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Global Economy 2015 – Tale of Three Realities: Contraction…Conflicts…Crashes

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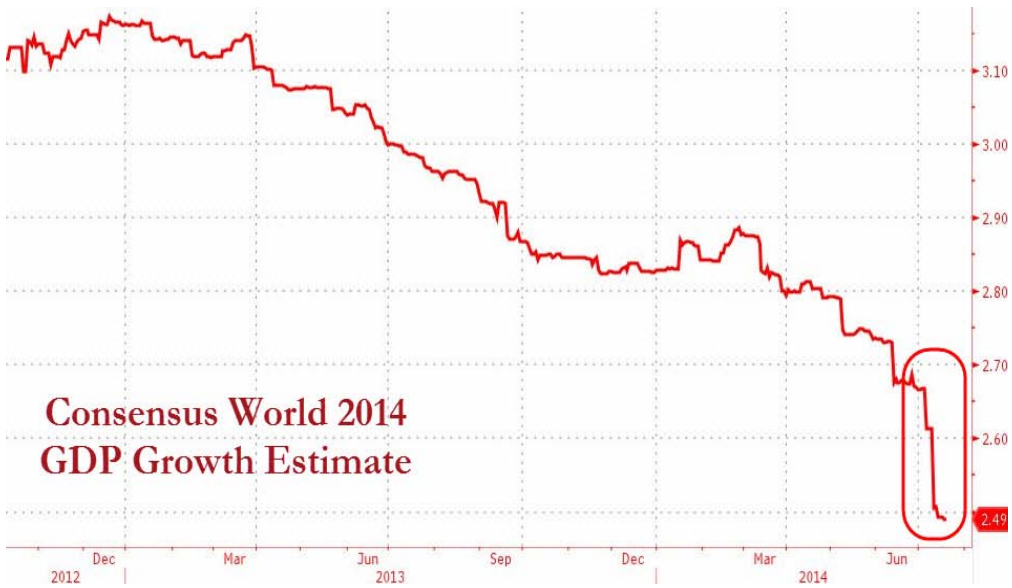
Mr. Dhillon's experience includes start-ups, venture capital, seed funding, and heading companies in construction and international power development. His extensive experience gives him in-depth knowledge and intuitive insights into macro and micro, national and international, geo-political and economic realities and trends. He has been invited to speak on international business at various forums, including as an expert witness for the Standing Senate Committee, Government of Canada, on "The Rise of Russia, China and India".



Source: Zero Hedge

At the start of 2015, the Global Economy is an unmitigated mess; globally contracting against lackluster demand, disrupted and mangled by geo-political, economic, religious and ideological conflicts, and absurdly unbalanced by rising liquidity driving financial/asset markets, against contracting economies and earnings. We feel the global economy is heading towards far greater trouble, rather than any recovery.

Usurped and taken hostage by the Federal Reserve and the other major Central Banks, the Global Economy has become the ATM machine and an experiment of National and International Bankers, the very wealthy asset owners and financial speculators. Meanwhile, financial risk has been covered by Central Banks, and legal risk by governments willing to let off criminally guilty Banks with fines, along with non-admission of guilt. The average working person who produces the major portion of the global economic productivity and wealth creation, and usually underwrites the risks of this manipulating elite, through bailouts and through the erosion of their own equity and savings, have lost control of their economies and their destiny. The real economies have languished and retracted, tens of thousands of jobs are still being 'rationalized' as most advanced economies bob in-and-out of recurring recessions or near recessions, while the Central Banks repeatedly flood the financial markets with paper money and absurdly low or negative interest rates. This free-for-all at the top has created a bizarre economic scenario.

"Absurdly Unbalanced"

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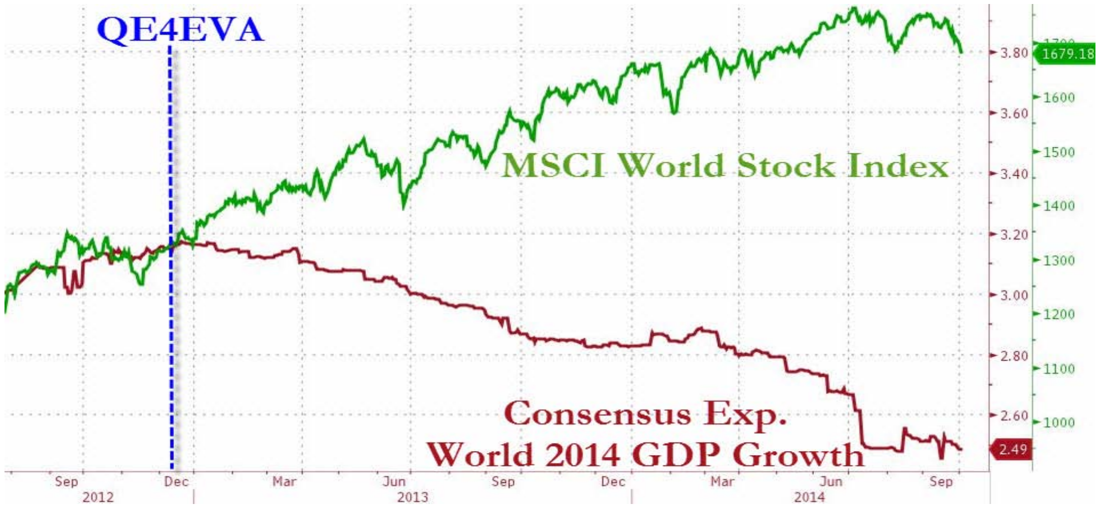

Source: Zero Hedge

Collectively the major economies have had Quantitative Easing (*'QE'*) in the range of $60 Trillion, at record low rates. And all that easy money has produced, is an unsustainable 'recovery' with ongoing hardship for most, and superficially elevated asset markets and the exceptional enrichment of a very few. This dichotomy and widening divergence was produced by years of unsound policies of endless money printing, unprecedented debt growth, rampant financial speculation, banking fraud, artificially inflated financial markets detached from economic reality, grotesquely widening inequality, contracting global demand, deflating GDPs, continuing high unemployment, job losses, and widespread conflicts, resulting in an economic and humanitarian global catastrophe swamping hundreds of millions worldwide. Entire countries and economies, like Greece, are teetering on the edge of bankruptcy and default in spite of hundreds of Billions and Trillions in bailouts over the past six years (*the 'looming catastrophe'*).

So far the Central Banks have failed miserably in fostering sustainable global or national economic recovery, but succeeded admirably in boosting asset markets, creating unprecedented inequality globally, and loading up the global financial system with un-repayable financial debt. Most of that debt will have to be re-negotiated or 'written-off' resulting in massive wealth destruction. It is the deleveraging that was supposed to have taken place, but wasn't allowed to, post the 2008 crash. Now, collectively we have all climbed up to the much higher level debt diving board, to take a deeper dive into the growing global economic and geo-political disaster and dysfunction.

On the whole, the global public is strapped on to an ever wilder ride, with no escape, being shaped and steered by the Central Banks that are visibly losing control of their evolving debt-laden creation, that especially over the past 6 years has been masquerading as sound economic, monetary and fiscal policy. Now, this debt engorged 'bug' called the Global Economy, is en-route to its inevitable meeting with the reality windshield, but this time, the

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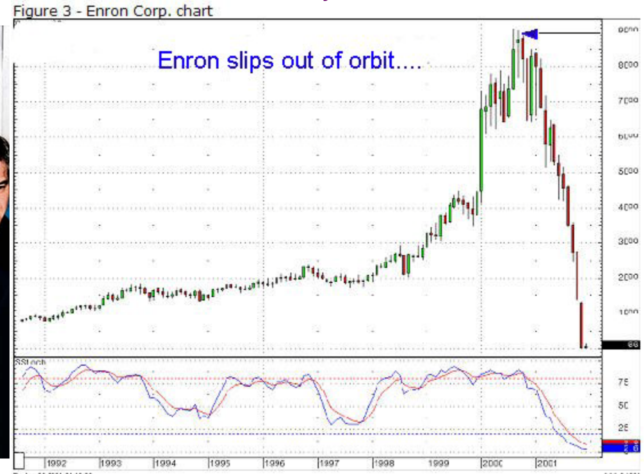
engorged bug will not only obliterate itself but it might also obliterate the windshield. Welcome to the economic catastrophe engineered by the "Smartest Guys in the Global Room" - to paraphrase the former Enron's 'brightest stars', who were equally confident of their invincibility.

Figure 3 - Enron Corp. chart



This inflating monster of unbridled greed and unrealistic expectations is the culmination of decades of rejection of regulatory, financial and economic discipline by the financial and global industry, and at their behest, by governments and their economic advisors. This steady growth in global liquidity, combined to an extent with important advances in technology, unleashed a prolonged period of increasing prosperity and consumption, resulting in global asset market appreciation and international trade prosperity. It also led to an assumption of a possible 'perpetual consumer-demand driven global economic model', that could provide endlessly growing trade, jobs, profits and expanding markets; a sort of economic nirvana, primarily built on ever escalating debt. That model worked until the increasing liquidity and the accompanying global prosperity unleashed the inevitable greed, corruption and over-consumption, which reached its zenith in the US sub-prime credit and financial securities fraud by the US based financial institutions that finally crashed the global financial system, in late 2008. The offending financial institutions and the collapsing global financial system were rescued by the governments through the Central Banks at the cost of the majority of the populations, and the same institutions are still being doused with easy money and encouraged to go out and play.

The severity, scale and suddenness of the crash caught most of the financial industry, governments and the public, unprepared, and the resulting deep contraction in financial markets, economies, and international trade devastated the security and financial position of the average person as unemployment spiked worldwide, equity disappeared and debt became a major and overriding burden. Suddenly, the demand driven economies of the World were awash in overcapacity, unemployment, debt and sharply shrunken global demand. The two Charts on the following page sum up the key problems afflicting global economies since the crash of 2008, dramatic

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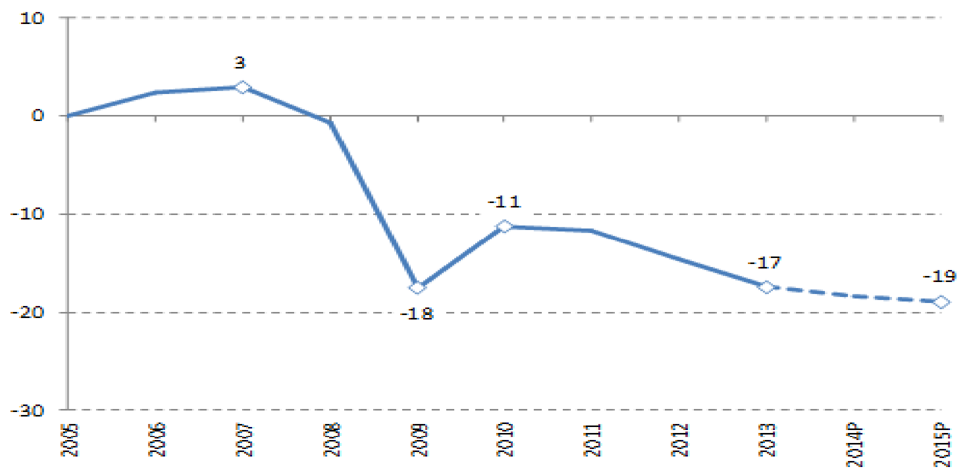
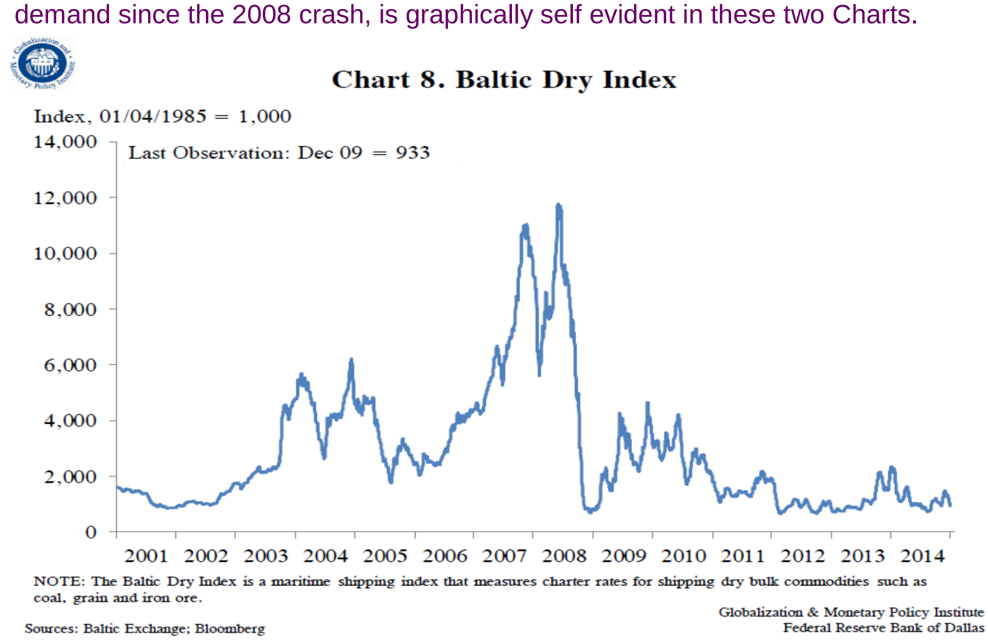
and persistent shrinking global demand, resulting in global economic contraction, over capacity and resulting potential conflicts, as governments try and deflect the increasing angst and public's attention from home grown problems. The tools used thus far, by the Federal Reserve and the other Central Banks, to stimulate demand have been massive and recurring financial stimulus and interest rate suppression. Both of these measures are the wrong kind of tools, and are being applied to the wrong end of the economies (*top-down*), doing next to nothing for the public while excessively enriching the already ultra-rich. The steady decline in global export volumes over the so called recovery years speaks eloquently to the failure of these economic policies that have been applied so vigorously thus far.

Chart: Deviation of world merchandise export volumes from pre-crisis trends, 2005 – 2015 (2014 - 2015 Estimates).



Source: World Trade Organization (WTO) Secretariat

Supporting the above Chart is the one below as it shows the steadily falling trade indicator of global dry goods shipments. The declining global trade and demand since the 2008 crash, is graphically self evident in these two Charts.



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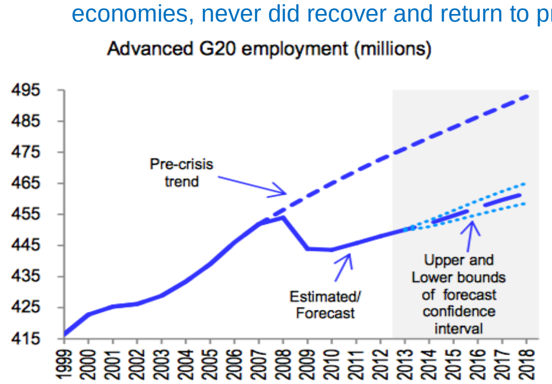
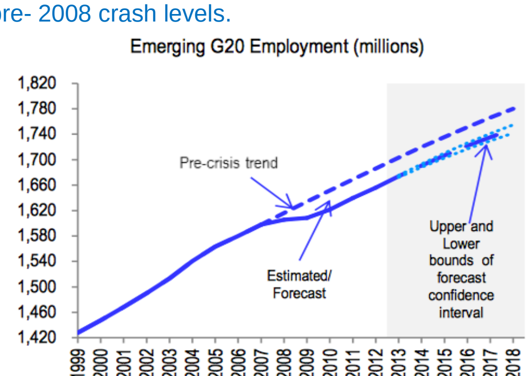
The post crash emergency intervention by governments was a study in cronyism economics by the powerful political and financial interests that had corrupted and crashed the system in the first place. The US Government, at the epicenter of the crash, was advised by the investment bankers of Wall Street, who shamelessly looked after their own interest at the expense of the public. Hundreds-of-Billions in immediate bailout funds to the largest financial institutions, over the past 6 years have turned into a flood of ever growing Trillions-of-dollars at near zero interest rate. The global financial system was flooded by Trillions-of-dollars in bailout and easy money, fabulously enriching the minute fraction of bankers, traders, and the already global wealthy (*the fabled 1%*), while costing the majority, their savings and home equity, and as they got laid-off by the tens-of-thousands, their very livelihoods. In most Southern European, the Middle Eastern, some South American and Asian countries, unemployment is in the double digits, and youth unemployment is in the soul crushing range of 25% to 50% plus. The current policies are robbing the youth of this generation of decent prospects of gainful employment, and the debt being piled on is robbing future generations.

This flood of near free money from the Central Banks, in the Tens-of-Trillions-of-Dollars (*which future generations will have to pay for*), has done next to nothing for the vast majority of the public, or the underlying economies, as is witness by the current rates of global unemployment, consumer debt overload, and industrial overcapacity. The resulting deflationary forces are requiring newer and ever greater amounts of QE and still lower, and in fact incredulously, negative interest rates in some advanced economies. For the populations of the advanced economies this is an ongoing disaster, as their jobs are increasingly tenuous, and their savings are gutted by ZIRP (*zero interest rate policy*), forcing the turn towards greater and riskier asset market speculation, as is the plan, and a possible wipeout.

For the emerging economies as a whole, the 2008 crash induced economic contraction was not as severe as in the advanced countries, and therefore the change in employment numbers was less, but the crash did bring their high single-digit and double-digit growth rates down quite a few notches, and since then they have struggled to pick up any real momentum, with the Western demand having failed to return to the pre-crash days.

The Charts below show that the employment levels in Advanced and Emerging economies, never did recover and return to pre- 2008 crash levels.





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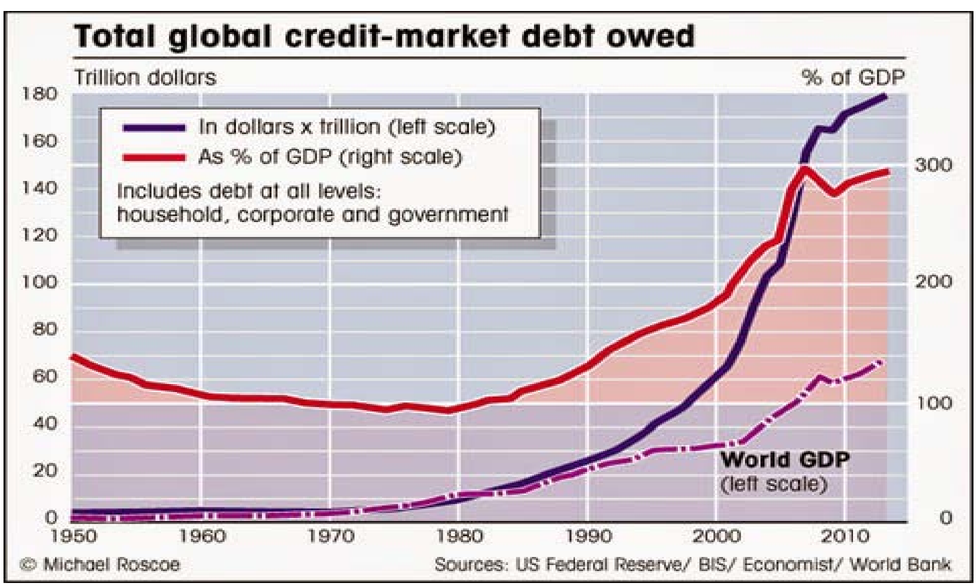
The increasing liquidity unleashed in the World goes back decades, and has spawned major bubbles and crashes, in Asia (*1997*), and in the West (*2000 - 2008*). Rather than being slowly curtailed and the focus shifted to desperately required structural reform, it was decided that ever greater liquidity, after every crash, was exactly the medicine required to bring the global economies back to the favoured state of '***perpetually expanding demand and consumption'*** that was now expected defacto, to be the only acceptable economic state globally. Centuries of economic cycles, human behavior and natural laws were to be tamed by the emerging power of the '***recession busting Central Banks***' (*our emphasis*).

Most governments, always amenable to be bought by powerful vested interests, always fearful of unhappy constituents, and always ready to spend beyond their means to placate them, discovered the unadulterated joy of the money printing presses (*through their Central Banks*), and thereby the means to try and keep everyone happy. Globally, they have piled on the debt with unmitigated abandon, which continues till today (*the current balance being a lot higher than the Charts below show*). Since 2007, US$57 Trillion in debt will have been added to the global economies, according to a report by McKinsey & Company. Debt has continued to rise much faster than the World GDP, creating a massive net deficit in serviceability. That's why, unless debt creation is dramatically curtailed **and** economic productivity rises dramatically to narrow the widening gap (*Chart below*), even at today's low rates this overhang of unproductive debt will be unserviceable and will have to be written-off, with very negative effects.



The gap has not been wider in the 60 plus years shown

The global Central Banks and the their governments are hoping to inflate this debt away over time, but as we had stated before, without proper deleveraging and restructuring, sustainable economic recovery could not take place, and is still unlikely. Therefore the chances of inducing controlled inflation is unlikely, what is more likely is that in the determination to induce inflation, in a naturally occurring deleveraging cycle, so much unproductive debt will be piled on that the global system will crack under the strain. As countries, companies and consumers struggle, the economically-detached financial markets are being driven up, inexorably, by a continuous flood of cheap and easy money, creating a very real threat of a prolonged and serious correction. After all, such policies till date have resulted in a fracturing global economy, falling trade and demand, deflation, currency wars, real and geo-political proxy wars.

As new Trillions are printed and pushed into global banks and large financial institutions, and into the gleeful hands of financial speculators at near zero percent interest rates, lessons in lack of ethics and morality aside, what is truly alarming is the fact that the governments and their economic advisors are not changing course, as their actions of ever larger stimulus packages fail to deliver the desired results. Instead, as their goals are not met, like irrational gamblers they are doubling-down with ever bigger bets.

The growing debt expansion and liquidity continues to promote over indulgence in speculation and mal-investment, and an ever fragile, unstable, geo-politically fracturing global economy that is inexorably deteriorating instead of recovering. This is the exact opposite of what was supposedly desired by the years of global stimulus and interest rate suppression by all governments and Central Banks. Additionally, the means chosen to douse the dangerous flames of the 2008 subprime credit and debt conflagration have been ever greater truckloads of debt in the form of printed money, and the resulting larger conflagration is met with even greater truckloads of printed money. The decision to smother the fire with the fuel that started it all, ever growing mal-invested liquidity - spawning asset bubbles - is now the strategy and remedy adopted by most Central Bankers today, the hapless public is along for the ride.

Central Bank led solutions are not fixing the severe economic and the resulting social problems of the vast majority of the populations in most countries, where unemployment is still in the double digits, and youth unemployment is in the range of 50% or more. These struggling countries, still being battered by the effects of the last crash, and now wallowing in un-payable debt, make up the bulk of the current Euro Zone. If Greece is successful in renegotiating its debt from its creditors, other heavily indebted countries whose populations are facing similar hardships, will follow suit. That will unleash waves of volatility in the financial markets, further rocking an incredibly shaky boat. If Greece is unsuccessful in its negotiations, then all bets are off for the continuing integrity of the current makeup of the Euro Zone. A day might come when the Euro Zone will fracture into a North and South dual entity, but for now the desire of its members is strong to keep the Euro experiment intact in spite of the economic and political challenges.

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EUROPE: By the beginning of this year (*2015*), Europe (the '*Euro Zone*') was in such desperate economic shape it needed to be rescued again by its Central Bank to the tune of a $1.3 Trillion stimulus package. But more importantly, its persistent state of economic stagnation, coupled with its unwieldy financial and political structure, has spawned a tidal wave of frustration and rebellion that resulted in the election of a far left government in Greece. To us this is akin to a hand grenade going off in an armory storeroom full of much larger ordinance. There are ticking political and debt time-bombs in neighbouring countries of France, Italy, Spain and Portugal and others. The recent developments in Greece have the potential of blowing the Euro Zone and the Global Economies apart, in spite of all parties trying desperately to prevent such a seemingly inevitable and explosive outcome. A rebellion has been started by the Greek people against the unbalanced and structurally flawed economic model that has been employed over the past six years, and it will spread to other countries (*European and non-European*) which are in similarly untenable indebted positions. The global Central Bank led solutions are not fixing the severe economic and the resulting social problems of the vast majority of the populations in most countries, where unemployment is still in the double digits, and youth unemployment is in the range of 50% or more. These struggling countries battered by the last crash and now wallowing in un-payable debt, make up the bulk of the current Euro Zone. If Greece is successful in renegotiating its debt from its creditors, other heavily indebted countries will follow suit. That will unleash waves of volatility in the financial markets, further rocking an incredibly shaky boat.

In a normal democratic country it is very difficult for one government to rule effectively, due to incompetence, corruption, competing demands of vested interests, and the usually fractious and uncooperative opposition parties they have to contend with. In the Euro Zone there are 18 countries with the Euro as the single currency, and 28 overall member governments, plus all their opposition parties that together have to maintain enough of a consensus for the Euro Zone to operate semi-effectively. It is entirely admirable how the Euro Zone has been able to come together and not only hold together all these years, but in fact become a desirable organization to join and expand. But these last few years of extreme economic stress has brought to the fore the serious shortcomings of a partially integrated political, economic and financial system. The Chart below gives an idea of the political complexity of the Euro Zone, and though dated, the political volatility depicted is quite representative even now.

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Source: Deutsche Welle

The negative and constraining aspects of a single currency for such a culturally and economically diverse body have become quite a problem, especially for the struggling southern Euro Zone economies. Without the ability to devalue their individual currencies to adjust to their true internal weaknesses, these countries and economies are at a serious disadvantage in this time of contracting international trade markets, both in the Euro Zone and outside of it. This unwieldy structure is holding them hostage in a time of painfully needed economic and currency adjustment, where they need maximum freedom to maneuver individually, but are instead locked into a 'collective'. The net result is, the southern European countries are finding the prolonged agony of contracting economies, the need for recurring bailouts, the resulting imposed austerity measures by their Northern members, especially Germany, crushing debt, staggeringly high unemployment - especially amongst their youth - and severely eroded lifestyles, all quite unbearable. This prolonged and ever growing pain is fostering radical political and ideological shifts, nationalism, racial intolerance, and political radicalization, resulting in fringe political parties coming to the fore, and to power. All these seemingly intractable problems are spawning a backlash and resentment in the populations of these countries, which the fringe parties are exploiting. The anger is growing against the lack of economic improvement, imposed and painful austerity measures, the North – South economic divide and the ongoing suffering. This growing resentment, in the hardest hit Southern economies, may result in the ultra left or ultra right wing nationalist political parties coming to power, on a platform to break away from membership of the Euro Zone, and free themselves from the constraints and inflexibility of a single currency, and the dictates of the bureaucracy that runs the Euro Zone from Brussels.

Since the rapid rebound in 2009, the Euro Zone has barely managed to stay above water, with its GDP slipping back into negative growth territory in 2011 (*Chart next page*) and barely coming up for air in 2014. In January 2015, the

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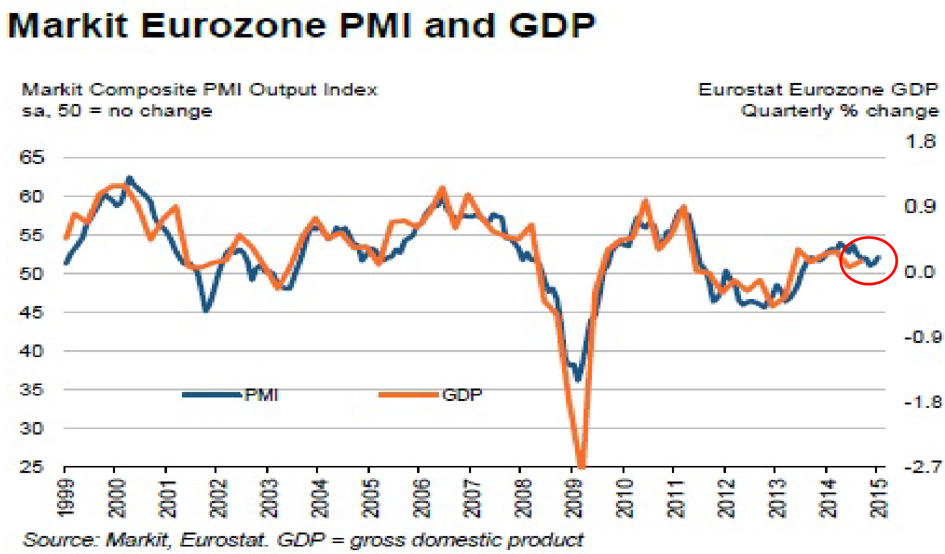
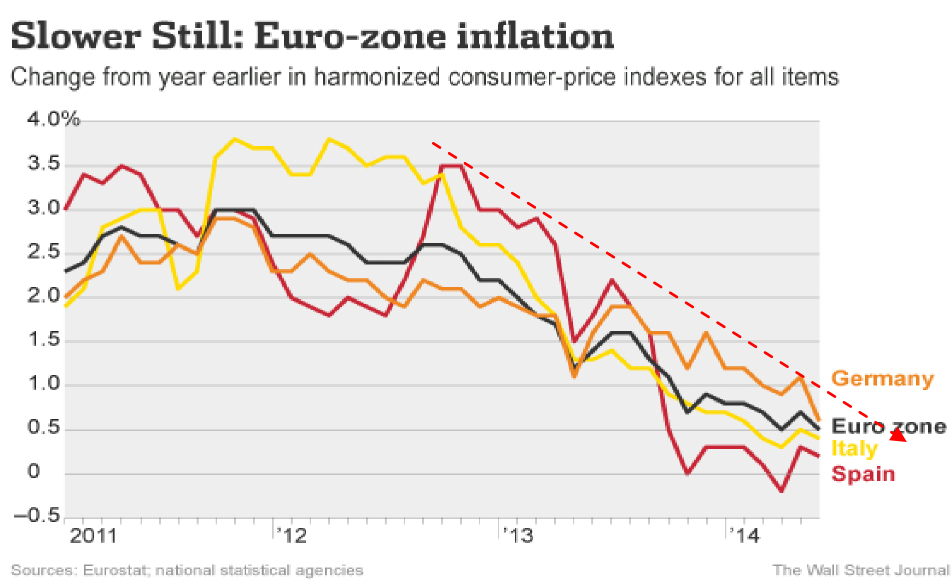
Euro Zone (*EU18*) is barely above negative growth territory at about 0.03%.



Besides the economies stagnating, the Euro Zone is also fighting a losing battle to the forces of deflation (*Chart below*), forcing the European Central Bank (*ECB*) to propose an aggressive One Trillion plus round of stimulative action through sovereign bond purchases of its member governments.



Today, Europe is inundated with a number of economic and political problems that are serious enough to threaten its very structure as the Euro Zone and its single currency, the Euro. Its internal economic and political problems are being exacerbated by its confrontation with Russia's aggression and the resultant drop in trade exports and energy imports from that country. In fact Europe is embattled by external and internal conflict that may not go away anytime soon and may lead to a disaster for the Union.

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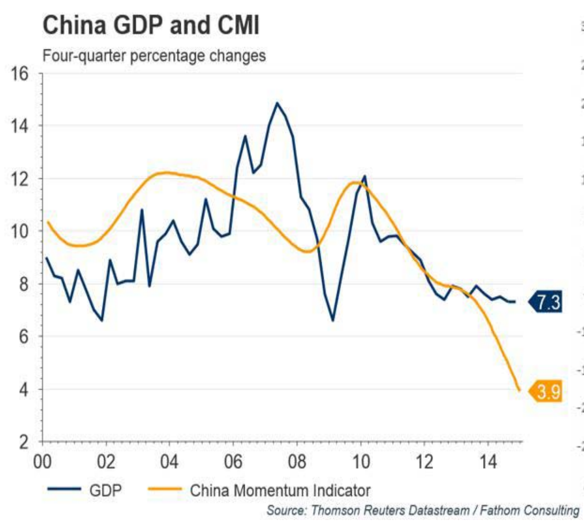
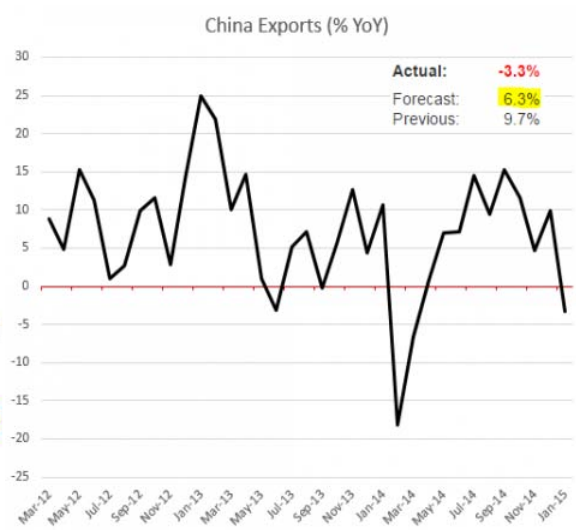
CHINA: The other growing threat to global economic stability is deflating China. Bereft of the seemingly endless voracious global consumer demand for its manufactured goods, China is sinking in serious overcapacity, years of mal-investment, and significant corporate, local government and State owned enterprise unproductive debt. Its government is desperately working all its control strings to try and engineer a 'soft landing' as its economic growth rate decline *accelerates*. The targeted 7.5%+ growth rate has long been discarded, and the new 7% target is also an illusion as its true rate of growth is probably in the vicinity of 5% or less, and heading lower. The required turn inwards, towards internal consumption, to compensate for the drop in Western consumption, will take years if not decades to be adequate enough to help boost China's GDP growth rate into the double digit range again. China will probably settle down to a more moderate rate of growth as its economy matures, and it faces increasing competition from less developed rivals that are further behind on the development curve. At this time almost all indicators are pointing down in China, and in our view it will not reverse this trend anytime soon.





Apart from a slowing economy, being pushed down by the *decreasing* global demand and *increasing* global competition, particularly in manufacturing (*as every struggling economy tries to boost its exports, which is just about everyone at the expense of China*), China's real estate and credit markets are posing an ever growing financial threat to its over bloated, over mal-invested financial system. Between the slowing economy, declining asset markets (*factories, land, overdeveloped real estate, and stock piled commodities - already paid for*), its famed local State and corporate shadow credit markets, and wide spread corruption, which in spite of a much publicized crackdown is endemic to the system, in our view, even China's powerful Government is facing a few too many challenges to be able to control everything and land it gently. The odds are certainly against it.

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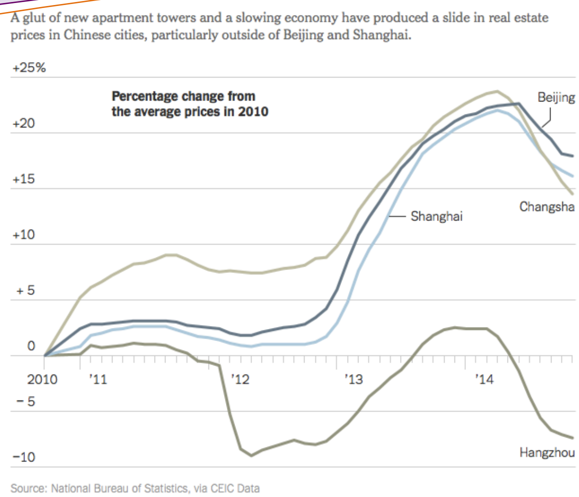

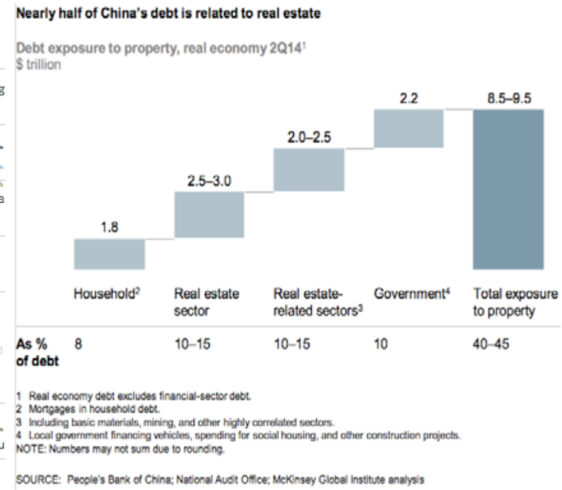

China also faces external geo-political-economic threats and shocks that could upset its plans for a controlled soft landing. Like all major economies it is exposed to competition (*especially the Yen and the South Korean Won*), risks in global currencies (*especially the US dollar*), and any major correction in the global debt/stock, real estate and commodities markets. In its current economic state China is particularly vulnerable.

Most experts, economists and analysts have tremendous faith in the political and financial power of the Chinese government to avoid any real problem to its economic, financial and political system, and therefore cannot see any possibility of a crash or a hard landing. They may be right; the Chinese government has tremendous power internally, and a fair bit externally. But we do not have such faith, as we know along with its strengths China also has tremendous weaknesses, economic and political, internal and external. To us, China today is a combination of an earlier version of the economically infallible Japan, and the once all powerful political and military superpower, the former U.S.S.R. And given the right conditions, in fact evolving right now in the geo-political economic global arena, we believe China is heading for significant economic difficulties as the kaleidoscope of global economic and political readjustments shift to China's disadvantage.

The tremendous cushion of foreign reserves that China holds is vulnerable to a U.S. dollar collapse, hard as it seem to envision at this time. China is more than aware of its vulnerability and has been aggressively divesting its U.S. dollar horde by investing in hard assets abroad, encouraging trade deals in Yuan, and in purchasing and stockpiling gold. These measures cannot compensate for the shrinking global demand and internal financial and social problems that China is facing today. Therefore, we can see problems both on the economic and political front plaguing China in the coming years and hence China contributing to the growing global volatility, while itself being increasingly affected by the current external global economic weakness, and the escalating geo-political turmoil.

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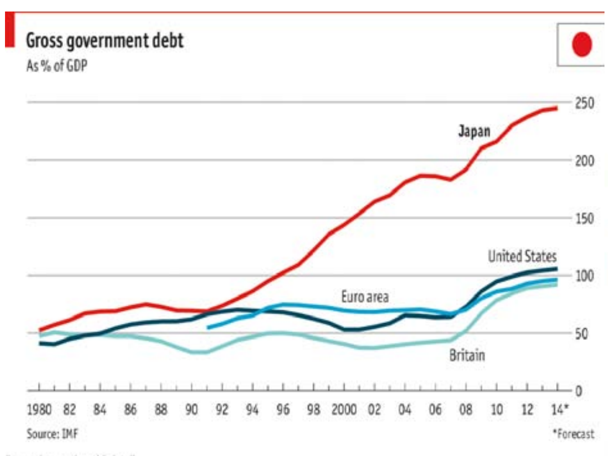
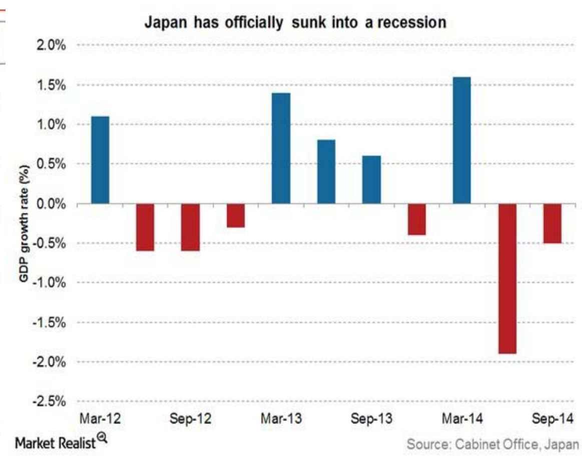
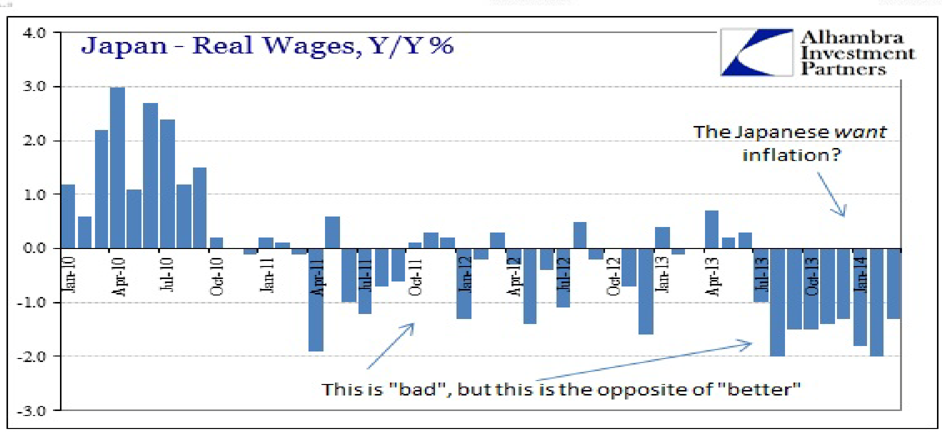
JAPAN: To us, it seems Japan is beyond redemption. Abenomics, as applied so far without the long required reforms isn't enough. The required social and economic reforms needed to correct what ails Japan have not materialized for over two decades. Japan is locked in an endless static state of negative rates, limitless money printing, dramatic yen devaluation, a stagnant economy and rapidly worsening demographics. The Abe Government and its ultra-supportive Central Bank have pulled out all the stops in flooding the financial system with liquidity, but its economy stubbornly continues to sag. Of course, as envisioned, its aggressive drive to continuously weaken the Yen till the elusive, and until now, always out-of-reach target of 2% inflation rate is discovered and captured, is predictably triggering rounds of currency devaluations from competing countries, in a downward spiral in the zero sum game of international currency wars.

Recently, the US Government has appealed to the G-20 Finance Ministers to **not** engage in currency devaluations as a means to boost economic growth. In a steadily deteriorating global economic environment, where every country is increasingly for itself, and desperately needed exports are required to support growth, even in the US, we think there is little chance any Finance Ministry, particularly Japan's, is going to heed the US's admonishment and show too much restraint, if it means their economic well-being is at stake. The Charts below show the dangerous divergence of the current dramatic ballooning of Japan's debt, versus its actual current economic performance.







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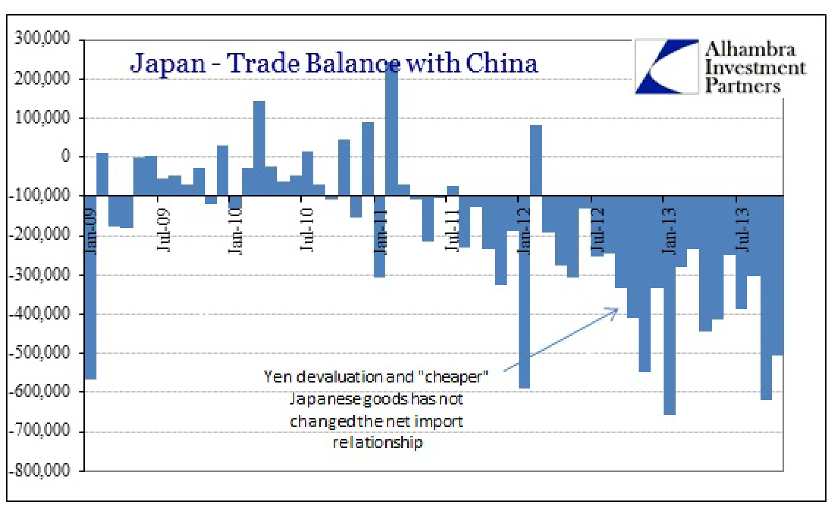
So far Abenomics has failed. As is well known Prime Minister Shinzo Abe went to the polls and got a strong mandate from the Japanese people to 'carry on!' And he has. The Bank of Japan has pulled out all the stops in printing money and devaluing the Yen, in its attempt to boost inflation. The same model as most every other Central Bank is using, only far more turbo-charged. In fact so turbo-charged that no country has quite gone into this "full-speed-ahead!" and "damn-the-torpedoes!" mode, in quite such a fashion. In our view, Japan will still fail in its desperate attempt to break out of its deflationary trap as it faces a declining world market demand, currency wars, global competition, corruption, crony capitalism, static internal demand and sharply worsening demographics. Additionally, most of Japan's largest companies have a significant portion of their manufacturing situated in foreign countries where they are not helped by a devalued Yen, but are affected by the local business and political environment, and the values of local and international currencies. All these factors present too many strong headwinds for Abenomics to overcome, in our view. These factors mean that Japan will continue to struggle till meaningful reforms are undertaken.



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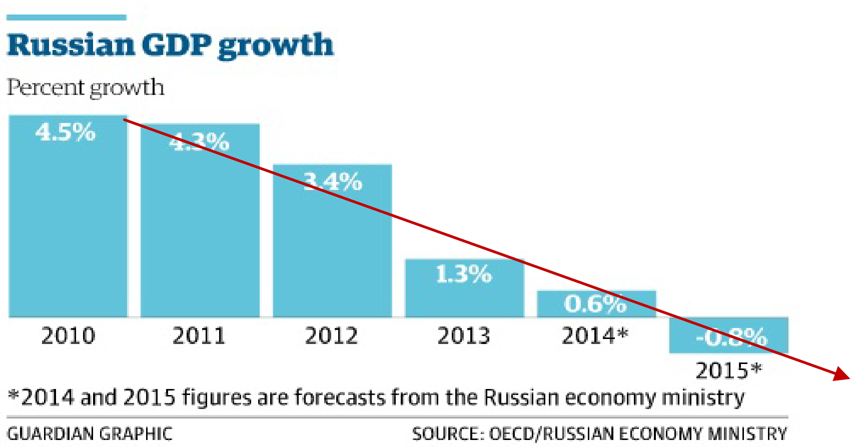
RUSSIA: Currently the Russian economy is imploding due to its ill-timed geo-political strategic play in Ukraine, with all the resultant negative consequences such as western world sanctions, capital flight, the destruction of the ruble and the resulting high interest rates. Additionally, all these negative consequences have run into a devastatingly inopportune and ruinous oil price collapse, triggering a virtual crisis in its primarily energy based economy. The Russian people are once again facing economic ruin as their economy gets battered by external and internal forces outside of their control. President Putin (*the supreme oligarch*) is determined to bring back some of the power Russia enjoyed in the glory days of the U.S.S.R., while also pushing back at the hemming in of the current Russia by the Western Alliance (*NATO*).

With its former industrial might shattered, and scattered, as it lost its satellite eastern European countries, the Russia of today is economically diminished, handicapped and overly dependent on its natural resources. The Chart below shows its declining growth rate, as lack of global demand pushes down commodity prices. The western sanctions, but more so the steep international oil price decline, if it holds, will seriously hurt the Russian economy in 2015, probably a lot more than the Chart indicates.



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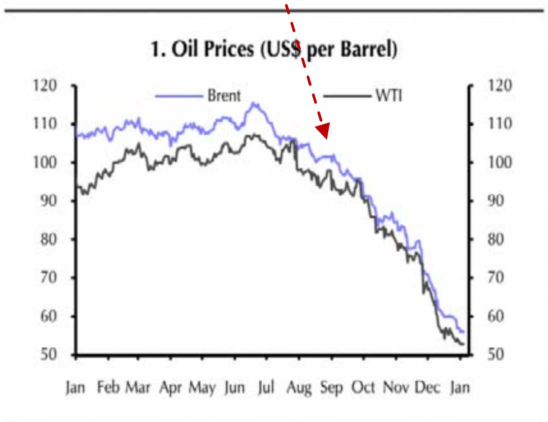
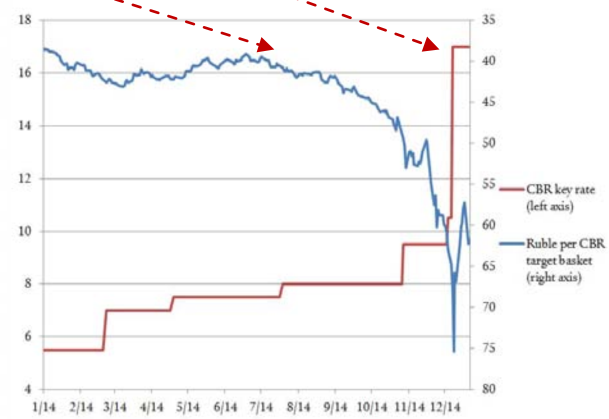
OIL PRICE COLLAPSE- ROUBLE'S COLLAPSE- INTEREST RATE SPIKE = RECESSION!





While the oil prices have recovered a bit, we do not see any quick resolution to Russia's economic and geo-political problems. It is not possible for Russia to escape its vulnerabilities to low oil prices, or to diversify its economy any time soon; it is also not possible for President Putin to back down on his much internally promoted - 'international restoration of Russian power and pride' - Ukraine power play.

In both instances President Putin is in a corner, with no easy and internally acceptable way out. Being pressured internally by a collapsing economy, and externally - primarily by the NATO Alliance (*Europe & the US*) - President Putin becomes altogether far more dangerous now than before. While nobody knows exactly what he will do to extricate himself and Russia from the potentially face-losing economic straight jacket, or the geo-political face-off with the West that has developed under his singular leadership, one thing is reasonably certain, Russia will not be contributing anytime soon to global economic and political security.

At the moment Putin seems to be brow-beating and out-maneuvering the US led NATO Alliance, gaining territory in Ukraine, and gaining influence in Europe and the Middle East. So far he is winning and racking up geo-political and territorial gains. These successes may encourage him to expand his end game in the face of a hesitant, seemingly fractured and weak-kneed Western Alliance. Therefore the end result over the near term will be rising geo-political tensions, instability, and significant financial volatility.

Nobody wants to contemplate an actual war between the West and Russia, but these days almost anything seems possible. Putin has already laid down the gauntlet of a possible conflict and warned the West of Russia's significant nuclear power and capability. Using that ultimate threat and his absolute control over Russia at this time, Putin is in a position to gamble more than any opposing Western leader can. In 2015, the possibility of a major and globe threatening war should be unthinkable, but there we have it, an unthinkable possibility, however remote.

Additionally, Putin is reveling in the new found centre stage role he has created for himself. Rising from life-long obscurity he is not going to give up that attention soon.

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Feeling increasingly isolated Russia is attempting to sow seeds of disunity among the Euro Zone members to lessen the effectiveness of their opposition to its current acquisitive and strategic ambitions in Ukraine. Redrawing the lines of geo-political spheres of influence and drawing-in its ideological partners (*dictatorial regimes*), China, Syria, North Korea, Egypt and even the recent economically disaffected, the left leaning and disenchanted Greece, Russia is increasing its international geo-political heft.

President Putin is playing the old cold war game effectively (*being a former KGB expert*), and in our view though ultimately contained, as the West has too much economic heft and fire power, and China needs the consumption of the West far more than Russian oil at this time, he will nevertheless show a few more daring moves before he is done. Those moves will add to the already heightened geo-political economic risks that the global environment is seething with. A cornered Putin is dangerous, and that is precisely what is scaring Germany's Chancellor Angela Merkel, as she is from the former East Germany and therefore is familiar with the mentality of such Russian KGB operative elite. In our view, we can only expect more short term economic and political grief for the global economy from Russia. It has become an increasingly 'one-man' State. Putin is a man who obviously has an insatiable appetite for personal power that he is unwilling to share or relinquish. He has the ruthlessness to be serious when he challenges the West with his nuclear armed war machine, to try to push back NATO's ever encroaching missile defense systems in near neighbouring countries.

Vladimir Putin set out to be the undisputed power in Russia (*he has accomplished that*) and secondly to restore Russia to some of its former geo-political power, and in trying to do so he has been and will continue to be completely ruthless with his own people, and the outside World. Having effectively silenced or eliminated all opposition within the Country, and convinced the Russian people into believing in him as Russia's savior, Putin has also closed all exits for himself and Russia, and has no choice but to threaten, bluff and browbeat the West into backing off.

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AMERICA: On the other side of the ideological, political and economic spectrum, the United States has been, all professed good-intentions aside, extremely damaging to the international geo-political and economic stability. Its heavy-handed, incredibly sloppy and disastrous interventions in the Middle East has destroyed entire countries and regimes, cost hundreds of thousands of civilian lives and seriously destabilized the entire area. Today, there is more war, terrorism, lack of security, lack of human rights or proper governance than ever before. It's embarrassingly hypocritical slogans of the export of "democracy, equality and human rights" etc. has left a swath of troubled and strife torn countries from Afghanistan to Iraq to Syria to Libya, whose innocent citizens are left to deal with the God-awful mess of ungoverned countries and sectarian/terrorist dominated violence. Those of us who believe in the genuine values of democracy, equality and human rights, are deeply disappointed in the performance of the sole 'Super-power' as it "policed" the World. While not all the problems can be attributed to the U.S. interventions, yet it had a large part to play in the mess the Middle East is today.

Middle East 2014: Chaos and Regional Wars

We are also deeply disappointed in the performance of the US when it comes to it the being the bastion of honest, ethical capitalistic values. Its performance on that front over the past decades has given the not-so-capitalist world enough ammo to jeer and sneer at the so called capitalist system. Bluntly put, the American capitalist economic system and values have been hijacked by rampant greed and extreme unethical behavior of its financial community, powerful elite and selfish vested interests and lobbyists. Over the past two decades, the expose of fraudulent, deceitful and criminal behavior of its political, banking/financial and business individuals and institutions has been stunning. It is not that this sort of thing does not happen anywhere else, in fact it almost routine in other parts of the World, but we hold the American system to a much higher standard - because they profess loudly to the World to do so themselves. Now that America exposes feet-of-clay, it is very disappointing and dangerous to the rest of the World.

Apart from having spawned fraudulent and reckless behavior in its own asset and financial markets through increasing deregulation, excess liquidity and greed, it exported vast quantities of toxic assets to foreign markets, creating

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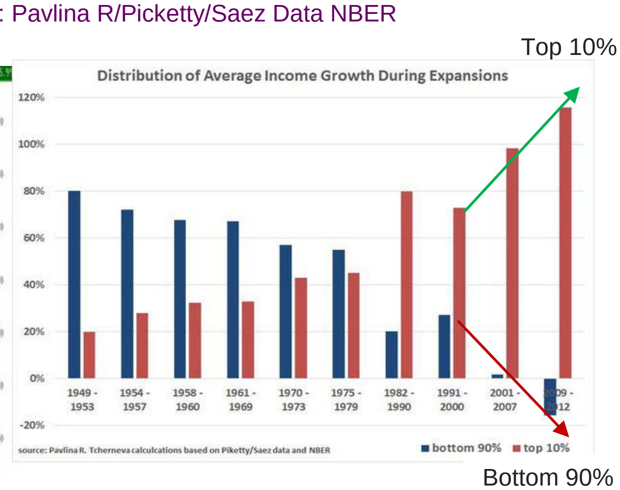
waves of destabilizing crashes, volatility and insolvencies. Its sub-prime credit shenanigans along with all the other toxic financial instruments created to leverage returns and fees almost limitlessly, through packaging and repackaging, for all intents and purposes broke the global financial system, which after over $57 Trillion dollars being injected into it, is still is not quite fixed. Not only is it not fixed but it has turned into a new type of reality which is detached from all known models and past economic realities. The only ‘old thing’ this new reality is doing is creating an enormous global bubble in debt, equity and real estate markets that once again threatens the global financial and economic system.

The Federal Reserve led and set the pace for the rest of the Central Banks, particularly in the advanced economies, in opening the spigots of excessive quantitative easing and extreme interest rate suppression. The pseudo recovery in the US is encouraging other countries and economic zones to adopt the ‘Fed Model’, as their own condition continues to worsen, even though the supposed architect of the successful model of ever expanding liquidity coupled with increasing deregulation, former Federal Reserve Chair, Alan Greenspan, has been busy discrediting it and acknowledging the harm it has caused and is about to cause yet again. Now, after all the Trillions spent the questionable ‘recovery’, if any’ is fragile, tenuous and generally reversing. But the stock and bond markets along with the US dollar have been unstoppable as they shrug off all manner of national and international stream of bad, and at times, alarming bad news and totally ignore fundamental economic realities.

The first Chart below shows the stock market ignoring developments such as the end of QE3, deteriorating ‘Macro’ economic data, and even dramatically declining ‘Forward Earnings’. With the markets ignoring all negative news that in normal times would have caused retrenchment, or at the very least – hesitation - today’s markets just keep going. The effect of the policy of excess liquidity in the form of QE and zero rates has been to create an unstoppable stock market, and an unprecedented enriching of the top 10% (2nd *Chart*) while the majority 90% lose ground.

Source: 1st Chart: Zero Hedge – 2nd Chart: Pavlina R/Picketty/Saez Data NBER



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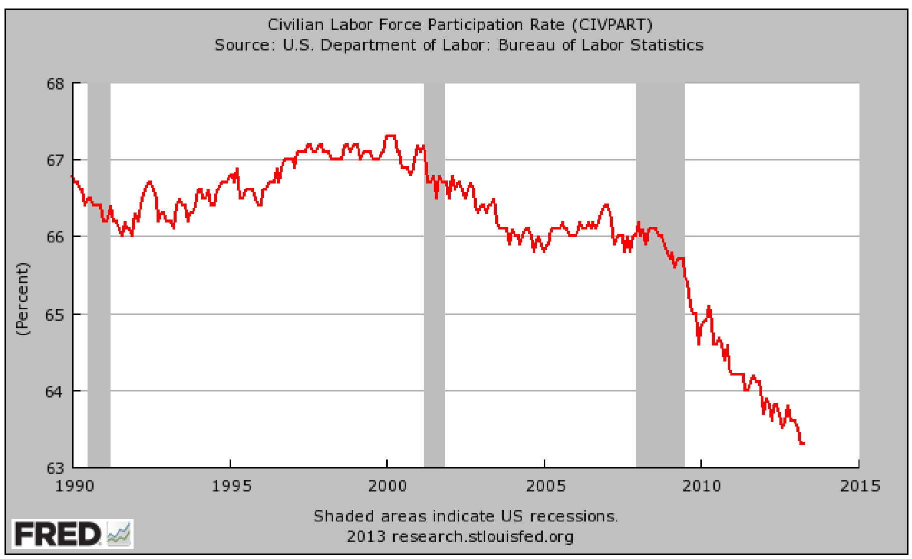
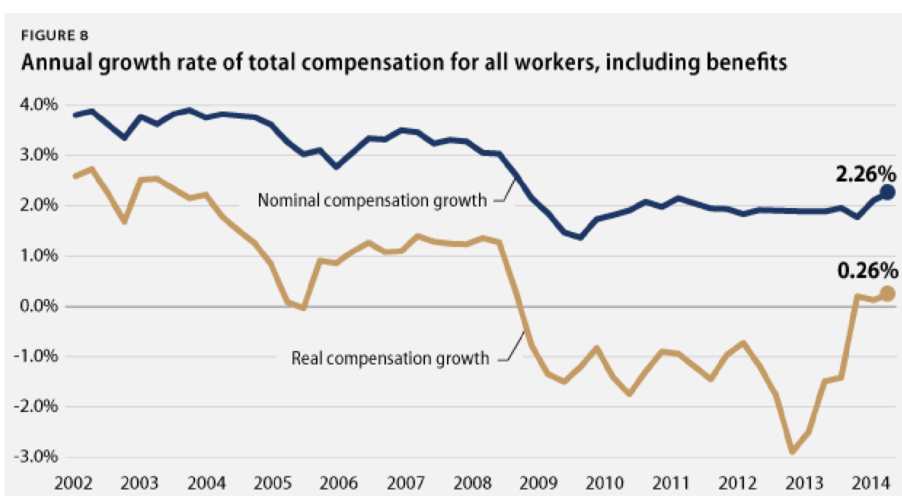
The American profligate spending recently, and over the past decades, and its current gravity-defying, levitating financial markets pose a serious threat to its economy, and hence to the global economy. The day its markets correct, they will take down the global markets far more dramatically than after the 2008 crash. This seeming invincibility of the US currency and financial markets, along with a seeming recovery, has greatly emboldened other Central Banks to follow suit and hit every recurring sag, in economic performance with greater doses of liquidity. The fact that the economies aren't recovering and are requiring deep structural changes is being ignored, as that would be painful, and could exact a price from the ruling class.

The low unemployment numbers achieved by the US do not reflect the steadily declining rate of labour participation (*Chart below*), nor do they reflect the poorer quality of jobs being the mainstay of the current improving unemployment numbers, nor do they indicate the declining and stagnant compensation for all workers over the past decades.





Source: Bureau of Labor Statistics, "Employment Cost Index," available at http://www.bls.gov/news.release/eci.toc.htm (last accessed August 2014); Bureau of Labor Statistics, "Consumer Price Index," available at http://www.bls.gov/cpi/ (last accessed August 2014).

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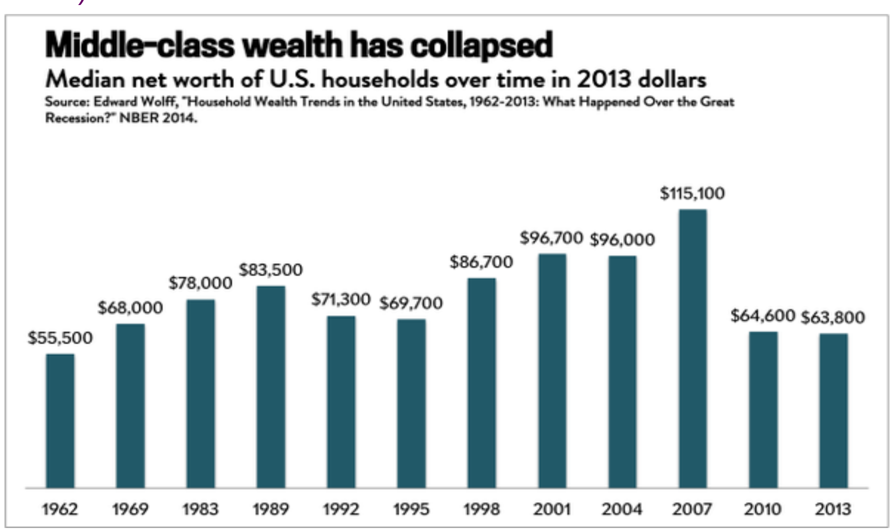
This reality of the 'much worse off' majority - coupled with the loss of wealth and equity of the average person, in the crash of 2008, has resulted in home-ownership in the United States being pushed back to **pre-1995** levels.

Middle class America that built the wealth and economic might of America have lost serious ground, with their incomes declining or stagnating at best, and their household wealth having fallen by almost 41% since 2008 (*Chart below*).



The top 10%, while enriched incredibly in the past 6 years - do not the American economy make; nor do the stock or bond markets; which also have soared to record highs. They reflect, to a degree, the underlying wealth of the general economy. But in this case (*post 2008*), the incredible growth in wealth, as denoted by the rise of the top 10% and the financial markets, is directly due to the flood of cheap money pushed into the markets by the Federal Reserve in the past 6 years, and certainly not due to the growth in productivity in the economy, or any other economic fundamentals. Yes, there has been an improvement in the growth of the economy, but it was at the cost of more than $4.0 Trillion being printed and pushed out by the Federal Reserve, most of which didn't go into the economy. Our steadfast contention

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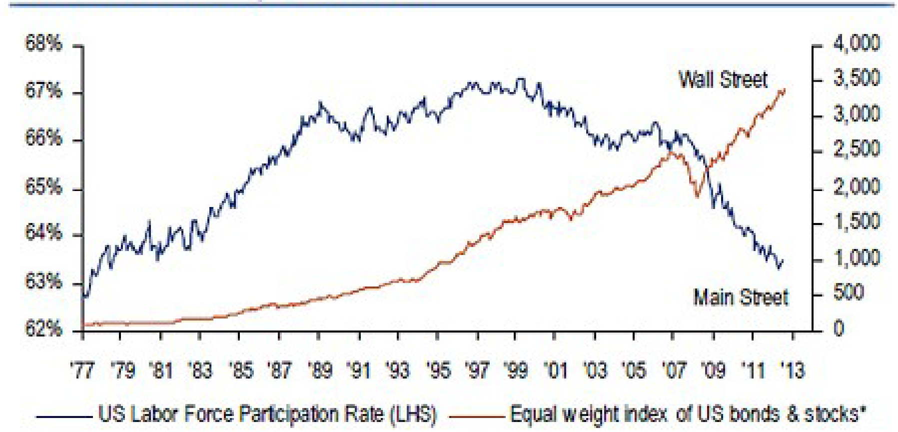
has been that the American economy never did recover, and any signs of health are primarily due to an extraordinary intervention by the Fed to inflate it, at great future expense. Having said that, in our previous Reports we had identified the US economy as one of the few that would show growth, and it has. But from here on out, while most analysts and economists expect strong on-going recovery we expect retrenchment. As mentioned above, we expect all the negatives in the current global economic structure and the retrenchment in most of the major global economies to act as a drag on the US economy in spite of the fact the Fed cannot afford to raise interest rates.

In an increasingly unstable and dangerous global geo-political environment, the wealth, military power and relative stability of the US economy, has acted as a magnet to capital fleeing the more dangerous or unstable places, thus helping to drive up the dollar, asset prices in real estate, and stock and bond markets, beyond the prolonged active inflating by the Fed. This is where we feel the greatest danger now lies, in the inflated values of the asset markets in a volatile and increasingly unstable global environment. The current situation makes the possibility of a major correction sometime this year almost a certainty and the avoidance of one a miracle. Yet at times miracles have known to have happened. The United States of today may be known as ‘the cleanest shirt in a basket of dirty laundry’, but we over the past few years have not seen it as such. We see too much dirt of its own to differentiate it much from most of the others in deep trouble. The Federal Reserve white wash has not washed much with us.

Chart 2: Wall Street Boom, Main Street Bust



*Equal weighted total return index of US equities (DJIA) and US government & corporate bonds (B0A0)
Source: BofA Merrill Lynch Global Investment Strategy, Bloomberg

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There are a number of other major economies that could be covered in greater detail but the economies covered above, in our estimation pose the greatest risks for the global economic system today. So briefly:

Australia is on the edge of the precipice for having bet heavily on a deflating China; while **Canada's** resource rich economy is also beginning to unravel as commodities markets worldwide face a prolonged slump. In anticipation of an eroding global environment, the Bank of Canada has already started cutting its historically low interest rates further, in the forlorn hope of avoiding a serious slowdown. Unfortunately as a major export nation Canada is always seriously exposed, particularly to the US, and to the rest of the external economic environment, and at this time that external environment is looking really bleak.

The U.K. which posted positive growth numbers last year, along with the US, is also going to be sucked into the spinning vortex of the economic negativity created by all of the crumbing economies named above, and will therefore deteriorate over this year.

Most of the rest of Asia (C*hina already covered above*) is generally going to grow, including India, but the entire area is increasingly vulnerable to the continuing deflating western demand on the export front, and the strengthening US dollar on the financial front, even as the resulting collapse in commodities is helping the energy and resource importing economies for now. But the receding tide of contracting global demand, increasing export competition leading to continuing currency devaluations, and the threat of US dollar flight back to the US may still drag them backwards and into shallower economic growth rates.

Last year we foresaw a 'Looming Catastrophe' in the making. Well here it is, with enough geo-political conflicts, asset and debt bubble threats, and violent volatility in play, to satisfy the most ardent dooms-dayers, and give commentators and analysts more material to discuss and pontificate on, on a daily basis, than they could possibly have hoped for. Practically, every single day some geo-political-economic bad news explodes on to the global stage, and is shrugged off, because now the global financial markets have bought into the fact that the Central Banks are the global economy, and this state of constant injections of stimulus is the 'new normal', and it won't change, because it can't, because governments and their Central Banks won't let it. A surprise awaits those with such faith in governments and Central Banks.

Behind the current disturbing kaleidoscope of events and developments, is a larger looming catastrophe of truly worrisome proportions, as the three realities of asset and debt bubbles, persistent global economic stagnation, and geo-political conflicts spin ever closer to one another, till the day they intertwine and become a marauding global monster of falling markets, sharply contracting economies, conflicts, global political fragmentation, and protracted global deleveraging and restructuring.

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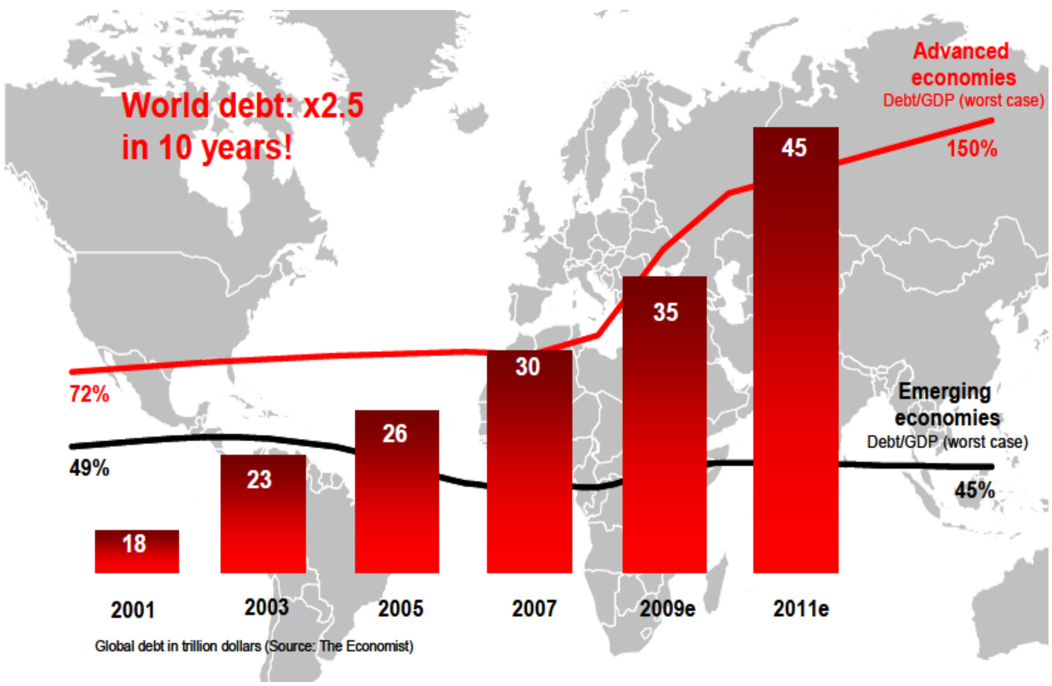
As we survey the current global economic reality, it is starkly clear that Quantitative Easing (*QE*) in all its excessive glory has failed miserably these past six years, to bring about any semblance of sustainable economic recovery. We had been steadfast in our contention all along that overly prolonged stimulus would not bring about economic recovery but in fact would be counterproductive, and after a point become the problem itself. That point was long reached in the global economies, and today (*beginning of 2015*), none of the major economies are able to stand on their own feet without their respective Central Bank's constant, active, and at times excessive support, either by cash stimulus or through extreme historic low rates, or both; not Europe, not China, Japan, all the others, not even the US economy. And thus the global debt continues to climb as Central Banks keep propping up the shaky and retrenching economies, particularly since 2008.



The growth in debt in of itself would not be such a problem if it produced measurable economic value at a rate greater than the rate of its own growth. But as we see in the Chart on the following page, the global GDP rate (*69%*) which is the blunt instrument of value creation, is substantially lower than the growth rate of the global debt growth rate (*103%*).That growing and accumulating debt 'overhang' (*Japan and Europe have dramatically ramped up recently*) and the net deficit in productivity and value, will have to be paid sometime in the future, and it is a fast growing bill.

As global governments increasingly encumber themselves under mountains of debt, a greater percentage of their future GDP will be used to just try and service that debt. That is why they must have inflation and extremely low interest rates - otherwise the cost of servicing the debt becomes too high.

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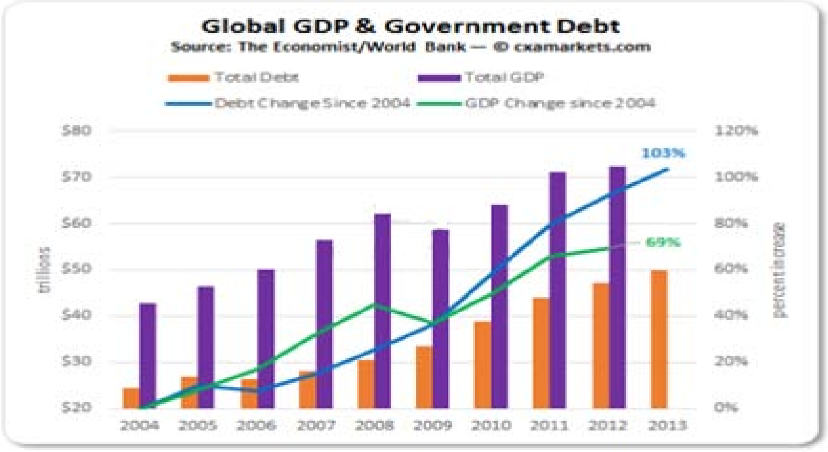

What a quandary the Central Banks of major economies have created for themselves and everyone else, an economic environment based on steadily climbing unprecedented amounts of debt, where they cannot afford to raise interest rates, or to stop quantitative easing, doing either *risks a collapse.*

For governments and Central Banks to keep going with the quantitative easing is to substantially increase risk as relatively unproductive money floods the financial system, increases debt and feeds the speculative bubbles in the asset markets that have no economic foundation under them. It is all starting to resemble the scene from one of the Indiana Jones movie where he is frantically running in-front of the giant round boulder that is rolling towards him and threatening to crush him (*the boulder being the economic/financial catastrophe that has been created to-date, and the Central banks and their governments being the running Indiana Jones trying to outrun it*).

This current economic aberration has so distorted the normal market forces that we cannot blame anyone for feeling that we are in some sort of a surreal movie environment, where reality is permanently suspended and everything in the end is going to be alright. Unfortunately, everything is not going to be alright as the current global economic status and data shows. It's an unmitigated disaster, being compounded by the very practices that caused it in the first place. All the unlimited printing of money by the Central Banks is doing, is making the rolling rock bigger and faster.

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After being proven right in our anticipation of a 'non-recovery' to-date, we remain skeptical of a global economic rebound in 2015 for the same reasons as before. We believe global overcapacity coupled with low global consumer demand is the real problem, and is going to remain a problem as modernization in the advanced and emerging markets, coupled with global technological advances (*higher efficiencies - robotics*) continue to increase per capita productivity, thus further exacerbating the over capacity problem globally.

Furthermore, the integrated global economies, in what now seems to be the former golden days of inter-dependent and expanding global trade, have developed into antagonistic, competing, disparate, self serving opponents rather than the collectively supporting allies that everyone had hoped for, a couple of decades ago. The age of narrowing interests driven by the fight to survive at the cost of other economies is here (*the age of beggar thy neighbour*). The weapons of this particular type of warfare are the Central Bank printing presses and the drive for lower interest rates to debase currencies and support speculation in their respective asset markets.

It has been our contention that methods employed so far by governments and Central Banks will not work because they overwhelmingly favour the already privileged and the wealthy 1% to 10%, create potentially dangerous asset and debt market bubbles, ***and the hoped for trickledown effect to the masses does not materialize, and is an imperfect, clumsy, and agonizingly slow process which has proven ineffective in combating the tri-part impact of over capacity of the global economies, the indebtedness of the consumer and the resulting lack of consumption*** demand since the 2008 crash.

It's not surprising that global growth is underperforming, but it is problematic that it is underperforming after global stimulus of about **$57 Trillion** has been already spent over six years, trying to make it perform!

Additionally, with the absence of any real stable recovery, or the return to a pre-2008 'normal economic environment', without the need for abnormal interest rate suppression, and the extraordinary injections of financial stimulus, and the weak job markets, the global consumer has no confidence to go out and spend, particularly when most of the them have not been the recipients of the near free cash that has been flowing by the Trillions from the Central Banks into the Banks, without directly benefitting the personal financial condition of the majority of consumers, which for most remains highly uncertain and stressed.

As we don't see a return to a robust demand by the global consumers any time soon, we do not see any chance of a sustainable recovery this year, but we do see a real likelihood of all things getting worse. The problem areas that are going to contribute to the growing threat of a disaster are the 'Greek problem', the 'Russia/Ukraine problem', the 'Contracting China problem', the 'Irrational Exuberance in the US problem', and the 'Excessive Global Debt problem'.