



# Market SitRep

## Reflation Redux



# Topics

- China's Addiction
- Oil Update - Still Bearish
- The False Reflation Trade
- Quant/Technical Overview



# China's Addiction

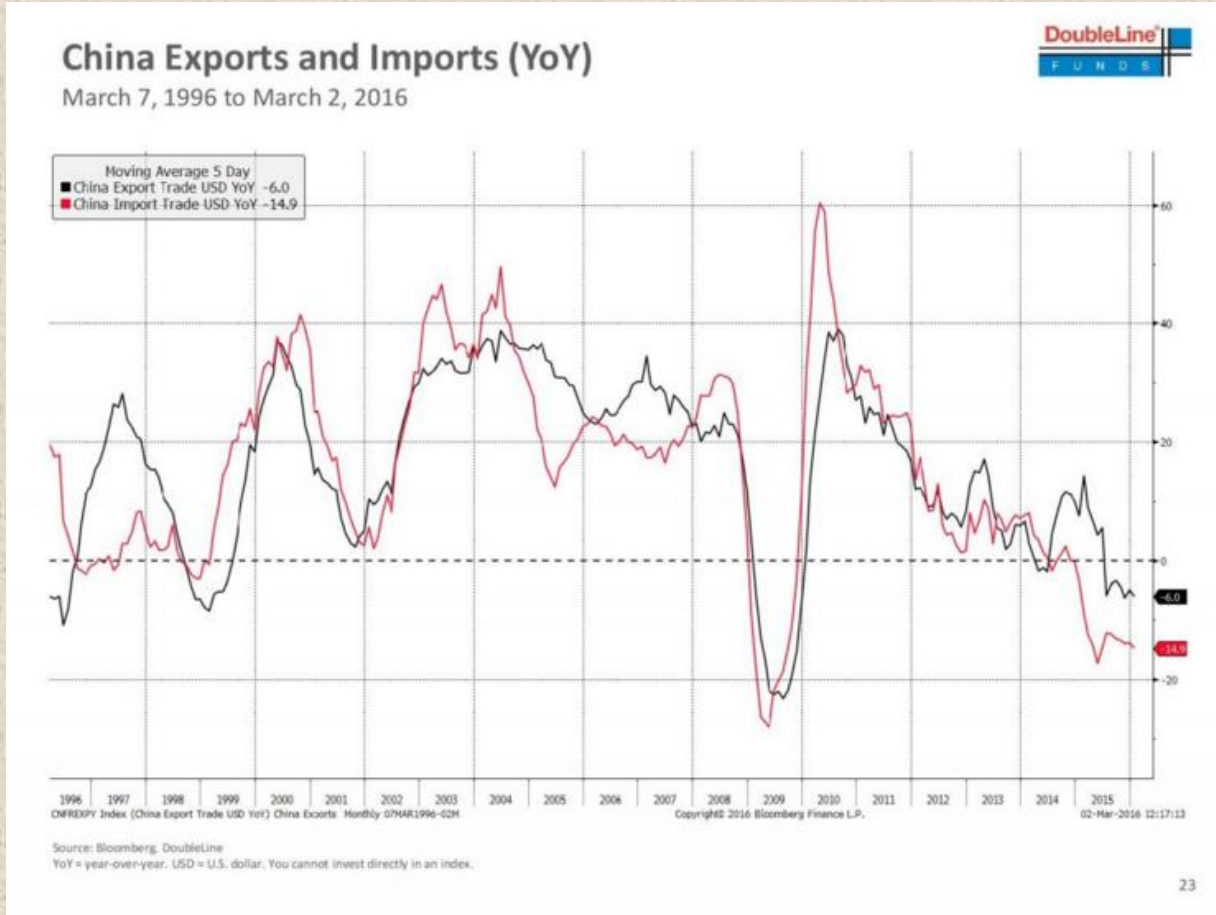


# Same Shit Different Day

- China is slowing.
- They try to fix it by adding on more and more debt.



# Same Shit Different Day





# Same Shit Different Day





# Same Shit Different Day

- What do they do?
- More debt!
  - Margin debt
  - Mortgage debt



# Same Shit Different Day

- Remember the margin debt fueled rally in Chinese equities last year?





# Same Shit Different Day





# Same Shit Different Day

- They are igniting the fire again.

# Same Shit Different Day

- WSJ reported that China Securities Finance Corp., which is a state lender that provides funds to brokerages for margin finance has ramped up activity again.
- They resumed offering short-dated loans and cut the interest rates on a longer-dated ones.



# Same Shit Different Day



# Same Shit Different Day

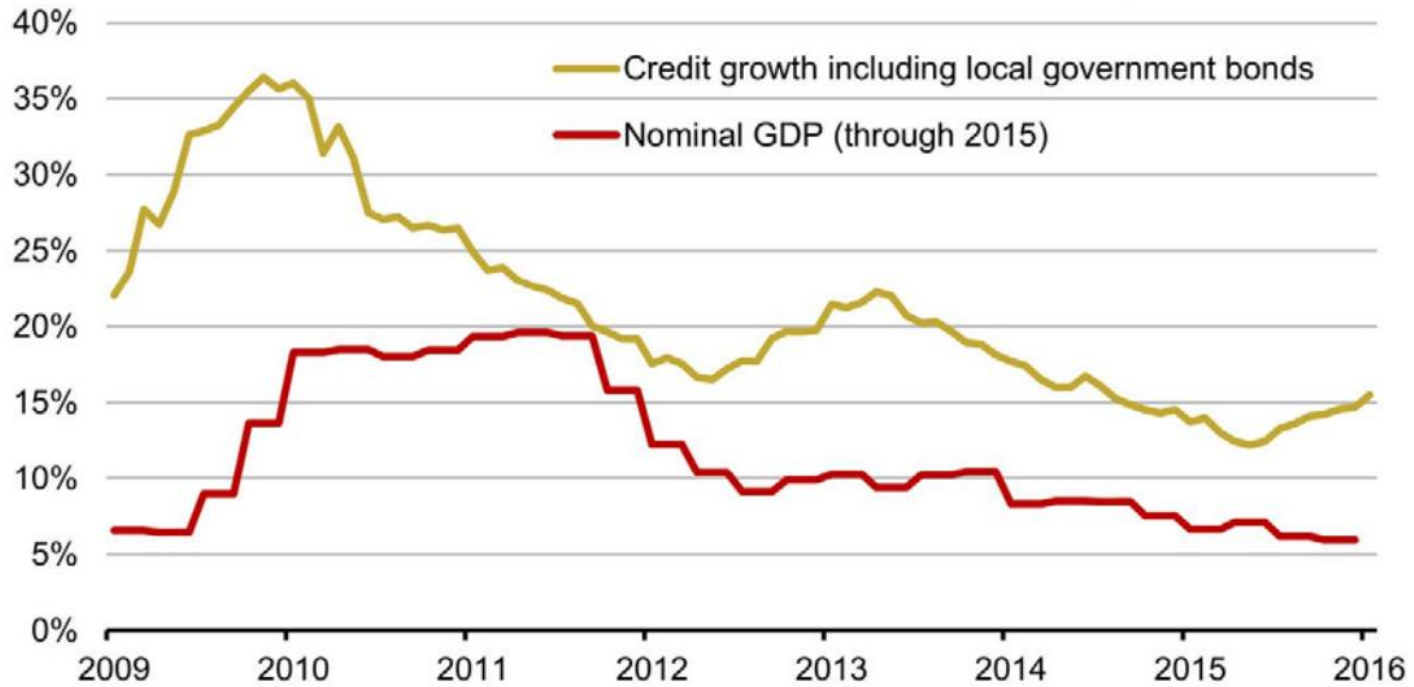
- The problem is China has also neared that “pushing on a string” point where every new unit of credit is having a smaller and smaller multiplier effect on demand.



# Debt Up Growth Nowhere

## Less Growth, More Debt

China's economy is slowing, but it isn't deleveraging, as credit growth expands faster than nominal GDP. That should continue under Beijing's 2016 economic plan.



Sources: CEIC, People's Bank of China, National Bureau of Statistics | THE WALL STREET JOURNAL.

# Property Goes Nutty

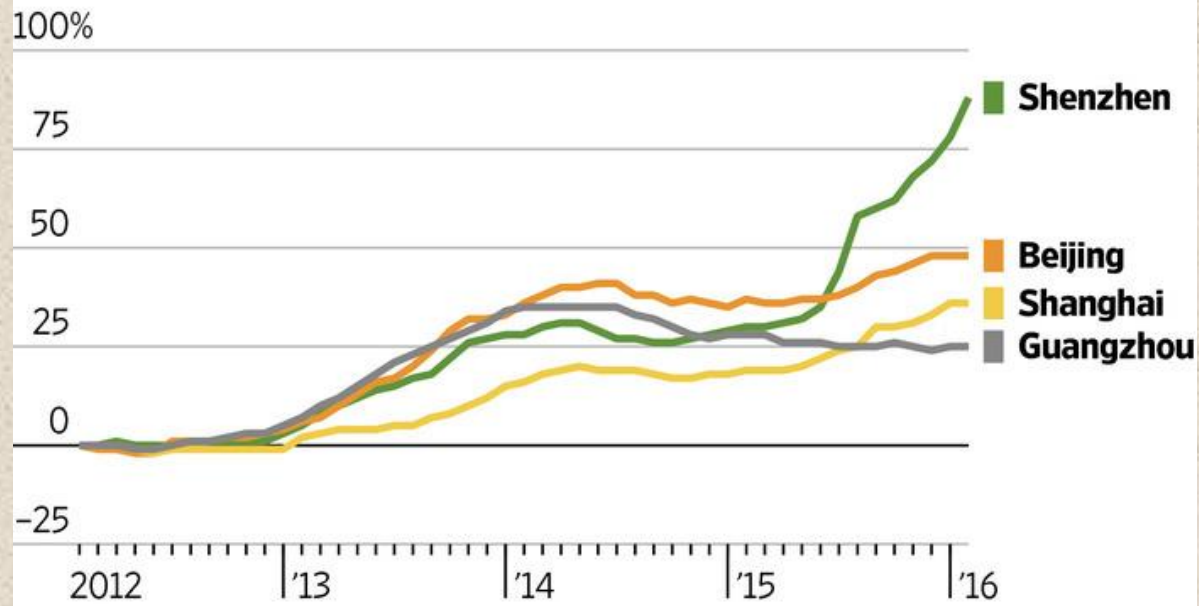
- Real estate is the “in favor” mechanism for credit growth.
- China real estate looks a lot like the Chinese stock market back in 2015.
- The same boom bust is the likely scenario.



# Property Goes Nutty

## Special Economic Zone

Average selling price of new apartments, percentage change from January 2012



Source: Wind info

THE WALL STREET JOURNAL.



# Smart Vs. Dumb

- The smart money is using the hot market and easy credit to move capital outside of China.
- The dumb money is using the hot market and easy credit to play the real estate market like a game of baccarat.

# Smart Money

- The informed wealthy are using the easy credit conditions and the hot real estate market to raise cash and convert their CNY into USD because they are afraid of a devaluation.
- Caixin, an economic publication from China, explained the process.



# Smart Money

- Step 1 - Owner marks up a property that they already own
- Step 2 - Owner gives an employee the down payment and fakes his income so he can get a mortgage



# Smart Money

- Step 3 - Employee buys the property from the owner at an inflated price, owner pockets the cash (minus down payment he gave to employee)
- Step 4 - Owner fakes some invoices through his business to convert the CNY into USD

# Smart Money

- The owner now waits for the PBoC to devalue the yuan. His money is not trapped in local real estate anymore. He can convert back from USD to CNY after the devaluation.
- The employee gets to live in a luxury spot until the bank forecloses on him.

# Dumb Money

- The poorer uniformed speculators, the same who bought the stock market at highs last year, are piling into the housing bubble to make a quick buck.
- They will be fleeced yet again.

# Dumb Money

- There is speculation that the Party wants the citizenry to pile into houses on purpose.
- If the people hold illiquid assets they can't escape when the big devaluation comes.



# Oil



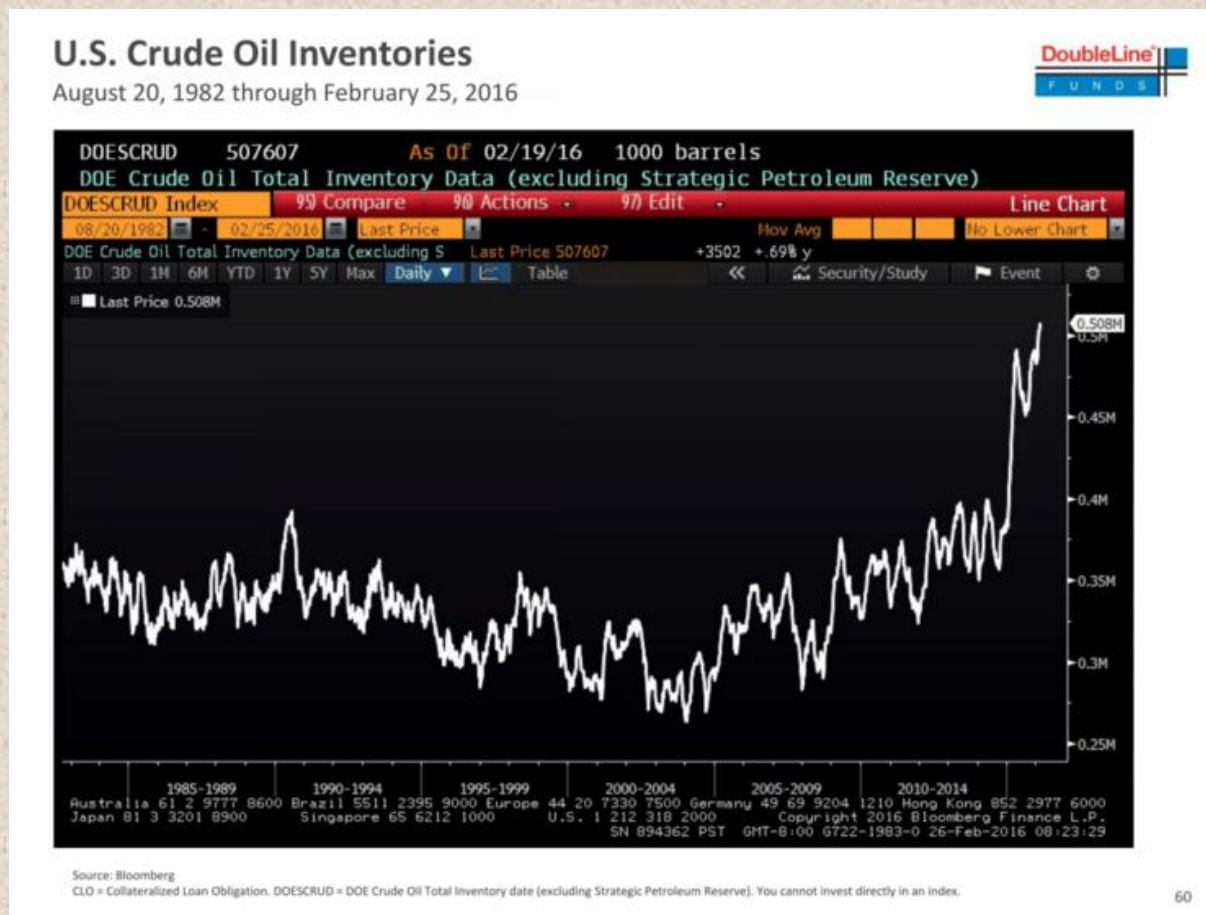


# Inventories Through The Roof

- Oil is going to have a hard time rallying with all the excess inventory around the world.
- Best of luck to the oil bulls.
- We still think sub 20 oil is coming.

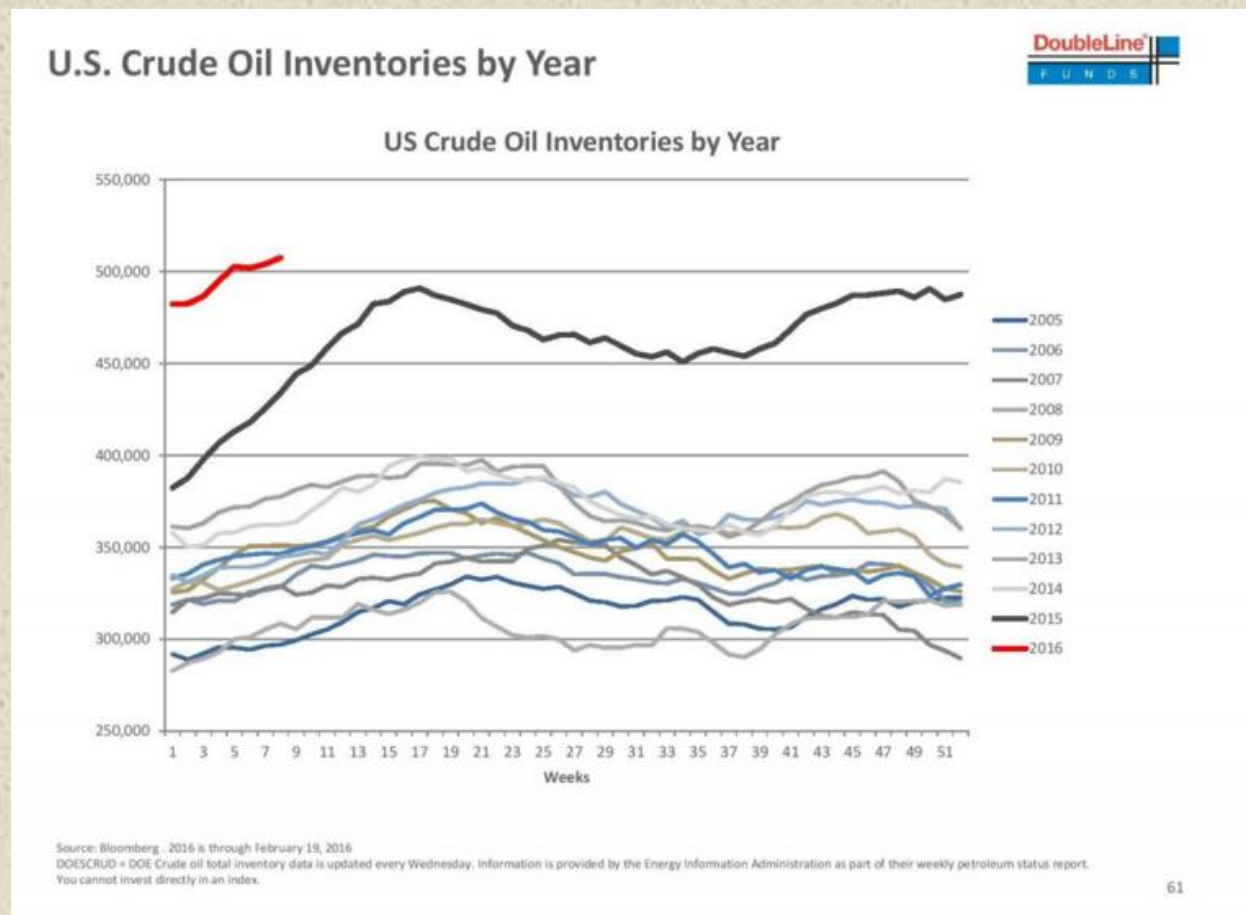


# Inventories Through The Roof





# Inventories Through The Roof





# Inventories Through The Roof

## The Second Act in Oil Market Rebalancing

Clearing inventories accumulated since 2014 could take until next decade



Source: International Energy Agency

Bloomberg

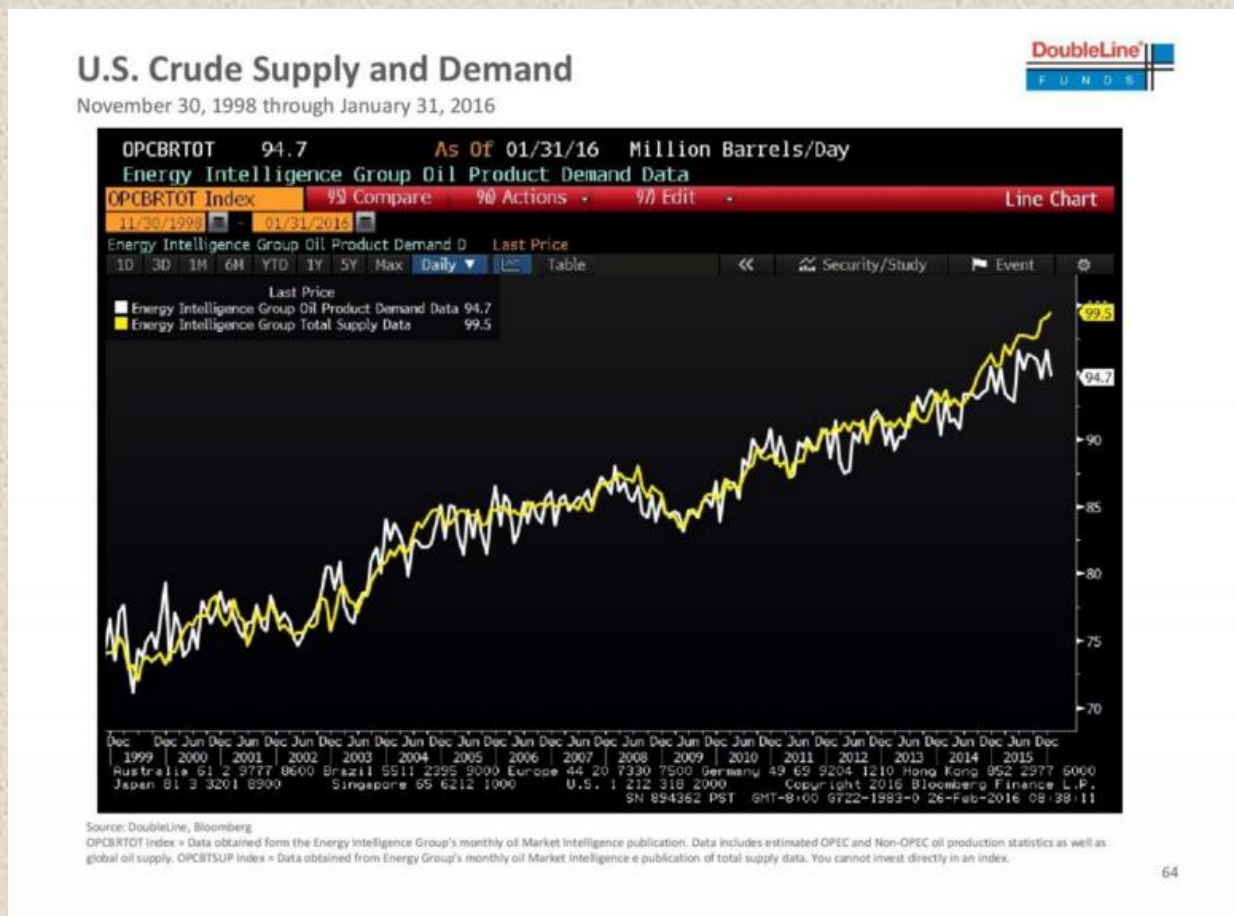


# Supply And Demand

- The gap between supply and demand is getting worse not better.
- We have a glut in oil period.



# Supply And Demand





# The False Reflation Trade

# False Trends

- The market is trading like inflation is back on the table.
- There is battle right now between inflationary monetary policy and the deflationary effects of the long term debt load.





# Charts

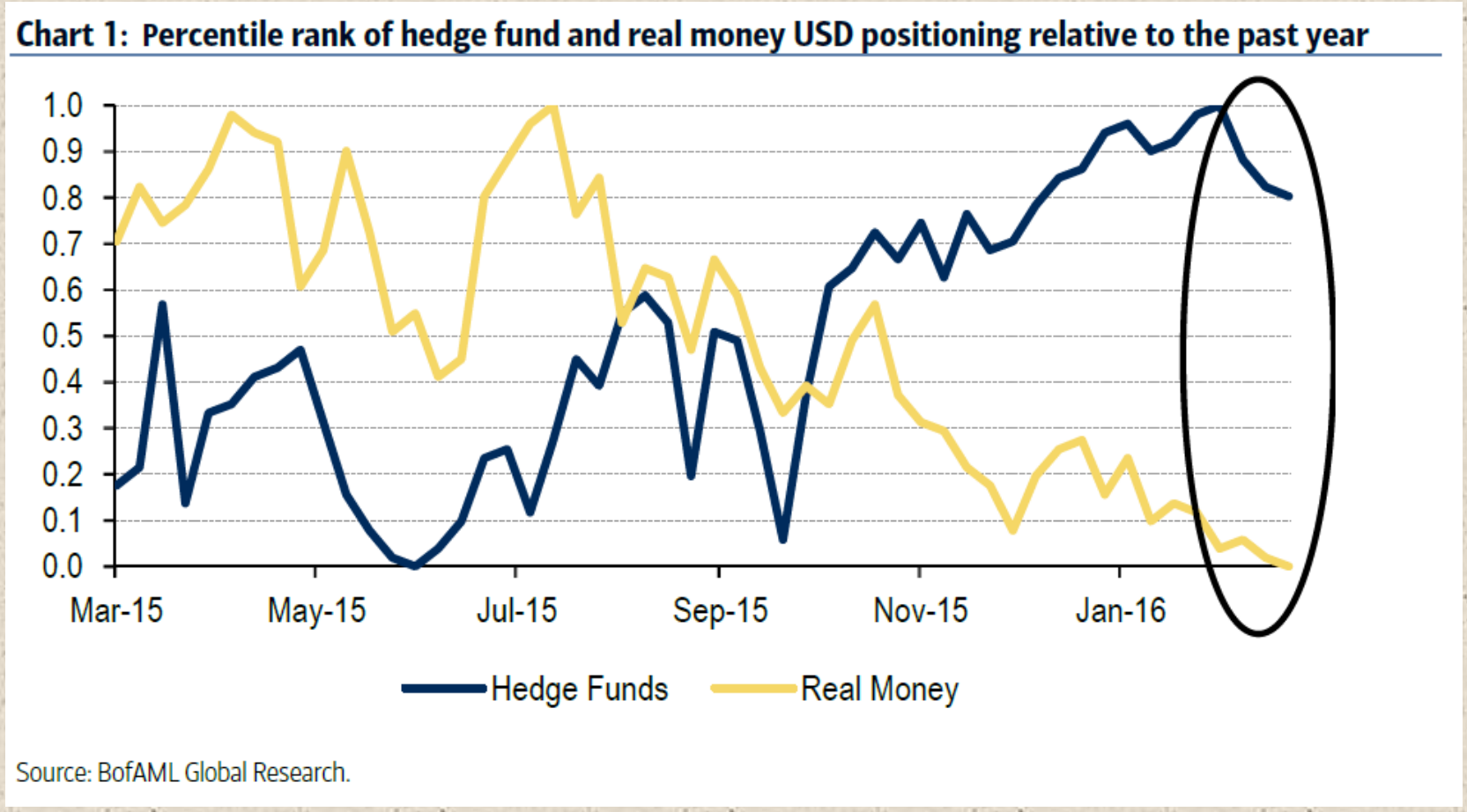
- Dollar
- Gold
- Oil
- Ags

# Repositioning

- But we believe all these moves are short term hope jags due to repositioning.
- The hedge funds are unwinding mistimed bets causing the dollar to drop.
- The dollar weakness causes the entire “inflation” complex to rally.



# Unwinding From Hedge Funds





# Deflation Is Still Dominant

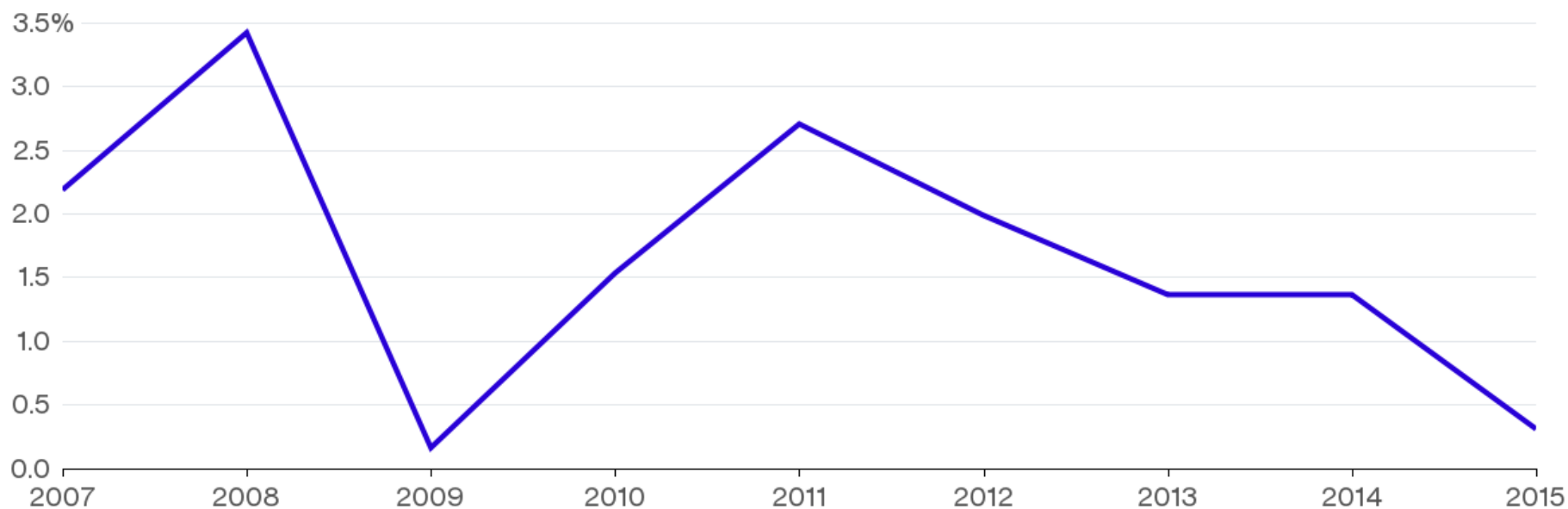
- The recent hints of US inflation are completely transitory.
- They're a smokescreen.
- They are small ripples knocking against a tidal wave of deflation.



# Chart

## Time to Fire Up the Helicopters?

Inflation stays soft in advanced economies since financial crisis



International Monetary Fund

Bloomberg



# Dalio Agrees

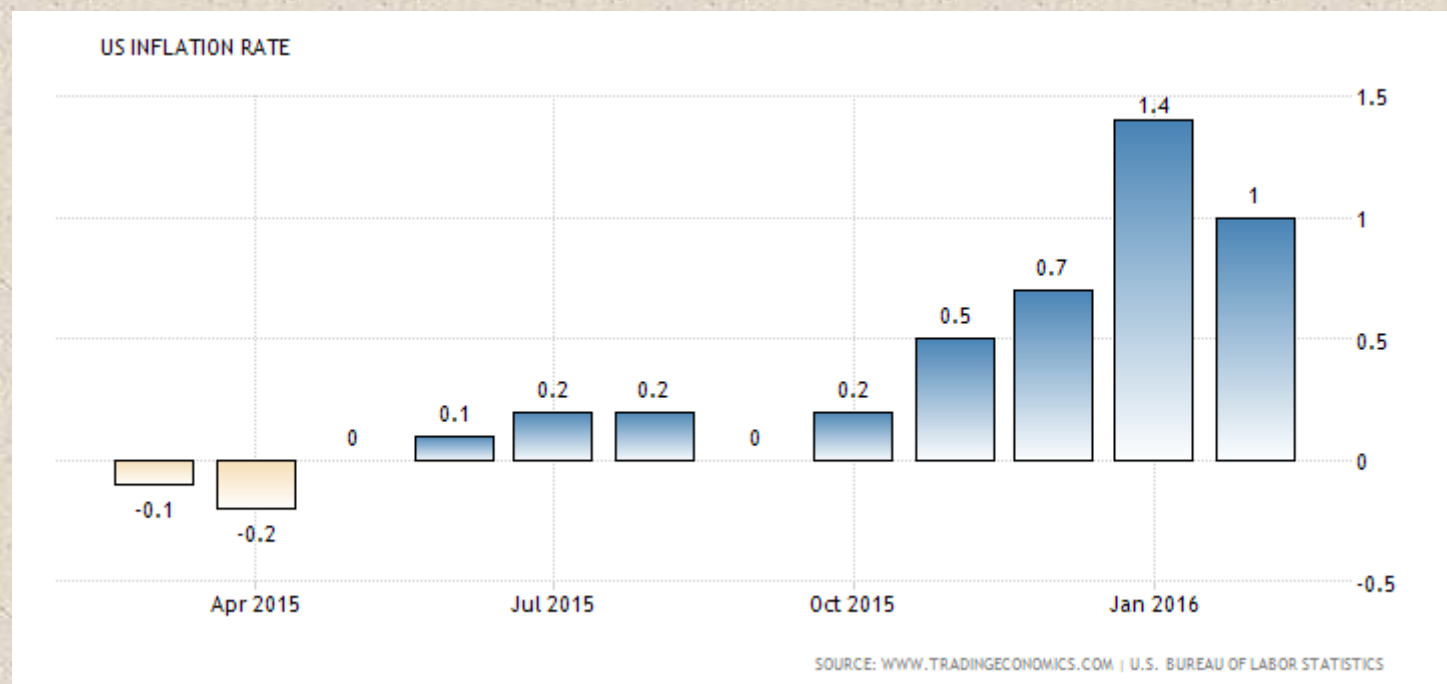
- “If you look around the world, our risk is not inflation and our risk is not overheating economies.” –Ray Dalio



# Fed Is Still Hawkish

- According to Bullard (Federal Reserve Bank of St. Louis President) the Fed will not hesitate to raise rates and tighten further once inflation nears targets.

# CPI







# PCE

## PCE Inflation Distribution and Dispersion Indicators

echo

PCE Measures - 12-Month Inflation Rates*	15-Jan	15-Jul	15-Nov	15-Dec	16-Jan	Ten Year Average
<i>Distribution of Inflation</i>						
Total	0.16	0.32	0.52	0.68	1.25	1.73
Core	1.29	1.26	1.39	1.46	1.67	1.67
10th Percentile	-2.43	-2.42	-1.28	-1.88	-1.14	-1.78
25th Percentile	0.15	0.00	0.10	-0.23	0.00	0.88
Median	2.26	1.27	1.81	1.98	1.68	2.12
75th Percentile	3.03	3.09	2.92	2.92	3.03	3.19
90th Percentile	3.99	3.73	3.22	3.30	3.32	4.41



# Bonds Still Holding Up



# The Runway Is Short

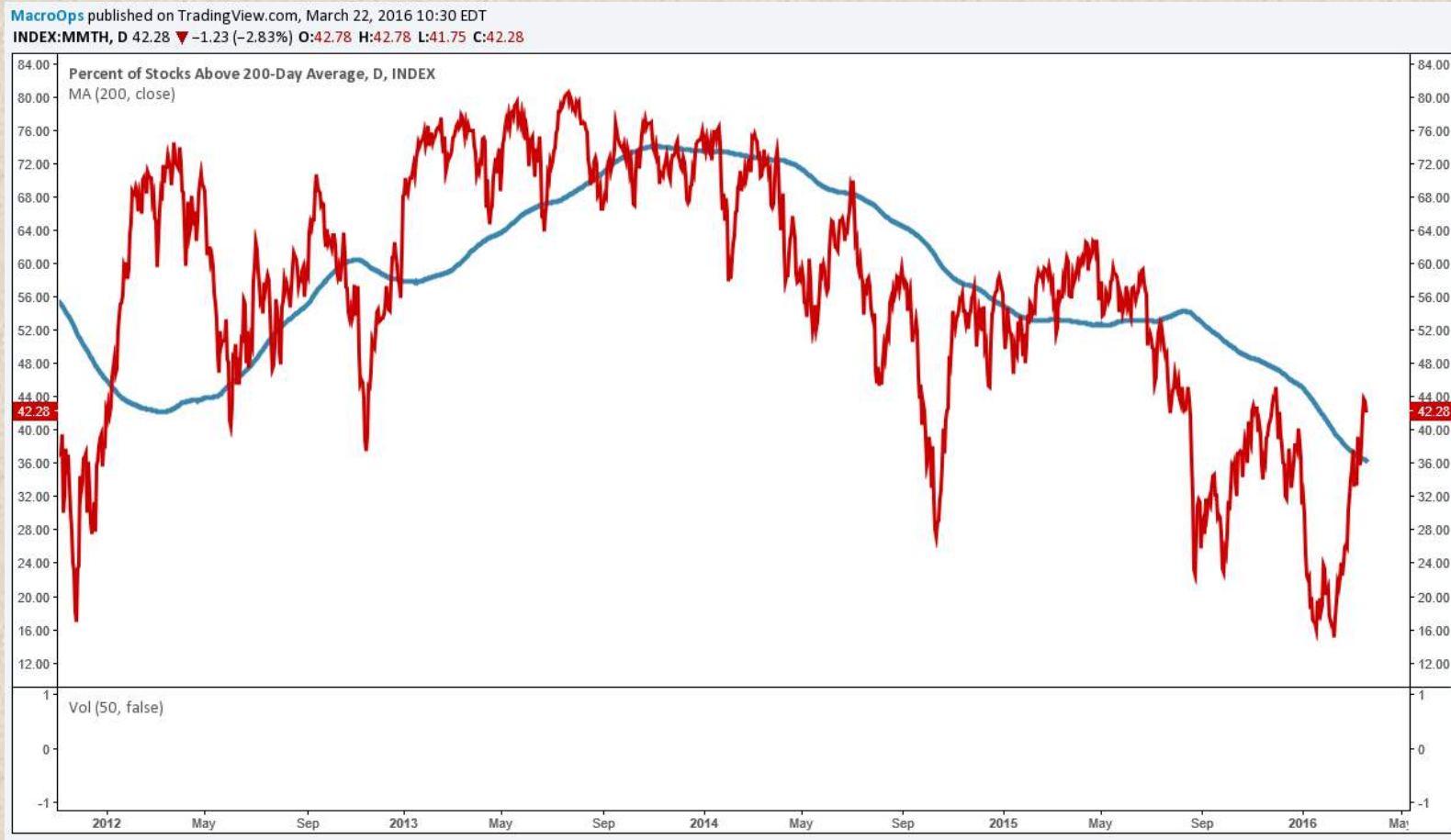
- The “reflation” trade doesn’t have a lot of runway ahead of it.
- There are massive deflationary headwinds on a global scale that do not make this trade attractive.
- As we know, debt loads make rampant inflation near impossible at this point.



# Quant/Techs

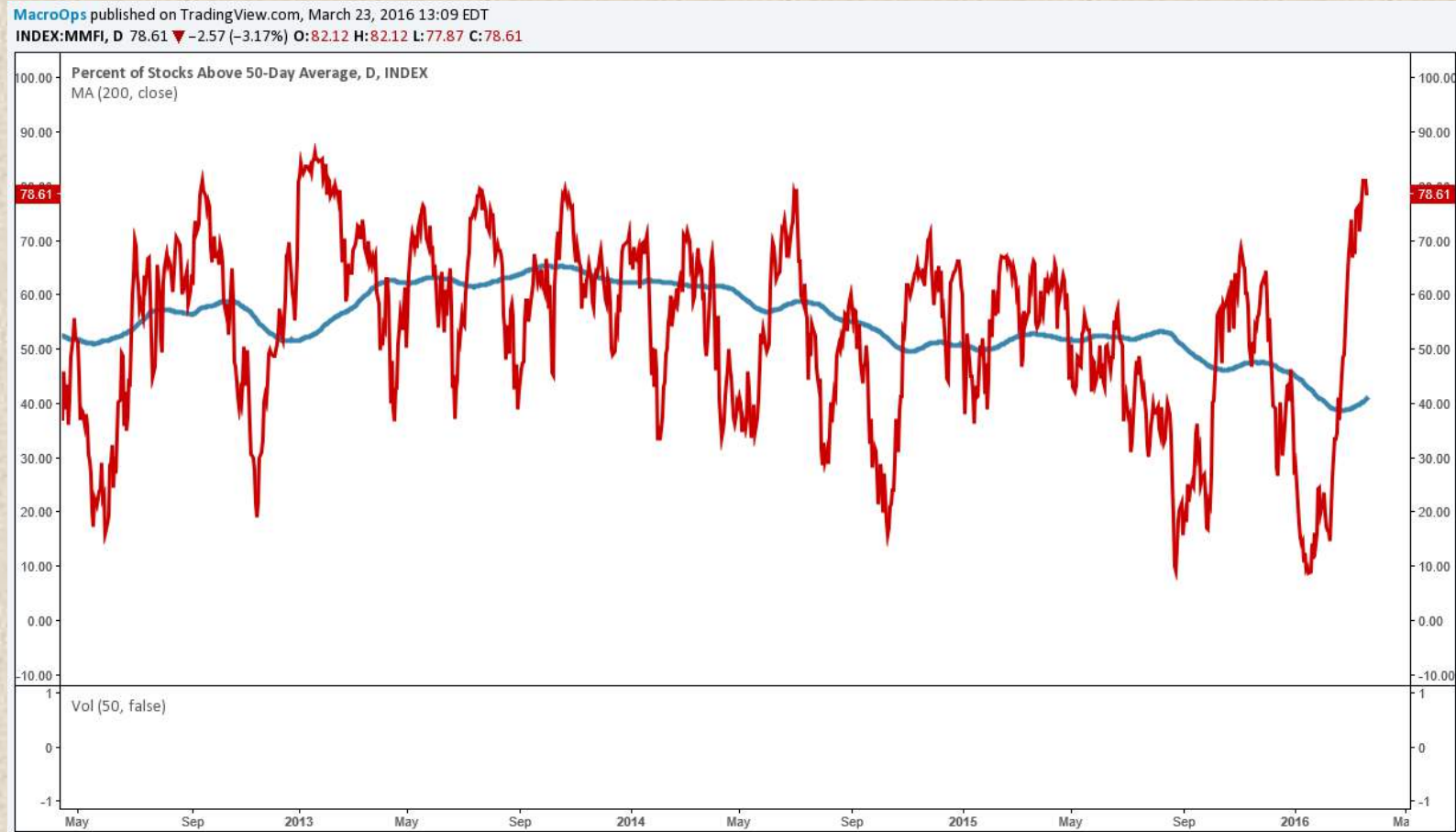


# Stocks Above 200 MA





# Stocks Above 50 MA





# SPX Vs. Percent Above 200 MA





# Canary In The Coal Mine







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