Newsclips/Daily Commentary

August 27th, 2018

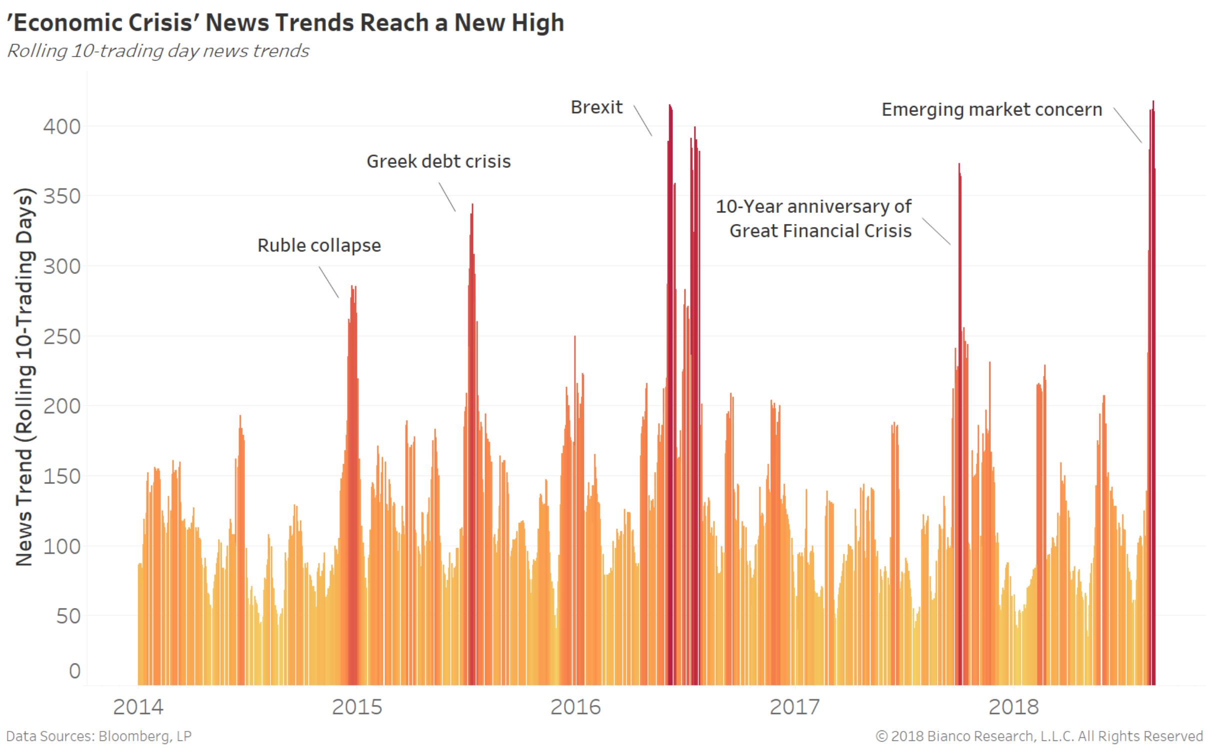
Why is Everyone Shouting 'Crisis?!'

Summary

Financial media are awash with talks about potential crisis, but the risk of sizable equity drawdowns are low. The Eurozone is beginning to produce economic data beats, while the U.S. turns to misses. Past similar instances have kept a lid on the S&P 500 and U.S. 10-year note yields.

Comment

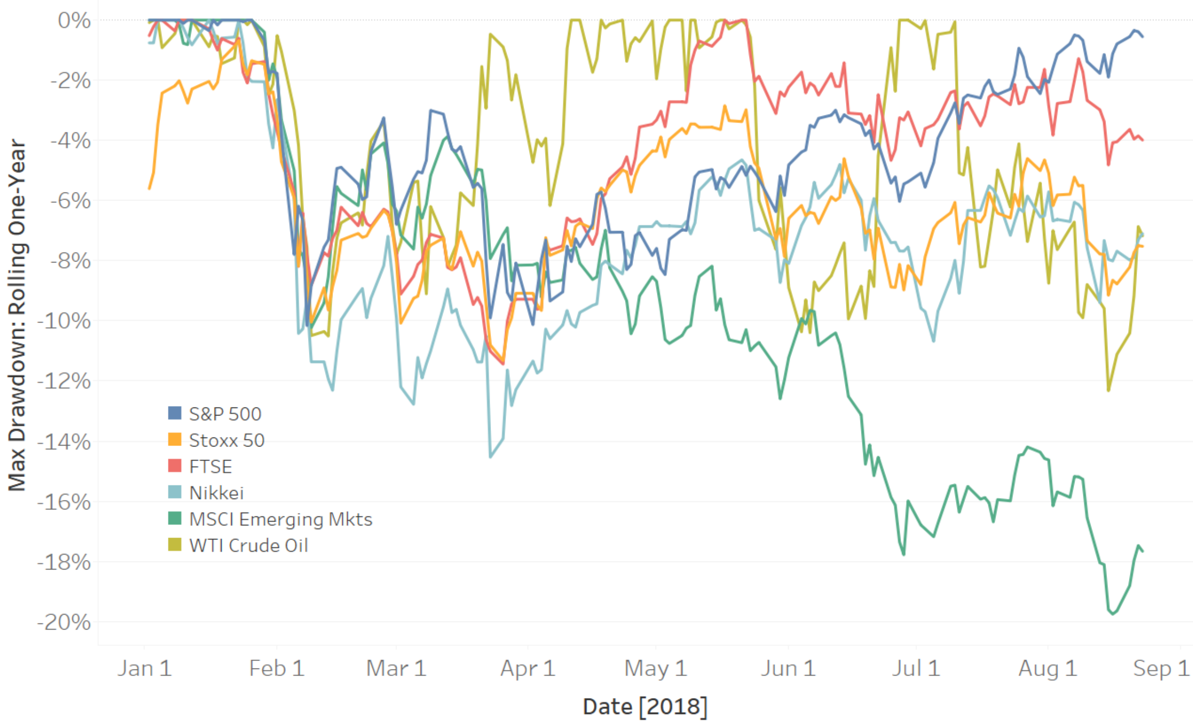
The buzzword of the past two weeks has been 'crisis,' even with little indication of contagion from Turkey's woes. The chart below shows rolling 10-trading day news trends for 'economic crisis' since 2014. The frequency of concern or alarm by financial media has hit a new high, beating out the Greek debt crisis and Brexit vote.



The euphoria of global synchronized growth coming into the year has faded, but markets have taken in stride currently isolated risks to the global landscape. The next chart shows drawdowns by major equity indices over rolling one-year periods.

Emerging markets have suffered most at -18%, followed by the Stoxx 50 at -7.5%. The S&P 500 is nearing a new all-time high.

Emerging Markets the Only Sore Spot



Data Sources: Bloomberg, LP

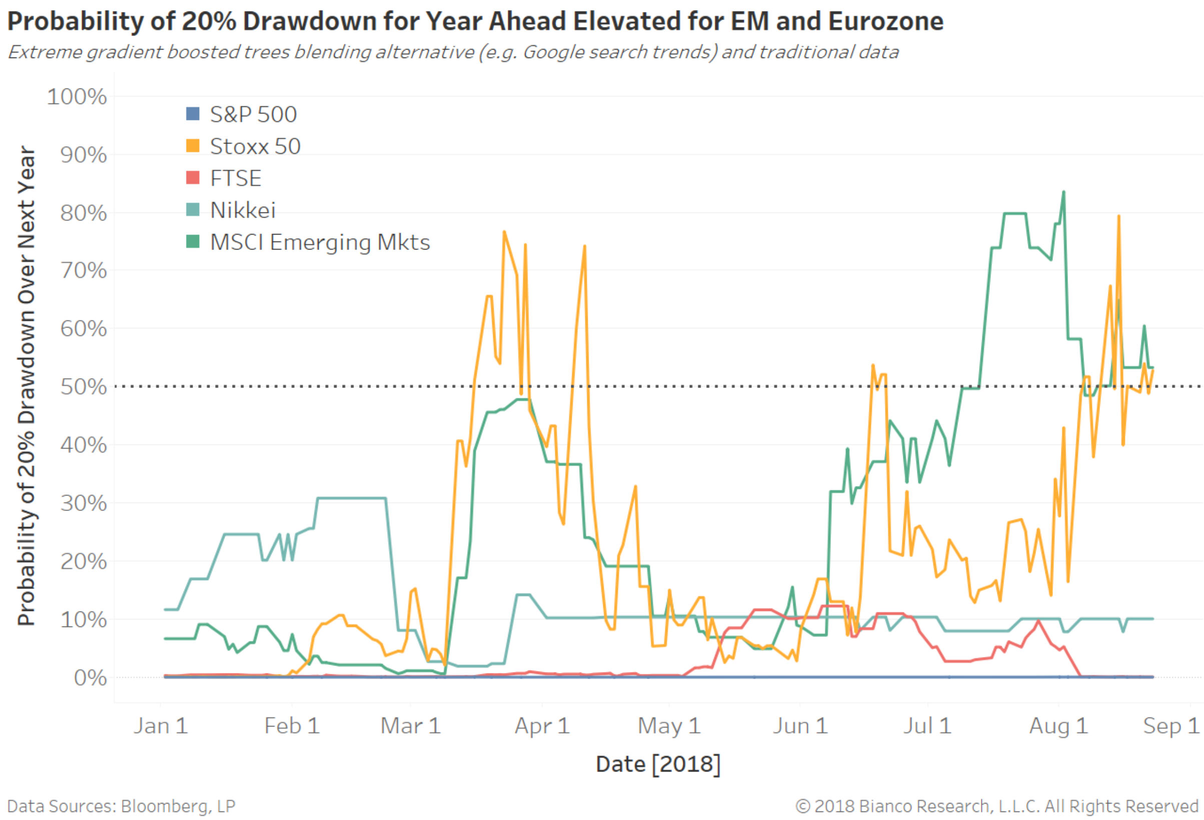
Instead of predicting recessions, we model for probabilities each equity index drops more than 20% within the year ahead. Inputs include the following:

- Global Google search trends for spending, credit, stress, and much more
- Economic data changes
- Economic data surprises
- Monetary, trade, and public policy uncertainty
- Central bank shadow rates
- Central bank rate hike timing

Probabilities are currently elevated for the MSCI Emerging Markets and Stoxx 50 indices at just over 50%. This should be of no surprise given their already sizable drawdowns. European banks are of course more sensitive to escalating risks out of Turkey.

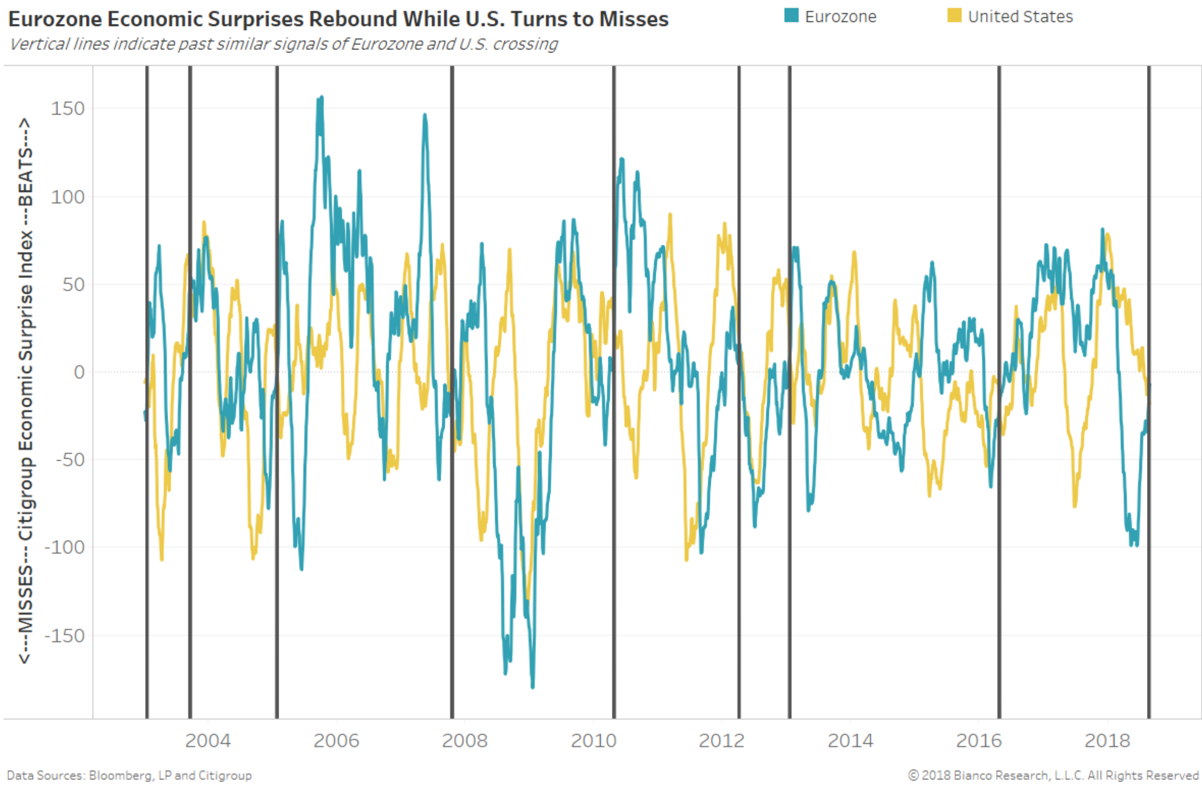
On the flip side, the S&P 500, Nikkei, and FTSE's probability of entering a bear market are well below 10%.

We would need 80+% probabilities of 20% drawdowns before becoming very concerned. For now economies are ready to converge, but this in no way implies a dramatic slowdown.

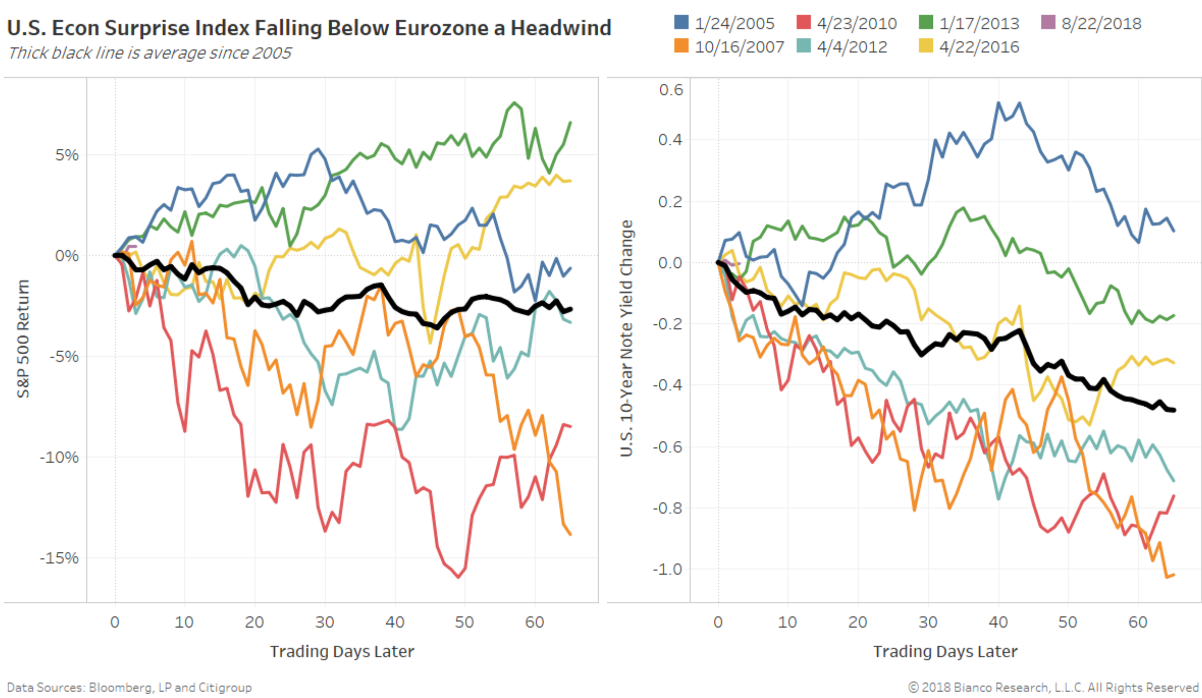


Risk of a sizable drawdown across U.S. equities is very low, but a turn to economic data misses suggests muted returns. The chart below shows U.S. (yellow) and Eurozone (blue) Citigroup Economic Data Surprise Indices.

We mark with vertical gray lines similar instances of the Eurozone and U.S. indices converging and then crossing. In other words, the Eurozone recoups, while the U.S. sees a string of misses.



The last set of charts shows S&P 500 returns and U.S. 10-year note yield changes after these past similar signals. Over the following month the S&P 500 and U.S. 10-year note yield have on average fallen 2.5% and 19 bps, respectively.



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