Money, Macro & Markets

Two more prime examples of Keynesian lunacy this week to keep you smiling (even if only through gritted teeth).

Firstly, Richard Jerram of Macquarie Capital whose 'holey dollar' emblem must be getting to his cognitive faculties. Like many a crude underconsumptionist before him, what the worthy Mr. Jerram recommends for Japan (and not on the first of this month, either) is a good dose of monetary disruption to jolt it out of its perverse reluctance to repeat the mistakes of two decades ago.

"You need to tell the public that the last 10 to 15 years have been a terrible mistake. It's a question of whether you want a crisis now or a crisis later." The solution, it seems, is to set short-term interest rates at minus 3-4% (sic). *"The idea that nothing can be done is a fantasy. If you fight deflation, it appears to hurt pensioners and lower income workers, but it might be better in the long term."*

Well, that certainly would give us the crisis he seems to want to enjoy now. What our Richard appears to have overlooked in his rush to get all Gesellian is the global shockwave such a drastic act of folly would unleash – by destabilising exchange rates, nitro-boosting commodity prices, and disrupting asset markets – Oh! We forgot – that's exactly what Mssrs. Bernanke, Trichet, King & Zhou have been about for much of the past two-and-a-half years!

Next up was the famously irascible Pascal Lamy, director-general of the World Trade Organization, bemoaning the fact that the statistics gathered by his army of tax-privileged bureaucrats reveal far too *much* information by not cross-cancelling nearly everything travelling up and down the richly complex chain of production and thus leaving only some putative 'value-added' residuum for the world's army of shallow macro-empiricists to plot in their presentational PowerPoints.

Riled by having to reveal, by default, that global trade fell by 12.2% in 2009 – as opposed to the 4-8% some think that left-over would have suffered if it were given the full GDP-style treatment - Monsieur Lamy complained that: *"It makes everything appear more volatile - that creates a political problem."*

Clearly, the fact that the seed merchant, the farmer, the waggoner, the miller, the wholesaler, the baker, and the grocer all have a living to make out of the bread business, *as well as* the delivery boy who finally exchanges the loaf for the housewife's coins, bears absolutely no weight in modern economic analysis and all intelligence about their role as intermediaries should be expunged from the official record forthwith!

Meanwhile, *we* will continue to pay attention to such gross numbers – along with the relatively sparse data we get for business sales, port loadings and freight traffic – as being far more diagnostically useful than many of the more popular, but inherently bastardized aggregates such as the Lamy's of this world seem to prefer.

Staying wit h trade, we note that the latest global numbers for January show that the rebound from last Spring's abyss were continuing apace, with EM Asia+Japan still responsible for roughly three-fifths of the gains in trade and for more than four-fifths of the increment evident in industrial production.

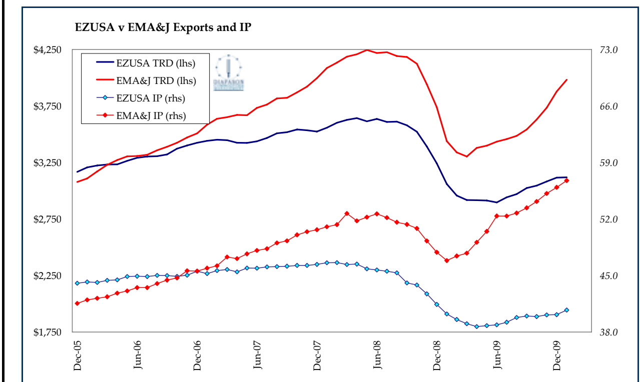

Fig 1: The World is still a one-trick pony

Take the case of Germany as an example. Since last April's 5 ½ year low in overall business revenues there, sales have climbed some 9.3% from the base (representing about €1 out of every €7 lost during the slump). However, this bare figure disguises some sharp sectoral disparities, with *domestic consumer* sales still languishing close to their post-Reunification lows (non-durables are actually 6.3% *below* where they stood last April), while *export* sales are up 18.7% (regaining 40% of their steeper percentage loss), led by capital goods shipments headed outside the EU (guess where) which have risen 34% in the same period to recoup half of their precipitous plunge.

Though the comparatives associated with the bounce sound impressive, these disguise both the fact that manufacturing and mining output volumes are still 17.5% of the Boom's peak, at levels first attained way back in 2001 – *and that they seem to have lost all upward momentum since the early autumn.*

Fig 2: German MfG & Mine output: 1991-td

The lesson to be drawn from this is the one Richard Adkerson, CEO of Freeport McMoran, revealed to Reuters recently:- *'China… has created a copper price that would justify all of our capital expenditures, but two thirds of the world's … markets … remain weak. When you have the price supported solely by China, we are just not so comfortable going all out right now.'*

But, in this most beta-rewarding of all worlds. Have there been any losers? Well, yes, for it seems that the market has been far too dumb for the smart money to have a chance. With the S&P500 up 6.6% YTD, the fact that the FT was reporting that such luminaries as Brevan Howard, Moore Capital, and Tudor were in the red – while the average hedgie was flat - means that this quarter might just be in danger of witnessing an indiscriminate stampede for fee-justifying gains along the line of least resistance – i.e., along the one already being taken.

As we have often observed, risk appetite trades under a regime of near-zero interest rates can draw all assets higher, regardless of their intrinsic merits – at least to the point where not just the Emperor's, but the whole Imperial Army's, nakedness is suddenly revealed (usually at the point it is about to attempt the passage of the Berezina).

Fig 3: USD/JPY 25d Risk Reversal v MSCI EM/World

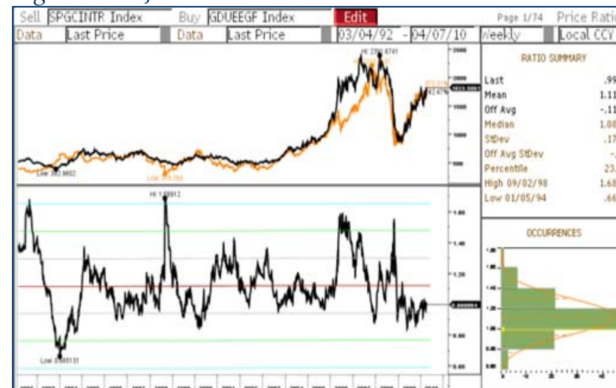

Fig 4: MSCI EM v Base Metals (TR): 1993-td r2=0.93

How far could this run? Estimating the limits of irrationality is always the hardest of calls to make, but we could point out that the following chart (viz., the tinder of the MSCI World TR compared to the oxygen of OECD narrow money) would be just TOO neat to be true if the equity market, at least, were to top out somewhere in the next 10-15%.

Fig 5: MSCI World TR/ OECD M1: 1973-td (ln scale)

Commodity Corner

In such an environment, though crack spreads are already at seasonal, 26-year, percentage lows; despite the fact that the last few weeks have seen an alarming rise in crude inventories; regardless of the fact that all-barrel net spec longs are worth more than they were at the July'08 peak, if the current break out holds (and if the attractor of the last 6-months' mean of ~$80 does not therefore 'recapture' the price), the results could be dramatic.

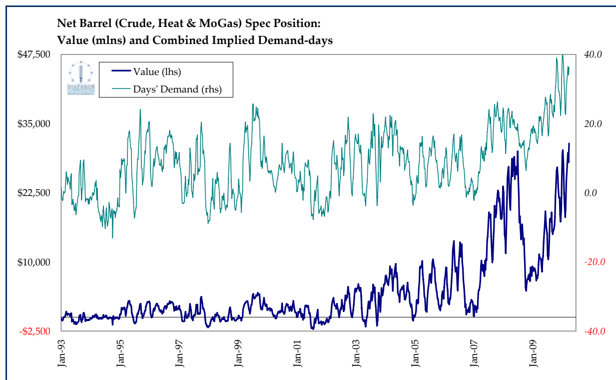

Fig 6: Oil complex net spec long values…

Fig 7: …but, if she DOES blow, send for Red Adair

What about the rest? Well, gold is making TWI highs, hewing to the furrow we have also delineated several times in the past months. If this pattern were indeed to come to a nice, symmetrical consummation, it would also imply a revisitation of the mid-point of gold's post-Bretton Woods world, real value range.

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Fig 8: Gold x USD TWI: 1999-td

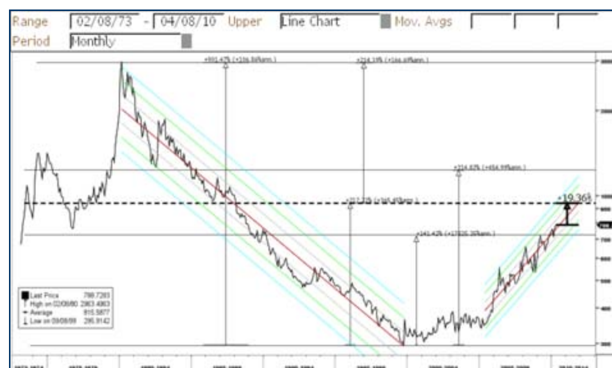

Fig 9: World 'real' price of Gold: 1973-td (ln scale)

On this same basis, metals are the most expensive sector (*quelle surprise*!), energy sits mid-range, and the post-Bronze Age agricultural depression remains in place to chide the Eco-doomsters, the Huxleyites and the associated sons of Malthus.

On a more intuitive, TWI reckoning, Agri is in the process of testing its uptrend from the 2004 lows, close to the subsequent range's fib point, the 2002 high, and right on the post-1973 average. *If* it bounces, we can look forward to replaying the consolidation area of the last two years and can scale in (and stop out) longs accordingly: we can also look to overweight it against the rest, hoping the channel trend will hold. If not – well, at least beer should stay cheap.

Fig 10: Agri x USD TWI: 2001-td

Fig 11: Non-Agri v Agri TR: 1983-td

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