



A PEEK AT THE WEEK THAT WAS - January 25, 2014

*Patient Capital... Positioned for Profit*

***"A pack of lemmings looks like a group of rugged individualists compared with Wall Street when it gets a concept in its teeth."***

Warren Buffett (1930 - )

Lemmings...those little rodent creatures found in colder climes, actually don't commit mass suicide as is popularly thought. But the lemming like mass behavior concept is well ingrained in our culture so let's go with Warren on this one. Why? Well, because last week the rodents were jumping ship at Club S&P, en masse. Supposedly, it was a currency crisis in the emerging markets that set off the stampede as fears that Jaunty Janet Yellen will pull back the pours sent the local currency of many countries into a spin. From [Bloomberg News](#), January 24, 2014 [emphasis ours]:

***Contagion Spreads in Emerging Markets as Crises Grow***

***The worst selloff in emerging-market currencies in five years is beginning to reveal the extent of the fallout from the Federal Reserve's tapering of monetary stimulus, compounded by political and financial instability.***

***The Turkish lira plunged to a record and South Africa's rand fell yesterday to a level weaker than 11 per dollar for the first time since 2008. Argentine policy makers devalued the peso by reducing support in the foreign-exchange market, allowing the currency to drop the most in 12 years to an unprecedented low.***

***Investors are losing confidence in some of the biggest developing nations, extending the currency-market rout triggered last year when the Fed first signaled it would scale back stimulus. While Brazil, Russia, India, China and South Africa were the engines of global growth following the financial crisis in 2008, emerging markets now pose a threat to world financial stability.***

In fact, emerging market currencies came under intense selling pressure all through the week. Most dramatically, the Argentine peso sank 15.1%. The Turkish lira fell 4.4%, the Brazilian real 2.3%, the Russian ruble 2.9%, the South African rand 2.0%, the Chilean peso 2.0%, the Colombian peso 1.5%, the South Korean won 1.9%, the Indian rupee 1.8%, and the Mexican peso 1.6%.

Yes, folks, as we wrote about this last year when the Fed started hinting at tapering, many

emerging markets went into temporary shock mode. Then Bartender Ben thought better of reducing his pours and the problem appeared to disappear. But as last week showed, it has not. Ben's seemingly limitless money printing, designed as it was to artificially inflate asset prices so people would feel richer and spend more, really did neither. Most people don't feel richer and spending, as we've seen, is not exactly robust.

But a lot of that funny money did find a temporary home in foreign places, falsely implying that the locals were richer than they thought too. Now, that hot money is retreating...the tide is going out...and it appears that a lot of foreign folks were lolling about in Ben's liquidity bath without their fiscal swimsuits. So we see another of our beloved Ben's unintended consequences coming home to roost. And it is now upsetting the party goers at Club S&P.

The flashing neon "1800" sign is down, as the fabled S&P 500 slipped 55 points or so on Thursday and Friday. Mr. Market is worried...no where near depressed (yet) but certainly perturbed. He was so close to that chandeleir he could taste it. We suspect that he'll have another shot at swinging from it, once the merry mainstream media and the lovebirds on CNBC recommence their gibberings about all being well with the world. But ultimately, perhaps after one last gallant attempt, Mr. Market will crash and burn and his rehabilitation may take some time.

Meanwhile, Ms. Bond continues to watch Mr. Market like a hawk and her 10 year Treasury yield dropped from around 2.86% to close the week at 2.735%, with the big drop in yields corresponding with Mr. Market's swoon on Thursday and Friday. Ms. Bond is certainly concerned. She sees what is going on in the world (except, perhaps for Europe) and not all of it is pretty, as we'll find later in this week's Peek.



While Mr. Market swooned and Ms. Bond surveyed, the Gold Bar was celebrating. Well, not exactly celebrating but at least the patrons were feeling a little more chipper than they have been for a long time. They are beginning to think that the slump in their precious precious metals may be coming to a close as gold jumped from \$1,232 to \$1,275 per ounce in less than two days. You can probably expect more of such jumps, both up and down, as this game of chicken plays out.

As we wrote last week, a number of the big bank bullies have other ideas on what gold's price should be. Just last Tuesday, Morgan Stanley came out with their price predictions for 2014 and 2015. Once again, from [Bloomberg News](#), January 22, 2014:

***Gold Target Cut by Morgan Stanley Seeing 'More Pain to Come'***

*Gold will extend declines this year as gains in equity markets reduce the need for haven assets and increased regulation hurts risk appetite, according to Morgan Stanley, which lowered its bullion forecasts.*

*The 2014 target was cut 12 percent to \$1,160 an ounce and the prediction for 2015 reduced 13 percent to \$1,138, analysts Peter Richardson and Joel Crane wrote in a report today. Gold remains under pressure as the global recovery gains traction, increasing the risk of higher interest rates, they wrote.*

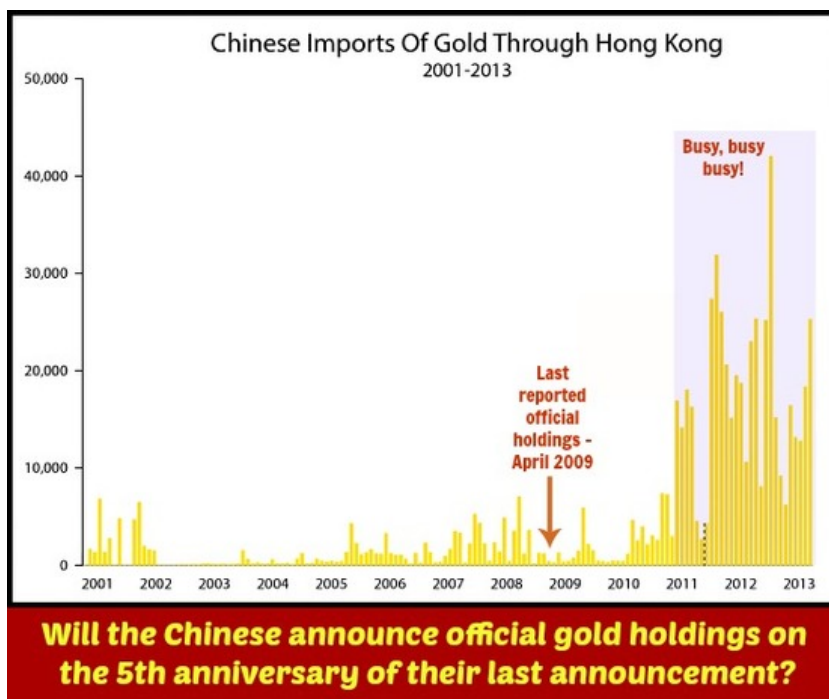
We're not sure what Messrs. Richardson and Crane are smoking or even what planet they are referring to. They are calling for a rosy globe and a reducing need for gold as a "safe haven asset". We beg to differ and offer in evidence another piece from Bloomberg News, January 24, 2014:

**Gold Mint Runs Overtime in Race to Meet World Coin Demand**

*Austria's mint is running 24 hours a day to meet orders for gold coins, joining counterparts from the U.S. to the U.K. to Australia in reporting accelerating demand boosted by the bear market in bullion.*

People are getting physical about their gold...oops...is that Olivia Newton-John song back in your head...after it took you most of last week to get rid of it. Sorry about that! But it is a fact, We have written often about the physical demand for bullion and coins, especially in China and India, where it is believed that every incoming international flight is chock full of Indians returning home with their legal limit of gold and gold jewelry. For example, on a recent flight from Dubai to India, almost every passenger was carrying the legally permitted limit of one kilo (2.2 lbs) of the shiny stuff.

As the graph below illustrates, the Chinese have been busy beavers in the gold import stakes themselves. And let's not forget that they keep every ounce of gold they mine in the Middle Kingdom...and they mine more than any other country on the planet...estimated at around 430 tonnes per year. In 2012 Chinese gold consumption was 832 tonnes and is estimated to have exceeded 1,000 tons in 2013 (you can do the math in calculating the shortfall between domestic supply and domestic demand).



As you may have noticed, the last time those canny Confucians announced their official government gold holdings was way back in April, 2009, when they proudly proclaimed that they were holding about 1,050 tons of the shiny stuff. They are expected to update that number shortly...and the result may be very surprising to many. From the [ShanghaiDaily.com](http://ShanghaiDaily.com), January 17, 2014,;

**China expected to announce it has more than doubled gold reserve, expert says**  
*CHINA may soon announce an increase in its official gold reserve from 1,054 tons to 2,710 tons, Jeffrey Nichols, managing director of American Precious Metals Advisors,*

said.

We suspect that the good Mr. Nichols may be somewhat short in his estimation. The Chinese could announce north of 3,000 tons or more, which could have them leapfrog from #5 to #2 in the world rankings...but still well behind Uncle Sam, who reputedly has over 8,000 tons...not including what he is "storing" for the Germans. Incidentally, last week we erred when we said that the US had only returned 37.5 tons of the Germans' own gold back to them. Apparently, our total was out by around 32 tons, which apparently came from Paris, not New York...presumably in armored trucks. In reality, despite the fact that the US has over 8,000 tons of gold, we could only return a measly 5 tons to those increasingly impatient Germans. Go figure!

The Germans are not impressed and after the NSA spying debacle, are starting to politely point fingers and ask questions. From Die Welt, January 19, 2014:

***The whole truth about the gold of the Bundesbank***

*300 tons of gold to be fetched from the cellar of the Federal Reserve in New York to Germany. Now explains the Bundesbank: Only five tons have arrived. Why is all this so difficult?*

You can read the whole article (in German or English) by clicking [here](#).

---

Moving along, this week we'll take another peek at the Middle Kingdom where we notice that the shadow banking system is starting to fray around the edges. And we'll peek at a potential default on January 31, the Chinese New Year, which may send shockwaves to many Chinese investors who may be about to learn the hard way that if something seems like it's too good to be true, it probably is.

And while we are there, we'll take a further peek at the growing hostility between China and old foe, Japan.

Then, we'll pop over to Europe to find out why someone near and dear to Ms. Bond, is worried...and wonder why everyone is so willing to lend their money to countries who really have not cleaned up their act much at all.

If we have time and space, we'll head south of the border to Argentina, we find that they are back to their perennial financial shenanigans and that, needless to say, the natives are restless.

Our chart of the week shows just how much global markets have gone up since Ben started lacing the punch bowl...and how much they could go down, in the event of a 2008 style reset.

Let's get started....after a (slightly rude) Aussie giggle which is a bit dated but oh so typical.

And to all our readers downunder, Happy Australia Day!





***Well first of all, tell me, is there some society you know of that doesn't run on greed? You think Russia doesn't run on greed?  
You think China doesn't run on greed?***

Milton Friedman (1912 - 2006)

Some Chinese investors may learn, as many a Western investor has already, that greed (sorry Gordon Gecko) is not always good.

A number of years ago, Chinese investors were seduced into investing in newly created "Wealth Management Products" or "Trusts", that promised things like a sweet 10% annual return. The demand and the supply of these products exploded and the asset base grew fast. According to the China Trustee Association, the assets managed by some 67 Trusts had grown to \$1.67 trillion by last September. That's a lot of yuan. Unfortunately, it is not exactly clear how many of these trusts are, in fact, trustworthy. One in particular...the inappropriately named **2010 China Credit Equals Gold No. 1**...is apparently about to blow up. From [Forbes](#), January 19, 2014:

***Mega Default In China Scheduled For January 31***

*On Friday, Chinese state media reported that China Credit Trust Co. warned investors that they may not be repaid when one of its wealth management products matures on January 31, the first day of the Year of the Horse.*

From [Bloomberg](#), January 24, 2014:

***China Trust Products Gone Awry Evoke Soros Crisis Echoes***

*The story of how a 3 billion-yuan (\$496 million) Chinese trust investment wound up on the brink of default shows what billionaire investor George Soros has called the "eerie resemblances" between the 2008 global financial crisis and the nation's debt market.*

Apparently, the money raised in this "trust" was loaned to a private coal company and surprise, surprise...things haven't turned out exactly the way the promoters planned. Now the Chinese are facing their "Hank Paulson" moment...do they bailout those unwitting investors or do they let the market teach them a lesson? Of course, in the West, just print, baby, print and bail out the bankers. But in China, they have a habit of actually punishing bad guys.

How passé, how primal, old sport. Bankers in jail...can't have that in civil society!

You can read more by clicking [here](#) for an excellent overview at ZeroHedge, or you can click on the articles above. But we suggest that it's worth keeping an eye on. Trouble in the world's second biggest economy and our biggest creditor is not a particularly good thing.

Something else to keep an eye on is the increasingly nasty rhetoric going back and forth between China and Japan.

As you will recall, they are having a squabble over some rocks in the East China Sea.

Then Japanese Prime Minister Abe visited a military shrine which the Chinese aren't too fond of. Then said Mr. Abe, who seems to be angling for a fight, stated that China would be better off spending money on improving their society as opposed to building up their military (even though Abe san is doing just that himself). Of course, this suggestion of butter before bayonets, on its face sounds wise, but to the Chinese it was a red flag to a bull.

Then the same Mr. Abe, being on a bit of a roll, suggested that the two countries were embarking upon something akin to the relationship between England and Germany in 1914...and we know how well that worked out. More red flag, more bull snorting.

Well, it all came to a bit of a head at the annual Davos economic shindig when China's foreign minister, Wang Yi, had heard and had enough. From [The Telegraph](#) (UK), January 24, 2014 - Ambrose Evans-Pritchard reporting:

***Japan-China war of words goes ballistic in Davos***

*Anybody who thinks China's dispute with Japan is subject to rational calculation should have heard the astonishing outburst a few minutes ago by China's foreign minister, Wang Yi.*

*"We will never allow past aggressors to overturn the verdict of history," he began. It went downhill from there.*

*When asked what he thought about the latest warning by Japan's leader Shinzo Abe that the two countries are like England and Germany in 1914, he exploded with barely contained rage:*

*"Why would he make such a statement? Japanese leaders like to rewrite their history, but the Chinese people cannot forget episodes of history. The invasion of Manchuria in 1930 was an infamous chapter in Japan's history. In 1937 they instigated the Marco Polo bridge incident before launching an all-out onslaught on China.*

*"Thirty-five million Chinese soldiers and civilians were killed. Who was the instigator? Who was the troublemaker? It is all too clear."*

The Chinese are not known for outbursts, especially in delicate matters like foreign affairs.

This brooding issue is bad enough but any such problem can be made far worse by bad economic circumstances when desperate politicians use convenient scapegoats to raise nationalist fervor as a way of distracting the punters from their real problems...which are always economic. If China's shadow banking and general economy goes south then this little spat between Asian neighbors could become potentially inflammatory stuff.

Best to keep an eye on where everyone has their matches...and their flame throwers...stored.



Source: AP / The Telegraph

And while we're on China and things economic, the US Securities and Exchange Commission (SEC) has kind've gone where no regulator has gone before...or at least recently...and come down hard on what we might call a lack of transparency in Chinese accounting standards. From [Russia Today](#), January 23, 2014:

***SEC suspends Chinese units of 'Big Four' accountants over audit secrecy***

*A US Security [sic] and Exchange Commission (SEC) judge has suspended the Chinese units of the so-called 'Big Four' accounting firms including Deloitte and KPMG for refusing to release audit information on China-based firms listed in the US.*

*SEC Administrative Law Judge Cameron Elliot suspended the Chinese subsidiaries of Deloitte & Touche, Ernst and Young, KPMG, and PricewaterhouseCoopers, saying they united had "willfully violated" US laws.*

*The China-based affiliates - BDO China Dahua, Deloitte Touche Tohmatsu Certified Public Accountants, Ernst & Young Hua Ming, KPMG Huazhen, and PricewaterhouseCoopers Zhong Tian refused to present data about companies based in China and listed in the US, saying they tried to comply with Chinese secrecy laws.*

Yes, it just gets curiouser and curiouser....especially for investors.

---

***We hope to see a Europe where men of every country will think as much of being a European as of belonging to their native land, and that without losing any of their love and loyalty of their birthplace.***

Winston Churchill (1874 - 1965)

Winston Churchill saw much trouble in Europe during his adult years. In fact, he lived through a time of multiple conflicts, from the Crimea to the devastating disasters of two world wars in relatively quick succession. Clearly he hoped that there would be no more. And so do the EU bureaucrats in Brussels. We wish them well too, for clearly an economically aligned Europe with free trade and free passage of both humans and capital makes sense.

But as we pointed out two week's ago, Europe is a tribal mishmash. The Greeks ARE different from the Germans. The French are not the same as the Finns. The Brits bristle at the Basque. The Slovaks like the sun but they are not Spanish. You get our point. People are different and think and behave differently. So getting everyone thinking and working alike is much more difficult than enacting a set of regulations and employing a bunch of bureaucrats to enforce them.

But a big part of the investor community obviously thinks the EU can and will become one big happy, united and loving family. Clearly this is so, because they are increasingly willing to lend money to sickly Eurozone countries for less than healthy rates. From the [New York Times](#), January 21, 2014:

***Banks Take On European Debt, Despite Underlying Problems***

*ATHENS — A wave of euphoria has swept over financial markets because investors now think Europe's sovereign debt crisis may be ending. But the enthusiasm masks a lingering problem. The harsh austerity programs used to regain their confidence have fanned deep recessions and high unemployment across Southern Europe.*

*Emboldened by promises from Europe's central bank to do "whatever it takes" to keep financial crisis at bay, investors are rewarding countries for sticking to their medicine.*

*In the rush to grab profits, said Mohamed A. El-Erian, the chief executive of Pimco, one of the world's largest bond investors, "investors are choosing to overlook all sorts of things."*

What things? Well...silly little things like staggeringly high unemployment, especially among the young, entrenched systems of labor and work regulations, dwindling demographics, the potential for social upheaval in places with high immigrant populations, the rise of increasingly populist and nationalist political parties and personalities, etc.. Add to that the fact that way too many loans on the books of banks, especially in Spain and Portugal are of the "extend and pretend" variety and you have any number of reasons to be concerned about the economic future of the Eurozone.

Let's just take a quick look at Italy, shall we. From ZeroHedge, January 21, 2014 [emphasis ours]:

*With all eyes gloating over Ireland's recent ability to issue debt in the capital markets once again (and now with 10Y trading only 40bps above US Treasuries), Europe's game of distraction continues. However, while spreads (and yields) tumble in all the PIIGS, with Italian yields at almost 7-year lows, it is perhaps surprising to some that **Italian bad loan rates are at their highest on record. Having risen at a stunning 23% year-over-year - its fastest in 2 years, Italian gross non-performing loans (EUR149.6 billion) as a proportion of total lending rose to 7.8% in November (up from 6.1% a year earlier).** As the Italian Banking Association admits in a statement today, **deposits are declining (-1.9% YoY) and bonds sold to clients (-9.4% YoY) as Italy's bank clients with bad loans have more than doubled since 2008.***

So...bad loans up, deposits down. Italian poverty rate soaring. Sure...why not lend them money...at cheap rates? We're sure they're good for it. Just ignore the chart below, which clearly shows that someone is not paying attention.



Returning once more to the Gray Lady's (NYT) article [emphasis ours]:

*But as has happened many times during the crisis, in the absence of pressure from financial markets, governments lose the will to carry out change seen as necessary to build a healthier base for future growth. In Italy, where a market panic in 2011 helped force then-premier Silvio Berlusconi from office, his successor Mario Monti soothed fears by pledging a spate of structural changes. Once markets calmed, the Italians returned to procrastinating.*

*With so many uncertainties still swirling, Mr. El-Erian said, "the jury is still out on what will happen in Europe."*

As the graphic below, courtesy of [The Economist](#), there are a lot of countries and a lot of



moving parts and a lot of diverse things that have to go right for this to end well. If we were a lender to Europe, we would be looking for healthier rates than what is being offered right now. Perhaps the Chinese will feel like lending, assuming they get their money back from the infamous **2010 China Credit Equals Gold No. 1**.



**CHART OF THE WEEK**

*"There are two times in a man's life when he should not speculate - when he can't afford it and when he can."*

Mark Twain (1835 -1910)

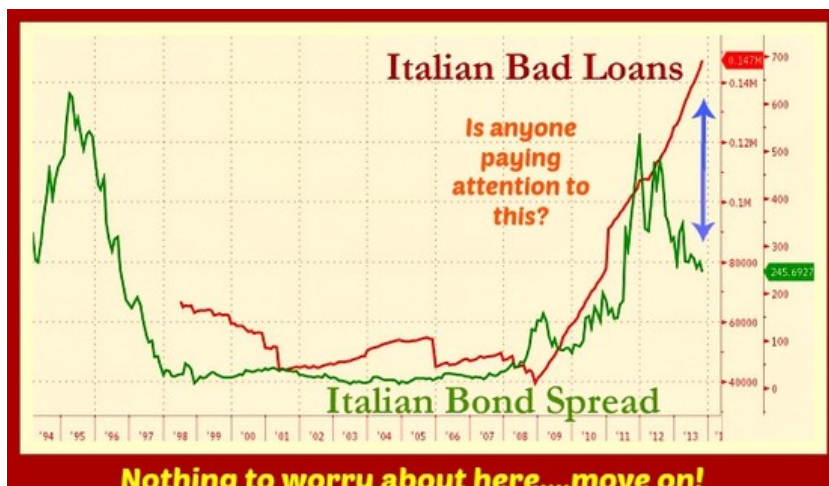
No time for a trip to Argentina this week but it will still be there next week and probably even more interesting by then.

Our chart of the week, which we borrowed from Ed Steer, via Nick Laird of Sharelynx, tracks the average performance of global markets. Think of it as a whole world Mr. Market.

Notice the similar trajectories between 2003 - 2008 and 2009 - 2014. Similar time periods, similar trajectories and both the by-product of Federal Reserve policy of easy (funny) money.

But there's probably nothing to worry about. Jaunty Janet will have our back. The Chinese and Japanese can sort out their own problems. Europe is under control and doing well.

There's really nothing to be concerned about at all! Best to concentrate on working out the odds for the SuperBowl.



Til next week...

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



[www.cravencapital.com](http://www.cravencapital.com)



212 797 0217



[bmacnish@cravencapital.com](mailto:bmacnish@cravencapital.com)

**Craven Capital is located at 11 Hanover Square, 6th Fl., New York NY 10005**

The information above is not and is not intended to be considered or treated as legal, tax or investment advice. Please consult your own lawyer, accountant or investment advisor on such matters.

11 Hanover Square 6th Floor | New York, NY 10005 US

