How Global Interest Rates Deceive Markets

JOHN MAULDIN | January 26, 2015

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> "You keep on using that word. I do not think it means what you think it means."
>
> – Inigo Montoya, *The Princess Bride*
>
> "In the economic sphere an act, a habit, an institution, a law produces not only one effect, but a series of effects. Of these effects, the first alone is immediate; it appears simultaneously with its cause; ***it is seen***. The other effects emerge only subsequently; ***they are not seen;*** we are fortunate if we ***foresee*** them.
>
> "There is only one difference between a bad economist and a good one: the bad economist confines himself to the ***visible*** effect; the good economist takes into account both the effect that can be seen and those effects that must be ***foreseen***.
>
> "Yet this difference is tremendous; for it almost always happens that when the immediate consequence is favorable, the later consequences are disastrous, and vice versa. Whence it follows that the bad economist pursues a small present good that will be followed by a great evil to come, while the good economist pursues a great good to come, at the risk of a small present evil."
>
> – From an 1850 essay by Frédéric Bastiat, "That Which Is Seen and That Which Is Unseen"

All right class, it's time for an open book test. I'm going to give you a list of yields on various 10-year bonds, and I want to you to tell me what it means.

United States: 1.80%

Germany: 0.36%

France: 0.54%

Italy: 1.56%

UK: 1.48%

Canada: 1.365%

Australia: 2.63%

Japan: 0.22%

I see that hand up in the back. Yes, the list does appear to tell us what interest rates the market is willing to take in order to hold money in a particular country's currency for 10 years. It may or may not tell us about the creditworthiness of the country, but it does tell us something about the expectations that investors have about potential returns on other possible investments. The more astute among you will notice that French bonds have dropped from 2.38% exactly one year ago to today's rather astonishing low of 0.54%. Likewise, Germany has seen its 10-year Bund rates drop from 1.66% to a shockingly low 0.36%. What does it mean that European interest rates simply fell out of bed this week? Has the opportunity set in Europe diminished? Are the French really that much better a credit risk than the United States is? If not, what is that number, 0.54%, telling us? What in the wide, wide world of fixed-income investing is going on?

Quick segue – but hopefully a little fun. One of the pleasures of having children is that you get to watch the classic movie *The Princess Bride* over and over. (If you haven't appreciated it, go borrow a few kids for the weekend and watch it.) There is a classic line in the movie that is indelibly imprinted on my mind.

In the middle of the film, a villainous but supposedly genius Sicilian named Vizzini keeps using the word "inconceivable" to describe certain events. A mysterious ship is following the group at sea? "Inconceivable!" The ship's captain starts climbing the bad guys' rope up the Cliffs of Insanity and even starts to gain on them? "Inconceivable!" The villain doesn't fall from said cliff after Vizzini cuts the rope that all of them were climbing? "Inconceivable!" Finally, master swordsman – and my favorite character in the movie – Inigo, famous for this and other awesome catchphrases, comments on Vizzini's use of this word inconceivable:

> "You keep on using that word. I do not think it means what you think it means."

(You can see all the uses of Vizzini's use of the word inconceivable and hear Inigo's classic retort here.)

When it comes to interpreting what current interest rates are telling us about the markets in various countries, I have to say that I do not think they mean what the market seems to think they mean. In fact, buried in that list of bond yields is "false information" – information so distorted and yet so readily misunderstood that it leads to wrong conclusions and decisions – and to bad investments. In today's letter we are going to look at what interest rates actually mean in the modern-day context of currency wars and interest-rate manipulation by central banks. I think you will come to agree with me that an interest rate may not mean what the market thinks it means.

Let me begin by briefly summarizing what I want to demonstrate in this letter. First, I think Japanese interest rates not only contain no information but also that markets are misreading this non-information as meaningful because they are interpreting the data as if it were normal market information in a familiar market environment, when the truth is that we sailed beyond the boundaries of the known economic world some time ago. The old maps are no longer reliable. Secondly, Europe is making the decision to go down the same path as the Japanese have done; and contrary to the expectations of European central bankers, the potential to end up with the same results as Japan is rather high.

The false information paradox is highlighted by the recent Swiss National Bank decision. Couple that with the surprise decisions by Canada and Denmark to cut rates, the complete retracement of the euro against the yen over the past few weeks, and Bank of Japan Governor Kuroda's telling the World Economic Forum in Davos that he is prepared to do more (shades of "whatever it takes") to create inflation, and you have the opening salvos of the next skirmish in the ongoing currency wars I predicted a few years ago in *Code Red*. All of this means that capital is going to be misallocated and that the current efforts to create jobs and growth and inflation are insufficient. Indeed, I think those efforts might very well produce a net negative effect.

But before we go any farther, a quick note. We will start taking registrations for the 12th annual Strategic Investment Conference next week. There will be an early-bird rate for those of you who go ahead to register quickly. The conference will run from April 29 through May 2 at the Manchester Grand Hyatt in San Diego. For those of you familiar with the conference, there will be the "usual" lineup of brilliant speakers and thought leaders trying to help us understand investing in a world of divergence. For those not familiar, this conference is unlike the vast majority of other investment conferences, in that speakers representing various sponsors do not pay to address the audience. Instead, we bring in only "A-list" speakers from around the world, people you really want to meet and talk with. This year we're going to have a particularly large and diverse group of presenters, and we structure the conference so that attendees can mingle with the speakers and with each other.

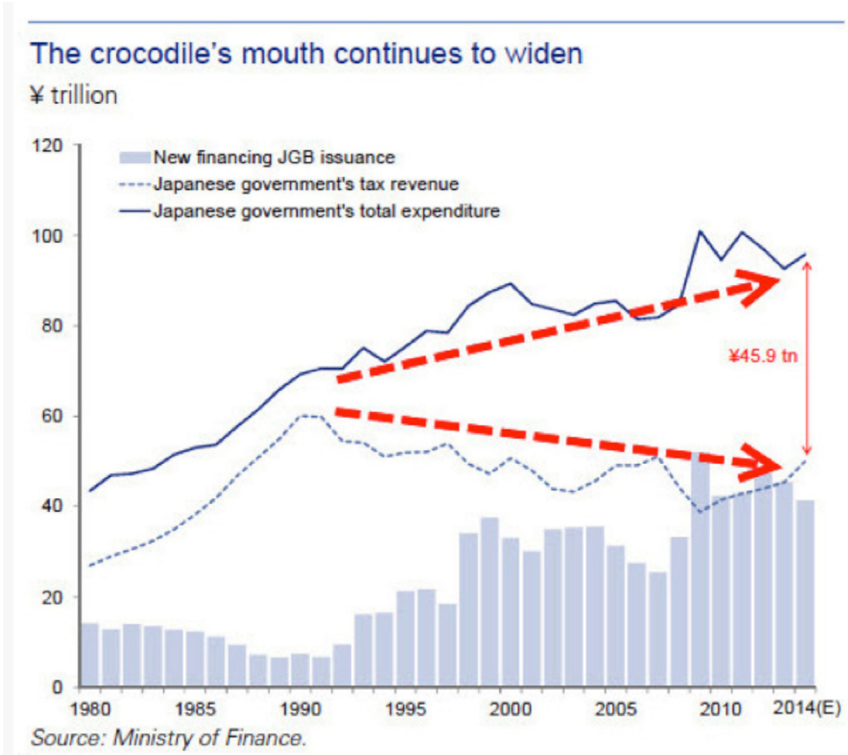
I am often told by attendees that this is the best economic and investment conference they attend in any given year. I think it is a measure of the quality of the conference that many of the speakers seek us out. Not only do they want to speak, they want to attend the conference to hear and interact with the other speakers and conference guests. This conference is full of speakers that other speakers (especially including myself) want to hear. And you will, too. Save the date and look for registration and other information shortly in your mail.

Now let's consider what today's interest rates do and do not mean as we navigate uncharted waters.

Are We All Turning Japanese?

Japan is an interesting case study. It's a highly developed nation with a very sophisticated culture, increasingly productive in dollar terms (although in yen terms nominal GDP has not moved all that much), and carrying an unbelievable 250% debt-to-GDP burden, but with a 10-year bond rate of 0.22%, which in theory could eventually mean that the total interest expenses of Japan would be less than those of the US on 5-6 times the amount of debt. Japan has an aging population and a savings rate that has plunged in recent years. The country has been saddled with either low inflation or deflation for most of the past 25 years. At the same time, it is an export power, with some of the world's most competitive companies in automobiles, electronics, robotics, automation, machine tools, etc. The Japanese have a large national balance sheet from decades of running trade surpluses. If nothing else, they have given the world sushi, for which I will always hold them in high regard.

We talk about Japan's "lost decades" during which growth has been muted at best. They are just coming out of a triple-dip recession after a disastrous downturn during the Great Recession. And through it all, for decades, there is been a widening government deficit. The chart below shows the yawning gap between Japanese government expenditures and revenues.



This next chart, from a Societe Generale report, seems to show that the Japanese are financing 40% of their budget. I say "seems" because there is a quirk in the way the Japanese do their fiscal accounting. Pay attention, class. **This is important to understand. If you do not grasp this, you will not understand Japanese budgets and how they deal with their debt.**

Under a Japanese law called the "60-year redemption rule," the government is required to retire its bonds in cash over a period of 60 years, irrespective of bond duration. In the case of 10-year bonds, this would mean that one-sixth of all 10-year bonds would have to be redeemed every 10 years for cash.

In the US and Europe (and to my knowledge everywhere else in the world), we simply roll those bonds over, and they are not part of the budget. When we adjust the Japanese budget for this redemption expenditure, we find that the primary expense (the proportion of the budget that is not interest expense and deficit financing) is "only" 87.8% for the 2015 budget. Given that the current budget estimates a 1.8% 10-year bond yield and that the government is rolling over those bonds at 0.22%, interest-rate expenses are likely to fall over the coming years. That is especially true when a significant portion of those rollover bonds will show up on the balance sheet of the Bank of Japan, which will remit the interest charges back to the government. Nice work if you can get it.

Table: Framework of the draft budget for FY15

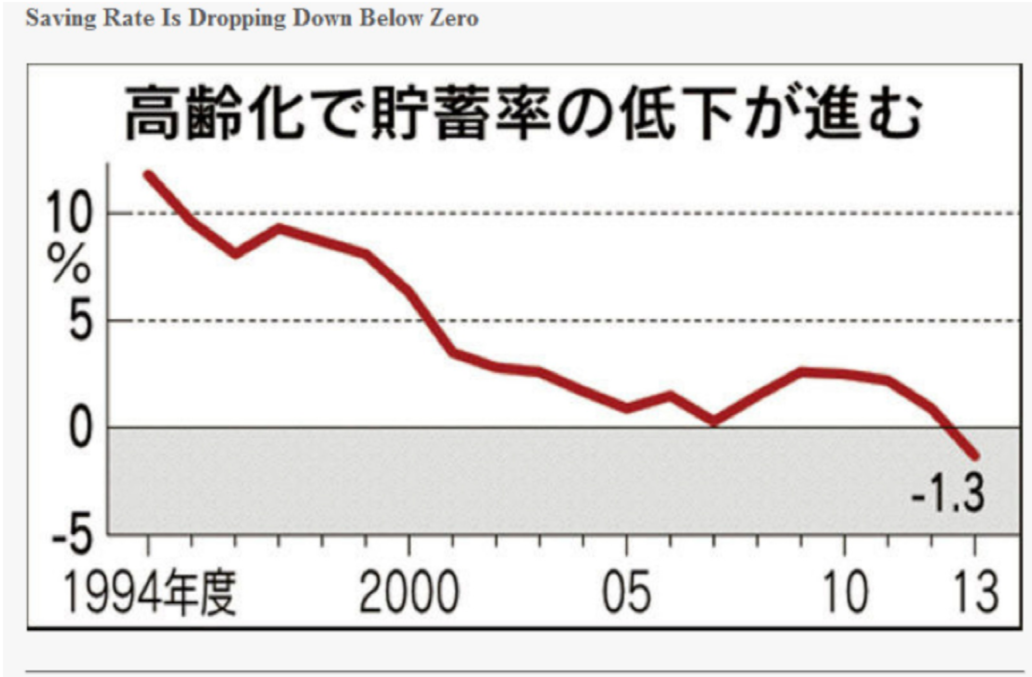
	FY2014 Budget (Initial)	FY2015 Budget	FY2014 → FY2015
Revenues			
Tax Revenues	500,010	545,250	45,240
Other Revenue	46,313	49,540	3,226
Government Bond Issuance	412,500	368,630	-43,870
Construction Bonds	60,020	60,030	10
Special Deficit-Financing Bonds	352,480	308,600	-43,880
Total	958,823	963,420	4,596
Expenditures			
National Debt Service	232,702	234,507	1,805
Primary Expenditure	726,121	728,912	2,791
Social Security	305,266	315,297	10,030
Local Allocation Tax Grants, etc.	161,424	155,357	-6,067
Total	958,823	963,420	4,596

Source: Ministry of Finance (Unit: 100 mil JPY)

This table is important. The Bank of Japan is now totally financing the government deficit, but this has not always been the case. Until the last few years, Japanese government debt was almost totally underwritten by Japanese savers. For many decades after World War II, the Japanese saved a high percentage of their earnings. And they tended to put their savings into various funds and pension plans that utilized high percentages of Japanese government bonds in their portfolios.

However, one of the things we know about savings rates is that they fall as a country's population gets older because retirees must draw on their savings. The problem is compounded when the ratio of workers to retirees begins to fall, which it is doing rather precipitously in Japan. A few years ago I began writing about Japan and the consequences of a negative savings rate. This was a new phenomenon at the time. I pointed out that either the Bank of Japan would have to undertake large amounts of quantitative easing, or the government would have to run surpluses, or interest rates would have to rise. But if interest rates were to rise, that would make the deficit worse and could precipitate a deflationary spiral. On the other hand, monetizing the debt would cause the currency to devalue. And then, suddenly running a government surplus could trigger a recession.

Japan had to choose among disastrous scenarios. They chose to monetize and thus allow their currency to fall – that was the easiest and best of the disastrous choices. The time for good choices came and went long ago, when they could have decided not to run such huge deficits.



Japan has had a “triple-dip” recession, partially self-inflicted. The government raised taxes (a lot) last spring, which immediately plunged the Japanese economy back into recession.

The recent QE binge did indeed help to raise inflation in Japan, although inflation is now falling again. The Bank of Japan is projecting close to 2% growth and 1% inflation for 2015 and hopes to see inflation rise to 2% by 2016. For Abenomics to work as planned, the Japanese need 4% nominal GDP growth. Four percent nominal growth can be produced by 2% real productivity growth plus 2% inflation. That growth, combined with the central bank’s retiring large amounts of government debt, would help reduce the debt-to-GDP burden – if it happens.

The False Information Conundrum

Now we come to the problem of what information Japanese interest rates really offer. First, remember that on days when the Bank of Japan withdraws from trading 10-year Japanese bonds, there simply is no trading. For all intents and purposes, the Bank of Japan is the bond market at the longer end.

Given that reality, what information can the market derive from the interest rate on the ten-year Japanese bond? As it happens, not much at all. **If the Bank of Japan is both the price maker and the price taker – if there is no real two-way market – then *the only thing we know from the yield on the Japanese bond is that it is what the central bank wants it to be.*** The yield doesn't tell us anything about underlying economic conditions in Japan, which, given their history, are not all that bad, relatively speaking (as we will see in a moment).

As noted above, the government is required to retire all of its 10-year bonds every 60 years. That stipulation has some very interesting consequences. If long-term bond rates stay at the level they are today, the Bank of Japan can replace a significant amount of the long-term bonds in the Japanese portfolio at interest rates between the current 0% for the 5-year bond and 0.22% for 10-year bond – that is if rates don't go even lower because the Bank of Japan pushes them lower. Think about that for a moment. Today Japan is paying about 1/8 the interest-rate cost that the United States is paying for a new 10-year bond. That means Japan can have eight times the amount of debt at the same interest-rate cost. The irony is that, under the current replacement regime, the interest-rate cost for the government is likely to go down even as the quantity of bonds goes up – unless interest rates go up. Now then, precisely what information does this set of dynamics signal to the markets? More on this question in a few paragraphs.

Japanese pension funds, insurance companies, and other investors are all moving into Japanese and foreign equities. They are doing so because low interest rates and massive quantitative easing mean that the yen is likely to fall. The only rational response is to move into equities and, even better, into equities denominated in a foreign currency. So, when these investors sell their long-term bonds back to the Bank of Japan, they are doing so at a considerable profit. (Remember, lower yields raise the actual physical sales value of bonds.) The Bank of Japan has essentially engineered profits for not only its government-sponsored pension funds but for all pension funds and insurance companies that sell those bonds. Another way to look at the arrangement is that you have to be paid to give up your higher-yielding asset when anything you roll over on the shorter end is going to pay you almost nothing.

Sidebar: There is a somewhat public rift between the new chief investment officer of the largest Japanese government pension fund and the Bank of Japan. The CIO apparently wants to go faster in switching over to non-Japanese bond assets. Since he is a leading figure in the pension world, his actions have consequences. What happens if he and a number of his cohorts all decide to "hit the bid" at a much faster rate than the Bank of Japan is supplying buying power? In a normal world that would mean either that the Bank of Japan must increase its quantitative easing or that interest rates would rise, as other buyers must be brought into the market. This little side tempest has the potential to become rather important. We will be paying attention.

Now, back to our story. In a rather perverse way, the Bank of Japan has to lower rates in order to encourage 10-year bonds to come out of the market. Otherwise, a pension fund just sells its lower-yield debt that is rolling over. (I can find no data on what bond duration is moving out of pension funds. If someone knows where to find this, please shoot me a note. I am quite curious. Maybe all this means nothing. Or maybe it is very important.)

Prime Minister Abe has told us that he intends to balance the budget in about five years, that is, by 2020. If the Bank of Japan moves a significant chunk of total debt onto its own books and the rest of that outstanding debt is at de minimus interest rates – *assuming the government actually manages to run a surplus* – it can retire debt and hold interest rates down a great deal longer.

The fly in the ointment, at least from the consumer's perspective, is that the value of the yen will continue to fall, which means that the food Japan imports (some 60% of its supply) will continue to rise in cost. On the other hand, oil at $50 and below is a huge boost to the Japanese economy. The bear market in iron ore, copper, and other industrial metals is also softening the impact of a falling yen.

The Halloween Surprise last October, when the Japanese launched their latest massive round of QE, forced the yen significantly lower against the euro. The number-one competitor of Japan and most of her industrial products (think machine tools, etc.) is Germany. The latest campaign by Draghi, et al., at the ECB has completely erased any gains made by the euro; and in fact the yen was lower than the euro over the last 12 months. But for those keeping score, the euro has now fallen 10% against the yen in less than two months. Which is why Kuroda hinted at further QE in Davos. Yes, I know he was referring to his inflation target, but it would be naïve to think that he is not also paying attention to exchange rates, given the chart below (euro-yen in red).

I know that many people seem to feel I am negative on Japan. That is far from the truth. There is a lot of opportunity in Japan, and the current government is having some successes in spite of the country's massive debt problems and demographic headwinds. So in the interest of being "fair and balanced," let's look at the following note from Peter Tasker, who offers some fascinating, if sometimes irreverent, commentary on Japanese economics and culture. He is thoughtful and well-written, which you might expect from a man who has written more fiction works based on Japanese culture than he has economic books, although he is essentially a man of the investment world.

He has a different take on the success of Abenomics. The facts on the ground suggest that Japan is in many ways improving, despite horrible demographics and lack of reform. (The Japanese are making remarkable strides in creating a hydrogen-based economy, which is something few people outside of Japan, and perhaps even many in Japan, understand the implications of. The "fire ice" deposits near Japan could be as big a game changer as shale gas is for the United States. And mining them is closer to reality than you think.)

Tasker uses a Monty Python skit to give us some insight on Abe's success:

> Much of the media commentary, both domestic and overseas, has been relentlessly critical, almost as if people have a deep emotional need for Abenomics to fall apart and the Japanese economy to slide back into the doldrums.
>
> In an attempt to provide some balance, we enlist the help of the Monty Python team. "What have the Romans ever done for us?" is a comedy routine from the classic Life of Brian film. In it a resistance leader, played by John Cleese, gives a barnstorming anti-Roman speech, only to be reminded of the various blessings the occupiers have brought – aqueducts, sanitation, wine, public order, etc. [You can see the hilarious skit here.]
>
> A contemporary Japanese version might go something like this:
>
>> John Cleese – What has Abenomics ever given us? Absolutely nothing!
>>
>> Voice from back – How about full employment?
>>
>> Cleese – What?
>>
>> Voice – Full employment. With the job-offer-to-applicants ratio at a twenty-two-year high, everyone who wants a job can get one. Isn't that pretty remarkable in today's world?
>>
>> Cleese – Alright, alright. I'll grant you full employment, but apart from that what has Abenomics done for us? Nothing!
>>
>> Second voice – Stock prices have doubled in two years. That must be good, no? It was the collapse in asset prices that set off the balance sheet recession that's been going on for ages.
>>
>> Cleese – Well, obviously stock prices. That goes without saying, doesn't it? So apart from doubling stock prices and achieving full employment, what has Abenomics done for us? Absolutely nothing!

Third voice – And real estate prices. They're rising all over the country now, even in regional cities. Homeowners are going to feel better about that.

Cleese – Okay then. Apart from achieving full employment, doubling stock prices and getting real estate prices moving…

Fourth voice – And corporate profits are through the roof too.

Fifth voice – Female labour force participation is at an all-time high.

Sixth voice – Didn't you say the bond market was going to collapse and interest rates would soar? Well, rates have gone down, not up!

Seventh voice – Tourists are flooding into the country

Eighth voice – And exports seem to be taking off at last.

Ninth voice – From next April wages will be rising faster than consumer prices.

Tenth voice – And companies are revising up capital investment plans.

Eleventh voice – The corporate governance reforms are having a visible effect. 60% of companies in the MSCI Index now have two or more outside directors and share buyback announcements are up 60% year-on-year.

Cleese – Alright, alright. Apart from full employment, higher asset prices, lower interest rates, record-high profit margins, better corporate governance, a tourism boom, more working women, exports and capex, what has Abenomics ever given us?

Twelfth voice – Nominal GDP growth?

Cleese – Growth! Oh, SHUT UP!

(With apologies, love and respect to Monty Python.)

That positive news aside, my biggest personal investment success over the past two years has been shorting the yen. And I fully intend to maintain that posture. Positive economic news will not soon remove the necessity of the Bank of Japan monetizing debt.

The Common Denominator between the Swiss and Japanese Central Banks

As everyone is aware, the Swiss took off their peg to the euro last week, and the Swiss franc promptly climbed 15%. If you look at the data for the past three years on the euro-Swiss franc currency cross, there is no information about the value of the Swiss franc relative to the euro contained in that data. If a central bank decides to control exchange rates or interest rates, then the information that the market should be taking from those rates is nullified.

Once the Swiss National Bank removed the peg, the market immediately gleaned the information that this was a franc worth 15% more. (I bet the Swiss National Bank was surprised at the violence of the move.) If the Japanese were to remove their support and involvement in the long-term Japanese bond market, interest rates would react far more violently than they did in the case of the Swiss franc-euro currency cross. Who in their right mind would want to buy a Japanese 10-year bond at 0.22%? Or even 1% (or 2% or 3% or 5%) if they were not convinced that the central bank would eventually bail them out?

In my opinion, the European Central Bank is getting ready to further remove true information from the European bond market. Interest rates normally reflect the market telling bond sellers about the value of their debt. If the ECB drives down longer-term rates, sundering them from normal market actions, it sends false information to the various governments about the value of their bonds; and it allows politicians to avoid making the real reforms that are necessary to get Europe growing again. Now, in fairness, the ECB is trying to give Eurozone governments time to make those reforms, but the track record so far suggests that politicians will not press forward with reforms if they are not faced with the necessity of doing so – and it typically takes a crisis to provoke them to action.

Draghi addressed the issue of whether the ECB would be removing real information from the European bond market with its latest QE announcement. He was asked the question directly:

> **Question:** You said that you'll keep buying bonds until inflation is back on track. So basically, you have an open-ended programme. Do you see anything in terms of the percentage of outstanding debt that you can buy before you start overly influencing price formation on the secondary market, as the European Court of Justice suggested that you should avoid?
>
> **Draghi:** The answer to the first question, yes, we will buy government debt up to the percentage that will allow a proper market price formation. Therefore, we have two limits. The first one is an issuer limit, which is 33%, and another one is an issue limit, which is 25%. In other words, we won't buy more than 25% of each issue, and not more than 33% of each issuer's debt. The 25% limit, by the way, is the one foreseen in order not to be a blocking minority in the collective action clause assemblies, basically, bond holders' assemblies, and it's the basis for us to be able to say, there is going to be pari passu.

I'm sure the ECB can produce a stack of academic studies that confirm that limiting their buying to 33% of the total outstanding government debt of a particular country will allow proper market price formation. I think this is one of those moments when, although in theory there is no difference between theory and practice, in practice there will be. If market participants expect that they can buy a high-yielding sovereign bond and that the ECB will eventually take them out, given that European banks have no essential limits on how much sovereign debt they can put on their balance sheets, the ECB is taking the risk out of holding Portuguese and Italian debt, both of which pay higher rates. Doing this is going to bring down the yield of lower-grade European sovereign debt far more than it will that of higher-grade bonds. Greece is its own special case, because it clearly needs some type of debt forgiveness or additional restructuring.

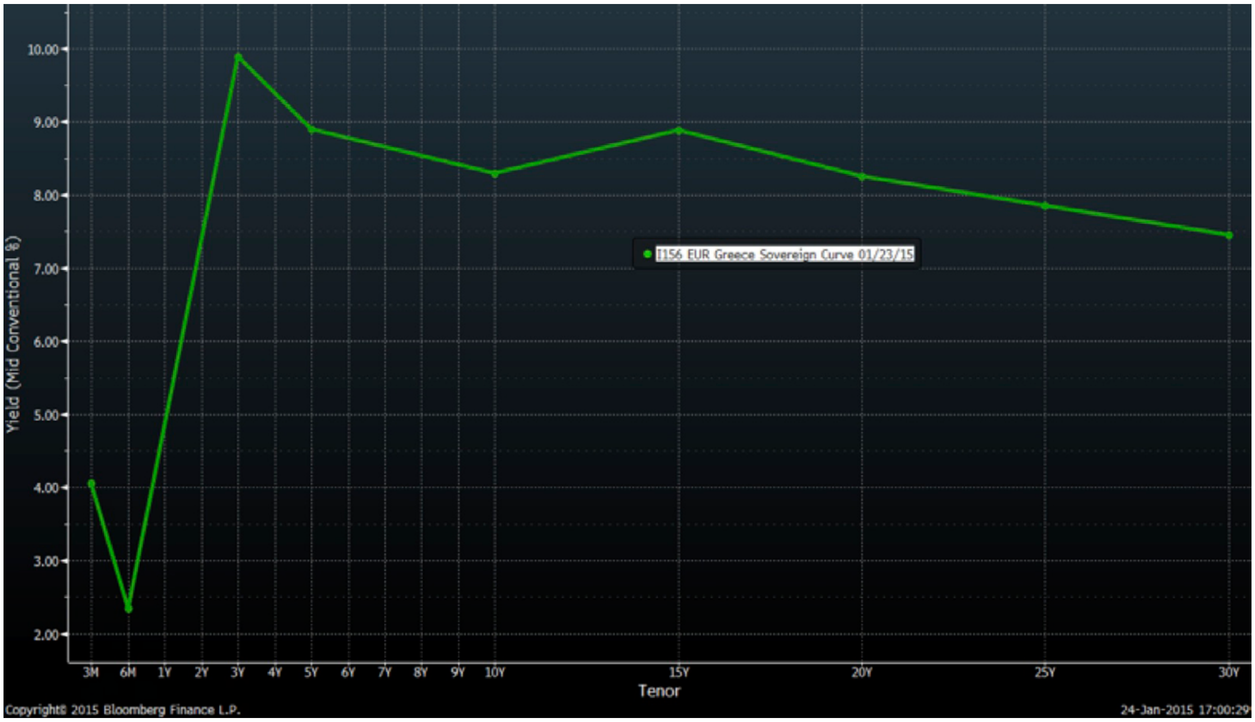
George Magnus (based in London) offers us this commentary on Europe and the ECB:

> Given the dire state of the Eurozone economy, QE is unlikely to push inflation markedly higher, especially in the periphery countries such as Greece, Spain, Italy and Portugal. Under these circumstances, it is inconceivable that others, such as Germany, would be willing to experience significantly higher inflation to compensate. In fact, there probably is no successful QE policy that, in addition to longer-term labor and product market reforms for debtor and creditor nations, does not also rely on comprehensive debt restructuring and relief, properly recapitalized banks, and greater fiscal activism by countries and institutions that are able to implement it. If Europe is to experience a sustainable rise in demand, investment, jobs and productivity, these policies must accompany QE – but no one expects the prevailing policy stance to change so much.
>
> This is not to criticize QE as such, but to lament the absence of complementary policy measures, and point to the risk of a political backlash among creditors and among voters generally against the single-minded emphasis on the ECB.

Time to Watch Greece Again (Sigh)

This weekend we are greeted with elections in Greece. It now appears that Syriza will be able to control the new parliament. They want to see a restructuring of Greek debt, which frankly is the only way possible for Greece to get out of its current long-lasting depression. A 175% debt-to-GDP ratio at rates far higher than Japan's (see below), without a central bank willing to purchase all that debt, simply does not qualify as a working business model. In the background is the collapsing Greek economy, which has shrunk by 25% in the past five years, while youth unemployment hovers at a staggering 50%. Prescription drug prices have gone up 30%; unemployment benefits end at 12 months; and the long-term unemployed lose access to state health care. The yield on the 10-year bond has dropped since the ECB's QE action, but it is still hovering above 8%. That is a far cry from the 0.22% Japan enjoys. Already, Greek taxpayers are delaying payments in anticipation of Syriza's promised abolition of property taxes.

The populist proposals made by Syriza will not fix any of the underlying structural problems and will likely make them even worse. There is simply not the money to do what they want. Undoing economic and labor reforms will put any future growth, which is the most important need, even further out of reach.



As an aside, if I were the young Mr. Tsipras, who will be the new leader of Greece, I would argue for a deal similar to what Ireland got for the bank debt they assumed. Ireland essentially turned their short-term debt into 40-year bonds with very small payments for the next few decades, and it's debt that can be rolled over when the time comes. There are very few politicians who are going to be worried about what will happen in 40 years. Such a program would buy time, keep Greece in the euro, and allow them to more or less stay in compliance so that the ECB could purchase 33% of their outstanding debt.

If no agreement is reached (and the deadline is approaching), Greece will face a cash crunch within months. The spectacle of a high-income economy running out of money has not been seen since the 1930s. The only way to cover the shortfall would be for Greece to quit the Eurozone and start printing its own currency again.

I actually think (based on reports today) that the Greek problem will be solved in the context of a crisis. It would be interesting if the Eurozone could allow Greece to leave without its having to leave the European Union. Such a formula certainly sparked both reforms and growth in Asia (hat tip Peter Tasker). Which brings us to the far more important point that the recent ECB action is likely to defer the day of reckoning that Europe needs to face, as well as the impetus for reform, further into the future. This is just another example of Eurozone management significantly lengthening the road down which the can will be kicked.

The ECB's QE also means that corporations all over the world are going to be able to borrow money at lower rates. This is going to mean more share buybacks and financial engineering, mergers and acquisitions, and private equity and less true new-business activity.

The Cayman Islands, Zurich, Florida, and New York

Grand Cayman, Zurich, and Florida are on my schedule, and New York is also looking likely in March. I am "entertaining" the Mauldin Economics writing and management team starting this weekend here in Dallas. Then in February it's on to the Caymans. It has been awhile since I was in the Cayman Islands, and this time I'll take a short hop over to Little Cayman to visit my friend Raoul Pal for a few days. A brilliant macroeconomist and trader, Raoul has now based himself in Little Cayman, although he frequently flies to visit clients. In March I'll be in Zurich (and maybe some other parts of Europe) and then hop back over the pond to Orlando. I will be in NYC later that month, and DC is calling. Not to mention La Jolla. The present wonderful period of reduced travel is coming to an end.

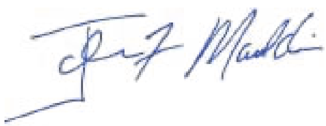
This weekend the writing team at Mauldin Economics begins to show up from around the world. Jawad Mian, whom you will soon get to know better, is already in town from Abu Dhabi, along with Olivier Garret and Ed D'Agostino. I'm going to take them to one of the best barbecue restaurants in Texas, called Smoke. Highly recommended. Then Jared Dillian will roll in from South Carolina and Tony Sagami from Bangkok via Montana. And of course Worth Wray will be here. Later in the week I'll be joined by my new partners (yet to be announced) in what will become Mauldin Portfolios, a portfolio design and management firm geared to helping you create for your clients portfolios that work in the present challenging environment. We'll do our best to understand the opportunities and risks in front of us, both those the market presents and the more direct business challenges.

I finish this letter from Tulsa, where I took the opportunity to spend an evening with my twin girls, Abbi and Amanda, and my granddaughter Addison (who for some reason takes a fright every time she sees me). Both young women are nesting in new homes, starting families, and dealing with "normal" issues. Their husbands are both focused on new job opportunities. It makes a dad feel good to see some optimism in his children. Sometimes we forget, in all our research on macroeconomics, that real people are affected in very real-world ways by the trends we analyze. Income inequality? More people are worried about simply getting opportunities, period. Jobs are the focus, not worrying about how much someone else makes.

Part of our conversation at dinner turned to the movie phenomenon *American Sniper*. While I had the privilege of meeting Chris Kyle a few times, my son-in-law Allen had a different experience in Iraq. On the wall where I slept last night was a certificate acknowledging Allen's participation in the taking of Fallujah as a young Marine corporal. He knew there were snipers and Seals assigned to his unit from time to time, but the movie brought back disturbing memories. His unit was at the spear tip on a number of operations. He came back a very different young man. After what he saw and did there, what are a few economic challenges here and there when no one is shooting back at you? I will see the movie soon. I know there are people in America who don't want to confront the realities the movie depicts; and looking back, some would opt for a decision do-over if they could; but a deep respect for how our young soldiers handled themselves is certainly in order.

It is time to hit the send button. They are calling my flight back to Dallas, where I will visit my mom and then head on to the gym before dinner with the guys. Have a great week.

Your thinking about monster smoked beef ribs analyst,



John Mauldin

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