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The Endgame has Begun

“The truth that makes men free is for the most part the truth which men prefer not to hear.”

Herbert Agar

“When others asked the truth of me, I was convinced it was not the truth they wanted, but an illusion they could bear to live with.”

Anais Nin

“Ah yes, truth. Funny how everyone is always asking for it but when they get it they don't believe it because it's not the truth they want to hear.”

Helena Cassadine

“There never was an idea stated that woke men out of their stupid indifference but its originator was spoken of as a crank.”

Oliver Wendell Holmes

INTRODUCTION

I was having a smoke outside a conference centre in Switzerland when a personable young man approached me. He introduced himself and explained that he was the pension fund manager of a substantial Swiss pension fund. He said that over the past three years he had submitted 38 different investment proposals to the pension's fund board of directors. They had approved all but one of them, which

he had regularly re-submitted, but still to no effect. His proposal? To invest some of the pension fund's liquidity in gold!

Now, let's consider this for a minute. An investment committee that, according to my new friend, had approved all kinds of investments over the years — in exotic products, emerging stock markets, frontier markets, developed markets, equities, bonds, real estate ... you name it — and which held cash positions in different currencies, was refusing to

put even a small sum of money into gold and gold-related investments....

I wasn't even surprised. I had just finished presenting to an audience of about 1,500 mostly conservative, upper middle-class Swiss people who lived in small cities or villages. I had asked who among them owned gold. No more than five people raised their hands. The response has been similar elsewhere in the world. Among a crowd of over 1,000 people at a conference in South Korea, just two people raised their hands. At a

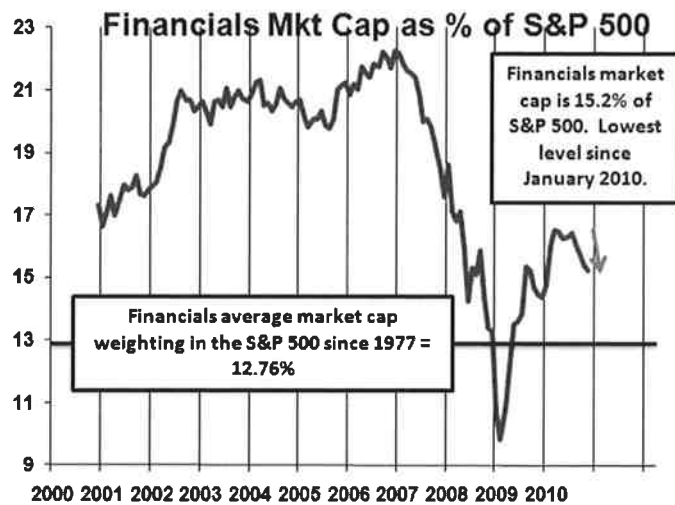
conference in Singapore organised by an investment bank, which was attended by long-only fund managers and hedge fund managers, only about three people raised their hands. I was surprised and asked the audience: “You are all intelligent people. You invest in all kinds of assets and currencies. Your livelihood depends largely on financial assets. So, why don’t you diversify some of your personal money into an insurance policy against a systemic failure? Why don’t you own some gold or silver?” The audience just looked at each other in silence.

I am not mentioning these findings here because I want to make a case for gold. Rather, I am asking myself — and I have done so for the past few months — why, ten years into a bull market, the vast majority of people still don’t own any gold. After all, by the same stage of the 1970s’ bull market, a huge gold bubble had formed, with investors the world over speculating around the clock in London gold. Similarly, ten years into the Japanese bull market of the 1980s, the entire world was heavily exposed to Japanese shares. (At the peak of the market in 1989, Japanese stocks made up more than 50% of the world’s stock market capitalisation.) The same thing occurred at NASDAQ’s top in 2000. You couldn’t go to a cocktail party or a dinner without some dumb-dumb — pretending to be an expert at picking high-tech stocks — telling you how much money he was making by buying and selling NASDAQ stocks every day. US residential real estate became the talk of the town in 2006 and 2007, right at the time it peaked out, and after an approximately ten-year bull market. Moreover, when a sector reaches the bubble or manic phase, it accounts for a very large percentage of the economy, or of the stock market capitalisation, and usually also of the total credit (this certainly in the case of real estate bubbles). In 1980, at the peak of the energy stock bubble, capital spending in the oil industry was extremely high, and the energy sector accounted for 32% of the market capitalisation of the S&P 500. In 2000, the TMT

sector (technology, media, and telecommunication) accounted for more than 25% of US stock market capitalisation. In late 2006, the financial sector (including financial subsidiaries of industrial companies) accounted for over 40% of S&P 500 earnings, and pure financial stocks accounted for 22% of S&P market capitalisation (see Figure 1).

Therefore, we can see that widespread and euphoric public participation, as well as the bubble sector becoming either disproportionately large or profitable compared to the rest of the economy, or accounting for a disproportionate share of total market capitalisation, are symptoms of a bubble or mania. But, this doesn’t seem to be the case

Figure 1 **Financials as a Percentage of S&P 500 Market Capitalisation, 2001–2010**



Source: John Roque, WJB Capital Group, www.wjbcapital.com

Figure 2 **Gold Price, 1999–2010**



Source: www.decisionpoint.com

currently for gold and precious metals.

So, I have to say, I'm truly puzzled as to why more investors don't own gold, given that its price has risen more than five-fold since its 1999 low (see Figure 2).

THE GREAT LIE ABOUT GOLD LEADS TO A MISINFORMED PUBLIC

I would even argue that investors and central banks have currently a lower exposure to gold than in 1999 relative to the size of all financial assets (see Figure 3). In the case of the US, gold reserves as a percentage of the monetary base have barely moved up since their 2001 low; and in Asia, where money and credit have expanded rapidly over the past ten years and where gold reserves were tiny to start with, gold reserves as a percentage of the monetary base have declined. "How is that possible?" some readers will ask. "After all, the gold price is up five times since 1999." Very simple! The value of financial assets in the world has expanded at an even faster pace than the value of gold. In the case of China alone, M2 is up from US\$1.5 trillion in 2000 to over US\$10 trillion currently (see Figure 4). (In addition, bank lending in China is now larger than in the US, although its economy is still far smaller.)

Figure 3 Gold and Gold Mining Shares as a Percentage of Global Financial Assets, 1920–2010



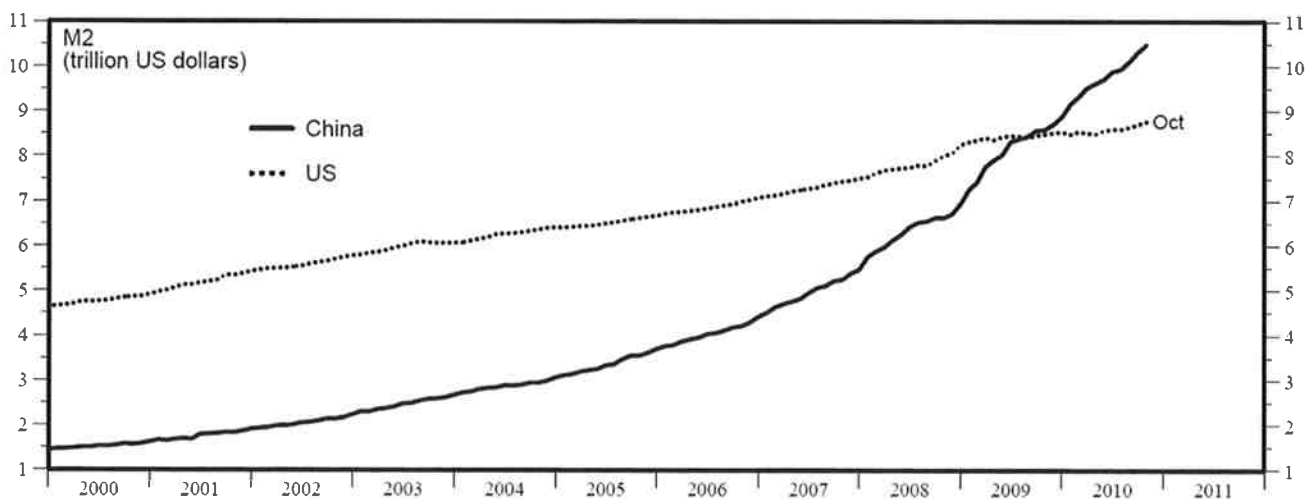
Source: World Gold Council, Kinto Asset Management

We, therefore, have to ask ourselves why central bankers, fund managers (with few exceptions), and individuals haven't meaningfully increased their exposure to gold compared to financial assets. I am aware that the Reserve Bank of India bought 200 tons of gold this year (at about US\$1,040 per ounce), but why did they wait so long before making this purchase? If stocks or real estate in any country had gone up five-fold in ten years, the entire population

would be gambling on these assets appreciating much more. However, this hasn't happened yet in the case of gold and other precious metals. Why not?

Joseph Schumpeter was right when he wrote: "The modern mind dislikes gold because it blurts out unpleasant truths." Not surprisingly, governments and central banks form the greatest "anti-gold" league. (This isn't to say that they have intervened actively in the gold and silver market

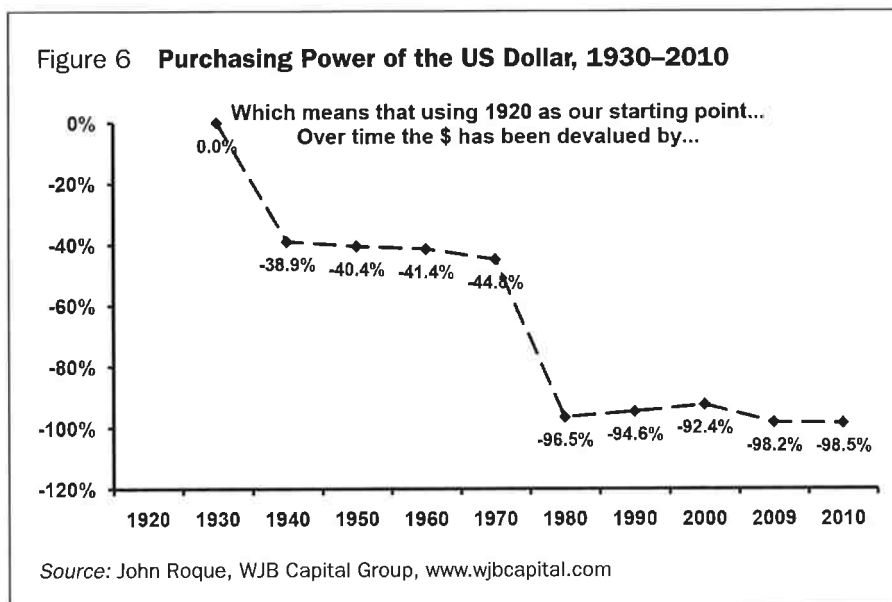
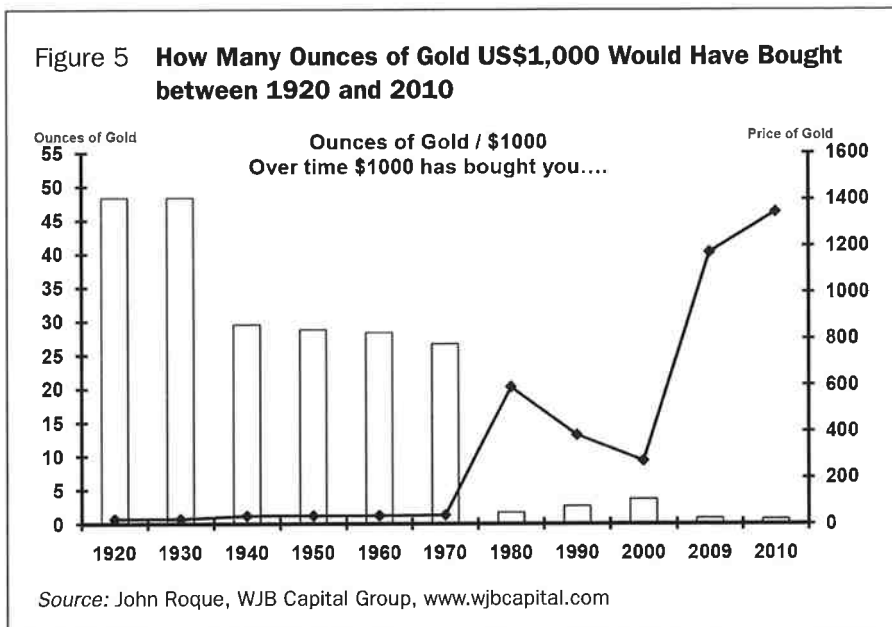
Figure 4 M2 in China Now Exceeds M2 in the US



Source: Ed Yardeni, www.yardeni.com

to suppress prices.) The price of gold reveals the truth, and the truth is that the purchasing power of paper money is continuously diminishing. Over time, no government and central bank can resist the temptation to issue more paper money (see Figures 5 and 6). Most fund managers, financial planners, and investment advisors love gold when it is declining in value, because a decline in the value of gold is a vote of confidence in financial assets from which the entire financial sector makes its living. Conversely, financial people hate gold when it is appreciating. Charlie Munger described gold as “stupid”. However, it isn’t gold that’s “stupid”; rather, when the price of gold moves up more than paper assets appreciate, it is most of the “paper shufflers”, who don’t own any precious metals and who invest only in stocks, bonds, and cash, who look “stupid” (see Figure 7). Of course, Mr. Munger and Mr. Buffett will never tell you that, although their fund may be up by 30% over the past ten years in US dollars (with some help from the government bailouts), it is down by 70% in a reliable unit of account (gold). Most of the other fund managers are in the same boat. They completely missed the bull market in precious metals. Therefore, either they don’t talk about gold and silver, or they talk it down.

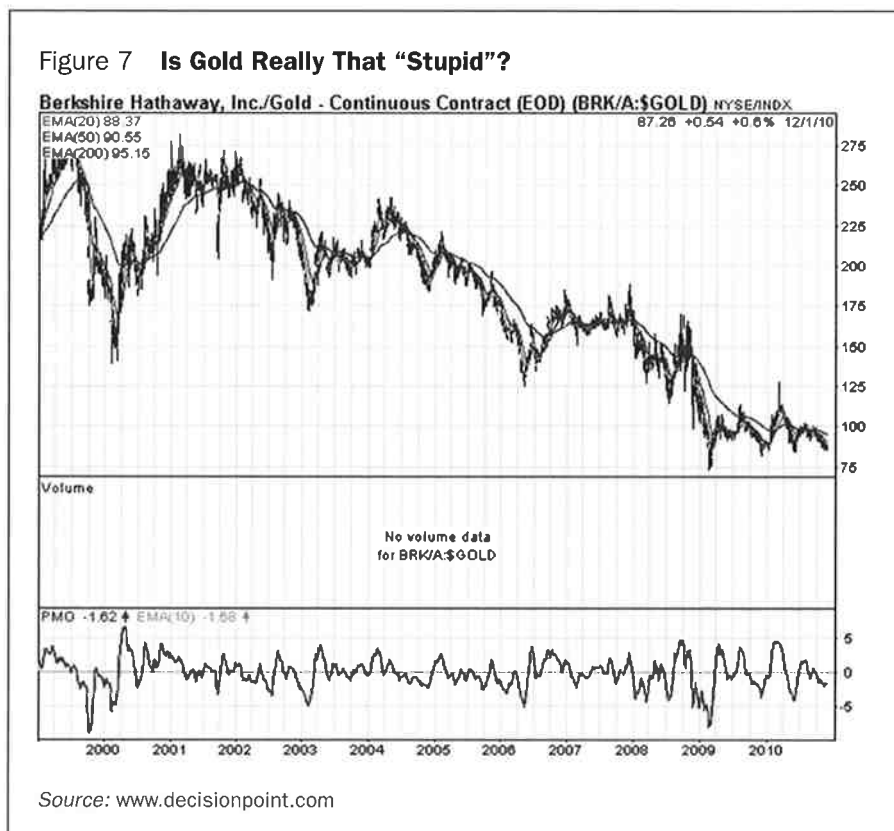
The deflationists are another very special breed of gold “haters”. Although, every year, they and their families spend more on food, education, transportation, energy, insurance premiums, health care, and hidden taxes, they want you to believe that the overall price level is declining. To be fair, they are at least intellectually honest: they hate everything — including stocks, real estate, industrial and agricultural commodities, art, wines, jewellery, and collectibles — because they believe all assets are in a bubble (see also below). The only asset classes the deflationists really love are long-dated US government bonds and cash. Bill Gates, while discussing (both positively and negatively) Matt Ridley’s book *The Rational*



Optimist, quoted John Stuart Mill, who in 1828 opined that, “I have observed that not the man who hopes when others despair, but the man who despairs when others hope, is admired by a large class of persons as sage.” I can only confirm this observation. I have a far larger audience when I am extremely negative about stocks than when I am positive, as has been the case over the last 18 months. In fact, at conferences, people often approach me looking disappointed and saying, “You’re not bearish.” I then have to explain that because I am ultra-negative about everything, I prefer to own precious metals, real estate, and

stocks, rather than bonds and cash. But, what I wanted to explain is that the deflationists have a wide and loyal audience because of the tailwind the central bankers provide through their continuous warnings about “deflation”, and because (as mentioned above) most investors missed out completely not only on the five-fold increase in gold prices since 1999, but also on the powerful stock market rally since March 2009. So, for the deflationist camp, a huge victory would be a collapse in gold and stock prices. (I am sure that the deflationists will be right one day, but whether you would wish to invest in US government bonds and

Figure 7 Is Gold Really That “Stupid”?



Source: www.decisionpoint.com

with negative real interest rates in most countries, and with central banks having no exit strategy at all, gold and silver have again become “hard currencies”, as has been the case throughout history. This is the only explanation I can come up with for why only a tiny minority of investors own gold and other precious metals.

There is a point I have made previously that I need to repeat here. A central bank can easily defraud the public. I am not talking here about such things as questionable bailouts at taxpayers’ expense. I am alluding here to a central bank pegging short-term interest rates below a broad measure of consumer price increases. (Probably the worst offender in this respect is the People’s Bank of China.) By maintaining short-term interest rates negative in real terms (adjusted for a broad measure of price increases), a central bank can — and it is well understood that this is done intentionally — defraud honest depositors, because negative real interest rates amount to an annual expropriation. Let’s say that you deposit \$1 million at a zero interest rate for a year, and that within this year a broad measure of price increases (not the Consumer Price Index (CPI), which is massaged by the Bureau of Labor Statistics, or BLS) shows that prices rose by 5%. In this case, the depositor will have been defrauded by the central bank of 5% upon maturity of the one-year deposit (see Figure 8).

Bear in mind when looking at Figure 8 that, according to Ron Griess, who produces some of the best historical charts, “the real interest rate is equal to the monthly average interest rate reported by the Federal Reserve Board minus the year-over-year rate of change of the Consumer Price Index as reported by the Bureau of Labor Statistics” (emphasis added). However, since the statistics published by the BLS are about as unreliable as the CPI in China and likely understate the cost-of-living increases by at least 3% (and possibly by as much as 7%), real interest rates are far more negative than shown in Figure 8.

cash until that day of reckoning is another matter — see below.)

The media is another gang of gold detractors. They need to supply the public with what the public wants to hear. The media touted NASDAQ stocks in the late 1990s, hyped residential real estate in 2005 and 2006, flaunted deflationary fears in 2008, and was an ardent supporter of Keynesian interventions over the last two years. Therefore, it’s not an option for the media now to explain the unintended consequences of those Keynesian interventions and expansionary monetary policies, and to admit to having missed the five-fold increase in gold prices.

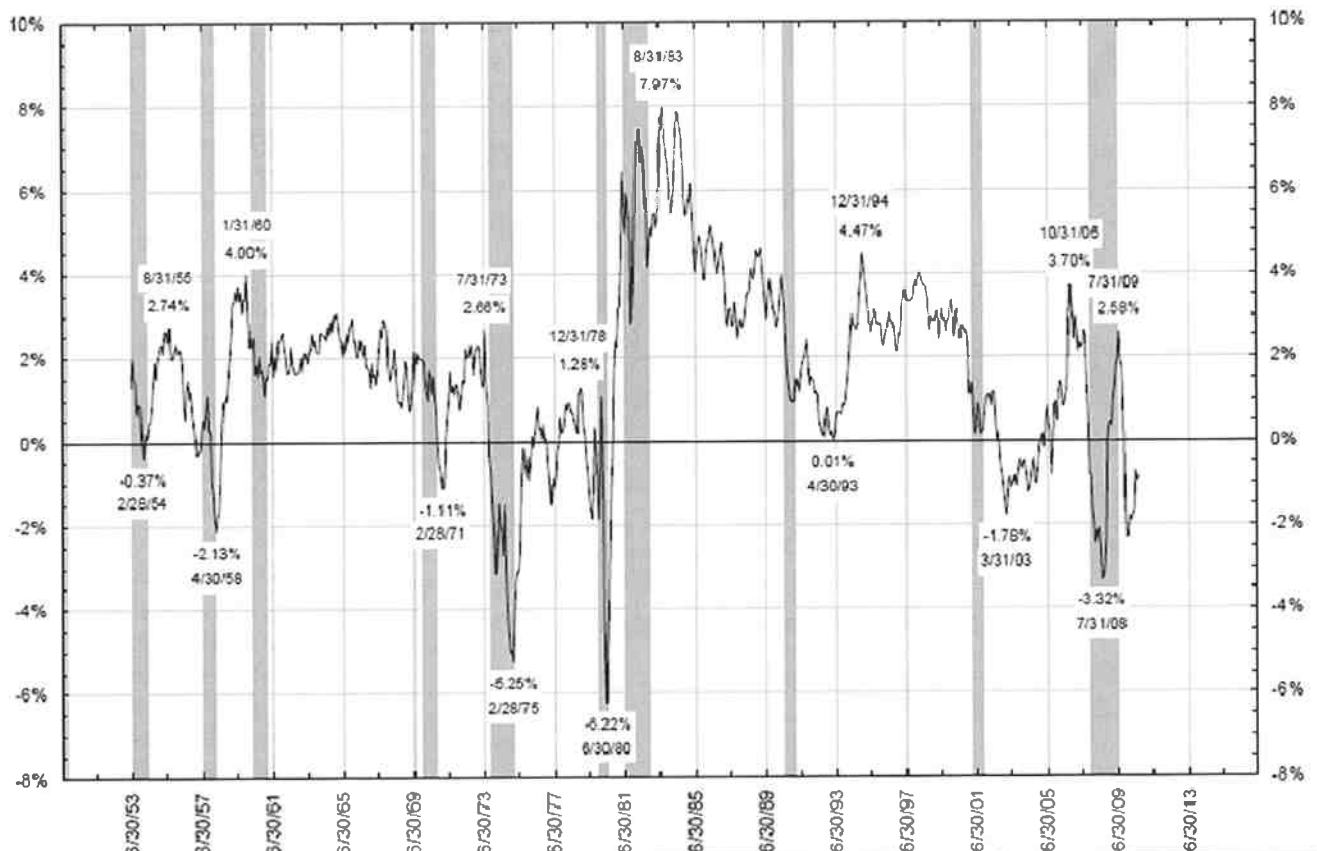
The worst critics of appreciating gold prices, however, are academics in the field of economics. Equipped with supercomputers, they have devised sophisticated economic models about everything that are of no, or very little, practical use. What these academics have in common is that they have never read about John Law and his experiment with paper money that led to soaring commodity prices (and the eventual expropriation of gold and silver in France). For these academics, who

are completely removed from economic reality, gold has always been and will always remain a “barbaric relic”. Whenever gold prices move up, they dismiss it as a completely “irrational bubble”. (But when the NASDAQ went to 5,000 in March 2000, or when home prices soared, they claimed that the market was perfectly “rational”.)

As I said at the beginning of this piece, I am not discussing here the future price movement of gold but the fact that, unintentionally (and in some cases intentionally), governments, academics, fund managers, the deflationists, and the media have completely misinformed the public about the value of precious metals (real money) in a money-printing environment. These people have labelled gold as a barbaric relic, a useless commodity, a speculative investment that will go nowhere, and a bubble. They have even compared it to washing machines. **However, what all these experts have failed to explain to the public — whether intentionally because it served their purposes, or unintentionally because of their ignorance — is that in a zero interest-rate environment**

Figure 8 Real US Treasury Monthly Average Yields, 1953–2010

1 year constant maturity



Source: Ron Griess, www.thechartstore.com

Now, it should be clear that when real interest rates are negative, **money is no longer a store of value and at the same time is an unreliable unit of account.** Mr. Munger, when interest rates are negative in real terms, it is not gold that is “stupid”, but “cash” and bonds, which yield less than the cost-of-living increases. Possibly, even Mr. Munger’s and Mr. Buffett’s fund is “stupid” in the current monetary environment. After all, Berkshire Hathaway’s stock is down by 70% against the price of gold since 2000.

Actually, I wasn’t particularly keen to write about gold, although I thought that discussing the low ownership of gold among central banks in Asia, mutual funds, and the public would refute the contention that gold is a bubble. However, what I was interested in was to show how governments, special-interest groups, academics, and well-respected business leaders can completely misinform the public if it serves their purposes.

WIKILEAKS

“The whole problem with the world is that fools and fanatics are always so certain of themselves, and wiser people so full of doubts.”

Bertrand Russell

It is against this condition of deception by the government and the media, and widespread dubious and illicit practices, that we need to consider the recent uproar by many politicians and their loyal supporters directed at Julian Assange, the founder of WikiLeaks. According to Hillary Clinton, “Let’s be clear. This disclosure is not just an attack on America — it’s an attack on the international community.... [Such leaks] tear at the fabric of **responsible**

government” (emphasis added). Sarah Palin, that eminent and wise expert on international affairs, weighed in by asking, “Why was Julian Assange not pursued with the same urgency we pursue al Qaeda and Taliban leaders? What if diplomatic pressure was brought to bear on NATO, EU, and other allies to disrupt WikiLeaks’ technical infrastructure?” Dennis Gartman, author of *The Gartman Letter* (info@thegartmanletter.com), which I consider a very good and informative daily read, and to be fair to Dennis he acknowledges that he is on “the political right”, thought that WikiLeaks had “done what shall eventually be seen as irreparable damage to the US diplomatic corps and to our military leaders domestically and abroad. People’s lives have been put at risk because of these leaks, and certainly people’s reputations have been done enormous and very probably

irreparable damage in having these cables made public." Gartman then quotes the views of the US Ambassador to Iraq, Mr. James Jeffrey, who opined: "To be clear — such disclosures put at risk our diplomats, intelligence professionals, and people around the world who come to the United States for assistance in promoting democracy and open government. These documents also may include named individuals who in many cases live and work under oppressive regimes and **who are trying to create more open and free societies**" (emphasis added). Gartman further adds:

[T]he more we consider the damage done by Mr. Assange of Wiki Leaks the angrier and the more fearful we become. The repercussions of what this idiot ... and we know of no other word that we can use to describe this fellow than this, for he is an "idiot" of the very first order ... has done in exposing backchannel diplomatic conversations and strategy discussions will echo for years into the future. People will be killed because of what he's leaked; the course of history will be changed ... and not for the better ... because of what he's leaked. Israel is in greater jeopardy now than it already was because of what he's leaked. Iran's nuclear capabilities are safer now because of what he's leaked. The Saudi Royal family is more fearful for their lives because of what he's leaked. The President of Yemen's life is in jeopardy because of what he's leaked. The lives of US CIA agents stationed around the world are in far greater jeopardy because of what he's leaked. The propensity on the part of Arab informers within Hamas, or the Brotherhood, or Hezbollah or Al Qaeda itself to continue to pass along information to the CIA, or M5, or Mossad or the Saudi intelligence agency are [sic] now all but ended because of what he's leaked.... What this man has done is unconscionable and yet he is seen by the Left as a hero. What

are these people thinking? Indeed, who are these people?

Glenn Beck was distinctively more relaxed when he (rightly) remarked: "Nothing! Nothing in this report so far is shocking; **it's all stuff you already know because you watch this show or you're not a moron. Or you knew it in your gut....** How many times does this show have to be right before Americans start listening either to this show, or more importantly their gut!"

I am hearing here some very strong views. Not surprisingly, I might add. I just wonder what Hillary Clinton has in mind when she speaks of "responsible government". A government that sanctioned the creation of one bubble after another, and in the process badly damaged the working class and the middle class? A government that is a bedfellow of the Royal Family in Saudi Arabia — the only country in the world where women are not allowed to drive and which, according to The World Economic Forum 2009 *Global Gender Gap* report, ranked 130th out of 134 countries for gender parity. Saudi Arabia was also the only country to score a zero in the category of political empowerment. Or a government that supports President Hamid Karzai in Afghanistan, who last year pardoned five border policemen who were caught with 124 kilograms of heroin and had been sentenced to terms of 16 to 18 years in prison, and whose vice president was caught in the UAE carrying US\$52 million in cash? In June, *The Wall Street Journal* (not WikiLeaks) reported that more than US\$3 billion in cash has been openly flown out of Kabul International Airport in the past three years, "packed into suitcases, piled onto pallets and loaded into airplanes", and calculated that "more declared cash flies out of Kabul each year than the Afghan government collects in tax and customs revenue nationwide". (Unofficially, probably another US\$2 to \$3 billion left the country.) Well, I suppose that the US supports Mr. Karzai in order to try to create a more

"open and free" society, as Mr. Jeffrey said.

One of my more knowledgeable friends, who writes under the pen name "Pater Tenebrarum" (and who is, aside from Jim Walker, the most accomplished economist of the Austrian School that I know — www.acting-man.com), argues that Gartman is quite mistaken when he thinks Assange is a hero of the Left.

In fact, Assange is a hero to everyone who does *not* worship at the altar of the State like Mr. Gartman, who seems to think that US government intervention all over the world is to be welcomed and has nothing but good results. We could probably easily find millions of people who would disagree rather vehemently with Gartman's view. (Frankly, who cares if the authoritarian king of Saudi Arabia "sleeps less well" now? The alleged increased risk to the safety of various people due to Assange's revelations sounds just like a regurgitation of government propaganda. Putting the government on the spot for its violations of human rights is far more likely to save lives than harm them.) Lastly, Assange is extremely courageous for exposing the lies and subterfuge of governments — we are all a tiny bit more free because of him. We owe him a great debt for opening people's eyes to what scoundrels populate the political class.... Our standard for judging WikiLeaks should be: are we, as citizens, better or worse off because it exists? I for one think **anything that seriously hampers the State** should be welcome to society (i.e., all of us).... WikiLeaks is uncomfortable because it reminds everyone how much lying and killing and whatnot is done in our name. That however makes it necessary. It is the modern-day replacement of what used to be the free press — the corporatist media that are too often confusing the dissemination of government propaganda with journalism [emphasis added].

Personally, although certainly not a leftie, but still having some social conscience (guess who in the US might be a bit of a leftie?), I support WikiLeaks for several reasons, though not because WeakiLeaks' revelations were anything I either didn't already know or suspect. As Glenn Beck said, "Nothing in this report so far is shocking; it's all stuff you already know." I think we live in a world where it is perfectly acceptable for governments to spy on each other and on corporations and individuals, but that in the view of some people (mostly politicians) it isn't acceptable that private individuals spy on the government. In addition, it seems perfectly fine for spy agencies to bribe and blackmail desperate people to "pass along information to the CIA", but for a company to bribe somebody to do business is a crime. Of course, the government will tell you that they pay out bribes "for our security", whereas the private sector pays bribes because of greed. This is the line every dominant institution has taken throughout history, from governments and religious institutions to unions, the mafia, and sects. These institutions have also always persecuted people with ideas or beliefs that challenged (or were perceived as challenging) their authority. The Roman emperors perceived the early Christians as a threat to the Empire, so they burned them. The Catholic Church, fearing for its authority, ordered Galileo Galilei to stand trial. The Inquisition sentenced him for "heresy" and sent him to prison. (The sentence was then converted to life-long house arrest and a complete ban on his publications.) Therefore, it shouldn't be surprising that governments and their cronies are after Julian Assange. Their aim is to bring him to court and, ideally, lock him up for the rest of his life — not because, as Mrs. Clinton claims, WikiLeaks "is an attack on the international community", but because it calls governments to account and challenges their authority. As the famous late columnist Sydney J. Harris remarked, "Intolerance is the most socially acceptable form of

egotism, for it permits us to assume superiority without personal boasting."

The Economist wrote that WikiLeaks, by "simply grabbing as many diplomatic cables as you can get your hands on and making them public is not a socially worthy activity". Sure, it isn't a "socially worthy activity", unlike selling weapons around the world, carpet bombing entire countries, printing money, manipulating markets, bailing out cronies of the government, and algorithmic trading. I sure don't know what a "socially worthy activity" is, but in this respect, I certainly wouldn't rely on the judgment of *The Economist*.

Astonishingly, *The Economist* then goes on to explain:

There are echoes here of Facebook founder Mark Zuckerberg's *famously aggressive position* that society is evolving towards more transparency and less privacy (a belief which is certainly convenient for a social-networking site that wants to be able to sell users' data). Maybe it's something about tech geeks, or maybe it's just related to the self-interest of people and organisations whose particular strength lies in an ability to get a hold of other people's information. But it definitely seems like we're learning a lesson here: **while information may want to be free, human beings are usually better off when it's on a leash** [emphasis added].

This says it all. We should have freedom of the press and of information, but only when it suits the government's purpose, and when it is acceptable to a board of editors' particular interests and political views. After all, we all know how qualified politicians and editors are at judging which information should be kept "on a leash". (I suppose *The Economist* will soon be praising China for keeping information on a leash.)

Since I have never met Mr. Assange, I wouldn't know if he is an "idiot" or not. But let us assume that Mr. Gartman is in the know and Mr.

Assange is an idiot. If that were the case, we would really need to ask who is behind his organisation. Personally, I think he must have some very powerful backers. (Some knowledgeable people think it may be the Chinese government.) Therefore, if I were the US government, rather than trying to bring him down, I would try to find out precisely where his backing is coming from (maybe even from the "right wing"). I should also like to call the attention of the Assange haters to these words of Erich Fromm: "Understanding a person does not mean condoning; it only means that one does not accuse him as if **one were God or a judge placed above him** [emphasis added]."

One more observation about WikiLeaks: Governments may lock up or assassinate Julian Assange and shut down his site. However, the genie has been let out of the bottle and thousands of other sites will be set up and dissipate similar news.

Some readers may be wondering why I am discussing WikiLeaks, since it has nothing directly to do with economics and financial markets. Correct. However, indirectly, WikiLeaks has a *lot* to do with economics. In the Western world, we find governments that have essentially bankrupted their countries (or will inevitably do so in future) demanding full disclosure from the corporate sector (e.g., about food and pharmaceutical products) and intruding on people's civil liberties, but getting upset when the private sector and people fight back. In the US, the government has so far refused to have the Fed — probably the world's most important financial institution — audited. In other words, it's fine for governments to manipulate markets, statistics, and information, and to mislead the public, but it's not OK for the private sector to do so. Such a social, political, and economic environment can hardly be very conducive to growth and "socially worthy"!

The attentive reader will also note the connection between the attacks of politicians on WikiLeaks and the central bankers' dislike of

gold. WikiLeaks exposes abuses by governments, and gold “blurts out unpleasant truths” about the value of paper money.

INVESTMENT OBSERVATIONS

What caught my attention on my recent visit to Switzerland is how many investors questioned the merits of investing outside Switzerland. Their argument was: “Yes, stocks in emerging economies might be attractive in the long term, but when valued in Swiss Francs they are not attractive because of the strength of the Swiss Franc.” What these investors are overlooking, of course, is that there will be times when a foreign stock market will appreciate at a much faster rate than the Swiss Franc (SFR) appreciates (see Figure 9). From Figure 9, we can see that, in Swiss Franc terms, the S&P’s performance has been horrible since 2000 (a fairly well-established downtrend). However, there were times, such as between 2003 and 2007 and between 2009 and 2010, when, despite the weakness of the US dollar (strength of the SFR), a Swiss investor would have done well by investing overseas (a point I explained about the performance of Mexican stocks in Peso and US dollar terms — see October 2010 GBD report). US stocks went up by 84% in SFR terms between 2003 and 2007, and by 67% between March 2009 and April 2010. (Since the April 2010 high, the S&P is down 9% in SFR terms — see Figure 8.) However, this isn’t the issue I wish to discuss here.

What I wanted to say is that no individual investor or fund manager anywhere in the world has ever approached me to ask about the merits of investing in paper assets when they were all depreciating against hard currencies such as gold, silver, and platinum. Interestingly, the Swiss investors who are concerned about investing in foreign stock markets never seem to consider that, in gold terms, their own investments had also been a disaster (see Figure 10).

I should add that, in Swiss Francs, the Swiss Stock Market Index (SMI)

Figure 9 **S&P 500 Adjusted for the Depreciation of the US\$ against the Swiss Franc, 2000–2010**



Source: www.decisionpoint.com

Figure 10 **Swiss Stock Market Index in Gold Terms, 2000–2010**



Source: www.decisionpoint.com

hasn’t exactly been a stellar performer either. It is at the same level as in early 1998. Therefore, I am wondering how long it will take

individual investors, pension fund trustees, and fund managers like Mr. Munger to look in the mirror and face the truth, and ask themselves

why their performance in paper confetti terms is OK, but is a disaster in terms of hard currencies.

My readers will now understand why the entire financial sector, economists, and especially central bankers, hate gold. As long as assets are valued in paper currencies, and as long as economists measure growth rates in paper currencies, everything looks fine, and for the fund managers the performance fees keep coming in. But if, one day, the investment community smartened up and asked for portfolios and economic statistics to be valued and measured, respectively, in gold terms, the game would be up — even for Mr. Munger and Mr. Buffett.

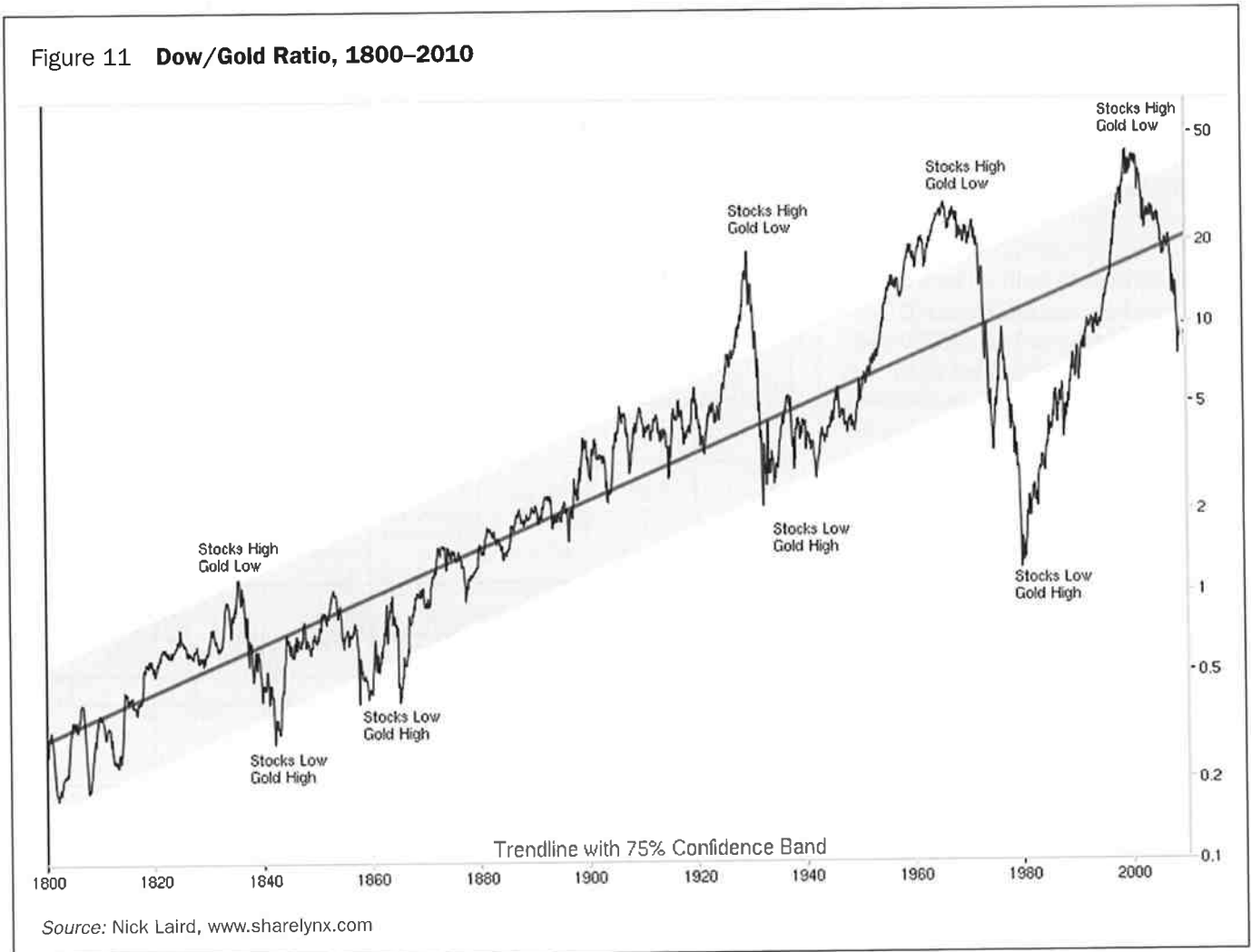
I don't want to be misunderstood. I am not saying this because I failed to capitalise on rising asset prices. I have had a large gold position for years and, thanks to Mr. Bernanke's outstanding skills in printing money,

my asset management and performance fees have benefited. Still, I admit that, valued in gold, the assets I had in 2000 are also down in value. (The overall assets are up even in gold terms because I have a high saving rate.) "How preposterous is it to demand that we should value asset prices and measure economic growth rates in gold and silver terms," economists at universities and central bankers will claim. Fine, I admit that gold and silver are not perfect value indicators of asset prices (see Figure 11). However, are confetti currencies printed by central bankers a more desirable indicator of real values and growth rates? Moreover, what seems to escape these academics, whose knowledge of history amounts to next to nothing, is that since human civilisation began, everything was always valued in gold and silver. Either there was an official gold standard (in the 19th century),

or money consisted of gold and silver coins. In addition, when governments diluted the content of gold and silver coins with copper and lead (as in the Roman Empire), the price of gold adjusted on the upside. So, in a way, we always had a gold and silver standard, either officially or through the market mechanism.

Above, I mentioned that gold isn't a perfect indicator of asset prices (see Figure 11). However, it has given several incredible buy and sell signals on the stock market: Excess valuations in 1929, 1969, and 2000, as well as tremendous undervaluations of stocks in 1932 and 1980. Two observations: First, a **continuously rebalanced** portfolio of stocks, which would include the return from dividends, would have performed far better than gold over the last 200 years. However, you would have had to rebalance the stock portfolio continuously, because

Figure 11 Dow/Gold Ratio, 1800–2010



90% of companies you might have owned in 1800 (canals and banks) would have gone bust in the “poor man’s depression” of the early 1840s. Investors never had to rebalance gold. Moreover, if we don’t consider gold as an investment class but as cash, then I would imagine that gold has performed better than most paper currencies in the last 200 years.

During that time, most paper currencies became worthless — that is, with the exception of the US dollar, the Pound Sterling, the Swiss Franc, and a handful of other currencies such as the Canadian, Australian, and New Zealand dollars.

Second, when the US expropriated gold in 1933, it gave a perfect buy signal for stocks (see Figure 11). And when governments, which control their central bankers (there is nowhere independent any longer), sold their gold in the late 1990s, it provided a perfect buy signal for gold. I have been trying to tell my readers that most central bankers (not Paul Volcker and Karl Otto Pöhl) are ignorant in terms of broad economic and monetary matters, but these facts clearly confirm my point. There was no necessity to expropriate gold in 1933, because stocks and the overall price level were already deeply depressed and would have recovered anyway (see Figure 11). Equally, it was a huge mistake to sell gold in the late 1990s, near its price low, when the Dow/gold ratio gave a clear buy signal for gold and a sell signal for stocks. (At the time, some central banks even started to buy stocks....) If I explained this to a man on the street, a man with some common sense — not an economist at a university or at the Fed — he would scratch his head in disbelief. But what can you expect from academics who, as James Grant pointed out, spend their time writing papers paid for by taxpayers, with titles such as “The Two-Period Rational Inattention Model: Accelerations and Analyses” and “Continuous Time Extraction of a Nonstationary Signal with Illustrations in Continuous Low-pass and Band-pass Filtering”?

From Figure 11, we can see that gold is moving into a relatively expensive area compared to equities. Moreover, it is in my nature to become more cautious about an asset class, such as gold and silver, after it has had a stunning performance over the last ten years (see Table 1). Then, I think that under a gold standard in the 19th century the Dow/gold ratio was reasonably constant. However, following the introduction of modern central banking it would appear that the Dow/gold ratio has become far more volatile, with higher peaks and lower lows. Therefore, I believe that it is realistic to expect a Dow/gold ratio of between 1 and 5 over the next few years, and that we cannot rule out a ratio of 0.5.

In recent weeks, there has been a lot of discussion about competitive

devaluations. In particular, Mr. Bernanke seems to think that rising stock prices are more desirable than a stable or appreciating dollar. The US administration’s pressure on China to let its currency appreciate strongly is essentially the same as devaluing the dollar against the Asian currencies. Ironically, the only currencies with which central bankers around the world have had a rousing success at competitively devaluing against their paper currencies are gold, silver, copper, and platinum. (Again, anyone with common sense will just shake his head.) As an aside, Jonathan Anderson, the excellent economist at UBS, recently completed a study on devaluations and their impact on economic growth (www.ubs.com/economics). His conclusion: “Keep in mind that the

Table 1 Spot Commodities: Ten-Year Annualised Returns for the Period Ending November 30, 2010

Silver (Handy & Harman base)	19.42%
Gold (London PM Fix)	17.99%
Tin (London Metal Exchange, cash seller)	16.56%
Copper (London Metal Exchange, cash seller)	16.37%
Copper (COMEX, spot)	16.27%
Lead (London Metal Exchange, cash seller)	15.93%
Cocoa (Ivory Coast #1, spot)	13.12%
Dow Jones/UBS Commodity Index	12.97%
Sugar (Raw Cane, World, spot)	12.54%
Nickel (London Metal Exchange, cash seller)	11.82%
Wheat (No. 2 soft red, St. Louis, cash)	11.12%
Platinum (London PM Fix)	11.00%
Soybeans (No. 1 yellow, Cent. IL, cash)	10.67%
Corn (No. 2 yellow, Cent. IL, cash)	10.58%
Reuters/CRB Continuous Futures Index	9.95%
Crude Oil (West Texas Intermediate, Cushing, spot)	9.91%
Heating Oil (New York #2, spot)	9.39%
Unleaded Gasoline (New York, spot)	9.34%
S&P GSCI	9.30%
Coffee (Brazilian in New York, spot)	9.02%
Zinc (London Metal Exchange, cash seller)	6.91%
Cotton (1-1/16”, Memphis, spot)	6.48%
Aluminum (London Metal Exchange, cash seller)	4.33%
Natural Gas (Henry Hub, spot)	-0.46%
Palladium (Engelhard industrial bullion)	-0.81%

Source: Ron Griess, www.thechartstore.com

evidence in 'favor' of devaluation is a lot less compelling than many people think." In addition, he notes (I think this is the relevant issue for the US):

... just because you devalue once doesn't mean the exchange rate "stays" devalued; knock-on inflation can take away competitiveness very quickly. Most studies point to the need for "follow through" in terms of **supporting macro policies in other areas; in particular, monetary policy needs to remain tight** and credible in order to prevent the inflationary effects of a weaker exchange rate from passing through immediately to domestic wages and wage expectations. Usually a **fiscal adjustment is also necessary** to ensure that there is no excessive monetary accommodation of the public sector and that private credit demands can be met.

Anderson (one of the best macroeconomists I know) really hits the nail on the head with these observations. Devaluations are only helpful if they are followed by "tight

monetary policies" and "fiscal adjustment". That is the key. However, what is the likelihood of "tight monetary policies" in the US? Zero! And what is the likelihood of a meaningful fiscal adjustment? Almost zero! On the other hand, what is the likelihood of precious metals appreciating further if the dollar declines more? Rather likely. What about if the dollar strengthens, and other currencies, including emerging market currencies, weaken?

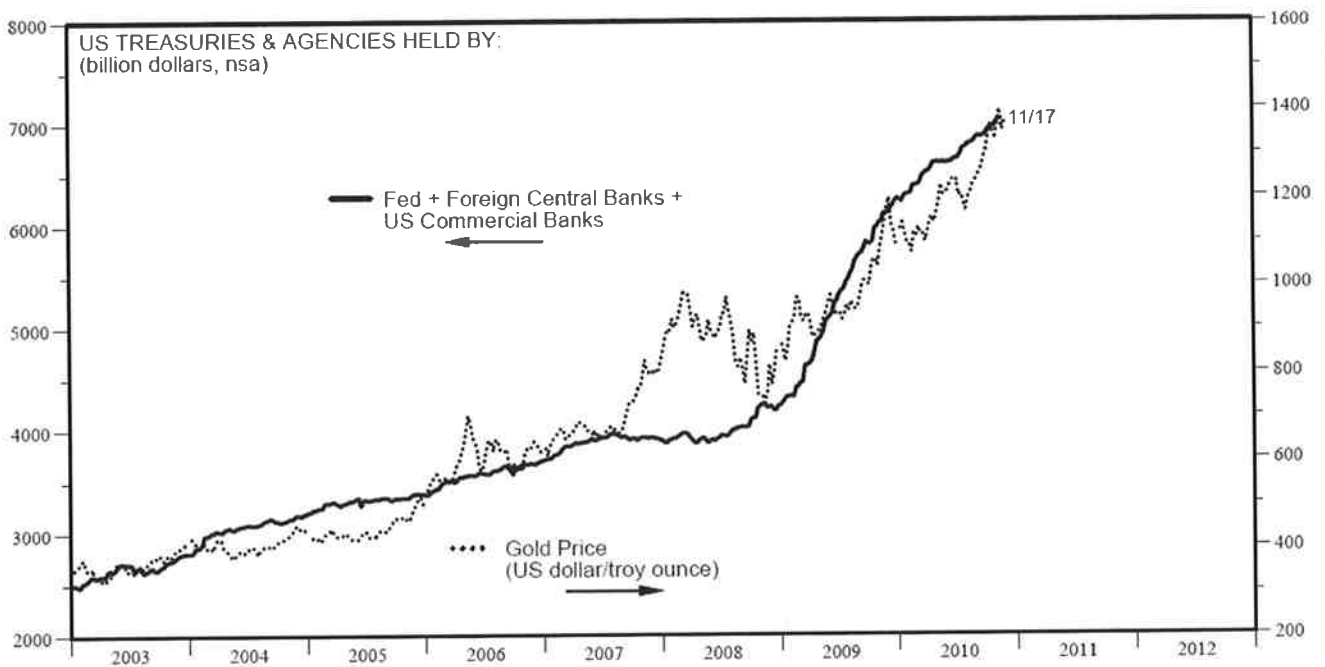
I pointed out above that, at a conference I spoke at in Seoul, hardly anyone owned gold. This is my impression of most people in the emerging economies. Therefore, if emerging economies' currencies and the Euro were to weaken against the dollar, I could make the case that the price of precious metals would increase even more than amidst dollar weakness. In many countries — including China, Vietnam, and India — there are restrictions on people investing overseas. But, they are permitted to purchase gold. Not surprisingly, Chinese gold imports jumped almost five-fold in the first ten months of 2010 (to 209 metric tons) from a total of 45 tons in 2009.

If, in 2011, the Chinese public no longer perceives real estate and equities as attractive, I wouldn't be surprised to see gold imports increasing to 500 tons.

There is another development that is likely to support gold prices. The Chinese government must be concerned about its worsening political relationship with the US. They and other foreign central banks are also concerned about their large exposures to dollar fixed-interest securities (see Figure 12). Therefore, why would they not accumulate gold on any weakness?

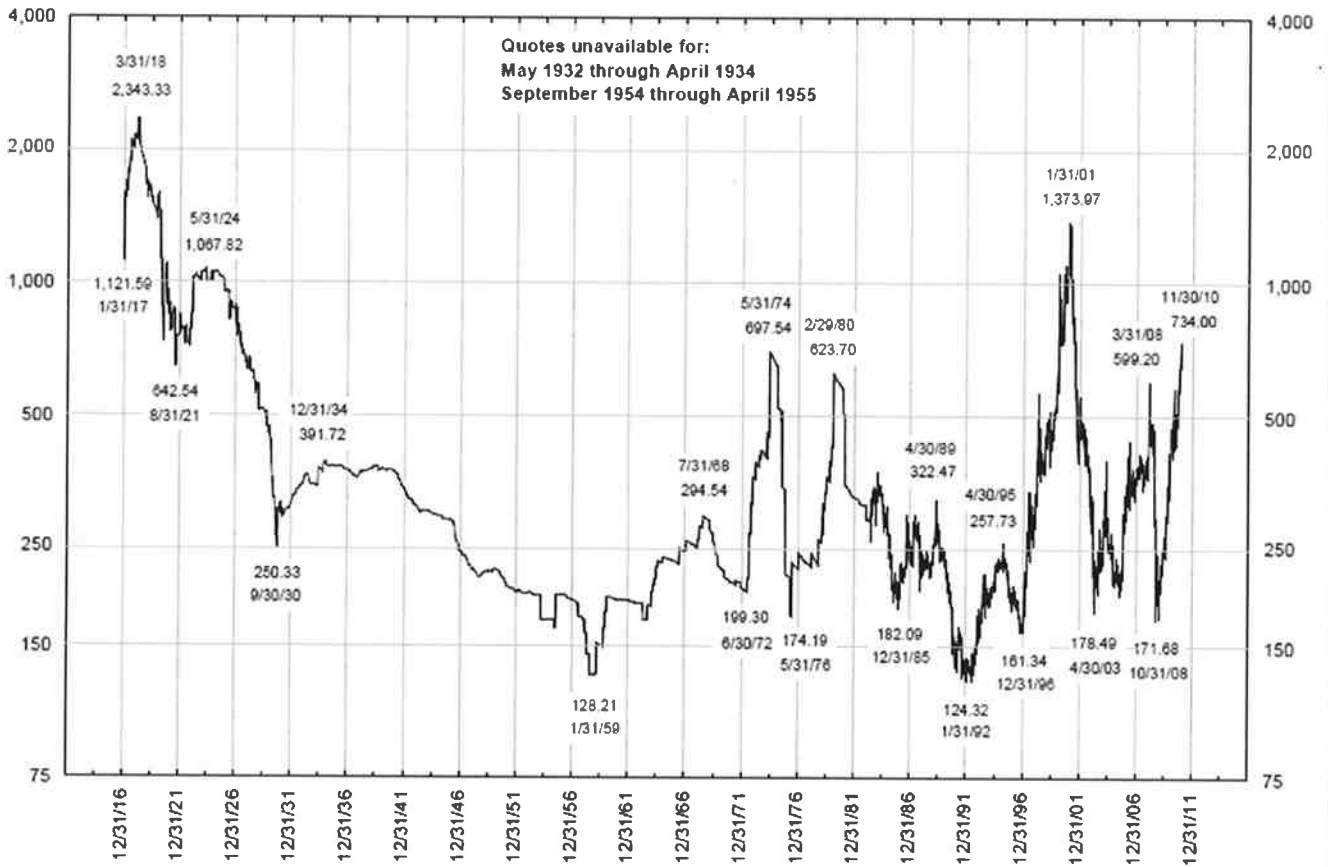
As I said above, I'm not particularly happy to continue to accumulate the asset class (precious metals) that has performed best over the last ten years. However, what are the alternatives? Should we invest in paper cash at zero interest rates and paper money government bonds? Investors will lose money either because of governments' printing of money or defaults, or a combination of the two (first, printing of money and then defaults), or because investors will underperform in financial assets compared to sound currencies such as precious metals. I

Figure 12 **Compared to the Increase in Treasuries and Agency Securities Held by the Fed and Foreign Central Banks, Gold Doesn't Appear to be Overvalued**



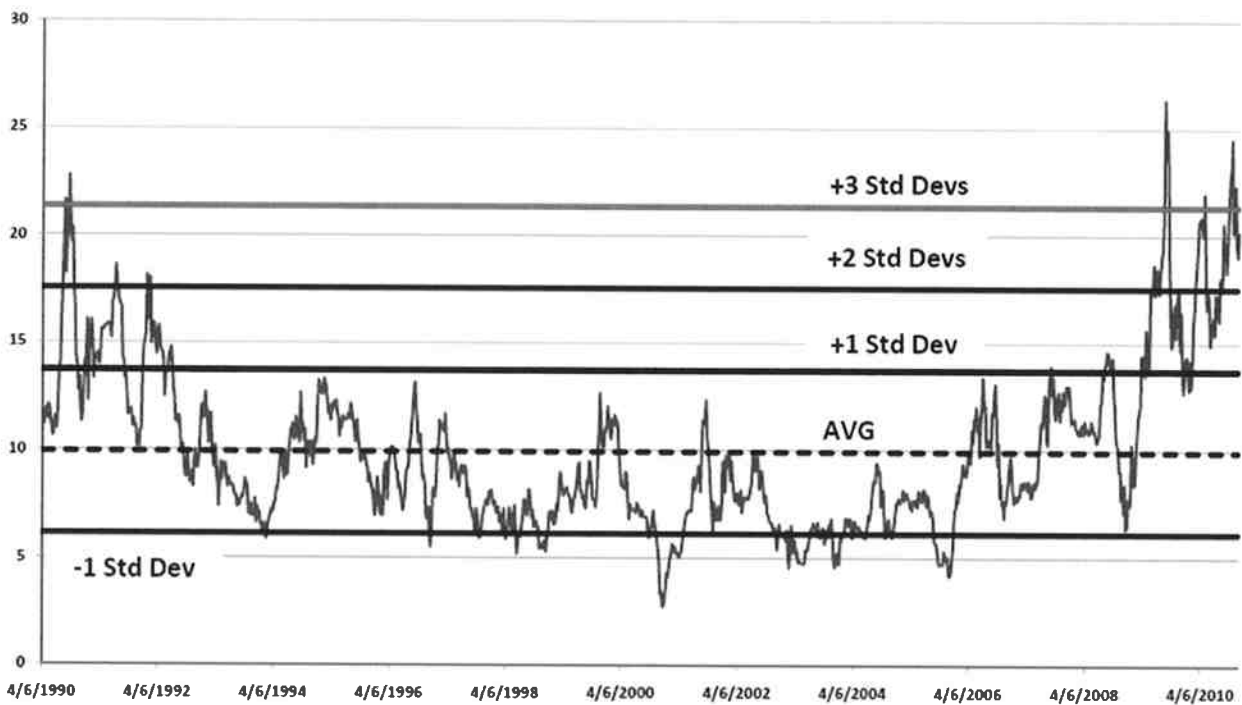
Source: Ed Yardeni, www.yardeni.com

Figure 13 Palladium (Adjusted for Inflation by CPI), 1917–2010



Source: Ron Griess, www.thechartstore.com

Figure 14 Oil Relative to Natural Gas, 1990–2010



Source: John Roque, WJB Capital Group, www.wjbcapital.com

Figure 15 **Suncor, 2003–2004**



Source: www.decisionpoint.com

Figure 16 **Nomura Holdings, 2001–2010**



Source: www.decisionpoint.com

am sure that some assets will perform better than gold and silver in the next few years. Perhaps platinum prices, which are still below their 1919 level in real terms and have shown a negative return for the last ten years (see Figure 13 and Table 1). Perhaps natural gas prices! In general, I think that energy (oil, gas, uranium) and energy-related industries (drilling, etc.) are attractive sectors. If the global economy continues to expand, oil demand will increase much further (especially if Mr. Roubini is right in forecasting that India will grow at a faster rate than China).

Alternatively, if the global economy collapses, the money-printing presses will run overtime and countries will go to war. Both scenarios should be supportive of energy prices.

Compared to oil, natural gas would seem to be extremely depressed and could be a strong performer over the next 12–18 months (see Figure 14).

Probably the best way to play a natural gas price recovery is by owning the First Trust ISE Revere Natural Gas Index Fund (FCG) or Chesapeake Energy (CHK).

Additional strength in energy prices would be favourable for countries

such as Russia (TRF, CEE), Kazakhstan, the Middle East (MES), and oil stocks such as Suncor (see Figure 15). I also still like Vietnamese stocks (VNM).

I reiterate my recommendation to accumulate Japanese equities. In my introduction, I alluded to the fact that few people own gold. In Japan, individuals have practically no direct exposure to equities. The best play on monetisation in Japan (inevitable sooner or later), higher Japanese bond yields, a weaker currency, and a bull market in equities is Nomura Holdings (see Figure 16).

THE ENDGAME

I have to say, I feel deeply troubled by the current investment environment. Asset prices are going up, not because of sustainable and sound fundamental economic factors, but because of unsustainable fiscal deficits and loose monetary policies practically everywhere in the world. With President Obama's agreement to sustain the Bush-era tax cuts for high-income earners in exchange for extending federal unemployment insurance and cutting the payroll tax

by US\$120 billion for one year, and Mr. Bernanke's recent remarks, it is fair to assume that we have reached the **Endgame**. Europe is also an active contender in the Endgame, as far more bailouts of sovereign defaults will occur. Lastly, China is also a favourite in the Endgame because its economy is showing all the symptoms of a bubble. The Endgame is no longer a question of *if*, but *when*.

As of mid-December, all asset markets are overbought (also precious metals), there is rampant speculation, and technical indicators have been deteriorating. **In short, I believe that, within the next six months or so, investors will be able to buy stocks and commodities at lower prices than today.** However, as I have maintained on so many occasions in the past, investors will most likely be better off in the Endgame by owning precious metals, farmland, and equities (see above) than by holding cash and government bonds. Moreover, the Endgame could last for another two to five years before its key players — governments and central bankers — fail and bring about huge losses for most investors.