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| |  | | --- | |  |   Joan Sees Red  John Mauldin | July 30, 2012  It seems like the whole world is expecting Ben and Mario to ride in and save the day with yet more stimulus. But to what effect, I wonder. Is a short-term rise in the market a cure for the basic disease of too much debt? And, as today’s Outside the Box hilariously points out, it can even make things worse.  Joan McCullough is perhaps my favorite curmudgeon. She writes so freely and with such style and feeling, but she also gives us such exquisite bits of information that no one else seems to find. Today, as I sat in a Denver hotel, I read her and just had to laugh a few times (mostly to keep from crying). She can be a tad hard on sensitive nerves, but we are all adults here, right? Be forewarned, though, that while she may pokes at someone you don’t like today, tomorrow she may be pointing out the issues with your guy. She is an equal-opportunity skewer.  Today she has Ben and Mario in her sights, and toward the end the poor Department of Labor incurs her wrath, too. On this both Joan and I agree: Europe is going to end in tears. The longer they keep piling up debt, the worse it will be. Their choices are Disaster A and Disaster B. Try to avoid both and you get Super Disaster C.  Joan has been trading and pontificating for longer than most of us have toiled and has forgotten more than I have ever known, assuming she ever forgot anything. She works with East Shore Partners, and God Bless them for giving her free rein to write as she sees fit. The wire-house boys would just die.  But before we hand it over to Joan, here is a quick paragraph from Yanis Varoufakis, writing about Greece at <http://yanisvaroufakis.eu/2012/07/28/23-crucial-days-for-greece/>. This shows just how absurd things are, and also how pernicious. The Greeks are paying back the ECB on the backs of Greek and other European taxpayers. Just to keep the game going. This is wrong on so many levels.  **On 20th August, the Greek government will have to borrow 3.2 billion from one arm of the Eurozone (from the EFSF) in order to repay another (the ECB). Yet Greece is insolvent. The very idea of an insolvent entity borrowing more from a community, like the Eurozone, in order to repay that same community is obscene.** All it does is to shift the burden from the Central Bank to the taxpayers of Germany, Holland, Austria and Finland. This is not an act of solidarity with Greece. It is an act of irresponsible kicking-the-can-up-a-steep-hill. The simple point I have been trying to drive home for a long while now is that the Eurozone must make a simple decision:  Either to give Greece a proper chance of exiting its current death spiral. Or to dump Greece now, before the Greek state loses all its remaining assets and before it gets deeper into debt. And if our Eurozone partners are not prepared to make up their minds (caught up in their own short term concerns and shenanigans), then Athens must force their hand to decide within the next 23 days. How? By announcing that Greece will NOT be borrowing on 20th August monies it cannot repay under the present scheme of things.  I am speaking tomorrow at the *Financial Advisor* magazine conference for my partners Altegris Investments. But first I get to be a groupie and meet George Will, who is one of the truest wordsmiths of my generation. Tonight there will be a dinner and then some fun with Altegris partner and old friend Dick Pfister and his team.  I fly home and then on to Maine to be with many more friends for the annual Shadow Fed fishing-camp meeting. I *think* I will be on Bloomberg at 6:30 AM with Tom Keene (he may be the only one awake!) and then on with Mike McKee at some point. They will be cutting away to Maine throughout the morning, so you might want to tune in. Some good commentary on the employment number should make for some fun TV and radio. They do tend to change the schedule at the last minute, but it will be good whatever it is.  Time to hit the send button. Good friends (including Vitaly Katsenelson) are waiting. Have a great week, and the letter will be heading your way Friday from Maine.  Your shaking my head at Europe analyst,  John Mauldin, Editor Outside the Box \_\_\_\_\_\_\_\_\_\_\_\_\_  Tuesday, July 24, 2012                     **All red is mine.**    All times ET.  **Joan McCullough, East Shore Partners, 1-212-226-1223**  **Trading:  1-800-222-8723** [**joanmccullough@eastshorepartners.com**](mailto:joanmccullough@eastshorepartners.com)    … “Such supplementary interventions [by the State], which are justified by urgent reasons touching the common good, *must be as brief as possible,* ***so as to avoid removing permanently from society and business systems the functions which are properly theirs****, and so as to avoid enlarging excessively the sphere of State intervention to the detriment of both economic and civil freedom. “* …. [Walter Bagehot]    When that was first posted in this space last week, I referenced it against the FED’s never-ending ZIRP.  Because once the State inserts itself too long or too hard, they take over functions that are not their responsibility and **thus expropriate a measure of our economic freedom**.  Which stinks.    Given the fact that we are now about the business of waiting for Draghi to show his hand (ahead of an upcoming FOMC meeting no less), perhaps it’s time to apply that papal pearl of wisdom to the LTRO and see how it shapes up.    I’m doin’ this off the top of my head and simplifying, so don’t nitpick; you know who you are.  Market history buffs will recognize this immediately; we’ll catch up with you guys tomorrow. ☺ The rest of the class, keep readin’:    The time frame is the mid 1850s/60s.  Right around the time of the US Civil War.  But we are in London.  At a firm called Overend, Gurney & Co.  Got that?  Good.    This was a hot, steamin’ bank.  They had a big business buyin’ bills of exchange at a discount.  They don’t use ‘em anymore.  But in their day, bills of exchange were the way the commercial markets got business done.    **For the Newbies only**:  I am in France.  You are in England.  I sell you  a cargo of X.  You write a bill of exchange ( a draft) payable to me on January 10, 1860 drawn on the Bank of Oo-la-la.  But I would rather not wait until the 10th of January.  Because I have other fish to fry/business to push thru.  So I endorse this bill of exchange over (sell) to Overend, Gurney & Co who purchases it from me at a discount. They then sit on it and collect full face value from my French Bank, Oo-la-la, come the 10th of the new year.    So what Overend & Gurney were doing was accommodating international trade thru short-term financing.  ***That is the key.  Short-term financing.***  They kept things humming along nicely.  **This was a function belonging to the free market system.  And it worked very nicely until O & G got stupid.**    Right.  I gotta’ go with the idea that at some point they got a tad over-creative with their financing biz as the tide of the day was changing in that segment.  Meanwhile, they had some nice profits, so they decided to invest them in long-term projects.  Oh boy.  They were short-term financing experts.  Now they decide to go long-term investor?  Uh-oh.    Well, this tack turned out to be a nightmare.  So in order to raise cash, they went public (became a limited liability company which hid certain liabilities) by offering their shares at a big premium.  Which got them liquid again.    But before a year was out, wouldn’t you know it, but the financial system was under a lot of duress in London.  I’ll try to make this snappy as it could get quite long.    This is about limited liability companies.  Laws were passed in the early 1860s in England to accommodate these entities.  All they had to do was scare up 7 or more members and register as a firm. And bingo, they were relieved of a lot of the usual responsibilities such as disclosure.  As you can guess, this was abused forthwith by some.   In the financing sector in particular.  Kinda’ like subprime:  some of these newly-registered, limited liability entities were willing to lend vs. crappy collateral … and at much higher rates.  So there was liquidity but at the end of the day, as always, no stability and that’s what eventually brought the house down.  A bank run by any other name … is still a bank run!    So, eventually, London got its own “Black Friday” which involved the collapse of stocks such as railroad names in which there had been great speculation. (Think of O &G’s “long-term investments”!) Thus began the “Panic of 1866”, the catalyst for which was the declaration a day beforehand that Overend & Gurney, WHO HAD RECEIVED A NOTHIN’ DONE FROM THE BANK OF ENGLAND IN RESPONSE TO A REQUEST FOR AID… could not meet their obligations.  (Remember that long-term investment portfolio?  Right. Sayonara.)    Needless to say, Overend & Gurney went down the tubes which was bad enough.  But the really bad part was that they took a boatload of other companies … including financials … down the rathole as well.    Aside:  Gurney eventually got on its feet.  And became part of Barclay’s.  I just spit my tea out my nose.  How funny is that, eh?  It survived to go on another 150 years to make headlines in the LIBOR mess.    **As the buffs know, O & G was located on Lombard Street**.    Enter Walter Bagehot.  Who wrote **“Lombard Street:  A description of the money market”**  back in 1873.    From his writings, developed what is known as the Bagehot rule. Which goes something like this:  In time of crisis, the central bank must nip any panic in the bud.  By making abundant loans … but against proper collateral and charging a premium.    This jibes with our opening quote which offers that the State can indeed step into any weak spot in order to facilitate the market if this action is for the common good.  **But they must not overstay lest they impose on our economic and civic freedom.**    So if you ask me, both the FED and the ECB have tread where needed, but both have way overstayed.  To the point where they have now become almost a permanent function in the market.  And they have also violated Bagehot’s rule in that they have encouraged moral hazard to the extreme.  The FED with ZIRP and the ECB with crap collateral and 1%, 3-year loans to deadbeats.  Repeatedly.  And look poised to continue with the same m.o.  NO GOOD ON ANY LEVEL.    Let’s stick with raggin’ on the ECB, shall we?  They have inserted themselves so profoundly into the financial mix that they are really no longer behaving like a central bank as they are no longer fostering stability.   Rather by taking huge risk on their books like any other run-of-the-mill commercial bank, they are putting the system in jeopardy.  Think in any terms you wish; the easiest way to get there is to wonder aloud how they exit this hellhole they have dug even deeper.    In the meanwhile, what is their contribution to solving the problems the Euro system is facing?  Right.  This morning we touched on this point briefly with this:  *… “The only lender to the banks was the ECB.  The only lenders to the sovereigns were the banks.  The more the sovereigns borrowed, the more the banks loaned them.  The more the debt racked up by the sovereigns, the more they are pressed to implement austerity.  The more austerity that is enacted, the slower the growth.  The slower the growth, the closer to default they creep.  Take the visual of a long line of collapsing dominoes.  That’s about right.” …*  Do you copy how bollixed up this is?  The efforts of the ECB can only have short-term, temporary impact.  What they are doing is propping these skanks in the short-term which does nothing in terms of reducing the overall debt.  As a matter of fact, it worsens the debt picture. Because I am thinking along these lines, the lines of *extend and pretend*.  This variety:  a bank gets dough at the LTRO.  Pays down some current obligations and makes the next sovereign auction look good because of their heavy participation.  These loans from LTRO are 3 years now, don’t forget.  So let’s say that after some time passes, this bank has an upcoming obligation.  Now what?  Where do they get the money to pay that down?  Right.  They have to sell some of the sovereign debt.  To whom? To the very entity who lent them the money to buy it in the first place.   And if the timing is anything less than optimum, you can bet your boots that they are selling this stuff at a loss.  Noting that the ECB has taken a boatload of the same paper in as collateral.  And there appears no end in sight to the madness.  Including the lowest blow of all, which puts the ECB right in the same category with the FED:  what they are doing has zip to do with the economy.  Like the FED, they have forgotten John Q. a long time ago and are acting solely as agents to keep the banks, the sovereigns and by extension, themselves, afloat.    Which brings us around to the final straw, referenced above.  The austerity.  I can’t figure out what the thinking is here, can you?  I mean, which side are we supposed to be rootin’ for?    A.    this country does not meet its austerity targets, gets no aid and the economy collapses.   Or  B.   this country meets its austerity targets, gets aid, but it’s too late because the austerity has already pushed it over the economic cliff.    I believe that Draghi *will* come with a bazooka; he’s in for a nickel already; you know what comes next.  But as we know, no matter what he does and I’m sure the effort will be a gangbuster … there is no permanent fix here unless we get fundamental change.    Do the math, Sunshine.  Fundamental change can only come about in the event that there is a massive restructuring of all this un-payable debt.  In the meantime, they are touchin’ themselves if they think this short-term meddling is gonna’ “stick”.    **Parting words**, thanks to BG who alerted me to the 7/30/12 memo which was posted on the DOL’s (ETA division) website.  <http://wdr.doleta.gov/directives/attach/TEGL/TEGL_3a_12_acc.pdf>  You should really take a good, hard look at this posting.    The background.  On January 2, 2013, if we don’t get the budget mess sorted out, sequestration will be implemented.  Which will hit the defense industry right between the eyes.  Knowing this, certain Defense Industry honchos have “threatened” the government with filing WARN (layoff notices) informing employees of possible firing owing to the sequestration of funds away from the industry.    The law specifies “60 day notice”.  That would put the filing right in front of the 2012 presidential election.    Just to underscore that these bums are lower than low, the DOL has decided that WARN notice filings in anticipation of sequestration would be INAPPROPRIATE.  They so stink, I could freakin’ scream.    … “Questions have recently been raised as to whether the WARN Act requires Federal contractors—including, in particular, contractors of the Department of Defense (DOD)—whose contracts may be terminated or reduced in the event of sequestration on January 2, 2013, to provide WARN Act notices 60 days before that date to their workers employed under government contracts funded from sequestrable accounts.  The answer to this question is “no.”  …    In addition, the preamble states that “it is not appropriate for an employer to provide blanket notice to workers.”  *Id*. at 16058.  Thus, in cases where it may be difficult to identify the worker who will actually lose his/her job because of the elimination of a particular position, the regulations provide that notice must be given to the worker who holds that position at the time notice is provided.  20 CFR 639.6(b).” …    The DOL is so full of crap, it’s not funny anymore.  Usually, they are all over companies, urging them to file so that they can be prepared to help anyone displaced. Unless of course, it might mean a few votes lost by the Administration.  I frankly cannot believe my eyes.    As for the denial of the “blanket notice”, the DOL is just plain lyin’.  Here’s a couple of “blanket” examples I grabbed from Pennsylvania in my fury:    **West Penn Hat & Cap Corp.**1000 Treadway  Creighton PA 15030     **COUNTY:** Allegheny  **AFFECTED:** Not Provided  **MASS LAYOFF  EFFECTIVE DATE:** Not Provided  **WARN NOTICE**    ***That’s real specific, ain’t it?***    **Canberra Industries, Inc.**  Warrington, PA     **COUNTY:** Bucks  **# AFFECTED:** N/A  **PLANT CLOSING  EFFECTIVE DATE:** 05/02/02  **WARN NOTICE**    ***Number affected?  N/A.  Another one, eh?***    The SUBJECT of this memo is:  **“Guidance on the Applicability of the … WARN Act” ….**    ***Guidance?***  Go here:  <http://www.doleta.gov/programs/factsht/warn.htm>    and read the last sentence.  Okay, I’ll do it for you:  “The Department of Labor, since it has no administrative or enforcement responsibility under **WARN**, cannot provide specific advice or guidance with respect to individual situations”.    Except when an election is at stake?  This is so over the top, I could spit.  Because there is NO CALL FOR THE FEDERAL GOVERNMENT TO MEDDLE IN THIS.  What they say in the disclaimer is true.  They have no administrative or enforcement responsibility here.  SO WHY THE HELL DON’T THEY KEEP A LID ON IT?  ***OMAB.***    If a company is gonna’ have a big layoff or a plant closure, they first notify the feds.  But the real deal is the next step whereby they notify the State.  That is where the action is.  That is who liaises with the federal government to get training and grants and all the other baloney that goes with this crap.  And of course, they notify the local municipality where the layoff is going to happen.    I gotta’ sign off.  I am about to blow a gasket.    Hasta manana.  If I make it.    ☺ |
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