



Greek Crockery

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T&B – How to Trade It

Ode on a Grecian Urn

From time to time, one of our readers enquires as regards the unusual title of our publication – *Truth and Beauty*. It is a bit of a conglomeration – two of our favourite out-of-consensus strategists, Chris Wood and Marc Faber, publish respectively *GREED and Fear*, and *Doom and Gloom*; we thus felt that something a bit more cheerful might be called for! (Those were more innocent times...) And then, of course, there was the poem by Keats... At present, as everyone goes into a blind panic over Greece, it seems oddly appropriate. The last lines of *Ode on a Grecian Urn*:

O Attic shape! Fair attitude! with brede
Of marble men and maidens overwrought,
With forest branches and the trodden weed;
Thou, silent form! dost tease us out of thought
As doth eternity: Cold Pastoral!
When old age shall this generation waste,
Thou shalt remain, in midst of other woe
Than ours, a friend to man, to whom thou say'st,
“Beauty is truth, truth beauty,” — that is all
Ye know on earth, and all ye need to know.'

Attic Sky Not Falling

*T&B would not be the first among our peers to come to grief for having ignored the Strategist's First Rule: Give an **exact number**, or give an **exact date**, but **never** give both¹. But we here take a deep breath, and risk an un-hedged call (not one hidden deep within the belly of the issue, but instead, right near the front, where, if we do get it wrong, we may well never fully live it down) – reiterating our view that **Greece shall (very probably²) neither default nor restructure with a loss of NPV for non-official/non-bank bondholders, at least not anytime within the next couple of years.***

Although we entitled one of our recent opuses “The Consensus is Not Always Wrong”, if we have learned just one thing in our many years of trading, it is that when everyone is jumping up and down, beating their hairy chests and spewing increasingly indignant invective, there is almost certainly a mispricing lurking somewhere nearby, just begging to be taken home!

Think Russia circa 1998. The local currency GKO had just defaulted, virtually the entire Russian banking system had gone the way of the dodo, while the currency had plunged by 60%. T&B only wishes we had a shilling for every opinion leader in the global media intoning how those scurrilous Russians had never repaid anyone in all of history... and very certainly never would! In fact, those few fools who took the plunge, buying some of the Russia 28s T&B was then peddling (during our brief stint in purgatory as Moscow Head of Fixed Income for a major German bank) made about 1500% profit over the next five years. (Ironically, most of those who resisted our efforts to stuff them with Russian Eurobonds – politely or otherwise – preferred instead to buy those new-fangled “risk-free” AAA-rated American CDOs... funny how risk will reliably crop up where one least expects it!)

Everyone – from Roubini (who never fails to remind us of a couple of his very good calls, conveniently forgetting some equally bad ones...) to our old friend, the sage of Houston (a fine strategist and superb writer) John Mauldin, who recently predicted hell-fire and brimstone for the Eurozone – is busy beating up on the poor Greeks and, by extension, the EU. The Anglo-Saxon media seem to be involved in a contest to see who can be the most hysterical – with the European Union variously (and stupidly) described as a “Ponzi scheme”, “an accident waiting to happen”, or, simply, and “an historic mistake”. Of course, all of this begs the question of why, if the Euro is indeed in such a parlous state, has it **been steadily revaluing against the dollar, up by more than 20% since the onset of the European debt crisis?**

As regards Greece, the level of invective is extraordinary. A Bloomberg poll showed that fully 85% of investors expected Greece to default in the near future; we read numerous brokerage reports discussing in painfully detailed legalese with deeply-quantitative precision how precisely it shall do so; at a recent conference addressed by T&B, there were precisely two people in the room (T&B and our old friend M.K.) who thought that Greece would NOT default. If nothing else, this trade is a contrarian's wet dream!

Perhaps T&B simply enjoys championing lost causes, but we would respectfully point out that while the economic situation in the core EU is troublesome, it is a hell of a lot better in Europe than in either the US or Japan! At 4.6% the blended EU fiscal deficit is less than half the US equivalent; total EU sovereign indebtedness is far below that of Japan or of the US (counting US unfunded liabilities), whilst Germany is enjoying a robust trade surplus, rapidly declining unemployment, a well-supported real estate market, and eminently sustainable economic growth (i.e. growth not supported by rising debt levels). Yes, a couple of the peripheral countries have fallen into debt traps from which they shall require an expensive rescue, while the condition of the banks in several more is worrisome – even the German Landesbanks are still stuffed with bad assets, although given enough time, the German banks at least will be able to earn their way out... Precisely as their American peers are now doing.

¹ Advice which, incidentally, would have been of benefit the Rev. Harold Egbert Camping, whose renewed prediction of the end of the world and the eminent arrival of Jesus – <http://www.ebiblefellowship.com/outreach/tracts/may21> – filled millions amongst the Great Unwashed with hope and fear, whilst affording the smug, Jewish, literate East Coast elites yet another opportunity to mock their countrymen, while regretting the fact that such people are actually allowed to vote!

² As discussed below, the “very probably” – added almost as an afterthought, is due to the one Joker in the pack: the possibility that the Greek political system will fail to make the necessary adjustments, frustrating European attempts at a rescue.

Why the Vase Shan't Splinter

The standard rejoinders we encounter are two: a) how shall Greece ever manage to repay the huge debt burden they have accumulated? and b) do we seriously imagine that the Germans will be willing to bail them out – assuming it were politically feasible? Actually, we think that we can readily dispose of both these objections, although there is one that people do not ask, and which is probably the weakest link in our argumentation: will the Greek political process not spring some sort of dreadful surprise terminating in an outright default – utterly suicidal, but not beyond the ken of an economically illiterate electorate in a democratic system?

As regards the first point, it is certainly true that Greece will never actually repay some substantial part of her debt – but that does not necessarily imply a default. We assume that, provided the Greek political system can be made to accept not just austerity, but also, an increasing degree of European tutelage and a fire-sale of some government assets, the old debt will be taken onto the European public balance sheet, to be rolled over *ad infinitum* at rates close to Euribor (European Libor) – at best allowing Greece to gradually amortize/inflate it away. In this context, we would note that Japan is running a debt/GDP of well over 200%, rendered sustainable by rock-bottom interest rates. To the reader who exclaims “*but this is merely kicking the can down the road*” we reply: *Precisely! Global finance (and indeed human life itself) involves nothing other. Are Japan or America (with a real deficit estimated at several times GDP, taking into account unfunded government liabilities) – engaged in anything but?* Keynes said it first - *In the long run, we will all be dead;* but T&B would simply add that there is certainly no hurry...

Perhaps less apocalyptic, we would note that the emerging markets debt crisis of 1981 wiped out literally the entire US banking sector – every money-centre bank was essentially bankrupted when a dozen “emerging” economies simultaneously submerged in the wake of Mexico, giving the lie to the convenient belief that sovereigns never defaulted. The Fed saved the day by allowing the banks to carry the defaulted debt at par, while engineering a steep US yield-curve, which allowed them to

earn their way out of the deep hole they were in. By 1989, when the first Brady plan was instituted, the banks were again solvent and the 30% haircut on the defaulted loans they swapped for the secured Bradys could be readily absorbed, indeed, by then they could book a profit, writing back a substantial share of the losses they had gradually provisioned.

Coming now to the case of Germany, reading some of the indignant commentary, one might almost forget which European country has been the greatest beneficiary of the Euro... The common currency is one of the main reasons that Germany has become the only country able to stand down China, in no small part due to its substantial industrial exports to Southern Europe – a situation not without parallel in the Chinese vendor-finance of US consumption. Indeed, the introduction of the Euro was enthusiastically backed by the German industrial lobby, which had grown weary of painfully squeezing out ever-increasing productivity gains, only to see them lost again when Spain or Italy devalued their currencies by a further 25%.

This is not to say there are many good options; bailing out Greece is indeed a very bad option for Germany – the **second** worst option out of the only two possible choices (**not** bailing out Greece would be at least an order of magnitude more expensive). There are two reasons for this – the first is that, whilst the German banks could clearly survive the first-round effects of a Greek default, the banks of other European countries to which Germany is exposed would likely fare worse, in turn imperilling their German counterparties. Therefore, in the event of a Greek default, the European Union would need to provide massive financial support to the banking systems of several other European countries to compensate for just the immediate losses.

But this is the least of their problems – the real problem is that – say you are short Greece, and it goes down on Tuesday – what do you do on Wednesday? You short Ireland and Portugal! Given the wave of panic that a Greek default would provoke, taking out the two next-weakest members would be akin to shooting fish in a barrel. By Friday, with two more PIIGS down, it would be time for the *plat de resistance* – Spain (don't worry about Italy and

Belgium – if Spain went down, there wouldn't be an EU worth saving...). Given what would be a dramatic loss in confidence in European sovereign issuers in the wake of a default by any of them, in order to stop the tsunami, the entire European Union would be forced to provide essentially unlimited funding to Southern Europe, which would have lost all access to public markets for years to come. All of this would come accompanied by a very costly post-default bailout of Greece, given the unpalatable alternative of having a Yugoslavia-type situation (well, at best, an Argentina-type) developing on Europe's southern flank.

Deconstructing "Restructuring" – A Non-Binary Trade?

There is considerable talk of "restructuring" the Greek debt, without anyone having a particularly clear idea of what this means – if in fact it mean anything at all. Any forced change in the terms of the instruments – i.e. a reprofiling, would constitute an event of default, triggering the CDS and opening the floodgates.

The only soft option is thus a "voluntary exchange", but despite all the prayerful statements by European politicians hoping for a painless way to present it to their seething electorates, to pull off a voluntary exchange without the agencies deeming it to be a credit event, downgrading Greece to SD (selective default) would require considerable creativity (and would not offer any true debt relief). Our best guess is that the European authorities will provide a strong incentive for the bank holders of Greek debt to swap into longer-duration instruments, maintaining their current exposure in return for some reassurance regarding the ultimate outcome.

That, at least, could provide a political glide path toward nationalization of the debt. European banks are currently highly susceptible to suasion by their Central Banks, and a suggestion that they maintain their exposure ("Vienna process") in return for being allowed to mark the bonds to par would probably fly. Furthermore, the ECB could refuse to repo the old bonds – for banks, this would render the swap essentially mandatory, while for non-bank private investors, it would make no material difference. The free-rider problem would be politically fraught, but we disagree with Barclays on this one, assuming it could be slipped past the electorate.

And, meanwhile, back at the Euro

One of the more extraordinary examples of cognitive dissonance encountered amongst the Anglo-Saxon consensus (echoed by that superb contrarian indicator, J.H.) is that the Euro is fatally imperilled by the European debt crisis, this despite the fact that, since the onset of the crisis, **the Euro exchange rate has gone from strength to strength...**

We will reiterate our view that, even in the highly unlikely event of an outright default by one of the PIIGS, the Euro-dollar trade would see a truly ugly mark-to-market for a season, but, ultimately, the Euro would be strengthened – as it would increasingly be seen as simply the Deutsche Mark successor currency...

The End Game – Oh, but where will it all End?

Again, J.M. Keynes had the last word on "the long-term" and we have little to add. In a slightly shorter term, we would expect that private exposure to peripheral European issuers will continue to be gradually transferred onto the books of the European Central Bank – precisely what occurred in the US during the recent credit implosion when the Fed purchased all manner of dodgy assets – from Agencies and banks alike.

The Germans shall, of course, demand their pound of flesh – a loss of national sovereignty for the errant South, i.e. an increasing degree of fiscal and political union to go with the monetary straightjacket. As we noted previously, what Germany failed to attain in 1914, and again in 1939, is now within her reach, not by any dastardly plot, but by pure happenstance. As we go to press, ECB chairman Jean Claude Trichet has called for the creation of a European Finance Ministry with oversight powers over the budgetary policies of member states. While this shall prove politically challenging, the current situation of monetary union with fiscal anarchy is simply not tenable. Necessity is the mother of invention!

Where could we be Wrong?

Assiduous readers will note that T&B has never been an unconditional fan of democracy, considering that, in the worst of cases, it can lead to the worst forms of populism: short-termism, economic hedonism, and an unwillingness to accept necessary pain. In the

context of the European debt crisis, the situation is particularly dangerous, as an economically illiterate populace is being fed with hysterical commentary from equally clueless journalists working for press barons having very non-transparent agendas. There is a danger of serious miscalculation – possibly in Germany, but far more dangerously, in Greece itself.

Our basic assumption is that, when staring down the barrel of a gun, developed countries will ultimately do whatever they need do in order to dodge the bullet. Therefore, despite a single-minded and criminally irresponsible campaign of *Der Spiegel* to bring down the entire montage, as well as Mrs Merkel's desperate attempt to save her own political skin, the German government will ultimately do whatever required to forestall a financial Chernobyl with truly dire effects on the German export machine (any dissenting smaller countries would likely be slapped into line by a mixture of concessions and the threat to withdraw their accustomed subsidies).

As regards Greece, on the other hand, we admit that we are confronted with an imponderable: a default would be catastrophic, quite literally sending it back into the Third World with its banking system dead, its corporate sector paralyzed, both the government and the corporates totally excluded from capital markets, a near-complete collapse in economic activity and a return to very basic coping mechanisms; indeed, given the political lability of Greece, there is no guarantee that this would not lead to civil disorder severe enough to imperil its fundamental political model.

That said, there are extreme leftist elements in Athens that would welcome the chance to bring down Capitalism (although historical experience suggests that the most likely final outcome would be a military coup). A game of chicken is now underway, with the opposition New Democracy party – having lied outrageously for years, fraudulently misrepresenting Greek sovereign finances in order to gain admittance to the Eurozone (including via currency swaps provided by Goldman's – swaps explicitly designed for the sole purpose of disguising the true state of the Greek balance sheet) – now enthusiastically playing politics with the emergency measures being pushed by Papandreou's Socialist party

as, not for the first time in Europe, a nominally socialist party is compelled by economic circumstances to apply rigorous economic medicine, with punitive effects upon its own electorate.

How to Trade It

Legal Disclaimer: do not try this at home – Greece is a high-risk trade, not suitable to private investors, widows, orphans or mammals.

Please do not invest money you cannot afford to lose... just send it to us!

Our reiterated out-of-consensus call is based not upon any certainty, but simply that the risk-reward ratio is totally skewed. There are no certainties in life (even as regards "death and taxes" – the latter, at least, can be evaded) but, equally, there are no "bad assets" – only bad prices. As investors, we seek to profit from the mispricing of risk that occurs when blind emotion takes over. Our long-Greek debt trade is obviously not without risk – as Russia might conceivably have defaulted in 2000, Greece could bite the dust this year – but we find that at moments of stress, market prices tend to grotesquely overestimate the risk of extreme outcomes, while also underrating the likely recovery values (not to mention the degree of risk implicit in numerous purportedly "safe" asset classes).

We are currently running non-negligible exposure to the 3-4 year segment of the Greek sovereign curve, in particular the 5 ½ of 2014 (YTM ~26%). Some of our smarter friends are buying the 15 and 30-year bonds – but these instruments are cheaper (respectively EUR ~43 and ~46) and their YTM is radically lower (11%/13% vs. 26% for the '14s) and since we are trading not in expectation of a default and restructuring, but rather, in the expectation that the bonds will be fully serviced, we think the upside greatest at the short end of the curve. Carry for the short end is attractive, with current yields around 10%, and given that financial markets tend to have the attention spans of goldfish, once the terror-of-the-week shifts to somewhere else, price action could be very rewarding.

As an afterthought (some of the best rationales for our trades come to us only after the fact!), if we are correct about the devastating effects of a Greek default – which short term would qualify as Lehman-

on-steroids – then in the event of a default, investors will likely take far more pain in a wide variety of other assets – from high-yield to G7 government bonds, equities, high-beta currencies and commodities – than on their Greek debt! The only obvious hiding places would be

UST and the dollar – for a few weeks at least. The belly of the Greek curve is now trading at default levels. How much lower can it go? Global equity markets can go at lower (“how much lower?” is one question we hope not to see answered...).

More Idiocy – This Time from the Left

One of our readers forwarded the following posting to us – a random sampling of the hokum one reads about Greece. When the Left and the Right agree on anything, it is almost certainly wrong!

Hello From Greece (from the website *Naked Capitalism*)

This is the fifth day and the crowd is increasing in Syntagma Square in Athens. There must have been more than 30,000 people this evening and there are still there more than 10,000 at 11.30 pm (today). As a genuine gathering of the multitude there are not prevailing slogans apart from “thefts” and “take a helicopter and leave this place” (it refers to what has happened in Argentina). Flags of Argentina can be also seen among the demonstrators. In the front a banner says in Spanish “we are desperate, we woke-up. What time is it? It’s time for them to leave”. People are dancing, shouting or just hanging around talking to each other. A “general assembly” is held at late hours in the square, where people can take the microphone, speak and say what they think freely. It’s not stopping and it will not stop although I think that maybe there will be less people the forthcoming days (sic).

... EU governments are blackmailing, asking for a national consensus of at least the governing socialist party and the conservative right party, but the conservatives do not accept. They are asking for a huge privatization plan, which practically spans all public enterprises, including water companies and land. The latter is something quite difficult to be accepted by the public opinion.

... Also a huge tax collection plan is under finalization, which according to leakages will cost 3,000-4,000 Euros annually for a family with four people. This means that a lot of marginally surviving people will fall below the elementary standard of living. Another 150,000 unemployed are expected for the forthcoming year. Final decisions will be announced most probably on 6 June – so keep this date in mind. It might be the beginning of real bloody demonstrations...

Another interesting story is that parts of the national capitalist class are seriously thinking of bankrupting the country and taking over with a new drachma. This is not discussed politically openly because a return to a national currency will be extremely painful for the masses. In fact the story of Argentina is well known. My impression of the overall situation is that for several reasons Greece follows the road to an open bankruptcy with several people waiting to benefit from that and nobody taking the political risk to support it. Since European governments are deeply divided on the Greek crisis, it is difficult to believe that they will act in a coordinated, quick and generous way to avoid the storm, although this cannot be ruled out.

T&B replies:

Dear JA,

A) Until a couple of decades ago, a majority of Greeks lived in generation-old poverty – not unlike that of peasants in other third-world countries; in the countryside the sight of farmers tilling the land with draught-animals, and the use of donkeys for transport was not at all unusual.

Thanks to the wonders of the EU, the Greeks have more recently become habituated to a European lifestyle. If they wish to maintain it – and one must assume that the vast majority do – then they shall have to behave like Germans; this includes privatization, taxation, retirement age well beyond the end of puberty, and actually working for a living... I am certainly not extolling these “virtues” – I am simply stating the obvious: that these are the ineluctable downsides of living by first-world standards...

B) As for the evil plot to bankrupt the system and buy the country on the cheap, this is pure idiocy. There are, no doubt, more than a few people who would love to do precisely that, and there are some guys in Greece who have plenty of money and power... But they are not the same people. The Greek ruling class would be wiped out by any exit from the Euro – with every bank in the country dead, most companies bankrupted, savings lost, collapse of trade credit, inability to cover vital imports, and extreme social and political dislocation with a highly unpredictable outcome in a country with a history of military rule within relatively recent memory.

Think Russia in 1998, or Argentina during its crisis. Both had a rough time of it, however both Argentina and Russia had suffered repeated bouts of extreme turbulence and thus had a long history of coping, while Greece has had time to become habituated to a European lifestyle, and the havoc would be very substantially worse than the disastrous few years that followed the Argentine default. Furthermore, Russia has oil, Argentina has a very rich agricultural sector – and both were helped to exit from their near-death experiences by surging commodity prices... this would not likely be the case for Greece.

US GDP – The Recovery that Never Was

One of the frequent challenges heard by T&B was that we were wrong to underestimate the strength of the US recovery. Our standard rejoinder was “with a 10% budget deficit and massive monetary creation, what is surprising is how tepid it has been!” We are now revising this view: We may have actually been misled regarding the actual strength of the recovery – which may in fact have been non-existent.

There are two reasons why the GDP measures are fraudulent:

- First of all, as pointed out by our friend John Mauldin, GDP measures consumption, and creation of more debt will reliably provide a sugar-fix. To quote his recent paper:

Real per capita GDP has recovered to within 2.5% of the 2007 peak of \$48,000 (in 2010 dollars). So, why do we feel so bad? For one thing, after two recessions, were up barely 6% in a decade. Furthermore, this scant growth is entirely debt-financed consumption. The real per capita Structural GDP, after subtracting the growth in public debt, remains 10% below the 2007 peak, and is down 5% in the past decade. Net of deficit spending, our prosperity is nearly unchanged from 1998, 13 years ago.

- Secondly, as T&B has repeatedly noted, no less than in Argentina, US inflation has been seriously understated for political reasons (numerous US entitlement programs are indexed for inflation). This has a substantial effect on reported GDP, which is calculated by correcting nominal economic activity for the rate of inflation (otherwise, an 8% increase in spending in an environment of 10% inflation would count as 8% growth – rather than as a 2% decline!). If one wishes to game the numbers, there are two ways to do so... the first, increasing nominal economic activity, is almost impossible, as it would require misrepresenting millions of data. The second is far simpler – simply understate the rate of inflation, i.e. the GDP-deflator, and you automatically increase the reported rate of growth.

To again quote John:

“The importance of the price deflator used by the BEA cannot be overstated. In calculating the “real” GDP the BEA continued to use an overall 1.9% annualized inflation rate, which is

substantially lower than the inflation rates being reported by any of the BEA’s sister agencies. The mathematical implications of the deflator are simple: a lower deflator creates a higher ‘real’ GDP reading. If April’s CPI-U (as reported by the Bureau of Labor Statistics) of 3.2% year-over-year inflation is used as the deflator, the reported 1.84% annualized growth rate shrinks to a 0.56% annualized rate, and the ‘real final sales of domestic products’ is actually contracting at a 0.63% rate. If instead of the year-over-year CPI-U we were to use the annualized CPI-U from just the first quarter (5.7%), the ‘real’ GDP would be shrinking at a 1.82% annualized rate, and the ‘real final sales of domestic products’ would be contracting at a recession-like 3.01%.”

(<http://www.consumerindexes.com>)

In any event, it is far easier to game the numbers than to game the underlying economy. Thus, while GDP numbers are less dire than we would have expected, housing numbers, employment, etc. strongly suggest that the US remains in recession.

Implications for global markets are substantial – equity markets have been overestimating global growth:

- The US now accounts for a bit less than 25% of global GDP; a recession there will necessarily have a meaningful effect on reported global growth:
- Our bearish call on the UST (expressed by keeping portfolio duration short – not by shorting the T-bond) is premature;
- Most controversially, QE3 – perhaps under another name – is only a question of time. We do not believe that, especially in an election year, the Fed will allow the necessary contraction to work its way through the system. Further stimulus of some sort is simply a matter of time;
- The dollar is likely to continue to weaken (but beware the volatility). Any hint of renewed US monetary stimulus will risk triggering a violent USD sell-off.
- Equities are likely to have a miserable time of it.

The Illuminations – Fear and Trembling in the Currency Markets: A Disclaimer

While T&B remains a long-term dollar bear, of late the currency markets have shown a propensity for violent moves that apparently fly in the face of economic logic. Predictably, just as we went to press with our last issue, global markets saw a violent swing into risk-off mode, followed by a couple of aftershocks – the dollar briefly surged by almost 9 points against the Euro – from 1.49 to almost 1.40 – before turning around and weakening back towards 1.45. Then, on Wednesday, 1 June, as another slew of bad US economic indicators were released – confirming if needs be that the famed economic recovery was something of a myth – again, the dollar briefly jumped by 1.5 points against the Euro.

We think we see a pattern here... economic logic and market logic are working in opposite directions. In the long-term, the dollar is weakening on fundamental economic grounds – the US is running both an unsustainable current account deficit and an irresponsible monetary policy, flooding the world with excess dollars. In the short-term, on the other hand, the dollar is the immediate beneficiary of any swing into risk-off mode. This poses a challenge for managers wishing to maintain the purchasing power of financial assets.

We would shift our focus to the Asian currencies – ex AUD/NZD, these are somewhat lower beta, though not immune to the general trend. Diversification can help somewhat, and to remain over-exposed to the USD seems a guarantee of ultimate impoverishment. We would currently trade it with tight stops, ready to reverse out and briefly go long USD during periods of stress. This will require fast fingers and steady nerves.

Our preferences remain gold, SEK, NOK, EUR, IDR, THB, SGD, TWD, MYR, and some NZD/AUD (in the trading portfolio). We would be net short USD, but ready to reverse out opportunistically.

Afterthoughts – Conspiracies and Flights of Fancy

T&B lives in a city where conspiracy theories are a cottage industry (viz: the wild and wonderful fantasies about a Sarkozy-Putin (i.e. the KGB) plot to bring down D. Strauss-Kahn), and where paranoia is considered a normal part of one's psychological makeup. We are usually disinclined to play, however given our distrust of the Anglo-Saxon media, it is interesting to speculate a bit about whether there is not a concerted effort to cast doubt on the survivability of the EU and the Euro.

Although at some point in the future, at least in selected geographic regions, the Chinese Renminbi will inevitably supplant the USD, both as a means of exchange and as a store of value (note the increasing issuance of Dim Sum bonds, and the rapid growth of Renminbi swap lines for commercial transactions in Asia, Eastern Europe and Latin America), the more immediate threat to the “exorbitant privilege” of issuing the world's reserve currency, is none other than the Euro, which along with gold, and despite all the recent volatility, is slowly supplanting the dollar within the composition of global Forex reserves. Along with the yield differential, this has been one of the primary drivers for the gradual strengthening of the Euro exchange rate.

Currency allocation is currently akin to a beauty contest in a town where all the girls are particularly ugly. The yen is an accident going somewhere to happen (though timing here is particularly hazardous), the USD suffers from a plethora of ills (irresponsible monetary policy, budget deficit, current account deficit, dire situation of the states and municipalities etc.) so the Euro would normally be the choice by default (*pun unintentional...*). Therefore, the creation of some hysteria about its imminent collapse is just what the doctor ordered for those intent upon preserving the pre-eminence of the USD.

While hard evidence of a coordinated media attack on the Euro is not likely to come to light, some of the recent hysteria suggests that there is – at the very least, a collective outburst of schadenfreude with an attempt to divert attention away from domestic problems by pointing out how bad it is everywhere else – at most, a last-ditch attempt to shore up the beleaguered dollar by trashing its competitors.

Happy Trading!

(and do be careful who you believe!)

T&B

*Readers are **welcome to forward T&B** to any party who might be interested. We write to be read!
Comments should be directed to Eric Kraus, on eric@nikitskycapital.com or
krausmoscow@yahoo.com*

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Readers will not find the accustomed plea for sponsors this issue. After the failure of negotiations with several potential sponsors – in part on freedom of expression grounds – we are giving up on it for now, and T&B shall remain a labour of love. Any of our readers who may have reaped some financial bounty by following our trading recommendations could do worse than to charter our great wooden sailing schooner, El Aleph (see: www.elaleph.ru) for a cruise around paradise (currently Komodo National Marine Reserve in Indonesia, West Papua after that); several of your colleagues – whom you may know – have recently done precisely that!

This message is provided for informational purposes and neither the information nor any opinion expressed herein constitutes an offer, or an invitation to make an offer, to buy or sell any investment funds, securities or any options, futures or other derivatives related to such securities.

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It should be assumed that the author and/or the funds he advises will from time to time have long or short positions in any of the assets discussed, or derivatives thereof. These positions may at times be contrary to the views expressed.

Like cats and horses, markets – whether emerging or emerged, are apt to do as they damned well choose, and a considerable measure of luck is required to come out in one piece. Exercise caution in all things. Good Luck!

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