

Weekend Reading

The Pause That Refreshes



On Tuesday, the market tumbled on concerns over Italian debt. (*A problem, by the way, I discussed a couple of years ago.*) However, on Wednesday, the market reversed course and apparently the crisis was over. Make no mistake, nothing was fixed or resolved, investors just chose to ignore the problem under the belief that Central Bankers will unite in some form of bailout. It isn't just Italian debt, which is magnitudes larger than Greece's debt crisis, but it is also Spain and a host of other smaller European countries that continue to ramp up debt in hopes that economic growth will someday bail them out. However, sustained economic growth has failed to appear. As long as interest rates remain low and negative in some cases, debt can continue to be accumulated even with weaker rates of economic growth. More importantly, as long as rates remain low, the banking system can continue to play the "hide-the-debt game" through derivatives, swaps and a variety of other means. But rates are rising, and sharply, on the shorter-end of the curve. **Historically, sharply rising rates have been a catalyst for a debt related crisis.** As long as everything remains within the expected ranges, the complicated *math* behind trillions of dollars worth of financial instruments function properly. **It is when those boundaries are broken that things "go wrong" and quickly so.** People have forgotten that in 2008 a major U.S. financial firm

crashed as its derivative based exposure "*blew up*."•No. I am not talking about Lehman Brothers, s. In just 365-days, Bear ring within a few weeks.



Bear Stearns was the warning

shot for the financial markets in early 2008 that no one heeded. Within a couple of months, the markets dismissed Bear Stearns as a "*non-event*" and rallied to a higher level than prior to the event, and almost back to highs for the year. Remember, there was "*nothing to worry about*" at the time, even though the Fed was increasing interest rates, as the "*Goldilocks economy*" could handle tighter monetary policy. Sure, housing had been slowing down, mortgage delinquencies were rising, along with credit card defaults, but there wasn't much concern. **Today, we are seeing similar signs.** Interest rates are rising, along with delinquencies, defaults, and a slowing housing market. But no one is concerned as the "*Goldilocks economy*" can clearly offset these mild risks. And no one is paying attention to, what I believe to be, one of the biggest risks to the global financial markets - **Deutsche Bank.**•

DB Deutsche Bank AG NYSE

30-May-2018

DB (Daily) 11.57

Open 11.51 High 11.62 Low 11.38 Close 11.57 Volume 10.3M Chg +0.27 (+2.39%) ▲



Deutsche Bank is clearly showing signs of financial trouble. More importantly, it is magnitudes larger, in terms of derivative-based exposure, than Bear Stearns and Lehman Brothers combined. Bear Stearns and Lehman Brothers were not banks and did not hold deposits. As such, they posed significantly less risk to the financial system. As Doug Kass recently noted:

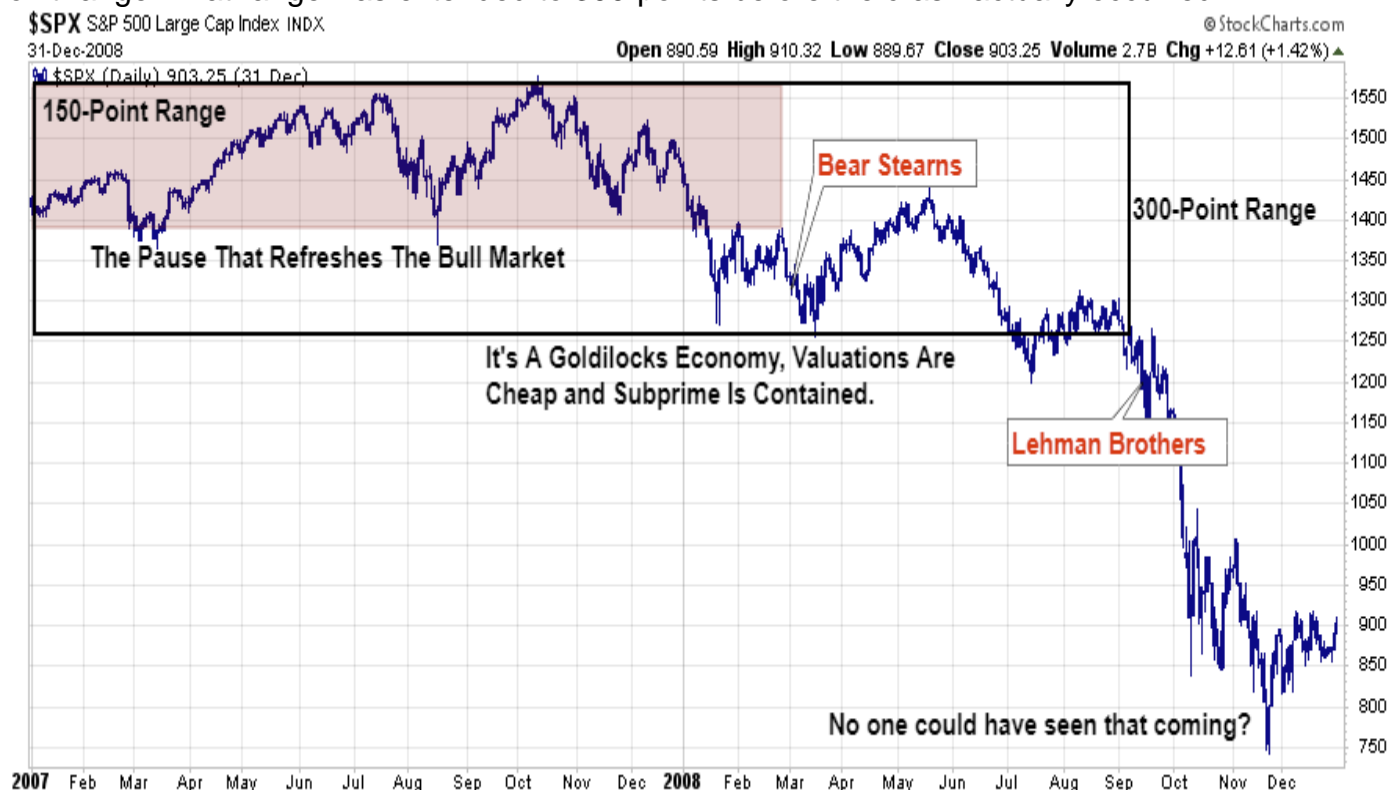
*"The collateral risks to Europe are large - most notably to ECB and to Germany. In it's extreme it could mean Italy separates from the rest of the EU. To me, as I have written in the past, Deutsche Bank is particularly exposed. But, to this observer, who has consistently warned about **Deutsche Bank being the next Black Swan** and the imbalances in the European banking system (particularly in Italy), the risks of a possible negative multiplier effect on other European financial intermediaries and on the region's economic prospects is profoundly real."*

But, while everyone loves a good bullish thesis, let me restate the reduction in the markets previous pillars of support:

- The Fed is raising interest rates and reducing their balance sheet.
- Short-term interest rates are rising rapidly.
- The yield curve continues to flatten and risks inverting.
- Credit growth continues to slow suggesting weaker consumption and leads recessions
- The ECB has started tapering its QE program.
- Global growth, especially in Europe, is showing signs of stalling.
- Domestic growth has weakened.
- While EPS growth has been strong, year-over-year comparisons will become challenging.
- Rising energy prices are a tax on consumption
- Rising interest rates are beginning to challenge the equity valuation story.

*While there have been several significant corrective actions since the 2009 low, **this is the first correction process where liquidity is being reduced by the Central Banks.***

Oh, and just one last chart. During 2007, and into 2008, the S&P 500 traded sideways in a 150-point range. That range was extended to 300-points before the crash actually occurred.



It was believed to be just a "pause that refreshes." Since January of this year, the S&P 500 has been trading in a 300-point range (similar in percentage terms to the period preceding Bear Stearns). It is also believed to just be a "pause that refreshes." Just something to think about as you catch up on your weekend reading list.

Economy & Fed

- Is A "Job Guarantee" Program The Best Dem's Can Offer [by John Tamny via Forbes](#)
 - The Fed's Verbal Gymnastics Includes Back Flips [by Caroline Baum via MarketWatch](#)
 - Trumponomics Is Working [by Stephen Moore via The Washington Times](#)
 - **One Side-Effect From Trump's Trade War Could Last For Years** [by Pedro Da Costa via BI](#)
 - People Are Less Selfish Under Capitalism [by Barry Brownstein via FEE](#)
 - Don't Worry About Rate Hikes Next Year [by Danielle Wiener-Bronner via CNN Money](#)
 - Europe Has A Big Problem [by Macromon via Global Macro Monitor](#)
 - Whither The Economy [by Mark Mellman via The Hill](#)
 - How To Defend Capitalism [by Wayne Crews via Forbes](#)
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Markets

- Biggest Pain For Trades Since WWII [by Tyler Durden via ZeroHedge](#)
 - Efficient Markets, Not So Much [by Kevin Muir via The Macro Tourist](#)
 - China's Yuan No Threat To The Dollar [by Simon Constable via Forbes](#)
 - Key Test Developing For Global Equity Rally [by Dana Lyons via The Lyons Share](#)
 - Mobius: Expect A 30% Drop In U.S. Stocks [by Evelyn Chang via CNBC](#)
 - Passive, Private Market Forces [by Seth Levine via The Integrating Investor](#)
 - Next Recession Might Not Be So Bad...Maybe [via Upfina](#)
 - Consistency, The Playground Of Dull Minds [by Anshul Khare via Safal Niveshak](#)
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Most Read On RIA

- How Far Can Stocks Fall [by Lance Roberts](#)
 - The Headwind Facing Housing [by Michael Lebowitz](#)
 - 70 Is The New 90, The Psychological Impact Of Higher Oil Prices [by Lance Roberts](#)
 - Retirement Planning - Life Happens [by Richard Rosso](#)
 - Kass: The World Is Flat [by Doug Kass](#)
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Research•/ Interesting•Reads

- NIRP's Revenge [by Wolf Richter via Wolf Street](#)
- Retirement Myths Vs. Reality [by Robert Powell via USA Today](#)
- How Much Have 30-Somethings Saved [by Alessandra Malito via MarketWatch](#)
- How To Reduce Your Investment Risk [by Dan Caplinger via Motley Fool](#)
- 4-Ways To Cut Spending In Retirement [by Paul Katzeff via IBD](#)
- The 4-R's That Built The West [by Art Carden & Deirdre McCloskey via FEE](#)
- Work 275 Years To Earn The CEO's Wages [by David Gelles via NYT](#)
- Next Recession? Some Haven't Recovered From The Last [by David Dayen via The New Republic](#)
- Time To Worry? [by John Cochran via The Grumpy Economist](#)
- Why Markets Are Worried By Italy Again [by Victor Reklaitis via MarketWatch](#)

- 2018-Internet Trends Report [by Josh Constine via Tech Crunch](#)
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“Government is one of the five evils - along with fire, floods, thieves and enemies.”**•Jeffrey Friedland, All Roads Lead To China**

Questions, comments, suggestions ? please [email me](#).