Q&A-S&P should drift lower in next 18 months; JPY to test 100: Jim Walker, Aletheia Capital

U.S. equities are expected to drift lower, with occasional bounces, for the next 18 months , **Jim Walker, chief economist at Aletheia Capital in Hong Kong,** told the Reuters Global Markets Forum on Wednesday, May 6.

"I think we are in the classic rebound phase after the initial shock but don't truly understand that the economic effects are likely to last until 2022 at the earliest," he said.

In currencies, Walker expected an 8% lower trade-weighted dollar by end of 2020. He said he was "long the Aussie dollar," and expected the yen to cross 100 versus the U.S. dollar.

Following are edited excerpts from the conversation:

Q: Three rate cuts and around an unprecedented $3 trillion in economic stimulus later, how much more can the Fed to keep markets and the economy supported?

A: I think it is anyone's guess now how much the Fed is willing to and able to do. It has become the second Bank of Japan, so the sky is the limit. Whether or not it will 'support' the economy is a different issue.

Q: What more tools do you see the Fed using from its ammunition from here? Do you see Fed going further, into negative territory?

A: The talk - among the monetary cranks, of whom there are many, is of Yield Curve Control. Not impossible by any means. It is just the case that central banks are all-in on a crisis that they themselves have created. The Bank of Japan has been running zero to negative interest rates for 30 years and is lucky if it averages 1% nominal growth. The Fed has managed to encourage both government and corporates to build debt since 2007 which means we start again in a highly overindebted position. The IMF estimated in October last year that a downturn half the size of the global financial crisis would result in $19 trillion in possibly failed corporate debt-at-risk, 40% of major economies' corporate debt. This is what happens when interest rates are suppressed for long periods of time. So more of the same can keep the corpse 'alive' but it is akin to "The Walking Dead".

Q: Do you see Fed going further, possibly into negative territory?

A: The Fed isn't in negative territory and has said it won't go there - it just does balance sheet expansion instead. Money market funds would collapse in the U.S. if they had to input negative rates.

Q: Just the announcement from the Fed on its plan to support the corporate bonds market sparked rallies across the spectrum and improved market functioning. But, over the longer-term, do you see a significant increase in downgrades, defaults and bankruptcies?

A: Yes, and the Fed didn't have to buy anything. It is still the case that, for most people, "In the Fed we Trust". But yes, significant downgrades, defaults and bankruptcies are inevitable.
Which sectors and companies are for the equity analysts. All I can say is that profit collapses lead to investment recessions and during investment recessions companies go bust, that is especially true if they are not covering their interest payments from existing earnings (which are about to go negative).

Q: Where do you see US equities before election in November?

A: Lower than here. I think we are in the classic rebound phase after the initial shock but don't truly understand that the economic effects are likely to last until 2022 at the earliest. I would expect U.S. equities to be drifting lower, with occasional bounces, for the next 18 months.

Q: Is a coronavirus-led trade war between the US and China likely to keep equity markets under pressure? Also, will it reinforce a dollar-supportive environment?

A: I don't think it will be a coronavirus trade war. It is all about politics and saving Trump's skin. He has shown himself to be totally unfit for leadership in this crisis and now needs a scapegoat. China is the easy one.
Dollar supportive? Difficult one, but I think that everyone will begin reassessing their debt loads and start paying down where possible. That might turn out to be dollar weakening, not supportive.

Q: And no safe haven appeal keeping the dollar supported either?

A: Not if the Fed goes for Yield Curve Control and depresses rates further.

Q: Where do you see the dollar going from here?

A: On a trade-weighted basis I think there is 8% downside by year-end. Against the yen, definitely lower. I would expect the yen to cross 100. We are long the Aussie dollar.

Q: Emerging economies (like Indonesia) seem to be following developed ones down unconventional paths by buying their own government bonds -- Is that a risky proposition considering concerns about rising inflation, which in turn could prompt a selloff in local currencies?

A: It is risky, but I think there was probably no choice given market conditions. More than a third of Indonesia's rupiah debt is foreign owned (the promise of BI intervention might stabilise things though). Remember, the rupiah lost 15% in March alone and reserves still fell by US$10 billion. That would have been scary. Not sure what other options would have been viable. If an auction failed that would be pretty damaging in itself for confidence and, specifically, the currency.

Q: Within emerging markets, what is your view on the INR?

A: Fundamentally I don't think there is much downside, but capital flows are still required to support it. I wouldn't be a seller at these levels, but I would be a very nervous buyer if forced into it.

Q: Wanted to get your view on oil -- supply-demand mismatch is expected to get balanced out by Q3, but there are continued expectations of OPEC+ further cutting output in the short-term. Do you see any discord/points of contention between Saudi and Russia, that could derail any further OPEC+ deal(s), or even the effectiveness of such a deal?

A: Impossible to predict the dynamics between Saudi and Russia (and, of course, the proxy war country of Iran). There needs to be supply cutbacks though just to get the stored oil used up. Without that there will be real weakness lasting into the autumn - bear in mind, transport is going to be very subdued for all of this year. So continuing pain in oil for now.