

Good morning,

Back from a brief vacation, a week later, I sit here trying to summarize what happened last week, and what may continue to happen... On August 4<sup>th</sup> ([www.sibileau.com/martin/2009/08/04](http://www.sibileau.com/martin/2009/08/04)), I had updated my forecast and said that equities could reach higher levels, from the stagnant range they were in July. I reaffirmed this view on August 18<sup>th</sup> ([www.sibileau.com/martin/2009/08/18](http://www.sibileau.com/martin/2009/08/18)) and do so once more today. Of course, in credit land, the tightening may continue, following the rally in equities. (I'm sorry; I should not call it a rally, but asset inflation). What drives this trend?

## 1.-Liquidity

For a hundredth time, I show below (source: Bloomberg) the chart with the 3-month Libor – Overnight Index swap spread. It is still making lower lows, with a close of 16.75bps last Friday. How much lower can it go? Before this mess unfolded, it was stable at 10bps, suggesting that it still has some room to tighten.



We are not watching this spread alone. Last week, Michael Cloherty (Bank of America) pointed out that Libor may not be a reliable metric lately, given the wide range in offered rates (3-mo Libor was 34.75bps on Friday and Mr. Cloherty estimated the range at 18bps, which is significant vis-à-vis 34.75bps). Why do I bring this up? Because I was exactly expecting this sort of cautionary comment. The answer to this is that the absolute level does not count. What matters is the relative level, the trend. We should not care about the exactitude of a spread at 16bps. That's not the story. The story is that this spread was above 100bps in March and is now at 16.75bps. Liquidity is out there chasing risk, and as long as we see this indicator, we may see the bid for risk continuing.

## 2. - Global Coordination in monetary policies

By now, it should be pretty clear that global coordination has been the stability factor in this crisis. As we said countless times, global coordination is what makes this crisis different from any other one in the past and it is the factor that has made this rally stable. In summary, liquidity fueled the rally and global coordination provided the stability for the rally not to be killed by the bears. It was on July 27<sup>th</sup>, a month ago; when we explicitly suggested this thesis (Implicitly, we suggested it on April 21<sup>st</sup>, when we said that all currencies are being debased in calculated order, denying gold the chance of playing a lucrative asset). A month ago, we said central banks can thwart any rebellion. This is what we saw two weeks ago happen in China and last week in Canada. In China, the Renmimbi is being "driven" to appreciate, with the central bank restricting liquidity growth and changing the composition of its assets both by asset class and maturity, while in Canada, the Federal Government plans to sell USD bonds, to boost foreign-exchange reserves and support lending by the International Monetary Fund. That is at least the official excuse. The most idiotic ground to justify this bail out on the USD was that Canada needed to diversify its sources of funding! What nonsense is that? We have capital flowing in spite of all the latest horrible fiscal policy and we even have the luxury of issuing bonds in our own currency, yet our government decides to ask investors to buy USD if they want to go long Canada risk? This is a perfect example of my point that we are going to see global coordination to a degree never seen before, and any rebellion will be dealt with swiftly.

**When will the rally stop? The rally will stop if and when, having a fiscal problem erupted within one (important) country, the rest of the coordinating countries (also important) refuse or are unable to lend a hand. If that happens, the price of gold would jump, destroying any currency's chance to be a reserve asset.**