Weekly Market Summary

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Markets in Desperate Need for Visibility and Guidance!!

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Over the past 10 days, market turmoil has eased with the devastating start to the year for financial markets taking a minor respite.

Yet, poor earnings and heightened volatility / turbulence in the market for emerging market assets as well as low-rated corporate bonds strongly remain in place, raising concerns that the breather for equity markets may be just a blip. Yesterday marked the sixth trading day out of nine that U.S. stocks ended on an up note, putting February in the green for major indexes (US Stocks Futures point to another positive session this afternoon). The Dow industrial Index is up 1.5% this month after slumping more than 9% in the first three weeks of the year (but still down 4.2% YTD). WTI oil, which had lately moved in the same direction with stocks, posted a strong week too, up 4.2% in what bulls call a positive sign for global growth (WTI for April delivery last at $ 33.60. A close above this level later today would signal bullish momentum for the medium term).

Also in a sign of new-found resilience, equities in both Europe and the U.S. on Thursday shrugged off a 6.5% selloff in Chinese stocks. Two months ago, declines like that would have dragged down global commodity and stock indexes. The buoyancy suggests investors are weathering negative news or are not too worried that the global economy is in decline or that the aging bull market has peaked.

Still, the recent rally faces obstacles: Markets continue to be edgy and sharp intraday moves remain the norm. Even as stocks rose Thursday, investors bought U.S. Treasuries, sending prices up and yields down (despite the usual negative correlation between those asset classes). The yield on the 10-year Treasury note declined to 1.70% from 1.75% the previous day. And new cracks emerged in the corporate bond market: Bankers for Solera Holdings Inc. this week had trouble generating interest in bonds for a takeover of the software firm, suggesting it is getting harder for heavily indebted companies to borrow. Additionally, earnings for the S&P 500 companies are on track to have dropped from a year ago for three straight quarters, which would be the first time that has happened since 2009 (overall, earnings for S&P 500 companies fell 3.6% from a year ago in the fourth quarter, with about 95% of companies having reported, according to FactSet data)

The big concern remains China, where analysts predict a financial crisis will strike as soon as this year. Non-performing loans are poised to surge as borrowers pile on debt to repay their existing loans, while companies face "big" asset write-downs as the economy slows and commodity prices sink. *"There is a significant possibility that China and Brazil, in particular, will have to undergo some form of economic or financial crises,"* John-Paul Smith - the London-based strategist who accurately predicted the slump in emerging markets that began in 2011 - said.

Smith admits that yields on emerging-market debt have grown more attractive in a world of rock-bottom interest rates and says that some developing-nation currencies, notably the South African rand and Mexican peso, look undervalued. But he is unconvinced that emerging-market bonds would be immune to economic turmoil in China and Brazil. He says investors should focus on allocating assets to specific countries rather than making blanket bets on global emerging markets.

Diverging policies at many of the world's major central banks and unpredictable geopolitical shifts are further muddying the picture for investors. In the U.S., the Federal Reserve raised interest rates in December for the first time in nearly a decade (to many, it's a one and done!), whilst policy makers in Japan and Europe are cutting interest rates into negative territory in a bid to stimulate growth. In the U.K., voters are grappling with whether to leave the European Union, creating additional uncertainty for markets.

And whilst many remain optimistic that the continuing central bank stimulus will plow money into the system and help underpin the global economy, others strongly argue that the overall momentum remains clearly on the downside. In that context, a Citigroup team of economists led by Willem Buiter recently signaled that "*to avoid a recession and a greater slowdown in potential output growth than is warranted because of worsening demographics, the world needs a global version of what we would call "Abenomics"* plus*,'" which in Citi's terms would be easy monetary policy coupled with fiscal stimulus and structural reform that would include "*material deleveraging*." But, given their recession call, the team does not believe these policy measures will actually occur as fiscal stimulus faces high political hurdles (starting with Germany's tough stance on this matter!). "*Even though we suspect that ongoing economic weakness and limited options for incremental monetary easing will probably reinforce the trend towards modest fiscal easing, we do not foresee a shift to decisive fiscal easing*," they sadly conclude.

Earlier today, China's central bank Governor - Zhou Xiaochuan - highlighted scope for further policy actions if needed. "*China still has some monetary policy space and multiple policy instruments to address possible downside risks*," Zhou said at a conference in Shanghai, speaking hours before meeting his counterparts from the Group of 20 developed and emerging markets. The People's Bank of China separately published a statement defining current policy as "prudent with a slight easing bias." The PBOC had previously used language pledging to maintain a prudent policy while maintaining "reasonable, ample" liquidity. Those comments echoed Finance Minister Lou Jiwei's confirmation that "*China still has the room to loosen fiscal policy*" (in opening remarks at the start of the G-20 meeting, which he is co-hosting with Zhou). Policies should include cutting red tape, targeted tax breaks, and increasing the mobility of migrant workers, Lou said. The PBOC has also been trying to restore stability to the nation's currency as capital flows out at a record pace. It reiterated today that there is no basis for persistent yuan depreciation: Recent moves to reference the yuan against a basket of currencies have "*now taken shape*," the PBOC confirmed.

As China hosts the world's top economic leaders during the same year when the yuan gains reserve currency status from the International Monetary Fund, it is finding its own policies are further in the spotlight. Economic leaders such as IMF Managing Director Christine Lagarde and U.S. Treasury Secretary Jacob J. Lew have called for better communication from the world's second-biggest economy. "*We have all been telling the Chinese that more communication, clearer communication would be helpful for the market*," Goldman Sachs Group Inc. President Gary Cohn said today in a Bloomberg Television interview in Shanghai. "*Hopefully, the Chinese are trying to more clearly communicate what their initiatives are going to be.*"

And to think I was starting to get overly worried about the sharply deteriorating risk sentiment in financial markets, the ability of monetary authorities to boost demand and the renewed fears of currency wars as the global economy becomes trapped in a low growth, low inflation and a low interest-rate equilibrium!?

Turns out it was just a minor “miscommunication” problem!!

**Abenomics refers to the economic policies advocated by Shinzō Abe since the December 2012 general election, which elected Abe to his second term as Prime Minister of Japan. Abenomics is based upon "three arrows" of fiscal stimulus, monetary easing and structural reforms.*

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