



# Things that make you go hmmm

## Never Say Never Again

"That men do not learn very much from the lessons of history is the most important of all the lessons that history has to teach."

– Aldous Huxley, *Collected Essays*

"History is moving pretty quickly these days, and the heroes and villains keep on changing parts."

– Ian Fleming

"... Looking at it in perspective, the fact that there would be a financial crisis was perfectly predictable: its general nature, if not its magnitude. Markets are always inefficient."

– Noam Chomsky

"And then one day when you're playing your little game you'll suddenly find yourself pinned down like a butterfly."

– Ian Fleming

"Would I say there will never, ever be another financial crisis? You know probably that would be going too far but I do think we're much safer and I hope that it will not be in our lifetimes and I don't believe it will be,"

– Janet Yellen

"He gazed up at the enormous face. Forty years it had taken him to learn what kind of smile was hidden beneath the dark moustache. O cruel, needless misunderstanding! O stubborn, self-willed exile from the loving breast! Two gin-scented tears trickled down the sides of his nose. But it was all right, everything was all right, the struggle was finished. He had won the victory over himself. He loved Big Brother."

– George Orwell, *1984*

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## THINGS THAT MAKE YOU GO HMMM...

# 007™

### NEVER SAY NEVER AGAIN

**M**aybe it's a universal truth with a far broader reach, but the role of James Bond is most certainly every *British* schoolboy's dream.

Weirdly two of the six men to have played the famous secret agent with the license to kill (sorry, but I'm not counting Barry Nelson or David Niven) have reached a point where they very publicly claimed they would never play the debonair spy again.

Daniel Craig famously told reporters he would "rather slash [my] wrists" than reprise his career-making role as 007 while Sean Connery's battles with producers Cubby Broccoli and Harry Saltzman were so acrimonious (Connery demanded more money to compensate him for the crushing media attention that came with the territory of playing Bond after he was photographed in a bathroom during the making of *You Only Live Twice* in 1967) that he walked, swearing that he would never again don the tuxedo and sip a shaken (not stirred) martini for the cameras.

However, after very publicly claiming he was done with Bond in 2015 and wanted to move on, Craig found himself plastered all over the media in July when he somewhat sheepishly climbed down (helped off his high horse, no doubt, by a large pile of cash waiting for him on terra firma).

**"Instead of saying something with style and grace, I said something really stupid"**, Craig said when explaining the foolhardiness of his earlier definitive statement about his being *done* with Bond.

Connery was equally resolute, claiming in 1971 after having been lured back by Broccoli (the producer, not the vegetable) to star in *Diamonds Are Forever*, that he would 'never' play MI6's most famous son again.

Twelve years later, Connery (with dodgy hairpiece in place) dusted off his Walther PPK once more as a feud between the Bond producers which dated two decades erupted:

***(Fox News): Broccoli and Saltzman hit a snafu with the fourth film "Thunderball," which would haunt the franchise all the way up to "Casino Royale" in 2006. Producer Kevin McClory, a close friend to Ian Fleming, claimed ownership of the story to "Thunderball" and cried plagiarism. After settling a lawsuit, Fleming gave McClory future filming rights to "Thunderball." Broccoli and Saltzman, in an attempt to keep Bond in their family, made a deal with McClory to make "Thunderball," under their brand and gave him the sole producer credit.***

***Saltzman and Broccoli thought the worst was behind them after “Thunderball,” but in 1983, McClory remade the Bond film with Warner Bros. as “Never Say Never Again.” McClory had managed to break Fleming’s character away from United Artists’ hold.***

***To add salt into an already open wound, McClory hired Sean Connery to return as Bond!***

As McClory’s production team searched for a clever title for what was no more than a remake of *Thunderball*, Connery’s wife, Micheline, suggested something which fit perfectly with the nod-and-a-wink that permeated so much of the Bond movie franchise. As a sly reference to her husband’s previous (and very public) abandonment of the spy, why not call the movie *Never Say Never Again*, Mrs. Connery playfully suggested?

McClory’s production team liked the idea so much (they thought the title would give them valuable press in the battle against Roger Moore’s portrayal of Bond in *Octopussy* which was released simultaneously), they not only used it as the film’s title, but they added a line to the closing credits:

***“Title “Never Say Never Again” by: Micheline Connery”***

Definitive public declarations like those made by Craig and Connery are never a good idea (damn, you see what I did there?) but, when all is said and done, an actor going back on such a statement usually involves a very simple, very straightforward, very easy to understand motive; money. Not only that, but it’s a stretch to think that anybody’s life changed as a result of taking said actor at their word.

However... when it comes to public figures who *aren’t* in the entertainment business, things change very quickly. When those public figures just happen to sit at the head of, for example, a central bank, then the ramifications of such statements take on a level of gravity which makes them positively dangerous.

We’ll get back to central bankers shortly (of course), but before we do, let’s dip our toes into the dangers of making declarative statements in the financial world with a reminder of a few words uttered by a famous economist from the great state of New York all the way back in 1929.

October, 1929.

October 16th, 1929 to be precise. Nine days before Black Tuesday (or the Wall Street Crash of 1929, if you prefer):

***(New York Times): Stock prices have reached what looks like a permanently high plateau,” Irving Fisher, Yale economist, told members of the Purchasing Agents Association at its monthly dinner meeting at the Builders Exchange Club, 2 Park Avenue, last night. Professor Fisher spoke on the subject of investment trusts and presented a defense for them against recent attacks in which they have been charged with responsibility for many present evils.***

***After discussing the rise in stock values during the past two years, Mr. Fisher declared realized and prospective increases in earnings, to a very large extent, had justified this rise, adding that “time will tell whether the increase will continue sufficiently to justify the present high level. I expect it will.***

***I believe the principle of the investment trusts is sound,” Mr. Fisher summed up, “and the public is justified in participating in them with due regard to the character and reputation of those conducting them...”***

Fisher then tipped his hat to another well-known (though recently less well-regarded thanks to his prognostications of impending doom) economist, Roger Babson in as far as margin debt was concerned:

***“But I agree with Roger W. Babson that many market operators had better get out of debt and out of margin account, that there is some unwarranted speculation, and that the market may be at its peak now and for several months to come...”***

However, having come so far, Fisher let his bubbling enthusiasm get the better of him, leading to one of those declarations of belief which, nearly 100 years later, still haunt him no matter how much good work he did in the rest of his career:

***“While I will not attempt to make any exact forecast, I do not feel that there will soon, if ever, be a fifty or sixty-point break below present levels as Mr. Babson has predicted.”***

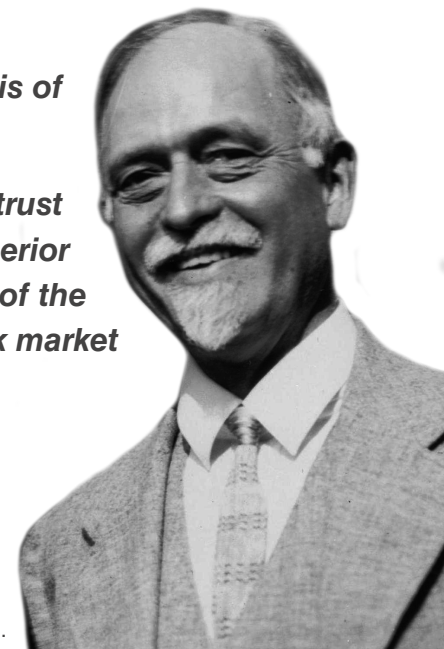
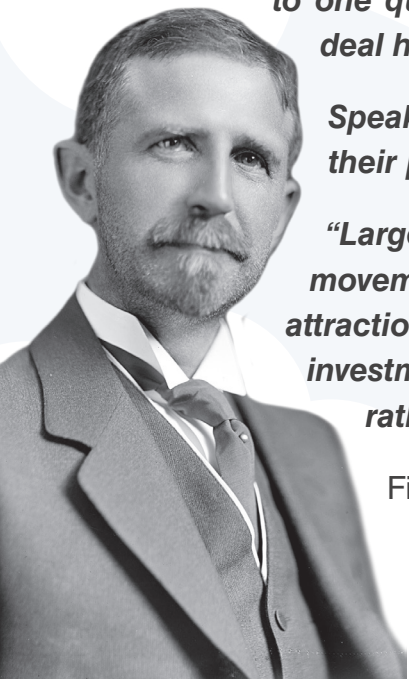
Finally, after having somewhat deferentially pooh-poohed Babson in his prepared remarks, Fisher made the cardinal speaker’s sin when prompted to answer a few questions from the audience; near-unqualified optimism:

***While the tone of his address proper reflected a moderate optimism, in the informal questioning which followed, Professor Fisher fell into almost unqualified optimism. In reply to one question, he declared that he expected to see the stock market a good deal higher than it is today, within a few months.***

***Speaking specifically of investment trusts, and his analysis of their proper value and function, Mr. Fisher said:***

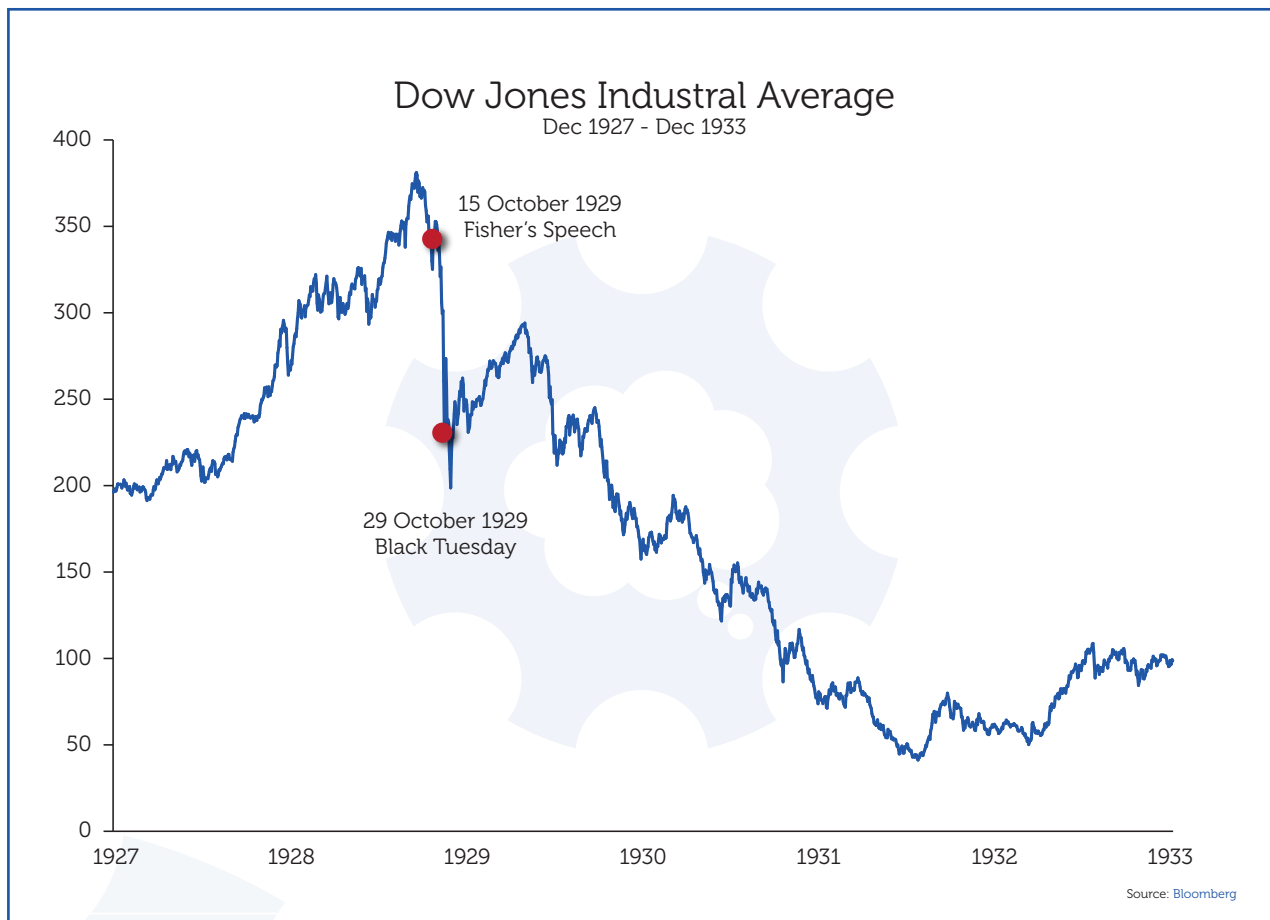
***“Largely through the influence of the investment trust movement, the public has been waking up to the superior attraction of stocks over bonds. And I believe the operation of the investment trusts as a whole has acted to stabilize the stock market rather than to make its fluctuations more violent.***

Fisher then explained why that time was different:



***“These investment trusts have applied special knowledge to diversifying risks. They diversify their holdings among many kinds of common and preferred stocks and bonds, foreign and domestic. They operate to shift risks from those who lack investment knowledge to those who possess it. In this way they are safeguarding the public whose speculative activities are gravitating into the hands of these skilled agencies which are able to forecast the true income of otherwise speculative properties.”***

What happened next is the stuff of legend.



More importantly than the crash itself, perhaps, is the fact that it took a quarter of a century for the Dow Jones Industrial Average to make a new high (as you can see in the chart on the next page).

At the time Fisher made his statement about the ‘permanently high plateau’ (oh Irving... ‘Permanently’? Really? You’re a smart guy, dammit), it would have been easy to nod and accept what he suggested.

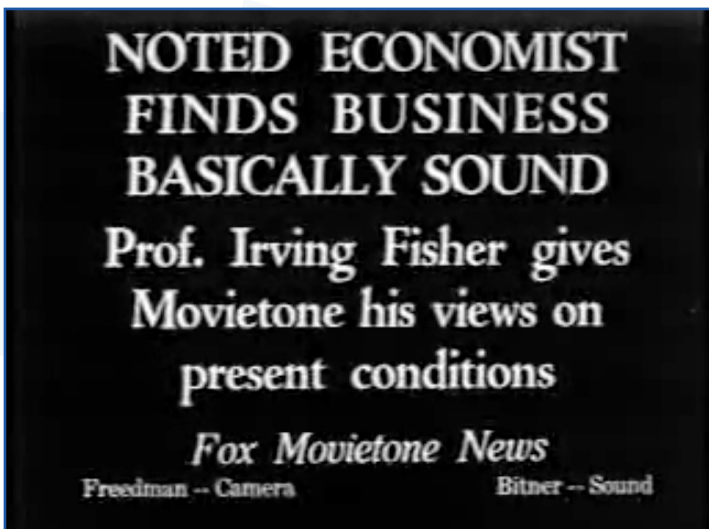
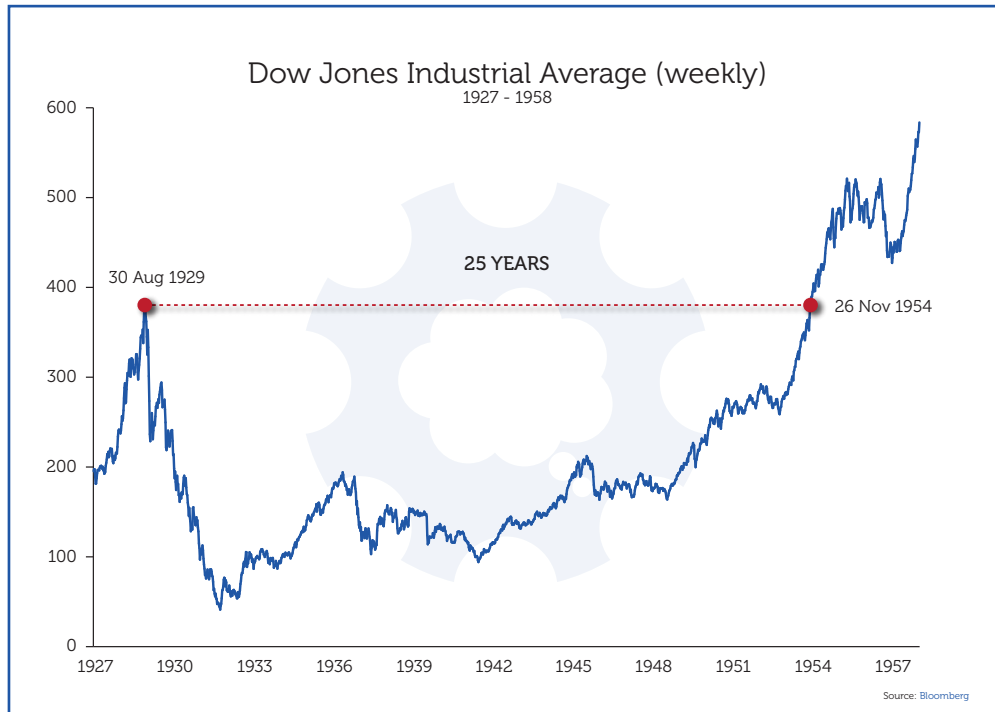
The Dow Jones had been climbing for eight years and the index had increased sixfold during that time but, having been made to look foolish by the 11% fall on October 24 (‘Black Thursday’ – just 9 days after his proclamation), the 13% fall on October 28 (‘Black Monday’) and the following day’s 12% decline (‘Black Tuesday’), Fisher declared the slide to be ‘only temporary’.

Fisher appeared on Fox Movietone News to offer some comfort to those hurt by the stock market crash:

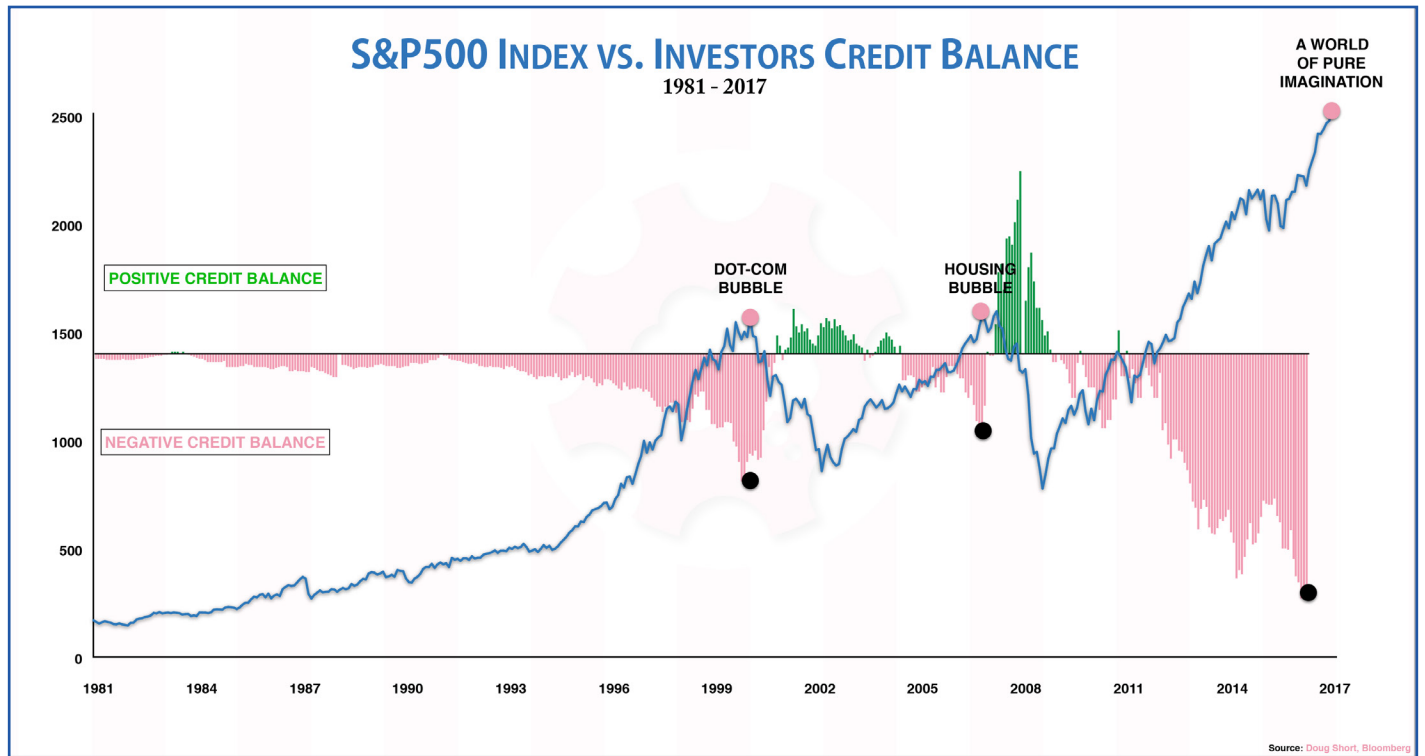
*“Stocks have fallen in a week, thirty percent and a week ago they had fallen some ten percent from the previous high of this year. The real reason, as I understand it, for this drop is that people have been speculating on small margins. It was not that the stock market was very much too high but that people were so enthusiastic about*

*making the money they properly expected to make in the investment of stocks tried to do business on a shoestring. They went into debt and the real lesson of this market is, if you buy stocks, buy them with your own money and not with borrowed money any more than can be helped.*

*If that lesson is learned, possibly in the end, this experience, to some people, may be a blessing in disguise. This country is fundamentally sound and the technical situation in the stock market is not going to prevent the great improvement, progressive improvement in our wonderful, prosperous country”*



Does any of what Fisher said sound even remotely familiar when pondering the modern-day financial landscape (apart from the blindly optimistic outlook, obviously)? No?



How about now?

Yes, once again speculators have failed to heed what Fisher himself pointed out as the ‘real lesson’ of the 1929 Crash:

***“...if you buy stocks, buy them with your own money and not with borrowed money any more than can be helped.”***

Of course, that is the whole point, isn't it? Investors *have* been helped – deliberately helped to go into an utterly obscene amount of debt, by almost a decade of zero interest rates. Is it any real wonder that they have been sucked once again into making the same mistakes that wiped out so many people (including Fisher himself) the last time a leverage-fueled speculative frenzy swept Wall Street?:

***(Time): After witnessing nearly a decade of growth, most economists, investors, and captains of industry believed that the market’s natural direction was up. The beginning of the crash struck them not as a sign of financial doom, but as an opportunity for bargains. Following the first of the black days, the New York Times was full of positive predictions: “I have no fear of another comparable decline,” said the president of the Equitable Trust Company.***

***Many of those optimists, including Fisher, went broke by mid-November.***

The dates change, the mistakes remain the same.

After making his declarative statement about ‘permanence’ in markets, Fisher (a widely-respected economist in 1929) was exposed as a man who knew as much about the future as every other investor – which is to say nothing – and his reputation was destroyed.

Fisher spent the rest of his life trying to understand what had happened and how he could have been so wrong and his conclusions will bring a wry smile to the most solemn of faces:

***(Time): [Fisher] went on to develop a new theory about what had triggered the crash: overly liberal credit policies that encouraged Americans to take on too much debt, as he himself had done in order to invest more heavily in stocks. By then, however, no one was listening. His theory didn’t gain traction until the 1950s, when, years after his death, Harvard economist Milton Friedman pronounced him “the greatest economist the United States has ever produced.” Fisher’s debt-deflation theory found its way into the spotlight again when overgenerous credit lines and huge debts prompted another U.S. market crash – this time in 2008.***

However, as ridiculous as using the words ‘permanently high plateau’ were, the sole reason his words are remembered 88 years later is his public profile at the time.

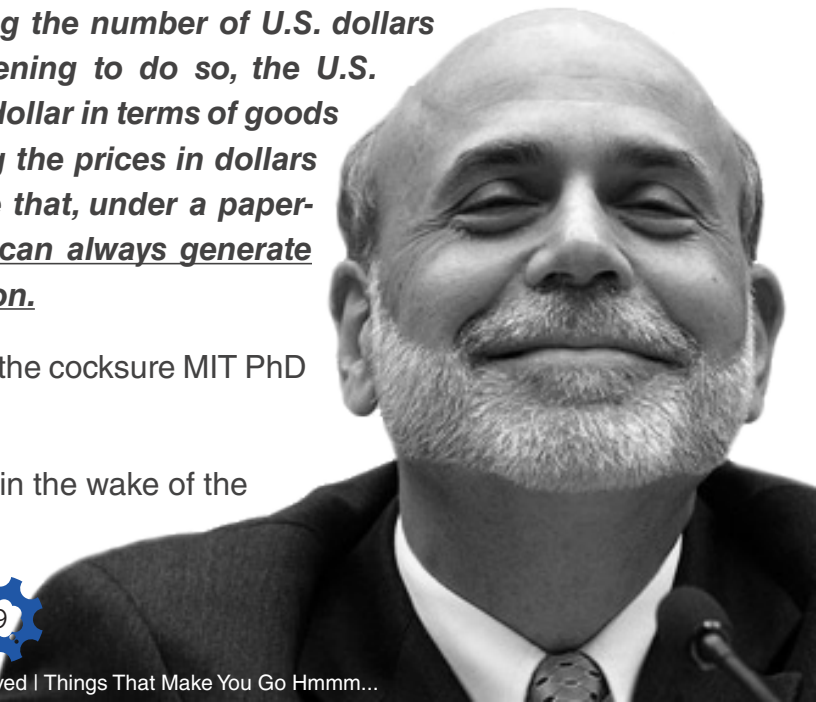
That ought to be enough, right? That ought to discourage other PhD-level intellectuals from speaking in such absolutes.

In November 2002, another preeminent economist of his time, Ben Bernanke, gave a speech at the National Economists Club in Washington, D.C. in which he too made a declarative statement:

***(Ben Bernanke): ...the U.S. government has a technology, called a printing press (or, today, its electronic equivalent), that allows it to produce as many U.S. dollars as it wishes at essentially no cost. By increasing the number of U.S. dollars in circulation, or even by credibly threatening to do so, the U.S. government can also reduce the value of a dollar in terms of goods and services, which is equivalent to raising the prices in dollars of those goods and services. We conclude that, under a paper-money system, a determined government can always generate higher spending and hence positive inflation.***

This time, instead of ‘permanent’ it was ‘always’ that the cocksure MIT PhD graduate offered the world.

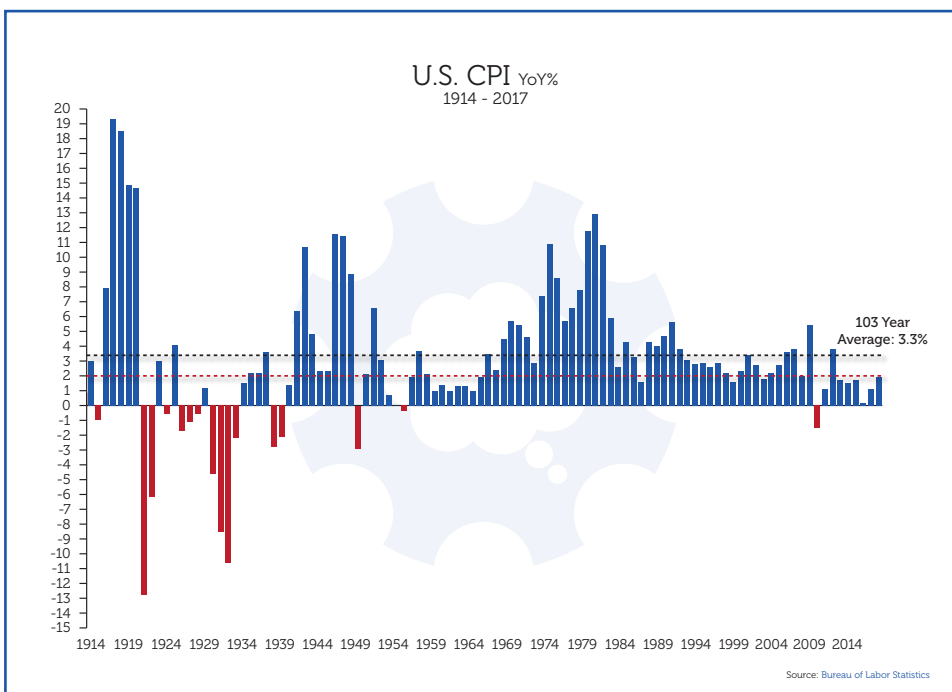
The same way Fisher had defended his assertions in the wake of the ‘29 Crash, Bernanke, too, doubled down:



*(The Atlantic): ...Bernanke defended the Fed's decision to buy up \$600 billion in Treasury securities against critics who claim the action could be inflationary, and said the Fed might purchase more in order to keep interest rates low, ward off deflation, and fuel economic growth.*

*“We’ve been very, very clear that we will not allow inflation to rise above 2 percent,” he explained, adding that the Fed isn’t printing more money with its purchase of Treasury*

*bonds, as some detractors suggest, and that it can raise interest rates instantaneously if inflation becomes a concern. When Pelley asked Bernanke what degree of confidence he had in his ability to control inflation, the Fed chairman responded, “one hundred percent.”*

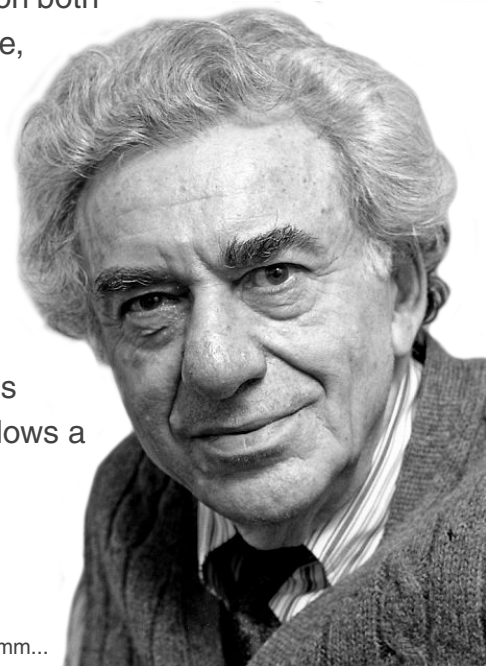


The chart, above right, shows U.S. CPI YoY going back to 1914 – the first year of the Federal Reserve’s operation.

To save you some time, I have added a red dotted line to show the level Bernanke was “100% confident” the FOMC would not allow inflation to rise above as well as a dotted black line showing the 103 year average rate of 3.3%.

Bernanke is widely acknowledged as one of the world’s leading authorities on both the Great Depression and deflation (for those of you with the intestinal fortitude, try Bernanke’s [Essays on the Great Depression](#)) so one would be safe in assuming that he has more than a passing familiarity with Fisher’s work on debt-deflation (and the development of that work by Hyman Minsky – he of the Minsky Moment). However, given the thrust of this week’s *Things That Make You Go Hmmm...*, it would be remiss of me to make assumptions so here is a little primer on Fisher’s theory.

According to his work, Fisher found that, when a credit-fueled bubble bursts (as they all inevitably do), a chain reaction is set off. That chain reaction follows a script which many of you will no doubt find comfortably familiar:



1. Debt liquidation and distress selling.
2. Contraction of the money supply as bank loans are paid off.
3. A fall in the level of asset prices.
4. A still greater fall in the net worth of businesses, precipitating bankruptcies.
5. A fall in profits.
6. A reduction in output, in trade and in employment.
7. Pessimism and loss of confidence.
8. Hoarding of money.
9. A fall in nominal interest rates and a rise in deflation-adjusted interest rates.

Any of that look familiar?

Of course, number 9 has been shunted to the front of the line at the first sign of any deflationary pressure in recent years as a means of trying to mitigate (or at least cushion) the impact of numbers 1 through 8.

Minsky is something of a hero to post-Keynesian school economists (a group of men and women who count the likes of Robert Skidelsky, Steve Keen, J.K. Galbraith, Michael Hudson and Stephanie Kelton amongst their number) so you can likely imagine their reaction to the fact that, in Bernanke's nine collected essays on the Great Depression, there is a single reference to Minsky (in Part 2, page 43):

***(Ben Bernanke): "Hyman Minsky (1977) and Charles Kindleberger (1978) have ... argued for the inherent instability of the financial system but in doing so have had to depart from the assumption of rational economic behaviour<sup>1</sup>."***

Now, that seems scant justice to Minsky's work (to say nothing of Kindleberger) but the last part of that sentence is highly instructional.

A gentle amble to the footnotes at the bottom of the page in question yields an even deeper understanding of the way Bernanke sees the world:

***"I do not deny the possible importance of irrationality in economic life; however it seems that the best research strategy is to push the rationality postulate as far as it will go."***

And there you have it.

The idea (which seems widespread amongst the tenured academic economists who sit at the heads of central banks) that irrationality in economic life should be dismissed wherever possible may make the creation of models that much easier, but it does a great disservice to those of us in their thrall.

Boiling it down to its simplest form, investor behaviour is governed by the twin emotions of greed and fear – neither of which is rational (OK... fine...I'll accept that rational fears exist. Fears such as being stuck in an elevator with the entire Kardashian family or those weird troll dolls) – so to try and take every possible opportunity to remove 'economic irrationality' from the question is ridiculous.

However, the fact that Bernanke and his ilk are at pains to try and do that goes a long way to explaining the latest example of this kind of hubristic nonsense:

***(Reuters): “Would I say there will never, ever be another financial crisis?” Yellen said at a question-and-answer event in London.***

***“You know probably that would be going too far but I do think we’re much safer and I hope that it will not be in our lifetimes and I don’t believe it will be,” she said.***



Yes, I know you’ve seen that comment and you probably rolled your eyes at it just as I did, but the foolhardiness of such a declaration bears expansion – if for no other reason than the fact that it emanated from the most powerful woman in the world (sorry Theresa but... well, no).

Now, had Janet offered *her* lifetime as the timeframe in question then, frankly, at 71 a case could have been made, but she chose our lifetimes...and that calls for an entirely different examination.

Let’s begin in a time that most definitely precedes *our lifetimes* .:

***(Otto Lightner, History of Business Depressions): “The important firm of Seuthes and Son, of Alexandria, was facing difficulties because of the loss of three richly laden ships in a Red Sea storm, followed by a fall in the value of ostrich feather and ivory. About the same time the great house of Malchus and Co. of Tyre with branches at Antioch and Ephesus, suddenly became bankrupt as a result of a strike among their Phoenician workmen and the embezzlements of a freedman manager.***

***These failures affected the Roman banking house, Quintus Maximus and Lucious Vibo. A run commenced on their bank and spread to other banking houses that were said to be involved, particularly Brothers Pittius.***

***The Via Sacra was the Wall Street of Rome and this thoroughfare was teeming with excited merchants. These two firms looked to other bankers for aid, as is done today. Unfortunately, rebellion had occurred among the semi civilized people of North Gaul, where a great deal of Roman capital had been invested, and a moratorium had been declared by the governments on account of the distributed conditions. Other bankers, fearing the suspended conditions, refused to aid the first two houses and this augmented the crisis.”***

These events occurred in 33 A.D. but, from that one storm and the resultant loss of three ships, the ramifications were both severe and far-reaching:

***(Bryan Taylor): When Publius Spencer, a wealthy nobleman, requested 30 million sesterces from his banker Balbus Ollius, the firm was unable to fulfill his request and closed its doors. Over the next few days, prominent banks in Corinth, Carthage, Lyons and Byzantium announced they had to “rearrange their accounts,” i.e. they had failed. This led to a bank panic and the closure of several banks along the Via Sacra in Rome. The confluence of these seemingly unrelated events led to a financial panic.***

***To protect themselves, banks began calling in some of their loans. When debtors could not meet the demands of their creditors, they were forced to sell their homes and possessions, and with money unavailable even at the legal limit of 12%, prices of real estate and other goods collapsed since there were so few buyers. A full scale panic followed. The panic occurred not only in Rome, but throughout the Empire.***

**(a quick trip back to the top of page 11 will show the first four dominoes of Fisher’s debt deflation falling in perfect sequence to begin what is the earliest recorded financial panic)**

Without rehashing every financial crisis of the last two millennia, if we move forward to the 18th century, we find financial crises occurring in 1720, 1763, 1769, 1772, 1785, 1792 and 1796. These crises encompassed France, the United Kingdom, The Netherlands, Germany, Scandinavia, India and the United States, while the 19th century was a hotbed of financial crisis as the table below shows:

Year	Panic	Country
1813	Danish state bankruptcy	Denmark
1815	Post-Napoleonic depression	Great Britain
1819	Panic of 1819	United States
1825	Panic of 1825	Great Britain
1837	Panic of 1837	United States
1847	Panic of 1847	Great Britain
1857	Panic of 1857	United States
1866	Panic of 1866	Great Britain
1873 - 1896	Great Depression of British Agriculture	Great Britain
1873 - 1986		
	1873 U.S. Recession/Depression	United States
	1884 Panic of 1884	United States, Europe
	1890 Barings Crisis	Great Britain
	1893 Panic of 1893	United States
	1893 Australian Banking Crisis	Australia
	1896 Panic of 1896	United States

The 20th century contained 25 fully-fledged financial and economic crises including a bunch of old favourites like the Panic of 1907, the Great Depression, the 1970s Oil Shock, the Latin American debt crisis and the Savings & Loan Crisis as well as Black Monday, the Asian financial crisis and panics in Finland, India, Mexico, Russia, Argentina (of course) and Asia.

Hell, the 1990s alone saw TEN financial crises.

What's more, the pace has picked up in the 21st century with 13 individual crises in the first 17 years of the century (and that is extremely generous as it wraps about ten individual national crises into the 2007 - 2009 Great Recession).

The point is, Yellen's claim that there will be no more financial crises in our lifetimes is utter hogwash bullshit.

My firm belief is that the next one will occur while those words of hers are still ringing in our ears and will make her look as foolish today as Fisher did in 1929.

Worryingly, however, the academic/central bank hubris has this week finally crossed over to the private sector:

***(Dallas Morning News): American Airlines CEO Doug Parker says the once-volatile industry has changed so radically that his company will never lose money again.***

***Even in a bad year, Parker says, the world's biggest airline should earn about \$3 billion in profit before taxes...***

***From 1978 through 2013, American's cumulative profit was \$1 billion. By the end of this year, Parker says, the Fort Worth-based airline will have earned \$19.2 billion in pretax income in the last four years.***

***Airlines have benefited in that span from lower fuel prices, higher revenue from fees, and less competition because of mergers. American, Delta, United and Southwest control more than 80 percent of the U.S. air-travel market.***

***"I don't think we're ever going to lose money again," Parker said. "We have an industry that's going to be profitable in good and bad times."***

Why do people say such things? Especially people like Doug Parker.

Parker was named CEO of America West Airlines (an airline with a long history of losing money and which had spent three years in bankruptcy in the 1990s) on September 1, 2011 and it was under his stewardship that the company received federal loan guarantees to prevent further bankruptcy in the dark days for the airline industry after the 9/11 terrorist attacks on the World Trade Center.

In 2005, America West merged with U.S. Airways – which was under Chapter 11 bankruptcy protection at the time – with Parker continuing as CEO, preferring to keep the U.S. Airways brand alive and then, in 2013, U.S. Airways bought the then-bankrupt American Airlines out of Chapter 11 and the two merged to create the all-new American Airlines.

The same American Airlines which, apparently, will ‘never lose money again’ in an industry which will (join in with the chorus folks) ‘make money in good times and bad’.

The table (right) shows U.S. airlines which have filed for Chapter 11 since 1979. Those shaded red ceased operations while those shaded green were acquired or merged.

Tough industry, the airline business.

But don’t take my word for it – here’s Forbes’ assessment of Parker’s comments:

***(Forbes): True, American earned just over \$1 billion in first-half profits this year. And all North American carriers combined earned \$15.4 billion in the first six months of 2017. But carriers this year are benefiting from fuel prices that are less than half what they were, on average, in 2013. Back then, the industry paid an average of \$3.07 a gallon. Last year, it paid just \$1.46. And so far this year, the average is about the same, although prices have recently spiked into the \$1.70-\$1.95 range in the wake of Hurricane Harvey, which disrupted oil production in the Gulf of Mexico and refining and pipeline operations in southeast Texas in late August.***

***In fact, last year, when American by itself earned \$2.7 billion, U.S. airlines combined to report “just” \$13.5 billion in net profits, down \$11.3 billion from the \$24.8 billion they earned in 2015. They experienced that staggering 45.6% decline in profits in 2016 despite the fact that they paid 36 cents, or 20%, less per gallon for jet fuel than in 2015.***

***Does that sound to you like an industry that’s so stable it could never possibly lose money again?***

Airline	Year
New York Airways	1979
AeroAmerica	1979
Florida Airlines	1980
Indiana Airlines	1980
Air Bahia	1980
Tejas Airlines	1980
Mountain West Airlines-Idaho	1981
LANICA	1981
Coral Air	1981
Pacific Coast Airlines	1981
Swift Aire Lines	1981
Golden Gate Airlines	1981
Pinehurst Airlines	1982
Silver State Airlines	1982
Air Pennsylvania	1982
Air South	1982
Cochise Airlines	1982
Braniff International	1982
Astec Air East	1982
Will’s Air	1982
Aero Sun International	1982
Aero Virgin Islands	1982
Altair Airlines	1982
Continental Airlines	1983
Frontier Airlines	1986
Eastern Airlines	1989
Partnair	1991
Pan American World Airways	1991
America West Airlines	2002
Sun Country Airlines	2002
National Airlines	2000
Trans World Airlines	2001
US Airways	2002
United Airlines	2002
Air Canada	2003
Flash Airlines	2004
US Airways	2004
Aloha Airlines	2005
Northwest Airlines	2005
Delta Air Lines	2005
Maxjet Airways	2007

The deeper you dig, the more outlandish Parker's claims become:

***(Forbes): Until 2014 the U.S. airline industry was still showing a net-negative number in the "profits" category.***

***For the first almost 85 years of their existence U.S. airlines were cumulatively still in the red. And even if you include the \$55.7 billion the industry has earned in the previous four years, their cumulative historical return on invested capital is staggeringly negative.***

***And that's not even counting the hundreds of billions of invested dollars written off in the dozens of bankruptcies that litter the industry's history.***

Indeed, the list of potential pitfalls that airlines have to navigate is, to quote the late Nick 'Goose' Bradshaw (I bet you never knew that was his full name!!), long but distinguished.

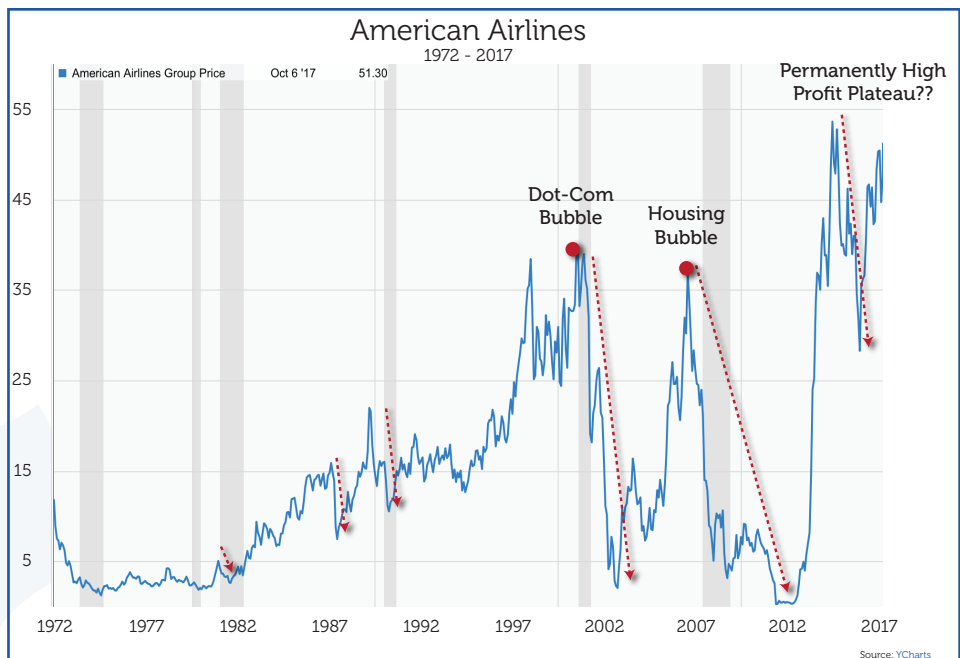
Leaving aside those volatile oil prices, the airline industry's high fixed costs leave them vulnerable to union action (not a good place to be as the squeezing of the middle class continues apace) while a recession habitually plays merry hell with airlines' profitability (need I remind you that we are nearing the second-longest expansion in U.S. history?)

Let's see, what else? Did I mention the fact that airlines tend to get stuck with too many of the wrong type of plane periodically due to changing customer tastes?

By 'periodically' I mean 'regularly'. It happened in the 1940s, 1950s, late-1960s, 1970s, early-1980s and again in the 2000s.

Meanwhile, the international markets (where the big U.S. carriers currently make the lion's share of their profits) are becoming not only more competitive, but far more difficult to navigate profitably as this piece of news (which hit the wire in the U.K. a mere four days after Parker's press conference) demonstrates perfectly:

Airline	Year
Aloha Airlines	2008
ATA Airlines	2008
Skybus Airlines	2008
Frontier Airlines	2008
Eos Airlines	2008
Sun Country Airlines	2008
Primaris Airlines	2008
Mesa Airlines	2010
Arrow Air	2010
Mexicana	2010
American Airlines	2011
Ryan International Airlines	2012
Pinnacle Airlines	2012
Southern Air	2012
SeaPort Airlines	2016
Republic Airways Holding	2016
PenAir	2017

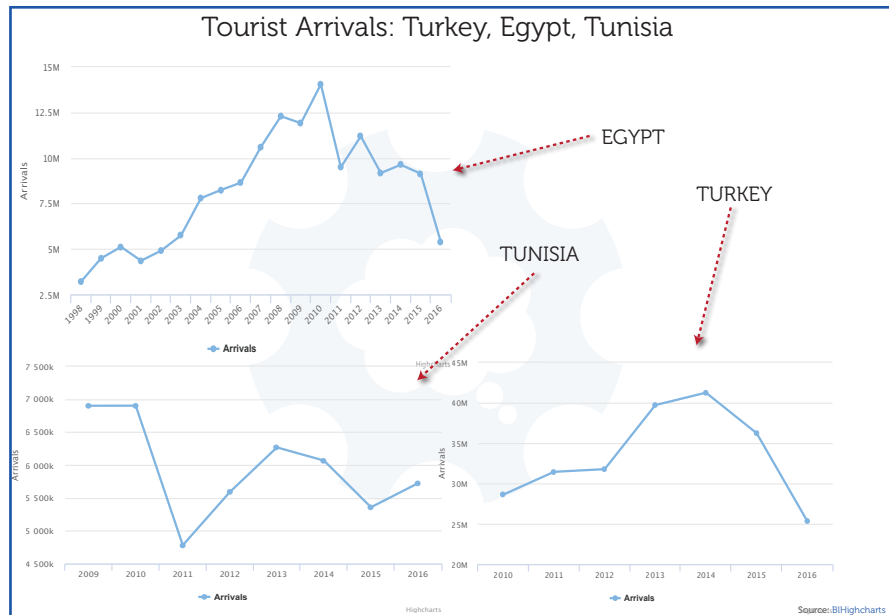


***(BBC News): Monarch Airlines has ceased trading and all its future flights and holidays have been cancelled, affecting hundreds of thousands of customers.***

***About 860,000 people have lost bookings and more than 30 planes will be sent by the Civil Aviation Authority to return 110,000 holidaymakers who are overseas.***

***Monarch employs about 2,100 people and reported a £291m loss last year.***

***Terror attacks in Tunisia and Egypt, increased competition, and the weak pound have been blamed for its demise.***



Now, the U.K.'s Monarch Airlines is no American Airlines competitor. It's a low-budget carrier which services largely fringe European tourism destinations (Turkey, Tunisia and Egypt were three of the carrier's big hubs) BUT... this was still the biggest airline bankruptcy in British aviation history.

The company was founded by the Mantegazza brothers in 1967 with two planes but had grown in the intervening half century to consist of a fleet of 34 planes and a staff of 3,000.

In 2015, the airline carried 5.7 million tourists to various holiday destinations (though that number was down on the 7 million who had flown Monarch during the previous year).

Britain's other two low-cost airlines, Ryanair and Easyjet, saw their share prices jump on the news of Monarch's demise on hopes of increased market share, but a few days later, the Easyjet share price came under pressure as its Q4 earnings suggested the company's revenue-per-passenger metric had fallen 3.7% on the previous quarter.

The UK Daily Telegraph's reporting of the announcement highlighted just how tricky the airline business can be:

***(UK Daily Telegraph): The fall comes as the airline industry struggles with too many available seats on flights. While some airlines have cooled the level of seat growth they had planned since the Brexit referendum last year, the low oil price has helped airlines keep a higher number of seats in the air than they might otherwise be able to do.***

***A vicious price war has also seen carriers fighting to cut fares. EasyJet said flights to beach destinations from the UK in particular had seen prices fall sharply...***

***In spite of pressures in the airline industry, with the collapse of Monarch Airlines this week and a raft of cancellations announced by Ryanair, easyJet said it would increase its seat capacity by 6pc in the next 12 months even though it expected downward pressure on ticket prices to persist.***

Airlines are notoriously fragile and incredibly sensitive to three inherently unstable factors; currency fluctuations, oil prices and economic recessions.

Leaving 2007-2009 aside, a report by Dawna L. Rhoades entitled: Crisis in a Fragile Industry: Airlines Struggle to Survive in an Uncertain Future, took a look at the airline industry amidst the shallow and short-lived recession of 2000-2001 in the United States.

What she found ought to make Doug Parker wince:

***(Dawna L. Rhoades): In early 2001, the U.S. airline industry was already feeling the effects of one of its great historical enemies—economic recession—and expected to lose \$3 billion.***

***Economic recession exposes overcapacity in the market— too many seats and not enough passengers. As demand falls, prices decline as carriers scramble to fill seats and retain market share. This tends to place further cost pressure on carriers struggling from declining yields, the difference between cost per available seat mile and revenue per available seat mile.***

***The industry then experiences a series of bankruptcies and consolidations before the cycle begins again.***

***The last U.S. recession in 1990–1991 combined with another perennial enemy of aviation, war (in this case, the Gulf War of the early 1990s), to produce industry losses of \$10 billion. These losses would pale in comparison to those of the current [2000-2001] crisis.***

***In fact, the first decade of the twenty-first century has been the “Perfect Storm” for the global airline industry that has experienced a confluence of four distinct factors.***

***Two of these factors have a long history of creating problems for the industry—economic recession and war. The other two factors were new—the 9/11 terrorist attacks and potentially severe contagious diseases such as Severe Acute Respiratory Syndrome (SARS) and bird flu.***

***Together these factors created a crisis that resulted in worldwide airline losses greater than all the profits made in the industry since the 1903 flight at Kitty Hawk by the Wright Brothers.***

As recently as 2012, IATA head, Tony Tyler’s ‘State of the Industry’ speech in Beijing focused on the difficulties inherent in the airline industry:

*(Tony Tyler): ...the state of our industry is fragile.*

*Over the last decade airline revenues totaled \$4.6 trillion. We were among the world’s fastest growing industries. But our best annual profit margin of the century so far was 2.9%. And the overall result has been a net loss of \$16 billion.*

*2012 is another challenging year. We expect revenues of \$631 billion but a profit of just \$3.0 billion. That’s a 0.5% net margin.*

*And that projection comes with some serious downside risks...*

*... The biggest and most immediate risk, however, is the crisis in the Eurozone. If it evolves into a banking crisis we could face a continent-wide recession, dragging the rest of the world and our profits down.*

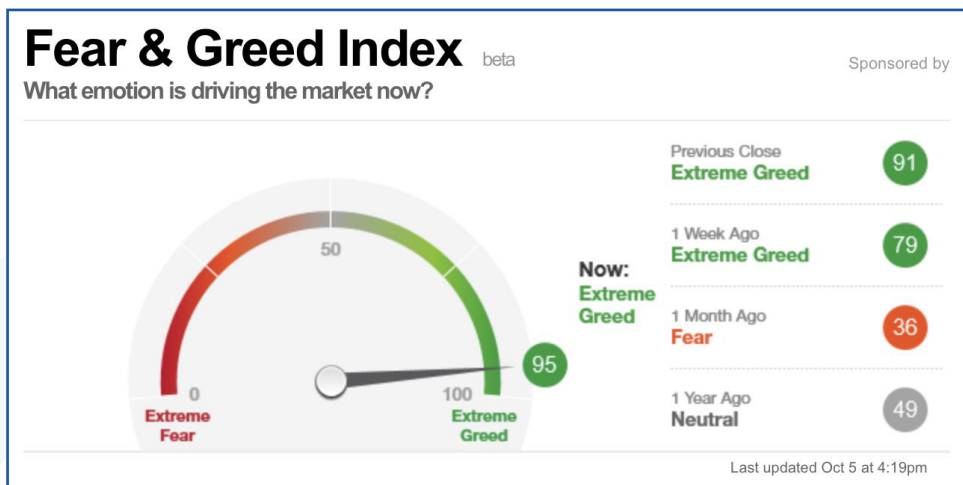
*The industry’s profitability is balancing on a knife edge. If the bottom line worsens by even the equivalent of just 1% of revenue, our \$3 billion profit very quickly becomes a \$3 billion loss.*

*Furthermore, competition to deliver value is as tough as ever. A web search priced economy fares for the 22,000 kilometer round-trip from New York to Beijing in the range of \$1,500. That’s seven cents per kilometer. By comparison, a New York taxi ride costs \$1.25 per kilometer, or 31 cents with four passengers on board...*

*Aviation is a complex global business. It’s not an easy one to manage. Profits, when we have them at all, are razor-thin. And keeping revenues ahead of costs is a never-ending challenge.*

That’s some place from which to make claims of eternal profitability, Doug.

Unfortunately, we can’t short remarks like Bernanke’s or Yellen’s, nor can we take the other side of pronouncements like those made by Fisher or Parker, but we *can* pay attention and note that these comments (as well as the kind of sentiment apparent in the gauge, right) tend to occur immediately before major moves in the opposite direction.





Peter Atwater ([@Peter Atwater](#)) of [Financial Insights](#) does incredible work in assessing when mood and sentiment may have reached extremes and all his warning lights are flashing bright red.

*(If you're not aware of Peter then I strongly advise you to rectify that and, at the very least, follow him on Twitter – you'll be glad you did in the coming weeks and months I suspect)*

For the time being, every asset class in the investing universe seems to have reached another permanently high plateau. I think we all know, deep down, that such an idea is not only ludicrous, but the very fact that sentiment has reached the levels spotted by my good friend Jonathan Tepper ([@jtepper2](#)) this weekend should have every one of you checking your portfolio.

**CNN Money** International + Markets Economy Companies Tech Autos India Video

Markets Now

The Dow could be so hot that it melts

**BARRON'S** ASIA EDITION U.S. EDITION

UP AND DOWN WALL STREET

**The Meltup Before the Storm?**  
Signs of a market top are emerging, but shares could move even higher b

**MarketWatch** f t in g+

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**Some investors see signs stock market 'on verge' of a melt-up**

Published: Oct 7, 2017 4:46 p.m. ET

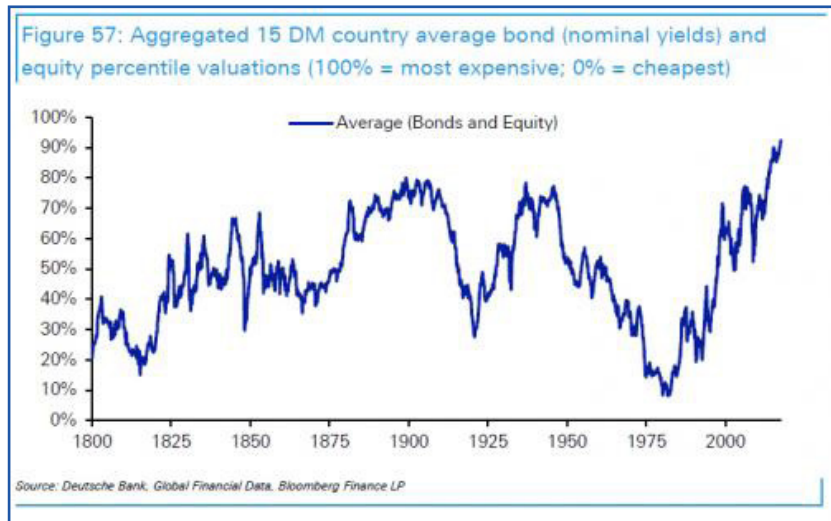


And while none of this is news to readers of *Things That Make You Go Hmmm...*, the fact that it is finally making it into investment bank research is yet another sign that things could well be about to blow:

**(Deutsche Bank): Figure 57 updates our analysis looking at an equal weighted index of 15 DM government bond and 15 DM equity markets back to 1800. For bonds we simply look at where nominal yields are relative to history and arrange the data in percentiles.**

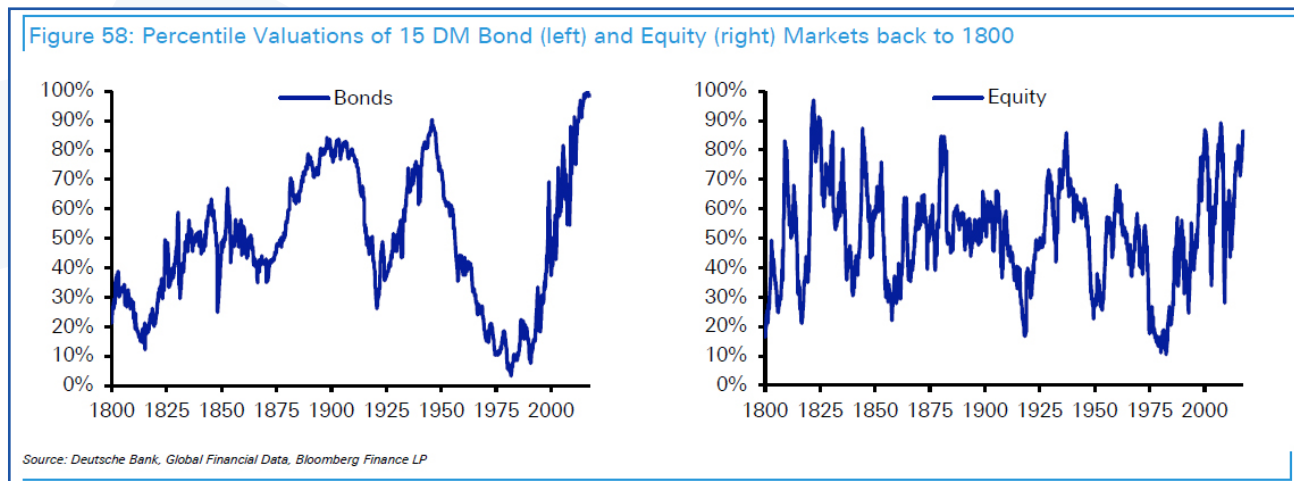
**So a 100% reading would mean a bond market was at its lowest yield ever and 0% the highest it had ever been. For equities valuations are more challenging to calculate, especially back as far as we want to go.**

**In the 2015 study ('Scaling the Peaks') we set out our current methodology but in short we create a long-term proxy for P/E ratios by looking at P/Nominal GDP and then look at the results relative to the long-term trend and again order in percentiles.**



**As can be seen, at an aggregate level, an equally weighted bond/equity portfolio has never been more expensive... it's easier to be black and white in terms of bonds long-term value. In short there isn't any relative to history...**

**For equities, current valuations are certainly stretched relative to nominal GDP through history. We have been more expensive but we are approaching the peaks of 2000 and 2007 and are in line with the most stretched valuations from the 1930s on this metric and higher than the 1929 crash point.**



**Given how weak nominal and real GDP has been post GFC, and how much of a downward trend both have been for several decades now, this shouldn't be a surprise...**

**... we'd repeat that history suggests all this is mean reverting over the medium to long term. If we look at more detail on the US which has the most developed history of equity data, including the longest series of earnings data through history we can see the longer term issues with equity market valuations.**

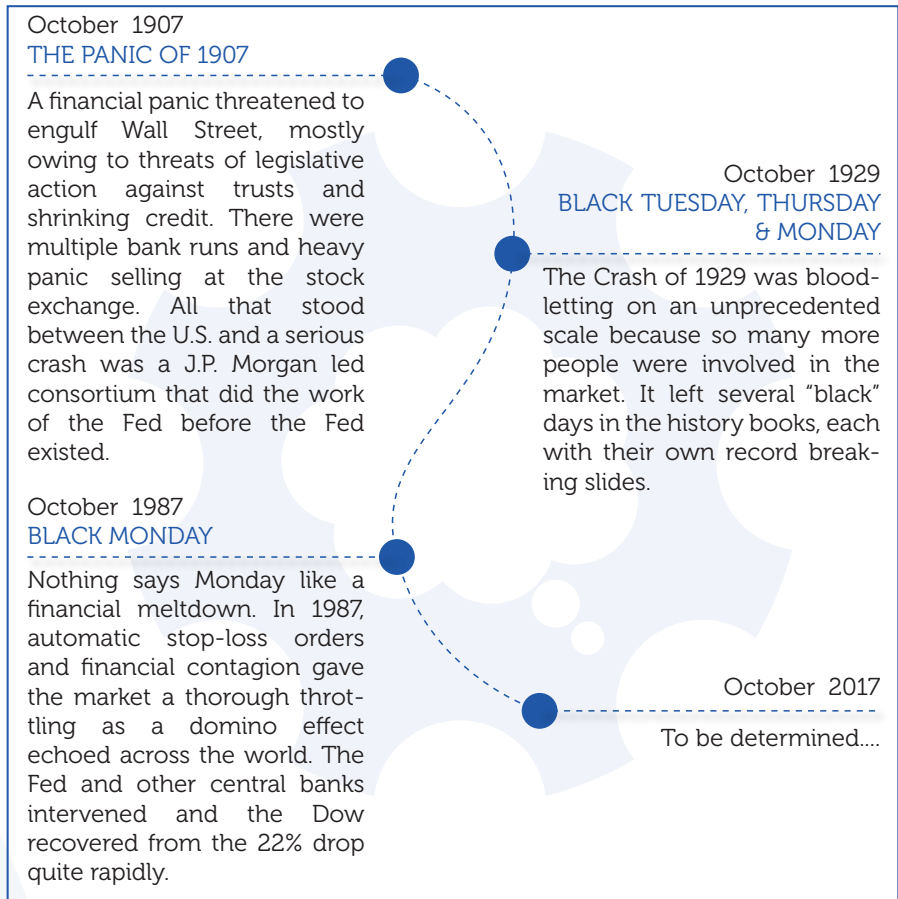
**Indeed the US CAPE ratio (Figure 61) has only been higher before the 2000 equity bubble bursting and was only slightly higher ahead of 1929 crash.**

Deutsche Bank's conclusion is just about as forthright as it's possible for an investment bank to be:

**"While there are no obvious triggers for historically high global asset valuations to correct, while they remain this high there is always a risk of a sudden correction that could be destabilising to a financial system and global economy that seems to require such elevated asset prices."**

The fact that the misplaced confidence and hubris of central bankers has now reached the private sector means just one thing in my mind; even though we made it through September unscathed, with the 30th anniversary of Black Monday only weeks away and the environment eerily similar to 1987, it's time to get serious about the likelihood of yet another in a long line of October surprises.

**O**K... so with the warnings of an elevated chance of impending problems in markets ringing in our ears, lets begin this week's journey around the world in Silicon Valley, where Elon Musk's Tesla is coming under increasing scrutiny – scrutiny which warrants a Things That Make You Go Hmmm... all of its own so watch for that in the coming weeks.



From the Valley, we head to Castle Rock, Colorado where yet another echo of the dot-com bubble is resonating around the Rockies – this time in the form of a biotech company which saw its stock soar when it simply added the word ‘Blockchain’ to its name.

Other stops include Qatar (where the Sovereign Wealth Fund looks set to become a seller of assets), Russia (where a pioneering blockchain bond is on the block), the Permian Basin (where drillers are finding dollars hard to come by) and Scandinavia (where we see a possible solution to the problem posed by the Rise of the Robots).

Meanwhile, in China, the country’s shadow banking system has even the World Bank on alert, while an acquisition by the nation’s leading car manufacturer is enough to raise the most static of eyebrows.

We also have time to ponder the fate of normalization and, in a sign that we have reached peak madness, Ireland, the country who brought you a housing crisis, a banking crisis and a sovereign debt crisis just a decade ago (and which already has €200 billion of debt outstanding – €50 billion of which will need refinancing in the next three years) has just issued bonds with a negative yield.

For reals.

Charts? Well we have four great ones from the excellent John Hussman, a look at how 3-D printing is set to change global trade and, in the wake of the awful Las Vegas shooting, a visual representation of the startling divide in America over guns which makes it abundantly clear just how polarizing the issue remains.

Lastly, we get an insight into how the ECB both views and tries to justify zero/negative interest rates, the chance to spend 20 minutes in the company of Kyle Bass (which, whenever I’ve been fortunate enough to have the opportunity, has always left me feeling smarter) and the co-host of The Investors Podcast, Preston Pysh, joins me for a conversation which not only puts a lot of this market ‘stuff’ into perspective, but offers a wealth of hard-won and battle-tested wisdom.

That’s all from me for another cycle. I’m heading to Dallas and then on to Oregon for the Aspen Round Table next weekend so hopefully I’ll see some of you along the way.

***UNTIL NEXT TIME...***

## TESLA IS IMMUNE TO BAD FINANCIAL DATA BECAUSE LOGIC IS OFFICIALLY DEAD IN SILICON VALLEY: ABOVE THE LAW

**L**ate yesterday, Tesla Motors reported that it did not produce even close to the number of Model 3 cars that it predicted it would in the third fiscal quarter of 2017.

That is objectively not good news for Tesla. The company has put a staggeringly high amount of pressure on itself to increase production on the Model 3 with a speed that is literally unprecedented in the history of manufacturing. Essentially, Elon Musk has staked the future of his car company on the notion that he can make one million cars a year by 2020. Tesla made 83,922 in 2016... total.

So in the cutthroat world of public market trading it stands to reason that Elon cannot afford even the merest suggestion of a hiccup in a manufacturing ramp-up plan that he has actually referred to as “Production Hell.”

Cue yesterday:

***The automaker built only 260 Model 3s during the quarter ended in September, less than a fifth of its 1,500-unit forecast. Output of the sedan that starts at \$35,000 – roughly half the cost of the least expensive Model S – was lower than expected because of unspecified “bottlenecks,” according to the company.***

Ah, so more a production “shart” than a “hiccup.”

A major miss on production goes to the heart of Tesla’s notional value. If it can’t come close to delivering on its primary goal, logic holds that Tesla cannot survive. Therefore trading on Tesla stock must have been disastrous today, right?

Wondering where this thought experiment lost its way? We’ll give you a hint: it was somewhere between “Elon” and “Musk.”

See, Tesla is not so much a car company as it is a cult of personality mixed with a quasi-religious belief in the disruptive superiority of Silicon Valley. In the eyes of Tesla believers, Elon Musk is a prophet and Tesla is his church. Tesla’s stock doesn’t trade on data, it trades on the current of faith and doubt among the Tesla faithful.

Like all public companies, Tesla has to deal with financial projections on a quarterly basis, but unlike almost any other public company, it has gamed the system so that Elon always revels in the accretive bigotry of low expectations. Just last week, Morgan Stanley analyst Adam Jonas wrote a note on Tesla that was more of a Tesla fanboy Reddit post than it was flinty-eyed financial analysis. Tesla’s results today fly in the face of Jonas’s predictions. We can guarantee you that his faith is not shaken.

But even if it were, it would not matter to Tesla investors. Just listen to these guys talk about Elon's major whiff on Model 3 production:

***“I would be surprised if anyone was surprised that they came up short,” said Sam Korus, an analyst at Ark Investment Management in New York, which holds Tesla shares. “When Musk gives a prediction, you know it’s an extraordinarily ambitious goal.”***

Hahaha! Yeah, Elon is kind of full of shit... and yes, we are invested in him.

***“Elon’s never made a number, ever,” said Ross Gerber, chief executive officer of Gerber Kawasaki Wealth & Investment Management, which holds Tesla shares. “Coming up short is what we expect of him.”***

Find a hedge fund saying this about literally any other company ever... We'll wait.

And while we wait, let Gerber finish that thought:

***“This guy has figured out how to land a rocket on a ship,” he said. “Whatever it is, he’ll get it sorted out.”***

This is all you need to know about Tesla. Investors have a messianic belief in the man behind the curtain because he is a visionary who is building the future via a solar panel empire (which has literally already damaged Tesla stock), a high-speed train company, and a \$21 billion attempt to privatize space travel. And it never seems to factor into Tesla investor thinking that Elon might be negatively distracted by these other pursuits.

But what is truly insane about the religiosity surrounding Tesla is that it's spreading. In fact, the same day that Tesla stock bounced on news that should have crashed it, WeWork founder and CEO Adam Neumann justified his company's new \$20 billion to Forbes thusly:

***“No one is investing in a co-working company worth \$20 billion. That doesn’t exist,” Neumann says. “Our valuation and size today are much more based on our energy and spirituality than it is on a multiple of revenue.”***

Even Erlich Bachman thinks this quote is Silicon Valley horseshit of the dankest vintage.

But Neumann is actually onto something. WeWork is at its core a real estate arbitrage play with techie bells and whistles that manages to incorporate persistently high costs with an unreliable revenue model. Is that worth \$20 billion without people buying into what WeWork represents?

Just kidding, WeWork isn't worth anywhere near \$20 billion. But the fact we're having this conversation is ridiculous.

Tesla and WeWork are just bald-faced symptoms of a disease that is spreading throughout tech. Snap, Etsy, Blue Apron, MongoDB, and sundry others have gone public with valuations that don't factor in the small detail of being profitable. And we are about to enter the heady days of watching Lyft and Uber rideshare their race to an IPO.

This era of counterfactual thinking has now spread into almost every nook and cranny of our shared American brain, but if we're going to start putting our money into it, Tesla can stop worrying about making more cars because there will be no one left who can afford them...

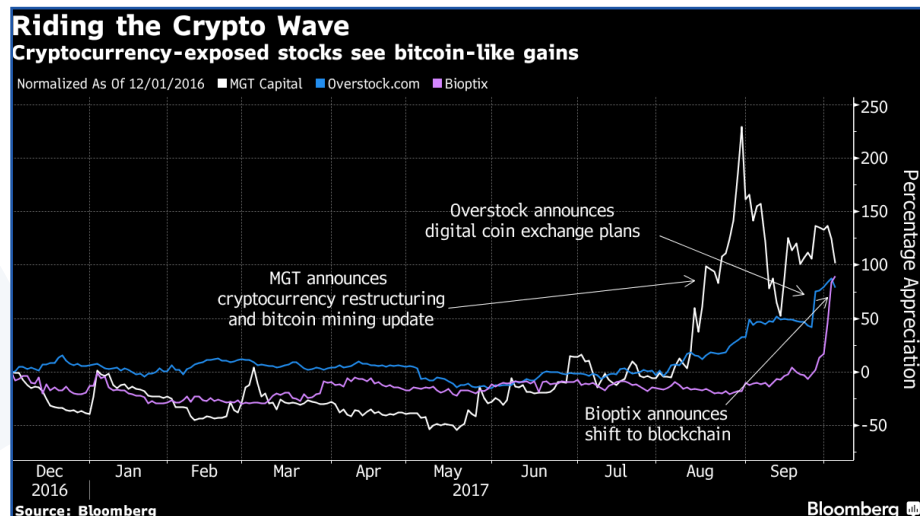
## A BIOTECH COMPANY CHANGED ITS NAME TO 'RIOT BLOCKCHAIN' AND ITS STOCK IS SURGING: BLOOMBERG

**U**sually when a company rebrands itself by diving into the digital currency space, the stock waits until after the announcement to take off. In the case of Bioptix Inc., a maker of diagnostic machinery for the biotech industry, it didn't bother waiting.

The penny stock nearly doubled in value in the days leading up to the company's announcement Wednesday that it's renaming itself Riot Blockchain Inc. to reflect a new focus on buying cryptocurrency and blockchain businesses. After the Castle Rock, Colorado-based firm formally unveiled the change in direction, the shares extended their rally, gaining as much as 17 percent to \$9.50, the highest intraday level since January 2015.

Other companies have shown that a foray into the cryptocurrency space is often rewarded by investors, at least initially, as the astronomical increase in the value of virtual coins has lured everyone from big banks to startups. Overstock.com Inc. shares rallied after the online retailer said it was starting a digital-coin exchange. Shares of MGT Capital Investments Inc., the cybersecurity firm with ties to controversial anti-virus software developer John McAfee, soared after the company announced a move into bitcoin mining.

In regulatory filings, the address Bioptix provides for its headquarters is identical to the address of a shipping and mailbox rental company called PostalAnnex, which sits next door to a Blimpie sandwich store in a Castle Rock shopping center. Karen Chase, a spokeswoman for Bioptix, said that the company uses the address for mail, and also operates a small office in the area.



Formerly known as Venaxis Inc., Bioptix bought out BiOptix Diagnostics Inc. in 2016, which wasn't the best move, according to Chief Executive Officer Michael Beeghley, who said Tuesday that the company wasn't in a big enough market and noted its significant cash burn.

"When I got on the board, they had made an acquisition that we decided as a board did not make sense, so we closed that down and then decided to change our focus," he said Tuesday in a phone interview. "We looked at the sector and said, 'How can we participate in this, and how can our shareholders participate in this very exciting industry that's like the beginning of the internet?'"

Its first move under the new moniker is an investment in Coinsquare Ltd., a Canadian exchange for trading digital tokens like bitcoin. Riot is paying a few million dollars for about a 12 percent interest in Coinsquare, and has warrants to increase its stake to 20 percent, Beeghley said. Next, the CEO is looking to buy companies focused on bitcoin mining, blockchain and security software. He said he plans to fund the deals with a combination of cash on hand and stock. Bioptix had minimal revenue in 2016.

"We've had a lot of success taking companies where we have closed down operations and identifying new sectors to invest," said Beeghley, who became CEO of Bioptix in April. "The most recent is Polarity -- ticker symbol COOL -- which we took public in March."

Bioptix has already shuttered operations, and is selling its remaining patents and intellectual property to a private company in the diagnostics industry. It will receive an upfront payment as well as a royalty stream that will likely be as much as about \$2.5 million, Beeghley said. Bioptix plans to change its ticker symbol to RIOT...

## QATAR FUND IS SAID TO WEIGH ASSET SALES AS IT LOOKS HOMEWARD: *BLOOMBERG QUINT*

**O**ne of the world's biggest buyers of trophy assets is becoming a seller.

Isolated by powerful Arab neighbors, Qatar's sovereign wealth fund is reversing a decade-long run in high-profile foreign investments to buttress its own economy.

The Qatar Investment Authority, which has reduced its direct holdings in Credit Suisse Group AG, Rosneft PJSC and Tiffany & Co. in recent months, is considering selling more of its \$320 billion of assets, which includes stakes in Glencore Plc and Barclays Plc, and channeling the proceeds into its home market, according to people familiar with the matter.

"Sovereign wealth funds, such as the Qatar Investment Authority, are always national buffers against adverse risk events," said Sven Behrendt, managing director of GeoEconomica in Geneva. "Since the boycott is such a risk event for Qatar, the assets stored within QIA will need to serve as such a buffer."

Bankers and lawyers who used to pitch acquisition targets to the QIA are now proposing asset sales, and have been told not to expect any major investments by the fund in the near term, the people said. The fund hasn't formally hired financial advisers to dispose of any assets but is considering which stakes are best positioned to be offloaded, they said. The QIA declined to comment.

Created in 2005 to handle Qatar's windfall from liquefied natural gas sales, of which it is the world's biggest exporter, the QIA and other Qatari investors have amassed holdings in Hollywood, New York office space, London residential property, luxury Italian fashion and even a soccer team. The QIA ranks as the ninth largest globally, according to the Sovereign Wealth Fund Institute.

"The QIA is being fiscally prudent by not actively pursuing new investments," said Rachel Pether, a senior adviser at the Sovereign Wealth Fund Institute.

"The QIA has approximately 57 percent of its portfolio in publicly listed securities, which means there is reasonable liquidity in its portfolio if further support is required."

The QIA last year saw its biggest overhaul since 2014, grouping \$100 billion of investments in local companies into a new unit and abandoning the Qatar Holding name synonymous with its highest-profile deals, people with knowledge of the matter said at the time.

After a dip in transactions in 2015 and 2016 as oil prices slumped, the fund regained its appetite for deals late last year, investing in Turkey's biggest poultry producer, Rosneft, and U.K. gas company National Grid Plc, all within a couple of months. A Saudi-led standoff that started in June has put the brakes on those ambitions.

The QIA plans to spend most of what remains of its \$45 billion investment target on U.S. assets as it seeks diversification, Chief Executive Officer Sheikh Abdullah Bin Mohammed Bin Saud Al Thani said last month.

The fund is also considering selling some of its extensive property portfolio, especially in the U.K. where it owns stakes in London's Savoy Hotel, the Shard skyscraper and the Olympic Village, according to another person familiar with the matter. The QIA also wants to sell an office building in London's Canary Wharf financial district that is leased to Credit Suisse, people familiar with the matter said last month.

<b>Global Portfolio</b>		
Some of Qatar's biggest overseas investments as of Jun. 5, 2017		
<b>Company</b>	<b>Stake %</b>	<b>Value \$ Billion</b>
Volkswagen AG	17	*11.58
Rosneft Oil Co.	9.75	5.49
Glencore Plc	8.49	4.51
Barclays Plc	5.97	2.76
Deutsche Bank AG	**6.1	2.2
Royal Dutch Shell Plc	2.13	2.19
Credit Suisse AG	5.01	1.49
Sainsbury Plc	22	1.71

Source: Bloomberg  
 \* Includes value of preferred shares  
 \*\* combined stake of Sheikh Hamad Bin Jassim and Sheikh Hamad Bin Khalifa

**Bloomberg**

The QIA has injected billions of dollars into local banks to shore up liquidity after Saudi Arabia, the United Arab Emirates and Bahrain cut diplomatic ties on June 5 amid accusations of funding terrorism, prompting their lenders to withdraw funds from Qatar, people familiar with the matter said at the time. Qatar has repeatedly denied the charges.

Qatar should also look at other assets that could be used as alternative buffers to reduce some of the heat on QIA, said GeoEconomica's Behrendt.

"The diplomatic boycott and economic blockade of Qatar sees basically two strategies employed by the parties: the Saudi-led coalition employs a 'wearing down' approach, Qatar a 'holding out' strategy," he said. "In the end it will be about who will have the longer staying power?"..

## [RUSSIA'S MOBILE OPERATOR ISSUES FIRST BLOCKCHAIN BONDS](#): *RUSSIA INSIDER*

**M**ajor Russian mobile phone operator Megafon will issue RUB500mn worth of blockchain bonds in the first ever Russian blockchain bond issuance, Vedomosti reported on October 2.

All the bonds, issued on a blockchain platform developed by the National Settlement Depository (NSD), were bought by Raiffeisenbank, according to the report.

Russia has gone a bit blockchain bonkers since president Vladimir Putin latched onto the idea at the more recent St Petersburg International Economic Forum (SPIEF).

"Blockchain is now the number task," first deputy Prime Minister Igor Shuvalov said at the SPIEF blockchain session, probably the third most powerful man in Russia. "The president is completely ill with this idea and understands that the gap and significant growth rates are based on the digital economy and technological leadership."

In what is remarkably rapid progress the Megafon bond was a test run of the new technology that could revolutionize the securities business. The zero-coupon bonds were sold at RUB982 (\$17) each against the face value of RUB1,000, with corresponds to an annual yield of 7.77%. Megafon said that the main goal of issuing blockchain bonds is testing the new technology rather than attracting funds, therefore the volume of the issuance was rather small.

The scheme has its obvious advantages as the transaction took a few seconds as opposed to a few days under the traditional procedure. In addition, the issuance of bonds with a higher total value is expected to bring about additional cost savings thanks to declining paperwork. And that is the point of the blockchain: the settlement and registration processes are hardwired into the very structure of the blockchain, negating the need for expensive and time-consuming back-office work.

The blockchain format also helped to decrease risks as the issuer and the investors are able to observe the transaction in real time removing the classic “delivery vs payment” risks.

Everything related to blockchain and cryptocurrencies is extremely hot in Russia these days, also falling in line with the government’s strategy for developing a “digital economy.”

In August, Russia’s leading exchange, the Moscow Exchange (MOEX) joined the blockchain craze and by preparing infrastructure for a cryptocurrency trading platform.

Around the same time, state-run lender VEB announced the launch of a blockchain competence centre aimed at introducing the technology to the country’s public sector.

Meanwhile, Russia’s Federal Agency for Technical Regulation and Metrology (Rosstandart) appointed a new technical committee to work on the standardization of “the software and hardware of distributed register and Blockchain technologies”

In September, Burger King Russia launched Whoppercoin, a cryptocurrency which can be traded for Whoppers...

## DRILLERS CHOKE OFF DOLLARS TO PERMIAN BASIN OPERATIONS: *HOUSTON CHRONICLE*

**R**ising production costs, high land prices and a shareholder push for financial discipline have dramatically slowed the land rush in the Permian Basin, one of the world’s most active oil fields.

Drillers spent \$35 billion in West Texas over a nine-month period that ended in early spring. By comparison, the collective value of land deals of the last six months is less than \$5 billion, energy research firm Wood Mackenzie reports.

Shortly after OPEC announced plans to curb global crude supplies, oil prices rose and drillers made a flurry of acquisitions in the Permian, willing to pay high prices to lease land that sits atop multiple stacked layers of oil-soaked rock that could ultimately yield another 70 billion barrels of crude in coming decades. But that multibillion-dollar push, prodded along by outside investors, couldn’t last forever.

The market was throwing money at them to buy things,” said Greig Aitken, head of upstream oil and gas mergers and acquisitions at Wood Mackenzie.

Land prices rose so high that new entrants found it difficult to make returns on their investments, often paying more than \$30,000 an acre. As a surge of drilling got underway and companies dispatched more rigs and fracking equipment across the vast plains, labor and equipment costs also began to climb, eating into the industry’s bottom line.

Plus, companies faced labor shortages after the oil downturn and much of their functioning equipment had been cannibalized for parts.

Investors, meanwhile, have grown impatient with an industry that has prioritized rapid growth over returns, and some of those groups have begun pushing companies to spend within their means, rather than relying on debt or other outside capital to drill new wells.

“It’s just taken the edge off the Permian,” Aitken said.

Last week, Anadarko Petroleum Corp., The Woodlands-based oil producer, made one of the most pronounced moves yet to appease shareholders, announcing plans to spend \$2.5 billion to repurchase shares through the end of next year. The company, analysts said, may be only the first to shift funds directly away from their investment budgets; most, however, have already signaled they’ll spend less than anticipated on developing oil fields this year.

“The investor base has become fatigued,” with shale drillers that still can’t cover their spending with cash flowing from their oil and gas operations, Mizuho Securities analyst Timothy Rezvan said. “Companies have started to walk back aggressive, multiyear production growth guidance.”

In the years of \$100-a-barrel oil, companies drilled wells at breakneck speed across the country and promised double-digit growth, fueled at different times by a mix of junk-rated bonds and stock sales to Wall Street investors, as technological breakthroughs opened up once-inaccessible sources of oil and natural gas.

This year, oil prices dropped below \$50 a barrel, burning investors who had bet on a strong recovery after two brutal years in which the industry axed hundreds of thousands of jobs and scores of U.S. oil companies went bankrupt. The crude-price decline was, in part, because of forecasts of rising oil production from U.S. oil fields - most prominently, the Permian Basin.

“Hedge funds have been hit hard trying to bet on the oil recovery,” said James Sullivan, an analyst at Alembic Global Advisors in New York.

Analysts say the conservative shift in market sentiment could signal the beginning of a new chapter for the U.S. shale-oil industry, one in which companies place a greater emphasis on shareholder returns. It takes years to build any kind of business, making investments and sacrificing upfront returns to become profitable over time. The shale industry, analysts said, is no different.

“At some point, the plan was always to harvest this investment,” Morningstar analyst David Meat said in Chicago. “We’re just seeing the early stages of getting to that point. It’s distorted by the fact that we’re coming out of a downturn.”...

## WANT TO SURVIVE THE “ROBOCALYPSE?” FOLLOW THE SCANDINAVIANS: *BLOOMBERG*

**A**re you in charge of a government and worried about how to save millions of jobs from the threat of automation? Nordea Bank AB has the answer: just do as the Scandinavians.

According to the latest Economic Outlook by the region’s largest bank, the best way to future-proof your economy is to have a highly educated workforce and low inequality -- two features that abound in the Nordics.

“A lot of work will be replaced by robots,” Nordea senior economist Erik Bruce said in an interview. “The difference is that we’re better prepared because we share the view that we should have a fair distribution of income and we make sure people are trained to take on a new role.”

His main advice to policy makers? “Free education probably isn’t the only solution, but it’s a good start.”

Bruce and his colleague Joachim Bernhadsen cite various studies predicting how millions of jobs will be wiped out due to automation. But the two analysts conclude that, rather than worry about what they call the impending “robocalypse,” governments should roll out the welcome mat to the robots.

As the authors point out, the fear that machines will make humans obsolete in the workplace is hardly new (the term “Luddite,” which describes people who resist technological change, derives from a group of textile workers who destroyed machinery in 19th century England). They also take issue with the basic assumption behind some of the more alarmist studies, namely that the next industrial revolution will destroy many more jobs than it will create. Rather, they argue that it will unravel at a more modest pace than many anticipate, and will follow a familiar pattern -- transforming, rather than eliminating, many of the workers’ tasks at risk.

There is a catch, however.

To make the most of automation, governments need to ensure high standards of education and encourage life-long learning, since both allow workers who fall out of the labor market to be easily re-trained. The second, and perhaps more controversial aspect, is to minimize inequality. The analysts cite a 2015 study by David Autor that suggests computers and the Internet have already had “a material effect on income distribution in the U.S.” by favoring highly-skilled labor.

Here’s how Finland and Scandinavia fare on the two issues:

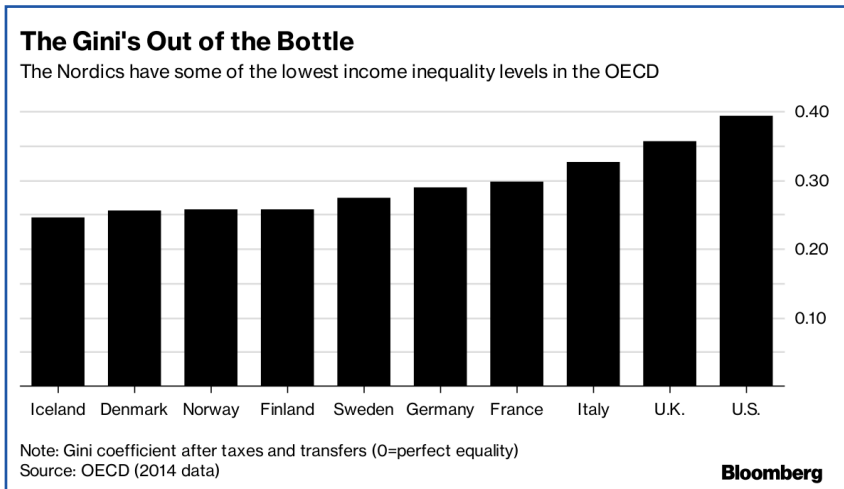
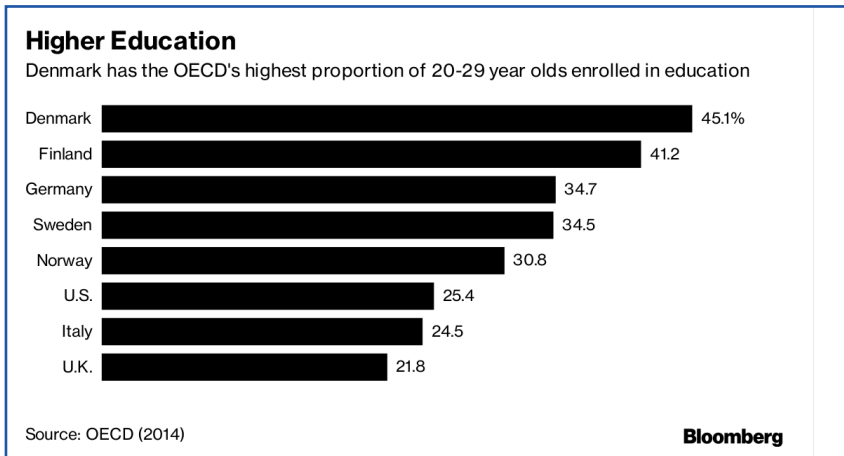
On education, not only do they beat the OECD average in terms of PISA scores, they also have an excellent track record at promoting life-long learning.

There are no college fees in the Nordics, and just about anyone can afford to study thanks to the safety net of the welfare state. In Denmark, for instance, students aged above 20 receive a monthly stipend of 6,000 kroner (\$953) from the state.

In terms of income inequality, it will come as no surprise to learn that the region with some of the highest income tax rates in the world scores particularly well.

If it's evidence that you need, just look at how globalization has impacted the Nordics. Not only have these small, export-oriented economies been enriched by the rise of free trade, they've also so far been spared much of the resulting social unrest witnessed elsewhere.

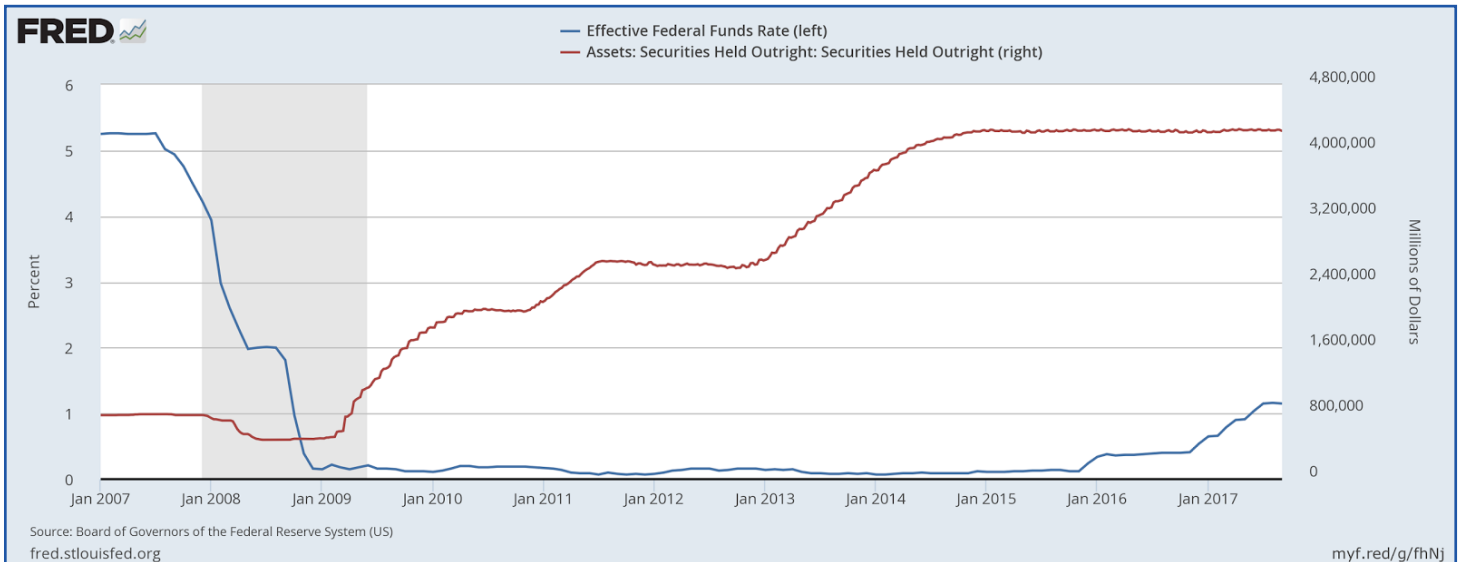
“Experience from the last 20 years clearly shows that the Nordic model promotes social mobility and equal opportunities,” the analysts conclude in Nordea’s Economic Outlook. “With the right policies, societies can address the distributional consequences of new technology. The Nordic countries are particularly well equipped to reap the benefits and meet the challenges from automation...”



## WHATEVER HAPPENED TO NORMALIZATION?: *STEPHEN WILLIAMSON*

**W**hat's become of the Fed's normalization plans? To get this straight, recall what's been abnormal about Fed policy for the last nine years or so. Here's a chart of the effective fed funds rate, and securities held outright by the Fed (next page):

Abnormal policy began at the height of the financial crisis in late 2008, when the FOMC agreed on a plan to target the fed funds rate in a range of 0-0.25% - a policy that continued until "liftoff" in December 2015. As well, beginning in early 2009, the Fed embarked on a sequence of quantitative easing (QE) exercises, which increased the quantity of securities held outright by a factor of more than five.



Further, the Fed got rid of essentially all of its Treasury bill holdings, and increased the average maturity of Treasury bonds and notes held. The Fed also purchased a large quantity of mortgage backed securities (MBS) - close to \$1.8 trillion. So, the Fed increased the size of its balance sheet substantially, lengthened the average maturity of securities held, and departed in a big way from a policy of “Treasury only.”

As outlined in this FOMC document, the FOMC began thinking seriously about how Fed policy might return to normal, and what “normal” might be, as early as June 2011. A formal normalization plan was posted by the FOMC in September 2014, and this is essentially what has been implemented since, more or less. The plan was:

- (i) Begin increases in the fed funds rate target.
- (ii) Reduce the size of the balance sheet by stopping the reinvestment policy, after increases in the target policy rate are well underway.

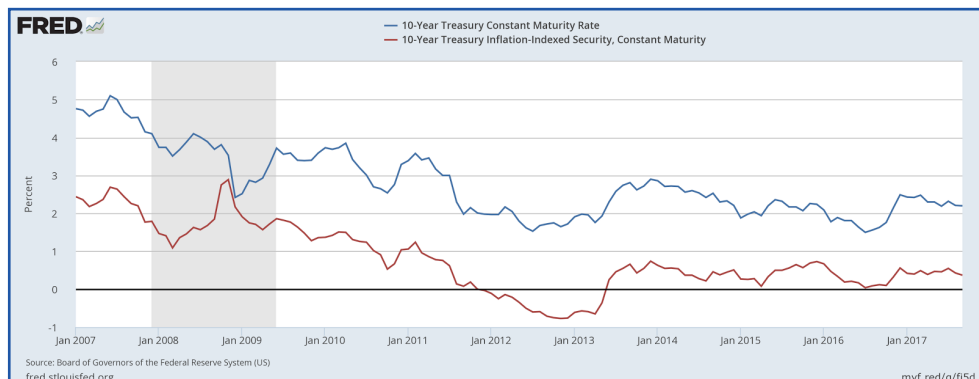
Increases in the fed funds rate target began in December 2015, and we have since had three more, with the target range increasing from 0-0.25% to 1-1.25% currently. Balance sheet reduction did not commence until October of this year, when the FOMC issued an addendum to the 2014 plan. The addendum contains explicit details about how the balance sheet reduction will occur. Reinvestment - a policy by which assets in the Fed’s portfolio are replaced as they mature, holding the nominal size of the balance sheet constant - did not stop abruptly, but its cessation will be phased in. It appears that the New York Fed did not purchase assets with a view to smoothing quantities that mature over time, and the FOMC seems concerned that the balance sheet not decline in a lumpy fashion, as it would without the caps on portfolio reduction outlined in the addendum.

Some questions that might come to mind (or should) on normalization, along with my answers:

1. Why did normalization start with interest rate increases first, then reductions in balance sheet size? It might seem logical, since QE followed the reduction in the nominal interest rate target to zero (effectively), that the Fed would normalize by first reducing the balance sheet to a normal size, and then increase interest rates.

Indeed, there are some good reasons why this is what should have happened. As short-term nominal interest rates increase, the profit that the Fed makes on the spread between the return on its assets and what it is paying out on its liabilities declines. As a result the Fed makes a smaller transfer to the Treasury each year. QE took place in the context of relatively low yields on Treasury bonds and MBS, and with a larger balance sheet, the asset portfolio is being financed by a larger fraction of interest-bearing reserves and a lower fraction of zero-interest currency. If short-term rates go high enough, transfers to the Treasury will stop. Economically, this is unimportant, as this amounts to the difference between interest paid on reserves by the Fed vs. interest paid on government debt by the Treasury, but politically this could be very dangerous territory.

The Fed should not give ammunition to its enemies in Congress. Added to this is the argument that QE was an experiment, with poorly understood consequences. Thus, the sooner the Fed ended the program, the better. So why not reduce balance sheet size before engaging in liftoff? Likely, because the FOMC was spooked by its experience in 2013. At that time, after the FOMC meeting that ended on June 19, Ben Bernanke announced that a winding-down, or “tapering” of the Fed’s QE program was likely to be later that year, and that the program would probably end in mid-2014. The financial market response to that announcement, and earlier public statements by Bernanke, is sometimes called the “taper tantrum:”...



## SOARING RATES OF 'SHADOW BANKING' ADD TO FEARS OF CHINESE DEBT, WARNS WORLD BANK: UK DAILY TELEGRAPH

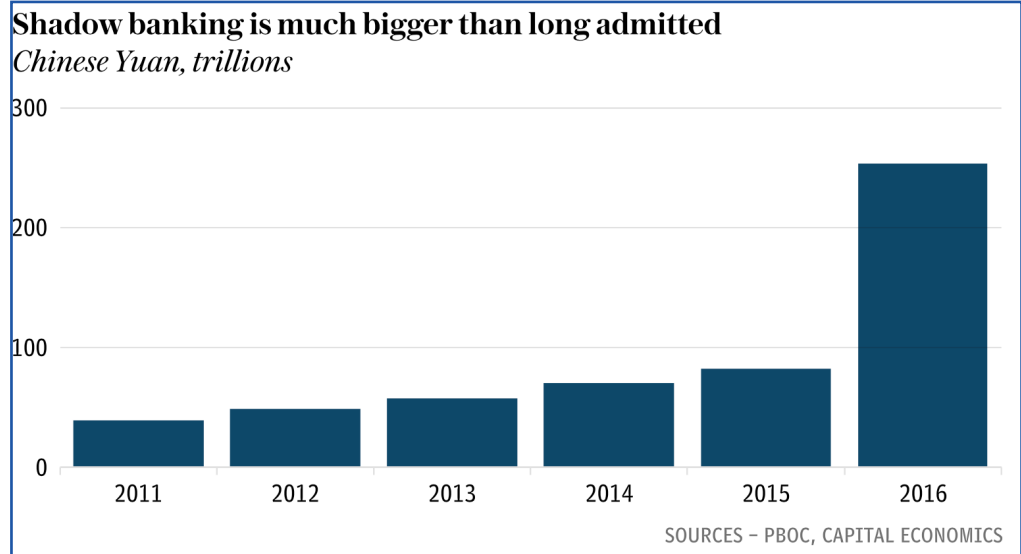
**F**ears that the steep growth of shadow banking could trigger a debt crisis in China’s have been highlighted by the World Bank.

In its October report on the East Asian and Pacific economies, the Washington-based financial institution cited Chinese debt levels, and specifically “shadow banking” as one of the greatest threats to regional prosperity. These activities were “creating additional vulnerabilities in the financial sector,” they said.

The three most representative shadow banking activities; entrusted loans, trust loans, and bankers' acceptances, had "soared from under 7pc of GDP in 2005 to over 31pc of GDP in 2016," the World Bank warned.

This finding comes as the World Economic Forum has also issued warnings that credit in China's financial system is building in a similar fashion to that seen in the US before the financial crisis.

Shadow banking, which the People's Bank of China defines as "credit intermediation involving entities and activities outside the regular banking system," has been variously estimated to consist of between 8-80pc of GDP. Ratings agencies such as Standard and Poors and the IMF have struggled to determine what the term ought, and ought not, to include.



"It's very difficult to separate out the shadow entities, they are so intimately related to the conventional banking system I'm almost loathe to call [them] entities. They are activities [within the system]," said Freya Beamish, chief Asia economist at Pantheon Macroeconomics.

This hard to define relationship means that even if shadow banking activity constitutes a small part of overall banking activity, the risk it poses is systemic, as these activities share the same balance sheets.

Bad debt could be as much as 20-30pc of GDP in China, warned Ms Beamish, adding that the highly likely liquidity squeeze coming from rising global interest rates would help reveal the scale of China's shadow banking and bad debt.

"There's the old adage that if the tide goes out you see who's swimming naked. Well, in China the point is if the liquidity dries up these companies won't be able to roll over bad debts and get new loans to pay the interest on old ones.

"We'll see which debts are bad debts. This could be a critical 18 months for China and [in] the medium term for Chinese growth," she said.

The authorities have visibly cracked down on activities in the insurance sector in the past year, reportedly detaining the head of major insurer Anbang, Wu Xiaohui. The former head of the insurance regulatory commission Xiang Junbo has also been placed under investigation for suspected “serious disciplinary violations,” according to the Central Commission for Discipline Inspection.

“Companies such as Anbang, have been buying long-term real assets outside of China, using shorter term liabilities inside China. Authorities have realised there’s a currency and an asset liability maturity mismatch,” said Ms Beamish.

Mr Wu met with Jared Kushner in late 2016, and the pair were reported to be close to an agreement on a joint redevelopment project of 666 Fifth Avenue. The insurance company bought the Waldorf-Astoria hotel for nearly \$2bn in 2014.

The authorities’ detainment of Mr Wu might not just be an effort to clear up suspect banking activities, but rather a sign, according to Ms Beamish, for the “US administration that they’re not going to just get to do deal with whoever they want,” in terms of building economic relationships.

Cleaning up China’s financial industry is a matter of controlling international political relationships as well as an effort to become attractive for foreign investment, she added...

## A CHINESE CARMAKER AGREES TO BUY A DANISH INVESTMENT BANK: *ECONOMIST*

**A** company that moves up the value chain from refrigerator parts to cars is impressive but not that surprising. A car company that buys an investment bank is audacious. But Zhejiang Geely Holding Group, a conglomerate based in Hangzhou, China, did not become big by paring its ambitions. Having successfully made the fridge-parts-to-cars transition at home, it went global in 2010. It acquired Volvo, a Swedish carmaker, from Ford of America. Now Geely is back in Scandinavia for another acquisition. This time it is buying one of Denmark’s biggest banks.

Saxo Bank announced on October 2nd that Geely would acquire 51.5% of its shares. It will spend over \$800m on the deal, which still requires regulatory approval. Sampo Group, a Finnish insurance company, will acquire 19.9% of Saxo shares for €265m (\$311m), and Kim Fournais, Saxo’s co-founder and chief executive, will retain 25.7%. The sellers are Sinar Mas, an Indonesian conglomerate, and TPG, an American private-equity firm.

Saxo was an early adopter of online securities trading and still invests heavily in financial technology. It makes a substantial portion of its profits from selling trading platforms to other firms. Daniel Donghui Li, Geely’s chief financial officer, says Geely hopes to expand Saxo’s technologies into Asia.

Besides facilitating this expansion, Geely does not intend to change how Saxo operates, let alone change its business model to finance car sales.

Geely is not the first Chinese firm to take control of a European bank. In September Legend, the largest shareholder of Lenovo Computers, announced that it would acquire 89.9% of Banque Internationale à Luxembourg, the oldest private bank in the Grand Duchy, from a Qatari company. Legend said it wanted to provide banking services to companies taking part in China's flagship "Belt and Road" project to build a latter-day Silk Road to Europe.

Other Chinese firms have bought smaller stakes in European banks. In May HNA Group, a part-owner of Hainan Airlines, increased its holding in Deutsche Bank to 9.9%, becoming its largest shareholder. Fosun, a big consumer group, owns 24% of Millennium BCP, Portugal's largest listed bank. Unlike Geely, however, Legend, HNA and Fosun have experience in the Chinese financial sector.

After 2014 Chinese companies had sharply increased their direct investment in foreign companies (see chart). Large firms made high-profile acquisitions of property, sports teams, film companies and other assets with tenuous connections to their core activities. Concerns over capital outflow and corporate debt led the Chinese government to introduce regulations limiting outward investment.

Geely's purchase of Saxo Bank suggests that Chinese companies are gradually regaining their appetites for foreign deals, even outside their core businesses. According to Edward Tse, chairman of Gao Feng, a firm that advises on the Chinese market, the Chinese regulations were primarily directed at a few companies that "splashed cash" on unwise deals. Geely, seen as having already successfully swallowed one prestigious foreign firm, may worry the authorities less...



## IRELAND RAISES €4BN IN NEGATIVE YIELD BOND SALE: FT

**Ireland** has sold its first ever bond with a coupon of zero per cent, with the country effectively being paid to borrow €4bn over five years.

The country brought in more than €10bn of orders for the debt, which matures in 2022. The bond, which is priced slightly above par, came at a yield of minus 0.008 per cent.

The absence of the coupon means Ireland will not have to make any interest payments on the bond, which will mature at a slightly lower value than that at which it was sold.

Investors who hold the debt to maturity are guaranteed to lose money.

Swathes of European sovereign debt have been trading at negative yields over recent years, with historically low rates and more than €1.7tn of government bond purchases from the European Central Bank forcing asset prices higher.

The German five year bond is currently trading at minus 28 basis points. Both Finland and Austria have this year issued bonds with zero coupons.

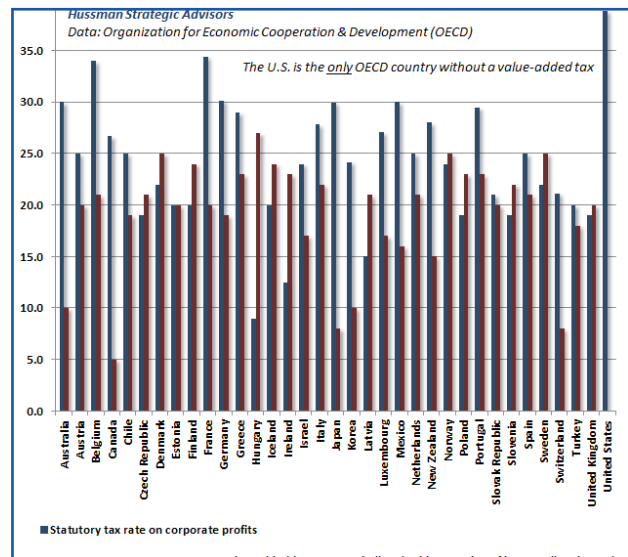
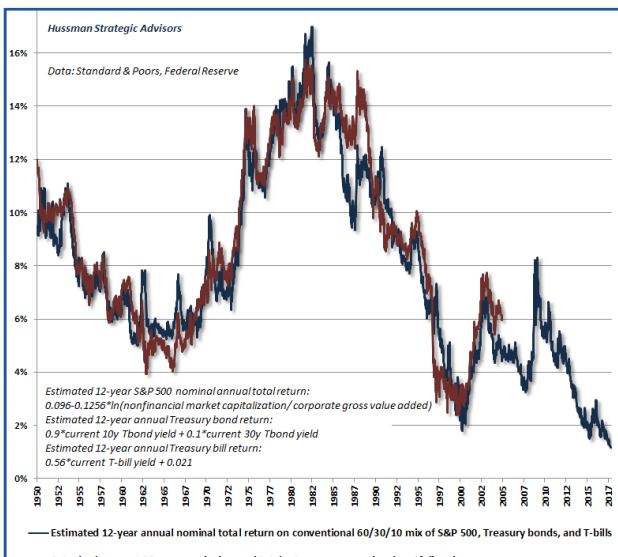
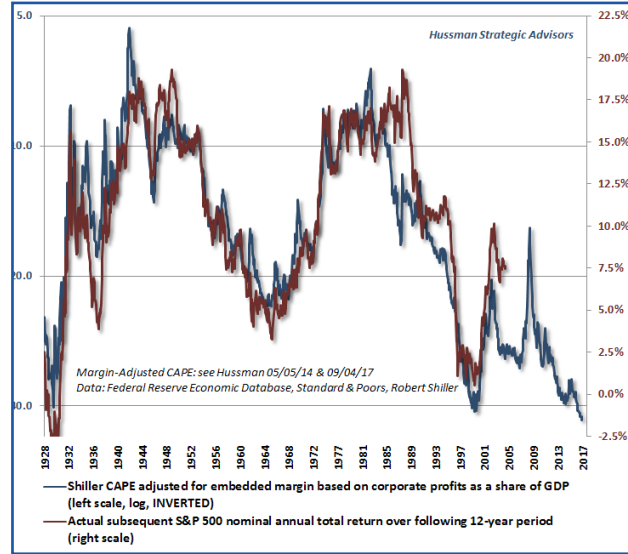
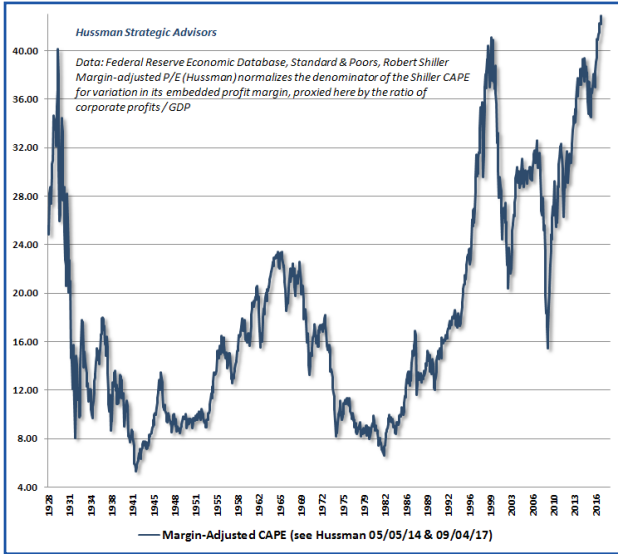
Ireland issued a 5-year bond in 2012 at a coupon of 5.5 per cent, in the midst of Europe's sovereign debt crisis. In 2015, they issued a 7-year bond with a coupon of 0.8 per cent.

More than a third of demand for the new Irish debt came from asset managers, with banks also providing 35 per cent of the book. Hedge funds represented 17 per cent of demand.

Irish sovereign bonds have performed well compared to other European countries over recent years, with the country's assets buoyed by perceptions of economic recovery.

The yield on its 10-year debt is currently at 0.72 per cent, significantly lower than Spain, which is trading at 1.78 per cent, but above the 0.33 per cent it touched last September...

# CHARTS THAT MAKE YOU GO HMMM...



**“The present moment of blissful delusion is remarkable to witness. Take it in. A few words and updated charts will do...”**

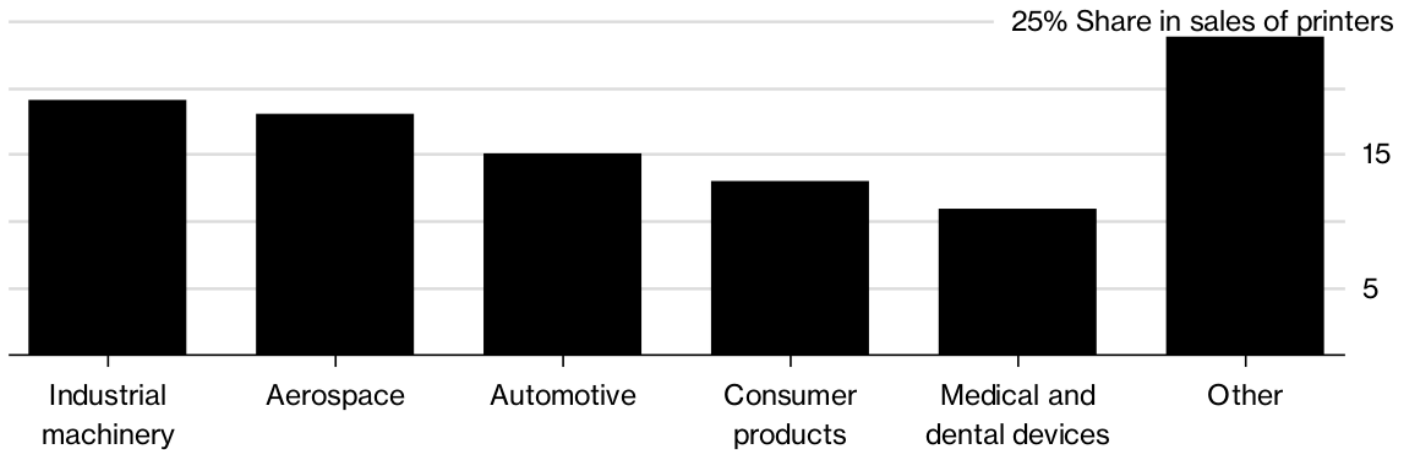
**S**O begins the latest missive from the always-thought-provoking John Hussman.

Blissful Delusion is an excellent read and, no matter what the detractors say about John being early, his thought process is thoroughly enlightening and I, for one, look forward to reading his thoughts every week...

[LINK](#)

## Where 3-D Printing Is Used

These are the top industries investing in the technology



Source: ING report, which credits responses from 61 producers of 3D printers asked what their customers use printers for

**Bloomberg**

**C**ritics of global trade might find something to celebrate in the advent of 3-D printing.

Raoul Leering, head of international trade analysis at ING, writes that growth in 3-D printing could wipe out almost one-quarter of cross-border trade by 2060. His review of the technology's landscape kicks off this week's economic research wrap, which also touches on innovation clusters, attitudes about men and women in the American workplace, and the demographics of art spending. Check back each week for a rundown of new and pertinent economic studies.

If high-speed 3-D printing makes mass production using the tool viable, it could cause major disruption to the global flow of goods, Leering writes. About half of manufactured good could be printed by 2060 if the current growth of investment in the technology persists, he estimates. That would cut world trade by a quarter, because it would require less labor and reduce the need to import intermediate and final goods from low-wage countries. That could cause trade deficits to narrow for major importers, though countries with a trade surplus could suffer.

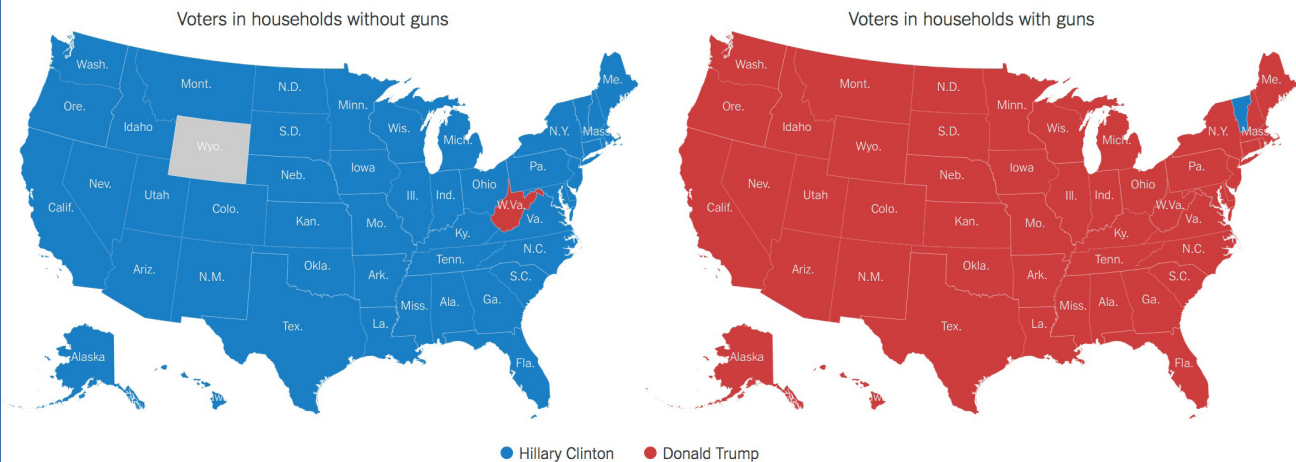
That's Leering's slow-growth scenario. If investment ramps up, doubling every five years, he guesses that as much as two-fifths of global trade could disappear. His estimates are uncertain (there is no data on the value of 3-D printed products and related services worldwide, and the technology hasn't yet evolved to the point that it's enabling mass production), but they highlight that there's potential for disruption...

[LINK](#)

# Nothing Divides Voters Like Owning a Gun

By NATE COHN and KEVIN QUEALY OCT. 5, 2017

2016 presidential election vote among ...



Americans are deeply split along demographic lines, but there aren't many demographic characteristics that embody America's cultural divide better than gun ownership.

**A**mericans are deeply split along demographic lines, but there aren't many demographic characteristics that embody America's cultural divide better than gun ownership.

In the wake of the mass shooting in Las Vegas on Sunday, the polling firm SurveyMonkey published a pair of maps from its 2016 presidential election exit polls. It showed the electoral maps for voters who said they had a gun in their home, and for those who said they did not.

In every state but Vermont – perhaps the most liberal state in the country, but one where Democrats, including Bernie Sanders, often support gun rights – voters who reported living in a gun-owning household overwhelmingly backed Donald J. Trump.

The opposite is true for voters who said they did not live in a home with a gun. In all but one state that could be measured, voters overwhelmingly preferred Hillary Clinton. (The exception was West Virginia; not enough data existed for Wyoming.)

Over all, gun-owning households (roughly a third in America) backed Mr. Trump by 63 percent to 31 percent, while households without guns backed Mrs. Clinton, 65 percent to 30 percent, according to SurveyMonkey data. No other demographic characteristic created such a consistent geographic split...

## WORDS THAT MAKE YOU GO HMMM...

**F**rom the assertion that prices *must* go up (not too slowly or too quickly) to the simplistic way this video explains the *necessity* to keep interest rates low and leave them there, this video from the ECB has to be seen to be believed...

Good job these guys are on the case...



[CLICK TO WATCH](#)

**K**yle Bass is one of the smartest and most eloquent hedge fund managers of our time and is always worth listening to.

In this interview, from his Barefoot Ranch, Kyle offers his thoughts on Greece, China, blockchain, Puerto Rican debt and gold as well as grasping the nettle and offering the thoughts of a proud Texan on gun control...

Something for everyone...

[CLICK TO WATCH](#)



**P**reston Pysh, the co-host of the brilliant [Investors' Podcast](#), joined me on Adventures in Finance this week and, if you haven't listened to our conversation, I thought I'd put it on your radar.

Preston's experiences in his first career – the one which came before he ended up in financial markets, is rich in colour and filled with valuable lessons which he is kind enough to share candidly with me in a truly thought-provoking discussion...

[CLICK TO LISTEN](#)



## AND FINALLY...



[CLICK TO VIEW](#)

**R**emember all those deserted Chinese cities that were all the rage a few years ago?

Well they're back and this time it's not just Ordos.

Between 1984 and 2010, the amount of built-up areas in China increased nearly fivefold – from 3,413 square miles (8,842 sq km) to 16,126 square miles (41,768 sq km). To construct these new urban zones, China used more concrete in the three years between 2011 and 2013 than the whole of the United States used in the 20th Century.

San Francisco-based photographer, Kai Caemmerer, has produced a series of amazing images which document these astounding landscapes...



Things that make you go  
**hmmm**

## About The Author

**M**uch to his chagrin, Grant Williams has reached 30 years in finance.

Over that period, he has held senior positions at a number of investment banks and brokers including Robert Fleming, UBS, Banc of America and Credit Suisse in locations as diverse as London, Tokyo, New York, Hong Kong, Sydney and Singapore.

From humble beginnings in 2009, *Things That Make You Go Hmmm...* has grown to become one of the most popular and widely-read financial publications in the world.

Grant is a senior advisor to Vulpes Investment Management in Singapore, an advisor to Matterhorn Asset Management in Switzerland and also one of the founders of *Real Vision Television*—an online, on-demand TV channel featuring in-depth interviews with the brightest minds in finance.

A regular speaker at investment conferences across the globe, Grant blends history and humour with keen financial insight to produce unique presentations which have been enthusiastically received by audiences wherever he has traveled.

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