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Not at Davos and proud of it

"We know Carney is blagging us, he knows we know but he has to keep a straight face and essentially say - look chaps no fundamental reason to keep rates at zero - in fact none whatsoever - but I need a couple of years to offload all our Gilts back onto you chumps."

- Analysis of UK central bank policy from an anonymous but well-respected City source.

So farewell then, forward guidance. We barely knew you. We were never fans of this policy and said as much. Here, for example, is what we wrote in 'The Spectator' last October:

"The financial crisis of 2007-8 was caused in large part by unsustainable property markets in the US, the UK and elsewhere. Credulous borrowers took on too much debt and credulous bankers encouraged them. The sudden abatement of that frenzy meant that governments had to step in to bail out otherwise insolvent banks. In the process, government finances disintegrated, hence the uneasy half-steps toward austerity undertaken throughout the indebted West. Yet central bankers now seem to believe the best medicine for a financial meltdown triggered by a housing bubble is a new housing bubble. George Osborne's sudden urge to tinker with his own Help to Buy scheme is an indication of Downing Street's nervousness about this trend.

"But there is only so far central banks can go in the cause of economic stimulus. Traditionally, cutting base rates has always provided a *'coup de whisky'* for jaded markets. So when base rates are stuck around zero, unorthodox stimulus is required. The Bank of England has provided it, in the form of its quantitative easing programme. For QE, read printing money. We've had £375 billion so far and not a whole lot of obvious economic recovery to show for it, other than in the property markets of Mayfair, Chelsea and Belgravia.

"Five years on from the collapse of Lehman Brothers, which threatened a second Great Depression, our central bankers are treated as gods. Since there is no counterfactual, we will never know what might have happened if western governments had pursued free market policies and allowed a few bankrupt banks to fail (or be wholly nationalised, rather than perpetuate the illusion of a healthy financial sector). What's clear is that central bank stimulus has entered hitherto uncharted territory: historically unprecedented base rates; trillions of dollars, pounds and yen conjured up to reconstruct bank balance sheets and support monstrous government borrowing; hyper-aggressive reflationary tendencies that have driven millions of investors into high-risk assets. If economic health could be measured in property values alone, the stimulus has

been a success. In terms of maintaining sound currencies or encouraging a climate of confident business investment, central bank stimulus has been a disaster.

"It's time to ask whose interests the central banks really serve. While they pay lip service to the interests of embattled savers, it is clear that their primary function today is to act as lenders and stimulators of last resort to a venal banking system — Danegeld, if you prefer, paid by savers through artificially low deposit rates and channelled to a narrow financial elite. But it will be a pyrrhic victory for Carney and his peers if our banks have been 'saved' at the expense of everybody else.

"The base rate — the fundamental reference rate for the price of money — is under the control of the Bank of England's monetary policy committee. What the Bank of England cannot entirely control, however, is the gilt market, which dictates how cheaply or expensively the UK government can borrow money over various terms. Alarmingly for Carney, gilt investors have already voted with their feet. ***His much heralded 'forward guidance' — flashy central bank jargon for keeping interest rates on hold until there is tangible evidence of economic recovery in falling unemployment numbers — has been revealed as farce by rising gilt yields.*** The market, in other words, does not believe the governor's pledge. In vowing to keep back the tide, Mark Carney is acting like a latter-day Cnut."

Longstanding readers will also appreciate that we feel toward central bankers the way lamp-posts would feel toward dogs – if they were capable of feeling anything at all. It's a sad thought that there is apparently nobody better qualified than Mark Carney from within this sceptered isle's native population of 63 million – but then we must accept that there are only so many Goldman Sachs alumni out there, let alone those that must squeak by on a housing allowance of just £250,000. If it were down to us, we would replace more or less the entire executive staff of the Bank of England (and the Fed, and the ECB..) with an old sock. With a nod to the democratic impulse, we could perhaps be allowed to vote for our favourite old sock from a roster of different socks, as opposed to suffer the economic indignity of unelected bureaucrats manipulating interest rates, and much else besides, in the cause of bailing out their buddies at otherwise insolvent banks (and governments).

But there's the world as we might like it, and there's the world as is. In the world as is, a popular January pastime for economists, fund managers and financial analysts is to issue unsolicited predictions about how the balance of the year will shape up, investment-wise. We have to assume that these are always self-interested and conflicted: Chinese equity managers will mysteriously forecast extraordinarily strong economic growth in China (and no blow-up of the shadow banking system); Gilt investors will mysteriously foresee strong performance from UK government bonds despite the fact that real yields are non-existent and Mark Carney is caught between a rock and a hard place (see above) when it comes to exiting from now unnecessary monetary stimulus; etc. etc. ad infinitum for all the different asset classes and their respective managers.

Well, we don't see the point. What's more interesting to those of us not sufficiently self-important to be wining and dining at Davos this year (Matt Damon ? Really ?) is to get an assessment of consensus expectations from the City, and then consider those. Helpfully, this is exactly what Espirito Santo's Marcus Ashworth has done. Here is his Top Ten summary of 'Street consensus' for 2014:

1. Equities to continue to grind higher, an up year but not as strong as 2013. Despite the fact that earnings are anaemic and buy-backs are the only response.

2. Bonds might be doing a bit better now, led by credit, but bond yields must go up substantially at some point this year.

3. Dollar to go higher, Yen lower, Euro to crack at some point surely.

4. Nikkei to put in another banner year, ahead of the pack as Yen weakens.

5. Oil lower as US supply alters the world dynamic, Iran and others become less pressing with supply snafus dissipating.

6. China to struggle to keep growth pace up, Government forced to prevent bankruptcies.

7. Gold to wallow as risk on makes it ever less of a hedge fund toy but gold bugs will continue to fret about the Bundesbank's gold and China buying it all.

8. Bank of England to be the first to raise rates but not before the ECB takes them negative. Fed will be all tapered out by the summer, November latest.

9. Credit [i.e. corporate debt] is about as tight as it can possibly get, in the trough, only a muppet would buy it down here.

10. Emerging markets are so, like, 2013; current account deficits and currency weakness will force slow money back to the major markets. Europe the new (only) alpha source?

Of course, one response to apparently consensus positions is to take the other side of the trade. But contrarianism for contrarianism's sake is also a dangerous game. More to the point, while any of us can state a market forecast with a degree of confidence, nobody really knows. From our own perspective, Marcus' Top Ten feels intuitively correct – these seem to us to represent a fair reflection of many investors' hopes / fears / biases / portfolios. So what could be the shockers ?

1. Equities don't necessarily grind higher for FY2014 as a whole, but mean revert on the basis of some exogenous shock that no-one saw coming; or for that matter in response to one of the many problems that are already well flagged.
2. Bond yields "go Japanese" to low levels well below consensus.
3. Fears / flows over (Fed) tapering cause currency markets to go mental.
4. Japanese stocks disappoint.
5. Some or other Middle Eastern black comedy in the making goes full Strangelove.
6. China fails to crash. (Or Renminbi fails to appreciate.)
7. Gold goes sharply higher in response to 3.
8. Gilt yields collapse as economic growth is revealed to be a fantasy conjured up by a central London property bubble.
9. Credit spreads remain tight (they are clearly poor value).
10. Emerging markets outperform.

So far, so entertaining. A harmless enough diversion. Mostly irrelevant to us, since we spend more time avoiding obvious flashpoints than flirting with them. We're positioned in

a) Creditworthy sovereign and quasi-sovereign bonds, with a growing allocation to floating rate exposure.
b) Deep value equities, concentrated in Asia and Japan (with currency selectively hedged).

c) Systematic trend-followers, which are nothing if not consistently uncorrelated to stocks and bonds.
d) Real assets, notably the monetary metals, gold and silver. This was obviously a pain trade last year, but for us it wasn't a trade at all, rather a conscious decision not to play in paper currency conflagrations-to-come.

It strikes us, in the light of Mr Carney's awkward gyrations over forward guidance, and anticipating a less than smooth tapering process from Janet Yellen at the Fed, that 2014 will be the year in which the central banking emperors' new clothes[1] are revealed to be from Primark rather than Prada.

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[1]Mixed metaphors, of a sort. We *know* that the emperor's new clothes consisted of his birthday suit and nothing else. Perhaps we should have said, after Warren Buffett, that 2014 will be the year when we get to see, from a universe comprising governments *and* investors, just who's been swimming naked.

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