The Wall of Worry Grows Taller

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The next two weeks full of uncertainty

The final two weeks of January will likely be packed with at least two market moving events. First, on January 22nd, the European Central Bank (ECB) will announce whether they will begin the much expected Quantitative Easing (QE) regime. The European bond market appears to have already priced in the ECB taking such actions.

In this order, ECB, Greece, and the FOMC can be market moving events.

Consequently, should Mr. Draghi drag his heels once again, then it is likely that sovereign yields will move modestly higher. Bond investors should not be fearful that market rates will move significantly higher as the prospects for continued deflation far overwhelm the risk that inflation begins to surface. Perhaps the ECB will announce that they have decided to begin their sovereign bond purchase program but will begin to implement the program after the Greek election. The second important date is January 25th when the Greek people go the polls to vote for a new government. As of this writing, the Syriza party is leading the incumbent "New Democracy" led by Antonis Samaras. A victory by Syriza could lead to more volatility for the euro with an accompanied decline of the currency.

On January 28th, the Federal Reserve Open Market Committee (FOMC) is scheduled to announce its decision on monetary policy. Since the Fed Chairwoman has already stated that the Fed will not raise rates before April, no one should expect any surprise from the upcoming meeting. Having said that, the FOMC may make reference to deflationary pressures that have surfaced in Europe and highlight the risk that the US economy may be negatively impacted from a weakening of the European economy. If the FOMC does make reference to Europe as a potential headwind, then financial markets will begin to anticipate that any rate hike will not occur until the 3rd quarter of 2015 (at the earliest) by the FOMC.

While these are key dates, investors need to remain focused on the underlying investment themes which are: diverging economic cycles between Japan-Europe and US-China, diverging Central bank policies, long-term cyclical uptrend in the US dollar versus major trading partners, equities broadly outperforming commodities and bonds. Against these broad themes, investors should tactically look to add to equity positions should equity markets have a negative response to any of the events that are scheduled to take place in the final two-weeks in January.

Low nominal interest rates, and in some markets negative nominal and real yields, suggest that investors are looking (tactically) for opportunities to reduce interest rate risk (reduce duration) to the intermediate segment of the yield curve. In the US, bond markets need to stay alert that the Federal Reserve will potentially begin the process of normalizing interest rates before the end of the year. European yields will likely tract somewhat lower even though yields are already sitting at new historical lows. Lower oil prices could cause deflation to spread in Europe forcing the ECB to become even more aggressive with QE.

The surprise move by the Swiss National Bank (SNB) to remove the cap of its currency from the euro may make it easier for Mr. Draghi to begin implementing QE as early as next week. The immediate impact of the SNB's decision lowered the value of the euro vs. the Swiss Franc by nearly 16%. The euro also continued its downward slide against the US dollar by nearly 1.50%. It is clear that the euro will remain under pressure well after the ECB initiates QE.