**June 20th, 2016**

# Financial repression…

Global equity markets took it on the chin last week as heightened anxiety over the upcoming referendum vote on whether the UK remains in or exits the EU compelled investors to take more of a wait and see approach as they moved to the side lines with some of their at risk capital. On the week the Dow lost 190 points (-1%) and the S&P 500 declined almost 1.2% (a drop of almost 25 points) with the losses in Europe a bit deeper.

The "Brexit" vote has been dominating the attention of investors on a daily basis with the

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

latest poll results moving markets depending on which way they lean – risk assets rally on poll results favoring the "Bremain" camp and sell-off when the polls shift towards "Brexit". Case in point is the latest opinion poll by Survation conducted on Friday and Saturday for the Daily Mail newspaper released on Sunday that showed 45% in favor of remaining and 42% in favor of leaving. These results contrast with a similar vote conducted by Survation on Thursday – prior to the assassination of British politician Jo Cox – which resulted in the "Brexit" camp leading by 3 points.

This subtle shift in the polls was enough to set off a 'risk on' rally which started in the futures market on Sunday evening and has carried over into the open of trading this morning, with this morning's move completely unwinding last week's equity market decline.

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

As you can see this remains a very fluid event with most polls showing the outcome as too close to call while the "betting parlors" (which is where actual money is at stake) peg the odds at nearly 80% that the UK remains in the EU following the results of Thursday's vote.

Make no mistake, this U.K. referendum vote is all about immigration and the Brits interest in reclaiming control of its borders even if it comes at the cost of a near-term economic recession. Recall that the E.U. is made up of 28 member countries which allows for free movement of goods, services, workers and capital across borders. The Financial Times ran with an editorial column last Thursday, stating "the influx of European Union migrants, far greater than successive governments predicted, has stirred fears about jobs, public services, and British identity". National security has leap-frogged individual

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

pocketbooks as it pertains to social motivations with the global rise in terrorism and the inability of an integrated EU to adequately police and control its borders.

The short-term capital market impact on a “leave” vote would (in my opinion) be material, especially with the overwhelming expectation that “remain” will be the eventual outcome. A “leave” outcome has almost entirely been priced out of the financial markets at the current time whereby investors should understand that a severe risk-off unwinding of investor positioning would transpire with a likely overshoot to the downside if the result ends up counter to current expectations. This is a little bit too one-sided positioning in terms of risk/reward for my taste, especially given the narrowness in the polls.

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

Nevertheless, it needs to be understood that even if the U.K. were to vote to leave, this vote is a non-binding referendum – meaning it is not a legally binding vote. Perhaps U.K. Prime Minister David Cameron underestimated the will of his citizen base behind this movement when he said he would listen to the people on the results of this referendum. But guess what – it's highly likely that Mr. Cameron would be forced to resign if the 'leave' camp prevailed and he therefore wouldn't be around to push it through Parliament. Speaking of Parliament, if the vote is as split down the middle as most of the polls suggest then there is virtually no chance that a Parliament (where 75% of the members oppose leaving the EU) passes a "leave" referendum. However, if the voting margin were to come in somewhere in the area of 60% to 40% in favor of "leave" then that would be a different story.

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

One last thing for investors to keep in mind is that even if the “leave” camp were to prevail, the U.K. would have what amounts to a two year workout period to ink new agreements with EU member countries as well as the rest of the world – so this would not be an immediate divorce.  This would likely result in a hit to growth for the entire globe which can ill afford such a hit in what is already a pedestrian global growth environment. Furthermore, the bigger global concern is how and if this would set off a domino effect with other EU members lining up to exit the pact in what ultimately marks the end of the EU as we know it.

Enough about that, as I do think in the end cooler heads will prevail and no matter which way the vote falls (unless the ‘leave’ camp prevails with a rather large margin) I don’t

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

think it ever leads to an actual 'Brexit'. Although, leaders and investors around the world need to be mindful of the growing anti-establishment movement that is taking hold across the world from the EU, to growing frustration with economic stagnation in Japan and the failure of Abenomics, to floundering confidence in China's leaders ability to smoothly navigate its economic transformation, to here in the United States with the rise of Trump – the presumptive nominee for the Republican Party who carries an unfavorablity rating nearing 70% with less than five months until the election.

The voting public around the world is putting the establishment on notice that it is no longer going to sit idly by and accept the status quo. This looks like the makings of a movement that has legs and will be growing in its

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

importance and impacts on economies, societies, and markets.

The Fed concluded its two-day FOMC meeting last week where they left the Fed Funds rate unchanged and for the second time in six months they significantly lowered both their economic growth and future interest rate forecasts. In a matter of nine months the Fed has sliced its forecast for the Fed Funds rate by 100 basis points! Now this may not seem like much to someone outside the financial profession, but this is a rather material acknowledgement that interest rates are set to remain 'much lower' for 'much longer' than what the Fed previously expected. This is of little surprise to the capital markets as they have held this expectation for quite some time, but it's taken the Fed a little while to accept this reality.

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

So here we have a Fed and its Chair Janet Yellen, that in the span of six months has gone from hiking rates in December (while guiding markets to expect an additional four hikes in 2016) on the back of stronger economic growth and an improving labor market, to a dovish shift in March when the global economy was on the brink of collapse (where they cited significant global economic risk weighing on global growth and guided markets to only expect two rate hikes in 2016 from its previous guidance of four hikes), to hawkish in April as global capital markets and economies stabilized (once again guiding markets to expect that a rate hike could come within the next couple months), to shifting back dovishly once again citing a global environment that is "vulnerable".

As a result Fed Funds Futures are only pricing in a 12% chance that the Fed hikes rates in

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

July (down from 21% before the FOMC announcement) with the odds of at least one hike coming by year end at 50%. This is the same Fed whose median 'dots' back in 2014 showed the funds rate forecast at 2.5% for the end of this year. I'm not suggesting that the Fed should be raising rates, far from it, and negative rates looks to be a complete disaster from what we're seeing in Japan and Europe. All I'm getting at is that the Fed has drastically overestimated the future growth and inflation profile of this economy and as a result backed themselves into a corner with what is looking more and more like nowhere to turn.

Chair Yellen's Q&A session following the FOMC meeting was quite interesting in the number of times she mentioned, implied, or referenced "uncertainty" and how it is clouding the future outlook for the economy

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

and Fed policy. I don't dispute her on this front as we are definitely in some uncharted waters where the efficacy of monetary policy has reached its expiration date. This creates an environment where any hiccup in the U.S. economy will likely render any offsetting policy implementation on the part of the Fed derisory.

The future impotency of monetary policy actions is among the growing list of items that worry me today (and there are many). Here we are over seven years into this zero interest rate monetary policy experiment where we have almost $10 trillion in global sovereign debt trading with a negative interest rate. Just think about that for a minute – an investor is willing to pay a central bank a penalty for giving them the right to borrow their money; that completely undermines the principles of

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

finance.  This is what financial repression looks like.

This ultra-accommodative global monetary policy experiment has created an environment where global debt has ballooned to such levels that it's difficult to comprehend the potential unintended consequences.  As a result of the cost of money becoming virtually free a recent study by McKinsey showed that global debt has increased by $57.4 trillion from 2007 through the second quarter of 2014.  To put this in context, the debt/GDP ratio has expanded from a comfortable and manageable level of 87% in 2000, to 142% in 2007 (Housing bubble), and as of mid-2014 stood at 199%.

How did we get here?  Well, for one we've seen 650 interest rate cuts since September 2008 which equates to about one interest rate

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

cut every three trading days. Lowering interest rates wasn't enough, so global central banks started to buy assets (quantitative easing) where they saw their balance sheets expand from $7.1 trillion at the end of 2008 to $17.5 trillion in 2016 (this includes the Fed, ECB, BoJ, BoE, & PBoC). The ECB has become the poster child for this largesse as it is now buying €10 billion in corporate bonds monthly – this is in addition to the €80 billion per month in government bond purchases.

What's problematic about current ECB policy is that the entire Euro area corporate bond market is estimated to be only €600 billion in size. At some point you would suspect that the intervention by the ECB will start to obstruct market liquidity.

So here we are in the unenviable position where cheap money has elicited the expected

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

result of enticing borrowers to tap the credit spigots and thereby pull consumption, investment, and spending forward from the future in the hopes that it would propel economic growth to a higher sustainable level. With that higher sustainable level of growth the economy would experience its normal carry-over effects: job growth, inflation, increased capacity utilization, corporate profit growth, rising wages… all of which theoretically is a reflexive cycle which drives an increased standard of living for all and the ability to pay back all this cheap debt during better times down the road.

Unfortunately for the Fed and investors, this economic cycle is in its late stages and on many metrics starting to show its age: employment, manufacturing activity, corporate profits, industrial production, capacity utilization, manufacturing activity,

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

and consumer confidence have all peaked and rolled over in the last eighteen months with some of these metrics in outright contraction. This expansion is now the fourth longest in U.S. history as it sits at 85 months old and far surpasses the average length of 59 months in the previous thirteen expansions since 1930.

Many have been quick to dismiss the World Bank revising down its global growth forecast for 2016 to 2.4% from its forecast of 2.9% growth at the beginning of the year. Let me put that 2.4% growth forecast into perspective for a moment: World GDP growth was 1.8% in 1974, 1.8% in 1980, 1.4% in 1991, 1.8% in 2001, and 1.5% in 2008.

The commonality between all these years is that they all represented the first year of a U.S. economic recession. Yep, and that 2.4% forecast (it is just a forecast for now) is only

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

70-80 basis points above levels that corresponded with prior recessions.  Not very uplifting, I know, and this is not a forecast on my part, but rather an observation.  Although, if and when a recession comes to pass (and on this front I do think the probability of one starting in the next 12 months has risen considerably) it shouldn't take anyone by surprise.  Recessions are a normal occurrence and part & parcel of business cycles – since 1930 the U.S. economy has experienced thirteen recessions (nothing rare about that) with a much more prolonged expansion following every one of them.  I would expect nothing different this time.

I'm sure there are many possible explanations for why the economy can't attain escape velocity with interest rates at zero and central bank balance sheets at all-time highs.  Or, why the yield curve continues to compress to cycle

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

lows?  In my opinion it is because there is entirely too much debt in the system and the absolute level of debt has crossed over the bound of stimulating growth to inhibiting growth.

I find it beyond ridiculous to hear the growing chorus of the crowds that the solution to this dilemma is full scale fiscal stimulus spending package.  Really, throw more debt at what is a burgeoning debt problem?  Come on, give me a break – you can't fight a fire with gasoline. Tax reform both on the corporate and individual level makes sense, and there is momentum on both sides of the isle to find common ground.  But given it's an election year and the divisiveness that remains engrained in our political culture, it is highly unlikely that anything can and will get done in the next twelve months.

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

As for the markets, here we are with asset prices across the gambit of investment opportunity sets that are all artificially inflated by central bank policy.  The S&P 500 hasn't made a new high in over 13 months (up about 2% on the year and down 1% over the last twelve months), and this resiliency is admirable in the face of corporate profits that have declined almost 10% over that span (looking down the pipe of a fourth consecutive quarter of year-over-year earnings decline when Q2 results are reported).  Global interest rates are at all-time lows with bond prices (which move inverse to yields) near all-time highs.  Real estate prices on a national basis are approaching all-time highs and have moved into bubble territory in certain markets, i.e.) London, New York City, and San Francisco.

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

All this amounts to an investment environment today that makes it very challenging to invest responsibly.  It is extremely difficult for investors today to find an income stream in either the debt, equity, or real estate markets that is both high enough to subsidize their standard of living and safe enough to protect their capital.

What is materially different today than the first six years of this bull market from 2009-2015 is that in those initial years investors were able to substitute capital appreciation for income.  Why? Because asset prices were going up and investors could just sell gains to create income without impeding principle. Investors are now coming to the realization that capital gains can no longer be counted on as a substitute or replacement for income.

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

Over the last 18 months capital appreciation has been non-existent in the equity markets (that is unless you've been nimble enough to time the ups and downs). Capital appreciation has continued to work in parts of the fixed income market, but with the sovereign debt of 90% of the world's GDP trading at sub 2% interest rates, it's difficult to imagine there is a lot of meat left on this bone. Real estate prices have inflated in tandem with most other asset classes bringing cap rates down to low levels and most commodities don't provide an income stream.

The choppy up and down volatility exhibited in most markets around the world over the last year and a half is investors trying to catch the last leg of what is a very mature market cycle. And they are doing so as a result of the lack of fundamental justified investment opportunities

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*

in attempt to fit a square peg through a round hole – soon they'll find out it just doesn't fit.

** Capital Market Musings & Commentary will be taking a brief sabbatical next week, followed by the 4th of July holiday the week after. We wish you all a safe and festive holiday weekend. **

**Corey Casilio**
*Partner, Portfolio Manager*
101 Ygnacio Valley Road
Suite 211
Walnut Creek, CA 94596
corey.casilio@clpwm.com
925.448.2215

Casilio Leitch Investments is a private wealth management firm, focused on providing financial advisory and investment management services to individuals, families, and institutions. The firm was founded on the principles of Character, Integrity, and Trust and pledges to abide by these principles, dutifully focusing on our fiduciary responsibility to our clients throughout our financial advisory relationship.

*The articles and opinions in "Capital Market Musings and Commentary" are for general information only, and not intended to provide specific investment advice. Performance, dividends and other figures have been obtained from sources believed reliable but have not been audited and cannot be guaranteed. Past performance does not ensure future results. Investing inherently contains risk including loss of principle. Corey Casilio is a founding partner of Casilio Leitch Investments, a legal business entity. Advisory services offered through Casilio Leitch Investments, a CA State registered investment advisor.*