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## **All Hail King Goldman**

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FYI, I am going to be on CNBC Reports tonight, Wednesday the 12th, around 8:15pm discussing today's market action after the Fed meeting.

If you're about to take a vacation or staycation, enjoy and stay safe!

I've been talking about some books lately and although most of you think I am not smart enough to read, I grabbed The Fourth Turning to read on the beach this weekend. Thanks to my friend John McClure for the suggestion. He also recommended that I keep sharp instrument away as I make my way through the book.

It's hard to pick up a business magazine or newspaper without reading an article on Goldman Sachs. During the multi year bull market, they were the heroes, the firm that everyone wanted to work for. They epitomized capitalism.

But as we've seen on so many fronts, both financial and otherwise, human nature has a history of turning heroes into goats as the landscape changes. Remember how many folks, present company never included, lauded King Alan Greenspan for his "flawless" work until the world changed forever. Look at how quickly he was blamed, correctly from my seat.

During the crisis, Goldman's shares collapsed like most of the other financial institutions, from roughly \$255 to \$50 late last year. As with Morgan Stanley, they "accepted" their share of TARP money. As with many other global firms, the AIG bailout was really about bailing out Goldman and the others. I said the same thing about Bear Stearns in March 2008. It was more about saving JP Morgan than Bear.

In any case, it's clear to me that the playing field is not level where Goldman is concerned. But how could it be? With so many ex Goldman employees either taking key government posts directly or indirectly, their influence would be hard to suppress.

Who wouldn't want to hire professionals with a long history of success on their resume? And that's what Goldman is most guilty of. The crisis eliminated so much of the competition and whether you like it or not, agree or disagree, Goldman figured out how to leverage the AIG bailout money along with the TARP infusion to the sum of \$4B in profit last quarter.

It's not a question of IF they used taxpayer money to earn their billions. Of course they did! Who wouldn't use money with a guaranteed backstop from the government?!?! I don't blame them or begrudge them. I am jealous, sure. But hey, they did pay back all of the TARP money and buy the warrants back, so the taxpayer made out very nicely. Just not as well as Goldman or the employees did!

Hindsight is 20/20 and hopefully we all learned from the crisis. But if this ever happens again, you can be sure the terms of receiving taxpayer money will be a tad more onerous.

I've heard and read countless conspiracy theories about Goldman controlling the market or actually being the market. They're fun and "sexy" to discuss, but in reality, we're dealing with hundreds of billion dollar and trillion dollar markets. There is no way one institution could leverage even \$20B to control flow.

Think about your business and imagine if 75% of your major competition went away. Isn't that what happened with Bear, Lehman and Merrill? Goldman and Morgan were basically given the best license possible to print money. Use OPM (other people's money).

If you want to delve deeper, you'll find that Goldman is making much their money from trading operations. With the credit and fixed income markets broken and few

competitors, they were able to essentially guarantee huge profits from small amounts of capital as spreads began to normalize.

In the equity market, Goldman has dominated the computerized trading area like no one in history. I don't recall the exact the numbers, but my memory says they are accounting for more program trading volume than all other firms, COMBINED. So clearly, they found some inefficiencies that can be exploited, for now.

Goldman has become a major market bellwether, like Apple, Fed X, Wal Mart and JP Morgan that bears watching closely!

## Excellent Economic Piece Reprinted

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The following article was written by one of my favorite economists, David Rosenberg, formerly of Merrill Lynch and now back in his native Canada. It was printed in John Mauldin's [weekly newsletter](#).

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August 4, 2009

U.S. GDP Review --  
Consumer, Where Art Thou?  
By David Rosenberg

Lunch with Dave

by David A. Rosenberg

U.S. GDP Review -- Consumer, Where Art Thou?

While the headline real GDP number came in a tad better than expected, at -1.0% QoQ annualized rate, the back data were revised lower and show the recession to be deeper. First quarter of this year, for example, was revised to -6.4% from -5.5% previously. And, it may not be lost on anyone that the four consecutive quarters of economic contraction was unprecedented in the post-WWII era; ditto for the -3.9% year-on-year trend. In other words, while nobody is willing to go out on the limb and call this a depression (the same academics that brought you "The Great Moderation" during that last great albeit leveraged economic expansion are now labeling what we have endured over the past year-and-a-half as "The Great Recession"). This does go down as the worst economic performance both in terms of duration and intensity since "The Great Depression". While we are past the most pronounced part of the downturn, it may still be premature to call for the end of the recession merely because of the prospect of a positive third-quarter GDP result. After all, we saw GDP advance at a 1.5% annual rate in last year's second quarter, and if memory serves us correctly, the NBER did not subsequently declare the end of the recession. And even if the recession is ending, as we saw in 2002, that does not guarantee a durable rally in risk assets. Sustainability is the key, and it remains the wild card.

The details in today's report left something to be desired. Consumer spending came in at -1.2% annualized, twice the decline expected by the consensus. This occurred in the face of gargantuan fiscal stimulus and leaves wondering how this critical 70% chunk of the economy is going to perform as the cash-flow boost from Uncle Sam's generosity recedes in the second half of the year. Imagine, government transfers to the household sector exploded at a 33% annual rate, while tax payments imploded at a 33% annual rate and the best we can do is a -1.2% annualized decline in consumer spending in real terms and flat in nominal terms? What do we do for an encore? In the absence of the fiscal largesse, it is quite conceivable that consumer spending would have shrunk at a 10% annual rate last quarter! Nonresidential construction action sagged at an 8.9% annual rate and this was on top of a 44.0% detonation in the first quarter. Ditto for equipment & software 'capex' spending, also down at a 9.0% annual rate and this too followed a 36.0% collapse in the first quarter. Residential construction slumped sharply yet again, this time at a 29.0% annual rate. These are the guts of private sector spending and collectively, they contracted at a 3.3% annual rate -- the sixth decline in a row. So while there are many calls out there for the recession's end, it remains a forecast as opposed to a present-day reality.

As expected, inventories were sliced sharply -- by \$141 billion at an annual rate, which alone subtracted 0.8 percentage point from headline GDP growth. But with consumer outlays slipping 1.2% and no signs of a 3Q recovery in sight, based on early back-to-school results looking rather tepid thus far and spending intentions in the confidence surveys rolling over, we wonder aloud just how much re-stocking we are going to see this quarter and even if we do, whether it will be a one-quarter wonder and set the stage for a fourth-quarter relapse. (Hopefully it has not been lost on anybody that the Chicago PMI inventory index in July hit its lowest level since June 1949. So maybe there is less to this inventory story than meets the eye.) Something tells us that an equity market trading north of a 760x multiple on reported earnings is not prepared for such a prospect.

While it is tempting to strip out the inventory withdrawal and look at the fact that outside of that, real GDP contracted at a mere 0.2% annual rate, misses the point. While inventories will undoubtedly add to current quarter growth, we doubt that we'll see another quarter of 13.3% growth in defense spending either. This added to GDP growth in 2Q by almost the same amount that inventories subtracted. Not only that, but the sharp improvement in the foreign trade sector, which added 1.4 percentage points to GDP growth in 2Q, is unlikely to be repeated either. The overwhelming consensus is that real GDP will be positive in 3Q; but the key for how 4Q will shape up will rest in how real final domestic demand performs, which sagged at a 1.5% annual rate in 2Q, and -3.3% for private sector demand.

We remain in the deflation camp for the sole reason that the data compel us to. Wages and salaries contracted at a 5.0% annual rate in the second quarter and have deflated 4.3% on a year-over-year basis. This is the flip side of having the majority of companies beating their earnings estimates by aggressive cost-cutting -- a wage contraction of historical proportions that bites into aggregate demand and requires recurring doses of fiscal stimulus and other gimmicks (like "Cash for Clunkers") to establish a floor under the economy.

And, it is not just labour income that is still in deflation mode. Practically all forms of income are deflating from a year ago -- interest income is down 4.5%, dividend income is down 23.0% and proprietary income is down 8.0%. The only income that is really going up is the income from Uncle Sam, which is up more than 10.0% and we

have reached a point where a record of nearly one-fifth of personal income is being accounted for by paychecks out of Washington. But it should be known that Uncle Sam himself does not create income -- he borrows cash from current bondholders and future taxpayers. Not the stuff that seems deserving of a 760x multiple.

Inflation was non-existent in the second quarter, with the GDP deflator flat and taking the YoY trend down to 1.5% from 1.9% in the first quarter. (We have seen out of the diffusion indices, such as the Chicago PMI, that pricing trends are in reverse.) This lack of pricing power along with sustained negative volume growth, dragged nominal GDP down at a 0.8% annual rate and -2.4% on a year-over-year basis, which is something we haven't seen since the fourth quarter of 1949. And, what should matter most for stocks and bonds is nominal GDP -- price multiplied by volume. Indeed, Charts 1 and 2 illustrate the case -- the rate of change in the S&P 500 (Chart 1) and the rate of change in bond yields (Chart 2) ultimately track the trend-line in nominal GDP growth.

## Forecast Summary Part Deux

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To summarize my position before the comments:

Stocks remain positive, having hit our first target of 9000. Although we should see some short-term weakness this and maybe next week, nothing has changed to alter Dow 10,000 sometime later this year.

Treasury bonds also remain positive, but just began their big move. I expect them to be a leading performer this month or so as long-term rates fall test their July lows.

Gold has remained stubbornly in a trading range since early March. But that is ending now. Its pattern of higher lows and lower highs should resolve itself to the downside almost immediately. The MINIMUM downside for gold should be \$850 ish, but we'll reassess as we get closer to \$900.

Energy has been in a trading range the past few months, but that looks like it's about to end. With the dollar strengthening, it's going to be tough for oil to run much above the recent highs.

The dollar has bottomed and should see a major upside move in the coming weeks and months.

My comments from last week are basically the same.

*Roughly a month ago, I compared the current stock market to that of 2003 when the last bear market was ending. The recent rally from the March low behaved much like the rally off the March 2003 trough, showing little pull back or weakness for several*

months. Then, like we all do after a huge meal, there is a period of digestion before consuming food again.

With stocks breaking out late last month, the comparison to 2003 continues. That roadmap would see the current market run almost unfettered to year-end, something that seems remote right now. It's something we'll keep an eye on, just like the comparisons to 1938, 1932 and 1906-07.

As far as the treasury bond market goes, I do love just how unloved this area is. All we hear about is how much money the Fed is printing and how large out budget deficits are going to be in the years. Oh yeah, and my favorite, how the Chinese are going to stop buying our debt. That last one really cracks me up!

I've mentioned it several times before, but it's still a classic. In the early 1990s, everyone was so worried that the Japanese would stop buying our debt and takeover California. Little did we know, but we should have sold them the whole state! Let them go worry about how to save this sinking ship.

Folks, the Japanese didn't stop buying our bonds and nor will the Chinese. While we likely have seen a major, major peak in bond prices (low in bond yields), I am not concerned that treasuries are going to see a giant collapse. For now, with sentiment still so negative and price action constructive, there should be some significant gains this quarter.

Turning to the dollar, it's hard to find any asset with more negativity surrounding it, even worse than treasury bonds. With price finally breaking below its 2009 low, I don't how many people are left to sell. This makes it very vulnerable to a powerful and emotional reversal before in the next week or so. While our Global Asset Allocation strategy remains long the euro, we are dancing very close to the door!

For comments on gold, I might as well just say "ditto" and move on. Nothing has changed since we first turned negative around \$1000 in late February/early March. As you know, I totally think the hyperinflationary argument is bogus and do not see gold exploding higher here. I think there is a better chance of deflation than runaway inflation with \$52T in credit being vaporized, not to mention the lack of banks leveraging their assets to loan money.

But as I've mentioned before, our Short-Term Gold Program can and does take long positions as conditions warrant. And our last trade was certainly a good one, as we were able to take a nice bite out of the recent strength.

After being positive on energy from early March to mid June, I've been confidently neutral ever since. Way to take a stand, right? It's tough when you feel the odds are the same for a big move in both directions. Energy is approaching an important line in the sand, but is also overbought and in need of a rest.

*Should oil be able to close above \$74 for a few days, it would really "energize" the bulls' case. However, a move above \$74 that immediately fails would likely see a fast move towards the \$60 level where the bears have control. While price action sides with the bulls, my forecast for a strong dollar is clearly bearish for the commodity sector. As a consumer of energy, my preferred path is the downward one!*

## **Investment Quotes/Adages To Live By**

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"When in doubt, get out!"

"If it's obvious, it's obviously wrong."

-Joe Granville

"It's ok to be wrong, but it's not ok to stay wrong."

"This time is different."

"The markets require the patience of a dozen men."

-Robert Rhea

"Luck is the residue of effort."

"The most bullish thing a market can do is go up in the face of bad news."

"The most bearish thing a market can do is go down in the face of good news."

"The market can remain irrational far longer than you can remain solvent."

"You cannot legislate the poor into freedom by legislating the wealthy out of freedom. What one person receives without working for, another person must work for without receiving. The government cannot give to anybody anything that the government does not first take from somebody else. When half of the people get the idea that they do not have to work because the other half is going to take care of them, and when the other half gets the idea that it does no good to work because somebody else is going to get what they work for, that my dear friend, is about the end of any nation. You cannot multiply wealth by dividing it."

~~~~~ Dr. Adrian Rogers, 1931

"Bear markets seem to be divided into three phases: the first being the abandonment of hopes upon which the final uprush of the preceding bull market was predicted; the second, the reflection of decreased earnings power and reduction of dividends, and the third representing distressed liquidation of securities which must be sold to meet living expenses. Each of these phases seems to be divided by a secondary reaction which is often erroneously assumed to be the beginning of a bull market." - Robert Rhea via Tim Woods

## **Upcoming TV Appearances**

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CNBC Reports - August 12 at 8:15pm

CNBC's The Call - August 24 at 11:30am

WTNH (ABC in CT) Good Morning CT - August 30 at 7:25am

CNBC's Worldwide Exchange - September 15 at 5:30am

CNBC's Worldwide Exchange - October 20 at 5:30am

You can view most of the past segments by clicking below.

## **Media Appearances**

### **Friends And Family Plan**

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