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July 2016

Since the start of the year policy makers have unleashed a bewildering range of responses to avert slow growth and the risk of deflation

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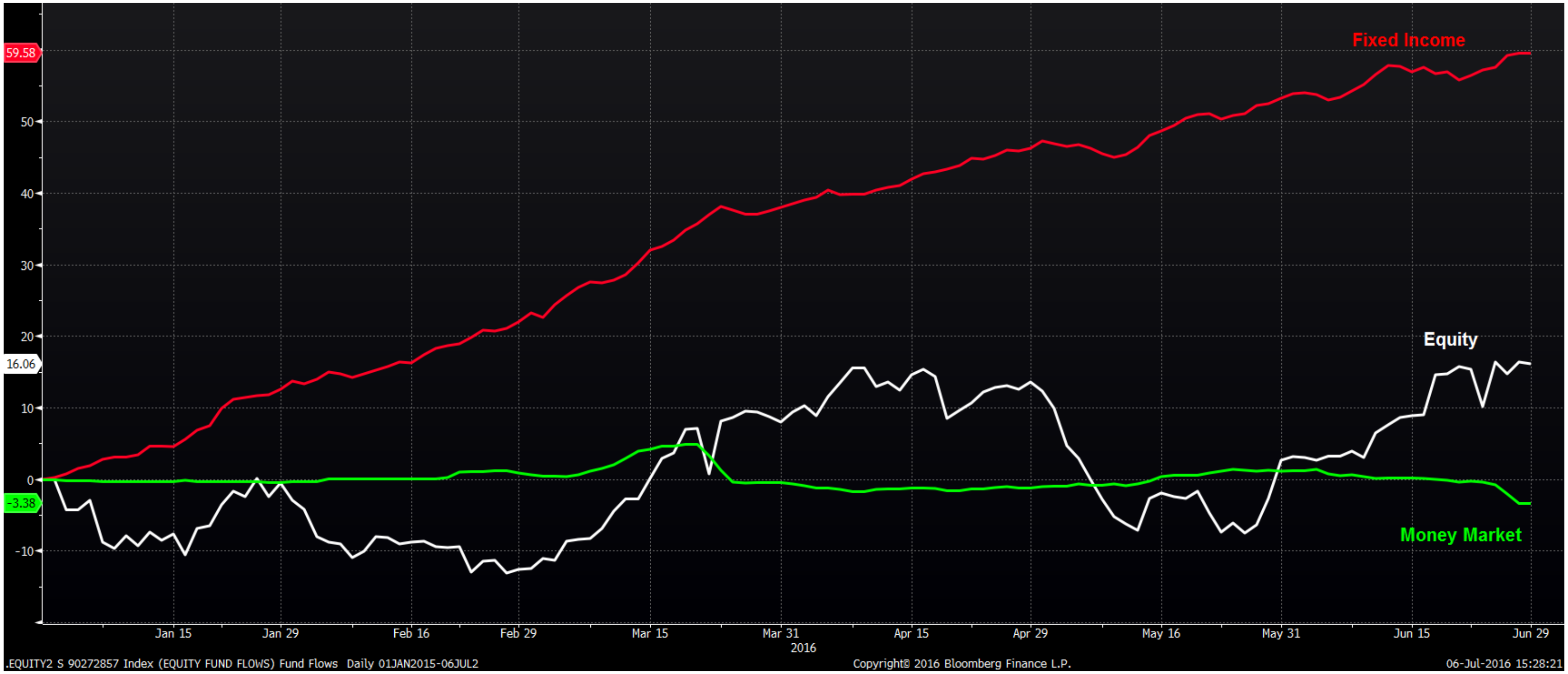
Policy makers think this is sustainable …we don’t

The divergence between stocks and bond markets is at levels that historically hasn’t been sustainable
PS. In the past bonds were right and stocks were smoking the good stuff!

Central bank Policy has driven a duration feeding frenzy with inflows into fixed income ETF and bond funds massively outstripping that into stocks or money markets



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Risk Parity has now fully re-leveraged
Therefore any bond weakness or increased volatility will be toxic

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Reserve managers are no longer selling bonds as they did in 2015 but they are unlikely to be buyers in early next year

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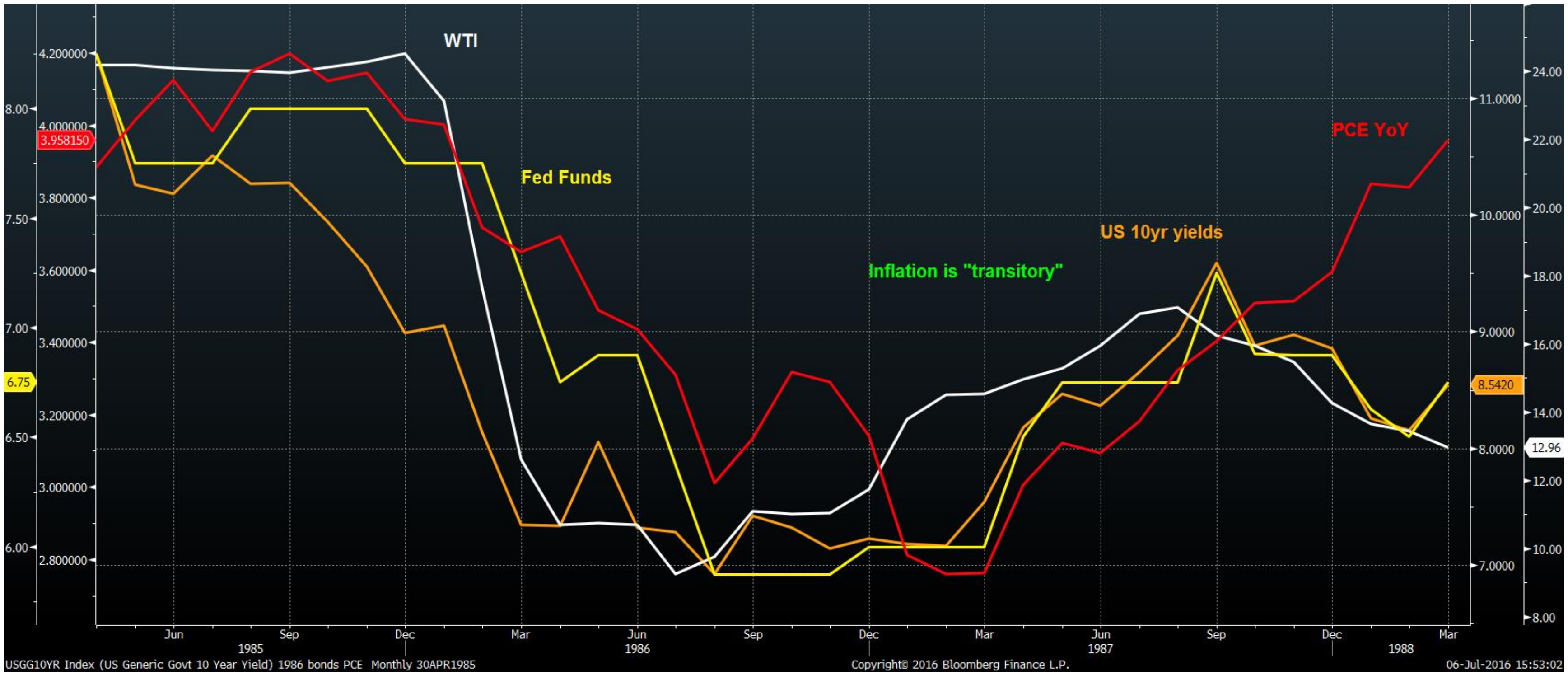
At the end of 1985 US oil production hit 9mio barrels. The Saudi's launched a price war

BONDS held in as bonds carried well and leant on Greenspan's credibility

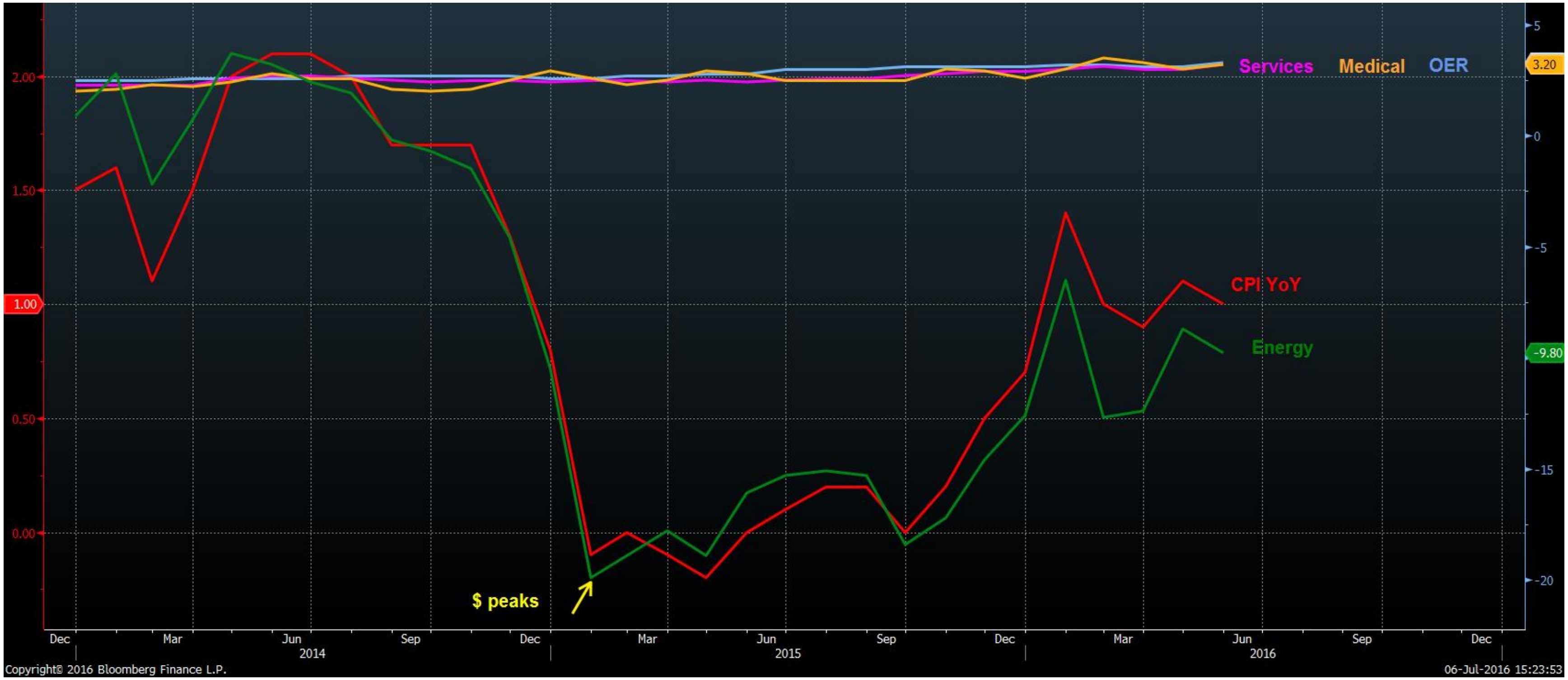


The biggest issue is the resolution of the inflation saga

Central banks have eased or delayed hikes because of fear of deflation as oil fell

But we haven't had deflation only transitory and stimulative disinflation

Crude has now rallied 80% plus. If that's sustained into 2017 energy CPI goes from falling 20% YoY to rising 20%



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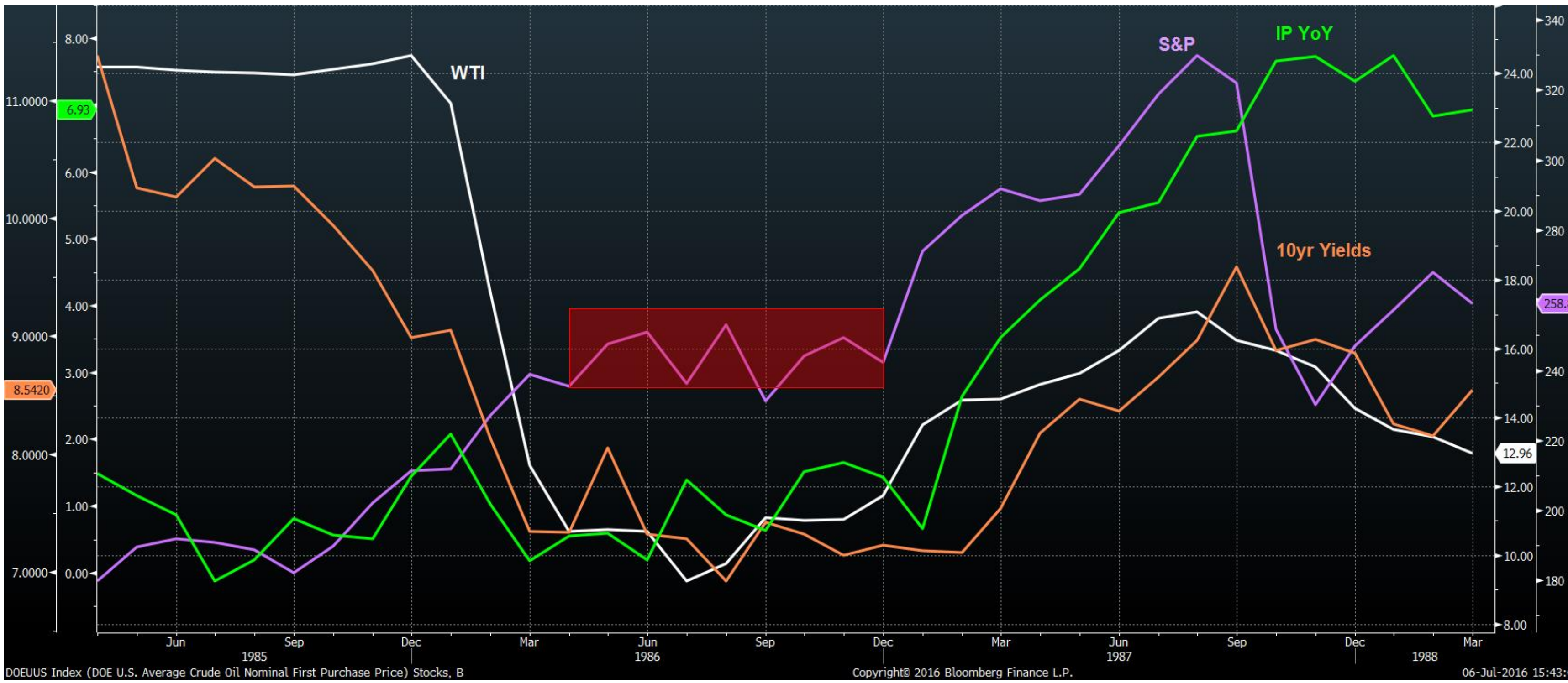
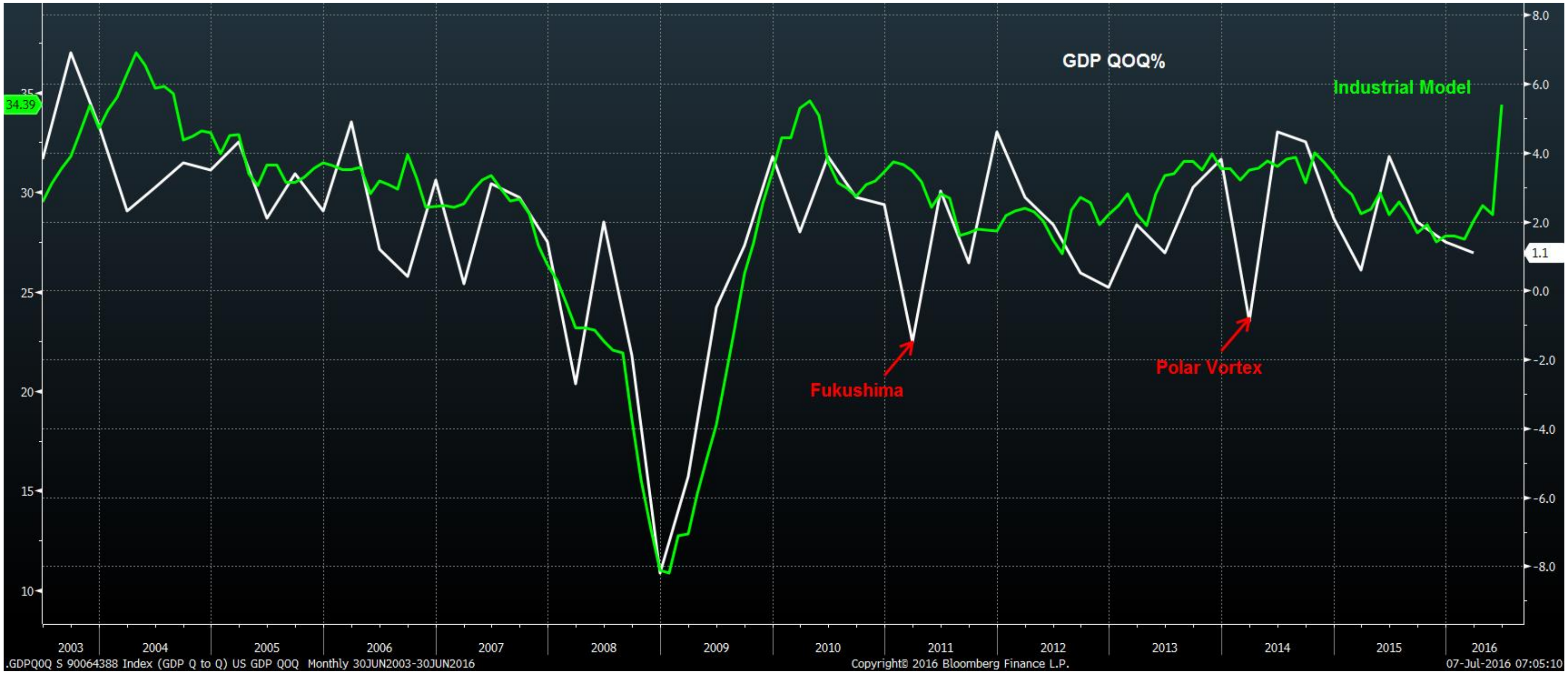
Sequencing
First oil and inflation pick up off the lows
Then stocks break Then inflation accelerates and finally IP picks up as the fallout on the oil industry passes



But its not just inflation
Last months low NFP looks like an aberration

Plus what happens if growth really picks up?

Its early days but some of our US models are suggesting a rapid acceleration into Q3



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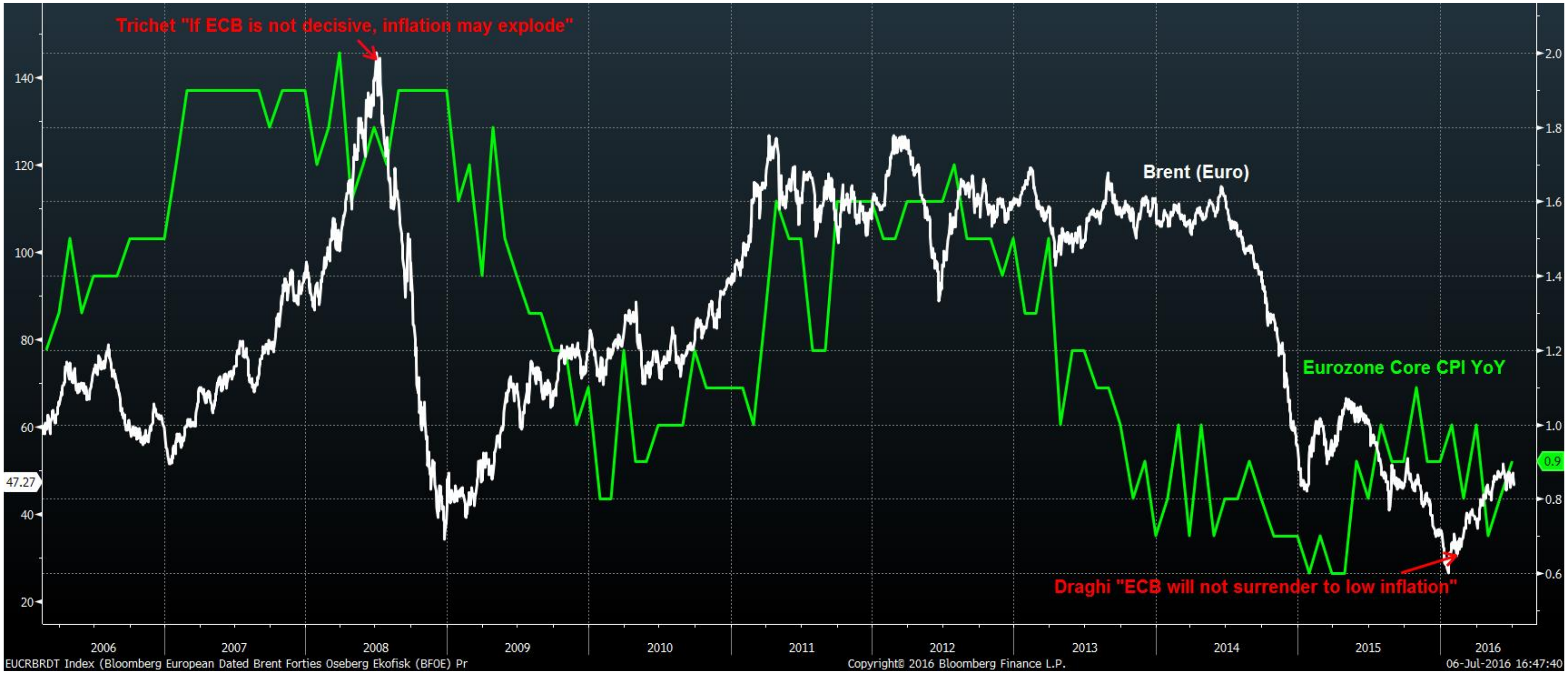
We are also seeing growth and inflationary pressures pick up in Europe

Do you really want to place your faith in the ECB record on inflation and oil?



Breakeven bonds look very cheap

We first recommended breakevens back in December but we believe they are just pausing before they move rapidly higher in the second half of the year as inflation accelerates PS. We would stick to 5yr or under

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