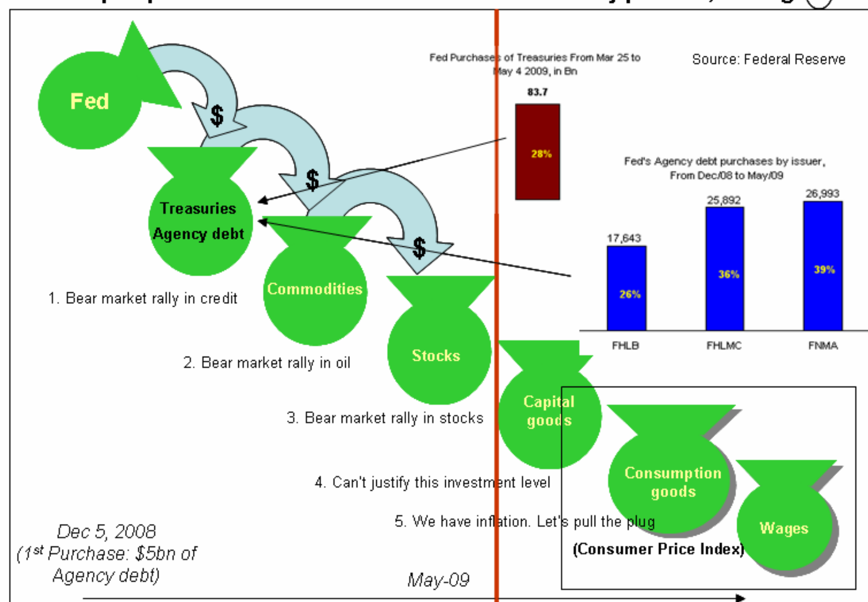
Tincho's letter

Toronto, Wednesday, May 6th, 2009

Good morning,

I cannot stress enough how important is the rule of law. When nations prefer kneeing to rulers instead of bending to the law, misery finds a new home…I was thinking this yesterday, while I read that dissident lenders to Chrysler were asking to remain in anonymity because of death threats (request was not accepted), or when the Chairman of the Fed said to Congress he's making money for the Treasury, or when the Secretary of the Treasury, who admitted evading his own taxes, spoke against tax evasion, etc. Common opinion treats politics and economics as different beasts. Law and finance are separate. Finance is a "hard" science and politics and law are "soft" sciences. Nothing could be farther from the truth. Bankruptcy legislation and the judiciary power determine recoveries in default, which impacts credit spreads, which impact the cost of capital of an economic system, counterparty risks and funding costs. Legislation like TARP/TALF impacts relative value among different issuers, which impacts correlation (of defaults, given that assumptions on issuers' *relative* probabilities of defaults change) in structured credit products. This list is certainly not exhaustive but illustrates the point. All the changes brought about by political risk finally find an outlet in foreign exchange fluctuations. Institutions and capitalism are indivisible. There cannot be capitalism without the rule of law and once you have institutions and rule of law, you cannot avoid capitalism. **Inflation is nothing else but corruption impacting our liberties to trade and save.**

I updated the waterfall chart I first put out in the April 14th letter. As shown, since the start of the inflationist policy, $70.5bn of Agency debt, $83.7bn of Treasuries and $1.5bn of TIPS have been bought by the Fed, that used its monopoly to print money out of air. In perspective, the Fed bought 28% of both the Agency debt supply and Treasuries supply = the market was only willing to buy 72% of the supply. Since this started, the market has sold off Treasuries to reinvest this new money in oil, which had its price affected from $32/bbl to $54.64, equities (S&P500 from 666pts to 904pts), credit, et al:



The question rises again: What now? How do we spill liquidity over from the equities and debt markets to boost investment and consumption demand, as the chart above suggests? When will debt restructurings, refinancing and amendments to credit agreements to address liquidity concerns stop, and issuance to fund capital expenditures take over? And if we see this, will it be as with Teck Resources Ltd. 2014 and 2019 Notes issued yesterday? With coupons of 9.75% and 10.25% respectively? Are the markets **convalidating** double-digit coupons or do they see this as a transition for tighter days? **Back to Keynes, who wrote that: "…whilst a decline in the rate of interest may be expected … to increase the volume of investment, this will not happen if the schedule of the marginal efficiency of capital is falling more rapidly than the rate of interest…"**, I wonder if Teck's marginal efficiency of capital will be higher than its coupons, **while at the same time its share price continues to increase**. **If Keynes is right AND the market is never wrong, Teck's produce prices should rise for this to make sense…**

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