



# GLOBAL / EM LIQUIDITY TRENDS & MARKET IMPLICATIONS

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# PRESENTATION OUTLINE

- How we use monetary / liquidity analysis (Ian)
- Global macro / policy outlook (Simon)
- Implications for EM (Ian / Simon)
- Q&A



IAN BEATTIE

# HOW WE USE MONETARY / LIQUIDITY ANALYSIS



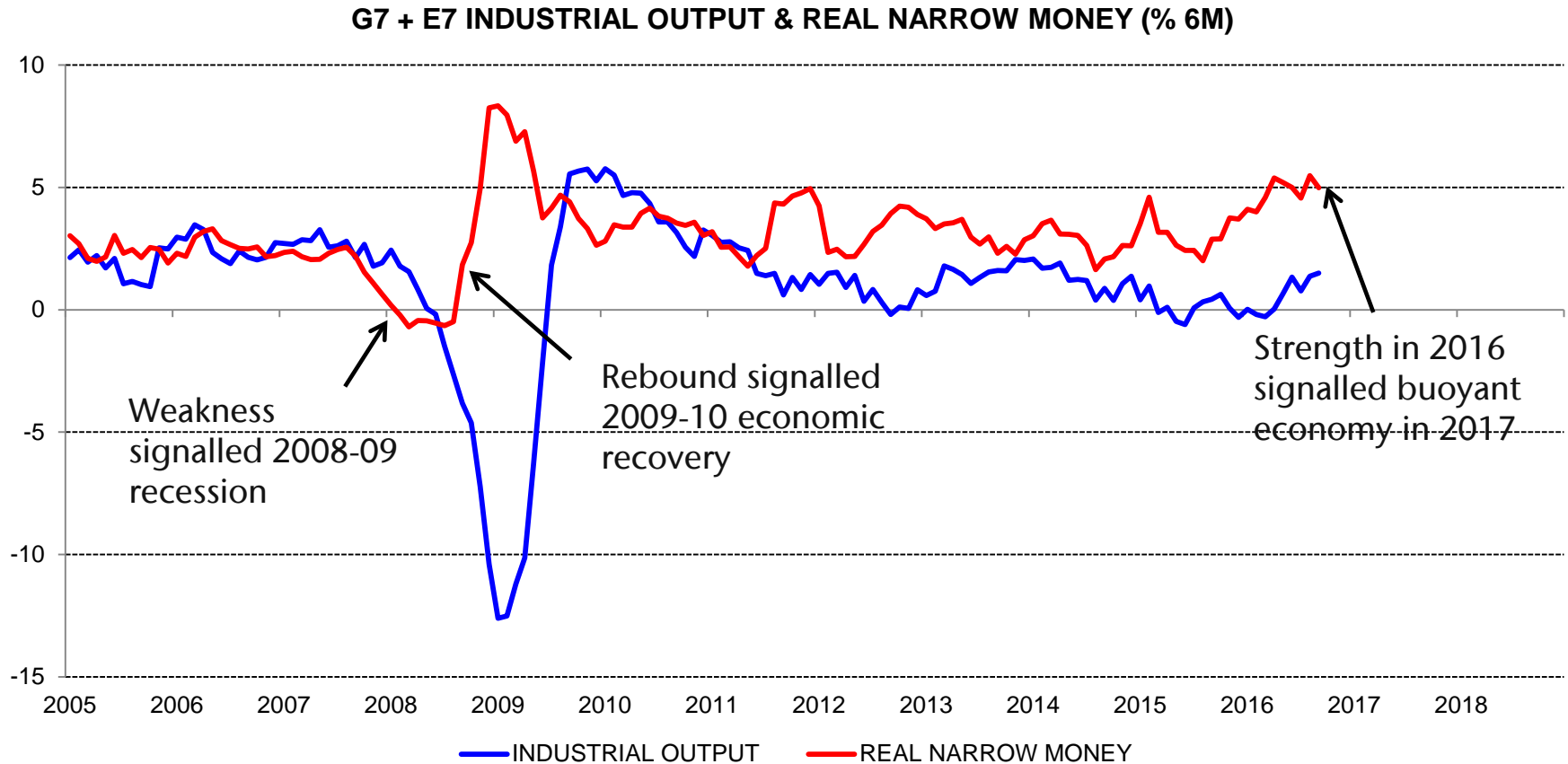
## HOW WE USE MONETARY / LIQUIDITY ANALYSIS

1. Real (i.e. inflation-adjusted) money leads the economy
2. “Excess” money drives markets – “the liquidity theory of asset prices”

## REAL MONEY LEADS THE ECONOMY

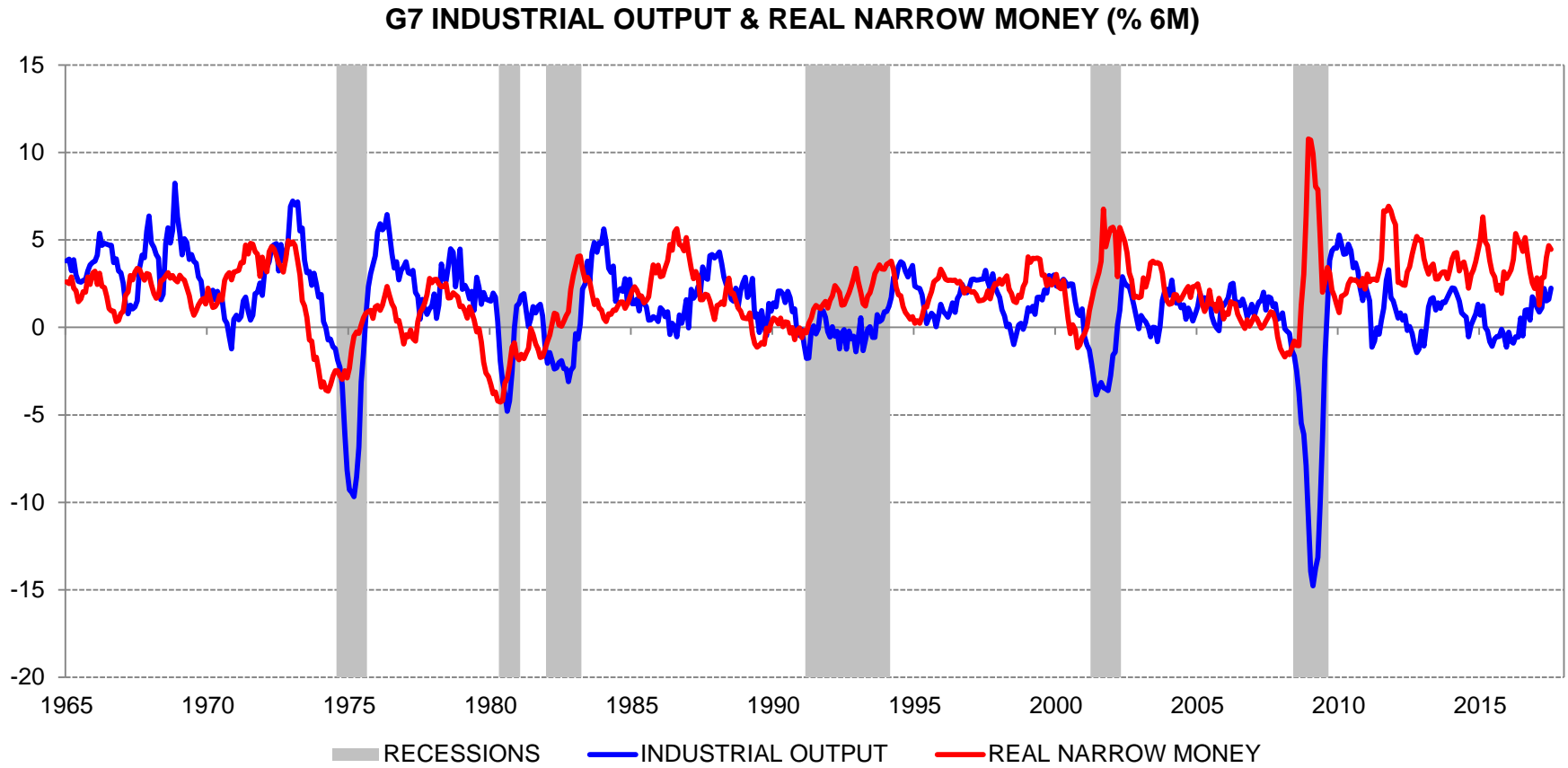
- Turning points in real money growth lead turning points in economic growth by 6-12 months (average = 9 months)
- Narrow money (M1) works better than broad money (M3)
- Narrow money = currency in circulation plus demand / overnight deposits

# REAL MONEY LEADS THE ECONOMY - EXAMPLE



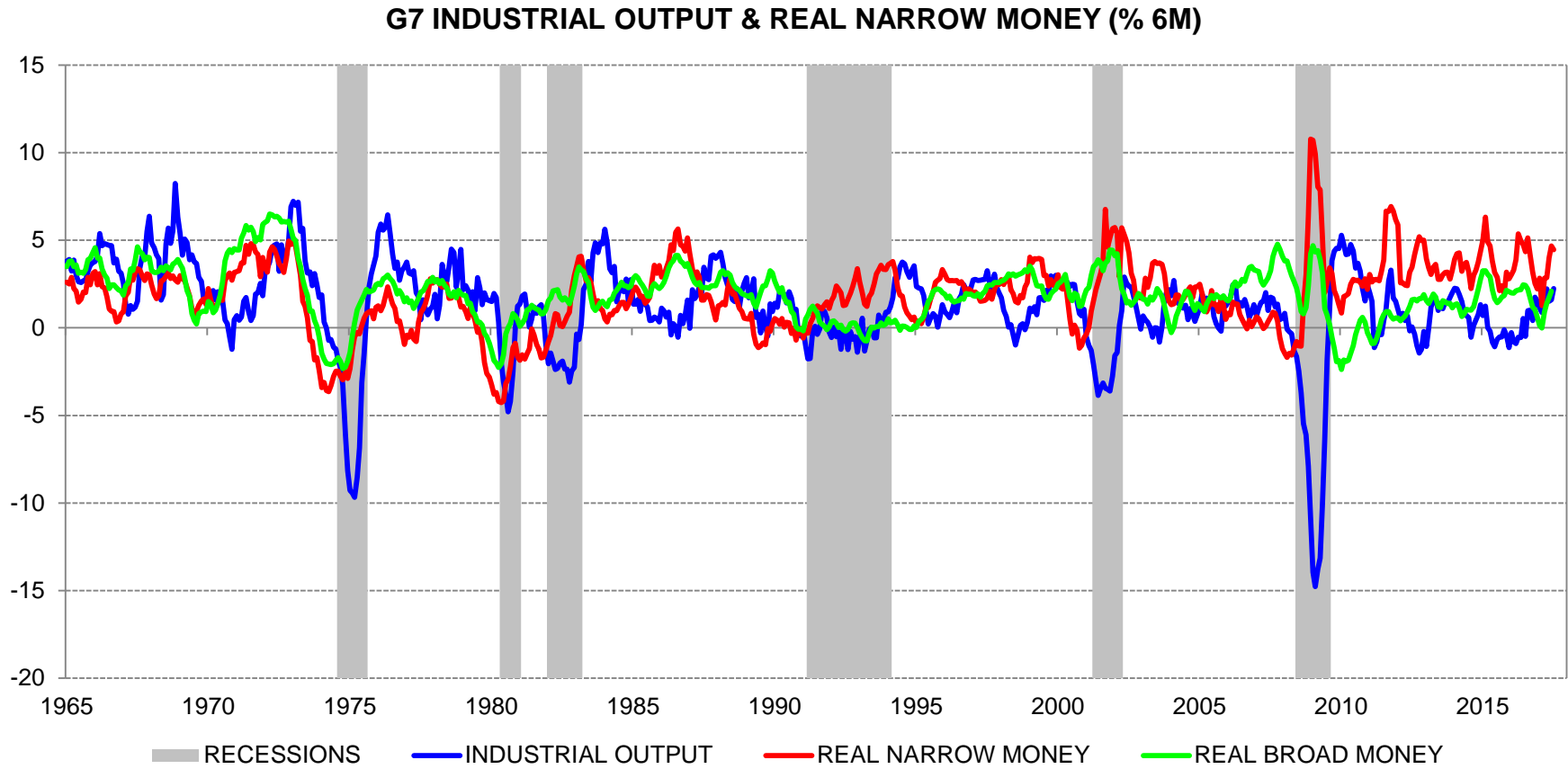
**Real narrow money trends correctly signalled that the global economy would be strong in 2017, contrary to downbeat consensus expectations in late 2016.**

# REAL MONEY LEADS THE ECONOMY – LONG-TERM PERFORMANCE



**Real narrow money has led economic swings consistently and contracted ahead of the six global recessions since the 1960s.**

# REAL MONEY LEADS THE ECONOMY – NARROW VS BROAD MONEY



**Broad money signals have been less reliable – real broad money did not contract before the last two recessions.**



## “EXCESS” MONEY DRIVES MARKETS

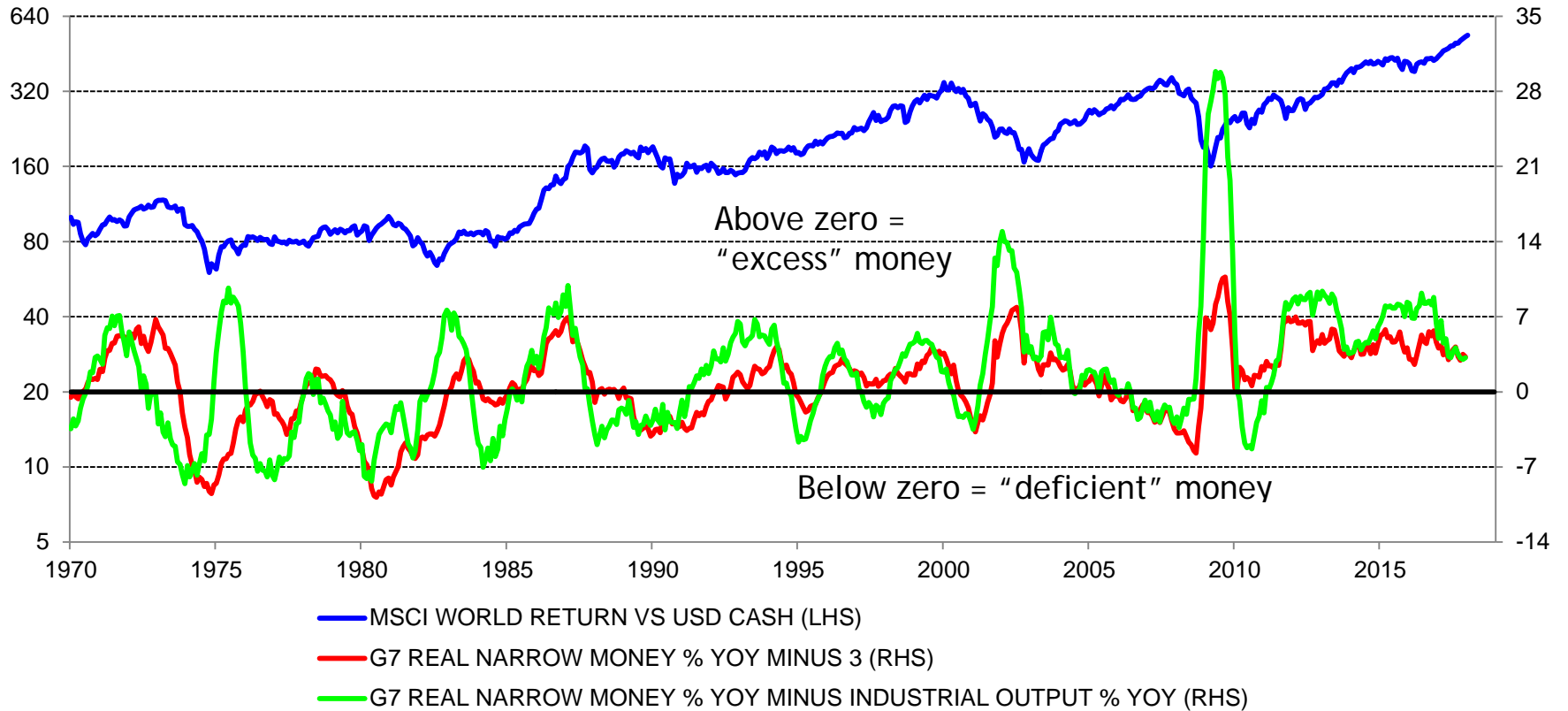
- According to liquidity theory, asset prices tend to rise if money grows faster than the needs of the economy
- Conversely, slow money growth relative to economic needs results in a liquidity drain on markets
- The impact of excess / deficient liquidity on particular markets depends partly on the economic cycle

## “EXCESS” MONEY DRIVES MARKETS

- How to measure excess money?
  1. Difference between real money growth and long-run average (G7 = 3% per annum)
  2. Difference between real money growth and industrial output growth
- Both approaches have value

# “EXCESS” MONEY DRIVES MARKETS

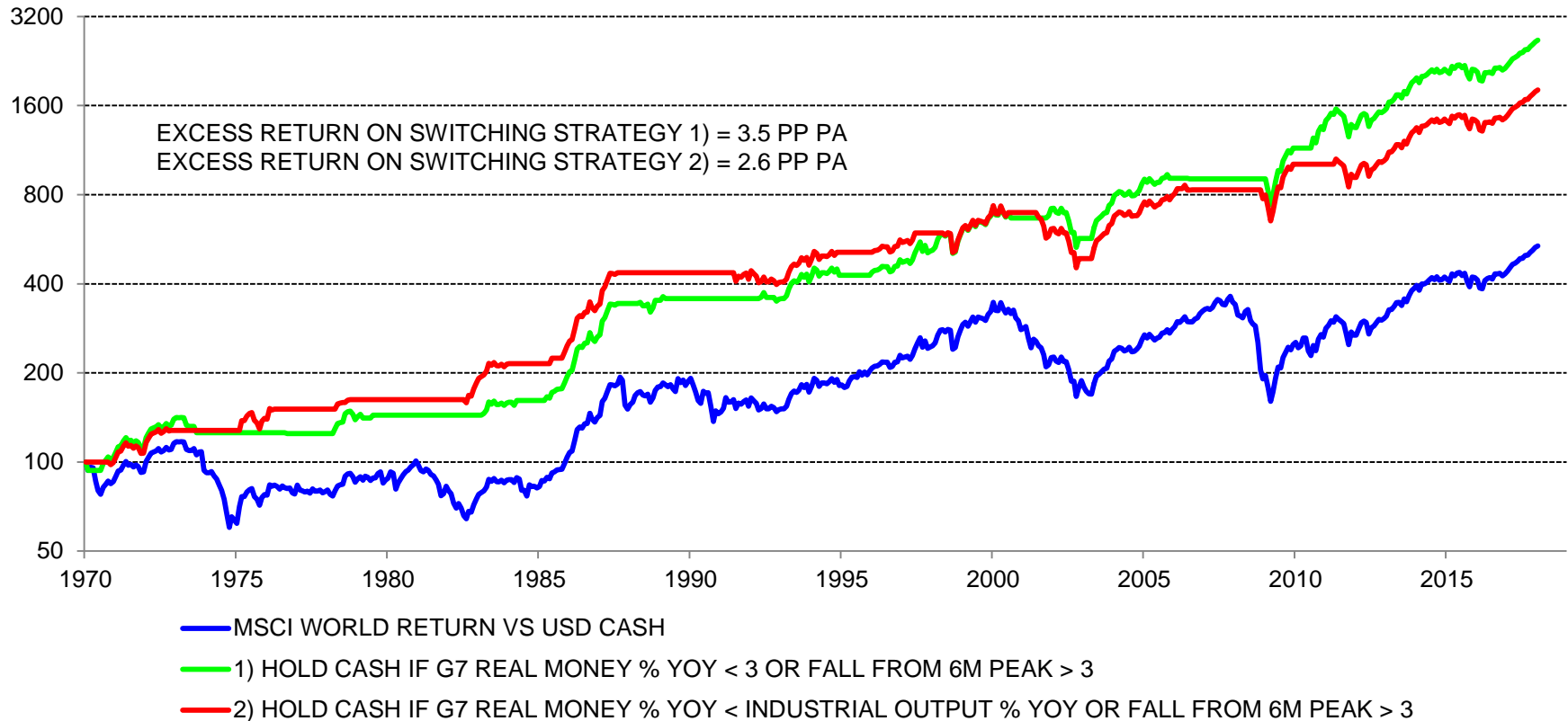
### MSCI WORLD RETURN VS USD CASH & G7 "EXCESS" MONEY



**Global equities outperformed cash on average when the excess money indicators were positive, and underperformed on average when they were negative.**

# “EXCESS” MONEY DRIVES MARKETS

## MSCI WORLD RETURN VS USD CASH & SWITCHING STRATEGIES



**Simple switching strategies based on the excess money indicators would have captured much of the upside in equities while limiting drawdowns.**

## SUMMARY

- Monetary / liquidity analysis can provide important insights about economic and market prospects
- The excess money indicators are still positive but have fallen, suggesting a less favourable outlook for markets



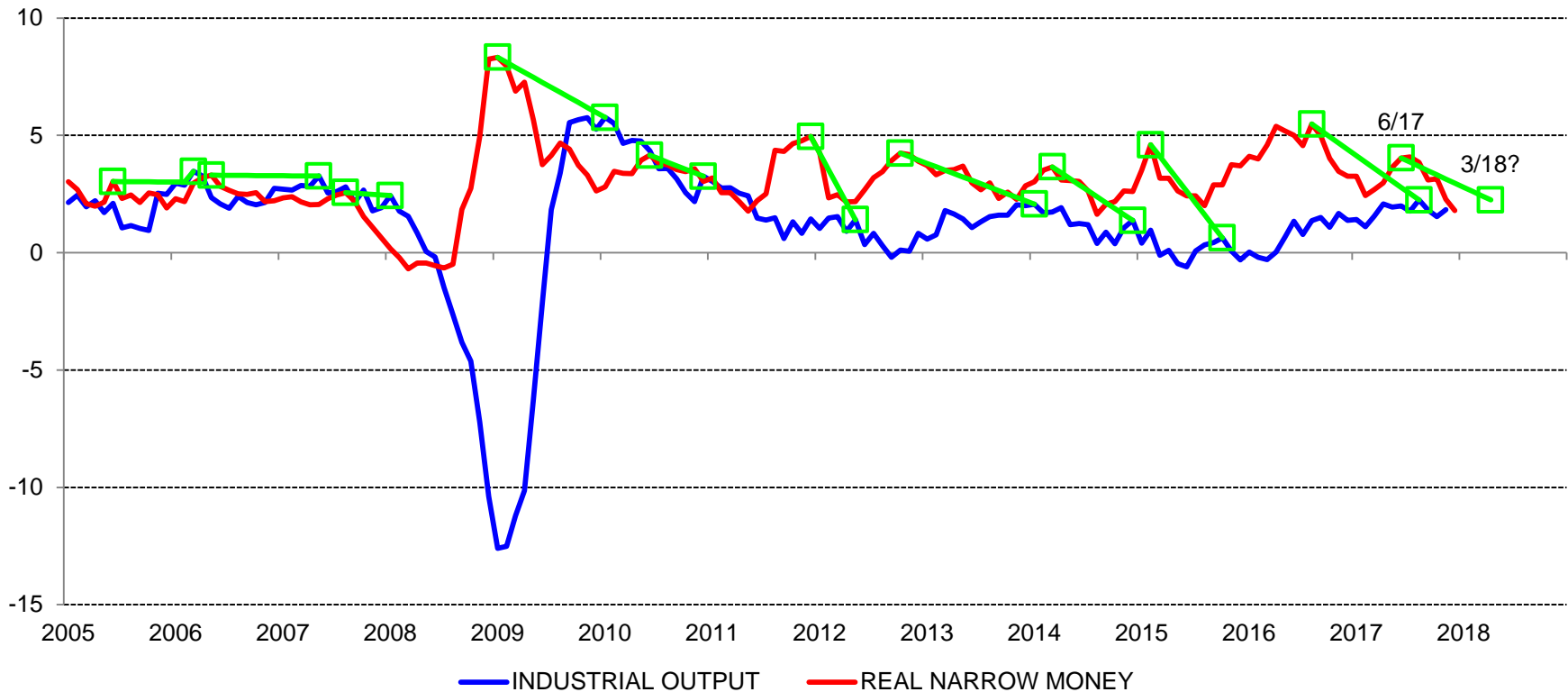
SIMON WARD

# GLOBAL MACRO / POLICY OUTLOOK



# GLOBAL MACRO / POLICY OUTLOOK

**G7 + E7 INDUSTRIAL OUTPUT & REAL NARROW MONEY (% 6M)**  
AVERAGE LEAD TIME AT HIGHLIGHTED PEAKS = 9 MONTHS



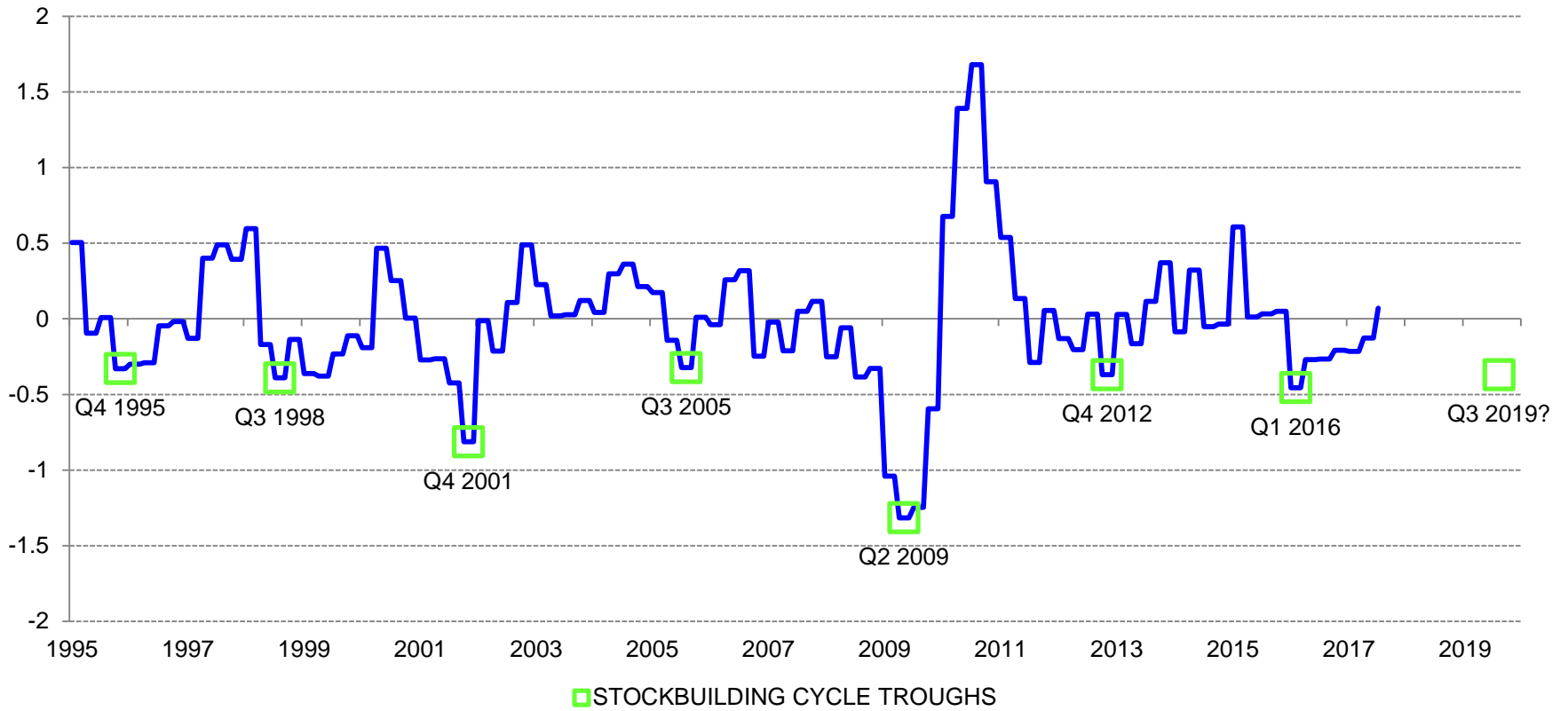
**Real money growth has fallen significantly since June 2017, suggesting that economic growth will weaken from around spring 2018.**





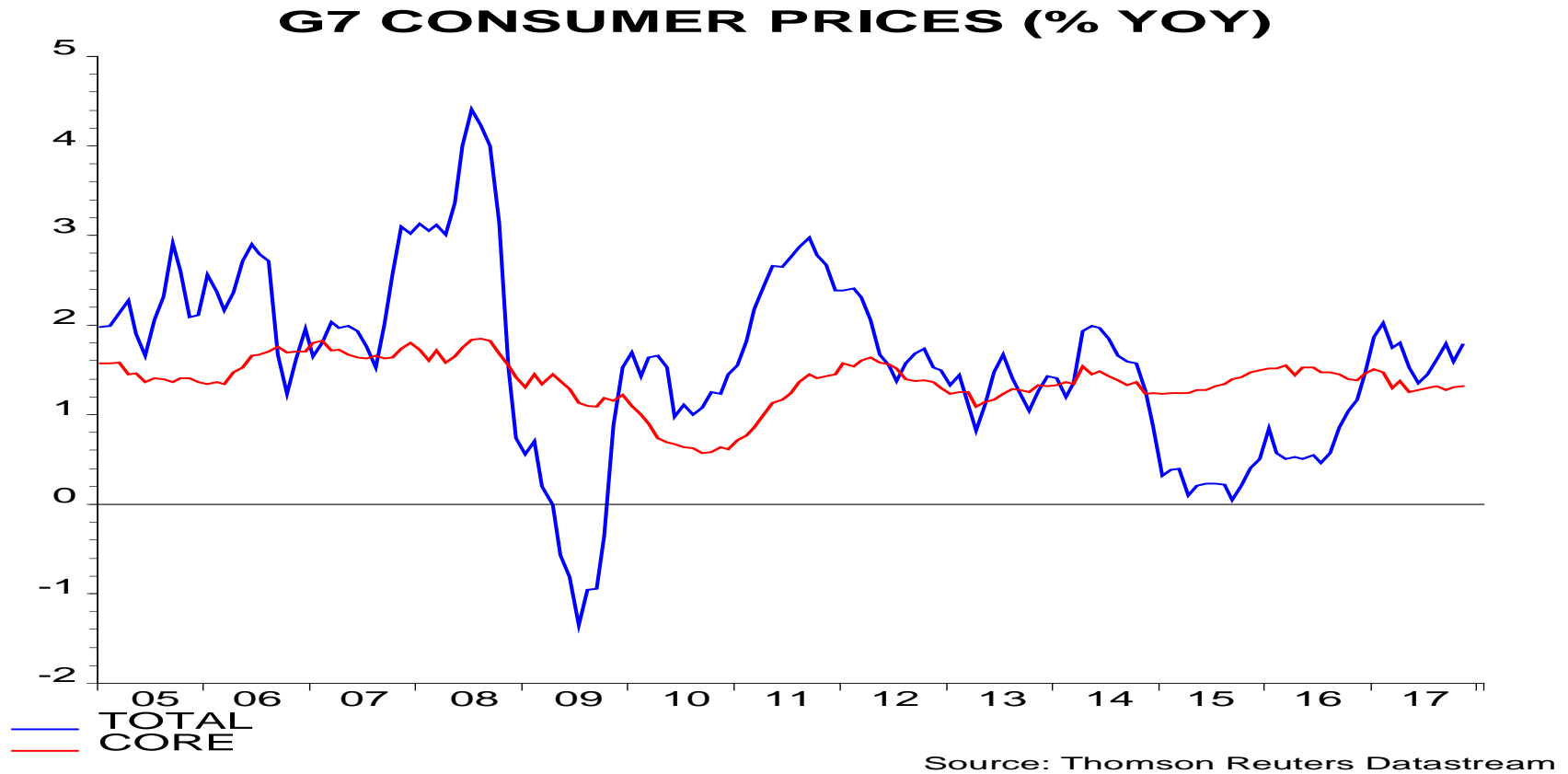
# G7 STOCKBUILDING CYCLE – SCHEDULED TO PEAK SOON?

### G7 STOCKBUILDING AS % OF GDP, YOY CHANGE



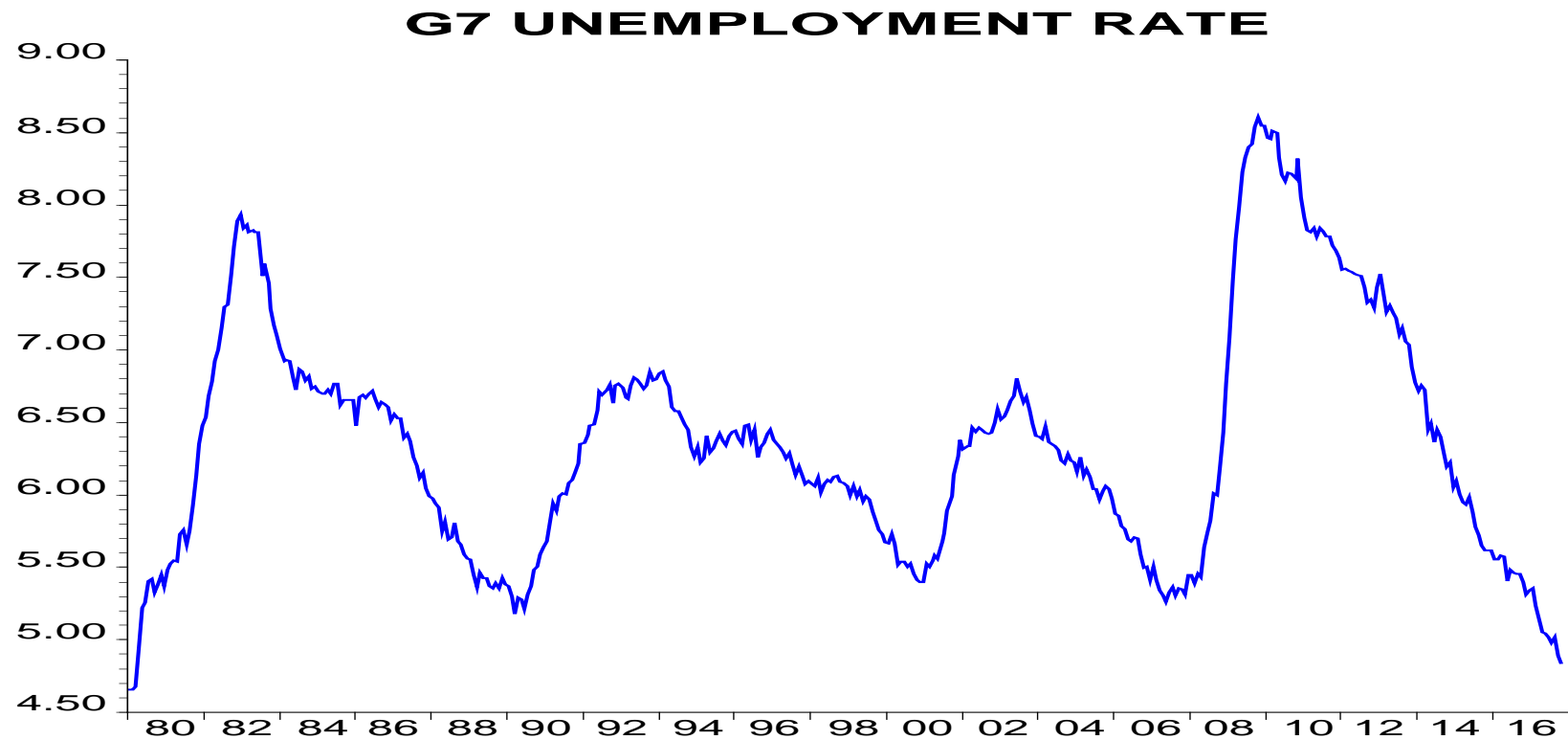
**Recent strong growth partly reflects an upswing in the stockbuilding cycle but this may peak in H1 2018 and become a drag in H2 2018 / 2019.**

# G7 CONSUMER PRICE INFLATION



**A reversal higher in energy and food prices lifted headline inflation in 2016-17 but core inflation remained stable.**

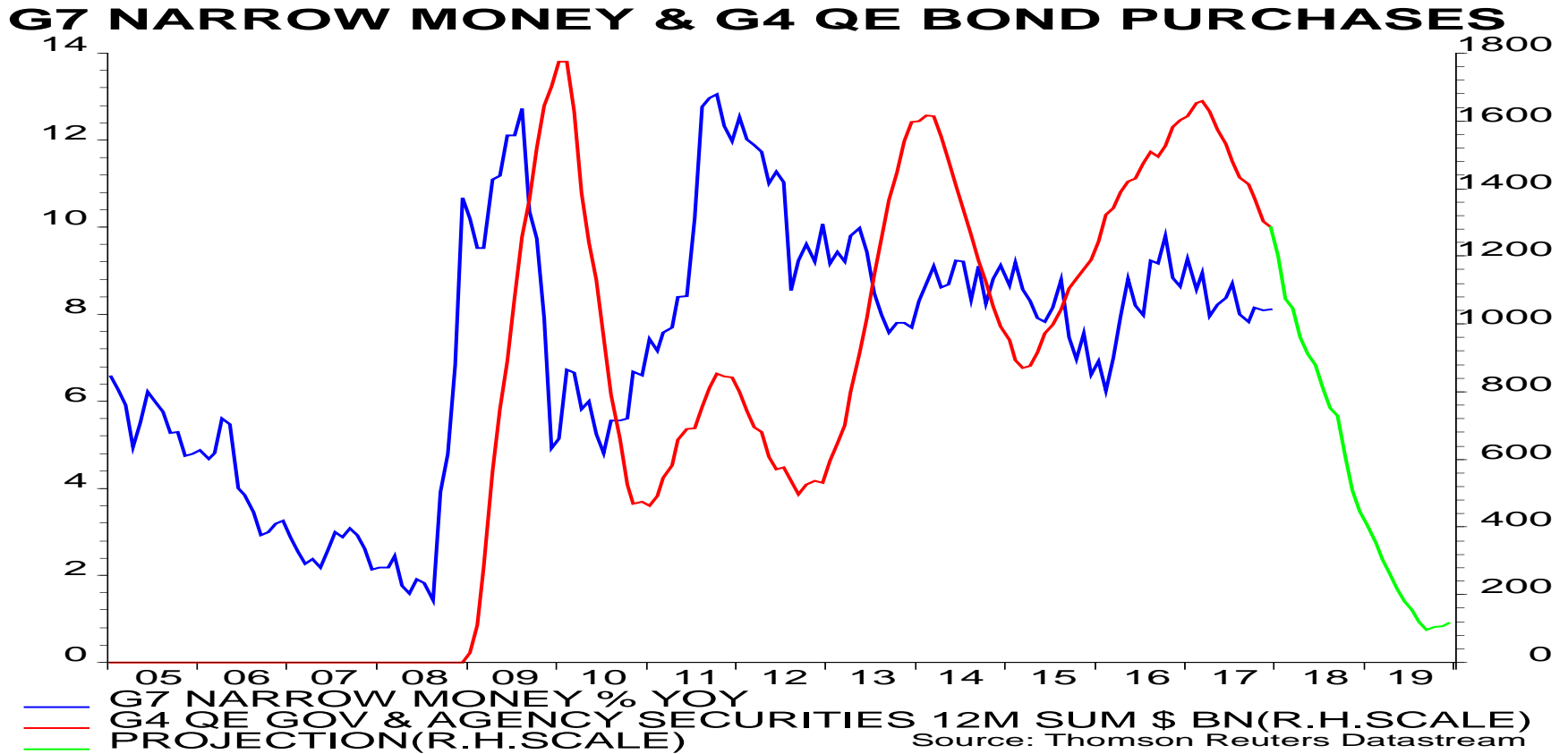
## G7 UNEMPLOYMENT RATE – LOWEST SINCE 1980



Source: Thomson Reuters Datastream

**Increasingly tight labour markets suggest upward pressure on wage growth / core inflation.**

# QE SUPPORT FADING



**The 12-month flow of QE peaked in March 2017 and is on course to halve by mid-2018.**

## SUMMARY

- Global growth is likely to cool from spring 2018
- However, G7 central banks will probably tighten policies in response to stronger wage / core inflation pressures
- Coupled with the planned wind-down of QE, this may cause money growth to weaken further



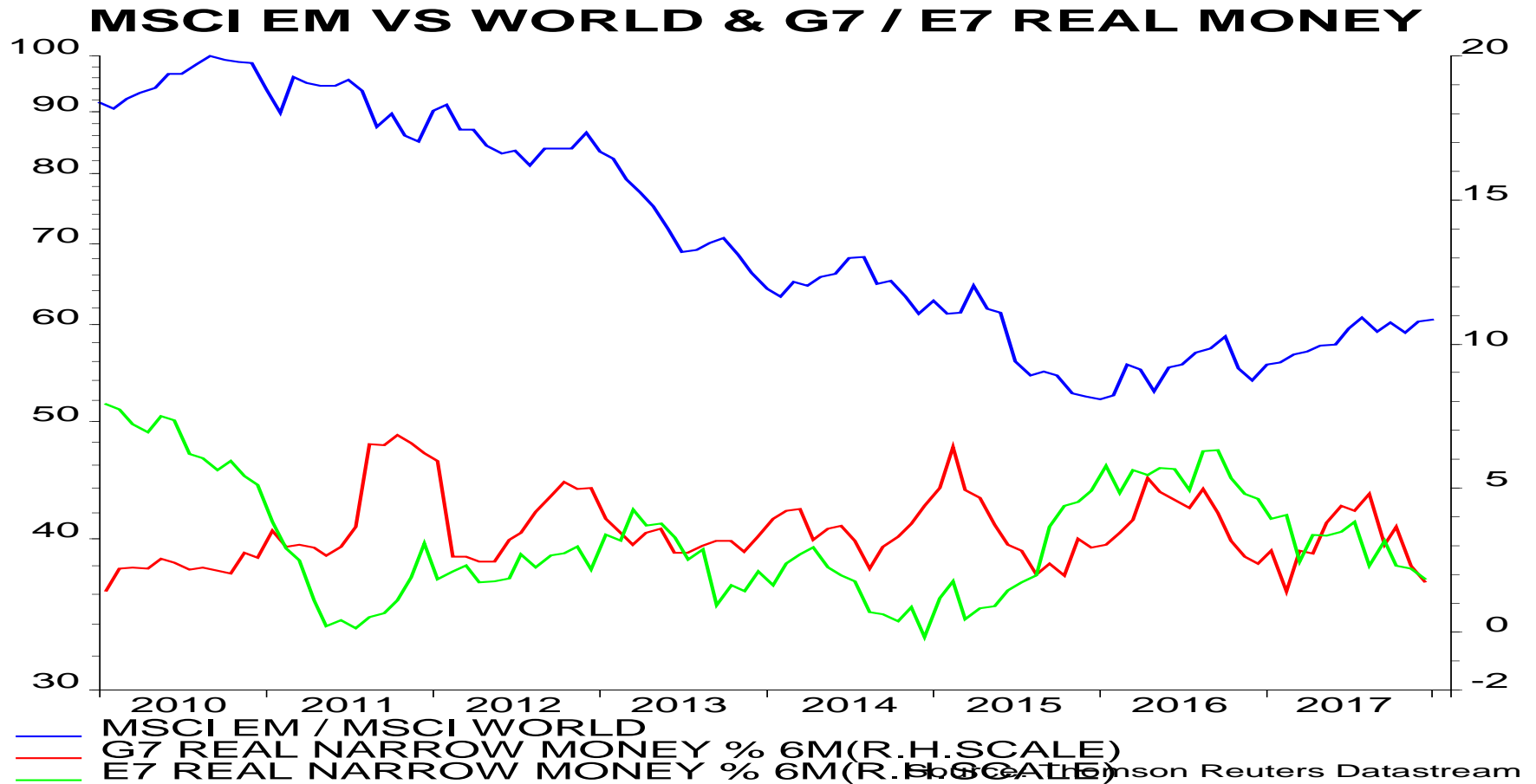
IAN BEATTIE & SIMON WARD  
**IMPLICATIONS FOR EM**



## IMPLICATIONS FOR EM

- We use a seven-factor checklist to assess whether emerging equity markets will outperform or underperform developed markets
- One of the factors is the gap between real narrow money growth in the E7 major emerging economies and the G7 developed economies

# EM RELATIVE PERFORMANCE & G7 VS E7 REAL MONEY GROWTH



**The real money growth gap was positive for EM between late 2015 and early 2017 but is now neutral.**



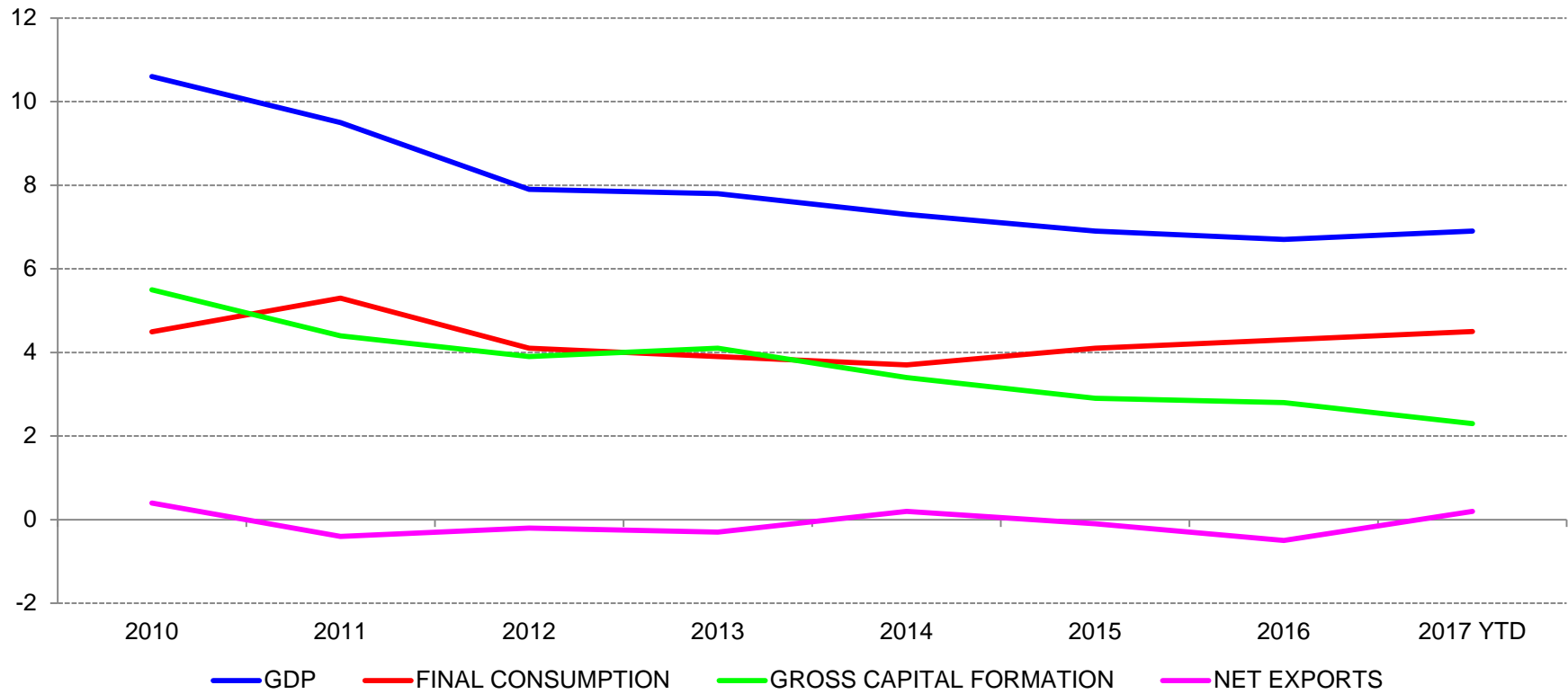
## EM RELATIVE PERFORMANCE CHECKLIST

Factor	Condition for Outperformance	Current Assessment
Real money growth	E7 above G7	≈Similar
Valuation	Low absolute / relative to DM	✓Relative yes
Earnings revisions ratio	Above DM	✗No
Global Industrial cycle	Upswing	✗Nearing peak
Global Excess Money	Positive	✓Yes but falling
Commodity prices	Upswing	✓Yes
US Dollar	Falling	≈Trend unclear

**The checklist is mixed.**

# CHINA IS REBALANCING SUCCESSFULLY

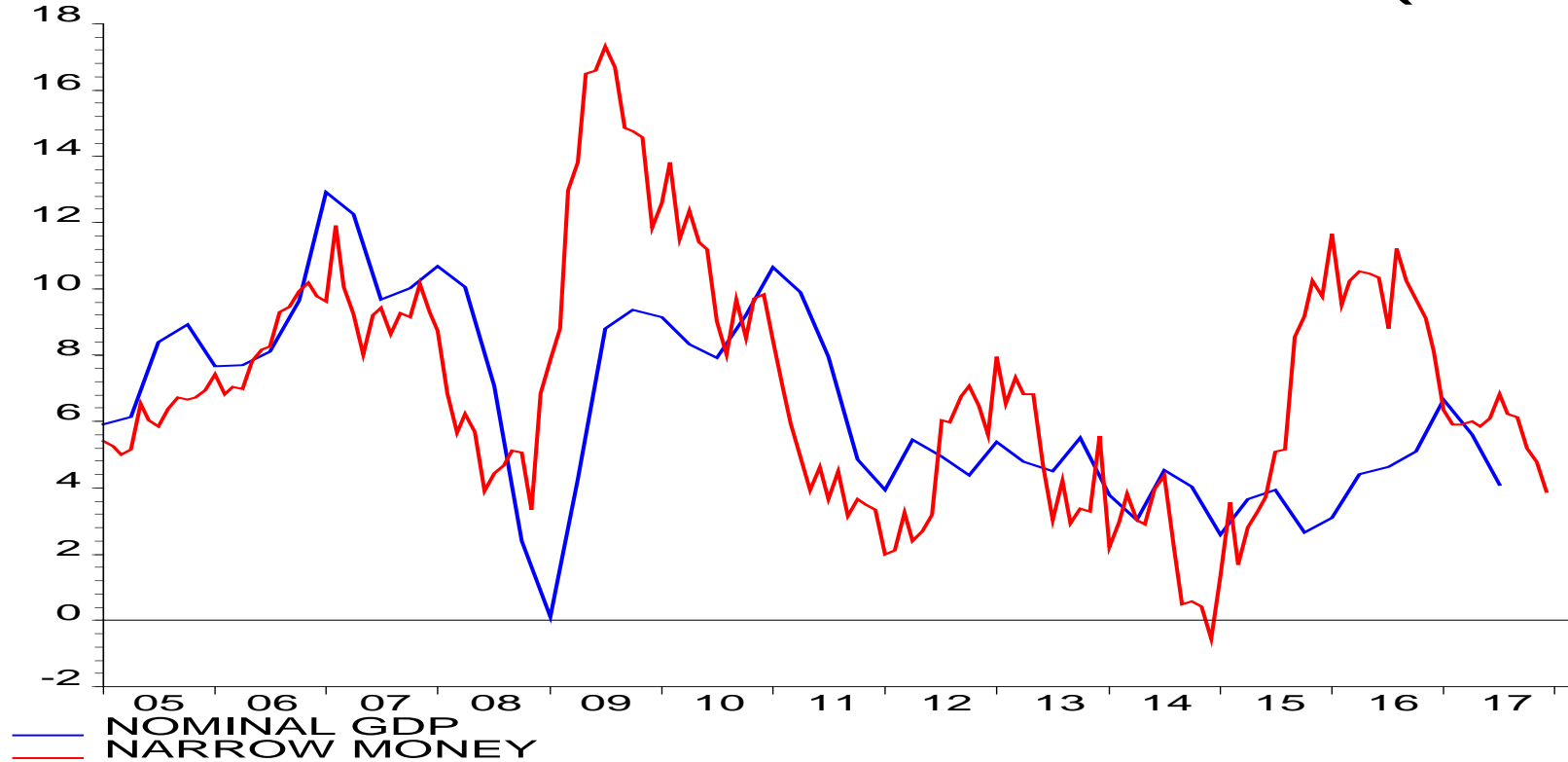
**CHINA GDP BY EXPENDITURE COMPONENT  
(PP CONTRIBUTION TO GDP % YOY)**



**Consumption accounted for two-thirds of GDP growth  
in 2017, up from about 40% in 2010.**

# CHINA ECONOMY & NARROW MONEY

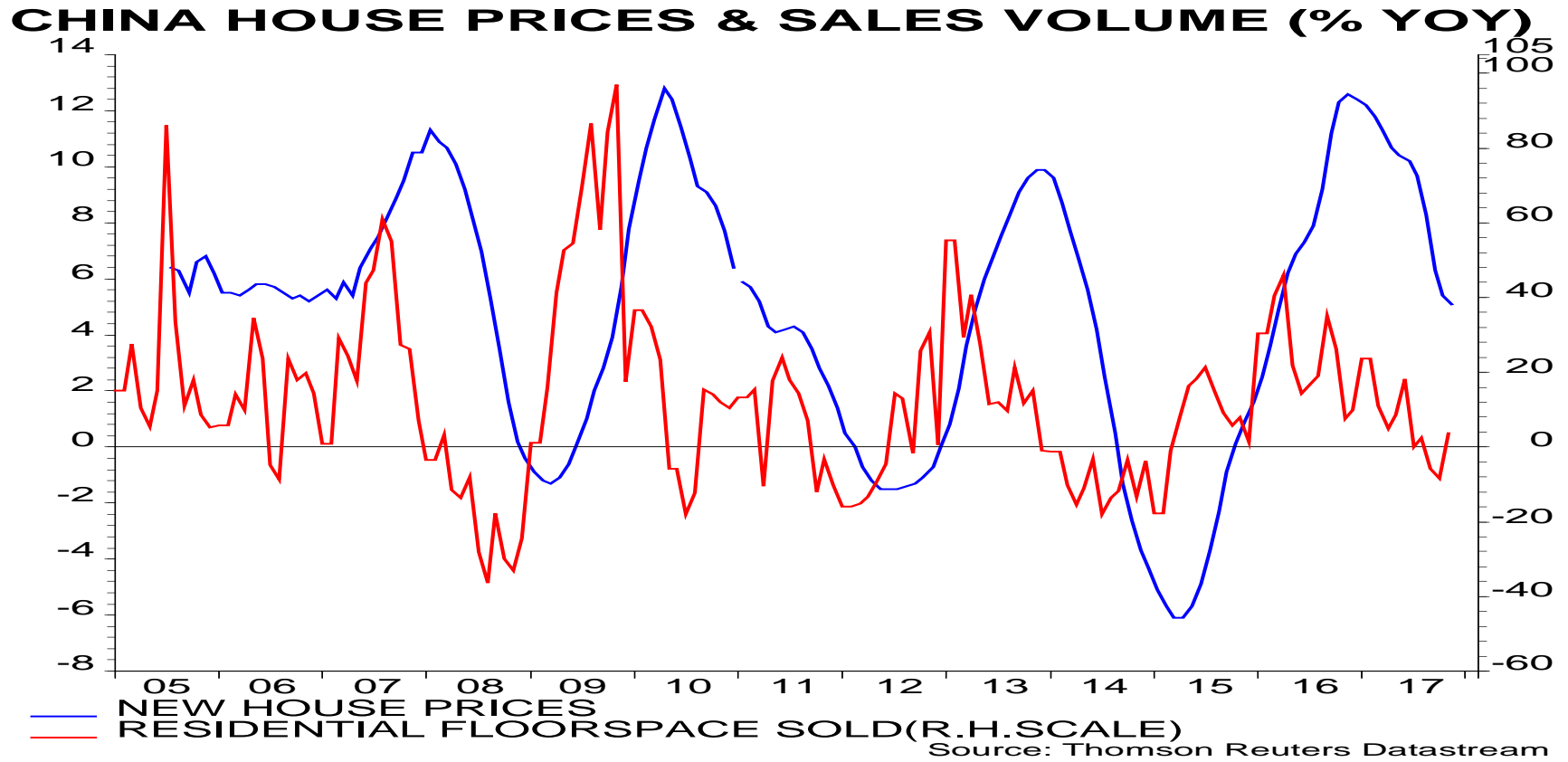
## CHINA NOMINAL GDP & NARROW MONEY (% 6M)



Source: Thomson Reuters Datastream

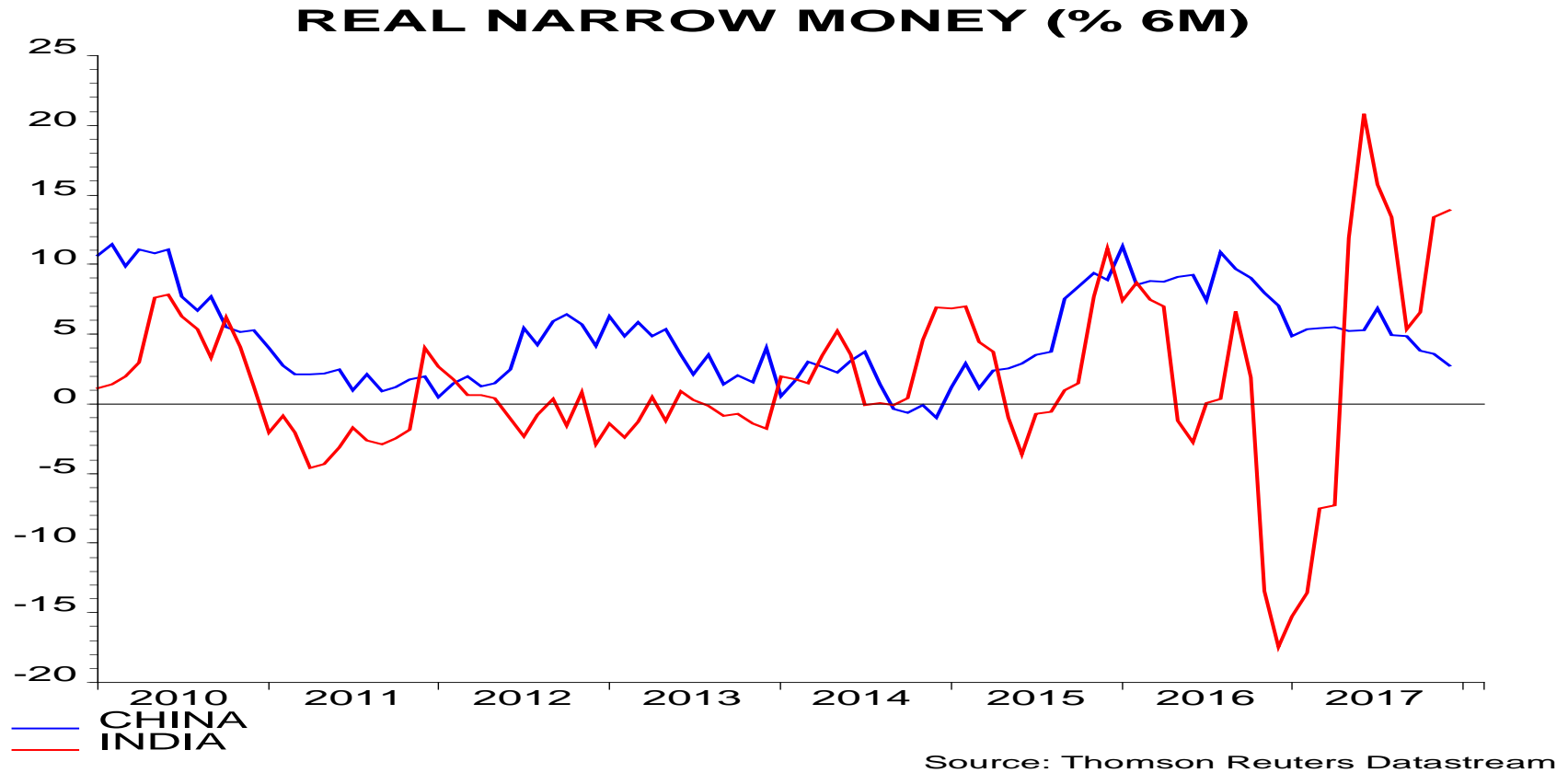
**Money trends gave a positive signal in 2015-16 but now suggest caution.**

# CHINA HOUSING MARKET



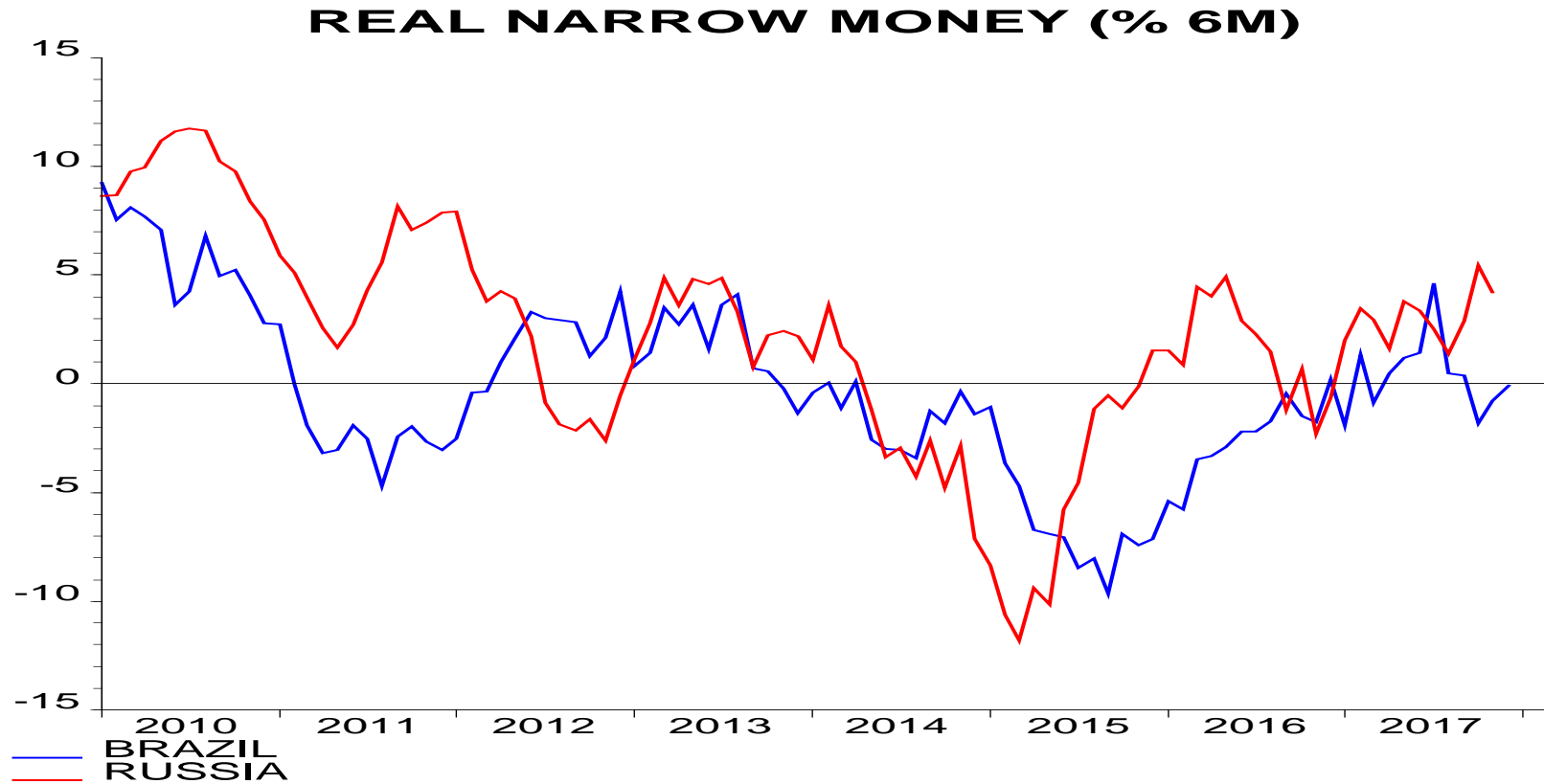
**Housing market weakness may contribute to a policy reversal during H1 2018.**

# REAL NARROW MONEY – CHINA VS INDIA



**China outperformed India in 2017 but relative money trends suggest a reversal.**

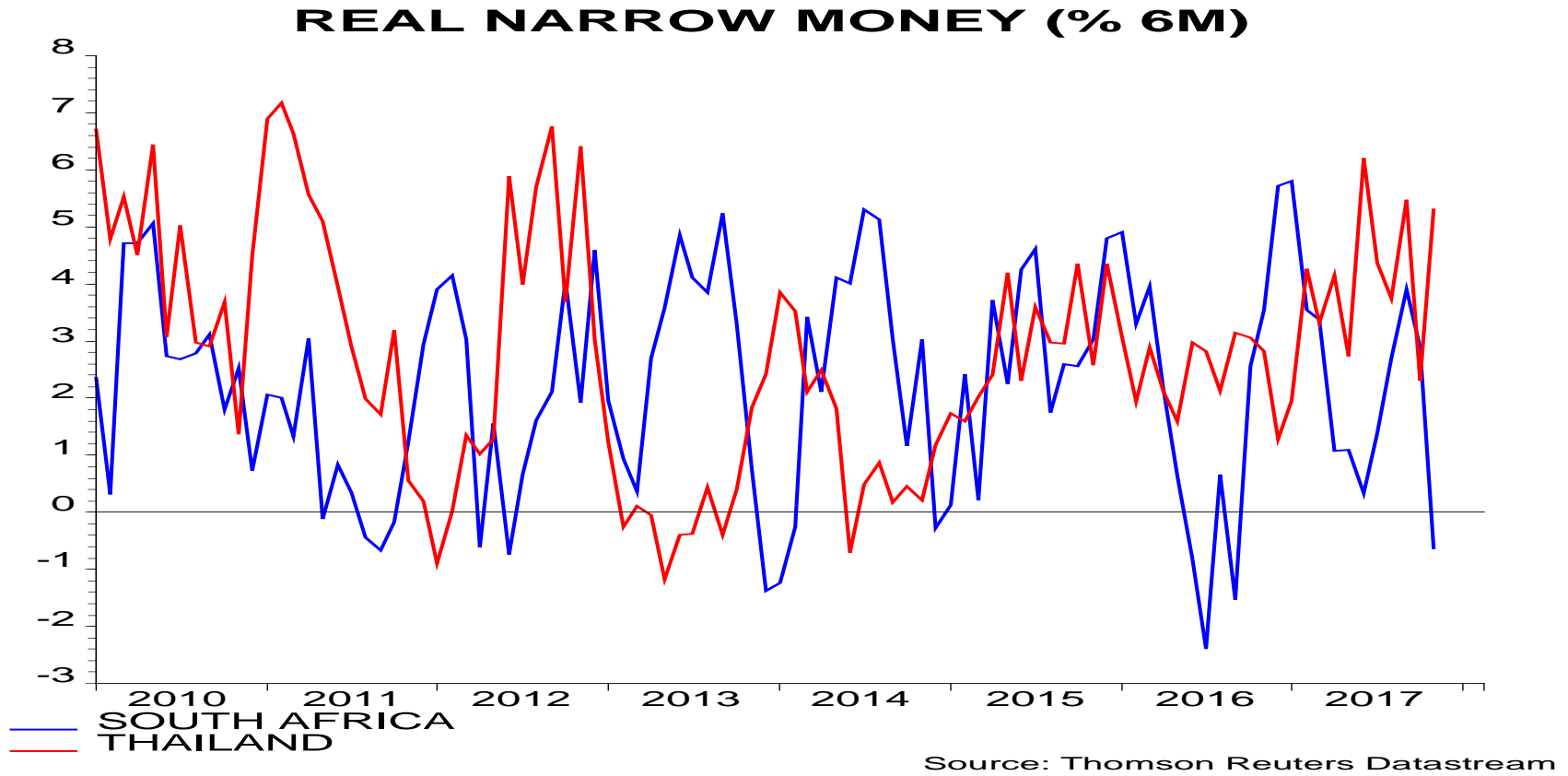
# REAL NARROW MONEY – BRAZIL VS RUSSIA



Source: Thomson Reuters Datastream

**Policy rates have been cut by more in Brazil but money trends favour Russia.**

# REAL NARROW MONEY – SOUTH AFRICA VS THAILAND



**The political backdrop has improved in both countries but money trends favour Thailand.**

## SUMMARY

- Cautious economic / market outlook
- Slowdown and policy tightening risks focused on developed markets
- EM checklist neutral
- China: long-term positive, short-term cautious
- Significant liquidity divergences within EM – potential for country selection



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