--When asset prices become overstretched, any small changes in perception can cause a rapid collapse

--This seems to have happened with Apple

--It offers a warning for richly priced equity and junk bonds

AAPL and Other Fears

Apple shows that it doesn't take much bad news, or indeed marginally short of fantastic news, to prick exaggerated expectations. And when the slide starts, it's hard to know where it might stop.

Back in September, Apple Inc. (AAPL) shares peaked at above $700. Overnight, after their latest quarterly report, at one point the shares slumped to under $460 in after-hours trading.

That downward trajectory is worth remembering in light of the corporate bond market, where high-yielding issues are nothing of the sort--yields on junk-rated debt are now at historic lows.

But it's not just junk bonds where there's a risk that investor enthusiasm might be getting ahead of itself. U.S. equities in general are increasingly being priced, if not for perfection, then for exceptionally good times.

The Vix, the so-called fear index derived from the implied volatility of S&P 500 options prices, has collapsed to under 13, which broadly characterized the top of the market range during the years of market excess that ended in financial crisis.

Yes, in some respects, markets are still far short of pre-crisis extremes. High-yield spreads over government debt are still substantially wider than they were during the boom times. Cyclically-adjusted equity price-to-earnings ratios are substantially below their bull-market peaks, even if they're more than a third above long-run averages.

And yes, central bankers and regulators have intentionally been supporting market valuations by forcing down long-dated yields through quantitative-easing policies and financial repression (ie forcing private-sector investors like banks and pension funds to buy government bonds).

But it seems that even central bankers, are starting to realize things might be looking a little bit... deja vu.

Just this week, Bank of England Governor Mervyn King warned that with "long-bond yields at unsustainably low levels, there is a risk to financial stability."

Others have worried publicly about the fast appreciation of agricultural land prices in the U.S. as well as other bubbly assets.

Will the fear of financial bubbles and eventual rapid and painful dislocations make central bankers more reluctant to add further monetary stimulus? Possibly, though only at the margins. Janet Yellen, Federal Reserve vice chair, and front runner to replace Ben Bernanke when his term ends next January, has admitted withdrawing stimulus without causing major market disruptions won't be easy. But she's also among the staunchest doves on the Fed board and determined to introduce even more policy accommodation.

It seems that there's no real change to central-bank thinking that prevailed before the crisis, when the then Fed Chairman Alan Greenspan argued against popping bubbles and, instead, dealing with the consequences when they finally collapse under their own weight.

Bank of England

LONDON--The Bank of England appears to be losing faith in buying bonds to support recovery in the U.K. and has instead signaled that fresh policies and some fine-tuning of its objectives may offer a better route back to growth.

Minutes of the Monetary Policy Committee's January meeting record officials' concerns that printing money to buy bonds, a policy also known as quantitative easing, may be losing some of the potency it once possessed in stoking demand in Britain's flagging economy.

The BOE has so far bought 375 billion pounds ($594 billion) of U.K. government bonds under its QE program, but most analysts anticipate there will be no more purchases this year unless the U.K.'s prospects weaken considerably.

The MPC's conclusion on QE's waning effectiveness reflects concerns among rate-setters that bottlenecks in the economy are obstructing growth and bond-buying can't help to fix them.

One of the chief impediments they see is the U.K.'s dysfunctional banking system, which officials fret is weighed down by bad loans that make banks unwilling or unable to finance a recovery. Banks counter they are willing to lend but no one wants to borrow, and complain that tougher regulatory demands are preventing them from opening the credit spigot.

Tackling this logjam is the goal of BOE policies aimed at repairing the banking system and keeping it stocked with cheap cash, policies that appear to be gaining in importance in the central bank's armory as the attraction of bond-buying diminishes.

The central bank and the U.K. treasury have launched a funding-for-lending scheme, or FLS, to channel cheap funds to banks that dish out more loans. Rate-setters have taken heart the FLS is working from promising signs such as lower loan rates and surveys showing banks plan to make more credit available. But the program has yet to lead to a pickup in lending and some economists are skeptical it will.

"I don't think it will kick-start a huge amount of lending," said Philip Rush, an economist at Nomura, who thinks banks are more likely to use the cheap cash to pay off debts. He added that whether it works or not, it may discourage the MPC from more bond-buying as long as policy makers' faith in the funding scheme's potential persists.

Meanwhile, the BOE's new Financial Policy Committee, which monitors threats to the financial system, is trying to tackle the deeper problems in the banking system by getting banks to raise capital and clean up their balance sheets and to get themselves in better shape to fund new loans.

BOE Governor Mervyn King said in a speech on Tuesday that restoring Britain's banking system to full health is essential for economic recovery. Yet progress has been slow, not least because two of the U.K.'s biggest lenders--Royal Bank of Scotland Group PLC (RBS) and Lloyds Banking Group PLC (LYG)--are partly state-owned and the government has refused to stump up any extra cash to help repair their balance sheets. The FPC will review banks' progress in March.

Mr. King, who retires at the end of June after 10 years at the helm of the BOE, said on Tuesday that with output in the U.K. still stuck below its pre-crisis peak four years after the crisis broke it may be time to go further and review the U.K.'s monetary policy framework.

The U.K. regime, which requires the BOE to keep annual inflation at 2% except when to do so risks causing "undesirable volatility in output," has been in place for 21 years. This degree of flexibility has permitted the MPC to tolerate a persistent overshoot of its 2% target for a large part of the past five years, on the grounds that to keep it constantly near 2% by raising interest rates would have sunk the economy.

But the limits of that flexibility are not clearly spelt out and Mr. King suggested tweaking the framework to make the trade-off between growth and inflation more explicit. He hinted that guidance on the future path of interest rates, something recently adopted by the U.S. Federal Reserve but so far avoided by the BOE, could also play a role in any new monetary setup.

The BOE's efforts to explore new policies reflect a broader debate in central banking about how best to drum up growth in Western economies that are struggling to overcome the hangover of the financial crisis that brought down investment bank Lehman Brothers Holdings Inc. in 2008 and triggered a global recession. The Fed, the European Central Bank and the Bank of Japan are also experimenting with new tools and novel approaches to their own problems.

Mr. King, however, dismissed a more radical idea doing the rounds in policy circles that calls on central banks to abandon their inflation targets and focus instead on delivering growth. Targeting nominal gross domestic product, or the cash value of the economy, has been floated as a potential way out of a slump by Bank of Canada Governor Mark Carney, Mr. King's successor.

But Mr. King said ditching the U.K.'s inflation target would be a bad idea that would risk resurrecting the economic turmoil that plagued the U.K. in the 1970s.

"The battle to bring inflation expectations down was long and hard and involved persistently high levels of unemployment. Wishful thinking can be indulged if the costs fall on the dreamers; when the costs fall on others, it is unacceptable."

Japan Fighter Jet Scrambles

TOKYO--The frequency of scrambles by Japanese fighter jets against Chinese planes rose sharply during the October-December quarter, underscoring growing concerns that the territorial dispute between the two nations is escalating into more dangerous tensions in the sky.

The increase shows Tokyo is responding aggressively to Chinese planes intruding into the areas inside and outside of what Japan considers its airspace over the East China Sea, where the two neighbors have squabbled bitterly over a group of small uninhabited islands known as Senkaku in Japan and Diaoyu in China.

Japan's Self-Defense Forces said Thursday the air force conducted 91 scrambles against Chinese aircraft in the latest period, the largest quarterly tally since Tokyo started disclosing such data in 2005. For decades, Japan has routinely dispatched fighter jets to keep foreign aircraft - mostly Russian jets - out of its airspace, but the number of scrambles against Chinese planes has been rising sharply in recent years.

During the first three quarters of the current fiscal year from April, Japan conducted 160 scrambles against Chinese planes, more than the 156 in the full year ended March 2012, and 54 in the prior year. The latest quarterly number was up from 54 scrambles for the July-September period and 15 for April-June.

Diplomatic dialogue between the two nations aimed at resolving the dispute has been largely put on hold following a leadership change in Beijing in November and one in Tokyo in December. In a subtle initial effort by Japan's new government to reach out to China, the leader of a small party in the ruling coalition is visiting Beijing this week, carrying a letter from Prime Minister Shinzo Abe to Xi Jingping, China's new leader.

Natsuo Yamaguchi, the leader of the New Komeito party, met with Chinese foreign minister Yang Jienchi Thursday. "You come to China for the visit at an important time of Sino-Japanese relationship," Mr. Yang told Mr. Yamaguchi, according to Xinhua, China's state news agency. " We hope the tour contributes to maintaining and pushing forward the ties." The content of Mr. Abe's letter hasn't been disclosed.

Until recently, the confrontation over the disputed islands centered on cat-and-mouse chases between lightly-armed coast guard cutters from the two sides. Government officials and analysts, however, have expressed concerns that the dispute may have entered into a new and riskier stage with more frequent appearances of Chinese naval ships and aircraft from both nations in the areas increasingly close to the islands.

James Schoff, an analyst at Carnegie Endowment for International Peace, said what's new is the "frequency and the duration of lingering and loitering" by Chinese patrol boats in sensitive waters and the use of aircraft right over the disputed islands.

"It fits into the Chinese narrative that we are there to keep you out," said Mr. Schoff, who was until recently an Asia policy adviser at the U.S. Office of the Secretary of Defense. " The narrative has changed to be 'Not only is it we can go there but you can't be here.' That's a fundamental change."

In a move that alarmed officials from Tokyo and Washington, a patrol plane from China's State Oceanic Administration flew into the airspace above the Senkaku islands on Dec. 13, undetected by Japanese military radars. Once a coast guard boat spotted it, the Japanese air force t dispatched eight F15 fighter to scramble.

Taking the confrontation one step further, China's defense ministry said on Jan. 11 Beijing sent in two of its J-10 fighters close to the Senkaku airspace after a Chinese plane was followed by Japanese F-15 fighters, according to Xinhua.

To rein in tensions, U.S. Secretary of State Hillary Clinton called on both Beijing and Tokyo last Friday "to take steps to prevent incidents and manage disagreement through peaceful means" while warning Beijing that the U.S. "oppose any unilateral action that would seek to undermine Japanese administration."

China snapped back. On Sunday, Chinese foreign ministry spokesman Qin Gang said that "the comments by the U.S. side are ignorant of facts and indiscriminate of rights and wrongs. " China has long contested Japan's effective control of the islands and blames the U.S. for placing the rocky outcrops under the control of Japan after World War II."

Aussie Dollar and North Korea

SYDNEY--The Australian dollar fell Thursday as news that North Korea planned more rocket launches hurt sentiment already weakened by disappointing earnings from Apple Inc. and a downgrade to the International Monetary Fund's global growth forecast.

At 0508 GMT, the Australian dollar was buying US$1.0513, down from US$1.0534 late Wednesday and below a session high of US$1.0557.

HSBC's preliminary Chinese purchasing managers index for January, which rose to a 24-month high of 51.9 from a final reading of 51.5 in December, wasn't enough to boost the Aussie dollar.

"Traders are now looking for the next catalyst to drive the markets higher," said Ben Taylor, a trader at CMC Markets. "Many are pointing to continuous central bank support around the world, a rebounding China, improving risk in Europe and general low inflation as drivers."

Domestically, economists continue to debate the future direction for Australian monetary policy after fourth-quarter inflation data relased on Wednesday cleared the way for more central bank easing, if required.

While few analysts expect the Reserve Bank of Australia to cut rates when it meets on Feb. 5, further easing is tipped over coming months that would take upward pressure off the Australian dollar.

"More stimulus will likely be needed," said Citi economists in a note. "Policy is still working, but is reliant on a narrower range of channels. Key will be asset prices, and in particular the share market, which already is responding helped by improved global developments."

They argue that borrowing costs for consumers should be at least another 50 basis points weaker.

Since November 2011, the RBA has cut its cash rate by 1.75 percentage points.

A survey of 18 economists by The Wall Street Journal shows a low expectation of a cut in February--13 out of 18 economists expect no change in the RBA's key rate. Market pricing for a rate cut is hovering around 40%.

"We continue to look for the bank to wait until March," said Skye Masters, an interest-rate strategist at NAB.

Dollar and the Currency Wars

The dollar may have helped to start it.

But, don't expect the dollar to win it.

The currency war, that is.

If anything, as more countries and more currencies engage in the battle to boost exports the dollar is likely to find itself under even more upward pressure.

So far, the dollar's reaction has been muted, with the U.S. Dollar Index spending much of the first month of 2013 in the same narrow range as it traded in the last month of 2012.

But that doesn't mean the U.S. currency still won't take off.

Early in the new year, financial markets were flooded with optimism about global growth, hopes of an end to the euro-zone debt crisis, and confidence that the U.S. would resolve its fiscal problems.

However, as the new year has wore on, much of this hope has been showing large dents.

In the case of global growth, strong rebounds among many emerging markets aren't being matched by the same sort of performance in the developed world. On the contrary, the International Monetary Fund this week cut its forecast for global growth this year and next, both by 0.1 percentage points.

This means there will likely be more pressure on more countries to try and export their way out of recession, even if this means devaluing their currencies to do so.

A new government in Japan has already declared its intention of doing just that, and there are already signs that other countries, including the U.K., are only too happy to talk the value of their own currencies lower with promises of further monetary easing.

The U.S., by comparison, appears to be staging a more sustainable recovery, especially now that the immediate fears about going over the "fiscal cliff" have passed.

If this continues, the dollar could well find that it not only benefits from a slightly more hawkish Federal Reserve but from a return of safe haven status as international investors worry about what sort of global recovery a currency war will bring.

Hopes of an early end to the euro-zone debt crisis are also starting to fade.

The immediate risk of a sovereign default has gone away, now that the yields of key debtor nations, such as Spain and Italy, have fallen back to more sustainable levels.

With this has come the return of investor flows to debtor nations, as well as an improved flow of credit which is taking the pressure off European banks.

However, the economic picture in the euro zone is not getting any brighter. If anything, recent figures suggest that in some member countries things are going from bad to worse.

Unemployment in Spain is at new record levels with a youth unemployment rate of nearly 60%, indicating the depth of recession the country continues to face.

In Germany, manufacturing activity may have picked up as the country continues to display high levels of economic resilience. But, in France, manufacturing activity is at a three-year low, according to the latest purchasing managers' reports from both countries.

All this could swiftly undermine the growing confidence in the euro zone, especially if investors once again take the view that the debt crisis will drag on and on.

Put this altogether and the bright sentiment that helped to boost equities and other higher risk asset markets at the start of this year is already fading fast, and talk of a rotation out of safe havens of old--such as the dollar and the U.S. Treasurys--is starting go quiet.

JOBLESS CLAIMS AT 5 YEAR LOWS

WASHINGTON--The number of U.S. workers filing new applications for jobless benefits fell to another five-year low, indicating a strengthening labor market.

Initial jobless claims, a measure of layoffs, fell by 5,000 to a seasonally adjusted 330,000 in the week ended Jan. 19, the Labor Department said Thursday. Economists surveyed by Dow Jones Newswires had forecast 360,000 new applications for jobless benefits last week.

The level of jobless claims is at its lowest point since January 2008, near the start of the recession.

The four-week moving average of claims, considered a more-reliable figure because it smoothes out often volatile weekly data, fell by 8,250 to 351,750. That was the lowest level since March 2008.

The recent fall in claims is a sign of a steadily, though slowly, improving labor market, since a slowdown in layoffs often coincides with increased hiring. Employers last month added 155,000 jobs, roughly in line with the average pace of hiring over the past two years. The jobless rate held steady at 7.8%, a historically high level but down from the above-8% level seen through much of the recovery.

The level of claims can be difficult to gauge this time of year due to seasonal factors. A Labor Department economist said there was nothing unusual about the latest batch of data, though figures for three states were based on estimates.

The data showed the number of continuing unemployment benefit claims--those drawn by workers for more than a week--declined by 71,000 to 3,157,000 in the week ended Jan. 12. Continuing claims are reported with a one-week lag.

The number of workers requesting unemployment insurance was equivalent to 2.5% of employed workers paying into the system in the week ended Jan. 12, unchanged from the prior week.

LONG END BUYING

11:51 EST - Count New York-based global macro hedge fund Anji Capital Management as a bond bull. Kevin Chen, chief investment officer, says in an interview Thursday that he initiated wagers last week on price gains in 30-year bonds. He argues that economic fundamentals are very weak, citing disappointing corporate earnings, such as those from Apple; higher taxes also will hurt consumer spending, he says. Chen declines to reveal the size of the fund or more details on the long bets. So far this year, Treasury bonds maturing around 30 years have lost about 1.5%. The 30-year yield rose by 3bps Thursday to 3.06%. Chen says anytime the yield rises above 3%, it's a good buy. "Higher yields mean mortgage rates will go up and the real estate would get hammered," he says. "This will be the last thing Bernanke wants to see.”

VIX Performance = Prolonged Bull Market?

11:23 EST - The low VIX might be heralding a transition to a prolonged bull market, according Jim Strugger, derivatives strategist at MKM Partners. "The risk floor imbedded under implied volatility during the crisis era is crumbling," Strugger writes. This "suggests that the macro-driven investment style forced onto more traditional fundamental long/short investors in recent years will dissipate." This shift from a high to a low volatility environment last occurred in March 1991 and October 2003, he said, "which both marked the beginning of multi-year bull markets for U.S. equities." VIX up 1.2% to 12.61, but remains on track for fourth-straight finish below 13

Gold Vix and ECB

12:34 EST - Signals from the gold options market are ringing alarm bells for gold traders. The Gold VIX, which uses options prices to forecast the likelihood of rapid shifts in gold futures, is trading at 12.57, after finishing yesterday at the second-lowest level in the index's 4 1/2-year history. A decline in volatility tends to presage large price moves: Gold futures slumped 3% over three days after the Gold VIX closed at an all-time low of 11.97 on Dec. 17. Comex Feb gold recently trading down $14.90, or 0.9%, at $1,671.80/troy oz. (tatyana.shumsky@dowjones.com)

12:33 EST - The ECB will release data on early LTRO repayments tomorrow, which will provide an indicator of liquidity needs in the European banking sector, and of how quickly the central bank's balance sheet -- a key EUR/USD driver -- may shrink, says Valentin Marinov at Citi. (The Citi forecast is for repayments between EUR50-100 billion of EUR1.02 trillion outstanding.) But it's not just the size of the repayment that matters. If banks that repay loans end up selling peripheral bonds they had deposited at the ECB as collateral, then peripheral bond spreads will widen, possibly sending a the euro lower. On the other hand, if banks hold onto that collateral, it may push up short-term rates in the euro zone, supporting the single currency. Euro traded at $1.3375 from $1.3319 late Wednesday, according to EBS via CQG.

SPAIN EMPLOYMENT – OR NON-EMPLOYMENT

MADRID--Spain's unemployment rate reached a record 26% in the fourth quarter, the latest sign of deepening recession even as growing investor appetite for the country's government bonds brings relief from the country's debt crisis.

Data released Thursday by the National Statistics Institute showed the economy continued to shed public- and private-sector jobs in the final quarter of 2012 as the government worked to slash a big budget deficit.

The number of unemployed is expected to grow in coming months as troubled banks close branches and lay off thousands of workers as part of an agreement to receive European Union aid.

The new jobless figure illustrates how hard austerity programs are biting. Aiming to narrow its budget deficit to 4.5% of gross domestic product, from around 9% of GDP in 2011, the government has raised income and sales taxes, slowed the growth of pension payments and cut unemployment benefits. Public administrations have also been discarding workers, cutting back purchases and putting a brake on investment.

This week brought another negative number from the Bank of Spain: The economy contracted 1.7% in the fourth quarter from the same period of 2011, its worst quarterly performance in more than two years. And the International Monetary Fund weakened its forecast for Spain's economy by 0.3 percentage point, saying it anticipates a 1.5% contraction this year.

Spain's government expects the economy to shrink 0.5% this year.

The downturn contrasts with recent signs of investor interest. Spain this month has sold about 15% of its bond-issuance target for 2013.

The yield on 10-year Spanish government debt is now about 5%, the lowest since March of last year, according to Tradeweb.

Spanish banks, which were shut out of wholesale financial markets for most of 2012, have issued billions of euros in new bonds in recent weeks.

Even as they reported a drop in 2012 profit, Banco de Sabadell SA and Bankinter SA said Thursday they would begin this year to repay emergency-liquidity loans from the European Central Bank.

Analysts said the disconcerting jobless figure obscures other positive developments in Spain's economy. Wage growth has eased, while productivity and exports have increased. The country is becoming more attractive for foreign investment. The current-account deficit is narrowing to close to break even.

"All of these things are growing out of the adjustment that happened in the crisis" in Spain, said Gayle Allard, an economist at IE Business School in Madrid. "They are reasons for optimism going forward. I think 'buy Spain' is a reasonable thing to do right now."

The investor optimism isn't yet translating to the street, where Spaniards across the country demonstrate nearly every day against government austerity programs and mass layoffs.

Thousands of people thronged Calle Alcala in downtown Madrid late Wednesday, despite near-freezing temperatures, to protest plans by Bankia SA and three other nationalized banks to eliminate 10,000 jobs.

Unemployment is particularly high among foreign workers who were drawn to Spain by the millions during a decadelong housing boom starting in the mid-1990s.

Five years after that boom went bust, the unemployment rate among foreigners is more than 36%. More than 300,000 foreigners have left the labor market since 2008 even as the number of Spanish citizens in it has stayed about level.

"This last year, you can tell everything has gotten worse. There's like 20 candidates for each available job," said Jorge Jimenez, a 39-old Ecuadorean citizen standing outside an employment office in downtown Madrid Thursday. A former waiter now unemployed for five months, he is receiving €500 ($666) in monthly jobless benefits, which will run out this summer.

Mr. Jimenez said he hopes his Ecuadorean wife can hang onto her job as a housekeeper so they and their three children don't have to leave Spain, joining an exodus that keeps Spain's jobless rate from climbing even higher. But that possibility is looming large.

"If things don't get any better at some point, we'll just have to go back to Ecuador," he said.

YEN

16:26 EST - The dollar's 4 pm surge against the yen was triggered by a series of stop-loss orders set right above Y90, says Fabian Eliasson, vice president of currency sales at Mizuho in New York. USD/JPY is now at its highest level since June 2010. Eliasson says the dollar's got more room to run; he's advising clients to get in at these levels for a trade to the mid-Y90s. "There is still too much momentum in dollar-yen for it to stop now," Eliasson says. Investors earlier this week were disappointed the BOJ didn't announce even more-aggressive easing, but Eliasson says Japanese government officials might pick up the anti-yen slack by engaging in some jawboning. USD up more than 2% on day at Y90.38, according to EBS via CQG; it rose as high as Y90.56.

Another 5 Year HIGH

16:11 EST - Plunge in Apple's shares puts the whammy on the Nasdaq, but S&P 500 and Dow industrials soldier on, marking fresh five-year highs despite looking fatigued near the close. Stocks were making their standard final-hour sprint higher but ran out of gas 15 minutes short of the close, leaving the Dow with less than half its gains at session high, and S&P 500 barely limping in with a rounding-error gain. Unexpected drop in jobless claims helped sentiment on consumer discretionary stocks and health-care.