

Davos – And the Euro

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Perfect! Last week, the Swiss National Bank in reaction to market pressure, ended its crawling peg against the euro. The Swiss Franc surged 40% versus the euro, before settling around 20% higher, and roughly 17% against the already strong dollar. So, guess what? Attendees at The World Economic Forum – an annual gaggle of the global financial elite held in Davos, Switzerland, which starts today – just saw their trip get a lot more expensive.

Most people who attend (or who aspire to attend) just call the meeting “Davos.” It’s been described as a meeting of the 1% - wealthy business CEO’s, high-ranking government officials, heads of international organizations, and, occasionally a famous economist, artist, professor, or author. And, don’t forget the press – they are everywhere.

For the most part, the meeting is made up of people who believe the “elite,” in business and government – the ones often called the “smartest people in the room” – can “fix” just about any problem that exists in the economy or society.

Last year’s theme was “Resilient Dynamism.” No joking; to the people at Davos that actually means something, or at least they all pretend that it does. This year, it’s “The Reshaping of the World: Consequences for Society, Politics and Business.” Some attendees actually think a central authority can Reshape the World and still have Resilient Dynamism.

Reading the agenda items, it sounds like an interesting conference. The panels will fret about financial market risk, inequality, global warming and talk about designing the perfect regulatory environment for fixing all these things.

While they may not say it exactly like this, they believe a “partnership between government, business and academia will produce a ‘better’ world.” And why shouldn’t they; many of them would be the central planners in that supposedly better world. But what these government, business, and academic officials just found out is that markets ultimately control prices, not central planners.

The Swiss National Bank, the central bank of Switzerland, had previously tied the local Swiss Franc to the

value of the euro. It did this to prevent the Swiss Franc from rising too much against the euro, which would, in theory, have made Swiss exports less competitive.

But, Switzerland has an excellent long-term monetary track record. The Swiss Franc has generally *gained* strength versus other currencies (even the US dollar) in the past 45 years. As a result, investors from around the world still prized investing in Switzerland. Moreover, with the European Central Bank threatening more quantitative easing, these two forces (one long-term and one short-term) put upward pressure on the Swiss Franc. To offset that upward pressure the central bank had been intervening in the foreign exchange market by buying Euros, issuing more Swiss Francs and racking up losses.

Continuing the peg would have swelled its balance sheet even further. In the end the “smartest Swiss in the room” were forced to cave to market forces. The world was aghast. Journalists, politicians, central bankers, and all forms of central planners were stymied. Their best laid plans of more QE to solve Eurozone problems took a massive hit. This is a lesson we doubt will be learned.

In the end, markets always win. You can only fight them for so long. The foreign exchange markets wanted the Swiss Franc higher because it represented the collective wisdom of people protecting their own assets, not just the Mandarins at the central bank who had temporarily decided it’d be better if the Swiss Franc didn’t move higher.

Keep that in mind when you hear breathless interviews and reporting from Davos in the week ahead, on what the smart set, the elite, thinks about world problems and how to solve them. Because in the end, what they often say is that they know better than markets. But, the Invisible Hand, which most of them refuse to believe in, and many try to control, is simply more powerful.

If they really want to “Reshape the World,” Davos attendees will agree that getting out of the way and trusting that Invisible Hand is a much better solution than the ones they will likely dream up.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-21 / 7:30 am	Housing Starts – Dec	1.040 Mil	1.057 Mil		1.028 Mil
1-22 / 7:30 am	Initial Claims – Jan 17	300K	304K		316K
1-23 / 9:00 am	Existing Home Sales – Dec	5.080 Mil	5.090 Mil		4.930 Mil
9:00 am	Leading Indicators – Dec	+0.4%	+0.5%		+0.6%