Rabobank Market Strategy

Sweetener colloquium – February 2019

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Market Strategy

Rabobank International – New York

MARKETING COMMUNICATION

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Structural issues

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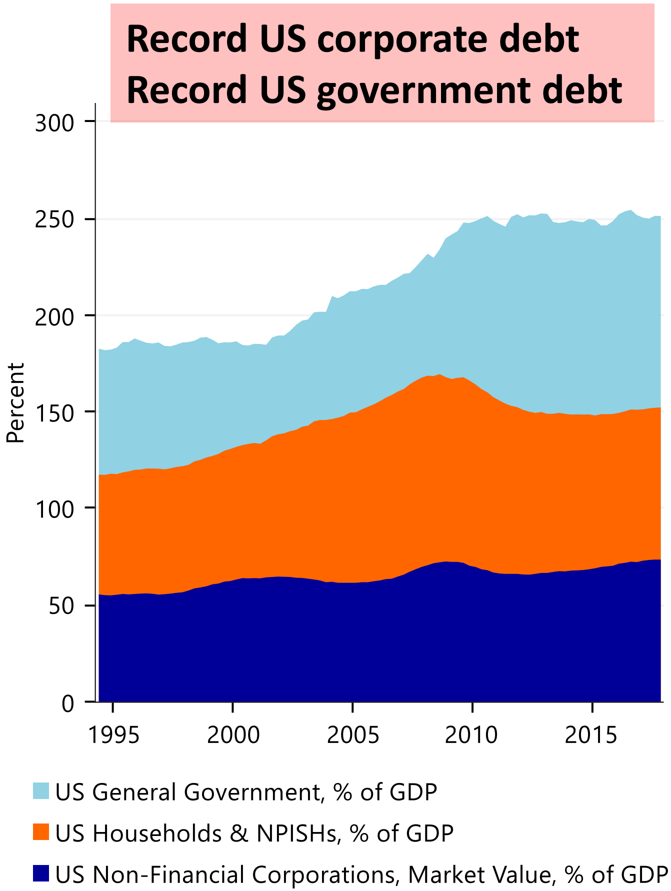
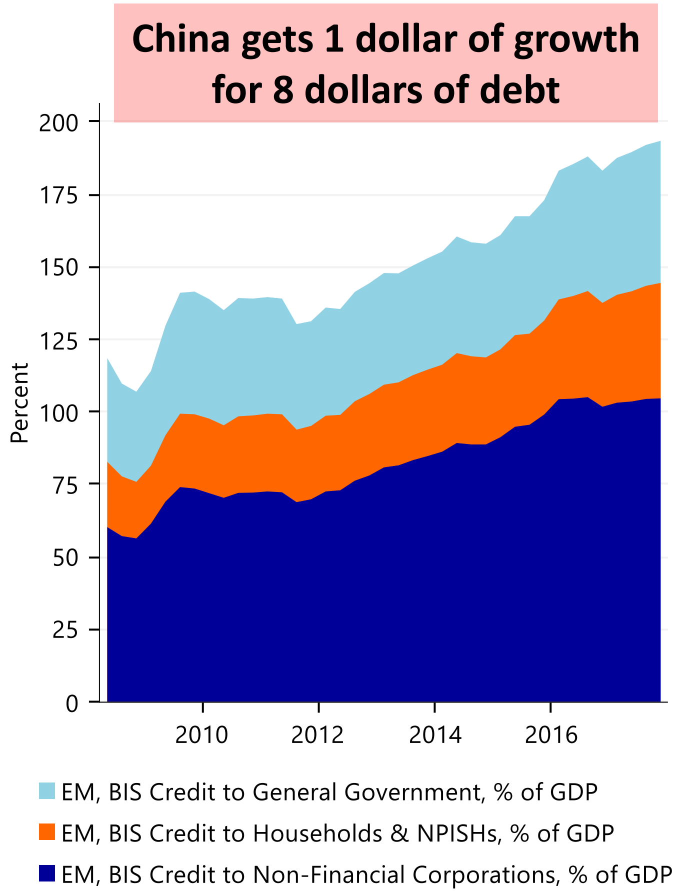
Debt has been the main driver of growth since the '80s
But has the debt = growth limit been reached?

US = government + corporate, EM = corporate + other





The emerging world is now a bigger slice of the global GDP pie than the developed world

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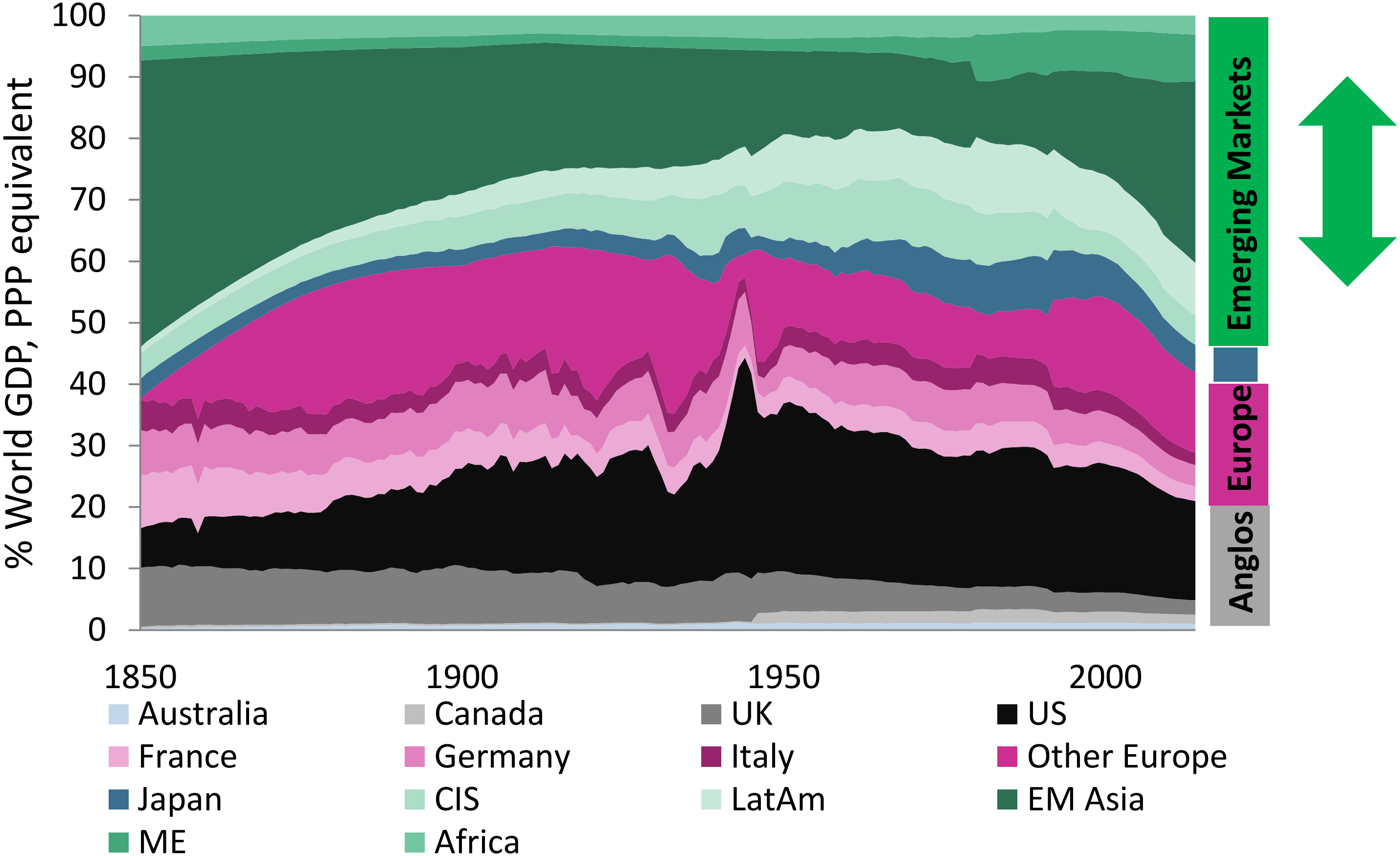
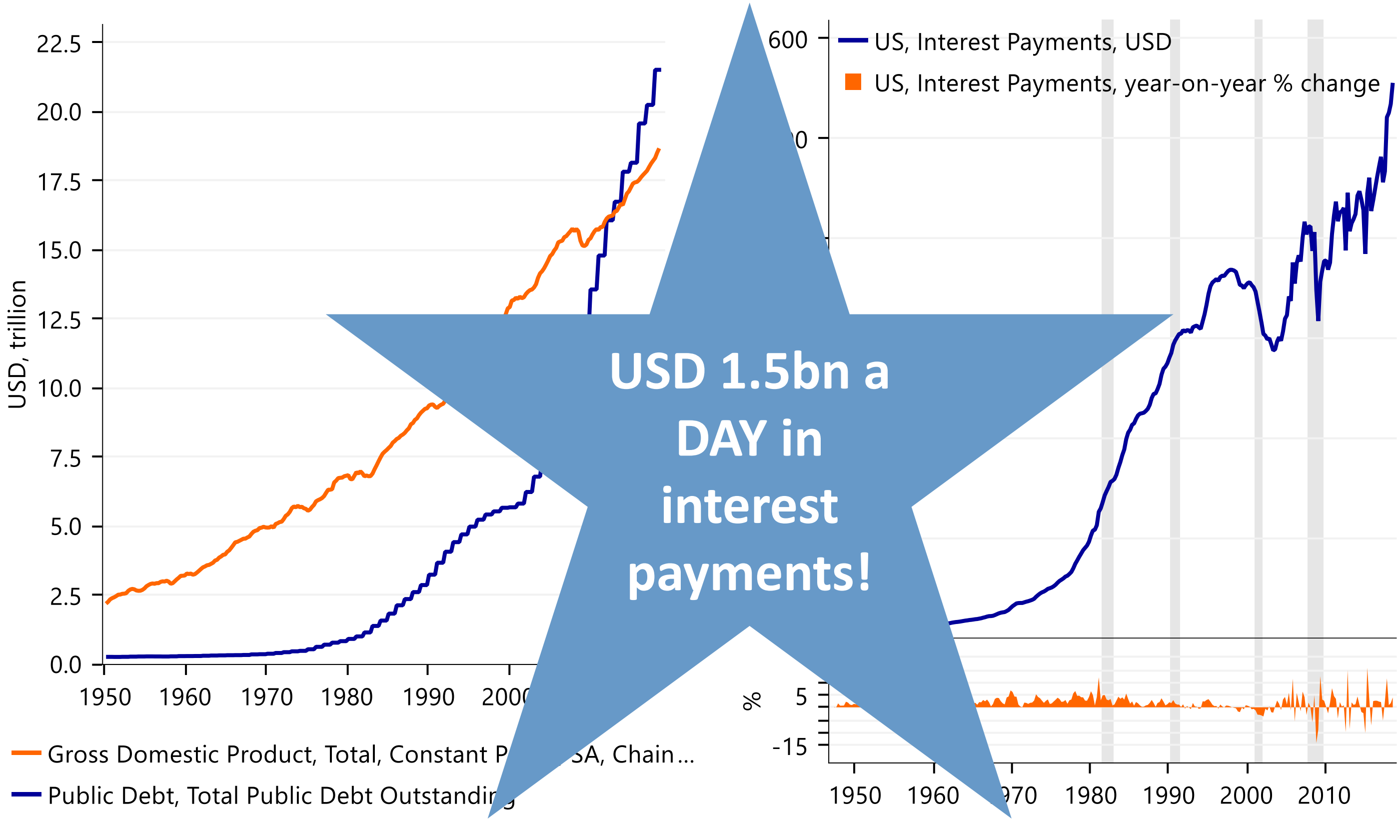
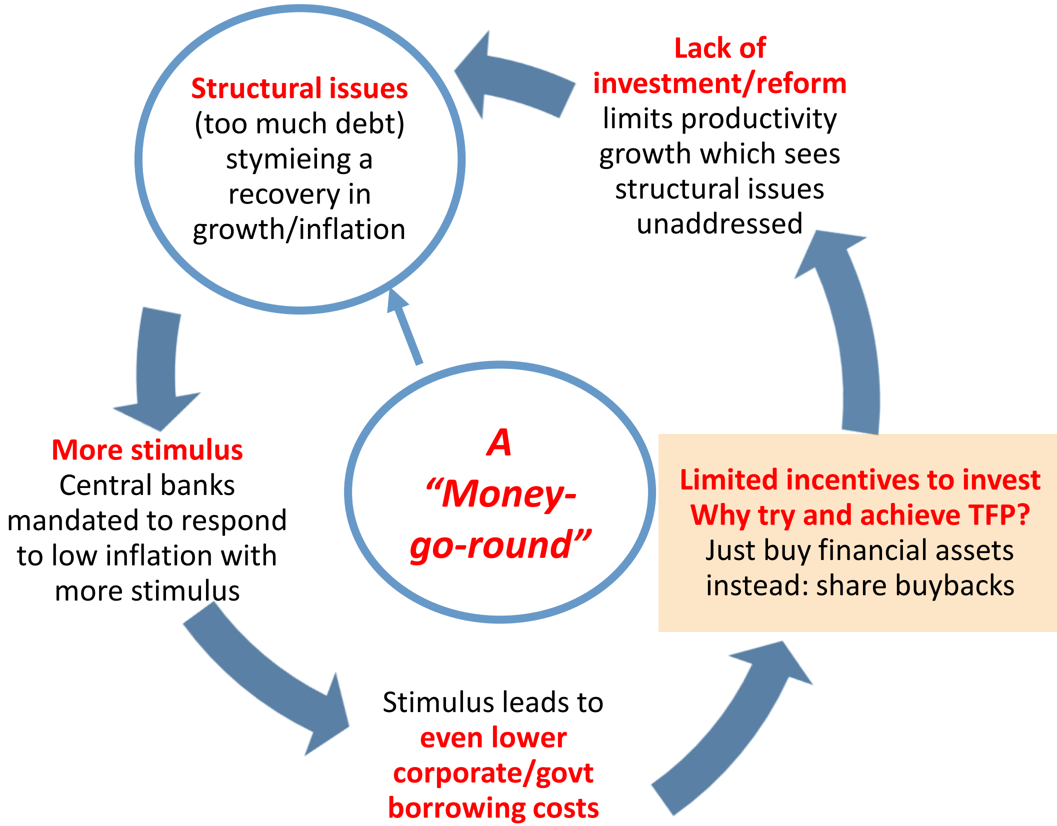


As EM leverages up so does the US government Debt to GDP about to pass WWII



Why didn't cheap money fuel growth? = 'Financialisation'
(The only slide I have kept in my deck for the past 4yrs!)



- **Low wage growth in G10 economies**
- **High levels of private debt**
- **Growing income and wealth inequality.**
- **Lack of real world investment.**

= Falling productivity

= Lack of wage growth

=Disgruntled voters

= Rise of populism

All this debt hasn't fuelled much real world growth BUT, it has led to asset price inflation

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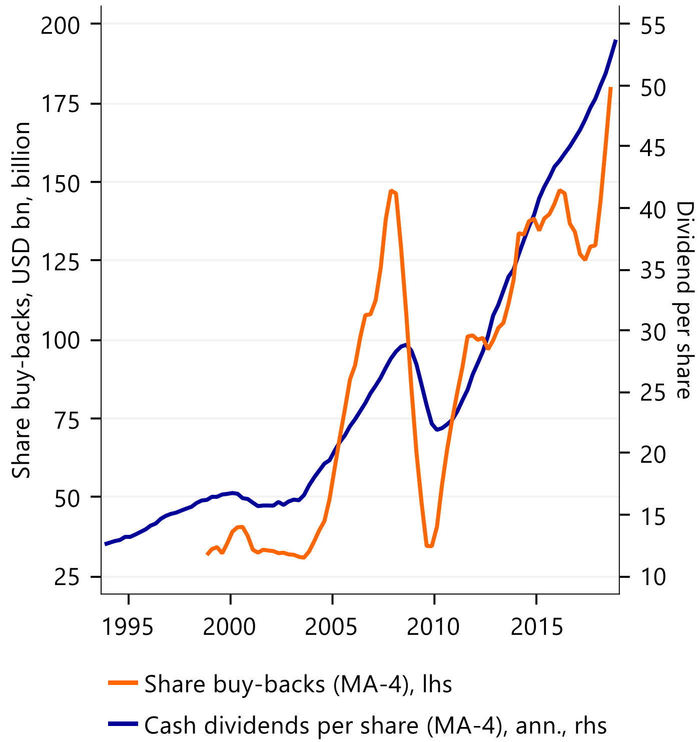
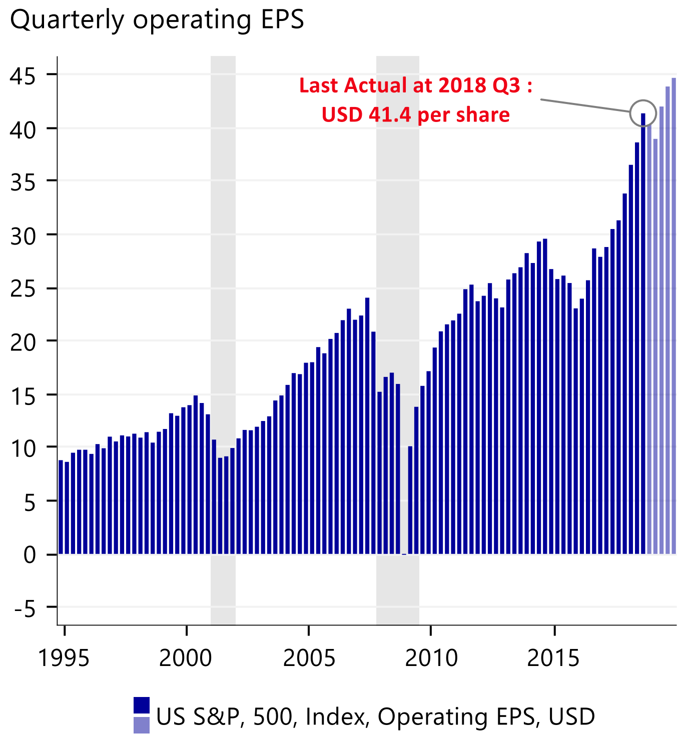
QE..."Higher stock prices will boost consumer wealth and help increase confidence, which can also spur spending" - Bernanke

Money Returned to Shareholders



S&P 500 Earnings Per Share (EPS)



Asset inflation + low wage growth = rising inequality
Rising inequality = political populism

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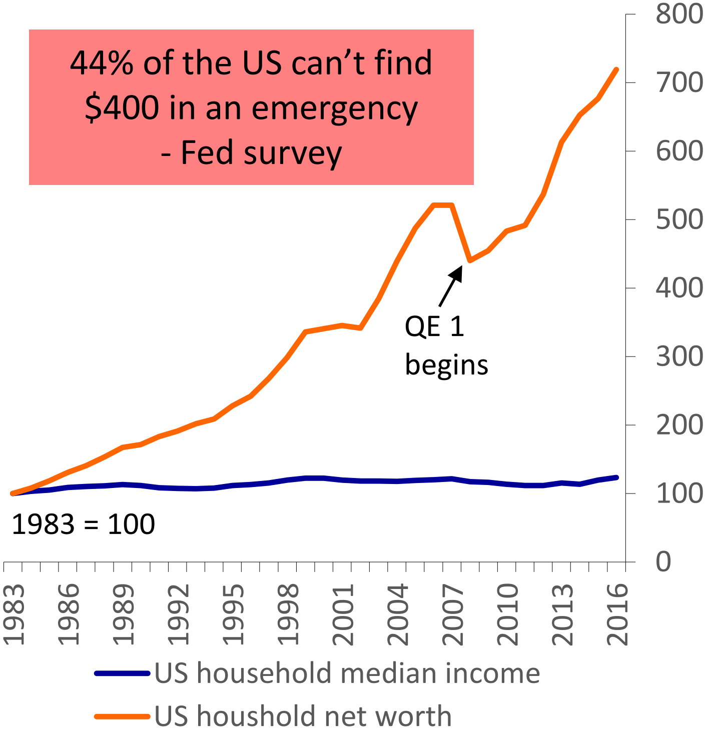
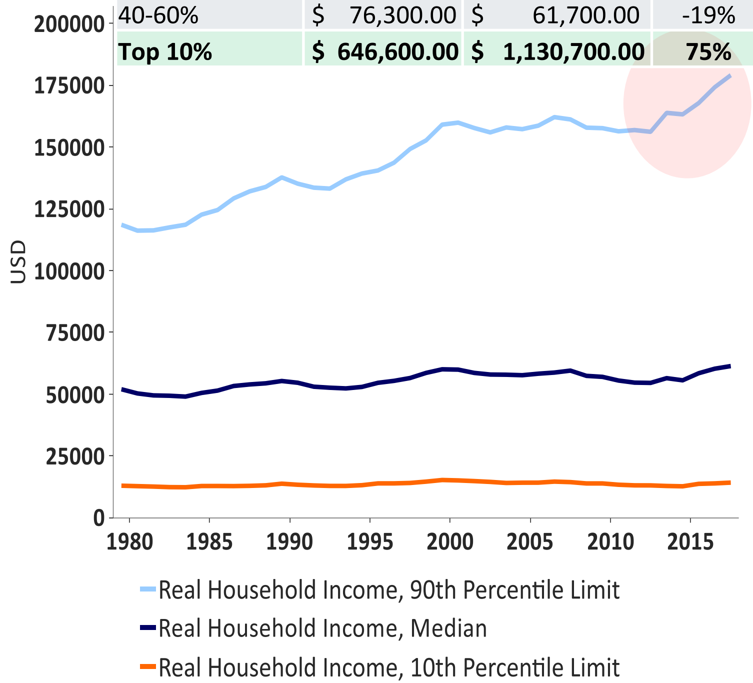
The top 10% of US households now own 84% of all stocks
– Edward Wolff (Economist at NYU)

44% of the US can't find $400 in an emergency
- Fed survey



Median Net Worth, 15yr change			
	1998	2013	Change
All Families	$ 102,500.00	$ 81,200.00	-21%
Bottom 20%	**$ 8,300.00**	**$ 6,100.00**	**-27%**
20%- 40%	$ 47,400.00	$ 22,400.00	-53%
40-60%	$ 76,300.00	$ 61,700.00	-19%
Top 10%	**$ 646,600.00**	**$ 1,130,700.00**	**75%**



Did low wages help pull down unemployment?
If so, will higher wages drive unemployment?

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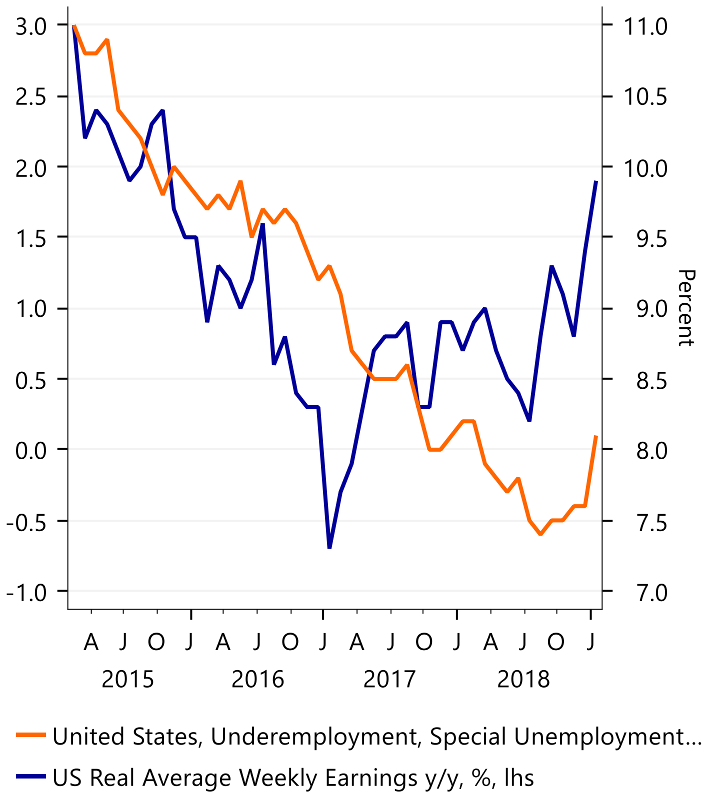
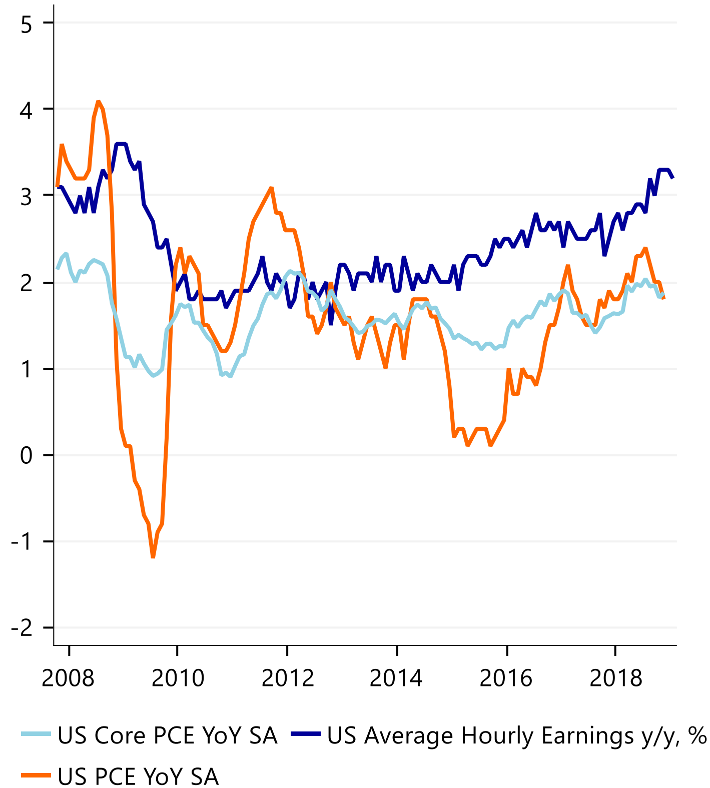
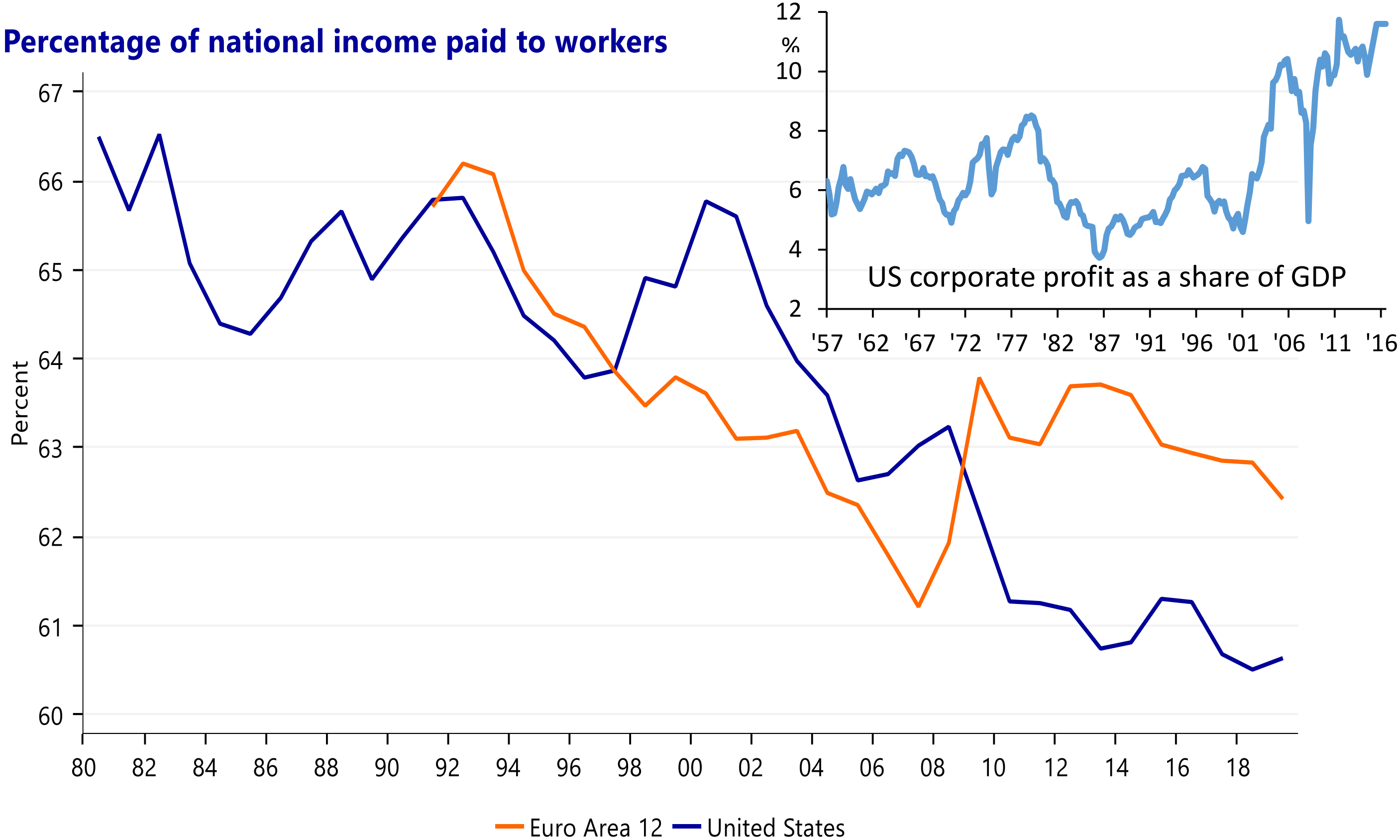




Workers receive a smaller and smaller piece of the pie



When inequality rises, voters want to shake up the system.. Brexit, Trump, Italy, AMLO, Macron, Bolsonaro

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European elections on May 23rd could highlight a seismic shift in the European outlook

Late cycle behaviour

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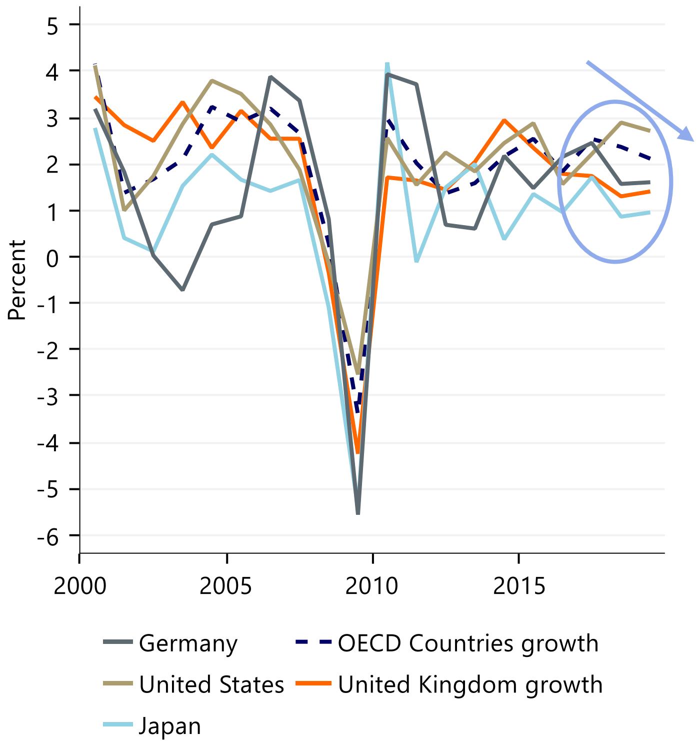
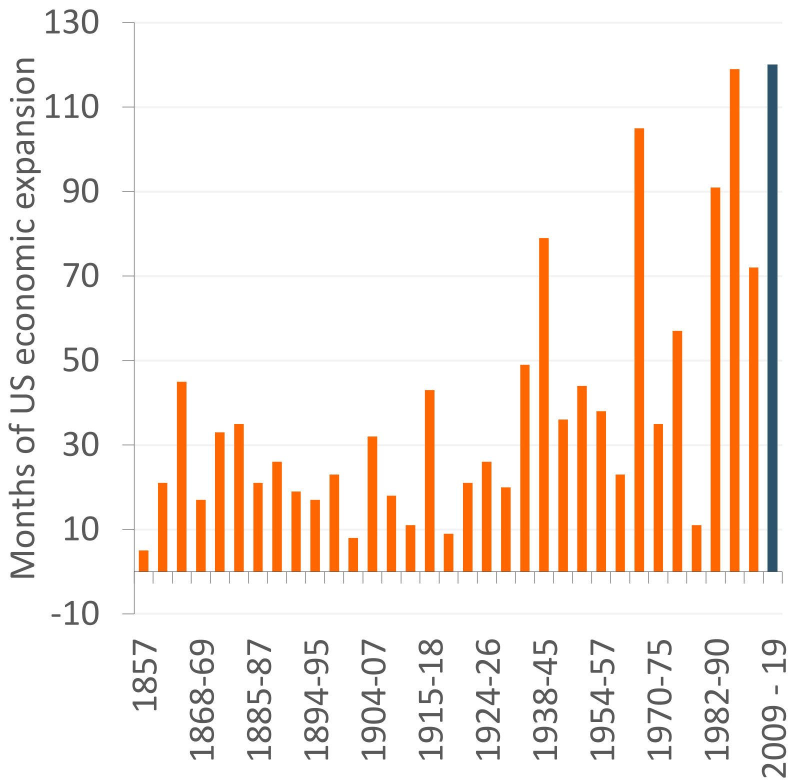
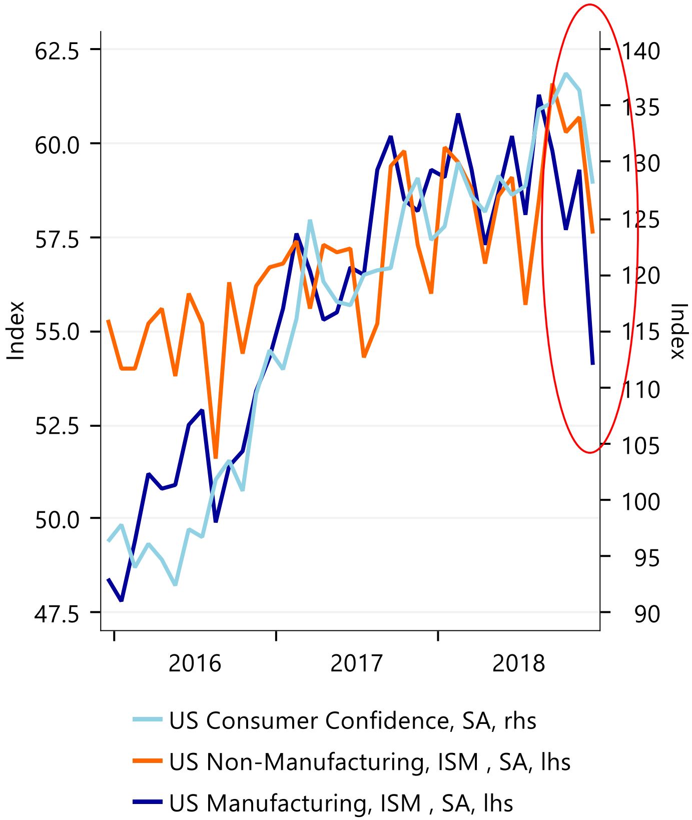
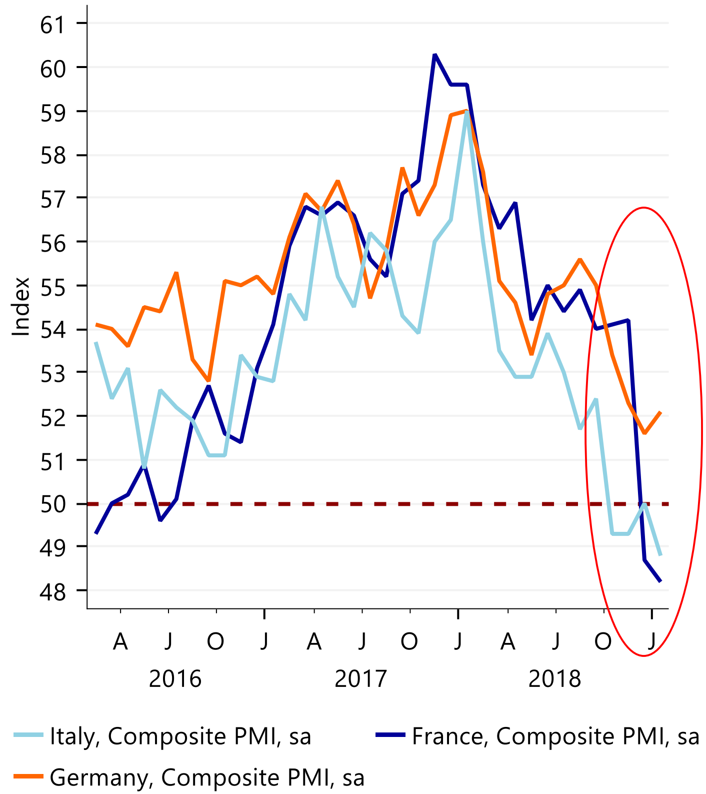
The US is close to the longest recovery on record but growth is now slowing (and not just in the US)



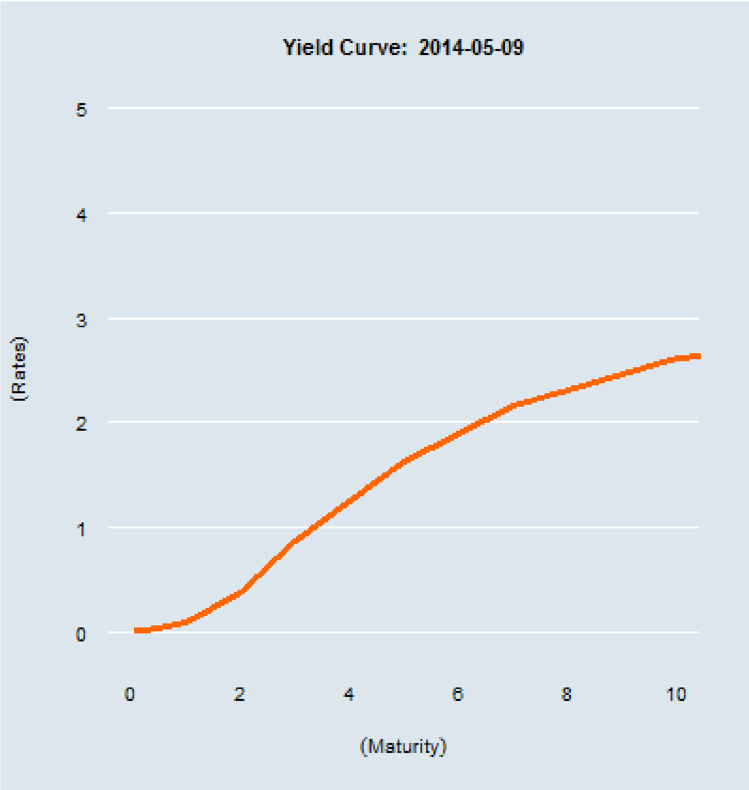


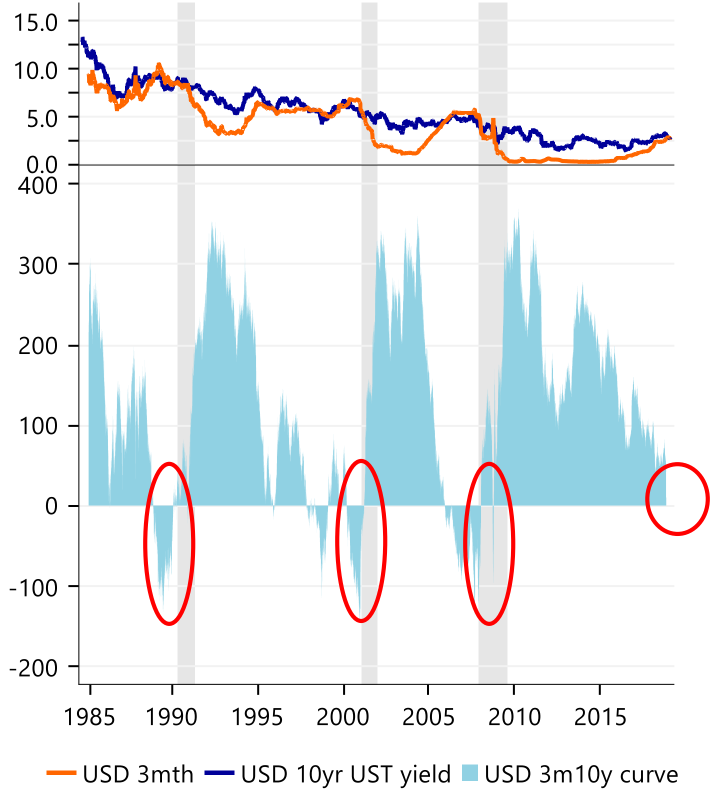
Tighter monetary policy and trade wars are weighing
Surveys are turning for the worse



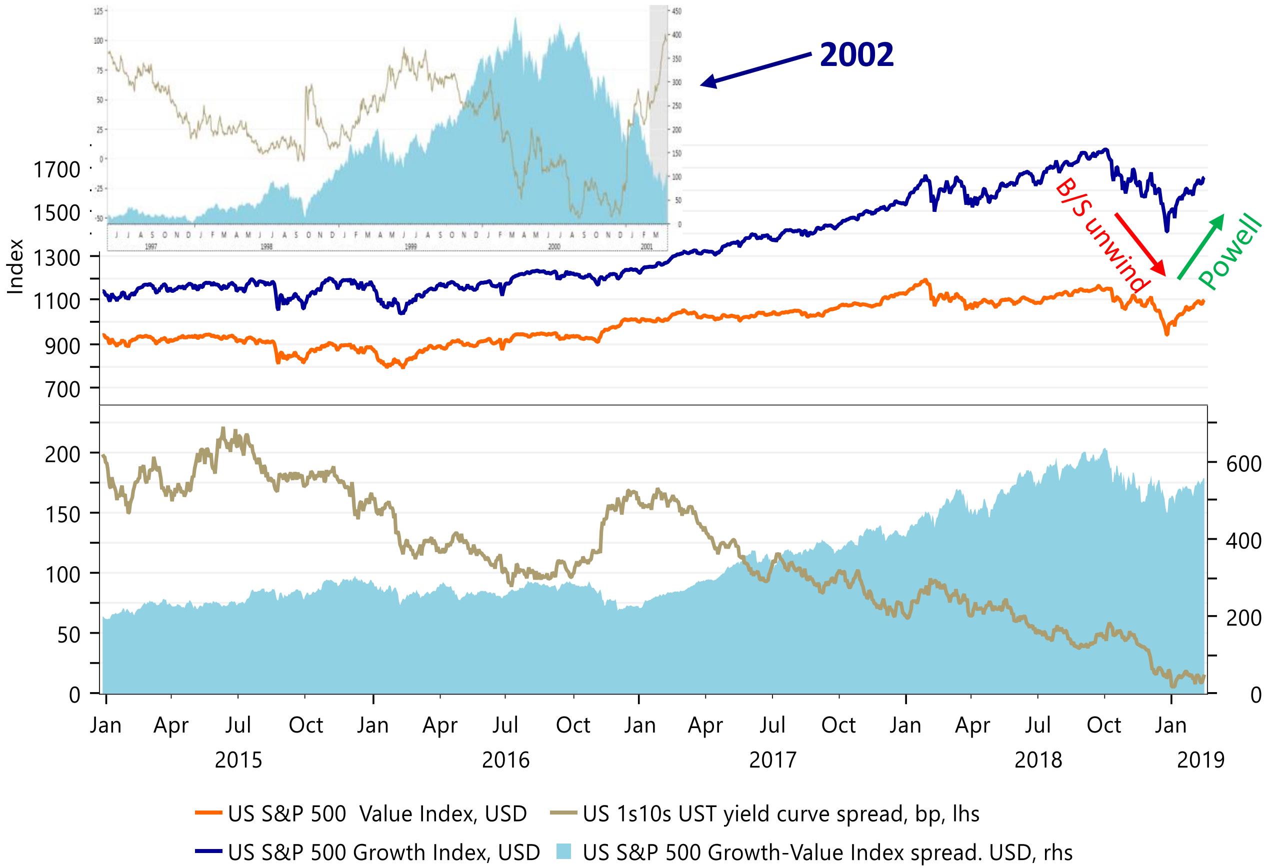


The classic US recession indicator...inversion is the signal then the curve bull steepens into the recession





Value equities outpacing growth equities although Powell u-turn reversed this



Defensive equities outpacing cyclicals...
Until the Powell put came back into play!

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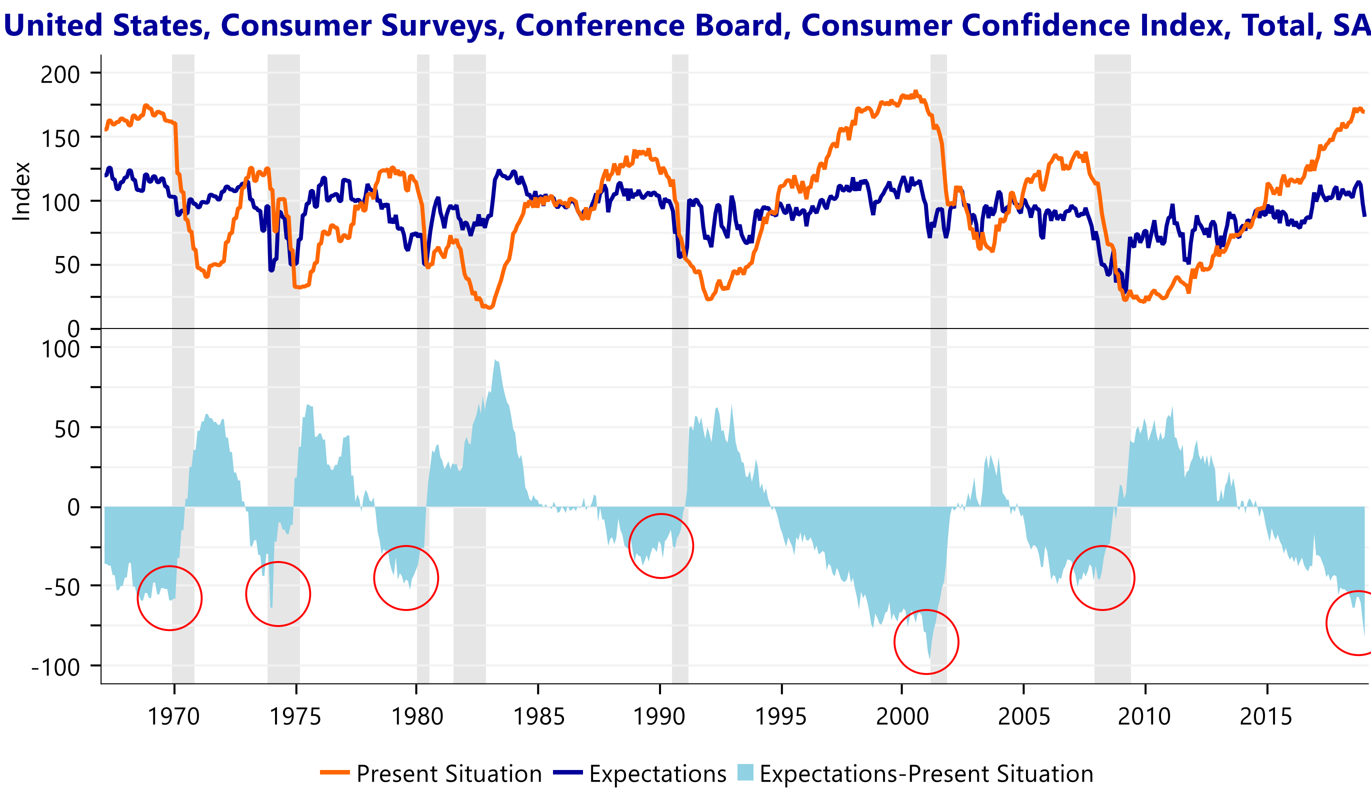
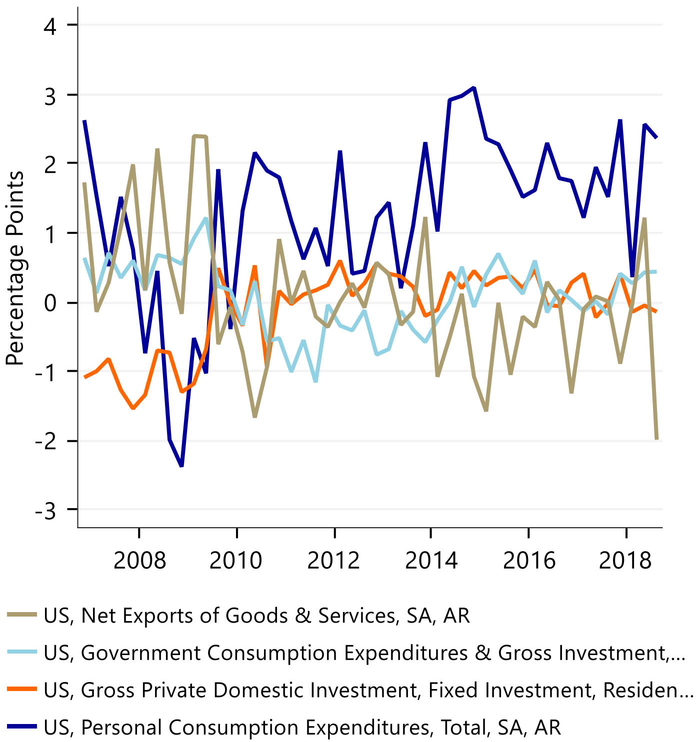
MSCI USA Cyclical Sectors-Defensive Sectors Return Spread USD Index

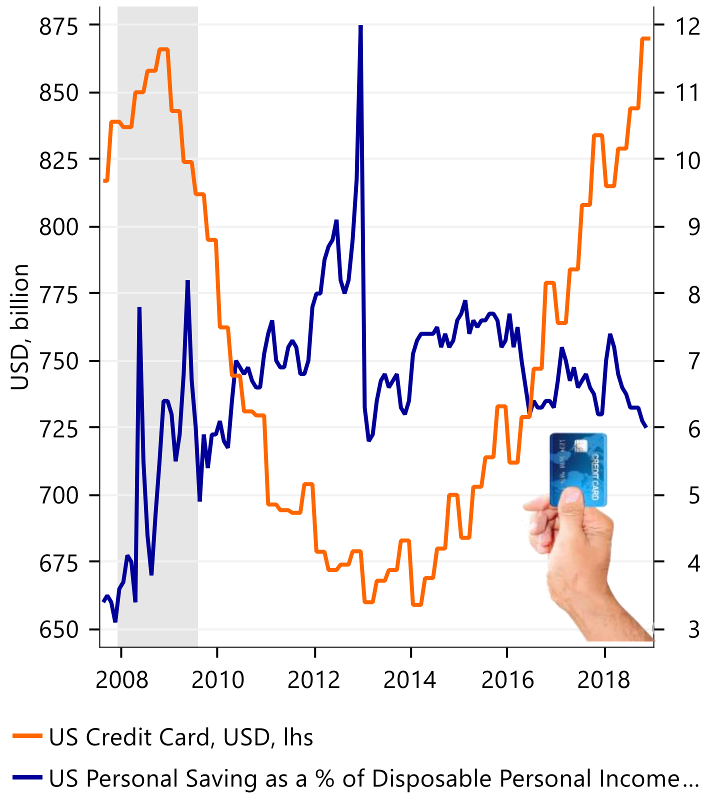
Consumer confidence: present vs. expectations at stretched levels (as we see before every recession)



Growth is primarily supported by consumption…
But how much is consumption being supported by credit?

United States, GDP Contributions, SA, AR





Home sales and autos are suffering...badly
New seriously delinquent auto loans just hit '08 highs

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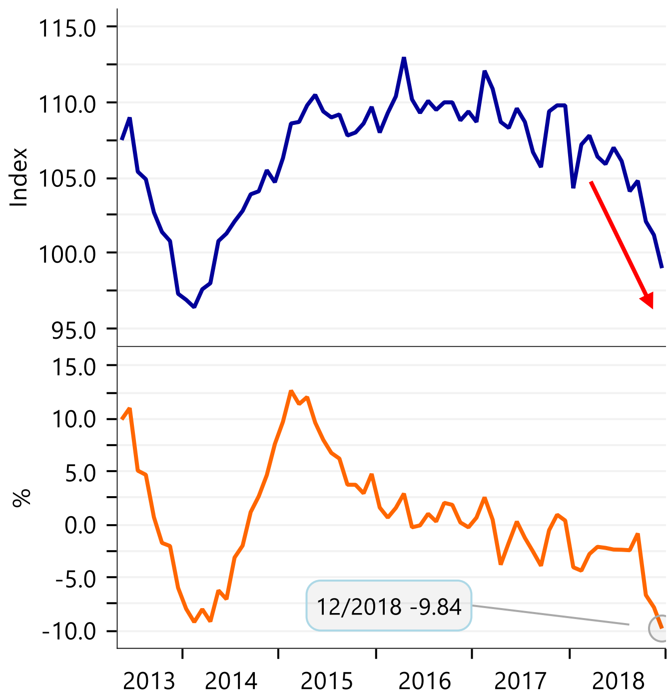
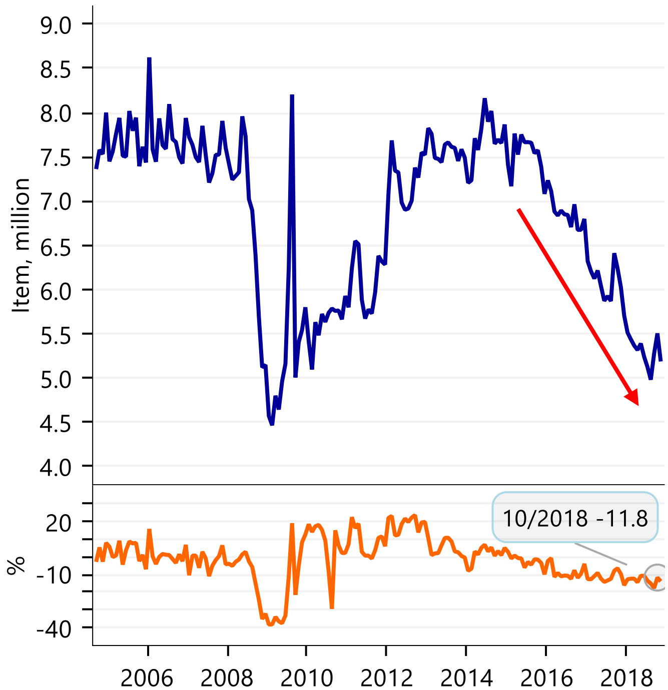
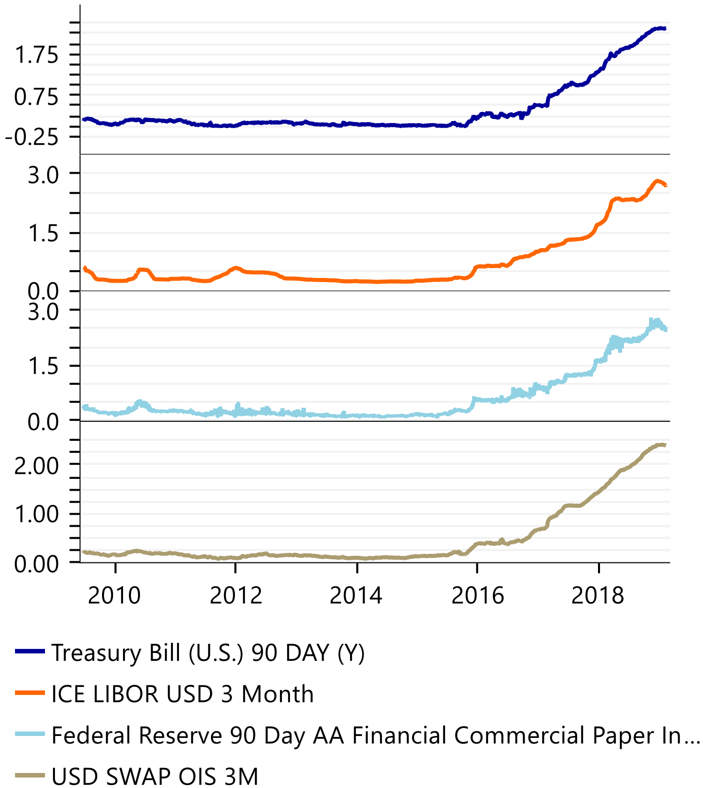


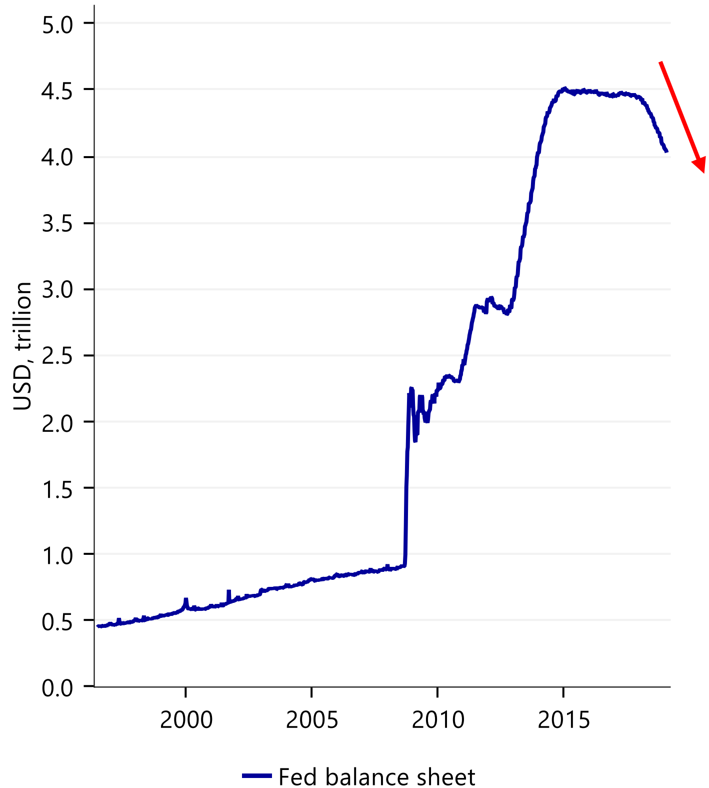
US, Pending Home Sales Index, SA
US, Pending Home Sales Index, SA y/y, %



US, Vehicle Sales & Registrations, SA
US, Vehicle Sales & Registrations, SA, y/y %

Tighter US financial conditions & shrinking balance sheet





Has the PBOC help US equities this year?
RR cuts, sneak QE, balance sheets expand again

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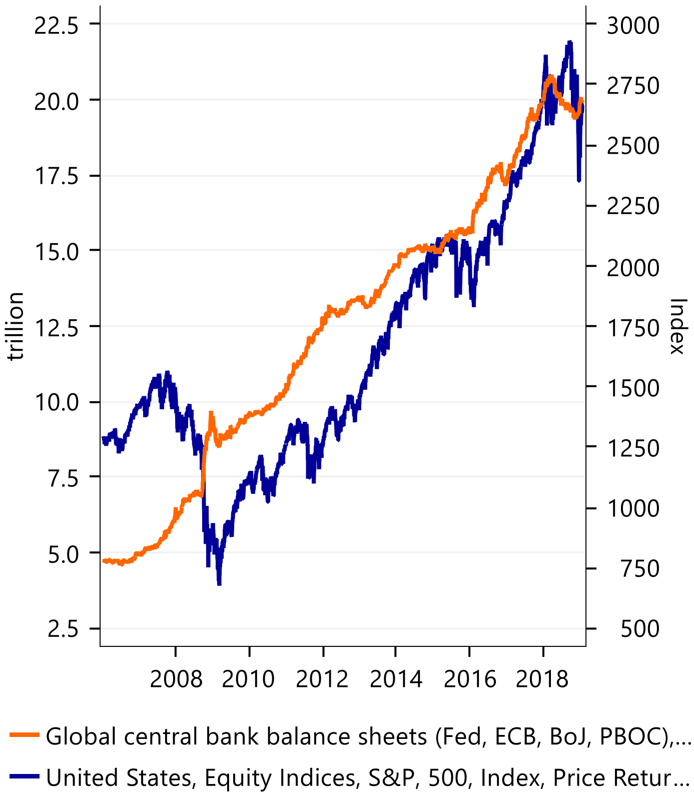
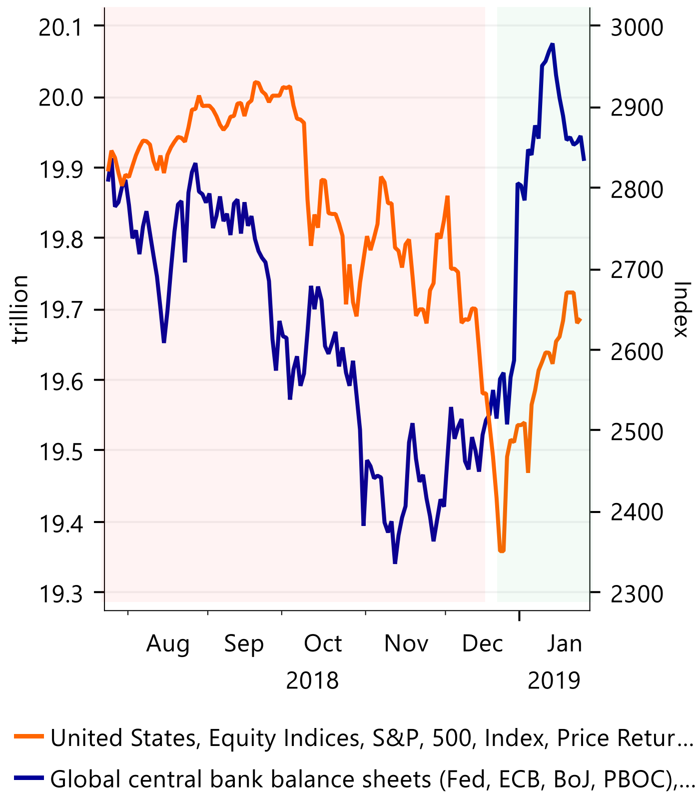




Fed's DOT plot projects 2 rate hikes in 2019 but Powell has turned dovish and we expect 0 (and cuts in 2020)

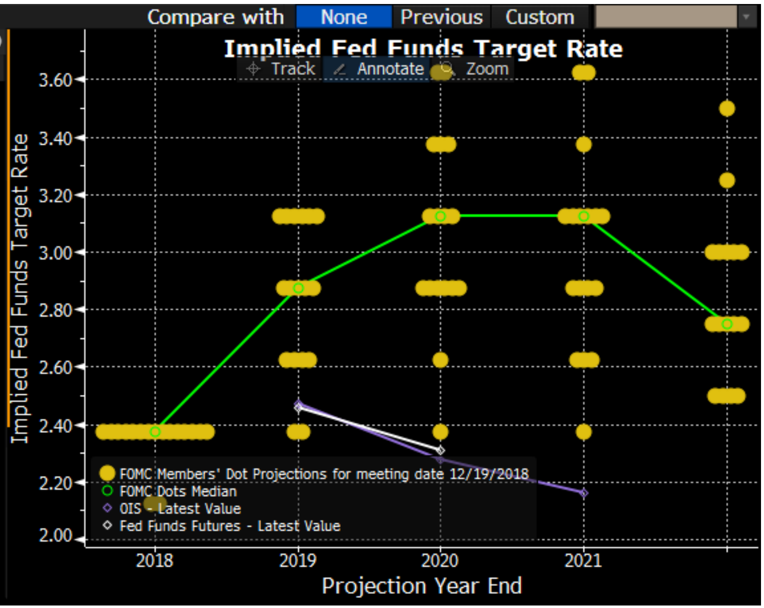
Rabobank expects no further hikes in 2019 and we expect the Fed to pause its balance sheet unwind in H2 of this year before cutting rates in 2020.

Chairman Powell January 6th 2019: "We're listening carefully with – sensitivity to the message that the markets are sending and we'll be taking those downside risks into account as we make policy going forward" ... The Fed is able to "adjust policy quickly and flexibly"

BE Fed Spectrometer

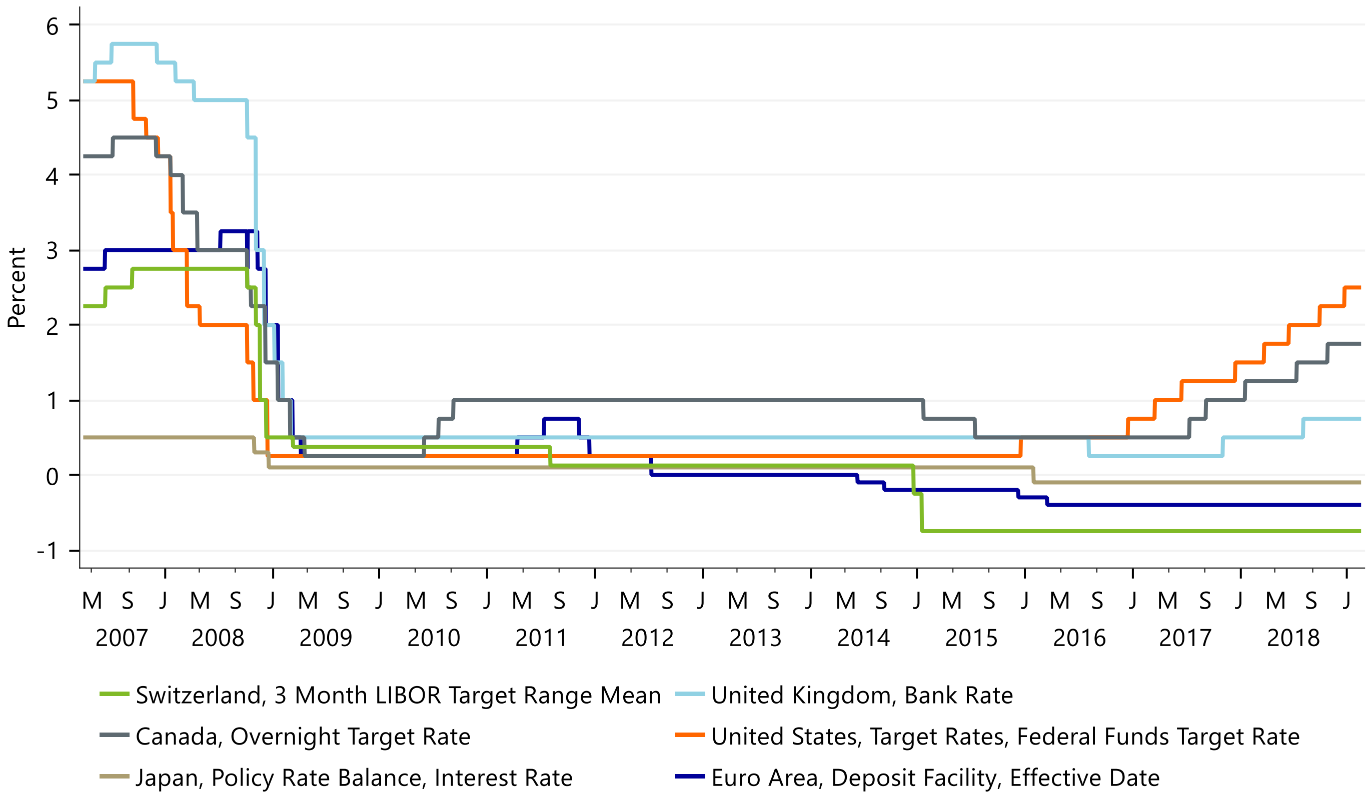
As of 01/09/2019 for 2019

Incl.	Member Name	Role
MH	Esther L George, Kansas City	FRB
H	Michelle W Bowman, Governor	BoG
H	Loretta J Mester, Cleveland	AV
H	John C Williams, New York	FRB
H	Eric S Rosengren, Boston	FRB
H	Thomas I Barkin, Richmond	NV
N	Jerome H Powell, Chairman	BoG
N	Richard H Clarida, Vice Chairman	BoG
N	Randal Keith Quarles, Vice Chairman:S...	BoG
N	Lael S Brainard, Governor	BoG
N	Patrick T Harker, Philadelphia	AV
N	Robert Steven Kaplan, Dallas	AV
D	Charles L Evans, Chicago	FRB
D	Raphael W Bostic, Atlanta	NV
D	Mary C Daly, San Francisco	NV
MD	Neel T Kashkari, Minneapolis	AV
MD	James B Bullard, St Louis	FRB
	(Vacant, Governor)	BoG
	(Vacant, Governor)	BoG
	(Vacant, Governor)	BoG



If the US sneezes, the rest of the world catches a cold

If recession spreads, how can other countries respond?! Are they really going to raise rates if the Fed is cutting?



Trade

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Number 1 risk according to survey of 600 executives

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Tier One Risks

1. Retrenchment of globalisation/increase in protectionism
2. Oil price shock
3. Asset price collapse
4. Emergence of disruptive business model
5. International terrorism
6. Unexpected regulatory change
7. Global recession
8. Instability in the Middle East
9. Increased competition from emerging market companies
10. Talent shortages
11. Climate change
12. Increased industrial pollution

Tier Two Risks

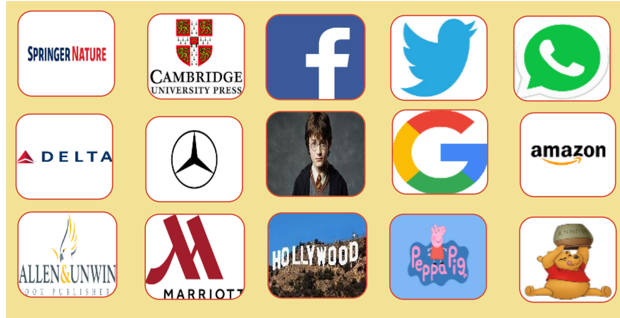
13. Increased macroeconomic volatility
14. Pandemic (eg, H5N1)
15. Rise in anti-globalisation sentiment
16. Flooding in populated area
17. Drought/Lack of freshwater services
18. Dramatic increase in communicable diseases (eg, AIDS, malaria, tuberculosis)
19. Rising cost of raw materials
20. Downward pressure on prices
21. Failure to honour contracts
22. Recession in country in which you are based
23. Significant increase in interest rates
24. Disruptive technology forces change in business model
25. Rising labour costs
26. Decline in recognition of intellectual property rights
27. Poor levels of education and skills
28. Bribery and corruption
29. Cyberterrorism
30. Difficulty affording pension obligations
31. Dramatic increase in chronic diseases (eg, cancer, heart disease, diabetes)
32. Power outage
33. Talent/skills shortages in IT
34. Decline in customer loyalty
35. Increased competition in home market
36. Exposure of confidential data
37. Disruption to business from viruses, spyware and malware
38. Systems failure/downtime of essential IT services
39. Decline in customer base
40. Fiscal crisis caused by demographic change
41. Rise in environmental protests
42. Major hurricane
43. Nationalisation of assets (eg, in South America/Russia)
44. Trade embargo
45. Earthquake
46. Lack of skills due to ageing population

Source:
Economist Intelligence Unit survey, 2008.

Source: Economist Intelligence Unit (EIU)

This is not just about trade, this is about world power...

China plays by a different set of rules – unfair competition and innovation stealing? **This is now a Cold War**



19th Party Congress shows
China rejecting US-centric world order

President Xi now leader for life?

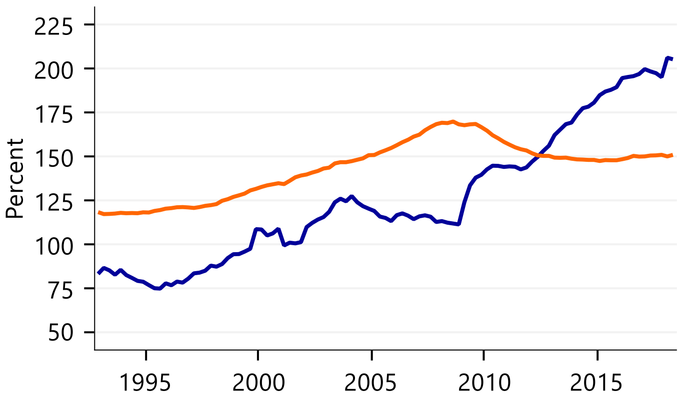
"The new world order cannot be just dominated by capitalism and the West, and the time will come for a change."

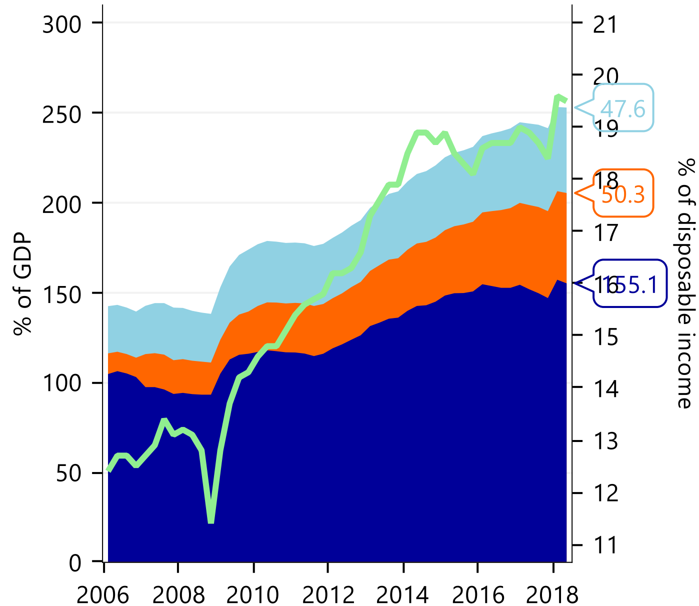
"By 2050 China is set to regain its might and re-ascend to the top of the world."

- China's Great Firewall – VPNs banned in 2018?
- Cyber-Security Law requires all data on Chinese citizens to be kept *only* within China
- WeChat app being officially recorded at all times
- China aiming for Social Credit System by 2020
- Monitor and rank actions of every citizen & legal person to generate "*official trustworthiness*" score
- Belief that big data and AI can make central-planning beat free markets

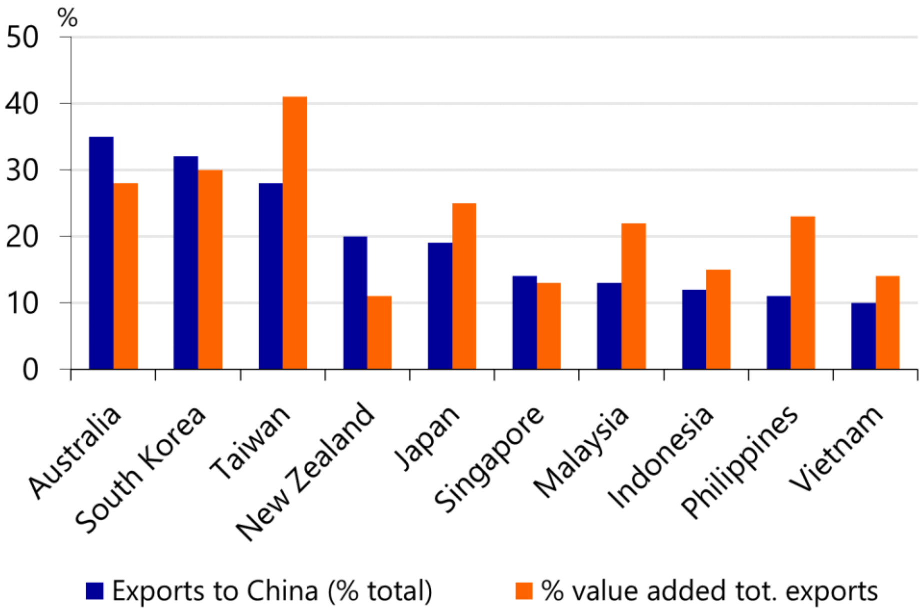
Debt, debt and more debt (Oh, and liquidity injections too)

China manipulates the exchange rate and tries to stop capital flight.
In Q4 exports to Hong Kong surged hinting at the ‘15/’16 dynamic of over invoicing to get money out of the mainland. There was a huge surge in precious stone imports into China too.





What about the rest of the world?



On balance, the (looming) effect on other countries depends on the type of country…

The geopolitical plates are moving

- Advanced economies who are important trading partners for China could be **negatively affected (Australia, NZ)**
- Countries who have a cheap labor advantage could **benefit (Vietnam, Indonesia, Mexico)**
- Some LatAm countries may see **export destinations shift (Brazil, Argentina)**

Despite all of this…volatility still remains relatively low as vol events prove short lived while policy is easy

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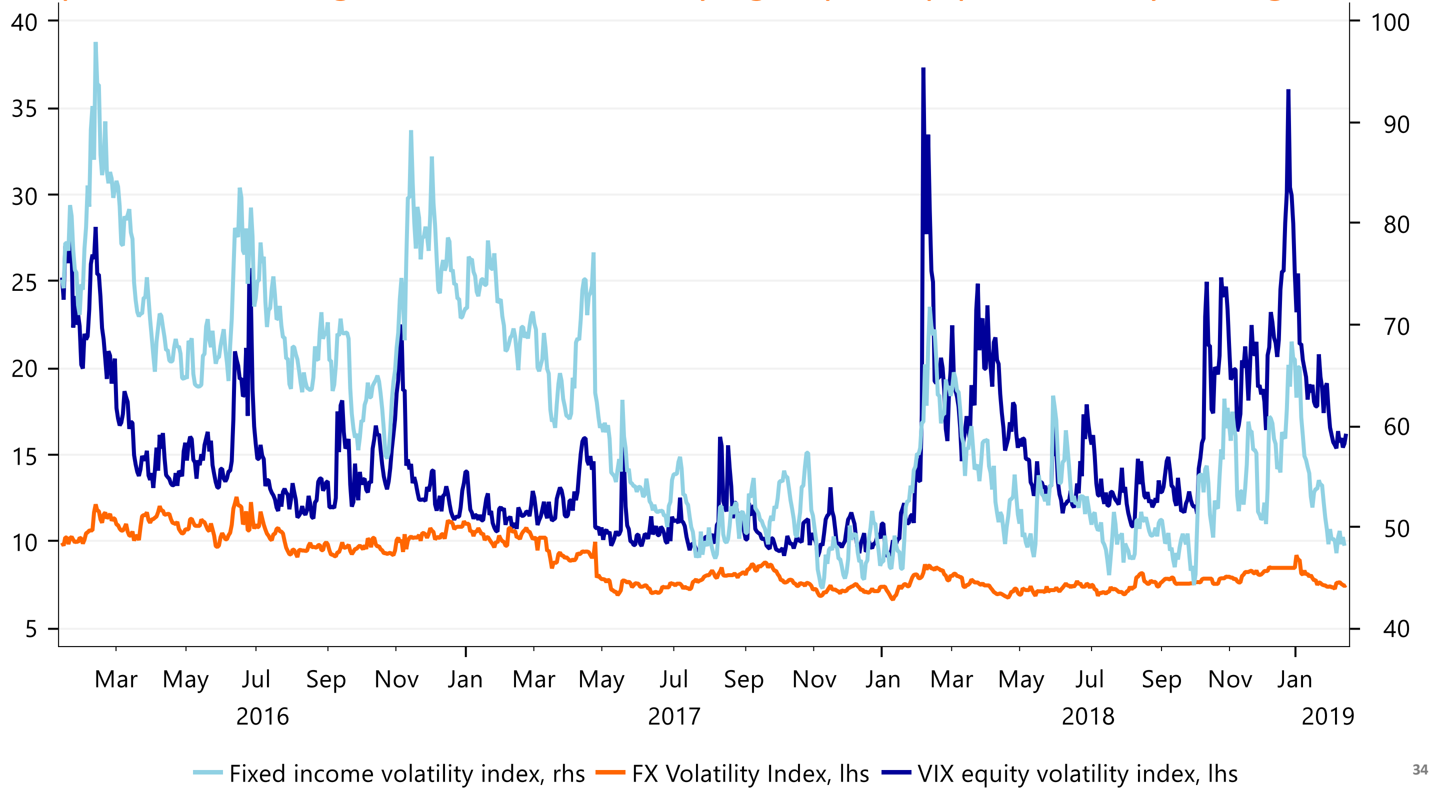
In addition, the market is structurally short vol due to the proliferation of passive investing, ETFs and traders trying to pick up premium by selling vol



Summary

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The US is still the cleanest shirt in the dirty laundry basket but will fall into recession next year – others will follow

Lack of wage growth means a lack of demand driven inflation and the continued rise of populism

Fed will not be able to raise rates further, it will halt the balance sheet unwind in H2 and start cutting rates in 2020

Debt continues to rise globally and this remains a key concern
China is key and USD/CNY is set to explode higher

Trade Wars are likely to get worse before they get better
This is not just about trade, this is a cold war with China

Less differentiation between EM and more “running to 1” in terms of correlations

Market volatility likely to remain sporadic but if the Fed doesn’t halt the balance sheet unwind it will pick up more structurally in H2

Important notice

Non Independent Research

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