FINANCIAL REVIEW

Nov 17 2017 at 6:33 PM

Market euphoria could be setting up a Minksy moment, Paul Keating says

Former prime minister Paul Keating at the Hearts and Minds conference at the Sydney Opera House on Friday. Daniel Munoz

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High appetite for risk has created a "speculative euphoria", says former prime minister Paul Keating, who argues that markets are vulnerable to a correction that nobody is prepared for.

"No-one's running for the door, and also right now, no-one knows where inflation is or when it might spring back. We're in this twilight zone where asset prices are popping, the valves are popping on the engine, we know that."

But "it's only when the screws go on that these distortions will reveal themselves, and Mr Minsky actually might have his moment again," he said. A Minsky moment is when leverage-fuelled asset prices are brought down suddenly after a long period of growth.

Mr Keating told an audience of prominent investors at the Sohn Hearts and Minds Conference in Sydney on Friday "you can't quite understand the fact that markets are so relaxed and comfortable about the conditions we're in".

The one thing about running an economy," the former treasurer said, "is you get a lot of road feel." That was telling him "it's been almost too good for too long". When volatility is low and prices are high, the distortion building up in the system "only reveals itself at the moment some stress is put on the system".

Mr Keating said central banks should be more concerned about the impact of their actions on asset prices than wages and inflation, and the real worry was that central bankers themselves lacked conviction in their policies.

At the second annual Sydney chapter of the Sohn event, Mr Keating's concerns were echoed by investors from the venture capital world, bonds and equities.

The long bull run in stocks and other asset classes, including property, has been aided by extreme policy settings such as quantitative easing, which have remained in place even as economies have recovered and jobs have been added, because inflation has remained stubbornly low.

Ben Alexander of boutique bond fund Ardea says this period of central bank stimulus will go down in history as "crazy" and "extreme". But as they prepare to withdraw support it could mark the end of the so-called central bank put, where the equity market can count on money being pumped into the system as stock markets weaken.

"Rates are artificially low, volatility is artificially low, so complacency is at artificially high levels. The thing that got us here is about to be withdrawn so you should be worried," the fixed income investor said.

A panel of Silicon Valley experts wrestled with disruption and questioned the concept of money and industry as we know it.

Joe Lonsdale from 8VC questioned the future of fiat currency, because "one of the things government's really screwed up for hundreds of years, especially more recently, it's controlling currencies, controlling the money supply and managing finance". Central banks were fuelling inequality and debt was mounting. "Bitcoin and Ethereum, the top two crypto-currencies, provide a mechanism to control the money supply that takes it away from government, means they can't screw it up any more, so you may in 10 years, 20 years from now be thinking of your wealth in terms of these crypto-currencies. It's something to think about as you look to invest right now."

Atlassian co-founder Mike Cannon-Brookes posed the question, "are software companies going to figure out how to move into industries faster than the industries figure out how to become software companies?". "You see this in all these industries and that is a fundamental challenge, to see who wins that battle."

The Future Fund's chief investment officer, Raphael Arndt, saw the age of unprecedented debt accumulation that began in the 1980s coming to an end.

"This is not sustainable. The coming reduction will be a headwind to asset prices and returns," Dr Arndt said. Among the mega-trends which posed risks to equity markets and economic growth was slowing population growth and income inequality. "The low policy rates set during the GFC have pushed up incomes and improved conditions in emerging markets but haven't done anything for the working class."

Dr Arndt believed this disaffection, which has led to the rise of populist politics and protectionist policies, will linger. The Future Fund holds high levels of cash and invests in hedge funds that deliver returns that are uncorrelated to equity markets to manage the risks posed by megatrends.

Fund manager David Prescott from Lanyon Asset Management said: "We know the bond market is in a bubble, and the equity market isn't far behind. We can see the equity market, perhaps 30 per cent down."

Mr Keating was convinced that China will overtake the US economy, predicting "they are going to head the US off at the pass at $US18 trillion if it's the last thing they do". After 2021, the centenary of the Communist Party's birth in China and when he sees it taking the mantle of the world's largest economy, "all you punters out there buying Chinese stocks, you've got to get them on the way up and just as we cross over 2020", it was time to sell.

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