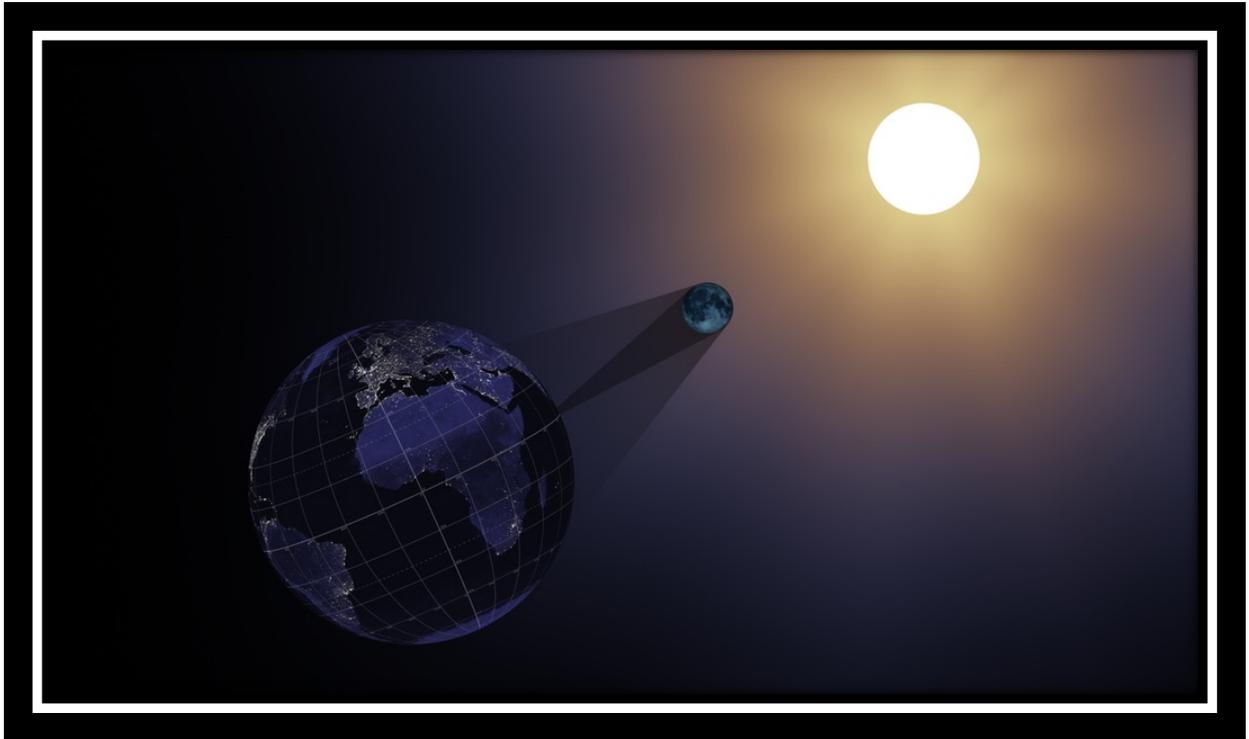


Using Gravity to Frame Uncertainty in the Global Economy, the Markets and Geopolitics



Source: NASA <https://svs.gsfc.nasa.gov/4426>

As never before, the global economic landscape appears chaotic and difficult to understand. The dramatic shift by the Federal Reserve, the US-China trade negotiations, and the use of algorithms/Artificial Intelligence (AI) in trading all drive uncertainty in the global economy, the markets, and geopolitics.

Yet, there is a way to frame the chaos to engender confidence towards the future. While simple heuristics or rules-of-thumb don't always provide the knowledge we seek, they can provide a path to understand how disparate forces work and how to gauge their impact.

Stop for a moment and remember the last time you knocked over a cup of coffee on the kitchen counter. See the image. What's at work here? The weight of the glass, the contents and the mess you have to clean up? Take it a bit further, what is the force applied? Gravity.

How does gravity play a role in the global economy and markets? Think gravitational pull: the larger the mass of an object, the stronger the force. For our purposes, the objects we want to focus upon are called market narratives. We're going to define market narrative using Nobel prize-winner in economics Dr. Robert

Shiller's definition of narrative economics: the study of the spread and dynamics of popular narratives, the stories, particularly those of human interest and emotion, and how these change through time, to understand economic fluctuations.¹

Here are my top three market narratives: Federal Reserve policy, US domestic policy, and technology. Now, let's put them in a framework based on their gravitational pull by choosing planets that best represent their size and force.

Fed policy = the Sun

US domestic policy = the Earth

Technology = the Moon

Three different planets, three different masses, three different gravitational forces acting upon the economy and markets. At times, each body's pull or market narrative can exert strong influence on market movements and economic outcomes.

Here's how this relates to geopolitics. The Federal Reserve's monetary policy, interest rates and quantitative tightening, radiate out beyond the United States to impact the emerging markets of India and Thailand. US domestic policies, like tariffs and sanctions, exert force to impact Iran or China or Mexico or Canada. Technology through cyber security breaches, like Huawei and US elections, creates waves upon countries and companies.

If the planets align with the forces are all pulling in the same narrative direction, the conditions are excellent for a strong and powerful reaction in the markets. For example at the end of December, the Sun (i.e. Fed) was telling the markets it was confident in the US economy, it was confident to raise rates, and it was confident to continue quantitative tightening. At the same time, the Earth (i.e. US domestic policy) was about to raise tariffs on China to 25% and the US government was shutting down. At the same time, the Moon (i.e. technology) had created market structure changes that were pro-cyclical (HFT/algo/AI). All three aligned and all three pulled the market narrative into a negative theme, which created the worst December in the history of the US stock market.

However, there are times when each of our planets can exert force and pull the market narrative in different directions. For example in January, there was a strong Fed positive pull on the market narrative with the US central bank policy shift from raising interest rates to staying on hold. This shift dominated all other narratives in January and most the US domestic narratives in March. The positive Fed narrative or theme overwhelmed the negative US domestic narratives from the no US-China

¹ <https://cowles.yale.edu/sites/default/files/files/pub/d20/d2069.pdf>

trade agreement to the weakening of US economic statistics to the anticipation of the Mueller Report release.

Over the next few weeks, I'm going to create research/blogs covering all three of these topics to provide context on how to view each market narrative and it's potential to impact the global economy and markets. For now, frame these as the Sun/Fed, the Earth/US domestic policy, and the Moon/technology. We'll see how well Isaac Newton's theory and our cup of coffee can inform and educate us about the global economy, the markets, and geopolitics.²

² https://en.wikipedia.org/wiki/Isaac_Newton