

The LIBOR rate-fixing debacle that has engulfed Barclay's, the world's fourth largest bank, should not have surprised anyone. For global banking in recent decades has descended into a self-reinforcing cycle of 'the bottom line justifies the means, any means'. And Switzerland's UBS had telegraphed the issue last year when it told shareholders it had reached a settlement with the authorities in exchange for immunity from criminal prosecution. It is likely to have far-reaching consequences. As in the case of the Great Whale debacle that recently besmirched the previously lily-white reputation & credibility of the world's No. 8 bank, JPM Morgan, there have been no executive protestations this was the work of a "rogue" operator in the organization. LIBOR levels underly much of the pricing of the US\$600+TR global derivative structure; so no doubt a veritable tsunami of suits & counter suits by aggrieved parties will ensue that will drag on for years. Barclay's ex-CEO Bob Diamond, who previously headed its investment banking arm that, among many other things, provided the questionable LIBOR levels, sought to splatter some of the mud on the Bank of England. The list of the almost 20 banks being investigated for their possible role in this malfeasance reads like a Who's Who of global banking & includes the Royal Bank of Canada, JPM & Citibank (No. 10) in the US, HSBC (No. 3), Germany's Deutsche Bank (No. 2), Switzerland's Credit Suisse, Holland's Rabobank & Japan's Bank of Tokyo-Mitsubishi. And it cannot help but undermine the case of those in the industry, and its paid lobbyists & apologists, incl. Mitt Romney, who have steadfastly maintained there is no need for more regulation of the banks.

About 96% of all goods manufactured in the US in some way or other entail materials produced by the chemical industry. When experience suggested the demand for chemicals 'leads' industrial production & the economy by 3-8 months, the American Chemical Council created the Chemical Activity Barometer that tracks, among others, its industry output & prices, and hours worked. It currently trails the Fed's Industrial Production Index by the biggest margin since March 2009.

A major Canadian pension fund, the \$55BN Ontario Municipal Employees' Retirement System (OMERS), has announced the sale of its US\$850MM position in 11 private equity funds. With its private equity operation now worth \$6.5BN, it believes it has the critical mass needed to start investing directly in private companies, rather than paying external managers to do so for it for a 2% management fee & 20% of the profits - *what a deal for the managers, getting their overhead paid for **and** 20% of the "upside" (& none of the "downside" risk) - this, along with the recent disappointing results of many hedge funds, means the hedge fund craze likely has peaked.*

The market was agog when Waterloo, Ont.-based RIM, maker of the once almighty Blackberry cell phone, reported a half a billion dollar loss for the First Quarter. But few people took note of the fact that this included a huge non-cash item from the total write-down of goodwill on its balance sheet. And many people overlooked the fact that, as the shares traded at \$7.54, the Company sat on a \$2.2BN pile of cash (\$4.20/share) & on another pile of patents that, if the Nortel experience is anything to go by, could be worth a great deal, if not more than \$4.20/share. And the new CEO may have done the smart thing by throwing everything but the kitchen sink into the loss column for the quarter, so that henceforth he can outperform expectations that are lower than a snake's belly. And it is a reflection on the quality of analysts' coverage of the firm that none of them ever reported in the Company's super-hyped heyday that the two co-CEOs had offices 10 minutes apart, seldom met & had different strategic objectives (by the way, RIM's fall from grace means that co-founder Mike Lazarides is now worth only a mere billion dollars, down 85% from three, four years ago).

According to the China Daily China's legislators are split over a proposed law that would make it mandatory for children not living at home to visit their parents "frequently" (last year already,

they passed a law that people were responsible for the financial & emotional wellbeing of their parents). China has about 400MM migrant workers who have left their parents in, often remote, rural areas to find their future in the big cities where opportunities are greater, pay better, & the future more promising - *the problem may be less with these migrant workers, millions upon millions of whom return home each year for the Chinese New Year, than with the better-educated, upwardly-mobile new middle class, part of whose lifestyle involves an intentional shedding of their links with tradition. Be that as it may, it's amazing how in one generation a centuries'-old tradition has been destroyed.*

The recent headline Fistfights erupt among Syrian opposition shouldn't have surprised anyone but the politically naive. For Syria is one of a number of countries whose borders in colonial times were drawn on maps by politicians in faraway London and/or Paris with no regard for, oft long-established, ethnic/religious fault lines. In Syria the result thereof now is an opposition united on only one issue, a wish to get rid of the Alawite Bashar al-Assad regime, but divided along ethnic & religious lines on just about every other issue. Meanwhile, there is evidence of growing al Qaeda-inspired activities in Syria which, unfortunately, lends credibility in some quarters to Bashar al-Assad's claims that the uprising is nothing but a "terrorist plot" (ever since 9/11 it has become SOP for any tinpot dictator to refer to anyone not in his good books as a "terrorist").

In all the hullabaloo about the destruction of historically significant religious shrines, tombs & mosques of the Sufi brand of Islam in Timbuktu, little has been said about the fact that the perpetrators are Sunni Muslims belonging to Anar Dine (Defenders of the Faith) for whom Sufism is heresy & whose beliefs are shared by the puritanical Wahabbi-dominated Saudis.

An Alberta oil rig worker, half way into the Province of Québec, & after earlier having been encouraged by other members of the QPP, on the 46th day of a cross-country run that started in Newfoundland to raise \$1MM for an Edmonton Children's hospital was arrested by another member of the Québec Provincial Police after he refused to comply with an order to get off the Trans-Canada Highway because it wasn't safe or legal (after having been given a court date & released, he continued on his merry way, albeit on a secondary road parallel to the Trans-Canada). But all's well that ends well; for after this story went viral he was flooded with donations.

Yassar Arafat's widow's demand that her husband's body be exhumed, eight years after his death in a French military hospital could pose problems for Israel. This followed an al-Jazeera report that Swiss scientists had found traces of Polonium-210 (the same compound that in 2006 killed former KGB agent Alexander Litvinenko in London after he drank tea, unbeknownst to him, laced with the stuff) on clothing & personal items she said he had used in his final days,. For, if it were found in his remains, while the possibility has been mooted he may have been poisoned by Palestinian rivals, a British radiation expert familiar with the Litvinenko affair opined that a sample large enough to kill a man could only come from a government with civilian or military nuclear capabilities (thus the stuff used to do in Litvinenko was eventually traced back to a specific nuclear installation in Russia). While his French doctors at the time said he had died from a massive stroke, his medical records showed he suffered from inflammation, jaundice & a blood disease that, while it has numerous potential causes, never was clearly traced back to a source.

In a new twist on election irregularities, the day after the July 1st Presidential election, outlets of Mexico's largest supermarket chain, Soriana, were swamped by people carrying gift cards given to them by members of the PRI to support its candidate (who won the election after his party's

11 year absence from power), only to become vexed when they used them to learn they were be worth just one-fifth of the \$37.50 promised - so *the fraudulent were defrauded - poetic justice!*

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MARKET COMMENTARY (Blackstone, Byron Wien)

- When in doubt about global events, I hop on a plane to Europe to consult “The Smartest Man in Europe”, whom I have been referencing in my writings for over a decade due to his *past* uncanny ability to see trends long before others do. He told me that :

as an optimist I may **believe** policy makers will do what’s needed to avoid disaster, he, as a realist, **knows** the temporizing measures policy makers resort to always at some point prove insufficient, & that in financial matters we’re now getting there;

in democracies people want governments to do more for them, but at no cost to them (“*always*” *in this case means the past half century*). Politicians get elected by promising benefits, not by raising taxes that would avoid increasing the debt;

everything is OK as long as the ten-year bond yield doesn’t exceed the nominal growth rate; for if it does the cost of debt service becomes unsustainable - that’s where Spain & Italy are at right now, but the US not quite yet (the **real determining factor is the relationship between the growth rate of the debt vs. GDP; for, even if interest rates are minimal, if the former exceeds the latter compounding over time over time will create fiscal unsustainability**);

the developed world’s standard of living is declining & its Debt/GDP ratio is 100%, over the threshold where economic growth potential is curtailed, while in the developing world it’s rising & the Debt/GDP ratio is one-third that rate;

Greece’s Prime Minister is well-intentioned but the Greeks won’t take prolonged austerity laying down. The weak countries have two choices, austerity or default : Ireland is the poster child for the former, and Russia & Argentina for the latter;

the authorities will do everything possible to prevent/(*delay?*) a catastrophe. They will continue to print money on the basis that the higher inflation it must ultimately lead to is the lesser of two evils. But defaults will eventually lead to a banking crisis & an acceptance of a 7% nominal growth objective (2% real & 5% inflation).

The heart hopes he will be proven wrong this time but the head says the odds are he won’t. Blackstone was founded in the mid-80’s & today is one of the world’s largest & most successful hedge fund operators. Byron Wien, its Vice Chairman, now in his late 70’s, earlier in his career was Morgan Stanley’s Chief Investment Strategist for 21 years, & in the past decades has collected career achievement accolades by the bushel. In January he issued his ‘Ten Predictions for the New Year’ for the 27th year in a row. This year they were : oil to hit US\$85 & the S&P 500 1400, US GDP growth for the year to exceed 3% & unemployment to dip below

8%, the Democrats to regain control of the House but lose that of the Senate, Europe developing a long-term plan, the computer to become the terrorists' weapon of choice, investors to flee into the currencies of "prudent governments", the Arab Spring to "mature" by ending al-Assad's rule in Syria (weakening Iran, Hezbollah & Hamas) & the emerging (equity) markets to rise 15% [of his ten predictions for 2011 two were outright wrong (the level of the S&P and of UST yields), three were right (the price of gold & of oil, and Europe) and five "partially right" (China, Afghanistan, housing, farm product pricing, and GDP & unemployment), an improvement over his 2011 performance when none were 100% right. .

LET'S NOT HAVE FACTS GET IN THE WAY OF A GOOD STORY (BCA, July 2012)

- The Eurozone is on the edge of collapse. With bank runs proliferating on the periphery, "muddling through" is no longer an option. Political developments in Germany, not Greece, will determine the Euro's fate. It will take a massive riot to prompt a long overdue policy response to save the Euro. And the earlier failure of the Mario Draghi-led ECB to cut its refi rate shows it simply didn't understand the seriousness of the situation;
 - The Fed's extension of Operation Twist paves the way for another round of QE later this year even though the economic- & market impact thereof will be small.
 - At the rate things are going in Greece, it will take 30 years of mass unemployment to catch up with Germany productivity-wise. It's hard to fire public sector workers when there are no jobs in the private sector - *Greece may be seriously 'downsized as its youngest & brightest leave for greener pastures elsewhere in the world;*
 - After a decade of inflation in the Eurozone periphery exceeding Germany's, the reverse must now occur. There are only two ways this can happen. Either German inflation stays low, forcing that on the periphery to go negative (which is economically & politically unrealistic) or it stays positive on the periphery & then in Germany must go to levels higher than historically have been acceptable, say 5%. Since a Eurozone breakup would decimate Germany's banking- & export industries, the latter will be the lesser of two evils for Germany (*although its voters may not see it that way*).

BCA is a Montreal-based source of often insightful financial market analysis, broadly defined.

US SENDS SHIPS, PLANES TO PERSIAN GULF AS TENSION MOUNTS **(NYT, Tom Shanker)**

- It has been quietly moving more military reinforcements to the Gulf in an attempt to deter Iran from attempting to shut down the Strait of Hormuz, and to back up the President's contention that all options are on the table. It has doubled the number of minesweepers to eight, has moved more stealth F-22s & F-15C warplanes onto bases in the region, & brought in the Ponce, an amphibious transport & docking vessel, to serve as a mother ship for the minesweepers & an operational base for Special Forces.
- This is also a political move to demonstrate "his two-track policy vis a vis Iran is not, as Mitt Romney alleges, a sign of 'weakness' " But as Sen. John Kerry (D.-Mass.), Chairman of the Senate Foreign Relations Committee, notes, he must strike a delicate balance between positioning enough forces to deter Iran (*from doing anything stupid and/or precipitous*) but not so much as to inadvertently suggest to Iran & Israel that an attack on Iran's nuclear sites is imminent (nor to encourage Israel to do so on its own).

*Possibly the main **real** risk to continued tanker traffic in the Persian Gulf would be concerns by the world's insurance industry that the situation there is so precarious as to warrant prohibitively high premiums, or the cessation of insurance coverage altogether.*

ROMNEY'S AMBITIOUS FIRST TERM AGENDA (msnbc, Michael O'Brien)

- He said recently that on his first day in office he will repeal Obamacare & that his other "Day One priorities" will include tax cuts & deficit reduction, approving the Keystone pipeline, issue more aggressive strictures on trade with China & repeal "job-killing regulations (incl. Dodd-Frank). And "in my first year I will make sure that we actually do take on immigration ... secure our borders ... (*and*) grow legal immigration in a way that provides people here with skill & experience that we want."

As to the latter, there is less interest abroad among the people he is talking about to come to the US because they can see greater opportunities in the country of their birth.

BORDER PRIVACY AGREEMENT THREATENS PRIVACY (CP)

- Last year Prime Minister Harper signed off on a 'perimeter security deal' to "smooth" the movement of people & cargo across the Canada-US border & beef up continental security, pursuant to which a 12-point Canada-US privacy charter was made public on June 28th. According to a senior official in Canada's Privacy Commissioner's Office the principles contained therein include some fundamental building blocks of good privacy practice but are far short of ideal since they are non-binding. And a source of special concern is that in some cases it will allow the US to pass Canadians' personal information on to third countries without permission.

Since 9/11 privacy has been increasingly been encroached upon. But sadly many people don't seem to care, if not enthusiastically aid & abet the process, as witnessed, among others by the Facebook phenomenon. George Orwell may well have been just half a century off in 1984.

BUYING APPLES TO APPLES, PAYING APPLES TO ORANGES (NP, Ted Rechtshaffen)

- Canadians are often taken for a ride when buying equity mutual funds, paying the world's highest management fees & not getting the superior management promised. The problem is that many large Canadian mutual funds are "closet indexers", whose track record closely mirrors their benchmark index. Thus the RBC \$4.9BN Canadian Equity Fund has a Beta of 1.01, i.e. its performance almost perfectly mirrors that of the S&P/TSX Composite (which a spokesperson for RBC Global Asset Management justified by saying it is "is intended to be a core Canadian equity holding and, therefore, is reflective of the S&P/TSX Composite"). And for that investors are being charged a 2.05% MER (over & above the manager's out-of-pocket expenses)? They would have been wiser, & better off financially, if they had put their money in the \$570MM RBC Canadian Index Fund; for it has an MER of just 0.71%, (which must be a huge money maker since operating an index fund costs little & requires little human involvement) & has outperformed the equity fund by 1.84%, only 1.34% of it accounted for by the difference in their MERs. Among all mutual funds with one year returns of -15% to -20%, the top ten holdings of five managed by Desjardins, RBC, CI, Investors (which recently announced it was lowering some of its management fees), & London Life, each with assets > \$1BN & \$11+BN in the aggregate, mirrored the top ten stocks in the Index (*that*

account for 33% of its total weight & are heavily bank-weighted; so much for “diversification”). The first three had Betas of 1.01 & the other two 1.06 & 1.08.

Given the level of Canadian MERs, being a closet indexer is a sure-fire way to be a consistent under-performer. And the fact so many major Canadian mutual funds are closet indexers says something about their view on the financial astuteness (or gullibility?) of their client base. While there are many managers who do “add value”, Canadians don’t seem to look as diligently for value in mutual funds as they do in, say, gasoline, cars or houses. Rather coincidentally, the Canadian financial services industry’s eye was just further blackened by the surfacing of an internal memo by West Coast sales reps of Standard Life (which of course was subsequently disowned by the Company) entitled Summer Project : 7 Ways to Increase the Value of Your Book and Generate More Revenues which promoted pushing clients to invest in products that, whether suitable or not for the client, would maximize agents’ revenue cum fee income stream.

MORSI VOWSTO FREE SHEIK JAILED IN U.S. (NYT, David D. Kirkpatrick)

- He pre-empted the military’s carefully choreographed swearing-in ceremony by taking his oath of office one day early, on June 29th, in televised speech in Tahrir Square in which he complicated his country’s relationship with the US by vowing to work for the release of Egyptian-born Sheik Omar Abdel Rahman who is in jail in the US for plotting to bomb New York City landmarks with the words “I see signs for Omar Abdel Rahman and the detainees’ pictures ... It is my duty and I will make all efforts to have them free, including Omar Abdel Rahman.” While the Brotherhood quickly moved into damage control mode, saying that there would be no questioning of the Sheik’s conviction, President Morsi’s comments cannot help but deepen American suspicions of him (& of the Brotherhood), the more so since he has a long history of opposition to the policies of the US & Israel, & once, in an interview with Shadi Hamid of the Brookings Doha Centre, voiced suspicions that still unknown hands had played a role in the 2001 attack of the World Trade Centre.

The latter is the more surprising since he has a Ph.D. in materials science from the University of Southern California.

AMID EURO CRISIS, SOME IRISH LUCK (Reuters, Neil Unmack & Hugo Dixon)

- The Eurozone needs a success story for its hapless crisis management with Ireland being its most promising candidate. So at last week’s Euro Summit trials balloons were floated about possibly easing the terms of its bailout (on the rumours of which the yield on 10-year Irish bonds tumbled to 6.30%). There is as yet no specificity as to how this might be done & how much money it might involve, but the objective seems to be to improve the government’s balance sheet so as to make possible its early return to capital markets.

The Irish government has been known to have been closely following the details of other bailouts, looking for precedents that would support its case for easing the terms of its bailout.

AFTER THE WETTEST JUNE, UK BRACES FOR MORE RAIN (The Guardian)

- Last April was the wettest April, & June the wettest June, since records started being kept in 1910, & in June total rainfall (145mm/5.8 inches) was twice the ‘norm’ for the

month. Then on July 4th the Met Office issued a severe weather warning that as much as 60mm/2.5 inches of rain might fall in 36 hours, almost the 70mm/2.8 inch norm for July.

*Meanwhile, across the Atlantic, vast swathes of North America are in the midst of a heat wave & desperately short of rain, with in some places people being further inconvenienced by power interruptions that deny them access to air conditioning. All this prompted weather expert Kevin Trenberth, Head of Climate Analysis at the National Centre for Atmospheric Research in fire-scarred Colorado to remind people that he had warned them of the risk of such record-breaking weather conditions, & Jonathan Overpeck, a professor of geo- & atmospheric sciences at the University of Arizona, that "This is what global warming looks like at a regional or personal level ... (and) This is certainly what I and many other climate scientists have been warning about" (although others warn that it's far too early to say global warming is the cause of the wacky weather) - for my part I welcome such weather disasters since they will sensitize millions of people to the fact that the climate **is** changing, whether or not it is in part, or in whole, due to human activities.*

UK POLITICIAN SPEAKS OUT AGAINST THE TRAVESTY OF TRYING TO DEPORT RICHARD O'DWYER TO FEED HOLLYWOOD ANGER (TechDirt)

- According to MP Tom Watson "Somewhere behind the case *to extradite Richard O'Dwyer to the US* lie the powerful vested interests of the content industry. If they succeed in exercising their lobbying might by forcing the extradition of an able student to face trial in America, it will further undermine public confidence in an important treaty designed to combat terrorism ... Let's be honest about what is going on at the heart of this case : a generation for whom the net is not "new technology" is being hung out to dry by an older generation of lawmakers who don't understand the ...reality of the connected digital planet."

O'Dwyer is a 24 year-old university student who in 2007 launched TVShack, using a server in Sweden 'to provide a link to other websites without carrying any copyrighted material on its website'. This didn't stop the Southern District Court of New York from charging him with conspiracy to commit copyright infringement & criminal intent of copyright infringement (both carrying a maximum five year sentence) & the Justice Department from seeking his extradition from the UK under the Extradition Act of 2003. Last January a UK Magistrate ruled he could be extradited & two months later the Home Secretary agreed (both decisions are being appealed). The 2003 Act has been criticized for reducing the level of evidence needed for extradition (to the US) from "prima facie evidence" to "reasonable suspicion" [especially since under the Fourth Amendment a US extradition to the UK requires "probable cause" (which a government review claimed was not "significant different" from reasonable suspicion)]. O'Dwyer's lawyers argue any criminal prosecution of O'Dwyer should take place in the UK since he hadn't used US-based servers (and, by implication, that the US Justice Department's request amounts to an 'extra-territorial application of US law'). A petition recently launched by Wikipedia co-founder Jimmy Wales to halt O'Dwyer's extradition at last report had attracted 150,000 signatures in five days (half of them on the fifth day). While opponents to O'Dwyer's extradition can be found in all three parties, Watson, albeit since last year the first ever Deputy Leader of the Labour Party, is a bit of a loose cannon. Thus in 2006 he signed a letter to then Prime Minister Tony Blair calling on him to resign (which Blair called "disloyal, discourteous and wrong") & recently observed "there is more chance of parliament being hit by a meteorite than Tory MPs passing judgment on Rupert Murdoch", which prompted the Murdoch-owned Sun to call him "a fundamentalist zealot who denounces any deviation from socialism"

COPYRIGHT AGREEMENT REJECTED (Reuters, Claire Davenport)

- On July 4th, by a vote of 478-39 & 165 abstentions, the European Parliament rejected ACTA (the Anti-Counterfeit Trade Agreement) that has been four years in the making & has already been signed by, among others, Canada, Japan & the US. This was a victory for its critics who say it will punish people for sharing films, & for the tens of thousands who held rallies across Europe last fall, saying it would curb their freedom *to do as they pleased* & allow officials to spy on their online activities.
- According to its President, Martin Schultz, legislators weren't against intellectual property rights but felt ACTA left too much scope for abuses & had concerns "about its impact on consumers' privacy & civil liberties, innovation and the free flow of information." This vote raises doubts about ACTA's future since global adherence is a sine qua non for it to be effective, & about the planned update of the EU's own ten year-old copyright legislation that dates back to a time that Internet dial-up connections weren't capable of the rapid file sharing possible today. And it is raising concerns in the industry that it will give China reason to tell the EU (& the US) to get lost when they want it to enforce their copy rights.

ACTA failed to adequately differentiate between occasional users for their own enjoyment & those for whom copyright infringement is their livelihood. And, while it is hard to have much sympathy for some young people's claims (as in Québec's college tuition battle) that they are entitled to do what they want, there does seem to be a growing incidence in Western 'democracies' to write legislation that gives officialdom undue 'fishing rights'.

KENYA CANCELS IRAN OIL IMPORTS (AP)

- Some time ago the Government of Kenya signed a memorandum of understanding, but according to the Permanent Secretary (i.e. top civil servant) in its Energy Department not a *binding* agreement, with Tehran to buy Iranian oil. But on July 4th he said it would be "terminated" &, while he claimed not to be aware of such warnings, another government official said this was because the US had warned that Kenya risked being penalized if it were to proceed with the arrangement.

Along with the start of the EU embargo on Iranian oil on July 1st, & likely other similar US-induced reductions in third countries' interest in buying Iranian oil, this must be increasing the pressure on Tehran by the day, with as yet unknown, but hopefully not disastrous, global consequences.