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The health of the US big-500 companies

by Justin Hsiao

By a lot of measures, the US economy is pretty much in pink right now. It grew at the fastest rate at 4.6% (QoQ) in six year in Q2 2014. Meanwhile, ratio household debt of disposable income dropped below 100%. The unemployment rate decreased to 5.9% in Sep 2014 according to the US Bureau of Labor Statistics and the change of average hourly earnings was 2% (YoY) during the same period. All positive signals where supported by the Federal Reserve's latest Beige Book- reporting that the US economy grew at a "modest to moderate" pace. Even, Federal Reserve Bank of Boston President Eric Rosengren sticks to 3% growth forecast despite he sees an end for quantitative easing (QE). The 3 rounds of QE have propelled the US stocks to new highs i.e. S&P 500 (SPX) is up close to 60% since the days of Lehman Brothers collapse in 2008. But, talks of an end to QE3 are causing markets to be jittery. However, the recent market highlights the downside risks that are lingering the US economy. Even the tech giant IBM, one of the big-cap stocks in SPX components, reported sharply lower third-quarter profit on a surprising 4% downturn in sales.

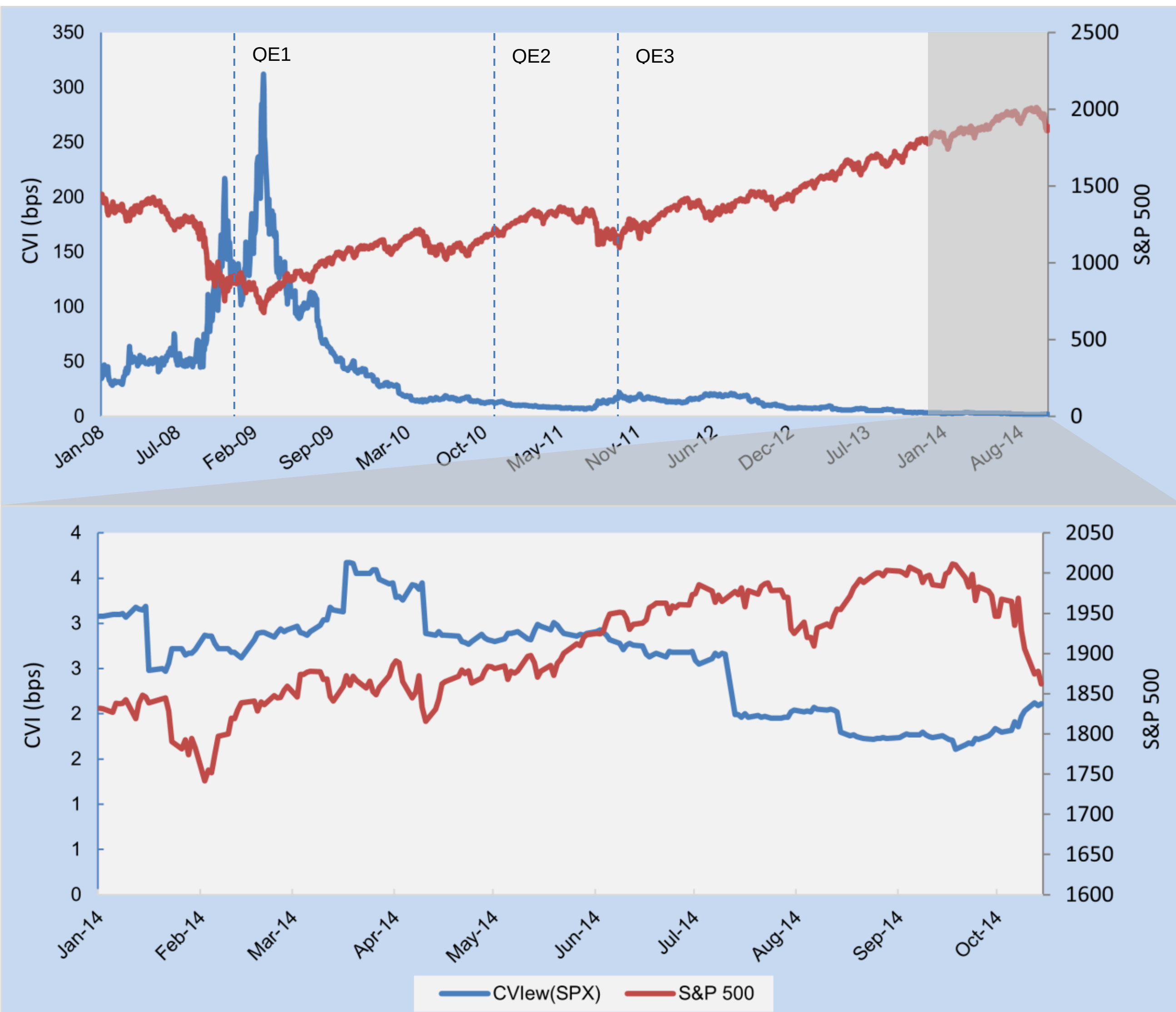

Figure 1: RMI equally weighted CVI for SPX and S&P 500. *Source: Bloomberg, Risk Management Institute*

In Figure 1, RMI's Corporate Vulnerability Indices (RMI CVI) for SPX gauges economic and financial environments in corporate credit markets of the top 500 large companies listed on NYSE or NASDAQ. The CVI which can be viewed as a stress indicator, started rising to 2.11 on Oct 15 from a low of 1.61 on Sep 14, the lowest value since 2008 financial crisis. Despite SPX just stood at its record high of 2011.36 on Sep 18, 2014, it recently had a biggest intraday loss since 2011 on Oct 15. This can be the turning point of the US economy, which postpones Federal Reserve's withdrawal of stimulus.

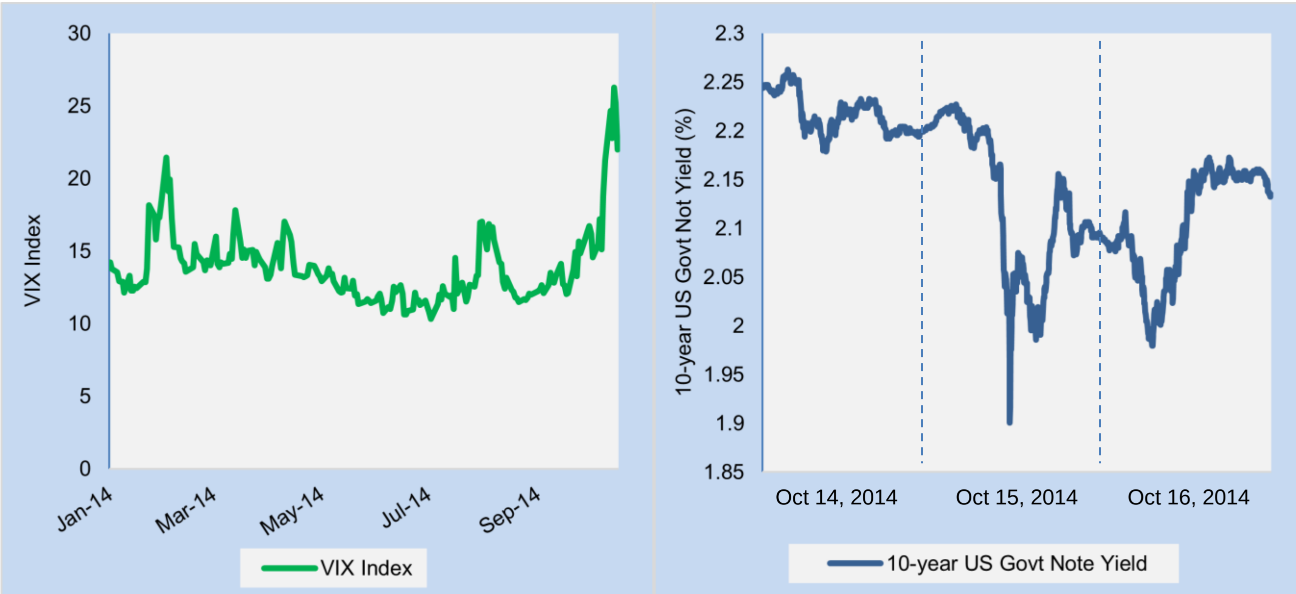

Figure 2a-2b: 2a (LHS) CBOX Volatility Index; 2b (RHS) 10-year US government note intraday yield. *Source: Bloomberg*

The increase of the RMI CVI and the plunge of the SPX can been further supported by the CBOE Volatility Index (VIX Index) in Figure 2-a. It peaked at 26.25 on Oct 15, 2014, the highest level since the euro zone sovereign crisis. VIX Index is calculated from the prices investors are willing to pay for options tied to the SPX. It is commonly considered as a fear gauge of financial market of the US. The recent elevation can be interpreted as US investors are in a cocktail of uncertainties ranging from faltering global growth, recurring problems in the euro zone, slowing Chinese economy to the spread of the deadly Ebola virus.

On Oct 15, the benchmark of US 10-year treasury dropped below 2% for the first time in 16 months. In Figure 2-b, the intraday level fell as low as 1.9%, which is the lowest value since May 2013. The long-term yield may come under pressure as investors rushed into safe haven of US government debt. Recently, Standard and Poor's downgraded France and Finland. Greece's intention to have an early exit from the bailout program also sparks the political risk in euro zone. Moreover, Germany, the powerhouse of Europe, had cut its growth forecast from 1.8% to 1.2% this year with a possibility of going into recession in the next 2 years. The market pull-back of the SPX price-earnings multiple has pulled back to 14.4 times on a forward 12 month basis. This is slightly above the 10-year average of 14.1 times and 5-year average of 13.5 times. Still, the upcoming policy from FOMC may hold the key to the direction of the SPX movement amid a still-struggling house market in the US and soft demand from Europe.

Credit News

SIA taking up majority stake to save Tiger

Oct 20. Singapore Airlines (SIA) will take majority control of Tigerair as part of a rescue plan for the loss-making budget carrier. SIA's stake could increase from 40% to 71% by January. This would pave the way for Tigerair to work more closely with the SIA on routes, flight timings and fares. In turn, this could benefit travellers by offering them more convenient connections and shorter waiting times when they transfer. Besides, Tigerair plans to sell its 40% stake in Tigerair Australia to Virgin Australia and to raise money by launching a right issue. According to Tigerair group CEO Lee Lik Hsin, there will continue to be challenges, but with steps taken to downsize the carrier and focus on the Singapore market, Tigerair is in a better place today. (The Strait Times)

- *Weekly Credit Brief covered Tigerair on July 29, 2014*

StanChart readies to close thousands of UAE accounts as US deadline

Oct 20. Standard Chartered has notified thousands of UAE small and medium enterprise customers closing their accounts as it responds to pressure from US regulators to cut its risks following an anti-money laundering settlement. Under a settlement agreed with the New York State Department of Financial Services in August, the bank was fined USD 300mn and given 90 days to end high-risk relationships with SMEs in the UAE and suspend processing of dollar-denominated payments for some clients at its Hong Kong unit. The UAE central bank said in August that between 1,400 and 8,000 Standard Chartered accounts in the country were expected to be affected by the US settlement. (Today)

High household debt manageable: Moody's

Oct 21. The high level of household debt in a number of Southeast Asian countries poses a risk for private consumption growth and banks' asset quality, but is ultimately manageable, says Moody's Investors Service. Even though elevated household debt could place refinancing pressure on mortgage and consumer credit as the global credit cycle gradually tightens, the risks are well contained and can be mitigated by government action. (The Nation)

PBOC injects liquidity into banks (Ecns)

IBM woes point to a fresh overhaul (WSJ)

Regulatory Updates

Credibility meets compromise in Europe's bank stress test

Oct 19. The European central bank (ECB) is going to announce latest health checks of European's 130 biggest banks on Oct 26. The ECB promised the checks would be “comprehensive assessments” of how well prepared the banks were to withstand another financial crisis. However, according to the sources, ECB has had declined a lot of pleas from banks and national supervisors for special treatment since banks have failed to provide all the data demanded, and supervisors have to revise the way they value assets. These compromises could threaten the test's reputation as tough and consistent. (Reuters)

BSP hikes minimum capital for banks

Oct 20. The Bangko Sentral ng Pilipinas (BSP) announced it was hiking the minimum capital requirement for all banks to strengthen the banking system after the Philippine government allowed more foreign banks operate in the Philippines on Oct 20. This move was in preparation for the regional financial integration among members of the Association of Southeast Asian Nations (ASEAN). (GMANews)

Banks warned of stiffer penalties

Oct 20. Federal Reserve Governor Dan Tarullo has warned the banks, which are not doing enough to curb misconduct of their employees, will face stiffer constrains and punishments if they do not improve. He also mentioned that financial stability concerns would dictate that big firms, which cannot be managed effectively, need to be dramatically downsized and simplified thus can be well-managed. (FT) (Subscription required)

Banks blame bond volatility on tighter regulation (FT) (Subscription required)

Banks set to defy European regulator on bonus rules (Telegraph)

Bad bank behaviour could drive break up : Fed's Dudley (WSJ)

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