An intrinsic part of Cantillon Consulting's service to its clients is to offer Sean Corrigan's unique take on global markets; one which admirably bridges the gap between analysis and action. In addition to regular TV appearances, Sean has been widely published, both on the web and in print. A demonstration that financial folly is nigh on eternal, his book, *'Santayana's Curse'*, is available for Kindle.

WHO Take our publication, ***'Money, Macro & Markets Monitor' (M4)*** as an example. This is written from the perspective of someone who has been actively involved in the game for the best part of three decades. As a distillation of the insights to be had from this long experience in participating in and observing, reading, and writing about markets, M4 is aimed principally at informed, professional decision makers of all kinds—whether financial advisors, wealth managers, asset allocators, middle office executives or members of the board as well as those trading more actively at banks and funds, or as managers of their own capital.

WHY The aim is to collate and sift through the news and the numbers as they arise to try to understand not just what is actually taking place, but what the market consensus *thinks* is happening. By doing this we can hope not only to identify emerging trends but also to recognize when old ones are becoming stale, helping our readers to maximize gains and minimize risks.

HOW At root, we work from the premise that the Credit Cycle *is* the Business Cycle; that fluctuations in money and credit are what give rise to instabilities in economies. It is our lot to live in a period where the checks and balances on such turbulence are much less robust than ever before; one where the deliberate violation of such restraint as does remain has become the very goal of active policy. To understand the interplay between money, asset markets, and the real world is the crux of what we do.

THE UNDERLYING APPROACH There is not much here that is a dull repetition of the mainstream economics practised so widely today. It may be a strange confession for the author of a publication called ***'Money, Macro & Markets'***, but we like to start thinking about things from the individual perspective before working upwards to the collective—from micro to macro as it were. No spurious pseudo-science, just the rigorous application of logic tempered in the forge of experience.

APPLYING THE LESSONS We know fundamentals matter, but we also know that we call the *'sentimentals'*—the many intangible elements of valuation—can easily overwhelm them, especially in financial markets. So, having considered the underlying state of affairs, we will use technicals to try to infer when and with what vigour the Herd will react. Conversely, we will look out for what price action can tell us about the fundamentals.

PRACTICALITIES We will monitor the growth of money and credit and try to track them as they flow through the system, changing its topography as they do. Trade numbers, business revenues, production, prices, and payrolls, whether these bring surplus or deficit and involve borrower or lender will figure. All will be examined, as will market activity itself—the building of positions, whether the mood is trend following or mean reverting, bullish, bearish or plain bamboozled.

In all, we will do our best to keep you entertained as well as informed and to provoke many of the right questions as well as to provide some of the right answers. Welcome aboard!

Sean Corrigan

WHO

As a glance at the *'Money, Macro & Markets Monitor'* will reveal, much is necessarily written from the perspective of someone who has been actively involved in the game for three decades, firstly as a trader then in that sweet spot between the staff officer chateau of pure economic commentary and the frontline trenches where risk positions are actually taken and managed. Along the way, a great deal of effort has been expended to put solid, theoretical flesh on the bones of this practical understanding. More has gone into reinforcing the latter with an underpinning of diligent historical reading.

Hopefully a distillation of the insights to be had from this long experience of participating in, observing, reading and writing about markets and economies, what we do is aimed principally at informed, professional decision makers of all kinds—whether financial advisors, wealth managers, asset allocators, middle-office executives, or members of the board as well as those trading more actively at banks and funds or as managers of their own capital.

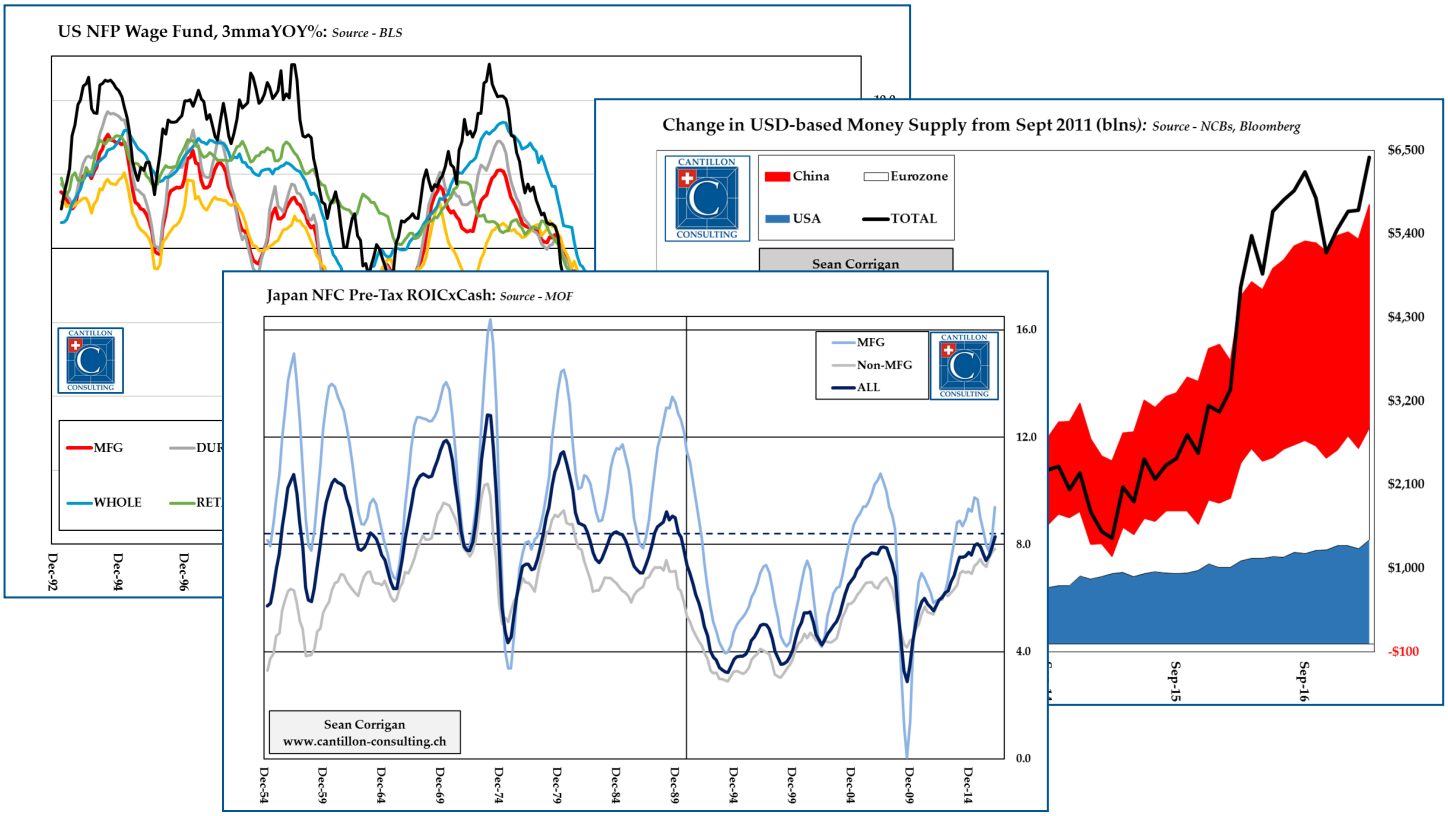
Though these good men and women will comprise our primary readership—and hence the articles will unavoidably be as replete with the sort of specialized terminology which informs any distinct field of human activity—we hope it will not prove inaccessible to anyone possessed of a reasonable familiarity with the financial sections of the media.

Indeed, with this very much in mind, an important part of our work will involve the demystification of the metier , the explication of the process, and the education of our audience

WHY

The aim is to collate and sift through the news and the numbers as they arise to try to understand not just what is actually taking place, but what the market consensus—as well as the policy-making hierarchy—*thinks* is happening and what it imagines are the implications of that conception. By doing this, we can hope to identify emerging trends but also to recognize when these are becoming stale or indeed are beginning to sow the seeds of their own negation.

In this way, we hope to help our readers to maximize the gains to be had from their own particular endeavours as well as to help minimize the risks inherent to them.



HOW

At root, our work is based on the belief—long associated with the Austrian School—that the Credit Cycle *is* the Business Cycle: that fluctuations in money and credit are what give rise to instabilities in economies and that it is our lot to live in a world where the checks and balances on such turbulence are much less robust than ever before, one where the deliberate violation of such restraints a do still exists has become the very goal of active policy.

Conversely, we also argue that the highly elastic structure of the credit system—combined with the essentially unbounded ability to create the supply of money upon which it rests—means that disturbances in the non-monetary (i.e., the 'real') economy do not always set in motion that series of self-governing adaptations which would otherwise damp them out in a truly free market

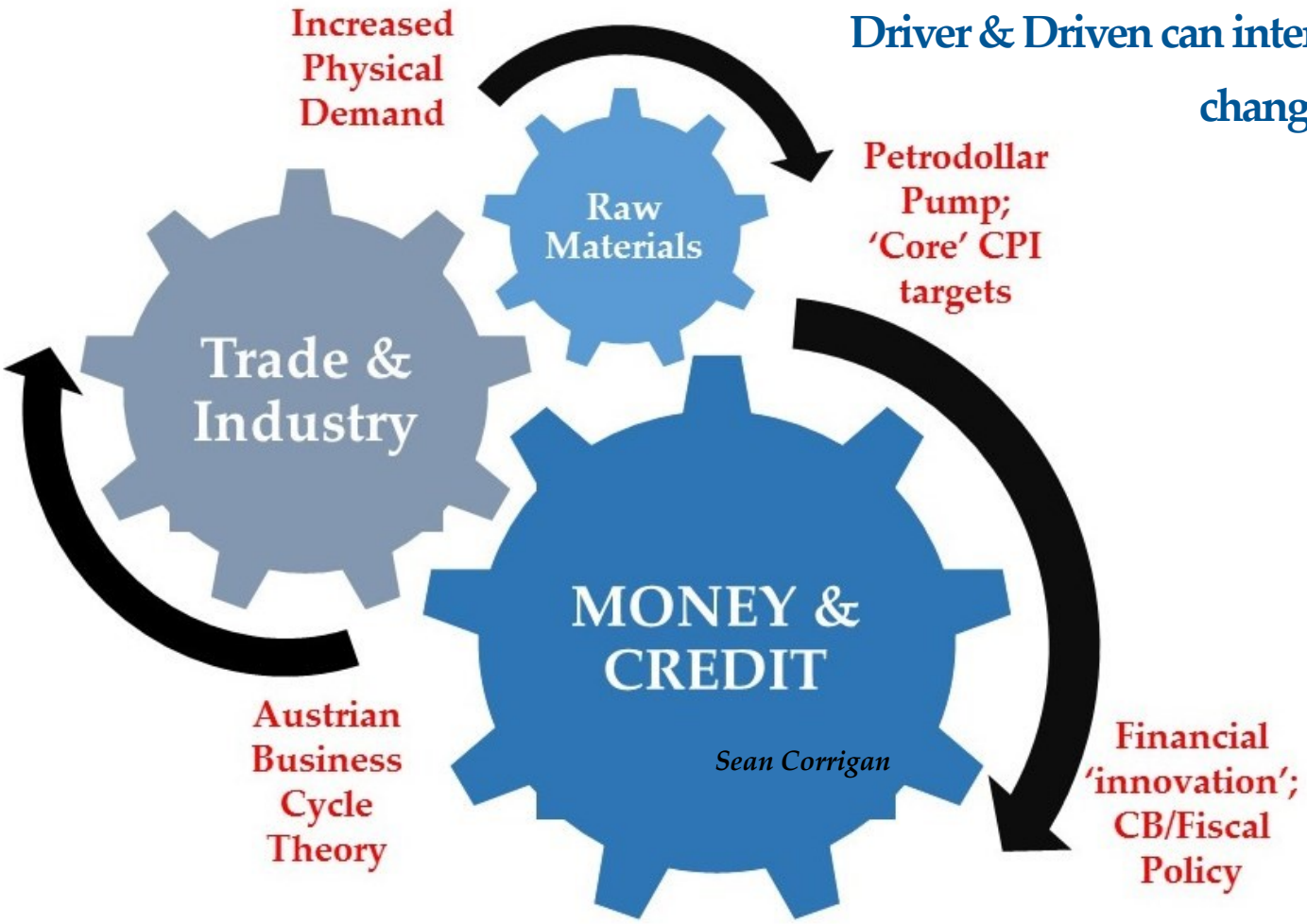
Instead of dying away, real-side departures from the norm can all too easily bring about parallel, aggravating developments in money and credit which—at their most violent and damaging—go by the name of 'bubbles'.

Throw a large enough stone into this particular pond and far from the ripples spreading out and slowly dissipating to leave nothing more than a slightly raised water level behind them as one might expect, the waves may instead trigger a subsurface landslide and unleash a tsunami of activity in the credit markets.

Thus do technology booms and busts regularly take place, as well as those floodwater surges of inflation and ebb tides of deflation which emanate from the money side alone.

'The Fluttering Veil'

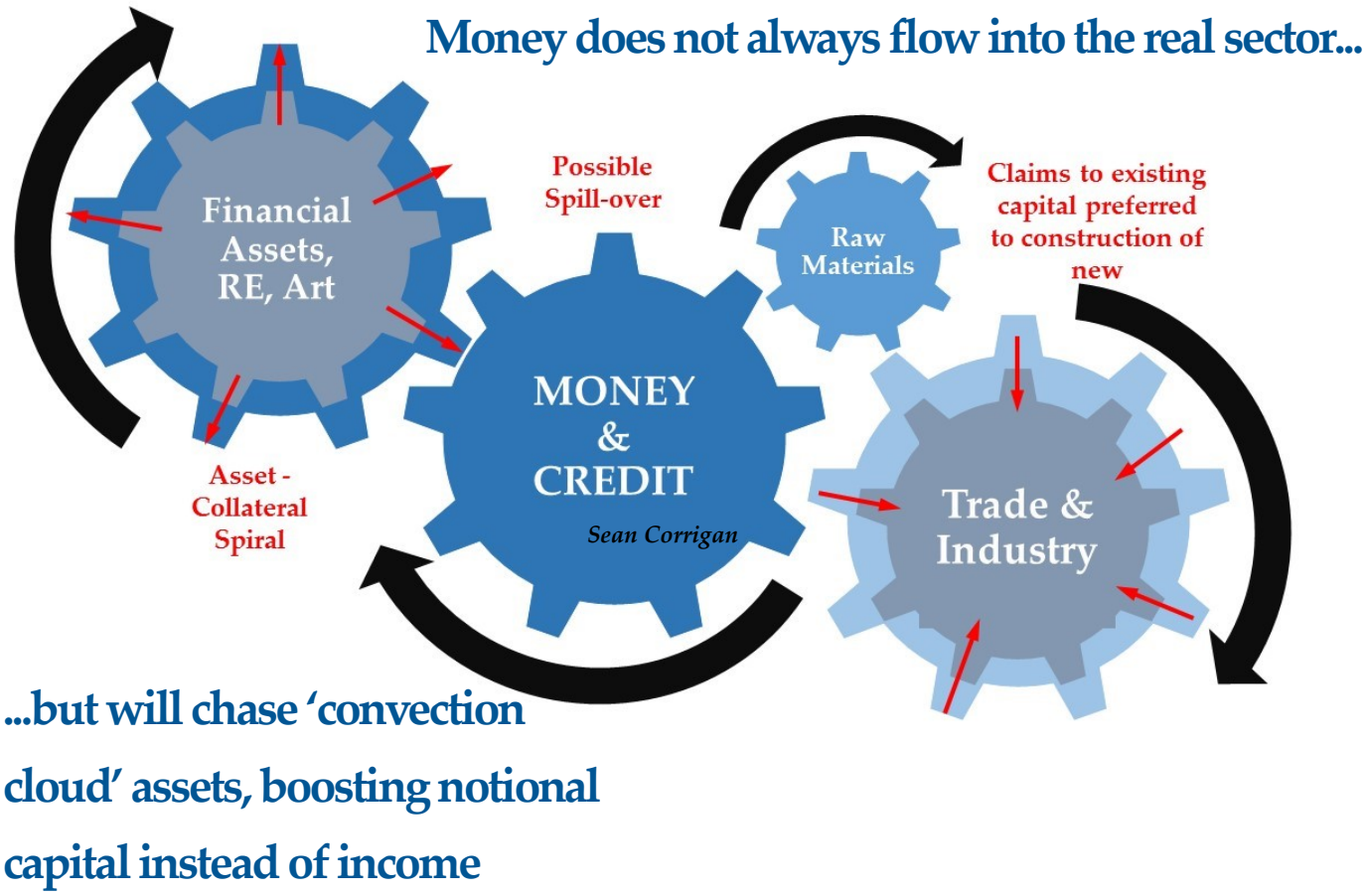
In the interplay between real and monetary factors, Driver & Driven can interchange



Money does not always lead, but it does have to follow

Far from there being any mechanistic linkage from monetary cause to real-side effect as some would propose, for us the picture is far more complex and highly case specific. Sometimes too much money and credit are created—often as a deliberate act of policy—to wash back and forth, overspilling their functional channels, and eroding the underpinnings of our wealth. On other occasions some new excitement in the world of goods and services catalyses a burst of monetary excess which breaks all the bounds of the natural order and topples the new Tower of Babel that way.

In performing our analysis, then, the aim is to monitor when and how such influences are at work; to offer our advice about how to exploit them; to try to determine when they are turning malign; and finally to alert you when we feel they are reaching what is often a highly dangerous climax.

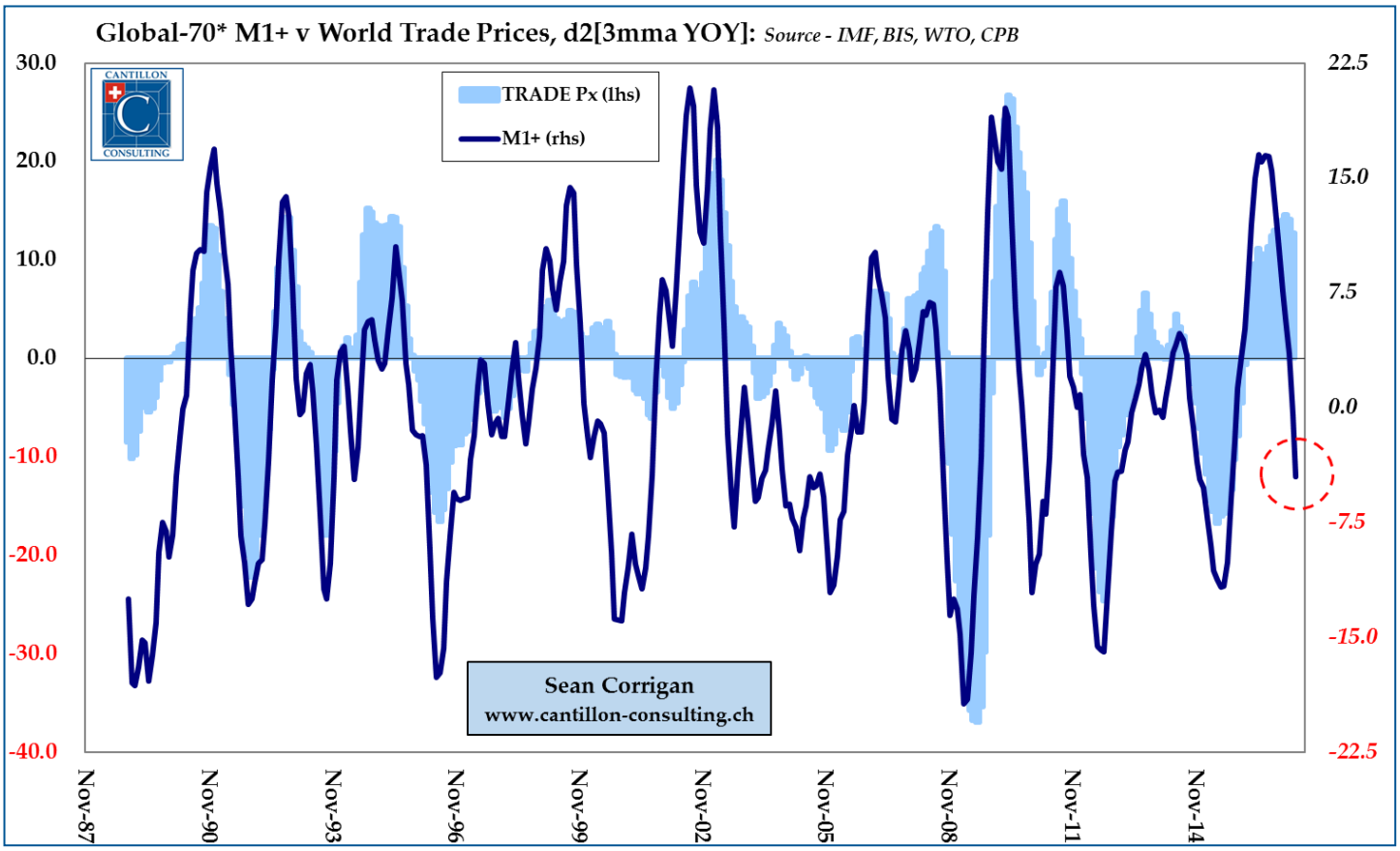


THE UNDERLYING APPROACH

Here you will not find too much that is a dull repetition of the mainstream economics practised so widely today. It may be a strange confession for the author of something called *'Money, MACRO & Markets'*, but we like to start thinking about things from the individual perspective before working upwards to the collective—from the micro to the macro, as it were.

Partly this is because we're not all that enamoured of the reverse quantum threshold of weirdness which invokes all manner of 'fallacies of composition' as you add more and more people to the mix. This sort of thing leads many to argue that a number of patently absurd 'paradoxes' intrude at the aggregate level, such as the one which suggests that if at least some of us are not habitual spendthrifts, the economy will quickly collapse in a self-impoverishing loop of pointless miserliness. This, in turn gets is into the muddle in which we find ourselves today: everyone has too much debt, but if no-one borrows, we are told, there can be no growth.

While you will see plenty of overlapping wiggles drawn in the graphs on these pages, we are acutely aware that correlation is not causation and that, in any case, the judicious selection of the right starting point or the superposition of two upwardly trending series can always be relied upon to add a sheen of spurious linkage between the two so it can masquerade as that imposingly scientific-sounding utility, a 'model'.



Money decidedly *does* make the world go round…

...or at least spins with it

We were also taught long ago to beware the ever present temptation to treat whatever appears in an Excel cell as an unchallengeable representation of not only an absolute but also an eternal truth. Data gathering is merely a means of approximating a highly complex reality and in part it depends upon the preconceptions of the data gatherer himself, as the father of GDP accounting, Simon Kuznets, was only too happy to admit (though it is a crying shame nobody now stops to consider that too uncritical a focus on GDP always seems to suggest Keynesian solutions to Keynesian problems because, from the first,, it lent itself too readily to a Keynesian imagining of the economy).

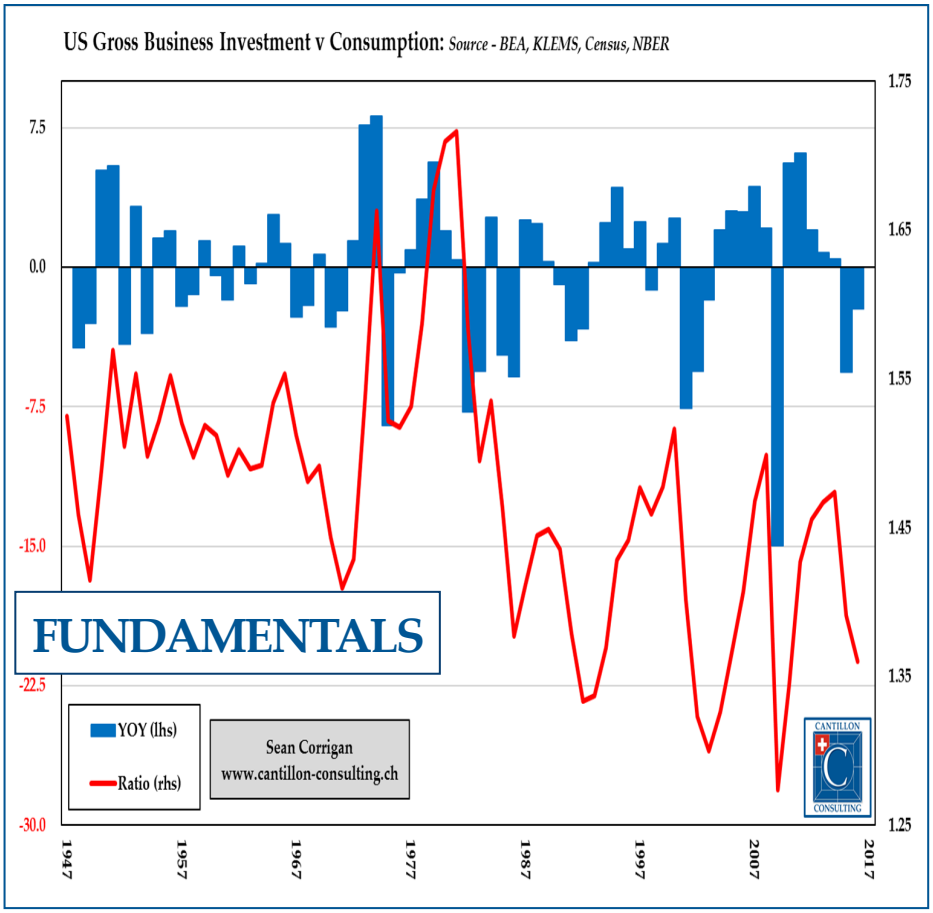
Furthermore, while the laws of economics may be constant, the institutional framework in which they act are not. Real life is not a laboratory where we can isolate the single variable in which we are most interested in order to gauge its effect, much less one where we can re-run the experiment at will.

The better bet, then, is to start by thinking about what could be happening, whether it might actually be happening, and THEN to check for such empirical confirmation of our hunch as can be had from the numbers to hand. That is largely what you will get here.

In another vein, there is much energy wasted—and, in financial markets, vastly more money!—over the question of how closely we come to emulating that mathematical goody-two-shoes so beloved of mainstream economists, the 'rational agent'.

It is much closer to the truth to say that he is a 'rationalizing agent': that, ever since he hunkered down beside a flickering camp-fire among the members of the extended family which comprised his hardy band of hunter-gatherers, he has constructed a narrative by means of which to impose some mental order upon the terrifying whirl of events which have engulfed him. We Moderns may have substituted Sharpe ratios for shamanism and risk-parity for the reading of runes, but we are all wedded to the *ex post* neatness of a good *Just So* story, all the same

This leads us to the truth propounded many years ago by Mises and his followers: namely, that while we can assume that humans are as rational as they can be within the limits of their understanding in trying to fulfil their wants or to lessen their discomfort, the perceived intensity and the ordering of those desires not only have their origins far beyond the realm of the rational but, additionally, they are unique to each and every human actor. Hence why we have a multi-trillion dollar industry which is devoted to exciting and re-ordering our wants by way of advertising and marketing.



APPLYING THE LESSONS

This may seem a somewhat philosophical preamble to the question of how we go about our work, but it does have an undoubted relevance to that undertaking.

This is as follows. Given the subjective nature of the wants we have just described, we know from bitter experience that it is all too easy for what we call the '*sentimentals*'—the many intangible elements of valuation—to overwhelm the so-called 'fundamentals'. Indeed, since those same fundamentals rest on the preferences buyers and sellers express when they trade with one another, they, too, are nowhere near as concrete and immutable as people like to pretend.

In financial markets this is even more true, especially when, for large numbers of participants, ownership is a fleeting, if not a wholly incidental concept in the game. Get in, get out, go home square is the overriding mantra of the many.

In such a world, it may well be important to know the levels at which successively ranked producers of a good will or will not then find it profitable to continue to produce, but one should not forget that even the losers may persist until they have exhausted all possible means of funding or that their default may open the way for new owners to run the operation without the bearing the burden of interest payments to the original lenders. Secondly, there may be large stocks of goods, lying around ready to be used when capacity is withdrawn, many of them largely unrecorded. Fundamental analysis may not reveal this until well after the fact: an awareness of the price action might pick it up at once.

Thirdly—and perhaps most significantly of all—when prices fall, it may just be that innovation has made the threatened supply redundant or that subjective tastes—our 'sentimentals'—have simply turned unfavourable. Whether we are dealing with the good as an end in itself or as an input to some significant other market, demand can fluctuate for reasons which do not necessarily show up on a cost of production spreadsheet. Whether the fickleness of fashion or not, in this case it is the fundamentals themselves which have been altered.

In our particular arena, things do not even have to be that well-founded: market players may just be chasing each other's tails in that downward spiral of sell dear, buy cheap that can take place without immediate reference to the market for any physical good. And if that can occur when we are talking about something material, say a metal or a McMansion, how much more can the spiral persist when we are dealing with nothing more than an equity quotation—or, even more abstractedly, an ETF ticker—and hence a disembodied certificate entitling its holder to a minuscule share of the residual income reported by the company long after the buyer has exited his fleetingly held position?

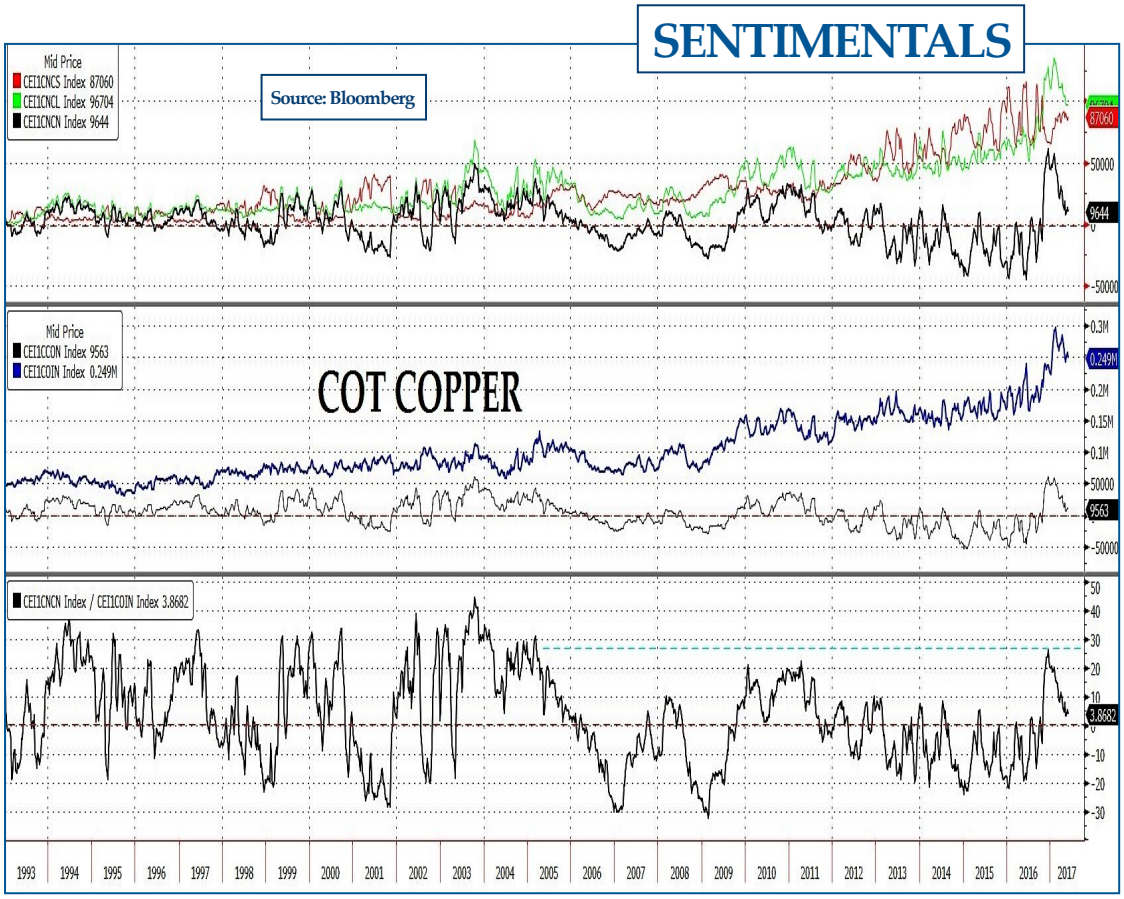
If we are therefore to take best advantage of the churning sea of bids and offers, we must not only have some sense of what a fair, fundamental price is deemed to be, but we need to develop an awareness of where market action and reaction might cause it temporarily to visit, no matter how far removed from the ideal that may lie.

As a diagnostic to help us gauge all this we must therefore make judicious use of that study of the market we call technical analysis. Again, this is not to be employed dogmatically like the casting of a horoscope, but in a spirit of testing our assessment of the balance of preferences to see if the market is indeed doing what a cross check with past analogues of the current behaviour suggests it 'should' be doing

Looking at things from this heuristic perspective allows us to learn just as much from what would otherwise be detailed failures of prediction as from our successes. If the price blows right past a supposedly important 'chart point', it may be that some greater imperative has come into play and that in turn might signal that a major change in market dynamic is underway.

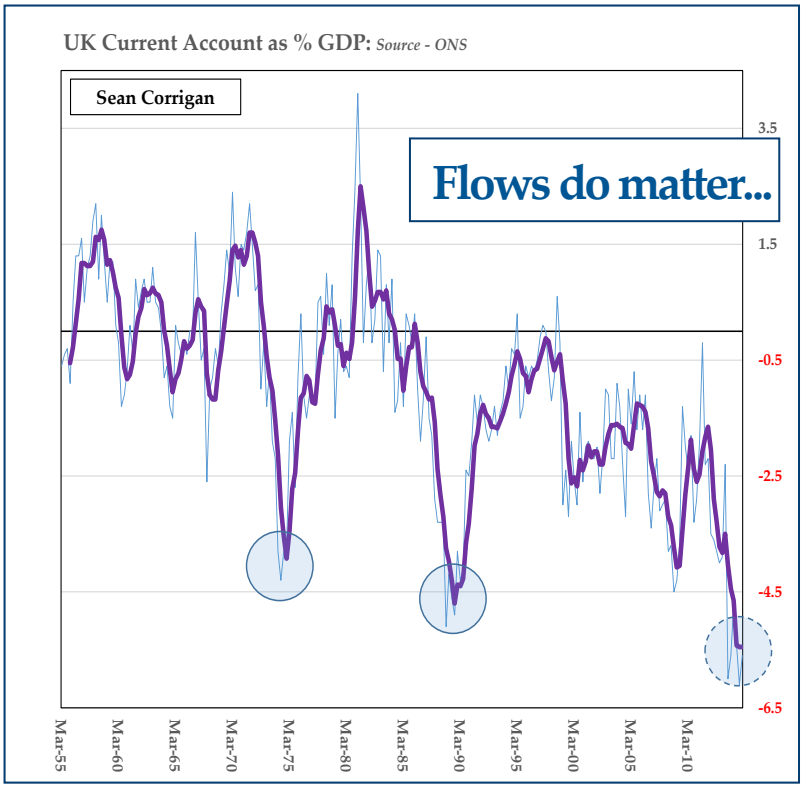
Close inspection can also reveal what patterns and formations are providing trading signals for other users of the approach, whether human-discretionary or black-box systematic, and thus offering us a small edge upon which we can act.

So there we have it: a study of the fundamentals gives us context and may even provide an anchor in a sea of uncertainty while an appreciation of the sentimentals prevents us from being dragged down under its weight when the ocean currents shift beneath our keel.



PRACTICALITIES

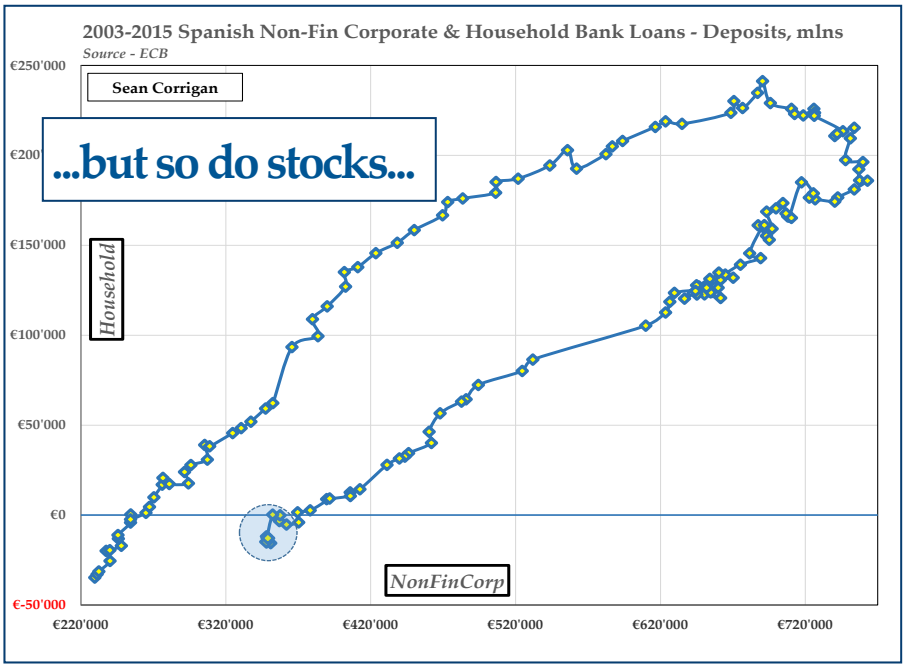
To sum up, our starting point will be to take note of the growth of measures of money and credit at several levels of aggregation and to try to see where the inevitable variations in the current are having most impact. A good deal of attention will therefore have to be paid to the pretensions and prescriptions of today's dominant clique of over-mighty central bankers as we do this. In the spirit of full disclosure, the reader should expect no breathless wonder at their deeds and words in these pages!



We will next try to track how much of this money and credit is flowing through to the top line of productive business and in what proportion it is filtering down from thence to the owners and the workers at those concerns. Shipments data, financial accounts, trade numbers, production and price indices as well as certain business surveys are among the tools we employ to build up this particular element of the picture.

Needless to say, a close watch will be kept on that insatiable devourer of our hard-earned wealth, the state. Taking note of how much it directly confiscates, how much it bids away via its privileged access to credit, to what uses it puts its swag, and - more intangibly, but none the less importantly—paying heed to the attitude it displays to profit and profit-makers are all key considerations for those who have to put capital at risk under its jurisdiction.

We also consider it imperative to pay close attention to balance sheets—whether those of enterprises, of households, or of nations—though we must also be aware that balance sheets do balance and that accounting identities are a dangerous substrate from which to try to understand dynamic processes. That does not mean they should be ignored, however, as so much of the mainstream has managed to do these past 40 years or more. By looking closely at them, we can begin to see if the fragility born of eating too much cake today against the promised delivery of too much cake tomorrow is starting to mount. Once such structural weakness develops, history teaches us that even modest levels of extra stress can lead to sudden, catastrophic failure without ever giving a warning in traditional risk counters such as VaR readings.



As has been already been discussed, a good deal of the day-to-day focus will be on the markets themselves where we will try to identify trends, turning points, opportunities and dangers over the longer horizon as well as the short. The goal here is to try to spot situations when the mood of the market is shifting or is prone to shift—to find the moment when things are becoming stretched or attenuated, or when they start to trade at the limits of their accustomed bounds. Breakout or mean reversion? To spot either early enough can be to gain a potentially lucrative insight.

Beyond that, the challenge is to try to achieve a synthesis of all these cross-currents, however ephemeral that may be in its specifics. Conversely, the inevitable inconsistencies—even contradictions—in reasoning will have to be noted and filed away in the box labelled 'cognitive dissonance', there to await their eventual transfer to the more richly decorated container entitled 'paradigm shift' for it is when the weight of contrary evidence becomes just to much to ignore that markets tend to undergo their more significant changes of course and fortunes are won and lost.

It is at such moments, too, that new narratives are constructed around what were formerly only inconvenient truths to be ignored. Now it is that the brief, anguished cry of '*How did THAT happen*?' rapidly mutates into a sage-sounding declaration of '*As we have long been predicting…*' and the incoming 'fundamentals' become radically re-interpreted in light of the newly-adopted—sometimes 180^0-rotated—'sentimentals'.

Rationalizing actors, not *rational* ones, remember?

***In fine*, we will do our best to keep you entertained as well as informed and will seek to provoke many of the right questions as well as to provide some of the right answers. In short, we hope to shine a few bright shafts of illumination though the fogs and frets of uncertainty which comprise the prevailing weather system in the world of investment.**

We hope you will join us—here, at Cantillon Consulting—in our endeavour.

Disclaimer

All content is intended to give general advice only. The investments and instruments mentioned therein are not necessarily suitable for every individual and you should use this information in conjunction with other advice and research to determine its suitability for your own circumstances and risk preferences. The value of all securities and investments, as well as the income derived from them, can fall as well as rise. Your investments may be subject to sudden, often substantial, declines in value which may not be recoverable; others may expire worthless after a specified period. You should not buy any of the securities or other investments mentioned with money you cannot afford to lose. In some cases there may be significant charges which may reduce the value of your investment. You run an extra risk of losing money when you buy shares in certain securities where there is a large difference or 'spread' between the buying price and the selling price, a circumstance which means that, should you sell them immediately, you may get back much less than you paid for them. In the case of investment trusts and certain other funds, these may use or propose to use the borrowing of money in order to increase the size of their exposures and/or invest in other securities with a similar strategy. As a result, movements in the price of the securities may be more volatile than the movements in the prices of those underlying investments. Some investments may involve a high degree of such borrowing (often referred to as 'gearing' or 'leverage') This means that a small movement in the price of the underlying asset may have a disproportionately large effect on that of your investment. Accordingly, a relatively small adverse movement in the price of the underlying asset can result in the loss of the entirety of your original investment. Changes in rates of exchange may have an adverse effect on the value or price of the investment and you should be aware that additional dealing, transaction, and custody charges for certain instruments may result when these are not traded in your home currency. Some investments may not be quoted on a recognised investment exchange and, as a result, you may find them to be 'illiquid'. You may not easily be able to trade your illiquid investments and, in certain circumstances, it may become difficult, if not impossible to sell the investment in a timely manner and/or at its indicative price. Investment in any of the assets mentioned may have tax consequences regarding which you should consult your tax adviser. All reasonable care has been taken to ensure that all statements of fact and opinion contained in the either written or spoken form are fair and accurate in all material respects. All data is from sources considered to be reliable but its accuracy cannot be guaranteed. Investors should seek appropriate professional advice if any points are unclear.