Private Wealth Advisory

Investment Research That Converts

Central Banks Are Out of Ammo

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A tectonic shift has taken place.

From 2008 until mid-2016, the financial world and global economy were largely driven by Central Banks.

We have reached the end of this era.

In the last two weeks there have been numerous "tells" from the European Central Bank (ECB), Bank of Japan (BoJ), and the US Federal Reserve (the Fed), that they realize they've reached the limit of what monetary policy can achieve.

These "tells" have two elements:

1) "Standing pat" or the decision to not engage in more stimulus
2) Central Bankers calling for Governments to begin fiscal stimulus.

Let's run through these items for each bank.

First up was the ECB, which met on September 8th.

The hope from the investment world was that the ECB would extend its QE program and possibly cut at least one of its three rates deeper into NIRP.

Instead the ECB did nothing:

> ***The European Central Bank left its €1.7 trillion ($1.9 trillion) stimulus unchanged*** *at a policy meeting Thursday, brushing off concerns over economic shock waves from Britain's vote to leave the European Union and disappointing investors expecting the ECB to act again soon.*

September 28 2016

SHORT-TERM ISSUES

- Central Banks are done… for now.
- Markets prepared to correct.
- Will Deutsche Bank lead to a banking crisis?

INTERMEDIATE-TERM ISSUES

- Global GDP to plunge as deleveraging accelerates.
- Central Banks to increase QE and launch some form of helicopter money (6-12 months out)

LONG-TERM ISSUES

- Central Banks to lose credibility.
- Eventual market collapse of 50%+ (likely 1-2 years out).
- A scramble for high-end collateral to bring about systemic collapse.

Phoenix
CAPITAL RESEARCH

> ***The decision to stand pat, even as new forecasts showed the ECB missing its inflation target for years, underlines how central banks are approaching the limits of what they can achieve without support from other policy areas, notably governments.*** *In China earlier this month, Group of 20 leaders warned that monetary policy alone can't fix the world's economic ills, and pledged to boost spending and adopt overhauls aimed at boosting growth.*
>
> ***Despite that, Mr. Draghi said policy makers didn't even discuss fresh stimulus, and praised the effectiveness of the bank's existing policy measures,*** *which include negative interest rates and €80 billion a month of bond purchases.*
>
> *http://www.wsj.com/articles/european-central-bank-leaves-rates-unchanged-1473335620*

ECB President Mario Draghi failed to even *discuss* more stimulus. Insetad, he pushed hard for Governmental fiscal stimulus, particularly from Germany.

> *He also aimed an unusually direct rebuke at Germany,* ***criticizing Berlin for not boosting spending to support the economy.***
>
> *"**Countries that have fiscal space should use it,"** Mr. Draghi said. "Germany has fiscal space."*
>
> *Mr. Draghi is due to travel to Berlin later this month to address German lawmakers,* ***his first such visit in four years, amid criticism of the ECB's easy-money policies in Europe's largest economy.***
>
> http://www.wsj.com/articles/european-central-bank-leaves-rates-unchanged-1473335620

Now, Draghi has been urging EU nations to engage in fiscal stimulus since at least 2014. **However, this marks the first time he's openly targeted Germany.**

This is a very important development.

The ECB's relationship with Germany has been a contentious one for years. German politicians, regardless of how they really feel about the ECB's policies in private, cannot appear to favor said policies in public (the German population, remembering Weimar, is staunchly opposed to loose monetary policy).

For this reason, there has been something of a public spat between Draghi and key German

political leaders, particularly Chancellor Angela Merkel and Finance Minister Wolfgang Schauble.

Previously, this spat has been one sided: the German camp attacking the ECB's policies, and the ECB defending said policies.

In this context, for Draghi to openly call for Germany to engage in its own fiscal stimulus marks a major turning point.

Indeed, this, combined with the fact that Draghi *didn't even discuss additional stimulus* indicates that he is handing the responsibility (and potential blame) for future stimulus off to EU sovereigns (of which Germany is the largest).

In brutally simple terms, Draghi has effectively said, *"I'm done. You want to complain about the economy? You can run it!"*

He is following up this with an actual meeting with German lawmakers tomorrow.

Barring an absolute crisis or disaster in the EU, the ECB will end its current QE program in March of 2017 (within five months). The ECB is done for now.

Let's move on to the Bank of Japan (BoJ)

The BoJ has also admitted a similar failure of monetary policy and shifting of responsibility to Japan's Government.

As I've noted before, the BoJ is at the forefront of Central Bank monetary policy: it first cut rates to zero in 1999 and launched its first QE program in 2000. As such the BoJ has 16 years' experience with these tools.

With that in mind, back in January 2016, right before announcing the BoJ's foray into NIRP, the head of the Bank of Japan, Haruhiko Kuroda stated that **Japan has a "potential growth rate of 0.5% or lower."**

This was an implicit admission that no matter what the BoJ does, Japan's GDP growth is limited. **This marked the first time in modern Central Banking history that a senior level Central Banker admitted he was powerless to solve his nation's economic woes.**

Since that time the BoJ has been effectively in a holding pattern. The only major policy change it has committed was to double the pace of its EFT buying from about $29 billion to $58 billion per year (this comes to less than $5 billion per month: peanuts for Central Bankers).

Meanwhile, the Japanese Government has announced a $276 billion stimulus plan.

True, this only comes to about 5% of GDP, but taken together with the fact the BoJ isn't launching any new monetary programs, it too signifies as shift in policy away from Central Banks to Governments themselves.

Indeed, the real "tell" came last Thursday when the BoJ announced it would NOT be increasing QE, but would instead be targeting its "yield curve." Put another way, the BoJ is no longer actively engaging in stimulus with the intention of boosting Japan's economy, but is instead going to shape Japan's bond markets.

> ***"The BoJ's September 21 decision to move to a framework of 10-year yield targeting marks the beginning of the end of QE (the focus on asset purchase size and balance sheet size as primary instruments of monetary policy),*** *with notable read-through to other central banks," the economists, led by Willem Buiter, said in a new research note on Thursday morning.*
>
> *QE is an unconventional form of monetary policy where a central bank essentially creates new money to buy assets like government bonds. This process aims to directly increase private sector spending and is tied to a target such as returning inflation to desired levels.*
>
> *However, BOJ Governor Haruhiko Kuroda and his team have radically altered that policy.* ***The bank implied that it was moving away from balance sheet expansion and would buy 10-year Japanese sovereign bonds so that the yield would hover around the zero percent level****. This would amount to a shift towards asset price targeting, seen as a better and more sustainable way to facilitate its buying, rather than simply having the explicit target of increasing the amount of money it prints.*
>
> http://www.cnbc.com/2016/09/22/citi-declares-the-end-of-qe-as-japan-overhauls-its-policy.html

Let's run through this…Back in January the head of the BoJ implicitly admitted that monetary policy couldn't generate significant economic growth. Since that time the BoJ has effectively done nothing of note. And now the BOJ is admitting that it won't be expanding its balance sheet but instead will try to keep its 10-Yr rate at 0%. Meanwhile, the Japanese Government announced its first fiscal stimulus in two years.

That makes two major Central Banks stepping back from aggressive loosening and "passing the buck" off to their Governments.

Which brings us to the Fed.

The US Federal Reserve shredded whatever little credibility it had left last week when it failed to raise rates despite NUMEROUS Fed Presidents prepping the markets for a rate hike in prior weeks.

It is one thing for Fed Presidents and Governors to play "good cop, bad cop" concerning rate hikes. It is entirely another for THREE Fed uber-doves (Rosengren, Dudley, and Williams) to ALL push for a rate hike in public only to have the Fed vote NOT to raise rates.

So why didn't the Fed raise rates?

Because the economy is in fact in much worse shape than the "official data" suggests.

The Fed failed to hike rates last week. And this Monday, the New York Fed dramatically reduced its forecast for 3Q16 and 4Q16.

- 3Q16 GPD growth forecast dropped form 2.8% to 2.3%.
- 4Q16 GPD growth forecast dropped form 1.7% to 1.2%.

Bear in mind, this is the NY FED we are talking about: one of the most overly-positive financial institutions in the world.

The reality is that the US is already in recession. This recession will not be admitted publicly for political reasons until mid-2017 (much as the recession that started in late 2007 wasn't publicly admitted until the end of 2008).

Indeed, even large banks are admitting the data is recessionary, though they attempt to claim there's nothing to worry about (they're wrong, the 1986 corollary is false: if anything the current environment is more akin to 2007).

Markets Chart of the Day

1986 was the only episode over the past 30 years in which all four of our warning indicators were activated without this leading to a recession

US recession warning signals	1986	1990	2001	2008	2016
Falling profit margins	✓	✓	✓	✓	✓
Fed's LMCI negative	✓	✓	✓	✓	✓
Capex growth negative	✓	✓	✓	✓	✓
Speculative default rate above 5.5%	✓	✓	✓	✓	✓
Recession	x	✓	✓	✓	?

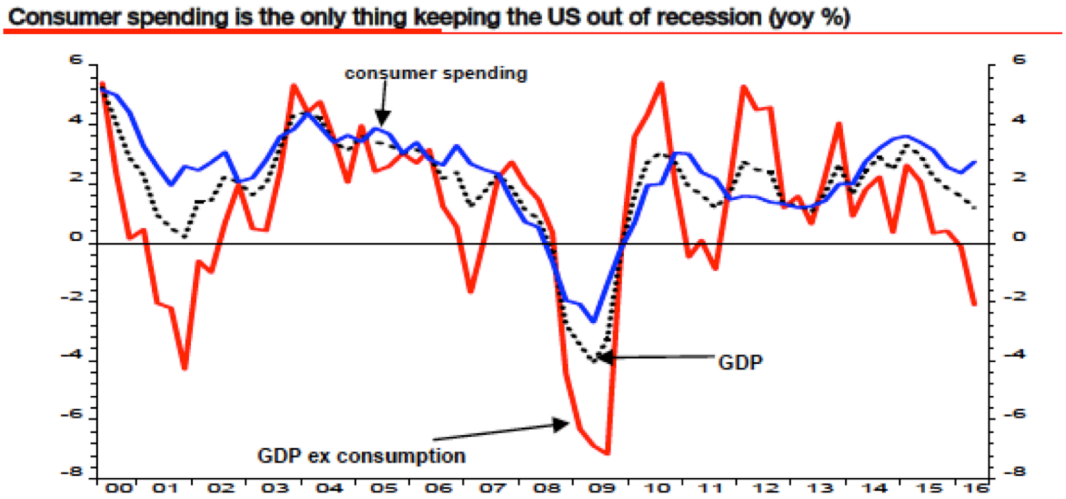
BUSINESS INSIDER

In terms of other data points suggesting the US economy is in recession, I see that:

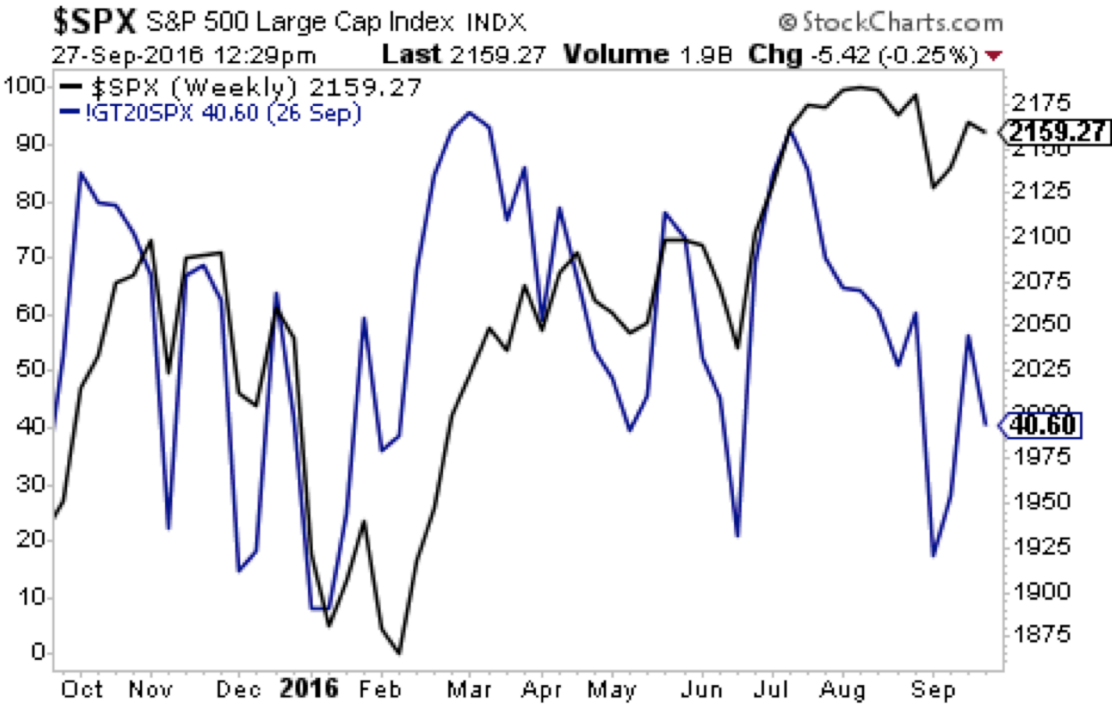
1) US Durable Goods Orders are DEEP in recessionary territory.
2) Small Business Profits are DEEP in recessionary territory.
3) Inventory to Sales ratios are DEEP in recessionary territory.
4) Corporate profits have contracted for six consecutive quarters (only happens during recessions).
5) Business Investment as a contribution to GDP is in recessionary territory (h/t Albert Edwards).

Long-time readers know I've been calling for a US recession for some time. The reality is that the US clearly entered a manufacturing/industrial recession in mid-2015. Services are now following. Indeed, as Albert Edwards pointed out in a recent note, **ex-consumption, US GDP is well into recessionary territory.**

The only items holding the fragile US economy up are consumers spending money they don't have!

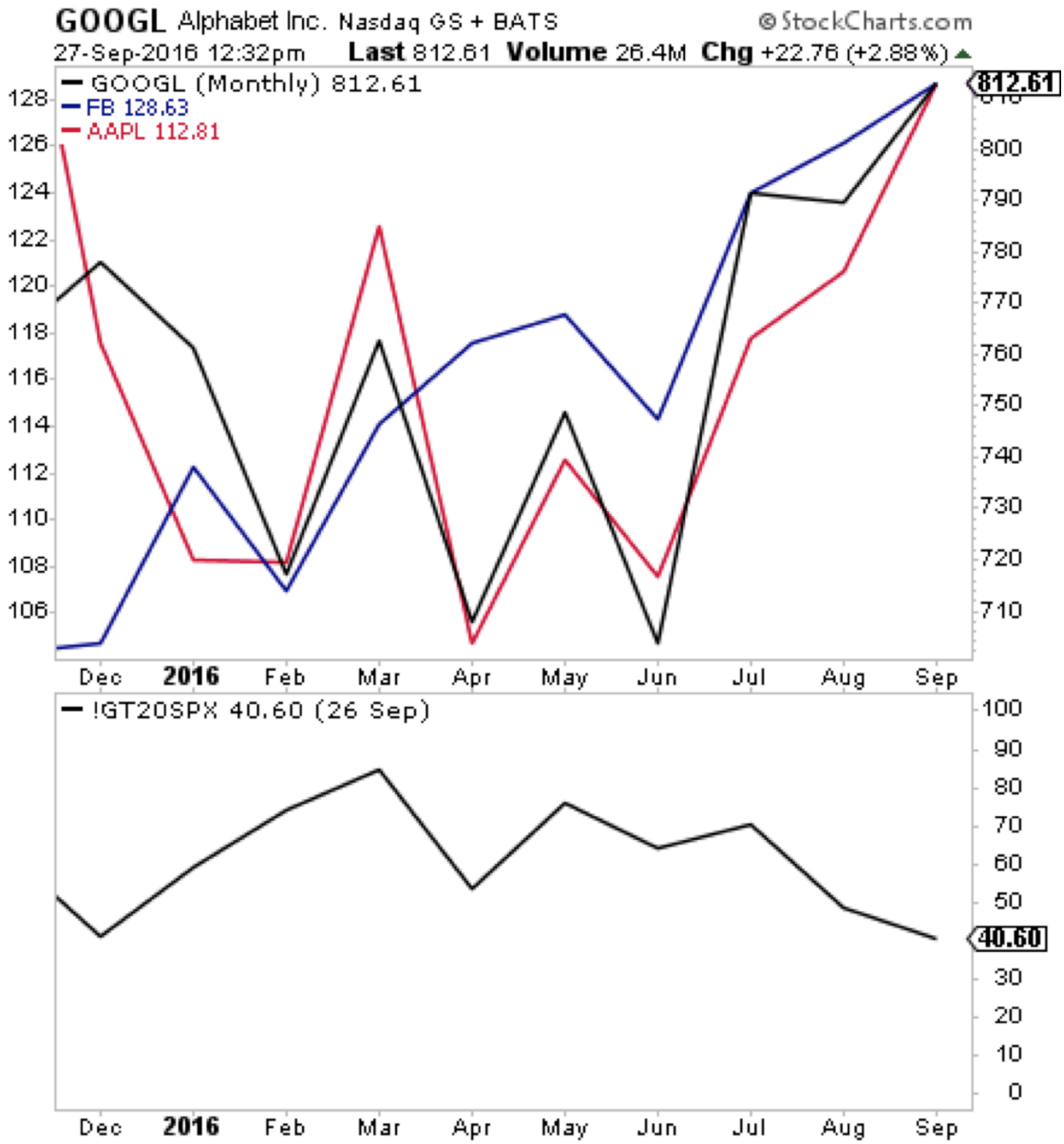


Regarding the US stock market, we are seeing fewer and fewer companies participate in the rally. The number of S&P 500 individual companies that are trading above their 20-exponential moving averages (EMAs) has plunged since March despite the S&P 500 rushing to new all-time highs.



H/T Arbi

Those few companies that continue to rally are a handful of big tech companies, specifically, Facebook (FB), Apple (AAPL) and Google (GOOGL). The below chart compares their performances' to the number of S&P 500 companies above their 20-EMAs.



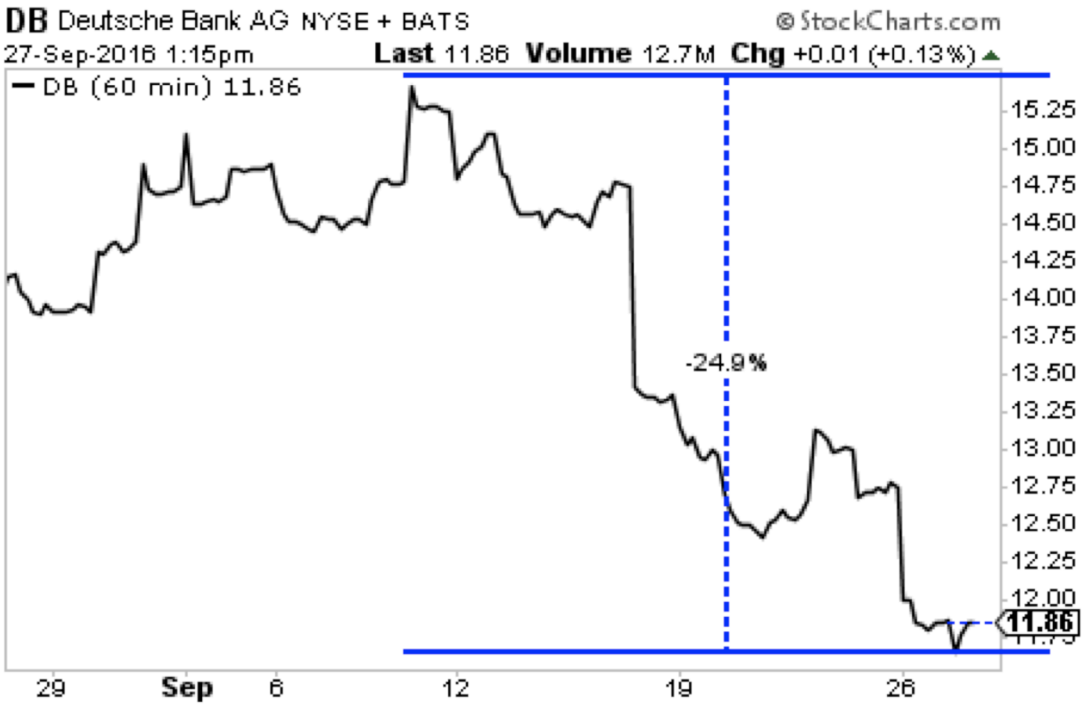
Put simply, we have Central Banks puling back from engaging in more individual stimulus at the same time that markets are losing participation.

This favors a significant correction here.

The one question is whether or not it will be a Crisis?

The clearest candidate for a potential Crisis is Europe, particularly it's banking sector.

As I stated two weeks ago, the first major sign of trouble was a collapse in Deutsche Bank (DB). That firm is now down 25% in the last three weeks.



What exactly is triggering this meltdown is unclear. The markets seem to sense that it's in Italy as the Italian stock market (EWI) has begun collapsing too.

European Financials (EUFN) have taken out their trendline running back to BREXIT. They are now forming a downtrend. Again, this is a VERY bad development.

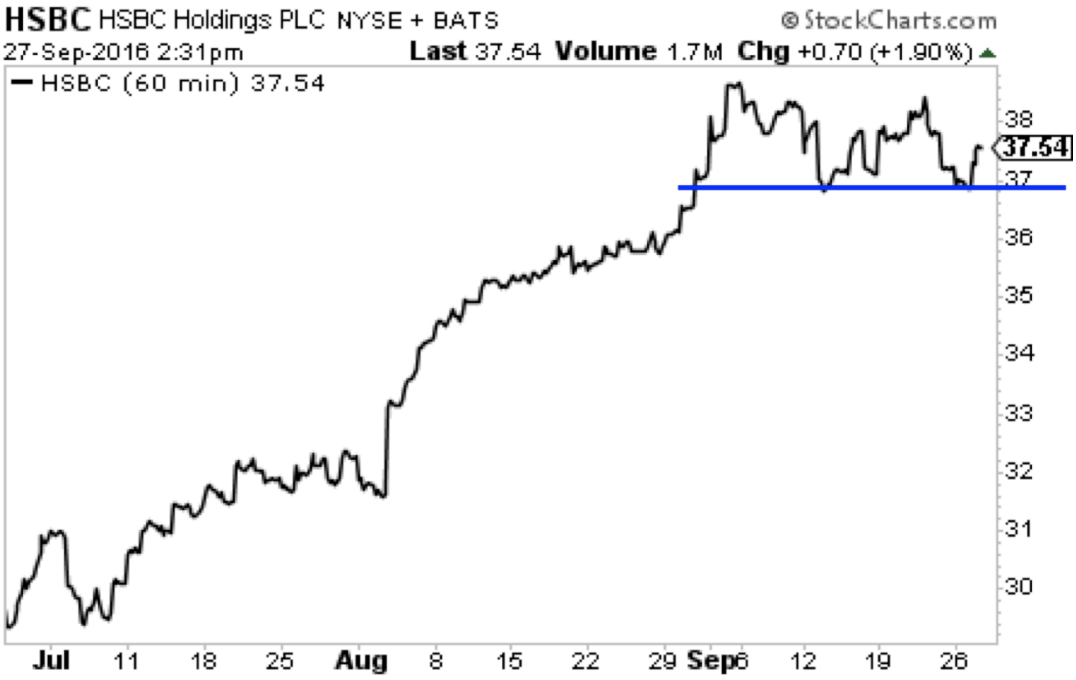
Let's run an update on all the big EU banks.

Looking at them, I see a desperate attempt to "hold the line" (support). When these lines go, Europe is in SERIOUS trouble.

Credit Suisse (CS)

Barclays (BCS)

HSBC (HSBC)



Lest you think this situation is not spreading, take a look a Morgan Stanley (MS) and Goldman Sachs (GS). Both have critical lines of support that are breaking or in danger of breaking.

BIG PICTURE: the US market is holding up because of a few companies being ramped higher. The culprits for this scheme are likely the banks and a handful of investment funds that are keen to hold the market together in order to close out the quarter with the best possible returns.

This ALL ends this week. Once Friday closes, there is NOTHING to hold the markets up. The Bank of Japan and the European Central Bank have BOTH stated that more stimulus is not coming now. The Fed is on the sidelines until after the election.

The global economy is contracting. The US economy is moving into recession. And there is a massive banking crisis brewing in Europe (Deutsche Bank is just the start).

And the FANGs (the few companies that are holding the market up) are ready to Crash.

Amazon is in a blow off top. This could EASILY fall to 650 in the next 60 days.

Facebook (FB) is going to $117, possibly $115 in short order.

Action to Take: Short Facebook (FB).

Apple (AAPL) looks very weak to me. I think it could go to $90 if not $70.

Let's close out our long and go short here.

Action to Take: Sell Apple (AAPL) if you have a long.

Action to Take: Short Apple (AAPL).

Let's also close out our Wal-Mart long.

Action to Take: Sell Wal-Mart (WMT) if you have a long.

As for stocks as a whole**,** the S&P 500 is in a triangle pattern. It has a date with 2,050 even if it FIRST breaks out to the upside. There are simply too many negative issues here. And in terms of potential positive surprises, there are none.

In plain terms, even if the S&P 500 makes one final run to retest its all-time highs, it's set for a significant correction before December.

Buckle up, because the period of market tranquility is ending. Whether or not we get a full-scale Crash is unclear. For certain the markets are primed to correct. Whether that correction morphs into something worse depends on what happens in Europe.

At the end of the day, barring a bail-out or bail-in, Deutsche Bank (DB) is going to zero. The long-term chart says it all. And it's not pretty.

This concludes this month's issue of ***Private Wealth Advisory***.

I'm watching the markets closely and will issue updates as needed. Barring any new developments you'll next hear from me next Wednesday in our usual weekly market update.

Until then…

Best Regards,

Chief Market Strategist
Phoenix Capital Research

For a full run down of our winning streak/ recently closed trades, visit the subscribers' only ***Private Wealth Advisory*** website. There you will see a full list of ALL of our closed trades running back to November 2014.

http://phoenixcapitalresearch.com/privatewealthadvisory/

OPEN POSITIONS

US DOLLAR CARRY TRADE IMPLOSION PORTFOLIO

POSITION	SYMBOL	BUY DATE	BUY PRICE	CURRENT PRICE	GAIN/ LOSS
Ultra Bullish Dollar ETF	UUP	5/23/11	$21.79	$24.65	13%
UltraShort Euro	EUO	4/10/15	$27.68	$23.81	-14%
UltraShort Yen ETF	YCS	5/27/15	$94.48	$59.41	-37%

RELATIVE US STRENGTH PORTFOLIO

POSITION	SYMBOL	BUY DATE	BUY PRICE	CURRENT PRICE	GAIN/ LOSS
Nuveen Muni. Fund	NIO	1/2/14	$13.12	$16.14	42%
Exxon	XOM	9/24/14	$95.82	$83.24	-7%
RPX Corp	RPXC	8/5/15	$15.48	$10.21	-34%

INFLATION PORTFOLIO

POSITION	SYMBOL	BUY DATE	BUY PRICE	CURRENT PRICE	GAIN/ LOSS
Gold		3/17/10	$1,120	$1,330.00	19%
Silver*		3/17/10	$16.23	$19.22	18%
Uranium ETF	URA	6/8/16	$15.49	$13.02	-16%

*** Avg. price of $17.50 and $14.97**
Price as of market's close on 9/28/16.
Prices include dividends

FANG / RETAILER SHORTS PORTFOLIO

POSITION	SYMBOL	BUY DATE	BUY PRICE	CURRENT PRICE	GAIN/ LOSS
Amazon (SHORT)*	AMZN	2/25/15	$484.19	$816.11	-69%
American Eagle Outfitters (SHORT)	AEO	5/26/16	$15.36	$18.11	-18%
Facebook (SHORT)	FB	9/27/16	$128.69	NEW	SHORT!
Apple (SHORT)	AAPL	9/27/16	$113.09	NEW	SHORT!

***Avg. price of $385.37 and $583**

MARKET HEDGE PORTFOLIO

POSITION	SYMBOL	BUY DATE	BUY PRICE	CURRENT PRICE	GAIN/ LOSS
UltraShort Nikkei ETF	EWV	1/6/15	$67.46	$39.77	-41%
UltraShort Emerging Market ETF	EEV	1/20/16	$24.03	$15.02	-37%
UltraShort China ETF	FXP	1/20/16	$59.95	$30.43	-49%
UltraShort Brazil ETF	BZQ	1/20/16	$74.40	$19.83	-73%
UltraShort Financials	SKF	2/10/16	$56.82	$39.97	-30%
UltraShort Russell 2000	TWM	2/10/16	$47.92	$29.06	-39%
UltraShort Gold ETF	GLL	5/26/16	$82.75	$69.05	-17%
UltraShort Silver ETF	ZSL	7/20/16	$29.20	$28.55	-2%
UltraShort S&P 500 ETF	SDS	7/27/16	$16.60	$16.53	0%
Rio Tinto (SHORT)	RIO	8/12/16	$31.08	$32.23	-4%
Silver Juniors (SHORT)	SILJ	8/31/16	$15.39	$15.47	-1%

*** Avg price of $26.98 and $21.08**
**** Avg price of $110.71 and $38.10**
***** Avg price of $60.95 and $51.69**
******Avg price of $52.94 and $42.90**

Price as of market's close on 9/28/16.
Prices include dividends

EU BANKING CRISIS PORTFOLIO

POSITION	SYMBOL	BUY DATE	BUY PRICE	CURRENT PRICE	GAIN/ LOSS
European Financials ETF (SHORT)	EUFN	7/5/16	$14.86	$16.95	-14%
Credit Suisse (SHORT)	CS	7/5/16	$10.30	$12.82	-24%
Deutsche Bank (SHORT)	DB	7/5/16	$14.18	$4.35	-5%
Santander (SHORT)	SAN	2/3/16	$4.13	$8.66	-9%
Barclays (SHORT)	BCS	7/5/16	$7.92	$23.93	-2%
France ETF (SHORT)	EWQ	9/16/16	$23.38	$24.23	-4%
Italy ETF (SHORT)	EWI	9/16/16	$10.78	$10.98	-2%

*** Avg price of $25.89 and $26.99**
Price as of market's close on 9/28/16.
Prices include dividends