

CALIFORNIA CALLING

Another Fiscal Emergency, A Shudder in the Muni Bond Market

Kerry Tribe, from the How Many Billboards Project, Los Angeles | Edited by Gregor Macdonald

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Mike Bellafiore
Of SMB Capital
Takes Trader to School
At SMB University

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CALIFORNIA CALLING

California is sagging under the enormous liabilities of a super-sized welfare state, where millions remain unemployed, but need to be fed. To fill the gap between revenues and costs, California borrows. It borrows in the capital markets, it borrows from the government, and it even tries to borrow from its own cities. But the municipal bond market shuddered this week in a sign that reality finally approaches. Ring, ring. Cali is calling.



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A NOTE FROM THE EDITOR

Welcome to StockTwits Macro Weekly, the weekly magazine of the StockTwits investment community. Each issue features a core essay, written by the Editor. Around this, we build in the key news events and observations, from the past week. [To have each issue sent to you, sign up here.](#)

You will also find StockTwits Macro Weekly functions as a live document, that is eminently clickable and is therefore a helpful launching pad to other relevant content. Feedback from readership is welcome, and we are always on the lookout for written contributions from the community: gregor@stocktwits.com

The advertisement features the Gregor Weekly logo on the left, which includes a house icon and the text "Gregor Weekly" and "gregorweekly.com". To the right, the text "Gregor Weekly" is written in a large, stylized font. Below this, the website "gregorweekly.com" is listed. A yellow starburst graphic contains the text "Premium Blog". Underneath, the heading "Member Benefits" is followed by a list of four items: "Hand crafted model portfolio", "Real time changes to model portfolio", "Mid-week portfolio discussion", and "Weekly macro note". At the bottom, a red banner with white text reads "Sign up for two-week free trial".

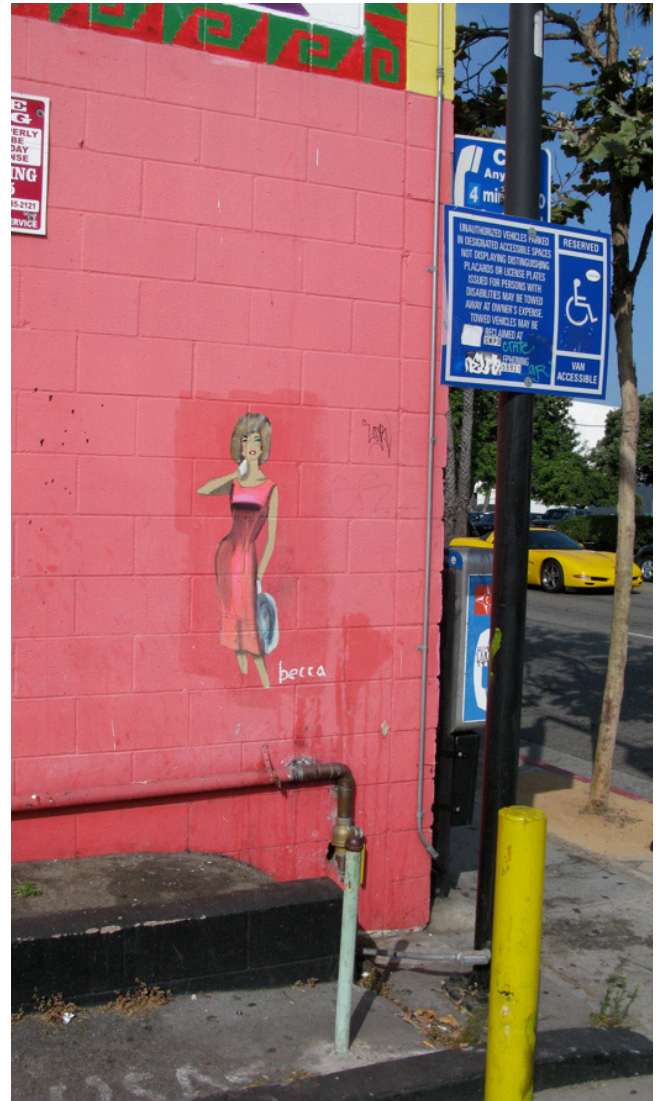
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CALIFORNIA CALLING—When the governor of California declared [yet another fiscal emergency last week](#), it hardly seemed like news. The Golden State’s annual budget peaked out north of 125 billion three years ago, and has been crushed twice since that time as revenues evaporated and the legislature fought amongst themselves, searching in vain for a solution. However, fiscal emergency 3.0 in California comes as the [comptroller](#) reported last week *slightly* higher revenues but a much bigger overall crunch, which will greet the incoming governor Jerry Brown with a 25 billion dollar looming shortfall. Indeed, despite serial accounting tricks that have pushed borrowing and liabilities into every subsequent fiscal year, it would seem California’s day of reckoning finally approaches. Last week, the California municipal bond market lurched downward [along with other state muni markets](#). And, even more data on California’s quickly accumulating liabilities came to the surface. Is California finally about to cross a debt servicing threshold, the likes of which will truly impair its ability to borrow?



One of the key differences between the United States and Europe is that Washington can much more easily funnel money to the states than Brussels can to its own member countries. We have seen that difference play out this year as each blow-up on the periphery of Europe triggered a separate political event within the Brussels-Paris-Berlin triangle. Even as the IMF is now getting involved in [this week’s Ireland Crisis](#), the situation continues to involve France and Germany as they are both now pressuring Ireland to [take funds from the EFSF](#). In the United States, meanwhile, distribution of funding

Indexes

INDU 11192 TNX 2.79 GOLD 1368.40 VIX 20.61 SPX 1199.21 DXY 78.133

StockTwits.TV: SMB University with Mike Bellafiore



One of the great things about StockTwits.TV is that it offers a mix of news programming, interviews, and live interactive shows. There is also some very good educational programming at StockTwits.TV, and SMB University uses the platform to make a great presentation. This week, we checked in with [Mike Bellafiore, of SMB Capital](#).

In ***Adapt: The Market Doesn't Care What You Want it to Do***, SMB has put together a very useful primer on how to set up a proper, disciplined day trade. Mike pays particular attention to the Tape, which he says can be fairly well replicated now through the use of a basic Level II trading platform. Indeed, we really enjoyed hearing Mike's stories of the "old days" (the 1990's!) when Tape Reading was a more common skill. This is must watch StockTwits.tv., especially for those who believe Tape Reading is a "lost art." Not so! [Watch the show here](#).

[StockTwits.TV](#) can also be taken as an iTunes subscription.

comes more quietly. In truth, a stealth bailout of US States has been going on for some time now. The problem, however, is that just as in Europe, the lending is marked to new debt. It would nice if both Brussels and Washington simply printed up debt-free cash to replace lost revenues and collapsed debt to the troubled states. However, as global reflationary bailouts are still essentially just asset swaps, these merely extend the day of accounting. For California, the municipal bond market may finally be anticipating that 2011 will bring an encounter with reality.

One of the key methods that Washington has used to shovel capital to the states is through the unemployment fund. While most are aware that an unemployment check is composed of a blend of employer, state, and federal funding--fewer are aware that states can apply to Washington to borrow their share of unemployment payment liabilities. And California has gone *full tilt* in borrowing to pay its share of unemployment . According to [ProPublica](#), California's new debt to Washington on this score reached 7.6 billion as of July, 2010. This Autumn, that level has now topped 8 billion *officially*. But last week the [Sacramento Bee reported](#) that current liabilities have now reached 10.3 billion.

Appropriately, this is classic California accounting: liabilities accrue while the recording of those liabilities is delayed as long as possible. But such delays will not prevent California from having to pay interest on that debt, estimated to rise towards 400 million next year. More broadly, however, the quickly accruing liabilities of California are now becoming quite substantial, especially when set against an economy that has failed to recover.

One of the painful realities of large states like California is that while employment has been [dialed back to levels of ten years ago](#), population of course continued to grow. The result is a new, super-sized welfare state whose needs

have expanded greatly while the FIRE economy (Finance, Insurance, Real Estate) continue to melt away. While it's true that exports in the United States have recovered nicely, and that Silicon Valley continues to capture capital flows that produce nice revenues for Sacramento, the balance between California's total state revenues, social safety-net payments, and 35 million residents has tipped over dangerously. Anecdotally, the budget cuts to services, schools, parks, and other social services are now beginning to reveal themselves more fully as parents are asked to kick out pocket cash to maintain school services, and attendance at food banks skyrockets. The average California unemployment check currently runs about 320.00 dollars a week. A wage rate of about 8.00 dollars an hour. Food Stamp benefits are even lower, and currently run at an average of about 100 dollars per person, per month. Perhaps that's why the government calls it the *Supplemental* Nutritional Assistance Program (SNAP) because those payment amounts would certainly not fund the core of a person's diet. As of late summer, Food Stamp usage in the big counties of California like Los Angeles and San Bernardino advanced well, well above 10% of the population. Interestingly, average food stamp usage rates in California are very close to the unemployment rate above 12.00%.

It is somewhat worrying, in addition, that California is currently liable to replace so much of its lost economy through transfer payments, at a time when gasoline and food prices are on the rise. Pump prices are back above three dollars a gallon in California. Rising dairy and meat prices mean that the meager food stamp and unemployment benefit is vulnerable to debasement. Indeed, should the purchasing power of these "coupons" decline substantially, both the Federal Government and Sacramento are going to find themselves in a new stage of crisis.

Fear of a Gold Planet



As if gold didn't need another reason to skyrocket higher, a quiet bomb was dropped last week as Robert Zoellick, current President of the World Bank, suggested gold should be considered as part of global currency reform. Despite this proposal being absent from [the lede in the Financial Times](#), which published the editorial, the news spread quickly. Many in the econo-blogsphere were not happy. Not mention the post-war economics establishment.

One ignored aspect of the ensuing debate, in which folks like Nouriel Roubini weighed in (negative), is that significant accumulation of gold and silver has been taking place globally for some time. Additionally, the position of the US Dollar as the world's reserve currency is now precarious, and to boot: Washington and the FED seem quite willing to use the dollar as a weapon to fight a trade war. So what's all the fuss? Perhaps it's that the "debate" over the return to some form of gold backing is rather moot at a time of competitive devaluation, and gold use is rising. Just this week, for example, the ICE told brokerage clients that [gold would be accepted as margin collateral](#).

Inflation and Borders



It would be an understatement to say China's inflation data spooked global markets last week. While the 4.5% figure met expectations, there was chatter that [the real inflation rate was nearly twice that](#). As a result, commodity markets started pricing in yet another rate hike in China, and that hit everything from Chinese equities to soybeans.

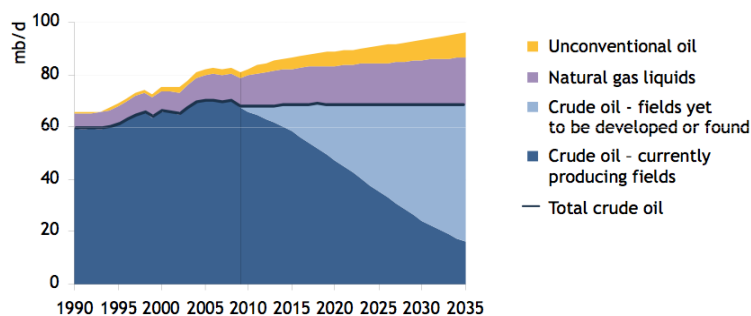
Intriguingly, this occurred in the same week that a number of very public fights broke out in the United States about the threat of inflation. One of the most high profile disputes graced the pages of the Wall Street Journal, after Sarah Palin made public remarks criticizing the FED, and warning of inflation risk. Palin was quickly dressed down by [Sudeep Reddy of the WSJ](#), but the rebuttal from Reddy was hollow, to say the least. Perhaps a larger consideration is at work here, and that's [the concept of Border Bias](#). If global markets fear inflation in China, why not fear inflation everywhere? After all, the whole world is seeing massive rises in the price of commodities, and "here" in the US input-cost profit-margin warnings have started. One thing is for sure: data, not politics, will settle these questions.

After last week's [California Muni Bond Shellacking](#), some remarked that this was a technical interference between that market and the flow of Build America Bonds--yet another program Washington has to distribute funding to the states. Maybe, but California has tapped that facility as well. What this means is that next year's projected 25 billion dollar budget shortfall is just a headline. The Golden State's future liabilities are piling up even faster than that figure indicates, and it appears the municipal bond market is finally getting wind of the reckoning. As the state comes to market with [another multi-billion dollar bond issuance](#), at around 14 billion, we wish good luck to the state's bond salesman Treasurer Bill Lockyear as it appears the capital markets are finally doing the math on California.

--Gregor Macdonald, 14 November—Amherst, MA

~(Absurd) Chart of the Week from IEA Paris~

World oil production by type in the New Policies Scenario



Global oil production reaches 96 mb/d in 2035 on the back of rising output of natural gas liquids & unconventional oil, as crude oil production plateaus

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