Weekly Market Summary

14th of July 2017

Rigged Financial Markets Driven by News on More WH Meetings with Russian Operatives & Further Potential Appointments of Ex-Goldman Sachs Staff at the Fed !
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The semi-annual Congressional testimony of Fed chairwoman Janet Yellen was expected to be the most important event of this week. After all, the Monetary Policy report to Congress - prepared by the Board of Governors of the Federal Reserve twice a year (February and July) as mandated by the Humphrey-Hawkins Full employment Act of 1978, and presented by the Fed Chair to the Committee on Banking, Housing and Urban Affairs of the Senate & the Committee on Financial Services to the House of Representatives - usually provides the top US central banker with a golden opportunity to prepare markets for upcoming Fed actions (be it a rate rise or rate cut, or more lately QE extension and tapering).

However, this time around, it did not reveal anything new in comparison to the minutes of the FOMC's June meeting (released on July 5th): Federal Reserve Chair Yellen noted that the U.S. economy should continue to expand over the next few years, allowing the central bank to keep raising interest rates, while also stressing a gradual approach to tightening as the Fed monitors too-low inflation. "*Considerable uncertainty always attends the economic outlook…There is, for example, uncertainty about when -- and how much -- inflation will respond to tightening resource utilization*," Yellen said. Financial markets welcomed the Chair's slightly more cautious stance on the inflation outlook and prudent wording on the future course of rate rises, with equities rallying by roughly 0.8% over the past 48 hours (ending close to or at record highs!) and 10-year US yields dropping by 4 basis points during the same period. With inflation now the guiding light for the Fed's upcoming rate-rise path, this afternoon's June Consumer Price Inflation (CPI) data – released at 3:30 pm Bahrain time - will be closely monitored and could eventually determine the trend of the USD and US interest rates for weeks to come (Bloomberg consensus is for a slow +0.1% month-on-month increase translating into a +1.7% year-on-year rise).

More importantly Yellen's current term as Fed Chair expires on February 3rd, 2018 - which could make Wednesday/Thursday hearing one of her last before the House and Senate committees. She was asked several times about whether she would serve a second term as Chair during the House hearing. "*It is something that has not been an issue so far,*" but it is "*certainly something that I would discuss with the President, obviously,*" Yellen said in response to a question. In past weeks several reports have suggested that President Trump could soon pick Gary Cohn, who currently head the national Economic Council, to replace Yellen when her term expires in early 2018. Cohn was formerly the president and chief operating officer of Goldman Sachs (Surprise!) from 2006 to 2017 (it is remarkable how a group of Goldman Sachs alumni has surfaced in Donald Trump's inner White House circle! That includes Cohn, along with Steve Mnuchin (Treasury Secretary), Dina Powell (Deputy National Security adviser) and Steve Bannon (Chief Strategist); A development that has confounded Massachusetts Senator Elizabeth Warren, an outspoken critic of Wall Street's bad behaviour leading up to the financial crisis and since, and prompted her to say *that "Donald Trump promised to drain the swamp; then he put enough Goldman bankers on his team to open a branch office of Goldman in the White House!").*

Mr. Trump has by no means ruled out reappointing Ms. Yellen to the position when her current term expires. After being sworn in as President, he abruptly ceased his attacks on the Fed Chair, in part under the influence of Mr. Cohn. With speculation on Mr. Cohn's intentions intensifying, senior administration officials have insisted it is early in the process and no decisions on the Fed have been made, with one stressing that there was nothing imminent on the cards in terms of any kind of move for Mr. Cohn. If the former Goldman Sachs banker were to seek the Fed post, however, it could mark the first time the central bank had a chair without an extensive economics background since the tenure of G William Miller, who served a brief and troubled stint in the late 1970s under Jimmy Carter. That makes some former Fed officials nervous. "*I have nothing specific to go on [to suggest] that he understands monetary economics,"* said Joseph Gagnon, an ex-Fed official who is now at the Peterson Institute for International Economics. "*I would reserve judgment but I have no reason to think he does. I would support reappointing Janet Yellen, and it would be in President Trump's best interests to do so*."

Talking about Trump's best interests, the US President recently declared that his son was "*innocent"* as the scandal over his campaign's ties to Moscow escalated with Donald Trump Jr's admission that he met a Russian lawyer to get damaging information on Hillary Clinton (purportedly being offered by a senior Russian official). "*My son Donald did a good job last night*," Mr. Trump tweeted on Wednesday. "*He was open, transparent and innocent. This is the greatest Witch Hunt in political history. Sad*!" The US President added in an interview with Reuters that he had not known of his son's meeting with the Russian lawyer until a few days ago, but defended him for agreeing to it. "*I think many people would have held that meeting,*" he said. Christopher Wray, the Trump administration nominee for director of the Federal Bureau of Investigation, told Congress that he disagreed with the way the president had characterised the Russia investigation being led by Robert Mueller, the justice department special counsel. "*I do not consider Director Mueller to be on a witch-hunt*," Mr. Wray told the Senate judiciary committee during his confirmation hearing. "*An effort to interfere with our election is an adversarial act,*" he added. Mr Trump Jr. took to Fox News on Tuesday night to defend the June 2016 meeting that occurred after an acquaintance told him that an old business partner of his father had information that was "*part of Russia and its government's support*" for the Trump campaign. Asked whether he had worried that the information was purportedly coming from a Russian official, Mr. Trump Jr. said the situation occurred before the current "*Russia mania*" and added: "*I don't even think my sirens went up or the antennas went up*". Critics have pounced on the revelations contained in emails between Mr. Trump Jr and Rob Goldstone, a British music industry PR executive, as evidence of collusion between the Trump campaign and the Kremlin. The US president has previously denied that his campaign aides had any involvement with Russia - but that claim has been seriously undermined by those surfacing emails, which his son released on Tuesday to pre-empt a New York Times story. Jared Kushner, the President's son-in-law and now White House aide, and Mr. Manafort – the former Trump campaign manager – also attended the meeting Mr. Goldstone had arranged for Mr. Trump Jr. with Natalia Veselnitskaya, a Russian lawyer. This latest controversy about last year's presidential campaign dims the U.S. economic outlook, according to Dan Ivascyn, chief investment officer at Pacific Investment Management Co. (PIMCO); President Donald Trump's key initiatives such as a health-care overhaul, tax cuts and fiscal stimulus are less likely to win approval before the 2018 mid-term elections as polemics build, Ivascyn suggested. "*We are becoming a bit more cautious about the possibility of meaningful legislation*," Ivascyn said. "*These types of distractions are just going to make it even more difficult to gain consensus*." U.S. stocks initially dipped on Tuesday (160 points lower on the Dow Jones Industrial Average) and trading volumes spiked intraday after the release of e-mails by the younger Trump about meeting with the lawyer, though they ended higher as Wall Street recovered from Trump Jr. bombshell. Ivascyn co-manages the $88.9 billion PIMCO Income Fund, which has returned an average of 8.1% over the past five years, outperforming 99% of its peers, according to data compiled by Bloomberg.

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