MONEY MACRO AND MARKETS
Unconventional Wisdom. Original Thinking.
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HINDESIGHT LETTERS

The Humours of Change Alley

For all that our Overlords are supposedly such big thinkers - dripping as they are in academic honours of every stripe, their every word so eagerly received by the 24/7 rolling-news press pack – the level of Groupthink and self-mimicry they practice is so very disappointingly high. Thus, in justifying her latest decision *not* to decide, Mme. Yellen last week trotted out that latest echo-chamber meme, the *'so-called neutral rate of interest'* which *'many econometric and other studies show'* is *'quite depressed by historical standards...'* possibly *'…near zero…'* in real terms.

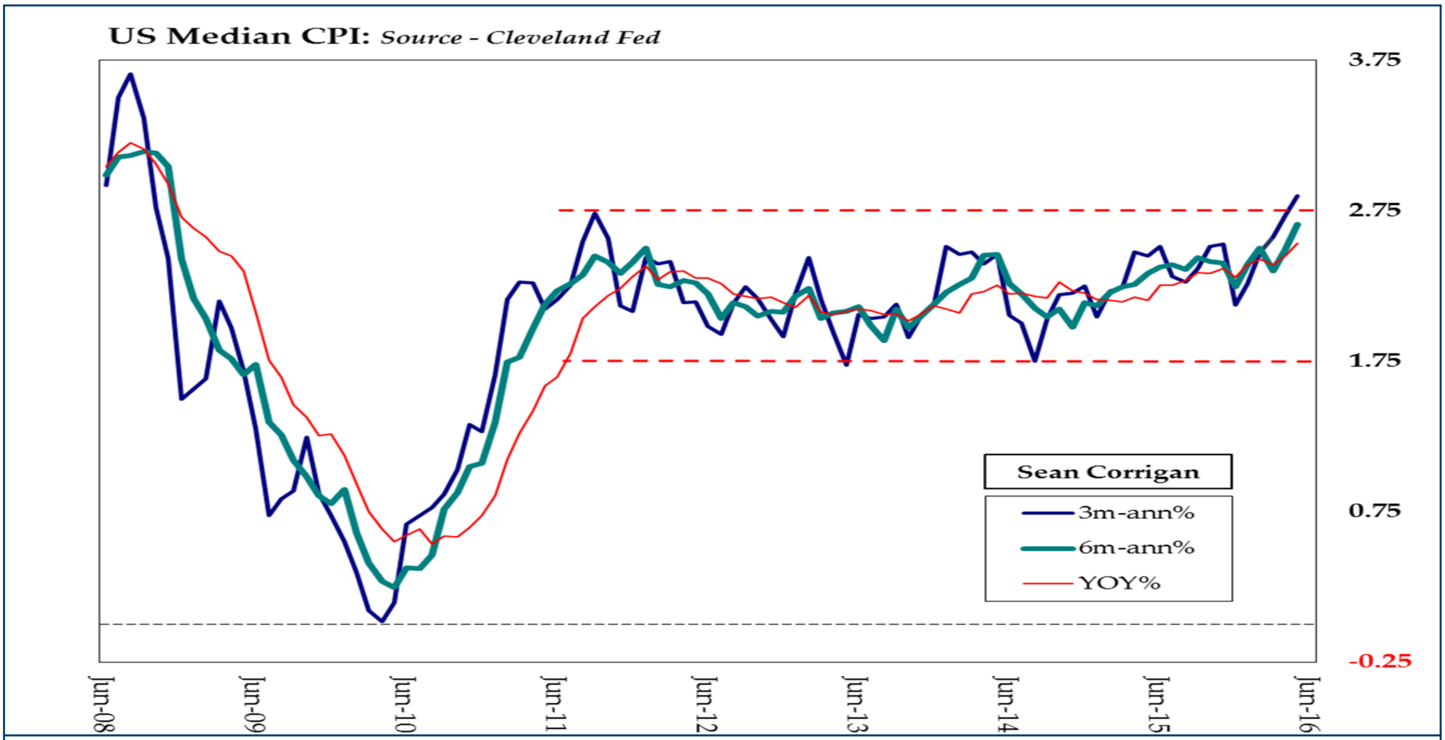
Ok, Janet, but MCPI is at 2.5%, a 7-year high and the median rate seen this past quarter-century. Furthermore, it is accelerating at the fastest rate in almost four years. Core CPI, if you still prefer that measure, is at 2.2%. The second change in the Core PCE deflator is a whisker off its 23-year mean reading. New home prices are up by almost a half in the course of the past 4 1/2 years. Yet Fed Funds are marooned at Depression Era lows of 35bps. You do the math (sic)!

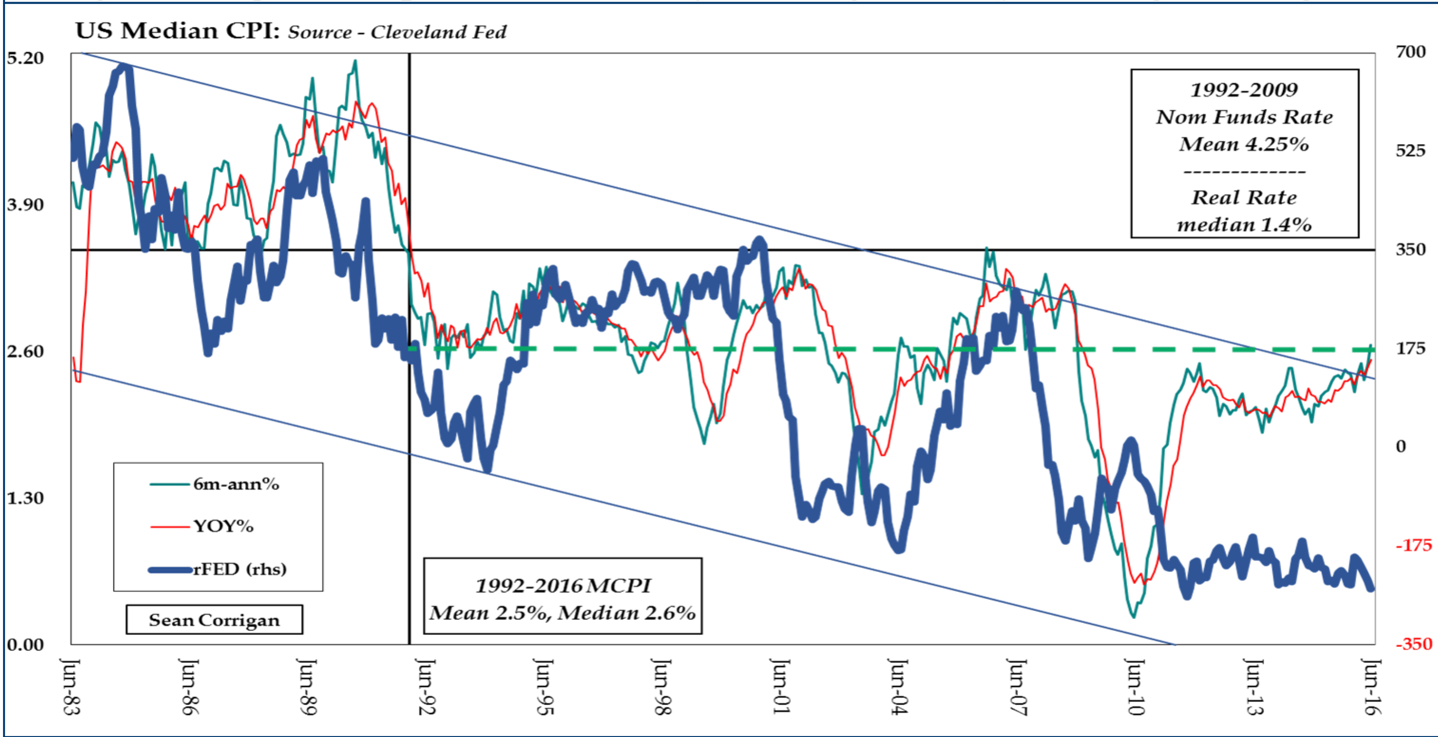
Supposedly, if we take Yellen's word for it, these 'neutral' rates are being held down by slow productivity growth. But this represents both a seriously flawed piece of thinking *and* a failure to ask an obvious question. The flaw is that low productivity societies are poor, capital-deprived, inefficient, often inflation-prone ones. So, on the first count, the scarcity of both physical goods and of loanable funds means real interest rates should be *high*, not *low*. The second feature will tend to push at least nominal rates up and, if the inflation becomes sufficiently volatile, real ones, too, alongside them. In this, we see her whole argument dismissed. The question not being asked is whether the doctrine of trying to cushion every ill-effect of entrepreneurial miscalculation, though that ends by destroying all rational pricing in capital markets, is itself the root cause of subdued productivity growth. This would be so through the removal of some good part of that financial Darwinism, that fierce selective pressure which operates across the profit and loss account, which ensures that material evolution takes place, advancing our general material well-being, one business failure at a time.

Instead, the Fed and its peers have chosen to flood the world with more money than it can usefully employ and so have deliberately depressed investment returns across half the globe. As the Fed Chairwoman herself put it in the post-FOMC press conference: *'our very purpose… [has been] to drive down longer-term yields by making these assets scarcer, and hence more valuable to the public that wants to invest in long- term securities. And we were consciously attempting to drive down that term premium.'*

All very well and good, Janet, but that means an increasingly thickening wedge of what were formerly sub-marginal economic projects have now been made viable. Moreover, given the sort of power-law distributions which tend to pertain in such phenomena, each successive artificial lowering of the interest rate you engineer brings successively larger populations of ever lower-return businesses into play, thereby causing a rapid reduction of the average even before we reckon the malign effects of cheap finance on otiose government expansion.

You want to solve the 'productivity puzzle'? You want to avoid the curse of 'secular stagnation'? You want people to succeed? You want to know what is the true 'neutral' rate of time discount? **Then allow the market to root out the unproductive. Stop subsidizing the forces of stagnation. Steel yourself to allow some people to fail so that others may advance. LET INTEREST RATES FIND THEIR OWN LEVEL!**


US Median CPI: Source - Cleveland Fed
3.75
2.75
1.75
0.75
-0.25
Sean Corrigan
3m-ann%
6m-ann%
YOY%
Jun-08
Jun-09
Jun-10
Jun-11
Jun-12
Jun-13
Jun-14
Jun-15
Jun-16


US Median CPI: Source - Cleveland Fed
5.20
3.90
2.60
1.30
0.00
700
525
350
175
0
-175
-350
1992-2009
Nom Funds Rate
Mean 4.25%

Real Rate
median 1.4%
6m-ann%
YOY%
rFED (rhs)
Sean Corrigan
1992-2016 MCPI
Mean 2.5%, Median 2.6%
Jun-83
Jun-86
Jun-89
Jun-92
Jun-95
Jun-98
Jun-01
Jun-04
Jun-07
Jun-10
Jun-13
Jun-16


US Core CPI YOY & d2YOY
Courtesy
Bloomberg
3.5
3.0
2.5
2.2
2.0
1.5
1.0
0.5
1.50
1.00
0.526
0.00
-0.50
-1.00
-1.50
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016

After all that careful manoeuvring to get the market to pre-price in a hike which the Fed really, really knows it should carry out but cannot summon the courage to enact, wouldn't you know it - a 'rogue', lowball non-farm payroll miraculously intervened.

Given that NFP has clearly become the touchstone of policy – being unquestionably THE most reliable, never-to-be-revised, most *leading* of all indicators - and showing the utter pointlessness of the batteries of sophisticated models run the by armies of PhD economists who populate the Marriner S Eccles Brain Trust – no-one could afford to be indifferent to what may yet turn out to be a mere burst of statistical noise.

Therefore, immediate panic ensued.

Over the course of the next few days, the entire yield curve shifted lower and steepened with green Eurodollars shedding 30bps in implied yield and the 30-year bond - rallying 6 ½ big ones along the way – moving 19bps lower. Junk spreads also moved in appreciably – obviously the most logical response if the economy is about to fall over yet another cliff!

The dollar also took a hit, losing around 2 1/2% against its main counterparts, a swing which, when added to the interest rate decline (as well as a little extra assistance from events in Europe), helped reinvigorate a failing precious metals market. Gold ran up 5.6% and silver roared skyward by 8.7%.

Stocks, interestingly, did not receive such a fillip for all the breathless headlines about record highs. In fact, the average stock – as gauged by the Value Line index summoned a paltry 2.4% rise, all of which it had given back by the end of the succeeding week. Goldilocks' porridge was obviously not quite as much to her liking as it has been of late, even before further 'uncertainty' wafted in from abroad in the form of weak Chinese data and the narrowing odds against a Brexit 'Leave' verdict.

It is certainly the case that the reported numbers were poor. Compared to a mean/median of 193k a month in private job additions over this past six years or so, June's paltry total – of 65k after we add back the 40k Verizon strikers – was 1.9 standard deviations away from what we have become used to.

Indeed, taking the raw, 25k increment, this was the worst showing since early 2010, capping off a three-month run which has been the worst since 2012. If we compare instead aggregate hours scaled for population, it can be argued that the figure has been edging into a zone which has been typical of past recessions – though, with frequent short-lived spikes in the record, this indicator needs the confirmation of subsequent bad months ahead.

The NAPM surveys appear to corroborate this, with the employment indices for both the manufacturing and non-manufacturing sectors dipping below the 50.0 contraction/expansion threshold. If we roughly weight the two, using the total payroll count for manufacturing and service jobs as our multipliers, again we see that, in matching the lows of February this year and, before that, the one set in December 2011, we again have to go back to the latter stages of the post-Lehman rebound to find a weaker reading.

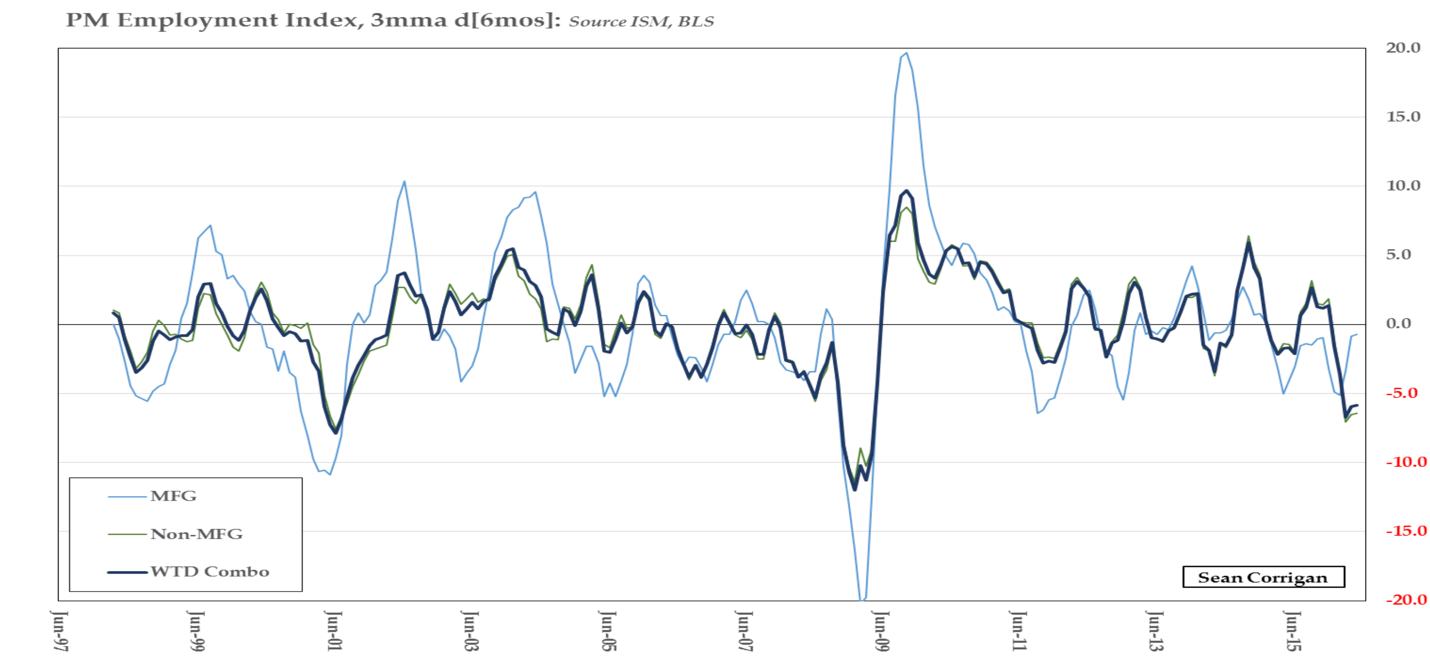
Conversely, however, both initial and continuing employment claims remain at multi-decade lows in outright terms (the former, for example, stands 1.9 sigmas below the 32-year mean) and at a new nadir in the 47-year series as a percentage of the population.

If we are to hope to find possible grounds for a reconciliation of these two, seemingly disparate sets of figures, one only has to listen to the latest business surveys. These seem to be sending a consistent message: namely, that the well of willing and able workers has effectively run dry.

Take the NFIB's '*Report on Business*' which had the following to say:-

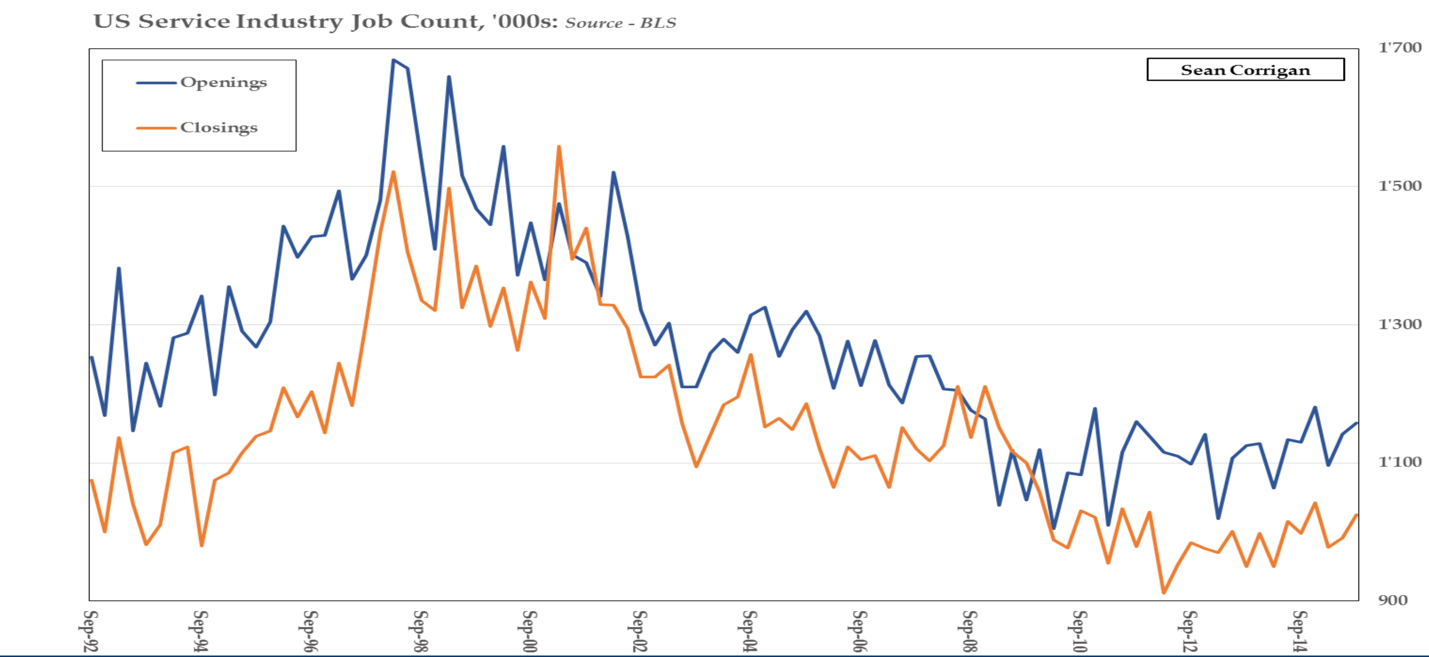
'53% (up 5 points) reported hiring or trying to hire, but 46% reported few or no qualified applicants for the positions they were trying to fill. Hiring activity increased substantially, but apparently the 'failure rate' also rose as more owners found it hard to identify qualified applicants. 12% of owners cited the difficulty of finding qualified workers as their 'Single Most Important Business Problem'… a high reading for this recovery period. 29% of all owners reported job openings they could not fill in the current period, up 4 points, revisiting the highest level for this expansion.'

At the other end of the scale, the Duke University-CFO Magazine quarterly survey revealed much the same problems, as Fuqua School of Business Professor Campbell R.



PM Employment Index, 3mma d[6mos]: Source ISM, BLS
20.0
15.0
10.0
5.0
0.0
-5.0
-10.0
-15.0
-20.0
MFG
Non-MFG
WTD Combo
Sean Corrigan
Jun-97
Jun-99
Jun-01
Jun-03
Jun-05
Jun-07
Jun-09
Jun-11
Jun-13
Jun-15

US Goods Industry Job Count, '000s: Source - BLS
Sean Corrigan
425
375
325
275
225
175
Openings
Closings
Sep-92
Sep-94
Sep-96
Sep-98
Sep-00
Sep-02
Sep-04
Sep-06
Sep-08
Sep-10
Sep-12
Sep-14



US Service Industry Job Count, '000s: Source - BLS
Openings
Closings
Sean Corrigan
1'700
1'500
1'300
1'100
900
Sep-92
Sep-94
Sep-96
Sep-98
Sep-00
Sep-02
Sep-04
Sep-06
Sep-08
Sep-10
Sep-12
Sep-14

Harvey noted.

'Our survey shows the aggregate [payroll] umbers miss a crucial point. U.S. companies rate difficulty hiring and retaining skilled employees as their second biggest concern – while last year it ranked fifth… [they] plan to increase their workforce by 2% over the next year, which would reduce the unemployment rate to levels not seen since the late 1960s. CFOs are telling us that expected wage increases 3.3% will greatly outpace expected increases in product prices [of] 1.5%.'

Accomplishment and aptitude failings aside, it is also clear that business formation has been in deep-freeze in the US – something for which it is very hard not to lay the blame at the doors of the state capitols, as well as that of Congress itself, for the ever increasing burden of cost, legislation, and regulation that they impose upon businesses, large and small.

The official figures on business births and deaths come in several slightly different versions - with three different levels of topicality and a partial confusion between 'firms' – i.e., legal entities – and 'establishments' - i.e. physically distinct workplaces—but each shows a similar picture.

Taking the BLS version – at only six months out of date, by far the most timely – and it becomes all too evident that while net job creation in this recovery has been passable, the numbers of firms both being formed and folded has slumped to a secularly low percentage. Corporate Darwinism is no longer quite so red in tooth and claw, it seems.

Thus, after moving only cyclically through the decade which stretched from the 'credit crunch' to the Tech bust, the change in the numbers of those employed at private establishments either opening or closing each quarter declined from around 1.65 million to 1.27 million in 2014/15 - a drop of 25%. If we note that the overall establishment count rose by a sixth from 320,000 to just under 400,000 (a gain due entirely to an increase in the service sector), we can quickly deduce that many of these additions were micro firms (predominantly, from the evidence of other reports, sole proprietorships) and also that the jobs per establishment average itself underwent a decline of some 35% - and as much as 55% in the most badly affected industry, namely, manufacturing.

Indeed, in the last-named sector, this shrinkage combined with a 30% reduction in establishment births and deaths to produce a swingeing 70% reduction in the jobs associated with such birth/death firms.

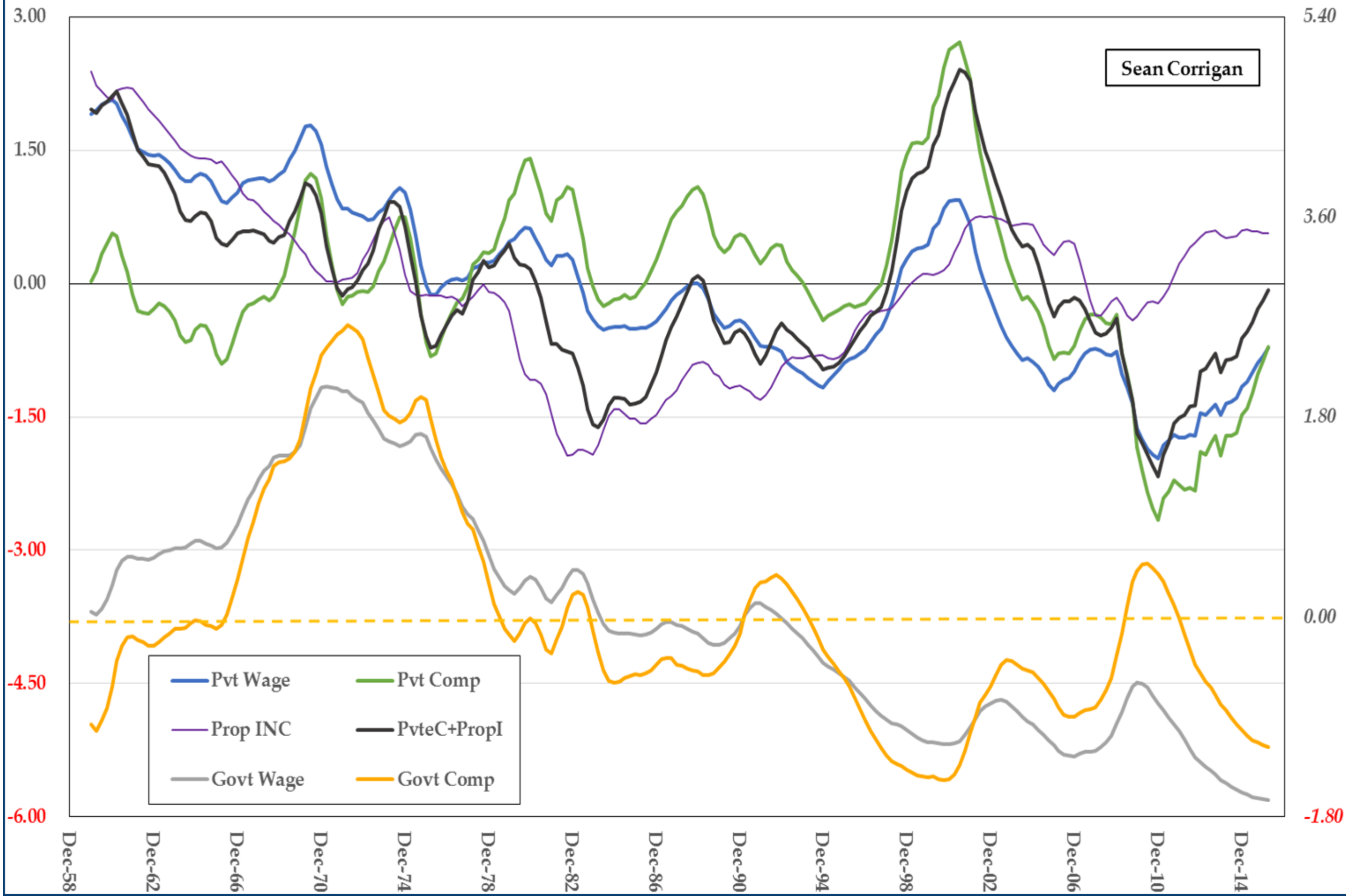
In this distributional shift, might we have something of an explanation for the so-called 'productivity puzzle' currently furrowing brows in Ivory Towers everywhere? After all, when the latest sheaf of forms to fill, records to keep, and licences to obtain lands with a thump on the desk of some giant MNC, the extra hours involved in administering them represent a vanishingly small fraction of the total used, but when Bob the jobbing Builder has to forsake his plasterboard and plumbline for pen and iPad, average useful output takes on a decidedly southward slant

In passing, we should also note that this rise of what the government officially terms 'non-employment companies' – i.e., self-owned enterprises – goes some way to explaining some of the supposedly weak growth in wage income by shifting it into the 'proprietors' income column'. Other influences are the sizeable rise in benefits, as opposed to pay, and the generally welcome drop in the proportion of government jobs. [One wonders also if the traditional survey questions adequately account for such a shift in status and thereby severely understate the participation rate. Answers, please on a postcard.]

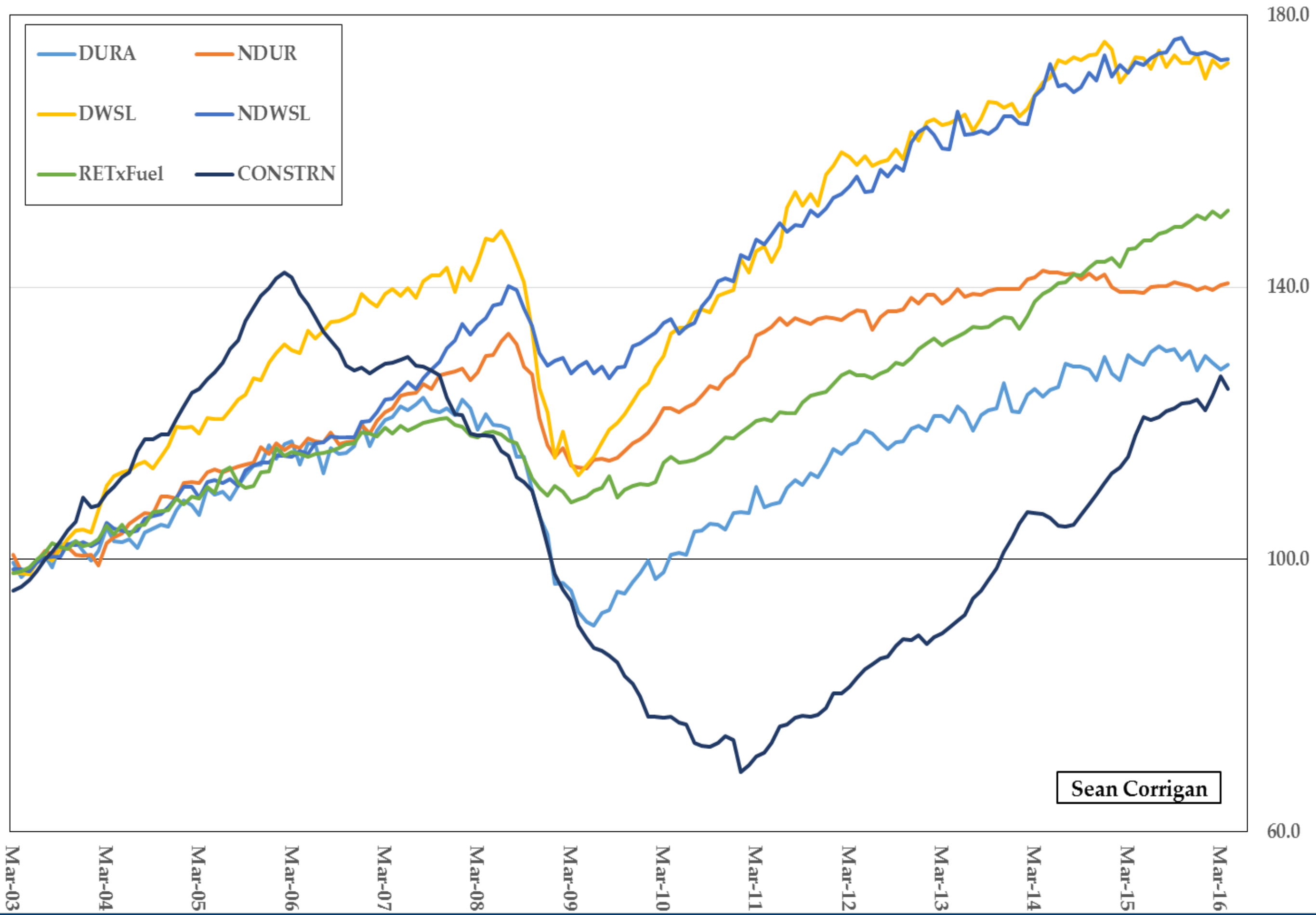
An elaboration of this same phenomenon of difficulty in hiring can perhaps be also found in the Economic Innovation Group think-tank's recent report, *'Recovery & Growth'* which showed that half of all net new company formation as did take place of last has been concentrated in just 20 metropolitan counties – a tally which represents one in fifty such jurisdictions, if a far less skewed one-third of the population. The lucky few were located principally in Southern California, New York, and Texas while would-be employers outside such metropolitan clusters have often been left high and dry.

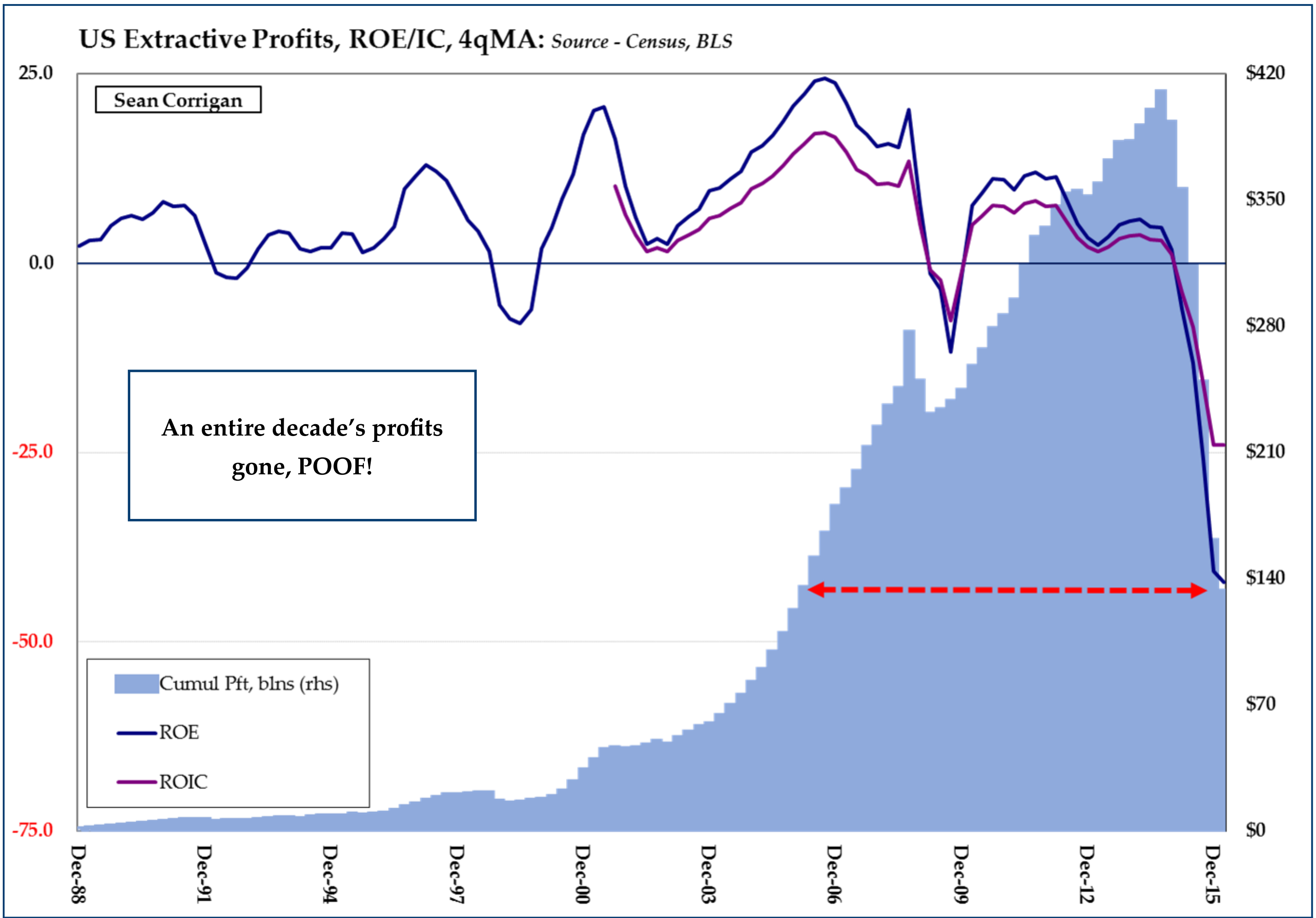
With everyone who is not otherwise racking up crippling debts in a bus-stop university as part of their rush to get to the big city - there either to sit writing near-identical apps of dubious added utility in a ZIRP-funded, reverse-Matryoshka doll, cyber start-up, or else microbrewing the beer to sell on one's pulled-pork, hipster Street Food combi - it is perhaps no wonder that unsexy, but otherwise viable businesses in the boondocks seem to be struggling to re-

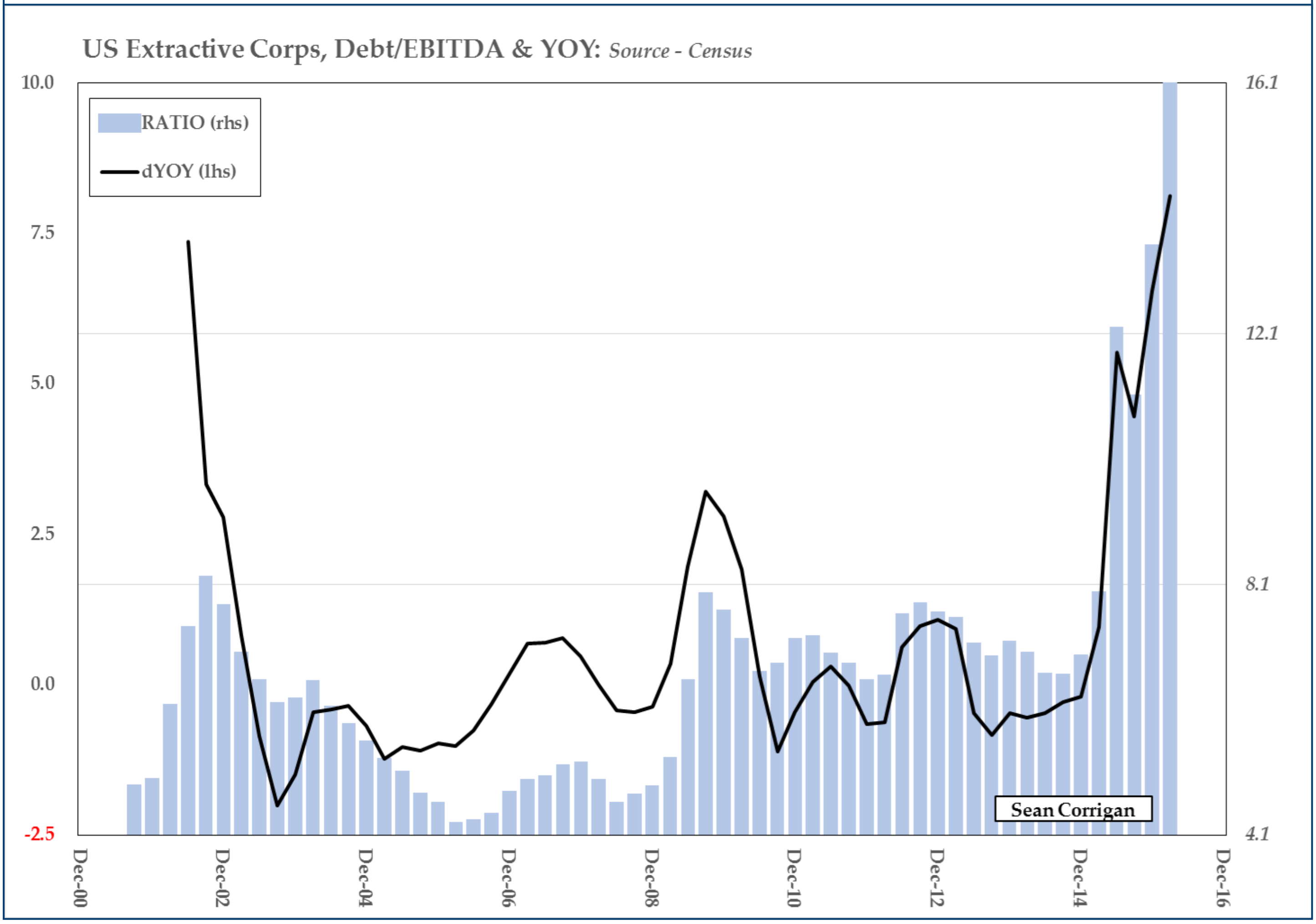
US Wage, Compensation & Proprietors' Income normalized share of GDP: *Source - BEA*



US Biz Revs Ex-PetroCoal, Metals/Minerals, Fuel/Gas dealers, 2003=100: *Source - Census*




US Extractive Profits, ROE/IC, 4qMA: Source - Census, BLS
Sean Corrigan
25.0
0.0
-25.0
-50.0
-75.0
$420
$350
$280
$210
$140
$70
$0
An entire decade's profits gone, POOF!
Cumul Pft, blns (rhs)
ROE
ROIC
Dec-88
Dec-91
Dec-94
Dec-97
Dec-00
Dec-03
Dec-06
Dec-09
Dec-12
Dec-15


US Extractive Corps, Debt/EBITDA & YOY: Source - Census
10.0
7.5
5.0
2.5
0.0
-2.5
16.1
12.1
8.1
4.1
RATIO (rhs)
dYOY (lhs)
Sean Corrigan
Dec-00
Dec-02
Dec-04
Dec-06
Dec-08
Dec-10
Dec-12
Dec-14
Dec-16

cruit diligent, much less adequately-skilled, workers.

Such tantalising microeconomic possibilities aside, the regular reader of these pages will be very familiar with our warnings that trends in business revenues in several broad sectors of industry have been clearly outstripping revenues for some good while now – a disparity which usually does not end well either for the shareholders or the workers involved.

They will also be aware that we have been careful to qualify such comments with the observation that a good part of the sluggishness in revenues has been due to the collapse in commodity prices (recently greatly reduced, of course) and that it is the margin achieved on those now-lessened sales that counts, not the volume of flows through the cash register, *per se*.

Thus, while waiting for profit numbers to catch up with revenue estimates, we have fallen to stripping out the contribution of petroleum & coal and primary metals from manufacturers and wholesalers, while also removing fuel dealers and gas stations from retail revenues, when we do our detailed comparisons.

The results of this exercise have been a touch more reassuring than those derived from the raw numbers. Rather than falling 7.5% from the August'14 peak, manufacturing revenues are now seen to be down only 0.4%: disappointing, yes, but not disastrous. Similarly, an unadjusted wholesale revenue decline of 7% turns into a modest gain of 1.1%. Dropping gas and fuel from the retail reckoning likewise improves matters, leading to a near doubling of the growth rate from 3.4% to 6.6%.

Though we should not entirely relax our concerns – nor disregard the fact that revenue losses in the abstracted sectors have undoubtedly cost people their livelihoods – this does allow a certain tilt towards the idea that it might be the supply of labour, not the demand for it, which is generally at fault.

Of course, as we have said, developments in revenues are only a rough guideline to what we might expect from the truly decisive variable, the profits which will show if there might be some room to take on that marginal, extra worker or, indeed, to retain that similarly marginal last one currently on the payroll.

Those profit data for the first quarter are now arriving and they do seem to show that there was something of an improvement for the 'higher' orders of business, at least.

Manufacturing, as a whole, had revenues declining by 4.1% (split between durables and non-durables -1.2% to -7.3%) and after-tax profits retreating 2.4% (split +5.5% durable, -8.7% non), according to the Census numbers. But note that primary metals (including the globally-pressured steel industry) accounted for 92% of the revenue drop and for 76% of the earnings shortfall.

Similarly, petroleum and coal were responsible for almost all the non-durable sector's revenue slippage and for 210% of its aggregate losses – which means, of course that other sectors are doing rather better than once they were.

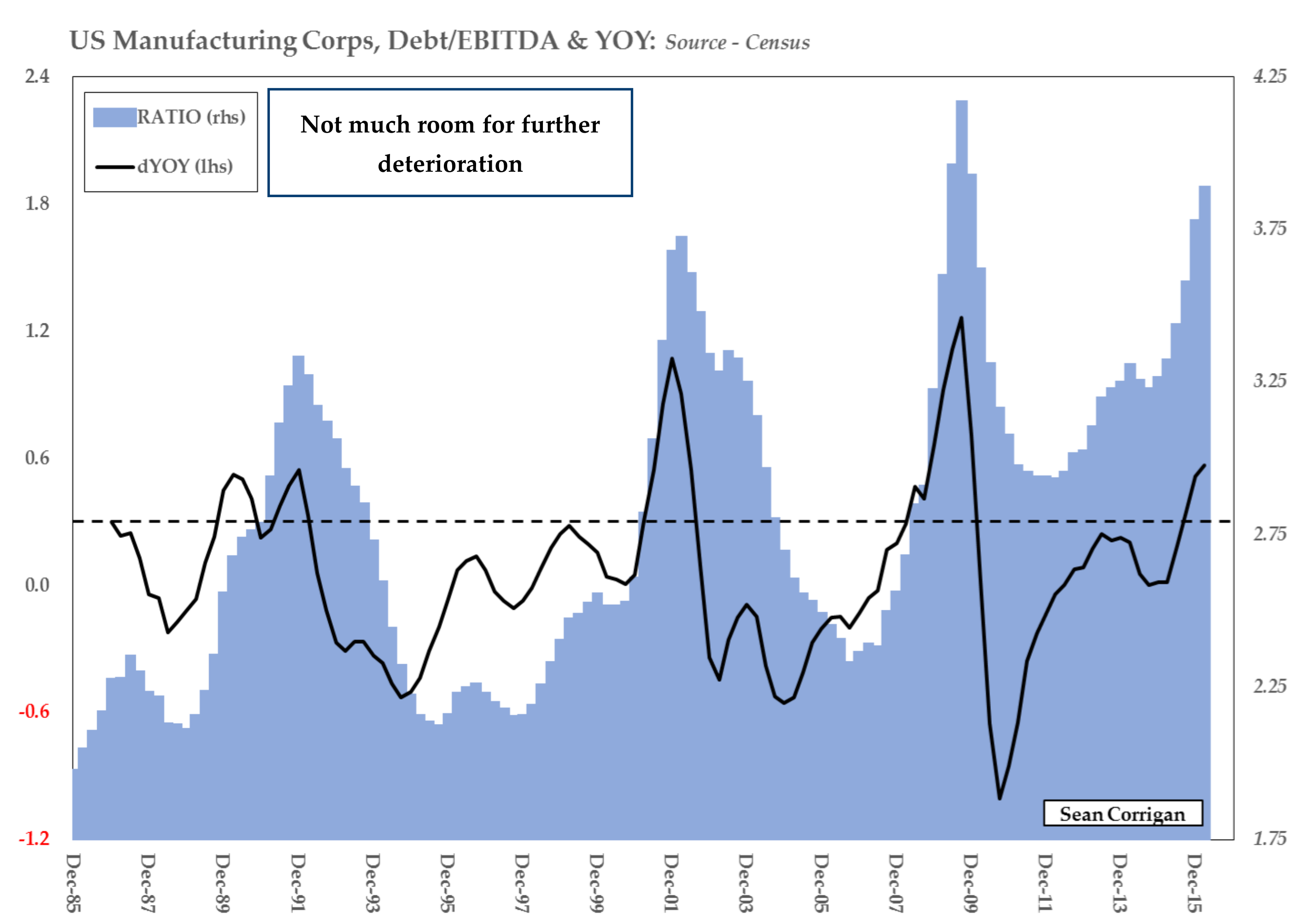
So, if we take out just these two lines, the remaining enterprises reveal rising after-tax profits both sequentially and YOY – of as much as 10% in that latter instance.

Adjusted wholesalers, too, enjoyed a major bounce from last year's bleak QI to register a 26% improvement. Even the 4-quarter MA came in positive, thanks to a nice gain in the previously struggling non-durables business.

As for the losers themselves, losses in QI shrank substantially from QIV, and even the bombed-out extractive category endured a smaller flood of red ink than has been the case for the past four quarters. Indeed, the latter's move in the direction of break-even was particularly notable in relation to the catastrophe recorded in the final trimester of 2015, though with the rider that operating income dipped further into the minus column and that debt/EBITDA accordingly hit an eye-watering 16:1.

The one sector which was previously doing well - not an unalloyed joy to those of us not in thrall to the myth that 'the consumer is 60% of the economy' – was retail. The latest profit numbers, however, may be suggesting that may be taking a turn for the worse, even before the ludicrously backward imposition of a higher minimum wage takes effect, firstly on profits and then, inevitably, on employment.

Finally, and here we have no profit break-out for the exact category, it must be noted that core capital goods shipments have slid to five year lows, dwindling at a 5.1% clip which is not that far short of recessionary and which


US Manufacturing Corps, Debt/EBITDA & YOY: Source - Census
RATIO (rhs)
dYOY (lhs)
Not much room for further deterioration
Sean Corrigan
2.4
1.8
1.2
0.6
0.0
-0.6
-1.2
4.25
3.75
3.25
2.75
2.25
1.75
Dec-85
Dec-87
Dec-89
Dec-91
Dec-93
Dec-95
Dec-97
Dec-99
Dec-01
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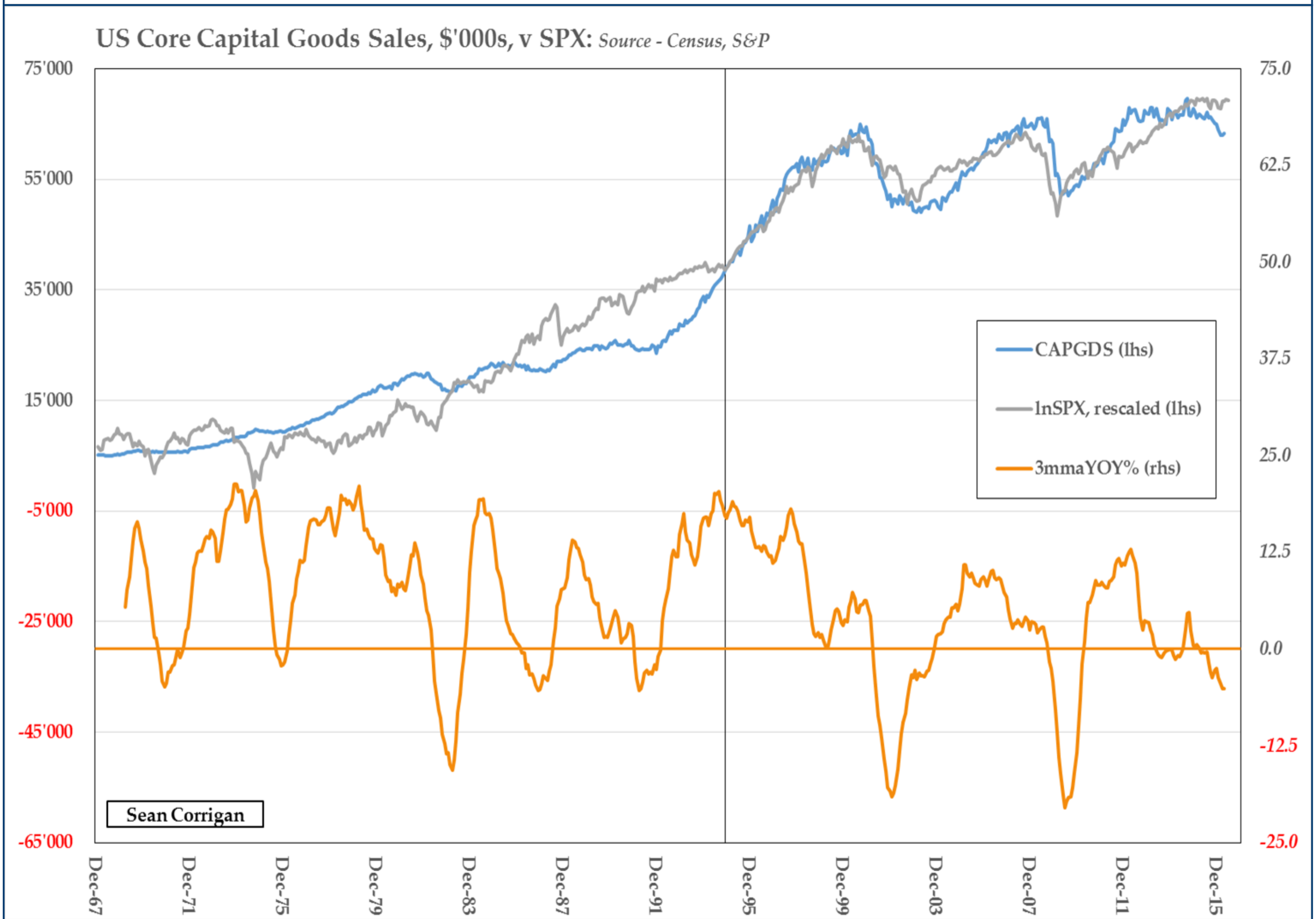
Dec-11
Dec-13
Dec-15


US Core Capital Goods Sales, $'000s, v SPX: Source - Census, S&P
CAPGDS (lhs)
lnSPX, rescaled (lhs)
3mmaYOY% (rhs)
Sean Corrigan
75'000
55'000
35'000
15'000
-5'000
-25'000
-45'000
-65'000
75.0
62.5
50.0
37.5
25.0
12.5
0.0
-12.5
-25.0
Dec-67
Dec-71
Dec-75
Dec-79
Dec-83
Dec-87
Dec-91
Dec-95
Dec-99
Dec-03
Dec-07
Dec-11
Dec-15

should bode ill for a stock market with which its destiny has been closely tied these past twenty years.

To sum up then, there may be structural headwinds in operation which are both preventing more hiring and stopping much of what hiring there is from resulting in proportionately more output. Some of these impediments are being foolishly imposed by the state. Others are being encouraged by the present lax standards operative in money and capital markets.

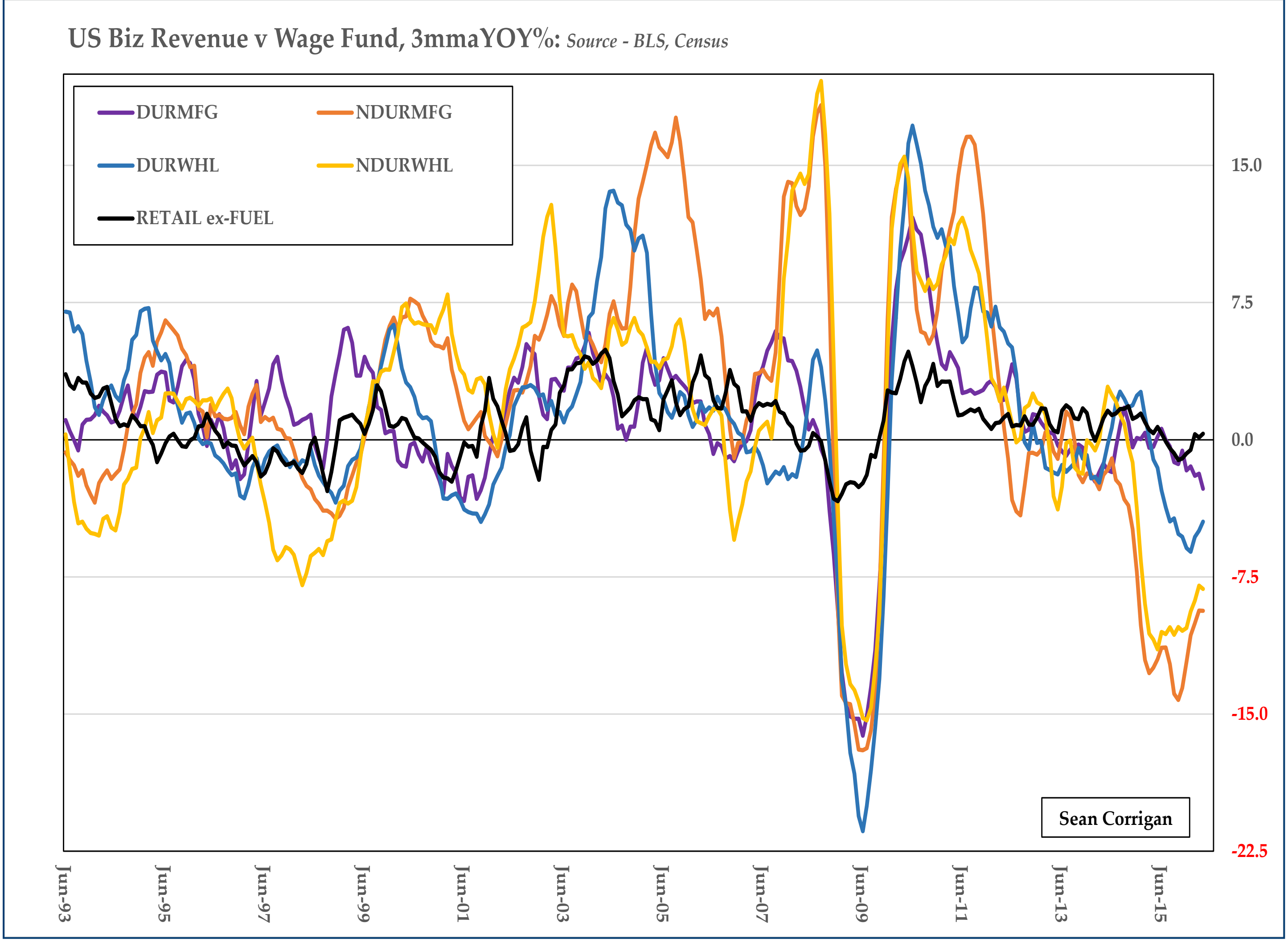
Conversely, trends which we follow in the relation between payroll growth and revenue generation have broadly been reflected in the crucial area of profitability and hence should not exert too adverse an effect upon employment levels in coming months.

Indeed, even the ailing sectors displayed some sign of improvement during the first three months of this year, with two notable exceptions at opposite ends of the productive structure.

Down at the sharp end, retail sales have at last started to falter (though, ironically, increased fuel prices may now mask this deterioration just as lowered ones had formerly served, somewhat misleadingly, to suggest it). Up at the other extreme, core capital goods are starting to flash amber for equities as much as for the economy.

All too predictably, this has all been sufficiently ambiguous to allow further procrastination from a pusillanimous Fed which is far more frightened of being criticised for actually doing its job of normalizing monetary settings than for sitting idly by while imbalances build and the anaemia of perverse incentives intensifies.

No change then. And precious little change expected.



It is exceedingly hard, demeaning almost, to pay serious attention to markets when the main task of which analysis presently consists is simply to guess what excuse the central banks will next seize upon either to continue or, worse, to intensify their assault on the basic functioning of those same markets.

But even if done through gritted teeth, try we still must – either out of a concern that we must remain aware of just how artificial the situation is as protection against that far off day when sanity again prevails in the counsels of the central banks, or because developments in the markets can give us an insight into the workings of the economy at large and, hence, into when and how the prevailing policies will find their expression.

Amid such confusion, we should therefore take into account as wide a range of indicators as we can by means of which to judge whether or not the market is overpriced and to what degree that is the case, if so.

In looking first at the relation between valuation and the generation of income, we find that enterprise value and a close proxy for EBITDA presently stands at levels only ever exceeded during the raging fever which was the (first) Tech Bubble. Similarly, market capitalisation stands at a proportion of net private product (a kind of enhanced Q-Ratio) which only yields to the excesses in evidence at the turn of the millennium and one whose emergence roughly synchronises – as it has for much of the past two decades of revaluation – with an acceleration in the issuance of debt.

Stepping back to connect the last of these with the first, debt/EBITDA is also rising into what has historically been dangerous territory and doing so, moreover, at what has previously turned out to be a dangerous pace of 16 extra percentage points per annum

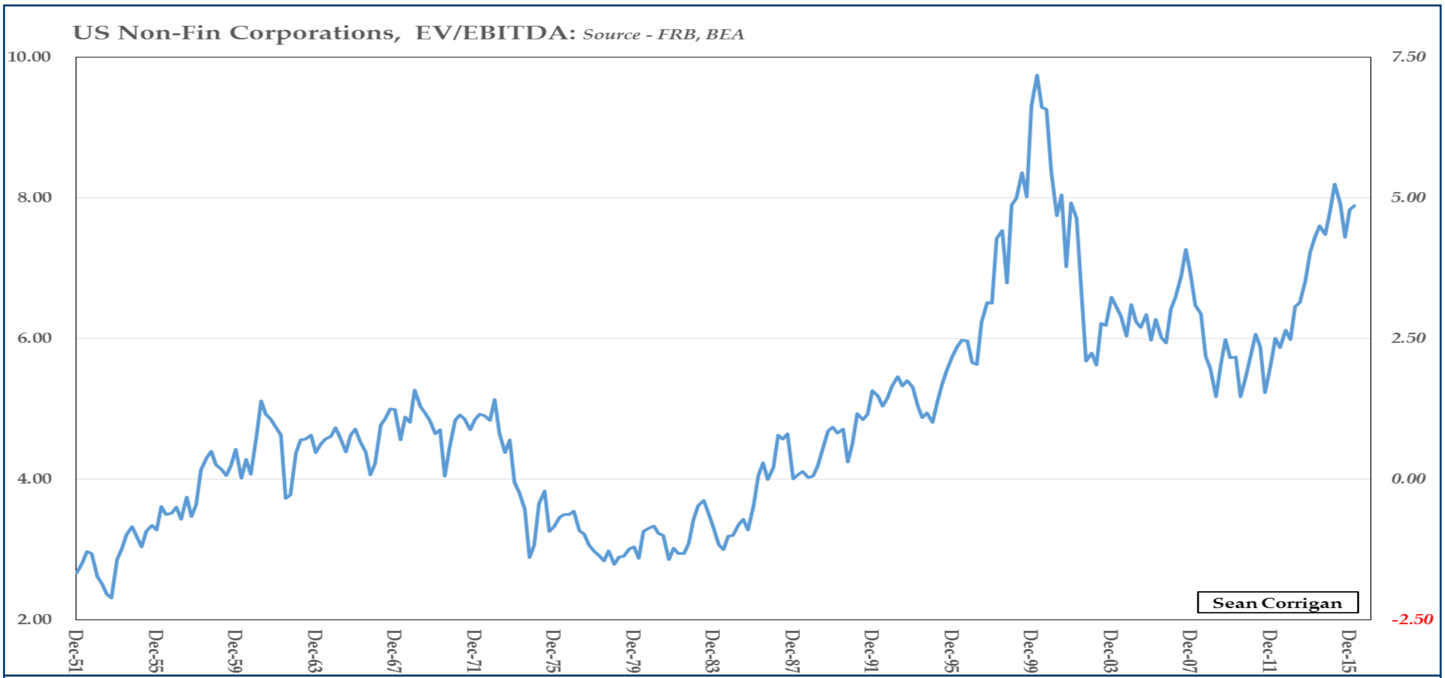
Though they have eased off somewhat in the past few quarters, non-financial corporations are still borrowing at a pace only exceeded in the run-up to the Lehman debacle, as indeed are non-corporate borrowers. Only households' continued modesty in this regard serves to keep the rise in overall private-sector indebtedness in check, though that, too, is a restraint which may be progressively weakening as consumer credit rises faster than income for the first time in over a decade and as mortgage purchase applications hit six-year highs.

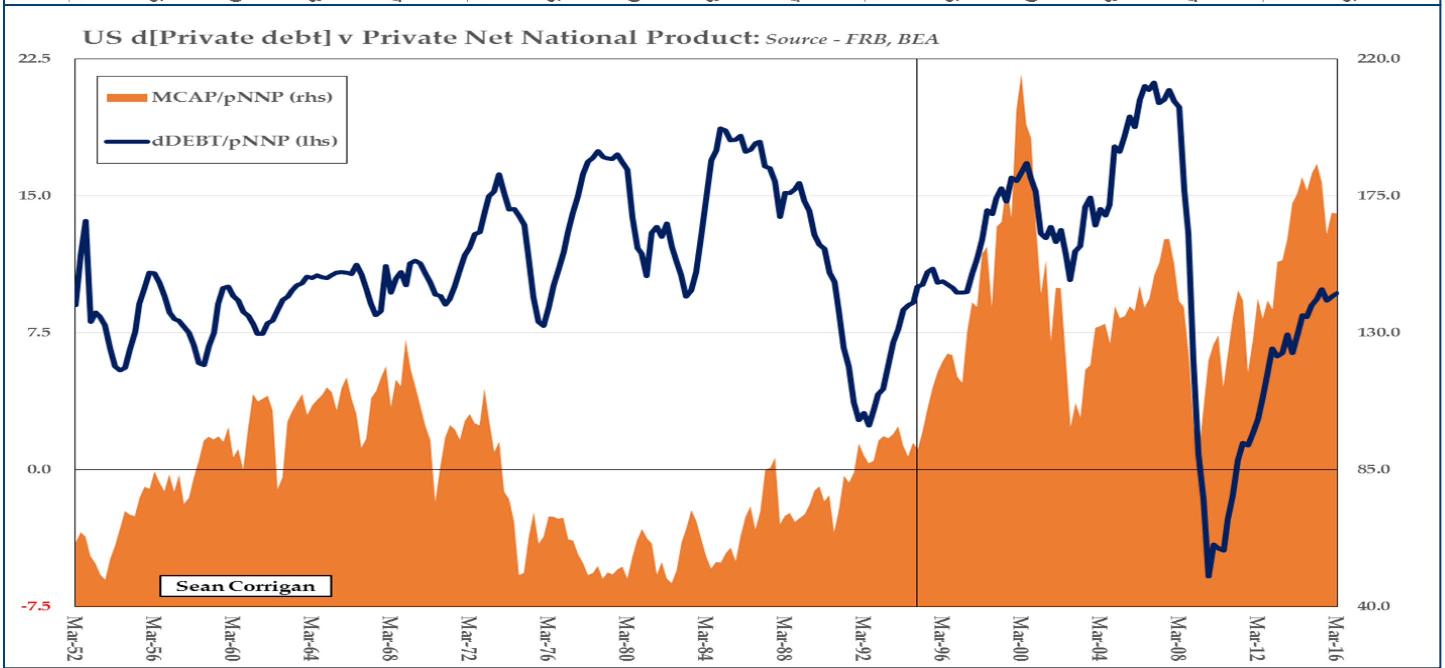
Price/book is another revealing measure, one full sigma over the 65-year mean and in the 86th percentile of that sample after we allow for the existence or otherwise of a tally of one-for-one valued net financial assets. If we further adjust to reckon real estate holdings in relation to replacement cost, rather than with reference to hypothetical market valuation (and note that proper, conservative accounting would further reduce them to an historic cost basis), the degree of extremity only increases, to produce a 1.4 sigma, 92nd percentile reading.

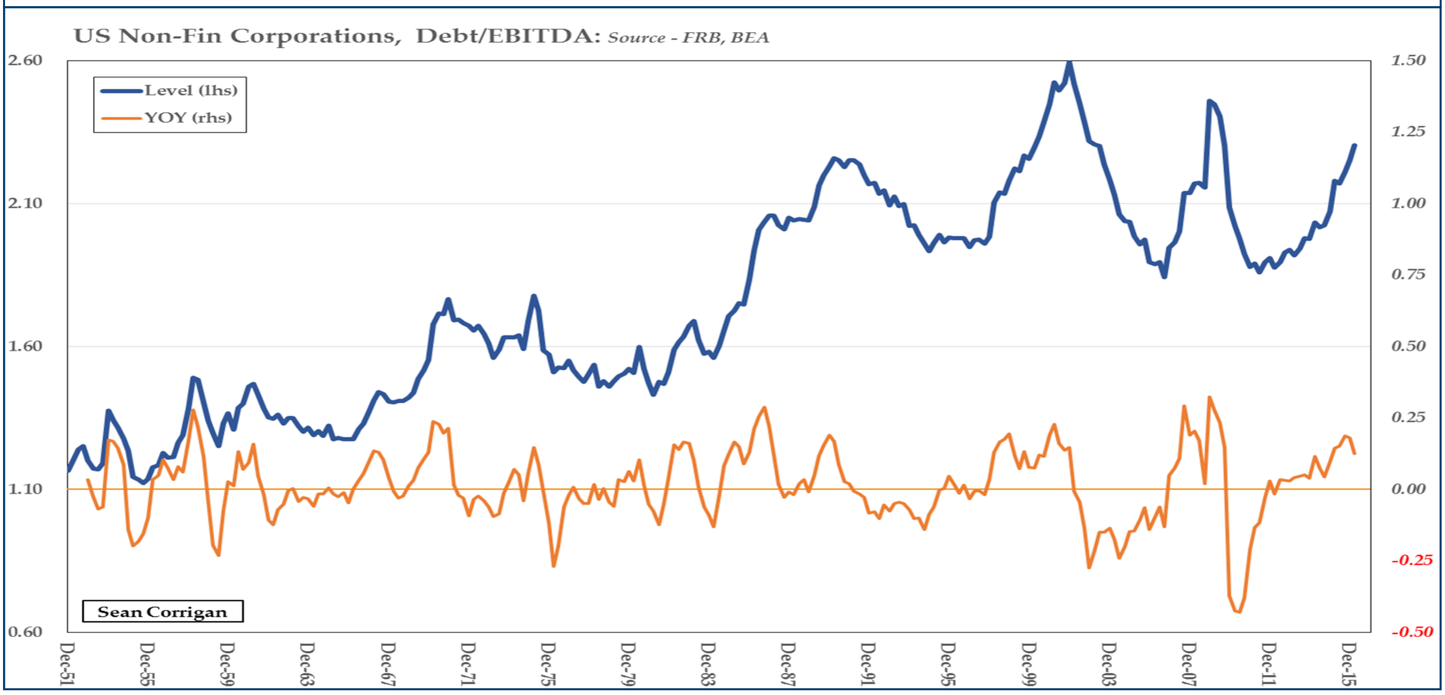
Worse yet, fully three-quarters of the past six year's change in net worth and two-thirds of the simultaneous gain in market cap can be attributed to the $6.1 trillion upward movement of the notional value of that same real estate. The degree to which this itself is an insubstantial phantom of the bullishness fostered by vanishing interest rates can be seen from the fact that the replacement cost total has simultaneously risen by only $1.3 trillion. In thus outstripping the worth of the physical increment of bricks, glass, rebar and land by a whopping factor of 4.7, the effective price/book for corporates' RE portfolio has itself therefore soared to a level of 150%; a point where it actually now just pips the spurious multiplier applicable at the very pinnacle of the sub-prime/CDS bubble for the honour of all-time first place.

Additionally, a further $2.2 trillion has been added to the aggregate balance sheet's catch-all, '*miscellaneous, other assets*' category within which, or so the Fed tells us, is to be found the entry for goodwill. The sharp-eyed reader will quickly notice that, when taken together with the possibly illusory gains in real estate, the legacy of paying often-unwarranted premia for M&A activity – an undertaking which always becomes progressively undisciplined as interest rates fall and stock prices rise – makes up 100% of the entire recovery's addition to net worth and 92% of that to market cap. Vanity of vanities! All is vanity!

That P/E ratios are nowhere near their peak is a matter which gives comfort to those only interested in superficial signs of health, yet even these are at the very upper limit of the past 65-years' distribution, if only we exclude the years either side of the TMT boom, Even with that Go-Go episode included, price/sales sits at the highest point in the


US Non-Fin Corporations, EV/EBITDA: Source - FRB, BEA
10.00
8.00
6.00
4.00
2.00
7.50
5.00
2.50
0.00
-2.50
Sean Corrigan
Dec-51
Dec-55
Dec-59
Dec-63
Dec-67
Dec-71
Dec-75
Dec-79
Dec-83
Dec-87
Dec-91
Dec-95
Dec-99
Dec-03
Dec-07
Dec-11
Dec-15


US d[Private debt] v Private Net National Product: Source - FRB, BEA
MCAP/pNNP (rhs)
dDEBT/pNNP (lhs)
22.5
15.0
7.5
0.0
-7.5
220.0
175.0
130.0
85.0
40.0
Sean Corrigan
Mar-52
Mar-56
Mar-60
Mar-64
Mar-68
Mar-72
Mar-76
Mar-80
Mar-84
Mar-88
Mar-92
Mar-96
Mar-00
Mar-04
Mar-08
Mar-12
Mar-16


US Non-Fin Corporations, Debt/EBITDA: Source - FRB, BEA
Level (lhs)
YOY (rhs)
2.60
2.10
1.60
1.10
0.60
1.50
1.25
1.00
0.75
0.50
0.25
0.00
-0.25
-0.50
Sean Corrigan
Dec-51
Dec-55
Dec-59
Dec-63
Dec-67
Dec-71
Dec-75
Dec-79
Dec-83
Dec-87
Dec-91
Dec-95
Dec-99
Dec-03
Dec-07
Dec-11
Dec-15

record – a combination which speaks of margins enjoying something of a purple patch, albeit one which has recently been fading noticeably from deepest indigo to a much less impressive mauve.

The interrelation between all of the foregoing is, of course, the fact that cheap debt is boosting earnings not only by lowering interest costs, but by artificially enhancing price multiples via ongoing heavy share buy-backs. These are being conducted at close to a $50 billion-a-month pace, one only ever outrun as the world approached the precipice of the GFC. Add these to record dividend disbursements and the near $1.2 trillion a year, combined pay-out has begun to set new dollar records and to beat all bar the pre-Crash, spike highs when compared to national product in general or to corporate fixed investment in particular.

Though the connection between the two is sometimes as prone to overstatement as it is devoid of a hard, logical explication, it is tempting to conflate the falling, if oscillatory trend in corporate investment seen this last 35 years with the concomitant rise in the pay-out ratio and so to give vent to suspicion that the focus on generating financially-engineered returns may be coming at the expense of delivering real, end-product derived ones.

This has lately been enabled largely – the cynic might say wholly – because of the central bank's egregious suppression of interest rates; a policy which has not only encouraged corporate management teams in their prodigality, but which has left investors little option but to close their eyes and buy in preference to accepting the unpalatably poor mix of current risk and prospective return on offer in a bond market which is increasingly coming to be populated not so much by fixed *income* instruments as fixed *outgo* ones.

Whatever the caveats we should derive from the above, they have not been enough to prevent returns on US equities from so outstripping those delivered by their peers these past few years that their relative measures are now either close to, or indeed beyond, the best levels seen in the entire floating exchange-rate era. Nothing seems 'cheap' on this score, either, albeit that some justification can be had from the fact that the States has not suffered misfortunes on a similar scale to those undergone by many of its global rivals.

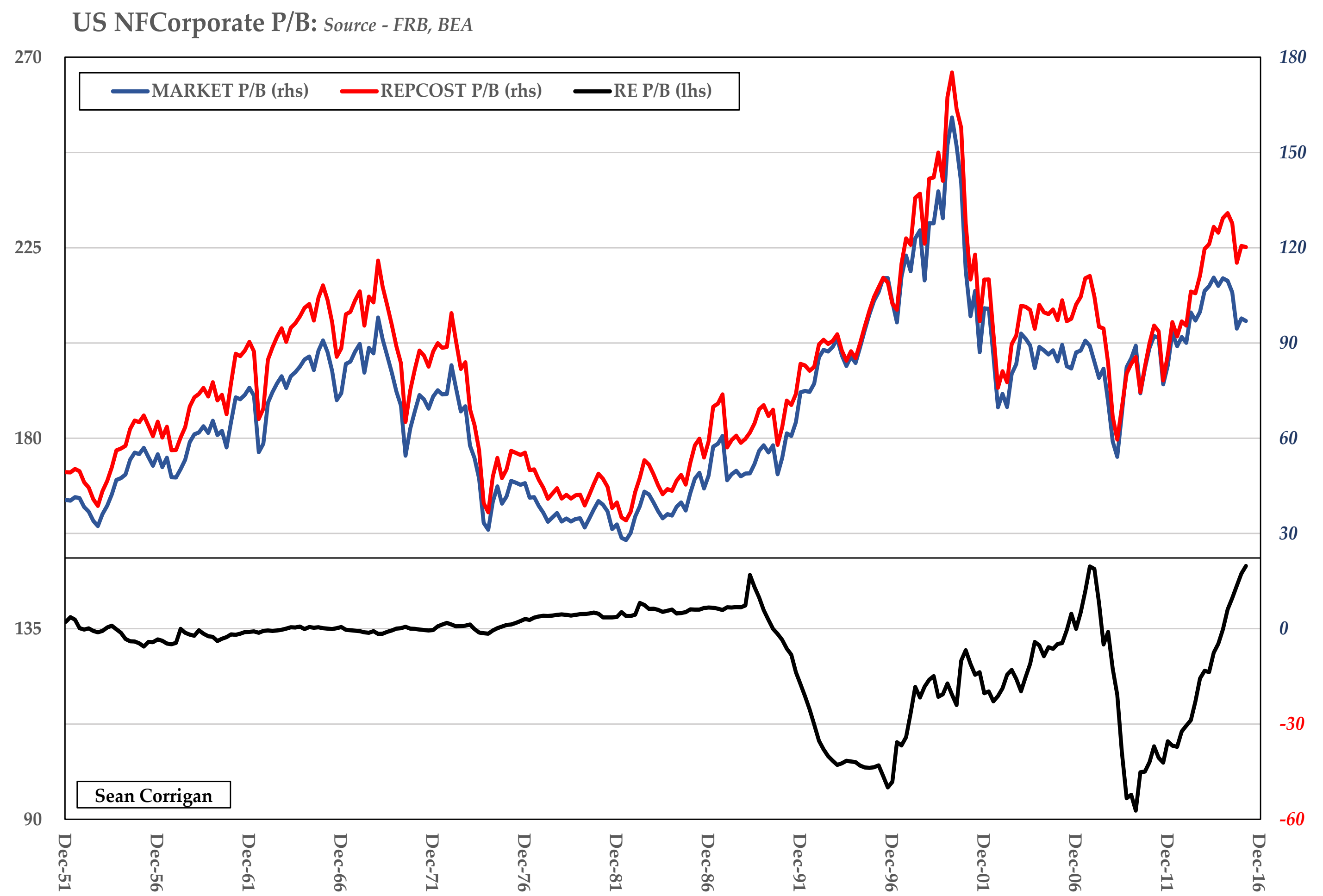
To add some hard, numerical substance to our more qualitative estimates of the extent to which both longer-term investors and shorter-term punters have been sucked into promoting such rich valuations is problematical, to say the least. Measures of market positioning vary, each in their own way conveying some partial truth about the whole; few of them unequivocally testifying to the motivation or commitment of either buyers or sellers.

What we *can* say, however, is that the latest NYSE data point to the fact that, as a proportion of market cap, both gross and net margin debt (the latter derived from the former by the subtraction of free cash balances) are greatly elevated; that shorts (as proxied by credit balances) are unremarkable in their magnitude; and that net longs – while down from recent peaks - are a long way from portraying balance, much less outright bearishness.

Faute de mieux, bonds' wild over-pricing is helping dispel much latent disquiet about the prospective returns from stocks at present, while the perception that the Fed is not so much writing puts as reinforcing the decking beneath the market is enough to soothe many an uneasy conscience, to boot.

Ultimately, one has to bear in mind that if the first asset class has become nothing more than a momentum play, the second has become increasingly reliant on the maintenance of that self-same momentum – a dynamic to which there must inevitably be a term limit however much extended it may be by the irresponsible actions of the monetary authorities.

Buy, then, as you no doubt must. But when you do, please bear in mind that you are not so much walking in the footsteps of the Sage of Omaha as in those of the Cincinnati Kid.


US NFCorporate P/B: Source - FRB, BEA
MARKET P/B (rhs)
REPCOST P/B (rhs)
RE P/B (lhs)
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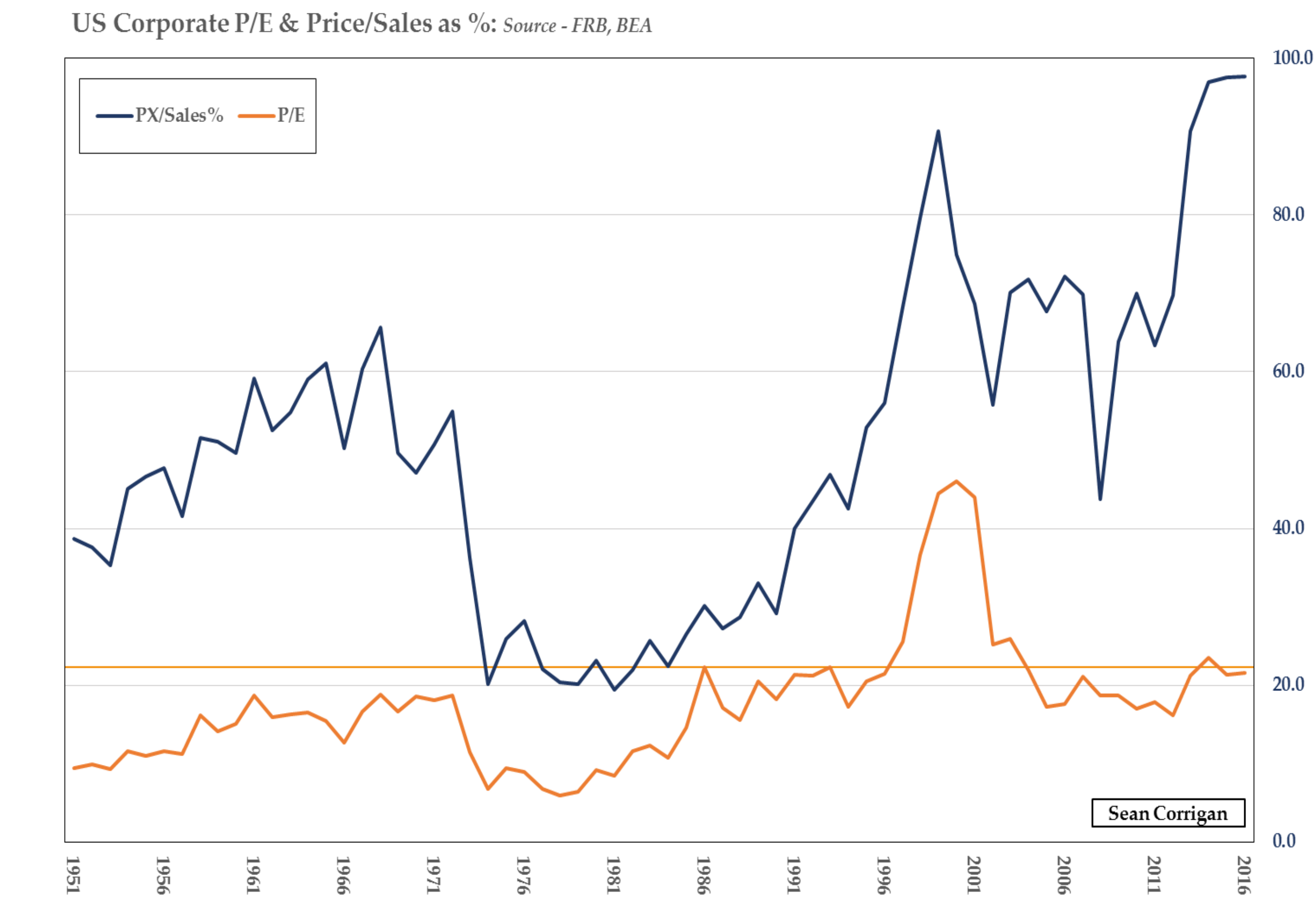
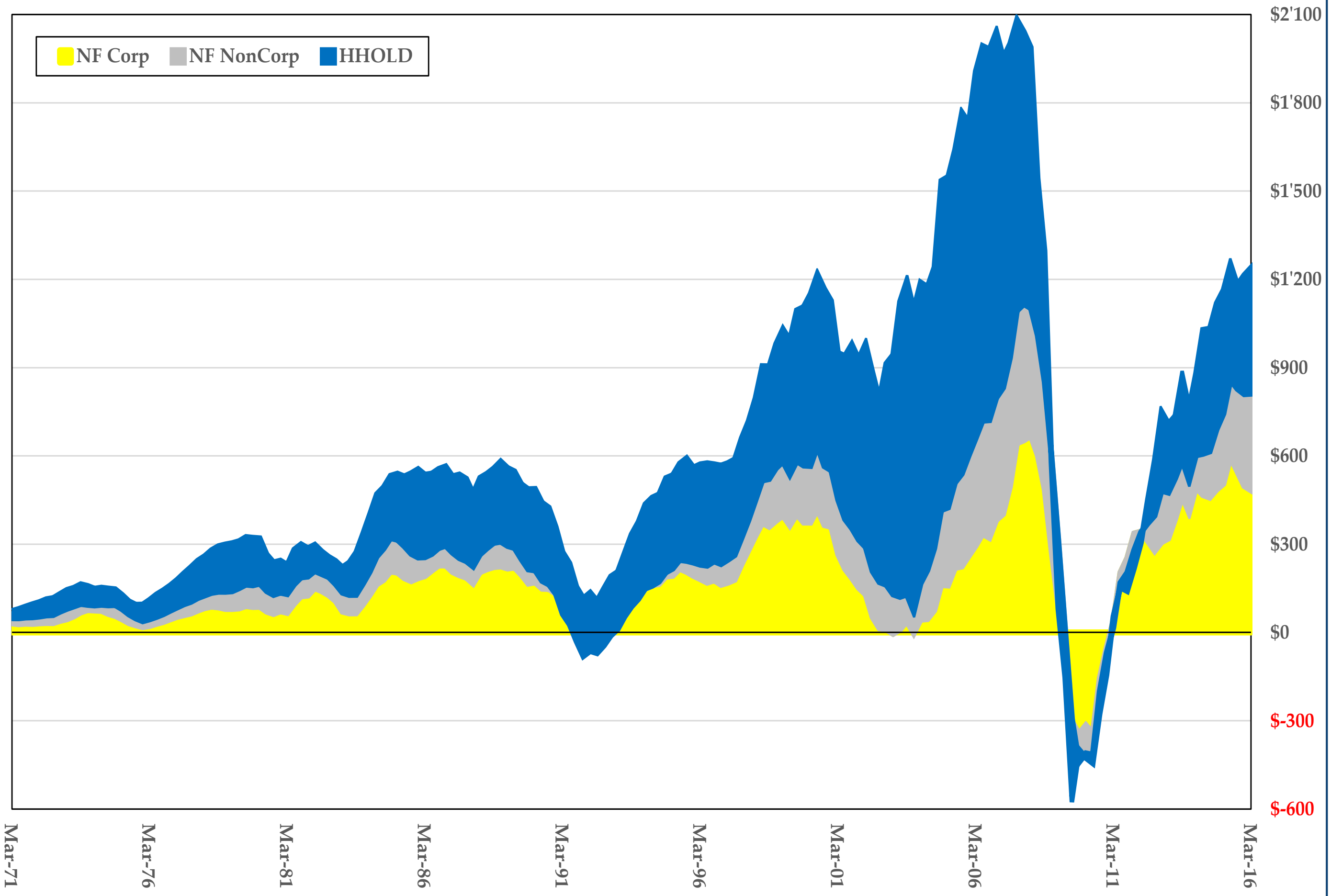
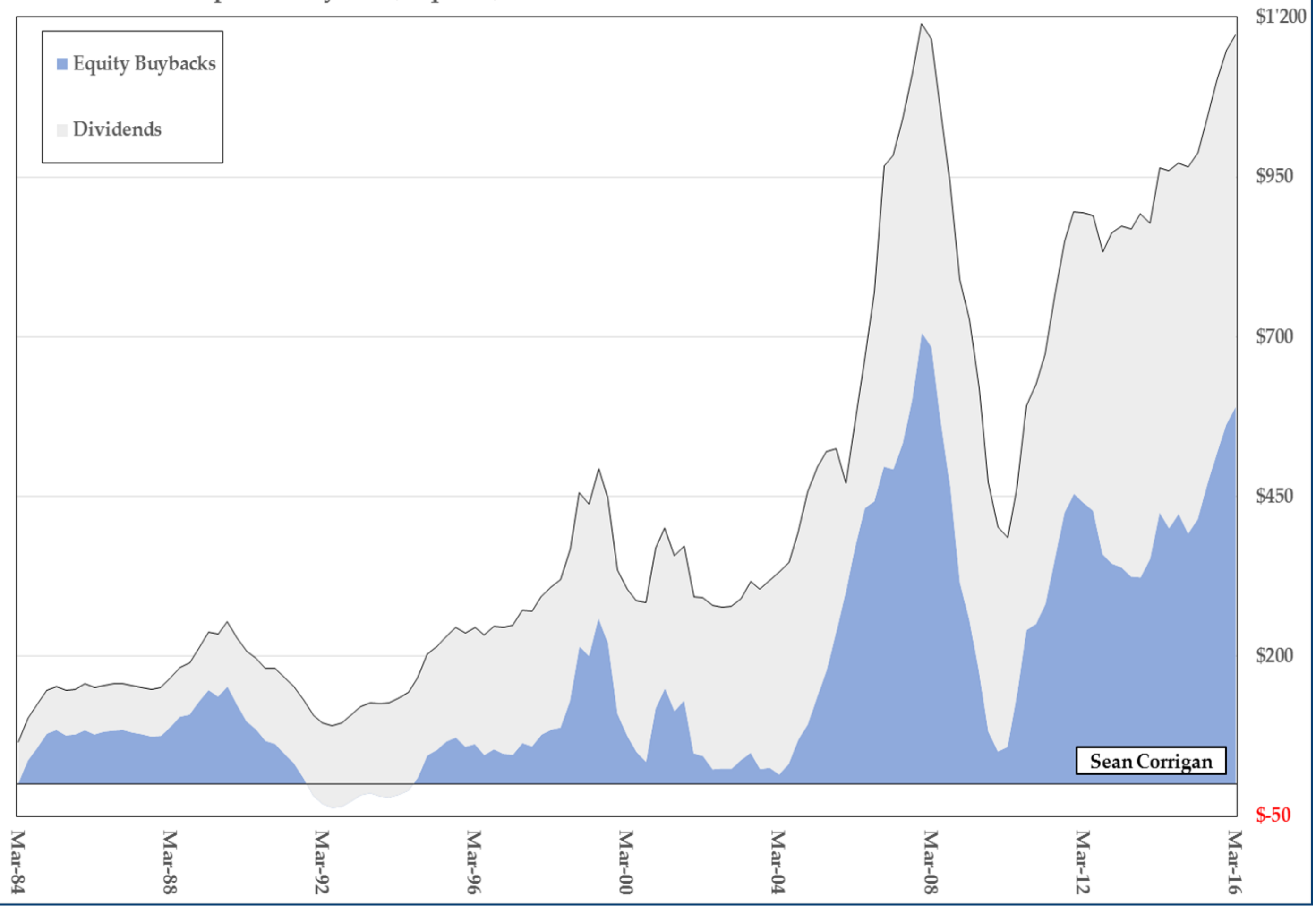
270
225
180
135
90
180
150
120
90
60
30
0
-30
-60
Dec-51
Dec-56
Dec-61
Dec-66
Dec-71
Dec-76
Dec-81
Dec-86
Dec-91
Dec-96
Dec-01
Dec-06
Dec-11
Dec-16


US Corporate P/E & Price/Sales as %: Source - FRB, BEA
PX/Sales%
P/E
Sean Corrigan
100.0
80.0
60.0
40.0
20.0
0.0
1951
1956
1961
1966
1971
1976
1981
1986
1991
1996
2001
2006
2011
2016

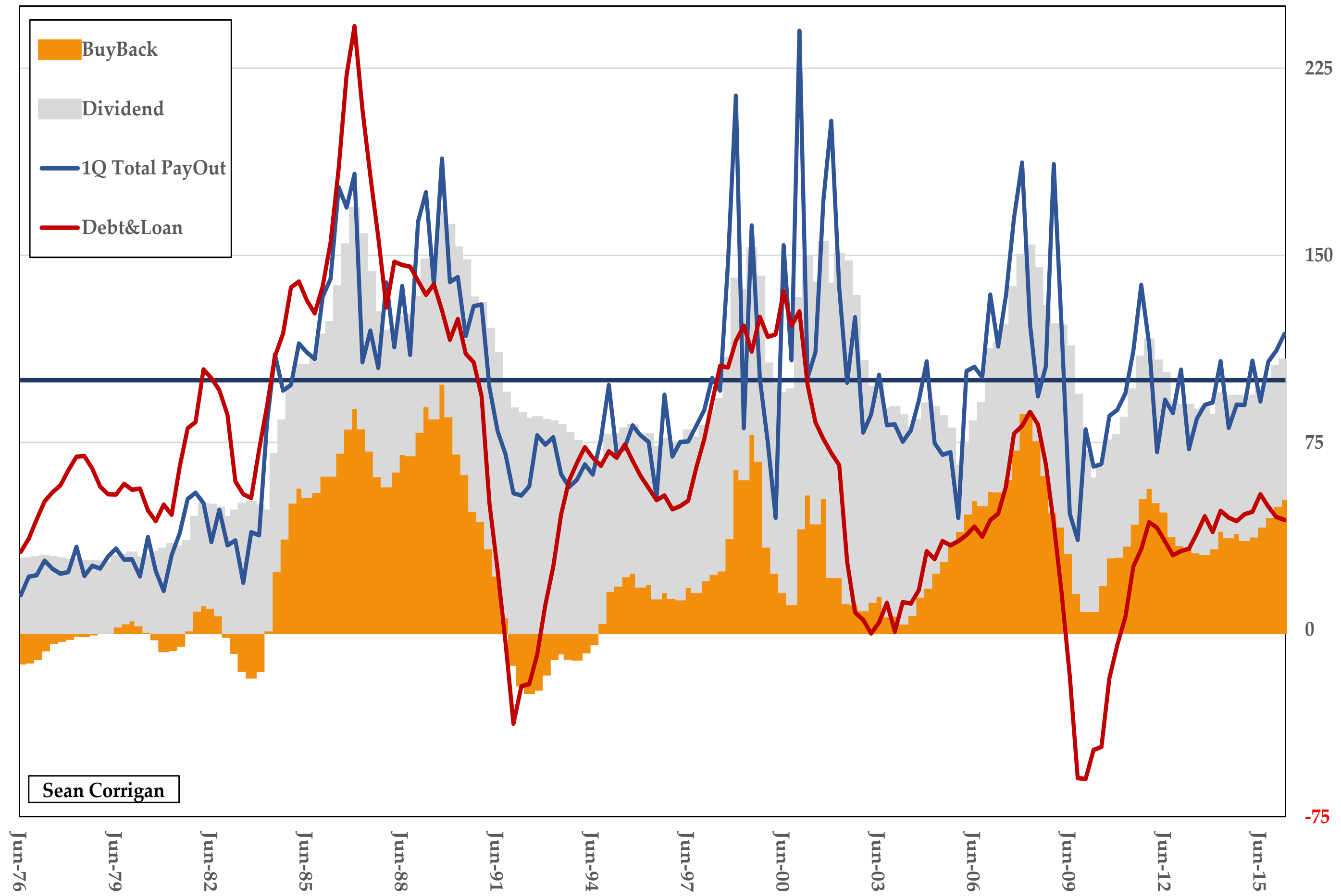
US Private Non-Financial Debt Accumulation, 4q sum, blns: *Source - FRB*



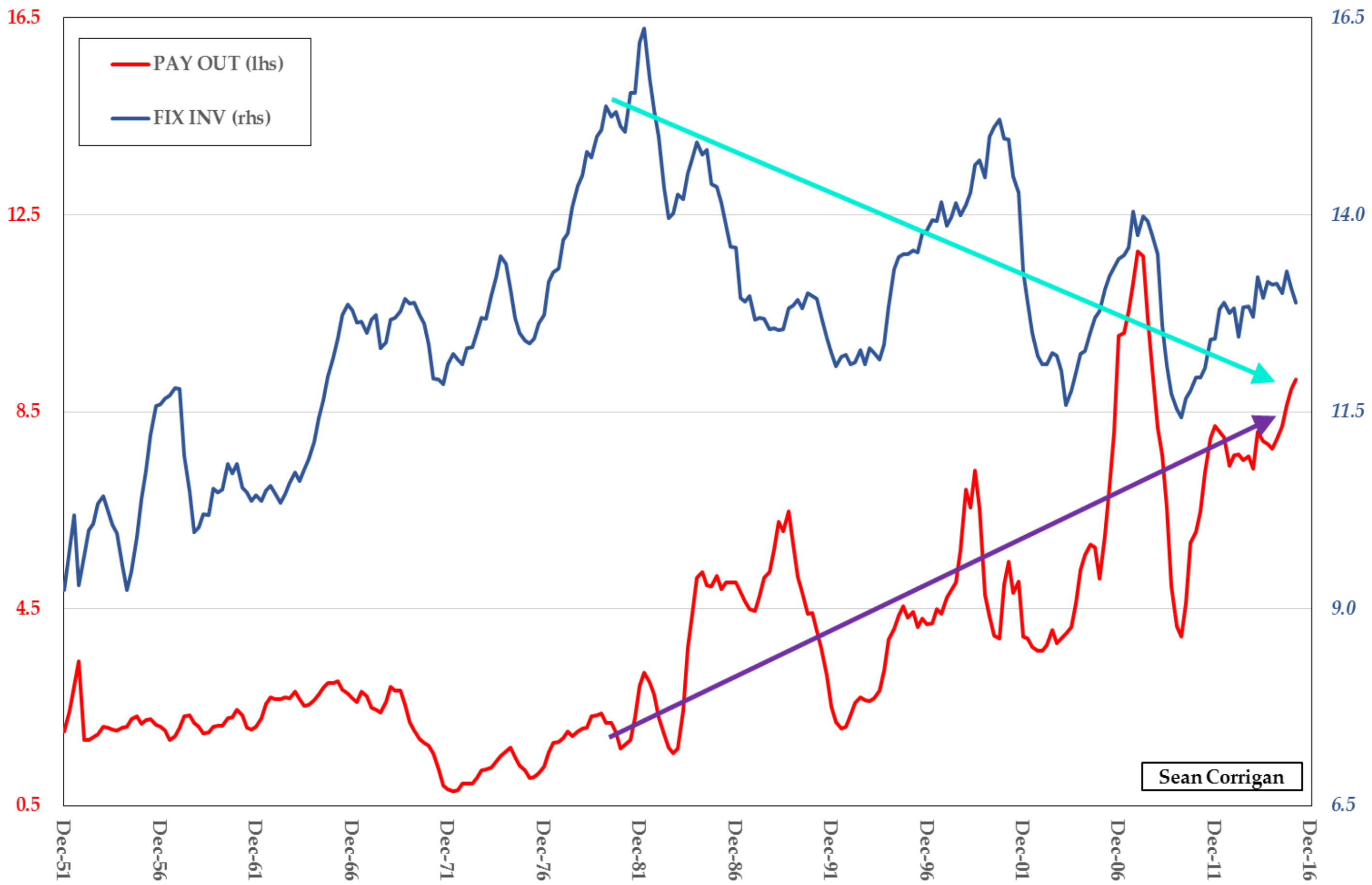
US Non-Fin Corporate Pay-outs, 4q sum, blns: *Source - FRB*

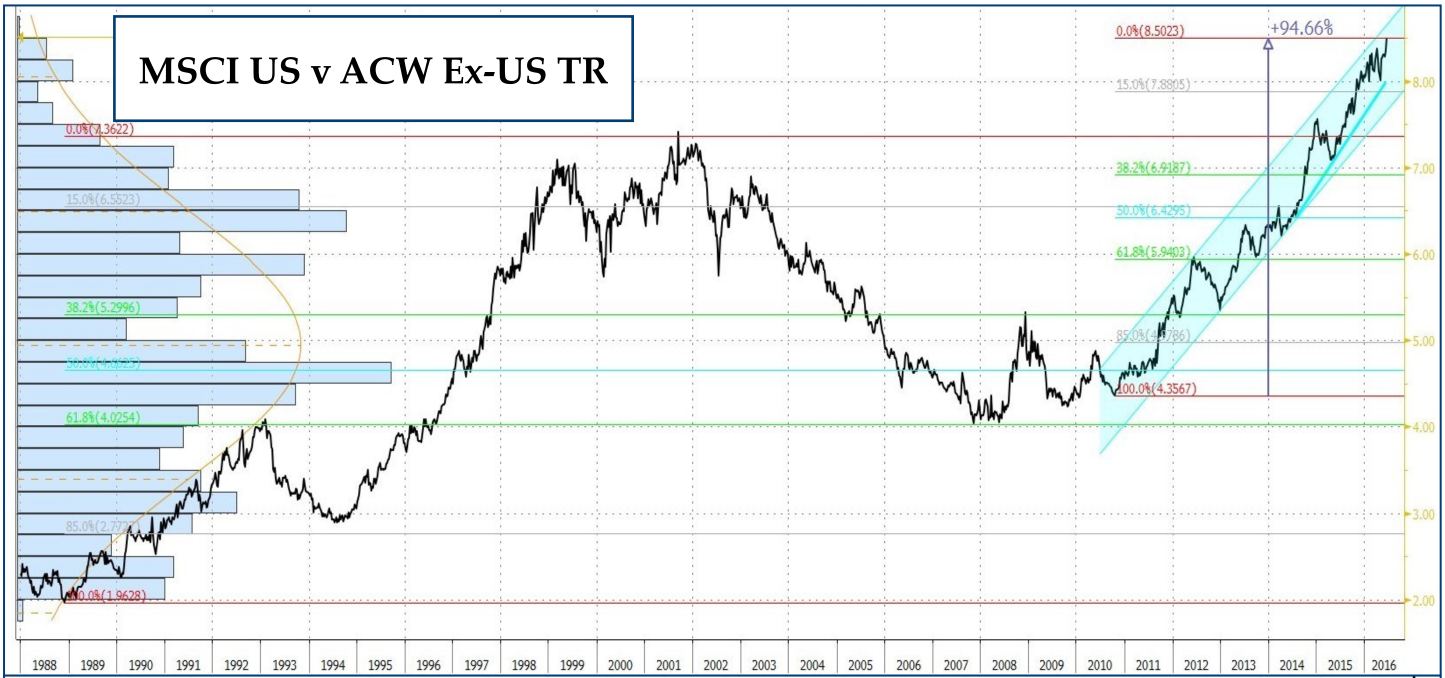


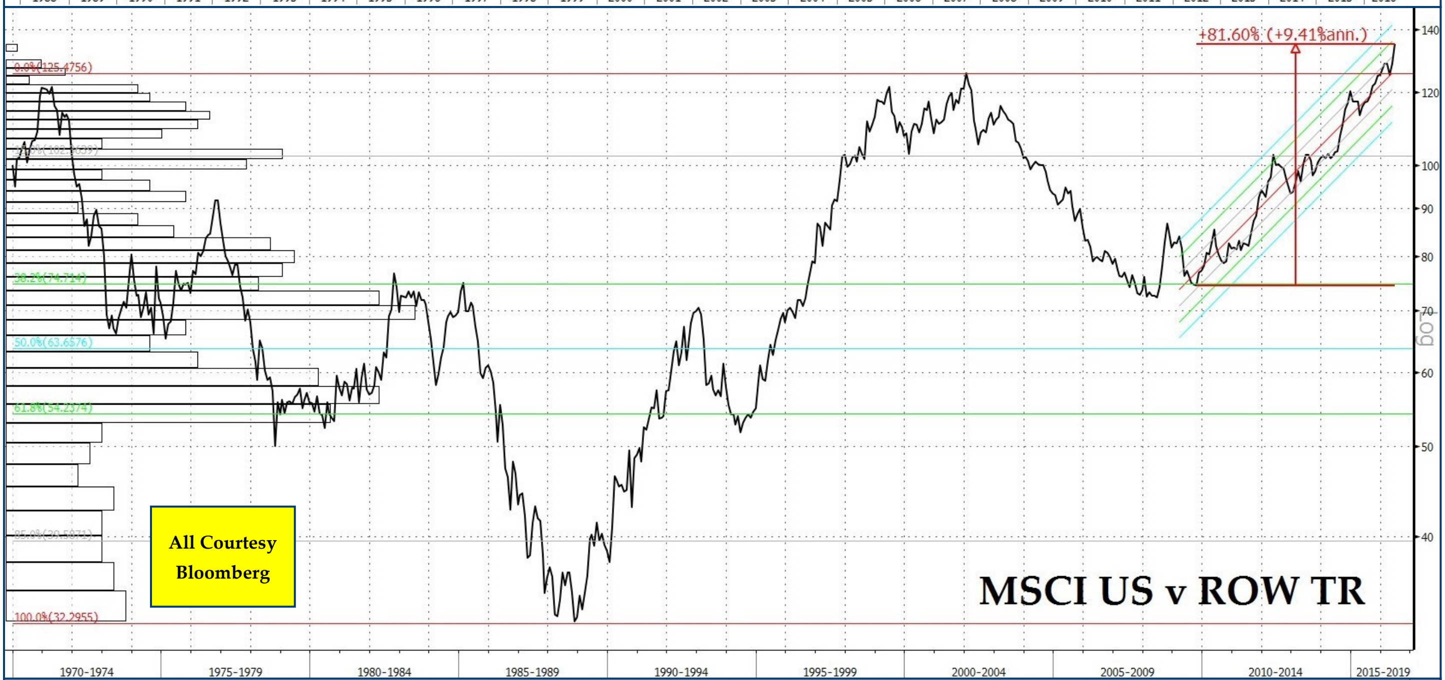
US Non-financial Corporates, Pay-out/After-tax earnings 4Qma%: *Source - FoF*



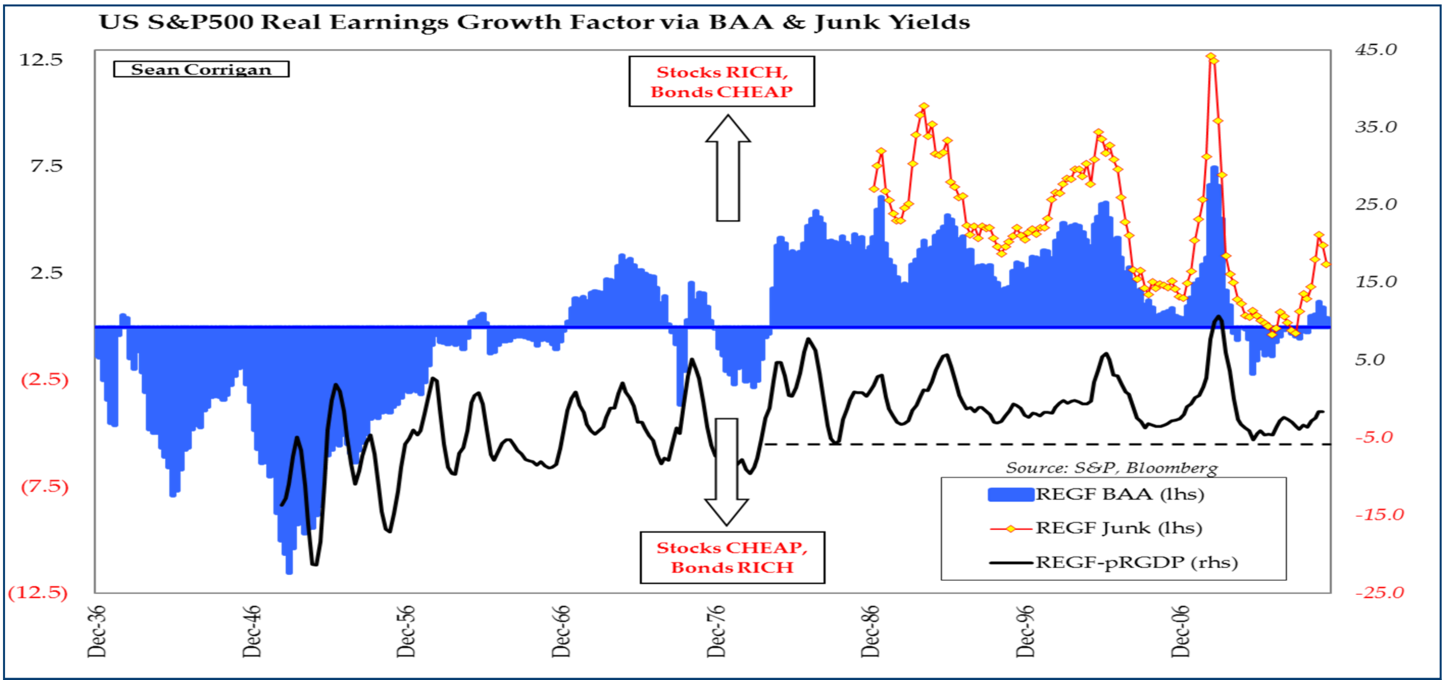
US Non-Financial Corporates Pay-out v Fixed Capex as % of pNNP: *Source - FRB, BEA*




MSCI US v ACW Ex-US TR
+94.66%
1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016


+81.60% (+9.41%ann.)
All Courtesy Bloomberg
MSCI US v ROW TR
1970-1974 1975-1979 1980-1984 1985-1989 1990-1994 1995-1999 2000-2004 2005-2009 2010-2014 2015-2019


MSCI US v World Ex-Japan
1970-1974 1975-1979 1980-1984 1985-1989 1990-1994 1995-1999 2000-2004 2005-2009 2010-2014



US S&P500 Real Earnings Growth Factor via BAA & Junk Yields
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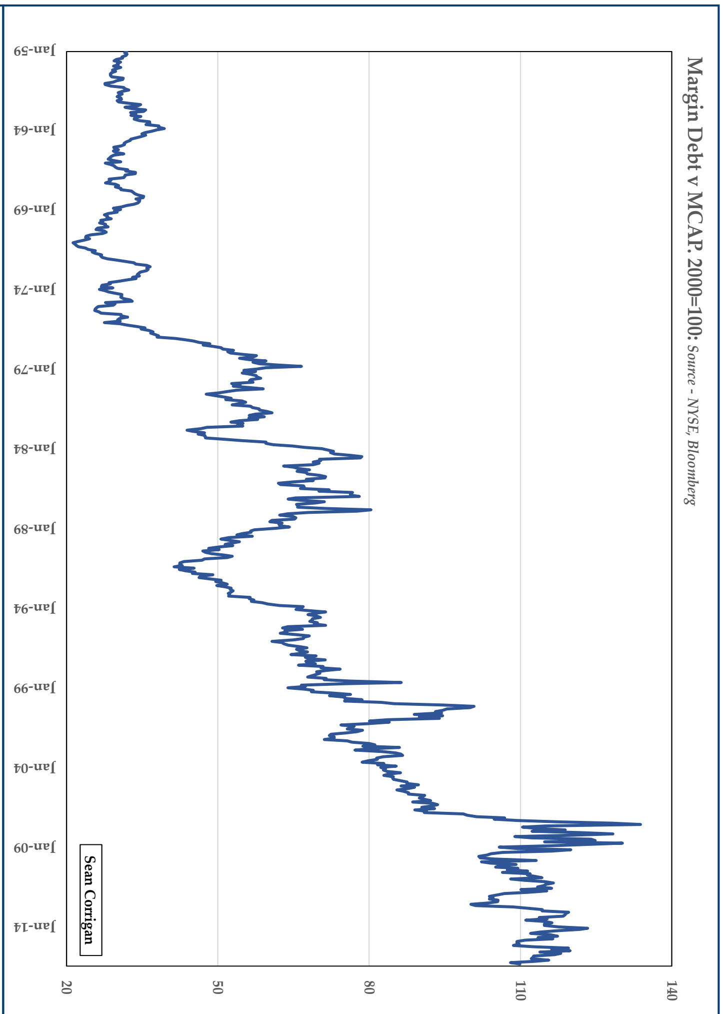
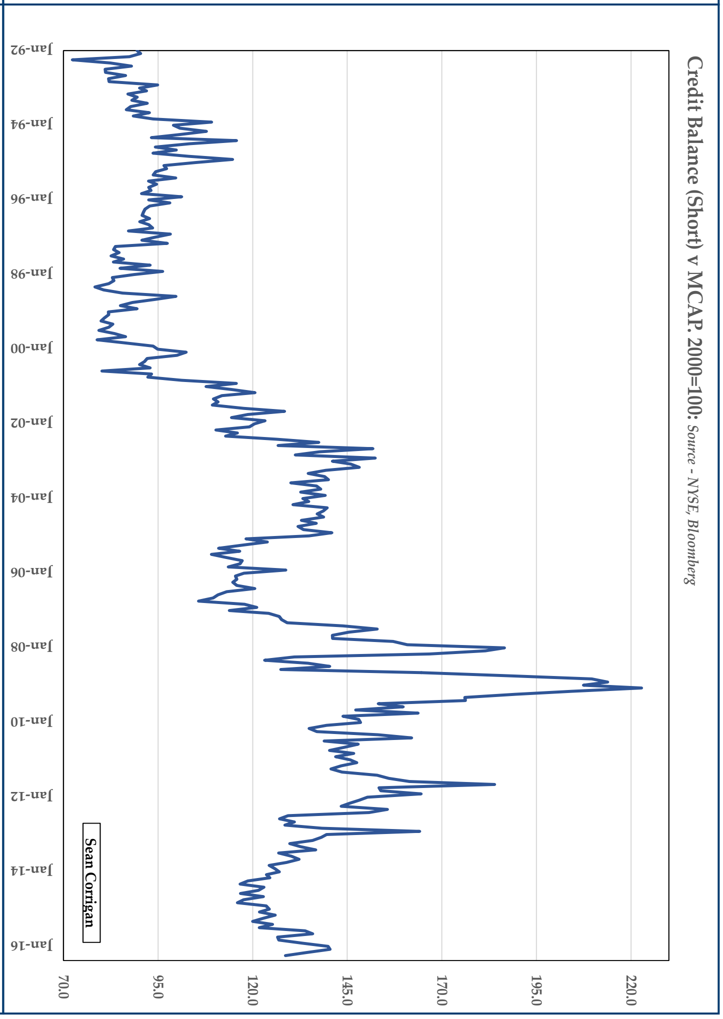
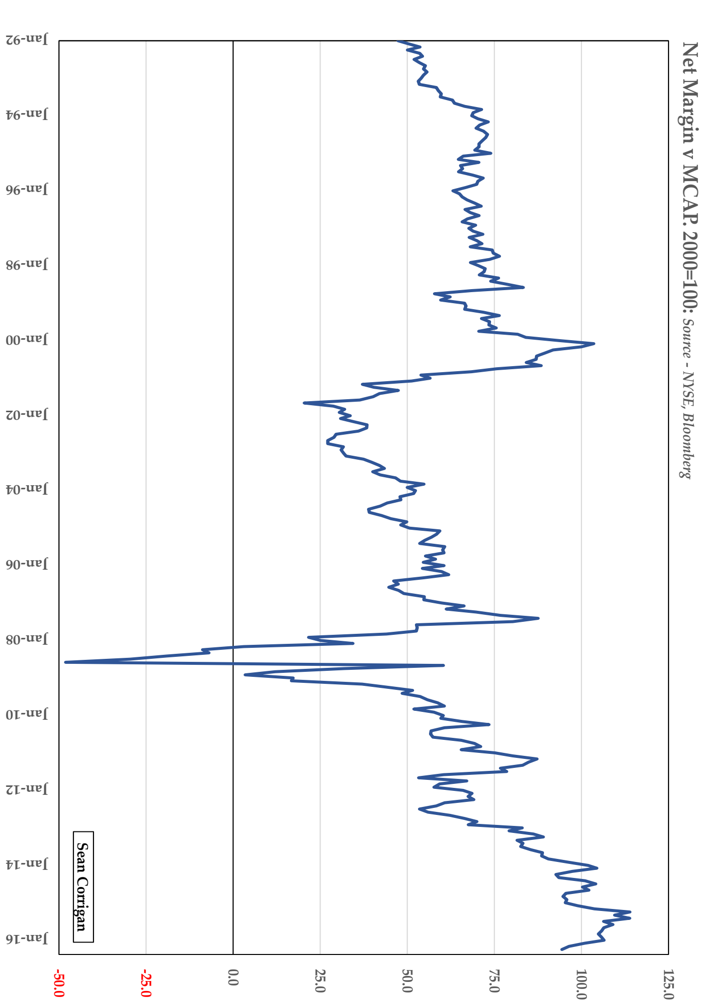
Stocks RICH, Bonds CHEAP
Stocks CHEAP, Bonds RICH
Source: S&P, Bloomberg
REGF BAA (lhs)
REGF Junk (lhs)
REGF-pRGDP (rhs)
12.5
7.5
2.5
(2.5)
(7.5)
(12.5)
45.0
35.0
25.0
15.0
5.0
-5.0
-15.0
-25.0
Dec-36
Dec-46
Dec-56
Dec-66
Dec-76
Dec-86
Dec-96
Dec-06

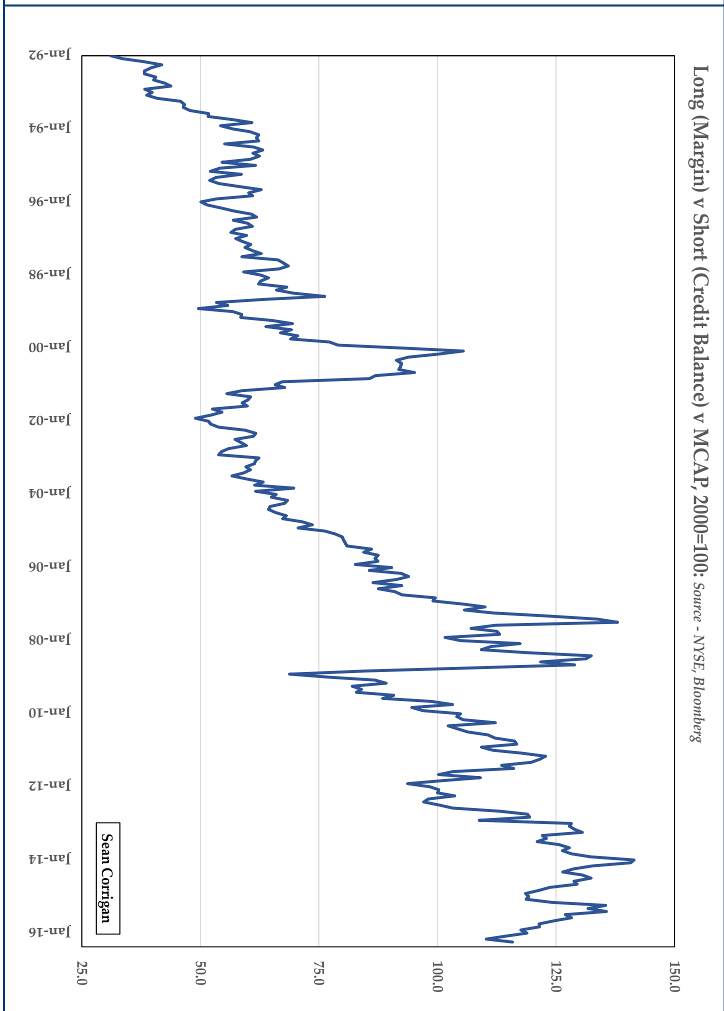
MSCI US v Barclay's AGG Bond TR
Courtesy Bloomberg
+155.48% (+20.25%ann.)
+146.45% (+15.07%ann.)
+245.62% (+3.25%ann.)
+107.18% (+4.51%ann.)
Stocks v bonds underlying trend the same 3.2% pa as GDP
424.059
500
400
300
200
100
Log
'76 '77 '78 '79 '80 '81 '82 '83 '84 '85 '86 '87 '88 '89 '90 '91 '92 '93 '94 '95 '96 '97 '98 '99 '00 '01 '02 '03 '04 '05 '06 '07 '08 '09 '10 '11 '12 '13 '14 '15 '16

Courtesy Bloomberg
UST Vol-based Risk:Reward
+378.68%
+235.38%
Not so much risk:reward as Russian roulette with five chambers loaded
1.2812
1.0000
0.9000
0.8000
0.7000
0.6000
0.5000
0.4000
0.3000
0.2000
Log
1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016


Margin Debt v MCAP. 2000=100: Source - NYSE, Bloomberg
Sean Corrigan


Credit Balance (Short) v MCAP. 2000=100: Source - NYSE, Bloomberg
Sean Corrigan


Net Margin v MCAP. 2000=100: Source - NYSE, Bloomberg
Sean Corrigan


Long (Margin) v Short (Credit Balance) v MCAP, 2000=100: Source - NYSE, Bloomberg
Sean Corrigan

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