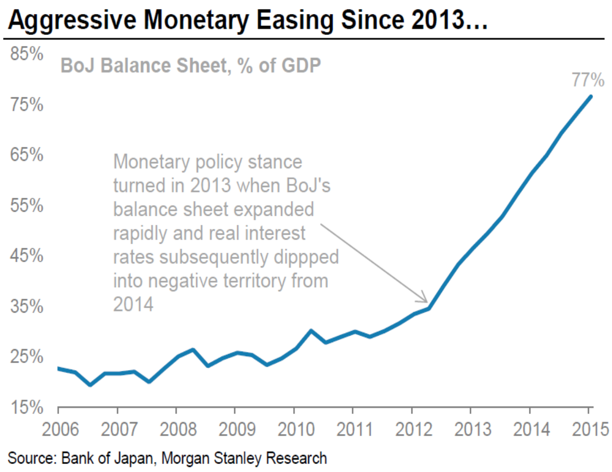
The Month Ahead May 2016: Money no enough.

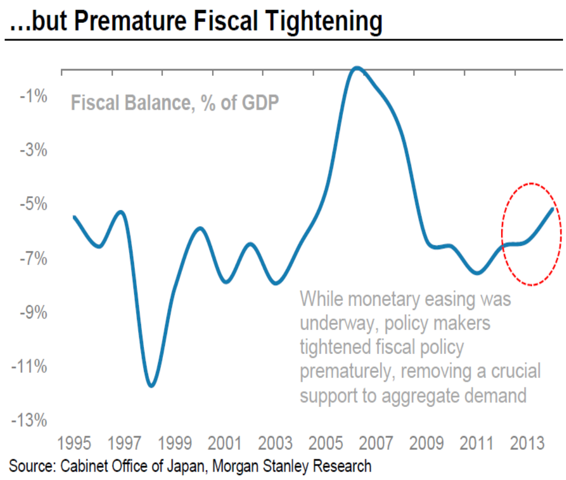
Unconventional policy responses including the deployment of Negative Interest Rate Policy (NIRP) has received much debate as well as consternation about its efficacy to restore growth for the global economies. We have written quite extensively that it has certainly worked in preventing contraction in growth, restored employment and stoke incipient growth in wages. We have also observed through measurable metrics that it has lowered the cost of debt, improved financial conditions and instigated the propensity to lend and borrow in some countries. While we agree the sustainability of such results is still debatable, we have caution readers from ringing the death knell on these policies. A fact to bear in mind is that as of 1Q16, Eurozone GDP has already recovered past its 2007 level and unemployment rate and saving rates in the US are better than pre-GFC levels. Without QE, none of these outcomes could have happen.

Recently, there has been rumblings about the introduction of helicopter money as another variation of unorthodox policy tools. Popularised by the esteem economist, Milton Friedman, helicopter money is the increase in discretionary public spending or tax cut financed by additional creation of money by central banks. The manner in which helicopter money is implemented is for central banks to deposit this newly created money directly into their respective government's account thereby financing government budget. The difference between the QE as we currently know of it and helicopter money is that in QE the transmission mechanism is indirect via reduction in short and long term interest rates while helicopter money is direct financing with the stated aim of facilitating an expansionary fiscal responses. Besides crediting to the government coffers, the advantages of helicopter money it avoid the crowding out effect and the risk of Ricardian's equivalence. However, the biggest inertia to this policy tool is that it robs off central bankers' independence; a virtue all developed markets central bankers' extol. But in less development markets like China and Russia, there's no such separation between monetary and fiscal policies. Maybe we should all regress towards a centralised government apparatus!

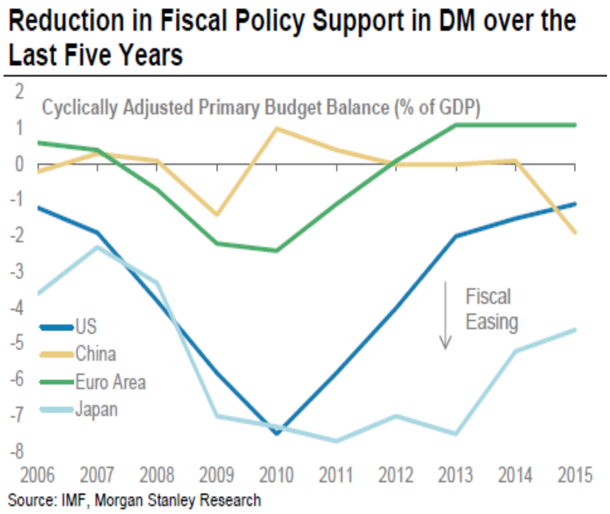
While credit (pardon the pun) must be given to the Messrs Bernanke, Draghi, King and to a lesser extent Kuroda, pouring money simply isn't enough to get the global economy above its purported growth potential. A collective and sizeable fiscal policy response globally is required to achieve that. The past three years sub-par growth can be traced to the untimely reduction in fiscal support by government despite an increasing accommodative monetary environment from the central bankers. Across the globe, under the guise of balancing their budget, waves of austerity policy post-GFC has negated much of monetary policy benefits to growth. Subsequent QEs have seen the ensuing monetary multiplier effect been reduced. A negative demonstration of this misstep would be the Japanese. Since 2013, BOJ has been the most aggressive central bank in deploying QE including NIRP which resulted in private sector re-leveraging, a rise in inflation expectation and accompanying higher growth in the earlier stages. But they made the same mistakes twice when they increased the consumption tax from 5% to 8% in April 2014, much like they did in 1997. Back in 1997, this ill-timed tax hike coincided with the Asian crisis extending its run of morbid economic fortunes for another decade. In recent times, they made the mistake from expanding fiscal deficit by as much as 9.4% of GDP in FY3/12 but prematurely contracting it to less than 5.6% by end of last fiscal year.

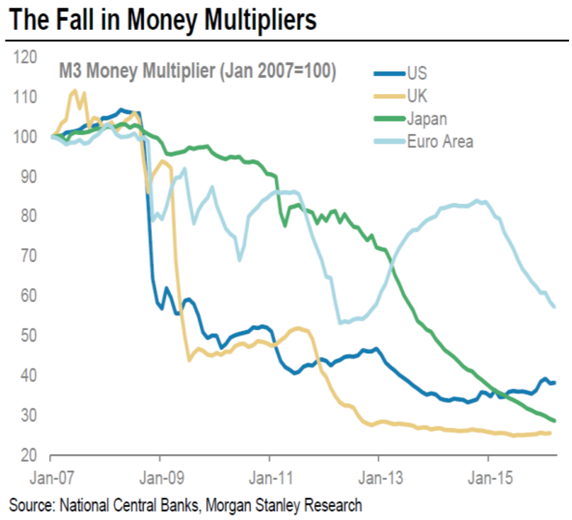
Japan – Opps I did it again (Britney)





With the markets increasingly militant about the limits of such unconventional monetary policy, it is understandable central bankers have become more vociferous that only structural reforms enacted by government in the long-term and facilitated with short-term fiscal shots can pivot the global economy back to its potential.





We are of the view that such responses are on the horizon and perhaps already in motion. In the next few para, we will outline what we believe could happen in the coming quarters globally to dovetail monetary lubricant with fiscal upshots. We are of the opinion the G7 Summit slated this month will be the forum several countries and institutions such as IMF will be discussing on such a need.

China clearly has lead with an aggressive dual and coordinated pillars of monetary and fiscal policies enacted since 2Q15. While last month's credit data have slowed from a very strong 1Q16, we believe their stance remains accommodative and expansionary on both fronts. We believe Japan will be the next to deliver this much needed panacea. We believe the consumption tax hike will be postponed when debated in July followed with a fiscal package that could amount to JPY 6-7 trillion targeting urban infrastructure and energy projects funded by low or even negative interest lending by government led institutions. We think Japan could use the G7 Summit to announce such an intention. We think UK could next in line given the slippage the economy has already seen even without the hanging albatross of a Brexit. While an outright reversal of current tightening budgetary can only happen if there is UK choose to leave Euro, we believe is highly plausible the pace of further tightening will ease if they elect to remain. Timeline could come only after Brexit referendum on 23rd June.

Aside from China and Japan that will follow this script, we believe India and Korea will also enact stronger fiscal responses in their current fiscal year. For example in India, the government has already budgeted 24% increase in infrastructure spending in FY17 which by itself amounts to 2.8% of GDP. Moreover, the government has already budget for an increase in government employee wages. Over in Korea they are looking to turn on the monetary levers first with the ruling Saenuri Party proposing a "Korea-style monetary easing" urging the Bank of Korea to purchase bonds issued by the Korea Development Bank (KDB), mainly to boost the KDB's ability to restructure heavily indebted loss-making companies in the shipping and shipbuilding industries. The BOK is generally supportive of the government's plan to improve the capital structure of KDB and KEXIM including capital injection, buying hybrid bonds and even using current lending facility to increase these two agencies banks' capital thereby allowing them to restructure moribund sectors as well as support fledging industries.

In the US the timeline and the form of fiscal response are less obvious with the upcoming elections obfuscating further. However if we look beyond the entertaining campaign rhetoric, there are some common priorities for both Trump and Clinton. Both have advocated a significant boost in infrastructure investment, for example. Sec. Clinton has an explicit proposal to add an additional $275 billion to federal infrastructure spending over the next five years; Mr. Trump has not made a detailed proposal but has alluded to significant new infrastructure spending as well. While Sec. Clinton has not detailed a corporate tax reform plan, some aspects of Mr. Trump's appear closer to the current administration's proposal than to Republican plans in Congress.

Ebony and Ivory (Jackson and Mcartney)

	Clinton	Trump
Personal Tax	■ 4% surtax on income over $5mn ■ 30% minimum tax on taxpayers with income greater than $1mn ■ Limit value of deductions/exclusions to 28% rate ■ Tax carried interest as ordinary income ■ Tax capital gains on assets held less than 2 years at ordinary income tax rates; full preference only for assets held at least 6 years. Tax derivative mark-to-market gains annually as ordinary income.	■ Reduce personal tax rates to 10%, 20%, and 25%; taxpayers under $25k income ($50k joint) would pay no income tax ■ Repeal the alternative minimum tax (AMT) ■ Limit value of deductions/exclusions ■ Tax carried interest as ordinary income ■ Tax dividends and capital gains at 20%
Corporate Tax	■ Impose "exit tax" on tax inversions; raise ownership change threshold to 50% to qualify for expatriation ■ Limit earnings stripping via interest deductions ■ Additional R&D incentives	■ Reduce rate on corporate and pass-through income to 15%; repeal most corporate tax preferences ■ Tax US-based MNC foreign income as earned; maintain foreign tax credit ■ 10% tax on accumulated untaxed foreign profits
Intl Trade	■ Impose "duties, tariffs, or other measures" against countries manipulating curencies ■ Oppose TPP unless currency and auto provisions strengthened ■ Renegotiate NAFTA and review other trade agreements ■ Take countervailing action against dumping ■ Oppose China's "market economy" status	■ Declare China a currency manipulator; impose duties on Chinese imports ■ Oppose TPP ■ Renegotiate NAFTA
Immigration	■ Enact reform legislation with path to citizenship ■ Continue and potentially expand deferred action programs	■ Build a wall on southern border; increase enforcement/deportation ■ Require e-verify nationwide ■ H-1B visa restrictions; "pause" immigration of foreign workers
Infrastructure	■ Boost spending by an extra $275bn over next 5yrs ■ Reinstate Build America Bonds ■ Finance costs through business tax reform	■ Supports substantial but unspecified new infrastructure spending
Min. Wage	■ Raise federal minimum wage to $12/hr	■ Position unclear
Health Care	■ "Public option" in ACA; allow 55 and over to buy in to Medicare ■ Increase ACA subsidies ■ Repeal the "Cadillac tax" on high cost health plans ■ Negotiate Medicare Rx prices; expand drug rebates ■ Drug importation from abroad ■ Set minimum level for pharmaceutical company research	■ Repeal the Affordable Care Act ■ Tax deduction for individual health insurance premiums ■ Allow health insurance to be purchased across state lines ■ Negotiate Medicare Rx prices ■ Drug importation from abroad
Soc. Security	■ No Change	■ No Change
Student Loans	■ Tuition-free community college ■ Allow refinancing of student loans	■ Position unclear

Source: Goldman Sachs

It's Time (Imagine Dragons)

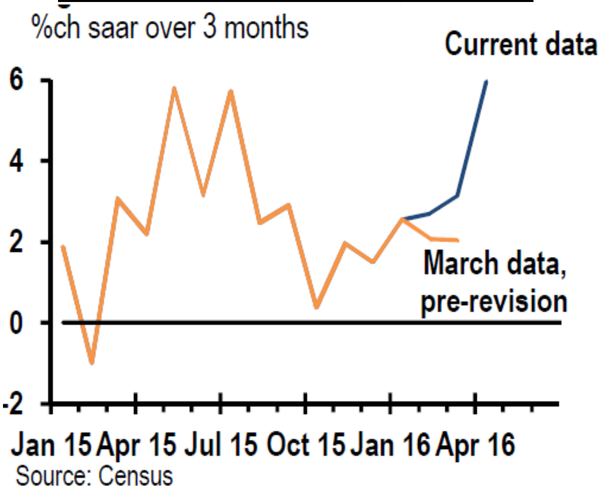
Summary Table: Fiscal Policy at a Glance

	US	Euro Area	Japan	UK	China
Current State of Private Sector Leveraging	Aggregate private sector modestly leveraging. Corporate sector leveraging offsets household sector deleveraging.	Slight buildup of leverage in 4Q15 in both household and corporate sector but overall leverage still lower as compared to end-2014	Slight buildup of leverage in 4Q15 in both household and corporate sector but overall leverage still lower as compared to end-2014	Deleveraging as whole, led by corporate sector. Households are building up leverage	Continued buildup of leverage in both the corporate and household sector
Current Stance of Fiscal Policy	Broadly neutral	Moderately expansionary	Contractionary	Contractionary	Expansionary
Next Possible Policy Actions	Increased infrastructure spending, implementing broad reforms for corporate taxes	Reduce tax burden for households and further increase in spending in response to refugee crisis	Postpone scheduled consumption tax hike in April 2017; implement supplementary budget of JPY 6-7 trn for FY 2016, with greater likelihood of postponement and more spending due to no additional monetary easing in April	Slow the current pace of fiscal tightening (i.e., target for balanced budget rather than surplus)	Further increases in infrastructure and social welfare spending; implement VAT reform for services sector; room for further cuts in tax and administrative fees for small private companies
Timing of Policy Actions	No meaningful action before the conclusion of elections (due in Nov)	Ongoing moderate fiscal expansion is likely to carry through to 2017	Possible announcement during G7 Summit in May	Any fiscal easing remains contingent on the outcome of the Brexit referendum	Expect fiscal expansion to remain until 2017
Political/Legal Hurdles to Implementation of Fiscal Stimulus	Overall fiscal policy direction is dependent on outcome of November elections. Legitimacy of 'helicopter money' remains a controversial issue	Fiscal rules and institutional set-up prevent a substantial fiscal expansion. Direct financing of budget deficits by the ECB is banned	Political agenda (Upper House Election in July, G7 Summit in May) expected to accelerate the fiscal expansion plans. Bank of Japan already overfunding fiscal deficits by large margin, and this is likely to continue	Bias towards fiscal tightening as there is substantial political capital tied up in reducing the deficit. Financing of deficits have not been an issue, given significant overseas demand for gilts, but wide current account could potentially change foreigner willingness to hold UK assets	No political and legal hurdles but slowing fiscal revenue growth likely to constrain the government's ability to accelerate spending. Local governments may also stay risk-averse in initial big capital spending due to the ongoing anti-corruption campaign. Further, coordinated monetary easing likely to ensure smooth liquidity conditions
Effectiveness and Efficiency of Fiscal Stimulus	Returning infrastructure spending to historical norms over the course of one year could boost GDP growth by up to 0.8pp.	Ongoing fiscal expansion is expected to boost GDP growth in the short term	Fiscal measures are likely to boost growth, but more in 2017. Revival spending for Kumamoto may restore potential output to pre-quake levels in the region. Welfare spending for working families may raise labour force participation	Investment spending can provide a significant multiplier effect on growth but difficult to implement in timely fashion. The multiplier on tax cuts may be lower due to leakage into import demand	Fiscal easing has been effective in reviving growth, but given the nature of the expenditure mix which is biased towards investment spending, each cycle of easing faces diminishing returns

Source: Morgan Stanley Research

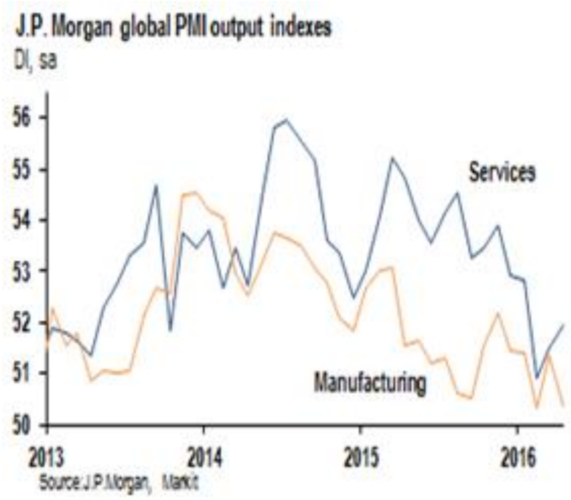
Back to economic ticker watching. Our central thesis of strong employment and even stronger consumer spending bootstrapping manufacturing resurgence in 2Q16 remain intact. In fact a sense of dejavu sets in for this writer as it has been three years running that we have a repeat of weak 1Q followed by strong 2Q for most global economies. Last Friday data from US core retail sales underscores the first hypothesis. Total retail sales increased 1.3% in April while core retail sales increased 0.9% and there were notable upward revisions to results for prior months. Current data shows total retail sales were up 4.9% saar in the three months through April and core retail sales were up 6.0% leading to real consumer spending increased 3.4% over the past three months, higher than consensus forecast by a good 100 ppt. Latest global all industry PMI indices in April supports the second tenet. Global PMI was up 0.1pt in April building on 0.7p gain in Mar. At this level, it corresponds to 2.3% ar gain in global GDP in line with consensus forecast for 2Q16 and is a jump from estimated 1.9% in 1Q16. Furthermore, inventory declined further while new orders staying in expansionary level.

4M16 US Retail Sales exceeding consensus



April Global PMIs build on Mar gains

As services PMI improved while finished good inventory declined on the back of little change in new orders index; stays in expansionary level. An inventory rebuilding phase is way overdue.



Asset Allocation Strategy:

With our thesis of an accelerating 2Q16 and a hopeful prayer of concerted fiscal responses in the coming quarters, our view to overweight equities remains intact. However, we prefer to look for income rather than outright growth trades and we elaborated within each asset classes below.

Equities: Overweight (maintain Overweight EM, upgrade US to Overweight from Neutral, Neutral in Europe but Japan remains Underweight)

At the country level, we retain EM Overweight but switched our Overweight from Europe to the US on concerns of Brexit for the former and sector preferences in energy, industrials and IoT in the US. We are watching and waiting for Japan's fiscal policy. However, the key alteration is our willingness to trade reflationary trades such as industrials and commodities for dividend yielding strategy in the coming months. The safety of low-beta dividend strategy is a better volatility adjusted strategy for the coming months as we head into the last inning of this stellar equity bull markets since 2009 further curtailed with at best fair valuation in the US. There is the imminent risk of earnings downgrade in Japan while China is stuck in a value-trap, the Sell-in-May-and-go-away adage looms even larger. While small cap exposure and L/S managers will remain in our portfolio from an alpha generation perspective, overweight dividend strategies like REITs in Japan and Europe, high dividend yields in US and Europe financials and dividend-oriented fund managers are preferred option in our overweight stance in equities.

Bonds : Underweight

Credit spreads and the plan to shorten duration will be the key strategies for the coming months. We very much favor credit spreads as a good source of income. Spreads remain above historic average in most markets and given our positive view of oil we prefer HY credit over out-right positions in equity in the same space. Similarly, we prefer EM credit overweight than EM equities due to valuations. Given we are at a cusp of oil induced inflation which could be further catalyzed by rising wages, we believe the current yield curve is too complacent about the number of times and magnitude of Fed hikes in 2016. Shorten duration in UST for risk-off hedge, look to add TIPS and US financials for Fed hikes in early July unless we have Brexit.

Commodities: Neutral

We continue to prefer oil and would look to add Gold in sync with our rising inflation view. We prefer to own oil related credit over outright or equities.

FX: Reversing our call and look to revert to our long-standing USD hegemony view.

Near term, we think DXY has found a bottom but we are not expecting significant rally until July. Exiting our longs in Yen and EUR.

Alternatives Investments: Increasing for non-correlated market returns

We have added a quantitative trend follower manager that has very low correlation to both stocks and bonds in addition to our allocation to US and Asia L/S equity managers.

We have also been very bullish about real estate particularly in Europe and Japan.

Cash: Underweight.

Featured Picture/Quote:

Prince on capital. RIP your Purple Highness.

> "All people care about nowadays is getting paid, so they try to do just what the audience wants them to do. I'd rather give people what they need rather than just what they want."

https://www.youtube.com/watch?v=NFXZNt4oLkE

Enjoy this.