# N I G H T B E R G

*Overview* | 2016

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## Live Macro Strategy Product

Nightberg is an independent New York-based *global macro strategy firm*, born from the partnership of experienced, broad talent from the macro hedge fund industry. The firm's clients include some of the world's leading macro hedge funds and family offices, asset managers, Fortune 500 corporations, government agencies, and advisories.

Nightberg offers a *live macro strategy product*, creating and publishing original, high-quality investment insights with a special focus on foreign exchange markets. Blending economic, policy, price action, and capital flow inputs, the firm strives to be a unique voice on macro investment opportunities.

## Founders & Partners

Nightberg was established in 2015 by Mario Manna and Birgir Haraldsson. Prior to Nightberg, Mario was a senior trading strategist at global macro hedge fund pioneers Bridgewater Associates and Moore Capital. He also held senior sales roles at Navigate Advisors and Jefferies. Birgir was formerly a strategist at Harness – a macro currency hedge fund partially owned by Brevan Howard. He also worked as a global macro analyst at renowned hedge fund Caxton Associates in New York and Jefferies.

Pia Family Office – the investment vehicle of Christopher L. Pia, founder and CIO of Pia Capital Management and formerly an original partner, board member, and senior portfolio manager at Moore Capital for 20 years – is a seed investor in the firm.

## Products & Services

Nightberg publishes its proprietary investment insights six days a week, offering a strong menu of products to its clients. The firm's publications are the following:

- *Sunday Observer:* published on Sunday, this investment-letter style product analyzes themes, the multi-asset class price action, and global capital flows.

- *Macro Portraits:* tracks the evolution of macro narratives as new, incremental economic and policy information is reported.

- *Country Reports:* visually powerful chart-book that offers a comprehensive assessment of economic and policy profiles of investable countries.

The firm also offers bespoke research upon request.

# N I G H T B E R G

*Sunday Observer* | December 20, 2015

## Fragile World and Fearful Investment Capital as 2016 Rings In

**TOPIC**

GLOBAL

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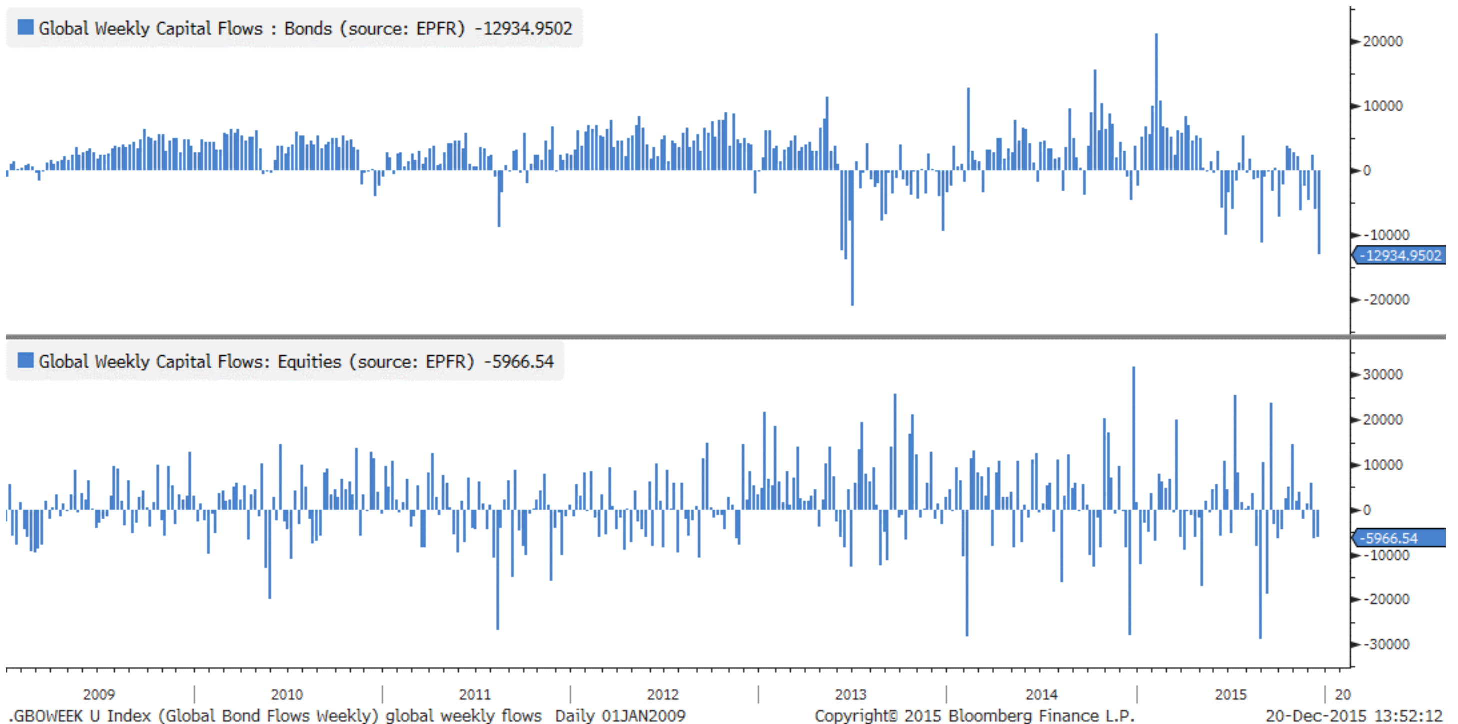
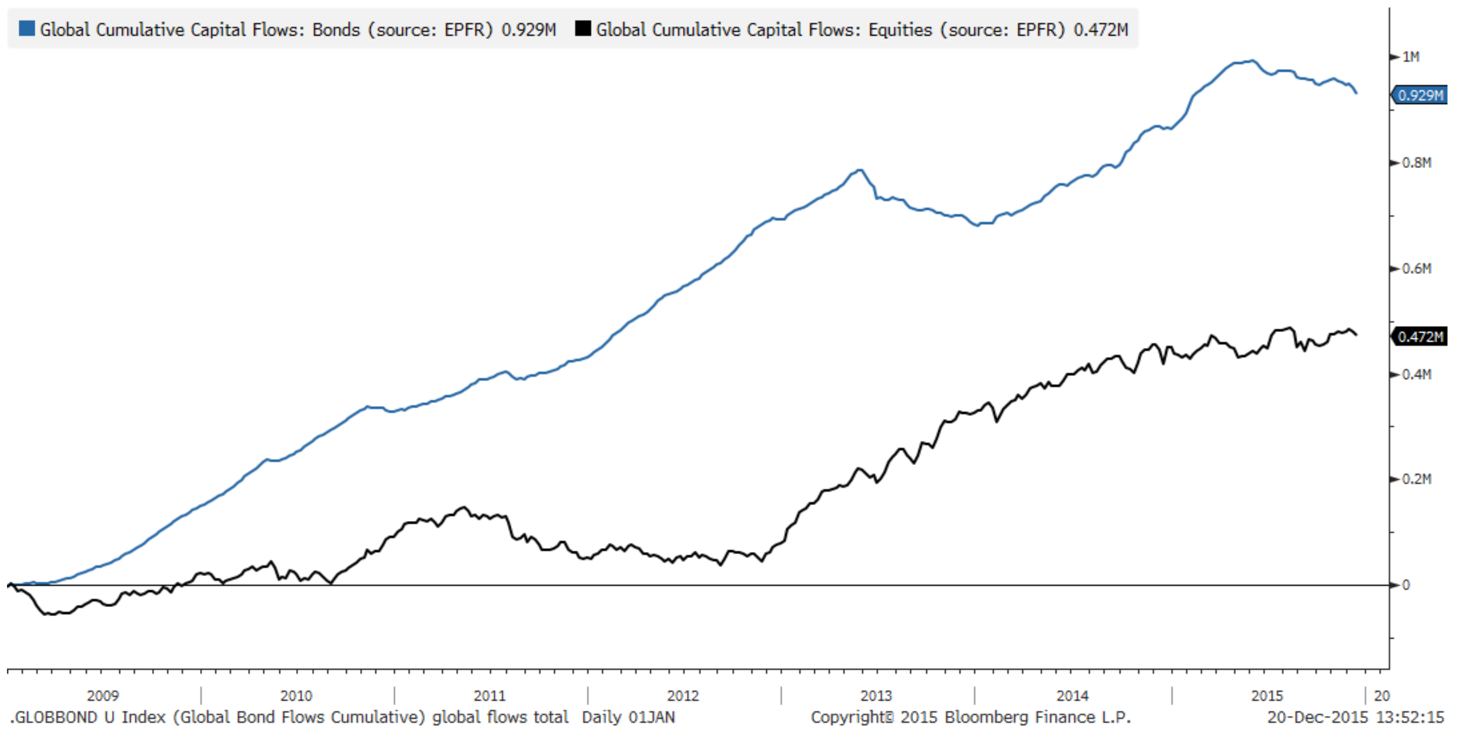
We carry the concept of a *fragile world and fearful investment capital* into 2016 as our characterization of the global landscape to guide the quest for trading opportunities. In practice this translates into an environment which is selective and discerning with local narratives driving performance and leadership. Placing the weak against the less weak is the order with decreased risk exposures and scare reflected in cash balances that are now close to levels last seen in the 2008 crisis. In this context, the credible tail-risk to internalize over the investable horizon is a US growth deceleration.

To start, the angst in the capital flows was particularly deep last week with both global bonds and equities facing withdrawals. The former asset class was hit hard with a total of $13B pulled out by investors. To give some context around this number this is the steepest pace of outflows from global bonds since the Taper Stress in mid-2013. Moreover, this is also the third largest weekly drainage over the whole post-crisis period. These are significant figures.

While the outflows were less dramatic in equities they do emphasize the lack of spirits in the asset class this year. Precisely, we've had $21B in fresh allocations into global equities year-to-date which is miniscule in comparison to the $125B and $245B in inflows seen in 2014 and 2013. The story is the same in bonds with $65B injected into the asset class in 2015 which is a lot weaker than the $180B last year. Outflows of $8B were recorded in 2013.

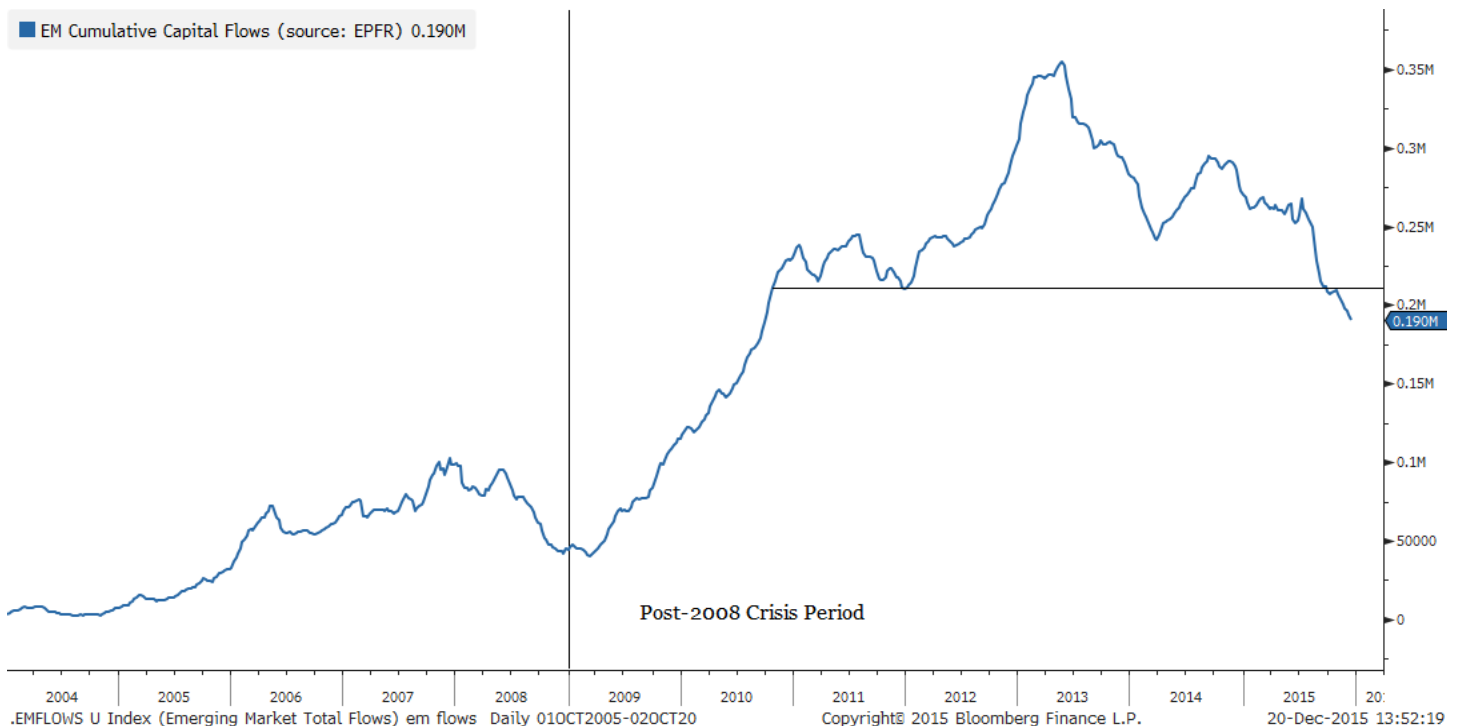
In short, we see no *behavioral shifts* in the global capital flows as this synchronized allocation-fatigue into bonds and equities persists with no catalyst of change in sight.






Buried under these aggregate figures is the ongoing liquidation of EM exposures from global investment portfolios. This year the selling has occurred at a rapid pace with the year-to-date amount at $80B which dwarfs the $13B and $18B in outflows out of EM bonds and equities in 2014 and 2013. The third consecutive year of withdrawals from EM assets is now officially recorded.

The question is whether this streak and acceleration in selling pressures marks a climax in the EM negativity. Even as the three-year pessimism slogan has some attractive contrarian features we would tread carefully. To our eyes, even as we've pulled out one-half of the amount that came into EM assets in the post-crisis period there is nothing to say that more can't be liquidated. The soft side is further selling, not an inflow spurt.

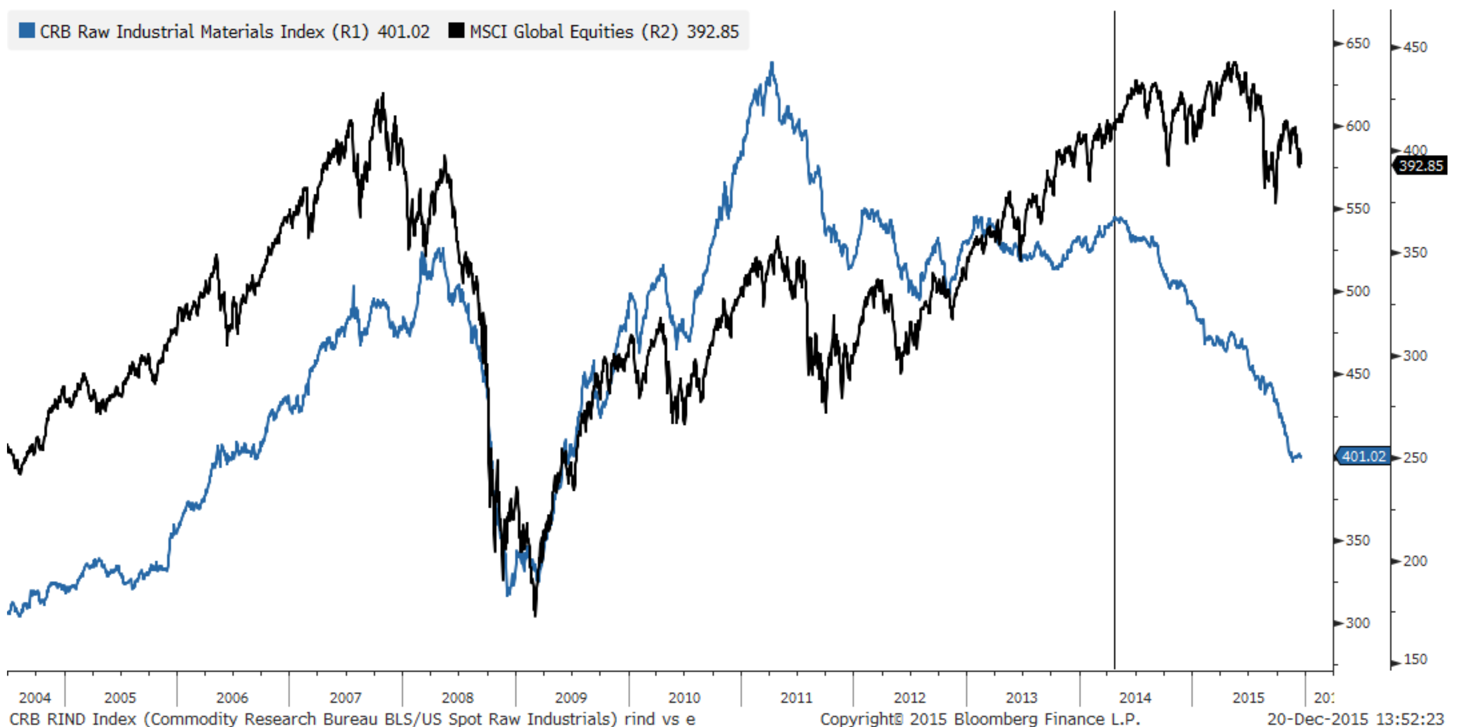


This is particularly true if one believes that downside risks to global growth are credible. Fragile growth environment will place a lid on the extent to which the global capital flows can take off and sustain a broad price appreciation, EM assets included. We believe the balance of evidence points in this direction with 'real-time' growth indicators we trust for cues on the world economy remaining weak.

The main 'real-time' growth indicator we look at is the *Raw Industrial Materials Index*. It comprises various producer inputs, namely: burlap, copper scrap, cotton, hides, rubber, lead scrap, print cloth, rosin, steel scrap, tallow, tin, wool tops, and zinc. The historical correlation it has with world trade and growth is significant at roughly 75%.

We would highlight that after a breakdown in correlation between this growth metric and global equities due to the significant capital allocations into the latter in late 2012 and onwards we've now seen a clearer convergence between weaker growth and equity performance. This is best reflected in the MSCI Global Equity Benchmark that has lost momentum in 2015 and started to trade a dynamic of diminishing corporate opportunity and growth with more intensity.

If the year-to-date loss of 6% for global equities holds into year-end it would mark the first negative result since 2011 and follow the meager 2% returns in 2014. Again, this underscores the relative value world we're in. Indiscriminate price appreciation is not in store as the global capital flows are simply not there to support it. In the meantime, global equities are left in an air-pocket.




Compounding these concerns we have on global growth are the broadening cyclical risks within the US economy. Should they surface in real the *external implications* would be considerable in light of the broad-based growth fragility elsewhere – as seen in the above 'real-time' growth signal we like to track for these purposes.

The US is now the key source of demand within the world trade cycle as EM spending has busted over the last year-and-a-half with any loss in its impulse hitting an already troubled cycle. Thus, we fear that the US could *deepen* the ongoing deceleration in the world economy. We believe this is a credible tail-risk that needs to be internalized.

This weakened risk profile around US growth prospects also has considerable *internal implications* in light of the stress that's been building within credit markets in recent quarters as key commodity markets have rolled over. Idiosyncratic sector issues as well

as a broader growth anxiety have already led to tighter lending standards. The risk now is that a weaker US growth fuels a negative feedback loop causing lenders to retreat on rising uncertainty and further hurt growth and credit markets in the process.

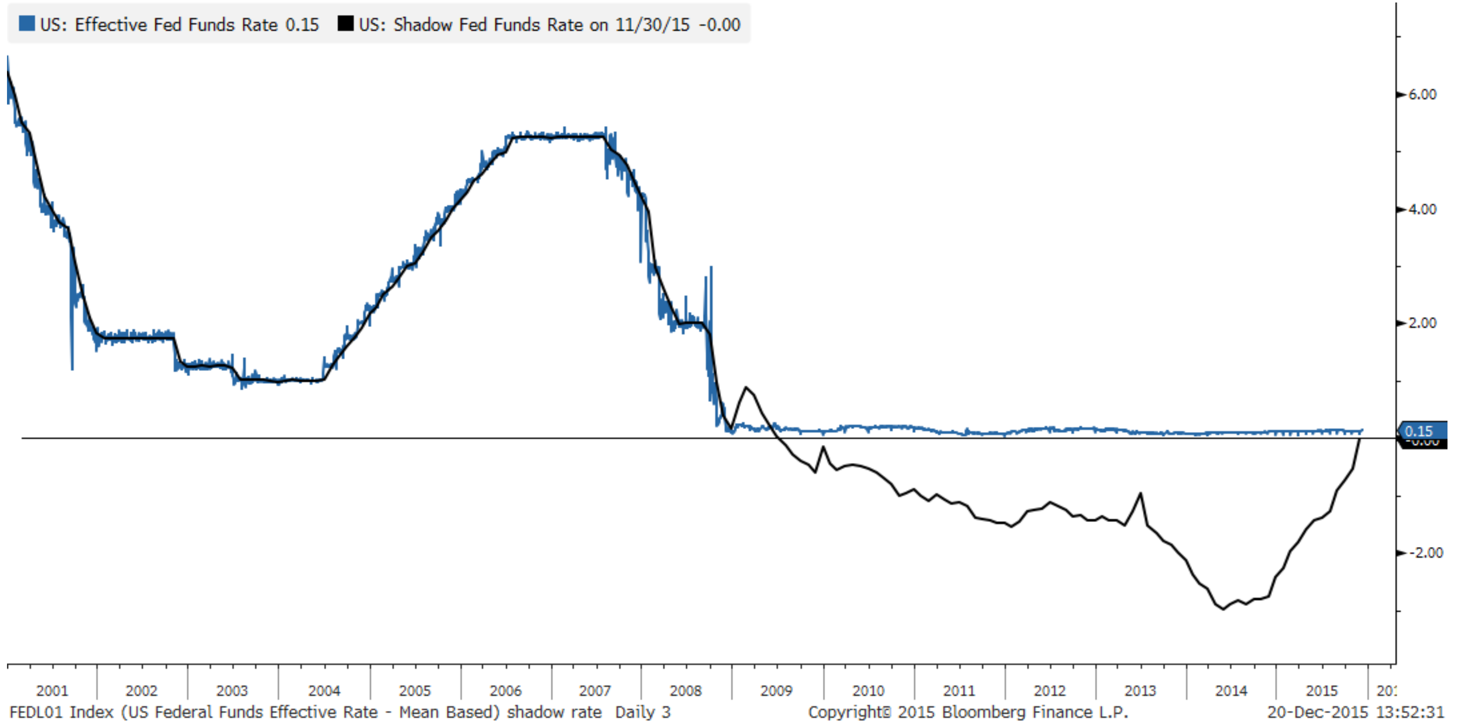
While we think the balance of evidence is broad enough to make this US scenario credible – spanning from a stressed manufacturing sector, weaker economic sentiment, rising household savings, and an impending high-watermark in consumer spending – we reckon the skepticism on this thesis as the key source of weakness is *currently* the manufacturing sector. Due to its minor weight in aggregate demand the argument goes that this softness is inconsequential.

We realize that the services sector is the dominant force of the US economy but we would avoid dismissing the weaker manufacturing results on such grounds alone. The embedded growth signals one can extract out of the manufacturing reports have a solid historical correlation with GDP growth. We see no reason to look through them. Also, this manufacturing context means that the bar is now a lot higher for the services sector to deliver solid results to keep the growth recount alive and well.

In other words, the informational value attached to *future results* from indicators on services activity is asymmetric: deep misses can quickly switch the growth narrative into a more negative posture as other sectors are already cratering.

To that end, it's important to reflect on the shortfall in the Markit Services PMI Survey this past Friday which came in at 53.7 (56.1 prior) while a reading of 55.9 was expected. This was a twelve month low for the headline index and the confidence sub-index came in at its lowest level since August 2010. Underlying trends are losing momentum.

Even as the metric may well reverse next month this should at minimum be internalized ahead of the more influential Non-Manufacturing ISM Survey on January 6th. It rests at solid levels but the recent *rate of change* has been rather poor and steep.




In this environment where it's prudent to keep an open mind on the balance of risks to US growth one should not forget that prior to the recent rate hike the overall stance of monetary policy had been on an *incremental tightening path* since mid-2014. This is seen in indicators such as the Shadow Fed Funds Rate which aims to measure the *total policy accommodation* by conventional and unconventional tools. At the same time as we faced a reset lower in EM growth and broad external stress financial conditions tightened in the US.

To conclude, we believe the origin of macro opportunities lie in *incremental shifts* in economic fortunes. These small-scaled changes are often insufficiently internalized, leaving portfolios anchored to outdated analysis as new market cycles emerge. Our key point is that one shouldn't dismiss the possibility of a US growth deceleration even as key sectors are *presently* not under stress. The *future* may have something else in store. If these growth risks materialize in 2016 the current sources of market stress will intensify: credit woes, commodity weakness, and EM liquidation. It would also mean that the strong USD trade fades out eventually as it gets too demanding for the economy.

# NIGHTBERG

*Macro Portraits* | June 9, 2016

**TOPIC**

US

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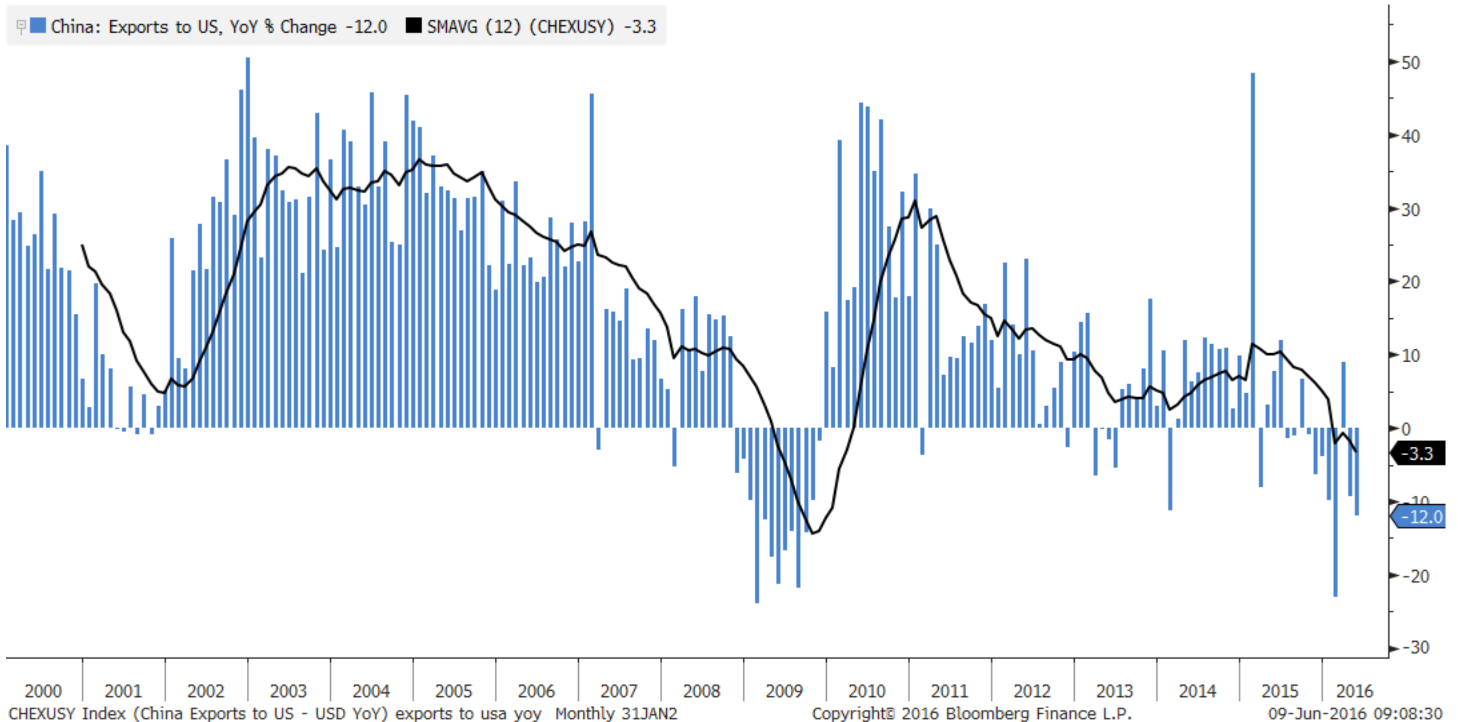
## Balance-of-Risks Around US Consumption Cycle Are Worsening

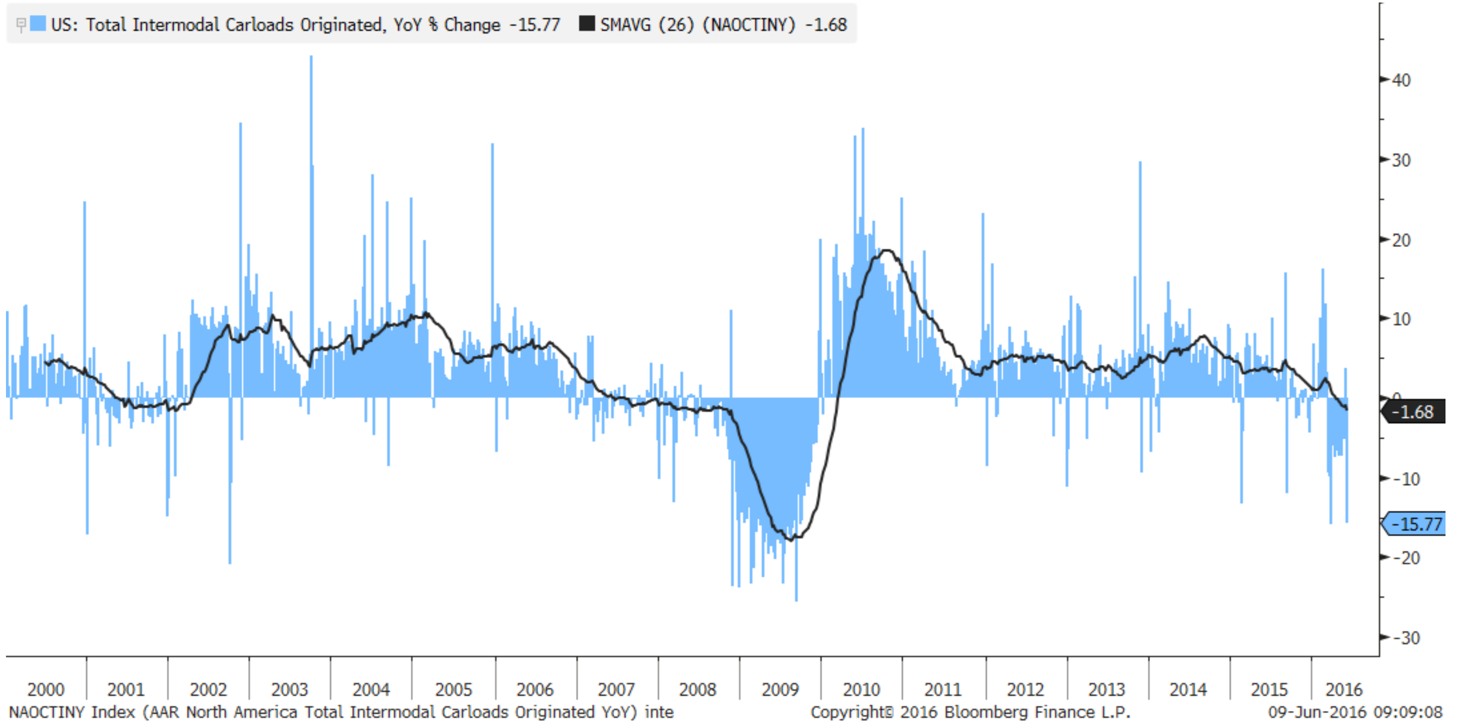
The world's single largest trade relationship is between the US, the import heavyweight that accumulates roughly 13% of global shipments, and China, the export heavyweight that accounts for around 12.5% of the global export cargo. China is the largest source of imports for the US economy and the US is the largest destination for Chinese export goods. In that context, how this activity is evolving is of great interest to try and measure the state of local economic conditions in the US as well as the external environment that Chinese corporates stand against. Specifically, with a large chunk of the goods shipped from China into the US being consumer and high-tech products, there are some proxy-elements embedded in this data set for US consumption dynamics.

That being said, the first thing to internalize from yesterday's export release out of China is the ongoing destruction in shipments into the US. We've seen a persistent streak of prints in negative territory over the past few quarters, and, more importantly, the deep underlying trend-measure (12 month-moving-average) is now resembling readings only last seen throughout the financial crash in 2008.

That last point is important as it goes to show that this reset lower in the US-China trade dynamic is turning out to be durable and signaling a consumption exhaustion in the US.

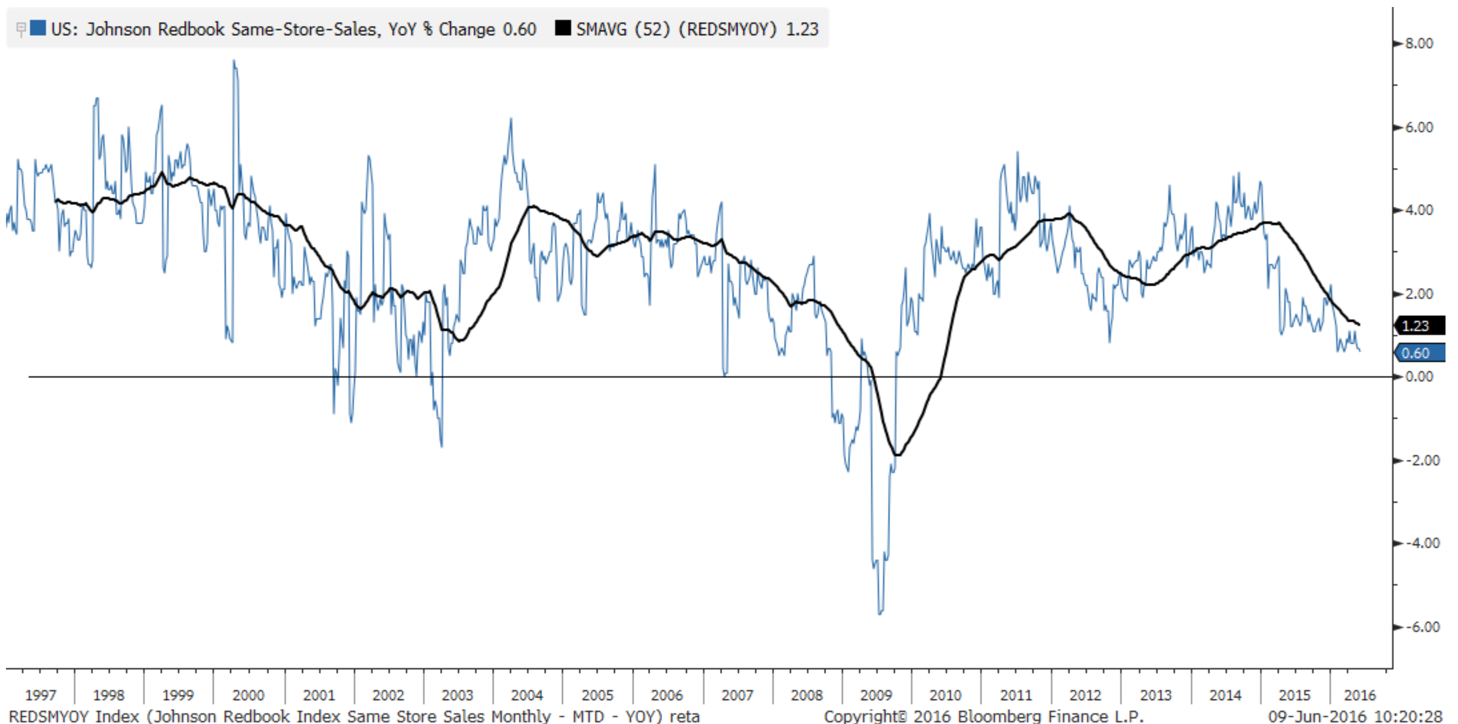
In light of this, we're watching carefully how the US consumer goods import projections from the new *gKNi Trade Nowcasting* tool evolve over the summer months as signs of fatigue are already at hand. Note that we act as strategic analysts on this web-based platform that offers live forecasts for global trade flows developed with proprietary algorithms and over +25,000 trade related time series, including real time logistics data.






Tying this import weakness with some of the weekly proxies we track to gain insights on the US consumer cycle it's clear that the balance-of-risks are skewed in favor of *incremental weakness* as opposed to a recharge in strength. One of these is the growth in intermodal carloads – the consumer exposed part of the railroad sector that hauls everything from computers to toys, frozen chickens, and auto parts – where a significant shift for the worse has taken place in recent quarters. In fact, the current compressed readings only resemble the results into the growth stresses in the early and late 2000s.

Meanwhile, we have the weekly retail sales data continuing to signal a quite uninspiring environment with the multi-week trend-measure at its lowest now since mid-2010 when the economy was finding its feet again after the 2008 bust.



It's in the context of those questionable consumption proxies that the weak payrolls report last Friday comes with a significant souring in growth outlook attached. We are not closing our eyes to the volatile nature of the payrolls release on a monthly basis and one cannot exclude the possibility that this was a genuine freak-report, however, with a host of measures already suggesting an exhaustion in the appetite for physical capital by US corporates it would be logical to see a leakage into the appetite for human capital.

Thus, we'd say it's prudent to shift the risk-calculations on the US outlook accordingly as a weaker labor market would compound the consumption challenges that have risen independently over the recent quarters. We will see some consumer related releases into the Fed meeting next week, such as the sentiment report tomorrow and then the monthly retail sales reading on Tuesday. How these turn out to be is anyone's guess but the broad strokes of the consumer construct are at least suggesting a somewhat fragile foundation.

In this backdrop, we'd expect any surprises towards added weakness in these reports to have a stronger influence on the price action of the Dollar as the anchor in everyone's mind now is the poor payrolls release from last Friday with any souring in other consumer-related data fattening its psychological stronghold. Positive data surprises would only offer a modest Dollar relief as the fate of the last economic bastion – the labor market – would still be left unresolved.

Overall, the balance-of-risks around the US consumption cycle have worsened with a further softening likely offering the catalyst to take the Dollar through the low-end of the trading range that has defined its performance since early 2015.

# NIGHTBERG

*Macro Portraits* | March 18, 2016

**TOPIC**

GLOBAL

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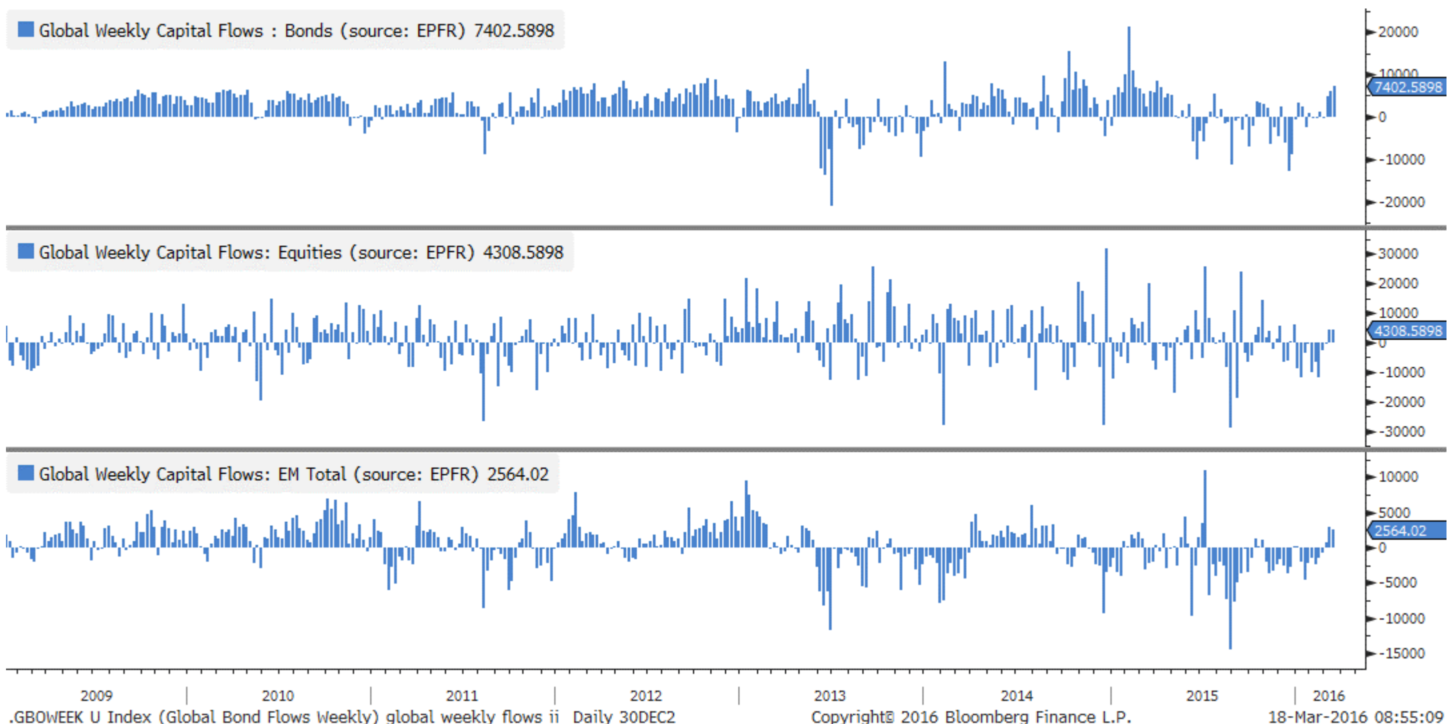
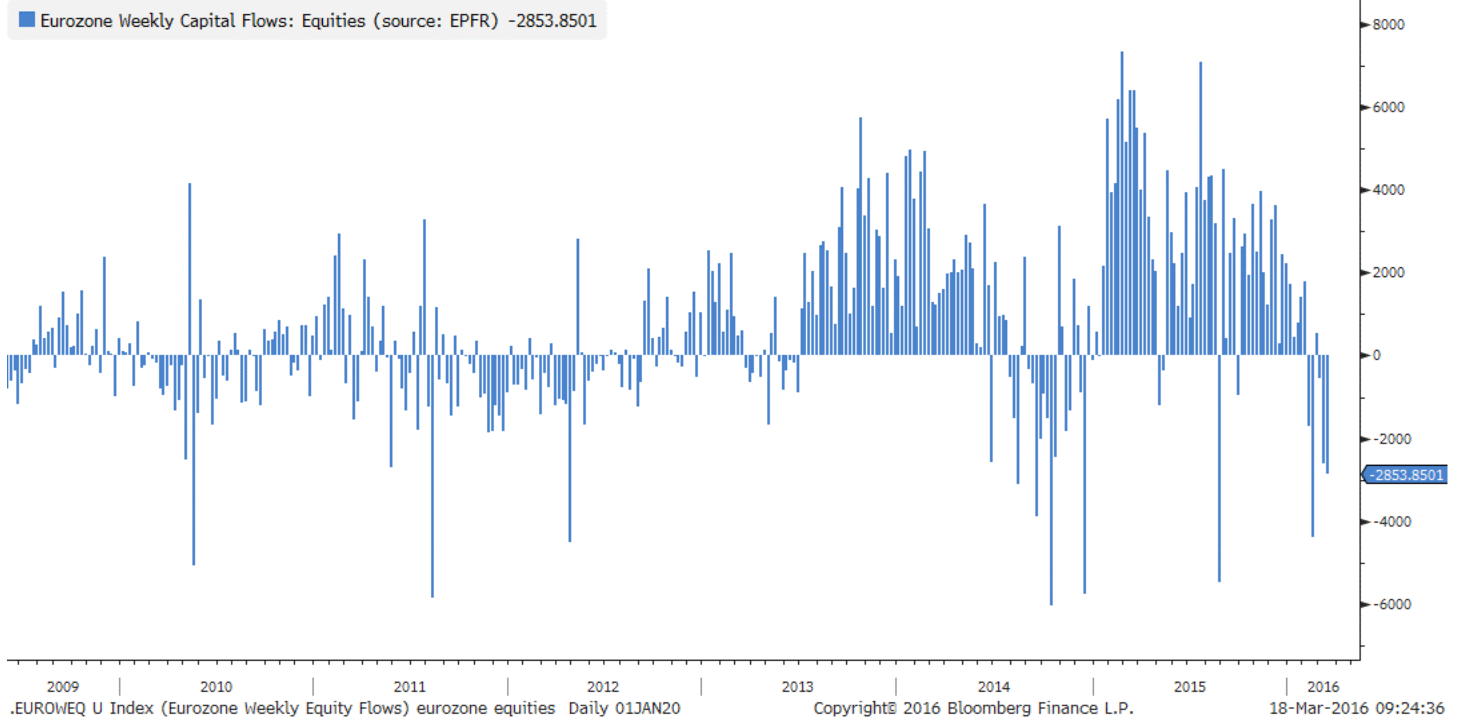
## Fear Continues to Recede in the Fund-Flows as Rotation Underway

The global fund-flow picture saw further respite this week with inflows being recorded into both equities and bonds at the aggregate level for the third week running. Within the EM space a notable improvement is now being recorded with the depressed appetite for the asset class that's been in place since mid-2015 (more broadly, the fund-flow regime for EM has been uninspiring ever since early 2013) seemingly running its course now. Meanwhile, the US is seeing solid inflows as well into its equity and bond markets. Overall, the notion of a market regime that's mutating towards a leadership from the under-loved commodity-linked instruments was further expanded this week as the Latin American region pulled in a considerable amount of capital while the Eurozone is seeing further liquidation away from its populated equity market within global portfolios.

Looking at the absolute sizes of this week's inflows into global bonds, equities, and emerging markets we keep printing values well above the post-crisis averages for each of these groups. In bonds, we saw a near $7.5B injection (post-crisis average: $2.5B), $4.3B in equities (post-crisis average: $1.1B), and $2.5B in total into EM assets (post-crisis average: $0.4B). When comparing these figures against their rolling one-year averages the premium is somewhat fatter.

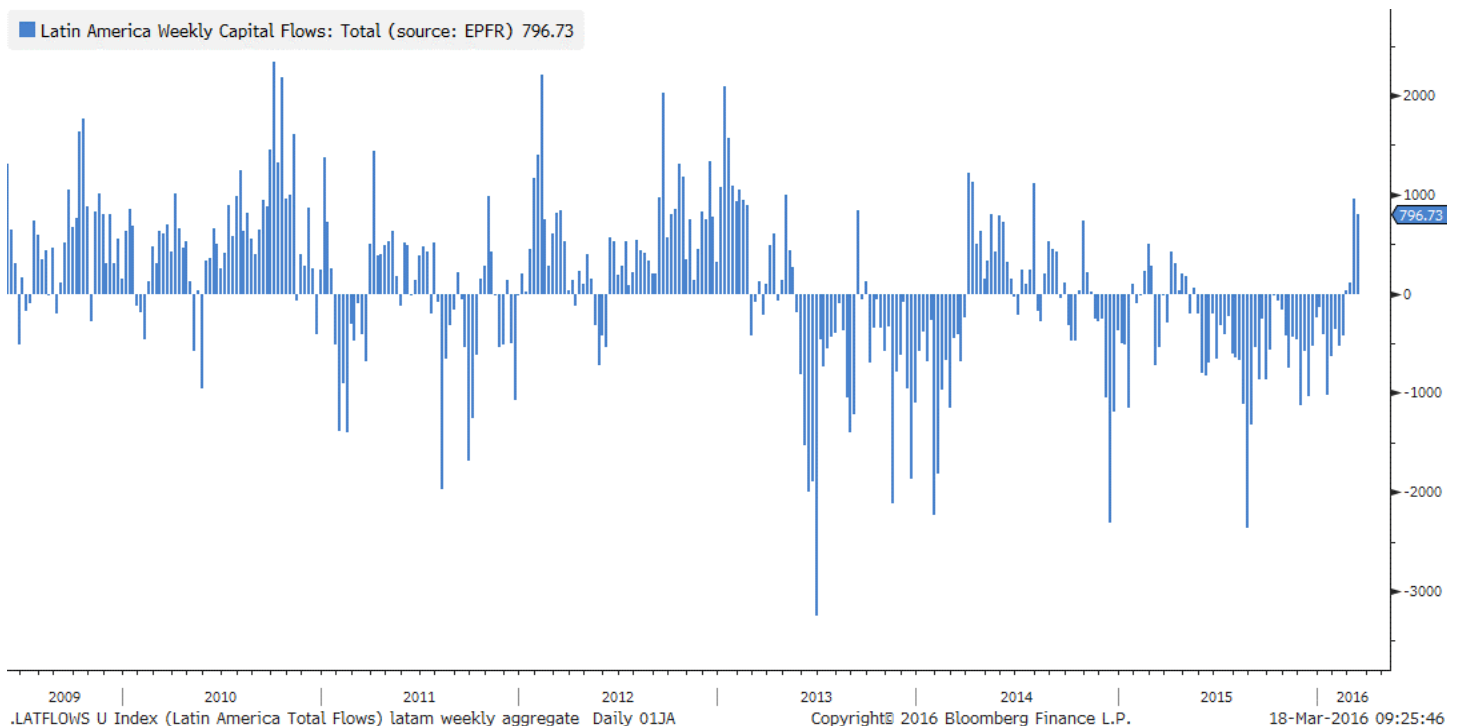
Heading into the ECB last week we were seeing further liquidation out of the equity market in the Eurozone. This week confirmed this growing fatigue in the fund-flows as deeper withdrawals were reported even as an added policy support was delivered only few days ago. Thus, the marginal buyer looks to be exhausted at this point as this dominant equity position within global portfolios is being trimmed with some force now. This negative dynamic looks likely to get expanded in the upcoming weeks.






Within the EM flows, which were recorded into both equities and bonds and across all geographical regions, we would highlight the strong injection into Latin American assets for the second week in a row. This follows the notoriously uninspiring fund-flow environment that's been in place over the last three quarters and comes amidst a social unrest in Brazil as protests against the government have erupted over the last week, yet, also giving hopes of impending political shifts. Some relief has been delivered from oil as well and the USD climax that was further propelled this week is helping.

The bottom line is that fear is receding in the fund-flows and cash levels are sitting at multi-year highs. Pull-factors are no longer flamboyant monetary policies as positioning is bloated in these markets while bastard-assets are now seeing the light of day again.



# NIGHTBERG

*Country Reports* | April 7, 2016

## Growth and Policy Leadership a Story of Yesteryear

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US

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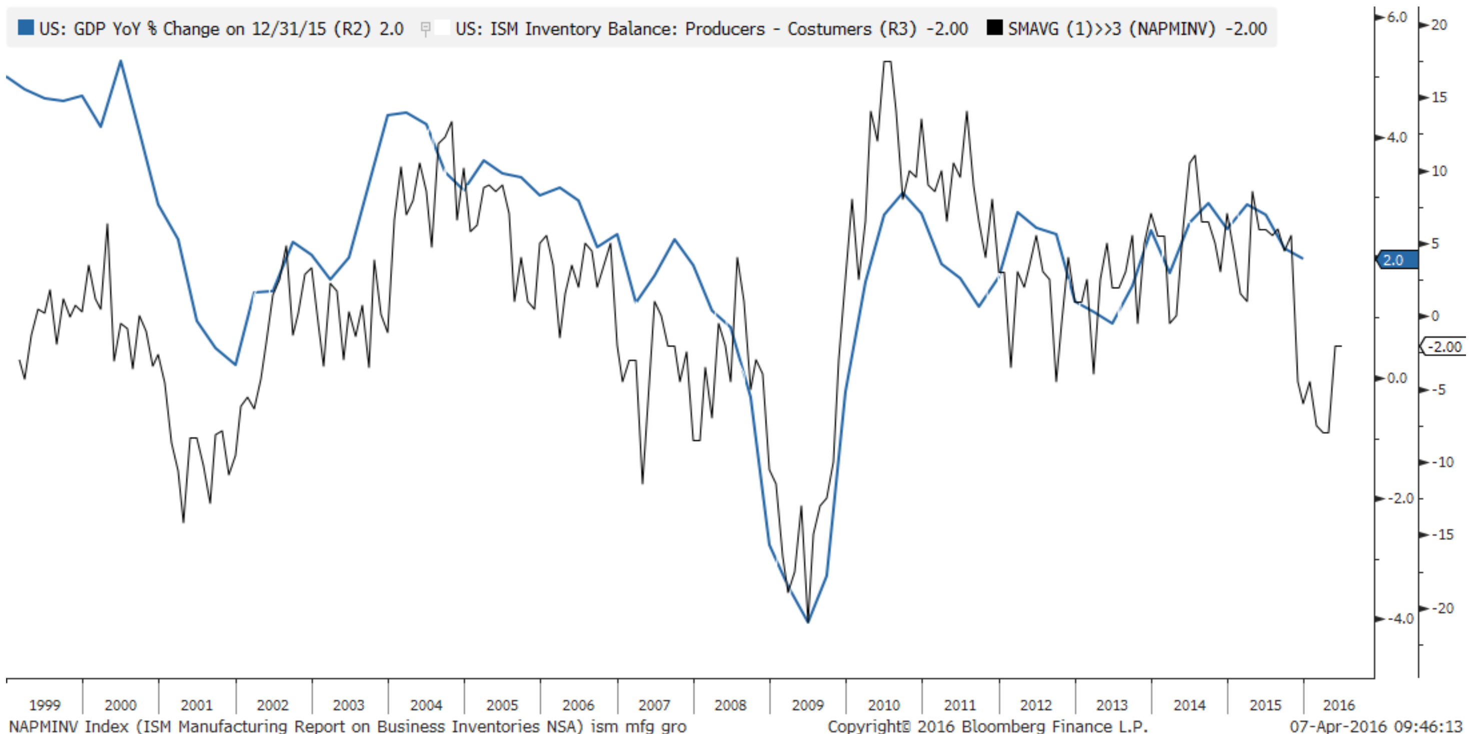
We've been guided by Janet Yellen's speech from September 24th of last year labelled *Inflation Dynamics and Monetary Policy* and the pillars of the Federal Reserve's 'Reasonable Confidence' concept that were laid out in those remarks to measure the risks around the broader policy narrative. Recall the three conditions she highlighted as being important to be met for the Fed to be 'reasonably confident' that inflation will return to the 2% target over the medium term:

1) Fed needs to be 'reasonably confident' that we will see continued solid growth.
2) Further gains in resource utilization will have to be recorded.
3) Longer-term inflation expectations need to be anchored near pre-recession levels.

Going into the December meeting there were already credible risks observable around the first and the third conditions but we suspect the Fed's quasi calendar-commitment to commence the normalization process before year-end left it with no choice but to pull the trigger at the time. It was the wrong decision but for the right reasons. Meanwhile, the risks around those two pillars have risen further over the last few months.

In the context of this 'Reasonable Confidence' framework the complete reversal in policy narration by Yellen in her speech on March 29th titled *The Outlook, Uncertainty, and Monetary Policy* is understandable. It's in line with the toned down message and we'd say more accurate assessment of economic reality in the Fed's statements this year.

The policy stance is now an 'insurance' approach as opposed to a 'prudent' posture as flexibility is asymmetric. Any shock to employment growth would clearly rock the boat.



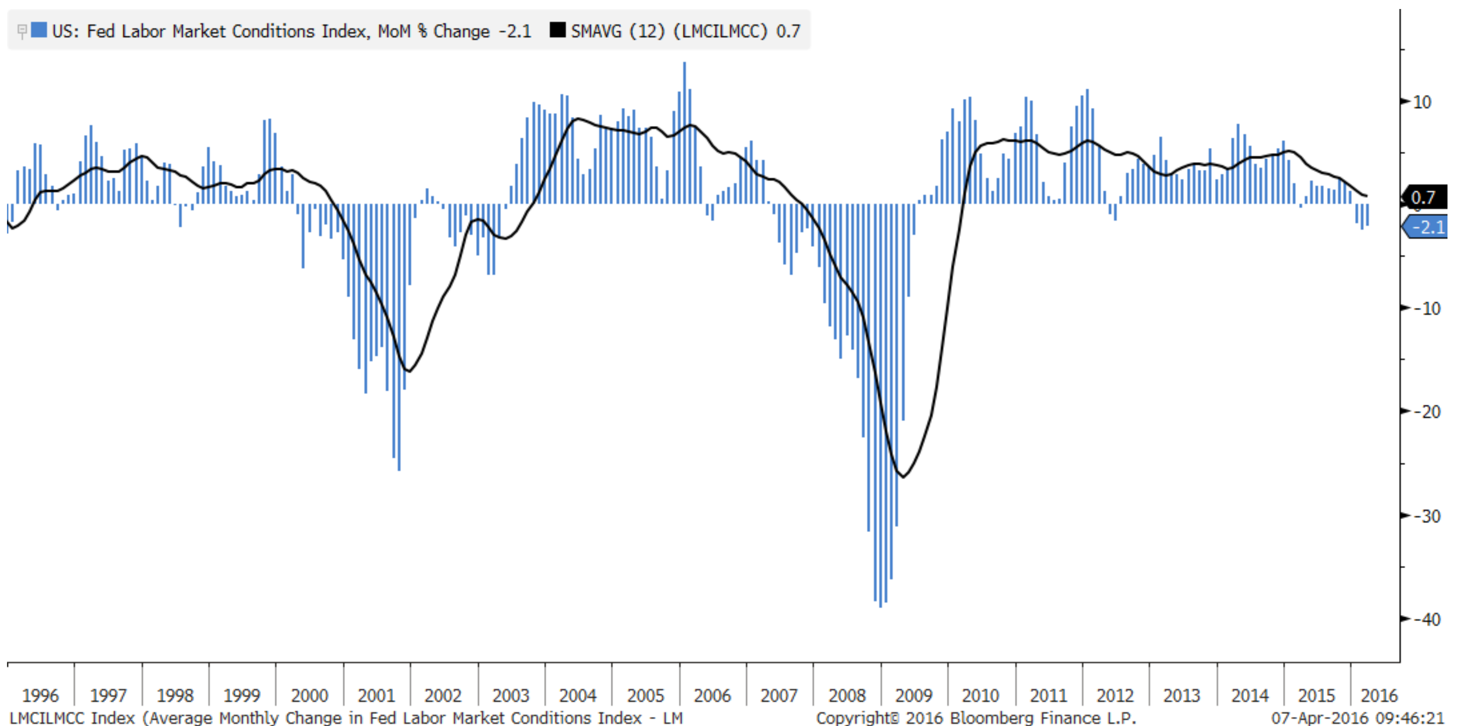
Regarding the economic outlook, whether one looks at it through an industry angle (i.e. manufacturing and services) or under an expenditure approach (i.e. consumption and investment as an example) a broadening moderation is detected. This is being reflected in the low results of GDP Nowcasts at this point with the headline Atlanta Fed measure at its weakest level in over a year now at 0.4% quarter-on-quarter annualized.

With the industry debate – the relevancy of weakened manufacturing trends as its weight in the economy is miniscule – settled on February 3rd when ISM non-Manufacturing Survey reset itself into a lower range we're more interested in the expenditure dynamic.

In short, private domestic demand is weakening as both investment and consumption have set in the high-watermarks for this cycle. This is visible within the hard data, such as in the demand for capital goods and weekly retail sales proxies, and the soft data as well as business and consumer confidence is souring. We've seen the Fed's language on this facet of the economy shifting over the course of the year with the description of local economic strength being scaled down. The investment cycle is now seen as 'soft'.

One area we'd keep a close eye on in upcoming months is the fate of domestic auto sales that have shown fairly weak results of late. With Yellen citing this as one area of *'particular strength'* only two months ago as she offered her testimony on the economy to Congress the turnaround in the sector must be seen as a disappointment within policy circles. Signs of exhaustion in this economic bastion are emerging with conviction.

While the public sector is providing incremental impulse at last the complications that are surfacing in the private sector along with the uninspiring external outlook mute this more positive effect. Also, even as the gradual recovery in the housing sector is ongoing it's far from being stellar.



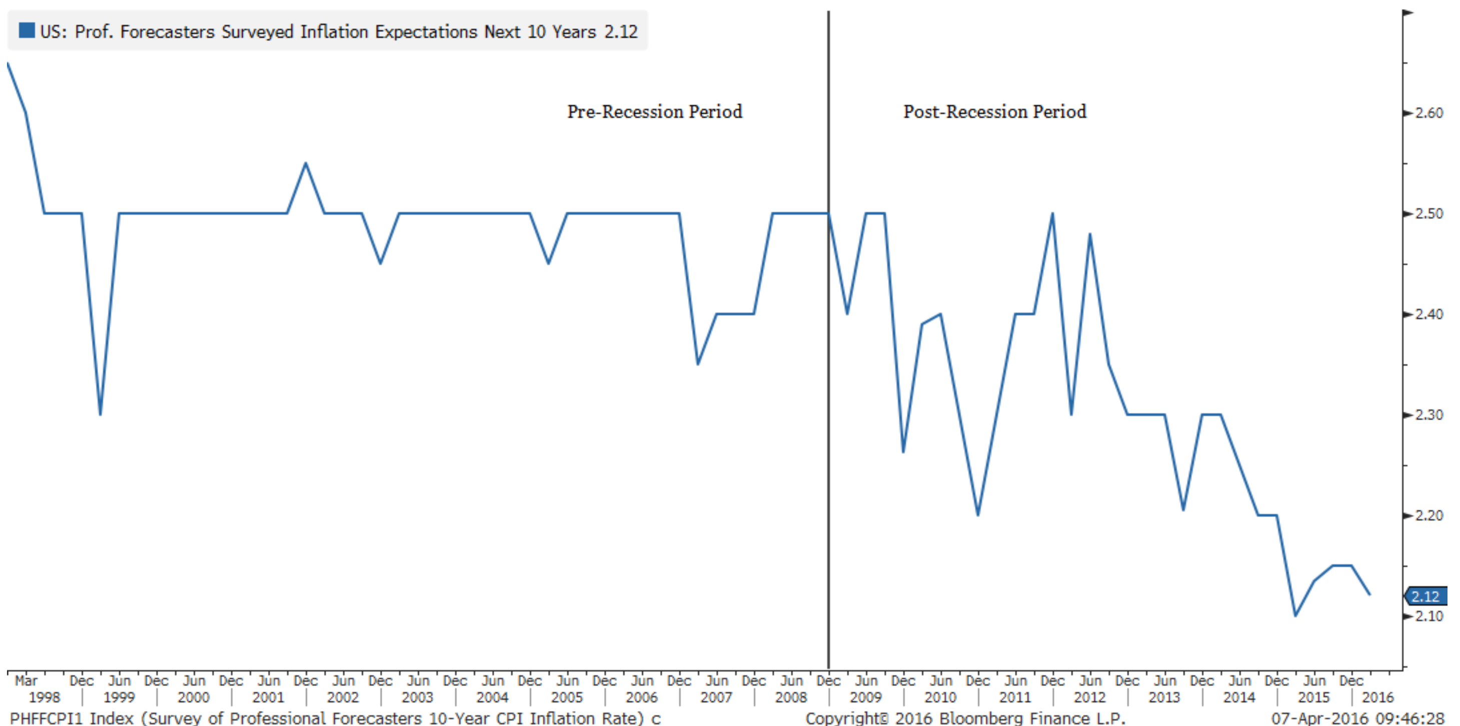

With the balance of risks to economic growth skewed to the downside and the appetite for physical capital coming off in the corporate sector the outlook on the appetite for *human capital* is softening around the edges. This isn't just a hypothetical proposition derived from a logical sequencing of recent economic outcomes but an empirical fact as the Fed's Labor Market Index – comprises nineteen inputs – is now weakening.

Of course, the recent readings are no shock-results but it's more the incremental shift from great to less great that should be internalized. Especially as other measures, such as the employment inputs from the ISM surveys, have offered a similar dynamic over

the last few months. One should at minimum be open to the idea that added gains in resource utilization may stall.

This may be all that is needed to shift the calculations further for the Fed as its already been somewhat vocal of late on two of the three pillars of the 'Reasonable Confidence' concept: growth dynamics and questionable inflation expectations trends. We say this as Yellen has stated that the current low level of unemployment may still understate the slack that actually exists. It's for this reason she suggested in her remarks on September 24th that driving unemployment temporarily below NAIRU might be appropriate.

Thus, just as the steep drop in ISM non-Manufacturing Survey on February 3rd caused a readjustment in expectations on the US economy and consequently marked the climax of the USD, we believe any unexpected 'shock' to employment trends has the potential now to serve as a catalyst for the next part of this saga.




With this in mind, the multi-quarter deterioration in inflation expectations and what seems to be a more genuine concern on this issue within the Fed now should be realized. Recall that one of the conditions around the 'Reasonable Confidence' concept was that longer-term inflation expectations needed to remain *anchored* near their pre-recession levels. Given the evidence, this pillar didn't have much chance from the start with the Fed taking on a creative license when describing the status of inflation expectations.

That has been changing now with Yellen's speech on March 29th a watershed in the Fed's approach on the issue. Far more caveats and concerns on inflation expectations were found in her remarks than before although her baseline of stable expectations was left unchanged. To our eyes, inflation expectations are anything but stable and the drift away from pre-recession levels has been ongoing for a period that spans years now.

It is in many ways surprising that a deeper debate whether inflation expectations are unanchored hasn't taken place. Any further slippage probably makes that unavoidable.

We're cognizant of the recent acceleration in spot inflation but aren't holding our breath. Given the cyclical risks, troubled inflation expectations, signals of weakening pricing powers within some of the business surveys, and the supply overhang both locally as well as globally – reflected in elevated inventory-to-sales ratios – we're not confident this will turn out to be sustainable over a policy-relevant time horizon. Moreover, wage growth shows no convincing signs of accelerating to the topside with style.

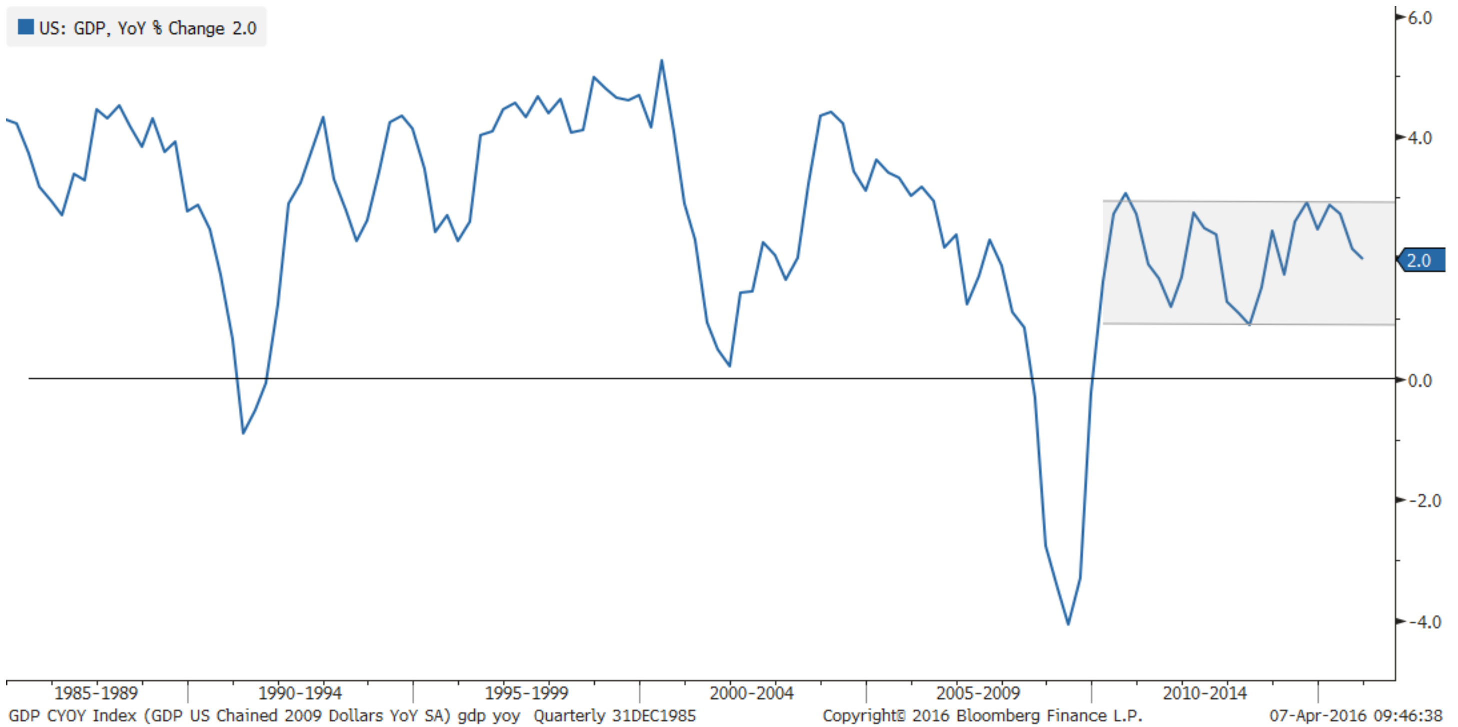
We asked earlier in the year whether the lack of policy flexibility as interest rates are low and the recent rate hike were *crippling* the *creative thinking* of where things could evolve for the Fed. We said this as we could feel it in our own psyche. We proposed it might be easier to think about what could be delivered by the Fed over the coming twelve months in this domestic and international context if the policy rate was currently at 5%? To expect 100bp in rate cuts didn't seem unreasonable at that point and the same conclusion holds today.

It's for this reason that we continue to see US growth as the most important macro-force to get right in 2016. Notwithstanding the upcoming presidential elections, the coming quarters look set to be highly interesting. Whether heightened concerns on inflation expectations by Yellen are the first steps in using the issue as the scapegoat for a policy reversal remains to be seen. Thus, we will be paying close attention to see if any mentioning of policy-conditionality tied to the evolution of inflation expectations will be delivered in informal remarks and individual speeches.

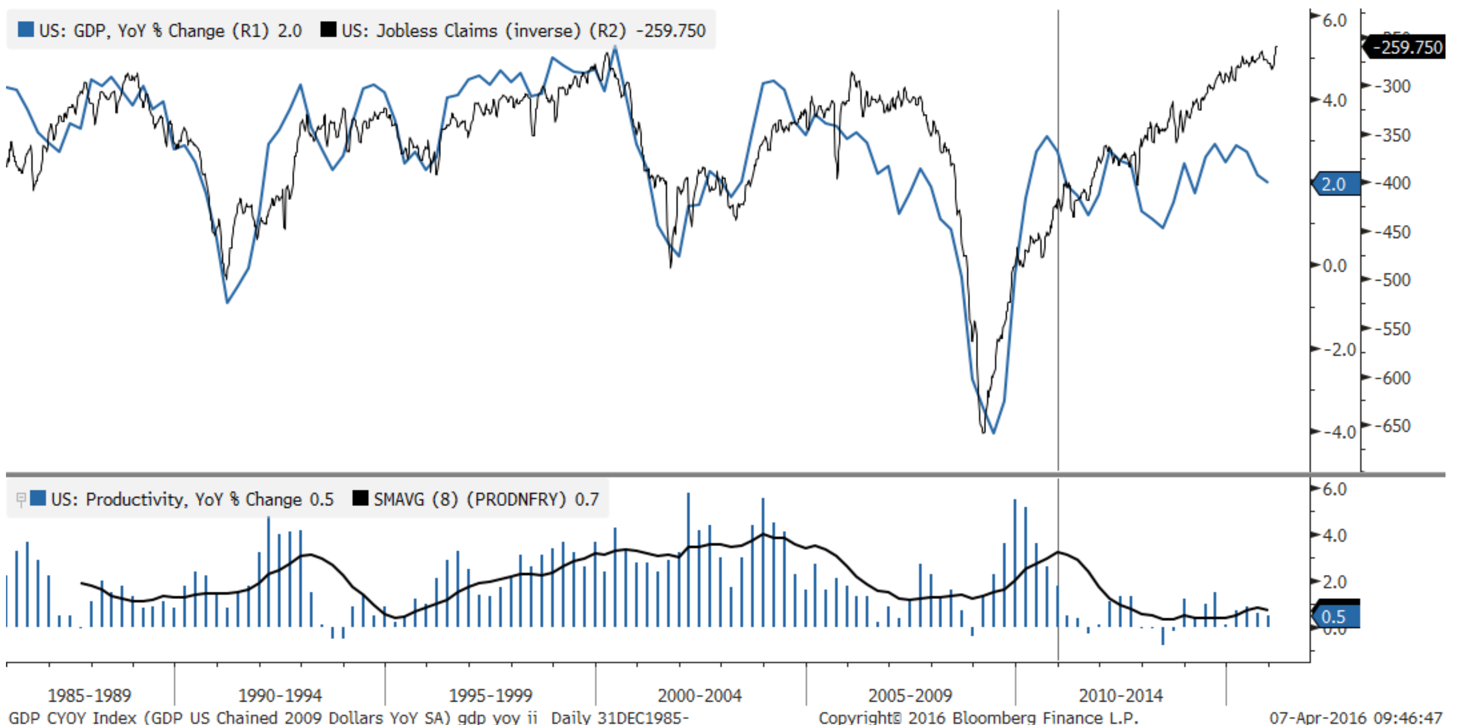
Overall, the narrative of growth and policy leadership out of the US remains a story of yesteryear with the USD the ultimate casualty.

## Chart Book: Economic Fundamentals

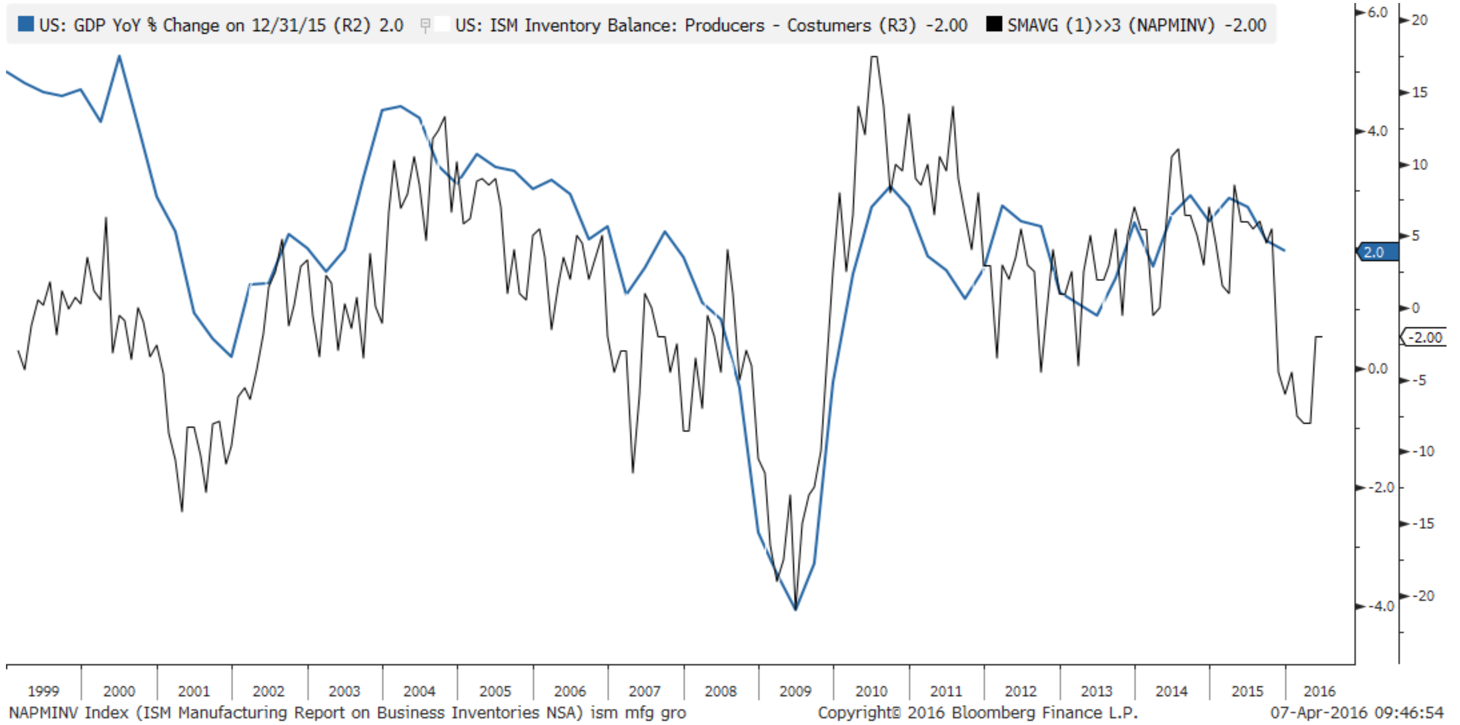
Growth within the post-crisis era is best described as being stuck within a range of 1-3%. We're currently right at the mid-point with the outlook coming with considerable downside risks attached.



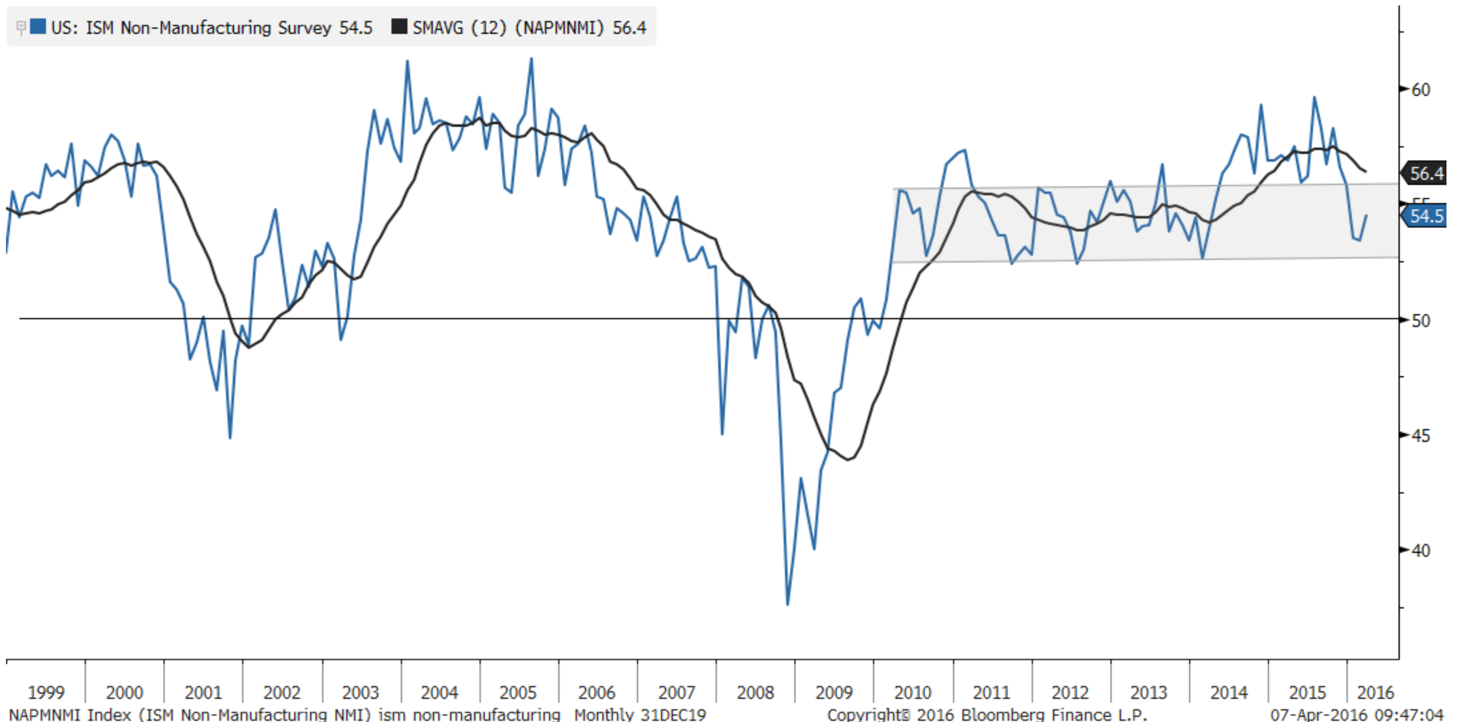

Even as growth outcomes have been modest in a historical context the labor market has managed to absorb a great amount of people as seen in the current low levels of initial jobless claims (note: shown inversed on chart). This dislocation has left productivity as the casualty as its year-on-year readings have been extremely low in recent years which may help to explain the modest wage gains throughout the recovery.



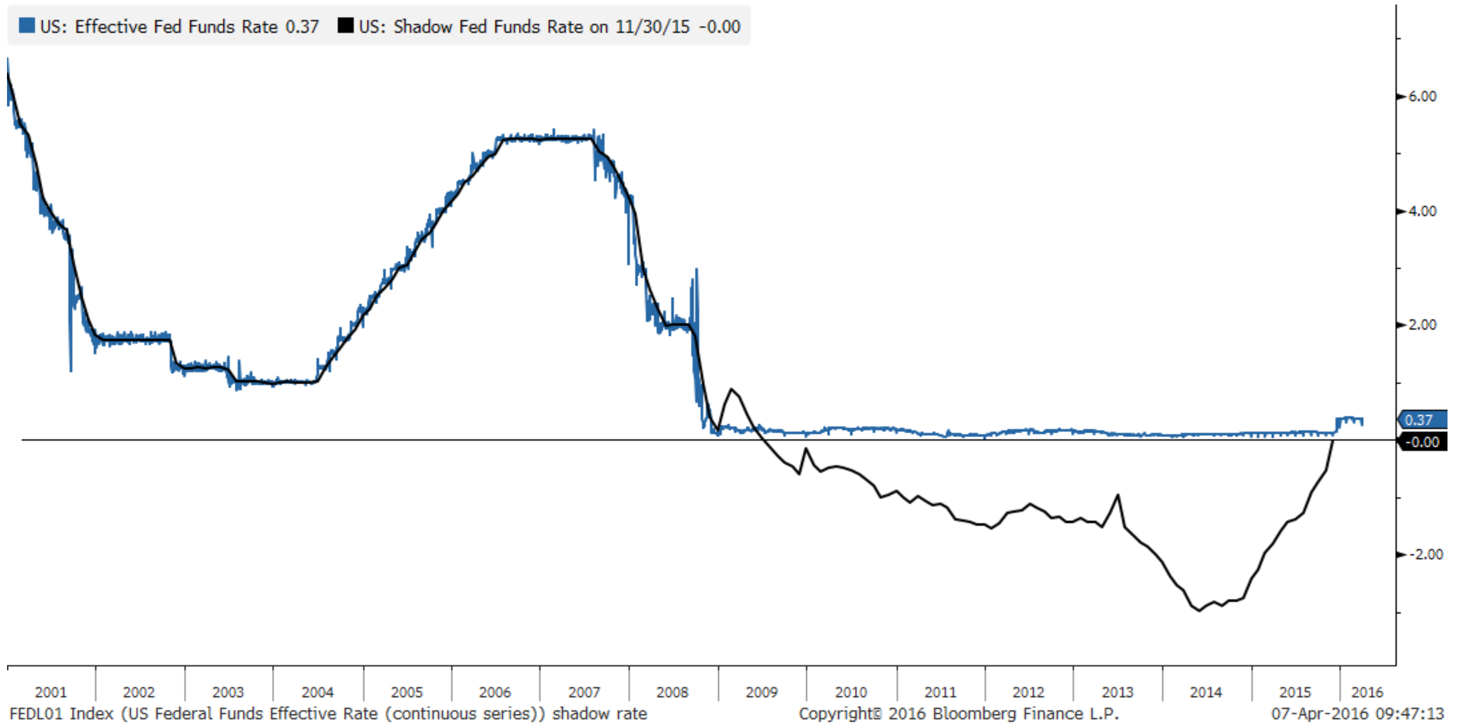
Cyclical risks have risen with the embedded GDP proxy within the manufacturing sector – inventory imbalances of the ISM Survey – hinting at considerable downside risks to growth since November of last year. Taking recent readings at face value we seem headed for 0% readings for GDP in the coming quarters.



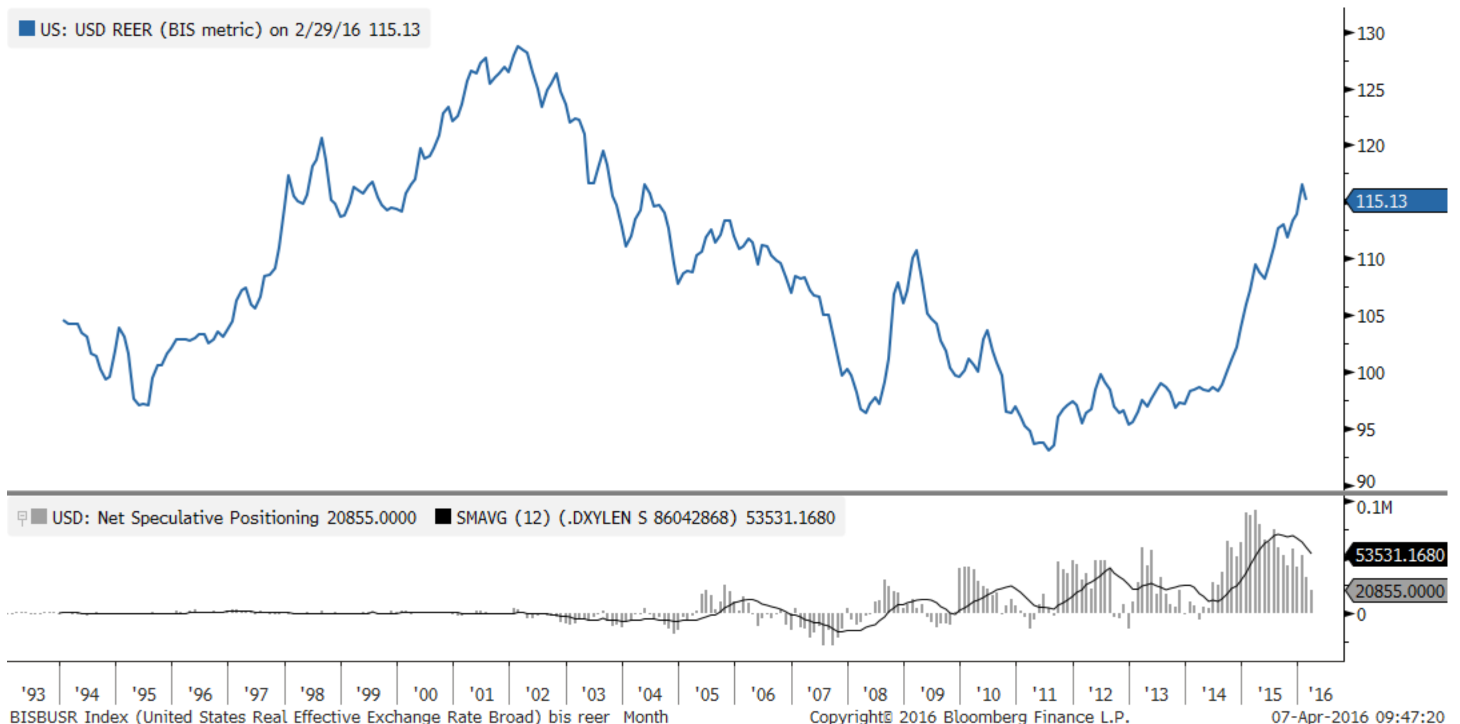

We realize these growth proxies have been dismissed to some extent due to the modest weight of manufacturing in overall economic activity. Thus, it needs to be internalized that the metrics we have on offer for the dominant services sector have lost momentum at a rapid pace of late. From an industry perspective the growth-deceleration is looking broad-based now. We're just short of penetrating the low-end of the post-crisis range in the services facet of the economy.



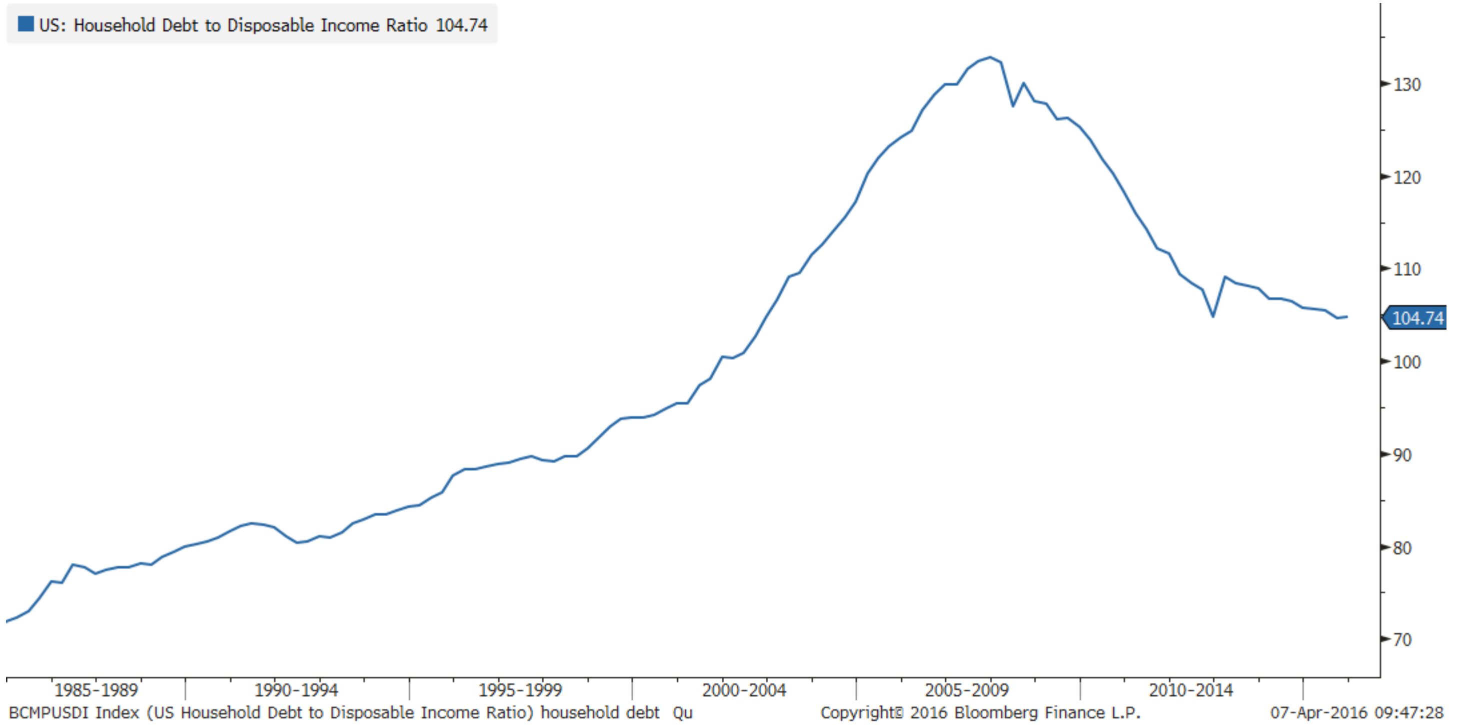
In this context of swelling economic risks, one shouldn't forget that the degree of policy accommodation has been descending since mid-2014. This is best reflected in the rapid reversal in the Shadow Fed Funds Rate (metric aimed to measure the joint effect of traditional as well as unconventional tools such as QE and forward guidance). While this is only a rough guidance and should be approached as such, the Shadow Rate is suggesting that policy has tightened by 300bp already over the last eighteen months.



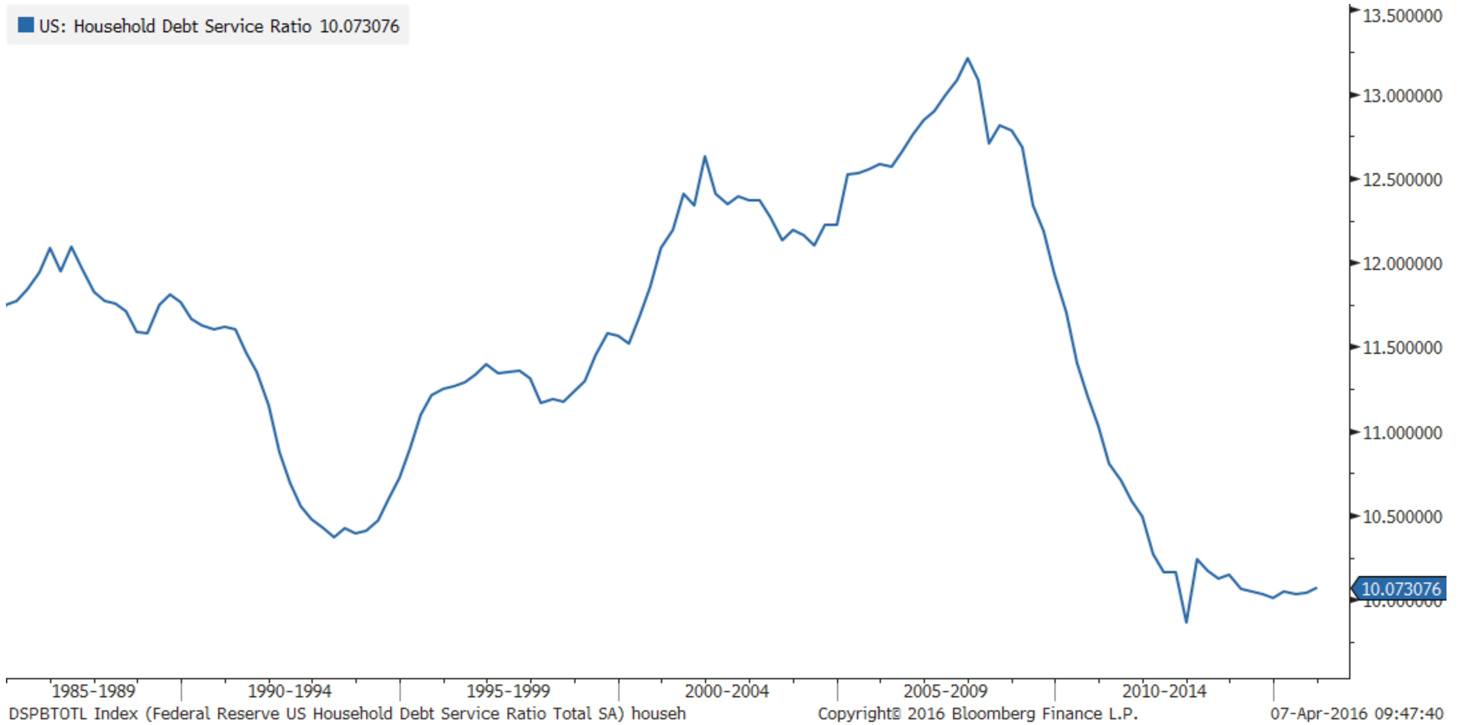

Moreover, the US dollar has appreciated considerably over the last two years. All this signals that monetary conditions have tightened far more then what the modest 25bp rate hike in December would suggest. Given the recent cyclical signals the economy appears fragile in this new regime.



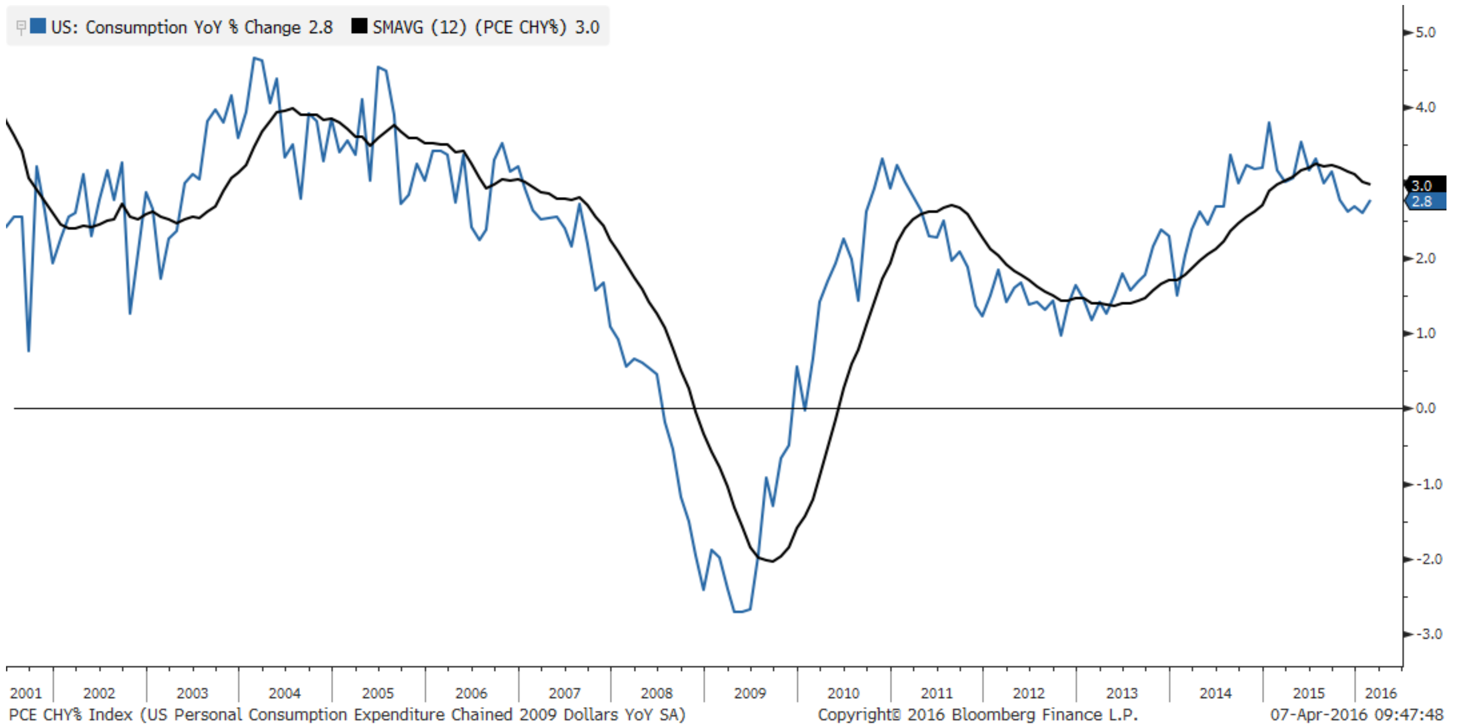
On the consumer side, household balance sheets have improved considerably in the aftermath of the 2008 crisis with debt ratios at levels last seen a decade ago.



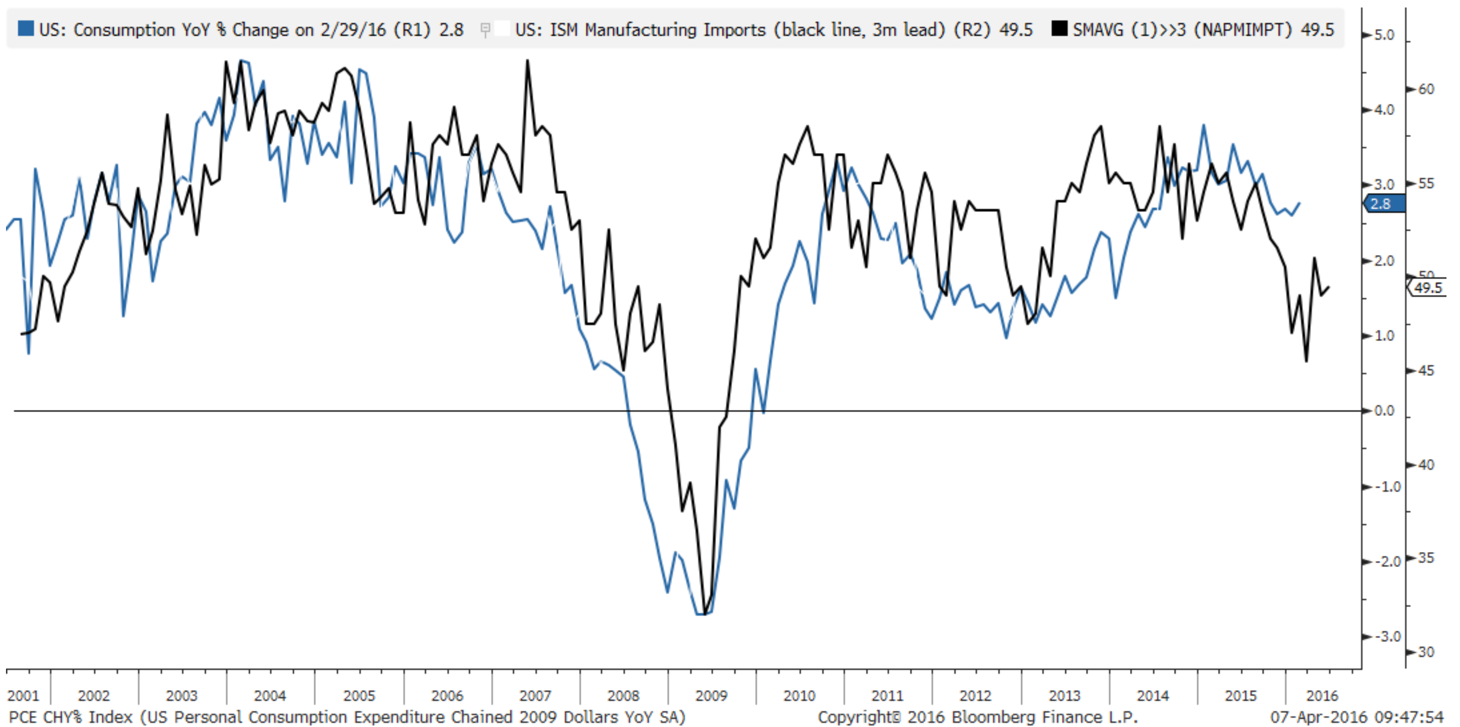

Moreover, this drop in debt levels and the low level of interest rates has left the debt service burden for households at multi-decade lows. This suggests that a 'theoretical' potential for consumption to accelerate meaningfully can be claimed to exist.



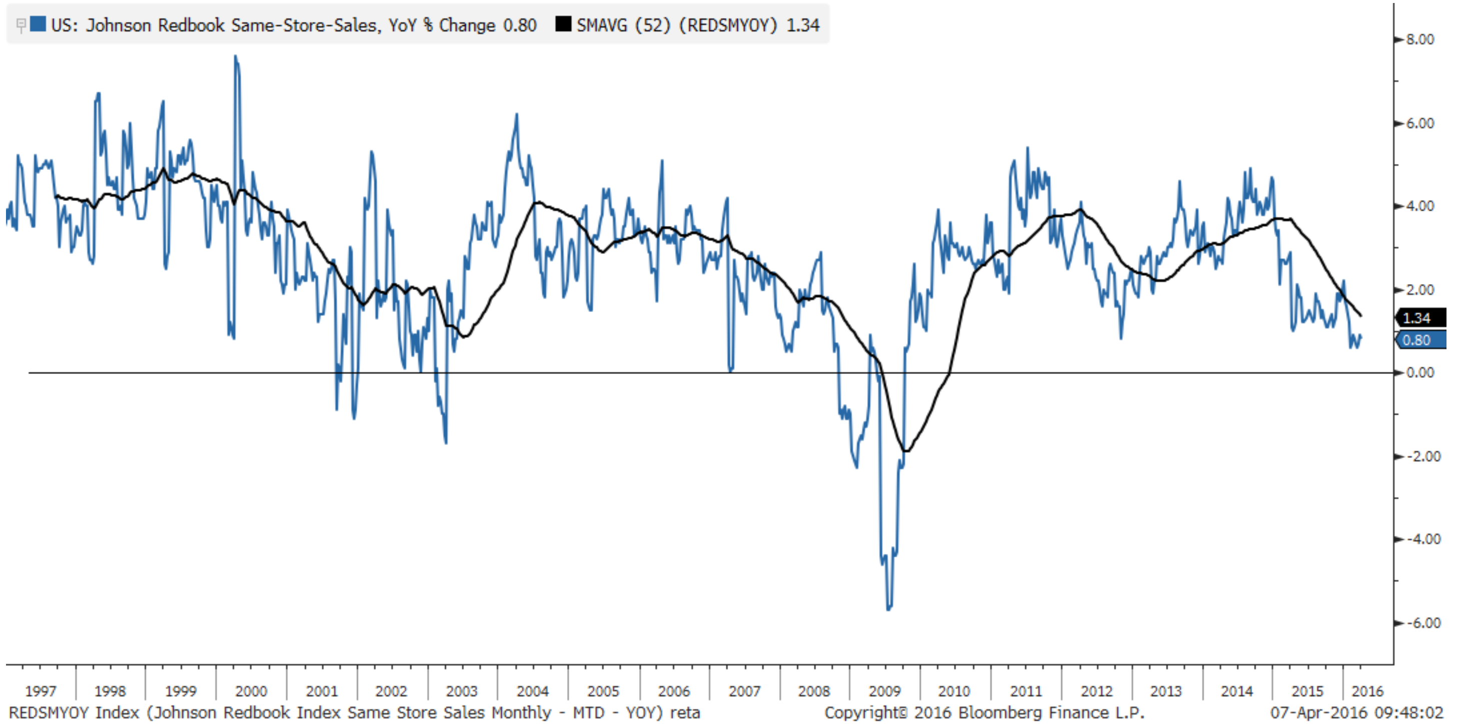
Nevertheless, consumption has set in its high-watermark already with the year-on-year readings softening and underlying trends turning the corner. Tougher comparisons (i.e. base effects) will likely drive these results lower in upcoming months.



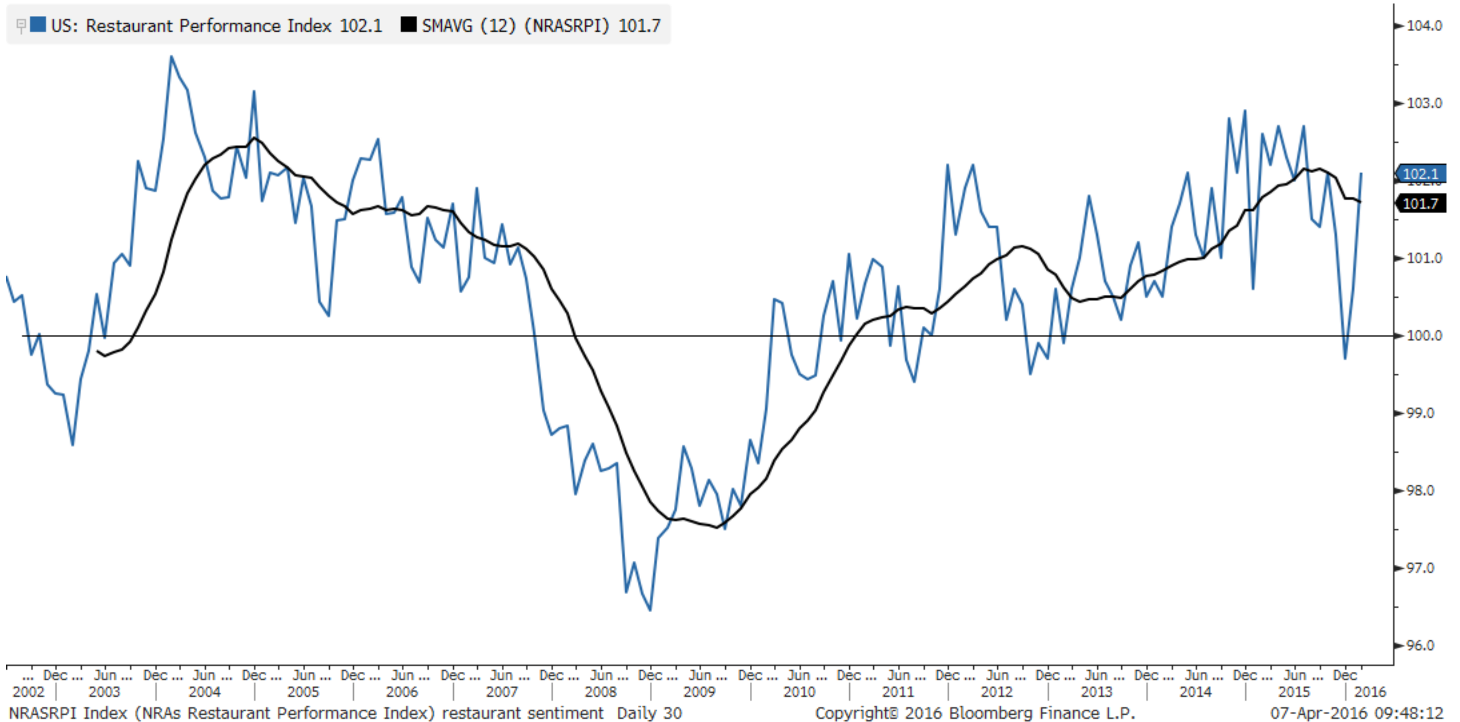

Import proxies from the ISM Manufacturing Survey also suggest that consumption may weaken as the year progresses. Nowcasting trade projections we've seen from logistics specialist Kuehne+Nagel for March guide us in the same direction with current forecasts showing the sharpest annual contraction in imports since mid-2009.



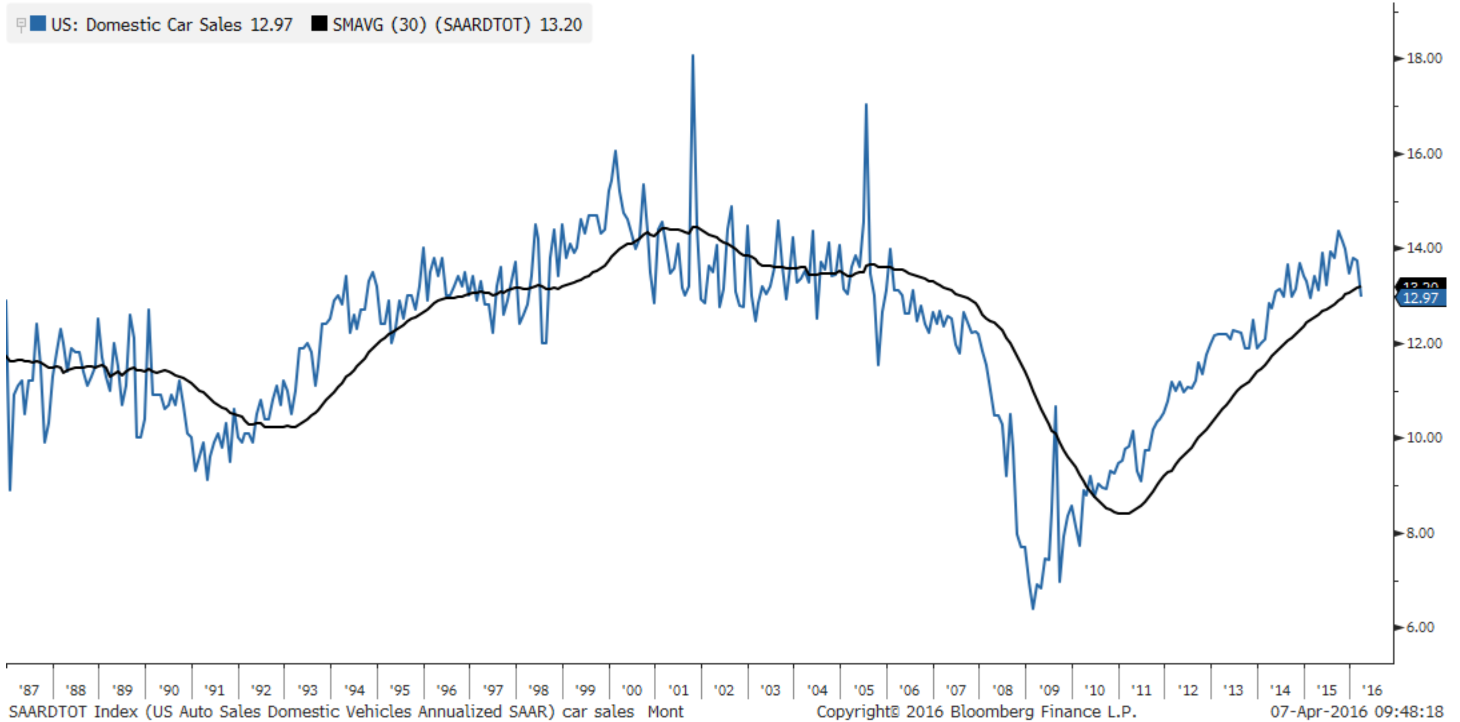
The weekly retail sales proxy certainly suggests that consumption momentum has come off quite a bit in recent quarters. Looking at the underlying trend-measure (52 week-moving-average) we're now at levels only seen in the growth funks in 2001 and 2008. Spot values have shown no signs of turning higher towards incremental strength.



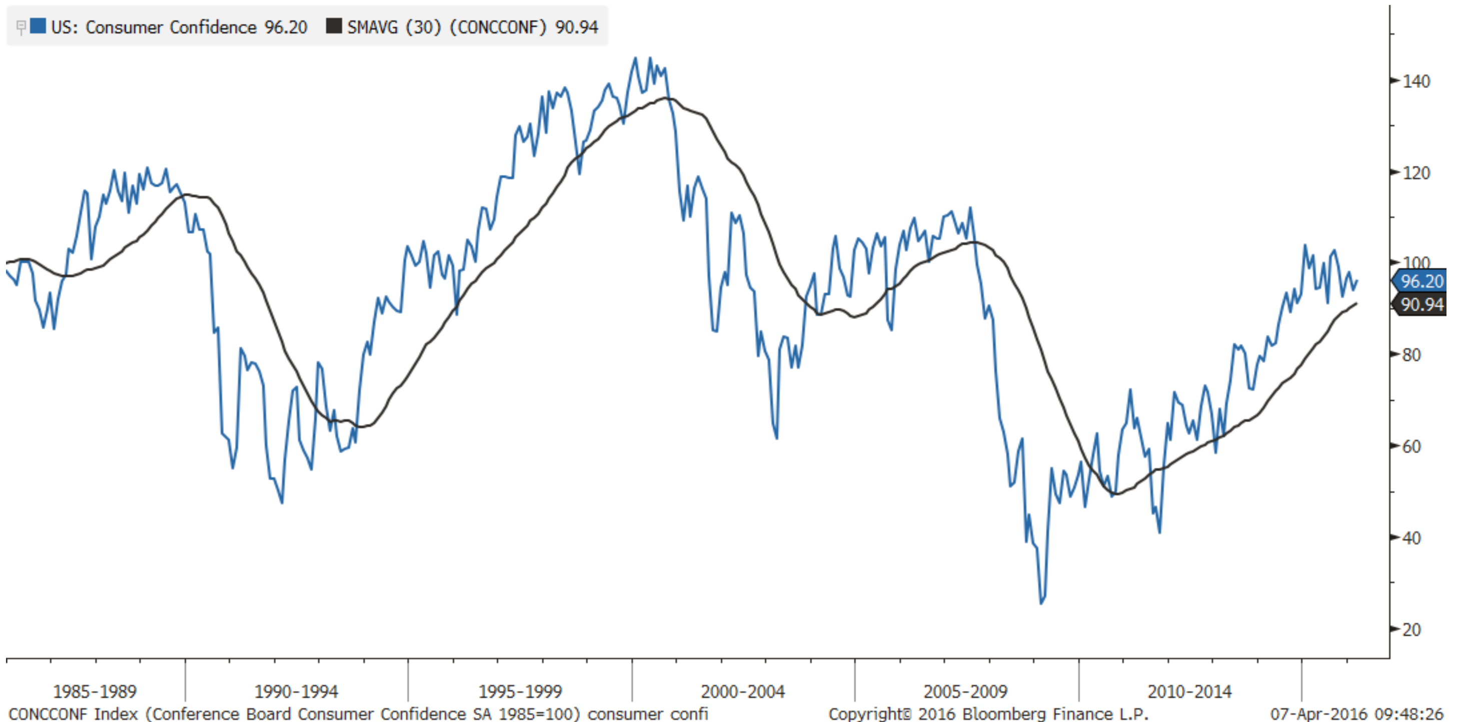

Sentiment in the domestic restaurant sector has shown signs of peak-conditions in this consumer-driven part of the economy as well.



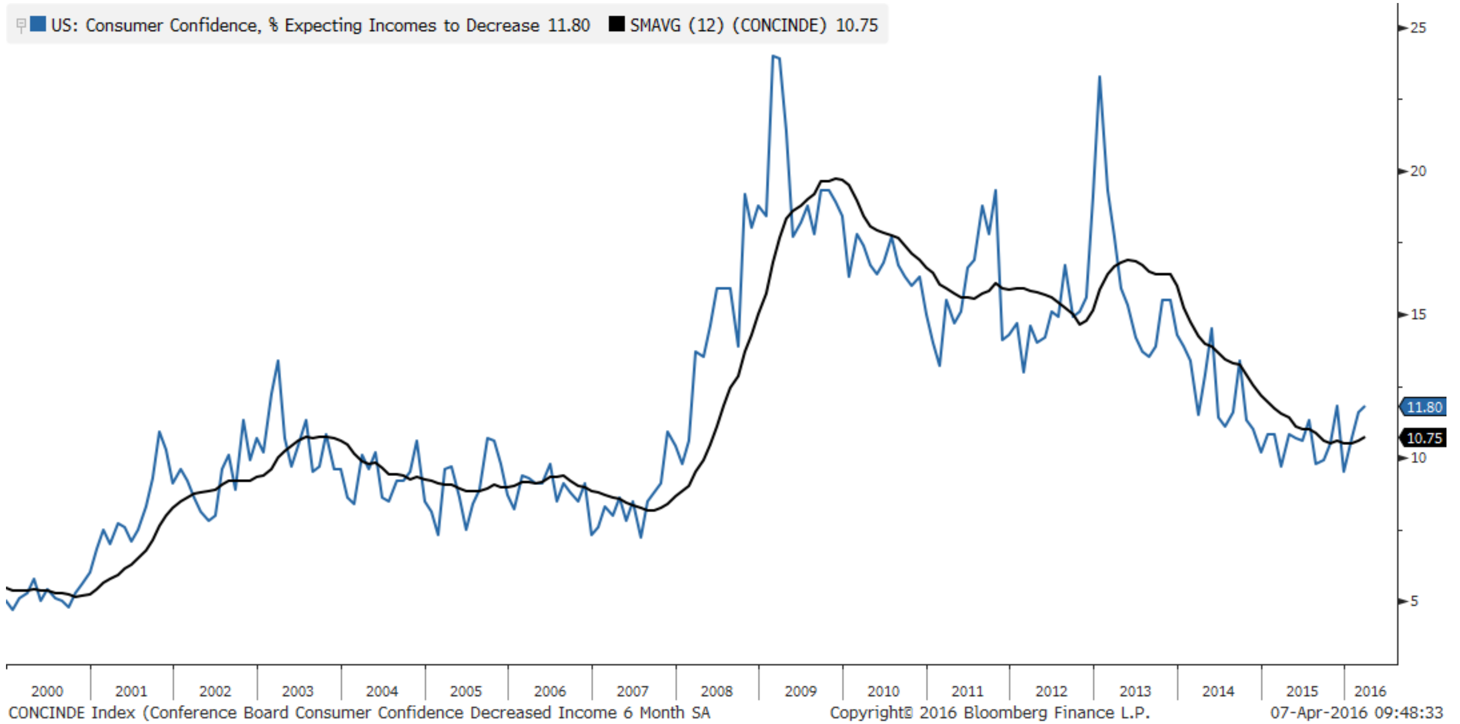
Importantly, the bastion of economic strength (particularly from the Fed's perspective with Yellen highlighting this as an area of *'particular strength'* only two months ago) looks to be rolling over. Domestic car sales have now cut through the deep, underlying trend-measure to signal auto-cycle-exhaustion. Moreover, the recent loss in momentum has been substantial with the rolling six-month percentage change virtually the steepest since mid-2009.



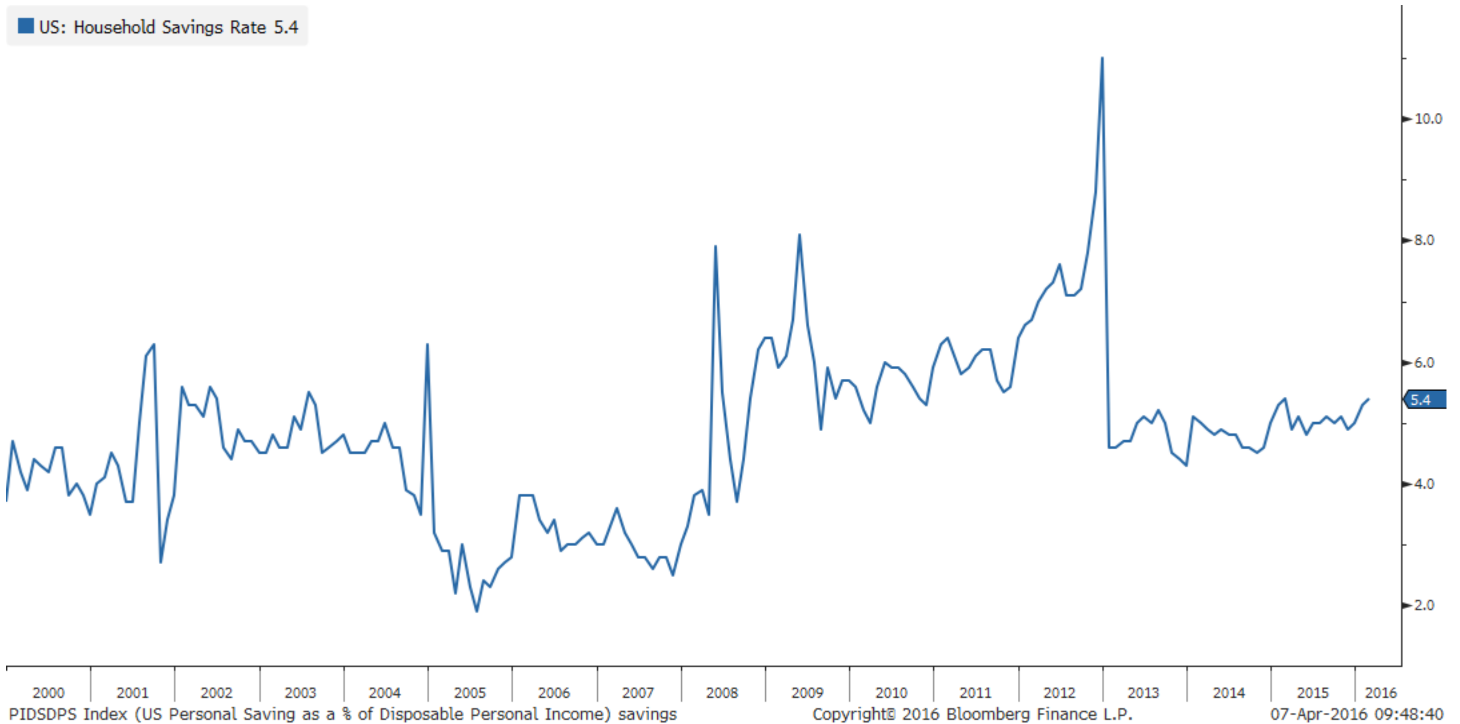

Consumer confidence has set in its high-watermark as well. Whether we cut through the trend-measure is something to monitor carefully for an inflection point in consumer spirits. We're close to the trend now and look set to test it in upcoming months.



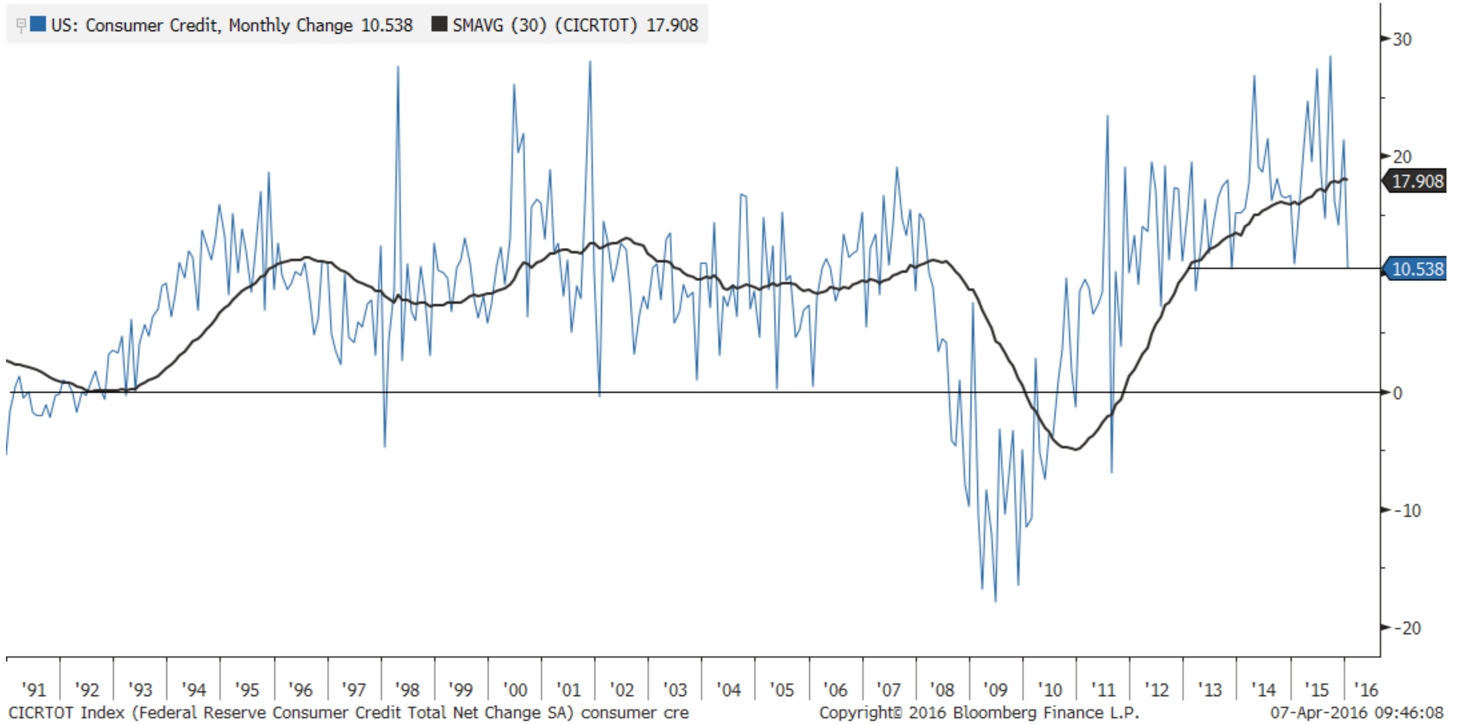
Within the consumer confidence survey, we're particularly interested in the sub-indices such as the barometer measuring the percentage of households expecting their incomes to *decline* over the coming six months. While we want to avoid exaggerating the recent results we're carefully monitoring what seems to be a potential reversal to the topside. If true, one would assume savings to increase as income prospects turn less rosy.



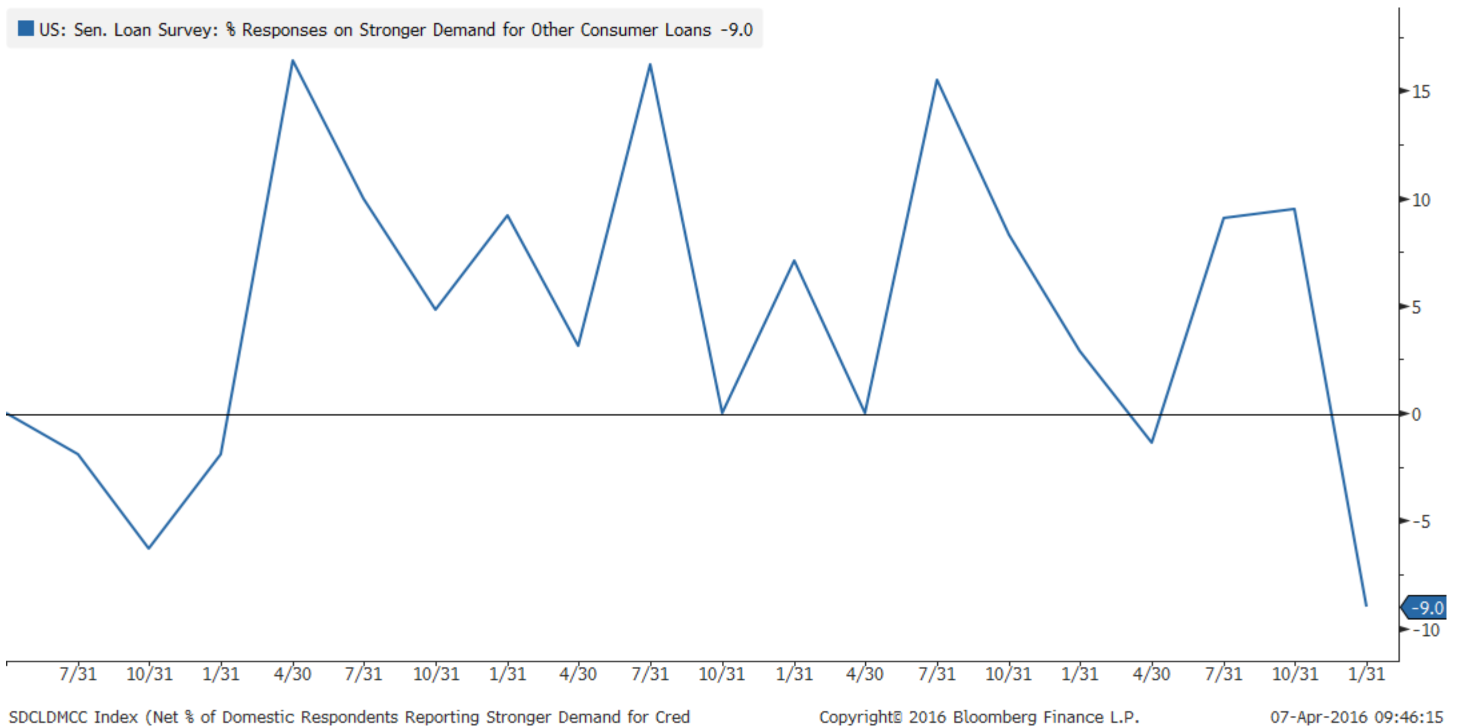

To that end, even as the level of household savings has been broadly stable in recent years we've seen some incremental increases over the last few months. This comes at a time when the debt service burden is at a multi-decade lows – suggesting there is some true inertia to spend in the making.



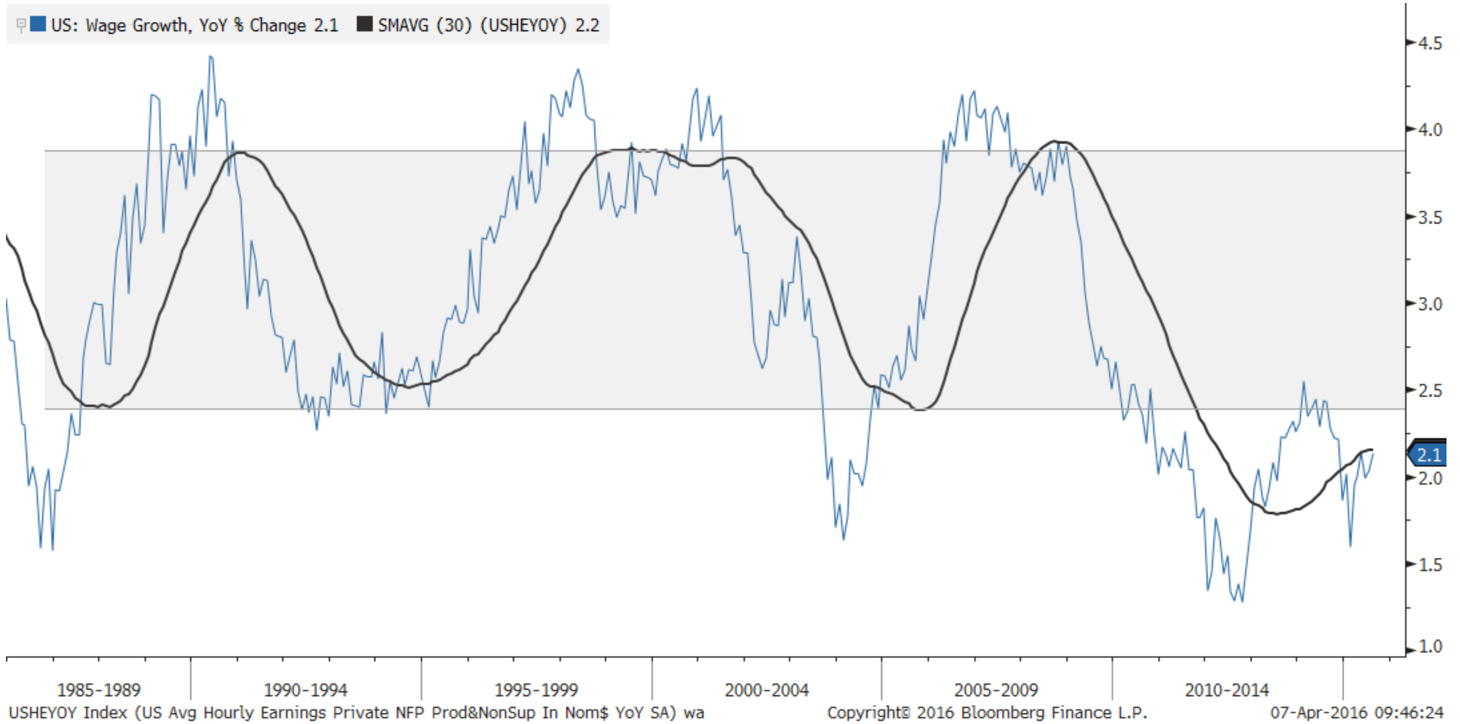
The casualty from these softened consumer confidence measures looks to be the credit cycle as the monthly uptake has lost momentum with both the revolving as well as the non-revolving segments adding to this result.



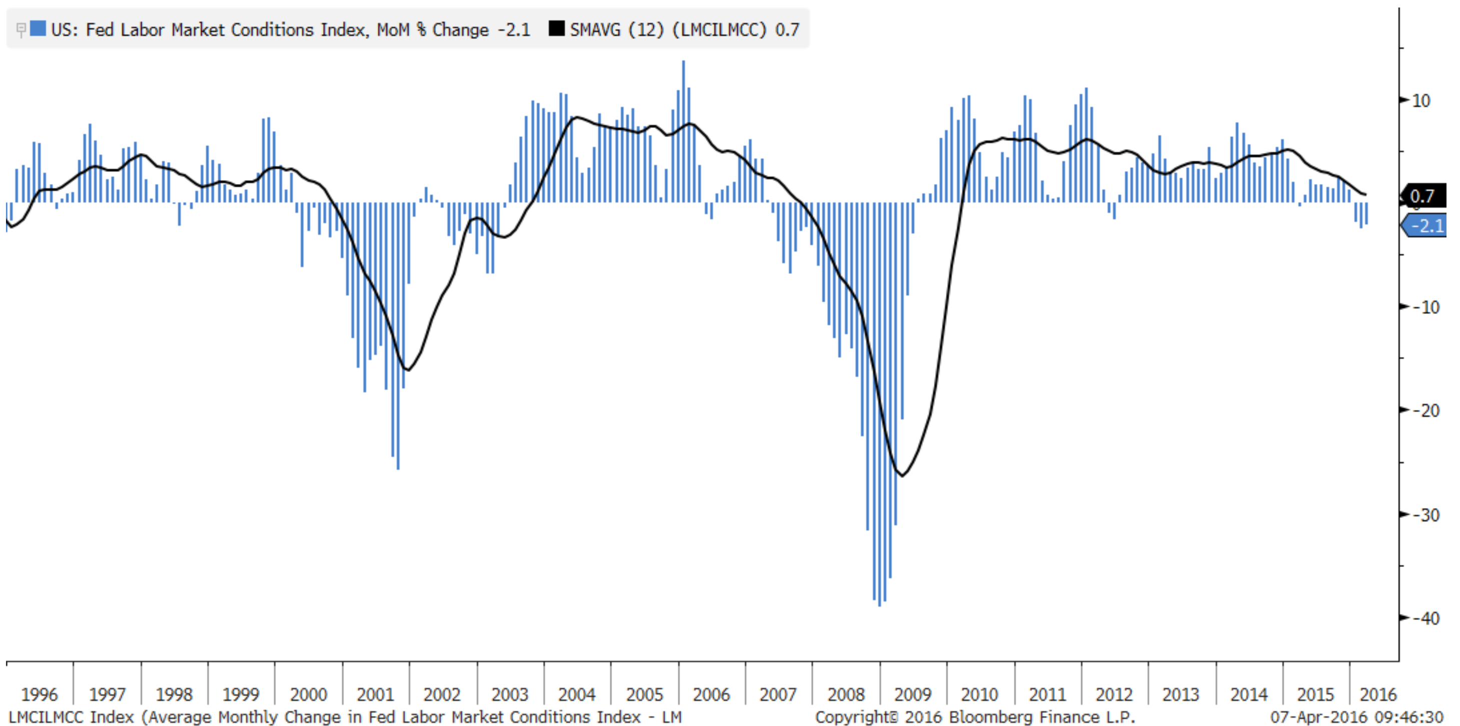

This fits the Senior Loan Officer Surveys where the net balance of banks reporting on stronger demand for consumer loans above and beyond auto and credit cards has turned negative (i.e. a larger number of banks are reporting a weaker demand for credit). The results for auto and credit cards show a similar dynamic although the absolute levels have yet to fall into negative territory.



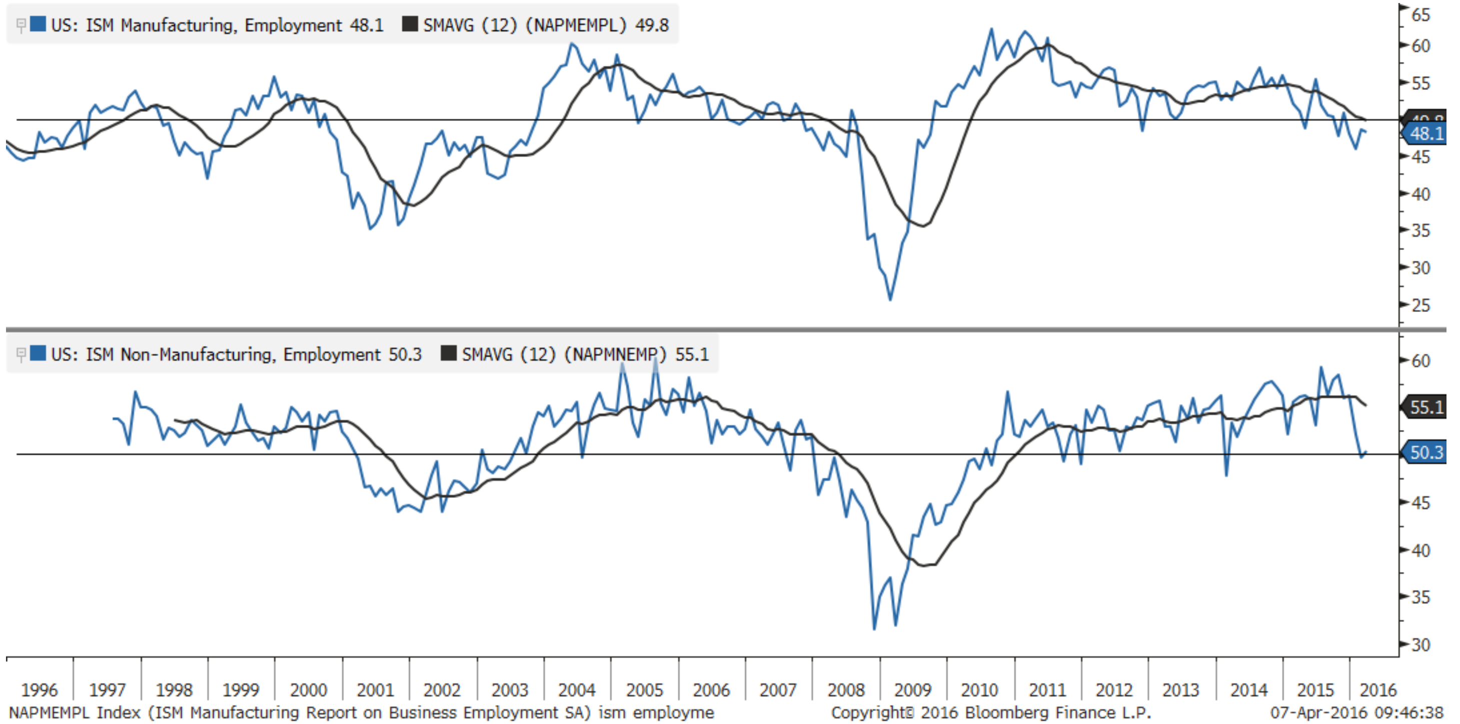
With the incremental impulse from the credit channel looking set to shave off from consumers' spending powers the wage effect won't offset it with much force. When looking at the deep, underlying trend-measure (30 month-moving-average) for private wage growth it's evident we haven't even managed to climb up to the low-end of the historical range for the last thirty years. Low productivity may be one explanation.



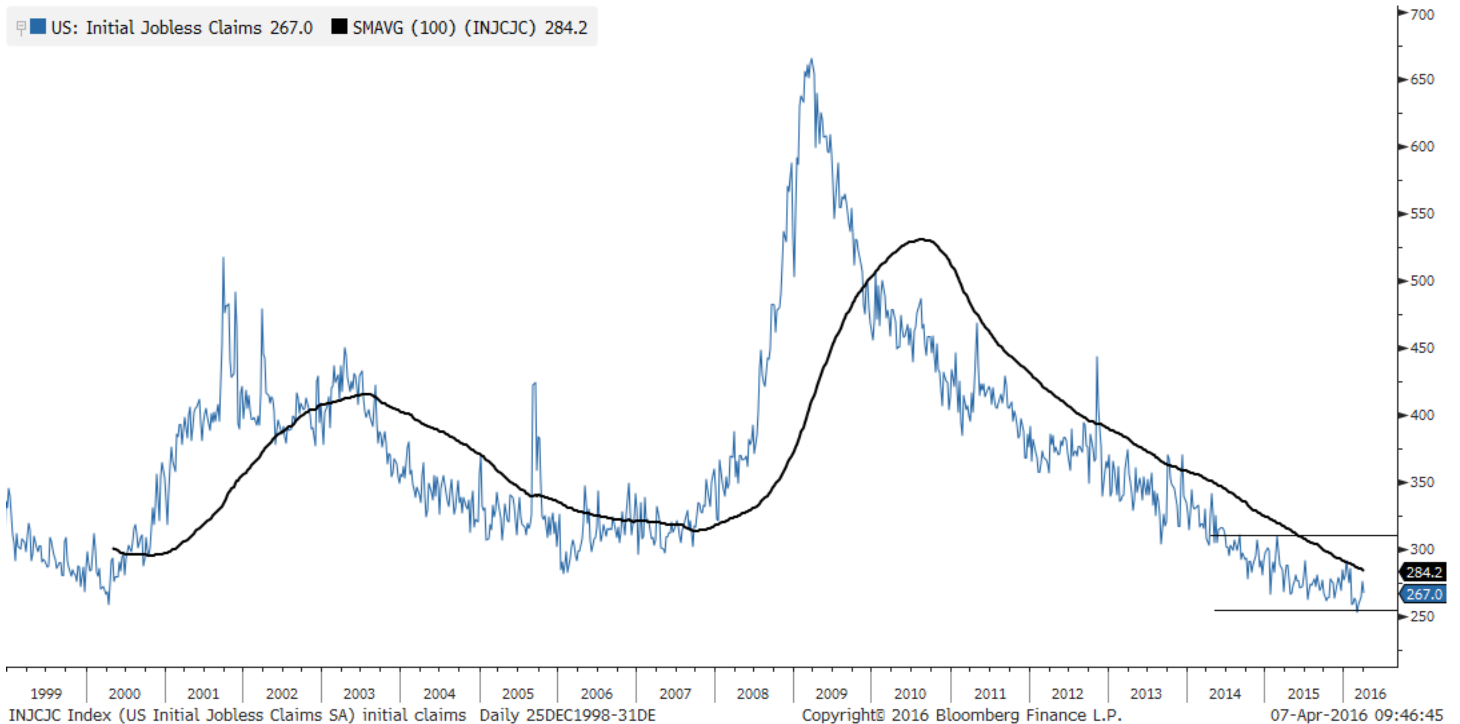

In light of the more fragile consumer profile the ongoing deterioration in the Fed's Labor Market Condition Index should be seen as concerning (this metric comprises nineteen indicators that measure the state of employment conditions).



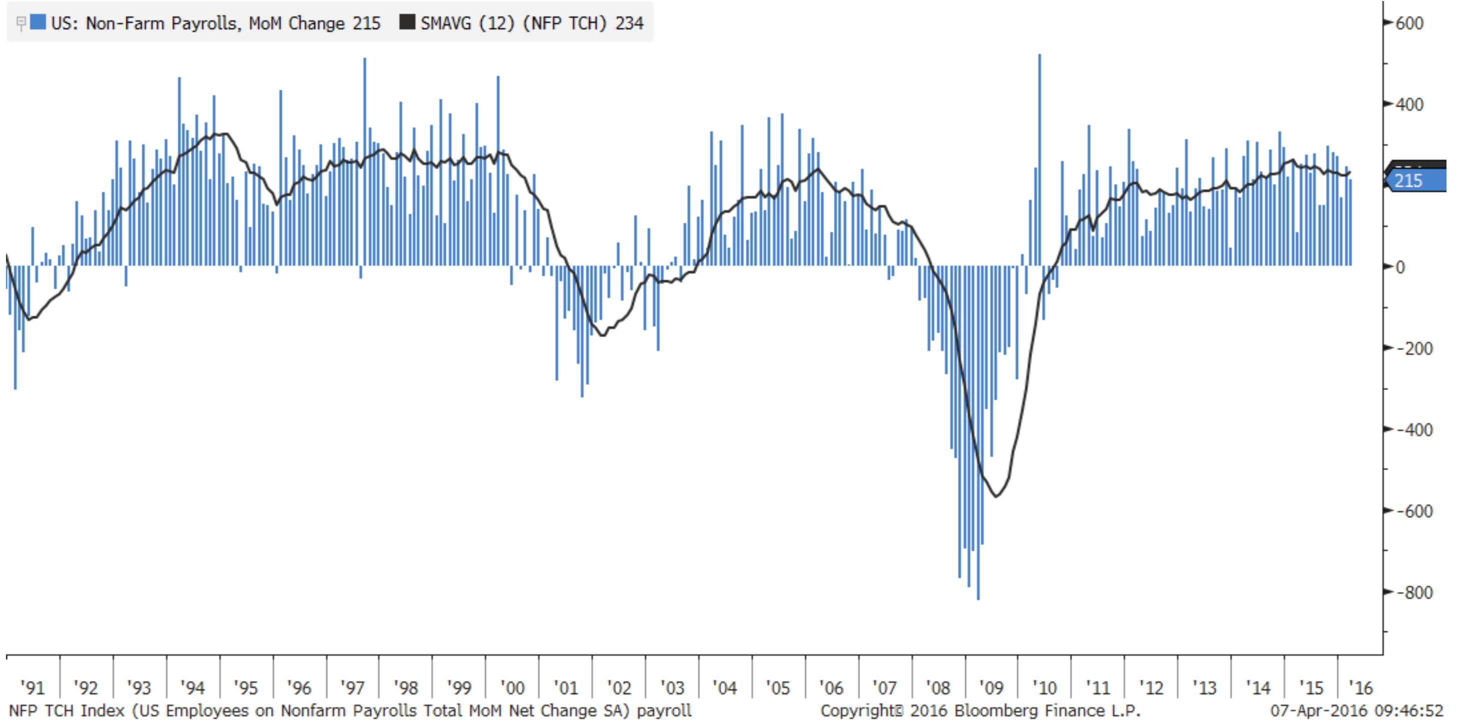
The ISM surveys are not included in the aforementioned labor market measure but recent results have shown a similar dynamic. Corporates in manufacturing as well as in the services sector are reporting a diminishing appetite for human capital.



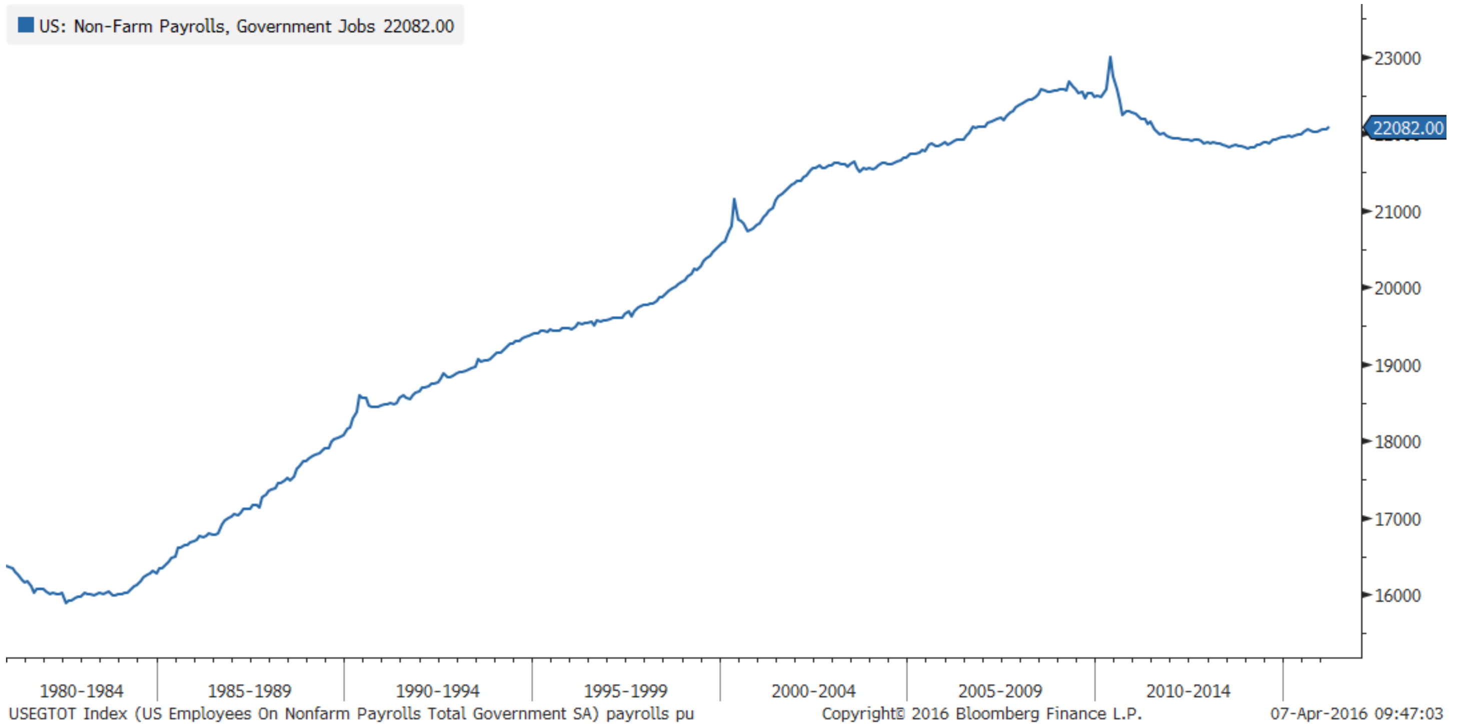

However, even as these jobs-indicators have weakened we're yet to see any convincing signs of stress in initial jobless claims. We seem to be marking a bottom for this cycle but no credible signs of a collapse in the labor market are detected here at this point.



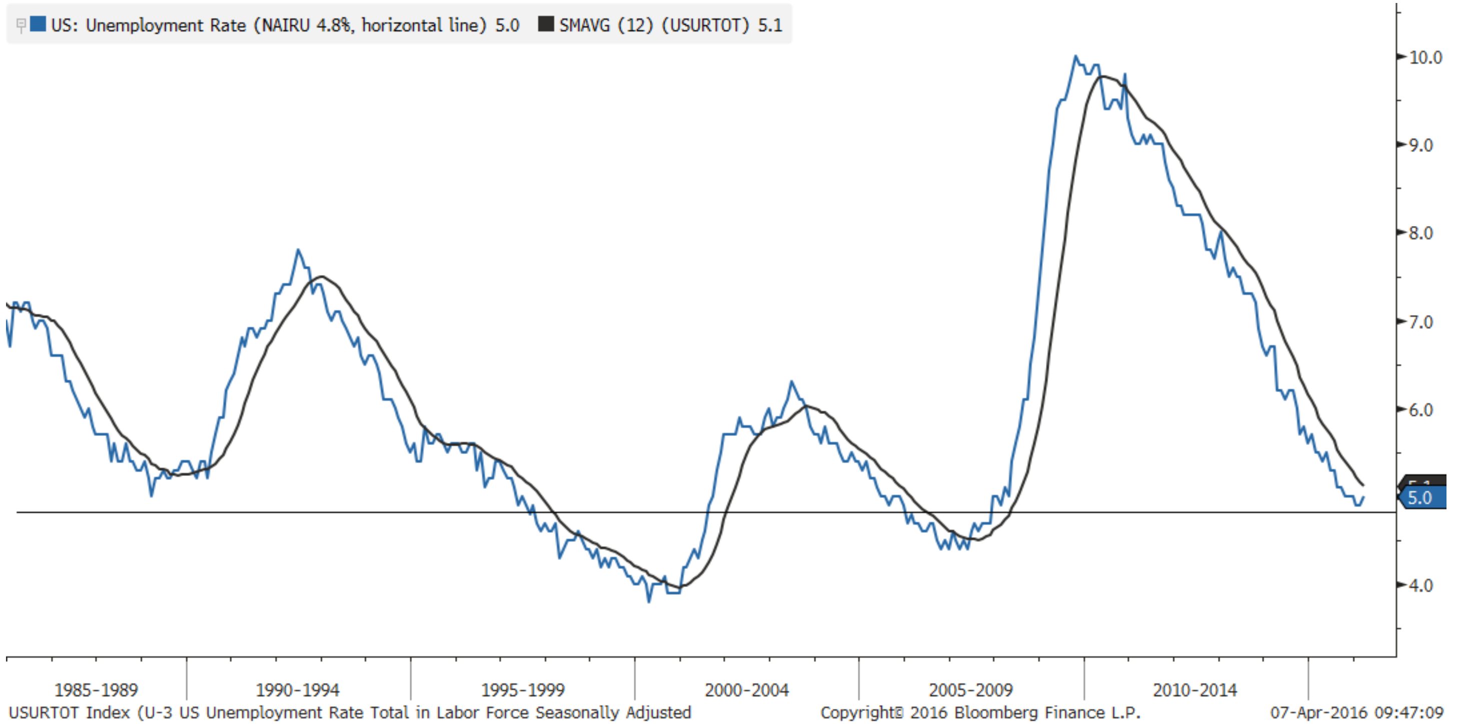
Payrolls have been quite steady and we've employed 234 thousand new people each month on average over the last year.



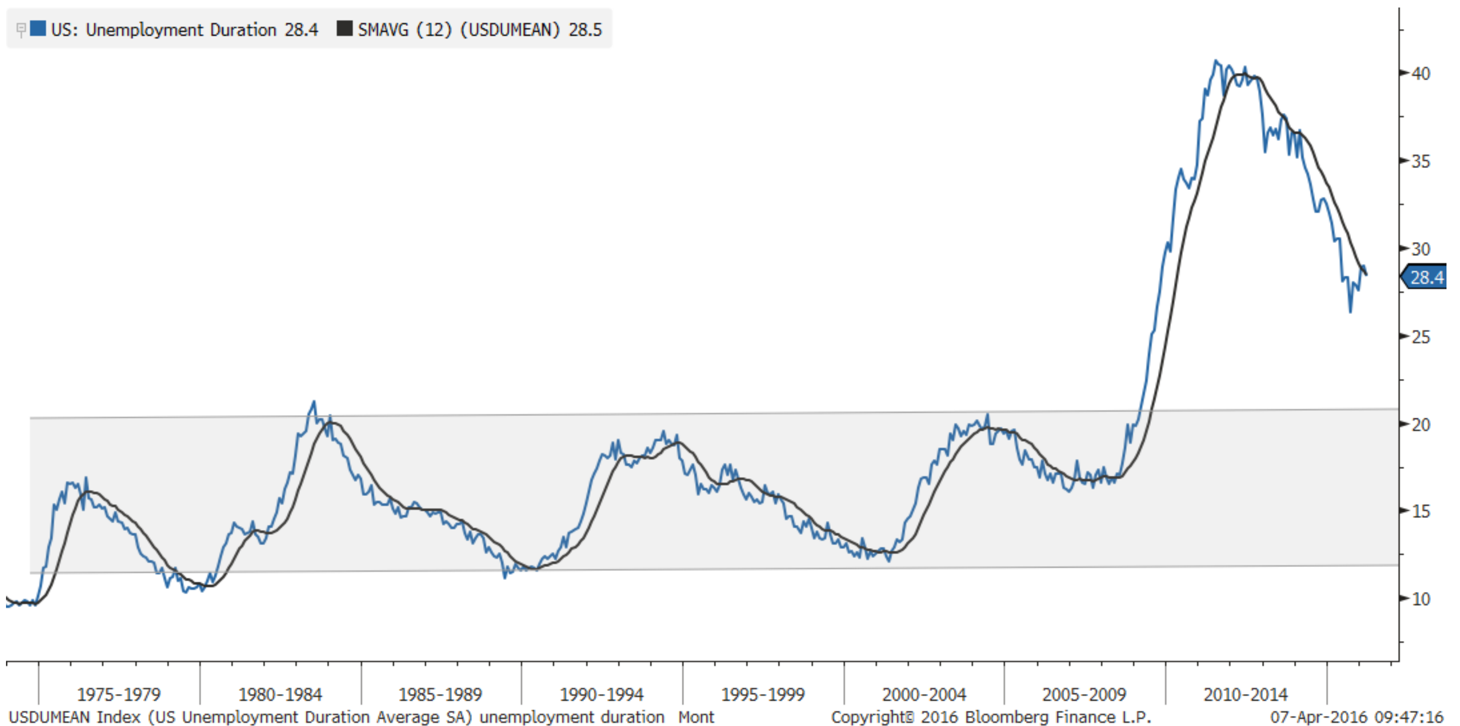

Marginal additions to employment have come from the government in recent years.



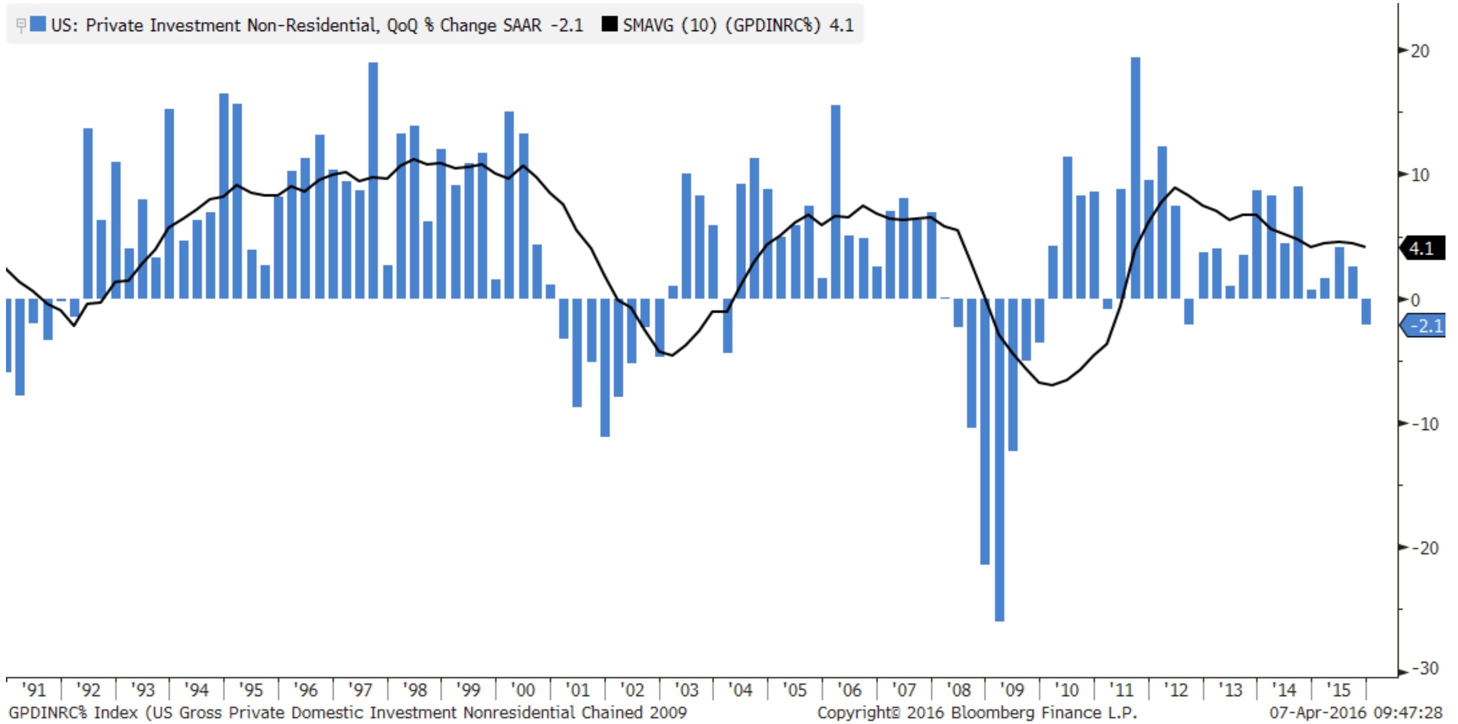
The unemployment rate has fallen dramatically over the post-crisis period – aided by the drop in the participation rate – and we're now just short of the Fed's NAIRU estimate of 4.8%.



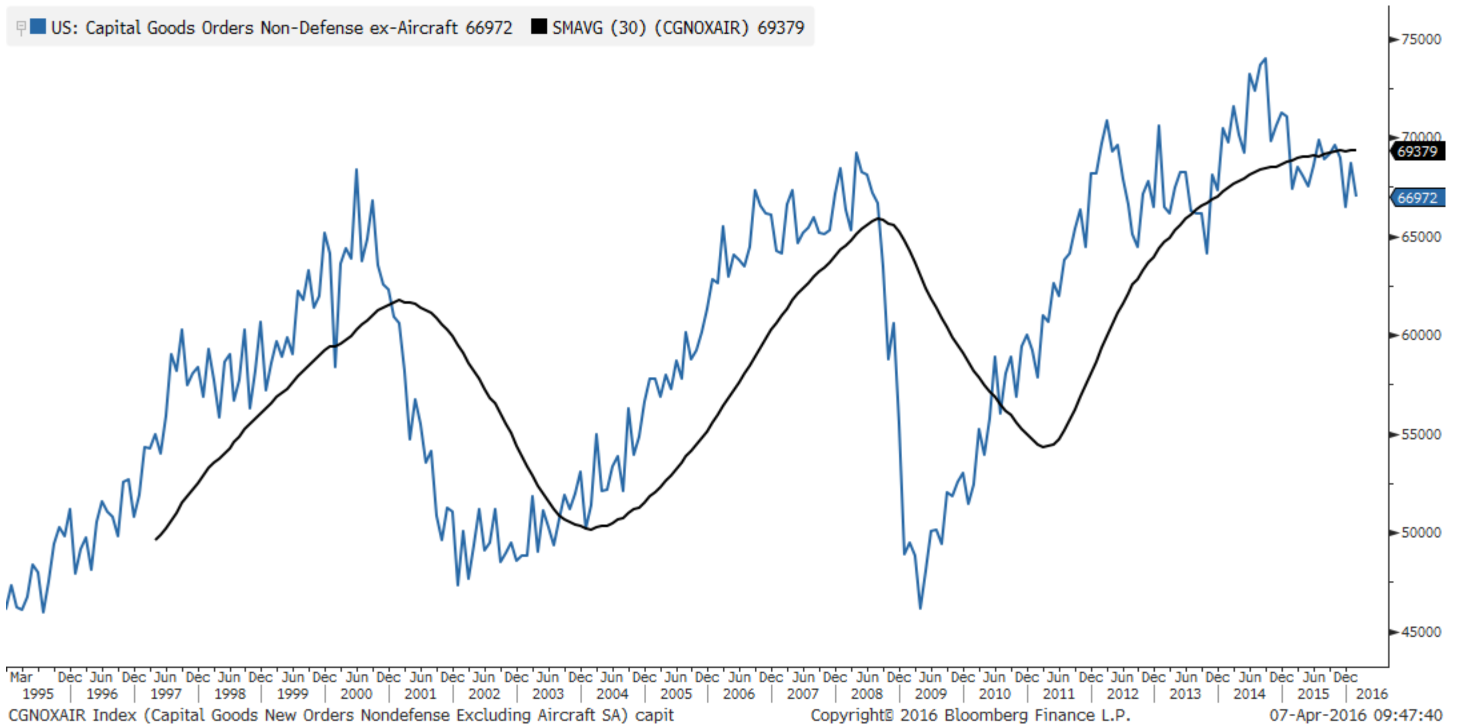

However, despite improvements in bringing the number of unemployed individuals lower the average duration of unemployment remains elevated. We're still above the top-end of the range that defined this metric into the 2008 crisis.



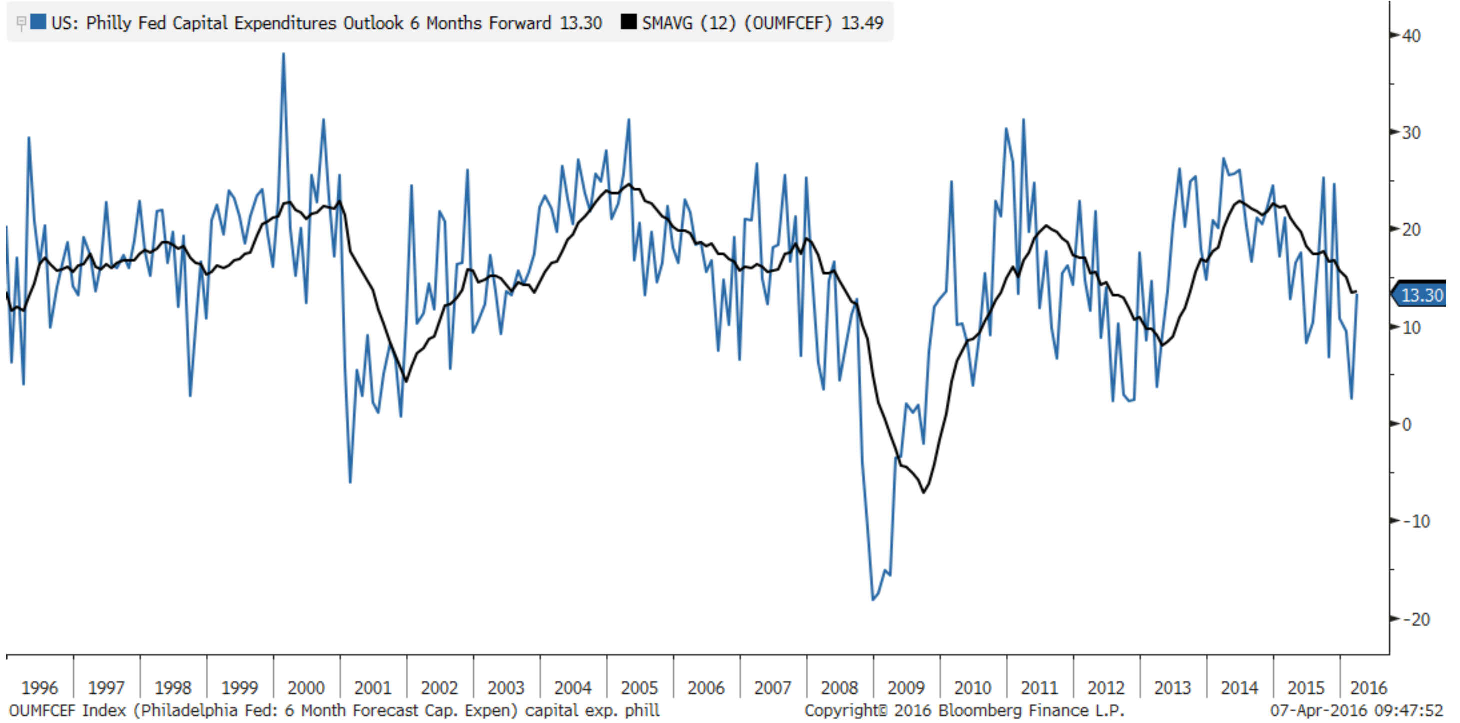
While the consumer part of the economy faces cyclical challenges we're also seeing a clear deterioration in the investment facet. The Fed has become more concerned on this part in particular with the March statement referring to the investment cycle as being outright *'soft'*. To that end, the latest data show the non-residential part contracting over the quarter.



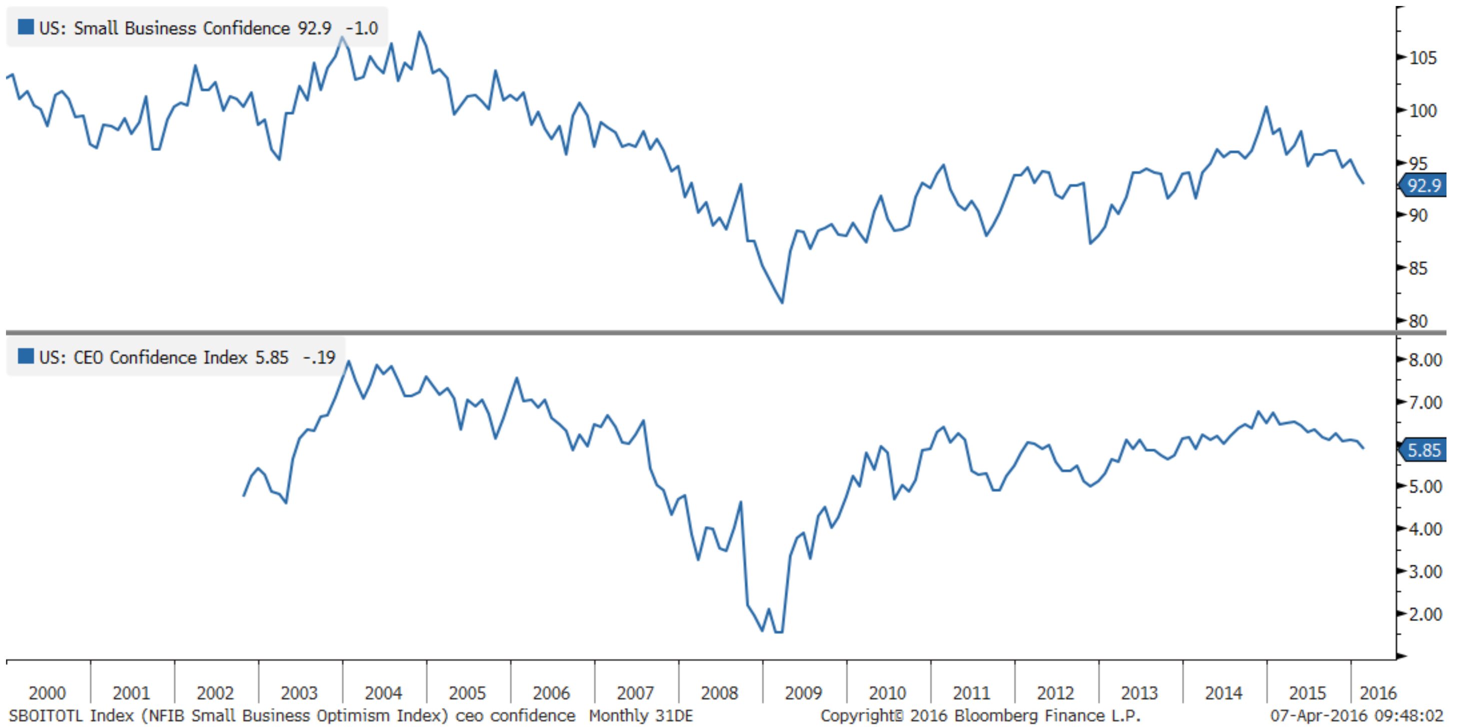

The demand for capital goods has dried up and signals this weaker dynamic. This hasn't been a complete collapse as in 2000 and 2008 but taken on a more hockey-stick formation. Still, the result is the same: investment appetite is cratering.



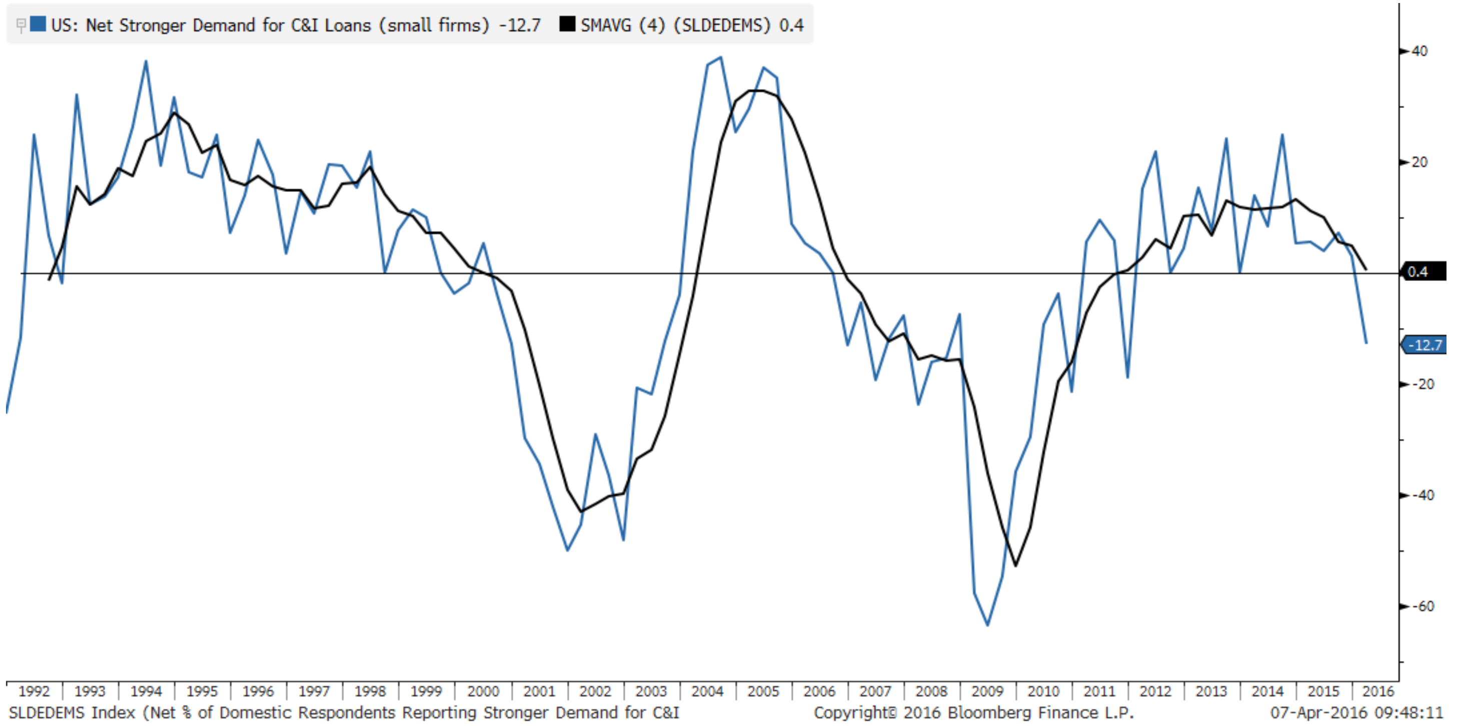
Some of the business surveys, such as the capital expenditure component of the Philly Fed manufacturing report, suggest the same: investment appetite is cratering.



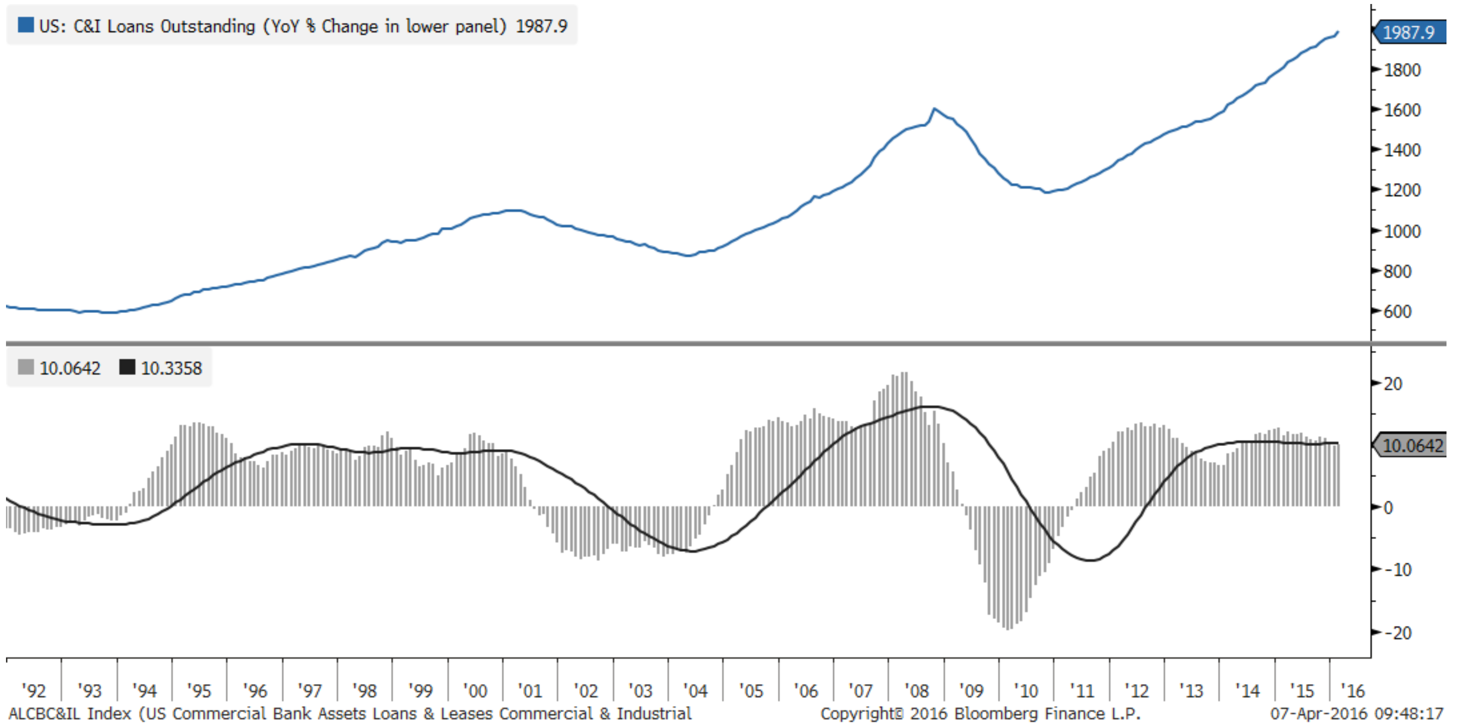

More broadly, business sentiment is losing ground. This is seen in the small business sector as well as in the CEO Confidence Index. Together with the weaker consumer confidence readings this shows that private economic sentiment is softening.



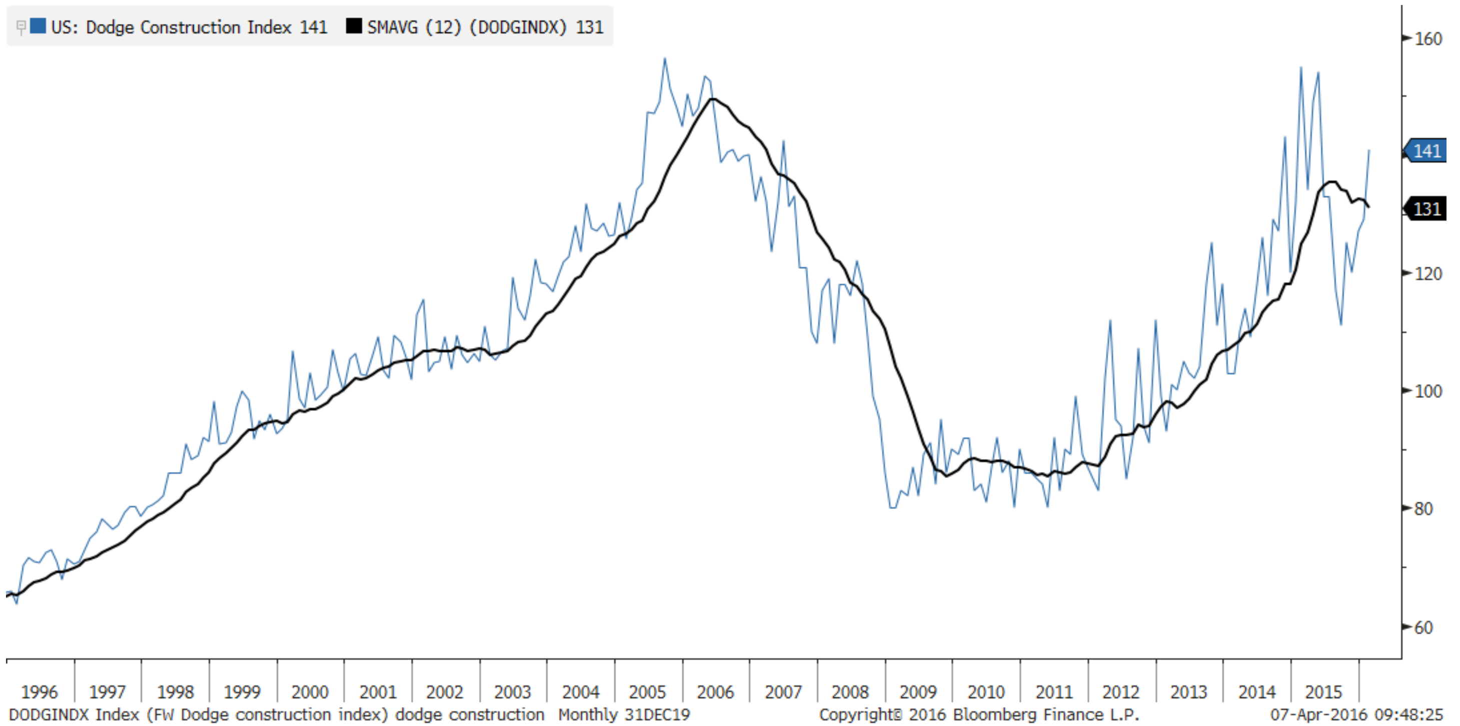
Recent results from the Senior Loan Officer Survey show that demand for credit in the corporate sector is dropping fast. One of the reasons that have been cited for this decline is a diminished investment appetite.



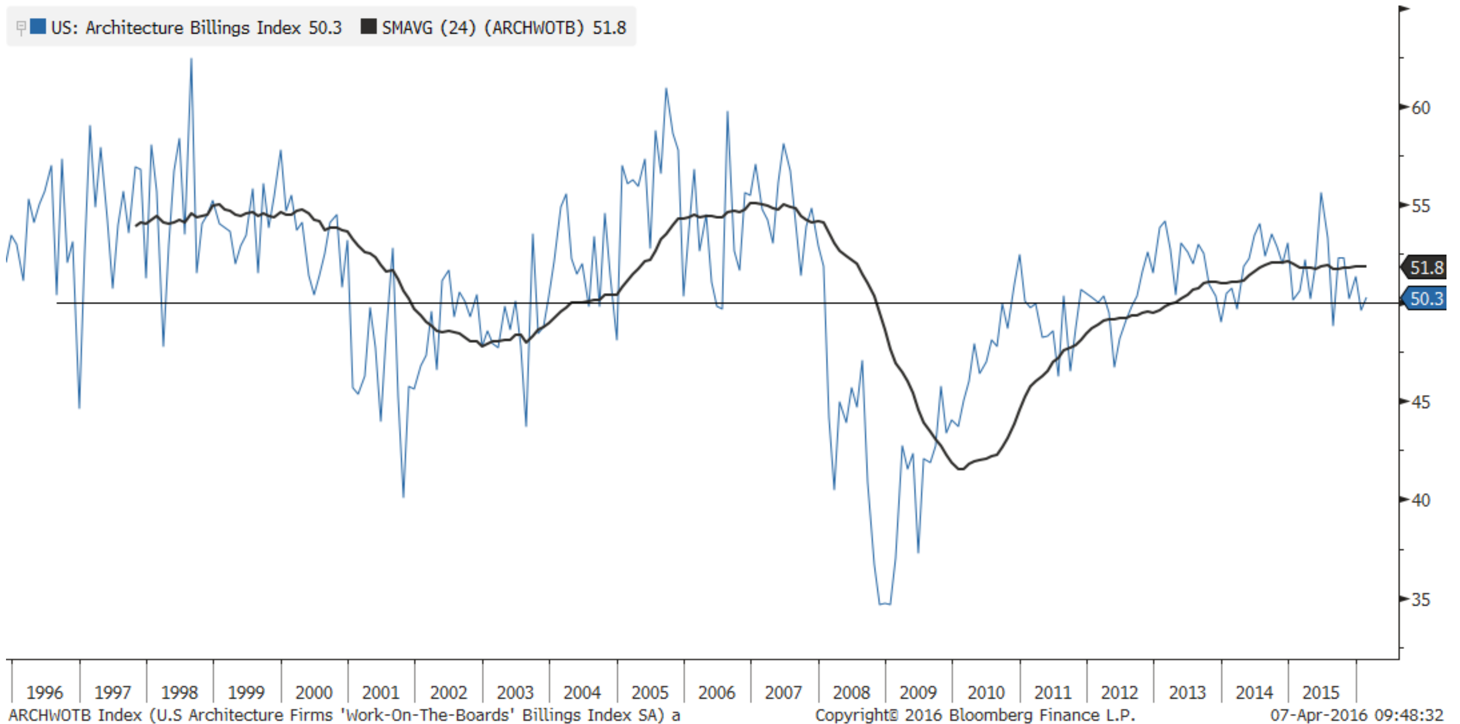

We've yet to see any of this resulting in softened business credit growth but it should be viewed as highly likely given the destruction signaled within these surveys.



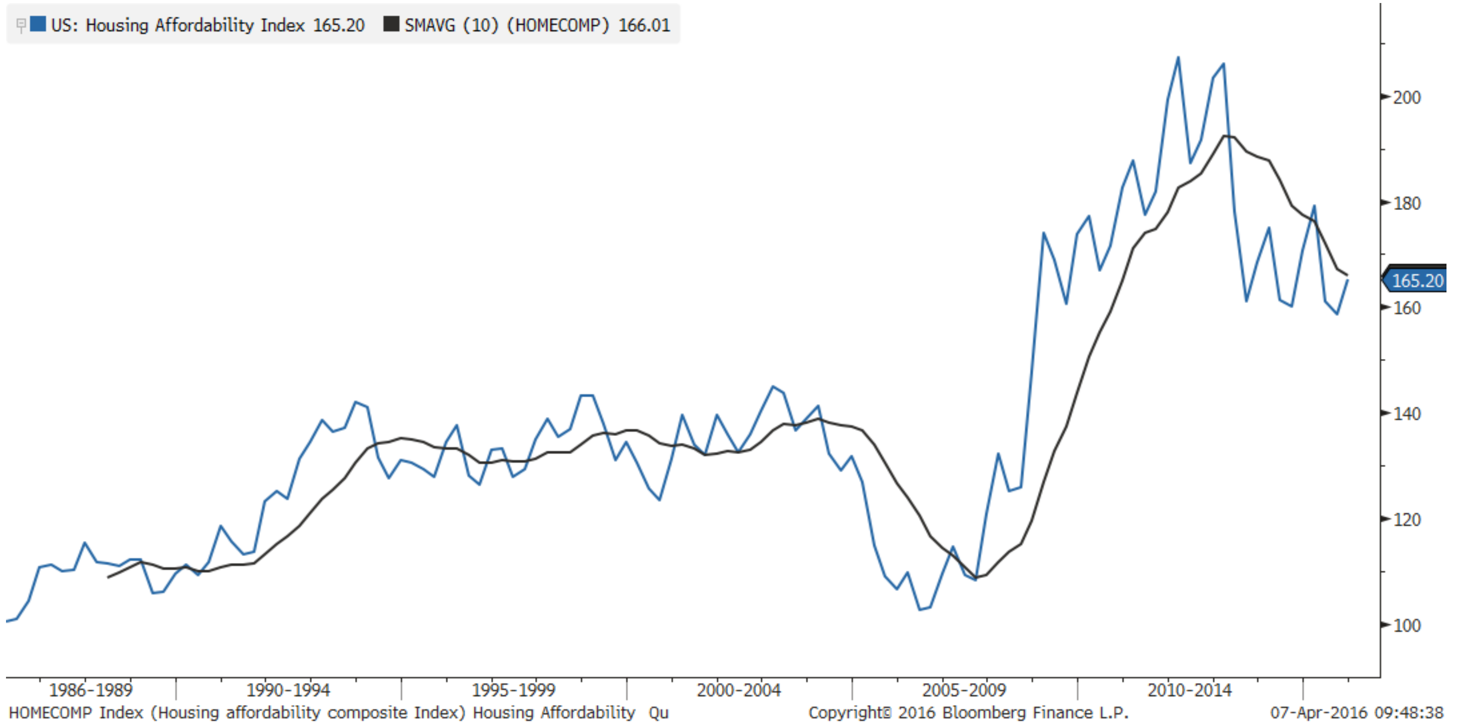
We've seen some acceleration in the Dodge Construction Index – barometer for new starts in residential and non-residential construction – but trends look to be setting in a high-watermark for this cycle.



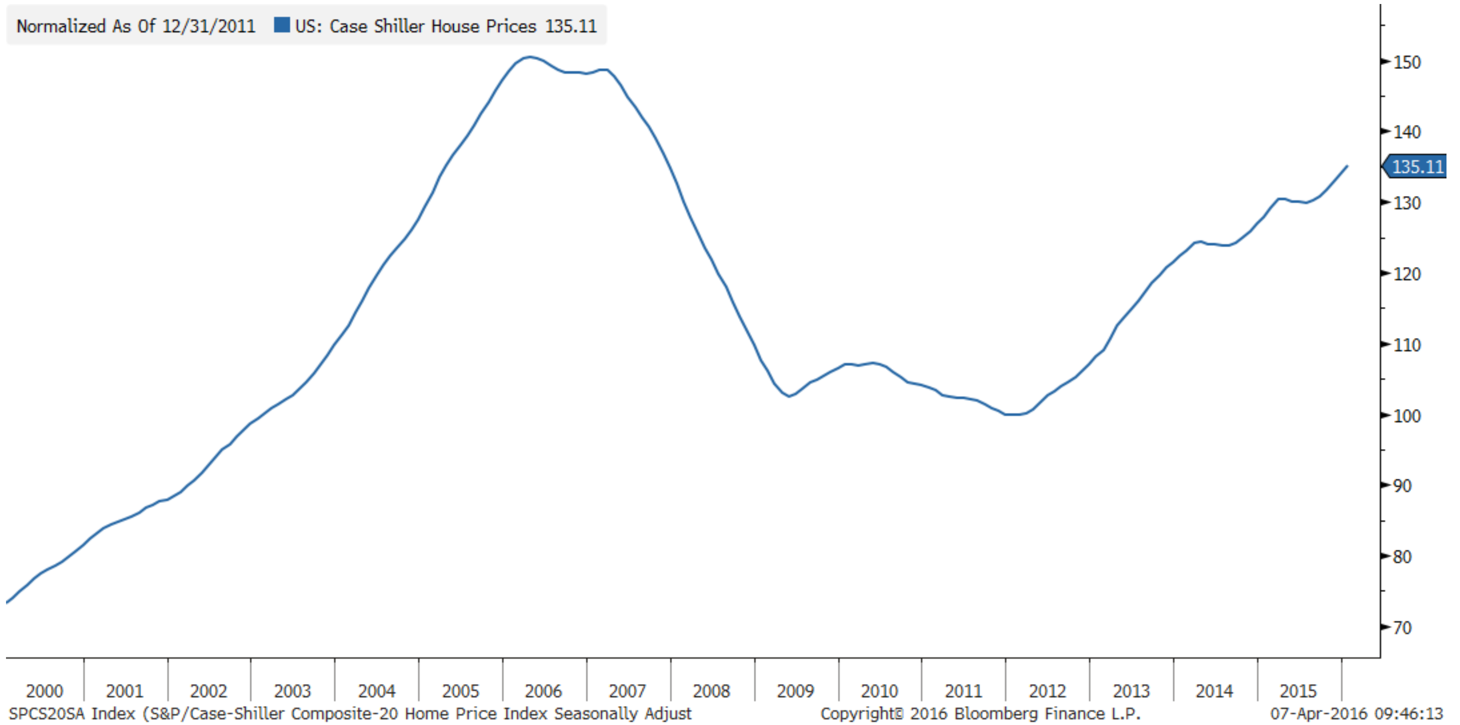

Demand for design services has flat-lined over the past two years in a modest growth territory. However, current spot values signal that activity is barely growing as we reside at the neutral 50 level.



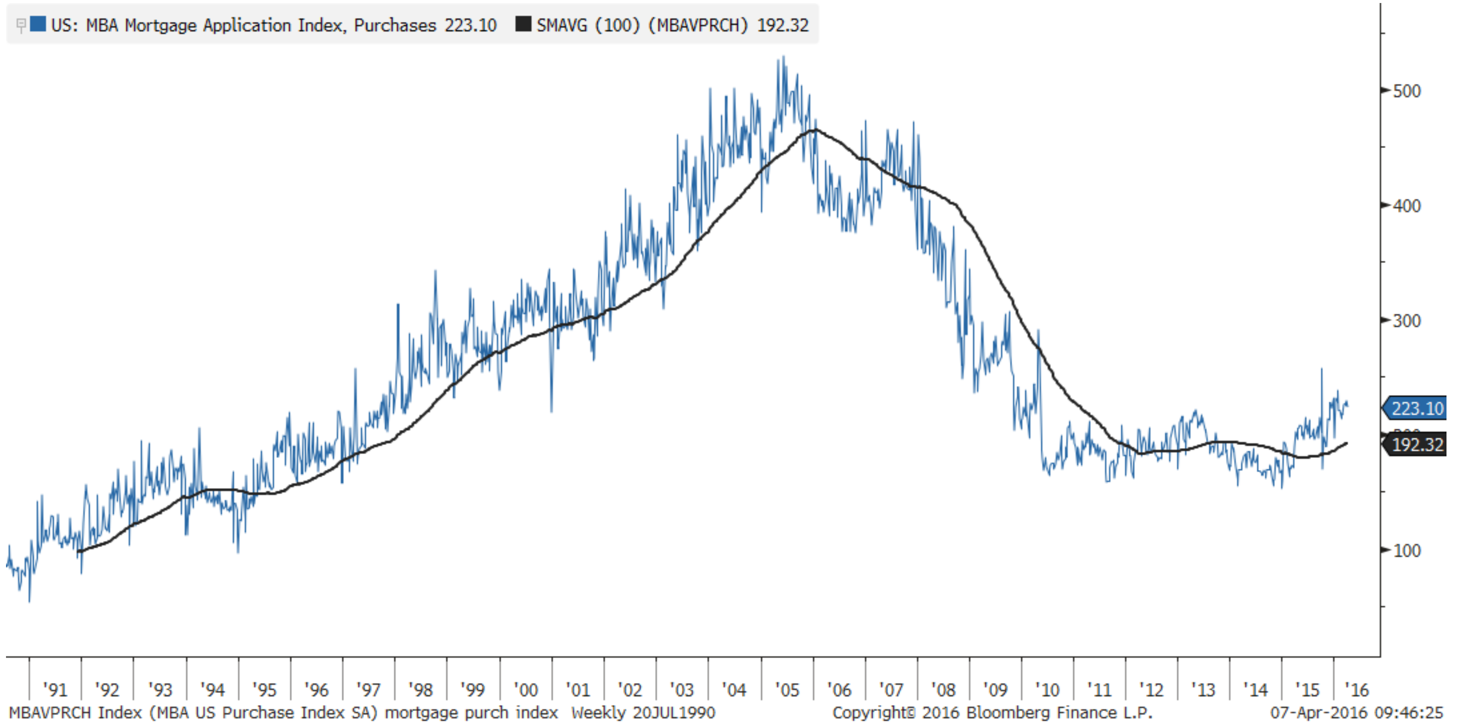
As for the residential sector goes we've seen housing affordability come off somewhat in recent years, yet, it remains relatively high in a historical context (note: higher values indicate more affordability and vice versa).



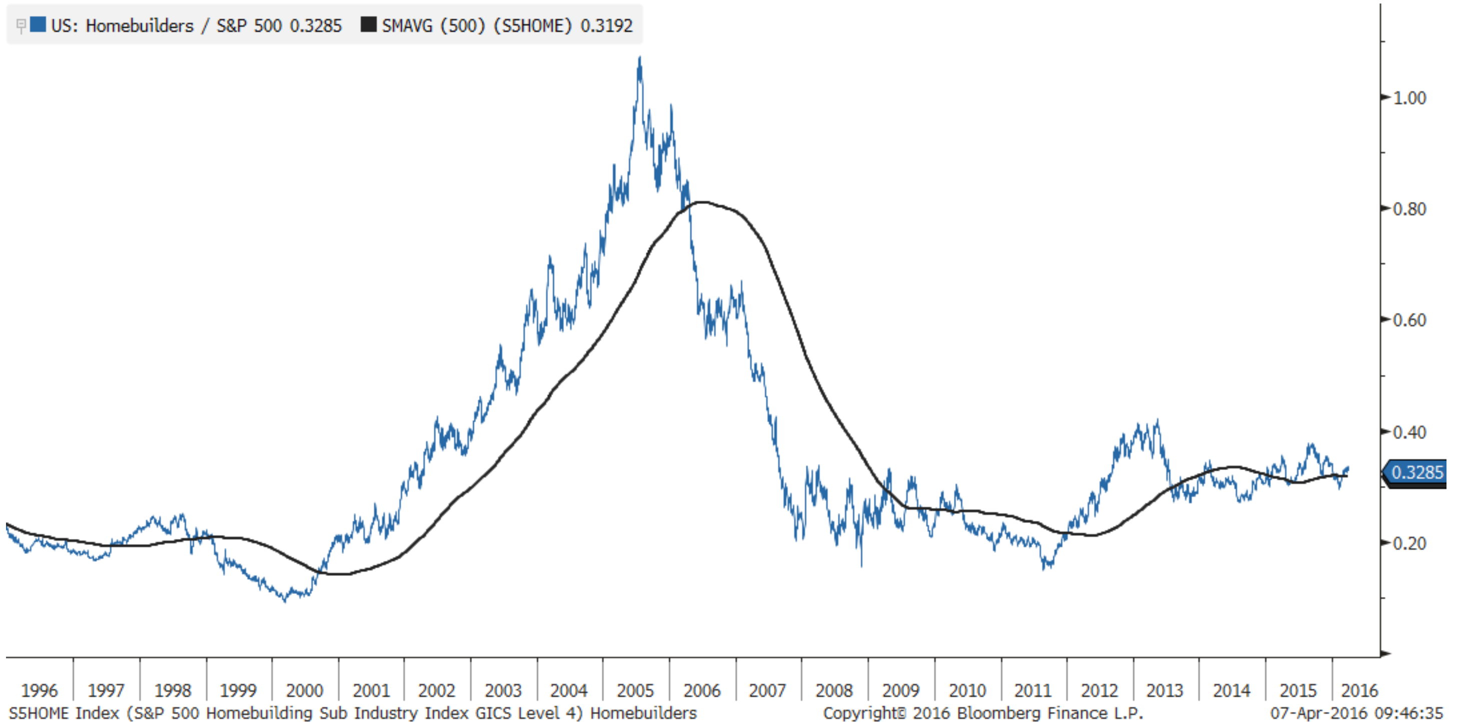

The 35% increase in housing prices over the last four years has eaten into affordability measures.



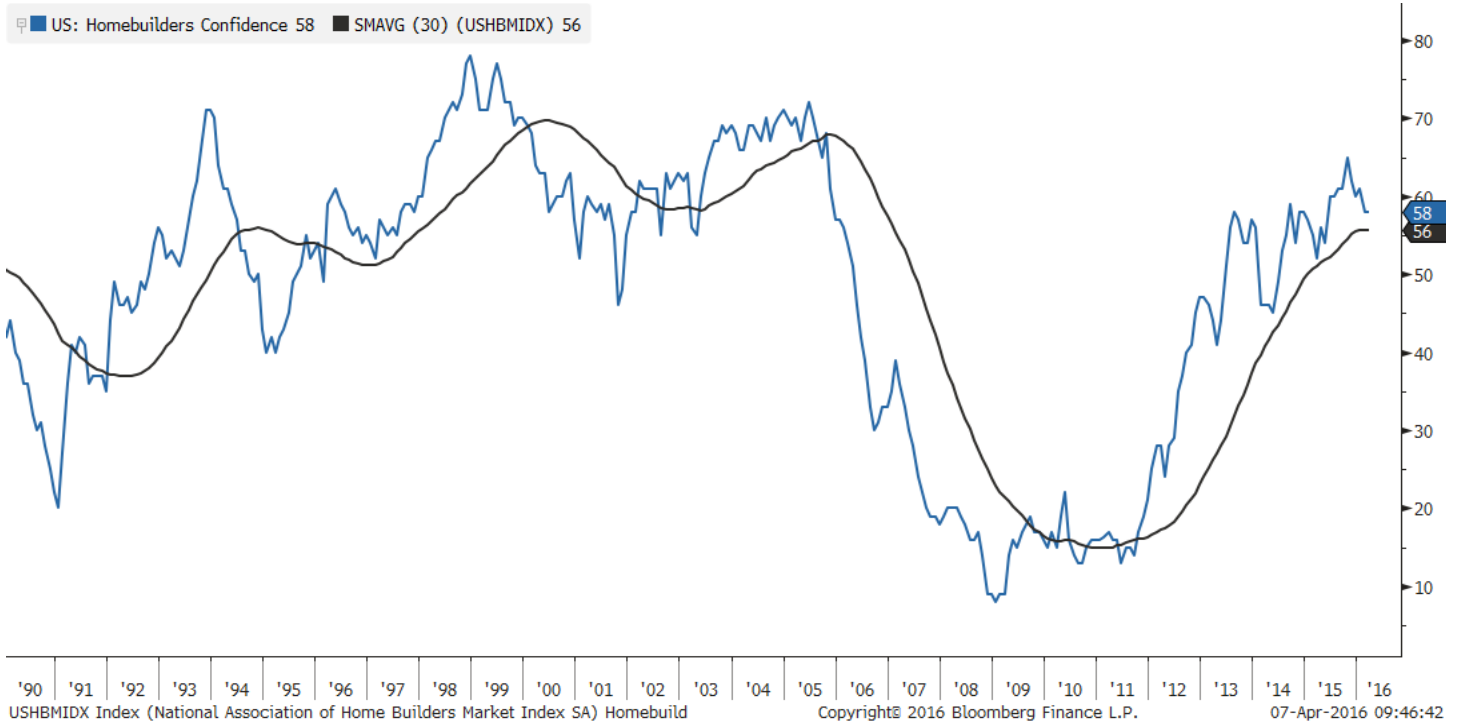
We've seen some acceleration in the weekly mortgage applications for home purchases. This measure had flatlined for roughly five years but there are some signs of life now.



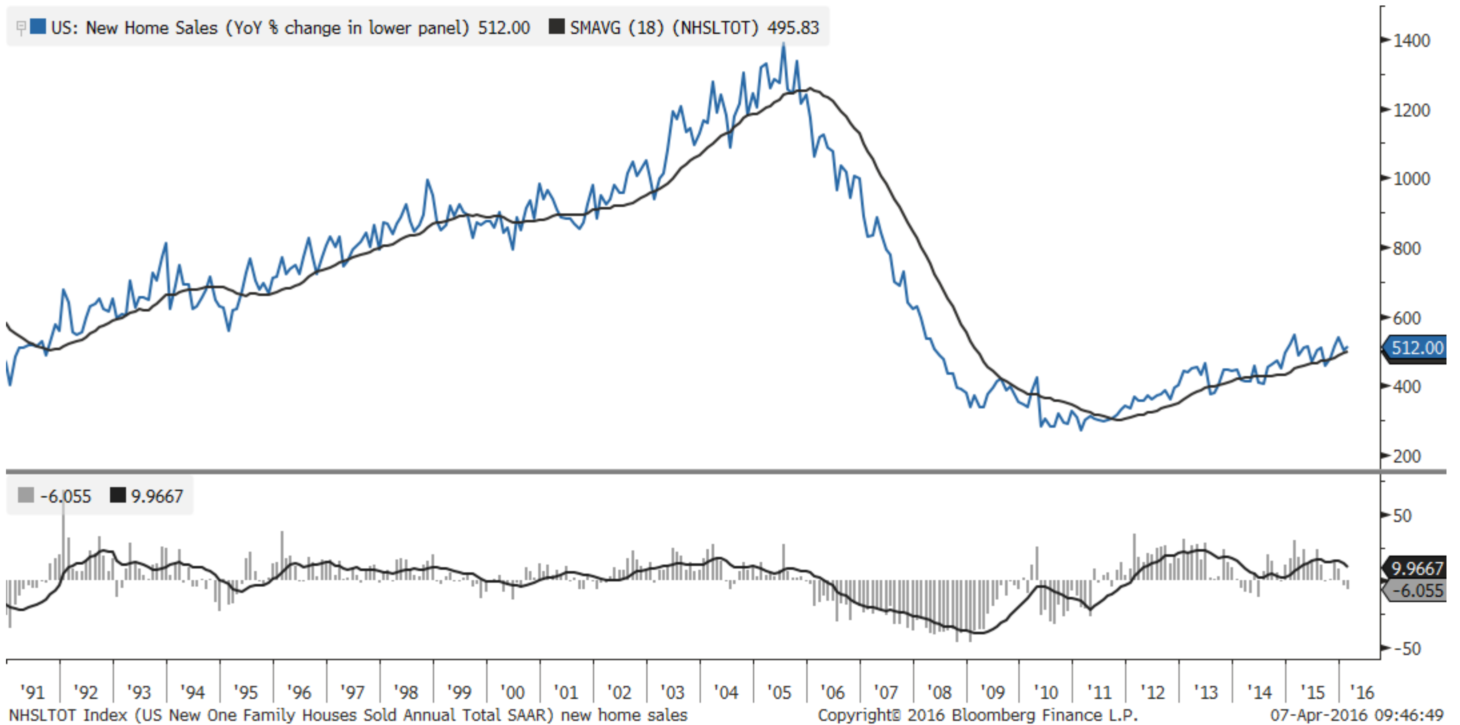

Looking at more 'alternative' high-frequency metrics to measure the health of housing cycle we don't detect much above and beyond static conditions. The relative ratio of Homebuilders vs. S&P 500 has historically offered timely lead on housing activity and there is nothing much to get excited about at this point.



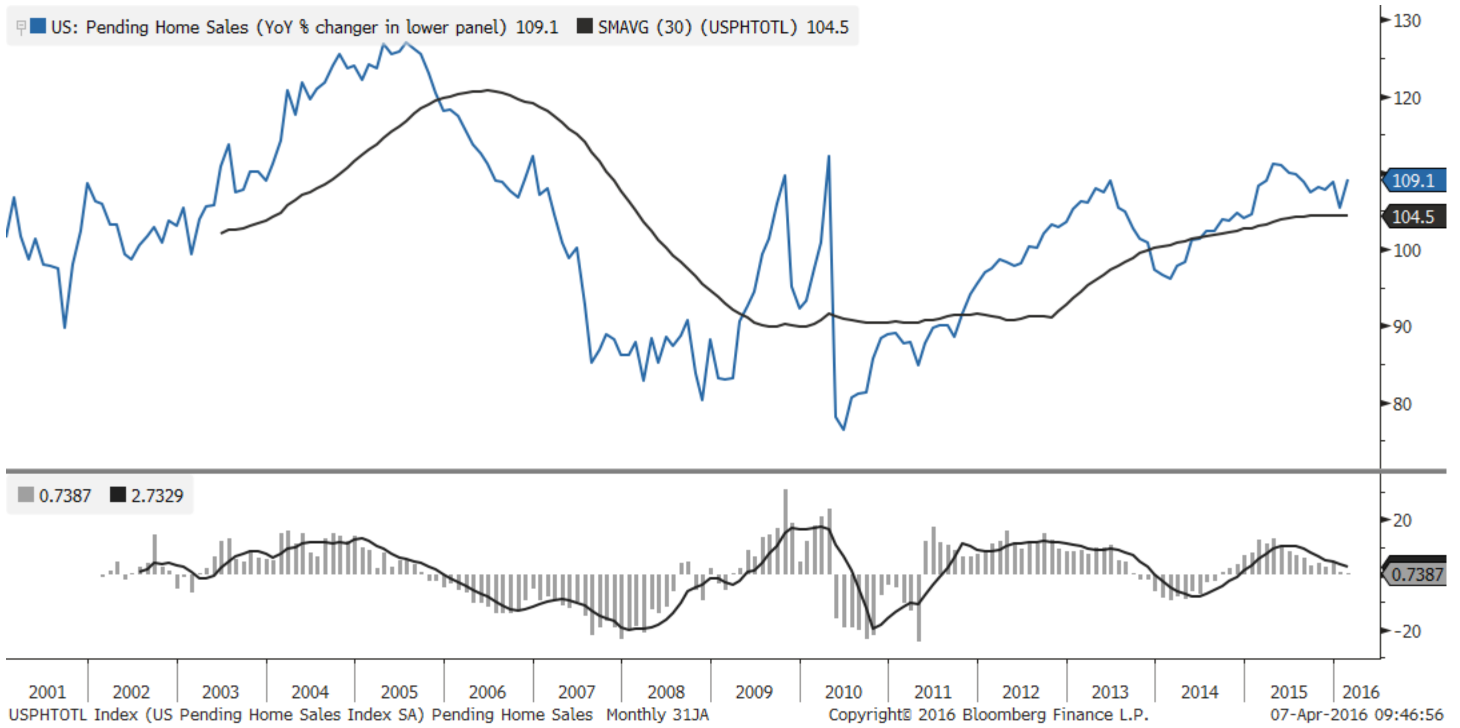
Confidence by homebuilders remains relatively elevated but it's starting to look a bit 'forced'. In other words, we're seeing spot values finding it harder and harder to exceed the deep, underlying trend-measure with conviction. That we're nearing peak-sentiment in the sector should be seen as a wide-open possibility.



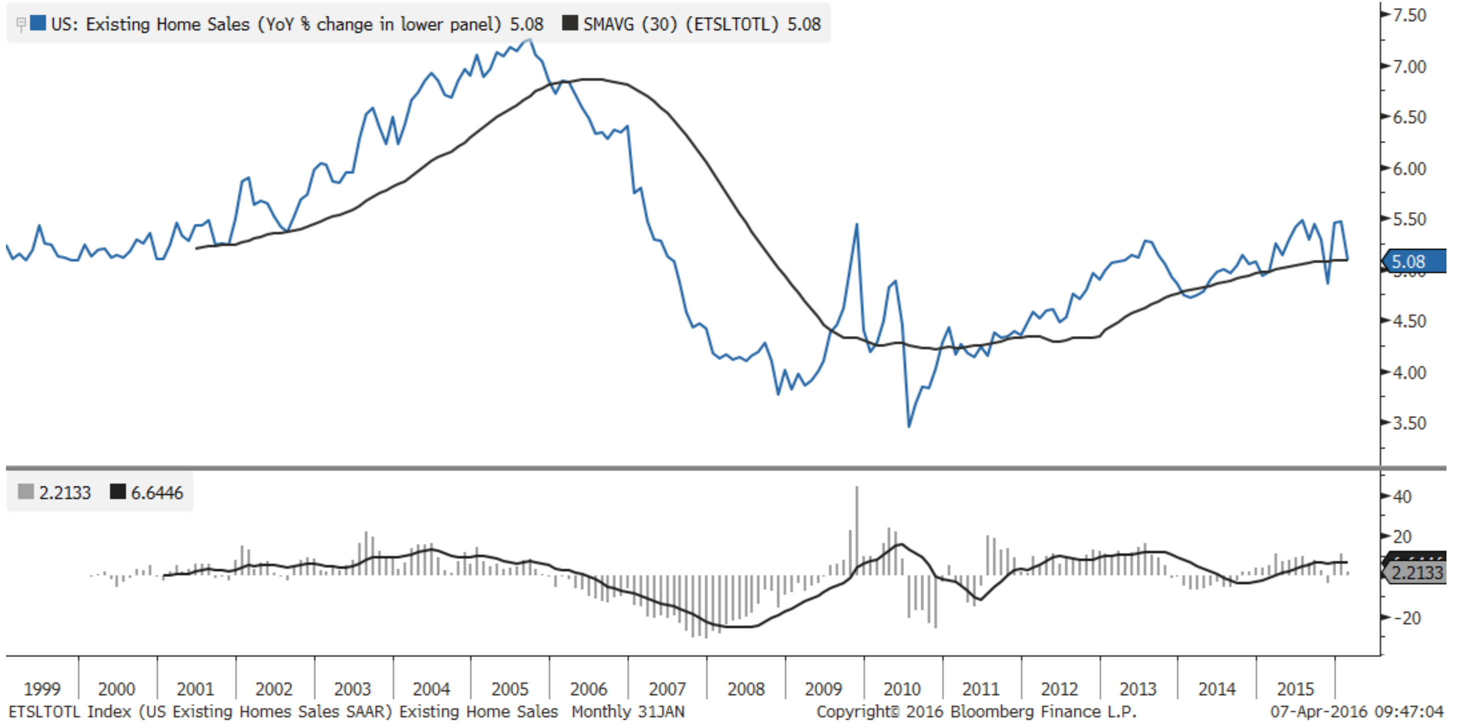

New home sales continue to drift upwards at a gradual pace but it's evident that some fatigue has emerged in the data over the last few months. This is best reflected in the reversal in the year-on-year changes that have fallen into negative territory.



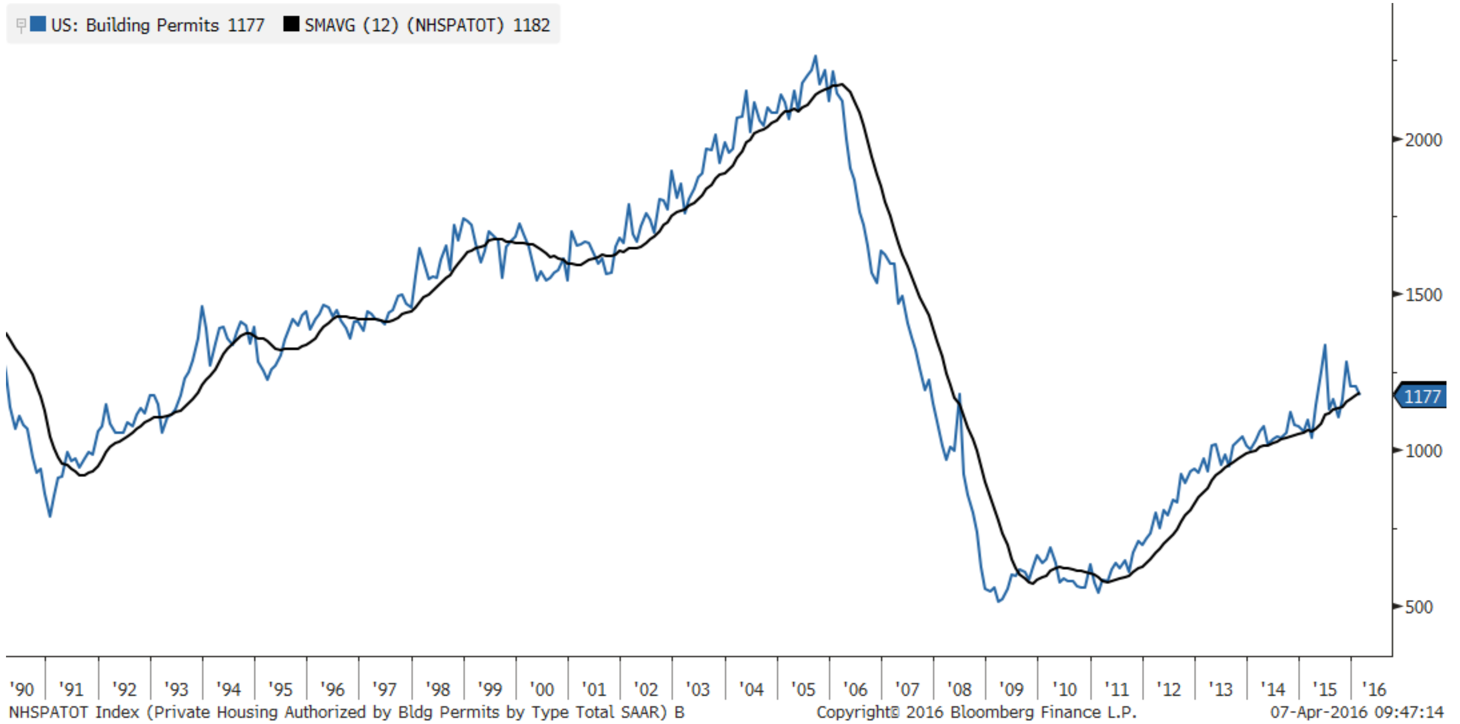
Pending home sales are also uninspiring with a clear loss in momentum seen over the last year. This is reflected in the year-on-year changes and in the deep, underlying trend-measure that is also losing momentum.



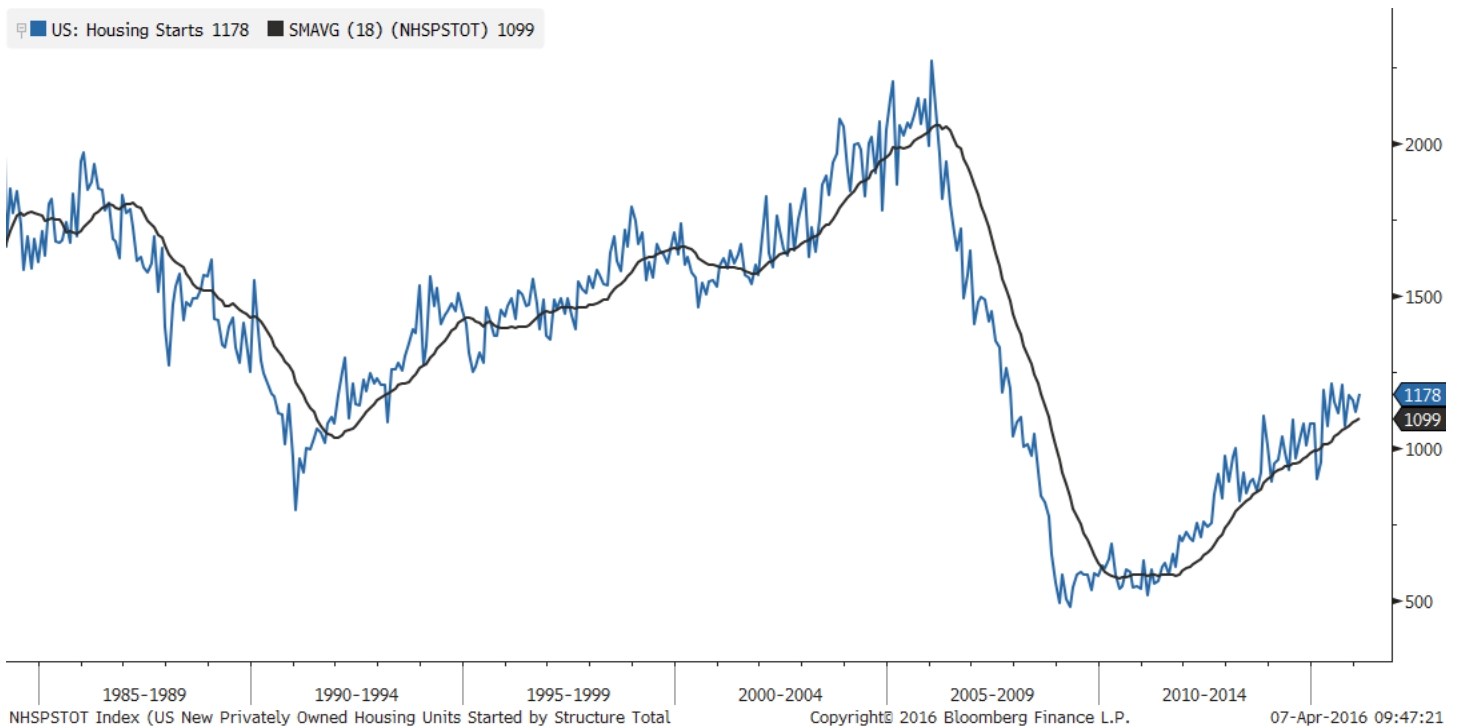

Existing home sales reflect the same pattern with a fatigue emerging over the last year as well.



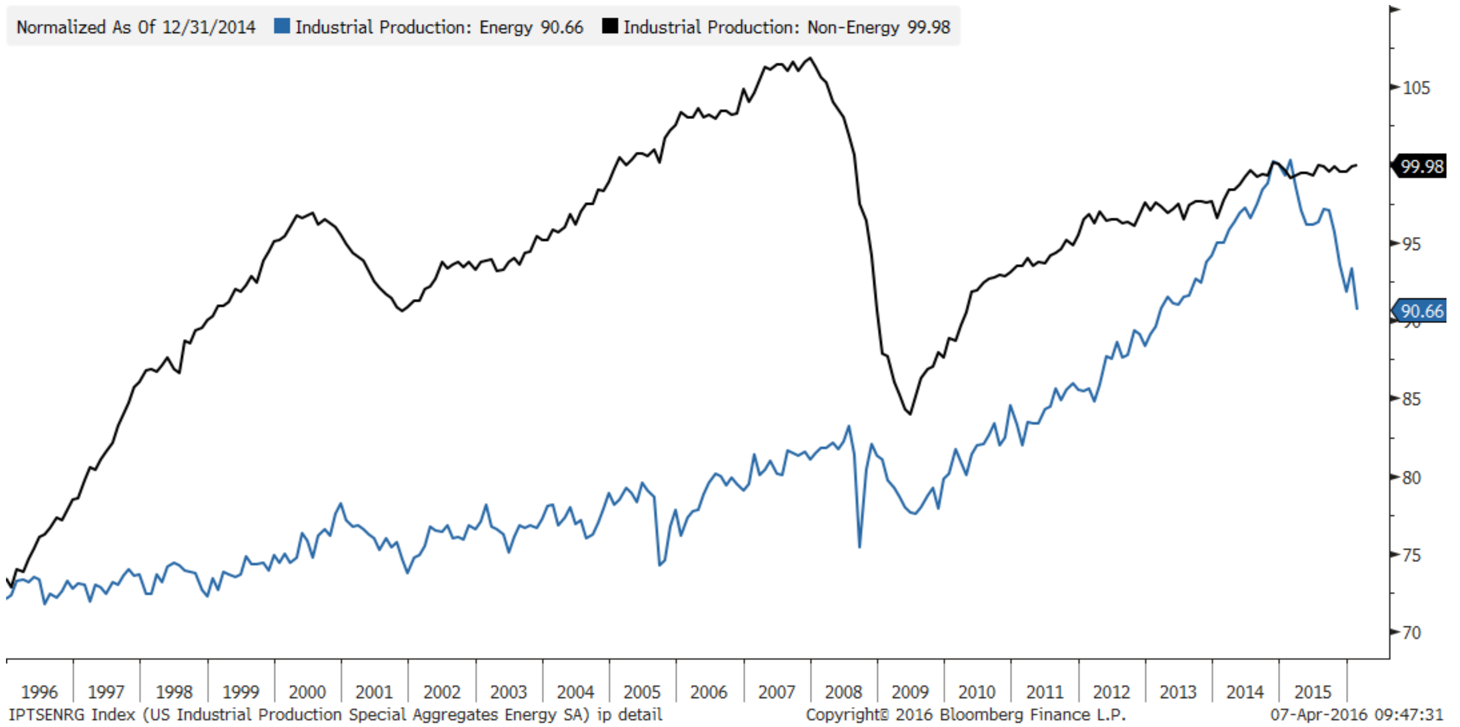
Building permits continue to track higher and some momentum has built up of late.



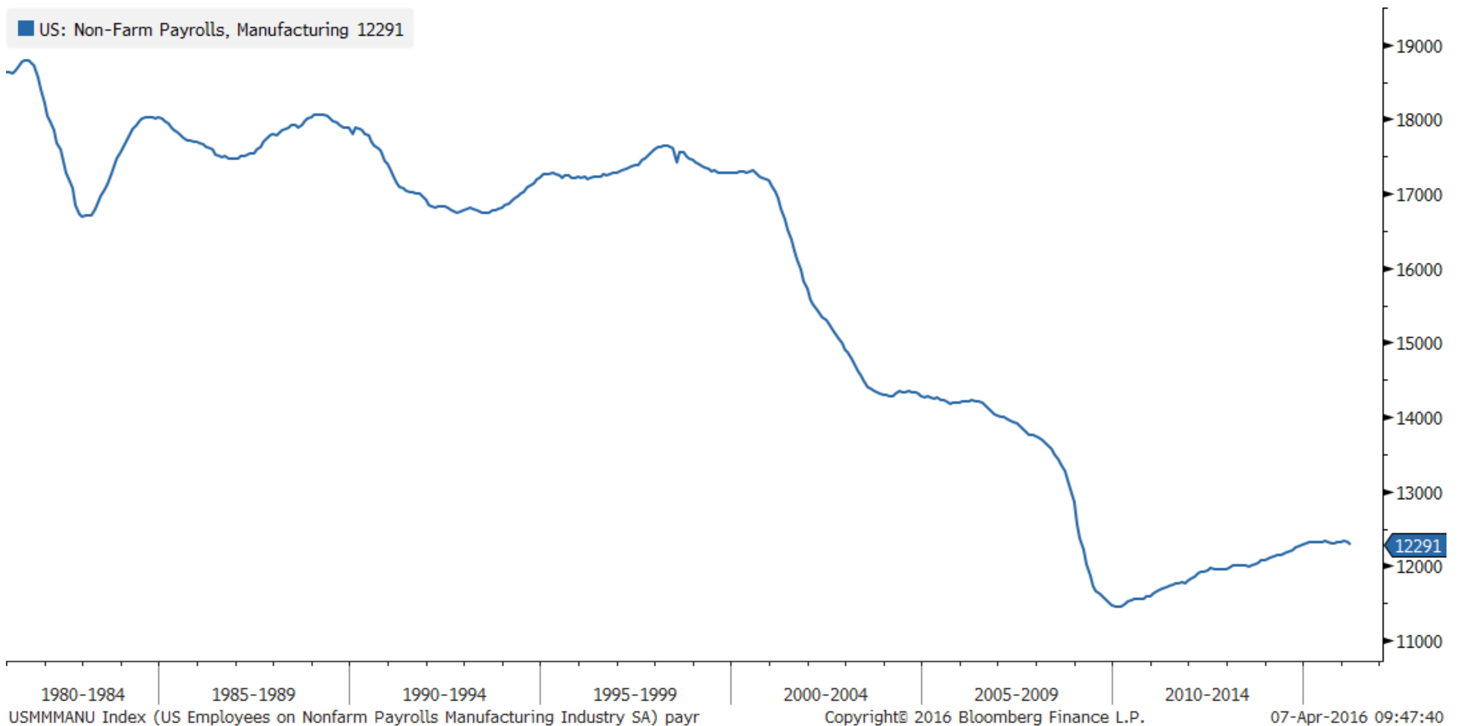

Housing starts are trending higher as well. Overall, the housing cycle is no cloud over the economy but it doesn't seem to be it's 'star' sector as well.



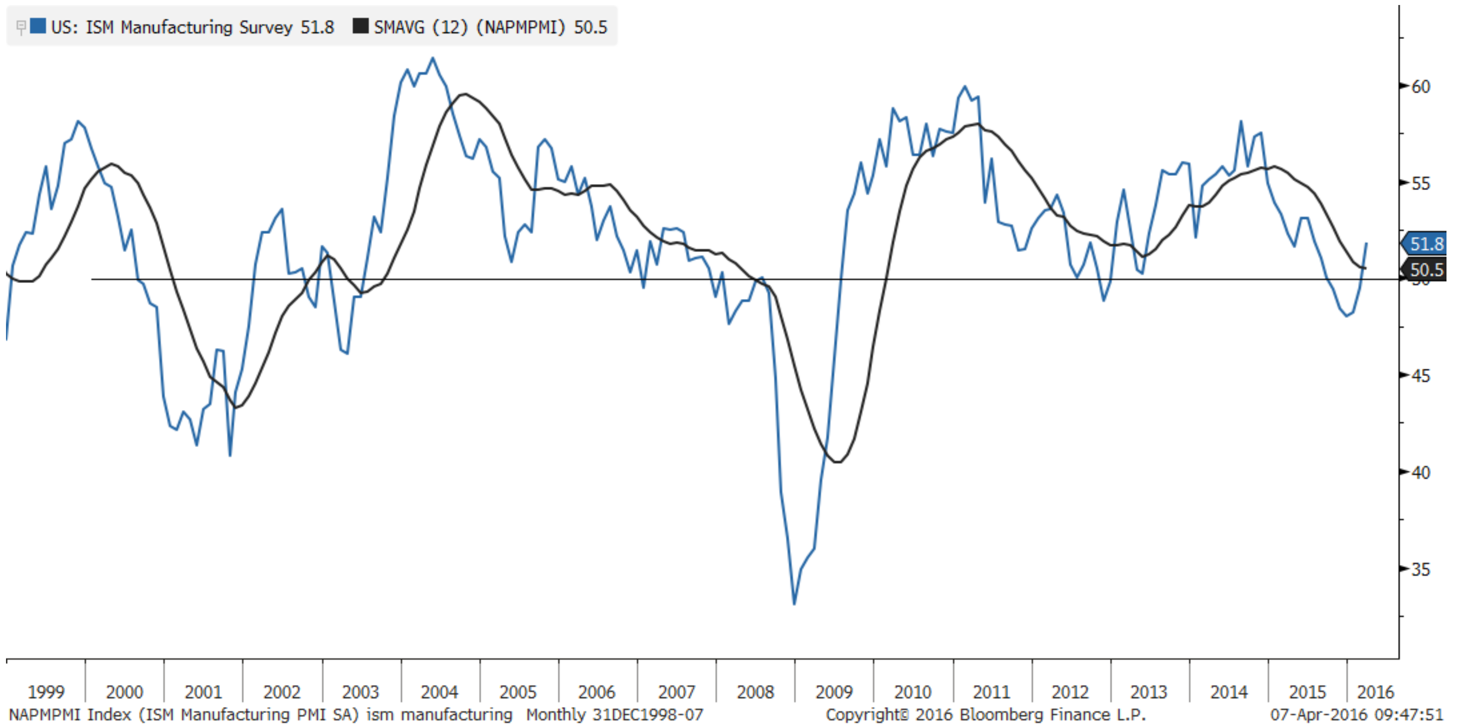
The industrial sector is two-faced at the moment: clear divergence has emerged between energy and non-energy sectors. That energy is feeling the heat is not surprising given the epic collapse in oil prices but it's the weak non-energy dynamic that is of more interest. Strong currency has been one headwind here.



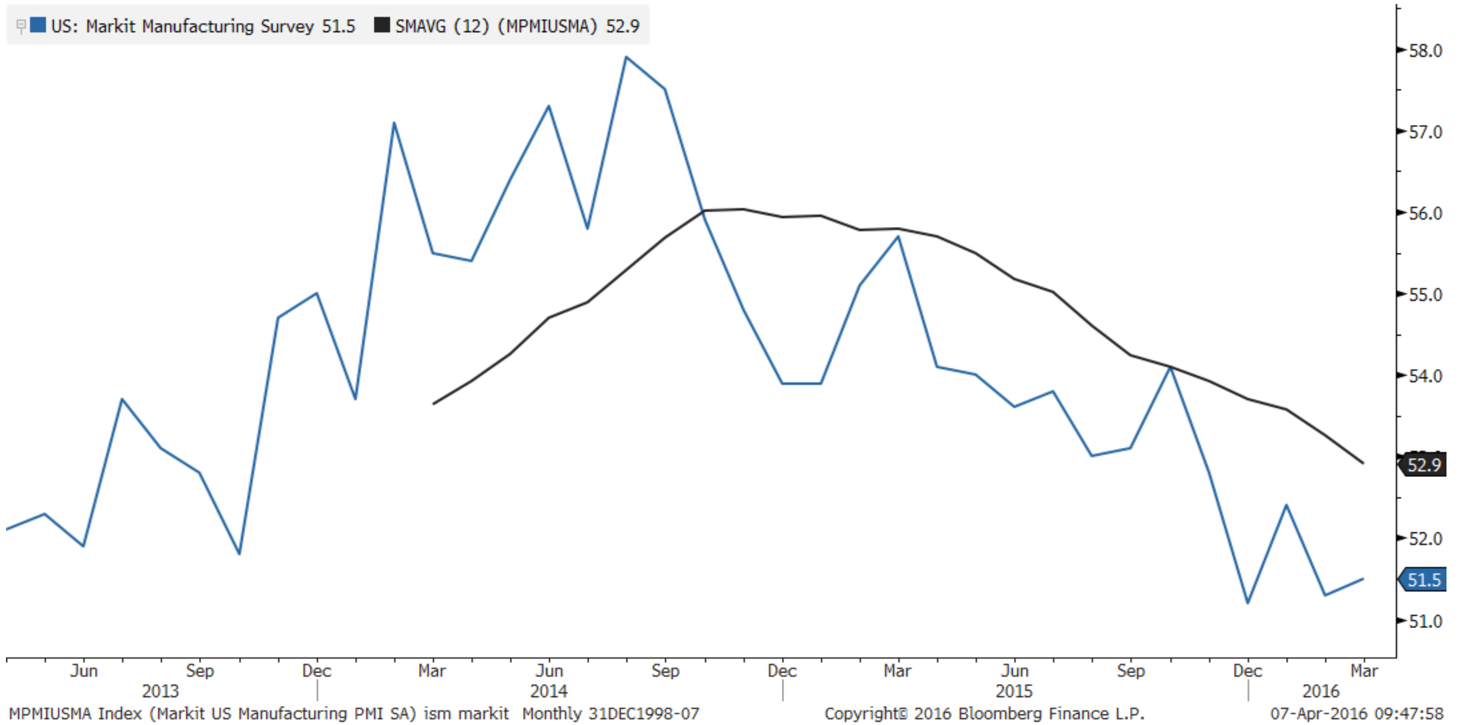

With those uninspiring industrial trends, the renaissance of manufacturing jobs growth looks to be coming to an end.



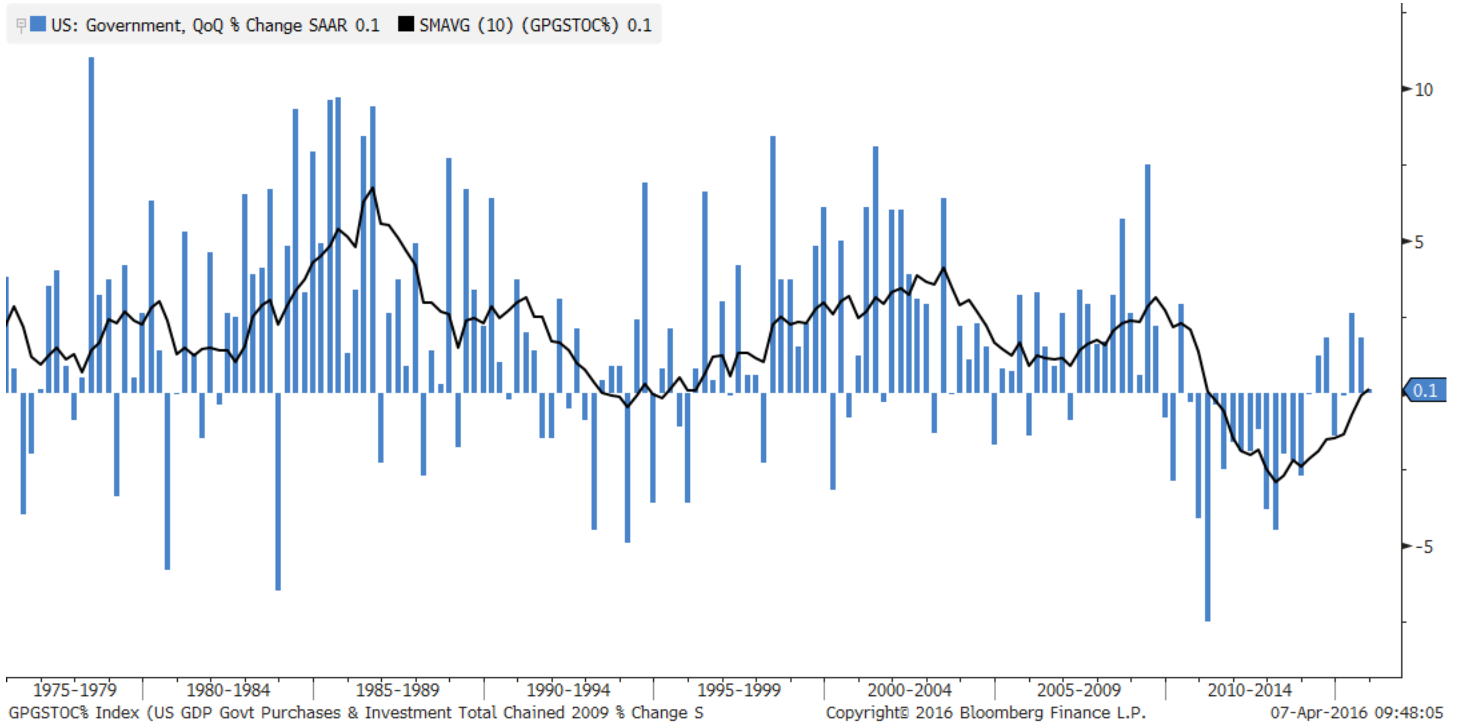
Recent ISM Manufacturing Survey readings have offered a modest relief but it's not clear whether the downtrend has been arrested in earnest. More data will be needed to gain a clearer picture on the outlook.



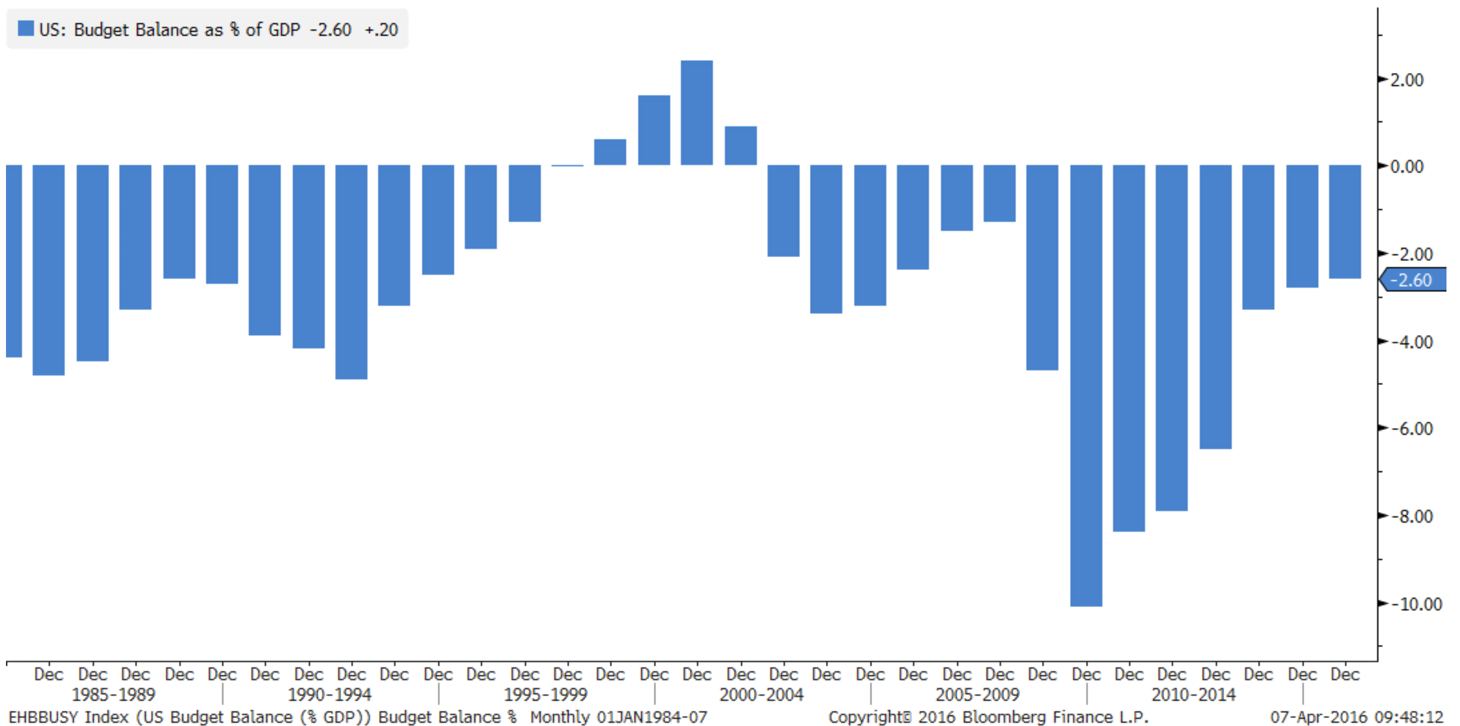

This is especially important to internalize as the Markit Manufacturing Survey is showing no signs of turning the corner at this point.



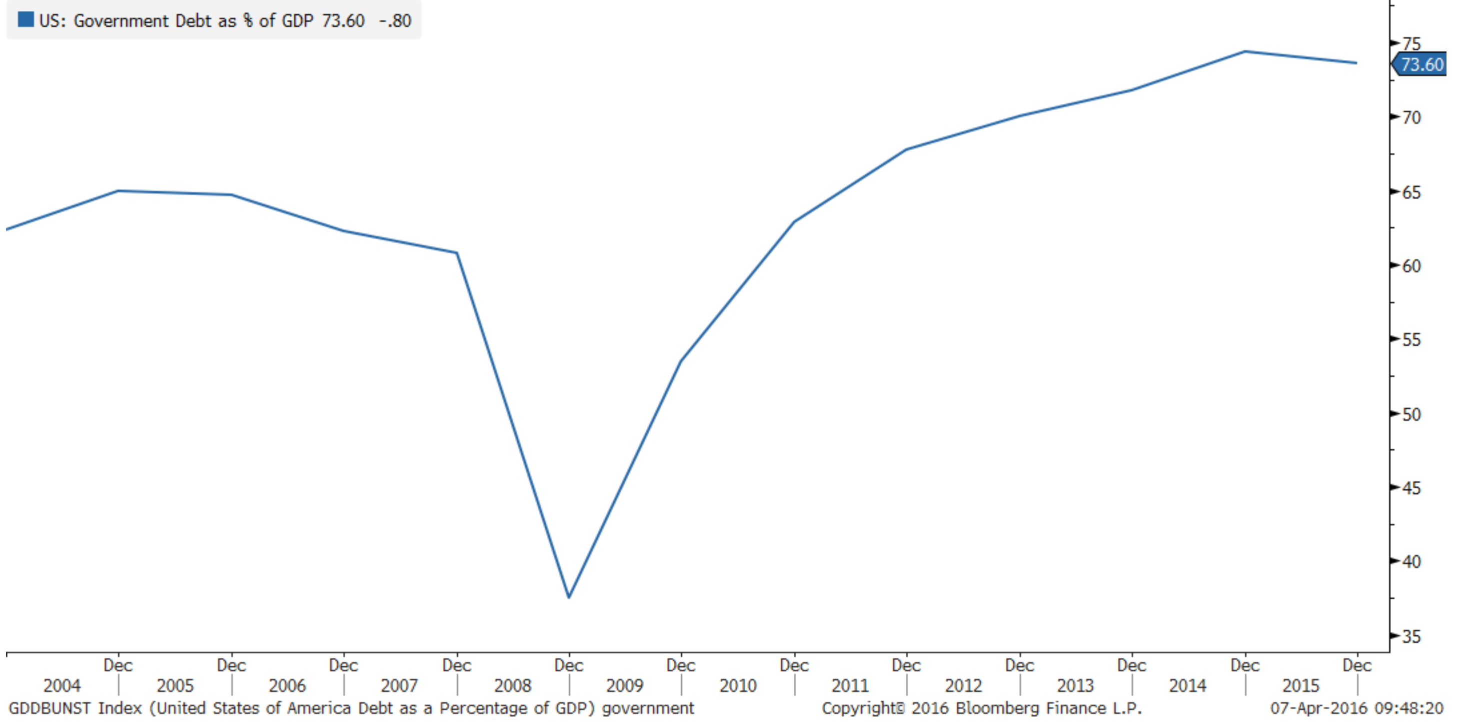
The drag from the public facet of the economy has diminished greatly over the last two years as the government is now offering a positive impulse. Looking at the underlying trend (10 quarter-moving-average) one can detect the unprecedented headwind that the public sector produced for the economy in recent years.



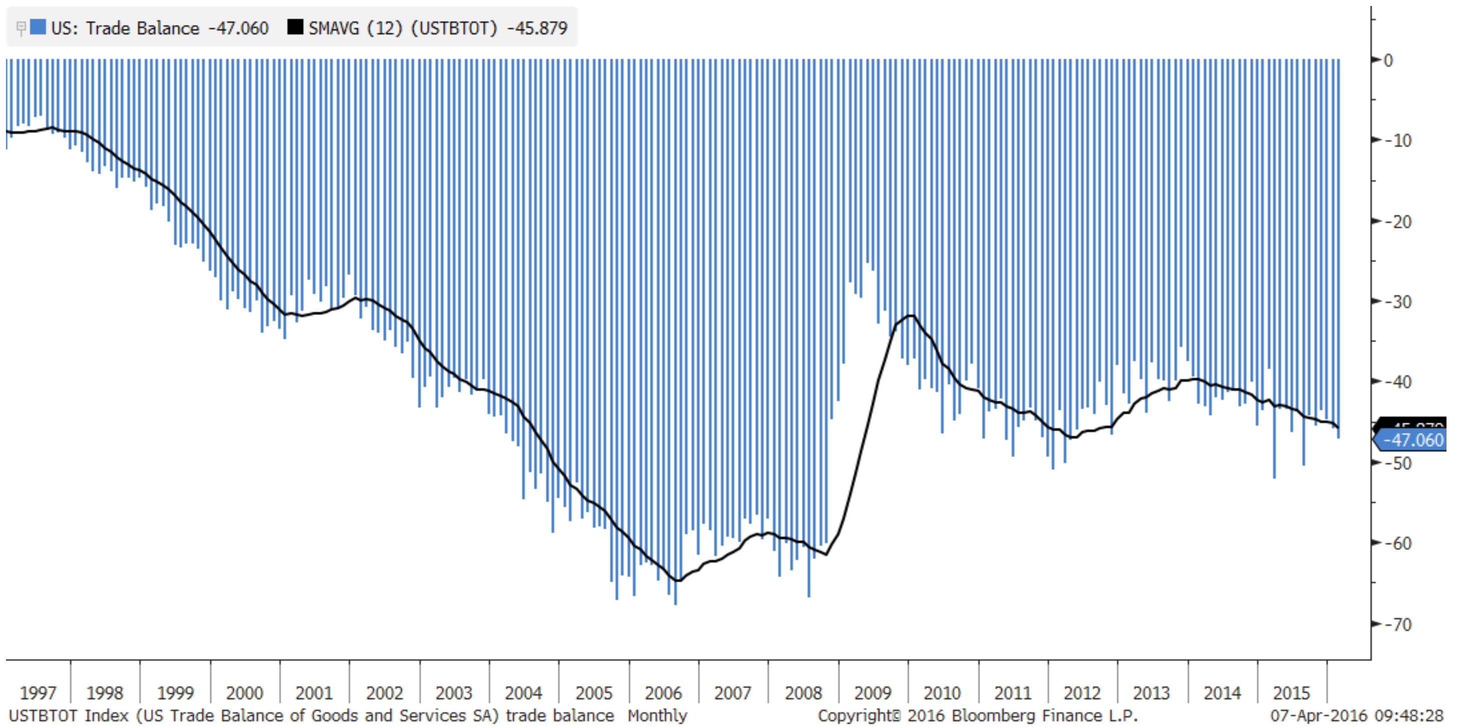

The flipside of this prudent fiscal regime is a far better budget situation with the deficit now at -2.5% of GDP after being roughly -10% a few years ago.



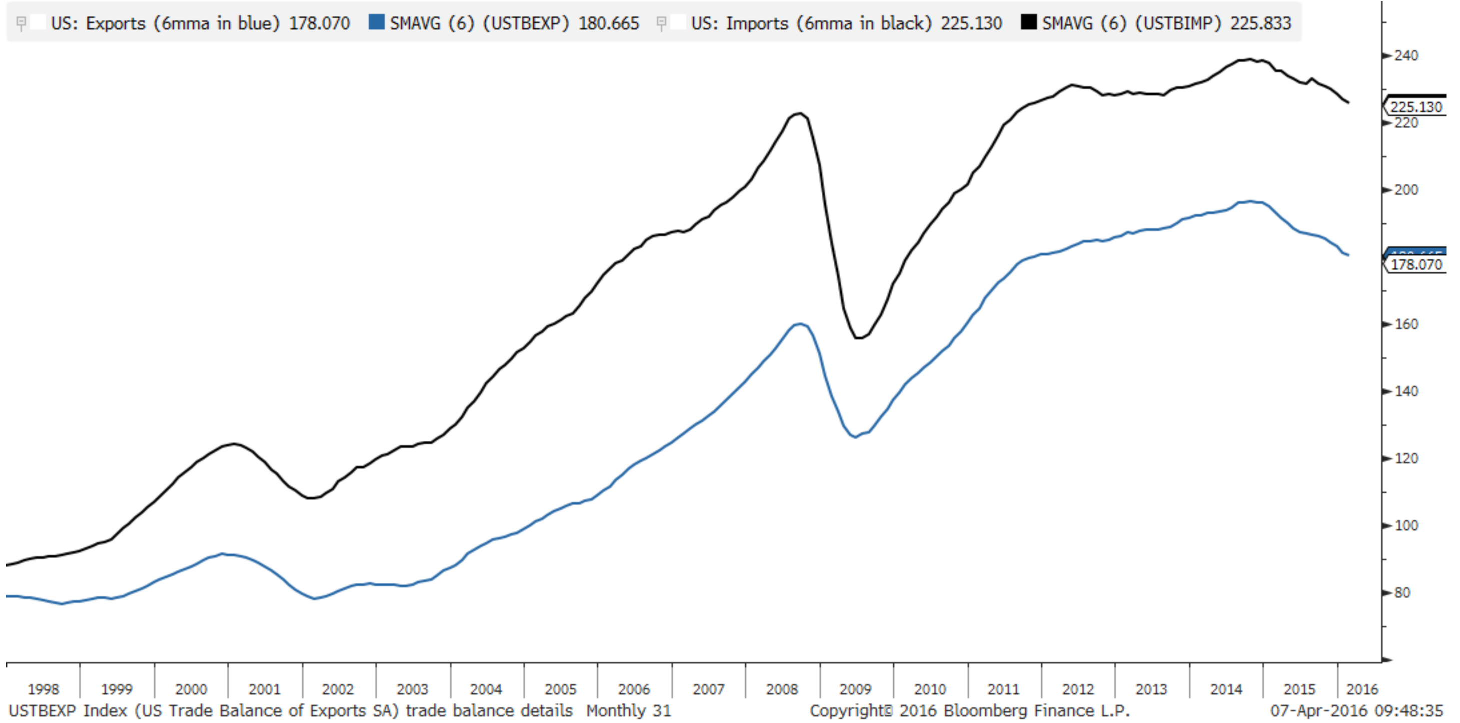
Government debt levels are stabilizing at roughly 75% of GDP.



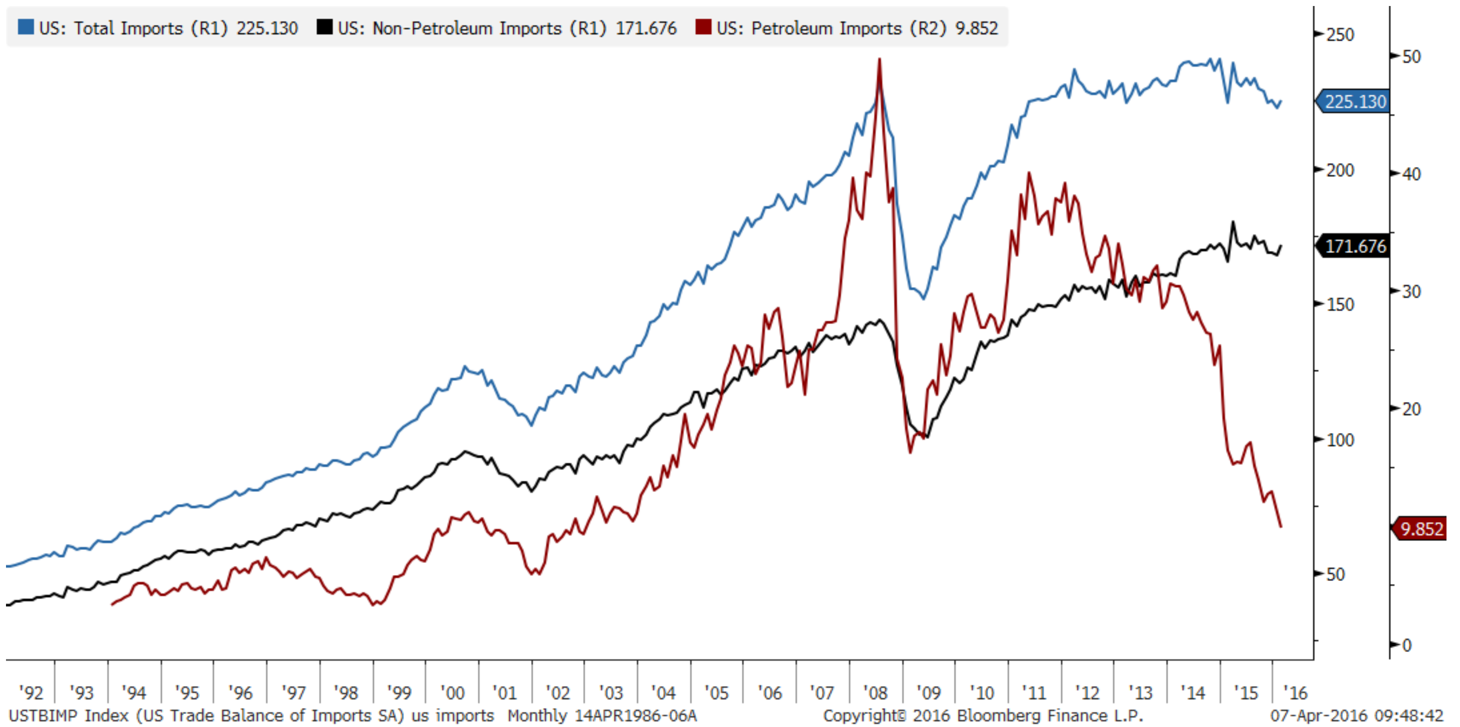

The trade balance has widened over the past two years.



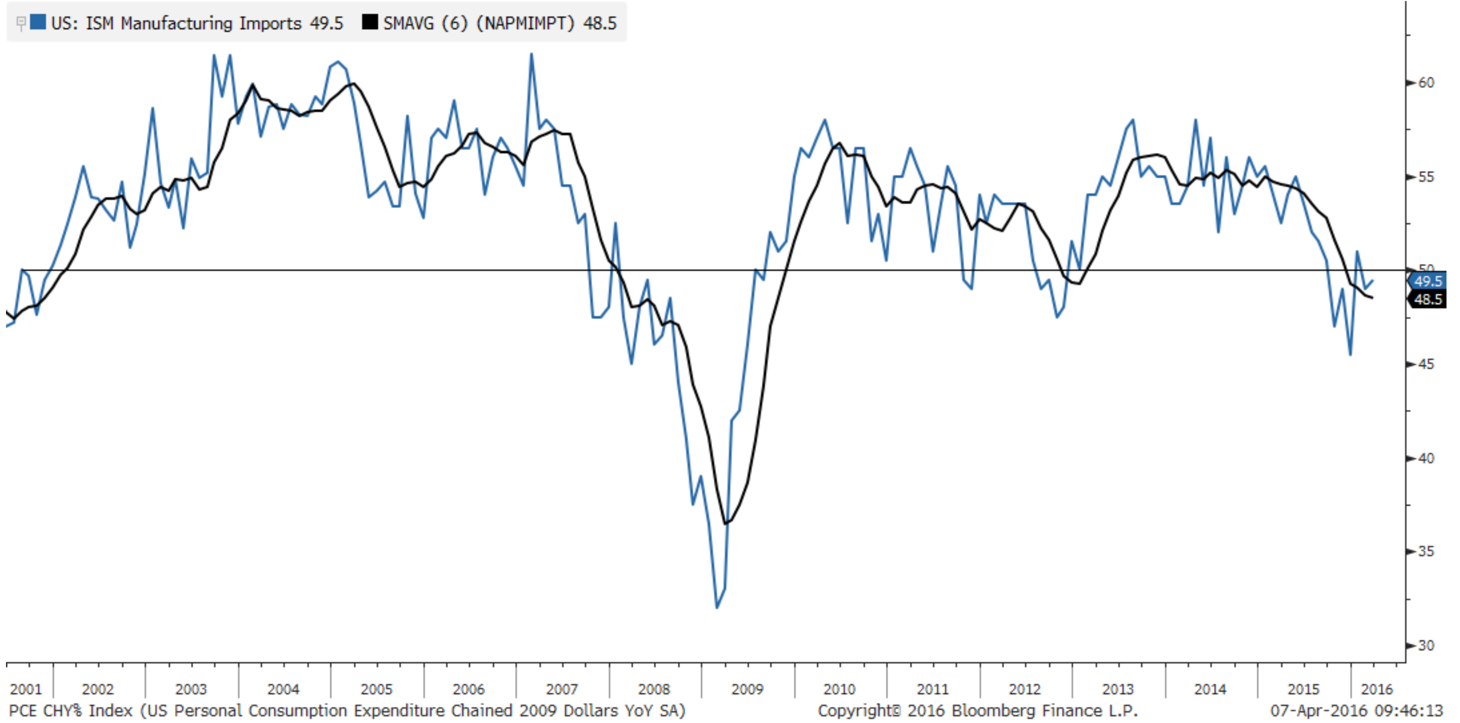
This development has been caused by a relatively faster slippage in exports compared to the level of imports which have nevertheless declined as well.



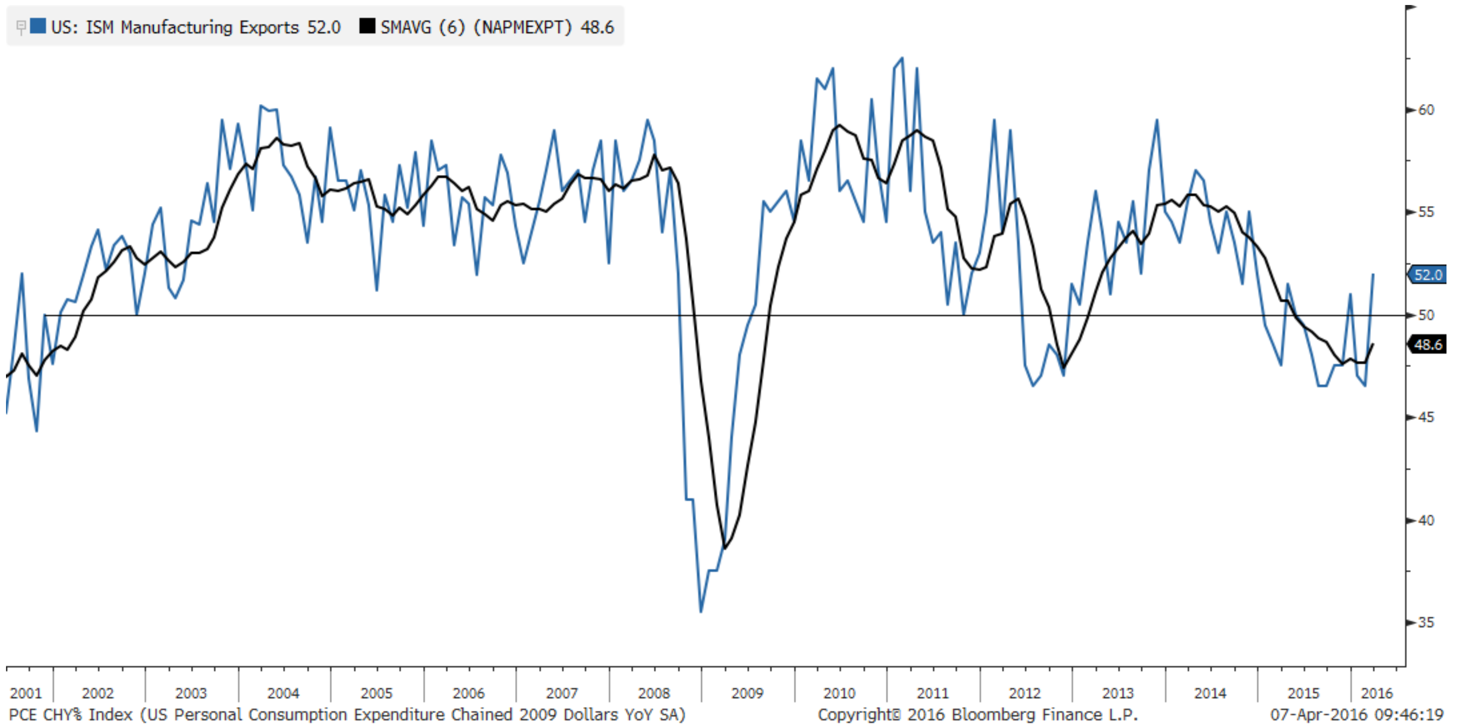

More broadly, when looking at the underlying dynamics of the import facet it's clear that the domestic oil sector revolution and subsequently its steep price drop have helped in bringing down import costs. The non-petroleum component softened as well.



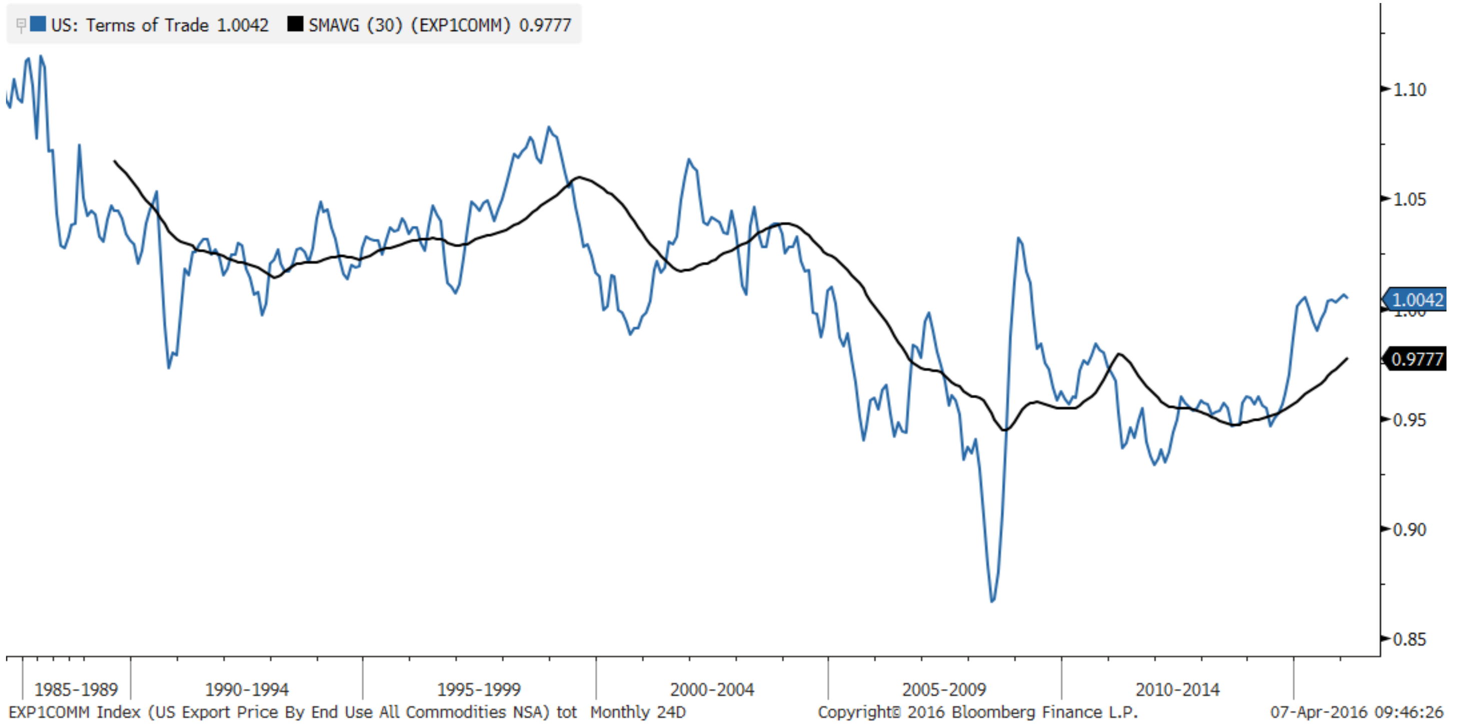
Import proxies from the ISM Manufacturing Survey have hinted at downside risks to imports (and consumption accordingly).



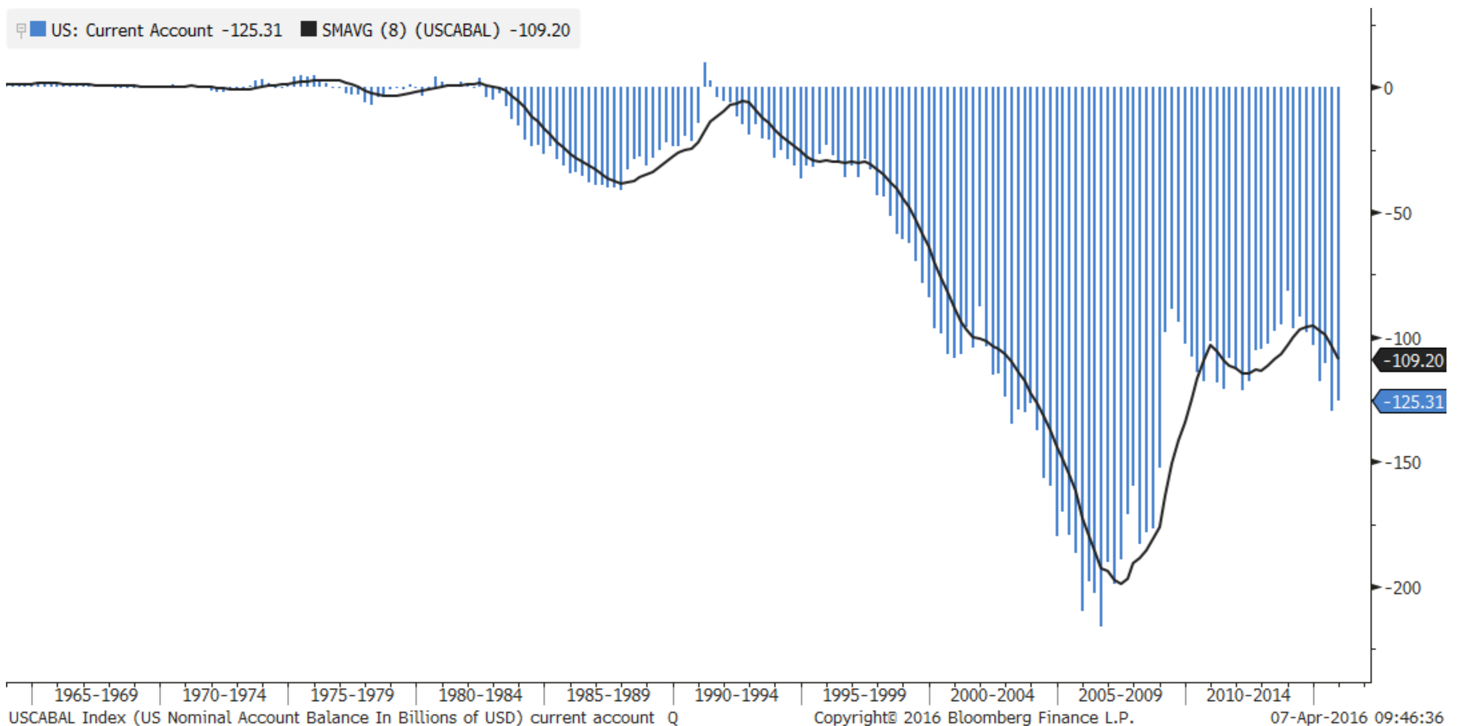

There are some signs of relief on the export side as the ISM Manufacturing Survey has reported slightly better results for the external order book in recent months.



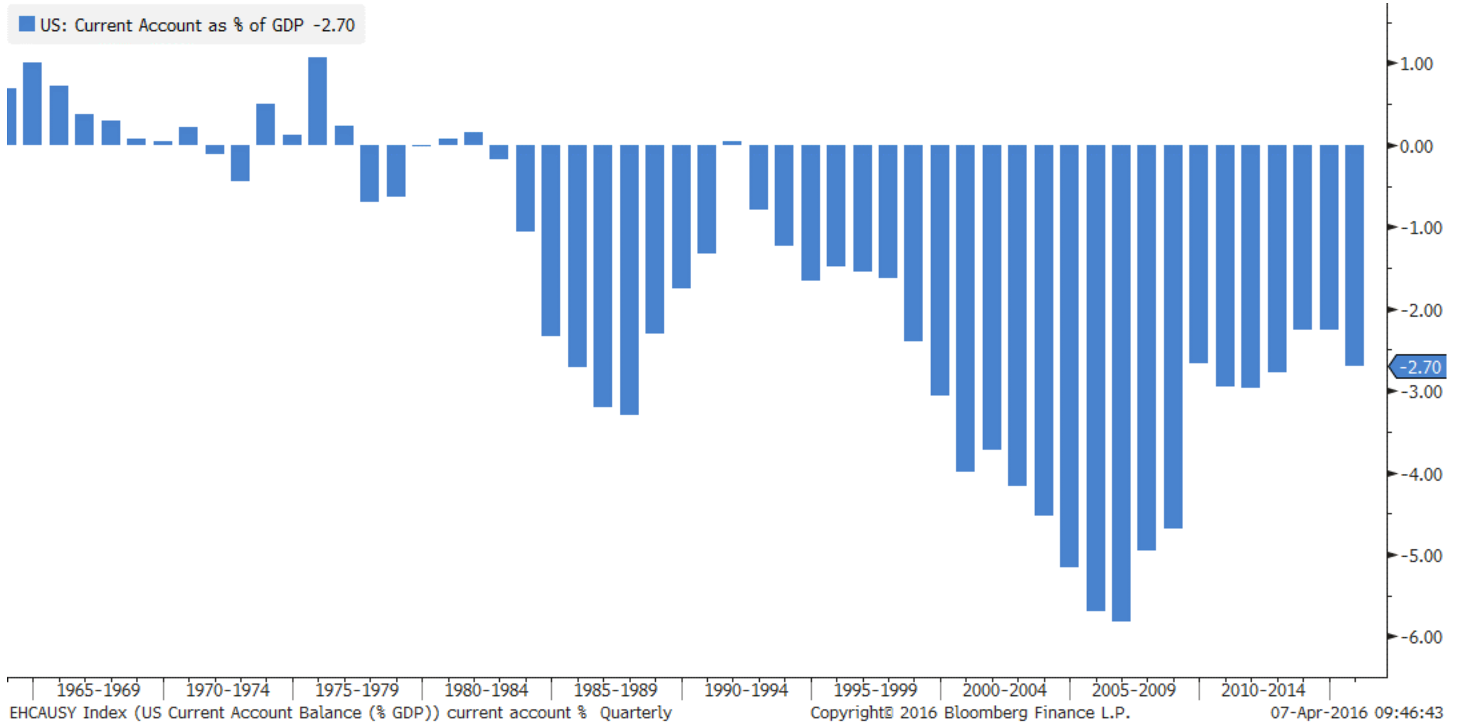
Broad commodity weakness has helped to improve the terms-of-trade that are rising.



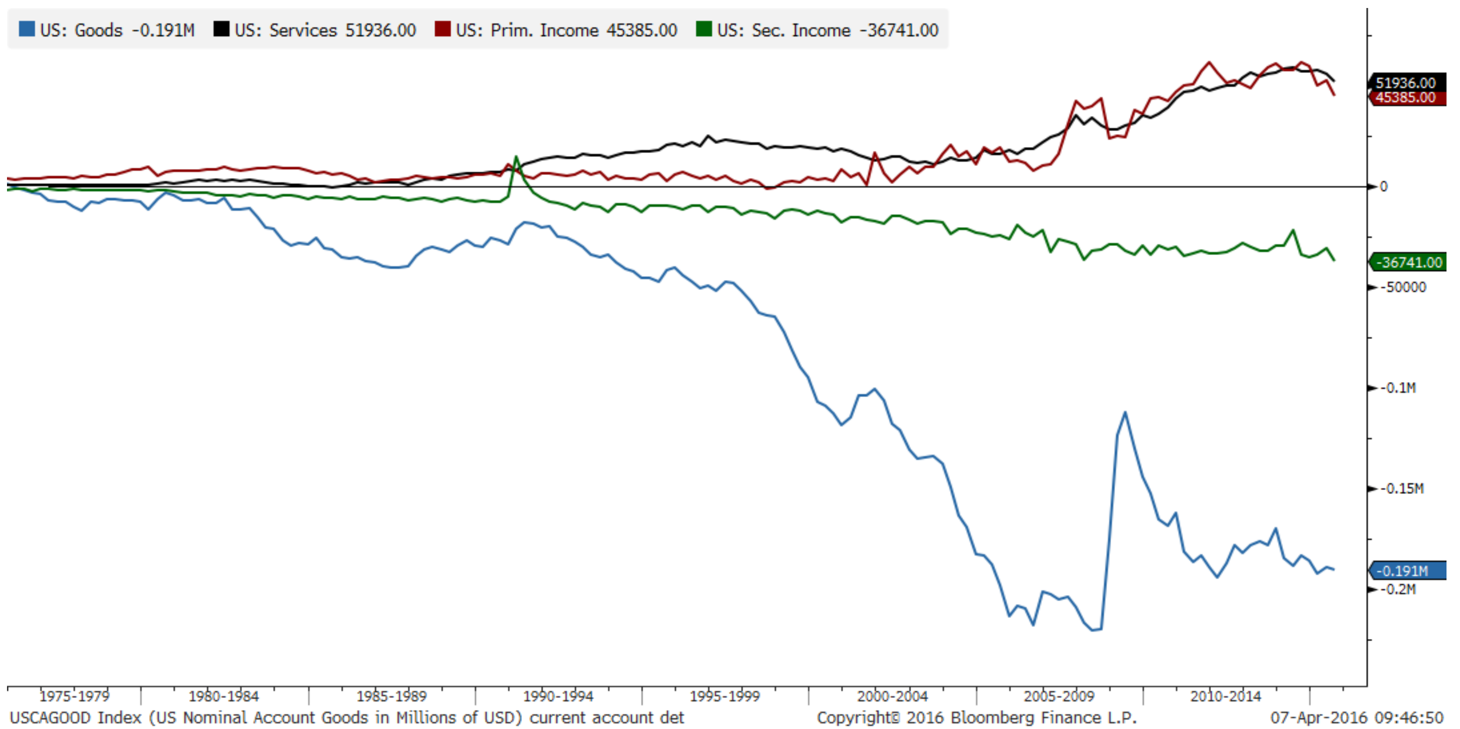

In line with the wider trade deficit we're seeing the current account tracking lower again as well.



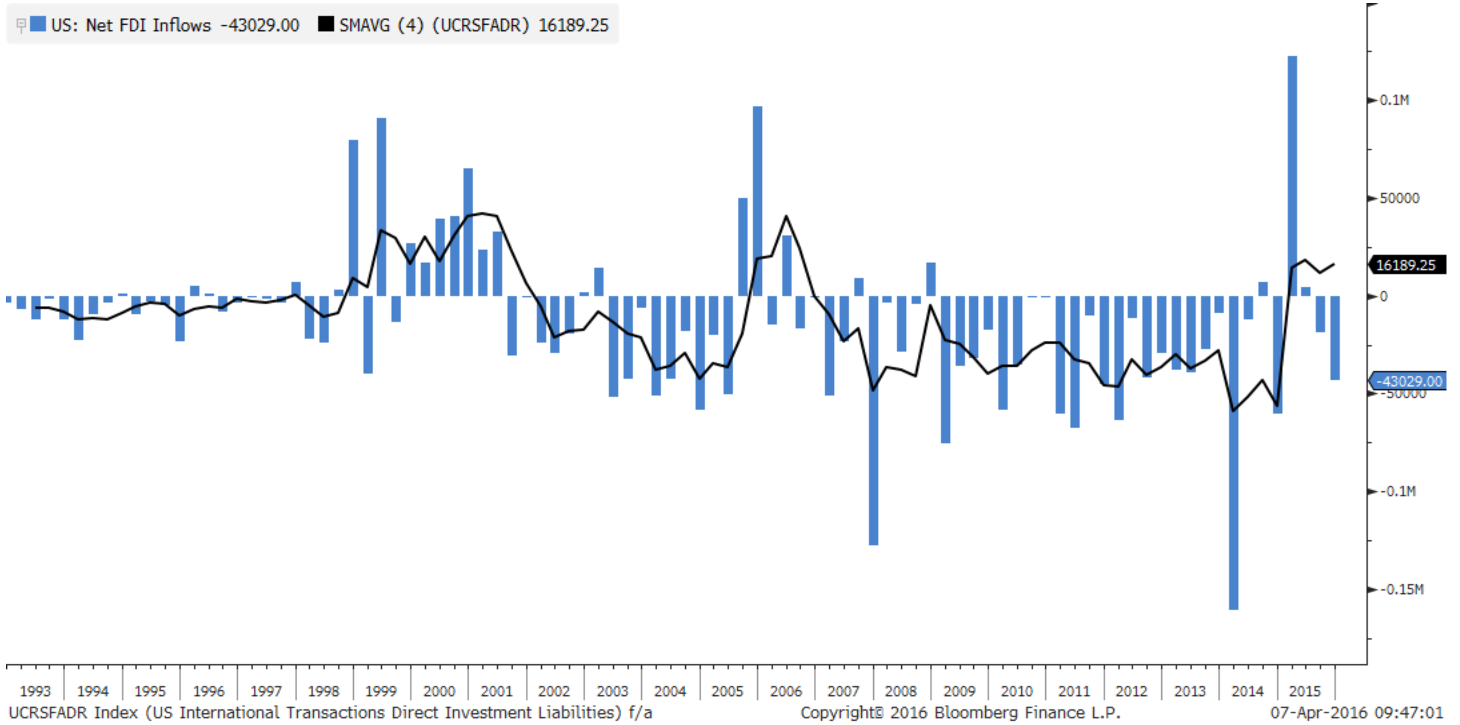
The deficit amounts to nearly -3% of GDP and is forecasted to stay at the same level by the end of 2016.



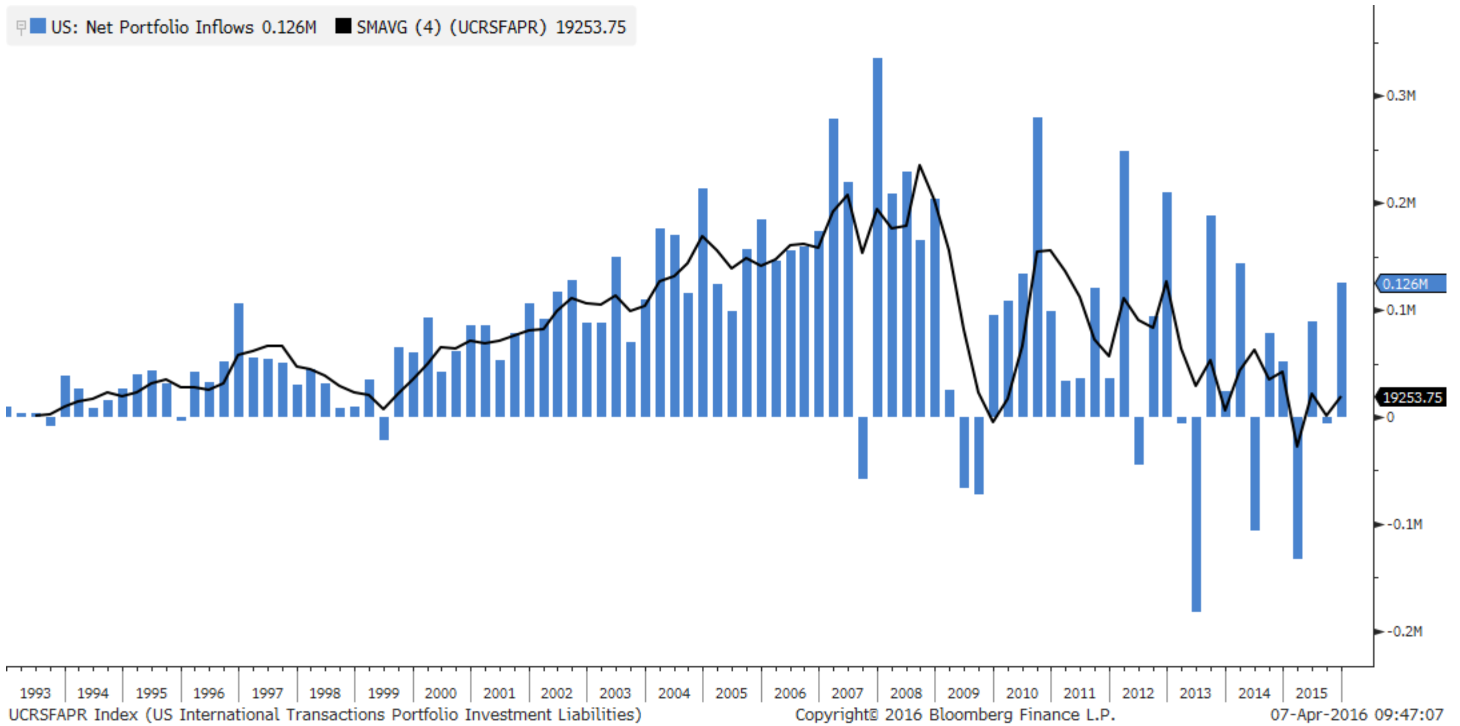

Looking at the underlying dynamics of the current account it seems that it's been a quite broad-based softening in the components that has resulted in a wider deficit at the aggregate level.



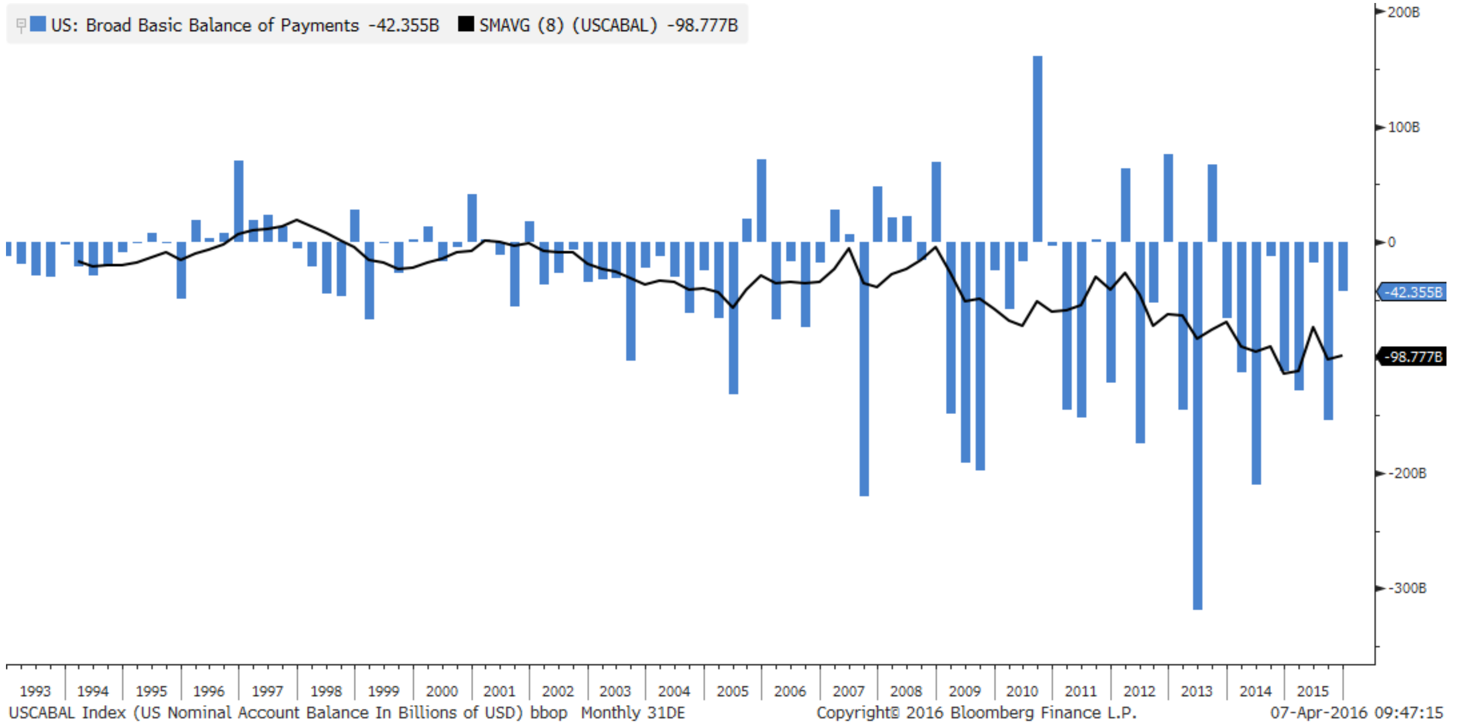
Net Foreign Investment has generally been negative but seems to have balanced out slightly in the last few quarters.



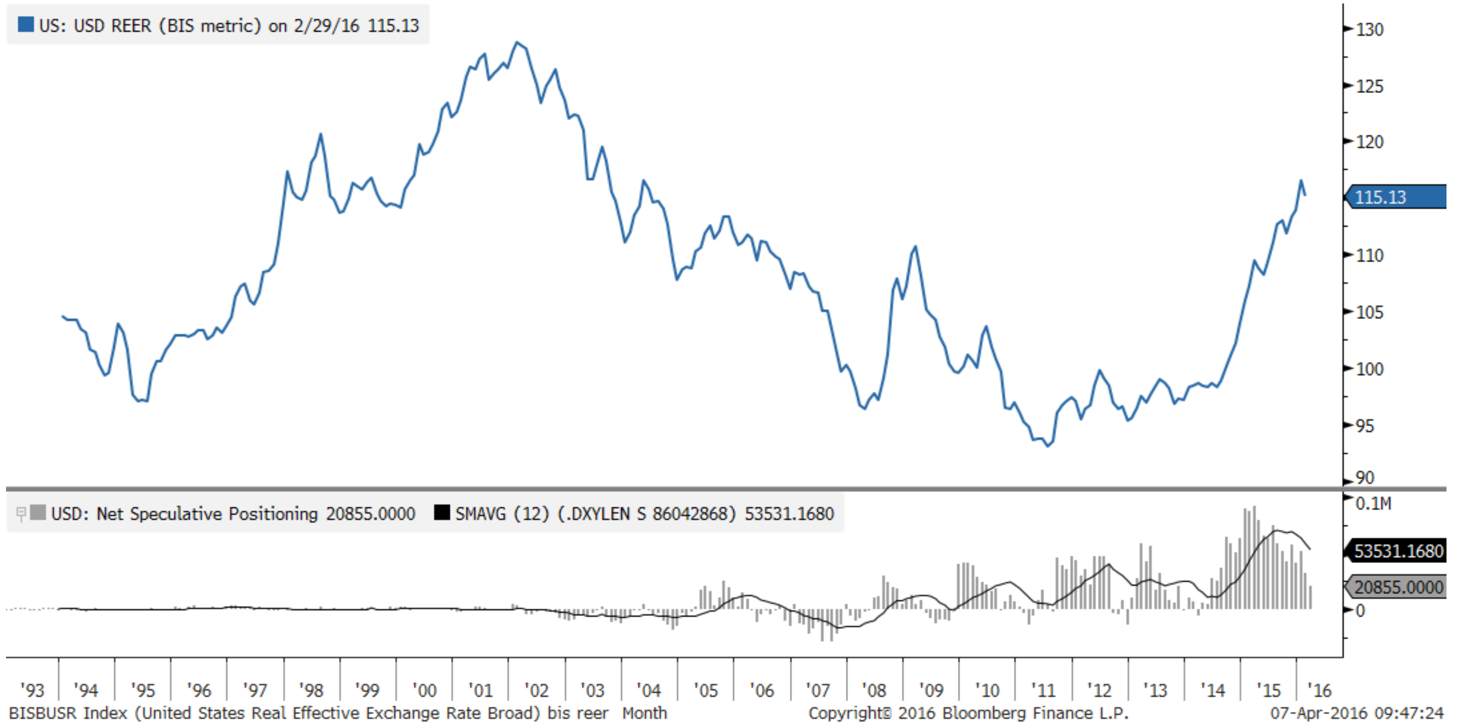

Net Portfolio Inflows have been far less flamboyant in comparison to the pre-crisis trends. The rolling four-quarter result is just shy of being flat.



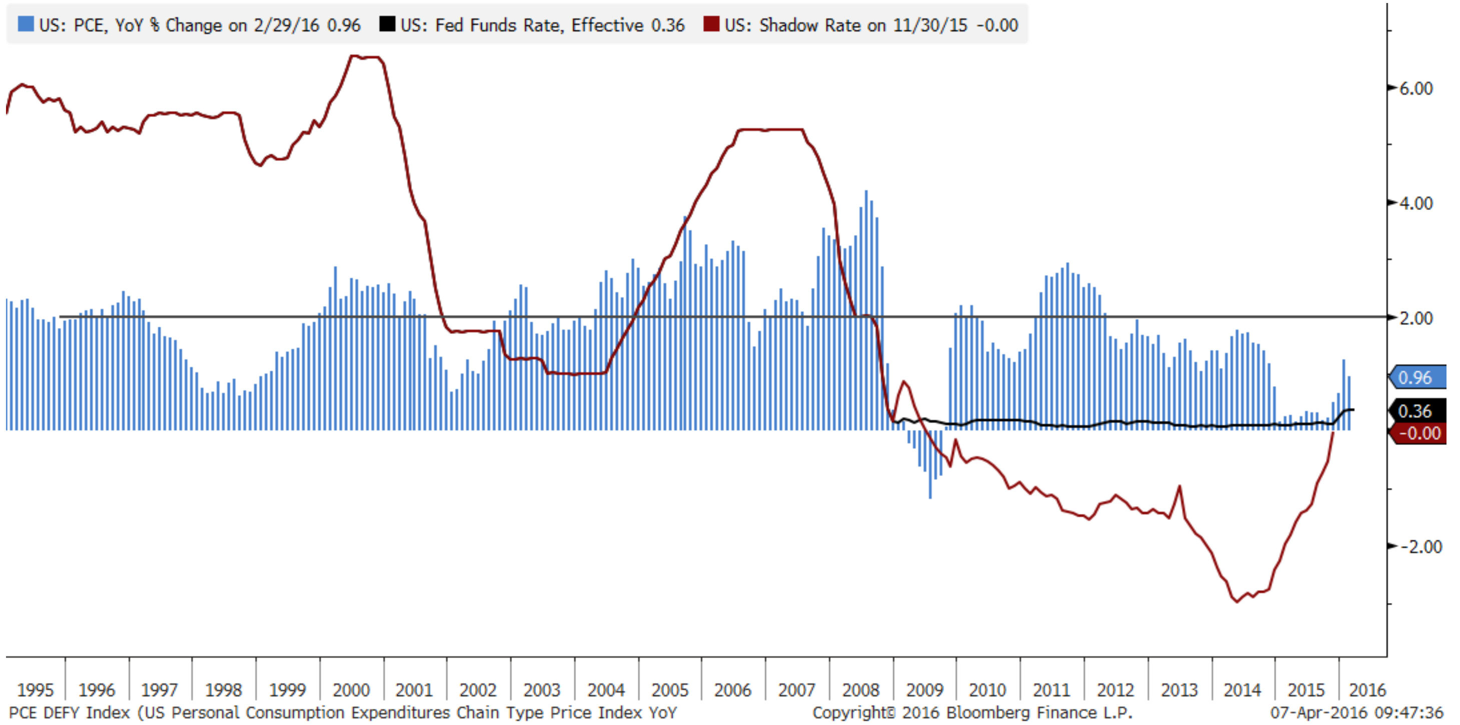
Taking it all together, the broad basic balance of payments remain negative and just short of record low levels. This offers natural depreciation pressures on the USD.



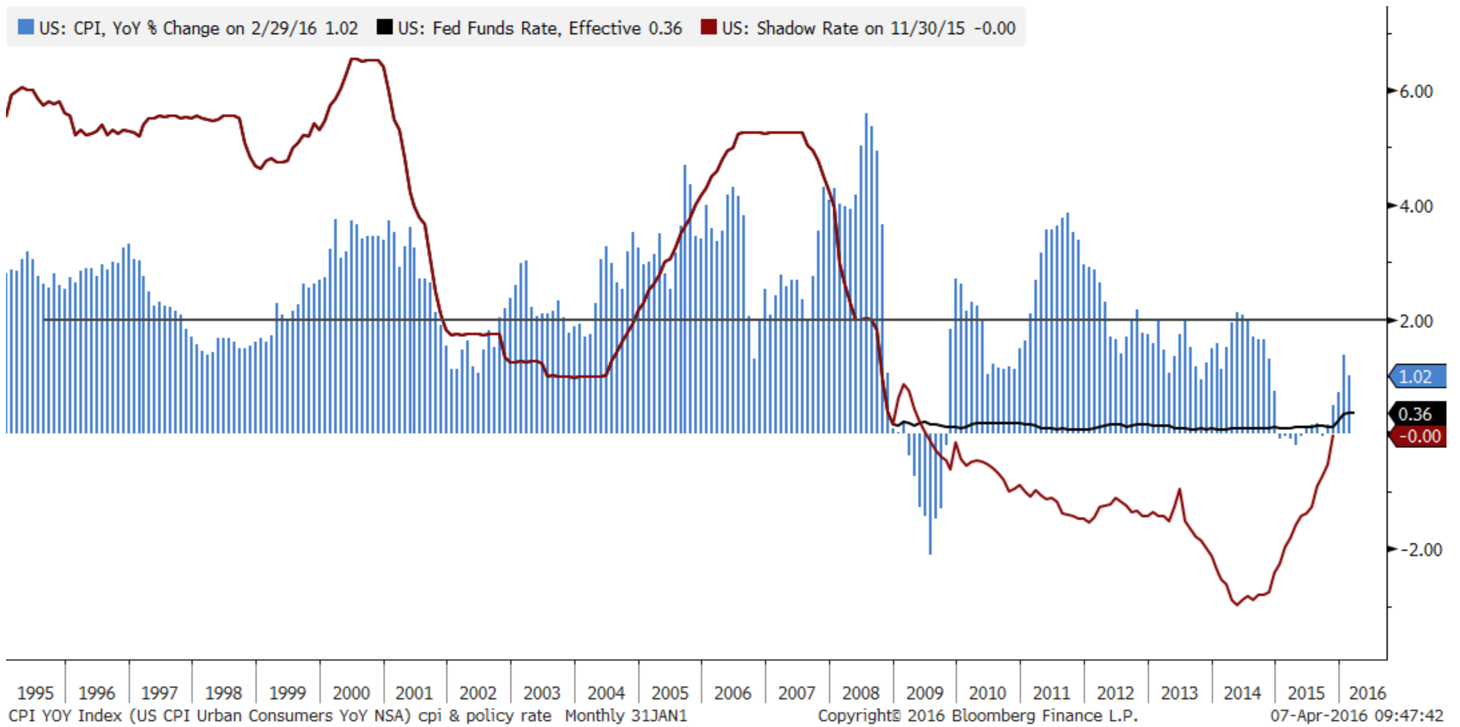

The USD has nevertheless strengthened substantially over the last two years – to a degree sustained by a swollen speculation on the local policy cycle as well as on actions by other major central banks. This has hurt exports as well as brought with it downside pressures on inflation.



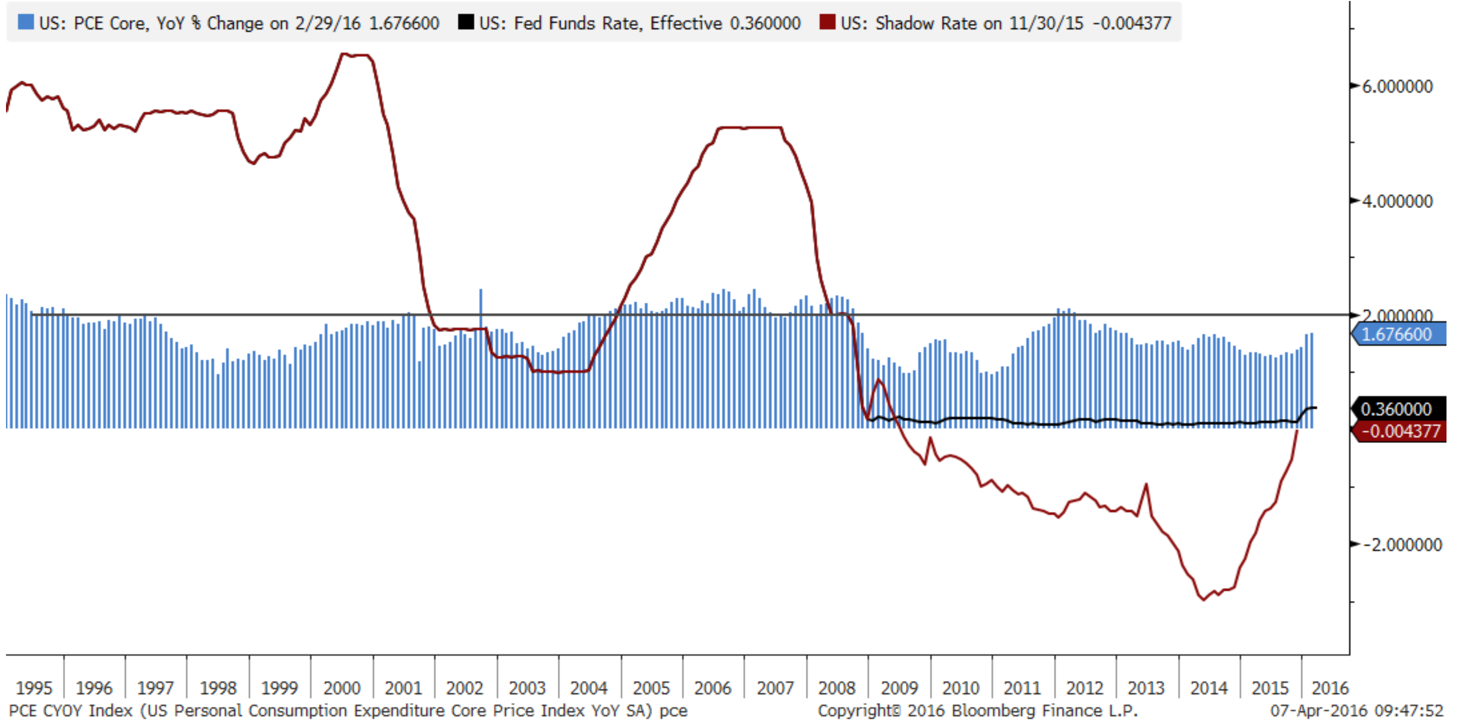
Turning to inflation, even as we've seen some acceleration in the benchmark headline measures (PCE) of late we're still well below the 2% level. Again, in this context, recall the hints of policy tightening by the Shadow Fed Funds Rate and the stronger USD over the last two years.



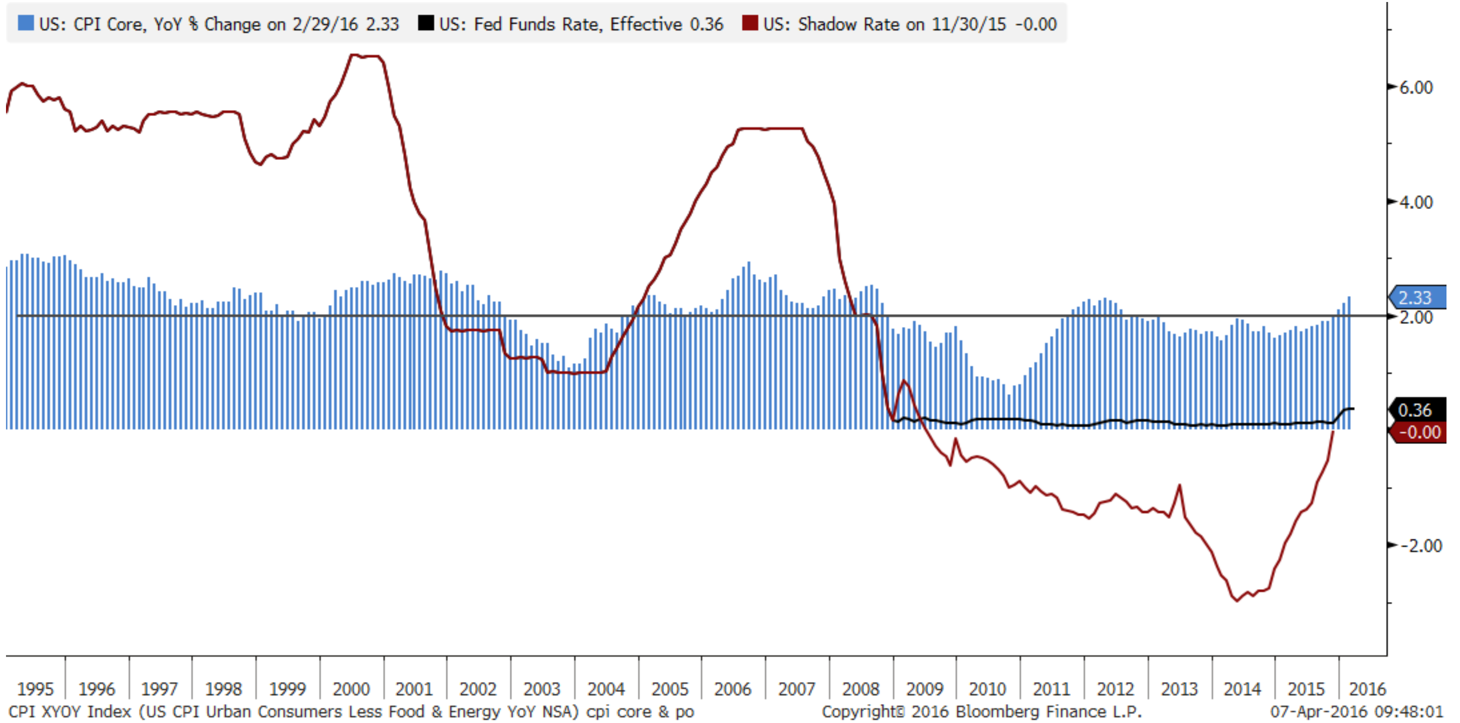

The CPI inflation metric signals similar dynamic when looking at the headline results.



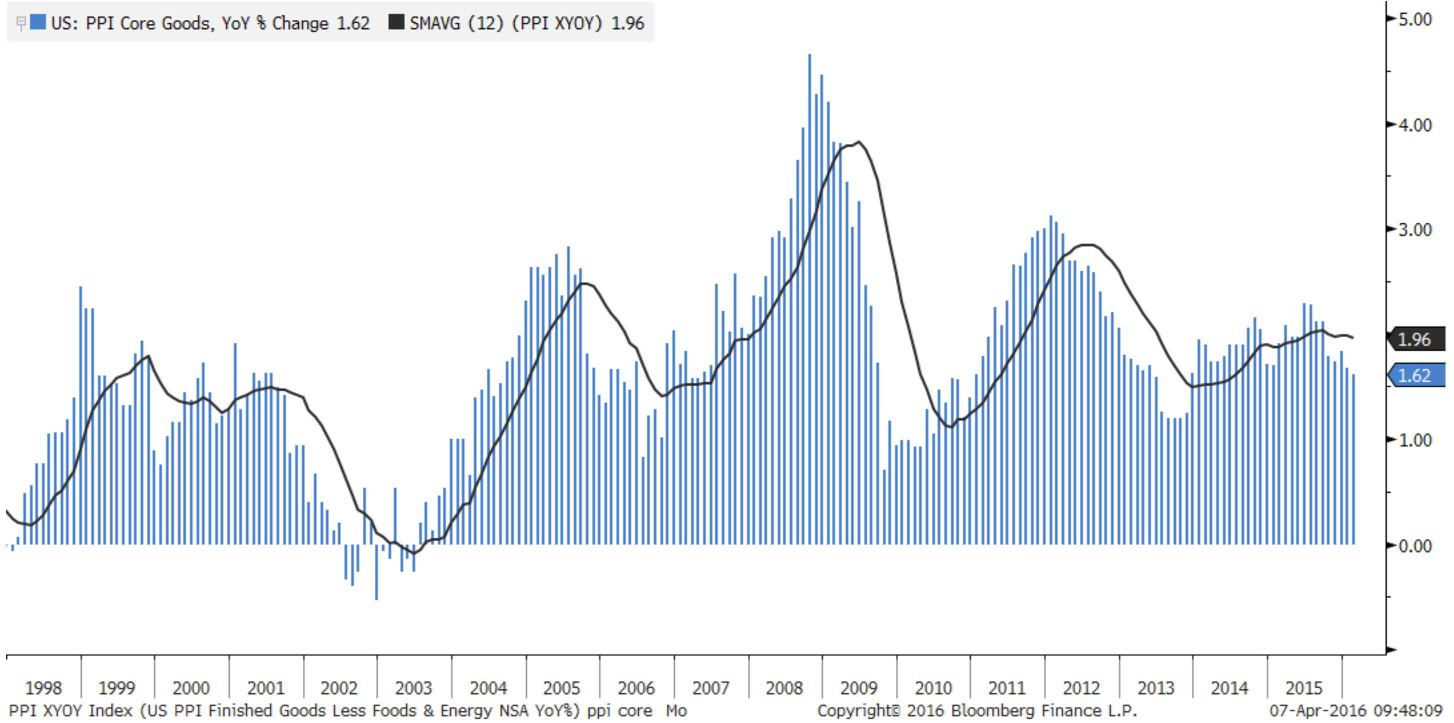
We've seen some increase in the core measures as well with the PCE barometer tracking higher over the last two months. However, we're still below the 2% level.



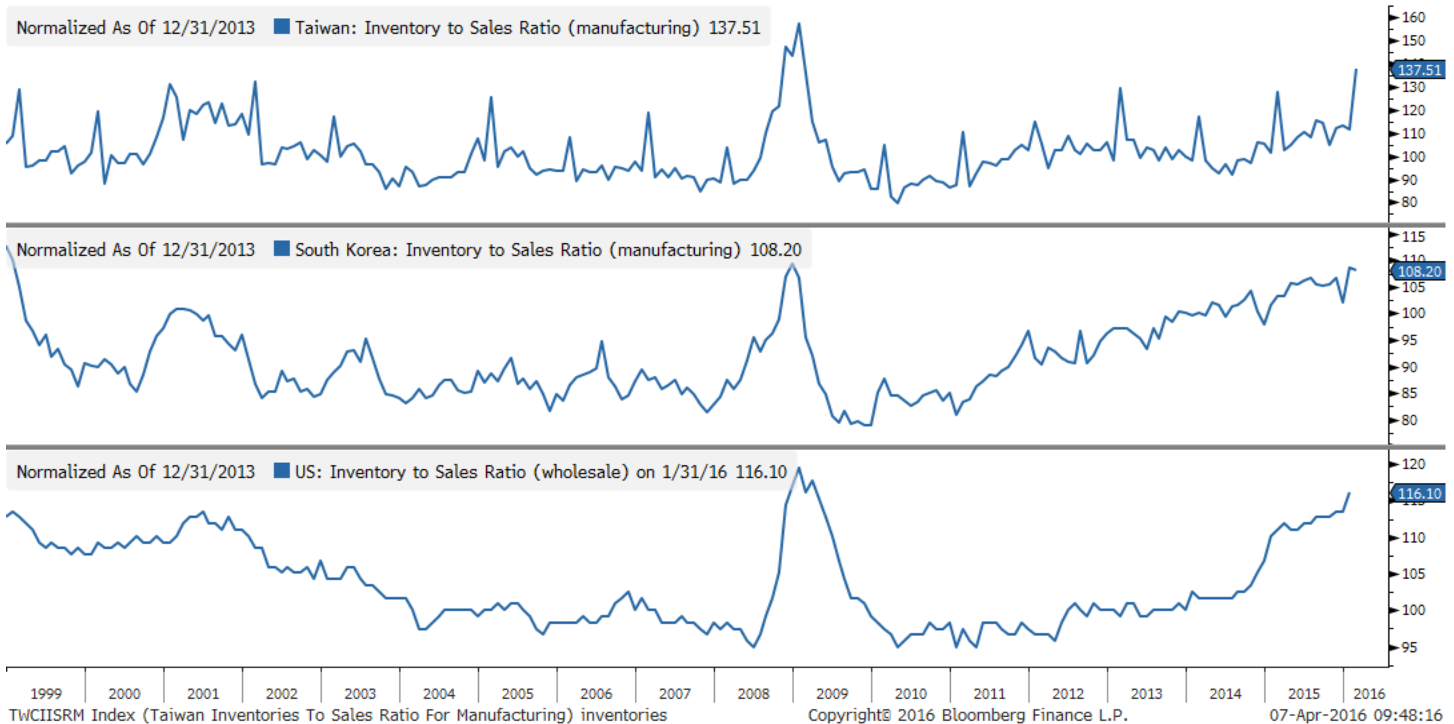

The CPI core measure is showing the strongest advancement and is now exceeding the 2% level by a decent margin. However, note that this metric has historically always traded at a higher level in comparison to the PCE measure.



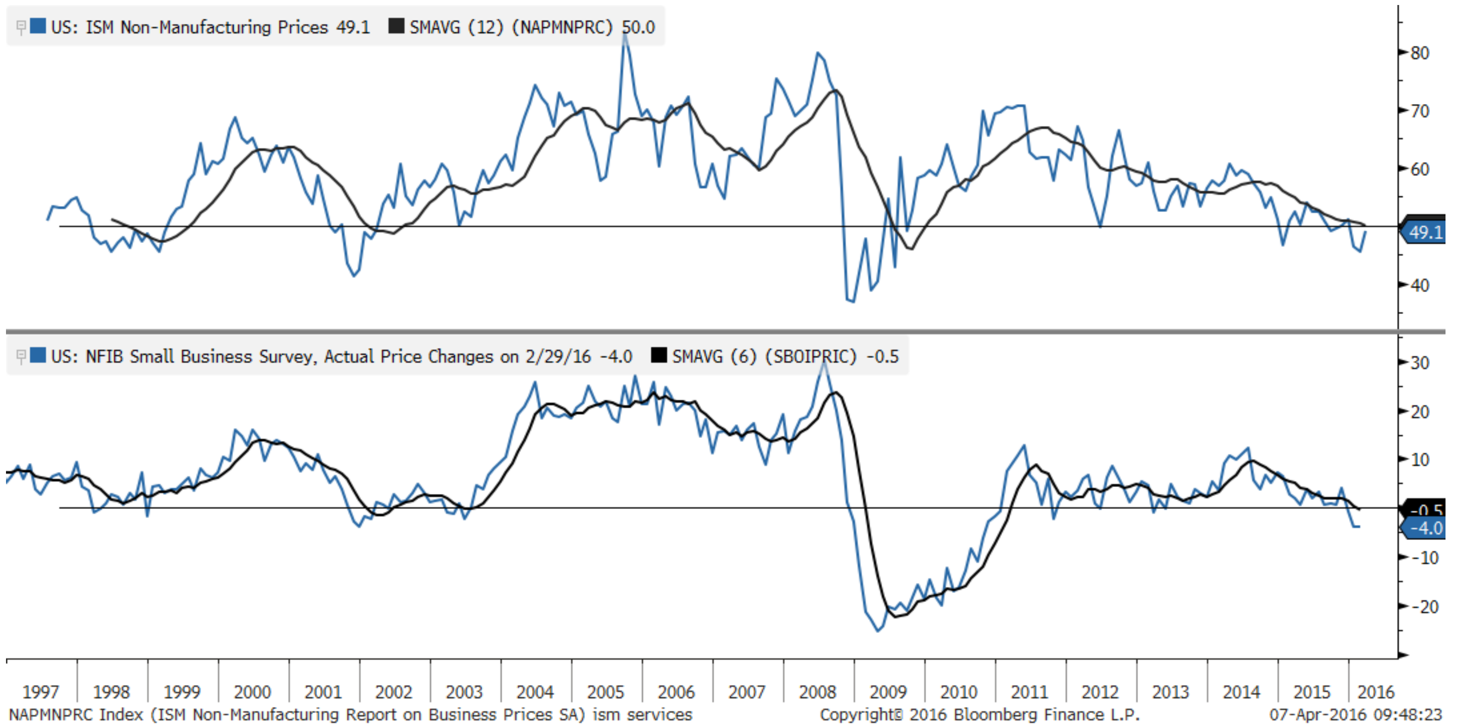
Producer prices seem to be deflating at the margin with spot values slipping slightly away from the trend-measure. Not a meaningful reversal but incrementally softer.



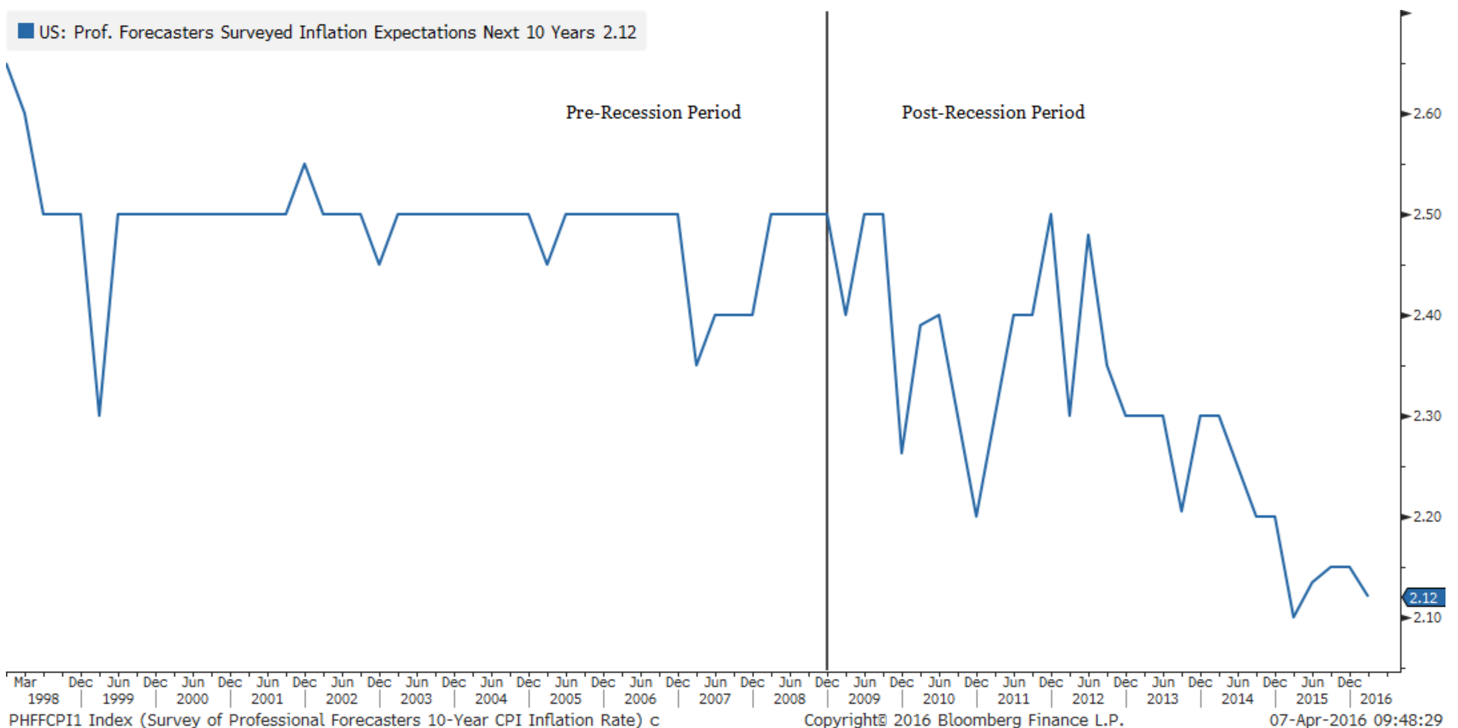

There would nevertheless seem to be further downside risks to prices overall as the level of inventory-to-sales in the US wholesale sector is just shy of its 2008 highs. In other words, US corporates look to be holding on to a far larger roster of goods than necessary which raises the risk of seeing 'fire-sale' prices if growth softens further. This also applies to the external channel with inventory levels also swollen in key global-trade bellwethers: Korea and Taiwan.



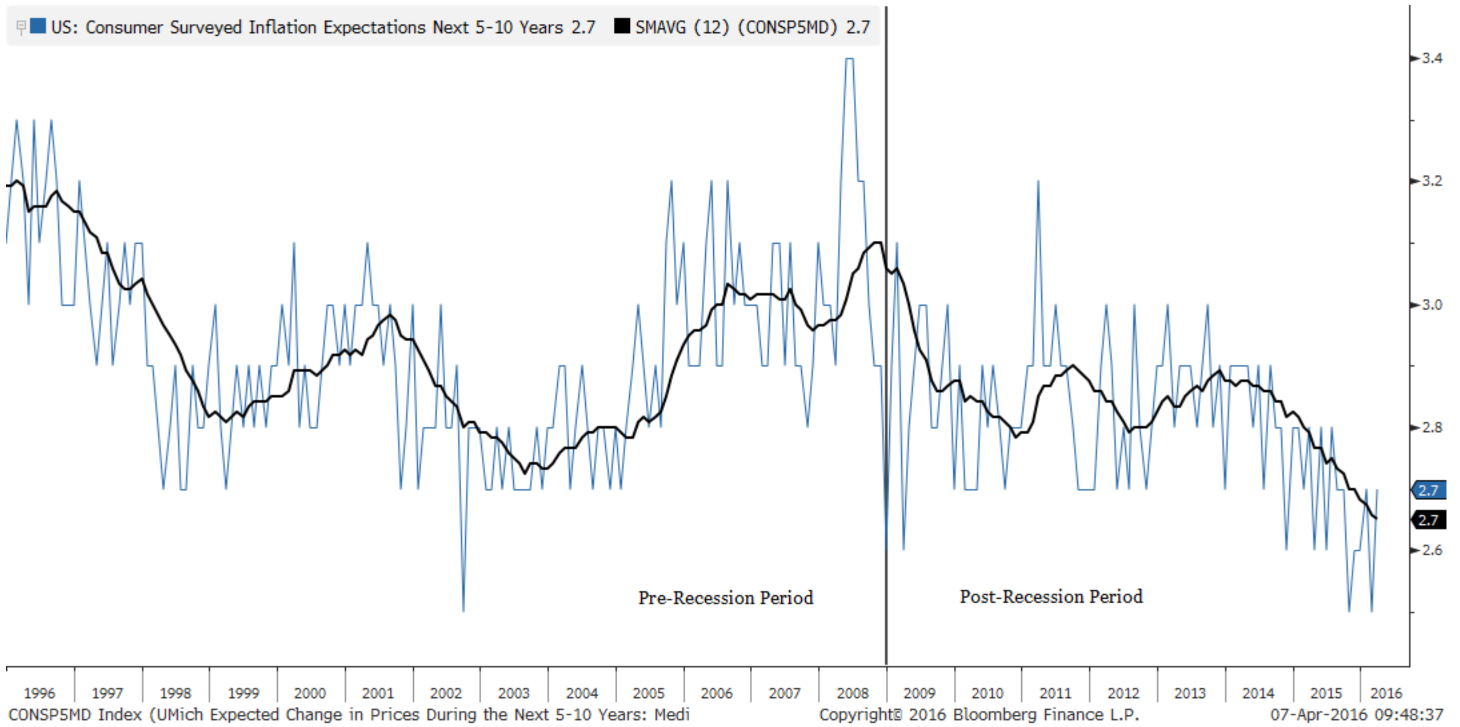
Despite the increase in spot inflation we're actually seeing the corporate surveys going in the other direction. For example, the ISM Non-Manufacturing Survey as well as the Small Business Confidence Survey are signaling diminished pricing power if anything of late. Meanwhile, the inventory overhang looms large.



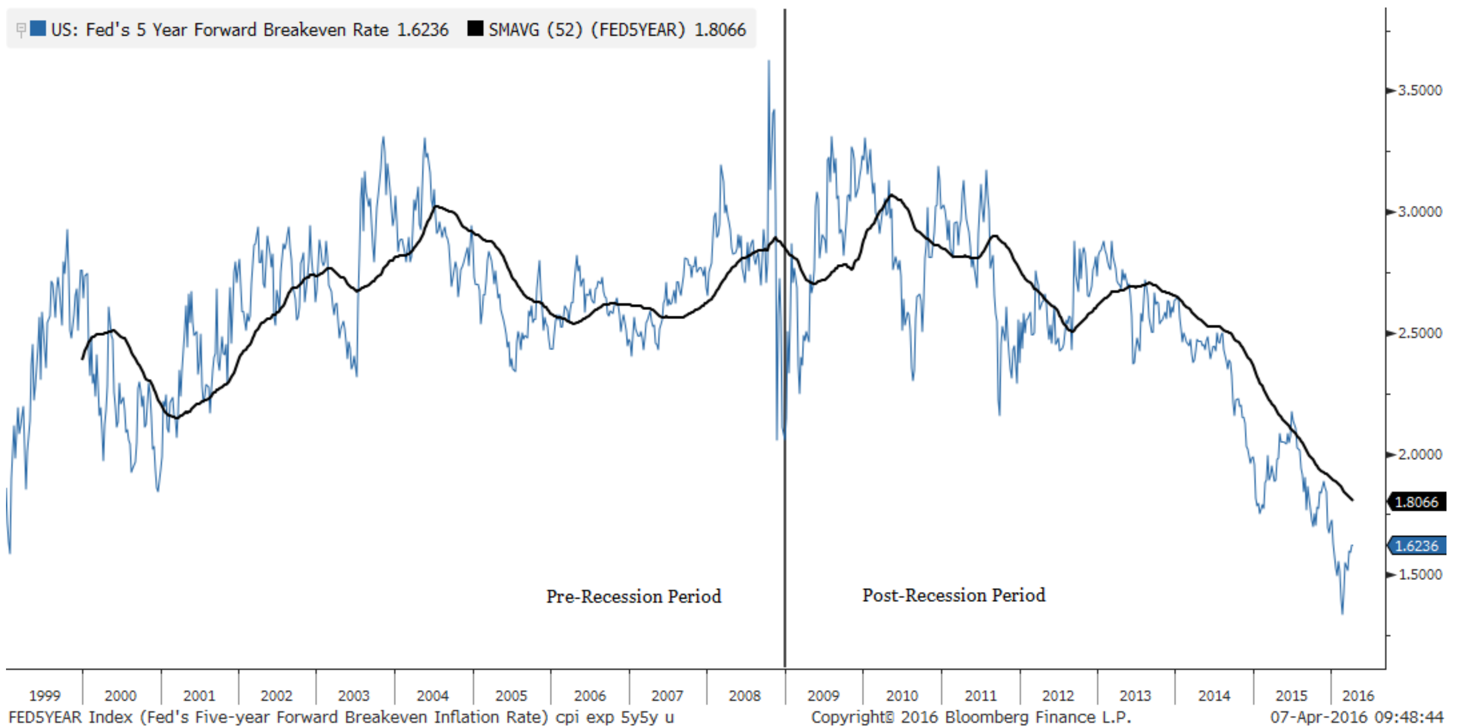

While business surveys suggest a very timid price aggression by local corporates the surveyed inflation expectations measures keep tracking lower. Notice the complete difference between the pre and post-recession periods. It's clear we're far from seeing inflation expectations anchored *'near'* their pre-recession trends in the survey on professional forecasters.



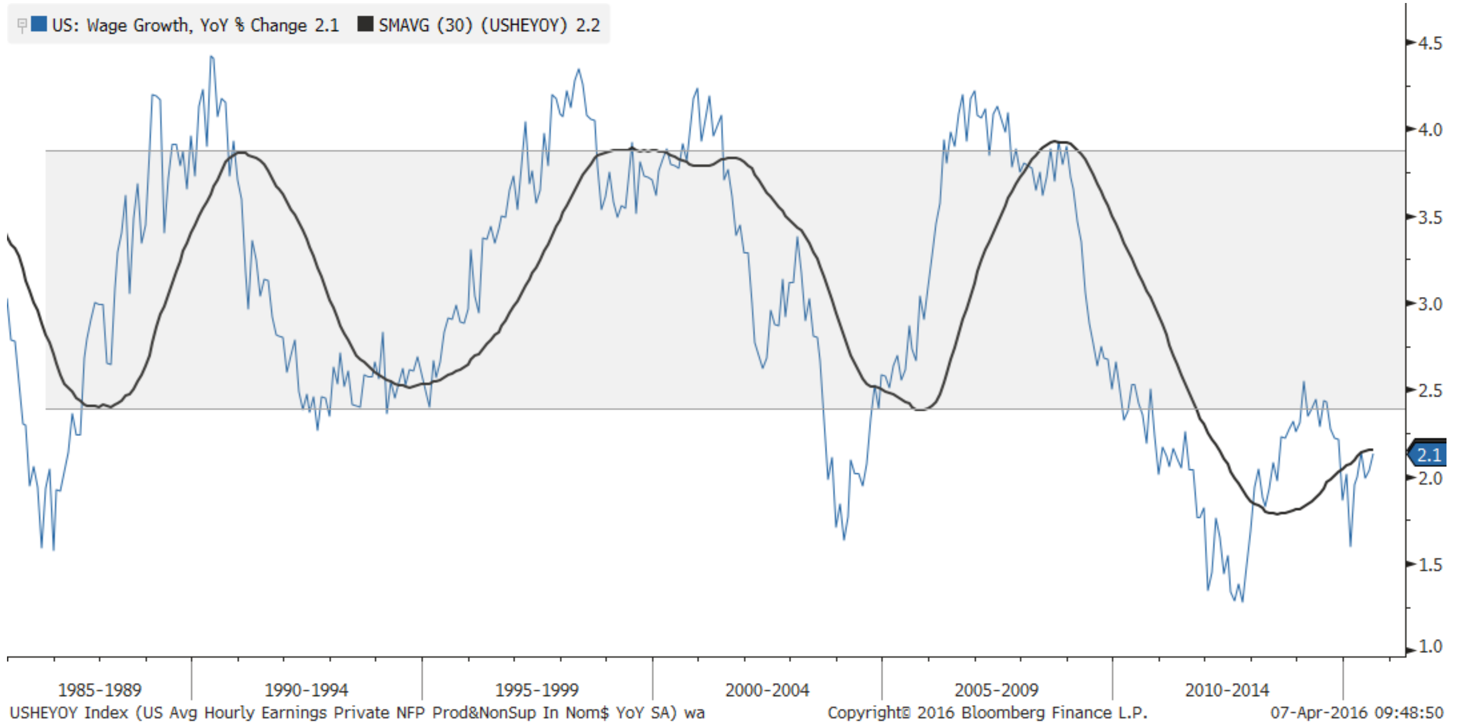
The story is the same when it comes to longer-run surveyed inflation expectations in the consumer facet of the economy. In fact, we're seeing the underlying trend-measure now at record low levels and the spot-results have been penetrating historical thresholds as well. The question has to be asked whether inflation expectations are unanchored?




Market-based measures of longer-run inflation expectations depict the same dynamic with underlying trend-measures at all-time lows here as well. Again, we're far from seeing inflation expectations anchored to their pre-recession trends.



Meanwhile, despite the tighter labor market, we've not seen any meaningful spurt in wage growth.




Overall, in this battered economic profile where downside risks prevail we're only few bad prints away for labor market measures such as initial jobless claims to provide the catalyst that brings the US narrative on a different trajectory.