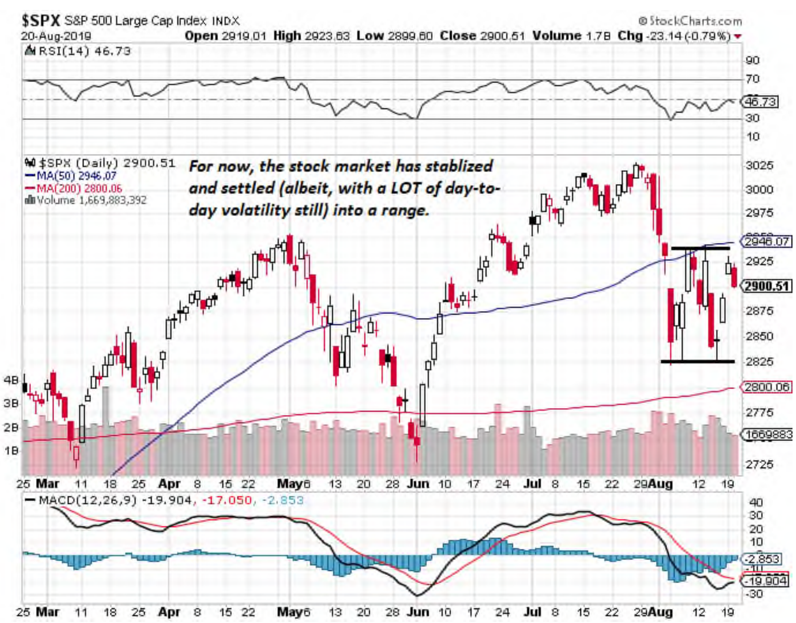
THE National Investor

August 21, 2019 *You can get information anywhere. Here, you get KNOWLEDGE.* ***COMMENTARY***

IT'S THE MARKETS…NOT THE ECONOMY…WHERE SOMETHING WILL "BREAK"



Hope Springs Eternal!

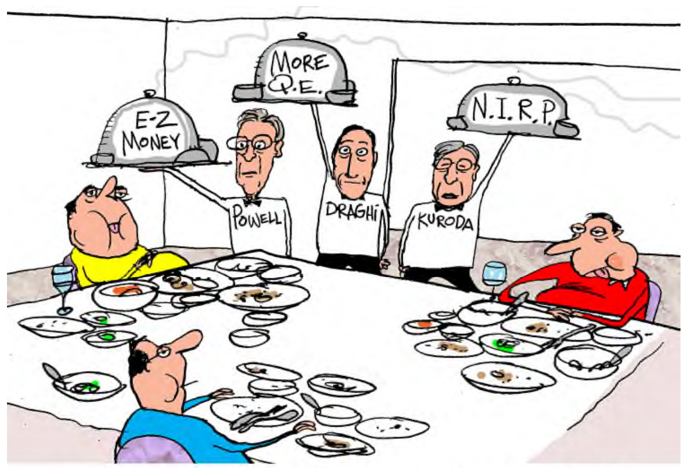
The new week started off on Monday with a renewed rebound for risk assets. Optimism over 1. President Trump *supposedly* holding out a new olive branch to China and 2. The prospect of "Central banks gone wild" as *CNBC*'s Rick Santelli quipped the other day have—for the time being—arrested what was looking to be a significant free fall for global equities.

Some good economic news is out this morning also, showing the resilience of, at least, the American consumer; this in the form of good quarterly numbers from Lowe's and, especially, Target (the latter of which raised its outlook.) That this continued narrative of a decent-enough performance for the U.S. economy could mean that the Federal Reserve will *not* be as forthcoming as markets (and President Trump) are pining for doesn't matter for now. It's reason enough today morning for a few "Buy the dippers" to stick their necks back out a little.

More of a blind faith than normal seems to exist right now in global markets which remain oblivious to the dark clouds that have been forming in several foreign *markets*. Most do not believe Trump is serious about sticking to his guns where China is concerned. He "won't risk" his re-election or the U.S. economy much longer, it's thought. He'll blink, some say (or already has, in his recent modification of new tariffs and more.) *You won't want to be defensively invested if The Orange Wonder rolls over and calls off the trade war*!

As for the central banks, markets still have sufficient "muscle memory" from the past, early effects of the "extraordinary" post-2008 monetary policy regimens that they are somewhat oblivious still to the mess that NIRP, ZIRP and Q.E. have wrought. That ever more of this in places like Europe especially has NOT led to renewed economic growth *but has instead solidified recession and deflation forces* is still lost on most of those urging the Federal Reserve to go more "all in" itself on this. At least some seem to get this; notably, Boston Fed President Eric Rosengren, who has warned that further cuts by the Fed not only won't move the needle on growth much, but will further exacerbate the financial imbalances that are already present.

The Fed, of course, *will* move further down the easing road itself, even if it is with Rosengren still a dissenter; *the question is not if but how/when*. We might get a little color on that at the impending late Summer picnic and gab fest out in Jackson, Wyoming, though anyone expecting *specific* policy unveiling might be disappointed. We'll see.



"Don't stop now...we have more food, and we'll even lower the price!"

The urgency right now for all these monetary alchemists has much less to do with economic growth (or the lack thereof in Europe, which is slipping more clearly into recession.) Nor is it about trying to stoke more "inflation." **It is about making sure that global *markets* do not seize up as they did back in 2008**.

HOW MUCH OF AN EMERGENCY?

Keep in mind we would not be seeing these increasing oceans of liquidity and a lot of "emergency" easing of late were it not for the clear and present danger that *markets* are coming unglued once more. I have spoken and written of this in considerable detail of late, **especially where the seeming Achilles' Heel of global markets—Asia generally, and Hong Kong and China *both* specifically—is concerned**. The health of the U.S. economy and consumer will mean *nothing* in the grand scheme of things if something "breaks" there (or in Europe, where we aren't hearing the full story of what a now-zombie Deutsche Bank means) and global markets fall in on themselves.

Last week, both Hong Kong and China sought to get out ahead of events. In Hong Kong, a massive monetary and fiscal stimulus alike was unveiled in order to stop bleeding, capital flight, etc. As I pointed out recently (echoing some warnings of hedge fund manager Kyle Bass) **there is no financial center on this planet more leveraged than is Hong Kong**.

One of the *many* questions at least a few farther-sighted investors are asking is what happens as this whole global skyscraper of cards starts to unwind when it comes to such leveraged—but now, tainted—centers as Hong Kong? If those like legendary investor and "Investment Biker" Jim Rogers are right (see https://www.rt.com/business/466897-hong-kong-capital-jim-rogers/), Hong Kong may well be on its way to history's dust bin. Only a fool would believe that such a thing—and the many other changes *now underway*—will come about seamlessly and without major dislocations from time to time in the functioning and liquidity of global markets.

In China proper, authorities last weekend unveiled a rejiggering of their interest rate structure which effectively lowers borrowing costs for *all* businesses, not just the most credit-worthy ones. (For more color if you like, see https://www.cnbc.com/2019/08/20/china-economy-pboc-reforms-loan-prime-rate-bank-lending-rates.html?recirc=taboolainternal.) **Here again, this is less about economic growth than it is shoring up the most bloated debt market colossus on the planet**. Especially with that recent drop in the yuan and all signs pointing toward a further managed decline in that currency, it will be all officials in that country can do to keep a larger implosion at bay. *And this is ever more the case as the U.S. Dollar's strength continues to weigh on Chinese (and other) debtors owing trillions in U.S. dollar-denominated debt*.

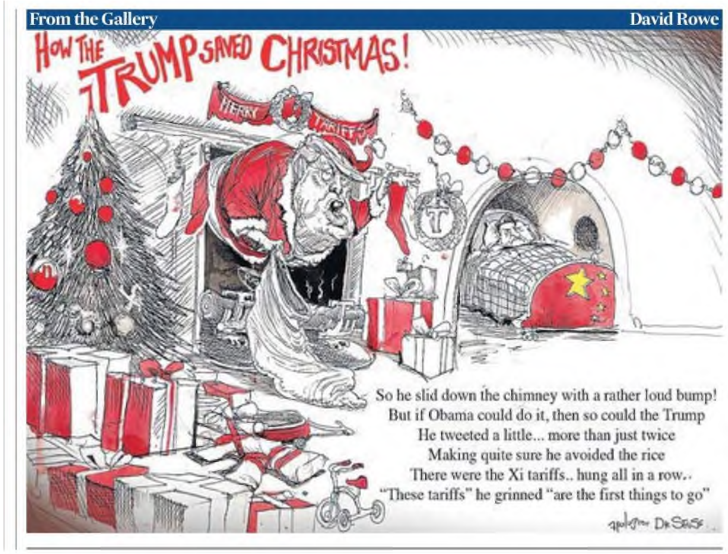
Not to be outdone by those in Hong Kong and China, E.C.B. President Mario Draghi is readying another major bazooka firing on his way out the door. Channeling his own "inner Trump," E.C.B. Governing Council member and Finnish bank chief Olli Rehn last week spared no superlatives in raising expectations for just how much more E-Z money Frankfurt is ready to unleash come its next meeting in September. The E.C.B., he says, is ready to "overshoot" market expectations in how much farther into negative territory rates can be pushed and in how many more bonds the bank can buy. *That negative rates and world-leading Q.E. to date has done squat for Europe's economy was not addressed*. Maybe someone needs to remind Rehn, Draghi and the rest of that old definition of insanity; Doing the same thing over and over again, and expecting a different result.

Elsewhere, trouble spots have opened up in Argentina, where the surprise defeat of President Macri has opened the door for a renewed "socialist" takeover of that country. The peso and markets there have plunged in response. Mexico has cut interest rates for the first time in several years, joining a host of other developing countries globally. Brazil's economy is teetering on the edge of recession.

"TRADE" TALKS

For the sometimes whimsical Leader of the Free World, there are essentially two "emergencies": that the stock market is not still hitting record highs, and that a too-slow Fed easing cycle will doom his re-election chances. To *some*, the appearance has thus of late been of a man losing his nerve a bit where the Cold War with China is concerned. Last week, President Trump hobnobbed by phone with some major bank leaders, trying to figure out how things are on Main Street and if he really *does* need to be more worried about the U.S. economy, tariff effects, etc.

In addition, he held a much-ballyhooed dinner meeting last week with Apple C.E.O. Tim Cook, in part over Cook's worries that Apple was at a competitive disadvantage now due to tariffs. Even before that, the president had announced that some of the tariffs due to take effect on September 1 were being delayed until December, in order that consumers (including buyers of Apple iPhones and more, which were among the import tariffs delayed) wouldn't see Christmas Season price increases.



I could still be proven wrong; and after all, I have many a time pointed out ways in which The Orange Wonder flip-flops on key issues with no warning. **But I think the narrative of these tariff delays being a "cave-in" or some such thing has been woefully overdone**. What he has done, as I see things *so far*, is to take steps to tweak existing priorities in a way to help U.S. businesses and consumers; not China.

Ditto where Huawei is concerned. Nothing has changed there except for an added 90 days for some U.S. telecom companies to "wean themselves off" of the Chinese tech giant, as Commerce Secretary Wilbur Ross puts it. Indeed, that the break with Huawei will likely prove irreversible was underscored 1. by the adding of 46 more Huawei subsidiaries to the so-called "entity list" (i.e.—blacklist) and 2. The defense and security establishment coming forth with much more evidence of late of Huawei dirty tricks and cyber espionage.

Faced with increasing questions—if not some thinly-veiled taunts—over his past claims that this trade war, tariffs, etc. were nothing but a bed of roses for the U.S., **Trump has been changing his tone to, quite possibly, reflect both a little more reality and a resolve to stay the course**. Yesterday, he commented in answer to whether consumers, businesses and the U.S. economy generally might suffer a bit more pain after all, that, "Whether it's good or bad short term is irrelevant." He continues to stress that this New Cold War with China was a long time coming and must be seen to its conclusion; and that nobody until him was willing to push this.

And as I have increasingly pointed out especially since that sea change on May 1, that this has become WAY more than a trade war is more evident than ever, given the increasing security and military overtones, **and the fact that the Defense Establishment and Deep State seem to be driving this bus ever more**. And that goes both ways. As much as Apple, American farmers, fentanyl and the rest, we're hearing about the U.S. fomenting (or helping to foment) the protests in Hong Kong. . .U.S. arms sales to Taiwan. . .the Chinese company working on the Hinckley nuclear project in the U.K. having stolen U.S. technology. . .renewed disputes over the South China Sea. . .*and much more that has nothing to do with sneakers, soybeans and smart phones.*

Were this all just about one Donald J. Trump and his "Art of the Deal"—and his self-absorbed nature and desire to go down in history as the greatest deal maker of them all, as well as the reincarnation of George Washington—I might buy the idea that he'll find some way to arrive at a rapprochement with China. **But we're past that now.** He may have no more ability to turn back now than Barack Hussein Obama kept his promise to be a more "peaceful" and circumspect president, only to send drones to bomb half the developing world. . .cause a revolution in Ukraine that backfired. . .and further roil the Middle East (with the able help, of course, of his sociopathic Secretary of State.)

It strikes me that neither the Trump sycophants nor those with T.D.S. have much of a clue of the larger forces at work here; and that we are already on a path that may not have a happy ending.

CENTRAL BANKS TO THE RESCUE…BUT MORE ADDED HARM THAN GOOD?

In his speech this week at the Kansas City Fed's Jackson, Wyoming gathering (officially entitled "Challenges for Monetary Policy") **Fed Chairman Jay Powell's first order of business will be to say what's needed so that markets do *not* rebel as they did in late 2018**. The usual suspects among Wall Street and Establishment pundits, of course, are warning that if Powell does not quickly show he plans to get as aggressive (wild?) as other central banks, markets could throw a fit; see, as one example, Jim Bianco's warning at https://www.cnbc.com/2019/08/17/stocks-will-tumble-if-fed-doesnt-get-more-aggressive-james-bianco.html.

And for good measure, President Trump is dialing up the pressure on the Powell-led Fed as well. But whether he—and spoiled markets—get what they all want right away is questionable. At best, Powell will offer some hand-holding and vague promises to be ready to actually do something more if warranted. But as I said in one of the most recent issues, he's not in a hurry to prove that the Fed going to zero rates/renewed Q.E. will be just as impotent as we've seen in Japan and Europe.

I'm personally curious to see to what extent stuff we *haven't* already seen is discussed. Will the Fed at least (given it's the one main financial power on the planet, and still with a plus sign in front of yields) try to engineer a steeper, positively-sloped yield curve? Will they and, especially, the E.C.B. come up with ways to re-liquefy credit markets, **given that their "easing" has served paradoxically to dry up credit and securitization in the private sector**? Ideas such as 50- and 100-year paper in MASSIVE quantities is being discussed.

What markets *don't want to hear but likely will* is that the central bankers will make a renewed effort to put the burden for the future on elected officials and fiscal measures. They will point out the obvious—that monetary policy tricks have done all the heavy lifting to date and are starting to lose their effectiveness—and suggest that more aggressive direct fiscal stimulus is needed. Trump has already teased us all with a *possible* payroll tax cut, among other things (this despite the best U.S. economic performance in recorded history, mind you.) German officials are talking about direct fiscal stimulus. China, of course (and now Hong Kong) are full tilt in that direction.

Last but not least, I'm going to be curious to see **to what extent the U.S. dollar's intractable strength is addressed**. Here too, Trump crows about the best economy in solar system history; but has a hard time with *this* particular consequence of that.

I certainly don't see Powell suggesting that there will be such an aggressive, near-term ramp-up of easing on the Fed's part to take much steam out of the greenback. And that's the case, in part, given that everyone else IS in that "gone wild" mode now. Yes, he seems to know now how much damage that is doing elsewhere. So does The Orange Wonder (though he's more worried about the harm the dollar might do to his re-election chances than to banks in Argentina or Hong Kong, or construction firms in China.) But Powell is not at "shock and awe" stage yet.

So the biggest risk coming out of Jackson is that the U.S. Dollar not only stays strong, but makes yet another new high for this relentless move. The odds are better than even of this happening for the *variety* of reasons I have been outlining. This could punctuate a significant let down for markets come next week.

Further, bear in mind that the rise in the dollar now is not as much the "good" kind we saw much of last year; where the U.S. economy led the world forward, had better individual fundamentals, etc. **Now, it is due more to fear.** Further still, as I pointed out last week, there are growing signs of *dollar shortages* and related stress in some foreign money and credit markets. This comes as both economic growth and the ability/willingness of lenders to lend has bogged down. If we do see the greenback move to new highs with any kind of momentum, that will serve to do what the drop in interest rates has done: trigger recession fears, algorithms that will sell stocks and commodities, etc.

A dollar surge will tank markets and launch a mad dash for (mostly dollar; secondarily yen) liquidity. This vicious circle will feed on itself until the Fed—after the fact, as in 2008—stops the wreckage from spreading.

THIS—not any weak spots in the American economy, which remains relatively strong—is what concerns me. Before long I think that Jerome Powell's warning from early in his tenure will come true: that a new recession—perhaps a global one—will not come about in the usual way, but be caused by previously-blown bubbles bursting and then feeding over into economies. In the 2000-2002 time frame and again in 2007-2008, these busts were more uniquely American. This time, the U.S. (specifically, the Fed) will merely have been but one accomplice of sorts to a Chinese/Hong Kong credit crisis (most likely) or another outside our own four walls.

So notwithstanding the ability of the U.S. stock market particularly in recent days to stabilize, I am continuing to advocate the more notably defensive posture I've adopted in the last few weeks. I'll have added market comments—including on our specific portfolio allocations—for Members in a follow-up e-mail very soon.

Don't forget that those of you so inclined can follow my thoughts, focus and all *daily* ! ! !

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