

**Quote of the week** - "Value in financial markets is no longer a function of the discounted cash flow of future income, but instead is determined by the amount of money the central bank is printing and especially how much it intends to print in the coming months." - Charles Gave, the French-born Chairman of Hongkong-based GaveKal, an investment research/portfolio management consultancy firm. *(This quote was purloined from John Mauldin's December 9<sup>th</sup> Outside the Box column Of Central Bankers, Monkeys and John Law<sup>1</sup>, attached to which are two essays by Charles Gave, one from last April entitled The Apex of Market Stupidity & a recent follow-up with the same title as John's column, both of them well worth the few minutes it would take to peruse them. Also of interesting in Mauldin's reference to Trump's latest rant as "the most boneheaded, ill-conceived I have ever heard from a politician in my life" (excuse me, Trump is not a politician, part of his appeal for some people) since it gives "ISIS and other Islamic terrorists a further rationale to hate the West (& a powerful recruiting tool?) on the grounds that 'See, it's just like we said. The West does not just want to go after us; it wants to destroy Islam. They hate us; that's why we must fight back. Everything we do in our jihad is justified because of their actions' ", and his confession, a few lines later, that "Donald Trump is the only man in America who could get me to vote for Hilary Clinton", quite an admission for sexagenarian, well-right-of-centre Texan.*

**Quote of the week No.2** - "Trump is a demagogue. And we as Jews, and also as Israelis, know what a demagogue is, historically. The Republican Party has a long list of candidates vying for the presidency, and we have to change the leadership in the White House, which has caused a lot of damage, but Donald Trump is not the answer ... it takes more than a salesman to be President." - Marc Zell (age 62), a Vice President of Republicans Overseas & a party representative in Israel. Born in Washington, D.C, he is an international lawyer with an AB from Princeton & a JD from the University of Maryland (Baltimore) who in 1988 moved, with his family, to Israel.

**An intriguing observation** - My TV is usually on BBC News in the living room. The other day, while having lunch I caught the tail end of the latest Miss Muslim World contest (all contestants were fully dressed & wore hijabs). And what really caught my attention was a comment by Miss Muslim UK who, when interviewed on BBC, noted that what she was really taking away from it all was that "How British I am".

**"How confident are you in the candidates' ability to handle the threat of terrorism** - In a nationwide telephone poll between December 4<sup>th</sup> to 8<sup>th</sup> this was the question Pew Research asked 1,275 adult Americans, incl. 431 Republicans & 384 Democrats planning to vote in their parties' primaries. Hilary Clinton outdrew Donald Trump 78-71 among the "very" or "somewhat" confident, although he outdid her 40-35 among the very confident ones. Ted Cruz was 71-30-41, Mario Rubio (59-20-39) & Ben Carson (59-16-43) were tied, as were Jed Bush (53-17-36) & Bernie Sanders (53-14-39) who brought up the rear among those named. As to the likelihood of another terrorist attack in the next few months the 79% "very" or "somewhat" response rate slightly exceeded the 78% rate right after 9/11 but was well short of the 85% peak a few months later, 85% was very or somewhat concerned about such an attack by terrorists from outside the US & 89% about one by people already in the US but inspired by foreign terrorists, while 84% believe, 70% very much so, that ISIS is a threat to the security of the United States.

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A Scottish adventurer who in the early 18<sup>th</sup> century era of the 'boy King' Louis XV was the instigator of a massive Ponzi-type scheme that is known as the 'Mississippi Bubble'.

**IDF veteran joins ISIS** - On December 10<sup>th</sup> Arab intelligence sources reported a 25 year-old Muslim Israeli citizen who had been in the IDF until January 2014 had gone from Israel to Turkey & from there to Syria to join ISIS; furthermore, that there now may be up to 150 Israeli Muslims fighting for-, or detained by-, ISIS<sup>2</sup> (although it said this was the first known case of an IDF veteran doing so). This comes one month after Israeli security forces arrested five young men *from the ancient 8,500 inhabitant town of Jaljuliya, not far from Tel Aviv on the border with the West Bank, where it is only 20 kms from the Mediterranean*, for planning to join ISIS (a relative of one of whom in October had paraglided from the Golan Heights into Syria to join the jihadis fighting there).

**Labour wins by-election** - It was necessitated, in the supposedly 'safe' Labour Manchester region constituency of West Oldham and Royton by the death, in mid-October, of the incumbent, a 45-year House of Commons veteran. To the surprise of even many party insiders, Labour won by a landslide (62.1% vs. 54.8% in May) with UKIP again coming in second (23.4% vs. 20.6%), the Conservatives trailing badly (9.6% vs. 9.3%) and both the Lib-Dems & the Greens once again losing their deposit - *while Jeremy Corbyn lost no time marketing this as a vindication of his policies, the turnout was low (40% v. 60% last May), the new Labour MP is a mid-thirtieths (half Corbyn's age) personable candidate who had been on the Council off & on for a dozen years & was made an OBE in the latest Birthday Honours List), had been elected as their standard bearer by the party faithful by a "staggering majority" over his (Corbyn's) choice, and who in the leadership vote had not voted for Corbyn but for the fourth place 'Blairite' finisher, Liz Kendall.*

**Pain, Alberta style** - The son of a friend recently phoned his father, somewhat upset; small wonder, an early Millennial working in financial services, he faces a 27½% salary cut - *Anecdotal evidence like this is unnerving. For with only 12% of Canada's population, Alberta accounts for over 20% of the low down payment, highly leverage owner-occupied home mortgage debt in the country. Between 1999 & 2012, the percentage of households in Canada with a mortgage debt-to-disposable income ratio of over 5x more than tripled from 3.4% to almost 11%. Total household debt, two-thirds of it accounted for by home mortgage debt, grew in the Second Quarter QoQ at a 4% annualized rate, i.e. faster than before-tax wages, to 164.6%. While the optimists point to the fact that Canadian banks are "well-regulated", this ignores the fact that in the past decade or so, a high cost 'shadow mortgage market' has sprung for sum prime-type credits that accounts for as much as 4% as all new mortgage originations. And the late Gen X/early Millennial generations, of which Alberta has a higher proportion than all other provinces, are most at risk.*

**University of Chicago cancels classes** - After being notified by the FBI on Sunday November 29<sup>th</sup> of an online threat of gun violence on its Hyde Park campus the university cancelled all Monday classes & told students in on-campus housing to stay indoors - *someone may just have wanted an extra long weekend; thus in the late 1960's, when the Department of Finance in Ottawa was still domiciled in the old, massive Confederation Building, there was a bomb threat after lunch on a nice Friday in early summer. So outside everybody went & by the time the police finished searching the building it was going-home time. After this occurred several more times, always on a Friday after lunch, the then Deputy Minister, a tough little b\$%^&\* if ever there was one, decided "enough is enough" & out came the word "Everyone stays put!". That was the end of the bomb threats.*

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Doing so is not without risk; for last March ISIS executed an Israel Muslim from East Jerusalem, Muhammed Musallam, was executed by ISIS, accused of being a Mossad agent.

**GLEANINGS II - 645**  
**Thursday December 10<sup>th</sup>, 2015**

- **VOTERS LIKE TRUMP'S PROPOSAL FOR MUSLIM BAN (Rasmussen Reports)**A national phone survey by this 12 year-old Ashbury Park, NJ-based polling firm asked three questions, one of which was "Do you favor or oppose a temporary ban on all Muslims entering the United States until the federal government improves its ability to screen out potential terrorists from coming here?" Despite the international uproar, condemnation by President Obama & disapproval by nearly all of those running for President (*one exception being Ted Cruz*), 66% of Republican voters favored it (with 24% opposed & 10% undecided), as well as a plurality of all voters (46-40-14).

*Like most pollsters Rasmussen has on occasion been spectacularly right & spectacularly wrong and has had a lot of near misses, & allegedly has somewhat of a Republican bias*

**BIGGEST 2016 RISK MAY BE JUST BEHIND US (Reuters, Mike Dolan)**

- Since mid-2014 over one trillion dollars of market capitalization has been wiped off oil company stocks worldwide. The almost US\$2TR of debt sold by energy & mining companies since 2010, much of it junk bonds from small shale oil & gas firms, face a rising wave of downgrades & defaults. *Another* 2TR Euros of European government bonds are yielding negative returns as an oil-seeded deflation scare prompted the ECB to go on a bond-buying spree. The deflationary impact of yet another drop in oil prices has equally alarmed central banks that are about to tighten, like the Fed, & those that are easing, like the ECB & *just about all others*. The crashing commodity prices have caused the currencies (& *economies?*) of the commodity-exporting nations to implode & net private capital flows into emerging markets to go negative for the first time since 1988 [*according to the Washington-based IIF (Institute of International Finance) by US\$541BN*]. New investment in global equities, bonds & real estate by oil-fueled sovereign wealth funds is drying up &, huge asset withdrawals by state institutions from private asset managers have been reported [the foreign assets of SAMA (Saudi Arabian Monetary Agency alone are shrinking at US\$120+BN annual rate & *Norway expects to have to make a 'draw' from its sovereign wealth fund in 2016*]. And the combo of lower-for-longer oil price & higher **real and/or US** interest rates could prove toxic for corporate credit-, & emerging-, markets (*especially for the foreigners who borrowed trillions of US dollars unhedged*).
- The prospect of oil prices not quickly returning to US\$60 was going to be a challenge for many companies & governments. Among all the *possible* 2016 market risks envisaged by banks ranging from the Middle East & geopolitics, through central bank 'mistakes' to market liquidity shocks, few listed another halving of the price of oil (*JPMorgan now says OPEC inaction & stronger US supplies "increase the risk of a first quarter price collapse"*). But after OPEC last week produced no output caps-, never mind cuts-, Brent slumped to < US\$40 & WTI to < US\$37, & according to Goldman any thought of a rebound in-, never mind any stabilization of-, oil prices in 2016 is unrealistic since "a milder winter, slower EM growth and the lifting of international Iranian transactions will cause inventories to build further ... These factors imply ... the near-term risks to the forecast remain skewed to the downside" & limits on global oil storage capacity could see WTI to go "as low as \$20".
- Moody's is expecting "staggering adverse conditions" for oil & gas-, and mining-, companies (that it says were delayed & cushioned this year by their hedging programs,

fixed-price contacts & running down cash balances), will lead to a rise in defaults among them in 2016, with Managing Director Daniel Gate observing “Diminishing liquidity and *more* restricted access to capital markets are now pushing more firms closer to default.”

*And since September the number of daily ‘block trades’ on NASDAQ (large ones by ‘institutional’ investors) has remained stable while that of ‘non-block trades’ (that typically originate with ‘retail’ investors) has grown quite substantially; historically the latter have been ‘counter-indicators’ since retail investors tend to sell when they should be buying, & vice versa.*

### **IS \$50 BILLION THE PRICE OF REPO SAFETY? (WSJ, Katy Burne)**

- Repurchase agreements, aka “repos”, involve short-term ‘wholesale’ loans secured by USTs or other bonds; in the US this is a US\$2.6TR market (*i.e. roughly 15% of US GDP*). The *private sector Depository Trust & Clearing Corp.* (DTCC), “a firm at the centre of Wall Street plumbing”, through a unit called the *Fixed Income Clearing Corp.*, acts as the facilitator of-, backstop for-, & clearinghouse in-, this market<sup>3</sup>. Regulators are concerned<sup>4</sup> its resources are insufficient to prevent the market from seizing up in case of a large default & panic such as after the Lehman Brothers collapse in September 2008; so the DTCC is now seeking a US\$50BN line of credit from the banks & traders in the repo market.

*One must wonder if this is just a precautionary move or one of ‘battening down the hatches’<sup>5</sup>”.*

### **U.S.HOLIDAY SHOPPERS SHIFTING TO ONLINE PURCHASES (BB, Lindsey Rupp)**

- Over the Thanksgiving sales period brick-and-mortar retailers suffered as more shoppers skipped the malls & shopped online. According to San Jose, Cal.-based Adobe Systems on Thanksgiving Day US\$1.73BN was spent online, up 25% YoY, & the next day, Black Friday, another US\$822MM by 11 a.m. (up 15% YoY) while Chicago-based ShopperTrak reported brick-and-mortar sales during these two days to have been down YoY to US\$12.1BN (without giving any specifics).

*The online numbers refer to gross sales & do not allow for goods being returned. According to Kurt Salmon, a 1400-employee Atlanta-based management consultant, one-third of all online sales are returned & in busy periods even more, usually because the goods shipped are the wrong size, colour or make, or even the wrong product altogether. And in clothing many ‘buyers’ never had any intention to purchase the item(s) but only wanted them for a special occasion-, or just to have the pleasure of trying them on as if in a brick-and-mortar store cubicle-, before*

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<sup>3</sup> Evidence of how quickly things can get out of hand in a clearing house environment can be seen in the Bank of New York experience in the 1980’s. At the time it had a profitable sideline acting as a clearinghouse for UST transactions by what were then called “country banks” (i.e. smaller banks outside the major financial centres). One Friday a flaw in its computer system caused it to continue paying buying banks but not credit the bank with the proceeds from selling banks, with the result that by the market’s close this then US\$40BN bank had run up a US\$20BN overdraft with the Fed.

<sup>4</sup> In part due to the growing illiquidity in the bond market &, even more so in the repo market where both Goldman’s & Morgan Stanley’s repo ‘books’ are own by nearly 50% YoY.

<sup>5</sup> A navy term dating back to the wooden ailing vessel era when, if a storm was coming, canvas was nailed over all doorways & hatches with wooden slats called ‘battens’.

returning them, while others order the same item in a number of colours & sizes to keep some & return the rest.

## **MAJOR DISAGREEMENTS HOBBLE CONGRESS BUDGET TALKS**

**(Reuters, Richard Cowan)**

- The Friday December 11<sup>th</sup> deadline to fund the government for the rest of this fiscal year (i.e. until next September 30<sup>th</sup>) is now clearly out of reach & the Senate *already* passed a bill on Wednesday, that the House will consider on Friday, to roll it forward until next Wednesday, December 16<sup>th</sup>, at which point the options will be another extension or risk the second government shutdown since 2013. House Speaker Paul Ryan (R.-WI) said “the sides were trading offers ... talking to each other” but wouldn’t commit himself to meet the new deadline & pressures are building on the Republican side, in the aftermath of the San Bernardino shooting, to hit the pause button on Obama’s Syrian refugee program, *puny as it may be (10,000 for all of 2016)*, while Minority House Leader Nancy Pelosi (D.-CA) says the Democrats insist, in the wake of San Bernardino, that the two decade-old law banning the funding of research into gun violence (that she calls a “terrible thing”) must be ended.

*And there are lots of other contentious issues, incl. The GOP’s right wing continuing insistence that Planned Parenthood be defunded, (despite a recent USAToday poll showing 58% of those polled opposed this, the Senate last week passed a bill doing so 52-48 that the House will consider next week & that the President has vowed to veto). The Republicans are bound & determined to attach riders to any funding bill to roll back some critical ‘Volcker Rule’ risk-taking constraints on the banks put in place since 2008 & to defund the Consumers Financial Protection Bureau. And the Democrats have a wish list of tax credit proposals to, among others, promote clean energy that the Republicans have long opposed : the extremists on both sides of the aisle rule the roost!*

## **ECB DISAPPOINTS MARKETS WITH BARE-MINIMUM EASING PACKAGE**

**(Reuters, Balazs Koranyi)**

- On December 3<sup>rd</sup>, it cut its deposit rate from -0.2% to -0.3%, extended the life of its QE program by six months & announced it would start buying municipal debt (*due to a lack of senior government debt?*). But, based on Draghi’s signals the market had expected more, a hike in monthly bond purchases & a bigger move into negative territory for the deposit rate, and had not anticipated the municipal bond market move, *which may curb ECB demand for senior government bonds*). So at the market’s close the Euro was 2.4% stronger<sup>6</sup> (which is deflationary, i.e. at cross purposes with the ECB’s policy stance) & the bond market had tanked. This prompted Nicholas Wall, a portfolio manager at Atlanta-based, US\$800BN AUM Invesco Fixed Income to comment “The biggest danger is that market reaction may put ECB in an awkward position ... A large sell-off in bonds and a stronger euro will tighten financial conditions and make inflation harder to generate”.
- *Apparently with support from some others* the two German members of the 25-member ECB Governing Council, Bundesbank President Jens Weidman & Executive Board member Sabine Lautenschlaeger argued monetary policy is already exceptionally loose,

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<sup>6</sup> Although still 4% below the level it had been at the time of its last meeting, on October 22<sup>nd</sup>.

growth is rebounding<sup>7</sup>, & the main reason inflation is hovering near zero is the fall in oil prices that has boosted household spending. This elicited a comment by Toby Nangle of London-based asset manager Columbia Threadneedle (AUM £300+BN) that “The non-unanimity of the decision is important, and the market’s disappointment is important ... for it limits President Draghi’s ability to guide markets who will naturally become more suspicious of his power to deliver the Governing Council.”

*Six days after the Draghi setback on December 3<sup>rd</sup>, Yves Mersch, the Governor of Luxembourg’s central bank &, since 2012, on the ECB’s six member Executive Board responsible for its day-to-day operations and, as such, an ex officio member of the 25 member policy-setting Governing Council, told a meeting of a journalists’ club “a great majority of European central bank governors did not want to boost QE further ... the measures (in place) are appropriate ... and more is not needed to reach our goal.” It has been alleged for some time that, ahead of the policy setting Governing Council meetings, Draghi has been briefing a select few banks & hedge funds on what he will propose, thus giving them a chance to ‘position their book’ (a practice known as “front running” that officially is illegal but nevertheless condoned in North American banks’ “high-frequency trading” operations ), something that the market’s visceral reaction, Nangle’s comment & Draghi’s status as a Goldman alumnus endow with a degree of credibility.*

#### **RUSSIA CAN’T AFFORD OIL PRODUCTION CUT (Reuters, Dmitry Zhdannilov)**

- Vagit Alekperov is CEO of Lukoil, with 1.8MM bbl/d Russia’s second largest oil producer (& largest gas producer), as well as the world’s second-largest listed oil company (after ExxonMobil). In Vienna for the December 3<sup>rd</sup> OPEC meeting he said the day prior to it that, despite repeated calls from OPEC to act in tandem, he aimed “to maintain production ... We have repeatedly tried to think about it, But we simply cannot do it.” *Lukoil accounts for approx. 2% of global oil production & so is in the same league production-wise as OPEC members Angola & Nigeria. It operates the giant Qurna-2 field in Iraq on a US\$1.90 fixed-fee-per-barrel-produced basis which at the time seemed like a great deal for the Iraqi government since it would give it 100% of any upside but that is now making it so difficult for it to pay the concessionaires that it has instructed them to quit spending the government’s money on new investments but to, nevertheless, maintain production levels.*

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**More on the San Bernardino massacre** - The USC (United States Code) is a “consolidation and codification by subject matter of the general and permanent laws of the United States”. Title 18 thereof constitutes the US Criminal and Penal Code, § 2331 of which defines “domestic terrorism” for the purposes of Chapter 113 of the Code entitled “Terrorism” as follows :

- “activities with the following three characteristics :acts dangerous to human life that violate federal or state law  
•appear intended (i) to intimidate or coerce a civilian population; (ii) to influence the policy of a government by intimidation or coercion; or (iii) to affect the conduct of a government by mass destruction, assassination or kidnapping; **and**<sup>8</sup>

<sup>7</sup> The ECB itself has raised its GDP forecast for 2017 & conceded , that the recovery, even if still tepid & prone to geopolitical risk, was actually becoming more broad-based.

<sup>8</sup> Bolding mine for emphasis.

- occur primarily within the territorial jurisdiction of the U.S.”

So this shooting does not appear to meet the second criterion, & certainly does not meet the generally accepted definition of terrorism as “the use of violence and intimidation in the pursuit of political aims.” Moreover, terrorism typically involves the indiscriminate killing of total strangers whereas the victims in this case were co-workers; so this shooting may have far more in common with the 1999 Columbine High School massacre than with Timothy McVeigh’s 1995 Oklahoma bombing or 9/11. President Obama did his nation-, his party-, & himself a disservice when he didn’t stop the FBI from playing up -, & continuing to play up- (*for self-serving purposes?*) the terrorist card & did not make an effort to ‘dampen down’ emotions. For in not doing so he pandered to-, legitimized-& played into the hands of-, and allowed the terms of the discussion to be set by-, breathlessly headline-seeking mass media outlets, and gave credence to his political opponents’ further fanning of the flames of a Joe McCarthy<sup>9</sup> 2.0-like anti-Muslim mass hysteria<sup>10</sup>.

This was not the first time that, in recent years, people with real-, or perceived-, grievances against current or past co-workers and/or superiors in the work place, or fellow students and/or teachers in educational institutions, have turned guns on them in what have become known as “revenge” or “rampage” killings<sup>11</sup>, only the first time that the perpetrators were Muslims who, while they had apparently been ‘radicalized, were ‘lone wolves’. The President would have been wiser-, served his the nation’s-, his party’s-, & his own interests better-, & helped to slow down the growing polarization of-, & intolerance in-, American society, if he had used this occasion to make the case for less bullying of-, & more tolerance for-, those with views that differ from one’s own. And the ‘fix was in’ for him to be hoisted on his own petard, & undermine the impact of whatever he was going to say, when on CNN a few hours before his Oval Office Address to the Nation on December 6<sup>th</sup> (only his third in almost seven years), the view was he’d “better focus on terrorism, not gun control.”

**Putting the undertakings in Obama’s speech<sup>12</sup> in perspective** - In March 2002, six months after 9/11, the then US President told the world “The terrorists will remember the 11<sup>th</sup> as the day their reckoning began ... Every nation should know that for America the war on terror is not

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<sup>9</sup> McCarthy was the junior (Republican) Senator from Wisconsin for ten years until 1957 terminated by his death at age 48 (purportedly from alcoholism). He made his name-, and (briefly) became a household word in the US, when, in the early 1950’s, prompted by the Alger Hiss affair, he went on a public witch hunt that saw Communists and/or homosexuals and/or other undesirables in every closet & under every bed, especially those in the State Department & the Truman Administration, the Voice of America, and the US Army, destroying many careers & reputations in the process. But by 1954, two years into the Eisenhower Administration he had become a liability to the GOP to the point that a fellow Republican Senator compared him with Hitler & accused him of “spreading division & confusion”, leading to a “Joe must go” movement in the party that, while not successful, nevertheless put an end to his limelight-hogging escapades.

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<sup>11</sup> Most spectacularly so last August in Roanoke, Va. when disgruntled former colleague shot & killed newsreporter Alison Parker & photojournalist Adam Ward on live TV as they were interviewing the Executive Director of the local Chamber of Commerce.

<sup>12</sup> Talk is cheap & Obama is very good at it, but action speak louder than words & in the past seven years he has squandered the good will & the high expectations that accompanied him into office.

just a policy, it's a pledge." But the Global Terrorism Index (GTI) produced by the Sidney, Australia-based Institute for Economics and Peace (IEP) & based of data collected by the University of Maryland's National Consortium for the Study of Terrorism and Responses to Terrorism (START), show that "There has been a dramatic rise in terrorism over the last 15 years. There are nine times more people killed in terrorist attacks today than there were in 2000 ... In 2014, 32,658 lives were lost to terrorism, the highest number recorded, and an 80% increase from 2013." - *And since the beginning of the Syrian civil war in 2011 the number of terrorist 'kills' has risen dramatically, six-fold to about 30,000 in three years. Growth has been most dramatic In Nigeria, with the death count there going from zero, or next to nothing, in 2011 to over 6,500 YTD; Boko Haram is now a bigger killer than ISIS (with the number of its 'kills' up 317% YoY); but it is low on people's radar since those killed are black & live far from the Nigerian oil fields.*