Appetite For Distraction

> "Nobody really understands gold prices, and I don't pretend to understand them either."
>
> — Ben Bernanke

mon·ey ***(mŭn'ē)***

1. A medium that can be exchanged for goods and services and is used as a measure of their values on the market, including a commodity such as gold, an officially issued coin or note, or a deposit in a checking account or other readily liquefiable account.

2. The official currency, coins, and negotiable paper notes issued by a government.

3. Assets and property considered in terms of monetary value; wealth.

> "There's fool's gold — pyrite — and then there's fool's gold — gold owned by idiots willing to trade it for worthless dollars."
>
> — Jarod Kintz, This Book Has No Title

"The desire of gold is not for gold. It is for the means of freedom and benefit."

— Ralph Waldo Emerson

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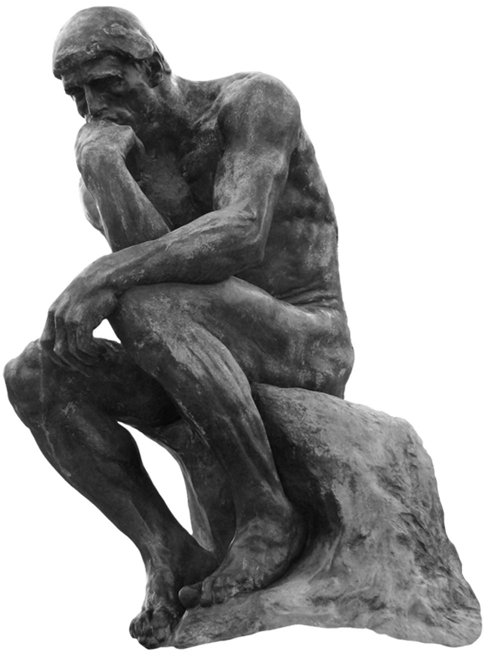


Things That Make You Go *Hmmm...*

In 1996 I fell in love.

The moment I landed in Charleston, South Carolina, on my way to a small barrier island 35 minutes away for a family vacation, I got that feeling in my stomach that this was a special place.

Eighteen years on, and my love affair with the Carolina Low Country has only deepened.

Now that I live in Singapore, my visits are far more infrequent than I would like, but whenever I get the chance to spend time amongst the marshes or at the beach, I fall in love all over again.

The city of Charleston is beautiful. Small enough to walk around, but filled with wonderful restaurants, gorgeous architecture, quaint shops, and the vibrancy of youth that comes with being home to several colleges (Go Cougars!).

It has twice been voted "America's friendliest city" by *Condé Nast Traveler* (a judgment I can second, having done my fair share of traveling around the United States over the years) and also "the most polite and hospitable city in America" — though in fairness, that particular award was bestowed upon the fair city of Charleston by *Southern Living* magazine, which may well have a dog in that particular hunt. No matter.

Above all, however, the city is filled with history; and this week I am going to share with you a story which illustrates beautifully why understanding history is perhaps more important today than ever before — certainly when you are considering what to do with your savings.

Charleston is the oldest city in the State of South Carolina, founded in 1670 as Charles Towne — a tribute to King Charles II of England. Seven short years after the War of Independence ended, that name, funnily enough, was changed to its present form.

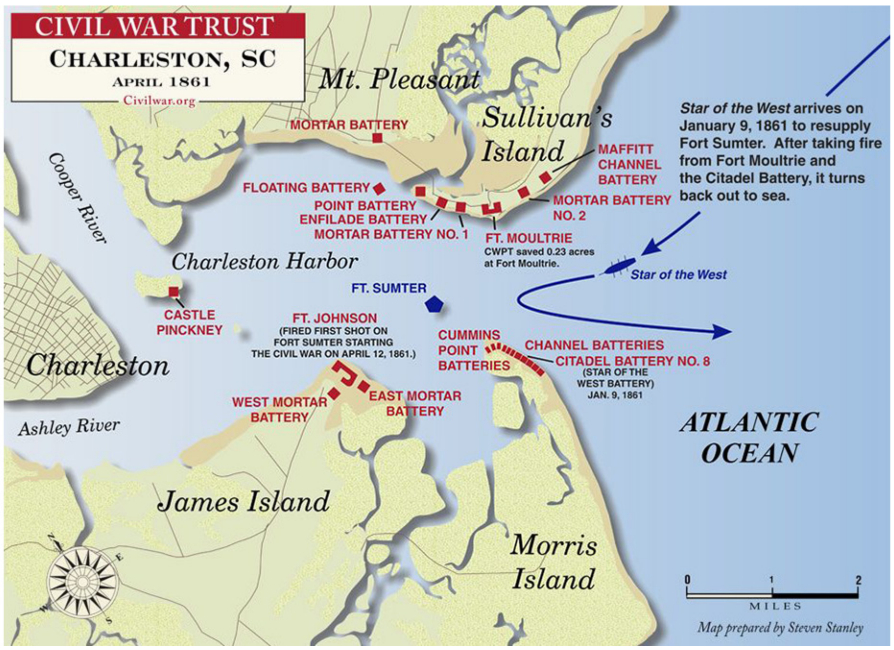
But Charleston's greatest claim to historical fame is two events that occurred 83 days apart in early 1861.

On January 9, a group of cadets from The Citadel, a military college (Go Bulldogs!) that still sits just north of downtown Charleston, opened fire on the Union ship Star of the West as it entered Charleston Harbor on its way to resupply the troops stationed at Fort Sumter.

South Carolina had seceded from the Union in December 1860 after the election of Abraham Lincoln; and the Union commander, Major Robert Anderson, had subsequently moved his command post from Fort Moultrie on nearby Sullivan's Island to Fort Sumter, a far more substantial fortress that guarded the entrance to Charleston Harbor. But, as Anderson would discover, it was also something of a sitting duck (see map below).

Slowly but surely, Confederate troops began to lay siege to Fort Sumter, surrounding it with battery after battery — though no shots were fired.

At least, not until April 12, 1861.



Source: civilwar.org

As one look at this map makes clear, it was only a matter of time until the fort fell; and that time turned out to be just 34 hours, during which a savage bombardment rained down upon the beleaguered Union troops.

Anderson evacuated Fort Sumter (he didn't surrender) on April 14th with, remarkably, no loss of life on either side. Bizarrely, but perhaps unremarkably, the only casualty of the engagement occurred when a gun exploded during the surrender ceremonies (yeah, "ceremonies," apparently), killing one poor Union soldier who had made it safely through the barrage.

This engagement began the US Civil War, a conflict that would take the lives of almost 700,000 Americans and wound nearly half a million more.

It was during the siege of Fort Sumter that the story I want to share with you takes place. (Yes, I am afraid that everything so far is just background).

This story came to me from the pen of Jared Dillian, the very talented writer of an excellent publication called *The Daily Dirtnap;* and the moment I read it I knew I had to share it with my readers, because it illustrates perfectly something I have been talking to people about for years.

Readers can, and definitely ***should*** check out Jared's fantastic work HERE; and to give you a taste of Jared's enviable narrative prowess, I am going to let him tell you the story as he told it to me:

The Calhoun Mansion

> *Let me tell you again why I like gold and silver.*
>
> *I was in Charleston two weekends ago for my mom's birthday. We did a horse and carriage ride, a historical tour, around the city. I always thought those things were cheesy, but as it turns out, the horse and carriage tours are very highly regulated, the tour guides have to pass a series of knowledge exams and then take continuing education. I kid you not! Ours had been doing it for six years, and was good.*
>
> *So as we went by the Calhoun Mansion on Meeting Street, the tour guide fella starts telling us about the house. It was built by a guy named George Walton Williams, who was the richest guy in town. This was back during the Civil War. It's a 24,000 square foot mansion with 14 foot ceilings. It's just monstrous. It cost $200,000 to build — back in the 1860s! So how did Mr. George Walton Williams make his money?*

> *Well, as you probably know, Charleston is a port city, and during the War, the Union Navy blockaded the port and then bombarded the city for weeks and months, but during this time, there were these guys who were "blockade runners" who would sneak by the navy ships, bringing necessary supplies to the city, which was under siege. Blockade runners made a lot of money — five grand a trip sometimes — but you know who made even more money? George Walton Williams did.*
>
> *He financed the blockade runners.*

Williams was not the only one doing this, but he was the most successful, why? Because he insisted on being paid only in gold and silver. If you know your Civil War history you also know that there was a Confederate currency, and I don't know if Mr. Williams had a particular view on the Confederate dollar, but at the conclusion of the war, the Confederate dollar collapsed, and everyone was left holding the bag — except for George Walton Williams.

Williams became like a J.P. Morgan character in the city — Charleston was the center of Southern finance, and Williams singlehandedly bailed out the Broad Street banks. He also built a pretty cool house.

Sorry to interrupt; I know you were enjoying Jared's prose, but we're just about to get to the point of this story, so I want to make sure everybody is paying close attention.

This next paragraph contains the fundamental principle of investing in gold and silver, which so few people genuinely understand — despite the multitudes of commentators expending countless thousands of words.

Hit 'em between the eyes, Jared:

So these anti-gold idiots are just that, idiots, or else they have the memory of a goldfish, because currencies come and currencies go, as sure as night follows day. It is the natural order of things. And as you can see, it's not about trading gold to get rich or getting long gold or buying one by two call spreads or getting fancy, it literally is about protecting yourself in the end. It's not like Williams got rich. He just stayed rich. Everyone else got poor.

It's not like Williams got rich. He just stayed rich. Everyone else got poor.

That's it. Right there.

Thanks, Jared, I'll take it from here.

So ... five pages in and we've yet to see our first chart — that's another first, but at least it's a familiar chart:

Source: Bloomberg

That is a chart of the gold price from the beginning of the secular bull market in 2000 to today, and it lies at the root of the fundamental misunderstanding about gold that I want to address today, with the help of Jared's wonderful story.

The bull market in gold started for two very distinct reasons and amongst two very diverse groups of people.

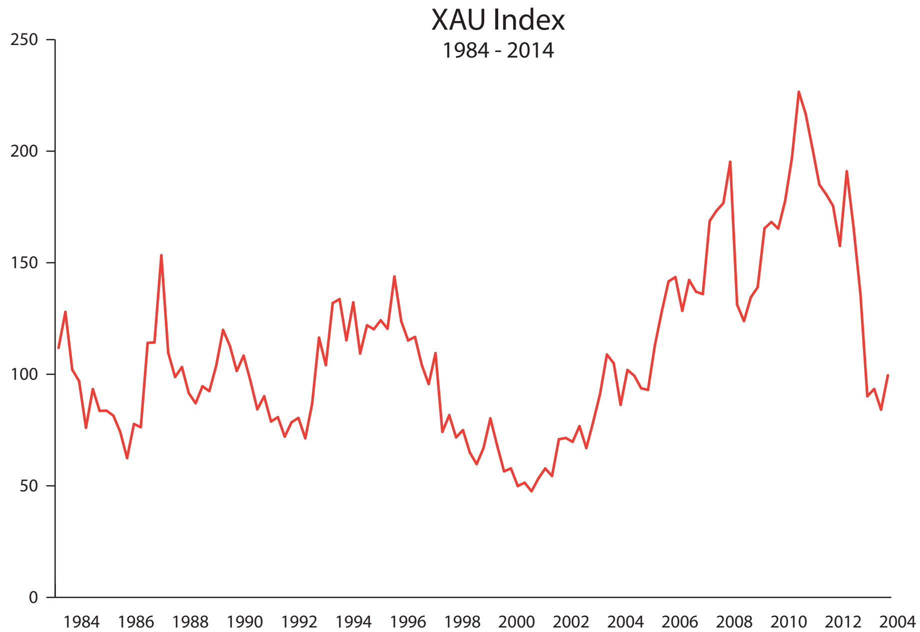
The first group were those who saw a commodity of intrinsic value that had fallen so completely out of favour that it was trading at or below the cost of production, along with a group of companies producing that commodity whose stocks were so out of favour that they simply had to go higher over time.

This is what the chart of the gold price looked like heading into 2000:

As you can see, gold was beaten down — hard.

Between 1980 and 1999, gold fell from $850 to $250, and had there been an ETF for gold mining stocks as there is today, it's safe to assume that it too would have been battered almost beyond resuscitation. What we DID have was the Philadelphia Gold and Silver Index (XAU), a capitalization-weighted benchmark that includes the leading gold and silver mining stocks.

The index was formulated with a base value of 100 as of January 1979 — we'll get back to why THAT'S important shortly — and as you can see here, by 2000 it had taken what is known in the industry as "a pasting":



Source: Bloomberg

Shares in gold and silver mining stocks halved between 1979 and 2000 and fell fully 70% from their interim high of 1987, so it's safe to say they were as beaten down as the metal itself, if not more so. Once the market changed its opinion of the mining stocks, however, they took off, soaring almost 400% between 2001 and 2011. The reason for this massive rally? Why, the change in the metal's fortunes, of course; and that's what attracted this first group of people who contributed to the gold bull in the early 2000s — the traders.

These people saw an opportunity to make money by buying something low and selling it high — as they would a stock or a bond or a piece of real estate.

But gold is different, and to illustrate why that is, let's turn our attention to the second group of people attracted by gold around the turn of the century (sheesh — that makes it sound so long ago).

The second group of people were those who looked at the landscape around them, saw the massive amount of debt that had been created over the previous four decades, and began to fear for the future of fiat currencies in general and the US dollar in particular.

These people didn't so much care about the price performance of gold (though most realized that the balance of probability suggested the path of least resistance was higher), as they cared about protecting a portion of their wealth from confiscation, which might come either through the inflation that was clearly going to be required to dissolve the debts, or through a dramatic loss of confidence in the mighty US dollar.

The price of gold wasn't their chief concern. Not even remotely. In fact, for the second group of people a falling gold price was a good thing because it enabled them to swap more of their dollars for the precious metal.

When you acquire gold, if your concern is the price you pay for it, then you belong in the first group — the traders — and should calibrate your expectations accordingly. If the gold price jumps from $1,000 to $1,500 and you sell your gold, locking in a nice profit, then you are happy and can either move on to your next investment or wait for a pullback in the price to be able to reload and try to repeat your success.

The danger with this approach is that it's also really rather easy to buy gold at $1,900 and find it languishing some $600 dollars lower a couple of years later. Ask "that guy." You know "that guy," right? We all do. He's the one who, when gold hit $1,900 in August 2011, told you it was definitely going to $2,500 and bought a bunch of it — through the ETF, of course. No point going to all the trouble of buying the metal itself.

Ask him. He'll tell you how much gold SUCKS.

"That guy" has been the one selling to crystallize his loss — or perhaps doubling up and going short to try to recoup his loss because the one-way guaranteed trade is back on, he claims — only this time it's headed in a more southerly direction. He's been the guy calling for gold to go to $1,000 or maybe even back to $600.

He often works in the research department of an investment bank.

Want to know what the second group of people have been doing as gold has fallen from its 2011 highs?

Accumulating more. Exchanging more of their fiat currency for physical metal.

Not futures contracts. No. Physical metal.

And no, not "buying more." Accumulating more.

I choose my words very carefully.

This group of people are the investors.

It has never ceased to amaze me that, whenever and wherever I discuss gold with folks, the first question I am asked is invariably this one:

> *"Where does the gold price go this year? $2,500? $3,000? Higher? What's your 'number'?"*

My answer is always the same:

> *"It doesn't matter."*

At least, it doesn't if you are in the second group of people.

The story of George Walton Williams demonstrates this perfectly.

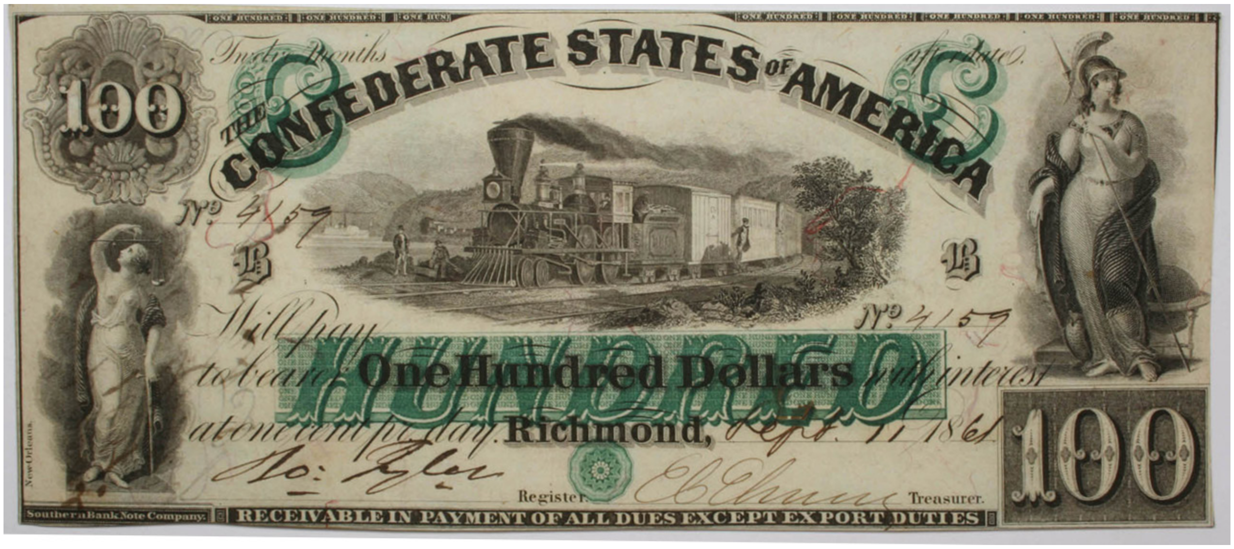
Williams wasn't refusing to accept anything but gold and silver as payment because he thought the price of gold was going to rise and he'd make a profit. There were no futures contracts, ETFs, or options on gold trading back then. No. Williams wanted gold and silver because they were *money* and would remain money no matter what happened after the Civil War had run its course.

Williams' alternative was to accept Confederate dollars in payment for his services to society:

> *(Wikipedia): The Confederate States of America dollar was first issued just before the outbreak of the American Civil War by the newly formed Confederacy. It was not backed by hard assets but simply by a promise to pay the bearer after the war, on the prospect of Southern victory and independence.*

What would YOU rather have been handed as payment? A piece of paper that represented the promise of a group of individuals to pay you back — based, no doubt, upon their ability to tax those who had just won their "independence" from the Union after their inevitable victory — or a lump of metal that history had proven would be accepted by either side, no matter the victor in this little fraternal scrap?

Yeah, you're right; when I put it THAT way, it's hard to make a case for one of those alternatives.



What happened? Well:

> *(Wikipedia): As the war began to tilt against the Confederates, confidence in the currency diminished, and inflation followed. By the end of 1864, the currency was practically worthless.*

Want to venture into the weeds a bit further to see how the mechanics of the devaluation played out? OK:

> *At first, Confederate currency was accepted throughout the South as a medium of exchange with high purchasing power. As the war progressed, however, confidence in the ultimate success waned, the amount of paper money increased, and their dates of redemption were extended further into the future. Most Confederate currency carried the phrase across the top of the bill: "SIX MONTHS AFTER THE RATIFICATION OF A TREATY OF PEACE BETWEEN THE CONFEDERATE STATES AND THE UNITED STATES" then across the middle, the "CONFEDERATE STATES OF AMERICA WILL PAY [amount of bill] TO BEARER" (or "...WILL PAY TO BEARER [amount of bill]" or "...WILL PAY TO BEARER ON DEMAND [amount of bill]").*
>
> *As the war progressed, the currency underwent the depreciation and soaring prices characteristic of inflation.*
>
> *Near the end of the war, the currency became practically worthless as a medium of exchange. This was because Confederate currency were bills of credit, as in the Revolutionary War, not secured or backed by any assets. Just as the currency issued by the Continental Congress was deemed worthless because they were not backed by any hard assets, so, too, this became the case with Confederate currency.*
>
> *Even though both gold and silver may have been scarce, some economic historians have suggested that the currency would have retained a relatively material degree of value, and for a longer period of time, had it been backed by hard goods the Confederacy did have, perhaps such as cotton, or tobacco. When the Confederacy ceased to exist as a political entity at the end of the war, the money lost all value as fiat currency.*

"Poof! It's gone." That's how these things happen. Always.

Of course, the ultimate irony is that today a crisp, uncirculated Confederate $100 bill will auction for upwards of $5,000...

But I digress.

The point of owning gold is NOT to get rich but to stay rich, and sometimes, simply by staying rich, you can become very wealthy indeed — just as Williams did.

Owning gold isn't about the price. Trading it is. Owning gold is all about possession.

For the last couple of years, the traders have been in control of the price and have driven it down because it stopped going up. That sounds simplistic, but it's true. During that time, however, the investors have taken advantage of the leverage applied on top of the physical gold market to acquire more.

A lot more.

One of the big reasons this isn't readily apparent to Western investors is the fixation in that part of the world with trading gold. Here in the East, it's all about ownership.

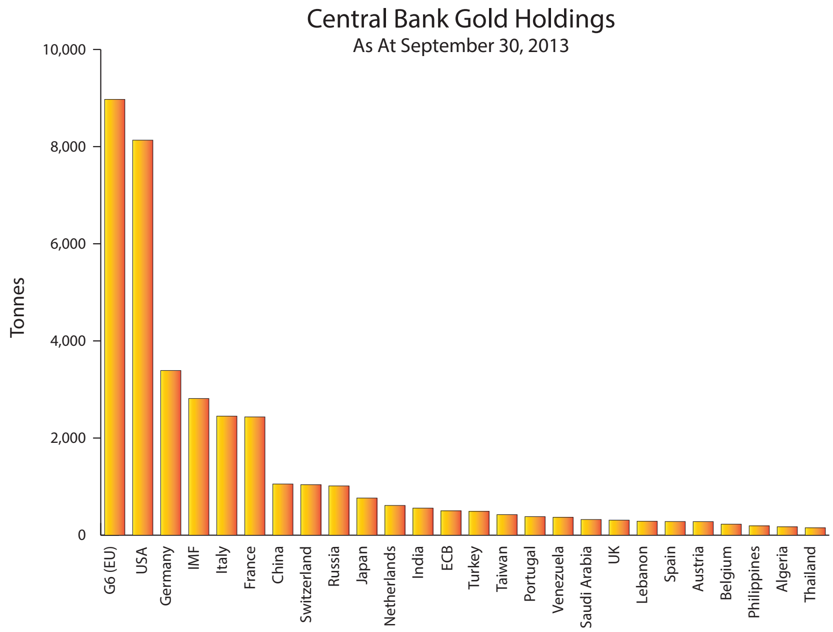
If you talk to most people in the West about gold, they have no idea about the price or its recent direction. Narrow your sample audience down to those with a passing interest in finance, and they will likely know that gold is an awful investment whose price only goes down. (Had we conducted this little survey in 2011, the results would have been different, but that only illustrates the point.)

Ask a random group of people in the East about gold, however, and the conversation is completely different.

In this part of the world, people talk about how much gold they (or their parents or their grandparents) own. They will tell you stories of the first time they handled a gold coin (usually as a child), and they will know the price but not have much of an opinion on how good or bad gold's performance has been — it will be far less relevant to them. They just know that you don't trade gold; you own it.

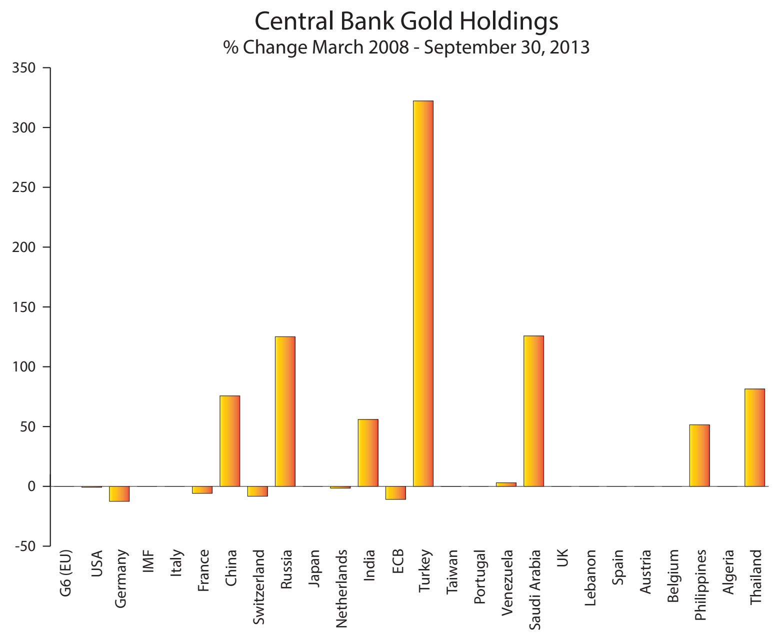
To further illustrate this point, let's talk about our old friends the world's central banks.

The chart showing the 25 largest central bank holders of the world's gold looks like this:



Source: WGC

If we take a look at the changes in those holdings between 2008 and 2013, an interesting phenomenon emerges: central banks in the East, as their reserves have grown, have been accumulating gold:



Source: WGC

Since 2008, the central banks of China, Russia, India, Turkey, Saudi Arabia, Thailand, and the Philippines have increased their gold holdings on average by 119.67%. This number is derived from the available data published by central banks, which, let's face it, can be a little sketchy in some jurisdictions.

Like the data disseminated by China, for example.

In 2009, the PBoC announced that its gold reserves had leapt from 600 tonnes to 1,054 tonnes — an increase of 75% — and there those reserves have stayed. Officially.

That's the Party line. However, there is overwhelming evidence that suggests China's gold reserves have increased by significantly more than 75% since March of 2008:

> *(Shanghai Daily): China's gold consumption and production both notched new records last year as bullion prices plummeted, spurring feverish sales of jewelry and bars in the world's biggest gold market.*
>
> *China's gold demand jumped 41.4 percent annually to 1,176 tons in 2013, led by strong growth in jewelry and bars, the China Gold Association said in a statement on its website today. The national industry association is comprised of exploration, mining, processing, manufacturing and other gold-related industries.*

China's yearly consumption has topped India's 1,000 tons, making it the world's biggest gold market in 2013, according to data from the domestic association and the World Gold Council.

The World Gold Council said in November that India's combined demand for bullion in the first three quarters was 715 tons, while China's was 821 tons.

So I think it's safe to describe the demand for gold in China as "pretty healthy," don't you? No surprise to the investors in the physical metal, sure, but perhaps news to the traders of paper?

In addition to experiencing a huge surge in *demand* for gold, China has managed to keep a streak going on the other side of the supply/demand dynamic:

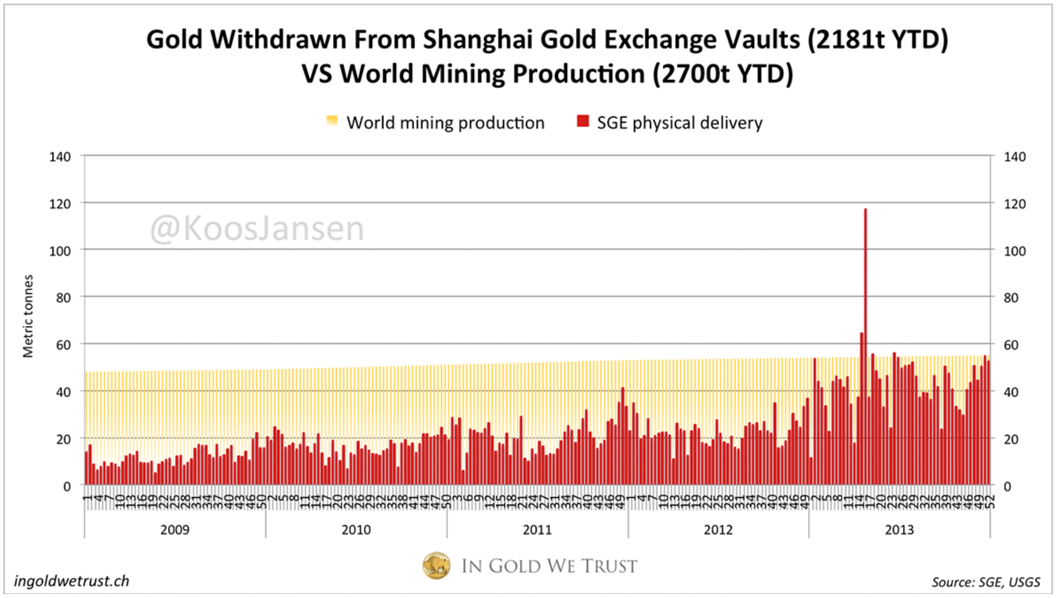
(Shanghai ~~Mouthpiece~~ Daily): On the supply side, China has been the top bullion producer for seven straight years. Gold production increased 6.2 percent from a year earlier to 428 tons in 2013, the China Gold Association said.

Koos Jansen did a little digging of his own:

(Koos Jansen): Friday the numbers were released on total Chinese gold demand for 2013. Total demand can be measured by the amount of physical gold that is withdrawn from the vaults of the Shanghai Gold Exchange. In the last full trading week (#52, December 23 – 27) of 2013 there were 53 tons of physical gold withdrawn, which brings the yearly total to 2181 tons.

Yes, total Chinese demand for 2013 was 2181 tons, excluding PBOC purchases....

So, for China, being the largest producer of gold in the world — again — was not enough. They needed more, for some reason. *(Nota bene,* Koos's numbers for mine supply in the chart below include all the gold produced by both China and Russia. Why do I mention that? Read on).



Source: Koos Jansen

Total Chinese demand for gold was 2,181 tons, EXCLUDING PBoC purchases (the PBoC apparently do not buy any gold through the Shanghai exchange), which is a pretty staggering number for a country whose official reserves total less than half that sum ... but it gets better.

In an open letter to the World Gold Council in late 2013, Eric Sprott (a man who embodies the essence of a gold investor as opposed to a trader) broke down global supply and demand (insofar as the data opacity allows). His results are presented here:

Supply	Partial Year	Annualized	Source
Mine Production	1,383	2,765	GFMS
less Chinese domestic production	270	440	China Gold Association
less Russian domestic production	122	183	WBMS
Total Mine Production (excl. China & Russia)	**991**	2,142	
Demand			
Hong Kong net exports to China	716	1,074	HK Census
Net imports to Hong Kong	471	707	HK Census
Thailand – net imports	157	313	UN Comtrade Stats
Turkey – net imports	124	248	UN Comtrade Stats
India – net imports	551	1,102	UN Comtrade Stats
Central banks – changes in reserves	216	431	IMF
Other countries (jewelry, coins & bars)	655	1,309	GFMS
Total Demand	**2,890**	**5,184**	
Other Sources of Supply			
Gold recycling	672	1,344	GFMS
ETF outflows	724	917	Bloomberg

Source: Sprott Funds

See that number there? The one in red? Well, the amount of gold ***physically delivered*** through the Shanghai exchange in 2013 was 38 tons MORE than the year's entire available global mine production. (I say "available" because neither China nor Russia allows the export or sale of a single ounce of gold mined within their borders.)

Think that doesn't matter?

China has stayed silent on the levels of its gold reserves since 1999; but rather curiously, there recently began a wave of speculation that the Chinese were about to clue us in with a more current number. It started with a story in the *Shanghai ~~Mouthpiece~~ Daily:*

> *(Shanghai ~~Mouthpiece~~ Daily): China may soon announce an increase in its official gold reserve from 1,054 tons to 2,710 tons, Jeffrey Nichols, managing director of American Precious Metals Advisors, said.*

The People's Bank of China has not reported any increase in official gold holdings since 2009, when the central bank said the official reserve was at 1,054 tons, which accounted for only about 1 percent of its multi-trillion foreign exchange reserves.

The PBOC has been "surreptitiously" adding to its official gold reserves. It has bought a total of 654 tons in 2009 through 2011, another 388 tons in 2012, and more than 622 tons last year, mostly from domestic mine production and secondary supplies, Nichols said in a commentary posted on NicholsOnGold.com yesterday.

Suddenly, the math was being done in even the most unlikely of places:

(FT): A 500-tonne gap in China's gold consumption data is fueling talk that the central bank took advantage of weak prices last year to bulk up its holdings of the precious metal.

The last time the Chinese central bank said it increased its gold holdings was nearly five years ago, in early 2009. Officials have since then repeatedly insisted that they do not view gold as a useful asset for diversifying the country's $3.8tn mountain of foreign currency reserves.

But the latest official figures show that China imported and produced far more gold in 2013 than its citizens bought. This chasm suggests that the central bank was a buyer in the gold market last year in spite of its protestations to the contrary, say analysts....

Adding up the reported and estimated figures, Na Liu, of CNC Asset Management, calculated that China's "apparent gold consumption" exceeded 1,700 tonnes in 2013, more than 500 tonnes higher than reported.

"We would not be surprised to hear the People's Bank of China announce a new, significantly higher figure, if it chooses to do so," Mr Na said. The PBOC has said that its gold reserves have been steady at 1,054 tonnes since April 2009.

Right in the middle of that article lies the key point:

Officials have since then repeatedly insisted that they do not view gold as a useful asset for diversifying the country's $3.8tn mountain of foreign currency reserves.

Gold is NOT a useful asset for diversifi.... look!! Over there!!! A squirrel wearing a raincoat!

DISTRACTION!!!!

Central banks continually rubbish gold as a worthless asset class because it constricts their ability to produce money at the push of a button. Not only that, but it offers their citizens the means to reduce their reliance upon a nation's fiat currency — one has only to look at the goings-on in India last year to see what THAT looks like.

Deep down, though, central bankers know what gold is for and why you hold it. They ***know***.

In 1999, a group of central banks came together through the Washington Agreement on Gold to jointly manage sales of the precious metal. That agreement worked fairly well for a period of time (it was renewed twice, in 2004 and 2009, and will be up for renewal again this year), BUT there are a couple of things worth pointing out about that little agreement.

Firstly, take a look at the central bank signatories:

Österreichische Nationalbank — Austria
Banque Nationale de Belgique — Belgium
Suomen Pankki — Finland
Banca d'Italia — Italy
Banque de France — France
Banco de Portugal — Portugal
Schweizerische Nationalbank — Switzerland
Banque Centrale du Luxembourg — Luxembourg
Banco de España — Spain
Bank of England — United Kingdom
Deutsche Bundesbank — Germany
De Nederlandsche Bank — The Netherlands
Central Bank of Ireland — Ireland
Sveriges Riksbank — Sweden
ECB

See any Eastern central banks in that list? No.

Why? Well, for two reasons: one, they didn't have any "surplus" gold, and two, THEY'RE NOT SELLERS.

Secondly, take a look at the text of the Washington Agreement:

> *In the interest of clarifying their intentions with respect to their gold holdings, the above institutions make the following statement:*
>
> > *Gold will remain an important element of global monetary reserves.*
> >
> > *The above institutions will not enter the market as sellers, with the exception of already decided sales.*
> >
> > *The gold sales already decided will be achieved through a concerted programme of sales over the next five years. Annual sales will not exceed approximately 400 tonnes and total sales over this period will not exceed 2,000 tonnes.*
> >
> > *The signatories to this agreement have agreed not to expand their gold leasings and their use of gold futures and options over this period.*
> >
> > *This agreement will be reviewed after five years.*

The first statement in that agreement? "Gold will remain an important element of global monetary reserves."

DISTRACTION!!!

Penultimate statement of the agreement? "*The signatories to this agreement have agreed not to expand their gold leasings and their use of gold futures and options over this period.*"

But, wait? You mean they lease their gold out? But I thought ... oh, never mind.

Interestingly, when the agreement was resigned in 2004, that text had changed:

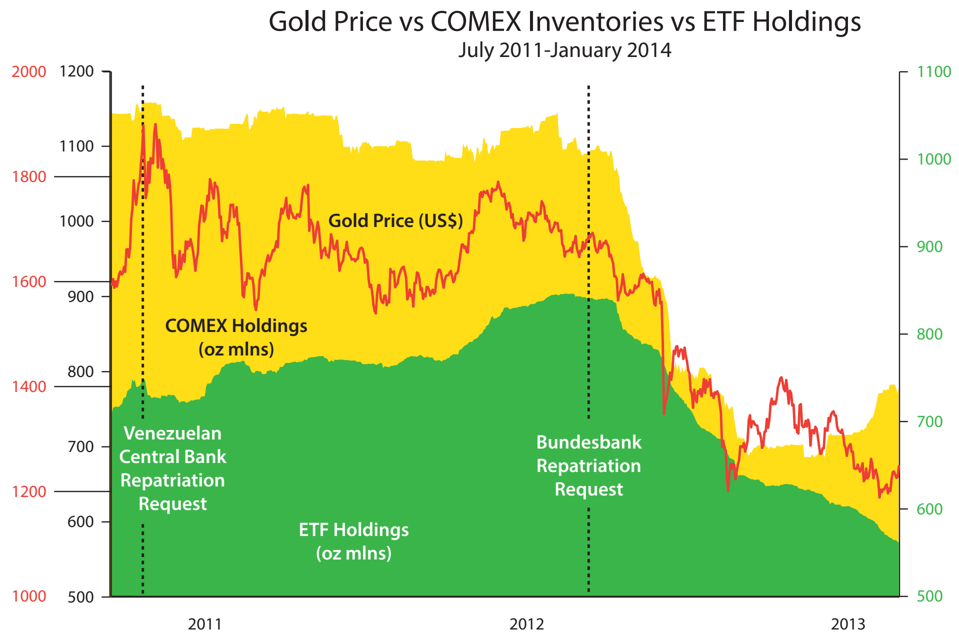
> *"... the signatories to this agreement have agreed that the total amount of their gold leasings and the total amount of their use of gold futures and options will not exceed the amounts prevailing at the date of the signature of the previous agreement."*

And ... by the time the third Washington Agreement was signed in 2009 (during which time the price had risen three-fold) ***that section of text had disappeared altogether***.

Hmmm...

The Washington Agreement worked when central banks were *selling* their gold because there were always buyers, at lower and lower prices — those were the investors soaking up the bullion.

NOW we have a bunch of central banks aggressively trying to BUY gold; and what they're finding (unsurprisingly) is that the investors aren't sellers, so the only people left from whom to acquire gold are the traders — and they have a very limited supply of actual metal:



Source: Bloomberg

That's a chart I've used before, and I use this previous version again here rather than redraw it, because the two vertical dotted lines are important.

Venezuela broke ranks first, demanding repatriation of its gold in early 2011 — a move which, counterintuitively, stopped the rising gold price in its tracks. A similar request from the Bundesbank in January of 2012 for a far larger amount saw the beginning of a strange but massive outpouring of physical gold from the major trading repositories — the COMEX warehouses and the ETF vaults.

Meanwhile, as the earlier charts and the recent data out of China show, Eastern central banks are buying — AND TAKING PHYSICAL POSSESSION OF — as much gold as they can, as fast as they can, because they KNOW what it represents.

Now let me ask you this:

If the very people who have the ability to basically create all the paper money they want out of thin air, whenever they need it, are exchanging that paper for gold at a record pace, what conclusions could you draw?

Would you think for a second that they are accumulating gold because they think the price is going to go up and they can make a quick profit?

Of course they're not.

Do you think they'll sell all their gold when the price reaches $2,000? How about $2,500?

When Western central bankers rubbish gold as a "barbarous relic" or, as in the case of Ben Bernanke shortly before he ~~started his job at The Brookings Institution~~ left office in January, admit to a complete lack of understanding of it, does it not strike you as strange that, having accumulated significant stockpiles of gold over the years, they aren't in a hurry to swap any of it for paper money (well, with the notable exception perhaps of the United Kingdom, thanks to the antics of Gordon Brown, King of the Idiot Chancellors)?

It shouldn't.

Gold is held by Western central banks for exactly the same reason individuals ought to hold it: protection.

Central banks are accumulating gold because it cannot go BANG! like fiat currencies do.

Individuals should be doing the same — not being sidetracked by the distractions.

It's not about price. The story Jared shared with us demonstrates that beyond any doubt.

If you own gold, it will do all the heavy lifting for you when the time comes, just as it did for George Walton Williams.

It seems only fair to leave the final word this week to Jared, who, in a postscript to the story of the Calhoun Mansion added this:

> *If Calhoun had been paid in quarters, he would be just as rich today. But not because 800,000 quarters as CURRENCY held their value. It is because the silver content in those 800,000 quarters is worth about $4,000,000 today.*

Bingo!

Hopefully that clears a few things up.

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OK ... so housekeeping first.

- I am hitting the road next week, bound for Seattle, where I will be catching up with my great friends at Evergreen GaveKal and speaking at their Annual Outlook event. (If you are in the area and would like to attend, you can email the lovely Lindsay Hall here). From there I head to a freezing cold Toronto to speak at PDAC on March 2nd before heading home, so if you don't hear from me for a couple of weeks, you'll know why.

With my travel schedule out of the way, let's get to this week's *Things That Make You Go Hmmm*.... We kick things off with Jeremy Warner, who patiently explains to us why the Eurozone crisis is just getting started. Whilst on the subject of Europe, we look at the latest unseating in Italy, examine a rather inflammatory claim from a senior figure in Germany's Die Linke party, and profile the spin doctor doing rather a good job of making Le Front National a more appealing choice for French voters.

Elsewhere, Harry Dent warns of the latest imminent bursting of Australia's housing bubble; China's trust products are back in focus; we look for lessons from that perennial basket case Argentina; and the *NY Sun* manages to get Yellen and DeGaulle together (in the same article if not the same room).

What else? Well, we have a fantastic series of long-term charts, Matt Taibbi's latest broadside against the Vampire Squid, the unfolding disaster in Ukraine, some historical wisdom around US house prices from David Hay, and interviews with Jim Grant and John Mauldin, as well as a fascinating debate between ~~the forces of good and evil~~ high-profile anti- and pro-QE exponents.

Enjoy that one.

Last but definitely not least, I bring you a vocal performance that sends shivers up and down my spine every time I hear it.

Until Next Time...

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Eurozone crisis is just getting started

On the face of it, they seem worlds apart. Switzerland's referendum vote against the free movement of labour, the ruling by the German Constitutional Court on the European Central Bank's (ECB) attempts to save the euro, and the warning to Scotland that it won't be allowed to keep the pound if it votes for independence — these might seem unrelated, but in truth they are all part of an increasingly explosive stand-off between the forces of national sovereignty on the one hand, and political and economic integration on the other.

With elections in May likely to give rise to the most Eurosceptic parliament in the EU's history, Europe's long-running financial and economic crisis is threatening to spill over into an all-encompassing political one. According to Berlin and Brussels, Europe's dark night of the soul — its most serious crisis since the Second World War — is now essentially behind us, with the promise of a slowly recovering economy and renewed political harmony to come. To my mind, it has hardly begun. Europe's epic attempt to impose political union on widely divergent countries is being broken on the back of economic hardship, popular discontent, and financial disintegration.

Virtually all successful currency unions start with political union, and then proceed through shared insurance, institutions, and fiscal arrangements to a common form of exchange. Europe, it hardly needs saying, is trying to do it the other way round; it has forced monetary union on an unsuspecting public, and now, via the resulting financial crisis, hopes to bulldoze through the shared fiscal and political arrangements that might eventually make it work, culminating ultimately in a United States of Europe.

Supporters of Scottish independence propose a still stranger approach. They want to scrap what hitherto has proved a relatively successful political and fiscal union but, for the time being at least, keep the pound. Yesterday, George Osborne, Ed Balls, Sir Nicholas Macpherson and other members of the Westminster elite came together to deliver the inevitable verdict: the Scots cannot have national sovereignty as well as monetary union with the rest of the UK, whatever fiscal rules might be put in place to help sustain such an unstable construct. They must choose between self-rule and economic union.

It is a similar choice that now faces Switzerland, and indeed, Europe as a whole. Even in Germany, which so far has largely escaped the ravages of the eurozone crisis, the schism is becoming ever more apparent.

Last week, the German Constitutional Court did a remarkable thing; it outsourced final assessment of the ECB's policy of doing "whatever it takes to save the euro" to the European Court of Justice (ECJ). This seemingly innocuous passing of the buck can be read two ways. To believers in the European project, it's a positive development which removes a key threat to evolution of the single currency into a more sustainable form. Germany seems to have given up its right to veto whatever it deems to be monetary financing of struggling governments, and instead given the final say to the ECJ, which because it nearly always adopts an integrationist approach, is almost certain to give the thumbs up.

But there is a less benign way of looking at the German court's ruling, for it contained a sting in the tail. Yes, the ECJ must decide, but the judges then went on to say that the ECB's policies did indeed amount to monetary financing and were therefore in all probability illegal.

Next to God and the Bundesbank, there is no higher or more trusted authority in Germany than the Constitutional Court, so when the ECJ determines to contradict it, there's going to be an almighty backlash. German acquiescence in the euro will begin to fracture....

*** JEREMY WARNER / LINK

Yellen and DeGaulle

"Yellen snubs emerging nation pleas" is the headline that catches our eye in the wake of the first testimony before Congress of the new chairman of the Federal Reserve. It was streamed across the top of the *Financial Times*. The pleas Mrs. Yellen was snubbing were over "effects of 'taper,'" meaning over the slowdown in the pace at which the Fed is pursuing its quantitative easing. The FT quotes India's central bank governor, Raghuram Rajan, as saying the Americans are "washing their hands" of emerging markets.

Far be it from us to worry about the rest of the world (we'd be happy, we sometimes joke, to see it run by an American colonel), but we happen to be sympathetic to this complaint.

It's bad enough that we Americans have to make our economic decisions by triangulating off the "forward guidance" of a pyramid of Ph.D.s at the Federal Reserve. Imagine how galling it must be to the editors of the *Financial Times* and the rest of the Europeans, Africans, Asians, and South Americans.

This is a moment to remember Charles of Gaulle. In February 1965, at the height of his stature, the president of the French Fifth Republic held a famous press conference in the Elysee Palace. He gathered 1,000 journalists in a room and sat them in gilded chairs. He himself sat, we noted when we first wrote about this moment, at a cloth-covered table in front of the newspapermen and women and warned that the dollar had lost its transcendent value and called for a return to the gold standard.

The virtue of the gold standard, in the eyes of DeGaulle, was that the system was not particular to any one country but imposed the same measure of value and thus of discipline on all of them. *Time* (magazine) stood still in amazement: "Perhaps never before had a chief of state launched such an open assault on the monetary power of a friendly nation," it said. Less than half a year later, President Lyndon Johnson signed the 1965 coinage act, beginning the formal debasement of American money.

Janet Yellen doesn't want to talk about DeGaulle's point. The political wise men and women fail to reference it (the FT itself often mocks the gold standard even though its editors front the very phenomenon that galled DeGaulle). Chairman Bernanke didn't want to talk about it. Congress is all too happy to delegate the power it was granted in the Constitution to regulate the value of our coin (and foreign coin). So the emerging nations are the losers, for now. When they finish emerging, though, watch out.

*** NY SUN / LINK

German Left (Die Linke) VP Claims "Euro Divides Europe, No Benefit to EU"

In a *Ziet Online* interview, Sahra Wagenknecht, Die Linke vice president and economic spokesperson, says the "The euro splits Europe" and there is no benefit to the EU.

ZEIT ONLINE: Ms. Wagenknecht, what is the biggest advantage of the European Union mean to you?

> Sahra Wagenknecht: After the Second World War, the united Europe has brought peace. But ever since the Maastricht Treaty and the Lisbon Treaty, the European Union has developed in a direction that primarily serves the interests of big business and banks. ... Integration reduces the welfare of the majority in Europe along with growing anti-European resentment. We have 19 million unemployed in the south of Europe and a disastrous austerity policies, for which the European Commission is responsible as part of the troika. Entire countries are incapacitated and plunged into the social abyss.

ZEIT ONLINE: Do you agree [with] your life partner Oskar Lafontaine, that Germany should withdraw from the euro?

> Wagenknecht: He has not suggested that Germany exit the euro, but that a new currency system with stable exchange rates and capital controls in place of the euro occurs. The euro as introduced, does not work, but divides Europe.

ZEIT ONLINE: What's the alternative? Return to the D-Mark?

> Wagenknecht: It is clear that a resolution of the single currency must not allow exchange rate speculation. There must be institutions that hold the currency market stable. And it needs capital controls.

ZEIT ONLINE: You argue like the AfD.

> Wagenknecht: I beg to differ. AfD top candidate Hans Olaf Henkel is a neo-liberal economic lobbyist who throughout his life seeks low wages and welfare cuts. The AFD is not for a social Europe.

ZEIT ONLINE: The Left Party is the AfD for the poor?

Wagenknecht: Nonsense. Even the middle class would benefit from more welfare state and a better wages.

ZEIT ONLINE: Is end the EU the only message of the Left Party before its European Congress?

Wagenknecht: That's not our message. We want a Europe that is socially and democratically and met, for example, the tax evasion by the rich and corporations with uniform tax rates at a high level. We hope that there will soon be a much stronger active resistance from the people of Europe and that the frustration just does not discharge in the election of right-wing populist parties.

ZEIT ONLINE: Will your party will discuss how to deal with military operations?

Wagenknecht: Of course. I find the current debate on more military involvement in Germany spooky. We've seen that the military operations in which we have participated, such as in Afghanistan, the people did not benefit. On the contrary, thousands of civilian deaths were the result. Humanitarians do not need bombs. German soldiers have no place abroad.

ZEIT ONLINE: What would happen if there were a new Srebrenica [genocide in Bosnia]? Would the green helmets then stand idly by?

Wagenknecht: Wars are never out of humanitarian reasons. Take a look a look at how conflicts arise in many conflicts, including in the Congo and elsewhere, European countries have supplied weapons and fueled the civil war. Some of these were proxy wars. And then come the arsonists. That's hypocritical, it's about raw materials and geostrategic positions.

ZEIT ONLINE: Between Left Party and the Greens and the SPD prevails a Thaw. The party leaders of the Left and the Greens meet. SPD General Secretary Yasmin Fahimi was open to joint coalitions. Is a Red-Red-Green coalition in front of the door?

Wagenknecht: It's good that there is finally calls. However, significant political differences remain. When I look at the policy that makes the SPD in the grand coalition, this differs significantly from what we want politically....

*** MISH'S ECONOMIC ANALYSIS / LINK

Snatching the baton

In the ever-inventive political slang of Italy, it was a *staffetta* — a relay, or handover. But it looked more as if the baton was being torn from the runner's hand. On February 13th a meeting of the centre-left Democratic Party (PD) passed what amounted to a motion of no confidence in the prime minister, Enrico Letta (pictured), himself a member of the PD. As a result, he decided reluctantly to step aside in favour of his party's ravenously ambitious new leader, Matteo Renzi, who has for months now been decrying the performance of Mr Letta's government.

An optimistic way to look at what has happened is to recognize that the 39-year-old Mr Renzi is bursting with energy and that he may be able to force through reforms that Mr Letta struggled to get approved. The young mayor of Florence has the advantage of an understanding with Silvio Berlusconi, the de facto leader of the opposition, on what both men see as the priorities for Italy: the approval of a new electoral law and a reform of the constitution to make Italy easier to govern.

The pessimistic approach to the latest twist in the country's seldom-predictable politics is to point to at least three reasons for doubting whether Mr Renzi will in fact succeed in shaking up Italy in the way he hopes. About the first of these—his inexperience—he could do nothing. Mr Renzi was chosen for his electoral appeal. His biggest job so far has been running a city of 370,000 inhabitants, roughly the same size as New Orleans or Stoke-on-Trent. He has no experience of parliament, let alone government.

But both the other handicaps are of his own making — the consequences of his decision not to wait for the election that would almost certainly have been held next year. It means, first of all, that he will be saddled with the same awkward coalition that made it so difficult for Mr Letta to pass reforms. The principal minority partner in the coalition is the New Centre Right (NCD), an offshoot of Mr Berlusconi's party that has very different views from the PD on a wide range of issues. And whereas the gentlemanly Mr Letta enjoyed a special rapport with the NCD's leader, Angelino Alfano, the altogether brusquer Mr Renzi does not.

By entering government in the way that he is about to, moreover, Mr Renzi has robbed his fellow Italians of the opportunity to choose him to be their leader. That is an Achilles' heel at which his adversaries will doubtless take aim incessantly during his premiership. And, as the case of Gordon Brown in Britain made clear, voters resent having prime ministers thrust upon them and can take revenge on them when it comes to election time.

Nor is the similarity between what is happening in Italy today and what happened in Britain seven years ago the only historical echo. In 1998, an earlier leader of the PD, Massimo D'Alema, toppled his ally, Romano Prodi, and took his job. Mr D'Alema also prided himself on his good relations with Silvio Berlusconi. And he too had ambitions for a grand constitutional reform. The upshot was that Mr Berlusconi ran rings around him and his government achieved very little.

But history need not repeat itself. And three handicaps need not outweigh a sufficiently important advantage. It is up to Mr Renzi now to prove the doubters wrong....

*** THE ECONOMIST / LINK

The parable of Argentina

A CENTURY ago, when Harrods decided to set up its first overseas emporium, it chose Buenos Aires. In 1914 Argentina stood out as the country of the future. Its economy had grown faster than America's over the previous four decades. Its GDP per head was higher than Germany's, France's or Italy's. It boasted wonderfully fertile agricultural land, a sunny climate, a new democracy (universal male suffrage was introduced in 1912), an educated population and the world's most erotic dance. Immigrants tangoed in from everywhere. For the young and ambitious, the choice between Argentina and California was a hard one.

There are still many things to love about Argentina, from the glorious wilds of Patagonia to the world's best footballer, Lionel Messi. The Argentines remain perhaps the best-looking people on the planet. But their country is a wreck. Harrods closed in 1998. Argentina is once again at the centre of an emerging-market crisis. This one can be blamed on the incompetence of the president, Cristina Fernández, but she is merely the latest in a succession of economically illiterate populists, stretching back to Juan and Eva (Evita) Perón, and before. Forget about competing with the Germans. The Chileans and Uruguayans, the locals Argentines used to look down on, are now richer. Children from both those countries—and Brazil and Mexico too—do better in international education tests.

Why dwell on a single national tragedy? When people consider the worst that could happen to their country, they think of totalitarianism. Given communism's failure, that fate no longer seems likely. If Indonesia were to boil over, its citizens would hardly turn to North Korea as a model; the governments in Madrid or Athens are not citing Lenin as the answer to their euro travails. The real danger is inadvertently becoming the Argentina of the 21st century. Slipping casually into steady decline would not be hard. Extremism is not a necessary ingredient, at least not much of it: weak institutions, nativist politicians, lazy dependence on a few assets and a persistent refusal to confront reality will do the trick.

As in any other country, Argentina's story is unique. It has had bad luck. Its export-fuelled economy was battered by the protectionism of the interwar years. It relied too heavily on Britain as a trading partner. The Peróns were unusually seductive populists. Like most of Latin America, Argentina embraced the Washington consensus in favour of open markets and privatisation in the 1990s and it pegged the peso to the dollar. But the crunch, when it came in 2001, was particularly savage—and left the Argentines permanently suspicious of liberal reform.

Ill fortune is not the only culprit, though (see briefing). In its economy, its politics, and its reluctance to reform, Argentina's decline has been largely self-inflicted.

Commodities, Argentina's great strength in 1914, became a curse. A century ago the country was an early adopter of new technology—refrigeration of meat exports was the killer app of its day—but it never tried to add value to its food (even today, its cooking is based on taking the world's best meat and burning it). The Peróns built a closed economy that protected its inefficient industries; Chile's generals opened up in the 1970s and pulled ahead. Argentina's protectionism has undermined Mercosur, the local trade pact. Ms Fernández's government does not just impose tariffs on imports; it taxes farm exports.

Argentina did not build the institutions needed to protect its young democracy from its army, so the country became prone to coups. Unlike Australia, another commodity-rich country, Argentina did not develop strong political parties determined to build and share wealth: its politics was captured by the Peróns and focused on personalities and influence. Its Supreme Court has been repeatedly tampered with. Political interference has destroyed the credibility of its statistical office. Graft is endemic: the country ranks a shoddy 106th in Transparency International's corruption index. Building institutions is a dull, slow business. Argentine leaders prefer the quick fix—of charismatic leaders, miracle tariffs and currency pegs, rather than, say, a thorough reform of the country's schools....

*** ECONOMIST / LINK

Australia's housing bubble ready to burst, US investment guru claims

If you are one of the many thousands of Australians at risk of being priced out of the property market, you had better wish that Harry Dent has got his sums right.

Dent, an American investment guru who uses demographics to forecast economic cycles, thinks the soaring housing market is ready to burst any day now, perhaps reducing values by as much as 50% in some places.

Dent, who was in Sydney this week to promote his book *The Demographic Cliff*, has a formidable record. He claims credit for predicting Japan's deflationary decade and the US boom and bust of the past 20 years, and has now turned his numbers on Australia.

"I don't see an upside in Australian real estate but there is a lot of downside. If you are going to own a house and live in it forever then perhaps it's OK to buy a house, but speculative property — don't do it."

With housing valued at 10 times average incomes — the same level as California's just before the subprime crash — Dent thinks Australia is heading for a fall which will be sparked by a sharp reversal of the current global economic recovery.

"I see a decline in the 30-50% range across Australia, although it may vary from city to city," he says.

"The rule with bubbles is that they always go back to where the bubble started. So the US housing bubble started to grow in 2000 and now house prices have fallen back to that point — a 55% fall."

He is supremely confident that it will also happen here.

"Most people buying houses are aged between 28 and 41. When they can't afford to buy a modest house for 800k as in Sydney, for example, then demand falls and real estate falls."

While the many Australians with large mortgages might view Dent's forecasts with alarm, he insists a crash would benefit the economy.

"People should be praying that real estate will fall because it's not good for living standards and it's not good for the economy to have such high prices."

As a young consultant working for Bain & Company, Dent's job was to study consumer spending patterns for his clients, mostly small- and medium-sized businesses.

He discovered that he could predict what he calls the "spending wave" according to people's age. At that time the postwar baby boom generation were having children and reaching the peak of their lifetime spending — not just on mortgages, but nappies, food, school fees and all the other extras that come with raising children.

The problem comes as that large generation passes its spending peak — at 46 in the US and about 47 in Australia, the UK and other western countries — and starts planning for retirement. This is the crux of his pessimistic world view.

"For the first time in history, the generation following is smaller. I spotted this first with Japan in 1988-89 where their demographics were turning. Everyone thought the 90s would see Japan pass the US and become the biggest economy in the world, but it collapsed and has been in deflation ever since," he explains.

"The same thing is now happening in the US and Europe, especially southern Europe. Everyone thinks that in the current crisis we are fighting a debt bubble but it's not a temporary financial crisis, it's a demographic crisis.

"Now I go to South Korea, for example, and say to them 'you are Japan on a 22-year lag'. The Korean market peaked last year and will now decline."

Many economists believe that this kind of doom-mongering is misplaced and that China, with its centrally controlled economy and huge cash reserves of more than US$2t, can keep on growing and drag the world with it.

But Dent is in no doubt which side he is on.

"We've had bubbles throughout our time — oil, gold, stocks. But China is the biggest bubble in modern history. It's 30% overbuilt in everything and has huge over-investment. The housing market is valued at 28 to 35 times income in the major cities. London, by way of contrast, is 15 times.

"For people who say the government can control it, I say that's bad. It means a bigger bubble and a bigger burst."...

*** UK GUARDIAN / LINK

The Vampire Squid Strikes Again

Call it the loophole that destroyed the world. It's 1999, the tail end of the Clinton years. While the rest of America obsesses over Monica Lewinsky, Columbine and Mark McGwire's biceps, Congress is feverishly crafting what could yet prove to be one of the most transformative laws in the history of our economy — a law that would make possible a broader concentration of financial and industrial power than we've seen in more than a century.

But the crazy thing is, nobody at the time quite knew it. Most observers on the Hill thought the Financial Services Modernization Act of 1999 — also known as the Gramm-Leach-Bliley Act — was just the latest and boldest in a long line of deregulatory handouts to Wall Street that had begun in the Reagan years.

Wall Street had spent much of that era arguing that America's banks needed to become bigger and badder, in order to compete globally with the German and Japanese-style financial giants, which were supposedly about to swallow up all the world's banking business. So through legislative lackeys like red-faced Republican deregulatory enthusiast Phil Gramm, bank lobbyists were pushing a new law designed to wipe out 60-plus years of bedrock financial regulation. The key was repealing — or "modifying," as bill proponents put it — the famed Glass-Steagall Act separating bankers and brokers, which had been passed in 1933 to prevent conflicts of interest within the finance sector that had led to the Great Depression. Now, commercial banks would be allowed to merge with investment banks and insurance companies, creating financial megafirms potentially far more powerful than had ever existed in America.

All of this was big enough news in itself. But it would take half a generation — till now, basically — to understand the most explosive part of the bill, which additionally legalized new forms of monopoly, allowing banks to merge with heavy industry. A tiny provision in the bill also permitted commercial banks to delve into any activity that is "complementary to a financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally."

"From the perspective of the banks," says Saule Omarova, a law professor at the University of North Carolina, "pretty much everything is considered complementary to a financial activity."

Fifteen years later, in fact, it now looks like Wall Street and its lawyers took the term to be a synonym for ruthless campaigns of world domination. "Nobody knew the reach it would have into the real economy," says Ohio Sen. Sherrod Brown. Now a leading voice on the Hill against the hidden provisions, Brown actually voted for Gramm-Leach-Bliley as a congressman, along with all but 72 other House members. "I bet even some of the people who were the bill's advocates had no idea."

Today, banks like Morgan Stanley, JPMorgan Chase and Goldman Sachs own oil tankers, run airports and control huge quantities of coal, natural gas, heating oil, electric power and precious metals.

They likewise can now be found exerting direct control over the supply of a whole galaxy of raw materials crucial to world industry and to society in general, including everything from food products to metals like zinc, copper, tin, nickel and, most infamously thanks to a recent high-profile scandal, aluminum. And they're doing it not just here but abroad as well: In Denmark, thousands took to the streets in protest in recent weeks, vampire-squid banners in hand, when news came out that Goldman Sachs was about to buy a 19 percent stake in Dong Energy, a national electric provider. The furor inspired mass resignations of ministers from the government's ruling coalition, as the Danish public wondered how an American investment bank could possibly hold so much influence over the state energy grid.

There are more eclectic interests, too. After 9/11, we found it worrisome when foreigners started to get into the business of running ports, but there's been little controversy as banks have done the same, or even started dabbling in other activities with national-security implications — Goldman Sachs, for instance, is apparently now in the uranium business, a piece of news that attracted few headlines....

*** MATT TAIBBI / LINK

The Spindoctor Behind the New Front National

It is a cold, icy day in winter and Florian Philippot is strolling through the streets of Forbach, the town where he would like to be elected mayor. People hurry up to shake his hand, a store-owner hands him a cookie and the woman at a café next to the train station offers him a coffee. An old Tunisian man puts his arm around Philippot's shoulders.

Philippot is the candidate for Front National (FN), a party designated as "extreme right" in France, but he is received with open arms on his walk through Forbach. Nobody blocks his path, nobody insults him. Who, after all, should be afraid of this nice young man?

"This is the first time I'm going to vote extreme right," says the slightly over-exuberant woman behind the counter of a shop Philippot visits. "It's not extreme right," says Philippot. "Let's just say it is a coherent choice." A look of dismay falls over the shopkeeper's face. "I didn't mean it derogatorily. I just mean — it is certainly more extreme than anything that I've voted for before."

Florian Philippot is a calm 32-year-old who is not particularly tall or handsome. His youth, however, lends him a trustworthy appearance. His polished shoes and well-tailored greatcoat makes him look like the elite-school graduate that he is. Philippot isn't just any candidate. He is the deputy head of the Front National, the party's chief strategist and the most important advisor to his boss, Marine Le Pen.

French voters will go to the polls for local elections in March, and Philippot hopes to win in Forbach, a town of 22,000 located on the German border. And his chances are decent. Behind Marine Le Pen, Philippot is the Front National's most popular politician. He makes almost daily appearances on radio or television, where he comments on the political developments of the day and criticizes both the leftist government and the conservative opposition. When he isn't being interviewed, he resorts to Twitter to spread his message.

Until just a few years ago, the Front National was considered to be little more than a collectino of unelectable, racist outsiders. Now, though, it is seeking to establish a reputation as a professional movement with friendly candidates and operatives. More than anyone else, Philippot is symbolic of the change. The party has never had a figure quite like him: He has been a high-ranking official in the Interior Ministry's inspector general's office and he is a graduate of the top schools HEC and ENA, where many of the country's elite are educated.

No matter where one goes in France these days to visit a Front National office or to accompany a candidate on his rounds, one encounters a movement full of excitement. The year 2014 is a decisive one for the party: It expects strong showings in both the local elections and in the European Parliament elections in May.

The party already won a symbolic victory back in October when it emerged victorious in an essentially meaningless regional election in the southern French city of Brignoles. In the run-off election, the FN contender beat a candidate who was backed by both the Socialists and the conservatives. It was seen as an indication that the alliances of convenience between the left and right, which has long kept the FN at bay in run-off elections, are no longer working.

According to a recent survey, the Front National could end up with 23 percent of the vote in the European election in May, which would make it the strongest party in the country, ahead of both President François Hollande'sSocialists and the conservatives. Philippot is also a candidate for the Europe vote, heading up his party's list for the eastern part of the country.

On a recent winter evening, Florian Philippot is sitting in Les Bons Amis, a restaurant in Geispolsheim, a tiny town in the Alsace near Strasbourg, about 90 minutes from Forbach by car. Some 150 people are packed inside, along with a handful of journalists.

He waits patiently for the local party leader to finish her remarks on Kosovars loitering around town and then he takes the floor. "Something great is taking place," he says. "We are experiencing a popular momentum. You can feel it and the powers that be can feel it too. That is why they are so uneasy."

Philippot's speeches are rhetorically outstanding, but his personality isn't particularly charismatic. He presents an image of a country in which immigrants establish parallel societies while the common French are at the mercy of globalization. He says that Socialists and conservatives — under the diktat of Brussels — pursue the exact same policies: They favor large companies at the expense of the people. Philippot quotes Marine Le Pen: "Globalization means using slaves to manufacture products that are then sold to the unemployed!"...

*** DER SPIEGEL / LINK

Trust Product's Rescue Too Close for Comfort

Hundreds of investors were counting down to a big payoff when suddenly the trust company handling their money warned they might lose everything.

The online warning issued by China Credit Trust Co. Ltd. (CCT) on January 15 said an investment product that financed a struggling coal mining concern in the northern province of Shanxi might default. The product was to mature just two weeks later, on January 31, the first day of the lunar new year.

The notice posted by CCT, which had in fact had paid decent interest since the three-year product was issued in 2011, said each of the retail investors might lose their entire principal, which totaled 3 billion yuan.

Investors were understandably shocked by the warning, and news of the impending default spread fast after domestic and overseas media picked up the story.

A week later, though, a solution started to gel. Executives from CCT and Industrial and Commercial Bank of China (ICBC), whose branches in Shanxi and cities including Shanghai sold the product on behalf of CCT in their office space, met to discuss a possible bailout. They also sought support from investors that had shown interest in the financially strapped mine owner, Shanxi Zhenfu Energy Group Ltd.

A plan was hammered out, and ICBC took the lead in giving investors the news: The bank told the investors that all principal would be repaid to all who agreed to transfer their rights to Zhenfu shares to three anonymous institutional investors by January 31.

A client manager at ICBC's Shanghai branch said nearly 700 people invested in the trust, each with at least 3 million yuan. It is unclear how many of them signed the agreement, but there has been no report of anyone losing their principal after the agreement was reached.

The institutional investors — with support from CCT, ICBC and the Shanxi provincial government — then bought all of the trust plan's Zhenfu shares, the source said.

Before the new year arrived, the deal had been settled and investors had been fully repaid the principal plus an average of 7 percent interest for each of the product's three years.

One investor widely cited by Chinese media told Caixin he invested 10 million yuan in the trust in 2011 based on expectations of annual interest earnings of around 10 percent. He said his expectations were met for the first two years, but that the third year's payment on January 8 was equal to only 3 percent.

Chen said he sensed the investment was in trouble, but did not anticipate a major loss, assuming the bank would never let trust investors lose their money. He said he also considers himself a valuable ICBC patron worthy of a bailout, especially considering that he's even helped the bank find other good clients.

For trust product investors in China, the CCT product's near-default and subsequent bailout rang a familiar bell. At least other three trust companies, two of which are listed, were forced to deal with a troubled investment product in 2013 alone.

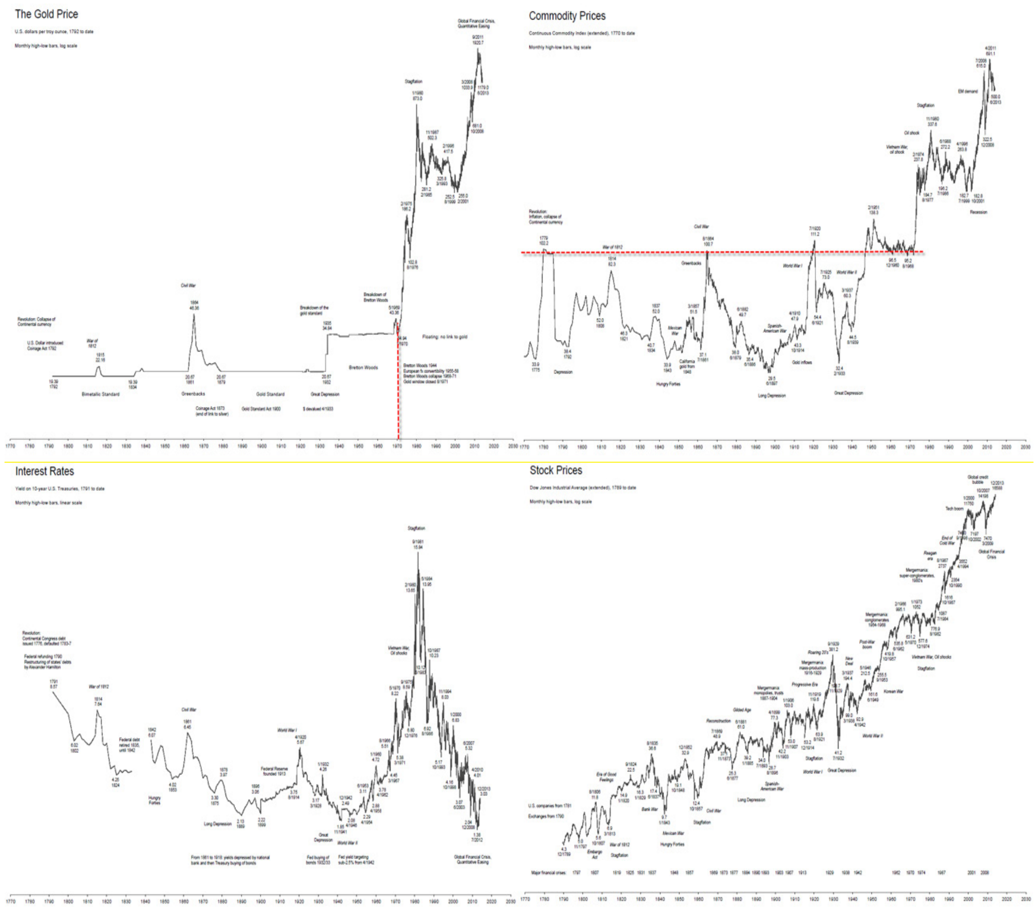
Investors almost lost all their money when a fertilizer company defaulted on a 570 million yuan commitment tied to a trust product. The product was sold by Shenzhen-listed Shaanxi International Trust Co. Ltd., which in August was forced to repay investors out of its own pocket.

Shanghai-listed AnXin Trust & Investment Co. Ltd. was similarly caught between a rock and a hard place after a property developer missed a debt repayment deadline. AnXin seized and then sold assets that had been used as collateral before repaying investors in full.

The country's largest trust firm, Citic Trust Co., was likewise forced to try auctioning a trust product's collateral assets last year after the borrower defaulted. When no bidders surfaced, Citic was forced to buy the assets, according to a source. Investors of the trust were then repaid in full....

*** CAIXIN / LINK

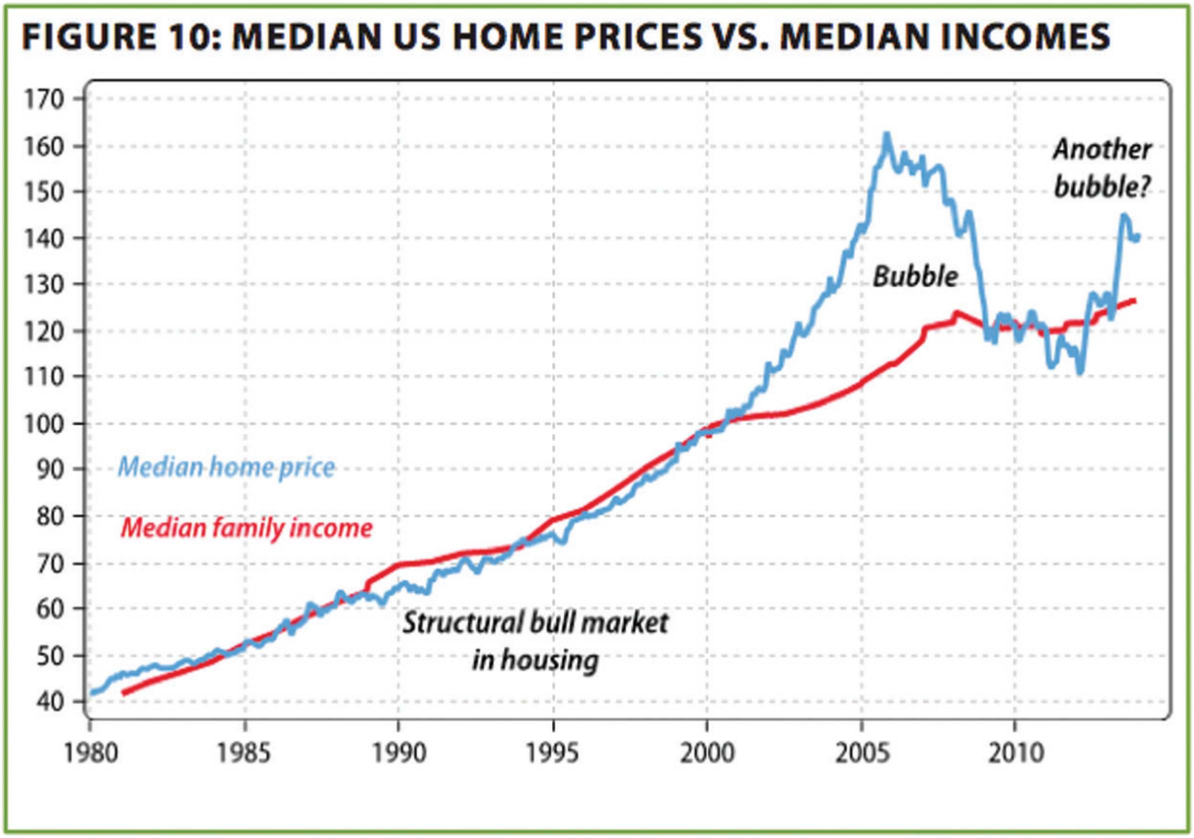
Charts That Make You Go *Hmmm...*



Source: SoberLook

In a week when history has yet again taken centre stage in *Things That Make You Go Hmmm...*, these amazing long-term charts going back to US independence seemed extremely apropos.

*** @MACRO_TOURIST (VIA ZERO HEDGE) / LINK



Source: Evergreen GaveKal

History is quite clear that societies can only pull forward affluence for so long until the realization unceremoniously sets in that there was only so much wealth to accelerate. Once that epiphany occurs, the adjustment process is both swift and painful, much like the bull fighter's final thrust.

For a real life example that should still poignantly resonate in the minds of investors worldwide, consider what happened with housing a decade ago. After years of largely tracking median family income, home prices dramatically detached from that crucial fundamental factor (after all, one needs cash flow to make mortgage payments, a reality that both regulators and lenders blithely ignored).

This breakaway lasted for several years, emboldening the real estate bulls to proclaim a new era. But, as the great Bob Farrell has said, there are no new eras—excesses are never permanent. The housing market had pulled forward years of price appreciation into the period from 2001 to 2006—aided and abetted by the Fed's overly loose monetary policies and chronic bubble blindness—and the puncturing of this mania nearly detonated the global financial system.

*** DAVID HAY / FULL COMMENTARY (EMAIL)

Ukraine's sovereign CDS spread is approaching the high reached right before the Russian bailout was announced. The currency is nearing the pre-bail-out lows.

The market is all but discounting the nation's ability to obtain the next batch of bailout funds — wherever it comes from — before defaulting.

> *Euronews: Financial experts have warned Ukraine is on the brink of default with some saying currency reserves are enough for only two months. Russia has provided the first three billion dollar tranche of a loan. With the political stand off the rest has been frozen.*

There are no easy answers here, as the nation faces a daunting challenge of obtaining cash to run its government for the next few months. Many view the country as a victim of tensions between the West — who prefers to see a certain type of government there — and Russia, who is not too interested in Ukrainian sovereignty. Some analysts warn that Russia could escalate its pressure on the former Soviet republic.

> *WSJ (Stephen Blank): — Behind its coercive diplomacy in Ukraine is the threat of force, either incited by Russia or carried out by it. Recent reports of pro-government militant groups forming in eastern Ukraine, calls in the Crimean legislature for Russia to "rescue" them from Ukraine's anti-government uprising, and repeated discussions in the Russian media about partitioning Ukraine, all point to a pattern of escalating pressure from Moscow—a pattern that paves the way for the use of force.*

In the mean time, the tensions on the streets are rising, as both sides — the protesters and the authorities — harden their stance. Time is running out for Ukraine.

*** SOBERLOOK / LINK

Words That Make You Go *Hmmm...*

CLICK TO WATCH

Two minutes with Jim

Grant is worth hours in the company of most financial commentators (myself included!!), so take this opportunity to avail yourself of the wisdom of one of the great minds of finance as he explains what Janet Yellen SHOULD have said in her first testimony, had she been truthful, and also explains the consequences of the Fed having its "thumbs on the scales of finance."

My buddy John

Mauldin made one of his rare appearances on Eric King's website this past week, and the result is a fascinating interview covering the recent gyrations in emerging markets, The Taper, the mindset of central bankers, fund flows, and his predictions for "The Big One."

CLICK TO LISTEN

Pick a side.

This gentleman is Liam Halligan of the *Daily Telegraph* (and a regular feature in these pages). After a lengthy correspondence, he engages fellow economist Prof. Tim Congdon in a lively debate about the likelihood of inflation or deflation in our future.

One of them is staunchly pro-QE and believes it will all be fine...

The other is Liam Halligan...

A VERY instructive video

CLICK TO WATCH

and finally...

Hands up if *you know who this beautiful lady is. Thought so. Anybody who has watched the movie* 20 Feet From Stardom *will instantly recognize the incomparable Lisa Fischer, who has toured with the Rolling Stones since 1989, singing some of the finest backing vocals ever heard.*

Every night on tour, Lisa and her powerhouse voice take centre stage for one of the best tracks the Stones ever recorded, "Gimme Shelter."

Lisa will be in Singapore (with the Rolling Stones) in a few weeks, so here is a taste of what the crowds at the Marina Bay Sands will be treated to when they play:

Gimme Shelter, Rio de Janeiro, 1995

If you are a music fan and you haven't seen 20 Feet From Stardom*, do yourself a favour and put that right. It's an extraordinary film, featuring Lisa and a host of other amazing voices.*

You can follow Lisa on Twitter @lisafischersing

CLICK HERE TO WATCH VIDEO

Hmmm...

Grant Williams

Grant Williams is the portfolio manager of the Vulpes Precious Metals Fund and strategy advisor to Vulpes Investment Management in Singapore — a hedge fund running over $280 million of largely partners' capital across multiple strategies.

The high level of capital committed by the Vulpes partners ensures the strongest possible alignment between the firm and its investors.

Grant has 28 years of experience in finance on the Asian, Australian, European and US markets and has held senior positions at several international investment houses.

Grant has been writing *Things That Make You Go Hmmm...* since 2009.

For more information on Vulpes, please visit www.vulpesinvest.com.

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66th Annual CFA Conference, Singapore 2013 Presentation: "Do The Math"

Mines & Money, Hong Kong 2013 Presentation: "Risk: It's Not Just A Board Game"

Fall 2012 Presentation: "Extraordinary Popular Delusions & the Madness of Markets"

California Investment Conference 2012 Presentation: "Simplicity": Part I : Part II

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>
> Grant Williams

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