Weekly Market Summary

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Just When You Thought You'd Seen it All! More Disturbing Stories Out This Week!

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Ugh!! Just when I thought I had seen it all in my 28-years' professional career, along came another jaw-dropping set of events this week! Whilst I always knew that gyrations in financial markets can be startling, my evolving concerns/worries are mostly related to the soundness of current politicians' mucking into economic cycles and their repeated "*bullying*" for pre-emptive monetary policies!

After all, the claim that additional short-term monetary stimulus will always be effective and safe is simply not true! Whoever advocates that line of reasoning may be right in the short term; Easy money can sometimes keep growth up for an extra quarter or two, or even possibly stave off a financial or banking crisis until after an election! However, in the long term, too-low interest rates and too much lending only worsen existing economic and financial problems (I am a strong believer that financial excesses were behind most economic downturns in the past 3 decades). Politicians – and lately central bankers - lack the credibility to resist these short-term temptations. However, reality is quite distant from this ideal. When Trump and his fellow leaders complain about defiant central bankers, their pressure is far more likely to do harm than good; Under such unfortunate circumstances, the uncomfortable status quo is a terrible alternative and the pretence of central bank independence is worth defending.

By all standards, it surely has been a crazy week - from its start - and only God knows if more pleasant/unpleasant surprises are in store before we break for the weekend! Below is a recap of major alarming developments that have shaped the political/economic landscape over the past few days:

One Bad Leveraged Loan Isn't a Liquidity Scare: Leveraged loans are type of loans extended to companies that already have considerable amounts of debt and/or poor credit history. Those loans are costlier to the borrower as lenders consider them to carry a higher risk of default (credit risk). Now, with all that as a backdrop, imagine a $693 million leveraged loan that was trading at 97 cents on the dollar losing about a third of its value in one day. This is effectively the recent saga of Clover Technologies. Whilst its loan is not especially large by Wall Street standards, yet its stark and swift decline set off fresh alarm bells - bells that regulators have been sounding for months. It also highlighted the perils of investing these days in the $1.3 trillion market for leveraged loans, where a global chase for yield and lax protections/covenants (a plus for issuers / disadvantage to buyers who have less insight into how the companies are performing) has allowed an explosion in borrowing and lax underwriting. With market illiquidity suddenly becoming a prominent concern in credit circles — the episode shows how loans to highly leveraged companies can quickly implode when fortunes change.

Short & Long-Term US Rates Heading Back to Zero! Two senior Federal Reserve officials stressed the need to act quickly if the U.S. economy looked likely to stumble, reinforcing bets the US central bank could cut interest rates by as much as half a percentage point later this month. Fed Vice Chairman Richard Clarida and New York Fed chief John Williams buoyed stocks and bonds with their dovish remarks Thursday afternoon, in some of the final comments from central bankers before they enter their blackout period ahead of a July 30-31st policy meeting. "*You don't need to wait until things get so bad to have a dramatic series of rate cuts*," Clarida told Fox Business Network, citing economic research. "*We need to make a decision based on where we think the economy may be heading and, importantly, where the risks to the economy are lined up.*" Clarida, the No. 2 official at the Fed, spoke not long after Williams appeared in New York saying that: "*When you only have so much stimulus at your disposal, it pays to act quickly to lower rates at the first sign of economic distress*" (although a New York Fed spokeswoman has since clarified that Williams's prepared remarks were "*an academic speech on 20 years of research. It was not about potential policy actions at the upcoming FOMC meeting*"). U.S. money markets priced in 41 basis points of easing in July after the two men spoke! And if that wasn't confusing enough, we had Bob Michele - the chief investment officer and head of global fixed income at JP Morgan Asset Management – telling Bloomberg TV yesterday that investors should now look to ride U.S. Treasury yields "*all the way down to zero*." For 10-year notes "I think that's where we're headed over the next couple of years," Michele said. "*The rally in bonds hasn't even begun yet*."

UK and EU Brexit Talks Get More Hostile: A meeting of chief Brexit negotiators in past week has been one of the most difficult encounters of the last three years, according to European officials, who are bracing for talks to become more hostile under the next British government. The EU side is weighing up possible concessions it could offer the U.K. to avoid a chaotic no-deal Brexit, according to European officials speaking on condition of anonymity. But the encounter between Brexit Secretary Stephen Barclay and the EU's chief Brexit negotiator Michel Barnier in Brussels risks hardening the EU's stance, making it more difficult to find a way out of the deadlock. The EU side is braced for the prospect of Boris Johnson - someone they see as an untrustworthy populist - becoming prime minister. Johnson is taking a tougher line (especially in relation to the Irish backstop) than Prime Minister Theresa May, vowing to leave the bloc on October 31st, with or without a deal. For those who insist that parliament must be given the right to try to stop a no-deal Brexit, this week brought good news and relief! Indeed, the House of Commons voted in the past 48 hours - by 315 to 274 – to back an amendment that in effect ensures that Parliament must sit and conduct proceedings in the leap-up to the next Brexit deadline; The margin of victory for the anti no-deal MPs was high when compared with many other previous votes. Additionally, some 17 Conservatives voted with the rebels – again a high figure and an important signal to Mr Johnson that parliamentary opposition to Britain crashing out of the EU is sealed. The British pound rallied on the news (last at 1.2530 versus the US Dollar).

Full-Blown Currency War on the Way? A full-blown currency war where major central banks and governments, including the U.S., deliberately weaken their currencies can no longer be ruled out, PIMCO's global economic adviser Joachim Fels wrote in a report. The view is in line with a rising chorus of Wall Street analysts who warn that President Donald Trump's repeated complaints about the foreign exchange practices of key trading partners heightens the risk of U.S. intervention to weaken the dollar. Fels describes current conditions as a "*cold currency war, round three*" that is at risk of escalating. "*Following a pause since early 2018, the cold currency war that has been waging between the world's major trading blocs for more than five years has been flaring up again*," Fels wrote. "*Moreover, even an escalation to a full-blown currency war with direct intervention by the U.S. and other major governments/central banks to weaken their currencies, while not a near-term probability, can no longer be ruled out*." Yesterday, Treasury Secretary Steven Mnuchin said there is no change in the U.S.'s dollar policy "*as of now*" but wouldn't rule out a shift at some stage in the future (so comforting!!☺). There has been "*no change to the dollar policy*," he said during an interview Thursday following a Group of Seven finance ministers' meeting in Chantilly, France. "*This is something we could consider in the future but as of now there's no change to the dollar policy*." President Donald Trump has repeatedly brought up his preference for a weaker dollar as of late. He tweeted this month that Europe and China are playing a "*big currency manipulation game*" and called on the U.S. to "*MATCH, or continue being the dummies*." The US President made noise behind the scenes, too, lamenting to job candidates for the Federal Reserve board that the dollar's strength could blunt economic growth.

Talking about the Donald, and putting aside his recent "racist" attacks on four Democratic congresswomen (and the North Carolina crowd chanting of "*Send Her Back!*" as the US president listed "*unpatriotic or anti-Semitic*" remarks he said Representative Ilhan Omar had previously made), it appears that Theresa May has so far been unable to find a replacement UK ambassador to the U.S. who does not think Trump is an "*idiot*" ! "*We will search high and low until we find someone in this country who doesn't think Trump is a nitwit*", the UK Prime Minister was quoted saying! (Trending pleasantry on social media in past week ☺).

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