THE RIO CLUB

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IMF WARNING

The IMF's warnings over asset bubbles add to the murmuring in the trading halls which are all leading to the forecasted change in market sentiment.

On Thursday, 16th May, the IMF warned in its Global Financial Stability Report that, should the unconventional monetary policies in place at present be carried on against a backdrop of relative economic stability, this could create volatility in the financial system and asset bubbles. **I underline this warning!**

Members should note that one of the unusual market features seen as a direct result of nearly four years of aggressive monetary policy from leading central banks, such as the US Federal Reserve, are the synchronised rallies witnessed across all the main asset classes. The reason for this is largely because the pricing mechanisms of markets have been distorted by colossal inflows of central bank money.

The Fed could be the first to move on the withdrawal from the current unconventional monetary policies in play today.

But the question perhaps should be - Could the US economy maintain some sort of growth without it, particularly with sequestration – tax rises and government spending cuts – all gathering momentum? Although it is true that there has been talk in the US of an unwinding of QE by the end of this year, given the true nature of the US recovery it is likely that QE will continue.

The simple conclusion therefore is that a withdrawal of this easy money is most likely to lead to synchronised bear markets across those same asset classes with the risk currencies likely to suffer considerably. This is an investment opportunity which I will take advantage of for those in the regular account.

My warning is that, any attempt to withdraw it will unleash intense volatility across currencies and asset markets as they realign themselves for the new monetary reality.

I will leave members with the obvious. The world will eventually have to learn to live without QE since continuing to use it fosters potentially damaging financial bubbles. This in turn would likely lead to another global crisis!

Currencies moving lower

I predict that the Euro will fall further. As for commodity currencies such as the Australian Dollar, New Zealand Dollar and Canadian Dollar they are already in full retreat in US Dollar terms. To comment on the debased free fall of the Japanese Yen, this currency may find a little reprieve as Japanese investors typically repatriate funds during periods of high volatility, which means that they are buying their own currency.

Finally currencies such as GBP have, just as forecast, recently stabilised partly due to the Bank of England which, as mentioned, did an about turn by ceasing to talk down the currency. Also the Bank of England's recent actions to put new QE programmes on hold adds further weight to help stabilise this currency.

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