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ASSET MANAGEMENT

"By the Way"
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"Global Decoupling" is the latest overused jargon favored by pundits to describe the current world economic environment. It is meant to imply that rather than all the global economies rising or falling in concert, as was the case in 2008-2009, we are now at a stage where there are in fact meaningful disparities. The nature of the investment industry is to attempt to take complex issues and boil them down to simple concepts that can be more easily dealt with and understood. Fortunately, for once anyway, these buzzwords provide quite an accurate depiction of reality. Today, of the world's largest economies, the U.S. pretty much stands alone as a source of strength, while China, Japan and the countries of the Eurozone are in various stages of slowdown and even recession. One simple explanation (which we have expressed before) is that as the U.S. is a very consumer oriented economy, it benefits from low interest rates and low inflation much more so than the other economies which rely more on external trade. Whatever! While momentum ebbs and flows, the U.S. continues to show solid growth (3rd quarter real GDP revised to a 3.9% annual rate) and remains the investment environment of choice. Decoupling has also occurred amongst the policies of the central banks of those various economies. The U.S. has not yet started to tighten, but the rate of easing has certainly been reduced. On the other hand, Japan is going all in, vowing to do whatever it takes to avoid deflation and raise its GDP growth rate. Europe continues to threaten that more stimulus is on the way, and China surprised everyone last week by lowering policy rates. The old quote "don't fight the Fed" has become "don't fight the Fed, the Bank of Japan, the European Central Bank, the Peoples Bank of China, etc." The good news is more liquidity remains the investor's friend.

There are two ways to read the PBOC's lowering of rates. First, that China has successfully transitioned from an investment and trade dependent economy growing at double digit rates to a more consumer-centric economy growing at 7 – 7½%, and now requires a slight tweak to stay in that range. Alternatively, things may be much worse than we thought requiring a strong policy response, and this is only the first of many moves that will be needed to shore up the economy. There is also a third theory that this is an effort to lower the value of the yuan to compete with the rapidly declining yen. We do not need currency or trade wars, they remind one of the 1930's. Analysis is clouded by the fact that one is suspicious of the accuracy of reports from the Chinese National Bureau of Statistics. On that topic, it is bewildering that the International Monetary Fund growth formula (which is based on job creation), recently estimated the Chinese economy grew at 2.2% in 2013, versus the official report from Beijing of 7.7%. Such a large discrepancy is impossible to reconcile, but emphasizes the point that we really don't know. What we do know, is China is no longer the engine driving global growth and commodity prices, which is not a huge negative as long as the current economic climate does not worsen significantly.

Japan is technically in recession again. As mentioned above, Prime Minister Abe is fully committed to stimulating the economy, but so far has not been terribly successful. He has called a snap election to establish a consensus to continue such policies. The stock market is up; the yen is down; as one would expect given those strategies. As proof of Japanese corporations' dependence on export trade, a recent study pointed out that despite the Japanese domestic economy having had negative 0.17% growth over the last 20 years, the TOPIX (Tokyo Stock Price Index) showed EPS growth of 8.65% per year over the same period.

It doesn't take much for European economic news to be considered positive. On November 14th it was reported 3rd quarter GDP for the Euro Zone was up 0.2% and Germany narrowly avoided falling into recession. The news was greeted as better than expected and elicited a sigh of relief. We are not that impressed, and the risk of a "triple dip" recession is still very real, looking into 2015, with domestic demand weak and reduced exports likely given the weakness in Russia and China. In addition, inflation came in at 0.4%, much lower than the 2% target, thus deflation fears remain. More monetary easing by the Central Bank seems to be in order. Germany has been a major obstacle to such a policy; now that its economy is suffering, perhaps a more aggressive strategy will be implemented.

The bull market continues, and as Strategas Research tells us, the S&P 500 has not declined in the 12 months following a midterm election since 1946. We live in unique times, which I believe call for extra vigilance. In my mind Mohammed El-Erian at Allianz, (ex of PIMCO) put it best: "You need to have a responsive mindset and you need the ability to course-correct because this is a very unpredictable world".

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