



MONEY, MACRO & MARKETS

September 2016

Part III: US equities

Sean Corrigan

WHERE THE MONEY GROWS: Wall St & West

At last week's FOMC, as well as chickening out once more over raising rates, Janet Yellen gave another rambling, often self-contradictory press conference in which she sought to explain her Committee's latest display of pusillanimity.

For example, Yellen talked of how the Fed was still 'data dependent' – i.e. that it would await the first patter of raindrops before searching in the cupboard for an umbrella – but then boasted of how it was 'forward-looking' and of how it did not favour a 'whites of the eyes approach' to economic overheating!

Then, too, the case for a rate hike was similarly said to have 'strengthened', but clearly had not strengthened anywhere near enough to warrant an actual response on her part. Moreover, there was some macroeconomic mumbo-jumbo about how the US had much lower growth potential than heretofore but that this meant our esteemed Madame Chairwoman felt it had 'more room to run'.

Fully prey to the productivity fallacy of interest rate determination (a hoary old tautology of no greater respectability than the real bills arguments which used to carry so much weight at the Fed), she also kept insisting that the funds rate was so close to the unobservable chimera of the 'neutral rate' – itself an econometric circularity in the hands of the mainstream – that settings were only 'modestly accommodative', but then went on to talk about how, around the world, they were 'highly' so. If she thinks the first can occur amid the second, she must believe in the sort of impermeable barriers at the border of which one of the current presidential candidates can only dream!

Even more confusedly, she argued that, this high degree of 'accommodation' seemed '*to be necessary for countries to be able to achieve their inflation and employment objectives*'. But if such rates as we have *are* those needed to bring things to that happy pass, they are either then themselves the elusive, pixie-dust neutral rates (since that is their definition) – and hence are not at all 'accommodative' – *or* the central banks of the 'advanced' nations are wilfully pursuing 'objectives' well beyond the sustainable limit by dosing activity with a good deal of sub-neutral stimulus.

Ah, well.

But it was in here strangulated treatment of asset markets that Dr. Yellen reached the acme of her expository skill.

Witness the following assertion:-

Yellen: Of course, we are worried that bubbles could form in the economy, and we routinely monitor asset evaluations. While nobody can know for sure what type of valuation represents a bubble – that's only something one can tell in hindsight – we are monitoring these measures of valuation, and commercial real estate valuations are high.

We shall deal with the utterly irrational 'rational expectations' school canard of bubble undetectability in a moment, but note that what she has said here is that she can't know if there IS a bubble until AFTER there has been one but, nevertheless, there isn't one at present!

Ain't that just Dandy! Groucho Marx would be proud of that display of absurdity.

Then she offered up this giant hostage to fortune, if only in the spirit of she-would-say-that-wouldn't-she:

'Overall, I would say that the threats to financial stability I would characterize, at this point, as moderate. In general, I would not say that asset valuations are out of line with historical norms.'

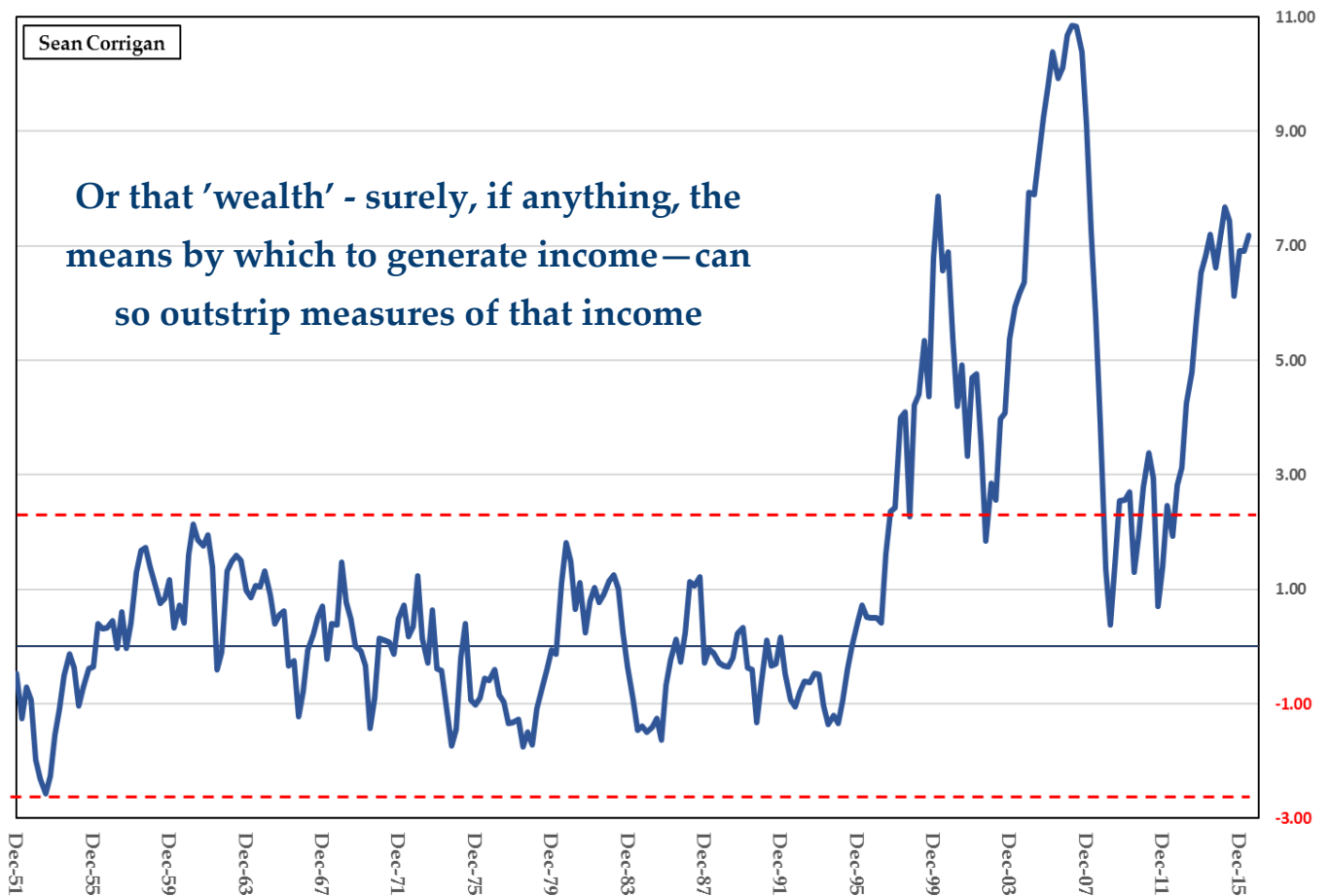
Patently, if she has somehow arrived at the determination that there is no indeterminably constituted asset bubble in operation, then it figures that non-bubble asset prices cannot be out of line with their norms. Chalk one up to answering one's own question in the affirmative.

But how much truth is there in this claim? It hardly needs us to expound the proposition that bonds are way out in the far reaches of the distribution – from BAA to AAA, Moody's indices have not been here since the end of the last great episode of yield suppression, from the latter years of the Great Depression, through the war socialism of WWII and past the Korean conflict and for a few, brief years after the end of the Treasury Accord.

As for bonds elsewhere around the world – well, enough said.

In the end, it all comes down to equities and real estate and even the Fed admits there may be problems with some elements of the latter!

As for stocks, the comparison with nugatory bond yields is the Max Factor on a particularly ugly porker, but whether



we look at price to book, earnings or cash-flow; whether we examine the relationship between what is paid out and what is taken or what remains in after other disbursement; whether we consider levels of indebtedness, or returns to capital or equity - things are either deteriorating, already parlous, or at their worst with the exception of the metrics seen at the peak of the late Tech Bubble.

Hopefully, the charts appended here will demonstrate this beyond all hope of reutation.

As for 'wealth' in general, a certain Mr. Buffett once used to sneer at those who thought they were oiling up riches not through the sweat of the brow or the keenness of their wit, but by ringing up their broker between rounds of golf.

Well, for the third time in under twenty years, 'we' have been doing much the same, thanks to Mme. Yellen and Messrs. Carney, Kuroda, Zhou, and Draghi.

No wonder the 1% are reinforcing the bars to their gated communities and the sans culottes are abandoning the political clubs of those who seem to have abandoned them as all this has taken place.

No, Madame Chair. There is little in the way of modest about the divergence of your interest rate settings from

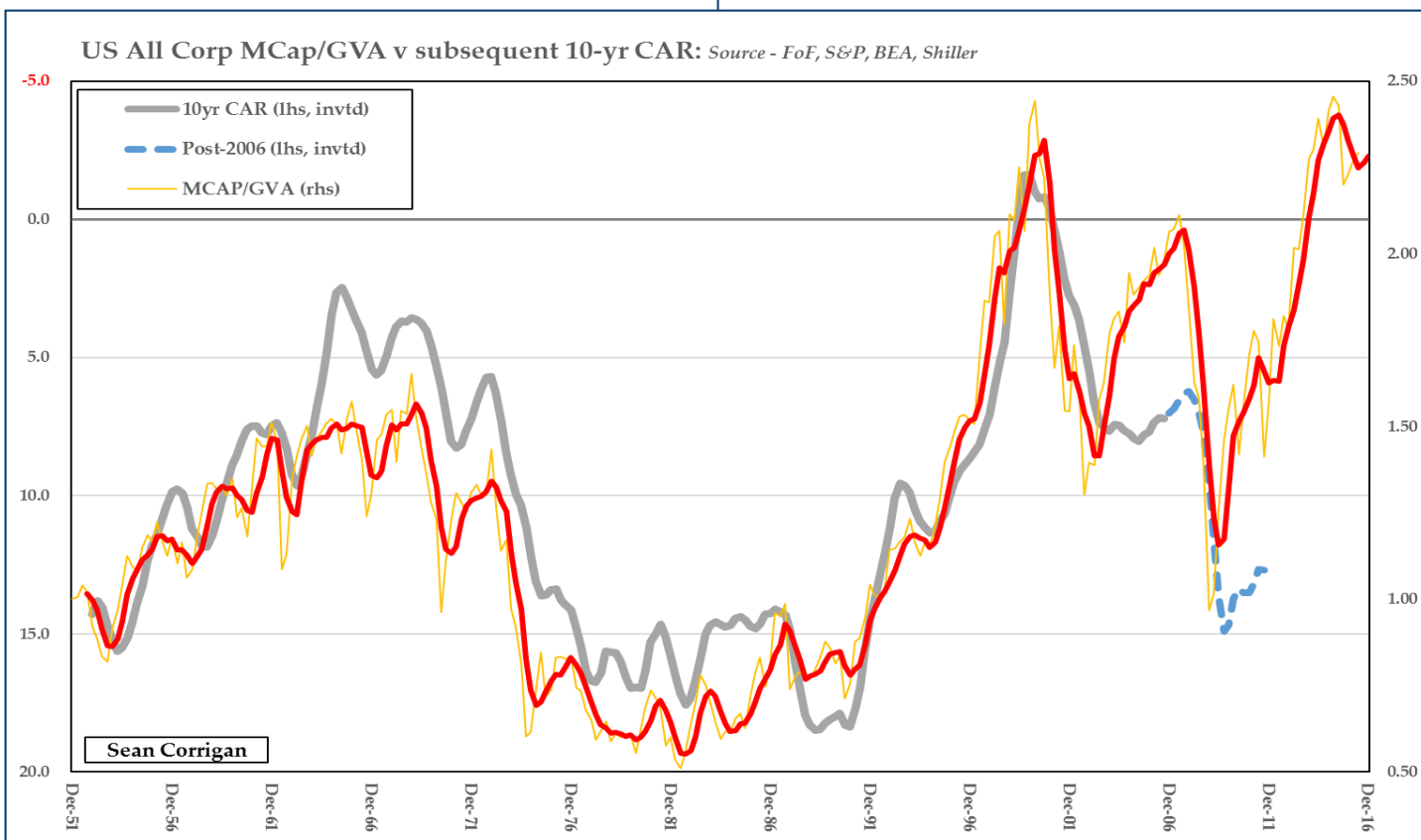
levels they should have attained, nor much in the way of historical precedent for where that has propelled asset valuations.

Those who can borrow – i.e., those who can credibly pledge the delivery of money tomorrow for the use of money today – have never had it so good.

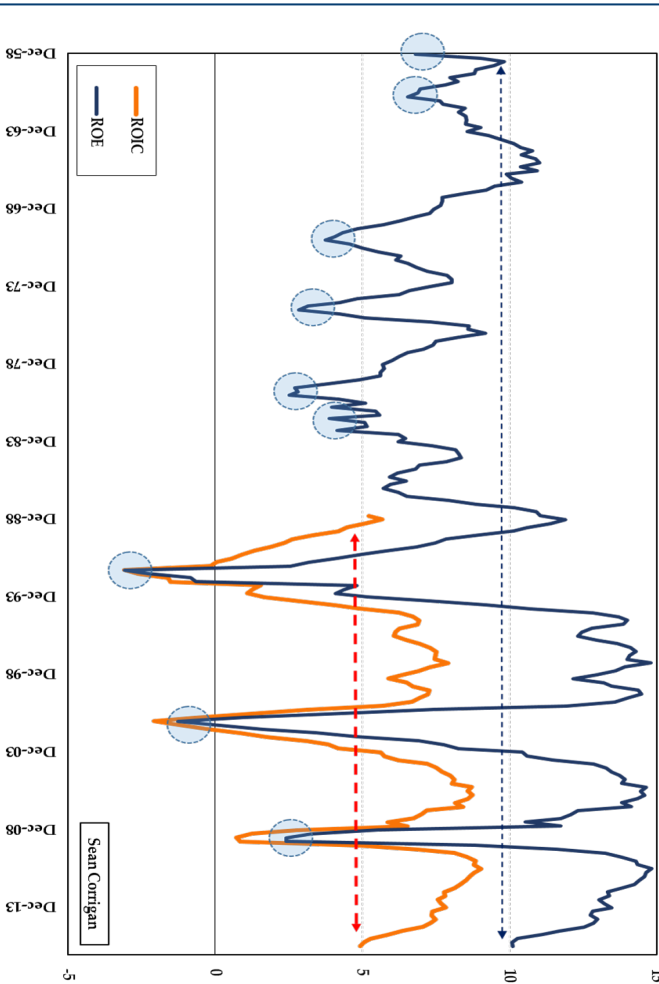
Those who cannot or will not are being forced to endure the noise of their richer neighbours partying upstairs on the higher levels of the apartment block.

Those who would instead prudentially provide for a less well remunerated tomorrow by lending are being priced out of the market by a monetary flood of biblical proportions. Worse, they are also seeing the greatest gains go not to those financing tomorrow's income-generating combinations of productive means and entrepreneurial skill at personal hazard but rather those being showered with often no-recourse table stakes by the MIT Macromancers so that they may make carefree gambles that their awareness of the Cantillon effects of selective inflation is sharper than that of the suckers sitting beside them.

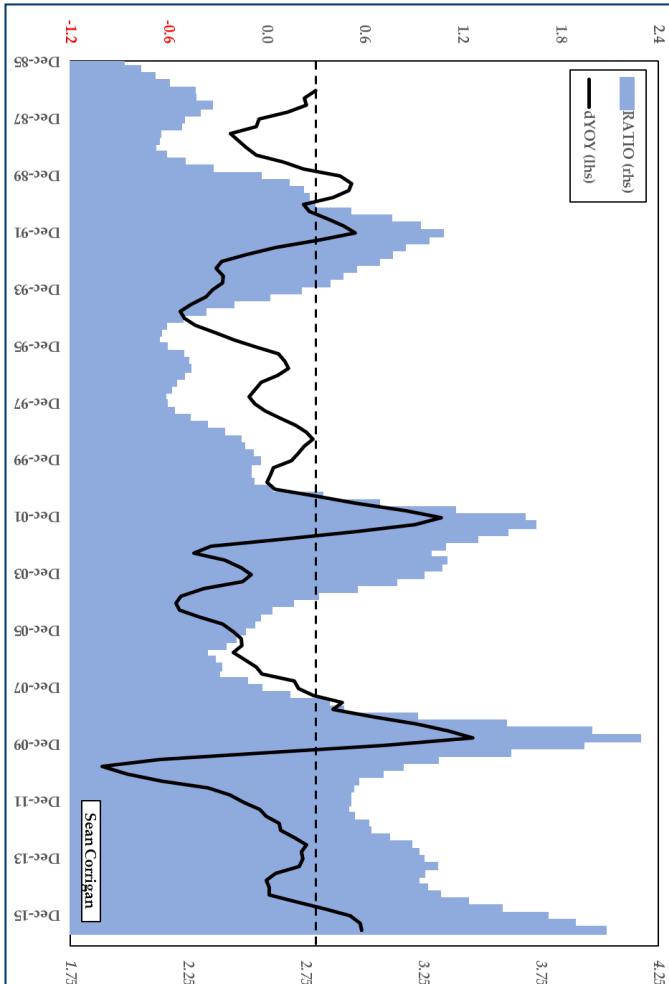
Yes, M. Coeuré, that is indeed a combination almost guaranteed to 'tear the social fabric', and to tear it, moreover, in a manner not readily to be reknitted.



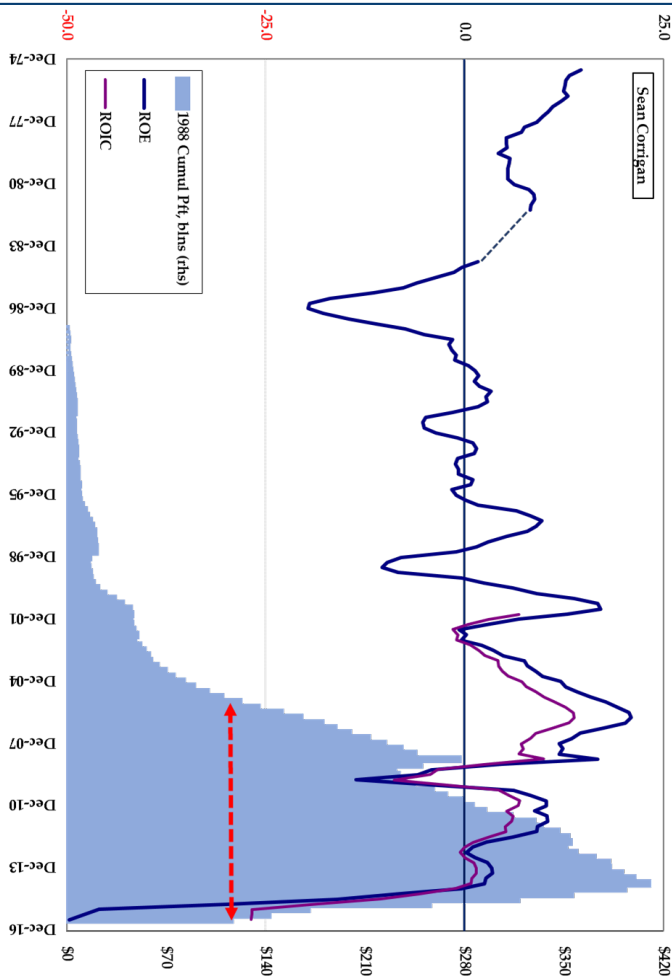
US MFG Real After-Tax ROE/IC, 4qma: Source - Census, BLS



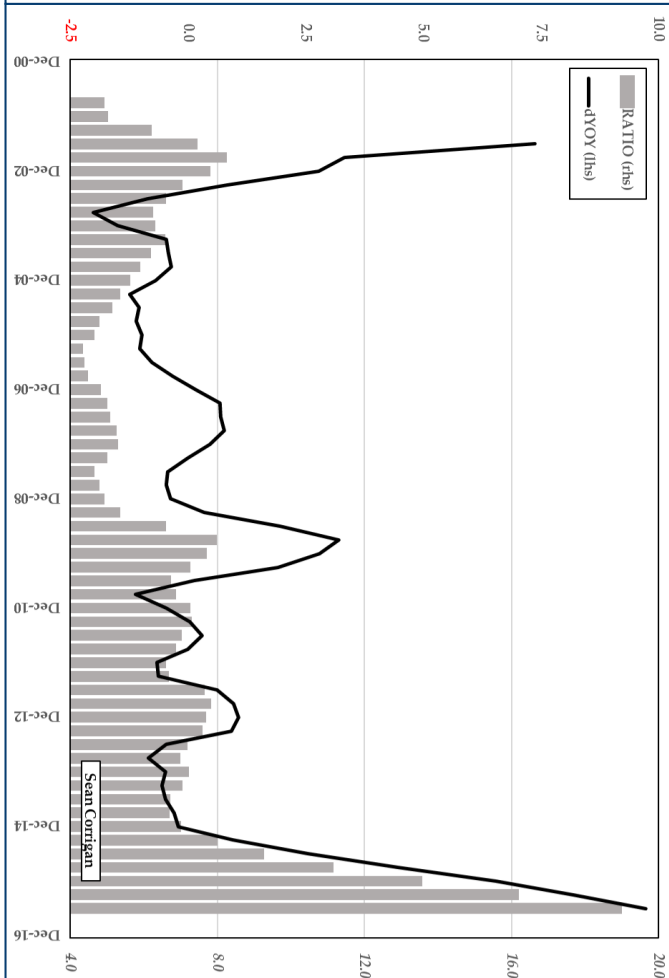
US Manufacturing Corps, Debt/EBITDA & YOY: Source - Census



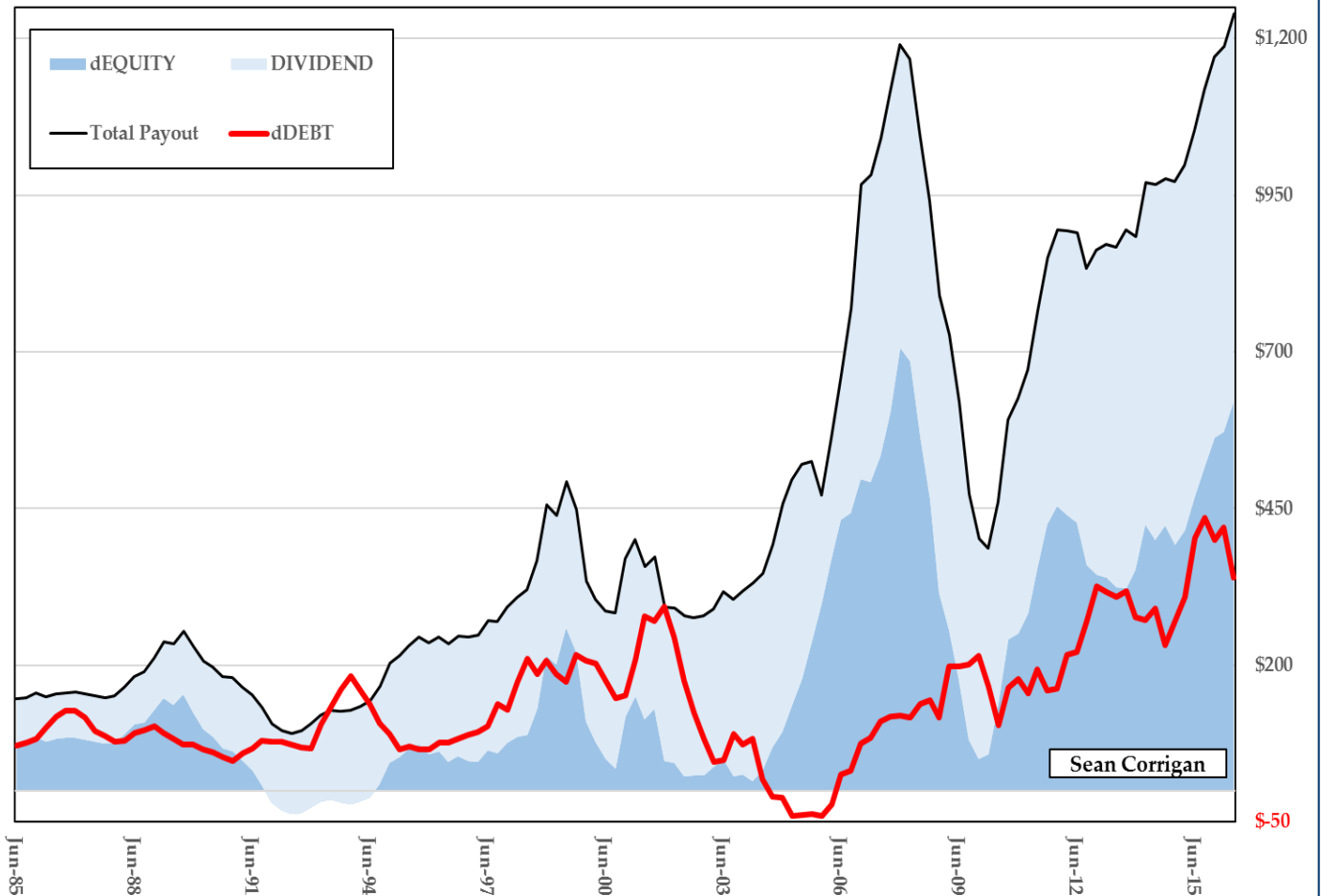
US Extractive Profits, Real ROE/IC, 4qMA: Source - Census, BLS



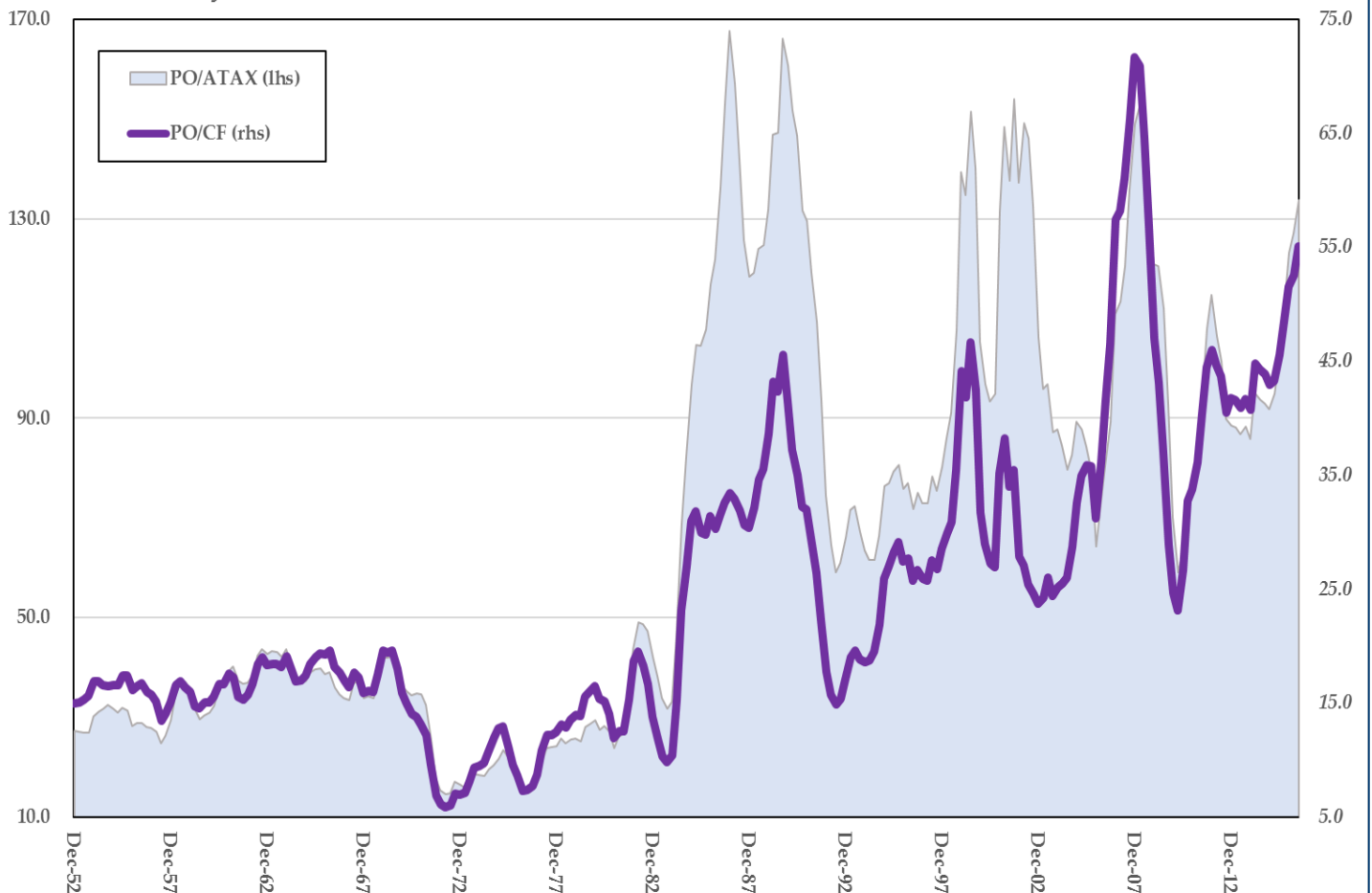
US Extractive Corps, Debt/EBITDA & YOY: Source - Census



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

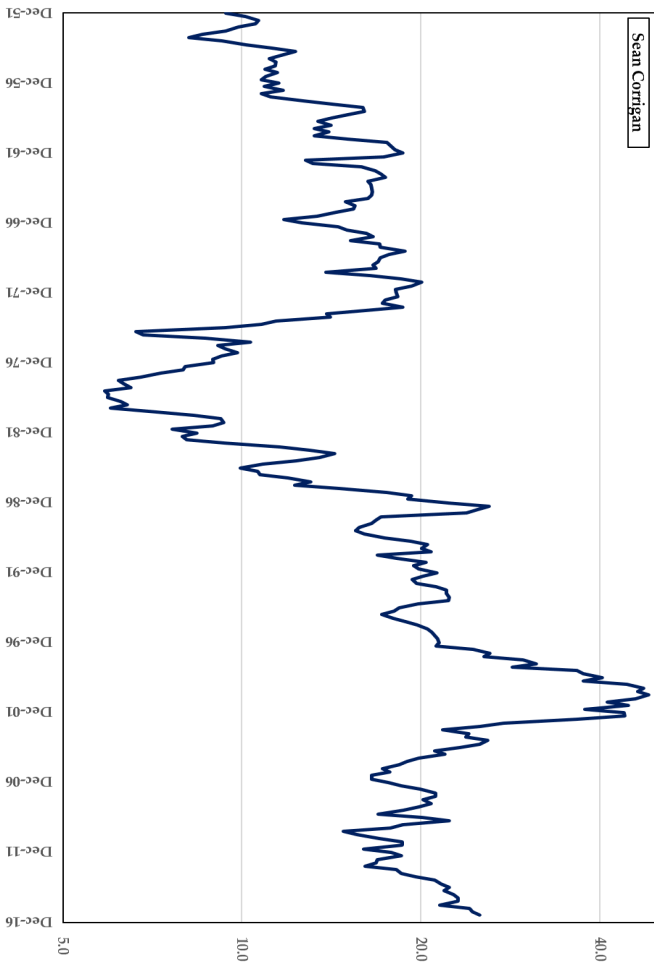


US NFC Pay-Out % of Cash Flow, Profits: Source - FoF



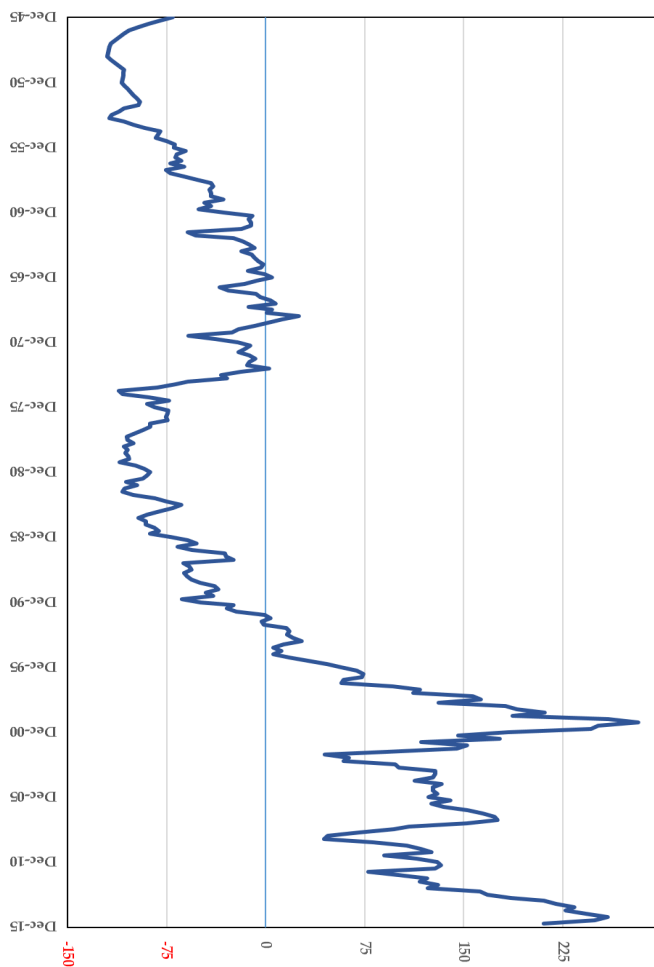
US Corporate P/E, In scale: *Source - FOF, BEA*

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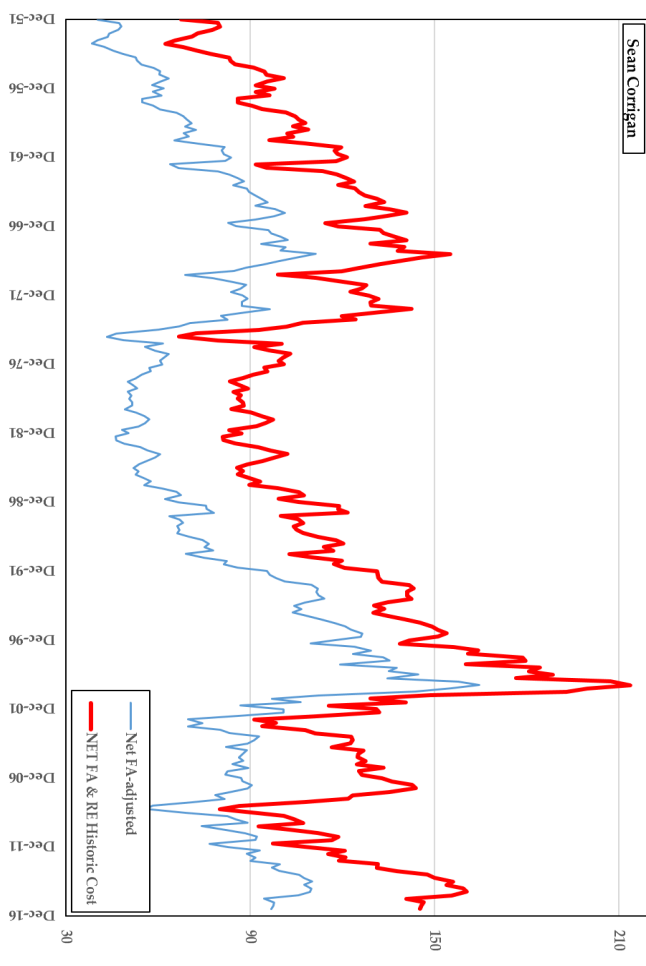
US Non-Fin Corporate Price to Sales: *Source - Fof, Census*

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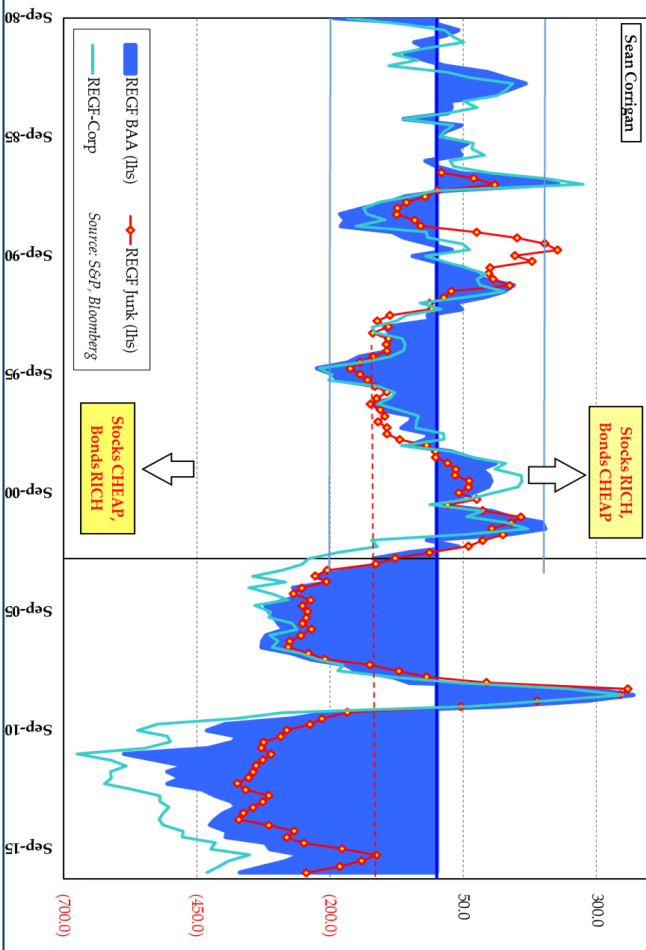
US Non-Financial Corporate Q-Ratio: *Source - Fof*

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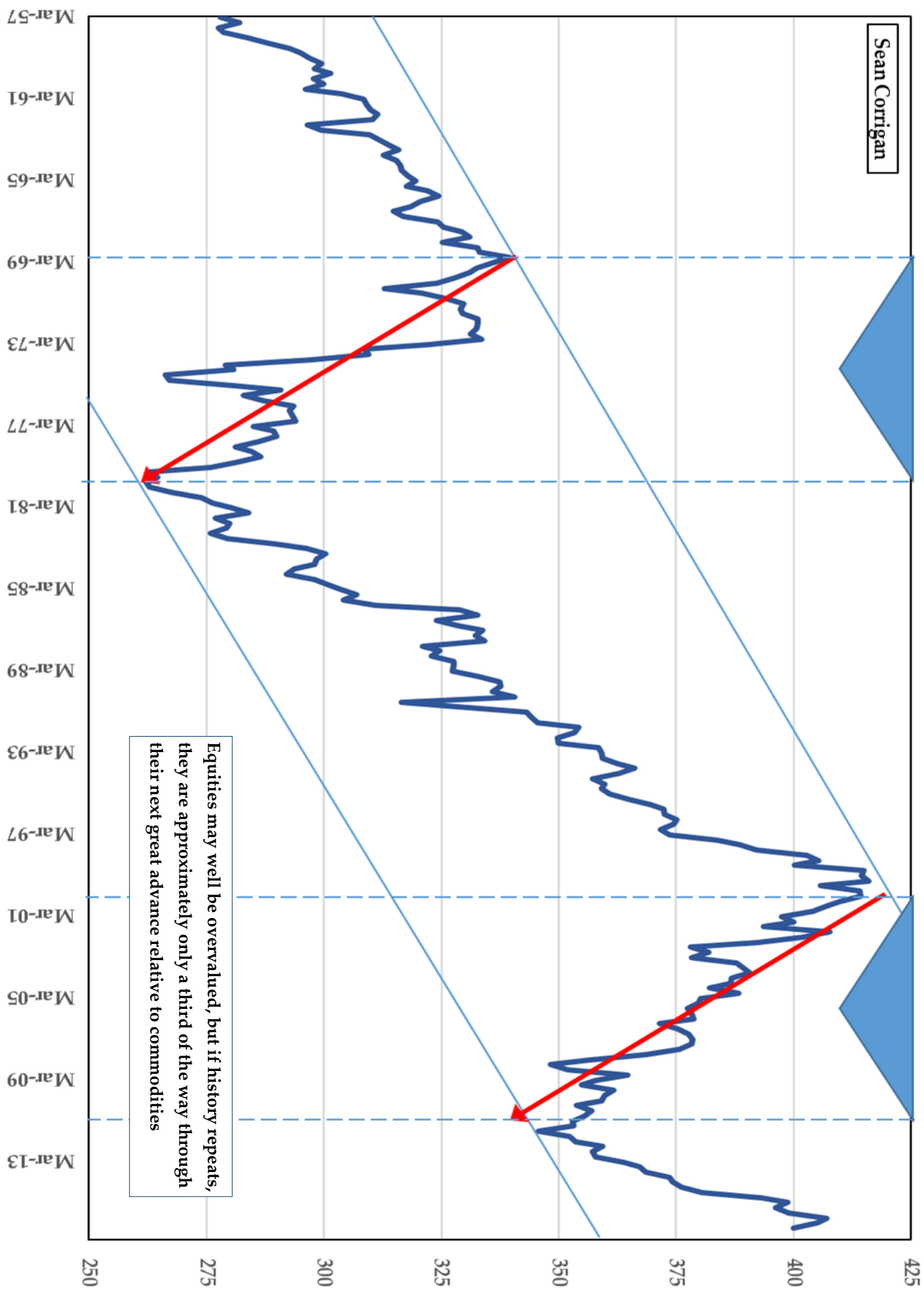
US S&P500 Real Earnings Growth Factoria via BAA, Corporate & Junk Yields,
100 sigmas of 1980-2003 Range

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US Non-Fin Corp Market Cap v Commodities, In scale: Source - FoF, IMF

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