Ten Seconds into 2014. More of the same.

The current volatility in global markets is unremarkable. What is remarkable is the lack of volatility in the past two years. The macro conditions envisaged in mid 2012 continue to hold. For details see:

Investment Strategy In a Crazy World April 2012

1. Long term global growth rate has stabilized along a slower growth path, mainly due to moderation in credit creation.
2. Developed Markets (DM) rebalance towards a neutral trade balance. Emerging Markets (EM) also rebalance towards neutral trade balance. Generally this is the rebalancing of economies towards better balance between investment, consumption and trade.
3. Aiding the resurgence of exports and manufacturing in DM is an entrenched technological or knowledge advantage.
4. Trade flows are supportive of USD.
5. Trade flows are raising true cost of funds for hard currencies.

1. DM growth to accelerate. EM growth to decelerate.
2. DM currencies to strengthen relative to EM.
3. EM curves to flatten relative to DM curves.
4. Bearish for commodities as DM are more efficient users of commodities relative to EM.
5. Much depends on EM response to current volatility in FX and rates. Raising short rates may not work in defending currencies. Side effects include depressing local

currency bond markets as cost of FX hedging rise. Hard currency bond financing faces obvious problems. Selling hard currency for local is an analgesic with poor long term prospects as foreign reserves are exhausted.
6. EM risk is likely to be continuous rather than catastrophic. Crises are unlikely. Steady underperformance is likely.
7. credit crisis risk has been postponed by the opaque bailout of the Credit Equals Gold product but refi risk is significant.

1. Avoid macro trades. Allocate to well hedged, idiosyncratic risk strategies.
2. But if you have to invest in macro fashion, invest in DM.
3. Overweight US risk assets.
4. Neutral, not underweight, USD duration.
5. Overweight European duration.
6. EM is weak, but there is a price at which EM can be bought.

1. ’s shadow banking system remains opaque and leverage is high once you include corporate credit to the infrastructure finance.
2. is in a feel good mode at the moment but much of the structural issues remain. The ECB will soon be banking regulator which is a positive, however, Glass – Steagall type legislation needs to be enacted. In the meantime, bank balance sheets remain opaque.
3. The Euro fails to clear labour markets. Employment is stabilizing but structural employment is likely to persist. Witness the recovery of labour markets in countries with a sovereign currency such as UK and US.
4. Man made risks such as risk pooling. Risk can be pooled in vehicles such as mutual funds, structured credit

vehicles like CLOs, or more insidiously, through conventions and systems. Common risk metrics and common risk systems are a significant risk to financial stability.

5. Non commercial risks. In a slower growth environment, human beings are less inclined to share, the propensity for unhealthy competition is raised. Risk of martial conflict is raised.

1. For every asset there is a price too high, and a price too low.
2. If there
   is no reason to invest, don’t. Every extension of risk requires a sound thesis. Where ends the thesis, where ends the trade.
3. Fundamentals are necessary but not sufficient. Psychologically susceptible investors are an important element to market pricing.