

Quote of the week : “Do I want *Singapore* to be like America - YES. Do I want its inability to control its drug problem - NO. Do I want its inability to control the gun problem - NO” - Former long-time Prime Minister of-, *and conceptualizer & builder of modern-* Singapore Lee Kuan Yew who died last week at age 91 (from a 2008 interview with Fareed Zakaria, part of which was rebroadcast on the latter’s GPS programme on CNN on Sunday March 29th, 2015) - *this sums up how many non-Americans feel about the US. While some say he wasn’t a role model since he was a dictator who repressed dissidents & didn’t allow “true democratic accountability”, as an exception to Lord Acton’s dictum that “absolute power corrupts absolutely”, he **was** a role model, & “true democratic accountability” these days is a “rara avis”, even in supposedly stellar democratic societies.*

Quote of the week No. 2 : “The Budget should be balanced, the Treasury should be refilled, public debt should be reduced, the arrogance of officialdom should be tempered , and the assistance to foreign lands curtailed ... People must again learn to work instead of living on public assistance.” - *While it may sound like 21st century Tea Party oratory, it was that of the Roman Empire politician Cicero, written in 55 BC, when he was back home, after having been pushed from power & exiled, and on the outside looking in.*

Two facts often overlooked in assessing the state of the US economy are that home ownership-, & residential rental vacancy-, rates are at 20-year lows (the latter being down to 7.2% from 11% five years ago) & that, while the official unemployment rate may be < 6%, if the participation rate today (at last report 62.9%) were like that five years ago (65.7%), it would be more like 10+%.

ADP (Automated Data Processing) is a Roseland, NJ-based provider of business outsourcing solutions with 60,000 employees & US\$10+BN in revenues that also each month it reports on new job creation in the US economy, two days before the the BLS (Bureau of Labor Statistics) does so. On April 1st its estimate was that 189,000 jobs had been created in March, disappointing a market that had expected 225,000, & creating worries about the April 3rd BLS number (*even though the correlation between their two numbers series is not particularly strong*). But the ADP number does suggest the economy may be weaker than hitherto assumed, giving Fed Chair Yellen c.s. another excuse to sit longer on their hands with regards to starting to ‘normalize’ US interest rates. And in this context it may be relevant that the Atlanta Fed’s “GDPNow” forecasting model, that it claims has been more accurate since 2001 than others, cut its forecast for 2015 US GDP growth from 2.0% to 1.25% during the period January 30th - March 6th as the consensus forecast only declined from 3.0% to 2.5% (& then skidded to from 1.25% to 0.2% by March 27th).

According to BBCNews America’s *traditional* protective shield for Israel *at the UN* is now up for discussion in the White House (which it says “feels like payback”) &, despite many opportunities to do so, it has yet to indicate if it will continue to run interference for Israel at the world body, and to Bloomberg Beijing wants to purge all foreign information technology from its military-, banks-, SOEs-, & government agencies by 2020, & replace it with local products.

In Europe the Greek situation is as unclear as ever. The only thing everyone seems able to agree on is that Athens will run out of money sometime this month. On Wednesday it submitted another “list” (*of proposed reforms*) &, having done so, was said to be in a ‘cheerfully optimistic’ mood even though one EU official called it “a very long way from being the basis for a deal”). And according to a WSJ editorial it is now time to start thinking more seriously about an EU without Greece (that it said ‘would strengthen the EU’ bit of potential good news former Prime Minister Antonis Samaras announced he would be willing to join a government of national unity (if Siriza’s junior coalition partner were to walk out?), which could give it greater credibility.

South Africa is facing its worst maize/corn harvest in eight years. A heat wave & a lack of rain in February, *the critical late summer growing season*, is now expected to result in a crop of just 10MM tonnes, down 35% YoY, & 20% below the five-year average. The resultant 20% jump in its wholesale price is bad news for both South Africa, & the neighbouring countries that import maize from it, & for their poor who spend a disproportionate share of their household budgets on food, as well as for their governments; for nothing is more conducive to social unrest than food price inflation (overall inflation in South Africa in February was up 0.63% MoM, vs. -0.09% in January, & the highest monthly rate since last July's 0.73%).

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Thursday April 3rd, 2015

GEOPOLITICAL TREMOURS : AMERICA'S NUCLEAR TALKS AND THE NEW MIDDLE EAST (Der Spiegel, Nicola Abé et. al.)

- The US is rethinking its approach to the Middle East & finding commonalities with its erstwhile enemy, Iran, while relations with its traditional allies are cooling. While Obama wanted to do things differently than his predecessor in, among others, his foreign policy, & become a moderator, rather than a policeman. *in the region*, the US is now involved more hands-on in the Middle East than ever before, and in sometimes absurd ways such as by backing the Sunni anti-Shiite coalition in Yemen while at the same time supporting the Iranian Shiite militias fighting ISIS in Iraq *under a Revolutionary Guards general*.

It is a sign of the growing arms race in the region (& its growing lack of faith in its long-time ally) that Saudi Arabia's 2014 arms imports were up 54% YoY to US\$6.46BN (causing it to replace India as the world's No. 1 arms importer) & are expected to jump another 51% this year (to US\$9.8BN) & that little Oman, with a population of 3.6MM (30% of them ex-pats) & armed forces of 70,000, was fourth in the arms import stakes (after India & China), with 2.2BN.

CALIFORNIA DROUGHT WORSENER BY GLOBAL WARMING (NYT, Henry Fountain)

- California's drought started in 2001 & is the worst in the 120 years records have been kept &, some say, may well be the worst in a thousand years. And scientists say that, while not necessarily **caused** by climate change, it has definitely been **aggravated** by global warming. Thus Michael Oppenheimer, the Albert G. Milbank professor of Geosciences & International Affairs at Princeton explains "The drought is made up of two components : not enough rain and too much heat ... The rain deficit is not clearly connected to climate change, but the planetary warming has made it more likely that the weather would be warmer in California." For higher temperatures cause more evaporation from reservoirs, rivers & the soil itself (*and from human-, animal-, & plant-, life?*), and will make it likely that California & other parts of the US will have more-, & *more severe-*, droughts in the future. Another *longer-term* consideration is that higher temperatures reduce the amount of precipitation that will fall in the mountains in the form of snow, & that the snow that does fall will melt faster, reducing the ability of the snow pack to store water during the winter months to release it during the summer months into the rivers that California has traditionally depended on to help meet its water needs.

On April 1st Gov, Jerry Brown issued an Executive Order imposing water use restrictions (for the first time in the State's history - the 1970's they were announced but never implemented) & ordered the State Water Resources Control Board to cut water use by 25% over nine months

(saying “green grass is a thing of the past”). And for effect he announced this, with TV cameras rolling, while standing on mostly snow-bare ground at the Phillips Station, 90 miles East of Sacramento on Highway 50 at the 6,800 foot level in the Sierra Nevada Mountains, that in years gone by would have been covered by as much as 66 inches (168 cms) of packed snow. But a recent poll found that, while 66% of Californians didn’t think his government isn’t doing enough to deal with the water situation & 69% said they worry that a decade hence the water situation in their region will be “inadequate” or “somewhat inadequate”, most would prefer voluntary cuts in water use (that, however, proved hopelessly inadequate last year when a call by the Governor for 20% lower water use resulted in less than half that) & that only 34% are in favour of government-imposed restrictions (many Americans seemingly still believe one ‘can make an omelette without breaking eggs’)

SEQUOIA’S MORITZ JOINS WARNING ON SILICON VALLEY VALUATIONS **(Fortune, Geoffrey Smith)**

- Sir Michael Moritz was an early investor on Google and PayPal, & now is Chairman of Sequoia Capital, a Menlo Park, Cal.-based venture capital firm investing in tech companies worldwide. He has now joined those worried about a tech stock bubble, prophesying death for a “considerable number” of the “unicorn companies”¹ with sky-high valuations. He told the Times of London “There are a whole bunch of crazy little companies that will disappear; there are a considerable number of unicorns that will become extinct.” And he is not alone; thus Bill Gurley, a general partner at the Menlo Park-based venture capital firm Benchmark & a major deal maker in Silicon Valley with an interest in Uber & Snapchat, told the latest SXSW (South by Southwest) Conference (a music cum film festival held in Austin, Texas in mid-March each year) that there is now a “complete absence of fear” in Silicon Valley & that more people than ever are now employed by money-losing companies there. Moritz also thinks the money splashed on Silicon Valley might be better spent in China, which he calls “the most vibrant setting for start-ups in the world ... (and) home to seven of the world’s most valuable start-ups in the world”, & that “Everybody in the West is in denial about China’s increasing tech strength ... The balance of power is shifting.”

The real player in Asia, & the world, in the years ahead may well be India, not China. It now has a more business-friendly government. Its GDP growth rate is accelerating, while China’s is slowing. China’s growth model was based on the export of generic low value-added consumer goods, & now is trying (painfully) to shift to a more domestic consumption-oriented one, while India’s all along was more focused on producing for a domestic market & on higher value-added production, and is only now becoming more export-oriented (an easier transition than the reverse). India’s dependency ratio is low & will remain so for years to come, while China’s, that is already much higher, is on an upward trend path as its population ages & its work force has started to shrink (high and/or increasing dependency ratios are a drag on an economy’s trend growth rate). China is starting to make life more difficult for foreign investors while India is, ever so gingerly, opening the door to them. Foreign-educated Indians are “repatriating” from abroad because they see opportunities there, while many smart, well-educated young Chinese are going, & staying, abroad, and their well-to-do elders are shipping their money abroad by the truck load. And financial problems of China’s SOE-, & local government-, sectors, that have

¹ US tech companies started since 2003 that are valued at US\$1BN or more in public markets or by private investors, many of them with CEOs too young to remember the 2000 dot.com crash.

hitherto been largely swept under the carpet, will be a “boat anchor” on their country’s economic growth & social stability in the foreseeable future.

TECHNOBUBBLE : THE 23 MOST EXPENSIVE TECH STOCKS (Forbes, Liyan Chen)

- Stocks with lofty valuations fall furthest fastest in market corrections. So, with the average price-to-sales (P/S)-, & price-to-earnings (P/E)-, ratios for the S&P 500 tech sector 3.5x & 18.0x respectively, we screened the publicly-traded US tech stock universe for those with P/S ratios of > 8x, & either negative earnings or a P/E of > 50. This produced a universe of 23 names, all of whom have high YoY revenue growth (averaging 58%) but half of whom were nevertheless losing money. Three were familiar names, Twitter, which has the highest P/S ratio (21.5) & is losing most money (US\$577MM), causing Stifel Nicolaus’ Scott Devitt to tell investors “Longer term, we remain concerned about Twitter’s ability to grow into a platform large enough to justify today’s valuation”, LinkedIn, that, while valued over US\$30BN, has yet to turn a profit, & Facebook, while its profits were over 5x those of the other 9 companies that made money combined, it has a 17.5x P/S ratio, the second-highest of the lot. Among the others, Yelp still trades at a P/E of nearly 100x even though its share price is down 46% YoY, HR software provider Workday is valued at US\$16+BN despite losing US\$250MM fighting off other start-ups seeking to horn in on its market, & Cvent has a P/E of > 700x P/E (911x to be exact) while its YoY sales growth was only half the group average *which makes one wonder why event planning is deemed such a hot product.*
- The article also provides a link to a slide presentation that compares the various companies’ P/S-, & P/E-, ratios, and earnings (market cap details are additional) :

| | Market Cap | P/S | P/E | Earnings |
|--------------------|------------|------|-------|-------------|
| Cvent | US\$1.16BN | 8.3 | 911 | Minimal |
| Demandware | 2.28BN | 13.2 | * | - US\$29MM |
| Ellie Mae | 1.60BN | 9.8 | 117 | <US\$50MM |
| Facebook | 232.9BN | 17.9 | 76 | US\$2,900MM |
| Fireeye** | 6.23BN | 13.1 | * | - US\$444MM |
| Grubhub | 3.87BN | 14.5 | 150 | <US\$50MM |
| Guidewire | 3.74BN | 14.5 | 179 | <US\$50MM |
| LinkedIn | 31.93BN | 14.2 | * | - US\$16MM |
| Palo Alto Networks | 12.23BN | 17.6 | * | -US\$251MM |
| Paycom Software | 1.73BN | 10.1 | 239 | <US\$50MM |
| Paylo City | 1.51BN | 12.1 | * | -US\$18MM |
| PricePoint | 2.33BN | 10.9 | * | -US\$64MM |
| Qualis | 1.58BN | 12.5 | 55 | < US\$100MM |
| ServiceNow | 11.9BN | 16.0 | * | -US\$179MM |
| Splunk | 7.18BN | 15.8 | * | -US\$217MM |
| SPS Commerce | 1.11BN | 8.7 | 413 | Minimal |
| Tableau | 6.59BN | 16.7 | 1,059 | <US\$50MM |
| Twitter | 32.32BN | 21.5 | * | -US\$577MM |
| Veeva Systems | 3.32BN | 11.6 | 99 | <US\$100MM |
| Workday | 16.28BN | 19.6 | * | -US\$248MM |
| Yelp | 3.53BN | 9.3 | 97 | <US\$100MM |
| Zendesk | 1.89BN | 9.5 | * | -US\$67MM |
| Zillow | 5.77BN | 13.2 | * | -US\$44MM |

* No earnings, no P/E ratio.

** This company’s a net loss is in excess of its total revenues.

FORMER ATLANTA EDUCATORS JAILED IN TEST CHEATING SCANDAL **(AP, K. Brumbach)**

- On April 2nd 11 former Atlanta educators, incl. a principal, teachers & administrators, were convicted on racketeering charges (that their lawyers said were inappropriate) for their roles in a scheme to inflate students' scores in standardized exams. They will be sentenced later this month (such charges carry up to 20 years' jail time) & the judge ordered them kept locked up until then. They were motivated by a desire to collect bonuses and/or to keep their jobs in the 50,000 pupil Atlanta public school system. According to Georgia University law professor Ron Carlson "this is a huge story ... it has to send a message to educators ... across the nation playing with student scores is a very dangerous business."
- Similar scandals have erupted in recent years in Philadelphia, Washington D.C., Nevada & other public school systems, as officials link funding & bonuses to performance, & close poorly performing schools. In this case a State investigation found that the problem was widespread & that as far back as 2005, educators had fed students answers to questions, & erased or changed answers after tests were handed in, & that those who tried to report it had been threatened. Among those charged had been the Atlanta public school system's superintendent who maintained she was not guilty until the day she died a month ago from cancer, but who was said to have been one of the higher-ups pressing educators to inflate scores so as to qualify for extra federal funding.

The real victims are the students who later in their studies find themselves ill-prepared for the demands made on them. And this may only be the tiny tip of a huge iceberg. For, apart from such chasing of funding, North America's educational system has been generally suffused with a dogma that it is too stressful for students to have to face up to failure.

WALMART RATCHETS UP PRESSURE ON SUPPLIERS TO CUT PRICES (WSJ, P. Ziobro)

- Its US\$288BN domestic sales account for 60% of its total business. But it has been losing market share at home to the likes of Kroger Co, & Costco; so, while total domestic sales were up 3% YoY, in stores open over one year they were up only 0.3% YoY. And its promise to raise wages & its efforts to develop an e-commerce presence, is creating bottom line pressure. So it is pressing suppliers harder than ever to cut prices & has eliminated its joint marketing/promotional activities with them, telling them to apply the money saved to lowering prices (in the process also reducing suppliers' control over how their products are marketed & making them more vulnerable to competition from house brands.

Its initial business model was to build huge stores in huge markets. But there are only so many of those. So it started diluting its brand by going into ever-smaller markets, with a gradual, deleterious effect on its competitive edge. And pushing it suppliers ever harder to cut prices has its limits &, where US suppliers are concerned, in the short run may have a deleterious effect on the economy.

CHINESE LEADERS PUSH FOR "GREENIZATION" (Xinhua)

- On March 24th China's top leadership, in a meeting of the CPC's Central Committee chaired by General Secretary (& *President*) Xi Jinping *himself*, approved a guideline on "conservation culture" that it said should be considered in all aspects of government that

highlights the greenization of production, the economy & life styles (i.e. lower consumption, boost green industries, & promote a low carbon, thrifty lifestyle).

A “thrifty lifestyle” will be a hard sell in a ‘nouveau riche’ society.

“ABENOMICS” ARCITECT SAYS BoJ MUST EASE AGAIN BY APRIL 30TH
(Reuters, L. Kihera)

- Kozo Yamamoto is *Cornell University-educated*, a close ally of Prime Minister Abe & a leading monetary policy expert in the ruling Liberal-Democratic Party. He told Reuters on April 1st that “The economy is at a standstill and prices are seen falling ahead. To do nothing is not an option for the BoJ ... Further monetary easing is absolutely essential to ensure that the Japanese don’t slip back into a deflationary mindset.” Meanwhile, the BoJ has stood pat since October, signaling no further stimulus is needed for the moment & insisting that rising wages & improvements in the economy will boost inflation to its 2% target during the current fiscal year (that ends March 31st, 2016).

*What the BoJ is afraid of is that greater stimulus will cause the Yen to go into a precipitous freefall. Meanwhile, the final March PMI came in at 50.3, down 1.3 pts MoM, & perilously close to the ‘tipping point’ (into recession). Abe’s problem is that he is more popular than his policies. Thus a January poll found that, while his approval rating had gone **up-**, & his disapproval rating **down-**, marginally, the share of voters who said the economy was “headed in a negative direction” had jumped from 19% to 30% YoY & that in a poll two weeks ago 62% had opposed his plan to re-start the nuclear reactors shut down after Fukushima, while those approving it had gone from 35% to 27% YoY.*

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RIVLIN URGES NETANYAHU TO EXPEDITE FORMING COALITION (JP)

- Ahead of swearing in the new Knesset² on April 1st, President Reuven Rivlin pleaded with Netanyahu to form a new government asap³ since, until he does, the government is limited in its ability to serve the public, saying “The public is suffering from this paralysis.”⁴ While on March 30th one Likud MK on its negotiating team said the coalition talks were going ‘surprisingly well’, there are still issues with Avigdor Lieberman & Naftali Bennett

² It met for four hours & fifteen minutes, one-third of it accounted for by two, much-longer-than-planned recesses, long enough to be sworn in, re-elect the Speaker, approve Netanyahu in the ‘caretaker government’ being in charge of seven ministries (Finance, Health, Environment, Education, Science & Technology, Justice & Welfare), & decide to adjourn until May 4th.

³ By law, the first person asked to form a coalition has 28 days to do so upon the expiry of which he/she can ask for, & get a 14 day extension. If still unsuccessful, the President can ask another person to try & put together a coalition for which he/she gets 28 days, with no extension. If still unsuccessful, a new election must be called. Historically coalition building in Israel has taken 20 - 100 days. The 100 day record was set in 1955/56; then it gradually declined to 20 days following the 1992 & 1996 elections, after which it went from 29 in 2001 to 30, 37, 49 & 40 in 2003, 2006, 2009 & 2013 respectively. On April 1st, Netanyahu was on Day 8 of his mandate.

⁴ Rivlin is exaggerating, For during previous Israeli coalition-building hiatuses, & during the 541 day all-time record required for building a coalition in Belgium in 2010/2011, the bills kept getting paid, the trains kept running, the garbage kept being picked up, police kept policing & firemen going out on calls; the one thing that couldn’t be done was introduce new policies (*would that be so bad?*).

over portfolio allocations, and there are still calls emanating inside Likud for a national unity coalition with the Zionist Union that the latter's leader, Yitzhak Hertzog, keeps rejecting.

*According to Haaretz Netanyahu had already doublecrossed Kahlon; for while he said before the election he wanted him as Finance Minister &, when the results were in, promised him he wouldn't make any economic decisions without his approval, Netanyahu then went ahead & promised the United Torah Party the chairmanship of the Knesset Finance Committee & Shas the Planning Directorate of the Interior Ministry⁵ [both moves to make it more difficult for Kahlon as Finance Minister to push through the economic reforms he had advocated during the election campaign, thereby seeking to neutralize him, as he had Yair Lapid as Finance Minister in the last government. And there are other problems. The Governance Bill passed by the Knesset on March 11, 2014 included a clause, at the insistence of Yair Lapid, part of whose platform it had been in the 2013 election, limiting the number of Ministers to 18 (down from 30, not many years ago), and at least 20 of Likud's 30 MKs expect and/or are-, or feel entitled to-, a Ministerial post. Lieberman & Naftali Bennett both want the Defense Minister's post held by Likud's Moshe Ha'alon (who wants to keep it) & Lieberman says that, if he doesn't get it, he expects to remain Foreign Minister. This means that, with the three 'key' ministerial posts gone, all that's left for the rest of the Likud MKs (the UTP & Shas want ministries important to their political base but of little interest to the other parties) will be a dozen, or fewer, ministerial posts of lesser substance. And then there are Lieberman's & Naftali Bennett's legislative demands : the former that capital punishment must be reintroduced for terrorists & the latter for a "nationality bill" (that would enshrine into law that Israel is "the nation state of the Jewish people" - as a precursor for the removal of all Arabs from Israeli soil?) & the imposition of a high tax on NGOs he says are acting against Israel's interests), with both claiming these are sine qua nons for their participation in any coalition government. And while Netanyahu could (just) manage without Lieberman, he needs the support of **both** Kahlon **and** Naftali Bennett. So the continued noise about a national unity government isn't altogether surprising, especially since the President is known to favour the idea. But since Likud & the Zionist Union between them still only have 54 seats, they would need help, in which case there appear to be three main options : with Kahlon's help a more centrist one with 64 seats (in which Hertzog would be most comfortable), with the United Torah Party & Shas a right-wing one (67 seats) that Netanyahu would like but would involve a sell-out on Hertzog's part), & an extreme right wing one that with Likud's 30 seats, Jewish Home's 8, Shas' 7, United Torah's 6 & Yishrael Beitenu's 6, may **really** fit Netanyahu's bill, but would still require either the support of Kahlon, Lair Lapid or Meretz to get over the magic 60+ seat hurdles, but with which all three would be, to varying degrees, uncomfortable with, especially since it would almost certainly result in (all but total?) international ostracism.*

⁵

Prompting Kahlon to cancel the coalition discussion meeting scheduled for March 26th.