Patient Capital.... Positioned for Profit

A PEEK AT THE WEEK THAT WAS - December 14, 2013

Editorial Note: Once again, this week's Peek will be an abbreviated issue related to differing time zones and related travel schedules. We sense the collective relief. But it gets better...more cartoons, less graphs. See, we do listen!

I choose the likely man in preference to the rich man; I want a man without money rather than money without a man.
Themistocles (527 BC - 460 BC)

Last week, we took a peek over at the developing tensions in the East China Sea as the Middle Kingdom flexes its growing muscles over a few deserted rocks. This week, we thought we might take a quick gander around some other parts of the globe to see what is going on...and of course, there is a lot going on, especially in Euroland...even if you never hear about it in much of the mainstream US media. In the process, we'll try to shine the spotlight just a little on our friendly Euro bankers. Everyone knows how much they like the spotlight.

But first, what's up with Mr. Market? He is usually quite exuberant during the holiday season. But this week he was a bit depressed. Maybe he just partied too much during the year and is feeling some effects. The neon 1800 sign is down again but not to worry, Bartender Ben will keep plying the booze at Club S&P till his shift ends in January and his able assistant, Zesty Janet Yellen looks like being confirmed by our Congressionial geniuses to take over the next shift. She likes a heavy pour too so we're sure the party will be back a'rockin' soon. As our chart of the week will show, there are so many more party bulls than grumpy bears, it must be so.

Party or no party, Ms. Bond is remaining sober and vigilant. Her 10 year treasury has stuck around 2.87%. During the week it dropped briefly below 2.80% but quickly bounced back. Looks like Ms. Bond is keeping a close eye on both Bartender Ben and Mr. Market. She can be such a buzz kill when she wants to be and there will come a time when she will be fed up sufficiently with both Ben and that crazy Mr. Market to take things into her own hands.

The Gold Bar got interesting on Tuesday and then again on Thursday. The shiny stuff started the week around $1,228 per ounce before rocketing to $1,265 or so the next day. It took off so fast that it actually stopped the market briefly while the punters caught their collective breath. We've seen that happen a couple of times recently on the selling side when some culprit dumps a bunch of phoney paper but for it to happen because of too much buying is unusual. Of course, come Thursday and the usual shenanigans returned with the paper price being pummeled yet again. Expect more volatility in this space as the paper and physical markets continue to dislocate...especially as we watch for any effects from that piece of swiss cheese called the Volcker Rule, which finally passed regulatory muster last week.

You've heard about the Volcker Rule, of course. It's named after former Federal Reserve Chairman Paul Volcker who, according to many, actually did his job apolitically in rescuing the US from the scourge of inflation back in the 70s and 80s. Yes Dorothy, that's the same inflation that Bartender Ben, Happy Haruhiko Kuroda and Super Mario Draghi are so desperate to reignite today (more on that later). This rule, a part of the Dodd Frank Act, named after another couple of political gems (Smoot Hawley was already taken) is designed to stop the banks from trading with customer money that is insured by the FDIC (read..."taxpayer").

Anyway, Mr. Volcker apparently had nothing to do with the rule that bears his name. And probably just as well. It is so full of gaping holes and special exceptions, that its effect on curbing greedy bankers is likely to be minimal. And they have until June 2015 to figure out all the angles and trust us, they are already well ahead of that deadline.

You can read more about the Volcker Rule by clicking here for an optimistic editorial piece from the NYT and here for a more realistic piece from Forbes. And speaking of Volcker, we'll also take a quick look at some inflation numbers from 2000 till now...even though inflation does not officially exist, of course.

And what's this...according to Forbes...Caesar is forcing...err...encouraging the private insurers to provide cover (at a loss, if necessary) to those left out in the health care cold this winter because the much vaunted website can't seem to get off the tarmac. Hmmm...that happened to us once during a Russian winter when those big Tupolev tires got iced to the runway. It could take a while to get this "Dreamliner" up in the air too...and we're not sure how safe it might be at 35,000'.

But don't worry, as the cartoon below (thank you Ed Steer) illustrates, none of the really important people wil be on board. You can click here for the little piece of Yuletide cheer from Forbes. So, let's press on...

Hah...we're covered....let them eat coal!

I do nothing but go about persuading you all, old and young alike, not to take thought for your persons or your properties, but and chiefly to care about the greatest improvement of the soul. I tell you that virtue is not given by money, but that from virtue comes money and every other good of man, public as well as private. This is my teaching, and if this is the doctrine which corrupts the youth, I am a mischievous person.

Socrates (469 BC - 399 BC)

OK...off we go to see all the good stuff going on in Europe during this festive time of year. Everything must be good there. The Euro is trading above US$1.37. Business must be really humming. Maybe so. Maybe no.

Let's look at the European banks first because they have all the money. Well maybe so Maybe no. Many big Euro banks are under tremendous pressure on a number of fronts. The ECB (European Central Bank) has printed up and advanced them over one trillion euros and a lot of that is still outstanding...in fact most of it. Unfortunately, it comes due in 2014. Spain and Italy both owe over $200 billion each and quite frankly they don't have it.

Money supply in Europe is falling fast, and so is bank lending. In October, bank loans declined by 6% in Italy, and by 19% in Spain. These countries are already under massive pressure, and they don't have banking systems that can support any decent rebound of the economy. They have essentially stopped lending. They are in a struggle for survival.

That is one of the primary reasons that the ECB lowered their discount rate by .25%. To make matters worse, European banks will need another 280 billion euros to comply with Basel III capital requirements in 2014. Bitcoins aren't going to do it. Where are they going to find another $280 billion lying around?

They have never really, really dealt with their bad debts. For the most part, they have simply rolled them over and rolled them over, putting off the inevitable day of reckoning when all this toxic stuff will have to be marked to market. Like every other banker, they are hoping for salvation from the consumer and the "growth fairy".

That's a problem. Almost 25% of the young consumers (under 25) in Euroland don't have jobs. In certain countries it's downright scary. For example, Spain's youth unemployment rate just hit 57.4%, while in sunny and not necessarily cheery Greece, 58% of the kids are definitely not alright (click here for that fabulous Who song of almost the same name). Meanwhile over in Italy and Portugal, their youth unemployment is running at 41.2% and 36.5% respectively.

What does all this mean? Kids don't have jobs and no jobs means no money. No money, no spending. No spending. No consumption. No "growth fairy". Despite all the printing, money is still very tight. The money that isn't tight is buying the stuff that rich folks perceive as stores of value...or prestige...or both. You know...those fine art pieces and pink diamonds.

So...back to the Euro banks. They are going to need a lot of bucks...or euros...and soon. Where do they get it? Germany won't let the ECB print like our Ben and Janet. Hmmm...a quandary. Wait...what about the depositors...our loyal customers? Some of them are prodigious savers and lousy spenders. What about them? We got 'em in Cyprus and no one made a really big fuss. Why not?

Enter fabulous Fabrizio Saccomandi, the Italian Economy Minister with a simple solution.

From Reuters, Tuesday December 10:

> ***Italy backs 8 percent minimum bail-in for ailing banks***
>
> *Italy's Economy Minister Fabrizio Saccomanni said on Tuesday that public intervention on troubled banks should come after inflicting losses on bondholders through a*

minimum bail-in of 8 percent of total bank liabilities.

Note the word "minimum" in the last line.

Obviously, others in Euroland liked what breezy Fabrizio had to say, because of December 12..according to the Financial Mirror:

> ***After "Cyprus experiment", EP and Council reach deal on bail-ins***
> *Having experimented with the banks rescue in Cyprus in March, European Parliament and Council Presidency negotiators reached a political agreement Wednesday on the draft bank recovery and resolution directive, the first step towards setting up an EU system to deal with struggling banks. This directive will introduce the "bail-in" principle by January 2016, thereby ensuring that taxpayers will not be first in line to pay for bank failures.*

No, taxpayers will not be the first responders in the next great bank rescue...savers will be. And who the heck do they think savers are, if not taxpayers? If this were not so cruel and sick, it would be comedic.

So there you have it folks. If all else fails in Euroland, they simply steal...err...appropriate (much softer word) enough depositor funds to make everything good again. At least until the next time.

We wrote about this after the Cypriot tragedy and noted that Canada and many other "developed" nations have adopted bail in provisions to help deal with the next banking disaster (for there surely will be one). If you nasty savers won't tip the "growth fairy", then we'll simply dock your account while you sleep.

And speaking of docking accounts, just how did things pan out in Cyprus? Turning to Reuters yet again...July 28, 2013 (yes, a bit dated, we know)

> ***Cyprus, lenders set Bank of Cyprus bail-in at 47.5 pct, sources say***
> *Cyprus and its international lenders have agreed to convert 47.5 percent of deposits exceeding 100,000 euros in Bank of Cyprus to equity to recapitalize it, banking sources said on Sunday.*
>
> *Under a programme agreed between Cyprus and lenders in March, large depositors in Bank of Cyprus were earmarked to pay for the recapitalisation of the bank. Authorities initially converted 37.5 percent of deposits exceeding 100,000 euros into equity, and held an additional 22.5 percent as a buffer in the event of further needs.*
>
> *"There was an agreement concluding at a final figure of 47.5 percent this morning," a source close to consultations told Reuters.*

Well, isn't that just peachy. I wonder if those "large depositors" (read..."savers") were consulted on the size of the haircut? Of course, some cheesed off Cypriots are suing and we wish them luck...but they should remember that possession is 9/10ths of the law...especially the banking law.

But think about this for a second...through no fault of your own, other than being rude enough to save something rather than consume all your hard earned moolah, you lose almost half of your savings in order to bail out a bunch of profligate bankers. Somehow the idea of stealing the savings of folks in a country (Italy, in this case) where 40% of the youth are unemployed is not a good way to promote social stability and confidence.

But what would we know...we are neither bankers or politicians?

Don't think it can happen in the land of the free and the home of the brave. Sure it can. The enabling language is buried somewhere in Dodd Frank of course. You just can't make this stuff up.

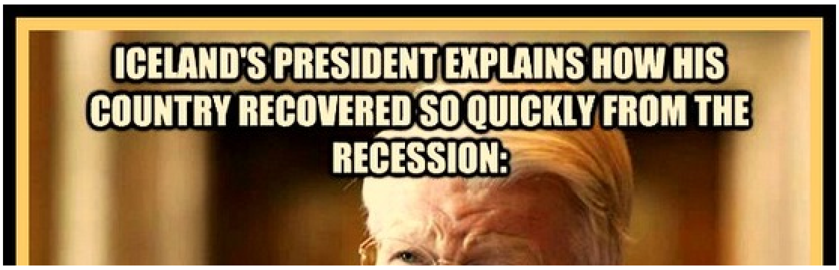
If you are interested in learning more about the whole bail in thing, you can click here or on the image below for a half decent and only slightly incendiary, synopsis.

Meanwhile, over in silly little Iceland...you know...the place where the whole Euro crisis kind of started...those descendants of Nordic marauders have gone nuts. They are actually jailing bankers. The nerve of them. You can't do that. You can bail them out and pay them big severance bonuses but jailing is out of the question.

From the BBC, December 12, 2013:

> ***Iceland jails former Kaupthing bank bosses***
>
> *Four former bosses from the Icelandic bank Kaupthing have been sentenced to between three and five years in prison.*
>
> *They are the former chief executive, the chairman of the board, one of the majority owners and the chief executive of the Luxembourg branch.*

Wow...maybe there is hope yet. But probably not. Even Iceland, for all their toughness, has adopted a bail in provision for future use. But, hey, it's a start. What about mandatory jail terms for breach of the new Volcker rule. That would give it some teeth, wouldn't it? Hah...dreaming again!



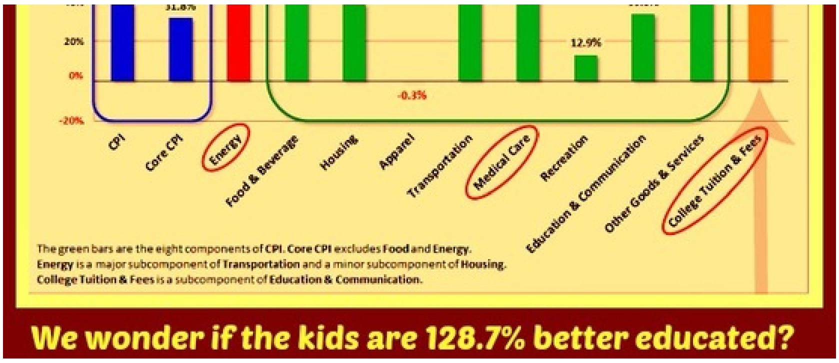
Rather than love, than money, than fame, give me truth.
Henry David Thoreau (1817 - 1862)

Paul Volcker tamed inflation through some heavy handed policy that included ultra high interest rates. Ben and Janet are trying to coax it back through a combination of ultra low interest rates and money printing on a breath-taking scale. Of course, we all know that inflation is already very much alive in select company, like artwork, high end real estate, pink diamonds, fast horses and even faster cars.

In many respects, it has also come to a theater near you, especially if you are in need of food, energy, health care or have the odd kid or two trying to get a decent "education".

The graph below, courtesy of Grant Williams in his oft quoted *Things That Make You Go Hmmm* from earlier this week clearly displays what we already know...most things, with the possible exception of clothing and electronics, are far more expensive than they were 10 years ago. The gentleman whom Grant borrowed this chart from, one Mr. Jim Quinn (there is nothing original in this world) said it best so we will shamelessly steal his words...with our own emphasis and comments added:

> *First things first.* ***Losing 39% of your purchasing power over the course of 13 years is criminal*** *[the Yankee dollar has lost that much value since Ben started printing]. This was purposely created by Greenspan/Bernanke and the Federal Reserve. My annual salary has not gone up by 39% since 2000. Therefore, I've lost ground.* ***I'm sure that most Americans have not seen their wages go up by 39% since 2000.***
>
> *But now we get to the falseness of the data. If the BLS measured CPI as they did in 1990, without all of their hedonistic adjustment crapola [he's referring to " hedonics" which you can read more about here if you are truly masochistic or click on " sorcery" or " alchemy" for the simpler explanation], it would exceed 60%. The housing figure of 39% is a pure lie.* ***Even after the housing crash, the Case Shiller Index is 50% higher than it was in 2000.*** *The houses in my neighborhood sell for an 85% higher price than they sold for in 2000. They can't fake the price of energy, so* ***the 121% increase is real****. They can't manipulate tuition costs, so the 129% increase is real. Are you really paying less for clothes today than you did in 2000?* ***The 68% increase in medical costs isn't even close to the real increases, which are above 100%*** *[yeh...but surely we can get a waiver from Obamacare like Harry, Nancy and the gang in DC, can't we?].*



Even the price of Christmas 2013 is up a stunning 7.7% over Christmas 2012, at least according to PNC Bank. You can check the prices of partridges and pear trees, jumping lords and dancing ladies yourself by clicking here.

So while Ben and Janet, who seemingly don't eat or drive a car (but thankfully, do wear clothes), would have us believe that core inflation is less than 2%, we who live in the real world wonder what life will be like if and when official inflation hits 4%...or 8%...or even 10%...as it was when Paul Volcker ascended the Fed throne in August 1979.

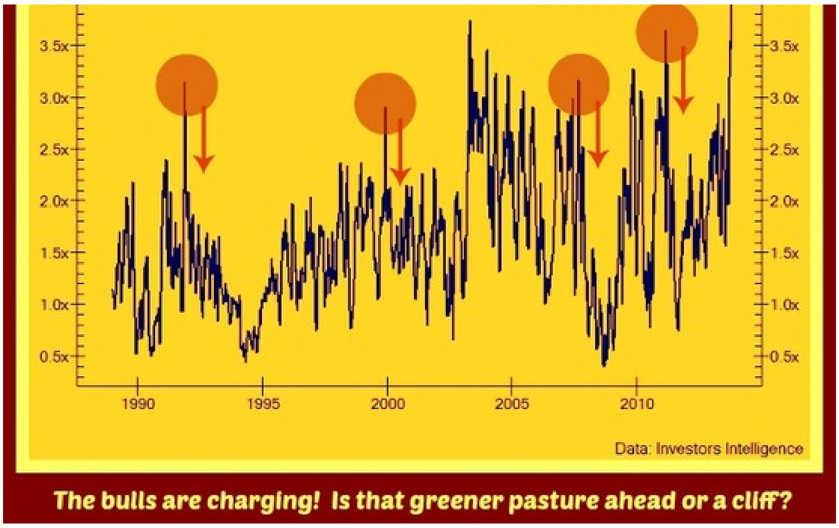
Hmmm...indeed!

CHART OF THE WEEK

J.P Morgan, when asked what the stock market will do, replied... It will fluctuate.

The latest Investors Intelligence report is out and comes complete with the increasingly interesting (and potentially perturbing) sentiment chart: The number of party bulls increased in number yet again and now stands at 58.2%, up from last week's 57.1%. This is another milestone high for 2013. We are getting closer and closer to the magic 60% of late October 2007, so the party at Club S&P can keep on rockin', especially if Ben and Janet keep a'pourin'.

But, as we've seen this week, it may make sense to know where the exits are, especially if Mr. Market makes another leap for that chandeleir.



Til next week...

"Ignorance is the curse of God. Knowledge is the wing wherewith we fly to Heaven."
William Shakespeare

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