Weekly Market Summary

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A Year-End 'Red Hot' Risk-On Rally.... Will It Persist Throughout 2020?!

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What a Difference a Year Makes!

Last December, US central bankers looked past market fury and White House criticism - unanimously voting to hike the overnight benchmark interest rate by 25 basis points (to 2.25% - 2.50%) in their final decision for 2018, even as market's expectations for a rate rise had dwindled on account of depressed equity/oil prices and weaker global data. In his ensuing press conference, Chairman Jerome Powell emphasized that whilst the Federal Reserve takes financial conditions into account when setting policy, they are only one of many factors it considers. In the end, the Fed's sole mandate - according to Mr. Powell - is to ensure stable prices and low unemployment, and as long as the country's economic fundamentals remain sound, the financial markets can do whatever they want! One week prior to FOMC decision, the European central Bank ("ECB") had ended its €2.6 trillion programme of bond purchases despite a deepening economic slowdown in the Eurozone in 4Q2018 (Italy in recession, Germany just avoiding one!) and a depressed core inflation rate (hovering around 1.0% Y/Y, half the ECB's 2.0% target). Back then, Mario Draghi confirmed that quantitative easing had been a resounding success and the "*only driver of this recovery*" at crucial moments; And whilst the ECB President warned of "*downside risks*" to the economy, he did stuck to his line that the sudden slowdown over recent months was a hiccup caused by one-off factors and disruptions in the car industry - insisting that monetary policy remains "*very accommodative*" and citing buoyant investment.

Then, as traders were getting themselves ready for the long holiday weekend, Donald Trump spooked already anxious investors (after threatening and going ahead with a partial US government shutdown) with his latest harsh criticisms of Federal Reserve policy actions: "*The only problem our economy has is the Fed … They don't have a feel for the Market, they don't understand necessary Trade Wars or Strong Dollars or even Democrat Shutdowns over Borders*"; Additional unease also came in the form of a Bloomberg News report that President Trump had contemplated firing his handpicked Fed chairman over the central bank's interest rate increases. Trying to calm the markets, Treasury Secretary Steven Mnuchin (another Trump's clown) spoke with CEOs of six large U.S. banks and tweeted that the bank bosses assured him there was plenty of money in the system (ring any bells? similar phone calls were common practice during the 2007/2008 market meltdown).

The end results? A total meltdown in U.S. equity markets and oil prices! Reacting very badly to poor year-end liquidity and White House developing drama, the Dow Jones Industrial Average index and oil prices tanked on December 24th, 2018, closing the day at 21,792 and $42.65/barrel respectively. US bonds and gold prices, on the other hand, rallied sharply, with UST 10-year yields moving lower to 2.70% (still roughly a full percentage point above current levels).

Fast Forward to Late 2019!

Following the rise of the 'Doves' earlier this year (a dovish central banker is one that supports monetary stimulus to revive or jumpstart the economy, whilst delaying rate hike(s) well after economic data has shown a marked improvement in growth and a surge in inflation), US and European central bank officials actively unleashed more stimulus throughout the second half of 2019 - in the form of renewed rate cuts and quantitative easing (an end to quantitative tightening in the US). A key reasoning behind the renewed dovishness of central banks lied in the souring economic picture - a concern emphasized by yet more downgrades to the economic outlook in past months and gloomy reports released by the IMF, World Bank and OECD. Another explanation was that central bankers were influenced by market pressure; In this respect, an early 2020 study by the Bank for International Settlements cited market volatility and central banks' changing rhetoric as another instance of the "*extraordinarily tight*" relationship between policy makers and financial markets.

Yet despite all the negative press coverage, 2019 is fast drawing to an end with a big bang and global growth is projected to enter 2020 on a firmer footing! The catalyst? Two of the biggest hurdles constraining the world economy in past few years have just been cleared over the last two weeks! "*The China trade deal and U.K. election result have taken out a major tail risk overhanging markets and companies*," said Ben Emons, managing director for global macro strategy at Medley Global Advisors in New York. "*Business confidence should see a large boost that could see a restart of global investment, inventory rebuild and a resurgence of global trade volume*." At the same time, the U.S. economy is still going strong, with nominal growth north of 4.0% and the unemployment rate hovering at a record 3.5% low (Bloomberg chart displays an all-time low of 2.5% in May 1953!). As a result, Wall Street stocks have managed to shoot to fresh records - with the Dow Jones Industrial Average jumping 138 points higher yesterday to close the session at 28,377 (6,585 points, or 30% higher from the December 24th, 2018 closing. Just Surreal!). Oil prices too have benefited, with WTI closing at $61.18 a barrel yesterday, on course for its third weekly gain after deeper OPEC+ production cuts and a significant surge in speculative crude positions (on the back of the US-Chinese de-escalation in their ongoing trade dispute and the improving global economic outlook).

These positive developments also come amid broader signs that demand across much of the world is stabilizing as key global manufacturing gauges trough. The International Monetary Fund had flagged upside risks to its recent outlook if major trade tensions were resolved and policy makers in the US and Europe have also sounded more upbeat at their monetary policy meetings last week. ECB President Christine Lagarde did note that the Eurozone's economic slowdown was showing signs of bottoming out and Federal Reserve Chairman Jerome Powell confirmed the prognosis for the U.S. remains favourable. Elsewhere, the Chinese government has said it would improve the effectiveness of fiscal policy in 2020, whilst Japan is on course for a new fiscal stimulus (till infinity ☺).Morgan Stanley economists now expect the global economy to recover some momentum in 2020 with growth improving from a trough of 2.9% in the fourth quarter of this year to 3.4% by the end of 2020, with that uptick driven more by the rest of the world than the U.S.

Nonetheless, as we head into 2020, I would again caution our valuable clients against holding mainstream views on financial markets. I mention that to provide a clear reminder that what "*everyone knows or assume to know*" is usually unhelpful at best and wrong at worst! And what CFOs/Finance Officers should worry most about & really focus on are the risks that other market participants haven't considered. For instance, the US-China phase one trade deal still leaves some complicated issues unresolved, paving the way for fresh clashes as Trump runs for re-election next November (assuming impeachment efforts don't remove Trump earlier). As for Brexit, the sweeping election victory by Prime Minister Boris Johnson's Conservative Party would most likely mean Britain leaves the EU on Jan. 31st, with such outcome – coupled with looser fiscal policy - putting a growth rebound in play. However, at the same time, Johnson must now negotiate a new trade deal with the EU by the end of next year, meaning fresh uncertainty will emerge. "*Brexit could continue to weigh on economic activity as the difficult task of forging the U.K.'s new trading relationships is just beginning*," said Simon Wells, chief European economist at HSBC Holdings Plc. Last, but not least, the latest improvement in US housing and consumer confidence data and the melt-up in stock prices largely rest on investors' faith in low rates. The recent rise in long term European and US yields (the 2s10s UST rate gap touched 31 bps yesterday, its steepest level in over a year) - if sustained – could soon spoil the party and interrupt or reverse the bull market in stocks!

On this last cautious note, I would like to thank all our clients for their continuous support & business dealings with GIB throughout 2019! Merry Xmas, Happy New Year and best of luck navigating volatile markets in 2020!

I will resume my regular market updates in mid-January 2020. In the meantime, feel free to get in touch with the Treasury Sales team at GIB for all your Treasury needs, as the lady/gentlemen on the Desk will surely be around at all times to assist (by e-mail (Trsy.Sales@gib.com) or by phone (+973 17511511)).

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