# Thoughts after 2 weeks Off The Grid. November 2019.

Equity markets have made new highs while bond markets have stalled. Economic data are mixed following months of signs of slowing. India's economy has slowed drastically, China's slowdown seems to have moderated, Europe still looks weak albeit the data seems to have stopped deteriorating and the US economy seems to have firmed from prior weakness. The overall picture still looks weak and the central banks have had to maintain or increase accommodation. While I was out, the Fed cut interest rates another 25 basis points and the probability that rates will not be cut further this year has risen from 60% to 80%.

Why are equities rising? The Fed continues to provide liquidity, cutting rates, and increasing repo operations as well as bond purchases, in a move it has declined to call QE, yet is practically identical to QE in form if not in detail. Share buybacks continue apace as cheap credit allows firms to raise debt to fund buybacks, increasing corporate leverage further. Bad for bond holders but good for shareholders. Lower interest rates also support higher valuations.

Why are bonds stagnating? The bond market is broader than the equity market. There are many corporate issuers without listed equity, there are mortgages, and other ABS. The weak economy is manifesting in this broad measure, while the equity market representation is shrinking.

The loan market has been an area of focus. Weaker covenants and documentation, collateral leakage, and falling short term interest rates have impacted this market. The fundamental reality is that if loans are in trouble, equities are in much worse trouble, since they are first loss. The practical reality is that technicals, that is demand from investors and ETFs, central bank liquidity, share buybacks, et al, support equity markets while falling interest rates make loans less attractive. Interest rates are an important driver of loan performance these past weeks as a comparison with HY bonds reveals. Spreads have not widened much for HY bonds, yet loan spreads have widened (suffered) more.

Where to from here? The Fed has signaled that it will be data dependent from here and has removed any language signaling a leaning towards raising or cutting rates. The momentum from the recent rate cut is still driving asset prices and the bond market but the transition from easy to neutral at the Fed is likely to take hold in the coming weeks.

Equity markets should continue to richen into the year end as central banks continue to support markets for risk assets. They will do so until they cannot and it could be some time before they run out of ammo. When they do, they will have raised valuations to even loftier levels and the correction will be steep. Until then, for the intrepid trader, momentum will carry the market.

Duration is hard to call. The Fed needed to get the inversion out of the front to 5 year end of the curve and it has nearly achieved that. Recessionary pressures from the yield curve are gone. But the curve is sufficiently flat that there is no room for flattening without inversion and recession, and there is little impetus for steepening while the Fed has resumed bond buying.\

As for EUR duration, Draghi’s swansong rate cut and QE resumption probably marked the end of the EUR duration trade for some time. Both Draghi’s and Lagarde’s concerted call for more fiscal support are a signal that either the ECB will not accelerate accommodation, or it cannot. And if fiscal support really comes, it would certainly push rates higher.