A watershed for financial markets

By David Stockman via Zerohedge, 17 Dec 2015

I believe the world is at the greatest financial market inflection point since 1929. One that calls for a basic truism:

You can make a profit in a rising market if you are long. And you can profit in falling market if you are short.

The $64 million question

How can you know the market's direction?

There are all kinds of financial advisors, market seers, chart readers and fancy investment formulas. Each purports to answer that question. But all of these assume some kind of steady state world in which the future unfolds in a grand cycle based on past history.

"Just get some good pattern recognition software" a financial TV advertisement might tell you, and "you're all set to make a killing."

I don't believe that for a second. **We are in uncharted waters after nearly 20 years of madcap money printing by the Fed and other central banks.**

Everything has been wildly inflated - stocks, bonds, real estate - and also the entire real economy as measured by global GDP. That includes trade volumes, capital spending, commodity prices, energy and mining capacity, manufacturing investment, bulk carriers and containerships. Also, warehouse and distribution facilities, brick and mortar retail space and much, much more.

The world's central banks are out of dry powder

But before we get to some of the facts about this great financial deformation, let me get right to the investment thesis. **The world's central banks are finally out of dry powder. They no longer have the means to inflate the global credit and financial bubble.**

That's why I'm calling today's FOMC meeting the most crucial inflection point since 1929.

We have reached the apogee of history's greatest credit inflation. Now we're hurtling into a prolonged worldwide deflation. You can already see this deflation in the plunge of oil, iron ore, copper and other commodity prices.

The Bloomberg Commodity index has fallen 70% since its 2008 peak. And it has now reverted to levels not seen since 1999 — while falling lower by the day.

For a while Wall Street trumpeted all of this as the "commodity supercycle." They insisted that $120/barrel oil and $200 per ton iron ore were a sign of unprecedented growth and prosperity.

An orgy of credit expansion

But that's nonsense. It was the manifestation of an orgy of credit expansion that was unsustainable, and destined to end in a fiery crash. The one happening now.

Central banks are pushing on a string. They can't generate more credit no matter how hard they try because most of the world is at what I call "peak debt." That's the point where households, companies, governments and even countries are tapped out. **They're stuck with such monumental debt burdens that they can't service any additional debt no matter what the interest rate — even zero or below.**

Case in point: The European Central Bank (ECB) has pushed deposit rates in Europe to negative 0.3%. Yet, private credit to households and business remains flat. ***That's because they are already swamped with more debt than they can handle in an economic context of virtually no real growth.***

Likewise, Japan is off the charts with public and private debt equal to 450% of GDP. But despite years of zero interest rates and massive money printing by the Bank of Japan (BOJ), credit stopped growing long ago. Japan is now in its fifth recession in seven years.

Fed between a rock and hard place

And now the Fed is pinned between that kind of rock and hard place, too. It has kept the money market interest rate pinned at zero for 84 months running. It has been truly lunatic.

You can't have free short-term money forever. It would allow financial gamblers to fund their speculations — so-called carry trades –with zero cost money indefinitely. You don't need to know much about human nature to know that's a recipe for a speculative mania and a subsequent bust.

At the same time, this so-called business expansion is getting long in the tooth. It's been 78 months since the June 2009 bottom. The average post-war economic expansion lasted only 60 months. And only one lasted appreciably more than the present cycle. That was in the 1990s, before we had $19 trillion of public debt and nearly $60 trillion of total credit outstanding including households, business, finance and government.

The Fed has dithered and equivocated itself right into an impossible corner. When it raises interest rates — even by 25 basis points — tomorrow, it will begin tightening right in the teeth of the next recession. The economic downturn is already gathering force throughout the world. And, in my judgment, it will hit American shores next year or shortly thereafter.

Fed thinks the U.S. economy is looking just peachy

Of course, our clueless Keynesian money printers at the Fed think the U.S. economy is looking just peachy. That's because they track the wrong indicators. Especially the heavily manipulated, seasonally maladjusted and constantly revised jobs numbers published by the Bureau of Labor Statistics (BLS).

Most of the jobs they keep reporting are what I call "born again" jobs that were lost in two recessions so far this century and then temporarily recovered again. Or they are part-time jobs

in bars, restaurants, retail stores and temp agencies that pay less than $20,000 at an annualized rate.

By contrast, if you look at full-time, full pay jobs in manufacturing, energy, mining, white collar professions, information technology, business management and services or finance and real estate, there are currently 70.5 million of these breadwinner jobs. That's 3% less than 16 years ago when Bill Clinton was still in the White House.

The illusion of recovery, not the real thing

The Fed is looking at the illusion of recovery, not the real thing. If it were real, we would not have 102 million adult Americans without jobs. Or a real median household income of only $54,000 — a level originally reached way back in 1989.

And we would not still have 46 million citizens on foods stamps compared to 18 million at the turn of the century. Or **35% of the population receiving some form of public assistance.**

We can cut to the chase: The Fed's drastic spree of so-called extraordinary policies - zero interest rates (ZIRP) and quantitative easing (QE) - have backfired. They inflated the Wall Street casino and crushed honest savers and retirees. They've also left the Main Street economy stranded in the weakest recovery since World War II.

That's not hyperbole. Other than on a very short run basis due to the plunge of oil and commodity prices, consumer inflation has been running about 2% per year. Based on historic patterns and the principles of sound money, nominal interest rates should be in the 4-5% range to allow for a real return for risk, illiquidity and deferral of consumption by savers.

The difference between that and current zero rates is astonishing when viewed at the macro level.

Since there are upwards of $10 trillion of bank deposits and like savings in the US economy, the Fed's ZIRP or zero interest policy results in the arbitrary and unjust transfer of some $400 billion per year of interest from savers to borrowers, banks and Wall Street speculators.

Consider a working American who spent 40 years at the median wage, lived frugally, and managed to accumulate a nest egg of $250,000. If he is now retired and needs to stay liquid for health or family reasons or out of prudence and therefore has his money invested in CDs or treasury bills, here's what he gets: $750 annually. That's less than one Starbucks cappuccino per day! That's right. One cappuccino for a lifetime of thrift.

The next stock market crash

The point here is not to harp about the injustice of it all. The point is that this very same injustice has massively distorted the financial system and created the set-up for the next stock market crash.

But another stock market meltdown does not mean that you need take it on the chin again… maybe for the third time in the century.

The markets are not remotely prepared for the deflationary recession that is now engulfing the world economy. That's why today's action by the Fed is going to be such a shock. While there may at first be a dead cat bounce or an effort by the robo-traders and hedge fund speculators to spark a relief rally, it will be short lived.

Fed is powerless in the face of the coming downturn

Then the morning after will set in. As the signs of global deflation and recession become increasingly frequent and obvious, the casino gamblers will come to realize that the Fed is out of dry powder. It will be powerless in the face of the coming downturn.

That's where my event recording and brand-new project will make all the difference. Its purpose is to help you spot the most compelling opportunities to profit from a falling market. Please view both the video and my special invitation now by clicking here.