

Good morning,

We are back from a relaxing time with friends, at the shores of Lake Huron, only to find that I may have now to update my views. Let's see:

-Equities:

Everyone always needs a benchmark. To judge my view on equities, I read on Friday the voice that is perhaps the most bearish in the market, the one that calls for lower lows before 2010 (S&P500 below 666). For the sake of honesty, this analyst (that will remain anonymous) is calling for an S&P500 reaching 1022-1050pts before October, when the sell-off should begin (The sell-off would be triggered by disappointing sales figures and weak consumer data). Thus, so far, things (including yesterday's close at 1002.63, +1.53%) are playing out according to plan. However, the analysis is a bit inconsistent, in my opinion. It calls for inflation after the sell-off (within the next 12 months, with oil and gold at above \$100 and \$1,500 respectively) and it bases the pessimism in the naturally intuitive failure that the transfer of losses from private to public sector represents. I believe the inconsistency with an inflationary scenario (i.e. asset prices falling and consumer prices rising) is clear by now. The other point, the one about the failure in transferring losses, well, that is precisely what makes this crisis unique. I would say that such failure is a certainty, when you deal with local, closed economies. However, when you have global coordination of monetary policies by the biggest central banks (i.e. liquidity suppliers) ensuring the market remains liquid; well...a forced sell-off seems unlikely. In conclusion, given the high respect I have for this analyst's opinions, if the sell-off will come when macro data disappoints and so far the data is not disappointing, and if you share my view that a globally coordinated debasement can be successful, you should believe we cannot see equity prices falling. If we cannot see equity prices falling and macro data continues to improve, then sooner rather than later, we should be seeing higher equity prices. Thus, I have to update my view about errant, stagnant equity prices, in favor of higher levels. Perhaps a key level to hold this view in S&P500 can be 944pts.

-Yield curve:

Until now, I firmly believed the yield curve would remain steep. It was a view that played well. However, from now on, I am in doubt. Late action and speeches by the Fed indicate that an exit strategy would favor an increase in short-term interest rates. The increase would be driven by interest paid on reserves and of course, the Fed's withdrawal from Treasury auctions. However, as I've been relentlessly repeating, the problem is the fiscal deficits. And I think you would side with me if I said that I don't think these deficits will decrease. The deficits for 2009 and 2010 are estimated to be approx. \$1.35 trillion and \$1.23 trillion respectively, without including any healthcare reform. How big is this? To put it in perspective, on July 29<sup>th</sup>, Bank of America's Credit Strategy team published a report (Situation Room: "Rolling over the mountain of High Yield debt"), where they expressed concern on the market's capacity to refinance high yield loan maturities estimated at \$361BN, starting in 2013. If \$361BN four years down the road is of concern....how about \$1.23 trillion just next year???!!!! You can now pretty much see how significant the crowding-out effect is starting to be. Each dollar that goes to buy Treasuries should in theory (that is, if it hasn't been printed out of nowhere!) not be available to refinance high yield debt. Therefore, with ongoing stratospheric fiscal deficits until at least 2011, any increase in short term rates will be validated by the Treasury. The question then arises on the value of the USD....If we are going to have higher short-term rates, should we not see the USD gaining value? It is possible, but it is certainly too early for me to answer this. I remain very vigilant then.

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Onto other things now, I have been doing a fair amount of reading this long weekend. In general, I've found a certain level of complacency. Analysts are beginning to point to favorable economic data to validate the rally in equities and credit. Even relative value trades (i.e. HY loans vs. HY bonds) are recommended on the basis of better economic metrics. Make no mistake; as much as this crisis was all about de-leveraging, this rally is all about re-leveraging. It is all playing out on the back of enormous amounts of monetized debt that will have to be paid, sooner or later. Yes, it can take years to become visible, but the tears will be there nonetheless. In fact, if all this nonsense of financial regulation ends up being passed in the US Congress (and in other countries as well), the pain will be unbearable. And if this monetization is ever challenged by the markets or faces political obstacles leading to un-coordination, the dream we are currently living will turn into a horrible nightmare in no time.