



A Winter's Tale

Ring out the old, ring in the new! 2016 certainly started with *the* most head-thumping, ice-crystal fragile, itching-behind-the-eyes, hair-on-the-tongue, stomach-churning hangover in memory as traders and investors alike have dragged themselves back to their desks still jaundiced from a 2015 which offered few easy returns to anyone.

High grade US debt lost 1.9%, junk 4.5% while the EMBI eked out a paltry +1.3%. US equities likewise made a bare 1.3%, but ROW ones lost 2.6% and EM's shed a hefty 14.6%. All four classes of commodities suffered a blood-bath, ranging from the merely gory 12% loss on precious to the utter exsanguination of -40% in energy. Hedge funds came up short and cash was no comfort either since, if you *were* fortunate enough either not to endure negative interest or be taxed on your hoard, you still probably did not cover the general rise in the cost of living.

That said, from the perspective of the first two weeks of January, the old year looks like a comparative golden age. Just about every stock market you care to look at has already slipped several percent with the likes of Biotech off double digits and the ChiNext down almost a quarter. As for commodities and their associated currencies — well...

All in all, the market seems to be buying reluctantly and selling cathartically, having gone from greed to ennui to frustration to a creeping sense of fear. It would not take much, one feels, to convert the latter into a full-fledged attack of panic. Even that good ol' Mario Magic seems to be in short supply — being not so much a case any longer

of 'whatever it takes' as of a plain, bored-teen 'whatever!' Fatigue has set in over arrowless Abenomics; Fred Karney's BOE Circus have forward-marched us to the top of the hill and marched us down again once too often. The PBoC is in full Keystone Kops mood and the Fed is trying to persuade itself that it will continue to raise, rather than lower, rates as the year progresses, barring calamities unforeseen from abroad.

This hurts since the central banks, if not themselves the main act these past three and a bit years, have certainly placed the advertisements in the local press, printed the tickets, kept front of house, sold the ice-creams in the interval, and swept the aisles afterwards. Sadly, the play itself has become stale, the dialogue predictable, the acting wooden, and the orchestra out of tune. Not so much the *'Force Awakens'* as the *'Bourse Forsaken'*, perhaps.

Out in the real world, far from the cabbalistic pursuit of 2.0% p.a. CPI rises and the Carrolean idea that if we just *believe* that prices will rise we will happily borrow and spend enough to make them do so — and thus make ourselves instantly richer — decisions are made — and their consequences realised — at the intersection of many different margins. Sad to relate, many of those are beginning to erode as the last foot-pound of leverage has been employed to decreasing effect; the last evergreened loan has failed to re-fertilize the distressed borrowers' soil; and the flight from cash has reduced the chances of return everywhere to, if not through, zero.

In the meantime, earnings are finally losing their uncanny ability to outstrip drought-stricken revenues and the gains to trade are shrinking along with its declining volumes and idled container ships. Oblivious to all this, far too many governments are striving manfully either to reduce the remaining returns directly, or make the labour which helps provide them artificially expensive, or both.

Add in Europe's *Volkseinwanderung*, the internecine crescentade in the Middle East, the simmering tensions between the Great Powers in any number of locations and it is easy to read something horribly *fin de siècle* in all this. As in Shakespeare, the stage direction for 2015 might well read: *'Exit, pursued by a bear'*.

Sean Corrigan

IL MILIONE: Tales from Cathay

One must suppose that Xi and Li will be looking forward to the Lunar New Year break with more than their usual anticipation after yet another chaotic week on the financial markets in China. Not that they will be putting their feet up by the fireside for it is becoming apparent that both politics and economics are coming to something of a head in the face of a drumbeat of dispiriting data.

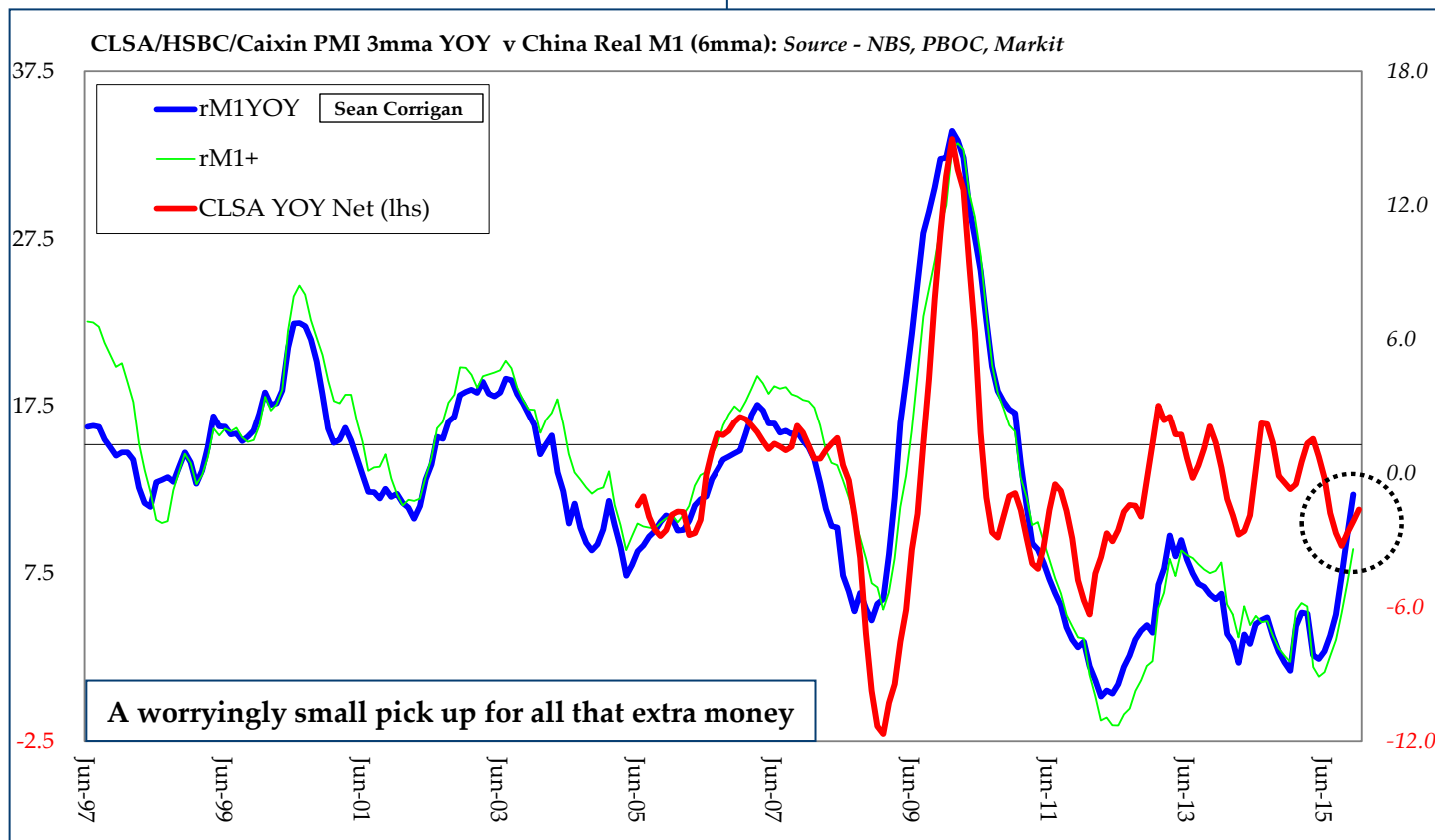
To their credit, Xi and Li are still talking the talk, even if they are still struggling – in the face of inertia, vested interests, and perhaps plain incomprehension on the part of their colleagues in government – to walk the walk.

It is of note that several lengthy articles have appeared in the press of late in which clear parallels have been drawn with the experience of 1998. These have tended to laud then-premier Zhu Rongji for both his wisdom and foresight in cutting away much of the dead wood which was choking growth in that era. It is also significant that much emphasis has been placed in such a retelling of the fact that it took three to four years of hardship before his efforts started to bear fruit but also that, when they did, the harvest more than compensated for the hunger pangs which had been suffered in the meanwhile.

Yet again, we hear Li vowing to avoid ‘strong stimulus’ and ‘flood irrigation’ as a metaphor for indiscriminate monetary laxity of the kind still being practiced in Draghi’s Europe. Expectations management here is not all about brainwashing people into spending what they cannot afford today for fear that prices will rise by 2% tomorrow, but is patently an exercise in preparing the populace for harder times to come.

Headlines were made when Li Wei of the CDRC opined that the 6.5% GDP growth needed to deliver the envisaged doubling of national income over the current planning horizon would be something of a stretch in current circumstances, but he was only making a little more concrete the sentiments given earlier voice in a major People’s Daily piece when what was coyly referred to as a ‘senior authoritative figure’ – surely Li, or even Xi, himself? – stated that ‘Supply-side structural reform is an urgent task that cannot afford any delay, otherwise the sickness will become graver’.

With clearly more of an echo of the far-ranging philosophy of Reganomics than the fatuous money illusion of today’s Abenomics, the speaker emphasized that the time had come to grasp the nettle. ‘There is now a window for us to roll out supply-side structural reform, but the opportunity won’t be there forever,’ he told the paper.



IL MILIONE: Tales from Cathay (continued)

Continuing in this admonitory vein, the Figure said that *'It's a pass that we must go through... Under the current situation, it is impossible to expect a V-shaped economic recovery through short-term stimulation... the national economy is likely to experience an L-shaped growth period.'* Devotees of geometry will here note that the second limb of an 'L' lies decidedly in the horizontal plane and is not angled upward 45° to the vertical like that of a 'V', so this is bleak counsel, indeed.

At the annual year-end meeting of China's top economic mandarins - the closed-door Central Economic Work Conference - the country's economic *Nomenklatura* had already wrestled the new doctrine into some kind of shape.

'We're not facing a lack of demand,' one such official confided to the press afterwards *'What we need to do is to carry out supply-side reforms to meet the unsatisfied demand'*

Reinforcing this insight, the People's Daily 'authority' said bluntly: *'Keynesianism won't help much in addressing medium-and-long-term economic ills. The cure lies in structural reform.'* In this face of such blasphemy, little wonder that it has emerged that the NY Times' chief economic rabble rouser now feels that China is doomed!

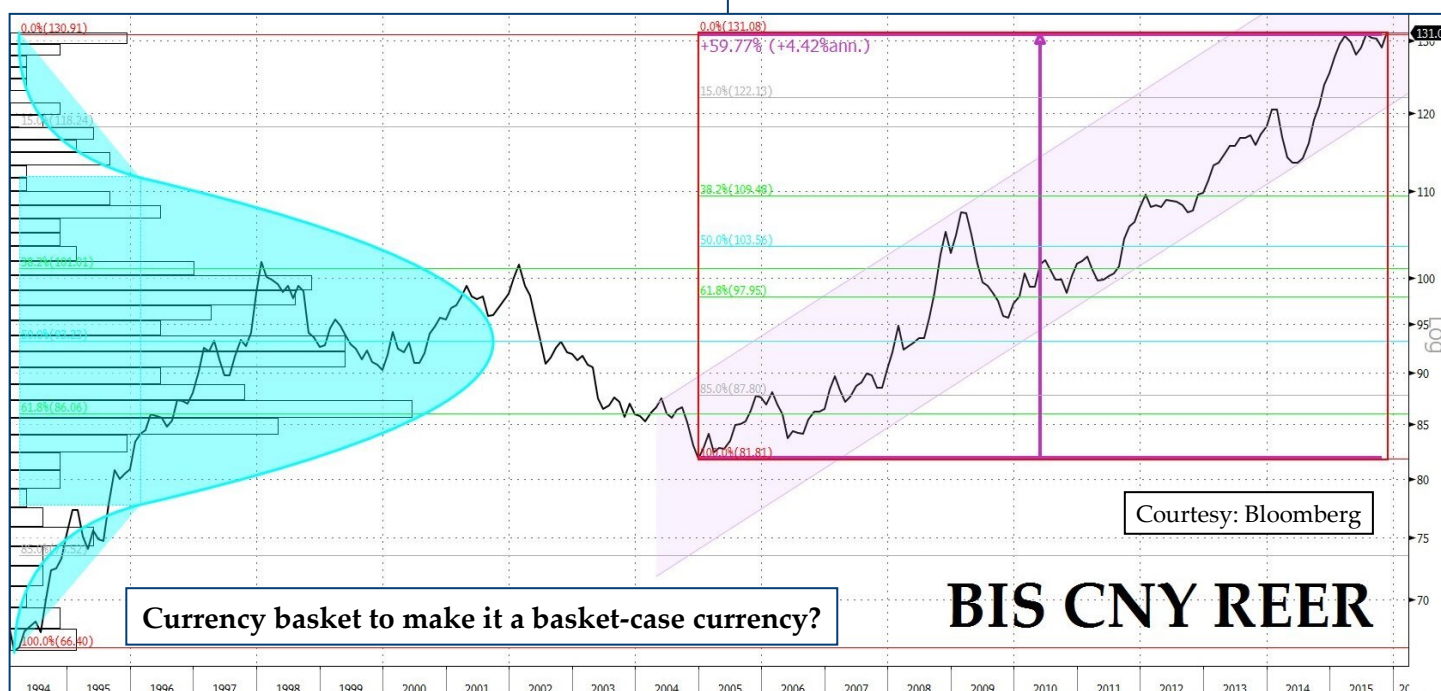
In the course of symposium symbolically held in the heart of the ailing Shanxi coal-belt, Premier Li led another high-powered grouping in what was this time a very public discussion of the nation's ills, personally stressing what is fast becoming the familiar theme that several key issues need to be addressed.

Excess capacity should be resolved, the financial system strengthened and debt levels reduced while deploying the social safety net and removing perverse career incentives among the local cadres. Old industries should give way to the new, measure to improve productivity should be enhanced and innovation should be encouraged, said Li.

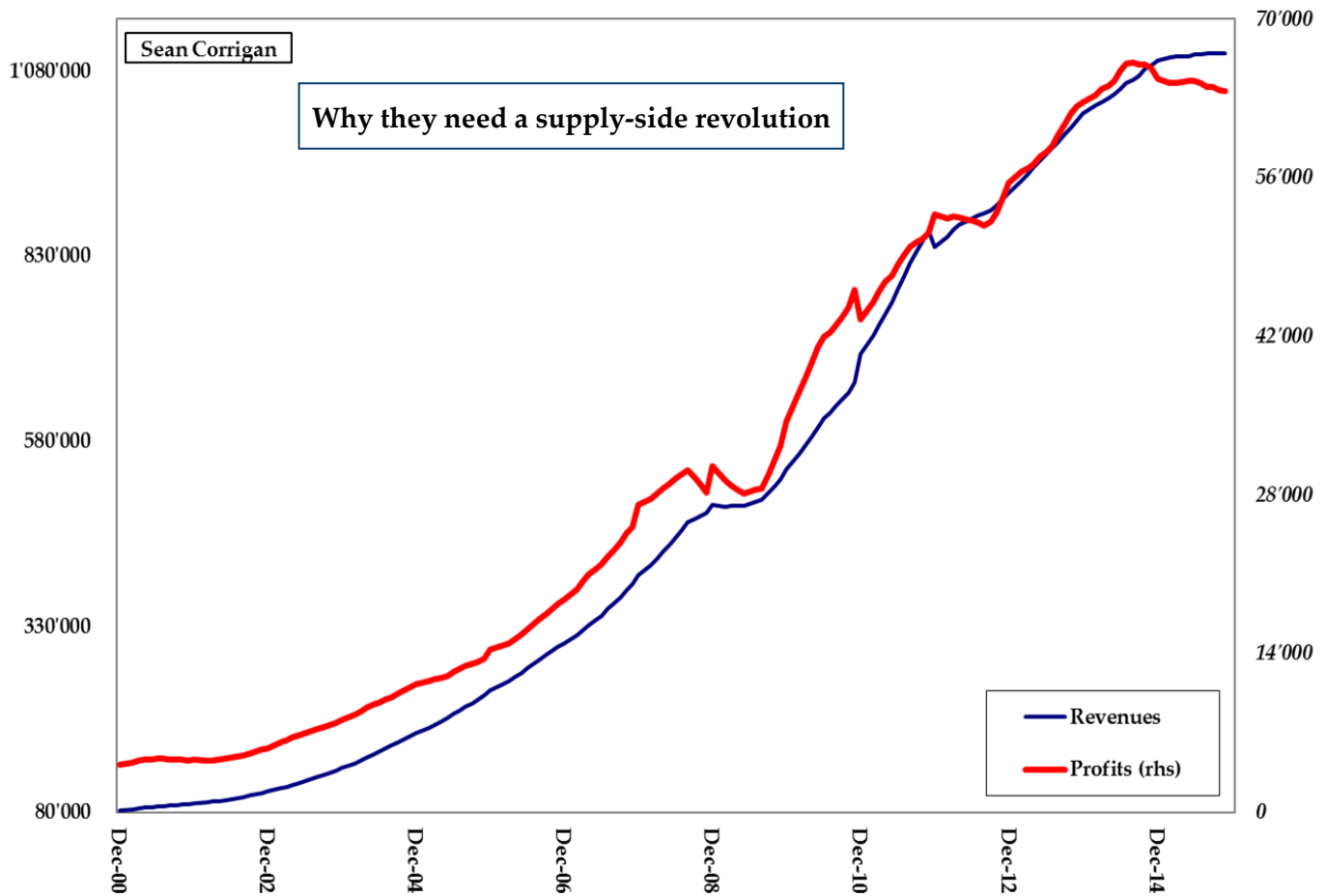
Yes, we have heard similar wish-lists being litanised in the past to all too little effect but the barrage of pronouncements screaming 'Death to the Zombies', together with the not-so-subtle enjoinders for compliance and 'moral' behaviour among the Party faithful (as instanced by the directives issued by Xi himself at the latest Central Leading Reform Group meetings) and the ongoing cases of 'Tigers' being arraigned willy-nilly *pour encourager les autres*, make it hard to avoid the impression that, this time - with all other options fast running out - the words might be in earnest.

If they do contain some substance this time, here is a summary of their intent: the allocation of labour, capital, technology, resources should be optimized; overcapacity should be tackled, zombies shuttered, and entrepreneurship fostered in promising new areas; government action should be more market-oriented; and the financial system should be reformed so as to support development of the real economy.

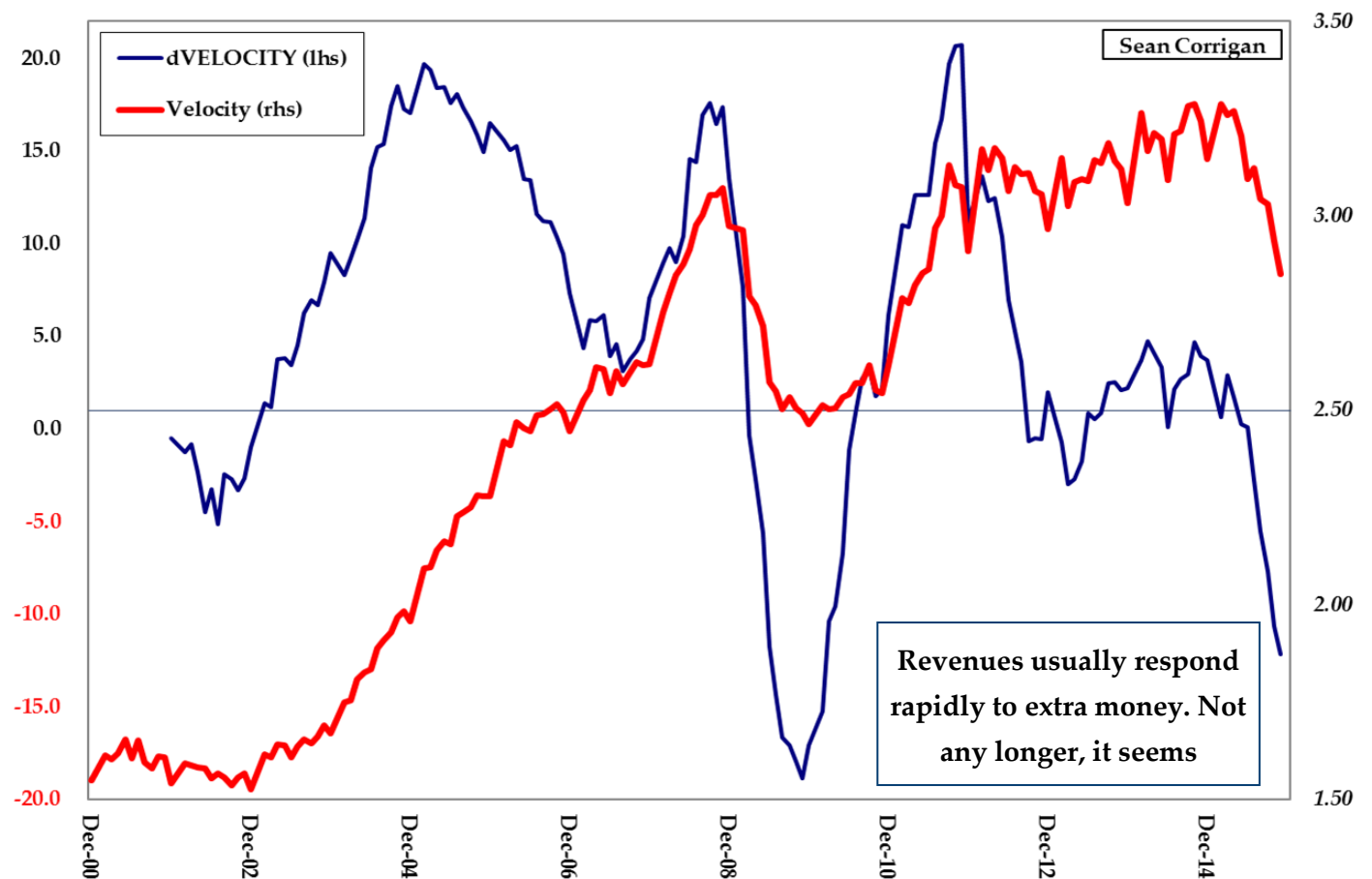
Though it would be naïve to think that this focus on the supply side rules out all chance of further monetary - and



CHINA Industrial Enterprise Profit & Revenues, Rolling 12 mos, CNY100 mln: Source - NBS



CHINA Industrial Enterprise Revenues v M1: Source - NBS, PBC



IL MILIONE: Tales from Cathay (*continued*)

especially fiscal – relaxation and even more credulous not to ask how far the regime will really go in allowing the emergence of bottom-up solutions rather than continuing to subscribe to the myth of top-down omniscience, it does leave the impression that the attempt will at last be made to change the overall approach. That could be something which has profound ramifications for us all.

Double, double, Toil and Trouble

Bringing all this to a head, it is all too evident that the overhang from the summer's disastrous equity bubble still plagues the functioning of a market which the authorities must be desperate to restore to working order so that they can use it to lessen the productive sector's perilous over-reliance on bank finance (both covert and overt) by persuading the masses that their savings are better held in the form of ordinary shares than as WMPs or P2P Ponzi schemes.

Alas for them, they have already seen one step forward and two steps back being taken in the infant days of the new calendar year as the imposition of a circuit breaker mechanism - constructed with trigger levels so closely

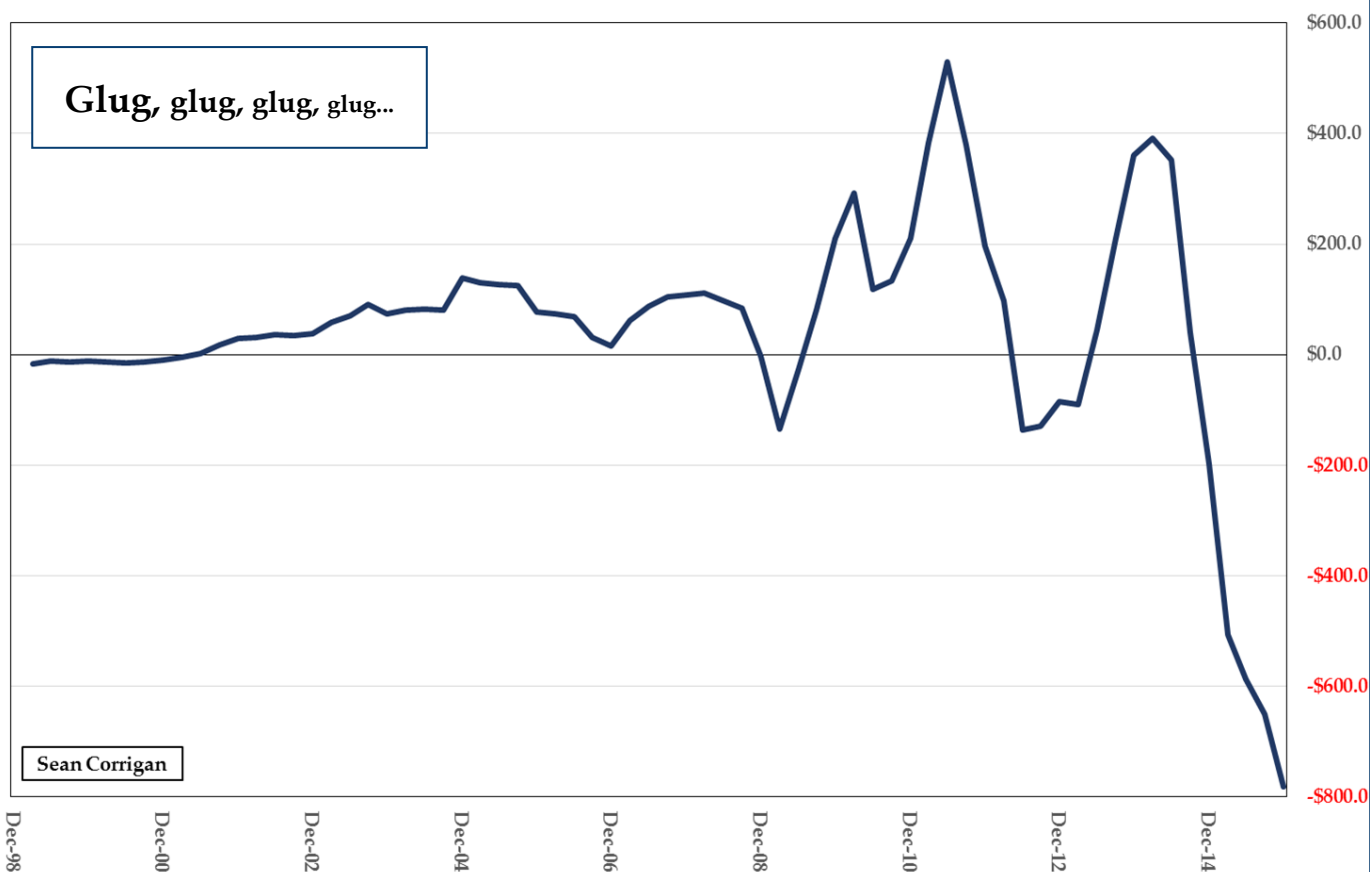
spaced as almost to ensure a total suspension of trade once any appreciable selling pressure were to mount – had to be ignominiously retracted after only two days of operation to the accompaniment of the bugles of the Plunge Protection cavalry riding to the rescue.

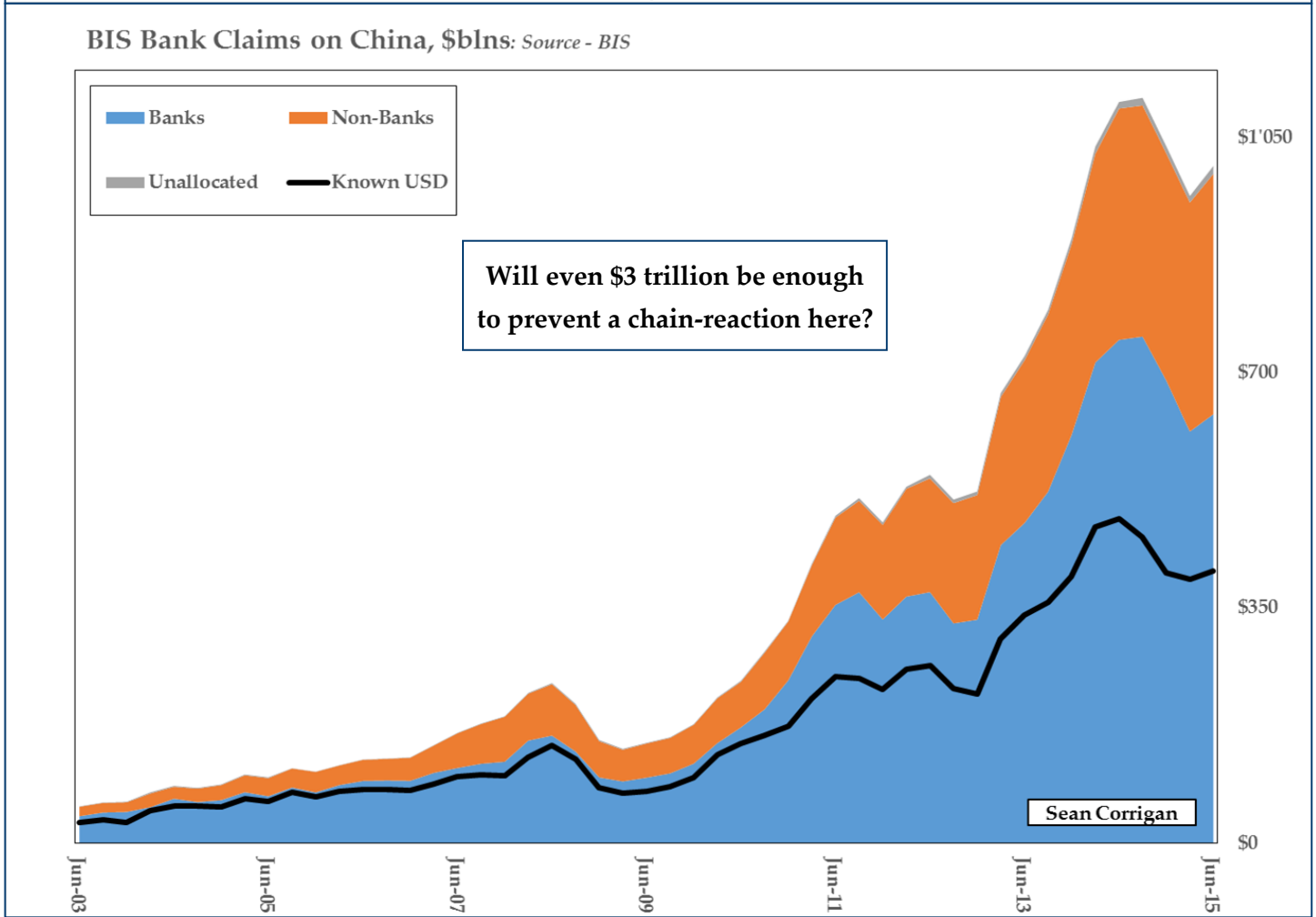
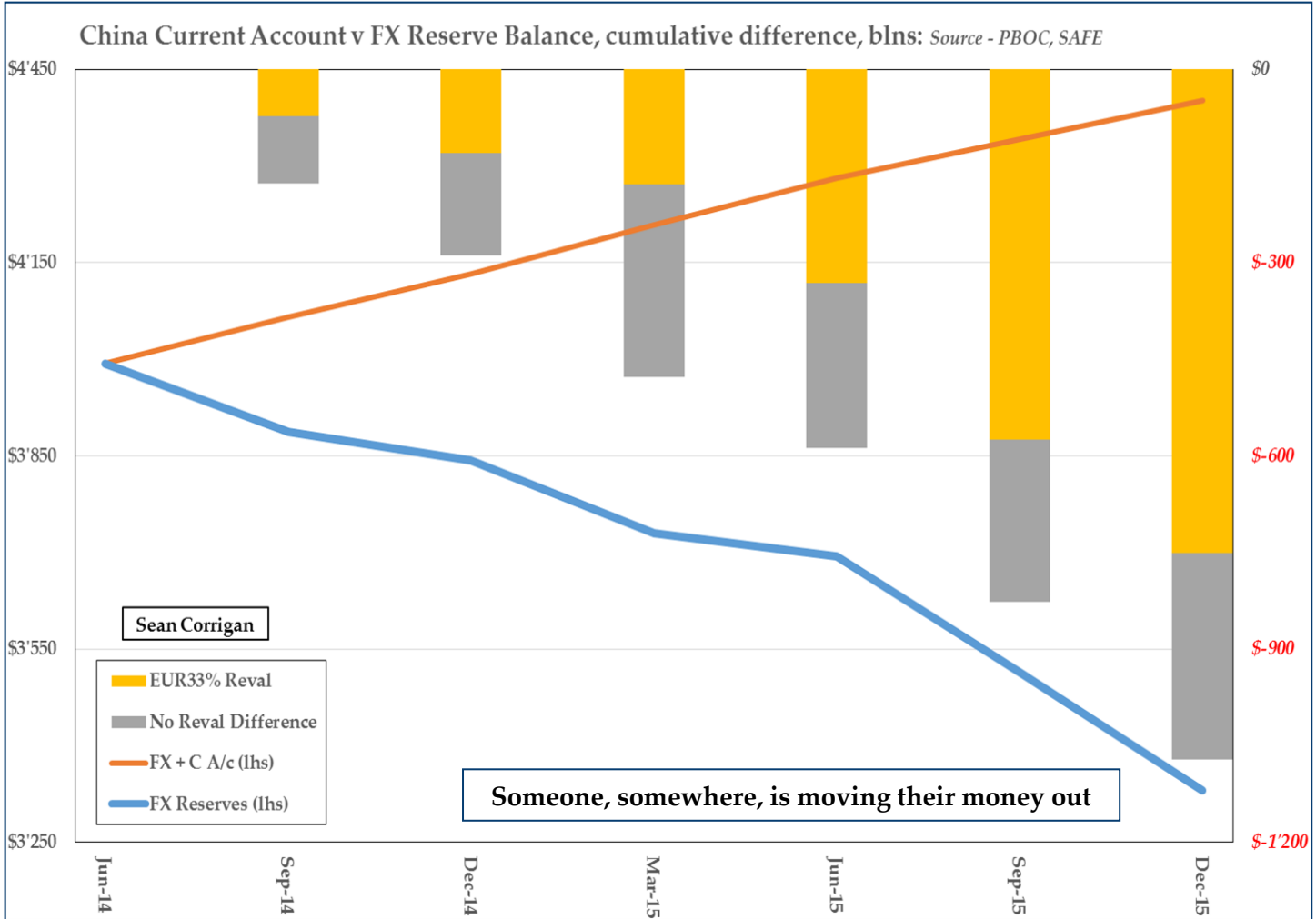
Whether the latter were being commanded by George Armstrong Custer or Philip Sheridan is a question as yet undecided: battle still rages.

Following up in the attempt to dispel the gloom, CSRC spokesperson Deng Ge was eager to assure those attending a scheduled news conference late last week that, in light of a spate of stories forecasting that a pending simplification of the listing procedures would unleash a flood of up to 400 IPOs in the coming year, the regulator would '*...make rational arrangements regarding IPO approvals in order to insure a smooth transition from the approval system to the registration-based system.*'

Further to ram home the message that prospective buyers need have no fear of being swamped by insider selling, the Shanghai Exchange followed up by banning all those owning 5% or more of any listed stock from selling more than

Chinese Current Account - Accumulation of Forex Reserves, 4Q sum, blns: Source - Bloomberg





IL MILIONE: Tales from Cathay (*continued*)



the equivalent of 1% of such a company's total capital in any three month period. Though one can understand the intention, this was perhaps not a restriction best guaranteed to encourage those nervy new investors to enter the fray in any size.

As well as being unusually vulnerable to the ongoing delivery of downbeat macro news, the course of the stock market of late has been intimately bound up with the fate of that other barometer of faith in the economy, the exchange rate.

Here again, after several days of panicky dealings and much rumoured intervention, emollient words have not been lacking with the PBoC declaring stoutly on its website that even though *the '...international and domestic financial situation remains complicated and severe...'* and despite the fact that nefarious capitalist running-dogs had engaged in a shocking attempt to *'...profit from speculating on the yuan'*, all would in fact be well.

Such activity, you understand is utterly *'...unrelated to the demand of the real economy and does not reflect the real market demand and supply, which only leads to abnormal fluctuations in the yuan's exchange rates and sends the wrong signals to the market'* – that last something which, presumably, is a monopoly privilege of an increasingly hapless officialdom.

'Faced with the speculating forces, the central bank has the capabilities to keep the yuan basically stable at a reasonable equilibrium level,' Central Mother admonished in a not entirely convincing manner.

Oh, and, in case you were wondering, the Bank also vowed to carry out *'prudent monetary policy'* while working to

ensure *'reasonably abundant liquidity'* – intentions not necessarily in concord with the vow to crush the speculators even if it has succeeded in driving rates sky high in the much thinner offshore market.

Nor will anyone overlook the potential significance of the formal admission by the PBoC's Ma Jun that, as has been widely suspected, the Bank was indeed now applying a currency basket system, not a dirty peg to the US dollar alone, and that this change had been enacted to stabilize the *'foreign trade competitiveness of the country'*.

For its part, SAFE has, of course, already been active in banning certain unnamed foreign banks from trading and in insisting that rules should be rigorously applied while threatening that inspections would be intensified. The exercise of *'moral suasion'* seems to be in full swing in other ways, too.

With local press reports suggesting that banks in Shanghai and Shenzhen have been swamped by customers wanting to swap their depreciating yuan for the mighty greenback or its HK shadow, there is talk not just of ad hoc limits of \$5,000 per transaction being imposed (together with a limit of three such transactions a week) but of the need to book appointments to conduct the swap as much as a week in advance. Actual cash shortages are also occurring. Conveniently, it seems that online banking systems have meanwhile been suffering glitches and black-outs, further frustrating those anxious to move their funds into what they perceive to be a safer currency with an urgency described by various employees of the Big 4 banks to the People's Daily as *'scary'*.



As a back-up to such restrictions, SAFE added to the soothing chorus, saying that reserves remained '*relatively abundant*' and that the nation's financial system was '*largely stable*' – though the more anxious among its audience might well have found those qualifying adjectives an exercise in damning with faint praise. For its part, Xinhua was sufficiently alarmed to publish a major article in which it sought to persuade its readership that the currency was unlikely to depreciate fast enough to make up for the loss of interest suffered when holding dollar instead of yuan deposits at the bank – a line of argument which surely rang a little hollow with all the good people engaged in what the mischievous might call an incipient *bank run* at the nations' foreign exchange counters.

The Hole in the Wall

The numbers, of course, tell a somewhat different tale to that being espoused by the regime, as typified by last week's revelation of a record, one-month drop in the reserve count. As bad as this was, it merely continued a trend which has been intensifying ever since reserves peaked out in June of 2014 – about the time that the oil price collapse began, bringing a run on emerging markets in its train.

Since that brief high point, China has lost \$663 billion in reserves at the same time that it has recorded a cumulative

current account surplus of over \$400 billion – a combination which implies a drain of more than \$1 trillion, or not far shy of \$2 billion a day. As much as one third of this could be ascribed to revaluation effects on the reserves non-USD components - perhaps those which mirror the proportions to be found in the newly-prominent trade-weighted basket (of which more below)?

But even if some reasonable fraction of the remaining \$750 billion represents no more than a shift from public to private holdings of foreign currency, this still leaves us with irrefutable evidence that a mighty flood of money has poured across the borders, much of it falling into the 'unidentified' category in the BOP numbers which, last quarter, was nigh on as big as the official total itself.

All in all, China was responsible for three-fifths of the growth in the world's foreign exchange reserves during the 2 ½ year period from Dec-12 to June-14 and accounted – with a pleasing degree of symmetry - for three-fifths of the losses sustained globally in the subsequent 18 months of emerging market flight and commodity price collapse.

At this juncture, it may seem as though the \$3.3 trillion which remains in the war-chest would be more than enough to tide the country over, but we should bear in mind the experience of the 'Asian Tigers' in the late 1990s, when seemingly prudential levels of official reserves were

IL MILIONE: Tales from Cathay (*continued*)

nevertheless unable to be mobilized so as to shore up the tsunami which struck often highly-leveraged corporate balance sheets. Indeed, as SAFE made known in its latest bulletin, a major contribution to QIII's \$150 billion drop in liabilities (and hence the concurrent \$180 billion drop in reserves) was due to those worried about the currency risk paying down such debt on just those grounds.

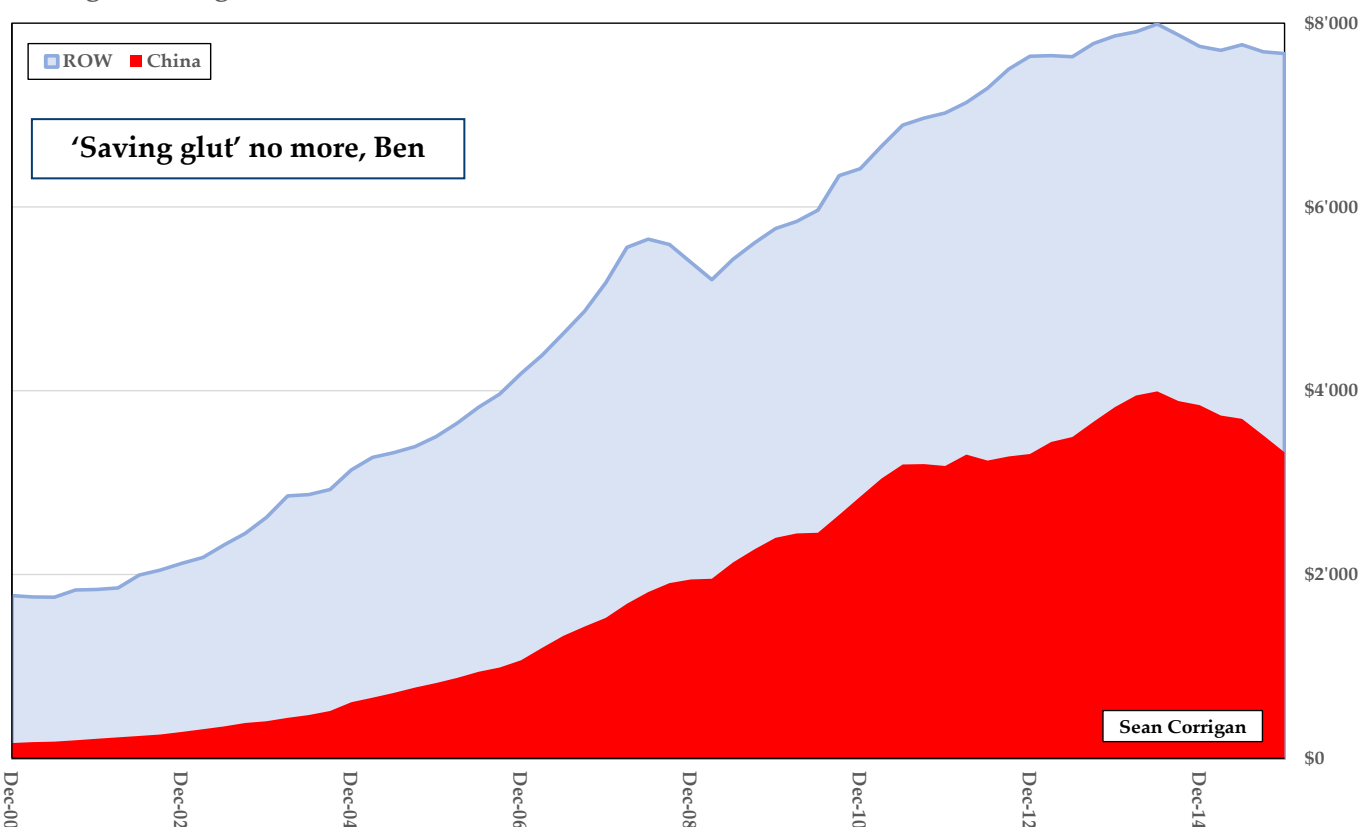
Overall, the first of the best two fixes we have on the scale of China's current vulnerabilities comes from the BIS which tells us that, as of June, its member banks' cross-border claims on the country amount to just over \$1 trillion of which total close to two-thirds was owed by financial counterparties and two-fifths was denominated in USD. For its part, SAFE set the nation's external debt exposure in September at a larger \$1.53 trillion, roughly half of that being short-term in nature, an overlapping half being denominated in foreign currency (predominantly US dollars), and just under a third comprising liabilities of non-financial entities.

On the surface of it, then, there would appear to be more than \$4 remaining in the coffers for every \$1 owed to the outside world, but before we allow our fears to be totally allayed by what seems to be a generous margin of safety, let us call to mind that a sizeable part of those reserves –

having been put to use in support of all sorts of strategic initiatives of often dubious commercial merit over the years - will not be composed of anything liquid enough for the mounting of a swift defence. Secondly, we should reckon on that – as is ever the case – if the tide really does start to rush out of the harbour, all manner of sub-surface mines are likely to be uncovered in the form of hidden liabilities and derivative nastiness, hitherto unsuspected. Finally, if panic does eventually set in, the debtors' rush to cover past borrowings will be greatly magnified by the creditor classes' simultaneous urge to preserve the value of their savings in whatever manner the authorities will allow to them.

In summary, while a meltdown must still be confined to the outer tails of likelihood, we would do well not to become overly reliant on linear arithmetic or on official blandishments to stay calm.

Foreign Exchange Reserves, blns: Source - IMF, PBoC



WHERE THE MONEY GROWS: Wall St. and West

Since we last wrote at length, no-one will need reminding that the Fed finally summoned up the resolve to enact the long-awaited rate hike to the accompaniment of much rhetorical bluster as to how the newly-invigorated Committee foresees the delivery of a further four increments of 25 basis points over the course of the year, conditional – as ever – upon their reading of the data (and, naturally, the direction of the political weathervane).

Ironically, if one disregards the fraught state of the stock market - which is arguably being buffeted about by a different set of adverse winds – it is not entirely obvious that the FOMC did anything at all. Next year's eurodollars, for example, sold off 20 tics either side of the mid-December meeting, only to rally all the way back to 9-10 week highs. 2-yr Treasuries spiked 15bps higher in yield to a 5 ½ year peak - only to give it all back since the turn of the year.

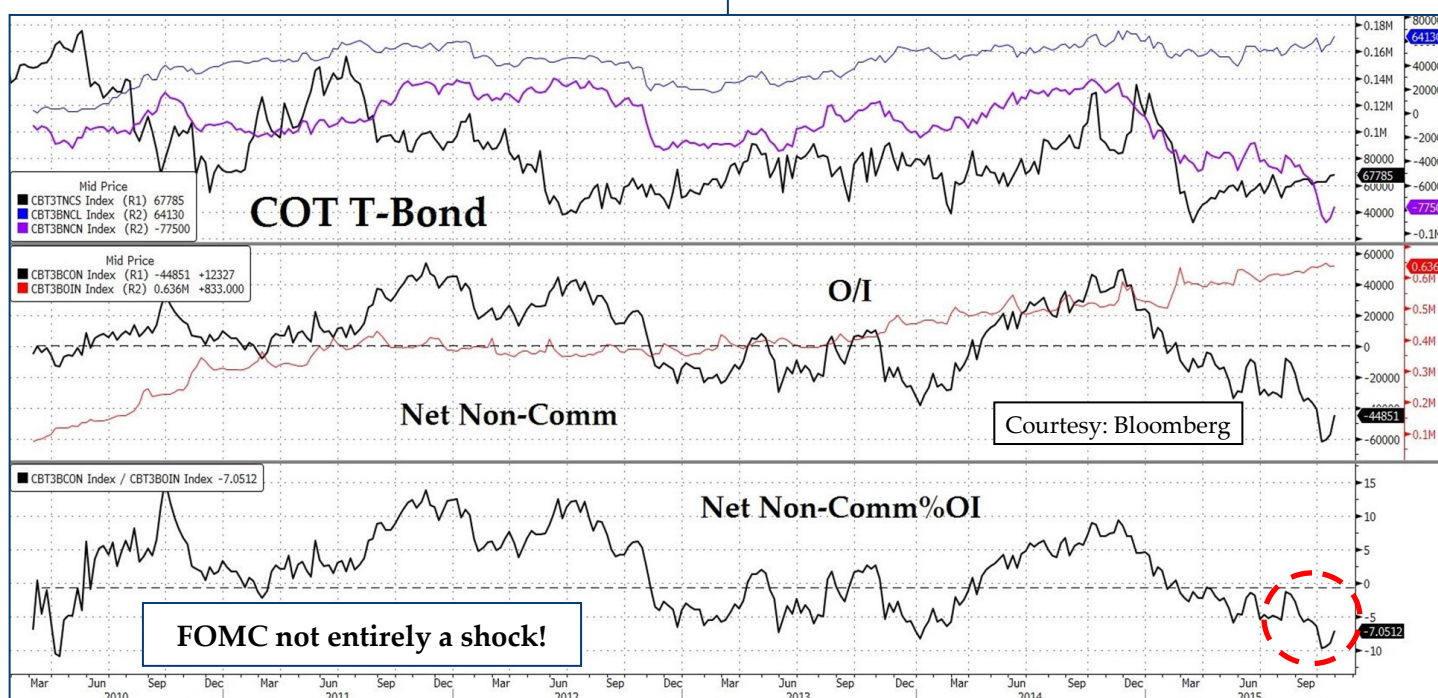
Swaption vol is back at the same level as before, so no-one has much appetite to bet on big moves in rates. Long end swap spreads have plunged back to near-record negative levels and indeed have been joined for the first time ever by maturities as short as 4-years, so presumably the hunger for better quality assets is as intense as ever in some sectors of the market. Even junk yields have seen their previous seven months' steep ascent ease over into level flight just shy of the 9% mark.

Similarly, if some EM currencies continue to suffer, not so the majors and thus the dollar's TWI is exactly where it was eight weeks ago back at the start of November when it first broke, somewhat tentatively, out of the previous 10-months' range.

What *has* changed perhaps is market sensitivity to bad news. As we have written, ever since the Crisis first broke out what seems like half a lifetime of bad economics, special pleading, and serial political incompetence ago, the myth of the 'Ghost of '37' has exerted a powerful influence on the market but now it howls more hideously than ever.

Given that a whole generation of bull market geniuses has grown to maturity since QE was first inflicted upon us and given, too, that most people's economic understanding stops and starts with some mindlessly-repeated piece of cod-Keynesian quackery, it seems both past bearing and beyond comprehension to the Many that the world will not instantly fall apart around them if the Fed persists in its 'mistake' of not striving to deliver them largely unearned, inflationary returns of 16%+ per annum as it has managed to do for much of the past six years.

Which is not to say that the US recovery will run faultlessly onward, its throbbing pistons never missing a beat along the way. This is, after all, a very mature cycle and the errors in its genome are starting to accumulate, the accretions of old age beginning to show through its slightly sagging flesh. *Yikes, Scooby!*



WHERE THE MONEY GROWS: Wall St. and West *(continued)*

Governmental stupidity aside – and there is enough of that to go round between the EPA, the Department of Health, and now those pushing for wider implementation of that routine job-killer, the minimum wage – cycles tend to succumb to the weight of their own success as entrepreneurial discipline weakens and heroic acts of both CEO hubris and suburban overstretch occur under the baleful influence of elevated stock prices and depressed bond yields.

Indeed, 2015 saw record volumes of US high grade corporate debt issued, the \$100 billion-a-month pace accounting for almost half the worldwide total and representing the fastest pace in Thomson Reuters' 36-year record. Adding to that, US borrowers also spoke for half the global pool of syndicated loans – adding a further \$2.2 trillion to their tally in the process. A good part of that was contracted for nothing more productive than the \$437 billion of equity buybacks which took place over the first nine months of the year – a total only ever exceeded in a like period at the very pinnacle of the previous bull market in 2007. M&A absorbed another chunk as, once again, almost \$1 in every \$2 in a worldwide \$4.7 trillion orgy of dealmaking – yet another all-time high – involved American companies, the \$2.2 trillion spent in the course of almost 9,962 transactions scoring a whopping 64% increase on 2014's total. Private equity contributed a substantial \$700 billion to the pot, the

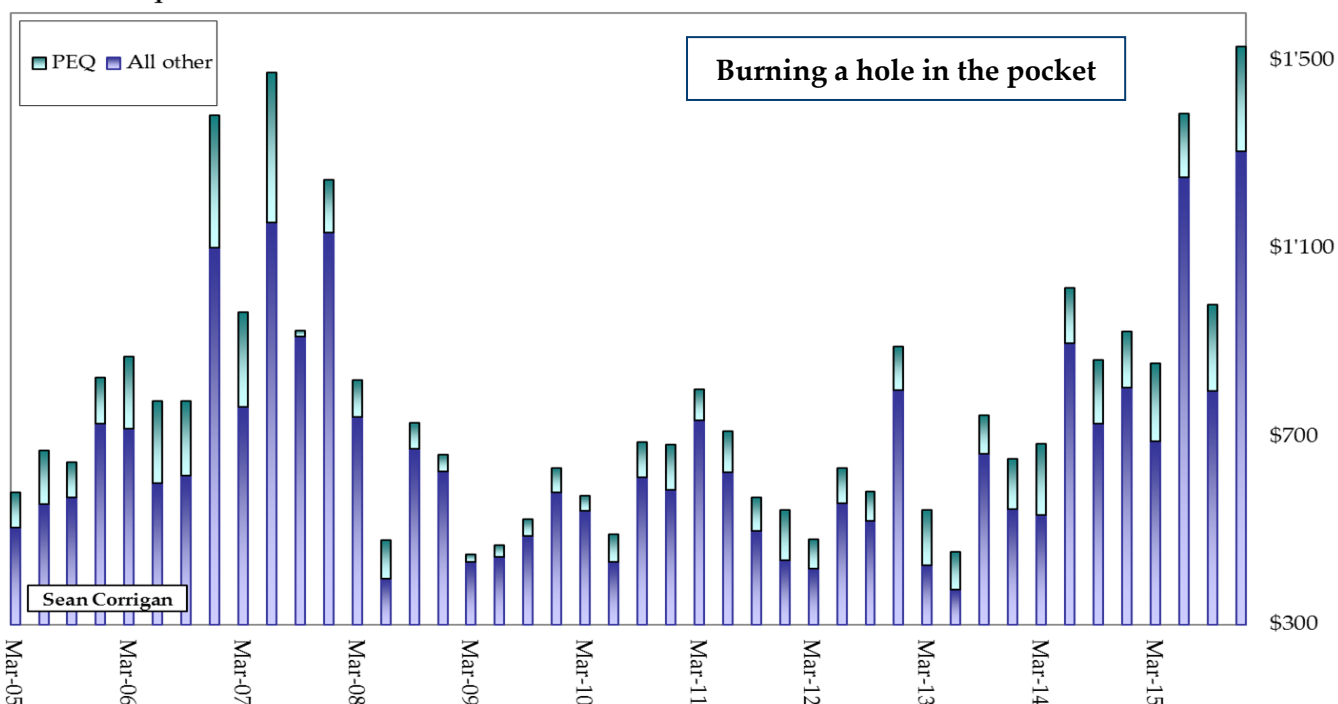
largest such figure since—you guessed it—the last bull market high, eight years ago. Do you suppose for a moment that this will all turn out to be money well spent?

Many of the classic late cycle signs are emerging elsewhere across the system. Consumer credit is rising, especially in relation to autos. These may be cheaper to run thanks to Harold Hamm and the boys, but the car is still a pricey, rapidly depreciating asset whose resale value may be about to plummet given the record numbers expected to be coming off lease this year. Self-liquidating they are not!

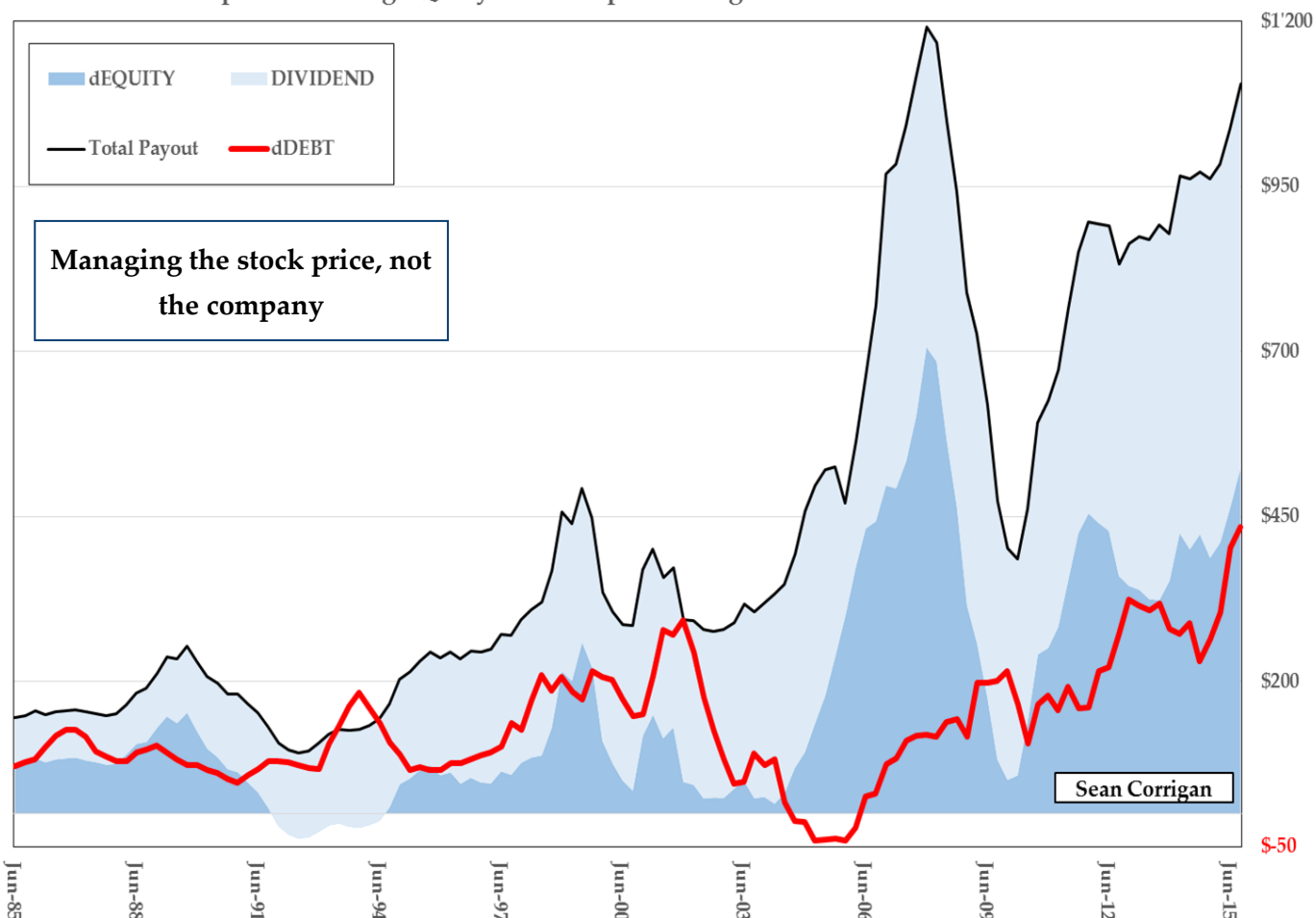
Another interest-sensitive, incorrigibly unstable area, construction, is presently toward the front of the pack in terms of hours worked and payroll outlays. As is typical of a system where money rates are too low for long-term sanity, such non-tradeables are beating out the tradeables (exports are struggling in the US, as elsewhere) and the front end of the nationwide assembly line which we Austrians call the 'structure of production' is doing far better than the back end where extractive industries are, of course a disaster, and where manufacturing is finally beginning to falter.

While that mix persists and the exhaustive-consumptive strength masks the productive-creative weakness, the Fed is likely to hew to its line. If and when it backtracks in the face of some intensifying level of adversity, the howl of 'I told you so' will be truly deafening even though the most vocal of the naysayers will demonstrably have had no real idea of the underlying forces at work.

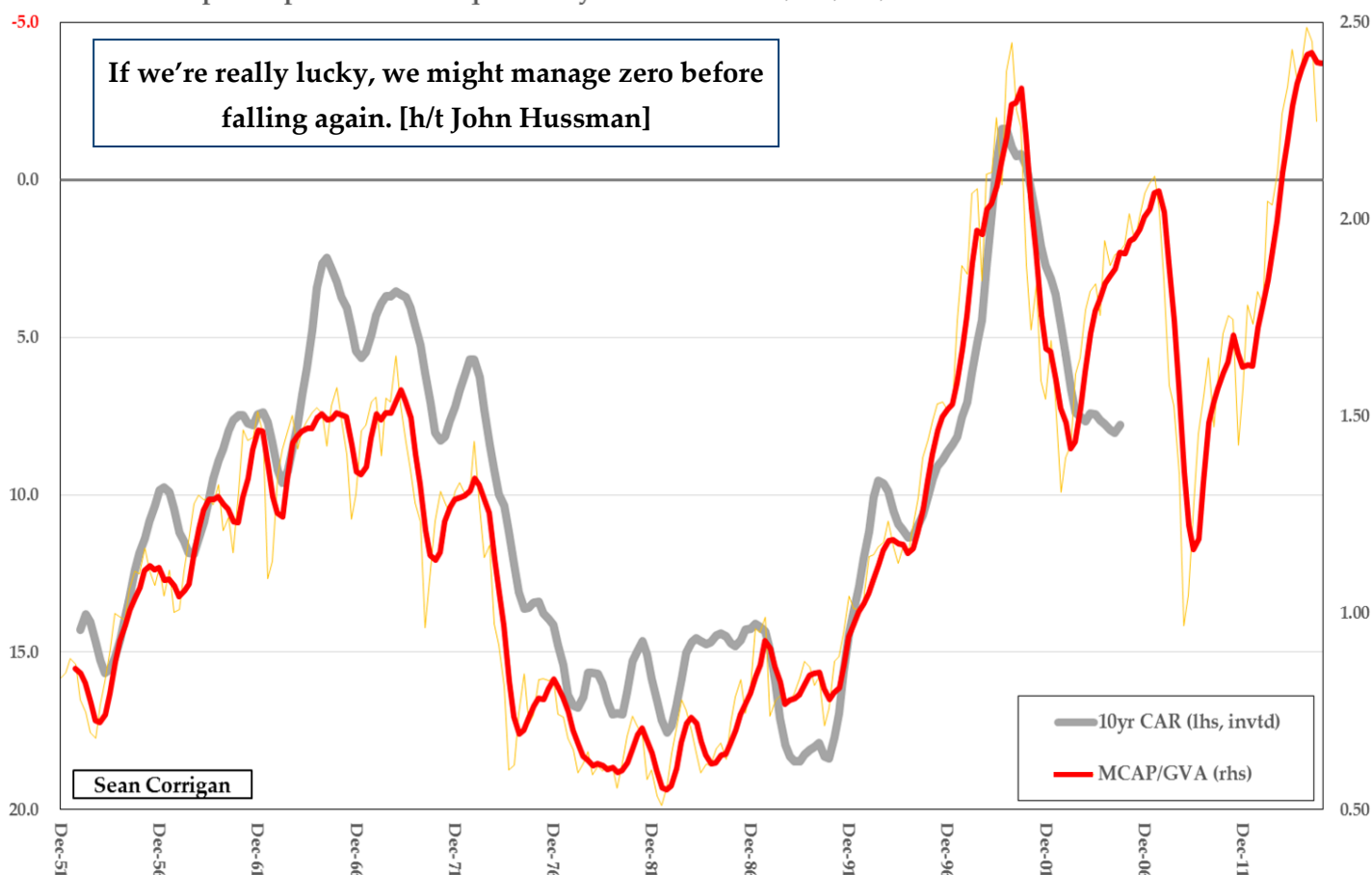
Global Acquisitions announced (blns): Source - Thomson Reuters

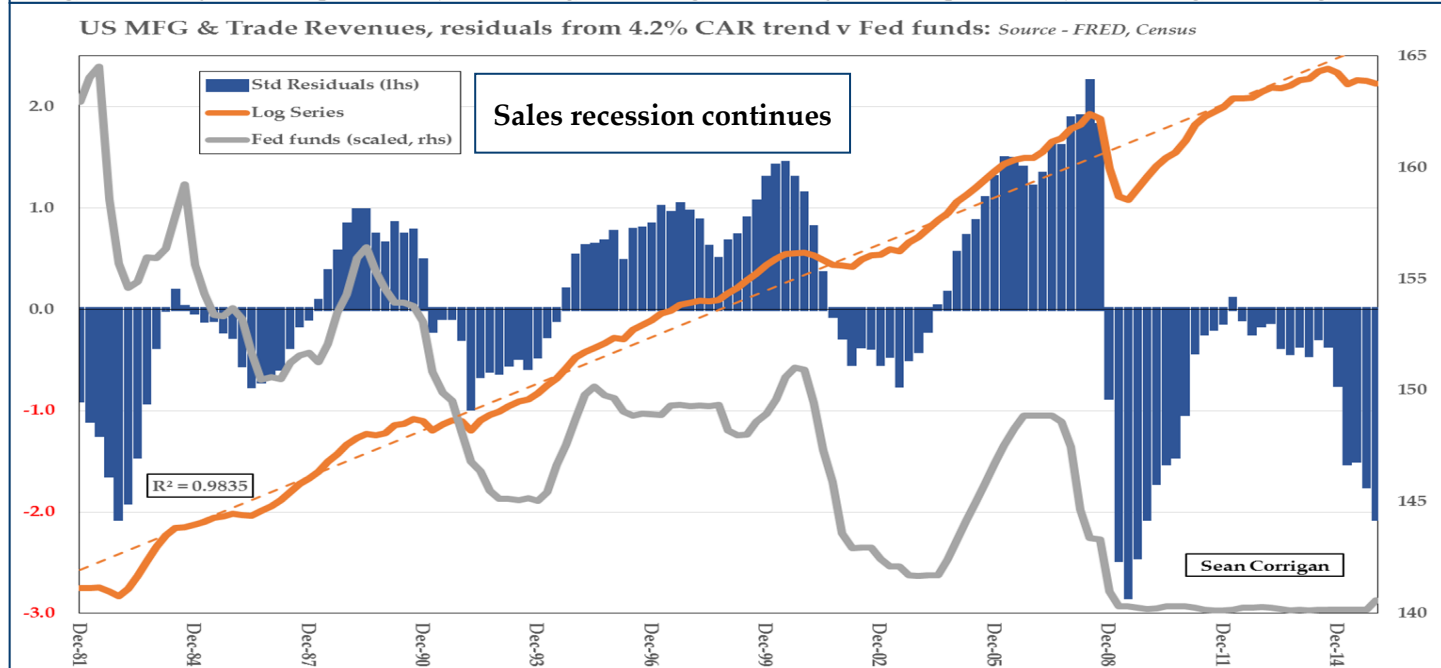
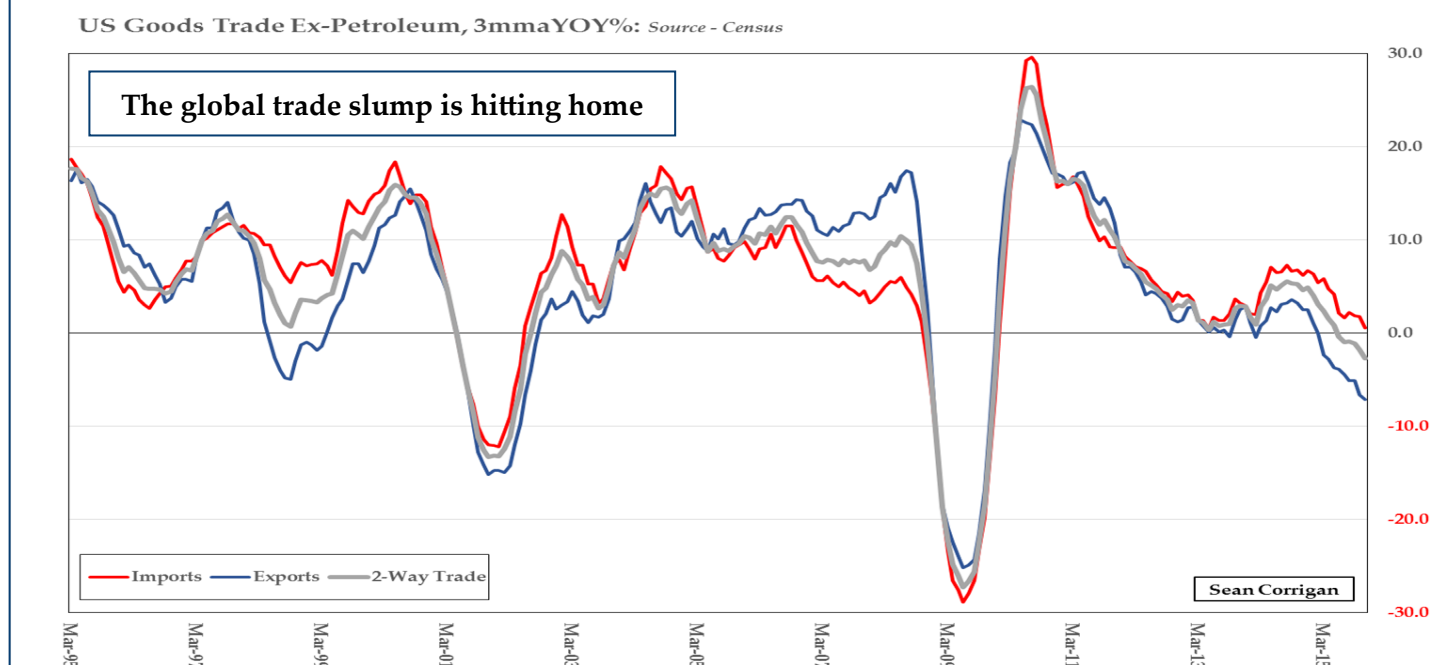
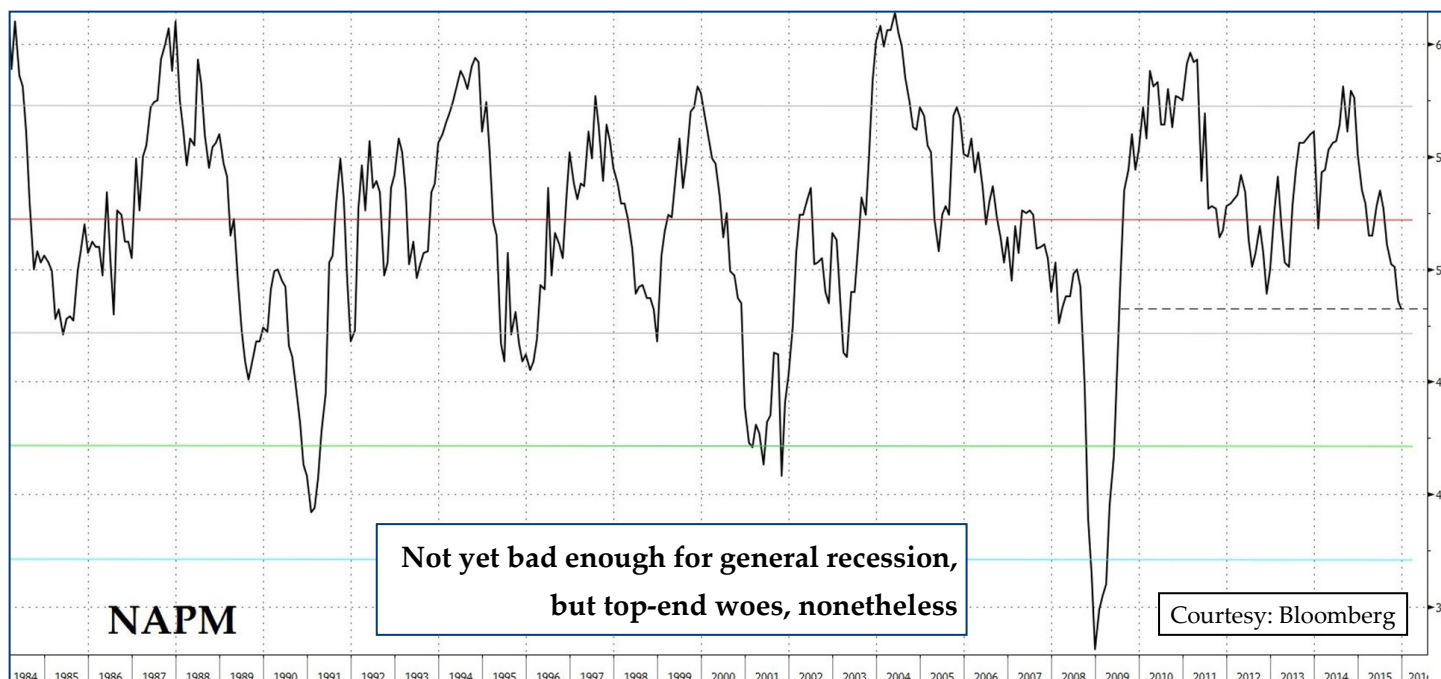


US Non-FIN Corporates rolling 4Q Pay-out & Capital change: Source - FoF

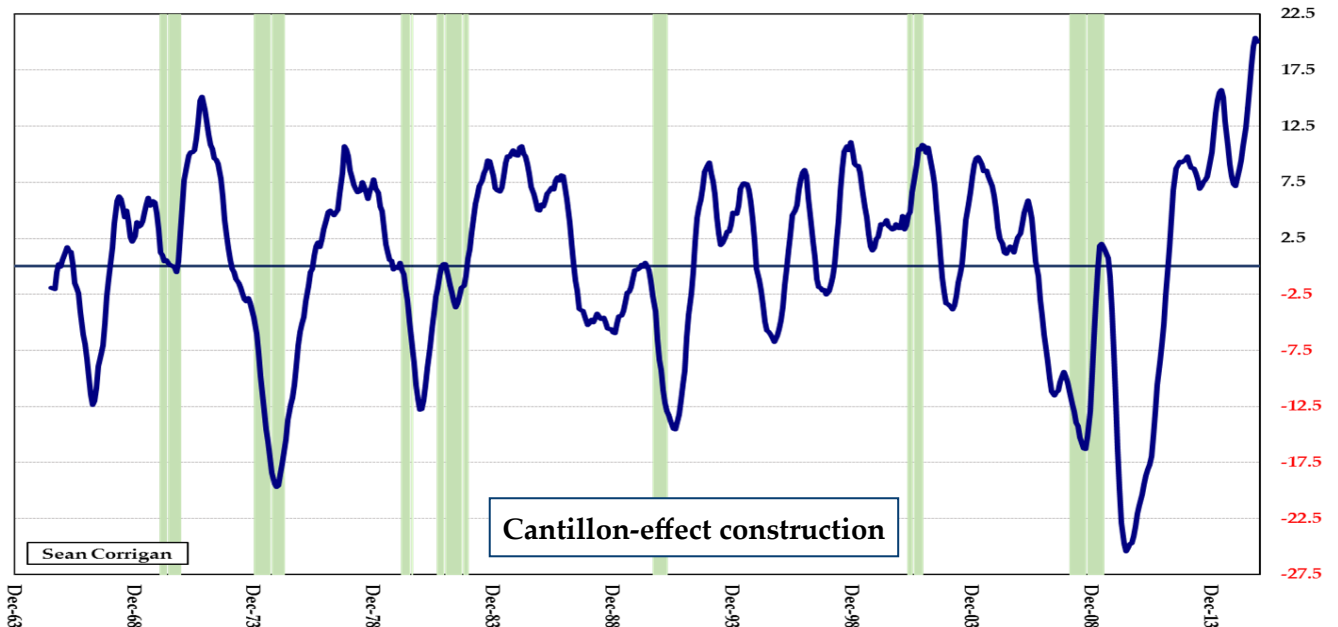


US All Corp MCap/GVA v subsequent 10-yr CAR: Source - FoF, S&P, BEA, Shiller

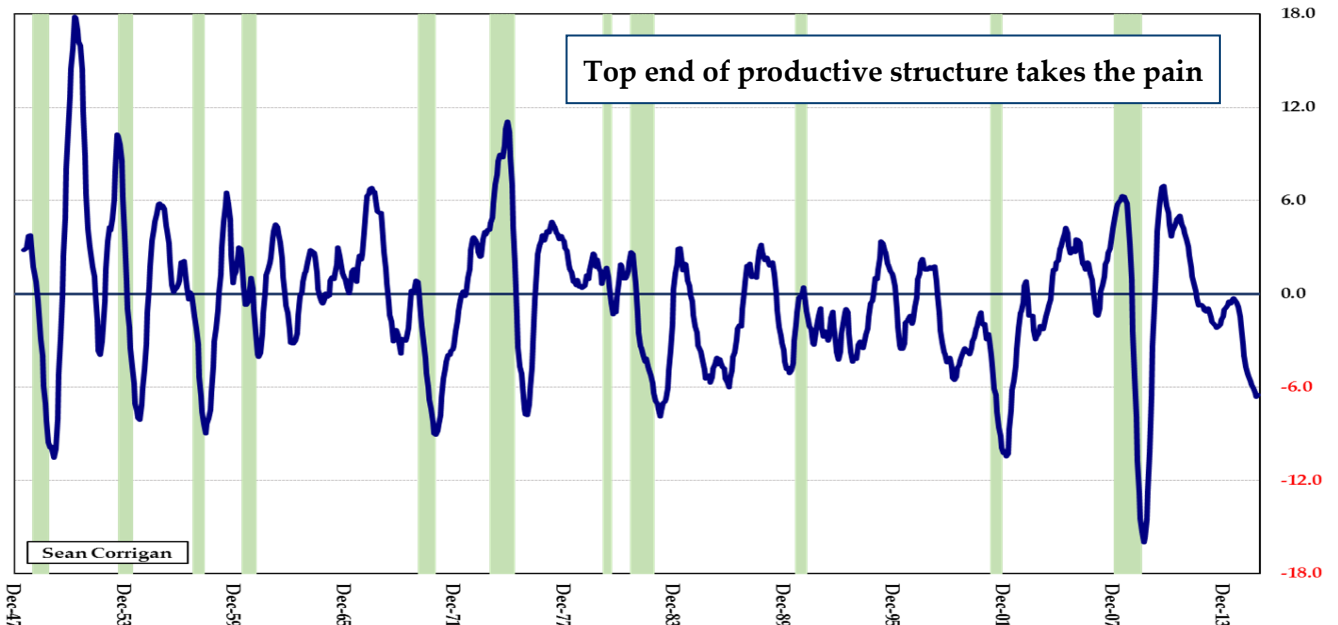




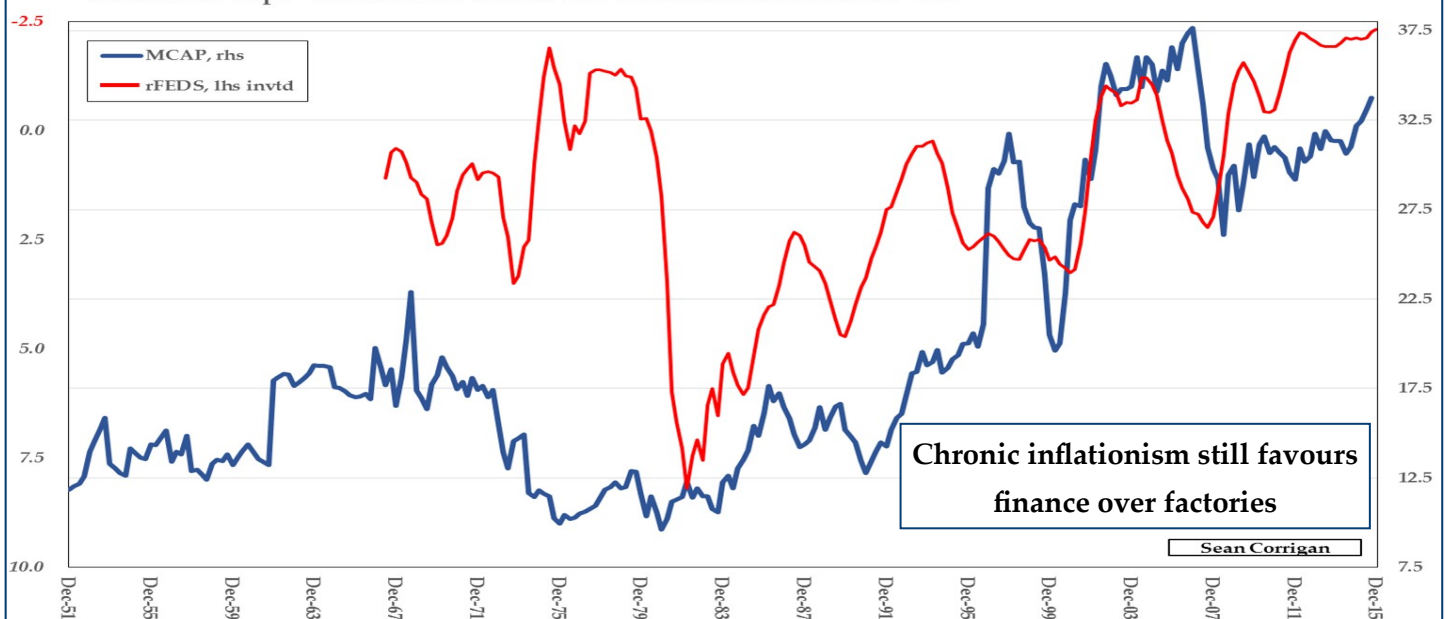
US Pvlte Construction v MFG Sales, 6mma YOY%: Source - NBER, Commerce



US MFG v Retail Sales, 6mma YOY%: Source - NBER, Commerce



US Market Caps - Financial as % Non-Fin v Real Fed Funds: Source - FRB



HEAVY FOG: The View from Albion

According to Mark Carney's latest pronouncements, the UK is not undergoing a 'debt-fuelled recovery'. Hmmm!

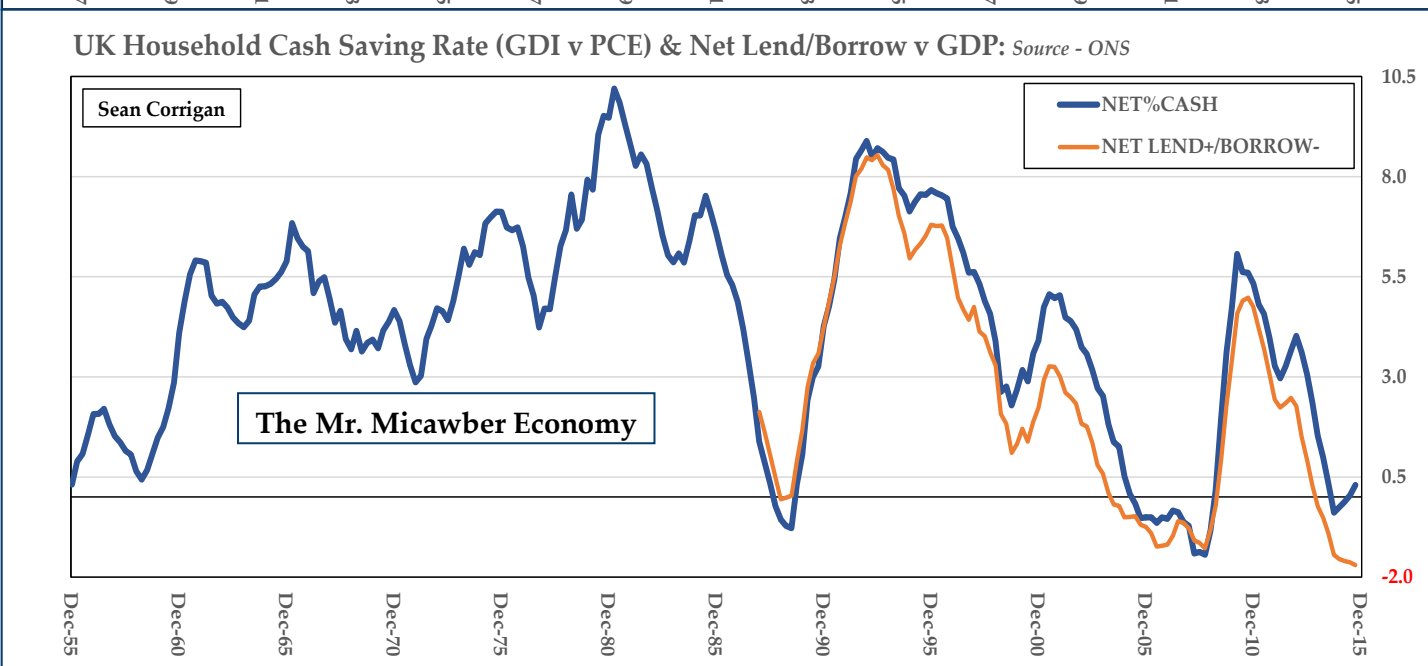
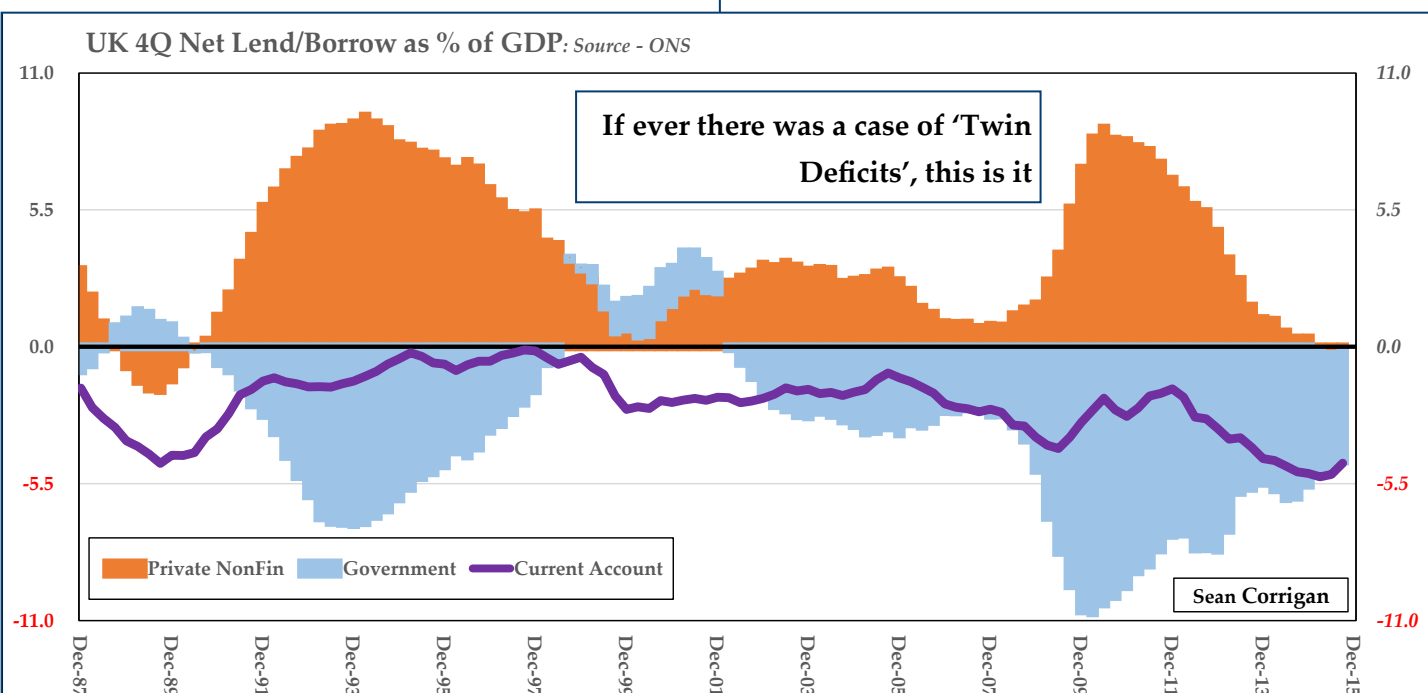
Prima facie evidence that things are running too hot is that the current account continues to wallow in the red to the tune of around £95 billion a year, around 4.7% of total and 6.0% of private GDP—and not because the country is importing vast quantities of capital goods with which to restore its flagging competitiveness, either.

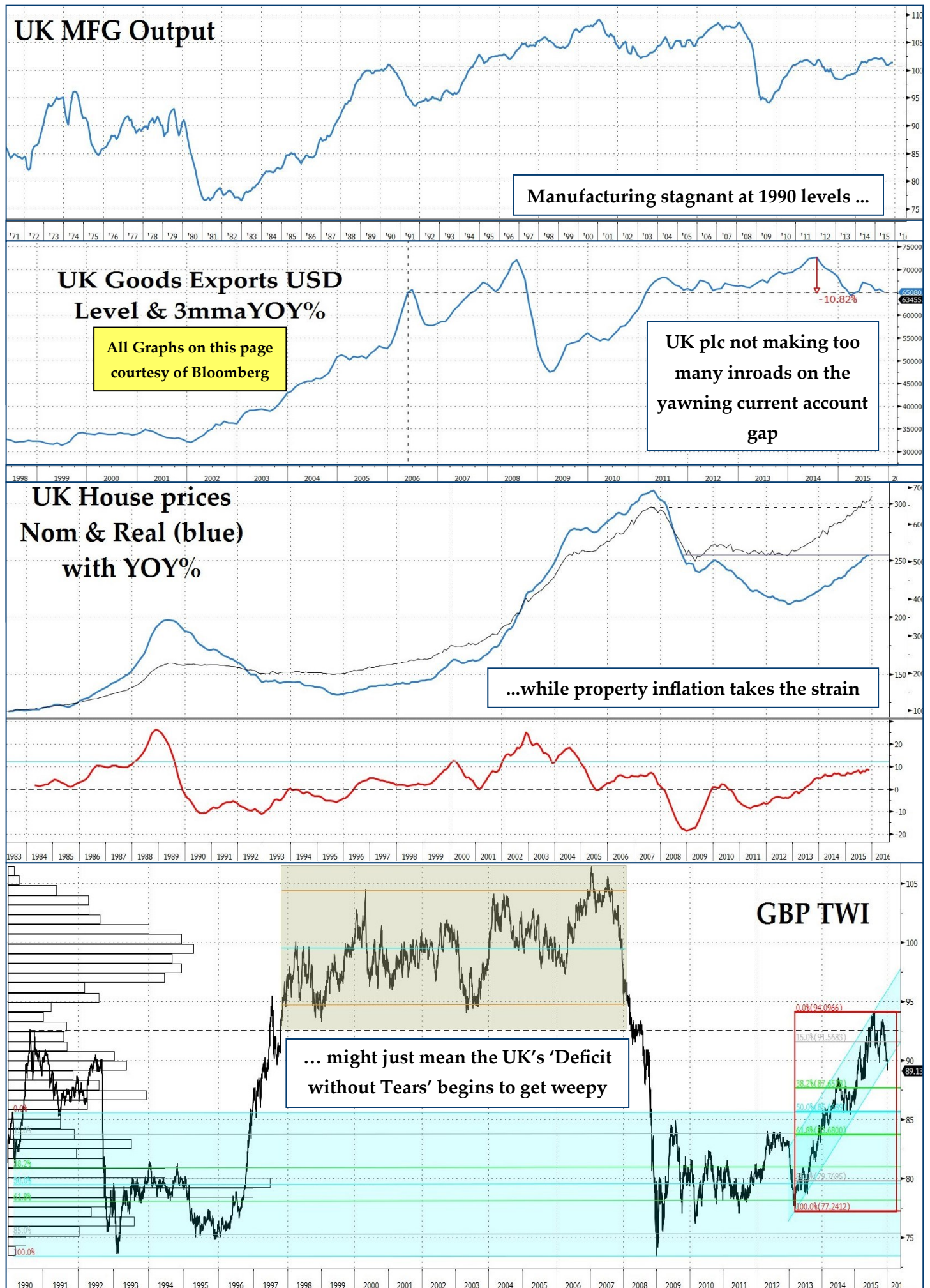
As the chart below reveals, the principal cause of this overspend—both arithmetically and functionally—is government. Its still sizeable deficit, four years into a much-vaunted recovery, almost exactly matches the external gap,

leaving the private non-financial sector in broad balance.

That latter happenstance, however, is a cause of concern of its own, for the typical relationship one would expect—of individuals foregoing current consumption in order to assist the provision of goods in future by investing in business—has been turned completely on its head in Britain. Business lend 1.7% of GDP: households borrow it. This means that firms are financing their own sales rather than putting resources to work to aid their own betterment.

Pace, our dear Governor, but as a result households are contracting net borrowings 50% greater in sterling terms than on the eve of the Crash, proportionately the largest on record.





ACTA DIURNA: The European Perspective

If there has been one welcome side-effect of the Christmas break, it has been that the worthies of the Latin Council of the ECB have been too busy roasting by their Yule logs and dipping into the *vin chaud* to bother us overmuch.

It is a respite which, alas, will soon come to an end.

When it does, the worry must be that the *Flucht nach Vorne* obsessives on the Board will again start to fret that the otherwise very welcome further declines in the price of fuel, foodstuffs, and other raw or semi-processed inputs will cause 'price expectations to become unanchored' and so will cast about for new ways to erode the value of the life savings of a greying Continent and to prevent all possibility that financial markets might generate useful signals about what resources should be put to what use and over what horizon.

With real money supply booming along in the low teens – and with that rate of climb being shared across almost all of the realm of the single currency and *not* confined just to the Nordic fiefdoms – it is time for the ECB to declare finally that too much is more than enough - and desist.

In truth, as the graph overleaf tries to illustrate, the position of households (and to a significant if lesser extent, cor-

porates) across the region has improved markedly as their deposit holdings have burgeoned and their debts have grown weakly or even shrunk.

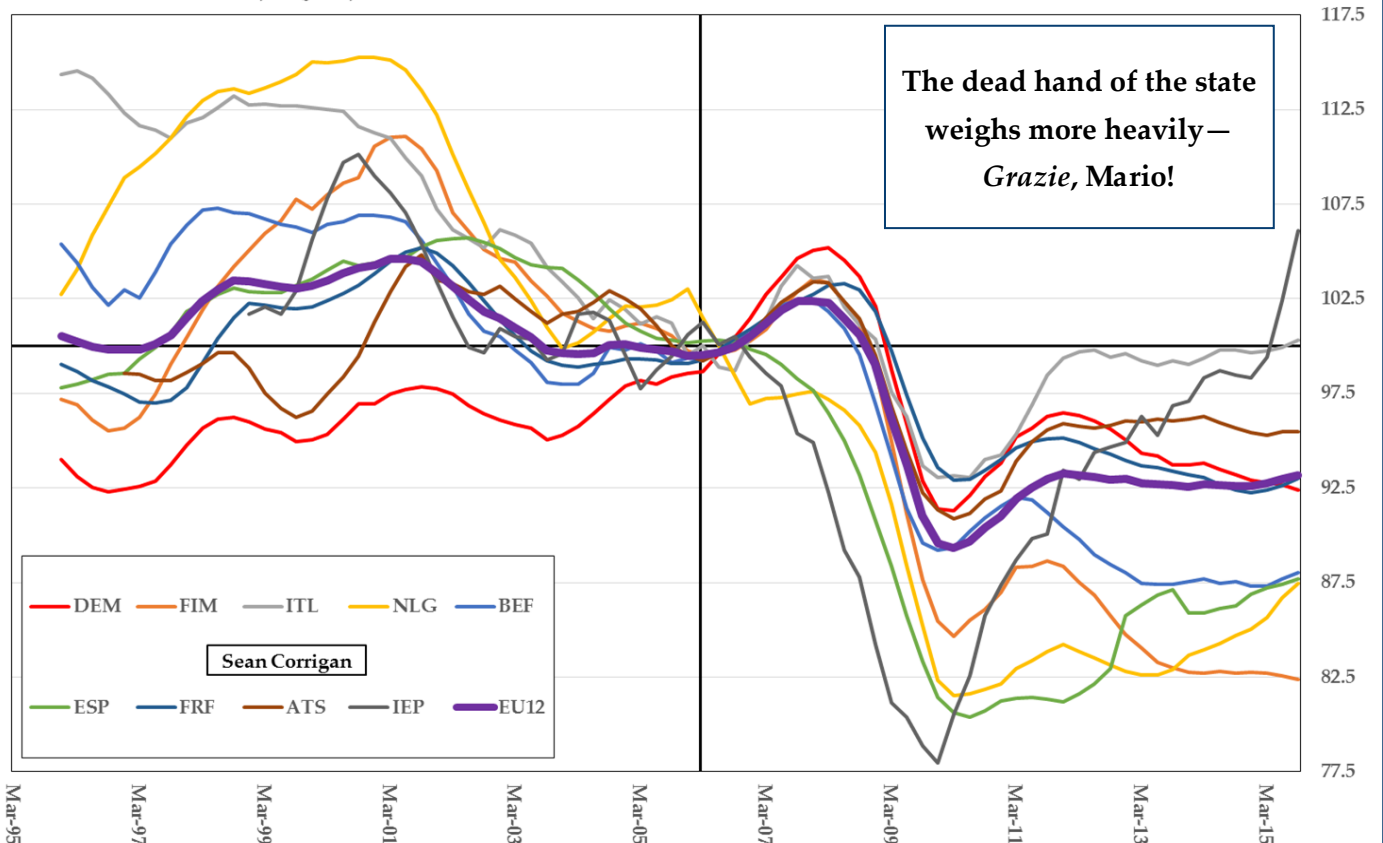
No one is more aware than your author that aggregates can hide a multitude of sins but, nevertheless, it remains the case that household are more likely to be hurt, not helped by even more monetary laxity, while businesses outside Scandinavia will feel only modest relief from their burdens on this reckoning.

More to the point, what the graph of the relative sizes of public and private GDP components strongly suggests is that the ECB is succouring a sector of society possibly even less productive than the Zombies who also enervatingly draw their sustenance from its teat – *viz.*, the state itself.

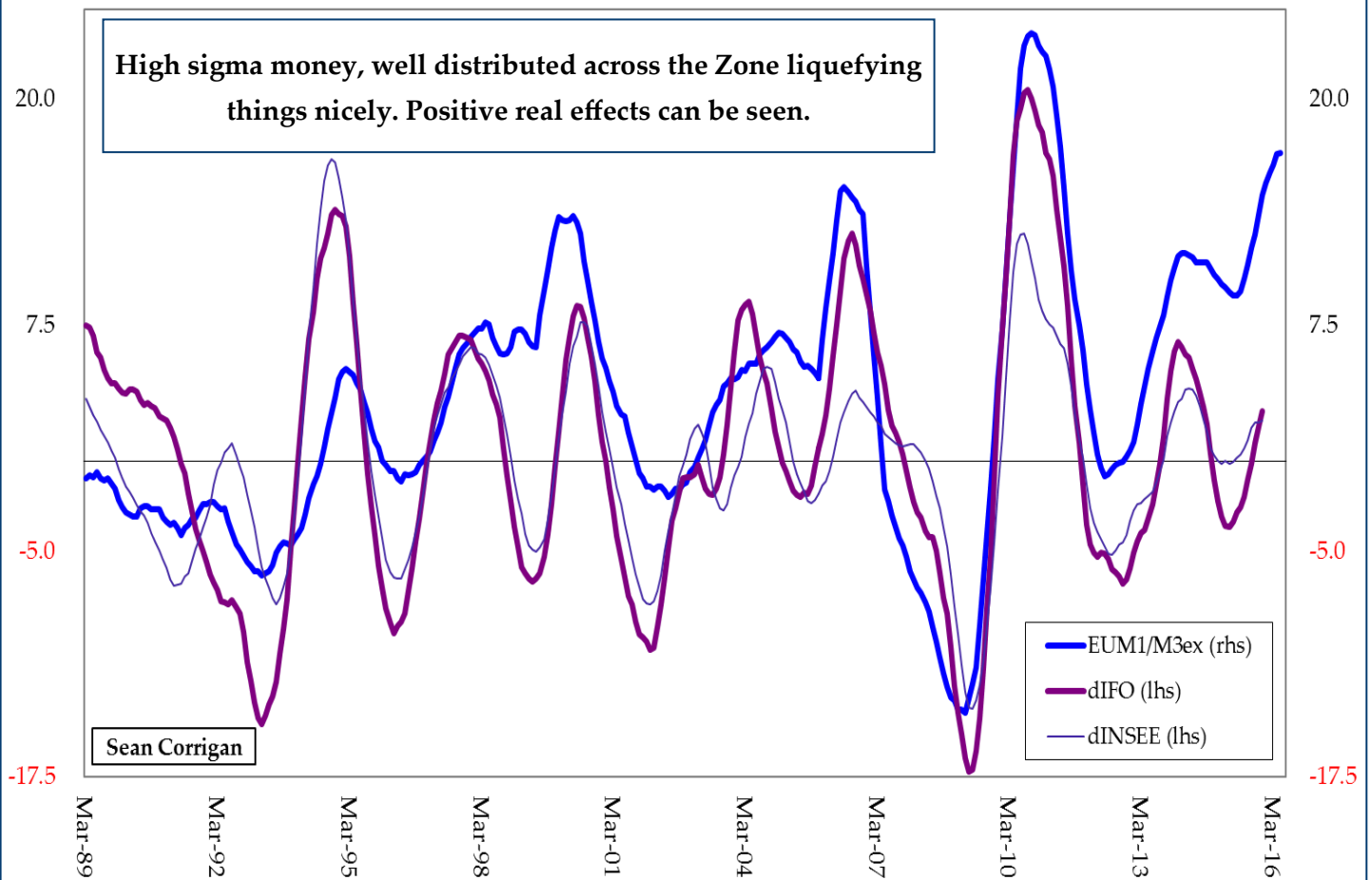
A glance at the credit figures reinforces this. In the past seven years, bank credit to governments has soared 64% or €1.4 trillion versus a gain of 16%, €300 billion, in the prior seven. In that time private sector credit lies unchanged (arguably a blessing). Shift the starting date to Dec'11 and private credit is down €625 billion, public up by €815bln.

Those wondering why stagnation persists need look no further.

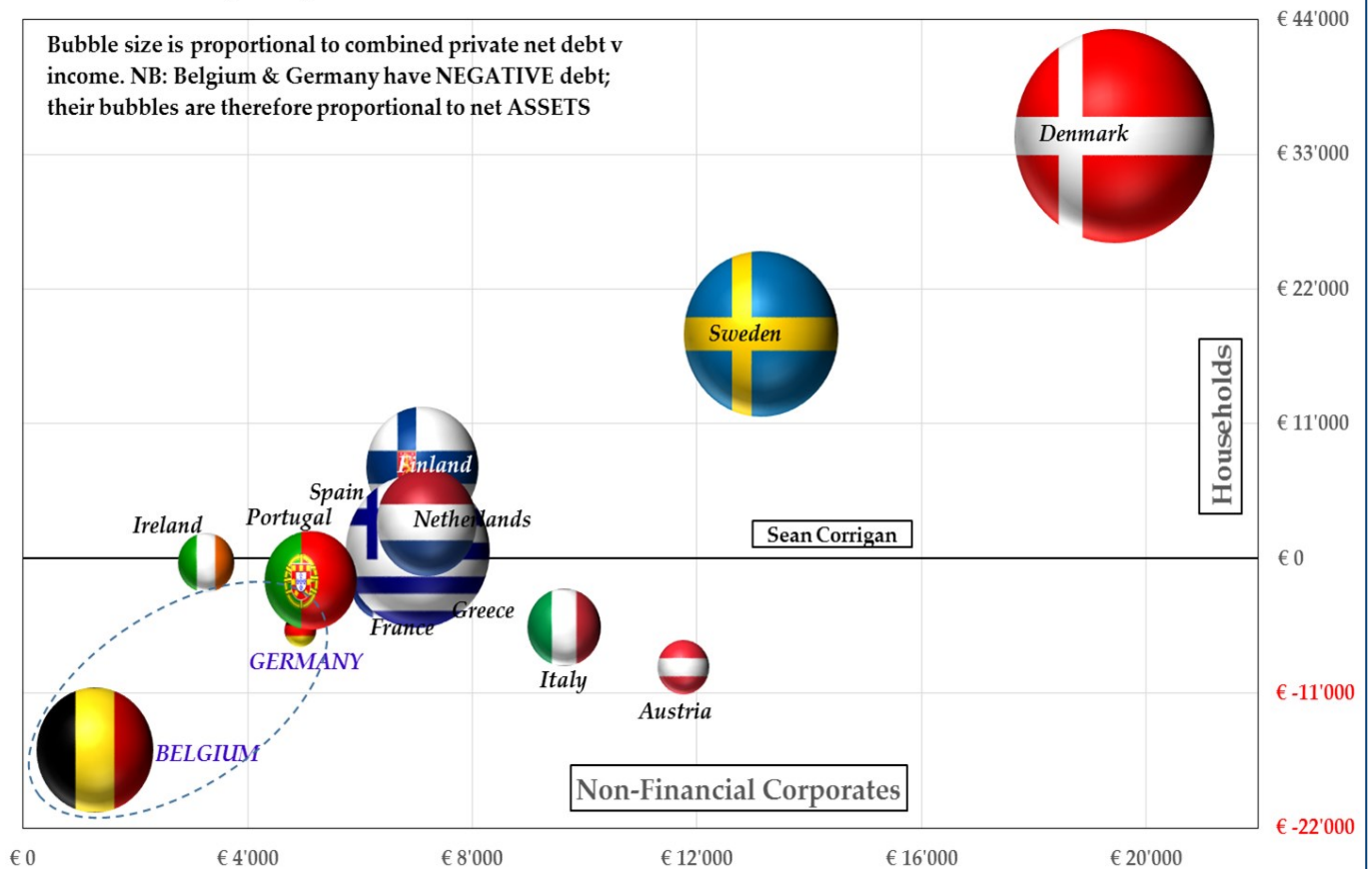
Private/Public GDP, 4Qma, 2005/6=100: Source - Eurostat



EUM1/M3-exM1 v dIFO, dINSEE, t+6 (YOY%): Source - ECB, Bloomberg



Net Bank Debt per capita as % of 2014 median household income: Source - ECB



BUY CHEAP, SELL DEAR: Market Observations

The old Wall St adage runs that '*stocks are not bought, they are sold*', but the idea here is that they are sold to eager acquirers and that the act of selling does not therefore depress the price too much. The same cannot be said of what we have experienced these past six weeks or so.

If the damage in the major indices—measured from the early December highs—has so far been limited to a 'corrective' 10%, others—whether geographically more far-flung or more sector-specific—have not been so fortunate.

Within that latter group, any number of coalmine canaries have been teetering on their perches. At the solid end of economic activity, Manpower is off 20% despite an ostensibly robust job market in its home territory. Fedex has been down as much as 30% from 2015's highs while Maersk (in USD) has halved.

At the frothier end, the quintessential boom-bust stocks have been chirruping frantically, too. Sotheby's has shed 55% to hit a six-year low and to return to a price first seen in the boom of all luxury booms back in the '*Rising Sun*' late-80s. Swatch (again in USD) has endured a slump of a similar magnitude as President Xi's anti-corruption boys round-up anyone seen wearing too blingy a wristwatch. The swaggering sellers of souped-up Beetles, Porsche, are not far behind that mark. Burberry, likewise, has been more about checks than tartans of late, dropping 40%+ from recent highs. And if global property king, Jones LaSalle, has only shed 20% so far, the drop has nevertheless threatened to do some serious damage to its previously stellar chart patterns.

Given that many of those at the conspicuous consumption end have made their dough peddling fripperies to the *nou-*

veaux riches of China or the usual-suspect oligarchs of the oil and mining patch, their current weakness is only to be expected. But one key distinction nevertheless remains to be made in relation to the ongoing fall in foreign reserves of the supposed 'savings glut' nations.

If the drop is being driven by the urge to reduce one's foreign currency *liabilities*, the act will initially reduce credit both at home—where, however, the central bank is fully able to offset the decline in the all-important high-powered money—and abroad but the latter only on the assumption that the original offshore bank lender does *not* replace its now expiring asset with the securities being sold by the central bank (perhaps indirectly as a repo extended to their actual non-bank buyer or as a knock-on if their purchase displaces some other holding). Hence, this will potentially—but not inevitably—act to contract 'liquidity' abroad, especially in securities markets. Money rarely 'moves to the sidelines', remember: the bulk of it is extinguished along with the position it was originally called into being to finance.

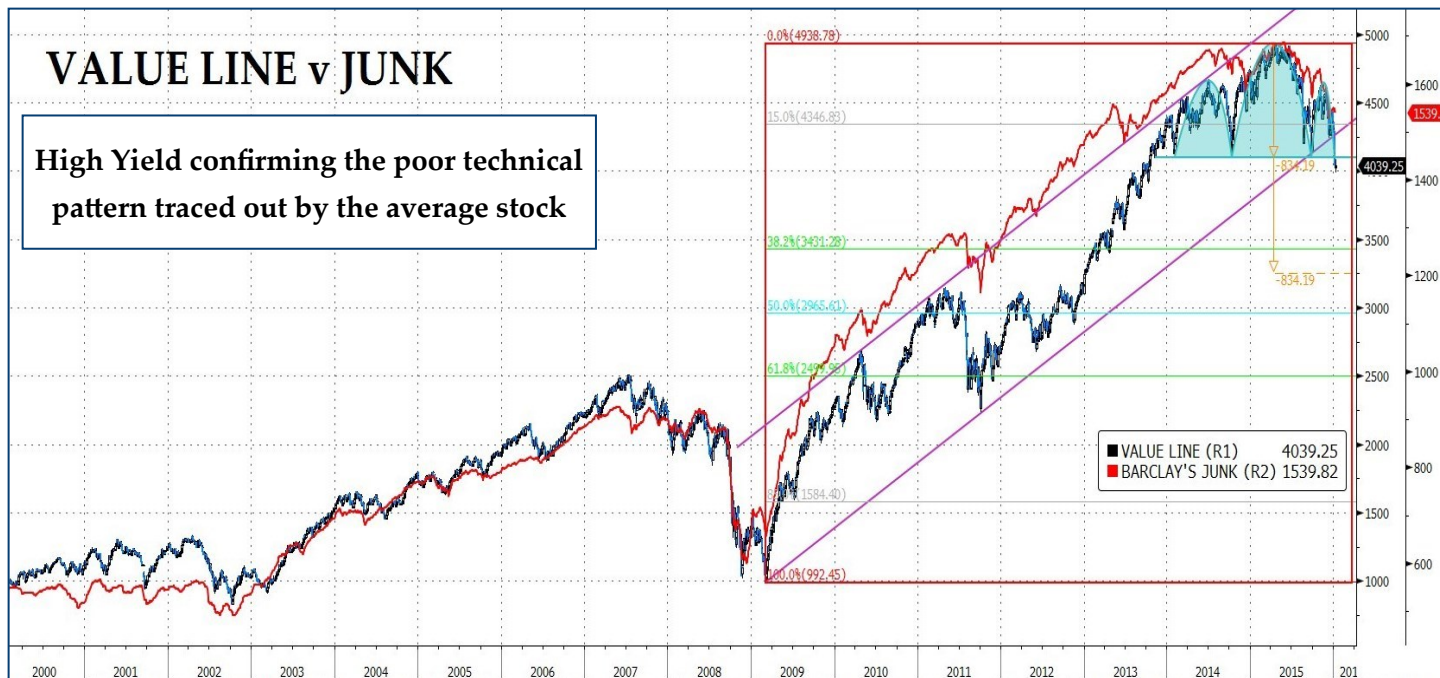
Conversely, if the efflux is based on domestics trying to acquire *assets* abroad, effectively all that occurs is that the CB 'privatises' some of its reserve holdings. In this case, both net and gross external positions will be unchanged in magnitude, if in less easily mobilized form should the superstructure later crack and assistance be required. Similarly, the desire for foreign investments will be undiminished in aggregate if perhaps altered (along with spreads or relative values) in composition. Here, too, the CB can mitigate local effects but only at the risk of replenishing the well which others are more than happy to help empty.

Markets will feel a world of difference between the two cases so we must be alert to which of them is taking place.



VALUE LINE v JUNK

High Yield confirming the poor technical pattern traced out by the average stock



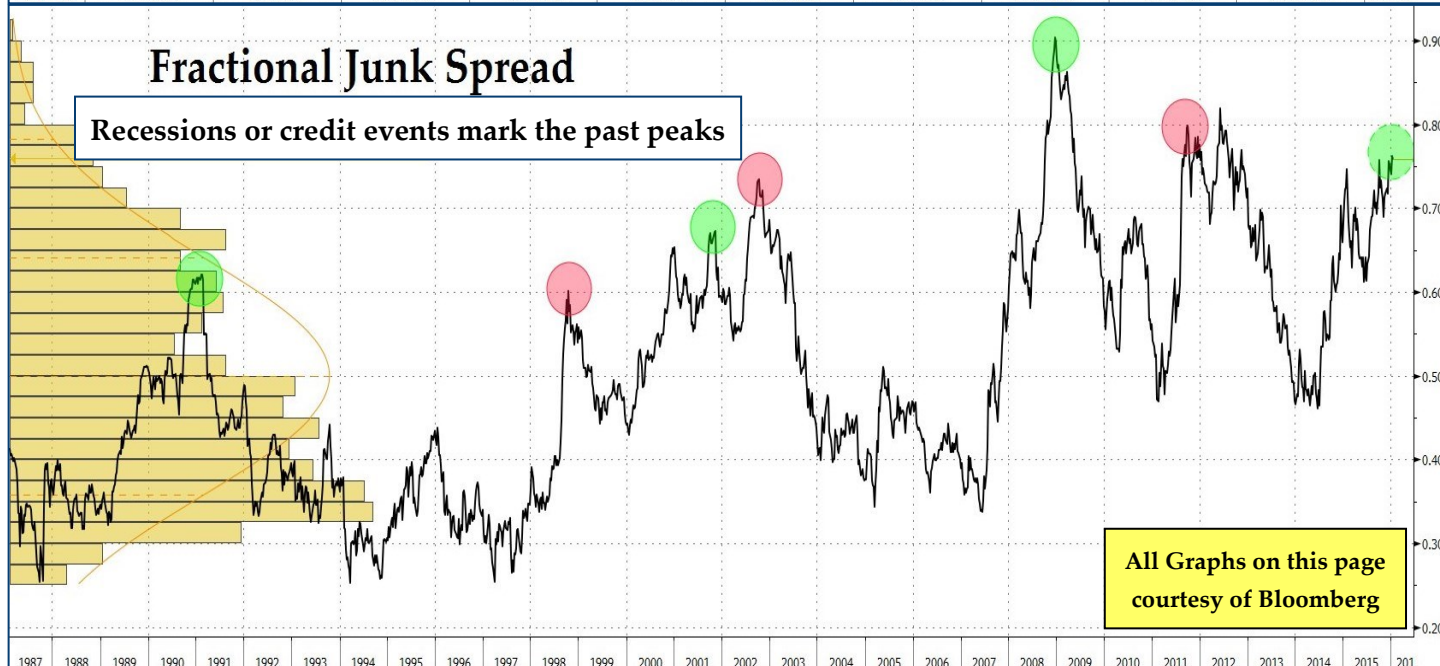
MOODY's BAA-AAA

Only one false recession alarm in the history of this spread



Fractional Junk Spread

Recessions or credit events mark the past peaks



All Graphs on this page courtesy of Bloomberg

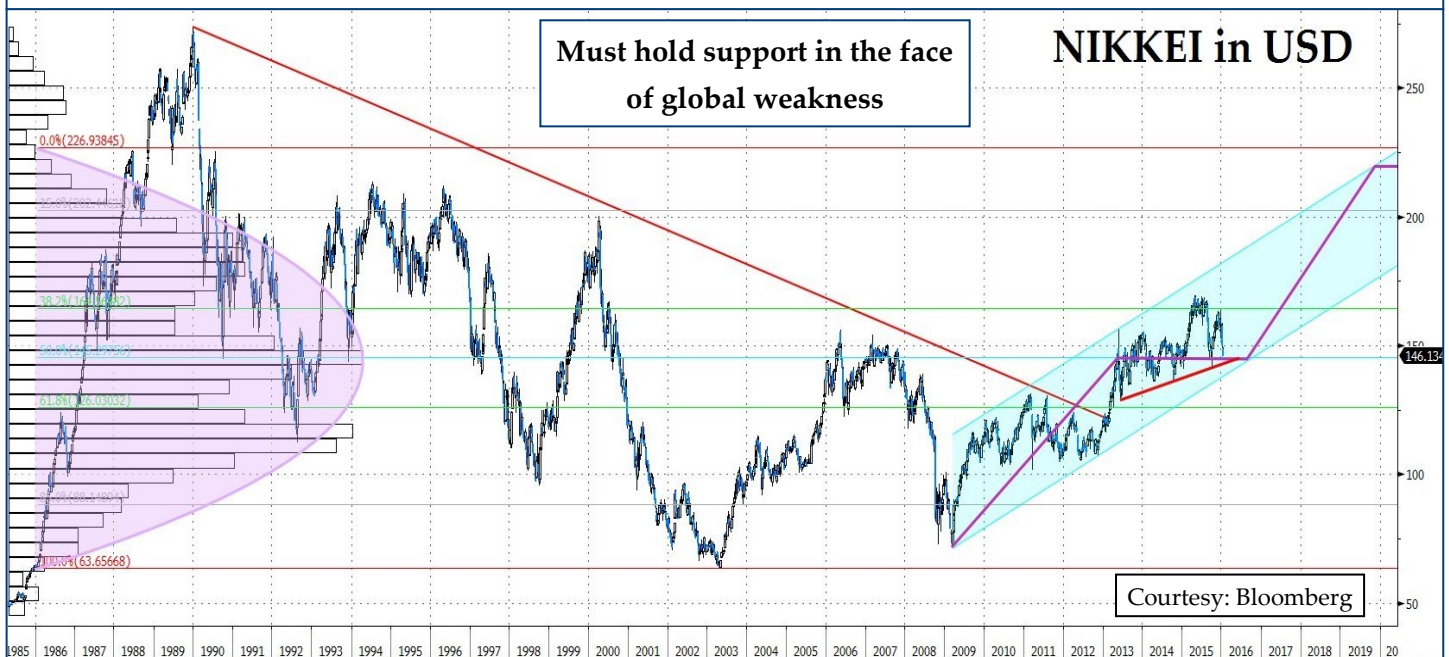


With this ratio so elevated, no room for margin declines



Must hold support in the face of global weakness

NIKKEI in USD



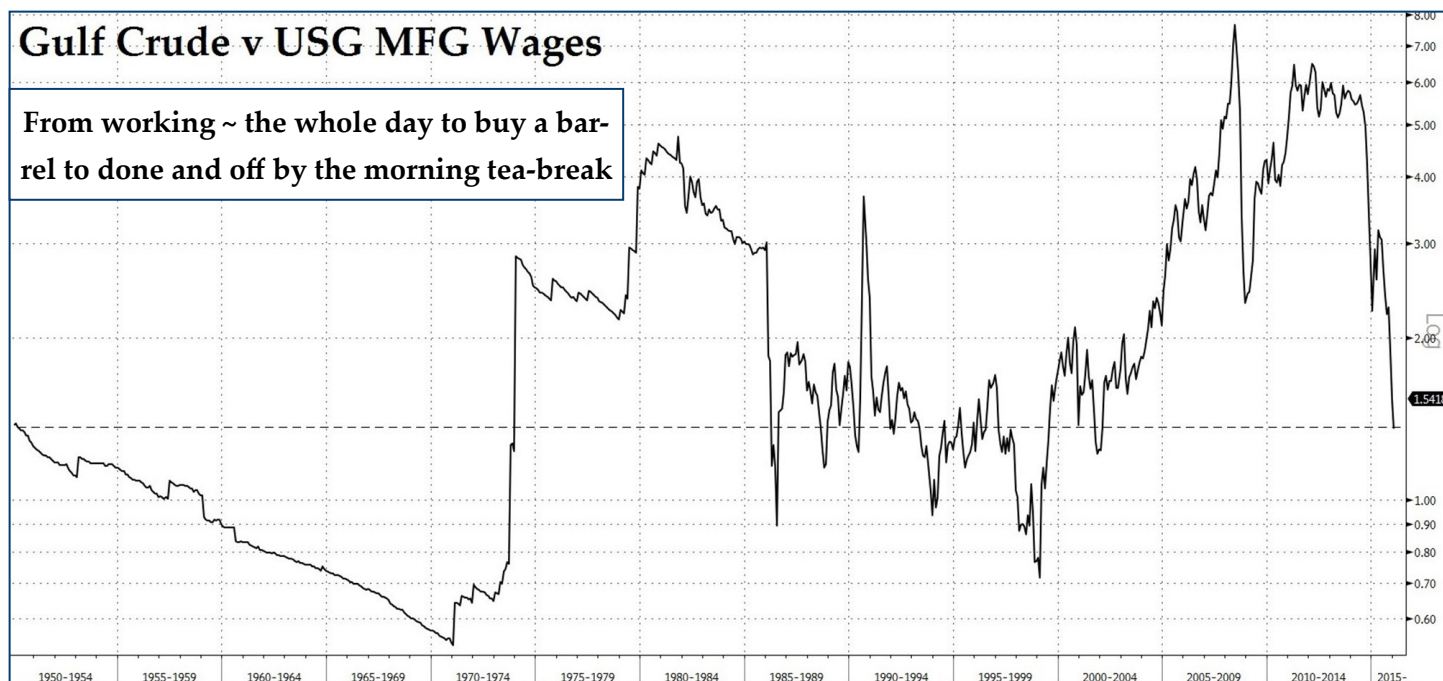
MSCI Canada in USD

The Blue-eyed Sheiks getting the blues & the shakes



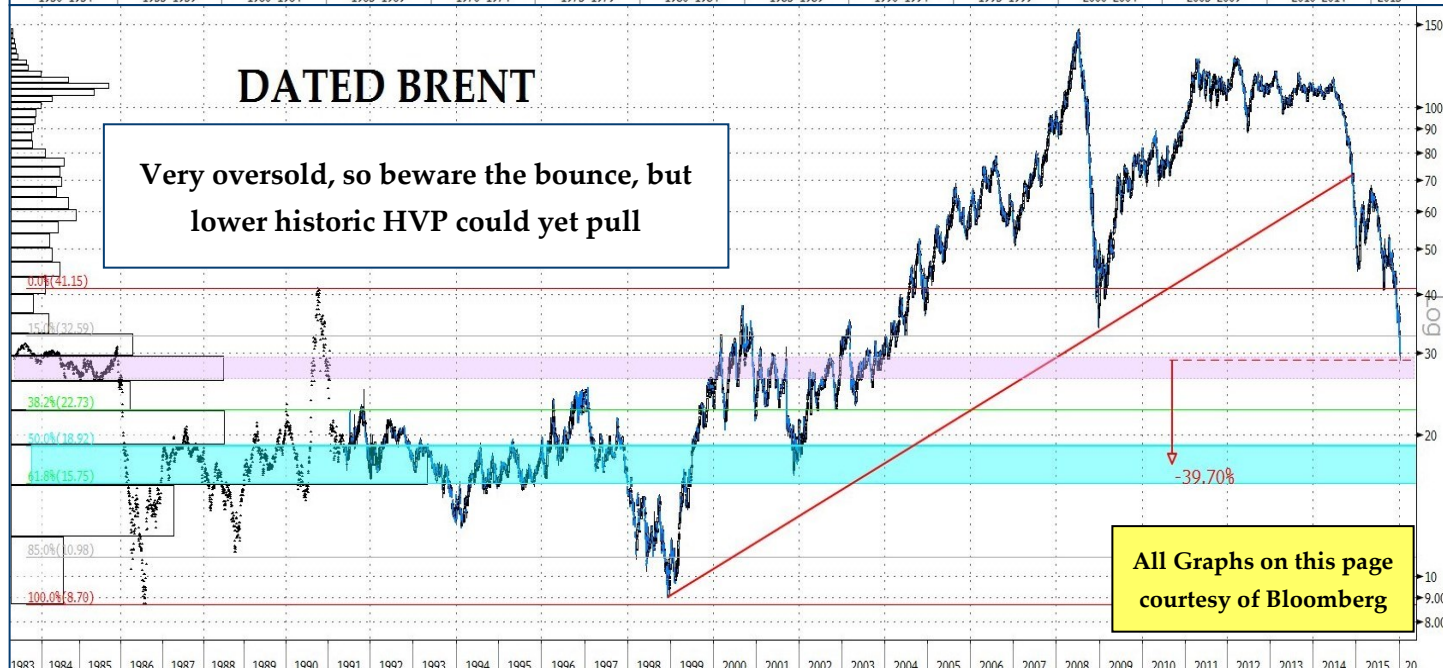
Gulf Crude v USG MFG Wages

From working ~ the whole day to buy a barrel to done and off by the morning tea-break



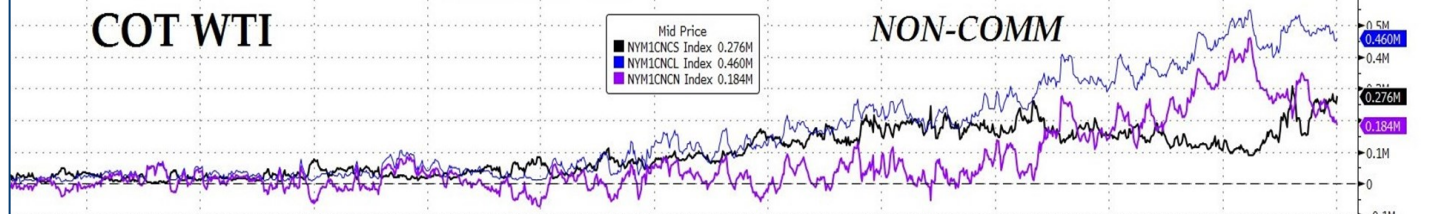
DATED BRENT

Very oversold, so beware the bounce, but lower historic HVP could yet pull



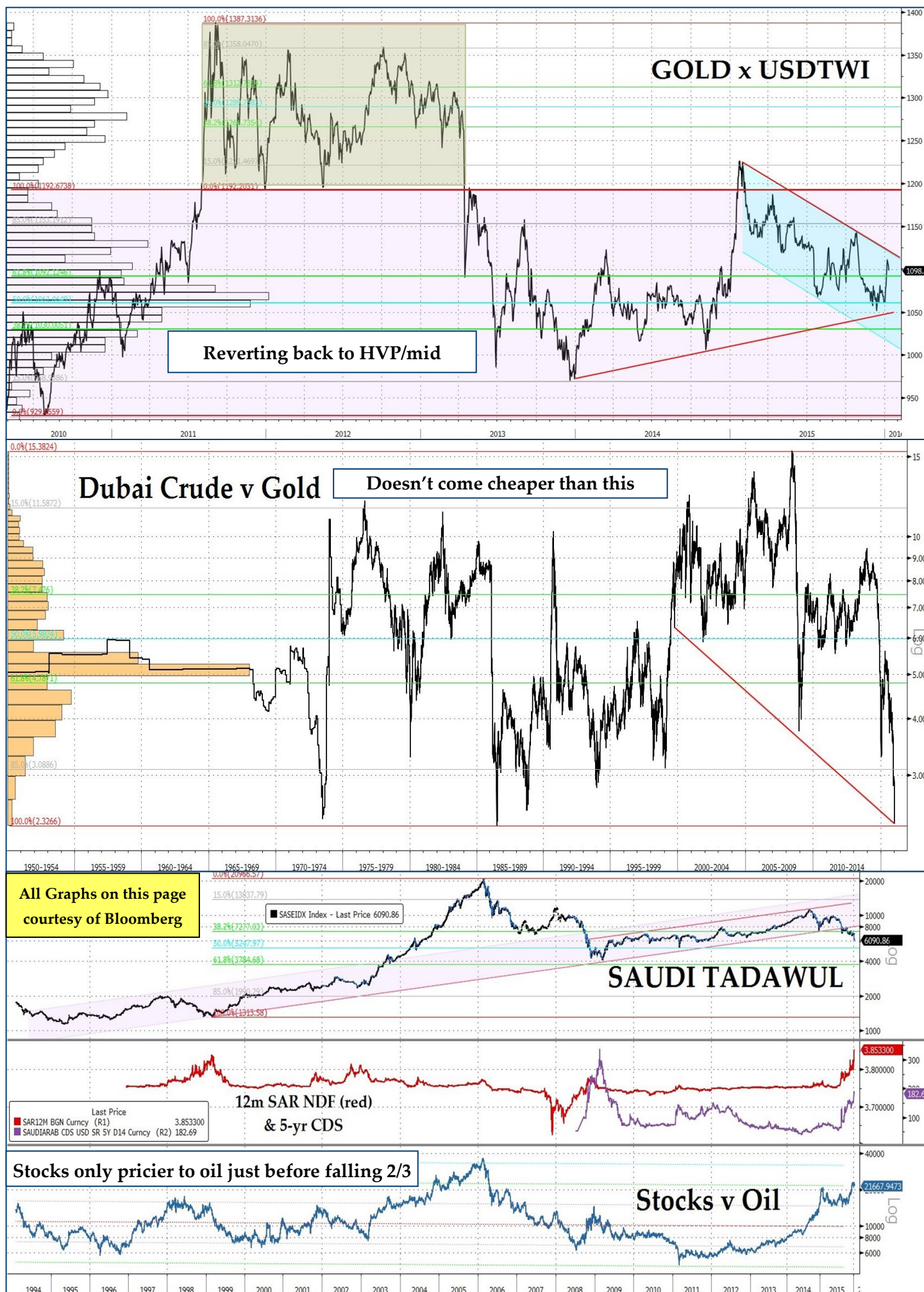
COT WTI

NON-COMM



NB: Market has gone SHORT in past recessions





Disclaimer

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