CASH AND CAPITAL CACHES
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A character in the 1963 movie "It's a Mad Mad Mad Mad World" reasons: "Now look, let's be sensible about this thing. There's money in this for all of us. Right? There's enough for you, there's enough for you, and for me, and for you, and there's enough for…" [they all race to their cars]. (Stanley Kramer, director)

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TREASURE

Everyone knows that money shifts into, within, and between geographic regions and broad financial sectors (stocks, interest rates, foreign exchange, commodities, real estate) sometimes are substantial or even "dramatic". Price movements and other statistics indicate this. However, seldom is it underlined how gigantic capital marketplaces are.

The International Monetary Fund's "Global Financial Stability Report" (September 2011; "Statistical Appendix", Table 1) provides evidence for end 2010. World GDP for 2010 was about $62.9 trillion dollars. Stock marketplace capitalization represents about 87.6 percent of world GDP. World stock marketplace capitalization was about $55.1 trillion, with debt securities about $94.8 trillion (just under $41.4tr public, about $53.5tr private). "Bank assets" are over $100tr.

It pays to ponder the economic consequences of a significant increase or decrease in the value of a given category such as equities. What if worldwide stock marketplaces in general descended (ascended) only ten percent relative to these end 2010 numbers? Such a stock price decline probably would have notable consequences for consumer and corporate confidence and spending. A $5.5tr tumble would be about .9 percent of 2010 worldwide GDP. What if there was a much bigger slump or rally in equities?

However, that slide in stocks probably would injure some economies (and the net worth of their households and other players) more than others. Would it matter much if American stocks weakened on a sustained basis around ten percent? Such an US equity decline is a noteworthy absolute sum and large from the GDP and net worth perspective as well. US stock marketplace capitalization at end 2010 was $17.3 trillion. Suppose one uses 2011 US GDP at around $15.1tr (Bureau of Economic Analysis; the 2010 level in the IMF table is $14.5tr). A ten percent equity dive equals about 11.5pc of GDP (1.73/15.1 trillion).

Take another view using Federal Reserve data. According to the Federal Reserve's "Flow of Funds" (Z.1, Tables B.100.e and B.100; 12/8/11, next release 3/8/12) 2Q11's equity shares for households (and nonprofit organizations) were about $19.2tr. A ten percent equity dive equals around 12.7pc of GDP (1.92/15.1). End February 2012 US stock valuations probably are roughly around that 2Q11 total. A ten pc slump in stocks (using US equities as the benchmark for all stock holdings by US households) of $1.92tr equals around 12.7pc of 2011 nominal GDP (1.92/15.1), or around 3.2 percent of 2Q11's household net worth of just under $60 trillion (3Q11 $57.4tr is most recent Z.1 information). US end 3Q11 household net worth still remains beneath end 2007's over $65.1tr.

With consumers around 70 percent of the US economy, the Fed's assorted accommodative monetary policies during the ongoing worldwide economic crisis that emerged in 2007 have sought to boost (and sustain rallies in) equity prices.

Valiant battles by US politicians and regulators to rally housing prices have been less successful. The Z.1 notes that owner's equity in household real estate at 3Q11 at $6.2 trillion remains very distant from end 2006's lofty $12.8tr.

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Not all the funds (money; financial instruments) in a given category readily will shift from one category (such as stocks) into another (such as US Treasury securities). Also, not all stocks, debt instruments, and physical commodities such as petroleum or copper are in "free supply".

In any event, picture also the effect of a flow of one or two percent of the "value" of a given marketplace to another. For such a move "between" marketplaces, especially imagine a one or two percent "cash transfer" from relatively large (major; deep) playground to a smaller (minor; thin) one within a given broad arena (whether stocks, interest rates, or elsewhere). Also, think of a move (diversification or otherwise) from a large general field (such as stocks or debt securities; cash in bank deposits) into a smaller one such as commodities.

According to the International Energy Agency, total OECD industry petroleum stocks on land were 2611 million barrels (2.61 billion; government controlled stocks were an additional 1531 million barrels: "Monthly Oil Report", Table 5, 2/10/12). At $100 per barrel, industry stocks at end 4Q11 are worth $261 billion. At $150 per barrel, they are worth over $390 billion. A modest shift by "investors" or other noncommercials into commodities ownership, even if it is concentrated in forward marketplaces rather than in physical supply (and even if some of the funds pointed into commodities are kept aside on reserve, rather than sent directly into those marketplaces) can have large price consequences for those commodities. Remember that not all the physical (spot) commodity is in free supply. Also, forward marketplaces such as futures are not domains entirely separated from their related cash (physical) ones. Anyway, compare these petroleum inventory valuation sums with world stock marketplace capitalization at end 2010 of $55.1 trillion, public debt securities of $41.7 trillion, and private debt securities of $53.5tr. Even one percent of $55 trillion looks pretty big relative to the petroleum physical inventory value.

HOARDS- OFFICIAL FOREIGN EXCHANGE RESERVES

The epic hero Beowulf ruled his "wide kingdom" "well for fifty winters, grew old and wise as warden of the land until one began to dominate the dark, a dragon on the prowl from the steep vaults of a stone-roofed barrow where he guarded a hoard…The intruder who broached the dragon's treasure [by stealing a "gem-studded goblet" while the dragon was sleeping] and moved him to wrath had never meant to." "Beowulf", translated by Seamus Heaney

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The International Monetary Fund's "Currency Composition of Official Foreign Exchange Reserve" statistics ("COFER"; 12/30/11) offer insight into central bank ownership patterns. COFER statistics do not reveal holdings by individual nations. They break worldwide totals into "advanced economies" and "emerging and developing economies"). COFER data begins in 1995.

COFER foreign exchange reserves include the monetary authorities' claims on nonresidents in the form of foreign banknotes, bank deposits, treasury bills, short and long term government securities, and other claims usable in the event of balance of payments needs. Allocated reserves are those whose currency composition has been identified.

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Review claims in US dollars and other currencies relative to allocated reserves from 1995 to 3Q11, the most recent data period. As the tables are in millions of US dollars, dollar trends influence these percentages.

How can US dollar trends influence percentage totals of “claims in US dollars” relative to allocated reserves? Suppose US dollar claims are unchanged between two time periods. All else equal (no change in buying or selling of securities, etc. in general), as the COFER framework reports reserves in millions of US dollars, US dollar depreciation makes the reported value of claims in nondollar form (in Euros, Japanese Yen, and so on) larger in dollar terms. Grand total allocated reserve claims in dollars therefore increases (nondollar claims converted to dollars is larger than before, add this to the unchanged specific current US dollar claims amount).

Consequently, all else equal, dollar depreciation makes for a falling percentage of “claims in US dollars” as a percentage of allocated reserves. “Claims in US dollars” (the numerator) remain the same. But the denominator (claims in US dollars plus the other claims in dollars; combined these equal allocated reserves) is larger due to the bigger US dollar amount of the nondollar claims after adjustment for the dollar’s decline. So (all else equal), claims in US dollars as a percentage of allocated reserves fall if the dollar depreciates.

Keep in mind that the tables do not reveal everything about reserves. For example, allocated reserves at end 3Q11 represent only 53.5pc of total foreign exchange holdings.

COFER statistics hint at a rough pattern. A relatively high percentage share of claims in US dollars is associated with a strong broad real trade-weighted dollar (“TWD”), with a lower share with a feeble TWD. Of course one also could examine various currency cross rates in this context.

The broad real trade weighted dollar’s (“TWD”) major high was around 112.8 (monthly average; Federal Reserve, H.10 data) in February 2002. Worldwide allocated claims in US dollars peaked around then, with 1Q02’s 71.6pc in dollars. The US dollar share for advanced economies was 70.6pc in 1Q02. The percentage of official claims in US dollars by advanced economies has fallen since 1Q02, with 3Q11’s at 65.2pc. The broad real TWD reached a new all-time low in July 2011 at 80.5. Subsequent months for the TWD reveal an advance only to around prior major lows around 84.0 The TWD reached a major bottom in July 1995 at 84.0. Worldwide claims in dollars as a percent of allocated reserves at 59.0pc likewise were low (advanced economy dollar claims 53.0pc).

The share of the US dollar has declined since just before and during the worldwide financial crisis. At end 4Q06, it represented 65.5pc of allocated reserves; such dollar claims were 64.1pc at end 4Q07, 63.2pc at end 1Q08 (key April 2008 TWD low at 84.2).

At end 4Q08, claims in US dollars were only 64.1pc, with 1Q09 edging up only to 65.2pc, even though the TWD achieved a notable high in March 2009 at 96.9 (major bottom in S+P 500 3/6/09 at 667) after a sharp rally from April 2008’s 84.2. However, at end 2009 these claims were a bit lower, at 62.1pc; by end 2010 they were 61.7pc.

At end 3Q11, claims in US dollars also equaled 61.7 percent of allocated reserves; the Euro FX’s 25.7pc captured second place. At end 3Q11, the UK pound sterling had 3.9pc, the Japanese Yen 3.8pc.

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The emerging and developing countries total foreign exchange holdings (not just allocated reserves) as a percentage of the world total foreign exchange holdings has increased steadily since 1995. In 1995, they were 32.9pc, in 2000, they were 37.1pc. At end 2005, they were 51.0pc, rising to 63.7pc at end 2007. By end 2010, that percentage was 66.6pc. At end 3Q11, for the most recent COFER data, their massive $6.8 trillion in total foreign exchange holdings were 67.2 pc of the almost $10.2tr in world total FX reserves.

Several emerging and developing countries have run large current account surpluses, particularly in recent years. This surely has contributed to their growing share of world foreign exchange reserves.

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From 1995 through 2001, claims in US dollars as a percentage of their allocated foreign exchange reserves by emerging and developing nations at year end were steady between 73.8 to 75.7pc. Despite the sideways level for 1995-2001- even as the dollar rallied, the reduced US dollar claim percentage of their allocated reserves for the emerging/developing category since 2002 fits the general overall decline in the TWD since its 2002 peak. Since 1Q02's 74.2pc (recall the broad TWD pinnacle then), that share has steadily eroded. By end 2002 it was 68.7pc, by end 2007 62.1pc. At end 2010, their claims in US dollars were 58.3pc. At end 2Q11 they were 57.0pc, with 3Q11 slightly higher at 57.6pc.

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However, what does the fairly strong TWD in 1Q09 versus its April 2008 trough alongside the absence of any significant increase in the percentage of worldwide US dollar holdings over that time span indicate? It strongly suggests that something more may have been going on in ("behind") these official reserve patterns than the consequences of US dollar appreciation. A reasonable conjecture is that it reflects a determination by developing/emerging nations in general not to expand their exposure to the US dollar. Given the longer run trend of their declining US dollar claims, they even arguably are trying to reduce their US dollar claims regardless of dollar fluctuations.

First, look at advanced nations. Their dollar claims grew modestly from 1Q08. US dollar claims rose from 1Q08's 64.4pc to 67.1pc by end 2008, marching to 68.7pc at end 1Q09. The advanced economy group thus fits the guideline of strong TWD alongside a higher US dollar claims percentage. What about the emerging/developing category? Even as the TWD advanced over fifteen percent from its April 2008 low to its March 2009 top, US dollar claims for the emerging/developing group of economies remained immobile. At end 1Q09, the percentage was only 61.2pc versus 60.8pc in 4Q08, and the even higher 1Q08 level of 61.9pc.

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Suppose US federal fiscal deficits remain extremely large in both absolute arithmetic terms and as a percentage of US GDP for several more years (and watch out for the so-called long term as well in regard to these deficits). Numerous variables influence decisions by public (official) and private marketplace inhabitants to buy (or hold or sell) the US dollar and US securities (and other US dollar denominated assets). However, these trends in developing/emerging nation foreign exchange reserves indicate that the willingness of many developing/emerging countries to finance huge US fiscal deficits (or won other dollar denominated assets) is not unlimited.

US SECURITIES- MONEY TRAILS

In Horatio Alger, Jr.'s mid-19th century American novel, "Ragged Dick", or "Street Life in New York", Dick states: "Some boys is born with a silver spoon in their mouth. Victoria's boys is born with a gold spoon, set with di'monds; but gold and silver was scarce when I was born, and mine was pewter." Frank replies: "Perhaps the gold and silver will come by and by, Dick."

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Take a look at the US Treasury's "Treasury International Capital" ("TIC") reports, such as the "Major Foreign Holders of Treasury Securities" release (2/29/12).

At end December 2011, major foreign holders owned just over five trillion dollars of US Treasury securities (marketable and non-marketable bills, bonds and notes). Foreign official holdings of about $3.62 trillion were 72.3 percent of this. Within the official total, T-Bills were $358 billion, T-Notes and T-Bonds about $3.26tr.

Since end June 2011, when the Federal Reserve's glorious second round of money printing (QE2) ceased, foreign holders added about $311 billion to their total. If federal deficits continue to be around one trillion dollars or more, unless domestic US demand for UST jumps, annual net overseas buying of UST probably will have to remain substantial. The second half 2011 net foreign UST buying, though seemingly sufficient relative to that period's deficit funding requirement, was not massive.

From end June 2011 to end December, official holdings of T-Bills dipped from $411bb. Place currency trends to the side. US nominal T-Bill yields are near zero, with current negative return from them relative to US inflation rates. This situation probably will continue given the Fed's policy of keeping its policy rates at extremely low levels well into calendar 2014. Thus foreign official (and probably foreign private) ownership of US T-Bills will continue to fall.

Unearth some further details in the TIC report. Of that $311bb addition of all UST from end June to end December 2011, foreign official sources added only about $101bb. Private overseas purchasing was over $210bb. Assume that "flight to quality" (safe haven) concerns diminish somewhat. Current nominal US interest rates are near rock-bottom levels several years out into the UST yield curve, with negative or meager returns from them after inflation. This situation is likely to continue for many more months given Fed policy. So how eager will foreigners (and non-official ones in particular) be to keep being substantial net buyers (or even owning the same amount of) longer-term US Treasury debt?

The Major Foreign Holders report does not breakdown a given country listing into foreign official and foreign private (general public) categories. However, mainland China ownership of US Treasury securities fell about $155bb from end June 2011 to end December. Most of mainland Chinese ownership probably is official. Hence this Chinese decline is a warning regarding the ready ability of America to fund its budget deficit.

Recall the COFER statistics discussed above. COFER does not identify individual nations. The big boost in COFER holdings in recent years (and in its developing/emerging group) hints that COFER includes China. China may have (or wish to increase) other official dollar-denominated reserves (assets; think of stocks and real estate, perhaps) other than UST. Most of the Chinese UST net selling probably is from official sources. Thus, this Chinese net selling pattern of UST tends to confirm the viewpoint indicated from a preceding review of the COFER data. The official sector of many emerging/developing nations probably does not want to increase their US

dollar reserves (claims) in percentage terms. Moreover, many within the emerging/developing category may only wish to add little to, merely maintain, or even slash their dollar denominated reserves. To the extent actions by the foreign private sector in emerging/developing nations mirrors the official one, this orientation likewise is true of the nonofficial realm.

Look beyond mainland China in this TIC report in regard to these considerations. Oil exporters held around $259 billion in UST by end December. They thus added only $16 billion to their big UST stash from end June. Russia's UST total at end 2011 was around $150 billion, down slightly from end June 2011's $152bb.

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Note the recent coincidence in time of a bottoming of yields in the "flight to quality" destination. Compare the 10 year government notes of the United States, Germany, and Japan. Recent UST 10 year note lows were 1.67pc on 9/23/11 and 1.79pc on 1/31/12. The Japanese JGB 10 year low was 1/16/12 at .94pc (compare JGB bottoms at .83pc 10/7/10, .44pc 6/11/03, and .72pc 10/2/98). The German 10 year government note valley at 1.64pc on 9/23/11 was the same day as the UST note one. It made another trough at 1.74pc on 1/13/12 (about the time of Japan's mid January 2012 low), as well as one at end January (1.78pc on 1/31/12; compare US 10 year).

Suppose there is some inflation, and that low nominal yields result in very low real (or even negative) yields. In the absence of another round of flight to quality concerns, how eager will official and private players be to own (or at least to be substantial net purchasers going forward) of government debt of these nations?

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See "Preliminary Report on Foreign Holdings of U.S. Securities at End-June 2011" (2/29/12) for another viewpoint of overseas holdings of US securities. Though the Preliminary Report describes the situation of several months ago, it provides further details regarding not only debt holdings, but also equity ownership, and on an individual nation basis.

The Preliminary Report splits long term debt into asset-backed securities and "other"; short-term debt is another category. This survey identifies $7.73 trillion in long term debt securities at end June 2011 ($1.14tr of these are asset-backed) and $881 billion in short term debt ones, for a total of about $8.61tr. Foreign official holdings represent a substantial share of these categories. The foreign official group held $421bb of asset-backed (36.9pc), $3.42 trillion (51.9pc) of the remaining long term debt securities, and $439bb (49.8pc) of the short-term debt.

Connect the Preliminary Report to the Major Foreign Holders study. The Major Foreign Holders table states that in June 2011, foreigners held $4.69tr in UST. Subtracting that UST amount and the Preliminary Report's $1.14tr of asset-backed securities from the combined $8.61tr in long term and short term debt in the Preliminary Report leaves about $2.78tr. Much of this $2.78tr probably is corporate debt.

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According to the Preliminary Report, at end June 2011, foreigners owned about $3.91 trillion in US equities. These overseas holdings of US equities are rather significant. They are 22.6 percent of end 2010's $17.28 trillion US stock marketplace capitalization (Global Financial Stability Report, September 2011;"Statistical Appendix", Table 1). In contrast to the big official share of foreign holdings of UST securities, the foreign holdings of US equities are primarily by the private sector. Foreign official stock ownership was $593bb, or 15.2pc of total foreign holdings of US equities.

The largest equity holders are the United Kingdom ($442 billion), Cayman Islands ($433bb; compare Luxembourg's $291bb and Switzerland's $227bb), Canada ($416bb), Japan ($304bb), and Middle East oil exporters ($214bb). China held $159bb.

US Treasury TIC data also provide net purchases (or sales) of US securities by foreigners. The February 2012 report has data only through December 2011. However, in the stock marketplace context, focus this TIC data for the US equity realm. The S+P 500 made an important high on 5/2/11 at 1371. From July 2011 through end December 2011, foreigners were net sellers of about $42.3 billion (and net sellers in five of the six months).

This total is not huge relative to total foreign stock holdings (as of June 2011 and surely the levels thereafter). Also, history does not clearly show that net foreign stock selling almost always appears alongside marketplace tops or significant price declines. In addition, maybe this second half 2011 net selling pattern shifted to net buying in first quarter 2012 as American equities rallied.

Nevertheless, as foreign holdings are an important share of the US equity landscape, this fairly sizable net foreign selling is a warning sign of potential eventual weakness in US equities. August 2007's $40.6 billion foreign net sales total is the record high net sales in any given month (data back to 1978; previous other individual month net selling highs were much less. Recall September 1998's $10.5bb, September 2001's $11.5bb, and December 2006's $11.6bb). Although overseas sources were not net sellers in the seven preceding months of 2007, or the first three months of 2008, the August 2007 net foreign selling burst was not long before October 2007's major pinnacle in the S+P 500 at 1576 (on 10/10/07). The net July through December 2011 total net cashing out of about $42.3bb is even slightly larger than the August 2007 net sales amount. Moreover, foreigners again became net sellers of US equities in April 2008 (about $11.6bb), not long before the final S+P 500 summit at 1440 on 5/19/08.

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Let's venture back to interest rate battlefields again. The declining US T-Bill holdings by foreign officials displayed in the Major Foreign Holders report since June 2011 (and from November to December 2011) argues that foreigners overall probably also have been net sellers of US T-Bills recently.

Now travel to TIC monthly net buying (selling) data for the US securities debt sectors by foreigners (official and other). This gives detail only for longer term debt (US Treasury notes and bonds, long term agency bonds, corporate bonds). Foreigners were net sellers of UST notes and bonds in December 2011 ($16.6 billion). This is not a huge net sales total. But given low UST rates, this net liquidation of longer term UST securities warns that going forward foreigners probably will be relatively unwillingness to finance ongoing large US federal deficits. Even if foreigners do not become consistent net sellers of UST, they may become less fervent net buyers. In that regard, compare 2011 with 2010. The average monthly net buying for calendar 2011 by foreigners of US Treasury notes and bonds was about $31.5bb, only 53.7 percent of 2010's $58.6bb monthly average net purchases.