Weekly Market Summary

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Fire and Fury Will Soon Hit Markets! However Not the Type You Previously Referred Too*, Mr. President!

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On Tuesday August 8th, US President Donald Trump issued an intense warning to North Korea, saying it "*best not make any more threats against the United States*" as that would "*be met with fire and fury unlike the world has ever seen*". Trump's fiery statement followed a Washington Post report citing a leaked US intelligence memo that acknowledged North Korea could make nuclear warheads small enough to fit on missiles, and that they may have 60 such devices. Yet a week later, on Wednesday August 16th, Trump's chief strategist Stephen K. Bannon (*dismissed last Friday night - the latest in a string of high profile WH shake-ups*) mockingly played down the American military threat to North Korea as nonsensical: "*Until somebody solves the part of the equation that shows me that ten million people in Seoul don't die in the first 30 minutes from conventional weapons, I don't know what you're talking about, there's no military solution here, they got us*."

The debate at the West Wing has now shifted to the US debt ceiling question (the latter is a limit that Congress imposes on how much debt the federal government can carry at any given time, When the ceiling is reached, the US Treasury cannot issue more bills, bonds or notes, and can only pay upcoming bills as it receives tax revenues. Congress must now raise the ceiling - last suspended at $19.808 trillion – by September 30th 2017, or face the risk of having the US federal government defaulting on its bills!). At a wild political rally in Phoenix on August 22nd, President Trump threatened to shut down the federal government if Congress refuses to send him a spending bill that funds the U.S.-Mexico border wall on which he staked his presidential campaign (silly me, who thought that Mexico would be paying for the wall, that "*impenetrable, physical, tall, powerful, beautiful southern border wall*"! ☺). "*If we have to close down our government, we're building that wall*," Trump told thousands of supporters gathered in Phoenix for his address. "*One way or the other, we're going to get that wall*." However, that is not a new threat! In a May 2nd tweet, Trump asserted that "*our country needs a good "shutdown" in September to fix the mess!*" With funding for the government running out at the end of September, the U.S. facing a separate deadline to raise the nation's debt limit, and Congress not due back from recess until September 5th , the next six weeks could get very bumpy (investor anxiety has already started to manifest itself in short tenors Treasury bills as investors start demanding higher rates on 1-month paper relative to longer 3- & 6-month tenors in order to compensate for default risk). Moody's Investors Service, Fitch and S&P - the 3 major credit rating agencies - have said in separate statements that the U.S. credit rating could be in jeopardy of Congress cannot secure a deal before the deadline!

Moving back to my "*fire and fury soon hitting markets*" headline warning, such relates to the current low volatility setting as bond markets head into this afternoon's long-awaited economic speeches by US Fed Chair Janet Yellen (5:00 pm Bahrain time) and ECB President Mario Draghi (10:00 pm Bahrain time) at the Kansas City Fed's annual Jackson Hole Policy Symposium - with traders highly anticipating that central bankers would stick to script, leaving long-term yields hovering around current depressed levels (this market complacency and herd mentality thinking never ceases to amaze me! ☺). Markets are predicting that Yellen will probably reiterate that the US Fed is watching inflation and expects it to eventually pick up. Draghi reportedly will not deliver a new policy message, either, preferring instead to delay QE tapering discussions until the ECB Governing Council's next meeting on September 7th.

An “*Actionless Jackson Hole*,” as BMO Capital Markets puts it, would be a reprieve from a week of political drama. And whilst central bankers could effectively shy away from any clear hints on monetary policy, the mounting tensions between ensuring financial stability by damping market euphoria and stubbornly dormant inflation is likely to emerge as a major theme. “*This is the key issue for monetary policy today*,” says Mohamed El-Erian, chief economic adviser to Allianz. “*There is now starting to be a concern about financial stability that was not there six months ago*.” According to some Fed policymakers, the recent easing of financial conditions (higher equity prices, tighter credit spreads, weaker US dollar) means that the economic effects of the FOMC’s actions in gradually removing policy accommodation has so far been largely offset by other factors influencing financial markets, and that a tighter monetary policy than otherwise is warranted. However, the Fed “inflation doves” too have some strong arguments, with the US consumer price index undershooting economist forecasts for the past five months running despite a very hot labour market.

One of the most dangerous things in trading is to confuse what one thinks "should" happen with the forecast of what "will" happen. Investors underestimated the tailwind from QE in the previous bull market, and they will similarly now underestimate the headwind from reverse QE. For my part, I strongly believe that this could be a much more important and upsetting Jackson Hole than many economists realise! And similar to previous instances, there is surely a strong case for investors to be underestimating the pain that would ensue! With the world economy rising in the second quarter of 2017 at its most rapid pace in 2-1/2 years - and well on its way to a year of faster and firmer and more broad-based growth – centrals bankers should stay the course on policy exit measures after years of unprecedented easing, accepting their unofficial mandate to ensure financial stability - irrespective of the short term outlook being clouded by stubbornly tepid inflation (and idiotic presidential tweets). After all, the US Federal Reserve has already signalled that it will probably get moving on unwinding its $4.5 trillion balance sheet in September, and Yellen could solidify that view. The ECB, on the other hand, is entering a crucial phase of its battle to restore euro-area price stability: The region’s recovery has gathered pace since the start of the year, allowing officials to pledge that talks will start this fall about a strategy for 2018 that could include gradually reducing purchases to zero (currently at € 60 billion a month). That has become more evident since a Draghi speech in late June, in which he referred to reflationary forces, sending the euro currency higher (although ECB officials were quick to announce that investors had over-interpreted that message!).

*To end this weekly piece on a humorous note, President Trump lost another battle with grammar on Thursday, mixing up “there” and “their” and “too” and “to” in early morning tweets about his speeches this week. “*The Fake News is now complaining about my different types of back to back speeches. Well, **<u>their</u>** was Afghanistan (somber), the big Rally…..” Trump wrote, before continuing, “..(enthusiastic, dynamic and fun) and the American Legion – V.A. (respectful and strong). **<u>To</u>** bad the Dems have no one who can change tones!*” Trump's latest social media typo (which he has since corrected) comes just days after he used the word "heel" instead of "heal" while tweeting about the anti-white supremacy demonstration in Boston. Many delighted in the fact that it took the president three tries to properly edit his tweet! (I promise to edit my write-up’s title and make the necessary amendments before day-end ☺).

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