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After the flood

Chris Bailey, *European Strategist, Raymond James Investment Services*

"The crowd
Spurning step by state
Blame something else
Thirsting
Within without
Sighted
Weeded
How they run"

After the Flood, Talk Talk

Financial markets tend to go up akin to climbing stairs and fall as if you are in a lift, reflecting the slow mania of greed and the more immediate and direct fear realisation

October is a month that has a stock market reputation for volatility and in 2018 - at least in this sense - it did not disappoint. Hindsight watchers will point to the nervous tone of the International Monetary Fund's World Economic Outlook document concerning higher interest rates and global trade angst as the straw that broke the camel's back, but in reality a slow rotation in favour of more defensive equity market names had already been quietly occurring over the summer.

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Financial markets tend to go up akin to climbing stairs and fall as if you are in a lift, reflecting the slow mania of greed and the more immediate and direct fear realisation. Such is the nature of financial market psychology. I remember well my first period of serious market dislocation as a professional investor. Information immediacy was not quite what it is today back then, but there was plenty of evidence of the first four stages of grief - shock/denial, pain/guilt, anger/bargaining and depression/reflection - well before we had even countenanced what our clients were feeling.

Back then one of the key lessons I learnt was that what really matters is how you react. The key for global financial markets for the rest of this year and into 2019 is best captured by the fortunes of the US dollar, which is our own canary in the coal mine. Simply put, further firming in the dollar bodes poorly for financial markets, whilst a dollar fade opens up the scope for less fear about the impact of higher interest rates and global trade policy slipping more overtly into a protectionist mess.

It was the great monetarist economist Milton Friedman who correctly observed - in his defence of floating exchange rates - that a currency move was very powerful because it had the power of changing the relative price of all constituents of an economy. In today's world, a firming dollar is likely to be associated with global investors becoming progressively even more sceptical towards the emerging markets and policy rhetoric or actions influenced by perceived trade imbalances and competitive threats. A weaker dollar is no panacea but it offers today a safety valve capability.

Now, currency analysis is beset with challenges but ultimately, I see the direction of an individual exchange as being a single, compressed insight into the policy credibility of a country's financial, economic and political set-up relative to prevailing expectations. There is little doubt that the American economic performance of recent years should make Europe feel truly embarrassed. However, this relative perception feels as stretched as it can be. The imminent midterm elections in the United States raise the spectre of political gridlock and more constraints on being able to push through trade tariff legislation. Meanwhile, in Europe the Brexit and Italian budgetary debates are already zones of material worry. As I write, some further mumblings concerning further inching towards a Brexit deal have pushed up both the Pound and the Euro, at a time when key emerging countries such as China are continuing to show a capability to help their local economies continue to tick over. Such thoughts are enough to make my reaction function to October's volatility more focused on searching for opportunities than worrying about threats.

However - with regard to the US dollar - it was my Father who recently put it best. In the middle of October's financial market volatility, my parents made their inaugural trip to the United States. Upon their return, when asked what they thought, one of his first reactions was to note how expensive he found almost everything...

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