Weekly Market Summary

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A Lousy US Election … A Messy Brexit … And $50 Trillion of Hoarded Cash!!
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By early morning next Wednesday, it is believed that the world would know who the next US president is going to be. Nonetheless, if the vote is too close, results may take a few more hours to decode. For the sake of all our sanity let us hope that we don't get a repeat of the 2000 US election where the final result was not known until a month and four days after America went to the polls. Back then, due to the 'hanging chads', the election outcome was in legal dispute for weeks, though eventually Republican George W. Bush narrowly won over Democrat Al Gore. 16 years later, the presidential race looks insanely close to revive old thoughts and memories.

In past days, election blues have hit the stock market hard (the S&P 500 index has been down 7 days in a row) as a recent ABC News/Washington Post tracking poll placed Trump 1% ahead of Clinton at 46% to 45% - his first lead in this poll since May (possibly influenced by the FBI headlines from last Friday). The previous ABC News/Washington poll which came out over the weekend had Clinton ahead by the same amount. It is worth noting that the current 1% separating the two candidates is well within the survey's 3% margin of sampling error (in other words it is extremely close!). More interestingly, the same poll also showed that only 45% of Clinton supporters are now "very enthusiastic" about Clinton, compared to 52% in the last survey. It is the reverse for Trump supporters, where 53% are now "very enthusiastic" compared to 49% previously! And whilst other polls (NY Times/CBS) and market chatter clearly continue to favor Democrat Hillary Clinton with 4 days to go till election, the probabilities of her winning seems now to be similar to that of the UK staying in the EU just prior to June's referendum (once bitten twice shy for many). So are Americans about to have their own Brexit moment, a president nobody thought stood a chance only a short while ago!!

Elsewhere, breaking news out of the UK yesterday afternoon showed that the UK government had lost a Brexit lawsuit over the Article 50 vote. The U.K. government must now hold a vote in Parliament before starting the two-year countdown to Brexit, a panel of London judges decided, likely setting up a constitutional confrontation at the country's Supreme Court next month. "If notice is given under Article 50, it will inevitably have the effect of changing domestic law," Judge John Thomas said Thursday, delivering a decision that is a setback for Prime Minister Theresa May's plan to unilaterally start the withdrawal process by the end of March by invoking Article 50 of the Lisbon Treaty. Theresa May's latest defeat in courts leaves the prime minister facing serious uncertainty over her EU exit strategy, with the prospect of months of delays and a concerted move by MPs to push her towards a "soft Brexit".

Still, the UK prime minister remains determined to face down a revolt by pro-EU MPs and stick to her plan to begin the Brexit process by the end of March 2017. "We have no intention of letting this derail our timetable," her spokeswoman said yesterday. The government has said it will appeal to the Supreme Court, but if May loses for a second time the action will move swiftly to parliament. From Mrs. May's perspective, the ideal solution would be to present parliament with a simple non-amendable motion giving MPs a binary choice after a short debate on whether or not to approve Article 50, tough MPs and peers could attach conditions to their approval of Article 50, including demanding that the prime minister publish her negotiating strategy.

Supporters of a "soft Brexit" want to put pressure on Mrs. May to negotiate a deal that retains membership of the single market and the customs union and could use the passage of an Article 50 bill to push her down that route. Goldman Sachs – in a note released yesterday – expects UK Sterling could fall between 20% and 40% relative to pre-referendum levels (when it was trading north of $1.50) in case of a "hard Brexit", with a base for cable to reach 1.10. Over the short term, Thursday's High Court decision could see cable settling around 1.26 in the near term (last 1.2475) according to the same report.

Last, there has been a lot of discussion about how much cash, investors are holding nowadays. The world's largest asset manager - BlackRock - puts the figure at more than $50 trillion, a number that includes a host of different metrics, from central- bank assets to financial-firm reserves and consumer savings accounts. Private-equity firms are amassing great piles of liquid securities as a share of their portfolios to levels that match the highest since 2001, with Blackstone saying that nearly one-third of its assets under management are in cash.

So what is the meaning of this trend toward bigger cash cushions? Some investors blame this phenomenon on how expensive various assets (government bonds, stocks, emerging markets …) have become and are now worried that - once multi-bubbles pop - bonds and stocks will fall in tandem. In such a scenario, bonds that have historically been thought of as safe haven investments would not provide the same buffer against equity losses that they have traditionally (hence the move to replace highly-rated government bonds allocations with cash). Others believe that just because there is more cash in the financial system does not necessarily mean that it will be available to buy securities, nor that it will prevent a re-pricing of debt and equities that have been propped up by years of unconventional monetary policies. In fact, it could even indicate more risk out there, as Fund managers may be holding more cash to offset a bigger pool of leveraged derivative bets, which may or may not be sufficient to compensate for the risk.

Investors are certainly skittish right now, as evidenced by their elevated liquid reserves, and in all truth their fears may be well warranted - at least in the short term - given the crazy world we live in! Hopefully, I will have better news to share in next week's Friday market summary.

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