

For me, February 1<sup>st</sup> is always “Hump Day”, with three wintry months behind us & three less wintry months to go, with one hour & 45 minutes more sunlight and with the sun getting noticeably warmer.

**Clarification** – Last weekend one of you wondered about my periodic use of the term “hoi polloi”. While appreciating that in the modern lexicon it is often used derogatorily, as ‘snooty upper class Englishmen’ used to, in my six years of taking Greek in high school I was made to suffer through reading Plato’s *The Republic* in the vernacular. So I use the term the way he did, to denote the ‘ordinary people’/‘the voters’, as opposed to the officialdom, whom he referred to as “hoi oligoi” (‘the few’), from which the word oligarchy is derived.

**Alberta’s unemployment rate** – At 7.4 % it is at an almost 20 year high (the last time it hit this level was in February 1996); in addition this is the first time since 1988 that it has been higher than the national average (*which is a blow to the Alberta psyche*) - *and the worst is still to come; thus employment in Edmonton has been propped up by an unusually high level of construction activity in the city centre that will start running down in the Second Quarter & will have run its course completely by the Second Quarter of next year.*

**Better days coming for Falun Gong in China?** - On January 12<sup>th</sup> former Vice-Minister of Public Security Li Dongsheng was the first high-ranking official to be convicted & sentenced this year (to 15 years for bribery) as part of President Xi’s now four year-old anti-corruption campaign. But on the day of his sentencing the business magazine *Caixin*, a conduit into the Party leadership’s compound, put this in the context of his job, starting in 2009, as head of the notorious secret police task force, *the 610 office*, established in June 1999 by then Party Leader Jiang Zemin to eliminate the Falun Gong movement. The Epoch Times, its voice abroad, takes this as evidence President Xi does not support the Falun Gong witch hunt.

**For those who like to keep a tally** - Cruz walked away from the Iowa caucuses with 8 delegates, Trump & Rubio with 7 each, Carson with 2, and Paul<sup>1</sup> & Bush with 1 each, while ‘across the aisle’ Hilary got 22 & Sanders 21.

**Israel’s fertility rate** – At 3.04, it is unusually high for a developed country. But it tells only part of the story; for according to Israel’s Central Bureau of Statistics in 2010 Haredi women averaged 6.5 children (& *the ‘Modern Orthodox’ over half that*) and Muslim women 3.5 (down from 7.5 & 4.6 in 2005). This highlights a potential existential threat to Israel’s survival in its present form; for it implies that over the next couple of decades the economically less dynamic components of its population will start accounting for a larger share of its electorate.

**London’s Syria Pledging Conference** - This was at the best a case of ‘locking the barn door after the horse has bolted’ & at worst ‘a photo op’. The past experience with pledges has been one of ‘talk being cheap’ but writing cheques a horse of a different colour. While the headlines screamed US\$6BN & US\$10BN, the devil always is in the detail; for Prime Minister Cameron’s announcement included the word “approaching” US\$6BN & the US\$10BN is for the period 2016-2020. While US\$6BN had been the very amount needed last year, only US\$4BN had actually been paid in. And the number of migrants in Jordan, Lebanon & Turkey may have changed little, if at all, YoY as the ranks of those departed for Europe were replenished by those newly displaced or, in the case of economic migrants, newly arrived; in other words, despite all brave talk, even in a best case scenario (i.e. all pledges are honoured), there will likely be little,

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<sup>1</sup> He has since withdrawn from the race.

if any, scope for new programs. Another flaw may be that it was all couched in terms of helping Syrian refugees (who account for less than half the total migrant flow). Possibly the only positive note was that *hopefully* the Europeans have (belatedly) come to the conclusion that it's best-, & most cost effective-, for them to keep the migrants where they are.

**Outlook for oil prices** - Last July the Paris-based IEA (International Energy Agency) noted there had been 12 consecutive months of growing global inventories of crude oil & petroleum liquids<sup>2</sup> accumulating at rates as high as 3MM-, & averaging 2MM-, bbl/d & expected a continuation thereof, albeit at a more modest pace, until at least yearend. And a January 12<sup>th</sup> 2016 report by the Washington-based EIA (Energy Information Agency) showed a similar, but updated, trend & suggested that, while the accumulation rate may have peaked, the trend is unlikely to end until mid-2017 [although it's underlying assumption of global demand increasing from 94MM bbl/d in 2015 to 98MM bbl/d next year (i.e. by 2+% per year) may be a bit exuberant since it grew by only 1.5% last year]. More interestingly, it also contained a chart showing that, while OECD Commercial Crude Oil and Other Liquids Inventory Days of Supply had been in the 55-to-60 day range in the five years ending January 1<sup>st</sup>, 2015, it had jumped to 65 days last year & may remain in the 65-to-70 day range until at least January 1<sup>st</sup>, 2018 (*while any increase in interest rates before then will create an incentive to get that ratio down to a more historical level, thereby creating a further supply 'overhang' not conducive to any early price recovery*)

**GLEANINGS II - 652**  
**Thursday February 4<sup>th</sup>, 2016**

**FIVE INVESTOR CHALLENGES IN THE COMING DECADE OF DISRUPTION**  
**(Mauldin Economics, John Mauldin)**

- A Decade of Disruption is here. This is not necessarily bad since it can jolt us out of too-comfortable routines & force us to face a new reality (which beats *mindlessly* postponing the inevitable, *which has a nasty habit of getting uglier the longer one waits to 'take the bull by the horns'*). In the next 5-10 years we will face five challenges :
  - **Reality will catch up with politics** - While we are coming to the end of governments' ability to keep their promises, the common thread in all political candidates' rhetoric still is an unwillingness to confront the wave of deficits from ever-growing entitlement spending : as things stand now, by 2023 US entitlement-, & military-, spending & interest payments will consume all our tax revenues;
  - **Governments will hit their credit limits** - This has already happened in Japan (*where 40% of its budget is funded with borrowed money in a Ponzi scheme that makes Bernie Madoff's look like child's play*). It no longer has a bond market; for, while the government still goes through the motions of issuing bonds, the Bank of Japan is now the only buyer (*i.e. the debt is now being 'monetized'*);
  - **Geopolitics will drive the global agenda** - Nations' & economies' development faces increasingly tighter constraints. Putin is wrestling with a collapsing oil revenue stream, Europe is trying to cope with huge migrant inflows & Beijing is asserting itself in Asian waters (*to divert its citizens' attention from its growing domestic challenges?*). And who will lead the world as the US starts looking inward?

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And according to Bloomberg during the 47 months ended November 30<sup>th</sup>, 2015 crude oil supply had fallen short of consumption in only 11 of them.

- **Currency wars will intensify** - In the years ahead money will morph from a medium of exchange into a weapon often yielded by leaders with little to lose (making them that much more dangerous). The world will see more competitive devaluations & massive currency interventions that will make investment abroad a minefield for some investors (& a *cornucopia of opportunity or others?*); and
- **Technology will disrupt everyone** - It is racing ahead faster than ever before & changing our lives more than ever. A decade ago no one had an iPhone, now they are everywhere. We cannot even begin imagine today what will be common in 2025 & how will it change our lives.

*He is straightlining, a methodology that works 99% of the time but fails dismally at turning points. There appears to be a disconnect between his first two challenges & his last one. For the whole iPhone cum instant gratification cum planned obsolescence cum conspicuous consumption phenomenon has been is driven by the credit creation path we've been on &, when that music stops, so will it. The only thing that can be said for certain is that those who face up to reality, & take appropriate hard-nosed action-, first, like Ireland did in the European debt crisis, will recover first.*

#### **FOUR ROADS OUT OF IOWA FOR REPUBLICANS (fivethirtyeight.com, Nat Silver)**

- On the eve of the Iowa caucuses there are four possible outcomes :
  - **Trump beats Cruz & Rubio does well** - This is the CW with there being much talk about Rubio 'gaining momentum'. And a Trump-Rubio matchup would offer the GOP the clearest choice between forward-looking/conservative & populist/radical;
  - **Trump beats Cruz & Rubio does badly** - in this case the party elite will start capitulating to Trump (some of which has already has started to happen);
  - **Cruz beats Trump & Rubio does poorly** - this could give Cruz a 'bounce' going into New Hampshire (not a good hunting ground for him due to its lack of evangelicals) but is the nightmare scenario for those Republicans who are hoping to stop him;
  - **Cruz beats Trump & Rubio does better than expected** - with Trump having failed to live up to the their hype, the media may turn on him, making it difficult for him to recover. This would be a typical Iowa outcome, with an "outsider" with evangelical support doing well but one insider's *unexpectedly* strong performance giving him a leg up on all the other establishment candidates.

*We are now in narrative No. 4. What killed Trump was the very high Republican turnout & relatively few 'late-deciders' supporting him; for while a month earlier he had the support of 39% of those who had decided how to vote, in the caucuses he had the support of just 13% of those who had only in the last week decided how to vote. Meanwhile, Rubio's fund-raising drew in US\$14.2MM in the Fourth Quarter (from 93,000 donations in all 50 states), over twice that in the Third Quarter, an amount that was, however, still well short of the \$20MM raised by Cruz.*

#### **DONALD TRUMP IS SHOCKING, VULGAR AND RIGHT (Politico, M. Scott Mahaskey)**

- *In a piece well worth reading in its entirety, the key phrase may well be "Trump doesn't think Hilary is impressive and strong. He sees her as brittle and afraid". It also notes that in a poll last month by Mercury Analytics almost 20% of Democrats said they would consider crossing over from the Hilary-, to the Trump-, camp.*

*Her shrill, hard-edged TV appearances doesn't instill confidence. She may have been unnerved by the interview President Obama gave Politico last month in which he referred to Sen. Sanders as a "bright, shiny object" & by the two of them, a few days later, having had a tete-a-tete in the Oval Office from which Sanders emerged calling it a "very positive and constructive meeting" (prompting speculation Obama was having second thoughts about Hilary's candidacy, speculation his Press Secretary was later forced to deny). As to Democrats 'crossing the floor', there is 'many a slip between the cup and the lip' and , in any case, it is likely Trump-related.*

### **SIX CASUALTIES OF THE STRONG US DOLLAR (Mauldin Economics, Tony Sagami)**

- In 2015 the US dollar was up 12% against a basket of trade-weighted foreign currencies, the biggest one-year gain in four decades, & in 2016 it is expected to appreciate another 4% against the Euro & 6% against the yen. Here are six major US casualties :
  - **Kimberley-Clark** - Its 2015 revenues were **down** 6% (while its global sales volume had actually been **up**), & it expects them to be down another 3% this year;
  - **Proctor & Gamble** - The US generates only 40% of its sales, Europe 26% & Latin America 10%, with the rest coming in almost equal parts from IMEA<sup>3</sup>, China & Asia-Pacific. Last quarter its sales were down 9%;
  - **Johnson & Johnson** - 2015 revenues were reduced 7.5% by "currency losses";
  - **Monsanto** - It gets 43% of its revenues from outside the US, just reported a loss for the Fourth Quarter & has cut its 2016 profit guidance by 8%;
  - **DuPont** : While sales slid 9.3%, almost all of it was 'accounted for by the strong dollar' & its Fourth Quarter EPS were -29¢, down from +74¢ a year earlier; and
  - **3M** - It gets about two-thirds of its revenues from outside the US, reported 8.3% lower profits & expects the currency effect to have another 5% impact this year.
- If US stocks in investors' portfolios derive more than 40% of their revenues from outside the US, they should consider selling them : fighting the strong dollar is futile.

*And Caterpillar's global retail sales in December were down 16% YoY, after having declined 12% in 2014, 8% in 2013 & 1% in 2012, with the impact of its exposure to the resource sector increasingly reinforced by that of the stronger US\$. But the above advice may well be dated; for only in Jack & the Beanstalk do trees grow to the sky & forecasting FX movements is even more of a mug's game than most other forecasting, with the only two sure things being that turning points come typically when least expected & change goes further faster than expected.*

### **BIGGEST CASH HOARD IN CANADA'S HISTORY (Investing Daily, Ari Charney)**

- Canadian consumers are sitting on \$75BN more cash<sup>4</sup> than usual & have been piling it up for the past four years (in 2015 at an 11% annual rate), according to the CIBC at a much faster rate than at any time in the past 25 years.

*The headline is misleading; for \$75BN pales all but into insignificance compared to the \$700BN in 'dead money' squirreled away by Canada's corporate sector. Both are a function of a greater-than-usual sense of uncertainty as to what the future might bring. And both their willingness to sit on cash is 'collateral damage' from the central banks' 'unconventional monetary policies' of*

<sup>3</sup> India, Middle East & Africa.

<sup>4</sup> That's a lot of dough, roughly \$2,000 for every man, woman & child in Canada!

recent years that have driven interest rates so low as to make the 'opportunity cost' of holding cash irrelevant.

### **CANADA'S WAGE-GROWTH WINNER IS .. PRINCE EDWARD ISLAND (Huffington Post)**

- According to StatCan's Wage growth in Canada, Nov. 2014 to Nov. 2015, average wage growth in Canada during the period had averaged 1.5% & ranged from 3.2% in PEI to minus 2.3% in Alberta.

*Job growth had been highest in B.C (2.6%) & Ontario (2.3%) and lowest in Saskatchewan (minus 0.6%) & Alberta (minus 3.1%), with Québec's 1,600 job loss 'statistically insignificant'.*

### **CREDIT ADDED TO LIST OF BANK WORRIES (Bloomberg Gadfly, Lisa Abramowicz)**

- Investors are starting to worry about more than just profit declines at the biggest banks; they are increasingly concerned about their ability to repay their debt (*and the scope for losses for them from the falling oil prices*). Thus in the case of the *struggling* Deutsche Bank a couple of BNP-Paribas analysts told clients on February 4<sup>th</sup> that the consensus forecast that it would have to increase its loan loss provisions by 19% to 1.14BN Euros might not be enough. As a result, Deutsche Bank's 6% contingent convertible bonds<sup>5</sup> plunged to a level down 13.4% WoW & 18% YTD. This marks a departure from the sentiment of recent years when the biggest banks were deemed impervious to credit risk even as their earnings outlook started to look more iffy. And investors have started dumping all lower-rated bank debt tied to European firms with commodity and/or China exposure.

*Meanwhile a real banking crisis may be in the making in Italy where the ratio of bad loans to total assets is 16% for its No. 1 bank, 17% for No. 2, & 5% for No.3 and where, with seven other banks having ratios in the 6% to 27% range, the booby prize, for 33%, goes to No. 6, the Banca Monte dei Paschi di Siena (that has 6MM customers & is the oldest bank in the world, and received a 4BN Euro bailout in February 2013 & in June 2014 raised US\$8.7BN in new equity), whose share price is down 50% YTD to the point where its market cap is now less than 30% of the US\$8.7BN in new equity it raised 19 months ago. And as investors & depositors scurry for safety, the former are dumping bank bonds & the banks have been losing deposits (Bloomberg Gadfly is a new initiative launched last November to "provide rapid, smart takeaways on the day's most important news on markets, finance, companies and technology").*

### **THE END OF CHINA'S LONG VIEW (The Bridge, Robert N. Hein)**

- Once, when former Chinese Premier Zhou Enlai was asked about the impact of the French Revolution on China<sup>6</sup>, he said "It's too soon to tell"; this has long been taken as indicative of Beijing's proclivity to take the 'long view'. This made it the envy of American strategists, whose planning horizon seldom extends beyond the current Administration, as they watched China growing in global stature with the long-term goal to replace the US as the world's super power. But that goal may now be at risk. For the one-child policy has led to an aging demographic that in 2012, for the first time in decades, saw its labour

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<sup>5</sup> A new class of bank bonds automatically converted into equity in case of a specified 'trigger event'.

<sup>6</sup> In his mid-twenties he had lived for a time in France.

force shrink, & to a growing single male/single female imbalance that is apt to lead to social unrest. And its economic growth has begun to decelerate, reducing its scope for the growth of its military-, & economic -, spending required for the fulfillment of its global military & economic ambitions.

- Last, but not least, is the so-called 'middle-class trap', when the transition from a poor economy producing low valued-added goods to a middle class one producing higher value-added ones requires more of an investment in (*higher*) education infrastructure than China has made. And while the wealthy can send their children overseas for their education<sup>7</sup>, the lack of adequate local educational infrastructure will hamper its transition to a more advanced economy, while rising labour costs will cause the industries on which its economic miracle was based to migrate to lower cost countries elsewhere in the region. In this process the Communist Party is discovering that the price of a more advanced economy is a middle class that demands rights, & its reaction thereto, *greater repression*, is not a sign of a healthy administration, but of one that feels endangered.
- China's power is still rising but the rate is flattening & Beijing knows the time for achieving its super power ambitions may be growing short; so in the years to come, it is will become more aggressive in its pursuit of its objectives (*but less able to afford it?*).

*The Bridge is an "international journal focused on strategy, national security and military affairs" & the author a 'blue water' Captain in the US Navy & "career Surface Warfare Officer" who has been a 'federal executive fellow' at Brookings.*

### **RED PONZI RISING (Contra Corner, David Stockman)**

- Following are some tidbits from his lengthy doomsday article on China :
  - Near Shanghai developers have built a shopping mall that is a replica of the Pentagon & near Tianjin other developers spent US\$50BN on a replica of Manhattan, complete with the Rockefeller Center & the Twin Towers; both have the same problem, no people;
  - In 15 years China's steel production increased twelve-fold to 825MM tons, but is now expected, rather optimistically, to decline to 750MM tons whereas China's steel making capacity is 1.2BN tons, most of it built in the past decade;
  - While in 1994 China produced 1.4MM "barebones, communist era" cars & trucks, in 2015 this had grown to 23MM, largely 'Western-style' units. It now has a 33MM unit production capacity, while demand growth seems to have peaked;
  - There are 70MM vacant luxury apartments in the country; and
  - In the past three years China consumed 6.6 gigatons of cement, almost 50% more than the 4.5 gigatons the US consumed in the **entire** twentieth century.
- He summarizes the Chinese-, & global financial situation as follows : "It is the greatest economic train wreck in human history barreling towards a bridgeless chasm ... China is *merely* the rotten epicentre of the world's two decade long plunge into an immense central bank fostered monetary fraud and credit expansion that has deformed and destabilized the very warp and woof of the global economy."

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there are now an estimated 300,000+ of them in American universities alone, 5x the number 15 years ago, at least some of whom, when they return home, may be filled with ideas the ruling Communist Party may not like.

*After getting a BA in History from Michigan State & spending two years at Harvard studying theology, Stockman (now age 69) got involved with politics at age 24 as a Congressional staffer. After serving two terms as a Republican member of the House, his career hit its zenith when in 1981 Reagan picked him, at age 35, to be his first Director of the Office of Management and Budget (thereby making him the youngest Cabinet member in the 20<sup>th</sup> century). He has, seemingly aptly, been described as the “ultimate Washington insider turned contrarian).*

**CHINA ANNOUNCES 400,000 STEEL WORKER JOB CUTS**  
**(World Socialist Website, Samuel Davidson)**

- Beijing plans to slash steel production capacity by another 100-150MM tons (over & above the 90MM tons it has already cut). This will cost an estimated 400,000 steelworkers their jobs, with Li Xinchuang, Head of the China Metallurgical Industry Planning and Research Institute, telling Xinhua “Large-scale redundancies in the steel sector could threaten social stability.” And estimates are that, in addition to those directly involved, for every job lost in steel making, three will be lost in related-, & supporting-, industries. In addition, another three million workers in the steel-, coal-, cement-, aluminum- & glass industries are expected to lose their jobs over the next few years as those industries too seek to cut capacity.
- While in 2014 China steel output had been 823MM tons (49.4% of the global total), in 2015 it was 804 tons, down 2.3% YoY, slightly less than the 2.8% global average.

*This may over the medium term, & at the macro level, not be such a calamitous event as it may appear in the short run & at the micro level (although it may be in the short run be conducive to social unrest); for as existing jobs in manufacturing are lost, new ones will open up in the service sector. Many of those involved are migrant workers from rural areas, some of whom may well decide not to return to the “Big City” from their annual migration home for the Chinese New Year, which could be positive if they were to decide to deploy their newfound skills to set up businesses back home, or negative if they were to sit & sulk about being hard done by, thereby becoming a potential festering source of social unrest.*