Weekly Commentary 36

Volatility without Direction - We have seen it before and we will see it again…

One week of extreme choppiness. The markets ended up where they started by Friday close, after crashing by an amount that caused panic when it was happening. From peak to trough and then back, the markets churned through trillions of dollars.

What exactly happened?

As I reported last Friday, the economic data that came out did not look good. The unemployment data in the US were way below expectations, and there was an immediate call on the Fed to cut interest rates. Market participants, on the view that the US economy was slowing, were worried that the failure of the Fed not to move more aggressively on rates was going to hurt the US economy. But this expectation became self-fulfilling.

Since markets are global, Japanese stocks were the first to react to the prospect of a fall in interest rates. For the longest time, the Japanese have had interest rates significantly lower that those prevailing across the Pacific. As a matter of fact, the markets have carried out what is known as a “carry trade”.

This involves big institutional investors borrowing Yen at very low rates, sell the Yen and also buy US stocks, and everything else that creates a “positive carry”, ie makes a margin between the low cost of Yen borrowing and the higher investment return on anything bought on borrowed funds. This was the main reason why the Yen was sold off for the last 1 ½ years. It came to a screeching halt on Friday. First, the Yen that was aggressively shorted until it got to above 160, was bought back.   This led to a huge rally in the Yen, until it reached about 140.

The rise and fall of the Yen from 2019 to 2024. That was how it looked like over a five year time frame. But looking at it over the last one year tells us how the rally in the yen happened and how the dollar crashed last week:

This unwinding of the carry trade, led to Japanese equities collapsing since these were all levered trades, and when they cut the borrowing, they had to also cut the investments bought with borrowed dollars. Clearly, those who lost money got margin calls, and this exacerbated the selling. And this selling wave spread to the US markets on Monday.

The Wall Street Journal reported how this happened.

Why the Yen Carry Trade Unwind Has Further to Go

By
Chelsey Dulaney

The carry trade isn't unwound yet.

Investors are rushing to close out one of the most popular investment strategies of recent years: making investments with borrowed Japanese yen.

Many investors have been participating in the so-called carry trade. Here's how that works: an investor borrows the currency of a place where interest rates are low, like Japan or China, and uses it to invest in a currency where interest rates are higher, like Mexico.

The trade depends on the borrowing currency remaining cheap, and market volatility remaining low. Both of those factors have turned against investors in recent weeks as the yen surged, forcing them to close out out their positions.

Hedge funds and other speculative investors were holding more than 180,000 contracts betting on a weaker yen on a net basis, worth more than $14 billion, at the start of July, according to CFTC data. By last week, those positions had been cut to around $6 billion.

But this is just a small corner of the market for borrowing in yen, notes Chris Turner, global head of markets at ING.

In recent years, banks, asset managers and others have also aggressively borrowed in the Japanese currency. They were encouraged by Japan's negative interest rate policy, which it only ended in April, years after Western central banks began aggressively raising rates to combat inflation.

Japanese banks had lent about $1 trillion to foreign borrowers in yen as of March, according to BIS data, up 21% from 2021. Much of the recent growth in cross-border yen lending has been in the so-called interbank market, where banks lend to each other, and to non-bank financial firms like asset managers.

The problem, Turner said, is that it's been expensive to hedge currency risk for the past few years, so many of those borrowers likely didn't. As they rush to do so now, it essentially creates more demand for yen, he said. This risks a vicious circle, as the yen's strength causes investors and others to close out their weak-yen bets, by buying more yen.

CNBC also says:

Investors are unwinding the biggest 'carry trade' the world has ever seen, SocGen strategist says

PUBLISHED MON, AUG 5 20249

by

Sam Meredith

KEY POINTS

- A rapid unloading of "carry trades" extended on Monday, with market participants seeking to roll back on the popular trading strategy amid a dramatic global sell-off in risk assets.

- Carry trades refer to operations wherein an investor borrows in a currency with low interest rates and reinvests the proceeds in higher-yielding assets elsewhere.

- "You can't unwind the biggest carry trade the world has ever seen without breaking a few heads. That is the impression markets give us this morning," Kit Juckes, chief foreign exchange strategist at Societe Generale, said in a research note published Monday.

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Carry trades refer to operations wherein an investor borrows in a currency with low interest rates, such as the Japanese yen, and reinvests the proceeds in higher-yielding assets elsewhere. The trading strategy has been hugely popular in recent years.

Traditional safe-haven assets, such as the yen and the Swiss franc, surged on Monday, fueling speculation that some investors were seeking to quickly unload profitable carry trades to cover their losses elsewhere.

"You can't unwind the biggest carry trade the world has ever seen without breaking a few heads. That is the impression markets give us this morning," Kit Juckes, chief foreign exchange strategist at Societe Generale, said in a research note published Monday.

Juckes said that a recent batch of weaker-than-expected U.S. economic data, including the labor market report of Friday, manufacturing data and few other soft indicators, had sparked "a huge reaction" in a thin August market.

"That's the easy bit to understand. The tougher question is what happens next," he added.

Juckes flagged that the biggest foreign exchange market reaction was still one of "position reduction." He said long positions against the Japanese yen for the Australian dollar, British pound, Norwegian krone and U.S. dollar were all being taken off.

A push below 140 a dollar for the Japanese yen in the near term "would be unsustainable given the impact on equities and inflation," Juckes said.

Advisory firm says yen carry trade is not dead.

The Japanese currency has risen sharply against the U.S. dollar in recent weeks, trading at 143.36 per dollar at 4:35 p.m. London time on Monday. It marks a stark contrast from the run-up to the July 4th U.S. holiday, when the yen fell to 161.96 per dollar for the first time since December 1986.

Alongside weak U.S. economic data, an August stocks slump has been exacerbated by disappointing major tech earnings and by a more hawkish Bank of Japan. A change in Japanese monetary policy prompted one strategist to warn of the "implosion" of the yen carry trade over a short-term basis.

Separately, Russell Napier, co-founder of the investment research portal ERIC, said in a recent instalment of his "Solid Ground" macro strategy report that investors have now been provided with a glimpse of the impact that a change in Japanese monetary policy can have on U.S. financial markets

Another analytic piece found in Fortune magazine reported this:

How an obscure Japanese yen trade sparked a global market meltdown—and why the worst could be yet to come

BY**LEO SCHWARTZ**

August 7, 2024 at 2:29 AM

As global stock markets plunged on Monday, financial analysts pointed to an esoteric trade involving the Japanese yen as a key factor for the decline. Markets have since rebounded but, with volatility surging and investors feeling skittish, there are fears that the unwinding of the yen-based "carry trade"—which describes profiting off interest rate spreads across different currencies—could drive further losses.

The popularity of the Japanese carry trade is easy to understand. While central banks such as the Federal Reserve increased interest rates in the face of inflation, the Bank of Japan kept its interest rate near zero—or even lower—to incentivize economic growth. As a result, investors such as hedge funds would borrow the yen on the cheap to move into assets with higher growth potential, such as U.S. Treasuries, stocks, and other currencies. "It's one of these trades that was a no-brainer for a lot of people," said Chester Ntonifor, a foreign exchange strategist for BCA Research, in an interview with *Fortune*.

That all changed in late July when the Bank of Japan increased its interest rate to 0.25% amid concern about the yen falling against the U.S. dollar. Suddenly, with the yen rising in strength, many investors were forced to exit their positions, including through potential margin calls and liquidations. "It's a classic case of up the staircase and down the elevator shaft," Scotiabank chief currency strategist Shaun Osborne told *Fortune*. "When everyone tries to get out the door at the same time, it becomes very crowded and gets ugly."

Market impact

While the popularity of the carry trade among institutional investors is indisputable, its exact magnitude—and its impact on Monday's calamitous stock market decline—is still an open question.

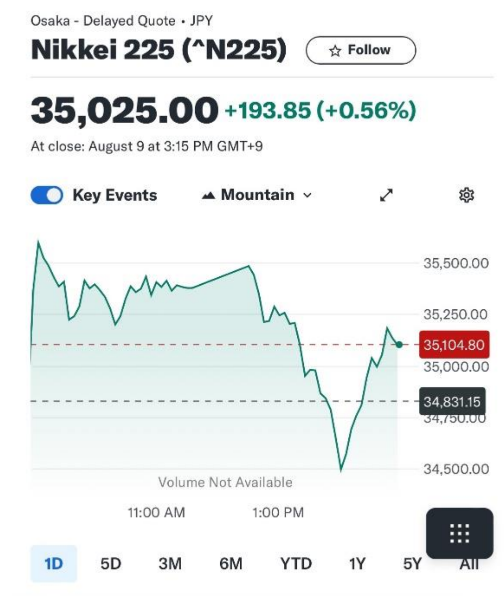
Both Osborne and Ntonifor told *Fortune* it would be difficult to quantify how much money had flowed into the carry trade, but Osborne pointed to a key metric that demonstrated how quickly investors were fleeing. According to his estimations, short positions in the yen—meaning options contracts that borrowed the yen, betting that it would stay level or decrease in value—peaked at around $31 billion in late June. New data through last Tuesday showed that the figure halved to around $15 billion, indicating that traders were closing their positions and exiting the trade.

The S&P 500 fell 3% on Monday—its biggest one-day drop in nearly two years. Some financial experts pointed to the unwinding of the carry trade, with investors forced to exit their positions, which in turn would push down prices,

to return yens that they had borrowed. Other factors, including a disappointing jobs report, also contributed to the decline. Still, Osborne described the carry trade as a “self-feeding mechanism,” where more money will continue to flow out until market sentiment improves. “The risk is certainly tilted toward more equity market weakness in the near term,” he said.

And while Japan’s stock market index, the Nikkei, suffered its worst daily loss on Monday since 1987, a staggering rebound on Tuesday indicates that the Bank of Japan’s strategy could be working, with yens rushing back into the country. “You have inflows into Japanese assets, which will help Japan relative to the rest of the world,” Ntonifor told *Fortune*, arguing that investors have been undervaluing the yen.

The chart below shows the precipitous decline—and sudden rebound—of the Nikkei:



What comes next?

The current drama over the yen may be far from over. Arindam Sandilya, JPMorgan’s co-head of global FX Strategy, told Bloomberg TV on Tuesday that the carry trade unwind is only 50%–60% complete. Ntonifor estimated that the process will take another two to three months, although he added that the Bank of Japan is unlikely to institute further rate hikes.

As traders exit their positions, the yen could continue to gain in value, forcing other investors out and exacerbating the trend. Other wild cards could also come into play, including the U.S. election. Former president Donald Trump said in July that one of his second-term priorities is a weaker dollar relative to the yen, which some analysts say contributed to the Japanese currency’s rally.

Although the carry trade has long been one of the most consistent strategies for investors, its abrupt lack of viability will continue to ripple across global markets. “When these situations correct, they do correct usually in a fairly spectacular manner,” said Osborne. “That points to volatility certainly persisting for a little bit longer here.”

And by Friday, the markets had come back…according to the Wall Street Journal:

Wall Street Ends Wild Week in a Surprising Place

Inflation data next week could lead to more big swings

By

Vicky Ge Huang

Aug. 9, 2024 4:39 pm ET

Down, up, down, up—then up just a little more.

That is how the S&P 500’s wild week went, and the last gasp Friday brought it to just about where it started the week: up 12% for the year.

The sudden turbulence in markets this week shattered a summer lull that many traders had suspected wouldn’t last, after stocks had soared to hang at pricey new heights. Fueling the jumpiness in recent days: the unwinding of a popular trade and any bit of data that seemed to indicate whether a recession might finally be in the cards for the U.S. economy.

There were no big clues on the latter on Friday, and the Nasdaq Composite and Dow Jones Industrial Average both rose, but logged weekly declines of 0.2% and 0.6%, respectively.

The big swings might not be over. Job market worries have been center stage in recent days, but traders’ attention will soon turn back to how inflation is faring, when the consumer-price index for July is released Wednesday. Retail sales will follow a day later.

“The market is apt to be volatile between now and Labor Day,” said George Ball, chairman of investment firm Sanders Morris. “Trading volumes will be thin and there will be palpitations up and down related to various economic data releases.”

Stocks’ roller coaster week started Monday, with a sharp selloff after Friday’s disappointing jobs report. They swung back and forth the next two days, then jumped Thursday after filings for unemployment benefits fell more than expected, easing concerns that the labor market is weakening.

One relatively steadying factor for markets this week has been corporate earnings, which have remained upbeat. Among the S&P 500 companies that have reported results, 78% have delivered better-than-expected earnings for the second quarter, roughly in line with the five-year average of 77%, according to FactSet analyst John Butters.

In the bond market, a rush of debt sales by companies of varying credit ratings this week suggests investors remain optimistic about the economic outlook. After a quiet start on Monday, 33 companies with investment-grade ratings issued $45 billion of debt for the week, according to Tom Murphy, head of investment-grade credit at Columbia Threadneedle. The volume was slightly above this year's average weekly issuance, he said.

"We are not seeing anything that looks like a recession in either earnings, commentary or guidance coming from our issuers," said Murphy.

The yield on the 10-year U.S. Treasury note slipped to 3.943%, snapping a three-day gaining streak.

Among individual stocks, Taiwan Semiconductor Manufacturing Co.'s American Sdepositary receipts rose 1.6% after the world's largest contract chip maker said revenue jumped 45% in July from a year ago. Expedia shares jumped more than 10% after the travel-booking company reported higher revenue for the last quarter.

In Japan, where some of the wildest trading has taken place, stocks extended their recovery after Monday—when they suffered their worst day since the 1987 market crash. The Nikkei 225 ended the week down 2.5%.

So, what happens next week? Are we going sideways or are we going to crash again?

It's not possible to predict the trend, although it is clear that the carry trade is not fully unwound yet. How do we know that? Anything that was built up over years cannot be resolved in a week. As the FT commented:

US stocks end rollercoaster week back where they started

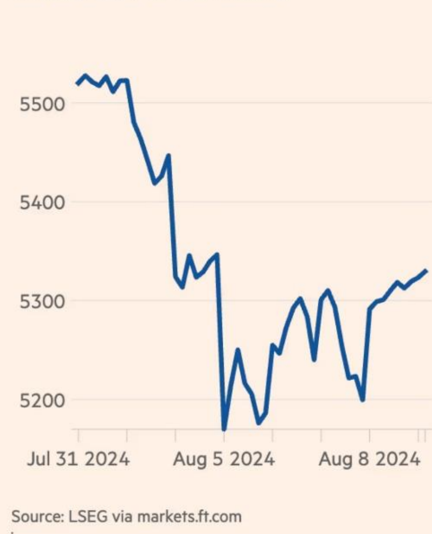
Global equities claw back bulk of losses from Monday's sharp sell-off but mood remains cautious The rebound in stocks came on better signals on the health of the US labour market as unemployment claims fell faster than expected

Wall Street eked out gains on Friday that all but erased the losses investors suffered in a week of volatile trading that included some of the worst and best days for US stocks in almost two years. In New York the benchmark S&P 500 and the tech-heavy Nasdaq each closed 0.5 per cent higher on Friday, leaving both little changed on the week.

Friday's gains lifted the S&P 500 more than 4 per cent above the lows it touched on Monday when a global sell-off sparked by weak US jobs figures a week ago turned into a full-scale rout. Although most big equity markets have recovered the bulk of Monday's losses, indices remain below the levels from before the US jobs report last week that first fuelled concerns about the health of the world's biggest economy and triggered the selling spree. The S&P 500 needs to gain another 2 per cent to recover its levels from before the sell-off began, while the Nasdaq Composite remains about 2.7 per cent short.

"We are not completely out of the woods," said Beata Manthey, head of European equity research at Citigroup. The recovery of the past two days was spurred by better signals on the

health of the US labour market on Thursday as unemployment claims fell faster thanexpected.



Investors were on Friday also beginning to turn their focus to two July reports due next week, saying rising worries about the strength of the US consumer meant Thursday's retail data could provide more of a steer for markets in the near term than Wednesday's inflation report.

"The primary financial markets concern remains the risk of a significant tightening of financial conditions leading to a private sector retrenchment," said Gregory Daco, chief economist at EY. European stocks rose, with the Stoxx Europe 600 index gaining 0.6 per cent to close marginally above the level it ended last week. France's Cac 40 increased 0.3 per cent, while Germany's Dax rose 0.2 per cent and the UK's FTSE 100 gained 0.3 per cent. Earlier, Asian stocks rebounded, with Japan's Topix closing 1 per cent higher, while South Korea's Kospi and Hong Kong's Hang Seng rose 1.2 per cent.

Friday's relative calm followed data showing new US applications for unemployment aid — seen as a proxy for job cuts — had fallen to their lowest level in a month. Figures on Thursday gave a reading of 233,000 for initial state unemployment claims in the week ending August 3 on a seasonally adjusted basis, down from the previous week's upwardly revised level of 250,000 — and below economists' forecasts of 240,000.

"It was the jobs report last week that sent markets into a tailspin," said Kristina Hooper, chief global market strategist at Invesco, so "it makes sense it was a labour market point that would calm markets" this week.

A US soft landing remains in play Japan had borne the brunt of Monday's sell-off, with the Topix dropping 12 per cent in a single trading session. It rebounded the following day with the biggest one-day gain since 2008, as investors decided the decline had been wildly overdone. On Friday, the Topix was 3 per cent lower on the market close a week earlier.

"Volatility is still high, so we may continue to see market fluctuations [in Japan], said Naoya Fuji, equity strategist at Nomura, who emphasised that strong corporate earnings, share

buybacks and better corporate governance had helped the Japanese market recover from Monday's shock sell-off:

The meaning of the market sell-off

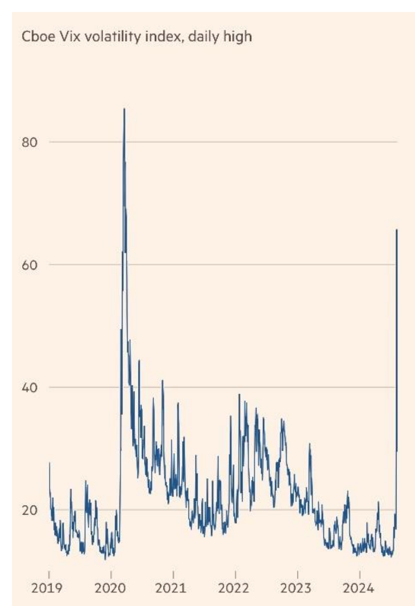
This week's rout signals the end of post-pandemic stability and the beginning of a new period of unpredictability

David Solomon, the chief executive of Goldman Sachs, is not normally found walking the bank's trading floor. Monday, however, was an abnormal day for many on Wall Street. Solomon headed down to the fourth floor of the bank's Tribeca headquarters as its traders grappled with one of the most chaotic days of market action in recent years.

He was not the only senior figure stalking the front office. Ashok Varadhan, the co-head of Goldman's global banking and markets business, was spending much of the day in contact with the team that traded securities tied to the Vix — the volatility index ubiquitously known as "Wall Street's fear gauge".

Upstairs, the group's wealth management practice was hosting a call for more than 5,000 investors answering questions on the likelihood of a recession, how weak US economic data had caught markets off-guard, and the hypothetical market impact of a war in Iran. Downtown, officials and traders on the floor at the New York Stock Exchange were discussing whether circuit breakers would force a marketwide trading halt for the first time since the outbreak of the coronavirus pandemic.

By the end of the day, almost 90 per cent of stocks on the MSCI All-Country World Index (ACWI) had fallen in an indiscriminate global sell-off. Nvidia — the chipmaker that had single-handedly driven almost a third of the US stock market's gains in the first half of 2024 — shed around $400bn in market value in the space of a few minutes, before adding most of it back in the next few hours.



Yet within a few days, most of the turmoil seemed to have been forgotten. By Thursday evening the ACWI and S&P were both down less than 1 per cent for the week.

On their own, the whipsaw swings of the past week-and-a-half say more about the psychology and structure of modern markets than they do about any fundamental shift in the economic or financial outlook.

But the moves did not happen in a vacuum. For some market veterans, the real aberration was an extended post-pandemic period of steady market moves. When this week's events are combined with other cracks that began emerging over the past month, there are signs of a longer-term shift that could lead to a period of increased volatility after years of unusual calm.

"The market was so certain there would be a soft landing in the US, that there was complacency that any other outcomes were even possible," says Joe Davis, the global chief economist at Vanguard. "There was so much concentration, too many investors and market participants all having the same view of the world . . . and that view was really warm and fuzzy."

Now, he says, there has been a "repricing of that thinking". Most observers believe the sheer scale of the moves over the past 10 days was out of proportion to the initial triggers.

The immediate spark for the sell-off was a pair of economic updates on the first two days of August — a survey of manufacturing companies, followed by official figures on the state of the labour market — that heightened concerns that the US economy was heading for recession and the Federal Reserve was moving too slowly to cut interest rates.

The jobs data in particular was well short of expectations, showing the US economy had added just 114,000 new jobs in July compared with expectations of around 175,000, but the figure was not even the worst result of the year. There was speculation at the New York Stock Exchange over whether circuit breakers would force a marketwide trading halt for the first time since the start of the pandemic

An initial sell-off spiralled out of control when Asian markets had a chance to respond on Monday, as the bad news about the US economy combined with concerns about the impact of rising interest rates in Japan and a stronger yen. Huge numbers of investors have taken advantage of Japan's low rates in recent years to borrow cheaply in yen and invest in assets overseas, including in large US tech stocks — the so-called "yen carry trade". The Tokyo stock price index suffered its sharpest fall in almost four decades, and the Vix "fear gauge" peaked at 65, a level only hit or surpassed a handful of times this century — including in the early days of the coronavirus pandemic in 2020, and at the height of the global financial crisis in 2008. A Vix of 65 implies investors expect the S&P 500 to swing an average of 4 per cent a day over the next month.

"At its peak, the ferocity of the selling was very reminiscent of the 2008 global financial crisis, but without the systemic risk fears," says Bruce Kirk, Japan equity strategist at Goldman Sachs. "The breadth and depth of the sell-off appeared to be driven a lot more by extremely concentrated positioning coming up against very tight risk limits."

Market makers say a lack of supply of derivatives to hedge against price movements in the early hours of Monday morning contributed to the sharp moves in the Vix, but in most areas the biggest driver was hordes of investors moving in the same direction, rather than a structural problem.

“There’s nothing wrong with the plumbing, the market makers were there, you just haven’t had the yin and yang of different views going against each other. Everyone is seeing the market the same way and responding to the data of the day,” says Patrick Murphy, head of NYSE market making at GTS, the trading firm.

The growth of certain investment strategies can make sudden momentum shifts more likely. Three brokers say multi-manager hedge funds — which have multiple portfolio managers or “pods” running different strategies — had been a key driver of the recent growth in Japanese markets. These funds are structured to be closed down or have positions liquidated very quickly when markets turn against them.

“The amount of money that is sitting outside of the regulated system, they can really move markets,” says one senior Wall Street bank executive. Jobs data at the beginning of August was well short of expectations, showing the US economy had added just 114,000 new jobs in July compared with expectations of around 175,000

Japanese stocks had also been boosted by domestic retail traders using high amounts of leverage; when those positions began losing value, margin calls for more collateral led to additional forced selling.

In the US, funds that use algorithms to follow market trends were particularly caught out by the string of disappointing economic data. Société Générale’s CTA index, which tracks the performance of 20 of the largest such funds, fell 4.5 per cent in the first week of this month, adding to selling pressure as funds scrambled to cover short positions. When funds that invest in momentum reverse course you can expect a “sharp reaction”, says Shep Perkins, the chief investment officer for equities for Putnam Investments, an asset manager owned by Franklin Templeton.

“There’s a saying: stability breeds fragility,” he adds. “The stability led to complacency and the market was testing folks to say, ‘hey do you know what you own?’”

A rebound on Thursday highlighted the lack of fundamental clarity in what had come before. Less than a week after the disappointing payrolls data, a separate — and traditionally less important — update on the US jobs market encouraged the S&P 500 to its best day since November 2022.

“The market is so fascinated with what is the latest data point,” says Jim Tierney, a portfolio manager at AllianceBernstein. “The ties between fundamentals and day-to-day stock price moves, I’m not sure they’ve ever been more disconnected than they are today.”

But there have been some signs of a more meaningful shift in the background. Pressure is building on multiple fronts including the US economy, corporate earnings, global interest rates and politics.

Growth in the US is clearly trending downward, and the second-quarter earnings season has been dominated by warnings about consumers cutting back on spending.

Investors had also been voicing concerns about stretched stock market valuations for months, particularly in the technology sector. Big gains for the largest tech companies, driven by enthusiasm about artificial intelligence, had helped prop up the wider US stock market, but most have so far shown little return on the hundreds of billions they have invested.

“The bloom is off the AI rose a little bit,” Putnam’s Perkins says. “Even Nvidia, the poster child for AI, announced a delay in a new chip. Given how much excitement was underpinning Nvidia, a delay like that matters.” Bank of Japan Governor Kazuo Ueda’s announcement of an interest rate rise on 31 July caught investors off guard

Investors were caught off guard by the Bank of Japan’s interest rate rise on July 31, but that also tied into a longer-term trend, with the BoJ having finally ended its negative interest rate policy a few months earlier.

Meanwhile global politics has grown more uncertain, with tensions flaring up again in the Middle East, and the entry of Kamala Harris as the Democratic candidate making the US presidential race more unpredictable.

Each change may have been manageable on its own, but the cumulative impact is beginning to have an effect. Stocks had been unusually calm since a brief sell-off last October, but this week would mark the fourth consecutive week of declines for the S&P 500, and the Vix had been slowly trending higher even before this week’s spike.

“There has been a decent amount of new information — when you start to stack four or five concerning things, it’s not unreasonable for the market to have done what it did” since mid-July, Tierney adds.

The shakeout caused by the unwinding of the yen carry trade in particular could be seen as one of the last gasps of the pandemic era of easy returns facilitated by easy money.

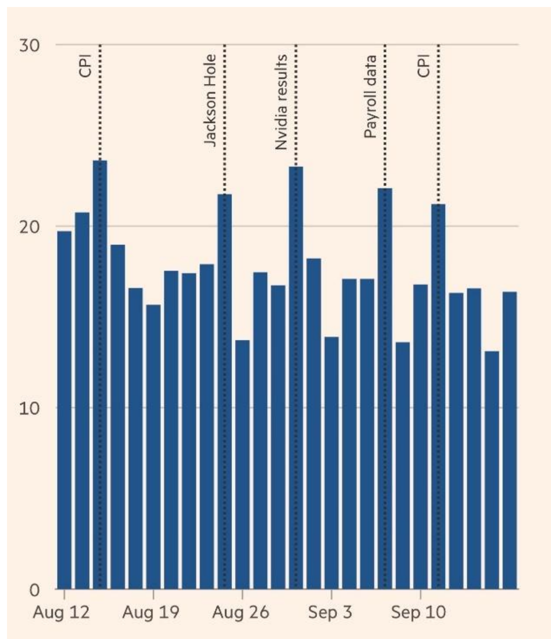
The beginning of the Federal Reserve’s rate hikes in 2022 was seen as the end of an era during which low rates dampened volatility and encouraged investments in risk assets, but in a globalised market, investors need not be bound by the rates of their home country.

With the last holdout central bank finally — gradually — moving away from its low rate policy, another long-term volatility dampener has been removed.

Investors are still trying to disentangle the ultimate impact of all these different factors, but few expect a return to the steady gains of the past 18 months. “From a trader’s perspective, we feel volatility is back in the market,” says GTS’s Murphy.

Markets have identified a host of potential set-pieces that could cause sharp swings in the weeks to come, according to analysis by Citibank. Options markets have priced in daily moves in the S&P 500 of around 1.5 per cent to coincide with the release of inflation data, the next payrolls update, the annual meeting of global central bankers in Jackson Hole, Wyoming, and Nvidia’s second-quarter results.

In a historical context, it was the almost two years without a 3 per cent daily drop in the S&P 500 that was more unusual than Monday’s price action in the US. “You see these events every once in a while. It was a reminder that when there is consensus thinking, the market can turn on its head in a very short amount of time,” says David Giroux, a chief investment officer and head of investment strategy at T Rowe Price.



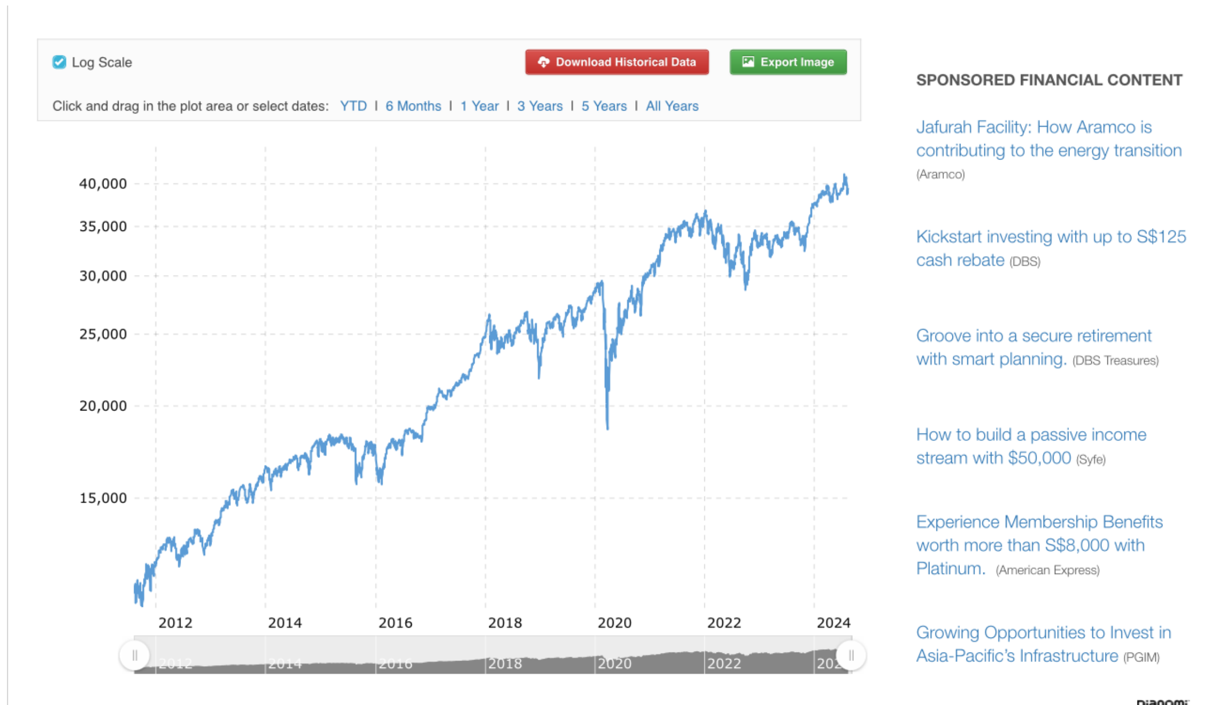
Even after a pullback from the high the market hit in early July, he points out that the S&P 500 is still up around 9 per cent year to date. "It only [feels] horrible because we've had a really good run in the marketplace and only had modest corrections and people got complacent," he adds. "At the start of the year people would have happily signed up for 9 per cent."

My take on these markets is as follows:

The market psychology is that the Fed, ahead of the Presidential election, is unlikely to let the stock market crash. Many people in America associate the stock market with the economy in general, and if equities go to hell, they will press the government to save them. Indeed, if you look at the media commentary I have picked up above, one gets the feeling that people don't want the good times to end. They want a continuously rising stock market, which they have been getting since covid ended. What's even more amazing is that institutional investors also clamour for protection from crashes. You would think that they should be able to tolerate some pain but no, they would rather get the government to keep pushing the inevitable to some undefined future. Kick the can down the road. As far as you can and as long as you can. They demand a rising stock market. This becomes political pressure on the decision makers and they always succumb. Everybody wants to have a good time, and nobody wants it to end. We got that last week.

We got the first part of the week punishing the markets for two days, for being excessively leveraged and being overextended. When the inevitable happened, everybody was scared by it. It wasn't even a big climbdown. The market fell by only a few percentage points on the DJIA and the broader indices on Tuesday, and the Fed, as if on cue, promised relief. The investors lapped it up. Prices stabilized on Wednesday. Once the fear abated, people came it to buy. And when the new economic data supported that strategy, they rushed out in droves to take it back up.

As such, we have a Teflon market. The bull market is unlikely to end. It will shrug off economic bad news because the markets will demand an appropriate response from the economic decision makers to make good on keeping stocks flying. And as long as we are in front of the presidential election, that will happen. So don't expect a crash in equities, bonds or the dollar whatever the economic numbers look like.



Here is a ten year chart of the US stock market, as represented by the DJIA. That crash in the beginning of the last week was nothing more than a blip and it led to panicky calls on the Fed to lower interest rates immediately. And it turns out, that there was no crash. This will continue until either Trump or Harris is elected in November. The US economy is not real anymore. It is just the stock market. The economy is highly indebted with the National Debt now cruising above 35 trillion which is more than the GDP. Who cares? As long as they can print money to pay for the expenditures, there is no need for fiscal prudence.

Therefore, the other thing we need to know is that the US Dollar will also not crash, whether or not there is geopolitical pressure for the US not to do things like freeze other people's assets. It is also the Teflon currency. For all the negative news you might get on Youtube on how the US is doing itself in, when it comes to the crunch, the US dollar will stay mighty.

As such, the adjustments to enable the pressures in the economy to be dissipated will be through US interest rates and US bond yields. One may think when the Fed needs lower interest rates to keep borrowing at multiple trillions a year, it would pose huge pressures to become more prudent. Nah... What for? Because if rates are high, and the debt burden requires more money to service, they will just print more money.

So my view is this. The US stock market will go up, and the US dollar will stay strong. The thing that will adjust that keeps things in balance will be US interest rates, which will stay high as well. And of course the US budget deficit will keep going up and so will their National Debt. But that does not matter…

As such, it will be very hard for BRICS to catch up with the US as the global hegemon. The financial tools which the US have to beat back the challengers are too powerful to ignore. So it is likely that for those of you who think China is the next economic superpower, you will have to think again.   China will be the manufacturing powerhouse, and will be the new hegemon in the economic sense. But it is unlikely to defeat the US geopolitically because of the latter's dominance in the financial sphere. The world will become multipolar not just between countries but also industrially. China will lead in infrastructure, manufacturing and exports, while the US will dominate in financial affairs.   This recent episode in the US stock market is very illustrative. And as capital inflows into the Dollar and US assets continue, the American empire will stay intact. America is not going away anytime soon.

Unfortunately…

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Fintech Entrepreneur, Money Manager and Blogger

Un-Influencer in a World full of Hubris

We no longer distribute the weekly commentary by email. It will be posted on our website. However, if you wish to receive it delivered to you, please let Wai Cheong know and he will send it to you by What'sApp. His What'sApp is 96873181.