Will Mid-March Madness Maul the Stock Market in 2017?

by Knave Dave

Mar 13, 2017 4:19 PM

Many of the 2017 economic headwinds I've described will hit during the Ides of March, just as the Trump stock-market rally shows signs of topping out. This might not be the Great Epocalypse — not all at once anyway — but a large and likely correction is looming. I think the bear is about to be let out of his cage.

Chaos emerged in emerging-market stocks last week, bond prices plummeted (yields rose to match their last 2016 high), stock-market volatility rose, and the Dow took its worst drop in 2017. Copper prices, a bellwether for recessionary conditions, saw their worst week since last September. It looked like the Trump rally in almost everything was rolling over last week, and that takes us into this week when several likely big bads are scheduled to hit on the same day.

Debt ceiling bomb about to drop

One of the biggest hits happens right on March 15th when the statutory limit to the rise in US national debt arrives. David Stockman has been speaking a lot lately about how March 15th changes everything for congress. Republicans have been loathe for years toward raising the debt ceiling, taking the government near default by using the ceiling and the "full faith and credit of the US government" as a budgetary bargaining chip.

Such a battle over the debt ceiling in 2011 caused a major stock-market plunge when Standard & Poors downgraded US credit for the first time in history because congress chose to walk too close to the precipice. Just prior to that credit debacle, I predicted the downgrade would happen even though I said congress would vote to raise the debt ceiling at the last minute of the last hour.

I said that would happened because Republicans knew they would not let the nation default, even as they pretended for negotiation reasons that they might. There error would be in thinking that their last-minute capitulation would save the US credit rating. I said that belief would prove to be highly misguided because no one else knew what Republicans would do. I said that such brinksmanship over something so important would certainly cause some credit-rating agency to believe that congress was becoming overly risky.

I predicted the downgrade would happen in late July/August, even if Republicans raised the debt ceiling, and the stock market would crash immediately. Four days after Republicans raised the debt ceiling, the US credit downgrade happened, and the stock market plunged. An all-out crash was only averted at the end of September when the Federal Reserve started its new stimulus brain child that Ben Burn-the-Banky called

"Operation Twist," sending the market's vital signs back on an upward path with breathless hopes of more quantitative wheezing.

Democrats are now embroiled over Republican efforts to disembowel Obamacare, which is moving toward a congressional vote just as the debt ceiling hits; so this time Democrats may be the ones to use the ceiling as a bargaining chip. I think they will be less likely to take things to the edge of the cliff than Republicans did, if only because everyone has seen what can happen when you play roulette like that; but they will use it to some extent, and they are likely to find Republicans who are reluctant to raise the ceiling, too. So, that battle begins in ernest this week, putting all of Trump's stimulus plans in peril, which puts all recent stock speculation at obvious risk since the Trump Rally was largely based on belief that Trump would amp up spending and hugely cut taxes — actions that would make the debt-ceiling problems much worse.

The debt bomb is likely to hit much harder this time than in the past because congress, in creating the free expansion of US debt that was allowed up to March 15th, stipulated that the US treasury could not build up a surplus of cash by taking out debt immediately prior to the debt ceiling date, as it did when Obama was in office as a way of buying the US time after the debt ceiling limit hit (i.e., this time the government could not take out debt while there was no limit in order to pile up cash for the time when there was a limit). In honoring that, the treasury has been spending down its cash on hand to make sure that the amount of cash remaining on March 15th is no higher than the the amount the government typically keeps on hand.

Only thing is, the treasury is now down to *less* than it usually keeps on hand, making one wonder whether the huge draw down has anything to do with bankrupting the Donald just as he approaches congress for action. The US treasury has plunged from $435 billion in cash back in October to just $66 billion as of the last count. Last year's cash balance at this time was $223 billion. One might be tempted to guess that such a spending of borrowed and hoarded cash had something to do with keeping the economy alive to the present and leaving it broke by the 15th of March. Even with so much spending of last-year's borrowed cash, the federal debt is up $237 billion since January.
One has to remember that the treasury has only been under Trump's control since January 2oth, by which time the balance was already well drawn down. One should also realize that numerous expenditures may have been made before January 20th that assured depletion of funds thereafter as the bills came due. David Stockman speculates that the initial borrowing and hoarding of cash happened in the belief that Hillary would win so she'd have a treasure chest to get her through the debt-ceiling crisis. It wouldn't be the first time Obama & Co. sidestepped the rules.

At the same time, tax revenues have been way down in 2017, which may be a less nefarious explanation for the cash drawdown. At the rate tax revenues are coming in, the government will face a greater cash crisis than it usually faces at this time of year. February's deficit was $190 billion more than last year's deficit for the month. February became the third consecutive month in annual government revenue declines and was the largest drop in revenue since 2008.

As Stockman has said a number of times in the past, nothing is more telling about the onset of recession than declining tax revenues. Government tax receipts almost always turn sharply negative just before a recession. Confirming the possibility that we are already headed into recession, we saw US GDP growth fall off precipitously in the last quarter of 2016.

The fall in revenue is in large part due to a decline in tax filings. This could be because the IRS has said it will delay refund checks (so why rush to file?), or it could be because many liberals have said they will not file at all because they will not pay taxes to a government that is not their government at a time when they wish to secede from the union or flee to Canada. (You know, the same people who were enraged beyond measure when Trump wouldn't promise that he'd accept election results if they won! Oh, the hypocrisy!) Nearly six-million fewer people have filed their taxes this year than at the same time last year (an 8.5% decline in US tax filings).

The main thing I'm pointing out is not whether the drop in taxes is due to recession or tax warfare, but that revenues are declining at a time when debt will also suddenly be frozen and that (for whatever reason, nefarious or benign) cash is just about out, too. That presents a big problem with or without recession. Usually, when tax receipts fall off as we head into recession, the government just takes out more debt. This time it can't, and this time it has less cash socked away to survive on than it had when the debt ceiling hit during Obama's reign, and this time the US has an even more aggressively divided congress than it had under Obama and has far greater debt interest payments to maintain.

So, the treasury can play some accounting games to keep the government running for a little longer, but not nearly as long as it did during the last debt-ceiling crisis when congress kicked the can down to the road to land in the middle of this week. I'd say, as I did earlier in the year, its game over by late June or July.

And this is exactly what I have said throughout the Great Recession is the monumental failing of congress time after time. Each time it kicks the can down the road, which it has been doing since the financial crisis of 2008, it makes the next crisis worse by refusing to take the pain of correction on at the time. A cowardly congress, afraid of an electorate that would rage if it was ever told it had to live within its means, has created a debt-ceiling bomb.

The Yellen put goes kaput … and kaboom!

Also scheduled for March 15th is a likely Federal Reserve interest-rate hike, now priced into the market at about 100%. On its own, then, a rate increase wouldn't make much difference, being fully priced in, but timing as it does with other things, it's one more bit of bad news for a market that has only thrived on and, so, is addicted to the Fed's free drugs.

I believed and said all of last year that a financial apocalypse was only avoided in 2016 by Janet Yellen keeping her foot down hard on the accelerator — a sudden reversal of the Fed's telegraphed plans, which had promised three interest-rate increases. The Fed and the Obama administration saw the Fed recovery going up in smoke last January as oil prices and stocks plummeted. I suspected their multiple "emergency closed-door meetings" (their designation) and immediate "emergency" meeting with the president and vice president had everything in the world to do with keeping the economy alive on life support until the end of the election in order to ward off a Trump victory, knowing full well their recovery was on the ropes.

I also predicted repeatedly that Yellen, whose continued existence as Fed chair beyond 2017 has been threatened by Trump, would act to remove government stimulus after the election if Trump won, likely just long enough after Trump's inauguration to make it look like the resulting collapse of the Fed's economic recovery program is Trump's fault. The Fed, I said, will seek to make Trump the scapegoat for their own recovery failure. I have maintained all along that the economy is only alive on Federal Reserve life support and that, as soon as all life support ended, the patient would die because the patient actually died back in 2008. I believe that begins this week.

Yellen's reversal from full-on stimulus to a policy of economic tightening can be seen happening around Trump's victory by looking at her words. When it looked like Hillary Clinton was going to win, Yellen talked of letting the economy "run hot" by going into inflation above the Fed's target of 2.0%. Right after Trump won, Yellen announced a likely rate hike in December and then three more for 2017. Even with GDP sinking rapidly, Yellen and her cohorts speak only of rate hikes. Why would you let the economy "run hot" at 3.5% GDP growth in the third quarter, but start talking of raising rates rapidly when the economy plunges to 1.9% GDP growth in the fourth quarter?

It all seems to underscore my statement in the first half of 2016 that the Epocalypse wasn't going to happen in 2016 after all because the Fed and the Obama Admin. would do everything they could think of to boost the economy without looking like they were in the panic mode that all of their emergency meetings would indicate. And then they'd let it collapse.

The Fed kept its balance sheet in the upper reaches (essentially, kept money supply in the stratosphere) long enough to assure rising inflation, and job recovery has been consistently strong in all the ways that the Fed cares about or pays attention to. Because we are now at peak employment (by Fed measures) and above target inflation, the Fed is without reason (by its own flawed measures) to keep from raising interest.

I have also said all along that the Fed cannot raise interest without crashing its own recovery. We saw that happen in December of 2015. In December of 2016, it raised them a second time, but it raised them into the Trump Rally, which was a situation of extremely irrational exuberance that made such a raise possible, but now on March 15h, it will raise them with impeccably and predictably poor timing.

A couple of months after Trump officially entered office is the perfect time to back off the accelerator and let the wheels of recovery begin to grind and squeal to a halt.

Rising interest rates could cause a bond-market crash, too. Bond yields are already rising (likely in anticipation of an interest hike). The simplest way to put this it that rising interest rates mean investors (such as bond funds) who want to sell the bonds they are already holding have to sell them at a lower price in order to allow the buyer to make a better return as a way of making up for the fact that *new* bonds are offering better interest. So, they take a bond bath. However, if money from stocks flees to bonds as a safe haven, a bond crisis may be averted, as that will press yields down, raising prices up for those who currently hold bonds and want to sell them.

Higher interest rates — if they keep rising — also put the squeeze on companies that have been taking out debt to buy back their stocks and drive up stock prices by creating their own demand while reducing the supply of their stocks. Buy-back activity has been a large factor in the rise of stock prices. So, the Fed's upcoming rate hike — if it raises bond prices as it is intended to do — will put a little more braking action on stock buybacks at a time when the Trump rally has already turned downward.

The rise to an actual one-percent Fed target for the base rate at which bank's borrow starts to sound like we're finally re-entering the realm of real interest at last, leaving the near-zero bound behind. It also strengthens the US dollar, further hurting both exports and domestic sales because imported goods compete more favorably.

While the European Central Bank continued its quantitative easing this week, it is under increasing pressure due to inflation to discontinue. The governor of the Bank of Japan is also questioning his bank's pedal-to-the-medal approach of keeping interest down. So, the Fed is backing off near the time in which Japan and the ECB are backing off, too, meaning the tightening of money supply grows globally as we go into the summer. (The ECB has announced it will taper its QE from €80 to €60 billion monthly, and the BOJ appears set to silently miss its previous annual target for bond purchases in what some are calling "stealth tapering.") It's all that free money that has been inflating stock prices. I don't think everything comes crashing down in March, but this week likely marks the start of major failure.

This will provide the scapegoat that globalists need as we move toward further EU exit votes to say, "See, this is what happens when you elect nationalist leaders." Watch as that becomes the winning argument because they will be arguing into the face of rising fears that appear to be Trump and Brexit failures, and fear will grab any lifeline. It's an easy argument for those who are ready and willing to believe it.

The smart money has already left stocks, moving into bonds, so the big investors aren't the ones to take the fall so much as the small guys who have gone chasing the wild rally. When the dumb money pours into the market just as the smart money leaves, that's when markets crash.

Everyone making for the exits

With the Netherlands set to hold parliamentary elections on March 15th, we may see the Dutch join the British and the US in exiting the globalist system. Popular eurosceptic lawmaker Geert Wilders leads the polls with his nationalist call to make the Netherlands "independent again." Hear any echoes of "Make America great again?" Wilders told the Associated Press, "I see the European Union as an old Roman Empire that is ceasing to exist. It will happen." In the latest shocking poll, 56% of Dutch voters wanted to exit the EU.

Nexit could light up the radar screen in perfect timing with the Fed's rate increase and the arrival of the US debt ceiling. Brexit temporarily spooked the stock market, but Nexit would be a much larger jolt. The Netherlands is part of the Eurozone, whereas the UK was not, making Nexit more significant if it becomes an imminent prospect.

In fact, the Netherlands was one of the original founders of both the European Union (back when it was the European Economic Community) and the Eurozone. So, Nexit is potentially a much bigger jolt to the euro-psyche than Brexit, as the British never fully joined at the hip (wallet). Eurocrats have identified the Netherlands, France and Italy as a trifecta of nations that would destroy the Eurozone if they exited. The British, of course, have extended open arms of trade toward the Dutch if they exit to help both countries with the trade outfall of exiting.

Wilder has called for a referendum to exit the EU. So, a Wilder win means full steam ahead for Nexit, and the Eurozone will shudder to its core on the eve of March 15th *if* he wins.

Beware the Ides of March.