ALPINEMACRO
A Unique Mind On The Markets

October 17th, 2018

"The Boom and How It Will End: Are the Risks Bigger Than We Think?"

David Asher, Vital Financial

Moderated by **David Abramson**

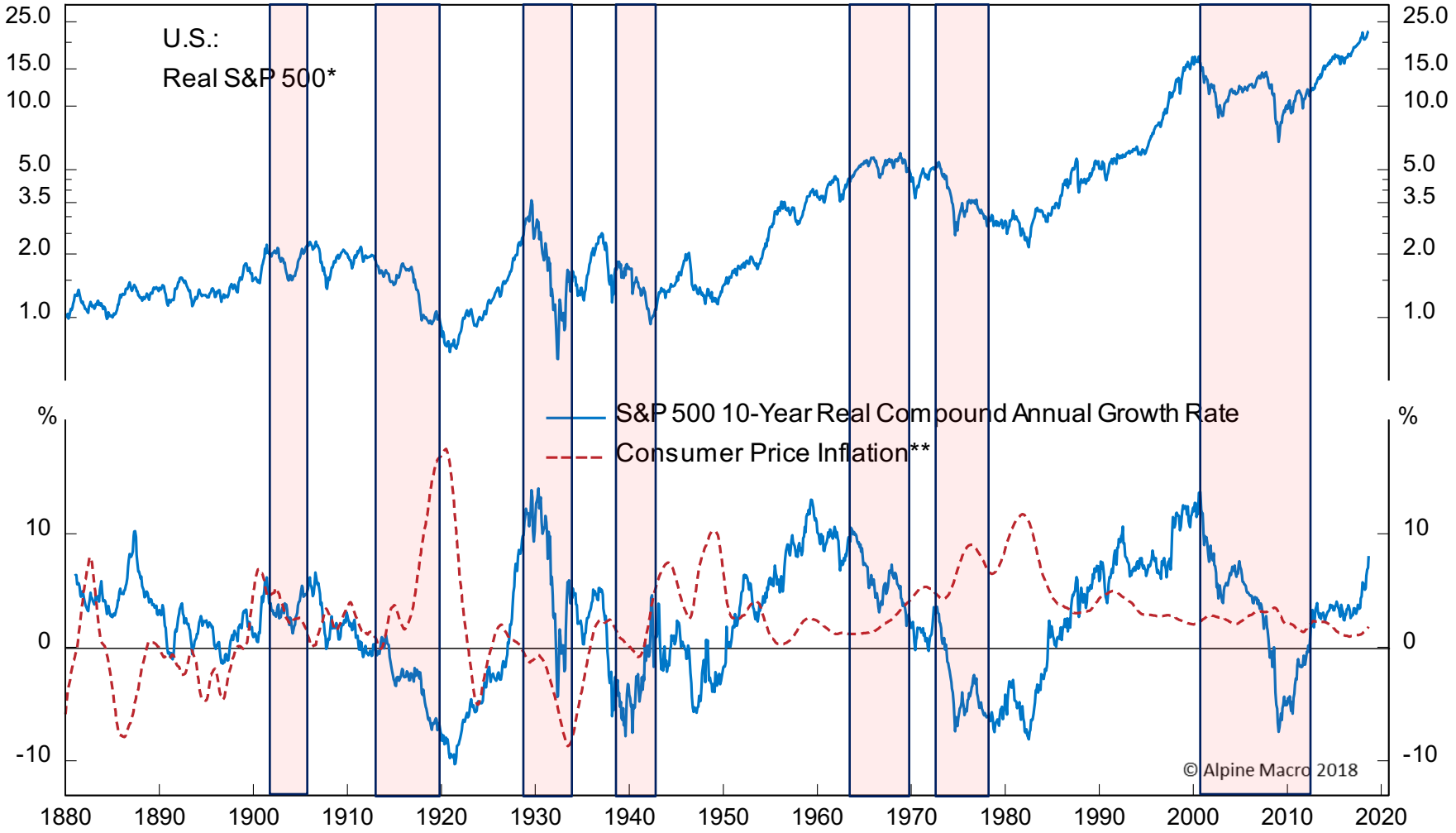
Senior Strategist, Alpine Macro

NYC Investment Conference | University Club |New York City, NY

Why be Worried about the Long Cycle Continuing?

- The pre-WW I breakdown in the long cycle and international economic and political convergence seems to be repeating itself. There are equal echoes of the late 1920s rising rates, protectionism, isolationism, nationalism, and indifference to preserving the global order. These all are risk factors that end long cycles, typically.
- How much longer can the longest growth cycle in US history continue? Can/Will this time be different?...
- EM is particularly worrisome. There is only a shallow risk premium on growing China slowdown, trade war, and US interest rate risk, while US$ denominated debt continues to go skyward (especially ex-China).
- Biggest economic risks are geo-political: The US Iran oil sanctions could blow out the supply-demand balance in oil markets and trigger a recessionary oil shock in 2H next year….
- China is on course toward a “militarized hegemony” in Asia, while Iran, Russia, and Turkey are collectively making a coordinated power grab in the “Muddle East.” These grabs could end badly.
- Prospective peace with North Korea is a largely illusory construct and actually could eventually lead to conflict. The Norks will not give up their nukes….

Significant Inflation and Deflation are Long Cycle Killers – Typically they are Triggered by Protectionism and War



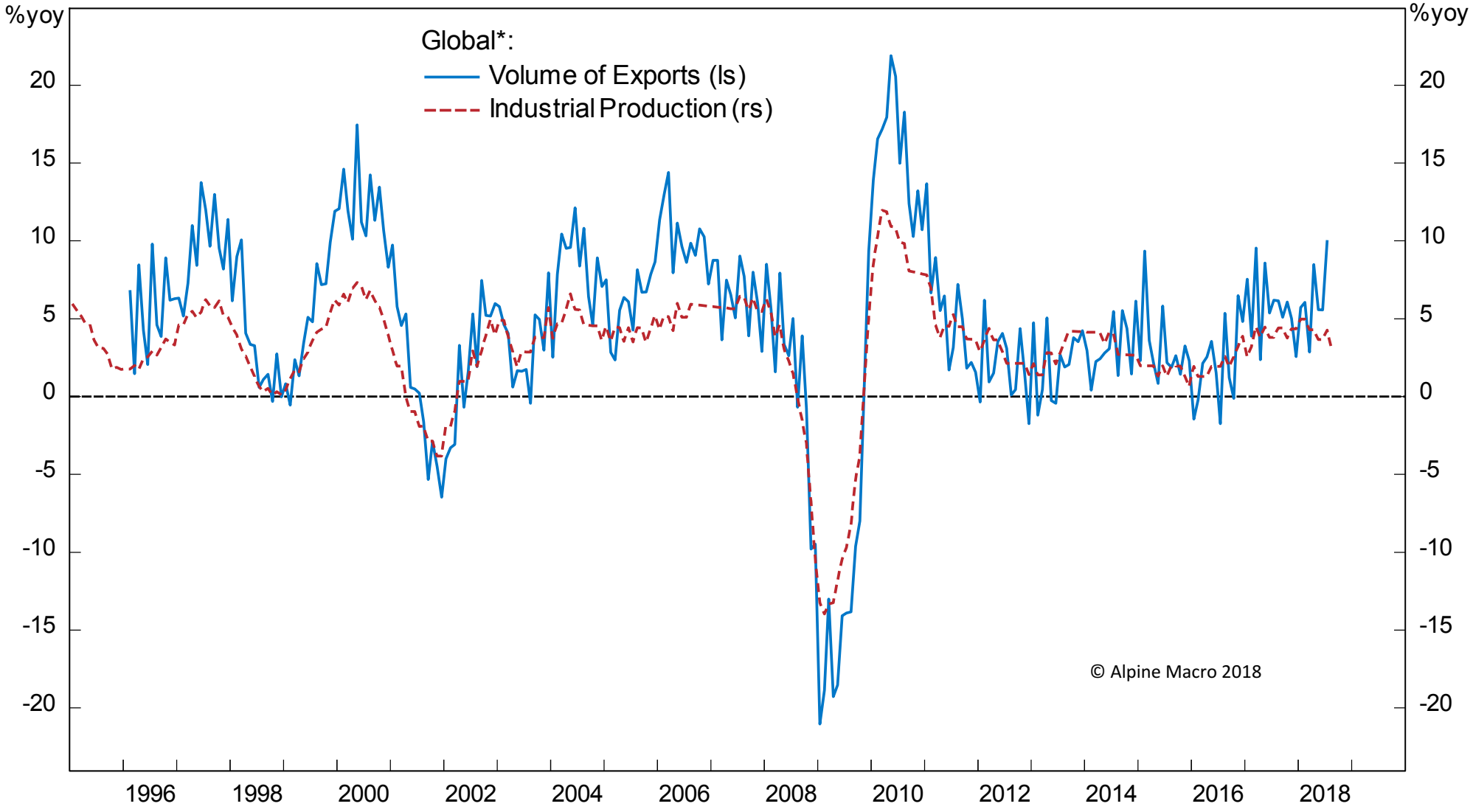
*Deflated by CPI index and rebased to January 1880=1

**Shown as 3-year moving average

Periods of War or Protectionism

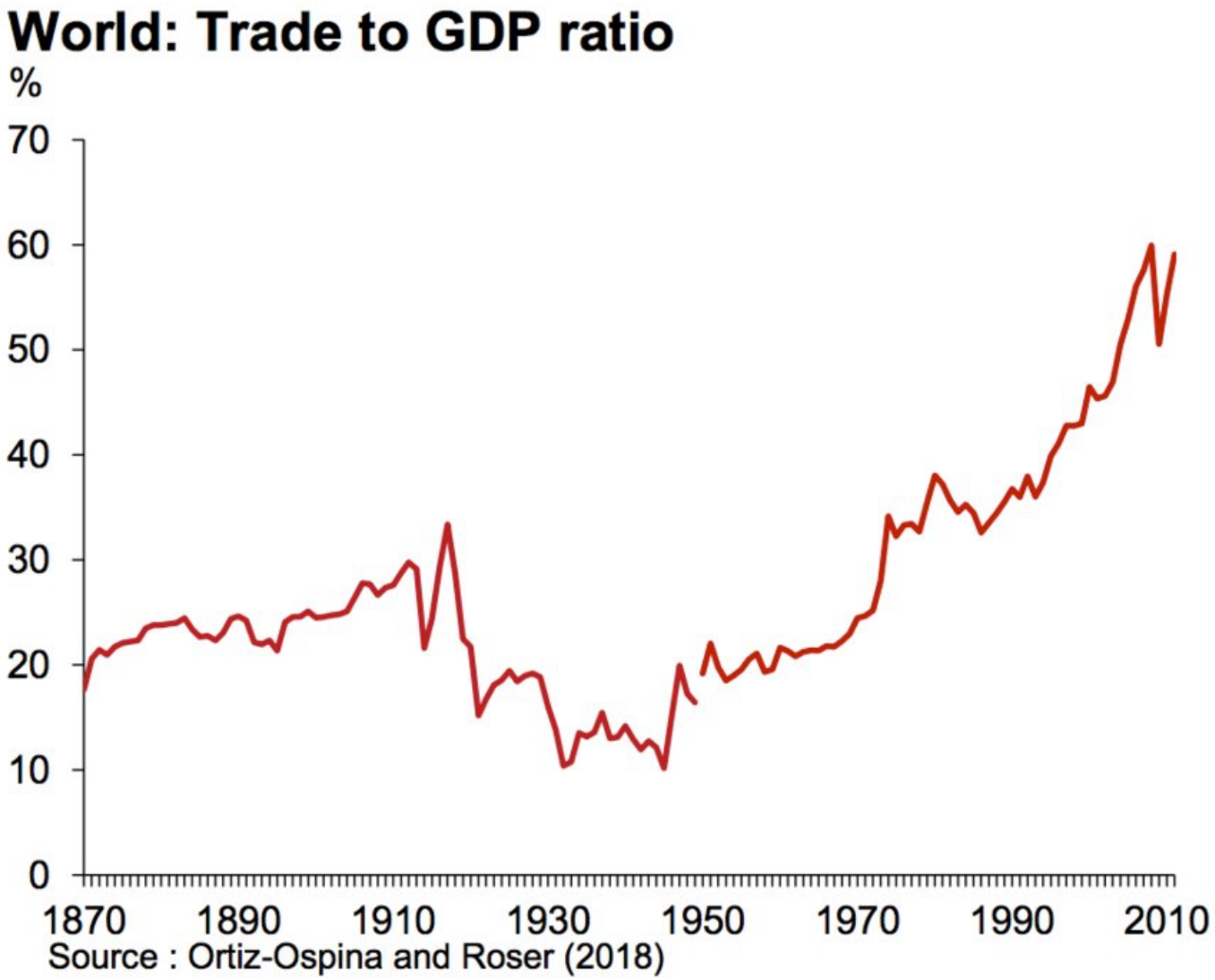
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Global Trade Recovering, Just in Time for Protectionist Wave….

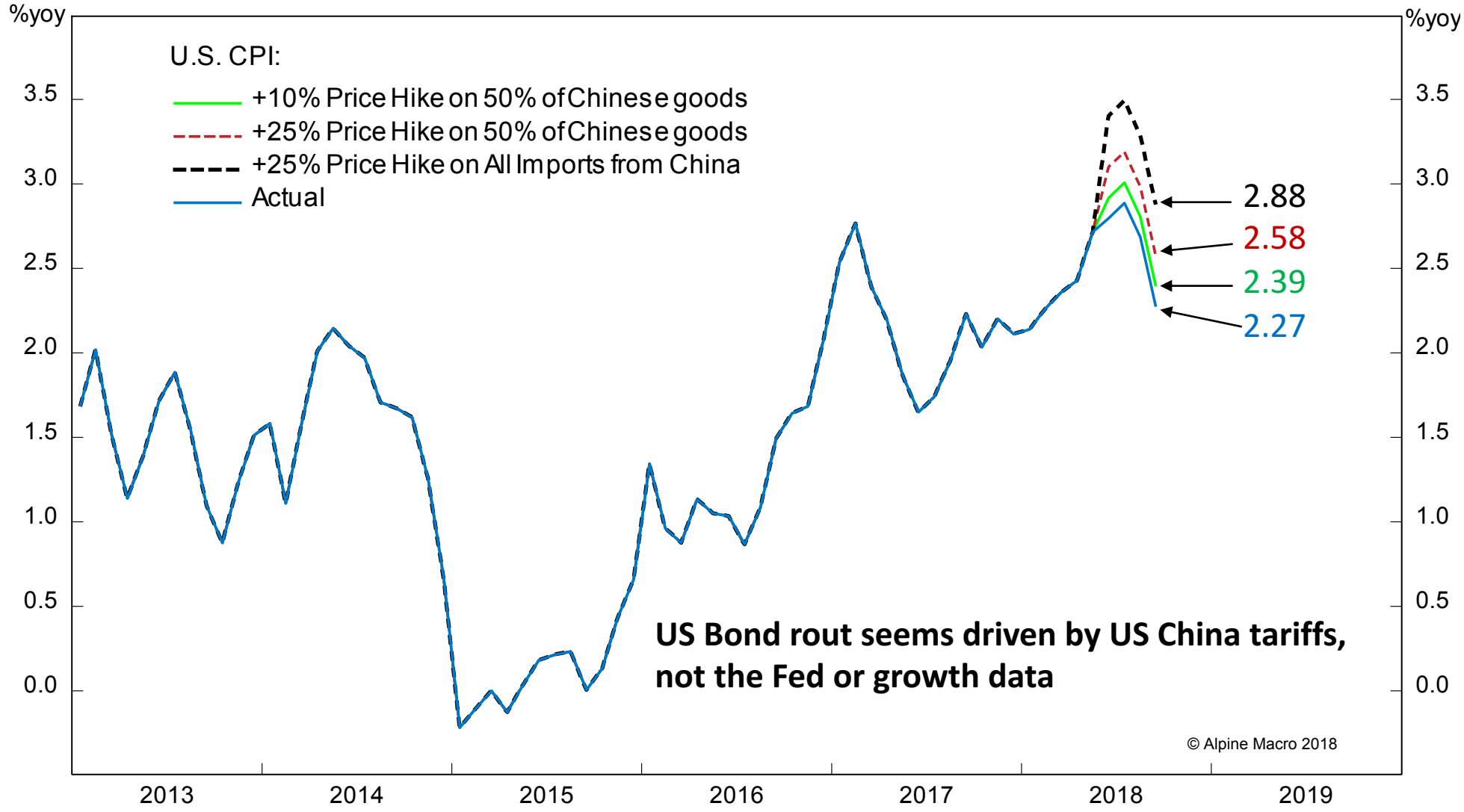


*Source: World Bank Global Economic Monitor

It Took Decades for Trade to Recover after the First World War

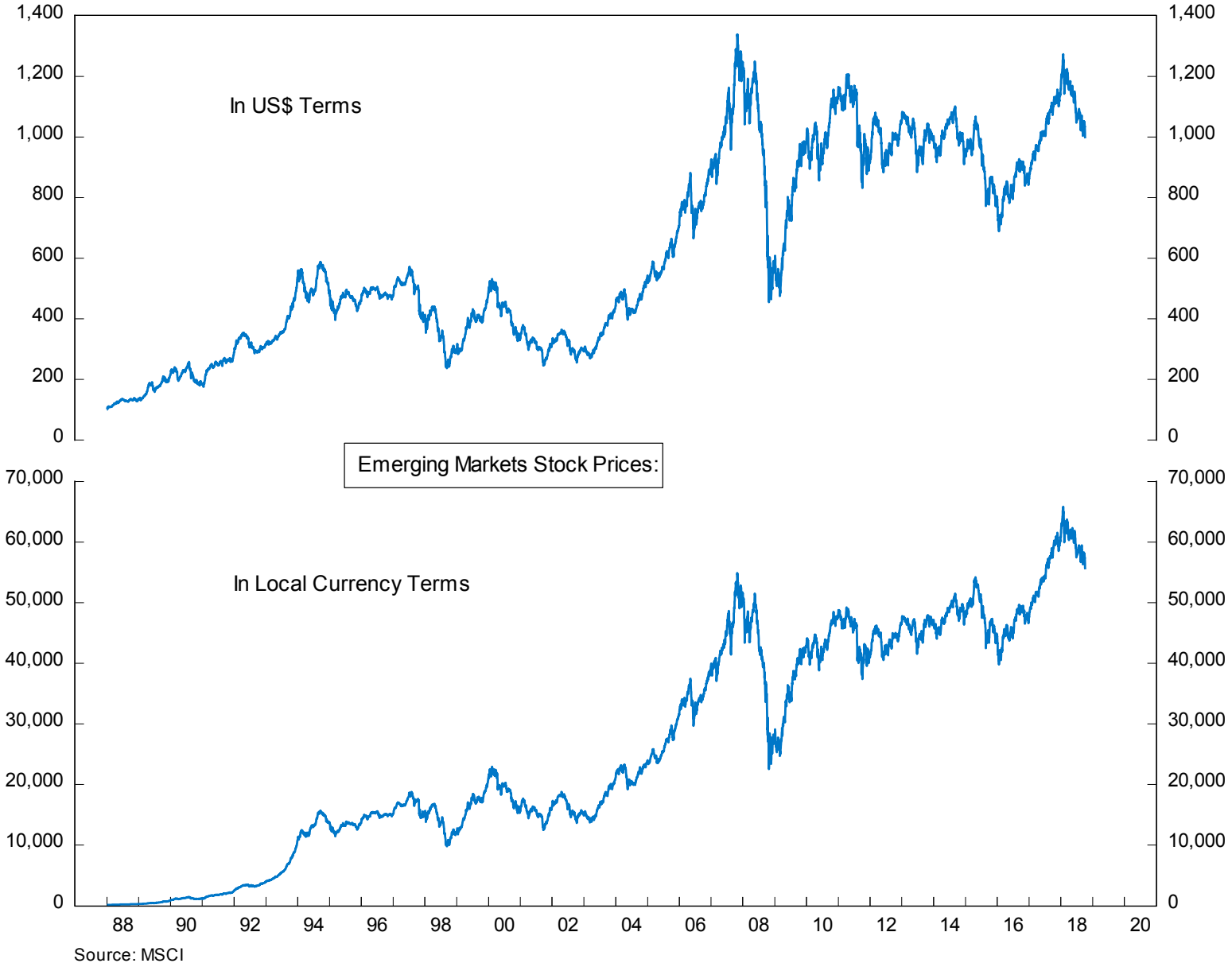


U.S. CPI: Gauging the Potential Inflation Impact of Tariffs on China

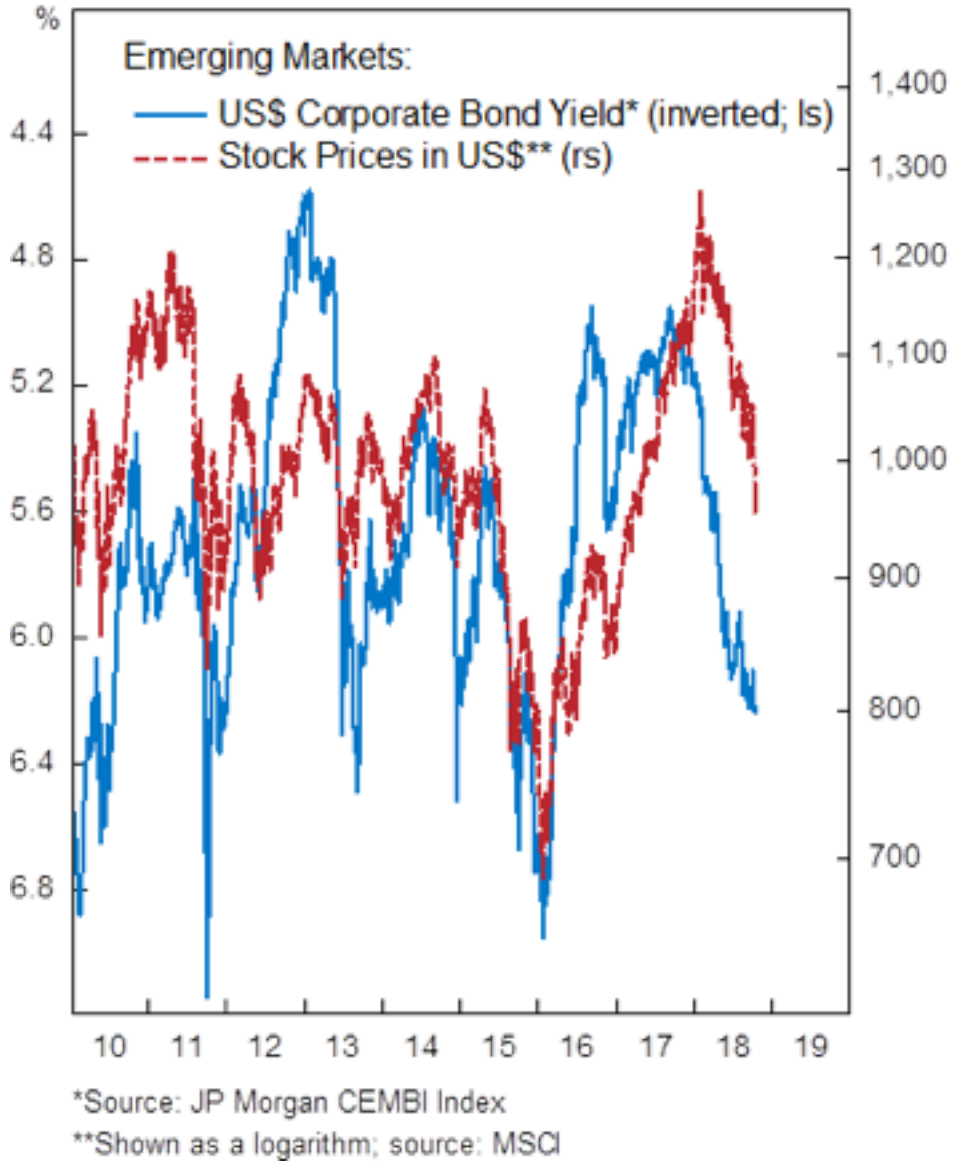


Note: alll simulations assume price hikes as of June 2018

EM Remains Especially Vulnerable to Rising US Rates and Protectionism



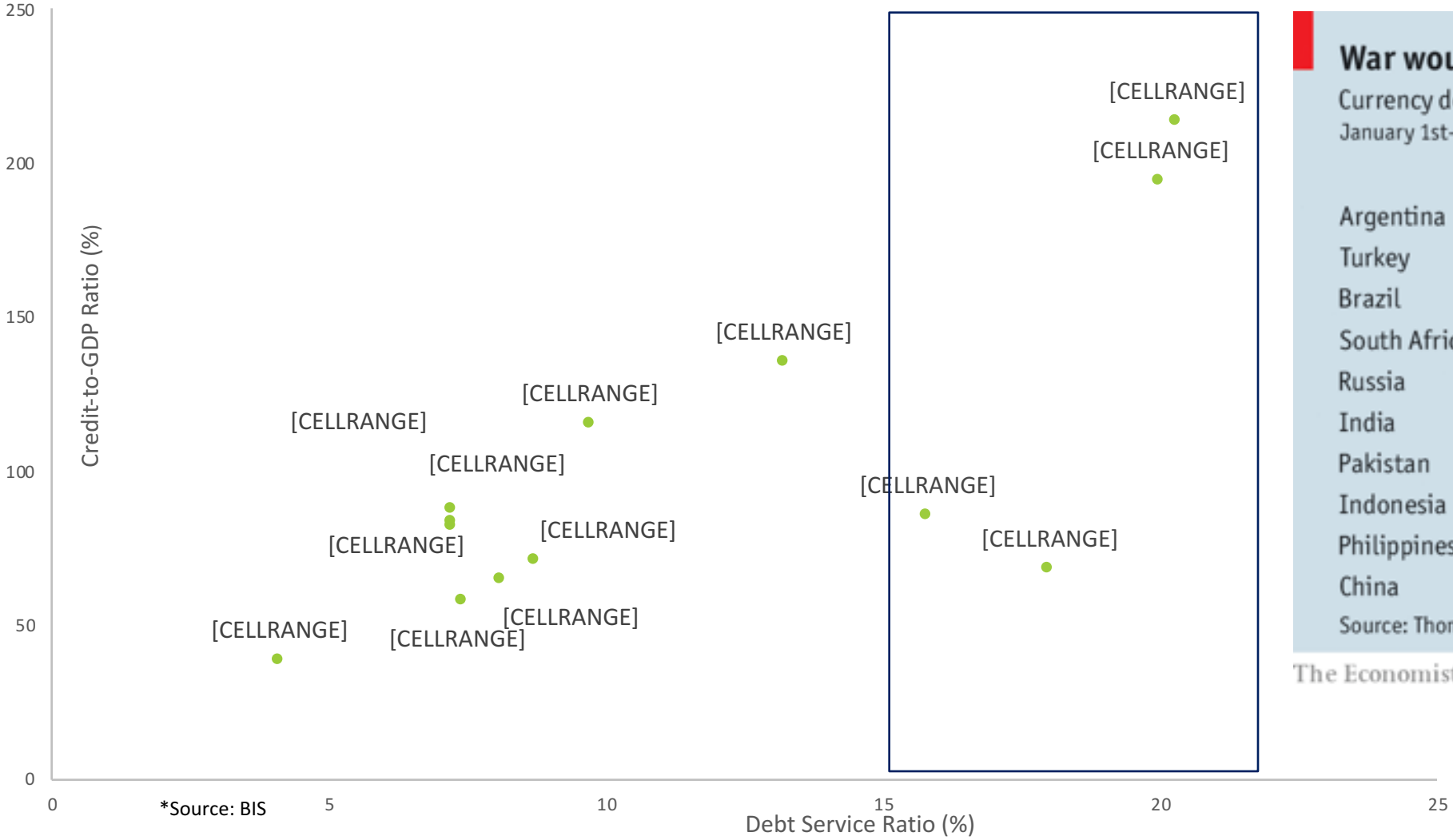
Source: MSCI



*Source: JP Morgan CEMBI Index
**Shown as a logarithm; source: MSCI

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Emerging Markets Non-Financial Private Sector Debt Ratios



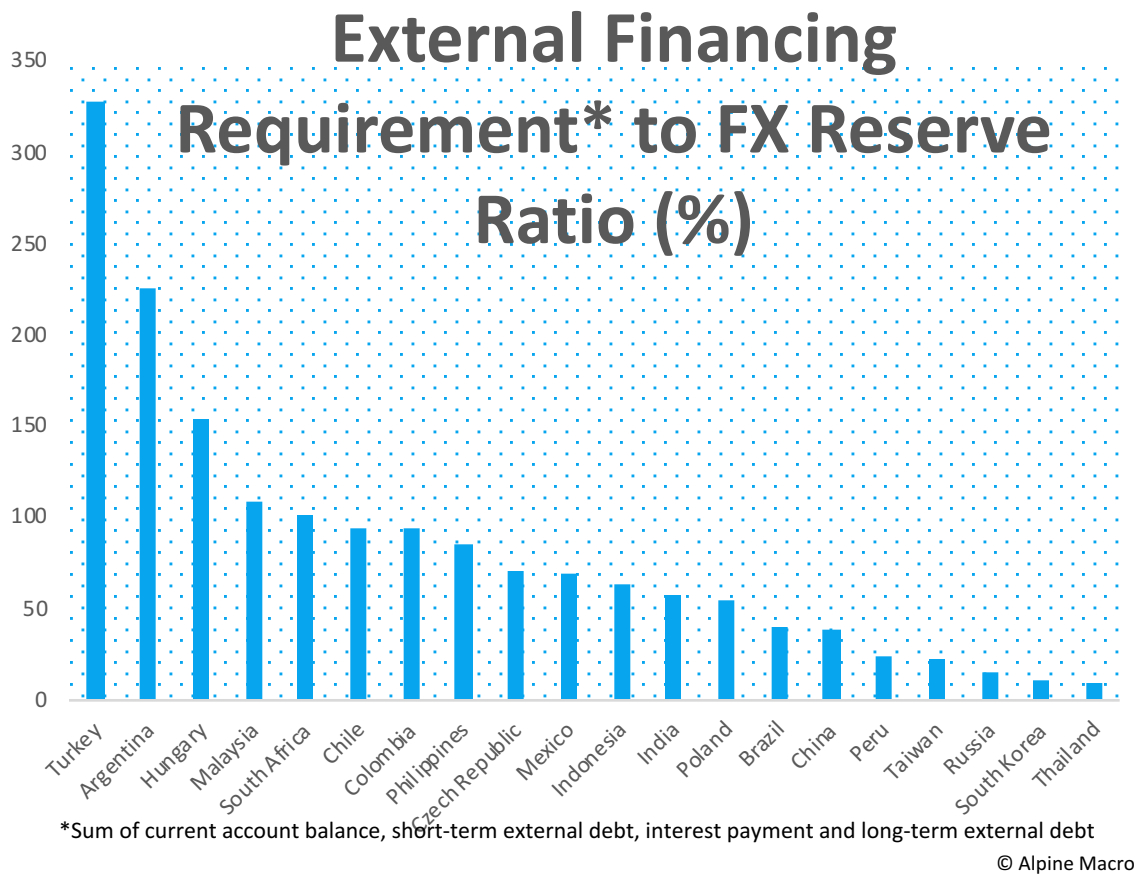
*Source: BIS



The Economist

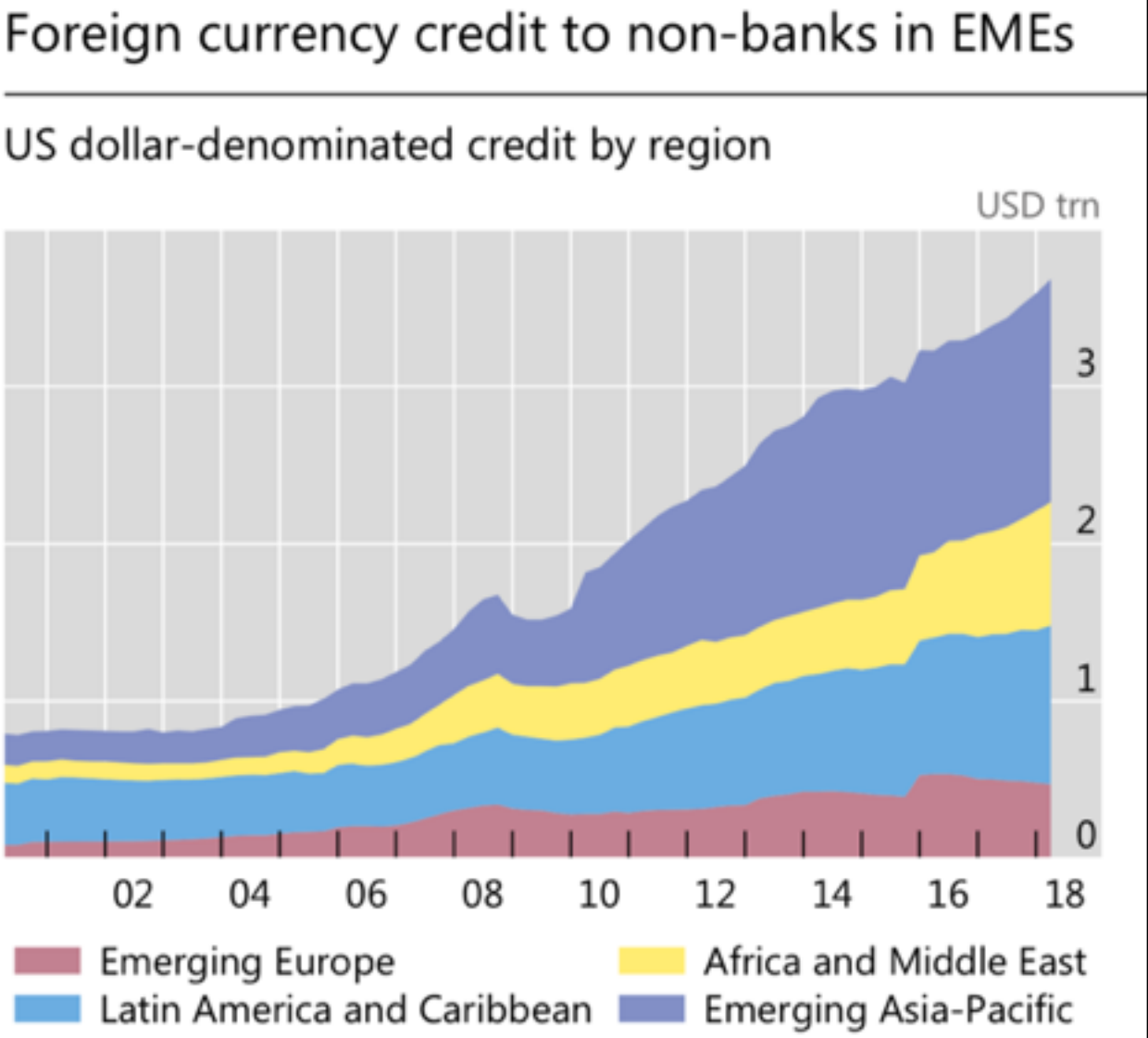
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EM US$ Debt Bubble could Burst…



*Sum of current account balance, short-term external debt, interest payment and long-term external debt

© Alpine Macro



Source: BIS

Treasury Secretary Mnuchin: I won't be 'losing any sleep' if China dumps US bonds in retaliation over trade

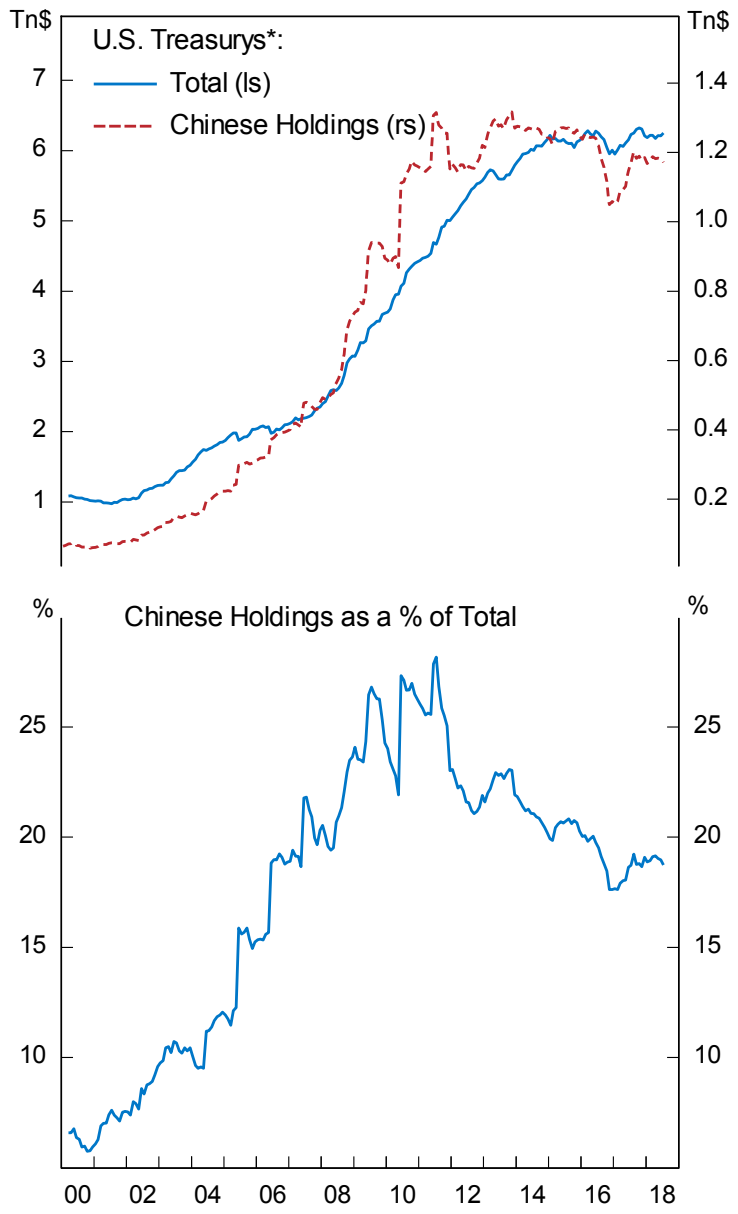
- Treasury Secretary Steven Mnuchin says he isn't worried about China selling U.S. Treasurys in retaliation over trade.
- "If they decide they don't want to hold them, there are other buyers," he says.
- Some have speculated that China could hit back at U.S. tariffs by selling a huge chunk of the more than $1 trillion of U.S. Treasury bonds it holds.

Berkeley Lovelace Jr. | @BerkeleyJr

Published 7:18 AM ET Fri, 12 Oct 2018 | Updated 2:39 PM ET Fri, 12 Oct 2018

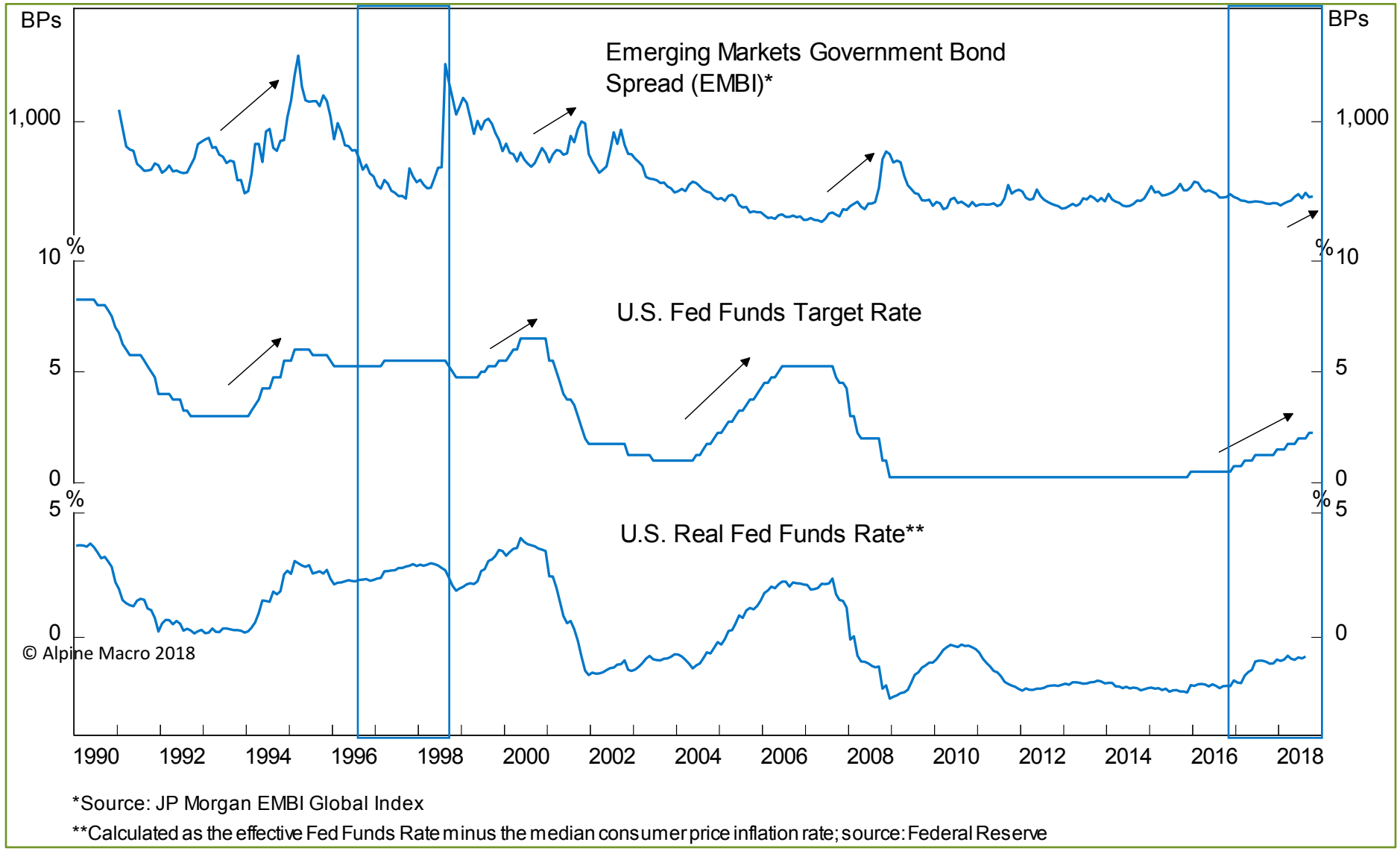
CNBC





*Source: U.S. Department of Treasury

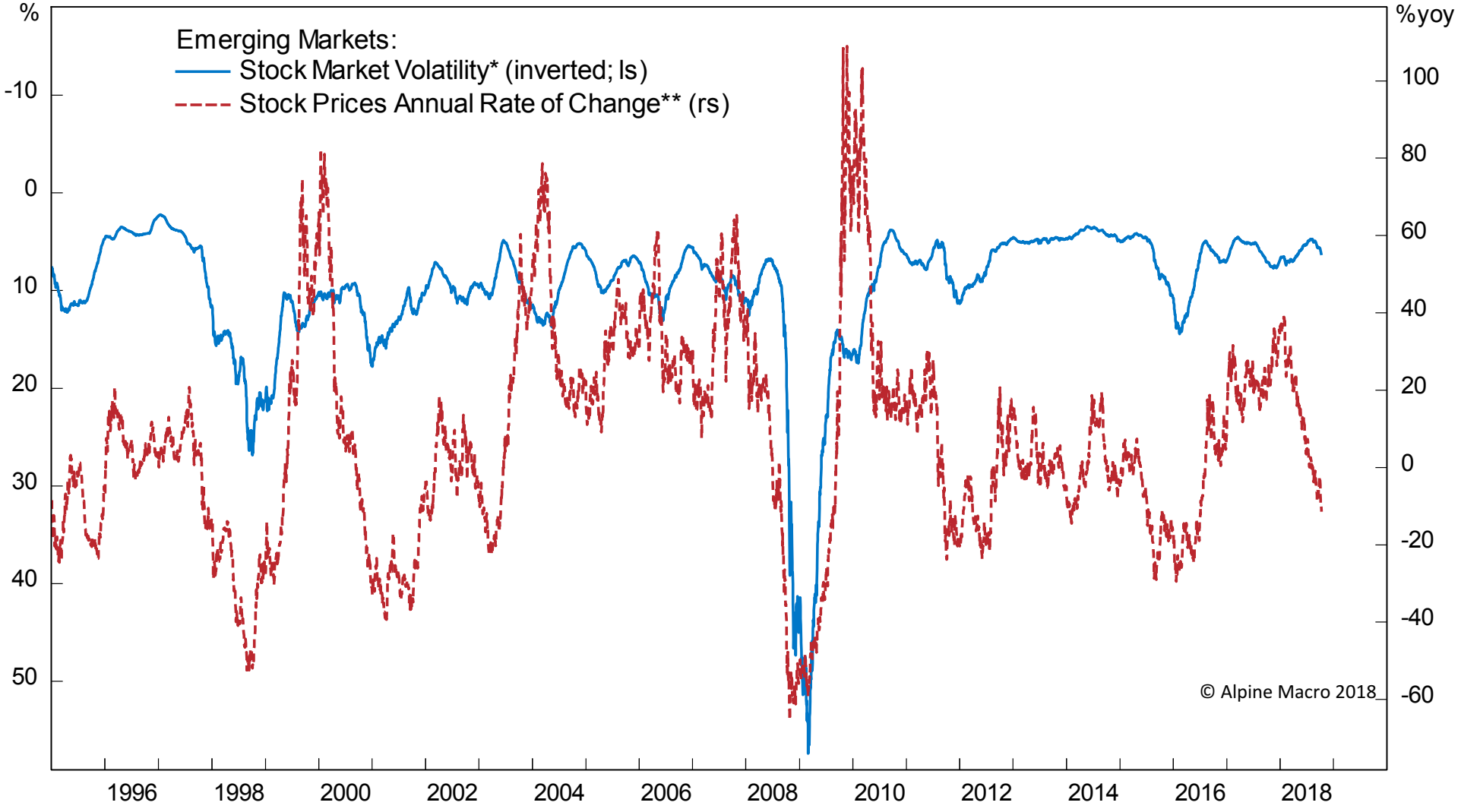
EM Bonds: Not yet pricing in Real Rising Risk—Reminiscent of 1997….



*Source: JP Morgan EMBI Global Index

**Calculated as the effective Fed Funds Rate minus the median consumer price inflation rate; source: Federal Reserve

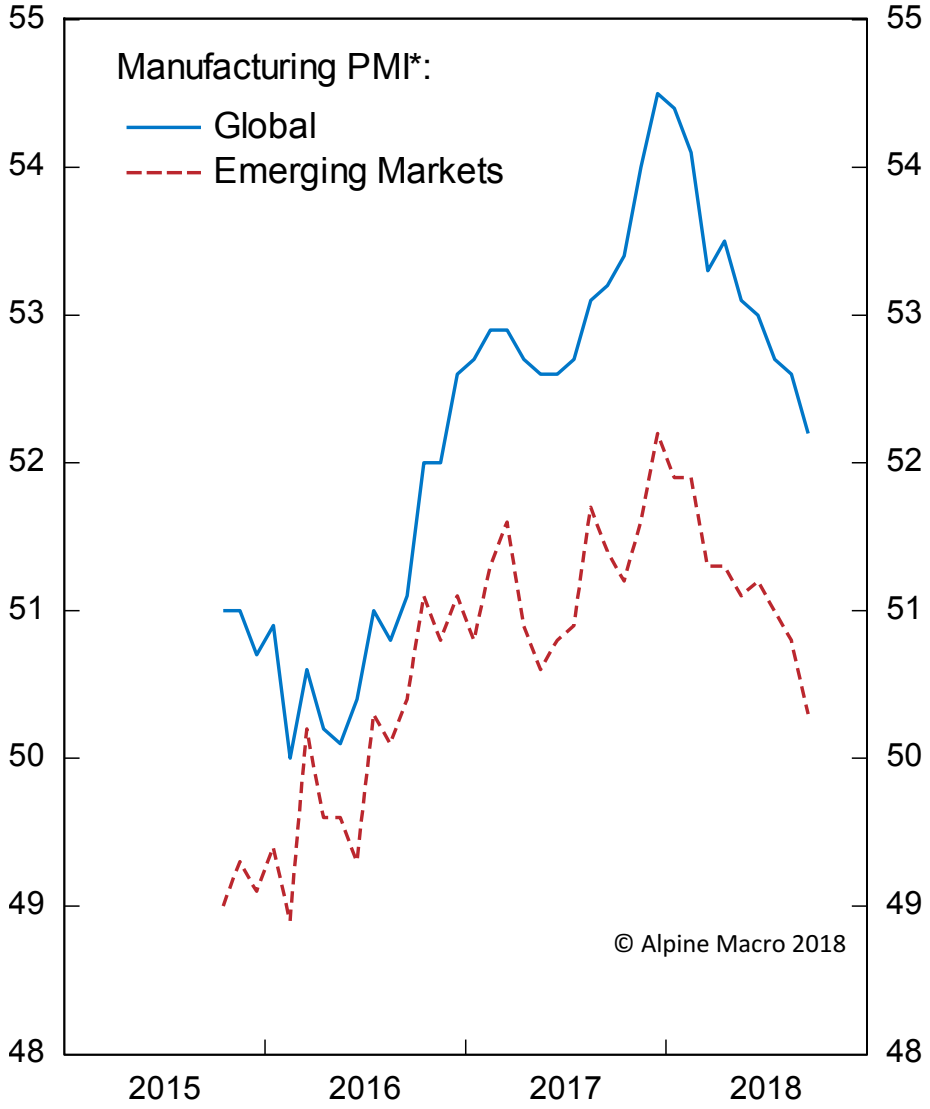
EM Stock Volatility Disconnected from Reality….



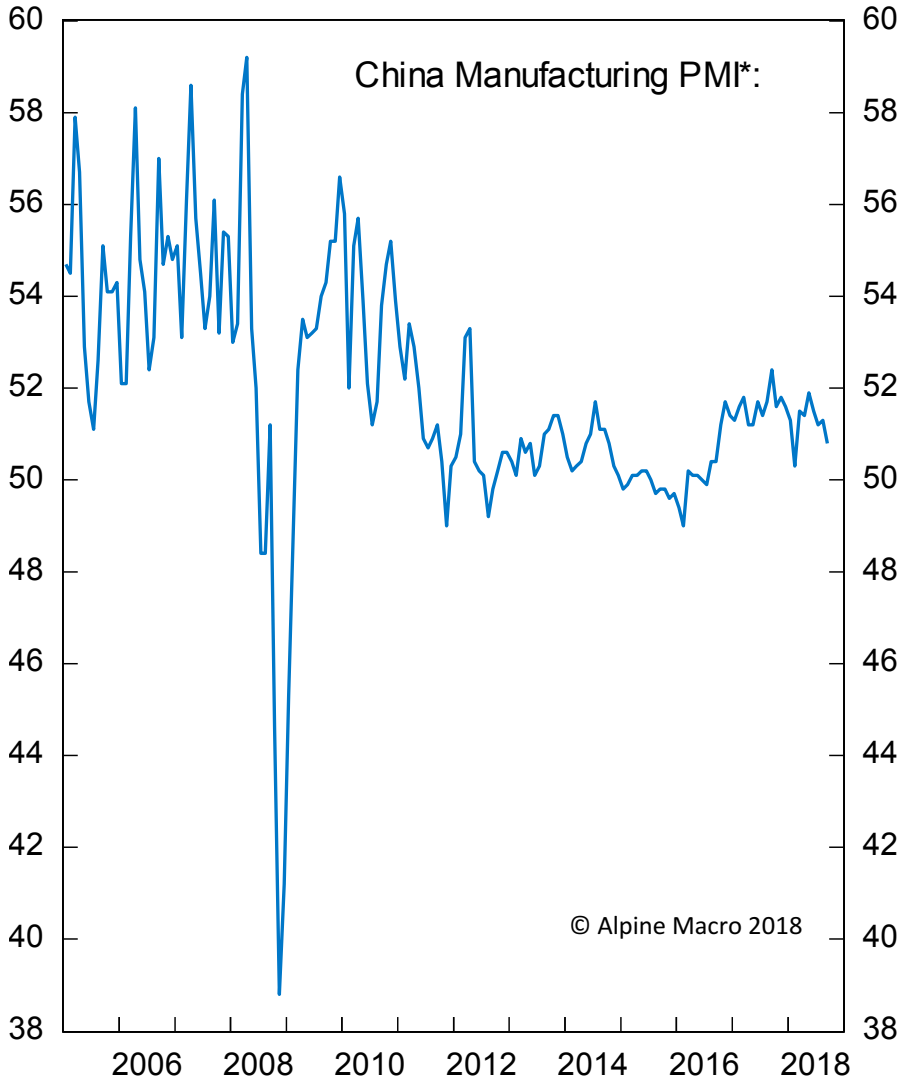
*Annualized; Alpine Macro calculation

**Source: MSCI

China Slow Down Amidst EM Breakdown does not Augur Well

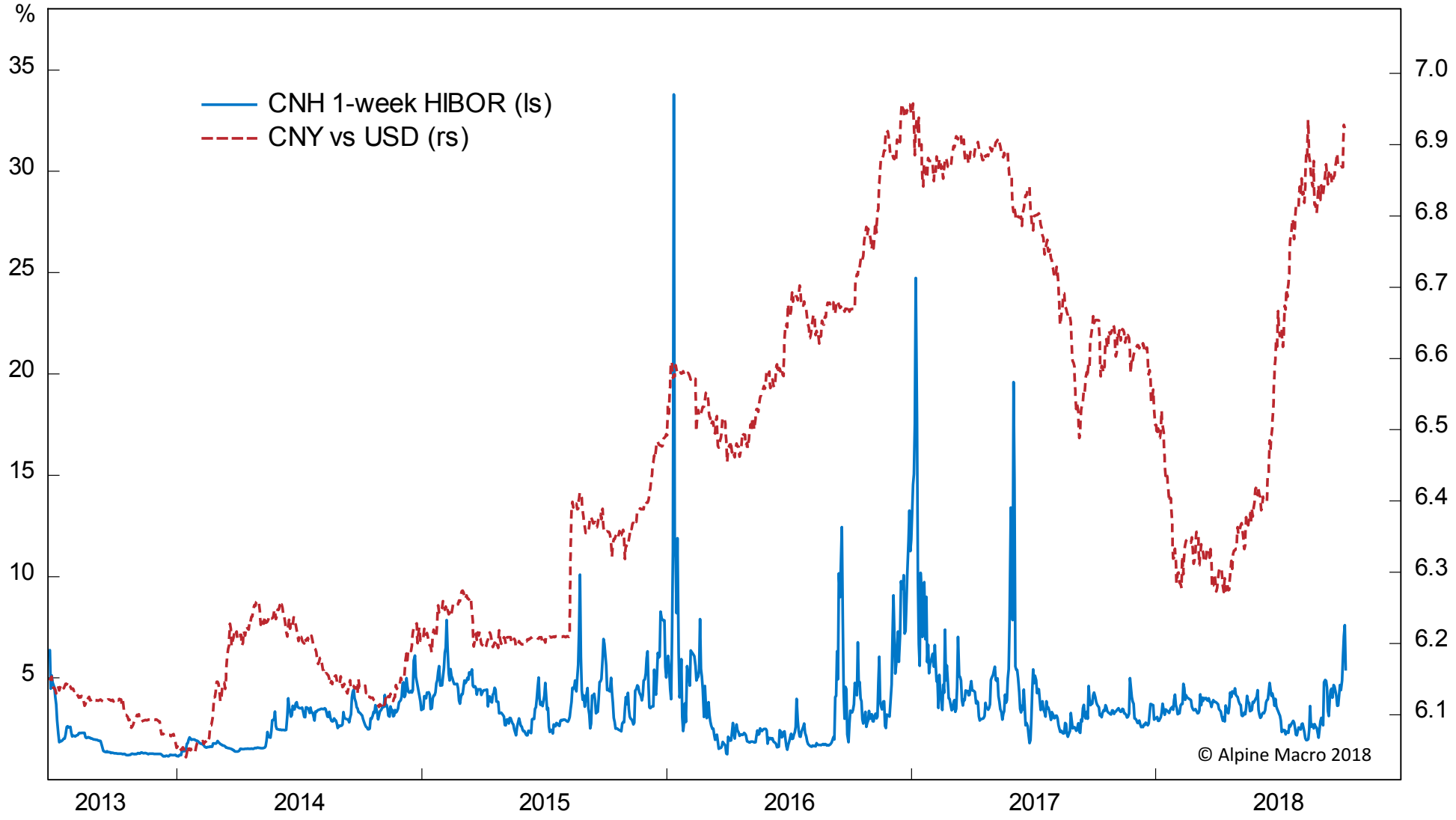


*Source: Markit



*Source: China Federation of Logistics & Purchasing

HIBOR Spike Portends Further CNY FX Volatility



Risk of South China Sea Strife if Beijing Enforces Defense Zone



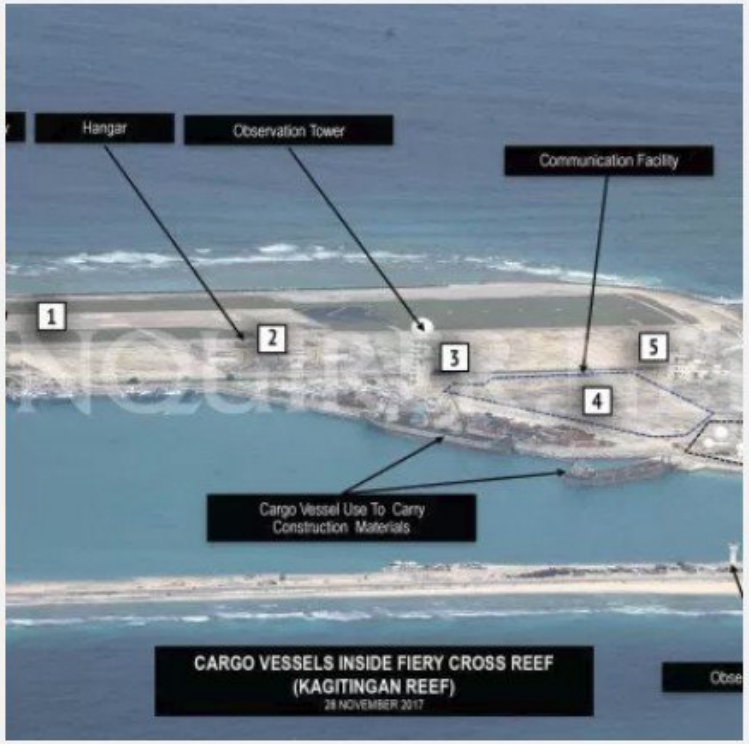
FILE - Air Force Lieutenant General Liu Shou-Jen introduces a map of Air Defense Identification Zone (ADIZ) in the East China Sea during a press conference in Taipei, Taiwan, Dec. 2, 2013. Taiwan said its military planes have made about 30 flights into a part of China's newly declared air defense zone, which overlaps a similar Taiwanese zone.

China is Fortifying its “Great Wall of Sand” in South China Sea

Fiery Cross Reef

- Aerial photos ‘point to new Chinese signals hub’ in the heart of the South China Sea
- The CSIS Asia Maritime Transparency Initiative said the northeastern corner of Fiery Cross Reef was now equipped with a communications or sensor array bigger than those found on other artificial islands in the Spratlys.







SOURCE – South China Morning Post

North Korea could bankrupt South Korea on reunification costs and still end up with nuclear weapons. Do you want to own South Korean debt or Won right now????

North, South Korea agree to reconnect roads, rail amid U.S. concern over easing sanctions

- North and South Korea have agreed to reconnect road and rail links.
- The two countries said in a statement that they will carry out joint transport surveys later this month.
- U.S. concern exists over any easing of sanctions while the DPRK continues to progress its nuclear program.

Published 3 Hours Ago

REUTERS



Korea Summit Press | Getty Images

North Korean leader Kim Jong Un (L) and South Korean President Moon Jae-in (R) walk after the official welcome ceremony for the Inter-Korean Summit on April 27, 2018 in Panmunjom, South Korea.



The Legal Case for Striking North Korea First

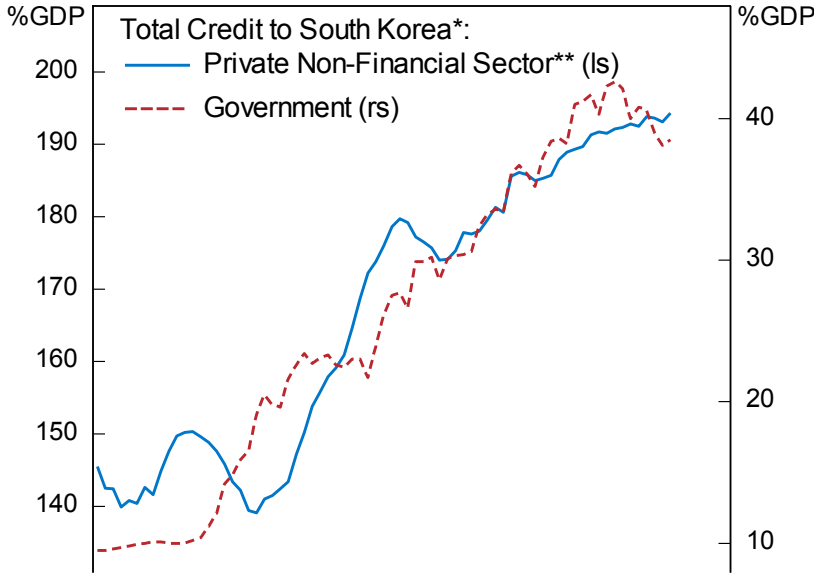
Does the necessity of self-defense leave 'no choice of means, and no moment of deliberation'?

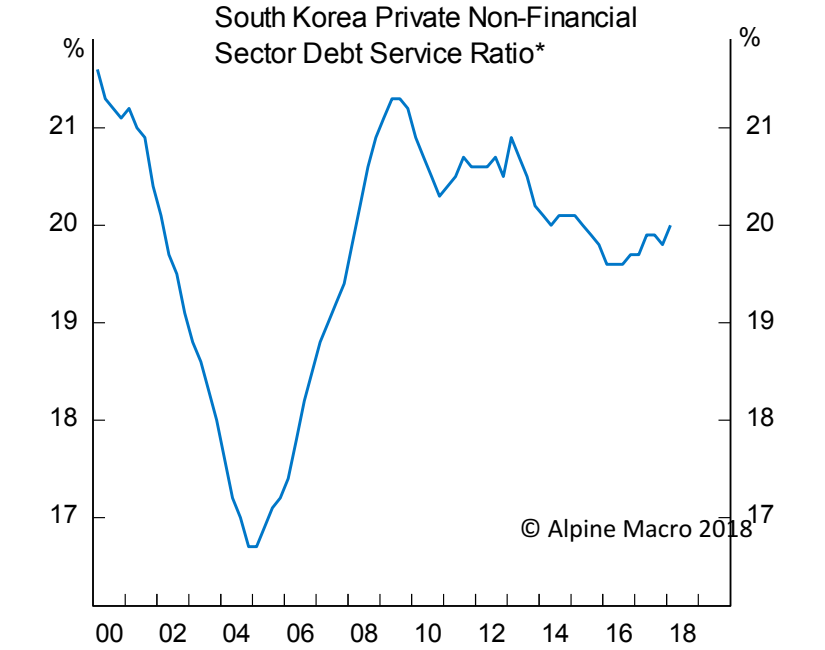
By John Bolton
Feb. 28, 2018 6:59 p.m. ET

423 Comments



An intercontinental ballistic missile on display at a North Korean military parade in Pyongyang on Feb. 2. PHOTO: YONHAP NEWS/ZUMA PRESS





*Source: BIS

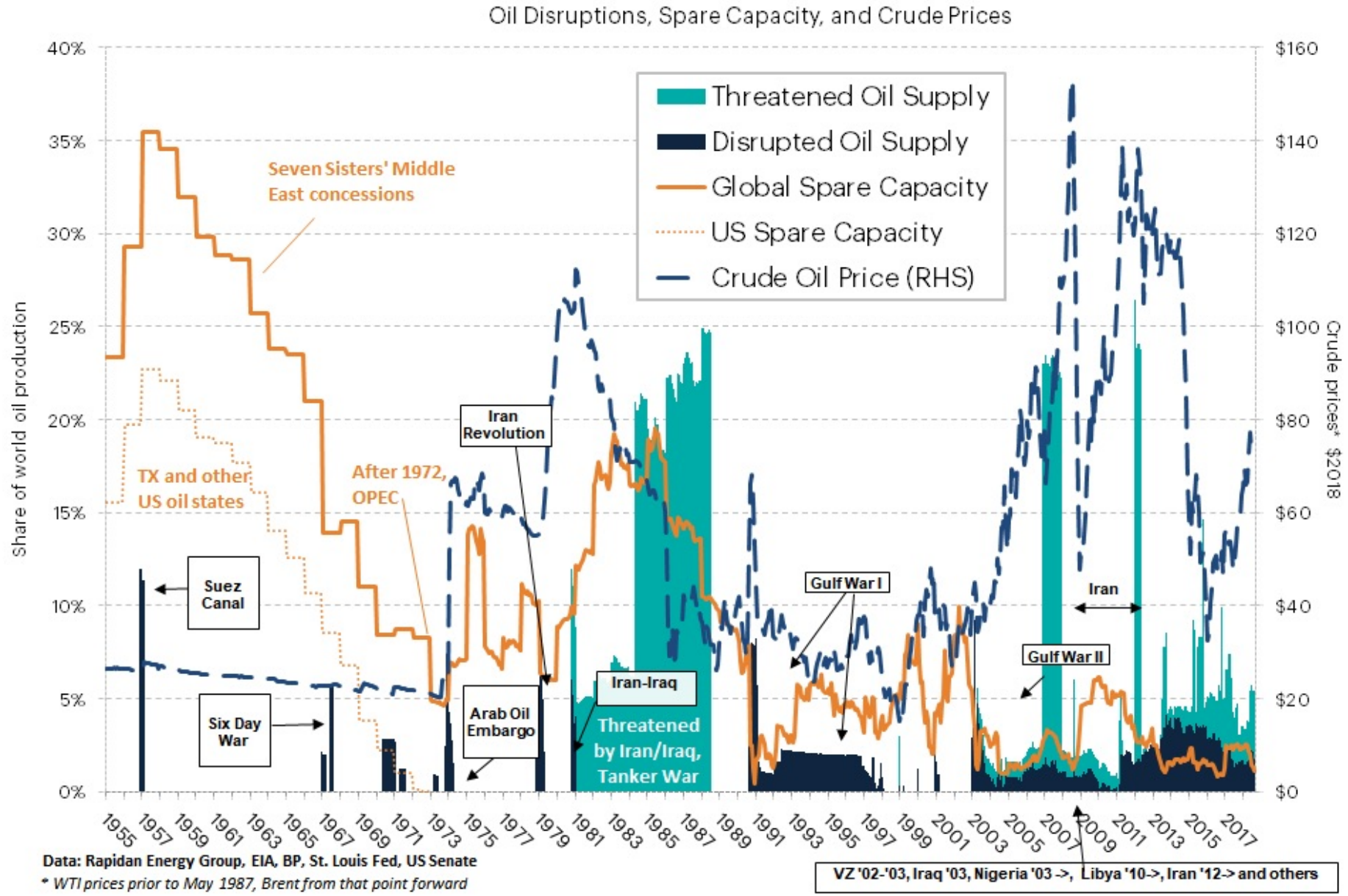
**Includes household and non-financial corporation





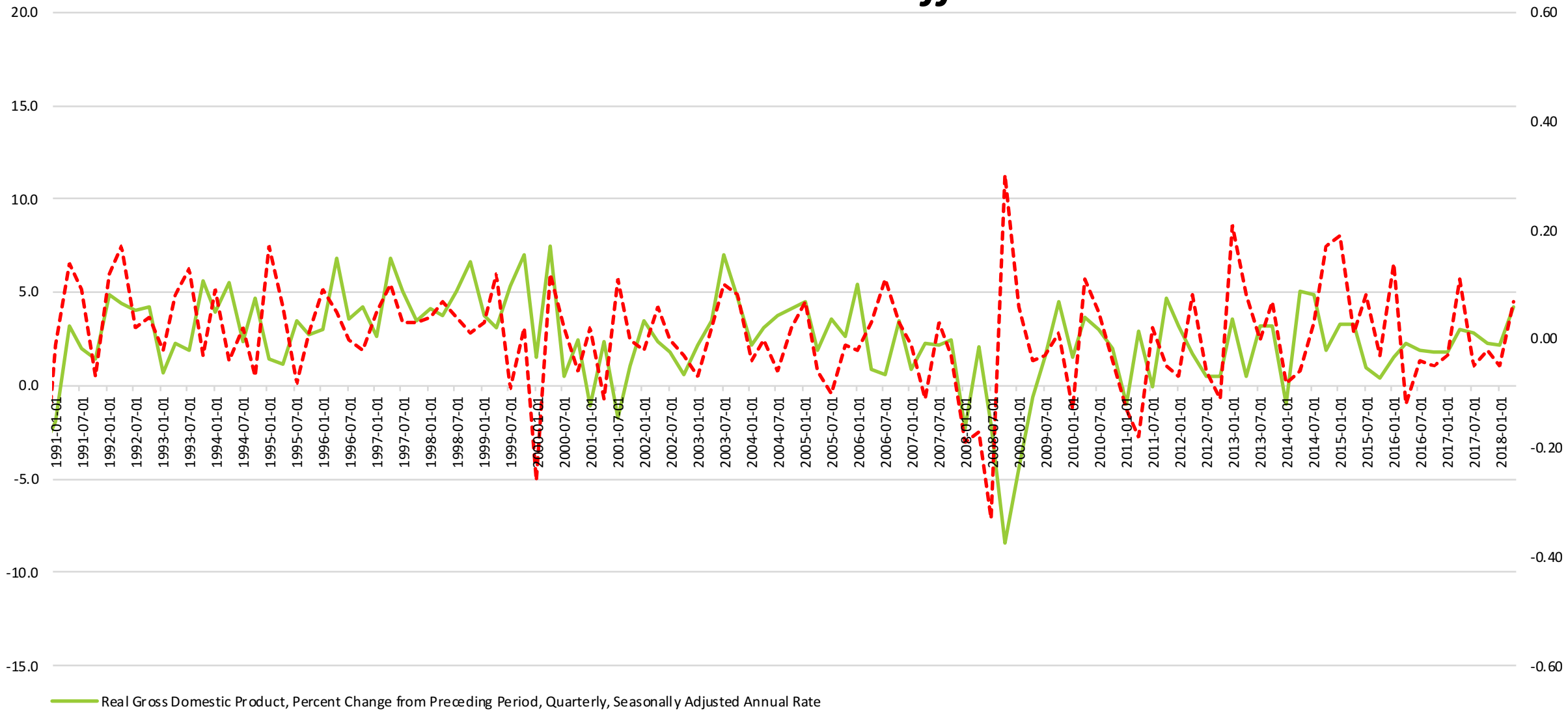
The US economy <u>still</u> runs on oil

Rising Disruption Risk and Iran Oil Sanctions Pressure Oil

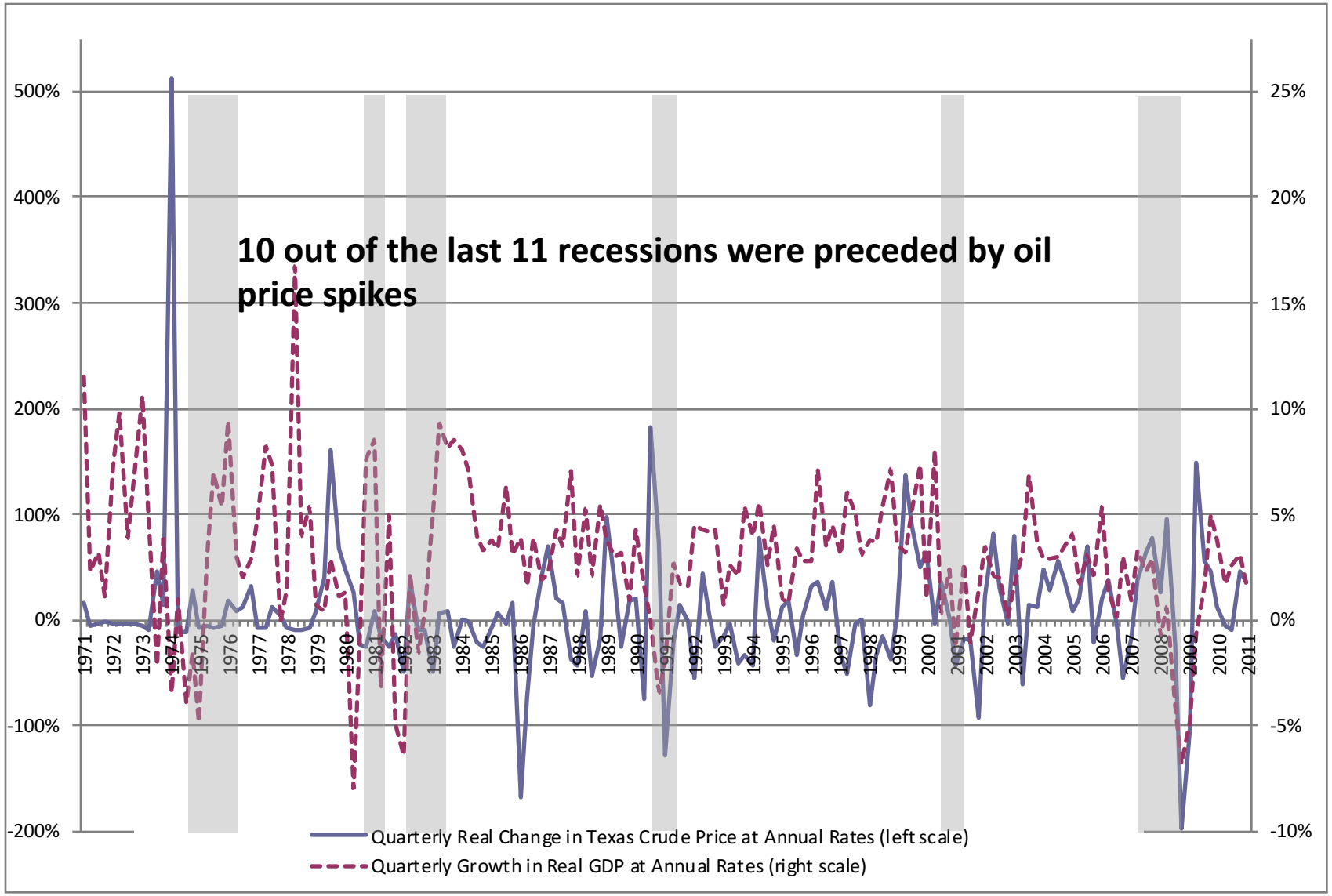


Typically When Energy Expenditure Goes Up, GDP Growth Suffers

Will this time be different?



US Real Change in Crude Prices vs. Real Change in GDP



Effects of Previous Oil Shocks on US Economy

Size of Quantity and Price Changes in Historical Oil Shocks

Episode	Supply Reduction	Price Change	Implied Elasticity
Oct 73 - Mar 74	4.0%	41.3%	0.10
Nov 78 - Jul 79	1.3%	38.7%	0.03
Oct 80 - Mar 81	1.2%	25.3%	0.05
Aug 90 - Oct 90	2.9%	71.6%	0.04

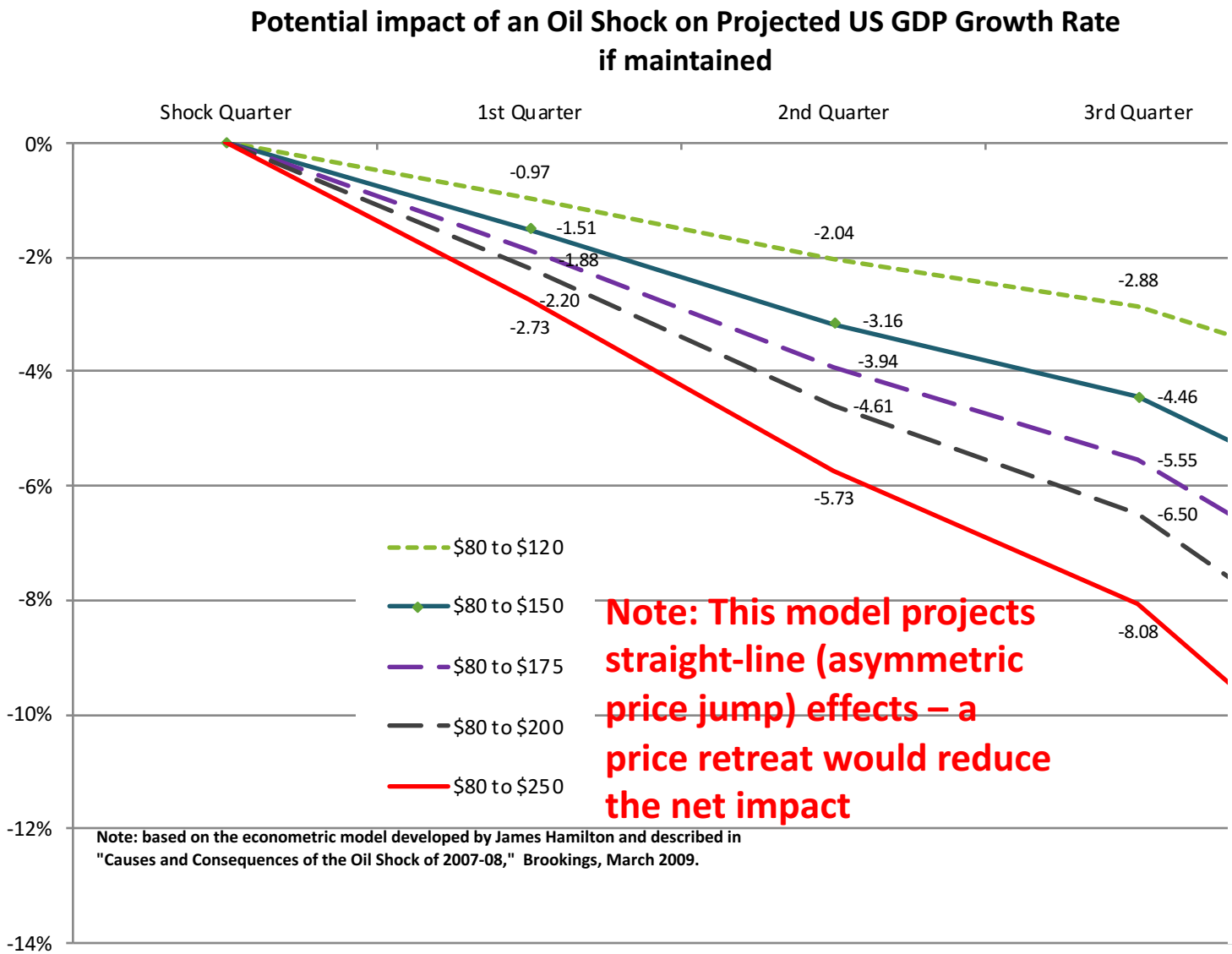
Average Annual GDP Growth Rates Under Alternative Scenarios

Period	Actual	Without Autos	Without Oil Shock (Blanchard-Gali)	Without Oil Shock (Hamilton)
1974:Q1-75:Q1	-2.5%	-2.0%	-0.1%	**2.3%**
1979:Q2-80:Q2	-0.4%	0.4%	0.4%	**2.5%**
1981:Q2-82:Q2	-1.5%	-1.3%	-2.0%	**2.0%**
1990:Q3-91:Q3	-0.1%	0.2%	0.5%	**3.6%**
2007:Q4-08:Q3	0.7%	1.2%	1.4%	**4.2%**
2007:Q4-08:Q4	-0.7%	0.0%	-0.2%	**3.2%**

Source: James D. Hamilton, "Causes and Consequences of the Oil Shock of 2007-08," Brookings March 2009

According to Hamilton, the US economy would have grown 3.2% between Q4 2007 and Q4 2008, not contracted by -.7%, had there not been an oil price shock

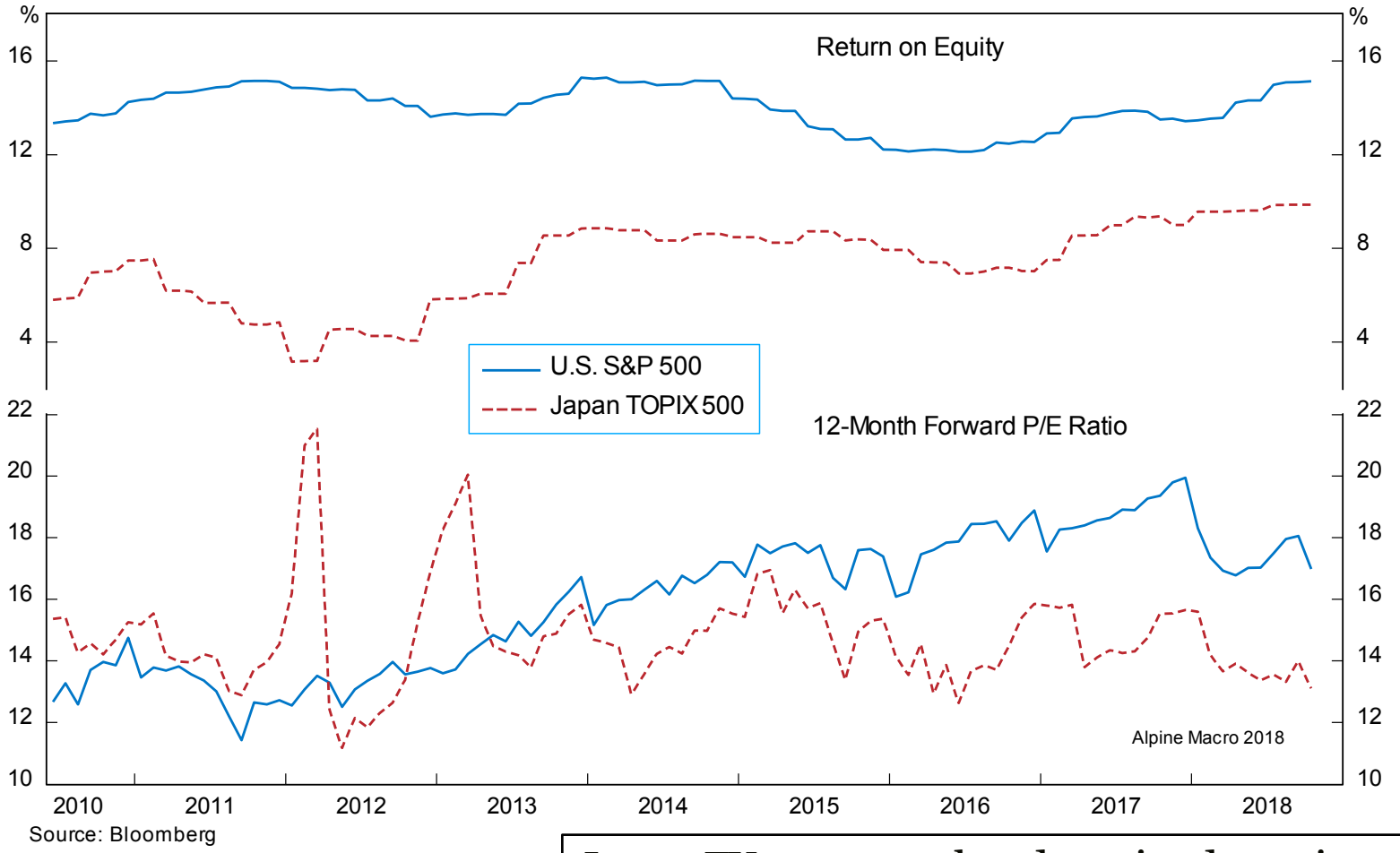
Simulating Economic Impact of Oil Shock Scenarios



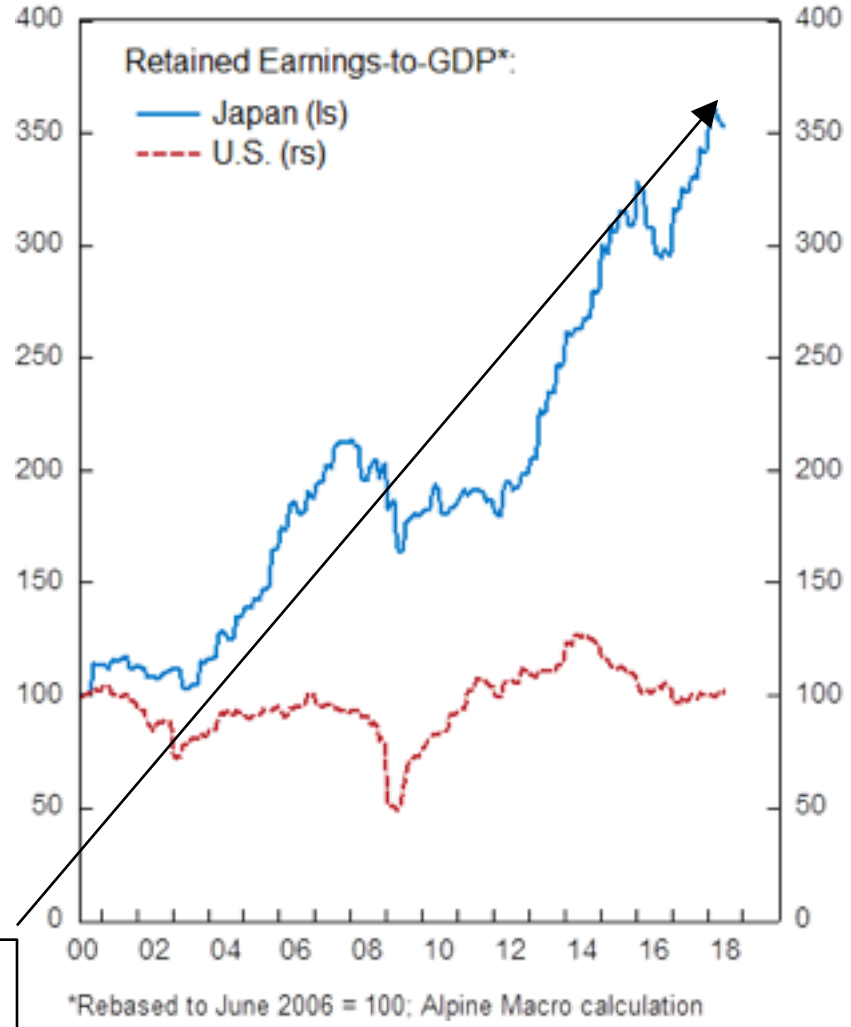
Just hope it doesn't drag on….

The World is Not Ending (Yet!)

There are Some Major Markets with Good Valuations - Japan vs U.S.



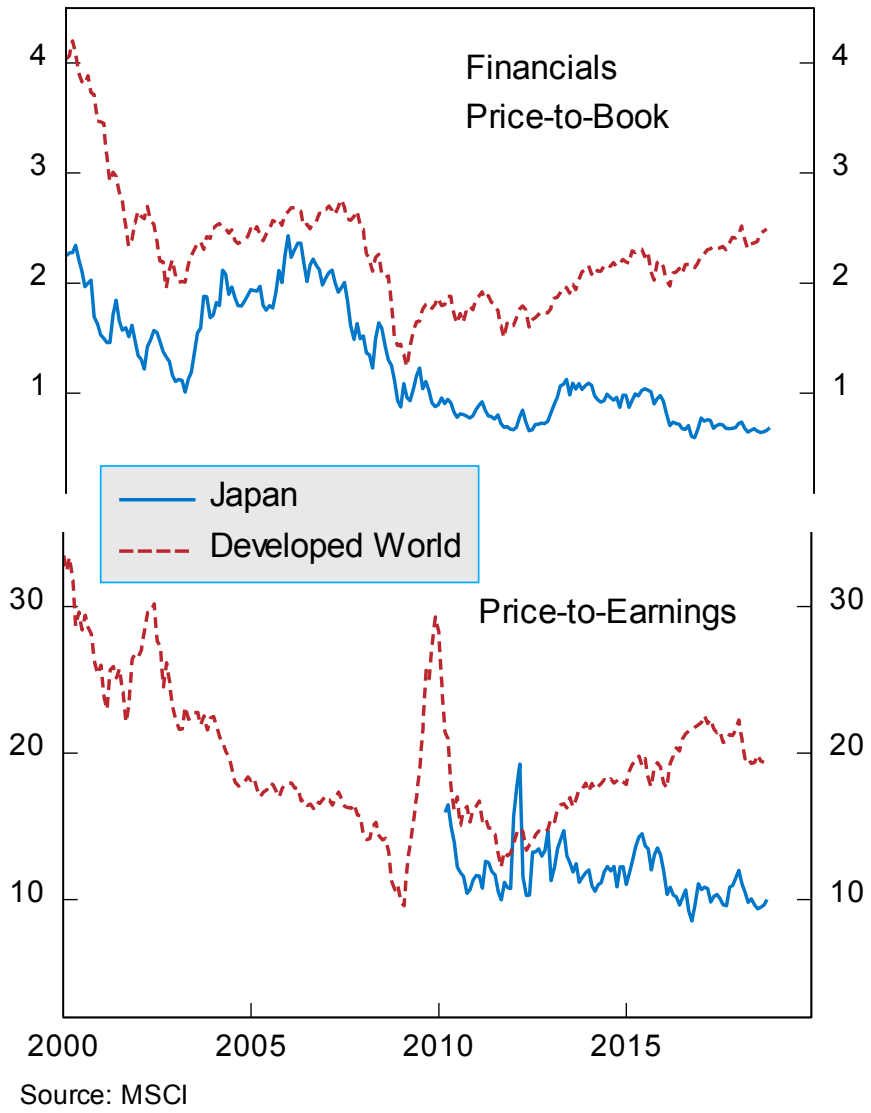
Source: Bloomberg



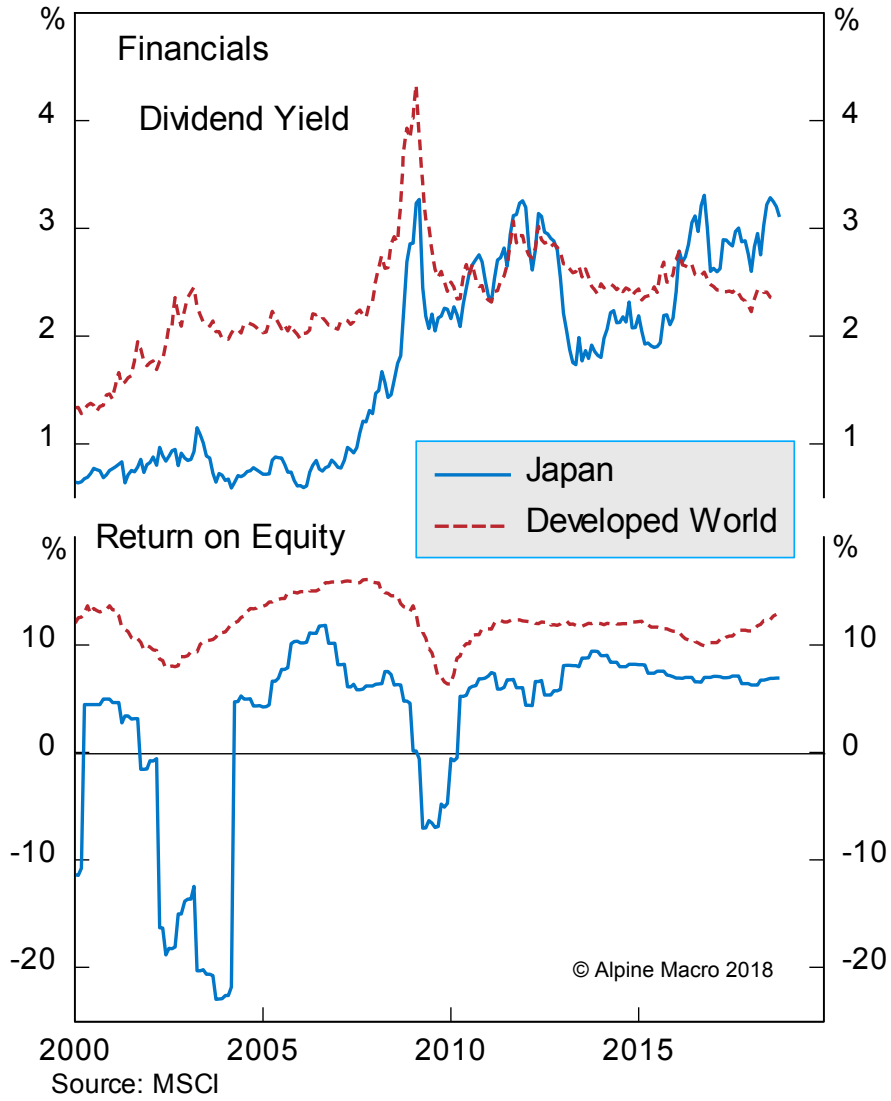
Japan FY17 accumulated retained earnings were 446.48 trillion yen ($4.01 trillion), up 9.9 percent from the previous year!!

© Alpine Macro 2018

Japanese Financials vs Developed World



Source: MSCI



Source: MSCI

Japan 1H 2019 Bold Predictions

- BOJ will go from NIRP to ZIRP in January 2019.
- Financial stocks, after many years of underperformance, will lead the TOPIX higher.
- PM will announce willingness to impose a punitive retained earnings surtax on large corporates that don’t raise wages +4-5% during spring shunto labor negotiations
- The Yen will return to 115-120 range.
- US-Japan will negotiate a Comprehensive Economic Security Agreement that will include a huge Japanese infrastructure fund for the US, a TPP conforming FTA, and a pledge by the US to work to join TPP.

Conclusions: *History doesn't repeat itself, it just rhymes*



- US economy remains strong but global fault lines are growing fast.
- Japan remains a value play and a sea of relative stability.
- Staying long G7 for now makes sense, especially in light of recent correction, but next year will be more risky. As in 1997 and 2007, credit and equity markets are significantly under pricing growing global macro risk.
- The US in "deliberate decline as a "policing power." A breakdown in the balance of power and increased multi-polarity are not inherently benign. Rising and aggressive China and Iran – both buttressed by Russia and North Korea – are a poisonous mix for globalization.
- EM dangers are growing. Korea is ironically vulnerable to "good diplomatic news". Trade war is leveraged to both Xi and Trump's egos. We'll see if Xi backs down to Trump…
- There are many endogenous reasons for the long economic growth and financial market cycle to be peaking out – a sustained oil shock could cause much more rapid decline as could steeper than expected rising interest rates, protectionism, and geo-conflict. All are likely. "This time won't be different."…..