



Australian Standfirst

Brace For Volatility

January 2020 Edition



Invest Now



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Any investor who would like to calibrate their portfolio to evolving market flows knows that selling too soon can be prove just as costly as selling too late and that investing never follows a glide path of uninterrupted success – investing is as much about tilting as it is about forging ahead.

In the professional vernacular, this is today referred to as the pseudo-verbs, “*Risk-On*” and “*Risk-Off*” and to sustain success within this tradecraft involves an almost dark art ability of coalescing intuition with that of established financial arithmetic.

No investor has ever mastered this proficiency but all those who have ultimately proven successful have demonstrated a humbled ability of equipoising these forces.



Remembering that the primary responsibility of any active manager is to modulate the amount of accepted risk and to always protect the base irrespective of arithmetically attractive outlying temptations, adroit determination between *Risks On* and *Off* is unquestionably found by tilting between qualitative rhyme and quantitative reasoning.





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Simplifying
Global Investing,
Elevating Funds
Management
and Empowering
Australians
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In our aspirational pursuit of this, in April 2019, our Australian Standfirst [DDPM Determination Process](#) correctly identified that the United States' bellwether bourse, the S&P500, was ratcheting-up both in terms of velocity and momentum and this led us to litigate the case that calendar years' 2019 and also 2020 remained strong, *Risk-On* linearities.

This was evidenced by the slope of the indices' beta coefficients near-perfectly flanking any of the regression data points that strayed from the mean.

The S&P500, with distributions, returned thirty-one (31%) percent in 2019, an impressive feat by any yardstick.

Our houseview ran directly contrariwise to the collective consensus of global financial pundits, who rang alarm bells and called for immediate *Risk-Off* across paramount US stock and fixed income markets.

Cite:- [Bloomberg: Rishaad Salamat, Yvonne Man & Stirling Larkin Discuss 2019 The Transition Year](#), 12 March 2019

Cite:- [US Equities Still Place To Be For Growth](#), 17 April 2019

Cite:- [Inversion Reversion Subversion](#), 1 June 2019

Cite:- [How The Inverted Yield Curve Affects Australia](#), 20 June 2019

Cite:- [Bull Rally And Not A Recession](#), 11 September 2019

Cite:- [Risk-On 2019-2020](#), 23 October 2019

Our [team](#) throughout early 2019 was outright heckled and told innumerable times that we were *off the mark* and that the advent of the US yield curve inverting was automatic cause to call for *Risk-Off* and the instigation of a stateside economic recession.

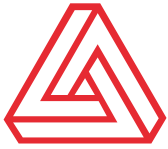
In the final analysis, we were correct and the global pundits wrong.

Telling others that they were wrong and that you were right in any domain of life is precarious, especially when discussing financial market machinations, notwithstanding, there is good reason on this isolated occasion to do so – cogent reasoning gave way to the phenomenon of deindividuation (Festinger, Pepitone, & Newcomb, 1952), which is a loss of self-awareness heuristic within groups – and assumptions were presented as iron law; rules that are no longer subject to reasonable dispute (when, as evidenced to the contrary, they were mootable).

There is substantiation for why Doctors, Lawyers and Architects, often make for the most unsuccessful of investors – they all rely on their professional trust of processes and rules and even though financial markets are supposed to be bedrocked in the science of economics (economics being a true science whereas finance a tradecraft overlaying said science), they are increasingly less so – such is the imperium of those dark arts.

These gilded professionals have understandable alibis however global financial pundits do not and for those pundits to dogmatically attempt to predict market and economic trajectories off the precept of regimen, is both dangerous for society *en-masse* and naïve in the face of the automation and Artificial Intelligence seiche.





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The hoopla surrounding the inversion of the US yield curve from April onwards and the paradoxically irrational and yet non-numerical assertion that S&P500 retracements and US economic recessions were ergo imminent, highlight that behavioural contagion and a suspension of qualifying arithmetic restraints forced pundits to follow a preordained glide path which no longer existed nor was warranted to begin with.

The phenomenon of hysterical contagion is a heuristic example of hysteria which overtakes unconscious decisions on the part of an individual and pushes professionals away from deliberation and towards binary calibration in step with an overriding collective behaviour.

An infamous example of this happened in 1962 and later came to be known as the, "*June bug epidemic*", whereby a mysterious disease broke out in a dressmaking department of a US textile factory, with symptoms including nausea, dizziness and vomiting.

Word of a bug in the factory that would bite its victims and cause them to develop the above symptoms quickly spread and soon sixty-two employees developed this mysterious illness, some of whom were hospitalised.

The news media reported on the case and after research by company physicians and experts from the US Public Health Service Communicable Disease Center, it was concluded that the case was one of mass hysteria.

While the researchers believed some workers were bitten by the bug, anxiety was probably the cause of the symptoms and no evidence was ever found for a bug which could cause the above flu-like symptoms, nor did all workers demonstrate bites.

Workers concluded that the environment was quite stressful; the plant had recently opened, was quite busy and organisation was lacking.

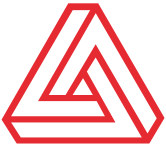
Of the sixty-two employees that reported symptoms, fifty-nine worked on the first shift, fifty-eight worked in the same area and fifty of the sixty-two cases occurred in the two consecutive days after the media supposedly sensationalised the event.

Cogent realisation that deindividuation in this example corrupted these individual's determination of risk in any realistic way, examples for us why not only being right over wrong matters but that understanding the influence of these dark arts is paramount in this new era of automation and Artificial Intelligence (accepting that the bots care little for your heuristics).

The dimensions of the issue were repeated in September when Greenback liquidity was squeezed and US Repo rates spiked, leading the US Federal Reserve's FOMC to stand ready and willing to provide liquidity as needed.

Knowing that the current Trumponics glide path may be interrupted between now and 3 November 2020, the Federal Reserve's, "*FOMC Put*" manifested via Repo repair and balance sheet injections (Quantitative Easing, or QE in all but name) could prove supportive of continued *Risk-On* for risk assets and bearish for the Greenback, as it is likely to encourage the FOMC to extend the shelf-life of its current capital injection programmes.





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Cite:- [Bloomberg Kathleen Hays & Stirling Larkin Discuss Global Rally Leading Up To 2020 US Elections](#), 26 November 2019

- Cite:- [Bloomberg Radio New York](#), 1 January 2020
- Cite:- [Bloomberg Kathleen Hays & Stirling Larkin Discuss Iran, Cyber, US Markets & Australian Bushfires](#), 8 January 2020

Currently with no moniker nor expiration date, a commitment of US sixty billion dollars per month, these unnamed FOMC injections began in October and are speculated to ratchet-up to US ninety billion if required in volatility pockets expected in either February or March of this year.

As quantitatively reasoned, any ratchet-up to and beyond US ninety billion dollars per month begins to rapidly loose impact as the law of diminishing returns would suggest.

Despite September's Repo repairs absorbing in excess of US two hundred billion dollars of liquidity, the perennial replenishing of the Treasury's working capital cash balances to target levels, under the proviso that debt ceiling constraints no longer apply begins to slide very close to the thin end of the wedge.

February and or March 2020 will see momentum continue to roll forward but the velocity of underpinning liquidity (injections) shudder and though this may not be sufficient to revert from *Risk-On* to *Risk-Off*, an interim tilt towards defence presents as prudent – [Offence wins games and defence wins championships](#).

In the realm of investing, the rate of compound returns is all that savvy investors care about and it's the severe losses that crush the rate of compounding, it is not the small loses, realised when a '*volatility tax*' is paid for several months in active efforts to mitigate the probabilistic expectation that large losses could crush an investors rate of compounding.

While 2020 remains an evidenced case of *Risk-On*, a recalibration towards defensive tilts heading into February and March allows the savvy investor to remain set on the glide path readied for the known unknowns that returning volatility will bring.



Yours,
Stirling Larkin
CIO, Australian Standfirst
Asset Management



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