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Louis Boulanger CFA
Office: +64 9 528 3586
Mobile: +64 275 665 095

louisboulanger ^{now}
Freethinking Investment Strategies

Issue 35 - 30th March 2010:

[It's All Good](#)

[Can You See Now That This Is a Currency Crisis?](#)

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It's All Good

"What has happened with gold is that it is a beneficiary of the deteriorating position of another asset class which is seemingly unrelated to it – sovereign credit bonds. Investors are looking to what is happening to what were considered the securest assets, government bonds."

"What they are saying is, 'what is the long-term store of value?' Nobody knows what inflation is going to be in two years, five years or 10 years from now. The other thing is we don't know what currency is going to do because the only major currency of the world that has powerful underlying strength is the Renminbi of China."

"Are we going to come out of this downturn in the OECD countries and go back to normal economic growth? Fourteen trillion dollars in deficits and extra creation of paper has gone on in the most gigantic rescue operation the world has ever known."

- Don Coxie
Chairman, Coxie Advisors LLC, and Strategy Advisor, BMO (Bank of Montreal)
Capital Markets
<http://www.kitco.com/reports/KitcoNews20100303A.html>

The Noughties are over; let's be grateful things didn't get worse and welcome with open arms the new One-ders! We should be confident that the elite will continue to do whatever it takes to preserve the status quo. After all, their power seems to have no bounds and we seem to generally welcome this, much without question. Don't worry, be happy!

This new decade promises to be entertaining, to say the least. All I hope is that it won't be another lost decade, as far as 'investments' are concerned... It's pretty clear from the chart below that money was best served by staying outside the system (i.e. exchanged for gold and silver bullion), awaiting future deployment:



It's pretty staggering when you consider how investment markets have NOT performed over the past ten years. Yet, most investors keep investing the same way as ever: putting all their money in financial markets, mainly in shares and bonds (and maybe also some in that good old familiar stuff, property). Why?

I'd argue it's simply because most people just don't know what money is anymore. I know that sounds pretty unbelievable, but that's what I've come to realise and believe is true. If you choose to simply take for granted that there is nothing wrong or nothing you can do about the currencies in which all of your investments must inevitably be denominated, then why should you worry or why should you change how you deploy your money?

We simply don't think of what we habitually use as money as perhaps being something of more and more questionable value. Why? Are we simply too busy or too embedded in the system to even want to begin considering the possibility that our currencies are in freefall, let alone do anything about it? After all, everything seems to be back to normal. Everything is fine again. The crisis is over, right?

The Lost Decade

It is useful to look at facts, rather than simply rely on impressions. A quick glance at the past decade shows just how badly investments have performed, both in terms of their annualized rates of return and the volatility of those annual returns (as measured by the standard deviation). This is especially the case when one considers the performance of NOT investing that money – i.e. buying and holding bullion – instead.

I have a lot of New Zealand based readers and so, here are the numbers from a NZ dollar perspective, using recognised market indices:

Past Performance Results for the Ten Year Period 1.1.2000 to 31.12.2009

Asset Classes	Actual Past Rates of Return (% pa)	Actual Past Standard Deviations (% pa)
INVESTMENTS		
Global Equities	-3.5	15.0
Australasian Equities	7.5	14.9
Commodities	6.4	20.0
Global Property	7.1	21.0
Global Fixed Interest	3.1	12.4
Australasian Fixed Interest	6.8	3.0
Australasian Cash	6.5	0.4
BULLION		
Gold	10.6	14.5
Silver	8.7	18.5

All percentages are expressed in annualized gross nominal NZ dollars, unhedged

I suspect that the general thrust of the above results would be much the same for investors with other base currencies, in that money was generally best served globally by staying out of the financial system or by not being invested. In other words, by simply converting your dollars, or whatever currency your money is denominated in, into bullion – gold or silver – and doing nothing else with your money for ten years, you would be wealthier today (and probably healthier too) than if you had invested it.

Of course, this assumes that you would have done no better as an investor than the markets. But to beat markets over extended periods of time such as ten years is not an easy thing to do. At the very least, it requires active decisions to be made as to what to buy and what to sell and when best to do so; a time consuming and possibly stressful occupation. On the other hand, bullion just sits there...

It should be obvious that not all is right if it's more rewarding to hoard bullion, and in doing so defer making investments, than it is to continually deploy our money at risk in the investment markets. This is not the normal situation. But these are not normal times either, which is precisely what seems to be overlooked by most investors and their advisors.

It is also important to recognize that during the past decade, the NZ dollar has fluctuated greatly relative to other currencies. This is not immediately obvious if one only looks at the NZ dollar appreciation (+) or depreciation (-) over the whole period. One also needs to look at the volatility (which is rising rapidly):

Currencies	NZD Rises (+) / NZD Falls (-)	Volatility of Exchange Rate
Australian Dollar (AUD)	+0.2% pa	8.1% pa
US Dollar (USD)	+3.3% pa	14.2% pa
Euro (EUR)	-0.3% pa	10.3% pa
Japanese Yen (JPY)	+2.4% pa	16.1% pa

But what is the NZ dollar if not another fiat paper currency backed by nothing except our continued faith in the NZ government's ability and willingness to pay its debts and the banking system's ethical conduct in its production role of the money supply? It seems to be the general opinion today that the NZ dollar is a strong currency. On what basis, what fundamentals, I ask?? Is it the sheep, the cows, the grass, the clean air or maybe the blue sky??

I prefer to keep in mind that the NZ dollar has actually depreciated (in other words, lost value) by a staggering 63.5% against gold in the past decade. That's a staggering 9.6% per annum. Inflation, as measured by changes in the Consumer Price Index, was only 2.7% per annum during that period. Where's the strength in that?!

Oh, its strength is not absolute, you say, but relative. I see: it's relative to other currencies, that the NZ dollar is strong. Ok then, and that's because...? Generally, when you have this kind of conversation with so-called experts, such as economists, you end up hearing arguments that the NZ economy is a commodity based economy and that's why. Huh? The currency is not the economy, stupid!

With the prevailing stupidity and blindness of *economists*, what will the new decade bring? Will we see a similar outcome in ten years time? Will bullion continue to outperform all investments? It all depends on what happens to money, dear readers. And I still don't see any sign of any willingness by the elite to change things, at least not on that front. So my money's on bullion staying on top. What say you?

Is the world turning upside down?

Central bankers are accumulating gold and ordinary people are not. Last year, central banks were net buyers of gold for the first time since 1988. In fact, they bought the most gold in any year since 1964. Total central bank holdings worldwide, according to the World Gold Council, grew by 425 metric tons last year.

True, that's only 1.4% of the gold central banks already held (according to official statistics). But it's the trend that matters: China, India, and Russia all added to their reserves last year. And it fits into a bigger picture of growing distrust of the world's reserve currency, the US dollar, and the other currency that was until recently making good progress in being considered as a good alternative to the US dollar for reserve currency purposes, the Euro.

"I think we already have a gold standard ... created by the marketplace," said the inimitable Marc Faber on CNBC earlier this month (see <http://www.cnbc.com/id/35912043>). It's not just the central banks that are buying gold: *"We have the [exchange-traded funds] that have proliferated, and we have more and more physical buying of gold."*

The problem with ETFs, which someone like Marc Faber should know, is that they do not offer gold ownership to investors, but only a paper promise. In the case of GLD for example, the gold ETF most used by investors, the shares simply track the price of gold and promises investors a return in dollars equal to the movement in the gold price. You never actually own the bullion.

It's not the price of gold that matters, but how many ounces of gold you actually own... The difference may not at first seem clear or even important. It will become clear however, when it is too late. When it will no longer be possible to buy gold bullion or after ETFs have been nationalised by governments who need the gold, then the light will shine brightly for all to see.

"We can forgive a child who is afraid of the dark; the real tragedy of life is when men are afraid of the light."

- Plato

(c. 428 BC - c. 348 BC)

Classical Greek philosopher and mathematician; mentor was Socrates and Aristotle his student.

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Can You See Now That This Is a Currency Crisis?

If Not Now, When?

"To some, the lesson of all this is clear. If all the issuers of paper money want to see their currencies depreciate, then the only answer is to own an asset that central banks cannot debase—namely, gold."

- Buttonwood, the author of 'The Economist' newspaper's column on the financial markets;

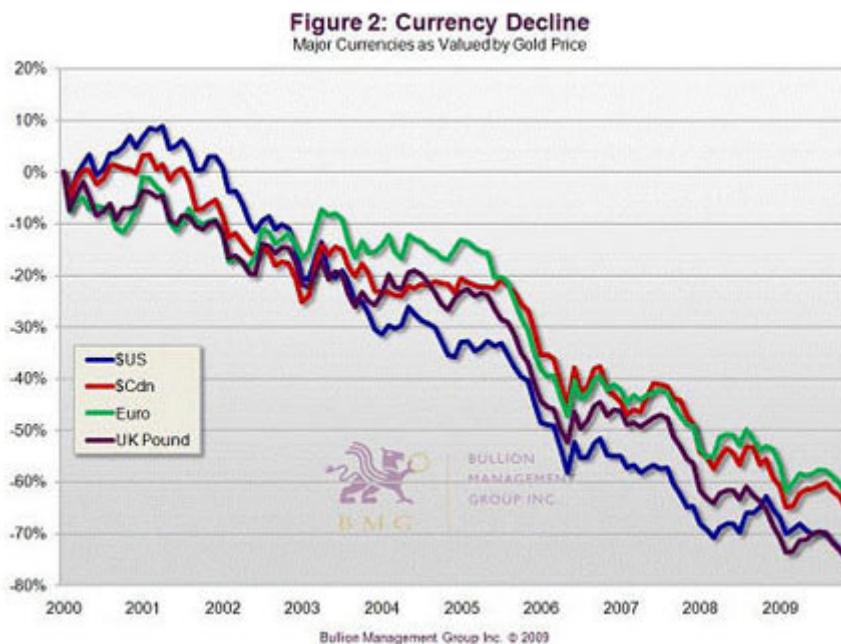
Above quote is taken from his column in The Economist print edition of 4 March 2010; source: http://www.economist.com/research/articlesBySubject/displayStory.cfm?story_id=15606339&subjectID=348885&fsrc=nwl

Well, well... This is interesting. It would seem that even 'The Economist' is now of the view that currencies are in a race to the bottom, as I put it in my speeches around the globe on 'Gold Is Money and Nothing Else'. Witness the title of Buttonwood's article in the print edition of 4 March 2010: 'Race to the Bottom - countries compete to weaken their currencies'. Sure makes a mockery of our so-called 'floating' currencies...



But don't be fooled into thinking that it is the US dollar only that's sinking or that it is the currency that will collapse first in this currency crisis. All currencies are in a race to the bottom. But, although it can be expected that they will all reach the bottom eventually (that is, unless there is monetary reform or a return to sound money before that happens), only one will reach the bottom first.

Will it then be the Euro? Will it be the British Pound? Will it be the Japanese Yen? Or will it be any one of the other 178 currencies circulating? Who knows! Who cares?! Just buy and hold gold and watch the train wreck from the sidelines:



Source: 'Gold Is Money', by Nick Barisheff, published in Money Magazine, March 2010.
The article is available in full in BMG's web based Learning Center –
see http://www.bmgbullion.com/doc_bin/03.16.10_Gold%20is%20Money.pdf.

EMU: European Monetary Union or European Madness Unleashed?

It's been fascinating, to say the least, to watch how European leaders have dealt (and not dealt) with the Greek debt problem. What a political circus it's been! The consequences of sovereign countries not being their own masters of monetary policy in their own country are emerging, as are many other facets of the political governance of the Euro.

On the 18th of March, German currency chief Ulrich Leuchtmann voiced an astonishing volte-face in suggesting that Greece should go to the IMF for a rescue. "We think the IMF is the ideal solution anyway, and would actually be good for the euro. It would establish discipline and avoid moral

hazard. It is much easier for the IMF to enforce austerity conditions," he said.

The European Union top brass had of course been saying for weeks that it would be intolerable to let Washington's International Monetary Fund (IMF) under the Eurozone tent. Euro Group President Jean-Claude Juncker said it would shatter the credibility of monetary union. But, the Daily Bell, based in Appenzell, Switzerland, asked in a staff report – see <http://www.thedailybell.com/900/Germany-Proposes-IMF-Greek-Bailout.html>:

"Is this all EU religious stuff: ideology and totemism? Mr. Juncker, the Commission's Jose Barroso, and their allies, have been trying to exploit the crisis to advance the EU Project, pushing the boat stealthily across the Rubicon towards fiscal federalism and a de facto debt union. They hoped that the Germans would not realize fully what was being done to them until too late. Chancellor Angela Merkel appears to have balked at this - understandably — seeing a standby facility for Greece as the beginning of a slippery slope that would leave German taxpayers on the hook for €3 trillion of Club Med debts."

And indeed she did. Chancellor Angela Merkel has halted at the Rubicon.



German Chancellor Angela Merkel's speech to the Bundestag was epochal
Source: http://www.telegraph.co.uk/finance/comment/ambroseevans_pritchard/7494718/Has-Germany-just-killed-the-dream-of-a-European-superstate.html

Greece's sovereign debt trap is the biggest crisis in the 11-year history of the Eurozone. And it could soon become the most serious crisis in the history of the European Union. The heads of Eurozone nations last week finally unveiled their latest plan to aid Greece: a pledge to lend Athens €22billion (two-thirds from Eurozone governments and a third from the IMF) if it cannot roll over its debts on the open markets.

But will it be enough to calm the bond markets which have been desperately selling Greek government bonds, pushing up Athens' cost of borrowing to double that of Germany? I don't know, but I'll be watching from the sidelines as this currency crisis continues to take its course...

QE and Interest Rates

No, QE does not stand for Queen Elizabeth, although she does have some influence I suspect. QE here stands for this euphemism economists use for the most extreme kind of so-called monetary policy, which essentially consists in central bankers 'stimulating' (you got to love how they use that word too...) the economy by buying financial assets (mainly debt securities) with money they create out of nothing: Quantitative Easing. The expression is so elegantly deceitful; it could only have been invented by such masters of illusion!

Ethics aside, printing money (i.e. QE in plain English) does work... for a time, that is. It can successfully defer the inevitable rise in interest rates that a free market would require for buying government debt that is increasingly unlikely to be paid back (or is increasingly likely to be based in a much devalued currency). But every man and his dog these days seems to have an opinion as to whether interest rates will rise or won't rise.

Truth is however, that the world isn't divided between people who think interest rates will rise and people who think interest rates won't rise. It is divided among four groups, as Terry Coxon of

Casey Research LLC quite eloquently put it recently:

“The world is divided among four groups:

- 1. People who think interest rates will rise.*
- 2. People who think interest rates won't rise.*
- 3. People who don't care. Most bond buying comes from this group. It is institutions that are covering dollar liabilities, especially insurance companies and banks. It is also fund managers who will keep their jobs if they can report some yield and fiduciaries who can avoid lawsuits by doing something conventional, however dumb it might be.*
- 4. People who don't know. Despite being highly intelligent in other ways, 80% of the human population have no mathematical intuition beyond the number 3, so they can have no confidence in any explanation as to what to expect the economy to do. They will buy bonds because, compared to the non-cash alternatives, bonds seem safe, and unlike cash, bonds provide yield.”*

What group are you in? I'm firmly in group 1: those who think interest rates will rise. But, as Doug Casey famously says, it's not because something is inevitable that it's also imminent. So, with QE in place and stupidity ruling the day, there is no telling how long it might take for the inevitable to come to pass. So we should be patient and wait... with our money on the sidelines, if you know what I mean.

This reminds me, by the way, that there is only a few days left before the Fed's self imposed deadline to halt its own QE program (the Fed is not the only central bank engaging in this dubious practice, of course, but it is leading the pack). Hummm... Will this QE madness actually come to an abrupt end on 31 March? Good question.

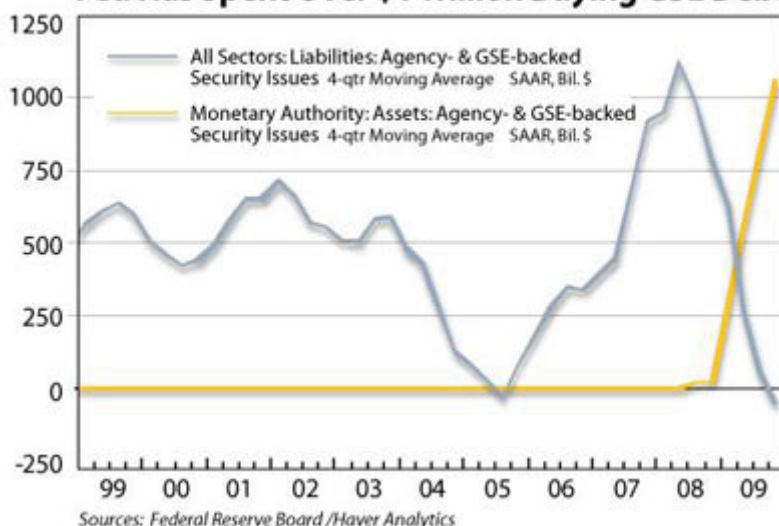
When it comes to such matters, there is no better source from my point of view than *The Richebacher Letter* (see <http://richebacher.com/about-the-letter>) to turn to, in order to get some level of understanding of what's going on and what may happen next. The Letter is a monthly, but every week an email update is sent to subscribers. Last week, it was entitled 'QE Finis; Long Live QE!' and focused on this looming end to QE...

“As you know, our analysis has suggested this is likely to be a big thing. The Fed has bought over \$1 trillion on government-sponsored entity (GSE) debt from the private sector. Private sector investors have taken the money the Fed has created. Given the yield on near cash instruments, we believe investors have turned around and invested the proceeds from their GSE sales to the Fed in risky assets. We also believe some of these investors have replaced their GSE positions with Treasury bonds. So directly, the Fed has bid GSE prices up and suppressed GSE-related interest rates (think mortgage rates). Indirectly, the Fed's money creation in the QE ops has suppressed Treasury yields and boosted prices of risky assets. At month end, then, a major prop beneath asset markets will go poof.”

What do you mean 'will go poof'?!

“To make this point clearer, and to size this all up better, we went rummaging around the Fed's Flow of Funds accounts to see who sold their GSE holdings to the Fed.

Fed Has Spent Over \$1 Trillion Buying GSE Debt



First, note that the GSEs themselves have not been net issuing debt of late. Yet the Fed purchases of GSE debt have gone through the roof with the QE ops. That means the Fed was buying GSE debt already outstanding and already held by other private investors and institutions. Who were the direct beneficiaries of the Fed's QE ops?

Look at the chart above. Do you see that line in the powering through \$1 trillion on April Fools' Day? That represents the Fed's QE purchases of GSE debt... and that is going to do a 180 — it is bound for zero. What happens, then, when broker dealers, households and money market funds go to sell their GSE debt after March 31 and there is no Fed on the other side of the trade, with a bunch of blank checks, prepared to buy the GSE debt?

Can you say train wreck? GSE debt is priced at razor-thin spreads over Treasury debt. Professional investors have determined these two assets are near-perfect substitutes now that the GSEs are under Treasury receivership. But the way we remember our Finance 101 class, when overwhelming supply for sale meets an absence of demand, prices must adjust until markets clear."

So, what will the Fed do? Will it or won't it? Stay tuned, I guess. That's all we serfs can do it seems: wait with baited breath and hope that our master illusionists will know what to do and do the right thing! I reckon it's better to watch the show with my money from the sidelines... if you know what I mean.

Don't Be IKISHBG'd!

In other words, don't be among the many that end up saying: "I Knew I Should Have Bought Gold"...

What is currently going on has already happened many times before, just not in our back yard! This brief article offers a good reminder: http://www.gold-eagle.com/gold_digest_08/vronsky021610.html.

In the meantime, whenever the price of gold (or silver) dips a little or even if it dips a lot, just smile and say 'thank you!' It does not matter whether you already possess any gold or not. If you don't, consider it a gift: you can buy it cheaper. If you do, you weren't planning to exchange it for paper money anyway, right? So it doesn't matter. Stay cool and, when the time comes for you to deploy that money again, you'll be laughing all the way to the bank!

"The last duty of a central banker is to tell the public the truth."

- Alan Blinder

American economist, currently a Professor at Princeton University; above was said on PBS's Nightly Business Report in 1994, when he was Vice Chairman of the Board of Governors of the Federal Reserve System

.....

“The public’s understanding of what money is and its origins has devolved to the point where the government monetary authorities can now inflate with impunity, with the ultimate result to be the destruction of the division of labour undoing all of mankind’s progress to date. The average Joe and Jane must trust the wise men and women working secretly in central banks around the world with what passes for money – paper and digits on a computer screen. These banks are the largest employers of academically-trained economists. But under the guidance of the Keynesian schooled, the central banks engage in monetary operations that fulfil the funding needs demanded by politicians for political ends.

The hopes, dreams, and living standards of millions are affected daily by these faceless bureaucrats that supposedly know exactly which monetary buttons to push and levers to pull to insure our prosperity. However, history shows that central bankers have but one strategy to cure all things, especially their past mistakes: print more money, with their plans for stabilization resulting in just the opposite.”

- Douglas E. French

President of the Ludwig von Mises Institute (LvMI)

Foreword, dated November 2009, to the recent republication by the LvMI of Carl Menger’s ‘On the Origins of Money’, which first appeared in the Economics Journal, volume 2, in 1892.

Your freethinking investment strategist, continuing to be of the opinion that there is no better way to look after yourself and your loved ones than by having the courage to search for the truth, think for yourself and act accordingly!

Louis Boulanger, CFA
Louis Boulanger Now Ltd.

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With each bullion bar purchased, the BCS registry maintains all the details of the BMG BullionBars™ and owners. None of the client details are at all connected to the internet, providing the highest security and confidentiality for BMG BullionBars™ owners. This registry also allows owners to easily sell their bullion.

A physical bullion deed, identifying smelter, serial number, fineness and exact weight of bars, is also issued for your recordkeeping. By entering into a storage holding agreement, the bullion will be stored at The Bank of Nova Scotia in Toronto, Canada. The Bank of Nova Scotia provides investors a secure, fully allocated and insured storage facility. On a delivery request, the purchaser is required to pay shipping, insurance and handling fee.

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