

May 12th, 2012

The greed days of the banks and insurance companies has not ended. JP Morgan just reported of a \$2 billion trading loss for the quarter on their synthetic credit portfolios. Synthetic credit portfolios is just another fancy name for asset backed securities or toxic debt. These types of synthetic products are what almost collapsed global financial markets in 2009. When institutions like JP Morgan say they have learned from such loss events that is correct. The new and improved synthetic credit portfolios allow banks and financial institutions to side step the new capital deposit requirements. A synthetic credit instrument allows banks to hold the loans it originates on their books transfer the debt along with all the risk to investors which intern allows the bank to remain compliant with capital requirements and continue to further lend. The biggest twist to these products is that the banks gain control of cash flow generated by the fixed income assets without owning any of the underlying bonds or assets. As the originator, the banks charge rich fees and mark ups. This is no different than CMHC deposit insurance for homebuyers with less than 25% down payment. Originally conceived just like deposit insurance to reduce or remove risk associated with lending. Insurance companies willingly underwrote the risk at a premium. Additionally, synthetic credit portfolios command a premium even though the underlying credit quality of the borrower is poor. So the more synthetic products the banks create the greater the insurance premiums being generated putting both the banking world and insurers in a highly profitable and rather cozy relationship. A third and just as big benefactor was quietly getting super wealthy. Credit rating agencies saw a surge in underwriting demand for such products. Between 2000 and 2006 synthetic credit came to represent 40% of the annual revenues of credit rating agencies. One major credit rating agency saw its share value soar 6 fold and earnings grew by 90% annually. In 2005, the value of synthetic credit was \$1.5 trillion. Today estimates put the value @ \$7 trillion.

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An important note for investors, institutions that produce these products transfer all the risk but retain full control of the income stream. Unlike a bond, the investor does assume all the risk but does have recourse and rights as a bond holder. These structured products offer no recourse or rights. Originally, the appeal of banks was that they offered peace of mind, knowing your money was heavily regulated and prudently managed. Now-a-days banks are administrators that charge fees on every penny that comes their way and are always finding new ways to charge fees.

To the surprise of all Americans, President Obama stepped into an arena no President dare jump into. Obama declared his views on same sex marriage and once again polarized Americans. To many, the President's actions bordered political suicide. But President Obama's actions are strategic. By declaring such social issues before re-election, he hopes to shape election issues to his strength. Obama's failings on healthcare still haunt him today. Where Obama shines is lowering unemployment and effectively dismantling Al Qaeda and the Taliban. By further moving himself to the left on social issues while keeping family values front and centre, the President hopes to magnify the neo conservative traits of the Republican party and scare away potential undecided voter or swing votes. More so, this is a bold move signaling the Democratic party is confident Obama will be re-elected for a second term.

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The Euro zone has officially entered a technical recession. European markets declined on Friday after JP Morgan's \$2 billion loss, weak economic data from China and as the impasse in China continues. The EU's GDP is forecast to start to recover in the second half of 2013. Downside risk still persists. Political shockwaves continue to hamper growth along with financial insolvency facing many member states bringing to question the future of the entire EU. Anxiety in the Euro zone will persist and is expected to peak in July as Greece may fail to form a new government sending bondholders fleeing.

Global markets are still very vulnerable to the machinations of banks and other financial institutions as witnessed by the announcement of JP Morgan's loss report. The upside trend of global markets was seen in the NASDAQ which ended up 0.3 % driven by performance in the semiconductor sector indicating expansionary investment behavior by corporations. In tandem, consumer sentiment is seeing a turnaround in America as indicated by the Reuter University of Michigan consumer sentiment index which jumped unexpectedly to 77.8 in May up from April @ 76.4. Expect to see continued weakness in the banking sector with the KBW bank index down 1.3%. Even though an economic power house such as JP Morgan tumbled 8.6% it did no drag the overall broad markets with it reflecting good resilience.

The American dollar has been on an upward path against other fiat currencies. The strengthening green back has seen the price of oil, gas and gold decline in the past three months.

In Asia, stocks fell for a third consecutive week. In China, industrial production, retail sales and fixed asset investment confirmed bearish expectations. The Shanghai composite lost 0.6% to end below a key psychological support level of 2400. A reporting of soft economic data increased the chances of a hard landing of the world's second largest economy. Hong Kong's Hang Seng followed by shedding 1.3%. China's industrial output growth slowed in April to the lowest level since May 2009 while retail sales levels slowed more than expected in the same month. Inflation did ease slightly. Chinese leaders are expected to release fresh policy easing measures to support economic growth.

Japan's Nikkei also ended below a key economic level of 9,000 for the first time in 3 months mainly driven by weaker than expected Chinese data. The broader Topix is down 0.9%. Leading electronics manufacturers Pioneer, Sharp and Sony out placed declines with all plummeting more than 5%.

Investors in Australia reacted to the JP Morgan's news knocking the S&P ASX 200 down 2.0% and the broader All Ordinaries lower 0.3%. Banks in Australia were punished slipping between 0.2% and 0.8%. Gold miner Newcrest bucked the trend up 2.5%.

India's benchmark Sensex was marginally lower reacting to. JP Morgan, Chinese data and ongoing EU impasses.

Gold prices hit 5 month lows due to a strengthening greenback. Gold shed \$11.50 to \$1,584 an ounce for June delivery.

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Oil prices have also been on the slide downwards with light sweet crude (WTI) for June delivery down \$0.95 to \$96.13 a barrel. Earlier Friday morning, the International Energy Agency nudged up it's 2012 oil demand forecast by 0.8 million barrels per day to 90.00 mb/d (million barrels per day). Production gains from non OECD countries offset declines in OECD countries.

Statistics Canada surprised everyone in stating the economy has generated 58,200 jobs in April. Compared to 12 month's earlier employment was up 1.2 % or 214,000. Adding to the uptrend was a recent report released by BMO showing that 56% of all corporations in Canada intend to hire in the next 12 months signaling further growth in employment coming soon. Given such robust growth the banks will definitely be pushing Governor Mark Carney to up interest rates. Unfortunately, this could hurt many Canadians whose financial affairs are just as fragile as the global economy.

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Here are the closing numbers:

Loonie	\$0.9991	
TSX	11,694.67	down 41.50
DOW	12,820.60	down 34.44
Oil	\$96.13	down \$0.95 a barrel
Gold	\$1,584.00	down \$11.50 an ounce