2010. Looking back. Looking forward.

2009 was an interesting year in a different way that 2008 was an interesting year.

In 2008 we thought that financial markets would disintegrate. In 2009, equities rallied, credit spreads tightened, the TED spread and LIBOR tightened while commodities recovered and emerging market sovereign bonds saw robust demand. Low risk developed world government bonds fared less well.

In 2007 we thought that food prices would be chronically high resulting in social unrest. The financial crisis of 2008 quickly reversed those expectations. In 2009, food and agri prices are rising once again.

In 2008 the decoupling of emerging markets was eagerly awaited yet did not materialize. In fact, export dependent emerging markets bore the initial brunt of the recession as trade volumes were decimated due to a confluence of slack demand and dearth of trade finance credit. Then the emerging markets led by China began fiscal expansion of significant proportions to compensate for flagging Western demand, spending mostly on infrastructure. The result has been a surprisingly short lived recession followed by a robust recovery.

In 2009 Japan held the promise of a new government after decades of the LDP. Expectations for reform were optimistic but then quickly evaporated. Japanese equities were sold off only to recover strongly in the final months of 2009.

At the start of 2009 investors loved cash, the USD, sovereign debt and gold as risk aversion swelled. Everything else they hated. At the end of 2009 they feared inflation would erode the value of fixed income sovereign instruments, they still liked gold, but equities had rallied and credit spreads tightened. Gold made successive new highs, but other industrial commodities had recovered as well. The USD was largely expected to weaken on the scale of the current account deficit.

Not only have financial markets weathered the crisis in the real economy but so far the social unrest hoped for by the perma-bears has not materialized and only two governments (Latvia’s and Iceland’s) have failed. India and Indonesia held elections won by incumbents in 2009.

Investors have a dismal record of macro success.

Broadly, investors who were bearish in 2008 continued to be bearish in 2009 and those bullish in 2008 likewise remained bullish in 2009. At least they are consistent. It seems almost as if investors have a view that is independent of the facts and seek the subset of data necessary to support the forgone conclusion.

What are the consensus views:

Weak USD. This is has a strong consensus following and is therefore likely to be confounded. Notice the developed economies like the US evolving into export economies?

High inflation. Also a strong consensus and likely to fail. Given all the money printing by governments who have to do it and those who don’t that inflation expectations are not higher? Isn’t it surprising that the US yield curve isn’t steeper and long rates closer to double digits? What gives?

Equity markets will crash. Not a strong consensus. It used to be but the bears have been defecting steadily which means a big correction is likely around the corner. Who know?

History tells us that by sticking to one’s view one will get the call right, if not the timing.

China’s economic policy is creating dangerous asset bubbles, especially in real estate. It all depends on your point of view. Its a bubble if you missed it, and its a fundamental theme if you didn’t. The gold bug thinks that gold at 2000 usd per oz is a fundamentally sound value for gold but that real estate at any price is a bubble. The real estate investor thinks that 100 grand HKD per square foot at the Peak is fundamentally supported while gold at 800 usd was a bubble. Its a bubble if you bought it at 5000 and its now offering at 1000 and worth 800.

Emerging markets will outperform. Too late, they already have. Now what? In 2009, the US, European and Japanese equity markets were pretty much neck and neck (up around 17%). Emerging Asia and Lat Am decided to outperform by a wide margin. It was quite surprising to see the Nikkei marginally see off the Dow given the bailouts, rescues, proactive fiscal and monetary policies of the US against a new administration 50 years out of practice and with 200 false starts in Japan. Indonesia ended up over 110% in 2009. Similar numbers were recorded in Brazil, China and India. If they falter, their volatility relative to developed markets is likely to be quite high and economists will need to quickly find an explanation for any steep correction.

Gold will continue to rise. The likes of John Paulson, risk arber turned macro trader, think so. I personally find it hard to think of something that has little use other than bling. I don’t know if it will rise, or fall, or trade sideways (you have to love market jargon), but I do like to look at the price of useful stuff in terms of gold. You see some interesting patterns when you think of gold as an intrinsically useless yardstick. Tell me then that the USD is over-valued and will fall, that I understand. Or oil will rise, or copper fall, etc etc. In gold terms.

As always, the most important decision is the macro one. Why? If you take a big macro decision, you tautologically make the macro decision important. If you take a less directional macro thematic view but instead scrub the micro structure of the markets for niche strategies, arbitrage and other inefficiencies, you relegate the impact of the big macro decision. Its a lot less fun.

At a more granular level and in particular in the alternative investment space, investors spent 2006 piling into hedge funds, 2007 staring blankly at an impending liquidity crisis, 2008 trying to scramble out of illiquid hedge fund investments and 2009 gallantly or sheepishly rescinding their redemption instructions on account of the strong returns.

At each decision node where investment decisions are delegated and where there is an asset liability liquidity mismatch, a degree of efficiency is lost.

It is the first business day of the year and unfortunately my big macro calls are not ready. Nor my alternative investment strategy outlook. So, sorry, you’re on your own for the moment, but once I see how things have turned out, I’ll be sure to write to tell you that I told you so.