Market Review End of January 2018

January was probably 2017's 13th month! Markets continued unabated their ascension. Things were different in the bond markets. As the global economy strengthens, bond markets are increasingly pricing in hawkish monetary policy shifts. Rates have been rising ahead of this potential tightening, producing negative returns for bond holders.

Market moves at the end of January

	Equities in Local Currencies							
End of January	**MSCI World**	**S&P 500**	**EuroStoxx**	**CAC**	**Spain**	**Switzerland**	**UK**	**Hong Kong**
Perf 1 Month	5.22%	5.62%	3.01%	3.19%	4.06%	-0.50%	-2.01%	9.92%
Perf 3 Month	8.66%	9.65%	-1.76%	-0.39%	-0.68%	1.01%	0.54%	16.43%
Perf YTD	5.22%	5.62%	3.01%	3.19%	4.06%	-0.50%	-2.01%	9.92%

	Commodities			Currencies vs EUR			
End of January	**WTI Oil**	**Gold**	**Copper**	**USD**	**JPY**	**GBP**	**CHF**
Perf 1 Month	7.13%	3.23%	-1.78%	-3.30%	-0.36%	1.47%	1.06%
Perf 3 Month	19.03%	5.83%	4.08%	-6.20%	2.54%	0.25%	-0.23%
Perf YTD	7.13%	3.23%	-1.78%	-3.30%	-0.36%	1.47%	1.06%

	Bloomberg Indices Bonds Total returns					
End of January	**Global Aggregate**	**US Aggregate**	**Euro Aggregate**	**US 10 Year**	**German 10 Year**	**Emerging Sovereign USD**
Perf 1 Month	1.19%	-1.15%	-0.45%	-2.20%	-1.54%	-0.17%
Perf 3 Month	2.67%	-0.83%	-0.88%	-2.26%	-2.11%	0.06%
Perf YTD	1.19%	-1.15%	-0.45%	-2.20%	-1.54%	-0.17%

The long overdue market correction did not happen in January, but in the early days of February!

This pattern happens time and time again. A Central Banker makes some conciliatory noises about how the economy is getting better, and then BAM! Markets instantly start testing their resolve by pushing prices against the Central Bank.

Weisshorn Asset Management SA - 29, quai des Bergues, Case postale 1800, CH-1211 Genève 1
+41 22 316 03 30 +41 22 310 31 18 info@weisshorn-am.com www.weisshorn-am.com

Central Bankers will resist these hawkish forces. We have seen this already with both the ECB ("whatever it takes" to save the Euro from Mr Draghi) and the BoJ. They will err in raising interest rates more slowly than the market wants. Over the past couple of years, the Federal Reserve has obviously been an exception. They have gotten somewhat ahead of the market. Yet that's now changed. Trump's election was a momentous signal that populist policies are what the people want. And what does that mean? More inflation.

Following a decade of unprecedented liquidity injections, removing them will take time, longer than the market is willing to accept. Countries, with few exceptions, have piled up debt in order to save banks and support individuals and corporations. Higher rates would choke various economies and a potential similar disaster could be around the corner. Central Bankers know it very well. Their only option is: removing this liquidity very slowly, hoping that growth will continue (this part of the plan is actually working) and inflate away debt so that it can be repaid.

When George H.W. Bush lost his presidency after four years in office, he blamed Alan Greenspan for not cutting interest rates fast enough in an election year. "I reappointed him, and he disappointed me," said Mr Bush of the Federal Reserve chairman.
Over the next few years new governors will be appointed at key Central banks around the world. America is setting a lead that others are likely to follow. Jerome Powell has just been appointed at the head of the US Federal Reserve, he will serve beyond the next presidential election.
Haruhiko Kuroda, head of the Bank of Japan, must be reappointed or replaced by April. Zhou Xiaochuan is expected to step down as governor of the People's Bank of China after 15 years. Big changes are coming at the European Central Bank (ECB). The eight-year term of its vice-president, Vitor Constancio, expires in May. He has one of four jobs on the ECB's six-strong executive board, including the top post held by Mario Draghi, which are up for grabs in the next two years.

The signs are that central bankers of Ms Yellen's kind (nurtured in academia, immersed in economic models, aloof from politics) are out of favour. The new central-bank bosses will probably, like Mr Powell, be generalists versed in the ways of government and masters of a brief rather than a theory. They are set, in short, to be more agreeable to politicians.
And this is a key element (see George HW Bush), which should be supportive of markets. Mid-terms election are due later this year in USA, and Mr Trump will do « whatever it takes » to make sure that the economy continue expanding for a few more quarters.

It is natural for politicians to want to hug central bankers closer. The bankers' powers have grown since the financial crisis of 2007-08 in part because governments have themselves been unable or unwilling to act. Central banks kept credit markets working, bailed out banks and gave confidence to shaky bond markets. They have since been given, or been given back, powers to regulate banks and to preserve financial stability.

The decline of the pointy-headed central-bank governor need not be calamitous.
Yet there is also good reason to worry. An independent central bank can be better trusted to act swiftly to curb inflation. That trust also gives it freedom to cut interest rates when the economy turns down. The kinds of problems set by a booming world economy and elevated asset prices (as is the case currently) are best tackled by experts at some distance from politics.

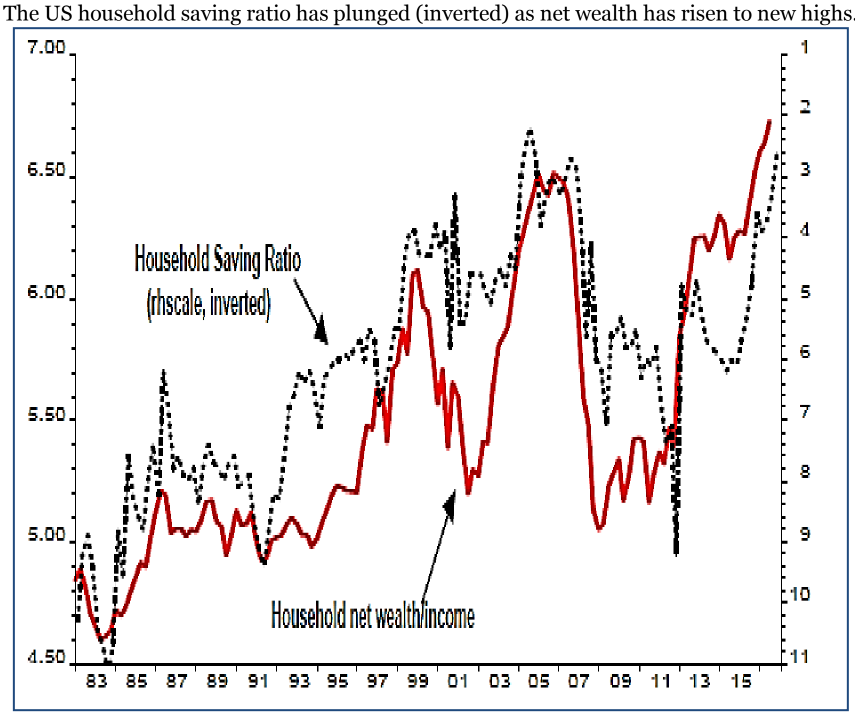
Markets are rightfully scared about the possibility that Central Bank governors indicate a policy change is the wrong play, but too many pundits are confusing their desire to have QE end with the message that Central Bankers are actually sending.

Whether it is the Bank of Japan defending lower interest rates and a weak Yen, or the ECB's comments regarding recent Euro strength, these Central Bankers are in much less of a rush to ease off the accelerator than the market believes.

They will overshoot and maintain their loose monetary policies a lot longer than one expects. The Bank of Japan especially has adopted the mantra that they need to be "responsibly irresponsible." The BoJ has been burned too many times assuming that the economic recovery has become self-sustaining, only to find that as soon as they withdraw stimulus, the recovery falls on its face. They aren't going to make that mistake again. No, the mistake they make this time will be completely in the opposite direction. Which is why it is foolish to constantly be looking for Central Bankers to ease off. They will do so only reluctantly and much slower than the market expects.
And what does that mean? Probably more of the same.

The S&P 500 is up approximately 35% since Mr Trump was elected. The wealth effect is a key component for US consumption (2/3 of GDP!). But Americans have borrowed even more against their personal assets in order to maintain their spending habits.

The US household saving ratio has plunged (inverted) as net wealth has risen to new highs.



Now what will happen if we get a 10% correction? Or heaven forbid, a 20% or 30% swoon?
Can you imagine the pressure the Federal Reserve Board Members will feel from Trump's tweets? Especially if the stock market declines because of overly tight monetary policy. And let's face it. That's always how these cycles end - it's only a question of how many tightenings before it stalls.

Weisshorn Asset Management SA - 29, quai des Bergues, Case postale 1800, CH-1211 Genève 1
+41 22 316 03 30 +41 22 310 31 18 info@weisshorn-am.com www.weisshorn-am.com

Until now, the US economy was expanding, interest rates were low and stocks were exploding higher, so the Fed and Trump were best friends. But make no mistake. This cannot last for ever.

Until further tangible indicators emerge, equity markets will be supported by Central Bankers. Bonds markets will show a different picture. Loose monetary policies will tolerate higher inflation levels. This is obviously bad for bond holders. But wait, will Central Bankers really achieve their Herculean goal? Probably not. They will fight forces which might be unstoppable. We could see periods of inflation but it will be cyclical and not structural. Long term trends such as automation, digitalization will continue pushing cost of production and services lower.

Central bankers will continue to fill their Danaïdes' cistern, hoping to raise inflation until asset prices reach bubble valuations similar to 2000 or 2008. But we are not there yet. Until then buy the dip!