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Eelco's Gold Market Update dd 2011-07-30   Investment Backdrop & Challenges

Our $8000 target for Gold becomes ever more secure as Gold keeps rising in an era of negative real investment returns, rampant global Fiat money creation and precarious bond, equity and derivative markets.

Today I'm going to look at the global economic investment arena as "The Backdrop" against which we have to make investment decisions. I may quote the US as it is the biggest economy, but the symptoms and problems are global.

The world is in a huge state of flux as a number of Global, National and Systemic crises are all balanced on a knife edge. I summarise these below:

- The world's currencies are declining in value with no end in sight. The world has printed money to the point where each country printed money/ debased its currency to protect its trade balance/export competitiveness. As a result, the world is engaged in tit for tat currency wars, a situation that normally spirals out of control as ever more Fiat money to required to keep the system going, until the currencies are worthless – a la Zim;
- Using this Fiat money, government deficits and debt have escalated to the point where most governments, states and municipalities are effectively bankrupt and future generations have been saddled with the burden of payment. The only solution is the resumption of fiscal discipline, a long painful road lined with significant tax increases, drastic expenditure reductions and draconian entitlement cutbacks. Currently this strategy is meeting with resistance from elected officials who do not want to sacrifice their gravy train and the public who do not want cuts in entitlements;
- Due to fears that tax increases and cutbacks could tip an already fragile global economy into recession/depression, which it would, governments have elected to print more money pending the resumption of robust growth. This allows them to defer the day when strict fiscal discipline is inevitable, but in a Fiat regime economic growth will remain elusive and the resulting inflation will impoverish the bulk of the population;

- All this Fiat money (liquidity) is providing ammunition for speculators to drive up equity and commodity prices, which is inflationary. More specifically, each QE initiative drives up share markets and increases commodity prices. Due to the lag effect, there is a very real risk that inflation will spiral out of control and graduate to hyperinflation. Had this money been spent on infrastructure development, it would still have been inflationary, but at least it would have reduced unemployment and benefited the working class. Instead QE's enrich the elected officials and the bankers;
- So why are we not seeing this inflation – because of manipulation and the currently reduced velocity of money (not discussed here). Government manipulation of inflation, growth and unemployment figures is part of an orchestrated misinformation campaign that is hiding the real state of the economy from the public at large. Eg. Official US inflation averaged 2.5% over the past 10 years, whereas we know that food, fuel, energy, medical etc costs have trebled and quadrupled in the last 5 years. This is born out by www.shadowstats.com (see alternate data tab) which reports that average inflation was closer to 10% using 1980's formulae. This means that pensioners and workers, who spend the bulk of their money on these consumable items, were not fairly compensated for cost of living increases as they received 2.5% instead of 10% increases. The cumulative effect over 10 years is that they now earn 50% less than they should and that they are no longer able to make ends meet. This explains the food riots in Mediterranean countries, which will almost certainly spread to the US, UK, Europe etc if food, fuel, energy, medical etc prices continue to escalate;
- This abovementioned suppression of inflation statistics means that GDP growth has been overstated and www.shadowstats.com suggests that the US has experienced negative GDP growth since 2000. Note, a recession that lasts longer than 3-4 years is a depression and that is characterised by declining asset prices and high unemployment. This means the US and the world are currently in a protracted inflationary depression;

- The US official unemployment figure of 9.2% (June 2011) is belied by the 23% figure reported by www.shadowstats.com, which is near the 1930's peak depression figure of 25%. This again confirms that all is not well;
- Not only is the US economy very fragile and probably in a protracted recession/depression, but the future looks very bleak as consumers are tapped out and fiscal cutbacks are imminent. More important, it will take at least a decade for consumers to recover and for excessive fiscal deficits and debt levels to be brought under proper fiscal and budgetary control;
- China is also looking overheated & fragile after 40 years of uninterrupted 10% p.a. growth. This is not normal as economies need recessions to get rid of the excesses that build up during rapid growth phases. There are also concerns that China's published statistics do not reflect reality;
- Add to this the fact that most global equity markets seem to be on the skids the future does not look rosy. This is beautifully illustrated by the spread of global equity charts displayed in Adam Brochert's article http://www.marketoracle.co.uk/Article29327.html. In the event that all the world's equity markets collapse at the same time, it would be catastrophic;
- The shift in power from the West to the East, the shift in manufacturing from West to East and the fact that the West is becoming more socialist while the East embraces capitalism exacerbate these instabilities. As the West flounders and the East flourishes, this will inevitably lead to tensions as the West tries to deflect attentions from its failings by blaming the East of a range of spurious frivolous "unethical" practices. Furthermore, as the West tries to protect its economies that are being drained by socialistic obligations, higher import tariffs and even trade wars could result;
- I have mentioned that most Governments, States and Municipalities around the world are effectively bankrupt with excessively high debt. The first signs that the deficit spending party is coming to an end is the current focus on bankrupt EU members and their respective bond markets. The US, its States and Municipalities are just as bad, but its bond yields have not yet risen as the US prints its own money and the Dollar is the reserve

currency. A global bond market collapse would be disastrous as the bond market is 3x bigger than the equity market. In my opinion, it is not a question of **if** but **when** we will have a global bond market collapse;

- To cap it all, the derivatives industry, which is mostly an unregulated, off balance sheet casino of bets leveraged as high as 100:1 that is estimated to be 10-20x bigger than the global equity markets at $800-$1400 Trillion. Warren Buffet called these "Financial Weapons of Mass Destruction". If the global derivative market collapses, life will never be the same.

In summary, the global economy has lived beyond its means to the point where fiscal debts are stifling future growth, while banks took unjustified risks and engaged in unethical practices. There is no doubt that the party is over and that the return to fiscal sanity will be painful for the global economy, equity markets and the public at large. Governments have elected to inflate (print money) in the hope that they can engineer a soft landing, rather than impose draconian tax increases, entitlement and expenditure cutbacks, which would cause equity and bond markets to collapse. As a result of this liquidity increase, equity markets may float higher in nominal terms but certainly not in real terms. Furthermore, commodities prices and consequently inflation are likely to rise on this sea of liquidity. Therefore, we almost certainly face a period of stagflation – negative economic growth with inflation. Setting your investment strategies in the face of negative real returns in bond and equity markets, coupled with a plethora of risks like the collapse of equity markets, bond markets and/or derivative markets will be challenging.

I stress that it is not possible to predict if one or all of the markets will collapse, nor is it possible to predict when or how long it will take before fiscal sanity prevails. However, it is certain that this is a time of economic uncertainty when extra care needs to be taken when setting your investment portfolio.

In view of all these uncertainties, one needs a conservative investment strategy. In essence, your first priority is to protect your capital and if you can earn a positive "Real Return after adjusting for Inflation", that is a bonus. Stated another way, if you do not lose money if and when the markets crash, you will be a winner and if your portfolio gains you are a genius. Note, if equity markets crash 50% and you lose nothing, you are twice as well off as you used to be relative to the majority of people.

Traditionally, investments are broadly allocated to the following baskets:

- Equities such as banking, retail and industrial shares;
- Treasuries/Bonds as this was the traditional "Safe" investment;
- Property as this was less volatile and secure in the long term;
- Cash/Money Market accounts;
- Resources & Commodities as these are always needed;
- Collectibles and Rarities as these offered long term gains;
- Gold/Silver as this was the ultimate hedge against crises.

Unfortunately some of these markets are currently looking less attractive as explained below.

Now you ask, "what are the current investment do's and don'ts". My answer is biased to broad rather than specific. Consider the following:

- The first problem we face is that we have difficulty measuring whether we are making a "REAL" return on monies invested given that we do not really know what the actual inflation rate is. To counter this, I first measure my total wealth at the end of every year "**in ounces of Gold"** as Gold holds its value in times of currency debasement (divide your wealth by the price of Gold). I also measure it in Swiss Francs, Euro's and Pounds. I then aim to grow my portfolio a little every year in ounces of Gold and to grow it by at least 10%-15% per annum in other currencies to be on the safe side, given that inflation is clearly high but not known;

- Given the indisputable fact that currencies are being debased, my first objective is to ensure that all my investments are currency hedged to protect them from losing value in Real terms. Since all currencies are being debased, we can no longer compare one currency with another to measure the rate of deterioration of any currency relative to another. In my opinion, Gold is the only real currency that holds its value, as it only rises dramatically when currencies are being debased and when other investments like Bonds/Treasuries offer negative real returns. Remember, Gold is not going up, it is the currencies that are going down. Currency hedges include Gold, Silver and all Resources & Commodities that are traded internationally. Currency hedges include tangibles like Gold and Silver and, in the long term, Property and, if you have the expert knowledge, Rarities and Antiquities like Coins, Stamps, Paintings, Furniture etc. The reason why a tangible like property holds its value is that it represents a fixed number of hours of labour and the property will always retain its value relative to the inflated or deflated wage of the workers. Currency hedges include equities of companies that trade or refine Resources & Commodities and companies that Export Globally. Currency hedges also include monies held offshore in currently strong currencies like the Swiss Franc, Singapore, Canadian and Aussie Dollars;
- Given the indisputable fact that most Governments, States and Municipalities have incurred excessive debt and are still engaged in deficit spending, their ability to repay, let alone service their debt is dubious. Therefore, since most of these agencies are effectively bankrupt, public Treasuries/Bonds can no longer be seen as safe haven investments as the risk of a global bond market collapse is very real. In my opinion, this is a market that should be treated with extreme caution or avoided;
- Given the indisputable fact that currencies are being debased, cash is not a good place to be as it is constantly losing value in Real terms;
- Given the indisputable fact that equity markets are being partly driven up by speculation and not sound fundamentals, coupled with the fact that the

general public is tapped out and cutbacks are likely, investments in equities should be treated with caution;

- Given the indisputable fact that the flood of Fiat money being printed across the globe is inflationary in the longer term and that this is likely to continue to drive the speculative boom in Resources & Commodities we almost certainly face a period of medium to high inflation. Traditionally, Banks, Retail and Industrial Shares do not fare well during periods of high inflation;
- Property is not likely to fare particularly well in the next decade as any crash will result in a decline in values. Similarly, inflation will inhibit people's ability to afford their higher repayments. Despite that, I would rather be in property than in say Treasuries/Bonds as property values may decline 10% while Bonds and Equities could decline 50%+;
- Another consideration is that Banks are not in a happy place and unlikely to fare well if there is another crash. My advice is do not keep money in Current or Savings accounts as this money will be lost in the event the bank fails. On the other hand, monies invested through the banks into Investment Funds is safe as the Funds are taken over by other banks in the event your bank fails.

Note, this is a broad discussion, not specific investment advice, so consult others before setting your investment strategies.

In summary:

- Avoid cash in current or savings accounts;
- Limit your exposure to Treasuries/Bonds or avoid this market;
- Limit your exposure to Equities (excluding currency hedge equities);
- Increase your exposure to Resources & Commodities;
- Increase your exposure to Gold & Silver and their equities;
- Within moderation, increase your exposure to Property;

- Increase your exposure to Rarities & Collectables if you "personally" have the necessary expertise not to be taken;
- If global markets start experiencing tough times, luxury goods and discretionary items are likely to suffer and discounters are likely to benefit. Eg. People will cut back on non-essentials. Cheap entertainment will replace luxury holidays. Discount clothing will prevail over brand names. Restaurants are likely to suffer as home cooking and entertainment regain popularity. Hospitals and healthcare providers will suffer as serious incapacity will prevail over frivolous ailments and hypochondria. People will use less fuel as they drive around less and manage with one car instead of two. Insurance will be cut.

Again, these are broad suggestions and should be treated as guidelines not specific advice. It is also important not to jump in but time your entry to these markets as prices do not move up in a straight line.

Question

If there really is a Bond market crash, the question has to be asked where too. The Gold market is so small, that it will be overwhelmed if only a fraction of the money from Bond and other markets moves into the safety of Gold & Silver.

For greater perspective, I recommend you read "Modern Fraud Money Explained", "Why Gold is going up and How High" and other reports on our website www.jhbcoinexchange.com.