

A View from the Trenches

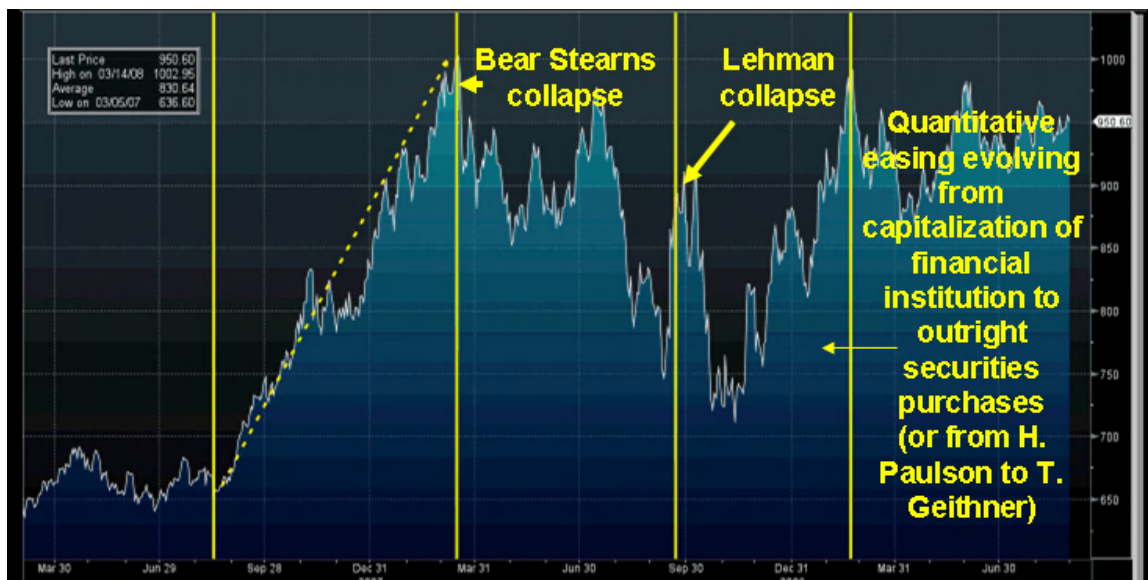
Toronto, Tuesday, September 1st, 2009

Good morning,

I am sure you will disagree with me, but I think that yesterday was an uneventful day. Yes, stocks in China had a hell of a sell-off, but...was anyone surprised? Was anyone surprised to see stocks in North America finish less than 1% lower? Perhaps the flag was the drop in the price of crude, below \$70. But besides that, a good indication of the mood in the markets is that in the Credit space, the IG12 index was up by only 3bps, while the HY12 index was actually down by 1/4 of a point.

We first postulated on August 19th (www.sibileau.com/martin/2009/08/19) the thesis that interest rates are going to stay low longer than anticipated. Since then, the market seems to side with this notion, as both the Bank of America's Rates strategy team and Goldman Sachs' Global Economics team explicitly elaborated on it (BofA's "Global Rates Focus" and GS' "US Economics Analyst: 09/34 - The Outlook for Fed Policy", both published last Friday). In the Goldman Sachs the document, it is interesting to note the notorious global approach to the subject, even though it specifically deals with the Fed. Thus, in general, I think that the global coordination of central banks is becoming more and more evident to the investing community.

I do not blame the obscure, bearish forecasters for taking the stand that government intervention will not work. I believe it has a lot to do with the academic tradition of handling the analysis of financial crisis at the single economy level. There is nothing wrong with that, for that had always been the case until 2008 (One could, with a lot of hindsight, make the comment that if the global financial cooperation is avoided, the global military "cooperation" replaces it, as the case of World War II shows). To picture this point, I thought there was no better chart than that of the price of the gold. This chart (source: Bloomberg) shows the evolution of the price since the start of the crisis. It didn't stop rising until central banks assumed a leading role with the bankruptcy of Bear Stearns and since then, it has not gone anywhere, trading with a very wide range. The vertical lines signal key events: The collapse of Lehman, and the beginning of the Obama administration. The underperformance of gold therefore is the best witness we have, to attest that global (not local) intervention is about to write a new chapter in economic history. But to be fair, it won't be a nice one, because there is still a lot of fiscal deficits to subsidize (i.e. central banks monetizing deficits) or cross-subsidize (central banks from some nations subsidizing the fiscal deficits of other nations, as in the case of Canada, that issues \$3BN in federal government bonds in USD to push a bid out of the Canadian dollar, depreciating the financial assets of Canadian taxpayers who save in Canadian dollars, in favor of US note holders).



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