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Financial Markets: Play your cards right

Higher? Lower? Nothing for a pair, not in this game. Forget Macroeconomics, what you need to work these markets is an advanced degree in Game-shows.

Source: Shutterstock

Scores on the board...

Further apologies to those who weren't brought up on a diet of cheap UK TV game shows in the 1970s and 80s. Today's titular homage to the late, great, Bruce Forsythe may seem bewildering.

But, as other financial market pundits try to describe what is going on, and Cameron Crise and John Authers are my absolute top picks and must-reads, I realized last night that the correct analogy for financial markets these days is not roulette, but the simple: "Higher, lower" of the game show, "Play your cards right".

What prompted this rare moment of lucidity? Usually, 2 bottles of decent red will do it. But on this occasion, it was a simple comment from a colleague. He noted that the absence of bad news yesterday meant that markets were "risk-on". But in the same way that you might greet a colour card or high number with a call for "lower" on the next card, this simply makes me want to call for lower bond yields, and lower stocks over the coming days.

All this would need would be a well-timed and negatively-themed tweet or any one of half a dozen other, largely political flashpoints (HK, Brexit, Kashmir etc) to provide another excuse to get more risk-averse. You probably don't even need that. Anyway, at that point, and for a brief while, it then makes sense to get bullish, as a further gap in the bad news provides an excuse to take on more risk. Indeed, bad news begets central bank easing, and increasingly, thoughts are turning to fiscal easing as the monetary channel becomes harder to keep working. Look at Europe, finally.

So bad news tends not to stay really bad for too long. Tariffs get postponed, blocked companies get reprieves, rates get cut, taxes get trimmed. But then it returns. And so on...

Catch a falling knife

So much for the day to day volatility, but here's a final question before turning to the events of the day. In 6 months time, not six days, will bond yields be lower or higher than today?

This is a bit different to the earlier question because it implies that there is a trend. And of course, there is, a whopping downward one for bond-yields. But as we pass each new, and seemingly impossibly low level for yields, the temptation to call a turn in the trend has been met with still further falls. Aggressively low bond forecasts made some months ago now look embarrassingly high.

So can they go lower? In my view, yes, and there are few fundamental barriers to this, because, in short, these are not fundamentally driven markets anymore. Yet more apologies to my rates colleagues. My macro world gave way to political craziness years ago, now yours is being swamped in the same way.

So for what it is worth, here's my thinking behind this longer-term "Play your cards right" question. If you believe that bonds yields are due a big turnaround (and PIMCO seems to think there is, if articles claiming they have trimmed government bond positions are correct), then ask yourself, what then is the fate of the equity market? After all, equity valuations are underpinned by exceptionally low rates. Unless such a bond yield up-move follows a strong pick-up in pricing power or real growth (probably only likely with a clear and comprehensive end to the trade war), the likely consequence of any such bond yield rally will be an equity fall, and in turn, that will drive the next downward leg in yields. So, my answer is "lower", though this does not preclude a substantial spurt higher along the way. but any increase should be seen as nothing more than a correction in the ongoing downtrend.

Politics - so much, what to choose?

There's plenty going on in the political universe currently, but the key political events of the last 24 hours seem to be centered on Europe.

UK: Boris Johnson got the inevitable thumbed nose from the EU's Donald Tusk on the Irish border question. Now what? Probably nothing until the UK Parliament returns on September 3 and tries to wrestle back control. That could spell an election.

Italy: Giuseppe Conte resigns blaming Vice Premier Salvini. Italian lawmakers must now try to create an alternative coalition, or go to the polls too.

And in Asia, HK SAR's Chief Executive, Carrie Lam, offered to establish a platform for dialogue, and investigate complaints about the police. The moves have been rejected by protest leaders, but it is movement at least, and as such, offers the hope for an eventual restoration of calm.

Day ahead

Following from yesterday's more upbeat minutes from Australia's Reserve Bank, which have helped keep the AUDUSD closer to 0.68 than 0.67, we get further minutes today from the US Fed and India's RBI. The Fed minutes are really the appetizer for the Friday Jerome Powell Show at Jackson Hole. The RBI minutes may shed some light on what was a very bizarre 35bp of easing at their last meeting. Can we expect more from them? Our India expert, Prakash Sakpal thinks so, with another 50bp of easing priced in before the end of the year.

Bank of Thailand minutes complete the picture today. We expect more from them too, though there are also details emerging about the government's fiscal stimulus plans, so there may be some trade-off of policies here.

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