the OtterWood list

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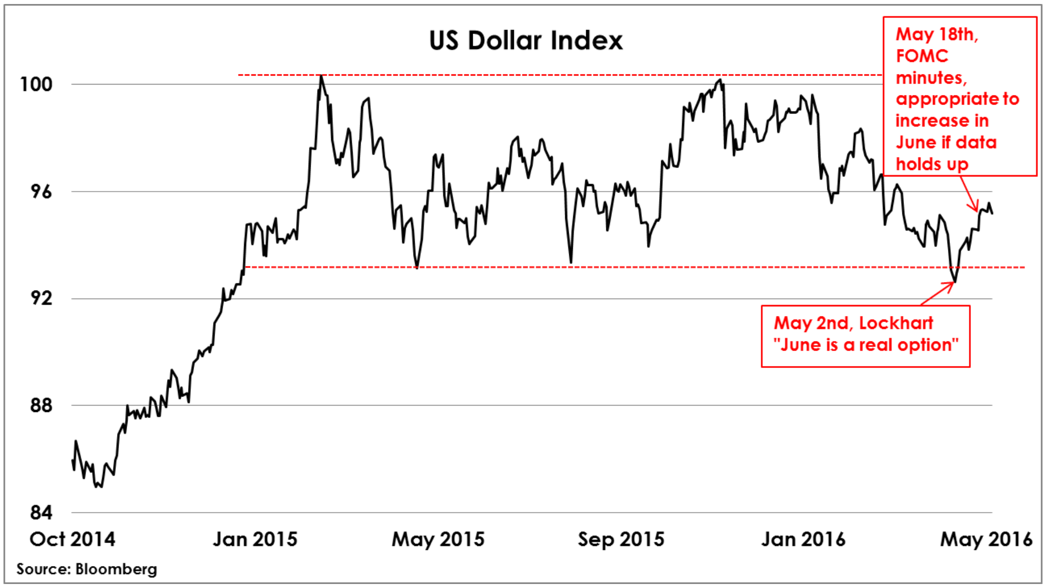
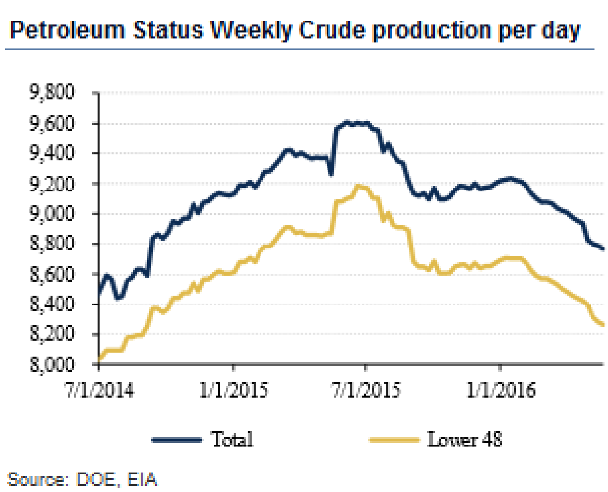
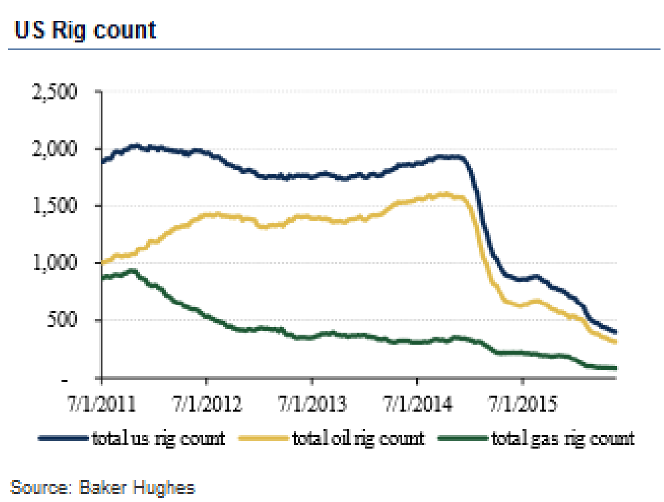
# *Weekly Market Recap for May 27, 2016*

The US dollar remains in its year+ long range. It looked like it was breaking down a couple weeks ago, however, out came Fed chatter to steer it higher. The chart below shows the trading range the USD has been stuck in and the moments where Fed chatter began earlier this month.




With the USD strengthening again, weakness is coming back to emerging markets and commodities, especially gold. Crude has held up due to falling production and rig counts, see below.



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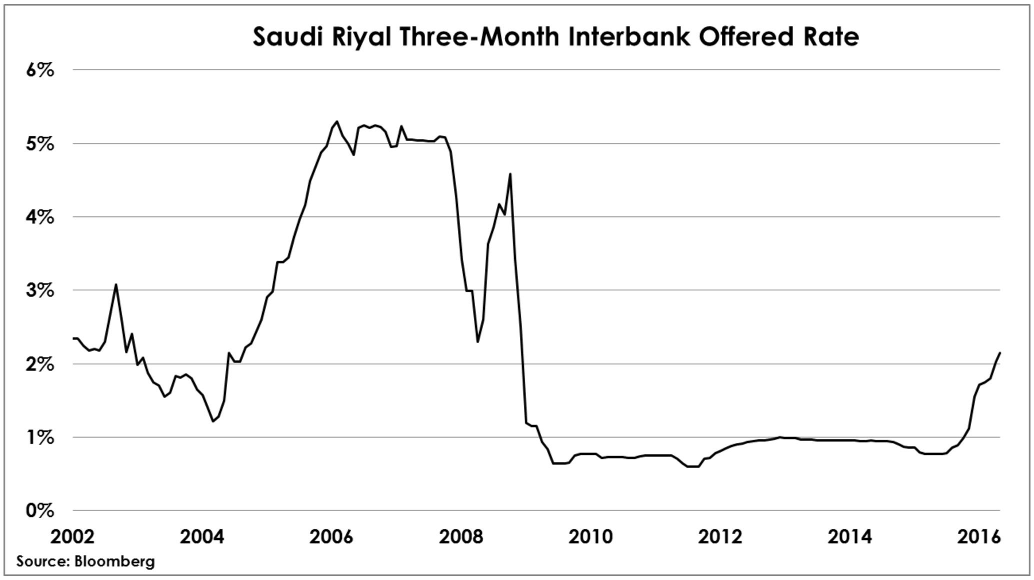
One place where recent USD strength is exerting real stress is the Saudi Arabia currency peg. Money continues to flow out of the country, putting pressure on the peg. Mounting stress in the banking system can be seen in the three-month interbank offered rates which reached the highest since the Lehman crisis in 2008, see below.




There is a strong case to be made for a one-off devaluation or complete break of the Saudi peg. Neither outcome would be shocking given the Swiss broke their peg in 2015 and China shocked the world with their devaluation last summer. The problem with a Saudi devaluation is the link to oil. Francisco Blanch from Bank of America says a break of the Saudi peg would cause oil prices to collapse to $25 a barrel!! This is something to keep a close eye on.

I don't believe the Fed can or will hike rates in June as interest rate differentials would be even more extreme than a year ago when the USD was surging higher. The ECB and BoJ have been much more aggressive with their policies the past year. The BoJ went into negative rates this year and is expected to do more while the ECB will now begin purchasing corporate bonds. A Fed rate hike would send the USD through the roof.

However, it is not a simple thing. Given all the chatter out of the Fed the past 2 weeks about how they are going to hike next month, not following through (again) would hurt the Fed's credibility. The following quote about the Fed

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from David Kelly, chief global strategist at JPMorgan Asset Management, says it best:

> "Having now worked hard in recent weeks to explain why June is on the table, provided the data remain relatively healthy, not following through with a rate hike in three weeks would only further undermine whatever credibility the Fed has left," he said.

No one has any clue as to what the Fed will do and it's clear that industry experts like this have little faith in monetary authorities. I don't blame them.

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# *Weekly Market RunDown*

| Stocks | Price (today's close) | Weekly % chg | YTD %chg |
|---|---|---|---|
| S&P/TSX | 14105.23 | 1.33% | 8.42% |
| S&P500 | 2099.06 | 2.28% | 2.70% |
| Nikkei | 16834.84 | 0.59% | -11.55% |
| FTSE100 | 6270.79 | 1.86% | 0.46% |
| Euro Stoxx50 | 3078.48 | 3.93% | -5.79% |
| Shanghai Composite Index | 2821.05 | -0.16% | -20.29% |
| Emerging markets ETF | 33.08 | 2.70% | 2.76% |
| Nasdaq | 4933.51 | 3.44% | -1.48% |

| Bonds | Yield | Weekly Net chg | YTD Net chg |
|---|---|---|---|
| Canada 10 year bond | 1.35% | 0.00% | -0.04% |
| US 10 year bond | 1.85% | 0.01% | -0.42% |
| Avg. cdn 5 yr mortgage rate | 4.64% | | 0.00% |
| US 30 year mortgage rate | 3.66% | 0.02% | -0.24% |

| Commodities & FX | Price (today's close) | Weekly % chg | YTD %chg |
|---|---|---|---|
| Gold | 1212.300 | -3.48% | 14.11% |
| Silver | 16.215 | -1.92% | 16.93% |
| Oil | 49.470 | 2.19% | 19.70% |
| USD/CAD | 1.304 | -0.54% | -5.76% |
| EUR/CAD | 1.450 | -1.51% | -3.58% |
| USD/YEN | 110.430 | 0.25% | -8.14% |
| EUR/USD | 1.111 | -0.98% | 2.32% |

| Gas | Price | Yest. Avg | Year ago avg. |
|---|---|---|---|
| US gas price at pump | 2.32 | 2.31 | 2.74 |
| Canada gas price at pump | 1.00 | | 1.06 |

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## Reads of the Week

**G7 Vows Growth Efforts As Japan's Abe Warns Of Global Crisis**

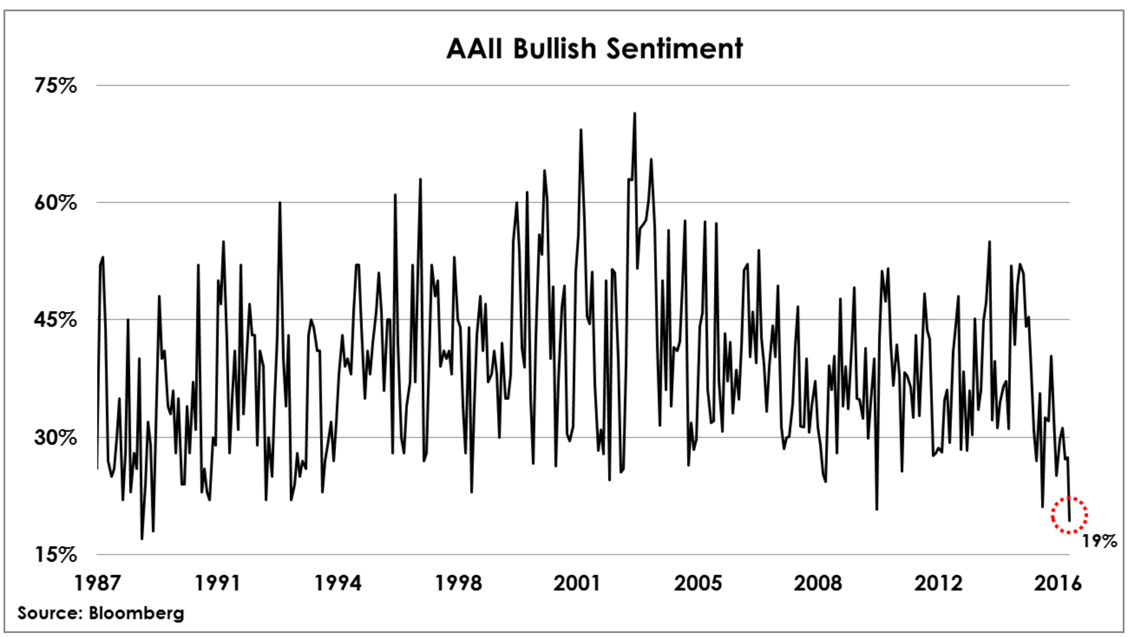
**Whether Trump or Clinton, Anxiety Creeps Into U.S. Stock Outlook**

**Greece Gets Its Bail-Out - Temporary Relief**

## This Week's Macro Thoughts

### Hard To Get Too Negative Given Sentiment

The American Association of Individual Investors measures investor sentiment on a weekly basis by surveying individuals to determine how many are bullish, bearish, or neutral on the stock market for the next six months.  The latest gage on who is bullish shows an extremely low reading of 19.34%.  It's hard to get too negative on the US market when no one thinks it's going up.



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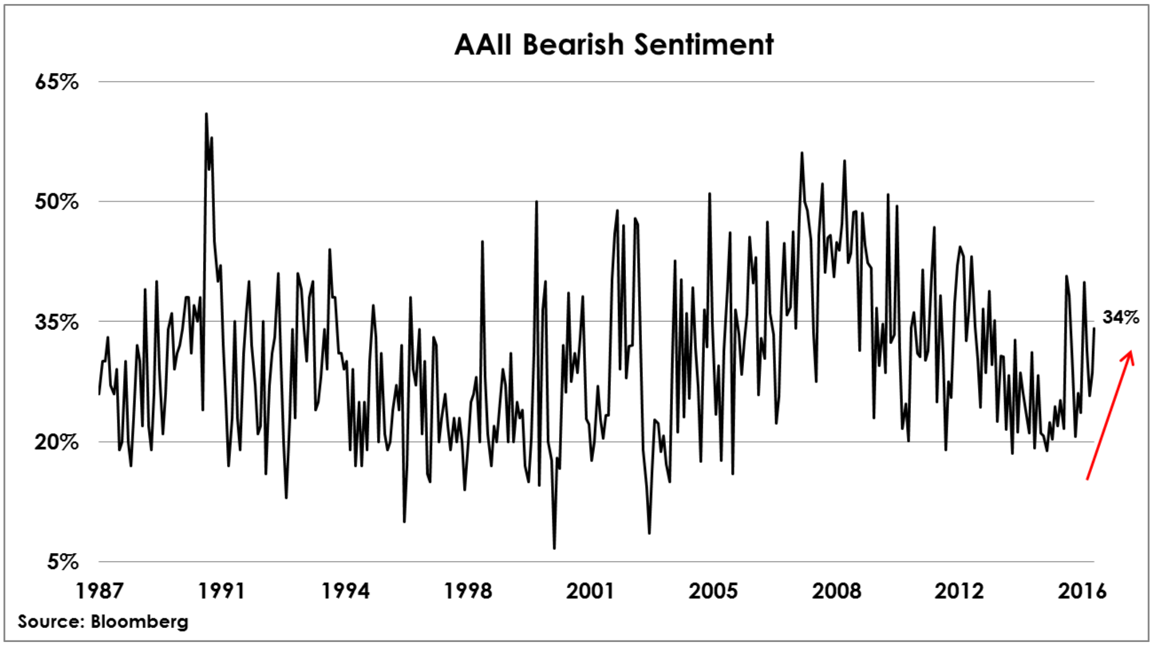
Additionally the percentage of bears is not at an extreme, however, it is on the rise…




## Fed Highlights Rising Delinquencies In Oil Producing Regions

The Federal Reserve Bank of New York released its quarterly report on household debt and credit which showed growing stress in oil producing regions. The long duration of the oil price collapse has hurt households with the highest levels of employment in the oil-and-gas industry. Notably auto loans more than 90 days delinquent have spiked significantly to levels seen just after the financial crisis. Mortgage delinquencies have managed to remain flat however the national average has continued to decline, see the charts on the following page.

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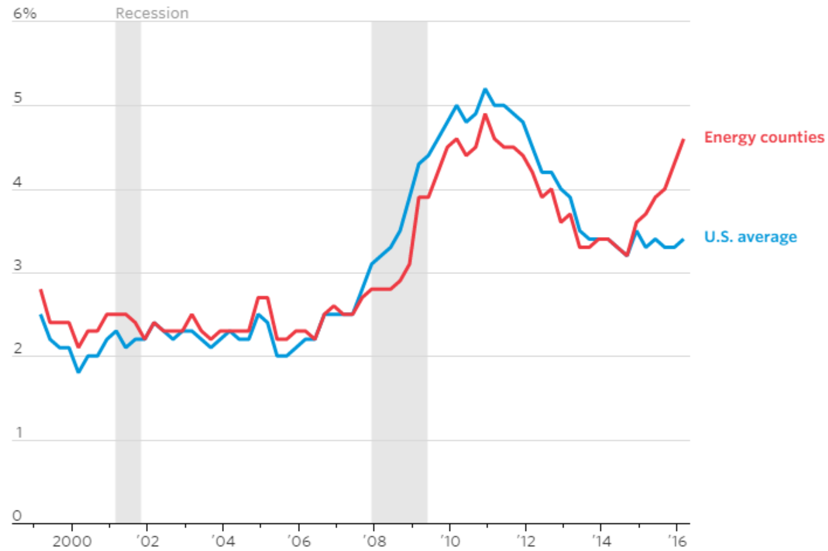
**Auto Delinquencies**

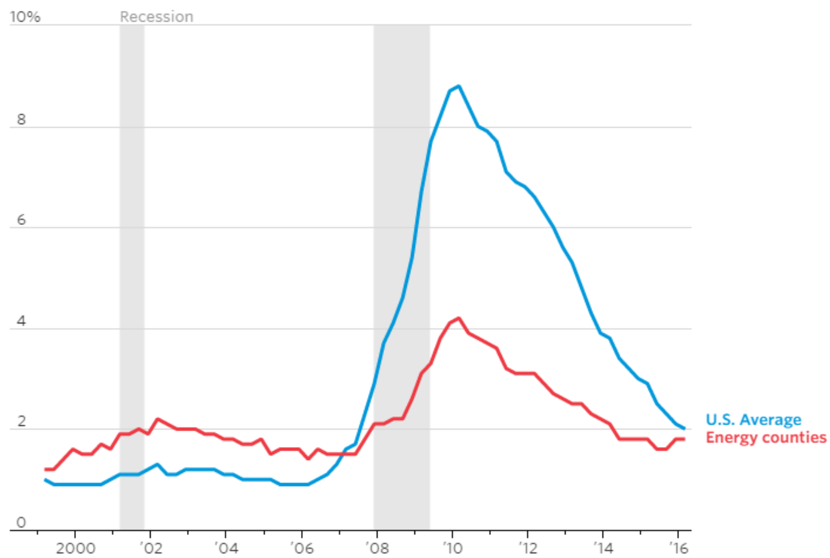
Share of U.S. auto loan balances that are more than 90 days delinquent




Source: Federal Reserve Bank of New York　THE WALL STREET JOURNAL

**Mortgage Delinquencies**

Share of U.S. mortgage balances that are more than 90 days delinquent




Source: Federal Reserve Bank of New York　THE WALL STREET JOURNAL

The report only focused on counties whose employment comprised at least 6% jobs in oil and gas employment as of the end of 2014. This amounted to only 1.7% of total US population however the analysis does show the real hardship in these counties.

See the WSJ article here and the supplement to the report here.

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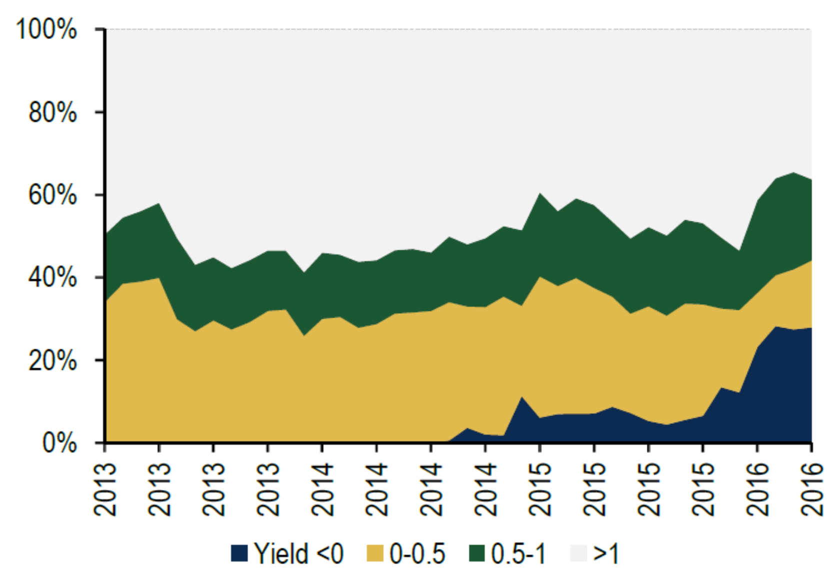
## Negative Rate Policies Depressing US Treasury Yields

Negative interest rate policies implemented by central banks in Europe and Japan have driven yields on many sovereign debt issues into negative territory.

If you look at the BAML Sovereign Bond index just 6% of the bonds had negative yields at the beginning of 2015. Since then the share of negative yielding bonds has increased to almost 30% of the index, see below.

**More than 40% of the market value of the DM sovereign index trades below 50bp**




We use the Merrill Lynch WSAV Index Source: BofA Merrill Lynch Global Research

With negative yielding bonds becoming the norm investors are instead reaching for the remaining assets with positive yields (i.e. US Treasuries). Private Japanese investors have purchased nearly $70 billion in foreign bonds this year with the sharpest increase coming after the BoJ adopted negative rates. Additionally inflows into US Treasuries from European funds have increased since 2014, see on the following page.

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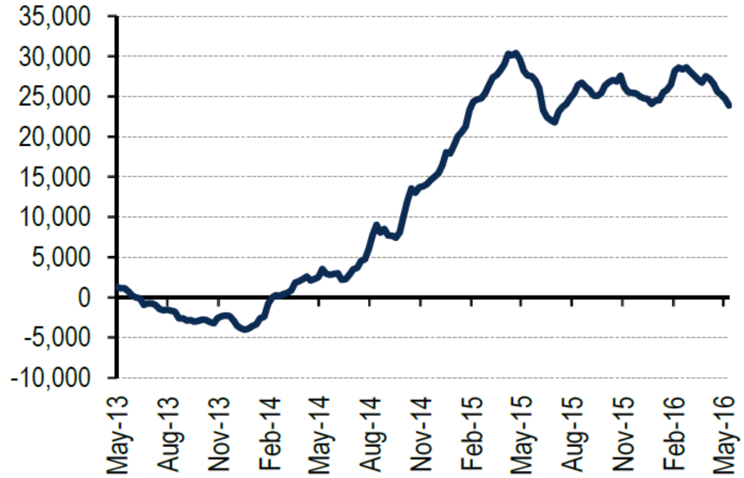
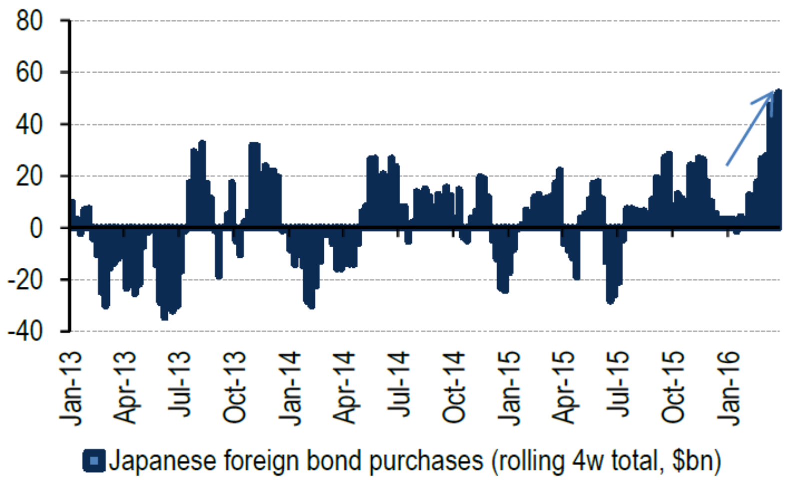
**Cumulative inflows from Euro area domiciled funds into intermediate and long term government bonds ($mn)**




Source: EPFR

**Japanese purchases of foreign bonds has picked up significantly over the last month**




Source: Ministry of Finance, Japan

According to an analysis by Bank of America Merrill Lynch **for every $100 currently managed in global sovereign benchmarks, avoiding negative yields would result in roughly $20 being pushed into overweight US Treasuries assets.**