Quote of the week - "Nothing beats a little cash in a bear market ... and the oldest form of cash is gold" - James Grant (age 68) - he went from being a Navy gunner's mate to getting an MA in international relations from Columbia via journalism at the Baltimore Sun & Barron's to founding, in 1983, Grant's Interest Rate Observer, an independent, value-oriented, contrarian *& often iconoclastic* source of *common sense* insights into capital markets; thus following the 2008 financial crisis the FT asked rhetorically "If Grant could see what was happening ... and warn of it in a well-circulated publication, how did the world's financial regulators fail to avert the crisis ... and how did the rest of us continue to make ... irrational decisions ..."

One of the more common sense observations of the Islamist phenomenon came from Kenan Malik. Born in India to a Hindu mother & a Muslim father (& an atheist himself), he was educated in neurobiology-, & has long been resident-, in Britain. Once a psychology researcher, he now is a writer with a number of books to his credit. For he described it as being a function of "an inchoate rage against modernity ... (*that has*) turned terror as an end in itself".

It is a joy to behold manipulators of economic data, in this case central bankers, being hoisted on their own petard. For, after having long pushed the idea that headline inflation didn't matter, only core inflation did (a contrived measure of inflation that ignores the impact on household budgets of their most common daily expenses, food & energy), they now face the unhappy reality that the collapsed oil price has pushed headline inflation down waaaay below core inflation - *So don't expect to hear much prattle about core inflation for at least the next year.*

The headlines made much of the fact that December's new job growth had been a slightly-better-than-expected 252,000, and it being the 11th-, & 4th-, month in a row it had exceeded 200,000 & 250,000 respectively), that the unemployment rate had slid another 0.2% MoM to 5.6%, down from 6.7% YoY, & that new job growth in 2014 had totaled 2.95MM, a post-1999 high - *but drilling deeper into the numbers suggested it wasn't all sweetness & light. 252,000 was down 100,000 MoM. The participation rate remained at a 36-year low 62.7%. Average hourly earnings had declined 0.2% during the month & for 2014 as a whole, at 1.7% YoY, had been flat in real terms. The strongest job growth was in low-paid occupations (retail, temporary agencies, leisure & hospitality). While last year's total new job growth number had been close to that in 1999, the population had grown 14% since. In December retail sales were down a 0.9% most notably so in electronics, clothing & auto sales, all highly 'discretionary spending' categories; and this came after November retail sales had grown by a less-than-expected 0.4%, although, due to the very strong October number (when consumer confidence had first become sensitized to the disposable income effect of the lower gasoline prices?), total Fourth Quarter retail sales were up QoQ. Finally the Labor Department reported that in the week ended January 10th new applications for unemployment benefits had been 316,000, 19,000 more than expected, causing the four week running average to rise to 298,000 (heralding an imminent breaking through the 300,000 level below which it has been for six months?)*

JPMorgan CEO Jamie Dimon was unhappy to the point of using profanity when he met the press after the bank had reported 6.6% lower Fourth Quarter profits at US$4.93BN[1], saying the bank was "under assault' from regulators. This raises three issues. The trend towards more regulation is largely a self-inflicted wound on the part of the 'too big to fail' banks; if they had acted more responsibly, & less shortsightedly, prior to-, & ever since-, 2008 the push-,. &

[1] Which nevertheless still generated a quite respectable Return on Equity of 10.50%; while this was down from 10.84% in the Third Quarter & from the recent high of 12.66% in the Second Quarter of 2013, it was well ahead of the 8.02% in the Second Quarter of 2014.

momentum of the drive-, for more regulation would likely have been much less compelling. Secondly, should banks, or any corporation for that matter, be 'entitled' to uninterrupted quarterly earnings growth (especially at a time that corporate profits are at all-time high levels relative to GDP, & in the case of the big banks in light of Goldman Sachs' CEO conceding three, four years ago in a Congressional hearing, that many of its *most profitable* activities had been of limited, if any, "real" economic value). Finally, whether there was any justification for his hissy-fit; for but for the growth on his watch in the bank's 'Wild West', 'customer be damned, the only thing that matters is the bank's bottom line this quarter' mindset, the bank might not have had US$990MM in legal expenses during the quarter & its quarterly earnings could have been as much as 12.1% higher, rather than 6.6% lower - *during the many years I had periodic dealings with JPMorgan it was the industry's 'class act', whereas today it is as scuzzy as Goldman*.

According to Pennsylvania-based Stephen Schork, publisher of The Schork Report, open interest in US$30 March oil puts has gone from 34 to 2,127 & that for June from 35 to 51,252 - *so there is a surfeit of speculators willing to take a flyer on oil being < US$30 two-, or five-, months hence*. Elsewhere it was reported Iraq's December's crude exports had hit a post-1980 2.94MM bbld record (& that it expects export shipments from its Northern Kirkuk fields to shortly double to 300,000 bbld while state-owned Missan Oil is planning to quadruple its output to 1MM bbld by January 1st, 2017), that in 2014 Russia's oil output had been a post-Soviet record high, that US shale oil output will continue to grow for two more years & that North Dakota's in November had risen to 1.19MM bbld, a six-fold increase in five years, & had climbed rapidly during the year despite a 50% price decline since mid-year, with the only offset being that political unrest has cut Libyan output to 380,000 bbld, down 25% YoY but up 80% from last spring's 210,000 bbld - *The last time Saudi Arabia quit being the 'good guy' in the mid 80s, fed up with being the patsy, having cut its output by 75% while everyone else merrily kept pumping, it took about 5 years for the price to recover to the point at which it had thrown in the towel.*

While in many countries car owners are enjoying lower fuel prices, the same is not always true in Asia. For there governments are taking advantage of lower crude prices to cut their costly fuel subsidy programs (*& are being encouraged to do so by the World Bank*). India[2], Indonesia & Malaysia have already done so (*so car owners there now pay **more** for fuel while crude proces are **down***), and Thailand & Vietnam plan to follow suit. The resultant decline in demand (they account for 8.3% of the global total), will somewhat offset lower price-driven demand growth elsewhere - *While Alberta's Premier has been musing his government may face a deficit of $6-10BN next year (15-25% of its budget), the other day, when it was mooted, in a well-educated group discussing Alberta's tax regime, that this may be an opportune time to raise provincial fuel taxes (possibly, so as have the medicine go down easier, with a statutory provision to gradually reduce them to their old level as oil prices recovered), the reaction was two-fold, "a 10¢ increase would only raise $1BN" & "farmers won't like it; for fuel is a major cost item for them[3]". Albertans still seem unwilling/unable to grasp the potential seriousness of the oil price decline for their province's economy; this was evidenced by last week's quarterly report of ATB, the Alberta government-owned (shadow) bank-like institution, that opined "Alberta's economy will suffer in 2015, but an outright recession is unlikely" & forecast its growth rate will merely be halved from last year's 3.9%. On the other hand, on January 12th Glen Hodgson, the Conference Board of Canada's Chief Economist, who last November at a Calgary conference had expressed a*

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2 India has been at this for a while; thus diesel in Mumbai is now twice what it was six years ago.

3 Which is really irrelevant since this would not be a matter of **increasing** their cost of production, but merely a question of the extent to which they should be allowed to decrease.

similar view (at which conference ATB predicted WTI of US$85-US$95 in 2015), said "It's going to be very hard for Alberta to avoid a recession this year" (this came the same day CNRL, a major oilsands player, announced it was cutting its capex budget by 28%, to $6.2BN, from the level it had announced less than two months ago. And the effect on the Alberta economy of the lower oil prices will be aggravated by the oil companies seeking to preserve cash so as to continue to be able to pay dividends to (mostly out-of-province) investors.

If a picture is worth a 1,000 words, then the January 11th Paris solidarity parade pictures told a tale. For in its official 'arm-in-arm' picture Netanyahu was separated from the host, President Hollande, by, & linked arm-in-arm with, Ibrahim Boubakar Keita, the (Muslim) President of Mali[4], while Mahmoud Abbas was only separated from EU heavyweight Angela Merkel (who on her right was arm in arm with Hollande) by EU President (*& former Polish Prime Minister*) Donald Tusk. And in another picture, former French President Nicolas Sarkozy was interposed between Netanyahu & Keita while Abbas was right next to Merkel - *Hollande was said to have been infuriated by Netanyahu. For his security adviser had asked him & Abbas to stay away (so as not risk having the Israeli-Palestinian issue intrude on the event). Both initially agreed; but at the last moment Netayahu, upon learning Avigdor Lieberman & Naftali Bennett were going, changed his mind, prompting Hollande to belatedly also invite Abbas (which he was only too happy to accept in the belief his presence would benefit his claims to Palestinian statehood).*

While in Paris, Netanyahu (*& Naftali Bennett*) took the opportunity to tell French Jews to emigrate to Israel "for their own safety"[5], presumably encouraged by the fact that in the Hebrew calendar year 5774 (that ended at sunset on September 24th, 2014) Jewish emigration from France to Israel 'to flee antisemitism, violence & economic malaise', had been up 70% YoY to 4500 (*more on this in the next Special Edition*). But of the Jews among the 250,000 French men & women who emigrate each year only a minor portion are Israel-bound. And, more generally speaking, this exodus may be 'hollowing out' the French economy; for those leaving are better educated & more ambitious than the immigrants that replace them, many of them from Africa (who in the years to come are likely to be more fruitful in producing offspring than the locals).

Meanwhile Israel's half million high school students staged a one-day strike on January 14th to protest the decision by a teachers' organization that its members would no longer accompany students on their days-long field trips that have long been a right of passage in Israel.

Last week's item about the Saudi succession implied the succession question seemed settled, at least until the death of Deputy Crown Prince Muqrin (age 69). But some believe Prince Muqrin "will never be king"; for while he may be a half-brother of King Abdullah & the youngest son of King Saud, he is not his sole surviving son; and the most prominent of the others, Prince Ahmed (age 72), has a dual advantage : he is a full brother of late King Fahd, King Abdullah's predecessor (who ruled the country from 1982 to 2005[6]) & his mother was one of King Saud's favorite wives while Prince Muqrin's had merely been a Yemeni concubine. But Ahmed must have displeased Abdullah in 2012; for only months after he named him Interior Minister, after being Deputy Interior Minister for 37 years, the King dumped him & 16 months later named Prince Muqrin Deputy Crown Prince - *so things could get messy after Abdullah dies.*

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[4] Who is University of Paris-educated & lived in France for 26 years.

[5] Which may well be a questionable claim since on a per capita basis, anti-Israeli violence in Israel exceeds the incidence of anti-Semitic violence in France (& appears to be on the upswing).

[6]. Although in name only from 1995 on, after he suffered a debilitating stroke.

According to the New York-based, online International Business Times Oxford University Press, the largest such entity in the world, has warned its authors not to mention pigs or pork in their books so as not to offend Muslims & Jews, and to be considerate of other cultures - *even if this may not have been as generalized an instruction as IBT alleges, & was just part of an exchange of views between the OUP & one of its authors (of a children's book), it would nevertheless be an unprecedented example of 'self-censorship', unworthy of this august institution.*

GLEANINGS II - 597
Thursday January 15th, 2015

HOUSE PASSES 40-HOUR WORK WEEK FOR OBAMACARE
(Washington Times, Tom Howell Jr)

- Congress took its first swipe over the next two years at Obamacare on January 8th when the House, under pressure from restaurant-, & other business-, interests, voted 252-172 (with 8 Democrats voting Yes) to repeal its provision making a 30 hour work week the point at which businesses must provide health insurance coverage (which critics say has prompted employers to limit employees to 29 hours). This bill would push 1MM out of employer-sponsored coverage, with those ending up in Medicaid or subsidized health insurance, according to the CBO, costing the Treasury US$53BN (over ten years). Meanwhile Republicans accuse Obama of opposing common sense fixes of the law (which even some Democrats don't deny) while the Democrats accuse them of feigning concern for struggling Americans (*with likely an element of truth in both charges*).

The White House & the Democrats maintain this bill just means that people will end up working just 39-, rather than 40-, hour weeks (which seems like a rather lame argument). Meanwhile, this could become a Mexican standoff, with the Republicans not having enough votes in the House to override a Presidential veto & the Democrats not enough to prevent a filibuster in the Senate. And this won't be the last Republican attempt to 'fix' Obamacare, although some others likely will have more support among Democratic lawmakers than this one.

IRAN VOWS TO HELP VENEZUELA STEM OIL PRICE FALL (Reuters, Mehrdada Balali)

- Venezuelan President Nicolás Maduro is visiting OPEC countries to lobby for higher oil prices. In Tehran on January 10th Iran's Supreme Leader Ayatollah Ali Khameni told him he backed coordinated action by their two governments to reverse the rapid decline in oil prices. For it was a "political ploy hatched by our common enemies ... The strange drop in oil prices in such a short time ... is unrelated to the market." This came after, earlier that day, President Rouhani had opined their two countries "can undoubtedly cooperate to thwart world powers' strategies ... to stabilize prices at a reasonable level in 2015."

*Three days later, on the 13th, Rouhani also warned "Those that have planned to decrease the prices against other countries will regret this decision" (presumably since only one-third Iran's budget is oil-dependent, vs. Saudi's 80% & Kuwait's 95%) - Khameni & Rouhani must be living in a dream world; for Saudi Arabia & Kuwait will have vastly more 'staying power' than their regime : while the former expects a US$39BN deficit in its US$230BN 2015 budget (up 63% YoY), it has US$736BN in its sovereign wealth fund, while Kuwait still runs big budget surpluses & has a US$548BN piggy bank (a high single digit multiple of its **total** annual budget).*

SWISS CENTRAL BANK BLINDSIDES MARKET BY SCRAPPING EURO POLICY (AP)

- Since September 2011, *to maintain the competitive position of its industry, half of whose exports go to Eurozone countries*, the Swiss National Bank (SNB) has capped the SF/Euro exchange rate at 1.20 (& as a result experienced a more than doubling of its FX reserves). But on January 15th it announced an end to this; for it had "concluded that enforcing and maintaining the minimum exchange rate for the Swiss franc against the Euro is no longer justified". And in the (*vain?*) hope of discouraging capital inflows it tripled its benchmark overnight interest rate from minus 0.25% to minus 0.75%. Market reaction was massive & immediate, the SF/Euro exchange rate jumped 30% (although that later moderated to 13% & 1.04), the Swiss stock market swooned 9% (as investors worried about companies' lessened global competitiveness & profitability), *& the price of gold 'popped' almost US$40 to the mid-US$1260s, a four months' high.*

The timing was not coincidental; for it came days after the SNB had reported record SF 38BN/ US$44BN earnings. But in the resultant kerfuffle, the Indian central bank cutting its overnight rate by 0.25% to 7.75% didn't get the attention it deserved, especially given the observation by its Governor, Raghuram G. Rajan[7] (who, in contrast to the practice in many central banks, has the sole responsibility for interest rate decisions), that "Crude prices, barring geopolitical shocks, are expected to remain low over the year."

<u>RUSSIA 'HAS DETERIORATED SIGNIFICANTLY'</u> (The Telegraph, Andrew Trotman)

- This was Fitch's message as it downgraded it from BBB to BBB- with a negative outlook[8]. It painted it as an economy struggling under the weight of a collapsing currency, falling oil prices, high inflation & declining international reserves, revised its 2015 GDP growth forecast from - 1.5% to - 4%, & said "growth may not return until 2017". While it expects the oil price to recover to US$70 later this year, it left itself an out by saying that, if it were to stay significantly lower, "it could precipitate a deeper recession, and put further strain on public finances, severely limiting the authorities' 'room for manoeuvre'.

In practical terms the downgrade matters little (except for holders of Russian bonds), although it will encourage more capital flight; for Russian issuers have been frozen out of international capital markets. Meanwhile, more & more educated-, professional-, and/or small business people are leaving, apprehensive about the outlook for the economy and its education-, & health-, systems, and fearful that Putin's talk about "national traitors" could make them a target, even if not politically active. Canada, Australia & the US are their preferred destinations, then Germany & France, and finally some of the Eastern European Slavic countries. While many expect to have no problem finding a job in their field, this does not apply to doctors; for their training in Russia vastly differs from that in North America & Europe (which does not, however, appear to apply to other healthcare workers).

<u>EUROPE PLUNGED INTO ENERGY CRISIS AS RUSSIA CUTS OFF GAS SUPPLIES VIA UKRAINE</u> (MailOnLine, Robert Lea)

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7 A former IMF Chief Economist, he is held in high regard abroad, but not universally so at home where his critics say he should have cut the rate months ago & has been too pre-occupied with fighting inflation (which at last report still 5%) & with rebuilding the bank's FX reserves).

8 The next downgrade will take it into 'junk' territory.

- On January 15th Russia cut its exports to Europe via Ukraine by 60% amidst the usual charges Ukraine was stealing from the gas in transit to the rest of Europe. In the process of cutting off Ukraine, it did the same to Bulgaria, Greece, Macedonia, Romania, Croatia & Turkey. The EU called this "completely unacceptable", saying it had come without notice & was contrary to *earlier* reassurances by the "highest Russian authorities."

By coincidence this came as Britain, which, as North Sea output continues to decline, relies for a growing 15% of its natural gas needs on Russia, experienced one of its coldest nights this century (as the overnight temp. dipped to - 10 C/14 above F). And this came the day after Russia's central bank announced it would sell, by the end of February, US$850MM from its US$88BN Reserve Fund, one of its two sovereign wealth funds (the other, the National Wealth Fund is slightly smaller). While this move intended to try & prop up the ruble (but likely is far too small an amount to do much good), it is being marketed domestically as one to boost the economy. And it also reshuffled the deck chairs on the Titanic with the recall from semi-retirement-, & appointment as Deputy Governor for Monetary Policy-, of Dmitry Tulin, long 'a man about town' in Russian banking, a move generally seen as a sign Moscow believes the primary short-term purpose of monetary policy now must be on averting a banking crisis.