

Weekly Market Summary

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Financial Markets Caught Between a Flip-Flop US President and a Wide Open French Presidential Race!

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Financial markets have been remarkably stable over the past months, with traders and money managers piling on bets that profit from continued stability (though would unravel spectacularly as soon as turbulence reappears!). As a result, various measures of actual and expected stock market volatility have fallen to post-crisis lows, leading analysts/strategists to warn that similar complacency in the past had paved the way for epic market downturns. Could this week's unfolding political/geopolitical developments prove these folks right?!

The concern that any snapback could prove ferocious is partly driven by the rising popularity of betting on turbulence staying subdued - or "*shorting volatility*" in Wall Street slang. It is a trade that has proven very profitable in recent years, as post-crisis bouts of turmoil have quickly dissipated, with many investors seeing any sell-off as a chance to load up on more stocks and other "risk-on" assets. Increasingly, analysts say even some institutional investors are now systematically betting against volatility to stimulate their returns. But what if volatility does erupt and stay elevated? Traders would then have to scramble to hedge their positions, in turn worsening any surfacing market turmoil. Nevertheless, the only way to get a really extended period of volatility is when something real and big happens, like a shocking election outcome, multiple missile strikes or even erratic/impulsive policies by the world's "only superpower". My guess is that there has been little shortage of such disturbing news lately!!

Russia / Syria

On Friday April 7th, the US launched cruise missiles that targeted a Syrian air force base from where last week's gas attack in Idlib was presumably launched. But the most obvious damage they may have done is to US-Russian relations, despite campaign promises by Donald Trump for a fast rapprochement and better relations between the US and Russia. As Russian Prime Minister Dmitry Medvedev made it clear, the Tomahawk strikes increase the risk of a direct clash in Syria between two nuclear-armed powers! (*mind you that Russia was warned of the US actions in advance, but made no attempt to counter them by using deployed its missile defence systems*). What's more important though is the fact that Trump's isolationist election rhetoric has now evolved to military intervention abroad, a move hailed as a turning point in Washington by the foreign policy establishment - a group labelled as the "blob" who is united by the belief that the willingness to use military power is crucial both to America's global standing and to the stability of the world order! (I find it quite alarming that this military might is being led by a US president who could remember in details "the most beautiful piece of chocolate cake" being shared with his Chinese counterparts, whilst his generals were launching the 59 tomahawks on Iraq! Ooops Syria!! – check FOX interview with Maria Bartiromo for a good laugh or cry!).

North Korea

In addition to escalation with Russia and the Assad regime in Syria, there has been a simultaneous intensification of the crisis with North Korea. As the Strike Carrier group 1 (which includes the USS Ohio submarine, armed with 154 Tomahawk cruise missiles; Sounds familiar?) is on its way to the conflict zone, China is moving troops closer to the border. Similar to the US and Russia, China too has a set of "bottom or red lines". In addition to the risk of outright conflict, possible outcomes include a renewed pick-up of tensions between both countries.

At a news conference on Wednesday with visiting NATO Secretary Jens Stoltenberg, U.S. President Donald Trump said he had spoken with China President Xi Jinping the previous evening and "*I think he wants to help us with North Korea.*" *If that does not occur, "we're just going to do it alone."* (China, in turn, believes the issue of North Korea's intercontinental ballistic missile and nuclear weapons development should only be resolved through peaceful means).

There is also speculation that North Korea could imminently test-fire another intermediate - or long-range ballistic missile, tied to the present holiday. According to recent commercial satellite imagery of the Punggye-ri Nuclear test Site and US government sources, North Korea appears to have placed a device in a tunnel, that could be detonated tomorrow, when North Koreans will observe the "Day of the Sun" - marking the 105th birth anniversary of its founder, Kim Il Sung.

Upcoming France Election

With nine days to go before the first round of voting, France's election remains a race wide open! In that sense, the dynamics of the French vote is taking another turn, one that is increasingly reminiscent of Brexit and the US election. With many possible outcomes, including a second round involving far left (Jean-Luc Melenchon) and far right (Marine le Pen) candidates, many analysts are increasingly concerned with the April 23rd event. A new poll by Harris Interactive-LCP showed centrist Emmanuel Macron getting 24% of voter support. Le Pen had 22%, Francois Fillon of The Republicans had 20% and far-left candidate Melenchon was essentially tied at 19%. A poll by Sopra Steria for le Monde – released earlier today – showed first-round support for French presidential candidates far-right Le Pen and independent Macron slipping two points to 22% for both, with only two thirds of registered voters saying they are certain to vote (those who may abstain from voting cite their disappointment with French politicians). In that same poll, first-round support for far-left candidate Melenchon is currently up 1.5 points to 20%, and for Republicans' candidate Fillon up 1 point to 19%.

US President Trump's Flip-Flop on Policy Promises

A little less than three months in office, Trump is finding big promises are very hard to keep! The US president's declaration that he will not label China a currency manipulator stands as the clearest example of the difficulty he is having delivering on big campaign promises. Trump backed away from a signature pledge of his White House bid on Wednesday, days before release of a closely-watched Treasury Department report on the currency practices of major U.S. trading partners. "*They are not currency manipulators,*" Trump told the Wall Street Journal in an interview. The currency decision is one among many instances of Trump reversing course since taking office on January 20th. Within the space of a few hours on Wednesday, Trump also changed previously critical stances on the U.S. Export-Import Bank, the value of NATO, US interest rates, and Federal Reserve Chair Janet Yellen. Likewise, his promises to renegotiate NAFTA, slap tariffs on Chinese goods, and repeal and replace the Affordable Care Act in his first days have been blocked, delayed or abandoned. And the missile strike on a Syrian airfield last Friday was the sort of foreign military intervention that candidate Trump had warned against (when he previously indicated that the rest of the world should not expect the US to serve as global policemen).

To be sure, the difficulty Trump faces sticking to his campaign promises is familiar to every president. Barack Obama was unable to realize his pledge to close the prison at Guantanamo Bay or solve the Middle-East crisis, George W. Bush saw budget deficits balloon and the economy stall during his presidency, and overhauling the nation's health-care system escaped Bill Clinton's grasp. While Trump's promises during the campaign were often extravagant, he did at times switch positions or contradicted past statements. Questioned about flip-flops during a Republican primary debate in March 2016, he characterized it as a virtue. "*I've never seen a successful person who wasn't flexible,*" he said!

To conclude, as political obstacles grow - giving way to concern - the Credit Suisse Fear Barometer, which measures the cost of buying protection against declines in the S&P 500 Index, neared an all-time high this week - jumping 46% this month through Tuesday, when it reached 45.74. That is about a third of an index point away from its June 2016 peak ahead of the Brexit vote. The broader CBOE Volatility Index, known as the VIX, is up almost 30% this month. Other signs of investor nervousness include:

- The rally in US equities has stalled lately, with the S&P 500 index losing almost 2.5% (still a small correction) since reaching a record on March 1st, and slipping below its 50-day moving average for the first time since the November U.S. election
- The benchmark 10-year U.S. Treasury is starting to behave as it did in the run-up to the Brexit vote, as yields fall while volatility climbs in one-month options, according to the Merrill Lynch Move Index. US 10-year treasury yields are now significantly lower at 2.23%, after peaking at 2.62% just a month back! And it is the same story in other major markets, with German and Japanese 10-year benchmark yields back near 18 bps and zero respectively, after a brief rally in yields through the first quarter of the year.
- Safe-haven trade - such as gold and Japanese yen buying - are back in vogue. The yellow metal is closing in on \$1,300-an-ounce mark (last at \$ 1288) for the first time since before Trump's victory. A four-day winning streak helped it rise above the 200-day moving average this week. The yen also strengthened below 110 per U.S. dollar (last at 108.90) for the first time since November, with the USD dollar extending its slump after Trump told the Wall Street Journal on Wednesday that the greenback was "*getting too strong*".

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