Weekly Market Summary

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What Happens When Financial Markets Totally Lose Faith in the "*Chosen One*" ?!?

Fadi Nasser - Deputy Chief Investment & Treasury Officer

Ouch, those months of August!? In 2007, a French bank (BNP) froze funds; In 2008,US banks were on the verge of collapse; In 2010, the Greek crisis was spreading to peripheral countries; In 2011, Italy was hit by the EUR crisis and S&P downgraded the US sovereign credit rating to AA+ ; In 2012, the Eurozone was still somewhere between self-destruction and ultimate relief, thanks to the ECB; In 2014, Russia moved self-propelled artillery onto the territory of Ukraine; And in 2015, China's stock markets declined abruptly. The summers of 2017 and 2018 were not perfectly calm either, but were shaky like other summer months, due to worries over geopolitics, and the US President's inflammatory rhetoric against a couple of Asian countries (not to mention the "*very fine people on both sides in Charlottesville*" statement made by Mr Trump in August 2017!)

Anyways, that is history; Here comes my first weekly update for the month of August 2019, after a very enjoyable break in beautiful Bavaria - Germany!

It is often assumed that markets have absurdly overvalued prices of financial assets and then precipitated the price reversal once they had realized the glaring disconnection between the economic reality and the valuation of those financial assets in question. The buzzword often used here or there to describe this phenomenon is the term *Self-Fulfilling Prophecies*. The latter refers to the socio-psychological phenomenon of someone "*predicting*" or expecting something, and later this "*prediction"* or expectation comes true simply because one believes it will, and the resulting investors' herd behaviours align to fulfil those beliefs (strongly suggesting that peoples' beliefs influence their actions). For instance, if investors think the stock market will crash, they will buy fewer stocks or sell their equity portfolios – rapidly leading to a wider market selloff. My personal favourite illustration remains market players' strong belief that they should rush to purchase the Japanese yen every time there is a financial, political or geopolitical crisis (previously a result of large held current account surplus balances – Japan being a net creditor to the world), despite Japan's current mounting negative fundamentals (record outstanding debt, ageing population, slowing productivity, …). In other words, if you know that whenever the world panics, the Japanese yen is going to rise – even if market fears are the result of North Korea's threats to wipe Japan off the map! ☺ - then it makes it a no-brainer to buy the Yen, although you are unsure exactly why everyone else is!

In early July, we released a piece entitled "*Are Central Bankers Still in Control as Bond Mania Continues Unabated*" where I suggested that bond investors/traders – driven by deteriorating global economic fundamentals, a bullish technical outlook for fixed-income prices, idiotic presidential tweets and dovish central banks' talk – were madly piling into government bonds on bets the era of ultra-loose monetary policy would extend unabated, forever (or else, why would someone buy a 10-year German bund yielding -0.70% p.a. or a Swiss 30-year bonds returning -0.55% p.a.?!). Since then, government bond prices have continued their relentless and irrational ascent - driving yields on various instrument to record lows (with 30-year UST yield trading to a record low of 1.92% on July 15th! Worth checking the US Debt Clock.org, a US$ 22.53 trillion hole and counting!). And whilst the narrative supporting the move was exciting (will surely come to that later), many market players were buying solely on the calculation that they would soon be able to sell to someone else for an even higher price – the classic condition of a speculative frenzy as set out many years back by MIT economist Charles Kindleberger in "*Manias, Panics and Crashes*". The key thing here is that we are all hard-wired to herd, with a large weight of evidence of herd mentality bias in the financial markets; For example - in the late 90s - many dotcom companies did not have financially sound business models, but most investors bought into them because everyone else was buying too! We just often find it emotionally, psychologically and materially painful to go against the crowd! Psychologists have found that it may actually cause embarrassment and physical pain for people to be contrary investors.

In such surreal context, it is safe to note that stormy clouds had been gathering on the horizon for some time now, but only in past weeks has the mainstream media started its extensive coverage of the impending recession in the US and its potential impact on President Trump's chances of winning a second presidential term in 2020 (God forbid! ☺). A meaningless tiny and brief negative spread showing between US 2-year and 10-year Treasury yields last week (Thanks God, we're back slightly into positive territory! We can safely continue with our normal life ☺) – last witnessed in March 2007 – triggered panic disorder amongst Wall Street traders and quickly pushed market "*experts*" to speculate about the timing and severity of the next economic slump, and how investors should be preparing for it (nothing beats a farmland investment in New Zealand if you ask me, or possibly a long-term membership at Trump's Mar-a-Lago exquisite club!). After all, an inversion of the yield curve (longer-dated yields trading inside short-term rates) has occurred prior to every single recession since the late 1950s and is usually viewed as an important leading economic signal for things to come, even though a pre-election recession in the US remains far from certain at this point in time (still not our central case scenario). It could also just reflect an unwarranted and extremely pessimistic mood among bond investors about the economy's future performance.

Continuing our weekly market coverage without mentioning the Donald … Oops, too late!!

Whilst we're on the topic, then, Mr. Tariff Man's deceptive tweet on Thursday August 1st (*"…During the trade talks, the US will start, on September 1st, putting a small additional Tariff of 10% on the remaining 300 Billion Dollars of good and products coming from China into our Country. This does not include the 250 Billion Dollars already Tariffed at 25%..*") should effectively be viewed as the prime catalyst for the chaos and confusion that took hold of financial markets in past three weeks, hammering stocks and sending investors in a hurry under the protective umbrella of government bonds; As equity values sagged, bond prices jumped - in what possibly will be remembered as one the most ferocious rally in ages (a 50 bps yield drop in 2-weeks!) A day before, on July 31st, the Federal Open Market Committee ("FOMC") had - as largely anticipated - reduced its target for the July Federal Open Market Committee by 25 bps (to a new range of 2.00% - 2.25%) in response to a weaker and riskier global environment in the context of little inflation pressure in the U.S., while leaving open the possibility of future cuts. Still, the statement felt less dovish than the one in June, offering less of a guarantee to a rate cut at the next meeting on September 18th and prompting the extremely busy US Commander-in-Chief to release the following angry tweet "*As usual, Powell let us down, but at least he is ending quantitative tightening, which shouldn't have started in the first place - no inflation. We are winning anyway, but I am certainly not getting much help from the Federal Reserve*!".

Fed Chair Jay Powell, from his end, tried to thread the needle between dovish and hawkish at his Wednesday press conference, but realistically had no hope of pleasing market participants who thought a series of interest-rate cuts (in excess of 75 bps) were already in the bag before the end of 2019; The Fed just isn't there yet, with most recent US data (Non-Farm Payroll, CPI, Durable Goods Orders, Retail Sales, Building Permits, NY Manufacturing Survey) continuing to beat market expectations.

Where Does That Leave Us? as we now head into the all-important weekend central bankers gathering on a small resort in Wyoming for the Kansas Fed's annual Jackson Hole event? In all honesty, I have little clues or clear answers at this point in time! ☹ There comes a time in one's life when displaying humility and keeping a low profile is all that matters! Also, acceptance and enhanced preparation for continuous frustration from politicians' thoughtless words and policies for the foreseeable future remains a MUST!

To end this weekly piece on a happier - but still very perplexed - note, I reproduce some of the weirdest official statements made over the past few days:

- As minutes of the recent India monetary policy committee meeting were released, central bank watchers were left scrambling for their dictionaries and Google searches. The reason? MPC member Chetan Ghate's confirmation that "*estimates of economic growth in India have ultimately been subject to a fair degree of **floccinaucinihilipilification***". Notwithstanding this, growth is likely to pick up! (Hurrah !!)

- President Trump said Wednesday that he is the "*chosen one*" to wage a trade war with China and asserted that he is winning. "*This is a trade war that should have taken place a long time ago*," Trump told reporters at the White House. He then looked to the sky and proclaimed: "*Somebody had to do it. I am the chosen one.*"

- President Trump said he cancelled his trip to Denmark after a "*nasty*" comment by the country's prime minister about the U.S. president's interest in buying Greenland (Seriously?!?). Trump told reporters on Wednesday that it was "*inappropriate*" for Prime Minister Mette Frederiksen to remark that Trump's desire to buy Greenland was absurd. "*When they say it was absurd -- and it was said in a very nasty, very sarcastic way -- I said, 'We'll make it some other time*,'" Trump told reporters. He added: "*She's talking to the United States of America. You don't talk to the United States that way, at least under me*." (Hoo – Ah, Al Pacino – Scent of a Woman!). <u>As a reminder, that is the same President the market awaits for finalizing a fair trade deal with China</u>

- President Trump warned of an economic crash if he loses re-election, arguing that even voters who personally dislike him should base their ballots on the nation's strong growth and low unemployment rate. "*You have no choice but to vote for me because your 401(k), everything is going to be down the tubes,*" the President said at a Thursday rally in New Hampshire. "*Whether you love me or hate me, you've got to vote for me.*"

Kindly note that you are not losing your mind, everybody else is! ☺ Things are crazy and getting crazier! And yes, we are entering a period of increased turmoil on a global basis, but the future is still ours to make. So, let's make it a fabulous one!! ☺

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