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Canary in the Mine

Unless you're living on planet "Love Tron" with "Chocolate Thunder" (retired '70s NBA player Daryl Dawkins made famous by his backboard shattering dunks) you're probably already aware of the increasing volatility in global securities markets. A 200-point move in the stock market, up or down, is now de rigueur depending on the latest Fed utterance. This, of course, says nothing of the global sell off in bonds taking place.

Government bonds, typically the epitome of safety, particularly from economic leaders such as Germany and the U.S. have seen yields sky rocket and prices crater. As investors stampede out of bonds in anticipation of higher yields on the horizon, this makes money harder to raise. In turn, this threatens the fragile global economic recovery.

If lots of bonds are sold and few bonds are bought, this tightens global liquidity. This is occurring even without the much ballyhooed rate increase on the Fed's part.

When higher interest rates do come, this will increase the government's borrowing costs. This will result in either decreased government spending or an increase in taxation. Either way economic activity is diminished. Maybe this is why the Fed keeps delaying the inevitable (moving rates off zero). They want to have it both ways; they want asset price normalization without major dislocation but they don't want the impedimenta associated with higher cost of funds.

If you get the feeling your omniscient central bankers are stumbling around in the dark, you're right. They're caught between a rock and a hard spot. To avoid the pain associated with market driven asset re-pricing following the housing collapse, they opened the money spigot. Now, it can't be closed. As the stoics used to say, "Pain avoided now is simply pain endured later."

Central bankers simply don't have an end game. Or as Bill Gross of Janus Capital says, "Central bankers don't exactly know the way home." Having over stimulated global capital markets with trillions of dollars in excess liquidity the past few years, what happens when it dries up?

Like the canary miners used to carry with them when they went down into the coal mines to warn them of dangerous gases, the global bond markets swoon is an early indicator of turmoil to come.

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