



# LXV Research: Chart Pack

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# Europe: The old economy needs fiscal stimulus



The fortunes of the European equity markets have been closely tied to the state of global industrial complex.

There are far fewer 'new economy' companies in the European markets.

No wonder then that Christian Lagarde, president-elect, of the ECB is calling upon European governments to cooperate more closely over fiscal policy.

# Europe: A high CA surplus => very little spending



Record low, even negative, interest rates have not stimulated spending.

Rather spending, and by extension appetite for credit, has slowly been eroded.

Europe has little choice but do undertake fiscal stimulus to revive demand.

# Europe: Trade balance with the UK



The sharp drop in the GBPEUR cross has not improved the UK's trade balance with Europe.

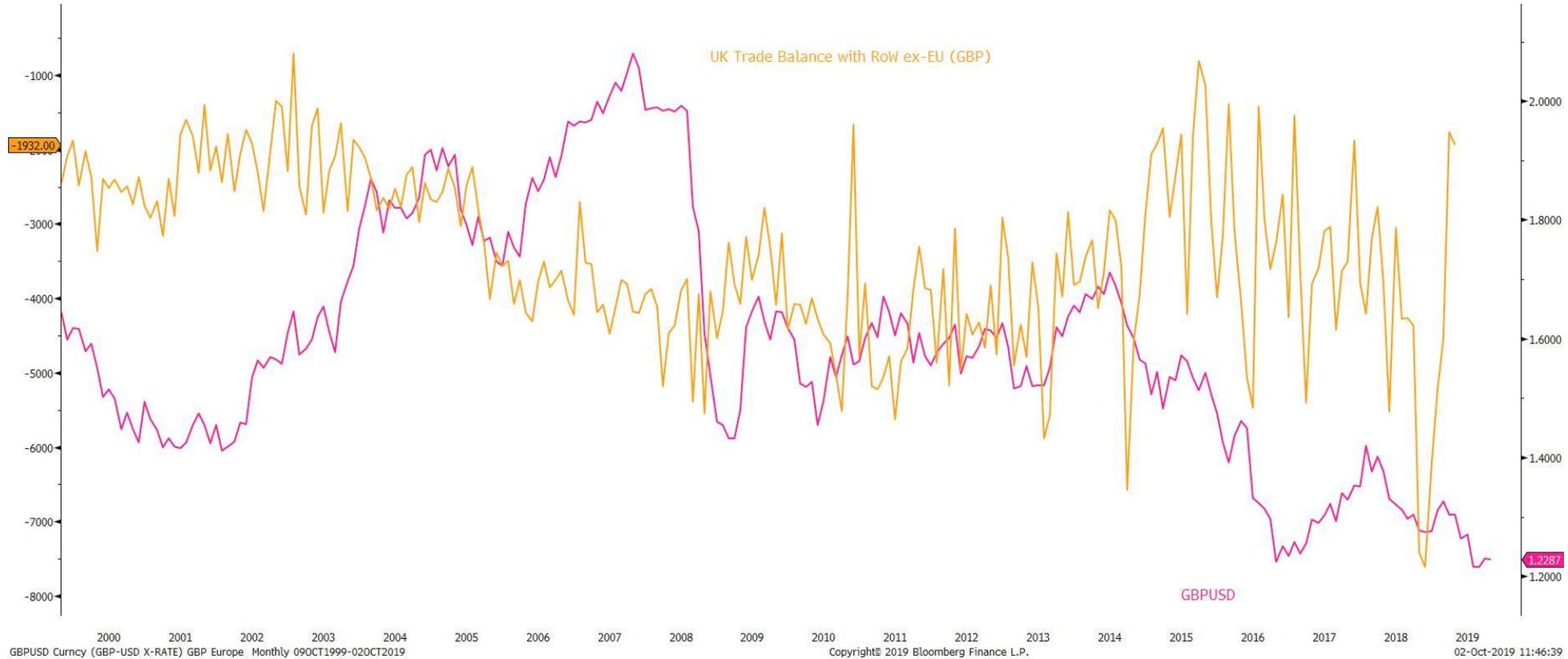
Rather, the trade balance has remained steady in GBP terms. Suggesting that the ease of doing business with the Eurozone has continued to facilitate trade between the UK and Europe.

**At the same time, it suggests that there is a chronic lack of demand emanating from Europe.**

Brexit is likely to be worse for Europe than for the UK.

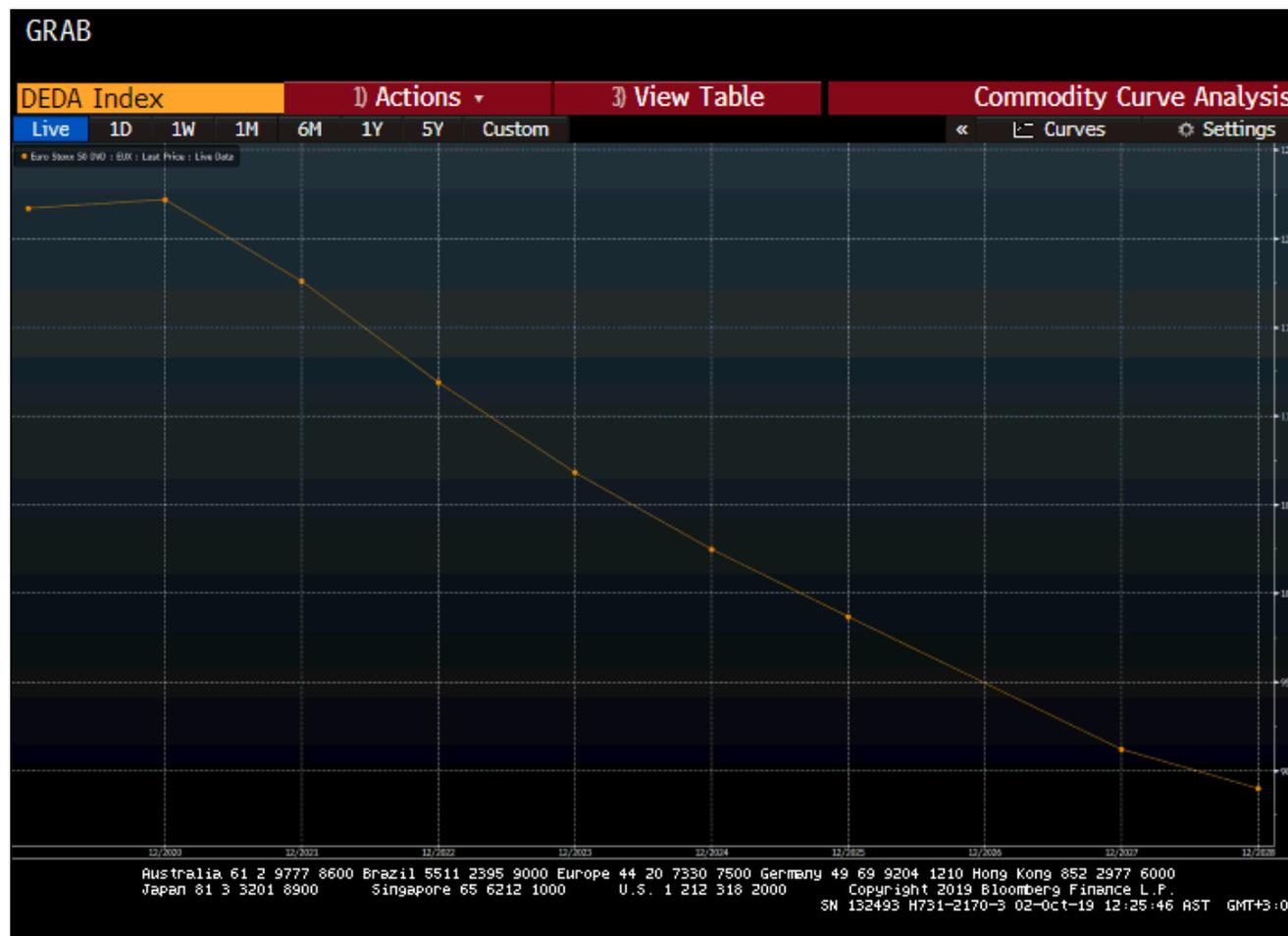
A strengthening of GBP would support European exports.

# UK: Trade balance with the RoW



In contrast, a weakening of the GBPUSD cross has coincided with an improving trade balance for the UK with the rest of the world.

# European dividend index futures (1/3)

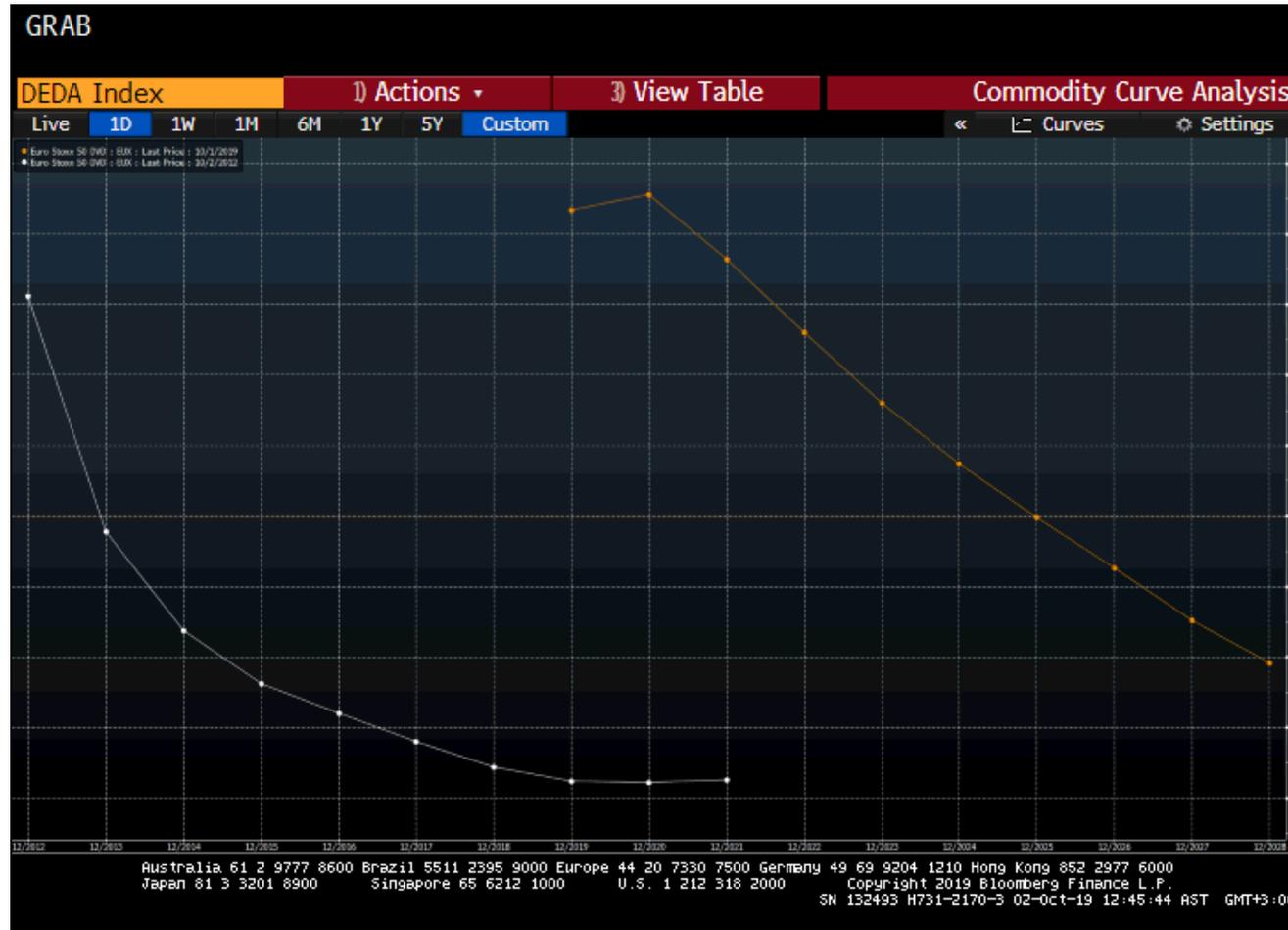


Markets are pricing in a deflationary bust in European stock dividends.

Some of this is due to a technicality... the presence of price insensitive sellers in the form of structured product hedging flows.

Nonetheless, this creates an opportunity for patient capital.

# European dividend index futures (2/3)

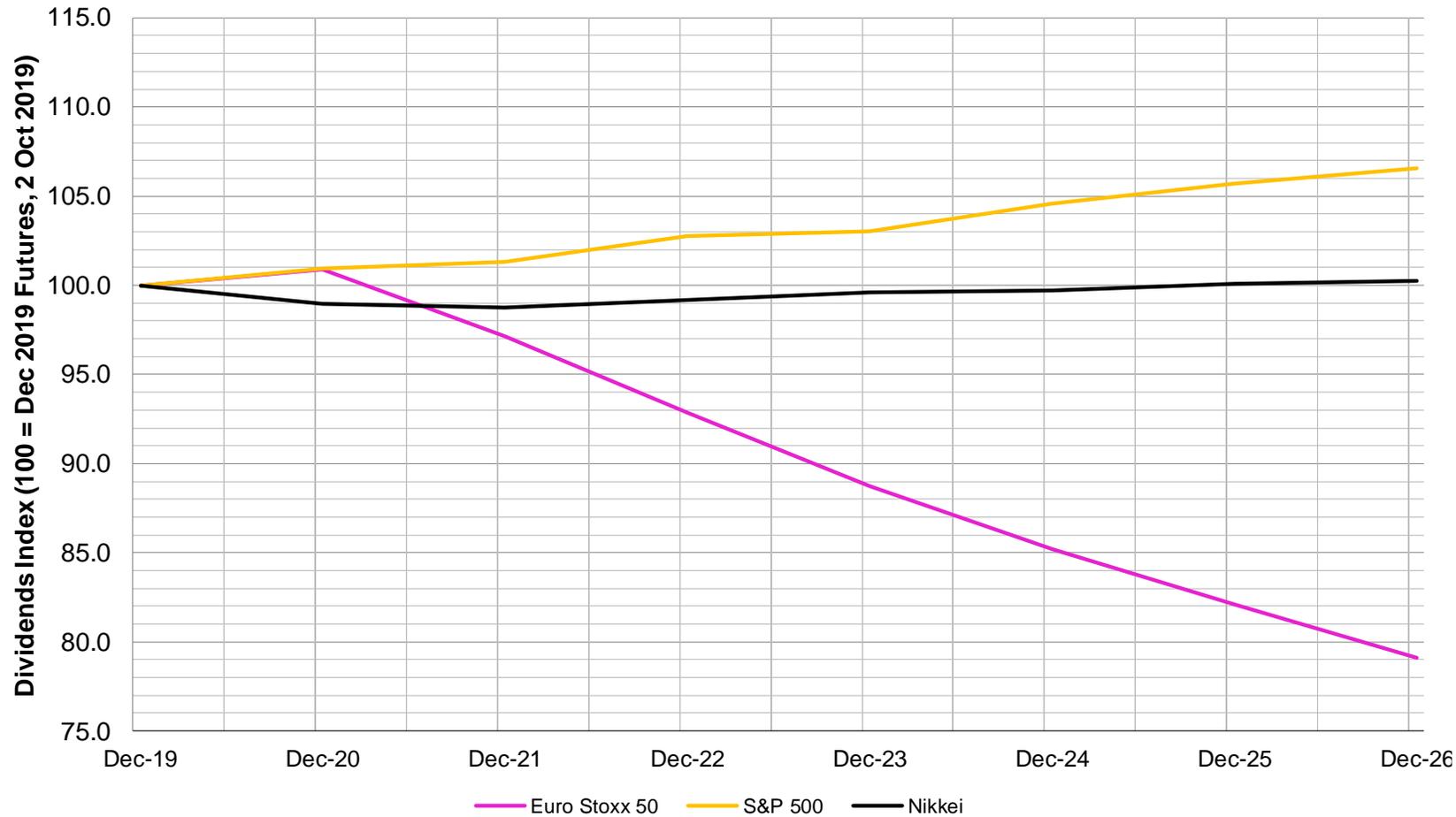


The pricing of long-dated European dividend futures today is comparable to that at the height of the European sovereign debt crisis.

**If you had bought December-2019 dividend index futures in December-2012, the realised return would have been 6% annualised on a fully funded basis.**

The primary risk is of managing margin calls in the short-term.

# European dividend index futures (3/3)

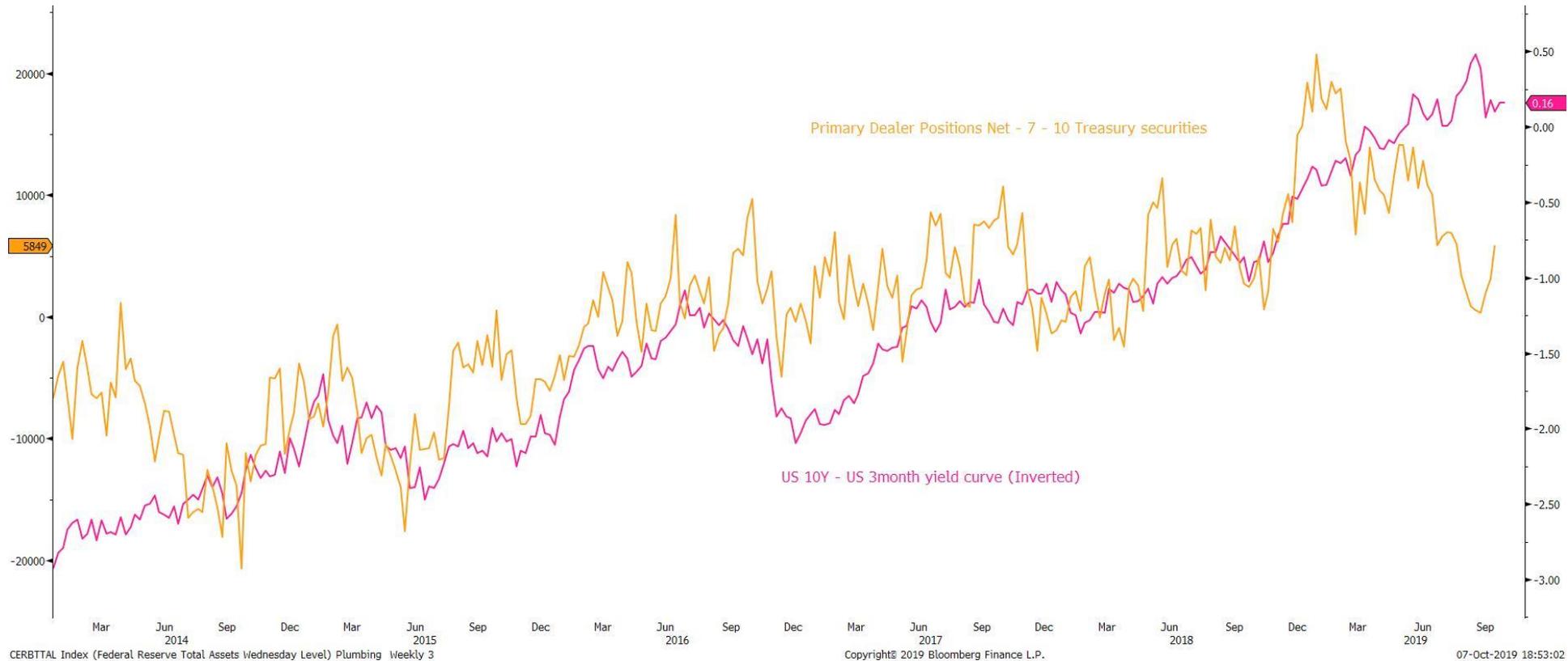


European dividend futures are an anomaly when compared to US and Japanese markets.

Notable risks in Europe are of (1) tax reform leading to an increase in buybacks and lower dividend pay outs and (2) tech / high growth companies, which typically do not pay out dividends, joining the benchmark.

Irrespective, a 20%+ drop in dividends by 2026 from current levels suggests that the risks are more than priced in.

# US: Recent drop in long-term yields was different



The chart is of the US yield curve (inverted) versus the net positioning of primary dealers in long-dated Treasury securities.

As the yield curve flattened and inverted, real money was stepping away from participating at the long-end of the bond market. The shortfall had to be made up by primary dealers.

**The recent rally in long-dated bonds, however, coincided with a reduction in primary dealer inventories. Suggesting that recession fears drove real money – retail or pension funds / insurance – back into long-dated bonds.**

# USD: Long-term funding pressures have eased



1 Year

5 Year



Suggesting that foreign investors sold into the recent bond rally and released dollar liquidity.

# And showing signs of easing in o/n funding markets

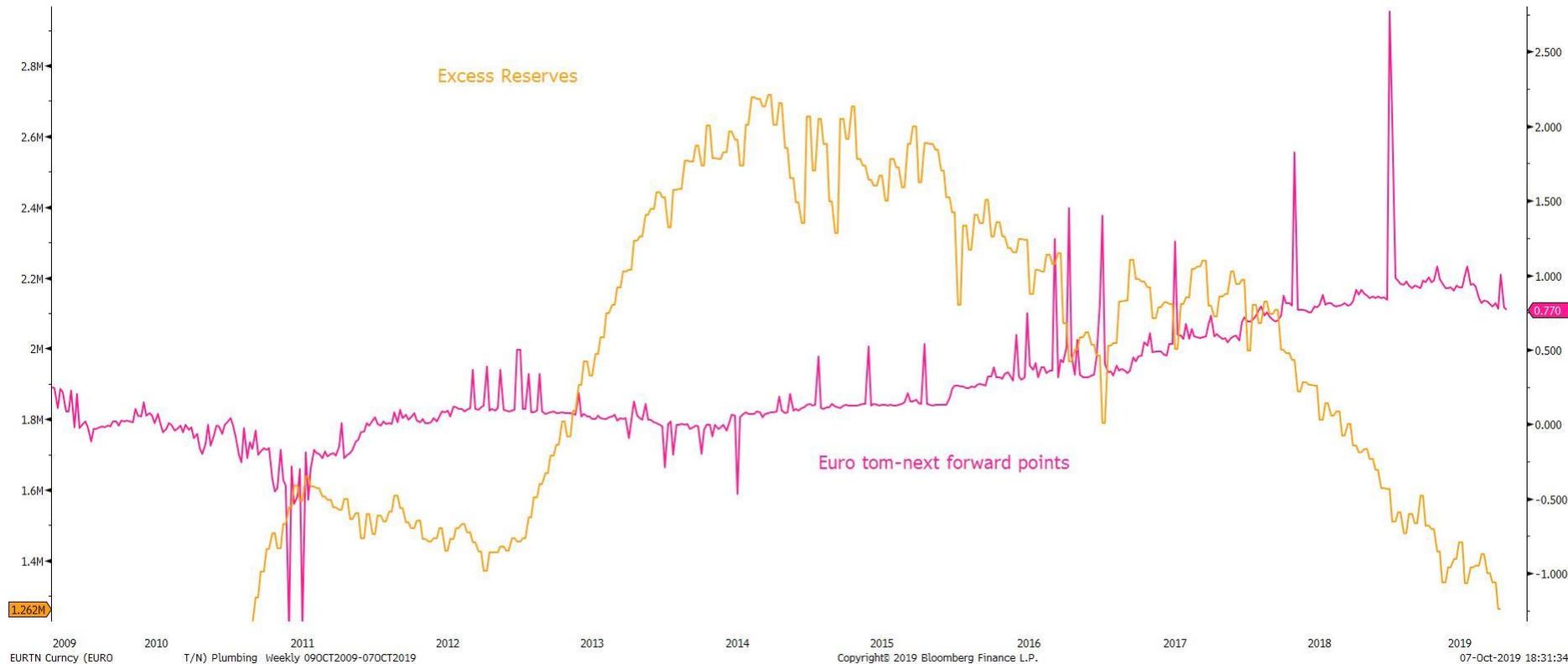


3 September 2019

The chart is of the year-over-year change in the OECD Leading Indicator Index for major economies versus the yield on the US 10-year Treasury bonds lagged by 3 months.

The leading indicators index tends to lead long-term yields by, approximately, three months.

In 2018, long-term yields over shot to the upside based on the leading indicators index. **Today, the index is signalling that yields are too low and on a cyclical basis economic activity in the major economies has bottomed and is turning up.**



# US: Possibly eased by flows into MM and prime funds





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