Black Swan Capital
Currency Currents
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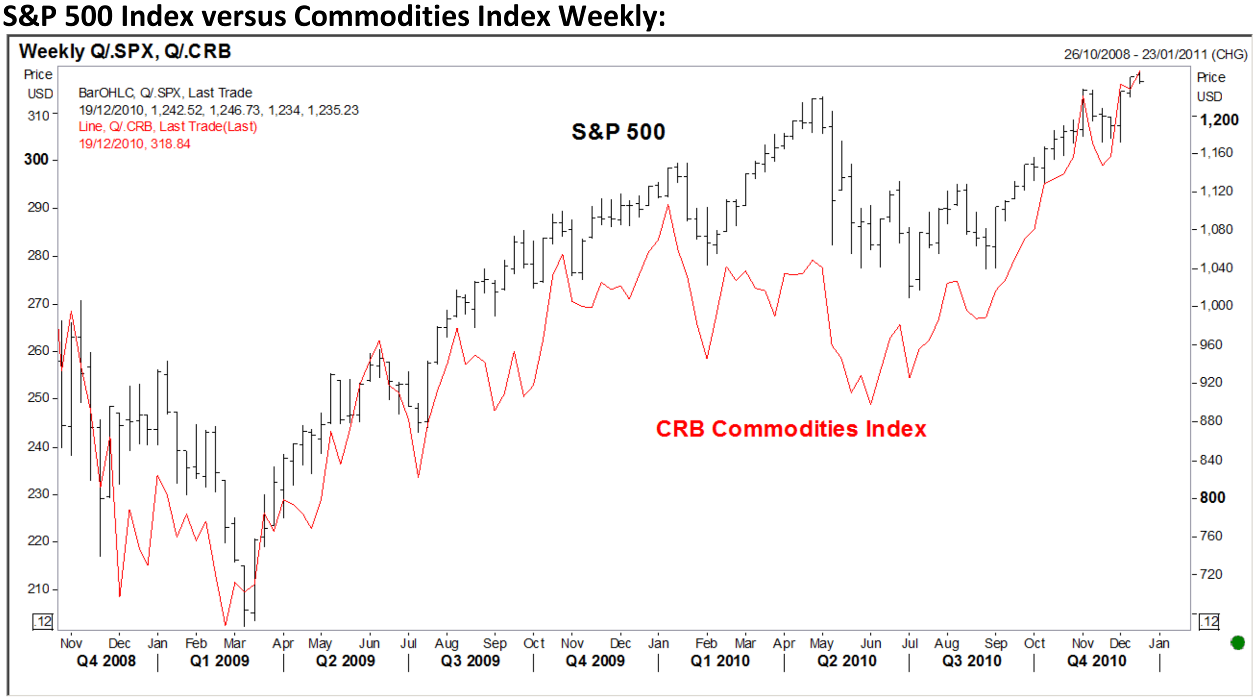
All swans are white again.

Jeremy Siegel had an op-ed in *The Wall Street Journal* this week. And he also did an interview with Reuters. If you don't know of Mr. Siegel, just know that he is a big-time equities guy.

> "After 1929 and the crash it took about 20 years for people to get enough faith back to begin to go into stocks. Now, I don't think it's going to take anywhere near that long now, because the situation as bad as it was; but **this is certainly the most risk aversion that I've seen** in probably 50 years of mine."

What stood out in that interview was his perception of unrelenting risk *aversion*. It was a bit of a head-scratcher since: 1) stocks are in a sustained uptrend since March 2009 (minus a hiccup in mid-2010) and 2) commodity prices have burst higher since May (with some pullbacks mixed in). The moves in these two asset classes have come despite global risk keeping currencies a bit honest.

S&P 500 Index versus Commodities Index Weekly:



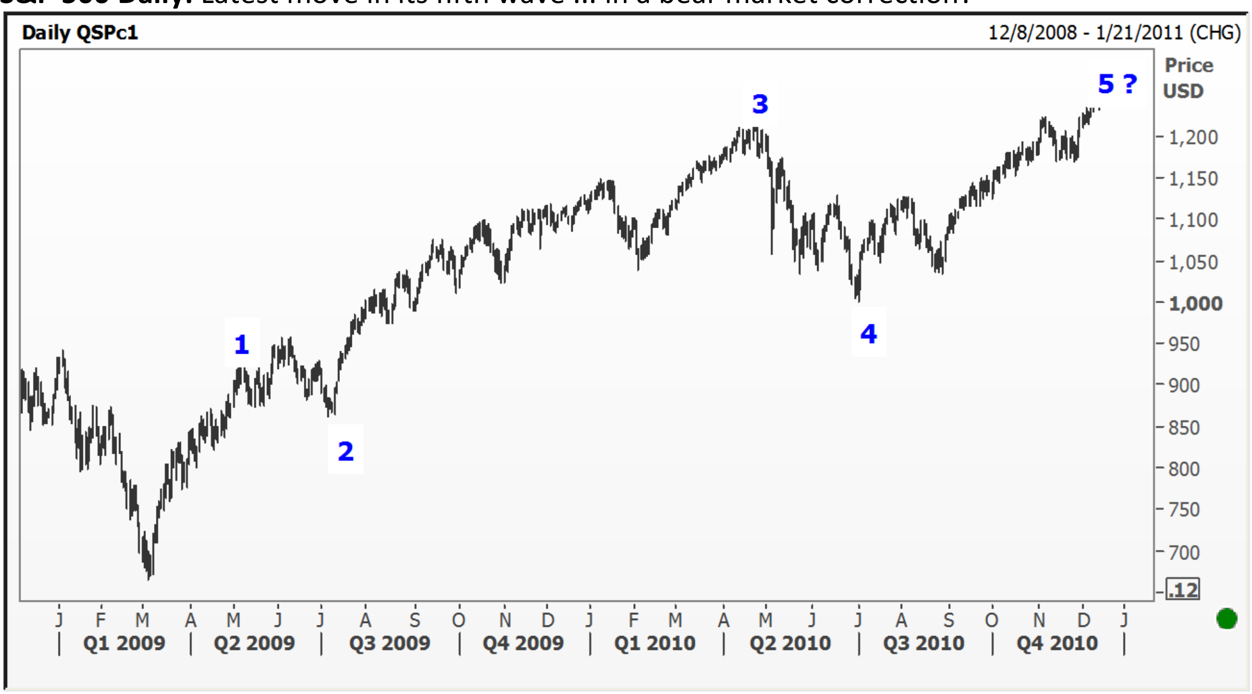
We, a mirror image of Mr. Siegel, are instead a bit surprised by the unrelenting risk *appetite*.

As an example, investors' optimism seems to have reached a point where it makes sense to bring on two new copper-backed ETFs. A friend sent us this information after our Tuesday piece, in case you can't resist:

- ETFS Securities launched a copper ETF, ETFS Physical Copper (PHCU), on the London Stock Exchange on December 7th. The amount of copper it is starting with is unknown. In London, such funds are known as ETCs, or Exchange-Traded Commodities.
- JP Morgan is launching the J.P. Morgan Physical Copper Trust, which will start with 61,800 metric tonnes of copper in storage.
- The iShares Copper Trust will soak up another 121,000 metric tons.

Though, from a contrarian perspective, the timing here could indicate copper and risk appetite have topped.

S&P 500 Daily: Latest move in its fifth wave ... in a bear market correction?



Elliot Wave International notes that S&P futures traders are the most bullish they've been in 4 years! Other sentiment surveys indicate even more bullishness among individual investors.

Anyway ... much of the optimism likely stems from *un*usual improvement in usual economic data. Besides some improvement in manufacturing numbers et al, there seems to be improvement in sentiment numbers too. Small businesses optimism is steadily, albeit slowly, improving. A growing number of CEOs of major US companies expect to see sales growth, increased capital spending, and payroll additions over the next six months.

We acknowledge the small improvements that small businesses and big-time CEOs see in the economy. But we think the improvements don't yet outweigh the potential risks that the economy will be held down, and recovery really won't equate to self-sustaining progress.

But then again, maybe we're just perennially seeking that black swan event.

Common knowledge is back to believing all swans are white.

But why is the black swan completely off investor radar screens? After all, the black swan was at one time *the* explanation for why markets were acting as if Armageddon was only a few days away.

Ahhh, yes.

So has the world been rescued from Armageddon? Just picture it: "When an asteroid the size of Texas is headed for Earth the world's best deep core drilling team [Ben Bernanke, Hank Paulson, Tim Geithner, Jean-Claude Trichet, and some players to be named later] is sent to nuke the rock from the inside" ... saving financial markets from certain doom.

Or don't investors truly understand the risks? Maybe. Ignorance is bliss.

Or is mal-advisement on the part of financial advisors and portfolio managers to blame? It seems money managers are roaring bulls again.

For example: there was a portfolio manager on CNBC yesterday morning ...

> "I think you have to be long in this market ... like I've been saying over a year to you and Erin that the economy isn't in as bad as shape as most economist and analysts think it was and is. I think if you look at companies, they've got tons of cash on their books, at some point in time companies are no different than individuals – the more money you have it's going to burn a hole in your pocket and they're going to go on an acquisition binge ... Although I don't believe [the market] is going to go up 18%, it should be up around 8-12% next year unless we get a surprise on the upside; **but I don't see any surprises on the downside.**"

Technically, it's not a surprise if you see it coming. But we understand his point ... even though we don't really *understand* it. It's one thing to think the positives outweigh the risks in this environment; it's another thing to admit you see NO downside risks in this environment. If you can't think of a plausible alternative scenario that is 180-degrees from your current view, you really shouldn't be handling other people's money is our belief.

Did I mention Jim Cramer said yesterday to ignore Spain? Effectively saying it will have "no impact" on US stocks.

Also, Andrew Garthwaite of Credit Suisse seems to concur with Jim ... or Jim concurs with Andrew – not sure. Mr. Garthwaite seems to think expected rises in government debt inside of Spain will be manageable. Moody's threatened a downgrade on Spain this week:

Ratings agency Moody's warned Spain on Wednesday that its debt could be downgraded, saying it was worried about its high debt funding needs, indebted banks and regional finances, although it did not expect Madrid to have to follow Greece and Ireland in seeking an EU bailout. (Reuters)

Yet today's bond sale was smoothly absorbed. Could this be one indication that investors are ready to shake off the eurozone fiasco?

From the trusty *Leto Market Insight*:

> At some point early in the year, Portugal will be obliged to accept a Greek-style bailout from the European Financial Stability Facility (EFSF) on terms and conditions that will further shrink its GDP. After Portugal, the EFSF under existing triple-A rating rules will not have enough money to bail out Spain, and the German Parliament will need to vote to increase EFSF funding.
>
> Let us assume that Schäuble is correct and that the German Parliament will indeed be ready and willing by then to take such vote. The result will be a dilution of German creditworthiness and an increase in the interest that Germany itself will have to pay on its own debt. But the German fiscal legislation operates under the constitutional requirement of a balanced budget by 2015, which places a limit on how much more Germany may contribute to the EFSF.

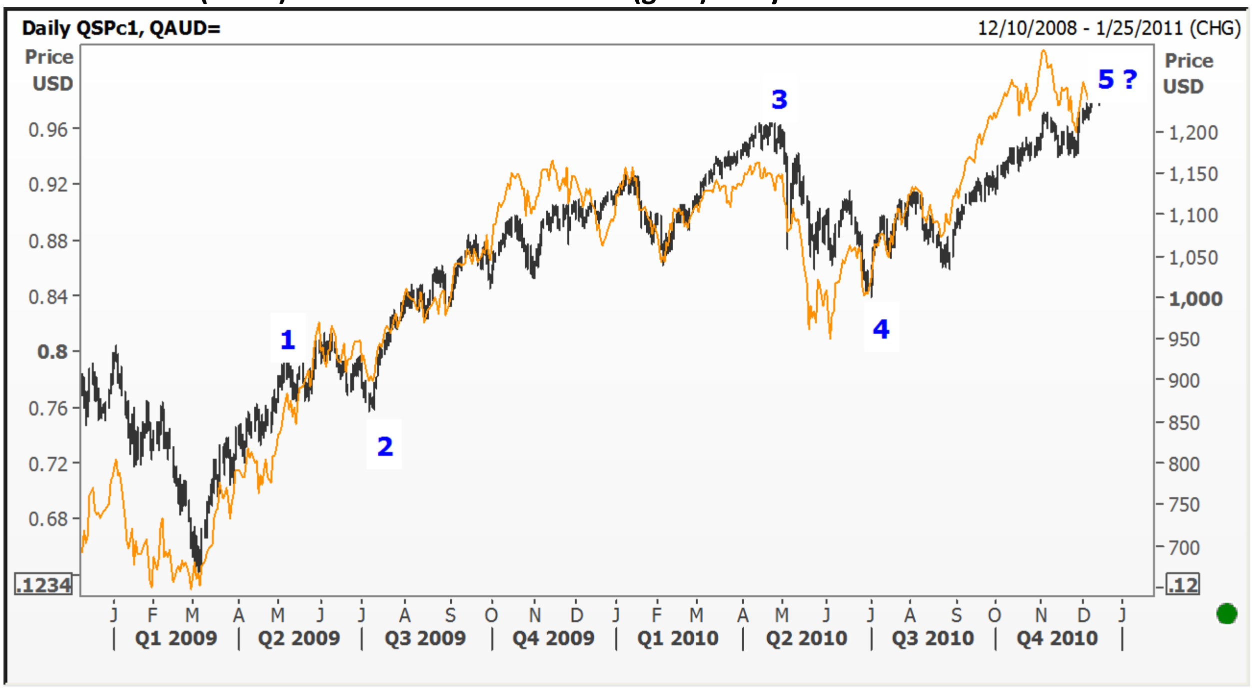
It may be a little bit early to shake that off. This from Reuters this morning:

> The Swiss National Bank held interest rates on Thursday despite the economy's brisk recovery this year, saying the euro zone debt crisis and a strong Swiss franc were hurting the export-dependent Alpine country.

Kind of like Batman on a dark rainy night in Gotham, no one sees a black swan coming. That is the nature of a black swan event. But it doesn't mean just because momentum is going your way you should assume risk is effectively reduced by virtue of price proving your rationales—which are rationales that may have nothing to do with price going your way.

The fact is this, when things look brightest in markets it coincides with peaking danger; when thinks look bleakest it coincides with minimal risk. It is the Tao of markets. It is the way it is and the way it has to be.

S&P 500 Index (black) versus Aussie dollar-USD (gold) Daily:



Remember, all swans were white until Australia was discovered. Stay tuned.

Regards,

John Ross Crooks III
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