Realm Market Review: Can you Hear it? 4th January 2013

Investor fear over the past few years have driven investors into unprecedented (read distorted) asset allocations. Of course, the rationale has been totally justified- preservation of capital is the primary concern (and it still is) and risk minimization all the rage. A consequence of this has been the creation of “safety bubbles.” Let’s name a few of them: Gold, core sovereign issues, money market deposits, long Yen and USD, short EUR currency, and many more.

As far as I can tell, the Central Banks are doing all they can to UNDO the performance of safety bubble assets. Note when the US Federal Reserve decided to take the gloves off and monetize debt and target a specific economic variable, the Yen has been hammered, Bonds have weakened, the USD had fallen, the EUR appreciated, and Gold has traded sideways, but equities have risen. The safety bubble hasn’t burst, but it’s sprung a leak, and the hissing sound is that of the air escaping from the price bubble of these instruments.

Let’s look that chart below. The top graph shows the US dollar performance of a bond fund, a Gold ETF and a listed fund that invests in Yen, over the past 2 years. The second is an equally weighted chart of the same combination.

Source: Bloomberg

So what you may ask? Ultra-aggressive Central Bank activity is showing up in precisely the manner they would prefer; non-inflationary asset price reflation. Investors are not well positioned for this, mentally or financially. The charts show sideways/negative returns from safety assets in the past 18 months. Meanwhile equities have had a good year. So left to its own devices the ingredients for a large shift into risk are there to see.

Add to this the strong possibility of a “European Euphoria” equity rally over the survival of the EUR and Eurozone economy, and the scene is set for a dazzling rally that will test the most ardent economic bears.

It may last for 4-6 months at best, before economic reality bites. In our view 2013 will have early upside, followed by a good deal of subsequent volatility. The key will be to stay sober and realize the price swings as they unfold and see them for what they are. For the Economic bears, it will be tough going, as the Central Bankers have become well-honed and flushed with success.

It's hard to beat the "house" when they own the game and the cashier. The Policy makers do not want the bears to win- the safety bubble is leaking, and the bears may have to hibernate until later in 2013.

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