Quote of the week - "In times of great stress ... men are apt to abandon too much of their past social devices and venture too far upon uncharted courses. And the consequences have always been reaction, sometimes disaster ... Half-educated statesmen today ... think they find salvation for their troubled fellows in the arbitrary modes of the man who fell an easy victim to the cheap devices of the lewd Cleopatra (*i.e. Caesar*) ... *They forget that* the Caesars succeeded only for a short moment as measured by the test of history ... it would be no sin if statesmen learned enough of history to realize that no system which implies control of society by privilege seekers has ever ended in any other way than collapse ...*To fail to learn from such* blunders of the past *was to embark on a course toward* another war and chaos." - William E. Dodd, a Southern liberal Democrat & professor of history at the University of Chicago who in 1933, shortly after Hitler had come to power, became Roosevelt's last minute choice, after several others had turned down the job, as his first Ambassador to Germany (a position he held from 1933 to 1937). He was not popular with the striped pants' set; for his father had been a dirt farmer in North Carolina & he had gone to Virginia Tech (& subsequently gotten a Ph.D. from the University of Leipzig), and, above all, because he didn't approve of diplomatic high living at a time his country was in the midst of the Depression. He made this speech, a none too covert criticism of Hitler & his gang, on October 12th, 1933 just nine months after Hitler had come to power, getting "extraordinary applause" from the businessmen & diplomatic corps members in attendance but infuriating Goebbels (who in the audience) & Hitler (who was not[1]), to the point where the former sought to block publication of his speech, but failed when three major newspapers published excerpts anyway.

According to hedge fund manager Doug Kass, President of Palm Beach, Fla.-based Seabreeze Partners Management, while the entire US banking community has a US$300TR exposure to derivatives, America's biggest four banks account for 80% (US$240TR) thereof[2]. So, since their net worth is about US$750BN, they are 300x leveraged (& these are the institutions that in the recent omnibus bill got a "Get out of Jail Free" card at the expense of the tax payers if they were to step into a cow flap) - *so, while the real risk in exposure to derivatives is only a tiny fraction of their nominal value, it would only take a 0.3% write-off to entirely wipe out their capital base.*

Steven Rattner (age 62) started his career, with a degree in Economics from Brown's University, as a journalist at the NYT & now is Chairman of Willett Advisors LLC, the private investment entity that manages Michael Bloomberg's billions; sandwiched in between these were stints at increasingly more senior levels on the sell side at Lehman Bros., Morgan Stanley & Lazard Freres, on the buy side at the Quadrangle Group, a private equity group he co-founded that invested in in media & communications' firms and, finally, as the lead adviser to the 2009 Presidential Task Force on the Auto Industry. On New Year's Eve he had an Op-Ed piece in the NYT that seems to put him in the category of what one money manager calls "See-No-Evil" analysts & commentators, For of the 10 charts he uses really only one appears to support his positive year end message (*and that one, showing how many people had gained coverage under Obamacare, is in the eyes of many Americans anything but good news*). The first two charts, dealing with new job-, & real GDP-, growth that he uses to illustrate the "crosscurrents of the past year in economics and politics" are entitled <u>The Economy Picks Up Speed</u>; while at first glance they look impressive since the trend lines go almost straight up, one soon realizes this a)

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1 As witnessed by the fact that in his next call to Foreign Minister Konstantin von Neurath he was made to wait for several hours past the time for his appointment.

2 That is said to have benefited during the recession from an estimated US$500BN in federal funding & guarantees accounting for a disproportionate share of that US$240TR.

is due a compression of the units on the x-axis & b) that this does not evidence an acceleration of growth in 2014[3]. And then, when one drills a bit deeper, it becomes evident that the six year compound annual growth rates for new job creation & GDP were 0.98% & 2.19% respectively, not all that impressive for an economy recovering from the severest recession in many a year; furthermore that while in 2014 the average number of new jobs created, at 241,000, had been up 24% YoY, it had been, rather than being "remarkable", barely enough to keep up with the growth in the labour force. His next two charts, that showed how much crude oil-, & gasoline prices had declined since mid-year, failed to note that while the former had declined by 48.4%, the latter had done so by only 35.7%. And after that they really were all bad news : wages had lagged, inequality grown worse (with America's UN GINI coefficient, which measures inequality on an after tax basis, higher than that of any other of the 13 other North American & European countries in his sample universe), with the government having been of little help in changing that, it had been "Very Good at the TOP"[4], and the 113th Congress had been the least productive one in the post-WW II era by a long shot (*while lobbyists representing vested interests are having increasingly more-, & government lawyers with the public interest in mind having increasingly less-, involvement in the final form of the bills that do get passed*), while public opinion had been polarized enormously.

Saudi Arabia's 90 year-old King Abdullah was taken to hospital on December 31st 'for tests'. This may prompt some uncertainties for the global oil market although, if he were to die, or become incapacitated, succession would unlikely be an issue. For in 2012 the King designated the now 79 year-old Prince Salman, long influential in 'family matters', as his successor, & in March of last year Prince Muqrin (age 69) as Deputy Crown Prince. Meanwhile, late on January 1st, after Brent crude has hit US$56, Iran's Deputy Foreign Minister Hossein Amir Abdollahian told Reuters that "There are several reasons for the drop in the price of oil, but Saudi Arabia can take a step to have a productive role in this situation ... If Saudi does not help prevent the decrease in the oil price ... this is a serious mistake that will have a negative result on all countries in the region."

Oil States International is a Houston, Texas-based, 75 year-old oil service company that went public in 2001. In 2005 it bought a number of accommodation facilities for oil & gas company staff in Canada & Australia which it spun off last May at US$22/share into a NYSE-listed stand-alone company called Civeo. At last report the latter operated 11 lodges & camps in the Alberta oilsands region, and several others in Manitoba, Saskatchewan & BC. Since its IPO Civeo shares have had a chequered history, peaking at US$27.17 on June 29th, slipping to US$13.01 by September 28th & then to US$8.01 on December 22nd, and finally taking a 50+% one-day nosedive to US$4.11 on December 29th[5] when it announced its 2015 guidance; for it envisaged First Quarter revenues & EBITDA of US$160-175MM & US$45-55MM respectively, down from US$200-210MM & US$65-70MM in the Fourth Quarter, as it expects occupancy rates in Canada to be half last year's 75% (with the decline in occupancy rates in its Australian facilities

3 Remember that GDP 'growth' in the First Quarter of 2014 had been minus 2.9%.

4 Since 1980 the top 1% on Americans have increased their share of total income from 7.6% to 19.3% to a level 20x-, & the top 0.01% (of whom Rattner himself likely is one) from < 0.5% to 4.1%, 410x-, that of the average household.

5 Which has caused major losses for at least some hedge funds.

only marginally less serious)[6]. As part of its resultant retrenchment, Civeo suspended its 13¢ quarterly dividend & announced the closing of two camps, & the letting go of one-third of its staff, in Canada (while not ruling out further cutbacks), with CEO Brad Dodson noting "There are few major oilsands construction or expansion projects forecast for 2015, reducing the demand for labour and accommodations ... Certain regions on the Athabasca oilsands region are oversupplied for rooms, negatively impacting our outlook for occupancy and average daily rates."

In Edmonton, the Old Year ended-, & in Calgary the New Year was brought in-, with unusual violence. For on December 29th a man shot & killed five adults and two children (one of them only one year old) in a home in North Edmonton, then traveled halfway across the city to kill a women in her home in South Edmonton before traveling to Fort Saskatchewan 25 kms/16 miles Northeast of the city where, under siege by police, he shot himself in a restaurant in which he had holed up. Then early New Year's Day there was a shooting at a house party in Calgary in which seven people were shot, two of them in a life-threatening manner (one of whom has since died).

Anecdotal evidence suggests US shale oil companies are demanding service companies cut their prices by as much as 50% (& apparently getting away with it, at least for now) - *this will enhance their competitiveness at home & abroad, but bodes ill for the others' share prices.*

Effective January 1st Lithuania officially became the 19th Eurozone member country (& the last of the three former Soviet Baltic republics to join). This was really just a formality; for, with its Lita pegged to the Euro, it hadn't had an independent monetary policy for years. While marketed as likely to generate economic benefits & gain a (*minor*) say in Eurozone decision-making, the real reason, like the other two, was to try & immunize itself against a possible Russian invasion - *Lithuania, with a population of 3MM people is the largest of the three & also the one where Putin would have the least 'justification' to move into to 'safeguard' the interests of the ethnic Russians living there; for it somehow was less affected by Stalin's Russification program, with a result that 80+% of its population is still ethnic Lithuanian & only 8% Russian (while the corresponding numbers for Estonia are 1.3MM, 70% & 25% and for Latvia 2MM, 61% & 26%*)[7].

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THIS ERA OF LOW-COST OIL IS DIFFERENT (BB, Mohamed El-Erian)

- Having seen it all before, many analysts & policy makers are "looking through" the latest drop in oil prices & treating it as a cyclical-, rather than a secular-, event. This may be a mistake; for this time it is a function of a change in the supply-, rather than the demand-, model. Over the years markets have been conditioned to expect OPEC to cut output in response to sharp drop-offs in the price of oil, with Saudi Arabia as the 'swing producer' doing most of the heavy lifting (thereby providing the basis for an eventual price rebound), while turning a a blind eye to other OPEC members' 'cheating'. But in the

[6] Another fact not helping its bottom line is that the Canadian & Aussie dollars are down 8% & 16% respectively vis a vis the US dollar since mid-year.

[7] While the most recent numbers for Ukraine were 78%-17%, for Eastern Ukraine 66%-30% and for Crimea 24%-60%.

process Saudi Arabia learnt an important lesson : once lost, market share is not easily regained; hence it's refusal this time around to cut production. So market forces will take over, unprofitable oil fields will be closed down, alternate energy development discouraged & new capacity development put on the back burner. And with lower oil prices giving their consumers more money to spend on other things, GDP growth in oil-importing countries will benefit, while they will undermine the political structures of-, and create political unrest & foster the growth of extremist movements in-, oil-exporting countries. While few had expected the price of oil to fall so far so fast, more surprises may be coming in the form of economic, political & social changes that not long ago would have been deemed remote, if not unthinkable.

*The mantra "This time it is different" is often heard in volatile times; but it seldom turns out that way. And the reason for it not going to be different this time lie in the very consequences of the low oil price he mentions. For even in the most unlikely event that demand were not to increase by a single barrel, the closing down of no longer profitable production, the cutbacks in developing new sources of supply (**and** the lifecycle output attrition of oil wells) will eventually cause demand to catch up again with supply (although it may well take longer on this-, than on past-, occasions). On the other hand, he is likely 'right-on' in prognosticating that the drastically lower oil prices will create a serious potential for major political & social upheaval in the oil exporting countries.*

US OPENING OF OIL EXPORT TAP WIDENS BATTLE FOR GLOBAL MARKET (Reuters)

- On December 30th the Commerce Department issued a long-awaited document outlining what kinds of oil can be exported & announced it had started approving a backlog of export requests. This prompted Ed Morse, Global Head of Commodities Research at Citigroup in New York to tell clients in a research note that "This move can open the flood gates to substantial (*1+MM bbld?)* increases in exports by the end of 2015."

This is an attempt by the Administration to meet the demands of oil companies that have been complaining that the fast-growing supply of domestic oil has overwhelmed local demand, forcing them to sell their oil at as much as US$15 below world market prices.

ISREAL 'SATISFIED' AS PALESTINIAN UN RESOLUTION FAILS (AF-P, Jaafar Ashtiyeh)

- On December 30th the UN Security Council failed to pass a controversial resolution[8] on Palestinian statehood sponsored by Jordan. The vote fell one short of the nine required, with 8 countries (China*, Russia* & France*, *Argentina, Chad, Chile, Jordan & Luxembourg*) voting in favour, two (US* & Australia) voting against, and five abstaining (UK*, *Nigeria, South Korea, Lithuania, & Rwanda*). This prompted Israel's Deputy Foreign Minister Tzahi HaNegbi, a close associate of Netanyahu, boast "Every Israeli who wants peace with our neighbours can only be satisfied with the result of this vote ... This deals a blow to efforts by Mahmoud Abbas to embarrass & isolate us", and his boss, Avigdor Lieberman to issue a statement that said in part "The failure of the Palestinian vote at the Security Council should teach the Palestinians that provocations and attempts to force Israel into unilateral processes will not achieve anything - quite the

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8 That not only set a one year deadline on the peace negotiations but also that it would be based the 1967 boundaries (incl. East Jerusalem as its capital) & called for a December 31st 2017 deadline for the removal of all Israeli security forces from the West Bank.

opposite". On the other hand, Public Radio International said Israel had only narrowly avoided a fiasco & that this was only a "short-term victory" which wouldn't halt international pressure for a Palestinian deal while Russia called the outcome a "strategic error", with its envoy to the UN, Vitali Churkin, saying "Russia regrets that the UN Security Council did not manage to adopt the draft resolution."

* these are the five permanent members with veto power of the Council.

China, Russia & France voting for-, & the UK abstaining from voting, must have dismayed the Israeli government, and ought to have given Messrs. HaNegbi & Lieberman food for thought. But, having said that, the outcome was never ***really*** *in doubt; for as long as the US has a veto & is prepared to use it to protect Israel, all such resolutions are doomed. Even so a lot of pressure was brought to bear on Security Council member governments to minimize support for it[9]. Thus US Secretary of State John Kerry was known to have made a baker's dozen phone calls abroad to that end, & three weeks before the vote Netanyahu had personally called his French counterpart, François Hollande, to try & get him, in vain it turned out, to change his government's mind about supporting it.[10] The day after the vote, December 31st, the PA leadership met & decided to have Abbas sign no fewer than 22 international agreements, the most important one of which was the Rome Treaty establishing the International Court of Justice (despite the fact that Washington has warned it that seeking membership in it could lead to an anti-Palestinian backlash in the US Congress) where, if is admitted to membership, which is not going to be decided overnight & which is not a foregone conclusion, the Palestinians have long been making noises they will seek to lay charges of war crimes against the Israeli government (which caused Lieberman to bluster that "Abbas can sign any treaty he wants, the only ones committing war crimes in the conflict are the Palestinians themselves who are responsible for murderous terrorism against babies, children, women and men indiscriminately for the past hundred years" & Naftali Bennett to say the Palestinians might find themselves in the prisoner's box on war crimes charges - one must wonder how wise a move it was for the Palestinians to be so pro-active during the run-up to an Israeli election (unless, of course, they have decided that continuing to have Netanyahu as Prime Minister will help to isolate Israel-, & benefit their cause-, more.*

<u>PETROBRAS DEADLINE PROMPTS SOME BONDHOLDERS TO PUSH FOR DEFAULT</u> (Reuters, Jeb Blount)

- Petrobras, Brazil's state-backed oil company is the sixth-largest oil company in-, with operations around-, the world. It is in the midst of a huge US$221BN five-year capex program, driven by its plans to develop its huge, *but not cheap*[11], offshore oil & gas

9 And it may have worked in at least one case; for, while the Palestinians thought they had the necessary votes 'in the bag', when push came to shove, Nigeria, that must feel very vulnerable with oil prices at these levels, abstained, rather than supported the resolution.

10 And then let his displeasure known when the French ambassador to Israel called on the carpet at the Israeli Foreign Ministry the day after the vote to communicate the Israeli government's displeasure, was received, not by the Minister, or his Deputy, but by the **Deputy** Director-General of the Ministry's Western European Department

11 The Tipi/Lula oil field is located 250 kms/160 miles East of Rio de Janeiro (under 2000 metres/ 6,600 ft of water **and** 6,000 metres/16,000 ft. of salt, sands & rock water) & the Jupiter natural gas & condensate another 37 kms/23 miles further out in the South Atlantic. Last January, an article in the WSJ on Brazil's offshore oil & gas reserves was headlined "Abundant but Expensive".

reserves. But it is also the world's most indebted listed oil company, with, among its debt, almost US$54BN in bonds governed by US law in New York. And it is also engulfed by allegations of a massive (*US$1.6BN?*) corruption cum kickback scandal that have raised doubts about the real value of its assets & forced postponement of the publication of its Third Quarter results until January. This, however, contravened the terms of its US bond issues under which it must publish its results within 90 days of the end of any quarter, in this case by December 29th; so a group of bondholders led by New York-based Aurelius Capital (*the same "distressed bond' fund that earlier led the pack that wouldn't agree to Argentina's debt restructuring & took it to court with, for Argentina unpleasant results*) are pushing to have it declared in default as a "precautionary step" (which would only require a request by investors holding 25% of the bonds of **any one** of the 20+ issues involved). And to complicate matters further, the Company has now, as a result of all this, been frozen out of global capital markets & is seriously at risk of losing its investment-grade credit rating.

When the Company announced in late November that it was delaying publication of its Third Quarter results, it said this was necessitated by a "unique moment in its history". This would only be "technical default" which Petrobras had two months, i.e. until early March, to remedy. Meanwhile the plot thickened with allegations Petrobras' US$24BN employee pension fund had been involved & by its decision to suspend payments to, and prohibit the bidding for-, & the awarding of-, new contracts by 23 major local & international construction companies, incl. Brazil's largest (which. Apart from the low oil price, may further crimp Petrobras' offshore reserve development plans). And while there has been no suggestion that President Dilma Rousseff was involved, or benefited personally, there have been suggestions others in her office & in her party may have done so, while the fact remains that it had taken place 'on her watch' as Chair of the Petrobras Board.