



Gazing into the abyss

*Whoever fights monsters should see to it that in the process he does not become a monster.
And if you gaze long enough into an abyss, the abyss will gaze back into you.*

Friedrich Nietzsche

Well, once again the equity markets charge down like the Light Brigade only to pull up in a cloud of dust, peer into the bear market abyss, and recoil in horror at what lies therein, unable to cope with the magnitude of the reality a proper down market could show us.

Miners know what it is like to go from champagne-swilling, egocentric Masters of the Universe, to shrill, dishevelled demagogues shouting that the end of the world is nigh. They know because they have seen it; a lot of commodity related equities are down over 80%. I guess they don't have the attention of central banks – or investors for that matter.

But equities are a bit more of a serious matter – that is our future you are talking about, not just the purses of those swashbuckling commodity speculators!

The equity markets may have recoiled in horror, but is this permanent or are they just like wildebeest on their migration which, when faced with a river, remember the terrors contained in those quiet meandering waters and hesitate at length until the push of the herd behind them leave them no option but to plunge?

We may well know shortly.

On the road last week seeing investors, one again couldn't help feeling that wealth managers, more and more, are getting corralled into the bond abattoir – particularly by way of the high yield pen.

"Yield at any cost" is their mantra. "Clients want black ink at any cost," says another. And so they contemplate increased risk in exchange for some paltry yield.

We shake our heads in disbelief at the complacency surrounding the high yield debt markets, which are packed like a sold-out theatre in the West End. When the fire alarm goes off it makes no difference whether there is a fire or not. It is just a matter of confidence which, suddenly shattered, could lead to a maelstrom of panicked investors, who – as they flee – find there are no reasonably sized exit doors. With nowhere else to turn, the investors direct their attention to Theatre Management who have assured them they have the Mother of all Fire Extinguishers held by the Mother of all Fire Departments: the Central Bank.

For our money, a contained fire of the credit markets is probably likely whilst yields are trapped at the zero bound but equities march to their own tune. We believe this August's action was an important tell, much like August of 2007, and if their 'significant' technical support levels are breached, general equities will continue along the time honoured path followed by their commodity-related cousins... down... in a big way.

If we do not see equities fall, "that which does not kill us, makes us stronger". Should the markets withstand such a significant test of the support, this will likely embolden them and we can expect substantial moves to the upside in response.

Either way, we don't see the market remaining where it is.

*It is by going down into the abyss that we recover the treasures of life. Where you stumble,
there lies your treasure.*

Joseph Campbell

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