MARKETPLACE FIREWORKS
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"Do you remember things that made sense? Things you could count on? Before we all got so lost? What are we gonna do, Charlie? What am I gonna do?" Ron Kovic, in the film "Born on the Fourth of July" (Oliver Stone, director)

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OUR CURRENT HORIZON: THREE EXPLOSIONS

Statistics and stories constantly bombard marketplaces. In today's marketplace environment, and especially when an especially enthralling news item bursts into view, many gurus and coaches scream about current or prospective crises, panics, and bubbles (overvaluation).

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One epic which has enthralled audiences from time-to-time in recent years, and especially lately, is the tragicomic Greek economic and political odyssey. What will be the potential implications for the Eurozone and other key global marketplaces? Now that Greece voted "No" in its 7/5/15 referendum, what will happen next in its tortured negotiations with its creditors? What clever schemes will crowds of worried bankers and fearful leaders agree upon, if any, to avert additional financial chaos and postpone comprehensive reckoning with Greece's debt disaster?

Rumors circulate that "Greek banks prepare plan to raid deposits to avert financial collapse" (Financial Times, 7/4-5/15, p1). In any case, at present this hugely indebted nation probably needs more money, perhaps another €60 billion in extra aid. See the International Monetary Fund's "Preliminary Draft Sustainability Analysis" (Table 1, 6/26/15; Financial Times 7/3/15, p4). http://www.imf.org/external/pubs/ft/scr/2015/cr15165.pdf

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Puerto Rico's governor, facing that US commonwealth's debt fiasco, less than two weeks ago declared that the island's debt of about $72 billion "is not payable". Hoping to restructure his domain's obligations, he seeks to avoid a "death spiral". (NYTimes, 6/29/15, pA1, pB2).

The governor commissioned a study by former IMF and World Bank officials ("Krueger Report", 6/29/15). The experts concluded: "A crisis looms." The strategic solution involves intertwined structural reforms, fiscal reforms and public debt restructuring, and the establishment of the commonwealth's institutional credibility. http://recend.apextech.netdna-cdn.com/docs/editor/Informe%20Krueger.pdf Have we heard such recommendations in recent years in regard to other nations around the globe?

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Stare at the heavenly spike in China's Shanghai Composite stock index. Some clairvoyants at various points wondered if the Shanghai Composite was "severely overvalued" or in "bubble territory". From lows around 1974 on 3/12/14, 1991 on 5/21/14, and 10/23/14 at 2297, it thereafter blasted higher to its 5178 apex, attained less than a month ago on 6/12/15. Its meteoric rally ended with a remarkable bang and a precipitous slide. The index has crashed nearly thirty percent to its 7/3/15 low around 3630.

To remedy this bloody collapse, China has announced various share support schemes, including a share buying scheme, halting IPOs, and targeting short sellers (NYTimes, 7/5/15, p8; Financial

Times, 7/3-4/15). Will the ending of the wonderful party in Chinese stocks scare stock owners (including “investors”, and especially leveraged players) in other realms?

CONCLUSION

Recent debt-related troubles in Greece and Puerto Rico and the collapse in the Chinese stock battleground are not isolated or entirely unique (special) marketplace events. They are signs and symptoms of widespread and intertwined marketplace phenomena. They are examples of and interconnected with current problems and related (linked) marketplace price movements around the globe.

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It is a truism that times change, but that does not mean that times necessarily are entirely or substantially different. Some historians may hearken back to the 2007-09 worldwide economic disaster; the United States real estate catastrophe and the demise of Lehman Brothers were not mere flare-ups. They did not stand alone. Debt, leverage, and credit problems were worldwide, even if they varied to some extent from place to place; their consequences erupted around the globe.

The Federal Reserve, European Central Bank, Bank of Japan, Bank of England, and China’s central bank have engaged for many years in highly accommodative monetary programs. Despite lax policies such as sustained yield repression and massive quantitative easing (money printing), international debt, leverage, and credit problems did not disappear. They persisted and have reappeared. These central bankers have provided cosmetic fixes, not permanent ones, to such difficulties. Remarkably easy money policies, aided by political deficit spending, have helped to spark and sustain worldwide GDP growth since around early 2009.

Yet that past success does not guarantee future triumphs. Is worldwide growth decelerating? Probably. Note the downward growth revisions in recent months for 2015 for the United States by the International Monetary Fund (Article IV Consultation, released 6/4/15) and the Fed (Economic Projections, 6/17/15). Indications of a Chinese slowdown preceded its recent stock tumble. There have been concerns about the property marketplace, shadow (and other) banking, and increasing debt. “China orders banks to keep lending to insolvent provincial projects” declares the front page of the Financial Times (5/16-17/15, p1). Note the continued bear marketplace trend in base metals in general. Through May 2015, China’s year-on-year electricity output was about flat, up only .2pc (National Bureau of Statistics).

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Some issues obviously matter more to some traders (and marketplace sectors) than others. But in today’s interconnected global marketplaces, various key stock, interest rate, currency, and commodity playgrounds intertwine in diverse and often-changing fashions. Moreover, these arenas are never separate from the “real” economy. So flashy economic stories about one marketplace or nation can spark or accelerate modest and sometimes even dramatic price travels in numerous venues.

And regardless of which exciting tales currently capture substantial trading and media attention, they usually reflect and interconnect with crucial (and so-called “underlying”) economic (financial, commercial) and political phenomena. These noteworthy variables, issues, trends, and opinions regarding them not only capture the attention of many marketplace players, but also necessarily remain major factors for Wall Street price action and Main Street prosperity.

SOME FINANCIAL FIREWORKS: DEBT, "BUBBLES", AND INFLATION

"The most stringent protection of free speech would not protect a man in falsely shouting fire in a theater and causing a panic." US Supreme Court Justice Oliver Wendell Holmes, Jr., in Schenck versus United States (1919)

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The debt and leverage (credit) problems in the United States and elsewhere which developed prior to yet culminated in the Goldilocks Era arguably remain unsolved, or have appeared in related forms. For example, America in general has a love affair with debt. The overall consumer debt burden has lightened somewhat since the darkest nights of the 2007-09 crisis. However, federal debt has jumped up. Thus America's overall indebtedness remains quite significant. See the essay, "America's Debt Culture" (4/6/15). http://www.leohaviland.com/wp-content/uploads/2015/04/Americas-Debt-Culture-4-6-15.pdf

Now look further forward in time and picture a slow-burning fuse tied to an explosive charge. America's Congressional Budget Office declares: "The long-term outlook for the federal budget has worsened dramatically over the past several years". Federal debt held by the public is about 74 percent of GDP, "a higher percentage than at any point in U.S. history except a seven-year period around World War II". Suppose current law remains generally unchanged. Although debt held by the public dips slightly for the next few years, growing budget deficits propel federal debt held by the public to over 100 percent of GDP by 2040. "The historically high and rising amounts of federal debt…would have significant negative consequences, including…increasing the likelihood of a fiscal crisis." ("The 2015 Long-Term Budget Outlook", 6/16/15; "Summary", p1; chapter 1, Figure 1-1, p11).

Let's take a detour onto one of America's entrancing debt highways. Outstanding US student loan debt at end 1Q15 was about $1.2 trillion, which obviously dwarfs Puerto Rico's debt. But about 11.1pc of aggregate student loan debt is 90 or more days delinquent or in default (Federal Reserve Bank of New York, "Quarterly Report on Household Debt and Credit", May 2015). Ten percent of $1.2 trillion is $120 billion, still far more than Puerto Rico's $72 billion.

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Worldwide general government gross debt as a percentage of nominal GDP remains lofty. According to the International Monetary Fund's April 2015 "Fiscal Monitor", it stood at 65.0 percent in 2008. However, this debt soared to 80.5pc in 2012. The worldwide percentage has remained around that height (79.8pc in 2014). The IMF weathervane declares that percentage is unlikely to slide much soon; they forecast 80.4pc for 2015 and 80.0pc in 2016.

What about general government gross debt within the advanced economies camp? From 72.0 percent of GDP in 2007 and 78.8pc in 2008, it skyrocketed to 106.8pc in 2012. Although some nations have cut their budget deficits, gross debt has stayed quite elevated, with 2014 at 105.3pc and 2015's forecast at 105.4pc. It drops to only 101.1pc in 2020 (Table 1.2 and Table A7).

Japan's general government debt as a percent of GDP at end 2014 was a towering 246.4pc. Compare Greece's estimated 177.2pc. By 2020, Japan's rises to 251.6pc.

Also keep in mind debt crises in the Ukraine and various other emerging/developing nations.

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Long-lasting highly accommodative monetary policy, notably sustained yield repression and massive money printing by the US Federal Reserve and its friends, have been widely praised by investment patriots in stock and interest rate instruments, and especially by US stock marketplace bulls. The ravenous appetite for yield (return) promoted via policies embraced by the Fed and its allies helped to propel many equity and debt prices in America and elsewhere to very high levels. And more and more cheap money, whether for governments, firms, or individuals, whether in America or elsewhere around the globe, can inspire more and more borrowing and leverage.

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July 4 devotees fervently stare at the as the evening sky as fireworks extravagantly explode. Money-worshiping Wall Street players and Main Street dwellers nowadays avidly ask whether the S+P 500 will plummet significantly from its all-time peak at 2135 on 5/20/15, or instead resume its majestic ascent. The essay "Marketplace Party Tantrums" (6/15/15) remarks: "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?"

Prices in once-skyrocketing American stock and interest rate instruments display beginnings of heading back toward earth. The essay concludes: "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." "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."
http://www.leohaviland.com/wp-content/uploads/2015/06/Marketplace-Party-Tantrums-6-15-15.pdf .

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Strong corporate earnings of course help stocks to climb higher. So do share buybacks. But look also at leverage measures for US stocks. Tops in NYSE margin debt levels in recent years often roughly coincide with important peaks in the S+P 500; troughs in margin debt fit key bottoms in the S+P 500. Recall the margin debt low in February 2009 at $173.3 billion alongside the S+P 500's major bottom on 3/6/09 at 667. Compare April 2015's recent record high at $507.2 billion and the $499.1bb May 2015 level just under that with the S+P 500's 5/20/15 high to date at 2135.

On a related front, the Financial Times underlines "US takeovers soar close to $1tn fuelled by cheap money and search for growth". Average US deal valuation in first half 2015 surpassed the previous high, that of 2007 (6/30/15, p13).

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"US Inflation Signals" (6/7/15) emphasized: "'Inflation' is not confined to measures such as the CPI or personal consumption expenditures; 'the economy' includes other inflation benchmarks. Various indicators signal there is more inflation 'around' in the US than most believe. Underline American wage increases. Note central bank and marketplace murmurings regarding high valuations or so-called asset bubbles; keep in mind the climbs in US equities and home prices from their financial crisis depths. Money supply growth remains robust. The steely determination

of the Fed and its central banking allies to achieve their inflation objectives heralds that monetary policy probably will remain quite lax for some time even if the US eventually raises rates."
http://www.leohaviland.com/wp-content/uploads/2015/06/US-Inflation-Signals-6-7-15.pdf

Frantic "flights to quality", quests for suitable yield (return), and other supply/demand considerations, not just low inflation statistics, can rally prices of debt securities. Yet sustained central bank yield repression probably created, or at least encouraged, "too low" yields for (perhaps even a price "bubble" in) key government debt securities such as those of the United States and Germany. In the Eurozone, the horrifying enemy called deflation approached. The European Central Bank fired back with a gigantic money printing plan involving government debt securities. Some European government security interest rate yields went negative.

However, the US (and German) debt security price bull move reversed recently (a so-called bubble popped).

The 10 year US government note established an important yield bottom at 1.64 percent on 1/30/15, above 7/25/12's major bottom at 1.38pc. The 30 year UST bond's low was 2.22pc on 1/30/15. Since January 2015's valley, the US 10 year rate shot up roughly 50 percent to 6/11/15's 2.50pc. The 1/2/14 summit at 3.05pc represents important resistance. In any case, what should the yield on US 10 year government notes be if inflation (such as in the PCE) stands at 1.50 percent or higher? What will foreign holders of US Treasury securities do if rates continue to march higher?

Watch for rising yield trends in US corporate and municipal bonds. Moody's Baa index of corporate bonds established a low at 4.29pc on 1/30/15, the day of the UST 10 year's low. It jumped up to 5.30pc on 6/26/15. The Bond Buyer Index for 20 year general obligation municipals (state and local) low was 1/15/15's 3.29pc; its recent high is 6/11/15's 3.87pc. See the Fed's H.15 data.

The 10 year German government note made a key bottom on 4/17/15 close to zero, at .05 percent (not long after the UST 10 year note made a minor low at 1.80pc on 4/3/15). Bund yields thereafter blasted higher, reaching 1.06pc on 6/4/15. The Japanese 10 year JGB made a significant trough in 2015 shortly before the UST's, on 1/20/15 at .20 percent. It reached .55pc on 6/11/15.

Thus if US stocks recently reached "too high" levels due to subdued interest rates, rising interest rates (or growing fears of them) can be a factor inspiring those equities to retreat (burst their bubble). The S+P 500's 5/20/15 top at 2135 followed a period of rising UST 10 year note yields. The recent high in the European stock marketplace (STOXX Europe, 600 stocks; "SXXP") was about 415 on 4/15/15, around the day the Bund yield spike commenced.

Regardless of whether or not American government note yields recently were (or are still) "too low", the recent sharp increase in UST 10 year note rates probably reflects not just a technical correction or a growing belief that the Federal Funds rate (and thus yields in US government securities) will rise in the relatively near future. That noteworthy UST yield leap probably also warns that US inflation "in general" has grown or will do so soon.

Watch signals such as the US five year forward inflation expectation rate (St. Louis Fed). This has hovered around two percent in recent weeks. Since the start of 2010, it approximately has ranged between slightly under two pc to around three pc. This signpost made lows at 1.93pc on

1/29/15 and 3/17/15 at 1.94pc. It thereafter has gradually edged up, reaching 2.18pc on 6/26/15 and 7/1/15.

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Inflation of course is not the only source of rate jumps. The history of junk bond marketplaces and sovereign debt crises (including the current Greek situation) shows that creditworthiness fears (lack of confidence in ability to pay debt obligations) can ignite rate rises.

OTHER RELATED EXPLOSIVE SITUATIONS

Grateful Dead, "One More Saturday Night"
"I went down to the mountain, I was drinking some wine,
I looked up into heaven, Lord I saw a mighty sign,
Writ in fire across the heaven, plain as black and white;
Get prepared, there's gonna be a party tonight."

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With the 2007-09 crisis experience in mind, particularly in relation to the S+P 500, monitor in the current context the broad real trade-weighted US dollar level and trend ("TWD"; Fed H.10, monthly average). The TWD advanced from a low around 84.2 in April 2008 (just before the S+P 500's final high at 1440 on 5/19/08) to 88.8 in September 2008, leaping up to 93.9 in October 2008. The S+P 500 was blasted to bits from around 8/11/08's 1313 and 9/19/08's 1265. The TWD's March 2009 high at 96.9 arrived around the time as the S+P 500's 3/6/09 major low at 667.

The broad real TWD established a major low at 80.5 in July 2011. Over the past several months, its ascent has taken it to levels around the key October 2008 level. The recent TWD high was March 2015's 94.9, and it has dipped only slightly since then, with June 2015 at 93.9. The 2007-09 financial crisis era points to the importance of the October 2008 and March 2009 TWD levels. The TWD's ability to remain around the October 2008 level represents a warning sign that a notable fall in the S+P 500 (and "related" marketplaces) probably beckons. A TWD charge toward or above its March 2009 pinnacle obviously would underline this danger confronting stock owners.

Although the broad real TWD is not reported daily, the nominal TWD is. The nominal TWD's recent low, 5/15/15 at 112.8, occurred shortly before the S+P 500's 5/20/15 high at 2135.

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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). It made an interim high 9/4/14 at 1104. However, the MXEF nosedived to a notable low several months ago, on 12/17/14 at 906 (25.2 percent beneath late April 2011's high), near important support around 875 (877 low 6/4/12, 878 trough 6/25/13). An attack on and particularly a breach of this 875/906 range probably would cause shouts that an economic crisis was emerging or spreading.

Feebleness in the MXEF thus may intertwine with (confirm) strength in the broad real TWD. Such MXEF weakness also may warn of (lead; confirm) a S+P 500 decline.

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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 bounced up to 3003 on 5/5/15, it since has broken beneath its January 2015 floor (note the TWD strength), touching 2601 on 6/30/15. This decisive breach of January 2015's trough warns of global economic weakness. It underlines the likelihood of slowing Chinese GDP growth in particular.

After its celestial high at 1921 on 9/6/11, gold (nearest futures continuation) crashed 41.2pc to 1130 on 11/7/14. Recall the TWD's bull move from its record low at 80.5 began in July 2011. After gold climbed up to 1308 on 1/22/15, its price has eroded. A break under its November 2014 low would be noteworthy, especially if accompanied by TWD bullishness.

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The broad Goldman Sachs Commodity Index is heavily petroleum-weighted. It has not exceeded its spring 2011 highs around 762 (4/11 and 5/2/11). The GSCI renewed its bear trend following 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 GSCI collapse accelerated after that gathering, halting on 1/29/15 at 372 (down 51.1pc from the 2011 summit).

Petroleum prices then rallied and thus steadied the GSCI. However, the GSCI rally stopped on 5/18/15 at about 455. Note the closeness of this mid-May date to the nominal TWD's recent daily low, 5/15/15 at 112.8 and the S+P 500's 5/20/15 high at 2135.

Watch to see if further progress occurs in the Iranian nuclear discussions. The fierce civil war in Iraq thus far does not seem to have significantly endangered 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.

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