LUNDGREEN'S
ECONOMIC SPOTLIGHT

WEEK 20 2018



REACHING GLOBAL MILESTONES

Lundgreen's Capital constantly grows its business and continues to gain international recognition



LUNDGREEN'S CAPITAL:
Advising large and professional clients about investments and financial risk management.



PETER LUNDGREEN:
Founding CEO of Lundgreen's Capital and a trusted advisor for clients. Peter is also a conference speaker and an experienced source for the global media with 100+ appearances annually.



LUNDGREEN'S CHINA FUND
A mutual investment fund listed in Luxemburg investing in carefully selected value stocks and attractive growth stocks plus bonds.

The market never sleeps - we're always up for a conversation.

Lundgreen's Capital
professional investment advisory

Hammerensgade 1, 2nd Floor, DK – 1267 Copenhagen K, Denmark – Phone +45 70 26 88 55 – www.lundgreenscapital.com

Lundgreen's Capital is a licenced investment advisor regulated by the Danish FSA

U.S. ECONOMY TOWARDS A DANGEROUS CROSSING

A development in the U.S. economy is increasingly exciting - the stress field is created by the unemployment rate, 10-year Treasury yield, and expected rate hikes from the central bank (Fed).

The graphic shows the trend in the U.S.' 10-year Treasury yield compared with the unemployment rate since 1962. Every time the 10-year interest rate rises from below and crosses the unemployment rate in an upwards move, a crisis followed. Except in 1995 to 1998 when the crisis first evolved in 2000/2001 with the dot.com bubble bursting. I define a crisis broad like an economic crisis, rising unemployment, sharp decline in stock markets etc.

Not very does often does this dangerous cross occur so it is almost the financial market's astronomical event when it happens. Last time, the cross was just recognisable, but none the less followed by the global financial crisis in 2007 / 2008. More often, there has been a run-up period of up to a few years before, for example, the unemployment has begun to rise.

In economies and the financial markets, upturns and downturns are a part of the normal life. Though I argue that there is still too much classical textbook thinking that these swings take place with a certain frequency and therefore are somewhat controlled - but my assessment is different.

In my view, the economic cycles (including the following movements in the financial markets) since the mid-1980s represent a new economic paradigm every time a new economic cycle starts and does not repeat a previous cycle.

The consequence is that every time the financial markets are facing the described dangerous cross, it is time to consider how the market reactions will be and how the economic / financial world looks like on the other side of the crisis. My big concern this time is that the global economy contains such huge imbalances that it can be extremely difficult to forecast how fast a crisis and a new paradigm can develop – and what will the new paradigm be?

Examples of global imbalances are the directions in the major economic zones. To describe China's economy for the coming 10 years in a few lines then, the country is widely expected to become the world's largest economy. Though more important is that China is also becoming the world's largest single market, but not necessarily easy for foreign companies to access.

Europe remains in an everlasting navel-gazing process

Graphic:

USA - 10 YEAR INTEREST RATE AND UNEMPLOYMENT IN PCT.



currently dominated by the world's largest divorce between the EU and Britain. In addition, the major EU countries stumble in their own domestic politics, and therefore the forward moving cooperation between the member countries also stumble.

Moreover, since the financial crisis, the southern European EU members have not done anything about the life-threatening debt pile, so all-in-all it looks like another 10 years in a standstill.

In contrast to Europe, the U.S. economy is very agile and the American economy can provoke the largest movements in global financial markets – in several ways. One example is caused by the three important elements that I initially mentioned, as they are moving, although nobody knows how much.

The U.S. unemployment now stands at 3.9 pct. Official data from Tuesday the 8th of May showed that at the end of March, there were 6.6 million vacancies in the United States, which is 1 million more vacant jobs than one year before.

There is no sign that this development changes, meaning there will soon be more job vacancies than unemployed people in the United States. I am aware that there are still people who can enter the labour market, and some are currently part time workers, but the unemployment rate will drop further.

Parallelly, the U.S. 10-year Treasury yield has now broken the 3.00 pct. level and will move higher, actually are the two curves approaching each other fairly quickly. I expect however, that a 10-year Treasury yield ranging from 3.25 to 3.50 pct. will compete with the stock market and attract bond investors from Europe.

Therefore, there is a natural limitation in the speed of the increase in the 10-year Treasury yield, but the direction is clear, and much depends on the U.S. Federal Reserve Bank (Fed). For several years, I have argued that the Fed is lagging with the rate hikes- and it's still the case. The labour market is at risk to overheat, which Fed's planned interest rate hikes won't counter.

Further, there is a medium-term inflationary pressure, though long term I am not worried. But currently, the rising inflationary pressure is more persistent than the financial markets expected just six months ago, and the price pressure from raw materials, including oil, continues the upward trend.

This factor adds to the possibility that Fed would raise interest rates more than expected, despite that the latest inflation data for the service sector excluding energy and housing rent is under control.

It could for example be in steps by 0.50 percentage points instead of the 0.25 steps that is priced in the markets right now. Such bigger hikes would certainly send the 10-year Treasury yield above the unemployment rate, causing the dangerous crossing again.

Partly, the consequences would be what I describe as natural, like a slowdown in the economy, higher unemployment and more turbulence in the financial markets. These reactions are normal to deal with, but the global imbalances cause a risk of extreme market movements, and the reactions will not be limited to the United States.

The global debt burden has never been greater, and it is now so heavy that the International Monetary Fund (IMF) doesn't sleep well at night. Nobody can forecast the consequences if this market turmoil occurs, however, it is normal for investors to sell out of assets, including debt.

Should this scenario become reality within the next 1½ years, the Eurozone would be caught in an unprecedented situation. The government debt is historically high, there is no fiscal manoeuvre room, and with the central bank refinancing rate at zero the monetary policy, options are the same – zero.

Despite the trigger originating from the U.S., the reaction could very easily spread to Europe and hurt the European bond markets, and even generate bigger swings in Europe than elsewhere.

Disclaimer: This report has been prepared by Lundgreen's Capital ApS for information purposes only. It is not an offer or solicitation of any offers to purchase or sell any securities, currency or financial instrument. The evaluations, calculations, opinions and recommendations of this magazine should not replace the making of own opinions about whether to make any such transaction. Whilst reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation is made as to its accuracy or completeness and no liability is accepted for any loss arising from reliance on it. Lundgreen's Capital ApS, its affiliates or staff may perform business services, hold, establish, change or cease to hold positions in any securities, currency or financial instrument mentioned in this report. Additional information is available from Lundgreen's Capital ApS. This report is not intended for anybody outside the European Union. Lundgreen's Capital ApS, Copenhagen, is acting as an Investment Management Advisor under the inspection of Finanstilsynet / Danish FSA. This publication is published pursuant to Executive Order No. 1234 of 22 October 2007 on the compilation and dissemination to the public of certain investment research. It is strictly prohibited to use the photos in this publication in any way. Short quotes from the publication are allowed if the source is mentioned. In case that a whole section or article is used it can only happen if it has been approved by Lundgreen's Capital ApS. The contact details can be found on the website www.lundgreens.com.