CERNO CAPITAL

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Central Bank actions over the summer have sustained the belief in the potency of monetary intervention and has engendered the notion that the key central bank players are “in-step”, tugging in synch on the corners of the trampoline that sits below an economic high wire.

The fact that these beliefs are anchored on the actions of just three sympathetic central banks - the Fed, ECB and BoE (of which the BoE is of marginal importance on a global footing) from the world’s 190 nations speaks to both the imbalance of wealth and influence throughout the world, and relative balance sheet size.

It can hardly be denied that the mix of soft macro data and high monetary impetus, now in place for over three years, does more than just underpin key asset classes, it is actually driving asset inflation quite effectively. A tracker on the US equity market has been the asset of choice this year. Equities are a leading indicator and, by anchoring Fed policy to employment levels, which is a lagging indicator, the Fed has indicated, in a very clear way, that it intends to push very hard indeed.

Within the developed world, Japan remains apart, sustaining the deflationary pall over that economy through half-hearted action. As we approach the end of the year, thoughts naturally turn to the outlook for 2013, and what is often most relevant to investment returns is particularly where expectations might change. Japanese policy is one area to look to. Markets would welcome a much more determined effort to reflate and depress the level of the yen. Robust policy initiatives, clear implementation and communication would form an investor’s wish list.

China will have a new government soon and by next year, the new personnel will have considered their response to what appears to be a very soft economic environment. The incoming leadership will already be harbouring some concern in relation to the groundswell of labour discontent. The past five year period was meant to be all about harmonising society by improving terms for lower paid workers. Whilst the base costs of manufacturing assembly have risen through wage legislation, worker satisfaction has not. The prospect of devaluation of the RMB might not be at the vanguard of any package of restorative measures but is something that should already enter investors’ minds. Were it to transpire, the flow of capital into Emerging Market credit markets would come to a juddering halt.

It is clear to almost all that prevailing policies in the Eurozone, as applied to debtor countries are exacerbating the debt burden. In our opinion, the wrong policies are being adopted and policy mistakes are what turn recessions into depressions. Aspects of the southern European condition already more closely resemble depression like conditions. Although we are unable to envisage the sequence of events that will enact wide-scale change in both policy and prognosis, the unexpected is exactly the catalyst to realise better investment returns.

Germany relaxes, Japan and Europe reflate, China devalues. These are seismic developments that, in aggregate, would attract long odds of occurring. Legions of well educated people are deployed to analyse, describe and envisage economic events - however their consolidated track record is quite poor. Certainty is not the objective in investment even though our brains tell us that is what we desire. Uncertainty is the investor's friend, especially if it comes with its bed-fellow: value. Value is still in equities, it is not in bonds. That will be our call for 2013.

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