

Quote of the week - "The Fed has been screwing around ... for over a year, to get the market used to the idea of a 25 bp rate hike. I don't call it a success when you need a year of jawboning to raise it a quarter of a point. I call this hopelessly inept¹." - Jared Dillian (*Lehman Brothers' Head ETF Trader at the time of its demise in September 2008, he turned his back on Wall Street; now living in Myrtle Beach SC, he is an author & publisher of The Daily Dirtnap, a daily market letter for financial market professionals*).

Spanish election - It will be held this Sunday, December 20th. The one sure thing the polls seem to indicate is that the two traditional mainline parties, Prime Minister Mariano Rajoy's People's Party & the country's second oldest, Socialist Workers', party will lose ground, with the former polling just 25% voter support (down from 45% in 2011) & the latter 21% (vs. 29%). On the other hand, one all but brand new party, the centrist C's (Citizens) is polling 16% & another one, the left wing/populist, anti-austerity Podemos (We can) party, 20%. The interesting thing, however, is that with the economy now having produced nine quarters of growth, the last four at a 3%-4% annual rate, Podemos' voter support in the past year has declined by one-third while that of the C's has quadrupled - *So it hopefully will be possible to cobble together a more viable (right-centrist) coalition than was the case in neighbouring Portugal after its October 4th election (because its GDP growth rate in the last nine quarters had twice been in negative territory & over the last four quarters had grown at a rate half that of Spain?)*.

The December 6th - 9th NBC poll - It showed Hilary beating Trump decisively (50-40) but otherwise the results fell within its 3.6% error range : she was marginally ahead of Cruz (48-45) but equally marginally trailing Rubio (45-48, although she, rather surprisingly, outdrew him among Hispanics 59-36) & Ben Carson 46-47.

The Fed' balance sheet - At the end of WW II the size of the Fed's balance sheet was equal to 20% of GDP. Over the next three decades it was gradually whittled down to 5%, its pre-Depression level, after which it grew slowly to 6.5% by 2008. After Lehman it initially skyrocketed & then kept growing, peaking at 19% in 2011 & has declined only marginally since. And the Fed now may be hoisted on its own petard, with its hands tied where its balance sheet is concerned; for in quintupling its balance sheet size to almost US\$4.5TR since 2008², it acquired US\$2TR of UST-, & MBS-, securities that will mature over the next three years that, if it weren't to "roll them over" (i.e. buy new bonds with the proceeds of maturing bonds in a kind of Ponzi scheme), would risk unwanted upward pressure on interest rates.

The Fed hiked the Fed Fund rate, so big whoopee? - Once upon a time, in the pre-Bernanke era, this was a real world-significant rate; for it was what depository institutions short of mandatory reserves with the Fed paid other such institutions for the overnight use, on an uncollateralized basis, of any balances they had with the Fed in excess of their requirements. But the Fed flooding the market with liquidity since 2008 has led to the Fed Fund market becoming, as one analyst put it, "a shadow of itself in term of trading volume" - *daily turnover has shrunk 75% to US\$50BN, a picayune amount compared to the US\$6TR daily turnover in the "repo market" (in which banks borrow UST securities overnight from each other) which can achieve the same purpose.*

¹ It seems to be increasingly a fact of life that, whereas once the Fed **controlled** financial markets, these days it has **become its hostage**.

² But in terms of 'budget-ballooning' the Fed has been a piker compared to the ECB whose QE activities in the past **nine months** boosted its balance sheet by 75+% to 26% of GDP.

Voter turnout in the first-ever Saudi election open to women - Of the 1.35MM male registered voters almost 600,000, i.e. 44%, actually did vote, whereas 106,000 (82%) of the 130,000 female registered voters did so (even if there weren't allowed to drive themselves to the voting places) - *outcomes like this are potential 'green shoots', even though the bodies for which the elections were held have little real power.*

GLEANINGS II - 646
Thursday December 17th, 2015

PROPOSED MOVE ON FED DIVIDEND IS TROUBLING (NYT, David Zaring)

- The Fed has in the past not had to worry too much about invasive legislation by Congress although Republicans have unsuccessfully sought to have its books audited by a *third party*, limit its discretion in setting monetary policy & even get rid of it altogether. But the new highway bill may change that; for Congress has decided to fund the Highway Trust Fund from two raids on the Fed's budget that, if it becomes law (*it was signed into law by President Obama on December 7th*) will constitute troubling interference in the Fed's affairs. The first would be a *one-time* siphoning off of US\$19BN from the Fed's US\$29BN 'rainy day fund' (to handle possible losses) & the second to cut the 6% dividend the Fed has long paid to its member banks to 2.2%, with the resultant annual savings going to the Fund. While the US\$10BN remaining in the rainy day fund will likely be sufficient as a reserve against losses, for the Fed has never lost any money in its trading³ & the dividend is an anachronism, and it's unusual for a government agency to pay dividends to those it regulates, it isn't clear why the banks should pay for highway construction so that Congress or can be seen as doing something about highway construction without raising taxes.
- Fed officials worry the dividend cut may cause some banks to cash in their shares (yes, *it is 'owned' by the banks it regulates*) to become state-chartered (*resulting in a Fed loss of control over them*). But worse still, this banana republic-like move poses a threat to the Fed's (*critical?*) independence⁴ &, while the lawmakers have been highly critical of the Fed for being 'too cozy' with the big banks, they themselves have had no compunction at all about accepting political donations from those selfsame banks.

The Highway Trust Fund funds two-thirds of all state-initiated road construction-related spending⁵, the cost of which has increased a great deal over the years, while the growth of its revenue stream has been much slower. Increasing fuel taxes would be an application of the 'user-pay' principle. The last time they were hiked was under Bill Clinton in 1993 when they

³ This may be a questionable assertion. For since 2007 the Fed's bond portfolio has quintupled to US\$4+TR and, when interest rates go up, the potential book losses on a bond portfolio of that magnitude would be truly mind-boggling (at least if the Fed were to practice what it preaches, i.e. "mark it to market").

⁴ Some will argue (justifiably so?) the Fed itself started this self-immolation process when, in the aftermath of the 2008 financial crisis, Bernanke allowed 'the nose of the camel into its independence tent' by becoming the politicians' handmaiden when he let monetary policy do all the 'heavy lifting' while the politicians sat on their fiscal policy hands.

⁵ Which the American Society of Civil Engineers claims they have been doing at only about half the rate needed to maintain the country's road system in good order.

went to 18.4¢⁶ & 24.4¢/per gallon for gasoline & diesel respectively. Since then cars have become far more fuel-efficient & people have been driving less (in the past decade total miles driven annually by all Americans have leveled off at about 250TR miles while the population grew by 8%). So in recent years the Fund has experienced chronic revenue shortfalls & on 30+ occasions since 2008 has it been necessary for Congress to vote stop-gap, supplementary funding totaling US\$68BN for it from the Treasury's General Fund. And with oil-, & fuel prices as low as they are, Congress, if it hadn't been so dysfunctional, could have followed the example set by the governments of a host of countries (incl., but not limited to, Abu Dhabi, Angola, Egypt, Ghana, India, Indonesia, Iran, Kuwait &, Malaysia) that have taken advantage of the low oil prices to cut their fuel subsidies and/or raise fuel taxes. (The author teaches Legal Studies and Business Ethics at the Wharton School of Business).

THE OUTLOOK FOR 2016 AND BEYOND (Lloud George Advisory, Robert Lloy George)

- There could be big political changes ahead in the US & France, trouble in the EU, a declining property market & slowing economy in China, higher interest rates in the US & lower ones in Asia, and gold may start a slow ascent to U\$2,000 over the next five years, as 'the aura of invincibility around the central banks begins to dissipate, and faith in fiat (paper) money, including the dollar, starts to decline.'
- In China growth will keep slowing until it hits a 'new normal' of 5%, deflationary pressure will continue due to overcapacity in almost every sector, secular items such as the Internet, healthcare & the environment will be the focus for investors, and for consumers travel, upgrading their appliances and/or buying their first car (& less on buying property, leading to a probable major change in real estate valuation by 2017-2018).
- What is fascinating in the world today is the geopolitical impact of the dramatic fall in the price of oil & other commodities. Russia will see a decline in GDP of 4% or 5%, with similar pressures coming to bear on Iran, Iraq & Saudi Arabia (& others outside the Middle Eat, first & foremost Venezuela), while the shrinking of OPEC's power will cut off some funding for ISIS & the jihadists. Meanwhile, there is a serious problem in Europe with refugees & immigrants and with keeping up the guard against internal security threats, while the terms of trade have improved dramatically for Asian countries.
- We see opportunities in wind & solar, in natural gas & nuclear, in clean water (a pressing need in all emerging countries), in electric cars &, even more so, in batteries, and in the deflationary impact of the Internet on a wide range of economic activities and creative innovation & discovery.

The writer is a great-grandson of one-time British Prime Minister David Lloyd George. Educated at Eton & Oxford, he has been in the investment business for over 40 years. In 1991 he founded Lloyd George Management, concentrating on Asian securities at a time few others did, ramping up its AUM to US\$17.7BN by September 2007 before selling the firm to BMO in 2011, retiring from it three years later & starting his new, Hongkong-based firm earlier this year. His current advisory mandates include the Eton College Endowment Fund & the IMF's pension plan.

FOR SOME, US\$22 OIL IS ALREADY THERE (BB, Angelina Rascouet)

- As Brent crude crashed through US\$35, Mexico Mix crude is already selling at below US\$28 (down 73% in 18 months & an eleven year low) & Venezuela is in the same

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If inflation-adjusted, the rate would now have been 30¢ & the Fund would have been 'in clover'.

boat⁷. Iraq is offering its heaviest oil to Asian buyers at US\$25. The heavy, sulfurous Western Canadian Select brings US\$21.37 (*in Cushing, Okla., i.e. after paying to pipeline or rail it there*), & bitumen itself, a heavy, black, viscous mixture of heavy oil, clay, sand & water, brings US\$13, down from the mid-sixties in June 2014.

And rather counter-intuitively, at these, for many loss-making, prices, producers are still incented to boost output, concerned prices may slide lower still in the weeks & months ahead.

DESTROYER FIRES AT ‘PROVOCATIVE’ TURKISH SHIP IN AEGEAN SEA (AP)

- On Sunday December 13th the Russian guided missile destroyer Smetlivy was in the Northern Aegean Sea, near the Greek island of Lemnos. According to the Russian Defense Ministry, when a Turkish fishing vessel, the Koroglu Balikcilik, approached in a “provocative” manner, it couldn’t establish radio contact with it & when it failed to respond to visual signals & flares, it fired warning shots when it was 600 metres away, causing the Turkish vessel to rapidly change course & pass it at a 540 metres distance.

Upon being summoned to the Russian Defense Ministry later that day, Russia’s Deputy Minister lectured the Turkish military attache in Moscow on “the possible harmful consequences of the reckless actions of Ankara in regard of the (Russian) military contingent fighting international terrorism in Syria”. But the Russian side of this story sounds fishy. First of all, it was a matter of David & Goliath : Smetlivy’s length was 4x that of the Koroglu Balikcilik and it has 10x its gross tonnage, and maximum-, & cruising-, speeds of 70 & 33 kmh vs the Koroglu’ 13.3 & 7.4 kmh. At 600 metres the Turkish vessel was still about three minutes steaming at top speed from the Smetlivy. And strangest of all, 84 hours later commercial tracking sources reported the Koroglu Balikcilik to be in the Eastern Black Sea near the port of Batumi, 1,400+ kms from Lemnos (so it would have had to travel there at an average speed well in excess of its rated top speed).

MERKEL IS UNDER SIEGE - AND SO IS EUROPE’S CENTRE (G&M, Timothy Garton Ash)

- Angela Merkel may be Time Magazine’s Person of the Year but that is small consolation as she faces a near-revolt at next week’s party conference where her party’s youth wing wants to propose ‘capping’ the number of refugees let in the country, with guesstimates being that as many as 40% of the delegates may support the idea. She has long been the personification of “Die Mitte” (the centre), for in the past decade she, & Germany with her, have been Europe’s political, economic, diplomatic & ideological centre in the debt-, Ukrainian-, & now refugee-, crises. But European politics have been sliding rightward, in Austria, Belgium, Czech Republic, Denmark, France, Netherlands & Poland, and in Germany itself the anti-immigration, Euro-sceptic & rightwing-populist AfD party is now up to 8% in the polls. Even ordinary, humane Germans are starting to mutter “Enough is enough”, we cannot do this all on our own; for with the exception of Sweden, most of Germany’s EU partners have taken hardly any of these, often traumatized, people who come from very different cultures, and, rich & well-organized as Germany may be, it is starting to crack under the resultant strain.
- In a best case scenario all these, mainly young, people will *in time* be successfully integrated into German society and, if so, will go a long way to address it’s chronic

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While its national 2016 Budget assumed a US\$40 price & its FX reserves are declined 32% in the past year, from US\$21.5BN to US\$14.6BN, creating major challenge for the first non-Chavismo government in 16 years.

demographic problem of an aging, native-born population living in a generous welfare state. But to do so German society will have to change some of its settled ways in rather short order; and if it cannot, the result will likely be a downward spiral of mutual distrust (& *resentment?*) between the non-Muslim majority & a Muslim minority (*with all the negative consequences thereof*). This may well be the last & greatest challenge for this extraordinary leader & if she can pull it off, she deserves the Nobel Peace Prize.

To put things in perspective, Germany, with one quarter of the US population, has taken in more refugees this year alone than the US has in the past decade, & has had to do so with little advance notice. On a proportionate basis, the US & Canada would have to take 3.2MM & 350,000 refugees respectively rather than the 10,000 & 25,000 carefully vetted ones they have committed themselves to. In the event, she headed off the incipient rebellion with a strong & defiant speech in which she defended her "humanitarian imperative" at the height of the crisis but pledged the time had come to "reduce the number of refugees appreciably." Meanwhile, wintry conditions have slowed, but by no means stopped, the flow of refugees & migrants, with Germany's EU partners along the way being only too happy to help them on their way to their desired destination, Germany (the author is a professor of European Studies at Oxford & a senior fellow at Stanford University's Hoover Institution).

WHAT THE FRENCH ELECTION RESULTS MEAN FOR THE 2017 PRESIDENTIAL RACE **(The Guardian, Alberto Narelli)**

- While in the first round Marine LePen's Front National party topped the polls in six of France's twelve regions, in the second, run-off round Nicolas Sarkozy's newly renamed Les Républicains party took seven of them, President Hollande's Socialist Party got the other five & the FN's best performance was to come second in four regions (despite it's voter support going from 27.1% in the first-, to 27.7% in the second-, round. The main reasons for this were an 8.5% bigger voter turnout, the withdrawal of some mainline party candidates & (Socialist Party-encouraged) 'tactical voting'⁸. Be that as it may, Sarkozy did less well than expected & as a result faces some unrest in his party, Hollande, despite his low approval rating, came out better than expected & the FN attracted record voter support, will now have a presence on all regional councils (whereas before it had none on half of them) & more than doubled its share of the popular vote from that in the 2010 presidential election (from 11.5% to 27%).

But the FN faces two problems : in every region its share of the vote in the cities was less than the regional average (i.e. its urban support base is weak) & these elections showed that the Socialist voter will come out in bigger numbers to keep the FN at bay.

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AS CRUZ RISES IN US PRESIDENTIAL POLLS, TRUMP CALLS HIM A MANIAC **(Reuters, Doina Chiacu)**

- Sen. Ted Cruz (R.-TX) has been careful not to criticize Trump's 'temporary' ban on Muslims' admittance to America remarks publicly, but recently did so at a private fund raiser. And his dogged pursuit of conservative voters in Iowa (where the first Republican

⁸ When, rather than voting for the candidate of their choice, voters hold their noses & vote for the candidate whom they think is most likely to defeat the one they **really** don't like.

primary will be held on February 1st) has propelled him there into a ten point (31-21) lead over Trump (up 21 points from last October, mostly at the expense of Benson Carson, now third with 13%, ahead of Sen. Marco Rubio (R.-FL) with 10% & the latter's former mentor & former Florida governor, Jed Bush with 6%). So on Sunday December 13th Trump told Fox News Sunday "I don't think he (*i.e.* Cruz) is qualified to be president ... (*that*) he has the right temperament ... the right judgment ... when you look at the way he has dealt with the Senate, when he goes in there like a, you know frankly, like a little bit of a maniac ... you are never going to get things done that way", touting his ability to get along with liberals & conservatives as the hallmark of his being a "world class businessman".

A case of the pot calling the kettle black?

CRUZ TRUMPS TRUMP FOR SCARY (G&M, Konrad Yakabuski)

• No one should strike more fear in the hearts of reasonable people than this Canadian-born Texas Senator who could emerge as the main beneficiary of the chaos Donald Trump has visited on the GOP. Since first being elected in 2012, he has proven himself to be the most self-serving & nakedly ambitious lawmaker on a Capitol Hill that has more than its fair share of such people. While Trump comes across as a braggadocio, he is a calculating & self-obsessed flamethrower who has built a diehard following among evangelicals & Tea Partiers. His biggest "achievement" to date has been to make Congress even more dysfunctional than it already was; for he genuinely hates government & sees obstruction as the best way to raise money. He deems the 2013 16-day government shutdown that he was instrumental in orchestrating a victory (& tried to have a repeat thereof this fall, but failed). His campaign employs the most sophisticated data mining methodologies, using "psychographic targeting", tailoring pitches to *individual* voters based on the personality traits they exhibit in the social media (contrary to the image he seeks to project as a crusader against the surveillance state). In the December 15th debate he carried the isolationist banner. He is against "sticking our nose in foreign entanglements" & doesn't care if Assad slaughters his own people but says he would "carpet bomb [the Islamic State] into oblivion" since it is a direct threat to US security (thereby exciting his base but disregarding the resultant collateral damage among civilians.. And it is hard to find people who like him, his college roommate told the Daily Beast "I would rather have anyone else be the president of the United States. Anyone ... I would rather pick someone from the phone book."

One can only hope that in the end the GOP rank & file in the primaries or, in a worst case scenario, the July 19th - 21st Republican convention, will have the common sense to give the likes of him & Trump the finger, or at least a thumbs down.

TWIN PATHS OF RUBIO AND CRUZ END AT THEIR POLITICAL PERSPECTIVES (LAT, Noah Bierman)

- Edging closer to Donald Trump at the top of the Republican presidential field are two men with similar biographies : in their mid-forties/*Generation Xers*, first term Senators from the Sunbelt, born five months apart to Cuban-American families, propelled into the Senate by Tea Party rage, & projecting themselves as a hard break from not just President Obama, but also from the Bush Republican Party). But there the similarity ends : while Rubio emphasizes his ability to convey conservative values to a society in the midst of rapid social & technological change, Cruz seeks to antagonize the Washington

elite so as to appeal to an audience feeling betrayed by country's demographic & economic transformation. Their different visions have become a crucial sub-plot in a GOP nominating contest that has become a freewheeling competition for the party's identity. Or as Brandon Newton, a North Carolina GOP District Chairman puts it : "We are moving on ... We've run people who are from ... the same mold recently. And them (*sic*) two ... come from different backgrounds."

- Cruz positions himself as the outsider, promising to alter traditional electoral norms by uniting the most conservative factions of his party; according to Ramesh Ponnuru, a senior editor at the National Review & a fellow at the American Enterprise Institute⁹, "A lot of conservatives feel that the leaders ... in Washington have failed to fight for them ... It's not just that they've lost but that they haven't really fought."¹⁰ And despite GOP leaders warning the party needs to move to the middle to broaden its appeal, Cruz argues a combo of social conservatives, Tea Party supporters & libertarians can win if united behind a single candidate who excites them enough to go out & vote, especially since the political middle is shrinking as more voters get their information from partisan sources, telling Fox News "Every time we listen to ... 'run to the middle' we get clobbered."
- Rubio's aggressive foreign policy-, & anti-terrorism-, stance are GOP orthodoxy & his backers believe only he can unite both the arch conservatives Cruz is courting & the mainstream Republicans who find Cruz's edges too harsh or, as one puts it, "Cruz's support is deeper but with a narrow bandwidth". He & his advisers believe national security will be the pre-eminent issue in the election & that Cruz has compromised traditional Republican strength to win over the libertarians. And he told NBC's Meet the Press on December 13th "Each time he's (*i.e.* Cruz) has had to choose between a strong national defense and some of the isolationist tendencies in American politics, he seems to side with the isolationists ... this is an important issue to have a debate over. It's not personal." And Cruz, while vowing to wage an aggressive anti-Islamic State campaign, last week opposed toppling Syrian President Bashar al-Assad since doing so and "allowing radical Islam to take over a nation is not benefitting our nation's security". And their different paths are reflected in those flocking to their banners; thus last week Cruz was endorsed by an influential, anti-abortion/anti-gay conservative Iowa Christian & Rubio by a late forties Chicago billionaire hedge fund manager & patron of the arts & education.

*One problem that has been dogging Rubio for some time, that he has been unable to shake, have been the allegations of at best financial ineptitude & at worst dishonesty in his financial dealings while a Florida state legislator; nevertheless a scenario is plausible of the party establishment uniting behind him and letting Trump & Cruz fight over the **really** disaffected right wingers.*

5 TAKEAWAYS FROM THE GOP DEBATE (Politico. Mike Allen)

- The top sub-plot now is the increasingly raw fight between Cruz & Rubio as to who will be the non-Trump. The morning after the December 15th debate the Des Moines Register headline was "Iowans, Trump slips, Rubio shines." While Christie was at his

⁹ Both bastions of conservative thinking.

¹⁰ Which seems an odd comment to make, given the dysfunctionality of Congress they seem to have been responsible for.

best, capping a great month, this wasn't enough to syphon attention away from his better-polling rivals. And Jeb Bush had a moment, albeit not a lasting one. Here are the five takeaways :

- Rubio** is like Obama in 2008, only more so at this stage, & more consistent; that's why the Hilary camp fears him & would prefer to do battle with Cruz (compared to whom Rubio was more detailed & convincing);
- Cruz** looked afraid of Trump, smooching up to him &, according to a top Republican behind-the-scenes power, "sailing into a big gender gap with women";
- Bush** finally showed spine. While still outmatched, he kept going after Trump, telling him "Donald, you're not going to be able to insult your way to the presidency ... Leadership is not about attacking people and disparaging people";
- Trump** is never good in debate but that seems not to hurt him in the polls; and
- Carson** is fading.

The field appears to be thinning, but one never knows, it's still 'early innings' & a lot can happen in the seven months until the July 18th-21st Republican Convention in Cleveland, Ohio's Quicken Loans Center.