
The Daily Shot; September 22 - Global Macro Currents

The Daily Shot <editor@dailyshotletter.com>
Reply-To: The Daily Shot <editor@dailyshotletter.com>
To: ejvarsos@gmail.com

22 September 2016 at 07:29

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The Daily Shot[®]

Greetings,

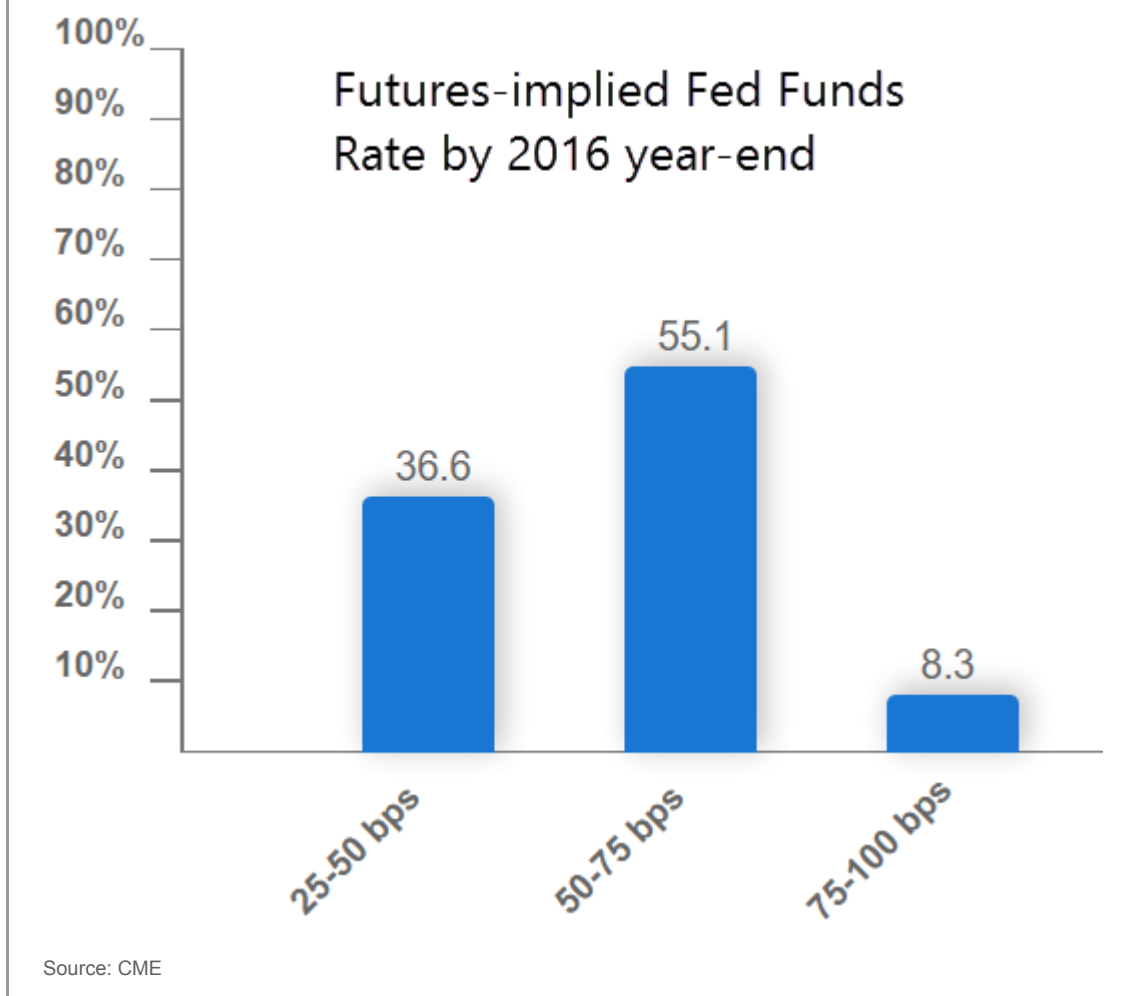
We begin with the United States where, as expected, the Federal Reserve has left rates unchanged. The divided FOMC, however, hinted that a rate hike is coming soon.

Against this backdrop, the Committee decided to maintain the target range for the federal funds rate at 1/4 to 1/2 percent. The Committee judges that the case for an increase in the federal funds rate has strengthened but decided, for the time being, to wait for further evidence of continued progress toward its objectives. The stance of monetary policy remains accommodative, thereby supporting further improvement in labor market conditions and a return to 2 percent inflation.

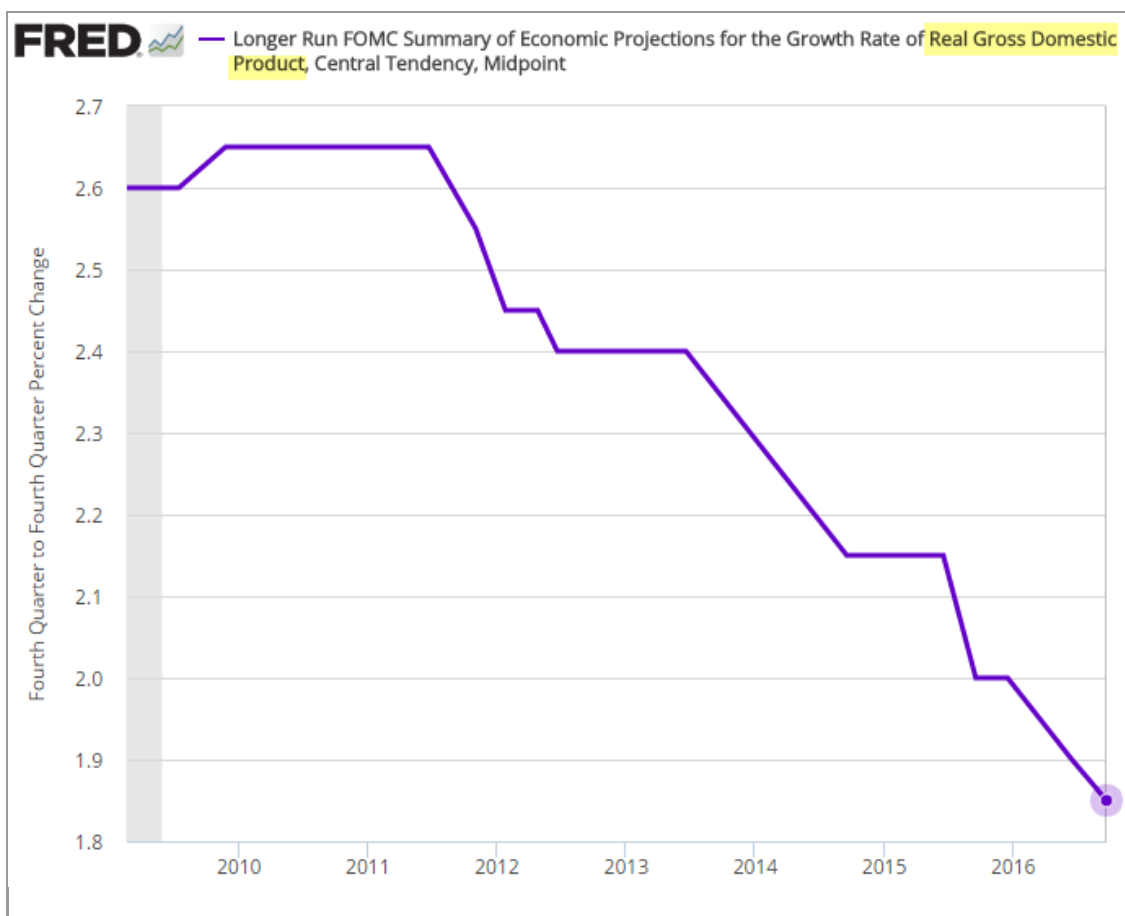
Voting for the FOMC monetary policy action were: Janet L. Yellen, Chair; William C. Dudley, Vice Chairman; Lael Brainard; James Bullard; Stanley Fischer; Jerome H. Powell; and Daniel K. Tarullo. Voting against the action were: Esther L. George, Loretta J. Mester, and Eric Rosengren, each of whom preferred at this meeting to raise the target range for the federal funds rate to 1/2 to 3/4 percent.

Source: FRB

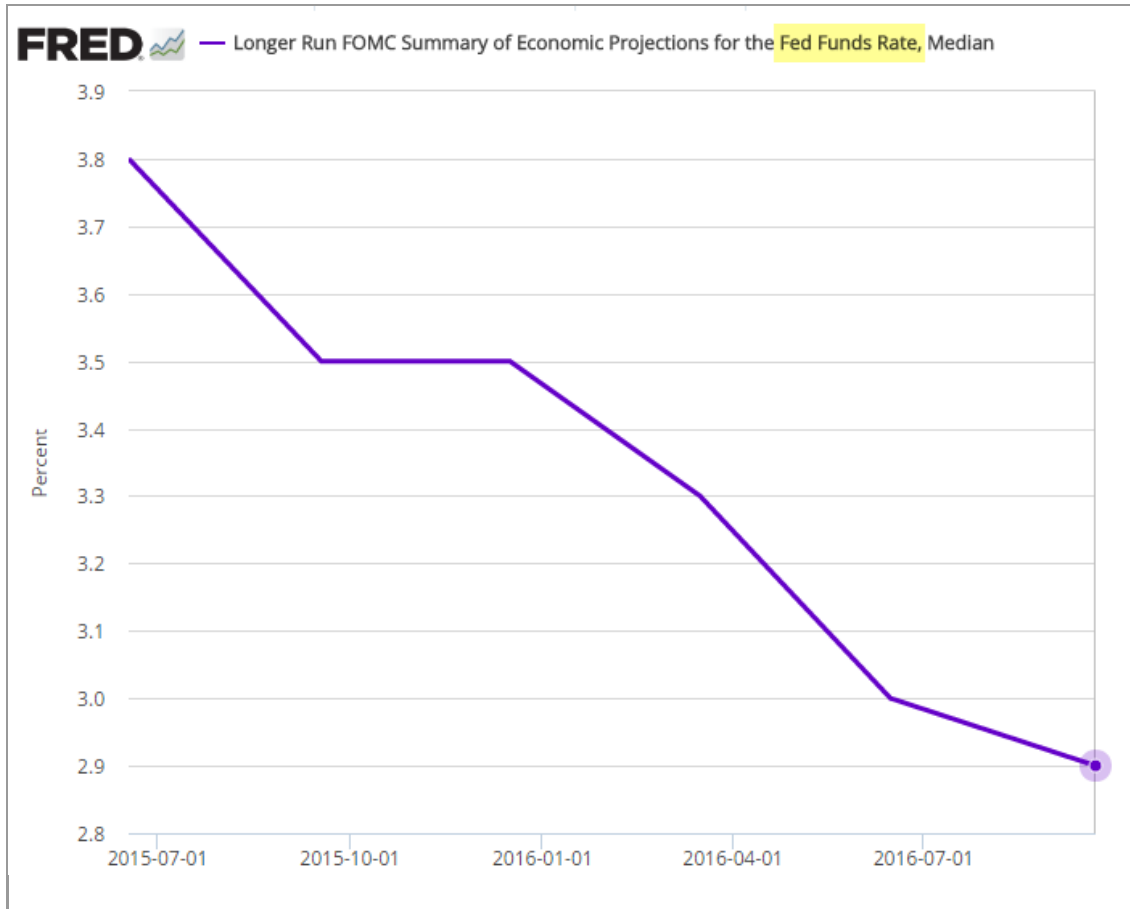
The futures-implied probability of a rate hike by year-end is now above 60%.



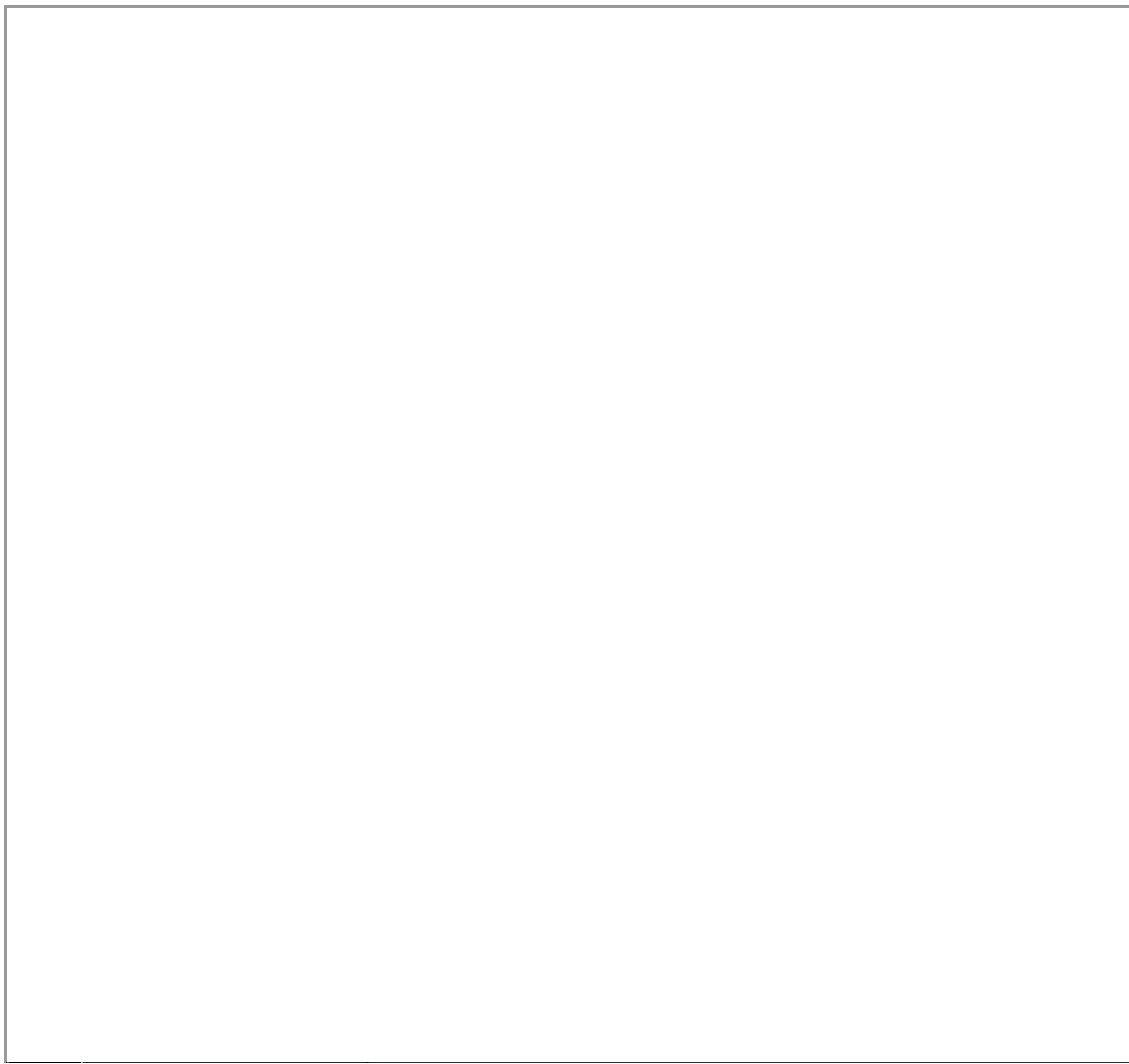
One of the key results from the FOMC meeting - something that the media doesn't seem to cover much - is another downgrade by the Fed of the US long-term growth. The central bank now believes (on average) that the United States economy won't grow faster than 2% in years to come. The FOMC has been steadily downgrading its expectation for long-term growth over the past five years - from 2.65% to 1.85%.

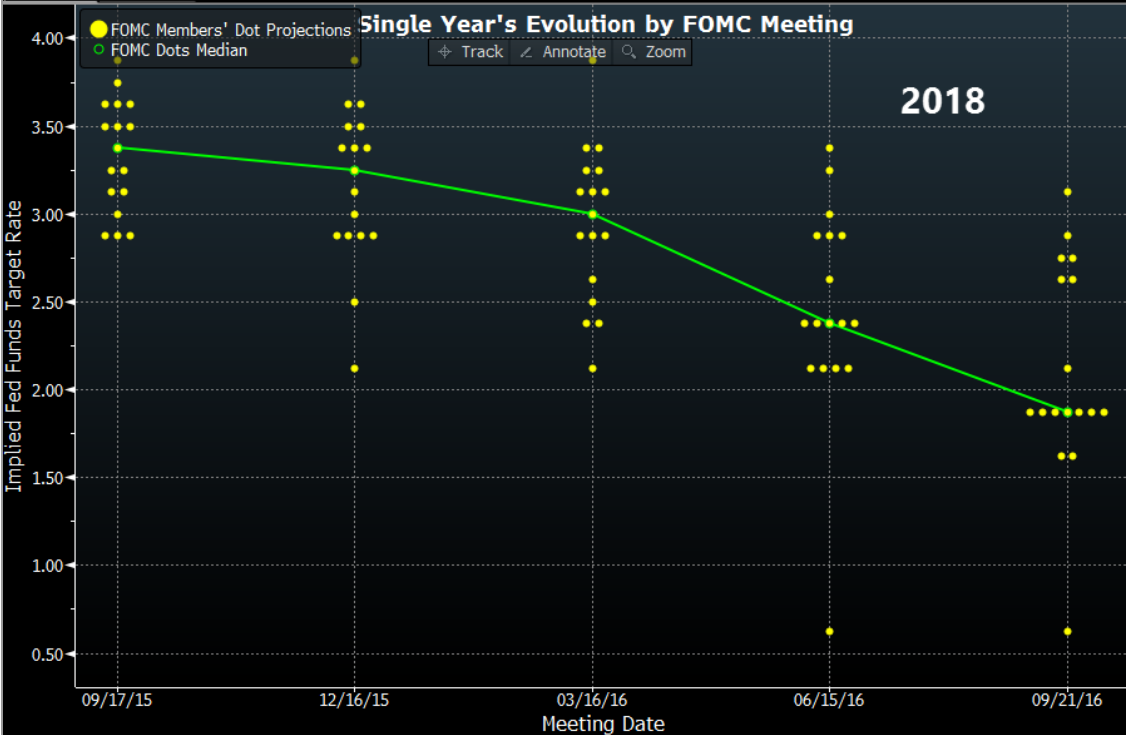
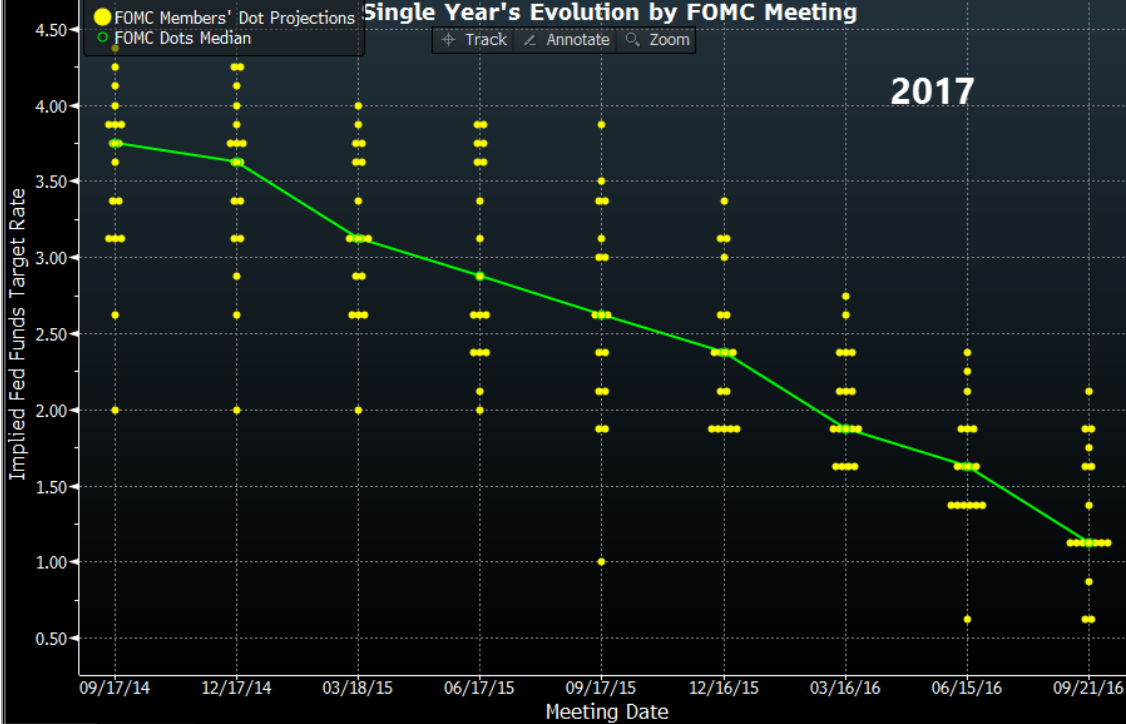


As a result of the above, in just over a year, the Fed has downgraded the US long-run fed funds rate from 3.8% to 2.9%.



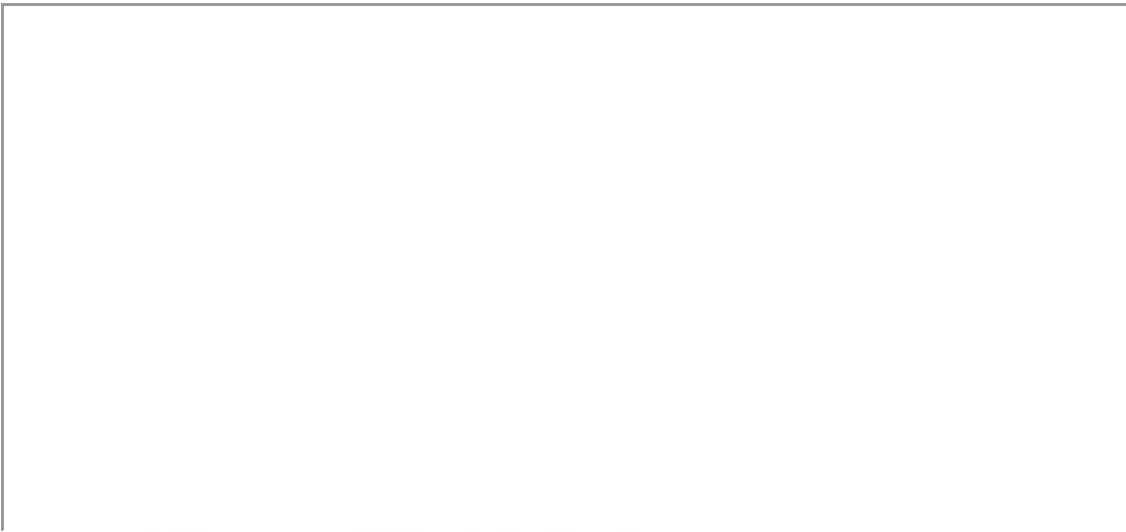
The FOMC has also been consistently downgrading the fed funds rate projections for the next couple of years.



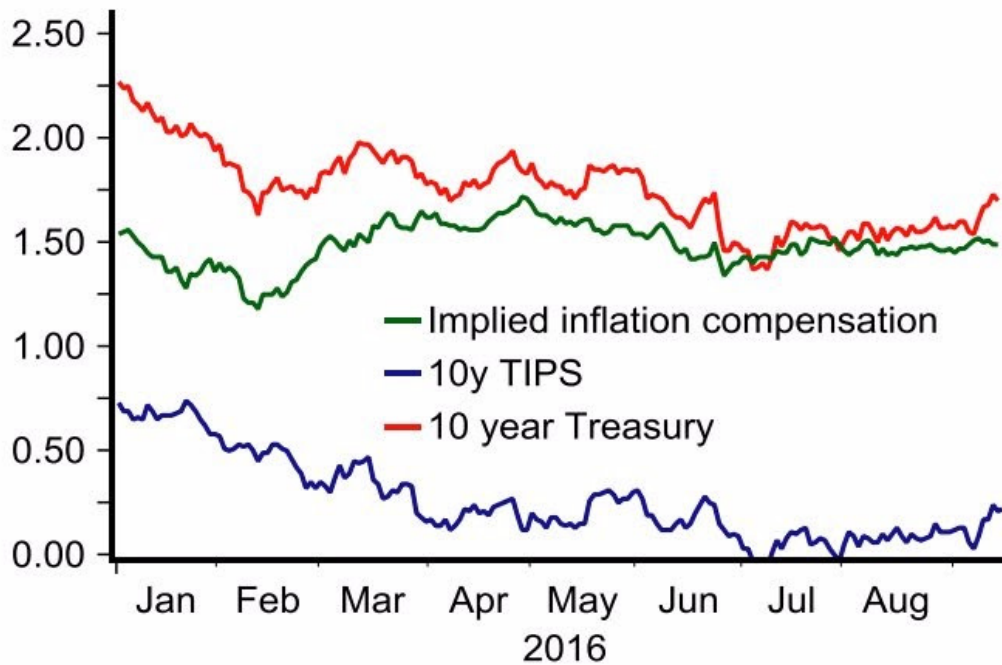


Source: Bloomberg

In other US developments, markets remain convinced that inflation will stay benign in years to come.



No sign of US inflation fears...



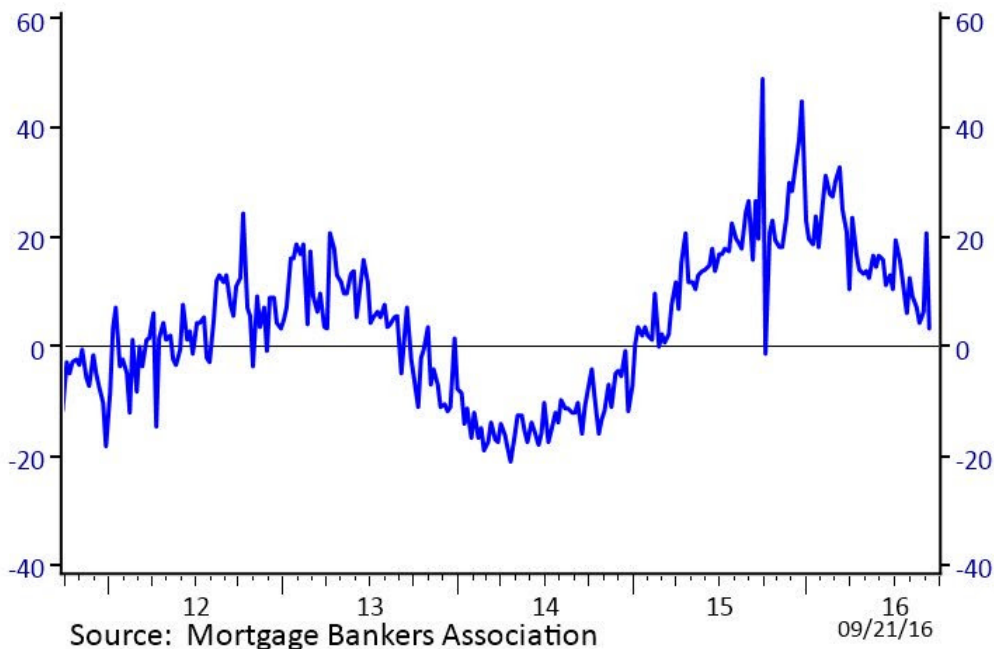
Source: Macrobond, Macquarie Research, September 2016

Source: Macquarie, @joshdigga

According to the Mortgage Bankers Association, growth in US mortgage activity for home purchases, while still positive, has been declining.

Mortgage Loan Applications for Home Purchase

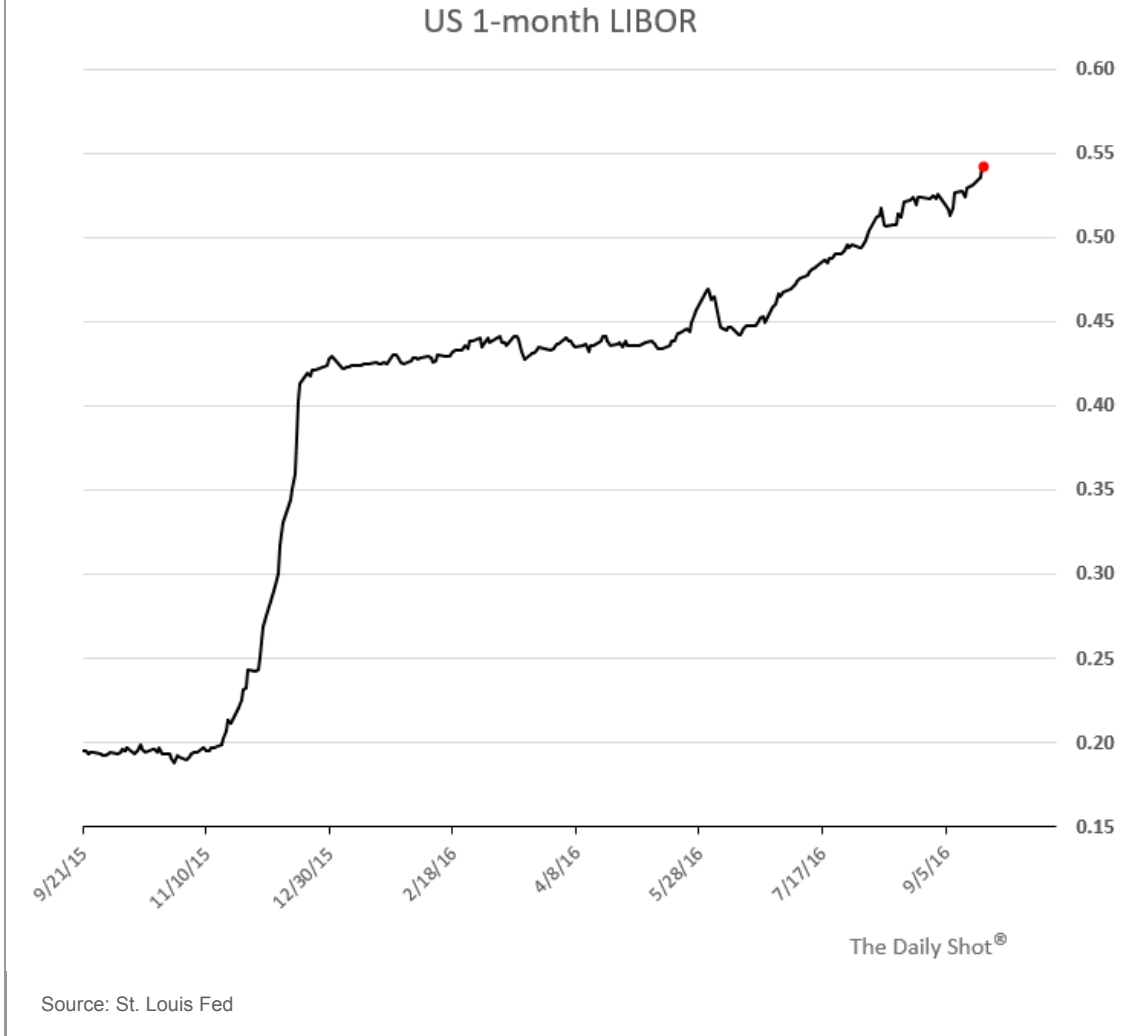
% Change - Year to Year



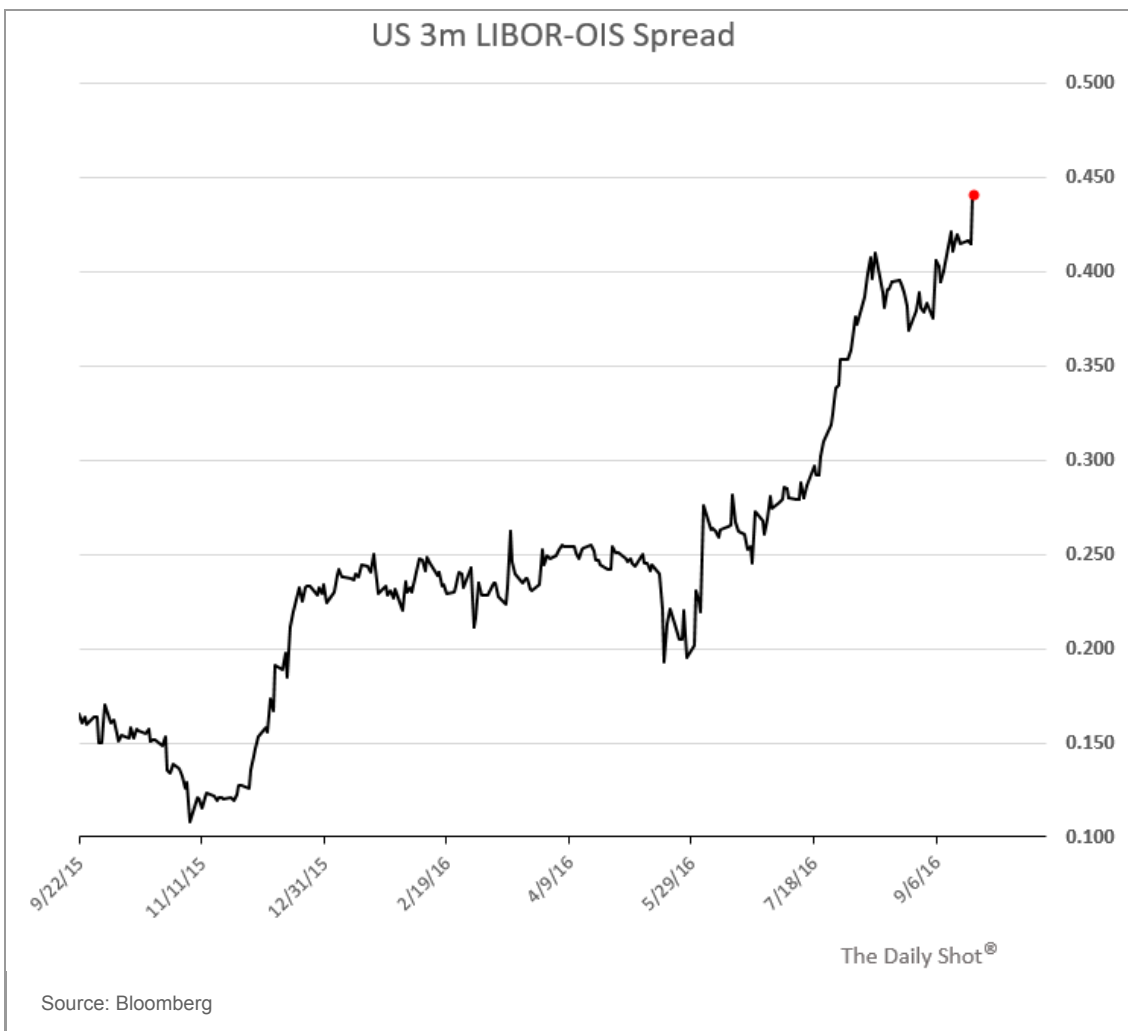
Source: Mortgage Bankers Association

09/21/16

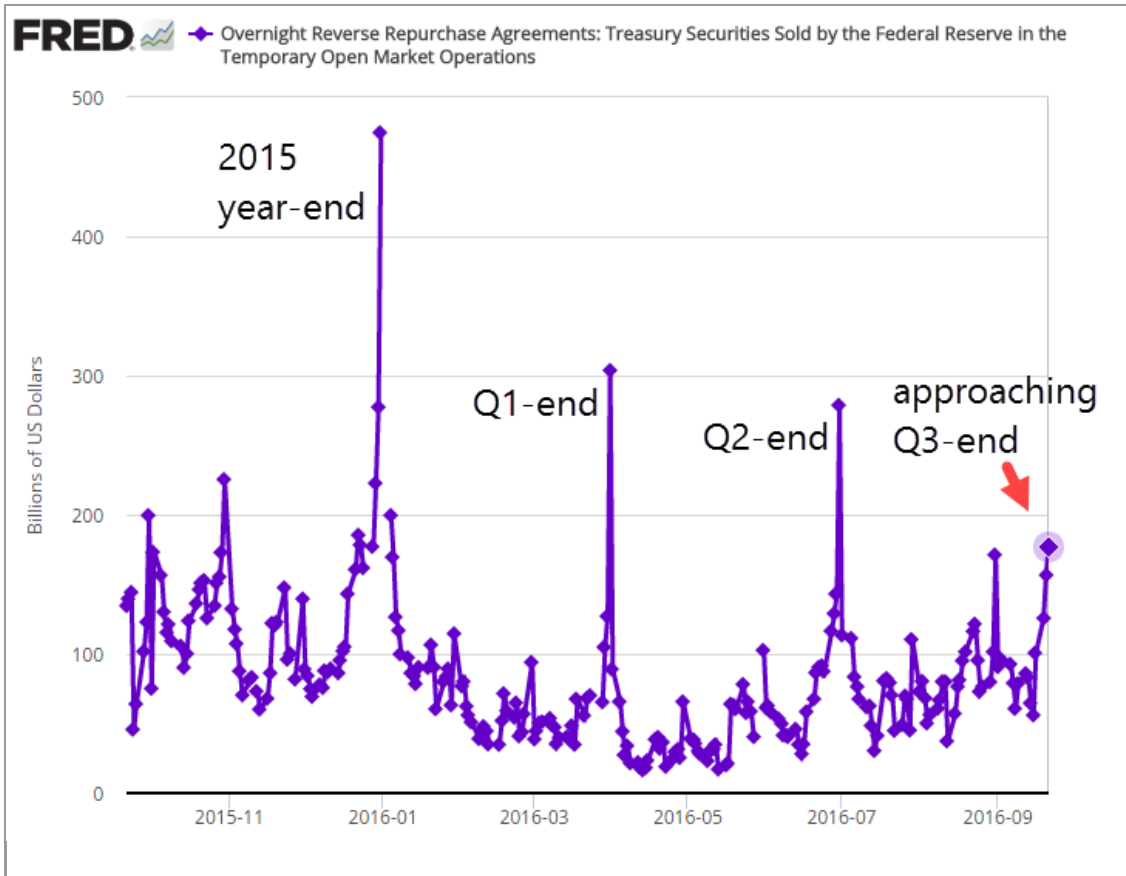
Now let's turn to the funding markets, where US dollar LIBOR continues to grind higher.



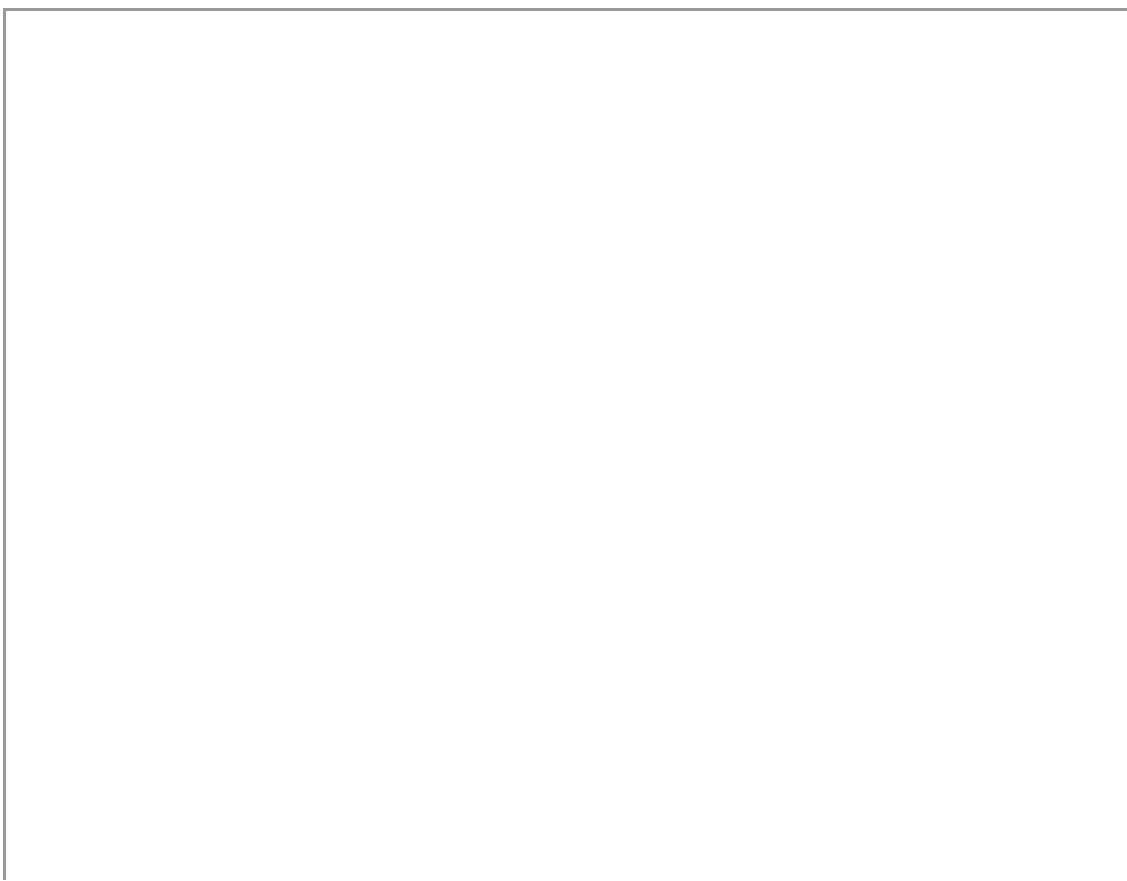
At the same time, OIS rates have declined in response to the Fed's inaction, pushing the LIBOR-OIS spread to multi-year highs.



The uptake of the Fed's RRP program has been steadily rising as we approach the end of the quarter. Some expect the usage to spike on the last day of the month by more than it has in previous quarter-ends.



Next, let's go to Japan where the BoJ has shifted to a more flexible quantitative easing regime that would allow it to target specific portions of the yield curve rather than the blunt instrument of purely buying securities. The central bank also committed to allow inflation to rise above the 2% target. Here is a nice summary from Goldman.



- In a fundamental shift, the central bank is shifting away from quantity targets, ...
- ... replacing them with yield curve targeting (specifically 10-year yield around zero).
- In an additional change, the central bank now aims for an inflation overshoot, ...
- ... committing to keeping real rates low across the curve until inflation exceeds the 2 percent target.
- The switch to yield targeting is a nice way to snuff out the JGB scarcity debate, ...
- while the “inflation overshoot” language is a clear and meaningful dovish shift.
- Ahead of this meeting, there was speculation that the BoJ would stage a retreat.
- This is not that and should see \$/JPY move to 108 by year-end, in line with our forecast.
- Our rates team thinks that the shift from a vertical demand curve for bonds from BoJ to a horizontal one ...
- ... could create more upside for reflation trades, such as long breakevens.

Source: Goldman Sachs

The BoJ is not happy with the results of the negative rate policy which ended up tightening financial conditions.

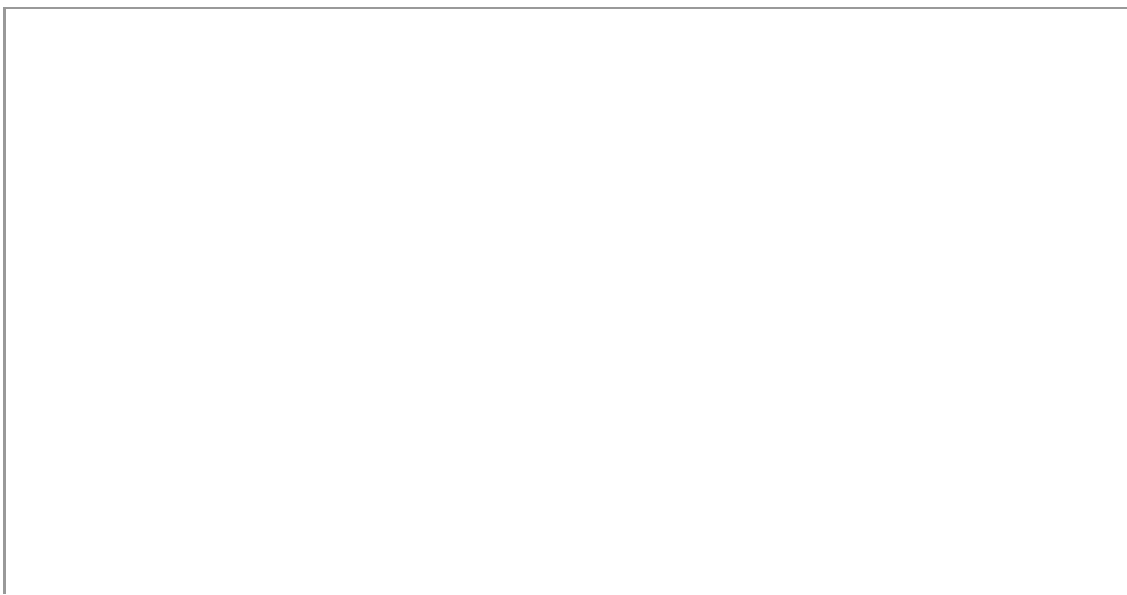


Exhibit 2: Financial Conditions Tightened After BoJ's NIRP Foray in January 2016

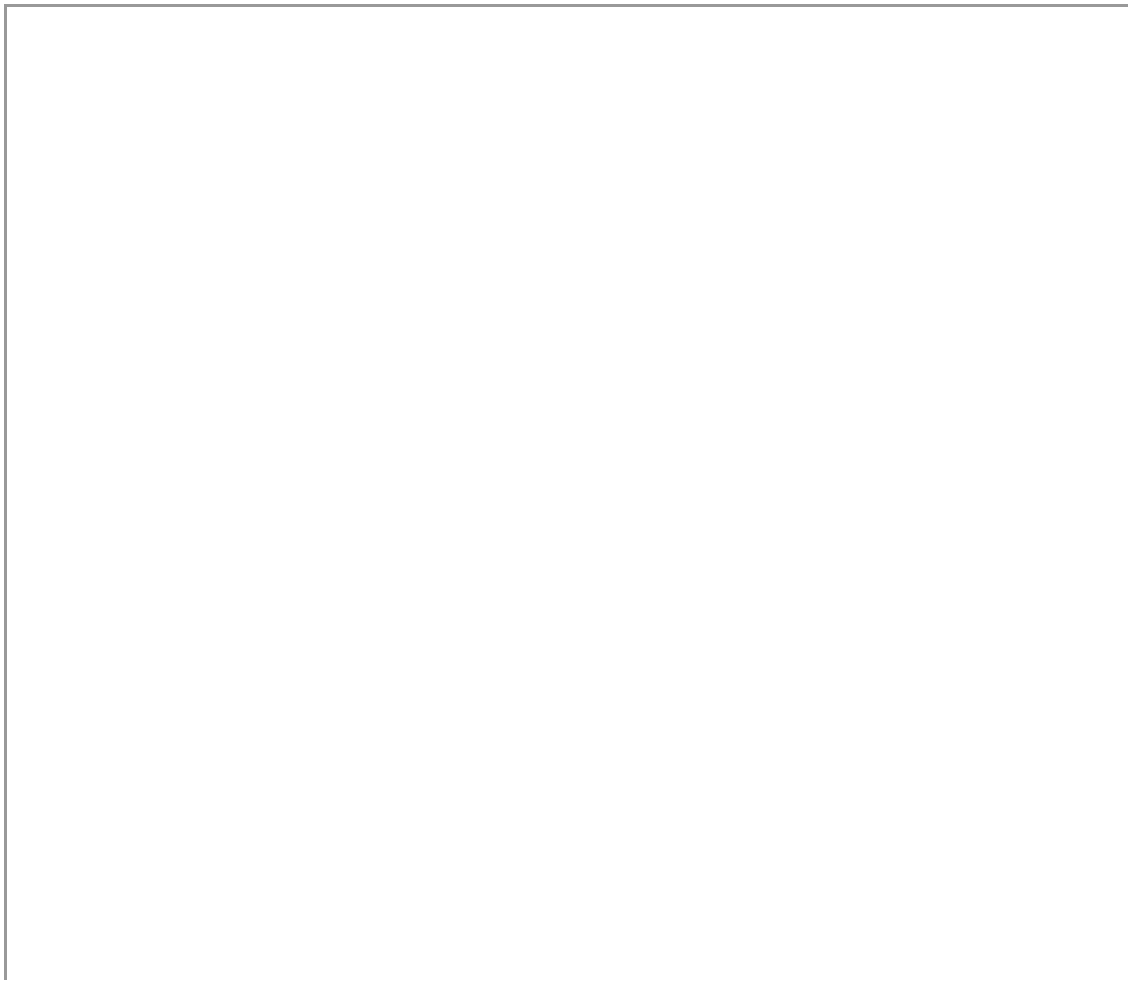
GS Japan Financial Conditions Index



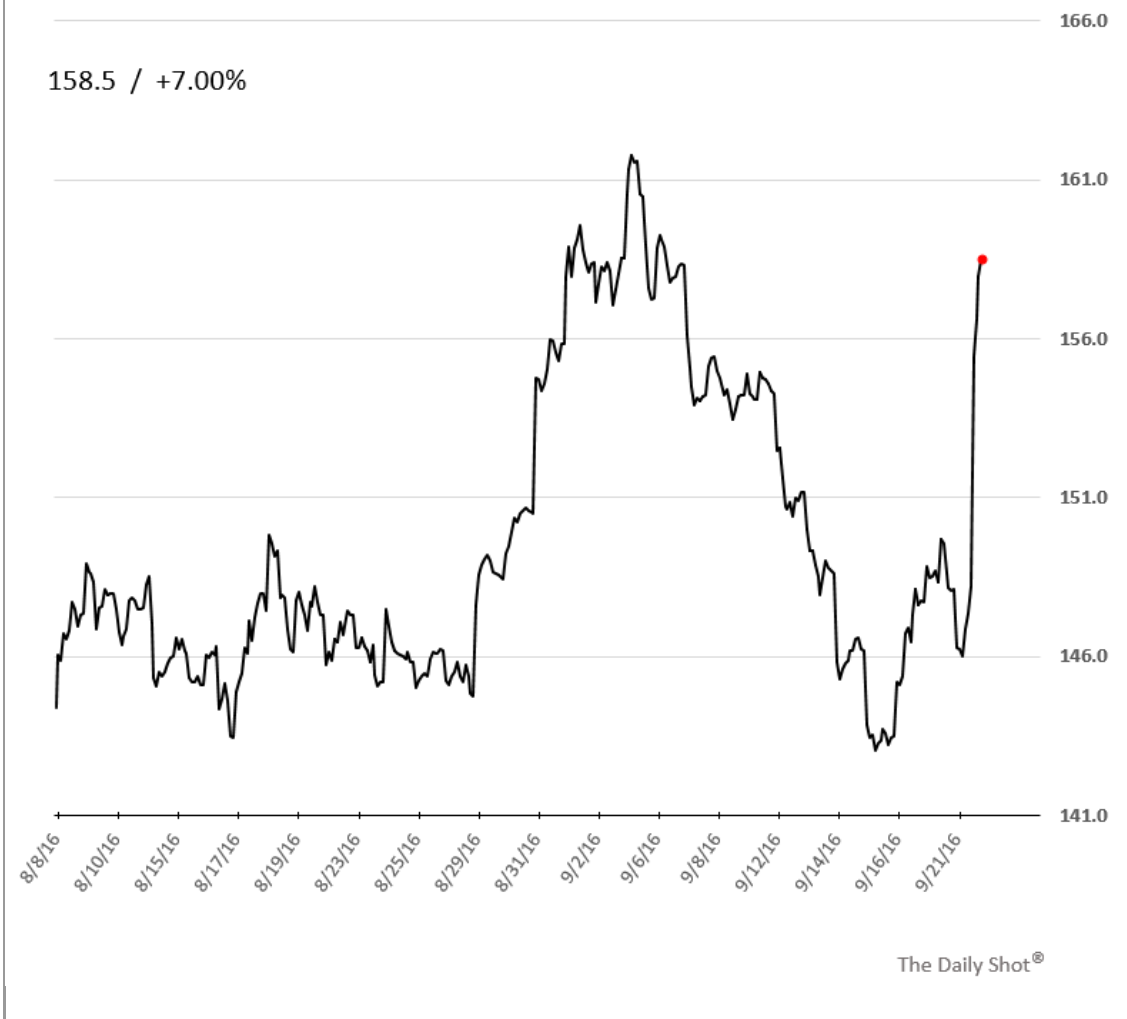
Source: Goldman Sachs Global Investment Research

Source: Source: Goldman Sachs, @joshdigga

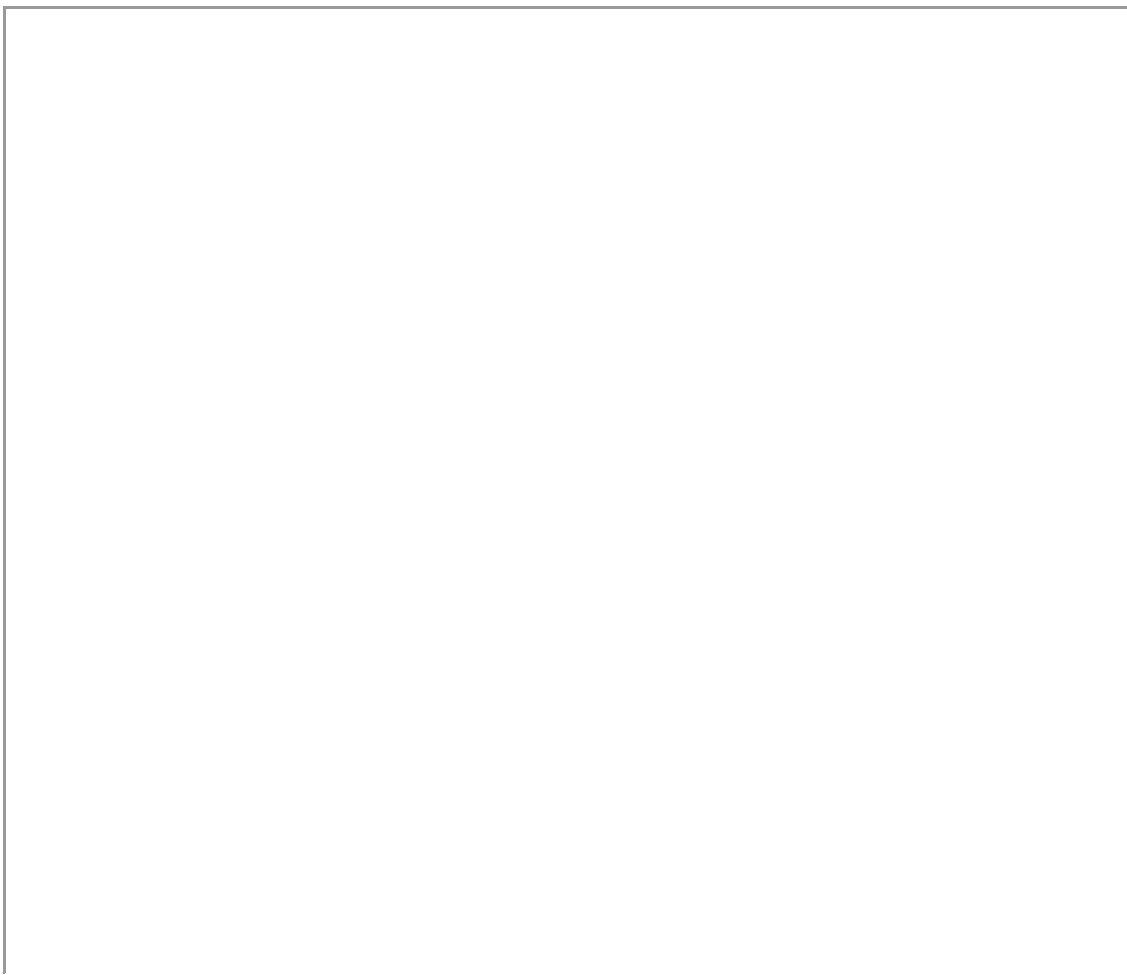
Instead, the central bank can now target the shape of the curve, keeping it sufficiently steep to help the banking sector (which came under pressure from negative rates). Japanese bank shares rallied sharply in response.

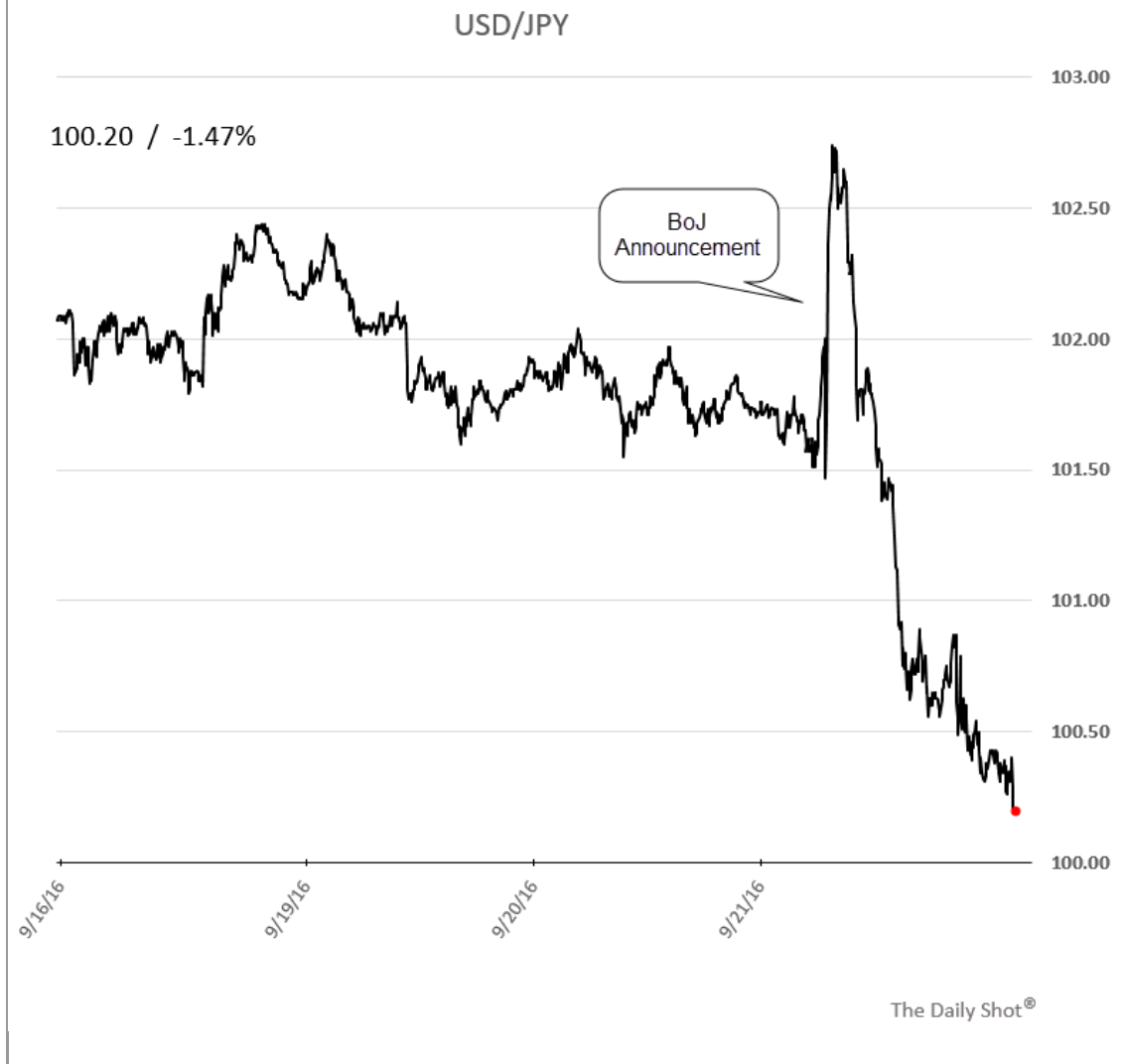


TOPIX Banks Index

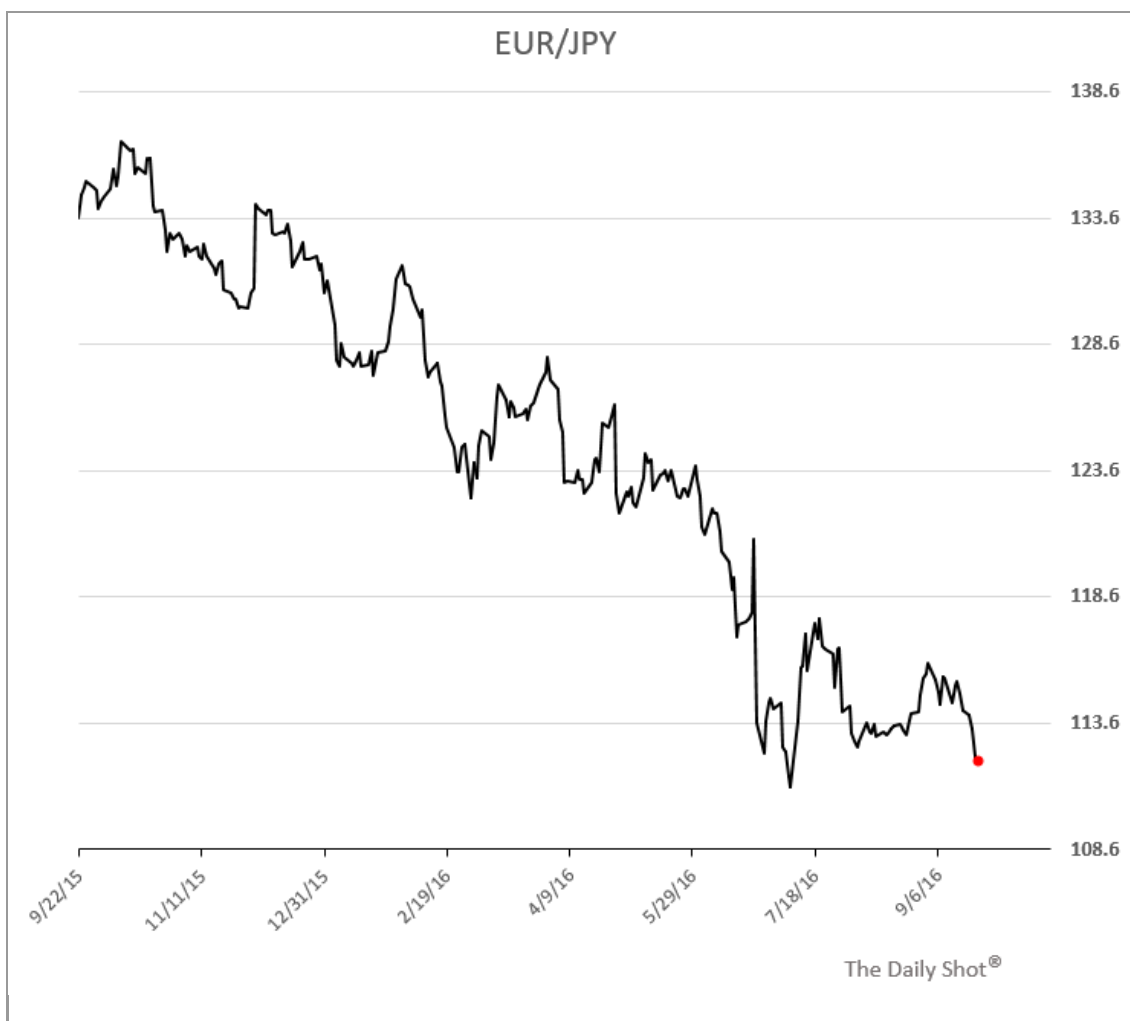


As discussed yesterday, the dollar initially rose (yen fell) on the BoJ announcement. However, that trend later reversed. The Fed's inaction that helped the yen strengthen further is not what the BoJ had been hoping for.

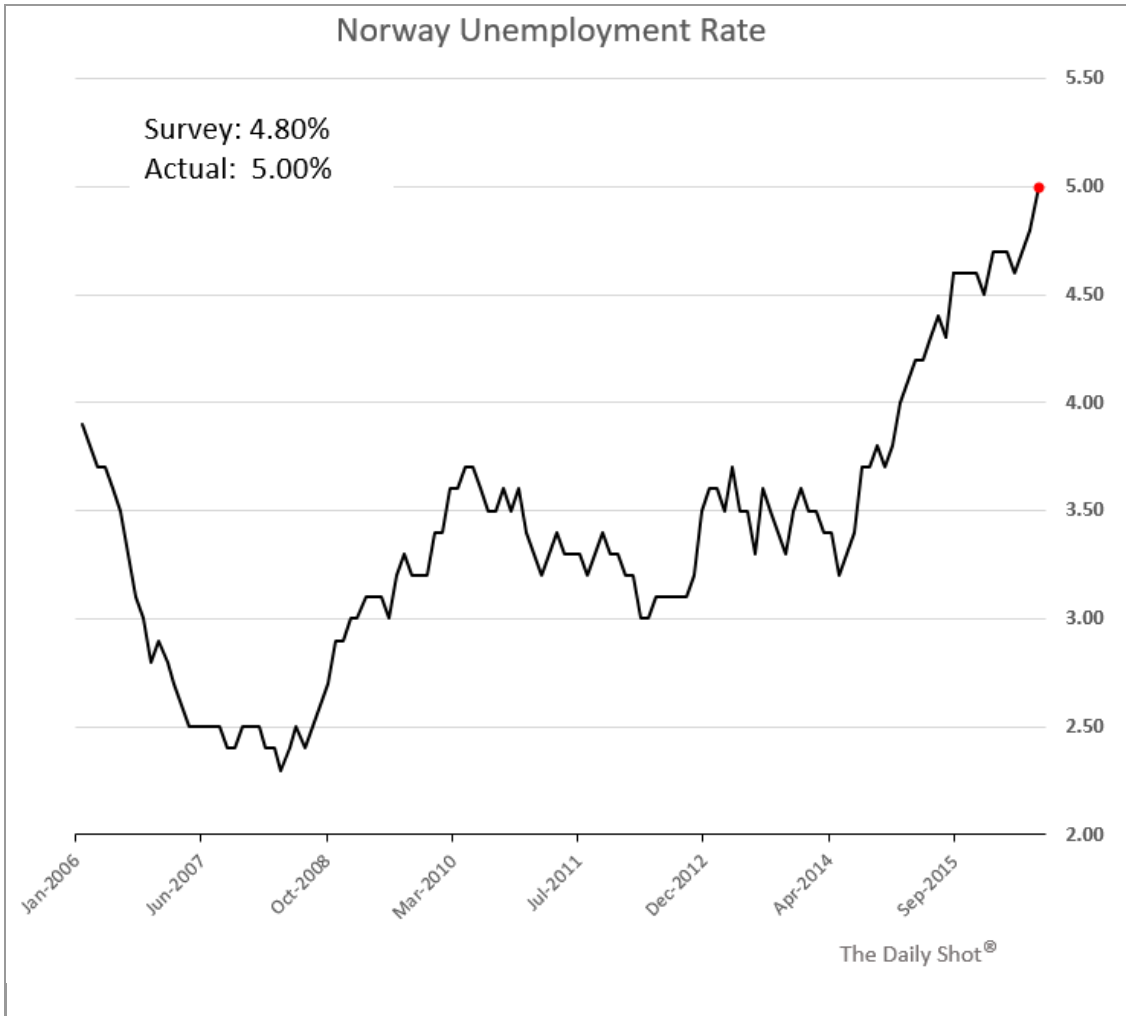




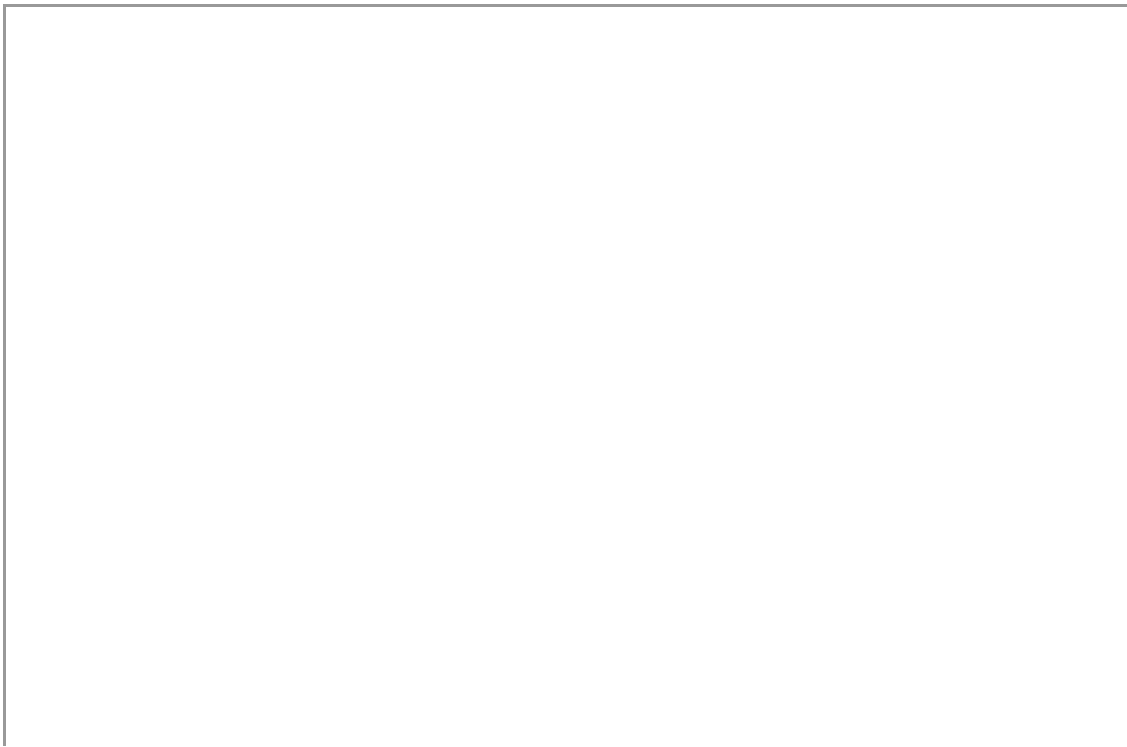
The yen strengthened sharply against the euro as well, which is likely to hurt Japan's exporters as well as cap any gains in inflation.

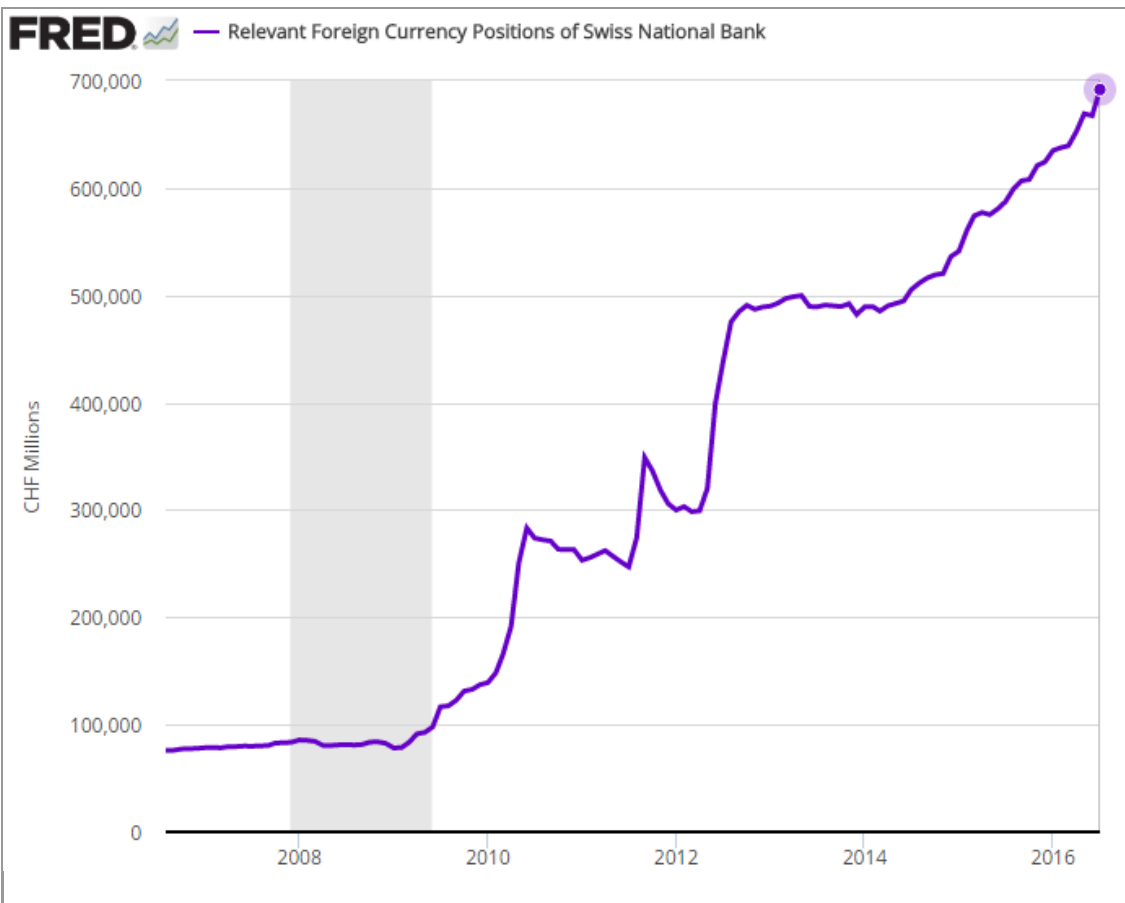
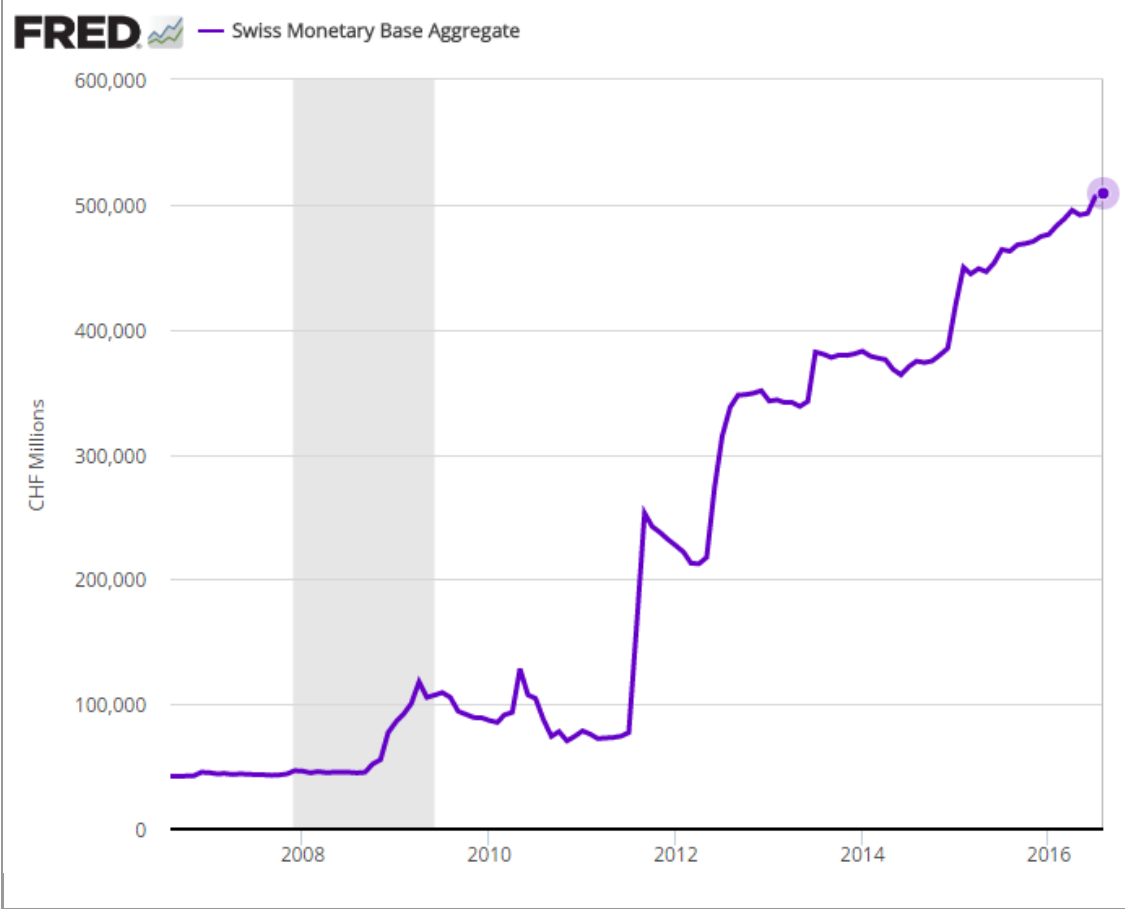


1. Turning to Europe, Norway's unemployment rate unexpectedly hit 5%. While this would be considered a great success for many nations in Europe, Norway saw its unemployment rate double since 2008 (when oil prices peaked).

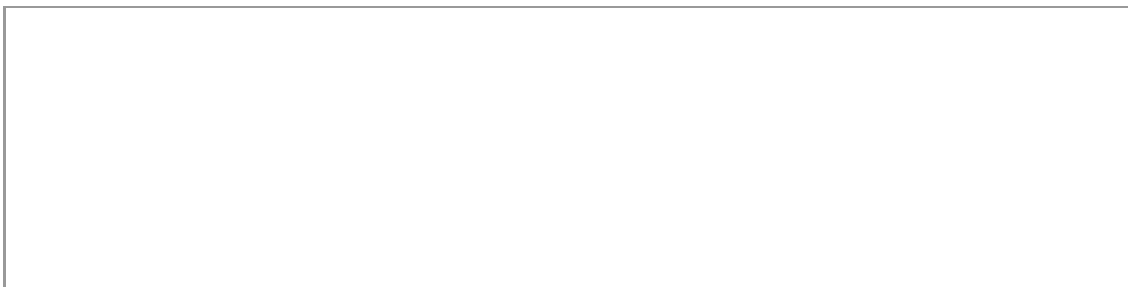


2. The Swiss National Bank's balance sheet continues to expand, pushing the monetary base to record levels. The central bank's holding of foreign currency, which is mostly euros, is now **larger than Switzerland's annual GDP**.





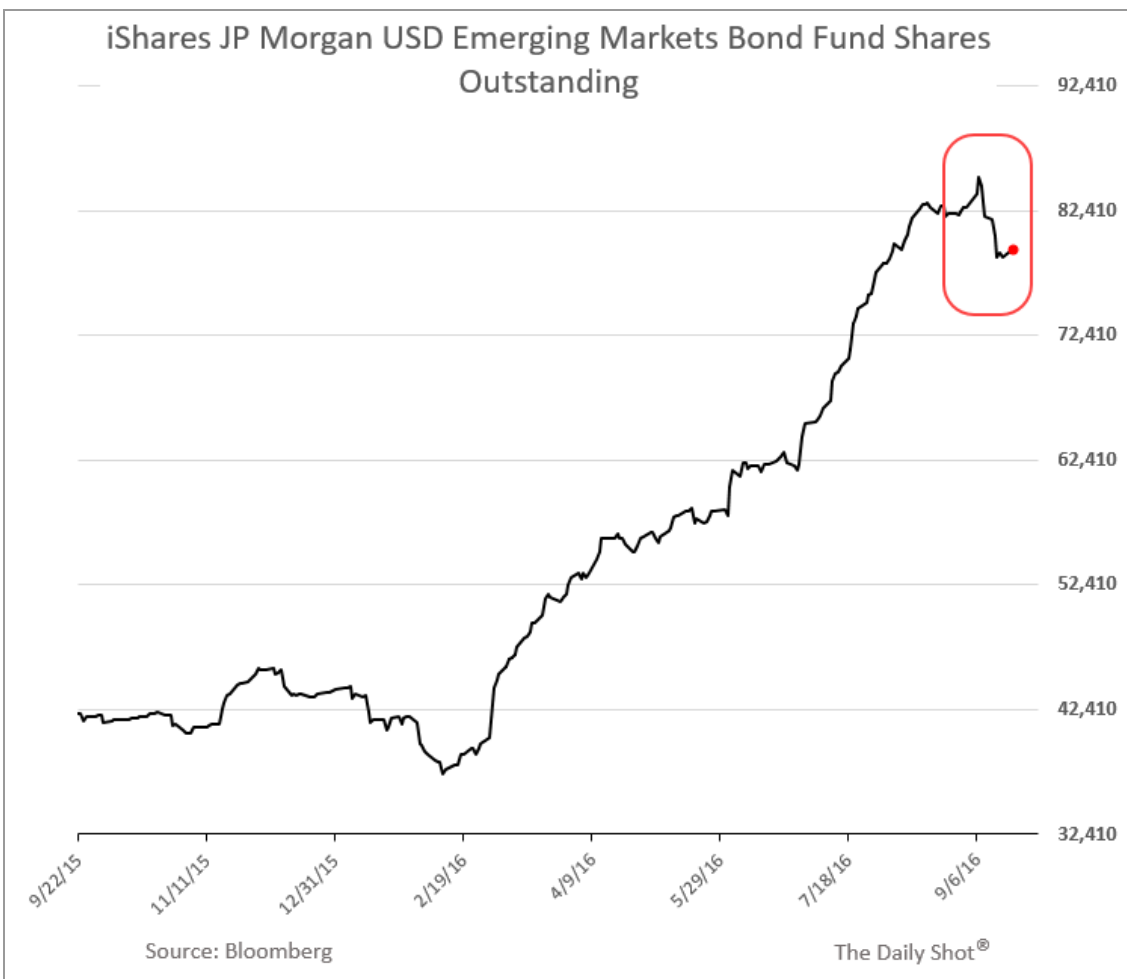
3. Portugal's bonds are under pressure again.



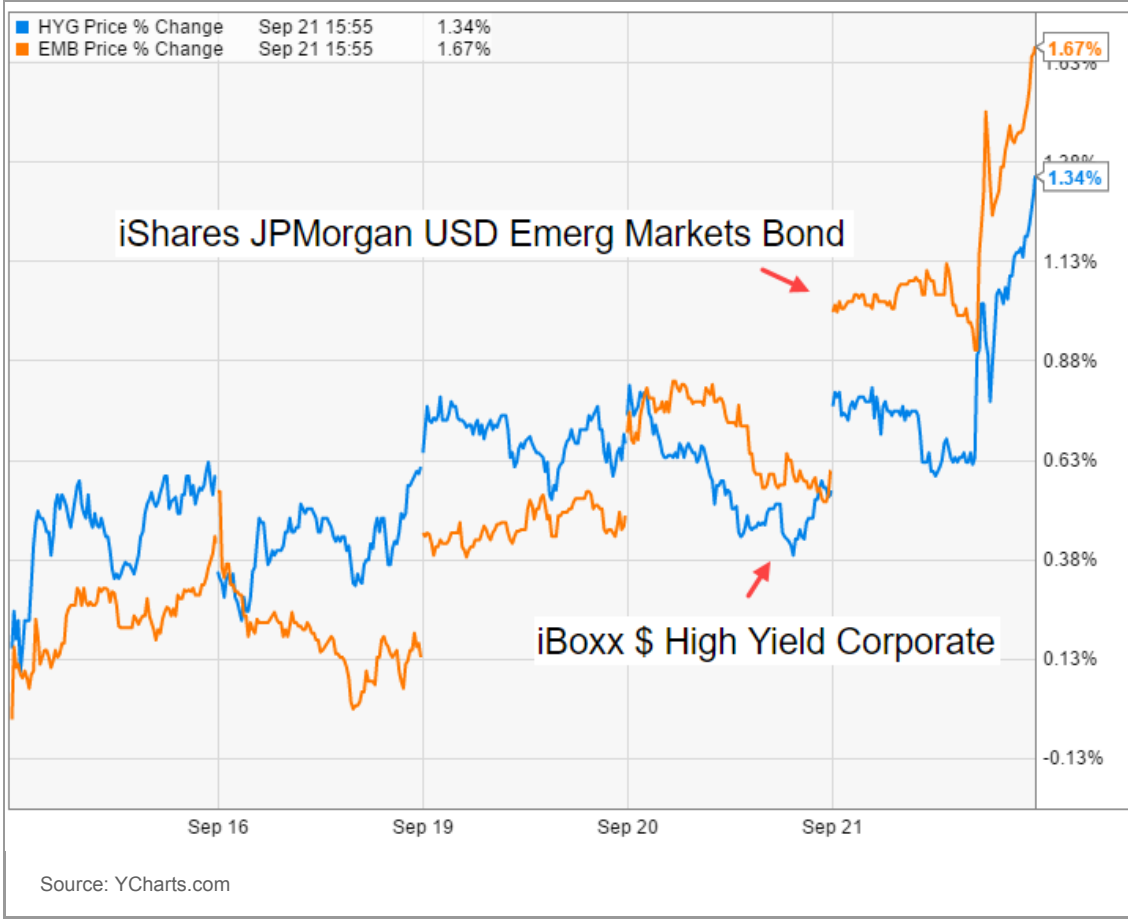
Portugal 5yr Government Bond Yield



1. In emerging markets, debt fund flows seem to have stabilized.



In fact, EM debt funds rallied sharply after the Fed's decision to hold rates unchanged. The chart below compares the largest US HY fund with the largest public EM debt fund over the past week.



2. Related to the above, Argentina's dollar bonds rallied sharply, with the yield approaching recent lows.





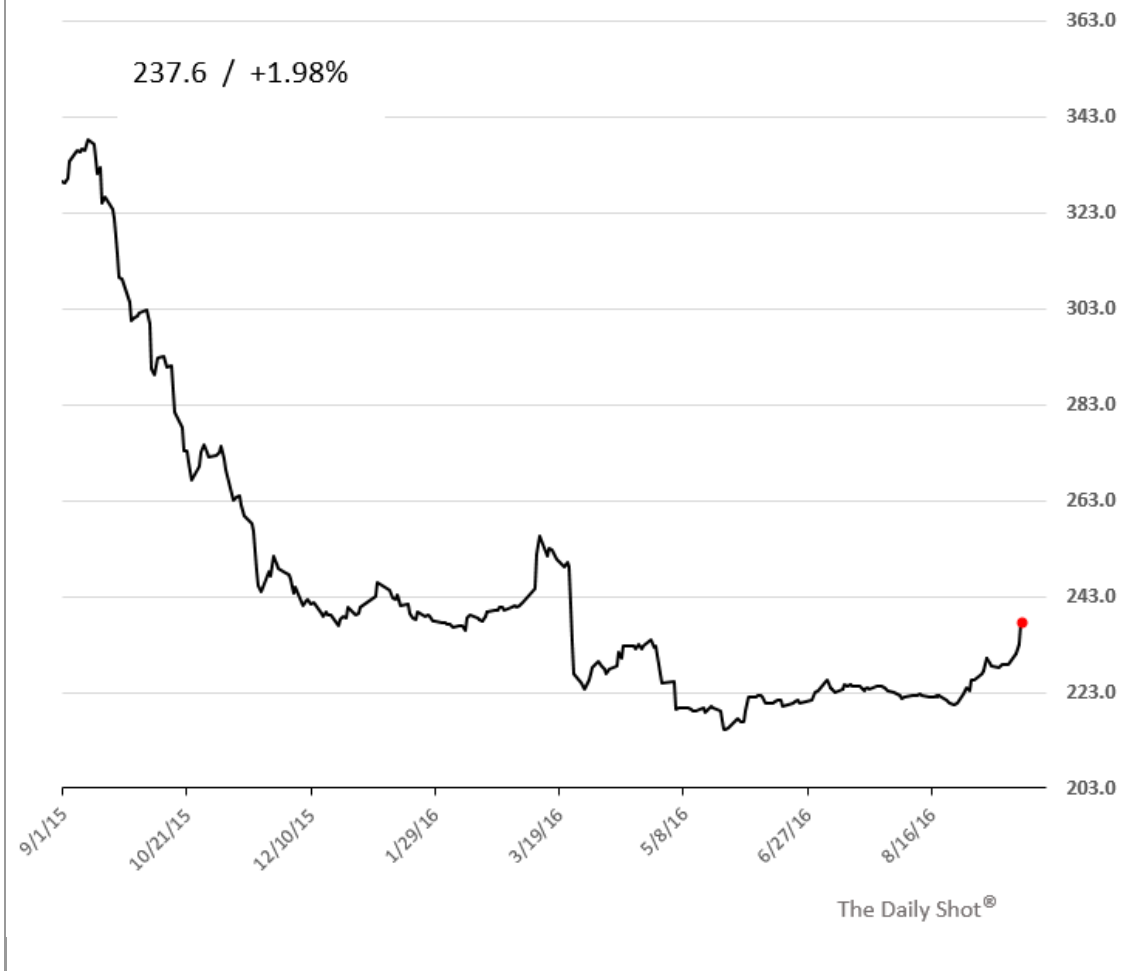
3. EM equities had a spectacular day.



4. Even the Ukrainian stock market is showing signs of life.



Ukraine PFTS Index



5. EM currencies rallied across the board on the Fed's announcement.

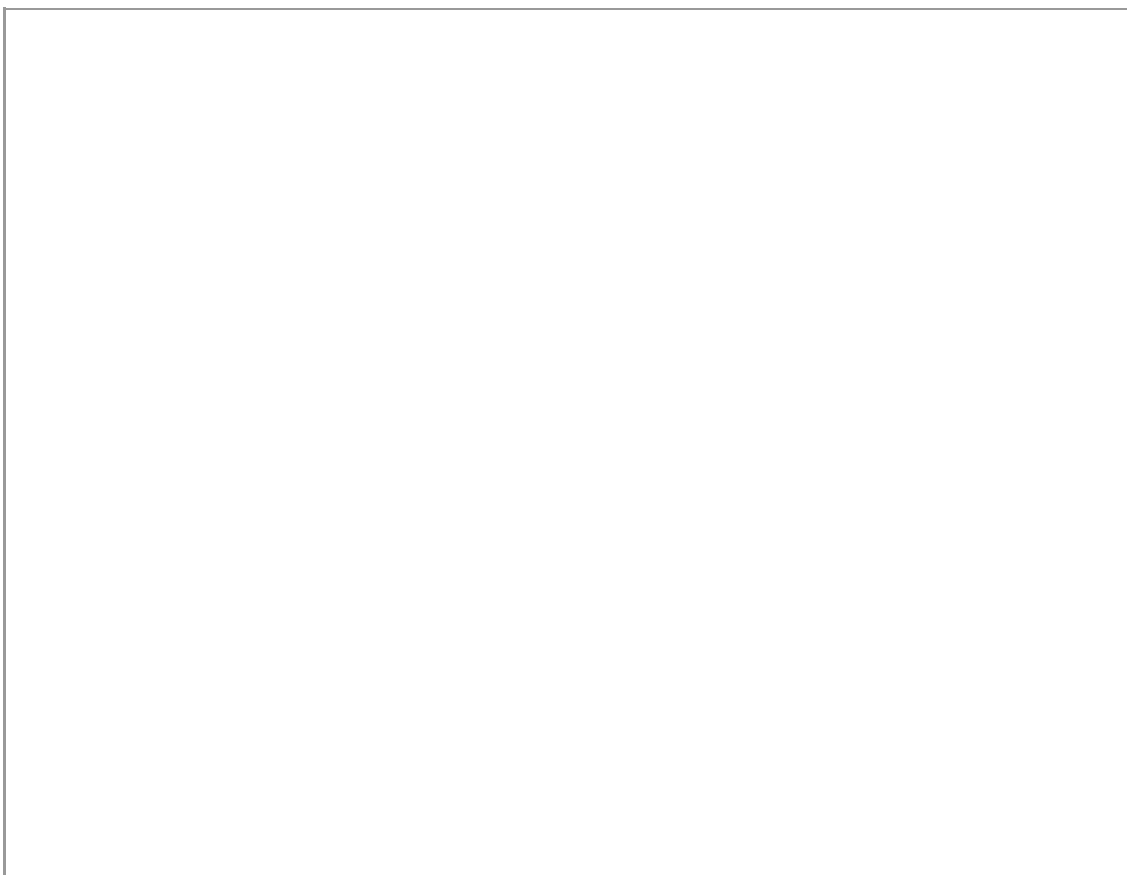
J.P. Morgan Emerging Market Currency Index



6. The biggest winner was the South African rand.



1. We now turn to commodities, where gold rallied in response to the FOMC decision.

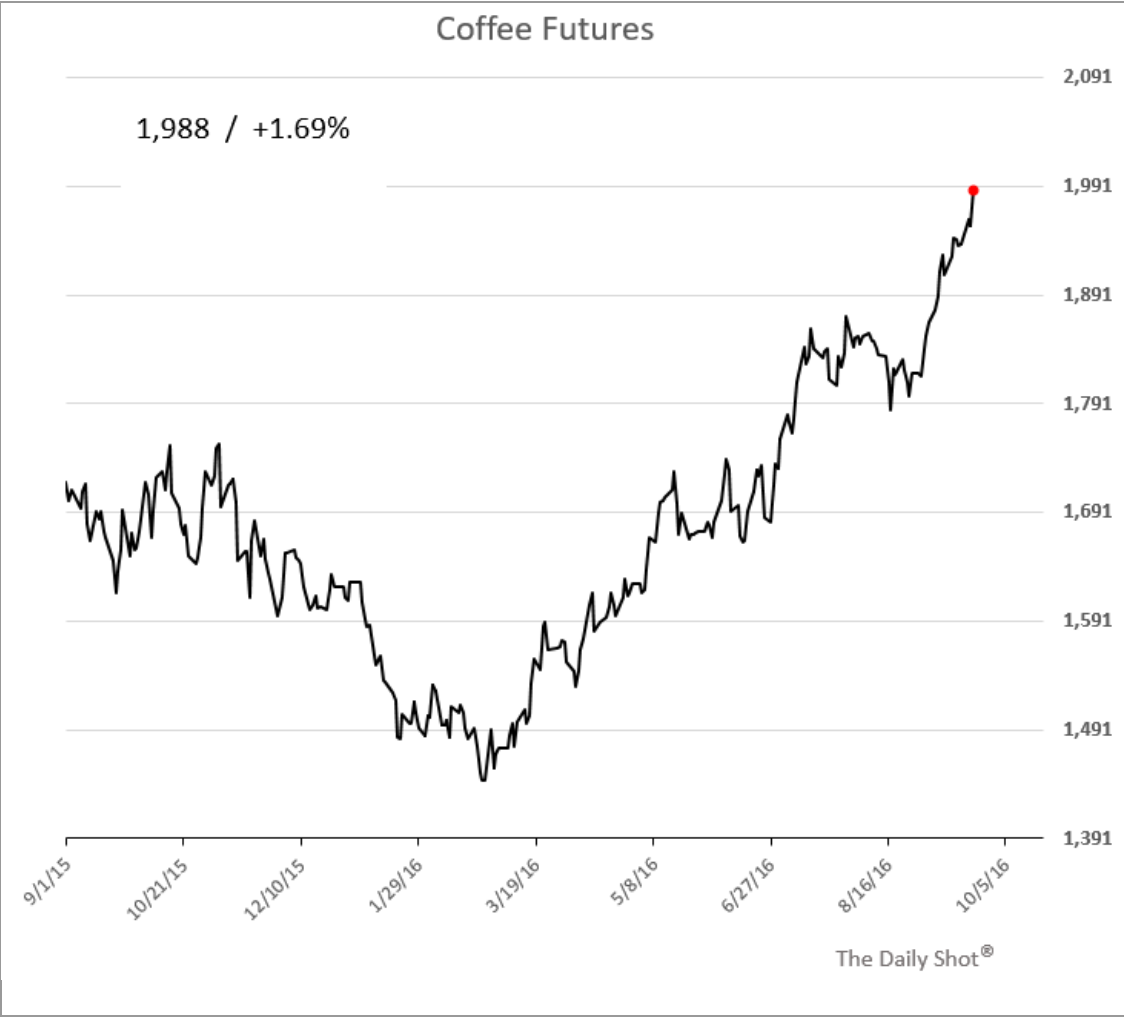




2. Lead resumed its climb.



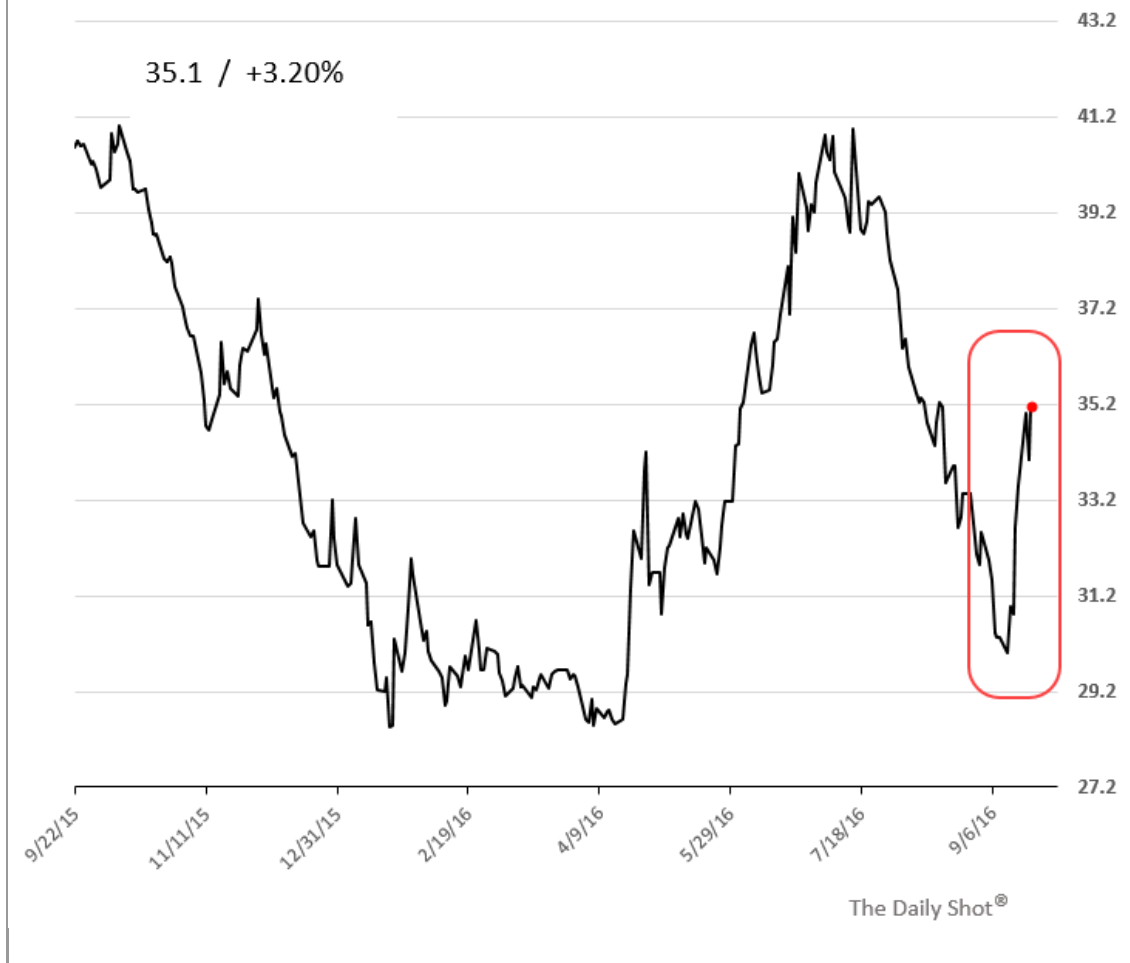
3. Coffee is having an amazing few weeks on tighter export markets.



4. The UK natural gas jumped 3% due to some unplanned outages. This spike is likely to be temporary as LNG feeds ramp up.

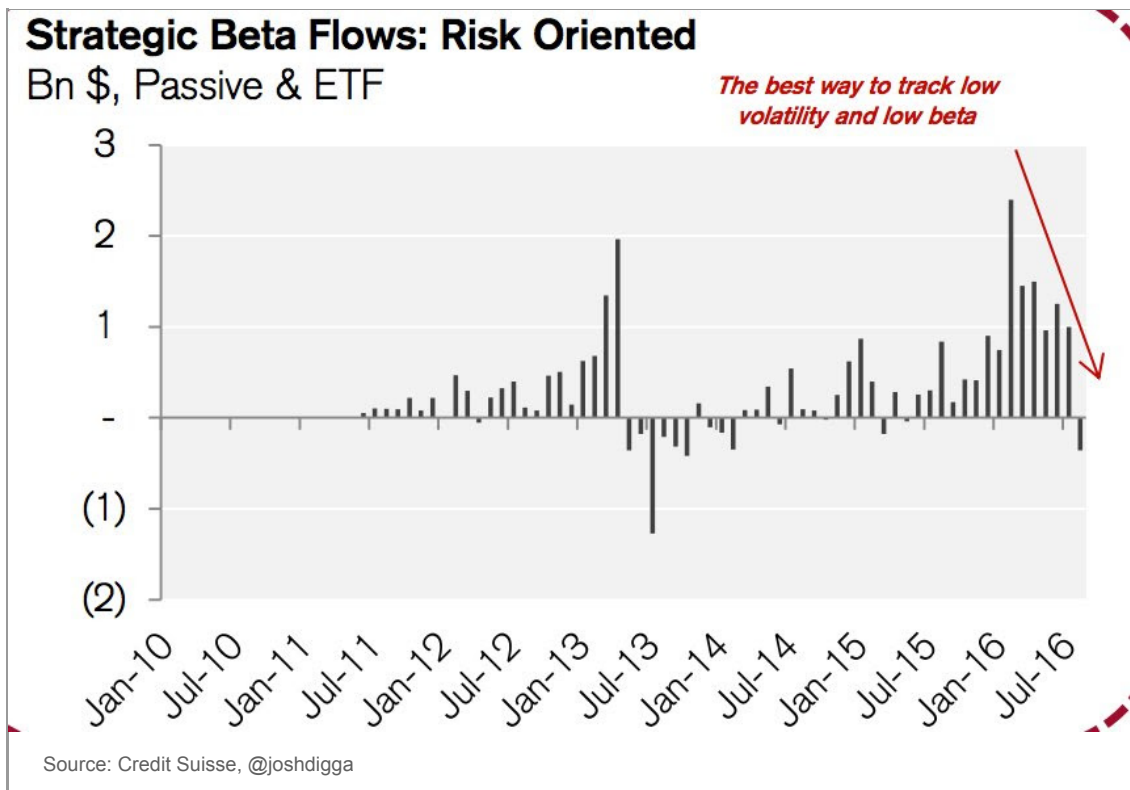


UK Natural Gas Futures



Now let's look at some fund flow data from our friends at Credit Suisse.

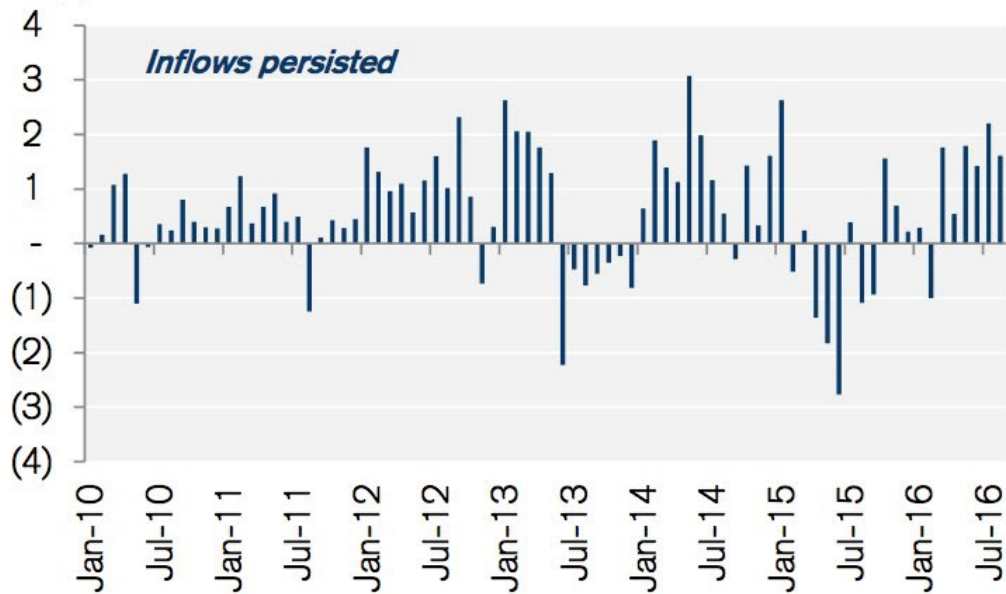
1. The so-called "strategic beta" funds saw outflows for the first time in over a year.



2. Yield-oriented funds continue to enjoy inflows.

Real Estate Flows

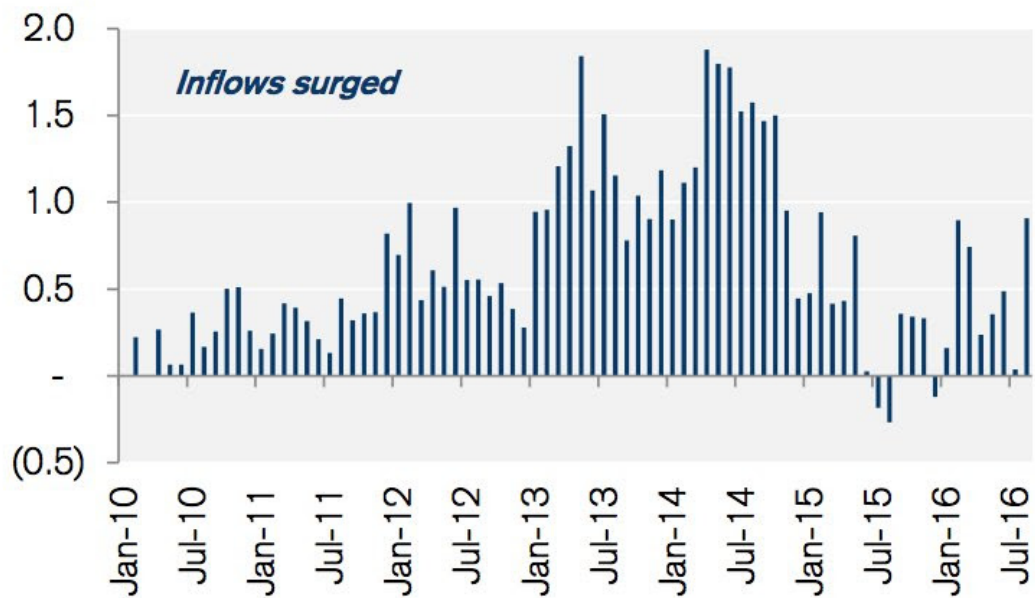
Bn \$, Active & Passive w/ETF



Source: Credit Suisse, @joshdigga

Energy MLPs

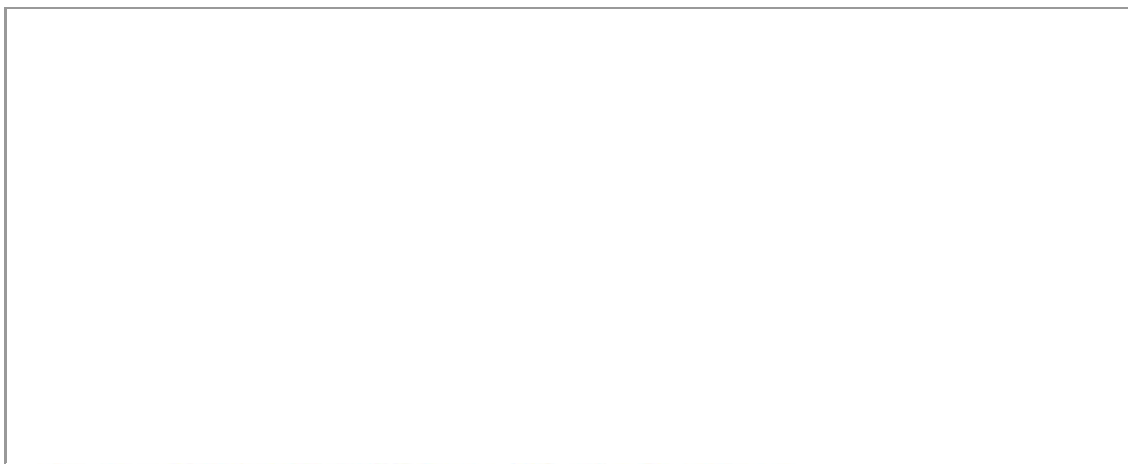
Bn \$, Active & Passive w/ETF



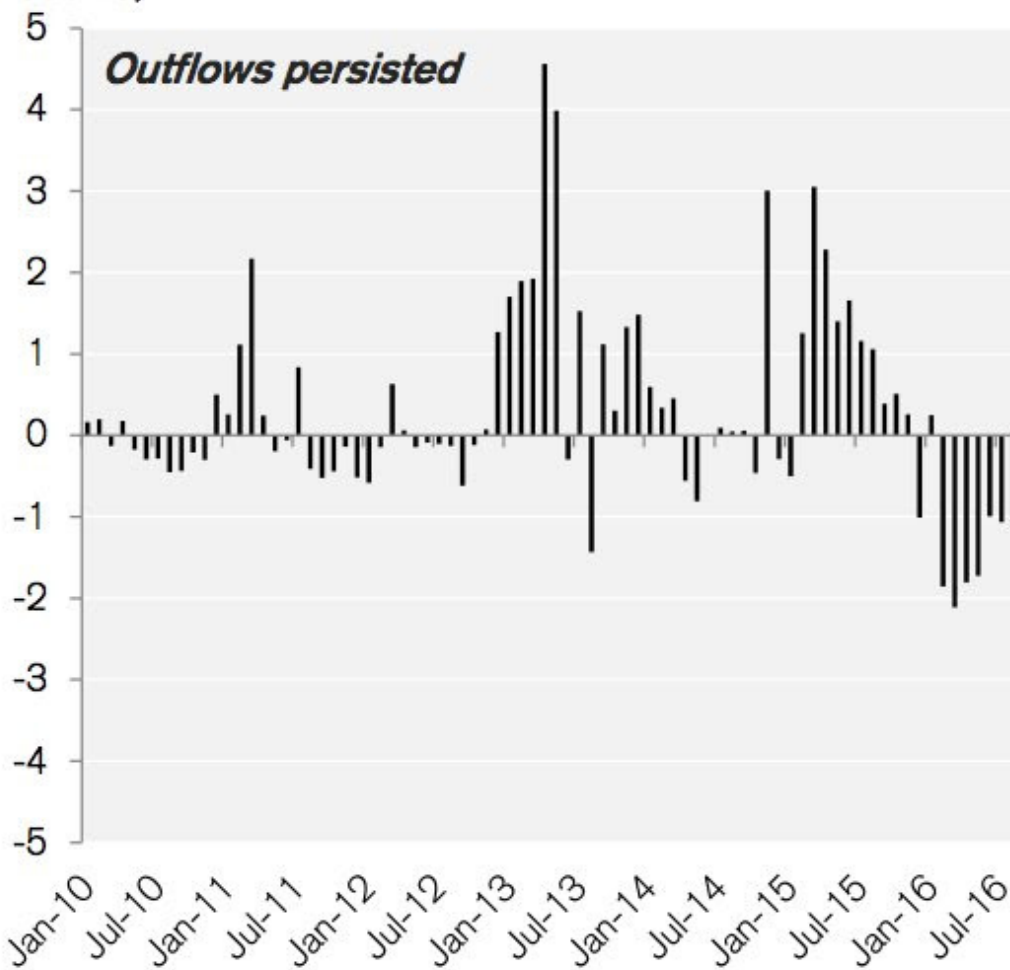
Source: CS US Equity Strategy, Morningstar; through August 2016

Source: Credit Suisse, @joshdigga

3. Japan-focused equity fund outflows continue.



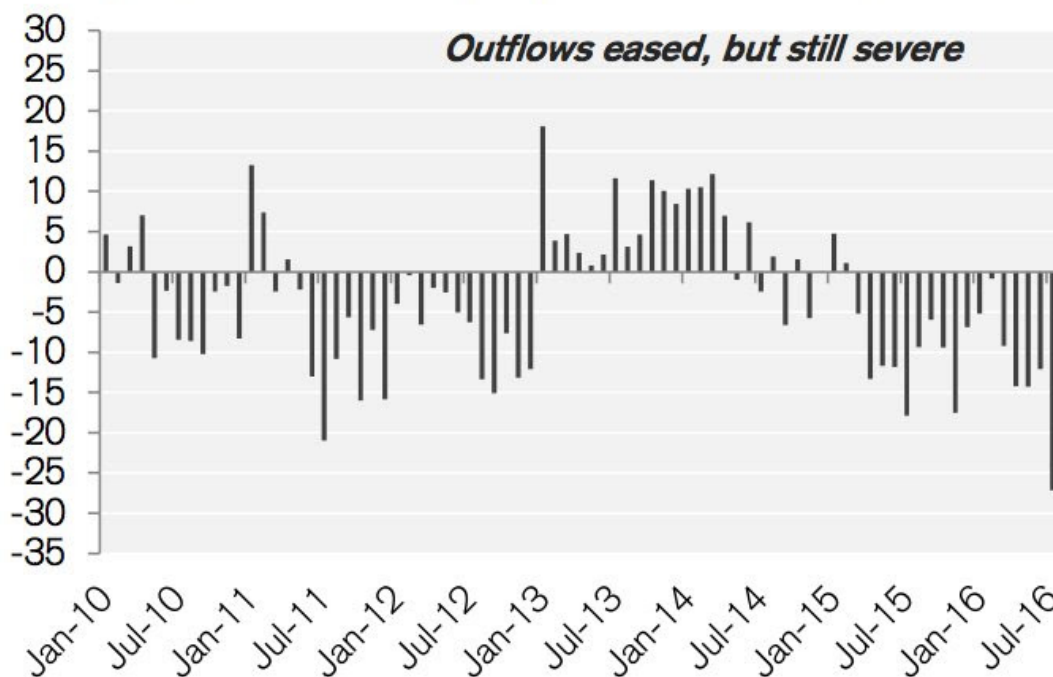
Japan Equity Fund Flows (Bn \$, Active & Passive)



Source: Credit Suisse, @joshdigga

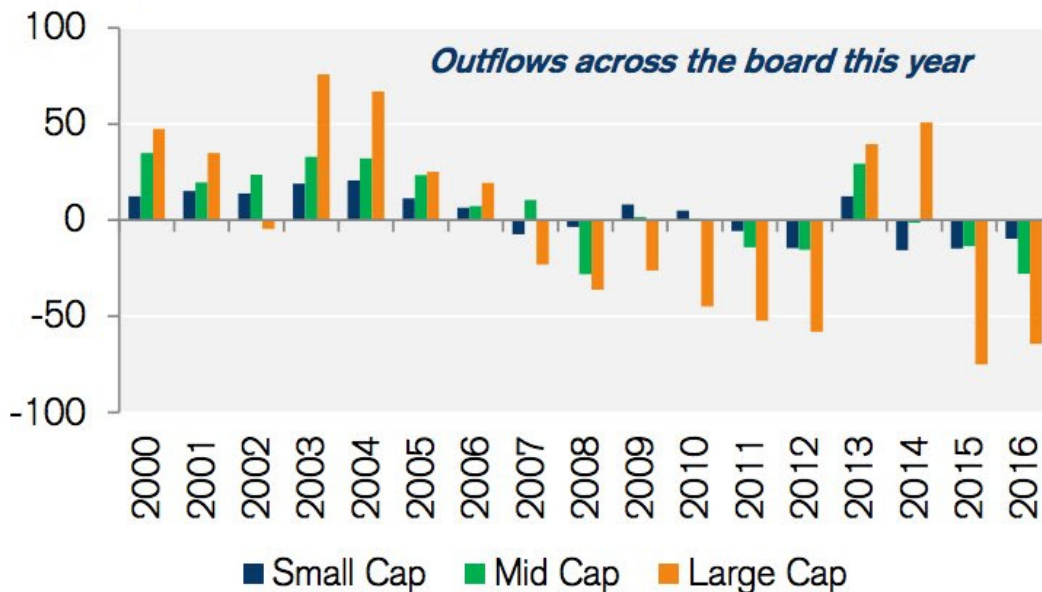
4. US equity fund outflows have been severe. The second chart below shows flows for large-, mid-, and small-cap funds.

US Equity Funds Flows (Bn \$, Active & Passive)



Source: Credit Suisse, @joshdigga

Total Flows by Size Segment (Bn \$, Active & LT Passive)



Source: Credit Suisse, @joshdigga

1. In global developments, yields on average are still below the pre-Brexit levels.

Fig 2 ...taking on a global weighted average basis not yet back to pre-Brexit level & far below historical norms

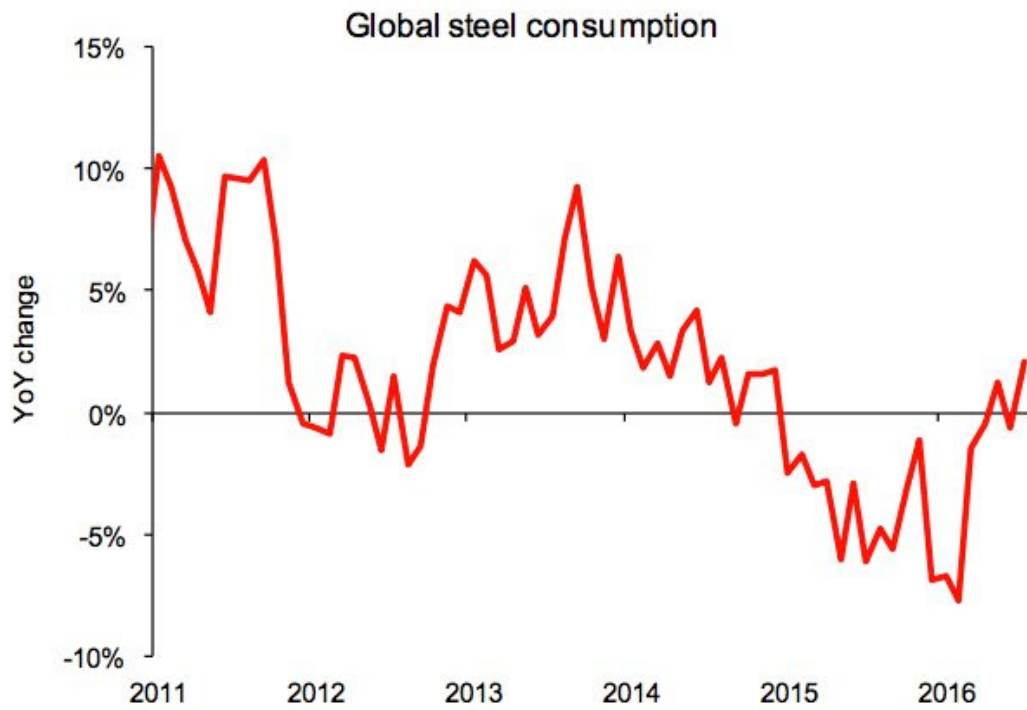


Source: Markit, Macquarie Research, September 2016

Source: Macquarie, @joshdigga

2. Global steel consumption has turned positive (year-over-year).

Fig 24 Global steel consumption has recovered back to positive YoY growth



Source: worldsteel, Macquarie Research, September 2016

Source: Macquarie, @joshdigga

Finally, it seems that the 2008 federal government's bailout of Freddie and Fannie is rearing its head again. Could this development impact the mortgage market?

Miami investors win access to secret documents in Fannie Mae fight

BY NICHOLAS NEHAMAS
nnehamas@miamiherald.com

A federal judge on Tuesday ordered the U.S. Treasury Department to release more than 50 documents it tried to keep secret in a lawsuit over government-backed mortgage giants Freddie Mac and Fannie Mae.

The plaintiff is Miami-based mutual fund Fairholme Fund, which filed suit in the Federal Court of Claims in 2013. Fairholme is one of many Freddie and Fannie investors [suing the federal government](#) in different venues. The plaintiffs claim the government illegally seized the companies' earnings after the bailout. The Obama administration says it is acting within the guidelines of Congressional legislation.

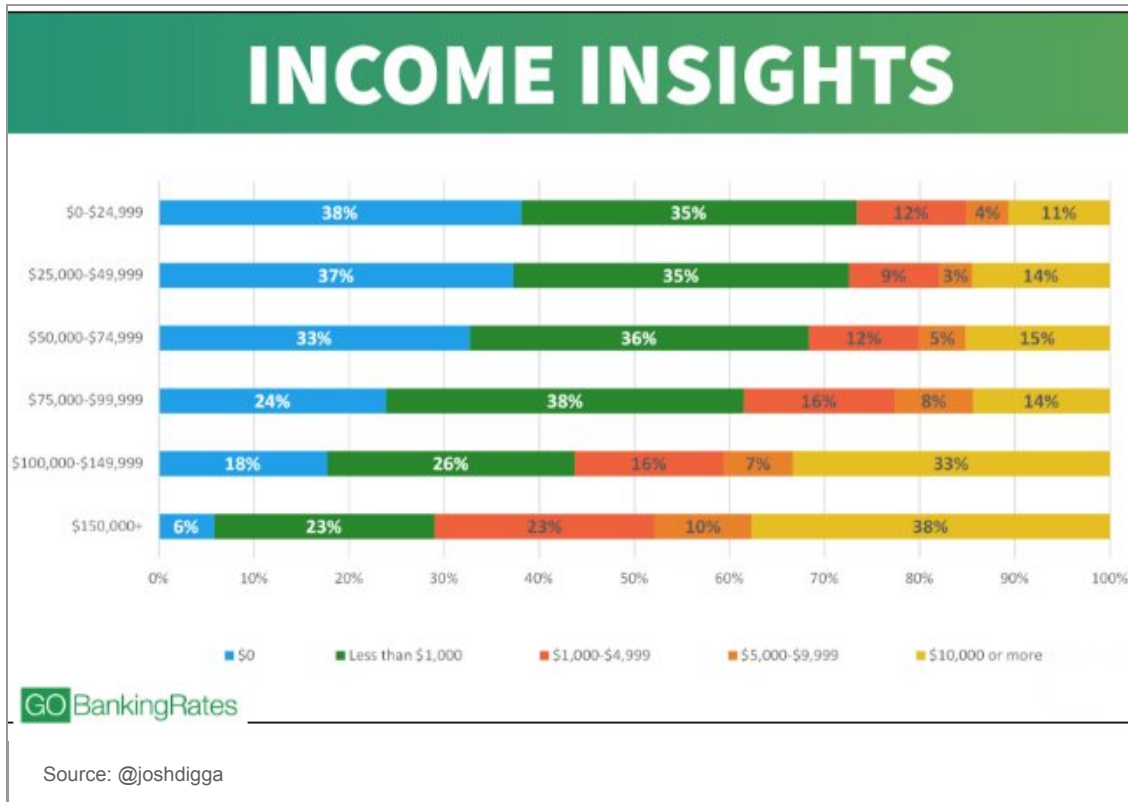
Source: Miami Herald, h/t @MattGarrett3; Read [full article here](#)

From our sponsor:

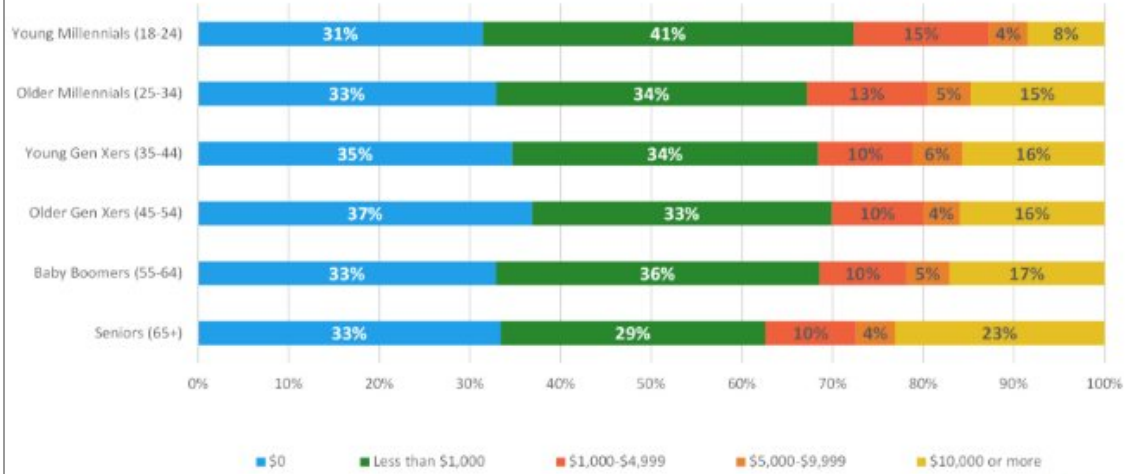
Visit our friends at On Pepper for alternative investments portfolio management technology.



1. Turning to Food for Thought, apparently, 69% of Americans have less than \$1,000 in savings.



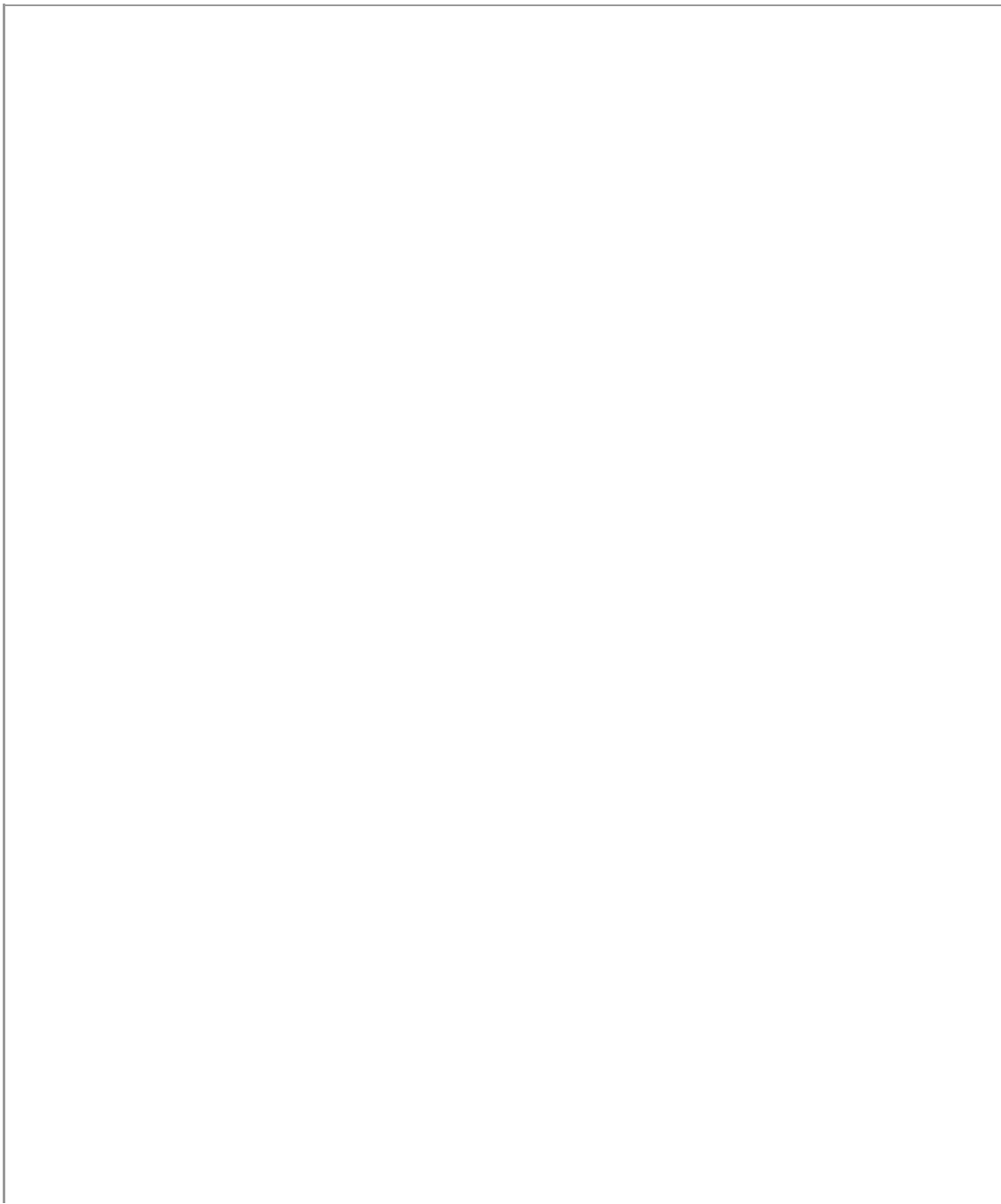
AGE INSIGHTS



GO BankingRates

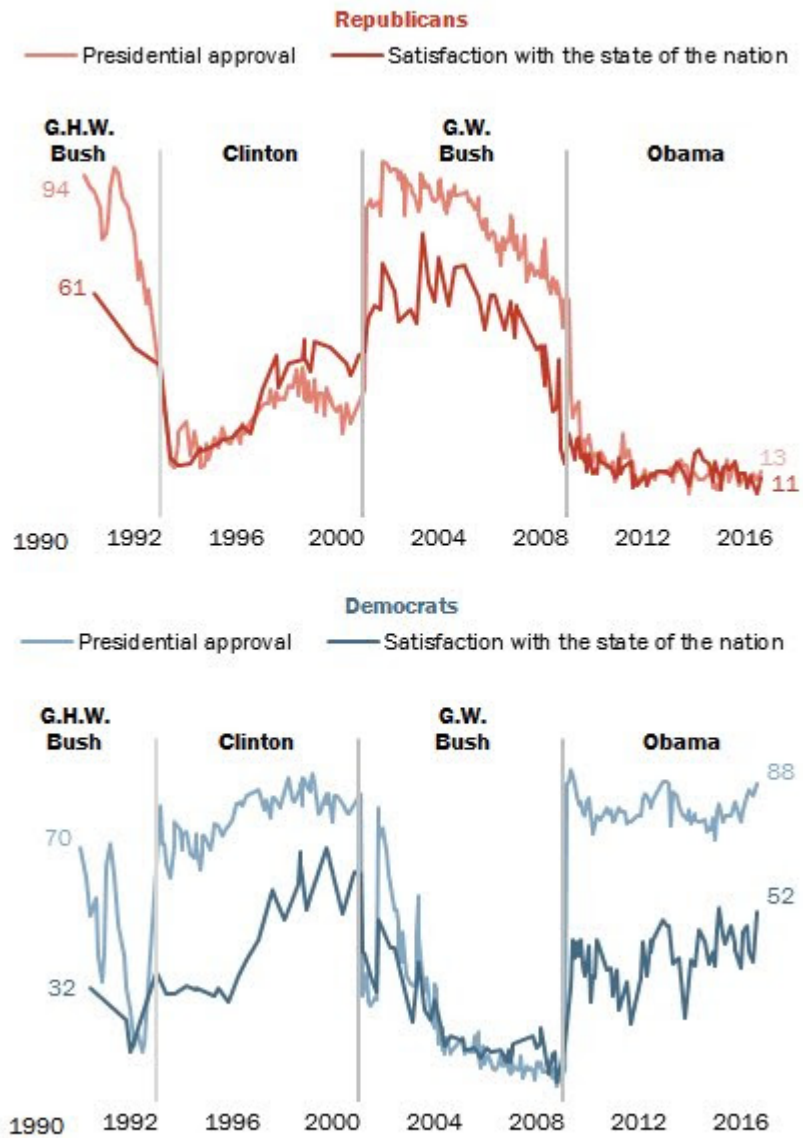
Source: @joshdigga, [Further Reading](#)

2. Presidential approval vs. satisfaction with the state of the nation.



For those who share president's party, satisfaction with country tends to be lower than job approval

% expressing ...

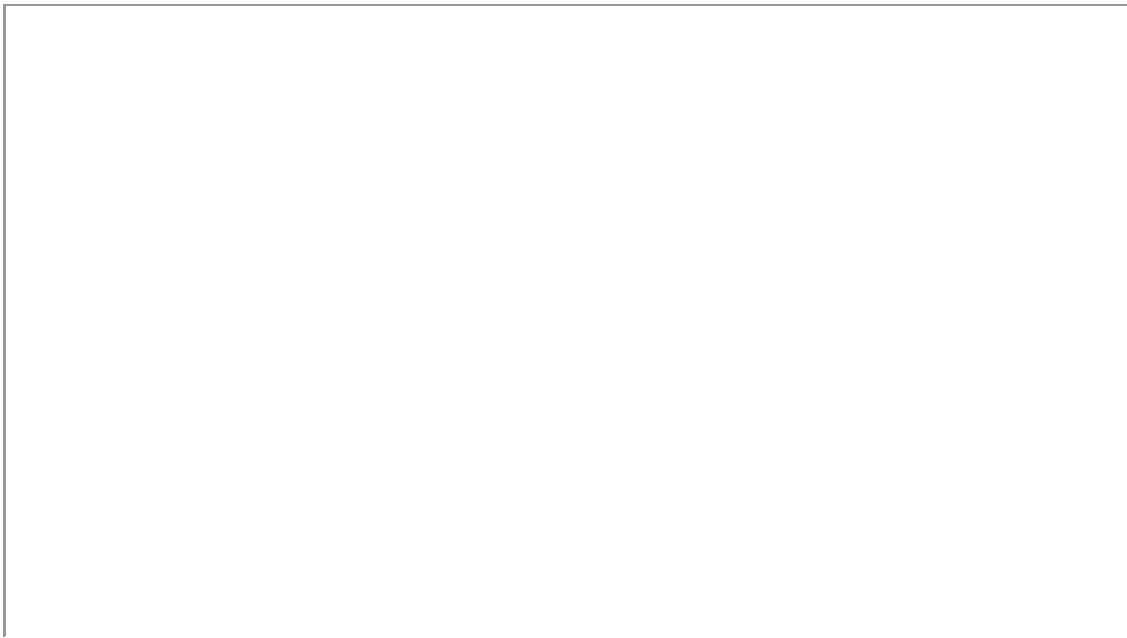


Source: Survey conducted Aug. 9-16, 2016.

PEW RESEARCH CENTER

Source: @FactTank, @Tmp_Research; Read [full article here](#)

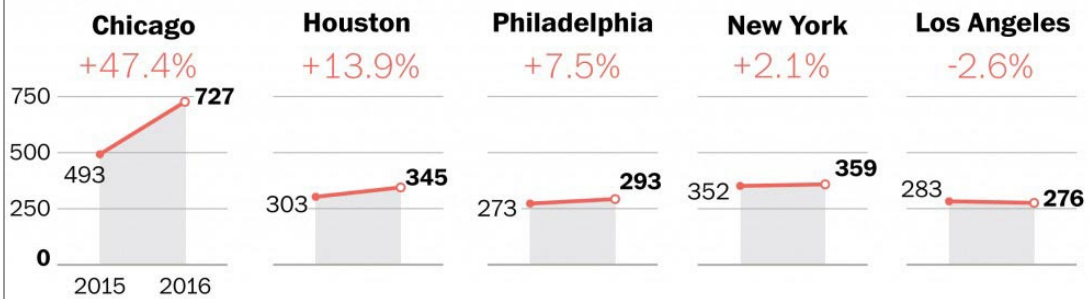
3. Chicago's homicides on the rise.



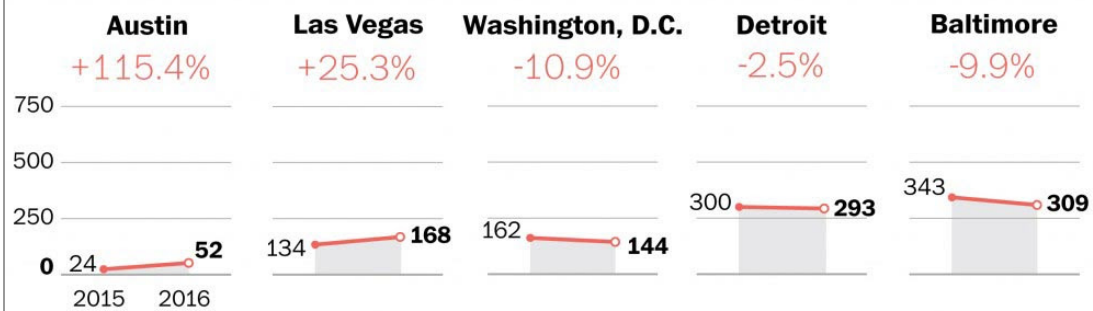
Rise in Chicago's homicides

The number of murders in Chicago is projected to reach more than 700 at the end of this year – higher than in cities with larger populations.

CITIES WITH MORE THAN 1 MILLION PEOPLE



CITIES WITH LESS THAN 1 MILLION PEOPLE

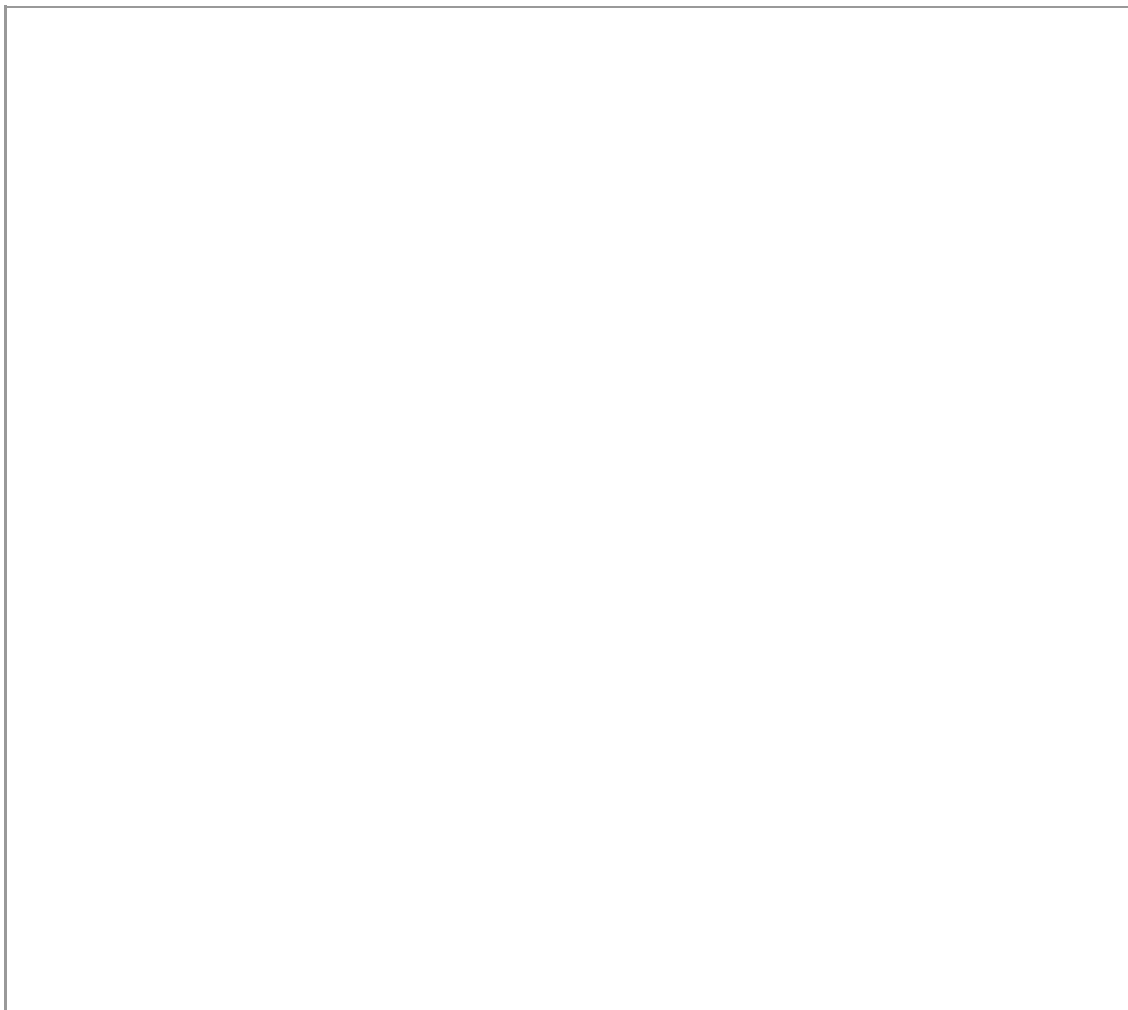


Sources: Brennan Center for Justice, U.S. Census Bureau

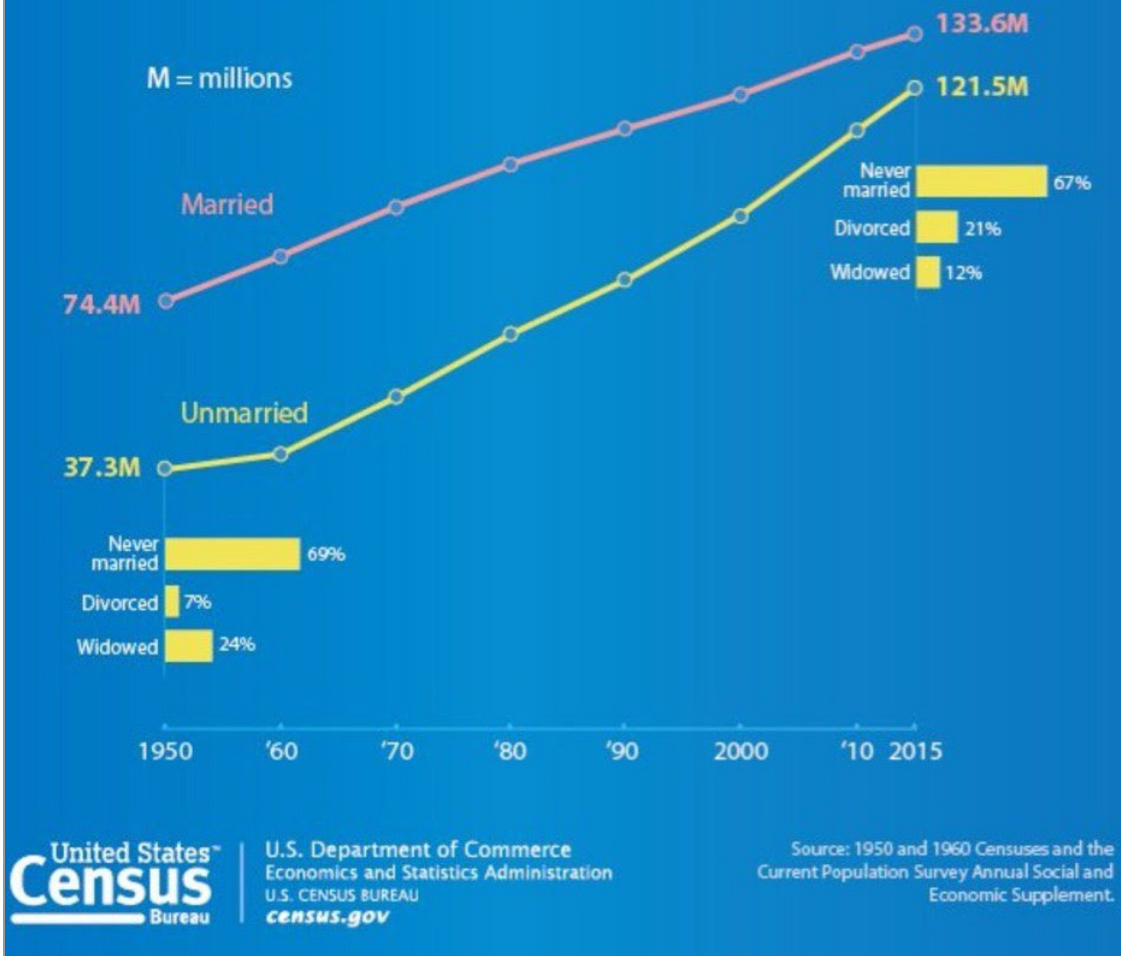
CHRIS ALCANTARA/THE WASHINGTON POST

Source: @PostGraphics, @Tmp_Research; Read [full article here](#)

4. The gap between married and single Americans.

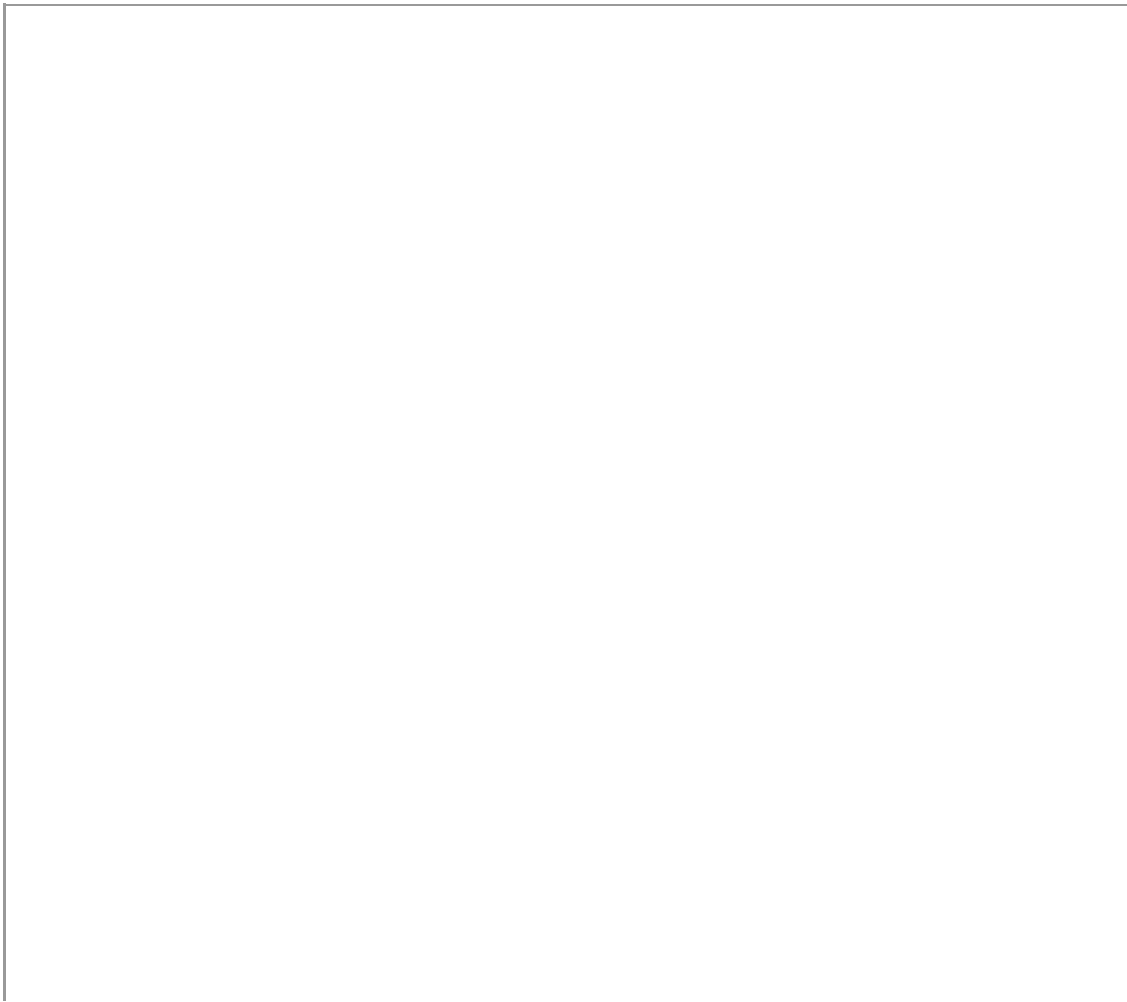


The Gap Between Married and Unmarried Americans Age 15 and Older Has Narrowed Since 1950

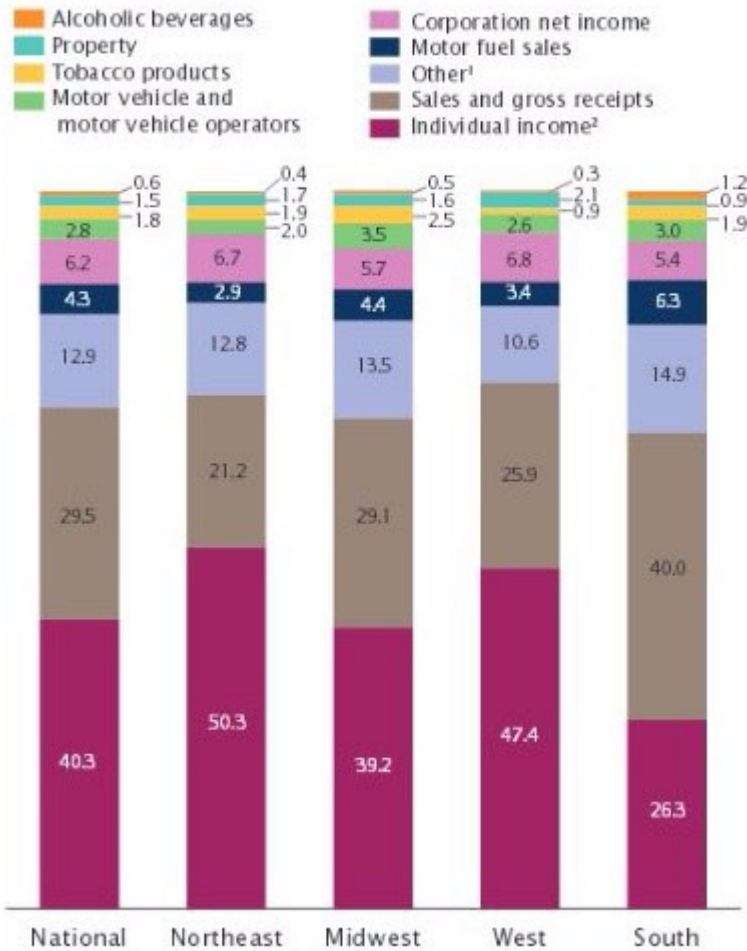


Source: @paul1kirby, @uscensusbureau

5. US state governments' revenue sources by region.



Distribution of State Government Revenue by Type of Tax for Nation and Census Regions: 2016 Q2



Source: @uscensusbureau

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