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Liquidity remains central banker's tipple of choice, says Momentum Global Investment Management

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James Klempster, portfolio manager, Momentum Global Investment Management explains why Liquidity remains central bankers' tipple of choice:

"The UK plans to raise GBP 127 billion in gilt sales this year, which is a huge volume for the market to digest if there is no meaningful appetite, especially given the current lowly levels of the benchmark government bond yield and the fact that interest rates are likely to rise at some point in the relatively near future. This serves to remind us that safe haven government bonds remain unsustainably expensive at present levels and, as a result, we retain low allocations to these securities, instead preferring to achieve fixed income exposure via elements of the credit markets.

"Demand at gilt auctions has fallen to its lowest level since the financial crisis - June's auction of 10-year securities marked a six year low. Perhaps take up was low because potential bidders had one eye on expected rate rises but it could also be a sign that buyers of gilts are finding it difficult to justify gilts at today's persistently low yields. If the former, it again demonstrates the importance of central banks managing expectations as effectively as possible whilst there is an elevated level of economic uncertainty. If the latter and gilt buyers are starting to fatigue, this suggests gilt yields should rise.

"The Fed had an unenviable task last week. Had they increased rates, it is likely that the market would have responded badly on the basis that fragile economies both in the developed and developing world weren't 'ready' for the US tightening its monetary policy no matter how modest a rate rise would have been. Yet the Fed's decision to do nothing was also greeted with negative price action globally, as market participants collectively asked 'what does the Fed know that we don't?' While their inaction seemingly delays the inevitable, on balance the Fed made a sensible, if conservative choice: if action and inaction were both to be greeted badly they may as well opt for inaction over an *actus reus* that would have been over-analysed for decades to come. As I noted last week, the Fed is desperate to avoid putting up interest rates only to have to cut soon after.

"Over the weekend other central bankers added their weight to the Fed's dovish stance, with the European Central Bank's (ECB) Benoît Cœuré suggesting the Fed's decision to keep rates unchanged co is "a confirmation of our diagnoses of the existence of risks in the global economy". This sentiment was echoed by his colleague, executive board member Peter Praet, who stated "we share the concerns about the outlook for the global economy". Praet went further by confirming that the ECB would contemplate cutting interest rates where shocks were of such import that they risked lower inflation.

"In a similar vein, the Bank of England (BoE)'s Chief Economist Andy Haldane warned that the risks to UK growth and inflation mean that the case for a UK rate rise is 'some way from being made'. Indeed, Haldane believes that the balance of risks are skewed 'squarely and significantly to the downside'.   Haldane also suggested that the BoE may

have to cut rates to combat low inflation: "were the downside risks…to materialise, there could be a need to loosen rather than tighten the monetary reins as a next step to support UK growth and return inflation to target". This view was not universally shared, however, with former Monetary Policy Committee member Andrew Sentance suggesting “Andy Haldane's spouting rubbish here…cutting interest rates from all-time low is unnecessary. Doing so when economy in 7th year of recovery is totally foolish."

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For further information please contact:

Kate Aitchison	Lansons	020 7294 3637
	momentumgim@lansons.com	
Russell Andrews	Momentum Global Investment Management	020 7618 1803
	russell.andrews@momentumgim.com	

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