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301 Yamato Road, Ste. #3160
Boca Raton, FL 33431
Phone: 877-243-6616 Direct: 561-430-5525



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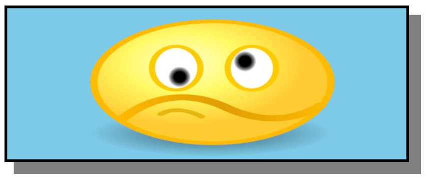
# *The systemic bastardization of modern finance*


***Stephen Giauque, CFP®***
***Financial Advisor, President, Triple Crown Wealth Management Group***


As testament to how twisted today's internal market logic has become; on May 30th, the S&P 500 closed at 2788. That night, at a Thursday night rally in Arizona, President Trump rolled out some fresh new red meat to his base calling for tariffs on all Mexican imports into the U.S. that would begin on June 10th and ratchet ever higher until the Mexican government materially ceases immigration traffic into the U.S. As of this writing, the S&P 500 is now higher by over 100 S&P points and, incredibly, is now back to within less than 2% of its April 30th all-time high. And what has happened since that Thursday night announcement? Nothing good on that still dead Chinese trade deal. And now, as of Friday June 7th, we now have further confirmation that the last vestige of "*strong economic data*," via the "lagging" jobs data, is no longer something the bulls can really hang their collective hats upon. That threat of tariffs on Mexican imports never materialized, so that's a wash. So what *DO* we have? Well, we have a bunch of bankers who have blown perhaps the greatest bubble of all-time, telling markets that they might be on the verge of using whatever remains of their now severely diminished cache of crisis fighting tools simply to prolong their eventual day of reckoning.

Clearly, the recent bounce off the May lows has come about for no other reason than that the trajectory of the economy, and for that reason, projections for corporate earnings, have finally flipped from "*still propped-up*" to "*uh, oh, we might have a problem*." While logic might suggest otherwise, amidst an era flipped upside down by the intrusiveness of the globe's major central banks, this is evidently a good thing. As for the May jobs number, when released on June 7th, it came in weaker than expected. Yet, in a world flipped upside down, for the time being, *weak* may be the new *strong*. Yet, if markets are essentially clinging to hopes of maintaining perpetual frothiness, irrelevant to most things of economic importance happening in real life, anything that forces the hand of their primary sponsors, the Federal Reserve, into cutting rates might just prolong that fantasy a while longer.



| Index | June 12, 2019 | YTD% |
|---|---|---|
| S&P 500 | 2880 | +12.2% |
| Dow Industrials | 26004 | +11.5% |
| Nasdaq Composite | 7831 | +18.0% |
| Value Line Arithmetic | 6048 | +12.3% |
| Russell 2000 | 1520 | +12.7% |
| U.S. Dollar Index | 96.71 | +0.07% |
| Gold (ounce) | $1335.58 | +4.2% |
| Silver (ounce) | $14.85 | -3.3% |
| Amex Gold Bug Index | 170.92 | +6.2% |
| Oil (NYM Lt Sweet/barrel) | $51.37 | +13.1% |
| 30 Year Treasury Yield | 2.62% | -0.40% |
| 10 Year Treasury Yield | 2.13% | -0.56% |
| 2 Year Treasury Yield | 1.88% | -0.60% |




***Steve Giauque, CFP®*** *(pronounced Gee-Oak) has more than 26 years of financial planning experience. Visit Steve's website at* ***www.StephenGiauque.com*** *Steve works out of the Boca Raton branch of Raymond James Financial, 301 Yamato Rd., Ste. 3160, Boca Raton, FL 33431.* ***He can be reached toll free 877-243-6616 or directly at 561-430-5525. Fax: 561-241-6418***


Printing just 75k net new jobs for May versus an expected 180k was a clearly a disappointment, wait, errr, I mean pleasant surprise for a market and hence an economy now woefully hooked on central bank sponsorship of easy money. Whatever level of strength witnessed throughout this dysfunctional cycle that has been prolonged by artificial means (central banks), the trajectory of that "strength" appears to clearly be waning. And the evidence of this appears to be even more vivid now. Two days prior to the government's recent "varsity" jobs report, ADP reported the weakest *private payrolls* report in 9-1/2 years. Also, the May jobs report comes just a few months since February's report that was the weakest since September 2017, the month that was impacted by two severe hurricanes that made landfall in the contiguous U.S. Accordingly, the condition of U.S. labor markets, a lagging indicator, is beginning to gibe with the prevalence of much of the *leading indicators* that have been flashing troubles for several months and quarters now.

This bad, I mean, "good news" came just days after stocks saw their second-best day of the year on June 4th. The best day of the year (so far) came on January 4th. What do the two days have in common other than being on the 4th day of a month that begins with the letter "J"? I'll give you a clue….Jerome Powell. The more recent June 4th ramp in stock prices could best be described as being a byproduct of the Fed's 2nd pivot. Lets call it "*pivot 2.0.*" Readers might recall early in the year when it seemed markets were in free-fall, with losses of roughly fifty S&P 500 points (almost 2%) in just the first 2-days of trading to kick-off the new year. Recall, this had followed the worst December for the stock market since 1931. So the stupid and reckless were on the defensive. But then, miraculously, the Federal Reserve, for some reason, felt that the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time might be just right for current Fed Chairman Jerome Powell to utter some soothing words. But what's better than a single Fed Chairman speaking soft nothing's into the collective ears of financial speculators everywhere? How 'bout multiple current and former Fed Chairs, all on the same stage at once, speaking calmly, but more importantly not sweating or grimacing in pain. On that day, Fed Chairman Jerome Powell was joined by his two most recent predecessors, Janet Yellen and Ben Bernanke —-in kind of a money printers reunion; and a gathering clearly designed to be a display of unwavering unity among current and former proponents of egregiously loose monetary policy and serial bubble blowing. When queried about current monetary policy amidst an otherwise casual exchange between he and the moderator, Powell actually read his response from a prepared paper, just so markets understood how clearly and unequivocally he had their backs. It was off to the races for the stock market. But even as market's went on its incredibly robust ride up thru late April, a complimentary batch of robust corporate earnings and economic data have been mostly deficient. That January 4th re-launching of the market's speculative influences was deemed to be the day that Powell and the Fed *pivoted* from a path of further tightening, to one that was now deemed to be more accommodative to the market's whims. It was a fun few months of market wilding, even if it was mostly absent the traditional fundamental underpinnings. It also opened up a wide enough window of rampant speculation that allowed billions of dollars worth of profitless zombie startups to be sold to the public and even tradeable thingy's (cryptocurrencies) have seen a modest bump in activity. Since reaching its fresh new all-time April 30thhigh, however, markets began losing momentum again. Promises of rate cuts and if needed, more QE, appears to had only been capable of pushing the Nasdaq and S&P 500 to marginal new all-time highs and only for a brief few days. The Fed's bubbles began leaking and as of Monday, June 3rd, *Pivot 2.0-Eve*, the S&P 500 had surrendered all of 6.8% from its April 30th all-time high. What were we to do?

Bullard, Evans, Clarida and Powell. That's what we do. In a matter of roughly 16-hours, we witnessed the *re-re-affirmation* of the Fed's collective love for financial speculation. First by St. Louis Fed President James Bullard, then Chicago Fed President Charles Evans, Fed President Jerome Powell, and finally, just for insurance, Vice-Chair Richard Clarida all combining for what might now be known as *pivot 2.0*. I don't need to recount what these folks said, but they definitely *did not* warn investors that rampant speculation might be bad for their wealth. So Tuesday, June 4th, was the second-best day for markets year-to-date. It goes without saying, and I know regular readers (both of you) have heard me say this multiple times, but for these clueless sots to proclaim that a *lack of inflation* is among the primary risks to economic prosperity (in so many words), while these same folks implicitly urge rampant speculation, world record levels of debt and leverage and all of the other unintended consequences associated with their actions, especially the gross chasm of wealth disparity and its ancillary outcroppings of political extremism, is nothing short of monetary malpractice. However, I can't stress it enough that trying to "play" in a market that by many measures is now as overvalued as any in prior history (*record market-cap to GDP, S&P 500 Price-to-median revenues, etc*.), despite their urgings, and one that at times is seemingly held together with nothing more than Trump trade tweets and implicit promises from the Federal Reserve to lower rates from a level already near zero (if we take an average of the world's four most prominent central banks) it feels about as brittle of a situation as we might fathom. I'll add that world record levels of global debt relative to global GDP on top of what appears to be a weak and weakening global economy lends little support to the equation as well, absent those otherwise hopes of more enabling of financial speculation.

But while this all goes on (trade roulette and more central bank bailouts), there is increasing evidence that the actual economy, the thing from which all corporate earnings and ultimately the value with which markets at least used to try to assign some kind of reasonable valuations to all those fractional interests in corporate America (stocks), is going from weak to weaker.

Volkswagen (NWAPY) is the latest global auto manufacturer to announce massive layoffs. According to multiple reports the German auto maker plans to purge 4000 from its payrolls. According to *Bloomberg*, global auto manufacturers have now announced 38,000 job cuts over just the past 6-months. A recent report by the online auto trade journal, *AMN (aftermarketNews*), reports that retail auto sales in May likely declined 3.1% year-over-year. The year-over-year drop would represent the fifth successive monthly decline in U.S. auto sales. Also, according to the report, new vehicles sold in May spent an average of 74 days on dealer lots. This marks the highest level of U.S. retail auto inventories based on "days-of-sales" for the key month of May going back to May of 2009. China reported its 11th monthly drop in car sales falling 16.6% year-over-year in April. The Flash U.S. Manufacturing PMI for May printed 50.6, down from 52.6 in April. That now marks a 116-month low for that data series. New Homes sales reportedly dipped again in April, down 6.9% month-over-month in April, even as mortgage rates plumbed their lowest levels in over a year. ADP's Private Payrolls report for May printed net gains of just 27k in May. This was far short of the expected gain of 180k, per *Reuters* and marked the weakest ADP report since May 2010. This report preceded but gibed with the weak May Non-farm Labor report two days later cited in the third paragraph of this letter. Germany's IFO business climate index printed 97.6 for May, marking a fresh 4-1/2 year low for the EU's largest economy. A recent Forbes report said that imports to China from the U.S. have fallen at an annualized pace of 30.2% year -over-year. This is a huge swing from a reported year-over-year increase from 2017 to 2018 of 10.1%. Data out of South Korea, a major exporter of semiconductors and electronic components, the guts for which basically propel the broader global technology sector spells even further troubles for the health of the global economy. According to *Bloomberg*, exports out of South Korea fell for the sixth consecutive month in May and were down in 9.4% year-over-year. Further confounding a bizarre 30+% rally for the entire group of semiconductor stocks up thru the end of April, per the Philly SOX Index, exports of semiconductors out of South Korea fell an alarming 30% year over year in May. Furthermore, this occurred amidst a near free-fall in computer chip prices as global inventories of unsold semiconductors climbed to historic all-time highs per a recent Credit Suisse report.

Outsized influences of stock buying algorithms, in my opinion, is the only way we can explain that bizarre ramp in the entire semiconductor sector up thru late April, which had become a *de facto* Chinese trade deal proxy for the entire algorithm trade trolling industry. It had become obvious, at least to me, that these algorithms were running roughshod over any incoming negative fundamental pieces of data, of which there was no shortage of, but not as plentiful as those well-timed stock market rigging Trump tweets espousing the soon to be signed *awesome* trade deal with China which never came about. A recent Bloomberg story, quite literally, illuminates the sheer insanity that has besieged stock markets amidst this era of central bank sponsored QE, ZIRP, NIRP and yield curve control (Bank of Japan) and all of its mutant extensions for which it has provide nourishment. The headline read, *Stock Traders Wait Anxiously for a Trump Tweet to Reverse Rout*. I kid you not. While I certainly feel for my fellow, advisors and strategists who deploy value, macro and fundamental based methods and disciplines within their practices, for having had to endure this distorted post-crisis

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era. But I feel particularly sad for the newer generation of investors, analysts, strategists and traders who have been conditioned at the very inception of their careers to believe that this is all normal.

As we get deeper and deeper into this cycle, it is rather obvious to me that we are witnessing a market that has essentially been overcome by the myriad of ridiculous self-reinforcing bubble making devices which collectively make this era wholly unique to any prior bubble era. Amidst the collective daily influences of corporate buybacks, passive investing and headline and momentum chasing algorithms, I don't think it's a reach to say that the day-to-day influences being exerted throughout stock markets by real human critical thought processes is not only at an all-time low, but for someone who have watched mostly unimpeded stock market activity since my early 20's (over 30-years), comparing today's markets and its current characteristics, to those of pre-2008 markets (pre-radicalized central banking) is akin to comparing a classic work of art to a lude girly magazine. One is art and the other is mere porn. What we have today is not a well-functioning efficient market. What we have today is the unadulterated bastardization of financial markets.

Clearly, from what I've witnessed since 2008 amidst the ongoing unprecedented radicalization of central banking and its subsequent bastardization of financial markets (*i.e. that traditional and historic tether between real underlying economic and corporate fundamentals and the prices being set in financial markets has been severely diminished and in many ways, seemingly totally severed*), news that might seem potentially damaging to stock markets and forward discounting of current values seems to get tamped-down and contained. And then perception of that previous obstacle or perceived risk to market values, upon its perceived resolution, gets priced-in almost as if the threat had never been present in the first place. In other words, fear and apprehension, two very healthy attributes of any well functioning market are quite scarce, while there is almost no shortage of the market's collective eagerness to speculate and participants willingness to trust implicitly without much examination or verification. Accordingly, every *risk-to-resolution* scenario that comes and goes, appears to net-out additional gains that seem unlikely to have occurred if that previous risk had never presented itself in the first place. I cant help but worry that the kind of conditioning of investor behavior that this emboldens eventually comes with a very dear price for the very reason that we learn at a very early age not to stick our hands over a burning flame, and not to stick *Play-Doh* up our noses. This now quite elongated era of the unrelenting conditioning of a new generation of investors not to fear but instead to trust implicitly otherwise bad economics, bad politics, bad corporate management bad monetary policy, and the systemic build-up of debt and financial leverage without question is going to send many investors to an early grave.

The perverse logic that now dictates market psychology and its current internal dysfunction is perhaps best exemplified by the very means with which central bankers have twisted and distorted the very meaning of a word as simple as *inflation.*

Today, clueless central bankers obsess over what they deem to be too slow a pace of our collective *costs of living*, i.e. inflation. Peter Boockvar, Chief Investment Officer at Bleakley Advisors, recently suggested that the press should insist that the Fed replace the word '*inflation*' with the words '*cost of living*,' '*and then see how this analysis and conversation goes.'* For every Fed meeting that passes, it's yet another lost opportunity for a member of the Fed's press pool to stand up and ask Chairman Jerome Powell or whoever is the presiding Fed Chair at the time, "*Why is it that you don't think that our cost of living is rising fast enough?"* Of course, we would hear about the Great Depression and risks of sparking a "deflationary spiral" or some B.S. such as that; but the real answer is that the Fed and their cabal of other complicit central banks need hedonically mutated inflation calculations to hide behind as a means to continue to implement what is now no less than monetary malpractice with their *real* primary goal aimed at keeping all of their bubbles from popping, both debt and equity.

The Kansas City Fed at times can be a rare beacon of wisdom among a broader group of seemingly clueless Fed minions who by now are clearly beholden to Wall Street interests and are sadly trapped in their economic models that have just minimal and tenuous connections to the real economy. In a recent CNBC interview of Kansas City Fed President Ester George she was quoted as saying something that I felt was worth passing along, given the very rare episodes of sobriety witnessed by any modern Federal Reserve member. George opined that the Fed should not be so eager to cut interest rates and that "*low inflation"* appeared to be of little concern to anyone, "*but financial market participants and economists who fear that the central bank is undershooting its 2-percent target and thus should ease policy to boost activity."* George went on to clarify, "*As I listen to business and community leaders around my region, I hear few complaints about inflation being too low. In fact, I am more likely to hear disbelief when I mention that inflation is as low as measured in a number of key sectors."* And that, "*This leads me to the observation that inflation as experienced by households and businesses is fundamentally different from inflation as viewed by financial market participants and many economists."* While George is not always consistent with her messaging on such subjects, she has said something that runs totally counter to the prevailing wrong-headed wisdom that now permeates Fed and broader global central banking *group think*. Alas, most interviews of current Federal Reserve, European Central Bank and Bank of Japan representatives are spent lamenting about the devastatingly "*low levels of inflation,"* even as 43% of the citizens which comprise the richest nation on the planet, are effectively poor. In a study called the *United Way ALICE Project*, and the results published in a recent CNN article, the study found that 43% of all Americans "*don't earn enough to afford a monthly budget that includes housing, food, child care, health care, transportation and a cell phone."* So the next time you hear a central banker lament about the woefully low level of inflation (i.e. cost of living), ponder that one.

The German government just issued a fresh new batch of 10-year bunds sporting a record *negative yield* of 0.24%. In other words, for any pensioner eager enough to lend the German government €100,000 for 10-years, that retiree can look forward to turning that €100k into roughly 97,625 euros 10-years later in June 2029. Yes, a net loss of roughly €2375. Meanwhile, Deutsche Bank (DB) published a piece in January 2018 explaining how the price of an apartment in Munich "*more than doubled between 2009 and 2017."* This is yet another instance of real financial bastardization where the pricing of such a key market barometer, i.e. the very cost of money, is now totally untethered from its everyday uses, i.e. to pay for real goods and services. When you have real inflation of things like food, housing, healthcare, education, etc. running at a rate substantially higher than what lenders are being compensated for in terms of a loan, you have financial bastardization. That critical link between real life and real uses of money have been severed from whatever methodologies are now at work and are now overwhelming the market's natural price setting or price discovering capabilities. Think about the absurdity of a negative yielding bond, amidst an economic environment of rising prices? Forget about the fictitious ramblings about there being no inflation. Again, that is pure propaganda being pushed by the price fixers themselves and those few who benefit from that charade. Imagine if two total strangers were introduced to each other because one stranger needs a loan and the other total stranger has liquid funds, but has no immediate use for it, yet he or she knows that his or her cost of living is going to be higher 10-years from now. So I'm not talking about a doting grandmother agreeing to lend money to her beloved grandson because he wants to start a business or make a down payment on his first home purchase or any other "arrangement" where the emotional attachment of the lender to the borrower elicits urges of wanting to be chari-

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table by offering an interest free loan. And even then, such a loan is probably not really totally free of interest or future compensation. The grandmother while being charitable, may implicitly be expecting something less tangible in return, perhaps love or appreciation. But again, in a global market where we have $12-trillion worth of negative yielding debt exchanging hands between strangers, absent the lender expecting even love, gratitude, appreciation or a hug, its absolutely and totally insane (read: financial bastardization)!!!

I contend that what we've witnessed is an effective hi-jacking of the true underlying meaning of the word "*inflation,*" by those who have the most to gain by denying its very existence but also who hold the purse strings capable of making its false premises transformed into real manifestations in so far as how prices are now being set in financial markets. Not much different than those who deny global warming— the polluters and their political accomplices. Who would that be? 1) The Federal government and state governments. The Federal government has an obligation to fund its two key entitlement programs, Social Security and Medicare and partners with state governments in assisting with the funding of many additional welfare or social safety-net programs. Attaching the real rising costs of funding such programs to a metric that understates the real rising costs of living is one way to keep its promise. (2) Wall Street and highly indebted corporate entities. If you can convince potential investors that "inflation" is subdued or at least rising at a lower pace than it really is, creditors will not insist on an interest rate commiserate with the real loss of buying power of their principle for the term of their loan. (3) Central Banks. This is the key to the whole charade. Central banks simultaneously protest the existence of real inflationary pressures while simultaneously engineering extraordinary and unprecedented inflationary policies all with the aid of its cabal of accomplice inflation deniers (Wall Street and the Federal government's bean counters). The continuation of these policies are aimed primarily as a means to ameliorate elevated debt burdens and for some to justify record stock market valuations. However, the relentless and circular self-entrapment of this policy simultaneously fosters an environment that implicitly encourages governments, municipalities, corporations and consumers to take on even more debt due precisely to the mispricing of new debt issuance (i.e. debt issuers recognize the relative attractiveness of going even deeper into debt relative to what that principle will really be worth at the end of the loan's termination). The knock-on effect to all of this is that as the globe's entire financial system continues to get leveraged-up to extreme levels. Accordingly, we not only have inflation in the real cost of living, but the whole symbiotic charade has successfully conspired to blow a multitude of epic-sized asset bubbles aided by the prolific issuance of debt and the leveraging-up of virtually every class of asset. So here we sit in a boiling cauldron with the inflation of basic necessities and debt levels simultaneously spiraling out of control congruently with stocks, bond and real estate markets all effectively being priced for absolute perfection.

While it almost feels nostalgic now to reminisce about the old days when the U.S. Federal Reserve used to care mostly about the relative purchasing power of the U.S. dollar amidst the implementation of mostly *sound monetary policies* even as it lurked deep in the background to act as a rare lender of last resort. For the most part capitalism was left to fend for itself amidst mostly unfettered price discovery deemed to be both a sufficient, fair and a natural arbiter best left alone to efficiently allocate capital and to help differentiate financial winners from financial losers. Today, they're no less than the architects of a bastardized version of capitalism.


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**Raymond James Financial Services**
**301 Yamato Road, Ste. #3160**
**Boca Raton, FL 33431**

***E-mail: Stephen.Giauque@RaymondJames.com***
***Web: www.StephenGiauque.com***




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