Infomail
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New Year, Same Crisis
(Deleveraging, Part II)

The world's financial markets are roaring back early in 2012 after a lackluster 2011. In fact, I like it because it's happening without any fanfare and with very low volatility. We are into the last week of January and we have not yet had a 1% daily move in the market.

It's also that time of year when Wall Street is abuzz with the old adage, "so goes January, so goes the year." Admittedly, the January Barometer has a pretty good track record. Since 1950, the indicator has registered only seven (7) major errors for an 88.5% accuracy ratio. The last 38 up First Five Days (of a New Year) were followed by full-year gains 33 times (for an 86.8% accuracy ratio) and an average 13.9% average year gain in all 38 years. Every down January on the S&P 500 since 1950, without exception, preceded a new or extended bear market, a flat market, or a 10% correction.

The "great deleveraging" continues in the world, and it will continue to have a profound impact upon the real economy and choices of policymakers. Periods of deleveraging are not uncommon, and typically follow periods of speculative excesses, asset bubbles and financial manias, when debt burdens rise to unsustainable levels on the mistaken belief a new growth paradigm has emerged. Once these bubbles burst, it ushers in a period of debt reduction, marked by slower than usual economic growth, which pretty well is where we stand today.

What can be argued is it's "different this time", is the scope and scale of the deleveraging required. This one is both broad across various sectors but also all across the globe and happening simultaneously. The adjustment period will no doubt be choppy, but will force dramatic policy decisions by politicians along the way.

In Europe, we still are waiting for the end game. The European sovereign debt crisis has been the epicenter of the financial markets, and until a firm resolution is agreed upon, one which backstops their banks, the volatility will continue. The best case scenario is they agree on a fiscal integration to go with the monetary union (the Euro). The worst case scenario is Europe goes through a messy divorce. Given the EU was 50 years in the making, I would guess the latter is not an option (at this time!).

All in all, progress is being made, and it takes time for 17 nations to agree on everything, but markets and investors are an impatient bunch.

China almost single handedly saved the day in 2009 when it embarked on a massive fiscal stimulus program. It created a surge in global economic growth, as well as commodities. Now the debate rages whether or not China can maneuver the ever elusive "soft landing". I really would not want to bet against China. It's a command economy and they have the cash resources to reflate if they chose to. Right now, they are growing at "only" 8.5%.

In the USA, we have modest but positive growth. The US economy has held up quite well, and economic growth is in the 2% range, and unemployment is falling. It doesn't mean they are out of the woods longer term. They need the political will to do the right thing but 2011 showed us that right now the USA has done anything but, with all the rhetoric, posturing and a political system which appears to be broken.

Overall, I see positive signs in the US economy. Growth in US retail and car sales, loan growth, and corporate earnings and balance sheets are the best in years.

Now comes the hard part…

We seem to now live in a world in which the outcome lies in the hands of policy makers in Washington, Brussels and Beijing. They took a while, but now seem to "get it". More central banks are easing, including Japan and England. It suggests the deflation-inflation roller coaster is turning for the better. The big question is if their actions, after lots of rhetoric, will be fast enough and big enough to offset the ongoing deleveraging.

This will be one of the main themes for 2012.

Stay Tuned,

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