GordonTLong.com

LIVING ON BORROWED TIME!

MACRO INSIGHTS

Gordon T Long
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Living on Borrowed Time

Excerpted from the latest MATA Report

We have continuously reported the steady deterioration we see in the overall financial markets, but despite this the markets have continued to soar to new dizzy heights. For the first time in history it has occurred in both the equity markets and the bond markets at the same time.

We now have a bubble in the equity market that makes the Dot.com bubble pallid in comparison and a bond bubble that is larger than the equity bubble as over $2T in bonds are forced to trade at negative yields which previously had been considered the natural limit of the upside to a bonds price appreciation.

In the equity markets this is primarily because of three reasons:

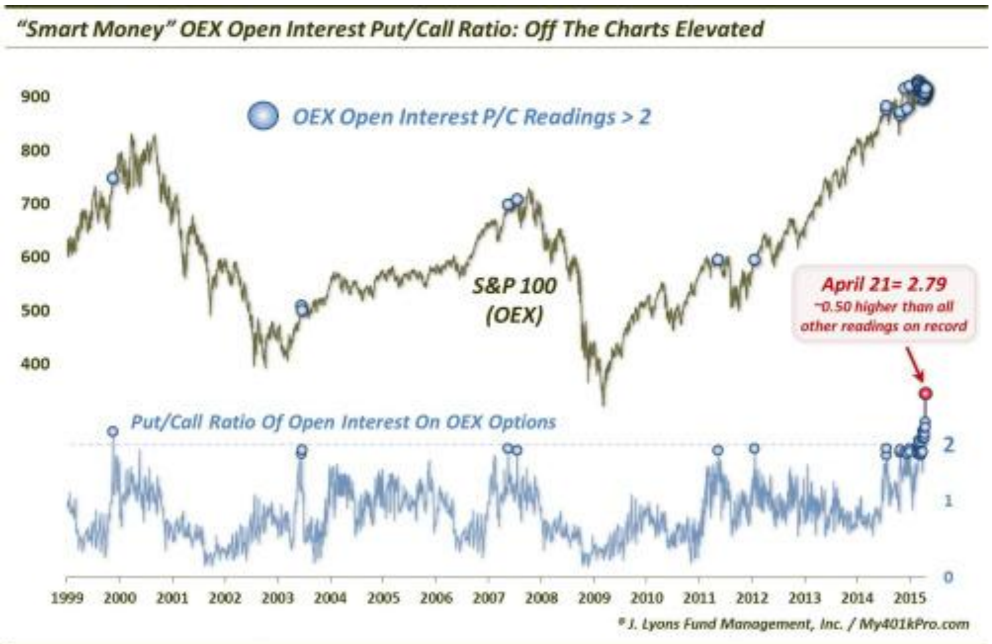
1. Corporate Tax Incented Buybacks reaching unprecedented levels,
2. Central Bank interference in the markets through large scale options buying,
3. Sovereign Wealth Fund & Government Pension Plan Buying,

All three of these have previously been unheard-of and are basically different forms of market manipulation.

Recently the Swiss Central Bank admitted it was buying shares. It was disclosed that in 2013 it moved from 12% to 16% of their total asset holdings. The Swiss Central Bank joined the Bank of Japan in this admission where the BOJ has interceded 33 times in the markets in the last year. The Norway Sovereign Wealth Fund unveiled in June of last year that it planned to buy 5% of every European stock.

The result of this is financial markets are exhibiting patterns and behavior that has never (or at least seldom) been witnessed before. The signs are eerie that markets may have reached the point of being "wobbly". Like trees that grow too high, they eventually become unstable and topple.

EERIE SIGNS


"Smart Money" OEX Open Interest Put/Call Ratio: Off The Charts Elevated
OEX Open Interest P/C Readings > 2
S&P 100
(OEX)
April 21= 2.79
~0.50 higher than all
other readings on record
Put/Call Ratio Of Open Interest On OEX Options
900
800
700
600
500
400
2
1
0
1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015
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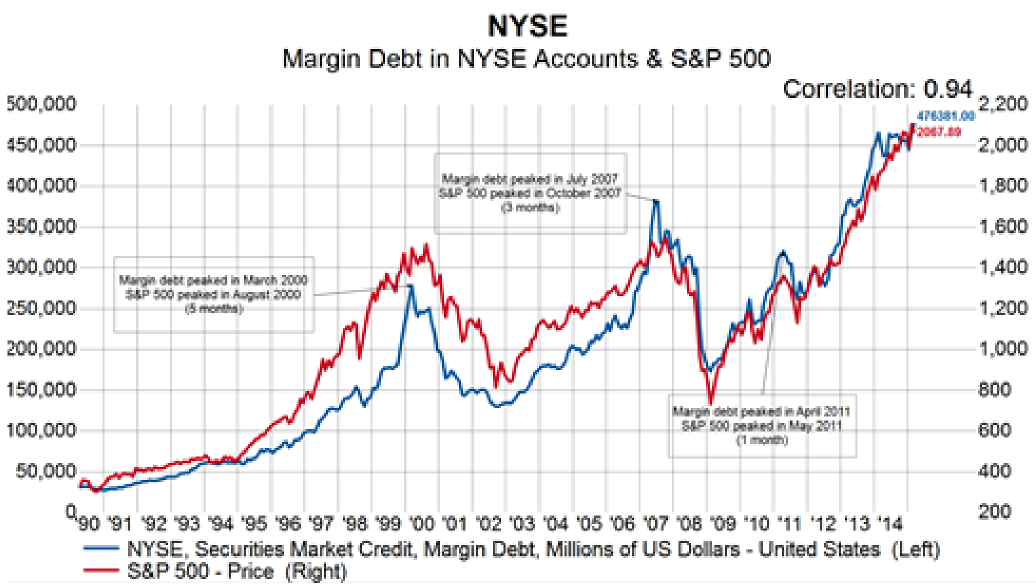
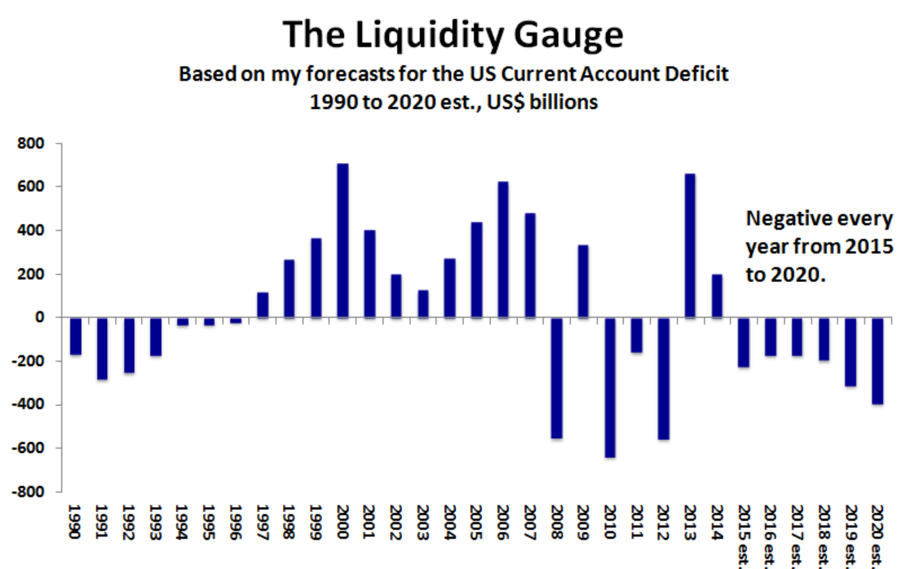

NYSE
Margin Debt in NYSE Accounts & S&P 500
Correlation: 0.94
Margin debt peaked in March 2000
S&P 500 peaked in August 2000
(5 months)
Margin debt peaked in July 2007
S&P 500 peaked in October 2007
(3 months)
Margin debt peaked in April 2011
S&P 500 peaked in May 2011
(1 month)
476381.00
2067.89
500,000
450,000
400,000
350,000
300,000
250,000
200,000
150,000
100,000
50,000
0
2,200
2,000
1,800
1,600
1,400
1,200
1,000
800
600
400
200
'90 '91 '92 '93 '94 '95 '96 '97 '98 '99 '00 '01 '02 '03 '04 '05 '06 '07 '08 '09 '10 '11 '12 '13 '14
NYSE, Securities Market Credit, Margin Debt, Millions of US Dollars - United States (Left)
S&P 500 - Price (Right)

Chart 1: US equity decoupling: disconnect between flows and prices

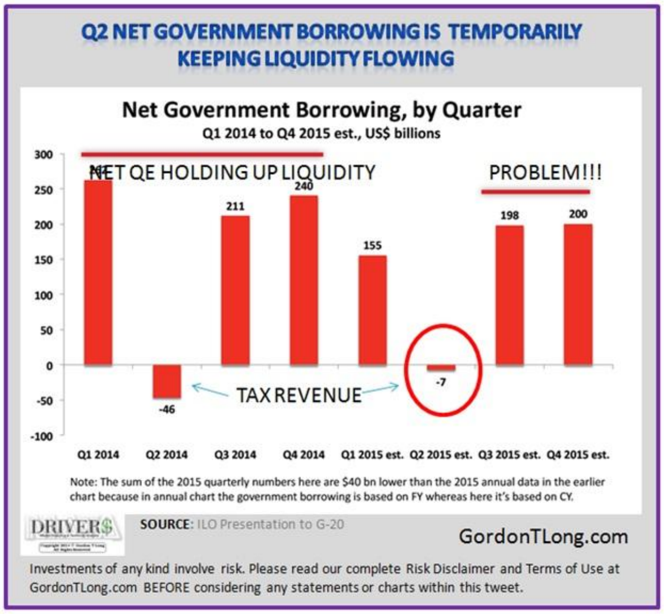
Source: BofAML Global Investment Strategy, EPFR Global

LIVING ON BORROWED TIME

We may have reached the point where we are living on borrowed time. The reason for this is that in spite of this buying pressure, liquidity is trying up. According to the work of Richard Duncan liquidity will go negative in Q3 2015 unless the Federal Reserve resumes its expansion of the Federal Reserve's balance sheet.



Recently we are experiencing a respite from this collapse due to Q2 seasonal flows due to tax filing year ends.

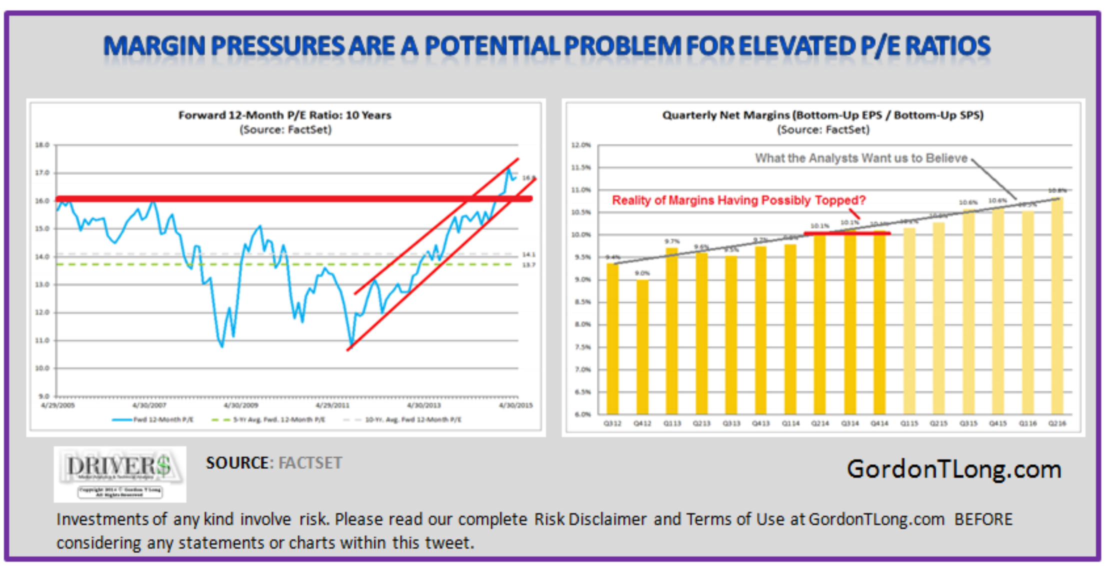


MARGIN WORRIES AHEAD

Margin pressures have become our biggest concerns going forward. Top line sales revenue has been flat to falling in the S&P 500 for some time now. Bottom line earnings have been held up with financial engineering and buybacks to increase earnings per share by reducing the number of shares outstanding and the total amount of dividends needing to actually be paid out.

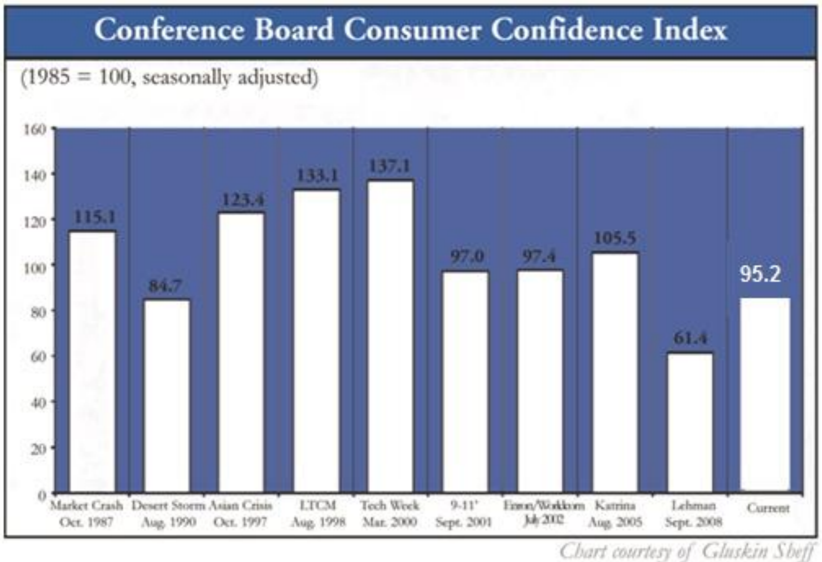
To make all this work, margin has been increased by dramatic reduction in the workforce, its pay, benefit coverage and full time / part time status. As a consequence the middle class in America has been fundamentally "gutted" and its purchasing power in real disposable income seriously eroded.

To offset this, debt levels have increased (primarily in student and car loan levels) along with government expenditure levels. Corporate profits are soon going to be unavoidably impacted.



SHIFTING DOWNWARD SENTIMENT

The US household is now feeling this as sentiment begins to plummet and discretionary spending falls.



BUYBACKS LEVELS ARE NOT SUSTAINABLE

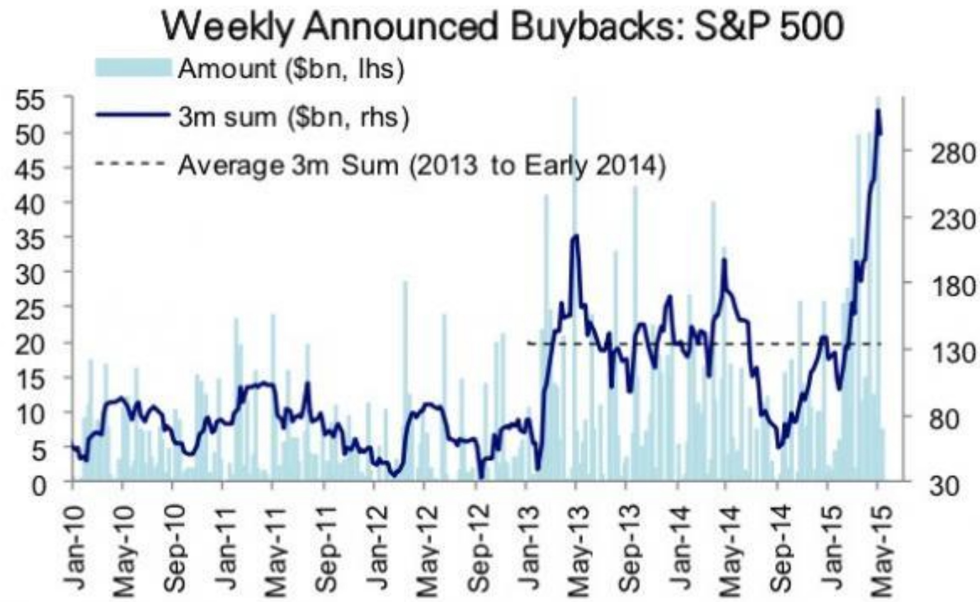
When 90% of all profits are being returned to shareholders in the form of buybacks and dividends you know it is unsustainable and will soon come to an end. How can long term top line sales / revenue growth be maintained without re-investment of profits?

Exhibit 4: We expect S&P 500 buybacks to grow by 18% in 2015
as of April 23, 2015

$ Billions	2012	2013	2014	2015E
Capital Usage				
Capital Expenditures	$637	$649	$702	$676
Research & Development	207	228	248	245
Cash Acquisitions	228	156	185	195
Share Buybacks	396	476	514	604
Dividends	305	333	376	404
Total Capital Usage	$1,772	$1,843	$2,025	$2,124
% Year/Year Growth				
Capital Usage				
Capital Expenditures	10 %	2 %	8 %	(4)%
Research & Development	7	10	9	(1)
Cash Acquisitions	2	(31)	19	5
Share Buybacks	(2)	20	8	18
Dividends	19	9	13	7
Total Capital Usage	7 %	4 %	10 %	5 %

Source: Compustat and Goldman Sachs Global Investment Research.

Figure 72: Weekly buybacks and rolling 3m sum



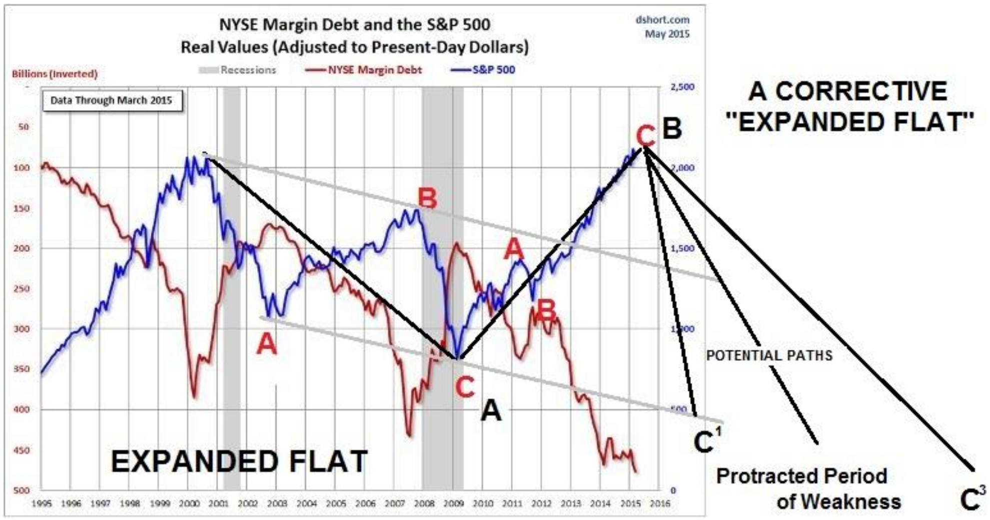
Source: Bloomberg Finance LP, Factset, Deutsche Bank

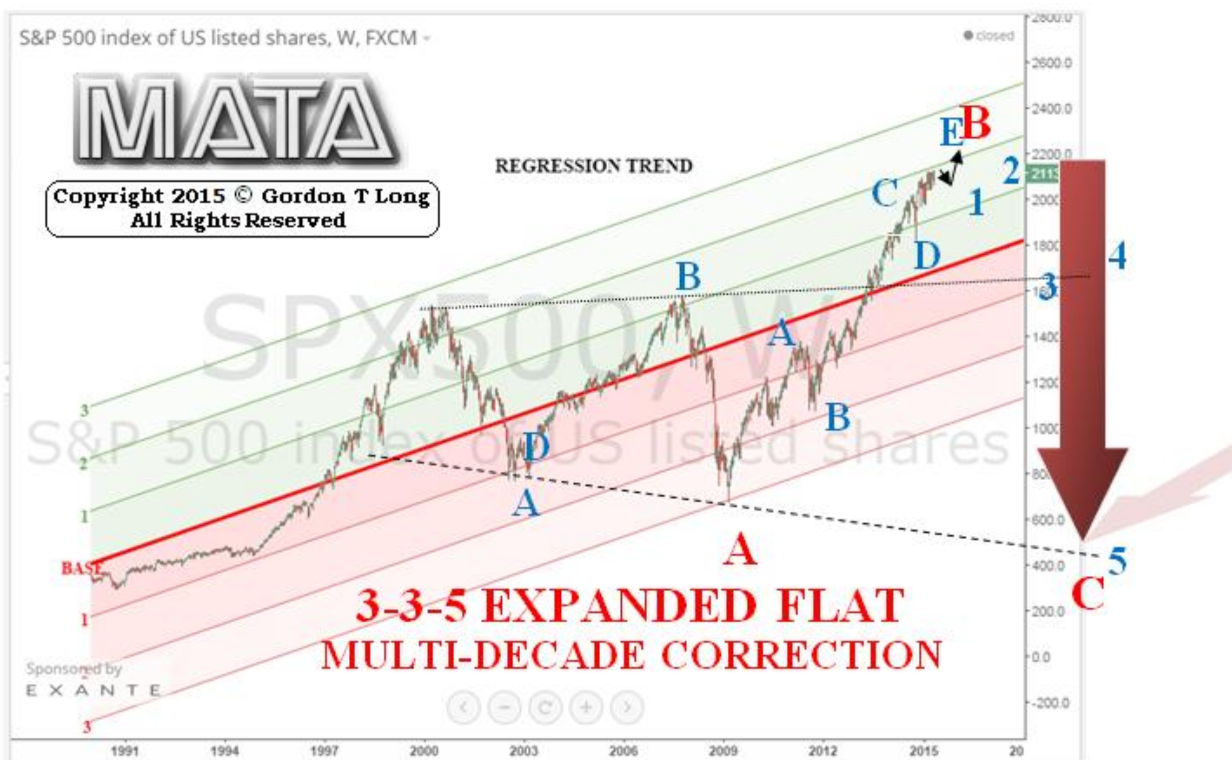
Figure 74: Quarterly history of buyback announcements

Source: Bloomberg Finance LP, Factset, Deutsche Bank

LONGER TERM VIEW

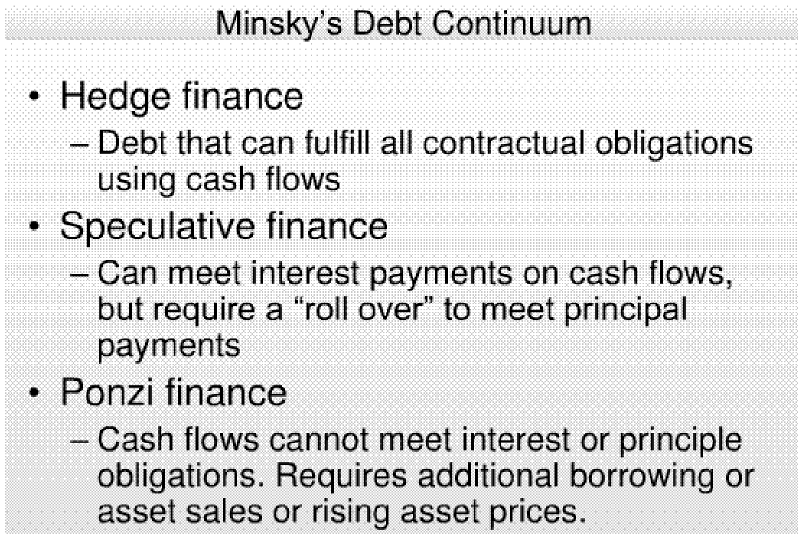
As we lay out in the May MATA we still see more increases in the equity markets in 2015 but have serious concerns beginning is 2016.

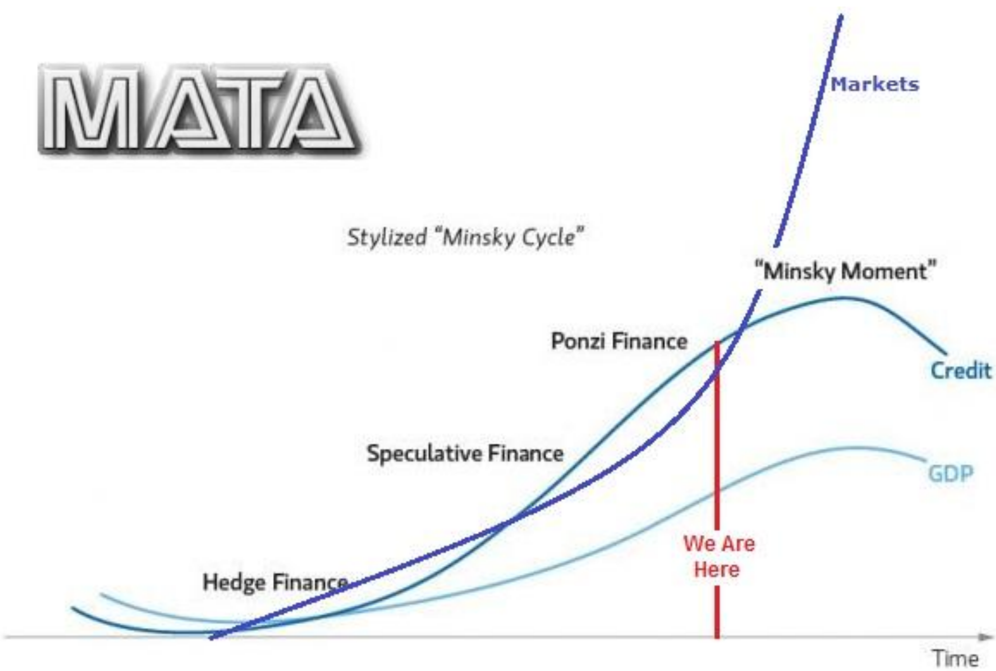




HAVEN'T CHANGED OUR POSITION

After the near term expected correction we still expect markets to head higher towards a "Minsky Moment" in 2015. This is based on the assumption that Central Banks will react to any deterioration in the financial markets with more liquidity pumping!





Gordon T Long

Publisher & Editor
general@GordonTLong.com