

Good morning,

We start a week in which \$236BN in bills and coupons will be supplied. Everyone I've spoken to in the last days has been a bit cautious on the signals of the officially introduced weak recovery. Yet, the markets (all of them) seem to validate the thesis that there is a change, there is renewed demand for risk.

As I was enjoying a good coffee on Friday in downtown Toronto with a friend and reader (he knows who he is), I made the comment I felt optimistic, or let's say not pessimistic (big difference there), about the whole situation. My friend brought up the issue of overall Q2 revenues. If revenues don't pick up, it won't matter whether companies manage to swap their debt maturities or reduce costs: Investors will rush for the exit. I had (and still have) trouble siding with this categorical statement. However, my friend's line of reasoning is flawless and when the logic is perfect, you can only disagree with the thesis if the axioms are wrong. What are the axioms this time around?

Most analysts seeking to understand what comes next have been busy of late, running regressions, showing metrics, prices in perspective. Perhaps the axiom, the main axiom (assumption) here is that we've been in the past through a crisis similar to the one at hand. We compare metrics vs. 2001, vs. the '70s or the '30s.

As my friend and I kept walking on Friday, I asked myself what is different this time. What makes this crisis unique in history? I think the answer is the improved degree of global coordination of monetary policy. We have never before seen the "political class" of the world in union, to save the status quo. Perhaps the most impressive testimony of this is the intervention in the bankruptcy of General Motors, by the governments of United States, Canada and Germany. This is just one example. The coordination between the ECB, the Fed, and the IMF via currency swaps has also averted a remake of a CreditAnstalt episode of 1931. The conditional commitment by the Bank of Canada to keep the overnight rate at 25bps until 2010 is another example, because it shuts one more potential outlet valve to all those (including me) that believe the USD "should" collapse. If you ask an insider, he or she will smile at you in disbelief. However, no matter how precarious the coordination is, from the outside, you can definitely see a global plan. Furthermore, if you compare this coordination to the sad political roads taken in the '30s (the same ones that led to World War II), you get a better picture of my point.

Do you think I am exaggerating here? Do you think taking a political perspective on financial analysis is "soft" and does not explain reality? Very well then, please allow me to put this in historical perspective to help you grasp the magnitude of what I am suggesting: Ask yourself, what would have happened if, instead of letting the French monarchy die in the revolution that started in 1789, the monarchies of all Europe would have helped Louis XVI suffocate the rebellion. More specifically, what if Great Britain, Prussia, Russia, etc. would have assisted the French treasury with their fiscal deficits? What if Turgot and Necker would have been supported by a pan-European mission to establish stand-by facilities and currency swaps with the British Treasury? Don't you think that, with the benefit of hindsight, the western monarchies would have not sought to avoid the political changes of the nineteenth century? I am absolutely convinced of that. Every king and queen in Europe would have helped the Ancien Regime survive. But in 1789, they did not have the benefit of hindsight.

Unlike the monarchies of the 18th century, the political (and financial) class of the 21st century DOES have the benefit of hindsight and acts accordingly. They know what happened in the 1930s... Therefore, the system of central banking, with fiat money, currency debasements and inflation MUST survive at all cost. Do I think that politicians consciously think in these terms? No. But they don't need to either. All they need is to fear the transition from an overleveraged way of living towards a more balanced one. Why? Because balance requires a lot lower public spending and a lot lower taxes; and politicians fear lower public spending and lower taxes. And also, because without central banking and currency debasements, the financial class of today would have to carry their investments on a mark-to-market basis, and that would be unbearable to say the least.

So, back to my point: Do I feel pessimistic? Not so much, because the global coordination that we are seeing today has a good chance of succeeding in delaying or even totally neutralizing the intuitive, textbook, rebalancing mechanisms that we are familiar with: A depreciating USD, a lower S&P500, higher REAL interest rates, flexible capital markets, etc.

In conclusion, it makes sense to think that if fundamentals don't improve, we can see a reversal in the recent rally. But at the same time, I firmly believe coordination among central banks can thwart any "rebellion". What is then the result? Tediousness in equities, further tightening in credit and steady unemployment.