

Tactical and Temporary Retreat. Tapering US equity exposure

Good investment and trading practice is that you always have a thesis and the thesis implies certain milestones, and profit and loss levels. If the milestones are not met, and the thesis is unchanged, even if profit targets are met or exceeded, one should reassess the trade, preferably cutting it while the reassessment is taking place.

I have long held that the US economy was on a sustainable growth path and that the level of growth would be low, circa 2% long term trend rate. This is a view held since October 2011. With the continuing recovery, one would reasonably have expected an eventual roll back of unconventional policy involving the large scale asset purchases by the Fed. QE tapering was therefore a positive signal, in my view. With the telegraphing of QE tapering, the moderation in the pace of Fed asset purchases, my view was that there would be some significant weakness, despite the advance signal from the Fed, and that this would be a buying opportunity. The prevarication by the Fed has meant that one of the milestones in my investment thesis, a particularly important one, had been missed. Regardless of the profit or loss situation on the trade, I would take it off the table. Do I think the US equity market will rise further? Yes, probably. However, my initial thesis implied an important milestone that was missed. This is a matter of investment discipline.

I maintain the view that the US economy is on a path of sustainable growth. That the new equilibrium trend growth rate is now closer to 2% than to 4% is likely to be confounding the models used by most forecasters and the Fed. This is a contributing factor for the Fed to be likely to be more accommodative than it needs to be on an ongoing basis, at least until it revises its long term growth rate. To be clear, I do not see a weak economy and I do not see the Fed as interpreting it as such. The delay of QE tapering is likely in respect of a confluence of a couple of risky events which

the Fed would like to see out of the way before it moderates its asset purchases. Topical issues like the German elections and the uncertainty around the possible structure of the coalition, the impending fisticuffs over the **US** debt ceiling and the historical turbulence around October time, have probably led the Fed to postpone QE tapering by a month or two. There may be some weakness in the market then that may be worth buying into.