

A View from the Trenches Toronto, Tuesday, December 24th, 2009

“...And when output has increased and prices have risen, the effect of this on liquidity-preference will be to increase the quantity of money necessary to maintain a given rate of interest...” (J. M. Keynes, “The General Theory of Employment, Interest and Money”, Chapter 13, Section III, 1936).

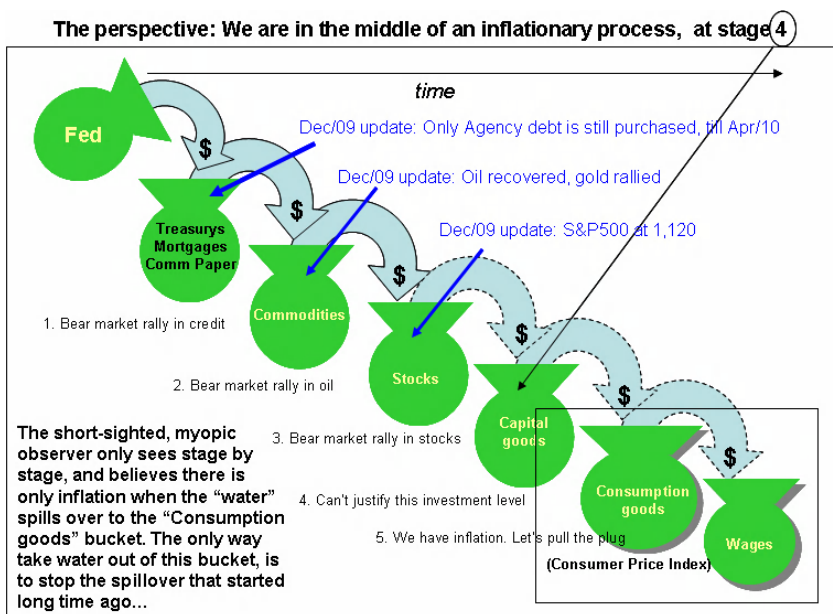
Good morning,

Below is the first chart that I included on my first letter, back on April 14th (refer: www.sibileau.com/martin/2009/04/14, “Remembering Harberler: The price level may be a misleading guide for monetary policy”). I think this chart says it all. Back in April, the spill over from the Treasuries and Agency debt/Mortgages markets was just beginning. As I foresaw, quantitative easing policies worldwide lifted commodities, taking oil to \$80+/bbl and gold to \$1,226/oz, and stocks, with for instance, the S&P500 reaching 1,120 yesterday.

Further, in the spring, we heard economists all along say that the markets were overvalued, that a second dip was on its way. All along, I stuck to my thoroughly explained thesis. I also thoroughly explained why the mainstream theses (i.e. **David Rosenberg’s:” Reversible rally or reflexive rebound?” Bank of America’s Morning Call Note, April 20th, 2009) was wrong** (For instance, also refer to my critic on Krugman’s view: “Why should we see lower lows in stocks and wider wides in credit?”, www.sibileau.com/martin/2009/05/19).

Entering 2010, we will reach stage no.4 shown below, where we should see an increase in prices for capital goods and raw materials, as well as the price of the companies that supply them. The tap feeding the waterfall will have shut for the most part, but the spillover effects from tighter spreads in credit will keep feeding a rally in stocks, along with M&A deals, increasing the leverage of companies. As the text for stage no. 4 reads, **we will tell ourselves that companies cannot justify their investment levels, and we will not be able to come to terms with P/E ratios**. This will only be the beginning of mankind’s greatest illusion or economic delusion. It won’t be nice, because along the way, the head of sovereign defaults will raise its ugly head. Get ready, but in the meantime, profit from the spillover effect. On this, please refer to my letters earlier this month.

Finally yet importantly, I would like to wish everyone a healthy and prosperous 2010. It has been a pleasure writing “A View from the Trenches” and exchanging intellectually challenging correspondence with many readers. This is the final letter of 2009. “A View from the Trenches” will be published again on January 4th, 2010.



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