Quote of the week : "The Delusion of Perpetual Motion. The Federal Reserve's promise to hold safe interest rates at zero for a very long period of time has not created a perpetual motion machine for stocks. No - it has simply created an environment where investors have felt forced to speculate, to the point where stocks are now priced to deliver zero total returns for a very long period of time[1] ... What we have now is a market that has been driven to one of the four most extreme points of overvaluation in history. We know how the other three ended." - John P. Hussman, *a Ph.D. from Stanford in his early 50s, who correctly predicted the 2008-2009 recession & has been critical since of both the Fed & the Treasury for the 'bad policy choices' they inveigled the Administration into making. He taught Economics & International Finance at the University of Michigan but left academia years ago & now manages a group of no-load mutual funds seeking long term growth & total returns,* ***and*** *protection against bad markets, i.e. he is what is known as a "bear market manager" (who underperforms when the market is 'on wheels' but shines when it sucks : thus, his flagship Strategic Growth Fund in recent years has underperformed but during this century's "lost" first decade had an annualized return of 7.7% vs. the S&P's* ***negative*** *0.8%).*

Last week's BIS Annual Report said among others that "leading central banks should not fall into the trap of raising rates 'too slowly and too late' ... The risk of normalizing too late and too gradually should not be underestimated ... (& *a couple days later in a follow-up statement that*) Particularly for countries in the late stages of financial booms, the trade-off is now between the risk of bringing forward the downward leg of the cycle and that of suffering a bigger bust later on." And Claude Borio, the Head of its Monetary & Economic Department, expanded thereon on by saying "There is a disappointing element of déjà vue to all this ...The signs of financial imbalances are there ... that's why we are emphasizing it is important to take action while the time is still there." - *Janet Yellen couldn't take this laying down; so in her 2014 Michel Camdessus lecture at the IMF on July 2nd she dismissed this apparent attack on her dovish bias by saying that monetary policy should "focus primarily on price stability in full unemployment because the cost to society in terms of deviations thereof ... would likely be significant" and that any risk of financial instability didn't require a change in monetary policy but could be dealt with by a "more robust macroprudential[2] approach" (a word she used 29 times in a 5,000+ word lecture), i.e more regulation.*

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1 What he means is that is that the coming market peak may not be matched for a long time; thus amidst all the hype about the S&P/TSX 300 recently setting a new all-time high, the media ignored the fact that it had taken six years almost to the day for it to match its previous high (& that meanwhile there had been a lot of blood in the streets), focusing on how much the indices have risen since the start of this bull market while ignoring that this came after a 50% drop (& that it take a 100% rise to recover from a 50% drop). And the same is true, in a general way, for the other major indices that recently set new record highs (which matters little to long-term investors holding financially strong, dividend-paying stocks, for whom market weakness that spook those with short time horizons are little more than background noise & present possible buying opportunities).

2 A concept used in central bank circles for years that Claudio Borrio in a 2003 paper distinguished from "microprudential" by saying the micro version applies to individual institutions & can be brought on by exogenous developments while the macro version version applies to the system as a whole & often was due to an endogenous cause (He was once referred to by the Economist as "one of the world's most provocative and interesting monetary economists" & in his paper also warned of the fragility of the financial system & defined the financial cycle as "a sequence of self-reinforcing interactions between perceptions of value and risk ... which translates into booms followed by busts."

On July 8th Mohamed El-Erian, Co-CEO of PIMCO until a few months ago[3], & now an Economic Adviser at Munich-based Allianz, PIMCO's parent, told CNBC's Squawk Box program that Janet Yellen's willingness to risk financial stability down the road by continuing easy monetary policies for immediate economic gains is an "all-in"bet[4], and said that "It's a race between financial instability caused by too much money being pushed into the wrong places versus the economy healing ... For now, the market is very comforted by what Yellen is saying". He then went on to say that "Congress is much too dysfunctional now to act on the policies needed to spur growth[5] ... So the Fed keeps the game going, hoping you get enough healing. And that's the big bet right now, that the markets are 'all-in' as well" - *there are two aspects to this worth considering : whether the accommodation provided by Bernanke-, & now Yellen-, has facilitated Congress' dysfunctionality, and how reliable an all-in partner the markets will be for Yellen (history has shown time & again that they are apt, at some point in time, to act like people in an overcrowded night club or theatre when someone yells "FIRE!")*

Former Fed Chairman Ben Bernanke is going around saying, at his US$250,000 speaking engagements, that we "will not see much higher interest rates in my lifetime" (*which makes one wonder if he has perhaps been diagnosed with a terminal illness*).

The euphoria about the latest job growth numbers ignored the fact the 62.8% labour participation rate in May was identical to April's 35-year low (& down from 63.2 in March & 64.4 at the end of the recession) & that many of the jobs created were low wage 'McJobs' and/or part-time ones (it takes 1.23 28 hour/week jobs to equate one 34.5 hour full-time one). Meanwhile the WSJ reported trucking is only the most extreme case of industries unable to find qualified workers, quoting employers as saying "suitable candidates don't raise their hands and individuals who do apply lack the right skills and experience", predicting this portends *inflationary* wage pressures.

Charles Gave (age 71) is a French economist who has been 'around the track' a few times & who is currently Chairman of Hongkong-based GaveKal Research Limited, one of several firms he has founded in his life. He is concerned about the wellbeing (*or rather lack thereof*) of America's poor; for he says that, with the exception of 1987 (when the market reacted to over-valuation), every bear market in the US in the past 30 years "has occurred against the backdrop of the poor experiencing a decline in their living standards". His "Wal-Mart CPI" tracks the cost of rent, food & energy[6], the necessities of life on which the poor must spend most, if not all, their

3 In what may have been a dispute with PIMCO founder Bill Gross (who years ago sold out to Allianz) that was most likely driven by the fact that for over a year now its Total Return flagship fund, the largest bond fund in the world, has suffered massive withdrawals. And Allianz subsequently appointing El-Erian as its Economic Adviser looks like a move to keep him 'on ice' until the now septuagenarian Bill Gross (who just has spent US$200MM of his own money on a bet that rates will stay low) hangs up his spurs.

4 A Texas Holdem poker term for when you don't have many chips left & need to go "all-in" to stay in the game; it is supposedly a bluffer's best friend "but only at the right time and with the right stacks of chips."

5 As witnessed by the uncertainty surrounding the Highway Trust Fund & Ex-Im Bank, the funding of one & the future of the other at this juncture should have been 'no-brainers'.

6 I.e. basically the mirror image of the "Core CPI" that central bankers are so inordinately enamoured with.

income, the ratio of which to official US CPI has increased 15% since 2000 (*it may be relevant in this context that today, July 11th, the WSJ reported that "slowing customer traffic worries retailers" &, elsewhere*, *the National Association of Business Economists that its members had shaded down their Second Quarter GDP growth number to 3.0%, from 3.5% last month*).

Hurricane Andrew in August 1992 cost the insurance industry a bundle. So it developed a new financial instrument to lay off its risk exposure to unforeseen & unpredictable natural disasters. Called "catastrophe bonds", they are sold by insurance companies to yield-hungry institutional investors, like hedge funds, typically have a three year term & pay a specific rate of interest, **but** if the specified natural catastrophe does occur, the investor loses his capital. These bonds currently trade on at a 4.7% yield basis, their narrowest spread over USTs in a decade.

According to Barclay's covenant-lite loans[7] now account for half of all corporate bonds outstanding & the spread between triple-A rated bonds & asset-backed sub-prime car loans is now at its narrowest since 2009; this prompted David Schawel, a North Carolina-based fixed income fund manager, to observe "The objective now is to reach a certain yield target instead of feeling good about the *credit quality of the* underlying credit" (*this ignores that in investment the return **of**-, rather than the return **on**, capital is Job No. 1 or, in Warren Buffett's words, "Rule No. 1 is never to lose money & Rule No. 2 is never to forget Rule No. 1".*

Between 1924 & 1985 the NYSE Market Cap/US GDP ratio ranged from 20.2% in 1942 to 80.3% in 1929, & on December 31st, 1984 was about 50%. From January 1st, 1985 the combined NYSE + NASDAQ Market Cap/GDP ratio had a sharp runup to 180.2%[8] by March 31, 2000, only to then crater by almost half to 96.4% on September 30th, 2002, recover to 144.0% by March 31, 2007 only to be halved again over the next two years. At last report it stood at 143% - *So in little more than a decade we have had, but seem to have forgotten that we've had, two 50% market corrections, each compressed over two years, bringing to mind Edmund Burke's observation that "Those who don't know history (or wilfully ignore its lessons?) are doomed to repeat it" or, as George Santanaya put it "Those who cannot remember the past are condemned to repeat it."*

The discrepancy between the US$8.9BN fine imposed on BNP Paribas for violating US sanctions, the US$2.6BN fine levied against Credit Suisse two months ago for facilitating tax evasion, & the US$1.9BN one paid by HSBC two years ago for money laundering, are causing some observers to draw a comparison between them & GlaxoSmithKline's bribery trials & tribulations in China. For to them both look like 'non-tariff trade barriers' that deal with foreign companies more harshly than with local ones. While evidence is piling up that the wheels of GSK's operations in China had indeed been greased with dollops of bribes, the amounts involved were of a magnitude that would be chump change compared to many Chinese companies' bribery activities, and in the US the sometimes much larger fines levied on local banks typically punished them for out-and-out dishonesty & fraud prior to-, & during-, the Great Recession, not for just circumventing regulations.

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7 Loans the documentation for which does not contain all of the covenants that have traditionally been included to protect lenders in case of unforeseen adversities (like default); as a result covenant-lite is not common at times bond buyers can pick & choose but are a common feature of the market when investors ravenous for yield turn the new issue bond market into a paradise for bond issuers.

8 Only a small part of which was accounted for by the addition of NASDAQ.

An op-ed piece in the NYT this morning, July 11th, entitled Break the Immigration Impass concluded “Signs of a more productive attitude in Washington - which passage of a well-designed immigration bill would provide - might well lift spirits and thereby stimulate the economy. It is time for 535 of America’s citizens (*i.e. the members of Congress*) to remember what they owe to the 318 million who employ them.” - *While it restricts itself to just a tiny part of the problem, the system’s rejection of many of those with advanced degrees from American universities, the real significance may well lie in the identity of the three co-authors, Warren Buffett., Bill Gates & Sheldon Adelson (the latter a major financial backer of Netanyahu who in 2012 spent untold millions supporting Newt Gingrich’s unsuccessful bid to become the Republican Party’s standard bearer & then a lot more supporting Mitt Romney’s failed attempt to dislodge Obama (& who therefore, if he chooses to do so, likely could do more than the other two combined to influence the mood of Republican lawmakers by funding, or withholding funding from, the blindly dogmatic, partisan ones for whom compromise is an obscene word.*

The ECB’s Mario Draghi is coming under growing pressure to weaken the Euro. While at US$1.36 it is down from US$1.39 two months ago, Airbus (*that last month suffered a severe blow when Emirates cancelled a US$16BN order for 70 A350s*) says it should be US$1.25, if not US$1.20 (a level it last hit on July 24th 2012, & before that on June 5th 2010) - *while this would help his efforts to ward off deflation, it would likely qualify as a competitive devaluation in a currency war context, taking the Euro from the midpoint to the bottom of its ten-year US$1.17 - US$1.55 price range.*

Banco Espirito Santo SA was the only one of Portugal’s three big banks not to require state aid when the country was on the receiving end of an EU bailout in May 2011. But earlier this week it announced its parent, Banque Privée Espirito Santo SA, faced a “serious financial situation” that could be damaging to it (prompting Moody’s to put the bank under review for a possible downgrade). According to the Portuguese newspaper Expresso some investors in its parent had been asked to exchange their maturing (short-term) commercial paper for stock and/or long-term bonds. Despite the issuer saying this would affect ”only a few clients” & central bank assurances this would not affect the bank, prices of the bank’s bonds plunged to record lows (& dragged Portuguese government bonds down with them) amidst concerns that European banks remain vulnerable even as the Euro region starts to emerge from its souvereign debt crisis[9] -.

Netanyahu’s latest Gaza campaign is giving whole new meanings to “appropriate force”, “guilt by association” & “asymetrical warfare”, the latter summed up quite aptly in a tweet from Tel Aviv-based human rights activist Elizabeth Tsurkov “We are targeted by mostly shitty rockets. Gazans are being shelled by heavy bombs. We have shelters, sirens, Iron Dome[10]. They have 0.[11]” According to the Israeli human rights organization B’Tselem since January 1st, 2009 565 Palestinians have been killed by Israeli security forces, vs 28 Israeli civilians & 10 security

9 This is not an uncommon phenomenon; for when things are **really** bad, it’s in no one’s interest to ‘put the cat among the pigeons’ while, once things start to improve the fear of causing collateral damage eases.

10 Which may not be as effective as people have been made to believe; for according to the IDF 48 rockets struck Israel on July 9th & Iron Dome intercepted 14 others (which may, however, be due to a deliberate policy to make its missiles count by targeting only those incoming ones that appear headed for built-up areas.

11 As a result, the casualty count as of July 7th was shitty rockets 0 - heavy bombs 87.

personnel by Palestinians, and as of last Monday night, July 7th, this confrontation between Hamas & Israel had resulted in a fatality score of "heavy bombs" 87 - "shitty rockets" 0. Bombing runs on what British Prime Minister David Cameron calls a "prison camp" are akin to shooting fish in a barrel & *remind me of the Luftwaffe in May 1940 flattening central Rotterdam to force the Dutch government to surrender (although the Israelis apparently give advance warning by phone to the residents of homes about to be bombed) - in all fairness, however, what may have disconcerted Netanyahu c.s.*[12] *was confirmation of the fact that Hamas has, & is capable of launching, rockets that can reach beyond Tel Aviv*[13] *(which potentially puts most of Israel's population within their range). And the Sword of Damocles hanging over Israel's head is the fact that (Shiite) Hezbollah in Lebanon has over 40,000 [4x as many as (Sunni) Hamas] far more powerful & technologically advanced, and longer range, rockets that would pose a serious danger to all of Israel if any of them were ever to fall in the hands of the (Sunni) ISIS.* ***N.B.*** *The news on July 11th was not good : Israel suffered its first casualties when two people were hurt when a rocket hit a gas station in Ashod, Southern Israel and, possibly far more ominously, rocket fire had started to come in from Southern Lebanon, a possible sign that Shiite Hezbollah may join the fight on Sunni Hamas' side (which, if it is more than a one-of event, Israel could not allow to go unpunished, thereby expanding the scope of the conflict, & which, if it were (a one-of event), should nevertheless send collective chills up the Israelis' spines!*

Vladimir Sorokin is a popular Moscow-based writer whose work was banned during the Soviet era & who has long been critical of his namesake Putin. In the May 8th issue of the <u>New York Review of Books</u>, he summed up his perception of the difference between the Soviet- & Putin's-Russian Bear as follows : "The only thing they have in common its their imperial roar. However, the post-Soviet bear is teeming with corrupt parasites ...(*that*) have multiplied exponentially in the past decade ... (*& are*) consuming the bear from within. There are no muscles, the bear's teeth are worn down and its brain is buffeted by the firing of contradictory neurological impulses "Get rich!" "Modernize!" "Steal!" "Pray!" "Build Great Mother Russia!' "Resurrect the USSR!" "Beware of the West!" "Invest in Western real estate!" "Keep your savings in dollars and euros!" "Be patriotic!" "Search and destroy the enemy within!" - *this bears out the suspicions of those who think Putin is a "Paper Tiger" & a shameless opportunist who is whipping up nationalist fever to obscure the shortcomings of his regime and/or a dreamer who lives in the past, whose dreams of Russia becoming a global world power once again will founder on its population aging & having declined from 148.7MM in 1991 to 143.7MM today (although that trend appears to have been arrested in recent years), its massive corruption & income inequality (half its population lives in poverty & derives little, if any, benefit from Putin's spending on his grandiose fantasies), & low life expectancies (65 years for men, 78 for women) and a high (40% & waxing) age-dependency ratio (that will be a drag on Russia's GDP growth potential).*

The morning after Brazil's humiliating rout in the FIFA World Cup semi-finals there were comments on the Street this may have an impact on the global economy. While this may be unduly gloomy, it will almost certainly have an impact on next fall's selection &, more particularly, on President Dilma Roussef's chances of re-election. For while in the latest poll she was still leading her main challenger 38-22, her support was slipping even then & the outcome of last Tuesday's soccer match is likely to augment many voters' unhappiness about the money

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[12] Although if this came as a surprise to them, there must have been a serious breakdown in Israeli intelligence.

[13] Thus one such rocket, after eluding the Iron Dome anti-missile shield, landed near Hadera, a seaside town North of Tel Aviv, 78 miles (125 kms) from Gaza.

spent on the World Cup (& the 2016 Summer Olympics), causing them to turn, & to take it out, on her, if not in the first round on October 5th then in the now inevitable second round run-off three weeks later.

GLEANINGS II - 570SP
<u>Thursday July 10th, 2014</u>

<u>IS THE BULL MARKET OVER? SIGNS AREN'T GOOD</u> (G&M, George Athanassakos)

*1.*On May 15th Credit Suisse reported the average number of trades in individual accounts at TD Ameritrade, Charles Schwab & E*Trade had reached its highest levels since 2000[14];

2. Last February margin debt was up 27% YOY to an all-time high. Previous highs were set in March 2000 & July 2007 - *margin debt declines have been market 'leading indicators';*
3. In 2013 the volume of IPOs was at a post-2007 high, up almost 100% YoY & Bernstein Research says YTD it's up another 63% (Thomson Reuters calls it 71%)[15];
4. Low quality stocks have outperformed better quality ones as the Fed's low interest rate policy prompted investors to put more money into companies more likely to go bankrupt;
5. Professionals have started saying the market is overvalued, *& acting accordingly*, although not unanimously so;
6. The Fed is withdrawing liquidity from the *bond* market while banks still sit on their hands - *the latter is not entirely correct : they are buying fewer bonds but lending more, albeit it not necessarily in the most beneficial places, i.e. consumer credit, especially car loans;*
7. Interest rates are at record lows & more likely to go up than down, especially given continued economic growth & growing inflation at the consumer level, *and the global unsettled political-, & still fragile financial-, situation;*
8. The share of US GDP accounted for by corporate profit is at a 50 year high (*& labour income at a 50-year low*) due to low interest rates & easing commodity prices *and stagnating real wages - but this cannot continue forever, & their share of GDP is way above the trend line to which, over time, it has always reverted*;
9. *Generally* speaking price-to-book values & P/E ratios are not extreme. Still, the S&P 500 trades at 2.71 x Book, higher than in all but three of the bull markets since the mid-1920s, & 70% of the S&P 500 companies trade above their 14.8x long-term P/E average [*& would have been higher still but for the unprecedented share buybacks having artificially inflated their EPS (Earnings per Share)];*While since 1881 Robert Shiller's CAPE (Cyclically Adjusted Price Earnings ratio) for the S&P 500 (& its predecessors) has averaged 16, it now stands at 25. This is not high in today's economic environment & not pointing to overvaluation, but only if one assumes a 7.2% earnings growth rate, i.e. one slightly below its 7.41% long-term average; but if we are heading into a period of higher interest rates & modest growth (*and higher taxes & social costs*), then it is indeed signaling overvaluation.
10. [illegible]

14 Retail investors habitually ignore the sage advice of the late John Templeton, one of the earliest & greatest international investment managers, who, like Warren Buffett operated intentionally "far away from the maddening crowds" (in his case from a strip mall in Bermuda, spending as more time on his religious pursuits as on what markets were doing at that very moment), to 'buy when fear-, & to sell when optimism-, is greatest'.

15 And yet the dollar volume of IPOs cannot hold a candle to that of share buybacks.

- So all but one of these are giving off negative signals, suggesting we're close to the end of the bull market & that investors should ease up on stocks - *still, with long bonds in a mark-to-market-, rising interest rate-, environment even more lethal than stocks, & cash generating negative real returns, carefully picked stocks may be the lesser of all evils.*

The bulls' case largely rests on a belief that "This time it is different" (the author teaches at the Richard Ivey School of Business at the University of Western Ontario; so he has the benefit of being twice removed from the 'Maddening Crowds', professionally as well as geographically).

CARL ICAHN SAYS IT'S 'TIME TO BE CAUTIOUS' WITH US STOCKS (Reuters, J. Ablan)

- In a telephone interview on July 10th he said that "In my mind, it is time to be cautious about the US stock markets ... While we are having a great year, I am being very selective about the companies I purchase."

Now in his late 70's, he has a long track record of highly profitable, albeit not necessarily long-term, investment, most recently as a hedge fund operator and, in years gone by, as a 'corporate raider' (who bought undervalued companies in hostile situations, often to break them up) & a green mailer (who bought a large enough block of shares in a company to make a follow-up hostile takeover bid seem plausible, thereby forcing management to take him out at a profit).

THE BOND TRAP (Value Walk, Peter Schiff)

- Since 2008 the Fed has kept rates at the short end of the curve *artificially* low, forcing investors to venture out on the maturity scale. One result thereof has been that mutual fund holdings of "risk-free" long-term debt by the end of 2013 were US$7+TR, 109% over their five-year earlier levels. Worse still, to 'goose' their returns many funds have leveraged themselves by borrowing short-term at the artificially low rates.
- Meanwhile Fed Governor Jeremy Stein (*with Vice Chairman Stanley Fisher deemed one of the two "moderate hawks on both the Board & the FOMC*) commented on what has long been obvious to many, namely that the bond market has lost liquidity & hence become vulnerable to seizing up (as it did briefly in 2008) if too many bond holders were to decide to exit at the same time. There are two reasons for that decline in liquidity : first the Dodd-Frank legislation that, with the best of intentions, made it more difficult for banks & other financial institutions to trade bonds for their own account, & secondly the Fed 'tapering' (*that has turned it from a constant buyer into a persistent* seller).
- A small but worrisome article in the Financial Times on June 16th noted that some Fed officials have therefore been talking about the need to make retail owners of bond mutual funds pay an "exit" fee when they liquidate their position[16] (a move which would, however, be within the purview of the SEC, the market regulator, not the Fed), thereby in essence creating a third level of interference with the market to 'correct' the distortions caused by the first two. So now that the Fed has herded investors out into the long end of the market, some of its officials think it needs to ensure they stay there by introducing exit fees; the problem with that is that if such fees were low they wouldn't be effective & if they were high they could spook bondholders into becoming that much more determined to get out, no matter what. But when Janet Yellen was asked about exit fees at her latest post-FOMC meeting press conference, she claimed to be unaware they had been discussed in the Fed, or that they were outside its jurisdiction.

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[16] An idea first mooted last May by the Black Rock Group, with AUM of US$4.4TR the world's largest money manager.

- The sad fact is that if investors continue to hold bonds until faced with a exit fees, these may be the least of their problems.

The Chair of the House Financial Services Committee, Jeb Hersarling (R.- Tx.) seems to have twigged onto this; for he has asked Treasury Secretary Jack Lew to investigate the Volcker Rule to see if it risks sapping liquidity from the US$10TR corporate bond market & amplifying future interest rate shocks (although he may just be trying to divert attention from the key role he & his Committee play in the survival, or demise, of the Exim Bank) - Schiff is the founder of, & Global Strategist at, Westport. Conn.-based broker-dealer Euro-Pacific Capital that, as its name indicates, specializes in non-US securities. He correctly foresaw the US housing crisis of 2008, & is about as much as a 'perma-bear' on the US economy & dollar as can be found anywhere. Be that as it may, in this instance he connects the dots in a way few others have &, while the idea of exit fees may well be 'beyond the pale', in raising the issue he highlights the pickle the Fed has gotten itself into also in a way few others have.

<u>WALL STREET'S WORST-CASE SCENARIO : A RUN ON BONDS</u> (BB, Nick Summers)

> •All it takes is a few mouse clicks to buy shares in a bond mutual fund or ETF, many of which *in their reach for yield* are invested in securities less liquid than those traded on the exchanges. But it also only takes a few mouse clicks to sell them, in which case the sellers expect their money back almost immediately, as they would if they sold their holdings in a money market fund. But if too many of them were to decide to do so at the same time, the resultant wave of selling *by fund managers to raise cash to meet redemption calls* could prompt buyers to sit on their hands (*expecting that doing so will drive prices lower*) & bring the system to a halt. So Wall Street firms have started warning clients that, if investors who view bonds as safe investments were hit with losses due to rising interest rates, there could be something akin to a run on the bank in the bond market, & that any sudden large demand for redemptions by holders of bond mutual funds & ETFs could force their managers to sell bonds at any price, potentially creating a downward spiral. Thus in a June 20th report Jan Loeys, Chief Market Strategist at JPMorgan Chase wrote that there is a risk "that when the Fed starts hiking *rates* in earnest outflows from high-yielding and less liquid debt will lead to a freefall in prices ... In extremis, this could force a closing of the primary market and have a serious economic impact." Others disagree. For Ira Jersey, Director of Rates Strategy at Credit Suisse, wrote on June 24th that many funds already carry a fair amount of cash, & the bank itself that "taxable funds have 9 ½% of their portfolio in liquid assets, such as cash and US Treasuries[17]", & Brian Reid, Chief Economist at the Investment Company Institute, that interest rate shocks are nothing new & that "markets aren't as fragile as people worry about", and that those who warn about systemic risk too often can numb investors to actual problems, the Chicken Little Syndrome.

As often the case in financial markets, Messrs Jersey & Reid are 'talking their book'. And as far as the latter's comment on the state of the market is concerned, its fragility increases directly, if not exponentially, with its degree of leverage. And there are few who deny that the leverage in the market today (& the 'mismatch' between borrowing short-term & investing longer term) is greater than usual, even though they may disagree on the exact degree thereof.

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17 Which in & by itself is interesting since it suggests they are hedging their bets against possibly larger-than-usual withdrawals; but what the bank glosses over is that in a serious run on bond funds, 'cash' held in the form of UST securities may not be of much use.

<u>JEFFERIES CEO WARNS OF "BAD BEHAVIOUR" RETURNING</u> (BB, Elizabeth Dexheimer)

- In his quarterly letter to clients Richard Handler, CEO of Jefferies Group LLC, warned that, as the financial services industry embraces greater risk, bankers & investors shouldn't repeat the "bad behaviour" that contributed to the credit crisis, saying "People who take shortcuts, are political[18], prioritize themselves above others, take excessive risk (*with other people's money?*) for personal gain, don't value capital or are unethical are outright cancers ... these types of people will not only flourish in the next crisis, but most probably will cause it ... We all may want to have our eyes wide open regarding the risk that is clearly starting to make its way back into the system ...(*while leverage*) does an incredible job of amplifying the good, it ... is equally capable of magnifying the bad ... (*and it's easy to get*) lulled into a false sense of purpose."

Since 2001 Handler (age 53) has been CEO of this New York-based global investment bank cum institutional securities firm. While it may be a pigmy compared to, say, Goldman, on his watch the Company's share price had grown by the end of 2013 at an 8+% compound annual rate, over one-third faster than Goldman's (while having a similar dividend yield).

<u>EURO IS NOT TOO STRONG - ECB'S COENE</u> (Reuters)

- He told the Belgian newspaper <u>Le Soir</u> on July 9th that the Euro is not too strong, saying that "just before the financial crisis ... (*it*) pointed to $1.55." Furthermore, that the ECB's mandate was to control interest rates & inflation & that any effect on exchange rates *of its actions to fulfil its mandate* was unintended, and that "We'll do what we have to do in terms of monetary politics but we should not go further ... the market for euros is so large that one would have to waste considerable financial resources (*trying to influence the exchange rate*) to have a very random result."

In fact, the Eurozone's improving economies & robust trade surplus, and foreign investors pouring money into US stocks suggest that the Euro should strengthen, not weaken [Coene's day job is that of Governor of Belgium's central bank (where he spent his entire career but for a couple of sojourns at the IMF and a few years in & around the Prime Minister's office).

<u>CARNEY FACES BREAKDOWN OF BOE CONSENSUS ON INTEREST RATES</u>
(BB, Emma Charlton)

- For its past 35 meetings, 12 since Carney took over, decisions by the BoE's nine-person MPC (Monetary Policy Committee) have been unanimous. But with Britain now having the fastest-growing economy among the G-7 members, Berenberg Bank Chief UK Economist, & former BoE official, Rob Wood believes "The bank will have to move to a more neutral level of interest rates at some point and some of the voters think that process should start sooner ... This could well be the last decision that is unanimous for a while", & that one of them will break ranks as early as next month's meeting.

It may be significant in this context that the MPC soon will have three members who have joined it in recent months & who will therefore not be restrained by their own past voting track record & that the CEO of the BoE's Prudential Regulatory Authority told bankers in a speech on July 10th that he will withdraw approval for any bank's risk assessment model if he deems it "inadequate",

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[18] A shot at Yellen? (see her above comments in response to the BIS criticism).

if the bank has not demonstrated the capacity to use it safely, or if he deems it too optimistic, saying that he has already disallowed "whole types of models".