

Asia anxious as US stock rally fizzles

Market confidence is a funny thing, you don't appreciate it when you've got it, but when you lose it, it is hard to restore



Reasons to be miserable

Making a list of bad things is always easy, and often fun. At the top of the list today I would cite poor earnings guidance from big-name industrial US firms. Some of these have been citing rising input costs, putting the blame on tariffs. Some of them have sizeable overseas earnings, which no longer look too rosy. This reflects another item on the "bad" list - a faltering global outlook. The US looks fine for now, and this will likely be confirmed later this week with strong US GDP data for 3Q18, but Europe and Asia have looked better. In Europe, the spectre of a messy Brexit has been hanging over heads for months now. But tensions are rising as deadlines draw near and a no-deal break up seems a real possibility. Add to that the Italian deficit standoff, and this isn't helping matters either. Geopolitical tensions are also peaking higher again as the Khashoggi murder ramifications ripple through markets. China's weak stock markets are a symptom rather than a cause of all of this, but add another risk factor into the equation, given the importance of pledged equity collateral in exchange for debt in the country.

Reasons to be cheerful

A list of positives is usually less dramatic and rarely as exciting to prepare. On this front I would start with the rather dramatic fall of oil prices. Saudi Arabia - hopefully chastened by the Khashoggi debacle - seems to be trying to make amends by pumping oil hard. The resulting rise in inventories of oil globally is weighing on crude prices - good news for Asia's inflation-challenged nations - Philippines, India (not now, but soon) and also the externally challenged (same list, but add Indonesia). Not that this yet makes enough of a difference to affect our expectation for more rate hikes from the central banks in these economies, but it all helps and makes it more likely that this is achieved with less currency weakness than would otherwise have been the case.

And then there are China's policymakers. We have had plenty of statements of intent from all the most powerful in the land, and some outlined policy initiatives, centering around further liquidity provisions. We now have to see what impact this will have on the ground. We don't expect markets to turn on a dime, but there is always the option of direct purchases if Chinese stock markets fall to levels which threaten debt recall and defaults. Such a plan is already in the works, roping in big financial institutions and potentially SOE's. It just doesn't seem to have got off the ground yet. Further stock declines could see the implementation of this plan accelerated. Though that is a bit like hoping to get sick so you can receive some medicine, I'm not sure that really counts on the list of positive things.

Market disaster indicators not providing much of a clue

What if anything can we learn from market indicators? Not much if truth be told. In terms of doomsday scenarios, there are a great many recession indicators readily accessible. Many of them, like the NY Fed recession probability indicator, mainly drive off the slope of the US Treasury yield curve. Probabilities have risen in recent months. But I'm not sure this is telling us anything more than if we simply looked at the yield curve slope and see that it flattened (before steepening again more recently). For what it is worth, the NY Fed index stands at 14.51% currently (probability of a recession in the next 12 months). If it gets to 50, then start worrying. Actually, if it gets to 30, you probably want to worry too.

But most of these indicators are pretty useless, telling you when you are in a recession - you will probably know as you will have lost your job - or working with statistical probit models, which seem to give a happy "all-clear" signal before spiking up instantly to "certain recession" with no room for reaction.

Other hoary old market indicators offer us little further insight. The so-called "smart-metal", copper, so-called because it is supposed to be a good bellwether for global industrial demand, is up from its September lows. Nothing wrong here. And the oil price declines seem more reflective of supply increases, taking crude back into the global sweet-spot of \$65-75/bbl than anything more worrying.

My favourite - the GDP-based profit data, is now looking very dated, and we won't get an update (I think) until the second release of 3Q GDP, which won't be for another month. But currently, it looks inconclusive but unthreatening. And the trailing EPS figures have nudged higher, even if the forward indication from firms is now softening.

The bond-equity correlation chart I referred to a week or so ago is still in positive correlation territory, though it is also turning down again. This will be worth watching - it looks as if it will have

to break one way or the other before too long, and my guess is down. Likewise, EURUSD, seems to find it easier to make new lows than make new highs. That is keeping Asian currencies on a broad weakening front. A bigger break on the downside for the USD could see Asian FX under severe weakening pressure again, with the USDCNY 7.0 level under particular scrutiny.

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