Weekly Market Summary

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Still Pretending to FULLY Understand Every Market Move?! We Surely DON'T!!
Fadi Nasser - Deputy Chief Investment & Treasury Officer

U.S. equity futures staged a rebound this morning after the worst two-day equity slump since February, as a combination of negative technical and persisting fears of trade wars continued to exert outsize influence on the stock market. December contracts on the Dow Index climbed as much as 1.3% in Asian trading Friday, compared with the cash market's 6.7% decline over the past week. Stock trading turned extra volatile yesterday as the S&P 500 neared and then fell through its 200-day moving average, a chart line that has put a floor under several selloffs earlier this year.

One of the worst myths out there is that the market is always rational and makes sense; That is surely not true! The other one is that many investors pretend to fully understand market moves: If that is the case and you have a really good theory about why stocks have tanked lately, then line up next to everyone else who has a really good theory! On any given day, the market can make seemingly random moves for reasons that do not make sense: Sometimes stocks go up when they should have gone down, and sometimes entire sectors move for ridiculous reasons! "*Never assume that just because something happened, it has to make sense because the market is always supposed to make sense. That's nonsense*," Jim Cramer – host of CNBC's "*Mad Money*" once said. The key is to understand the catalysts that make stocks (and other asset classes) move: If a move has nothing to do with the underlying prospects of the company, then take advantage of that irrationality, not buying into it by chasing the stock higher or panicking out of it at depressed levels (a la Warren Buffet's mantra: "*Be fearful when others are greedy and greedy when others are fearful!*")

Additionally, here is a dirty secret about the stock market: Much of the time, nobody has any earthly idea why stocks rise or fall on any given hour or day. The trouble is that many economists / consultants are paid to explain such phenomena, and so they often resort to that mysterious analytical technique known as "*guessing*." Take the US stock market's collapse on Wednesday/Thursday, including a 1400-point loss on the Dow, one of the worst on record. What happened there? As Barry Ritholtz – an author and Bloomberg columnist - points out, everybody has answers that are seemingly obvious now: Interest Rates! Trade Wars! Trump Tweets! George Soros! **But if these were so obvious, then why did nobody see the collapse coming?** The truth is, Barry writes, "*the random walk thesis of how markets move is* the best explanation we have."

We - at GIB - have long expressed our amusement at some of the market narrative & movements that have prevailed in past years - especially those that made little to no sense - and reflected that delight in the selection of ironic titles for previously released weekly market pieces:

- *Are We Back to Business As Usual?! Or Just Waiting for the Next Big Shoe to Drop?! (9th February 2018)*
- *Fire and Fury on Various Fronts!! Realities or Misconceptions?? (12th January 2018)*
- *A Totally Misleading Market Herd Behaviour! How Long Can This Continue? (9th December 2016)*
- *Messy and Irrational Markets.... Perfect Time to Plan a Summer Holiday!! (17th June 2016)*
- *Forecasting Financial Trends Was Never Simple! Especially When Sudden Shifts in Sentiment Rule!! (4th March 2016)*
- *No Straight Answers to Recent Market Carnage... Better Ask the Red Indian Chief!! (12th February 2016)*
- *Want to be Surprised?! Start Tracking Financial Markets! (29th October 2015)*
- *The New Market Normal: Surreal Events That Keep Recurring! (8th May 2015)*

- *Have Markets Decoupled from Fundamentals / Reality??!! (28th April 2014)*
- *Don't Believe Everything You Read! (7th April 2014)*
- *Trying to Make Some Sense of these Markets.... Join the Club! (24th January 2014)*
- *Confused with recent US Market Action?! Join the Club! (17th May 2013)*

Going back to this week's equity sell-off, the S&P 500 fell the most since February and the Nasdaq 100 had its worst day in seven years. But while the size of the declines were a shock, Wall Street traders reported little in the way of panic (surely the VIX index doubled in value over the past week - from 12 to 24 – but in the big scheme of things, such move is still considered minor). So which specific factors can be blamed for this latest bout of heavy selling / profit taking?

- ***Higher Short-Term and Long-Term US Yields:*** The equity sell-off was most likely precipitated by turbulence in the bond market. Strong US economic data and an increasingly optimistic tone from Fed officials had forced investors, in past weeks, to re-appraise their outlook for further interest rate increases, pushing the benchmark US Treasury 10-year yield to a seven-year high of 3.26% (last at 3.14%) early in the week (higher yields usually imply less favourable discounting for equity valuations). Speaking to reporters on Wednesday, President Donald Trump again criticized the Federal Reserve for raising interest rates, saying the central bank "*has gone crazy*" tightening too fast (also adding that central bankers are going "loco" [crazy in Spanish] and "wild" with "ridiculous" interest-rate hikes). He called the stock selloff "*a correction that we've been waiting for a long time*." The US Federal Reserve has a reputation of raising interest rates until "*something breaks*". Maybe markets are beginning to think that this time may be no different!

- ***IMF Growth Downgrade:*** The International Monetary Fund said the world economy is plateauing as the lender cut its growth forecast for the first time in more than two years, blaming escalating trade tensions and stresses in emerging markets. The Fund on Tuesday projected a global expansion of 3.7% this year and next, down from the 3.9% projected three months ago. It was the first downgrade since July 2016. Whilst the global economy is still on track to match last year's pace, which was the strongest since 2011, the new outlook suggests fatigue is setting in and the overall performance is masking divergence with mounting weakness in emerging markets from Brazil to Turkey. The Fund left its 2018 U.S. forecast unchanged (at 2.9%), but cut its expectation for next year, citing the impact of the trade conflict. Risks to the global outlook have risen in the last three months and tilt to the downside, the IMF noted: Threats include a further inflaming of the trade war between the U.S and countries including China (President Donald Trump has so far slapped tariffs on $250 billion in Chinese goods this year, and Beijing has retaliated with levies $110 billion of American products), and a sharper-than-expected rise in interest rates which would accelerate capital flight from emerging markets. Christine Lagarde, the head of the IMF, used her podium at a Balinese beachside conference centre this week to deliver some marching orders to economic policymakers in emerging markets. They should, she said, "*use all the tools*" at their disposal to stem the capital outflows that would inevitably be triggered by tightening monetary policy in the US, and the escalating trade war between the US and China.

- ***Italy's Persisting Problems:*** Only four months after taking power, unlikely allies Luigi Di Maio of the anti-Establishment Five Star Movement and Matteo Salvini of the anti-migrant League have picked a fight with Brussels that they could well win. Italy and the 18 other countries that use the euro as their currency have until October 15th to submit their 2019 spending plans to the European Commission for approval. The "*people's budget*" that Di Maio and Salvini have drafted in past week (it got approved by the Italian parliament in past hours) seeks to make good on costly election promises, while flying in the face of European Union rules that set limits on government deficits and debt. If the European Commission blinks, Rome gets away with new-style Keynesian stimulus, defying the prevailing austerity. If it is thumbs down, the Italians get a reprimand, which they can exploit to cement their hold on power by rallying their base and revving up their offensive against the Brussels elite. "*For the populist government, it's a win-win*," says Giovanni Orsina, head of the School of Government at Rome's Luiss-Guido Carli University. On paper, the fight is over money to start paying for campaign pledges: Five Star stumped for a basic income for the poor of €780 ($895) a month, while the League promised to cut taxes and lower the retirement age. The government's fiscal outline contemplates a deficit of 2.4% of gross domestic product for 2019, three times the gap targeted by the previous administration. Despite pressure from the EU and from investors, who have repeatedly pushed yields on Italian government bonds to multiyear highs (the high earlier this week was at 3.72%, a 4-1/2 year high. Last at 3.53%), the ruling coalition has refused to budge on that number, though it has agreed to lower deficit targets for subsequent years.

- ***Technical Selling:*** "*My best guess is that the latest sell-off is technically motivated given how low the market has gone*," said Shane Oliver, head of investment strategy at AMP Capital Investors Ltd. Additionally, worth noting that traders usually panic and turn bearish when stocks do not bounce back by the end of the session and the equity gauges subsequently close off at the lows of the day (I am guessing still no Jerome Powell "put" in sight, nor any imminent support from the Plunge Protection Team ("PPT") – though we promised to keep that thrilling info for a future write-up ☺).

This morning's rally in equity futures comes after U.S. Treasury Department's staff advised Steven Mnuchin that China is NOT manipulating the yuan as the Trump administration prepares to issue a closely watched report on foreign currencies, according to two people familiar with the matter. Additionally, Larry Kudlow - head of the White House National Economic Council - sought to project an image of easing trade relations, saying US and Chinese officials were discussing the possibility that Mr. Trump and his Chinese counterpart Xi Jinping might meet at next month's G20 in Argentina (although Kudlow noted that China had shown no willingness to accept US demands to end the escalating trade war). "*I believe it is better to talk than not to talk*," Mr Kudlow told CNBC. "*Thus far, their response has been unsatisfactory to our asks*," Kudlow added. "*Our asks are pretty common sense. Europe shares our view, and Japan shares our view and Canada shares our view. So, we'll see how it plays out*." These two positive developments have obviously helped support sentiment in past hours.

What is not so obvious, however, is Nikki Haley's sudden decision to leave her job as US ambassador to the UN by the end of the year, an announcement that surprised many in the White House - including Chief of Staff John Kelly and Vice President Mike Pence according to close officials (Trump teased an announcement less than 15 minutes before his appearance with Haley, after news organizations began reporting she would resign). Whilst the US President has so far suggested that he is considering Goldman Sachs Group Inc.'s Dina Powell for the job, he also noted that his daughter - pretty Ivanka - would be an "*incredible*" ambassador, but "*I'd be accused of nepotism.*" She and her husband are currently senior advisers to the president on the White House staff. "*I'm not sure there's anybody more competent*," Trump added (N O T!!!! ☺).

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