Let history lead to brighter future

By **Stirling Larkin**

OCTOBER 29 marks a day like few others and one that lives in financial infamy.

Globally minded ultra high net worth investors in particular, undistracted by the current tumult, remain squarely focused on this important day.

This is because on Wednesday October 29, 2014, at the scheduled US Federal Reserve Open Market Committee meeting, chairwoman, Janet Yellen, is widely expected to announce the end of "large-scale asset purchases", commonly referred to as "QE3".

This will mark the end of unconventional monetary stimulus in the US and is considered by many to be a crucial inflection point delineating between the -recovery years of the Great Recession of 2008 and the economy of tomorrow.

New York Fed president, William Dudley, said last week: "Because it looks very likely that the (asset purchase) program will have fulfilled its objectives, I expect to support a decision to end the program at the end of this month."

In June, Dudley also passed comment that "market expectations are that the Federal Reserve will start to raise short-term interest rates around the middle of 2015 — that sounds to me like a reasonable forecast."

However, of ominous coincidence, October 29 also marks the 85-year anniversary of "Black Tuesday", a day which saw the end of the roaring 1920s with a crash on Wall Street so large it triggered the Great Depression.

The common link between these two events, which unfortunately share the same birthday, is that both are consequences of direct government interference and not natural market forces.

What concerns UHNW investors today is that lessons learnt previously, surrounding such interference, may not have been remembered and may likely be repeated.

UHNW investors are generally more responsive to such changes primarily because a larger proportion of their net wealth is distributed towards rate-sensitive assets.

Quantitative easing may have disproportionately benefited them but, equally, its withdrawal, if mismanaged, could also inordinately vex them as well.

How the FOMC manages this sensitive transition on October 29 is all important and UHNW investors want to see that this committee returns to normalcy by relinquishing its crisis-era authorisations.

The “Black Tuesday” stock market crash of October 29, 1929 was triggered by the rumour that US president Herbert Hoover would not veto the grossly unpopular pending Smoot-Hawley Tariff Act.

According to former US Fed chairman Ben Bernanke, “economists still agree that Smoot-Hawley and the ensuing tariff wars were highly counterproductive and contributed to the depth and length of the global depression.”

There are, however, fortunately, some straightforward steps Australian investment communities can take to weather-proof their current portfolios and future investment decisions, immediately following the announcements made on October 29.

To do so the global investor must first grasp the following. When unconventional monetary stimulus was initially introduced in late 2008, the basic tenets of - investing became inverted.

This was witnessed by the fact that bad news was received by markets as good news, in that it meant that monetary stimulus would be maintained or even possibly increased.

This then meant that when subpar or poor growth metrics, statistics or announcements became public, markets very often acted counterfactually and instead of falling, as logic would suggest, in fact, rose.

With the expected end of unconventional monetary stimulus on October 29, astute investors are once more acutely aware that bad news is bad again and good news is good. This means an end to “Double Dutch”.

To ensure that Australian investors are sitting on the correct side of this ledger, investors and their advisers would be wise to maintain a hawk-like eye on all market sensitive announcements made immediately following this upcoming FOMC event.

These would include announcements such as the German October month-on-month CPI harmonised Index, US Dallas Fed Manufacturing Activity and HSBC China Manufacturing PMI numbers, which are all expected to be released in the last two remaining trading days of October, following the FOMC announcement.

As well, with the end of unorthodox US monetary policies comes the end of "US dollar suppression", which means that now is as important a time as ever for Australian investment communities to come to terms with our currency's profile in the context of globalised exchange rates.

It is thought that the Australian dollar is reconnecting with its weaker fundamentals, giving way to US economic outperformance, sharp declines in key commodity prices, weaker major trading partner growth and less supportive capital flows, seen in recent months. This is expected to continue as Australia's current account deficit widens beyond 5 per cent of GDP by 2015 year-end.

From a 13-year low at the start of the year, Australia's current account deficit has widened sharply in recent months and this is thought to be due to the dual deteriorations in Australia's nominal trade balance and net income deficit.

With global bond yields very likely to continue rising, coupled with a normalisation of the US dollar's purchasing power, the growing US economy and low-interest rate environment should support both US and Australian equity markets but greatly hurt the purchasing "punch" of the Australian dollar next year.

For proactive Australian investors sharing this sentiment now appears timely to consider investing in broadly based US equity market exposures priced in Australian dollars.

The simplest of such choices includes an investment in an ASX-listed S&P500 or Russell2000 tracking product, such as the iShares Core S&P 500 ETF (IVV) or the SPDR S&P500 ETF (SPY).

In Australian wholesale, these trends have led to a recent spike in 3-month credit linked note trade activity, likely driven by improving US growth and stable inflation; conditions that clearly support credit market fundamentals as well as risk appetite.

Also, with Brent Crude now below $US90 per barrel, some renewed interest has been seen in the investment grade energy sector, specifically in gas, oil equipment and oil services.

For October 29, let history become a rising road and a path to a brighter future.

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