"The King is Dead. Long Live the King."

Le roi est mort, vive le roi!
-- French proclamation as coffin of old king is placed into burial vault of Saint Denis Basilica.

The throne shall never be empty; the country shall never be without a monarch.
-- English Royal Council on death of Henry III in 1272, proclaiming Edward I king even though he didn't get the news until months later.

Every time I thought I'd got it made
It seemed the taste was not so sweet
So I turned myself to face me
But I've never caught a glimpse
Of how the others must see the faker
I'm much too fast to take that test
-- David Bowie, "Changes"

What we're witnessing right now in US markets is a shift in the Narrative structure around Fed policy, and it's hitting markets hard because the Narrative structure around the Fed as an institution has never been stronger or more constant.

As more and more generally positive US growth data comes out, most recently in last Friday's jobs report, the Narrative around Fed policy is shifting from "The Fed will keep rates low forever and ever, amen" to "the Fed is on rails to raise rates sooner and more than you thought". And that's a real bummer if you're long this market, particularly in a momentum or high-beta name.

A Narrative is just another name for what game theory calls Common Knowledge, which for my money is the most powerful force in human society. Common Knowledge is what topples governments, builds cathedrals, and starts (or ends) wars. It darn sure moves markets, particularly in a period of extreme global political fragmentation and stress, as we last saw in the 1930's and before that in the 1870's. As Keynes noticed (and successfully traded on with his own investments), market sentiment is driven by the creation or dissolution of Common Knowledge, and you can't play the Game of Sentiment well if you're not focused on it.

Common Knowledge is not just public information. **It's public information that everyone thinks that everyone thinks.** It's a signal that's broadcast publicly by a powerful "missionary" like Yellen or Draghi or a Famous Investor on CNBC or a Famous Journalist in the WSJ, so that we all know that we all heard the message. And if we think that everyone else has heard the message, then the rational behavior is to act *as if* the message is true, regardless of our private beliefs or observations. This is the Emperor's New Clothes…each of us can see with our own eyes that the guy is naked, but we're not really looking at the Emperor. We're looking at the crowd. Each of us is looking at all of us, and all of us know it.

So when the WSJ *tells us* that the Friday jobs report was good and strong, when Jon Hilsenrath *tells us* that this jobs report keeps the Fed "on track", when Fed Governor Bullard *tells us* today that Fed actions have been "sufficiently aggressive", when Janet Yellen *tells us* that she has a schedule in mind for raising rates…well, those are powerful public statements by incredibly influential missionaries. This is what creates Common Knowledge. We all heard these statements, and more importantly we all believe that everyone else heard these statements, too. So now we will all start to act *as if* the statements are true for Fed policy, no matter what we privately think the Fed will do or not do, and that behavior becomes a self-fulfilling prophecy, a snowball rolling downhill, as more and more of all of us start to believe that this is what all of us believe. This is the power of a crowd looking at a crowd, and it's a bitch.

What we're not seeing – and this is why the Narrative shift in Fed policy intentions is hitting the market so hard – is a change in the underlying and more fundamental Narrative that has controlled global markets for the past five years…the Narrative of Central Bank Omnipotence. I've written about this a lot (here and here, in particular), so I won't repeat all that, but the Common Knowledge structure around the Fed and other central banks in general terms is that the Fed is responsible for market outcomes. It's not that the "Fed has got your back" or that the Fed will always make the market go up. It's that the Fed is large and in charge. Central bankers giveth, and central bankers taketh away. That's the Narrative of Central Bank Omnipotence.

It's become fashionable of late to say that the Fed doesn't have as much impact on markets today as it has in recent years. This is, I think, an entirely wrong-headed reading of the game-playing in markets today. Or more charitably, from a game-theoretic perspective there has been zero evidence of a diminution in the underlying Common Knowledge belief structure that the Fed and its brethren are responsible for market outcomes. On the contrary, as these last few days and weeks and months suggest, a belief in the Fed as the ultimate arbiter of markets has never been stronger. The modern Goldilocks market environment is growth strong enough to avoid outright recession, but weak enough to keep the Fed in play. Whenever (and wherever, as this dynamic has been mirrored in Europe, China, and Japan) signs of strong growth and thus diminished central bank support have emerged, markets have sold off. It's only when growth falters and the drumbeat of increased or continued central bank support re-emerges that markets recover. When real world good news is market bad news, and vice versa, then rest assured that the Narrative of Central Bank Omnipotence is alive and well.

This Common Knowledge belief structure around the *institution* of the Fed is like the Common Knowledge belief structure around the *institution* of the monarchy in feudal Europe – incredibly powerful, phenomenally resistant to change, and imbued through popular belief with the power to determine economic outcomes. The Narrative around a particular Fed policy or Chair or regime will change and shift, just as the particular monarch sitting on a throne changed over time. But the underlying institution and its ability to shape the world through its core or existential Narrative changes much more slowly. Importantly, it's the maintenance of the institution – not the maintenance of any particular king or any particular set of policies – that's crucial for social control. That was true in 13th century England and 18th century France, and it's just as true in 21st century western democracies with central banks.

Bottom line: "don't fight the Fed" is a reflection of the institutional power of the Fed and the Narrative of Central Bank Omnipotence. It cuts both ways. You don't want to be short anything when the Fed is easing, and it's hard to be long anything when the Fed is tightening. The crowd is picking up on a shift in the easing/tightening Narrative and is beginning to act on that by selling, just as they acted on prior market-positive shifts in the easing/tightening Narrative by buying. Different monarchs; same monarchy. What's to come? More of the same, I suspect. Good real world news is bad market news, and vice versa, for as far as the eye can see. Why? Because the crowd is not going to fight the Fed.

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All the best,
Ben

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