Quote of the week : "We keep 'Little Red Riding Hood' out of schools because of the bottle of wine in her basket (*on the cover picture of a commonly used edition*). Why not assault weapons?" - **Mothersdemandaction.org** (full name 'Mothers Demand Action for Gun Sense in America). This organization was launched on December 15th, 2012, the day after the Sandy Hook Elementary School shooting by Shannon Watts, a 42 year-old Indianapolis mother of five (incl. two step children) with a career as a communications executive in progressively more senior posts in the government of Missouri, Monsanto, GE Health & Wellpoint. Started as a Facebook page entitled "One million Moms for Gun Control", a little more than one year later, on December 31st, 2013, it had 130,000 members & chapters in all 50 States, and had started seriously lobbying Congress for stricter gun control legislation which, together with its rapid growth, is of growing concern to the NRA.

Investors are chasing yield like never before. Thus Dialogic, a data provider, reported that YTD investors worldwide had bought US$139BN in junk bonds issued by non-financial entities, vs. just US$15BN in the same period in 2008 (*just before the Great Recession*). And if more evidence were needed, how about Numericable, a French cable operator, on April 23rd selling a record 7.9BN Euro-worth of junk bonds to help fund a 17BN Euro acquisition, two billion Euros more than it had expected, with the success of the issue helping it to get better pricing on another 4BN Euros in term loans.

The latest news from the US housing sector was not reassuring. While in March existing home sales were down only 0.2% to a 4.59MM seasonally-adjusted annual rate, rather than the 1.1% decline expected, after that it was all downhill. The supply of existing one family homes for sale rose to 1.99MM (a 4 months' high), a 5.2 months' supply (an 11 months' high), while the 5.5 months' supply of condos for sale constituted an 18-months' high. And new home sales dropped 14.5% MoM to a 384,000 seasonally adjusted (an 8 months' low) while a 2.2% increase had been expected (increasing the supply for sale from 5.0 to 6.0 months-worth), as (*due to home builders' overexuberance?)* the median new home price was up 12.6% YoY (& 11.2% MoM).

An interesting observation originated with a market analyst who opined that in the period ahead investors may be better off in companies that sell to other companies than in those that sell to consumers. His reasoning is that consumers' ability to spend is going to get squeezed between slow-growing *wages* & fast-rising food prices, while companies have no choice but to buy more & more modern equipment to stay competitive.

Amidst growing talk about the possibility of skyrocketing fruit & vegetable prices, it's worth remembering that California appears on the threshold of a second year of the most severe drought in decades, that water generally is in short supply & water for irrigation doubly so (& that the priority use of the water that will be available for irrigation will be to keep perennial fruit trees alive, rather than grow annual vegetable crops). As a result, word is that one half million acres of farmland in California (5+% of the total) may be left fallow this year. This will seriously impact on the nation's supply of some common vegetables; for California in past years supplied 95% of the celery grown in the US, 94% of the broccoli, 90% of the leaf lettuce, 89% of the cauliflower, 83% of the spinach, 66% of the carrots & one-third of the tomatoes. And while this may prove a boon for vegetable growers in other countries, this won't help American consumers much, since importing vegetables from afar is costly in terms of both transportation & spoilage.

One of the bigger operators in the Alberta oil sands, CNRL, has had recurring problems on its Cold Lake lease with bitumen bubbling to the surface. The instance, that started last year in at least three places & has yet to be brought under control, has so far resulted in a surface "spill" of 12,000 bbls (*i.e. 40-50 bbld).* This prompted the Alberta regulator last year to order it to quit "steaming" nearby wells (pumping live steam underground under high pressure to thin the bitumen enough to allow it to drain into a horizontal well) *until it could be established what had caused this & what could, if anything, could be done to stop it.* But last week, *despite the absence of an answer to either question*, it allowed it to resume steaming, at a reduced pressure, to keep the wells producing - *environmentalists are up in arms &, in doing so, the Alberta government has confirmed its "Full speed ahead & damn the torpedoes" policy bias.*

The April 18th US State department announcement that the decision on the cross border section of the Keystone XL pipeline will be delayed until the New Year for obvious reasons dismayed its proponents. It prompted an attack by the Canadian government on poor, old Jimmy Carter for having had the audacity to co-sign a letter, with nine other Nobel Peace Prize laureates, urging Obama not to approve it, an idiotic headline in a major paper that "Obama no longer loves us", & University of Calgary's Jack Mintz blustering "Canadian oil will be sold eventually to global markets with or without the Keystone" (if so, why fuss? Being able to sell it in a global market place to any one of many willing buyers is likely to be of greater benefit to Canada than having it moved by a monopoly transporter to a monopsonistic buyer).

The facts of the matter are as follows. Transcanada originally, & rather shortsightedly, routed the pipeline smack through the middle of Nebraska's environmentally-sensitive Sand Hills. This prompted enough opposition from environmentalists & from a number of members of the US Congress to cause President Obama to put the kibosh on it in January 2012. One year later Nebraska Gov. Dave Heineman approved a new route proposed by Transcanada that largely bypassed the Sand Hills & sanctioned its use of 'eminent domain' (aka as "expropriation"[1] [2]) to overcome the opposition of some landowners to the pipeline crossing their land. So the latter went to court & last February Lancaster County Judge Stephanie F. Stacey[3] ruled the Governor's approval of the use of eminent domain to acquire land in the face of the owners' opposition "unconstitutional". The case has now gone to the State Supreme Court. It is expected to hear it in the fall & render a decision early in the New Year. If it were to overturn the lower court's decision at that time, the President presumably would have to 'fish or cut bait' and construction might start soon thereafter & the line might be able to go into service as soon as mid-2017. But if it doesn't, TransCanada would be back to Square One & have to find another way to across Nebraska (which at best would mean another delay of up to three years) - *none of this would have happened, of course, if the Company had, instead of taking a shorter route cross-country, 'twinned' its pipeline on its existing right of way, East from Hardisty, Alta. to Manitoba and from there South through North- & South Dakota to Steele City, Neb. (the terminal point of the Northern Keystone XL).*

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1 Depriving a private owner, for compensation of sorts, from the ownership of his property for the public benefit

2 Historically eminent domain could only be used for projects that would result in "public use", such as building a highway. But a decade ago the US Supreme Court opened this up a great deal when it ruled that it could be used in any project that creates new jobs and/or taxes, and/or serves to revitalize a blighted area (*in an urban setting*).

3 *while Judge Stacey has been on the bench for only three years, nothing in her background suggests her ruling is likely to be overruled*.

In Europe the flash PMI for April was up to 54.0 from 53.1 in March, outdoing the 'no-change' expectation; this is the tenth month in succession it has been in positive territory (i.e. > 50) - *what was worrisome, however, was that this included a decline in France from 52.1 to 50.9*.

Britain's High Streets once were the focal point of their communities. But they have been struggling, first against an onslaught of chain stores on the outskirts & now with the growth of online shopping. So last year Prime Minister Cameron named Brendan Lewis[4] Minister for High Streets *with a mandate to reverse that trend.* Lewis' latest suggestion has been that, to help struggling pubs remain viable, school lunches should be prepared & served in them (as is already happening in some rural areas like Stow-on-Wold, Gloucestershire), a suggestion driven in part by school principals warning they lack the kitchen capacity needed to comply with the government's pledge of free school lunches to all kindergarten kids come next September. And last week Lewis criticized local councils that use parking enforcement as a revenue stream, pointing out that councils that had cut their parking charges had experienced a surge in the number of people downtown.

On April 23rd the most severe sandstorm in almost two decades swept through China's Gansu Province in North Central China, reducing visibility to as little as 65 feet & making it most unpleasant, if not impossible, to venture outside - *desertification is another environmental problem that to date has been largely 'swept under the rug'.*

The Standing Committee of China's National People's Congress is said to be considering allowing Provincial governments to sell bonds to help defray the cost of construction projects in their budgets (*but they would no longer be allowed to guarantee new debt taken on by third parties, presumably to improve transparency & reduce the scope for corruption).*

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Thursday, April 24th, 2014

NEW SOCIAL PROGRESS INDEX RANKS US 16th OUT OF 132 COUNTRIES
(The Daily Beast, Brandy Zadrozny)

- A team led by Prof. Michael Porter of the Harvard Business School has created a Social Progress Index *to look behind the pure economic numbers to see how well off people in these countries really were.* They used over 50 indicators, incl. nourishment, access to water & sanitation, and to basic knowledge & advanced education, life expectancy, GHG emissions, and personal & political freedom, in three broad categories : Basic Needs, Foundations of Wellbeing & Opportunity. The US didn't fare so well, coming 16th overall (vs. Canada's No. 7 & New Zealand's No. 1), despite having the second highest per capita income of the 132, after Norway (No.7). The one bright spot was that the US is still No. 1 in opportunity. But after that it was all downhill : 31st in meeting its citizens' Basic Human Needs, a poor standing in Information & Communications (with only 81% Internet users vs. 87% in both Canada & the UK), a 39th place in primary school enrolment & a 70th ranking in Health & Wellness (thanks to its obesity epidemic; *but what about child mortality & life expectancies?*).

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4 The rookie MP for Great Yarmouth who, with degrees in economics & law, and an LL.M, in commercial law, is a qualified barrister, and a long local government record.

*One observer attributes this poor performance to the existence in the US of a large "underclass". Be that as it may, this highlights once again how little **real** value the US gets for spending more on healthcare, as a percentage of GDP, than any other country.*

THE AMERICAN MIDDLE CLASS IS NO LONGER THE WORLD'S RICHEST
(NYT, David Leonhardt)

- According to 35 years' income data in the Luxembourg Income Study Database the American middle class is no longer the most affluent in the world. While the wealthiest Americans are outpacing their peers elsewhere in income growth, the lower-, & middle-, income tier citizens of other advanced countries have received considerable larger raises in the past three decades than their American counterparts. Thus on an after-tax basis middle class incomes in Canada that were substantially below those in the US in 2000 now are higher, and the poor in Europe earn more than poor Americans. The main problem is that, while the US economy has grown as fast, if not faster, than others, a far smaller number of households there has benefitted thereof. And while median incomes in Europe still trail those in the US, the gap for several, incl. Britain, the Netherlands & Sweden, is much smaller than a decade ago. And the struggles of the poor in the US are even starker than those of the middle class : while 35 years ago an American family of four in the 20th percentile of the income distribution made significantly more than its Canadian counterpart, today that is reversed. And the US median family income in 2010 was US$75,000, up 20% since 1980 but flat since 2000, after adjusting for inflation, while in Britain & Canada in 2010 they were 20%-, & in the Netherlands 14%-, higher than in 2000..
- This appears due to three factors :
    - **Educational attainment -** While America's 55-65 year-olds possess literacy-, numeracy- & technology skills well in excess of their counterparts' in other industrialized countries, younger Americans aren't keeping up; in fact those in the 16-24 year age cohort, who now rank near the bottom, well below those in Canada, Australia, Japan & Scandinavia, and close to those in Spain & Italy;
    - **Income distribution -** With more going to those in the higher income brackets, less is left for those lower down the totem pole; and
    - **Income redistribution -** Governments in Western Europe & Canada are much more aggressive in redistributing income in ways that raise the take-home pay of their low-, & middle-, income households.

The United States as a nation is like someone who stays too long in a hot tub that is just an itty-bitty too warm; he or she must depend on some outsider pulling him/her out in time.

BEHIND JANET YELLEN'S INFLATION DILEMMA (CNBC, Steven Liesman)

- Despite the high unemployment, the job market may be tighter than generally perceived. This is the view Deutsche Bank's Chief International Economist, Torsten Slok in his April 22nd report entitled Wage Inflation Now Above Pre-Crisis Levels, in which he also noted that *recent* median weekly wage gains in the 3% YoY range had for the first time since the Recession exceeded pre-crisis levels & that "It should now be obvious to everyone there is wage pressure in the pipeline and that the Fed will turn hawkish later this year."

- Yellen is resisting what is obvious to Slok & others, incl. Alan Krueger[5], namely that there may be much less slack in the labour market than generally believed. And there are growing concerns that the Fed has put so much fuel in the economy that any spark could ignite an inflation firestorm. And, while a touch of wage-induced inflation would be welcomed by a Fed wanting 2% inflation[6], Slok's view is that "if you wait until wage inflation is 3.5% and then she says now we need to do something, it's already too late."
- Jim O'Sullivan, Chief US Economist at High Frequency Economics believes the size of the Fed's balance sheet will "continue to provide new stimulus for years", complicating the job of reining in wage-induced inflation if it were to come about. And Alan Krueger says 3.7MM long-term unemployed are unlikely to come back into the work force & hence useless as a potential means to keep wage pressures down. Questioned on this Yellen conceded it was "conceivable" but continued "I think it is premature, frankly, to jump to the conclusion that that argument is correct ... the long-term unemployed are likely to move back more actively into the labour force and into the job market" & the 7MM Americans working part-time could exert downward pressure on wage growth by working more hours.

The labor force participation rate in March was 63.2%,vs. 66.4% pre-Recession, & 62.8% in March 1978. In the two years to December 31st, 2013 80% of the decrease in the rate was due to retirements. The rate among those over the age of 55 is only 40.3% & the size of this age cohort will increase from 20.9% of the population today to 25.6% a decade hence. And Yellen's faith in the wage-depressing potential of Americans working part-time may be misplaced; for many, like students, do so by choice, while in the case of many others their employers have them work part-time deliberately to minimize the cost of their benefit packages, incl. now that of Obamacare. And one credible market letter recently observed : 'The Fed has been remarkably unable ... to spot bubbles in the making. So it was not surprising that Janet Yellen in her speech to the Economic Club of New York never mentioned the word, although she lived through a couple of them while at the San Francisco Fed, and instead remained focused on employment. This makes it only more likely that she will keep the pedal to the metal monetary policy-wise & will only see the next bubble once it is in her rearview mirror. And the next bubble may the most serious of all, a currency bubble.' Since the advent of "and-and" economics[7] in the mid 1960's the world has experienced at least one financial crisis per decade. In the early 70's it was the gold price delinking (which led to the collapse of the post-War Bretton Woods system of fixed exchange rates). The 80's were 'bookended' by the US inflation crisis at the beginning, and the 1987 stock market crash & S&L debacle at the end. In the late 90's there was a cluster : the Asian crisis, the LCTM demise & the dot.com collapse. And, finally, another decade later, we had Lehman & the Eurozone crisis. So the odds favour another crisis lurking in the reeds, &

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5 A labour market expert who is back at Princeton after serving Obama from 2011 to 2013 as head of the CEA & prior to that as Assistant Treasury Secretary for Economic policy, and who co-authored a report last month that concluded, among others, that only 11% of the long-term unemployed were finding jobs.

6 According to CNBC prices overall are up 6.4% since 2011 (i.e. significantly more than the CPI) but beef prices 16.8%, chicken 18.4% & bacon a whopping 22.8% (and with the drought in California vegetable prices are expected to go "through the roof".

7 Which did away with monetary discipline & the old-fashioned notion that the 'dismal science' of economics was all about the allocation scarce resources & prompted a debt accumulation that will subject out grandchildren to a serious form of "either-or" economics

there seems to be no shortage of potential detonators, incl. Japan, China, the South China Sea, France, Ukraine, Russia, the Middle East, gold, derivatives, & the US dollar and/or stock market, and possibly even this summer's FIFA World Cup in Brazil (did anyone notice the outbreak of riots in Rio, just seven weeks before its start?)

ARCHITECTURE BILLINGS INDEX (*ABI*) MIRED IN SLOWDOWN (AIA[8])

- In March, after two months of modest recovery in the demand for design services, this ABI Index turned negative again (to 48.8, vs. 50.7 in March). This is deemed a leading indicator of construction, nine to twelve months out.

On the other hand, another such leading AIA indicator, its New Projects Inquiry Index, in March came in at 57.9 up from 56.8 MoM.

U.S. LAWMAKERS DEMAND B.C. BENEFITS BE SLASHED 90%
(Postmedia News, Peter O'Neill)

- The 1964 Canada-U.S. Columbia River Treaty provided the United States with flood control & other benefits through the construction of dams & reservoirs in B.C.(with it getting an average $220MM/year as its share of the power generated South of the border). Based on recommendations in 2013 by the U.S. Army Corps of Engineers & the Bonneville Power Administration, all 26 lawmakers from the four Northwestern states have now asked President Obama to start renegotiating the treaty this summer so as to have the payment to BC cut by 90% effective December 31st, 2015, arguing the treaty is "outdated & unfair".
- But the BC government last year came with a report of its own that said Canada wasn't getting enough of the benefits with BC Energy Minister Bill Bennett saying the Americans are lowballing the treaty's flood control benefits, & "We're actually hoping to negotiate more revenue ... there's more value on their side than we're getting credit for."

Another contentious bilateral issue we don't need. One of the Unintended Consequences of the Treaty was that the construction of the W.A.C. Bennett Dam blocked an age-old migration route for the Kling-Za woodland caribou herd in Northern BC that is said to have contributed to its decline from being as plentiful as 'bugs in a rug' half a century ago to a mere 20 (twenty) individuals today (while the locals have abstained from hunting them for nearly as long).

FIELDS TO REPLACE MULLALY AS FORD CEO (BB, Keith Naughton)

- Ford will announce Mark Fields, age 53, will succeed Alan Mullaly, age 68, as CEO.

In 2006, after a solid 37-year aeronautical engineering cum senior management career at Boeing, & being twice passed over for its top job, Mullaly quit, only to be courted by Bill Ford & becoming Ford's CEO in 2006, a year it racked up a US$17BN loss (he is now credited with having saved Ford from bankruptcy & having made it the only one of the Big Three that didn't have to go hat in hand to Washington during the Recession). Within three months in his new job he was frustrated by the squabbling among his top managers, & their obfuscation of the state of affairs in their areas of responsibility. So he instituted a weekly meeting at which all had to colour code (green for OK, yellow for caution & red for trouble) the situation in their bailiwick,

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[8] American Institute of Architects.

only to grow even more frustrated when week after week all he saw was green & more green until, one day, Mark Fields, then in charge of readying the new Edge SUV for market, raised a red flag, prompting his colleagues to gasp & hold their breath until ..... Mullaly started clapping. This marked the beginning of a new era of greater cooperation among Ford executives & propelled Fields onto 'the fast train" (although in all fairness he subsequently did prove his mettle when, as head of Ford's North American operations, he propelled it from generating record losses to record profits in the four years ended in 2012).

<u>LET ISRAEL GOVERN WEST BANK, ABBAS SAYS</u> (The Media Line, Linda Gradstein)

- He told a group of visiting Israeli journalists **on April 22nd** their country's policies had left his government powerless & that, if the peace talks fail, he might just dismantle the Palestinian Authority & hand the responsibility for running the West Bank over to Israel. Other Palestinian officials quickly dismissed this idea, with Saeb Erakat, the chief Palestinian negotiator, saying "No Palestinian is speaking of an initiative to dismantle the Palestinian Authority[9] ... But Israel's actions have annulled all the legal, political, security, economic and operations aspects of the prerogatives of the Palestinian Authority."
- Israeli officials dismissed this as an empty threat with a Foreign Ministry official saying (anonymously) "Let them threaten. It doesn't mean we have to panic ... Someone who threatens to cut off their nose to spite their face should be thinking about the implications. We're not going to fall into their trap and play their game." But Roni Shaked, a Palestinian expert at the Truman Institute at Hebrew University, disagrees; he is among a number of the Israeli analysts who believe that "for Israel it (*Abbas throwing in the towel*) would be a disaster ... It would mean an increase in terrorism because Abbas is the one who is stopping terrorism against Israel." And he believes it would strengthen Hamas as the sole surviving voice of the Palestinians.

Abbas is 79 years old & tired (among others of beating his head against the wall). And his failure to wring serious concessions from Netanyahu has, perhaps undeservedly so, earned him the odium of many of his fellow Palestinians, particularly the younger ones, who are in the majority, as being his lap dog. From a purely Palestinian perspective dumping the West Bank into Israel's lap could prove a master stroke : in the short run, it could place Israel in a position not unlike that of pre-1994 South Africa, an apartheid state with Bantustan-like enclaves (which would mobilize anti-Israel sentiments in the Arab world & elsewhere like never before & truly make it an international pariah) & make it much more difficult for official Washington to continue to backstop it in whatever it did, & longer term could prove to have been a way station on the road to a unitary state solution.

<u>RIVAL FATAH AND HAMAS AGREE ON A UNITY GOVERNMENT</u>
(**The Media Line & AP, Rami Almeghari**)

- A meeting in Gaza **on April 23rd** between Azzam Al Ahmad, *the Fatah official responsible for "reconciliation affairs"*, & Mousa Abu Marzouq, the Deputy Head of Hamas' political bureau-in-exile (who normally resides in Cairo but was allowed by the Egyptian authorities to travel to Gaza for the occasion) resulted in *another* agreement to form a government of national unity (in four weeks' time *, as if to give Israel time to try &*

[9] This is of course disingenuous : one just did, his boss.

get it to fall apart once again). The most significant part of this deal was the concession by Hamas to defer the contentious issue of the future of its security force until later.

- Israel was quick to denounce this initiative, saying it would make a peace deal more elusive, with Netanyahu pitching in with "Does he want peace with Hamas or peace with Israel? You can have one but not the other. I hope he chooses peace, so far he hasn't done so." On the other hand, in Gaza Hamas 'Prime Minister' Ismail Haniyeh, welcomed the move with "National reconciliation, ending the division and mending the rift has become a national responsibility." And Talal Ankal, a Gaza-based political analyst, said that it was now up to the Arab countries to encourage both sides to follow through on the deal (presumably with a promise of loads of financial backing if they do).

Whether the Palestinians follow Plan A or Plan B, neither would be good news for Israel, although Plan B might well be the lesser of two evils.

JAPAN OVERHAULS ITS PUBLIC PENSION FUND (Reuters, Chikafumi Hodo)

- The Abe government has reshuffled the Investment Committee of its US$1.26TR Government Pension Investment Fund (GPIF) in line with the Prime Minister's wish to have it make riskier investments & rely less on low-yielding JGBs (the "third arrow" in his policy quiver, the others being aggressive monetary & fiscal stimulus). Its membership was cut from ten to eight, two holdovers, one former member brought back, one each from the unions & big business, and three from the panel that last year spearheaded the drive last year to have the fund achieve higher returns, as a result of which it now has an asset mix target of 60% JGBs, 12% each Japanese[10] & foreign stocks, 11% foreign bonds & 5% short-term assets).

In absolute terms an investment strategy with 60% in low-yielding bonds & a 24% exposure to equities doesn't meet anyone's definition of "aggressive". And while the targeted 23% FX exposure does (meet that definition), it falls far short of what the Fund ***really*** *needs at this juncture, i.e. an all but total liquidation of all of its yen-denominated assets. But that is, of course, not an option. And while US$1.26TR sounds like a lot, & is a lot in absolute terms, in relative terms it is a mere pittance : 25% of GDP & US$10,000 per capita[11]; and to make matters worse, the aging of Japan's population has forced the Fund, since April 2009, to become a seller of assets to meet its day-to-day payment obligations, a process that can only accelerate as the years go by, as payouts rise & the earnings base shrinks . Meanwhile Norway in two decades built up, & is still, each year, massively adding onto, a nest egg of US$829BN, 1.7x its GDP & US$160,000 per capita. This is truly the story of the ant & the grasshopper, and evidence of with how little foresight & respect for the welfare of their grandchildren the*

10 This is likely well short of the level it would need to give the Japanese stock market the serious jolt Abe wants (as foreign investors hasten to 'front run' the GPIF).

11 This may seem to compare favourably with the situation in Canada where the C$170BN asset base of the Canada Pension Plan amounts to just 9.4% of GDP & C$5,000 per capital. But the Japanese fund is in a more precarious position, given its shrinking labour force & the resultant slowdown, if not cessation in net new money inflows, and its rapidly growing number of pensioners. Nevertheless, the CPP asset base is little more than a working capital fund, the returns on which help defray the current cost of pension payouts, rather than a pool of savings from which to grow an ability to pay future pensions, for it grew at only by about 5½% annually from contributions & investment returns in the five years ended December 31st, 2013.

developed countries' post-war generations allowed their leaders to run their nations' affairs on their behalf. It also supports the view of those who think Japan is a trainwreck waiting for a place (or time?) to happen & that Prime Minister Abe is in the position the Titanic's captain would have been one hundred years ago, if at the last moment he had realized the danger his ship was in & had sought to make a course correction : Too Little, Too Late!