

Insights in 140 words (from the db140 Team)

## Macro

Taylor rule - Monetary policy by discretion or equation? Even the House Republicans raising this question must concede that a formula is only as precise as its inputs. Consider the Taylor rule's three variables for example: the equilibrium real interest rate and both the deviation of inflation from target and output from potential. The long-run real rate was generally accepted as 2 per cent before the crisis. Janet Yellen's assurances of a lower terminal funds rate suggest it should be half that while secular stagnationists believe it is negative. Similarly some reckon headline unemployment underestimates America's output gap due to discouraged workers. Meanwhile others contend that labour markets are tight given low short-term unemployment. Feeding this range of inputs into a Taylor rule spits out a 50 basis point raise or cut next Fed meeting. Central banker discretion is hard to dispense with.

## Strategy

Share buybacks - IBM developed the first computer to beat a chess world champion in 1996. A year prior however the company booted up a less intellectually rigorous programme: share buybacks. That IBM's current chief executive this week boasted of halving shares outstanding since 1995 suggests too many corporate finance textbooks remain unread. To recap: buybacks are earnings per share accretive only because equity (with a higher implied earnings yield) is being replaced by (lower cost) debt. Indeed IBM's total debt has almost doubled since 1995 while shareholders equity is flat. But changing a firm's capital structure does not alter its enterprise value - more leverage simply means a riskier stream of earnings and hence a lower valuation multiple. IBM highlights the trade off. The stock has more than doubled in the past decade. But its price/earnings ratio has also contracted by two fifths.

## Stocks

Sugar and shelves - Coca-Cola's revenues and gross profits have fallen year on year for six consecutive quarters. Its rolling three year compound annual sales growth is now negative. Another consumer company with double the revenues grew them over the same period. Yet the latter, Tesco, fired its chief executive of three years this week (Walmart also replaced its US head despite solid growth). Meanwhile Coke reported more disappointing numbers on Tuesday and has underperformed the S&P 500 by a third since 2011. Its boss Muhtar Kent is admired and under no pressure whatsoever. Sure Coke is a profit machine, converting a fifth of sales into earnings, whereas Tesco's shareholders have endured £3bn of extraordinary losses over the past four years. But Coke's high margins have been drifting lower for a decade. What's a CEO for if not for supporting top and bottom lines?

## Finance

UnBundled - Reluctant party animals at the best of times, German insurers will not be celebrating this week's record high in 10-year Bund prices. Prolonged low interest rates are kryptonite for insurers as a string of bankruptcies in Japan during the late-1990s demonstrated. Life insurers with large duration mismatches are the worst affected - Moody's estimates the German sector has an average maturity of 20 years for liabilities versus six years for assets. High guaranteed returns on past policies don't help either. Sure guaranteed rates on new policies are down to 1.75 per cent from 4 per cent in 2000 but the average for the outstanding stock is still near 3 per cent. Thankfully investment returns remain above that for now. But Bundesbank stress tests suggest that if German bond yields stay low then investment returns could drop below guaranteed minimums by 2016.

## Digestif

Flying - Given the headlines from Ukraine, Taiwan and Algeria in the past eight days it is easy to forget that statistically speaking air travel has never been safer. Annual fatalities in plane accidents over the last five years average below 600 - the lowest in six decades and a third below the peak in the late 1970s. In the last 15 years alone fatalities have halved even as the number of flights and hours flown went up 50 per cent. Of the three tragedies this week two occurred mid-flight. But over the past 10 years about a half happened upon starting descent while a quarter took place before achieving cruise altitude. In terms of causes, human error accounts for over half of all fatal incidents, mechanical failure a fifth, while weather and sabotage have each caused a tenth of the disasters.