Weekly Market Summary

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Game Over!! Thank You for Playing!!

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Financial markets are characterised by a large number of participants with different appetites for risk, varying time horizons, diverse motivations and reactions to unexpected news, though a similar and common objective: Acing the next big market move and generating superior returns! As a result, the mathematical techniques and models used in the forecasting of financial markets have grown ever more sophisticated over the past years as traders, analysts and investors seek to gain an edge on their competitors. That includes - amongst other things - modelling with high frequency data, applying genetic algorithms to financial time series and analysing autocorrelations and variance ratio tests.

In his bestselling book entitled "*Forecasting Financial Markets ..The Psychology of Successful Investing*", the author - Tony Plummer - details the three dimensions essential to achieve successful trading, including an ability to understand the forces at work in logical terms, recognize (and neutralize) any emotional responses to market fluctuations, and design an investment process or trading system that generates objective 'buy' or 'sell' signals. Tony also provides a compelling insight into the psychology of trading behaviour and shows how "*following the herd*" (buying when others buy & vice-versa) can have disastrous results, whilst also demonstrating how one's ability to make money in the world's financial markets depends critically on his/her ability to make decisions independently of the crowd and irrational emotions.

But the above could only hold true - and to a large extent prove accurate – prior to the 2008 global financial crisis! In an economic letter sent to clients in late 2016, bond legend & guru Bill Gross (recently retired to enjoy quality time away from stressful markets!☺) did suggest that global markets had recently been transformed into a massive casino nurtured by the easy-money policy adopted by the word's central bankers! "*Our financial markets have become a Vegas/Macau/Monte Carlo casino wagering that an unlimited supply of credit generated by central banks can successfully reflate global economies and reinvigorate nominal GDP growth to lower but acceptable norms in today's highly levered world*," Gross wrote in his note. He added that "*a common-sense observation made by yours truly and an increasing numbers of economists, Fed members, and corporate CEOs would be that low/negative yields erode and in some cases destroy historical business models which foster savings/investment and ultimately economic growth … Ultimately though, in broader more subjective terms, it is capitalism itself that threatened by the ongoing Martingale strategies of central banks. As central banks purchase grow, and negative/zero interest rate policies persist, they will increasingly inhibit capitalism from carrying out its primary function – the effective allocation of resources based upon return relative to risk".*

It is only in such context that one can still make sense of the US equity markets' best start for a year in two decades (a whopping 16% jump YTD for the S&P 500, and we're just in late-April!), at a time the International Monetary Fund ("IMF") is cutting its outlook for global growth to the lowest since the financial crisis amid a bleaker outlook in most major advanced economies and signs that higher tariffs are weighing on trade (as a reminder, the IMF's warning that risks are skewed to the downside is largely based on a range of threats menacing the global economy, including the possible collapse of negotiations between the U.S. and China to end their trade war, and the departure of Britain from the European Union without a transition agreement, known as the "no-deal" Brexit scenario). "*The first quarter's rally would have been good enough to shut the whole year down and call it a day*," said Scott Colyer, chief investment officer at Advisors Asset Management. Even so, he adds, "*I'm paid to be a worrier. I look hard for signs that the markets are about to roll over every day. I don't see them*." And whilst current stock valuations are fat, earnings are falling and the pace of global growth is slowing, investors like Scott continue betting that central bankers will keep pushing stimulus (ECB and BOJ's relentless support to markets, coupled with the US Federal Reserve's dovish about-face earlier this year), whilst governments in Europe and Asia renew fiscal stimulus measures. For them, traders who worry about valuations are ignoring important variables – such as low inflation and depressed bond yields – which could in turn mean multiples can keep expanding!

To my mind, signs of a massive bubble that involves various asset classes are becoming clearer by the day! Yet, given the driver is fairly low rates that are continuously suppressed by dovish central banks, indications it could pop anytime soon appear negligible (at least for now.. maybe a 2020 story?!), leaving most traders willing to bet on further stretches in asset valuations and a market volatility that stays lower for longer (which might explain why implied volatility in currencies, equities and fixed-income markets has approached record lows, with the VIX index last at 12.00 and the MOVE index – a measure of price swings in U.S. debt - last at 49.00). Another odd observation is how economic common sense is being twisted in all sorts of ways to explain what is going on in the global economy and financial markets! Take for example recent US Federal Reserve governors' speeches, where it appears that the bullish leaning Fed officials remain bullish and the bearish leaning Fed officials remain bearish. However, the one major difference is that finally the U.S. Federal Open Market Committee ("FOMC") has openly acknowledged the fact that deteriorating conditions overseas warrant a lot of caution going forward - although it kept using the tired and old line of remaining data dependent; That - in turn - has triggered a further rally in government bond and equity prices, with the former benefiting from an overall deterioration in risk sentiment (weaker growth prospects) and the latter profiting from a late improvement in risk sentiment (the positive effect associated with central banks remaining on hold or extending stimulus)! Elsewhere, the rally in oil prices also continues unabated, mostly to do with a global tightening of crude supply (Russia, Saudi, Venezuela, Libya, Iran).

Last, but not least, a quick word on the 448-page Mueller report released yesterday afternoon. Whilst the Special Counsel stopped short of concluding whether Donald Trump had obstructed justice, he did fill his lengthy report with multiple instances where the US President did try to impede the overall Russian probe (previously Attorney General William Barr sought to make his own conclusions: No obstruction, No crime), all but inviting Congress to take action on at least 10 instances of potential obstruction of justice. One of those emerging acts of obstruction relates to a 2017 incident involving White House Counsel Don McGahn. Fascinating details of that story are reproduced below:

*On Saturday, June 17th, 2017, the US President called McGahn and directed him to have the Special Counsel removed. McGahn was at home and Trump was at Camp David. McGahn recalled that the President called him at home twice and on both occasions directed him to call the US Deputy Attorney general Rod Rosenstein, saying something like "call Rod, tell Rod that Mueller has conflicts that precludes him from serving as Special Counsel" (in other word instruct him to fire Robert Mueller). Feeling trapped because he did not plan to follow the President's directive but did not know what he would say the next time the President called, McGahn decided he had to resign. That same evening he called White House Chief of Staff Reinhold Priebus and told him that the President had asked him to "Do Crazy S**T" and that he would soon resign (though McGahn did eventually return to work the next day after Priebus and Steve Bannon asked him to do so, and remained in his job until October 2018!).*

I for one don't know what McGahn was complaining about …. He had to see this coming…. After all that was Trump's 2016 campaign slogan! (The Late Show with Stephen Colbert ☺☺).

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