MARKETPLACE PARTY TANTRUMS
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Lesley Gore sings in "It's My Party":
"It's my party, and I'll cry if I want to
Cry if I want to, cry if I want to
You would cry too if it happened to you".

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MARKETPLACE PARTIES

In action-packed Wall Street, whether in US stocks or another fascinating venue, winning money tends to attract attention. All else equal, and as a general rule, the more people in a given game there who capture and keep cash over time, the more likely it is that others will tend to join the particular party. Of course a gathering can get rather full, with "about everyone jammed into the room". Or, for one or many reasons, the joyous event may become less fun, with the affair perhaps eventually ending, maybe even on a dismal note.

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The S+P 500's long and monumental bull march following the dreary final days of the global economic disaster (major low 3/6/09 at 667) may persist, but it currently looks rather tired and seems to be ending. In any case, stock investors in general have enjoyed the engaging party (rally) in US equities. Interest rate bulls in key domains such as US and German government debt have celebrated substantial tumbles in yields relative to June 2007 heights. As the Goldilocks Era danced to its end, the 10 year US Treasury note peak was 5.32 percent on 6/13/07; the German 10 year government note top also occurred that day, at 4.70pc. During the worldwide economic recovery, many fortune seeking investors (and speculators) have raced after suitable returns by gobbling up lower-quality debt instruments.

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Competing coaches in Wall Street and Main Street assign a variety of reasons for the emergence, continuation, and ending of both general economic and specific marketplace bull and bear trends. Such wizards and their apostles advise and offer opportunities and warnings to eager audiences regarding marketplace phenomena, including important changes in central bank and fiscal policy. Guides and followers wonder and debate regarding what can spark, sustain, or alter the course of noteworthy price adventures within one or more stock, interest rate, currency, and commodity playgrounds.

Apparently dramatic price fluctuations and trend changes frequently inspire talk of volatility, spikes, mania, and panic. Colorful metaphors frequently punctuate descriptions and explanations. The Federal Reserve Board Chairman's May and June 2013 tapering talk regarding potential reduction in quantitative easing (money printing) generated wordplay of a "taper tantrum".

Sometimes preceding but often during or following particularly colorful displays of price patterns, marketplace and media ringleaders regale avid audiences with enthralling and excited language. Some speeches and arguments offer opinions regarding "fair (or true, real) value" (overvaluation and undervaluation; overshooting and undershooting; too high and too low, too rich/expensive or too cheap), natural (rational, reasonable, sensible) prices, and equilibrium.

Securities marketplaces in America and many other nations are of course very large and important to the so-called "real" economy, not merely the "financial" one. Assorted "investors" (buyers) own lots of stocks and interest rate instruments. Moreover, investment (especially in securities) has long been labeled as a reasonable, prudent, intelligent, logical, good, and praiseworthy practice. In general, selling of (or speculation in) securities (especially stocks) is less meritorious (and sometimes allegedly even bad); short-selling (especially of investment-grade equities) is often criticized as dangerous or bad.

Therefore, significant price declines in the S+P 500, and often in interest rate instruments (particularly in supposedly high-quality, investment grade government and corporate debt securities), generally inspires substantial dismay, including talk of "tantrums". "Tantrum" language, when specifically applied to the stock and interest rate context, usually applies to price drops (bear trends). Bull moves in securities prices, even if they are of the same distance and duration as a bear trend, generally are not labeled as tantrums, for bull moves profit investors. Tantrums can ruin a wonderful party, right? Consequently, it pays to consider the potential regarding and to be on the lookout for the actual emergence of widespread and growing fears and talk about notable falls in securities prices.

Packs of Wall Street partygoers debate the definition, existence, causes, and cures of "overvaluation" phenomena such as "bubbles". Recently, some players ask if the S+P 500, Chinese stocks, many key government bond playgrounds (picture those of the United States and Germany), and US home prices are bubbles (or overvalued and so on). Will a given bubble be burst or merely have some hot air taken out of it? To what extent will rising US Treasury and corporate debt rates dampen the United States (and international) recovery? Will climbing US government yields, or fears of them, pop a stock marketplace bubble?

This valuation rhetoric is particularly important when interpreted alongside rising nervousness regarding the worldwide economic recovery. After all, reduced GDP expansion may make it more challenging to generate corporate profits and therefore equity price gains.

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Frequent conversations nowadays regarding overvaluation and worries about international growth underline the merit of focusing on a handful of corners within several entangled marketplace scenes. That review may help money hunters to assess the risks of staying in or entering a particular marketplace ballpark. This brief survey indicates information regarding or price points within particular marketplace arenas that will not only may draw greater attention to and inflame action in them, but also likely will help trigger dramatic price moves in other playing fields.

SLOWING DOWN IN THE GLOBAL RACE FOR GROWTH?

The narrator Johnny Strabler (played by Marlon Brando) says in the film "The Wild One" (Laslo Benedek, director): "It begins here for me on this road. How the whole mess happened I don't know, but I know it couldn't happen again in a million years. Maybe I could of stopped it early, but once the trouble was on its way, I was just goin' with it."

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The International Monetary Fund's 2015 Article IV Consultation with the United States (5/28/15; released 6/4/15) forecast US real GDP (annual average) at 2.5 percent for 2015 and 3.0pc for 2016. Contrast the higher growth predictions heralded only a few weeks before the Article IV gathering ("World Economic Outlook", April 2015, Chapter 1, Table 1.1) of 3.1pc for both 2015 and 2016. In the interconnected global economy, does this downward revision for America warn of similar cuts for many other advanced nations or the world in general?

The IMF recommends America should “defer its first increase in policy rates until there are greater signs of wage or price inflation than are currently evident.” Based on the IMF’s forecast, and assuming no upside surprises to growth or inflation, “this would put lift-off [of policy rate increases] into the first half of 2016.”

Despite Japan’s gigantic fiscal problems, and despite its mammoth money printing festival, the IMF retains a monetary easing bias for Japan. It whimpers that the Bank of Japan “needs to stand ready for further easing” (2015 Article IV Mission, Concluding Statement, paragraph 14, 5/22/15).

The World Bank says a “structural slowdown” in emerging market growth may last years. (“Global Economic Prospects”, “The Global Economy in Transition”: June 2015). In a lengthy article on emerging markets, the Financial Times (6/11/15, p7) trumpets: “For 15 years developing economies made a big contribution to global growth but after a sharp fall in trade they are now a significant drag. The shift has profound implications for the world economy.”

In addition, international productivity growth rates have slowed (Financial Times, 5/26/15, pp1, 9).

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The International Monetary Fund’s “Fiscal Monitor” (April 2015) unveils general government gross debt for advanced nations (“Statistical Appendix”, Table A7). Average debt for advanced economies rose from 72.0 percent of GDP in 2007 (US 64.0pc) to 106.8pc in 2012 (US 102.4pc). For 2015, the average dips only slightly, to 105.4pc (America’s creeps up to 105.1pc). Thus despite the economic recovery, gross government debt continues to soar over 2007’s height. By 2020, the average slides only to 101.1pc (US 104.3pc). This still rather gloomy debt situation and outlook probably weighs on economic growth. For some advanced (as well as emerging marketplace) nations, growing concerns about creditworthiness could boost their interest rates. In 2015, which nations are in first and second place? Japan’s is 246.1pc of GDP, Greece 172.7pc.

In any case, recent IMF comments, when interpreted alongside advanced nation debt burdens, underscores concerns about sluggish international output.

See a recent IMF Staff Discussion note (“When Should Public Debt Be Reduced”; June 2015), which allegedly does not necessarily represent official IMF views or policies. Advanced economies, though “facing some of the highest ratios of public debt since World War II” in some cases should recognize that a “third course, of living with high debt, merits consideration in countries where debt sustainability concerns are not pressing.”

THE CENTRAL BANKING GAME

William McChesney Martin, Jr., a former Chairman of the Federal Reserve Board, stated over 50 years ago: “In the field of monetary and credit policy, precautionary action to prevent inflationary excesses is bound to have some onerous effects- if it did not it would be ineffective and futile. Those who have the task of making such policy don’t expect you to applaud. The Federal Reserve, as one writer put it, after the recent increase in the discount rate, is in the position of the chaperone who has ordered the punch bowl removed just when the party was really warming up." (Speech to the New York Group of the Investment Bankers Association of America, 10/19/55).

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The Federal Reserve's artful long-running extraordinary and very easy monetary policy (notably money printing/quantitative easing and interest rate yield repression) has battled not only to spark and sustain economic recovery and buy time for serious action in the federal and other debt realms. The Fed has fought to expand inflation rates to a supposedly sufficient level while simultaneously embracing a debt yield suppression strategy.

The Federal Reserve Board leadership of the past several years may declare itself a prudent chaperone. However, it so badly wants inflation and has remained wedded to its accommodative policies for so long that it arguably is not a sober caretaker. "Sufficient" inflation in America may be achieved faster than many clairvoyants forecast. In any case, various indicators signal that there is more inflation around in the US than most believe. For example, look at US wage trends, stock and home price levels, and money supply growth. Moreover, despite the Fed's entrancing rhetoric about its exit strategy, it lacks a coherent well-developed one. Talk about forward guidance and data dependence does not magically demonstrate a talent for knowing when to remove the punch bowl. Other key central banks married to creating adequate inflation such as the European Central Bank and the Bank of Japan likewise lack a credible exit strategy. See "US Inflation Signals" (6/7/15).

Interest rate increases in the US Treasury marketplace in recent months, and especially in recent weeks, may portend more than an eventual Fed willingness to edge the Federal Funds rate up. The yield gains may indicate the Fed is behind the curve on catching up to inflation "in general". And is yield repression no longer working as well as before? When such long-lasting yield repression weakens or fails, or is removed, might there be a notable upward bounce in yields that would surprise many onlookers?

The Fed meets June 16-17, July 28-29, and September 16-17, 2015.

RATE JUMPS

Ella Fitzgerald sings:
"Now you say you're lonely
You cried the long night through
Well, you can cry me a river, cry me a river
I cried a river over you" ("Cry Me a River", by Arthur Hamilton)

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The potential for "flights to quality" into safe havens such as United States and German government debt securities has not disappeared. Nevertheless, the recent fierce interest rate advances in American and German government 10 year note yields and uproar regarding them probably indicate that the bull party (price rally) in those and related domains is over.

The US Treasury10 year note established an important low at 1.64 percent on 1/30/15 (above 7/25/12's 1.38pc major bottom). The UST yield went racing up to about 2.50pc recently, probably due to factors such as growing inflation fears and potential Fed Fund rate increases. After all, even the Fed guardian hints the "Longer run" Fed Funds target is roughly 3.75pc (see its 3/18/15 "Economic Projections", Figure 2). Perhaps there was some mysterious unwinding of long positions ("bursting of a debt price bubble") in American and Germany government debt. The German Bund spiked up from its 4/17/15 low at .05 percent (just above zero). Compare the timing of Japan's JGB low on 1/20/15 at .20pc. A leap by the UST 10 year up to and especially over the three pc hurdle (3.05pc high 1/2/14) would upset most UST debt owners (especially investors) in America and overseas.

The widely-watched US two year note achieved a major trough at .14 percent on 9/20/11, with a final low at .19 on 5/8/13. The more recent stage in its yield advance commenced from .24pc on 10/15/14, followed (and thus alongside the UST 10 year) by 1/30/15's .45pc low. Swinging over resistance around .75pc (12/26/14) would attract more voyeurs to the field. Players and those in the grandstands also will watch right around .90pc (see the 2/5/11 and 4/1/11 highs) and the 1.18pc (4/5/10)/1.21pc (12/31/09) tops.

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During the yield repression era, marketplace voyagers have searched around the world for suitable yield (good or at least reasonable returns) in assorted corporate and sovereign debt securities of varying credit quality. The Financial Times headlines (6/13-14/15, p15): "Yield refugees eye returns from risky EM debt". What happens if "investors" and other owners at such parties rush to the exits?

In recent weeks, yields for corporate bond benchmarks such as Moody's Baa index (Federal Reserve H.15 data; seasoned corporate bonds, all industries) have walked higher, thus accompanying US Treasuries. The Baa index low occurred 1/30/15 at 4.29pc (compare its 9.54pc summit on 10/31/08). It spiked up to 5.20pc as of 6/10/15. The Financial Times reports "Investors step up junk ETF withdrawal" (referring to the US sector; 6/11/15, p22).

In the current environment, sustained substantial UST and corporate bond yield increases would be a warning sign to owners of the S+P 500 and many other stock marketplaces.

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Watch out for widening credit spreads, such as those between UST and corporate debt, or between two sovereigns such as Germany and Italy (or Greece).

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Will Greece's arduous debt negotiations have an unhappy ending for that nation, its creditors, and assorted financial marketplaces? Many worry that a worsening of the current Greek debt disaster will be ominous for global stocks. Eurozone finance ministers meet June 18. For several months, the Greek 10 year government note rate yield has expanded. Watch key levels around 14.0 percent; 13.93pc was 4/22/15's high, which neighbored the 7/22/11's 14.24pc explosive yield take-off point.

<u>CURRENCY QUARRELS, DOLLAR DIVERSIONS</u>

In recent years, in efforts to achieve or sustain their desired economic growth targets, assorted nations have warned about or engaged in currency wars.

The US dollar remains a widely-watched cross rate benchmark. However, focus on the broad real trade-weighted dollar ("TWD"; Fed H.10, monthly average). There's a warning bell for partygoers in various financial and commodity marketplaces. S+P 500 (and advanced and emerging stock marketplace) owners surely have memories of 2007-09's equity bear moves in the context of dollar strength.

The broad real TWD's 17.9 percent bull move from its record low of July 2011 at 80.5 to March 2015's 94.9 surpassed its 15.1pc ascent from April 2008 to March 2009 during the global economic crisis. During the TWD's bull move during 2007-09's worldwide economic disaster (April 2008 low at 84.2), it made a notable jump from September 2008's 88.8 to October 2008's 93.9. Around that time, the dreadful crisis accelerated, with the TWD peaking in March 2009 at 96.9. March 2015's TWD level stood close to October 2008's elevation, and. May 2015's 93.0 has not retreated much relative to March 2015's height. S+P 500 (and advanced and emerging stock marketplace) owners surely have memories of 2007-09's equity bear moves in the context of dollar strength. Should the TWD remain around current levels, and especially if the TWD advances toward March 2009's top, might some stock owners furiously seek to escape from some of their stock positions? Steadily rising US interest rates alongside a strong dollar could encourage stock marketplace worries.

FURTHER FESTIVALS: EMERGING STOCK AND COMMODITY MARKETPLACES

The MSCI Emerging Stock Marketplace Index (from Morgan Stanley; "MXEF") is a key benchmark for emerging marketplace stocks. Despite the worldwide economic recovery, the MXEF has never exceeded its 4/27/11 peak at 1212 (which in turn hovers below its 11/1/07 Goldilocks Era pinnacle at 1345).

The 12/17/14 MXEF low at 906 crashed 25.2 percent beneath late April 2011's high. Though the MXEF travelled up to 1069 on 4/27/15, it then sagged, sitting in the 970s last week. A vicious attack on the December 2014 support would probably warn of (or confirm) feebleness in the S+P 500.

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Chinese stocks ("A-shares"; listed in mainland China) are not included in MSCI global equity benchmark and probably will not be included until at least 2017 (Financial Times, 6/10/14, p1; currently only Chinese stocks listed in Hong Kong are included).

However, take a look at China's Shanghai Composite. Recall its lows around 1974 on 3/12/14, 1991 on 5/21/14, and 10/23/14 at 2297. It has skyrocketed since then, flying to 5178 on 6/12/15. Its explosive rally (aided by a flood of retail buyers) over the past several months differs significantly from the MXEF trend. Nevertheless, given concerns about slowing Chinese growth, many wonder if the Shanghai Composite is "severely overvalued" or in "bubble territory". Fears abound that substantial risks lurk in Chinese property playgrounds and in its banking (or at least shadow banking) sector. "China orders banks to keep lending to insolvent provincial projects" declares the front page of the Financial Times (5/16-17/15, p1). If the enthusiastic party in Chinese stocks ends with a bang (picture a dive of about 20 percent or more), that could scare stocks elsewhere.

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Like the MXEF, the London Metal Exchange base metal index ("LMEX") has not beaten its 2011 peak (2/4/11 at 4478, and note also 4/8/11 at 4469; compare 5/4/07 plateau at 4557) in the succeeding years.

The LMEX made an important low on 1/29/15 at 2667. Though it hopped up to 3003 on 5/5/15, it thereafter skipped downhill to 2716 on 6/5/15. A decisive breach of January 2015's trough, perhaps assisted by a renewed US broad real-trade weighted dollar rally, probably would represent an alert for (be a confirmation of) weakness in various stock marketplaces.

After its celestial high at 1921 on 9/6/11, gold (nearest futures continuation) crashed 41.2pc to a low at 1130 on 11/7/14. Recall the TWD's bull move from its record low at 80.5 commenced in July 2011. After gold climbed up to 1308 on 1/22/15, its price has eroded. Watch to see if a break under November 2014's floor, especially if accompanied by base metal weakness and TWD strength, encourages talk about economic feebleness in emerging marketplaces (and elsewhere).

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The broad Goldman Sachs Commodity Index, which is heavily petroleum-weighted, has not exceeded its spring 2011 highs around 762 (4/11 and 5/2/11). The GSCI renewed its fall from 6/23/14's interim top at 673; compare the date of the $110.48 high in OPEC's crude oil basket, 6/20/14. In their 11/27/14 meeting, OPEC oil ministers decided to maintain their production quotas. The bloody collapse accelerated after that gathering, halting on 1/29/15 at 372 (down 51.1pc from the 2011 summit). Though petroleum prices have rallied and thus steadied the GSCI, a renewed descent close to January 2015's lows may link hands with further falls in emerging marketplace stocks or continued (and perhaps even greater) firmness in the TWD.

Watch to see if further progress occurs in the Iranian nuclear talks. The fierce war in Iraq thus far does not seem to be significantly endangering oil output there. Potential attacks on the oil fields of Saudi Arabia or its regional allies at least for now are not a significant threat to production.

AT THE S+P 500 CIRCUS

"This ain't no party, this ain't no disco, this ain't no fooling around." From "Life During Wartime", a "Talking Heads" song

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The US stock marketplace has long extended invitations. Come one, come all! Yet nowadays, is the US stock marketplace "too high", "overvalued", or "irrationally exuberant"? Significant leverage (easy credit) regarding stocks parallels the Fed's long-running highly accommodative monetary policy. NYSE margin debt reached a new record in April 2015 at $507.2 billion. Why do many stock marketplace bulls (especially investors) still complain so loudly against even modest (incremental) Fed interest rate increases? Maybe the US and worldwide economy is less robust than many coaches publicly assert.

Looking forward, will corporate earnings growth and share buybacks be substantial? Suppose US government and corporate interest rates continue to rise, particularly while the US dollar remains strong. Suppose emerging marketplace stocks head further south.

In any case, for the S+P 500 scoreboard, what percentage declines from a newly-attained high would cause many to believe that the US stock marketplace was throwing a fit (having a tantrum)? The S+P 500 achieved an all-time high at 2135 on 5/20/15. A five percent drop probably would not cause much squawking. There still would be plenty of cake sitting on the table. The Fed probably would not mind the party in US stocks "calming down a little bit for a while".

However, a ten percent decline probably would significantly upset the bullish fraternity (especially investors), causing notable and widespread pleas for help. Keep in mind the stake the Fed has in preserving the stock marketplace and real estate major bull moves as important parts of its economic recovery strategy (which includes strengthening consumer balance sheets). Ten percent deterioration in US stocks probably would not change Fed policy significantly, though it might induce soothing Fed wordplay aiming to steady prices, as well as delays in raising the Fed Funds rate.

A decline of around 20 percent or more in the S+P 500 probably would cause (confirm) a tantrum in stocks. Most stock bulls would be angry at or scared by such substantial price decay. They surely would want significant steps taken to stop the fall and restart the bull trend. Many players probably would bellow loudly that the long-running party in stocks indeed and finally was over (or at least of grave risk of ending). Many politicians would be worried, the financial media noisy and agitated. This turmoil and talk probably would not be confined to America. In any case, suppose such a stock fall occurred. Such widespread crying, demands, and fears, given the Fed's devoted allegiance to and pursuit of its statutory mandate, probably would motivate rather frantic Fed action to rescue and rally the stock marketplace.

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