Michael Aronstein, Strategist, Oscar Gruss & Sons, Inc.
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MICHAEL ARONSTEIN, CHIEF INVESTMENT STRATEGIST OF OSCAR GRUSS & SONS, INC.,TALKS TO CAROL MASSAR ABOUT COMMODITY MARKETS, EQUITY MARKETS AND CREDIT RATING AGENCIES.

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SPEAKERS:
MICHAEL ARONSTEIN, CHIEF INVESTMENT STRATEGIST, OSCAR GRUSS & SONS, INC. CAROL MASSAR, REPORTER, BLOOMBERG NEWS

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CAROL MASSAR, REPORTER, BLOOMBERG NEWS: Joining us right now, as I mentioned, Mike Aronstein, Chief Investment Strategist at Oscar Gruss & Sons.

MASSAR: Where are you finding opportunities at this point?

ARONSTEIN: Well, we had a thesis last year that the U.S. economy particularly was going to be stronger than people thought and that carried us through most of the first quarter of this year and now we've been sensing something of a regime change. You know in general you've had people using every excuse possible to not invest in the United States. There was this whole intellectual architecture about China - was the new locomotive of the global economy and that fed into people's appetite for commodities, emerging market companies, all kinds of non-U.S. equity investment themes. We felt as though the U.S. was going to be the story for this year and particularly for dollar-based investors that's proving out.
It's been a very expensive venture overseas so far.

MASSAR: Right. Well, what do you make then of the 12 percent pullback that we've seen in the S&P since that April high. Is it the beginning of a new bear market or just a needed correction?

ARONSTEIN: I think it's just a correction in the sectors mainly that were tied to this whole, what I believe was a conceptual excess about, you know, non-U.S. demand growth.

The weakest sectors year-to-date have been affiliated with the idea that growth was coming out of the rest of the world and so the weakness you've seen in energy, even though it's been exacerbated by the events down in the Gulf, was already evident going into April. So it's not - this hasn't been simply a story of the spill, there have been other commodity sectors that have disappointed people.

Commodity markets as awhole have been quite weak and I think people have been surprised at how strong the dollar has been and again, the dollar was strong even leading up to the crisis point with Greece and it's been gathering strength.

MASSAR: You know we mentioned that you've had some great calls on the commodity markets. Where do you think we go from here in terms of commodities specifically? Do we start to - do we continue to see some selling pressures?

ARONSTEIN: Well, I think there's some risk in commodities generally and part of it derives from the fact that the flows, investment flows have become the fundamentals in the commodity markets, not the consumption by auto companies or the -

MASSAR: That can be kind of dangerous.

ARONSTEIN: It's very, very dangerous.

MASSAR: And fickle.

ARONSTEIN: Yes, you're absolutely right because you get the volatility of opinion there. It's much different than somebody ordering 40 tons of aluminum because they build aircraft. You have people trading who'd be willing to change their minds in 10 minutes and I think there is still an excess level of expectation across the investment spectrum with commodities as an investment medium rather than commodities as a useful tool of production. So that's one thing.

China also is offering the potential for commodity deflation because they've got so much excess capacity in some of the important commodity areas like steel. If their economy continues to slow, which it's doing.

MASSAR: Which we saw some numbers yesterday showing -

ARONSTEIN: Yes, the credit growth is starting to decline and they've been - they're central bank is among the tightest in the world. You know, they're not going to just stop production and lay off the people. They're going to keep producing and just export as much as they can. I mean they're - they are on a theme of job creation without profitability. So they're not that sensitive to selling the world at below the actual cost to produce and that's a risk in those things that they've really built capacity in.

MASSAR: What do you make about kind of the general sentiment, if you will, Mike, kind of around the globe and just so many different news stories sort of out of the Middle East right now. We still have the tensions within - between North Korea and South Korea, the news out of Japan and the resignation there. And kind of some uncertainty there in terms of that government going forward. I mean it just seems wherever you look around the globe at this point. Does it just make it even a more difficult investment environment or does it create more opportunities because again, it increases that volatility.

ARONSTEIN: Well, it's one of the dominant themes I think of the next five years or so. It's the -

MASSAR: We better get used to it.

ARONSTEIN: Yes, it's the decline of people - of the status of governmental authority and how the people in power react to it is really going to determine the investment climate. Whether or not they react the way Hugo Chavez reacts which is just shut down the economy, he didn't really care because the whole game for him is personal power and enrichment. Or whether politicians have the ability to react with some, some sense of humility and do what is right for the greater economic good rather than -

MASSAR: Track record not so good there.

ARONSTEIN: No, no, it seems that that endeavor attracts people without the character basis for humility. And you know one of the keys to life is the ability to admit that you're wrong. Certainly one of the keys to investing is we do it every day. But politics seems to have as one of its basic credos that you never admit that you're wrong, you just blame someone else or speak louder and that's - that's really a dangerous thing because we are in a world where - you know the private sector architecture and information transmission and all of that is beginning to overwhelm governments, which I think in their current structure are remnants of the last century really. But they're not going to die willingly or easily, many of them.

MASSAR: That seems like a pretty tough backdrop.

ARONSTEIN: It is. It makes life really, really complex from the investing side. And that's all right with us, but it doesn't -

MASSAR: Will you still see opportunities?

ARONSTEIN: Yes, there are always opportunities. Sometimes it's very, very difficult to separate the signal from the noise because people are overwhelmed with data these days and trying to ordinate, give a sense of what the waiting should be a to 1,000 different data points is really - it's very tough. You know, I spend, I don't know, 15 hours a day, 7 days a week doing it and it's still very tough and I've done it since the late '70s.

MASSAR: It's not getting easier.

ARONSTEIN: No, it's getting harder.

MASSAR: All right. Hold it on that note and we're going to come back and talk - continue our conversation with Mike Aronstein of Oscar Gruss & Sons.

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MASSAR: All right do want to go back to my guest. I'm talking with Michael Aronstein of Oscar Gruss & Sons. He is the Chief Investment Strategist. And, Mike, you kind of laughed a little bit when you heard about some of those comments from the head of Moody's. I mean the credit rating agencies, they're just worthless in your view or what?

ARONSTEIN: They're irreparably conflicted. You cannot rate somebody who pays you. It's just -

MASSAR: It's was just flawed from the start.

ARONSTEIN: Yes, conceptually, it's just invalid. There's no way. Just like if I go to apply for life insurance, the life insurance company doesn't let me pay the doctor. I can't give them a report from my own doctor -

MASSAR: Right.

ARONSTEIN: - who I pay. They send a doctor, and they pay for it. And that's the way the world works. You can't have that kind of structural conflict and expect people not to be affected by it. And you know the whole idea that they're going to clamp down and really try their best to present better ratings -

MASSAR: It's not going to happen.

ARONSTEIN: No, no. They didn't do it on purpose, but the business - first of all, forecasting is really tough. The market does it better than any of the agencies. You know the interest rate differentials tell you the varying amounts of risk in bonds. It doesn't take Moody's or Standard and Poor's to do that.

MASSAR: But will they go away?

ARONSTEIN: Grudgingly, they should. But I'm sure there are tremendous vested interest in keeping the system as it is. People are paid for it, even though in my opinion they shouldn't be and people are forced to use them. That's the tragedy - this is by government dictate that you must use a credit rating agency under certain circumstances, which you know is the Genesis of all monopolies from government. It's not from business practices. The only way you can truly have a monopoly is if government prohibits competition.

MASSAR: Let me ask you, though, we do have Warren Buffet, big shareholder in Moody's, although he's been paring that investment. You shrug your shoulders, what. Like, we won't get too much out of Warren Buffet or do you find it interesting that he's being questioned by the Financial Crisis Inquiry Commission today?

ARONSTEIN: He has a dog in that fight.

MASSAR: He does.

ARONSTEIN: He still, I believe he still owns stock in Moody's and I think he went into the investment with his eyes wide open, but personally I have just found it beneficial to steer clear of any embedded conflicts in any businesses in any financial interchange that I've participated in.

MASSAR: Just means problems.

ARONSTEIN: Yes, and there's no way around it and that's one of the big problems the Street has.

MASSAR: All right, and they're still trying to figure that one out.

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(BREAK)

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MASSAR: In the meantime, still with us is Mike Aronstein, Chief Investment Strategist at Oscar Gruss & Sons.

And, Mike, those futures are suggesting some gains at the open, a little bit of gains, but who knows because this market can start with gains and end with some pretty steep losses by the end of the session.

ARONSTEIN: Yes, that's another benefit of the regulatory regime we're under. You know the market, the SEC worked very hard to make sure that the market could trade in penny spreads and that you got rid of specialists. So now we do have a market that trades in penny spreads, but it can move 5 percent or 10 percent in a day with nothing happening.

MASSAR: But you've been trading for a while. Do the moves that we've seen, let's say in the last month, in the flash crash, I mean did that even kind of surprise you at the swiftness of the moves that we've seen as of late?

ARONSTEIN: Yes, that Thursday did surprise me. Fortunately, we - I have a partner who's been doing this for 25 years -

MASSAR: Strongheart?

ARONSTEIN: He keeps his hands on the controls, so we don't just send orders off into the cyberspace, but the complete evaporation of liquidity was - that was a wake-up call. But I think again, it has to do with the market structure that's been kind of enforced by regulatory attitude that people are better off if they can trade with penny spreads rather than having liquidity provided down there who's obligation it is to step in and make the markets somewhat more orderly. It's also when the exchanges all became for profit entities, then everybody involved with them was compensated on the basis of how much volume they could do.

MASSAR: Right.

ARONSTEIN: So they created an infrastructure that was kind of a benefit to people who were computerized, rapid traders. They don't really care about my order flow -

MASSAR: Right.

ARONSTEIN: They care about people who can do millions of shares a day through their automatic link to the exchange. And they - exchanges used to be something of a public utility and then became for profit corporations and that really changes the incentive structure quite a bit.

MASSAR: We've got about a minute until the opening bell, and you know we did get some economic news, mortgage applications, challenger job cuts down 65.1 percent, prior was down 71.1 percent. It's a big week for economic news, the jobs report. Do you think we're going to see any kind of good news, maybe provide some life to the markets?

ARONSTEIN: Yes, I think the economy's fine, and -

MASSAR: You think it's fine?

ARONSTEIN: Yes and getting better. And you know that's not been the problem. There have been some ancillary problems. They're almost financial market structure problems and problems with government and the entities that they've created like the Euro and like the entire EU.

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MASSAR: Again, Mike, you go back, you know - the economic fundamentals. It's true, you and others come on and say, you know, they're better. They're improving, they're stronger here in the U.S. But again, I guess I always ask, is it enough to outweigh all of the volatility that's outside the U.S. borders, the uncertainty? Is it strong enough?

ARONSTEIN: Well, the danger in markets generally arises at the point where the economy gets visibly strong. For one thing you get the draining of liquidity from the investment side into real economic uses. So if you look at points at which the market tends to become unhinged, it's right at the peak acceleration in the economy. So you know markets are a leading indicator of the economy. You think about the '87 crash, that occurred - that was the strongest quarter in several years in the fourth quarter of 1987. The economy was extremely strong at that point. So I think people having a very hard time with this because we are in a world where there's an overwhelming amount of information where the local volatility in markets is baffling and from my standpoint it's all right because I just hope that people will let us run their money. But it certainly makes the world of investing for non-professionals really perilous.

MASSAR: All right, we're going to leave it there. Mike, thank you so much. We appreciate your time this morning. Mike Aronstein of Oscar Gruss & Sons.

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