John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

ShadowStats Flash Update No. 9

Rapidly Mounting Financial-Market, Economic and Systemic Risks

September 25, 2019

**Sharply Elevated Risk of a Near-Term Stock-Market Crash
Reflects a Confluence of Unusual Risk Factors,
Either Developing or Already in Play:**

**Market Perceptions of Meaningful Risk for the
Removal from Office of the President Would Threaten U.S. Dollar,
Financial-Market and Economic Stability, and Trigger Flight to Precious Metals**

**Increasingly Unstable Global Political and Economic Conditions,
Including Trade and Oil-Market Turmoil, a Still-Deepening and
Unfolding U.S. Recession, Unstable Federal Reserve Policies**

The Onset of the 2019 Squirrelly Season

**2018 Extreme Income Variance Held in Place at
Levels That Tend to Lead Financial and Economic Crashes**

House of Representatives Opens Impeachment Inquiry

Such Presents Meaningful New Risks to the Financial Markets, Particularly in Combination With Other Factors Already in Play

A Serious Threat of Presidential Impeachment and Removal from Office Would Roil the U.S. Dollar, Stocks and the Economy. When the House of Representatives announced an official impeachment inquiry of the President, after the markets closed on September 24th, the U.S. Dollar and Financial Markets already had taken some hits and Gold had rallied in anticipation of the announcement. Major negative impact increasingly will loom for the dollar and markets, the more serious the threat becomes of actual impeachment and removal from office of the President. ShadowStats previously had discussed this potential circumstance, as discussed on page 3.

Risks of major financial-market panic have increased, where a variety of elements can combine in unexpected ways to generate historic panics. The negative shift in U.S. political risks are on top of other factors ranging from instabilities in Federal Reserve policy, unstable global political conditions (i.e. Brexit), rapidly deteriorating domestic and global economic conditions, trade turmoil, oil supplies and related political turmoil and extreme income variance in the United States to the onset of the 2019 Squirrelly Season. Pending ***Special Commentaries No. 985-A*** and ***985-B*** will review the current economic and Federal Reserve circumstances. Political risks, the Squirrelly Season and income distribution are discussed in the balance of today's missive, including related text from earlier writings.

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Perceptions of Political System Instabilities

[The following text is excerpted from ***Special Commentary No. 888*** of May 22, 2017.
The comments as to market impact still have relevance to today's circumstance.]

Perceived U.S. Political System Instability Would Threaten U.S. Dollar, Financial-Market and Economic Tranquility

Severely Stressed U.S. Economic Activity and an Extraordinarily Vulnerable U.S. Dollar Could Be Torn Apart by Untoward Political Machinations. Any developments suggestive of serious risk of impeachment [removal from office] for the President likely would have devastating, near-term impact on the U.S. dollar, related markets and domestic business activity. As seen during the Nixon era, perceptions of rising risk of impeachment can pummel a currency. Despite the oil shocks and other issues that hit the economy and markets in 1974, today's fragile and unstable economy, markets and financial system, post-Panic of 2008, likely are less able to absorb unexpected shocks.

... Fundamentally, the perceived stability of a nation's government remains closely intertwined with the health and stability of that country's currency, financial markets and economy.

As background, I consider myself to be an old-line conservative Republican with a Libertarian bent, and do my best to keep personal politics out of my writing. Accordingly, I generally avoid political issues in these *Commentaries*, unless the matter has the potential for significant impact upon financial or economic circumstances. Such a matter has arisen with the continuing controversy over President Donald J. Trump's firing of FBI Director James B. Comey, and mounting speculation within elements of the media as to a possible presidential impeachment. Last Wednesday (May 17th), the Justice Department appointed former-FBI Director Robert S. Mueller III as special counsel to oversee an investigation into alleged ties between the Trump presidential campaign and Russian officials.

No Basis for Impeachment Based on Current Information. Given information of varying quality put before the public, so far, there appears to be no basis for an impeachment. "Obstruction of justice" presumably is the legal angle being pursued relative to the firing of Mr. Comey. An attorney familiar with the law, in this circumstance, indicated that one has to show clear "intent," such as a bribery payment or an extortion attempt, with the need to prove that "intent" beyond a reasonable doubt, in order to develop a credible "obstruction of justice" charge. My friend did not see the clear "intent" element in the current information floated in the press. Eventually, the Special Counsel should address and clarify those issues.

Separately noted by another good friend, a complicating practical factor here has been that President Trump often appears to operate outside of established protocol, which sometimes works to the President's benefit and sometimes not.

Noted in *Commentary No. 846*, of November 11, 2016, "exit polls from the presidential election indicated the economy was the primary concern for voters. Trump had paid attention to the pocketbook issues that usually drive national elections. He recognized that despite happy headline numbers published by the government and touted by the Fed and Wall Street, underlying economic reality remained that Main Street U.S.A. continued to suffer in non-recovering economic stagnation, subsequent to the economic collapse into 2009. He addressed those needs and concerns, confounding the politicians and pundits who neither recognized, nor would admit to those underlying systemic stresses." See also the discussion in *No. 859 Special Commentary* of January 8, 2017.

Where Mr. Trump's electoral victory upset an establishment that had been advancing ever-expansive trade deals for decades, some of Mr. Trump's political antagonists were promising to pursue impeachment angles, even before the Inauguration. What is at work here easily could be the proverbial "investigation in search of a crime." While the headline issues pursued in the investigation may be alleged Russian ties to the election process, the motivating factors behind the "scandal" investigation most likely are issues tied to big money behind the global trade pacts.

Negative Developments for the President Easily Would Roil the Markets. The sharp decline seen in U.S. stock prices, the U.S. dollar and a rally in the price of gold during last Wednesday's trading was a small precursor of the type of market volatilities that could follow in the event of political circumstances deteriorating sharply. Last week's brief market turmoil reminded me of the era of the Watergate Hearings, before President Richard M. Nixon resigned his office in 1974. Recently out of college, I took on the currency trading and hedging for my family company, which imported power equipment from West Germany. As the Watergate Hearings progressed, and the news for Mr. Nixon looked increasingly bleak, the U.S. dollar's decline accelerated versus the Deutschemark. In those days, one could listen to the Hearings on the radio and have fifteen minutes to take a currency position before the markets began to move in response.

Major factors affecting the relative strength of the U.S. dollar versus another currency include relative interest-rate levels, relative economic activity, relative trade position, relative fiscal stability and relative political stability. Depending on the investigation and actions of the Special Counsel, or otherwise some surprise development in related areas, risks to relative political stability have moved to the fore as a "potential" primary disrupter to the U.S. dollar and domestic financial markets. Such joins deteriorating economic conditions and a potential shift in FOMC policy back towards expanded quantitative easing as "likely" currency-market and financial-system disruptors in the months ahead.

Median U.S. Household Income and Income Distribution/Variance

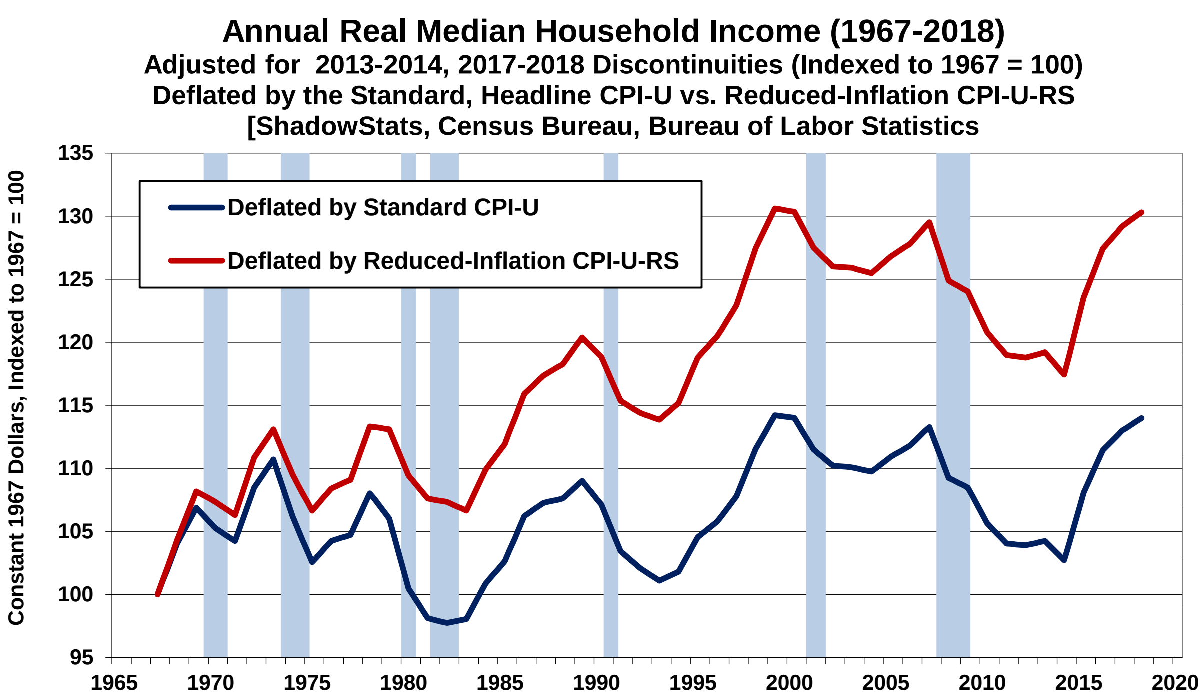
[Expanded detail will follow in ***Special Commentary No. 985-A***]

[See Series description in ***Consumer Liquidity Watch No. 5***]

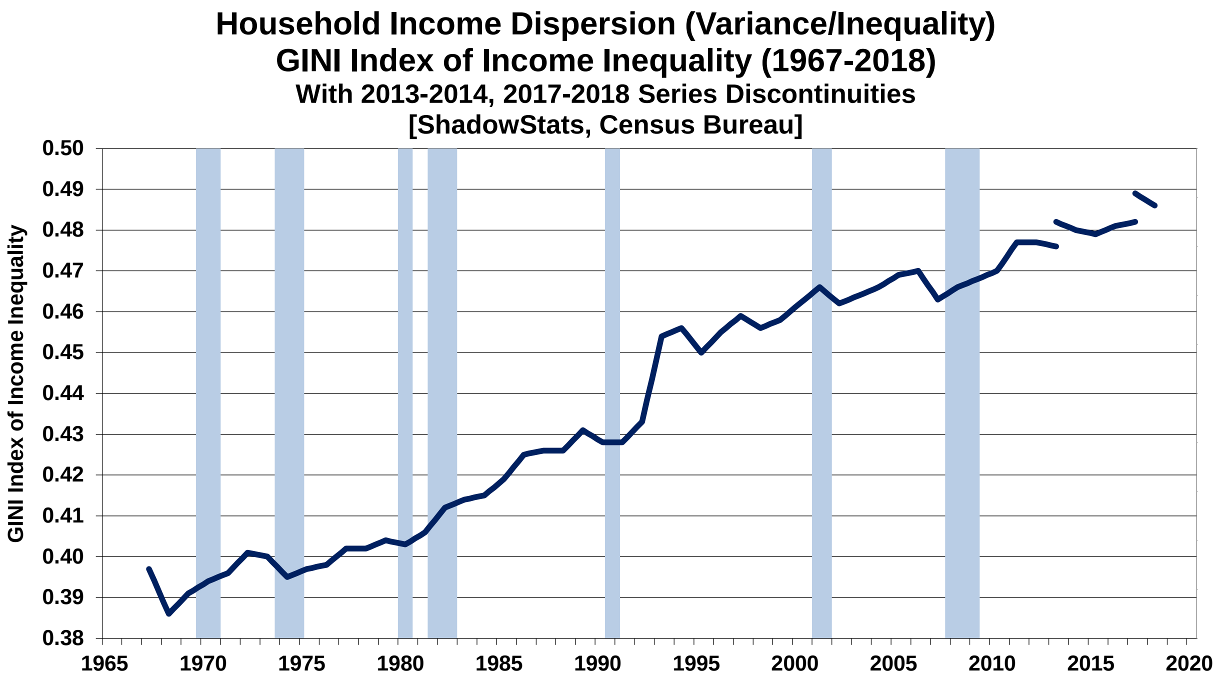
Following Three Years of Gains, 2018 Real Median U.S. Household Income "Was Not Statistically Different from 2017," Consistent With the FOMC's Tightening of Consumer Liquidity, While 2018 Income Variance Held at Extremely Dangerous Levels. In the context of continuing revisions to process and reporting, which has left much of the historical data no longer comparable with current headlines, the Census Bureau reported September 10, 2019 that 2018 Real Median Household Income was not significantly different from 2017, holding at the high levels last seen just before the 2001 and 2007 recessions (see ***Graph 1***).

Further, extreme levels of Income Distribution and Variance, which historically have tended to trigger financial panics and economic turmoil, broadly were not meaningfully changed (see ***Graphs 2*** and ***3***). Extended detail and discussion follows in ***Special Commentary No. 985-A***.

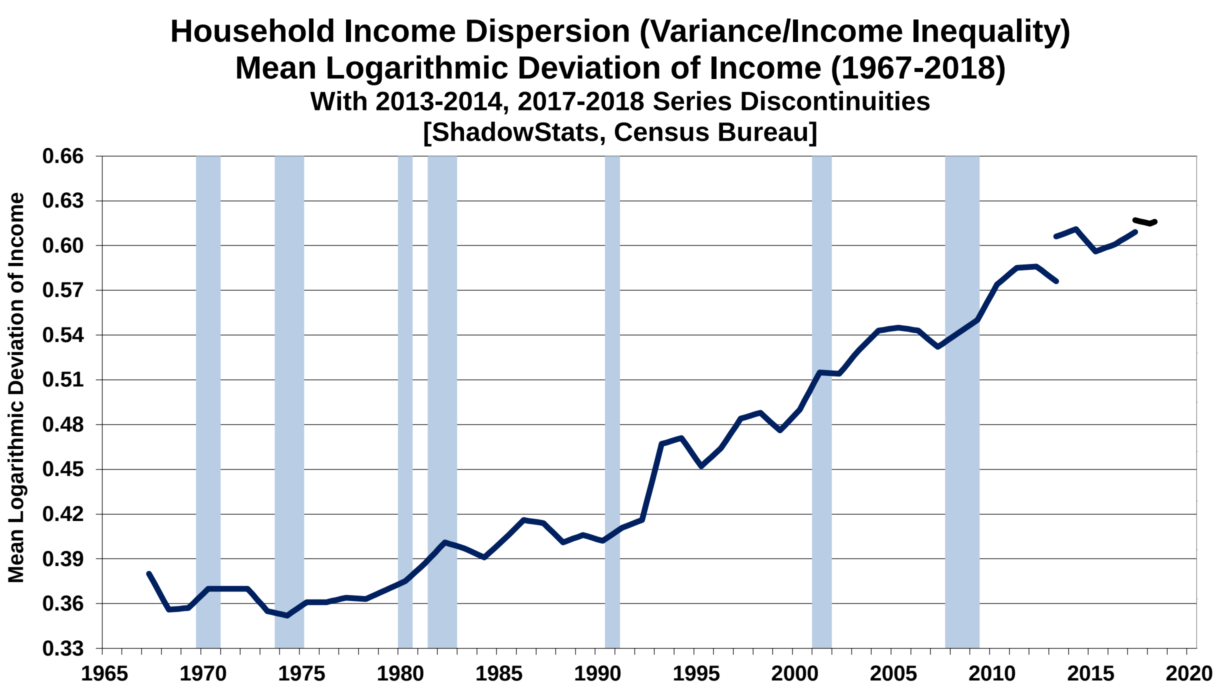
Graph 1: Annual Real Median Household Income (1967 to 2018), Adjusted for Discontinuities



Graph 2: Household Income Dispersion (GINI Index of Income Inequality), 1967 to 2018, With Discontinuities



Graph 3: Household Income Dispersion (Mean Logarithmic Deviation), 1967 to 2018, With Discontinuities



Squirrelly Season

Residual Squirreling Instincts in Investors Can Overturn Markets

[Excerpted from ***Commentary No. 967*** of August 24, 2017]

Squirrelly Season Intensifies Market Risks from Unstable Circumstances

Stock-Market Crashes, Financial Panics and Investors' Residual Squirreling Instincts. [This opening section is repeated with some updates and minimal changes from the *Opening Comments* of *Special Commentary No. 904* of August 14, 2017.] Four weeks shy of the first day of autumn, the squirrelly season almost is upon us. Some months before the 1987 stock-market crash, I retained a mass-psychologist in an effort to explain why stock-market crashes tended to take place in October and November (at the time, I was predicting an October crash). He came back with an answer that humans had a vestigial squirreling instinct. As the squirrels suddenly start gathering acorns for the winter, so too do humans, or at least their investment strategies suddenly can shift enough towards safety to burst an extreme stock-market bubble.

Discussed here previously, there are parallel stresses in other circumstances. For example, particular alignments of the sun and moon can help to trigger an earthquake, as was seen with a 2014 quake near Napa, California. "Ah, but we don't have an earthquake with every new or full moon!" noted my prescient wife in response to my comment to that effect, after having been awakened at the time by the temblor.

"True, but wooden chairs do not always collapse when I sit on them," I noted, having broken more than my share of antique wooden chairs, due to the basic fragility of the chair, my bulk and stresses from the active shifting of my body, while sitting. "The effects of those stresses build up and damage a chair over time," I explained. "When the chair is vulnerable to breaking, it will do so, given the right pressure."

The same is true with earthquake faults and irrational stock markets. Carefully massaged and orchestrated by Federal Reserve machinations and jawboning, in the wake of still-unresolved systemic imbalances from the financial panic and near-collapse of the U.S. banking system in 2008, and with strong, related support on Wall Street, the current strength and recent record-highs in U.S. equity prices should be viewed with extreme caution, particularly in the next several months.

Some Early Anecdotal Signals**.** The underlying squirreling-instinct issue is a repeating circumstance for the financial markets each year in the October/November timeframe. Rarely, though, has the circumstance been so fragile. In the weeks before the 1987 crash, one client with whom I discussed the squirreling theory was Treasurer of one of the largest U.S. corporations. "John," he responded, somewhat hesitantly, "a couple of weeks ago, I would have said you were nuts. I was looking forward then to buying a new car. Last week, though, I changed my mind—just a shift in mood—and decided to hold off for a while."

I mention the preceding, where, in the last couple of weeks, I have received an unusually high level of phone calls from clients expressing concern about the near-term direction of the stock market, the economy and systemic stability [a current 2019 experience as well]. If you would like to discuss this, please call me at (707) 763-5786.

Stocks rarely crash off record highs. The Dow Jones Industrial Average hit an all-time high in late-August 1987, and while it is off its more-recent all-time high of January 2018 by about 3.1% (-3.1%), the Standard & Poor's 500 closed at an all-time high, today, as we go to press on August 24, 2018.

Reviewed in *Hyperinflation Watch – No. 3*, faltering, underlying economic fundamentals, with potential non-consensus impact on FOMC policy, and potential negative-pressures from increasingly disruptive political circumstances, should begin to hit the U.S. dollar hard, where the dollar and gold appear to be moving off their respective near-term peak or trough. Parallel impact will loom for domestic-equity prices and prices of U.S. Treasury securities, at such time as dollar selling picks up sharply.

Intensifying dollar weakness was a problem in 1987. Alan Greenspan, then the new Federal Reserve Chairman, raised rates in September 1987 in an unsuccessful effort to prop the U.S. currency. Exacerbated by Saturday, October 17th comments of then-Treasury Secretary James Baker that the United States no longer would support the U.S. dollar against the Deutschemark, ensuing panicked U.S. dollar selling was a proximal trigger to the stock-selling panic on Monday, October 19th.

Watch out for intensifying selling of the U.S. dollar in the weeks and months ahead, particularly in the context of unexpected economic weakness, financial-system instabilities or a significant intensification of political problems for the Federal Reserve or President Trump (see *Special Commentary No. 888*). The time is at hand to look at battening down the hatches as a potential, great financial storm begins to move onshore, exacerbated by mounting domestic and global political tensions and concerns for unfolding economic activity and possible related shifts in central-bank policies/actions, still in the context of the largely unresolved banking crisis of 2007/2008 (again, see *Hyperinflation Watch – No. 3*).

Note to Subscribers: Today's ***Flash Update No. 9*** reviews unusual factors that can contribute to financial panics, particularly in combination. Some details here will be expanded upon in ***Special Commentary No. 985-A***, covering the underlying economic reality facing the United States and the FOMC, with ***No. 985-B*** reviewing current FOMC actions, policies and prospects, and updating the ***ShadowStats*** **Financial-Market ALERT**. Those two missives will be posted sequentially, with ***No. 985-A*** likely on September 29th and ***No. 985-B*** on October 1st. Daily Updates are found on the **ShadowStats Home Page**.

Except for increased, near-term risk of panicked markets, the *ShadowStats* outlook has not changed, specifically including a rapidly deepening U.S. economic downturn, reflected in mounting downside pressures on the U.S. dollar, flight-to-safety and upside pressures on gold and silver prices, and increasingly high risk of heavy stock-market selling in the weeks ahead. Your comments and suggestions are invited. Always happy to discuss what is happening.

Best Wishes — John Williams (707) 763-5786, johnwilliams@shadowstats.com

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