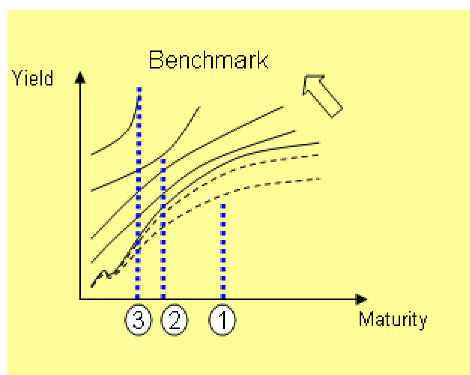
Tincho’s letter

Toronto, Monday, May 22nd, 2009

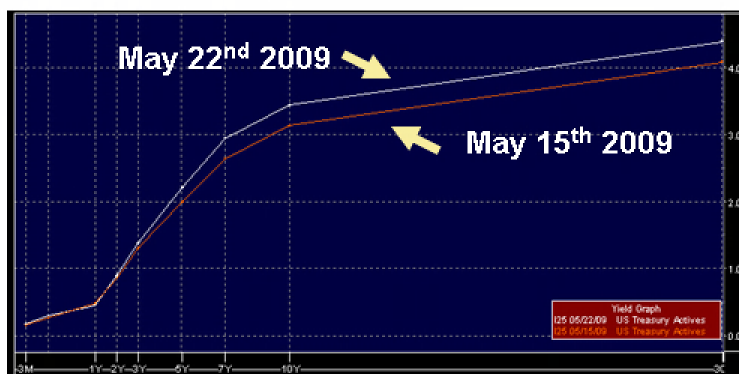
Good morning,

After last week’s action, I really don’t know what to write about. There is nothing really new, but only more of what we have been discussing so far. And that is sad. The market is pushing the Fed to assert a speed of money supply. What do I mean by speed? Fresh, newly printed USD per week! As we got used to understand certain speed metrics like kilometers per hour or annual returns, we now have to get used to newly printed USD per week. (When I lived in Argentina, for instance, people had gotten used to read the level of reserves of the central bank and the government bonds yield, next to the weather forecast in newspapers). We will now need to get used to read the speed of USD supply on a weekly basis. And expectations are built on this speed rate. For instance, next week, we have $101BN (Yes, one hundred and one BILLION) of US Treasuries being auctioned: $40BN in 2-yr notes on May 26, $35BN in 5-yr notes on May 27 and $26BN in 7-yr notes on May 28. The Treasury also sells $61 billion in three-month and six-month bills weekly auction on May 26. With this in mind, the negative outlook on UK’s AAA rating, the comments about the US losing its AAA rating, and the Fed’s refusal to bail out Municipal debt, the world runs for cover. The yield on the 30-yr note closed at 4.384%. The process we outlined in our letter of May 7th seems to be taking off (yield curve reflecting inflation expectations are to take a leading role, bringing REAL interest rates down). I reproduce the chart from May 7th (below left) and the change in the yield curve, since May 15th (below right):

Tincho’s letter of May 7th, 2009



Reality as seen on May 22nd, 2009



Source: Bloomberg Analysis: Tincho's letter

As we said endless times, the market uses the window provided by the Fed to sell Treasuries and put its capital away from the hands of Mr. Geithner and Bernanke. How can they escape? By buying assets that are as liquid as possible and as removed as possible from these hands. Buying gold? Not really. The IMF and other central banks still have some dry powder to shoot the price of this metal down. Other currencies? Only as long as the speed of their respective supply is LOWER than that of the USD. Note that we are not saying other currencies need not be subject to Quantitative Easing policies. At this stage, it really doesn’t matter any longer. Who else can spit out $101Bn in a week? All the cards have been shown, friends… What matters is speed! Whoever prints the fastest its problems away will set the benchmark. So, what asset is left? Yes, you guessed right: Oil! Oil cannot be manipulated by the Fed. Yes, the US can sell stocks from their Strategic Reserve. They could have done so earlier, and for whatever reason (perhaps related to the Saudi lobby), they didn’t. Oil is produced mainly outside of the USA and is the blood of the USA. Liquidity is thus assured. Can the price of crude still be affected by a slow recovery in GDP? Yes. But supply can be cut as well. And I don’t think we are going to see strong capital expenditures after the price action of 2008. Companies are going to be very careful on this front, and will not spend in anticipation of higher prices.

Let’s think ahead of the next phase: What can work as an exit strategy? Clearly, monetary policy cannot work. They will keep trying with currency swap agreements, they will abuse the IMF to extend USD-backed lines to emerging markets, they will press China into inflation by pushing them to keep hoarding Treasuries, they will threaten to sell gold, they will raise taxes, they will further regulate every piece of the financial system …But they will only be delaying the inevitable…So, what can work as an exit strategy? Spending cuts. Will this happen? No! So…how does the system adjust? With higher prices, lower USD, higher unemployment. **Can credit rally in this context? Is David Rosenberg right when he says the March 9 lows in stocks are to be tested again? Remember how those petrodollars of the ‘70s originated Latin America’s foreign debt (The same debt that was defaulted in the early ‘80s)? Isn’t that proof enough of how credit can rally?**

Martin Sibileau martin@sibileau.com **(647) 999-2055**

Disclaimer: The comments expressed in this publication are my own personal opinions only and do not necessarily reflect the positions or opinions of my employer. I prepared and distributed this publication as an independent activity, outside my regular salaried work. No part of the compensation I receive from my current employer was, is or will be directly or indirectly related to any comments or personal views expressed in this publication. All comments are based upon my current knowledge. You should conduct independent research to verify the validity of any statements made in this publication before basing any decisions upon those statements. The information contained herein is not necessarily complete and its accuracy is not guaranteed. If you are receiving this communication in error, please notify me immediately by electronic mail or telephone. The comments expressed in this publication provide general information only. Neither the information nor any opinion expressed constitutes a solicitation, an offer or an invitation to make an offer, to buy or sell any securities or other financial instrument or any derivative related to such securities or instruments. The comments expressed in this publication are not intended to provide personal investment advice and they do not take into account the specific investment objectives, financial situation and the particular needs of any specific person. All rights reserved.