

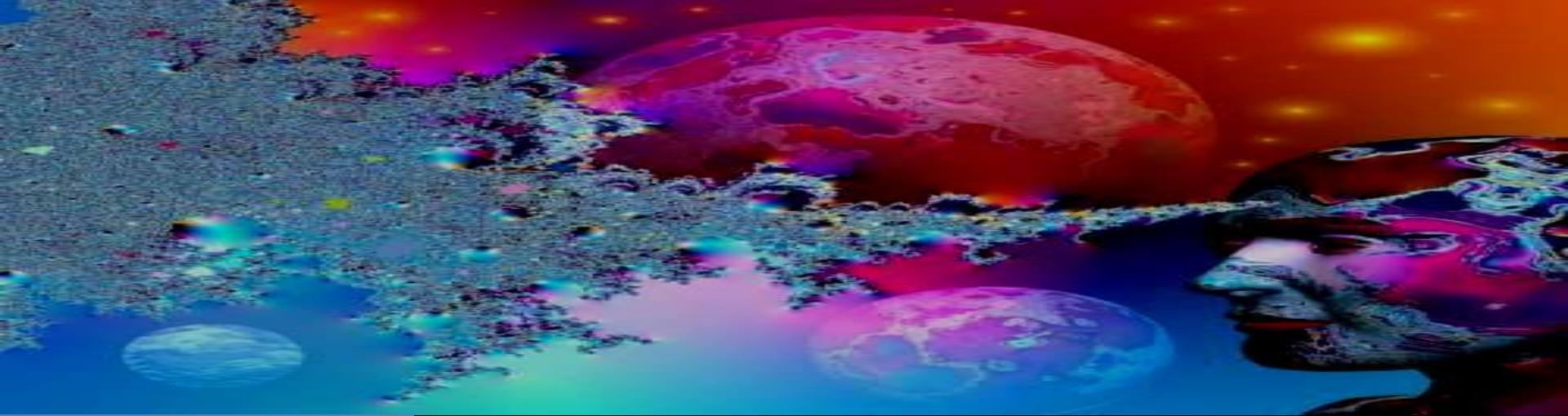
ACCA



Ahlan Wa Sahlan
Welcome

RECAP of 2009 End Presentation

- There are no good choices. If the right thing is done and the deficits are cut, it means very hard choices:
 - Can the Developed World keep its commitments to two wars and its massive defense budget? Medicare and Social Security reform are not painless. Education? Research? The "stimulus"?
 - But cutting the deficit by hundreds of billions while raising taxes by even more than is already in the works, is not the formula for sustainable recovery.
- We are in a deflationary, deleveraging world. A far different world than in the past.
- The markets can remain irrational or complacent for a lot longer than most of us think. It could be years. Or not.
- This is not a prescription for a return to normal growth. We are headed for a New Normal that is less than what the market currently believes.
- Can we Muddle Through? We have no choice but to do so.
- But it will not be fun. It will not be long-term 5% growth and unemployment going down significantly any time soon.
- Can we reverse the course? With a different attitude and leadership, maybe we can. But it won't happen next year, and it's unlikely in 2011.



*e*valuation must be supported by *e*vidence



tutor2u

Macro Matters

A Collection of Thoughts Presentation

Where Knowledge Shared is Knowledge Gained

ACCA CPD Event

15 January 2014

Hamid Hamirani

Mon(k)ey Puzzle



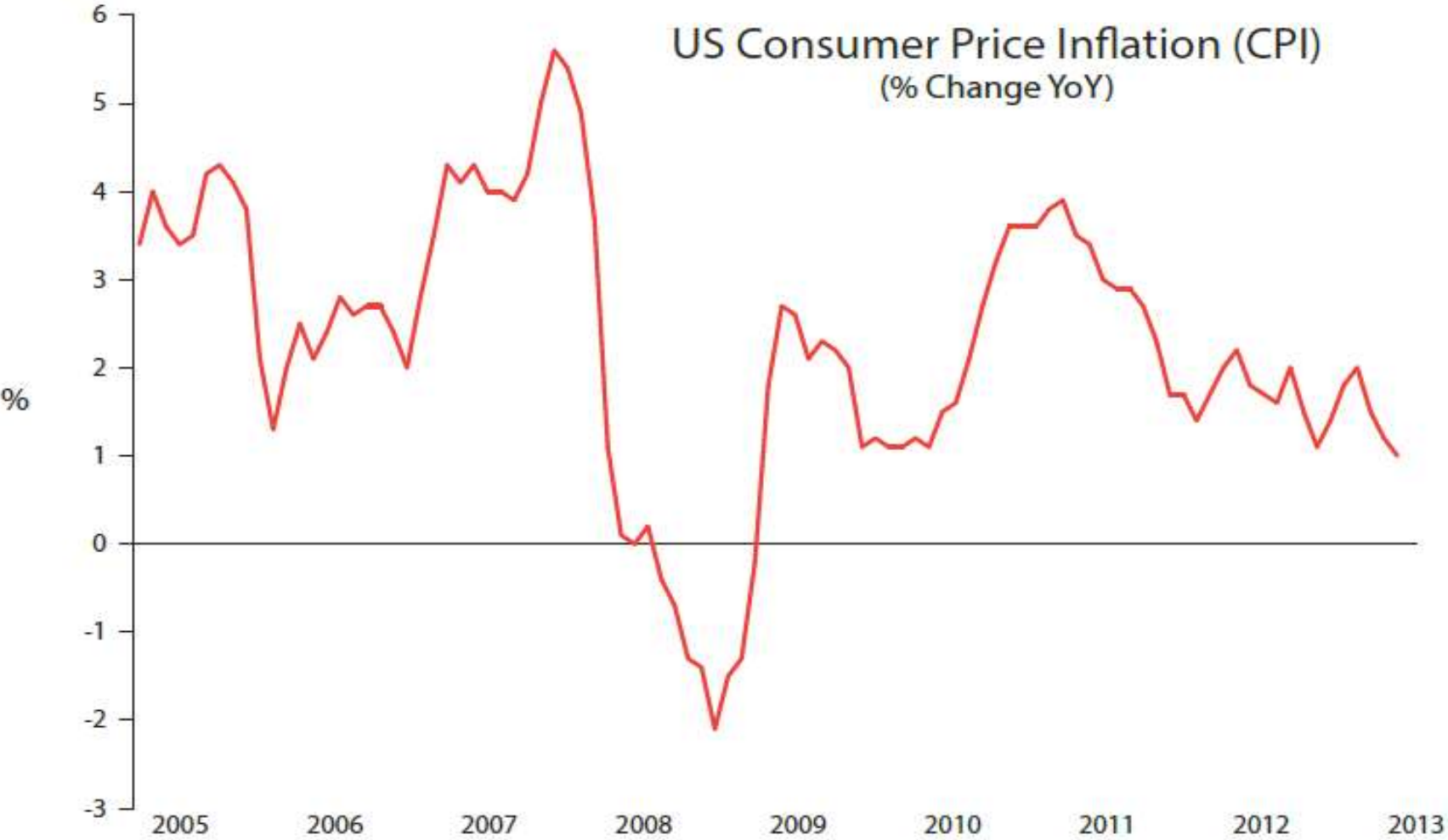
The people on that storm-tossed beach were confronted with something they didn't recognize, and though logic dictated that they ought to investigate further before they took any action, the animal spirits of a group of excitable people ensured that they forgot about clear-headed analysis and did something that their descendants still regret over two centuries later.



CPI on the Wall Street & RPI on the Main Street



CPI on the Wall Street & RPI on the Main Street

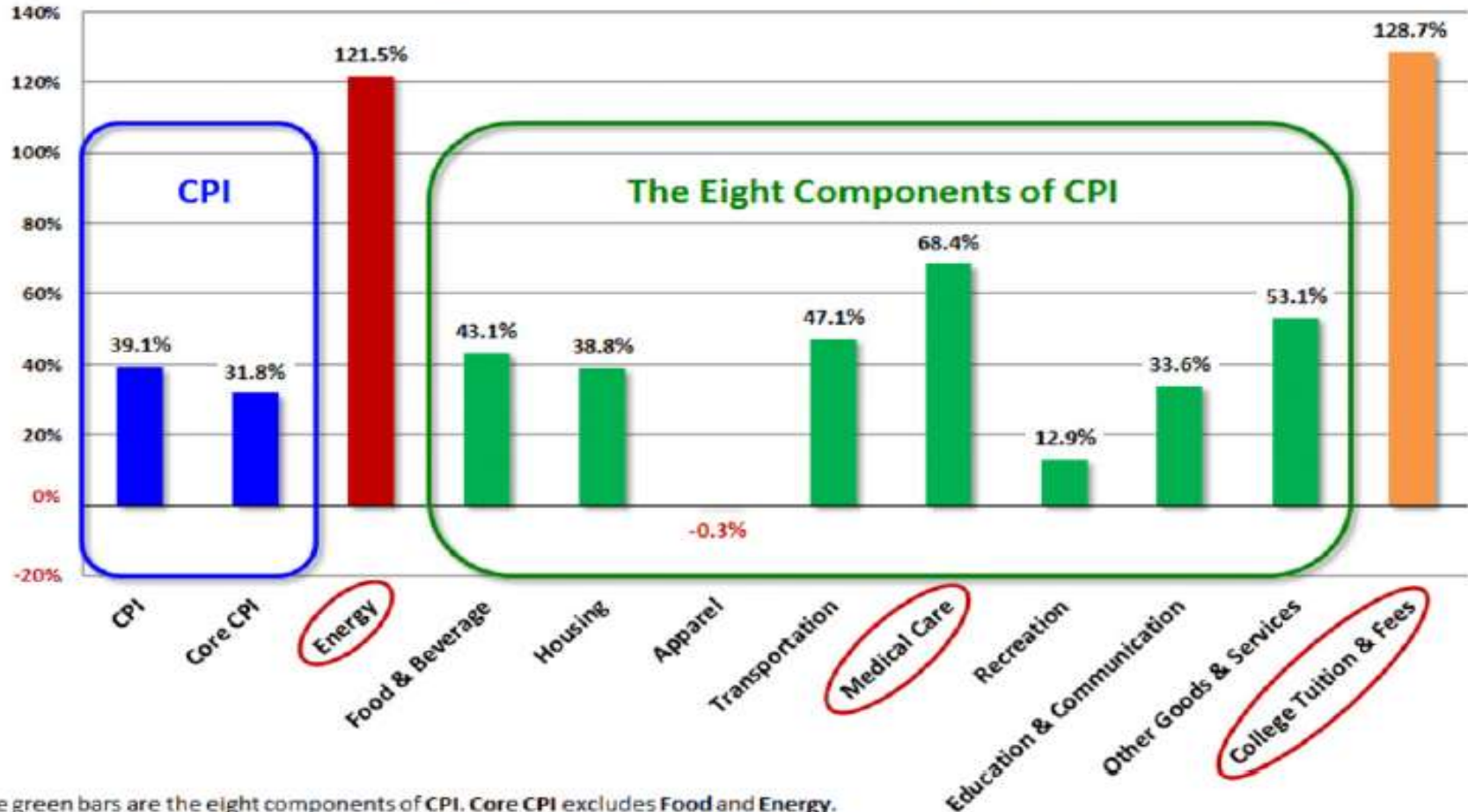


Source: Bloomberg

CPI on the Wall Street & RPI on the Main Street

Inflation Since 2000 Inside the Consumer Price Index

dshort.com
November 2013
Data through October



The green bars are the eight components of CPI. Core CPI excludes Food and Energy. Energy is a major subcomponent of Transportation and a minor subcomponent of Housing. College Tuition & Fees is a subcomponent of Education & Communication.

CPI on the Wall Street & RPI on the Main Street

Consumer Inflation - Official vs ShadowStats (1980-Based) Alternate
Year to Year Change. Through Oct. 2013. (BLS, SGS)



Source: Shadowstats

CPI on the Wall Street & RPI on the Main Street

HAGI Classic Car Top 50 index

220

*Note: index is market cap weighted;
based at 100 in December 2008*

200

180

160

140

120

100

Aug 2010

11

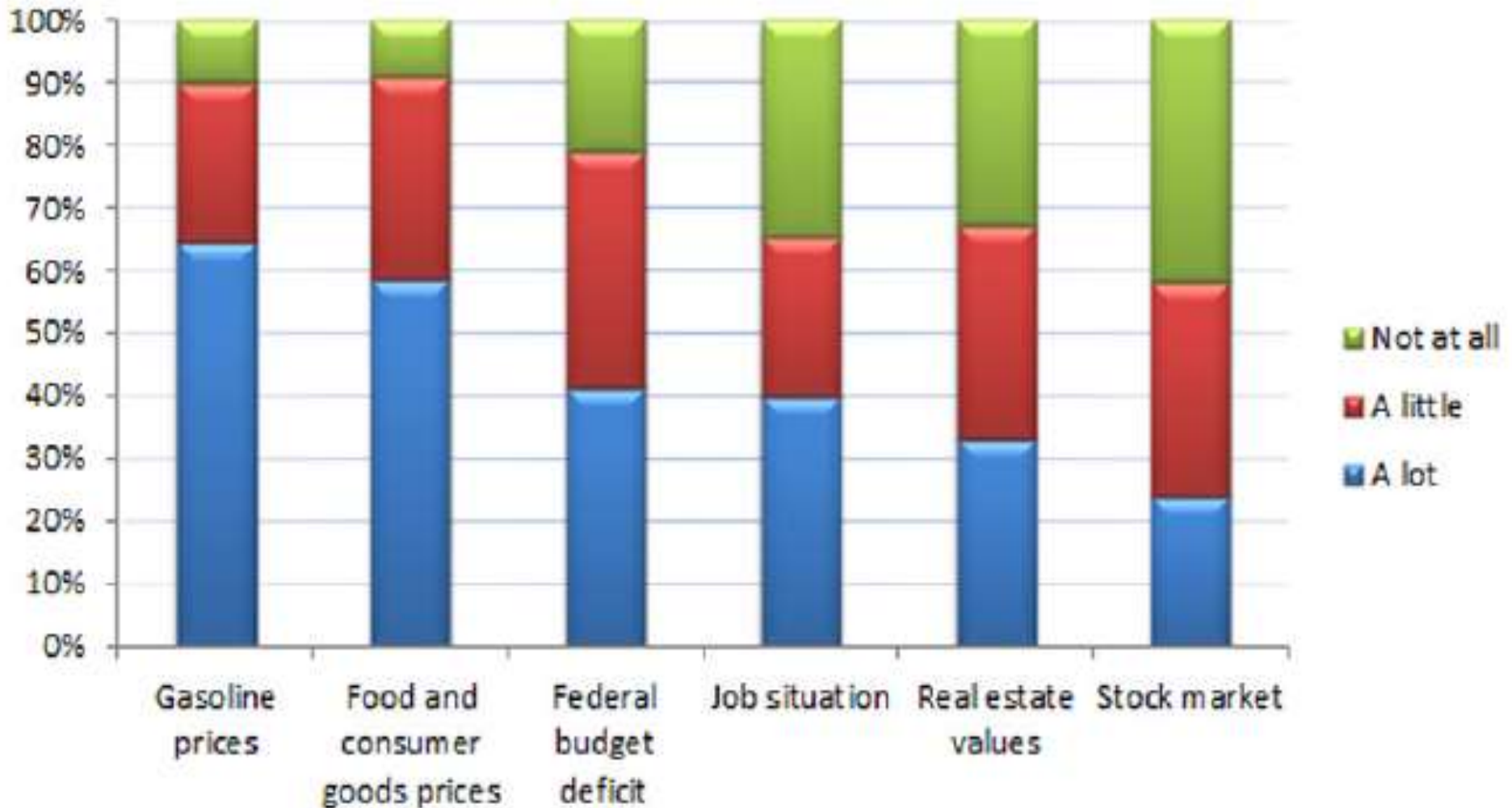
12

Aug 13

Source: Historic Automobile Group International

CPI on the Wall Street & RPI on the Main Street

How much does each affect your own household finances?



BAH-
TAKE IT IN
THE SPIRIT
WITH WHICH
IT'S GIVEN

INTEREST
RATES

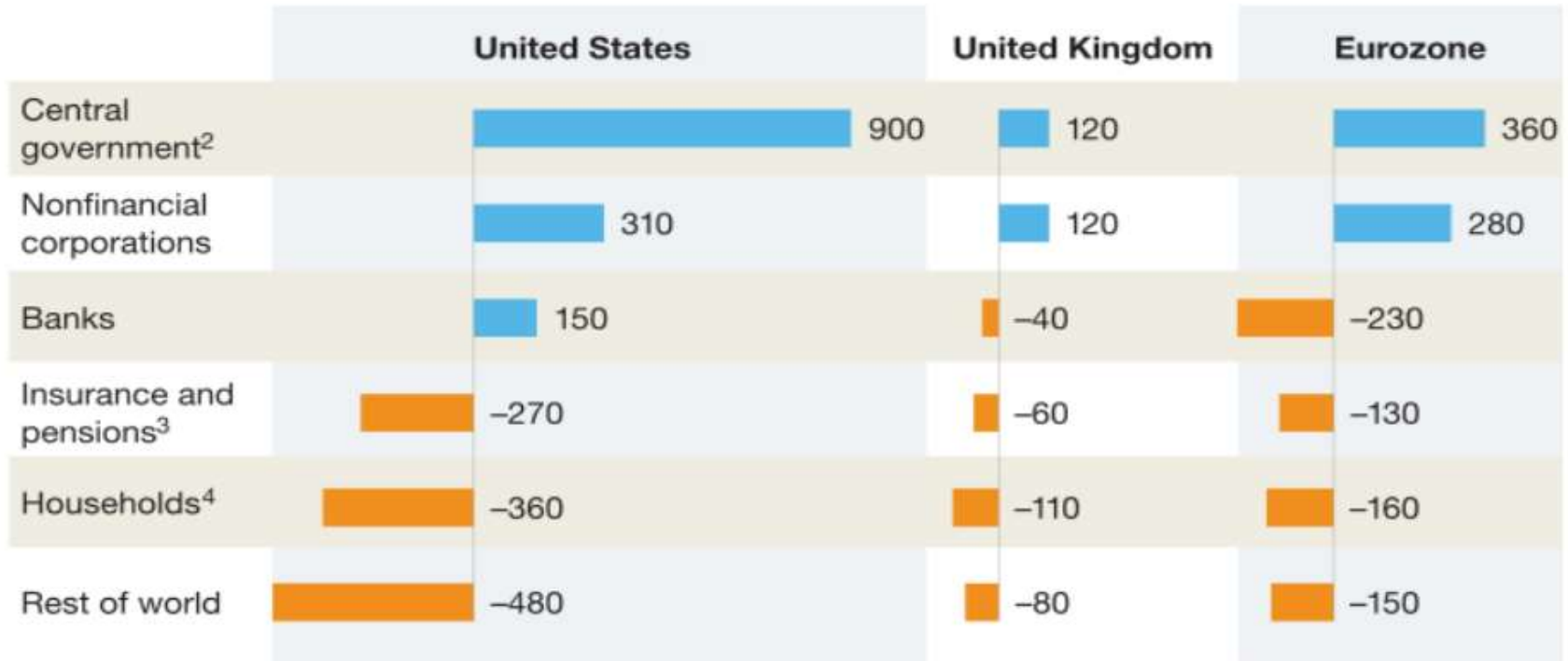
BANK

2/15/00



ZIRP- Cheers for Wall Street Misery for Main Street

Estimated cumulative change in net interest income, 2007–12, \$ billion¹



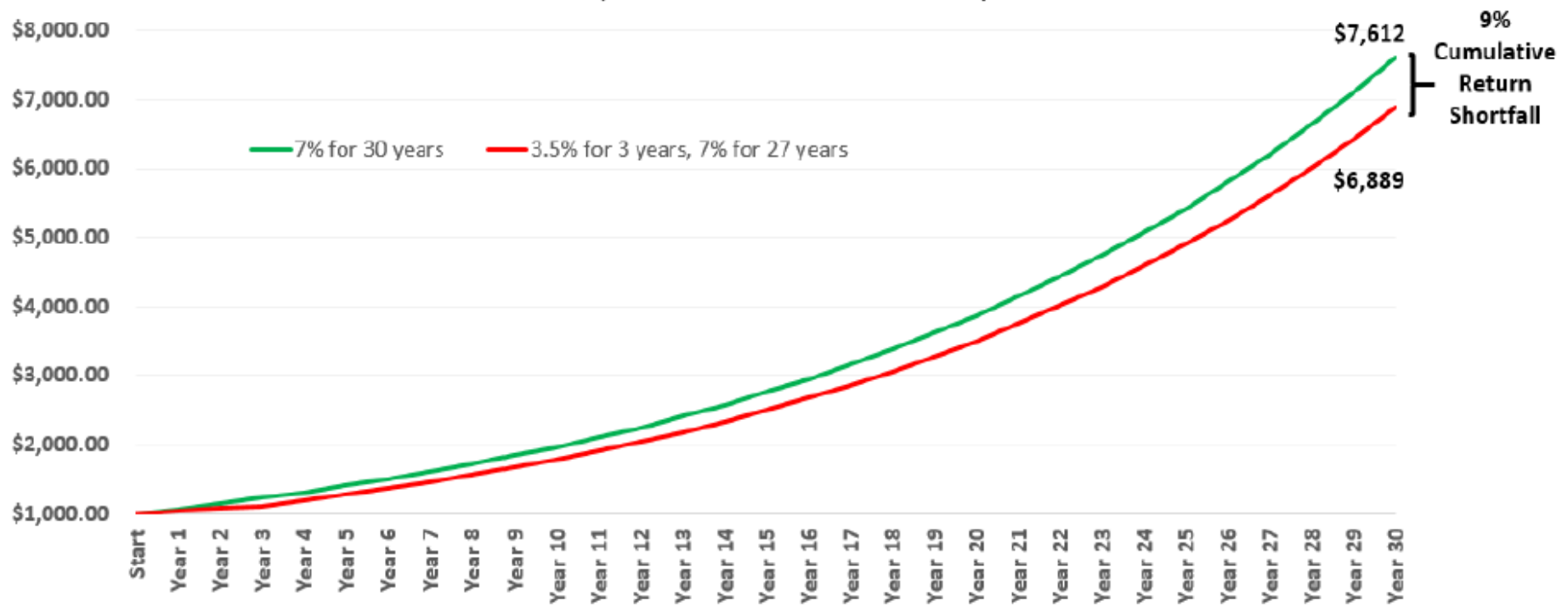
¹At constant 2012 exchange rates.

²Excludes added central-bank profits.

McKinsey estimates that households in the US have lost a cumulative \$360 billion. Meanwhile, banks and businesses have done very well.

ZIRP- Are we borrowing from future generations to finance today's consumption

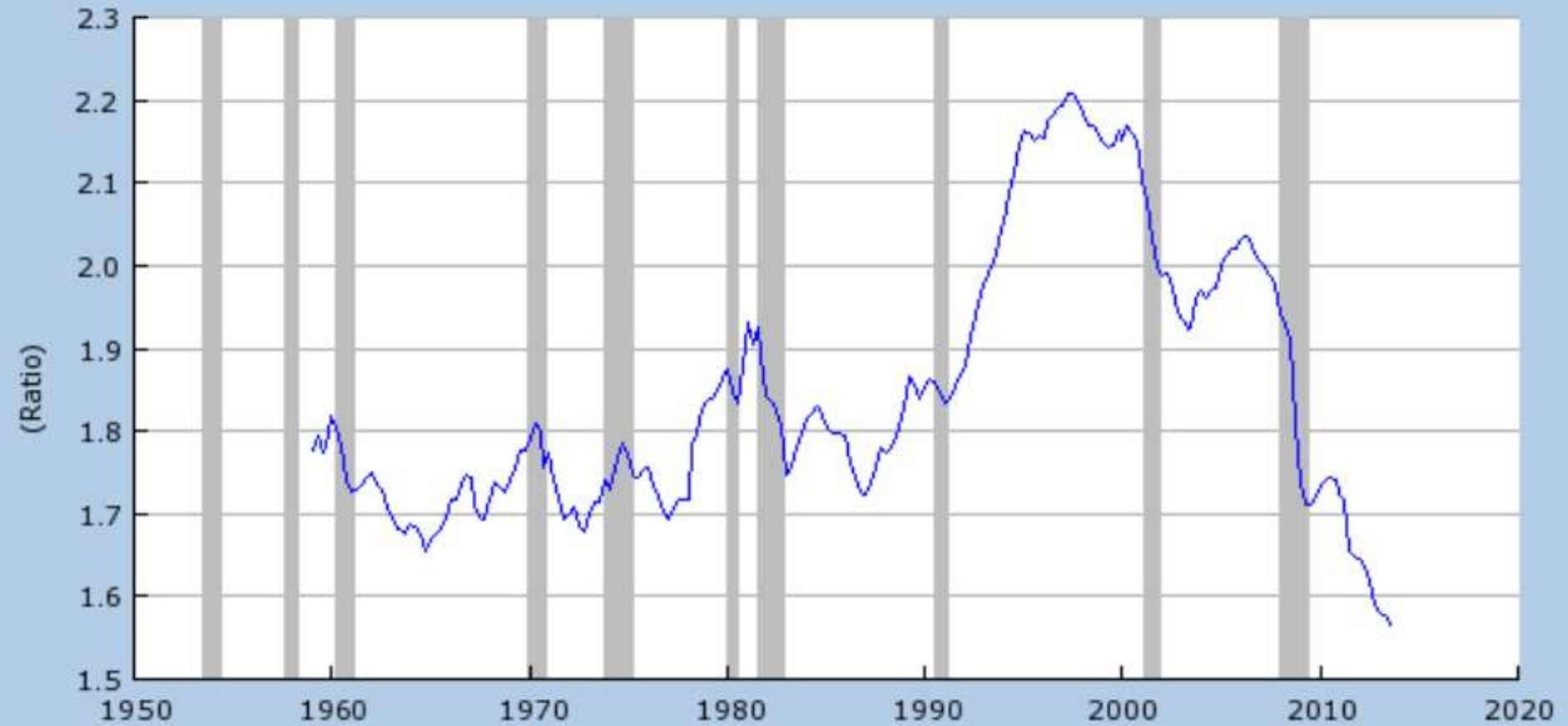
Growth of \$1,000 Over 30 Years - 3 More Years of ZIRP
(Nominal Return Scenarios)



The deficit will need to be financed or the future pensions available will be far less hence effecting future consumption— Are we borrowing from future generations to finance today's consumption

Even After ZIRP The Velocity of Money Remains All Time Low

Velocity of M2 Money Stock (M2V)
Source: Federal Reserve Bank of St. Louis



Shaded areas indicate US recessions.
2013 research.stlouisfed.org



ZIRP - Resulting in Misallocation Of Capital

When interest rates are held lower than the "natural rate of interest," it becomes more efficient for companies and investors to use money for financial transactions such as buying other companies rather than for productive purposes such as increasing capacity and competing for customers and sales.

Why take the risk of competition, which is fraught with problems, when it is so much cheaper to simply borrow money and buy your competition?

There is a reason that so many industries have effectively ended up as duopolies since the advent of low rates 12 years ago.

While ZIRP makes money for those who have access to capital and for those who can sell their assets, it does not create new productive capacity and thus jobs, let alone help to create more efficient markets and pricing.

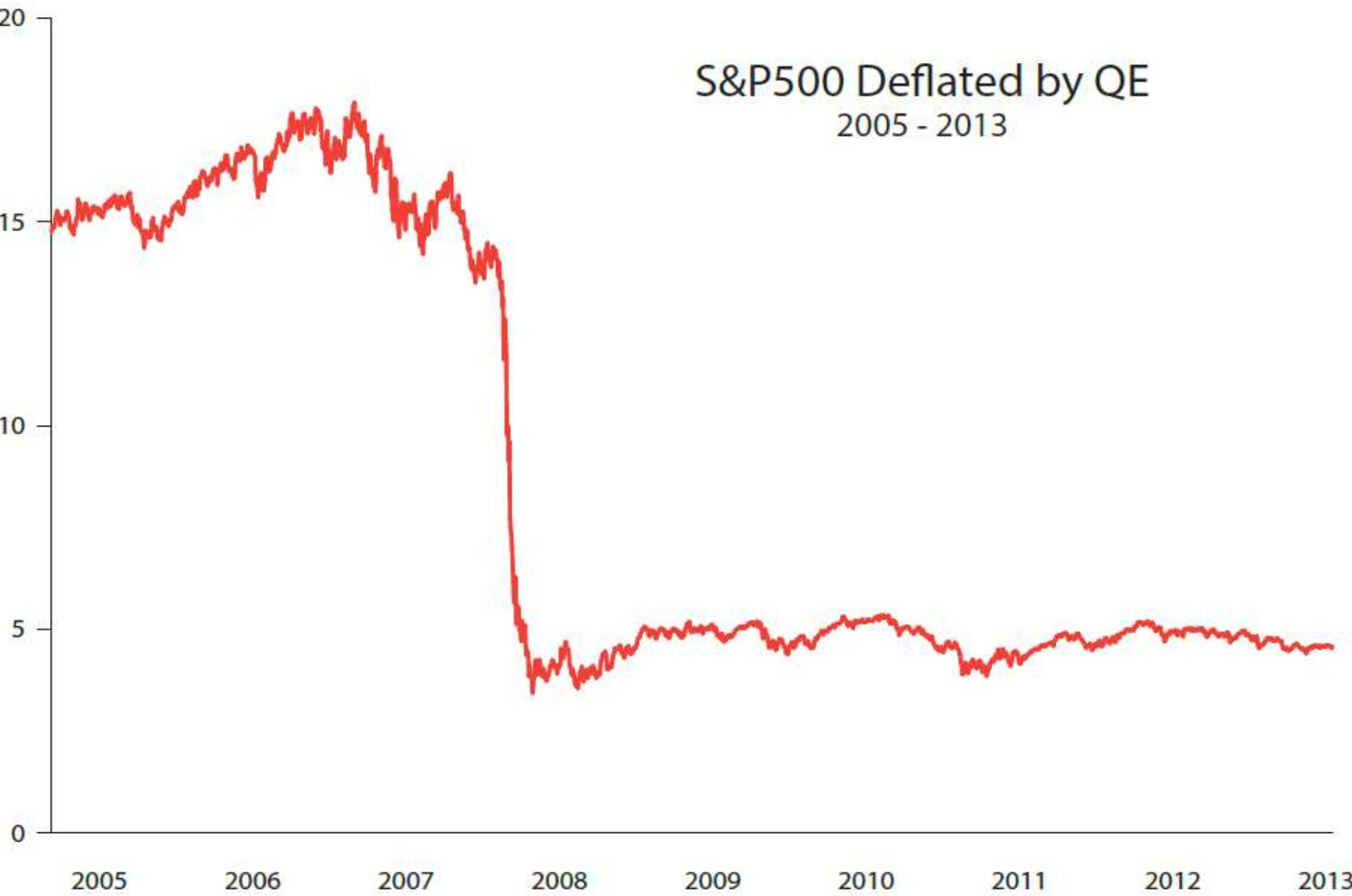
Economic policy makers: trying to control a variable you can't measure (inflation) with a tool you don't fully understand (money) in a complex system with hidden, unobservable and non-linear interrelationships (the economy) is a guaranteed way to ensure that most things which happen weren't supposed to happen.



Quantitative Easing Correlation to S&P 500 Index



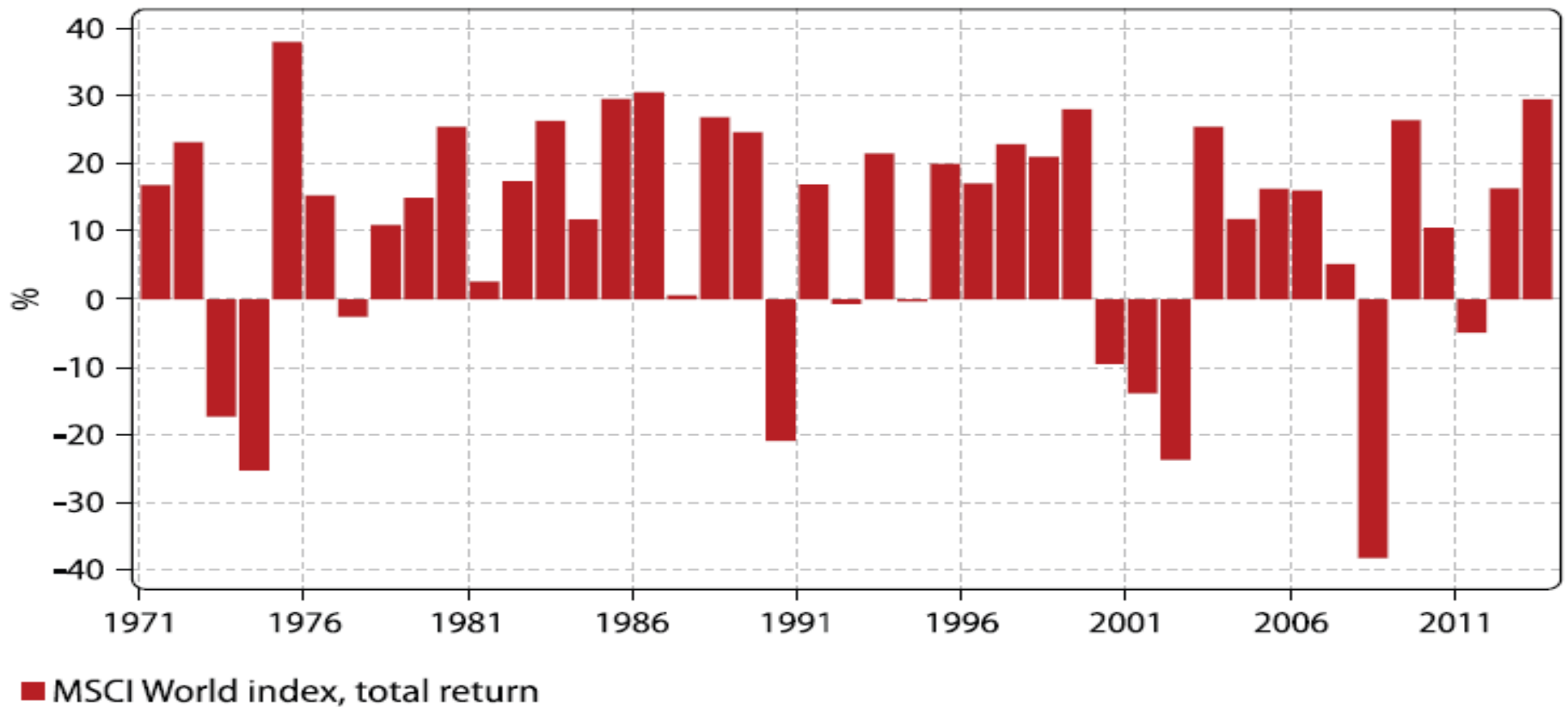
S&P500 Deflated by QE 2005 - 2013



Source: Raoul Pal/Remi Tetot GMI

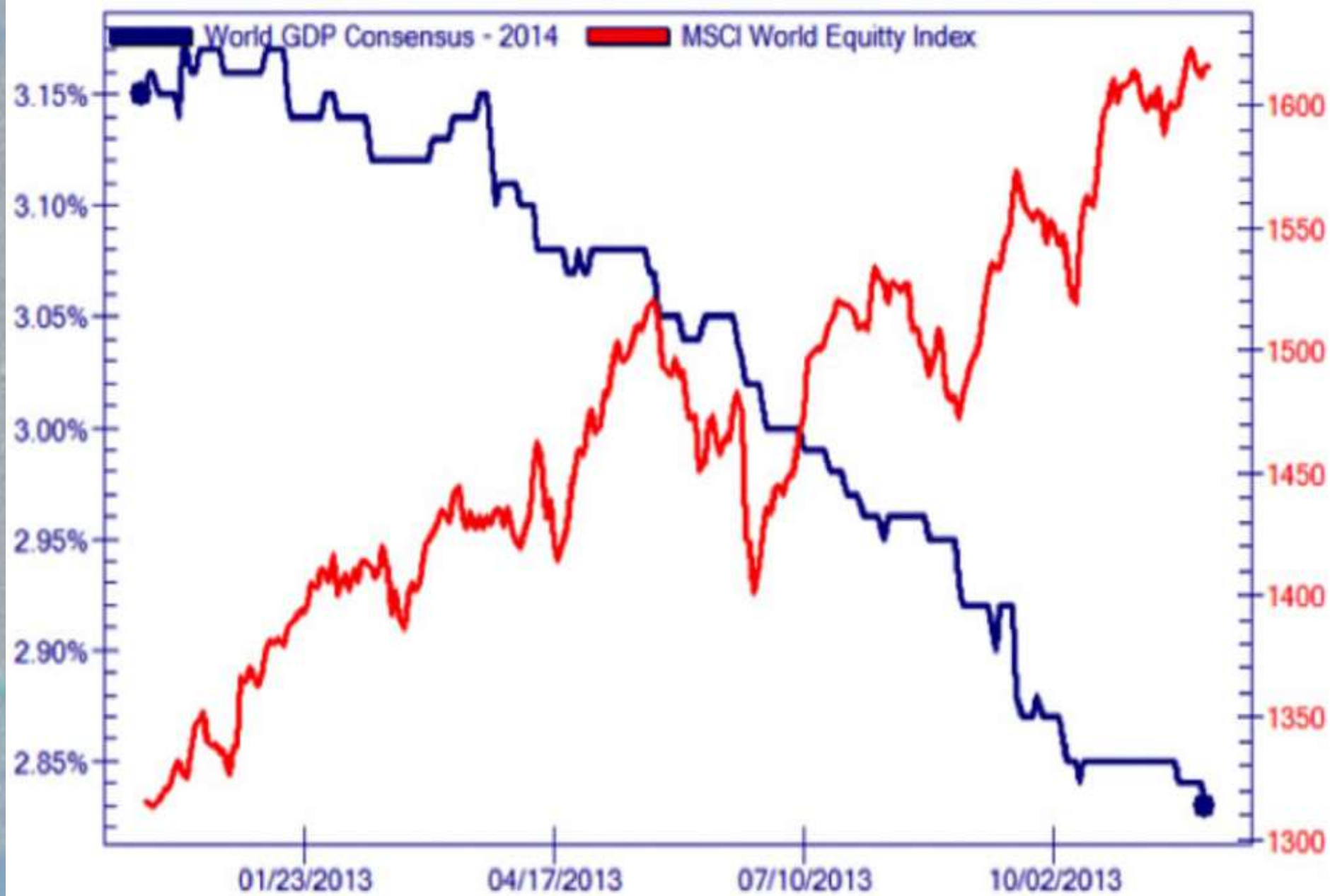
World equity performance has been decent

Mid & large cap; YoY % change

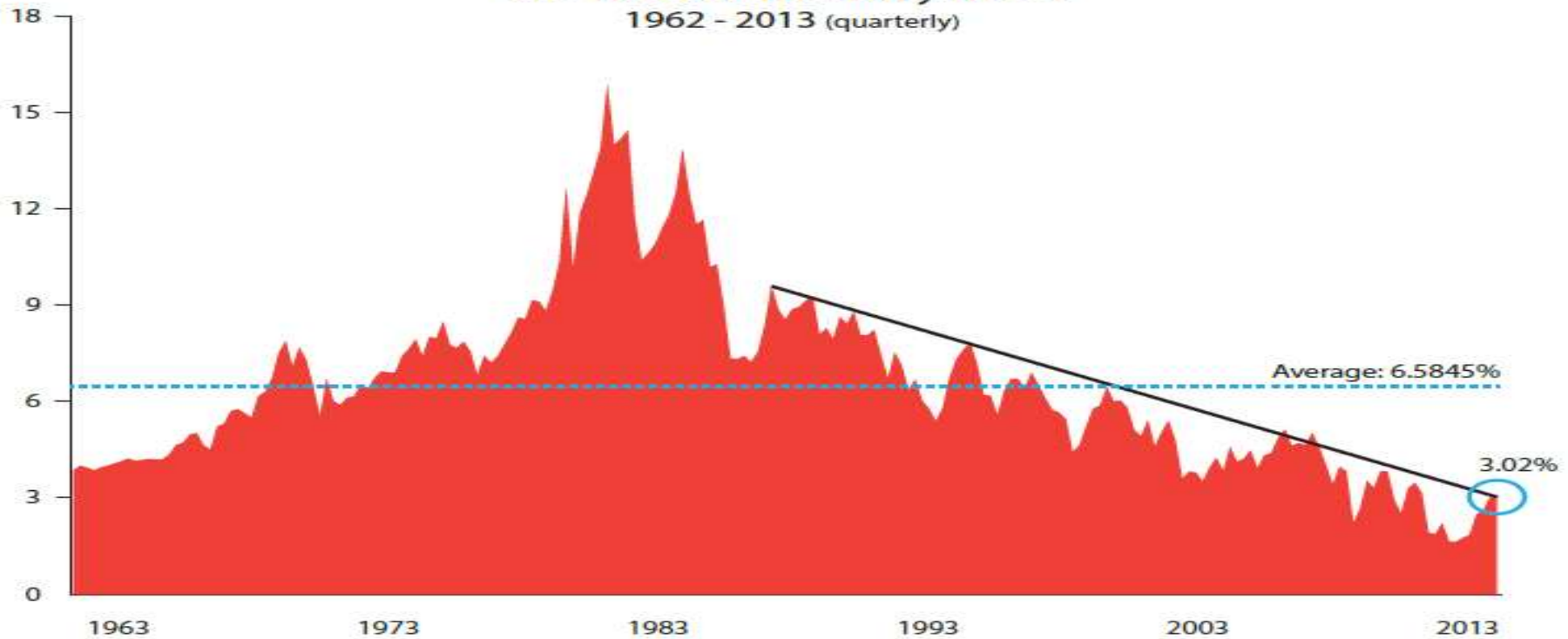


GaveKal Data - powered by Macrobond

Last year was a banner for global equities—one has to go back to 1986 to find a better annual performance. And yet years when global equities outperform bonds by more than 31% are rare. And when such disparities have occurred, equities were usually weak in the following year.



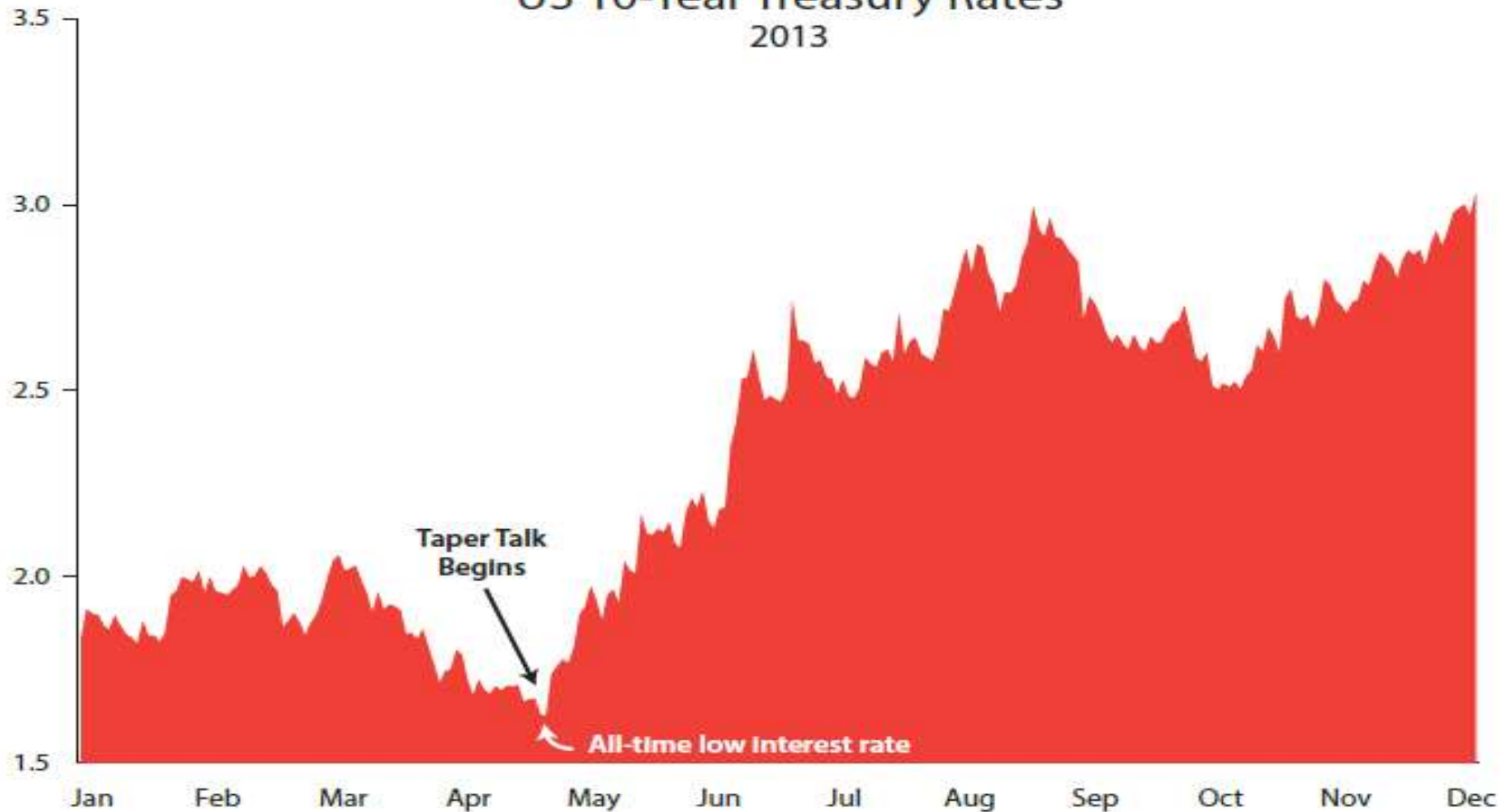
US 10-Year Treasury Rates 1962 - 2013 (quarterly)



Source: Bloomberg

(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. 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?

US 10-Year Treasury Rates 2013



Back in May, when Ben Bernanke provoked the Taper Tantrum, rates on the US 10-year Treasury were at their all-time lows of 1.625%. 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:

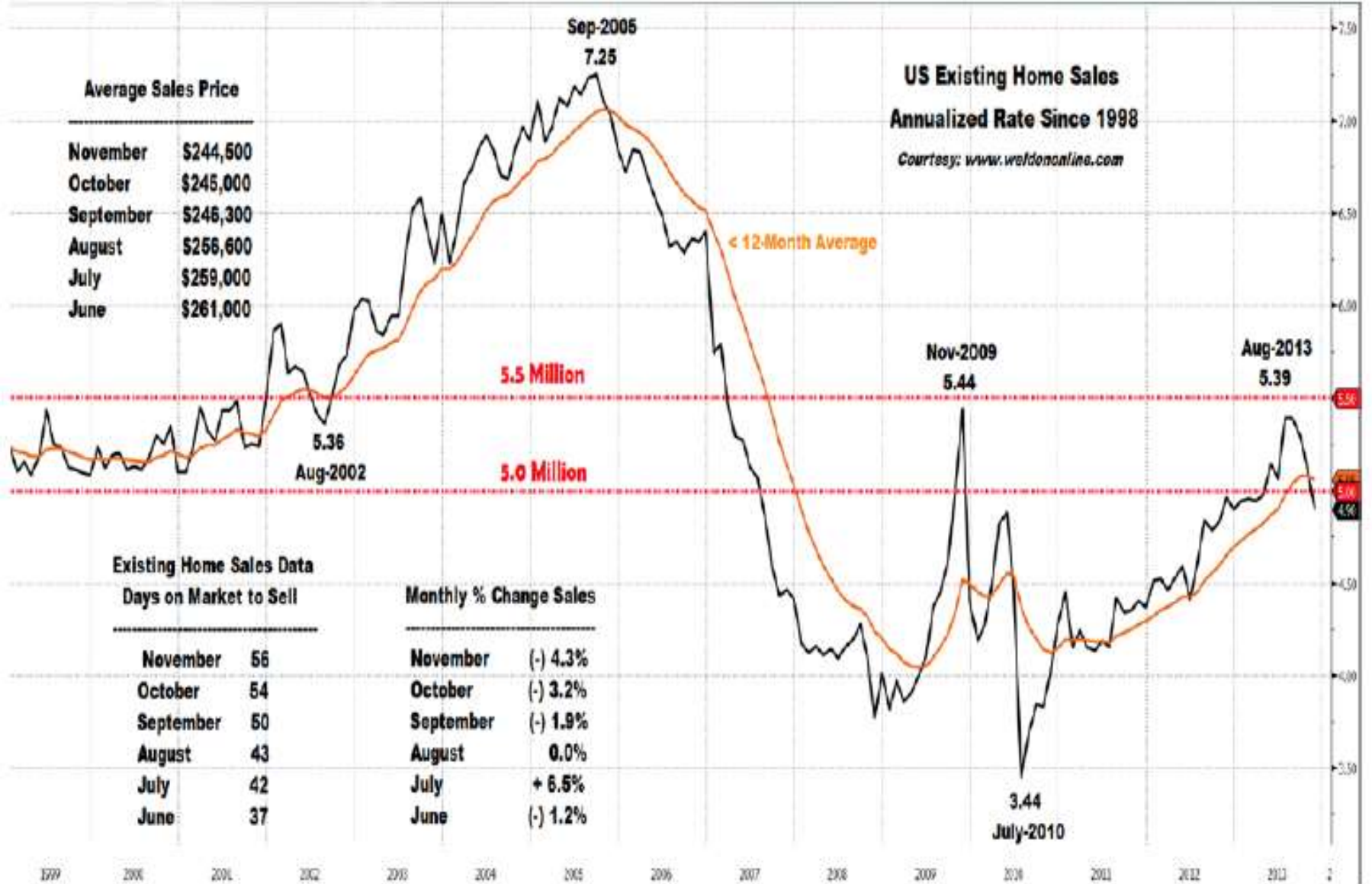


With the Fed now slowing their purchasing of Treasuries, the spectre of the loss of a free backstop has sent investors barreling back into high-yield debt as a means to supplement their loss of interest income and capital losses on government bond portfolios; and that move has given us one of those charts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

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	

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

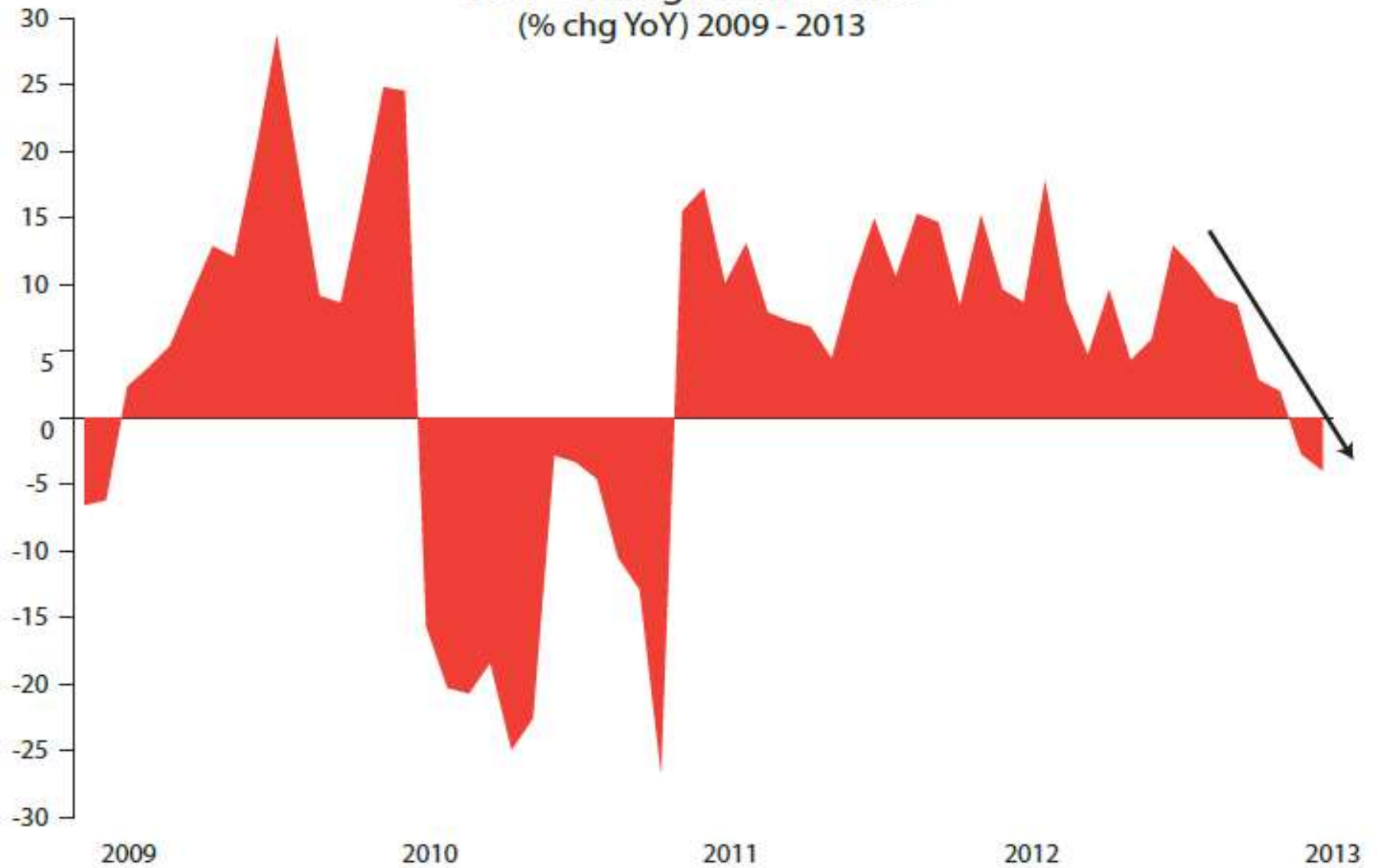
**I wonder what would happen if the Fed entrusted their \$85 bn a month to the smart money?
Think it would rush into Treasuries and MBS?**



Source: Greg Weldon

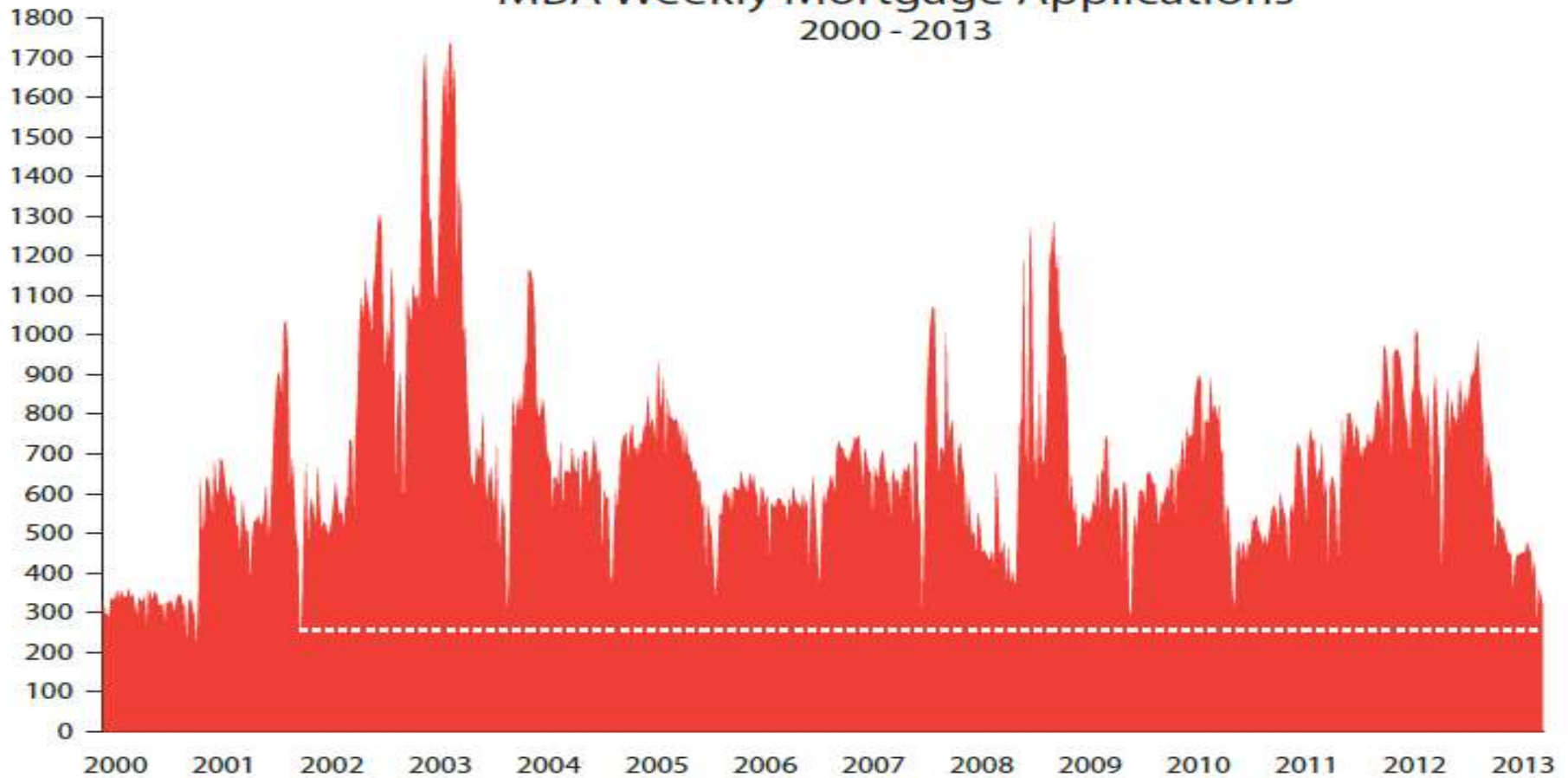
US Pending Home Sales

(% chg YoY) 2009 - 2013



Source: Bloomberg

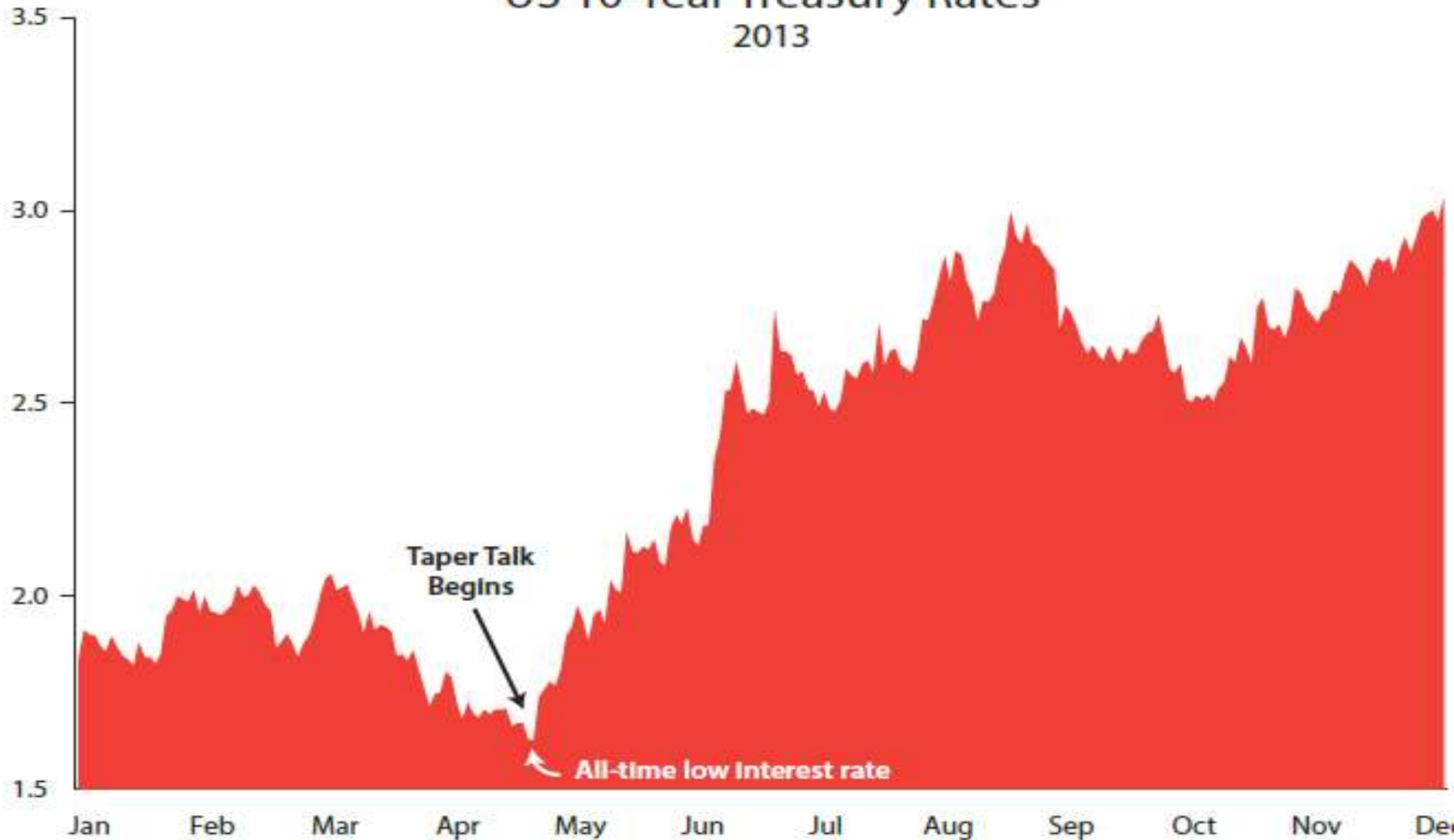
MBA Weekly Mortgage Applications 2000 - 2013



Source: Bloomberg

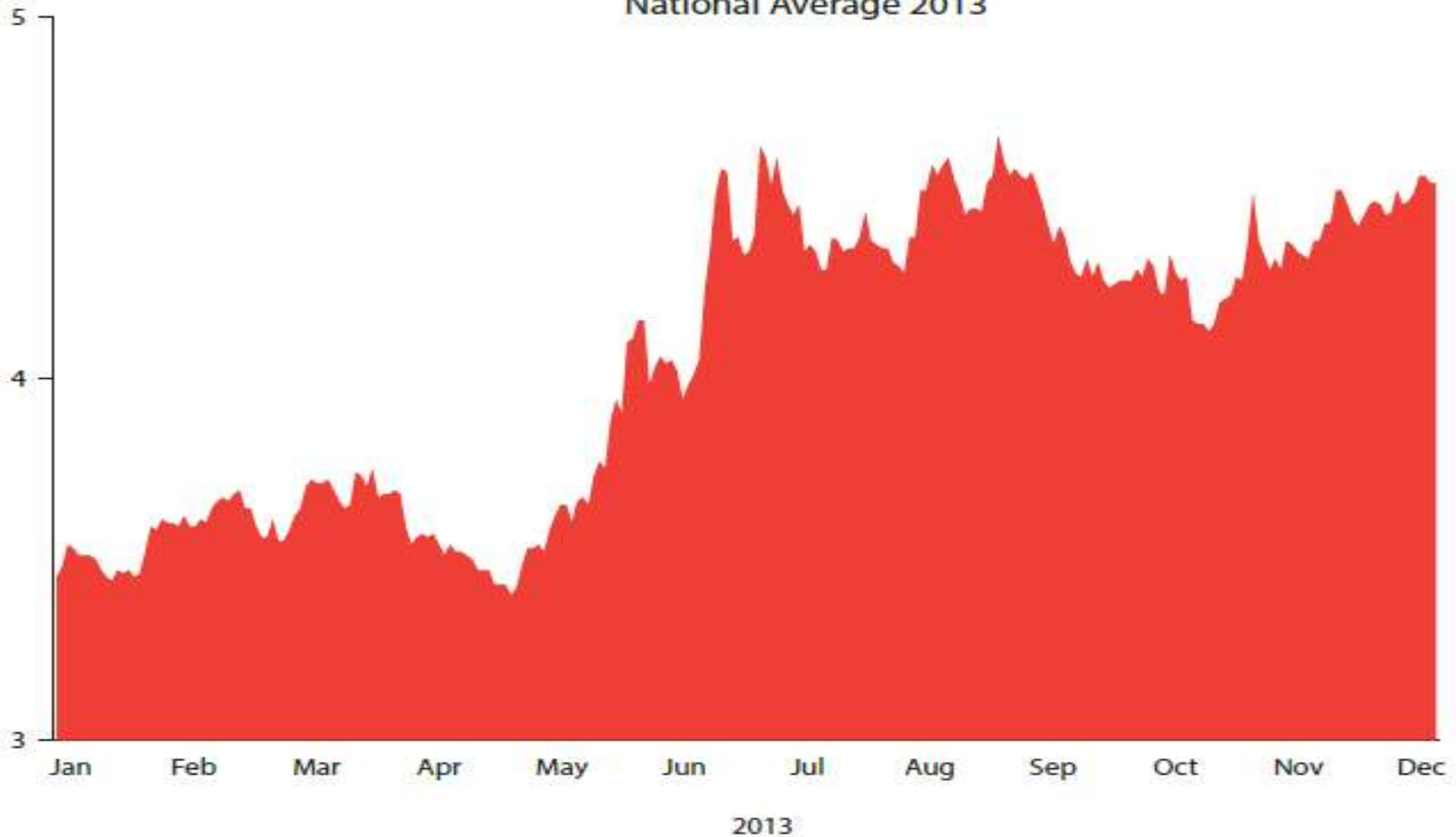
... and perhaps most alarmingly, the MBA's weekly mortgage applications data has fallen off a cliff: down 66% from its highs to a new 13-year low – yes, way worse than in the depths of 2008-9:

US 10-Year Treasury Rates 2013



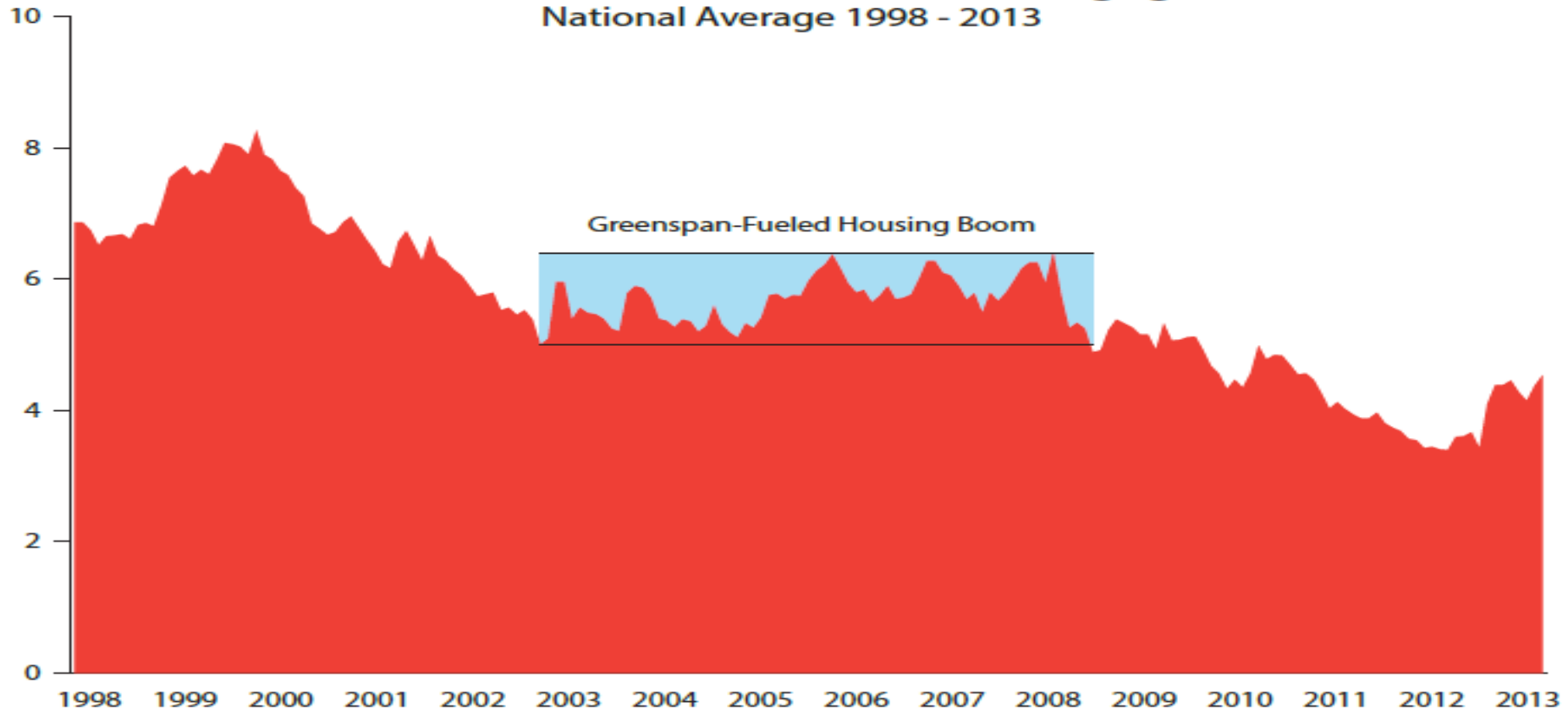
Source: Bloomberg

Bankrate.com US 30-Year Fixed Mortgage Rate National Average 2013



Source: Bloomberg

Bankrate.com US 30-Year Fixed Mortgage Rate National Average 1998 - 2013



Source: Bloomberg

You can see, the housing boom that was fostered by Alan Greenspan's low-interest-rate 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%.

So is FED now in Interest Rate Trap :

By purchasing a trillion dollars of Treasuries and MBS they have managed to:

- Save the banks that were too big to fail at the expense of tax payers (Consumers)
- And help generate interest of hedge funds in one of the major drivers of “recovery” housing.

But as the things seem to be now 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.

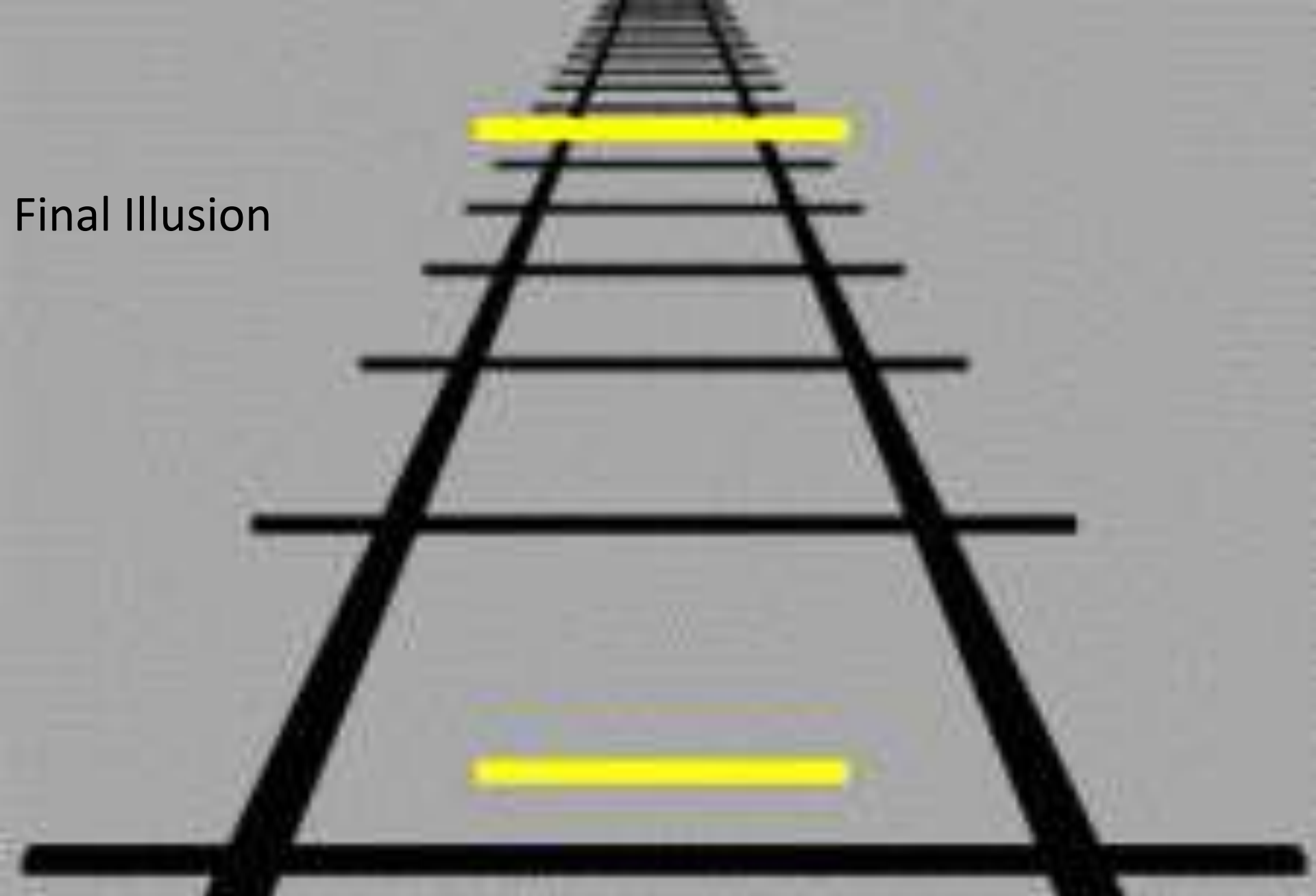
So ... does the Fed cooperate and taper the taper in order to stifle the rate increase — or does it defect, continue to tighten, and watch the housing market tumble again?

A difficult choice indeed

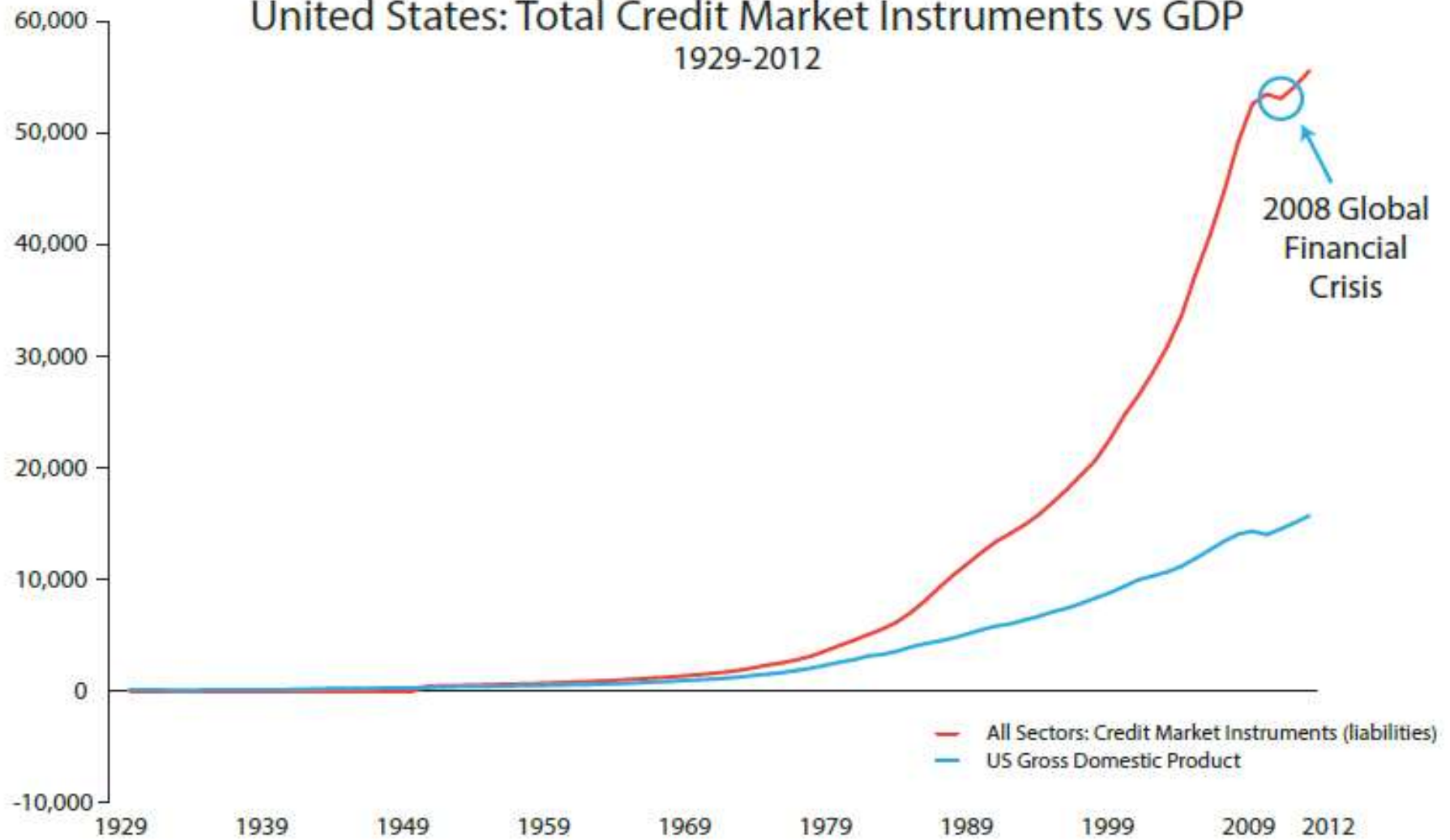
(Bloomberg): If rates rise, the market value of government bonds in particular — and all bonds in general — could be hurt significantly. For example, if the federal funds rate rises to 3%, a longer-term Treasury bond might lose as much as a third of its market value.

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

Final Illusion



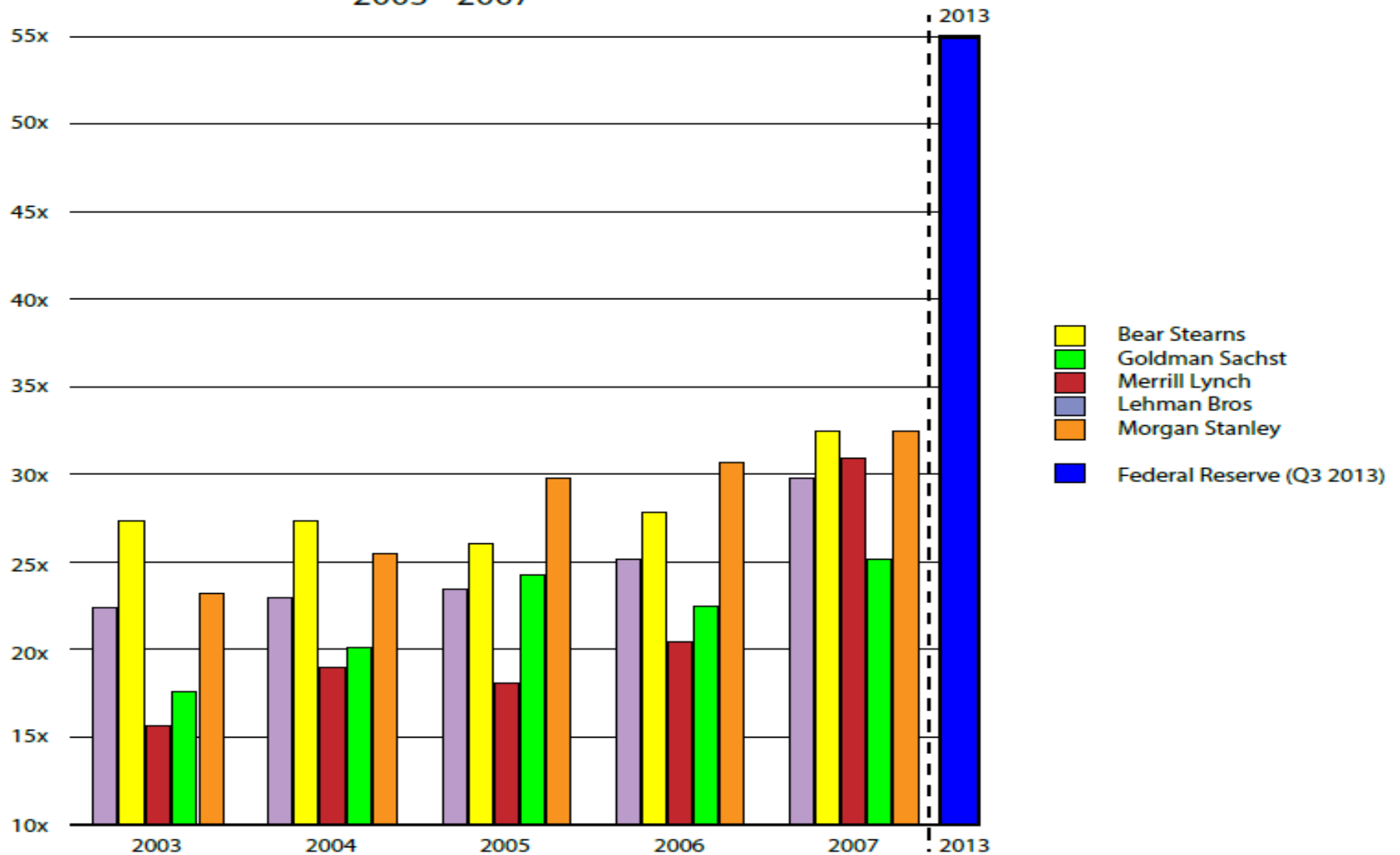
United States: Total Credit Market Instruments vs GDP 1929-2012



Source: St. Louis Fed

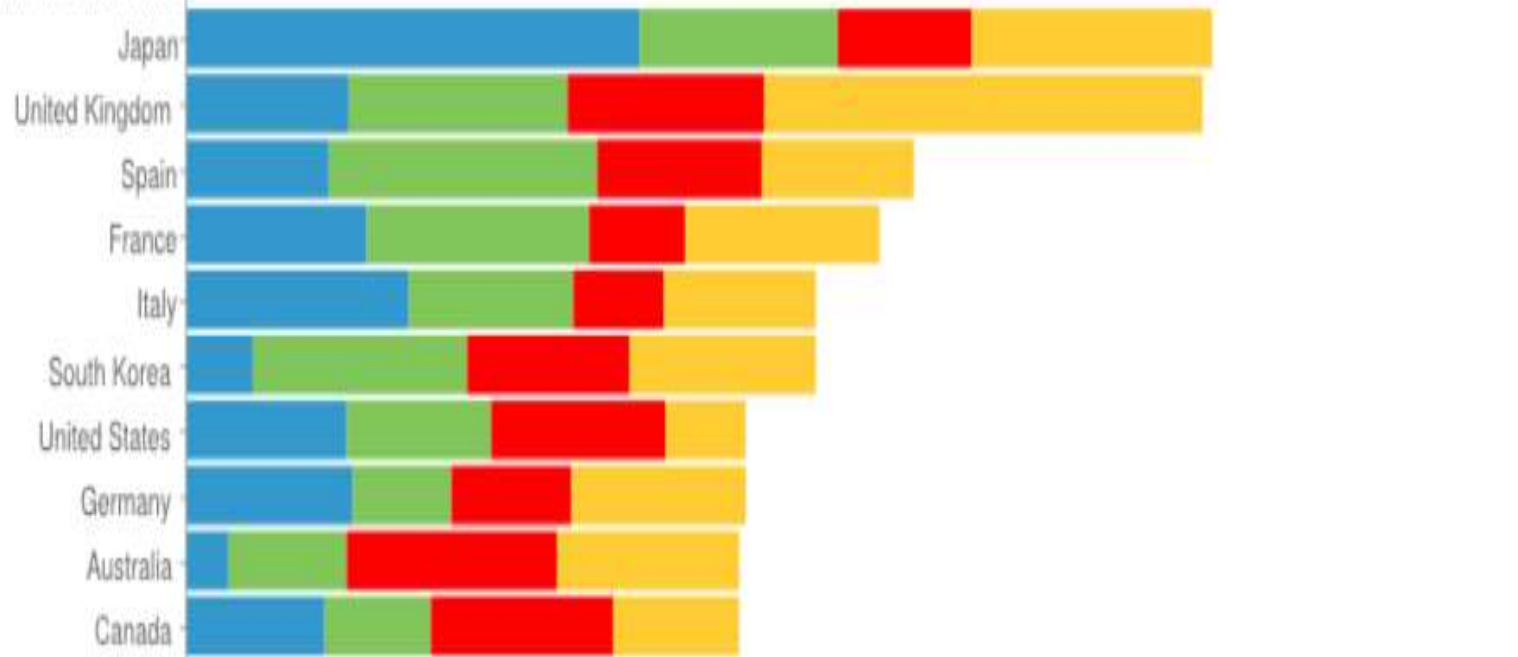
Major US Financial Institutions Leverage Ratios

2003 - 2007

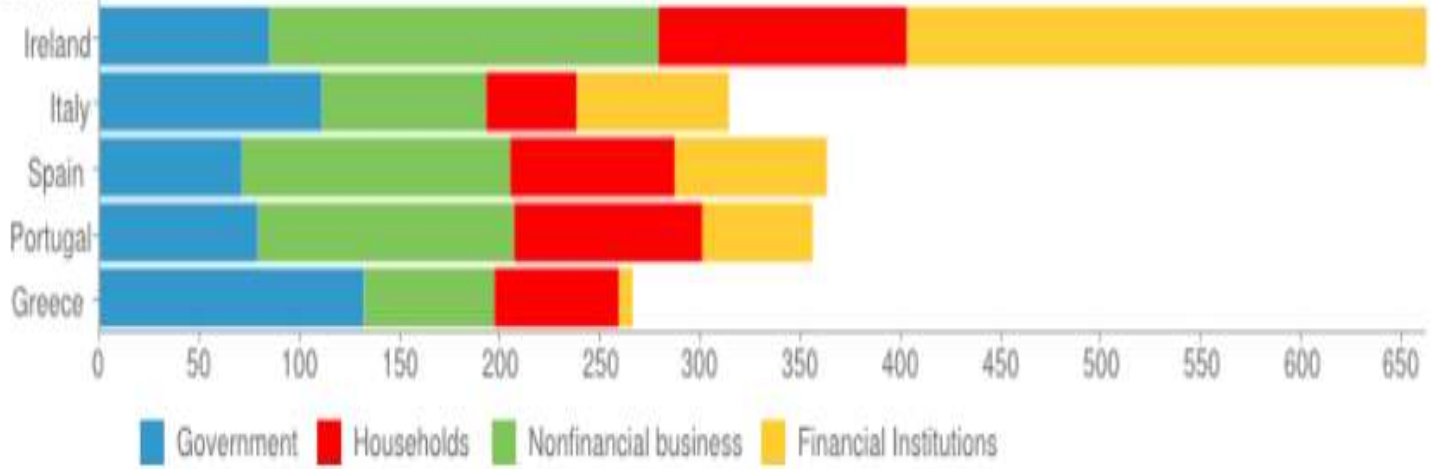


Sources: Wikipedia, company reports

10 LARGEST MATURE ECONOMIES



EUROZONE-CRISIS COUNTRIES



Right now, today, investors all over the world are confronted by markets that have been dressed up for the amusement of the crew in charge of the ship, and nobody seems to recognize what they are looking at.

Sure, they *look* like markets, but at the same time there is an unfamiliarity that is extremely unnerving to at least a few in the gathering crowd.

The majority of the mob, however, have decided that they look enough like markets to charge in blindly in the expectation that all will be as it should.

Things are not as they should be. Far from it.

Everywhere one looks are signs that the markets are just monkeys dressed up in fancy costumes.





Final Words

The views expressed in this presentation are purely of the presenter and does not represent the views of either the ACCA or Ministry of Finance.

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QUESTIONS



THANKS

