A JOKER IN THE PACK

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Market cycles have been an integral part of economic theory for centuries. So why do so many people think it's going to be different this time?

PAUL MURPHY

Paul Murphy is Investigations Editor at the *Financial Times*. He founded Alphaville, the FT's financial blog, in 2006.

Geoffrey Weaver strode towards the blackboard, chalk in hand, and began to write: "Since the Industrial Revolution in Britain, economic cycles have lasted, on average, nine years..." He paused, not so much for dramatic effect, but so as to survey the clutter of 16-year-old boys in front of him, some vaguely attentive, others less so. "*...and nobody knows why!*"

Weaver, a crumpled, old schoolteacher fond of tweed jackets and pipe tobacco, rattled through some broad themes and ideas that we would slowly digest over the coming months. But "Lesson Number One" was possibly the most important: that the subject we were embarking upon was not an exact science. Anything but. No one really knows why things happen – but they do.

So here we are, not nine years but 10 into the current cycle. Bar the odd wobble, the gradient of a line drawn on the chart of any major stock market index looks pretty straight and impressive if you start at the end of the first quarter of 2009 and end around now.

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Any blip, any loss of faith, even the apparent reversal of Big Tech just recently, looks minor and short-lived on that decade-long march of market progress. After more than 200 years of boom and bust, the "bust" aspect of the current economic cycle is evidently missing. Common sense tells us that investors should now be bracing themselves for the worst, drawing themselves in and reducing their exposure, because while no one really knows why economic cycles typically last nine years, we all know that economic cycles have not been abolished. Don't we? Perhaps not, judging by some of the messages that still pop into my inbox on a regular basis.

"What can we keep/learn from the 2016 risk-rebound template? 2016 stands as evidence that slow and slowing growth is not sufficient to drive cyclical assets lower. Given enough relief from (real) rates, risk sentiment can stabilise and even rally..."

"A sustained dovish signal is likely to be a powerful reflation mechanism today as well (should the Fed choose to send it in various different forms)..."

"A pick-up in China growth expectations to '18 levels alone would lift the Euro Stoxx 50 by circa 5% (and MSCI Emerging Markets by circa 8%), all else equal."

It would be unfair to name the authors of these emails, but such determined bullishness is typical of investment banking output lately. Perhaps we should not be surprised that someone whose job it is to sell stocks suggests we should buy them. But really? Now? Ten years in? And if so, which ones should we choose?

There's a joker in this particular economic cycle, of course, which is why most market watchers have pretty much given up trying to predict if and when the current cycle might end. The joker is quantitative easing (QE) – a concept that wasn't on the curriculum back in Weaver's day.

I suspect he may have been amused by the fact that no one really knew how QE would pan out, what saving the banks and avoiding outright deflation would actually cost. His lessons were packed with black comedy.

Many of the repercussions are now obvious: a decade-long tide of near-free money that lifted all asset prices, regardless of quality; a clear rise in wealth inequality, whatever the Gini coefficient says; Trump, Brexit and gilets jaunes. Worryingly, too, certain repercussions may have yet to appear.

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One particular problem springs to mind: corporate fakery and outright fraud. We've not only had 10 years of ultra-cheap money encouraging the sloppy allocation of resources. We are also in a world where management teams as well as capital are truly global. Throw in a possible tech bubble. It's a recipe for trouble. What investors patently need right now is experienced navigation, but even there we find something missing: people who have seen a financial cycle or two or three.

Taking the UK as a guide, official statistics for the broad world of finance are seemingly benign. The age profile across the workforce is a tad younger than other sectors in the economy, but it is stable over the years. Even the total employed in the business of managing money is more robust than many would imagine: around 1.1 million in Britain, compared with about 1.2 million pre-financial crisis.

But that jars with the anecdotal picture of the City of London. The crisis emptied dealing rooms of institutional knowledge. Older hands left the business, content to work on protecting what was left of their capital on their own, in semi-retirement, away from the front line.

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Equity research teams and sales desks across investment banking were repopulated pretty quickly after the ruptures of 2008-10, but by people who had experienced the crisis as an aberration, an event so extreme it was unlikely anything similar would happen again in their working lifetimes. The comfort blanket of QE has muffled markets' historical perspective.

But QE has also, perhaps, suppressed something equally important in financial markets – namely an understanding of what constitutes value. There's a sense that the trite old line about a rising tide lifting all boats will prove to be especially true when the tidal flow itself has been made up of such artificially cheap money.

Weaver would be appalled. He'd probably suggest there are too many people around with a bad financial education.

He'd point his pipe at market history and insist that sometime soon, when the investment climate darkens, which it will, there will be a need to pick your way through the inevitable recession. After all, they've been happening for two-and-a-half centuries now.

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WALTER SCOTT & PARTNERS LIMITED, ONE CHARLOTTE SQUARE, EDINBURGH EH2 4DR
TEL: +44 (0)131 225 1357 · FAX: +44 (0)131 225 7997
WWW.WALTERSCOTT.COM