Weekly Market Flash

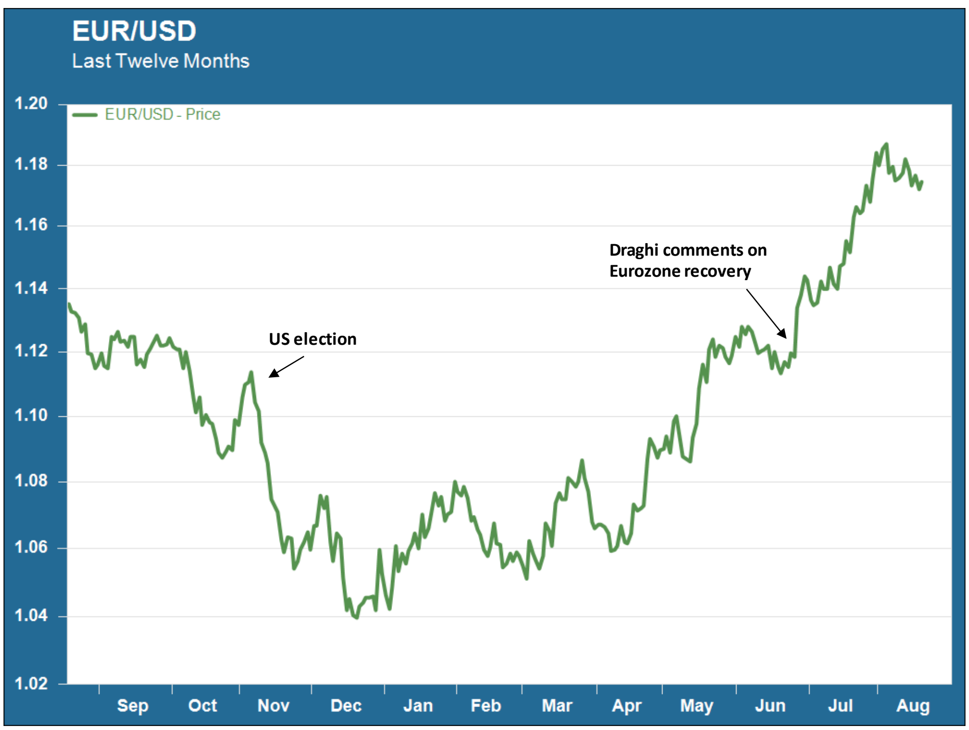
Rocky Mountain High

August 18, 2017

Jackson Hole is, by all accounts, a lovely redoubt, high up in the Rocky Mountains of Wyoming. As has been the case every August since 1978, the monetary mandarins who set the agenda for the world's central banks will dutifully traipse up to this hiking and skiing paradise next week for their annual economic symposium. The attention span of the global investment community will briefly train its attention on Jackson Hole, and not on account of the riveting topics on tap for keynote speeches and panel confabs. This year's symposium title is "Fostering a Dynamic Global Economy," an anodyne and, in this contentious day and age, somewhat wistful formulation. If nothing else, though, it at least rolls off the tongue more easily than last year's unfortunate word salad of a lead line: "Designing Resilient Monetary Policy Frameworks for the Future." Central banker says what?

Euron a Roll

No, investors' interest in the proceedings will be strictly limited to whatever policy utterances may spring forth from the lips of bankers, none more so than European Central Bank chief Mario Draghi. A frisson of anticipation rippled in late June from Draghi's musings about the stronger than expected pace of recovery in the Eurozone. These musings, not unlike Ben Bernanke's "taper" kerfuffle of May 2013, sent bond markets and the euro into a tizzy as investors imagined the beginning of the end of Eurozone QE. The euro in particular went on a tear, as the chart below illustrates:



Source: MVF Research, FactSet

So much did the currency respond to fears of a more aggressive QE taper by the ECB that a strong euro has replaced a strong Eurozone as the central bank's chief concern, as revealed by the most recent ECB minutes published this week. The euro's strength puts regional companies at a competitive disadvantage for their exports, and complicates the ECB's elusive target of 2 percent inflation. The characteristically cautious and incremental Draghi is thus likely to be on his guard to avoid any comments that could be interpreted by the market as hawkish policy leanings. Those tuning into the Jackson Hole proceedings may well come away with little more than the bland sentences peppered with bursts of arcane math that make up the majority of central bank speeches. More likely, investors will have to wait until the ECB's next policy meetings in September and October for guidance on the timing of QE tapering.

The Smell of Fear

Concerns about the euro come at the same time as a smattering of long-dormant volatility comes back into risk asset markets. The CBOE VIX index has found a new home above 15 in recent days – still below the commonly accepted fear threshold of 20, but well above the sub-10 all-time lows it has plumbed for much of the past several months. Global stock indexes have experienced some attendant turbulence in the form of 1 percent-plus intraday pullbacks – fairly tame by historical norms but enough to re-ignite the chatter about the duration of this bull market, expensive valuations and all the rest.

It's been awhile since shaky asset markets have tested central bankers' nerves. Nor is there any clear indication that this late summer volatility will develop into anything more than a brief passing thunderstorm or two. But we have sufficient evidence from recent history that the policymakers do react to asset prices. They will likely be wary of pushing too hard for normalization policies (tapering on the part of the ECB, balance sheet reduction and further rate hikes for the Fed) if they sense that such moves will feed into already jittery capital markets.

Chances are that the only "hikes" on the agenda at Jackson Hole will be the kind involving nature's beauty, not interest rates. We don't expect much from Wyoming to be moving markets next week. But the central bankers still face a dilemma: how to proceed with the normalization they so want to accomplish when (a) market reactions could be troublesome, and (b) the urgency from a macroeconomic perspective is not clear and present. This will be one of the key contextual themes, we believe, heading into the fall.

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