MONEY JUNGLE

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In financial fields, words aren't everything. Stare at the savage battle scene depicted in "The Bulls and Bears in the Market", William Holbrook Beard's famed 1879 painting. Why not play "Money Jungle", the jazz giant Duke Ellington's composition?

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CONCLUSION

The S+P 500 high on 4/4/14 at 1897 probably is an important top. "US Stocks: Shadows and Signals" (2/3/14) remarked that "during the darkest days of the worldwide economic crisis of late 2008/early 2009 as well as during the subsequent recovery, Federal Reserve Board easy money policies have played key roles in encouraging bull moves in the S+P 500 (and many other equity playgrounds). Likewise, the elimination of some of these schemes, particularly previous rounds of quantitative easing (money printing), has occurred alongside highs in American stock benchmarks. What does tapering foreshadow? The Fed's recent decision to reduce (taper) and eventually eliminate the current gigantic round of money printing warns that a notable top is or relatively soon will be in place."

As it has in the past, the Federal Reserve will try to prevent a substantial stock marketplace tumble. But unless the S+P falls around ten percent, they probably will say or do little of note. However, if the S+P dives ten percent or more, the Fed lions probably will roar about their determination to sustain recovery. A slump of about 20 percent from a peak (especially if it occurs quickly) boosts the chances that they will slow their current tapering program.

HAPPY HUNTING GROUNDS?

Oh, hear the call!—Good hunting all
That keep the Jungle Law!" Rudyard Kipling, "The Jungle Book

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Within and across fields such as stocks, interest rates, currencies, commodities, and real estate, the ardent hunt for sufficient "yield" by "investors" and others never ceases. Recall the glorious Goldilocks Era which preceded the worldwide economic disaster that emerged in mid-2007 and accelerated in 2008. As the Goldilocks Era neared its end prior to those dreadful days, packs of marketplace players eagerly foraged around in diverse (and sometimes very remote or complex) landscapes for adequate yield (good "investment" opportunities; fine returns). The global economic recovery began around mid 2009, with calendar year real GDP growth resuming in 2010. Over the most recent year or two in financial marketplaces (and especially currently), as during the late stages of the Goldilocks Era, the search for yield increasingly has become widespread and rabid. Such sustained heated quests, when reviewed alongside other indicators, warn of economic dangers.

The recent fervent hunting enthusiasm derives much of its inspiration from the sustained interest rate yield repression by central bank wardens such as the Federal Reserve, European Central Bank, Bank of England, and the Bank of Japan. The Fed's generous money printing festival intertwines with its yield repression scheme. The Fed and other supposedly vigilant central bankers undoubtedly do not want the global economic disaster to reappear.

Regard the S+P 500 in 2014, still far above its 2000 and 2007 peaks (1576 on 10/11/07; 1553 on 3/24/00)? Nevertheless, are we in the best of all possible worlds? In United States (and many foreign) stock marketplaces in recent times, wonderful growth stories abound regarding numerous enterprises with short histories and unremarkable (or no) earnings. Indeed, wishful prophets of profit can forecast an eventual emergence of such great earnings (at least over the long run). But first quarter 2014 earnings for the S+P 500 appear likely to slip relative to the comparable prior year period.

What about debt domains? Pundits flush out from the underbrush opportunities in emerging, developing, and even so-called frontier nations as well as in corporate junk bonds. Greece, despite its huge debt burden, has left its "bond exile" with a big note issue (Financial Times, 4/10/14, p1). Pakistan, "which had not issued a bond in global markets for seven years", also sold bonds to "blue-chip mutual funds" (NYTimes, 4/10/14, pB3). Weakening credit (lending, borrowing) standards also signal looming financial risks. Note also the record New York Stock Exchange securities margin debt.

The International Monetary Fund's recent World Economic Outlook (April 2014, Table 1.1) chirps that world real GDP will rise 3.6 percent in 2014 (stretching up from 2013's 3.0pc) and 3.9pc in 2015. This international watchdog admittedly worries about topics such as too low inflation (or deflation) as well as debt burdens, including emerging marketplace corporate debt (World Economic Outlook and Global Financial Stability Report; April 2014). Yet arguably they and other wizards are underestimating potential marketplace troubles and risks.

Did wise owls foresee the worldwide economic disaster that emerged in 2007 and accelerated in 2008? The Financial Times headlines "IMF cuts downturn danger to near zero" (4/9/14, p1). This low assessment suggests complacency.

Also, the IMF and most other sentinels stubbornly continue to forecast very strong Chinese growth (IMF says 7.5 percent for 2014, 7.3pc for 2015) despite ominous signs of debt difficulties in local government and property arenas. Despite such sunny viewpoints of the IMF and others, China's Premier recently declared that its 7.5pc growth target for 2015 was "flexible". He ruled out new action to stimulate growth so long as employment was "fairly sufficient" and that no "major fluctuations" happened (Financial Times, 4/11/14, p2). In addition, a few days ago China also failed to sell all the bonds it offered at an auction(Financial Times, 4/12-13/14). See also "Chinese Rates: Opening the Gates" (12/2/13) and "Another Marketplace Tapering Tale: the China Story" (9/9/13). Moreover, despite the excitement over "Abenomics", Japan may be weaker than many believe; see "Japan: the Land of the Setting Sun" (3/7/14).

Although worldwide budget deficits as a percentage of GDP have fallen from their 2009 peak at around -7.8pc, they have not evaporated. The IMF forecasts a deficit of -3.5pc of GDP in 2014 and -3.0pc in 2015 (Fiscal Monitor, April 2014, Table 1.1). Worldwide general government debt consequently remains significant. Despite falling slightly from an 80.6pc of GDP high in 2012 to 78.6pc in 2013, 2014's is 78.2pc and 2015's 77.5pc. And general government debt of advanced economies will be unchanged at a mountainous 107.1pc in 2014 versus 2013. Japan's almost certainly will remain stratospheric in 2014, at over 243pc of GDP (Fiscal Monitor, Table 1.2).

The long run gigantic bull move in US stocks (major low in the S+P 500 at 667 on 3/6/09) probably has bred widespread complacency regarding the risks of a notable US (and international) economic slowdown (or downturn).

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Let's identify a few bullet points for several financial marketplaces. Previous essays detail many of these and related topics in greater depth, including relationships between various stock, interest rate, currency, and commodity marketplaces.

TAKING STOCK

"Like a true nature's child
We were born, born to be wild", Steppenwolf, "Born to Be Wild"

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Financial warriors, regulators, and the media often apply labels such as volatile, turbulent, and wild to stocks, especially when those instruments apparently are falling sharply or dramatically. Such language regarding American stocks and stock sectors has emerged in recent days.

Various statistical measures as well as visual ones attempt to measure and forecast "volatility". Depending on the perspective chosen for the given marketplace, including the time horizon selected for review, opinions differ as to what constitutes high, low, and average volatility.

For United States equities, the VIX S+P 500 index is a widely monitored volatility yardstick. History evidences frequent associations between significant S+P 500 bear trends and large VIX climbs (to high volatility levels).

The Federal Reserve's yield repression battle, keeping Federal Funds pinned to the ground under .25 percent (monthly average) since December 2008, probably has encouraged a gradual decline in VIX volatility. Since late December 2012, the VIX has roamed between about 11.0 and 23.0. A breakout over the 23.0 elevation probably will confirm a bear move in the S+P 500.

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Earnings for S+P 500 companies "are expected to record their first year-on-year decline in quarterly earnings since 2012." (Financial Times, 4/12-13/14, p1). Such an earnings drop will make herds of equity bulls unhappy, right?

There are various measures of profits and after-tax profits. Overall United States after-tax corporate profits (without inventory valuation and capital consumption adjustments) as a percent of nominal GDP for the past two years have been very high relative to long run history.

American after-tax corporate profits without inventory valuation and capital consumption adjustment were 10.97 percent of nominal GDP in calendar 2013 and 10.80pc in 2012. Not only do these exceed the Goldilocks Era high, 2006's 9.94pc. They are the peaks for data extending back to 1929. They decisively fly over the post World War Two average (1946 through 2013) of 6.46pc.

The US and international economic situation of course can and does change over time. The marketplace past for US after-tax earnings does not mandate a given future level for them. However, history indicates that sustained earnings slumps from recent levels would make the bullish case for US equities less compelling.

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Securities margin debt at the NYSE reached almost $466 billion at the end of February 2014. What occurred in this variable during the prior fierce S+P 500 major bull charge? The S+P 500 reached its 1576 summit on 10/11/07. The NYSE margin debt peaked not long before that, at $381bb in July 2007.

TAKING INTEREST

Surely many hopeful money lovers would enjoy the composition "Easy Money", performed by the Fletcher Henderson Orchestra.

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In recent years, sharp and sustained declines in various key stock marketplaces such as the S+P 500 often have inspired fearful "flight to quality" runs into US Treasury instruments (and to the German Bund and other safe havens). The US Treasury 10 year note reached a high at 3.05 percent on 1/2/14. Should the S+P 500 continue to decline from its recent high, monitor important support around 2.35pc to 2.50pc (2.47pc yield rise take-off point 3/18/09; 2.33pc low 10/8/10; 2.42pc high 10/28/11, 2.40pc top 3/20/12).

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Arguably the long run bear move in US interest rates since the UST 10 year's 7/25/12's major bottom at 1.38pc has been leading to a stock marketplace decline.

Besides, the Fed snarls that it is determined to achieve a two percent inflation target. Other central bankers accompany the Fed in this inflation-seeking march. So arguably even if a flight to quality situation emerges, the long run direction in US government yields probably remains up.

"America the Debtor" (3/17/14) comments: "Remarkably little progress has been made in the comprehensive (all-inclusive) US debt situation since 2009's very lofty percentage." Rising rates can result from severe fiscal problems, not just via inflation.

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All else equal, although much depends on the US budget deficit's size, what happens to US rates if foreigners continue to reduce their net buying (or become net sellers) of US Treasury notes and bonds? Net foreign buying was about $36.0 billion per month in 2011 and $34.7bb in 2012. However, it collapsed to $3.6 billion per month in 2013. Suppose Americans do not take up the slack. After all, the Fed currently indicates it will keep tapering its ravenous purchasing program.

TAKING TRIPS: THE US DOLLAR

Guns n' Roses sings in "Welcome to the Jungle":
"Welcome to the jungle, we got fun and games
We got everything you want, honey, we know the names
We are the people that can find whatever you may need
If you've got the money, honey, we got your disease".

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The broad real trade-weighted dollar ("TWD") touched its major high in March 2009 around 96.8 (monthly average, March 1973=100, Federal Reserve H.10). The S+P 500 reached its major trough that month, at 667 on 3/6/09. The TWD raced downhill to its record depth at 80.5 in July 2011.

Since July 2011, though the TWD clawed its way up to 86.2 in June 2012, this rally was modest relative to the March 2009 level (and February 2002's lofty 112.8). It has not surpassed this June height. In March 2014, it stood at 85.7. Many roar that a "weak dollar equals strong US stocks, strong dollar equals weak US stocks". The rather feeble TWD probably has encouraged the S+P 500's ascent over the past couple of years.

However, a weak TWD dollar may not continue to prop up US stocks. A break toward the 80.5 bottom arguably is bearish for American equities, particularly if it connects with worries regarding severe US fiscal problems and foreign net selling of US securities (particularly UST).

Cross rates obviously matter for US equity trends. A rally in the Japanese Yen versus the dollar (a break under Yen 100.0; then watch Y96.6/Y95.0) accompanied by a further decline in the Nikkei stock marketplace from its recent plateau (12/30/13's 16,320; note 4/3/14's interim high under 15,200 relative to the S+P 500's 4/4/14 top) probably will be bearish for the S+P 500.

What if the dollar weakens against the Euro FX? A decisive leap above 1.40 in the EuroFX against the dollar cross probably will be bearish for the S+P 500, especially if the European Central Bank does not rather quickly embark on its own quantitative easing (money printing) program. The timing (including legality) of any ECB QE is a thorny issue. However, the ECB probably will not engage in QE rapidly even if the Euro FX surpasses 1.40. Interest rate reductions, including negative rates, are a more likely first step.

TAKING ACTION: EMERGING STOCK MARKETPLACES AND COMMODITIES

In the movie "Predator" (John McTiernan, director; starring Arnold Schwarzenegger), a character states: "She says the jungle…it just came alive and took him."

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Emerging stock marketplaces ("MSCI emerging stock markets index" from Morgan Stanley- the MXEF) and commodities "in general" (broad GSCI commodity index) have traveled in a serpentine sideways to down path since their spring 2011 peaks. This portends that future economic growth levels may disappoint today's optimistic forecasters. A noteworthy decline in the S+P 500 probably will intertwine with bear moves in emerging marketplaces and commodities.

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