

GLEANINGS II - 733
Thursday October 26th, 2017

Quote of the week - “The polarity in economics and living standards is contributing to greater political polarity ... It is also leading to reduced confidence in government, financial institutions and the media” - Ray Dalio (age 68), founder & former Co-CEO of Westport, Conn-based Bridgewater Associates, now with AUM of US\$160BN the largest hedge fund in the world. With a Net Worth of US\$17BN & ranked 27th on the Forbes’ List of the 400 wealthiest Americans, he bases his assessment on the fact that since 1980 the top 40% income group has seen growth in their net income while the bottom 60% hasn’t, with the result that the top 40% now have 10x as much wealth as the bottom 60%, up from 6x in 1980 (five years after he founded Bridgewater), which he attributes this to the top 40% spending more on education¹ & being more adaptable to the changes in technology that are changing the job market.

Arizona could become a ‘centrefold’ battlefield in the mid-term elections - Sen. John McCain has glioblastoma, a particularly nasty brain cancer &, in his own words, his prognosis is “very poor” (the average life expectancy after diagnosis is 15 months - although that means, of course, that half will live longer, & some sufferers have lived 10+ years or more after diagnosis). And since, in a possible ‘watermark’ October 24th speech in the Senate, the state’s junior Senator, Jeff Flake, announced he won’t run next year, there is a possibility that GOP control of the State’s two Senate seats could go up in smoke twelve months hence (albeit only if the Democratic Party can get its act together) - *For while the CW is that Arizona is a GOP ‘stronghold’, the reality is that, according to an October 1st report by the Arizona GOP Secretary of State, the party affiliation of its 3,665,316MM registered voters is : Republican - 1,268,748, Democrat - 1,106, 675, Other - 1,250,879, Libertarian - 31,941 & Green 7,073. Add to that the greater optimism in the state from the improved real estate market, the growing evidence of disenchantment among those who voted for Trump a year ago & the state’s historically low turnouts (29.1% last year, 22.8% 2008 & 30.1% in 2010) & such an outcome is not outside the realm of the possible, especially if Steve Bannon were to succeed in having Tea Party activists win next year’s GOP primaries.*

Bioterrorism has the potential for killing more people than nuclear weapons - This is what Bill Gates told the Munich Security Conference last February 17th, saying “The next epidemic has a good chance of originating on a computer screen ... governments need to prepare for these epidemics the same way we prepare for war.” - *This two-day conference was launched in 1963 as-, & remains-, a private sector undertaking, and has been held in every one but two years since, usually in February. Over the years it has become an important global venue for the exchange of views on international security matters by the world’s senior politicians and representatives from the armed forces, academia, civil societies, business & the media. Attendance is typically in the 350 range and, while, during the Cold War it was largely NATO-centric, its purview has since broadened to the point where attendees now come from 70 countries, incl. Japan & the BRIC ones (even though the Kremlin still perceives it to have an anti-Russian bias).*

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EXPERTS WARN OF GLOBAL MARKETS MURKY FUTURE (BB, Sid Verma)

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In recent years he has stepped up his philanthropic largesse (mainly on education), to US\$120+MM

- **Grantham Mayo van Otterloo (AUM US\$77BN)** - While in the past 5 years US stocks have posted 14.3% annualized returns, it expects 4% negative ones over the next seven;
- **Morgan Stanley** - A 60/40 equity-bond portfolio will deliver 4.2% returns over the next decade, a low not seen since the early 2000s;
- **Goldman Sachs** - It projects losses over the next 12 months for US stocks, credit markets & all commodities except oil, after a rally that has spurred fears over “bubblicious” valuations against a backdrop of still modest growth;
- **Zurich-based GAM (AUM of SF131.1BN)** - Bond investors will be lucky to get half the returns achieved since 2009 & at prevailing valuations it will be a nightmare for equities;
- **Geneva-based Pictet Asset Management (AUM of SF478BN)** - Traditional stock-bond splits in developed markets will get real returns of just 1% over the next five years;
- **RBC Global Asset Management (\$307BN AUM)** - Higher yields will spur negative returns in developed bond markets & returns on equities will lose their valuation tailwind; and
- **Rotterdam-based Robeco (AUM of 147.3BN Euros)** - While the global recovery still has legs, with quantitative tightening there is now more of a prospect of a mild recession.

In markets unanimity often is counter-indicative, but this may be the exception to the rule.

RALLY CONTINUES, BUT ‘THIS IS KIND OF HOW BULL MARKETS END (CNBC, Jeff Cox)

- Thus spake BAML’s equity & quant strategist Savita Subramanian on October 17th, and more specifically “What we’re in right now is the sort of euphoria around stocks that’s been missing for this entire bull market” (*that began in March 2009*). She feels the mood is shifting as companies are cutting back on their share buybacks (*because their shares are no longer ‘good buys’?*)², investors are demanding more from companies when they report their earnings, & “people are starting to buy the dream that stocks can only go up ... That’s what I worry about. It’s not the age of the bull market, cause bull markets don’t die from old age. It’s just *that* a lot of things we’re looking at look very late cycle.”

After four out of five S&P 500 companies outperformed the market’s earning expectations in the Third Quarter, as did three out of four did in the Second Quarter, it had little effect on their share prices, in fact in the latter case some of their share prices actually declined, suggesting that these higher earnings had already been factored into investors’ expectations.

TRUMP MAY REPEAT A TRAGIC HISTORY (WP, Fareed Zakaria)

- In May 1964 the US had < 20,000 soldiers in Vietnam as trainers & advisers. But President Lyndon B. Johnson told McGeorge Bundy, his National Security Adviser, “I don’t see what we can ever hope to get out of there with once we are committed ... I don’t think that we can fight them 10,000 miles away from home and ever get anywhere in that area. I don’t think it’s worth fighting for, and I don’t think we can get out ... I look at that sergeant ... this morning ... He’s got six little kids ... What in the hell am I ordering him out there for? What the hell is Vietnam worth to me ... What is it worth to this country?” He was asking the right questions & understood Vietnam wasn’t vital & could easily become a quagmire. And yet, he couldn’t bring himself to the logical conclusion - withdrawal. Like any president he couldn’t see how he could admit failure; so he ended

² Thus last February the WSJ carried an article headlined “Stock Buybacks are so Yesterday”.

up raising troop levels there from 20,000 to over 500,000. For in American foreign policy, when faced with a choice between backing-, or doubling-, down, the choice is always for the later.

•In two critical areas, North Korea & Iran, Trump has dramatically raised the risks for the US, & for no good reason. Wanting to appear tougher than his predecessor, his position on both is maximalist : totally denuclearize North Korea and stop Iran making ICBMs & supporting proxy forces in Syria, Yemen & Iraq (*a US ally in the region?*)³. He views international negotiations like he does business deals, as win-lose situations he must win. But in the international arena both sides have to worry about how a deal will play out at home; for neither can afford to be seen as 'losing'. As a leading business person said to me recently, "Trump is playing two-person negotiation, thinking it is just him and the other guy ... But actually there are *other* people outside (*or rather in?*) the room - the two nations' publics - that place huge restraints on the negotiators". So in any international negotiation there must be an element of win-win⁴; if not, one side cannot sell a deal at home⁵. Thus, according to a senior Mexican official, there was a way to renegotiate NAFTA, & even to finance the wall, but "Trump needed to allow us also to declare some kind of victory, give us some concessions. Instead he started by humiliating us and made it impossible for [President] Enrique] Pe a Nieto to make a deal ... *for no Mexican government can be seen to ... surrender to Washington.*"

The comparison in the first paragraph is of limited relevance; for times have changed. 9/11 introduced two new elements to American foreign-, cum defense-, policy-making, thousands of miles of oceans no longer safeguard the US & warfare has become "asymmetrical"^{6 7}. And since then cybersecurity has added yet another dimension to it (as would bio-, & nuclear-, terrorism) : so isolationism is no longer a viable option & 'foreign adventures' may no longer be a matter of choice, ambition or US 'pecker stretching', but of necessity. And right now the picture is further complicated by the fact that, while during the Cold War era the key decision makers on both sides were-, or were assumed to be-, rational people, today in the key conflict of the early 21st century, both final decision makers are blinkered, over-confident megalomaniacs, with the one on our side devoting too much of his own-, & by derivation-, the nation's time, resources & attention to what is, at least in the short run, a secondary-, if not tertiary-, national security issue, Iran.

TRUMP APPROVAL RATING DIPS TO NEW LOW IN Fox NEWS POLL

³ And in Lebanon?; for Tehran sees Syria as a bridge to that country & the Mediterranean.

⁴ I remember Henry Kissinger expressing a similar thought in a CNN interview two decades ago : 'A deal in which one side is sublimely happy, & the other isn't, is not a deal that is going to last'.

⁵ Thus I can remember Henry Kissinger telling his interviewer on CNN two decades ago that any deal in which one side is sublimely happy & the other side distraught, is not a deal that will last.

⁶ In which nations with massive modern hi-tech weaponry face small, lightly armed groups that, as Mao Tse-tung once put it "must move among the people like a fish swims in the sea" & the former are handicapped by the fact that they present-, & provide the others with-, many site-bound targets (of which the others only need to pick one, and are ill-suited to the kind of 'house-to-house street fighting' that the occasion calls for.

⁷ The Vietnam War was a sign of things to come; for the US mighty military machine ended up being 'shown the door' by lightly-armed 'slant-eyed slopeheads' wearing thongs.

(Politico, Christiano Lima)

- Its latest poll results were released on October 24th. They showed that the percentage of voters that approved of him had dropped by four points to 38% from September (to a level 10 points below that in February in its first post-inaugural poll), & that the disapproval rate had risen to 57%, a new high, and a combination of an 83% approval rating among Republican, 30% among independent-, and 9% among Democrat-, voters.

Earlier this month a January-September survey of 472,000 registered voters by (the supposedly slightly left-biased), Washington-based MorningConsult found that Trump's approval rating had dropped in every state & overall was down 19 points & that he had failed to improve his standing even in states that he had won by large margins in the 2016 Presidential election.

UNREGULATED LENDERS WORRY CMHC⁸ CHIEF (Reuters, Matt Scuffham)

- On October 20th Evan Siddall, its CEO, warned that new rules to reduce risky lending by the Canadian banks are pushing *aspiring* home buyers into the arms of unregulated lenders & that steps should be taken to curb their growth, "Right now, the level of activity (by unregulated lenders) is relatively low, but we have created an incentive for it to be higher ... To the extent that we continue to shrink the space (*for the banks to operate in the home mortgage market?*) then riskier loans just move outside our purview and we need to think about what that means to us." And, he said CMHC is researching how much of Canada's \$1.4TR mortgage market is being served by unregulated lenders & investigating whether their activity posed a systemic threat to the broader market and "Do I think we need further measures in the federally regulated space. No, I don't. Not for now ... The risk in that space has gone down. We've done our job."

His last statement appears irrelevant, since he earlier implied that any systemic risk lay in the non-regulated part of the market (Canada's version of the US sub-prime market that caused its housing market to crater a decade ago) & that the more effective the measures to choke bank mortgage lending, the greater the risk posed by the unregulated lenders ; it's a bit like a balloon : if one sticks his/her finger in it in one place, it must bulge somewhere else.

CANADIANS 'NOWHERE NEAR PREPARED' FOR INTEREST HIKE (CP)

- YTD the Bank of Canada has twice raised its key interest rate. This has had an immediate effect on the cost of all floating rate mortgages, home equity lines of credit & new fixed rate mortgages, and a delayed one for home owners with fixed rate mortgages upon their 'renewal'. And an Ipsos online survey for MNP Ltd., a 4,000 employee, Calgary-based *'full-service chartered accountancy cum business advisory firm with offices across Canada*, of 2,005 adults between September 18th & 21st found that one in three is already feeling the effect of higher interest rates & one in four fears that if they rise further they will be in financial trouble. *And what's more important*, seven in ten said that with interest rates *seemingly bound to be* heading higher, they will be more cautious in their spending, and four in ten they have little scope for dealing with unexpected expenses at the end of the month & are just \$200 away from financial insolvency. According to Jamie Feehy, Managing Director of Canadian Structured

⁸ Canada Home Mortgage Corporation, the federal government agency that provides-, & insures third party-, home mortgage funding.

Finance at *the* Toronto-based DBRS rating agency, this is a function of getting “that nice house on a nice street that is big enough to put kids ... *which means that* they are just absolutely leveraging themselves to the hilt.”

Feeney is oversimplifying a more deep-seated problem, that of Canadians’ general lack of financial acumen & perspective; for < 70% of Canada’s nearly 13MM households own the home they live in &, at last report 40+% of them were mortgage-free.

PUTIN SLAMS CANADA FOR ‘POLITICAL GAMES’ (NP, Marie-Danielle Smith)

- On October 18th, *five years after the US Congress had done so & three after the European Parliament had voted for sanctions against 30 Russians allegedly involved in the Magnitsky case*, Canada’s Parliament passed The Justice for Victims of Corrupt Foreign Officials Act (aka the Sergei Magnitsky Law after the young Moscow lawyer who was tortured-, & died-, in a Russian jail after blowing the whistle on corrupt *Russian officials*⁹), to allow Ottawa to impose sanctions on foreigners accused of human rights violations, seizure their assets in Canada & bar them from entering the country). During its travel through Parliament, the Russian Embassy in Ottawa warned of “countermeasures” that might be imposed in retaliation & the day after passage twittered it would cause irreparable damage to the Canada-Russian relationship while the Kremlin’s website reported that Putin during a press conference in Sochi had accused the Trudeau government of playing “unconstructive games” & conspiring to “blow up more anti-Russian hysteria”.

The Putin clique hates sanctions targeting individuals; for it robs them of opportunities to hide money-, & spend time-, abroad.

CHINA CENTRAL BANK WARNS OF ‘MINSKY MOMENT’; WHAT DOES IT MEAN (Reuters)

- On October 19th, on the sidelines of the *all-important* quinquennial Communist Party Congress, PBC Governor Zhou Xiaochuan (age 69) warned of the risk of a “Minsky moment”¹⁰ (*when seriously overextended borrowers must sell assets regardless of price, causing markets to spiral lower & cash to become king*), citing the high-, & rising-,

⁹ Magnitsky had been doing the leg work for an American turned British citizen, Bill Browder (now age 53), who in 1996 had gone to Moscow to found Heritage Capital Management (HCM), had stayed after the 1998 Russian financial crisis & turned HCM into the largest foreign investor in Russia. Once a fan of Putin, he was in 2006 banned from Russia for “national security reasons” (but according to the Economist because he had interfered with the flow of funds to “corrupt bureaucrats” & their accomplices) after which the assets of HCM disappeared into the hands of local third parties while he was accused, as is almost routine in Russia for dealing with asset-rich individuals of “tax fraud & later sentenced in absentia to 9 years. Three days after passage of the Canadian law, Putin managed to have Browder placed on the Interpol ‘arrest list’ (which means that he risks being arrested & extradited to Russia, if he leaves the UK), some thing that Interpol had refused to do four years earlier.

¹⁰ In a paper entitled “The Financial Instability Hypothesis” the American financial economist Hyman Minsky in 1992, two years after his retirement from St. Louis-based Washington University & four years before his death, outlined how debt can build up during periods of growth until it becomes excessive even as the economy appears to be stable.

corporate¹¹-, & household¹²-, debt, saying it could take years to bring it down to more manageable levels & pledging to fend off its risk. Minsk's theories were "rediscovered" during the 2008 global financial crisis, with the then San Francisco Fed President Janet Yellen telling an audience in 2009 "one of the critical features of Minsk ... is that borrowers, lenders and regulators are lulled into complacency as asset prices rise."

- Corporate debt in China, *much of it of inefficient SOEs (whose debt load, according to MacQuarrie Research, quadrupled in the eight years ended in 2015)*, has climbed rapidly since China launched a massive stimulus program to cushion the economy in the global financial crisis (*although Beijing recently has taken steps to try & restrain its further growth*). The IMF said in August that it expects China's non-financial (i.e. government, corporate & household) sector's debt to rise from 242% of GDP last year to 300% by 2022 (*i.e. the end of President Xi's new five year term*), after earlier warning its credit growth was on a "dangerous trajectory", while the BIS warned late last year that excessive credit growth was signaling a banking crisis in the next three years. And both Moody's and S&P have downgraded China's sovereign credit rating *for the first time in nearly two decades* citing worries about the rapid buildup in debt after years of credit-fueled stimulus to meet official GDP growth targets, and S&P said on October 24th China has taken only "baby steps" in deleveraging its economy & *far bigger strides are needed*; for, while credit growth is showing signs of slowing, it expects it to continue to outpace economic growth, 'leaving thinner buffers to deal with any crisis'.

*Zhou is a 'princeling' & supposedly among the more intellectual of Chinese leaders (he spent one year in the 80's as a "visiting scholar" at the University of California, Santa Cruz). A chemical engineer by training with a Ph.D. in Automation & System Engineering he has spent most of his career in finance & has a reputation as a 'reformer'. Having been Governor for 15 years during the regime of three Chinese Presidents & three Fed Chairs, he is the 'doyen' of the central bank governors' corps. Last October 10th he told the Beijing-based bi-weekly financial magazine *Caijing* that three drivers will be needed to keep the economy on a rapid growth path : more foreign trade, a market-based yuan rate & a relaxation of capital controls (none of which seem to figure large in President Xi's thinking). And his pledge to fend off the Minsky risk is not one to be taken 'to the bank'; for both his age & his priorities will give President Xi (who early in his first term lost his reformist zeal to an urge to re-assert the Party's dominance over everything, incl. the economy, so as to become China's third "Great Leader" (after Mao & Deng)¹³, reason to replace him with someone more malleable.*

MADAGASCAR PLAGUE OUTBREAK KILLS 94 (AP)

- The plague is endemic in this country (*with an average 400 cases, mostly of the bubonic variety reported each year*). WHO reported on October 20th that an unusually large outbreak (that for the first time it has affected its two biggest cities), has killed 94 of the 1,153 suspected cases. But, according to a senior local WHO official, while more cases are expected, the quick deployment of human resources & all types of intervention, will help contain it. Over 70% of cases are of the more virulent, airborne "pneumonic"

¹¹ Now At last report roughly 125% of GDP, vs. 44% in India, 40% in Russia & 38% in Brazil and 66% in the US, 58% in the UK & 56% in Germany.

¹² Now 45% of GDP (< half that in developed countries), up from 20% a decade ago.

¹³ A la 'Mao made the country, Deng made it prosperous & Xi made it powerful.'

variety¹⁴ that, can-, & will-, kill within 24 hours. While both respond to common antibiotics, the bubonic form often found in the country's remote highlands is more amenable thereto.

The WHO says the risk of global spread is low & advises against travel-, or trade-, restrictions but is seeking US\$5.5MM to support its plague response (Madagascar, a French colony until 1960, is a 600,000 sq. km. island with 25MM inhabitants off the Southeast Africa Mozambiquan coast that is best known for its rich fauna, incl. animals, like the lemurs, that aren't found anywhere else).

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Bad start for the new WHO¹⁵ Director General - In 2006, after the sudden demise of the incumbent Lee Jong-wook (from a stroke at age 41) the then, Hongkong-born, WHO Deputy Director General Margaret Chan (a graduate from the University of Western Ontario in Home Economics & Medicine now aged 60) was, with strong support from the PRC, appointed to succeed him, & for the 10 ½ years she ran it, despite the H5N1-, SARS-, Ebola-, & Zika crises, with little controversy (the only exception being the 2013 Ebola crisis). Last July 1st she was succeeded by Ethiopia's 52 year-old Dr. Tedros Adhanon Ghebreyesus, who as that country's Minister of Health from 2005 to 2012, had made great strides in improving his country's healthcare delivery service¹⁶. Last week, at a WHO conference in Montevideo, Uruguay, on non-communicable diseases (*not a top priority for the Agency*) he announced having named, in recognition of his "contribution to public health" & his role as the leader of a country that "places universal healthcare coverage and health promotion at the centre of its policies to provide healthcare for all", the 93 year-old Zimbabwe President Robert Mugabe as its 'goodwill ambassador' (*for a two year term*)¹⁷ on non-communicable diseases' to ensure other leaders would make combating them a priority, praising him for having established a fund for non-communicable diseases *that is* "an innovative domestic resource mobilization approach that other countries can learn from." But this created such a firestorm of governmental protests¹⁸, a couple days later he announced he had dropped the idea.

¹⁴ Whereas in past years the vast majority of cases was of the bubonic variety.

¹⁵ Headquartered in Geneva & founded in 1948, it now has 170 member countries, a staff of 7,000 (half of them in 147 offices outside Geneva, & a budget of US\$2.5BN, the seventh-largest in the UN 'family', (after peacekeeping - US\$8.9BN, the UN itself - US\$5.7BN, UNICEF & WFP - S\$5.4BN each, UNDP - US\$4.9BN, UNHCR - US\$3.8BN).

¹⁶ To the point that Melinda Gates named him to the 2012 list of "50 people who will change the world (one of the other 49, appointed by someone else was Richard Branson) and that in 2015 he was named, possibly with greater justification, "one of the 100 most influential Africans".

¹⁷ This is a common thing for UN agencies to do, pick luminaries to advance their cause; thus past goodwill ambassadors have included Queen Rania of Jordan (UNICEF), Crown Prince Haakon of Norway (UNDP), former New York Mayor (& founder of the Bloomberg News Service) Michael Bloomberg (WHO), actress Angelina Jolie (UNHCR) & Mrs. Laura Bush (UNESCO).

¹⁸ In part because it is a known fact that Mugabe & his cronies routinely go abroad for their healthcare (YTD Mugabe has been in Singapore at least twice for that purpose) and in part because Zimbabwe's annual healthcare budget is just US\$22 (i.e. 2.2% of per capita GDP) vs. US\$250 in South Africa (i.e. 9.1% of its per capita GDP)

“I don’t think it should be the government’s business to tell a woman what she should or shouldn’t be wearing” - This was Prime Minister Trudeau’s lame-brained reaction to the October 18th passage in the Québec Legislature of Bill 62 that bans citizens with their faces covered from providing or receiving public services in the province (thus ignoring the fact that an Angus poll a couple weeks earlier had found support for the bill among 87% of those polled, incl. the “strong support” of 60% - *My view on the issue is simple & has nothing to do with Islamophobia. I have no trouble with hijabs (that are no different in essence from the babushkas Ukrainian women wore when they came to Canada years ago or those the Hutterite women wear to this day) but draw the line at niqabs & burkas. Before I left Holland as a still-wet-behind-the-ears 18 year-old, my father told me “You are choosing to go & live in Canada; so it behooves you to live there by their rules, not by ours”, which was good common sense advice. Canada is not a country in which covering one’s face is accepted behaviour and if someone were to show up face-covered in a store, a SWAT Team should-, & hopefully would-, be there within minutes. And my understanding is that the Koran merely stipulates that women should dress “modestly” (if so, face covering by Muslim women is a cultural affectation, not a religious requirement). And this is part of a phenomenon prompted by untrammelled ‘political correctness’ that promotes “the tyranny of the minority” under which a loud-, & not always very large-, minority expects to impose-, & to be successful in imposing-, its will on the majority (thereby totally bastardizing the essence of the Western democratic model.*