Weekly Market Summary

July 26th, 2019

Waiting for Your Favorite Politician & Central Banker to Continuously Surprise You ?? Wait No More !! Fadi Nasser - Deputy Chief Investment & Treasury Officer

For many, visions of the end of the world tend to be extreme: A planet that is fatally fracked, flooded, hurricaned, nuke-cratered! No survivors, or maybe few (*check the latest stories relating to Silicon Valley CEOs buying Doomsday bunkers in New Zealand*!), dazed and dust-grimed, roaming a wasted landscape, eating canned beans, each other. For others, it might be a slow burn, apocalypse-wise. After all, the "*end of the world*" entails not just the actual end, that last gasp of human breath, but all the agony / torturous events leading up to it, too. Those probably include Britain's vote to cancel its membership of the EU roughly three years back (with a little over three months to go until the "*extended*" exit day), Donald Trump's win of the US presidency in late 2016, in a stunning upset over Hillary Clinton, and most recently Boris Johnson's (the British Trump) election as the new UK's Prime Minister!

At our end, we have repeatedly outlined in past writings various threats to financial markets - ranging from geopolitical developments in our region to Italy's debt crisis, UK's Brexit uncertainties, US & Europe political madness, bubbly equity and fixed-income markets and most importantly ongoing trade wars between the world's biggest economies - and accordingly warned against current investors' complacency (both misplaced and unjustified!).

Nonetheless, with economic data continuing to hold up strongly throughout 2019, fears of a swift hard landing in the US - and elsewhere – appeared premature and overblown, perhaps also delayed by accommodative monetary policies in Europe and Japan whilst China continued unveiling extra measures to boost economic growth (looser monetary policy and cash injections). Now, with global economic data starting to deteriorate fast, the Trump administration's growth-boosting policies already behind us and investors' animal spirits still running high, one has to wonder whether the financial world order will soon crack fast!

But then, once again, the Impossible can Happen! Courtesy our creative & inspiring central bankers and politicians, "*beautiful*" outcomes are still in the making. For this week, those are summarized below:

- **European Central Bank's Dovish Stance**: ECB President Mario Draghi set the stage for his European Central Bank to deliver another round of monetary stimulus in September to combat the Euro area's severe economic slowdown. "*This outlook is getting worse and worse*," Draghi said in Frankfurt on Thursday after a meeting of the ECB's Governing Council. "*It's getting worse and worse in manufacturing, especially, and it's getting worse and worse in those countries where manufacturing is very important*." Policy makers confirmed they expect rates to stay at present levels "*or lower*" through at least the first half of 2020, opening room for a September reduction in the deposit rate from the record low of -0.40% (yes minus!). Officials also signalled they will restart their bond-buying program if needed. "*The Governing Council has tasked the relevant Euro system Committees with examining options, including ways to reinforce its forward guidance on policy rates, mitigating measures, such as the design of a tiered system for reserve remuneration, and options for the size and composition of potential new net asset purchases*." The ECB's latest move comes as central banks around the world turn dovish, suggesting monetary easing will soon be amplified. The U.S. Federal Reserve is widely expected to cut rates by 25 bps next week (unless Trump fires Powell & brings instead Murat Uysal, Turkey's new central banker who delivered a whopping 425 bps cut to the Turkish benchmark borrowing rate!). Whilst the euro initially slid and bond /equities rallied on the ECB's announcement, all asset classes reversed course by the end of the session as Draghi downplayed risks of recession in the Eurozone and suggested that Governing Council members had "*different nuances*" over the exact design of any package

(What now?! The twisted traders' logic dictates that equity prices rally when there is a recession and sell off when growth is solid ?!L).

- **Meet the Newly Elected UK Prime Minister, Mr. Boris Johnson**: Boris Johnson was crowned leader of the Conservative party and became Prime Minister last Wednesday, facing perhaps the most daunting political challenges of any British leader in peacetime. Mr. Johnson beat Jeremy Hunt in the race to succeed Theresa May as Tory leader, securing 92,153 (66%) votes to the foreign secretary's 46,656 (34%). The former London mayor will immediately be confronted by the challenge of uniting his divided party and charting a course out of the Brexit impasse. Mr. Johnson, one of the leading figures in the 2016 referendum campaign to leave the EU, has promised to deliver Brexit "*do or die*" on October 31st, Britain's scheduled departure date from the EU. In a speech to Parliament after the first meeting of his new cabinet on Thursday, Johnson said he would "*turbo-charge*" preparations for a no-deal divorce as he set out his priorities for government. But Brussels has signalled it will not accept his proposed changes to Theresa May's EU withdrawal (European Commission President Jean-Claude Juncker saying it is the best and only deal possible!) If neither side backs down, Britain will be on course to drop out of the EU on the exit day deadline with no agreement in place to ensure smooth cross-border trade and orderly markets. That could trigger delays at ports, shortages of essential supplies including medicines, difficulties with transactions of all stripes, and a recession. Faced with Brexit deadlock at Westminster and the possibility that he could soon lose his majority, Mr Johnson has taken a team of seasoned Brexit campaigners into Downing Street with a view to holding an election within months.
- **Uneventful Mueller Testimony to Congress:** *NO COLLUSION, NO OBSTRUCTION! KEEP AMERICA GREAT! TRUTH IS A FORCE OF NATURE! IMPEACHMENT'S OVER!* (that would be Trump exploding on Twitter as the testimony concluded). Robert Mueller had warned his testimony before Congress would not go beyond what he already said in his 448-page written report on Russian interference in the 2016 presidential election. Over nearly seven hours on Wednesday, he largely stayed true to that promise, and gave both Democrats and Republicans reason to feel frustrated! He said too little for critics of Donald Trump, but too much for the President's supporters. The former special counsel made clear he had not exonerated Mr Trump of acting to obstruct the Russian probe. He disagreed with the President's characterisation of his investigation as a "*witch hunt*" and he warned that Russian meddling threatened the 2020 US election. But the 74-year-old's delivery was disappointing to House Democrats who had been keen to use his televised testimony to focus public attention on Mr Trump's conduct and ensure that the idea of a lawbreaking president was embedded firmly in the electorate's consciousness in the run-up to 2020. Instead of detailed replies, the former FBI director delivered variations of "*true*" and "*yes*" for much of his appearance. At times, Mr Mueller's testimony was halting and difficult to hear, even inside the hearing room. David Axelrod, a former senior adviser to Barack Obama, said on Twitter: "*This is very, very painful*." The former special counsel had been reluctant to testify and spoke only after receiving a congressional subpoena. He sought to stick closely to his report, an approach that still yet drew the ire of Republicans. Mr Trump, who had long insisted Mr Mueller had in fact exonerated him, later seized on the Republicans' argument that Mr Mueller "*didn't have a right to exonerate*". As the hearings drew to a close, Mr Mueller stepped an inch or two beyond his written conclusions on the issue of Russia, WikiLeaks and Mr Trump's response to their role in the 2016 election. When shown the praise the President had heaped on WikiLeaks in 2016 as it released emails the Russians had stolen from the Democratic party, Mr Mueller could not hide his disapproval. "Problematic is an understatement," he said!

In an economic letter sent to clients in late 2016, bond legend & guru Bill Gross (retired in early 2019 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".*

I wonder what Mr. Gross would say now, at a time the Fed is gearing up to cut rates when US growth is around potential, unemployment at record low and trade uncertainties threatening to blunt the impact of any rate reduction; Or his possible views on the ECB promising to revive its QE program with 2-year & 10-year German bund yields already hovering close to -0.78% & -0.38% respectively! Needless to reiterate that world's central banks are simply in danger of storing up problems for later (fuelling asset bubbles and propping zombie companies) by cutting already low interest rates to bolster a "*weakish*" global economy and encouraging a dangerous build-up in leverage in a world where total debt is already approaching $250 trillion!

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