



# *Rabobank Market Strategy*

*Sweetener colloquium – February 2019*

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**Market Strategy**

**Rabobank International – New York**

**MARKETING COMMUNICATION**



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# Structural issues



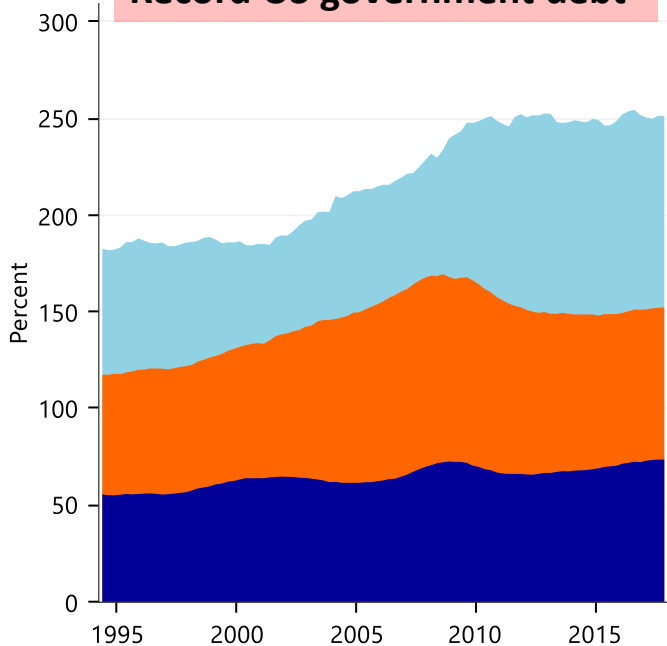
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Debt has been the main driver of growth since the '80s  
But has the debt = growth limit been reached?



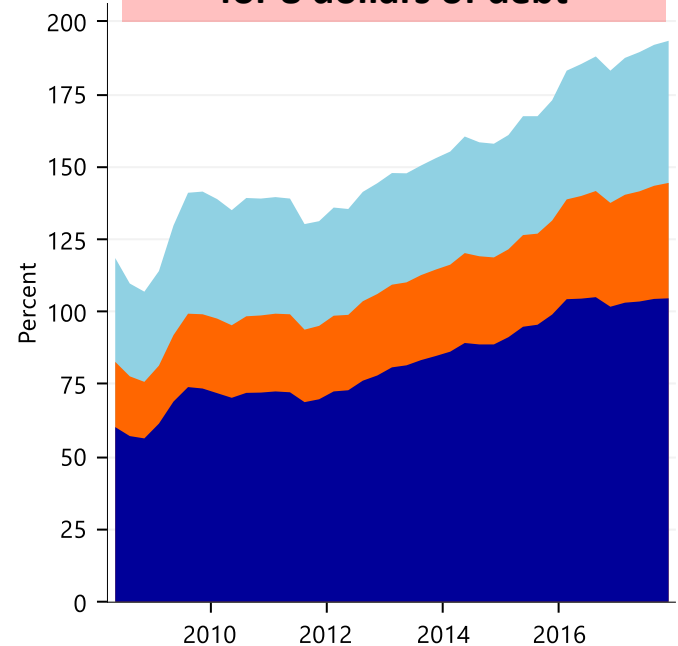
# US = government + corporate, EM = corporate + other

**Record US corporate debt**  
**Record US government debt**



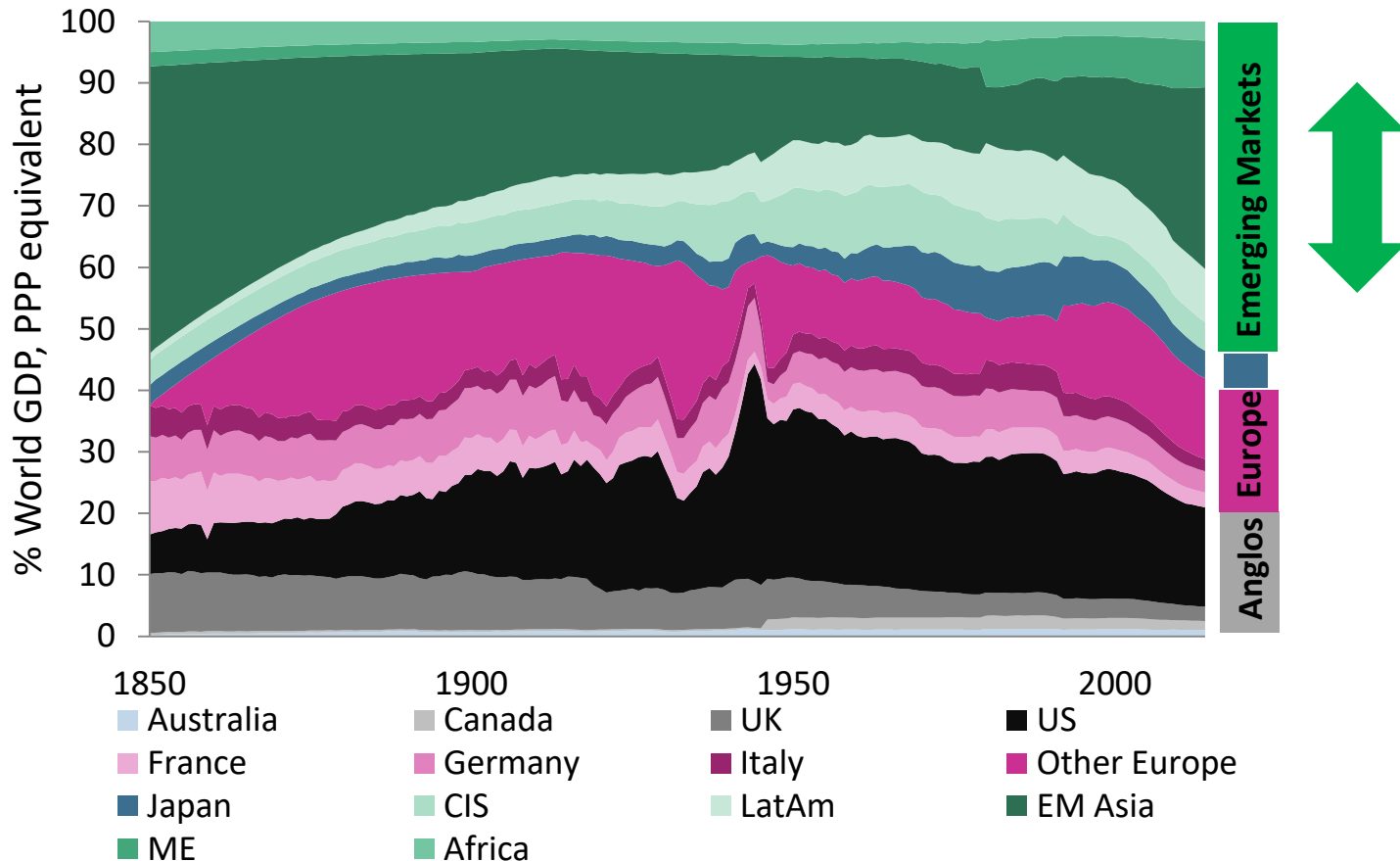
- US General Government, % of GDP
- US Households & NPISHs, % of GDP
- US Non-Financial Corporations, Market Value, % of GDP

**China gets 1 dollar of growth**  
**for 8 dollars of debt**

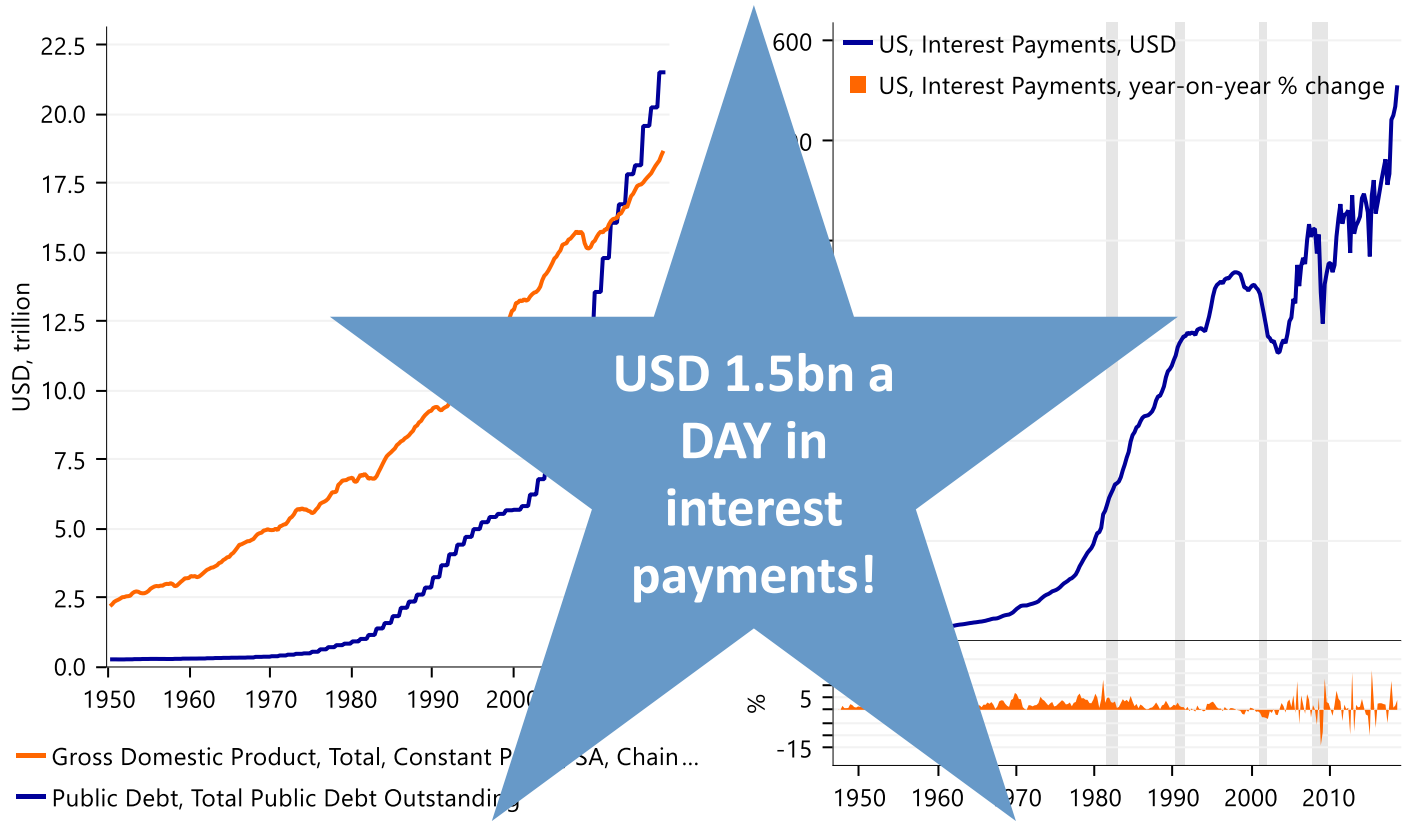


- EM, BIS Credit to General Government, % of GDP
- EM, BIS Credit to Households & NPISHs, % of GDP
- EM, BIS Credit to Non-Financial Corporations, % of GDP

# The emerging world is now a bigger slice of the global GDP pie than the developed world

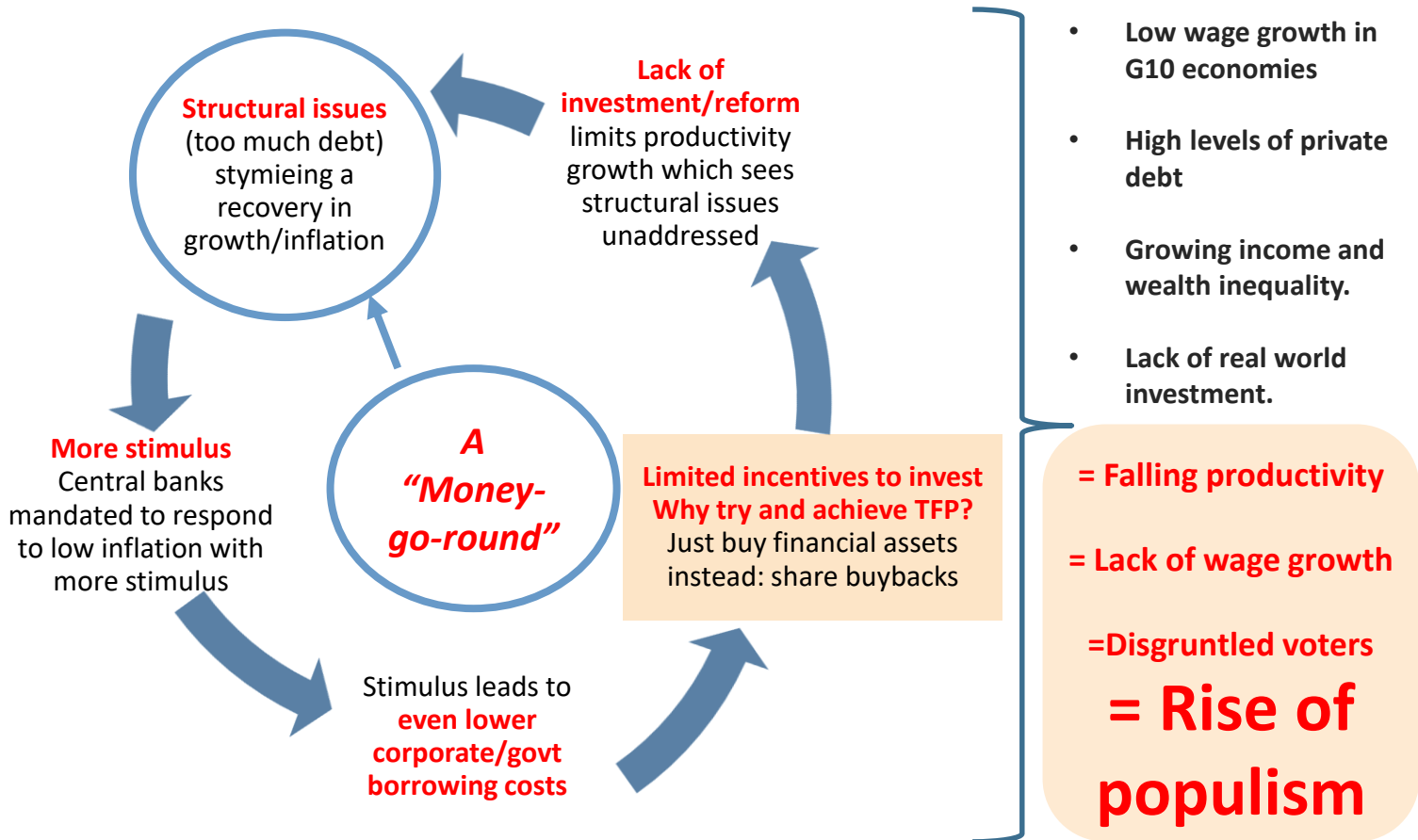


# As EM leverages up so does the US government Debt to GDP about to pass WWII



# Why didn't cheap money fuel growth? = 'Financialisation'

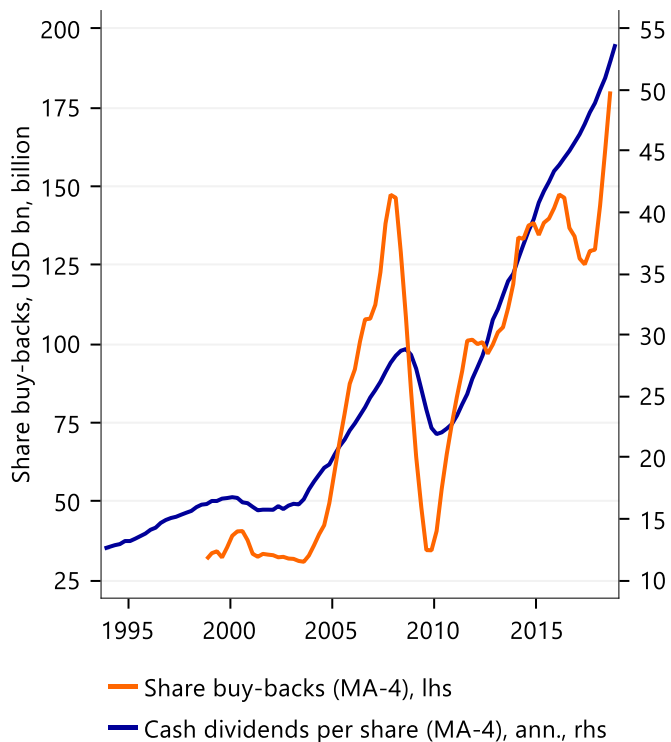
(The only slide I have kept in my deck for the past 4yrs!)



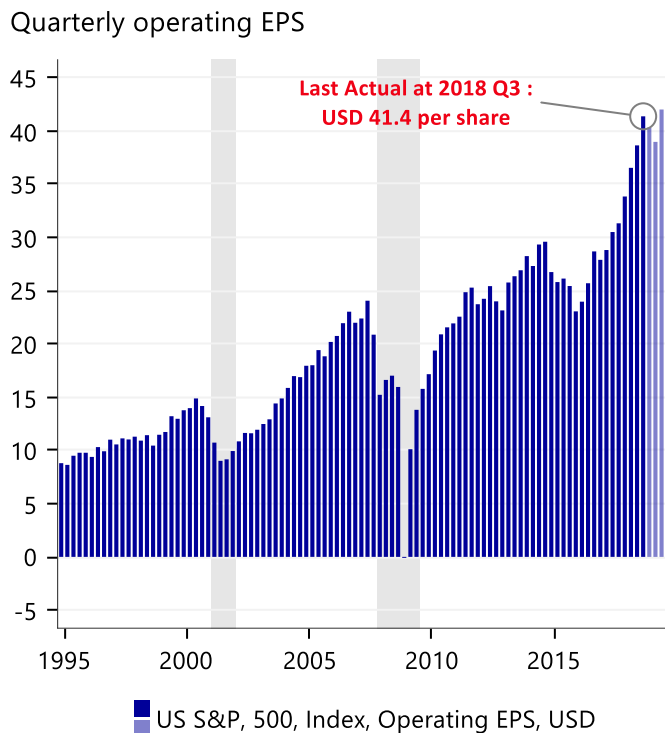
# All this debt hasn't fuelled much real world growth BUT, it has led to asset price inflation

QE...“Higher stock prices will boost consumer wealth and help increase confidence, which can also spur spending” - Bernanke

### Money Returned to Shareholders



### S&P 500 Earnings Per Share (EPS)





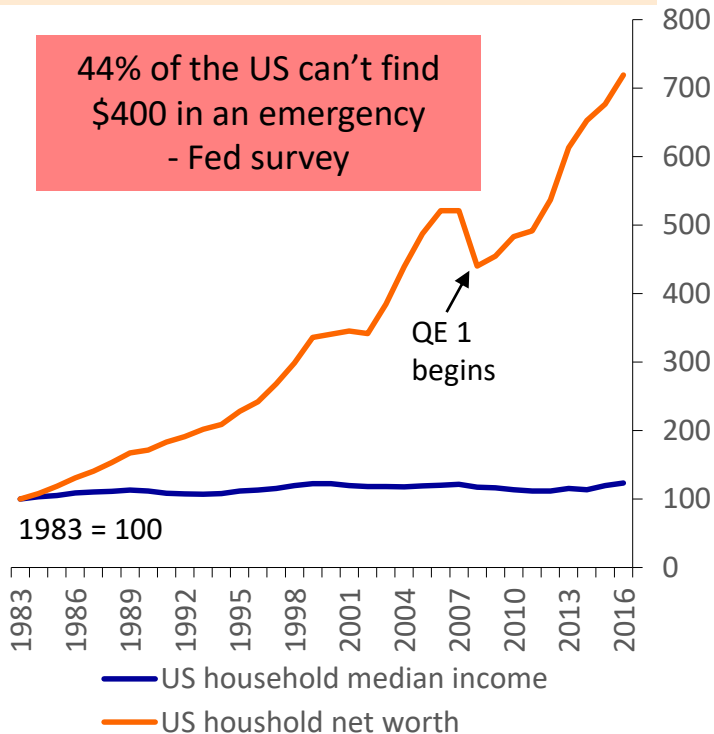
# Asset inflation + low wage growth = rising inequality

## Rising inequality = political populism

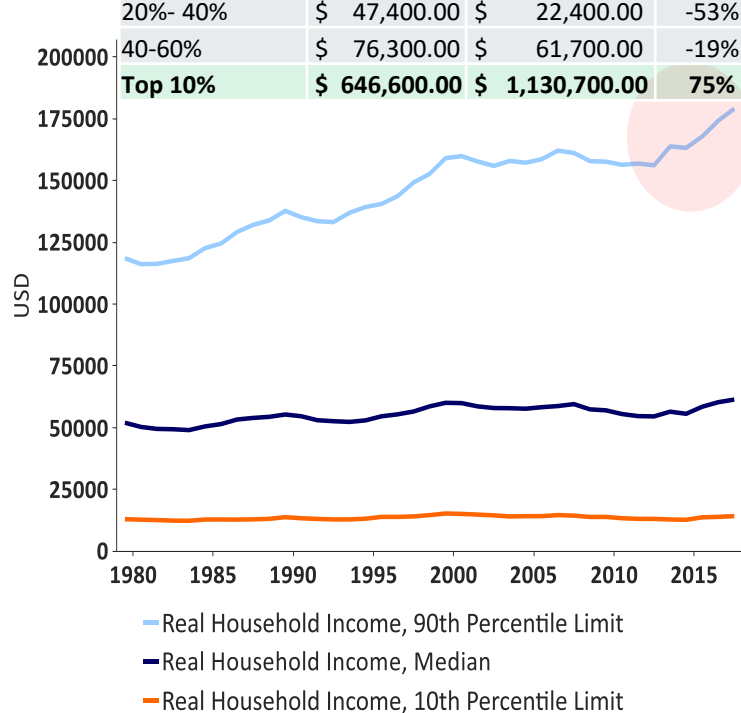


The top 10% of US households now own  
84% of all stocks  
– Edward Wolff (Economist at NYU)

44% of the US can't find  
\$400 in an emergency  
- Fed survey



Median Net Worth, 15yr change			
	1998	2013	Change
All Families	\$ 102,500.00	\$ 81,200.00	-21%
<b>Bottom 20%</b>	<b>\$ 8,300.00</b>	<b>\$ 6,100.00</b>	<b>-27%</b>
20%- 40%	\$ 47,400.00	\$ 22,400.00	-53%
40-60%	\$ 76,300.00	\$ 61,700.00	-19%
<b>Top 10%</b>	<b>\$ 646,600.00</b>	<b>\$ 1,130,700.00</b>	<b>75%</b>

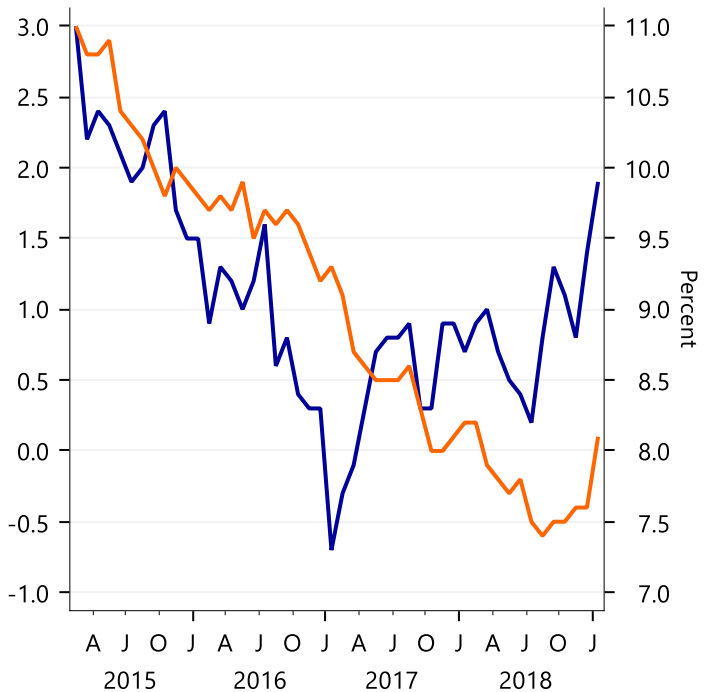


Did low wages help pull down unemployment?  
If so, will higher wages drive unemployment?

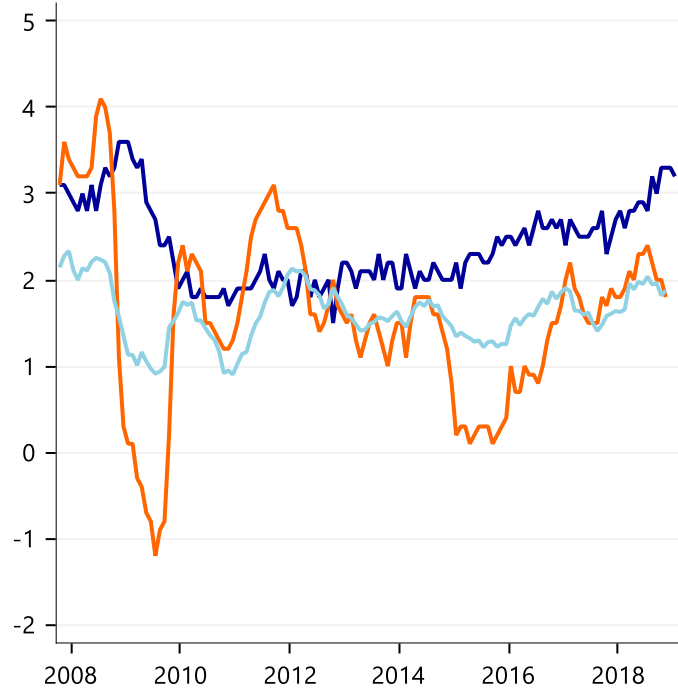
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# Did low wages help pull down unemployment? If so, will higher wages drive unemployment?

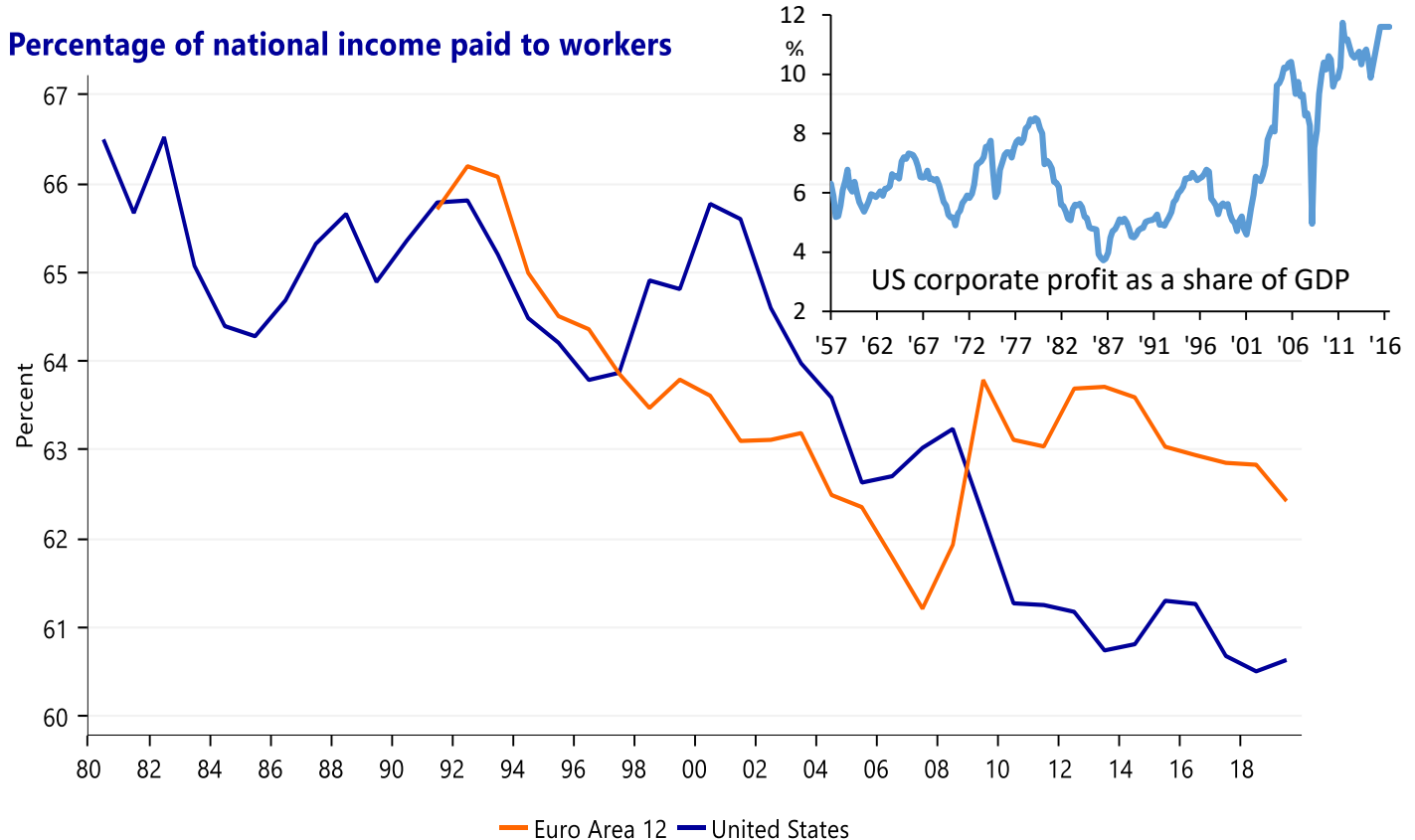


— United States, Underemployment, Special Unemployment...  
— US Real Average Weekly Earnings y/y, %, lhs



— US Core PCE YoY SA — US Average Hourly Earnings y/y, %  
— US PCE YoY SA

# Workers receive a smaller and smaller piece of the pie



# When inequality rises, voters want to shake up the system..

## Brexit, Trump, Italy, AMLO, Macron, Bolsonaro

European elections on May 23<sup>rd</sup> could highlight a seismic shift in the European outlook



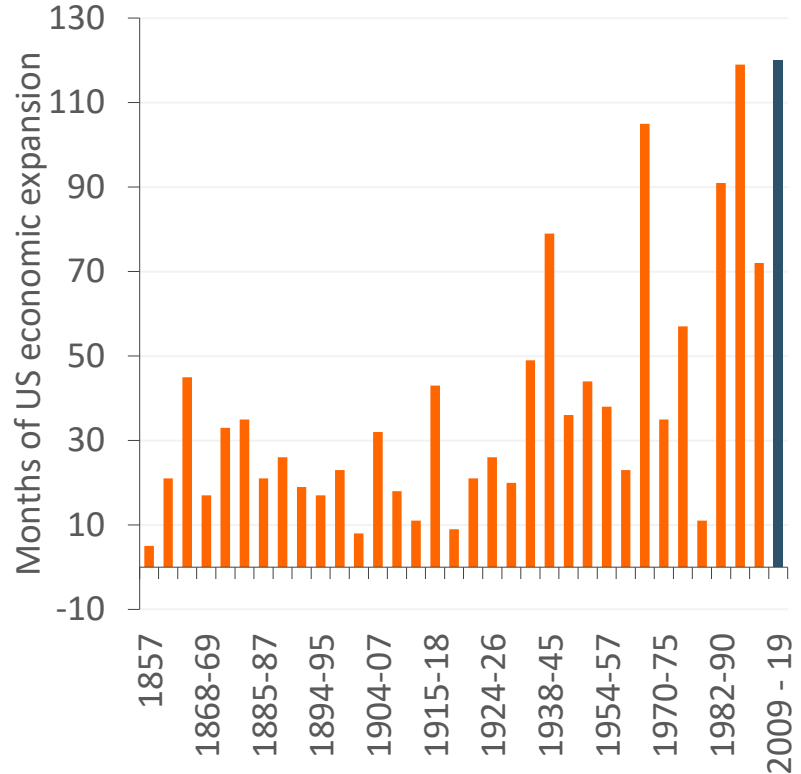
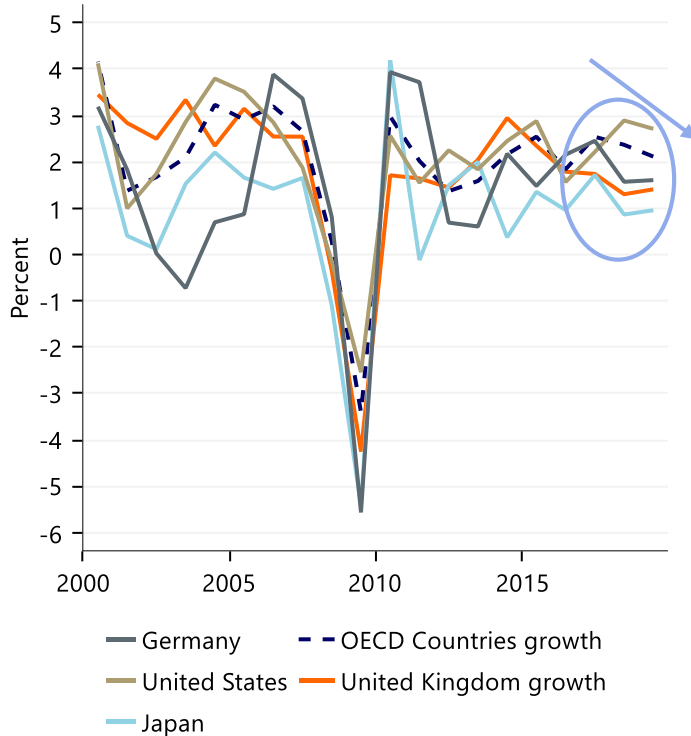


# Late cycle behaviour

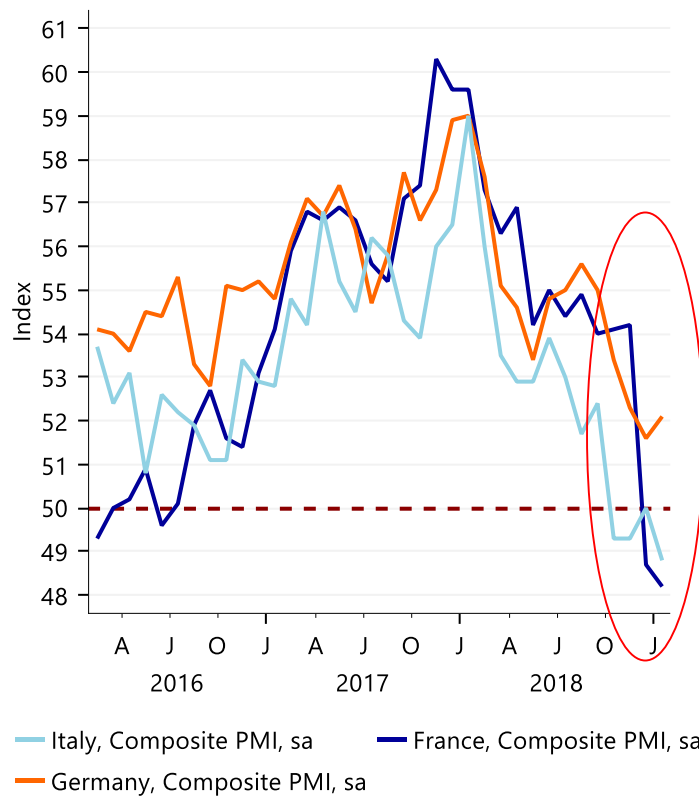
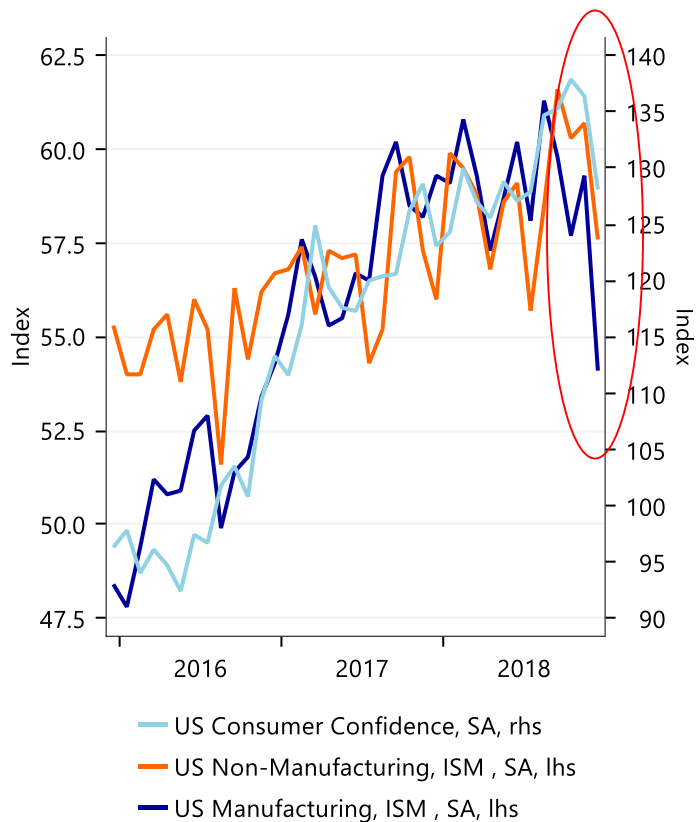


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# The US is close to the longest recovery on record but growth is now slowing (and not just in the US)

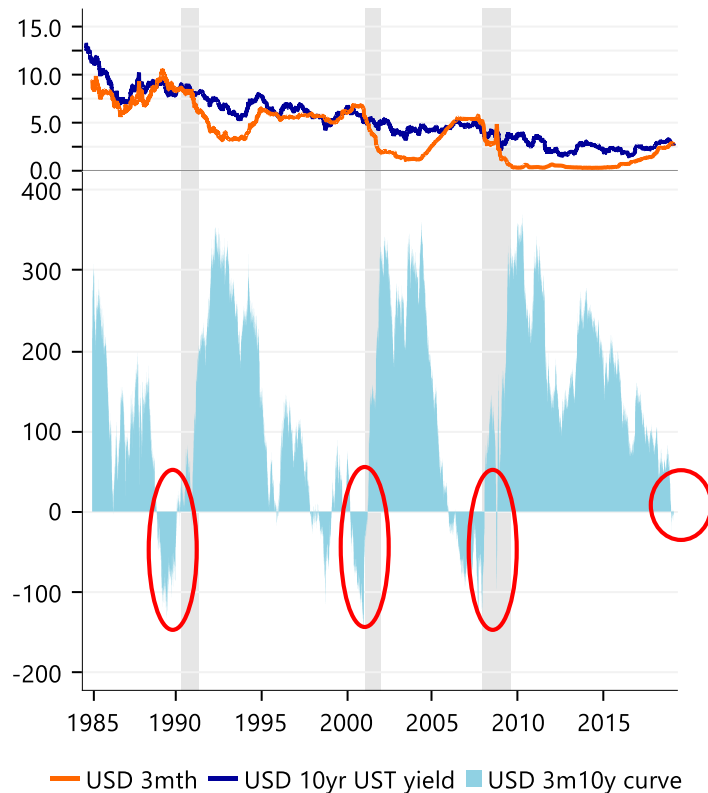
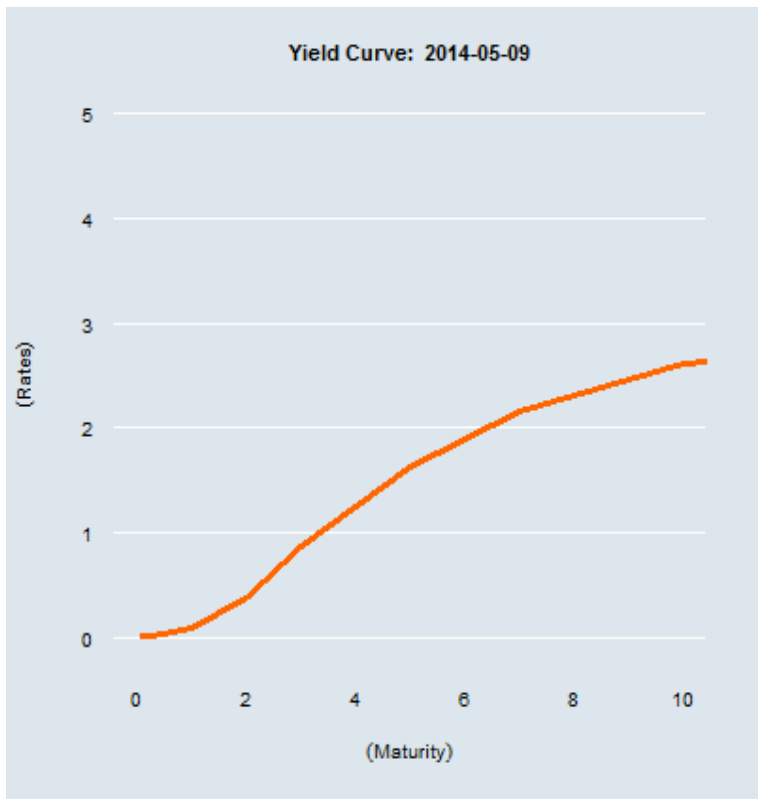


# Tighter monetary policy and trade wars are weighing Surveys are turning for the worse

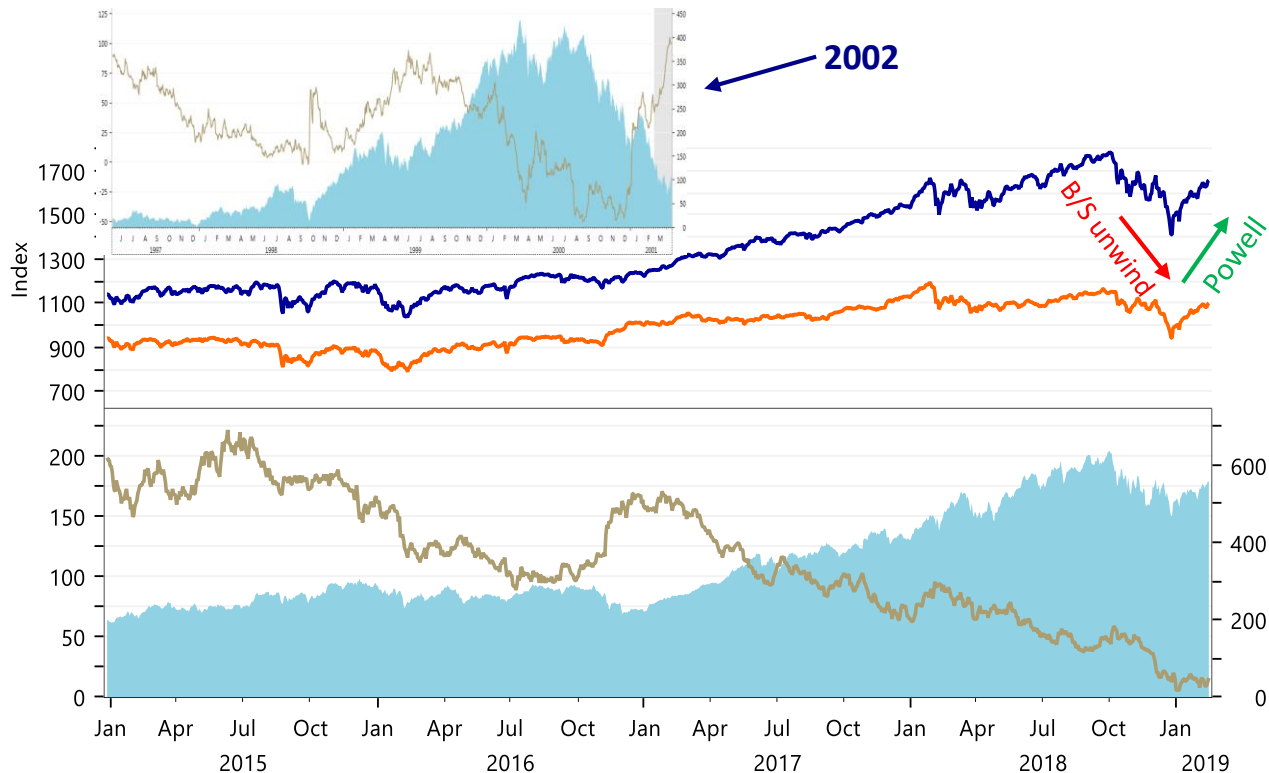




# The classic US recession indicator...inversion is the signal then the curve bull steepens into the recession



# Value equities outpacing growth equities although Powell u-turn reversed this



— US S&P 500 Value Index, USD   
 — US 1s10s UST yield curve spread, bp, lhs  
— US S&P 500 Growth Index, USD   
 ■ US S&P 500 Growth-Value Index spread. USD, rhs

# Defensive equities outpacing cyclicals... Until the Powell put came back into play!

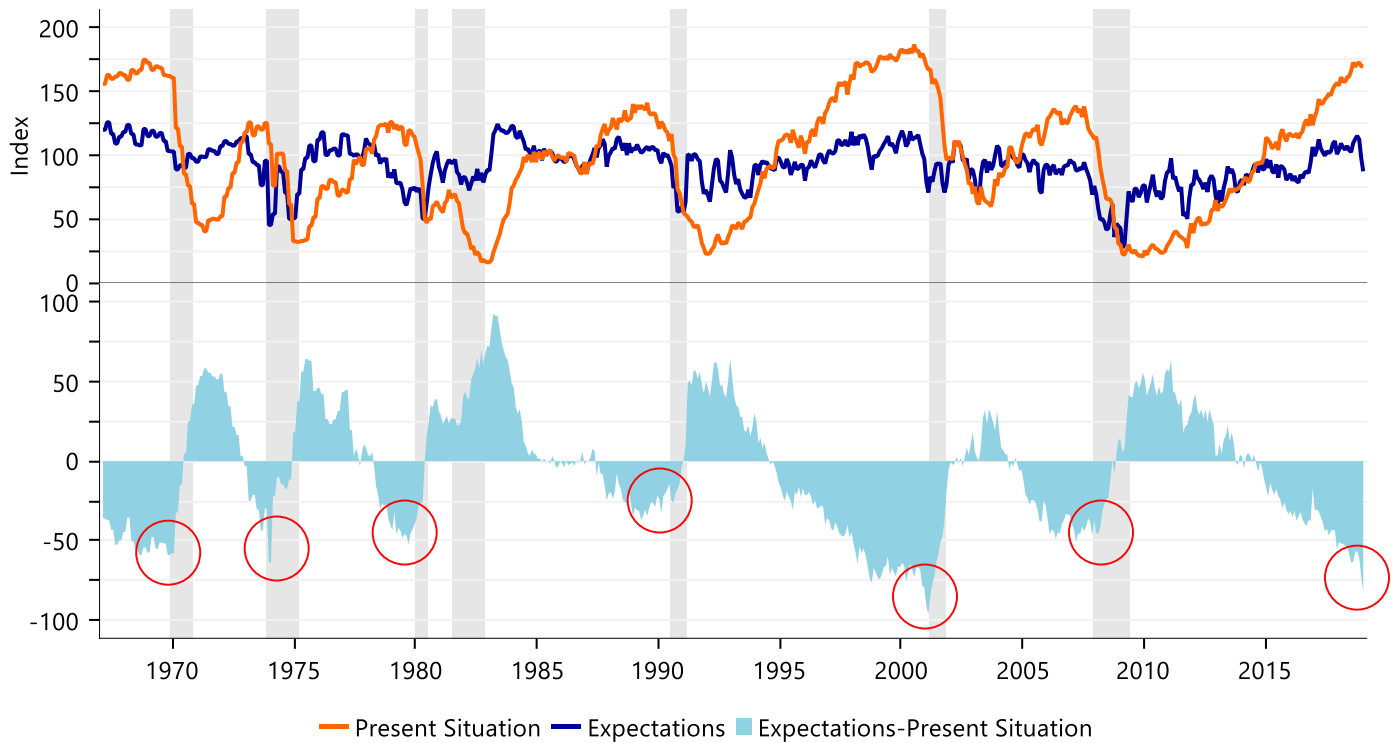


## MSCI USA Cyclical Sectors-Defensive Sectors Return Spread USD Index



# Consumer confidence: present vs. expectations at stretched levels (as we see before every recession)

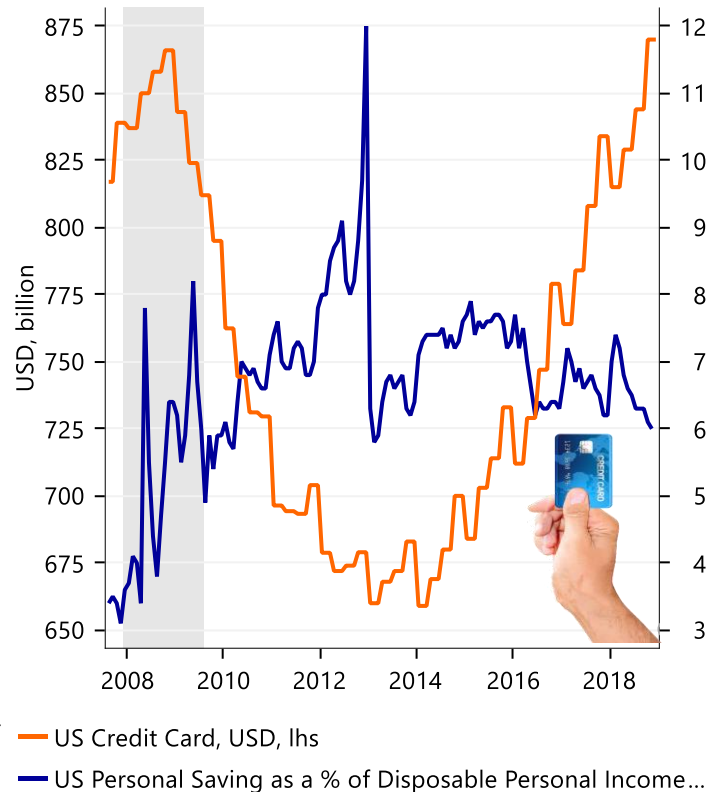
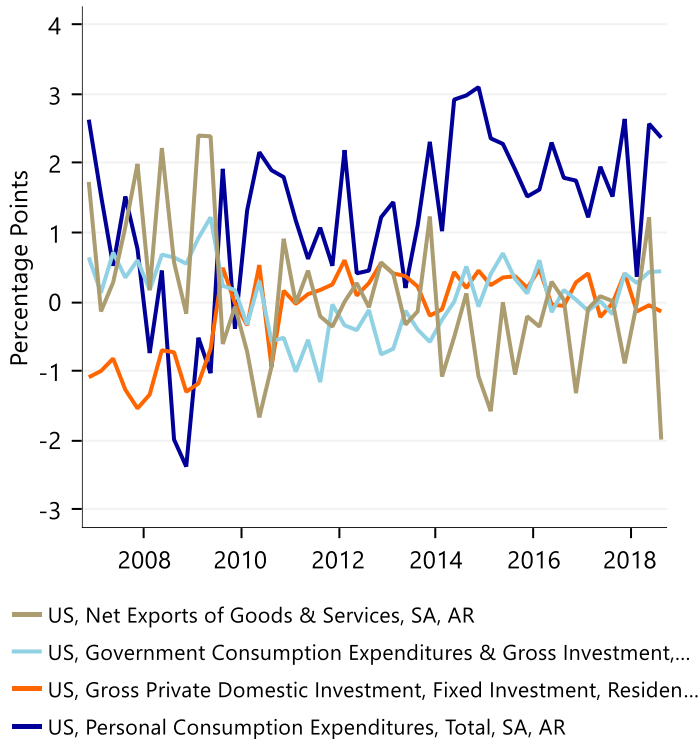
United States, Consumer Surveys, Conference Board, Consumer Confidence Index, Total, SA



# Growth is primarily supported by consumption...

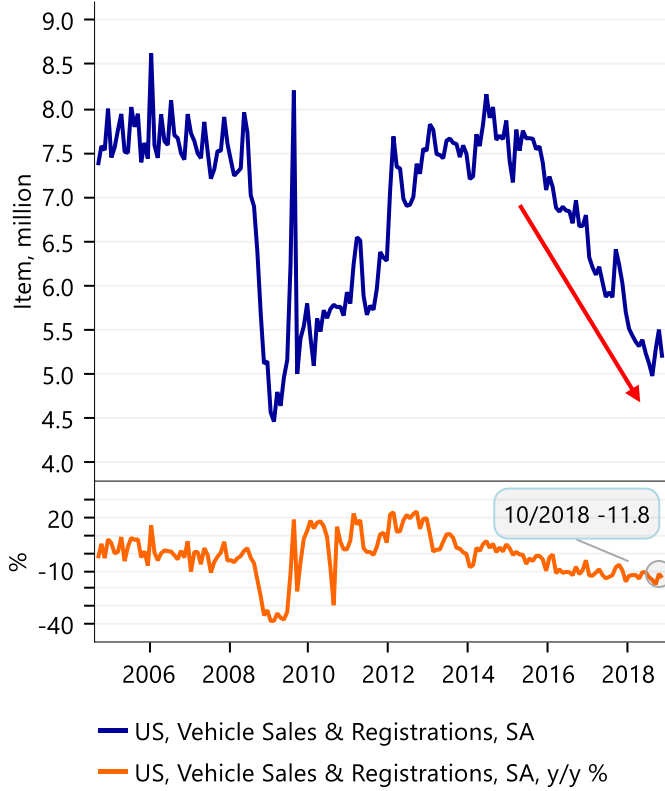
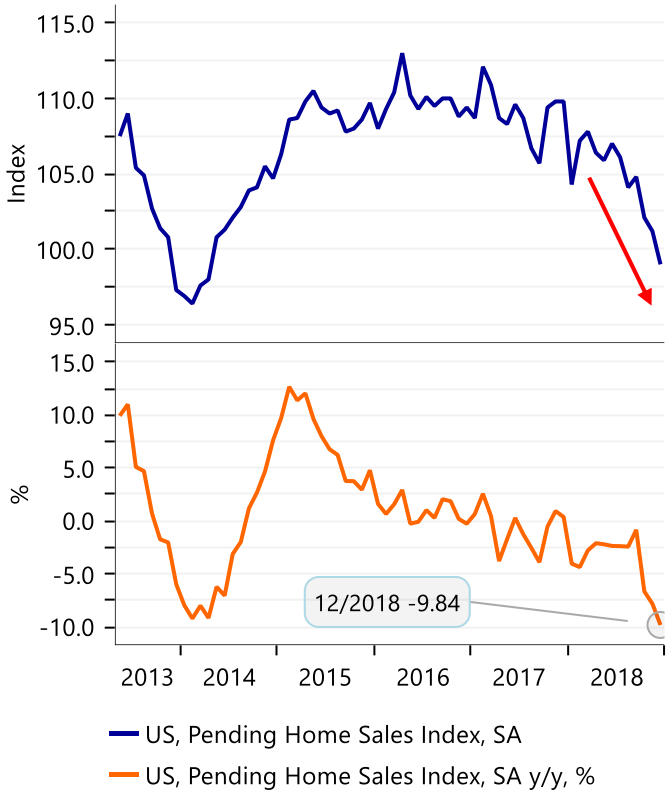
## But how much is consumption being supported by credit?

### United States, GDP Contributions, SA, AR

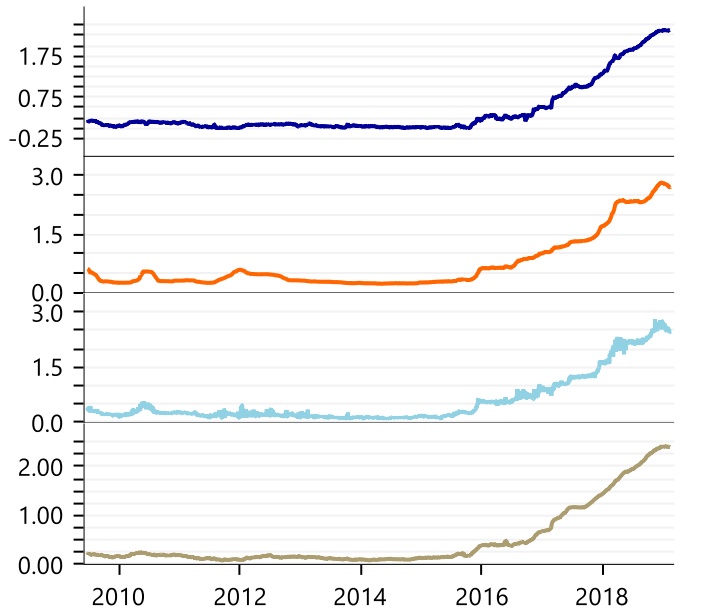


# Home sales and autos are suffering...badly

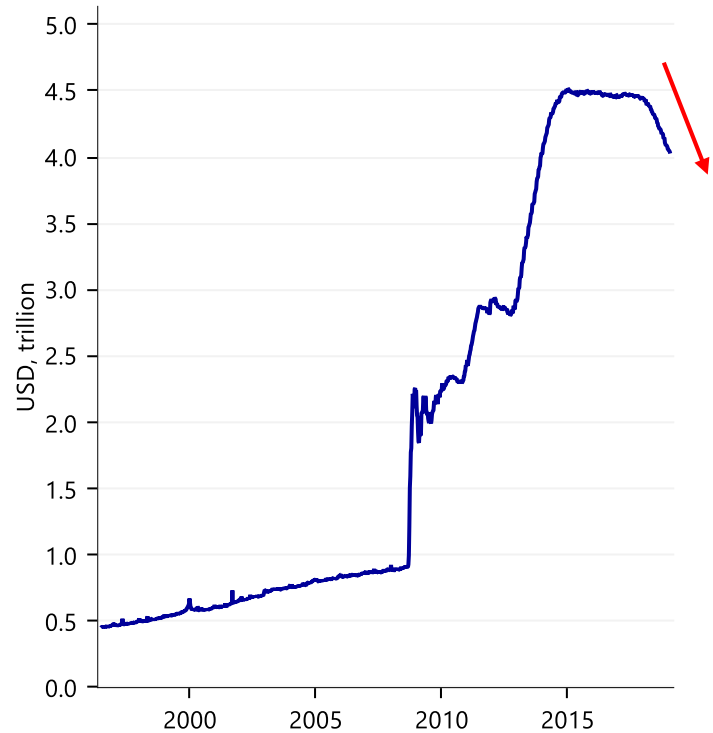
## New seriously delinquent auto loans just hit '08 highs



# Tighter US financial conditions & shrinking balance sheet



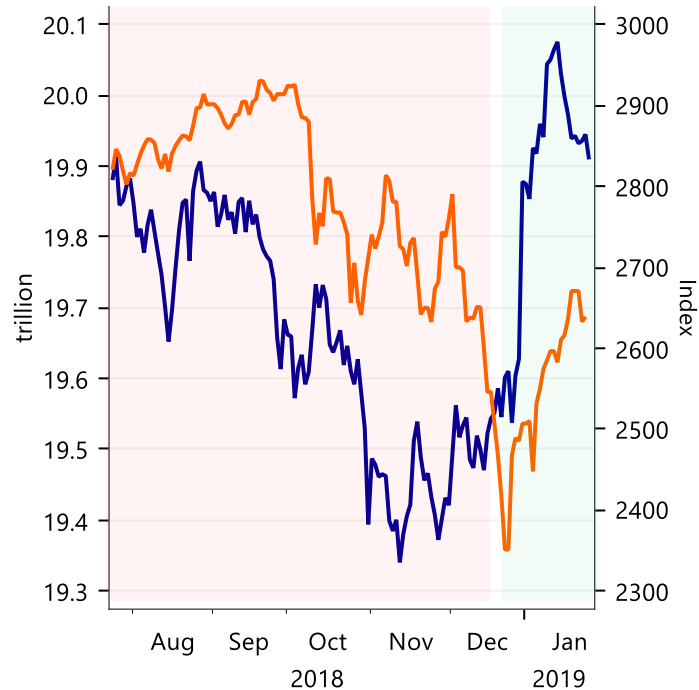
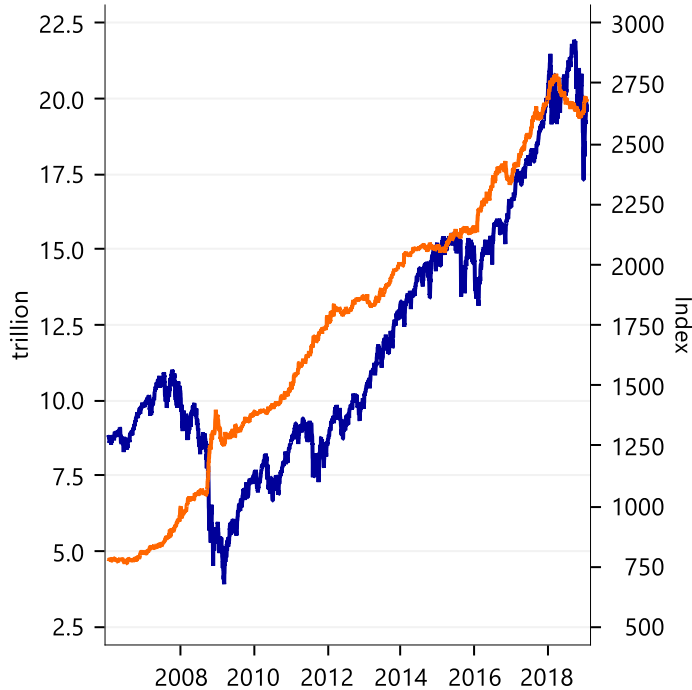
- Treasury Bill (U.S.) 90 DAY (Y)
- ICE LIBOR USD 3 Month
- Federal Reserve 90 Day AA Financial Commercial Paper In...
- USD SWAP OIS 3M



— Fed balance sheet

# Has the PBOC help US equities this year?

## RR cuts, sneak QE, balance sheets expand again



— Global central bank balance sheets (Fed, ECB, BoJ, PBOC),...

— United States, Equity Indices, S&P, 500, Index, Price Return...

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— Global central bank balance sheets (Fed, ECB, BoJ, PBOC),...

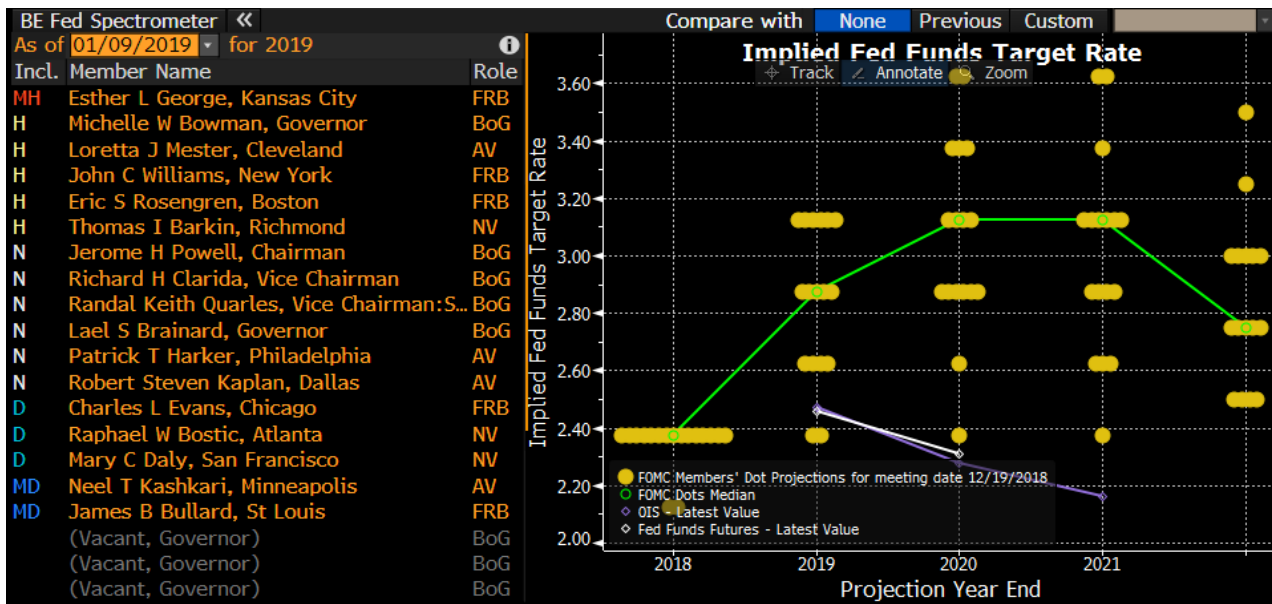


# Fed's DOT plot projects 2 rate hikes in 2019 but Powell has turned dovish and we expect 0 (and cuts in 2020)



**Rabobank expects no further hikes in 2019 and we expect the Fed to pause its balance sheet unwind in H2 of this year before cutting rates in 2020.**

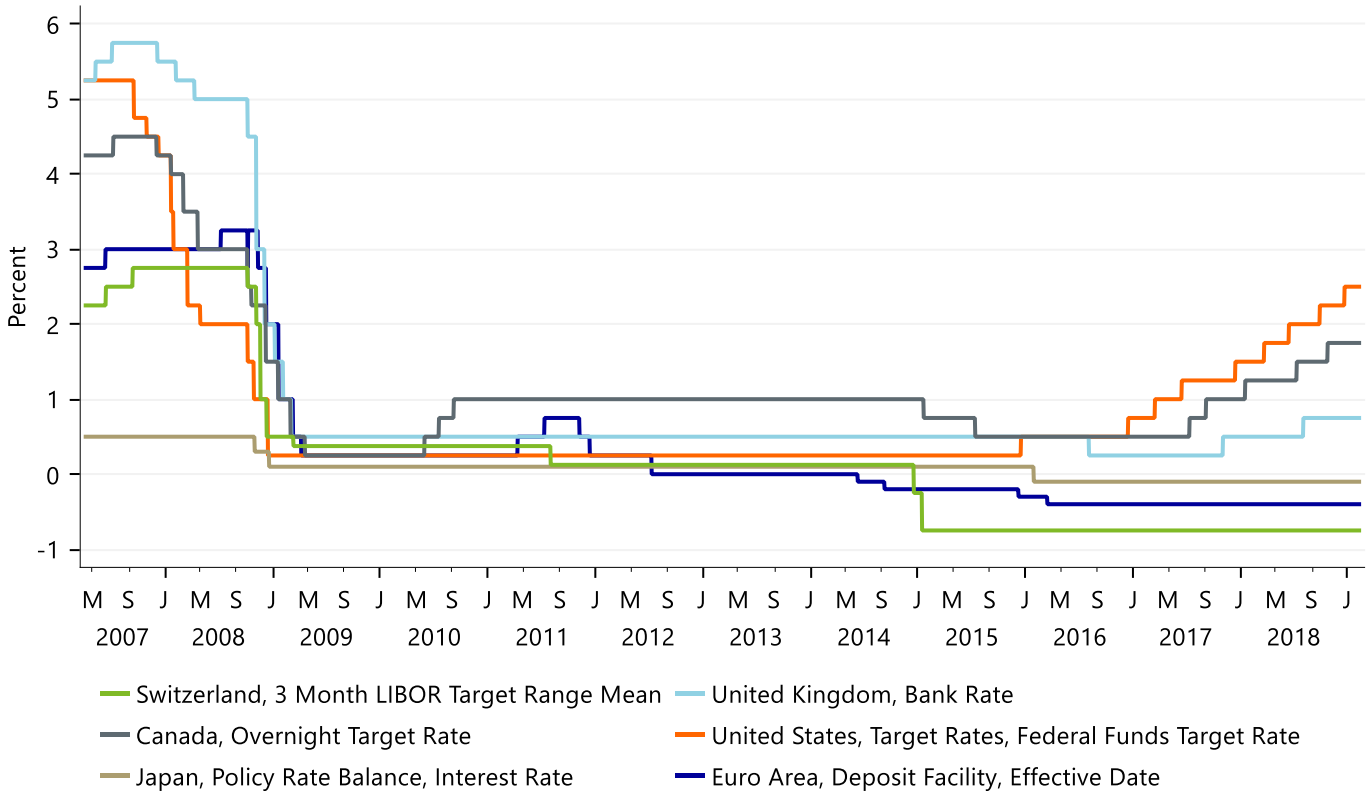
**Chairman Powell January 6<sup>th</sup> 2019:** “We’re listening carefully with – sensitivity to the message that the markets are sending and we’ll be taking those downside risks into account as we make policy going forward” ... The Fed is able to “adjust policy quickly and flexibly”



# If the US sneezes, the rest of the world catches a cold



# If recession spreads, how can other countries respond? Are they really going to raise rates if the Fed is cutting?





# Trade



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# Number 1 risk according to survey of 600 executives

## Tier One Risks

- 1 Retrenchment of globalisation/increase in protectionism
- 2 Oil price shock
- 3 Asset price collapse
- 4 Emergence of disruptive business model
- 5 International terrorism
- 6 Unexpected regulatory change
- 7 Global recession
- 8 Instability in the Middle East
- 9 Increased competition from emerging market companies
- 10 Talent shortages
- 11 Climate change
- 12 Increased industrial pollution

## Tier Two Risks

- 13 Increased macroeconomic volatility
- 14 Pandemic (eg, H5N1)
- 15 Rise in anti-globalisation sentiment
- 16 Flooding in populated area
- 17 Drought/Lack of freshwater services
- 18 Dramatic increase in communicable diseases (eg, AIDS, malaria, tuberculosis)
- 19 Rising cost of raw materials
- 20 Downward pressure on prices
- 21 Failure to honour contracts
- 22 Recession in country in which you are based
- 23 Significant increase in interest rates
- 24 Disruptive technology forces change in business model
- 25 Rising labour costs
- 26 Decline in recognition of intellectual property rights
- 27 Poor levels of education and skills
- 28 Bribery and corruption
- 29 Cyberterrorism
- 30 Difficulty affording pension obligations
- 31 Dramatic increase in chronic diseases (eg, cancer, heart disease, diabetes)
- 32 Power outage
- 33 Talent/skills shortages in IT
- 34 Decline in customer loyalty
- 35 Increased competition in home market
- 36 Exposure of confidential data
- 37 Disruption to business from viruses, spyware and malware
- 38 Systems failure/downtime of essential IT services
- 39 Decline in customer base
- 40 Fiscal crisis caused by demographic change
- 41 Rise in environmental protests
- 42 Major hurricane
- 43 Nationalisation of assets (eg, in South America/Russia)
- 44 Trade embargo
- 45 Earthquake
- 46 Lack of skills due to ageing population

Source:  
Economist Intelligence Unit survey. 2008.

Source: Economist Intelligence Unit (EIU)

This is not just about trade, this is about world power...



#MCGA

#MAGA

Don't  
tread on  
us!



# China plays by a different set of rules – unfair competition and innovation stealing? **This is now a Cold War**

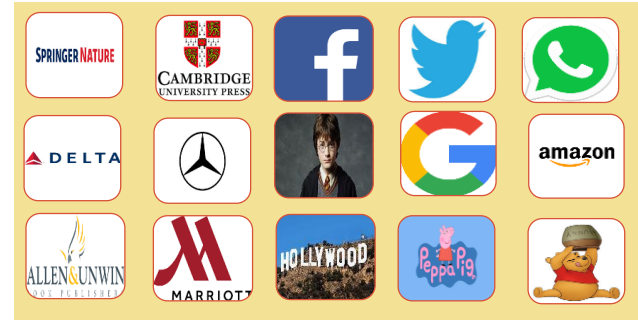
## 19th Party Congress shows China rejecting US-centric world order

President Xi  
now leader for  
life?



“The new world order cannot be just dominated by capitalism and the West, and the time will come for a change.”

“By 2050 China is set to regain its might and re-ascend to the top of the world.”

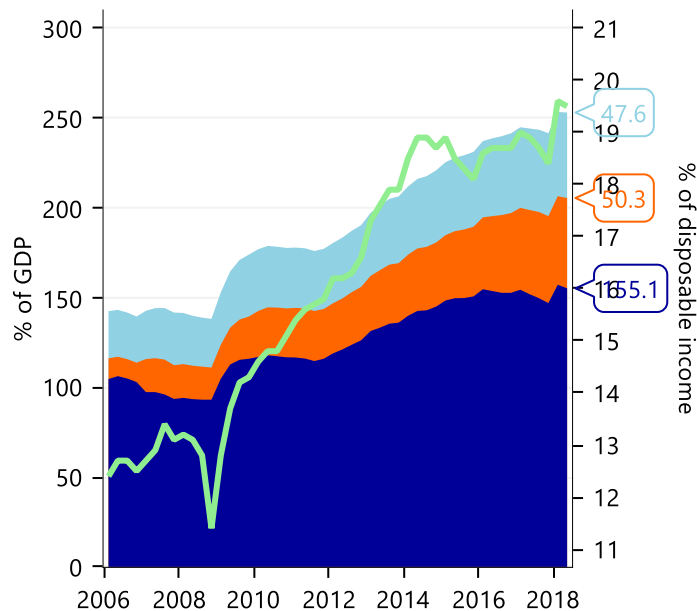
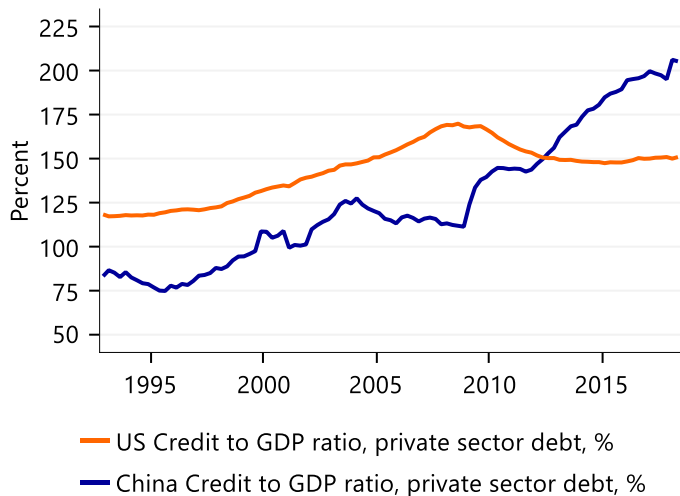


- China’s Great Firewall – VPNs banned in 2018?
- Cyber-Security Law requires all data on Chinese citizens to be kept *only* within China
- WeChat app being officially recorded at all times
- China aiming for Social Credit System by 2020
- Monitor and rank actions of every citizen & legal person to generate “official trustworthiness” score
- Belief that big data and AI can make central-planning beat free markets



# Debt, debt and more debt (Oh, and liquidity injections too)

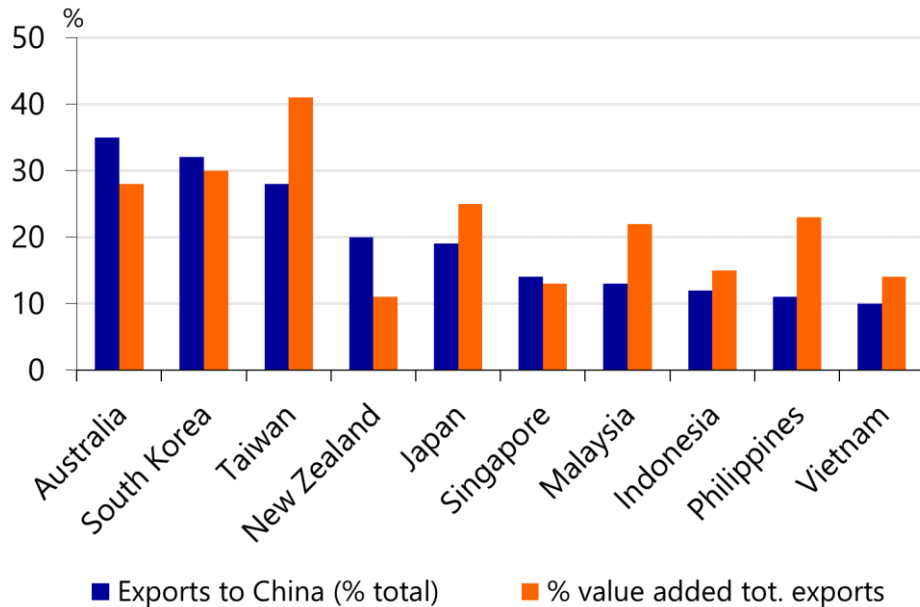
China manipulates the exchange rate and tries to stop capital flight. In Q4 exports to Hong Kong surged hinting at the '15/'16 dynamic of over invoicing to get money out of the mainland. There was a huge surge in precious stone imports into China too.



- Debt Service Ratio (private sector), rhs
- Public debt, lhs
- Household debt, lhs
- Corporate debt, lhs



## What about the rest of the world?



On balance, the (looming) effect on other countries depends on the type of country...

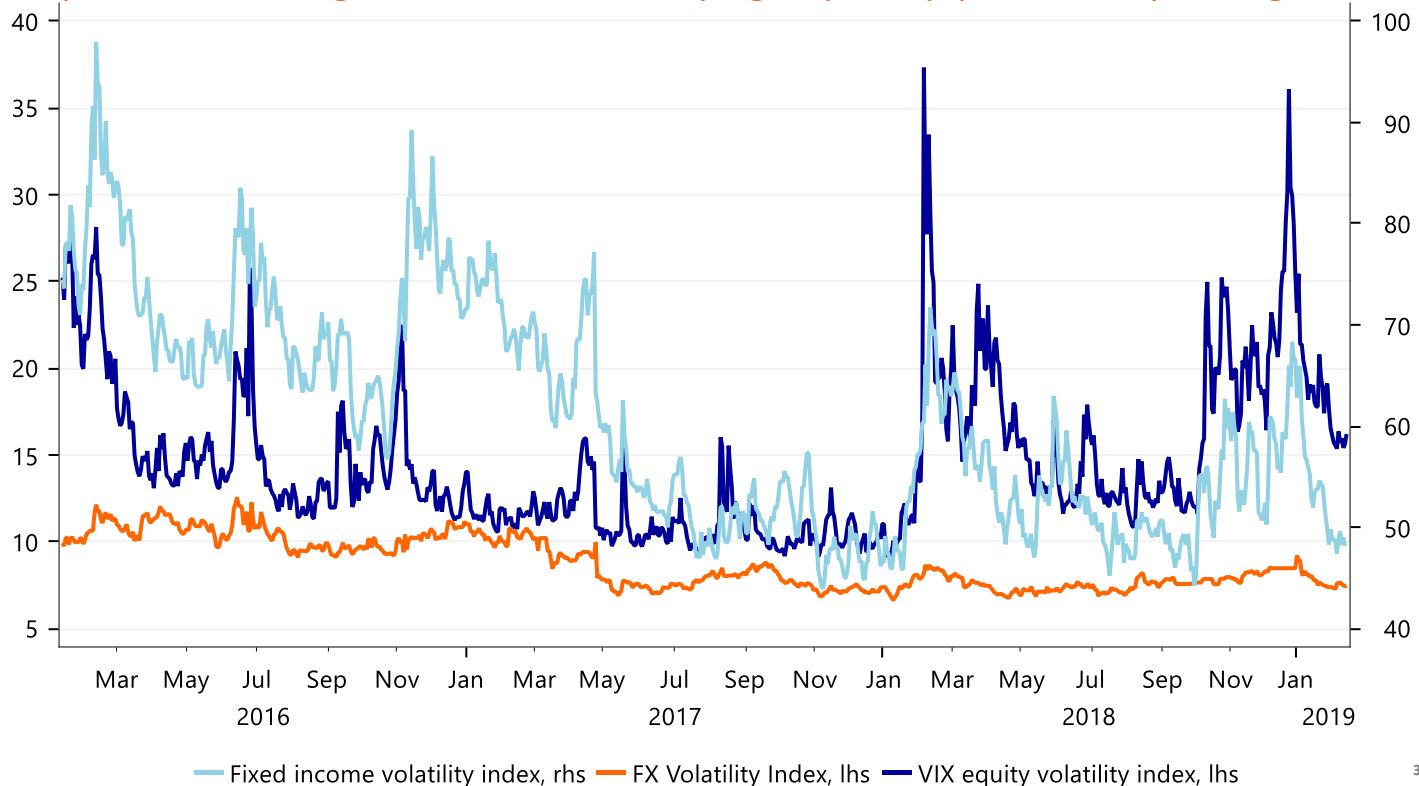
The geopolitical plates are moving

- Advanced economies who are important trading partners for China could be **negatively affected (Australia, NZ)**
- Countries who have a cheap labor advantage could **benefit (Vietnam, Indonesia, Mexico)**
- Some LatAm countries may see **export destinations shift (Brazil, Argentina)**

# Despite all of this...volatility still remains relatively low as vol events prove short lived while policy is easy



In addition, the market is structurally short vol due to the proliferation of passive investing, ETFs and traders trying to pick up premium by selling vol



## Summary

The US is still the cleanest shirt in the dirty laundry basket but will fall into recession next year – others will follow

Lack of wage growth means a lack of demand driven inflation and the continued rise of populism

Fed will not be able to raise rates further, it will halt the balance sheet unwind in H2 and start cutting rates in 2020

Debt continues to rise globally and this remains a key concern  
China is key and USD/CNY is set to explode higher

Trade Wars are likely to get worse before they get better  
This is not just about trade, this is a cold war with China

Less differentiation between EM and more “running to 1”  
in terms of correlations

Market volatility likely to remain sporadic but if the Fed doesn't halt the balance sheet unwind it will pick up more structurally in H2

# Important notice

## Non Independent Research



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