REFLECTIONS ON THE GLOBAL MACRO ENVIRONMENT

Jeremy Schwartz – Global Chief Investment Officer
03/14/2017

On last week's podcast, I had the opportunity to interview Jared Dillian, author of the professional investing newsletter "The Daily Dirtnap" and a writer for Mauldin Economics, as well as Marc Chandler of Brown Brothers Harriman (BBH), a specialist on currencies.

First, before I get to the discussion with the two guests: We heard from our co-host, Professor Jeremy Siegel, who was surprised that U.S. Federal Reserve (Fed) Chair Janet Yellen was giving the all-clear that the Fed would raise interest rates ahead of March 10's key employment rate figure. He speculated that Yellen had received a preview that the data would be strong. The only worry on Professor Siegel's mind regarding the current market environment was a drop in oil prices last week.[1] If market participants worry that the Fed might be tightening too fast, he said it could show up in commodities and oil prices first, and weakness in oil this week was a troubling sign to him, if it were to continue.

We then covered a number of topics with Dillian, including:

1. Why he thinks the Fed is way behind the curve in hiking interest rates and is likely to do three to four hikes in 2017.
2. His case for being bullish on financials over the longer run—even after the big moves after Donald Trump's November 8, 2016, election victory.
3. Snapchat's initial public offering—that came with no voting rights—which to Dillian is like high-yield bonds with no covenants for protecting bond holders; he thinks that is a sign that technology stocks are a part of the market that he wants to be short.
4. His case for the Toronto real estate market being a bubble and why he is short both the Canadian dollar as well as the shares of Canadian banks.
5. Why he thinks Brexit will be positive for the United Kingdom over the longer run and he is surprised the pound has not risen.
6. Why he still likes the BRIC countries in emerging markets, even after strong gains last year.
7. A discussion of his first Bloomberg View article, where he defends hedge funds against plain index funds due to the hedge funds' lower volatility approach keeping investor emotions in check during bear markets by keeping people invested throughout drawdowns.

In this last conversation, Dillian is on to something, pointing out that investors tend to have a hard time sticking with the market and remaining invested as it enters bear market territory, and that having strategies to lower portfolio volatility can be very important. I argued that this highlights the need for more low-cost hedged vehicles as the typical fee arrangement in hedge funds; particularly fund of funds, which was the focus of his article, are particularly problematic. I am sure we will see more strategies come out in this alternatives arena.

With Chandler, we talked about the following:

1. His new book, *The Political Economy of Tomorrow*[2], and changing trends in social relationships between man and woman, employee and employer, and citizen and state. This follow-up to 2009's *Making Sense of the Dollar*[3] takes an in-depth look at why he thinks we are in a strong-dollar regime.
2. Why he believes President Trump's victory and the Brexit were not a victory for populist policies but just for these candidates adopting some of the populist agenda.
3. Chandler predicts no populist party victory in European government elections over the coming months; in determining movements in the euro, he would therefore be focused on Fed policy and President Trump's fiscal policies—and there we still have policy divergence, with the Fed hiking more than any anticipatory changes at the European Central Bank.
4. Chandler is still bullish on the U.S. dollar; he believes people are still skeptical whether the Fed would undertake more than two hikes this year, and he thinks the odds favor a more hawkish Fed as shown in what he believes the dot plot will look like when released after its March 15, 2017, meeting. He thinks the Fed has shifted its mindset and that the global economy is stable, so it wants to take opportunities to normalize.
5. How President Trump's influence will dominate the Federal Reserve Board of Governors with more than five vacancies to fill over the coming 12 months.
6. How Germany is being accused of currency manipulation due to the euro being undervalued—from 2002 to 2012 the euro was much more dramatically overvalued.[4] While valuations of currencies may have long-term tendencies to revert toward fair value, in the short run many other factors will have the potential to dominate.

Dillian and Chandler are both returning guests to "Behind the Markets," and we appreciate their discussion.

Listen to the entire "Behind the Markets" podcast series here.

[1]Source: Bloomberg; refers to the price per barrel of West Texas Intermediate oil during the week of March 3–10, 2017.

[2]Marc Chandler, Political Economy of Tomorrow, Terra K. Partners, February 2017.

[3]Follow up book to: Marc Chandler, Making Sense of the Dollar: Exposing Dangerous Myths about Trade and Foreign Exchange, Bloomberg Press, August 2009.

[4]Undervaluation or overvaluation of the euro is measured on the basis of purchasing power parity, as calculated by the Organisation for Economic Co-operation and Development (OECD).

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DEFINITIONS

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Interest rates : The rate at which interest is paid by a borrower for the use of money.

Bullish : a position that benefits when asset prices rise.

Initial public offering (IPO) : The first sale of stock by a private company to the public.

High-yield Bonds : A high yield bond is a debt security issued by a corporation with a lower than investment grade rating. It is a major component of the leveraged finance market.

Covenants : Agreements within financial securities that specify certain obligations that need to be met at distinct points in time.

Short (or Short Position) : The sale of a borrowed security, commodity or currency with the expectation that the asset will fall in value, the opposite of Long (or Long Position).

Bubble : when market participants drive stock prices above their “fair value” in relation to some system of stock valuation.

Brexit : an abbreviation of “British exit” that mirrors the term Grexit. It refers to the possibility that Britain will withdraw from the European Unio.

BRIC : An acronym for Brazil, Russia, India and China.

Hedge fund : A hedge fund resembles a pooled investment vehicle administered by a professional management firm. It is often structured as a limited partnership or limited liability company. Hedge funds invest in a diverse range of markets and use a wide variety of investment styles and financial instruments.

Volatility : A measure of the dispersion of actual returns around a particular average level. .

Bear market : A sustained downturn in market prices, increasing the chances of negative portfolio returns.

Drawdowns : Periods of sustained negative trends of return.

Fund of funds : Funds that, instead of investing in individual securities, invest their assets in mixes of other fund.

Fiscal Policy : Government spending policies that influence macroeconomic conditions. These policies affect tax rates, interest rates and government spending, in an effort to control the economy.

Hawkish : Description used when worries about inflation are the primary concerns in setting monetary policy decisions.

Dot Plot : a chart based on the economic projections of the Federal Reserve board members that illustrates their views on the appropriate pace of policy firming and provides a target range or target level for the federal funds rat.

Fair value : Also known as “eNAV.” It is essentially an indicative value (IV) that is made in real time by calculating the basket value on every underlying tick and by adjustments that account for updated market new.