We have been in a tradable countertrend rally, and we are participating, while keeping a wary eye on the door. The crisis that began in 2008 is – at best – only half done, and it should be a priority to survive the remainder of the bad years, so as to be able to enjoy the next bull-phase – surely to occur sometime during the coming century or two. Patience is a great virtue, we are told. We hope to attain it – preferably RIGHT NOW!

Global Finance – Apocalypse postponed

-*from, say:* "Imminent Catastrophe of Galactic Proportions" *to merely "*Worried"

The announcement of unlimited bond purchases by the ECB with the proviso that countries requiring Central Bank support accept a binding austerity programme is the best news that could have been realistically hoped for. Numerous hurdles remain – political, legal, legislative and especially, public opinion in the creditor countries, which has ranged between the merely ignorant, the pompously obtuse, and the partisan-to-the-point-of- jingoism; as per usual, it has been badly misled by the media. Fortunately, in a rare display of political courage, the European leadership has shown some willingness to ignore the noise from the street.
Hope dies last, and a series of (for once, well- coordinated) statements by the likes of Merkel, Draghi and Monti over the last few weeks give some reasonable hope that the apocalypse may yet be averted.

The only real question is whether the emergings can provide enough growth to prevent a global crash. Our relatively bullish stance on China has thus far not been falsified – despite daily scare stories in the press, Chinese industrial output as just been announced at +8.9%, fixed asset investment is up 20.2%, retail sales are up 13.2%, property prices have stabilized, while 2012 GDP is estimated at about 7.5%. Given the absence of any net growth in export orders as the rest of the world contracts, these numbers are quite extraordinary.

That said, given the importance of their export sectors, neither China nor Russia is immune to the global downturn; at best, with deep and liquid domestic consumer markets and room to leverage, they are the sole remaining hope for global growth. Ex-Chinese growth, in 2009 the global economy would have doubtless swung into a catastrophic depression.

It is perhaps a thin reed – of the remaining BRICs, India's problems are now becoming painfully apparent (we have long considered Indian democracy to be a distinctly mixed blessing); Brazil is bouncing off zero growth; as regards South Africa, we never thought it belonged to the group, so its gradual decline is neither a surprise nor of any profound significance – Turkey and Indonesia strike us as far more credible baby-BRICs.

In short, investors would be well advised to discard any illusions; if the 30 years preceding the 2008 crunch taught them to expect V- shaped recoveries, other letters are now more likely – a long line of Ws for instance. Under these circumstances, we would tend to favour value, and, especially, the generation of cash flows to the investor – i.e. high dividends. Our own preferred asset class, emerging fixed income, is likely to continue to outperform quite substantially for as long as base rates remain capped, but economies do not collapse altogether.

It remains our working assumption that markets will enjoy a few more years of ultra- low interest rates, low (if no longer declining) inflation, and very weak growth – an ideal scenario for our leveraged debt plays. On the other hand, we consider that, at some point an inflationary breakout becomes inevitable – and trading strategies must be ready for rapid shifts. We continue to keep our durations short and our currency allocation flexible. Beware! The standard hedging strategy – shorting long duration benchmarks, could be savaged by outright monetary funding of government deficits via bond purchases in the secondary market.

Where could we be wrong? The danger, of course, is of a resurgence in inflation. While our working assumption is that, in the near-term, slow growth and unused capacity will cap price pressures, if we are wrong, the massive monetary creation of recent years will provide more than ample tinder for the conflagration. Furthermore, we cannot exclude the risk of governments consciously opting to inflate away their huge debt loads, which simply cannot be repaid without unacceptable social consequences. Ultimately Japan and the US are most exposed to this risk, with neither one having yet even begun to address their fiscal problems.

How to Trade It

Whether you are trading pork bellies or Venezuelan bonds, prices across all financial markets have recently been driven primarily by global risk-on/risk-off. The havoc in Europe had scared investors onto the sidelines – with huge piles of undeployed cash awaiting a chance to get itself into trouble. Thus, with any sequential improvement in expectations for the European Debt crisis – from, say: "Imminent Catastrophe of Galactic Proportions" *to merely "*Worried" *leads to a veritable lunge for risk.*

Currencies
We are back to shorting the US dollar against a broad range of currencies and hard assets. Given that the next fiscal crisis is likely to take place in Washington (though timing is a matter of conjecture – the "Fiscal Cliff" could potentially trigger a panic), we are looking to lay off the dollar exposure in the portfolios we manage.

Our primary hedges remain long the Singapore Dollar and the Chinese Yuan, with perhaps a side-bet on the Korean Won;

For the shorter time-horizon (the only one which anyone really cares about) we would be ready to buy dollars if for any reason the market moves back from greed to fear, while further shorting the USD with any further improvement in the mood.

Gold – by no means our favourite metal – has performed very nicely given further US monetization of debt. We would see it more as one component of a hedging strategy for dollar-based portfolios.

Fixed Income
Emerging corporate fixed income markets have been glorious of late. Unlike in 2008, during the worst of the most recent risk-off period they held up remarkably well, with money flowing out of equities, seeking yields above the negative real rates of benchmark assets. Much of the selling by prop desks and hedge funds being squeeze by respectively regulators and redemptions was absorbed into private banking, where emerging market debt has suddenly become quite fashionable. Traditionally conservative institutions are now happy to provide leverage against this once slightly disreputable asset class.

The main problem has been a lack of liquidity as some bank proprietary desks have been wound down, with risk limits slashed at the others.

Below you will find a presentation of an Improving Access to Asian Bonds.
It shows the comparative advantages offered b y this region over the western world as well as the growing liquidity along a stable and improved credit rating.

-Commodities

Although the Peak Oil theory is currently out of fashion, the new reserves being found are increasingly expensive to exploit, with lifting costs for the newest projects running to $50- $80 per barrel, not counting the huge Capex. Furthermore, the bearish consensus by oil company analysts has actually been a major factor driving the rise in oil prices; low predicted forward prices have meant that numerous projects were mothballed as being uneconomic given the high hurdle rate.

In view of the parlous global economic situation, we would rejoin the consensus in avoiding industrial metals (we did not say "go short' – just be cautious), would buy gold/silver, and especially, would remain long oil – if only via an "oily" portfolio, i.e. companies and countries heavily leveraged to the oil price.

While it is currently quite fashionable to be a commodities bear, much of this is based upon comically misguided views on China, and as noted by a friend in Beijing, the bearish commodities trade may already have its best days behind it.

-Equities

We would put a premium on liquidity, and would trade with a short time exposure, positioning via indices/ ETFs, *inter alia* in Chinese A shares, HK H shares, but also, selected Russian equities, we reiterate our preference for the oil Prefs: Tatneft, Banep, TNBPP and Surgut – in approximately that order.

On the other hand, we will stay clear of positioning in the US market, given the fiscal havoc to come.