Market Update

From: Mike Sullivan
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Subject: A Formal Fed Fail?

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Is a Santa Rally possible? We believe 'Yes', but don't expect that (if it materializes at all) that the warm and fuzzies will last very long. Offered here is our reflective view of history, and hence a peek at the future.

For years we have written about the fallacy of Amercia's 'central bank', the Federal Reserve. It is an entity not well understood by most Americans, and in an environment where asset prices rise because credit is both readily available and cheap, nobody really needs to, nor wants to pay attention to such a boring academic concept! If you own assets at this point in time, however, we think it may be worthwhile to reflect on events of the past and understand this entity. Of course, these are the points that we deem important to your financial well being as this potentially is a very pivotal point in time for asset prices everywhere.

Central banks are *notorious* for, throughout history, creating paper money, steadily increasing the pace at which they create that money, and enabling insiders and the wealthiest class to borrow, invest and speculate. Asset prices rise past the point of reason. Profits are extracted by some along the way until the point is reached where that particular bubble cannot be sustained any longer. Fast forward to today:

Prices of many industrially important items around the world are *collapsing*. They are plummeting in part because China had to stop building all of the empty cities it created in years gone by on the backs of its own money-printing machine. (Once you stop building cities that cannot be populated and paid for by real people with jobs, you no longer need the resources like copper and steel, nor do you need bulldozers, cranes or workers.) Prices are collapsing because the dollar has been getting stronger (commodities are priced in dollars, so their price obviously drops when you need fewer dollars to purchase them). And, they are collapsing because the Fed's latest bubble artificially drove up the price of oil, encouraged businesses to borrow at artificially low rates and chase the fracking boom. The result? Over supply of oil and too many companies. Just like copper and steel are falling because of China's fake boom, oil prices are collapsing because of the Fed's fake energy boom. Consumer prices overall? Well, we're not so lucky are we as the savings at the pump are not nearly enough to cover rising costs at the grocer and health insurers, are they?

In the U.S., the Federal Reserve 'hiked' interest rates on December 16th for the first time since 2007. They did this *in the face of declining economic data*. In *every* instance since 2009, in the face of the same such data (or better!), they did the *opposite*. They lowered interest rates and printed money (Quantitative Easing). By the end of that historic day, the major banks had all raised the rates that they *charge* Americans. None of them raised the rates paid to depositors. When contacted as to why, Bank of America's representative stated they would consider that perhaps in the future, based on what the competitive environment was doing. So, there's another 0.25% for the big banks and their bonuses but absolutely nothing for Grandma … predictably.

Masked by 'economic data' that looks better than it really is (thanks to constantly changing formulas …many call it phony data) and supported by money printing, the central banks have created economies that succeed only in the face of ever-expanding debt-based money. Unfortunately, never in history have such antics been successful for the public overall. They **have** been successful however at temporarily raising asset prices that *some* can profit from along the way. The rest of the world unfortunately simply rides the waves up and down, hoping constant cost-of-living increases don't out-pace wage increases.

Unfortunately, that's not the case. And, as you can see, this latest bubble has been no different for the broader public. And what happens next will be critically important to the future for anyone who has assets invested in any major market … stocks, bonds, real estate, commodities, and so on. Consider this recent quote from Charles Gave, respected long-time investment manager:

"What we are seeing is in fact in one of the stupidest possible applications of the Cantillon effect, whereby those who are closest to the money-printing, i.e. the financial markets, are the biggest beneficiaries of that printing. *This is exactly what happened in 1720 in France during the Mississippi Bubble inflated by John Law. The end results were not pretty.*

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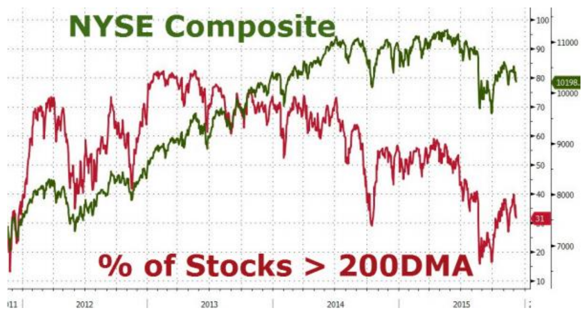
… I cannot remember a time when less thinking has ever been done in the financial markets, which is why I find today's financial markets infinitely boring._We are swimming in an ocean of ignorance, just like France in 1720. *It seems all the painful economics lessons learned over the last 300 years have been forgotten. I suppose that means we will just have to wait for another Adam Smith to appear."*

- Charles Gave, reflecting on 40 years of market participation

Like Charles, we are in awe of the degree to which investment markets have been destroyed by the central planners. We view this next three month stretch as potentially the most risky period we have faced, as the grand monetary experiment run by the Fed since 2009 is brought to a close. (At least they may attempt to close it down, until it very likely becomes clear to all they can never unwind it, nor pay back the debt.)



Source: Zerohedge

Hidden under the surface of major market index prices, 75 percent of stocks are in long term downtrends (underneath 200 day moving averages) otherwise called 'bear markets'. This weakness is hidden by big Wall Street players who boost a handful of large stocks which holds the value of the index aloft . But underneath everything that is not nailed down is being sold hand over fist.

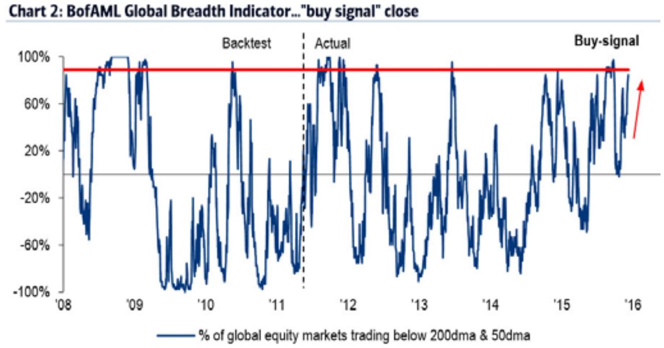
The very notion that the Fed will take the *exact opposite* action to their prior actions over the past 6 years (actions they verbally justified at the time based on the 'economic data' of that time), is stark evidence that there are truly no rules that guide their actions, no matter how much gobbledy gook they utter and altered data they use to disguise that fact.

The stock-buybacks that directly benefit a few (corporate insiders) while temporarily benefiting others (rising stock prices) are likely to dramatically slow-down in 2016 as the Fed slows down the money-spigot. If so, that will remove the major buyer from the marketplace. The buyback behavior itself- is just one of the major Fed-induced drivers of their bubbles, and its now turning into a major headwind.

Today is 'Quadruple Witching Day',a day in which the major market players move the market to a certain price-point in order to maximize their profit in the options market. After today (despite this heavy big-picture perspective), there is indeed a chance that we see a rally into year end, a strong one even. But it is largely technical, and like with Quadruple Witching activities it benefits the big boys.

Here is a 'buy signal' used by Bank of America / Merrill Lynch that signifies a 'short-squeeze' (drives stock prices upward) may be on the way into year-end (the article is available on our website):

Chart 2: BofAML Global Breadth Indicator…"buy signal" close



Source: BofA Merrill Lynch Global Investment Strategy, MSCI

Source: BofA/ML

We suggest anyone who has not yet lightened up on risk exposure consider a bounce an opportunity! If we can be of assistance, please contact us at (614) 734-WLTH(9584). Merry Christmas and Happy Holidays!