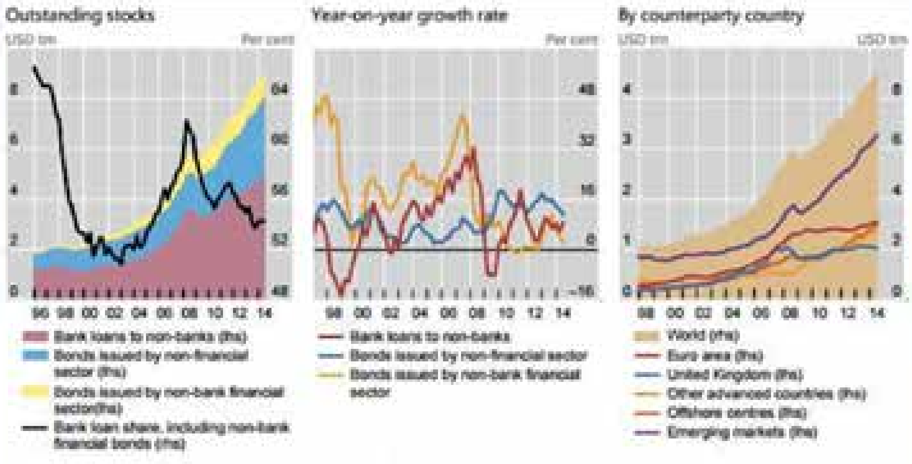
The Ghost In The Machine

Christmas 2015

ADM Investor Services International Limited

US dollar credit to non-banks outside the United States

Broken down by instrument and counterparty country — Graph 2



Notes: Bank loans include cross-border and locally extended loans to non-banks outside the United States. For China and Hong Kong SAR, locally extended loans are derived from national data on total local lending in foreign currencies on the assumption that 80% are denominated in US dollars. For other non-BIS reporting countries, local US dollar loans to non-banks are proxied by all BIS reporting banks' gross cross-border US dollar loans to banks in the country. Bonds issued by US national non-bank financial sector entities resident in the Cayman Islands have been excluded.

Sources: IMF, *International Financial Statistics*; Datastream; BIS international debt statistics and locational banking statistics by residence; authors' calculations.

to outflows from domestic markets, which would likely pressure (and indeed has pressured) local currencies, while all regions have some vulnerability to refinancing external liabilities, though in general these relate to FX, rather than interest rate considerations. As the old adage goes, managing an international bond portfolio is mostly about 'getting the currency right', rather more than any yield or duration considerations.

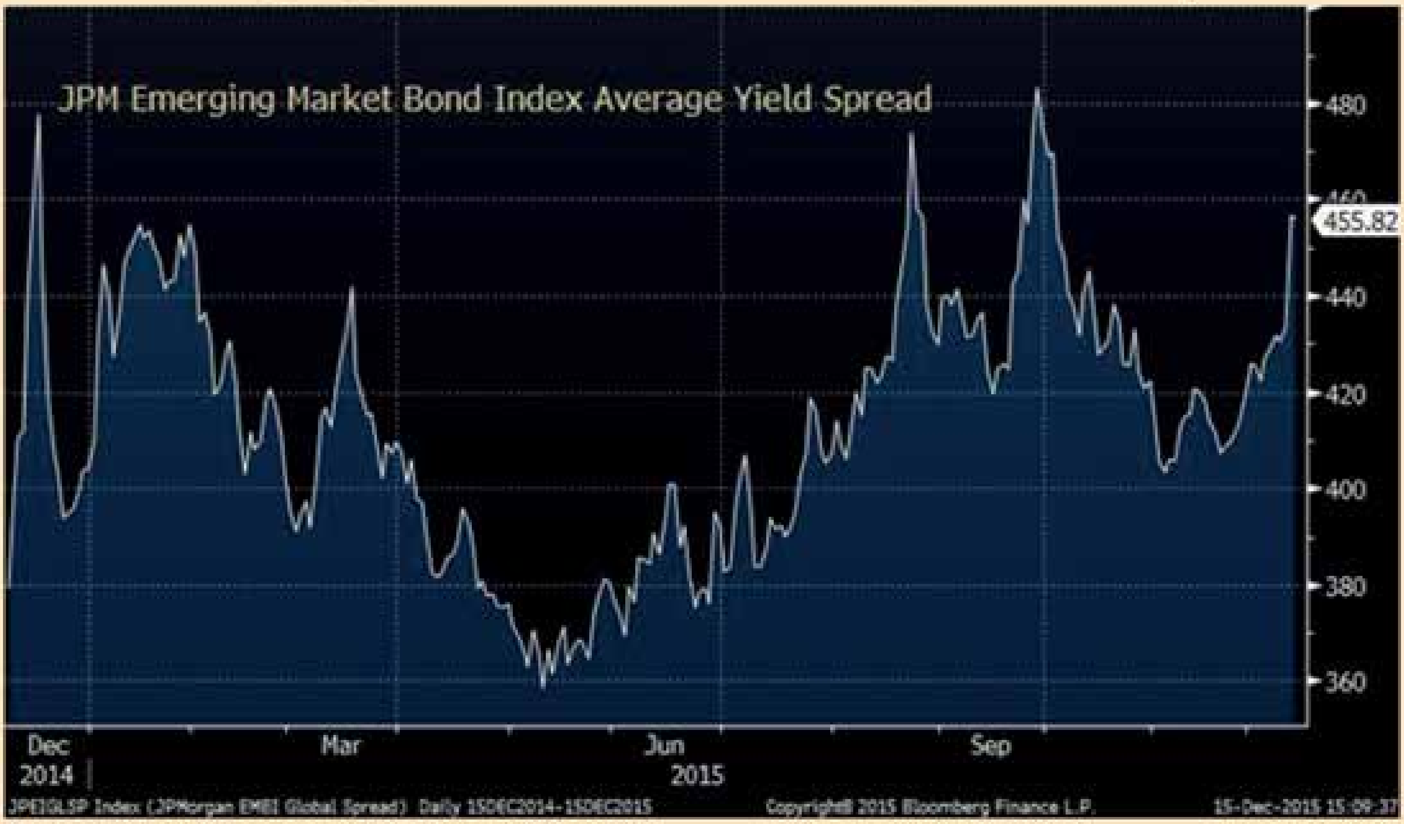
Clearly the term 'Emerging Markets' is a rather spurious 'catch all', which groups economies as diverse as South Korea, Mexico and India with Sudan, Ukraine and Venezuela. On the other hand, this also presents opportunities, particularly from the aspect of equally spurious and not infrequent 'pari passu' contagion effects, as per the largely unrecognised (un-complimented) moves by India and Indonesia to shift away from wasteful energy price subsidies (above all in budgetary terms), and the Mexican Peso's ordeals which appear to ignore a solid, though not stellar, economic performance, despite being tarred with an oil economy brush (NAFTA considerations being largely ignored in the process); even if this may owe a lot to a large 'consensus trade' unwind, against a backdrop of above average local market liquidity which contributed theretofore.

The key questions for 2016 in this vast array of the diverse and often non-correlated EM investment space (above all the spurious BRICS) may well not relate to the prices for primary resources, above all those for energy or metals, even if El Nino effects in the agricultural sector could well be very profound. But Latin America's most contentious borrowers, Argentina and Venezuela, both serve to underline the point that more or less auspicious outlook conditions for 'country relevant' primary resources are no replacement, or indeed counterbalance, to political instability and/or (gross) economic and/ or political mismanagement. The latter point also finds a mirror image in the GCC region, where the headwind of persistently lower oil prices has little to do with the cost of oil production, and far more to with associated budgetary largesse. This is not only associated with overly generous social benefits and any associated domestic (social) infrastructure development failures (one might compare the UAE with Saudi Arabia in terms of female participation in the labour force), but also with regional geo-political aims and associated military / 'defence' spending, perhaps most emphatically in Saudi Arabia and Qatar, and in a heavily differentiated fashion to the latter, Turkey. In the latter case a clear Trade and Current Account boost from lower oil prices, has been more than offset by both domestic political developments, and latterly by capricious regional interventions, which fly in the face of long established realities. Last but not least, one should never neglect the fundamentally well run non G-20 economies, whose solid credit ratings are well established, such as Chile and Botswana, as but two examples.

As per my initial preamble, 2016 would appear to be a year in which differentiation along national lines may be the most interesting proposition in any analysis of EM or rather "developing economies'" prospects, rather than the many other means of distinction, which have waxed and waned in popularity over the past ten to fifteen years. Nevertheless, it remains the case that the EM arena will be the biggest contributor to global GDP growth both in 2016, and for the foreseeable future, even if asset allocation will require considerable more thought and in-depth analysis.

Every picture tells a story...

JPM Emerging Market Bond Average Yield Spread



Source: Bloomberg

IBoxx US High Yield Indicies BB vs CCC

Source: Bloomberg

Economics & Politics

Economic Insights:

Stephen Lewis

e-mail: Stephen.Lewis@admisi.com

Tel: 020 7716 8256

A SEASON FOR REFLECTION

2015 has been a difficult year for investors. The reassuring regularities of the business cycle, which used to provide reliable signals for market action, appear to belong to a past characterised by other features now seemingly historical, such as inflation, positive risk-free nominal returns and the widespread conviction that the supply of credit is, and ought to be, unlimited. The realisation is dawning that the apparent prosperity of the decade–and-a-half up to 2007 merely reflected a credit-induced spending binge. Policymakers failed to recognise this at the time because of their obsessive focus on targets related to consumer price indices (CPI), where rates of increase were temporarily suppressed by the processes of globalisation. Consequently, their policies allowed, through the mediation of credit expansion, massive time-shifts in consumption from an as yet undetermined future. That future has now arrived, together with the shortfalls in demand created by those policy-induced time-shifts. Since the short-term expedients that central banks have adopted in response to the resulting deficiencies in demand have distorted capital market prices, investors feel unsure where value is to be found. The prospects are that 2016 will present even more challenging conditions for those seeking performance from their asset portfolios. The political and economic issues that surfaced this year seem set to stand in sharper relief in the year ahead.

What the past twelve months have revealed is how uncomfortable most investors feel when faced with geopolitical risks. To be sure, it had been difficult to ignore these risks ever since President George W Bush launched his 'war on terror' in 2001 but, it seems, international tensions have increased markedly since the early days of 2014 when turmoil erupted in Ukraine. Perhaps international political concerns have had a general effect in dampening expectations regarding future investment returns but, over the past twelve months, it would be hard to point to a significant market impact from any specific geopolitical event. Indeed, the strongest market reaction was to a shift in China's foreign exchange stance which was seen, rightly or wrongly, as carrying profound economic implications. Clearly, however, we are not living in the world that was envisaged after 1989, when the Berlin Wall fell. Shortly after that signal occurrence, academics were publishing books that suggested 'the end of history' had been reached. Even at the time, that seemed a large claim to make. After all, elections, revolutions, famines and wars were still going on, while these exercises in futurology were falling from the printing-presses. As their authors later clarified, however, they defined 'history' as the struggle between liberal, free-market socio-economic systems, on the one hand, and centrally-planned totalitarian structures on the other. It followed that what looked like the definitive triumph of one of these contending models must constitute the end-point of 'history'. Though this approach to understanding history seemed to omit a great deal, it was not without precedent. On the other side of the political fence, Karl Marx had maintained that war was a class-based phenomenon. Yet it would be stretching interpretations to justify such a claim. It would be difficult, for example, to make a case that the first well-documented conflict in history, between the ancient Egyptians and the Hittites, had much to do with class considerations. Human beings, it seems, can find a wide range of issues over which to fight and slaughter each other. In taking a view on what constitutes the essence of history, though, it is perhaps inevitable that we should adopt a perspective that reflects our preconceptions regarding what is really important in human development, irrespective of the objective realities.

The key practical point is that the 'end of history' gave rise to the notion that there should be a 'peace dividend'. This idea reinforced the economic optimism of policymakers during the 1990s. It encouraged them to err on the side of expansiveness when taking macro-economic policy decisions. However, the period since 2001, and especially the past two years, has shown that, whatever the 'end of history' is taken to mean, it did not justify cashing a 'peace dividend'. In some respects, indeed, the world appears more troubled now than it did before 1989. Consequently, the global economy may have to accommodate not only repayment of a peace dividend that was misappropriated but also diversion of resources, over and above that repayment, to strengthen internal and external security. Sooner or later, investors will arrive at a full appreciation of the implications that flow from adverse geopolitical developments. But their response will most likely proceed in piecemeal fashion, as and when company reports bring the bad news to their attention.

Another feature of the year now past has been the realisation that there are limits to what monetary policy can achieve. The confidence that Mr Bernanke displayed in his seminal speech on deflation in November 2002, when asserting that a central bank can always boost nominal incomes and inflation, is all but dispelled. There is, instead, much talk of the need for structural reform to assist central banks in their efforts. This theme is likely to emerge even more clearly in the year ahead, with Japan providing a test-case. There are dwindling hopes that the 'monetary arrow' of Abenomics will reach the Bank of Japan (BoJ)'s target of 2% inflation any time soon. All the same, and in a reverse of the position two years ago, the government is exerting pressure on BoJ, it seems, to desist from further easing rather than to intensify its efforts. There is recognition there that, in the real world, so many indirect effects influence outcomes (in this case, the damaging impact of a weak yen and rising import prices on household spending power and on the profitability of SMEs) that textbook monetary action is impracticable. Admittedly, the ECB will probably continue to trumpet the efficacy of monetary policy but that is because no other type of response to the euro zone's weak economic performance currently appears feasible. The policymaking structures are not in place for euro zone-wide fiscal action and structural reform. Only in the ECB does the euro zone find unity of purpose, for better or worse.

'Structural reform' was the buzz-phrase of 2015. There was a time, twenty years ago, when talk of structural reform was a way of broaching de-regulation of labour markets without immediately eliciting a hostile trade union reaction. The meaning of 'structural reform' has expanded since then. While labour markets are still a focus of attention for reformers in several of the advanced economies, product markets and infrastructure development are now also in their sights. The liberalisation of product markets through international trade agreements has been making halting progress but there are serious threats to the two major projects, the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership, from the passions likely to be released in a US election year. If either of these agreements hits the rocks, investors should regard it as a major blow to hopes of lifting world trade growth, which has ground to a halt in recent years. Prospects for infrastructure investment are probably better than those for expanding global trade, seeing that strengthening the productive capacity of the economy is one form of government spending that is widely approved. However, the time-lags between plans and action in this component of overall expenditure are characteristically long. The build-up in spending is likely to be gradual and will be more clearly evident in the latter years of this decade than in 2016.

Among the structural factors that have been attracting more attention in markets in recent times are demographics. The prospective impact of demographics on economic performance seems set to influence financial markets even more powerfully in the year ahead. For the past twenty-five years or so, the OECD has been warning that the advanced economies face a challenge to growth from ageing populations. Those of working age as a proportion of the total would, according to these warnings, inevitably shrink, raising risks of future labour shortages and of inadequate pension provision. In this respect, too, the future has arrived. Some policymakers, such as those in Germany, seem to believe they can avoid the worst of these problems by stimulating immigration. But, when judged in terms of national welfare and the ability to support government debt over the long term, merely maintaining or increasing the GDP misses the mark. The target should be to improve GDP per capita. There can be no assurance that immigration will generate an increase in GDP per capita; it would not, if the average output of immigrants were less than that of the existing population. Since denuding other countries, especially those in the developing sector, of their most highly-skilled workers is regarded as bad form, the most likely outcome of mass immigration in the short run is likely to be a dip in GDP per capita. Perhaps the unexpressed hope is that the fertility rate of immigrants will turn out to be higher than that of the indigenous population. Then, in the long term, there may be hope of halting shrinkage in the skilled workforce as the children of immigrants pass through education and job training.

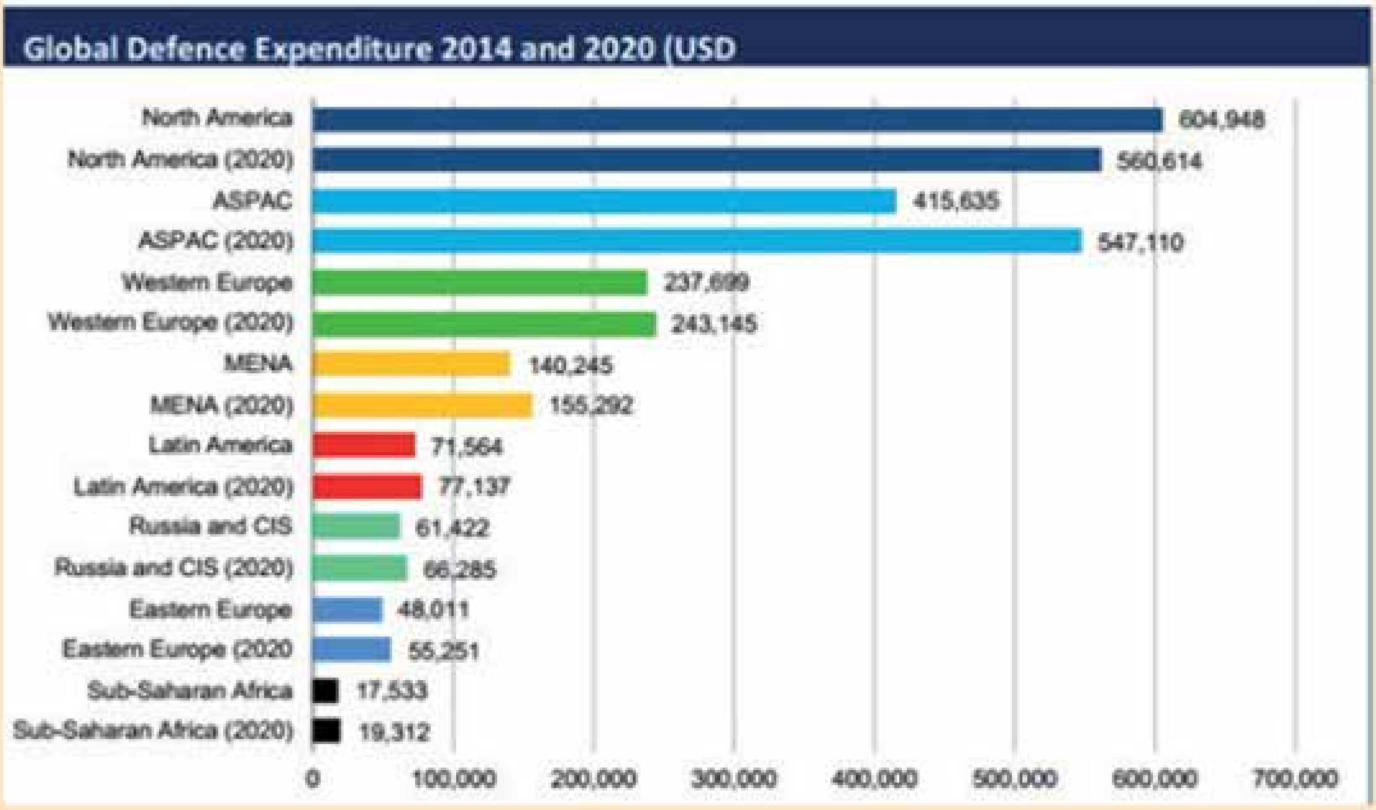
Another approach to the demographic challenge is to encourage indigenous women to bear more children. China took a step in this direction this year with the abandonment of its 'one-child policy' in favour of a 'two-child policy'. The Japanese government is also considering action, through improved childcare provision, to boost the birth rate. As with immigration, though, these approaches do not promise a quick fix. If successful, they would lead, in the short run, to a rise in the 'dependency ratio' (the proportion of non-workers, young and old, to the total population) and, hence, intensification of the demographic bind. In any case, there can be no assurance that loosening the practical constraints on average family size that may have contributed to low growth, or even contraction, in the population would result in significantly higher birth rates. Low birth rates in many of the advanced economies could also reflect shifts in social priorities which are unlikely to be reversed by purely economic measures.

But perhaps by the end of 2016 the demographic threat to growth will be seen in an entirely different light, if Mr Haldane, chief economist at the Bank of England, is right in projecting 15 million UK job losses from the spreading use of robots and IT in the provision of goods and services. There is increasing talk of an imminent 'Über moment' in financial services when a large proportion, a half or more, of the present workforce will be rapidly displaced by technology. It seems likely this will become a more immediate concern as 2016 progresses. To maintain social peace, governments may be under pressure to devise policies to redistribute income from those deploying the new technology to those newly unemployed who had never previously considered their jobs to be at risk. In these conditions, it may be an advantage for a nation to have a shrinking labour force because that might lessen the pressure on its government to adopt redistributive measures.

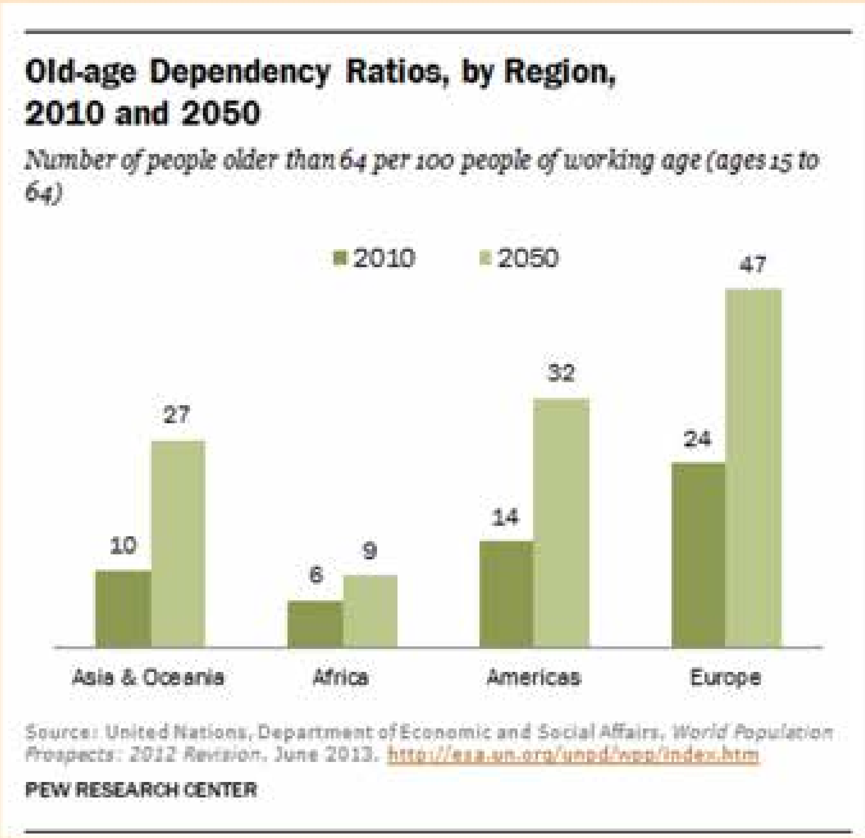
There is then plenty for investors to feel uncomfortable about as the New Year approaches. Reasons for concern go well beyond the current settings of macro-economic policy. Optimists may draw inspiration from the likelihood that a period of rapid political and economic change, such as the present, offers unusual opportunities for profit as well as the threat of unanticipated losses. But the prizes seem unlikely to go to those who continue to see the world through a prism that was already timeworn as 2015 opened. Indeed, investors are likely to have much more to think about in 2016 than the follies and foibles of central bankers.

Every picture tells a story...

Global Defence Expenditure 2014 vs. 2020 projection



Old Age Dependency Ratio



Coal in OPEC's Stocking

Steve Platt and Mike McElroy

+001 877-377-7931

Stephen.Platt@archerfinancials.com

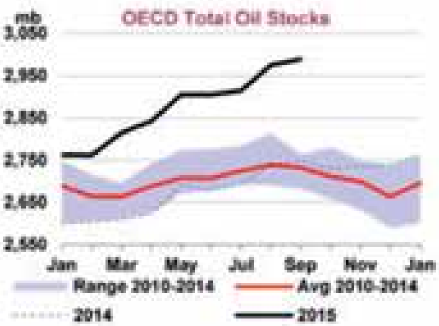
Mike.McElroy@archerfinancials.com

The failure of OPEC to restrain production at the meeting that took place December 4, took its toll as WTI values fell through the recent prompt low of 37.75 attained in August. The weakness reflects the realization that without the Saudis acting as the swing producer to offset the unfettered production of other OPEC producers such as Iraq and Iran, OPEC as a price setting cartel is basically non-existent. The organization, in the absence of a OPEC production target will be and instead will use the marketplace and low prices to force out marginal high cost producers. The market is now subject to the basic laws of supply and demand, which dictates that price be the final arbitrator of what makes economic sense.

These adjustments have been slow to develop despite the sharp fall in prices over the past year. The high prices dictated by the cartel in years past are now working against the market by slowing the adjustment process due to the over-investment that had taken place in not only petroleum but substitutes as well. The over-investment has caused imbalances that have been slow to reverse as indicated by the progressively lower prices.

Source: DTN Prophet X

For now it appears that 2016 will be a transition year. Whether prices need to fall much further remains to be seen. Certainly a key area of support basis the nearby will be at the 33-35.00 level, the lows reached in late 2008. A limiting influence on any strong recovery in values will be the record high stocks of crude which



will take time to be worked off. In addition, sluggish economic growth in emerging markets remains a concern given that these markets had been the major engines of growth prior to 2015. Despite the negative tone, we still see some positives for the Crude Oil market.

Source: IEA

- Although there is talk of the potential for Iran to increase exports by up to 1 mb/d once sanctions are lifted, we suspect that some of this oil is already flowing into global markets through Iraq.

- Reports that the Chinese are willing to increase their strategic reserves in the coming year.

- Possibility that some producers will build additional storage capacity to hold excess supplies, helping take pressure off nearby prices.

- The continuation of a low price environment that will encourage an expansion in demand for petroleum products and conversely limit the expansion of alternative energy sources.

- Hope can spring eternal with another OPEC meeting scheduled for May. Will the suffering be enough for producers other than Saudi Arabia to make concessions?

- A big question is whether some producers have reached their maximum output potential, particularly Russia and Saudi Arabia. Certainly budgets are straining to cover deficits and support investment in new production at current levels not only in these areas but in the US as well.

- Another consideration are the downstream assets that turn crude into products. Capacity additions have taken place in Saudi Arabia and the Far East but the question remains as to whether the increases are enough to match expected growth in demand from the lower prices.

From a price perspective, the flat price for crude is unlikely to make considerable downside progress much below the 33-35.00 area basis spot. The realization that prices will remain at lower levels longer than what had been anticipated should encourage further cuts in capital expenditures straining crude oil production going forward. Until the large inventory overhang begins to fall, upside price potential is likely to be limited as recovery rallies attract fresh selling by producers toward the 45.00 range. If anything products and particularly gasoline should attract the best support. High capacity utilization and further gains in product demand amidst limited refining capacity should help maintain and improve margins or cracks on

Source: DTN Prophet X

refining operations and to a lesser extent flat prices. The May Gasoline crack should attract good support on pull-backs toward the $18 per barrel level and potentially see values improve toward the 25.00 area as low prices and an improving economy attract demand to gasoline when US refinery capacity is limited.

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Global Metals Comment

Boxing day looms as Christmas comes early for Copper consumers.

Edward Fremlin-Key & Jason Geddis

e-mail: Edward.Fremlin-Key@admisi.com and Jason.Geddis@admisi.com

Tel: 020 7716 8081

It is a few years since the LME floor enjoyed the Christmas pantomime, when the brave and brilliant stood in front of their peers, mocking their friends, the market makers and the markets in order to entertain those still there trading on Christmas Eve.

All the while balls of hard cotton wool were being thrown across the ring, mimicking snowballs ready to hit your friend or foe and all before the Christmas raffle was drawn. For the clerks the raffle was the opportunity to take home a nice bottle of Christmas cheer, often one that had not been tried before, none the less a happy addition to the oncoming festivities.

These markets are but a memory now and nostalgia will not bring them back, reminiscing is often done through rose tinted spectacles, and in this case I am sure they are. It is easy to believe there was an innocence lost between then and now, the truth is the markets and their participants are little changed.

Those that remember the green screens, the hoot and holler and the point to point will be quick to remark otherwise when we consider the technical advances that have been made.

The traders hunger for power, control and profit are the dominant and unchanged characteristics we speak of here, in the survival of the fittest commodities traders are formidable opponents. Those showing the slightest weakness quickly become the prey of the strongest participants.

The carpetbaggers investing in a quick profit in the recent commodities bull run are now ripe for the picking. As seen earlier this year when Saudi Arabia would not cut oil production to bolster prices, leaving the over-extended fracking start-ups on their knees as debt repayments eroded any sensible chance of profit.

Comparisons are now being drawn in the copper market as Codelco sit holding the aces. Even at a loss other producers with over extended credit need to fulfil their market commitments, continuing to sell in to a market returning little or no premium. With workers protected by the unions and deals struck when the rally was in full swing, for many it will be more expensive to cut costs, lay off workers and idle production than to continue producing metal in this oversupplied market.

The Codelco advantage is multi-faceted as the weaker peso and reduced energy costs bring the cost of production for the Chilean state owned miner in at a discount of 25% to LME the price. Physical premiums add another $98 to the price, although this does cover cost, insurance and freight. The rich streams of copper at Codelco's disposal also offer various by products that yield additional income.

It's not all great for news for Codelco though, as earnings fell 47% Jan-Sep. Their response to the situation may have surprised some though, as at a time when others are mothballing smelters and closing plants they have slightly increased production through the same period.

Aggressive fund short selling is once again pushing the LME copper price lower and subsequently increasing the calls for Codelco and other producers to make cuts in production. With the latest news from China that copper imports jumped in November to a 22 month high, traders, financiers and consumers will remain eager to take advantage of the lower price. Those vested in seeing higher prices may find little solace from the major producers.

While the Chinese government looks at ways of curbing the heavy short selling its commodities fund undertake, it cannot argue with the fresh level of demand that the lower prices are attracting. The inbound shipments of copper and copper products rose 9 percent from a month earlier and were 10 percent higher than the same month last year. Ore and concentrate imports jumped 37 percent from October to 1.44 million tons.

With the shorts already appearing nervous on the slightest rally it will be difficult for them to contain the price if a fundamental cut in production takes place. As the smaller participants fall by the way side it may just be enough to keep Codelco from slowing production, more diversified miners suffering from the iron ore glut, are saddled with large debt and they may be forced to take the cuts necessary for their own survival

It also has to be remembered similar cuts made in other commodities have done little to hold the price up for long. As we fast approach the year end let the pantomime begin.

‘The Ghost in the Machine’ Editorial Team’

Editor in Chief	Stephen Lewis
	Andy Ash Paul Mylchreest Marc Ostwald
Digital Editor & Creative Design	Andrew Gibbins

Howard Jenkins

e-mail: Howard.Jenkins@[illegible]

Tel: 020 7716 [illegible]

Did you know... this about Sugar?

1. Sugar is one of the world's oldest ingredients. The people of New Guinea were most likely the first to domesticate sugar cane around 8000 B.C.

2. In the 16th century, a teaspoon of sugar cost the equivalent of £3.50 in London which is around £1.4 million per tonne (currently 1 tonne of white sugar valued around £275)

3. The word "sugar" originates from the Sanskrit word sharkara, which means "material in a granule form." In Arabic, it is sakkar; Turkish is sheker; Italian is zucchero; and Yoruba speakers in Nigeria call it suga.

4. Lemons have more sugar than strawberries

5. The only taste humans are born craving is sugar

6. Christopher Columbus introduced sugar cane seeds to the New World (Haiti) on his second voyage in 1493

7. About 70% of all sugar produced is used in its country of origin. More than 100 countries produce sugar commercially

8. Brazil is the world's largest sugar producer

9. India is the world's largest sugar consumer

10. According to brain scans, sugar is as addictive as cocaine

11. There are many different types of sugar. Six most common: Glucose found in Fruit and Vegetables. Fructose found in fruit and honey. Galactose found in milk products. Sucrose found in table sugar. Lactose found in milk products and Maltose found in malt products.

12. Sugar can be used to make oral rehydration solution (ORS), which can help prevent dehydration in children who have infantile diarrhoea or vomiting in developing countries.

13. Sugar is sometimes used in the production of cement.

14. Brown sugar can be used very effectively to clean skin and pores

15. Sugar from sugar cane and sugar beet is identical

16. Sugar is the main component of the fuel used in rockets by amateur rocket enthusiasts. If you burn sucrose with some corn syrup and saltpetre, you get sugar propellant, which is used to power small rockets.

17. Sucralose, now sold in the shops as Splenda, was discovered by scientists trying to create a new insecticide. Apparently, a research assistant who misunderstood his instructions to test the new compound thought he had been told to taste it. He discovered that it tasted sweet.

18. Tooth decay isn't caused by sugar; it's caused by the bacteria that feed off the sugar. These bacteria will actually feed off any carbohydrate, so starchy foods that can get stuck to your teeth can be just as damaging.

19. Children are sometimes prescribed a sugar pill marketed under the name of 'Obecalp', for minor complaints. When a doctor prescribes 'Obecalp', a pharmacist knows exactly what to do. Just read the name backwards!

20. Some people say that one teaspoon of sugar swallowed "dry" can cure the hiccups

21. Sugar cane can reach 30 feet high

22. Sugar prolongs the life of fresh cut flowers

23. The largest sugar refinery in the world is the Al Khaleej refinery in Dubai.

24. In 2001 scientists discovered sugar in outer space.

25. The UK Sucrologist Club has more than 200 members, who all like to collect the little packets of sugar you get when you order tea or coffee in a café or restaurant. They write a newsletter and visit sugar-producing companies. Some sugar makers now make interesting sets in the same way that stamps are issued to attract collectors. www.uksucrologistsclub.org.uk

Modern Gifts for Modern Magi…

Eddie Tofpik

Head of Foreign Exchange

e-mail: Eddie.Tofpik@admisi.com

Tel: 020 7716 8201

~~Gold~~ Bitcoin, ~~Frankincense~~ Heating Oil and ~~Myrrh~~ Sugar

OK…this is how the conversations went…
'…Eddie…for this coming December edition we'd like it to be a little more lighter…end of the Year, Christmas and all that...'
'…OK! I can do that. How about something updating the Three Kings story but with modern equivalents to gold, frankincense and myrrh plus maybe three new identities for the Magi?'
'Good, good…but please….no pictures of passports on barbed wire or men with hammers…'
'I was only trying to make a point at the time with the pictures that emphasised the text'.
'Yeah well, there seemed to be a theme coming through…so no pictures of ISIS flags this time or anything like that…OK!'
'….how about rubber ducks….?'

So dear readers, this started a train of thought which led here – if there were Modern Magi, what would they bring and who would they be? Starting with commodities - well, for Gold I've an easy simple answer – Bitcoin! I've harped on in print and TV as recently as this past November on Bitcoin being '…the modern equivalent of gold...' and '…a medium of exchange and a store of value'…blah, blah, blah. That job is done though as the saying goes, the value of BTC versus USD may go down as well as up…so a little financial caution and advice would be necessary. Next there was Frankincense.

Now I have some (limited) experience of Frankincense as my wife organised a large scale church nativity play where she actually managed to obtain samples of Frankincense and Myrrh…I don't know what happened to the Gold…but anyway. The Frankincense she had was in the form of oil, nice smelling but strong. So what could I use that was an oil…and strong…a strong oil – of course! Crude Oil! No…better yet, a refined version…Heating Oil (aka Paraffin or Kerosene). That would be something that could be used for heating, lighting, even some automotive power at a pinch and also be traded in hard times. There would be downsides, storage could be dangerous as well as cumbersome. Nevertheless, it would have value and so I'll add it to the Magi list. So next we have Myrrh…

The example of Myrrh I have seen seemed to be crystalline and I later found out it was the resin or sap from specific trees or bushes. So…difficult one this one, what sap of a tree or plant is crystalline…of course – Sugar. This had added poignancy as I recalled in my Eureka moment past family talks about hard times under Communism in Poland and the scarce value of Kilo bags (as were Jerry cans of petroleum products). Apart from its obvious food uses, kilo bags of Sugar were used as a means of payment or as gifts. So Sugar it is for Myrrh! There is also a downside (which impacts, upon reflection, Paraffin as well). Eventually it goes off…but in the case of Sugar, it could still be used as animal feed. Not much use if you have a Land Cruiser or a Land Rover for transport but then you could swap the Heating Oil for Gasoline.

So there you have it, after some thought I've perhaps three modern equivalents for the traditional Gifts. However, this leads to two other questions.

The first – how much? How much should a Modern Gift be? Well, there is some guidance in this – one of the principle measurements of ancient times was the Biblical Shekel. It was uncertain what its exact weight was in earlier time but from about the 2nd Century BC it was 218 Grains (or 15.126 Grams). Therefore a Biblical Shekel of Gold would at current prices (USD 1058.00/toz) be about USD 515. Convert this into Bitcoin (BTCUSD = 355.52) and it would be a gift of about BTC 1.44858 – I am assuming the electronic wallet and electronic device holding the wallet are thrown in for free.

Working out the quantity needed of Heating Oil and Sugar is a little more difficult. However, courtesy of numbeo.com I'm able to do a comparison of the cost of living between London & Ramallah, Administrative Capital of the PNA and as close a proxy as I could think of. Price of Gasoline there would be 4.26% higher at 111.5 pence/litre compared to the UK's 107.0 pence/litre. Consequently, Price of Heating Oil ought to be 4.26% higher than the current UK average of 32.0 pence/litre (courtesy boilerjuice.com) at 33.4 pence/litre loco Ramallah. So - taking all this into account, a Biblical Shekel's worth of Heating Oil today would be about 1,025 litres – a decent amount for any domestic storage tank and well within the towing capacity of a Land Cruiser, Land Rover, etc…

Finally we come to how much Sugar. Price comparison of groceries indicates on average 22.68% lower prices in Ramallah than in London so approximate supermarket White Sugar here at 48.0 pence/5 kg bag equates to (one would hope) about 37.11 pence/5 kg bag there or about 1,790 kgs of White Sugar… still within towing parameters.

All this is fine and dandy plus interesting in a geeky, mathematical economist sort of way as well as a bit boring I can hear you say. OK – here comes question two – who'll be our Modern Magi? You've had Bitcoin, Heating Oil and Sugar replacing Gold, Frankincense and Myrrh – who is going to replace Melchior, Gaspar and Balthazar? I think it ought to be related to the New Gifts I've planned and it ought to be known, somewhat charismatic modern figures. Why don't we try the following – for the bringer of the Gift of Bitcoin – Satoshi Nakamoto! Yes, I know this is a pseudonym for whosoever but as the 'named' inventor as such of Bitcoin/Blockchain it would be fitting and ideal…especially as all this is a hypothetical situation anyway.

Bitcoin was easy but Heating Oil…..not so easy. Maybe someone internationally known in the energy industry and ideally recognised outside of it – not easy, but upon researching a little, one name stood out that that might fit – Roman Abramovich – former owner of Russian oil company Sibneft and current owner of Chelsea Football Club. I think it does fit as it has my kind of symmetry - he often travels West to follow his (tarnished?) Chelsea stars.

Finally, we have Sugar. Now I pondered on this for quite a while until by pure serendipity it occurred to me – Sugar – Alan Sugar of course, or to address him correctly The Lord Sugar, the well-known entrepreneur and host of the UK TV series 'The Apprentice' (not to be confused with the other guy). I think this fits & rounds things off nicely.

However, this last addition brought up a small problem. The original Magi travelled from the East. Modern Magi should also travel from the East. Now you can argue Satoshi Nakamoto may originate from Japan (or Australia)– East for sure whilst Roman Abramovich has been Governor of Chukota Administrative Division in Russia, you can't get further East in Russia if you tried. However, what about Lord Sugar? He's from London! The answer is simple! He is indeed from London, from Hackney… the 'East End' of London – cushty!!!

A beautiful and happy Christmas to you all dear readers plus a glorious wonderful start to the New Year of 2016. I leave you with my personal Three Gifts for this Christmas Season – Love for those all around you, the Will to help others and Time to make it so. Merry Christmas & I'm happy to settle for the ducks instead of the ISIS flag.

Matt Lelliott
e-mail: Matt.Lelliott@admisi.com

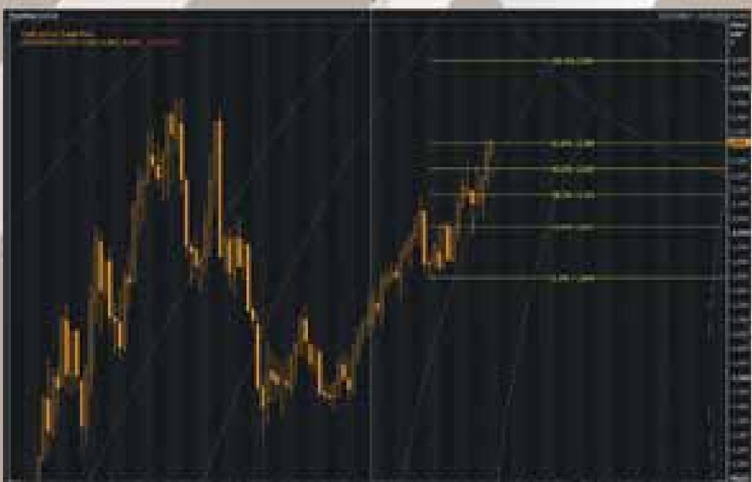
Tel: 020 7716 8485

Cocoa Trading
Hot Chocolate!

Hot Chocolate!

And by all accounts the market agrees.
One could argue that a recent love affair with Cocoa has been ongoing since late 2011 from where a significant uptrend has developed. Subsequently prices have raced higher towards 4 ½ year highs on the London and US ICE Cocoa markets and would appear quite the "darling" currently to the speculative investment community as Cocoa appears to be a striking stand out commodity amongst its peers by being 13% up on the year in comparison to the broad commodity GSCI index being down over 25%!

London 2nd month Monthly chart continuation
Aside from being one of the World's favourite tastes and an obvious Christmas season favourite the real spur for higher prices have come from accelerating global demand and the current suspicion for production deficits developing going forward. Growth in demand have strongly rebounded from lows seen in the post Financial crisis with the mature markets of western Europe and North America economies bouncing back to the sustained but relatively small percentage long term growth values whilst the emerging markets, especially those of the Far East, Eastern Europe, Brazil and the Middle East have been promoting strong double digit growth over the years to sponsor deficits and the erosion of stocks. This growth in demand has to a certain extent being compensated for by higher origin production but has not necessarily been fully met which has subsequently led to a long term advance of market and retail prices reflecting the long term growth trend.



Such has been the advance of prices over the last few years that a theoretical possibility of a 1 million tonne deficit by 2020 that was suggested by a major manufacturer was seized upon by the media and then by the popular press to suggest that the world was about to run out of Chocolate any time soon! Shock, horror!……Obviously, although high, prices don't yet suggest the necessity and need to rush out to stock up for the predicted and impending Chocolate Armageddon!

Perversely, may be one should just sit back, relax and savour the taste (albeit slightly more expensive) over the festive season?
On face value, recent prices rises seem set to continue higher, having challenged the recent 4 ½ year highs and might yet be set to replicate the heady days of the so-called "Chocfinger" rally of 2010, where all available tenderable stock was taken up by a London Trade house. Prices appear set to continue and make progress over and above those values on anticipated and increased production deficit. The production deficit is perceived to be centred on poorer West African output, particularly from the No 1 and 2 biggest global producers in West Africa from the Ivory Coast, Ghana, as well as Indonesia. The anticipated forecast of a significant deficit comes from a general suspicion that following back to back bumper harvests to date, there may well be some tree production fatigue, which appears to be pertinent to the surprise sharp decline in Ghana's production of the 2014/15 season. Production concerns have been further compounded by a very tangible and significant dry spell across West Africa in August and September of this year, which occurred at a critical juncture of the West African main crop development. The dry spell is also being directly correlated to a subsequent downturn in exporter

estimates of weekly bean arrivals at Ports which now appear to be tapering lower from a strong early seasonal start, which may in turn develop to progressive failure of crop outturn to match that of the previous year. Bullish arguments are further accentuated by the El Nino weather pattern which is due to peak in the Northern hemisphere winter/ spring and is anticipated to further compound potential weaker production output globally? This in turn has ratcheted up concerns going forward for the West African crop as we now enter the seasonal dry season which will impact to a lesser or greater extent with the drying "Harmattan" winds from the Sahara. Whist Indonesia itself additionally, has a well-known and readily identifiable correlation to dry weather and El Nino.

All this makes for a powerful mix of potential bullish fundamental and technical factors that has led to an overall and sustained higher price trend that has been further exasperated by an influx of "smart money" following the trend strength whilst being ultimately underpinned with the Industry purchases to support values in order to maintain and attempt to extend their ongoing forward price and physical cover.

Will there be a fairy tale ending and a merry Christmas for the specs?

It's looking good up to now with only limited corrections to date but it is not necessarily a given, inasmuch that the seeds of a possible decline have possibly already been sown? One might need to refer back to the old adage that "the best cure for high prices is high prices". Already we have seen the Industry go through significant exercises of raising retail prices and re-formulating, re-packaging and sourcing alternatives in order to compensate for higher underlying prices. Whilst the recent higher prices have already started to impact on the current processing margins of taking raw beans and processing this to cocoa related products such as Powder and Butter, which has been made even tougher on the back of strong gains of the Dollar but especially the weaker Euro with which a high degree of global cocoa is managed. Indeed the recent spate of poorer quarterly results from global Industry and processors stands testament to the tough trading environment that the commercial elements of the market are currently facing. Whilst the higher retail costs that are being passed onto the general individual consumers is apparently weighing on demand, never the development and environment of healthier eating habits and an increasingly more likely regulated control for sugar intake, advertising and retail promotions?

Perhaps the most tangible element at hand that could impact ongoing strength of market prices is the current highly developed long speculative position already in place. London according to the latest commitment of Traders report shows a new recent high of 88,871 managed speculative longs! This represents the highest record long since London figures were compiled back to 2011 and pips the recent high in July 2015 which saw a similar extended bull run higher which appears to have ultimately curtailed its advance and consolidated quite sharply subsequently.

This also falls happily within a raft of other circumstantial elements of perceived technical overbought conditions that come into play whilst a background of chart action makes for compelling theories to suspect that the market may yet also be within the advanced aspect of an ultimate 5th leg up on an Elliott wave, which has similar connotations to the high experienced in 2010 where the strong price advances ultimate paved the way and stimulated a substantial production spike reaction to higher prices, which ultimately led to a significant decline in the subsequent year.

Going forward, the current reality of the market is that we are running sharply higher on a perceived threat that has not yet crystallised to promote a significant sizeable deficit. The market appears to have conveniently ignored the pressures on current demand, a significant sharp increase in rainfall for West Africa during October and November, which while it may not make up for a sensitive growth point for the crop at least puts the soil moisture in good stead ahead of a normal and seasonal dry spell, perhaps even risks improving the tail-end of the main crop arrivals and may ultimately being beneficial to the start of the mid-crop. A lot appears to be riding on whether or not an intense seasonal dry spell with an assist from El Nino impacts the market over the next couple of months as a confluence of factors merge to either make or break this crop.

One thing seems certain, is that the ultimately the Cocoa market is likely to remain Hot!

Equities Are Awesome

Paul Mylchreest

e-mail: Paul.Mylchreest@admisi.com

Tel: 020 7716

Christmas Selection Box

I have almost magical, but slightly hazy from the passage of time, recollections of Christmas mornings in 1970s. Almost without fail, there would be a Selection Box containing five or six bars of chocolate and packets of sweets.

If memory serves, they were usually from Mars rather than Cadbury's (not sure why) and contained a Mars bar, Marathon (renamed Snickers these days), Twix, Milky Way and Treets…which were all great…as well as the slightly disappointing packet of Spangles. I'd usually eaten all of them (Spangles apart) by lunchtime.

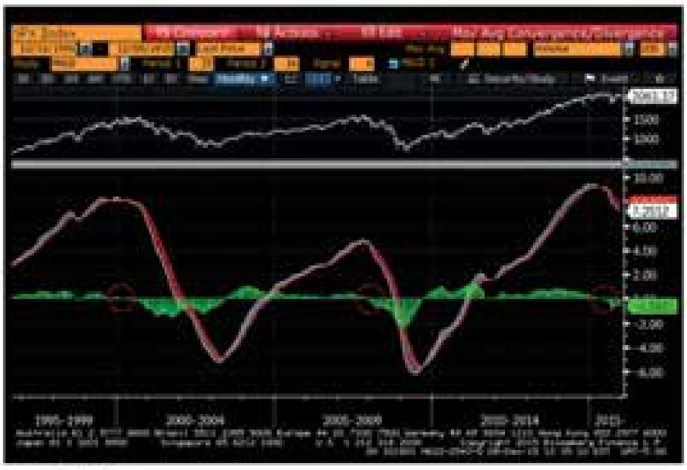
In keeping with the concept of a selection box (kind of), I thought I'd just mention several issues at the forefront of our current thinking. Whether they are consumed as a Mars bar or a packet of Spangles we leave to our dear readers.

Let's begin with the equity market before moving on to Emerging Markets (EM), the dollar, the Fed and credit markets and, finally, a new signal in precious metals.

From our research, crossovers in the monthly adjusted MACD indicator (using exponential moving averages of 25,26 and 6 days) was the best one we've found at calling the tops of the two previous bull markets in the S&P 500:

- One month before March 2000; and
- Two months after October 2007.

In the current bull market, it gave its first sell signal (see red circles in chart below) rather presciently at the end of June 2015 and remains bearish.



Source: Bloomberg

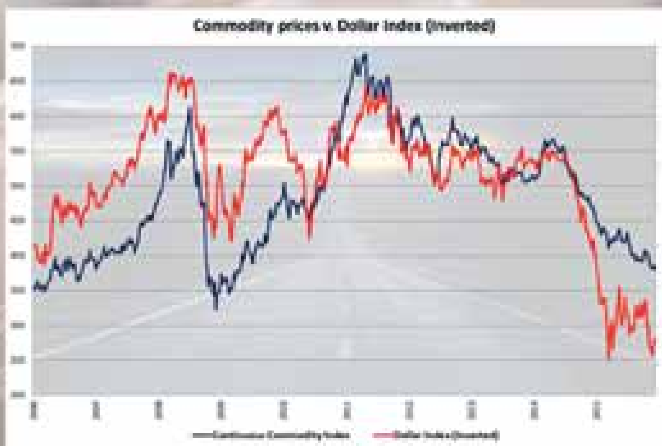
With dollar strength, weak commodity prices and the deflating of China's credit bubble, EM economies have been major drivers of lost economic momentum. My colleague, Lee Heyman, noticed that declines in the EMB – iShares/JPM USD Emerging Markets Bond ETF – have generally been leading the S&P 500 for well over a year.

Source: ADMISI, Bloomberg

We expect EM equities are going to retest and likely penetrate the summer 2015 low.

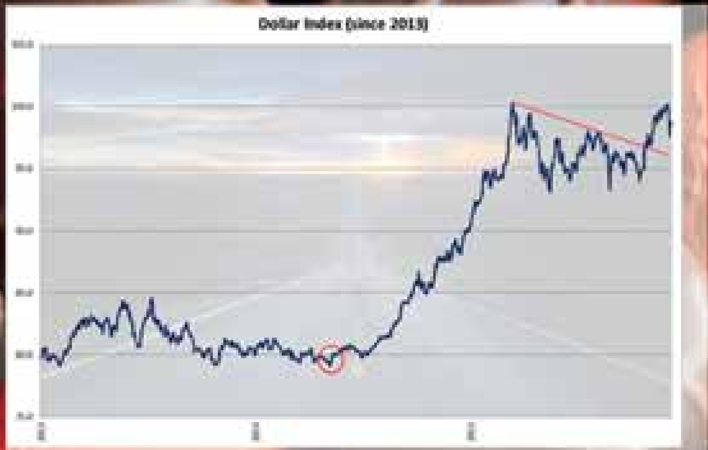
Source: ADMISI, Bloomberg

One potential bright spot for the EM world would be an easing in the deflationary pressures, but further strength in the dollar could frustrate this.



Source: ADMISI, Bloomberg

In our recent reports, we have focused on the central role of the dollar in the global macro outlook and the growing shortage of dollar liquidity in dollar markets outside the US., i.e. Eurodollars.



Source: ADMISI, Bloomberg

The background to this Eurodollar problem is the more than US$10 trillion of offshore dollar (Eurodollar) debt. The sheer magnitude of this Eurodollar debt is a relatively recent phenomenon, having risen more than 70% since the crisis.

It is being exacerbated by the growing reluctance of the major Eurodollar banks (basically many of the "too big to fails") to provide dollar liquidity in terms of balance sheet capacity, credit lines, etc, due to tighter regulatory requirements and more risk-averse strategies.

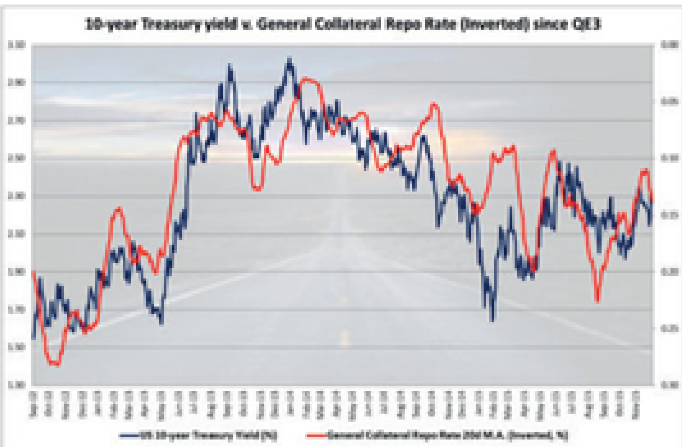
This is making the rollover of shorter-term dollar funding in wholesale money markets more difficult. The maturity mismatch is also frequently working in tandem with a currency mismatch. In essence, there is a "run" on Eurodollars and growing pressure on dollar liquidity more generally, which also stretches deep into shadow banking markets. Cross currency basis swaps represent the cost to banks of swapping deposits from one currency into another currency versus covered interest parity. For example, the more negative the Euro/USD 5-year basis swap, the stronger the desire on the part of banks to swap Euro deposits into US dollar deposits.

Source: ADMISI, Bloomberg

China is a focal point for Eurodollar illiquidity and is caught between a proverbial rock and hard place with the Renminbi. Headwinds for the Chinese economy are considerable as the leadership unwinds the worst excesses of an epic credit bubble while, in part, outsourcing monetary policy via the peg to a central bank with a tightening bias (the Fed).

As Eurodollar liquidity tightens, China can allow its banks to bid more aggressively for dollars and weaken the Renminbi, or use its dollar reserves to help rollover dollar funding. By providing dollars to the banks in exchange for Renminbi, the PBoC would be tightening domestic monetary conditions, i.e. bank reserves would decline.Our contention has been that if China continues selling dollar reserves to fund the dollar short in the banking system, it will likely hurt the domestic economy at a time when growth was already under considerable pressure.

In this situation, a rise in short-term dollar interest rates is unhelpful. The Fed is poised to raise rates using its Overnight Reverse Repo (ON RRP) facility for the first time, which will extend its reach into money and shadow banking markets. Since QE3, there has been a near perfect negative correlation between repo rates and long-term Treasury yields.



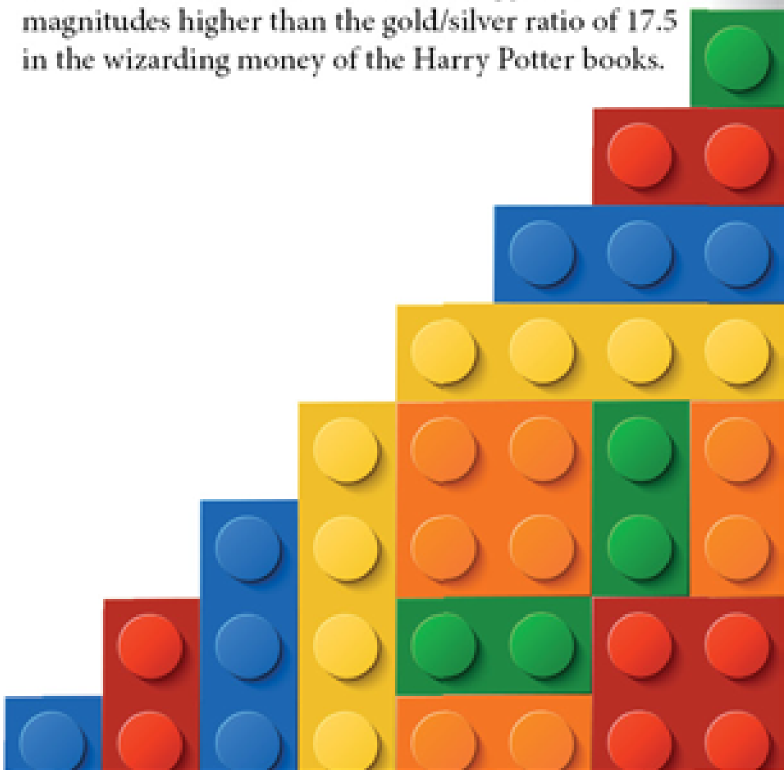
Source: ADMISI, Bloomberg

This raises an intriguing question – if the Fed raises short-term rates, will it push down yields at the long end of the Treasury curve? With the majority of investors expecting yields to rise across the entire curve, a contrarian trade might be presenting itself. Finally, let's consider an idea relating to precious metals which, rather obliquely, has a Christmas connection. Ned Naylor-Leyland and Joe Lunn of Old Mutual Global Investors took the adjusted MACD indicator we have been using for equties and applied it to gold and silver.

What they found was that the crossovers (see red circles) from positive to negative have provided good signals for subsequent declines in the gold/silver ratio since gold entered a bull market in 1999.

Source: Bloomberg

Clearly, the implication is that silver might be poised to significantly outperform gold in the coming months and years. This happens to fit with our view that the gold/silver ratio should return to the 30.0 level or lower in the not too distant future. For much of history, literally millenia, the gold/silver ratio averaged 15-16. It traded at 12.5 when in Alexander the Great's time and Isaac Newton set it at 15.5 in 1717 when he was Master of the Mint. This undervalued silver so much at the time that he effectively put Britain on a Gold Standard. The current ratio of 75.6 in (our) Muggle world is magnitudes higher than the gold/silver ratio of 17.5 in the wizarding money of the Harry Potter books.



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Editor's Note

Christmas 2015 Edition

Editor's Note

Welcome to the Christmas 2015 edition of

The Ghost in the Machine

It has been a long and lonely year in financial markets.

Many years have passed since we last saw so many quizzical faces staring at each other blankly and the atmosphere ruminating around the hallowed of halls of investment banks, investing institutions and retail clients appears to be not seasonal but relatively cheerless. Without doubt, markets have been manipulated by the actions of central banks to an extent where investment decisions have become highly complicated. The hunt for yield has been a predominant driver since the credit crisis but this year the buoyant dollar has been the red-handed enforcer in most of the market's moves. The Federal Reserve's long awaited rate rise and gentle expectations for next year's increases as well, have sat oddly to the rest of the world, where quantitative easing is still prevalent and currency devaluation has become the largest game on the planet.

As the dollar has risen, investors have piggy-backed the momentum behind that move and any other dollar related move driving it ever higher. The carry trade between the weakening euro and the upwardly-mobile dollar has been a rare profitable opportunity. The dollar's impact has also swept chillingly across all commodity markets, the fall nurtured by emerging market slowdowns, which in turn have struggled by being over-leveraged with dollar borrowing. What once were virtuous circles have now turned vicious. None greater than the oil market, where over investment in shale gas production, has led to over-supply of oil and now a worryingly low oil price , which has rocked the fabric of the corporate bond market , a desperately illiquid asset class, over populated by naïve retail yield hunters.

Many market participants are excited about the festive season and the New Year, if for no other reason than a rest!

Our last 2015 edition of Ghost in the Machine has a festive flavour and hopefully a number of commentaries and articles to make you smile. 'The Ghost's' first year in production has been really rewarding and we thank everyone who has contributed and also to those who have been fulsome in their praise.

Option Sleuth

Lee Heyman

e-mail: Lee.Heyman@admisi.com

Tel: 020 7716 8523

THE PURSUIT OF BALANCE

The Pursuit of Happyness was a film first screened about ten years ago. It was based around the fortunes of a homeless salesman and his son. I won't go into too much detail but it's a story of how good triumphs over evil and of how having faith in your dream makes all things possible. I'm sure this magazine will contain many humorous, upbeat and jolly seasonal articles. Nothing wrong with that, but in the pursuit of balance this one will not. Recent events in Paris, Mali and California do start to question the convictions of the film. Indeed there is a school of thought that says there is just as much evil in the world as there is good - it is counterbalanced, you cannot have good without having evil. And there is evil in us all. Good and evil are like two wolves fighting inside of our bodies. The one that wins is the one you feed. Whoa, bit too deep but it's not Christmas yet and won't be until the 25th which, I might add, is also when it ends.

It's been a strange year. There have been some tumultuous events and yet V2X has spent at least two thirds of the year in the 20 to 30 range. The breaking of the Swiss peg, a Chinese devaluation and the separate growth scare at the back end of August stirred volatility but briefly. It seems we have become toughened to no longer expecting Black Swan events. After the crash I was certainly guilty of always looking for the next disastrous event. I don't believe I was alone, but now I feel we have become too comfortable, too confident in central banks, too blasé about financial conditions in China, too convinced that emerging markets will soon start growing again, too accepting of negative interest rates on much of Europe's debt and too blinkered to the possibility that the slaughter in commodity markets will cause a banking crisis in Emerging Markets.

Source: Bloomberg

The more I look at markets this year the more I am convinced that their destiny has been based on the price of oil rather than anything else. There are those who will point to divergent central bank policy and earnings growth, but I think oil is the overriding factor. Evidence the FTSE (green line) and how it as fared against most of the main indices in Europe this year.

If the stock market cap is skewed towards oil, it will have suffered. The same goes for the US. I think this has serious consequences for next year's investment decisions. I believe at some stage next year, possibly within the next six months, Saudi Arabia will lead on a production cut within OPEC. There was little point in them cutting recently on 4 Dec. At this present time they are unlikely to

Source: Bloomberg

secure any help from Iran or Iraq and, as for non-OPEC acquiescence, the chances would again seem remote. If they wait, the crude overhang may be reduced and they can make a much bigger impact with a much smaller cut than they would have to make now. Chatter about Gulf devaluations are probably overdone, but an eye on Riyal futures prices, which recently hit a 13-year low, is probably needed. Pressure could mount for action sooner rather than later. Europe seems to be everyone's favourite destination for investment next year but if oil prices rise, this theory could be turned on its head. The other great consideration this year was currency. Currency risk has become and remains a serious risk for investors. Volatility is elevated. For example USD/YEN saw volatility under 10% in 2013/14 but this year it has marked between 10 and 15%. An extreme example of currency risk was the Swiss debacle when the peg broke. All those foreign investors, pilloried for accepting negative rates on Swiss debt, actually made a killing when the currency shot through the roof. That is perhaps a one off but it's a moot point when one considers that those who allocate most funds are US money managers who must now contend with the gyrations in currency markets more than ever. And perhaps there biggest conundrum is Europe. Has Draghi lost the dressing room? Economic convergence seems to be pulling in the opposite direction of policy divergence - Euro parity exponents are struggling to justify their opinion. Currency considerations will be key next year.

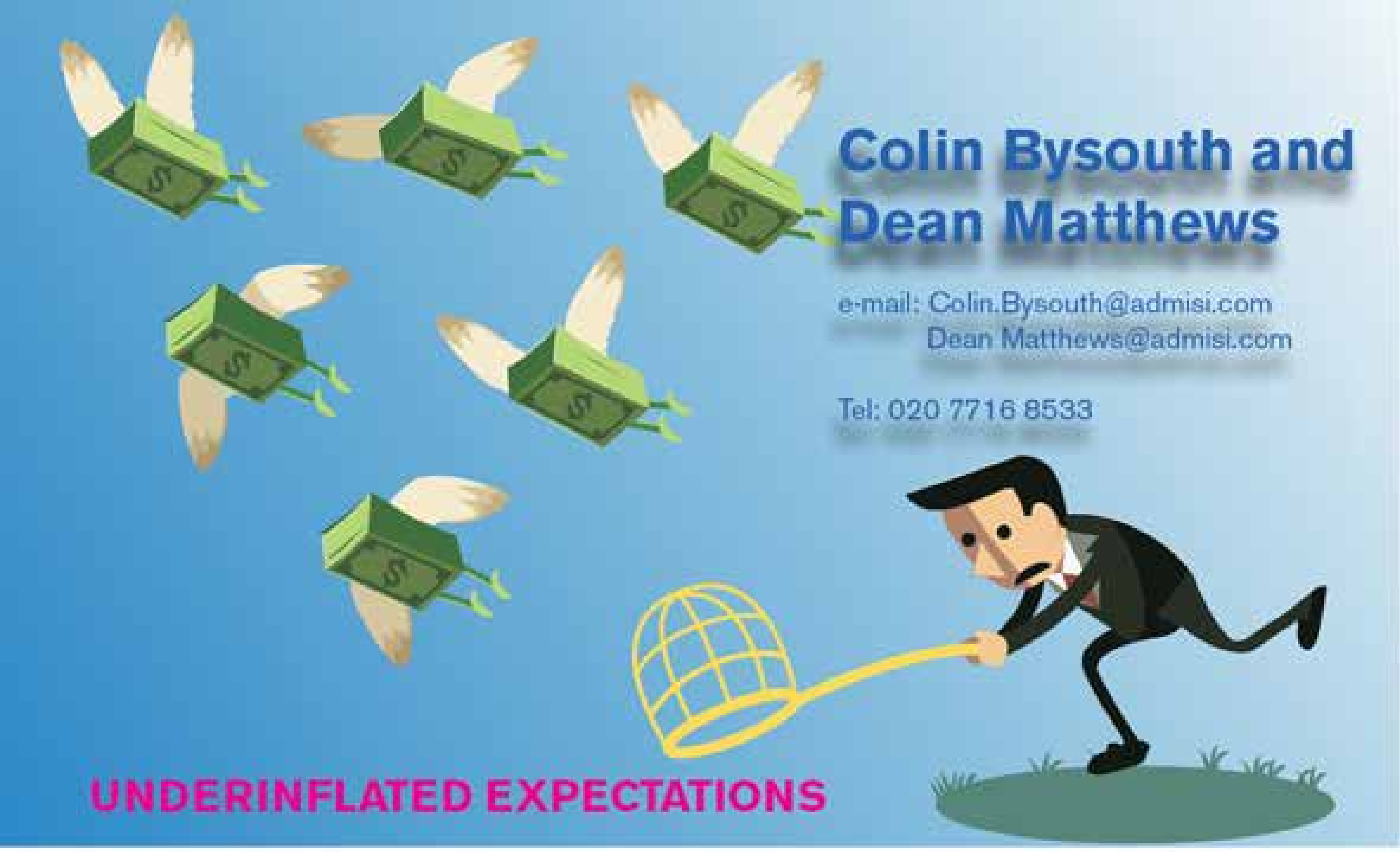
2016 Themes:

What's going to be hot in 2016? The globe of course. Or certainly hotter than it was. Are governments finally going to get serious about climate change? If they are then it has serious implications for investment decisions. Producers or users of fossil fuels and high emitters of carbon will be more severely taxed and low emitters and renewable energy producers will be encouraged and subsidised. Some energy producers may have to leave their reserves of oil and coal in the ground... indeed oil companies could become ex growth. However climate change investing has been a feature since 1992 and it is still yet to really produce a decent return. Indeed since 1999 the highest 100 carbon emitters within the S&P Global 1200 have still outperformed the lowest 100, although the gap is narrowing. Until governments finally bite the bullet and/or customers are willing to pay the price for renewables that sad statistic will endure.

The sharing economy. Here we go a Christmas theme! A time for sharing. Expect the sharing economy to take more of a bite out of incumbents market share. Hotels will likely see a bigger impact from disruptors such as Airbnb. Morgan Stanley says that about two thirds of US firms increased their travel budgets in 2015 and that a similar amount expect to increase them next year. Although budgets are increasing, firms are still mindful of costs. It will surely not be long before firms start to approve the "sharing economy" space for their staff. Look for more defensive mergers in the hotel space. IHG.L volatility is too low again. Sticking with the sharing economy theme, if oil rises expect Blablacar to benefit. Covering the cost of petrol will become more appealing to European customers.

Glaxo volatility is low. The pharmaceutical sector is one of the few where mergers do seem to produce positive returns. McKinsey, a consulting firm, reckons that two years after a pharmaceutical deal is announced a merged firm's share beat the industry average by 5%. Compare that to a tech merger and relative returns of -19% and one can see that the rationale for deal making looks strong. Glaxo is often mooted as a target. Portfolio manager, Neil Woodford, thinks there is value in the business, hence he is actively seeking a four way split of the divisions. Even the Company itself feels that 2016 will be the year of a "return to significant earnings growth."

Sorry it's not been festive but I hope the holiday is peaceful and enriching. Until next year.



Colin Bysouth and Dean Matthews

e-mail: Colin.Bysouth@admisi.com
Dean Matthews@admisi.com

Tel: 020 7716 8533

UNDERINFLATED EXPECTATIONS

The timing, pace, and subsequent effect of a US rate rise has long divided the opinion of market participants around the world. The trading community is bristling with debate over the wisdom of the Fed's actions or, indeed, inaction thus far. The cacophony from centre stage is deafening. Today, we set out our refreshments stall.

Painting the Picture

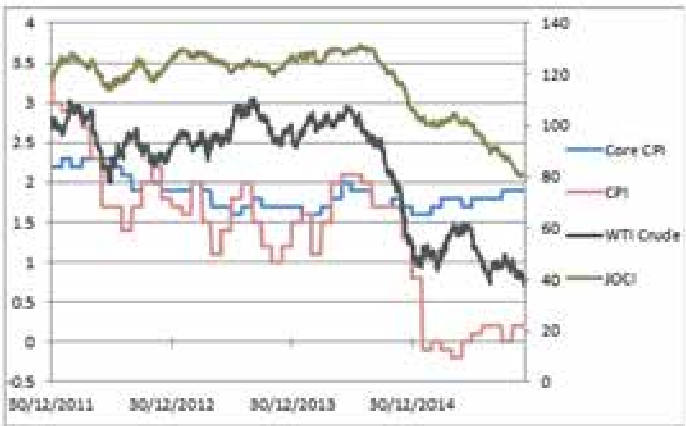
For those who prefer the tables and charts, they're included opposite…

As we go to press, the Fed is preparing to raise rates on the 16 December; we note how the US yield curve has flattened since 2H14. For example, the 2s-10s spread (the difference between the 2yr and 10yr US nominal treasury yields) is 80bps tighter at +130bps. A tighter spread, or flatter yield curve, suggests that investors do not fear the threat of excess inflation much, and the tighter or less accommodative monetary policy that would ensue.

The US 10yr break-even rate (the difference in yield between the 10yr conventional and the 10yr inflation-linked Treasury bond) has tightened 66bps to reside at +159bps. This is caused by a cheapening of the inflation-linked asset, or an appreciation of the fixed-rate asset – just like the 2s-10s spread, these are signs of tame inflation expectation.

Little surprise, then, that over the same period, US CPI fell from a 1-2% range to stand at just 0.2% currently. This can be attributed to the collapse of oil and commodity prices in general.

	2-10s	US CPI	10yr B/E	10yr nominal
07/2014	210bps	2.0%	225bps	2.60%
TODAY	130bps	0.2%	159bps	2.25%
CHANGE	-80bps	-1.8%	-66bps	-35bps



Reports of inflation's death are greatly exaggerated…

The tendency to focus on the most prevalent topic of the day in the financial press – be it labour data, GDP, China, or geopolitical developments – has seen inflation relegated. This once great measure, commanding fear and respect, lies alone and forgotten in its hospital bed. This is not to say that the state of the US labour market and the health of the world economy are not important – however that is a discussion for another day – but dismiss inflation at your peril.

It will recover. It will be grumpy.

On the 15 December, the day before the Fed's decision, the latest US CPI figures are released. Surveys currently point to a 0.6% YoY increase – a continuation of the recovery seen in our chart.

This is helped by a -0.3% MoM reading that is set to drop out of the comparison. We would also note that the next three months will see a cumulative -1.3% drop out due to this oil-induced base effect. Headline CPI would seem likely, then, to get back to 1.5% YoY without too much effort at all, while core inflation has remained steady since mid-2014 (currently 1.9%).

Should CPI rise as we expect, the current view on the inflation outlook, and by extension break-even rates, would need to change. Widespread talk that the Fed is moving too soon may rapidly swing in the opposite direction. An adjustment higher in nominal yields would become necessary.

To illustrate the point, we refer to the 10yr Treasury note and real yield relationship:

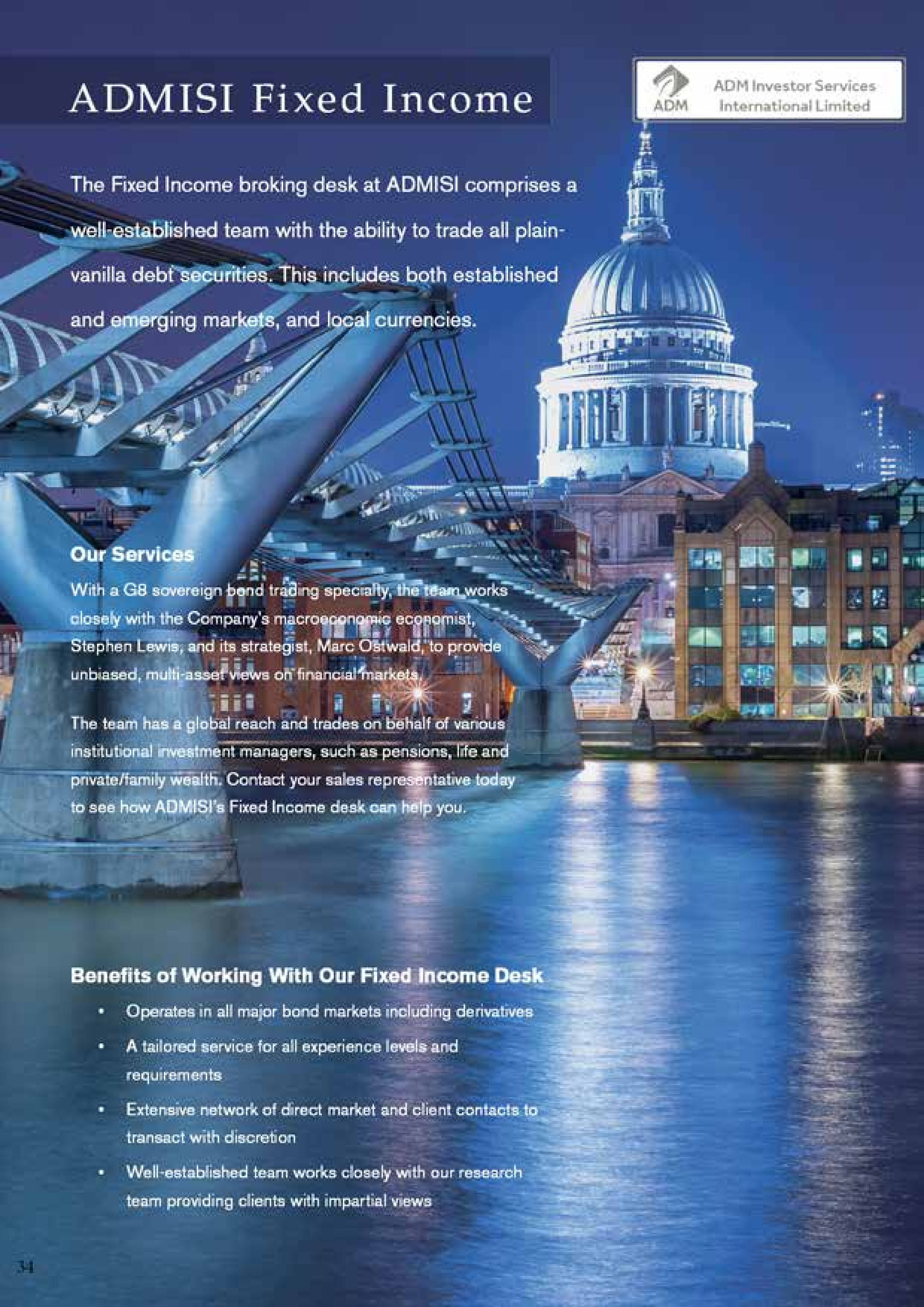
Source: Bloomberg

When revisiting the 5-year wedge formation which has featured in our previous publications, we continue to home in on 2.50%.

Would a back-up to this level be enough, though? Assuming a 1.5% CPI measure and a 2.5% 10yr yield, the resulting 1% real yield would look rather skinny. The measure currently resides at 2.05% – in line with the average over the past 20 years' of 1.98%.

So, what does all of this mean as we head into next year?

Following months of carefully crafted Fed Speak, market participants appear to have become acquainted with the idea of a 25bps rate rise and a very gradual pace of tightening thereafter. It is in this regard that we feel the investment community may have taken its eye off the ball.



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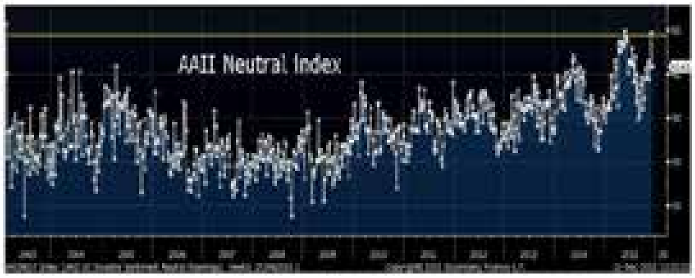
View from under a toadstool

Andy Ash
e-mail: Andy.Ash@admisi.com

Tel: 020 7716 8520

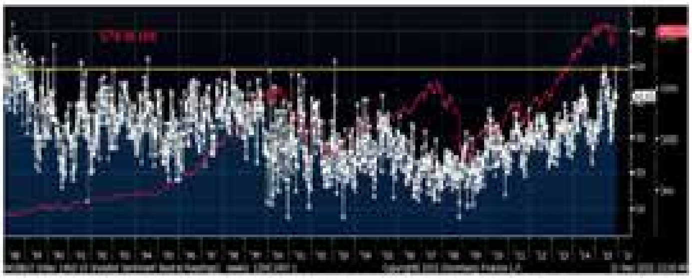
When a superhighway becomes a goat track

As year-end approaches with renewed volatility, it is unsurprising to see that more and more people are having less and less clue about what to do. The AAII Neutral reading, being part of a survey of 'individual investors', that indicates how many people are bullish, bearish, or neutral, now shows the most neutrals since May. Before that, the AAII neutral index has not been this elevated since 2003.



Source: Bloomberg

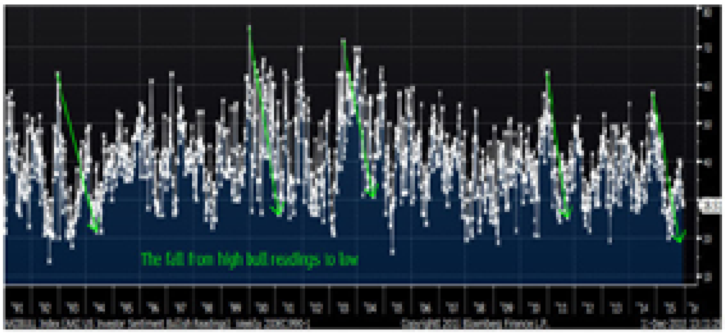
Over a longer time frame, such heightened neutrality seems to be the signal for a large impending move.



Source: Bloomberg

Prior to 2003, the previous period of 'mass neutrality' was July 1994. These periods are rare! Interestingly, both of these dates with neutrality reading over 50% were pretty much the starting whistle for enormous multi-year rallies. Of course, in both cases, the equity market had been very weak beforehand. It's not the same this time!

In 1994, the bull reading had gone from 63 at the beginning of 1993 to 21 in July 1994. So the neutral reading had risen as bulls deserted the playing field. The bull reading in November 2001 was 69, and January 2003 was down to 22. Again the neutral had risen at the expense of lower bull readings.



Source: Bloomberg

The bull reading in November last year was 58, high but not stellar, and had fallen to a very low 20 by June this year. The market corrected in July, reacting to that low bull reading, but has failed to go through the high since.

Basically, the neutral has to come from the bull or the bear reading and then go back into bull or bear. Normally it will not come out of bull into neutral and back into bull. Instead, it will travel from bull into neutral and then into bear. It is even more pertinent that this time it has occurred in December, when people are neutral but desperately trying to have a book that replicates what has worked in 2015.

Most predictions for 2016, call for more of the same, all orientated around a strong dollar. Come the New Year, neutrals will have to act as one cannot sit on the fence for too long, or money gets moved elsewhere. So the movement from neutrality this time will probably be sooner rather than later.

When we have seen this amount of 'neutral' before, it has been a pivotal moment for equity markets.

On Friday 11 December, we saw the ominous situation of a major bond fund manager suspending redemptions in its corporate bond fund, albeit that some of the holdings look particularly illiquid. The announcement stands as a major warning shot to the neutrals. Bloomberg reported:

"Third Avenue Management just couldn't take the pain anymore. Instead of continuing to sell distressed-debt holdings at incredibly low prices, the asset manager decided to make a drastic move that will inevitably kill some of its future business. It chose to prevent investors from leaving its Third Avenue Focused Credit Fund, a $788 million mutual fund that it has decided to liquidate. That means that these investors who want their money back are becoming 'beneficiaries of the liquidating trust' without a sense of when they'll actually get anything back, according to a notice to its shareholders dated Wednesday. 'Third Avenue is extremely disappointed that we must take this action,' it said."

It is a worrying confirmation of what we thought could happen and most of the investment community knew was inevitable. In this case, most of the investors are likely to be institutional, or at least high net worth. However, most corporate bond funds are populated by retail investors, hunting for yield. The absence of a natural exit is going to come as a shock to them.

The discount to NAV from the downturn in HYG and JNK (the high yield bond ETFs) is only average despite the sell off and large volume, so no significant log jam of unrequited selling yet. That can be bullish or bearish, depending on the time scale you are looking at.

Lipper say that investors moved 13.5 bln $ out of mutual funds over the last week, reported on 10 December and that is the fourth largest amount since 2006. This can often be seen as a capitulation and consequently a buy signal. Being in December with so much 'neutrality', as we noted above, who the immediate buyers will be is a concern…especially as volumes in other assets contract over the Fed announcement and in the run-up to Christmas.

Investors have also sold $7.2 bln of taxable bond funds. That is the second largest reading since 2002, the largest was in October 2008. Selling of bonds and equities together is a worry; it shows a new concern about all assets. Third Avenue won't help that thought.

Steve Freed

e-mail: Steve.Freed@admis.com

Tel: +1 312 242 7000

World Grain

The Outlook for Grains in Light of the Seasonal Drop in Volatility

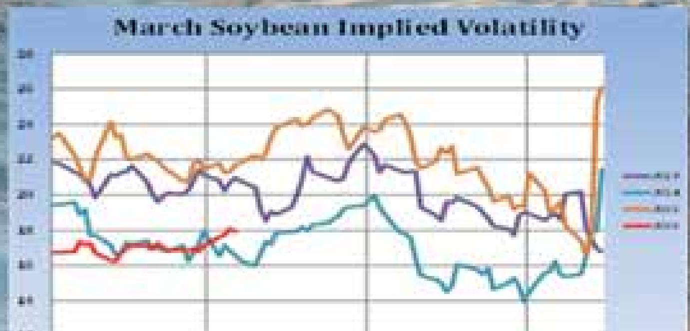
Globally there is too much capacity and too much supply. Energy prices have led a historic drop in prices, which are back to near 2005 levels before China started buying commodities, the U.S. introduced ethanol as a fuel alternative and index funds bought commodities as a hedge against inflation.

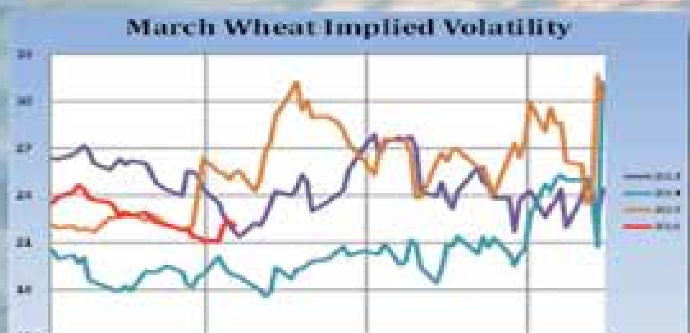
The charts below illustrate the seasonality over the last four years of market volatility in corn, soybeans and wheat. As you can see, volatility is near the recent lows. It is also apparent that historically, volatility declines after the first of the new year.

While 2015 U.S. and global supplies are adequate and a combination of slower world economies and a higher U.S. dollar has dropped the demand for U.S. exports, 2016 though could be a volatile year for grains. It possible that the new President of Argentina could change the country's agriculture policy.

Another potential game changer is the possibility that there could be a reversal from El Nino to La Nina, which could shift global weather patterns and result a drier than normal U.S. summer. Traders should be keen to any shift in weather that could impact supply and increase price volatility.

Happy Holidays!





Information from External Sources

A special thanks to the following non ADMISI contributors in the subsequent pages for their thoughts and analysis. We are truly grateful for their efforts. ADMISI would like to extend the opportunity to receive additional external contributors' analysis for inclusiion in subsequent editions of 'The Ghost in the Machine.' Please contact Andy Ash for further information. Tel: +44 (0) 20 7716 8520 or Email: andy.ash@admisi.com

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"Tis The Season To Be Flat, Tra La La La La...."

What stands out here?

1. **Beware of extreme positioning in long USD, short Commodities, short Energy & Mining stocks as we head into December with OPEC and Fed meetings as potential curveballs.**

2. **The fate of the Oil price lies in the hands of the distillate markets as we head into the winter heating season. US Refiners like Valero Energy Corporation (VLO Equity) are starting to look very expensive as they diverge from current refining margin fundamentals.**

As we head towards the end of the year, where do markets stand?

With the S&P500 (SPX) up 1.5% for the year, the Eurostoxx (SX5E) up 9%, one could be forgiven for thinking this year to be quite an uneventful one. The reality is that it has been anything but that! Surprise announcements from the revaluation of the Swiss Franc in January to Chinese Renmibi devaluation in August coupled with Fed swinging between dovish and hawkish stances all year, this year has given the Macro players a run for their money. Throw in collapsing Commodity prices and you have a perfect recipe for an absoute cleanse of the market's gastronomy; a forced detox if you may.

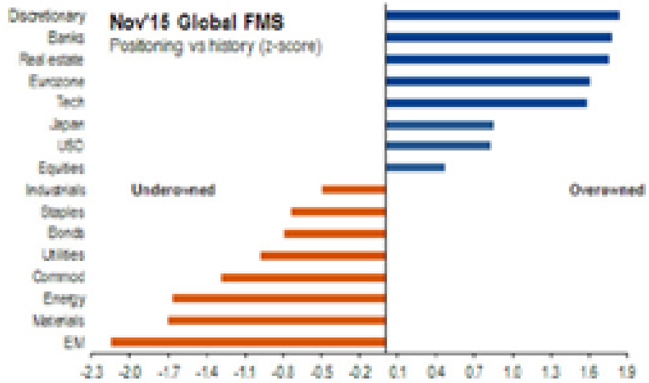
One thing is clear, there has been a clear divergence in Developed Markets outperforming Emerging Markets as the latter continues to rebalance from the excess capital flows seen over the years. This is evident in the extreme USD strength vs. Emerging Market currencies given their clear divergent monetary policy paths. The performance vs. Euro and Sterling have been a less of a forgone conclusion.

But a lot of the main themes such as long USD, short Commodities, Short Emerging Markets and their respective Currencies, and long Bonds for this year have played out. The question remains, how much more is there still to play for?

1) Beware of extreme positioning in long USD, short Commodities, short Energy & Mining stocks as we head into December with OPEC and Fed meetings as potential curveballs:

The November Bank of America Merrill Lynch Fund Manager Survey released last week confirms the extreme positioning in the USD and suggests it is the most vulnerable trade going into December. It is undeniable that fundamentally being long USD vs. most of G10 and Emerging Market currencies makes sense especially given the most recent Fed meeting suggesting first rate hike in December. My reservations here are based on how soon we got here and how assymetric the positioning is currently. See Chart 1 opposite that shows a heavy overweight positioning in Banks, Europe, USD vs. an extreme underweight in EM, Materials, Energy and Commodities. Not much margin for error. Hence going into the key Fed meeting on 16 December, I feel one needs to assess whether the risk reward here is compelling to still be positioned this way? December is a tricky time of year as funds unwind their portfolios and marked to market trends dictate year end prices. Liquidity driven trades can distort the bigger picture and push fundamentals aside.

Chart 1: Positioning As Of November BofAML Fund Manager Survey



Source BofA Merrill Lynch Global Fund Manager Survey

What makes me even more nervous here are the levels reached in certain Commodities over this time period. Taking a deep look at fundamental demand/supply balances across Oil, Copper, Iron-ore, MBCC year end targets (as discussed in past publications) based on existing oversupply were \$45/bbl Brent, \$4500/t Copper, and \$40/t Iron-ore. We are there right now! These markets are still plagued with excess supply but as we head into Q1, we need to monitor to see there if there is a change in demand going forward.

The market constantly comments (or rather hopes) on Chinese stimuli providing the catalyst to call the bottom in Commodity prices. What the market fails to understand is that Chinese reforms are targeted towards consumer led initiatives, not infrastructure ones. China's Fixed Asset Investment as a % of GDP is double the average of the global median (see Chart 2 on page 39) and it needs to rebalance slowly. It is moving from a capex heavy intensive model (need for Cement, Steel, Iron-ore, Copper for housing, railways, ports, etc.) to one that is more opex oriented (Energy, Aluminium, etc.) which can be seen in the lower year over year demand growth in the former Commodities over the last few years (Chart 3 below). Demand for Copper and Steel have been falling year over year since 2010 whereas Gasoline has seen an increase. (Cement is down 5% y-o-y vs. Gasoline up 19% y-o-y).

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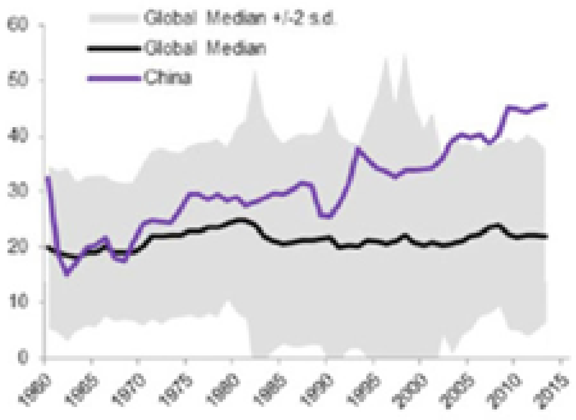
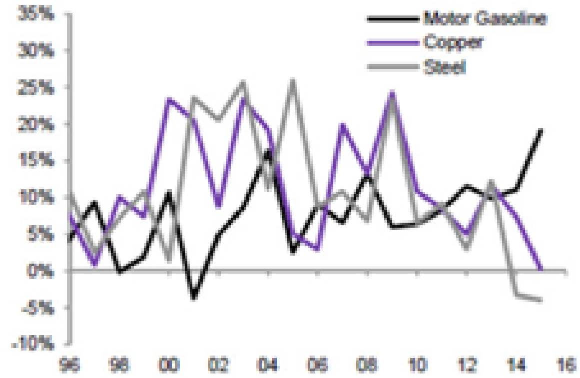
So when the market talks about "Chinese stimuli", it is important to put this in perspective to gauge which Commodities can benefit, as it is not the case of the rising tide lifts all as we witnessed back in 2004.

Chart 2: Fixed Investment As A % GDP , China vs. Global Average



Source: World Bank, Goldman Sachs Global Investment Research

Chart 3: Year over Year Change In China's Capex vs. Opex Oriented Commodity:



Source: EIA, IEA, Wood Mackenzie, CEIC, WSA, Goldman Sachs Global Investment Research

2) The fate of the Oil price lies in the hands of the distillate markets as we head into the winter heating season. US Refiners like Valero Energy Corporation (VLO Equity) are starting to look very expensive as they diverge from current refining margin fundamentals:

The global oil markets are currently very oversupplied. OPEC has been pumping on all cylinders following its strategy change last year, that is fighting for market share. Despite Lower 48 production already declining, production growth outside the US has been strong. Demand is not the problem as growth has surprised to the upside with 1.6mln bpd growth this year. Supply needs to pull back a lot faster. US shale producers are not incentivised to pull back fast enough as access to capital across US companies allows them to produce at these levels of $40/bbl WTI even.

There were whispers of a coordinated OPEC cut to be announced at the long awaited December OPEC meeting, but that is now just wishful thinking. The long awaited meeting just cemented the "free for all" strategy as every member essentially has the green light to pump as much as they can and like. After all, why should Saudi Arabia be the only one to cut production to support prices if Russia, Mexico and Iran are all focused on maximising their revenues? Oil is officially an open market now, and its price discovery will be determined by its true market fundamentals, physical demand vs. supply balances.

OECD commercial storage numbers show that the stocks of crude oil and refined products in September 2015 was 241 million barrels higher than in 2014, 274 million higher than in 2013, and 239 million higher than in 2012. Current OECD stocks cover about 98 days of consumption, up from 93 days in 2014. It is the rate at which supply is widening vs. demand that has depressed prices this year. But the problem lies underneath the surface in the product markets.

2015 has seen a strong year in gasoline demand growth compelling refiners to run near record utilisation rates adding to distillate stocks which have only seen modest demand growth relatively. Despite cold winter in US and Europe last year, European and US distillate storage situation is reaching historically elevated levels. If storage capacity runs out, the market will be flooded with distillate hurting its price, implying less demand for crude causing causing a further sell off in the front end of the curve.

US distillate inventories have built by 16 million barrels more than seasonal norm from February to September this year. Utilisation of US distillate storage is 51% (peak was 60% in 2009) with current available storage at 40 million barrels. European distillate storage is even worse as 15 million barrels larger than normal seasonal build has brought the storage utilisation to 96% in September. Now it all depends on the winter heating season. If cold weather fails to materialise, then the Oil market can see serious stress as these excess barrels will not be utilised.

What looks mispriced here?

Refining Equities have been the poster child for the Energy sector this year. The story has all been about the strong US Gasoline margins ("cracks") leading to an excess of free cash flow for the companies. Companies such as Valero, Holly Frontier, Marathon Petroleum, have all outperformed in excess of 40% this year as their free cash flow rises and they promise to distribute spare cash to shareholders via buybacks and dividends. With lower retail prices, higher disposable income, more miles driven, the gasoline demand story certainly seems to have legs. But this is a summertime phenomenon. The market is expecting another strong summer for 2016 and so is chasing these US refining Equities today into next year. That's a long wait!

Could investors be getting ahead of themselves? Let's take a look at the what the margins ("cracks") have been doing recently.

Chart 5: Valero vs. MBCC Proprietary Refining Margin Indicator

The blue line is the stock price of Valero (VLO Equity) that trades in the US. The green line is the MBCC in-house proprietary refining margin indicator built to track the marked to market refining margins seen across Valero's refineries.

As you can see the refining margins have come in quite hard since September yet the stock has massively outperformed as investors focus on the 75% net income payout ratio. No doubt the stock had a stellar Q3 2015 earnings given margins in the quarter were at highs. However going into Q4 2015 and 2016, the outlook looks a lot less compelling given turnarounds and inventory builds in the "shoulder" period.

It's all well and good to be long the stock as a play into 2016, but there could be some earnings downward revisions in the coming months to the tune of 15-20%. There is also a risk of the US crude export ban being lifted. It is doubtful that it will happen before US elections in 2016, however, if the bill were to be passed, it would be a big negative for the US refining equities as the price of WTI (US landlocked Oil) would reprice sharply higher vs. Brent (global benchmark) and take away the biggest cost advantage for these inland US refiners as they use WTI as an input source. Every $1 contraction of the Brent-WTI spread would represent an average 7% headwind to Refiners' EBITDA. Headline risk around a potential Congressional vote could present a risk to refining equities, especially after outperforming the S&P by 33% in 2015, and with refining margins near peak levels likely to normalize by Q4 2015.

Investors seem to be a bit complacent here and valuations are trading at highs. Time to take some profits and fade this rally in US refiners for now.

YTD PERFORMANCE:

Portfolio	% YTD
SPX (S&P 500 Index) YTD	1.47
SX5E (Eurostoxx Index) YTD	9.73
SXPP (Basic Resources Index)	**-20.50**
SXEP (Oil & Gas Index)	5.31
EEM (Emerging Markets)	-9.95
S&P GSCI Commodity TR Index	-27.80
MBCC Net Return YTD	9.86

Maleeha Bengali - Founder, MB Commodity Corner

Maleeha Bengali graduated from Cornell University with a Bachelors of Science degree in Engineering in 1997. For the past 14 years, she has worked as a Portfolio Manager/Trader for various Hedge Funds and Proprietary Trading desks across both US and Europe including UBS O'Connor, Goldman Sachs J. Aron, Merrill Lynch Commodities and Noble Group, where she launched and managed their Commodities and Equities investment funds specialising in Energy and Basic Resource Equities and the respective Commodities. Over the past 8 years, her strategy has generated a compound annual growth rate (CAGR) of 12% using systematic delta neutral investment trading strategies; minimising market and directional risk while maximising returns, focusing on alpha generation.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Contact Information

By mail:

ADM Investor Services International Limited
Millennium Bridge House
2 Lambeth Hill
London
EC4V 3TT
United Kingdom

By phone:

+44 20 7716 8142

By e-mail:

admisi@admisi.com

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Andy Ash
e-mail: Andy.Ash@admin.com

Tel: 020 7716 8520

Jack was bored

Jack was bored. He had been living with his mother at home for 28 years, which meant he was 28 years' old. His father who had been an investment bank equity salesman, had left them a couple of years back when his final salary pension had miraculously doubled, as the bank he worked for doubled his salary because they weren't allowed to pay him bonuses anymore. It was the only miracle Jack had ever seen. And then his father left.....and since then life had been tough.

They also owned a cow. His mother used to call it a 'cash cow' and every time she did, she howled with laughter but Jack didn't understand this. She often told him how years ago, the cow had been a high yielder but that seemed irrelevant now that the cow gave no milk at all. In fact with all the hay it ate, the cow had started to cost money with no return. His mother had recently been shouting aggressively at the poor old cow, calling it words like obl, bobl and worst of all, schatz. Jack had heard other children at the local school using this word about his friend Tommy in the toilets. He knew it wasn't good.
One day, as Jack sprung out of bed, he had an idea. He had been reading a book called 'Aladdin in Tech', about a boy who had dropped out of school, lived in a garage and made billions of money. Jack thought that if his mother would sell the low yielding cow and buy a couple of tech stocks with the proceeds, the same could happen to them, even though they didn't have a garage.

His mother was not keen on this idea however. "How can you go to the market and sell that worthless schatz cow and buy tech stocks, when you know nothing about markets. You are only twenty-eight, my darling, you have never seen a bear market, let alone visited one," she said. "But mum," Jack replied, "how can we survive with no yield, we have to go to town and sell the cow and buy something else, just anything." The mother knew he was right. She was old, had no money and as Jack had said they 'had to do something'. She was too tired and weakened to visit the market, so Jack would have to go alone.

The next day, the sun shimmered invitingly in the sky and Jack felt elated to be visiting the town. The market opened at 8 o'clock and was situated bang in the middle of the wine bar region. It wasn't a market as such, more like a fair ground. There were lots of bright flashing lights, people shouting and laughing and rows of barriers of entry leading to countless stalls with a dazzling array of produce.

As Jack reached the front gate, a group of stripy jacketed men approached him. They all had large black triangles stuck outwardly on their backs. Jack recognised them immediately; his mother had told him to avoid trading with sharks at all costs. He smiled, doffed his hat, and strode on, dragging the cow behind him.

Within an hour Jack had seen so many exciting things. There was the High Yield Beer tent, which was full of very tipsy people but appeared to have an enormous opening in the canvas and strangely no exit. There was the EM slide, a gigantic helter-skelter, but Jack didn't want to go on this though, as everyone at the bottom had lost their mat, were emerging from the chute upside down and furiously rubbing their heads. Jack had been warned by his mother not to get carried away. "I'll takeaway the punch bowl, "she reprimanded him," my friend Widow Bernanky told me that her friend Goldilocks Greenspan, had advised doing that when young pups didn't listen to their mothers and got over excited at the market." "Schatz to that," Jack whispered under his breath.

Eventually Jack espied a well-dressed man, who looked remarkably well tanned and decent. He very much looked as though he owned a garage. The large banner running across his stall told passers-by that his name was Jamie Diamond and he was in the area that specialised in cattle trading. Jack found it hard to talk to him, even though Mr Diamond had placed a comforting arm securely around Jack's shoulder, due to the incessant noise from the next door stall, a certain 'Prince Chuckle', who kept on jumping up and down shouting, "Keep Dancing, Let's Keep Dancing"." A lady standing to his right was shouting loudly at him, "Sir, will you stop yelling?" "I'm not Yellen, maam," The Prince retorted "Yellen… she is in the stall across the road …the one with the miracle printing press." Jack was grateful he wasn't selling the cow to Mr Chuckle ….the poor animal simply wouldn't survive.

EMERGING MARKETS GUIDE

With the coins in his pocket, albeit a disappointing amount, wrapped in a bit of paper, with 'IOU' written on it, Jack returned to the main hub of the market.

Jack was a good son and beneath the exuberance of youth, he knew what he had to do and that was naturally what his mother had told him. In a strange way he missed the cow. Peculiarly he had already seen a man drag it away. Jack had seen the gentleman before as he worked as the chief announcer for the 'Internet New Issuance' stall and walked all the way round the back of the fair ground, avoiding on-lookers, to place it in his extraordinary Bentley cattle truck. Why a person like that would be interested in such a lovely but low yielding cow, Jack thought.

The proprietor of the Gold Ghost Train, shrugged at Jack, as if he could read what he was thinking. Certainly no-one was boarding the poor man's tired and depressing gold train; the area rightfully lived up to its ghostly description. It was empty, in the shadows of the grander stalls and cold. Round the corner and back onto the main thoroughfare, the crowds were heavy and jostling in and out of geared coconut shy, where you paid for only one ball, borrowed five more and tried to hit a worthless coconut. Next to it, the brave were queuing by the 'Bash the Rat' down the drain pipe. Run by sinisterly named 'Regulator'.
Jack trudged on, desperate to join in but knowing it was wrong. He eventually arrived at the commodity stand. A gentle but dull merger of a flower stall and the 'bring and buy' cake table. The year before they had been two separate stalls but this year, with no-one interested in their produce, they had joined forces and sacked all the staff. Jack emptied his coins and note onto the table. The rather surly grizzled man looked at the IOU, raised it to his bespectacled eyes and laughed. "We don't take those son," he said. He handed Jack some beans. A packet with 'soya, cocoa and jumping', written in italics on the wrapping. "Go and plant those my boy" the man said, "it might take some time but when they start to shoot, build a big metal fence around them."

"To keep them warm?" Jack asked, "No my lad, because some day everyone will want them."

Developing Situations, Emerging Perspectives

Marc Ostwald

e-mail: Marc.Ostwald@admisi.com

Tel: 020 7716 8534

"Knowledge rests not upon truth alone, but upon error also"
Carl Jung "Modern Man in Search of a Soul" 1933

As a tumultuous year draws to a close, this article is less a case of reading the tea leaves for 2016, and rather more about sharing some perspectives on the many complex situations which so-called 'Emerging Markets' face in the year ahead, to some extent picking up on some of the themes that have previously been explored in prior editions of the Ghost in the Machine. By dint of time and space constraints, it is also something of a surface read, which we will nevertheless be happy to discuss and explore in greater depth on a one to one basis.

Many of the key themes and influences for the developing, and indeed the developed, world in 2016 are likely to mirror those observed in 2015; but the shift in the temporal frame of reference in effect redefines the prism through which one examines the implications in global, regional or national terms. A key theme for 2015 has been the contraction in global trade, with a concomitant discourse surrounding 'currency wars' and monetary policy measures, which directly or indirectly appear to be predicated on a 'competitive devaluation' strategy, with a great deal of often vacuous and tenuously rationalized arguments about a resultant boost to exports. Eminently, this is a "zero sum" or "beggar thy neighbour" type of policy, and highly ineffective, if not outright attritional, if practiced on a broad scale.

The lesson of 2015, when the performance of a variety of smaller and larger countries is examined more closely, is that it has largely been those countries with strong domestic demand, which have thrived – be that the USA or Germany, the Czech Republic, Poland, the Philippines or Mexico, to name but a few. A very over-simplified analogy would be that if a dairy producer focusses all its efforts on selling cream, but finds itself with its milk output in surplus relative to demand, then it clearly does not know (please excuse the pun) which "side its bread is buttered". In point of fact, the example of post re-unification Germany is excellent in this respect, given that protracted weakness in the DEM due to the costs of reunification, high interest rates and diversion of resources to the former East Germany was accompanied by one of the weakest periods for German exports in the post World War II era.

This leads us neatly onto some observations about China, starting with the frequently shrill but often poorly reasoned discussion about the 'devaluation' of the Yuan. As the chart overleaf highlights, the recent setback is, in point of fact, a modest correction to what had been a sharp appreciation of the CNY in Nominal Effective Exchange Rate terms since the start of 2014.

However, the more important perspective is to ask why the Chinese authorities would want to drive the CNY lower. After all, China is running a very large trade surplus, therefore there is little reason to try and boost exports via a weaker CNY, particularly as the primary effect would more likely be an increase in the cost of imported raw materials. China is also in the process of rebalancing its economy; moving away from its previous domestic investment and export demand led policies to focus on encouraging domestic private consumption. As has been much discussed, China has seen spectacular growth in its debt to GDP ratio, with a significant proportion denominated in USD; therefore a sharp fall in the CNY would also serve to increase the cost of servicing and/or refinancing those external liabilities. However it is the asset side of China's balance sheet which may offer the more important perspective.

As I noted in 'Visions of China', if China is to achieve its objectives of establishing the CNY as a reserve currency, rather than it largely being a payment vehicle for trade, and thus gradually opening its capital account, in terms of both inflows and outflows, it makes more than a lot of sense from both a theoretical and practical standpoint for China to manage its assets more productively. Above it all needs to invest in real sector assets internationally, not only to generate income which is not primarily based on the trade of goods, but also to facilitate investment and business opportunities for private sector companies (financial and non-financial). By extension, this will involve considerable outflows that will de facto put downward pressure on the CNY from time to time, and which will need to feature more prominently in any analysis, along with the fact that, with the domestic bond market finally starting to develop (above all the municipal government market as previously discussed) and being opened up to foreign investors, there should also be some counterbalance in terms of capital flows. It should also be added that a very sizeable proportion of outbound investment will likely go to Asia, Africa and Latin America, where the USD is dominant.

As has been well documented, 2015 has been an especially bad year for 'Emerging Markets' (EM) assets in most regions, predicated both on weak global growth, and what can be described as cyclically typical concerns about the impact of a rise in US interest rates and a firmer USD. The latter concerns are more than understandable, when one considers the series of BIS charts below on non-bank USD denominated credit growth, above all in EM since 2007.

As a further point of comparison, the outstanding volume of EM quasi-sovereign and corporate debt is now seven times larger than in it was in 2005, and whereas the outstanding EM debt volume was just 28% of that of the US High Yield Bond market in 2005, it is now over 80%. But this aggregated data disguises some very substantial differences across regions, above all in the balance of local currency to foreign currency issuance. Taking 2014 as an example, Europe, Middle East & Africa EM saw $20 Bln of local currency corporate issuance and $61 Bln in foreign currencies, EM Americas $39 Bln local and $98 Bln foreign currency, and in very sharp contrast EM Asia local issuance was $673 Bln and $129 Bln foreign currency. Per se, the risks for the EM regions are not uniform, with Asia clearly rather more vulnerable