"The Narrative Fix Is In"

A quick email to Epsilon Theory readers on what's happening in Europe, because we've seen this movie before.

On August 2, 2012 Mario Draghi gave the most disastrous ECB press conference of all time. The market anticipation was enormous leading up to the event, as this was the moment where the ECB would unveil the Outright Monetary Transactions (OMT) program -- a new, ultimate weapon to be deployed to rescue the euro. In truth, the OMT then (and now) was just a bunch of words. Powerful and nice-sounding words, to be sure, but just words. All hat and no cattle, as they might say in Texas. The Germans then (and now) were clearly not on board with the OMT, and European markets broke hard. Spain's stock market dropped more than 5% that day, and Italy's was close to that. Spain's 10-year bonds hit a 7.2% yield, and Italy's hit 6.3%. You can imagine what happened in Portugal and Greece.

But the most amazing thing happened the next day on August 3. What the *Financial Times* had originally called "Draghi's Blunder" was now written up as "Draghi's Bold Move". Every talking head and person of media influence (what game theory calls Missionaries) with access to the ECB or a European central bank started reading from the same playbook ("Mario is a genius", "markets got it wrong", etc.). I thought my head would explode if I heard the word "bold" one more time. Combine this with the European Plunge Protection Team buying up every risk asset in sight at the opening bell, and the rest, as they say, was history. European (and global) markets rocked on in risk-on mode for months ... years, really, if you focus on Eurozone sovereign rates. It's the purest example of Narrative creation and the Common Knowledge Game in action that I know, and was in many ways the spark for my starting Epsilon Theory.

So imagine my surprise to see in the *Financial Times* this morning an FT View piece (exactly the same venue as the 2012 Narrative putsch) with this headline: "Mario Draghi delivers a bold expansion of stimulus" and a picture of a beneficent, entirely satisfied Mario. Per the FT, Mario is "determined", "aggressive", and "bold". He "sends important signals", he has "strengthened" this and that, and he has "prevailed" over those pesky Germans.

And once again, this morning every talking head and every sell-side strategist is reading from the same playbook. Draghi didn't *want* the euro to go down. This was his master plan all along. Didn't you hear the bit about the ECB buying investment grade corporate bonds? Doesn't that get you kind of excited? And he's throwing China and the banks a bone. C'mon, you really need to look *here*, not *there*. It's what all the smart guys are doing. Aren't you a smart guy?

For the *Wall Street Journal* this morning, risk assets are up because "investors reassessed" the ECB announcement. Really? That's what happened? Real world investors stayed up till the wee hours last night and en masse concluded that they had just gotten it completely wrong yesterday? How about this for an alternative explanation: the allocation heads at one or two European mega-insurance firms were informed that they would be supporting risk assets this morning, the Narrative machine got into gear, and real world investors do what they always do, they play the Common Knowledge Game.

But here's the thing. We can gnash our teeth all we want about the hypocrisy and manipulation that's inherent in this exercise, or we can play the game and maybe make some money. We can focus on reality and stay negative on risk assets, or we can focus on the Narrative and be positive on risk assets. Does this Narrative fix last for months like August 2012? I doubt it. Too much has changed in the essential nature of the international monetary policy game. But unlike recent policy announcements that were NOT supported by the Narrative machine, this one is, and that gives it investable legs.

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