# Daily Note – France in big trouble


## Summary

**France: A picture tells a thousand words**

**Eurozone: Euro economists' consensus offers opportunity**

**Eurozone: Gotta love Greece**

**China: Premier Li has his eye on the ball.**

Good morning,

If you digest only one chart today, let it be the one below on the relentless rise of French unemployment. For a long time, I have maintained that France is not a little Germany – as French propagandists would have you believe - but rather it is a big Italy. I will turn to France in a little bit but first let's see what's going on in the rest of the market.

The winning streak is over for US equities, for the moment. The market just ran out of steam after being up the past 4 days. As discussed yesterday, we have added a small bearish US equity investment through some September 2014 put options. The advantage of options is that your risk is defined by the premium. I like to minimise the cost of being wrong in this way!

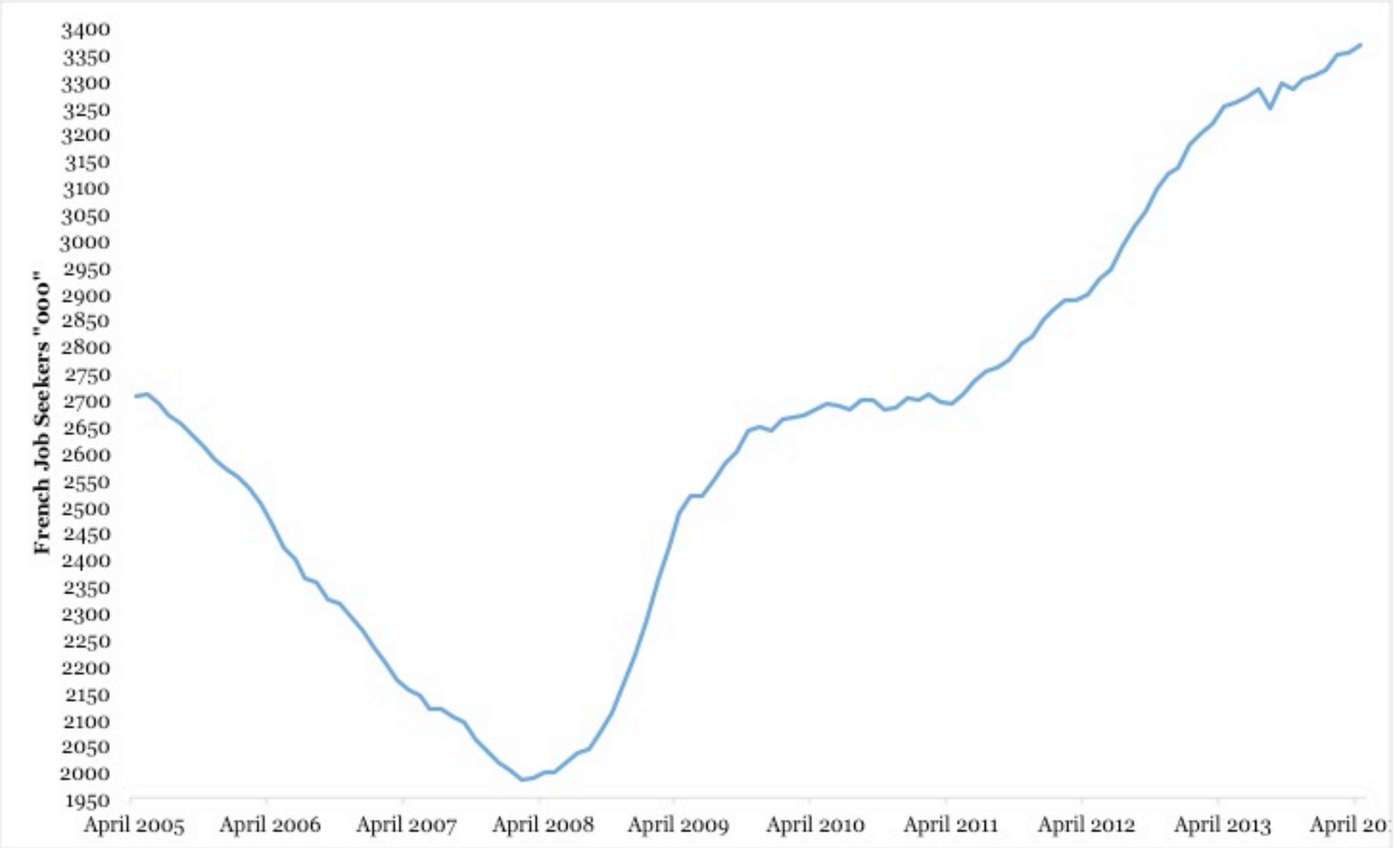
The USD rallied across the board and it is somewhat odd to see new cycle lows in both EUR/USD and US 10yr rates. Normally the opposite should be happening. But these markets are in strange form.

We saw a sharp rally in Treasuries overnight with 10 years closing 8bps stronger on the day. I am taking some losses on our US fixed income investment (because I am looking for higher rates and I am not getting them!) but I remain of the belief that the US economy is recovering and rates will have to reflect that some time soon.

Standing back from the daily price movements, it is clear Europe is faltering and America is growing and as a result of this, we added to our 10 year short investment towards the close last night.

Now let's go to the chart of the week. The last thing you want to be is unemployed in France. Look at what has happened to French unemployment below. French unemployment is now at an all time high.

**Figure 1: French Jobseekers increase to a record**




The rise since the crisis started has been relentless. When demand falls in France, wages don't fall in tandem. What actually happens is the "insiders"" protect themselves and the "outsiders" pay the price. So wages don't fall, but unemployment rises.

We see this process all over the continent due to large public sector workforces and strong unions who protect those on the "inside". The upshot is that unemployment rises relentlessly.

The economy can't grow with this level of unemployment and this fact, which feeds into the next argument, is that rates will be lowered in Europe next week.

**Eurozone:Euro economists' consensus offers opportunity**

I love when investment bank economists are in unison about something. This means there is an opportunity to do something different to the consensus.

According to Reuters:

*"Analysts said further easing by the ECB would have only a marginal impact on the euro. The currency, which rose over 4 percent against the dollar last year, is down nearly 2 percent so far this month and was trading around $1.36 on Wednesday. "The impact on the euro is largely priced in," said Christian Schulz, senior economist at Berenberg Bank. "The euro has already come down from $1.40 to $1.37 or $1.36 and there's going to be an additional knee-jerk reaction on the day but that's probably it."*

So what this means is that , according to consensus, Draghi will do a little but not a lot.

This type of investment bank consensus is music to my ears; I expect Draghi next week to exceed market expectations – to do a lot -and the currency will fall more than the banks expect as a result. We are positioned accordingly.

## Eurozone: Gotta love Greece

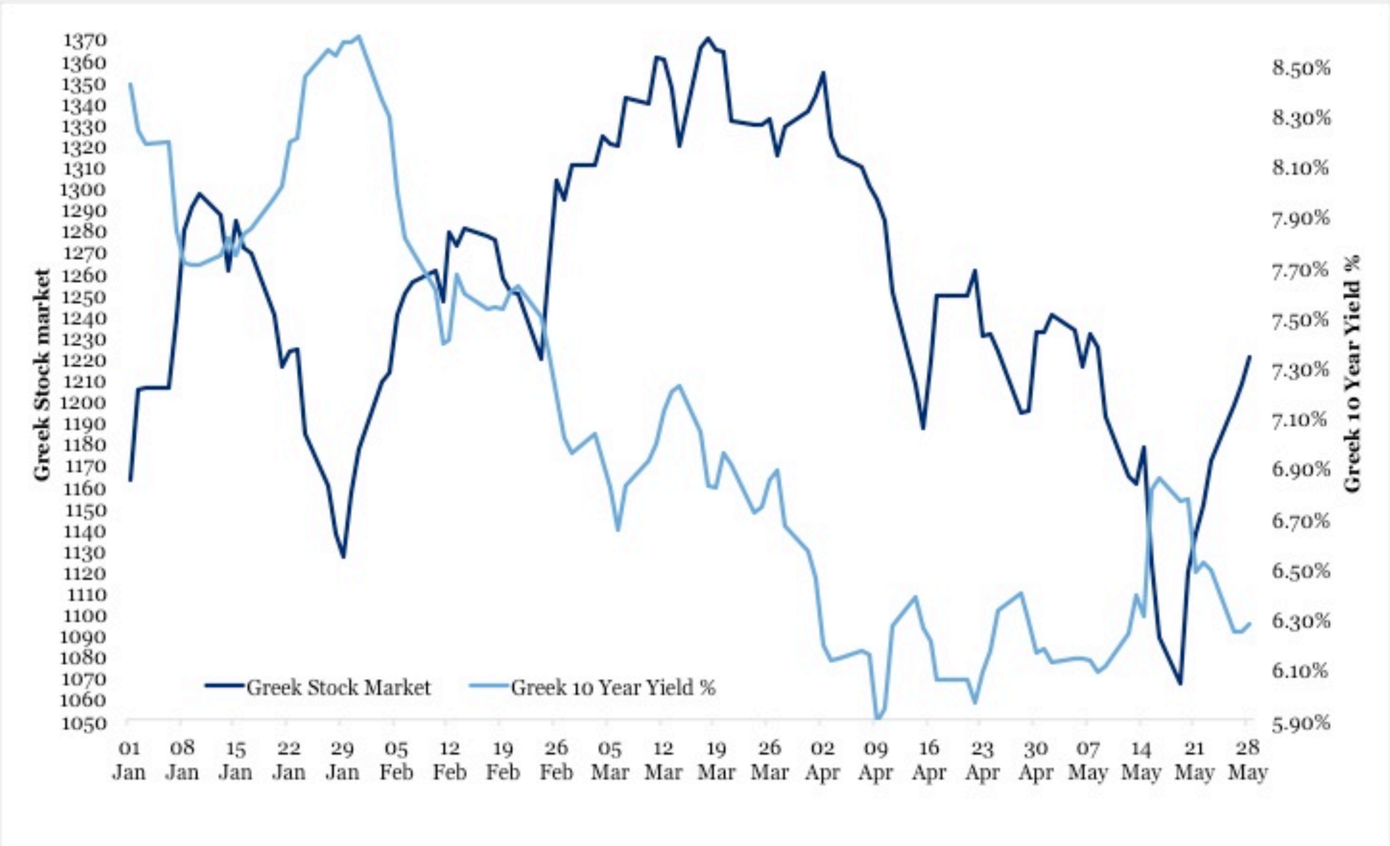
Ah Greece, you've got to love Greece. It orchestrates the biggest default in history and its bonds rally because everyone expects the EU to pay in the end. And what do the Greeks do? They vote against the EU who is paying their bar tab!

The outcome of the European elections in Athens increases the likelihood of early national elections (end of Q4 2014/ beginning of 2015). The most notable negative element was the sizeable decline in the popularity of the main governing party - New Democracy.

Bearing in mind that a long and difficult Troika review lies ahead in Q4, lots of things are now up in the air.

I am not sure how to play this yet. Let me dig a little bit more and come back to you on it.

**Figure 2: Greek 10 Year Yield vs Greek Stock Market**




## Eurozone: Economic data continues to slide

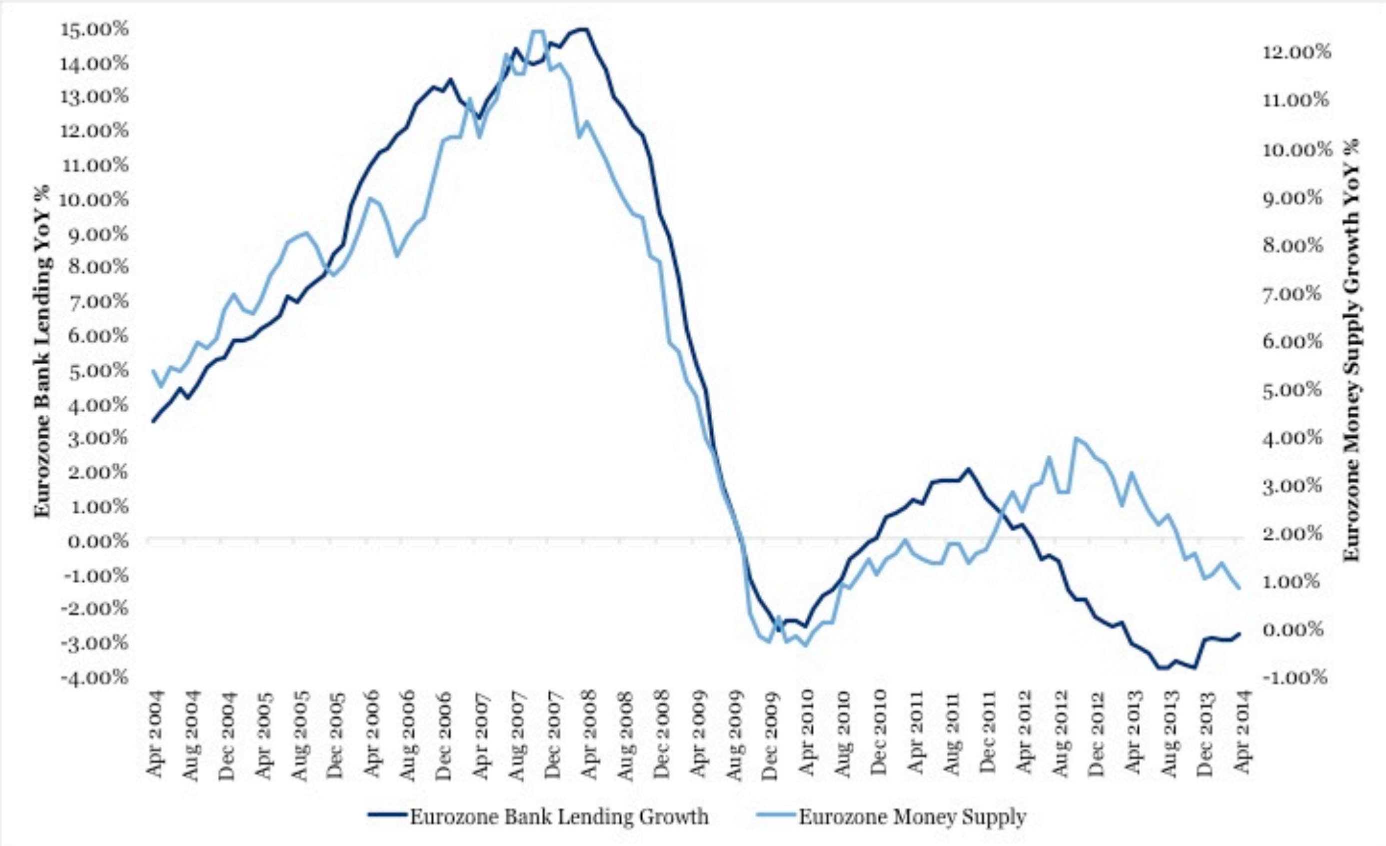
**Table 1: Eurozone Economic Data**

| Event | Country | Period | Surv(M) | Actual | Prior | Revised |
|---|---|---|---|---|---|---|
| Consumer Spending MoM | France | Apr | 0.50% | -0.30% | 0.40% | 0.60% |
| Consumer Spending YoY | France | Apr | 0.10% | -0.50% | -1.20% | -1.10% |
| Unemployment Change (000's) | Germany | May | -15K | 24K | -25K | -- |
| Unemployment Rate | Germany | May | 6.70% | 6.70% | 6.70% | -- |
| M3 Money Supply YoY | Eurozone | Apr | 1.10% | 0.80% | 1.10% | 1.00% |
| M3 3-month average | Eurozone | Apr | 1.20% | 1.00% | 1.20% | 1.10% |

Europe is becoming a cash economy. Credit is drying up and loans are non-existent. Euro area bank lending to non-financial corporations (NFCs) fell by €6.7bn in April, after a €4.0bn contraction in March.

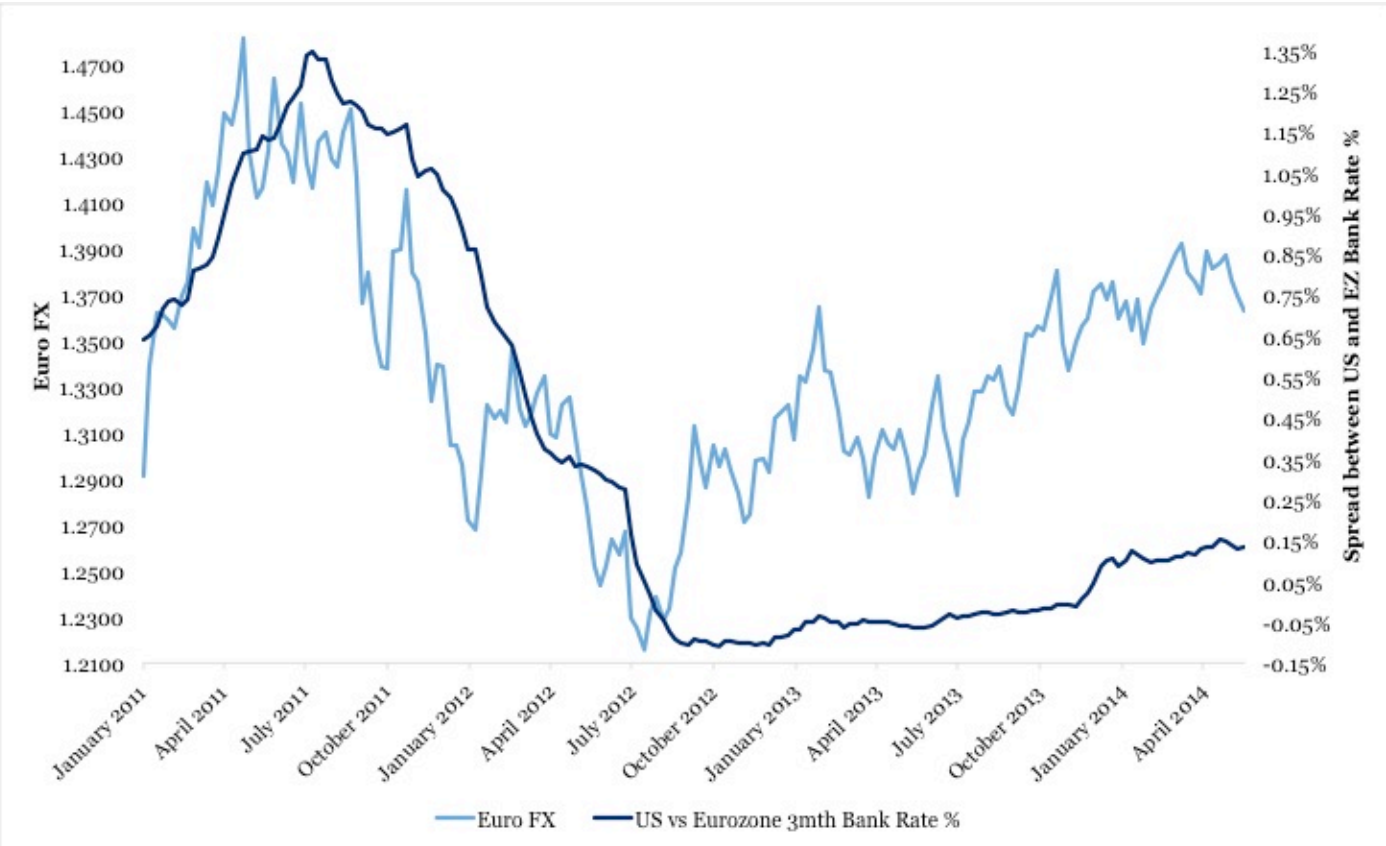
Lending rose in Germany and declined in Spain, while it was roughly unchanged in France and Italy. See below: without credit, prices will fall and the ECB will have to open the monetary spigots, properly.

**Figure 3: Eurozone Money Supply & Bank Lending**




I believe the Euro will fall back quite sharply in the months ahead.

**Figure 4: Spread between US & EZ 3mth Bank Rate % and Euro FX**



We are happy with the view that the Euro should be closer to $1.25 than $1.37. We continue to play this trade.

All you have to do is look at France's level of unemployment. The last time France's unemployment was rising like that and its currency was rising was in 1934. France stuck with the Gold Standard for a few more years and then abandoned it. The Euro is the Gold Standards of the 21st century. Time to read your history books again?

By the way, if you are interested in this stuff take time this summer to read this book.

You won't be disappointed.

## China: Premier Li has his eye on the ball.

As you know, one of my more contrarian positions is to be long Chinese stocks all year.

After the announcement of further policy action last week, we have heard very little from the Chinese authorities. Chinese stocks have rallied because global markets are more comfortable with the potential for further policy action from the Chinese authorities, both on the monetary and fiscal fronts. Here's what the boss man Premier Li had to say overnight:

*"Fundamental fiscal and monetary policy will remain intact" and*

*"China will adopt timely and moderate 'fine tuning' of economic policy"*

I remain over-weight China stocks and I'm very comfortable with the investment.

## Portfolio: US rates continue to weigh on performance

**Table 2: Our Portfolio**

| Trade Date | Closing Date | Pos | Market | Exposure | Trade Price | Current Price | P&L % | Price Target |
|---|---|---|---|---|---|---|---|---|
| | | | **Open Positions** | | | | | |
| 27/12/2013 | | S | Euro Spot | 150% | 1.389 | 1.362 | 2.90% | 1.32 |
| 13/01/2014 | | L | IPATH US TREASURY 5 YR BEAR | 150% | 39.044 | 37.4 1.4886 | -6.32% | 46 |
| 16/05/2014 | | L | IPATH US TSY 10Y BEAR | 150% | 26.343 | 26.2 2.4236 | -0.82% | 46 |
| 11/02/2014 | | L | ISHARES CHINA LARGE-CAP ETF | 150% | 35.207 | 36.89 | 7.17% | |
| 16/05/2014 | | L | IPATH S&P 500 VIX S/T FU ETN | 150% | 36.367 | 34.1 | -9.35% | |
| 29/05/2014 | | L | S&P 500 September 1850 Puts | 100% | 38.800 | 39.6 | 2.06% | |
| | | | **Open Position Return** | | | | **-4.35%** | |
| | | | **Closed Position** | | | | | |
| 12/05/2014 | 15/05/2014 | L | IPATH S&P 500 VIX S/T FU ETN | 100% | 37.207 | 38.15 | 2.53% | |
| 08/05/2014 | 09/05/2014 | L | IPATH S&P 500 VIX S/T FU ETN | 150% | 38.887 | 39.18 | 1.13% | |
| 05/05/2014 | 06/05/2014 | L | IPATH S&P 500 VIX S/T FU ETN | 100% | 39.650 | 39.93 | 0.71% | |
| 13/01/2014 | 02/05/2014 | L | IPATH US TREASURY 5 YR BEAR | 100% | 39.543 | 40.15 | 1.53% | |
| 24/02/2014 | 05/05/2014 | L | IPATH S&P 500 VIX S/T FU ETN | 100% | 40.950 | 40.8 | -0.37% | |
| 20/02/2014 | 07/05/2014 | L | LYXOR UCITS ETF DAILY SHORT | 150% | 36.243 | 36.35 | 0.44% | |
| | | | **Closed Position Return** | | | | **5.98%** | |
| | | | **Total Portfolio Return** | | | | **1.63%** | |