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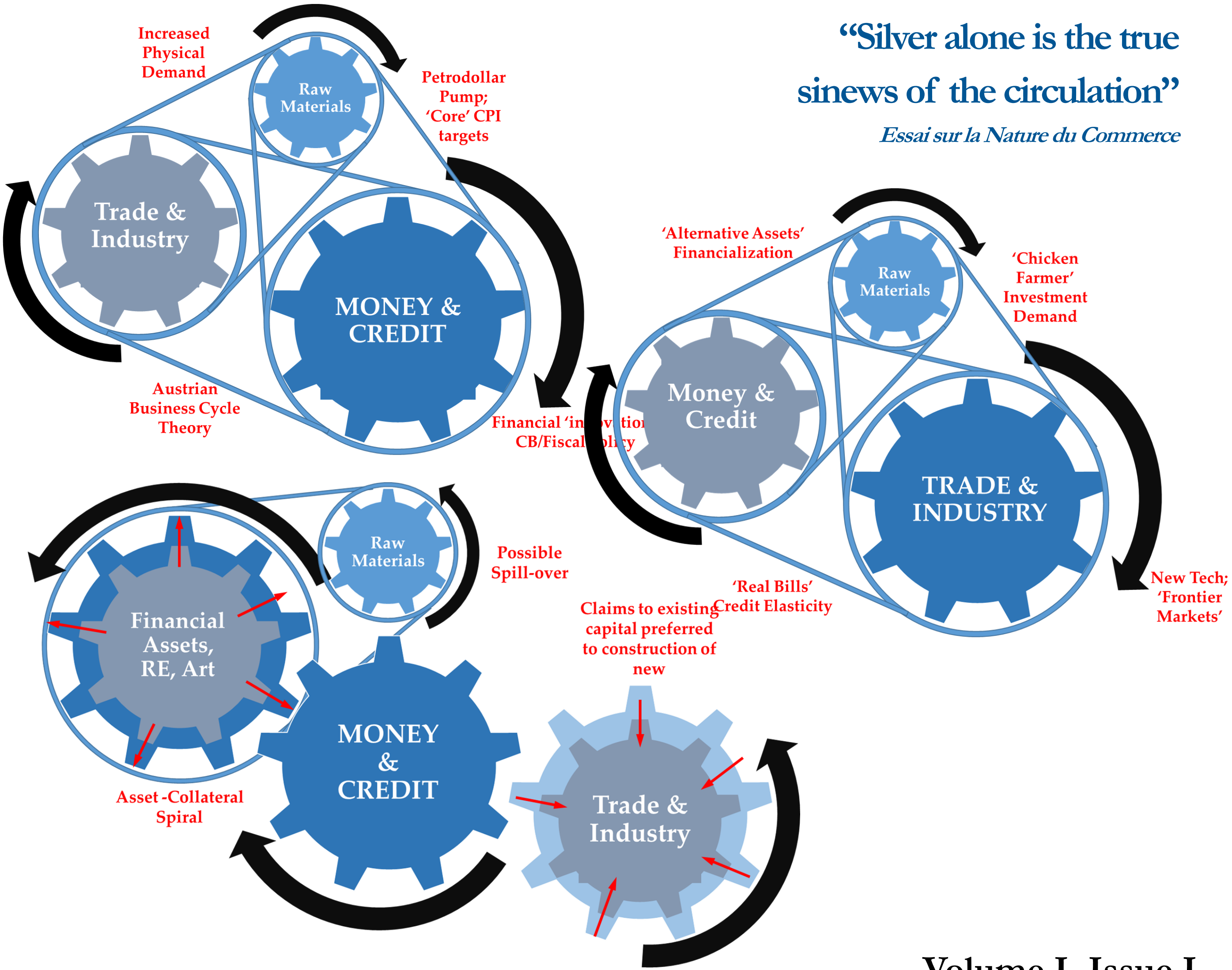


"Silver alone is the true sinews of the circulation"

Essai sur la Nature du Commerce

Volume I, Issue I

The Fall Approaches

'An Apple a day keeps the Doctor away' was all you needed to know during the past few months. But will the old saw hold true from here on in?

I might have given some account of the ebb, as I have of the flood of this phantom—for I can call it yet no more. Its fate must come ere long since there is no foundation equal to the structure that now stands upon it.

But the time is not yet. The little decrease or fall which happened a few days ago is not of the kind which must blow up the Machine… But this cannot support it long – it must fall at last and all I can say of it at present can only be this; that when it comes, GREAT WILL BE THE FALL OF IT

Daniel Defoe, "The Chimera, or, the French Way of Paying National Debts, Laid open", London, 1720

The Fall Approaches

The joys of autumn are almost upon us.

The sun slowly mellowing from its brassy summer glare to a more mellow warmth. The first hint of frost at night to end the long sweltering wakefulness of August. The morning mists wreathing the valley bottoms. The vines bursting with soon-to-be-picked fruit and the trees just starting, here and there, to put on their glorious, last panoply of russet, red, and gold.

But it's not just the leaves that often turn when the year begins, with gathering pace, to slip towards its chilly end. Markets often do, too, as the lazy distractions of the holidays are set aside and the focus is renewed on what it is we do to earn their fleeting pleasures.

Historically, markets often tightened and shook in autumn as cash drained out of our forefathers' far less elastic banks in order to pay for a harvest safely gathered in and now moving from field to barn to elevator in farms and homesteads dotted across a landscape far, far removed from the colonnaded Money Centres, glowering and forbidding amid a world of concentrated steel and skyscrapers and speculation in securities.

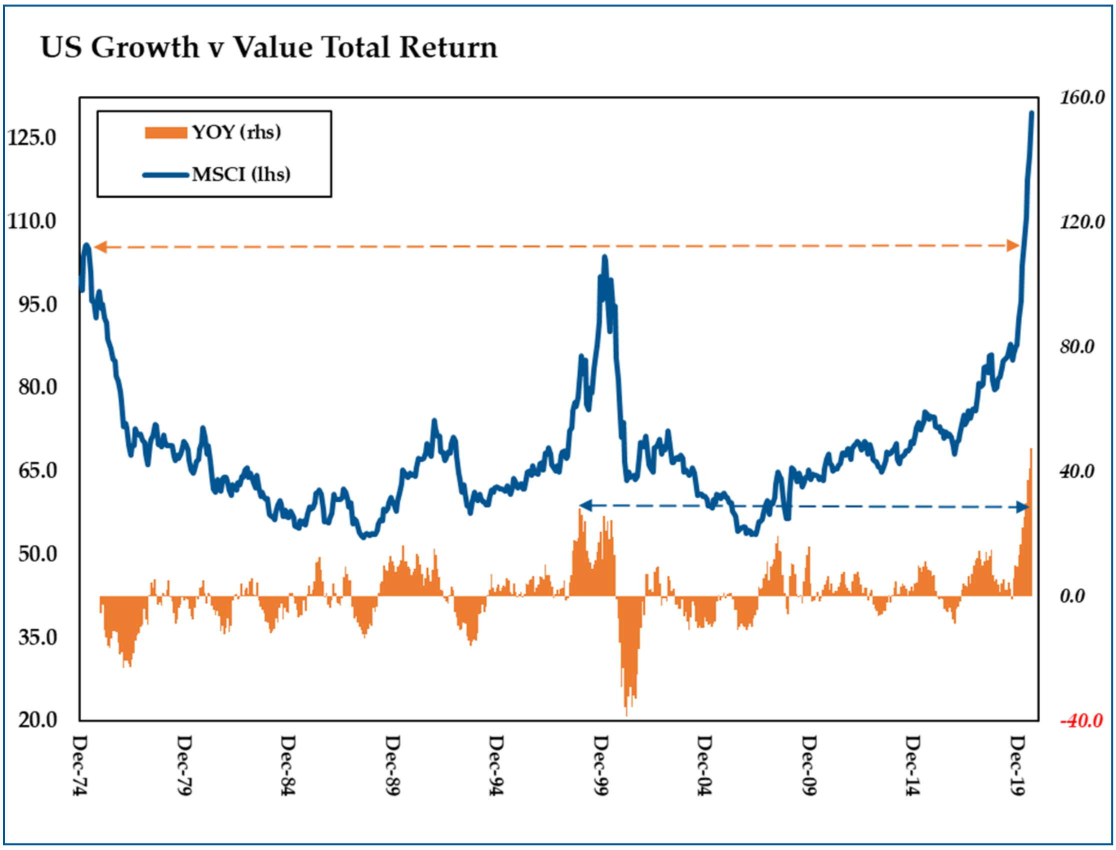
Today, such strictures no longer apply but there are more human factors at work to make the market sometimes rival for turbulence the howling gales outside which typically mark the equinox.

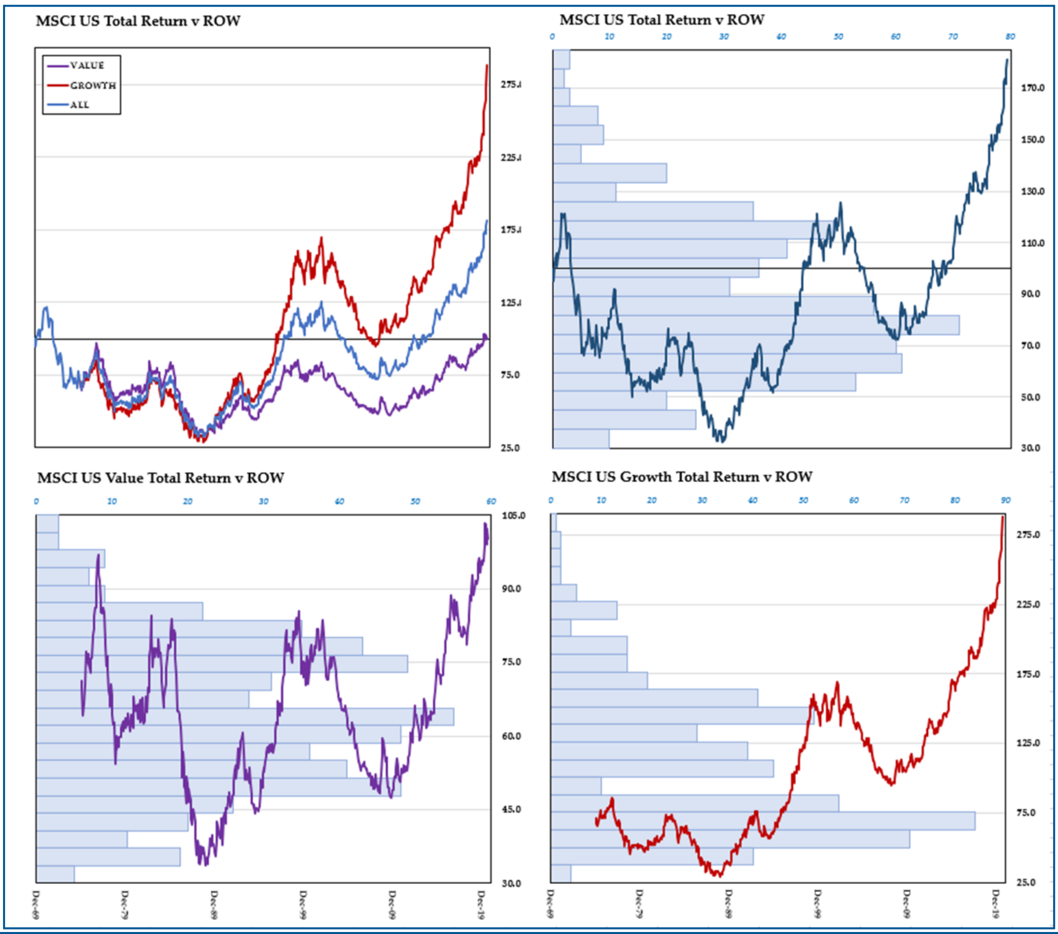
The period between Labor Day in the US and effective book-closing at the end of November is often one marked by a last effort to catch up if one has underperformed one's peers in an imperative matched by a similar reluctance to surrender one's gains if the converse happily applies. It is therefore a time when action can become narrowly funnelled into chasing winners or dumping losers; when not just the Robin Hood keypad-capitalists, but also the more established players can be herded into - or out of – much the same trades.

No-one wants to miss out on a year-end bonus or promotion, after all. Nor does anyone relish the prospect of having to fret all over Christmas and the New Year about just *how* one will phrase one's *Mea Culpa*'s to superiors and investors in the year-end review.

Given this backdrop, the sell-off in the Nasdaq – in the marvelled-at 'Growth' stocks, in the FAANGs, and in Tesla – comes at a moment which is particularly intriguing for reasons which go far beyond whatever coup SoftBank may or may not have attempted and whether those irritating Lockdown Livermores have finally gotten their comeuppance.

The point here is that while everyone has spent the last several months sagaciously pointing out how overpriced in relative, if not also in absolute, terms the 'Growth' stocks were, clearly no-one was particularly committed to selling them Indeed, one suspects that the joint influence of benchmarking practices and career preservation had probably seen many of those most vocally decrying the move quietly riding on its coattails instead.





Before the recent reversal, Growth's outperformance of poor old Value had seen a 4.7 sigma relative yoy gain of 48% which pushed the ratio to 4.3 sigmas above an almost trendless mean. Less well widely discussed, is the fact that even those Wallflower Value stocks have outperformed their peers in the rest of the world, if by nowhere near so extreme an amount.

Hitting One's Peak

A further thing of which to be aware is that - contrary to popular belief – markets do not generally fall on 'profit-taking' but on its polar opposite, loss realisation. The dynamic goes something as follows.

For some reason or another, some random stock – say, ZZZ – starts an unusual rise. The pop attracts attention and, initially, a few cautious buyers step in, whether technicians playing a break-out or the cynical (or the tinfoil-hatted) who darkly suspect it means Somebody, Somewhere, Knows Something.

Before long, the algos, too, are blindly joining in the newly-kindled enthusiasm. Then some Talking Head pops up on Fin-TV to explain why a company he had paid absolutely no attention to BEFORE it rose is now, in fact, doing so, before quickly adducing a host of convincing-sounding reasons why the move will long continue.

By this stage, the stock is the talk of Twitter. '$ZZZ' is trending and now the margin players are in, a couple of chancers from Cayman are trying to ramp it up, and the CFD and options day-traders are noisily elbowing in on the action.

ZZZ starts to go parabolic, then heads towards escape velocity.

Finally, right up there, in the rarefied atmosphere of Planet La La, the rocket's engines cease their burn and gravity again begins to take the ship in its inexorable grasp. The last, eager buyer gets top-ticked (Been there. Done that. Bought the T-shirt). He lifts the highest ever offer and waits smugly to get overbid by the next Greater Fool, as he has done so many times before during this run.

This time, however, no-one turns up to do so. The market goes offered, then prints lower. "*How can this be*?", he screams at his screen, the realization dawning that not only are there no Great-er Fools but that he is the Great-est of that hapless band.

He now rushes to hit the next best bid and, in doing so shakes out the second- and third-placed Chumps. They, in turn, displace the next few in the rankings and slowly that first, lonely pebble starts a slippage of several other pieces of precariously lodged gravel.

Chartists everywhere are now looking at the price action. "*Rejection*, " they sagely nod and stir into action, finally having a mark against which to put the stop-loss for their shorts. As more and more of the weaker-handed and thinly-margined drift toward the exits, a bigger-fish prop trader, nostrils tingling with the scent of blood in the water, swims into view and sells a block – just to see what happens.

C-R-A-C-K-K-K! With a sound like a high-velocity rifle shot echoing off the mountain walls, that first, tiny dribble of stones has become an avalanche, sweeping ever more of the bulls off their perches on the rock face. As they drop, they tug away in their turn another batch of those roped in below them.

The casualty list is mounting.

Sometime about now, our Talking Head pops back up on FinTV to explain why a company he had been so diligently boosting BEFORE it started to plummet is now, in fact, doing so, before quickly adducing a host of convincing-sounding reasons why the move will long continue.

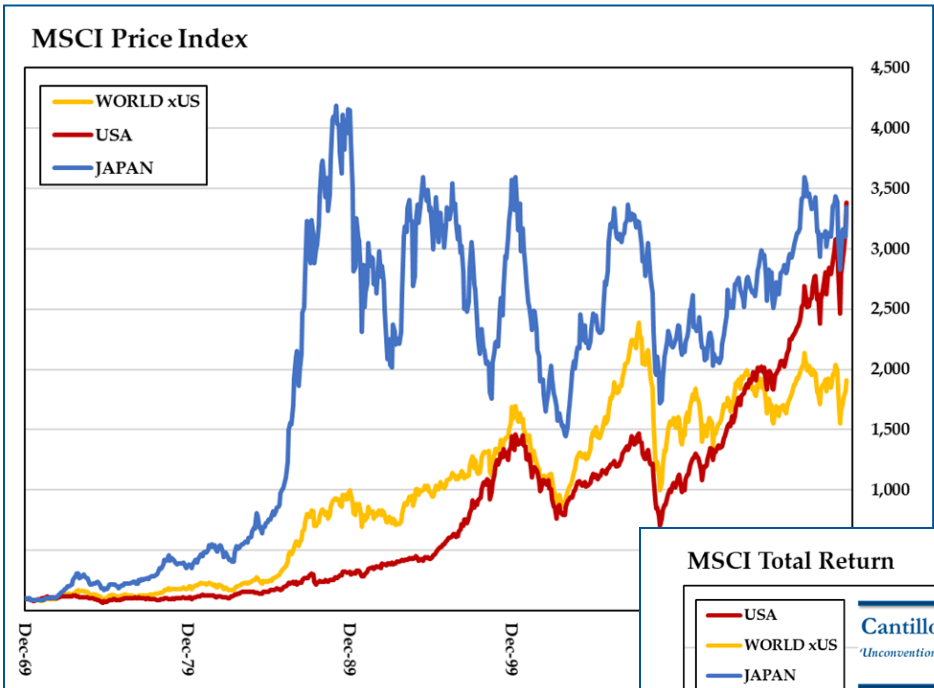
A new and ultimately greater danger sometimes intrudes at this point. Sometimes the first pebbles to slide come briefly to rest on an intervening ledge. Treacherously teetering there, right at the edge of the void, the pause in their descent only serves to encourage a re-emboldened few to scramble up atop them in order to get a better view of that now-unattainable, but tantalisingly near, summit.

When one of these Forlorn Hopefuls finally loses his footing in the renewed attempt to regain that peak, every man jack of the die-hard BTFD types will be projected off into a free-fall which will be even more precipitous and well-peopled than the first. Much of

FAANG's doubling since the March pan(dem)ic break displays a very neat formation.

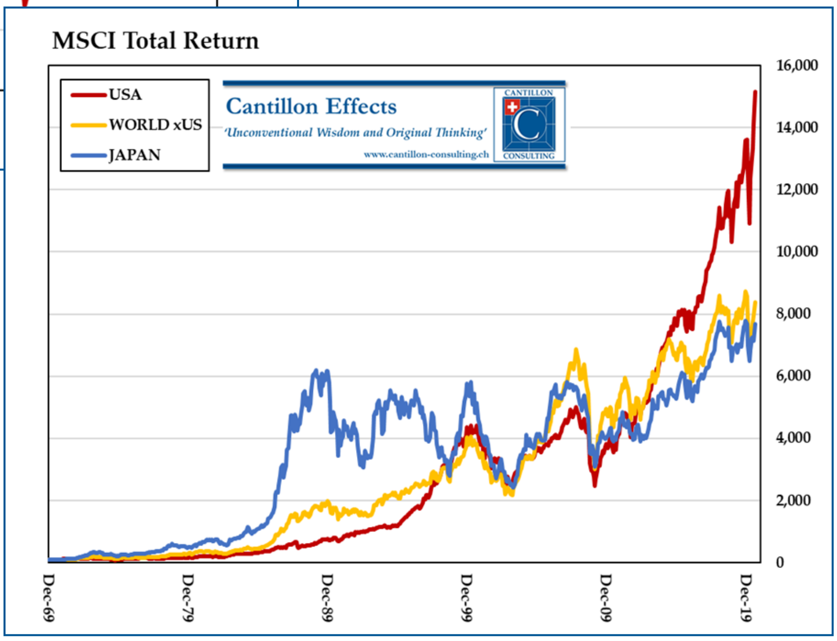
The channel & July highs held the first rotation and allowed a modest bounce. If this renewed attempt now falters—don't let your longs get trapped!

Courtesy: Tradingview.com



Warren Buffet has famously bought a stake in 5 of the big Japanese trading houses, doubling an investment in a generally-overlooked country with one in firms firmly rooted in the real world of the extraction, processing, and shipping some of the essential inputs to our industrial economy.

And why not? In price terms - via the relevant MSCI indices - the US has finally surpassed Japan for the first time since Nixon left the gold standard, almost 50 years ago. While Japan has not seriously lagged non-US stocks in terms of total return, it – like they – have been left trailing in the dust during this last, most ballistic phase of the move. Sell dear, buy cheap, anyone?



what was gained in the upswing will be lost in the down and much more rapidly, to boot.

As three hundred years of experience should teach us, thus do bull markets and bubble stocks often end. So might this one well do, too. Up by the stairs: down by the elevator shaft.

The Case for a Reversal

One thing that may not help is that the Just-So story of 'V-shaped' recovery may soon lose steam, being threatened both by the unrest being spread around the American election and by the Great Asymptomatic PCR Scare which is threatening to bring about the re-introduction of all sorts of Draconian 'preventative' measures, once more.

Without playing Armchair Epidemiologist for too long here, this current bogeyman of climbing positive test numbers would be risible were its potential consequences not so far-reaching.

As Fritz Machlup long ago said – in mockery then of the same sort of idiot savant central-bankers who so plague us today – those in charge are best described as the world's most stupid Magicians: so dumb that they are equally as surprised as their audience to be able to pull out of their hats the rabbit THEY THEMSELVES FIRST PUT THERE!

Governments everywhere, wanting to be seen to be 'Doing Something', are ramping up testing programmes. Unsurprisingly, the more questions you ask of the populace, the more 'Yes' answers you will get. If you only take that raw number into the reckoning- AND NOT ITS PROPORTION IN A BIGGER SAMPLE – you will inevitably get a higher count and hence a higher population-adjusted metric.

Without even considering how reliable such mass testing of the symptomless can be, the sheer stupidity of not taking test numbers themselves into account suggests either that our leaders should be impeached for their utter brainlessness OR for bamboozling the electorate with fear in order to further some deeper, darker agenda.

Either way, the very real threat now is that the nascent and still sickly recovery will again be swamped with lockdowns, travel bans, and business closures, allowing central banks and finance ministries to further pursue what has effectively been a stealth nationalisation of large swathes of private enterprise and to render many more alternative avenues of wealth and income generation totally unfeasible.

Go to Jail. Do NOT Spend $200.

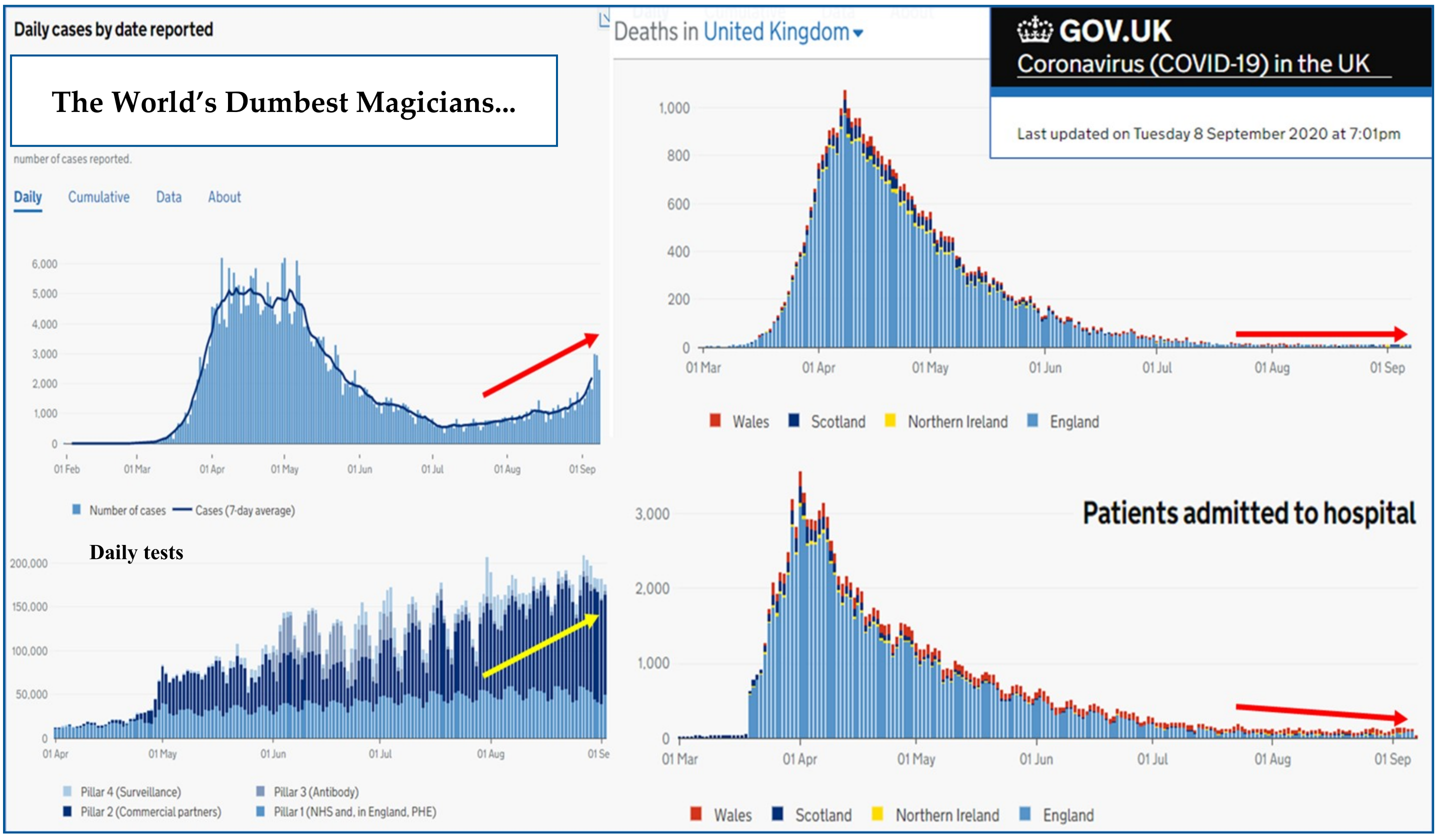
As part of that 'nationalisation' which masquerades under the guise of 'bail-out', vast quantities of government debt are being issued and underwritten, directly or indirectly, by the same central banks who love nothing better than to elevate a sneaky act of 'mandate' Mission Creep into a veritable Charge of Light Brigade.

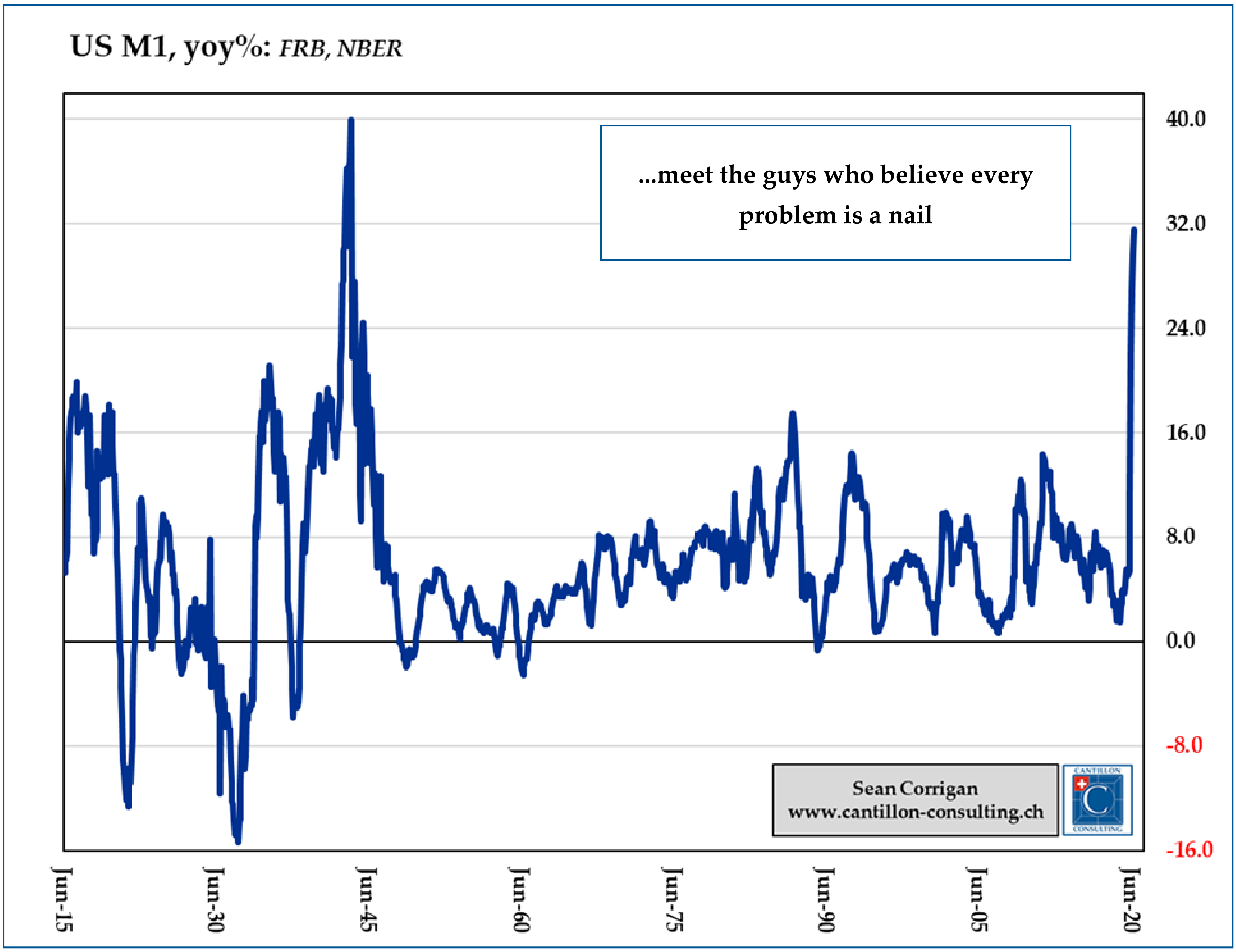
Yet there are still those who insist it is all in vain and that the effort will inevitably end in what that the modern stereotype categorises as 'Turning Japanese', if not a complete re-run of the Great Depression, '*Hey, Buddy. Can you spare a dime*?', street-corner apple-sellers, '*Grapes of Wrath*', and all.

To illustrate this contention, people keep dredging up charts of what they suppose to be falling monetary 'velocity' and arguing that this 'proves' that we are headed for deflation.

Leaving aside the technical issues over whether velocity really should be measured by M2 over GDP (the one not what we might best define as 'money'; the latter a lower-variance subset of a much wider range of economic transactions) - much less the more fundamental one of whether the concept itself has any real merit – this truly is mindless, given the circumstances.

We have long laboured to point out that the 'money' side of this equation has become increasingly fraught with interpretative difficulty given


Daily cases by date reported
The World's Dumbest Magicians...
number of cases reported.
Daily
Cumulative
Data
About
Number of cases
Cases (7-day average)
Daily tests
Pillar 4 (Surveillance)
Pillar 2 (Commercial partners)
Pillar 3 (Antibody)
Pillar 1 (NHS and, in England, PHE)
Deaths in United Kingdom
GOV.UK
Coronavirus (COVID-19) in the UK
Last updated on Tuesday 8 September 2020 at 7:01pm
Wales
Scotland
Northern Ireland
England
Patients admitted to hospital


US M1, yoy%: *FRB, NBER*
...meet the guys who believe every problem is a nail
40.0
32.0
24.0
16.0
8.0
0.0
-8.0
-16.0
Jun-15
Jun-30
Jun-45
Jun-60
Jun-75
Jun-90
Jun-05
Jun-20
Sean Corrigan
www.cantillon-consulting.ch

that the widespread reduction of interest rates to (and, often through) zero, coupled with that dramatic flattening of yield curves which has been driven by a combination of central bank balance sheet expansion, convexity effects, regulatory requirements, and increased, hot-money leverage has largely eradicated the opportunity costs between transactional accounts (money proper) and all other holdings (strictly, savings of varying degrees of accessibility).

Take the Eurozone, for example, where – on the eve of the Lehman crisis – M1 accounted for just over two-fifths of the total stock of the broader M3 aggregate but where the proportion has since swollen to 70% - a level unprecedented over the 50 years for which we have data (and over 15 more if we take German numbers as our guide before that).

This has come about as M1 has swollen 160%, or by €6 trillion, and all the other components have between them *shrunk* by over a fifth (~€1.1 trillion), leaving M3 overall to grow by a much lesser 55% (equivalent to barely 3.6% CAR).

Though these MONETARY trends have been in place for over a decade, we must also add the REAL side effects of governmental responses to the Coronavirus outbreak.

Sweeping restrictions on individual movement; widespread shuttering of businesses; injunctions to stay at home (amounting in many cases to anything from partial to complete house arrest), and all the rest of it have made the simple process of spending one's money more difficult *even where one remained still inclined to do so.*

We have frequently trotted out the Ben Gunn analogy to illustrate this, named for the shipwrecked sailor, marooned on the eponymous Treasure Island with only his now-useless hoard of pirate booty for company. Ostensibly rich beyond the dreams of avarice, he was in fact reduced to extreme privation because his physical situation meant the money could not possibly be spent, pending his rescue by Jim Hawkins and the rest .

If I take you hostage and chain you to a radiator in my basement, then taunt you by adding a bundle of dollar bills to the meagre daily ration of food and water on which I sustain you, would it make any sense whatsoever to proclaim that 'monetary velocity' had therefore fallen in your dungeon fastness?

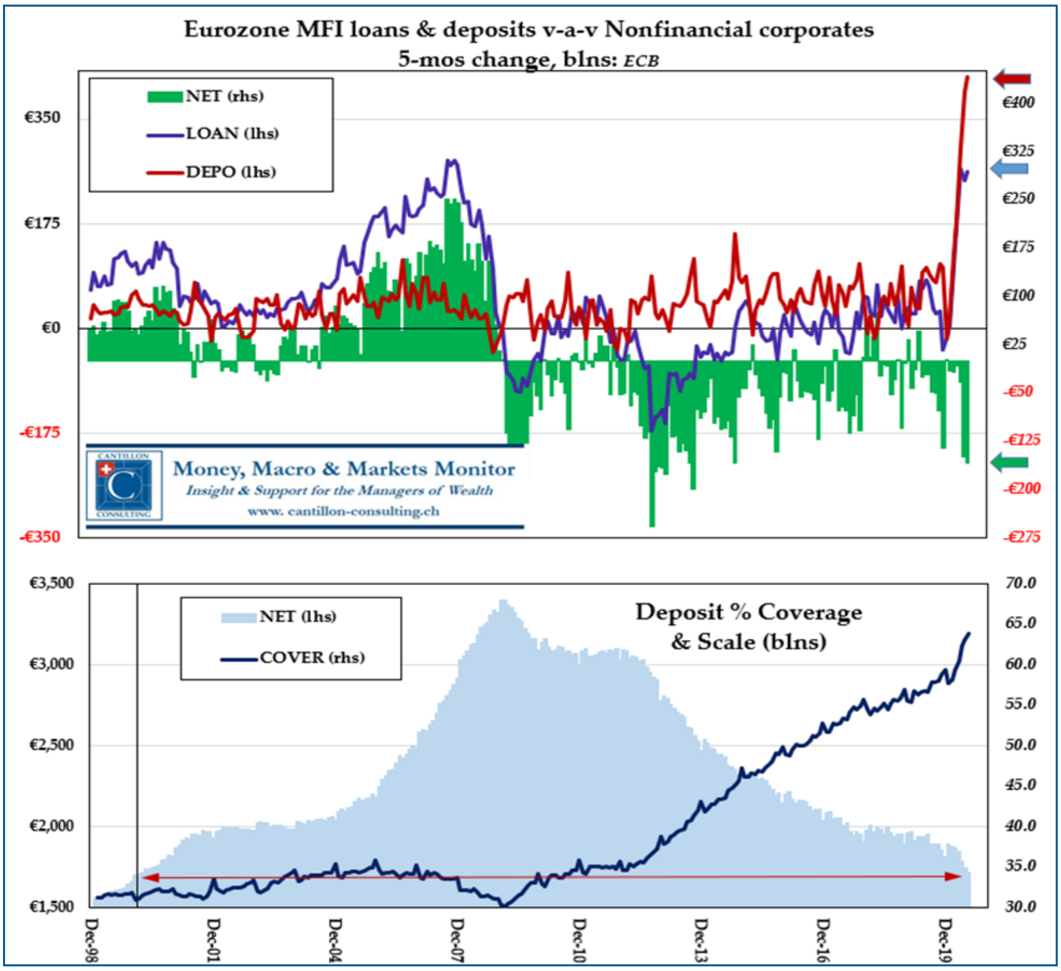
Squirrels gathering nuts in a flurry

Even where we grant some degree of accord with the idea, we also have to recognise that businesses, in particular, have been eager to exploit central bank flood release and, in many cases, government guarantees to build up precautionary war-chests of funds – often far in excess of the foreseeable needs of trade - *just in case…*

That every corporate treasury which can has built its very own *Juliusturm* can be seen from that fact that, since February, Eurozone non-financial corporates have drawn down €260bln in bank loans - a sum only topped in a like period at the climax of the pre-GFC bubble). They have also issued a net €115bln in securities (roughly twice the previous highest figure). Yet, look across at the other side of the T-account and you'll see that they have simultaneously laid up a not-wholly dissimilar €420 billion in new deposits – that accumulation itself an all-time high, some 2.7 times the previous best on record.

In the US, too, those corporates in manufacturing, wholesale, and retail surveyed by the Census Bureau, showed a hefty $440bln increase in debt in the first half of this year of which $6 out of every $7 was, however, covered by a $375bln cash build.

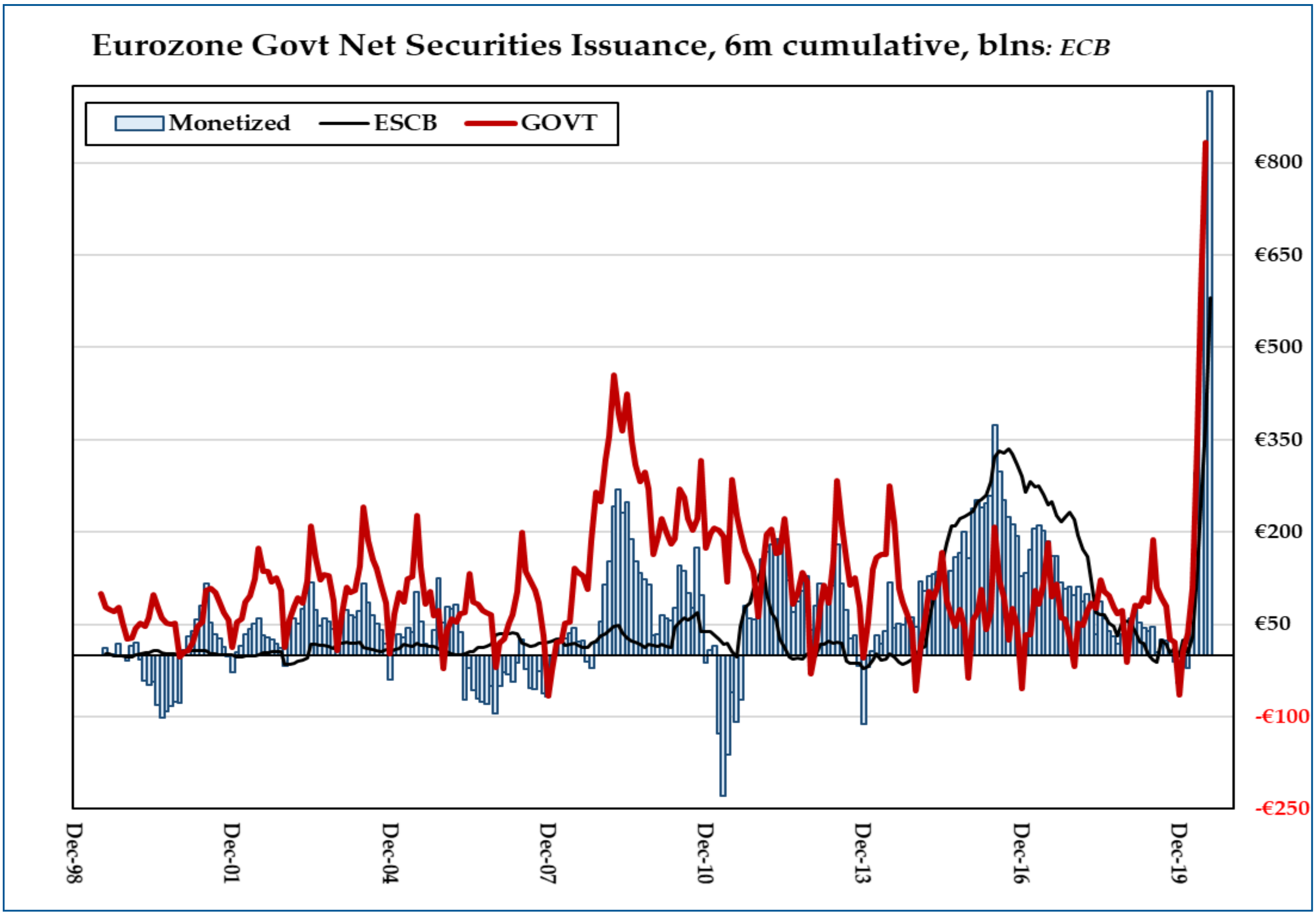
[*In passing, we should note that things were not quite so uniformly pretty across the sectors. Retail's large net debt reduction of $93bln (or almost 25%) stood in sharp contrast to manufacturing, where a three-decade topping percentage borrowing surge of over 10% (for a $378bln numerical gain, 2/3 above June 2015's prior summit) was*



As an example of the different motivations we discuss in the text, we can see here that European corporates are using the ECB's laxity to build themselves a cushion, a little insurance against possible hard times ahead.

What is also clear is that Eurozone governments are taking full advantage of the cheap, monetized debt they are being offered. Record issuance is causing hardly a ripple because the Banks as a whole are simply lapping it all up.

Weimar started this way, too, you might recall.



split between a $273bln cash-pile addition and a $164bln jump – after 2 ½ happy years of relative stasis - in already-elevated net debt levels.]

But the purpose of all this is not just to disparage those blindly dividing one time series by another and enthusiastically sharing the resulting squiggle.

Rather it is to point out that the highly vexed debate about whether the unrivalled monetary inundations – and, worse, the unchaining of the beast of Big Government which it has already effected – will lead to a high and rising inflation of prices or whether the woes weighing down our weary economic Atlas are now too heavy for him ever again to stand up, unbowed.

Put simply, there is no shortage of money (or credit) in the round. As ever, certain people and particular firms may of course feel such a dearth all too acutely, but it is impossible to argue that, on aggregate, any obvious shortage exists.

There may well be a lack of will to use such means in order to buy material goods or identifiable services – as opposed to letting them pile up on lenders' balance sheets or deploying them to chase securities' prices up and down the market. But such a lack may be more a matter of compulsion than of volition and, even where that latter is the case, the money's owner may rapidly change his or her mind, come that long overdue day that he or she is once again faced with a full range of possibilities to engage in expenditure, whether for productive/transformative or consumptive/exhaustive purposes.

In short, the monetary issue which we have yet to clarify is whether people will pay *down* the extra borrowing of which their under-used stockpiles are the proceeds, or whether they will pay the latter *out*.

At present, we have no real way of deciding this crucial question – save to note that where borrower and spender are separate agents with different agendas and are subject to very different constraints, it will probably be the behaviour of the former which decides the outcome.

Thus, where it is the government which is doing the lion's share of the borrowing – often at negligible *nominal* and negative *real* interest rates – and where it is blithely borrowing in the currency of its over-eager, highly accommodative, inflation-seeking, fiscally-captive, local central bank – then its many functionaries and form-fillers; its pensioners, placemen, and palace guards; its cohorts of contractors and collaborators; its myriad recipients of subsidy and subsistence will all find little need to hang back when the stores finally re-open, or to root around in the bargain bin when they do.

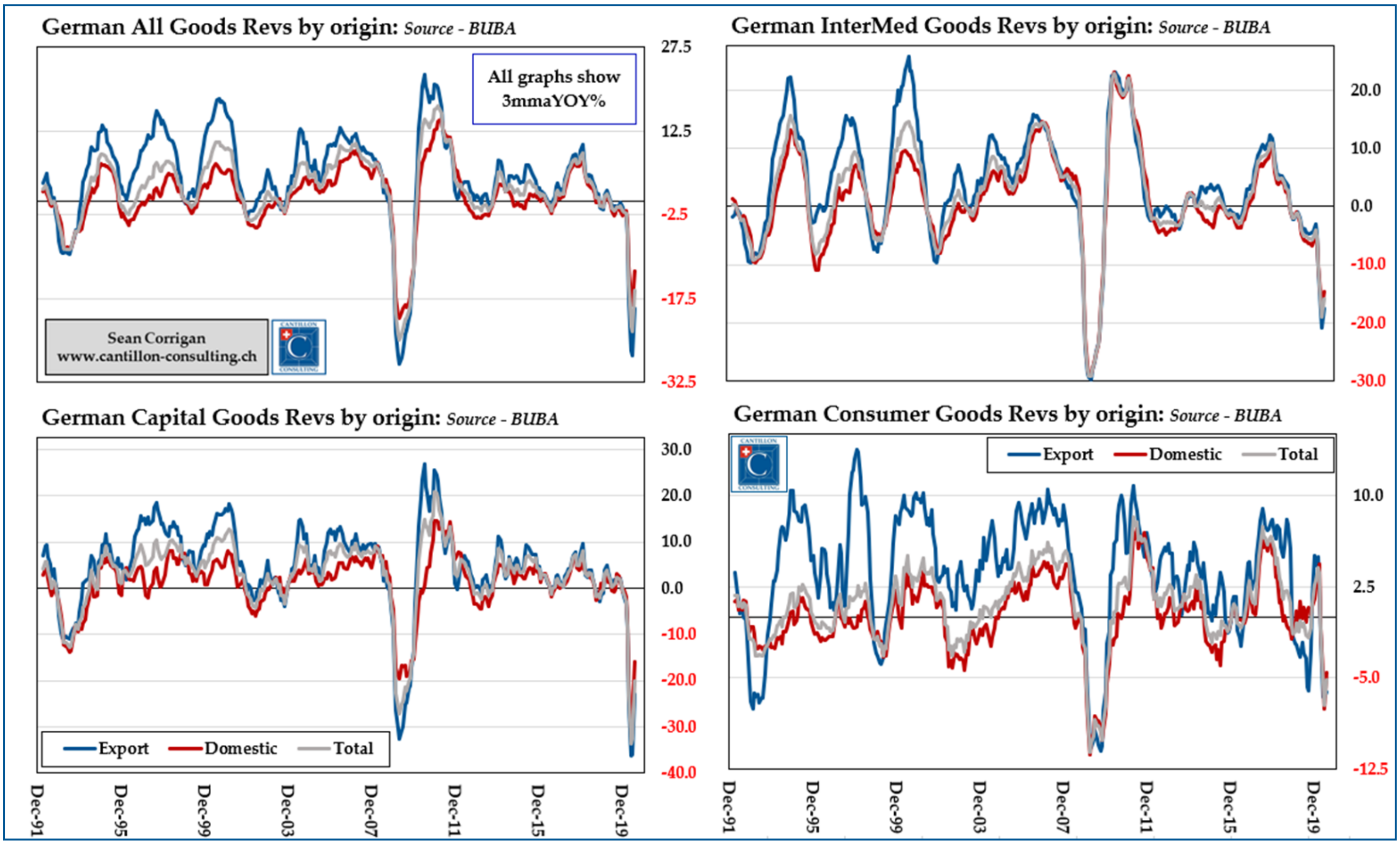
The Modern Prometheans

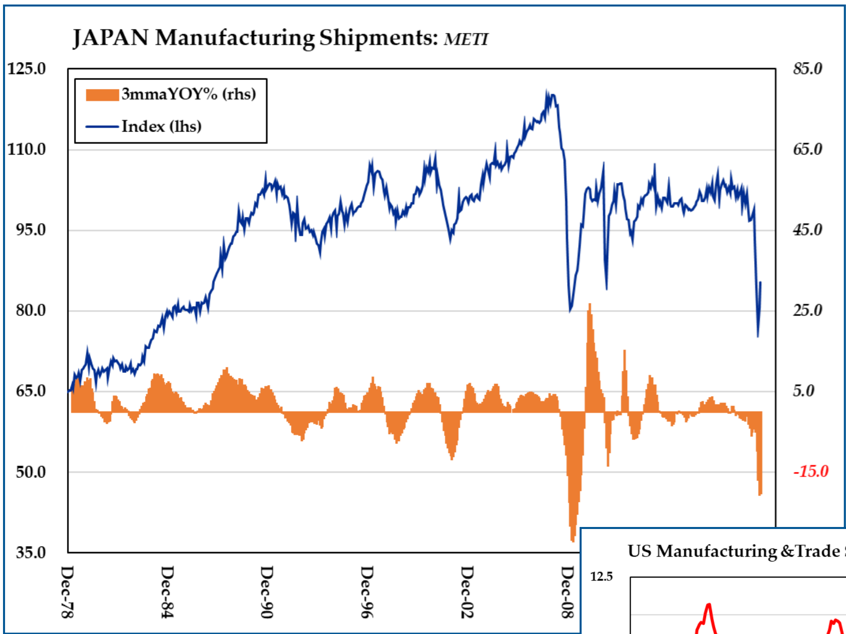
But even this is only half of the question. To have money to spend which has been called almost costlessly into existence is one thing, but if people can also begin to buy because they are once more enabled to sell – in other words if demand picks up because supply is again available – the foregoing will turn out to be a lesser, more ancillary evil, if an evil nonetheless.

Here the problem is almost entirely a matter of policy – or rather of many policies all converging at once on the poor entrepreneur as he or she tries to determine what the chances are that success will crown their endeavours.

We have all the intrusions and interdictions associated with COVID – some of them hopefully temporary but many, alas, all too likely to become permanent fixtures, groaning deadweights in the architecture of commerce.

Government is never the most constant of masters, its offices populated, as they are, by all too many human weathervanes. But its vacillations and the element of sheer caprice evident in the way it is disposing of the awful powers it has seized unto itself this past six months can only compound the diffi-

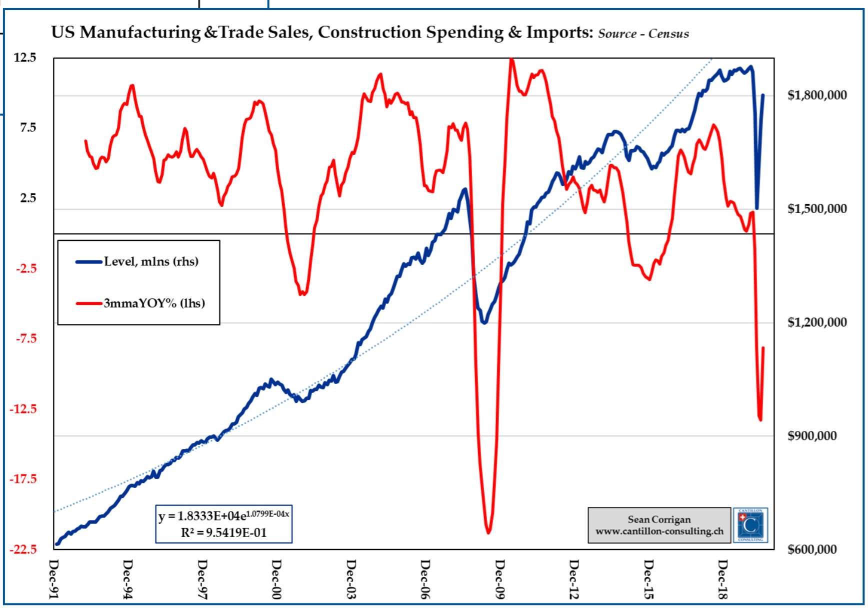




Is that a 'V' I see or is it a square-root sign, flipped over?

Or, worse, is it the short, middle leg of a big, impending zig-zag.

Consult your local Public Health Commissar to find the answer.



culties placed in the path of those brave souls who would earn their living at risk by better supplying the rest of us with whatever it is we want.

Adding greatly to such barriers to renewed prosperity, we have many ominous signs that, in their determined attempts to exploit the severe dislocations brought about by the human response to the epidemic, the moment has come for the various strands of Neojacobins to refashion not just the whole of our economic undertakings, but the most intimate details of the lives of the peoples who comprise it.

'*The Great Reset'. 'Build Back Better'. 'The Green New Deal'. 'The Fifteen-minute City'*. All the gleaming Utopianism being promoted under the aegis of these and other such slogans conceals the hard fact that they are being promulgated by Planners and Platonists, by both Prophets and Profiteers, all well aware that They who would refashion Man in Their image must first grind Him down into malleable human clay.

It is for this reason that those being borne along by the Zeitgeist of Virtue and making much of their espousal of such outwardly attractive aims should be explicitly reminded of the fact that very few would-be Utopias are constructed without the aid of barbed-wire and baton charges; that for every smiling Communard there is a starving Kulak and for every Pilgrim Father, a Pol Pot lies in waiting.

The Silicon Defence

This last may strike the reader as too much of a digression for a publication aimed at an analysis of macro trends and their impact on financial markets. But part of the inordinate enthusiasm for a mere handful of Tech stocks which has so dominated our narrative since the disease first spread out from Wuhan is that these are among the few businesses that seem to be not only immune to the present upsets, but in the vanguard of the profound changes which seem to lie ahead of us, whether we choose them or not.

Can you buy an airline if you're not sure it will ever again fill its seats or be allowed to fulfil its schedule? Can you buy a car company if it faces being compelled to undertake a premature abandonment of all the many skills and techniques, the immense physical and human capital, it has built up over a century or more? What about a retail business which must now limit footfall; surrender all efforts at enhancing customer experience, and which is doomed to operate in an emptied city precinct, itself denuded of office workers and reachable only by bike, bus, or Birkenstock?

No. Far easier to close your eyes and buy into concerns which shunt around electrons; which promise to benefit most from the Planners' patronage and the crippling of its larger rivals; or which pander to those cowering on the couch, conditioned by the state scaremongers to shun all contact with the neighbours and colleagues and be content instead to enjoy the shrunken sanctuary of living from lockdown to lockdown and from A to Z – from Amazon to Zoom.

The Compass Boxed

All of which neatly takes us back to the beginning of our piece. If we can stave off the 'State of Fear' ghouls trying to end our brief parole, ostensibly in order to stave off a so-far thankfully mythical 'second wave' of death and disfigurement, we would advise against buying too heavily into this somewhat perverse act of defensiveness and look anew at acquiring exposure to the basic inputs to any resumption of the normal practices of industrial civilisation.

If, however, it's all going to be House Arrest and curtain-twitching Covid 'Marshalls' – I give up. Just buy back your stakes in Apple and the like and WhatsApp me when you've been UBI'd, Tracking-App'd, Vaccinated, Digitally-currencied, and given the All-Clear to go out and mingle with more than five other human beings at once.


Courtesy:
Tradingview.com
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(6801.42)
(6332.66)
(5607.63)
(5238.87)
(4870.10)
(4145.08)
(3676.31)
−3131.01 (−46.01%) −313101
Commodity Crash
'Hidden' Recession
Value Line
The 'average' stock has done well to recover its COVID shock losses but is still trapped in the ~4 yr=old distribution. 6650 should cap the upside: 5950 the down.
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021


CSI300
6,000
5,350
4,700
4,050
3,400
2,750
2,100
1,450
800
Courtesy:
Tradingview.com
SZSE&SSE Margin Debt, blns
Not as frenzied as it was in the summer, but a great deal of hot money is still in here, keeping the market afloat despite China's wider woes
2,000
1,500
1,000
500
0
Dec-04
Dec-06
Dec-08
Dec-10
Dec-12
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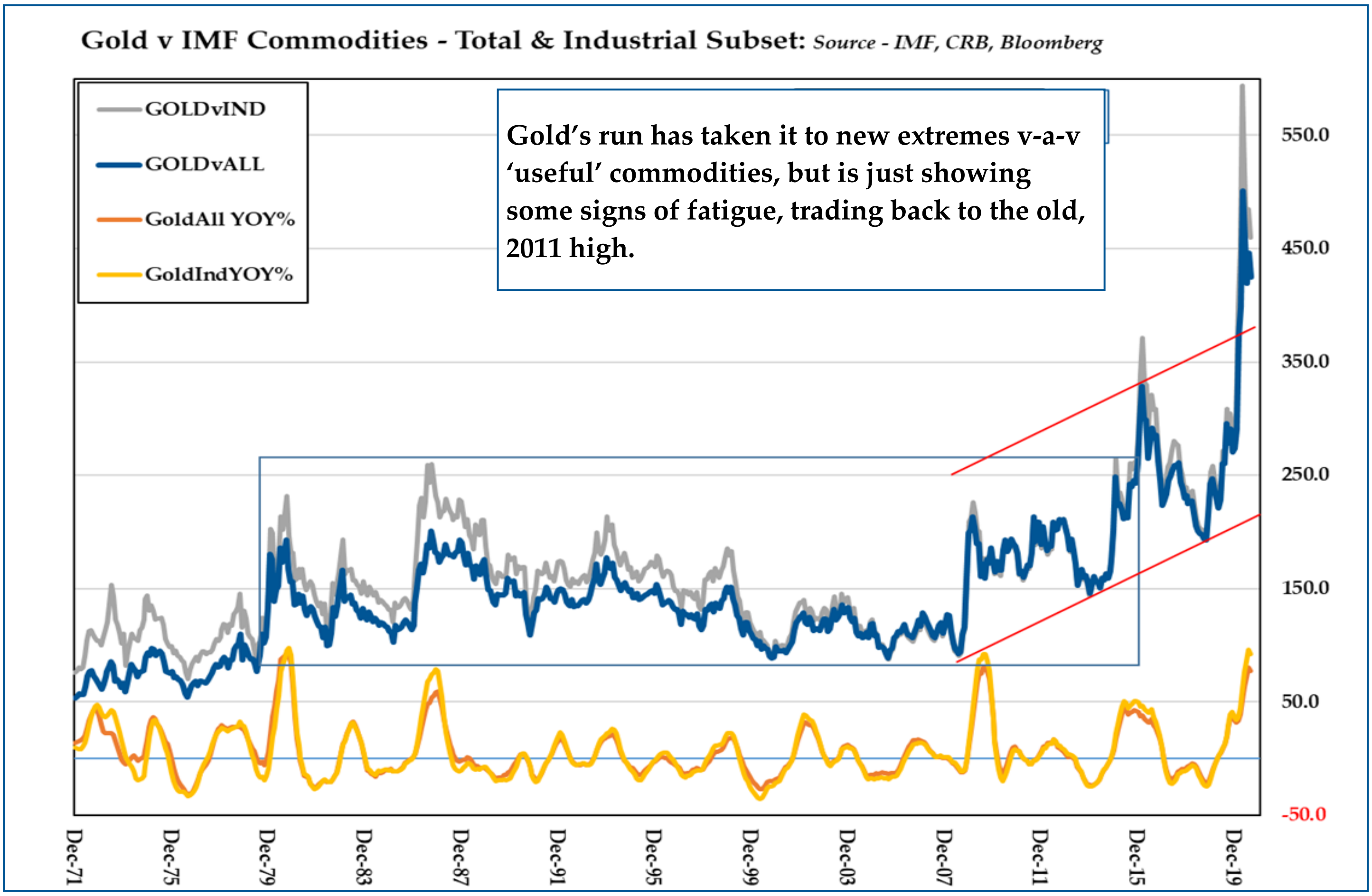
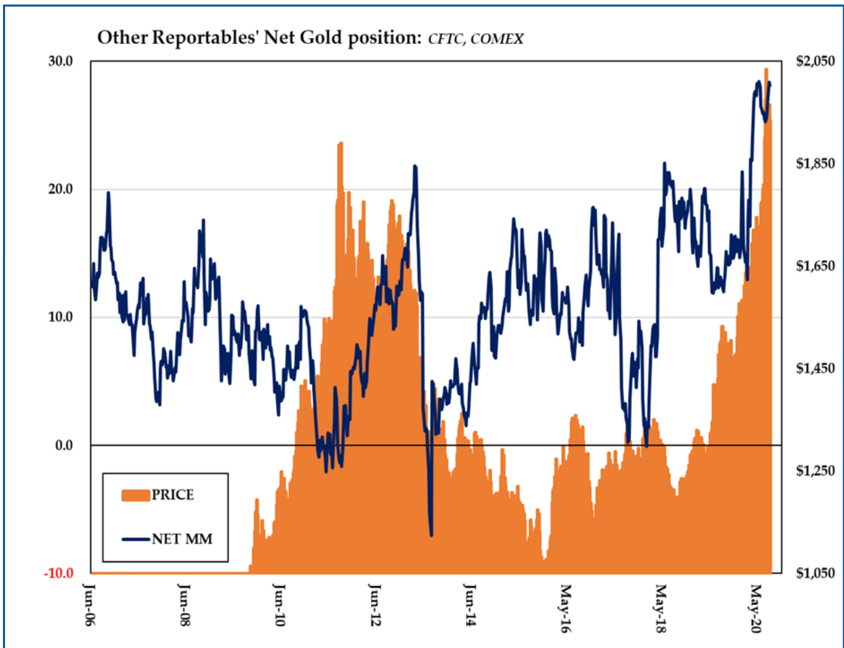
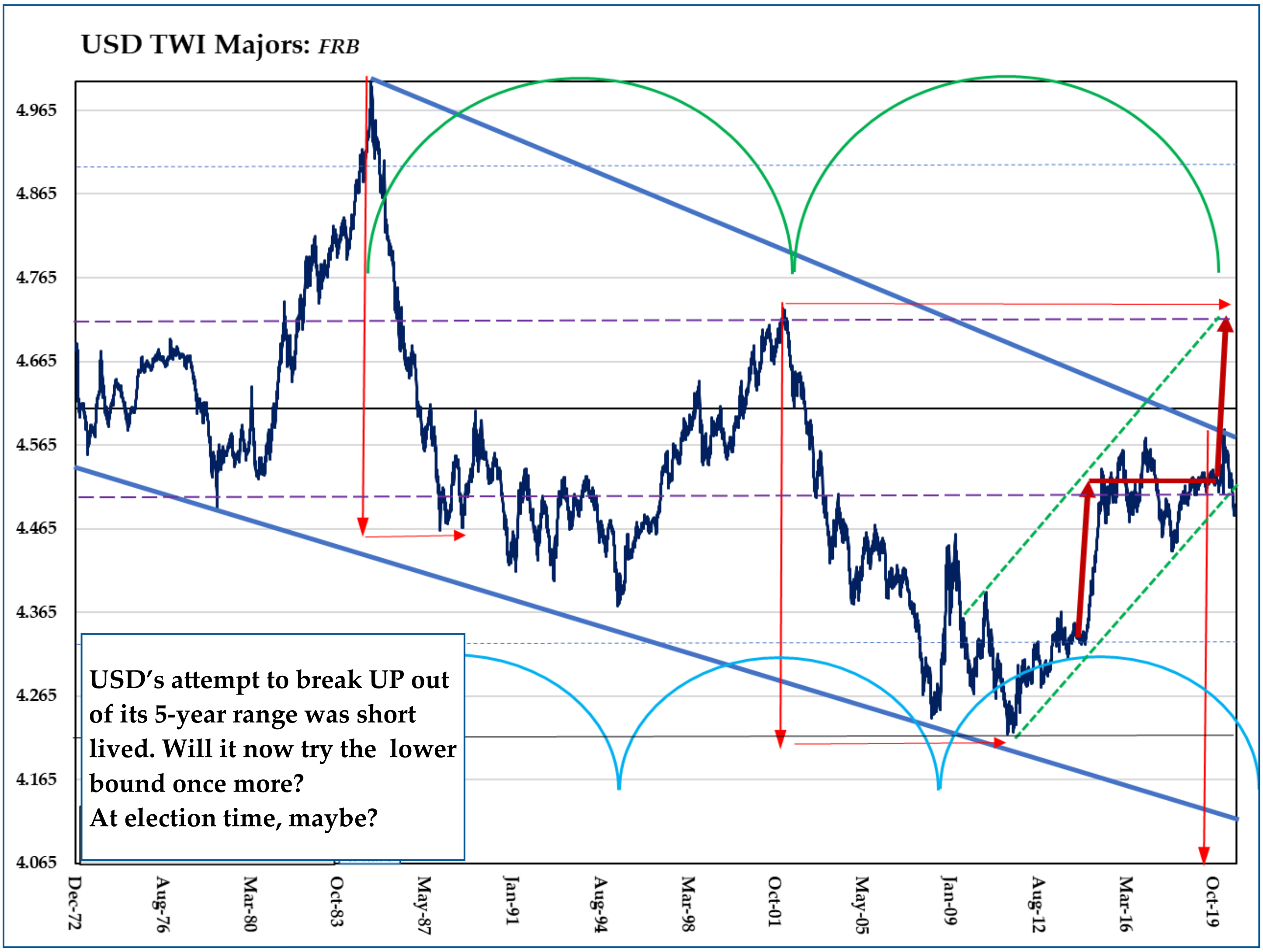
Dec-16
Dec-18
Dec-20

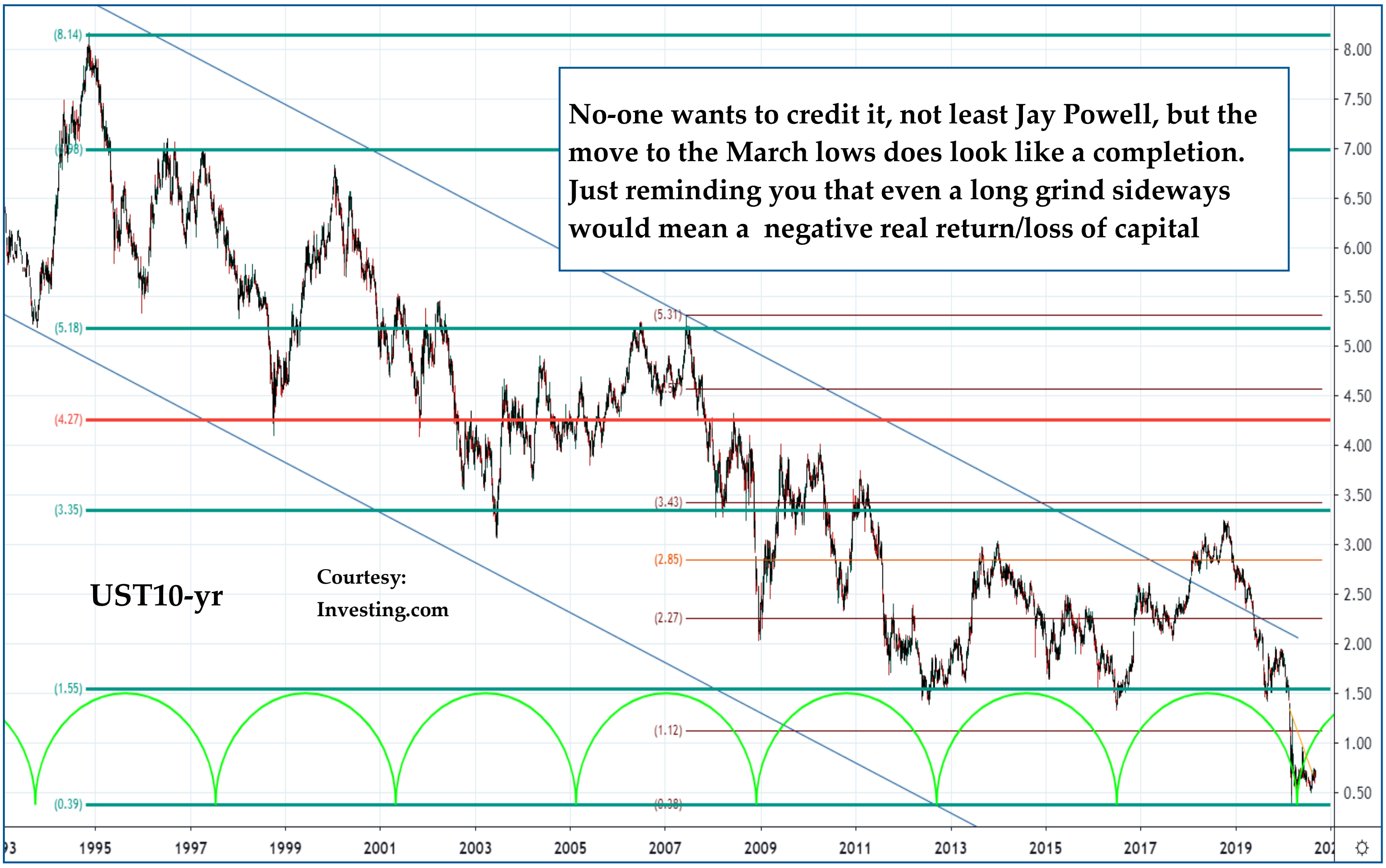


Gold's run has taken it to new extremes v-a-v 'useful' commodities, but is just showing some signs of fatigue, trading back to the old, 2011 high.



Note, too, who have been its biggest sponsors during the run-up. Not swap dealers, CTAs or hedge-funds, but 'other' speculators.
Hot hands?


USD TWI Majors: FRB
4.965
4.865
4.765
4.665
4.565
4.465
4.365
4.265
4.165
4.065
Dec-72
Aug-76
Mar-80
Oct-83
May-87
Jan-91
Aug-94
Mar-98
Oct-01
May-05
Jan-09
Aug-12
Mar-16
Oct-19
USD's attempt to break UP out of its 5-year range was short lived. Will it now try the lower bound once more?
At election time, maybe?


No-one wants to credit it, not least Jay Powell, but the move to the March lows does look like a completion. Just reminding you that even a long grind sideways would mean a negative real return/loss of capital
UST10-yr
Courtesy:
Investing.com
(8.14)
(5.18)
(4.27)
(3.35)
(1.55)
(0.39)
(5.31)
(3.43)
(2.85)
(2.27)
(1.12)
8.00
7.50
7.00
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6.00
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3.50
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