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PIMCO and RJ Update

PIMCO

Eye opening material right here boys and girls. Mr. Gross discussed how the central bank operates and put it in plain English. We love zerohedge, but so much of their material is difficult to interpret, so we appreciate Mr. Gross' succinct explanation. The FED purchases Treasuries at no cost since the sellers, or primary dealer banks such as BofA receive a credit, known as reserves, kind of like an IOU from the FED to the banks. Although the FED itself is purchasing trillions of dollars using their credit system, they don't have the assets to support, or put up collateral for their debt – a highly leveraged operation, and we know what happened to the high flying, debt machines during the Great Recession.

The FED receives annual interest, which is paid by the government through taxpayer money. The FED then sends the interest money back to the government, thereby paying down the cost of the financing for the Treasury. In essence, they are financing their Treasuries with zero interest bearing IOU, and then repaying the IOU with the interest received on their Treasury investment. This is why the FED could print trillions of dollars in cash, and purchase $85 billion in mortgage securities/month. In fact, the more securities they purchase, the more interest revenue collected by the central bank. The central bank supposedly only remits the profit to the Treasury, after issuing 6% dividend to the member banks, which are the primary dealer banks plus some others. But when one considers the zero cost of financing through the credit, reserves, then the interest received will essentially flow down to the bottom line. So, $2.5 trillion of investments, and let's figure 3% interest, then that alone is $75BB annually.

It's like COMPANY A, issuing corporate bonds and INVESTOR A, purchases the bonds and remits the interest received back to COMPANY A, thereby reducing COMPANY A's debt outstanding, and in due time, washing out the debt completely. Where did INVESTOR A get the money to purchase the bonds? INVESTOR A gives credit to LENDER A because LENDER A is a friend of INVESTOR A. INVESTOR A could, would bail out LENDER A, should LENDER A run into future trouble. That, my friends, is the system we have in place today.

What does the government do with the money received from the Treasury issuance? They have more USD and they use it in their budget to buy more stuff and spend more stuff for defense and non-defense budget. The US defense budget comprises more than 50% of the budget, mainly attributable to the financing in Iraq and Afghanistan. So more USD printed. If Korea, or a non-super power installed a system like this, the system wouldn't last for long because only the USD has the clout as the global trade currency to support the system, which is why the USD isn't devaluing into toilet paper.

RJ

Corporate issuance in 2013 to be lower than 2012 high. Mortgage 30 year agency bonds inched up slightly to 2.3%. 10 Year Treasury/A/BBB at 1.9/3.07/3.67%, respectively. Inflation concerns in the long run, will raise interest rate. Treasury yields higher 10% WoW, or up 0.1% across board as concerns over fiscal cliff somewhat defused.