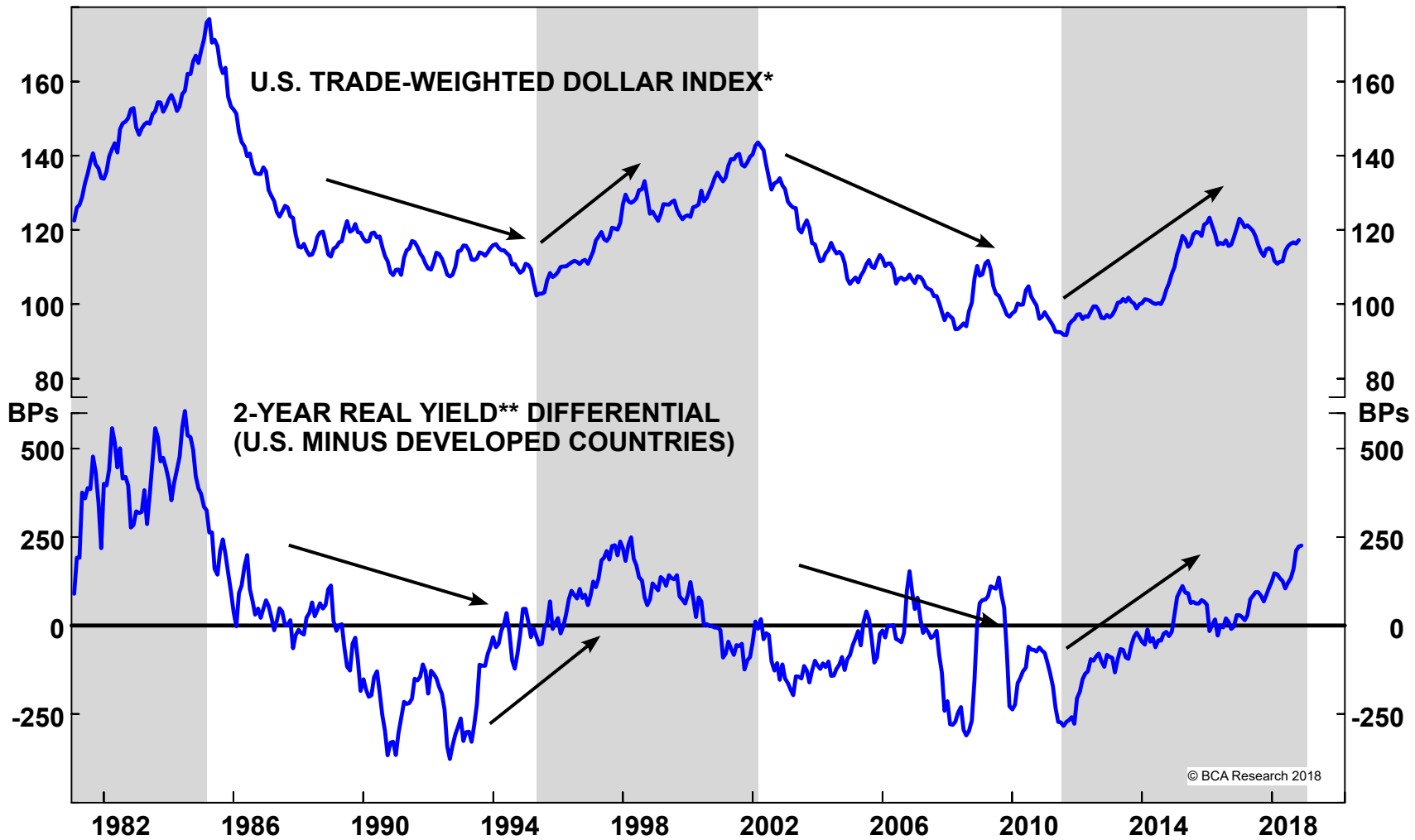


* BANK LOANS DEFINED AS THE SUM OF DEPOSITORY INSTITUTION LOANS AND MORTGAGES; CORPORATE DEBT DEFINED AS THE SUM OF DEBT SECURITIES AND LOANS.
SOURCE: U.S. FLOW OF FUNDS AND BUREAU OF ECONOMIC ANALYSIS.



* TIER-1 CAPITAL AS A PERCENT OF RISK-WEIGHTED ASSETS, SOURCE: FEDERAL RESERVE BANK OF NEW YORK.

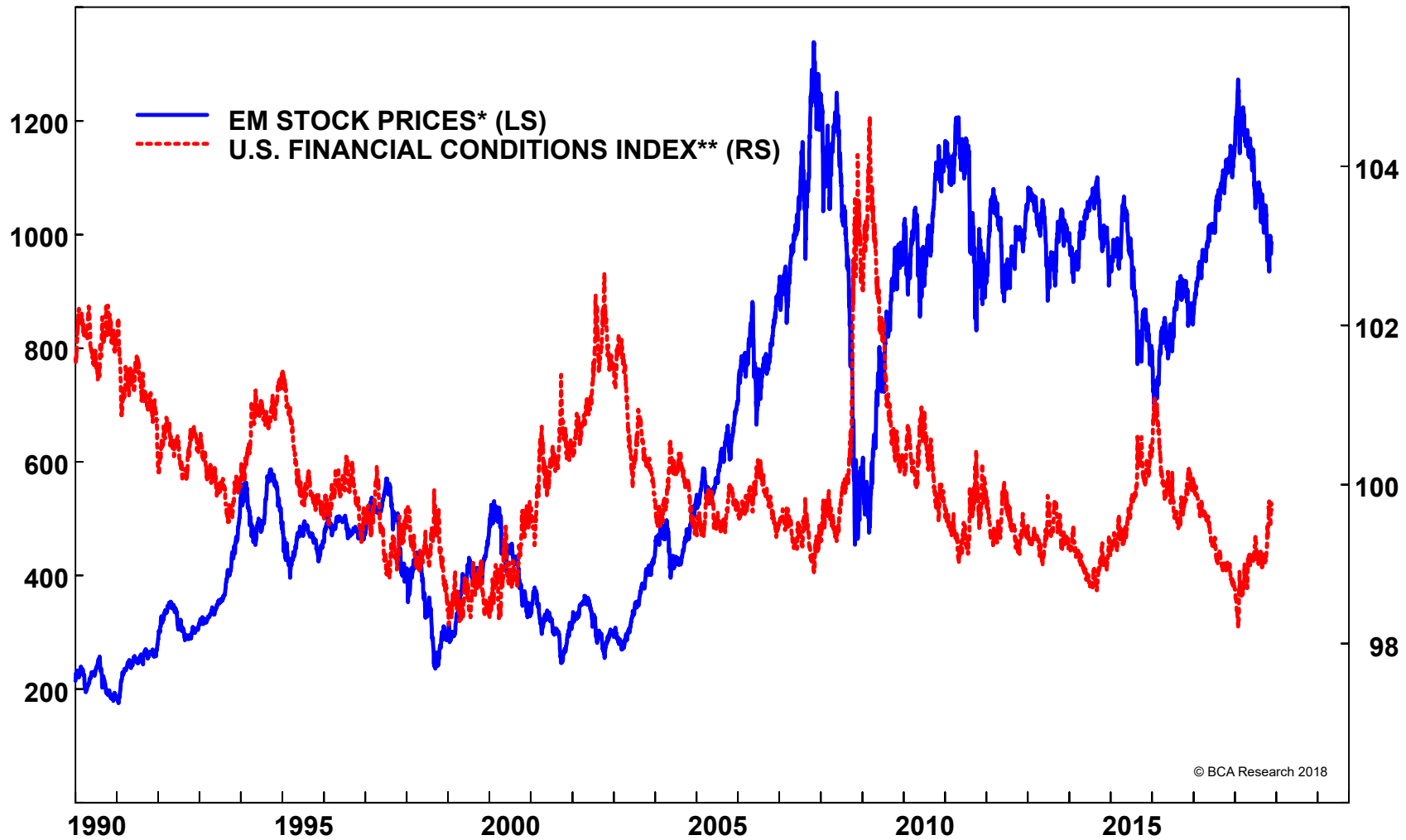
The Dollar Will Strengthen



* SOURCE: BANK OF ENGLAND AND BIS.
 ** 2-YEAR NOMINAL YIELD DEFLATED BY CONSUMER PRICE INDEX.
 NOTE: SHADED AREAS DENOTE PERIODS OF MAJOR DOLLAR APPRECIATION.

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Emerging Markets Will Feel The Brunt Of Tighter U.S. Financial Conditions



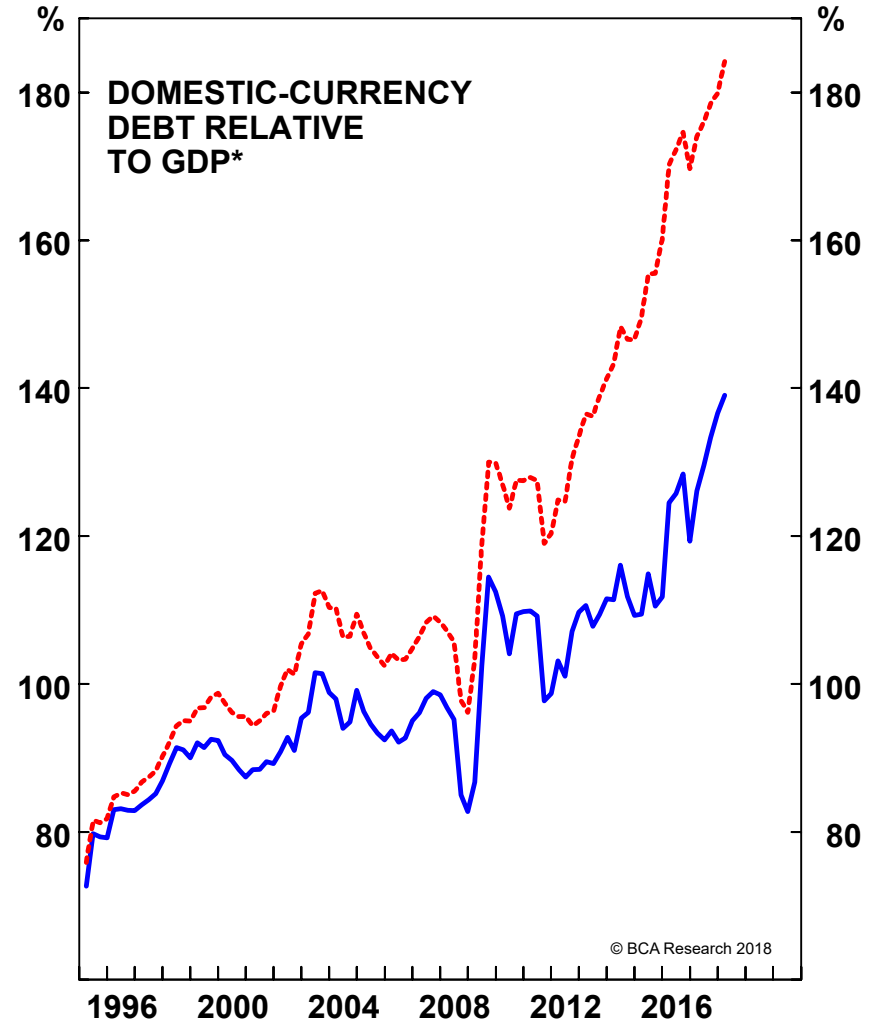
* IN U.S. DOLLARS. SOURCE: MSCI INC. (SEE COPYRIGHT DECLARATION).
** SOURCE: GOLDMAN SACHS (VIA BLOOMBERG L.P.)

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EM Debt is Worryingly High



* SOURCE: BANK FOR INTERNATIONAL SETTLEMENTS (BIS) AND WORLD BANK. BIS DATA FROM 2000. BACK ESTIMATES FOR THE 1990-2000 PERIOD ARE BCA CALCULATED BASED ON EXTERNAL DEBT DATA FROM THE WORLD BANK'S INTERNATIONAL DEBT STATISTICS.
 ** SOURCE: IMF.



* CALCULATED AS EM NONFINANCIAL DEBT MINUS EM NONFINANCIAL DEBT DENOMINATED IN FOREIGN CURRENCIES.
 SOURCE: BANK FOR INTERNATIONAL SETTLEMENTS (BIS), WORLD BANK, AND IMF. BIS DATA FROM 2000. BACK ESTIMATES FOR 1995-2000 ARE BCA-CALCULATED BASED ON EXTERNAL DEBT DATA FROM THE WORLD BANK INTERNATIONAL DEBT STATISTICS, BIS PRIVATE DEBT STATISTICS, AND IMF PUBLIC DEBT STATISTICS.

Vulnerability Heat Map For Key EM Markets

| | CURRENT ACCOUNT (% OF GDP) | NET INT'L. INVESTMENT POSITION (% OF GDP) | EXTERNAL DEBT (% OF GDP) | 5-YEAR CHANGE: EXTERNAL DEBT (% OF GDP) | EXTERNAL DEBT-SERVICING OBLIGATIONS* (% OF TOTAL EXPORTS) | EXTERNAL FUNDING REQUIREMENT** (% OF FOREIGN EXCHANGE RESERVES) | PRIVATE-SECTOR SAVING / INVESTMENT BALANCE (% OF GDP) | PRIVATE-SECTOR DEBT (% OF GDP) | 5-YEAR CHANGE: PRIVATE-SECTOR DEBT (% OF GDP) | GOV'T BUDGET BALANCE (% OF GDP) | GOV'T DEBT (% OF GDP) | 5-YEAR CHANGE: GOV'T DEBT (% OF GDP) | LOCAL-CURRENCY BONDS HELD BY FOREIGNERS (% OF TOTAL OUTSTANDING) | CPI (%) | OVERALL VULNERABILITY INDEX*** |
|--------------|----------------------------|---|--------------------------|---|---|---|---|--------------------------------|---|---------------------------------|-----------------------|--------------------------------------|--|---------|--------------------------------|
| TURKEY | -7.4 | -51.6 | 57 | 17.4 | 83.0 | 139.3 | -3.3 | 67 | 17.6 | -2.3 | 28.5 | -4.2 | 19.6 | 17.9 | 0.74 |
| ARGENTINA | -5.7 | 3.5 | 43 | 18.1 | 64.4 | 138.6 | 1.6 | 16 | 0.8 | -6.5 | 52.6 | 13.7 | 40.0 | 39.5 | 0.73 |
| COLOMBIA | -3.3 | -48.7 | 40 | 18.4 | 56.4 | 82.3 | -0.3 | 50 | 12.4 | -3.1 | 49.4 | 15.3 | 26.0 | 3.1 | 0.49 |
| BRAZIL | -0.7 | -25.7 | 34 | 14.8 | 83.0 | 59.6 | 7.3 | 60 | -2.8 | -7.8 | 84.0 | 21.8 | 12.0 | 4.2 | 0.38 |
| CHILE | -1.2 | -23.9 | 65 | 18.5 | 47.5 | 115.3 | 1.2 | 79 | 5.2 | -2.7 | 23.6 | 11.7 | 1.2 | 2.6 | 0.21 |
| MEXICO | -1.7 | -51.4 | 39 | 9.0 | 27.8 | 81.9 | -0.6 | 27 | 7.2 | -1.1 | 54.2 | 11.5 | 32.1 | 4.6 | 0.18 |
| SOUTH AFRICA | -3.4 | 11.1 | 51 | 15.3 | 25.3 | 44.9 | 2.3 | 66 | -3.0 | -4.5 | 52.7 | 11.7 | 40.2 | 4.8 | 0.13 |
| INDONESIA | -2.4 | -30.2 | 35 | 7.7 | 58.9 | 111.7 | 0.8 | 32 | 2.5 | -2.5 | 28.9 | 6.0 | 39.0 | 3.2 | 0.11 |
| PERU | -1.3 | -36.9 | 31 | 1.3 | 56.6 | 52.7 | 1.8 | 34 | 6.0 | -3.1 | 25.5 | 3.9 | 44.0 | 1.7 | -0.06 |
| MALAYSIA | 3.8 | -2.0 | 72 | 9.4 | 26.3 | 46.5 | 5.9 | 117 | 3.1 | -2.9 | 54.2 | -0.4 | 29.0 | 0.6 | -0.07 |
| CHINA | 0.9 | 12.7 | 15 | 1.1 | 33.0 | 21.9 | 5.3 | 159 | 30.4 | -4.0 | 47.0 | 12.7 | 2.0 | 2.3 | -0.10 |
| INDIA | -1.8 | -16.2 | 20 | -2.1 | 35.5 | 53.7 | 5.0 | 50 | -2.3 | -6.9 | 70.2 | 1.1 | 3.0 | 4.6 | -0.27 |
| PHILIPPINES | -1.6 | -10.7 | 23 | -0.1 | 28.2 | 34.2 | -0.1 | 48 | 14.4 | -0.3 | 37.8 | -10.0 | 0.0 | 5.7 | -0.50 |
| RUSSIA | 2.8 | 17.2 | 33 | 2.0 | 21.2 | 10.6 | 4.9 | 53 | 8.8 | -2.2 | 17.4 | 5.9 | 28.2 | 3.1 | -0.56 |
| KOREA | 4.5 | 20.1 | 28 | -5.3 | 24.2 | 23.7 | 3.2 | 144 | 7.4 | 1.9 | 39.8 | 7.6 | 12.0 | 1.4 | -0.58 |
| THAILAND | 10.6 | -6.9 | 33 | -1.5 | 12.8 | -4.3 | 11.4 | 112 | 5.7 | -0.6 | 41.9 | 0.0 | 15.0 | 1.5 | -0.83 |

* CALCULATED AS THE SUM OF REPAYMENTS OF SHORT-TERM DEBT OF LESS THAN 12 MONTHS, INTEREST PAYMENTS, AND AMORTIZATION DUE TO LONG-TERM DEBT IN EXCESS OF 12 MONTHS.

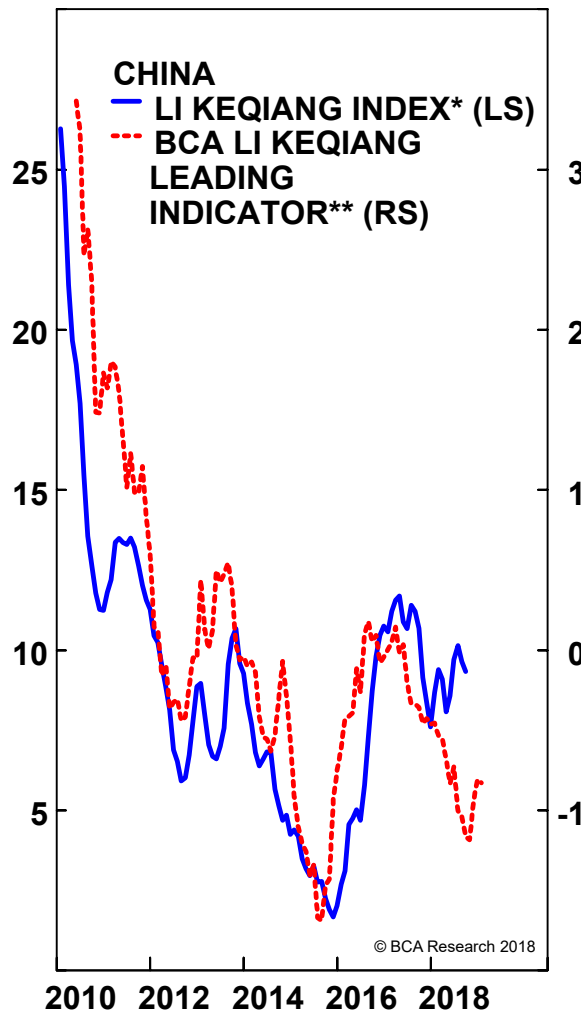
** CALCULATED AS EXTERNAL DEBT-SERVICING PAYMENTS IN THE NEXT 12 MONTHS MINUS CURRENT ACCOUNT BALANCE, AS A PERCENT OF CENTRAL BANK FOREIGN EXCHANGE RESERVES INCLUDING GOLD.

*** CALCULATED AS THE AVERAGE Z-SCORE OF EACH COUNTRY ACROSS ALL GIVEN VARIABLES, WHERE A HIGHER SCORE REPRESENTS MORE VULNERABILITY AND A LOWER SCORE REPRESENTS LESS VULNERABILITY.

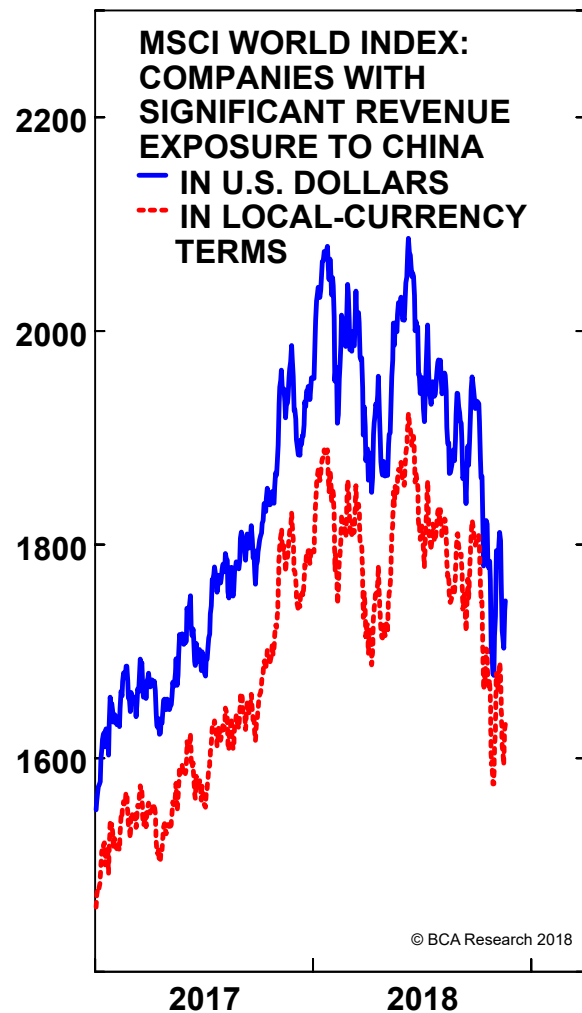
NOTE: RED SHADING INDICATES INTENSITY OF INCREASED VULNERABILITY, WHEREAS GREEN SHADING INDICATES INTENSITY OF DECREASED VULNERABILITY. BASED ON DATA FROM BIS, IMF, WORLD BANK, AND NATIONAL SOURCES. THIS HEAT MAP HAS BEEN MODIFIED FROM THE ORIGINAL VERSION PUBLISHED ON AUGUST 17, 2018.

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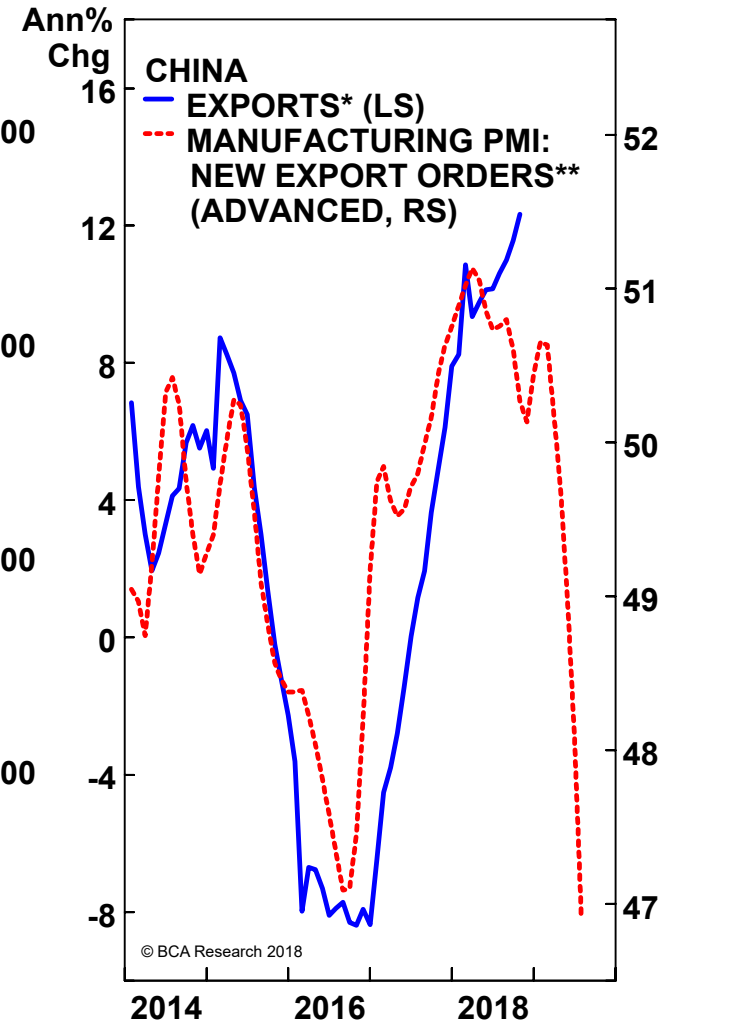
China's Economy Continues To Slow



* SHOWN SMOOTHED. SOURCE: BLOOMBERG FINANCE L.P.
 ** BASED ON 6 MEASURES OF MONEY AND CREDIT.
 *** SOURCE: NATIONAL BUREAU OF STATISTICS.

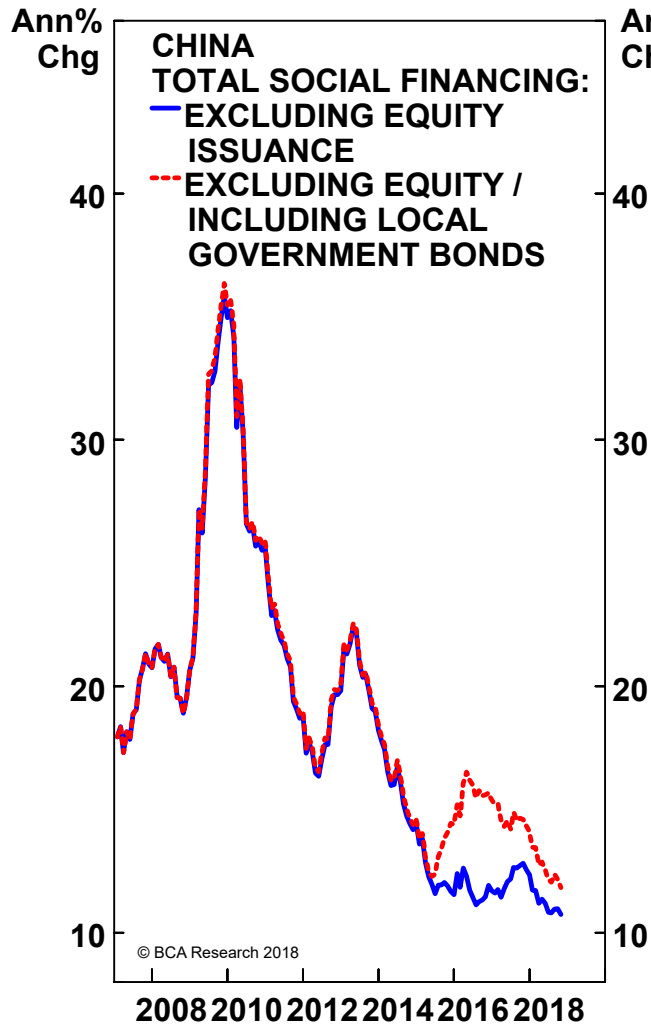


SOURCE: MSCI INC. (SEE COPYRIGHT DECLARATION)

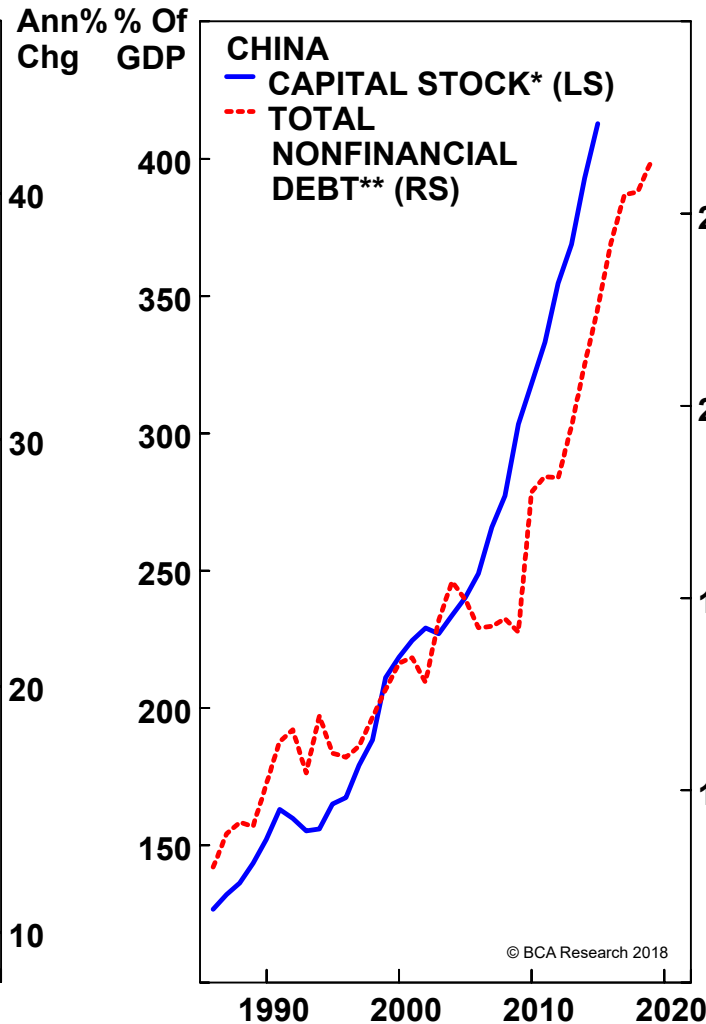


* IN U.S. DOLLAR TERMS.
 ** SHOWN ADVANCED BY 9 MONTHS. SOURCE: NATIONAL BUREAU OF STATISTICS OF CHINA.

Chinese Stimulus May Underwhelm

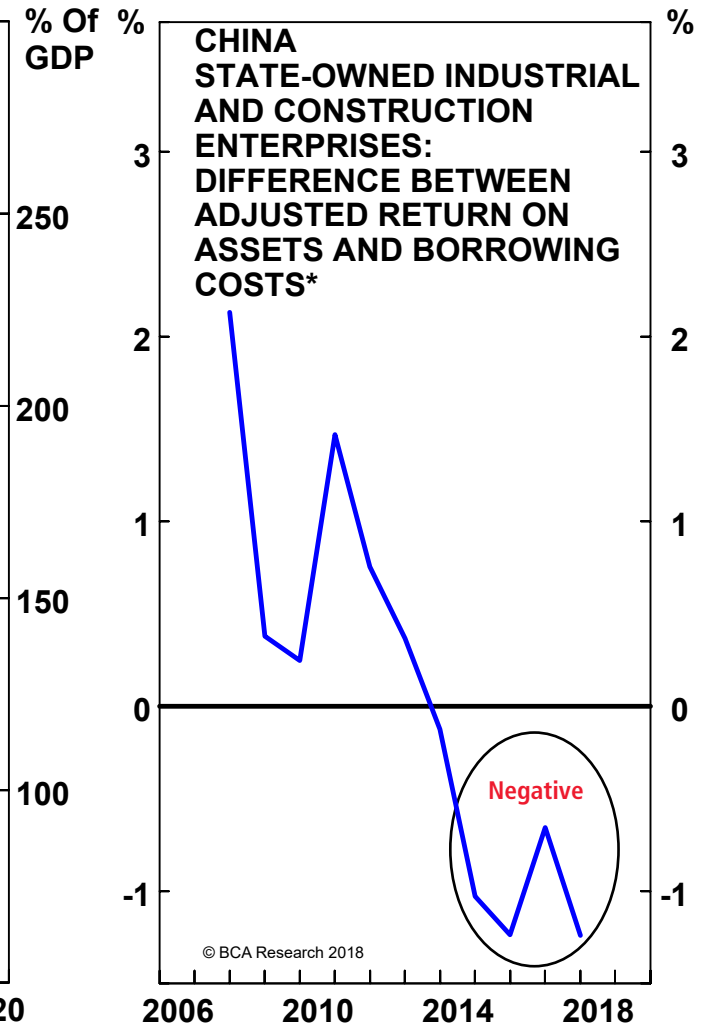


SOURCE: BCA CALCULATIONS.



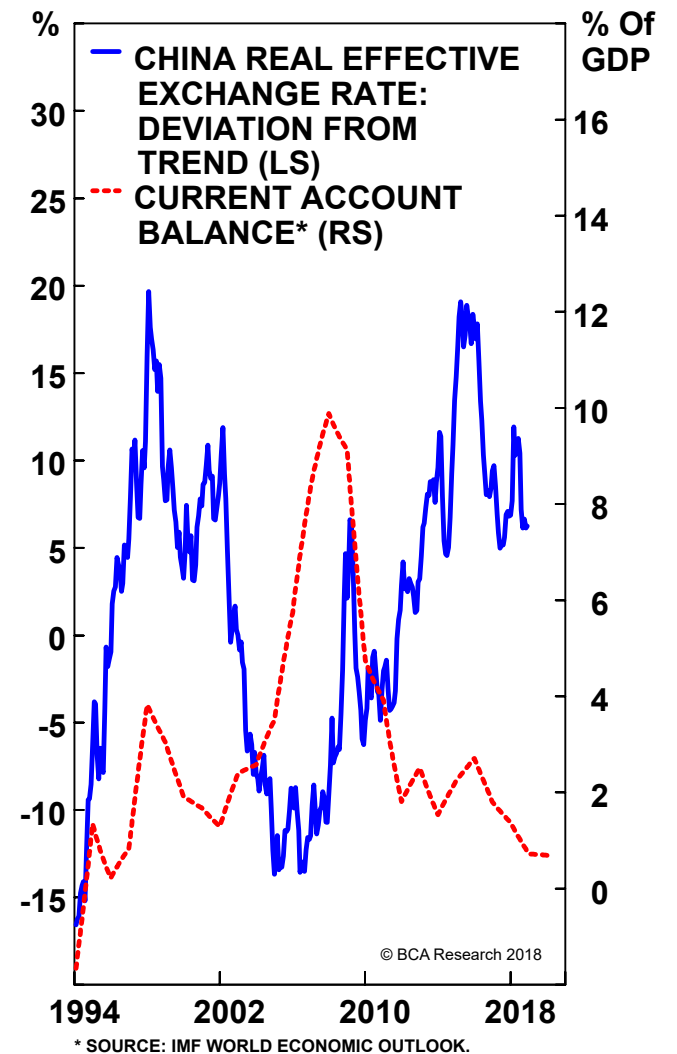
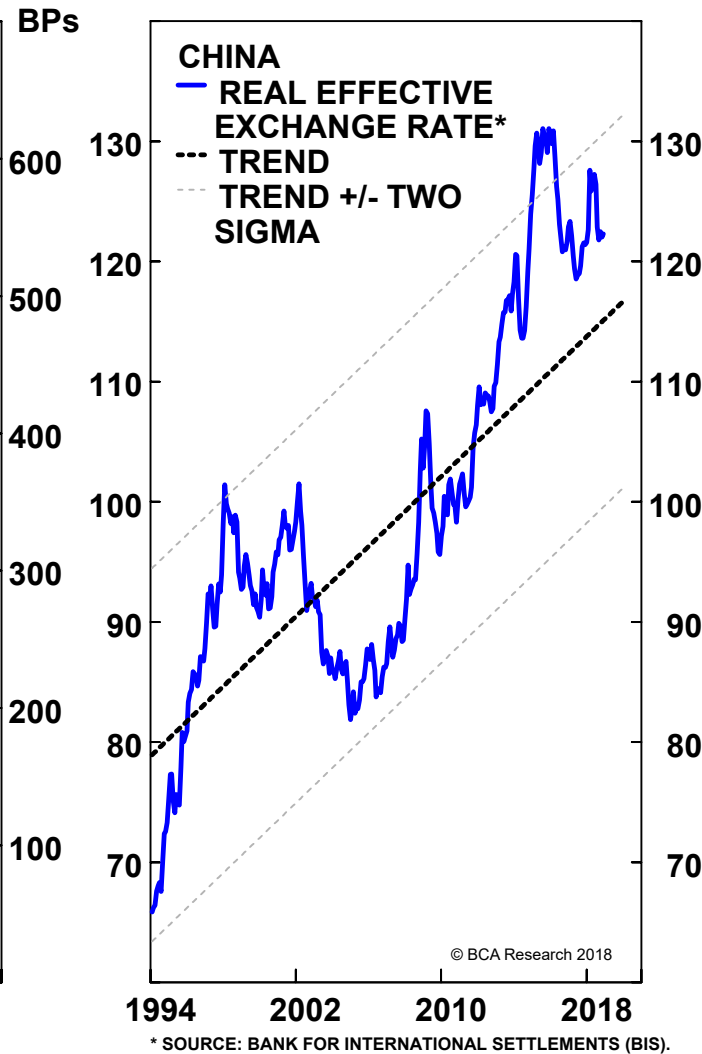
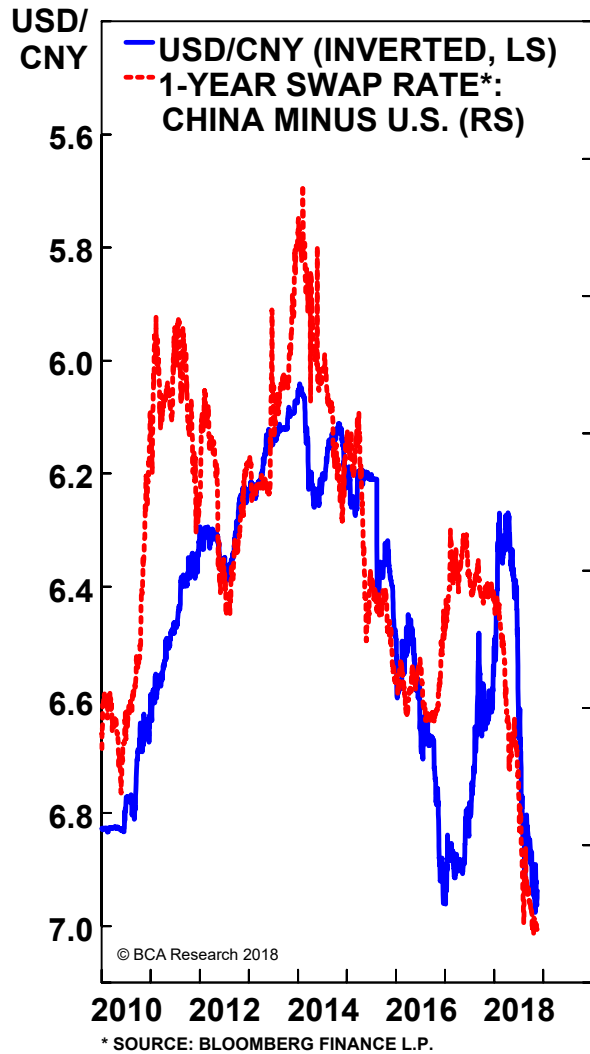
* BASED ON 2011 CURRENT INTERNATIONAL PURCHASING POWER PARITY DOLLARS. SOURCE: PENN WORLD TABLES.

** NONFINANCIAL PRIVATE DEBT PLUS PUBLIC DEBT; SOURCE: IMF AND BIS.

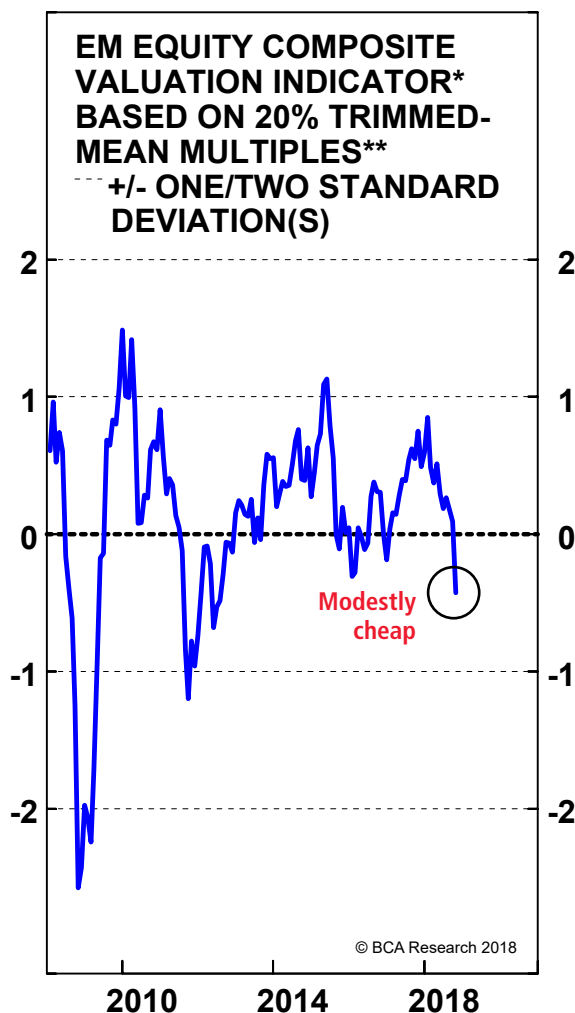


* ADJUSTED FOR INTEREST EXPENSES.

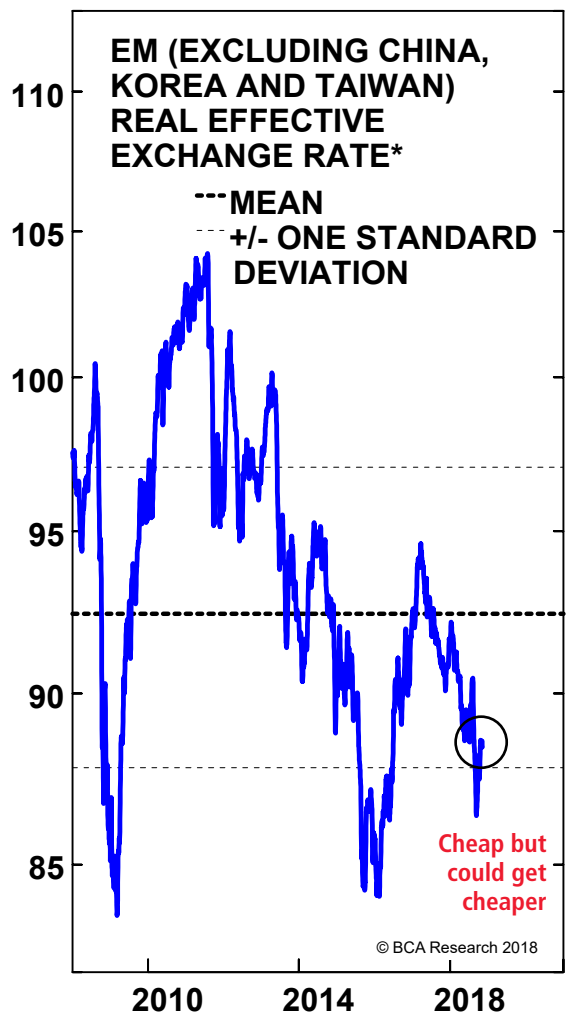
A Weaker RMB Ahead



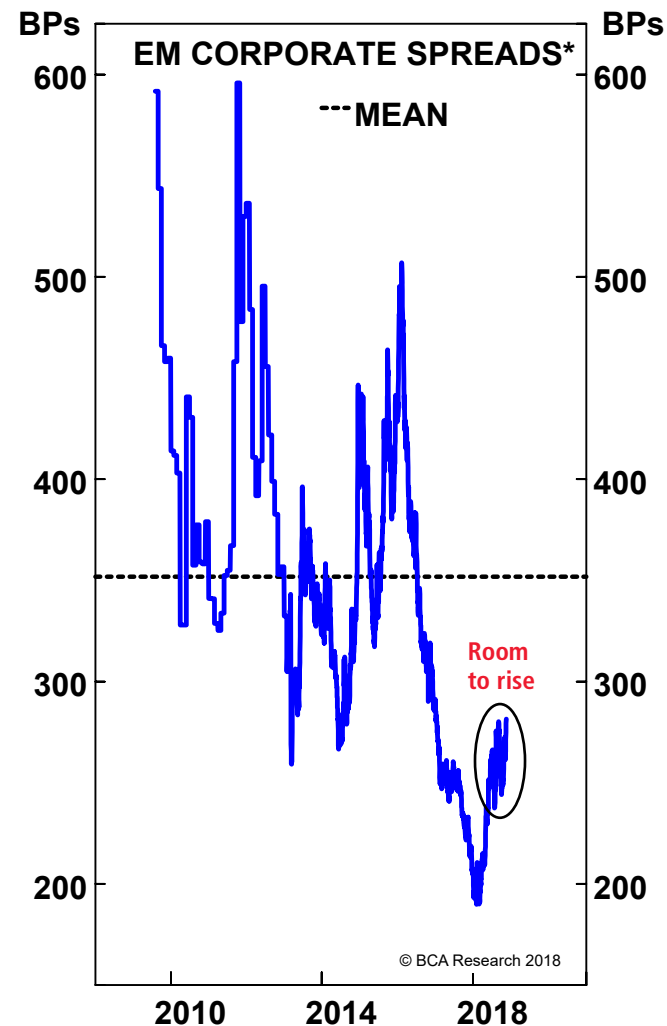
EM Assets Are Not At Washed Out Levels



* BASED ON TRAILING AND FORWARD PRICE-TO-EARNINGS, PRICE-TO-BOOK VALUE, PRICE-TO-CASH EARNINGS RATIO, AND DIVIDEND YIELD, STANDARDIZED;
 SOURCE: MSCI INC. (SEE COPYRIGHT DECLARATION) AND IBES.
 ** BASED ON 50 INDUSTRY SUB-SECTORS BY TRIMMING TOP 10% AND BOTTOM 10% SERIES.

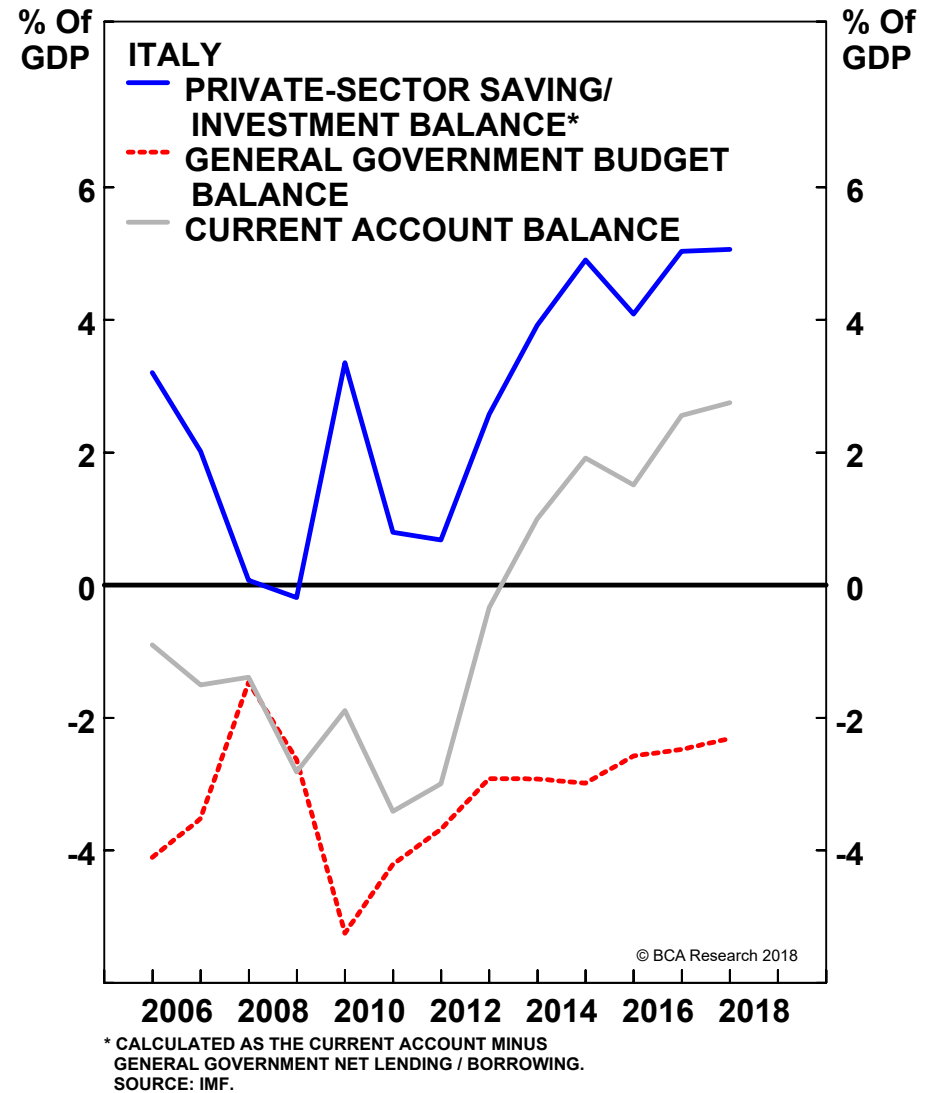
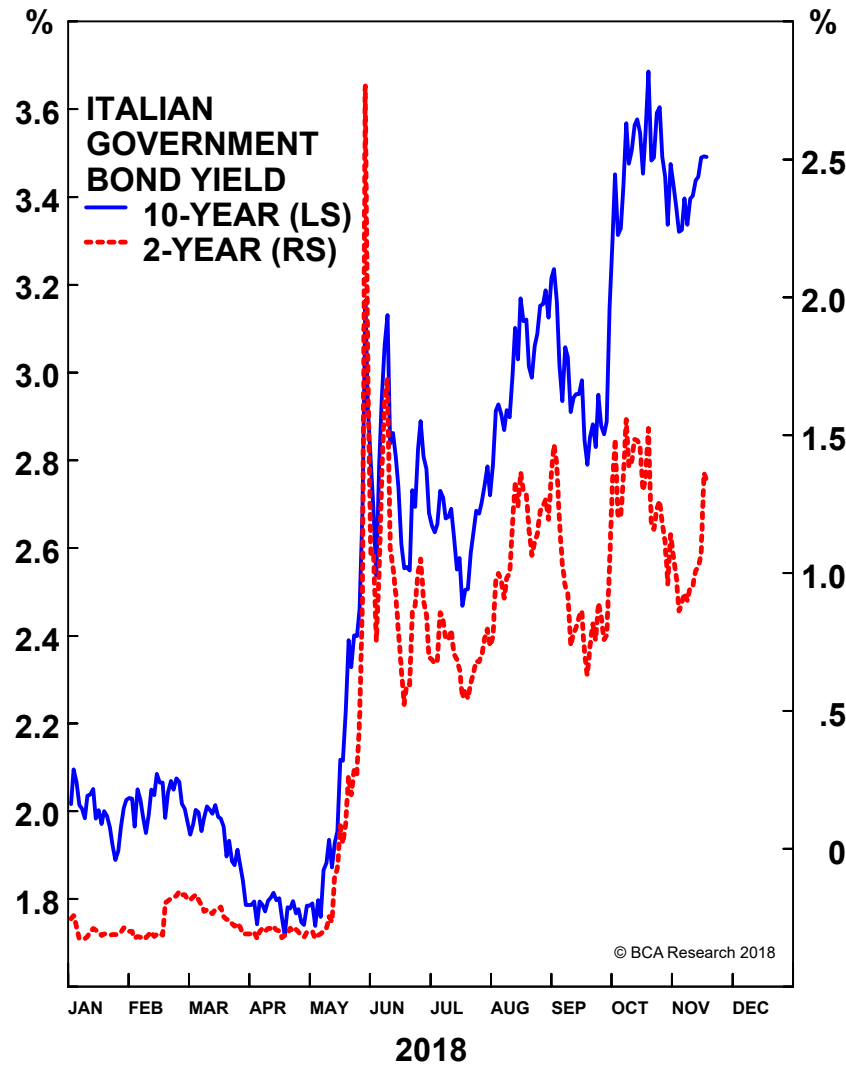


* INCLUDES 16 DEVELOPING ECONOMIES, EQUITY MARKET CAP WEIGHTED; BASED ON AVERAGE OF PPI AND CPI; BASED ON J.P. MORGAN CHASE & Co DATA.



* CORPORATE AND QUASI-SOVEREIGN OPTION-ADJUSTED SPREADS; SOURCE: BLOOMBERG BARCLAYS INDICES.

Tougher Times For Italy



Key Investment Conclusions

- **Equities:** Correction has further to run. Underweight deep cyclicals versus defensives. Underweight EM versus DM. Within DM, favor U.S. over both Europe and Japan in dollar terms.
- **Bonds:** EM stress will push down safe-haven DM government bond yields in the near term, but yields will rise more than expected over a 12-to-24 month horizon.
- **Currencies:** The bull market in the dollar is still not over. EUR/USD could fall to 1.12 by year-end.
- **Commodities:** Favor oil over industrial metals. Precious metals will also remain under pressure until the dollar peaks next year, before beginning a major bull run as inflation accelerates.



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