Global Strategy Weekly

I remain on a mission to counterbalance bullish investment groupthink

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Long-time readers will know that they get an unadulterated view on these pages. That view may sometimes be wrong, or 'early' as I prefer to call it, but no reader can ever accuse me of falling victim to the optimism bias that the sell-side usually suffers from.

- One of the key lessons that came out of the 2008 Global Financial Crisis was that it was a mistake to have ignored the dissenting voices in the mid-2000s who had warned that Alan Greenspan was presiding over the biggest credit bubble in history and that it would blow up spectacularly – they were all ignored, marginalized or ridiculed.

- In my particular case, the derision for my dire warnings in 2006 was water off a duck's back. For I had already trod a lonely road in sticking my neck out and identifying both the mid-1990s Asian miracle and the late 1990s Tech New-Era as gigantic credit bubbles that would ultimately burst. But there is nothing more difficult than a conversation with a true believer and suggesting their investment idyll is just a gigantic bubble waiting to burst.

- Unfortunately, such is the bias towards optimism there is little room for mavericks in the finance industry. I was lucky that my current and previous employer (Kleinwort Benson) took a risk. But even they might have balked if they had seen my school reports with comments from teachers like, *"A thorough nuisance. I hope he leaves"*. Charming!

- The most recent collective failure to think differently was western central banks' (and the economics industry generally) inability to predict that monetising huge fiscal deficits during the (supply constrained) pandemic would cause a surge in consumer price inflation.

- In that context the former Bank of England Governor (and chief economist) Mervyn King was making headlines last week. King criticised "groupthink" and the lack of dissenting voices at central banks for fuelling the inflation crisis. In particular he said it was "foolish" for central banks to rely on forecasting models that ignored the role of money – link and link.

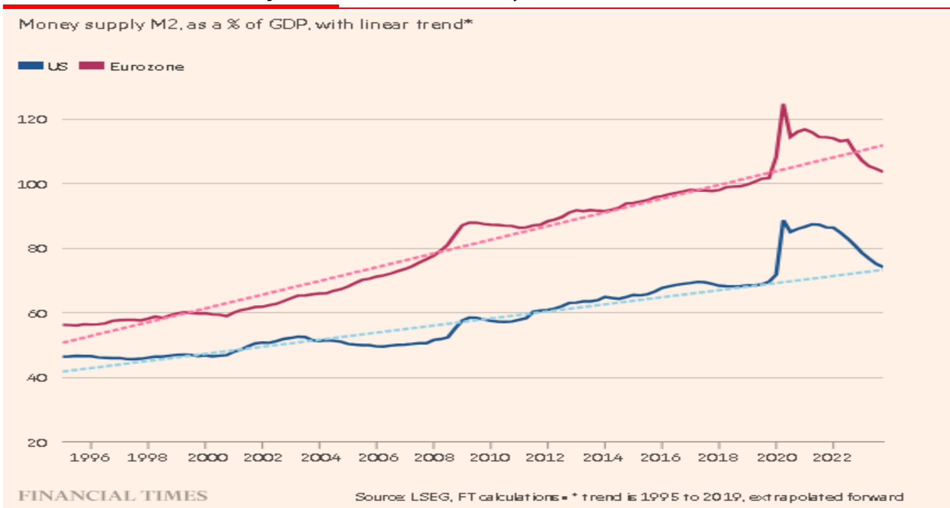
- With that last point in mind, I noted the FT's venerable Martin Wolf pointed out that the explosive expansion in broad money relative to GDP had now fully unwound. Indeed, broad money growth has been the weakest since the 1930s. Wolf writes, *"These numbers show a huge monetary boom and bust. In future, disinflationary pressure might prove excessive"* – link.

Global asset allocation

%	Index	Index neutral	SG Weight
Equities	30-80	60	30
Bonds	20-50	35	50
Cash	0-30	5	20

Source: SG Cross Asset Research

Measures of broad money have now returned to, or below trend in the US and eurozone



Source: Financial Times

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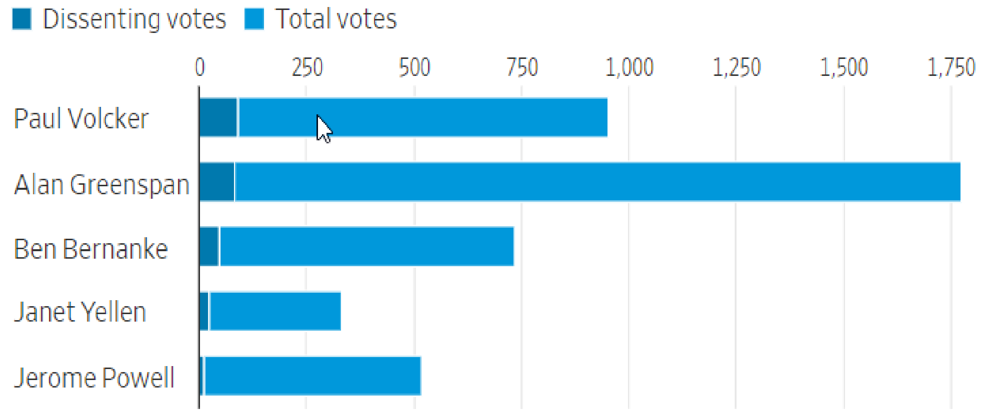
One of the best (worst?) examples of central bank groupthink is the US Federal Reserve. The WSJ recently wrote an article entitled ***Dissenting Votes at the Fed Are Almost Extinct.*** No wonder such egregious policy errors were made during the pandemic and will likely continue to be made.

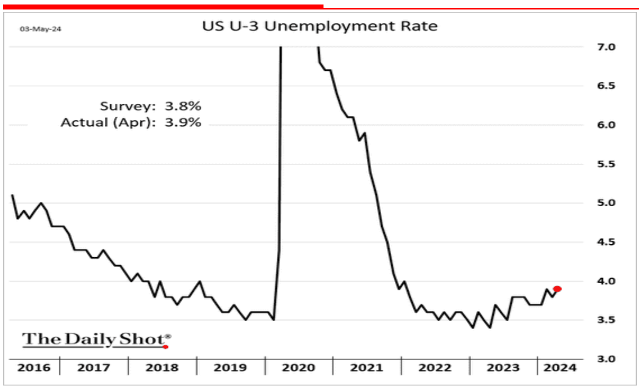
Declining Dissent: Federal Open Market Committee votes under Fed chairs since August 1979



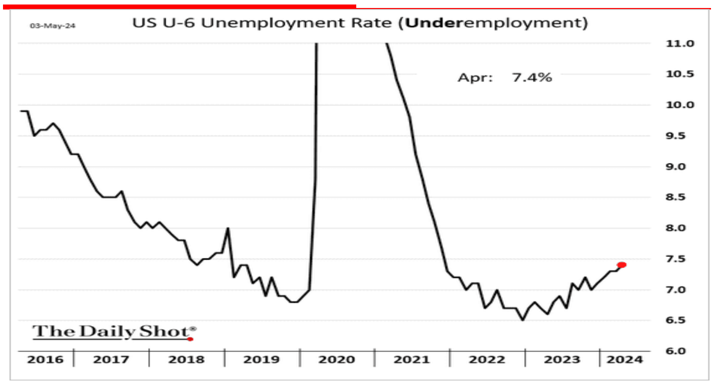
Source: Federal Reserve Bank of St. Louis, Wall Street Journal

So in the spirit of rejecting current investor groupthink, let me present some charts that suggest that investors might be wrong in swapping their recession forecasts for a ‘no landing’ outcome.

The US headline unemployment is rising slowly…



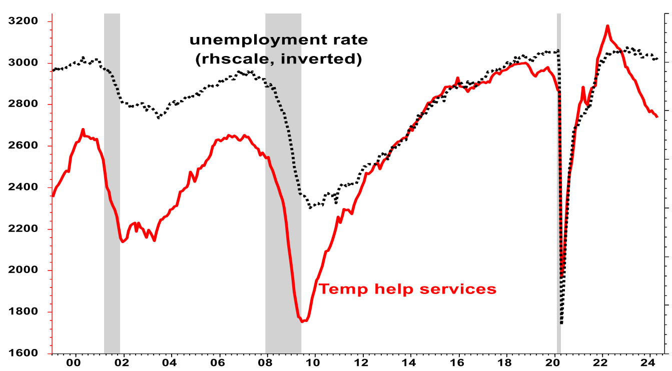
… but broader measures are rising far more quickly



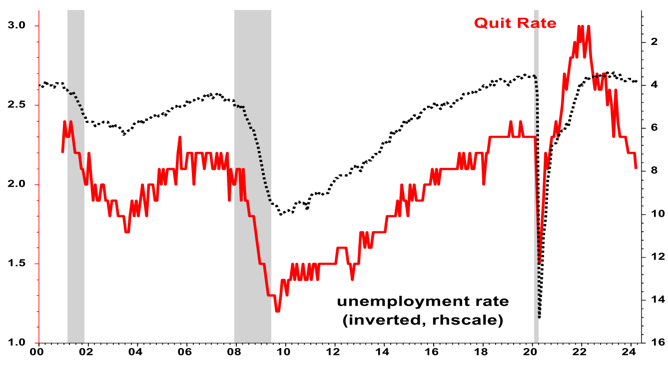
Source: The Daily Shot, @SoberLook

Not only are broader measures of unemployment rising more quickly than the headline rate (see charts above) but traditional coincident indicators of unemployment suggest that the labour market is far slacker than the headline unemployment and payroll numbers suggest.

The decline in US temp service jobs is recessionary…



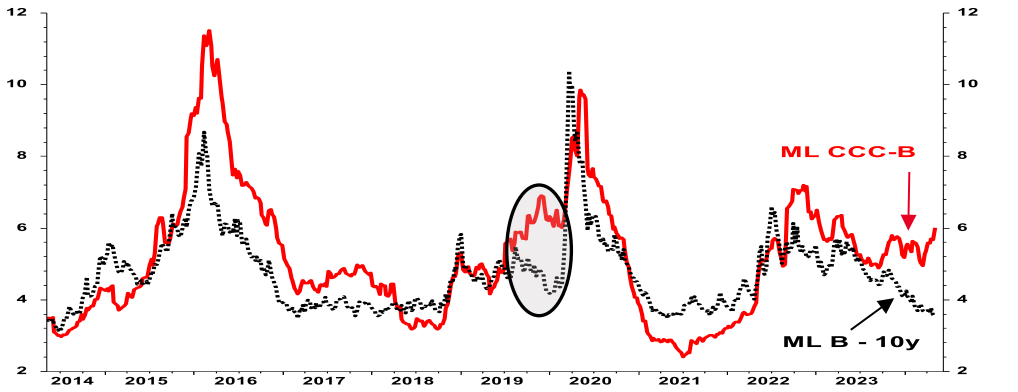
… and the JOLTS Quit rate suggests the same



Source: Datastream

We have previously warned that despite the “maddest chart” showing a collapse in aggregate corporate interest payments (despite a surge in Fed Funds), smaller cap and unlisted companies are in real financial distress. This distress is now showing up in in the CCC junk universe where spreads are widening sharply, despite higher grade bonds enjoying the tightest of tight spreads versus US treasuries (see chart below).

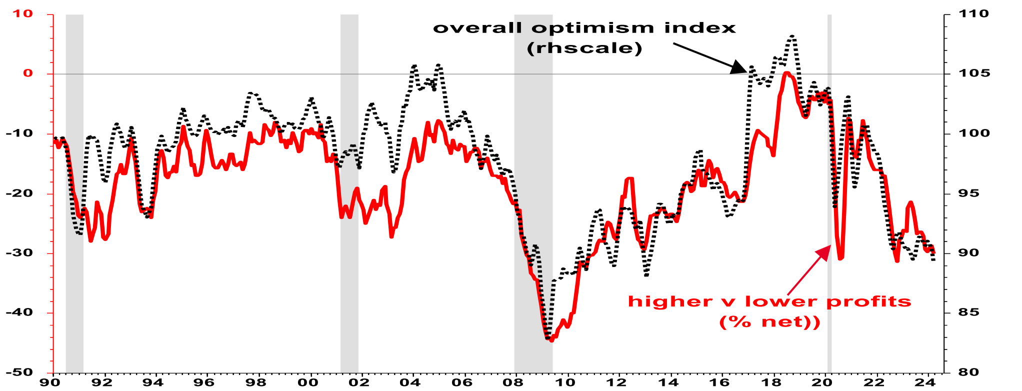
Junk spreads are widening (CCC minus B) while higher grade spreads are tightening – like 2019



Source: Datastream

The bankruptcy experts Epiq recently announced total commercial Chapter 11 bankruptcies had surged 43% yoy in Q1 this year – link. There is some debate about how much of this rise is due to smaller companies under pressure to repay pandemic loans, rushing to take advantage of a favourable provision in the law that is set to expire soon – link. But the small company sector is most definitely in severe difficulties, with the NFIB (which surveys optimism) finding a huge net 30% of small companies seeing lower profits versus higher profits – that is the stuff of recession.

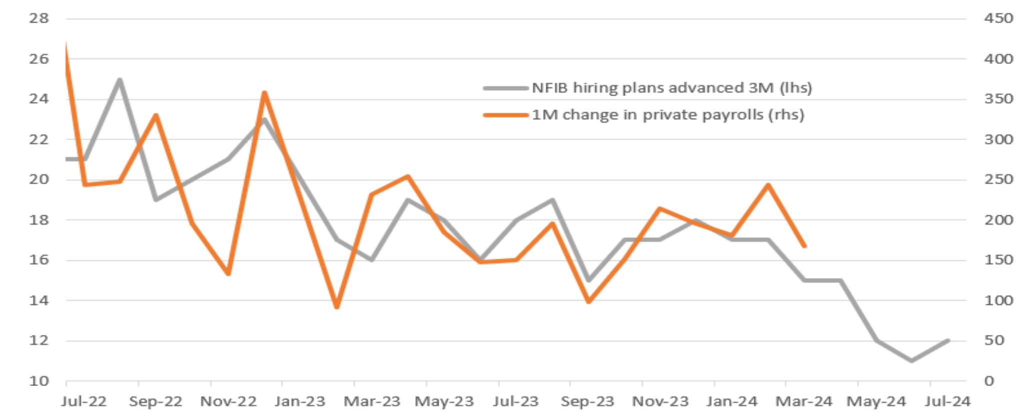
The unquoted small company sector is depressed, mainly because of a profits recession (3m mav)



Source: Datastream

If the small unquoted business sector is in pain, this likely spells the death knell for the economy overall as it is they, not the mega and large cap companies, which create the vast bulk of new jobs in the economy. And as the excellent ING Think points out, we need to watch the NFIB small company data closely as it correlates very well with the ups and downs of the key monthly payroll data. ING suggests we'll be seeing sub-100k payrolls very soon indeed. Recession anyone?

The NFIB survey points to further weakness in job creation to come



Source: ING Macrobond

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