

**Quote of the week :** “Tea parties are for little girls with imaginary friends” - This observation originated two years ago in the digital universe & now seems more relevant than ever.

**Quote of the week No. 2 :** “While all other sciences have advanced ... government is at a stand; little better practiced now than three or four thousand years ago.” - John Adams (1735 - 1826), second President of the United States (from 1797 - 1801) - *plus ça change ...*

Hongkong has become a major financial centre *although Beijing may have set the wheels in motion for Shanghai to surpass it in due course with its formal approval last week of its 28 square kilometre Free Trade Zone*. According to the BIS the Yuan has gone from being the 35<sup>th</sup> most commonly used currency in global trade in 2001 to 9<sup>th</sup> place this year (*helped, no doubt, by developments in London*). What has been particularly striking has been its progress since 2010; so following are the percentages of the currencies used in international trade in 2010 & 2013 respectively: US\$ - 84.9 (87.0)<sup>1</sup>, Euro - 39.1 (33.4), Yen - 19.0 (23.0), sterling - 12.9 (11.8), A\$ - 7.6 (8.6), SF - 6.3 (5.3), C\$ - 5.3 (4.6), Mexican peso - 1.3 (2.5) & Yuan - 0.9 (2.2).

It seems ironic that in the very week that in the self-avowed ‘bulwark of Western democracy’, the United States, Congress shot itself in the foot by caving in to a few dozen, wrecking ball-swinging, my-way-or-the-highway Tea Party types while in historically politically-dysfunctional Italy politicians kept their eyes on the ball & disowned Sylvio Berlusconi. And while on the subject of shooting, something good would come of today’s event on Capitol Hill if it were to prompt lawmakers to finally act on gun control. But that may too much to hope for.

What seems to have escaped most people’s attention is that, by failing to have last month’s FOMC meeting make a tapering decision, Bernanke has, as Greenspan did to him & Bush 43 to Obama, dumped the mess he created in his successor’s lap (unless Obama’s were to delay the decision to name his successor until after the next FOMC meeting on October 29<sup>th</sup>- 30<sup>th</sup> (*as he well may well do, given the present state of affairs in Congress*) **and** in the unlikely event, as the St. Louis Fed says is possible, a tapering decision were to be made at that meeting.

On October 2<sup>nd</sup> Mark Wiseman, the CEO of the Canada Pension Plan Investment Board had an hour-long ‘fireside chat’ at the University of Alberta for an audience of mostly students. His most fascinating observation was that in the 80 years ended in 2005 life expectancies of Canadian males had grown by 20 years (i.e. by three months each year) & of females by 23½ years (a trend that seemed to be unabated) - *that, folks, is one major contributing factor to pension funds being in trouble that even a major rise in interest rates could not offset, & a good reason why the entire public retirement age mindset & the retirement income maintenance system requires a serious ‘re-think’ from top to bottom*. He expressed the view that all investors should think more like Wayne Gretzky in his (ice)hockey playing days about ‘where the puck is going to be rather than where it is right now’ & decried ‘short-termism’ in business & finance. He also advocated a rigorous ongoing ‘rebalancing’ of portfolios to maintain their targeted debt/equity splits; this, he said, had benefited the Fund in 2008; for when the stock market cratered & eroded the value of its equity portfolio, it had forced the Board to sell fixed income assets & use the proceeds to buy equities at bargain basement prices, a trade it later reversed, at a very nice profit, when the equity market rebounded (helping its performance relative to those pension funds that had first sold equities in a panic at firesale prices, only later to buy them back at a premium. When asked about the Fund’s exposure to the BRIC countries he said that, while it had, despite some

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Surprising how well the US\$ has held up and, in fact, improved its position.

reservations, exposure to three of them, it had zero exposure to Russia since the returns there don't provide adequate compensation for the risk of being formally or informally dispossessed on short notice. One question I would have liked to ask but didn't get a chance too, was why the Board's staff numbered 1,000 while the Norwegian sovereign wealth fund, with over 4x more AUM, 'made do', as of December 31<sup>st</sup>, 2012, with a staff less than one-fifth that number (we have the same problem in Alberta where Aimco, the arm's length manager of various Alberta government pension-, & other funds, has a staff greater than the Norwegian fund with AUM that are only a tiny fraction of its AUM).

Reuters quotes unidentified sources within the Apple supply chain as saying the Company may not be able to roll out its latest version of the iPad Mini until next year, thereby missing the critical Christmas selling season & giving its competitors a further leg up (their market share, at 32½%, has already shrunk by almost one half in the past year) - *this is what can happen when a corporate management gives in to to shareholder-driven "short-termism"; thus when Steve Jobs was alive he relentlessly & remorselessly prioritized technical innovation in the belief that when products are leading edge, profits will follow*, whereas his successor has bowed to (hedge fund) investor short-termism pressure by borrowing gobs of money to boost dividend payouts (while the Company is cash-rich on paper - it alone accounts for nearly 10% of corporate America's entire hulking cash hoard - much of that money is squirreled away in places from which it cannot be liberated without giving rise to serious tax liabilities).

This week's edition has an item on Iran's involvement in Syria's civil war (& an expert's view on its likely outcome). But this is unlikely to figure large, if at all, in any US-Iran discussions; for, like it or not, Iran in this instance is seen by **both** Moscow **and** Washington as being on the side of the angels by helping Assad survive since both share the *by no means unjustified* fear that an Assad-less world would prompt a Sunni radicalization of Syria, or a regionally destabilizing breakup of the country that neither deems to be in their best interest.

On October 16<sup>th</sup> a potentially global precedent-setting case will be heard in New Zealand's High Court. It involves a 37 year native of Kiribati<sup>2</sup> & his wife who six years ago came to the country for higher ground (&, incidentally, for a better life for them & their three children, all of them New Zealand-born). Immigration officials have twice rejected his claim to refugee status based on the argument that rising sea levels, & so-called "king tides" that have started breaching his home island's defenses, make it too dangerous for them to return to Kiribati. A human rights' lawyer has now taken their case & will argue it before the High Court, indicating that, if necessary, he will take it to the Supreme Court - *the importance of this case lies in the fact that in the years to come climate change will start affecting the quality of life for people in different parts of the world differently & that, if his claim were to be sustained, it will set a precedent for future floods of claims by 'climate change refugees' that could make the existing political refugee claimant problem recede into insignificance.*

This Pacific island nation straddles the Equator & the International Date Line, and is a member of the UN, the IMF, the World Bank & the Commonwealth. Its 100,000 citizens live on 800 square kilometres on 32 atolls & one coral island (the latter of which is deemed one of the least suitable places in the world for agriculture) that are spread over 3.5MM kilometres of ocean. In 1999 two other, uninhabited atolls were submerged by rising ocean waters and, if the IPCC's forecast were proven correct & the ocean level rise 50 centimetres (20 inches) by the year 2100 the lot of them could either be submerged or become uninhabitable,

Once a year Google sponsors an 'International Science Fair', an online competition for students aged 13-18 around the world, "looking for ideas that will change the world". Among this year's winners was a 15-year old girl from Victoria, B.C. who invented a flashlight powered by the heat from the palm of the user's hand. She told the judges her idea was driven by her discovery that human beings are "like walking 100-watt light bulbs".

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**Thursday October 3<sup>rd</sup>, 2013**

**THE KNOWN KNOWS ABOUT CLIMATE CHANGE (Project Syndicate, Stefan Rahmsdorf)**

§ Publication of the fifth report of the UN International Panel on Climate Change (IPCC) warrants confirming what we know. There has been (*embryonic?*) climate research since the 1850s. Human activity produces greenhouse gases whose level in the atmosphere has gone from a pre-industrial level of 280 ppm to 354 ppm when the first IPCC report was issued in 1990 & this year surpassed 400 ppm (a million year high, as shown by ancient air bubbles locked in Antarctic ice). Human activity has attributed to this, the only argument being by how much, & *if it matters*. While many scientists have contributed to IPCC reports since 1990, its basic conclusions haven't changed, and neither has their 97-98% consensus that human-generated emissions cause (*or contribute to?*) global warming. But these facts have been so successfully challenged by well-funded special interest groups that many, *often well-educated* people are in the dark about the scientific consensus on the issue & believe there's *scientific* controversy where there is none.

*People typically opt for short term gain & long term pain over the reverse. That's why 'bribery politics' has worked so well for so long & why the West is in such a godawful mess (the author is a German climatologist & oceanographer, was a lead author of the fourth IPCC report, has a degree from Bangor University in North Wales & a Ph.D. in oceanography from Victoria University of Wellington, New Zealand, & teaches Physics of the Oceans at Potsdam University.*

**AMERICA FLIRTS WITH SELF-DESTRUCTION (FT, Martin Wolf)**

- The Republicans have shut down government rather than let a health law come into force as earlier agreed<sup>3</sup>, despite it being based on a 2006 Massachusetts law introduced by its then *Republican* Governor & 2012 *Presidential candidate*, Mitt Romney, despite it seeking to provide coverage to 32MM uninsured (& *sometimes uninsurable?*) Americans & despite the US spending 18% of its GDP on health (vs 12% in France & less in Italy, the UK, Japan & Canada), while leaving many people at risk *while getting worse health outcomes, incl. shorter life expectancies & a higher infant mortality rates*.
- Shutdowns have happened before. This one involves one-third of all federal spending, although over half the employees notionally affected are in 'exempt' categories. Still, it will be a nuisance (& *leave the impression abroad that Washington is dysfunctional at a level once only found in post-WW II Italy*). And it could get worse. For at mid-month the

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Which is not quite correct; for, as its supporters have repeatedly pointed out to its detractors, the law's constitutionality was upheld by the US Supreme Court & it will come into force on October 1<sup>st</sup>, shutdown or not.

US Treasury will hit the “debt ceiling” & by month’s end it will run out of cash. This means that in a best case scenario federal spending would have to be cut by up to 20%, prompting another recession & that in the worst case scenario the US would default, the consequences of which are unpredictable since there is no precedent (*at least not by a country that is one of the global economy’s kingpins, rather than an outlier*).

- What should the Administration do? Some argue (*on doubtful legal grounds*) that the 14<sup>th</sup> Amendment allows the President to borrow money without Congressional sayso (*but at what cost?*) while others advocate the *goofy* idea the Mint can cast a ‘trillion dollar coin’ as security for further borrowing from the Fed. Playing ‘chicken’ with the *wilfully* reckless is always scary & *risky*. We can only hope that, as Churchill put it, “the US will always do the right thing in the end, though not before exhausting all the alternatives.

*As Ken Rogoff put it, Obama brought this onto himself by establishing “a history of making concessions in the face of congressional brinkmanship”. But while the feeling seems to be growing the shutdown will go on until a “Grand Bargain” can be struck on **both** the healthcare **and** debt ceiling issues, the Republicans may get a surprise if, as the deadline for the latter approaches, Obama were to prove more dug-in than his track record would suggest him to be capable of. Elsewhere, Sen. Ted Cruz (R.-Texas), the Tea Party’s torch bearer on this issue who, despite being born in Alberta & hence ineligible to be President, gives every indication of having Presidential ambitions, is now complaining the shutdown ‘will lead to a terrorist attack’. And following the unproductive White House meeting on Wednesday evening between the President & the four Congressional Majority-, & Minority-, Leaders, House Speaker John Boehner (R.- Ohio) met at his office with the dozen most restless moderate Republicans, asking them to “Trust Me” (which in the business world is often is the last refuge of a scoundrel but in this case may mean he’s becoming fearful of losing control of his caucus). Meanwhile, lawmakers are taking the weekend off ‘to go home’ (where they hopefully will get an earful).*

### **QE WORKED FOR WEIMAR GERMANY FOR A LITTLE WHILE TOO** **(The Market Oracle, Michael Snyder)**

Today the US finds itself in a position like the Weimar Republic’s in the early 1920’s post-WW I Germany, deeply in debt with its economy struggling. And the Fed has used the Weimar playbook by printing money. This is an addiction that’s easy to start but hard to stop (as proven by an FOMC decision Peter Schiff of Westport, Conn.-based Euro Pacific Capital called “an admission the economy is basically weak ... the appearance of economic health would evaporate if stimulus were withdrawn ... (*it’s*) stalling for time ... hoping ... the economy will inexplicably roar back to life.” The Fed is caught in a trap of *its own making* : if it continues as it has, the financial bubbles will continue to grow but if it stops they will burst as *they must at some point, in a hard landing?*

*In making his case he uses three charts. One by the St. Louis Fed (long an outlier in the Fed System in its views, data collection & dissemination, and outreach to the community) shows that **in real terms** median US household income declined from US\$56,000 in 2000 to US\$51,000 in 2012 &, more importantly, that while, as expected, it did so during the 2008-09 recession, the rate of decline in 2011 was even more pronounced than during the recession & only leveled out in 2012. The second showed the ‘labor participation rate’ [the percentage of the (potential) labour force working or actively looking for work], falling off the cliff during the recession & at last report still being well below pre-recession levels (while unable to verify his numbers, the Bureau of Labor Statistics’ numbers show a like pattern, with the rate declining from North of 66% pre-recession to 64.6% at its end in December 2009, with one critical difference, namely that, despite the positive monthly new job growth numbers since, the rate had continued to decline*

further, to 63.2% last August. Finally he pointed out, once again based on St. Louis Fed numbers, that the M1 money supply, that had grown at a compound annual rate of 2.7% between January 1, 2000 & September 2008, had since then grown at an explosive 13.2% rate<sup>4</sup>. People like he may be making like the little boy in Hans Christian Andersen's *The Emperor's New Clothes* to the Fed's tailors & the American public's Emperor.

### **THE SHADOW COMMANDER (The New Yorker, Diane Filkins)**

- Last February Hassan Shateri was killed in Syria, on the Damascus-Beirut road. A senior commander in the Quds Force, an elite unit of Iran's Revolutionary Guards, he had been its liaison with Hezbollah in Beirut but had gone to Syria with thousands of other Quds Force members, & was leading Iran's efforts to bail out Bashar al-Assad, a key Tehran ally. Among the mourners at his subsequent memorial service in Tehran was the 56 year-old Maj-Gen. Qassem Suleiman, the Quds Force's leader for the past 15 years (during which he has sought to reshape the Middle East in Iran's favour by, assassinating rivals, arming allies & directing militant groups that killed hundreds of Americans in Iraq). He is a hardline supporter of the Iranian regime & so close the Supreme Leader that the latter has called him "a living martyr of the revolution". While short in stature, he is said to "have presence" &, while lacking formal education, to be a "shrewd, frighteningly intelligent strategist" who has orchestrated as many as 30 attacks in places as far-flung as Thailand, New Delhi, Lagos & Nairobi. According to John Maguire, a former CIA operative in Iraq, "Suleiman is the single most powerful operator in the Middle East today ... and no one's ever heard of him".
- With Shateri gone, Suleiman now runs the campaign against the rebels himself from Damascus, assisted by the heads of Syria's military, a senior Hezbollah commander & the chief of the Iraqi Shiite militias he has brought into the fight. Early 2013 was the nadir for Iran's involvement in Syria. Not only was Shateri killed, but Assad was losing ground to the rebels &, if he fell, Tehran would lose its link to Hezbollah, its forward base against Israel (so, despite the sanctions, Iran gave him a US\$7BN loan to keep Syria's economy afloat, telling him "we're not like the Americans. We don't abandon our friends."). And despite years of bullying & bribery, the Kurds had rebuffed Tehran's request for an *overland* supply route to Syria across Northern Iraq, resulting in an uptick in Iranian supply flights into the Damascus airport in late 2012, from a few a week to several a day, each carrying military materiel & members of the Quds Force (who have since coordinated attacks, trained militias, set up a system to monitor rebel communications & forced the Syrian security forces to cooperate with, rather than spy on, each other).
- The turning point came last April when the rebels captured the town of Qusayr in the Bakaa Valey near the Lebanese border thereby threatening Iran's link with Hezbollah in Lebanon. So Suleiman ordered the head of Hezbollah to recapture the town (which didn't take much prompting since the latter was aware of the threat to his 'rear link' with Tehran). And in early June they did succeed in retaking the town.

*Ryan Crocker is now Dean of the George Bush School of Government & Public Service at Texas A&M. But prior to retiring last year he was the State Department's uppermost Middle East expert, having spent all his career in & around the region & having served as Ambassador to Lebanon, Kuwait, Syria, Pakistan, Iraq & Afghanistan. What is perhaps most fascinating about the above article is its revelation that, in the months following 9/11, Crocker was in regular contact with Suleiman, who fed him intelligence about their common enemy, the Taliban (a flow of information that ended abruptly when Bush 43 made his famous "axis of evil" speech). And it is likely also significant in this context that during the Rouhani visit to New York he was invited to Iran's Mission to the UN for "private" conversations with "senior Iranian officials"<sup>5</sup>.*

### **HASSAN DOES MANHATTAN (NYT, Thomas L. Friedman)**

- After two press meetings with Iranian President Hassan Rouhani I believe his charm offensive is driven by domestic pressures that could result in serious direct negotiations over Iran's nuclear program. While their outcome can't be predicted, failure would present Obama with options that could make Iran a failed state. So pray they'll succeed!
- Rouhani garnered 51% of the vote (with the most successful of the other seven candidates, the Mayor of Tehran, *Ahmadinejad's successor since 2005*, getting just 16%). For in a country whose currency has lost two-thirds of its value in two years, and which has mass unemployment & 30% inflation, voters stampeded to support what seemed like the most liberal (*or least illiberal?*) of the lot, since they've learnt enough of democracy, and of Islamic ideology & sanctions, to want more of the former & less of the latter. So the real *domestic* power struggle is no longer about Revolutionary Guards & their business interests and religious leaders, but about Iran's silent majority's empowerment, & his charm offensive is dictated more by it than by the Supreme Leader.
- Due to the sanctions & its ongoing support for Assad in Syria, Tehran is now **overextended** while the 60% of Iranians under age 30 feels **underintegrated** with the rest of the world. Geopolitics is all about leverage. A decade ago the US was overextended in Iraq & Afghanistan, and lacked leverage, while today it's Iran's turn. So, with the negotiating table now tilted in our favour, we should offer Tehran a deal it can live with, one that recognizes its need, for the sake of its national pride, to have a peaceful nuclear capability, albeit not a weapons' one. The only question is whether *the hardliners* on either side will be willing to settle for half a loaf.

*Economics, rather than ideology, now seem to be driving the Iranian bus. It is interesting in this context that Rouhani has a Ph.D. in Law from Scotland's Glasgow Caledonian University (a not well-known, but quality, institution) & his Chief of Staff a Ph.D. in Economics from George Washington University, and that, as we saw last week, the long-time Minister of Agriculture under two previous 'reformist' Presidents is among his key advisers. Still, there will be no shortage of individuals intent on pouring poison in Obama's & the Supreme Leader's ears for their own short-termist, national-, rather than geo-, political reasons.*

### **NETANYAHU WARNS OF IRAN DEVELOPING BOMB (G&M, Patrick Martin)**

- In an inflammatory speech he warned the UN General Assembly President Rouhani's charm offensive is "a ruse ... a ploy", saying "I wish I could believe Rouhani ... but Iran's savage record flatly contradicts Rouhani's soothing rhetoric". He insisted that no matter what Rouhani says, *or does*, Iran is determined to build a nuclear bomb, something which he ain't going to let happen : "I want there to be no confusion ... Israel will not allow Iran to get nuclear weapons ... Last year when I spoke here, I drew a red line ... Iran has been very careful not to cross that red line ... but ... is positioning itself to race across *it* ... in the future at a time of its own choosing." This sharp contrast with reports of his meeting with Obama the day before was explained away by Barry Rubin, the Director of the Herzliya, Israel-based Global Research in International Affairs Centre by saying "These are things he couldn't say to Obama ... Israel ... doesn't want to criticize our ally directly ... he thinks Obama is naive and is being taken in by the slick Iranians."

*His attack on Rouhani for heading Iran's National Security Council ten, fifteen years ago when "Iran's henchmen" perpetrated several terrorist events abroad that killed Jews & Americans which, he said, Rouhani must have known about, overlooks the fact that in politics "leopards can lose their spots" & ignores the adage that "politics makes straight bedfellows" (as proven over time by, among others, Jewish terrorists becoming Israeli Presidents, the end of apartheid in South Africa and Jomo Kenyatta's & Nelson Mandela's conversions from purported terrorists into revered international statesmen, the legitimization of Sinn Fein in Northern Ireland 15 years, & Gadhafi's abandonment of his nuclear program a decade, ago. His firebrand talk is a function of his need for an external enemy to keep his coalition together & may reflect his dawning realization that the US trend towards greater isolationism, its "pivot" strategy, & the growing numbers of Muslim voters in US "swing" states is undermining the traditional core position of Israel in US foreign policy.*

### **CHINESE GOVERNMENT SEES ITS OWN REFLECTION IN WATER CRISIS** (Reuters, David Stanway)

- This year Beijing published a national "water census" which showed that of the 51,000 rivers identified twenty years ago 28,000 have "vanished". While it blames climate change for wreaking havoc on its scarce water resources, its critics say its headlong drive into building industrial prowess & huge power dams are as much to blame; thus according to Zhou Lei, a fellow at Nanking University who studies the effect of industry on the environment "China's water shortages stem more from problematic urbanization and water reserve management, rather than *from* the scape goat of climate change ... in my home town the water system ... (*has*) been totally ruined in the past twenty years due to a catastrophic urbanization plan, a construction mania and transportation mega projects." And while Beijing says it will spend trillions of yuan to boost *water* supplies, clean rivers & protect water tables, *the fact remains that*, even if supply were to remain steady, China's per capita water resources, at 2,100 cubic metres, are just 28 percent of the global average. Ma Jun, a water expert & Director of the Institute of Public and Environmental Affairs, has his doubts too, saying "In the last 50 years we have mainly focused on expanding water supplies, but ... I think we have in many cases reached a limit and need to shift our focus to conservation ... we spent our resources mainly on engineering and on technologies to drill deeper, build dams and work on water-driven projects but we have to work on conservation."

*According to the World Bank China uses four to ten times as much water per unit of production than the industrialized countries, with 70% of it going (often quite wastefully) into farm irrigation.*

## **FALLING ECONOMIC TIDE IN INDIA IS EXPOSING ITS CHRONIC TROUBLES** **(NYT, Keith Bradsher)**

•The Indian economy, once seemingly close to lifting millions out of poverty. is now in disarray, with worse to come in the next few months. Its recent decline has laid bare problems hitherto overlooked or ignored, incl. an antiquated infrastructure<sup>6</sup>, a sclerotic labour market, exorbitant industrial land costs, bloated SOEs that have prevented the development of a strong, globally competitive manufacturing sector & an all-pervasive, corrupt regulatory framework. Consumer price inflation, at almost 10% already among the highest in Asia, will worsen in the months to come as the government hikes the price of fuel & other imported necessities in an attempt to constrain its huge trade deficit.

*The resultant lack of a vibrant industrial base has Western buyers scouring Asia for alternatives to increasingly costly goods of Chinese origin bypassing India.*

## **CRISIS IS OVER, FRENCH MINISTER INSISTS (G&M, Campbell Clark)**

- Canada's Finance Minister has for three years warned that Europe's debt is a serious risk to the world & at the G-7 meeting earlier this year said the weakened debt-fighting resolve of European nations is "mistaken". Nevertheless, during his visit to Ottawa this week France's Finance Minister, Pierre Moscovici, the point man for Europe's growth party & left-of-centre advocate of pro-growth fiscal policies, maintained "the Euro crisis is over ... boosting growth is now the continent's challenge ... There could be moments of fits and starts ... But for the long term things are stable. The Eurozone is, on the whole, solid from now on ... We (*i.e. France*) have a much healthier financial situation. It is healthier in Italy. It is healthier in Spain. It's being cleaned up in Greece ... the *only* question we face now is how to recover our growth."

*Unless it expects a German "Grand Coalition" to come to its rescue, his government's pump priming scope is limited by a public sector that accounts for 57% of GDP, an AA+ credit rating with one foot in the grave & the other on a banana peel, significant minority-driven social unrest potential & a population not into giving up any of its entitlements. This is one case in which denials at the most senior levels may well be turn out to have been little more than wind,*

One Indian manufacturer of machinery for export whose plant is just 35 miles from the port it uses says it takes trucks up to seven hours to move his product there. While China in the last five years built 5,800 miles of high speed rail & 400,000 miles of two-lane, or more, highways, India managed no high-speed rail & just half that much highway mileage. And industrial real estate is far more expensive & electricity twice as costly.