A PEEK AT THE WEEK THAT WAS - January 11, 2014

Patient Capital.... Positioned for Profit

We apologize for a later than usual edition. Our excuse...snow storms, canceled flights, time differences, etc. Nothing too exciting but all legitimate during a northern winter. As such, this edition will be mercifully short.

Whenever you find yourself on the side of the majority, it is time to pause and reflect.

Mark Twain (1835 - 1910)

There is an old saying on Wall Street that as goes the first five trading days of January, as goes the month and as goes the month, goes the year.

Well, the first five trading days of January have come and gone and the action at Club S&P was a tad subdued. The S&P closed out the year at 1848.36 and by the end of the first five trading days, it was at 1837.49...down about 6/10ths of one percent. Hardly worth noticing and this is probably just an old brokers' tale anyway, but the last time the party at Club S&P was subdued at all during the first five days of January was in 2008. If you're intereested, you can read more about the so-called January effect by clicking here and here.

During the same first five trading days...on day three, in fact, Monday January 6, Jaunty Janet Yellen was officially ordained as Bartender Ben's successor on the 24/7/365 shift at Club S&P. From the Washington Post, Monday, January 6 [yes, emphasis ours, as usual]:

> *"She (Jaunty Janet) has proven through her extensive and impressive record in **public service and academia** that she is most qualified to be the next chair," Sen. Tim Johnson (D-S.D.) said Monday. "**Americans should feel reassured that we will have her at the helm of the Fed** as our nation continues to recover from the Great Recession."*

Call us crazy, but the thought of having an academic with absolutely no real life business experience, in charge of saving the world from Bartender Ben's unintended consequences is not reassuring to us at all. We suspect that our Janet may face a tumultuous period as she attempts to pull back on the pours at Club S&P.   Even Bumbling Bill Dudley, of the NY Fed (himself an avid advocate of more vodka in the punch bowl) has his concerns. Again, from the Washington Post:

> *"There is **no question there could be unintended consequences**," New York Federal Reserve Bank President William Dudley said at a conference in Philadelphia on Saturday, describing the challenge*

that Yellen and other central bank officials will face in coming years.

Believe us when we tell you that Jaunty Janet will encounter historic challenges during her term as Fed chair. She seems nice enough so we would like to think that she is up the challenge...for challenged she surely will be...on multiple fronts. Some are foreseeable. Many are not...for they will be borne of Ben's unintended consquences and who knows how many of those are lurking out there.

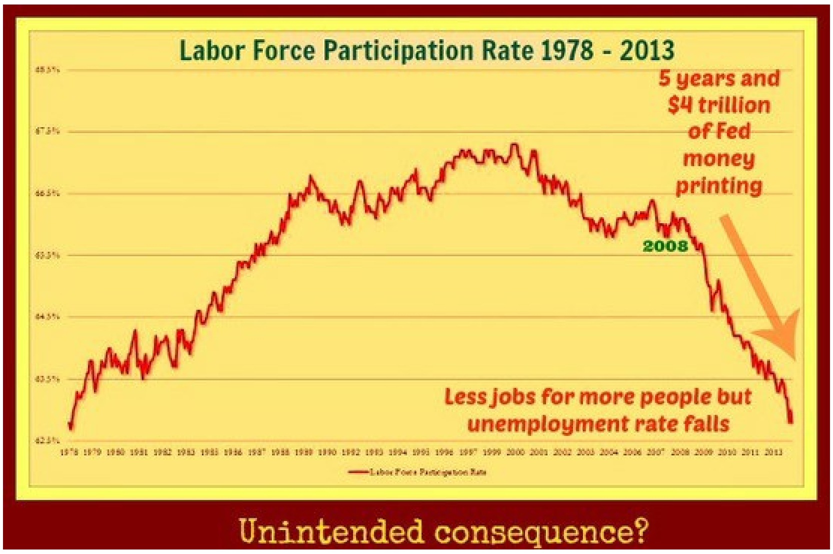
As we learned last week, the Fed has been taken over by academics, posing as proxies for the bankers. Academics rarely worry about unintended consquences, because those consequences are normally not that prevalent around the institutions of "learning" that these academics typically retreat to after the damage is done. But those same unintended consequences have a nasty habit of lurking about the homes and neighorhoods of normal people, upon whom they have an all too real and hard impact.

Case in point...the most recent unemployment numbers...and headlines like this from NBC...

Job growth weakest in 3 years; unemployment rate falls

How can the unemployment rate fall when there are less and less jobs available. It just doesn't make sense, does it?

Yes, the unemployment rate dropped to 6.7% but that's only because more "normal" people have given up looking for work as, in their real world, there are no real jobs. If people give up looking for work, they just don't count when it comes to the unemployment statistics...literally. Take a look at the chart below, courtesy of ZeroHedge and note how, in the real world, the labor participation rate has declined.



During December the civilian labor force dropped by almost half a million souls, from 155.3 million to 154.9 million, a fresh 35 year low. We have not seen participation levels this low since way back in the hard rocking days of 1978. So much for throwing funny money at the problem. Oh...and as we mentioned last week in our look at the numbers, Americans not in the labor force exploded higher by 535,000 to a new all time high of 91.8 million.

This is scary stuff, borne of Ben's unintended consequences. The stock market goes up, the labor participation rates goes down. Fundamentally strong markets are not made of such stuff.

For more insight into the latest jobs numbers, click here for a short and sharp expose by a gentleman named Paul Craig Roberts.

Now, let's take a look to see how Ms. Bond behaved during the first five trading days of the year. The yield on her 10 year Treasury dropped from 3.026% down to 2.99%...and then to 2.96% before falling to a low of 2.85% after the above mentioned jobs numbers.

So in the past year or so, the 10 year treasury...a benchmark for so much of the interest rate world...has ranged from a low of 1.62% up to 3.06%...almost twice as high. That's a big range for something that is supposed to be sure and true. More of the Fed's unintended consequences as the bond market seeks reality in an unreal ZIRP world.

Take a look at the chart below which shows Ms. Bond's 10 year treasury in action during 2013. That is a pretty impressive rise...unless, of course, you happened to have bought the 10 year when it was yielding 1.62%. If you did, you just saw the effective value of your bond go down by almost 50%. Ouch!. And as we noted in the chart itself, let's not forget that the 50 year average for the 10 year is around 6.5%.

How would you feel about collecting 1.62% for 10 years when your neighbor on the left is getting 3% and your neighbor on the right is getting 6%?. Probably not very good. But trust me...Ben and Janet don't care! You should though!

Over at the Gold Bar, the first five trading days have been interesting too. January 2 and 3 were strong. The patrons were happy. The next week, the pillaging continued with the big boys selling a lot of paper and driving the price down from $1,244 per ounce on Monday to $1,219 on Wednesday. Friday saw the shiny stuff basically going vertically back to as high as $1,247. The action is interesting. The big bankers are manipulating while the Asians are buying and hoarding. Who wins? We suspect that ultimately the golden rule will prevail...they who have the gold (in their hands) make the rules.

As the chart below shows, the timing of the trading is not even subtle. While the Gold Bar patrons were not surprised by the usual muggings on Wednesday and Thursday, the "slam up" on Friday may have surprised them. There is a persistent bid for both gold and silver but each time the price pushes past a point, the big paper sellers arrive to dump their pseudo-hard stuff. Friday's action is therefore even more intriguing. We will watch with interest what the rest of January brings. While we suspect that their will be a continued push to keep the precious metals from their true market price, the golden rule may already be in effect.

Notice the similarity of the timing of the "big trades" on all three days....this is no ordinary market

Other than our comments above, we'll leave the Fed alone this week....other than suggesting that you take a moment to read an interesting commentary on that hallowed, "independent" agency and it's 100 year anniversary by a long distance observer. He's an Argentinian and as such, has some first hand experience of the practical effects of financial shenanigans.

It won't take long and you may find it well worth your time. Click here for the link to the Russia Today website which carried the piece. Isn't it fascinating...and not the least bit disconcerting...that one has to go to the online news site of a former foe to find a critical assessment by a foreigner of one's own central bank. Such is the world in which we live.

After much threatening, we will finally take a somewhat delayed look at Europe this week. It will be relatively brief and focused on some potential secessionist hotspots. If we have time next week, we'll look at more hard numbers.

Our chart of the week takes a peek at the divergence in labor participation rates among the over 65s and the under 65s. The result may surprise you but the reasons shouldn't.

Let's get started...with a relevant giggle.

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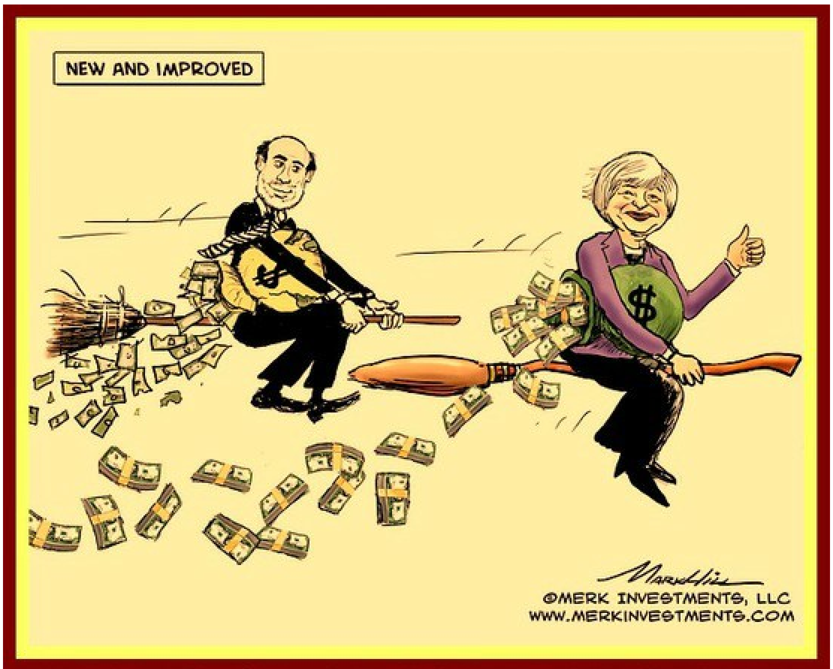


Watch out for that unintended consequence ahead Janet

No man is an Island, entire of itself; every man is a piece of the Continent, a part of the main; if a clod be washed away by the sea, Europe is the less, as well as if a promontory were, as well as if a manor of thy friends or of thine own were; any man's death diminishes me, because I am involved in Mankind; And therefore never send to know for whom the bell tolls; It tolls for thee.

John Donne (1572 - 1631)

We've not heard much about Europe recently in the news so we can presume that everything is just peachy over in the Eurozone, can't we? Latvia, with its 2 million struggling souls was just admitted as a member. Greece is off the front pages. Portugal and Ireland are back borrowing through the markets at reasonable rates of interest. Spain is under control. As is Italy. France is...welll...France is still France. So everything is good, right?

Well, maybe so and maybe no.

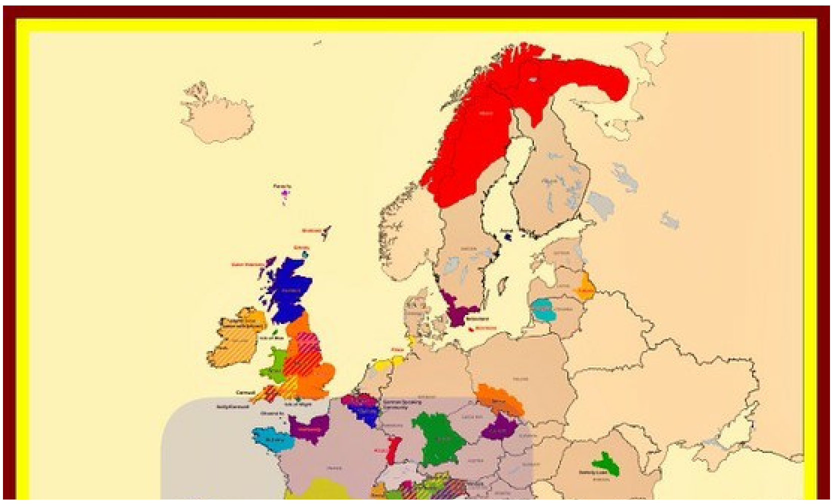
If you ask the Euro politicians and bureaucrats in Brussels, things are fine. If you ask the ratings agencies, you may get a different response. In fact, late last year, Standard and Poors brought down the hammer on the Eurozone's top credit rating. From Bloomberg News, December 20:

> ***European Union Stripped of AAA Credit Rating at S&P***
> *The European Union lost its top credit rating from Standard & Poor's, which cited the deteriorating creditworthiness of the bloc's 28 member nations.*
>
> *S&P cut its long-term rating on the EU to AA+, with a stable outlook, from AAA and maintained its short-term rating at A-1+. The downgrade came after S&P last month lowered its AAA rating on the Netherlands.*

France's president Hollande said in response to S&P's decision that it changes nothing. Bien sur, messeiur! The market barely noticed. That's the problem with markets. They barely notice, until they do. What might possibly make them take notice this time. Probably nothing because Europe is such a tightly knit homogenous gaggle of semi-related kin folk who all adore each other.

But just for the fun of it, let's take a look at some of the potential hotspots for a secessionist spat or two. Interestingly enough, from Wikipedia, we find that in countries from Albania to Wales, there are at least some folks who are not too happy with the status quo.

The graphic below, again from Wikipedia, shows the countries which have some degree of secessionist or separatist sentiment. Notice how much color there is in Spain, France and Italy...not to mention the UK. To dig deeper into this morass, click here for the relevant Wikipeda page.



The reality is that Europe is not one big happy homogenous family but more of a hotbed of tribal animosity and resentment going back centuries. Give credit to the bureaucrats for trying to bring them all together under one peaceful monetary union but bear in mind that there are many who prefer autonomy, with willing politicians ready to pounce on populist opportunity.

To view an excellent time lapse video showing the evolution of European borders over the past 1,000 years, click on the image below left. It is illuminating to say the least. If you are a real history buff and have time, click on the image below right to see how Europe has "progressed" from 3000 BC to the present day.

In either case, you'll notice that there has been an absolutely amazing movement in the borders of our modern nations over that time. Given that history, to expect everyone to be cosy and rosy forever under the current union is quite optimistic.

Let's take a peek at some of these secessionist shenanigans, shall we?

From NewsEurope, September 22, 2013: [emphasis ours]

> *Throughout Europe there are various regions hoping to secede from the larger country they are tied to. These movements are all at different stages with different degrees of demand. While some of these divisions may have been caused by the tensions of the recent economic crisis, many of these secessionist movements come from deeper conflicts found in culture and history, perhaps exacerbated by recent developments. A common theme for all of them, however, is the shared desire to be autonomous.*
>
> *One of the most well known separatist movements is found in Spain. The region of **Catalonia** has been fighting for independence for years. For the people of Catalonia, Spain has suppressed their culture since the times of Franco. While the movement to secede has been in action for years, it continues to gather momentum. **Catalonia is now attempting to push through a referendum regarding its independence**.*
>
> *Similarly, there is growing support for the secession of **Scotland** from the United*

> *Kingdom. There is a **planned independence referendum to take place in September of 2014**. While Scotland does not have the same overwhelming support for secession that is found in Catalonia, there are many people who feel Scotland is no longer fairly represented in the British Parliament.*
>
> *Another well know separatist movement can be found in **Belgium**. Between Flanders of the north and Wallonia of the south, Belgium is split in two. The desire to partition the country stems partially from cultural and language differences and partially from economic differences. The tensions between these two regions continue to increase and **the demands for separatism have only gotten stronger.***
>
> *There is another struggle for independence occurring in the **Basque region of Spain**. Compared to the other separatist movements, the desire for independence in Basque country has an additional element of violence. The Basque country previously faced a four-decade period of armed violence against Spain and France. While the majority of the violence has come to an end, **the separatist movement is still at the forefront of regional politics.***
>
> *Previously, there has also been **separatist behavior in northern Italy**. The area of South Tyrol began demanding independence not long after the beginning of the economic recession.*

So, there we have just a few hot spots. The Catalans will follow Scotland with a referendum for independence in November, 2014. The Spaniards have vowed to stop them. The Catalans have responded that the Spaniards will not have enough tanks to do so. Didn't Spain just have a civil war last century? Too much hot latin blood there perhaps but we hope sanity does prevail. The Spaniards can't afford to lose Catalonia as it is one of their most productive regions, but many Catalans seem determined to have their independence.

From Russia Today, December 13, 2013:

> ***Spain 'won't have enough tanks': Catalonia to vote on independence, defy Madrid***
> *The Catalan regional parliament has set November next year for a referendum on the Spanish province's independence. The government in Madrid blandly said the vote won't happen, but activists wonder how it might be stopped.*
>
> *Catalonia's four pro-independence parties, which hold a majority in the regional parliament, announced Thursday that the rich industrial Spanish province will hold a referendum on whether to gain greater autonomy or even total independence from the country's central government.*

Shades of 1914 indeed! This should make for an interesting 2014 in Europe. Bien sur, madam!

CHART OF THE WEEK

Retirement is the ugliest word in the language.
Ernest Hemingway (1899 - 1961)

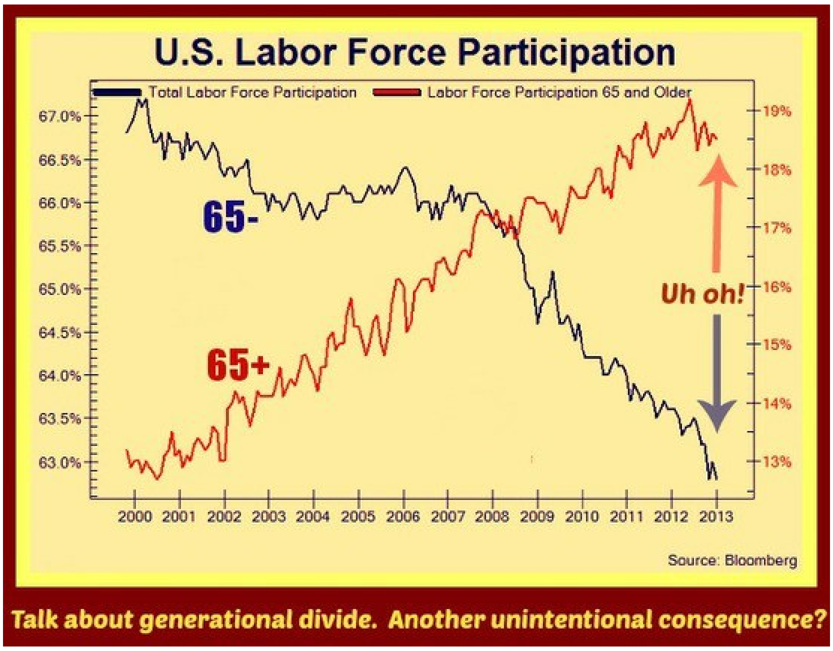
Earlier in this week's Peek, we discussed the latest unemployment numbers and the drastic drop off in the overall job participation rate. The graph showed an overall slide of serious proportions. However, when we bifurcate the numbers between those over and under the traditional retirement age of 65, we get an entirely different picture. Those over 65 are participating more and more, while those under 65 are dropping off like flies.

This is interesting...and we suspect, yet another unintended consequence of Bartender Ben's largesse to his banker buddies. Yes, there is no question that people are living longer and for the most part, healthier lives. And yes, it is also somewhat natural that those seniors would want to keep active and involved. And maybe Hemmingway is right about retirement being ugly, but ugliness, like beauty, is in the eye of the beholder.

In reality, many of those over 65 workers would choose cushy retirement if they could afford to do so...and there's the rub. They don't have the money and therefore, the choice. Successve market wipeouts in 2000 and 2008 have taken their toll of stock buyers and Ben's ZIRP has punished those invested in bonds and savings accounts. The 65 and over crowd may want to work or may not. But many of them have no choice other than to participate...to the chagrin of those 'younger" folks who can't find a job of their own and are just giving up.

Yes, it's sad...but it's the real world. It's not Princeton Ben...and it's not Stanford, Janet. It's Everytown USA...and it's rotten and it's sad. And it's an unintended consequence of years of Fed meddling and protection of Too Big To Fail (but not to profit) Banks. And it's the false reality of an academically artificial world.

And as we closed last week, we say again...reality eventually bites!



Til next week...

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

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