Weekly Market Summary

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The Relative Calm That Will Soon Give Way to a Market Storm!!

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The whole world is moving together and signs of a massive bubble that involves various asset classes are becoming clearer by the day. Yet, given the driver is cash printed by central banks, indications it could pop appear negligible for now and most traders still seem willing to bet on volatility staying lower for longer! That surely explains why implied volatility in currencies and fixed-income markets has approached a fresh low for the year (not to mention reduced volatility for gold and Chinese equity prices, with the latter falling to the lowest level in two years amid talks that state-backed funds are oppressing market moves!).

Yet, a Credit Suisse gauge known as the cross-market contagion indicator - which tracks price relationships in equities, credit, currencies and commodities - shows different markets are influencing each other more than at any time since at least 2008. Historically, very high correlations are associated either with a panic or a bubble. Extreme asset inflation tends to reach fever pitch partly because of what scholars call positive feedback, or where exuberance and herd mentality feed further investment. Some of the biggest bubbles of the past century were marked by this spillover to all asset classes. But once one market pops, volatility soars and inter-related bubbles deflate simultaneously as well!

With hindsight, it is usually easy to spot the asset class that starts things: In 2008, it was real estate; in 2001, dot-com companies. This time, it is clearly excess cash! With all the central bank experiments in Japan, Europe and even the U.S., there is just too much money lying around. Which poses a big dilemma: The dot-com bubble burst when it became clear many tech startups would never break even. The U.S. housing market popped after home prices detached so far from income it became obvious further rises were not sustainable. The question now is how can a central-bank-led cash bubble burst when there is an ever flowing money hose?

I firmly belong to the minority camp that is betting the current market calm won't last long! After all, many uncertainties - relating to US Fed policy, Chinese growth prospects and doubtful loans, US & European politics, oil prices, etc.. - will soon come up and rock the economic boat! That possibly explains why the tactical allocation team at Norway's largest bank – confronting massive central banks' stimulus inflating stocks and bonds - has chosen to open a bet on volatility for the first time. The specialized unit at DNB ASA is hedging its mixed funds by keeping duration short and buying volatility index contracts for the first time, according to Torkild Varran, CEO of DNB Asset Management, who oversees about 530 billion kroner ($64 billion). This cautionary message is also echoed by DoubleLine Capital CIO's Jeffrey Gundlach – who said during a webcast yesterday – that it is time for fixed-income investors to prepare for rising interest rates and higher inflation by reducing the duration of their positions, moving money into cash and protecting against volatility. "*This is a big, big moment and interest rates have bottomed. They* *may not rise in the near term as I have talked about for years. But I think it is the beginning of something and you're supposed to be defensive*." (DoubleLine's flagship Total Return Bond Fund has $ 61.7 billion AUM).

Moving to two important stories we have been tracking in the past 48 hours, and summarizing below:

- **European Central Bank Monetary Policy Meeting**: Traders were taken back yesterday by ECB President Mario Draghi's signals that the European Central Bank is in no rush to boost its asset purchases ("QE") at a time of mounting concern over e recovery in the Eurozone after the UK Brexit decision. About half of respondents to a Bloomberg survey conducted last week foresaw action by the central bank at yesterday's meeting, with almost all the others predicting changes in October or December. As a result, bonds declined with stocks, while the euro strengthened: Yields on Treasuries and German bunds due in 30 years climbed the most in more than a month. Global equities halted a five-day advance, whilst the euro rose against all but one of its 16 major peers.

- **Oil Prices Surge**: West Texas Intermediate for October delivery rose yesterday $2.12, or 4.7%, to $47.62 a barrel on the New York Mercantile Exchange. It was the biggest gain since April 6th, leaving prices at the highest close since August 26th. Crude inventories fell 14.5 million barrels last week, according to the Energy Information Administration ("EIA"). That was the biggest drop since January 1999. A 905,000-barrel gain was projected by analysts surveyed by Bloomberg before the release. Tropical Storm Hermine moved into the Gulf of Mexico on August 28th, disrupting shipping and output before moving northeast. Imports tumbled 1.85 million barrels. "The huge number is clearly a result of storm activity in the Gulf," said Michael Lynch, president of Strategic Energy & Economic Research in Winchester, Massachusetts.

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