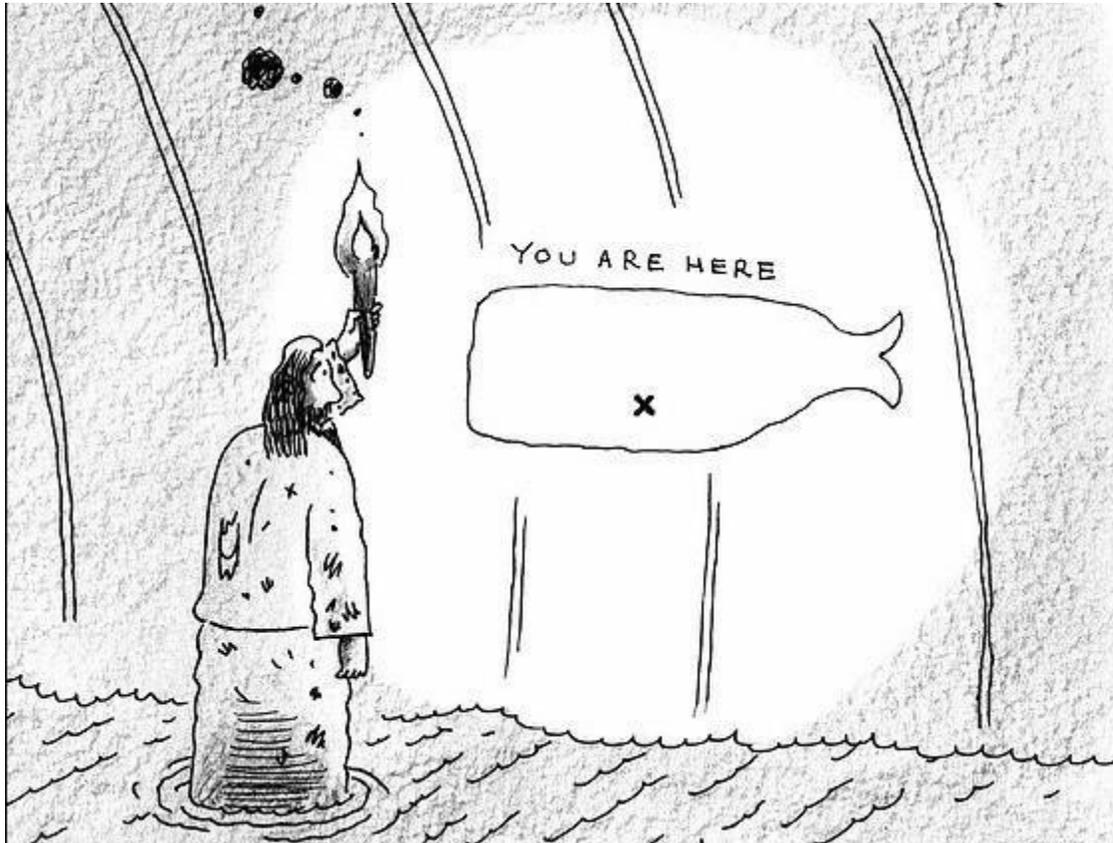




Epsilon Theory

# In the Flow – You Are Here, May 2019

May 13, 2019



We updated our five narrative Monitors last week with financial media tracking through April 30, so I wanted to focus today on our findings from that update, particularly as it relates to the recent re-escalation of trade tensions. The data can be accessed as a PDF file [here](#), a Powerpoint file [here](#) and as an Excel file [here](#).

For each of the five Monitors I've highlighted the finding that I think is most interesting. Put it all together and here's the skinny – **there's a tremendous amount of narrative complacency out there, particularly on Trade and Tariffs, which means this market has a long way down if the narrative focuses on negotiation failure.** It's not focusing there yet, but that's what you want to watch for. We'll keep watching for any changes of that sort in narrative-world, and in market-world you should keep your eye on USDCNY and iTraxx European senior financial CDS spreads. A quick move over 7.0 in the former or 100 bps wide in the latter is a sign that China is considering a currency float/devaluation. That's how China will declare these negotiations have failed.

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## Inflation

- Inflation language remains at a low-to-moderate level, but outside of central bank policy discussions and discussions of health care and education (esp. student loans), attention – its influence on broader narratives – is limited.
- **Consistent with prior updates - and despite our belief in the long-term shift in Zeitgeist toward inflation - we do not think there is a coherent short-term inflation narrative at this time.**
- Inflation discussions persist with somewhat higher intensity than usual in the usual pockets in emerging markets. Latin America and Middle East have become more central to EM inflationary narratives.
- We found it noteworthy in April that the language used in media to describe US inflation and central banking is *most similar* to language used to describe BOJ (relative to BOE/ECB/EM banks).

## Central Bank Omnipotence

- Our measures of both attention and cohesion of central bank omnipotence narratives flagged slightly in April.
- We think this is generally the result of (1) increasing separation in policy imperatives within the narratives surrounding the major central banks and (2) the brief emergence of a new (and separate) view on a potential rate cut in the US.
- Regardless, we continue to think that Central Bank Omnipotence is the primary governing narrative of risky asset markets in the US – with Trade and Tariffs emerging from complacency much more recently.
- **We also note the recent emergence of a *central* cluster relating to inequality, ‘failures of capitalism’, student loan debt and other issues making the rounds in US election politics.** These are surprisingly well connected across articles in the CBO dataset. We think shifting political pressures on central bank narratives are worthy of long-term monitoring.

## Trade and Tariffs

- For much of April, cohesion continued to drift downward, as trade and tariffs discussions splintered further into distinct Europe, North America, China and now US/Japan trade clusters.
- **Meanwhile, sentiment remained noticeably more positive than in the recent past, leading us to believe that the narrative structure is still highly complacent.**
- In early May, a couple well-placed tweets from President Trump very briefly showed some measure of the volatility-inducing potential of negative surprises on this complacent narrative structure.
- We suspect that focus *will* return to China/US trade discussions in May, and we would not be surprised to see sentiment retreat somewhat.
- Will the complacency about a positive outcome stick around? We think it will be heavily influenced by whether the additional tariff threat is a true negative surprise or a manufactured “wall of worry.” We lean toward the latter, but that is opinion and *not* something we necessarily see in the narrative data.

## US Fiscal Policy

- Rising sentiment and cratering cohesion in US Fiscal Policy narratives appear to be the result of electoral politics: wide-ranging, optimistic plans in popular areas (e.g. student loan debt retirement, medicare-for-all, infrastructure)
- There is, however, no central governing narrative, and financial market attention on fiscal policy narratives remains below historical levels. **We don't think it's an overstatement to say that financial markets simply do not care about US fiscal policy at this time.**
- Of interest: as covered elsewhere on Epsilon Theory, language used in articles about student loan debt continues to be among the most well-connected in the US Fiscal Policy dataset.
- While you may note a cluster of articles focused on the 'US Federal Debt Crisis' topic, we note that most refer to it as a *non-existent* crisis. It includes many pro-MMT style opinion and analysis pieces.

## Credit Cycle

- We are now comfortable characterizing the credit market narrative structure as *complacent*.
- There is very little overall structure to any one narrative about risks to credit markets, defaults or liquidity, and general coverage continues to be quite positive in sentiment about lending.
- In addition, each of the notable credit events large enough to merit a cluster of articles is visibly separate from the core of financial journalism.
- **In other words, the only people talking about Canadian Banks, China Debt Traps in the Philippines, or HNA's CWT International are people talking about those specific issues; they are NOT being pulled into broader discussions of fixed income and credit markets.**
- As noted elsewhere, the student debt market continues to be central to most coverage of credit markets.

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