There is a useful indicator to assess how opaque the market outlook is – the use of the word 'obvious'. It was particularly evident in the later stages of the Japanese bear market in 2012; the bears were inclined to the view that the market obviously had further to fall, while the optimists believed that Japan was an obvious candidate for the next bull market.

We are once again in an 'obvious' world – and there are two aspects which fight for the crown of self-evidency.

The first is the worry within the US central banking system that there are deeply deflationary forces which could well be very difficult to combat if they take the world by the throat. The other is that the combination of a massive supply of liquidity, coupled with no hiding place for savers in the cash deposit market, becomes an irresistible force for asset price appreciation.

These are not mutually exclusive ideas – indeed, we subscribe to both of them; what is nonplussing is that they lead to very different investment conclusions. It is worth saying that the price appreciation consequent on easy money is unsound, and will ultimately be reversed, but many a corpse has been found floating in the river whose average depth suggested all-round safety.

The markets are responding rationally to this. Those who are bearish, looking only at the fundamentals are forced to wait it out in the rising water, and it will be a matter of whether they can hold their nose and/or their nerve for long enough while the indices grind higher. Those who are bullish, whether through sunny optimism or a canny judgement of the situation, watch the Federal Reserve for some indication as to when they plan to pull away the punchbowl. The Governor of the Federal Reserve, pleased to have this sort of attention, and uneasily aware of the instability which would follow a loss of confidence in the Fed's ability, is becoming more circuitous in her explanation as to future tapering, flexible inflation targeting and other massageries to palliate the lower back pain of Mr Market.

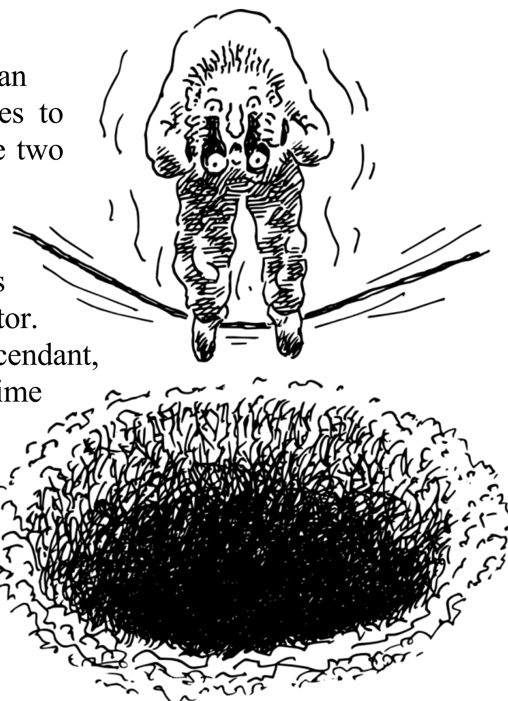
This is a biggish mistake. The first bit of guidance is always fascinating and informative, like those fireside films of the Royal Family picnicking on the coppery Dee. The trouble is that a generation later, this wedge becomes a chasm of intrusive intervention. 'Never apologise, never explain' shouted General Joffre during the First World War. For a long time, the Federal Reserve adopted this policy, doing whatever it chose, but in those years of innocence it was generally no worse than a mild hindrance to economic progress. The arrival of Alan Greenspan changed that – the Napoleon of money, he used the latent power of the Fed to make things happen in the economy. After 1994, the policy of silence was abandoned, when what seemed a small reversal of interest rate policy caused mayhem in the US bond market. It taught Greenspan that it was not the course of interest rates which would damage markets – it was the onset of an unexpected piece of bad news. In hindsight we can see that he then fell into the exactly opposite trap – the baby-step rise in interest rates prior to 2008 proved to be too easily understood, and was a primary cause of the borrowing-spree which threatened the very fabric of society when it unravelled.

We now have the reality of Fed control through explanation. They have to explain everything to the markets, but leave sufficient ambiguity in their words to leave the financial world guided towards, but not given, an answer. The problem is that the guys at the Fed haven't a clue what works and what doesn't. They really don't – they are like the Babylonian necromancers who had to foretell the future, and were astute enough not to say, 'it's going to be a boy', preferring the sort of predictions which say 'nations will rise and fall' by way of keeping themselves out of trouble.

The 'experts' do not present individually as ignorant – there are differing views, each cogent within its own framework, each articulated with the intellectual rigour and nervous energy of the theologian. My favourite vignette of this is the analysis of Finance Minister Takahashi's economic initiatives which coincided with a sharp upturn in the Japanese economy in the early to mid 1930s. All commentators agree as to what he did; they all agree as to what happened. But every variant of reasoning as to causation has been adopted – you can take your choice, and be none the wiser.

We thus have a double arbitrage between perception and reality; the first is that the Fed will be able to go on walking a tight-rope such that investors are encouraged and not spooked. The second is the belief that the Fed has a coherent plan. Neither is true. We can predict with confidence that one day the market will be surprised again, and given that QE has led market-players to favour risk investments, this is likely to be bearish in its impact. Given, too, the propensity of QE to bring about an unforeseen blessing, perhaps the onward flow of events will make evident a similarly unseen barb of some unfortunate element which disconcerts the financial world. The current thinking in the Fed is that QE no longer has effectiveness in helping the economy, only stock prices. If true, it may be undesirable, but it may also be necessary – market buoyancy is, perhaps, a crucial element in the recovery.

Put these two things together, and we have a central authority which can see that disinflation has become serious enough to mean that we are only one shock away from a vortex. When it comes to applying the right medicine, though, these doctors of economy are two pills short of a packet.



There is an interplay between central banks and the markets. The latter will go up while confidence remains, and the central banks will go on behaving in a way which validates the bull-market operator. It is why we like the Japanese market – while this phase is in the ascendant, this is the geared play, both in terms of the exuberance of its Prime Minister, Shinzo Abe, and in terms of its effect on the minds of the populace, who are reconciled to the inevitability of the deflationary conditions which are, in fact, far from inevitable; they are eroding under Mr Abe's blowtorch.

One day, however, the markets will take fright, and the authorities in America will have to decide whether to re-double their efforts to avert a deflation, or give up gracefully and accept it.

As to which it will be, the answer is blindingly… obvious. Last time unconventional methods were used (QE in 2009), the authorities chose inflation over deflation. To their amazement, they found that they had unleashed a powerful corrective to the deflationary forces, which, in those early days, had no deleterious compromise of confidence in the currency. Of course this emboldens the policymakers, and already the lines between printing money to buy existing debts, and printing money to fund new spending are becoming more blurred. The Japanese and Americans are already printing more than enough money to fund annual government spending, with no apparent cost, while closer to home, the nascent recovery in the UK has more to do with two 'failed' policies: Funding for Lending and Help to Buy, themselves variations on the same theme, than with George Osborne's hairshirt austerity. The next escalation therefore is to engage in ever more explicit forms of the same thing, continuing until people lose confidence in money. And as to the timing of that, the Babylonian Necromancers are no less qualified than the central bankers to have a view.

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