LWM Market Commentary
March 20, 2016

Dear Clients and Friends,

The stock market has now climbed back to break-even for the year. This after a roughly 10% decline thru mid-February (as measured by the Dow Jones or S&P 500). Will the rally continue? My suspicion is yes --- in the near term. But the more important (and more interesting) question might be --- why? In this commentary, I will attempt to answer that question. By way of background, I'd like to start with a re-print of some thoughts I have shared in a prior commentary. But first a brief hint to the eventual answer: it has everything to do with the monetary policies of the most important central banks around the world.

Commentary from September 22nd, 2015 with thoughts on **Central Bank Omnipotence:**

> "I believe the single most important phenomenon in the market today is the Narrative of Central Bank Omnipotence. Ben Hunt, of Epsilon Theory fame, coined this phrase and has been preaching about this for some time. His theory states in part that what is important about the markets is what people **think** is true. NOT what actually is true. He calls this "Common Knowledge". Right now Common Knowledge says that virtually every major world economy is "controlled" by central bankers --- whose populations actually believe they are "in control". Whether they are in control of their economies or not is unimportant --- as long as everyone believes they are.
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> As you might suspect, I do not believe these central bankers control much of anything in the long term. Consequently, if/when the world decides that central bankers are NOT in control of their respective economies ---- that will be a scary moment in economic and financial market terms. I believe that pivot point will be the beginning of the next major bear market. I believe it is coming --- but don't know when. Best to keep a watchful eye out for cracks in this narrative of Common Knowledge around the idea of Central Bank Omnipotence."

Over the course of the last 9 months, diverging monetary policy amongst the world's central bankers has become the first credible threat/potential crack to this narrative. As this divergence has emerged, the markets have traded lower. So, the question naturally follows: **Is Central Bank Omnipotence dying?** Has the market gone down because it is beginning to fear that central banks are not in control? Even though the market has recovered, is this 10% correction a warning sign?

Actually, I think quite the opposite --- that Central Bank Omnipotence is very much still firmly entrenched as "Common Knowledge". In fact, it is precisely because the investment world is so infatuated with every gyration of central bank policy that the market both went down 10% and retraced that loss. Let me explain:

As the Federal Reserve started moving in a different direction from the Bank of Japan and ECB last summer --- markets began to struggle. Hence, this sub-narrative of Divergent Monetary

Policy was born. But markets did not go down because they have no faith in central bank power. Rather, they went down because they DO have faith in that power and believed it was not being used correctly.

More recently central banks started to move in more or less the same direction --- in a coordinated fashion:

- When the ECB lowered its already negative interest rates and introduced a new quantitative easing policy tool by buying investment grade corporate bonds --- as it did last week.
- When the Federal Reserve formally began to talk down their need to raise interest rates --- as they did last week.
- While the Bank of Japan continued affirming its negative interest rates and other monetary stimulus.

…then --- the markets rallied. Because that is exactly what markets should do when Common Knowledge is that Central Banks are Omnipotent --- and are all moving in the same direction. And yes, I know that the rally started before last week --- but the formal announcements of central bank policy have been working their way into market prices many weeks before the actual announcements were made. Granted, this new alignment of central banks is definitely tenuous, but that doesn't make it any less real. Thus, it seems reasonable that the markets may continue to enjoy this rally while the alignment holds.

It is also important to note the continuing evolution of quantitative easing and negative interest rate policy. Please don't miss this --- it is BIG news. The Bank of Japan recently joined the ECB by moving into negative interest rate territory. Never before has so much sovereign debt around the world carried a negative interest rate. AND never before have serious central bankers acquired the debt of private companies --- as the ECB is now starting to do. By way of comparison, this would be akin to the Federal Reserve buying WalMart debt or IBM debt in the open market. When a major central bank "legitimizes" new policy tools (by using them) --- it necessarily means that other "legitimate" central banks are now free to use them as well. Ultimately, both of these new tools will likely be used by our very own Federal Reserve in the next financial crisis, thus lengthening the Central Bank Omnipotence Common Knowledge thesis. I had hoped that maybe we were getting close to an end-game on this one. But with these new tools --- perhaps not.

Eventually, the markets will adopt a new Common Knowledge. That is my firm conviction. And the longer it takes us to get there / the higher the markets go ---- the harder and farther I think they will have to fall. Which is precisely why at LWM, we will continue to search for ways of deploying capital that do not require a bull market in stocks or bonds to make money. Doing so is very difficult, but not impossible.

As always, please feel free to reach out with any thoughts or questions.

Kind Regards,
Jeremy Boynton

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