In all Investments it is a healthy Thing Now and Then to Hang a Question Mark on the Ideas we Have long Taken for Granted

Marc Faber

The Monthly Market Commentary Report

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In all Investments it is a healthy Thing Now and Then to Hang a Question Mark on the Ideas we Have long Taken for Granted

"I don't think necessity is the mother of invention--invention, in my opinion, arises directly from idleness, possibly also from laziness."
Agatha Christie

"Where large sums of money are concerned, it is advisable to trust nobody."
Agatha Christie

"My idea of education is to unsettle the minds of the young and inflame their intellects."
Robert Maynard Hutchins

"Education is not the filling of a bucket, but the lighting of a fire."
William Butler Yeats

"The supreme accomplishment is to blur the line between work and play."
Arnold J. Toynbee

"Ordinary riches can be stolen from a man. Real riches cannot. In the treasury-house of your soul are infinitely precious things that may not be taken from you."
Oscar Wilde

"Give me golf clubs, fresh air and a beautiful partner, and you can keep my golf clubs and the fresh air."

Jack Benny

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Following my ruminations about education in last month's report- I received an email from Appi Borgen, one of my readers who resides in the Netherlands. He writes: "I just want to give you a short picture about education and the labor market in the Netherlands. They are similar to what you described. I run a steel-construction company, doing reasonably well, but we cannot find workers. The work we do is not very high-tech, but it needs skill (welding) and our workers need to know how to read architectural plans and they require the necessary experience.
Since the government decided 15 years ago that we were to become a knowledge-based economy, most education that had to do with manual labor was scrapped. Thanks God we can still find people from ex-communist countries, like Slovenia, Hungary etc. But even these people are getting older and their children learn other stuff. How we can still build, carry out maintenance work and renovate old structures in the future? No idea. The Chinese will unlikely come to renovate the antique buildings on the canals in Amsterdam. Personally, I don't really care, I see my pension on the horizon and I shall be sipping gin-tonics in the sunset of one of our old colonies by then! Meanwhile my daughter studied Fashion Management in higher education. Now she heard that her diploma is worthless, because of corruption and low standards in the educational system. She spent 4 years to get it......"

I am bringing this up because I hear the same stories in Switzerland where to find skilled labor is extremely difficult. In addition, I had the pleasure of spending some time in January in Regina (capital of Saskatchewan), Saskatoon (also in Saskatchewan where the world's largest publicly traded uranium company- Cameco and the world's largest potash producer - Potash Corp - have corporate headquarters), Edmonton (capital of Alberta) and Winnipeg (capital of Manitoba). I should mention that these small Canadian cities are all very nice and charming but obviously, January when the temperature usually drops below minus 40 Degrees Celsius - is not the best time for a visit. The cold weather forced me to spend a lot of time at the hotel bars and in Regina - I was told by the barman that his colleague just bought a house for close to Canadian $700,000. I almost fell off my chair upon hearing this "high price" for an ordinary home - as I was told - because if there is an abundance of something in Regina it is an abundance of land. The population

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density of Canada is just 3.4 people per square Kilometer (in the US population density is 34 people per square Kilometer) and in Saskatchewan it is just 1.7! Dean- the barman, then explained that the reason prices were so high was due to the mining (mostly potash and uranium) and agricultural boom, which had led to a strong inflow of immigrants. At the same time there was in Saskatchewan - a shortage of skilled construction workers. Hence, there was also a lack of new construction which explained the high prices for homes. I am mentioning this because I feel that there is still a lack of understanding among investors about what ‘inflation’ and ‘deflation’ is all about and about the investment implications of these conditions. Under globalization, **leakages** do exist. Money printing in the US may not necessarily and immediately lead to sharply rising consumer prices in the US itself but the symptoms of monetary inflation can occur outside the US e.g. rising wages in China and soaring property prices in resource producing regions. Similarly, money printing by the US Federal Reserve and the ECB (see below) has led to depreciation in the purchasing power of these regions’ currencies compared to the currencies of boom countries such as Australia and Canada (see Figure 1).

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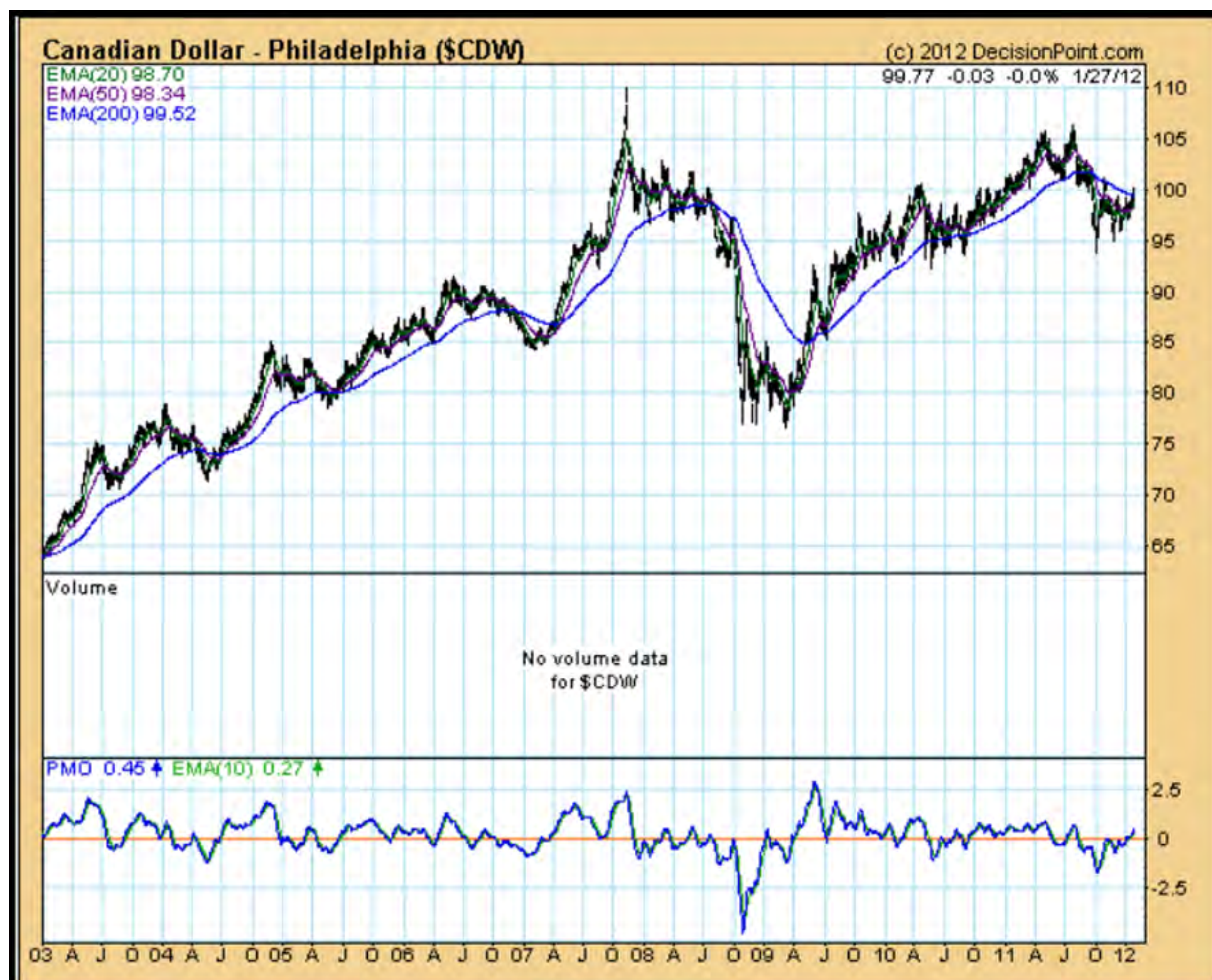
Figure 1: Canadian Dollar, 2003 - 2012



Source: www.decisionpoint.com

So whereas an American may be under the impression that there is little inflation in the US (for sure cost of living increases are higher than what the CPI published by the BLS implies), once he travels to Canada he will find that prices in Canada are far higher than five years ago. What I really want to reiterate is that the symptoms of monetary inflation will show up somewhere: either in wages or in corporate profits (as was the case recently) or in consumer, commodity, art, real estate, stock and bond prices - or in the appreciation of currencies. But somewhere monetary inflation will manifest itself. Moreover, the viciousness of monetary inflation is that its symptoms will not show up

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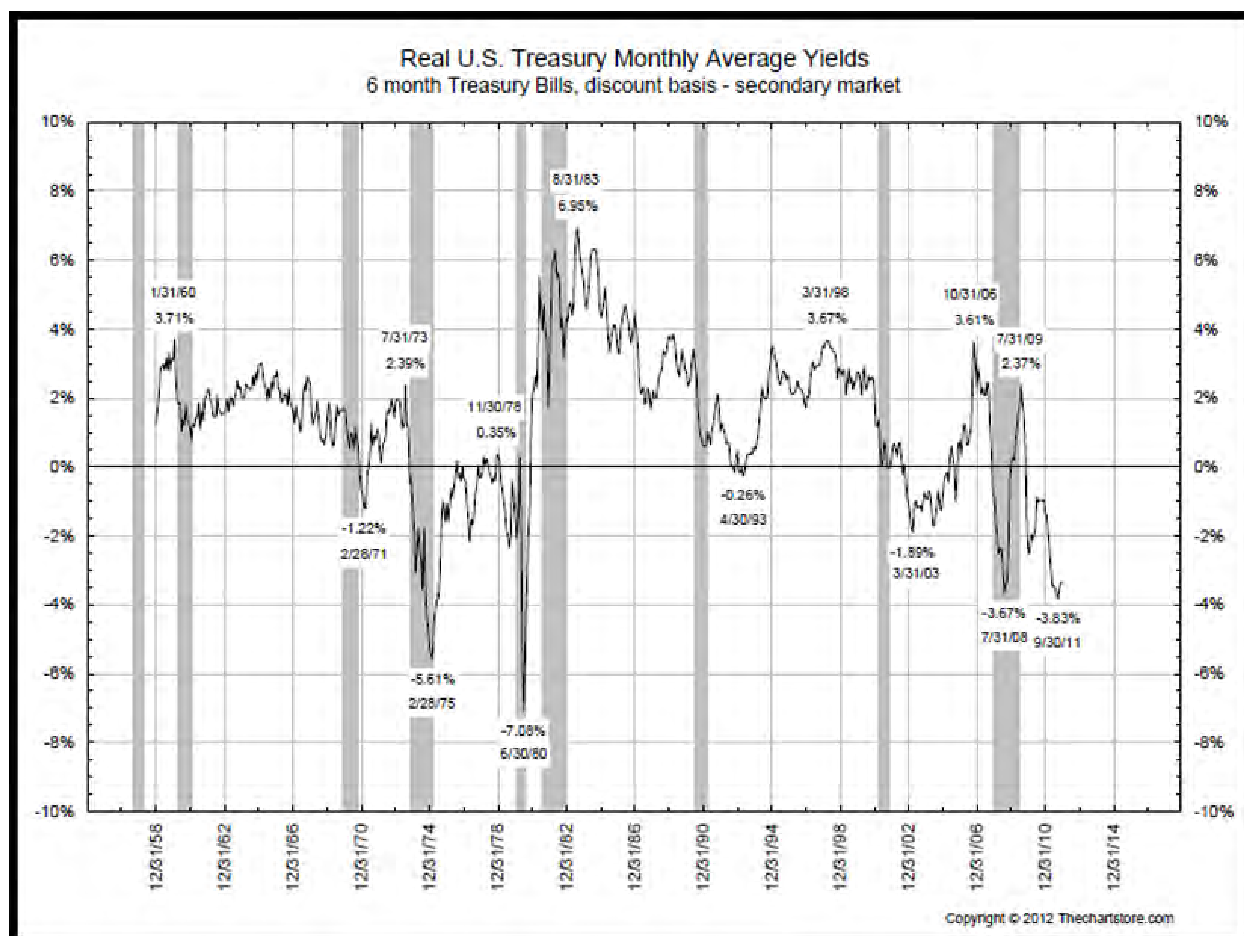
evenly and **simultaneously** but they will shift from one sector or region to another and lead to extreme economic and financial volatility. This is particularly true in an environment of negative real interest rates, which punish over time cash holders and therefore, increases the propensity to speculate (see Figure 2).

Figure 2: Negative Real Interest Rates Punish Cash Holders and Encourage Speculation (Real 6-Months Treasury Bill Rates, 1958 – 2011).



Source: Ron Griess, www.thechartstore.com

Above, I mentioned that monetary inflation will also lead to increased economic volatility. In the US, American Multinationals have reduced their payroll

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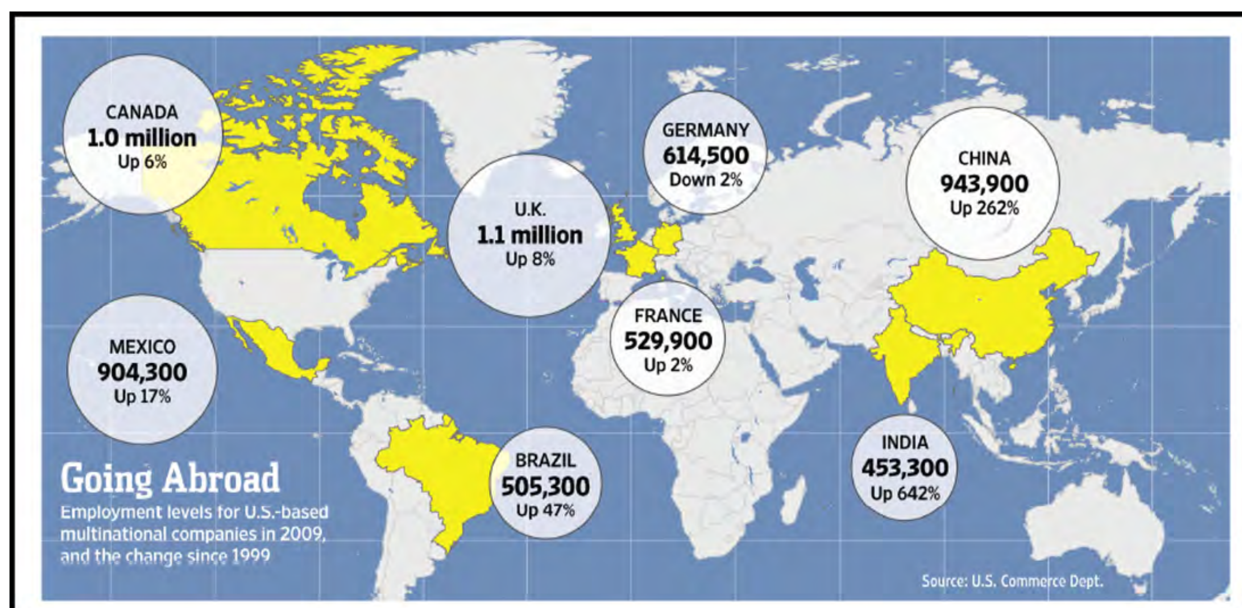
between 1999 and 2009 by 864,000 workers whereas they increased them by 1.5 million workers in Asia and 477,500 in Latin America (see Figure 3).

Figure 3: Employment Levels for US-Based Multinationals in 2009 and Change since 1999



Source: US Commerce Department, The Wall Street Journal

I am not implying that expansionary monetary policies were solely responsible for US Multinationals to shift employment overseas. The US housing bubble however- diverted capital from productive enterprises into senseless speculation, fostered overconsumption and brought about a collapse in savings and net capital investments (see Figure 4). And while I believe that in economics nothing is written in stone, it should be clear that economic policies which encourage the formation of bubbles (Professor Krugman's medicine for bringing about prosperity) and overconsumption lead by definition to a decline in savings and net investments.

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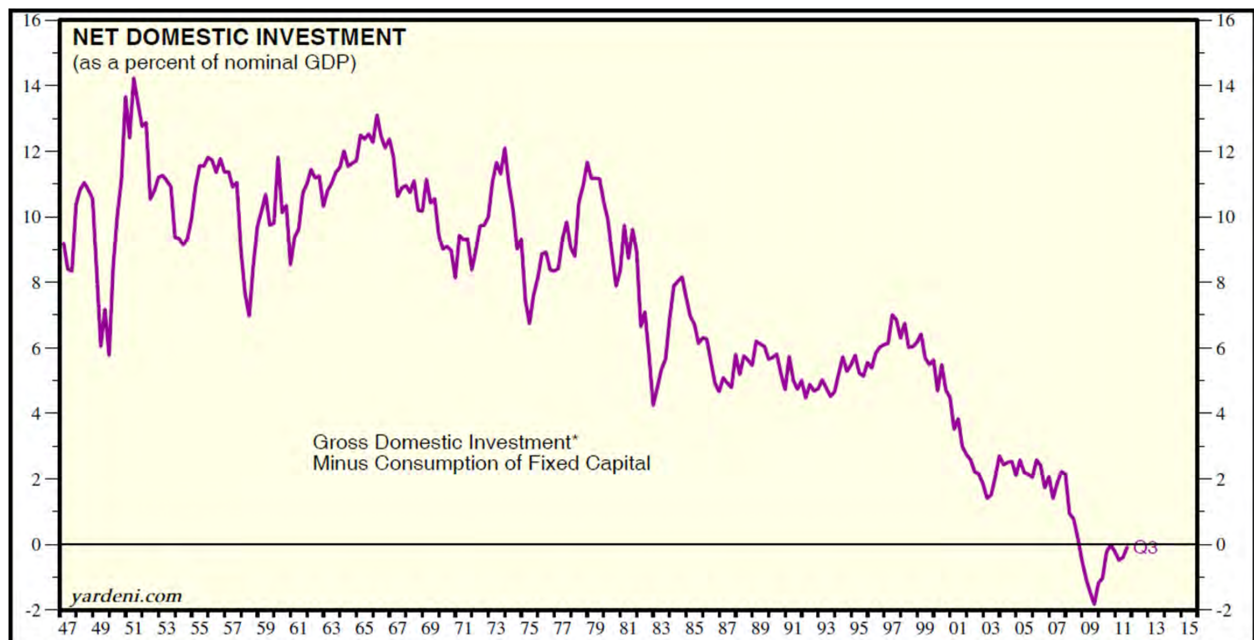
Figure 4: Net Domestic Capital Formation as Percent of Nominal GDP, 1947 - 2011



Source: Ed Yardeni, www.yardeni.com

To be fair, I need to add that easy money and a rapid expansion of credit can lead to a capital-spending boom. This was the case in the late 1990s when capital spending in the media, telecommunication and high tech sector expanded rapidly. Expansionary monetary conditions then lead to **over-investments** and subsequently to a capital-spending bust. Once there are overcapacities in a sector of the economy (oil exploration in the late seventies, high tech after 1999, US housing after 2007 etc.) no matter how much money is injected into the economy - the sector where over-capacities developed remains depressed for years. As a rule I would say that - the longer the capital-spending boom lasted and the greater the boom was - the longer the subsequent slump will last. I am bringing this up because some investors have been surprised by the extreme weakness in the Baltic Dry Index which declined by 44% in 2011 (see Figure 5).

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Figure 5: Baltic Dry Index, 2003 - 2012

Source: www.decisionpoint.com

Surely, demand is weak in China, particularly for iron ore (in December Chinese imports from Japan and Taiwan fell by 16% and 6% year-on-year respectively) and the global economy is slowing down. However, the global economy is in far better shape (superficially) than it was at the depth of the slump in late 2008. Global exports are at an all time high and yet the Baltic Dry Index is close to a record low (see Figure 6).

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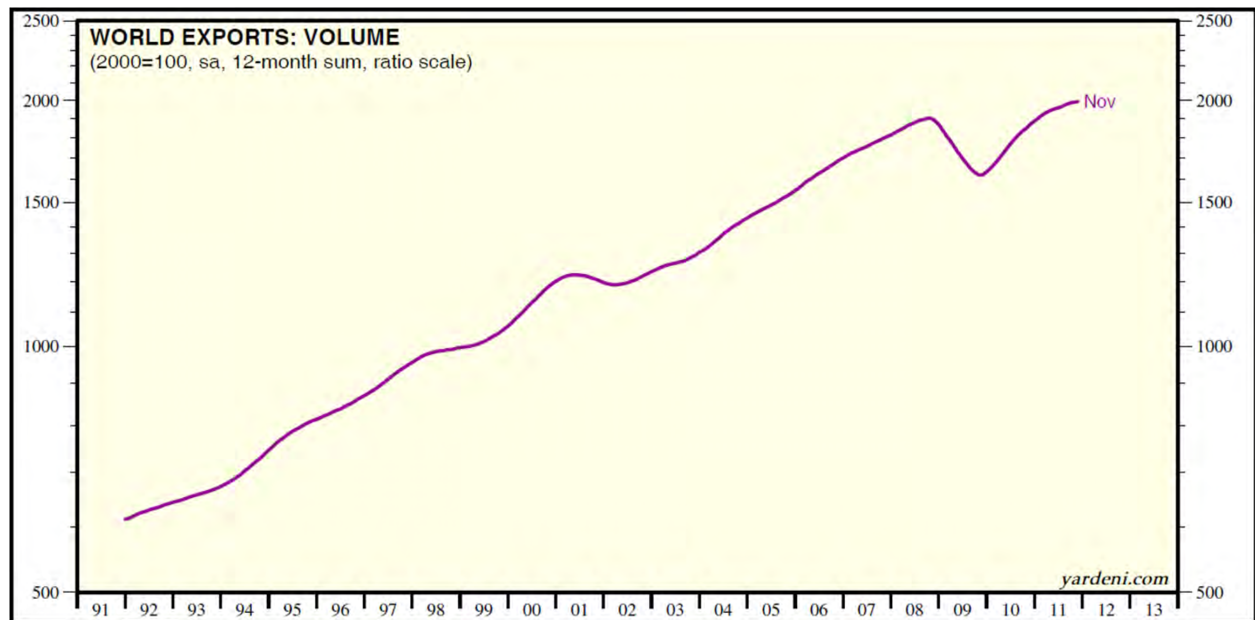
Figure 6: World Exports (Volume), 1991 - 2011



Source: Ed Yardeni, www.yardeni.com

Therefore, the slump in the Baltic Dry Index is not so much due to weak demand but due to continuous oversupply as ship-owners are now forced to take delivery of the ships they ordered during the 2006-2008 boom (see Figure 5). I should add that another reason for the Baltic Dry Index hovering near the 2008 lows could be that ship-owners are anticipating a slump in global exports! Above I mentioned that the global economy was in a far better shape 'superficially' than at the depth of the recession in early 2009. Yes, economic conditions have improved compared to the depressed conditions we had in 2008/2009 but only thanks to a "crack up" boom brought about by huge monetary and fiscal stimulus measures for which, there will be a price to pay at some point in the not too distant future (Ludwig von Mises: "There is no means of avoiding a final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as a result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved").

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The December 1, 2011 report concluded that we are "entering the strongest seasonal period of the year (December and January)" and that "rest assured, there will be QE3 and massive monetization in Europe in one form or the other! A strong rally would therefore not surprise me (European markets have also strong rebound potential). However, as I explained earlier - investors should not expect new stock market highs due to the huge overhead supply."

On a previous visit to Canada last year, I went to Halifax in Nova Scotia. As an aside, I consider traveling as an important part of one's education. I make it a point to go every year with my family or 'alone' to some new places in the world because new ideas arise frequently "from idleness" and "possibly also from laziness." More so, the art of living consists of blurring "the line between work and play." Anyways, in Halifax I met Keith Dicker who manages IceCap Asset Management and whose views - echo to a large extend my own views - about "money printing" and "expected returns" from investments. I let him therefore share his views with my readers and I shall then follow with some more investment observations (I have no business relationship with him).

IceCap Asset Management Limited

Global Market Outlook

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January 2012 – Great Expectations

Most Canadian pension funds are banking on 7% annual returns forever. Over the next few years, this unrealistic expectation will cost the respective governments and companies millions in shortfalls.

In the USA, the California Public Employees Retirement System assumes it will earn over 7.75% annual returns. This false hope will result in over $6 billion a year in lower than expected investment income, that will also have to be paid by the financially challenged state (i.e. the taxpayers).

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Meanwhile, Thelma O'Keefe continues to quietly sock away 5% of her paycheck each and every week and has no idea what all the fuss will be about when she is eventually told her pension benefits will be *slightly less* than originally promised.

Over 50 years ago, the average worker started to earn pension benefits and has been dreaming of working less, and golfing more, ever since. The Defined Benefit Pension Plan has been the rock of this dreamy foundation and is certainly a costly beast to say the least. Once the auditors, actuaries, custodians, lawyers, administrators, consultants, performance measurement guys, trustees and investment managers have been paid for their services, is there little wonder most of these retirement funds are running a little short.

Yet, the primary reason most people fall asleep with even a slight mention of the words "pension funds" is due to the complexities and confusion resulting from this cumbersome investment scheme.

However, after 3 quick espressos you'll see that the entire pension spectrum boils down to an educated guess as to how much money the pension plan will have to ***pay out*** to its retirees, and how much money its investments will ***pay in*** to the pension plan itself.

This "pay-out-in" dynamic is a precarious balancing act to say the least. Should guesstimates for either one fall short, the difference will have to be made up by tax payers for government pension plans, and by profits for company pension plans.

It is widely known by now that practically every government in the Western World is drowning in debt with no signs of growth anywhere on the horizon. Unfortunately, this looming pension funding problem could not have come at a worse time for these government supported pension funds.

Meanwhile, most companies are certainly flush with cash and are infinitely better off than their public pension fund counterparts. However, even this enviable position will not help due to the expectations of great stock and bond market returns.

Ever since the Western World pushed the ***debt envelope*** too far and proceeded to allow its governments to orchestrate one ill conceived bailout after another, investors of all shapes and sizes – including billion dollar pension funds and the

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little old ladies, have had to push their ***risk envelope*** too far and assume way too much risk in an effort to increase their investment returns.

All non-investment humans would certainly agree that this excessive risk taking is a touch unfair. However, this unfairness will turn into deep skepticism once this group realizes that they've been lead down the garden path.

How did this happen?

They say no one remembers the 60s, or even the 70s for that matter. In the investment industry, this forgetfulness is one of convenience. During these awful investment years, the average person didn't hold any mutual funds – buying stocks and bonds was a rich man's game. The relentless rise in interest rates from 5% to 20% successfully put the inflation genie back in its bottle yet it also produced a horrible period for stock and bond investors.

In the early 1980s mutual funds were becoming mainstream, and financial markets were just embarking on a golden age. Unknown to many at the time, 20% interest rates were about to become a fable from the past, and the pivot point to a romantic 27 year period of warm and loving returns for both stock and bond investors as well as a boon to every person to enter the investment profession during that time.

As with every mystery, the key to solving it lies with simply following the money. And when it comes to stocks and bonds, the cost of money or interest rates, is the money to follow.

The reason why there is so much emphasis placed on interest rates is because they are *THE* most significant driver of investment returns. When rates rise and fall, they directly impact bond prices. As well, when rates rise and fall they directly affect PE (Price to Earnings) ratios, which happen to be the key driver of stock market prices.

The PE ratio is yet more industry jargon and can simply be viewed as a number that measures how much investors appreciate every $1 dollar of profit from a company. In general, the more investors appreciate a company, the higher the PE ratio.

The attribute of the PE ratio which makes it special however, is that it acts as a lever to a company's stock price. Ask any respected (or disrespected) company

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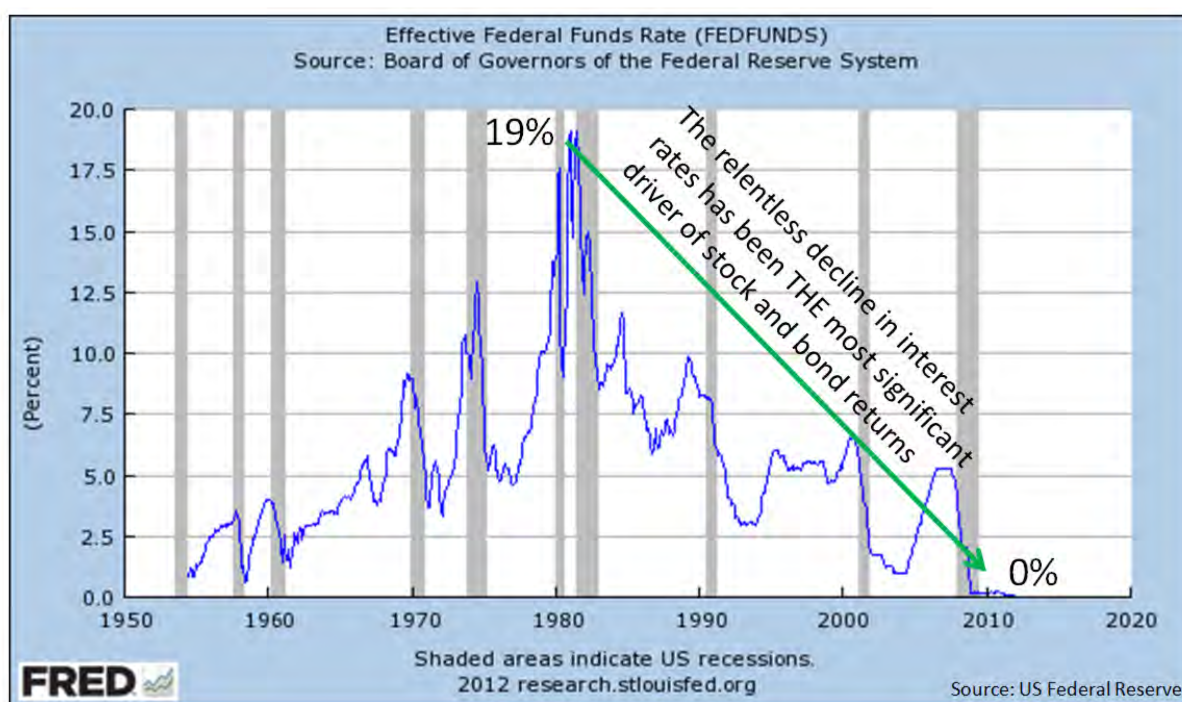
executive if they'd rather see their company's profits double or see the PE ratio double and you'll be surprised how unimportant profits are relative to the mighty PE.

Unfortunately, as mighty as the PE may be it will forever be greatly influenced by interest rates. And one thing is for certain, higher rates are not kind to this all important financial ratio.

We acknowledge that the price of money or interest rates have been changing since the dawn of time. ***Why should this time be any different?*** **Chart 1** below should clean up this false logic in a hurry. Simply put, interest rates cannot go any lower than where they are today, leaving "up" as the only long-term direction of change, which is inevitably bad for stocks and bonds.



Short term rates in every developed country are essentially at 0%. Meanwhile, long-term interest rates are also at all-time lows. Since 1981, interest rates have declined to never-before-seen levels. You can point to many reasons why rates have fallen, yet the fact remains every time rates have declined, stocks and bonds received an unprecedented boost to investor returns.

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The lack of space for interest rates to fall any further dramatically removes the wind from the stock and bond markets. This overly simplistic observation is the primary reason why future return expectations are unrealistic.

Today, the governments of Canada and the USA will happily pay you 2% a year for the privilege of lending them money for the next 10 years. The only way for these investors to earn greater than 2% is for long-term rates to decline further. Put another way, should long-term rates increase, this bond investor could very well lose money on their safest of bond investments.

Returning to the pension fund dilemma, it is quite obvious hitting a total return in excess of 7% from the bond market is beyond impossible. Let's assume the average pension fund has 40% of its money in bonds and is able to earn a generous 4% return from its bond holdings (by taking on a lot of risk). In order for the pension fund to achieve a 7% total return, it will need its stock portfolio to increase by 9%.

Most investment professionals are likely rolling their eyes at this point. After all, from 1980 to 2007 stocks ***always*** averaged greater than 9%. Yet, this back-slapping, gregarious group has chosen to conveniently ignore the fact that interest rates declined from 20% to 0% during this time frame.

There are however 2 scenarios that can propel stocks significantly higher. Since we know that it is unlikely (or downright impossible) for interest rates to go much lower, significant PE expansion is out of the question. The only other way for stocks to go higher is for profits to accelerate.

Since profit margins are currently near all-time highs, it remains unlikely that companies will be able to squeeze out additional profits by cost cutting or dare we say it – price hikes. This means the only other way for profits to grow is through good old fashion sales growth.

Considering US growth has stagnated at 2% while Europe is headed for -2% growth at best, and having just seen China downgrade their growth estimates, global GDP will be lucky to achieve a +2% to +3% annual growth rate. While the Japanese would give their left chopstick for +2% to +3% growth, the rest of the World has become quite accustomed to 4%+ growth. Needless to say, companies everywhere are going to be stretched to significantly grow their top line.

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All is not lost however. Pension funds (and investors everywhere) should know there is another, much simpler way for stocks to increase significantly and it only involves the push of a button.

It is not lost on anyone now that the World has too much debt and the governments involved absolutely refuse to let the ***real World*** act as it really should. By ***real***, we simply mean allowing banks to lose money on their bad investments – the bad debt has to be written off.

Most Western countries have borrowed and lived excessively beyond their means for many years. **Our charts on the next few pages shows for a fact that the World's central banks and their fondness with money printing are 110% committed to not allowing this debt pyramid to unravel.**

Unknown to many people is that over the last three years, extreme money printing moves have been and will continue to be implemented by these central banks. In another attempt to delay the inevitable, the Europeans have introduced the Long Term Refinancing Operation (LTRO) as their latest response to save the banks and Italy/Spain. There's no need to worry, IceCap will not lull you to sleep with the plan's details. All you need to know is that this is yet another way for Italy, Spain and every European bank to borrow more money indirectly from the European Central Bank for free.

The Italians and Spanish hail this plan a success. It has been so successful that markets are now expecting the European Central Bank to announce a second version of the LTRO. The net new amount created could easily top EUR 1 trillion. **For investors in the stock market, you should understand the propensity for the market to drive higher is now fully hitched to central banks and their propensity to print money.**

We completely believe that there is no free lunch anywhere in the World. While it may appear that one group is receiving a free lunch, there is another group paying the bill. Presently, global banks and sovereign countries are receiving the free meal. Meanwhile unbeknownst to many, conservative investors and tax payers are the ones actually receiving the bill.

For our pension fund readers, we ask you to be kind to your plan sponsor – it's not their fault market equilibriums have been distorted due to money printing.

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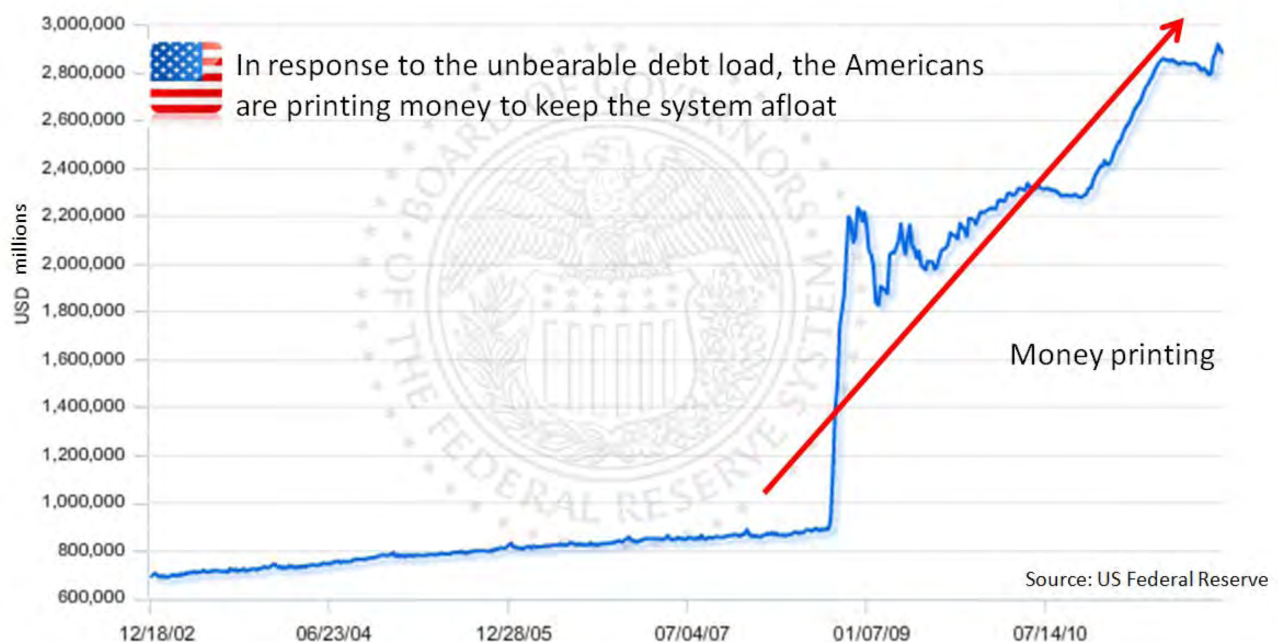
As a plan member however, it is your duty to ensure your plan's trustees are embracing their duty of care by grasping the importance of interest rates and their direct impact on long-term returns for both the stock and bond markets.

For our politicians, public servants and private plan sponsors, we suggest you invite your consultants in for a very long discussion about the level of interest rates and expected market returns. If you'd appreciate some support IceCap can help.

For everyone else, a similar and subtle (or direct) reminder to your financial advisor may provoke some interesting responses as well.



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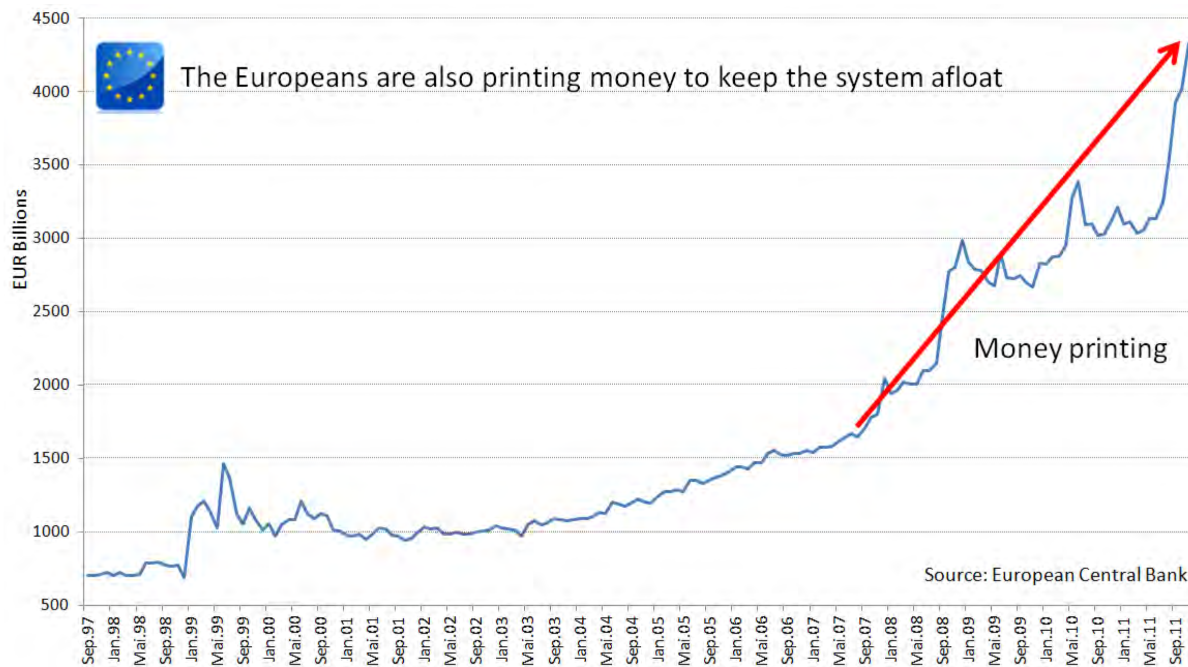

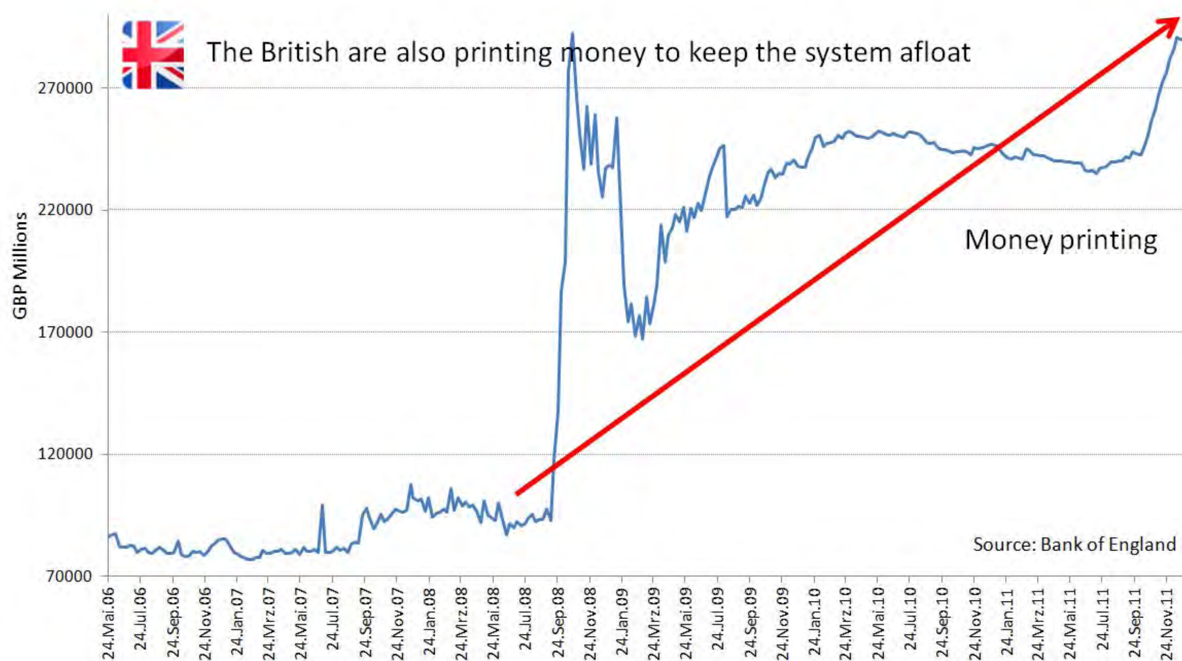

Game Over?

With a subtitle like this, one would think it wouldn't be buried on page 6 in our global macro outlook. Yet, what more can we say about Europe? Over the last 18 months, IceCap has beat this drum to a point where even Neil Peart would be proud. Day after day, month after month we strive to find more important

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investment stories to cover, yet, the allure of the upcoming European financial train wreck is impossible to ignore. And, quite frankly if it is ignored you do so at your own peril.

The latest action to cause greater consternation was the January 13th announcement by Standard & Poors that practically every European country except for Germany, Finland, the Netherlands and Luxembourg would have their credit ratings downgraded.

The impact is actually quite significant for several reasons. For starters, it means all of these countries will have to pay more interest when they borrow new money. Next, and most importantly – this inconvenience throws a huge monkey wrench in the main European bailout fund – the EFSF (European Financial Stability Facility).

Without confusing everyone with banal details, this enormous bailout fund has officially (unofficially, anyone without rose coloured glasses knew this all along) become a lot less functional. We believe the EFSF will dissolve into the sunset and be long forgotten about one year from now.

The final reason for all the hoopla surrounding this announcement is so elegantly demonstrated by the reaction from the French when officials responded that if France is downgraded, ***then Britain must also be downgraded***.

Truth be told, in the fantasy world of government sanctioned credit agencies, the French are actually correct with this statement. Yet, for the rest of us who do not live in this convoluted fantasyland one cannot help but to think of the pettiness amongst our World leaders.

While the entire preceding rambling may induce a deep sleep, we ask you to note the extent of the economic slowdown in all European countries. As of this writing we see the following:

1 – manufacturing is declining

2 – banks refusing to lend to people

3 – banks refusing to lend to other banks

4 – mounting job losses as companies prepare for the worst

5 – money supply growth plummeting

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So, what happens next?

It does appear that Greece may finally get their chance not to pay back their debt. Up to this point, the IMF and European Union have been lending money to Greece so that they can pay back previous loans to the IMF and the European Union – *yes, we cannot make this up*.

Once Greece defaults, it will not be pretty. For starters, the entire European financial system may freeze. In addition to Greece; Italy, Spain, Portugal and ever other European country will be scrambling to protect themselves and their banks. Meanwhile, governments and banks in North America and Asia will also be seeking to protect themselves.

Amidst the chaos, there will be one very important phone call – the European Central Bank will call the US Federal Reserve. We'd like to think they have already devised a cheeky code word similar to "blue horseshoe", yet regardless of what they say, we know what they will do – and that's press the shift-F7 key to begin printing a helicopter load of new money.

When you look at the amount of money that has already been printed and pushed to the banks, and the resulting muted impact on the economy we cannot help but be a tad concerned.

Let's face it, with the ECB and the FED covertly pushing over $3 trillion to the banks and it having a negligent impact on the broad economy, one should be very worried. The resulting trillion dollar question – "will the central banks continue with more of the same, or do something different?"

We expect another full on money printing assault by both the Europeans and the Americans. The trillion dollar question of course is whether they pull the trigger before or after a liquidity freeze.

The Europeans are likely to act before solely due them having the political capital to do so. The American money printers however are a little less fortunate as the 2012 Presidential Election is squarely in the way. With current data showing US growth and unemployment stabilizing, the US Federal Reserve cannot be shown to be doing anything to tilt the tantalizing World of American politics.

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Yet, should employment and growth data suddenly deteriorate then the Fed will certainly have a green light to start the printing presses once again. The other scenario to allow the Fed to begin printing again is a sudden liquidity freeze in Europe. We place a much higher probability on the latter at this point.

But, what if...

Current market chatter says the Greeks may actually strike a deal whereby private investors accept a 70% loss on their investments. Market reaction to this will undoubtedly be positive, yet the next reaction will certainly see the Irish and Portuguese governments also demanding the same treatment. Once that occurs, the momentum will then shift to Italy and Spain demanding the same treatment.

Before we know it, private investors everywhere will have taken their lumps and losses. Simultaneously, these same investors will refuse to lend new money to these deadbeat countries, leaving the ECB as the lender of last resort. By this time, the money printing machine will have easily cranked out in excess of EUR 3 trillion.

Yet (and this is an important "yet"), we may not get the chance to see this scenario develop. While the European profligate countries are receiving all the attention, let's not forget the very deep divide that is developing within Germany. The ultra strong German tradition of sound monetary policies remains alive and could very well ignite the not talked about scenario whereby ***Germany*** is the one who leaves the Euro-zone.

Both scenarios are bearish for the Euro, yet Germany leaving would be downright grizzly.

Our advice to Mario Draghi and the rest of the ECB – change your compensation structure to Deutsche Marks. It will be the best move of your career.

Our Strategy

2012 has gotten off to a nice start for the stock market. The increasing likelihood of additional money printing is also providing yet another boost to

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gold bullion. While bond markets have traded flattish, the real surprise has been the ongoing strength of the US Dollar.

For this short-term trend to hold, we'd need to see stabilizing economic data from the US and a return of private investors to the European funding markets. As headline data from the US seems ok at this time, European funding markets are effectively frozen. Based upon this very simple observation, financial markets are 110% relying upon additional help from the European Central Bank - should this not happen, we expect markets to revert back towards the stagnant holding period that has frustrated so many investors over the last 18 months.

In this environment, investors looking to become aggressive to make an extra buck or two may find themselves on the wrong side of the trade.

Our portfolios remain conservative, and well positioned for the eventual return of money printing from both the US Federal Reserve and the European Central Bank.

Shameless Self Promotion

Unlike American and European banks, and certain European governments, IceCap does not receive free money to support our lifestyle.

As always, we'd be pleased to speak with anyone about our investment management capabilities, as well as chat with pension funds about our new ***Global Investment Intelligence Service***.

Please feel to contact:

Keith Dicker at keithdicker@IceCapAssetManagement.com

Thank you for sharing your time with us.

As I said, I tend to agree with the views of Keith. US government bonds seem to be both from a short-term and longer-term perspective - pricey (see Figures 7 and 8).

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Figure 7: Commercials' Net Short Treasury Notes Position, 2009 – 2012

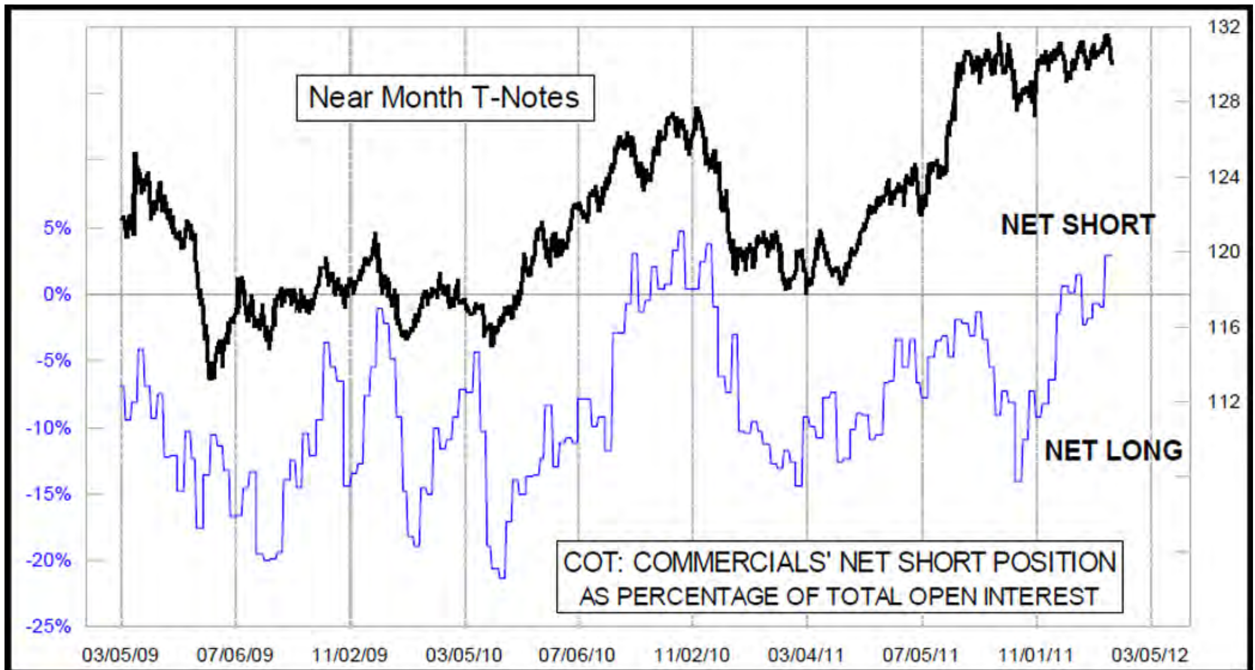

Figure 8: Continuous Near Month Treasury Bond Futures, 1980 – 2012

Source: Tom McClellan, www.mcoscillator.com

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Please note - how the commercials have had an almost perfect short-term market timing record. Net-long near intermediate market lows and Net-short near intermediate market tops (see Figure 7). In addition, it is clear that the bull market in bonds will eventually end. I should mention that - so far - the yield on the 30-Year Treasury bond remains above the low of 2.53% registered on December 18, 2008 (see Figure 9). I could therefore make the case that from a longer-term perspective - Treasury bonds yields are bottoming out and are likely to increase in future.

Figure 9: US 30-Year Treasury Bond Yields, 2006 - 2012

Source: Ron Griess, www.thechartstore.com

My friend Michael Gayed believes that 2012 will be a year of 'Reflation' and that the "bond bubble" will burst (see enclosed report). However, I am not yet shorting US long dated US Treasuries because the US stock market is currently

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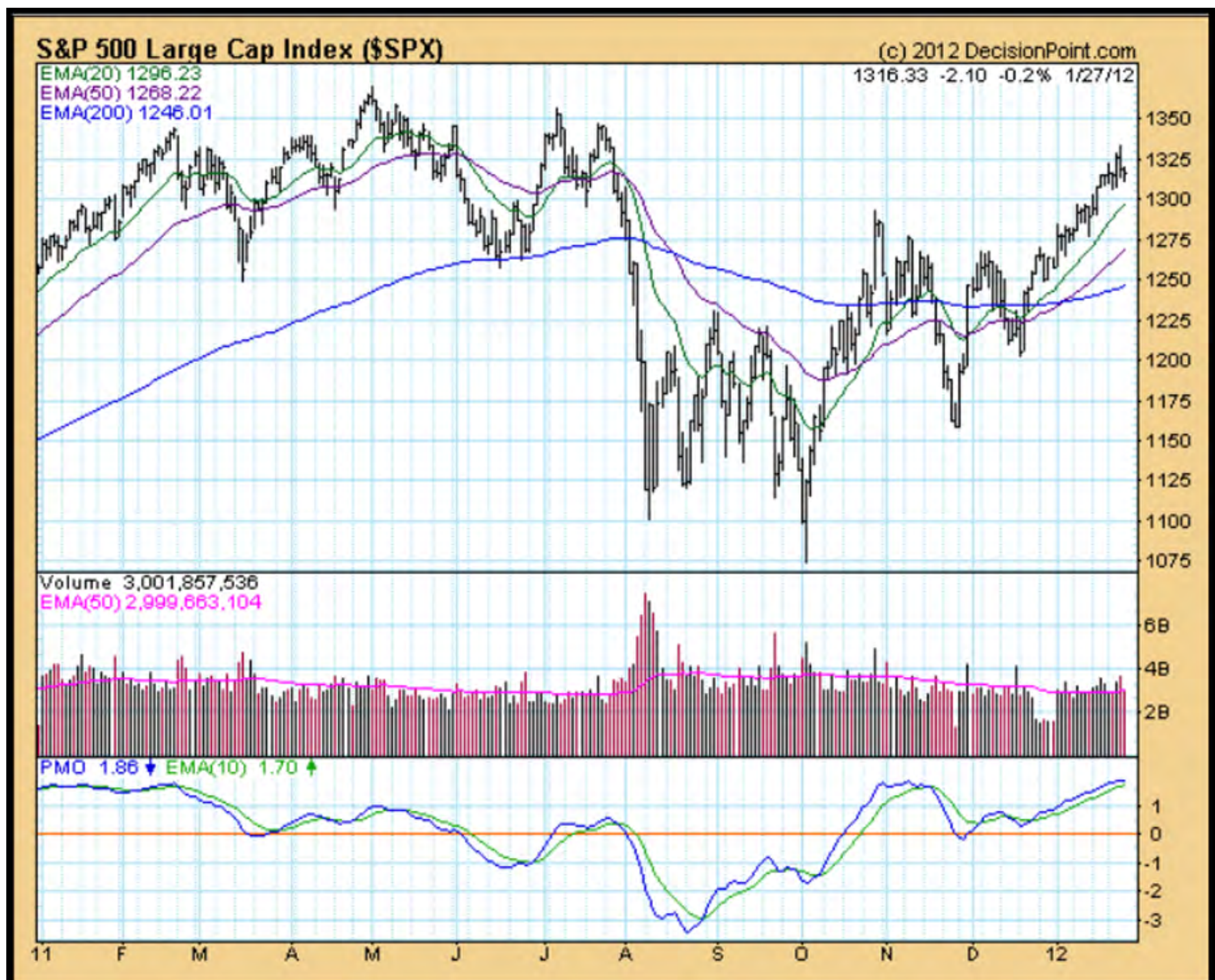
overbought - after having rallied from 1074 on the S&P 500 on October 4, 2011 and from 1158 on November 25 to a high of 1333 on January 26, 2012 (see Figure 10). This is in sharp contrast to the condition in late November, 2011 when I noted that - I was not negative about equities because following their August to October decline - stocks had become rather oversold (see December 1, 2011 report).

Figure 10: S&P 500, 2011 - 2012



Source: www.decisionpoint.com

What disturbs me is that whereas investors' sentiment was very negative last autumn - now - sentiment is rather positive. The common mantra seems to be

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"get back into stocks." Furthermore, it is very unsettling that the recent rally occurred amidst many stocks still breaking down and with very light trading volume (see Figure 11).

Figure 11: Daily US Stock Volume and S&P 500, 2007 - 2012

Source: Alan Newman, www.cross-currents.net

Consequently, I would not be surprised if the S&P 500 corrected in the period directly ahead to around 1250 (see Figure 10) while government bonds rebound somewhat.

In last November's report, I recommended aside from the purchase of financial stocks, the accumulation of homebuilders such as Lennar (LEN - see

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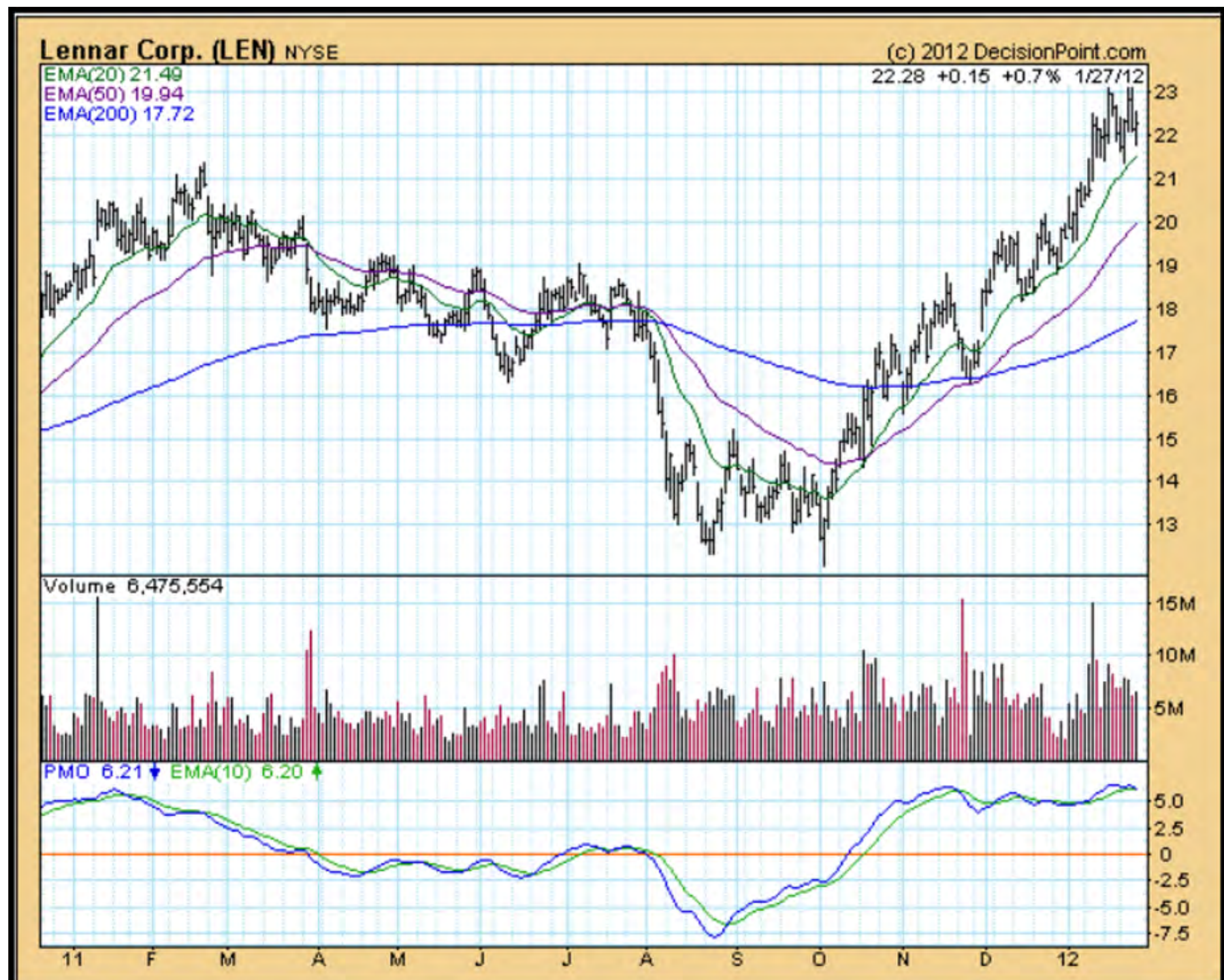
Figure 12), KB Home (KBH) and of lumber futures as well as of Weyerhaeuser (WY).

Figure 12: Lennar, 2011 - 2012



Source: www.decisionpoint.com

Homebuilders reflect best what has been happening in the stock market over the last three months. Coming from an oversold position in October they rallied strongly (both LEN and KBH are up more than 80%). However, now they are overbought and are likely to correct to the downside (see Figure 12). I maintain

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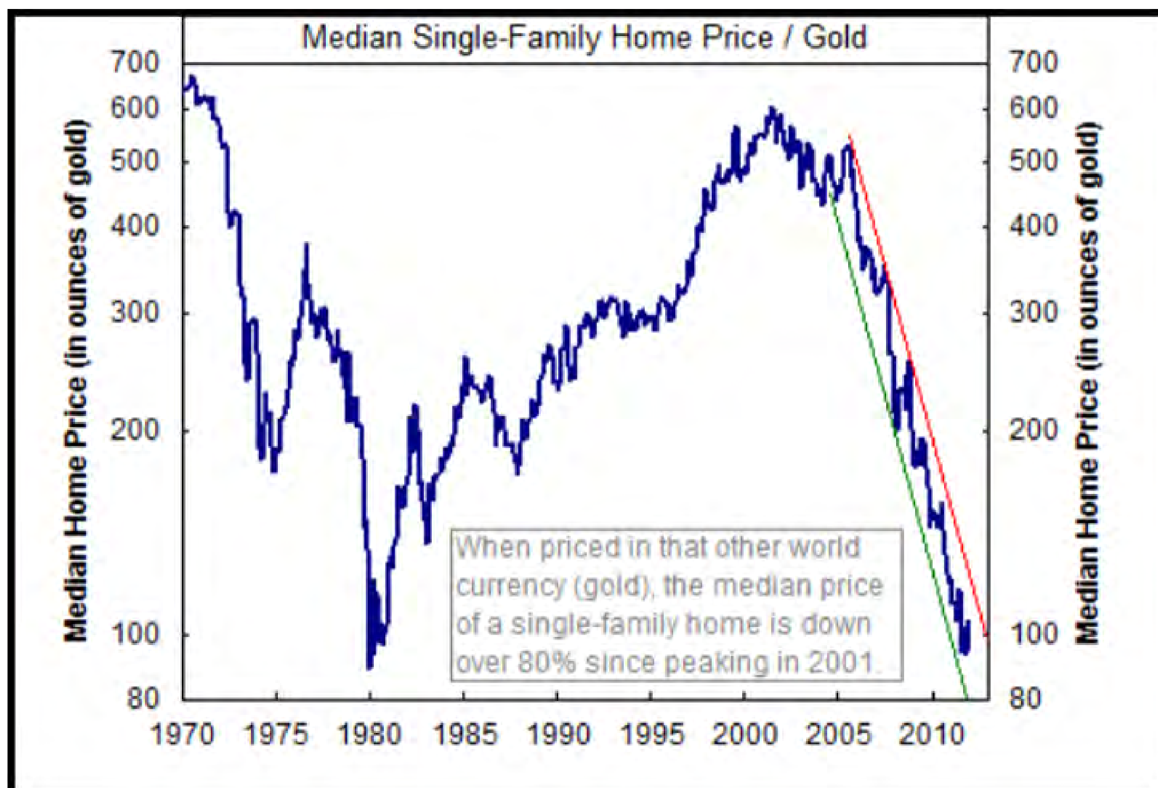
the view that US property prices are bottoming out and that home prices are extremely depressed relative to other asset prices (see Figure 13).

Figure 13: Median Single-Family Home Price Relative to Gold, 1970 - 2012



Source: www.chartoftheday.com

On a recent visit to Phoenix (Arizona) - a taxi driver told me that he had just driven a client to his newly acquired 5-bedroom, three storied house in a good location for which he had paid $120,000!

This is not to say that US home prices might not drop another 10%, but I can assure my readers that if everything I ever bought had been close to 10% above a major price low - I would be far wealthier person.

Above Keith Dicker opines negatively about the Euro. Right now, investors' sentiment about the Euro is very negative and therefore, some rebound potential does exist. Personally I am negative about all paper currencies

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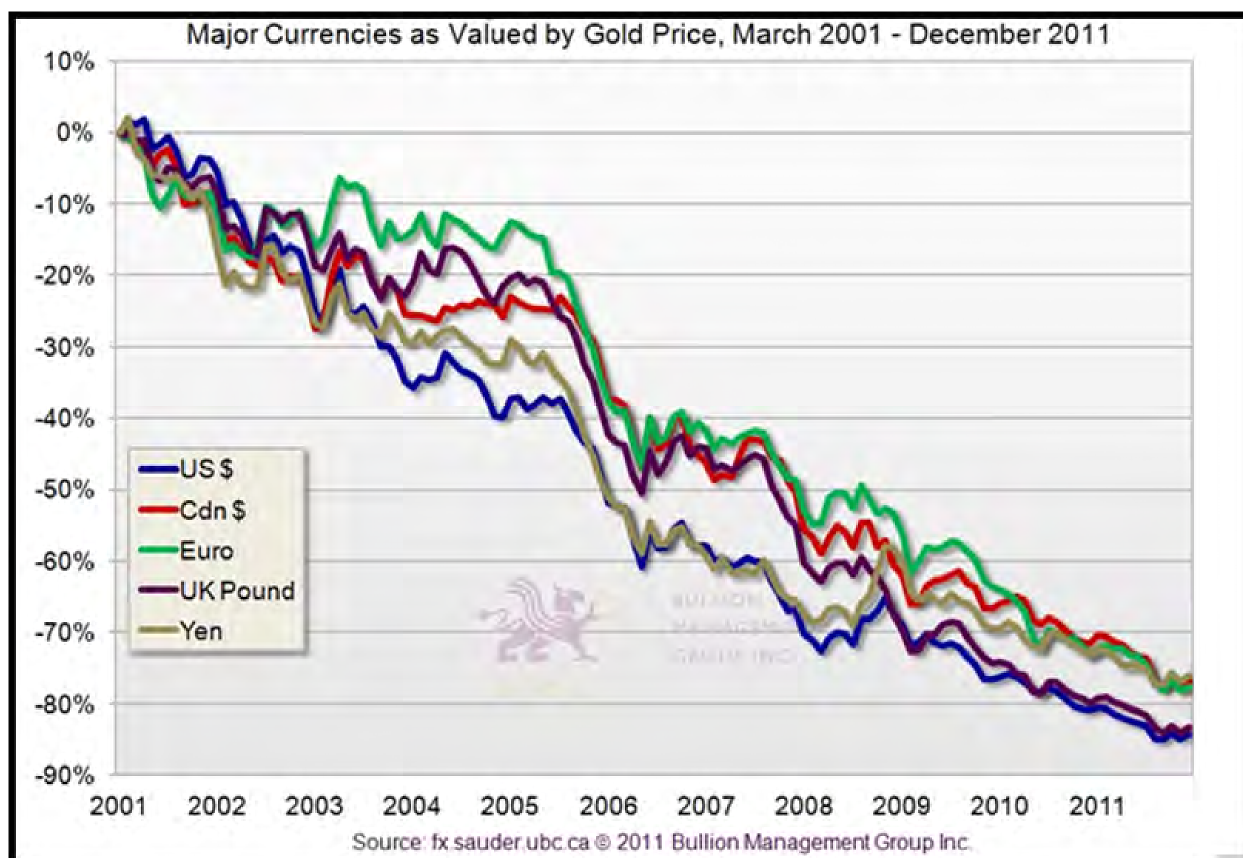
to a larger or lesser degree. With all the money printing that central banks around the world are implementing, it is likely that paper currencies will continue to depreciate over time against the price of gold (see Figure 14).

Figure 14: Major Currencies Valued in Gold, 2001 - 2012



Source: Bullion Management Group

As always, I recommend the gradual accumulation of physical gold as an insurance against irresponsible fiscal and monetary policies and incompetent and corrupt politicians. I believe the correction from the September 6, 2011 high is not yet over, but strong price support exists between $1500 and 1530 per ounce (gold bottomed out at $1522 on December 29, 2011 - see Figure 15).

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Figure 15: Gold, 2009 - 2012

Source: www.decisionpoint.com

I began this report by explaining that the symptoms of monetary inflation will not show up evenly and simultaneously but they will shift from one sector or region to another and lead to extreme economic and financial volatility, particularly in an environment of negative real interest rates. I am mentioning this here once again for the following reason: We have seen above that the US stock market is overbought and that several technical indicators are flashing warning signals. I also expressed some concern about a large number of stocks breaking down. However, I also need to point out that some important stocks such as Microsoft have broken out on the upside (see Figure 16). Consequently,

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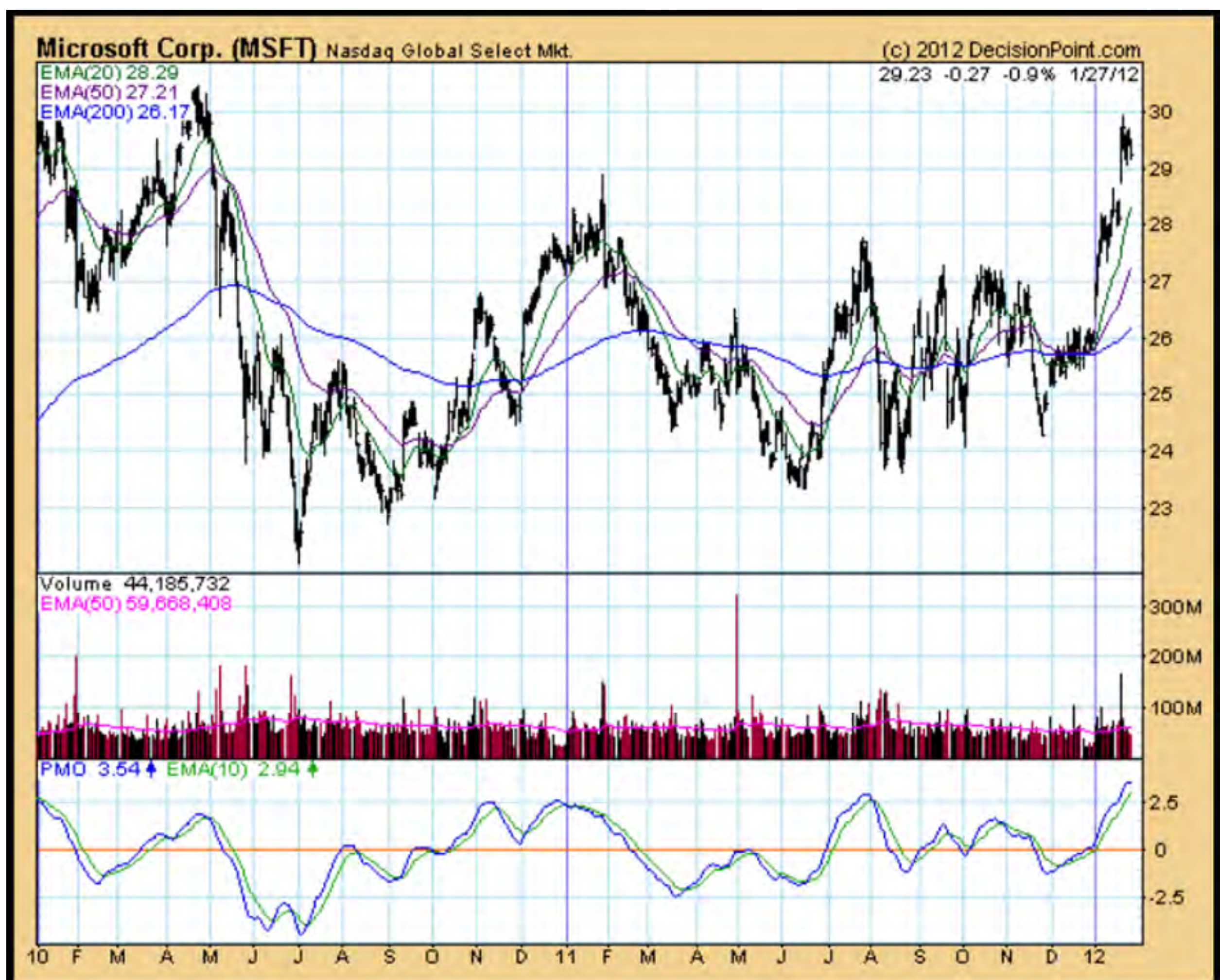
the previous trading range (in the case of Microsoft between $23 and $27) has become an area of support.

Figure 16: Microsoft, 2010 - 2012



Source: www.decisionpoint.com

I should also mention that a takeover of one company by another is announced almost on a daily basis.

There exists now for the S&P 500 - strong support between 1100 and 1200 (see Figure 10). What I wish to bring across is that we may be in stock

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markets where monetary inflation shifts from one group of stocks to another. In other words, stock selection may be more important than attempting to time entry and exit points for the indices. Meanwhile, I am less optimistic than some other strategists are but it is entirely possible that in the next few years - US Multinationals will once again hire more people in the US (see Figure 3).

In November, I mentioned that I had bought in Hong Kong a small position in Hang Seng Bank (11 HK), Swire Pacific (19 HK) and Sun Hung Kai Properties (16 HK). In late December, I increased these positions and added the following Thai stocks to my portfolio: Ticon Industrial (TICON TB), Rojana Industrial Park (ROJNA TB), Thanachart Capital (TCAP TB) and Kiatnakin Bank (KK TB). Not that I am wildly positive about Thai equities but some of these stocks have a dividend yield that is more than twice the yield on Ten-Year Thai Government bonds (currently at 3.2%). They also yield three-times more than Ten-Year US Treasury Notes. In Singapore I added to some positions in selected REITs (see Table 2 of the January report) and SATS Ltd (SATS SP), and I initiated a position in Wing Tai Holdings (WINGT SP). **My overall exposure to equities remains at around 25% of total assets.**

I am enclosing Michael Gayed's report: 2012: A Year of Reflation and Bursting of the "Bond Bubble".

Finally, I hope my readers will cherish the words of Oscar Wild who opined that, "Ordinary riches can be stolen from a man. Real riches cannot. In the treasury-house of your soul are infinitely precious things that may not be taken from you" and the infinite wisdom of Jack Benny who exclaimed, "Give me golf clubs, fresh air and a beautiful partner, and you can keep my golf clubs and the fresh air."

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