

Quote of the week - If you scratch an American ... you find an isolationist." Dean Rusk, Secretary of State under John. F. Kennedy & Lyndon B. Johnson (1961-1969).

New National Security Adviser - Despite all the praise heaped on Lt-Gen. H.R. McMaster's appointment by, among others, the Chairman of the Senate Armed Services Committee John McCain (who has been sharply critical of some other Trump nominations), following are some relevant considerations about this appointment :

- he is Trump's third choice, after Lt-Gen. Flynn (who was fired) & Vice-Adm. Robert Harward (who turned down his job offer);
- at age 54 he is much younger than-, & junior in Army seniority to-, Trump's other choices from the armed forces' "talent "pool". And whereas the others are retired, he is a serving officer & will remain so (which could prove problematic since his office & the Pentagon in have in the past not always been willing to 'sing of the same song sheet");
- he is said to be "smart, intense & fiercely outspoken; that latter made him popular with his equals but often grated on his superiors - *which may have been a contributing factor for him being passed over twice for promotion to the (one-star) general rank, as may have been the fact that in his book on the Vietnam War he bluntly accused the generals of the day to have "caved in" to the politicians;*
- like the Secretaries of State, Defense & of Homeland Security he is "skeptical" about Trump's idea of "making deal" with Putin (*that would be "good" for America*); and
- according to White House spokeswoman Sarah Huckabee he has "full authority to have whatever staff he sees fit" (Trump's reluctance to give Adm. Harward the same latitude allegedly was one of the reasons he had turned down Trump's job offer).

All this suggests that his relationship with the President could turn out to be uncomfortable for both & hence less than 100% effective.

No climate change? - 46 years ago Edmonton set a record when, for six weeks straight, the temperature never rose above 10 degrees below zero Fahrenheit/minus 23 Celsius. And one day last week it set a record for that date with a daytime high of +15 degrees Celsius; higher than in, Amsterdam (+8), Ankara (+3), Baghdad (+13), Beijing (+5), Beirut (+13), Berlin (+5), Boston (+2), Brussels (+10), Chicago (+12), Copenhagen (+5), Istanbul (+7), Jerusalem (+7), Madrid (+14), New York (+4), Nice (+14), San Francisco (+14), Salt Lake City (+9), Seoul (+3), Vienna (+6), Warsaw (+3), & Washington, D.C (+10) - *"one swallow does not a summer make" (Aristotle), but still ...*

The "fiduciary rule" - Trump recently signed a 'Presidential Memorandum' instructing the Labor Department to delay by 180 days from the planned April date the introduction of the Obama Administration's so-called "fiduciary rule" so it could be reviewed. That rule required financial professionals to put their clients' interests first when giving them advice on their investments (to keep them from steering their clients into products that maximized the commission & fee income for themselves)¹. After the signing ceremony, Trump handed the pen he had used to Rep. Ann Wagner (R.-MO), who had long agitated for this & who remarked "What we're doing is ... returning to the American people, low- and middle-income investors, the control of their own retirement saving", & White House Press Secretary Sean Spicer said in a briefing "The rule is a solution in search of a problem. There are better ways to protect investors

¹

Thus replacing the industry's "suitability standard" that lets them recommend products that, while generally suitable, may not necessarily be in their client's best interests.

and the ... Administration is taking action to do so.” - *The proponents are either willfully-, or in ignorance-, ignoring how the retail investor ‘wealth management industry often really works; thus, in the case of at least one Canadian Big Five Bank-owned wealth management arm young newcomers are told “your primary obligation is make money for the bank”. So much for Trump’s claim that he is on the side of the ‘little guy’.*

Soaring corporate leverage in the post-financial crisis era - According to Prof. Aswath Damodaran (who teaches corporate finance & valuation at New York University’s Stern School of Business) the “US Corporate Debt to Capital” ratio has gone from 25% in 2007 to almost 40% now - *the good news is that, since much of the new debt is of a ‘fixed rate’ nature (to ‘lock in’ the historically record low interest rates), the impact of any rise in interest rates may have a limited impact on future corporate earnings & the bad news that, all things being equal, the higher the leverage in a company’s balance sheet, the greater its potential risk exposure.*

GLEANINGS II - 699
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THE BEGINNING OF THE END (Seeking Alpha, Eric Parnell)

- In September 2011 the S&P500 Index was trading at 1,100+ which with annualized earnings of US\$792BN generated a Price-Earnings (P/E) ratio on a trailing basis of 13.3x, & in the Third Quarter of 2016 it was 2,100+ & earnings were US\$774BN (i.e. down 2.2%)² & the P/E a “historically extreme” 24.3x. And this doubling of the index occurred, according to the Investment Company Institute (ICI), during a period in which there had been a US\$1+TR net outflow from domestic equity mutual funds & ETFs. The primary driver of the rise in share prices, that more than offset the effect of such persistent selling by individuals & institutions, was the US\$2.7+BN corporate ‘buy-back’ of their own shares (that in 2007 peaked at a US\$700BN annualized rate, only then to ‘fall off a cliff’ to a US\$100BN rate by 2009 after which it recovered to US\$650BN by late 2015 and, as of the Third Quarter of 2016, has declined again to the US\$450BN.

The writer has a CFA & in 2005 founded tiny Glenmoore, PA-based Gerring Capital Partners (with 101 clients & AUM of US\$10.1MM); so his thinking processes are likely less affected by infectious mob psychology of money managers in ‘financial centres’ with a predominantly institutional clientele who tend to prefer being “stupid in a crowd ...rather than smart by themselves.”

²

Worse still, on an inflation-adjusted basis the 2001 earnings were equal to US\$855BN in 2016 dollars; so on a real basis the 2016 earnings were actually down 9.5% from 2011.

'MARKET RECONCILIATION LIES AHEAD', GOLDMAN WARNS (Bloomberg)

- David Kostin, its Chief U.S. equity strategist, wrote in a note to investors that “Financial market reconciliation lies ahead ... *(the)* S&P 500 Index will give back recent gains as investors embrace the reality that tax reform is likely to provide a smaller, later tailwind to corporate earnings than ... expected.” And elsewhere he & his team point out that, while corporate earnings estimates for 2017 have fallen by one percent since the election, the S&P has surged 10%, saying that “Something has to give.”

The market fell victim to candidate Trump's hype that seems to be slowly fading in the President Trump's wake-up to reality!

RYAN STRUGGLES TO SELL TAX REFORM PLAN TO FELLOW REPUBLICANS (Politico, Rachel Bader et. al.)

- On Tuesday February 14th House Speaker Paul Ryan showed up at the Senate Republicans' weekly lunch to *try* & salvage a controversial pillar of his tax reform plan³ that would change how imports & exports would be taxed *through a BAT (Border Adjustment Tax)*. Nevertheless, the very next day, on the floor of the Senate, Sen. Tom Cotton (R.-Ark)⁴ declared, with reference to the BAT, that “some ideas are so stupid only an intellectual can believe them.” And he apparently is not alone; for Senate Finance Committee Chairman Sen. Orrin Hatch @.-UT) has warned that the BAT idea is unlikely to have enough support to clear his committee, Sen. Roy Blunt (R.-MO), the 5th-ranking Republican on the Committee has gone on record that it “will likely go a different way”, according to Sen. David Perdue (R.-GA) the BAT idea “is a bad economic proposition” & the Senate Majority Whip, Sen. John Cornyn @.-TX) that “it's fair to say that there's a lot of questions as to how it would work and the assumptions on which it is based.”

The BAT idea been opposed by retailers like Wal-Mart with import-heavy product lines, awareness is growing that retailers hit with an import tax will just pass the cost thereof on to their customers, & there is a split on this issue among senior White House advisers, with the apocalyptic Stephen Bannon supporting-, & his former boss at

³ Ans Sen. Lindsey Graham (R.-SC) said in a February 19th interview on CBS' Face the Nation Ryan tax program doesn't have the support of even 10 Senators.

⁴ An interesting fellow. At age 39 he is currently the youngest Senator. After serving a two-year term in the House, he was elected to the Senate in November 2014. He got an undergraduate degree from Harvard in 1998 while editing the Harvard Crimson daily newspaper (the only daily in 110,000 inhabitant Cambridge, Mass., across the river from Boston). After being briefly sidetracked to graduate school at another university, he returned to Harvard graduating with a JD law degree at age 25. After a year of clerking for a Circuit Court judge & a couple more in private practice, enlisted in the army at age 28 and, after turning down a commission in its legal arm, later was commissioned in the infantry & served as a platoon leader in Iraq, from where he wrote an open letter to the New York Times accusing three of its journalists of espionage & endangering the lives of his men; this created a major stir & got him in deep trouble when the Chief of Joint Staffs was made aware of it. After five years on active service he transferred to the Army Reserve, from which he was released in 2013, at age 35.

Goldman, its ex-President & COO⁵ but now the White House Chief Economic Adviser, Gary Cohn, opposing the idea. But not introducing a BAT poses a potential serious policy challenge for the Trump Administration since the US\$1+TR (over ten years) in new revenue was to have paid for the promised steep corporate-, & income-, tax cuts. And word on Capitol Hill is that whatever ACA⁶ reform/replacement initiatives Paul Ryan may be able to push through the House will run into similar headwinds in the Senate.

CONGRESS TARGETS GUN BAN TIED TO MENTAL HEALTH (WP)

- The Obama Administration, *on its way out the door*, passed a regulation preventing an estimated 75,000 people with mental disorders from purchasing a firearm⁷. But the GOP lawmakers, egged on by the NRA & advocacy groups for the disabled, opposed it; so on February 16th the Senate voted 57-43 to reverse it (after the House had done so & the White House had signaled Trump would sign it into law). This move was spearheaded by *the octogenarian* Sen. Charles Grassley (R.-IA) on the grounds “it stigmatized the disabled & infringed on their right to bear arms, and the mental disorders covered under the regulation were filled with vague characteristics that do not fit the federal mentally defect standard.”

But the fact remains that in 2008, in D.C vs. Heller, the Supreme Court ruled 5-4 (contrary to the NRA’s claims) that the right to bear arms “is not unlimited”, while in writing the majority opinion the late arch-conservative Justice Antonin Scalia noted “like most rights the right to bear arms secured by the Second Amendment is not unlimited ... nor in our opinion should be taken to cast doubt on our longstanding prohibition on the possession of firearms by felons and the mentally ill.”

FITCH SEES RISING RISK OF CANADIAN HOUSING CORRECTION (FP, Garry Marr)

- On February 15th BMO’s Chief Economist Doug Porter said, after Toronto house prices had risen 22% in the year to January 2017, that its *housing* market was now in “bubble territory”. Earlier Capital Economics had questioned the long-term impact on the overall economy of such dependence on housing *wealth*. The next day Fitch pitched in by opining such price rises are unsustainable & not supported by fundamentals, and raised concerns about affordability⁸ since these prices are funded by record debt levels, saying “Household debt levels reached a new high of ...168 per cent of disposable income in the second quarter of 2016 and breached 100 percent of GDP. This is the first time ... household debt has

⁵ Who is said to have received a US\$100MM ‘exit package’ upon leaving his Goldman.

⁶ Obama’s Affordable Car Act.

⁷ ‘Social Security beneficiaries with psychological disabilities who *for that reason* have been assigned a money manager for their disability benefits’and who would be reported to the FBI for inclusion in its background data base among those ‘ineligible to purchase firearms.

⁸ Statscan found that in 2013 25+% of Canadian home owners with a mortgage spent over 30% of the gross family income (its definition of “affordability”) on housing

exceeded the size of the Canadian economy and is higher than the UK and US household debt burden⁹. Mortgage debt is the No. 1 contributor to household debt in Canada.”

Ottawa (which has vested interest in a healthy residential home market; for through CMHC (Canada Mortgage & Housing) it has a \$500+BN exposure to it, has already moved to tighten mortgage loan eligibility requirements. And any softening of the market or higher interest rates, or worse still any combination of both, could have serious negative impact on the economy, the former because of the “wealth effect” of changes in house prices (when house prices are in the ascendancy home owners feel ‘richer’ & hence more inclined to spend while as they are declining they feel ‘impoverished’ & hence more reluctant to spend), and the latter because approximately 30% of all Canadian home owners with a mortgage have a ‘floating rate’ one, while most of the rest have five-year fixed rate ones, which means that, all other things being equal, another 15% of all home owners with a mortgage will also feel financial stress when interest rates rise.

CHINESE FIRM CRIES FOUL ON McDonald’S (Reuters)

- Last month McDonald’s announced it had agreed to sell the bulk (80%) of its business in China & Hongkong for US\$2.1BN to state-backed CITRIC Ltd. (52%) & the US private-equity firm Carlyle Group LP (28%). Now a Chinese consultancy firm, *the Beijing-based Hagen Vanguard Group*, that previously helped *Chinese firms* win anti-trust battles against Coca-Cola & Apple, has filed a complaint with the regulators that this may hurt workers & consumers, a move that could delay regulatory approval.

This was prompted by allegations by a US labour union that the transaction will lead to poorer pay & working conditions for McDonald’s 120,000 workers in China (whom it doesn’t represent).

Leper GAINS IN FRENCH POLLS AS SECURITY CONCERNS WIN VOTERS (Bloomberg, Hailin Bouquet)

- The February 20th daily Opinion Way poll showed her up 1% to 27% for the first round in late April with Macron & Dillon tied for second with 20% while Macron was ahead of her 58-42 for the mid-May run-off (although by less than half the spread of two weeks ago *after he had shot himself in the foot during a visit to Algeria where he had said that aspects of France’s colonialism there could be considered to have been a crime against humanity.*

The market saw these polling results as an undesirable hike in risk; for the yield spread between 10-year French- & same maturity German-, government bonds widened 5 bps to a four- year high 0.79%.

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But what is really worrisome is that while the US the household debt-to-disposable income ratio **declined** between 2008 & the Second Quarter of 2016 from 95.1% to 78.8% & the UK ratio from 97.1% to 87.6%, in Canada it **rose** during the same period from 145.9% to 168.9%.

THE EUROPEAN UNION SET FOR A MAJOR CURRENCY UPHEAVAL (G&M, Carl Mortise)

- The EU is being forced down the road of currency reform, The E.C. & ECB are about to launch a project to partly dismantle the currency union since the political environment that spawned the Euro is unraveling. In addition to Greece's virtual insolvency & the ever-present risk of an Italian banking collapse, France's presidential election will be a seismic tremor undermining the common currency, with the National Front's Marine Le Pen as the battering ram. For while her anti-Brussels tirades had hitherto skirted around the Euro issue, last month her party voted to bring back the French franc so as to 'restore France's economic sovereignty & *global* competitiveness'¹⁰. And her nationalist, statist & anti-immigrant stance is resonating with the urban blue collars & the disgruntled rural.
- While she is now the favorite to win the presidential election's first round in late April, the CW is that she will get beaten two weeks later as the other parties will gang up on her in the second, as they did to her father in 2002. But things are different now. The once rising star of the *centre-right* former Prime Minister François Dillon *who not long ago was neck-on-neck with her* has dimmed on news he had arranged to have his (*English*) wife & two children put on the public payroll *without there being much, if any, evidence they had done much, if anything, to justify their salaries.* And the now third, 'independent', candidate Emmanuel Macron, a one-time Economy Minister in President Hollande's administration who last April set up a new centrist party, En Marche, (French for "Moving!")¹¹, also says the Euro won't survive unless Germany & France agree on structural reforms¹². So the run-off round may well feature two candidates who agree on one thing : the Euro is doomed!
- The increasingly widespread criticism of the Euro often overlooks that its creation was politically, not economically-, motivated. For the idea was spawned in Paris that feared a surge of German economic power in the wake of the fall of the Berlin Wall & saw it as a check on Germany & a way sought to force greater convergence onto the core EU states.

The dominant political force now at play in the developed world is no longer convergence but centrifugal! - The author is a Canadian financial journalist living in

¹⁰ Even though the debt markets aren't keen on the idea & S&P has described it as *potentially leading up to* 'the greatest sovereign default the world has ever known.'

¹¹ He founded the party (*because the well is poisoned for the Socialist 'brand'?*) & at last report claimed a 189,503 members (i.e. more than Les Républicains centre-right party & a multiple of the Socialists Party's. Its initials, EM, are, rather cleverly, identical to Macron's.

¹² He is not into re-introducing the Franc. Like other Euro critics he believes it failed because, rather than causing **all** economies involved to converge, it benefitted German exporters at the expense of the other economies. So he is pushing for fiscal convergence : a Eurozone budget with economic transfers from the stronger to the weaker brethren a la Canada or the US. But there is now way that Angela Merkel could support such an idea, not with her party politically on the ropes and the volume of protests against her Open Door immigration policy & the Greek bailouts having tripled in volume in the run-up to next fall's election.

London who has had a weekly column in the *Globe & Mail* since 2005, worked for *The Times* for 18 years, lastly as its World Business Editor, & since 2010 has been a partner at Kreab, Gavin, Anderson, a half century-old Swedish communications advisory firm with 25 offices, & 500+ corporate clients, worldwide.

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KREMLIN SCOFFS AT U.S. PEACE DEAL
(WP, Tom Hamburger & Rosalin S. Helderman)

- Michael Cohen, a Trump Organization lawyer since 2007¹³, Felix Sater, a Russian emigré to the US who has worked on real estate deals with it, & Andrii Artemenko, a Ukrainian politician¹⁴ recently had a 15 minute meeting in a New York hotel room on a peace proposal that envisaged all Russian forces withdrawing from Eastern Ukraine, a referendum in Ukraine on whether Crimea should be leased to Russia for 50 or 100 years & a lifting of all sanctions against Russia. The Kremlin's reaction was that any such proposal would be unacceptable. Dmitry Peskov, Putin's press secretary's comment was "There's nothing to talk about. How can Russia rent its own region from itself?", a view shared by Russian Foreign Minister Sergei Lavrov.

Pescov was right; this was a hare-brained idea that seems to have originated with Artemenko. For Cohen said afterwards he had received the proposal & out of politeness had taken it with him (from the meeting) but had not relayed its contents to anyone in the administration, while Sater claimed he had held the meeting out of 'honorable intent only' & had involved Cohen because his Ukrainian lawmaker acquaintance (i.e. Artemenko?) "was emphatic that he wants the war to end" & that "I was not practicing diplomacy and I was not having clandestine meetings, and ...the conversations with Cohen & Artemenko were not "a back channel to the Kremlin or anything like that."

13 His name was mentioned in a dossier prepared by a former British spy hired *last summer* by one of Trump's opponents *and made public just before last July's Republican convention* that had suggested that he had once served as a liaison between the Kremlin & the Trump campaign, something Cohen has always denied.

14 Who belongs to an anti-President Poroshenko 'Solidarity of Right Forces' bloc that had previously been aided by Paul Manafort, who from April, when he was brought in to establish some sort of order in the chaotic Trump campaign, until August, when he was fired after Trump had publicly referred to him as "low energy", a derogatory term he had previously used to describe Jeb Bush, & had blamed him for a newspaper article that had detailed the Trump campaign's internal troubles, and after newspaper reports that he (Manafort) had collected millions in fees from pro-Russian Ukrainian elements for secret lobbying in the US. Manafort was a long time GOP operative who had been involved in the election campaigns of Ford, Reagan, Bush 41 & Bob Dole, over the years had been an adviser to the Philippines' Marcos, the Congo's Mobutu & Angola's rebel leader Savimbi, *an unsavoury lot if there ever was one*, as well as to the pro-Putin President Ukrainian Viktor Yanukovich (whose ouster in 2014 amidst massive public protests gave Putin an excuse to foment the uprising in Eastern Ukraine) and who at the time was under "active investigation" by the CIA, NSA, FBI, ODNI (Office of the Director of National Intelligence) & FinCen (the Treasury's Financial Crime Enforcement Network).