Air Is Leaking From The Economy's Tires

There are several signs based on prior experience indicating that not only are the US and Global Economies losing steam but the fuel that has propelled it, ultra-low interest rates, is not only losing its effectiveness but is becoming a threat to the financial system and the economy.

1) IPOs of money losing companies with "innovative" or "disruptive" business models are not doing well. Even if you can borrow at negative interest rates you still have to pay back the principal and a negative rate of 0.5% does not cover a 25-30% capital loss. Investors are thus becoming more risk adverse and are choosing value and low risk options as compared to growth and higher risk. This can become a self-fulfilling and self-reinforcing decrease in venture investment again affecting economic growth.

2) There is a huge BBB investment cliff in that this is where much of the ultra-low interest debt is located and if a firm's credit rating falls below BBB or investment grade, then some institutional investors can no longer hold these bonds creating a double negative, because the firms affected will not be able to refinance easily leading to defaults. Since banks are now starting to issue CDS against some of these bonds this will magnify the effect of the defaults at the very time the FDIC is talking about reducing the capital that banks hold against such derivatives. This seems like a set up to repeat 2008 on some scale.

3) There has been a major disruption in global oil supplies due to the attack on Saudi Arabia's oil fields and Iran is unlikely to have any reduction in sanctions, yet the oil price has not gone up anywhere near what one would expect indicating weakness in demand. This is another signal that the global economy is not growing robustly. This is confirmed by negative growth in the US, Chinese and Indian manufacturing sectors.

4) GM is sustaining a strike that neither side will win because there is over capacity in the auto sector and declining demand. Any vehicle GM makes can be bought from someone else and in the process GM will lose permanent market share plus replacement and service business. Even so the strike may persist, putting pressure on all the ancillary economies dependent on their continued operation leading to further business and consumer cutbacks. Real unemployment will rise even if it does not show up in statistics because the GM workers will not yet be looking for work.

5) Interest rate cuts while not assured will have less and less impact on the economy and markets due to the fact the economy is getting weaker and thus lower rates while being a small boost for equities, bond values and mortgage refinancing will not bring additional investment for the same reason that the large US tax cuts did not but instead mostly found their way into stock

buybacks and increased dividends. If there is weak demand and excess capacity, then there is no need to borrow or use available cash for investment no matter how low the interest rates or increased after tax cash earnings. The problem is not cash availability but the need for new investment capacity that is the problem.

6) As the Fed and other Central Banks lower rates, they are pushing on a string while reducing their ability to deal with the existing slowdown or worse.

7) There are now 1.1 million less medically insured than last year. Therefore healthcare employment as a major job generator since 2008 has taken a hit.

8) Consumer confidence is now starting to emulate investor confidence. This could escalate quickly especially during the crucial holiday selling period. The China trade war does not help. This on again off again situation will only affect the markets not consumer or business behavior. Once uncertainty and volatility have been introduced, they are there until the downturn has gone its course. This is already being seen as businesses and consumers become more cautious and less optimistic.

9) All these factors can and are likely to interact so that a dramatic shift in any one of them can have a cascading effect. This means a Bear Stearns or Lehman or Anstalt Bank event or something else as yet unforeseen can act a trigger.

10) It will end badly because Central Banks have used up their tools propping up the current expansion. The Congress has also constrained the Fed's ability to innovate. Given large government deficits fiscal policy may also be a less effective response.

11) We are entering an unchartered road with a vehicle that may soon be running on its rims.