

May 2013



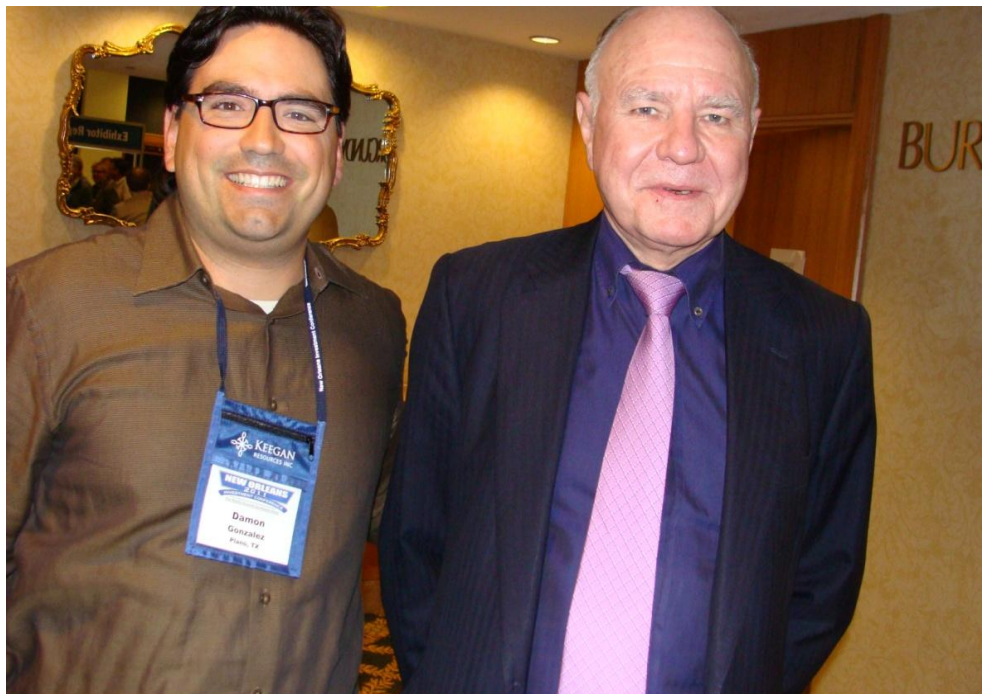
Heroes

I think it is important to have people that you look up to and strive to emulate in some way. Having heroes makes you work toward being a better person and gives you inspiration to grow. In the last five years, I have had the good fortune of meeting four of my biggest heroes and this month's letter is dedicated to them.

Dr. Marc Faber

Marc Faber is an Phd. Economist who was born in Switzerland. After grad school, he worked on Wall Street and then moved to Hong Kong and now lives in Thailand. He is most known for his monthly newsletter called the Gloom Boom Doom report that I have been reading since 2008. Faber is a popular guest on financial shows and author of one of my favorite investment books of all time, *Tomorrow's Gold*. The book is about far more than investing in Asia and gold and although it was written in 2002, it contains some timeless wisdom that is still very useful for today.

It is hard to think of all the things that I have learned from Marc over the years. He is the first reputable strategist that I ever saw use technical analysis (studying momentum indicators and charts). His respect for the craft caused me to read several books and get interested in this form of market analysis. Like many of the best investors, Marc is a student of Austrian Economics and because of his interest, I have read thousands of pages on the subject. I even wrote a newsletter about it in 2011 called "[Austrian Economics, A Primer](#)."



Over the years, I have always looked forward to the beginning of the month to hear what Marc has to say about the markets, his travels, and life. He always finds interesting topics to discuss and makes some great calls on market directions. I can credit Marc's

reasoning as to why I first became interested in investing in gold in 2008. I can still remember how he was adamant that we should wait till it went under \$800 before buying and sure enough gold dropped from around \$1,000 to under \$800 that year.

I have patterned my own newsletter along the lines of his, where I also discuss something I think my readers would benefit from and then address the financial markets towards the end. Marc is also incredibly honest about how he feels and is one of the few strategists to say things like "Davos is for liars" or with these policies "we are doomed."

Marc is a true student of life who continues to travel for fun and work. In my estimation, he is one of the best minds in the financial world and his deep knowledge of markets has inspired me to constantly grow in my knowledge. I hope I am as active and knowledgeable as he is by the time I reach my mid 60s.

Dr. Ron Paul

Although I have lived all but one year of my life in Texas, I did not know who Ron Paul was until my friend Mark told me that he was running for President in 2008. I watched a few of his campaign videos and became instantly enthralled with his message of liberty, peace, and free markets.

I didn't know what a Libertarian was until I heard Paul explain it. His philosophy of freedom and allowing everyone to do as they please as long as they don't harm other people or their property made so much sense to me. Although his ideas were not new, I had never been exposed to them and learning about the gold standard, Austrian economics, and Libertarianism helped me break through the matrix that most people live in. His ideas took me out of the left-right paradigm and allowed me to see the Statist- Self ruling paradigm of the world.

Ron has served many years in the US House of Representatives. He earned the nickname Dr. No for voting against any bill that was not Constitutional. In many instances, he was the sole no vote on bills because of his determination to do what he felt was right for the country. I admire Ron's determination to stick by his principals and his devotion to the Constitution. His



2008 book "The Revolution: A Manifesto" is one of the most influential books that I have ever read. As I read the book, I remember thinking things like: How could a Baptist favor legalizing drugs and prostitution? Isn't a gold standard antiquated? Could the non-aggression principal really work? Ron's books, interviews, and weekly writings have challenged me over and over. He has exposed me to an incredible world of freedom loving writers like Murray Rothbard, Ludwig Von Mises, John T. Flynn, Henry Hazlitt and others.

After resigning from Congress in January 2013 after serving for 23 years, Ron is not slowing down. Ron still writes a weekly column called Texas Straight Talk, recently started www.ronpaulcurriculum.com (for home schoolers), and has launched the Ron Paul Institute for Peace and Prosperity.

Glenn Greenwald

Glenn Greenwald was a Constitutional lawyer litigating cases of civil rights abuse before he began his writing career. I first heard about Glenn Greenwald in 2010 when he was writing for www.salon.com. He is the author of several books, including *With Liberty and Justice for Some: How the Law Is Used to Destroy Equality and Protect the Powerful* and currently writes about civil liberties for *The Guardian*. He has a very active twitter feed and he is the first person that I look to



to find the truth about a civil rights story that has come out. Greenwald was a big supporter of Wikileaks and Bradley Manning when those stories were breaking. He has an incredible ability of getting to the meat of an argument and standing up for civil liberties. He is not afraid of calling out the hypocrites in our

government and fighting for Constitutional civil liberties.

I had the fortune to listen to him speak in Richardson, TX in 2012 and my wife and I both could tell that we were in the presence of a one of a kind genius. I remember thinking if I really need a lawyer for something in the future, I will reach out to him to see if he can help because I have never heard a more articulate debater. Listening to him talk is just fascinating. He will make his point and as you

are thinking of an objection to his argument, he will address your objection like he is reading your mind. Glenn has challenged me to better articulate my arguments and to stand up for the powerless and weak in our society. I have only read one of his books and look forward to reading more in the future. Greenwald is only 46 years old and it is going to be awesome to watch what he does with his life over the coming years.

Michael Aronstein

I had the fortune of meeting Michael at an intimate breakfast in 2011 in Dallas. He and Michael Shaoul run the Mainstay Marketfield Fund, the single largest position across my client base. Before running the Marketfield Fund, Aronstein worked at Merrill Lynch and Comstock Partners. Michael has taught me a lot about investing through his monthly research reports and quarterly conference calls. I am not aware of a more transparent manager that provides investment advisors with the kind of access that he does. Their last conference call was nearly one hour and forty-five minutes because it was important for them to answer every single question that we had. In my estimation he is one of the best macro investors alive today. He has shaped my views around risk management, constructing a portfolio, and what the world may look like five years from now.

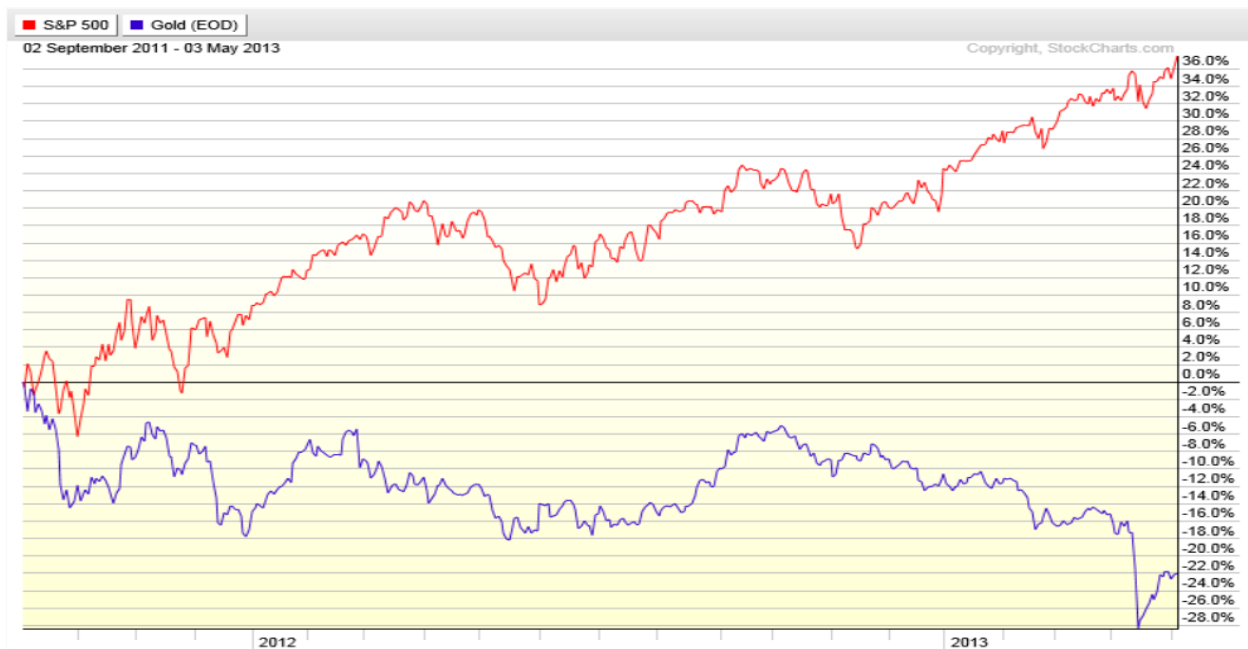
The Marketfield team is gifted at analyzing the world and determining where capital will flow. They also make sure they don't overstay their welcome and realize that all investments have a "sell by" date on them. I appreciate their objectivity and try to emulate their style. When they think Government bonds are cheap like they did in 2011, they will buy them. When they think government bonds are expensive (like they do now) they will sell them short.



Aronstein is cerebral and is extremely good at properly analyzing data releases and cutting to what really matters for markets. His team is not afraid of making controversial calls and they try to catch major market turns because "being right when the market expects the outcome that you're right about is meaningless." I hope Aronstein stays working for many years to come so that he can continue to play an important role in my client's and my own portfolios.

Markets

After the 2008-2009 asset crashes, gold outperformed US stocks until its all time peak in September 2011 at \$1927 per ounce. Since then, the US economy has looked a lot better than most market participants were anticipating and the problems in Europe have quelled. As you can see from the chart below, gold has massively underperformed US stocks since September of 2011. An investor in gold is down approximately 23% and an investor in the S&P 500 is up approximately 36% for a total difference in performance of 59%!



In the grand scheme of things, a 23% drop in the price of gold is not that big of a deal, but when you look at the opportunity cost of owning gold instead of the US stock market, it compounds the pain that gold bulls are feeling.

I have been warning for the last four years that the least painful options for governments would be to print more money. The UK, Japan, and the Fed have done about what I expected. Interest rates have stayed artificially low and the US is currently printing \$85 billion per month and the Bank of Japan is printing \$70 billion of Yen per month. I was recently shocked to find out that 23% of the 60 central banks surveyed have bought stocks or are planning to print money to buy stocks.¹ We live in unprecedented times and the above leads me to the question what many clients have asked:

Was \$1,927 the secular peak in gold prices?

¹ <http://www.zerohedge.com/news/2013-01-16/it-will-take-fed-seven-years-deliver-300-tons-german-gold>

Until the plunge on April 12 and 15th, I would have said I highly doubt gold has peaked. The price action over those two days was extremely disturbing to me. Someone clearly wanted to sell a large amount of gold and fast. Their selling sent the price below important support around \$1525 and I suspect this caused a lot of stop loss orders to activate. I am very bothered that gold is behaving poorly after new rounds of money printing, the Cypriot Bank crisis, and the news that it is going to take Germany seven years to get its gold back from the Fed.² You should question your thesis when the price action of your investment is not in line with the fundamentals.

The negatives for gold are: the recent price action, the economy looks better than expected, it had appreciated 668% from 2001 to 2011, and Bernanke may be forced to raise interest rates soon. The only investors that I respect that think gold's bull market is over is Doug Kass of Seabreeze Partners and the folks at Marketfield Asset Management. Here is a link to a recent interview with Michael Shaoul of Marketfield where he guesses that gold could bottom around \$1,100 and silver at \$11:

<http://www.bloomberg.com/video/gold-bear-market-could-mirror-2008-s-p-shaoul-9DCgwOn7QYml0xXbVsR5Wg.html>

Here is another interview he did on BNN:

<http://watch.bnn.ca/#clip910236>

I have a lot of respect for Michael Shaoul and Michael Aronstein at Marketfield and if you are bullish on gold, I think it important to hear their bearish arguments. They were shorting gold and silver on 4/12 to 4/15 and took most of their shorts off expecting the bounce that has come since. They plan to re-enter their short positions and think precious metals will be a lousy investment for at least five more years relative to other places you can put your money (they like US, European, and Japanese stocks).

The bullish argument for gold is: that it typically does well when interest rates are below inflation (negative real interest rates), it appears to me that we never entered a mania stage (how many people do you know who own gold?), and central bankers continue to compete to see who can devalue their currencies the fastest to boost exports. In the corner of the bulls stand:

John Paulson (hedge funder who made over \$1 billion in 2007 shorting subprime mortgages).³

David Einhorn (manager of Greenlight Capital and all around genius)⁴

Felix Zulauf (hedge fund manager)⁵

Kyle Bass (hedge fund manager featured in Michael Lewis' *Boomerang*)⁶

Dr. Marc Faber (writer of www.gloomboomdoom.com)⁷

² <http://www.bloomberg.com/news/2013-04-24/central-banks-load-up-on-equities-as-low-rates-kill-bond-yields.html>

³ <http://aurora-gold.com/billionaire-john-paulson-sticks-to-gold-says-volatility-possible/>

⁴ <http://www.reuters.com/article/2013/04/12/us-hedgefunds-einhorn-gold-idUSBRE93B17620130412>

⁵ http://www.kingworldnews.com/kingworldnews/Broadcast/Entries/2013/2/16_Felix_Zulauf.html

⁶ <http://www.zerohedge.com/news/2013-04-09/kyle-bass-perplexed-golds-low-price>

Marc Faber has given me permission to share his position on gold from his May 1st research report. In the report, he shares my concern with the price action in April. He notes that a collapse followed by the strong rebound and news of small buyers buying physical gold around the world looks like a bear market rally. At the same time, the Commitment of Traders report looks extremely bullish. He did purchase more gold at \$1,400 and as a fundamental investor, he will continue to buy more gold if the price declines even more because he believes the central bankers will continue to print. Faber has long advocated buying gold every month and recommends that his subscribers hold 25% of their assets in gold. His "best guess" is that gold drops back down to retest the \$1320 low we just saw and from there we will see if deflation is starting to take hold or if further monetary easing comes from the central banks.

So what should one do with their gold and silver? No one knows how the next five years will turn out. We can make our best educated guesses, but nobody can know for sure. I am currently going to hold on to all of my precious metals because when I go to www.usdebtclock.org, I can't imagine how we can "grow our way out of this problem." One of the biggest reasons I have advocated owning precious metals is to have some financial asset that is outside of the financial system as an insurance policy. God willing, I plan to live 70 more years and with that time frame in mind, I think gold is very likely to do well.

My advice to owners of gold and gold shares is to hear that even Marc Faber, a gold bull, is expecting a drop back down to around \$1,320. That is about a 10% drop from these levels and there is no assurance that \$1,320 contains the downside. I also suggest doing the math to determine if you can handle the drop if the bears are right. If you own ten gold eagles that are worth about \$1,500 today, how would you feel if you saw a \$4,000 loss as the coins went to \$1,100? If the Marketfield managers are right about silver, would you be able to hold your coins as they lose about 55% from here?

My suggestion is to think clearly about why you own precious metals. Do you own them as insurance against bad government decisions in the future? Did you buy them to speculate to make some quick money? If they do drop much lower, will you still believe in holding them to keep money out of the banking system?

During the last gold bull market, gold rocketed from \$35 per ounce to about \$200 per ounce as the stock market crashed in 1973-1974. When the stock market rebounded and the great depression didn't arrive, gold then proceeded to lose about \$50 and bottomed around \$100 per ounce. Can you imagine if you bought it for \$200 and you were sitting on 50% losses within two years? I suspect many people were scared out of their positions and sold out. Gold then went on a 750% move from \$100 to \$850 in 1980 and I am sure many missed out on the really big gains in the last bull market.

Another example of a major correction occurring in a bull market was the 1987 stock market crash. Many people thought that was it for U.S. stocks and missed out on a lot more gains in the bull

⁷ <http://marcfaber-trades.blogspot.com/2013/04/marc-faber-i-love-fact-that-gold-is.html>

market that ended in early 2000. Is gold in a correction or did we see the top? We can't know for sure. If your position in precious metals or miners is bothering you and you don't like having exposure to the asset class, please reach out to me and we can discuss your position and determine what the right strategy is for you. As I mentioned, I am holding my positions for now because I know I will not be scared into selling gold if it goes down to \$1,100 an ounce and I have a long term view that the debt of the world cannot be repaid in today's Dollars, Yen, or Euros.



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