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The unusual world of market highs… and deep uncertainty

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"Uncertainty is a very good thing: it's the beginning of an investigation, and the investigation should never end" Tim Crouch

Leafing through the reports on the performances of European financial markets during February two aspects stood out. The first was that the average equity investor did quite well with many markets moving to, at or around, all-time or recent highs by the end of the month. The second was that 'uncertainty' appeared loud and proud in every report.

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Welcome to the unusual market structures of 2017! At one level of course we should not be surprised, with a key reason why the Bank of England and European Central Bank – along with other regional central banks – are currently running such a loose policy is centred on fears that local economies are not growing fast enough, as residual issues from the global financial crisis or concerns about the impact of the Brexit referendum result, continue to linger.

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Shorter-term growth or economic momentum numbers are the least of Europe's issues today however. During the month both historic (GDP, employment) and prospective (confidence surveys, purchasing manager indices) economic data were published, which collectively looked more than workable. Reviewing just this data, it is not difficult to justify the stock market moves of recent weeks or months, especially as the still ongoing corporate results season has come in a little ahead of expectations.

However… it was a month of much more than just watching equity indices going up and acknowledging the better economic data. It was also a month when the European financial system again became obsessed with political-led uncertainty. Of course, upcoming elections in countries like Holland, France and Germany, the grinding UK Parliamentary debate about Brexit technicalities and the timing of the imposition of Article 50, plus the latest saga over Greek debt restructuring, were popular cited risk factors at the start of 2017… but in February they all seemed a little closer.

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I would probably be quite a rich man if I had a Pound for every time I saw a graph of either the spread of French government bond yields versus their German counterparts during the month. The so-called 'Le Pen indicator' chart was much discussed by the financial systems chattering classes and, of course, every observer of the pan-European financial market scene understands why this is, given France's pre-eminence in the construction of today's European Union and Eurozone. However, look at the (admittedly much maligned) opinion polls and a more mainstream political outcome in France remains the most likely ultimate outcome.

So is there – as the famous political dictum states – 'nothing to fear but fear itself'? Of course, as it is, politics and the evolving, and sometimes hard to pin down, opinions of a democratic electorate can have surprising outcomes. However, for the financial market observer, the twin occurrence of equity market optimism and the German sovereign short term bonds plunging deeper into negative yield territory, is hard to sustainably reconcile. And this is why European politics, starting with the Dutch elections later this month, are all important. Mainstream and not populist resulting coalitions or governments should result in a world which more supports the recent optimism of the equity markets than the pessimism of certain bond markets. It should also lead to equity inflows after the annus horribilis of 2016, where global investors lost faith in Europe and most of its currencies.

So is the future simple then? Move through the spring elections with mainstream party outcomes and everything in the world of pan-European investment will be fine? The resulting inflows certainly may help markets and shares push up in the days and weeks afterwards, but this tips us into then a new world where economies are no longer travelling but now arriving. Scrape away at the reasons why populist parties have pushed up the regional consciousness, and a lack of jobs, real wage increases and feeling of prospective economic security all rank highly. The current embattled mainstream political classes – if re-elected – are going to have to come up with more and better answers to these questions. Their ultimate success or not in creating a more attractive environment for electorates as well as businesses over the next few years, will hugely influence the currently rampant regional stock markets… as well as the cautious elements seen in certain fixed income markets. For medium-term financial market investors – as the quote at the top of this article states – 'the investigation should never end'.

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