

# Big Picture: Economy and Markets

## FBO's Big Picture: Economy and Markets

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It's possible that the economy is commencing a powerful new upturn... but why should it? One third of the country is living off of food stamps, one quarter of the country has negative equity in their homes and one sixth of the country can't find a job. Each of these statistics is a record - or close to it. And how could an economy struggling under record debts at 375% of GDP possibly have any growth prospects?

Our government is spending like a drunken sailor - and inflating the currency with abandon. But that's not all. Waiting in the wings to make the budget even worse, we note that:

- Budget caps for Fannie Mae and Freddy Mac losses have been lifted from \$400 billion to infinity.
- The FHA, which supported 23% of 2009 housing loans, is out of funds and will need bailouts.
- Federal Home Loan Banks have accumulated massive bad loans, just like Fannie and Freddie.
- The FDIC, with 400 banks on its troubled list, is also out of money. Another bailout.
- The PBGC is underwater. When pensions start caving in, it'll need taxpayer money to do its job.
- State funds responsible for paying unemployment claims are already borrowing from the feds.
- Pension funds for private and government workers are deep in the red (the three largest California pension funds alone are \$425 billion underfunded).
- War without end. The newest batch of 30,000 being sent to Afghanistan will cost \$30 billion/year.

How about state budgets? And our national debt, which jumped \$2 billion last year to \$14 billion. However, as serious as these numbers are, they pale compared to the \$75 trillion of unfunded baby boomer bubble retirement obligations that will increasingly become due and payable.

What we're in is truly unprecedented .. and downright frightening. The next two years could see everything come tumbling down. This is not a time to take chances. Hence, **our principal objective is to retain purchasing power.**

**We are still relying on the observations and advice of independent observers who saw this morass coming.** Our primary **investing strategies** remain:

1. Staying with the major trends - real assets and currency diversification - as long as they are supported by the fundamentals. Gold stood out like a beacon in the first decade of this century - tripling in value while being almost completely ignored by major media - and we intend to keep it as our #1 recommended investment.
2. Investing remaining funds in undervalued assets where we find them, and holding until they approach full value.
3. Avoiding risky developments and any potential permanent losses in capital. We expect to be cautious in taking on new investments in this environment.

### Now on to our current view of various asset categories going forward:

**Fixed income.** As long as the economy continues to deflate, cash will be a safe place to park wealth. Bonds yields, however, have been climbing and are nearing a point where they will signal the end of their 30-year bull market – and time to get out. PIMCO bond fund guru Bill Gross has already announced that he is dumping US government debt and buying non-dollar bonds. To capitalize on this development, we are preparing to short US Treasury bonds in the near future.

Overseas, we prefer bonds issued by natural resources-exporting countries with a stable financial system, notably Australian, Canadian and New Zealand dollars, and Norwegian kroner. And we like the Swiss franc, which still benefits from global confidence in its frugal ways. Ultimately, the Chinese renminbi and possibly the new Gulf currency (the “gulfo”) will be worth an investment – but not yet.

Short term fixed income returns remain miniscule, with yields on all Treasury bill, CD and money market accounts below 0.4% per year. With returns this low, the investment objective for fixed investments should be to avoid losing purchasing power.

**Stock markets.** Dow, S&P 500 and Nasdaq Indexes rose above 2009 highs in March, but price-earnings (P/E) ratios are now well above 20. Overwhelming historical data shows that from this point, the market’s return is likely to be flat for another 10 years. Further data shows that market conditions that existed at the 2009 low do not even approximate those seen at bear market lows – when high quality stocks with single-digit P/Es and dividend ratios above 5 become available. For these reasons, we believe that the next great bear market low still lies ahead.

There is a distinct possibility that the market could plunge 40% to reach new lows, triggering an even more severe decline. Big money remains on the sidelines and corporate insiders continue to unload their company stock. The government is still pushing the market up but we think the odds are against the feds being able to prop it up through mid-term elections in November.

We are maintaining a small position in mining stocks. Since we expect the resource sector to fall with the general market, we are setting ‘stink bid’ price objectives for a number of mining and energy companies we would like to buy at depressed levels. To offset the risk of a sudden market drop, which could occur without warning, we have established an initial offsetting short position against the Russell 2000 Index. When the drop is clearly underway, we may add other positions.

**Precious metals.** Gold has broken out from a massively bullish reverse head-and-shoulders pattern and built a base above \$1100 for further advance. It is rising in spite of a stronger dollar and has the potential to rise above \$1350 this year. Central banks around the world have reversed their roles and become net buyers of gold – registering a 425 ton net addition in 2009.

Gold is still subject to a temporary drop when the market plunges, but should recover quickly – reflecting its role as real money. Even if deflation sets in, gold will retain its purchasing power. We expect the gold price to eventually reach parity (1:1) with the Dow Jones Industrial Average. From a larger perspective, global financial interests appear almost certain to tie one or more future currencies to gold – at much higher prices. Gold is after all the only practical financial asset in existence that is not simultaneously also someone else’s liability and it has represented financial SECURITY for over 5000 years.

Silver is benefitting from disclosures during the March 25 CFTC hearing on gold and silver position limits. Massive manipulation of the silver market by JP Morgan was revealed, which may mute JPM’s ability to control the ensuing rise. However, if the upcoming market correction is accompanied by a dour economic outlook, we expect silver to once again sustain some collateral damage, since it is also an industrial metal. We are holding client precious metals positions in the Central Fund of Canada

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(CEF - 55% in gold, 45% in silver) and companion fund GTU (gold only). CEF is a private Canadian firm with a sterling reputation for integrity and the safest place we that we know of to custody paper metals. We continue holding 'excess' paper silver in SLV, which has recently been acting more responsibly.

We continue to STRONGLY urge conversion of at least two-thirds of allocated gold and one-half of silver to bullion and Wayne remains available to meet clients and friends at Dallas Gold and Silver (or other location of your choice) to assist you in making purchases.

**We remain deeply concerned** about the potential for major economic disruption - an unexpected, or 'black swan' event such as 9-11 - and strongly recommend taking defensive precautions. We have received numerous warnings about the potential for accelerated unemployment; waves of corporate bankruptcies; destruction of the commercial real estate market; a banking 'holiday;' increasing protests and riots in American streets; and more 'crazy' weather - drought, flooding, extreme temperatures, windshifts, earthquakes, volcanic activity, etc.

**Markers.** The stock market remains 'safe' as long as the Dow stays above 10,600. Gold would show weakness by dropping below \$1,090. A close in the US 30-year Treasury bond yield above 4.75% (which may already be happening) will likely signal a major turndown for bonds. Look for inflation to accelerate when the USD Index falls below 62 (from 81 presently).

*Wayne Peterson*

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