

Outrageous Predictions

SAXO
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2012: THE PERFECT STORM

Generating this year's Outrageous Predictions has been even more of a pleasure than usual, as it seems that never before have there been so many path uncertainties for the future, so we have had an infinite variety of scenarios to draw on. As usual, we try to keep at least a measure of consistency across the predictions by using a unifying theme. For this year, we settled on the theme for 2012: The Perfect Storm.

Saxo Bank's yearly Outrageous Predictions report has always been one of our more popular publications, and understandably so, as it frees us and our readers from the constraints of the high probability events in the middle of the supposed bell curve of possibilities. But there are a few key points I need to underline about this publication:

The first is that we always focus on "fat tail" predictions, i.e. events that are unlikely to happen, but are perhaps far more likely than the market appreciates. Saxo Bank first launched this publication 10 years ago as an exercise in looking at events which, should they happen, would change the outlook and performance of markets. This was before the concept of Black Swans was popularised. Our publication was rather inspired by option theory and looking at the tail-risk – an event which based on odds or logic has a very small chance of happening, but somehow still happens far more often than any model is able to predict.

Consider volatility during the 2008 Financial Crisis which no model could even imagine. Or think about a natural disaster like the earthquake/tsunami that hit Fukushima. Disaster planning could supposedly handle a very substantial earthquake and Fukushima was supposedly located in a low risk zone. But instead, Japan suffered an earthquake of severity which seemed impossible in Japan's geology, and the resultant tsunami wiped out back-up power. The unimaginable happened once again.

Saxo Bank's yearly Outrageous Predictions are not intended as real predictions and certainly not as "forecasts" in any way. Rather, the Outrageous Predictions are 10 important events with under-recognised probabilities in our view. Should any of them come to pass, they would change the way we need to analyse, trade and report the markets.

It is also important to note that our Outrageous Predictions nearly always have a negative bias, which is in fact a natural antidote to how the market normally operates. Human beings have a tendency to think positively, which is a natural part of our motivation to get up and go to work every day and a vital part of our survival instinct. Day in and day out we think about building a better future based on a continuation of the present. This is good for morale but does a poor job of preparing us for reality.

In that light, please do not let our Outrageous Predictions get you down. They have been prepared in the spirit of encouraging you to think outside the box and prepare for world-altering events. Thinking outside the box is rarely a comfortable exercise, but neither is dealing with an unpleasant surprise for which one has failed to prepare in any meaningful way.

Should one, two or three of our Outrageous Predictions come to pass, it would make 2012 a year of tremendous change. This may not necessarily be a negative thing either - and given the structure and uncertainties in the marketplace here at the end of 2011, we would suggest that even if none of our predictions come to pass, equally important and totally unanticipated events will. Sometimes we need to get to a new starting point before we can gain the right perspective. We hope 2012 will be the year where we start on the long march towards re-establishing jobs, growth and confidence.

Maybe, just maybe, our Outrageous Predictions can at least lead to a discussion on how we can prevent some of them from happening. We would like nothing more than to be proven wrong on negative views, but only if they are replaced with something better than the current central bank and government-manipulated paradigm.

Finally, I would like to wish you and your family Happy Holidays and a Prosperous 2012.

A handwritten signature in black ink, appearing to be 'Steen Jakobsen', with a long horizontal flourish extending to the right.

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OUTRAGEOUS PREDICTIONS 2012

1 - THE STOCK OF APPLE INC PLUMMETS 50 PERCENT FROM 2011 HIGH

No sovereign or corporate empire has ever maintained its superior position for long because attacks mount and loyalty fades. Going into 2012 Apple will find itself faced with multiple competitors such as Google, Amazon, Microsoft/Nokia, and Samsung across its most innovative products, the iPhone and iPad. Apple will be unable to maintain its market share of 55 percent (three times as much as Android) and 66 percent on the iOS and iPad as Android will gain further momentum and Amazon's low priced Kindle Fire will cut deeply into Apple's tablet reign. In relation to current earnings Apple is not expensive but expectations about future profit growth will come down hard as competition reaches insane levels and crushes Apple's profit margins.

2 - EU DECLARES EXTENDED BANK HOLIDAY DURING 2012

The December EU Treaty changes prove insufficient to solve EU funding needs – particularly those in Italy – and the EU debt crisis returns with a vengeance by mid-year. In response, the stock market finally caves in and drops 25 percent in short order, prompting EU politicians to call an extended bank holiday – closing all European exchanges and banks for a week or more. EU leaders gather like Vatican cardinals at a conclave to hammer out a “New Europe”. This could result in EU officials overstepping their mandate once again with new burdensome command and control measures that further violate the principles of the EU and free markets. Regardless, this “final” attempt leads straight to a popular overthrow of the old order and beginning of destruction of the sovereign debt time bomb. A period of pain is inevitable, but this will quickly allow a “new EU” to regroup with new membership and a new base from which its economies and markets can start planning for the future, rather than dealing with the mistakes of the past.

3 - A YET UNANNOUNCED CANDIDATE TAKES THE WHITE HOUSE

In 1992, a savvy, yet highly erratic Texas billionaire named Ross Perot managed to take advantage of a recessionary economy and popular disgust with US politics and reap 18.9 percent of the popular vote. Step forward to 2008, and Obama promises “real change” from eight years of Republican rule as the economy is nose-diving. Now, three years of Obama has brought too little change and only additional widespread disillusionment with the entire US political system. Going into the election in 2012, the incumbent Democrats are in ideological disarray and will get the blame for continued economic malaise and the favour-the-rich Republicans will never win the popular vote with the US rich/poor gap at a record width and social tension rising. In short, conditions for a third party candidate have never been riper. Someone smart enough to sense this and with a strong programme for real change throws his hat in the ring early in 2012 and snatches the presidency in November in one of the most pivotal elections in US history, taking 38 percent of the popular vote. A new political order is born.

4 - AUSTRALIA GOES INTO RECESSION

The Chinese locomotive has been losing steam throughout 2011 as investment and real estate led growth becomes harder and harder to come by due to diminishing marginal returns. The effects of the slowing of the up-and-coming Asian giant ripple through Asia Pacific and push other countries into recession. If there ever was a country dependent on the well-being of China it is Australia with its heavy dependence on mining and natural resources. And as China's demand for these goods weakens Australia is pushed into a recession, which is then exacerbated as the housing sector finally experiences its long overdue crash – a half decade after the rest of the developed world.

5 - BASEL III AND REGULATION FORCE 50 BANK NATIONALISATIONS IN EUROPE

As 2012 begins, pressure will mount on the European banking system as new capital requirements and regulatory pressure force banks to deleverage in a great hurry. This creates a fire sale on financial assets as there are few takers in the market. Troubled sovereigns, structural funding gaps and massive trading books set the scene for the largest bank rescue operation in Europe's history. Politicians, eager to score points with the public, create a regulatory mob enforcing value destruction in the banking system "in the name of greater good". A total freeze of the European interbank market forces nervous savers to make bank-runs, as depositors distrust deposit guarantees from insolvent sovereigns. More than 50 banks end up on government balance sheets and several known commercial bank brands cease to exist.

6 - SWEDEN AND NORWAY REPLACE SWITZERLAND AS SAFE HAVENS

Sweden and Norway are at risk of replacing Switzerland as the new safe havens – "risk" because, as we saw with Switzerland, becoming a safe haven in a world of devaluing central banks presents a number of risks to a country's economy. The capital markets of both countries are far smaller than Switzerland, (the combined FX volume in Sweden and Norway being a mere fraction of Switzerland's), but the Swiss are aggressively devaluing their currency and money managers are looking for new safe havens for capital. At the same time, Germany and its balance sheet are embroiled in the EU debt debacle and the classic safe haven appeal of 10-year Bunds is fading fast. Sweden and Norway sport excellent current account fundamentals, prudent social policies and skilled and flexible labour forces. Flows into the two countries' government bonds on safe haven appeal becomes popular enough to drive 10-year rates there to more than 100 basis points below the classic safe haven German Bunds.

7 - SWISS NATIONAL BANK WINS AND CATAPULTS EURCHF TO 1.50

Switzerland's persistency in fighting the appreciation of its currency will continue to pay off in 2012. After the dramatic failure of direct FX intervention in the market in 2009 and 2010 and after EURCHF threatened to destroy the Swiss economy with its death spiral towards parity in mid-2011, the Swiss National Bank and Swiss government finally joined forces to engineer an aggressive expansion of money supply and established a floor in EURCHF at 1.20. With Swiss fundamentals – particularly export related – continuing to suffer mightily in 2012 from past CHF strength, the SNB and government bear down further to prevent more collateral damage and introduce extensions to existing programmes and even negative interest rates to trigger sufficient capital flight from the traditional safe haven of Switzerland to engineer a move in EURCHF as high as 1.50 during the year, much to the chagrin of those who believe central banks can't intervene successfully.

8 - USDCNY RISES 10 PERCENT TO 7.00

The impressive growth rates in the world's second-largest economy, China, since the end of the Great Recession have been predicated on investment and exports. As marginal returns from building million-inhabitant ghost towns diminish and exporters struggle with razor-thin margins due to the advancing CNY China gets to the brink of a "recession", meaning 5-6 per cent GDP growth. Chinese policymakers come to the rescue of exporters by allowing the CNY to decline against a US Dollar - buoyed by its safe-haven status amid slowing global growth and an on-going Eurozone sovereign debt crisis - and send the pair up to 7.00 for a 10 percent increase.

9 - BALTIC DRY INDEX RISES 100 PERCENT

Despite the dry bulk fleet being expected to outgrow demand in 2012, leading to further over capacity, several factors could surprise resulting in a price spike in the Baltic Dry Index. Lower oil prices in 2012 could lead to an increase in the Baltic Dry Index as operating expenses go down. Brazil and Australia are expected to expand iron ore supply, further leading to lower prices and therefore higher import demand from China to satisfy its insatiable industrial production. In combination with monetary easing this leads to a massive spike in iron ore demand. The last shock that could impact the dry bulk market is exceptional dry weather, due to El Nino, leading to a plunge in hydropower electricity generation and thereby fuelling demand for coal imports.

10 - WHEAT PRICES TO DOUBLE IN 2012

The price of CBOT wheat will double during 2012 after having been the worst performing crop in 2011. The drop was brought about due to a combination of farmers responding to high prices in 2010/11 and normalised weather in the Former Soviet Union. However with 7 billion people on the earth and money printing machines at full throttle bad weather across the world will unfortunately return and make it a tricky year for agricultural products. Wheat especially will rally strongly as speculative investors, who had built up one of the biggest short positions on record, will help drive the price back towards the record high last seen in 2008.

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*Peter Martensen's painting "The Action" from 2009. 140 X 270 cm oil on canvas.
The painting is displayed in co-CEO and founder, Lars Seier Christensen's office.*