Weekly Market Summary

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Janet Jackson Rocks…. Janet Yellen at Jackson Hole, Not So Much!!
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Hurrah, we all made it!! It is finally Janet Yellen day at the Jackson Hole Symposium, the big economic event Wall Street has long been waiting for. Was there ever a speech by a Fed Chair that had been so anticipated, dissected and stressed over to this extent? It is partially down to the fact that Yellen has largely, even unprecedentedly, made herself unavailable for public comment; instead sending her lieutenants out in past weeks to confuse markets more. But more alarmingly, all Fed officials have put themselves in a situation where a minor 25 basis points rate hike announcement could now appear like a life-changing event?!

How odd it feels to remember whether we ever debated in such details how much they might do! Unfortunately, economists and traders have now been reduced to considering whether even a hawkish hint could throw the global financial system into cardiac arrest. Truth be told, not even the equity market will suffer for long from a one hike and low neutral-rate message. However FOMC members have embraced the notion that the world's fate hinges on their every move and that has affected their judgment and, frankly, adversely affected their forecasting abilities (they are desperately afraid of ever being wrong again after the dot-plot fiasco in past 2 years). Still, the Fed has no business at this point forcing investors to continue to ramp up risk in every manifestation. They are simply reinforcing the walls of the leverage prison from which they see no escape.

Will Janet Yellen shock today? Perhaps because the month has been so dull, many market participants are getting too excited by the prospects of a meaningful speech by the Fed Chair later today (5:00 pm Bahrain time) that will give market participants a lot more clues on the immediate Fed policy and lead to wild market gyrations.

Yet, there is a strong case for assuming that all the speculation and guessing in past weeks about Yellen's choice of words is a pure waste of time! Not only has the Chair tried to deemphasize the policy significance of the annual Jackson Hole event, but it is also unlike her to break new ground in a public address; Janet Yellen sees her role as delivering the message the Committee wanted transmitted, and not to unilaterally set policy as her predecessors Alan Greenspan and Ben Bernanke often had in the past. Instead, she sees the post FOMC meeting policy statement and press conference as the means for delivering important policy messages to the market. It is also unlikely that the Committee would have had an emergency meeting to discuss required policy changes that would need to be delivered to the market at this weekend's event. Moreover, the title of her talk is "*The Federal Reserve's Monetary Policy Tool kit - Designing Resilient Monetary Policy Frameworks for the Future"* and there is no question and answer period scheduled. This does not mean there will not be surprising sound bites to come out of the speech; but we already know the opinion of most of the Committee members and so nothing new is likely to be discovered. Expect lots of gossip and innuendo but nothing of substance. The next payroll report, due out on Friday September 2nd, might be decidedly more important to the market than this weekend's symposium.

Several FOMC members have spoken out in recent days, stressing that the Federal Reserve remains in tightening mode. Notably Vice-Chairman Stanley Fisher said last weekend that he thought the central bank was close to achieving its targets (i.e. was in a position to raise its rates), whilst Federal Reserve Bank of Kansas City President Esther George, speaking in a Bloomberg Television interview yesterday evening, repeated her case that higher rates were warranted with the U.S. nearing full employment and inflation rising toward the central bank's target. Separately, Dallas Fed chief Robert Kaplan told CNBC television on Thursday that "*the case is strengthening*" for another increase.

Relevant Market Update Going into Jackson Hole Symposium

- ***Economic Summary:*** The US economy created a further 255,000 jobs in July (after 287,000 in June), the US unemployment rate sits at 4.9% and average hourly earnings have last increased by 2.6%, while the core CPI currently stands at 2.2%. Whilst external factors have come to exert greater influence on the Federal Reserve's responsiveness, on this front also everything is positive: Brexit has not yet had any impact on the hard data, concerns over China have receded (in contrast to last year) and crude prices are holding within a range considered reasonable by all stakeholders. As for emerging markets, they are waiting to see how the Federal Reserve's policy affects the greenback and US interest rates. Certainly, the skeptics within the Federal Open Market Committee ("FOMC") will want to await third-quarter GDP data (released on October 28th) following the strong disappointment in Q1 and Q2 (+0.8% and +1.2% annualized growth respectively). And with the US presidential election on November 8th , many feel the Federal Reserve will be unlikely to move rates at the November 2nd FOMC meeting (leaving the Fed with 2 choices: Come off the fence on September 21st, or wait until December 14th, bearing in mind press conferences are planned after both meetings).

- ***Market Pricing:*** Traders currently see one-in-three odds of higher U.S. interest rates next month as more Federal Reserve officials have lately joined the chorus arguing the case for policy tightening before Chair Janet Yellen speaks Friday. Implied probability in futures markets of 32% is double what it was two weeks ago, and up from zero after the U.K. voted to exit the European Union in June. Two-year US Treasury yields, which are more sensitive than longer maturities to the monetary policy outlook, have risen from a low of 0.54% in early July and are last trading at 0.78%. By December 14th, the implied market probability for a 25 bps hike jumps to 58%.

- ***Market Reaction:*** If Janet Yellen surprises today and readies the market for an imminent interest rate hike, this would clearly push up the US dollar, lead to a sharp bull flattening of the US yield curve (i.e. rates across the curve would move up, but more so on shorter maturity bonds), and send emerging markets, gold and equities on the retreat. By contrast, if nothing gets really clarified, the EUR/USD would likely recover above 1.13-1.14, US rates would remain depressed, and global stocks will bounce nicely.

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