CERNO CAPITAL

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It's like romantic love. Unlimited pledges are what works. Nothing else.

Central bankers have markets in their thrall and their words alone have sufficed to keep the pot bubbling. Whilst we were wrong to suggest that August would contain challenges, we did not act on that thought and reduce exposure.

It is 25 months since QE2 was launched and with just an inflection of speech at Jackson Hole, Fed Governor Bernanke has been able to inspire risk assets. President of the ECB, Mario Draghi, (referred to recently in the FT as "Bernanke in Frankfurt") is of the same stamp and definitive statements as to the inviolability of the euro has done the same magic in Europe. Indeed, the ECB's balance sheet size is little changed on the year. While this displays estimable frugality in the face of the crisis, it is prone to change with the newly announced program named Outright Monetary Transactions or OMT. Every program deserves an acronym even if the euro variant has the soulless thud of eurocracy. The fact that Draghi was able to launch OMT in Frankfurt, both the actual and spiritual home of German banking, throws into relief the fact that Germany has just a single vote on the Governing Council of the ECB, not a veto vote.

The immediate market reaction was close to ecstatic, although presaged by some well placed leaking and market preparation. The obvious challenge of size and credibility was faced down on 6th September, permitting further yield tightening in the key bond markets of Italy and Spain. By not capping the program size, the Europeans appear have put aside their habit of negotiating finite levels of support where gargantuan gestures are required.

Some other challenges remain. First is the legal challenge being considered by Germany's constitutional court in relation to a previous program. Secondly there is the question of equity, as the ECB will have to ration between different sovereign markets with no working definition of what price level connotes dysfunction.

In Draghi's shoes, you would be somewhat happy that his intentions of themselves have the ability to shift market pricing in the desired direction and happier still that, by not containing the size of possible interventions, he has successfully borrowed some of the big-country effect of American monetary policy. Awesome, in their terminology. All this adds up to greater credibility than existed in the Trichet era, an essential requisite along with the blue suits, black shoes and wire glasses.

The economic, rather than legal, debating ground is over whether the responsibilities of a central banker should be asymmetric (containing only the risk of inflation) or symmetric (containing the risks of inflation and deflation). When Draghi refers to price stability he is referring to a symmetric set of responsibilities without mentioning deflation by name.

Whilst the capping of Spanish and Italian yield levels by adding a large, influential buyer to the market creates the perception of apparent containment of the crisis, it does not denote a change in the remedy, which is for additional strictures. Therefore the program is, in reality, more of a palliative and all the underlying solvency issues will continue to fret away. An empty apartment block on the Costa Brava on the 6th of September is still an empty apartment block on the 7th of September.

The history of the past four years is that the relative winners, in investment terms, have been those who have taken central banks at their word. It has not been a good time to be a naysayer. Consequently, equity levels in our portfolios are close to what we regard as long run par levels for multi-asset class investment. On the other hand, this is not a blanket approval of equities. Regional diversity in equity is beginning to increase even if it is not at all apparent in bonds. We should, by now, be getting to grips with the dominant equity theme of 2012 which is the outperformance of developed (principally the US) versus Asia and the Emerging Markets. As of this week, the French and Italian stock markets have outperformed Japan year-to-date.

Asian managers who are making money this year are doing it in some old, familiar places like Thailand and Singapore, not in the big economies.

The relative health of the US economy versus that of China is so stark that we are beginning to talk about the currency level of the RMB. Although China is not about to do anything of any consequence ahead of its mid October National Congress, surprises may well lurk beyond it. China’s aggregate economic data, other than its obviously faulty GDP series, are now incontrovertibly bad meaning that you no longer have to lurk in the offices of obscure renegade economists in Beijing to obtain a picture of the slowdown, it has infiltrated official data.

This is having some bearing on Japanese prospects. We know from the last 20 years of history that Japan is quite capable of turning a boom next door (China’s boom) into sullen and persistent deflation at home. Just imagine what misery could be conjured as China slows.

If it’s unlimited pledges of undying money that is required, somebody should tell the Japanese.

Let’s enjoy the Indian summer.

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