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Something to Think About

OAKWORTH CAPITAL BANK

COMMON CENTS

Back in the day, back before I was born, the Kingston Trio had a song called "The Merry Minuet." As my father liked the Kingston Trio, and I mean a lot, I grew up listening to the group's music, and I particularly enjoyed this song. In fact, the year after I graduated from college, I even sang it on stage in front of about 100 people in what would have been called a hootenanny in a simpler time. While I wasn't booed off the stage, let's just say I wasn't picking up roses after my performance.

For those unfamiliar with the song, here are the lyrics:

They're rioting in Africa
They're starving in Spain
There's hurricanes in Florida and Texas needs rain

The whole world is festering with unhappy souls
The French hate the Germans
The Germans hate the Poles

Italians hate Yugoslavs
South Africans hate the Dutch
And I don't like anybody very much

But we can be tranquil and thankful
And proud for man's been endowed
With a mushroom shaped cloud

And we know for certain that
Some lovely day someone will set the spark off
And we will all be blown away

They're rioting in Africa
There's strife in Iran
What nature doesn't do to us will be done by our fellow man

The Trio released this song in 1958, and, you know what, 56 years later I can change a few of the names and the song is still pretty hilarious, and accurate. So much so, this song, which I hadn't thought of in years, started playing in my head when I was reading the headlines this week. It really does seem the whole world is festering with unhappy souls.

The point? If you don't like what is going on in the markets this week, you have to thank the Ukrainians, Turks, Argentines, and Thais for your discomfort. US stock market performance has had absolutely nothing to do with corporate earnings, which have been pretty good, or domestic economic data, which has been reasonable enough. In fact, if we lived in

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Sheldon Harnick

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a vacuum here in the US, stocks probably would have risen a little this week. There would have been no reason for them not to do so.

However, those pesky corrupt officials in Turkey have caused that country's currency to fail apart. Rioters in Kiev appear to be set on toppling the Ukrainian government, which seems to be stacked with, again, corrupt officials. The Argentines quit propping up their currency in the secondary markets, and it fell to an appropriate market clearing level. The Venezuelans devalued their currency, in a strange sort of way, in an effort to stop that country's inevitable slide into economic ruin. Then you have the calamities in South Sudan and the Central African Republic. Ugh. It seems you can't "pick up the paper" without the rest of the world falling apart.

For all our problems in this country, and there are plenty, the biggest problems in the global economy and investment markets have very little to do with the United States. Oh sure, some folks have tried to make the argument the Fed's plan to 'taper' the latest quantitative easing program is giving the emerging markets the fits; however, when you peel back all the layers of the onion, you know, it seems the biggest problems in the world today have precious little to do with US monetary policy. Further, the Fed hasn't done anything yet! What's more, if a proposed gradual reduction in the Fed's printing of money is going to send some emerging economy in the toilet, well, it was sitting on the edge looking for an excuse to have a swim.

While this time may be different, and people are always inclined to think 'this time' is, we have been through this previously, to some degree. In 1997, emerging Asia completely collapsed, as currencies fell through the floor. The next year, the Russians defaulted on their debt, and devalued the ruble. Both times, central bankers around the world, and the IMF, swooped down, as though from on high, and ensured there was enough liquidity in the global financial markets in order to stave off a widespread economic downturn due to financial contagion. In both years, for a variety of reasons, the S&P 500 ended the year higher than where it started. That isn't to say August in both 1997 and 1998 didn't hurt, it/they did; however, where the rubber meets the road, investors lost far more money freaking out over headlines than they did anything else.

With that said, what if this time really is different? What if the increasingly intertwined global economy makes the lessons learned in 1997 and 1998 obsolete and irrelevant? What if all heck really does break loose, and we collapse like we did in 2008? What if….

According to the Federal Reserve's H.8 report, in December 1996, 'interbank loans (loans between banks)' were 5.3% of the collective balance sheet of the commercial banking sector in the United States. Cash assets were 7.2% of the aggregate balance sheet, and the difference between assets and liabilities (which is also known as equity, but is called 'residual' for the purposes of the H.8 report) was 9.6% of total assets.

Fast forward to December 2013, and 'interbank loans' were only 1.1% of the collective balance sheet; cash assets were 25.7%, and the residual was 15.5% of total assets, or a whopping $1.561 trillion. So, in so many ways, US banks are not AS susceptible to problems on other banks' balance sheets as they once were. There is a mountain of cash in the system, and an impressive amount of residual. As such, you can make a very salient argument, in aggregate, the US banking system is far more liquid, and solvent, now than it was way back in 1996, on the eve of two major disruptions in the emerging markets and their financial systems.

In case you were wondering, the liquidity 'net due from related foreign offices,' or how much the US banking system is reliant on their international operations for liquidity, is little changed from 1996 at around 6-7% of total liabilities.

But, is 1996 a fair comparison? Okay, how about December 2007, when cash assets were a paltry 3.2% of the

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aggregate balance sheet; interbank loans were 4.9%, and the residual was 11.9%? As such, there is more cash, read liquidity, sloshing about the US banking system; there is more equity, and banks aren't as exposed to other banks' balance sheets the way they were in 2007, before the dam broke.

Please make note: currency crises are crises of liquidity, and the US banking system currently has a lot of it. If the rest of the world is concerned there isn't enough, new Fed Chairman Janet Yellen can simply, and very easily, postpone the tapering of the quantitative easing program. While I personally don't think that has that much to do with overall economic activity, it would send a message to the worried emerging markets that, in so uncertain terms, there will be enough liquidity to see 'us' through the short-term unpleasantness.

Sure, that is kicking the can down the road, but haven't we been doing that, for all intents and purposes, for, quite literally, decades? Yes, we will have to pay the piper at some point; however, I would love to pay him with inflation-destroyed greenbacks rather than something that stores its value well. Wouldn't you?

Finally, the gross external debts (what countries owe foreigners in internationally accepted currencies) of the countries making the headlines these days are far, far less on an absolute and relative (as a % of GDP) basis than that of the United States. Turkey? Argentina? Thailand? Ukraine? I mean it isn't even close. Let me just say, according to the numbers I have seen, Belgium has a bigger external debt problem than Argentina, Turkey, Ukraine, and Thailand combined. That's right, Belgium.

So, I just googled Belgium, at 2:45 CST on Friday, January 24, 2014, and the top headline on that particular search engine (Google) was: "Infamous Restaurant freeloader Found Dead in Ghent, Belgium." This from the august bastion of journalism: South China Morning Post. Then, a few lines down was the even more newsworthy: "Belgium Gripped By Theft of Mayor's Pants From Anarchist Museum" found in the Telegraph (U.K.).

Before, I get too silly, this has a point: there is ample liquidity in the global banking system to see us through some turmoil in a few emerging markets, particularly those that don't have massive amounts of external debt in absolute and/or relative terms. Still, if push comes to shove, and it very easily might, the Federal Reserve can simply waive a magic wand and/or say the magic words, and, you know, investors in developed countries will likely soon forget about the rioting in Ankara, Bangkok, and Kiev. When there is a buck to be made, investors will make it. Besides, we all have our own corrupt officials to worry about, you know?

In the end, the oldie, but goodie, "The Merry Minuet" was/is a perfect theme song for this week, because, the more things change, the more they stay the same….even if we like to think this time is sooooo much different than any time previous.

Disclosure