GordonTLong.com

UNCERTAINTY & APPREHENSIVE UNEASINESS
Sentiment Takes on a Tone of Worry

MACRO INSIGHTS

Gordon T Long
3/6/2016

UNCERTAINTY & APPREHENSIVE UNEASINESS

Sentiment Takes on a Tone of Worry

Published to Subscribers January 20th, 2016

GFC Problems Only Got Worse!

Endless Indicators of Serious Problems in 2016

Over the past few quarters our monthly reports have focused on the rapidly decaying fundamentals around the world. There is little doubt any longer of the degree of global slowdown we are experiencing, and the fact the US is now being impacted.

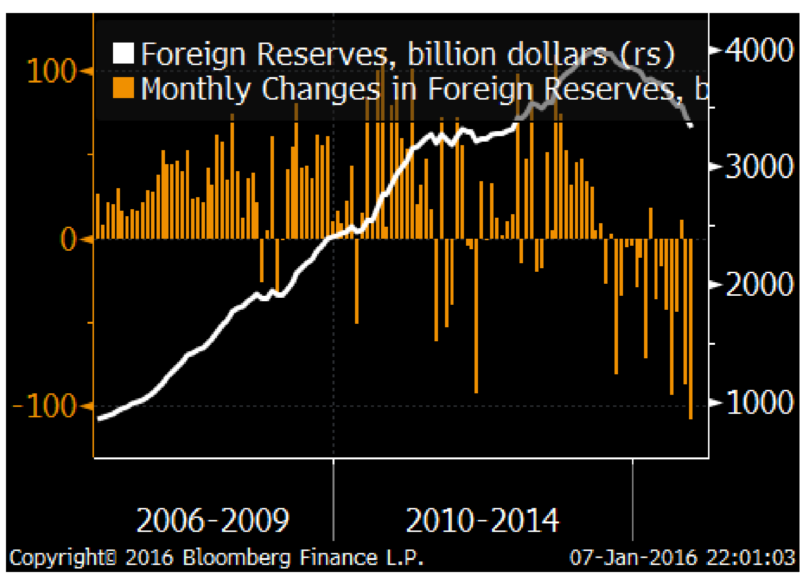
I am already reading mainstream writers talking about a potential US recession in 2016. The purpose of the GMTP mission has been achieved. None of this should come as any surprise to our subscribers.

Falling Global Reserves

It is time to shift our attention to what we now need to be focused on. That is what global events will dictate the seriousness of the outcome in 2016. Maybe more specifically, what will trigger the next round of central bank and government policy initiatives?

We need not focus on the US as it is going to be the tail on the dog reacting to events.

This chart of global reserves shows something quite startling. Reserves are not growing and in fact are shrinking!



The same players who were the biggest builders of foreign reserves are now the ones falling the fastest.

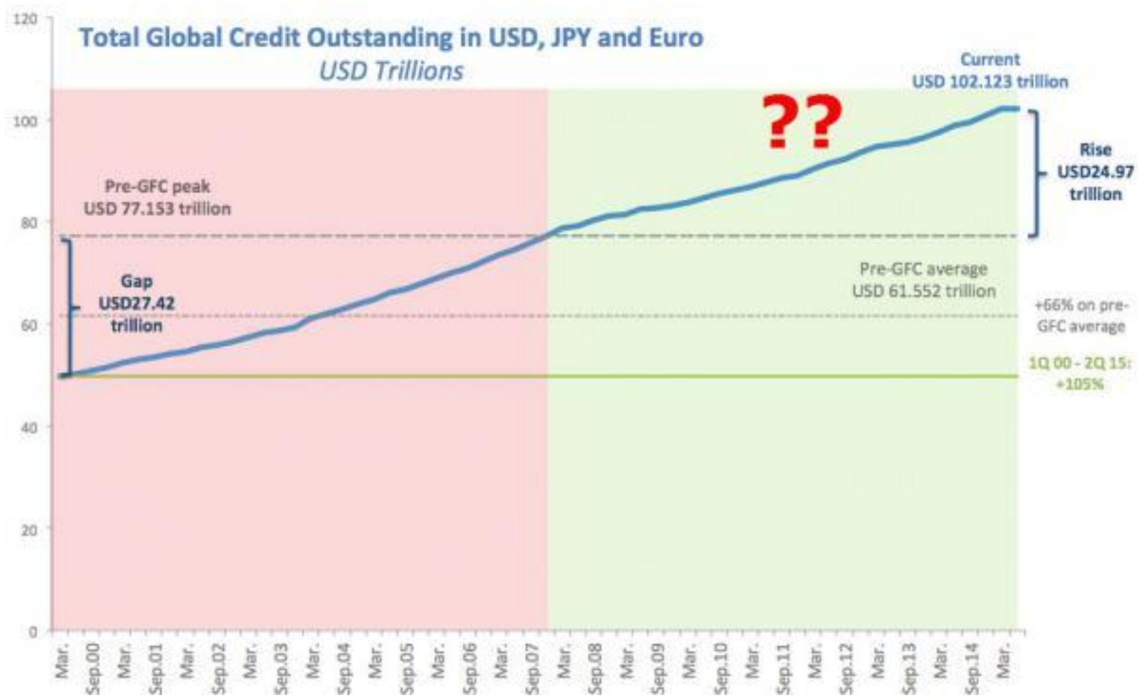
Who? China and the major (non US) Energy Exporters. That is where we will look in this report.

What Deleveraging?

Before we do though it is important to restate for our many new subscribers, nothing has changed since the 2007 financial crisis except to say the problems have only gotten worse!

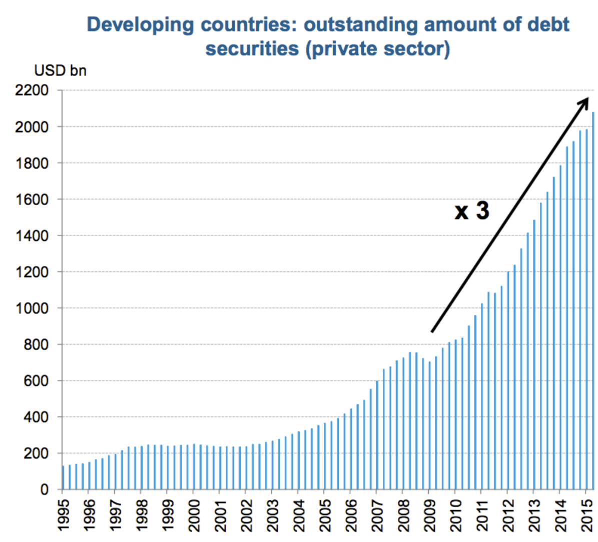
The media talked about the de-leveraging after the 2007 financial crisis and the reduction in debt overheads. Exactly where is it in this chart when we look at the three biggest culprits combined - the US, Japan and the EU. It has been more or less an uninterrupted line since the Dotcom bubble burst in 2000.

We had credit growth outstanding, denominated in these three currencies of $27.4 Trillion between 2000 and the GFC. We have had $24.97 since.



Only Continues to Get Worse!

The growth in private sector debt securities outstanding in the developing countries is up three fold since 2009.

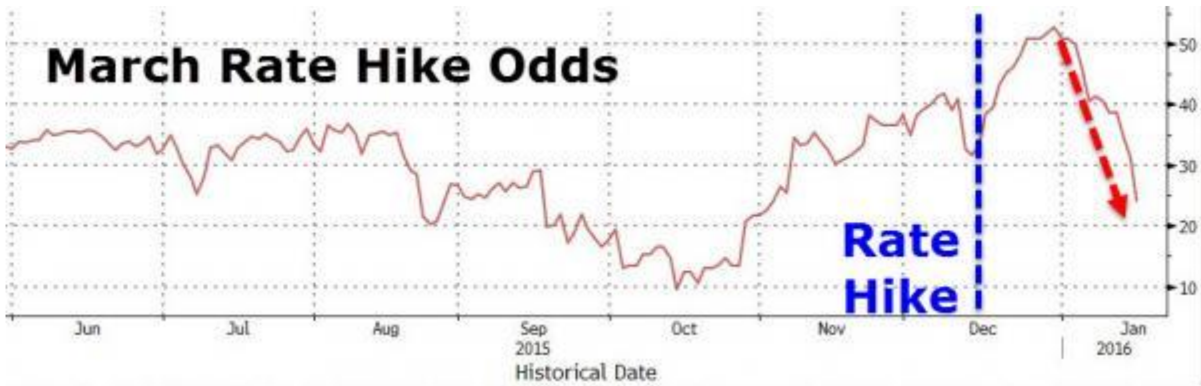


This is why we entitled a recent report "[Debt Storm over Emerging Markets]" because of the potential inabilities for these countries to handle the debt with falling export volumes and pricing power.

Declining Belief in Federal Reserve's Directional Statements

The fact the Federal Reserve was boxed into a corner and recently had to follow through on its directional statement to increase the Fed Funds Rate, it should not be construed that they will necessarily follow through on the gradual move upwards to 1.5%.

As more and more central bank analysts start to see the recessionary signals we have been pointing out you can expect the Fed to reverse course. As a matter of a fact this chart shows that sentiment has already begun to take form within the private sector analyst community.



FINANCIAL MARKETS – Heightened Nervousness

Global Equity Markets

Worst First 10 Days of the Year in History

This has been the worst year beginning start in the financial markets in history. Nothing even comes close to it. Minimally, it says there is a lot of repositioning going on as well as worry.

Over $15T Lost

Global stock market capitalization loses approximate $15 Trillion or about a 20% decline.

Half of all the gains since 2011 have disappeared since August on a global basis.

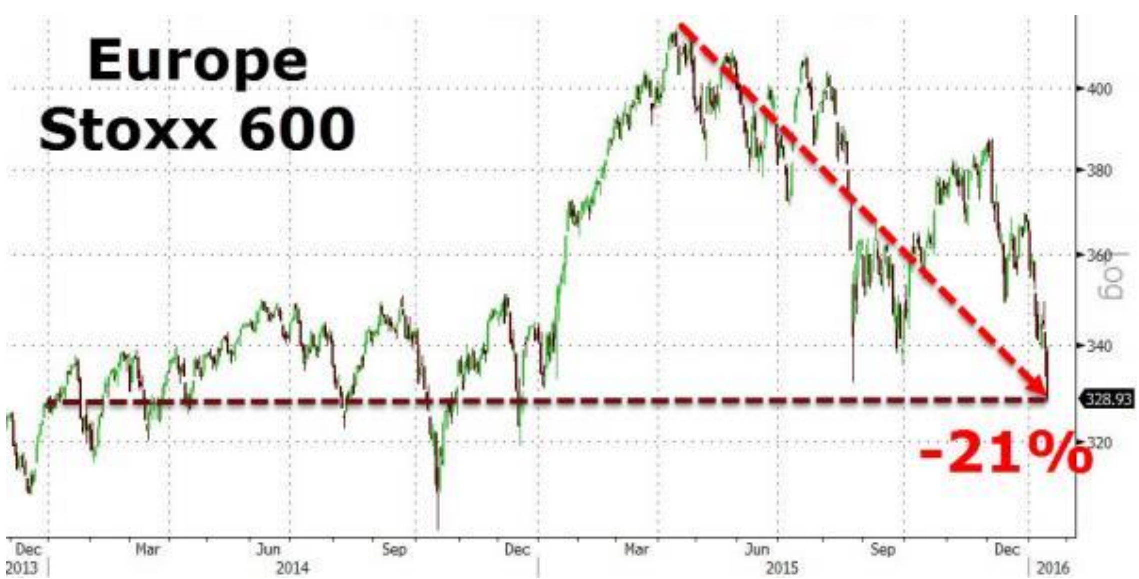
Investors wonder why since 2000 their portfolios have gone nowhere? It because the 2000 and 2007 drawdowns took their portfolios years to recover from on an absolute basis and when discounted for inflation likely many have still lost net purchasing power.

Wall Street is well aware of this.

Actually Worse Outside the US

It is important for Americans to realize that global markets have been hit the hardest and longest.

It is only now just beginning to be seen in the major US indexes.



Commodities, Then HY Debt it was built on, and next the Equity

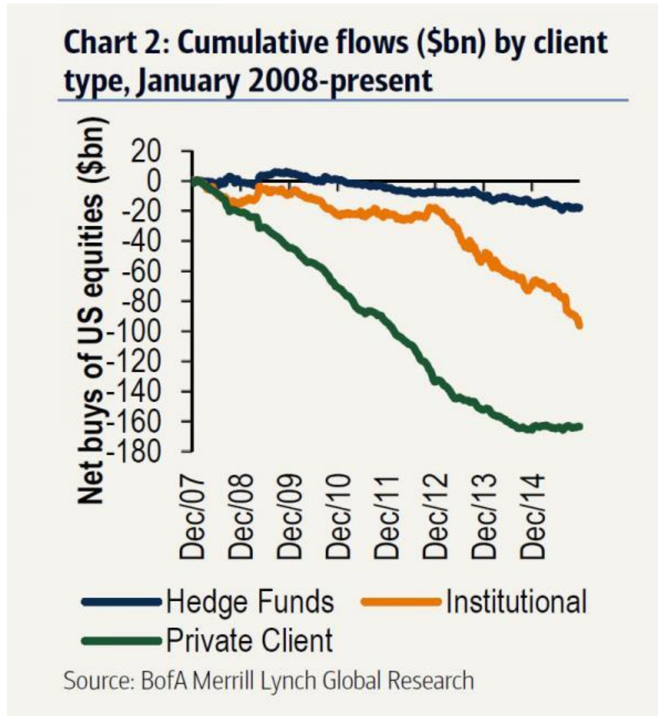
The cascading effect began in the commodities complex when the US Federal Reserve announced its intentions to "TAPER" shown here in red. We have discussed this many times, most recently in the "Canary in the Coal Mine" report when we discussed Glencore.

When commodity prices and oil specifically went over the cliff in mid 2014 we began to see the debt of leveraged players in the mining and energy complex become more expensive and the spreads on HY bonds begin to widen.   Recently this has become more pronounced as the credit cycle began turning in concert with this.

So far the US S&P appears to be only showing a minor rounding in trend. At least on the surface, since breadth shows it is being held up primarily by the "FANG" and "NOSH" stocks?

This has been easy to see coming

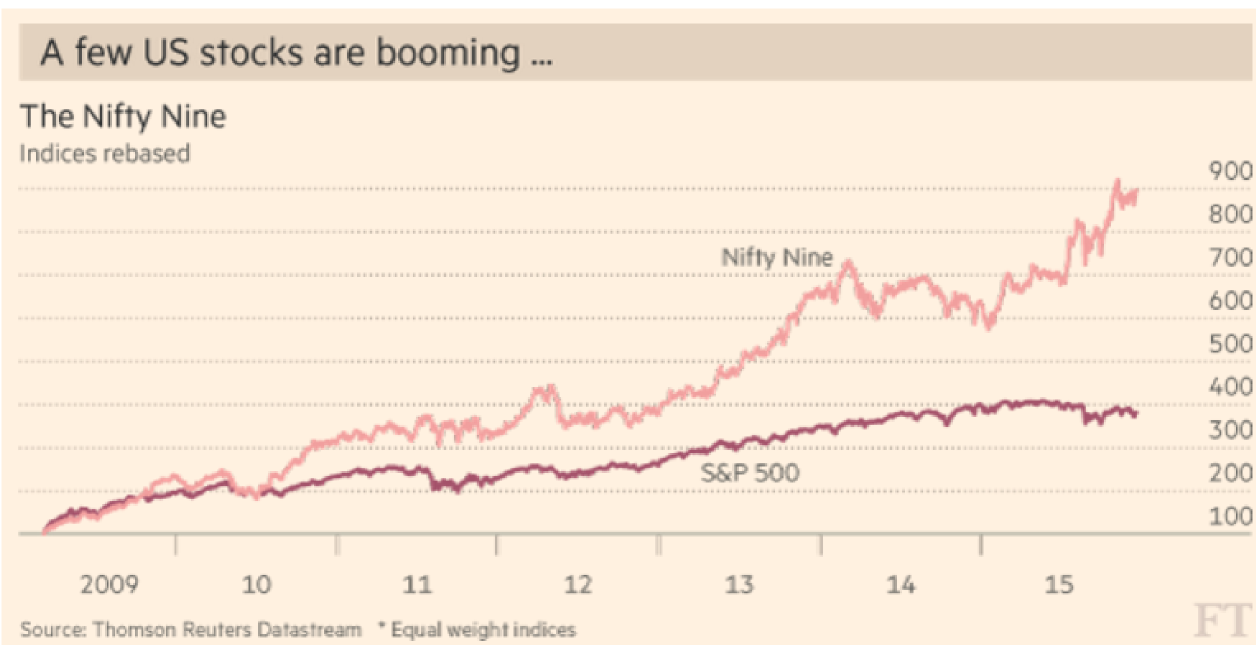
I have shown an older version of this chart previously. The professional money has exited if their fund prospective and incentive plans allow them to. This is pretty blatant and does not bode well for 2016.



No Breadth and a Few Hiding the Reality

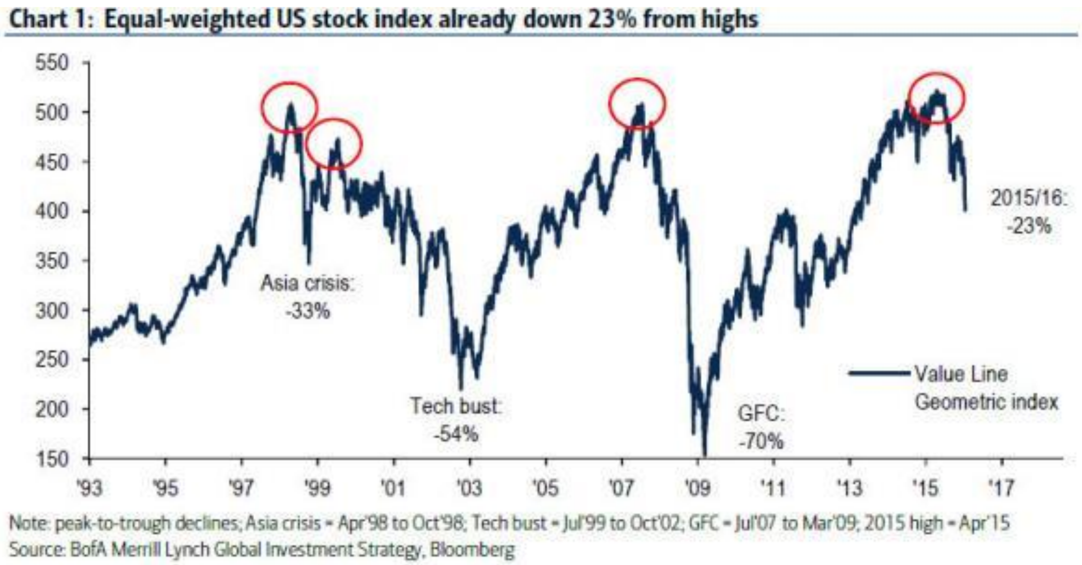
I mentioned the FANG & NOSH stocks which mutated to the NIFTY9 and most recently the FANTAsy stocks. All contained Facebook, Amazon and Netflix. I discuss these in the February edition of Triggers and the potential $1T seriousness of what this means.

The rise of index ETFs and mutual funds which all depend on these FANTAsy stocks, has never accounted for this much of the market before. The rapid emergence of Index ETFs accounted for nearly 30 percent of the trading in the U.S. equities market last summer. FANTAsy weakness will magnify, or even potentially cause flash crashes if they break critical support levels. This is an untested $1 trillion stock bubble problem! Let's examine the problems and where FANTAsy may be headed.



Equal Weighting Removes the Distortions

By considering an equal-weighted stock index which removes the FANTAsy distortions from the market, many technicians were able to identify clearly what was occurring as the triple top was put in.

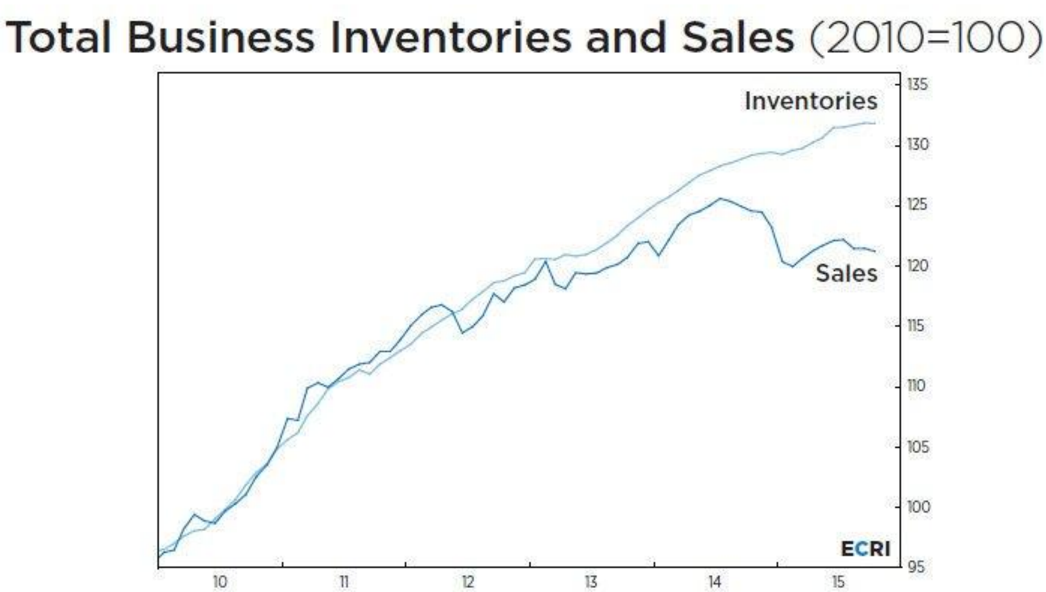


Channel Stuffing

Corporate revenue, margins and operating profits have been falling for the last few quarters. Recently cash flows and EBITDA have started contracting.

The expected outcome is to see desperate suppliers bolster sales by artificially "channel stuffing". This is occurring and often precedes a significant reversal in market direction.

As we discussed recently in "The Coming Auto Abyss", major Industries like the Auto industry will soon signal major problems. Watch for it! It is coming in 2016.



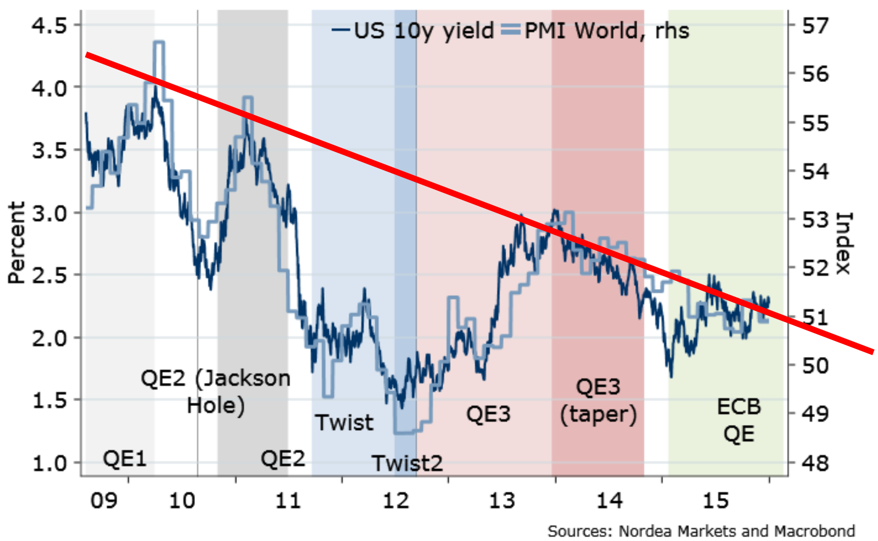
Gordon T Long
Market Research & Analytics
www.GordonTLong.com

Global Bond Markets

Falling Rates

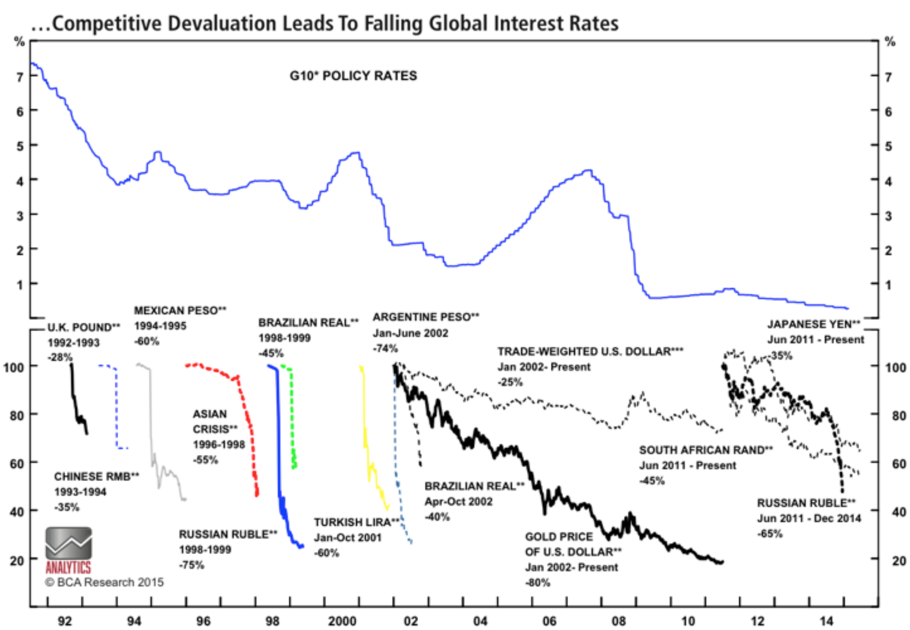
We have believed and still do believe that the 10 Year US Treasury Is headed for 1%. This is 100% opposite to the market which is convinced interest rates are going higher.

It was somewhat refreshing to read that Deutsche Bank is [now forecasting]() that the 10Y yield will slide to 1.75%. We don't feel so totally alone now.



To Be Expected

When money is debased the interest paid for it shrinks. Competitive devaluations have historically led to falling global interest rates.



Ominous Flattening of the Yield Curve

Additionally the flattening yield curve needs to be watched closely!

A flat or inverted yield curve is not historically a good omen.

ENERGY SECTOR – Collapsing Revenue and Collateral

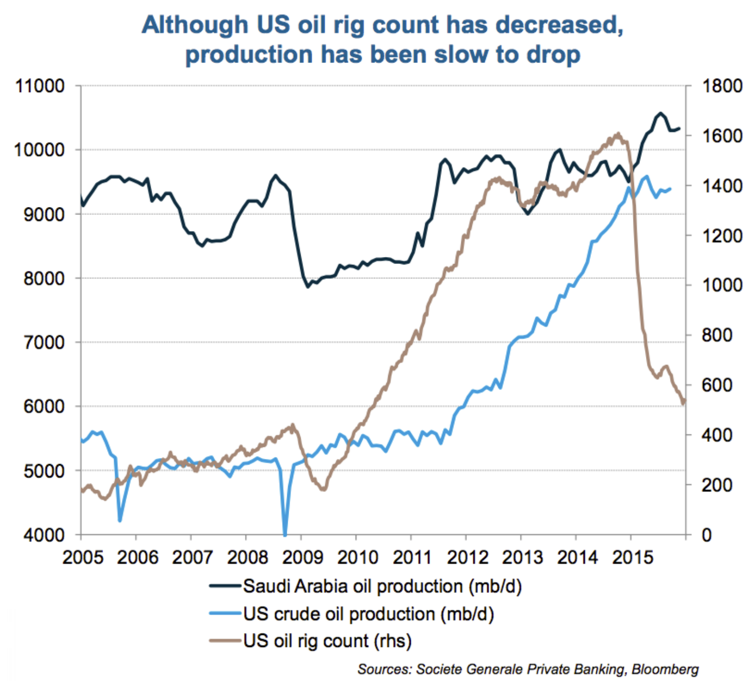
Supply Isn't Falling This Time

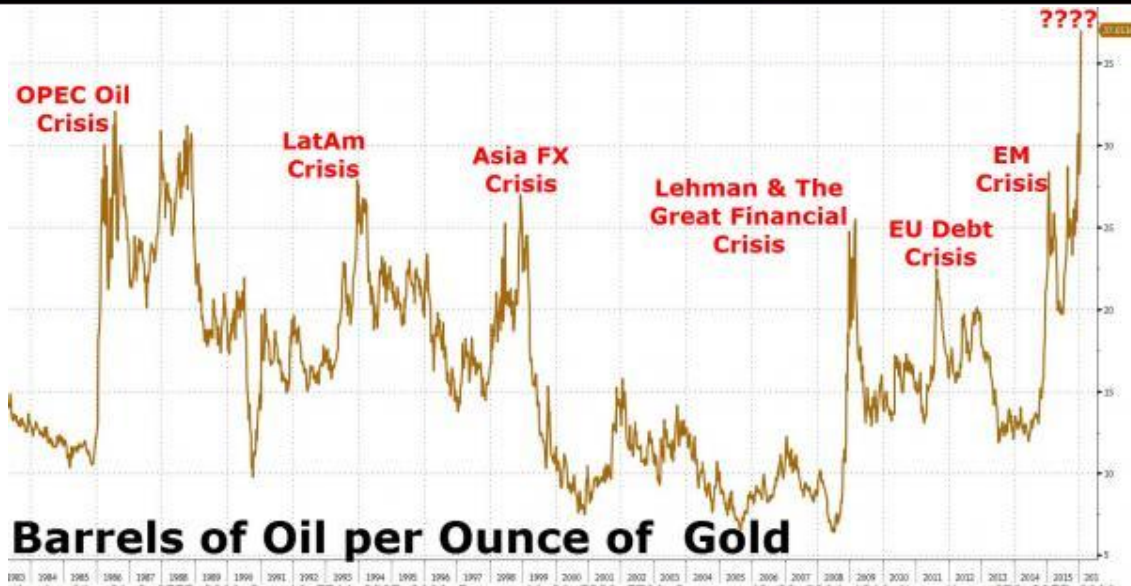
Let's switch gears and talk about two areas we need to pay particular attention to in Q1 2016.

The first is what is happening in the energy sector. Specifically, oil and gas prices. OPEC is not following its traditional strategy. Though measures such as oil rig count have fallen, Saudi production has not. Nor has it in any of the OPEC and Non OPEC producers.

Oil / Ounce of Gold

Oil priced in gold is at a historical low, even with gold having fallen significantly over the last two years. What is up here?

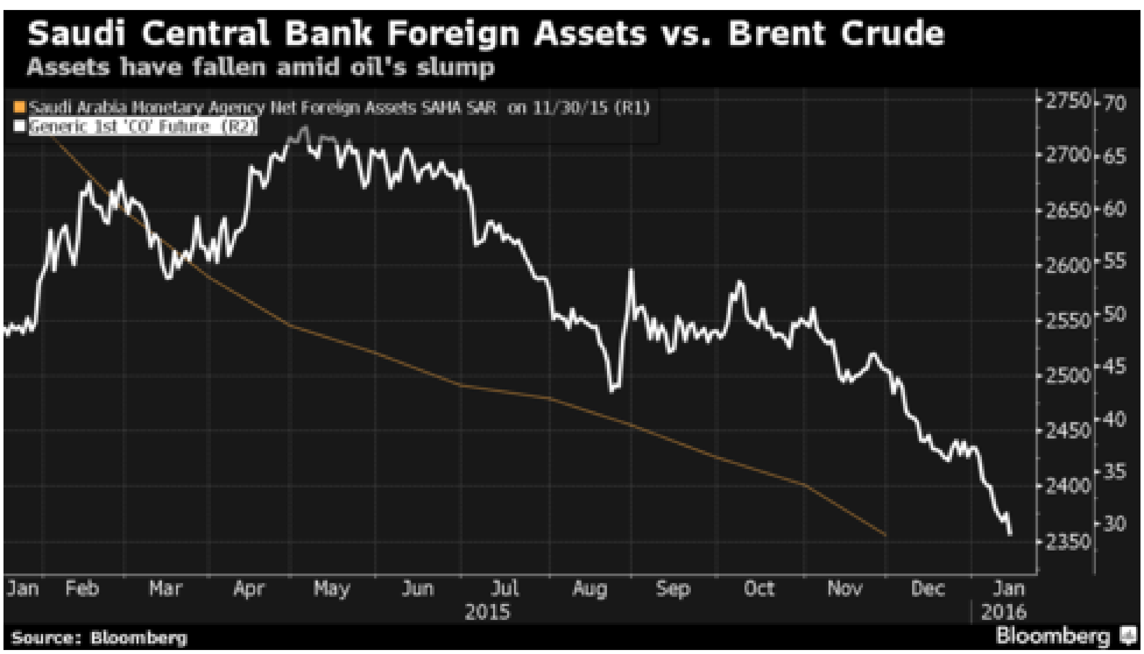




An Iranian / Saudi Oil War

First we have the anticipation of an Iranian / Saudi Oil War being baked into oil prices.

The price of oil was $115 per barrel 18 months ago until Saudi Arabia greatly increased production to initially crush rivals in the US and Russia. That was before the landmark Iran Nuclear agreement which removed sanctions on January 15th.



The Iranian Islamic Republic has vowed to return its oil production to pre-sanction levels that stood above 3m barrels a day. Iran is the holder of the world's fourth-largest reserves of crude and biggest deposits of natural gas,

> "*The oil ministry, by ordering companies to boost production and oil terminals to be ready, kicked off today the plan to increase Iran's crude exports by 500,000 barrels*,"
>
> .. the official Islamic Republic News Agency reported, citing Amir Hossein Zamaninia, deputy oil minister.

Iran will likely be able to add as much as 800,000 barrels of daily output this year from 2.7mbl/day. The country plans to raise output capacity to 5.7 million barrels a day by the end of 2020.

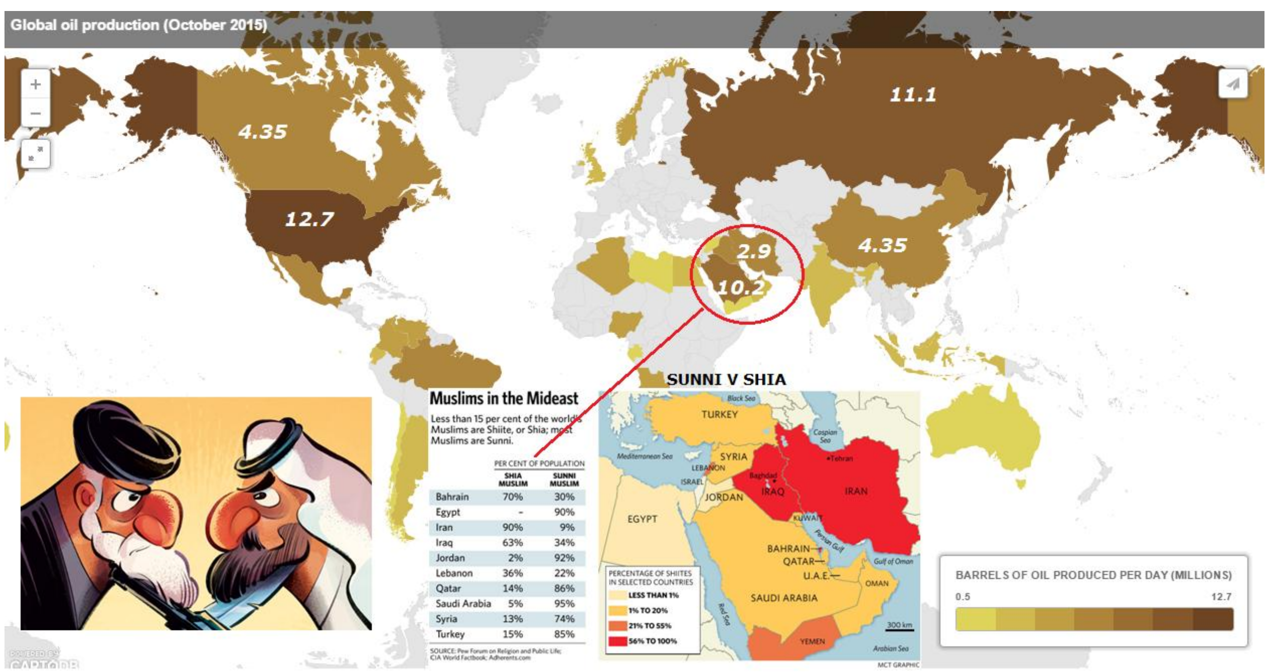
Stock markets across the Middle East saw more than £27bn wiped off their value as the lifting of economic sanctions against Iran has threatened to unleash a fresh wave of oil onto global markets that are already drowning in excess supply.

To the Death!

The shocker of Saudi Arabia privatizing the $10T Saudi Aramco is still being sorted out. It signals something ominous.

My recent video guest on the Financial Repression Authority, Yra Harris gave his well researched perspective, emphasizing there are a lot of geo-political aspects to the potential of Saudi Arabia privatizing its oil assets through an IPO. He cites:

> *1. It keeps the Saudis in the western camp as the possibility of the largest IPO ever will secure the Kingdom's protection. Could U.S. & developed stock markets absorb the demise of a $10 trillion company without undermining the entire financial system?*
> *2. If the Saudis cut production it will be done under the guise of enhancing shareholder value for if they failed to work for shareholders they might be sued by the SEC or else be challenged for a seat by some activist.*
> *3. It provides for a massive capital infusion & equity is cheaper than going to the bond market. Yra says some are arguing that the IPO will never happen because it will require too much public disclosure of the Saudi's oil reserves but he would advise checking through some of the Chinese corporations listed in the U.S.*
> *4. It will necessitate the western powers maintaining security for the Kingdom.. If the Saudis are a major part of investor portfolios the western governments will be guardians of the Monarchy. There are many facets to the idea of an Aramco IPO that, from a global macro perspective are very intriguing.*



CHINA – Collapsing Trade and Commodity Super Cycle

Chinese Markets

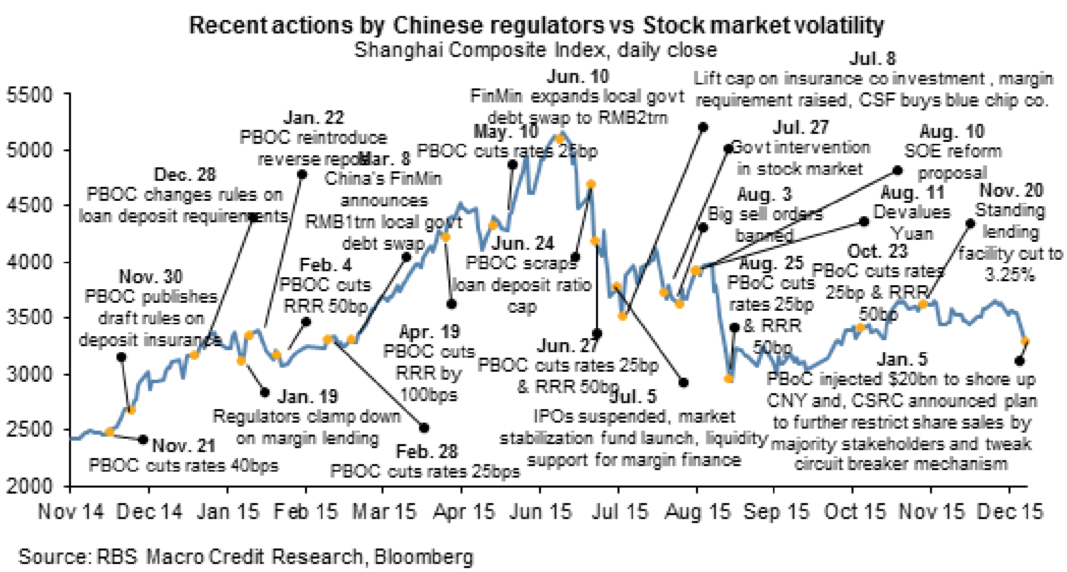
The second major focus in Q1 2016 should be the hard landing occurring in China.

Worst Market in the World

The worst performing stock market in the world is China, and that is with massive government intervention on many fronts. It is hard to imagine the destruction if the government was exercising totalitarian responses.

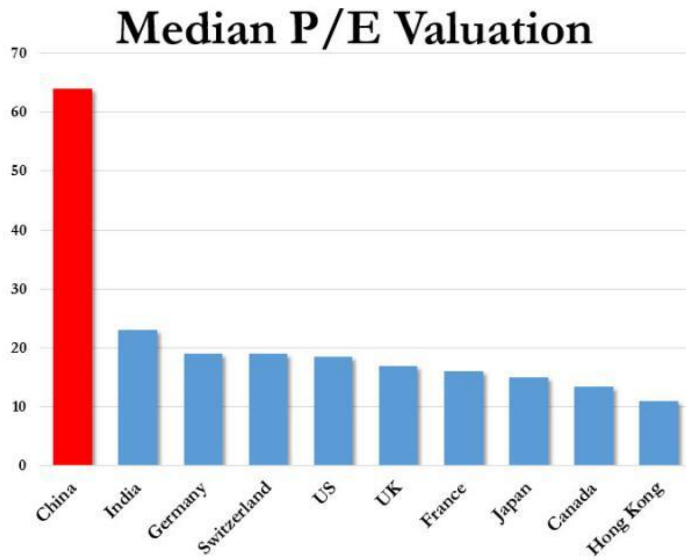
Government Control of Markets

I don't believe I am exaggerating when I say the Chinese government's regulatory reactions have been unprecedented in financial markets. I am highly skeptical they can avoid the inevitable adjustment that must occur.



Off the Charts over Valuations

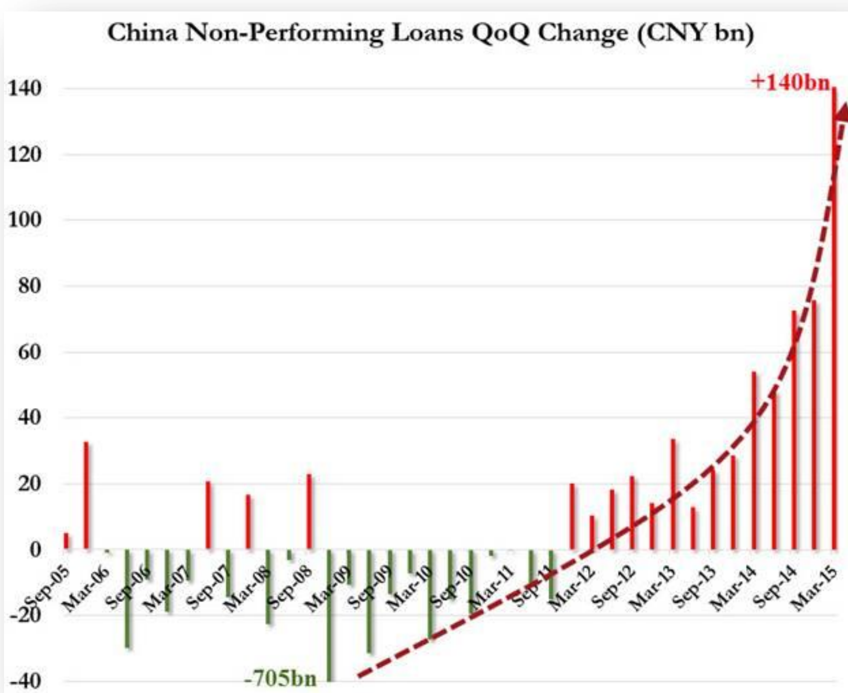
The adjustment can be seen here. It must be appreciated that the Chinese Stock market is still out of the stratosphere even when compared to the historically over-valued US market which we have been warning about throughout 2015.



Non-Performing Loans

If this is not enough, we have existing loans going bad and an inability to be rolled over with cheap money.

The bad loan problem is a developed nation problem and can be seen across the globe where excess supply has been built based on false demand stoked by a protracted period of Quantitative Easing.

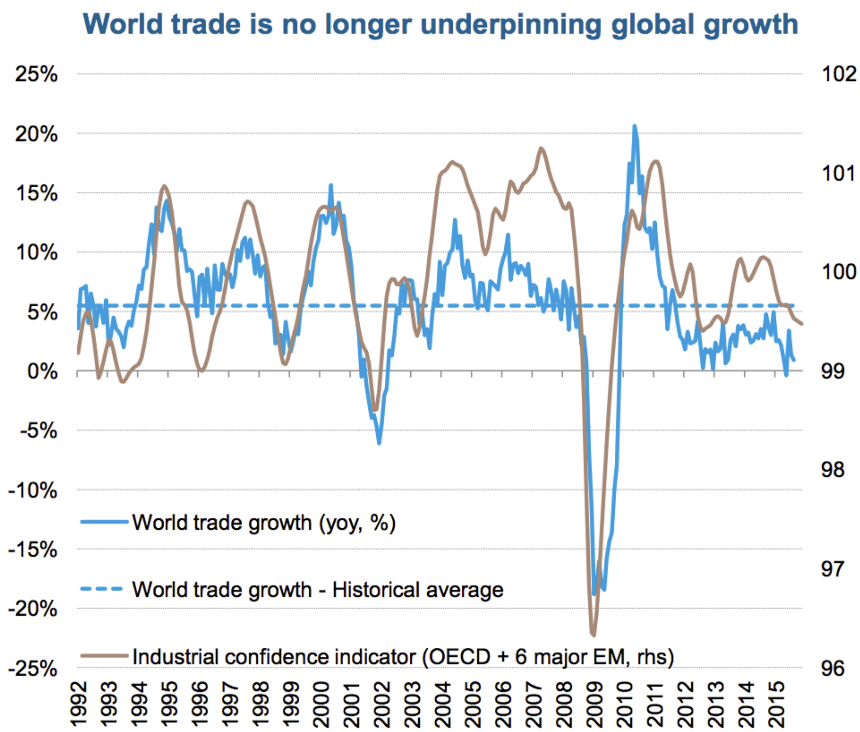


Gordon T Long
Market Research & Analytics
www.GordonTLong.com

Collapsing Trade

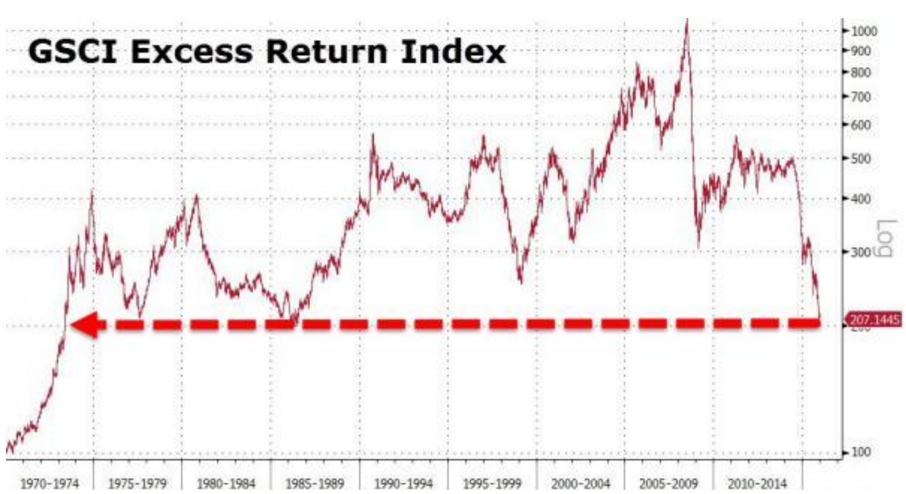
World Trade the Problem

Last month I talked extensively about slowing world trade. It continues to get worse with fewer and fewer transatlantic cargo ships actually out at sea because the Baltic Dry freight rates are below the operating costs of transport cargo ships. This makes it pretty clear that there is no demand. The last time we had anything even remotely comparable was in the early stages of the 2007 meltdown.



Super Cycle is over

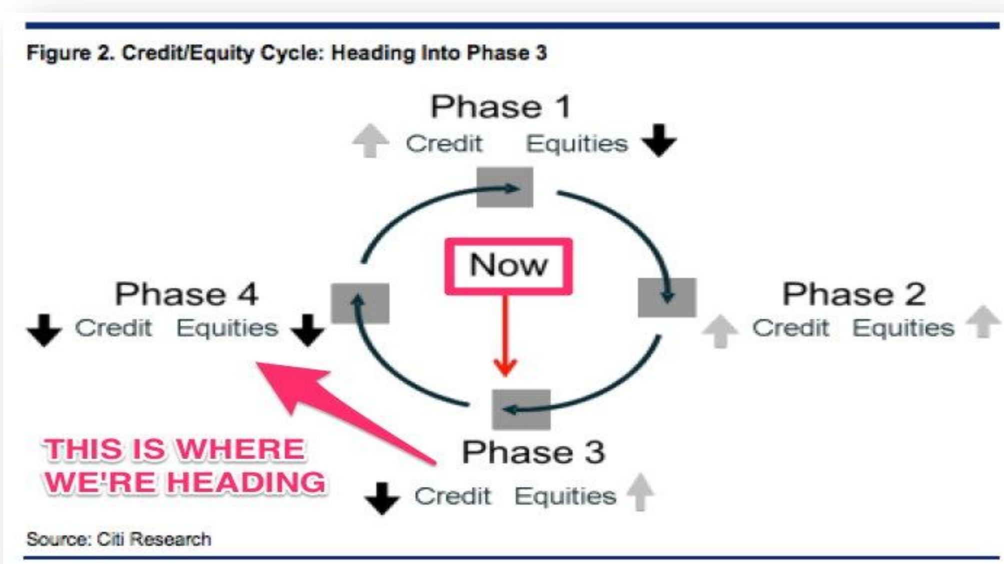
It is our belief that the Commodity Super Cycle is not only over but has already returned to levels not seen since the US came off the gold standard in August 1971. Maybe it is telling us something about the true store of value of the US dollar?



CREDIT CYCLE – Has Turned

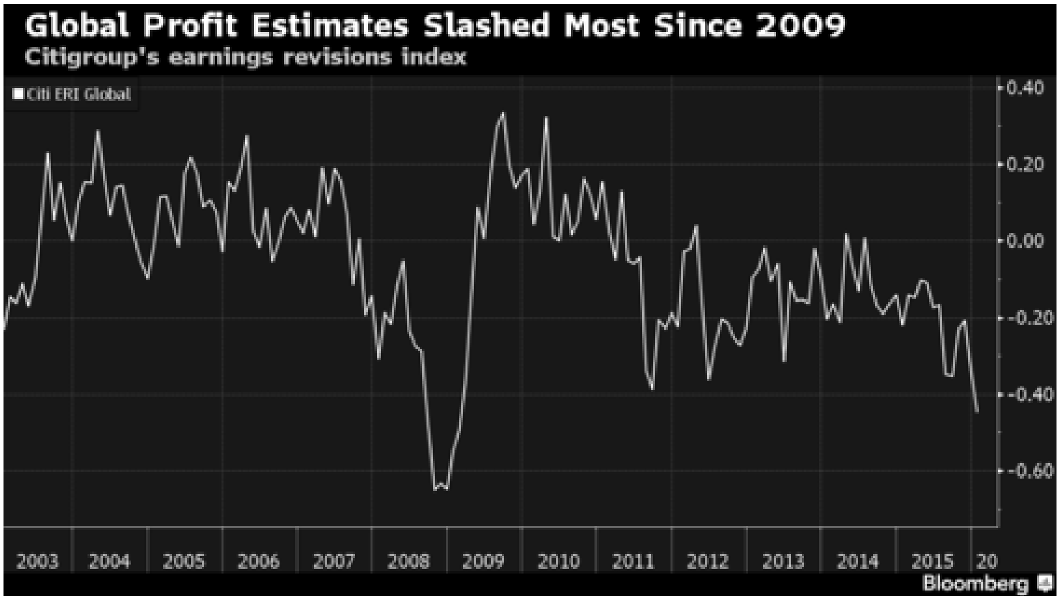
HY Upgrade-to-Downgrade Ratio

It is our position that the Credit Cycle has turned. This is not something that happens quickly or often. It is a major trend reversal and takes financial markets with it. Not necessarily in a straight line, but steadily over time.



HY Upgrade-to-Downgrade Ratio

The reason is profits are steadily falling and most importantly, free cash flow and EBITDA is contracting.



GLOBALIZATION TRAP REVISITED

Citigroup expects the spread of the contagion to continue from the falling high yield corporate bond market into the high-quality investment-grade corporate bond market:

> *"It is no secret to regular readers of our publications that we believe the credit cycle is quite advanced. As discussed in our HY outlook, we estimate that nearly $1tn of speculative-grade credits are at risk of default over the next downturn, as the stock of low-quality credit has soared.*
>
> *Recent contagion in US HY from energy woes has severely impacted ex-energy spreads while shutting down bond-market financing for low-quality credits. Our leading measure of non-bank liquidity has now even surpassed the weakness seen during the Eurozone crisis.*
>
> *These developments are a negative headwind for investment-grade corporate in 2016."*

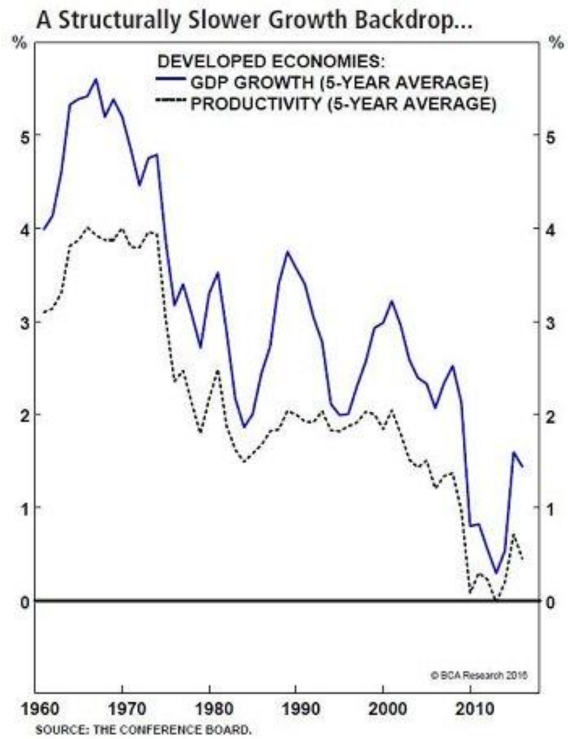
Will Investment-Grade Corporate Bonds Fall Like High Yield Corporate Bonds?

GLOBAL PROBLEM – Globalization Trap

A Structural Problem

It must be remembered that all of this is occurring in a structurally slower growth backdrop.

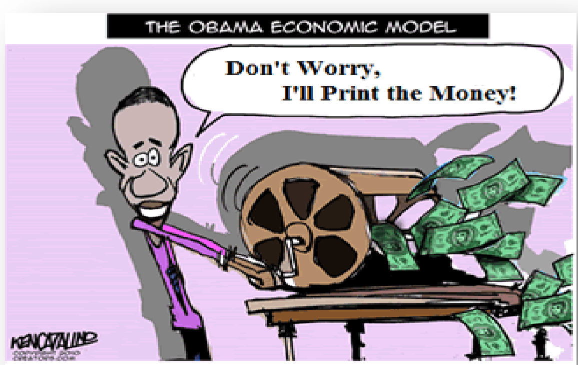
Productivity advancement in the Developed Economies has been steadily falling for decades and with it GDP grow rates. It is not only interest rates which are at the "zero bound" but also productivity and growth. It is no coincidence!



In closing, remember, the answer will be to print more money.

It is the only answer politicians will ever agree on.

Invest accordingly.



Until No one wants it or Trusts It!

Gordon T Long
Market Research & Analytics
www.GordonTLong.com

Gordon T Long
Publisher & Editor
general@GordonTLong.com