Weekly Market Summary

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Markets Caught Between Hopes & Fears ... A Random or Clear Agenda of Confusion?!

Fadi Nasser - Deputy Chief Investment & Treasury Officer

Latest Update on Coronavirus: Confirmed cases last at 9.74 million (from 8.60 million last week), with the death toll from the pandemic close to the 500,000 mark (492,410 last versus 456,802 deaths the week before). Sweden's state epidemiologist, Anders Tegnell, has accused the World Health Organization (WHO) of misinterpreting Covid-19 data and overstating the health risks his country faces. Germany's infection rate has fallen to the lowest in three weeks, at the same time the US is seeing a record number of new coronavirus cases - especially in Texas and Florida. Billionaire Bill Gate's foundation – with an endowment exceeding $40 billion - will now entirely shift its focus from HIV, malaria and polio eradication and give "total attention" to the coronavirus pandemic (still not sure whether this latest piece of news should make me feel safer or more nervous 😊)

Being unable to project the future direction of financial markets can be a stressful and painful experience, especially when one's responsibility is to provide dear clients and work colleagues with a correct and rational economic analysis, as well as accurate market forecasts. Whether our world witnesses a V-shape or "*Complicated and Restrained* " (quoting ECB President's Christine Lagarde exact words) recovery over the near term remains anyone's guess at this juncture, with the wildly uncertain path ahead making any prognosis dicey (instead of U & V, maybe it's time to pencil another symbol❓). After all, as noted in various previous reports, the Federal Reserve - as well as other leading central banks – continue to destroy true price discovery in this market by executing short squeeze after short squeeze. Moral hazard be damned, finance ministers' and central bankers' desire to support markets has overruled common sense – with well-timed announcements being made simply to fire up bullish enthusiasm and spark asset rallies that improve the technical outlook (i.e. a closing above a 200-day moving average and/or bullish intraday price reversals and engulfing candlesticks popping on charts). Lately, such positive notices did include the US Federal Reserve's plan to buy corporate bonds, the Trump's administration efforts to seek a $1 trillion infrastructure proposal to stimulate the economy, the Fed's easing regulations to free-up bank capital for lending (though banks can't use these increased funds to boost dividends or share buybacks) and last but not least the US President's assertion - via a comforting and honest tweet - that the trade deal between China and the US is fully intact (*what was White House trade adviser Peter Navarro thinking few hours earlier, when a remark he made in response to a Fox News interview suggested the trade deal was "over*"? 😊)

Almost three and a half year back I suggested to our valuable readers that when history looks back at 2016, a couple of words would stick out most prominently: Trump, Brexit and Surprise! After all, Donald Trump – real estate mogul and reality TV star – had surprised everyone (reportedly even himself 😊) by winning the 2016 US presidential elections after polls and experts tipped Hillary Clinton for the job. But even before that, there were other "*I-don't-believe-this*" moments during that same year; Most significant was the UK vote - on June 23rd - to quit the European Union after more than four decades, in a stunning rejection of the continent's postwar political and economic order. Still, back in those ordinary days (pre-lockdown, masks & 2-meter social distancing "mania"), markets were able to get over things fast and pretty much kept rolling! Faced with anemic global growth, terror attacks, humanitarian crisis and natural disasters, they barely blinked an eye! Surely Brexit surprised everyone, and market panic ensued - though for about few days only. A week after the Brexit vote, markets - even in the U.K. - had recovered lost ground, and then some. Donald Trump's surprise presidential win on November 8th, 2016 was much the same story, only in a highly compressed time frame. The Trump-inspired losses, which some market watchers had predicted would be in the double-digit percentages and long lasting, all occurred before US markets opened on November 9th and were rapidly reversed. At that time, it was noted that algorithmic trading had possibly made markets that much more efficient; Moreover, investors were maybe getting better at spying opportunities in crisis and becoming so accustomed to central banks' support and bull equity runs that they just did not believe anything would go that wrong!

Fast Forward to 2020!

Buoyant investors' sentiment earlier this year most likely led many in the market place to a false conclusion - i.e. that surprises don't really matter or that one is always better off "*selling the rumor and buying the fact*" - and as such left them fully exposed to the unforeseen and unpleasant coronavirus shock. As February was drawing to an end, fear tightened its grip on financial markets with global equities plunging (their worst week since the 2008 crisis), whilst most sovereign bonds - as well as the Japanese yen and Swiss franc – witnessed sharp rallies as investors sought shelter. Brent crude dipped as investors assessed demand prospects for commodities with the virus spreading and weighing on global economic growth (though the ultimate collapse in crude oil prices came two weeks later when a breakdown in OPEC talks in Vienna - followed by Saudi Arabia's announcement that it would abandon attempts to limit supply - resulted in a 50% price meltdown). And while many economists thought the depth of the hole the world economy had just experienced and/or was about to fall into meant climbing quickly back out will be difficult to achieve, fast and far-reaching policy interventions and actions (especially by the US and European governments and central banks, at a pace that puts the 2008 financial collapse handling in the shade) were sufficient to revive financial asset prices. By late March, markets were showing glimmers of optimism whilst traders and fund managers were once again fully confident that there will be light at the end of the tunnel! With emerging signs that the global liquidation rout for the history books was loosening its stranglehold across stocks, credit and funding markets, a powerful market rally followed! However, Covid-19 has re-emerged as a key driver of the global markets of late with concerns about a second wave of infections in the US (and elsewhere) aggravating fears once again about the world economic outlook (prompting the IMF last Wednesday to further downgrade its outlook for 2020 global GDP - calling for a 4.9% contraction this year, more than the 3% predicted in April. For 2021, the Fund sees growth of 5.4%, down from 5.8%).

Unfortunately, it was also not a coincidence that the financial system we are living in was becoming more unstable with every day passing; Entire nations were plunging deeper into debt, whilst taxpayer money was effectively continuing to flow to the same corporations that took on record obligations over this past decade, mostly to conduct stock buybacks and other financial gimmickry! One would have expected these mighty corporations to have spent time rebuilding their balance sheets, restocking their acorns for winter, storing in excess reserves for lean time! They could have, yes; Alas, they didn't! The lure of stock market riches had proven too strong to resist (Wirecard's "*elaborate and sophisticated fraud*" over the past years, that allowed more than $2 billion to go missing, and the latest appointment of KPMG - the auditing group criticized over the GBP58 million hole in fashion retailer Ted Baker's accounts and fined $50 million by the US Securities and Exchange Commission last year for violating auditor integrity regulations - to conduct an "*independent*" audit into Wirecard are clear examples of our ever-growing corporate capitalism tragicomedy!)

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. That could potentially imply that we may soon be headed for a wake-up call as the hypothetical risks (medical/economic/political and geopolitical) that investors brushed aside to fuel the latest global rally become once again a reality. And why should we worry that all these market ups & downs are happening? Simply because it brings us back to the moral hazard problem: Risky investors win during good times (by taking on more risk and earning higher returns) while the Fed and the US Treasury (or ultimately taxpayers) assume part of the downside risks when there is renewed trouble in financial markets!

Whilst the Federal Reserve (the same applies to other central bankers too) was intended to act as the "*lender of last resort*", its latest continuous intervention in markets (last in the credit space) has forced many economists to concede that the US central bank - under the leadership of its Charmain Jerome Powell and with a balance sheet size ballooning to more than $ 7.0 trillion (it was close to $800 billion before the 2008 financial crisis and $3.9 trillion before the Coronavirus outbreak) - has crossed the Rubicon (or alternatively the point no return!) This high-level idiom comes from an event in ancient Roam history; In 49 BC, Julius Caesar's army crossed the Rubicon River; this was previously forbidden! It was an event from which he knew there is no way back. When Julius Caesar crossed the Rubicon, that precipitated the start of a five-year Roman civil war, which ultimately led to Julius Caesar becoming dictator for life. Putting the Fed's recent actions into context and what it means for investors, the latest adopted expansionary policies - which did also push other central bankers to do the same - have created a new environment redefining risk and value!

What this highlight is the fact that there is nothing normal about what is happening today or what happens next. A New World Order? Who really knows? Donald Trump President for Life? Anything is possible 😊

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