Five absolutely incorrect consensus views

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Avoid the crowds.

By Brian Shapiro

As markets ebb and flow there are certain points where a majority of participants seemingly agree on a market view (consensus) which inevitably proves to be completely incorrect.

These are the five biggest fallacies in the market as seen through our crystal ball right now:

1- The U.S. Federal Reserve hikes rates and all U.S. interest rates go higher, including long rates.

It's actually the opposite. If the Fed finally hikes rates, inevitably the fallout could include a further dollar rally. If the dollar rallies then the U.S. export and commodity sector could slow down further, forcing lower domestic economic growth which will cause the yield curve to flatten as long rates go down. Perversely, if the Fed doesn't hike, then the market will perceive the Fed as potentially falling behind (the curve) and the curve steepens and long rates rise. Finally.

2- A Grexit (Greek exit) hurts the euro.

It may ultimately strengthen the euro. A Capitalist Union (EU) will work better without socialist nations attached to it. A Greek exit will create a stronger monetary union in Europe and a better framework for further European growth. This will ultimately lead to a stronger Euro. The worry is whether a Greek exit would spread to other leftist parties in Europe, but that would be a five to 10 year process (if it happens at all) and by then the EU monetary union will be a decade stronger. Certain populists may try to swing governments towards a socialist bent but Western Europe is far from that mentality.

3- European stocks will continue flying as ECB QE has weakened the euro.

The European stock markets *have been* the big winners but they are up already and the Euro is down and retail accounts are long. With the easy money having been made, it will be harder for markets to fly higher and any strengthening in the European economy may cause the Euro to rise, which would be contra to the reasons that the European market has performed so well in 2015. The easy money has been made.

4- That we are currently in the sixth year of a bull market that started in 2009 and we haven't had a correction.

The bull market that started in 2009 actually experienced a 20% decline from July to October of 2011 and the current bull market we are in is a new bull market that launched in January 2012 (when the June 2011 highs were exceeded). If we count from the lows in Q4 2011 then we are about three years into this bull leg, which is quite normal as five year bull markets have not been uncommon in the past 100 years. This leg can certainly last through most of this year and even into next year before we will finally dip, thus ending this leg of the bull.

5- That the indebted nations of the world, and particularly the G-7, would ever allow any deflation.

With external debt of over $40,000,000,000,000 (trillion) just in the G-7 nations, there is no chance any nation can do anything but REFLATE their economies, create inflation and thus depreciate their debt. Over the course of the past 100 years, the Fed (and now most G7 Central banks) have created and burst bubbles and this current cycle will be no different. However, until the Fed hikes rates in earnest there is too much liquidity for markets to contract. The ECB and BOJ are still performing QE. Further, the Fed is still stealthily performing QE with the reinvestment of principal and interest on their holdings. As they "dividend profits" to the Treasury, the Fed’s balance sheet still remains above $4.5 trillion (as of April 1) even though they returned more than $100 billion to Treasury (a requirement of Fed "earnings"). In essence, the federal deficit has been reduced by $100 billion, partially with earnings the Treasury paid on its bond holdings. All of the above mechanisms remain consistent with creating an inflationary environment which will come to fruition in time.

The outcome/endgame obviously includes a time when finally the Fed ultimately hikes rates. At that point we will have a chance to correct as a pause in the liquidity parade occurs. However, that correction will be a blip and not sustainable until it coincides with the ECB and BOJ also ending their QE's as the liquidity train will finally be over at that point. Throughout time, the stumbling points to higher equity prices have been higher interest rates, access to credit (aka credit weakness) or a geopolitical issue. Absent those factors, stock prices and market conditions remain favorable as liquidity and accommodation remain the rule and not the exception.

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