THINGS THAT MAKE YOU GO

Hmmm...

A walk around the fringes of finance

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"Finally, after the matter has passed from ashen-colored to white and yellow, you will see the Philosopher's Stone, our King and Dominator Supreme, issue forth from his glassy sepulcher to mount his bed or his throne in his glorified body. . . diaphanous as crystal; compact and most weighty, as easily fusible by fire as resin, as flowing as wax and more so than quicksilver . . . the color of saffron when powdered, but red as rubies when in an integral mass..."

– H. KHUNRATH *AMPHITHEATRUM*

"Alchemy is the art of manipulating life, and consciousness in matter, to help it evolve, or to solve problems of inner disharmonies"

– Jean Dubuis

"If you owe the bank $100 that's your problem. If you owe the bank $100 million, that's the bank's problem"

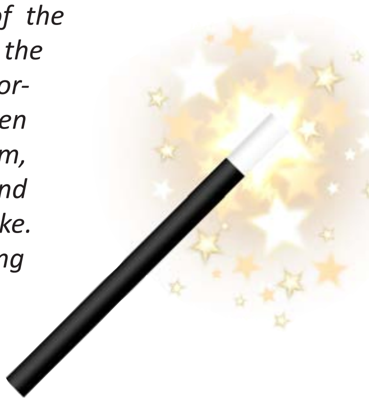
– JP Getty

Fans of J.K. Rowling's Harry Potter books will be vaguely familiar with the name Nicolas Flamel, though, unlike the book's eponymous hero, his wizardly sidekicks and characters such as Professor Dumbledore, Hagrid and, of course, He-Who-Must-Not-Be-Named, Flamel has one rather extraordinary (at least in the context of the stories) distinction: He actually existed.

Flamel's birth is steeped in confusion, but the later years of his life are well-documented due, in large part, to a book he wrote which was finally published in Paris in 1613, some 200-odd years after his death. The book, *Livre des Figures Hieroglypiques* or *Exposition of the Heiroglyphical Figures* contained an introduction that documented Flamel's search for a legendary substance that contained the most magical of properties including the ability to cure any illness known to man, and to turn base metals into gold through the process of alchemy.

The substance—sought fervently by men throughout history, not just Messrs. Potter and Flamel—is known as *lapis philosophorum*; The Philosopher's Stone:

> *(Wikipedia): According to alchemical texts, the philosopher's stone came in two varieties, prepared by an almost identical method: white (for the purpose of making silver), and red (for the purpose of making gold), the white stone being a less matured version of the red stone. Some ancient and medieval alchemical texts leave clues to the supposed physical appearance of the philosopher's stone, specifically the red stone. It is often said to be orange (saffron colored) or red when ground to powder. Or in a solid form, an intermediate between red and purple, transparent and glass-like. The weight is spoken of as being heavier than gold, and it is said to be soluble in any liquid, yet incombustible in fire.*



The physical properties of the Philosopher's Stone remain shrouded in mystery and some of the more esoteric descriptions of its appearance throughout the years tend to make it even more so:

> *(Wikipedia): Alchemical authors sometimes suggest that the stone's descriptors are metaphorical. It is called a stone, not because it is like a stone. The appearance is expressed geometrically in Michael Maier's* Atalanta Fugiens. *"Make of a man and woman a circle; then a quadrangle; out of the this a triangle; make again a circle, and you will have the Stone of the Wise. Thus is made the stone, which thou canst not discover, unless you, through diligence, learn to understand this geometrical teaching."*

Right then. So let me get this straight: we turn a man and a woman into a circle, then a quadrangle, then into some kind of a triangle and finally back into a circle again? Thanks Mike. Your seat in the European Parliament awaits.

Leaving aside whatever the hell Michael Maier was trying to explain to us, the Philosopher's Stone was long believed to be the key to the mythical process of alchemy; the science of turning base metals into gold.

According to legend, the Philosopher's Stone is created through the alchemical method known as Magnum Opus (Great Work) and this process is widely-held to consist of a series of four very distinct stages which between them number twelve individual steps (the original 12-step program). These have become known as the *Twelve Gates of George Ripley*—a famed 15th century alchemist whose twenty-five volume work on the subject contained the *Liber Duodecim Portarum*, a tome that brought him considerable notoriety.

The means to transform base metal to precious metal that man has searched for since the beginning of recorded time was laid out in simple and concise terms in the progression through George Ripley's 'gates':

1. Calcination

2. Solution (or Dissolution)

3. Separation

4. Conjunction

5. Putrefaction

6. Congelation

7. Cibation

8. Sublimation

9. Fermentation

10. Exaltation

11. Multiplication

12. Projection

This convoluted process would drive many men to distraction—including amongst them, one Isaac Newton, 'physicist, mathematician, astronomer, philosopher, theologian and alchemist' who, as Britain's *Master of the Mint* managed alchemy of a slightly lower quality when he moved the Pound Sterling from the silver standard to the gold standard by adjusting the bimetallic relationship between the two.

Newton suffered a nervous breakdown during an extended period of alchemical work which had nevertheless resulted in his producing substantive written research. That written research was later purchased by none other than John Maynard Keynes who, after studying it, proclaimed Newton "...was not the first of the age of reason, he was the last of the magicians".

But I digress.

Twelve distinct steps seems an awful lot of work just to turn lead into gold. It's far easier these days to just turn paper into money which only takes a couple of steps:

1. Plugging

2. Pushing

Now, I am certain that there are those amongst you who, based on past performance, would, at this point, feel extremely confident in placing a sizeable wager that we are about to go wandering off down a path strewn with references to attempts by central banks to turn paper into gold through the process of alchemy but I am afraid I am going to surprise/disappoint you by taking a turning of a different kind altogether and will concentrate my efforts – believe it or not—on the last of Ripley's twelve steps; Projection.

Projection, in alchemic terms, was the coup de grace, the final step in a long process whereby a small amount of the Philosopher's Stone would be cast into a molten base metal – most commonly the 82nd element in the periodic table, Lead - and, hey presto, that lowly element would be transmogrified into its near–neighbour just three steps higher in the table; #79; gold.

Projection was the moment when, despite all the work that went into getting to that last point in the program, hope and faith took over as the alchemist found himself having to rely on just a little bit of magic in order to get the outcome he so desperately wished for.

Throughout history, in all the annals of recorded time, every single alchemic projection ever attempted has turned out to be unsuccessful—a track record which gives alchemists only a *marginally* less-successful record than the Fed, the BoE, the Troika, the EC, the Eurogroup, the US Congressional Budget Office, the combined governments of the UK, Greece, Spain.... I could go on, but we've all got things to do so I won't.

Over the last five years, there have been so many 'projections' from the economic and political glitterati that have failed spectacularly as to be almost unbelievable. In fact, as I sat and thought about what to write this week, I struggled to think of a single major projection that *hasn't* come in on the bad side of good.

From Chairman Bernanke's confidently-delivered projection that *"subprime is contained"* in

March 2007, to Mariano Rajoy's promise upon being elected last November that Spain would *"...stop being a problem and instead form part of the solution [to the debt crisis]"* the hits have just kept on coming, so today we are going to look at the modern version of alchemy whereby finances are turned to farce and examine a few of the most outrageously poor *projections* of recent times. If time allows, I will even make a couple of '*projections*' of my own (thereby setting me up for ridicule at an as-yet-to-be-determined point in the future).

Ladies and gentlemen, in place of *The Twelve Gates of George Ripley*—and using Greece and Spain as examples—I give you *The Seven Fates of Grant Williams*, a series of steps that are certain to take place one after another, in sequence, once the primary stage has been initiated:

1. Greecification

This is the process whereby ordinary people are given estimates of important economic metrics by impressive-looking politicians who, when delivering said figures, sound confident and assured:

> *(CNN, September 21, 2011): The Greek government announced budget cuts Wednesday aimed at securing additional aid from its European partners as the debt-stricken nation struggles to dig itself out of a deep hole.*
>
> *Elias Mossialos, a government spokesman, said in a statement that the cuts demonstrate Greece's commitment to meet its obligations and remain a member of the European Union.*
>
> *The measures will enable Greece to achieve its budget targets for this year and next, "and allow the full implementation of the support of the Greek economy by 2014," said Mossialos.*

"... Mariano Rajoy of the opposition People's Party, the favorite to win a majority in the vote, has pledged not to stray from the deficit goal of 4.4 percent of GDP next year "under any circumstances."

> *(Bloomberg, November 17, 2012): Spanish Finance Minister Elena Salgado said the economy will grow about 0.8 percent this year, less than the government's target, and it's too early to know if the regions will meet their deficit goal this year.*
>
> *The new forecast is below the 1.3 percent government target that Salgado had said since August would be hard to meet, and is in line with the estimate of 0.7 percent published by the European Commission last week.*
>
> *Salgado said that while the central government will meet its budget-deficit target, it's not clear whether the regional governments will do so, casting doubt on the overall budget- deficit goal of 6 percent of gross domestic product.*
>
> *"I maintain 6 percent as the priority," Salgado said in an interview.*
>
> **Mariano Rajoy of the opposition People's Party, the favorite to win a majority in the vote, has pledged not to stray from the deficit goal of 4.4 percent of GDP next year "under any circumstances."**

2. Backtrackification

This is the process whereby, shortly after the Greecification process has been completed and , often, the promise of a bailout secured, the forecasts made in the first stage are altered to reflect a new and *'completely unexpected'* reality. The process can take anywhere from a matter of weeks to a matter of hours:

> *(CNN, October 2, 2011): The Greek cabinet announced late Sunday that it adopted a draft budget for 2012, but the debt-ridden nation will miss key deficit targets for this year and next.*
>
> *According to this preliminary budget, Greece's budget deficit will be 18.69 billion euros, or 8.5% of gross domestic product, in 2011. Greece had originally agreed to a defi-*

cit of 17.1 billion euros, or 7.8% of GDP, with the International Monetary Fund, European Commission and the European Central Bank.

The Greek cabinet said in a statement that the main reason it would miss the deficit target is due to a deeper-than-expected recession.

The Greek economy is now expected to contract by 5.5% this year, according to the statement. That's worse than projections of a 3.8% decline in May.

(Fundweb, March 2, 2012): Spanish prime minister Mariano Rajoy has warned that the country will miss the deficit reduction target it agreed with the European Union (EU).

Rajoy says the government will seek to bring its deficit down from 8.5% of GDP in 2011 to 5.8% this year. The Spanish government previously agreed to a target of 4.4%.

"...The missed target was mainly the result of the deeper-than-anticipated recession of the Greek economy that affected tax revenue and social security contributions,"

The news comes after all but two of the EU's 27 members signed a fiscal treaty to prevent countries from running up the kind of large debts that pushed Greece, Portugal and Ireland into needing bailouts from the international community.

The Spanish prime minister said he has not discussed the deficit with fellow EU leaders at the first session of the European Council.

"We will present our proposals according to what we consider to be reasonable and sensible, but this is not closed here, nor negotiated here nor discussed here," he told reporters.

"Nobody has asked me about the public deficit in Spain."

3. Transmission

The third part of the process is the conveyance of blame onto either external parties or a set of conditions that were *'completely unforseeable'* at the time Greecification commenced:

(BBC, October 3, 2011): The [Greek] government, which on Sunday adopted its 2012 draft austerity budget, blamed the shortfall on deepening recession.

(WSJ, October 3, 2011): The missed target was "mainly the result of the deeper-than-anticipated recession of the Greek economy that affected tax revenue and social security contributions," the Greek government said in a statement...

(Huffington Post, February 23, 2012): Last Thursday, Spain's minister of economy admitted that the 2011 budget deficit had missed the 6% of GDP target by about 2 percentage points and doubted that Spain could comply with the EU-imposed deficit target for 2012. With its debt risk still at high levels, the strategy of the new Spanish government is to shift the blame to the regional governments, like Catalonia, and at the same time use the crisis to grab back the power that was devolved to the regions in the 1980s.

(UK Guardian, April 30, 2012): Rajoy had insisted that all of Spain's economic troubles were the fault of his predecessor, the Socialist José Luis Rodríguez Zapatero. So now what? You can't change horses in a storm, but you can change scapegoats, the politician's favourite pet. Another culprit had to be found, and there we have it: Spain's regions and their "reckless over-expending".

4. Restatigence

The fourth stage is the announcement of a new, improved estimate that will undoubtedly prove to be the very worst-case scenario now that all problems are in the past and a completely realistic set of estimates have been made. It is the basis upon which the continuation of the process is underpinned:

(Marketall, February 22, 2012): Greece revised its 2012 budget targets in a draft bill which was submitted to parliament. The new estimates include the full impact of the 53.5% haircut on Greek government bonds.

Budget deficit target is revised to 6.7% of GDP from 5.4% before. The government now looks for a 2012 primary deficit of 0.2% of GDP from a primary surplus of 1.1% of GDP previously. Budget revenues are seen at 56.16 billion euros compared to 59.19 billion euros before, on deeper than expected recession. Interest payments are expected to reach 13.05 billion euros, up 300 million euros from November's estimates.

(WSJ, May 18, 2012): Spain's Budget Ministry said late Friday it has revised its budget deficit estimates for last year to a wider 8.9% of gross domestic product, largely because of more red ink reported by four regional governments.

In a press release, the ministry said it is maintaining its budget deficit target of 5.3% of GDP for 2012.

"... Much of the overrun was the fault of the regions, which have moved to the center of the country's fiscal crisis...[the regions] have a long history of budget overruns..."

Spain initially reported a budget deficit equal to 8.5% of GDP for last year, far in excess of the 6%-of-GDP target it had committed to with the European Union and international investors. Much of the overrun was the fault of the regions, which have moved to the center of the country's fiscal crisis.

Spain´s regions control almost half of spending, including socially sensitive areas like healthcare and education, and have a long history of budget overruns. They are now grappling with plummeting tax revenue in a weak economy after the collapse of a tax-rich housing boom and have encountered increasing difficulties to obtain financing from international capital markets, and more recently, even from local banks.

The revised budget deficit estimates released on Friday are mostly linked to higher debt reported by the regional governments of Madrid, Valencia, Andalusia and Castille-Leon.

The Budget Ministry said that the higher level of debt was uncovered by a program the central government launched this year to help the regions pay an estimated €35 billion in overdue bills to their suppliers. In exchange for credit lines to help them to pay the bills, the government required a full accounting of their outstanding debts. Many business leaders and economists had long suspected there were hidden debts at Spain's regions.

Under intense pressure from European authorities to slash spending, Spain has also pledged to cut its deficit to the 3%-of-GDP limit for euro zone countries in 2013.

5. Bullyfication

This stage occurs when, having added a sufficient amount of OPM (pronounced 'Opium' but standing for Other People's Money, this compound is critical if the chain reaction is to continue to its end point), the politicians involved use the leverage already built up in the first four stages to alter the dynamics of the process:

(UK Daily Telegraph, May 8, 2012): Stock markets around the world fell sharply as fears grew that Greece was moving towards a euro exit following Sunday's general election, where parties rejecting internationally-imposed austerity measures made major gains.

Alexis Tsipras, the head of Greece's radical Left-wing Syriza party, said that the result "nullified" bail-out deals with the European Union and International Monetary fund... Greece has received £190 billion in aid. In exchange, it is required to make deep cuts in public spending. Mr Tsipras called the loan agreement policy "barbaric".

(Bloomberg, May 30, 2012): Tsipras tells vot-

ers he has no desire to bring back the drachma. But neither does he believe that staying in the euro requires the massive cuts in government spending to which Greece's leaders have agreed as a condition of receiving international assistance over the last two years.

The case that Tsipras and his colleagues make is that it's those austerity measures—known in the country as "the memorandum"—that are the biggest threat to Greece's membership in the euro. By crippling the economy, Tsipras contends, austerity has brought Greece closer to insolvency and default, heightening the risk of a financial catastrophe throughout the European periphery, as panicked markets bring down country after country.

"... We will present information that is astounding. It is alarming in terms of the recession and unemployment, and it shows beyond any doubt that the current policy does not bring results..."

(AP, July 3, 2012): Greek government spokesman Simos Kedikoglou told reporters on Tuesday that Greece intended to present troubling data to EU debt inspectors throughout the course of meetings this week. "We will present information that is astounding. It is alarming in terms of the recession and unemployment, and it shows beyond any doubt that the current policy does not bring results. It brings the opposite results," Kedikoglou said.

(Bloomberg, June 1, 2012): Economy Minister Luis de Guindos said late yesterday that the future of the euro is at stake, as data showed a net 66 billion euros ($81 billion) of capital left Spain in March. "I don't know if we're on the edge of the precipice, but we're in a very, very difficult situation," he said at a conference in Sitges, Spain.

(UK Daily Telegraph June 2, 2012): Mr Rajoy has become the latest European politician to call for countries to, in effect, abandon their sovereignty in a last-ditch attempt to save the beleaguered currency

Mr Rajoy said a new central authority would go a long way to alleviating Spain's economic crisis as it would send a clear signal to investors that the single currency is an irreversible project.

He said: "The European Union needs to reinforce its architecture. This entails moving towards more integration, transferring more sovereignty, especially in the fiscal field.

"And this means a compromise to create a new European fiscal authority which would guide the fiscal policy in the eurozone, harmonize the fiscal policy of member states and enable a centralised control of [public] finances."

6. Renegotiation

Step six is when the power generated by the intensifying heat that is a by-product of the process switches sides, leading to a substantial shift in the molecular structure of the compound:

(Al Jazeera, June 23, 2011): Greece's new government has said it wanted to review several austerity measures that the debt-ridden country agreed as part of bailout packages.

The government on Saturday said it wanted to bargain for a two-year fiscal adjustment extension as it prepared for an EU-IMF audit next week.

A policy document released by the conservative-led coalition said efforts to "revise" Greece's bailout deal in talks with creditors starting on Monday include "the extension of the fiscal adjustment by at least two years," to 2016.

The aim would be to meet fiscal goals "without further cuts to salaries, pensions and public investment" and new taxes, it said, announcing a freeze on further civil-service layoffs, sales-tax cuts and longer unemployment benefits.

"The aim is to avoid layoffs of permanent

staff, but to economise a serious amount through non-salary operational costs and less bureaucracy," the three-party coalition document said.

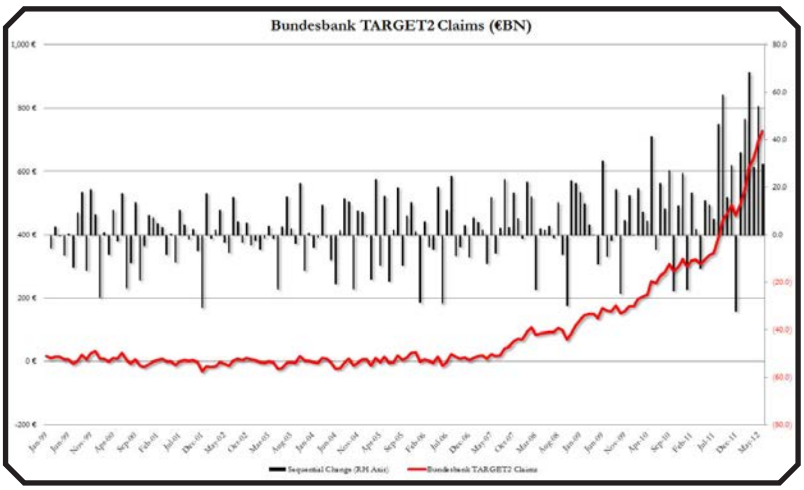
(Firedoglake July 10, 2012): Finance Ministers meeting in Europe agreed on a series of measures for Spain. First, they authorized a first installment of 30 billion euros for lending to Spanish banks, subject to approval from Eurozone governments. The money will be distributed by the end of the month, a faster schedule than previously considered. The real question is who is held responsible for the lending, the Eurozone bailout facility or the sovereign government. The assumption at the EU summit was the former, but talk that governments are actually ultimately responsible caused Spanish debt yields to soar, leading to this emergency action.

Second, the finance ministers agreed to slow down the austerity demands for the Spanish government.

At the same time, Spain's targets for cutting its gaping budget deficit will be eased as the country sinks deeper into its second recession in three years, with an unemployment rate of almost 25 percent. But the ministers demanded that Spain squeeze its austerity budget even tighter to meet the new targets.

"I would expect that some additional measures will have to be taken rather soon," the European Commission's vice president, Olli Rehn, said at the news conference.

For its part, the European Commission had proposed that Madrid's deficit target this year be relaxed to 6.3 percent of gross domestic product, from 5.3 percent earlier. Madrid also would get an additional year — until 2014 — to bring the deficit below 3 percent of G.D.P., which is the target for all euro zone countries.



CLICK TO ENLARGE

SOURCE: ZEROHEDGE

7. Realization

Now we reach the part where the truth finally dawns that the words spoken long ago by JP Getty are actually not *just* an amusing motif fit for the front of a t-shirt or a fridge magnet:

> *"If you owe the bank $100 that's your problem. If you owe the bank $100 million, that's the bank's problem"*

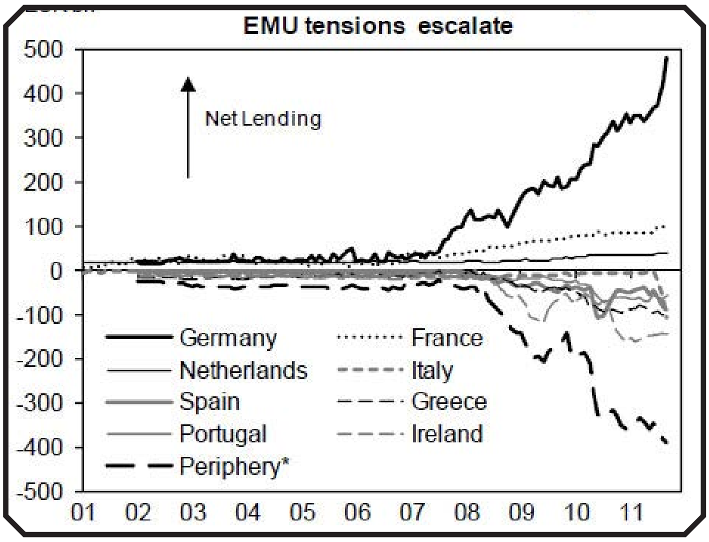
The sum total of bailouts offered to Europe's prodigal offspring is mounting daily, but the Achilles Heel of the entire construct continues to be the Target2 payment system which has been so assiduously ignored by most observers yet followed so closely by my friends at Zerohedge for many months now.

This problem remains below the radar of most observers but, I suspect, will turn out to be the straw that breaks the camel's back

(Zerohedge, 6 July, 2012): We have some good news for our German readers: in the month of June, your implicit cost of preserving the Eurozone (read the PIIGS) via TARGET2 funding of current account and various other public sector deficits and imbalances amounted to only €1 billion/day, down from €2 billion in June. We also have some bad news, which is that Europe's negative convexity ticking inflationary time bomb, which guarantees that with every month in which nothing is done to undo the Buba's onboarding of liquidity risk, the risk for an out of control implosion of German, and implicitly all

European monetary institutions, rises exponentially, and just hit an all time high of €729 billion.

To everyone who naively believes that a deus ex can come out of stage left and somehow reverse this guaranteed loss to German taxpayers in the form of even more guaranteed inflation down the road, we suggest you short the chart [previous page].



CLICK TO ENLARGE SOURCE: ZEROHEDGE

(For good measure, the chart above shows the debits on the peripheral side of the balance sheet versus Germany's credits).

And so you can see that the steps are the same in every crisis. They really are. Poor projections are made and in every case, as is the wont of human nature, the most palatable estimate is *always* given because it is far easier to keep people as happy as possible in the present. After all, maybe they don't actually *need* to be disappointed in the future. Things *may* just work out, and if they don't, well it can always be played off as an 'unseen set of circumstances' that led to the poor *projection* and the painful adjustment necessary to meet reality.

Unfortunately, as the events in Greece and Spain are proving, one such situation can be masked and dealt with, but multiple situations occurring simultaneously—each bigger than the last—is guaranteed to bring the house of cards tumbling down.

A long time ago now, I promised you a look at some of the more feeble *projections* of the last several years so, leaving aside those of Greek and Spanish politicians, let's kick things off with the US Congressional Budget Office (CBO).

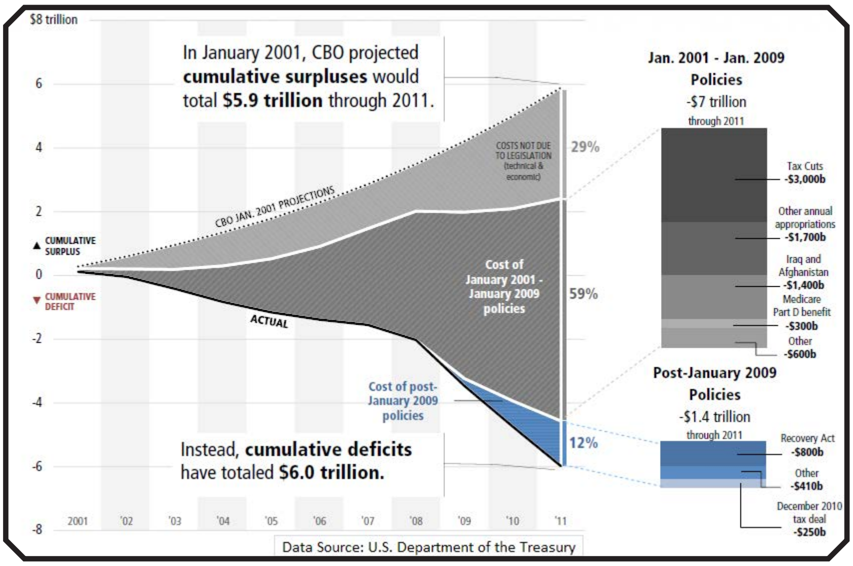
The CBO's *projection* record is second-to-none in terms of its ineptitude and the distance away from the mark that they regularly manage to achieve is nothing short of wondrous; particularly for a body which is described thus on its own website:

Since its founding in 1974, the Congressional Budget Office has produced independent, nonpartisan, timely analysis of economic and budgetary issues to support the Congressional budget process. The agency's long tradition of nonpartisanship is evident in each of the dozens of reports and hundreds of cost estimates its economists and policy analysts produce each year. CBO analyses do not make policy recommendations, and each report and cost estimate discloses our assumptions and methodologies. ***All CBO employees are appointed solely on the basis of professional competence****, without regard to political affiliation*

That's 'professional competence'.

(WSJ, August 30, 2001): In 1993, the CBO predicted that the deficit would soar to $653 billion in 2003. This week, they said that same budget will be in surplus by $172 billion. Little of that $825 billion revision can be explained by legislation or luck. Nearly all of it reflects the magnitude of past forecasting blunders.

Errors are unavoidable, but perpetual bias is another matter. CBO errors always tilt in a specific direction. Aside from the first year of recessions, the CBO always exaggerates future budget deficits and underestimates surpluses.



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SOURCE: US DEPT. OF THE TREASURY

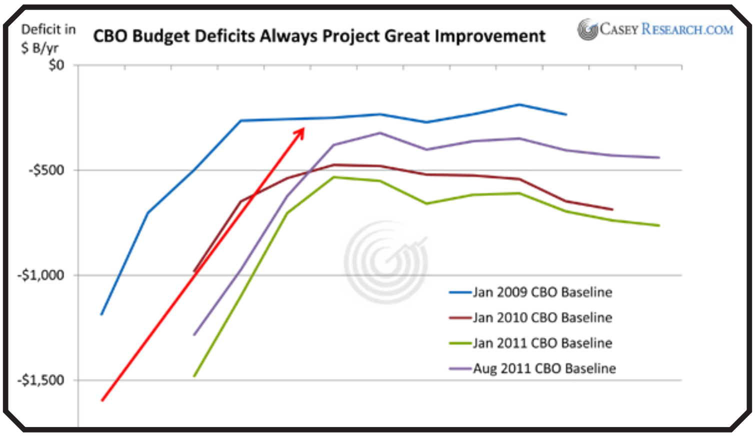
Yes, I know, "who could have seen the GFC coming in 2001?", right? Well take a look at the chart (left) to see just how off the mark the CBO has been since the very day it made the projection:

But it's not just the 2001 projection that is 'off'. As Casey research's Bud Conrad pointed out late last year, some people just never learn:

Looking at the future of government deficits, the Congressional Budget Office (CBO) starts with a baseline projection of the expected government budget deficit based solely on laws already enacted. In other words, the baseline doesn't account for new laws, which invariably expand spending. Not surprisingly, as you can see in the chart [below, left] of previously published baseline forecasts, the CBO's deficit projections are always optimistic about the expected deficit.

Past forecasts often overstated deficits by huge amounts even for the current year -- by $78 billion in 1992 and $102 billion in 1997. In early 1998, the CBO thought the next year's surplus would be $2 billion, but it turned out to be $125 billion. Looking further ahead, CBO errors have been staggering. Next year's budget, now estimated to be in surplus by $176 billion, had once been expected to show deficits of $579 billion (per the CBO's 1993 forecast), $349 billion (1995 forecast), and $188 billion (1997 forecast).

In January 2001, the CBO famously projected that cumulative surpluses in the United States would be $5.9 trillion through 2011. Instead, the United States ended up with cumulative deficits of $6.0 trillion during this period.



SOURCE: CASEY RESEARCH

Well at least we can take solace in their professional competence.

How about our old friends in the UK? Specifically Her Majesty's Treasury, who have some wonderful 5-year *projections* all of their own as we discussed in these pages a short while ago by picking the brains of the marvellous Greg Weldon (www.weldononline.com).:

(TTMYGH): ... UK government spending will increase, every year, including an expansion of +2.8% scheduled to be implemented this year.

The UK government is 'banking on' growth in Revenue that will exceed the rate of growth in Expenditures, including growth of +3.5% cooked-into-the-books for this year.

But, the margin for error is slim, with year-over-year Revenue forecast to grow by more than the growth in year-over-year Spending, by a mere £1.4 billion.

Over the next five years things get even more interesting.

> *In order to 'support' a sizable EXPANSION in SPENDING over the next five years (pegged at +12.7%), the UK Treasury is RELYING on an astronomical rise in Revenue over that same five year period, pegged at +33.4%.*
>
> *Revenue is forecast to rise by +£184.2 billion over the next five years, or by nearly +£40 billion per year.*
>
> *Ahem, excuse me ... perhaps the UK Treasury overlooked the FACT that Revenue in February, pegged at £38.631 billion was (-) 1.9% BELOW the year-ago February revenue of £39.381 billion.*
>
> *A decline of nearly £1 billion is FAR from the projections calling for a near +£40 billion per year increase over the next five years.*

Oh Boy.

Moving right along we reach more topical ground with JP Morgan's recent CIO loss which, on April 13 was famously described by CEO Jamie Dimon as "a tempest in a teacup". In the space of two weeks it ballooned to a $2bln loss that Dimon *projected* could possibly grow further to $3bln during the quarter.

"... A decline of nearly £1 billion is FAR from the projections calling for a near +£40 billion per year increase over the next five years..."

> *(Bloomberg, July 13, 2012): Botched trades by a JPMorgan Chase & Co. unit that Jamie Dimon had pushed to boost profit were masked by weak internal controls and may ultimately saddle the bank with a $7.5 billion loss.*
>
> *JPMorgan's chief investment office has lost $5.8 billion on the trades so far, and that figure may climb by $1.7 billion in a worst-case scenario, Dimon, the bank's chairman and chief executive officer, said yesterday*

Not great, Jamie, not great.

This most recent example is the perfect illustration of the point I have so laboriously been trying to make.

At the very moment the potential loss was announced as "possibly as high as $3bln", commentators began speculating as to the REAL magnitude of that loss. *Projections* as high as $9bln were mooted in the blogosphere and so, when the loss came in at a 'mere' $5.8bln (or, put another way, roughly double the worst-case estimate of a mere 8 weeks ago), it didn't look quite so bad and the stock rallied. Oh so quietly, the total loss *projection* was increased from $3bln to $7.5bln 'in a worst-case scenario'.

Worst-case, folks. More worst than the previous worst-case, admittedly, but definitely worst-case.

And so, with time and space running short, I could hardly take pot-shots at all and sundry for their poor *projections* without making a couple of my own so that my feet may also be held to the fire in the months to come and I shall begin with my friends in France and M. Hollande's recent *projections* about the amount of money his new tax increases will generate for the country's coffers.

Hollande's recent moves to raise income taxes, taxes on foreign-owned second homes, rental income and capital gains on property sales were instantly *projected* by the French Treasury to add a significant amount to their income:

> *(UK Daily Telegraph): The tax rises are part of a wider package of increases that are intended to raise €7.2 billion (£5.8 billion) to meet a budget deficit target of 4.5 per cent after the government of Nicolas Sarkozy left the French exchequer with an expenditure black hole.*
>
> *An additional €2.3 billion (£1.8 billion) will be raised from a levy on those whose net wealth is €1.3 million (£1 million)...*
>
> *The French finance ministry said the new rule would affect about 60,000 rental properties in France whose owners made an average profit of £12,000.*

> *It said this would add €50 million (£40 million) to French revenue this year and €250 million in 2013.*

My *projection*? This scheme will fail miserably and will end up reducing the overall amount of tax collected in France.

I base my own *projection* upon many similar efforts that have been tried over the years, but will pick on two specific examples; the ill-fated Crude Oil Windfall Profits Tax Act, signed into law by Jimmy Carter on April 2, 1980 and, most recently, in Britain where a new 50p top tax rate was 'projected' to increase tax revenues by more than £1 billion. The outcome?:

> *(UK Daily Telegraph): The Treasury received £10.35 billion in income tax payments from those paying by self-assessment last month, a drop of £509 million compared with January 2011... The self-assessment returns from January, when most income tax is paid by the better-off, have been eagerly awaited by the Treasury and government ministers as they provide the first evidence of the success, or failure, of the 50p rate... Although the official statistics do not disclose how much money was paid at the 50p rate of tax, the figures indicate that it is falling short of the money the levy was expected to raise.*

But why were the *projections* so errant, I wonder? Well, it appears that human nature is far more reliable than government *projections*:

> *(UK Daily Telegraph): Senior sources said that the first official figures indicated that there had been "manoeuvring" by well-off Britons to avoid the new higher rate. The figures will add to pressure on the Coalition to drop the levy amid fears it is forcing entrepreneurs to relocate abroad... A Treasury source said the relatively poor revenues from self-assessment returns was partly down to highly-paid individuals arranging their affairs to avoid paying the 50p rate.*

> *"It's true that SA revenues are a bit disappointing — it's still early, but it looks like there's been quite a lot of forestalling and other manoeuvring to avoid the top rate," said the source.*

Worse still was the money spent on increased taxation projects in the UK that failed to deliver the *projected* returns:

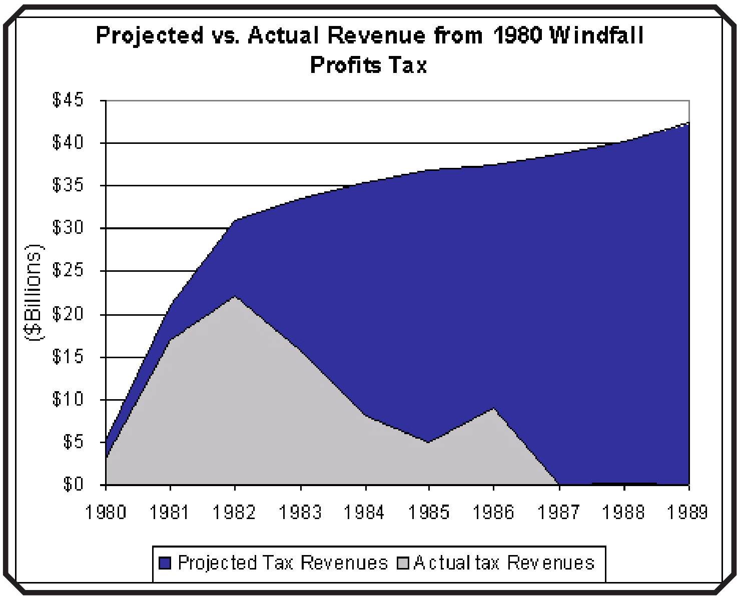
> *(Huffington Post): A public spending watchdog has found two projects costing £98 million that were set up to boost tax collection rates failed to help rake in any extra cash.*

> *The new systems at HM Revenue and Customs (HMRC) were expected to bring in £743m by the last financial year but had not delivered "any additional benefits"...*

> *"Two projects - Caseflow and Spectrum - received £98m of programme funding and were originally forecast to achieve net yield increases of £743m by 2010/11.*

> *"At the end of 2010/11, the two projects had not delivered any additional benefits."*

Carter's attempts to increase revenues through taxation were even farther from *projections* as this one, simple graph demonstrates:



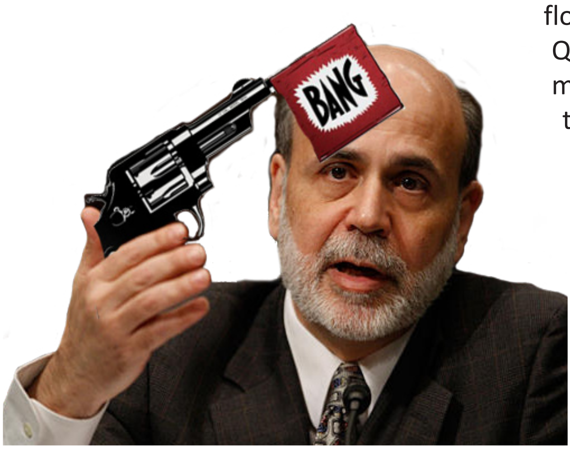
CLICK TO ENLARGE

SOURCE: CONGRESSIONAL RESEARCH SERVICE

If Monsieur Hollande thinks things will be any different in France he is, as they say in that neck of the woods, "en désordre".

Projection number two is that, when QE3 finally arrives (and arrive it will), it will mark the top of the S&P500 for a VERY long time and its positive effects will be far shorter-lived than many—including the Fed—are *projecting*.

Far from an overwhelming rising tide that will float all boats, QE3 will be a dismal failure and the last bullet in the Federal Reserve's gun will turn out not to be the hollow-point that many are *projecting*, but instead a simply a 'bang flag'.



In the course of the conversations I have whilst performing my day-job, I am constantly searching for anybody who is buying and holding stocks as an asset class because they offer tremendous long-term value, but I have yet to find them. Yes, there absolutely are some wonderful companies out there that offer tremendous long-term value. Corporate balance sheets have, by-and-large, never been healthier, companies are sitting on a heap of cash and, at ground level, businesses are doing extremely well. The problem comes with the fact that 99% of the people I speak to and 99% of the commentaries I read are either holding 'stocks' per se or recommending doing so for one reason and one reason only; they are *terrified* of missing out on the *projected* strong rally that will *undoubtedly* come once QE3 is unleashed by Ben Bernanke's Merry Band of Brothers.

That is a terrible, terrible reason to hold stocks and, when the correction comes, those good companies with strong, healthy balance sheets will be sold right alongside all the overpriced, overvalued stocks that take turns as the darlings of the analyst crowd (you know who you are, stocks). The only difference will be that the better companies' share prices will recover far faster once appetite for value and risk returns.

2008 is still too fresh in the collective minds of investors for there to be any other reaction to another major market swoon and, as the world nears the closest thing we have ever seen to a truly *global* recession, it's incredibly hard to see where the growth is coming from to justify buying stocks on 2% yields on multiples in the teens.

The 1982 bull market began with the S&P500 trading on 7x earnings and yielding 6.3% (green dotted line, left). It ended in the tech blow-off at 30x earnings and a 1% yield (red dotted line, left).

As we stand today, the S&P is yielding 2.5% and is trading at roughly 11x earning (blue dotted line, left). Expensive? Maybe not, but hardly the stuff dreams are made of.

SOURCE: **BLOOMBERG**

So there we have it, folks; a wander through the process that both begins and ends in *projections* of one kind or another. History will either look upon the two I have made kindly or with the type of scorn usually reserved for Central Bank governors or the CBO, but the one thing that gives me comfort in making them is that I have gone for the darkest end of the projection spectrum which will keep me nicely distant from those I desire NOT to emulate.

Be nice. After all, they're only *projections*.

I will leave you with a story, beautifully told by David Stockton that was culled from the transcript of an FOMC meeting in September 2005 and demonstrates the absurdity of *projections* (particularly in government-run institutions).

> "During World War II, [Nobel laureate, Ken] Arrow was assigned to a team of statisticians to produce long-range weather forecasts. After a time, Arrow and his team determined that their forecasts were not much better than pulling predictions out of a hat. They wrote their superiors, asking to be relieved of the duty. They received the following reply, and I quote "The Commanding General is well aware that the forecasts are no good. However, he needs them for planning purposes."
>
> - David Stockton, FOMC Minutes Sep 2005

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This week's edition is rather longer than usual thanks to my demented ramblings I'm afraid so I'll run you very quickly what you will find in the pages that follow...

Two looks at the 'Endgame' in Europe; one from the Wall Street Journal's Simon Nixon and one from my good friend John Mauldin, two stories on Libor-rigging; one that implies the Fed knew exactly what was going on a long time ago and one that suggests Barclays are about to turn turtle and point fingers at their peers, along with an examination as to why Treasurys may just be the worst investment in the world (personally, I would argue that distinction goes to French sovereign debt, but...).

China becomes a tool with which Mitt Romney and Barack Obama can beat each other about the head, Germany continues to play hardball with Greece and we take a look at exactly how Jamie Dimon 'hid' the CIO loss.

China's economic miracle has slowed some but Tom Stevenson argues that it is still humming along, we look at the phantom effect that FOMC meetings have on equity prices and there are charts of Stockton, CA's bankruptcy, consumer sentiment, Chinese commercial bank loans and the popularity of the rich in various countries around the world.

We have interviews with my very good friend Simon Mikhailovich on derivatives and correlation (don't miss that one) and Roger McNamee on the Facebook IPO scam as well as Janet Tavakoli schooling a poor business news anchor on the JPM CIO loss.

Finally, as Britain readies itself for the Olympic circus to hit town, we see a Chinese athlete who I'm happy to project *won't* be competing.

From Harry Potter to a potty hurdler; my work here is done.

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Words That Make You Go Hmmm.....

And Finally.....

The Gonnie, Gonnie Banks

#	Bank	Assets ($m)	Deposits ($m)	Cost ($m)
33	Glasgow Savings Bank, Glasgow, MO	24.8	24.2	0.1
	Total Cost to FDIC Deposit Insurance Fund			**0.1**

Feeling more relaxed about the euro crisis since last month's summit? Think again. The risk of a euro-zone breakup may actually be rising rather than falling, according to Bank of America Merrill Lynch strategists David Woo and Athanasios Vamvakidis. Using game theory to consider how the situation might evolve, they believe the crisis will boil down to a game of bluff between Italy and Germany in which neither country has an incentive to back down.

That doesn't mean this would be the best outcome for either side; in game theory, the most likely outcome isn't always what economists call "Pareto optimal," one that will bring maximum benefit to all players. Instead, the "Nash equilibrium" for the euro zone—the situation in which no player has an incentive to change strategy because to do so unilaterally would leave them worse off—is that Italy refuses to undertake the overhauls needed to enable its economy to grow and Germany refuses to provide the bailouts to persuade it to stay.

> "... If this is right, then the euro crisis boils down to a simple calculation: Is Germany willing to pay to keep Italy in the euro zone? Game theory says "no," say Messrs. Woo and Vamvakidis"

To reach this conclusion, Messrs. Woo and Vamvakidis undertook a simple cost-benefit analysis for each of the euro zone's 17 members. This looked at which countries were best-placed for an orderly exit in terms of the size of their fiscal and current-account positions. They also looked at the likely impact of an exit on growth, borrowing costs and national balance sheets.

The results make interesting reading: Italy and Ireland emerge as the countries with the greatest incentive to exit. In Italy's case, this is because it already runs a budget surplus before interest payments and has only a small current-account deficit. At the same time, its companies have the most to gain from devaluation. Surprisingly, the country with least incentive to exit is Germany since the cost-benefit analysis suggests a soaring currency would lead to lower growth, higher borrowing costs and big losses on overseas balances.

If this is right, then the euro crisis boils down to a simple calculation: Is Germany willing to pay to keep Italy in the euro zone? Game theory says "no," say Messrs. Woo and Vamvakidis. The problem is that even if Germany did pay, Italy would still have a strong incentive to exit eventually rather than undertake overhauls, leaving Germany worse off. And if Italy knows Germany will never pay to keep Italy in the euro, it is in Italy's interest to exit. This is a higher stakes version of the Greek impasse over the last two years, except that Italy has more reasons to leave and the euro zone faces a bigger bill to persuade Italy to stay.

Does that make a euro breakup inevitable? Not necessarily. In the real world, the game is complicated by history and politics. This analysis may not fully capture the true costs of a breakup for all countries. For the moment, there is little political pressure in Italy to exit the euro. Besides, one thing could decisively alter the equation, say Messrs. Woo and Vamvakidis: A much weaker euro would significantly reduce the incentive of any country to exit. One way or another, policy makers are likely to bring that about.

★ ★ ★ SIMON NIXON (WSJ) / **LINK**

Lloyds Banking Group may have been rigging its Libor submissions as early as August 2007, explosive documents released tonight by the Federal Reserve of New York suggest.

The documents, which lift the lid on the evidence gathered by US investigators into the scandal, contain an email in which a Barclays trader warns a New York Fed employee that the Libor submissions for Aug 28, 2007, including one from Lloyds, "look too low".

The whistleblower explains the improbability of the submission before saying: "Draw your own conclusions about why people are going for unrealistically low libors."

The claims about part-nationalised Lloyds, which is the second British bank to be implicated by US regulators after Barclays, emerged hours after Sir Mervyn King was drawn into the middle of the Libor scandal by a leak from the same batch of documents.

Emails released in New York showed that Tim Geithner had written to the Governor of the Bank of England in 2008, warning him about the risk of "deliberate misreporting" of Libor. The then head of the New York Fed, which acts as a Wall Street watchdog, included a memo of six recommendations needed to "establish a credible reporting procedure" instead.

The documents raise questions about how the Bank's senior management apparently managed to remain unaware of the abuses in the Libor market until "the last few weeks". Sir Mervyn is to be grilled by the Treasury select committee on the Libor scandal on Tuesday.

The documents were released after US politicians demanded that the New York Fed reveal all its correspondence with Barclays — fined £290m last month over the rigging of interbank lending rates — amid the escalating scandal that has shaken the City.

"... Tim Geithner had written to the Governor of the Bank of England in 2008, warning him about the risk of "deliberate misreporting" of Libor."

The evidence shows that the New York Fed gathered a mass of information about Libor rigging from sources inside Barclays in 2007 and 2008. On April 11, 2008, one Barclays trader told Fabiola Ravazzola, a New York Fed official: "So, we know that we're not posting, um, an honest Libor... And yet and yet we are doing it, because, um, if we didn't do it, it draws, um, unwanted attention on ourselves."

Mr Geithner told Sir Mervyn of the concerns about Libor misrepresentations at a meeting in May 2008. He then wrote his memo on May 27, 2008, urging Sir Mervyn to overhaul Libor.

In the memo Mr Geithner, who is now US Treasury Secretary, implies that he mistrusts the bankers who are left to choose Libor submissions themselves and has lost faith in the British Bankers Association (BBA), the body charged with overseeing the system.

"To improve the integrity and transparency of the rate-setting process, we recommend the BBA work with Libor panel banks to establish and publish best practices for calculating and reporting rates, including procedures designed to prevent accidental or deliberate misreporting," the memo says.

The memo calls for bank's "internal and external auditors confirm adherence to these best practices and attest to the accuracy of banks' Libor rates".

It adds: "To further enhance the perceptions of the BBA as an objective intermediary in the rate-setting process, we recommend greater transparency." On June 3, Sir Mervyn replied that the recommendations "seem sensible to us". He said he had passed the note to Paul Tucker, deputy governor, and asked him to talk to Bill Dudley, a senior executive at the US Federal Reserve, and the BBA, which was about to launch its own review of Libor.

UK DAILY TELEGRAPH / **LINK**

While the problems in the US, Japan, the United Kingdom, and Europe all stem from too much sovereign (government) debt, there are very real differences in how the Endgame plays out.

Europe has the basic problem of a being a monetary union without fiscal union. By that we mean that the eurozone nations have decided to use the same currency and central bank but have very different economies. Some countries need economic stimulus and the ability to lower the value of their currency (because of the relative value of their labor), and different countries have different inflation rates. One central bank size does not fit all.

There are three basic problems. All three must be dealt with or there can be no balanced outcome.

First, there is too much sovereign debt in the peripheral countries of Greece, Spain, Italy and Portugal. Ireland had a monster banking crisis (due to its housing bubble) and was forced to bail out its banks, and thus acquired too much debt.

Spain had a huge housing bubble that at its peak generated 17% of its economy in housing construction and real estate-related activities. Given the total collapse in that sector, is it any wonder that unemployment is 23%? This has wreaked havoc on the national budget, causing very large deficits. Plus, the Spanish banking system has been completely bankrupt for some time. We pointed all of this out in our book. And were told that we simply did not understand the problems of Spain. Some of the Spanish press was not kind. Up until a few months ago, the Spanish government fiercely denied there was any problem in its banking sector at all. Now they have had to ask for a €100-billion bailout.

Sidebar: Many thought German Chancellor Angela Merkel caved in to Italian and Spanish demands for relief. Spanish Prime Minister Rajoy said the money would come with no strings attached. He was mistaken. This week the agreement arrived, with 32 strings attached, some of which require serious austerity measures. Spain is supposed to cut its deficit to the 3% range. It is closer to 9% now. A 6% GDP cut in one year will reduce tax revenues more than forecast, so the deficit will be worse than forecast, therefore requiring more spending cuts and taxes to be raised. Merkel has been shown to be quite adamant in her demands, and her approval rate in Germany has gone up and is now at 66% for her handling of the eurozone crisis. She will not win any approval polls at all in Spain, Italy, or Greece; but those voters don't keep her in office.

"... Spain will soon need a major bailout. And that will come – it MUST come – with defaults on at least a portion of the debt"

Spain is now over the 7% level for its 10-year debt. Its two-year bond is now at 4.5%. Spain cannot even switch to short-term funding to relieve its debt pressure. It will soon lose access to the bond market at any price less than 10%, which is totally unsustainable. While Spain is not Greece, as the causes of its problems are very different, the result is the same. Too much debt means the loss of bond-market access. Spain will soon need a major bailout. And that will come – it MUST come – with defaults on at least a portion of the debt. The default may have another name, like "restructuring"; but bond holders will not get what they thought they were buying. Call it what you will, this will be default. Spain simply cannot service the debt it must take on.

Italy has run up over 120% debt-to-GDP and its 10-year bond is in the 6% range, which is unsustainable at current budget, tax, and spending levels. Six percent is clearly beyond the potential growth rate of Italy. Moody's just downgraded the country to only two notches above junk-bond level and left it with a negative outlook. Sean Egan had downgraded them already.

★ ★ ★ *JOHN MAULDIN* / **LINK**

Barclays' Libor rigging transgressions will be "put in perspective" by the fines handed out to other international banks, according to the first direct comments by the UK lender about the scandal's potential impact on the rest of the industry.

In a memo sent to staff yesterday evening and which has been leaked to me, the nine members of the bank's executive committee warned that the Libor crisis should not distract them from the core task of safeguarding Barclays' vast balance sheet.

"The macro-environment remains febrile, especially in Europe. We have to remain vigilant on balance sheet exposures and risk management. In short, our focus must remain on capital, funding and liquidity; improving returns; and driving income growth."

The memo, co-written by Marcus Agius, Barclays' outgoing chairman, apologised for the impact of the rate-fixing episode on the bank's staff, but hinted that its rivals were likely to be hit even harder than the £290m in fines imposed on Barclays.

"As other banks settle with authorities, and their details become public, and various governments' inquiries shed more light, our situation will eventually be put in perspective."

Approximately 15 other lenders, including Lloyds Banking Group and Royal Bank of Scotland, are under investigation by authorities probing a crisis which has also cast doubt on the competence of the Bank of England and Financial Services Authority. A string of inquiries has also been triggered, including one that will examine the business practices and culture of Barclays.

I understand that 90m emails and as many as 1m voicemails will be made available to the independent figure being drafted in to spearhead that probe, the details of which are being finalised this weekend.

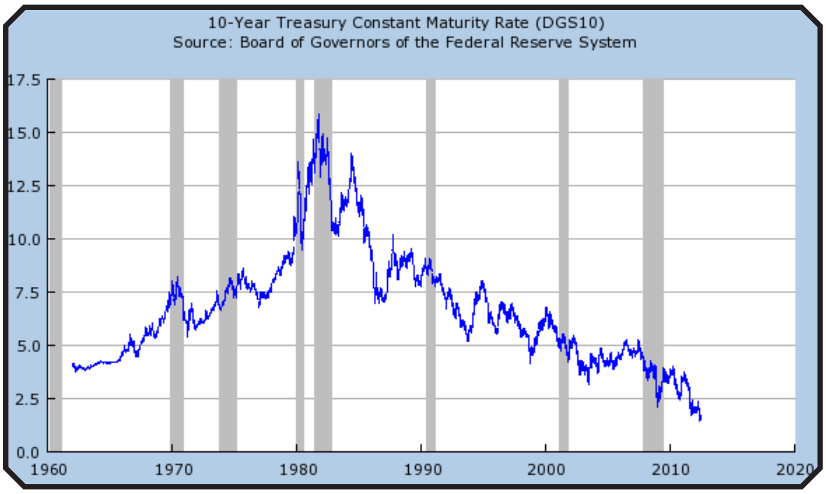
"Last week, it was announced that Sir Mike Rake, our Deputy Chairman, would lead an external review of business practices across the bank," yesterday's memo said.

"That review will begin shortly, and the independent reviewer will have access to every resource, and all the co-operation, he or she requires in order to complete the work. This is an important intervention to ensure that appropriate values are applied consistently across Barclays, and the Executive Committee will support and drive implementation."

SKY NEWS (VIA ZEROHEDGE) / **LINK**

I admit the headline is a little sensationalistic, but after Wednesday's WTF bond auction, I feel like slapping the market around the face with a rotten fish. Now certainly there are plenty of penny stocks headed to greater losses far sooner. And certainly, lots of people have made good profits on Treasuries by buying them and flipping them to a greater fool or a central bank. On the other hand, so did many during the NASDAQ bubble, or during the '00s ABS bubble. Bubbles are profitable for some, and that's why there have been so many throughout history. But once the money starts to dry up they become excruciatingly painful.

Treasury yields are just going lower:

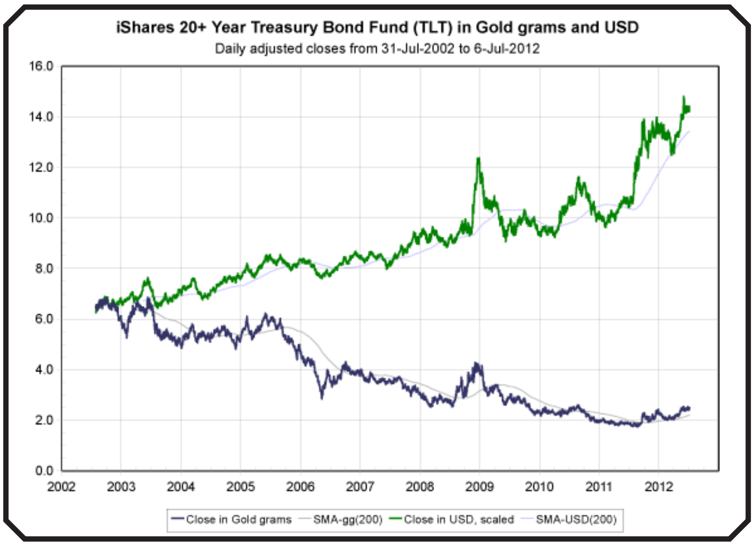


CLICK TO ENLARGE **SOURCE:** **ST. LOUIS FED**

After a 30-year bull market, you'd think that the financial media might have cottoned onto the idea that there is little scope left for real gains, either by holding bonds to maturity (inflation is outrunning yields) and even by flipping it off to a greater fool (or the greatest fool of all — the central bank).

In theory, there are no limits to how low rates could go. In theory, nominal yields could go deeply negative, so long as there are buyers coming into the market ready to buy at a lower rate, and a push a profit to bond flippers. In reality, even Japan — a nation that has adopted desperate measures including forcing financial institutions to buy treasuries to keep rates depressed — has not managed to push nominal rates below zero. The scope for great profits from flipping bonds seems to be evaporating. And in any case, the latter case of flipping bonds to a greater fool or the central bank balance sheet is a classic characteristic of a bubble. The inherent value in a bond is its yield; everything else is speculation.

In the classic bubble mentality, more and more financial media — hastened on by the prospect of deflation (something which the Fed is absolutely obsessed with preventing, and is prepared to print an unlimited amount of money to do so) — are calling Treasuries something that you can't afford to not own.



CLICK TO ENLARGE SOURCE: AZIZONOMICS

The reality, though, is that even recent years treasuries have not really been a good investment. Bond prices may have gone up, but they've been eclipsed by a harder kind of asset — gold:

★ ★ ★ *AZIZONOMICS (VIA ZEROHEDGE)* / LINK

It is a truth universally acknowledged that a man in possession of a major American political party's presidential nomination must be in want of a more assertive policy on China. Bill Clinton upbraided George Bush senior for "coddling dictators"; Mr Bush's son went on to accuse Mr Clinton, when president, of much the same thing. Barack Obama, during his first presidential campaign, called the younger Mr Bush "a patsy" in his dealings with China. Now it is Mitt Romney's turn: in February he described Mr Obama as a "near supplicant to Beijing".

Mr Romney, as befits the author of a book called "No Apology: The Case for American Greatness", says that if elected he would not hesitate to put China in its place. On his first day in office, no less, he has pledged to declare it a currency manipulator, a step that could lead to across-the-board tariff increases on Chinese imports. More broadly, he says he will force China to play by the rules of international trade and investment: no more theft of intellectual property, no more unfair subsidies for state-owned firms, no more predatory pricing. And economics is not his only concern: he promises to chastise China more loudly for its human-rights abuses and to bolster America's armed forces to counteract China's growing military clout.

As in most things, Mr Romney's China-bashing seems studied and methodical. He would like rich countries to impose "intellectual-property sanctions" on China, to prevent it from acquiring the advanced technology behind such things as passenger jets until it stops pilfering foreign know-how. Under the heading "Confront China Directly", his website pledges to end government procurement from China until China provides reciprocal access to American firms. Taiwan, he says, should be allowed to buy whatever weapons it wants. Meanwhile America's navy, he calculates, needs to build an extra six ships a year to handle all the challenges it faces, including an uppity China.

Mr Romney mocks the suggestion that he is gunning for a trade war (let alone a conventional one). An undeclared conflict is already under way, he suggests, and China is winning. Moreover, if America imposed punitive tariffs on Chinese goods, he argues, China would not dare to retaliate in kind because it has more to lose from an escalation in hostilities. China is selling America, he notes, $273 billion more per year than America is selling to China. "If you're not willing to stand up to China, you'll get run over by China," he insists.

The obvious response to all this is to shrug. Candidates may rage about China on the campaign trail, but when in office they become more temperate. Four years ago Mr Obama promised to do just as Mr Romney now demands, and label China a currency manipulator. Twice a year since then he has passed up the opportunity to do so. In part, that is because China's currency has been appreciating in recent years, and its global trade surplus shrinking. But mainly it is because picking a fight with an all-important trading partner, and the biggest foreign holder of American public debt, does not seem a bright idea when you are the one who will be blamed for the economic consequences.

ECONOMIST / **LINK**

Earlier this week, Greek leaders suggested they would ask for more time to hit austerity targets demanded by their creditors. Germany, though, is opposed, according to Friday media reports. IMF head Christine Lagarde also said it is "premature to discuss extension."

The idea doesn't seem to have gone down well. On Thursday, Greek Finance Minister Yannis Stournaras indicated that the leaders of the three parties represented in the country's governing coalition had agreed to ask for more time to make billions in cuts that have been demanded in exchange for emergency international aid. Greek Prime Minister Antonis Samaras also said this week that he would request that the deadline be pushed back.

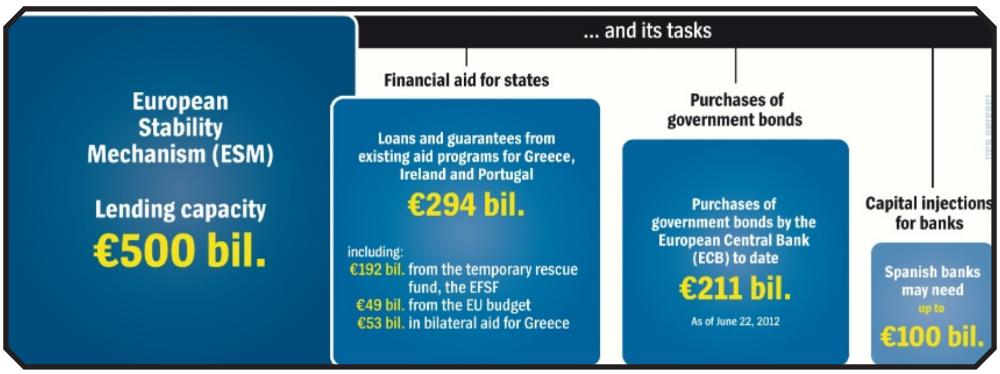
But on Friday, the response from Germany and elsewhere would seem to be a resounding no. Chancellor Angela Merkel's spokesman Steffen Seibert said that "neither the content nor the timeframe of the memorandum are up for debate," using shorthand for the austerity agreement between Athens and its creditors. According to a report in Friday's Rheinische Post newspaper, the chancellor would consider a postponement of "a few weeks" at the most. The paper cites anonymous government sources.

The Chancellery was echoed by the other two parties in Merkel's governing coalition. Speaking to German public radio station Deutschlandfunk on Friday morning, Economy Minister Philipp Rösler, of the Free Democrats, said "I have the feeling that the troika's patience is slowly coming to an end," referring to the trio made up of the European Commission, the European Central Bank and the International Monetary Fund. He also called into question whether Greece is even capable of being reformed to the degree necessary. "Our experience has, at the very least, made me skeptical," he said.

Alexander Dobrindt, general secretary of the Christian Social Union, the Bavarian sister party to Merkel's Christian Democrats, went even further. "From day to day, it is becoming more apparent that Greece only has a chance if it exits the euro," he told the daily Rheinische Post.

Greece has committed itself to saving an additional €11.5 billion ($14 billion) over the two-year period from 2013 to 2014, but is having difficulties coming up with ways to make further cuts in addition to the massive austerity measures it has already passed. A delay of the kind that Athens has requested would almost certainly necessitate billions in additional international aid.

One novel austerity idea that the Greek daily Ta Nea wrote about on Friday is that of cutting by half the amount the state pays for the salaries of priests and bishops in the country. At present, the state pays the entire salary of the 10,368 clerics in the country. Were Athens to make the Orthodox Church responsible for half of their salaries, some €100 billion in taxpayer money could be



CLICK TO ENLARGE

SOURCE: DER SPIEGEL

saved annually.

The government is also considering an increase in the length of mandatory military conscription from the current nine months to a full year as a way of cutting back on the number of career soldiers that need to be paid. Furthermore, university students whose period of study drastically exceeds the norm might be asked to pay significant fees.

Mostly, though, Prime Minister Samaras is at pains to show progress to both his European creditors and his voters. During the recent general election campaign, Samaras promised Greeks that he would request a deadline extension, a pledge that was largely ignored at the time due to the competing promise of his primary competitor, Alexis Tsipris of the leftist Syriza party, to cancel the austerity agreement with Europe altogether.

DER SPIEGEL / **LINK**

People don't tend to sit on the fence when it comes to investing in China. They're either firmly for the "economic miracle" or the "disaster waiting to happen" argument.

Beijing provided ammunition for both last week. A sharp slowdown in inflation to its lowest level in 29 months has turned last year's concern about overheating on its head. Two interest-rate cuts in a month and the broadest of hints from Premier Wen Jiabao that heavy infrastructure spending is back on the agenda confirm the view that the Chinese authorities are more worried about deflation these days.

"... I can't help thinking that there are three reasons why now might be an interesting time for investors to revisit China,"

GDP figures on Friday, on the other hand, indicated an economy that may be slowing from its previous super-charged rates of growth but is still humming, by the standards of the deleveraging developed world. What would we give over here for a growth rate of 7.6pc?

I was amused recently by a chart claiming to highlight the biggest bubble in China today – it tracked references in the media to mentions of a "hard landing" for the Chinese economy, which spiked higher at the end of 2011 and stayed there. It has become unfashionable these days to make the case for China and de rigueur to fret about bad loans, ghost towns and property speculation.

Negativity about China in the media may be a relatively recent phenomenon but the love affair with Chinese stocks soured some time ago. A comparison of the MSCI China index and its All World equivalent shows that Chinese shares have under-performed their global peers in four out of the past five years. They out-performed in five of the previous six.

The long-term case for investing in China has been made many times, frequently by me, but it's worth reminding ourselves briefly because it hasn't gone away. The investment backdrop continues to be sustainably high economic growth, increased urbanisation, a growing middle class, more domestic consumption, infrastructure spending and a vast population which means that investment themes once identified can continue for a long time before they reach maturity.

But I'm not blinkered to the bearish case, focused on an inability to trust government data, a still excessive dependence on exports to a slowing West, a string of corporate governance concerns, worries about the state of local government finances, over-investment (especially in the property sector) and companies with negative cash-flows failing to even earn the cost of capital.

All of these have more than a grain of truth in them and yet I can't help thinking that there are three reasons why now might be an interesting time for investors to revisit China.

First, the long-term case is intact. China's GDP per capita is roughly where America's was in the mid-1960s and demand for many goods and services from cars, to air travel, financial services and mobile phones remains a fraction of that in the US. The Chinese government has made it clear that it is willing to tolerate a much higher rate of wage inflation than in the past to drive consumption and improve living standards.

Second, in the short term the economy feels like it is at an inflection point. With its usual lag, easier government policy is beginning to feed into an increase in infrastructure projects, a stabilisation of bank-loan growth and an improvement in economic leading indicators.

Third, the markets have been pricing-in a deteriorating backdrop for a couple of years at least now. The valuation of the Chinese stock market is near to its 2008 low with the average share costing less than 10 times earnings. Apart from the bottom of the market at the end of 2008, this is the lowest level in at least the past 10 years. Measures of market sentiment are at levels that have indicated turning points throughout the past decade.

★ ★ ★ *TOM STEVENSON* / **LINK**

Here is perhaps the most amazing thing about JPMorgan Chase's (JPM) $5.8 billion trading loss: Take a look at the firm's overall results, and it's like the London Whale's misstep, one of the largest flubs in the history of Wall Street, never happened.

> **"... How the bank appears to have offset the huge trading loss is a prime example of how complex and malleable bank profits actually are, and how much they should be believed,"**

Back in mid-April, about two weeks before talk of the trading losses emerged, JPMorgan was expected to earn $1.21 a share in its second quarter. On Friday, JPMorgan reported that it had, Whale and all, earned exactly that.

How the bank appears to have offset the huge trading loss is a prime example of how complex and malleable bank profits actually are, and how much they should be believed. JPMorgan's quarter should give fodder for accountants to talk about for some time.

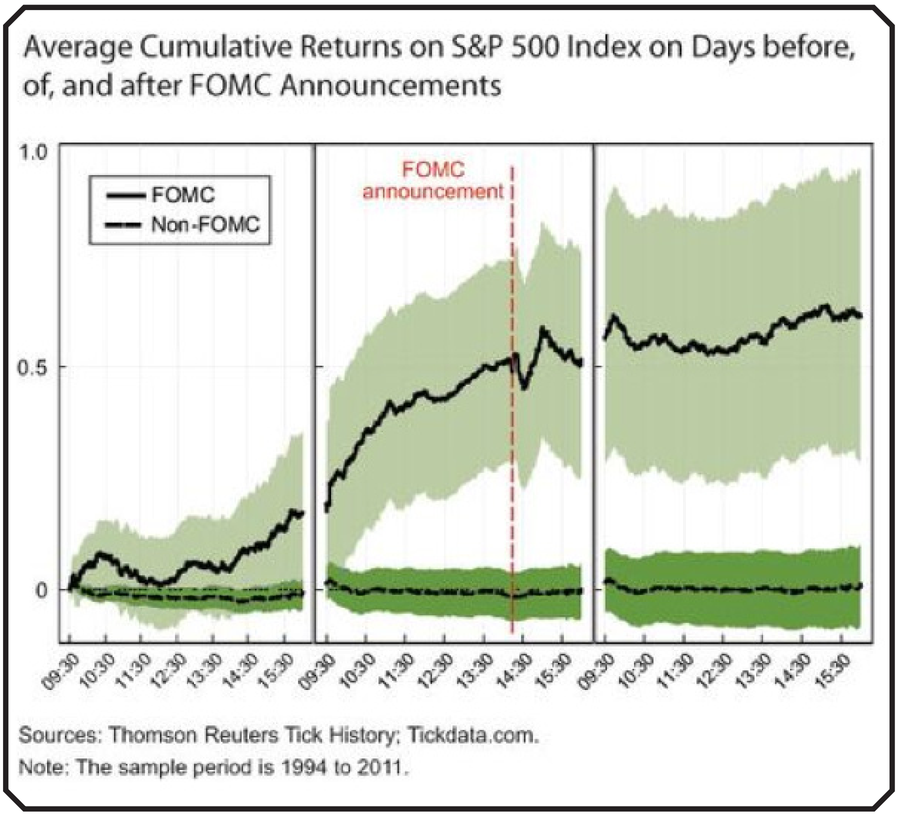
"Yes, I have seen these results, but I have also seen how the sausage is made and I am worried that I might get food poisoning in the future," Mike Mayo of Credit Agricole Securities and author of the book Exile on Wall Street told Dimon in a meeting with analysts following the bank's earnings release.

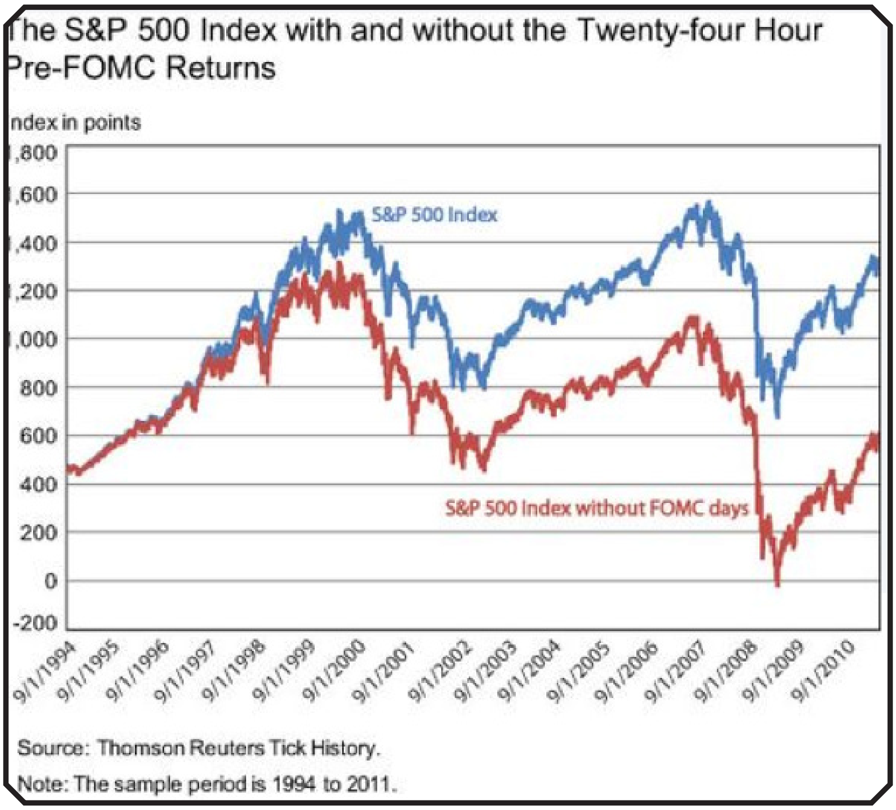
Sure some of JPMorgan's businesses were strong. Profits in its mortgage operations, helped by falling interest rates, rose by nearly $1.3 billion. But a good deal of JPMorgan's earnings came from some shifting of losses and an assumption that things for the bank, and the economy in general, are about to get a good deal better. That assumption might prove right, but it could also add to losses in the future.

So how do you make a nearly $6 billion loss go away? First stop taxes. The bank said that the London Whale's blunder cost the bank $4.4 billion in the second quarter alone. But that's before taxes. After it pays taxes, though, JPMorgan says the loss will shrink to just over $2.7 billion, which means the bank plans to take a $1.7 billion write off from Uncle Sam. Like any loss, banks are allowed to use trading blunders to offset taxable profits elsewhere in the bank. The question is the rate. At $1.7 billion, JPMorgan is writing off roughly 38% of the loss. That's not that out of line with the U.S. corporate tax rate, but it's a far larger percentage of profits than most companies actually pay. Nonetheless, on taxes alone, the bank was able to shrink the London Whale's wake to $4.1 billion.

We haven't left the firm's vaunted chief investment office yet. CEO Jamie Dimon has long said the portfolio is safe and that if he were to liquidate it today he could produce an $8 billion gain for the bank. In the second quarter, he dipped into some of that. London Whale aside, the CIO took a $630 million gain. Now we're down to $3.5 billion.

★ ★ ★ *FORTUNE* / **LINK**





CLICK TO ENLARGE

SOURCE: THOMSON REUTERS/TICKDATA

For many years, economists have struggled to explain the "equity premium puzzle"—the fact that the average return on stocks is larger than what would be expected to compensate for their riskiness. In this post, which draws on our recent New York Fed staff report, we deepen the puzzle further. We show that since 1994, more than 80 percent of the equity premium on U.S. stocks has been earned over the twenty-four hours preceding scheduled Federal Open Market Committee (FOMC) announcements (which occur only eight times a year)—a phenomenon we call the pre-FOMC announcement "drift."

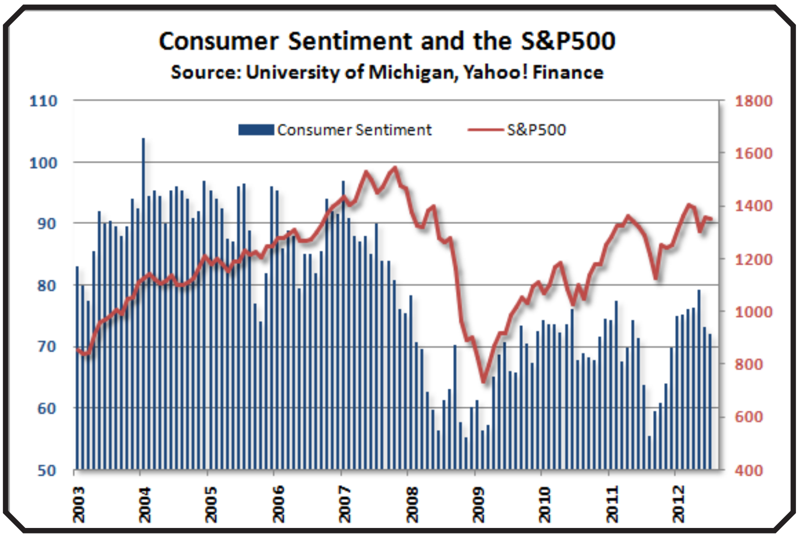
The pre-FOMC announcement drift is best summarized in the chart [top, left], which provides two main takeaways:

Since 1994, there has been a large and statistically significant excess return on equities on days of scheduled FOMC announcements.

This return is earned ahead of the announcement, so it is not related to the immediate realization of monetary policy actions.

The chart [bottom, left] visualizes this return decomposition. It shows the S&P 500 index level along with an S&P 500 index that one would have obtained when excluding from the sample returns on all 2 p.m.-to-2 p.m. windows ahead of scheduled FOMC announcements. In a nutshell, the figure shows that in the sample period the bulk of the rise in U.S. stock prices has been earned in the twenty-four hours preceding scheduled U.S. monetary policy announcements.

LIBERTY ST / **LINK**



SOURCE: IACONO

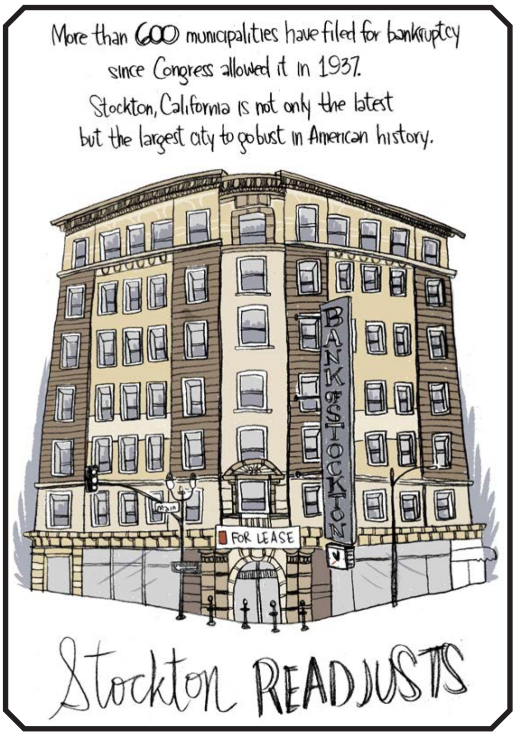
Consistent with other recent readings on the mood of the American consumer, the Reuters/University of Michigan consumer sentiment index fell from 73.2 in June to 72.0 in the first of two readings for July, its lowest level since last December when it registered 69.9.

There was some good news in that the current conditions index rose, from 81.5 last month to 83.2, however, the expectations component fell from 67.8 to 64.8, also the worst reading since last December. Lower gasoline prices had a positive impact as one-year inflation expectations fell from 3.1 percent to 2.8 percent and the five-to-ten year outlook held steady at 2.8 percent.

A weaker job market, concerns about a global economic slowdown, and growing anxiety about their financial future were clear to see as only 19 percent of respondents said they expect to be better off a year from now, the lowest reading ever for this survey. Only 39 percent said conditions would be better in five years.

Richard Curtin, chief economist of the consumer survey, cited depressed wage and job growth as factors in the overall decline and went on to note, "The June loss among higher-income households was associated with a large drop in favorable ratings of economic policies and a growing recognition that federal policies to bridge the fiscal cliff will not even be discussed until the very last minute."

TIM IACONO / **LINK**

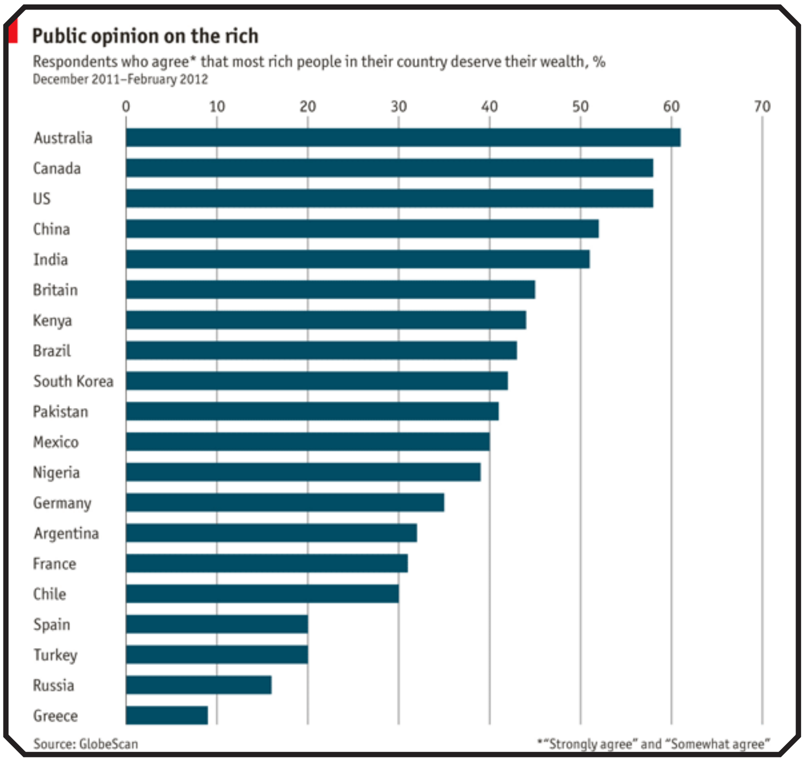


CLICK TO ENLARGE

The recent bankruptcy of Stockton, CA is the largest such filing in US history.

Accordingly, the Boston Review has put together a gigantic infographic that is well worth taking a look at. The scale of this default is enormous and one would be hard-pressed to get a true sense of that through the coverage afforded it in the media.

(courtesy of Barry Ritholtz)



SOURCE: ECONOMIST

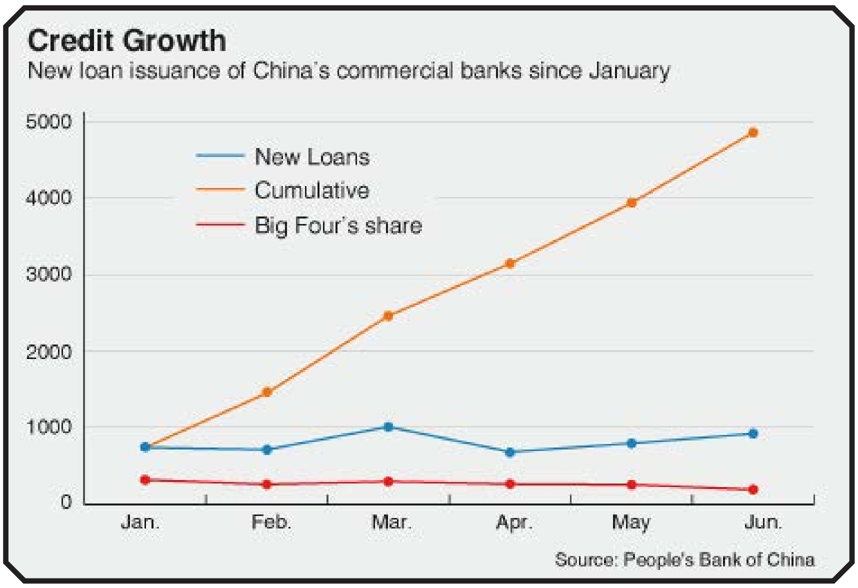
Some 39% of adults think that the rich in their country deserve their wealth according to GlobeScan, a market-research company which polled 12,000 people in 23 countries. Top earners have attracted more opprobium as their salaries and the performance of the economy have headed in opposite directions. Europeans and Latin Americans tend to have similar attitudes to the rich; the Anglo-Saxon world is a bit more forgiving. The biggest contrast, though, is between emerging economies (a group in which Russia sits, rather awkwardly). In China, where 600m people were lifted out of poverty between 1985 and 2005, about half the adults think their rich are rightfully so. But in Russia, an economy dominated by oligarchs who extract large windfall rents, only 16% do.

★ ★ ★ *ECONOMIST* / **LINK**

China's commercial banks extended a total 918 billion yuan in new loans in June, with small and medium-sized banks contributing most of that figure, data released by the central bank on June 12 showed.

The June loan figure was 126.6 billion yuan more than in May.

★ ★ ★ *CAIXIN* / **LINK**



SOURCE: CAIXIN/BOC

CLICK TO WATCH

Regular readers will by now recognise the rugged features of my friend Simon Mikhailovich. In this interview with Lauren Lyster of Capital Account, Simon gives a bravura performance discussing the vagaries of the derivatives market in general, the CDS market in particular and does as good a job as anybody in explaining just how interconnected the financial system really is—and how dangerous that situation could be.

As well as being a leading technology investor and the co-founder of Silver Lake Partners, Roger McNamee's role as co-founder of Elevation Partners has given him an inside track on the recent Facebook IPO. In this interview with Bloomberg TV, McNamee is scathing in his assessment of the IPO and the implications for the wider market.

I have my doubts that 'Chubby Wombat' is about to give his partner and friend, Bono, a run for his money in the music world, but then I wouldn't want Bono to chew through tech companies' 10Qs for me...

CLICK TO WATCH

CLICK TO WATCH

INTERVIEWER: This strategy generated $2 billion in profits over the previous four years before this year. Deposit money wasn't lost, and you know this. Critics, defenders say this trading loss was just not all that material, considering the bank still is able to report a profit today.

TAVAKOLI: Well, that's ridiculous. Now look at what you just said, that this unit reported 2 billion in profit over several years. Now they have $5.8 billion in losses year to date. The losses are climbing. The losses swamp the profits they reported previously...

Priceless

This rather forlorn figure is a Chinese hurdler who has just completed one of the great runs in hurdling history.

If only he knew as he crossed the line how much joy he would bring to others, perhaps he'd have been a little more upbeat...

Hmmm...

SUBSCRIBE UNSUBSCRIBE COMMENTS

Grant Williams

Grant Williams is a portfolio and strategy advisor to Vulpes Investment Management in Singapore - a hedge fund running $200million of largely partners' capital across multiple strategies.

In 2012, all Vulpes funds will be opened to outside investors.

Grant has 26 years of experience in finance on the Asian, Australian, European and US markets and has held senior positions at several international investment houses.

Grant has been writing 'Things That Make You Go Hmmm.....' for the last three years.

For more information on Vulpes please visit www.vulpesinvest.com

As a result of my role at Vulpes Investment Management, it falls upon me to disclose that, from time-to-time, the views I express and/or the commentary I write in the pages of *Things That Make You Go Hmmm.....* may reflect the positioning of one or all of the Vulpes funds - though I will not be making any specific recommendations in this publication.

Grant

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