The Trouble with Our Times Is that the Future will Not Be what It used to Be

Marc Faber

> **Government's view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it**
>
> **Ronald Reagan**

> **I contend that for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle.**
>
> **Winston Churchill**

> **Can it be believed that the democracy which overthrew the feudal system and vanquished kings will retreat before tradesmen and capitalists?**
>
> **Alexis de Tocqueville**

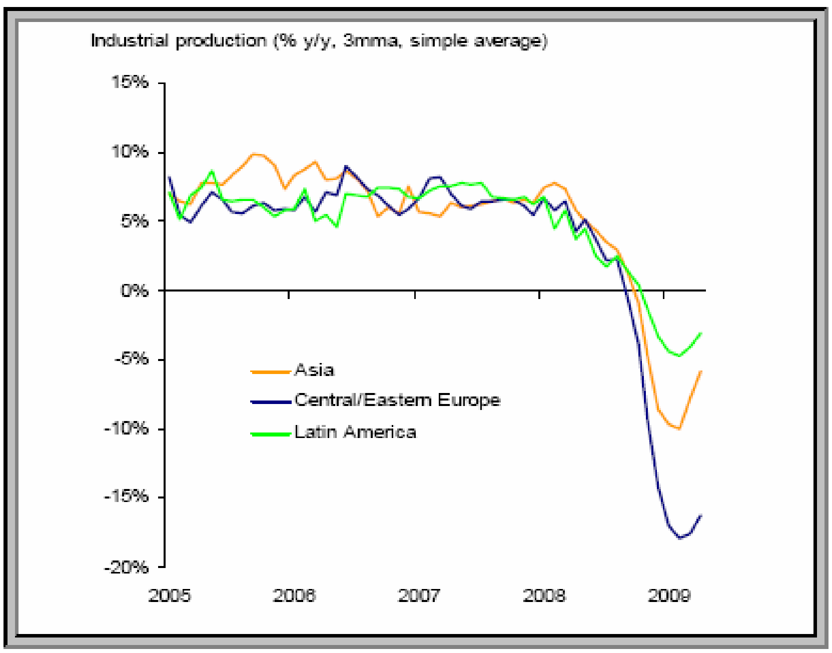
I was fortunate in my life to have traveled to Latin America, Eastern Europe, the Soviet Union, the Middle East, and Asia already in the 1970s. At the time there was still a huge difference between the level of development and the standards of living in Western European and US cities compared to places like Singapore, Hong Kong, Taipei, Seoul, Moscow, Prague, Budapest, Sao Paulo, Santiago de Chile, Dubai, and Bombay, just to name a few. All these places were if not totally destitute then certainly still very poor compared to western cities. I was reflecting about this on a recent visit to Sao Paulo, a city which along with the entire country has enormously developed in every respect - especially in

© Copyright 2009 by Marc Faber Limited - All rights reserved

the last few years. There is an exception to what I just said: the Sao Paolo airport is a total disaster! (By far the world's most beautiful airport terminal – a piece of art - is currently at the Barcelona airport. It was designed by Catalan architect Ricardo Bofill and inaugurated on June 16th. I used it two days later and it worked perfectly.)

I am mentioning this because the world has undergone profound changes over the last twenty to thirty years. Many places in the world that were unlivable in the seventies and eighties have now become attractive cities and countries to live and to work in and are also attracting large foreign investments. Many of my readers ask me where they should move to. I think that there are now lots of countries including Brazil that offer great opportunities. I should add that Brazil and Latin America have "survived" the financial crisis relatively well (see Figure 1)

Figure 1: Industrial Production in Emerging Economies



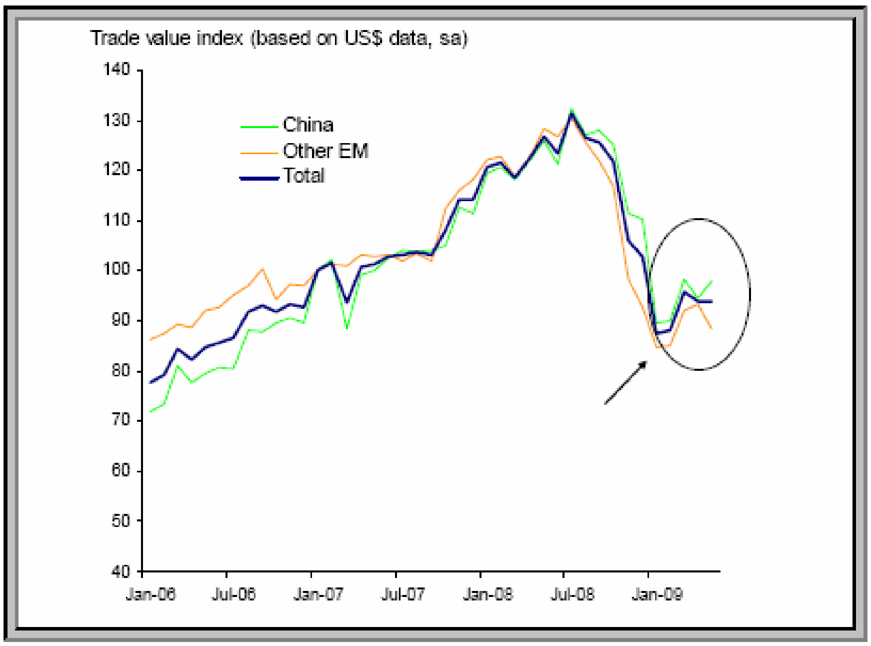
Source: Jonathan Anderson, UBS

In the 1950s and 1960s the US offered by far the best opportunities. But now, I think there are lots of places which offer not only better opportunities but also far nicer and freer lifestyles than the US does. As to which specific country I would recommend to live in I have no answer because that depends on each individual's personal conditions and likings, skills, assets, age, and life style preferences. I lived for thirty years in Hong Kong, which was sensational because it allowed me to

© Copyright 2009 by Marc Faber Limited - All rights reserved

learn and travel a lot. Now I live in Chiang Mai because when not on the road I like to have my peace, to read and write, and to enjoy a large office, a house and garden, and my dogs aside from the scenery and the nightlife! But one thing is certain: if I were again 25, the US would not be among my first choices to settle down. In my opinion, over the last thirty years the US has changed for the worse and the rest of the world for the better. This is not to say that emerging economies will be from here on problem-free. From time to time we shall have social unrest, even revolutions, pandemics, and because of strong growth also serious economic contractions such as the one that occurred during the Asian crisis of 1997/98 and the last one that is now happening in the Asian manufacturing and export sectors (see Figure 1 and 2).

Figure 2: No Strong Export Recovery Yet!



Source: Jonathan Anderson, UBS

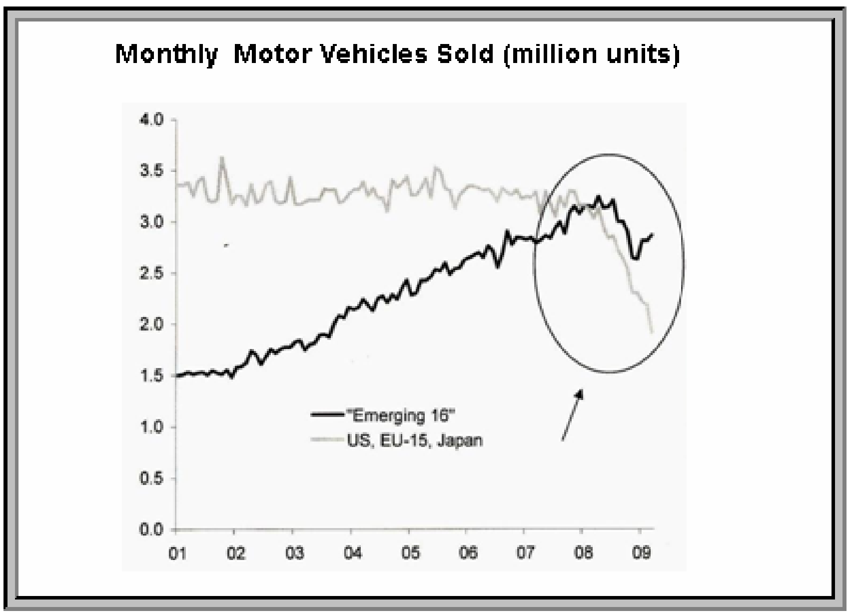
But when we consider that the US also went through a civil war, through repeated economic and financial crises, civil unrest, a depression, and was involved in several wars, then it should be clear that no society is immune to repeated hardship and enormous setbacks. If you sincerely do not wish to take any risk, then go and live straight after college in a nursing home!

The other reason I am reflecting about the changes that have occurred is that I frequently hear the comment that I was fortunate to move to Asia

© Copyright 2009 by Marc Faber Limited - All rights reserved

in the early seventies “when there still were so many opportunities,” which seems to imply that today there are less “opportunities.” I totally disagree! As a result of the breakdown of the communist and socialist ideology and also because of new technologies (telecommunication, computers, etc.), the world’s economic sphere - and along with it - economic and business opportunities have increased dramatically – I suppose along with competition. Expatriates from the western industrial countries will have to work far more to succeed because of the competition from educated and hard driven locals. But it should be clear that whereas growth will be limited in the mature “rich” countries, emerging economies are becoming an economic power block of their own. For the first time ever, car sales in emerging economies are now exceeding car sales in the affluent industrialized countries (see Figure 3).

Figure 3: Motor Vehicle Sales in Developed and Emerging Economies

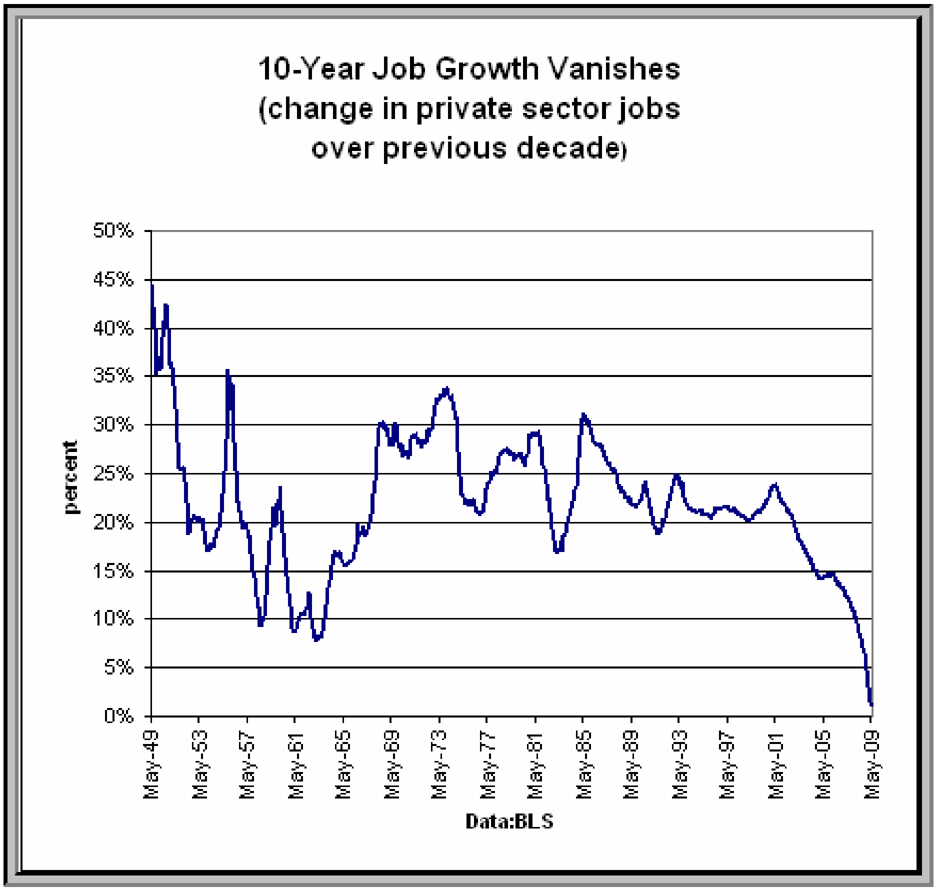


Source: Jonathan Anderson, UBS

There are a few more points I should like to add regarding “The New World Order.” Whereas up to the mid 1980s job growth was in industrial societies relatively healthy, job growth today (outside the government) is stagnating whereas employment growth in emerging economies is abundant (see Figure 4).

© Copyright 2009 by Marc Faber Limited - All rights reserved

Figure 4: Last Ten Years: Dismal Job Growth In The US!

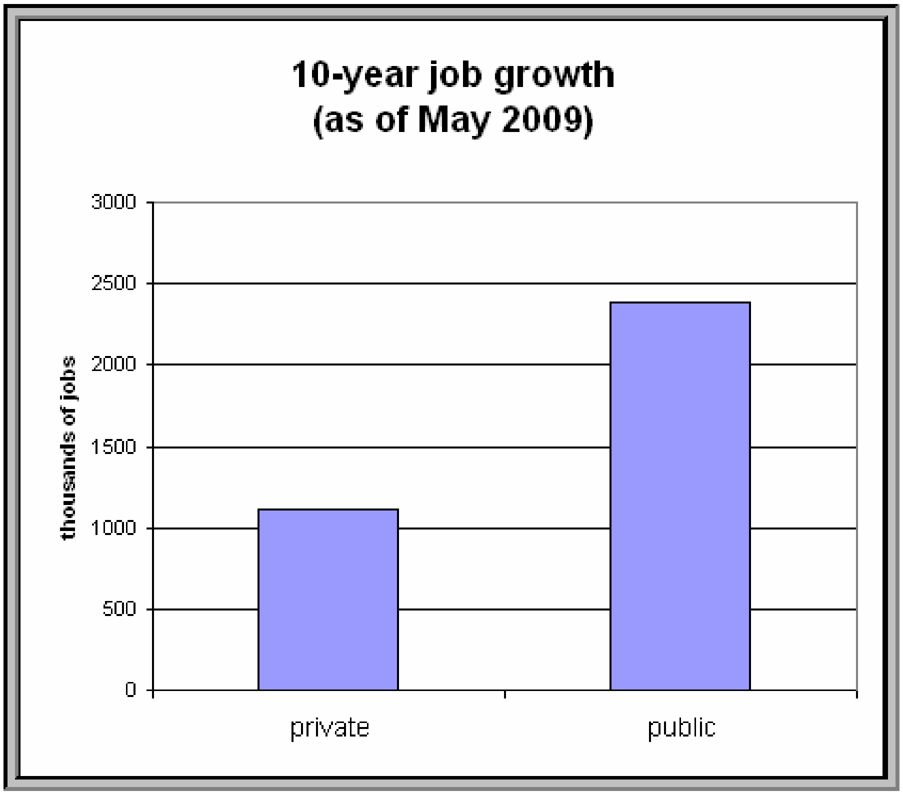


Source: Michael Mandel, www.businessweek.com

However, what is to be concerned about in advanced economies like the US is that not only the private sector is hardly generating any additional jobs (over the last ten years just 1.1 million in the US), but also the quality of jobs created, and the explosion of government-related jobs. Over the last ten years the public sector created 2.4 million jobs (see Figure 5).

© Copyright 2009 by Marc Faber Limited - All rights reserved

Figure 5: US Private and Public Sector Job Growth 1999 - 2009



Source: Michael Mandel, www.businessweek.com

In other words, the dynamic sector of the economy – the private sector – is hardly expanding whereas the mostly unproductive government sector is exploding. The State is becoming an increasingly powerful state within the State! Not good for one's personal freedom in my opinion! Nor, for that matter, for one's future tax liabilities!

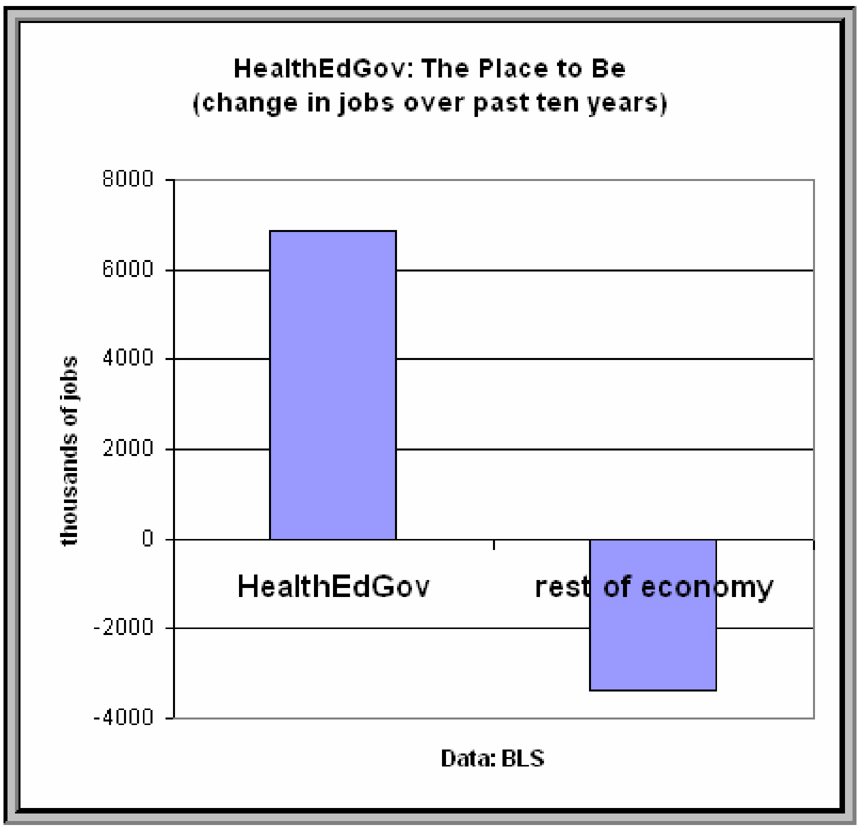
I should also like to stress that we need to look not just at economic growth statistics, but also at the quality behind the numbers. If GDP increased by 5% and growth came from additional credit and consumption, it would be of far inferior quality than if this growth came from capital investments and additional savings! In this respect US economic growth in the last ten years (if there was any at all) has been a catastrophe, a fact which is supported by the employment figures I just discussed (see Figures 4 and 5). Along similar lines the quality of employment growth has been dismal. Just consider the sectors which grew fastest over the last ten years (in 1000). Private healthcare: + 2,898, food and drinking places: 1,567, government education: 1,390 (please note that the US has one of the lowest educational standards among the

© Copyright 2009 by Marc Faber Limited - All rights reserved

advanced economies), professional and business services: 885, government ex health and education: 843, social assistance: 796, private education: 772, arts, entertainment, and recreation: 188.

Moreover, when we consider that private sector includes private healthcare, social assistance, and private education, that is, sectors which all receive significant government support, the employment growth picture is even worse (see Figure 6). I should add that over the last ten years manufacturing lost 5,372 million jobs. In other words, high paying manufacturing jobs have been eliminated and replaced by low paying healthcare and restaurant jobs (mostly nurses, helpers, and waiters).

Figure 6: Job Creation In Health Care, Education, and Government



Source: Michael Mandel, www.businessweek.com

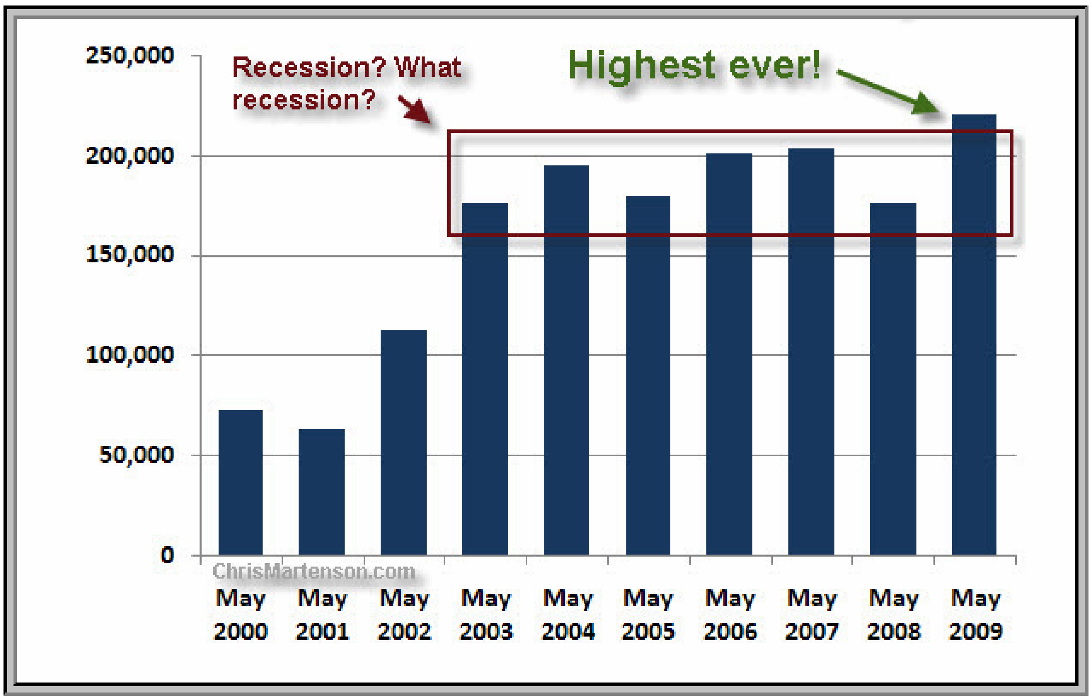
I should like to add a comment concerning government education, which added 1,390 million jobs over the last 10 years. A few years ago, after having read one of my reports, which painted a dismal picture of US employment and education, a professor from California contacted me who was an expert in education and had written books about it. According to him, all the jobs created in public education in California in

© Copyright 2009 by Marc Faber Limited - All rights reserved

the last 10 years had been in administration, but no additional teachers had been employed. Just so that you know that employment gains in public education may not increase educational standards!

One last point about employment in the US: the above statistics are based on government statistics compiled by the Bureau of Labor Statistics (BLS), whose credibility is badly tarnished. Can you believe that in May 2009, in the midst of the worst economic contraction since the Depression, the BLS added a record number of “phantom” jobs through Birth Death Adjustments (see Figure 7)?

Figure 7: Birth Death Adjustments Create Phantom Jobs



Source: Chris Martenson, www.chrismartenson.com

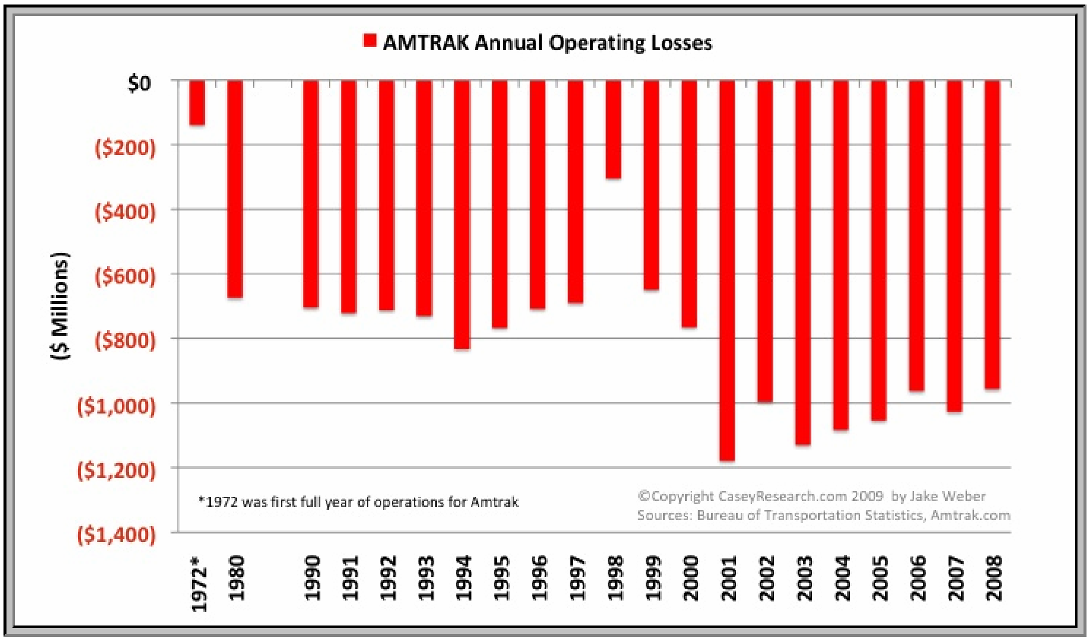
How “incredible” the BLS adjustments are, which have a positive spin on the employment situation, is evident from the fact that the BLS somehow created (statistically) 43,000 construction and 77,000 leisure and hospitality jobs when we all know in what dire conditions these two industries find themselves! All I can say is: beware of government compiled statistics (including the growth figures published by the Chinese government, which are certainly not supported by export figures from its main trading partners).

Needless to say that without the Birth Death Adjustments the unemployment rate would be far higher!

© Copyright 2009 by Marc Faber Limited - All rights reserved

So, unless you are interested in a government job, which nowadays tends to pay more than the private sector and provides very generous pensions (and they will be paid, although likely in worthless confetti money), I think that emerging economies offer better employment opportunities in the private sector. But if you are comfortable you will certainly find a job in Obama's government and for the best part of it you will never have to work for a profit! Just look at Fannie Mae, Freddie Mac, and Amtrak (see Figure 8). Surely, Government Motors has now plenty of job openings!

Figure 8: AMTRAK's Continuous Losses

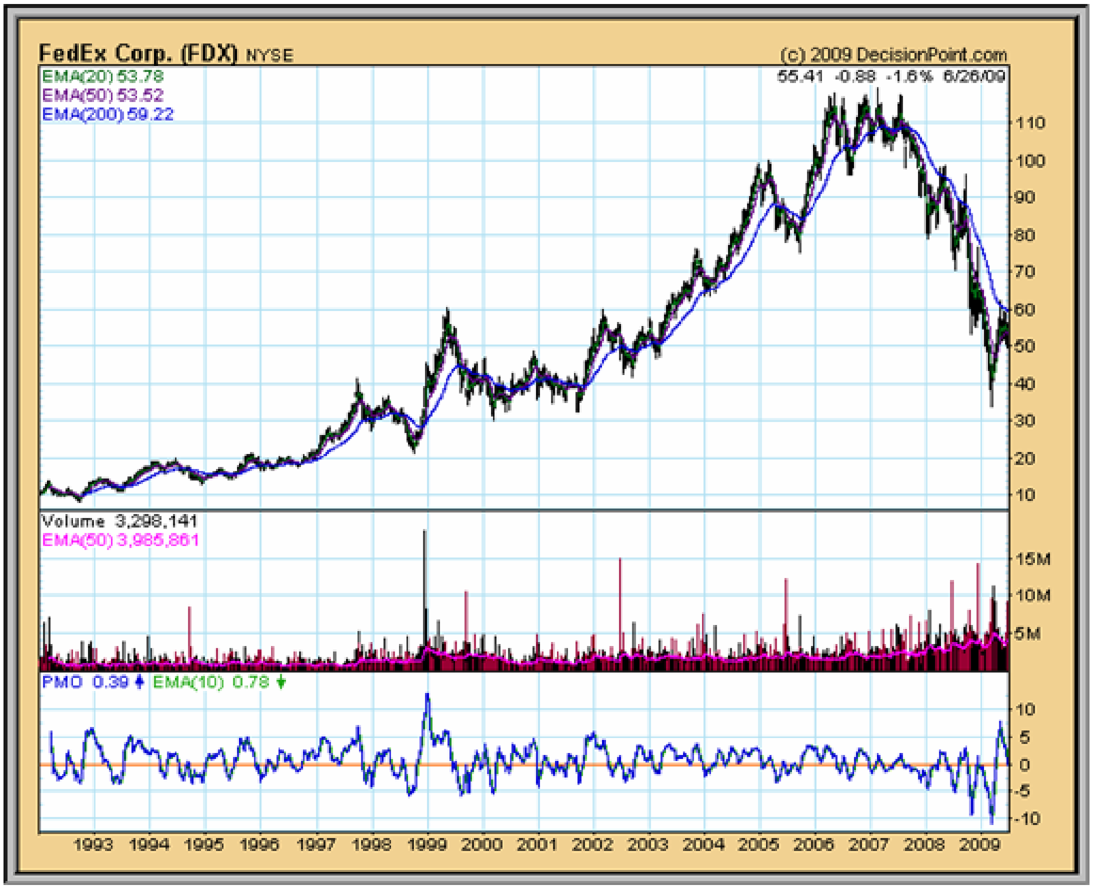


Source: www.CaseyResearch.com

The problem with government-run businesses is that usually they not only lose money, but that the services are also inferior to private sector companies. Look no further than at the US Postal Service and compare it to the efficiency of UPS and FedEx (Figure 9). (As an aside, it is interesting that some governments seem to be capable of running businesses efficiently – take the Swiss Postal Services and the railroads, the SBB, as an example - whereas other governments completely mismanage them.)

© Copyright 2009 by Marc Faber Limited - All rights reserved

Figure 9: FedEx – Does Not yet Signal a Global Economic Recovery!



Source: www.decisionpoint.com

All I wanted to explain above is that we live in a New World Order where growth and employment opportunities in the private sector are more promising in emerging economies than in advanced economies.

I should add that aside from getting emails about where to move to I also receive emails about what kind of jobs people should be looking for. I am neither a career consultant nor an employment agency (and we do not hire any staff at present – so please do not send me your CV) but my advice is to do something in which you have a special interest and where your heart is. You may excel as a teacher, a business manager, a trader, in advertising, or as the best mechanic for elevators or Mercedes cars. Money will come to you as a bonus for your diligence, reliability, kindness, and hard work. The opportunities are wide open. But if you neither know where to go nor what to do, then read Paulo Coelho's Alchemist (read it anyway) and watch this video on youtube: (http://www.youtube.com/watch?v=zlfKdbWwruY).

© Copyright 2009 by Marc Faber Limited - All rights reserved

Investment Observations

Earlier this year it was easy to call for a strong rebound in asset markets. Markets were extremely over-sold and sentiment was extremely negative. This is no longer the case (see Figures 9 and 10).

Figure 10: Financial Stocks Are no Longer Oversold

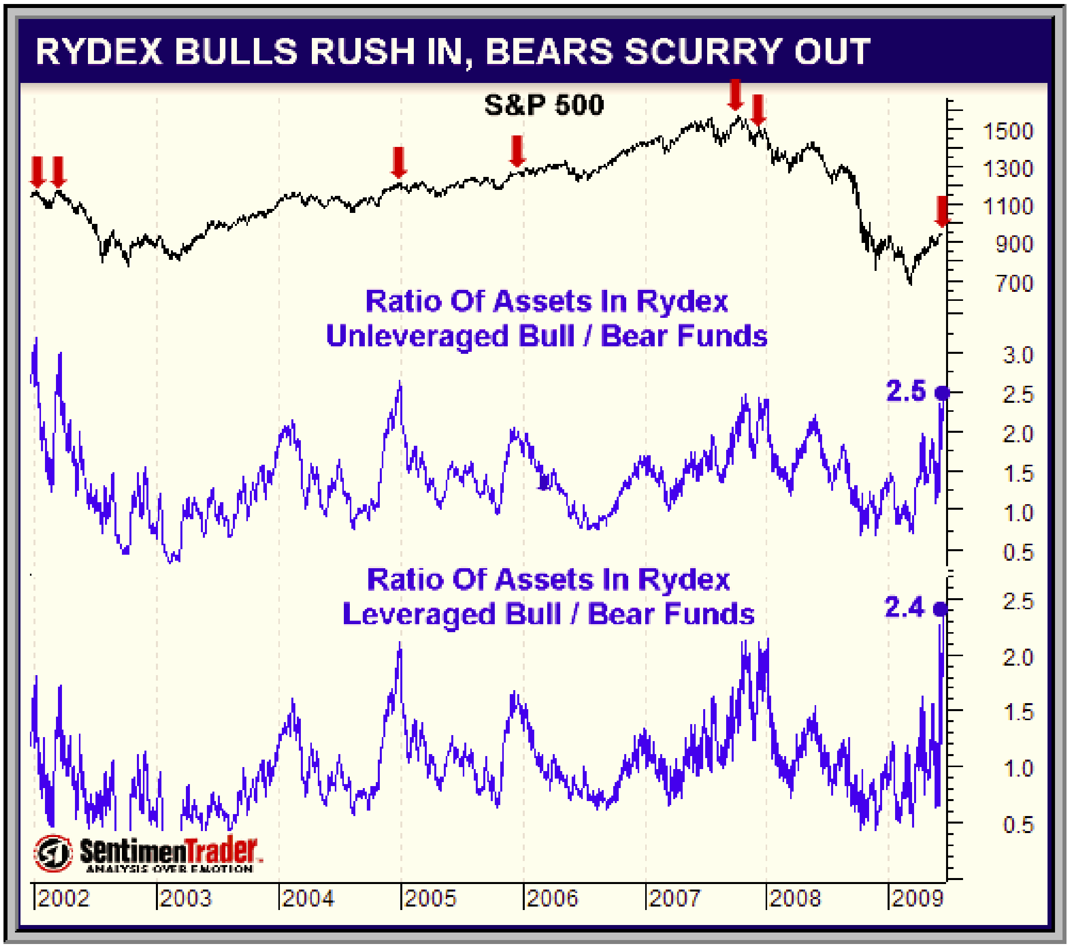
Source: www.decisionpoint.com

FedEx (FDX), a good indicator of economic activity around the world, fell from $ 121 in March 2007 (please note FDX peaked out long before the stock market) to $ 34 in March of this year and has since rebounded to $55. The financial sector ETF (XLF), which includes various financial service stocks, had fallen from $38 in June 2007 to less than $6 in March 2009, but has since rebounded to over $12. So, whereas at the lows in March 2009 the market was deeply oversold and sentiment extremely negative with assets in Bull Funds relative to assets in Bear Funds near

© Copyright 2009 by Marc Faber Limited - All rights reserved

record lows, now expectations are running very high that a major low has been reached – in fact bullish sentiment is higher than at the 2007 peak (see Figure 11).

Figure 11: Assets in Rydex Bull Funds Relative To Assets In Bear Fund

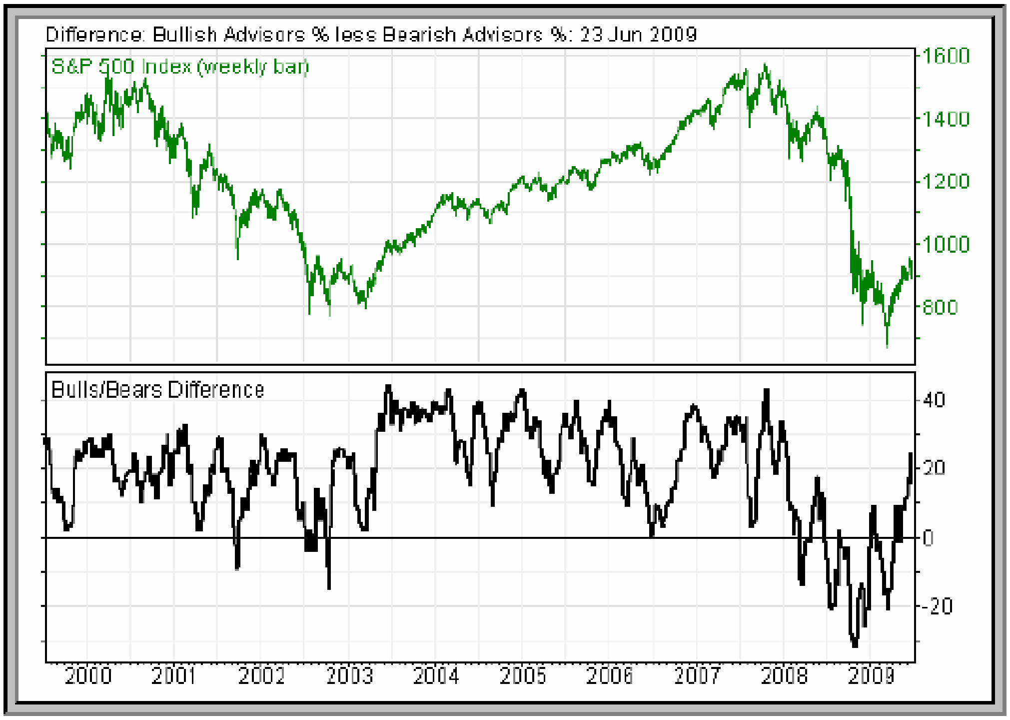


Source: www.sentimentrader.com

However, whereas most investors are positioned for a continuation of stock price increases (I do not know anyone who is net short the stock market), I do concede that bullish sentiment among investment advisors is not yet at extremes associated with stock market tops (see Figure 12).

© Copyright 2009 by Marc Faber Limited - All rights reserved

Figure 12: Bullish Sentiment Not yet at an Extreme!



Source: www.investorsintelligence.com

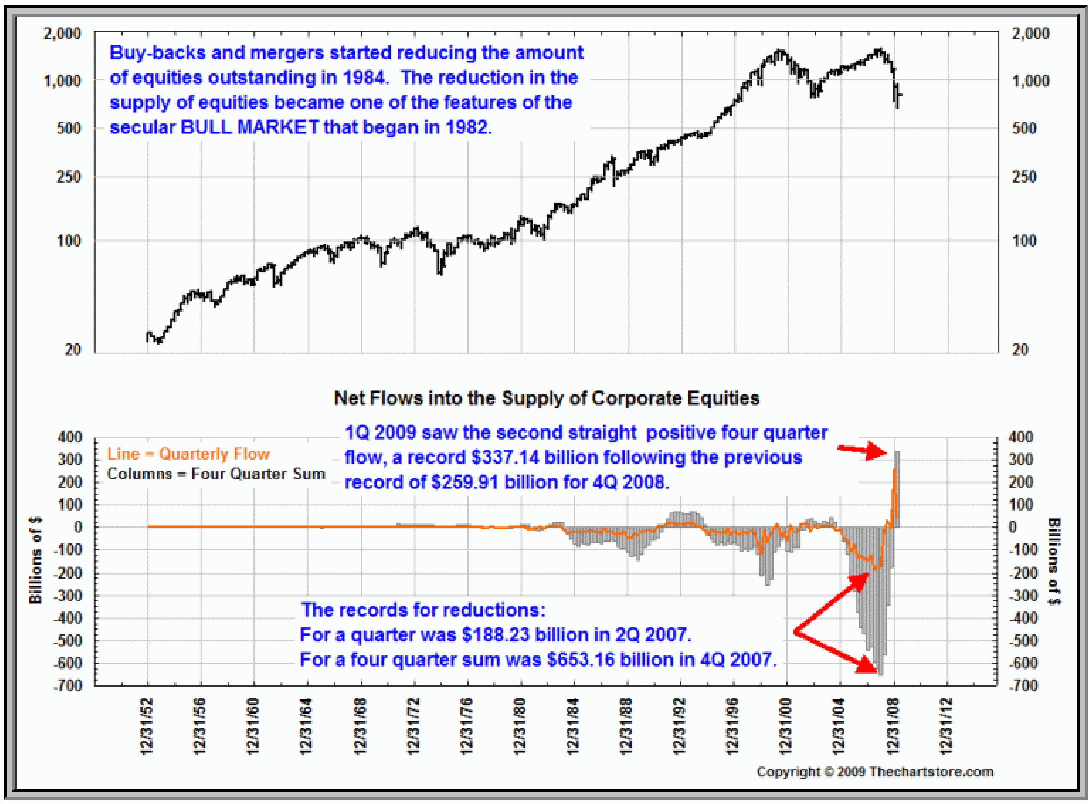
Also to consider is that cash positions are large as most investors missed the March to June 11 rally (S&P high at 956) and that there is very little resistance between 980 and 1200 on the S&P 500 (see Figure 12). On the other hand there is some resistance around 950 on the S&P 500. Worrisome is that corporate insiders have been selling at an extremely high pace. The last time there were more US corporate executives reducing their stock holdings than increasing them was in June 2007 shortly before the stock market topped out. According to Bloomberg, "executives at 252 companies in the S&P 500 unloaded shares since March 10, with total net sales reaching $1.2 billion, according to data compiled by Princeton, New Jersey-based InsiderScore, which tracks stocks. Companies with net sellers outnumbered those with buyers by almost 9-to-1 last week, versus a ratio of about 1-to-1 in the first week of the rally."

Please do not misunderstand me! It is not that I have a high regard for the intellect of corporate executives nor for their desire to enrich shareholders. But when it comes to their own money they are reasonably astute!

© Copyright 2009 by Marc Faber Limited - All rights reserved

Another negative for the stock market is that the demand supply situation has deteriorated. According to TrimTabs Investment Research, prior to May 2009 the highest level of share issuance in a given month was $38 billion. May brought about a new all time record with monthly sales totaling $64 billion! As can be seen from Figure 13, the bull market of 2003 to 2007 was partly driven by a reduction of shares outstanding through buy-backs and M&A activity (leveraging). Now, however, deleveraging is the order of the day and share issuance is running at a record.

Figure 13: S&P 500 and Net Supply of Equities, 1952 - 2009

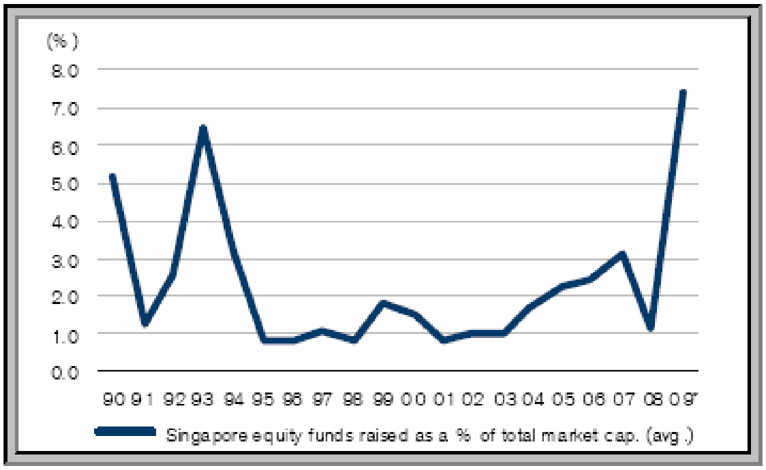


Source: Ron Griess, www.thechartstore.com

Share issuance is also running at a record level in many foreign markets and is diluting existing shareholders. In Singapore, equity funds raised as a percentage of total market capitalization is at an all time high (see Figure 14).

© Copyright 2009 by Marc Faber Limited - All rights reserved

Figure 14: Singapore Equity Funds Raised As A Percent of Total Market Capitalization

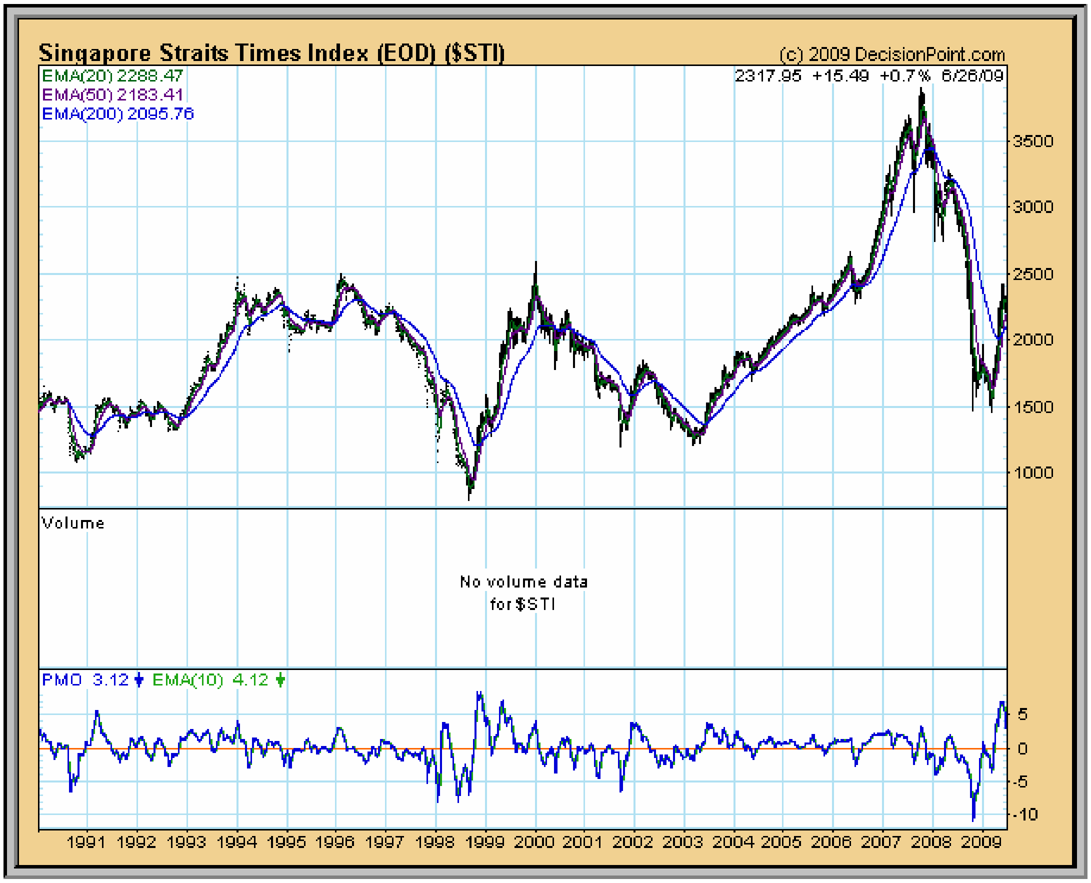


Source: Kim Eng Securities

High insider sales, high share issuance, and the market's near term overbought condition does not necessarily imply an immediate decline in equity prices, but indicate that stock markets are facing - aside from a likely anemic economic and corporate profit recovery - some strong headwinds. It should be noted that in 1993, the last time Singapore share issuance was running at a record, the market continued to advance well into 1994 (see Figure 15). Also, concerning the overbought condition of stock markets, we can see that in 1998, the Singapore market reached an extremely overbought level very soon after its low. However, thereafter, the market did hardly correct and continued to advance until 2000 (see bottom of Figure 15).

© Copyright 2009 by Marc Faber Limited - All rights reserved

Figure 15: Singapore Straits Time Index, 1991 - 2009



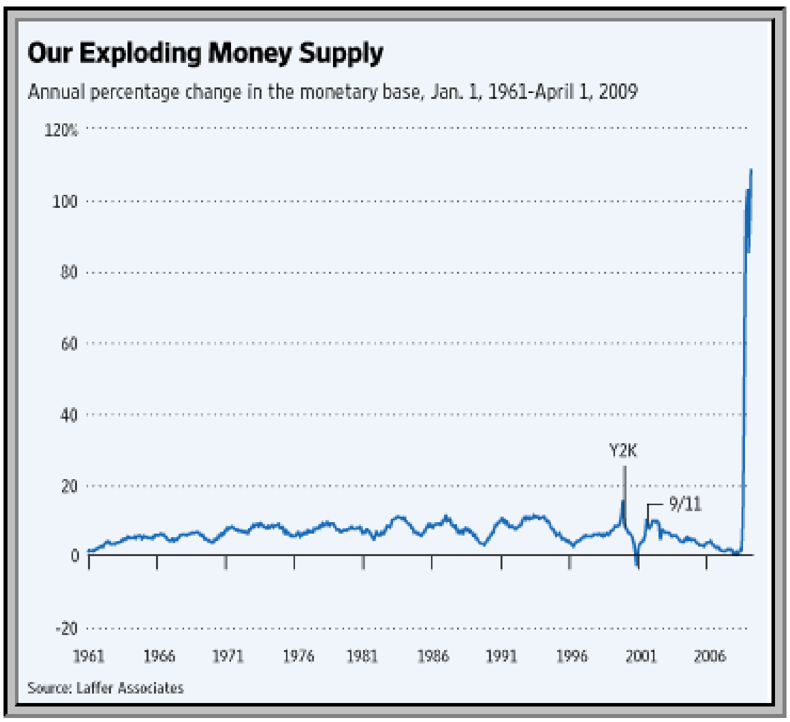
Source: www.decisionpoint.com

Therefore, a further rise in stock prices is possible despite several negative factors. It's just that the risks have increased following the stock markets' strong advances since the late 2008 or March 2009 lows (please note that many emerging markets bottomed out in October/November 2008). But, I tend to agree with Jack Bogle of Vanguard who in a recent interview expressed the following view: "When you ask about the next 10 years, I think the probabilities are very high that stock returns will be significantly above bond returns. I should say, and not at all parenthetically, that future bond returns are no secret. If you look at today's coupon, its correlation with the return on that bond is a mere .91. How could it be otherwise? If the long-term return on bonds is 8% and today's coupon is 5%, which do you think is going to tell you more about the future? We rely on the past but don't look at the sources of return! But that's the nature of my analysis on stocks as well as bonds: The sources of return. And the source of bond returns is the interest rate! Why don't

© Copyright 2009 by Marc Faber Limited - All rights reserved

we understand that? So, if we're not really in deep trouble as society and as an economy – and the chances are probably three out of four that we're in pretty deep trouble but the chances are also three out of four that we'll get through this – then we'll get back to something that approaches normal, although probably a slower version of normal. If I'm wrong on that, then my ideas about the probabilities of returns in the future are going to be incorrect. As the wonderful **Peter Bernstein**, bless his soul, would constantly remind us, you can bet that God exists or that God doesn't exist. But it's a question not just of the probabilities that God exists or doesn't exist, but of the consequences."(www.welling.weedenco.com). Well, there are chances we will **not** "get back to something that approaches normal" is there was a continuous period of deflation. But, as explained before, should the economy not recover soon, even more stimulus packages and more money would be printed (see Figure 16).

Figure 16: Annual Percentage Change in the Monetary Base



Source: Laffer Associates

Under these assumptions inflation would likely begin to accelerate and reduce bond returns while stocks could appreciate as money would flow

© Copyright 2009 by Marc Faber Limited - All rights reserved

out of cash (with zero return) and bonds, which would come under pressure.

Money printing is also likely to accelerate should the stock market sell-off again toward 800 on the S&P 500 (see Figure 12). For this reason I very much doubt that we shall see new market lows in the foreseeable future.

The consensus seems to think that we are in the midst of a correction and that thereafter the stock market will resume its rise toward 1000. A true contrarian would either argue for a new low below 666 on the S&P 500 (as some well-known strategists expect) or for the S&P 500 to soar within the next 12 months or so to 1200 (the view of some well-respected market technicians). Needless to say that such an upward move would also propel foreign markets up. In fact, they would likely outperform the US (see Figure 17)

Figure 17: Nikkei Average -Little Resistance Between 10,000 and 12,000

Source: www.decisionpoint.com

© Copyright 2009 by Marc Faber Limited - All rights reserved

I have to confess that I do not have a very strong conviction at this time. For the S&P 500 there is strong support around 880 and resistance around 950. I could envision a scenario where we break out briefly on the upside before a more meaningful correction unfolds. But as mentioned above, renewed weakness is likely to provide a buying opportunity.

In a recent survey of 200 European opinion leaders conducted by Global Europe, 91% of these “leaders” expected the US dollar to weaken further (see Figure 18). Time to make a contrarian bet?

Figure 18: Which Way, US Dollar?

Source: www.decisionpoint.com

Since March of this year until just recently there has been a shift of investors’ sentiment toward inflationary fears. Stocks and commodities rallied, the US dollar weakened and bonds tanked. **Personally, I would not be surprised to see for a while renewed deflationary fears developing with bonds rallying (as mentioned in last month’s report),**

© Copyright 2009 by Marc Faber Limited - All rights reserved

the US dollar rebounding and commodities and equities coming under renewed pressure.

Much will depend on economic growth in China about which I am highly skeptical. According to Gordon Chang, a sinologist and keen follower of economic developments, most of recently published economic figures "undercut the notion that there is growth in China at this moment. Take the first quarter of this year, for instance. When Beijing said that gross domestic product was up by 6.1 percent, exports were down (17.5% in January, 25.7% in February, and 17.1% in March), imports were down, consumer prices were down, producer prices were down, electricity consumption was down, sulfur dioxide emissions were down, water pollution was down, FDI was down, SOE profits were down, and government revenue was down. Unemployment was undoubtedly way up. In these circumstances, it is more likely than not that GDP declined."

Our friend Albert Edwards thinks that "we will look back on the Chinese economic miracle as the sickest joke yet played on investors" and that "the bullish group-think on China is just as vulnerable to massive disappointments as any other extreme example of bubble nonsense I have seen over the last two decades. The fall to earth will be equally as shocking."

Obviously, disappointments about growth in China (highly likely in my opinion) would be very negative for the prices of industrial commodities (including oil).

I have had many professional gamblers as friends and as clients (two of them made over $500 million – starting with nothing at all - by using computers to calculate the odds of bets on horses - I have seen the money, so it is no exaggeration). Most of the time the odds were not particularly favorable and they only took small positions. But once in a while, the odds were very favorable to take a large bet and that's when they made the big money.

Right now, I do not see anything that offers a particularly favorable risk reward opportunity and, therefore, I would take it easy. My doctor advised me "to cut back on predictions, "because as Mark Twain observed: "prophecy is a good line of business, but it's full of risks."

© Copyright 2009 by Marc Faber Limited - All rights reserved