

Our ANTI-Predictions for 2010: A Mid-year Scorecard

Back on New Year's Day, we published for the world to see what we called our *ANTI-Predictions for 2010*. Here, we laid out five key areas where we believed the consensus at the time would be proven wrong. Now, at the year's halfway point, it's time to take a fairly quick look back at those five counter-predictions, *every one of which has come spectacularly to pass*.

We will dispense with lengthy recaps here so as to limit the gloating; and also because what time we *do* have needs to be devoted to a looming change for one of these five predictions. For those of you who would like a refresher--or for fairly new subscribers who never have read the ANTI-Predictions--you're encouraged to read that January 1 piece again. It's still located on the front page of our web site. (The quick recaps below will assume that you're familiar with that prescient piece.) On some of these areas -- especially the China situation and the changing nature of the market's view of the U.S. dollar -- you'll be reading more in the very near future.

No. 1 -- There is NO "exit strategy." As we stagger bloodied, bruised and disillusioned into the second half of the year, it's becoming painfully obvious that those green shoots were crab grass after all. Early exuberance over reflation (if not fears of rising inflation) have been suddenly and

why, events haven't even let us devote a little attention to disinflation along the way.

Exuberance over the economy's prospects has turned to dread, despite all the smiles and reassurances of President Obama and others.

Though a couple lone wolves on and around the federal Reserve worry aloud about the central bank's propping up debt markets, forget about the Fed actually selling any of its assets. None of that has happened in the first half.

Second half outlook: In fact, the talk has now moved on to a "Q.E.-2," and we don't mean a big new ocean liner. The Fed is busily trying to figure out what to do next; and a new, bigger round of so-called quantitative easing is now back on the table. Chairman Bernanke has ordered his fleet of helicopters to be doubled, in anticipation of showering the financial system with even more dollars.

Ditto Washington. Even as governments in Europe look to austerity measures in an effort to live a bit more within their means, here we'll be occupied in the coming months with *more* stimulus and related efforts in order to revive a patient that has already flat-lined. The president will lead this charge personally, fearful that a failure to deliver more "help" for the economy could lead to a *real* shellacking in this Fall's mid-term elections.

No. 2 -- The Federal Reserve will NOT raise interest rates. This is just the way things turned out; and, now, everyone agrees with us that we won't see the central bank raise short-term interest rates for YEARS. Indeed, we really must here repeat the take-away thought from this ANTI-Prediction as it has become so strikingly evident just in recent days:

"In 2009, the Fed's maintaining of its 0 – 0.25% Fed funds rate level was taken as bullish by the market. In 2010, it will drive money back out



stunningly been replaced by fears of *deflation*;

of risk assets, once investors finally figure out that the Fed's maintaining of its low rate is BAD news for an economy that is NOT healthy after all."

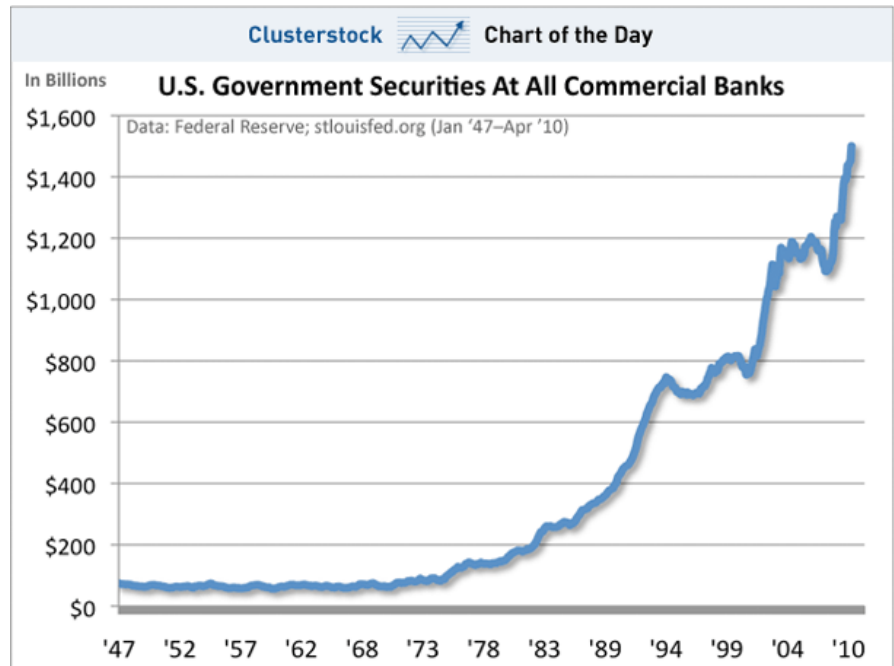
Second half outlook: No change.

No. 3 -- The market WILL NOT raise interest rates further; at least, in the near term. Of the five ANTI-Predictions we made, none ran counter to the overwhelming consensus of opinion more than this one. Just about everyone insisted to one degree or another that this would be the year that "the last bubble" -- U.S. Treasury bonds -- started losing its air. Why, even we recently felt it wise to bet this way, albeit briefly and as more of a trade, when it looked as though stocks would stage a decent rally and result in rates moving back toward their 2010 high level of 4% on the 10-year Note.

Thankfully, we had the sense to see this mistake, and got out of Dodge before losing anything; and in these last several weeks of 2010, bond yields have *plunged*. The first half finished with long-term rates at 14-month lows; under 3% on the 10-year Treasury bellwether, and dropping under 4% for a 30-year bond.

Everyone, his dog, his European cousin and his Chinese acquaintance have fought over Uncle Sam's low-yielding paper. In such a dicey, risk-averse world, Treasuries have been in often shockingly high demand. It's also helped that the banking system has pumped so much TARP and other money into the debt markets, rather than loan it to you or your neighbor (you can't have everything, now!)

Second half outlook: Presently, we feel that bond rates have even farther to fall in the near term, as the current stock market decline, commodity price weakness and the general state of siege strengthen their hold. The more they do, the greater the chances of a snap-back later on, similar to that of the first half of 2009.



HOWEVER -- Though the Fed *normally* does not exert direct control over long-term market rates, watch for talk to increase of the central bank doing what it did in the 1940's. Then, in order to support an economic expansion, it by *force majeure* essentially capped long-term bond yields at around 2%. This would be quantitative easing on steroids. But considering (among several other things we could mention) that the housing market is still reeling anew despite some of the lowest mortgage rates ever, it's a possibility.

No. 4 -- The U.S. dollar will STRENGTHEN for much, if not all, of the year. Yet another winner here, as the greenback's relentless, months-long rise (with a great assist coming from the euro and its implosion) attests.

Second half outlook: **Of these five, this is the one that threatens a decidedly different outcome now over the second half of 2010.** In recent days -- and especially in light of the underlying stark fiscal positions of the attendees at the just-concluded G-20 get-together -- it might fairly be said that Barack Obama himself has taped a sign to the U.S. currency's back that reads "Kick Me."

The dollar has buckled a bit these last few days (but has not yet been irreparably broken by any means) for a few reasons. First, the just-mentioned obstinacy of the president to continue running up record deficits in order to "help" us all.



America skated by all year long so far with a sought-after and strengthening currency because the president didn't so brazenly protest, "Hey, what about us! We're profligate to!" But he put on that show of late; incredibly, making an utter fool of himself by almost seeming to dare all the rest of the G-20 members to join his "stimulus" ventures, only to be humiliated in Toronto. So, if it turns out that the greenback's rally IS now over, we have just one man to thank. (In case you missed it, such is the president's complete lack of any desire to rein in government spending that his budget chief just quit in protest.)

For now (though for all we know these things could change again tomorrow) the **British pound** is enjoying a moment of glory. The new government of Prime Minister David Cameron is putting actions behind its campaign pledges; and all of a sudden, Britain looks more resolved than most anyone else to get its fiscal house in at least some better order. We should take a lesson from that; but we won't. So, with the rest of the world at least making an effort to rein in bloated budgets (even if, in the end, those policies are damaging to economies that *need* more fractional reserve-created funny money merely to survive) the U.S. is the odd, recalcitrant man out.

Beyond all the above, consider two other possibilities that the dollar could weaken:

First, beyond the budgetary issues, foreign governments (especially in Europe) are also angry that Obama has sought to rein in their various efforts to wring destructive speculation out of their markets. In particular, few seem able to understand what it is that he and his team thinks is *good* about completely unregulated derivatives and their creators/traders.

Make no mistake -- Europe has its troubles, which are only being overlooked right now as the dark cloud that's been overhanging it appears to be making its way to hover over the greenback. But with the overwhelming majority of both governments and citizens certain that reckless behavior in financial markets needs to be dealt with, America's resistance to cooperate in a global effort in this regard could render the U.S. -- and its currency -- a pariah. (This is one example of how we could move into El Erian's D.D.R. environment; other countries will worry about their own situations first, and Barack Obama's concept of globalization a *distant* second.)

There could also be at some point soon a



more friendly, concerted effort to manage a dollar decline in the hopes of resurrecting the kind of dollar carry trade-fueled reflation as that which followed the late 2008 financial panic. Policymakers the world over are terrified of deflation; and if a repeat of that period that saw a weak U.S. dollar prop everything up is deemed worth a try, it will be tried (But this time around, the beneficial effects of such a policy wouldn't even take us the year or so forward that the last go-round did.)

So, in summation, we're not *today* saying that the dollar's run is over. All things being equal, it should still hold up (if not rally further) as stocks and commodities continue to weaken. But it is time to be very watchful, as the end could be near.

No. 5 -- China will be a BANE, rather than a boon, to the markets. Since late last Fall, we have probably spent more time warning you about what was coming down the road in relation to China than on any other single subject. As we hit the 2010 halfway point, it's become more obvious that -- as we predicted -- *China is becoming a bane for investors.*

Go back and read the last page (p. 15, actually) of the May issue. (We DO still plan on a lengthy recap of this whole area, but simply haven't had the time quite yet.)

Second half outlook: 1. The yuan will end 2010 valued *lower* than just about all other currencies. (On this, we're heartened at how quickly everyone else is coming around to this possibility that we've been predicting for months.)

2. On again, off-again skirmishes are far more likely now to be followed by a more serious trade war; one most likely to be instigated by the U.S., and one that will hurt US far more than anyone else (there's that "D.D.R." again!) But, by golly, Chuck Schumer will show those tricky, backstabbing Chinese "trading partners" who's boss!

3. China's rate of growth will slow to one much closer to zero than most believe likely. This -- together with the country's increased use of some stockpiled materials from its copious buying of last year -- will keep downward pressure on the prices of *most* commodities for the balance of the year.

