full list [here](). Here are some I think are noteworthy.

> ***Surprise No. 1: Terrorism Dismantles an Already Fragile Global Recovery***
>
> *I fear we'll see attacks that demonstrate how terrorism incidents are systemic and not simply isolated. It could become apparent that we face a broad, aggressive wave of terrorism aimed (as expressed by ISIS) at defeating the West's world domination.*
>
> *Acceptance of this notion would cause significant disruption in global markets and the world's economies. Shares in airlines, hotels, entertainment companies (especially theme-park related) might suffer the most throughout the year.*

This may well happen, but I'll say this: if we let terrorist threats disrupt our economies, it will likely be because we let fear take control.

> ***Surprise No. 5: America Falls into Recession and Stocks Tank***
>
> *Too much debt, too little growth, fiscal-policy paralysis, a "spent" Federal Reserve and limited capital spending (which adversely impacts productivity) weigh down stocks in 2016. So do crony capitalism, geopolitical instability a further narrowing of market leadership and a further technical breakdown.*

This one would not much surprise me, for exactly the reasons Doug states. We are overdue for a recession. I think it will more likely strike in 2017, but I would admit that the probability of a recession this year is not low. I think a painful stock correction is likely even if we avoid slipping into outright recession. It may have already started, in fact.

> ***Surprise No. 6: Stagflation***
>
> *I think stagflation could join "screwflation" as a concern for 2016. Wages could rise and non-energy commodities (particularly agricultural) could pass the Federal Reserve's inflation target despite disappointing US growth.*
>
> *Although we could see slowing and recession-like growth in 2016's third and fourth quarters, the yield curve won't invert. But oil and a drought that causes higher agricultural prices could raise headline inflation to well above the Fed's target.*

Our traditional inflation measures are less and less useful in reflecting everyday life. They overstate the benefits of lower oil and understate rising healthcare costs. The Fed hiked rates because it thinks inflation is approaching the target range, but wage growth is still mild or neutral. None of this makes sense.

Under "stagflation" we could see flat wages, lower fuel costs. and higher food prices. The result would be net negative for most people, but it won't show up in CPI or PCE that way.

Surprise No. 9: The European Union Begins to Unravel

> *German Chancellor Angela Merkel's open-door immigration policy backfires and causes her to resign, while Britain leaves the EU (a "Brexit") under the assault of Euro-skepticism.*
>
> *Separatist initiatives in Scotland and other countries advance and France's National Front party rises to new heights in the face of immigration fears. Support to Greece and other EU peripheral countries diminishes, causing another emerging-market crisis. European borders are shuttered and trade comes to a halt.*

This one could easily happen. This week we posted a short video with George Friedman. He is very concerned about Germany, for reasons you will see in the video; and Germany is Europe's core. I've learned not to underestimate the EU's ability to postpone the inevitable, but I don't see how their union can last much longer, at least as currently structured.

Zervos: Spoos & Blues

David Zervos is the chief strategist at Jefferies & Company. He made a good call a year ago to raise European and Japanese stock exposure. Both outperformed US equities in 2015. Now he is losing confidence in that trade. He said this in a Dec. 22 year-end update.

> I am ending 2015 much less confident in both the European and Japanese QE-led reflation trades. Mario [Draghi] seems to have rolled over to a strengthening anti-QE German-led contingent. And Haruhiko [Kuroda] cannot seem to overcome the politically charged distributional asymmetries in stimulus that arise from a weaker yen. I certainly remain hopefully that they both can push ahead, but hope is no foundation for a high-quality trading theme. Instead, I'm pivoting back towards my old flame – Janet!!

Thank you, David, for coining the phrase "politically charged distributional asymmetries." It rolls right off the tongue.

David goes on to say how impressed he is with his old flame Janet Yellen's skillful management of the Fed's lift-off from zero rates. He thinks reflationary momentum will intensify as the year goes on. To take advantage, he suggests what he calls the "spoos & blues" trade. Spoos are the S&P 500 stock index and blues are US Treasury bonds. One or the other should do well in 2016, he thinks. He does not think the US can go into recession until we get an inverted yield curve, and we are a long way from an inverted yield curve.

Jensen: Liquidity Crisis Ahead

Neils Jensen at London-based Absolute Return Partners is one of the most thoughtful analysts I know. Like me, he thinks long-term and rarely attaches a time frame to his forecasts. Jensen thinks the big story of 2016 may be a “third leg” of the global financial crisis.

The first leg, of course, was the US subprime mortgage debacle and related breakdowns in 2007–2008. The second leg was the European sovereign debt crisis, which first blew up in 2010 and is still in progress, particularly in Greece.

What could be the next leg? One possibility he mentions is a widening emerging-market crisis as commodity prices fall further or remain weak. If the Fed follows through on its rate hike plans (far from certain), the dollar will strengthen further. This will make it harder for non-US borrowers to pay dollar-denominated debts.

That is a toxic combination for commodity-exporting companies and nations. Not only is their income plummeting due to low resource prices, but their debt servicing costs are increasing as the dollar moves higher. The potential for major implosions is significant.

I think this fear probably explains IMF chief Christine Lagarde’s open pleas for the Federal Reserve to consider the impact on emerging-market nations as it tightens policy. There is little sign the Fed intends to do so. I would argue that Yellen is right to ignore Lagarde. The Fed’s mandate is to maintain maximum employment and price stability in the US, not to bail out other countries. Nevertheless, the Fed could well spark an EM crisis that will spiral out of control and hurt everyone.

Jensen’s other “third-leg” candidate is a bond market liquidity crisis. New capital regulations discourage banks from holding non-sovereign bonds in inventory. The problem with this arrangement is that banks have long used their own inventories for market-making. They are the reason it is (or was) easy to move in and out of corporate and high-yield bonds with minimal slippage or delay.

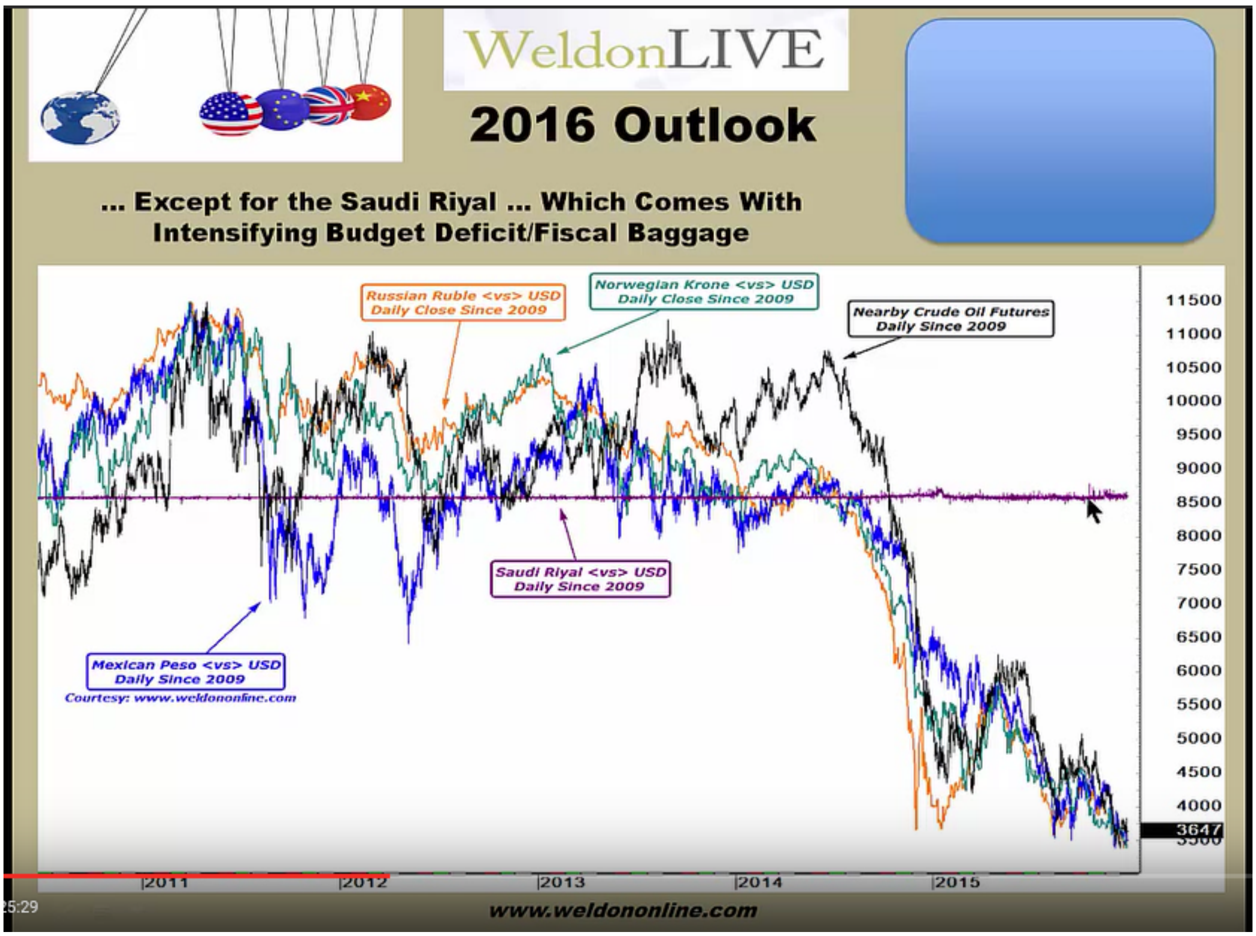
Liquidity is shrinking even as the amount of money in bond ETFs and mutual funds is growing. These products promise their shareholders daily liquidity. See the problem? Last month’s collapse of Third Avenue Focused Credit Fund may turn out to be the dress rehearsal for more such failures.

Jensen sees a high probability for both scenarios (EM crisis and bond liquidity crisis) to happen in 2016. Neither will be good, but the second one will have much greater impact on other asset classes like stocks, if it happens. And it would certainly not be good for world GDP growth.

Weldon: Currency Wars

My book *Code Red,* written some 2½ years ago, laid out the rationale for why I and co-author Jonathan Tepper believed that the last half of this decade would see an intensifying currency war. Indeed, we made the point that Japan, under the guise of quantitative easing, had fired the first shot. Greg Weldon’s forecast for the next year is that the intensity of the initial currency skirmishes (my term) will increase this year. In his 2016 forecast he lists 20 countries that have seen the US dollar appreciate by 50% over the last five years, representing a total population of 2.2 billion people. He also notes the interesting fact (one that I missed – he is so good at finding these little details) that Zimbabwe is planning to use the Chinese currency in order to cement ties with China.

I will offer one of Greg's scores of charts. It shows that the oil-based economies – Mexico, Norway, Russia – have seen their currencies fall along with the price of oil. The exception – the flat line in the graph – is the Saudi riyal, which is dollar-pegged. This peg can't last, and the other currencies in the Middle East that are pegged to the riyal are also going to come under pressure. (I note that Saudi Arabia is selling oil into Europe at $26, clearly intent upon maintaining market share!)



Greg and I have been talking about these currency phenomena for a very long time. I'm not sure how far back we go. He is an old-school commodity trader and writer, and his rapid-fire PowerPoints and voice webcasts cover almost everything that can be traded. He is bullish the gold mining companies, with the caveat that, if the FOMC proves to be as hawkish as some of its members sound (i.e., for more interest-rate increases this year), then the dollar will get stronger and gold will come under intense pressure, possibly making new lows.

I agree. If you can tell me what the Fed will do, I will tell you, with 90% certainty, what gold will do. The problem is, since I am reasonably sure that the Fed doesn't even know what it's going to do, it is very likely you don't know what it is going to do, either. We are all guessing. And guessing makes for a very fraught trading environment. You can see the first part of Greg's "2016 Outlook" here.

A Few Final Thoughts

Everywhere you look in the macro world, major and minor events reveal stress cracks at the edges. The Bank of Japan is now buying corporate bonds at negative interest rates in the open market. How in the Wide, Wide World of Sports can you have a functioning corporate bond market when somebody is buying at negative rates?

> "The market had looked at the 0.1 percent level as the floor for corporate bonds, but if investors can be confident that they can sell the debt to the BOJ at negative levels, that level may come down," said Takayuki Atake, an analyst in Tokyo at SMBC Nikko Securities Inc., a unit of Sumitomo Mitsui Financial Group Inc. "It's a landmark that we've reached negative yields for corporate bonds." (Bloomberg)

The VIX is back above its 400-day moving average, which is historically a good buying opportunity. While the absolute nominal index number has been higher, getting above the 400-day moving average is not the norm.

Long-term debt for oil exploration and production companies exploded by 70% since 2010 to $353 billion this last year, fueled by the low-interest-rate environment of the Federal Reserve. While the bonds are not selling well in the open market, the defaults are yet to come. Oil plunged below $30 this week, and there is a real possibility of its going much lower, given that Iran is, as of yesterday, free and clear to go into the markets with its production.

I could list multiple dozens of odd and troubling facts, but the upshot is that the world has given us a difficult trading environment. Stick with me this year as I peer through the fog to find a few opportunities here and there.

And let me end on a positive note. Even with all our economic and geopolitical troubles, the progress of humanity in overcoming many persistent problems has been persistent and impressive. Technology and social understanding are advancing on dozens of different fronts.

Let me suggest you watch this short YouTube video. It shows Elon Musk's Falcon 9 rocket landing on its pad. This rocket will cut the cost of space launches by 90% and perhaps eventually by 99% from today's cost. If you can watch this video without your emotions jumping, if you can see the young men and women screaming in joy over their success and not want to join them in shouting as you watch the rocket deploy its fins at the last moment and touch down ever so gently, then you are probably an NSA spy cam linked to a computer and *not* a human being.

How can you not be an optimist? Really? How can you not be?

Hollywood (Florida), Cayman Islands, and Surprises

I fly next Sunday to Hollywood, Florida, where I will be at the ETF.com conference with some 2000 people, talking about all things ETF. I will be giving the keynote address at the Tuesday lunch, doing interviews, holding meetings, and of course doing the rounds of dinners and gatherings every evening. I expect to learn a lot.

The following week I will go to the Cayman Islands to speak at the Cayman Alternative Investment Summit, one of the biggest hedge fund and alternative investment gatherings outside of the US. They have an impressive lineup of speakers, and I note that this year the celebrity guest speaker is Jay Leno. That should be fun. I just looked through the speaker list and noticed that Pippa Malmgren, who will also be at my SIC conference (see below), is speaking, and it will be fun to catch up with her again. I will be on a panel (moderated by KPMG chief Economist Constance Hunter) with old and brilliant friends Nouriel Roubini and Raoul Pal. At least I know that with those two guys there is no need to wear a tie.

And that is pretty much it as far as the scheduled trips. I know I still have to get to New York and a half-dozen other places for short trips, and will let you know if I'm in your area. But we are really trying to limit the travel as the work on my book grows more intense. "Oh deadline, where is thy sting?" is the refrain that echoes in my mind. If you are trying to write a book on what the next 20 years will look like, you can't take 20 years to write it.

Let me remind readers that my Strategic Investment Conference will be held in Dallas, May 24–27. We are finalizing the speaker list, which you can see at the website, and have just confirmed Niall Ferguson. I should note that both George Friedman and David Zervos, whose 2016 forecasts we just sampled, are among our all-star lineup. I am excited that on Thursday night we will be going to the biggest C & W bar in Dallas (Gilley's, for you locals) and taking over the entire place; in addition to longnecks, Mexican food, and barbecue, we will enjoy a conversational shoot-out featuring Michael Barone, Steve Moore, and Juan Williams, with a focus on the upcoming elections. Who knows – maybe we'll be talking about Biden versus …??? And maybe even a brokered Republican convention.

You can't even imagine what chaos a brokered convention would be. I have been a delegate to national conventions, where I have been intimately involved with and have led multiple floor fights on the state level at the largest state convention in the country. We haven't seen an open floor fight at the national level since 1948, and back then we had powerbrokers. Today there are no powerbrokers of any real consequence. And you may think that this or that candidate will walk in with a certain percentage of delegates that are "his" or "hers." That's not how it works. After the first vote, where you are committed, you are no longer legally bound. You simply have no idea what chaos could ensue. Maybe I should write about that story. The Rules Committee for the national convention, whose work is normally both arcane and mundane, is already engaged in serious discussions. And if things haven't changed by the time the gavel falls to open the convention, the convention gets to adopt its own rules. Normally, the rules suggested by the Rules Committee go uncontested. (I think maybe in '76 the Reagan delegates kicked up a little fuss.) Adding to the fun, the current Rules Committee members generally have to be reelected before the next convention. I can guarantee you, last year no one thought the most interesting committee assignment would be on the Rules Committee. And maybe it won't be.

The flipside of a brewing floor fight is that the media would be focusing on the convention for months in advance and would go to 24-hour coverage during the convention. It would be the ultimate reality TV show. Who gets voted off the island? Who gets fired? You couldn't buy that kind of TV time.

It is time to hit the send button. I think I am going to see Leonardo DiCaprio in *The Revenant.* My "Sunday off" will be spent reading Matt Ridley's new book, *The Evolution of Everything.* A relaxing way to do research for my own book. Cool techie hint: if you read a book in the Kindle app (as I do on my iPad), you can highlight and make notes and then go to them on your personal Amazon Kindle page at some later date. You're actually allowed to cut and paste from there. I fantasize about having my highlighted sections and notes from every book I've read for the last 50 years somewhere in the cloud. Dear gods, I would be dangerous.

Your rationally optimistic analyst,

John Mauldin

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