Money, Macro & Markets Monitor

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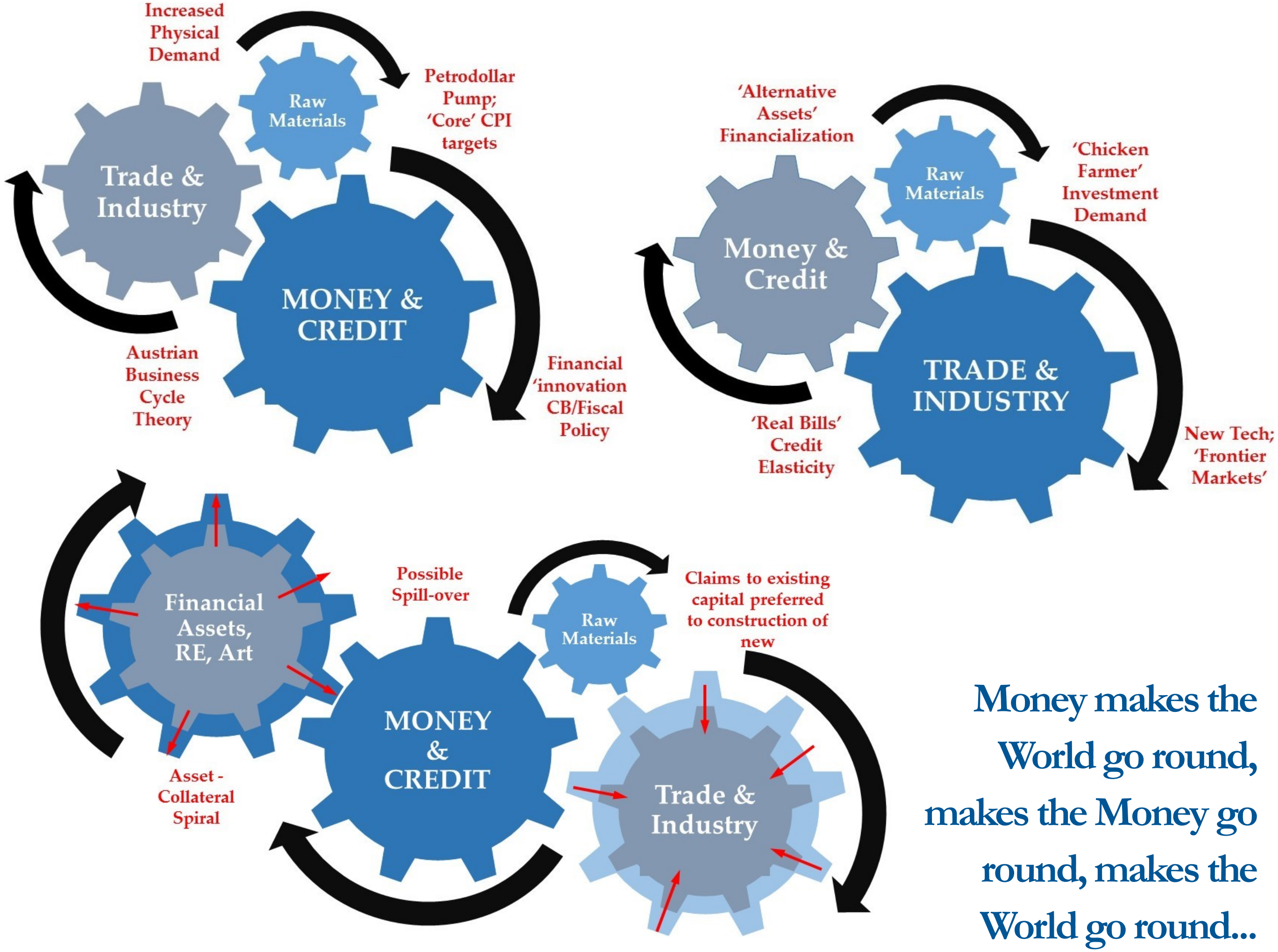
5th June 2017



Money makes the World go round, makes the Money go round, makes the World go round...

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Corporate returns looking good

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No worries yet, but...

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Election jitters intrude

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Bulls v Bears - an important distinction

USD:

Threatening a break

Volume I, Issue 3

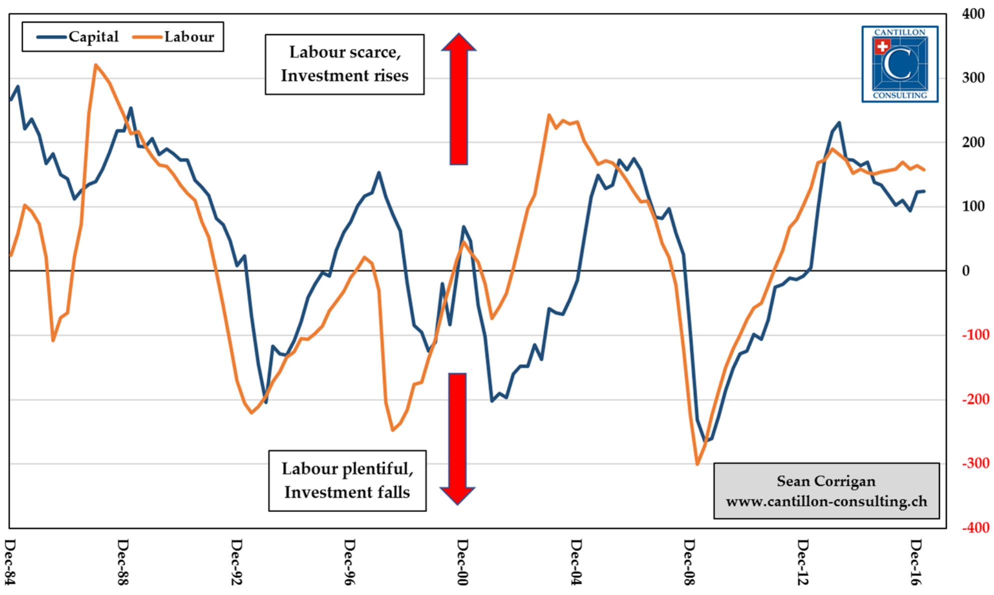
A couple of weeks ago we noted that the Nikkei, measured in USD, seemed to be building towards a test of a major trendline, the breach of which would open up significant room overhead. We also pointed out that, despite the enormous disparity in both real and nominal GDP between China and Japan (i.e., between most people's prime examples of a flourishing and a moribund economy, respectively), the Nikkei was no lower vis-à-vis the Shanghai Composite than at the start of this millennium.

Aside from the support being given the market by the joint influences of the BOJ's money printing and the pension industry's consequent change of asset allocation, there are fundamental reasons not to overlook what is arguably the world's least respected major stock market. For starters, there is the issue of balance sheets where MOF figures reveal that non-financial corporations' net debt stands at a 36-year low when expressed as a ratio of operating income and is also at a 57-year low versus equity. Then there are returns themselves.

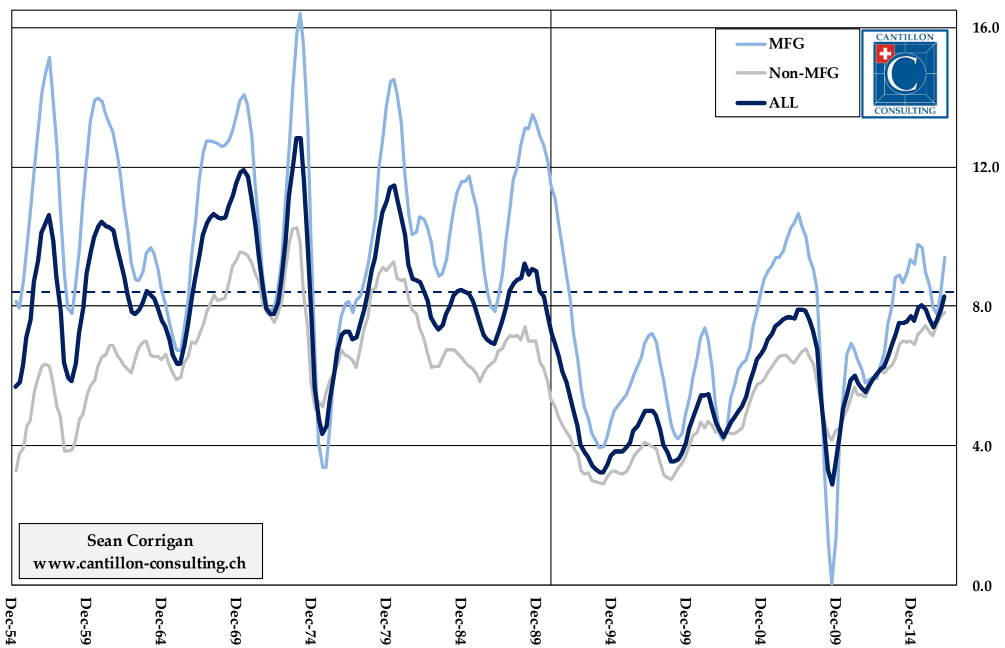
Though the absence of data on fiscal deductions means we have to settle for a *pre*-tax calculation, the return on capital (net of cash) for this universe has just regained the pre-bubble median of 8.4% for the first time since - well, since BOJ Governor Mieno took it upon himself to burst that same bubble back at the end of 1989. This renaissance has been led by the non-manufacturing sector where things have not been this good since way back in the early 1980s.

From the macro side, too, there are grounds for optimism. Faced by a notable tightening of the supply of labour which is due partly to the cyclical upswing and partly to demographic factor (under a million live births were registered last year for the first time in the 117-year record), businesses are increasing their call upon capital, investing more last quarter than at any time since the GFC. On a macro-accounting level, greater below-the-line investment implies more revenues with no corresponding cost—i.e. higher profits—even before the investments themselves pay off in greater economic productivity. A virtuous circle? Perhaps.

Japan Private Non-RE Investment v Vacancy/Job-seeker ratio, rolling 5-yr normalized:
Source - MHLW, CAO



Japan NFC Pre-Tax ROICxCash: *Source - MOF*



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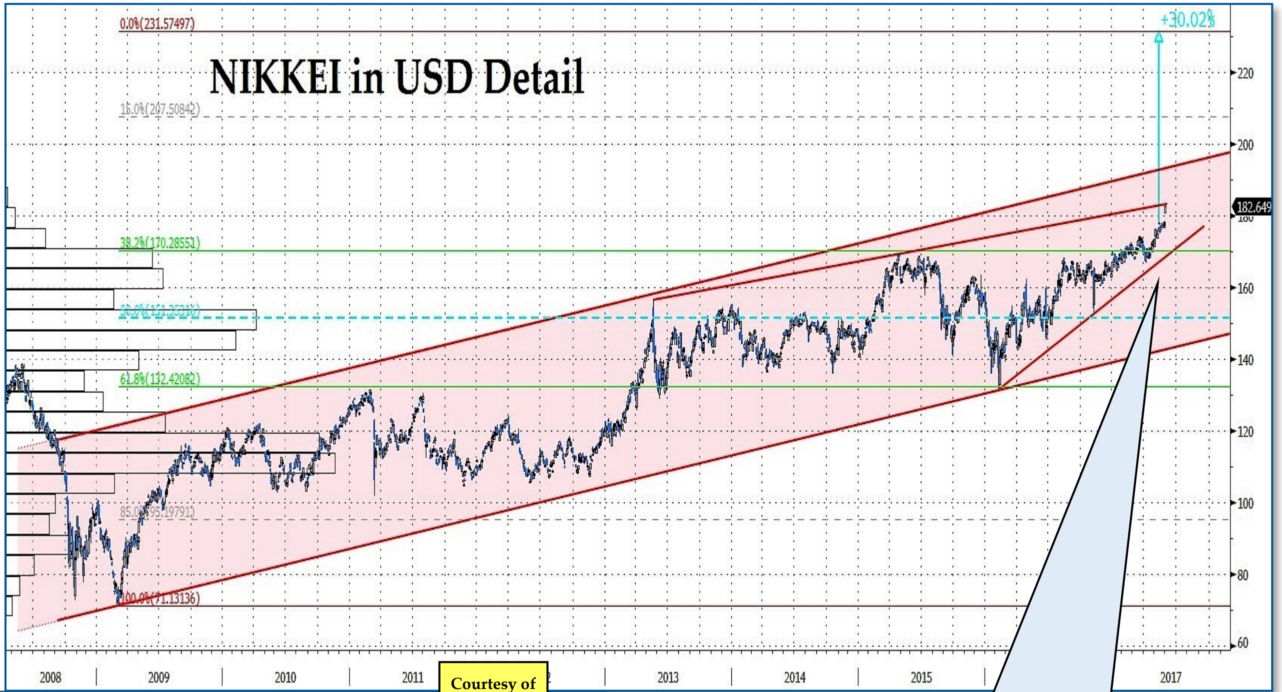
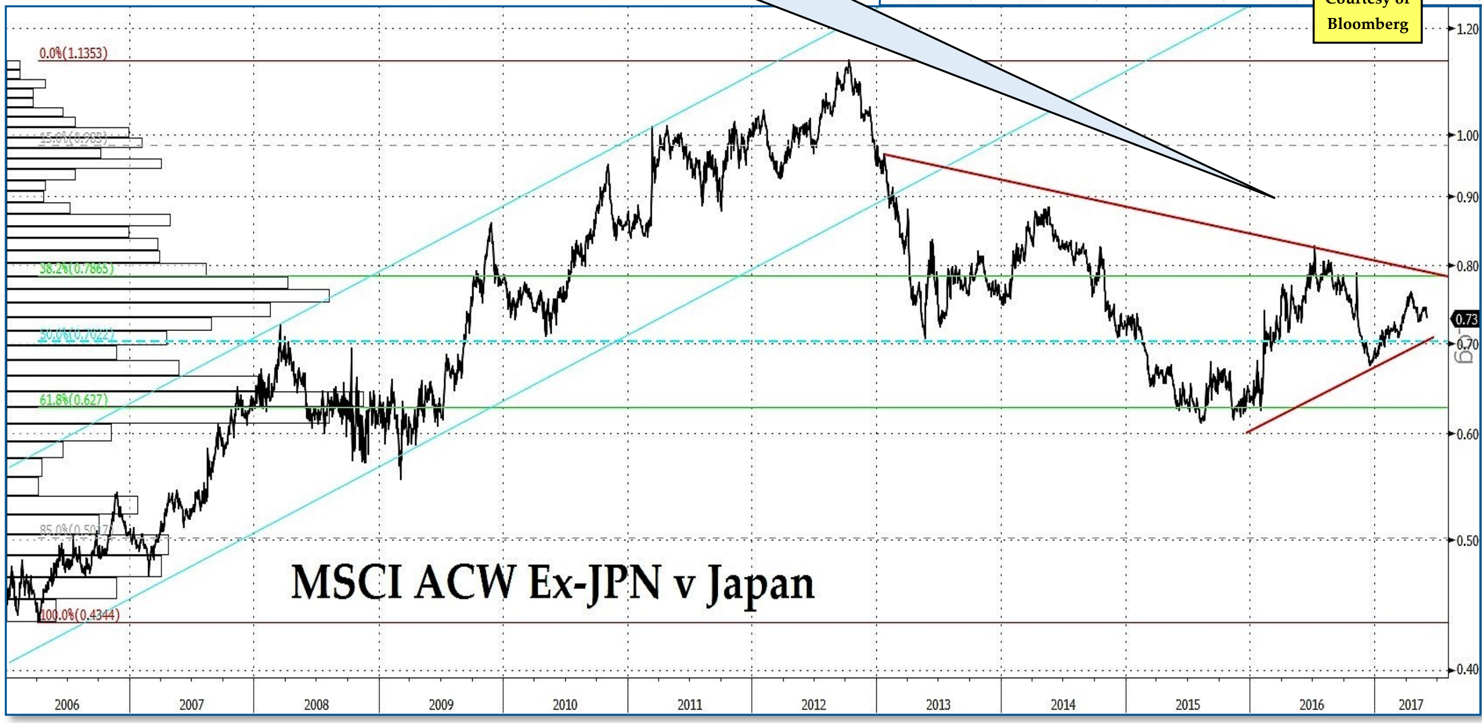


Courtesy of Bloomberg

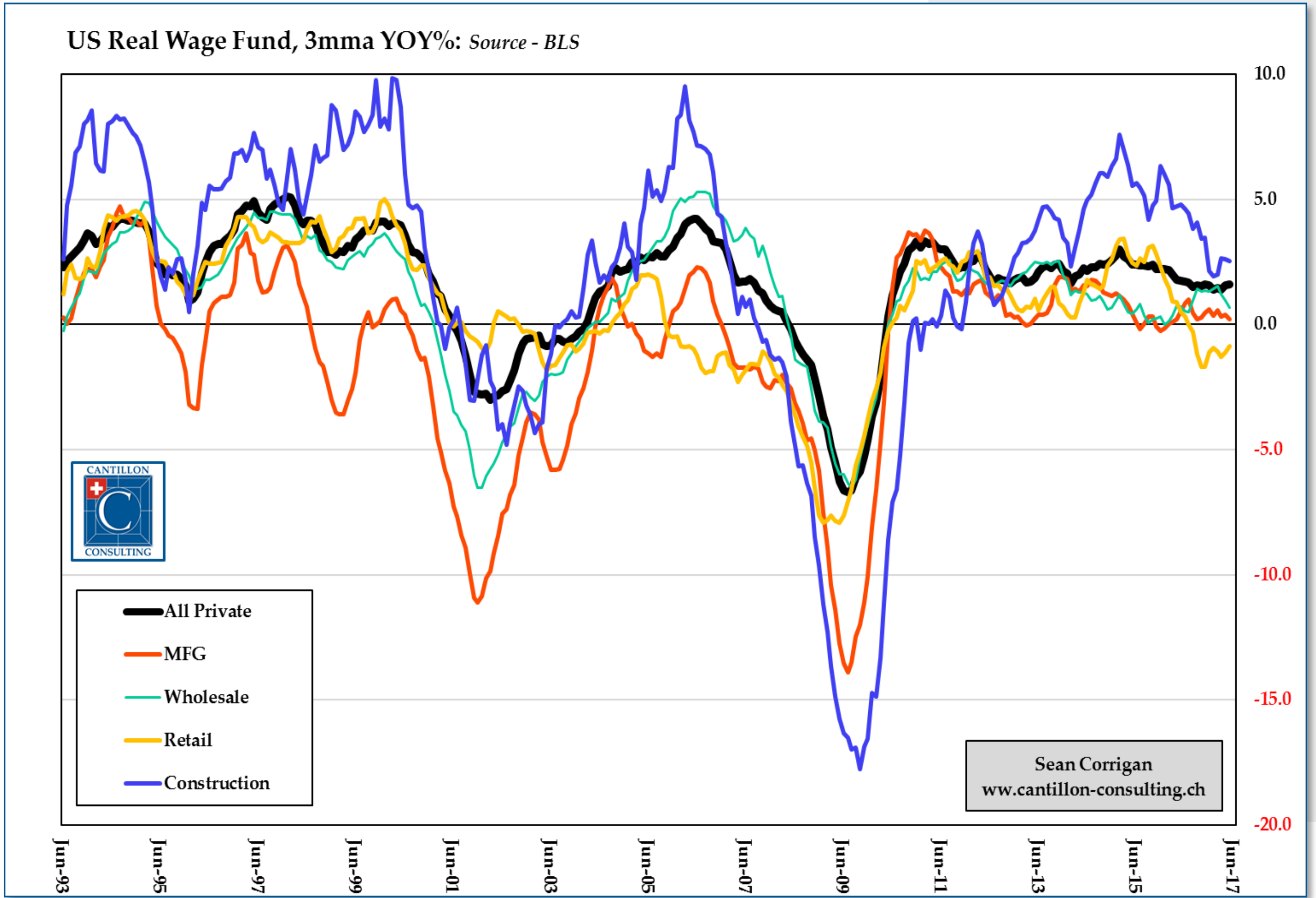
It is not apparent from this selection, but this ratio sits way, way up in the snow-capped heights of the full historic record, meaning that any break lower out of the pennant formation could potentially have a long way to run

No sign yet of a rejection of the new highs. Trendline may slow progress awhile, but bullish while above 2015's peaks



Though the data for the second quarter has been slightly less compelling than were QI's readings, business revenues *are* still growing. The last three months' tally for durables is up 3.0% on the like period in 2016 - the fastest growth since HI'2014. Despite three months of essentially unchanged results, core capital goods sales are still up 1.4% yoy; their best in 18 months. And, belying last month's disappointing drop, private construction outlays are 9.3% greater than in spring 2016. Trade is growing at its most rapid lick in five years.

Any further lack of progress in May/June might take some of the bloom off these all-important numbers, but there is no cause for alarm just yet on that score.



As for the NFP report, the market was disappointed enough to buy bonds, but not to sell stock. Coupled with downward revisions to the prior two months, the last trimester's 379k increase in private jobs was—subject to revision—the weakest in a year and the second weakest in nearly five. The pace of wage gains likewise slowed from February's 7 1/2 year high of 2.7% yoy to May's one-year low of 2.5%.

As the graph shows, we are still within the bounds of recent experience, but would not wish to see much further deterioration.

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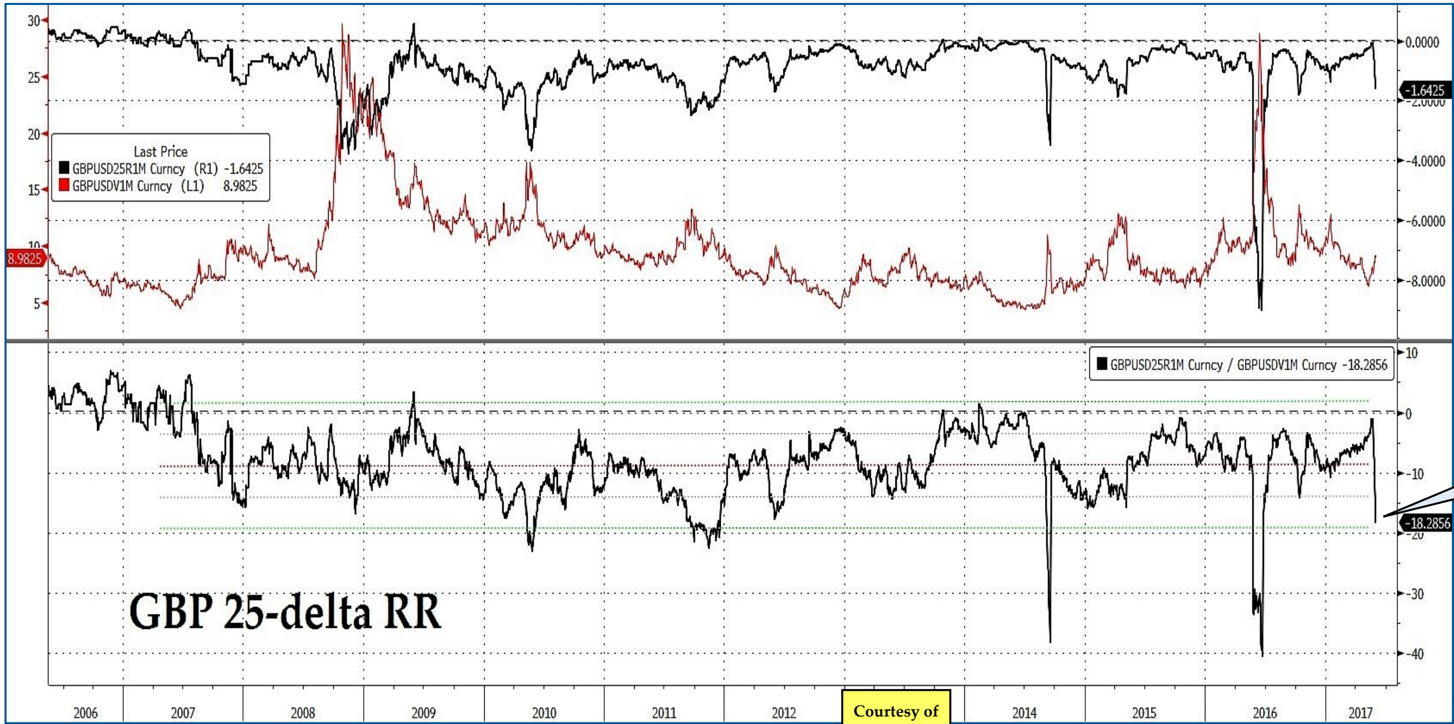
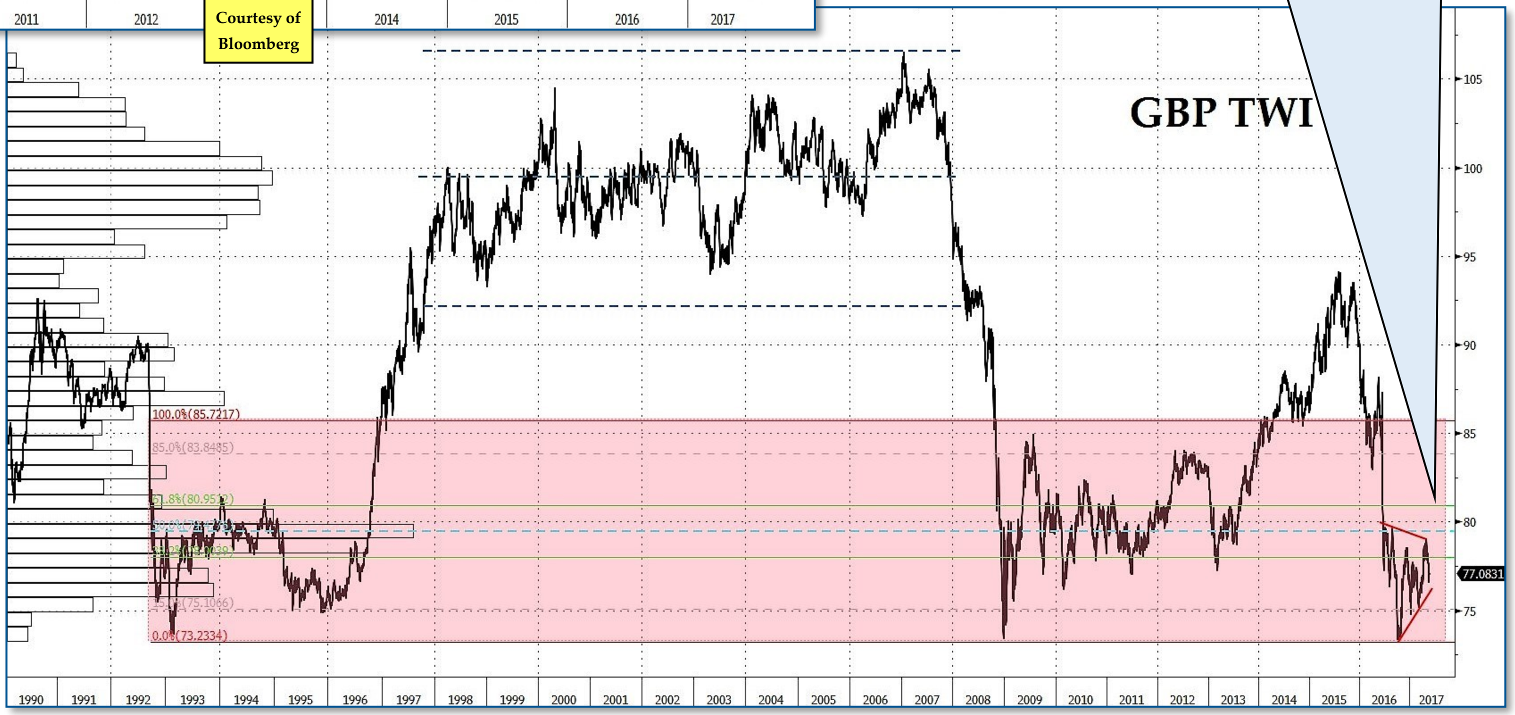
Nerves are finally creeping into UK market ahead of Thursday's vote. GBP risk-reversals are not anywhere near IndyRef or Brexit levels, but are none the less plunging



Courtesy of Bloomberg

Having stalled out at the mid-point of the crisis range on its TWI, the pennant needs to be watched for signs that new lows lie ahead



All courtesy of Bloomberg

For all the talk of how ominous this flattening is (a) it is a long way from past danger levels and (b) it is a *bull* flattening originating in a surfeit of liquidity

This is not the case in China where climbing yields mean we have a *bearish* flattening, one which may even signal a Hayekian ending to the recent boom

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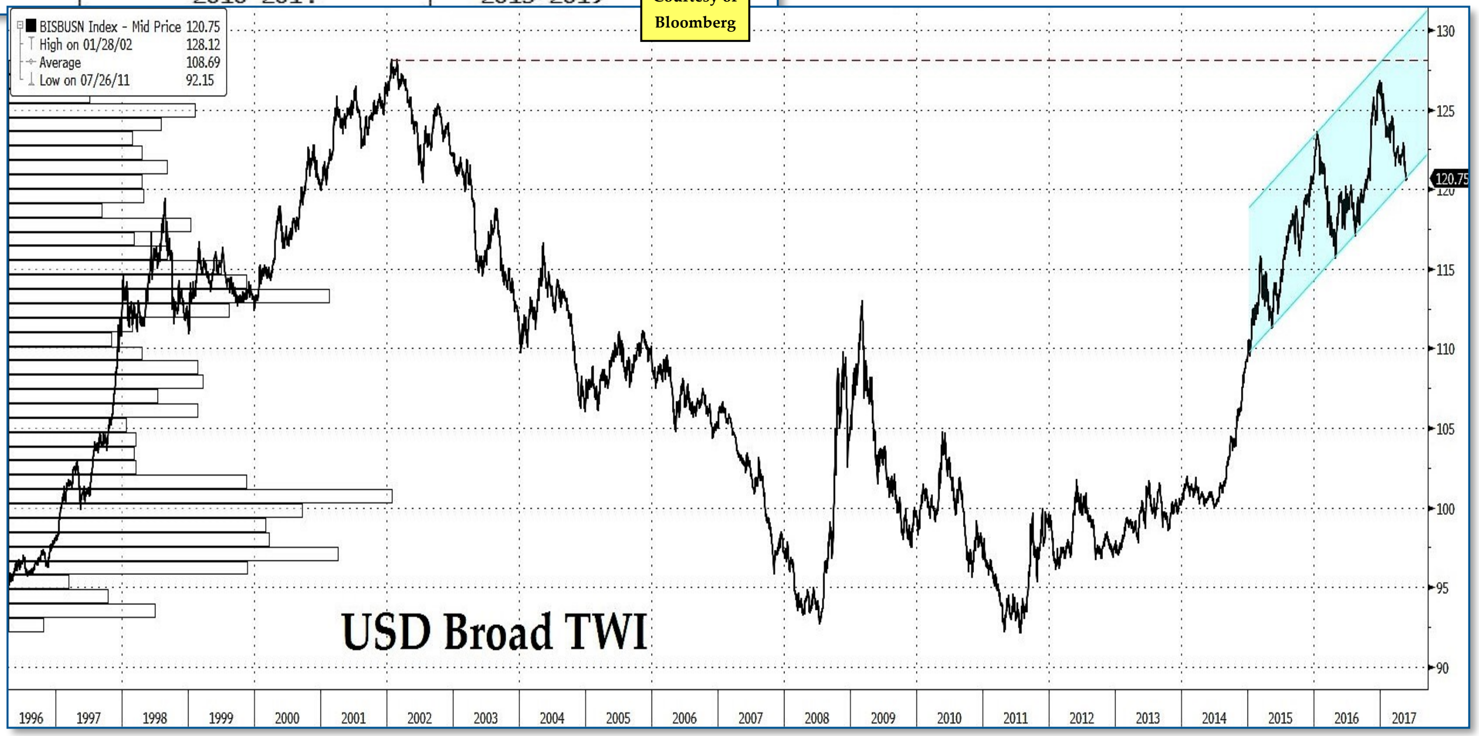
Has the US Dollar bull run finally come to an end?

The stock market is no longer obviously outperforming its peers; bond market differentials are falling; basis swaps signal much less offshore hunger for greenback funding. So perhaps it has.

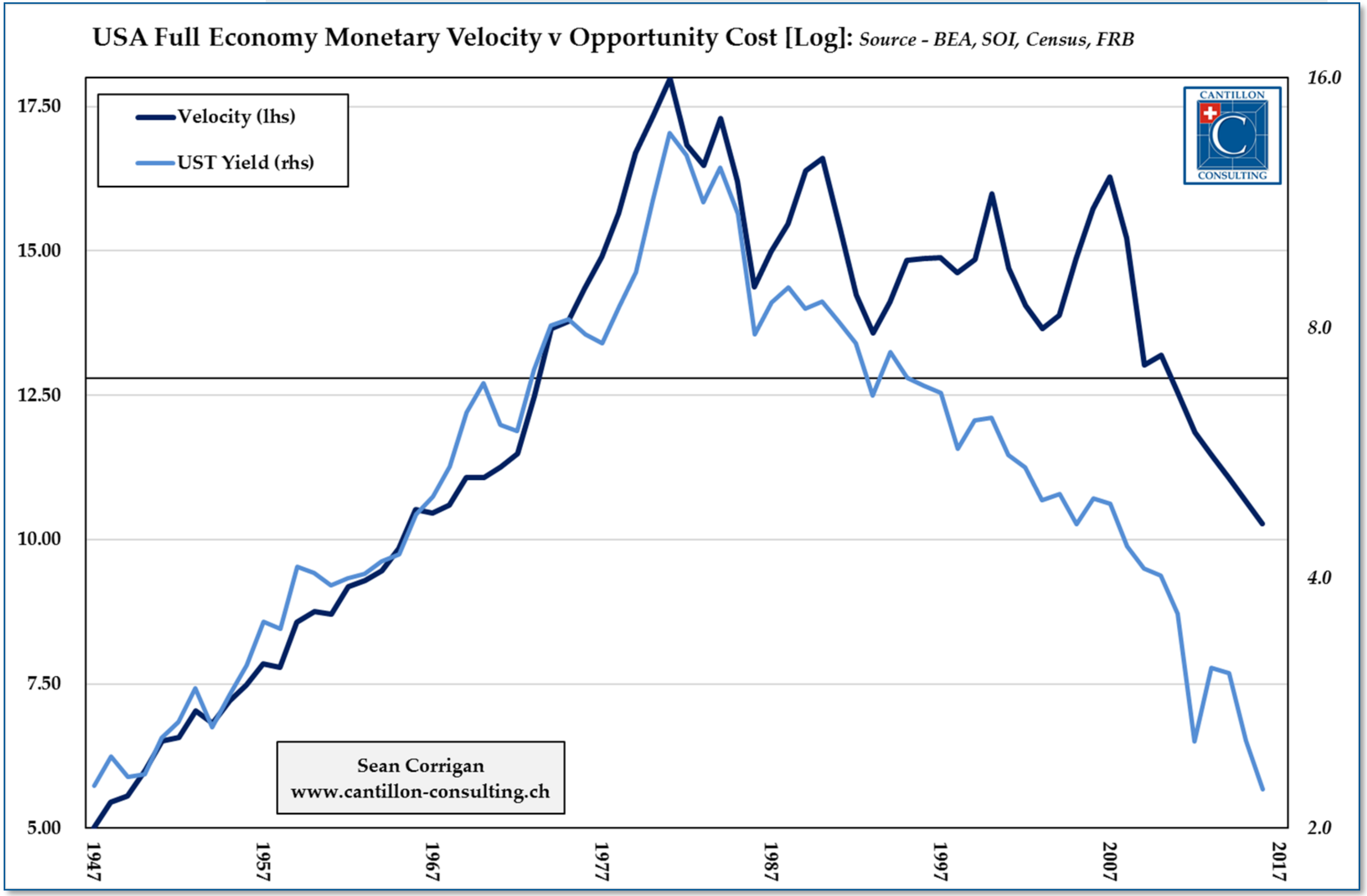
Watch these trendlines!

Courtesy of Bloomberg



BONUS CHART OF THE WEEK.

Commentary about the implications of a low 'monetary velocity' in the US often founder on an inappropriate choice of non-money aggregates, coupled with a lack of awareness that the hidden iceberg of spending can move, to some extent, independently of GDP. Moreover, a lowered opportunity cost of holding money (such as now) can expand its use beyond narrowly transactional ones. Given low bond yields, V is not THAT depressed



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