Third Party Research February 6, 2019

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Jubak Picks Daily Newsletter

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Forget Recession Worries – The Big Danger Now Is In The Credit Cycle

The Federal Reserve and the world's other central banks face an impossible choice.

On the one hand, they could have tightened the money supply by raising interest rates or other means. That would have risked sending economies near recession into recession–Germany, for example–and slowing growth further in economies that were already seeing signs of slowing growth. For the Federal Reserve, this is a very important part of the calculation–risk a financial market tantrum that revived fears of a bear market. Tightening the money supply would, on the plus side, have sent a strong message to credit markets that the current degree of risk-taking was over-done and that it was time to pull back on credit to riskier borrowers. In the short, term, unfortunately, that kind of signal to lenders would have added to recessionary forces, even if, in the longer-term, such action might have headed off a deep credit crisis.

On the other hand, these central bankers could have opted to put off interest rate increases and, in the Fed's case, to dangle the possibility of an early end to balance sheet run-offs of $50 billion per month that had the effect of tightening the money supply. That would have reduced fears of a pending recession–which would have the effect of reducing the likelihood of an actual recession since fears of a recession are a major element in bringing on an actual recession. It is the fear of a recession that leads CEOs to cut back on hiring and spending plans and encourages consumers to save a little bit more and spend a little bit less. The cost of putting off anything that smacked of tightening the money supply would be, of course, to encourage exactly the additional risk-taking that can lead to a deep credit crisis.

In the event, the Federal Reserve, at its January 30 meeting, opted for alternative #1.

That has had the effect of extending a stock market rally, reducing recession fears, adding to economic growth (probably), and exacerbating exactly the kind of risk-taking in the financial markets that is a big danger at this point in the credit cycle.

The M2 money supply for 12 major economies, including the U.S.A., China, the EuroZone, and Japan dipped to $69.8 trillion in November 2018 from an April peak of $73.1 trillion in April, and then rebounded to an estimated $72.6 trillion at the end of January.

Want some examples of how much risk investors and traders are willing to take on?

Ecuador sold $1 billion in new bonds while in the midst of talks with the International Monetary Fund for a package of financial support. A Greek offer for a 2.5 billion euro ($2.9 billion) bond sale was greeted with enthusiastic offers. Uzbekistan is planning its first international debt offering.

Also, the United States is moving to sell more than $1 trillion in Treasury bonds this year.

What may be most extraordinary about that mountain of government debt is how little buyers are charging for the use of their money. Italy, for example, has slipped back into recession and ranks as one of the world's most indebted countries with a debt to GDP ratio of about 132%, but 10-year Italian government bonds still held only 2.79%. As a whole, the world is awash in debt that pays nothing or less with $8.6 trillion in debt with a negative yield.

Total global debt hit a new high in the first quarter of 2018 at $247 trillion.

It is not just government debt that has soared. Debt among non-financial corporations across the globe rose to a record high of $75 trillion in the second quarter of 2018, the Institute of International Finance said in a report in November. China and the United States have been the biggest drivers in setting that record. But they have not been alone. A "significant proportion" of Brazilian, Canadian, American, and Chinese corporations struggle to pay interest on their debt, the report said. One-third of small firms in France, the United States, and China, for example, have an interest coverage ratio that is lower than what is generally seen as providing an optimal margin of safety.

Let us not forget consumers. U.S. consumer credit rose in November by the most in 16 years as credit-card balances surged, according to the Federal Reserve. Total credit outstanding rose at an 8.8% annual rate in November with revolving credit (credit card debt) growing by $11.2 billion in the month, the biggest increase in a year.

What this all looks like is the build to a Minsky Moment in the credit cycle. That is the moment in the credit cycle where excessive risk-taking comes home to roost in a major financial market reset. A recession would certainly be enough to trigger such a reset, and a credit crisis would make any recession worse.

The challenge, as it has been for the last year or two, is what do investors do to mitigate the risk of such a credit crisis. More thoughts on that soon.

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BW: See "About the Author" on the next page.

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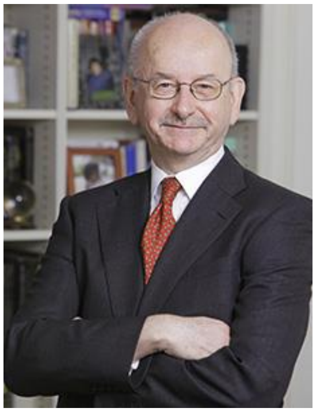

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Web sites: www.jubakpicks.com; http://jubakfund.com/; http://jubakam.com/

BW: here is an excerpt from Jim's WELCOME message on his website

After twelve years with MSN Money, I am excited at being on my own. The move gives me a chance to bring you, my readers, more and better ideas for profitable investing. Each week the folks at the MoneyShow.com and MSN Money will publish seven of my posts from this blog on their sites. That is already an increase in your weekly dose of Jubak from the days when I wrote Jubak's Journal twice a week. But you will also find another 18 or so posts a week on my JubakPicks.com blog that do not appear on either of those two sites. (Although they have appeared as much as three days ago and as little as a few minutes ago, if they are really important) on my new subscription site at http://jubakam.com/)

Here I am aiming for five posts a day five days a week. I won't always get to those numbers. Some posts just take longer to research and write and sometimes, like everyone else, I run out of gas and need to take a break. But my goal isn't some arbitrary number of posts, anyway. The goal is to bring you the best market intelligence that I can on a schedule that keeps you at least one step ahead of the market.

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