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Markets trending towards maximum distortion

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Last month, Fed Chairman Jerome Powell and the Fed cut its key benchmark rate, the Fed funds rate, for the second time since 2008 by a quarter of a point to 1.75% and therefor spent less than a year at or above 2% on its key benchmark rate. This means that the last time it cost financial speculators 2% or more to fund short-term funding of its operations for more than 12-months was from September 2007 thru September 2008.

Also, last month, China unleashed another round of monetary stimulus. The People's Bank of China slashed its required reserve ratio for its banks to 0.5%, marking the lowest "RRR" since 2007. A *Business Insider* report says that the latest cut to its bank reserve ratio would free-up as much as $126-billion for new business lending. Roughly 2-years ago, Chinese monetary authorities had attempted to reign-in financial leverage amidst fears that its shadow banking system had grown so unwieldly as to pose significant systemic risks to its banks and financial system. Clearly, concerns about its flagging export-centric economy now trumps prior concerns of it potentially reaching the outer limits of it's debt and leverage spectrum.

Mario Draghi and the European Central Bank also announced a fresh new money printing scheme in early September, since the other ones have worked so well. They also slashed it's deposit rate, the rate its member banks earn, I mean lose, on excess deposits held with the ECB, from minus 0.4% to a minus-er 0.5%. Yes, minus! The ECB also reduced terms of its existing outstanding loans to member banks and also introduced a new tiered deposit rate that is deemed to curry favor for certain entities that would be more severely impacted by the penalty of a negative deposit rate. Draghi and the ECB also announced a fresh new batch of overt bond market manipulation (quantitative easing) where it will ramp-up the old printing presses that had been put in storage for all of 8-1/2 months. Unlike the U.S. Fed, during these past 8-month where the ECB had finally stopped printing money, they never really came close to even suggesting that they would attempt to unwind a portion of the roughly €2.6-trillion of European debt instruments that it had brought onto its balance since late 2014 via its money printing scheme up thru the end of last year. Furthermore, both the duration of both the new *negative-er* rates and its newest money printing scheme were left open-ended per the ECB's Governing Council official policy statement which said, "*The Governing Council expects (bond purchases) to run for as long as necessary to reinforce the accommodative impact of its policy rates, and to end shortly before it starts raising the key ECB interest rates.*"

Index	Sept. 30 2019	YTD%
S&P 500	2976	+18.7%
Dow Industrials	26917	+15.4%
Nasdaq Composite	7999	+20.6%
Value Line Arithmetic	6188	+14.9%
Russell 2000	1523	+12.9%
U.S. Dollar Index	99.47	+3.6%
Gold (ounce)	$1471.50	+14.8%
Silver (ounce)	$16.95	+10.4%
Amex Gold Bug Index	203.27	+26.3%
Oil (NYM Lt Sweet/barrel)	$53.98	+18.9%
30 Year Treasury Yield	2.12%	-0.89%
10 Year Treasury Yield	1.68%	-1.02%
2 Year Treasury Yield	1.63%	-0.85%

The S&P 500 is an un-managed index of 500 widely held stocks. The Dow Jones Industrial is an unmanaged index of 30 widely held securities. The Russell 2000 index is an un-managed index of small cap securities which generally involve greater risks. There is no assurance these trends will continue. The NASDAQ Composite Index is an unmanaged index of all stocks traded on the Nasdaq over-the-counter market. The Value Line Composite Index is composed of all of the companies that are included in the Value Line Investment Survey. The Dow Utility Average is an unmanaged index comprised of 15 utility stocks. The Amex Gold BUGS (Basket of Unhedged Gold Stocks) Index is a modified equal dollar weighted index of companies involved in gold mining. Inclusion of these indexes is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Past performance does not guarantee future results. Commodities and currencies investing are generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising. U.S. government bonds and Treasury bills are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and guaranteed value. U.S. government bonds are issued and guaranteed as to the timely payment and interest by the federal government. Treasury bills are certificates reflecting short-term (less than one year) obligations of the U.S. government.

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Shortly after the ECB's newly announced asset bubble propping scheme, last month, the Fed made its second rate cut. Then, late last month the New York Federal Reserve was forced to implement QE-Lite by providing emergency liquidity for banks and other financial entities via its first "repo" operation since 2008 including its first "term repo," also a first since the financial crisis which are as close to outright QE as a central bank can get without actually doing so. The Fed's balance sheet, per the weekly release of its balance sheet data up through October 2nd, revealed that it had grown by $83.86-billion in just the prior week alone and has expanded by $176-billion in the 3-weeks since September 11th amidst their recent emergency repo operations and term repo funding.

So, what do you know? The Fed is already effectively doing QE without officially saying so. To put things in perspective, at the peak of the Fed's three post crisis QE

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operations, QE-3 was the most aggressive where it printed a maximum of $85-billion per month. So we have effectively seen the Fed quietly engaging in a form of QE that is about 2-1/2 times larger, during this recent 3-week period, than anything seen at the height of their post-crisis QE operations. I suspect this is probably why markets seem incapable of recognizing the toxic dose of it being both excessively frothy (highest ratio of market-cap-to-GDP in history), amidst a deteriorating economy, no corporate earnings growth and a record level of corporate leverage.

To further put things in perspective, the Fed is now cutting rates, effectively implementing QE, again, even as the S&P 500 had come to within a mere 1% from a new all-time high in late September.

We are now likely very deep into this *end-stage* of not only the longest bull market in U.S. history, but one that has been easily the most fabricated and falsified via the incredible and unprecedented levels of never-before-seen radicalized and globally coordinated central bank interventionist policies in history. Those same policies, I believe, have left us with perhaps the most pervasive, broad based and all-inclusive global financial imbalance in all of history. Yet, this is occurring absent the requisite solid economic underpinnings that should be a prerequisite of any bull market of this magnitude. The U.S. ISM Manufacturing Index for September just crumbled to its lowest level since 2009. A record number of people in the U.S. are now needing to work multiple jobs just to make ends meet per recent data from the Bureau of Labor Statistics. Corporate earnings have been running negative year-over-year. The OECD's (Organization for Economic Cooperation and Development) Leading Indicator fell to its lowest level since September 2009 in July. China's growth in industrial production recently printed a fresh 17-1/2 year low and FedEx's (FDX) CEO recently warned after a sizeable miss of his company's earnings and revenues, '*I think there is a lot of whistling past the graveyard about the U.S. consumer and the United States economy versus what's going on globally.*

Making matters perhaps even more precarious, is also the relative lack of central banking dry powder remaining at this juncture that might otherwise end-up being necessary to arrest the unravelling of such an epic and broad-based global financial bubble, whose footprints can be found in virtually all traditional asset classes from stocks, bonds, residential real estate, commercial real estate, collectibles, rare art and start-ups.

While I have thought the Fed and its policies would eventually be exposed for having engendered and popularized a policy that would eventually blow up in their faces (i.e. bubble blowing being allowed to supplant real organic investment and capital formation), I'm afraid that President Trump is also setting the Federal Reserve up, instead, for being errant in not succumbing to the market's whims fast enough when in fact, having done so too often in the past is exactly why, I believe, they find themselves in a nearly no-win situation today to begin with. The Federal Reserve's error was to allow bubbles to manifest in the first place and to further act as enabler of markets which has fomented a market environment in which fundamentals count for little and private market valuations of cash-burning fairytales (your typical start-up) are kited to the sky.

Part and parcel of an environment steeped in central bank-induced complacency are also perceptions that central banks would *not allow* another crisis similar to the crash of the tech bubble and the subsequent crash of the real estate and credit bubbles to ever materialize again. Yet their unhinged efforts to seemingly perpetuate eternal market froth absent the natural occurring cleansing process associated with the ebb and flows of an unobstructed business cycle, including the periodic and healthy excess cleansing recession, the accruing financial imbalances that this continues to hasten, and the coincidence of misplaced perceptions of near invincibility of the powers of central banks and their unconventional policies, including the duration that these policies continue to be applied, are exactly why a crisis of similar magnitude, or perhaps worse, is almost assured to have since been sown. We have such a small historical sample size of instances where central banks have been forced to implement interest rate policy at the zero bound and simultaneously intervene in bond markets with outright non-price sensitive purchases. Accordingly, I don't think anyone knows for sure what the outcomes will be especially so from the perspective of being forced back into an even more aggressive policy regime after being unable to truly extricate itself from its initially volley of unprecedented policy in the first place. All of this occurring in the 10-year aftermath since the epic credit crisis. But a few unintended mutant manifestations that appear to be direct off-shoots of this stuff, seem equally capable of initiating this era of radicalized central banking policy's eventual discreditation including the now very gilded age-like wealth gap and its derivative—the scourge of global political extremism.

There are so many anecdotal markers that are wholly symptomatic of the current era's epic fail, including the multi-year record stretch of corporate stock buybacks (much of which is debt financed). The immense levels of new global debt issuance. The near take-over of market price discovery by mechanized algorithmic trading and the subsequent crowding out of almost any discernable forms of value and fundamental investing disciplines. The new era's pervasiveness of passive investing (enabled by the central banks unprecedented propping-up of markets). And again, the grotesque levels of wealth disparity this has all fomented, and its derivative—-the nurturing of global political extremism. Corporate balance sheet's among non-financial entities have now reached all-time new record levels of net leverage per the *Wall Street Journal* in a recent report. Amidst the era's record level of corporate stock buybacks, corporations have acted as the biggest single source of stock buying during the current but aging bull market, per a May 29th CNBC report. And according to the same story, citing Larry McDonald, editor of *The Bear Trap Report*, 50% of all new net debt issuance since 2009 has brazenly been used for nothing other than to buyback their own shares. Absent the ongoing stock buyback binge, we really just have a market of very leveraged and expensive stock prices. In late August the average yields on all non-U.S. global sovereign debt went negative for the first time in history. In fact, the *most obvious* anecdotal sign of this era's epic failure, in my opinion, is the scourge of negative yielding debt. At its recent high in late August, a record $17-trillion worth of global debt was trading with negative yields.

So again, think about the cumulative level of unprecedented global central banking stimulus over the past 10-years, from quantitative easing (QE), zero interest rate policies and even the once unheard of use of negative interest rates or NIRP! Granted the currently running level of QE, between the Bank of Japan and

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the European Central Bank is not what it was at the height of maximum post 2008 double dosed stimulus seen from 2015 thru the end of 2017 (QE-III + zero interest rates), but extraordinarily loose nonetheless and would be deemed "panic levels" if this were any time prior to 2008. And then juxtaposing *THAT* with the anecdotal sightings of the kind of sheer unabashed "*you know it's a bubble when*," recent anecdotal market mutations which helps frame this moment in a more enlightening perspective. In addition to those mentioned above, we are also witnessing negative yielding junk bonds in Europe, a second consecutive year of trillion-dollar-plus U.S. Federal deficits, a nearly pure, pristine and delusive form of speculation in something called *cryptocurrencies* which has no intrinsic value and void of any real scarcity value. U.S. stock market capitalization relative to U.S. GDP is also now at an all-time high . I could go on and on. My list is now easily longer than anything I could have compiled in 2000 and again in 2007. Furthermore, there is now pretty clear evidence that these policies have disastrous effects to the banking system and the management of pensions that need to meet actuarially targeted returns on their assets in order to meet future beneficiary obligations. But clearly, the message is loud and clear. They cant stop now because addressing those deleterious side-effects would essentially be an admission of failure and it would also mean the era's distorted new version of capitalism (statist capitalism), and all of the bubbles it has spawned, could not survive absent the prospects of a continuation of falsified and manipulated costs of debt (interest rates)-- the nourishment for this epic dose of misaligned financial risk now interwoven throughout the globe's financial system.

The unintended consequences of years and years of unprecedented brands and the duration of radicalized central banking policies are finally more vivid and recognizable to the average viewer. So, they're now stuck with the choice of doing even more of the same, or to address the more recognizable abhorrent symptoms of their policies including the continuation of a policy that essentially starves savers and actuarially designed defined benefit portfolios such as pensions. A less tangible component to their abhorrent policies, in my opinion, has been the very threat to global democracies amidst the growing disenchantment with the widening disparity of global wealth. Again, addressing these side effects couldn't be more diametrically opposed to the survival of their financial bubbles. If they were to begin to address the wealth gap and the burgeoning pension and savings crisis' associated with zero and negative interest rates, all of the bubbles that are dependent upon the same money printing schemes (QE) and zero and negative interest rates would promptly begin to unwind; and probably in the form of a catastrophic global financial dislocation. They're so incredibly trapped and yet its been staggering to me how few it seems have recognized that one day this is where it would all lead.

Don't get me wrong. The global economy definitely has all the symptoms of an encroaching recession. And in prior eras, a responsible central bank would have already normalized its monetary tools, if for no other reason, to build some dry powder as a means to cushion the blow upon the arrival of the next recession. But also, as a means to govern financial speculation from running amok, as it now has. Unfortunately, they're now facing the worst of all circumstances as they have coddled financial speculators, spawned an epic wealth gap amidst the myriad of their bubbles and have engendered virulent strains of populism throughout the world's traditional democracies as a growing number of their populations now reject and protest this mutant and deformed brand of something still described as "capitalism."

Finally, on the first day of October Something notable happened in Japan's bond market, the most manipulated credit market on the planet. JGB (Japanese Government Bonds) futures saw their single largest drop overnight since 2016 . The culprit was a surprisingly weak auction of a fresh new batch of 10-year JGB's. Bloomberg reported that the Bank of Japan had also hinted that it may slash its ongoing QE (bond purchases) next month as a means to try to steepen its yield curve. This news came after Japan's giant Pension Investment Fund said it may begin purchasing more foreign debt instead of zero yielding domestic debt. The announced move by Japan's giant pension fund also comes as Japan's banks continue to struggle to turn a profit amidst years and years of a manipulated domestic bond markets and artificially suppressed interest rates. Alas, Japan's TOPIX Bank Index has been plumbing near all-time lows in recent months even as so many other global assets continue to gorge themselves at the trough of free leverage. Quoted in a recent Bloomberg report outlining the recent outbreak of volatility in JGB's, Peter Boockvar, Chief Economist of Bleakley Financial, warned, '*I always thought it was going to be a bout of higher inflation that was going to end the central bank monetary madness, but maybe it's just the realization that you need a functioning banking system in order to have a growing economy.*'

But Japan is not alone. Europe's key bank indices have also been flirting with all-time lows since late this spring. Clearly, the myriad of adverse side effects of the decade long coordinated and overt manipulation of the globe's bond markets and hence interest rates are going to rival the seriousness of the very issue that these same central banks had feared in the first place, that being another financial crisis that rivals the last one. Ironically, when and if that moment arrives, you'll be able to trace the origins of that crisis back to these same irresponsible policies.

And yet, the President of the United States is essentially all-in on this sad, last and final decomposition phase of this era of radicalized central banking manipulations. Toss another piece of furniture on the fire. A week after the Fed's last rate cut, the President of the United States tweeted, "*Our Federal Reserve cannot 'mentally' keep up with the competition - other countries. At the G-7 in France, all of the other Leaders were giddy about how low their Interest Costs have gone. Germany is actually "getting paid" to borrow money - ZERO INTEREST PLUS! No Clue Fed!*" Market historians and bubble forensics will someday find all of this to be incredibly delicious irony. Here is a U.S. President, who mistakenly views the level of the stock market as some kind of true and accurate proxy for his stewardship of the U.S. economy and at a point in time, with all of what I've described above about the relative levels of ongoing monetary stimulus and their resultant asset bubbles and social ill-effects, he is verbally flogging the presiding Fed Chairman for not throwing even more gasoline on an already raging global speculative fire. The Nasdaq, perhaps one of the best proxies for the level of broader market speculation, was up 25% year-to-date as of the day before that Fed rate cut in late July. The very fact that the Federal Reserve even implemented a rate cut given the clear and obvious levels of speculation currently coursing through global markets would be delectable historic irony by itself. But to further have

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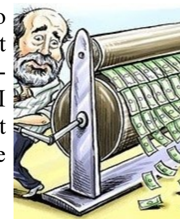
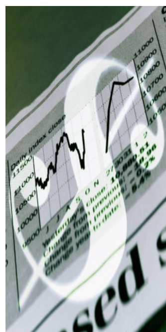
the residing President of the United States verbally excoriate the Fed for not cutting rates *enough*, given the broader circumstances, is nothing less than a nearly perfect and crystalizing moment for those future market historians.

What we're witnessing with this scheme of globally coordinated central banking policies, intentionally aimed to overtly manipulate global bond markets and hence the cost of money (free), now into its 10th year, has also given life to a plethora of self-reinforcing bubble mechanisms, including the mass adoption of indexing and passive investing by the general public who themselves have been emboldened (and possibly deluded) by such an artificial market edifice to believe that markets never go down and stay down long enough to really impact their respective retirement plans. Just don't look at Japan's Nikkei Index which peaked in 1990 and has never reclaimed that level since. If you were a 45-year old Japanese investor in 1990 that was fully invested in your domestic market (at the time, the envy of the world), you're now 74-years old, probably retired, and are still waiting to see your portfolio match the nominal number you saw on your brokerage statement 29-years ago. And then of course, the proliferation of and crowding-out effects of those stock buying algorithms. The evolution of algorithmic trading has been a useful byproduct to this era, even if its been coincidental to have come along almost simultaneous with this era of radicalized central banking. But its been an important ingredient to the entire blurring of financial risks because Wall Street's algos are among those entities that have a cozy seat right next to the central bank's huge spigots of nearly free money with which to further distort markets. This is why, despite the continuing enabling of risk taking by these ongoing unprecedented intrusions, amidst the markets simultaneously growing *lack of appreciation* for risk, the longer this goes on, things are in fact becoming ever more risky.

At its core, central banks overt suppression of interest rates and credit risks, when you think about it, is essentially aimed at purposely trying to delude the myriad of market participants into believing that risks at every juncture along that theoretical "*portfolio balance channel*," are muted relative to their true underlying intrinsic risks. The term, "*portfolio balance channel*" is *Fed-speak* to describe the entire population of all global assets in terms of their respective gradually rising risks along that risk spectrum. So, you can think of short-term U.S. treasury bonds as being that asset with virtually no risk at one end of the spectrum and then stuff like leveraged credit and equity derivatives at the opposite end; and everything else somewhere in the middle. Theoretically, when you have unfettered markets with properly functioning price discovery, the myriad of the globe's investors are deemed to be sufficiently adept at adopting those assets according to their own personal tastes for financial risk against their perceived expected returns relative to those perceived risks. But when you have central banks accumulate a significant portion of all those assets at the very front, low-risk end of that "portfolio balance channel," and in so doing also overtly "confusing" the market's "risk messaging," you essentially push everyone else further out on that risk curve beyond what would be their natural resting spot.

Again, when the real cost of money is distorted by just a little bit, those distortions become amplified by the time you get out to the most wiggly and least tetherable kinds of assets, such as start-ups, cryptocurrencies and derivatives of underlying risk assets. Combined with all of what I've discussed above, this effectively gives us a nearly perfect self-reinforcing bubble making machine which I'm afraid is going to be capable of luring just enough unassuming investors capable of being what I fear will ultimately be that final knock-out blow to the U.S. middle class.





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