

# A View from the Trenches

Toronto, Thursday, October 1<sup>st</sup>, 2009

Good morning,

Yesterday's session was full of noise. On the surface, we had the backward-looking macro data releases: MBA weekly Mortgage Applications at -2.8% vs. 12.8% (neutral in my view), the ADP Employment change at -254,000 vs. -200,000 consensus (positive), GDP QoQ annualized at -0.7% vs. -1.2% consensus (positive), personal consumption at -0.9% vs. -1% consensus (positive), Chicago Purchasing Manager at 46.1 vs. 52 consensus (negative). Thus, early in the session, we were in risk-taking mood. On top of this, the Department of Energy's weekly release of inventory data showed that gasoline inventories had fallen by 1.66 million barrels, while the market was expecting an increase of about a million. Oil, on the news, hit \$70+/bl, from \$66+ at open. Yet, none of this was enough to get us to close higher in equities. Why? While we have the positive data on the surface, deep underneath, we have the uncertainty over interest rates beginning 2010. Early in 2010, quantitative easing policies will be ending in the countries that implemented them and it will be up to the fiscal policies to take the lead.

As we have endlessly discussed here, the unique feature of this financial crisis of 2008 is the coordination in monetary policies. Monetary policy is easy to coordinate. There is only one head of a central bank in each country and all of them can meet at Jackson Hole, or Bretton Woods to plot against the value of our monetary assets. They can carry out balance sheet transfers overnight, they can surprise us with untimely comments, they can side with bankers to keep rates inordinately low, etc. Coordinating fiscal policies is however a different issue. It is simply impossible to coordinate them.

In the past two weeks, we have seen an explosion of research debating the future exit strategies. I have my personal opinion. However, it is an evolving creature and for the sake of clarity, I prefer to defer its exposition until further developments prove me right or wrong. In the meantime, we are going to witness volatility in the forex markets, on benchmark curves (today we saw an important steepening move in Treasuries), in swaps and agency debt while gold should quietly strengthen. It is also true, we may attribute some of these changes to the fact that we are trading at month and quarter end.

Below, I show the last seven trading sessions in the gold market (source: Bloomberg). You can see how gold sold off last Thursday, on the news that Robert Mundell urged politicians to implement the convertibility of the Euro vs. the USD. We commented the implications of this proposition two days ago (ref. "A Thought on a convertible Euro" [www.sibileau.com/martin/2009/09/29](http://www.sibileau.com/martin/2009/09/29)) and concluded that such convertibility is not feasible on political grounds and that the late sell-off in gold should be seen as an opportunity. Gold is 1.8% up since then. Was it a mere coincidence?



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