Three Secular Riddles

Rising Rates, Dollar Bull and the Transatlantic Alliance

Geneva, Zurich & Frankfurt
June 2018
Agenda

• From a Savings Glut to a Savings Squeeze
  Higher for Longer ... Much Higher for Much Longer

• Failing the Duck Test
  This Is Not What a Dollar Bull Looks Like

• Le Divorce
  The End of the Transatlantic Alliance
Understanding Interest Rates

- The interest rate is the price that clears the market for savings
- From GDP accounting: $X-M = S-I$
- Current account balances determines net savings
- In global capital markets, the equilibrium interest rate is set so that: $I=S=X=M$

→ If too many countries chase trade surpluses at the same time, excess savings will push interest rates down
The Triple Savings Glut of the 2000s-2010s

China, Germany, Russia and KSA accumulated $8 trillion in excess savings since 1999

What happened in 1999?

Source: OECD, IMF
What Happened in 1999?

The triple shock of 1999

- January: the euro was launched, the Deutsche Mark is retired
  → World’s largest exporter blessed with a weak currency

- August: Putin becomes Prime Minister as Brent prices recover from a secular low of $9.6
  → Opec and Russia’s oil revenues explode

- November: U.S.. China sign WTO agreement
  → China starts building $4 trillion reserve hoard
The Petrodollar Glut: $2.1 Trillion

Russia and Saudi Arabia accumulated surpluses worth $2.1 trillion since 1999

Russia’s oil revenues soared from $23 billion in 1998 to $435 billion in 2013

Source: OECD, IMF
The German Glut: $2.8 Trillion

Home Ownership Rate by Country

Germany: 52%
Japan: 62%
U.K.: 64%
U.S.: 65%
France: 65%
Canada: 68%
Netherlands: 68%
Italy: 73%
Greece: 74%
Spain: 78%
Poland: 84%
Singapore: 91%

Germans hate mortgage debt!

Source: World Bank
The Chinese Glut: $3.1 Trillion

The day China decided to build a $4 trillion reserve stash
The IMF’s public shaming of Suharto, Jan 15 1998
The Great Savings Squeeze of 2018: OPEC

The U.S. Has Become the World’s Top Producer of Oil in 2018
The Great Savings Squeeze of 2018: Germany

Auf Wiedersehen Balanced Budgets, Hallo Pension Shock
The Great Savings Squeeze of 2018: China

The Chinese Surplus Has Already Melted

China is no longer investing its currency reserves in U.S. treasuries.
The Great Savings Squeeze of 2018: China

India's growth should permanently overtake China's in 2018

Source: OECD, IMF
The Great Savings Squeeze of 2018: World

Projected World Growth Rates
Based on OECD Long-Term Forecasts

Deficit Countries GDP Growth
Surplus Countries GDP Growth

Global savings glut turns into a squeeze

Source: OECD, IMF
The 2018 dollar rally fails the four parts of the secular bull market “duck test”
It is an accident due to a BOP crisis in Turkey and Argentina, and the Italian political crisis
A Contained EM Balance of Payments Crisis

Total USD-Denominated Debt as a % of GDP
- China
- Mexico
- Turkey
- Brazil
- Indonesia
- Argentina
- Korea
- India

Current Account Balance as a % of GDP
- China
- Mexico
- Brazil
- Indonesia
- Korea
- India
- Turkey
- Argentina

Only Turkey and Argentina have high USD debt and growing funding needs.
A Contained EM Balance of Payments Crisis

Funding Dollar Index
Debt-weighted dollar exchange rate versus largest borrowing countries*

- Versus 11 Largest Borrowers
- Excluding Turkey and Argentina

No dollar shock for the largest EM USD borrowers

*Debt-weighted USD exchange rate versus CNY, INR, IDR, KRW, TRY, ARS, BRL, CLP, MXN, SAR and RUB

Source: Bloomberg
A (Mini) Euro Crisis

Ex. European currencies (77% of the Dollar index) the USD rally is much less impressive

Source: Bloomberg
A (Mini) Euro Crisis

The euro is still 20% undervalued!
The Deutsche Mark and French Franc even more undervalued.

Source: Bloomberg
Le Divorce: 4 Years of Humiliating Europeans

Sanctions on Russia Hit German Economy Hard

The United States and Europe last week announced the imposition of stronger sanctions against Russia in response to the ongoing crisis in Ukraine. German industry may be among the losers.

By Matthias Schepp and Cornelia Schneggal

Iran nuclear deal: The EU's billion-dollar deals at risk

Trump a signifié à l'ONU son retrait de l'accord de Paris sur le climat

Germany braced for impact of US steel tariffs

Trade tension set to rise as exemption for EU is expected to expire next week

European Banks’ Post-Crisis Litigation Could Cost $100 Billion

By Nicholas Comfort, Christian Baumgartel and Hayley Warren

December 21, 2017
Le Divorce: Europe No Longer Needs the U.S. Alliance

Goods Trade with China as a % of the U.S. in Major European Countries

- Germany
- France
- Italy
- U.K.
- Poland
- European Union

Germany trades more with China than with the U.S.!

Source: IMF
Le Divorce: Europe No Longer Needs the U.S. Alliance

Europe no longer depends on the U.S. Navy to trade with Asia
Le Divorce: Europe No Longer Needs the U.S. Alliance

Russia and Iran Could Supply All Europe’s Energy
By PIPELINE

EV revolution will reduce the EU’s dependence on Middle East oil

Source: Eurostat Energy Balances
Conclusions

1. The savings glut is turning into a savings squeeze: rates will go higher for longer
2. The recent Dollar rally is an accident, not a trend
3. Europe and in the U.S. are growing apart

→ Shorten duration, raise cash
→ Short-term treasuries and variable rate bonds are safe place to hide
→ Options are still historically cheap: HEDGE!
→ Most Asian currencies offer high real rates and keep their value against USD
→ Euro should resume its rally in 2019 after the Italian crisis settles down
→ Favor “continental” European markets: France, Poland, Spain, Italy (in a few months)
Vincent is the global macro strategist for INTL FCStone Financial Inc, BD Division, where he authors weekly commentary on asset allocation, flows, Europe equities and quantitative topics. Prior to joining INTL FCStone Financial Inc., Vincent served as Europe Strategist for Ned Davis Research Group where he started the firm’s European product. Vincent authored weekly publications on European markets, and designed proprietary trading models that combined fundamental, technical and macro indicators to identify major investment themes and market trends.

In November 2013, Vincent was awarded the Euromoney Padraic Fallon Editorial Prize for his in-depth study of the investment opportunities offered by the European debt crisis.

Prior to joining Ned Davis Research, Vincent was the Executive Vice President of TrimTabs Investment Research, where he headed the firm’s quantitative research. At TrimTabs, Vincent authored weekly research reports on flows, sentiment, and European capital markets.

Vincent designed and traded large and profitable strategies based on supply and demand indicators for top-tier hedge funds.

He has been frequently quoted in the Financial Times, Wall Street Journal, Bloomberg, Forbes Magazine, and Barron’s. Vincent was a subject matter expert on asset allocation for the level 3 of the CFA exam at the American College and he teaches Ethical and Professional Standards and Private Wealth Management for the CFA Society of San Francisco.

Vincent is a CFA charterholder. He completed a dual master’s degree at Sciences-Po Paris (Cum Laude) and Columbia University and speaks English, French, Italian, and Indonesian.
Disclaimer

INTL FCStone Financial Inc. is a wholly owned subsidiary of INTL FCStone Inc. INTL FCStone Financial Inc. is a broker-dealer member of FINRA and SIPC and registered with the MSRB. This material should be construed as market commentary, merely observing economic, political and/or market conditions, and not intended to refer to any particular trading strategy, promotional element or quality of service provided by INTL FCStone Financial Inc. It is not meant to be viewed as analysis or opinion of any security, country or sector. This information should not be taken as an offer or as a solicitation of an offer for the purchase or sale of any security or other financial instruments. The Economic Data presented is currently available in the public domain and while it is from sources believed to be reliable, it is not guaranteed to be complete or accurate. The content is not research, independent, impartial or a recommendation. This communication is not intended to be disclosed or otherwise made available to any third party who is not a recipient. INTL FCStone Financial Inc. is not responsible for any redistribution of this material by third parties, or any trading decisions taken by persons not intended to view this material.

INTL FCStone Financial Inc. in its capacity of market maker may execute orders on a principal basis in the subject securities. INTL FCStone Financial Inc. may have long or short positions in securities or related issues mentioned here. This market commentary is intended only for an audience of institutional investors as defined by FINRA Rule 4512(c). Investors in ETFs should read the prospectus carefully and consider the investment objectives, risks, charges and expenses of an exchange traded fund carefully before investing. Past performance is not indicative of future results.

Any rebroadcast, retransmission, or account of this webinar, without the express written consent of INTL FCStone Financial Inc, is prohibited.