Selling Out: Ignoring Corruption for the Temporary Wealth Image

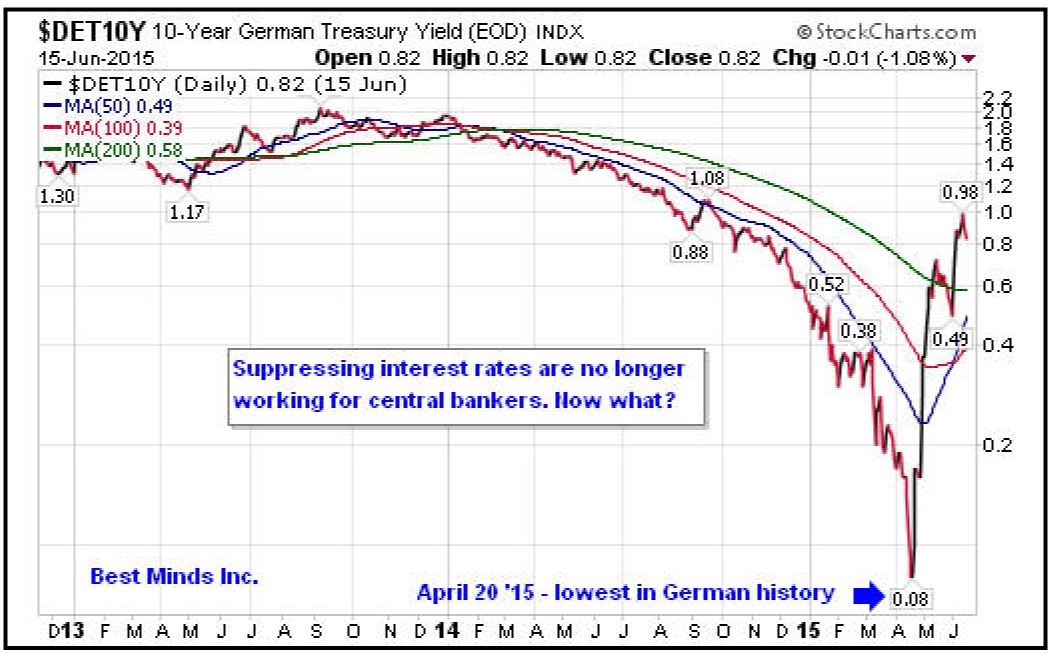
Doug Wakefield June 16, 2015

"What happens to price in a bidless market? It goes off a cliff….

Investors in stocks, bonds, and real estate are being herded off the cliff by the Federal Reserve. The name of the game in the New Normal is to force investors large and small into risk assets. When the risk assets blow up, the herd plunges headlong over the cliff en masse." [The Fed is Funneling the Investing Herd Off the Cliff, Charles Hugh Smith, June 12, 2015]

We are quickly coming to a point where the global party of "unlimited credit" backstopped by the highest authorities in global finance, central banks, can no longer stop what has already been repeated many times for centuries; the breaking of the stock and bond bubbles. In fact, the current bubble literally is facing the question of who will win in the game of money itself.

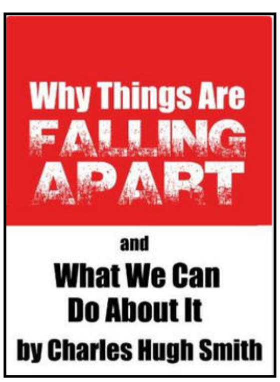

$SSEC Shanghai Stock Exchange Composite Index (EOD) INDX
© StockCharts.com
16-Jun-2015 Op 5004.41 Hi 5029.68 Lo 4842.10 Cl 4887.43 Chg -175.56 (-3.47%)
$SSEC (Daily) 4887.43
MA(50) 4519.54
MA(100) 3947.45
MA(200) 3272.62
Does this look like steady sustainable growth or a full blown mania that could end very quickly? Anyone studying history would know that this question was answered in 2007.
Best Minds Inc.
5178.19
3406.79
3049.11
2443.03
2334.33
2270.27
2177.98
2161.14
2078.99
1974.38
1949.46
1849.65
D 13 F M A M J J A S O N D 14 F M A M J J A S O N D 15 F M A M J


$DET10Y 10-Year German Treasury Yield (EOD) INDX
© StockCharts.com
15-Jun-2015 Open 0.82 High 0.82 Low 0.82 Close 0.82 Chg -0.01 (-1.08%)
$DET10Y (Daily) 0.82 (15 Jun)
MA(50) 0.49
MA(100) 0.39
MA(200) 0.58
Suppressing interest rates are no longer working for central bankers. Now what?
Best Minds Inc.
April 20 '15 - lowest in German history
0.08
1.30
1.17
1.08
0.88
0.52
0.38
0.98
0.49
D13 F M A M J J A S O N D 14 F M A M J J A S O N D 15 F M A M J

As we wait for the latest Fed press release (June 17) to feed trading algorithms at 2:00 EST, we back away from the near term. Instead of the relentless pursuit of “the bottom line”, we will examine the question, “Why is this happening again?” from an ethics point of view.

During bull markets, when the majority are enjoying the ride up, ethics takes a back seat to bottom lines. Only when trillions in losses are racking up across the landscape, does ethics and the lessons from history become more important than chasing the temporary wealth illusion.

Join the Crowd or Flee From It?



Charles Hugh Smith’s book, **Why Things Are Falling Apart and What We Can Do About It** (2012), has two ideas that we all should have considered three years ago, and based on the comments from one of his recent articles, has become far more critical this summer:

- `”Conformity. Studies have found that the need to ‘fit in’ leads people to accept blatant falsehoods if the

- “Overconfidence, also called hubris. This is the root of the phrase, ‘pride goeth before a fall.’ The individual who is supremely confident in the superiority of his judgment is an individual who will ignore evidence that he might be wrong.”

This becomes even harder, when the Chairman of the Federal Reserve publicly TELLS everyone that he is artificially inflating assets so everyone FEELS richer. Anyone thinking about his statement from September 2012 when QEIII was launched understands he was telling everyone this scheme was only temporary.

Fed Seeking to Create Wealth, Not Just Cut Rates, Yahoo Finance, Sept 14 ‘12

“The Federal Reserve wasn’t just trying to drive down interest rates when it announced on a third round of bond purchases Thursday. It was wants to make people feel wealthier – and more willing to spend.

‘…if the feel that their financial situation is better because their 401(k) looks better or for whatever reason - their house is worth more – they’re more willing to go out and spend,’ Chairman Bernanke told reporters. ‘That’s going to provide the demand that firms need in order to be willing to hire and to invest.’”

How many people do you know who believe that borrowing lot’s of money to make one’s “wealth effect” look good, actually changes the fact that they are BORROWING from their *future* to have that image *today*. How could Bernanke have ignored this basic principle of personal and business finance?

So what happens when a herd of investors, large and small, want to lock in their gains from Bernanke’s short-term experiment of “more debt will make you FEEL wealthy”? Will all of this new debt in the system go away, or will the public’s *feelings* change when the latest credit fueled bubble burst, bringing with it far more than massive financial losses again?

"Vogue editor Diana Vreeland's motto, 'Fake it, fake it', is now the First Commandment of the spin-doctor and the commercial maker. As Vreeland advises, 'Never worry about the facts. Project an image to the public.' The art of success is to create a world 'as you feel it to be, as you wish it to be, as you wish it into being.'" When No One Sees: The Importance of Character in an Age of Image (2000), Os Guinness, pg 2.2 [Quoted in Destroy a Currency, Extend a Rally, 11/8/14]

I Want Cash: Who Will Buy My "All Time High" Shares?

"Some investors take comfort in the fact that spreads (i.e., the price between the bid and ask) have remained low and healthy. But market depth is far lower than it was, and we believe it is a precursor of liquidity. ...The likely explanation for the lower depth in almost all bond markets is that inventories of market - makers' positions are dramatically lower than in the past. For instance, the total inventory of Treasuries available to market makers today is $1.7 trillion, down from $2.7 trillion at its peak in 2007.

Meanwhile, the Treasury market is $12.5 trillion; it was $4.4 trillion in 2007." [JP Morgan Shareholder letter from Jamie Dimon, April 8, 2015, pg 31]

Now are the global banks and central banks just now figuring out that the Fed's "wealth effect", of buying tens of billions of Treasuries each month since Bernanke's Sept. 2012 "feel wealthier and keep spending" scheme was announced, has actually been REDUCING liquidity, thus placing ALL investors in a market environment where risk is must higher right now than three years ago?

The following is a quote from UBS' Michael Schumacher, from a Zero Hedge article that was released a week before Bernanke's announcement, and pulled from a [Special Edition issue of The Investor's Mind]() released on Sept 21, 2012:

> "The Fed owns all but $650 billion of 10-30 year nominal Treasuries. Taking out, say, $300 billion in long term Treasuries almost certainly *would put tremendous pressure on liquidity in that market*...Ploughing ahead with a large, fixed size QE program *could cause liquidity to tank*."

And of course, any central banker reading the December 2008 BIS Quarterly Review right AFTER the collapse of world credit markets in the fall of 2008 would have known this long before 2012:

> "The scarcity of US Treasuries for repo transactions also manifested itself in a sharp increase in the number of Treasury settlement fails. Whereas fails to deliver Treasuries had average around $90 billion per week during the two years preceding the crisis, they rose to above $1 trillion during the Bear Stearns episode and then soared to record highs of almost $2.7 trillion following the Lehman default." [pg 46]

[Source – [The Big, the Bull and the Banker](), Dec 18 '08]

So when it is time to sell, who will buy all of the shares at "all time high" prices?

Stock Buybacks; Focusing on Casino Wins or Economic Good?

"Your mind thinks thoughts and the pictures are broadcast back as your life experience. You not only create your life with your thoughts, but your thoughts add powerfully to the creation of the world. If you thought that you were insignificant and had no power in this world, think again. You mind is actually shaping the world around you." **The Secret**, Rhonda Byrne, [Quoted at its 82nd week on the top two "Hardcover Advice" of the NY Times Best Sellers and in The Secret of Retirement Planning, Aug. 20, 2008]

Blaise Pascal once said, "Ordinary people have the ability not to think about things they do not want to think about." When one considers the massive levels of debt that corporations have taken on in order to buy back their own stock, a method which has given the impression to millions of investors that "the crowd" is buying the market, then millions of investors and thousands of advisors have a great deal to think about this summer, even if they do not desire to.

But hey, who can blame the public, since societies are build around the motto, "We can always borrow our way to the top", as central bankers have so firmly endorsed, especially since 2008.

Yet therein lies the problem. The last 6 years of massive intervention by central banks, using the "nuclear money option", has created a society that is addicted to big daddy always intervening to "remove risk", which never will happen.

Delay it rearing its ugly head, yes. Remove it, no.

Ultimately, like a person who knows the oil light is on in their car and keeps driving, ignoring reality will eventually have far more serious consequences.

Stanley Drunkenmiller, one of the most famous hedge fund managers in the world, was quoted in a recent article on CNBC [(1)], for his view the current record breaking levels of corporate stock buybacks: "I think it's nuts. If you're running a business for the long term, the last thing you should be doing is borrowing money to buy your own stock."

The same article pointed out that April was a record breaking month for stock buybacks being authorized, reaching $141 billion. If the rest of the year continued at this pace, we would reach $1.2 trillion, which would be higher than the previous annual high of $863 billion set in 2007.

If one's method for investing is "believe and shape the world around you", then who cares about history. If one's method is based on learning from our past and history, then we remember that the previous stock buying record year of 2007, was the start of the largest destruction of wealth, over $60 trillion, in history.

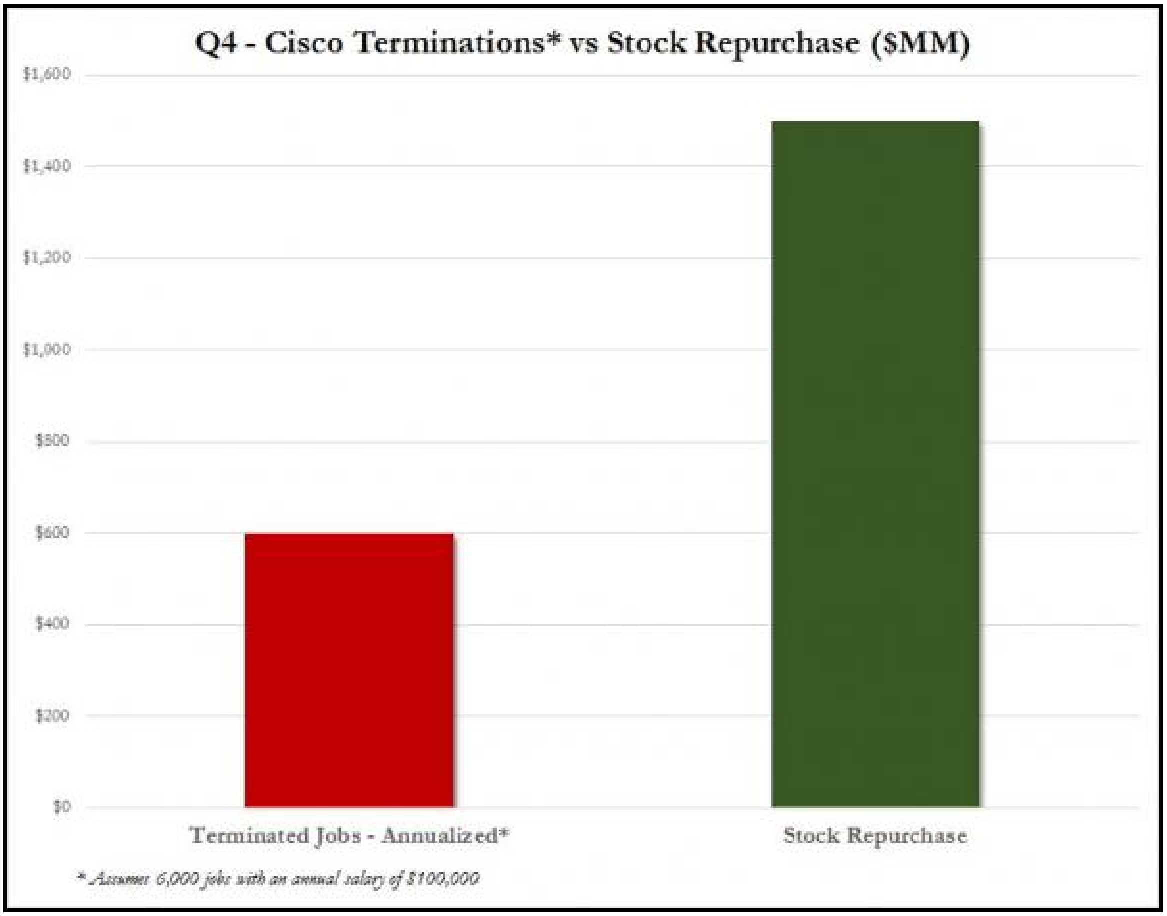
While doing my own research for this piece, I learned from another article, this one from the Boston Globe **(2)**, that since the early '80s when I was in my late 20s, that the nation's top publicly traded companies have gone from having 70% of their profits available to reinvest in their own business, to just 2 percent in 2014.

Bevis Longstreth, was a commissioner for the SEC in 1982 when the rule was changed that launched the buy back boom. Consider his insights of how distorted our markets have become:

> *"It is a terrible thing for the economy because the growth of the economy and the growth of individual companies depends upon their reinvesting in their business and expansion into other lines of business, and paying 98 percent of your earnings out as dividends or stock buybacks implies that you have no future."*

Bob Ordemann's team of 80 software developers and engineers were among the 8% or 6,000 workers that Cisco announced were being laid off last year. These individuals, many of whom had worked to build the company during their careers, were slammed with the reality that at the same time they were being laid off to "cut costs", the company was continuing to spend billions to buy back its own stock, a move which would reduce the number of shares on the open market and help "assist" its price in the financial markets.

If this were an isolated incident, it would be a moral travesty. Since this data supports that this has become a national epidemic, every investors trusting in a "comfortable retirement" while thousands of workers are axed, should understand that their own financial futures are at risk from these unsustainable schemes. When major corporations are stuck with declining stock prices and their creative and loyal workforce is not there to rebuild TRUE long term growth, how will that impact the "we" and the "me"?



[Source – [Cisco Sums It Up: Terminates 8% of Workforce While Buying Back $1.5 Billion in Stock], Zero Hedge, August 13, 2015]

With David Kostin's – Chief Equity Strategist at Goldman Sachs – in May 2013 and November 2014 presenting a 2015 year end value on the S&P 500 of 2100 [3], the record stock buybacks in April, record corporate debt levels, drastic reduction in US Treasuries in the hands of market makers to provide liquidity WHEN the major US stock indices break under their "nirvana lines" [4], then where will our markets find big money to keep stocks climbing when they start falling again like last October, when the Dow lost almost 1500 points in a little over 3 weeks?

Twenty years ago we might say to someone who said our markets were even "rigged" or "manipulated" to achieve the "always bull" image, that they were crazy, or one who believed a conspiracy theory. Well, no one willing to read can say that today. A "winning at all costs" attitude in order to continue "feeling wealthier in the short term", will ultimately bring severe consequences for us all, no matter who were are, or where we stand on the socioeconomic ladder.

DOJ Launches Probe Of Treasury Market Manipulation, Zero Hedge, June 8, '15

Six Banks Pay $5.8 Billion, Five Guilty of Market Rigging, Bloomberg, May 20,'15

Big Banks Fined $2.3 Billion Over Illegal Libor Cartels, More Fines on the Way, Forbes, Dec 4 '13

How many times will tens of millions of investors trust the powers of OZ more than the lessons from the previous 28 financial bubbles spanning the last four centuries? (5)

Sources:

(1) Q: Why Do Markets Fall Late In the Day? A: Buy Backs, CNBC, 6/1/15
(2) Feast for Investors Sells Workers Short, The Boston Globe, 5/31/15
(3) Investment Parachutes: Do You Have Yours?, Doug Wakefield, 3/27/15
(4) The Nirvana Trade, Doug Wakefield, 7/24/13
(5) "We have in fact searched through all the data that we can find on currencies, commodities, and stock markets and have found 27 bubbles. Unlike Chairman Greenspan, we have no problem defining a bubble: we arbitrarily use a two standard deviation events, the kind that would normally occur randomly every 40 years. Predictably (at least for believers in regression to the mean), all 27 bubbles broke and went all the way back to the preexisting trend. If it does not do this, it will be the first failure to do so in modern times." [GMO Quarterly Letter, "The Countdown Continues" (October 2004) Jeremy Grantham, pg 6, quoted on page 135 in Riders on the Storm: Short Selling in Contrary Winds (Jan '06), Doug Wakefield with Ben Hill]

Being a Contrarian, Remembering 2000

The big shift from longs to shorts and shorts to longs grows stronger with ever delay, warning any student of history.

Click here to start the next six months reading the newsletters and trading reports. It is extremely dangerous for so many people to place so much faith in the first ever “six month all time high”, or “Dow 18,000 level”. (12/5/14 – reaches 17,991 for first time in its history. 131 trading days later on 6/16/15, it closed at 17,903.)

On a Personal Note

Check out Living2024. It is my personal blog, not business. I wanted to have a place to write some deeper stories about where this entire drama seems to be taking us all. Check out my latest post, The Unlimited Mammon Master.

Doug Wakefield

President
Best Minds Inc. a Registered Investment Advisor
1104 Indian Ridge
Denton, Texas 76205
http://www.bestmindsinc.com/
doug@bestmindsinc.com
Phone - (940) 591 - 3000

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