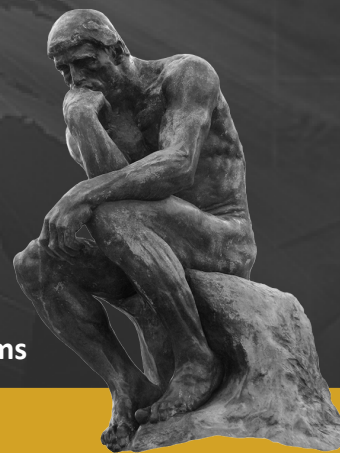


THINGS THAT MAKE YOU GO *Hmmm...*

A walk around the fringes of finance

By Grant Williams



To learn more about Grant's new investment newsletter,
Bull's Eye Investor, [Click here »](#)

06 January 2014

That Was The Weak That Worked: Part II

Quantitative Easing

n.

the introduction of new money into the money supply by a central bank

Financial Repression

n.

any of the measures that governments employ to channel funds to themselves, that, in a deregulated market, would go elsewhere

Recovery

n.

1. the act or process of recovering from a shock or a setback
2. restoration to a former or better condition

Payment Shock

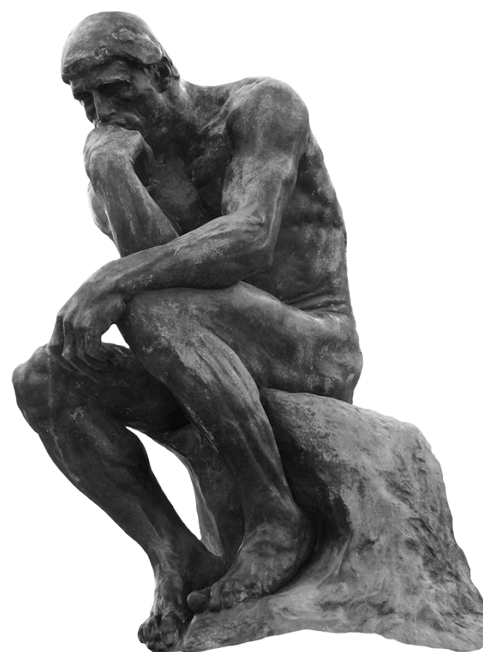
n.

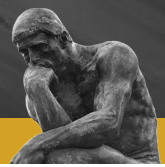
the risk that a loan's scheduled future periodic payments may increase substantially



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Things That Make You Go *Hmmm...*

Last week, in Part I of "That Was The Weak That Worked," we reviewed the equity markets in an attempt to see how equity investors managed to scamper through 2013 with the friskiness of puppies when all about them lay doubt and potential disaster.

We found the answer in quantitative easing – of course.

This week we will take a look at how the bond market managed to navigate the same 12-month period and see what can be learned about 2013 in order to forecast for 2014.

Let's begin by considering the subject of logical fallacies – an endeavor rendered more obsolete with each passing day.

(Deus Diapente): The study of logical fallacies is useful in learning how to think instead of what to think. In learning how to deconstruct an argument, you learn how to efficiently construct your own thoughts, ideas, and arguments. You learn how to find fallacies in your own line of reasoning before they're even presented, which is a valuable methodology for learning how to think. Which is a lot more honest, liberating, and possibly more objective than simply regurgitating what society, teachers, parents, preachers, friends, or politicians tell us...

"Learning how to think instead of what to think"?

The very idea is enough to send many into an Austen-like swoon, and yet within this relatively simple construct lies a principle that, if it were applied to today's markets, would have every rational investor rushing headlong into the hills.

Allow me to demonstrate using everyone's favourite logical structure: the syllogism.

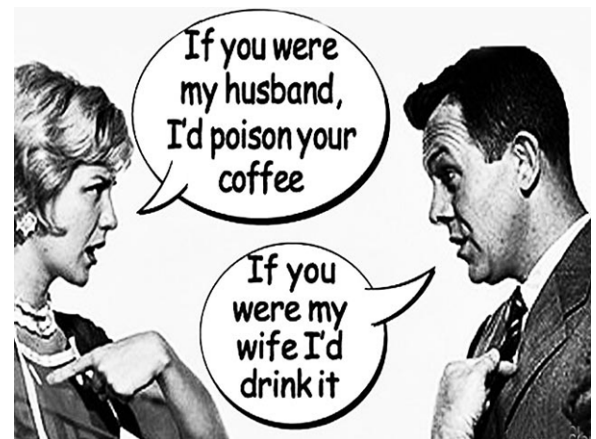
A syllogism is classified as a point-by-point outline of a deductive or inductive argument. Syllogisms normally contain two premises followed by a conclusion:

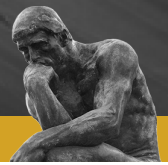
*Premise 1: Miley Cyrus is the most talented musician of her generation.
Premise 2: The most talented musician of every generation achieves legendary status.
Conclusion: Miley Cyrus is a legend.*

Simple.

The conclusion, from a purely logical standpoint, holds water. The problem comes when either of the first two premises is not accepted by the person to which they are proposed.

At that point, the argument starts to fall apart.





The common term for this kind of flawed argument is a "non sequitur," which literally means "it does not follow."

So let's apply the syllogistic approach to the concept of quantitative easing and see how we go:

Premise 1: Central banks have been printing money like lunatics.

Premise 2: Their printing of money hasn't had any ill effects.

Conclusion: Printing money doesn't have any ill effects.

Right then. There's our syllogism. Do you want to go first, or shall I?

Oh... ok.

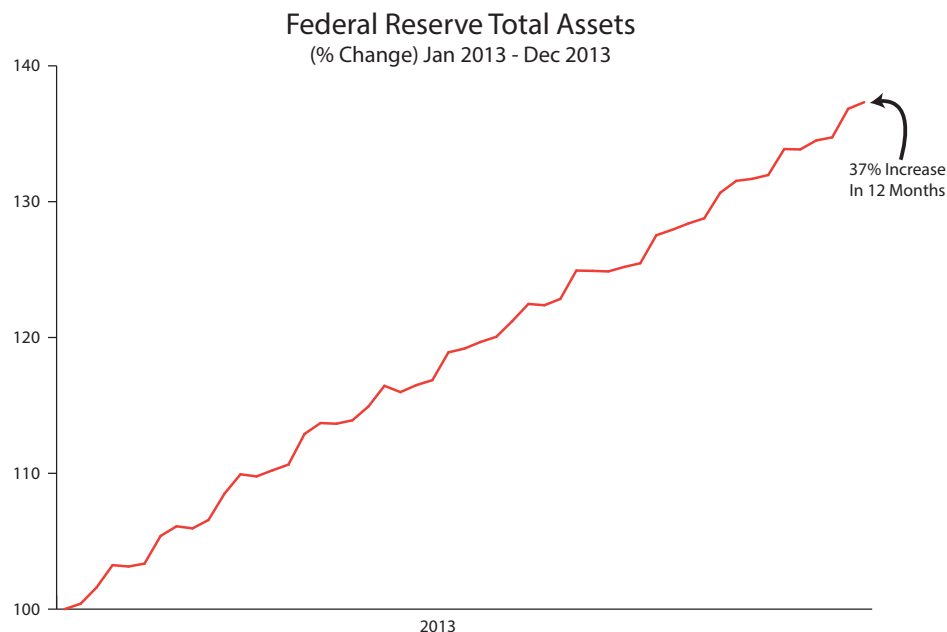
Quantitative Easing IV (or "QE IV" — so-called because it was injected directly into the veins of the monetary system) was unveiled on December 11, 2012, when Ben Bernanke announced, as Operation Twist expired, that in addition to the ongoing QE3 program (which committed the Federal Reserve to buying \$40 bn in MBS every month) he would sanction the additional buying of \$45 bn in long-term Treasury securities. Every month. ~~Forever.~~ Until further notice.

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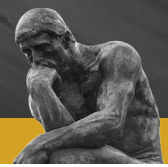
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The rest, as they say (whoever "they" are), is history.

The effect on the Fed's balance sheet is plain to see:



Source: Bloomberg



That's a very steady, predictable line; and markets, as we have discussed, LOVE steady and predictable. The consistency of this curve underpinned the strength in equity markets this year, as I demonstrated last week. But in Bondville? Well, that's another story...

Below is a chart I've used before that has been helpfully updated by Goldman Sachs (courtesy of Barry Ritholtz). It shows the coupon on the US 10-year Treasury going back to 1790 and highlighting every peak, trough, and major catalyst along the way.

My advice is to bookmark it for 2014.

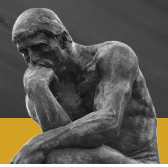


Source: [The Big Picture](#)

The only thing that ISN'T included on the chart is the average coupon over the last 224 years, which is a hair below 6%.

But the world is a very different place now than it was in 1790, obviously, and so it may seem unfair to take an average that goes back quite so far in time. So truncate the same chart to the period between 1962 and 2013 in the hope that a 50-year window is more palatable to grapple with. The beauty of that window is that it encapsulates both the high and the low prints for the entire 224-year span.

What do we find when we zoom in for our close-up (next page)? Well, we find that the average rate over the last 50 years was ... wait for it ... 6.58%.



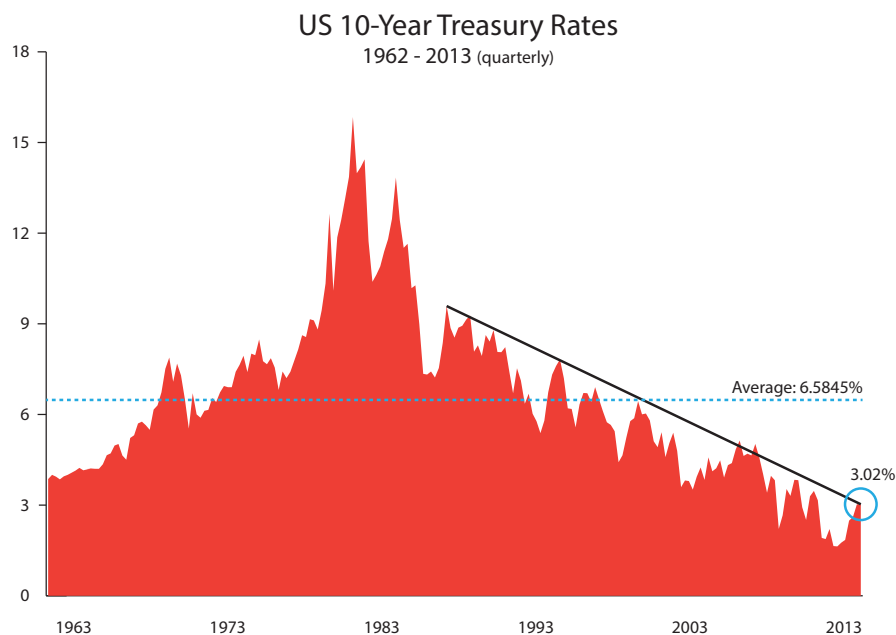
OK, so as we attempt to disprove our original syllogism, we have established that somewhere between 6 and 6.5% is probably a fairly representative rate for the US to be paying to borrow 10-year money from the rest of the world. Now, let's head back to the dictionary:

(Free Dictionary): Regression toward the mean

Noun 1. The relation between selected values of x and observed values of y (from which the most probable value of y can be predicted for any value of x).

Put in a slightly less mathematical way:

(Wikipedia): In finance, the term mean reversion has a different meaning. Jeremy Siegel uses it to describe a financial time series in which "returns can be very unstable in the short run but very stable in the long run." More quantitatively, it is one in which the standard deviation of average annual returns declines faster than the inverse of the holding period, implying that the process is not a random walk, but that periods of lower returns are systematically followed by compensating periods of higher returns.

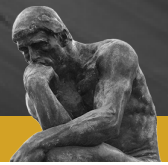


Source: Bloomberg

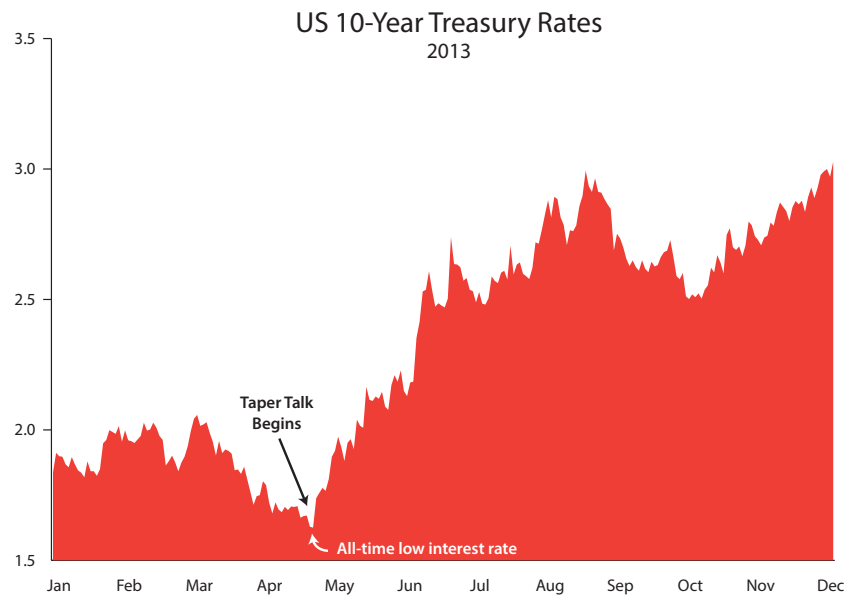
What that also means is that periods of lower rates are systematically followed by compensating periods of higher rates, which isn't great news as we continue to move inexorably higher from the lowest print in history.

Just because there HAVEN'T been any ill effects from QE doesn't prove there WON'T be. There goes our syllogism. Sorry.

As you can see from the downward-sloping trendline above, we have reached a somewhat crucial juncture.



Back in May, when Ben Bernanke provoked the Taper Tantrum, rates on the US 10-year Treasury were at their all-time lows of 1.6255%. Since then, almost imperceptibly, rates have climbed higher ... and higher ... and higher still, to the point where they have almost doubled since Ben let the cat out of the bag on that fateful day in May:



Source: Bloomberg

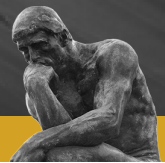
Ah yes, I hear you say, but it's not as though 3% is a steep interest rate for a country carrying a \$14 trillion deficit to pay to finance its debt — and you're right. The problem comes with that whole regression to the mean thing — and more specifically, the tendency for these moves in interest rates to overshoot.

Back in late April, before the first taper trial balloon was floated, Bloomberg had this warning for bond investors:

(Bloomberg): If rates rise, the market value of government bonds in particular — and all bonds in general — could be hurt significantly. For example, if the federal funds rate rises to 3%, a longer-term Treasury bond might lose as much as a third of its market value.

For every 1% increase in interest rates, expect the 10-year U.S. Treasury bond to lose 8.96% in price.

Historically, the 10-year Treasury bond returned a long-term average real rate of return and yield of 4.4%, according to Don Riley, chief investment officer of the Wiley Group. If the 10-year yield rose from 1.66% today to 4.4%, the price of that bond would fall 21 percent.



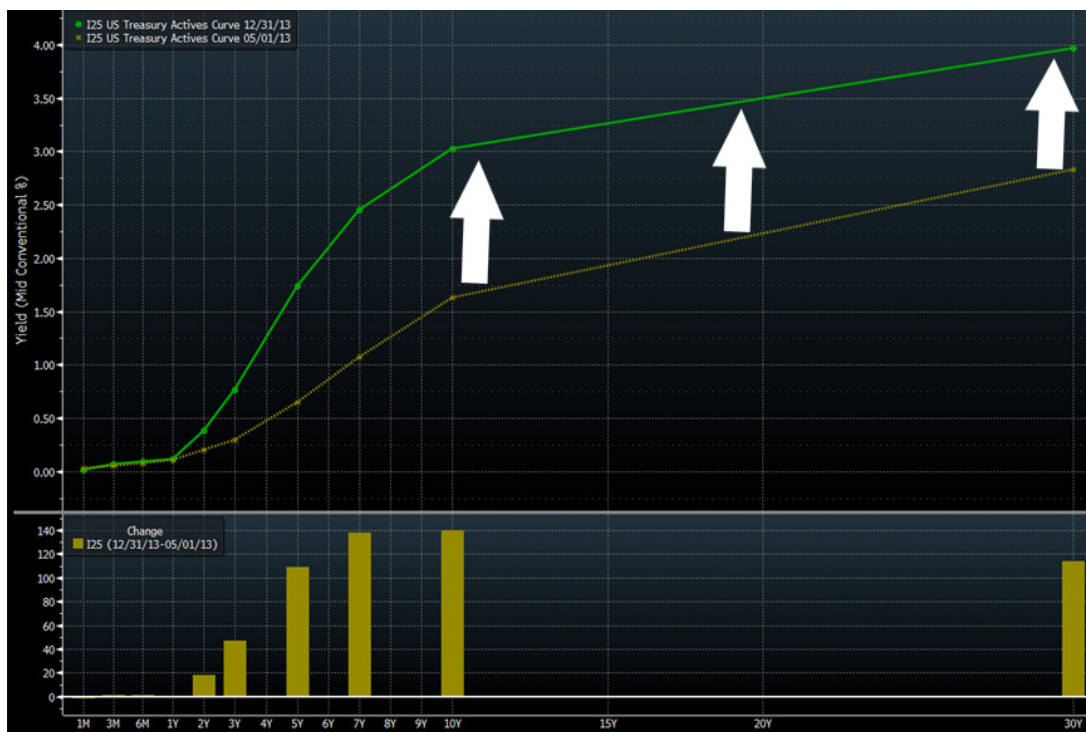
If and when interest rates rise again, are bond owners going to keep 10-year or 30-year Treasury bonds in their portfolios until those bonds mature? Very likely not. Who would want a 1.5% or 2.5% return for a decade?

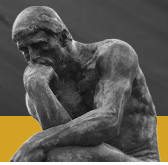
And in October, after the last-minute pullback from the edge that all but shredded whatever credibility the Fed had left, the FT weighed in with some alarming statistics from our old friends the IMF:

(FT): Monetary tightening in the US threatens to expose financial excesses and vulnerabilities that could wipe trillions of dollars off bond markets, the International Monetary Fund warned on Wednesday.

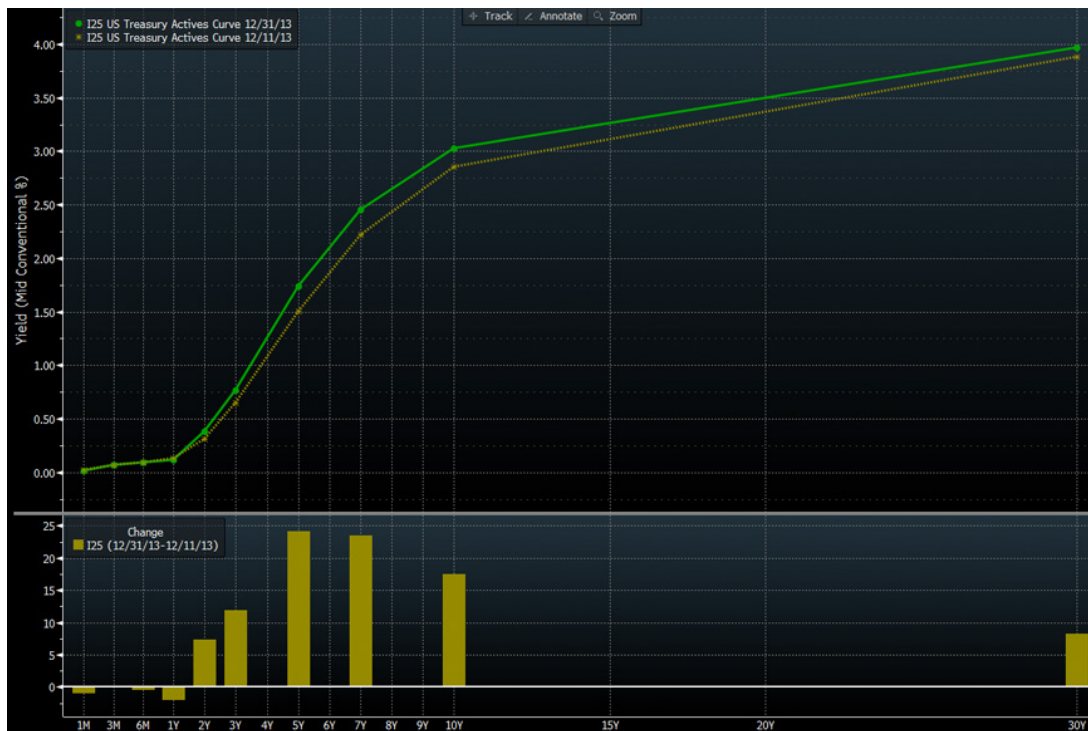
If the Federal Reserve's likely move to start scaling back its asset purchases or fallout from a possible US failure to lift its ceiling on public debt raise long-term interest rates by 1 percentage point, the IMF's Global Financial Stability Report (GFSR) estimates that the market losses on bond portfolios could reach \$2.3tn.

Well, since May, when all this taper nonsense began, rates have made sizable moves in the wrong direction, all the way along the curve:



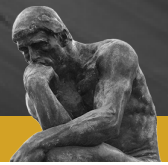


... and in the two holiday-affected weeks since the Fed's "Taper Lite" announcement, they've shown no signs of stopping:



Source: Bloomberg

With the Fed now slowing their purchasing of Treasuries, the spectre of the loss of a free backstop has sent investors barreling back into high-yield debt as a means to supplement their loss of interest income and capital losses on government bond portfolios; and that move has given us one of those charts you just have to love for the glaring disconnect that seems not to matter to anybody:



Source: Sober Look

Clearly, something is amiss here, but why worry about it now – just chase the yield. There will always be a greater fool to sell your position to, and if things get really sticky the Fed will probably ride to the rescue.

Right?

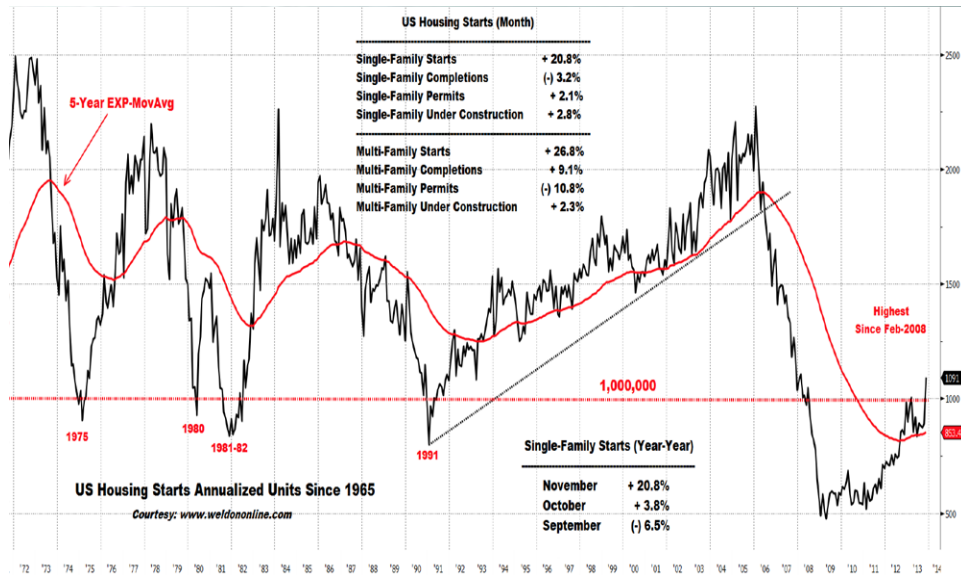
Maybe.

Meanwhile, it probably makes sense – seeing as the Fed is buying \$40 bn in Treasuries and \$35 bn of MBS every month in order to stabilize the market and keep rates down and the housing market "recovery" bubbling away – to take a look at what effect, if any, these rising rates are having on the aforementioned "recovery." To do that I'll enlist the help of my great friend Greg Weldon, whose chart work really is second to none.



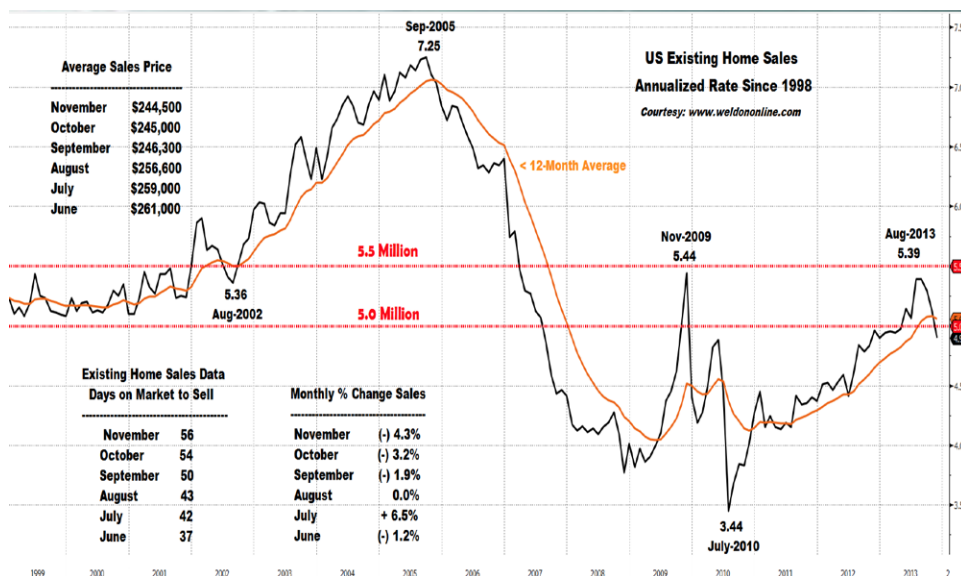
(Greg has again kindly offered a free trial of his work to Things That Make You Go Hmmm... readers. You can sign up [HERE](#). Personally, I think Greg's work is utterly invaluable to anyone trying to navigate these treacherous markets.)

Housing starts are strong; that's undeniable, though a lot of that is preemptive confidence.

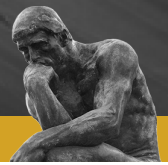


Source: Greg Weldon

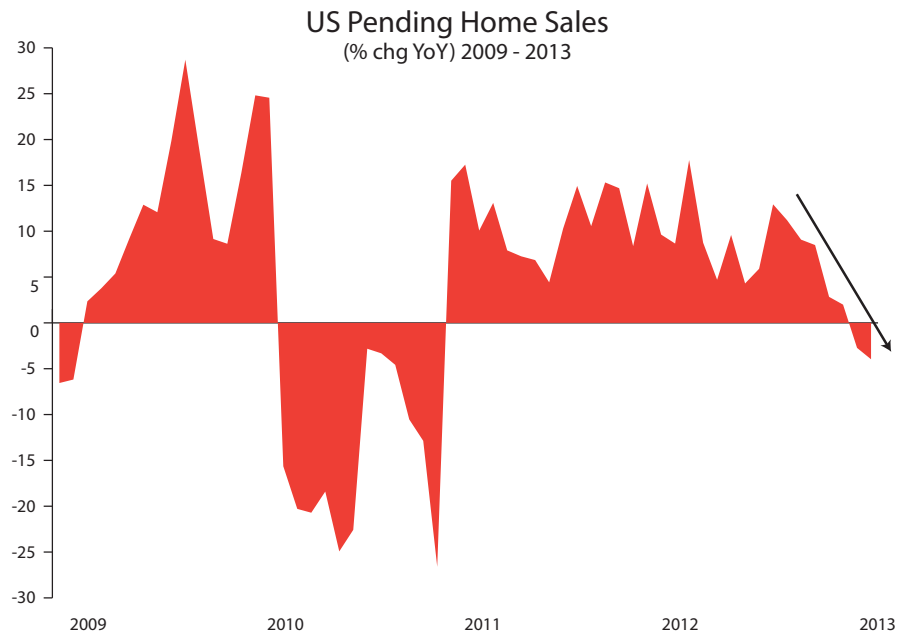
But housing starts aren't the whole story, I'm afraid. Existing home sales have faltered at a crucial technical level and turned down sharply:



Source: Greg Weldon

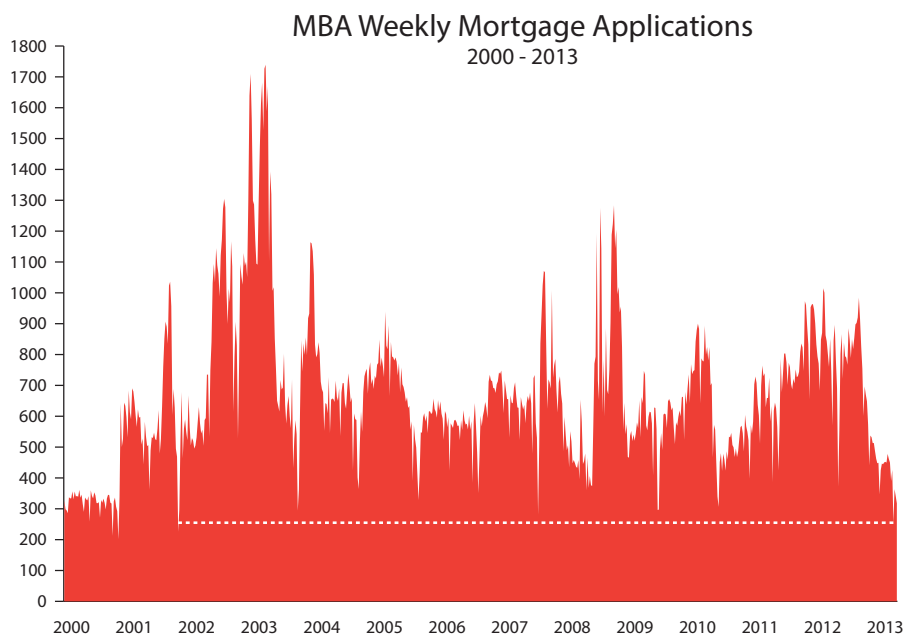


Pending home sales have turned negative YoY:

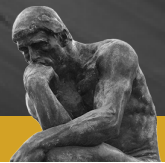


Source: Bloomberg

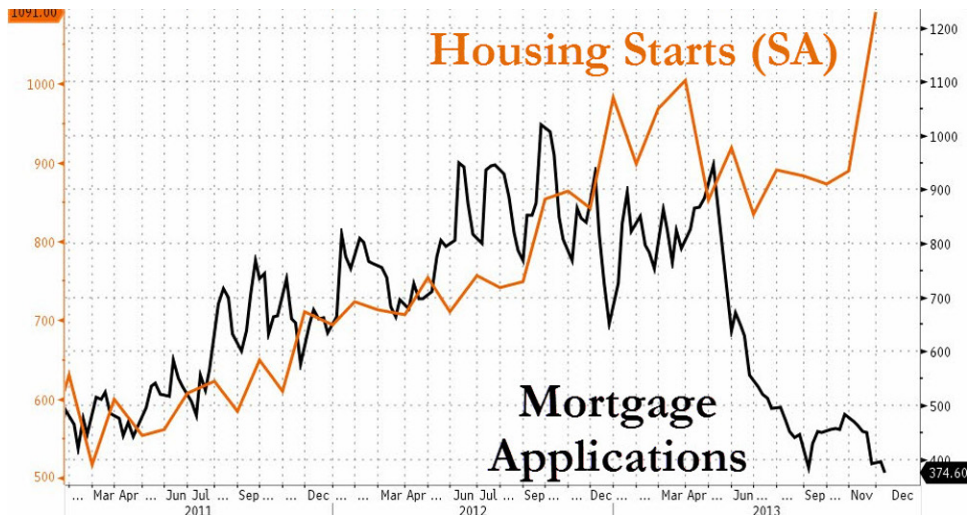
... and perhaps most alarmingly, the MBA's weekly mortgage applications data has fallen off a cliff: down 66% from its highs to a new 13-year low — yes, way worse than in the depths of 2008-9:



Source: Bloomberg



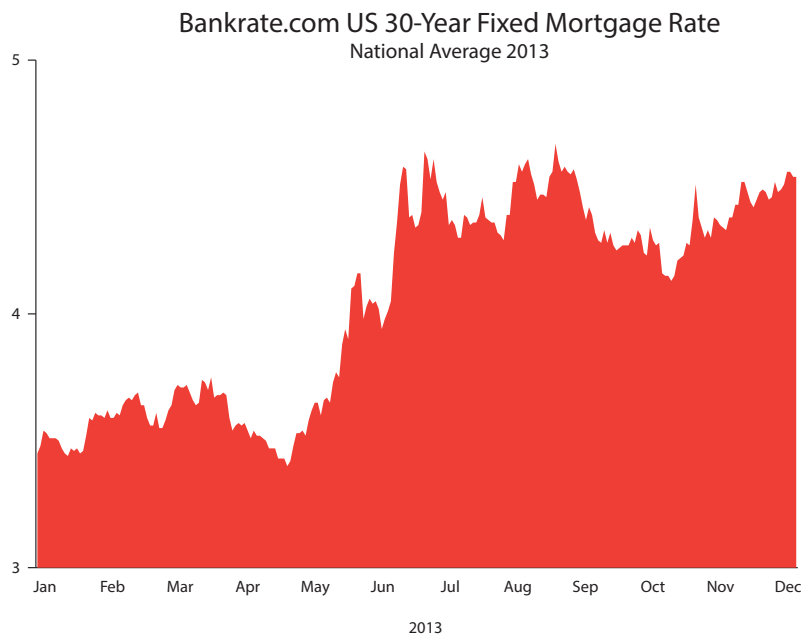
Overlaying a couple of these metrics gives us one of those wonderfully divergent charts that people never seem to pay any attention to until the divergence once again turns into convergence:



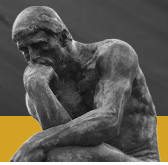
Source: Zerohedge

Why the change in direction for the housing "recovery"?

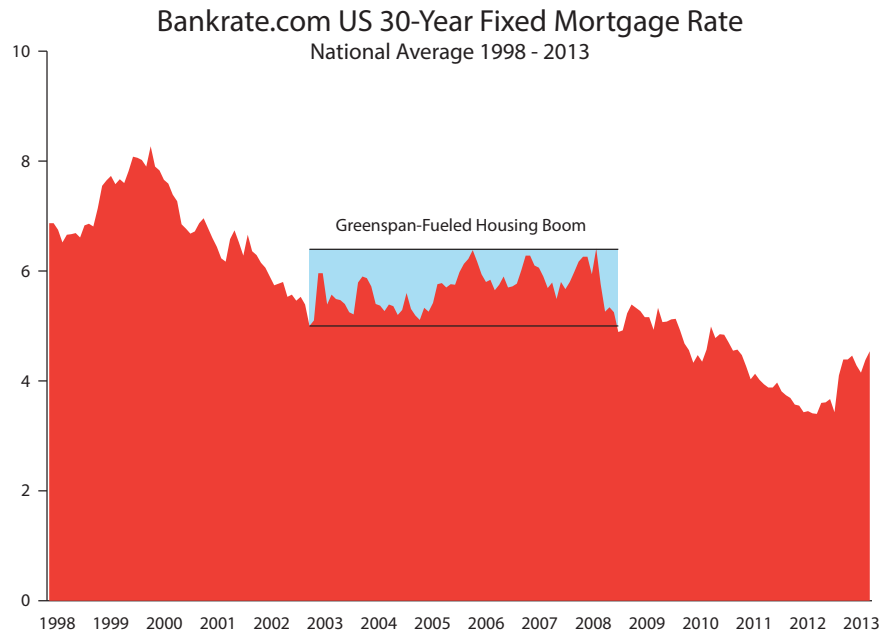
Well, unsurprisingly, as the rate on the 10-year has spiked since May, so have mortgage rates:



Source: Bloomberg



And if we step back and take a broader look at that chart, taking in the last 15 years, we see just how broken things really are:



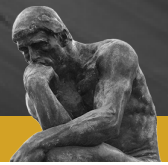
Source: Bloomberg

As you can see, the housing boom that was fostered by Alan Greenspan's low-interest-rate binge was born of rates around 6%. That level was low enough to generate the biggest US housing boom in history. Yet today's "recovery" in the housing market is being choked off by rates a shade above 4%. And in places such as Brooklyn a staggering 70% of homes are being bought for cash. The skew caused by that phenomenon has led to the bifurcation of the market.

(NYT): A handful of large private equity and real estate investment firms, including the Blackstone Group and Colony Capital, have bought billions of dollars' worth of single-family homes in some of the areas most affected by the housing collapse.

The goal for these Wall Street investors is not to buy and flip the properties for a quick profit à la real estate bubble of the early 2000s. Instead, they are hunting for steady, dividend-like returns they believe can be earned by renting out the homes.

Where these investors see opportunity, however, their critics see opportunists.... Those arguments may hold up in places like Phoenix or Las Vegas, which were overbuilt during the boom and struggled when the housing market collapsed. But prices have soared in parts of the market that weathered the housing storm, like Brooklyn, increasingly frustrating the dreams of first-time home buyers, analysts say.



The median price of a home in Brooklyn climbed nearly 12 percent in just the past year to hit a 10-year record, according to a recent report released by the real estate brokerage firm Douglas Elliman. Prices for highly desirable one-family brownstones in Brooklyn have leapt almost 40 percent in the last year to a median price of \$1.6 million.

Some real estate agents say investors, more often than not, have been at the forefront of buying activity.

"I'd say by the spring, maybe 70 percent of the sales we were seeing were to hedge funds, investors and others taking advantage of what was happening in Brooklyn" ...

So here's the Fed's own little prisoners' dilemma:

By purchasing a trillion dollars of Treasuries and MBS they have managed to ~~avoid the bankruptcy of several major investment banks~~ pick the moribund housing market off the floor and generate some interest in one of the major drivers of any "recovery." However, now that things are looking better (optically, at least), they need to cut back on the stimulus that has created the optimism. Their policy is leading to higher rates, which in turn are already starting to affect the nascent housing recovery.



So ... does the Fed cooperate and taper the taper in order to stifle the rate increase – or does it defect, continue to tighten, and watch the housing market tumble again?

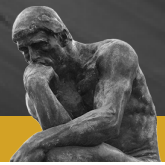
Tough choice, particularly as they know that the second they backtrack on the taper, the last vestiges of ~~cred~~Fedibility go ... POOF!

Remember that Bloomberg article we looked at a few pages ago? I'll refresh your memory to save you going back to it (and even throw in a little emphasis of my own for good measure):

(Bloomberg): If rates rise, the market value of government bonds in particular – and all bonds in general – could be hurt significantly. For example, if the federal funds rate rises to 3%, a longer-term Treasury bond might lose as much as a third of its market value.

For every 1% increase in interest rates, expect the 10-year U.S. Treasury bond to lose 8.96% in price.

Ah...



2013 has been loudly trumpeted as the year gold saw its first down year in 13. The headlines trumpeting the end of the gold bull market have been ubiquitous and unbelievably celebratory, for some bizarre reason. (Gold will get a year-end review all of its own – of course – shortly):

"Gold Notches Biggest Annual Loss in Three Decades"

"Gold's First Down Year Since 2000"

"Gold Set for First Annual Loss in 13 Years"

Those three are just by way of a sample.

What you WON'T find, unless you go looking in the weeds, is coverage of a similar fact markedly less gloated over:

(Bloomberg): Bond investors worldwide who were stung by their first annual losses since 1999 are bracing for more declines as the Federal Reserve pulls back on stimulus that's supported fixed-income markets for five years.

Debt globally fell 0.4 percent in 2013 as losses of 3.4% in U.S. Treasuries offset the 1.2% gain in corporate debt that was led by a 7% return in high yield, according to Bank of America Merrill Lynch index data. Europe's recovery from a sovereign debt crisis led to a 57% rally in Greek bonds and a 12% surge for those of Ireland.

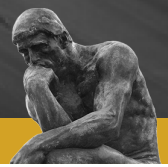
Yields in the six major government bond markets from the U.S. to Germany and Japan are forecast to rise next year with world economic growth poised to accelerate to 2.8% in 2014 from 1.98% this year, according to Bloomberg surveys of economists.

Now hold on just a cotton-pickin' minute.

Bonds have had THEIR OWN first down year in 14 years DESPITE the world's major central banks having supplemented the natural forces of ~~supply~~ and demand to the tune of a combined \$4.7 trillion over the past five years and around \$1.5 trillion this year alone, and that's not as newsworthy as the decline of gold?

Really?

You can be sure we'll get back to THAT little lapse in logic in Part III.



But for now, let's stay with bonds and look at the annual returns this past 12 months for various sectors of the largest pool of capital on the face of the planet:

Category	2013 Return
US Treasuries	-3.4%
High Yield	+7%
Financial	+2.2%
Industrial	-1.5%
Global Asset-Backed	-0.4%
Mortgages	-1.5%
Leveraged Loans	+5%
CCC-Rated	+12.8%
BB-Rated	+5.1%
Spain (Sovereign)	+11%
Greek (Sovereign)	+57%
Italy (Sovereign)	+8%
Ireland (Sovereign)	+12%
Data Source: BAML	

US Treasuries fell 3.4% in a year when the Federal Reserve monetized purchased over half a trillion dollars' worth. The other component of QE, mortgage securities, fell 1.5%.

Meanwhile, the Greek, Irish, Italian, and Spanish sovereign debt that litters bank balance sheets was all up double-digit percentages. (Italy, you ask? Oh, 8% is near enough – cut me some slack.) Meanwhile, the junk bonds that hedge funds and banks piled into in 2011 and 2012 were up 13%... Do I need to spell it out any further?

The big losers are the public and the big winners are the smart money. Again.

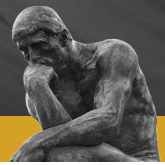
Surely this isn't a surprise to anybody. It's called smart money for a reason, and trusting your finances to the same group of ~~hopeless academics~~ government-appointed officials ~~with little or no real-world experience~~ who thought subprime was "contained" and that low rates for a couple years in the early 2000s were a great idea, is a gameplan guaranteed to turn out poorly.

I wonder what would happen if the Fed entrusted their \$85 bn a month to the smart money? Think it would rush into Treasuries and MBS?

Me neither.

2014 is going to be a bumpy ride for bond markets, folks. Count on it.

Government debt is at levels that only governments themselves would pay, at exactly the time when they are trying to lean more heavily on the private sector to take up the slack – good luck with that.



High-yield bonds will have significant gains that the holders will all be looking to lock in at once should we see markets wobble; and as for corporate issuance, well, the frenzied attempts to issue debt at current rates should tell you all you need to know:

(WSJ): Highly rated companies sold a record \$1.111 trillion of bonds in the U.S. in 2013, even as the debt offered the worst returns in five years.

This year's issuance volume is based on preliminary figures supplied by data provider Dealogic.

This year's issuance surpasses the previous record set in 2012, when investment-grade companies sold \$1.053 trillion of bonds. Dealogic's data goes back to 1995.

Despite the rise in yields, interest rates remain at relatively low levels, a situation that has encouraged companies to keep borrowing.

While holding investment-grade debt was a money-losing strategy in 2013, the bonds outperformed other kinds of debt....

The demand for high-grade corporate bonds this year was highlighted by two mammoth deals: Apple Inc. (AAPL -1.41%) sold \$17 billion in April, which at the time was the largest corporate bond ever sold. But it was beat several months later by Verizon Communications Inc. (VZ -0.28%), which sold \$49 billion of debt in September.

Interest rates, bond markets, and the housing market are inextricably intertwined. They always have been and always will be. Period.

You cannot monkey around with one piece of that eternal triangle and expect the others not to be affected at some point, and just because nothing bad *has* happened definitely does **NOT** mean it *won't*.

It will.

2013 may well have been The Weak That Worked, but the odds on that continuing for another 12 months are very short indeed.

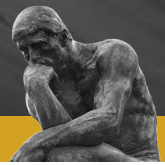
And so, as we wrap up this week, let's revisit the idea of logical fallacies and throw a couple more that the guardians of the global economy are relying on into the ring for good measure:

The Taper Syllogism

Premise 1: The Fed tapered its monthly asset purchases.

Premise 2: The taper had no major negative effect on markets.

Conclusion: Tapering has no negative effect on markets.



The Housing Bubble Syllogism

Premise 1: The government has all the data on the housing market.

Premise 2: The government sees no bubble in the data.

Conclusion: There is no housing bubble.

The Interest Rate Syllogism

Premise 1: The Fed sets interest rates.

Premise 2: The Fed has promised low rates of zero to 0.25 percent "... at least as long as the unemployment rate remains above 6.5 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored."

Conclusion: Interest rates will stay at zero to 0.25% and zero to 0.25 percent will be appropriate "... at least as long as the unemployment rate remains above 6.5 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored."

The Inflation Syllogism

Premise 1: The world's central banks have printed ~\$4.7 trillion.

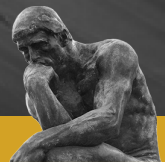
Premise 2: There is no noticeable problem with (official) inflation numbers.

Conclusion: Printing money doesn't cause inflation.

Your assignment: Discuss.

This week we kick things off with a comparison of the Bakken shale boom to the California Gold Rush of the 19th century — and the parallels are plain to see. Then we visit the latest member of the EU, Latvia, and find out that the embrace is a somewhat reluctant one (at least on the part of Latvians). Then it's off to Tehran, a city that many feel offers the chance of a century to investors, and to Japan, where Shinzo Abe's militaristic tendencies are complicating Japan's strained relationship with China — something the rest of the world could do without.

Meanwhile in Europe, there are bargains galore at the Great European Fire Sale if you happen to have a few billion kicking around and are looking for a private Greek island or a Polish castle, but the banking system is every bit as brittle as we feared — despite reassurances to the contrary from ~~central bankers~~ certain vested interests.



Those same central bankers hold the key to rejuvenating the world's economy (God help us), just as China and the US begin to toy with the idea of unwinding their massive stimulus efforts. Ambrose Evans-Pritchard warns of a dollar rally in 2014, and the IMF has released a paper that confirms the fears of many ~~conspiracy theorists~~ realists as it warns of a savings tax and massive debt write-offs by Western governments.

Charts display the wondrous effects of QE on the S&P 500 and the state of the bifurcated US housing market. You'll also learn everything you need to know about the global economy in two simple charts.

Jim Rickards returns to talk gold; there are a couple of closing slides from a presentation I did in Spain this year for a bit of fun; and last but not least, this week we gain an eye-opening insight into the attitude of central banks towards gold (eye-opening, at least, for those of us who didn't already have an understanding of that particular dynamic) as we bear witness to the wisdom of Adam Posen, former member of the BoE's Monetary Policy Committee (MPC).

It's worth reading [Posen's bio](#) before listening to the interview in order to understand who he is and what he's done. (Hint: don't bother looking for any experience in the private sector.)

In the third and final part of "That Was The Weak That Worked," we will look at how gold fared in 2013 (hint: pretty damn poorly) and try to sift through the confusion, manipulation, disinformation, and skewed rhetoric to understand what really happened and, more importantly, to learn where gold may be headed in 2014.

Until Next Time...

There's gold in them there wells

WHEN his neighbour discovered gold in a Californian river in 1848, Sam Brannan could have kept quiet about it. Instead, he filled a jar with gold dust and rushed around the streets of San Francisco shouting "Gold! Gold! Gold!" He had good reason to incite a gold rush: he owned a shop nearby. He became California's first millionaire by selling picks, shovels, beans and bacon to the horde of prospectors who heeded his call.

Gold fever spread fast. The lure of buried treasure "sucked nearly every free hand and available arm to the gold mines", observes H.W. Brands in "The Age of Gold", a brilliant history of the period. "They tore themselves from warm hearths and good homes, promising to return; they fled from cold hearts and bad debts, vowing never to return." The Alta California, a local paper, reported that "The whole country...resounds to the sordid cry of gold! GOLD!! GOLD!!!" It added that this would be the last issue for a while, since all its staff were heading for the gold fields.



America's current shale-energy boom has plenty in common with the gold rush, and might prove as momentous. It has created a gusher of wealth in remote places. It has lured young men to wild frontier towns, such as Williston, North Dakota. Jim Cramer, a television host, sounded just like Brannan when he reported from North Dakota in 2011. "This new black gold rush is just getting started!" he bellowed, against a backdrop of nodding donkeys. "Listen, people in this country who need a job, get up here!"

Unlike the Alta California, not all of *The Economist's* writers have headed for the frontier. But one correspondent, intrigued by the parallels between the two booms, put on stout boots, packed a copy of "The Age of Gold" and set off for Williston.

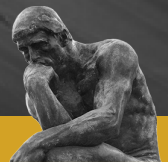
For the '49ers — as the men who hurried west in that year became known — the trek to California was arduous. "Mules old enough to travel well were unavailable at any price," writes Brands. Prospectors who made their way overland went "at the pace of the slowest oxen [pulling their wagons], no more than two miles [3.2km] per hour". Many succumbed to cholera, thirst or Indian arrows. One group, on escaping from the most godforsaken tract of the Mojave desert, doffed their hats, turned back and said: "Goodbye, Death Valley!" "The name stuck," notes Brands.

The journey to North Dakota today is more straightforward. Still, when your correspondent tried to reserve a rental car at Bismarck airport, they were sold out. He eventually found a pickup truck. Driving it through the Badlands was hairy: hundreds of huge oil lorries kept thundering in the opposite direction along narrow country roads. The pickup went much faster than an ox wagon, except in the traffic jam outside Williston, which looked like a long, motionless steel snake festooned with lights. A sign offered a cheerful welcome to "Boomtown, USA".

The communities formed by the two groups of migrants have some striking similarities. For gold miners in California, life was almost as rough as the journey west had been.

San Francisco in the summer of 1849 looked like "the bivouac of an army on the move", writes Brands; most of the buildings "were actually tents". The miners smelled awful. No one "could be bothered to wash dirty underwear, only to wash gold".

Workers in Williston today generally have it easier—though newcomers sometimes sleep in their cars, which is not advisable in the winter, when temperatures often drop below minus 20°C. Places to stay are scarce and expensive. Many oil workers live in "man camps", which look like college dormitories that have been built in a hurry. The companies that run them, such as Target Logistics of Texas, prefer the term "crew camps" to man camps; it sounds less burly and tattooed. But who are they kidding? When *The Economist* visited Tioga Lodge, one of Target's camps, 99% of the 930 residents were male.



It is a bare-bones place for men who work long, sweaty hours to sleep and eat. Happily the food is free and unlimited. The kitchens chop up vast quantities of meat into portions just small enough to fit on a plate. "They eat a lot," says the chief cook, Jeff Ball, who used to cater for troops in Afghanistan. Some workers heap their trays with meat and potatoes in the dining room, then walk over to the cafeteria to load up with burgers, hot dogs and pizza. Your correspondent, at the salad bar, felt lonely.

Mr Ball gives the oilmen whatever they want. If they crave blackened catfish and prawn gumbo like mom used to make in Louisiana, they can have it. Likewise if a crew from Mexico wants tamales. The only thing they can't have — in the man camp, at least — is alcohol. Oil firms prefer that dangerous machinery be handled by men with clear heads....

*** THE ECONOMIST / [LINK](#)

Latvia reluctantly joins euro after shock therapy, but controversy rages on

The tiny Baltic nation of Latvia is to join the euro on New Year's Day against the wishes of its own people, becoming the eighteenth and poorest member of monetary union five years after its economy crashed in flames.

The country has endured a 1930s-style depression and a drastic experiment in EU shock therapy with stoicism, abiding strictly to the terms of an EU-IMF bail-out.

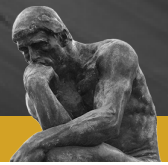
It has exported its way back to balance and defied critics by defending its euro-peg through thick and thin, yet the feat comes at a high social cost.

Euro accession has been greeted glumly by most of Latvia's 2m people, worn down by lay-offs and 28pc pay cuts for teachers, nurses, and police. A mass exodus of youth has served as an escape valve, leaving an older society behind. Latvia's population has shrunk by 7pc since 2007.

An SKDS poll in November found that just 20pc favour giving up the national currency, the Lats, brief symbol of sovereignty in the interwar years between interludes of Tsarist and Leninist occupation. The Lats was restored with great emotion in 1992 after Latvia broke free of Soviet control.

Few seem mollified by the familiar face of Milda — the braided 'Latvian Maiden' — on the new euro coins. Some 58pc are against joining the new currency, yet the government has chosen to press ahead regardless without a referendum.

Latvians are acquiescing quietly, if only because the euro helps to counter the strategic threat of Vladimir Putin's Russia to the East. "Russia's long shadow is the most important factor in Latvian politics," said Professor Ivars Tjabs from Riga University.



Latvia's leaders have sought to lock the country as deeply as possible into the western economic and security system, aiming to raise the bar high enough to discourage meddling from Moscow. Finance minister Andris Vilks says the euro is an insurance policy. "We can see what is happening in Ukraine. Russia isn't going to change. We know our neighbour," he told the Financial Times.

Latvia's ordeal of boom, bust, and recovery has set off a heated debate among economists worldwide over the pros and cons of rigid austerity and fixed-exchange rates, a dispute unlikely to be settled by euro-entry.

Olivier Blanchard, the IMF's chief economist, warned that Latvia's saga should be treated with "great caution", saying the country is sui generis and may not be a useful model for others. This has not stopped both sides digging in their heels.

European officials praise Latvia as the poster-child of "tough love" policies and a vindication of EMU "internal devaluation" strategy, proof that hard grind pays off better than a devaluation quick fix.

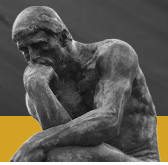
The economy grew by 5.5pc in 2011, and 5.6pc in 2012, and should grow by 4pc this year. Productivity levels have soared. The unemployment rate has dropped from a peak of 20.5pc to 11.9pc. Olli Rehn, the EU economics commissioner, says Latvia is a role model for EMU crisis states. "Tough decisions have allowed Latvia to emerge much stronger economically than before the crisis," he said.

Critics are exasperated by such claims, countering that it was the euro-peg that incubated Latvia's disaster in the first place, leading to interest rates that were far too low for a post-Soviet catch-up economy. The policy stoked an extreme credit bubble.

The country then lurched violently the other way, with GDP contraction of 25pc over eight quarters, and a 42pc fall in internal demand. Latvia's leaders clung to an overvalued exchange rate against the advice of the IMF — largely for political reasons, but also to shield middle-class homeowners with euro and Swiss franc mortgages.

Real GDP remains 8pc below its peak even now. The unemployment rate has been flattered by emigration. Prof Mihails Hazans from Latvia University said the majority of those leaving are under age 35, often the best-educated. Just 20pc plan to return within five years. Latvian society has been gutted....

*** AMBROSE EVANS-PRITCHARD / [LINK](#)



Central banks must show leadership to rejuvenate global economy

The decade and a half after the tearing down of the Berlin Wall was a golden age for central banks. It was a time of strong growth and low inflation presided over by committees of technocrats charged with taking the politics out of the messy business of setting interest rates.

The European Central Bank (ECB) was created, the Bank of England was granted operational independence and Alan Greenspan ruled the US Federal Reserve.

Mervyn King, who retired last year after a 10-year stint in charge at Threadneedle Street, described the period from the mid-1990s to the mid-2000s as the Nice decade. That stood for non-inflationary continual expansion and in the west was primarily the result of cheap imports flooding in from China, which kept the cost of living low and enabled central bankers to hit their inflation targets while keeping borrowing costs down.

Times have changed. The six and a half years since the financial markets froze in August 2007 have been anything but nice. Greenspan is no longer called the Maestro – the title of a hagiography by Bob Woodward before the sky fell in – and is instead vilified as a serial bubble blower.

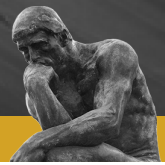
Central banks found that their traditional policy instruments were ineffective as the banks tottered in the autumn of 2008. They resorted to more potent weapons: dramatic cuts in interest rates, the creation of money through the process known as quantitative easing; inducements to persuade banks to lend; forward guidance on the expected path of interest rates to reassure individuals and companies that the cost of borrowing would stay low.

There was no 1930s-style slump and the global economy bottomed out around six months after the collapse of Lehman Brothers in September 2008. But recovery was slow by historical standards and the global economy has displayed signs of being addicted to the stimulants provided by central banks.

All of them will be under scrutiny in 2014 as the world's central bankers seek a way of getting the balance right in continuing to support activity without sowing the seeds of another asset bubble.

Get it right and the reputation of the Fed, the ECB, the Bank of England, the Bank of Japan (BoJ) and the People's Bank of China (PBoC) will be burnished. Get it wrong and the history books will look back on the crisis and its aftermath as the years when central banks lost the plot and saw their credibility shattered....

*** UK GUARDIAN / [LINK](#)



Rise in Total Gov't Debt Means Change Is Needed

Three months after an official audit of government debt was completed, the results have finally been announced. As of June 30, the total debt held by the central and local levels of government has reached 30.3 trillion yuan. Of that, local governments were 17.9 trillion yuan in the red.

This is the third time the National Audit Office has surveyed government liabilities. The survey was the work of some 544,000 auditors across the country. It was performed in August and September, and a report was given to the State Council, the country's cabinet, in mid-October. Suspicion had mounted about how horrible the figures were considering it took so long for the government to publish them.

Experts, especially those from overseas institutions and academia, tended to be pessimistic in their estimates of total local government debt, guessing the figure would be 18 to 25 trillion yuan. Chinese government officials and affiliated institutions were generally more sanguine, estimating it to be between 15 and 20 trillion yuan.

The audit results show that local government debt pretty much fell in between the two. The central government's debt was much closer to expectations due to its relative transparency.

Still, some skeptics say the audit office may have tweaked the figures to ease the blow.

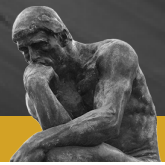
The latest survey employed the same techniques and the same definition of government debt as previous ones, but it was more thorough and comprehensive, reflecting most accurately the condition of government liabilities.

A breakdown of its result shows that the total debts of governments at the county and township levels were only 364 billion yuan as of June 30, far below expectations of 2 trillion yuan. Most of the debtors are rural credit cooperatives, private businesses and individuals.

Since 2007, the central government has been gradually alleviating government debt at the grassroots level on items including compulsory education and rural medical care. This contributed to reducing debt burdens.

Despite this, local government debt rose by 6.8 trillion yuan in merely 30 months, even though harsh policies restricted borrowing. That was rapid expansion. In particular, direct liabilities held by local governments increased by 3.9 trillion yuan in that period to 10.6 trillion yuan.

This year, the budgeted income for all local governments is expected to reach 6.7 trillion yuan. That means the ratio of their direct liabilities to income would be 158 percent. This alone is a strong argument that the central government's measures for controlling local government debt during the past three years have not been effective.



While most attention is focused on local government debt, the liabilities of the central government are also a big concern. As of the end of June, the central government's direct liabilities were 9.8 trillion yuan, up 370 billion yuan from the end of 2012. Meanwhile, the growth of its tax income has slowed. With an expected income of 6.2 trillion yuan this year, the central government's direct liability ratio is also as high as 158 percent.

The audit results also shed light on how heavy a burden the interest payments required by existing loans are for the government. Assuming interest rates of 3 to 7 percent, the direct liabilities held by the central and local levels of government – which totaled 20.7 trillion yuan – would require 620 billion yuan to 1.45 trillion yuan in interest payments. That would amount to 5 to 11 percent of the country's tax income. This means a loss in the financial resource available for social welfare programs.

Even though the total amount of government debt seems to be under control, officials can wait no longer to stem the growth. We need a more fundamental solution to controlling debt risk because previous measures have failed.

The Communist Party's Organization Department, which handles personnel matters, said in a document released on December 9 that the performance evaluation of officials would take into account government debt conditions. The annual course-setting Central Economic Work Conference also emphasized the need to prioritize controlling and finding a solution to local government debt.

A clear understanding of the debt's size and type would be the foundation for all other work. Including debt in the criteria used to assess officials would pin the obligations of a loan to whoever borrowed it.

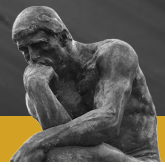
Such a mechanism would go straight to the heart of the problem in a system where bureaucrats answer to higher bureaucrats. But whether it can be effective depends on the weight of debt in the evaluation formula and how long the policy can be enforced....

*** CAIXIN / [LINK](#)

IMF paper warns of "savings tax" and mass write-offs as West's debt hits 200-year high

Much of the Western world will require defaults, a savings tax and higher inflation to clear the way for recovery as debt levels reach a 200-year high, according to a new report by the International Monetary Fund.

The IMF working paper said debt burdens in developed nations have become extreme by any historical measure and will require a wave of haircuts, either negotiated 1930s-style write-offs or the standard mix of measures used by the IMF in its "toolkit" for emerging market blow-ups.



"The size of the problem suggests that restructurings will be needed, for example, in the periphery of Europe, far beyond anything discussed in public to this point," said the paper, by Harvard professors Carmen Reinhart and Kenneth Rogoff.

The paper said policy elites in the West are still clinging to the illusion that rich countries are different from poorer regions and can therefore chip away at their debts with a blend of austerity cuts, growth, and tinkering ("forbearance").

The presumption is that advanced economies "do not resort to such gimmicks" such as debt restructuring and repression, which would "give up hard-earned credibility" and throw the economy into a "vicious circle".

But the paper says this mantra borders on "collective amnesia" of European and US history, and is built on "overly optimistic" assumptions that risk doing far more damage to credibility in the end. It is causing the crisis to drag on, blocking a lasting solution. "This denial has led to policies that in some cases risk exacerbating the final costs," it said.

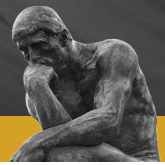
While use of debt pooling in the eurozone can reduce the need for restructuring or defaults, it comes at the cost of higher burdens for northern taxpayers. This could drag the EMU core states into a recession and aggravate their own debt and ageing crises. The clear implication of the IMF paper is that Germany and the creditor core would do better to bite the bullet on big write-offs immediately rather than buying time with creeping debt mutualisation.

The paper says the Western debt burden is now so big that rich states will need same tonic of debt haircuts, higher inflation and financial repression – defined as an "opaque tax on savers" – as used in countless IMF rescues for emerging markets.

"The magnitude of the overall debt problem facing advanced economies today is difficult to overstate. The current central government debt in advanced economies is approaching a two-century high-water mark," they said.

Most advanced states wrote off debt in the 1930s, though in different ways. First World War loans from the US were forgiven when the Hoover Moratorium expired in 1934, giving debt relief worth 24pc of GDP to France, 22pc to Britain and 19pc to Italy....

*** UK DAILY TELEGRAPH / [LINK](#)



When the Giants Unwind

China and the United States, the primary sources of economic stimulus since 2008, will begin to unwind their stimulus in 2014. The Fed's announcement of its first reduction in quantitative easing and China's rising interbank interest rate are signals of what is to come. The main driver for the unwinding is concerns of bubbles, not that economies are strong enough.

Unwinding stimulus, especially one so large and prolonged, is fraught with unintended consequences. Bubbles tend to pop, not deflate slowly. Even though authorities are calibrating their tightening steps carefully to achieve a smooth landing, financial turmoil due to a bubble bursting is possible, which may drag the global economy into another recession.

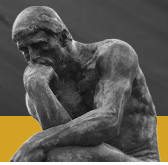
Even if no financial turmoil emerges, some assets are likely to come under strong pressure. The economies that depend on commodity exports and/or hot money to plug their current accounts may see their currencies under more pressure. The Australian dollar and Brazilian real are highly vulnerable. The Indian rupee is another weak currency. The Canadian dollar and Russian ruble may come under pressure too.

After the 2008 financial crisis broke out, I predicted widespread monetary and fiscal stimulus all around, and such stimulus wouldn't bring back sustainable and sound growth, eventually leading to another crisis. I also predicted that stimulus advocates will blame the failure on insufficient stimulus. My predictions are halfway there. Another financial crisis will make them whole.

The magnitude of the United States' stimulus could be measured by national debt rising from 62 percent to 100 percent of GDP and the Federal Reserve's balance sheet more than tripling from 2007 to 2013. The impact on asset prices is reflected by a 60 percent increase in household wealth from the crisis low and 21.4 percent above the 2007 peak — a level considered a bubble that led to the 2008 financial crisis. During the same period the U.S. economy has expanded by 6 percent in real terms and 15.8 percent in nominal terms. The current level of total employment is still below the pre-crisis level. It is obvious that the U.S. stimulus policy has had an outsized impact on asset prices and small one on the real economy or employment.

Why would the Fed decrease its QE while the economy is far from healthy? When the Fed first sounded its tightening warning in June, I argued that it was trying to manage an asset bubble. Before 2008, property appreciation was driving the U.S. bubble. Financial markets have been doing the job since. It appeared that the U.S. stock market was ready to spike like in early 2000 when the Fed sounded its warning. The market consolidated afterward. But, when the Fed backed off in September, it went on a tear again. When the Fed took its first step in December, it was viewed as too small to have an impact. The market has continued its rally. The S&P 500 rose by 30 percent in 2013. It remains to be seen if the Fed could prevent a rerun of 2000: the market surges in the first quarter of 2014 and falls sharply afterward.

China's stimulus, mainly through lowering the credit standard, led to a 175 percent increase in M2 from 2007 to 2013. The main growth consequences are a 61 percent increase in electricity production and an 82 percent increase in nominal dollar exports.



While the growth data are still impressive, they are small in comparison to monetary growth. If such a relationship persists, hyperinflation is likely. Further, the growth numbers have come down in the past two years, while monetary growth has slowed less. The trend suggests that the effectiveness of monetary stimulus is declining. Hence, achieving the same growth target brings a higher inflation rate.

The growth dynamic in the past five years depends on local governments borrowing money to spend. The declining effectiveness of monetary growth reflects the same declining efficiency in local government expenditure. The growth dependency on local government spending is tied up with property speculation. As excessive monetary growth triggers inflation expectations, money has poured into land and property. As local governments control all the land supply, they have been able to raise revenues from selling land and borrowing money with land as collateral. These two are the main channels for money supply to turn into expenditure.

Neither China nor the United States has built a sustainable growth dynamic with stimulus. As the stimulus side effects – bubbles and rising leverage – become the main show unwinding stimulus becomes urgent. This is why both countries are likely to take tightening steps....

*** CAIXIN, ANDY XIE / [LINK](#)

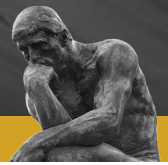
Welcome to the great European fire sale

For a non-EU citizen with dreams of the good life and a few million in the bank, 2014 could be a good year. First, snap up Maltese citizenship, and thus a European Union passport, for €1.15m (£960,000). Then splurge on a former cardinal's villa in Italy as the principle residence. For a fairytale winter getaway, Polish castles are going for a song. And what could be better for a summer bolt-hole than a Greek archipelago, a snip at €8.5m?

Europe's fire sale, which began as the economic crisis forced governments to find innovative ways to plug holes in their dwindling budgets, has reached new heights as ever-more intriguing state assets are touted for sale.

But a backlash is brewing, with governments and enraged citizens clashing over exactly who has the right to flog a nation's history and culture.

The Maltese passport bonanza has provoked public outcry and forced the government to rethink its plans. Outraged locals have scuppered the sale of an Italian island to a businessman from New Zealand. Even if governments can overcome political opposition to "selling the family silver", the privatisation expert Professor William Megginson says they face an array of hurdles ranging from a simple lack of interest in unattractive state assets to hazy ownership rights.



Dr Megginson, a professor of finance at the University of Oklahoma and a former advisor to the Italian government's privatisation committee, says: "In Greece's case they have had a few sales but they have fundamental problems that the assets they could logically sell – land – they don't even have an accurate land registry. It's not clear who owns land to sell. At a superficial level it sounds great, but there are real political problems with selling off bits of your country."

While there has so far been no great surge in privatisation in post-crisis Europe, there have been some headline-grabbing sales, particularly in hard-hit Greece. In May, a month before he abdicated in favour of his son, the Emir of Qatar, Hamad bin Khalifa Al Thani, bought six islands in the Ionian Sea – which were already in private hands – for €8.5m. The sale was considered a bargain for the Emir, who is reported to be building a luxurious retreat for his three wives and 24 children, and has raised hopes of a mini-gold rush in the region.

Italian authorities looking to line their coffers by selling an island or two may not have it so easy. In October a New Zealand businessman, Michael Harte, spent €2.9m on Budelli Island, a national park fringed with pink sand beaches just off the coast of Sardinia. He said he wanted to preserve it, but environmentalists were outraged. They collected 85,000 signatures urging a U-turn, and the government is now considering buying the island back.

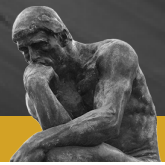
Italy could face similar hurdles with dozens of historic properties it plans to put under the hammer in the coming months. Austerity budgets have meant less money for the upkeep of state-owned sites, leaving many abandoned or in disrepair. For big tourist draws such as Rome's Colosseum and the Rialto Bridge in Venice, the government hit upon the idea of letting well-heeled fashion companies film advertisements at the sites in exchange for cash for repairs.

But for less illustrious sites an alternative plan was needed. The Local, a website covering Italian news in English, reported last month that 50 such properties were to be auctioned to raise €500m towards repaying Italy's national debt. They include the castle where the actors Tom Cruise and Katie Holmes were married, a former prison colony, and Villa Mirabellino, an 18th century former cardinal's residence in Lombardy.

While the authorities argue that such sales are the only way to preserve crumbling historic monuments, others are aghast at national treasures falling into private hands, and locals have launched a campaign aimed at stopping the sale of Villa Mirabellino.

If that campaign succeeds, would-be lords of the manor could instead consider one of 30 state-owned castles that Poland put on the market last year. The *Wall Street Journal* reported in November that the Ministry of Agriculture was preparing another 140 for sale in 2014. Buying them, however, is easier with an EU passport, and this is where Malta may be able to help....

*** THE UK INDEPENDENT / [LINK](#)



Not Fit for the Next Crisis: Europe's Brittle Banking Union

Lawyers are often sharp people, but they sometimes live dangerously – with a tendency to gloat so much that they lose track of what is actually right.

When German Finance Minister Wolfgang Schäuble, a trained lawyer, announced an agreement on Wednesday night in Brussels on the long negotiated EU banking union, observers might have been left thinking that he is precisely this type of lawyer.

On paper, Schäuble and his negotiators are right about very many points. They succeeded in ensuring that in 2016, the Single Resolution Mechanism will go into effect alongside the European Union banking supervisory authority. The provision will mean that failing banks inside the euro zone can be liquidated in the future without requiring German taxpayers to cover the costs of mountains of debt built up by Italian or Spanish institutes.

They also backed the European Commission, which wanted to become the top decision-maker when it comes to liquidating banks. The Commission will now be allowed to make formal decisions, but only in close coordination with national ministers from the member states.

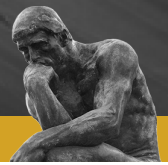
But it goes even farther. Negotiators from Berlin have also created an intergovernmental treaty, to be negotiated by the start of 2014, that they believe will protect Germany from any challenges at its Constitutional Court that might arise out of the banking union.

They also established a very strict "liability cascade" that will require bank shareholders, bond holders and depositors with assets of over €100,000 (\$137,000) to cover the costs of a bank's liquidation before any other aid kicks in. The banks are also required to pay around €55 billion into an emergency fund over the next 10 years. Until that fund has been filled, in addition to national safeguards, the permanent euro bailout fund, the European Stability Mechanism, will also be available for aid. However, any funds would have to be borrowed by a national government on behalf of banks, and that country would also be liable for the loan. This provision is expected to be in place at least until 2026.

The government in Berlin put a strong emphasis on preventing the ESM, with its billions in funding, from being used to recapitalize debt-ridden European banks. Schäuble was alone with this position during negotiations, completely isolating himself from the other 16 finance ministers from euro-zone countries. Brussels insiders report that it was "extremely unusual because normally at least a few countries share Germany's position."

To have succeeded in pushing all this through is a huge victory for the finance minister, particularly given that he was able to do so while he was at the same time defending his own job during coalition talks to form Chancellor Angela Merkel's new government in Berlin.

But is this really the right kind of agreement for Germany and Europe? Schäuble himself said that the compromise would mean a union made of wood rather than steel because it would not be accompanied by any treaty change. But did he spend any time thinking about how brittle several aspects of the deal are?



For one thing, it's complicated. If a bank falls into real trouble, a committee comprised of national banking supervisors and EU representatives will decide on its liquidation. The European Commission has the power to veto the decision. If that happens, then the national finance ministers have the last word. Sound complicated? It is. *The Financial Times* estimates, "In total, the process could involve nine committees and up to 143 votes cast." That's a lot to manage over the weekend's time that might be all that's available to decide on winding down a bank.

For another, it's underfinanced. By 2026, the new banking resolution fund is expected to be filled with a total of €55 billion. But during a deep financial crisis, this sum would get used up quickly. The rescue of a single Irish bank several years back required half that amount. An arrangement that lacks sufficient financing may not be credible on the markets, European Central Bank Vice President Vitor Constancio warned on Wednesday.

It doesn't go as far as its name implies, either. Much of the banking union will remain national. In addition to legacy problems at banks that still exist today, bailing out any new burdens will also largely remain the responsibility of national governments. Indeed, the banking union will initially remain a domestic affair, rendering the use of the word "union" a bit ironic at first....

*** DER SPIEGEL / [LINK](#)

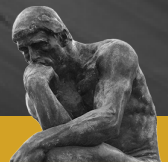
"Chance of a Century": International Investors Flock to Tehran

Daniel Bernbeck has learned that in Tehran there's no point getting worked up about things like the gridlock between Gholhak, his neighborhood in the northern part of the city, and downtown, where his office is located. Here he is again, stuck in traffic, with everyone honking their horns. Tehran is a murderous city, says Bernbeck, even without international sanctions and threats of attack from Israel.

Bernbeck is sitting in a gray SUV. He's a wiry, tall blond man who wears lawyer-like glasses. The only departure from the standard business look is a narrow soul patch on his chin, which suggests a certain degree of individualism. His cell phone rings. Bernbeck's Iranian secretary is on the line. She's expecting him, and the deputy German ambassador has also arrived, along with two investment bankers from London and Hong Kong. They are asking about stock tips for Iran.

"Iranian stocks for Hong Kong?" Bernbeck exclaims with a grin, and then says in his best Farsi: "The same bankers would have said a year ago: You're crazy." Then he asks the driver to hurry up, although it doesn't do any good.

Bernbeck is the head of the German-Iranian Chamber of Industry and Commerce in Tehran. He paves the way for business ties in a country where Western politicians have been trying for decades to make such relationships impossible, especially since 2006.



At the time, the Islamic Republic started to rapidly expand its nuclear program. Intelligence agencies predicted that it would be only a matter of a few years before the Iranians had a nuclear bomb. Arab Gulf states in the region felt threatened, and Israel was determined to go to war with Tehran if a political solution could not be found quickly.

For over five years now, Bernbeck, 50, has been living between these two adversarial worlds, more specifically "on the dark side of Mars, where the cannibals and Holocaust deniers live." Bernbeck says that's how Iran is portrayed in the West.

But his world has become much brighter since Nov. 24. That was the day when the five permanent members of the UN Security Council – plus Germany and Iran – signed a landmark deal in Geneva aimed at turning around the situation within the next six months. According to this agreement, Iran would roll back certain elements of its nuclear program and, in exchange, the West would ease economic sanctions.

Bernbeck believes in this possibility for a peace accord. Suddenly it appears to be there, the "chance of a century" that he has been waiting for, although this opportunity could still be dashed, like in 2005.

Back then, Iran only had a few centrifuges for enriching uranium, and negotiators were close to reaching an agreement that would have frozen its nuclear program at that level. But then the negotiations faltered and US President George W. Bush refused the deal.

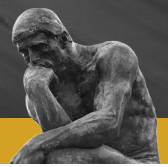
Today, eight years later, Iran has over 19,000 centrifuges. So why should things work out now? Perhaps because this time both sides have made concessions on the issue. The Americans have dropped their absolute demand that the Iranians abandon their entire nuclear program. At the same time, Israel's threats of war and, above all, painful international sanctions have forced the Iranians back to the negotiating table.

For the past three years, there have been virtually no bank transfers between Iran and the outside world, and revenues from oil and gas sales have plummeted. Only the Chinese are still making purchases, but instead of paying in hard currency they are delivering only bulldozers and construction machinery.

The sanctions have paralyzed Iran's economy. But Mohammed Hossein Rafi is one of the many Iranians who simply don't believe that. In fact, he says, the sanctions have only served to make his proud country even stronger.

Rafi ranks among the country's conservatives, the hardliners, the old faithful followers of Ayatollah Khomeini. He is sitting in the Iranian Artists' Cafe, and like most former revolutionaries, he wears his beard neatly trimmed around the chin. He keeps his cashmere coat on during the interview....

*** DER SPIEGEL / [LINK](#)



Great dollar rally of 2014 as Fukuyama's history returns in tooth and claw

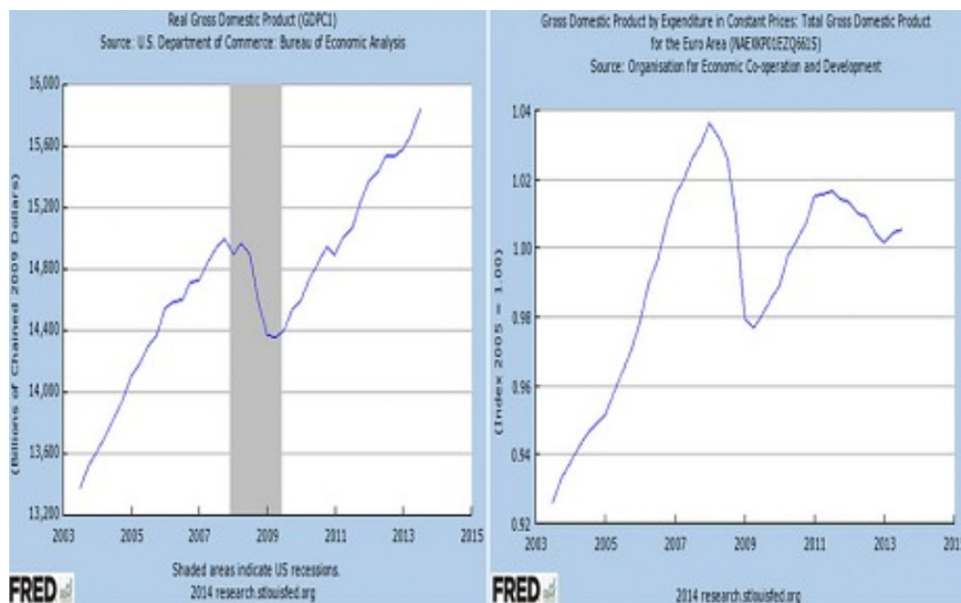
We enter the year of the all-conquering US dollar. As the global security system unravels — with echoes of 1914 — the premium on the world's safe-haven currency must rise.

The effect is doubly powerful since the US economy is simultaneously coming back to life. America has shaken off the most drastic fiscal tightening since the Korean War, thanks to quantitative easing. Growth is near "escape velocity" — at least for now — at a time when half of Europe is still trapped in semi-slump and China is trying to cool the world's most dangerous credit boom.

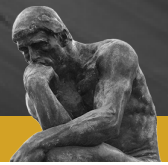
As the Fed turns off the spigot of dollar liquidity, it will starve the world's dysfunctional economy of \$1 trillion a year of stimulus. This will occur through the quantity of money effect, hitting in a series of hammer blows, regardless of whether interest rates remain at zero. The Fed denies that this is "tightening", and I have an ocean-front property to sell you in Sichuan.

It is hard to imagine a strategic and economic setting more conducive to a blistering dollar rally, a process that will pick up speed as yields on 10-year US Treasuries break through 3pc.

The annual rite of new year predictions is never easy. It is nigh impossible in the midst of a global regime change with so many political bombs primed to go off at any moment.



In case you had forgotten, China has imposed an Air Defence Identification Zone (ADIC) covering the Japanese-controlled Senkaku islands. The purpose of this escalation in the East China Sea is to test US willingness to back its military alliance with Japan, just as Kaiser Wilhelm provoked seemingly petty disputes with France to test Britain's response before the First World War.



The ploy has been successful. The US has wobbled, wisely or not depending on your point of view. While American airlines comply, Japanese airlines fly through defiantly under orders from Japan's leader Shinzo Abe. Mr Abe has upped the ante by visiting Tokyo's Yasukuni Shrine — the burial place of war-time leader Tojo — in a gesture aimed at Beijing.

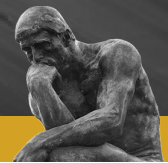
Asia's two great powers are on a quasi-war footing already, one misjudgement away from a chain of events that would shatter all economic assumptions. It would leave America facing an invidious choice: either back Japan, or stand aloof and let the security structure of East Asia disintegrate.

Trade this if you wish. The Dow Aerospace and Defense index (ITA), featuring the likes of Raytheon and Lockheed Martin, has risen 60pc over the past year, compared with 29pc for Wall Street's S&P 500.

Fuji Heavy Industries (robotics) is up almost 200pc this year in Tokyo, and Yamaha (also robotics) has doubled. Equities are pricing in rearmament. Japan raised spending on military equipment by 23pc last year....

The US is stepping back from the Middle East, leaving the region to be engulfed by a Sunni-Shia conflict that resembles Europe's Thirty Years War, when Lutherans and Catholics battled for supremacy. Sunni allies are being dropped, Shia Iran courted. Even Turkey risks succumbing, replicating Syria's sectarian fault lines....

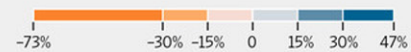
*** UK DAILY TELEGRAPH / [LINK](#)



Charts That Make You Go *Hmmm...*

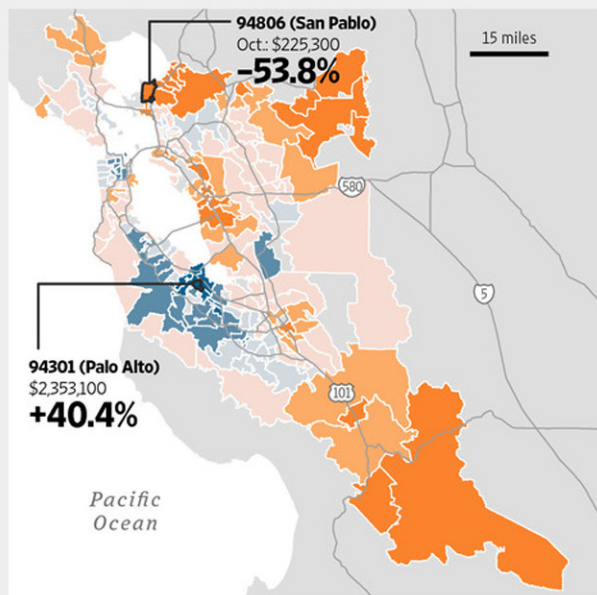
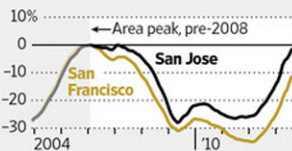
Metropolitan Divisions

Difference from the pre-2008 peak in each ZIP Code in the median home value



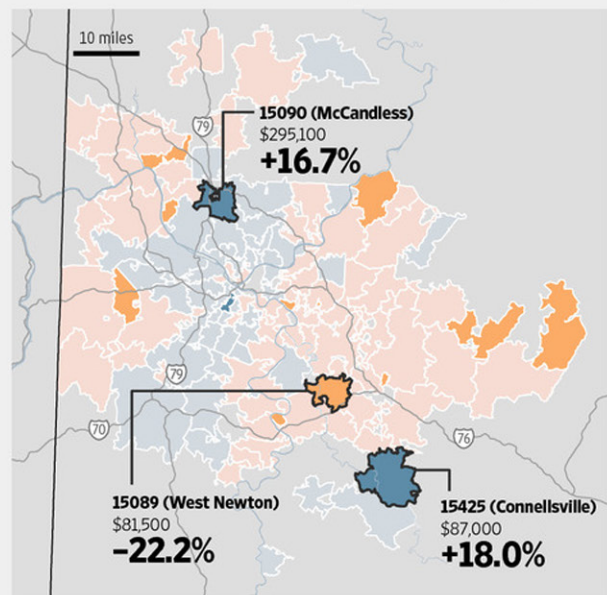
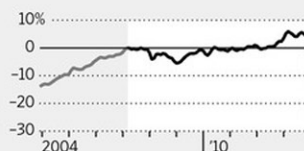
BAY AREA

Affluent Silicon Valley has fared well, while values in more distant suburbs hit hard by foreclosures remain depressed.



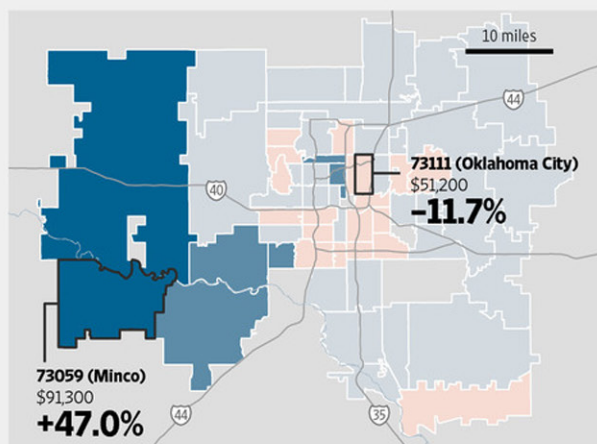
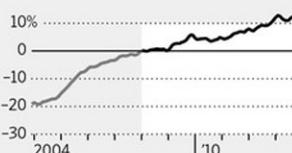
PITTSBURGH METRO

Pittsburgh had little home price boom and bust, and much of the metro area has recovered from any 2008 declines.



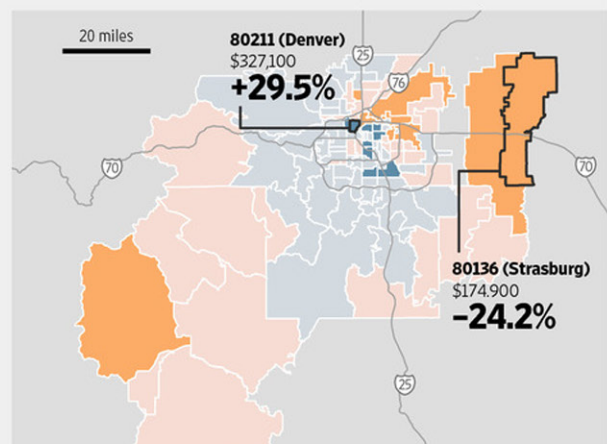
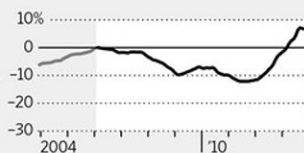
OKLAHOMA CITY METRO

It mostly escaped the housing downturn, as population and job growth have fueled steady gains.



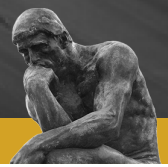
DENVER METRO

The region was among the first where prices fell, but low supplies of homes for sale in many areas have helped push prices to new highs.

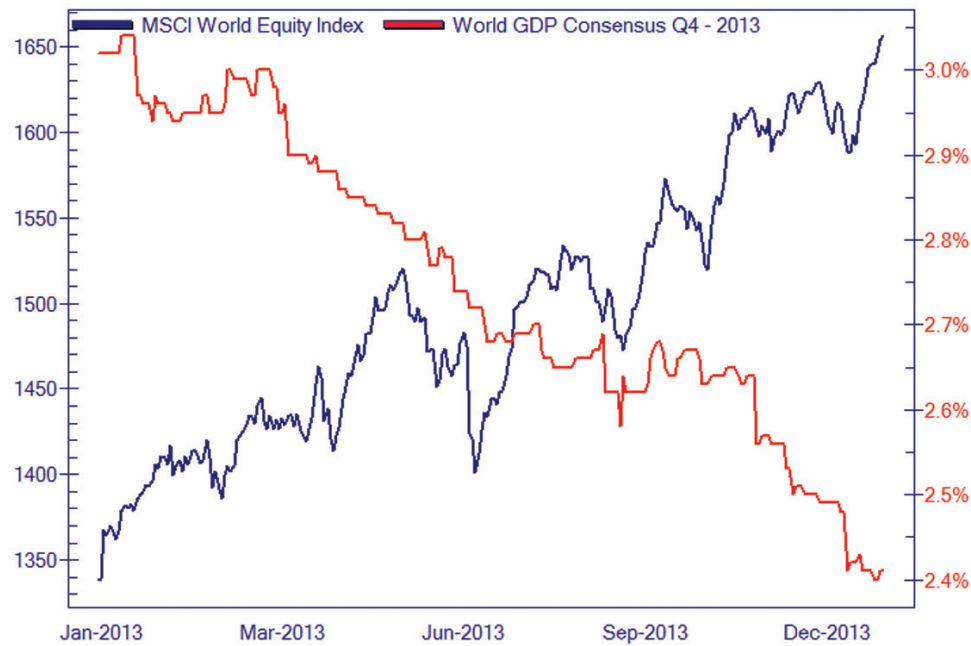


Source: Zillow Home Value Index reflecting the median home value estimate

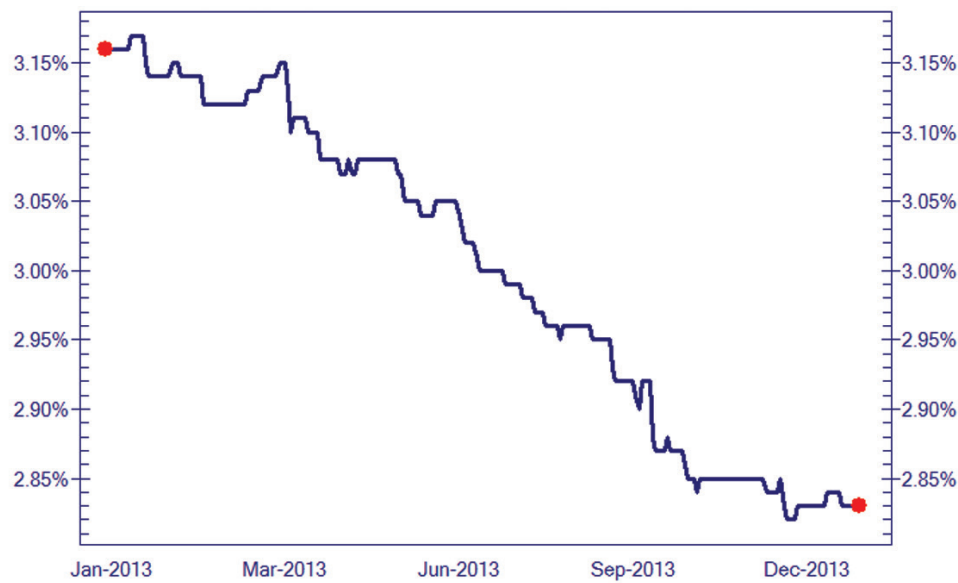
The Wall Street Journal



2013 Stock Prices vs. Economic Growth Expectations



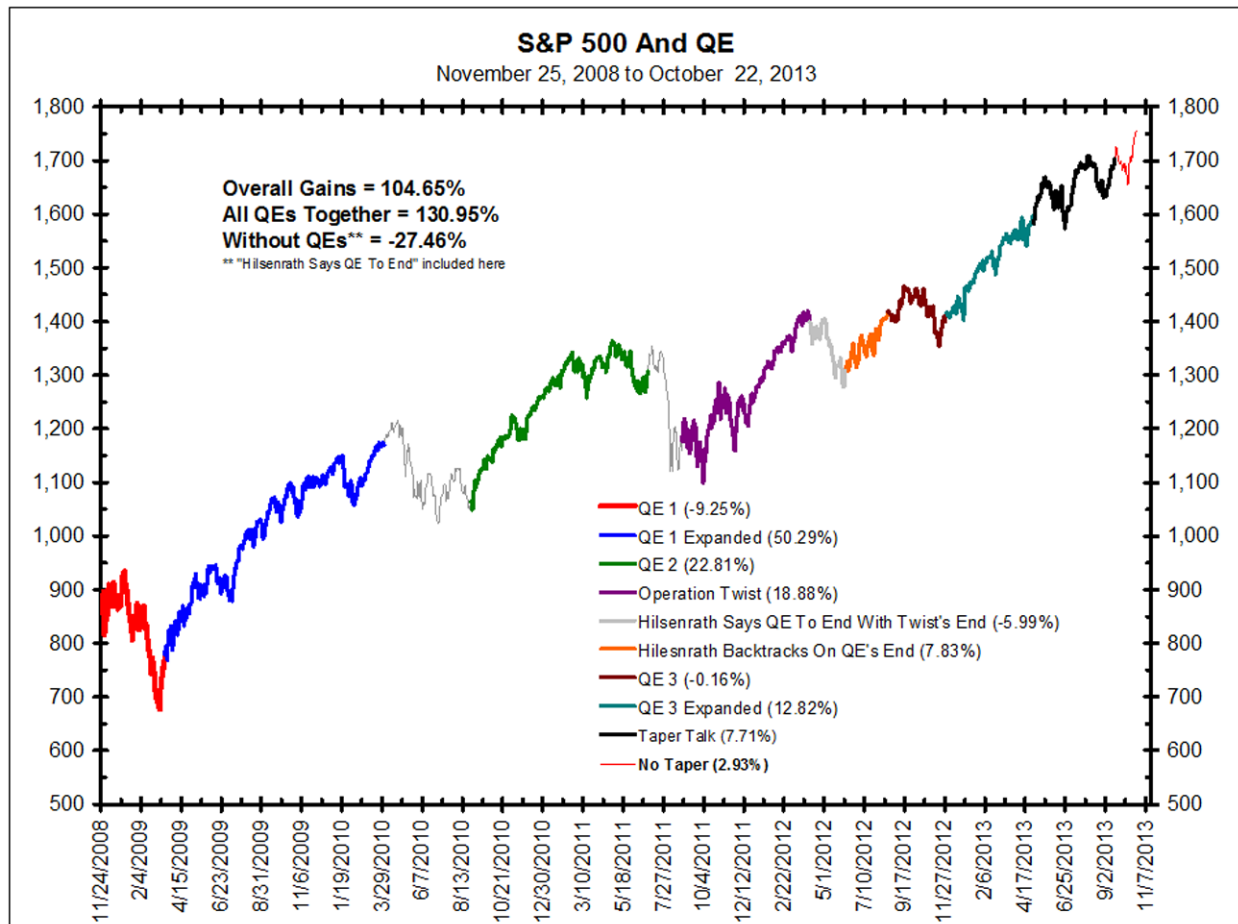
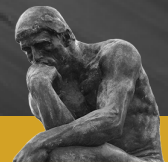
World GDP Economic Forecast 2014



Data: Bloomberg

[Source: Not Jim Cramer \(via ZeroHedge\)](#)

No need for any explanation from me. These charts from Not Jim Cramer do all the talking on their own.



Source: Forbes (via Barry Ritholtz)

Here is the most important factual find about the stock market I've learned for some many years: More than 100% of equity market gains since January 2009 have taken place during the weeks the Fed purchased Treasury bonds and mortgages.

And conversely, during the weeks when the Fed did NOT buy Treasuries or mortgage backed bonds, the stock market declined. Can you beat that? Credit to Michael Cembalest, Chairman of Market and Investment Strategy for J.P. Morgan Asset Management, for that extraordinary discovery.

Stunning, isn't it, that you owe outgoing Fed chairman Ben Bernanke for making you whole on your portfolio since the Great Recession ended. Get down on your knees tonight and pray that his successor, Janet Yellen, will need to keep purchasing bonds and mortgage securities to keep interest rates low and asset prices moving higher. That's the short-term blessing that realistically must be phased out sooner or later. Maybe later as a result of the debt ceiling crisis we just experienced and its ramifications for the U.S. economy...

*** FORBES / [LINK](#)



Words That Make You Go *Hmmm...*



[CLICK TO WATCH](#)

... and then there's this.

Former MPC member Adam Posen explains to Tom Keane why everybody should just chill out about the unwind of the trillions in stimulus created by the world's central banks.

Nothing to worry 'bout folks – this is just a "return to normal."

Oh, and any warm and fuzzy feelings you had about central bankers' attitudes toward gold are officially laid to waste here by Posen, who also offers a laughable analysis of Bitcoin.

Clown.

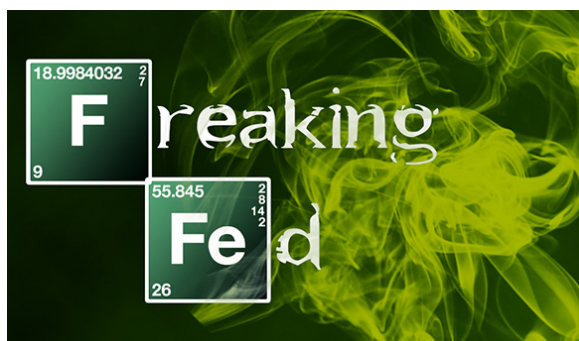
After a lengthy absence from these pages, Jim Rickards is back for the second week running, and this week he turns his attention to gold and shares his thoughts on the disparity between the falling price and dramatically rising demand.

Jim dispels the belief that falling GLD inventory is bearish for gold.

Great stuff...

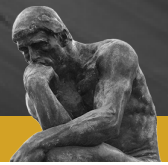


[CLICK TO LISTEN](#)



[CLICK TO WATCH](#)

Last, probably least (and certainly just for fun), here are the closing slides from a presentation I gave in June of this year entitled "*A Confederacy of Dunces*"...



and finally...

News anchor bloopers *are always funny.*

Always.

I can only assume it's because they are trying to be so serious; but either way, when these guys mess up, it's just flat-out funnier than when other people do it.

Here, courtesy of my buddy MB, is a collection of 2013's finest news bloopers (complete with a few juicy expletives, by way of warning for the sensitive amongst you). And of course the man in the picture, AJ Clemente, who became famous this past year for having perhaps the shortest career in media history, features heavily...

Poor guy.

This one's for you, Faizan!



[CLICK HERE TO VIEW BLOOPERS](#)

Hmmm...



Grant Williams

Grant Williams is the portfolio manager of the Vulpes Precious Metals Fund and strategy advisor to Vulpes Investment Management in Singapore – a hedge fund running over \$280 million of largely partners' capital across multiple strategies.

The high level of capital committed by the Vulpes partners ensures the strongest possible alignment between the firm and its investors.

Grant has 28 years of experience in finance on the Asian, Australian, European and US markets and has held senior positions at several international investment houses.



Grant has been writing *Things That Make You Go Hmmm...* since 2009.

For more information on Vulpes, please visit www.vulpesinvest.com.

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YouTube Video Channel: <http://www.youtube.com/user/GWTTMYGH>

ASFA Annual Conference 2013: "[Wizened In Oz](#)"

66th Annual CFA Conference, Singapore 2013 Presentation: "[Do The Math](#)"

Mines & Money, Hong Kong 2013 Presentation: "[Risk: It's Not Just A Board Game](#)"

Fall 2012 Presentation: "[Extraordinary Popular Delusions & the Madness of Markets](#)"

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