

Beyond the Tipping Point?

Or what's a Minsky?

AAII – DFW

Fred Richards

January 7, 2015

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Fred F. Richards, Jr.

Acknowledgements

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For your information

- Outlook 2015 can be viewed at:
- www.adrich.com
- The slides in this presentation can be obtained by going to:
- www.stratinv.net/public/Outlook2015.pdf

What's a Minsky?

- A ***Minsky moment*** is the point in the credit cycle when investors start to incur cash flow problems due to the growing debt load they have acquired in order to finance speculative investments.
- At this point in the cycle, a major sell-off begins as counterparties start to withdraw from the market, leading to a sudden and precipitous collapse in asset prices, accompanied by a sharp drop in liquidity.

— *Economist Hyman Minsky*

Hope vs Reality

- 2014 saw the market at new highs
- FED kept interest rates low
- Corporate financial engineering provided higher earnings
 - Stock buybacks
 - Reduced employment levels
- Greenspan concurs in “sluggish economy.”

Muddling-Through

- Good only in relation to others' troubles
- Brent crude down 49% in 2014
- Iron ore down 47% in 2014
- Copper off 15% in 2014
- Corn off 50%, Soybeans down 40%, Wheat off 35%
- Only by changing methodology can positive results be seen in GDP, CPI & unemployment

Federal Reserve

- Mandates
 - Monetary policy – 2% inflation = 19% theft decade
 - Stable prices – 1913 \$ now worth 3 cents
 - Moderate long-term interest rates
- Taking care of FED's constituents ... banks
 - Rebuild capital base from bad derivative positions
- ZIRP & QE damages lower & middle class
 - Interest on savings below true inflation

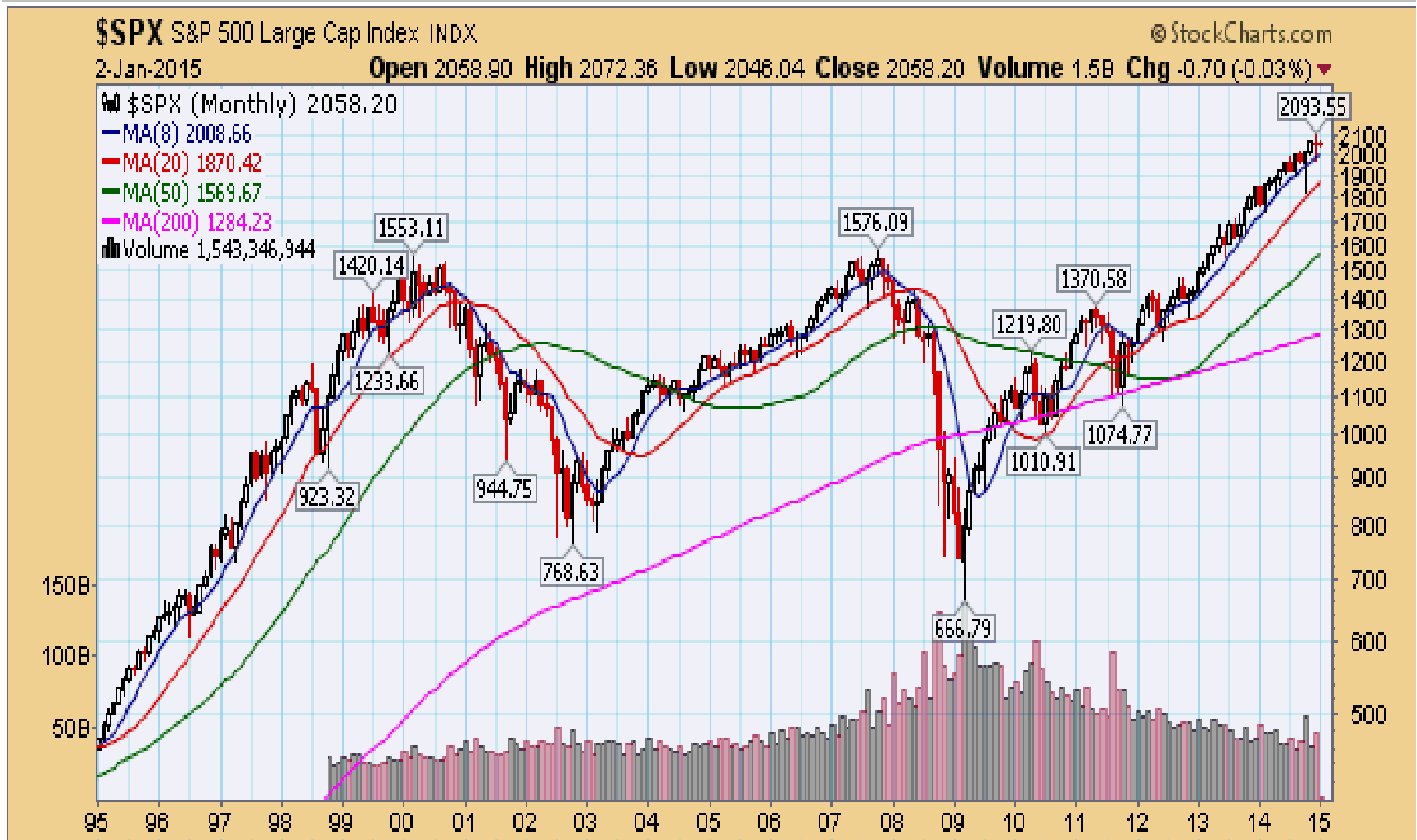
NASDAQ at record high!



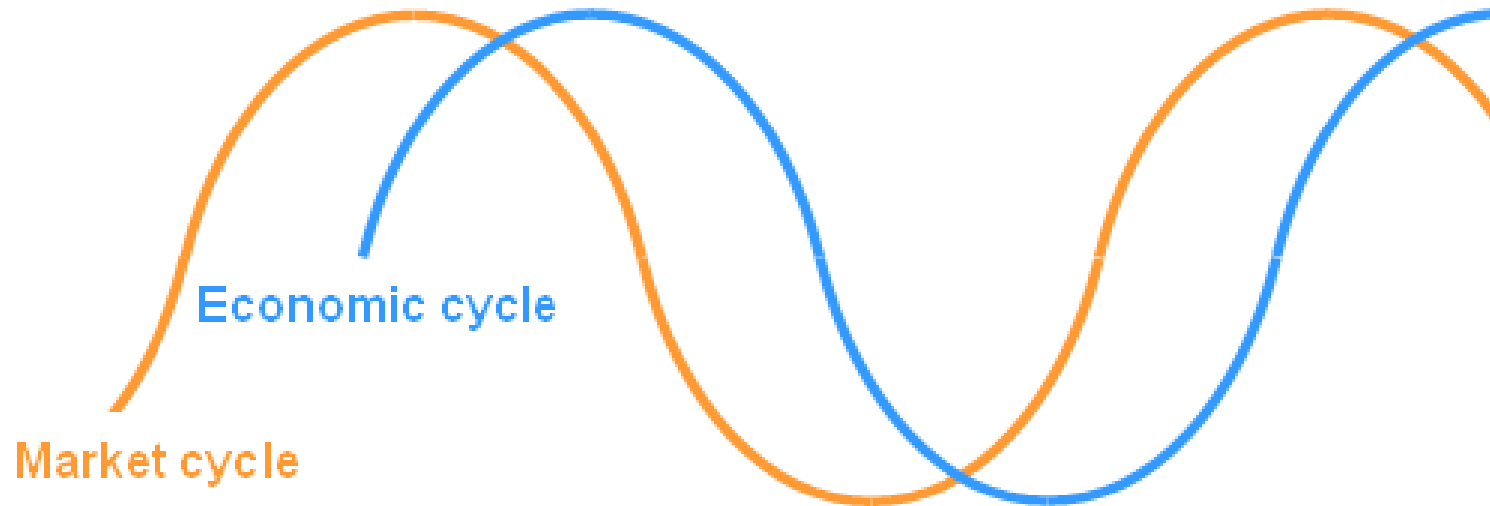
DJIA over 18,000 – new record



S&P 500 at record levels



KISS & SF!



Economic and market cycle relationship

Never forget ... cycles always continue
and
“great gains are often made when blood runs in the streets.”

Bearish Cycles

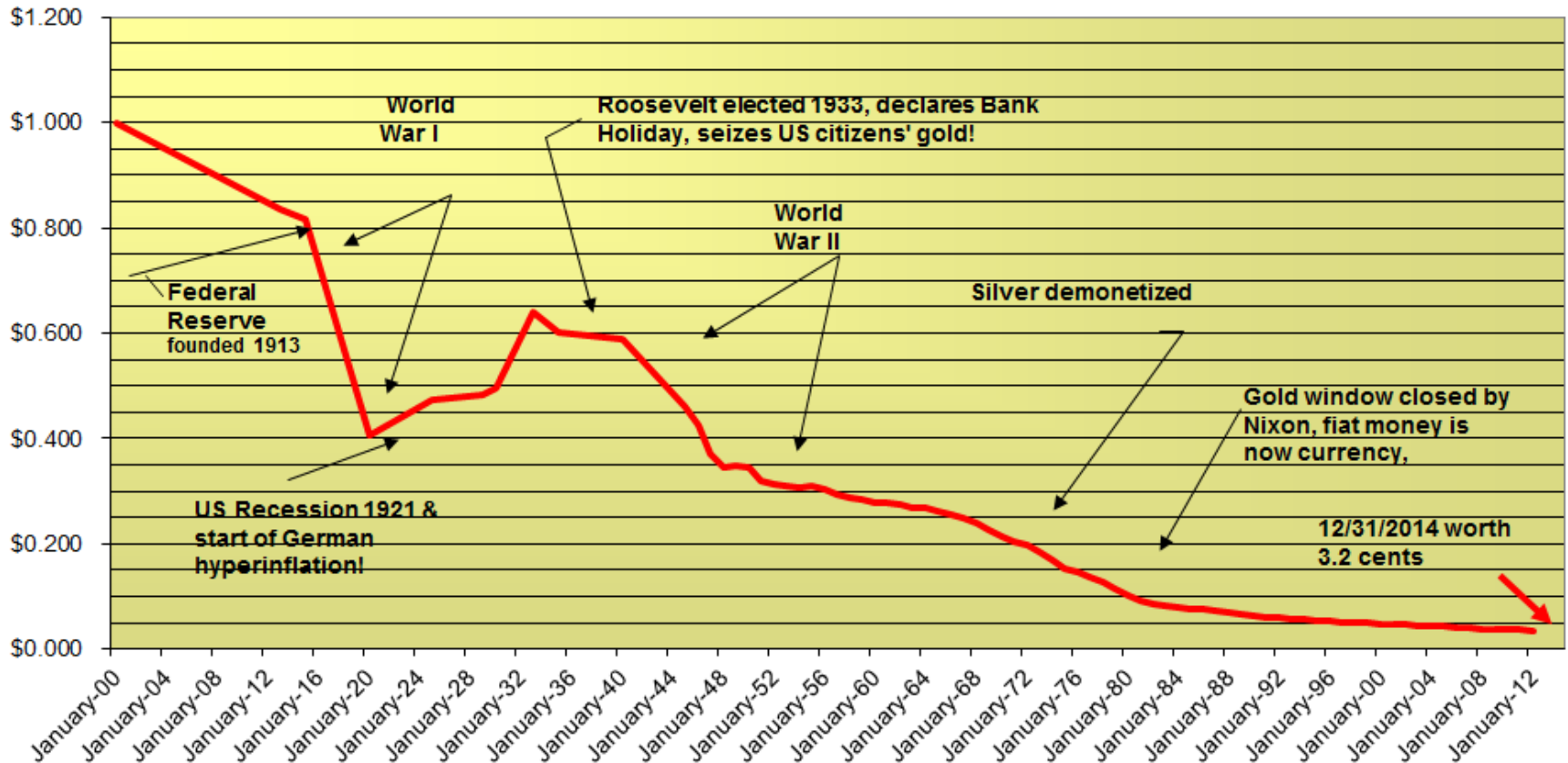
- Gold topped in September 2011
- Copper, aluminum & iron ore peaked early 2012
- Corn, soybeans & wheat in late summer 2012.
- WTIC and Brent crude topped in summer 2014.
- *US Stocks topped (?) December 2014*

Nominal Values

- Fall to reflect purchasing value of \$
- US \$ losing grip on role of reserve currency
- Advantages
 - Leverage in debt markets
 - Leverage in trade matters

The Ravages of Inflation

Value of 1900's US Dollar since 1900



© 2014 Strategic investing

— Value of 1900 \$

Source: U.S. Statistical Abstract, BLS Data

U.S. Dollar

\$USD US Dollar Index - Cash Settle (EOD) ICE

2-Jan-2015

© StockCharts.com

Open 90.81 High 91.44 Low 90.80 Close 91.43 Chg +0.81 (+0.90%) ▲



Gold Moves

- China #1 gold producer, reserves understated
- Germany demanded gold – good luck!
- Saudi Arabia repatriated gold from London
- Belgium, Switzerland, China & Venezuela remove gold from NY Fed & London
- Gold ETF loses over 50% of its assets
- US Gold reserves last audited in 1952
- Deep Hold Reserves (?)

NASDAQ in Gold



S&P 500 in Gold





Points investors should consider

You can never know tomorrow but ...

Points to Remember

- The debt cycle will end badly.
- Reducing headcounts & stock buy-backs do not build long-term growth.
- Is the U.S. still #1 economy?
- US dollar continues to lose lustre
- 50 million on food-stamps
- Real employment rate is 22%
- Real inflation is 9-12%

Obfuscation rules!

U.S. Federal Government Debt

Date	Intragovernmental Holdings	Public Debt	Total Debt
9/29/2013	\$4,761,904,290,623.49	\$11,976,279,236,073.80	\$16,738,183,526,697.30
9/30/2014	\$5,093,951,096,290.15	\$12,781,306,994,916.90	\$17,875,258,091,207.00
Change			\$1,137,074,564,509.70

Source: Treasury Direct - Debt to the Penny

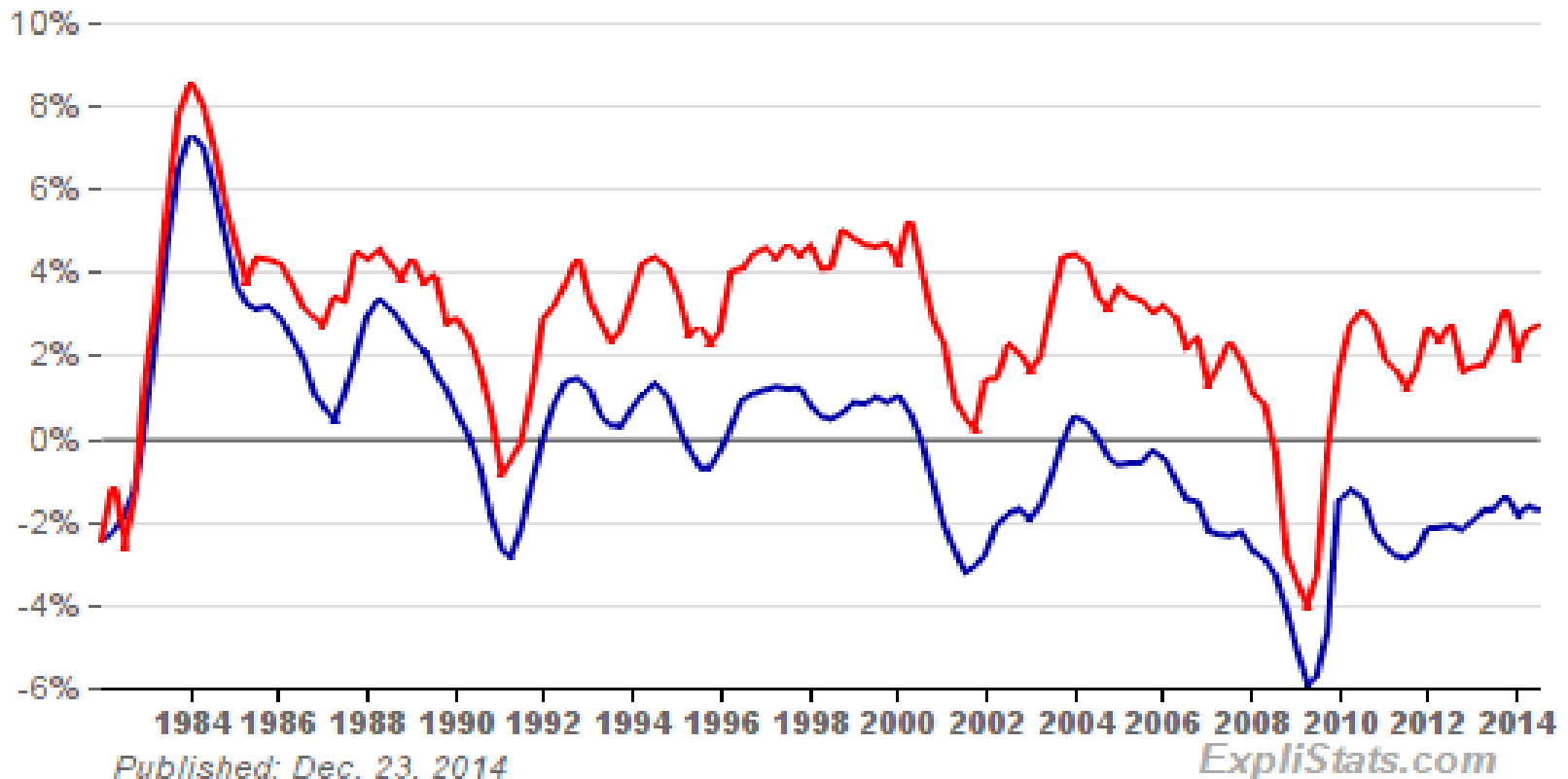
But FY 2014's deficit was reported as \$483 Billion, not \$1,137 billion!

Gross Domestic Product (GDP)

GDP Annual Growth - Official vs ShadowStats

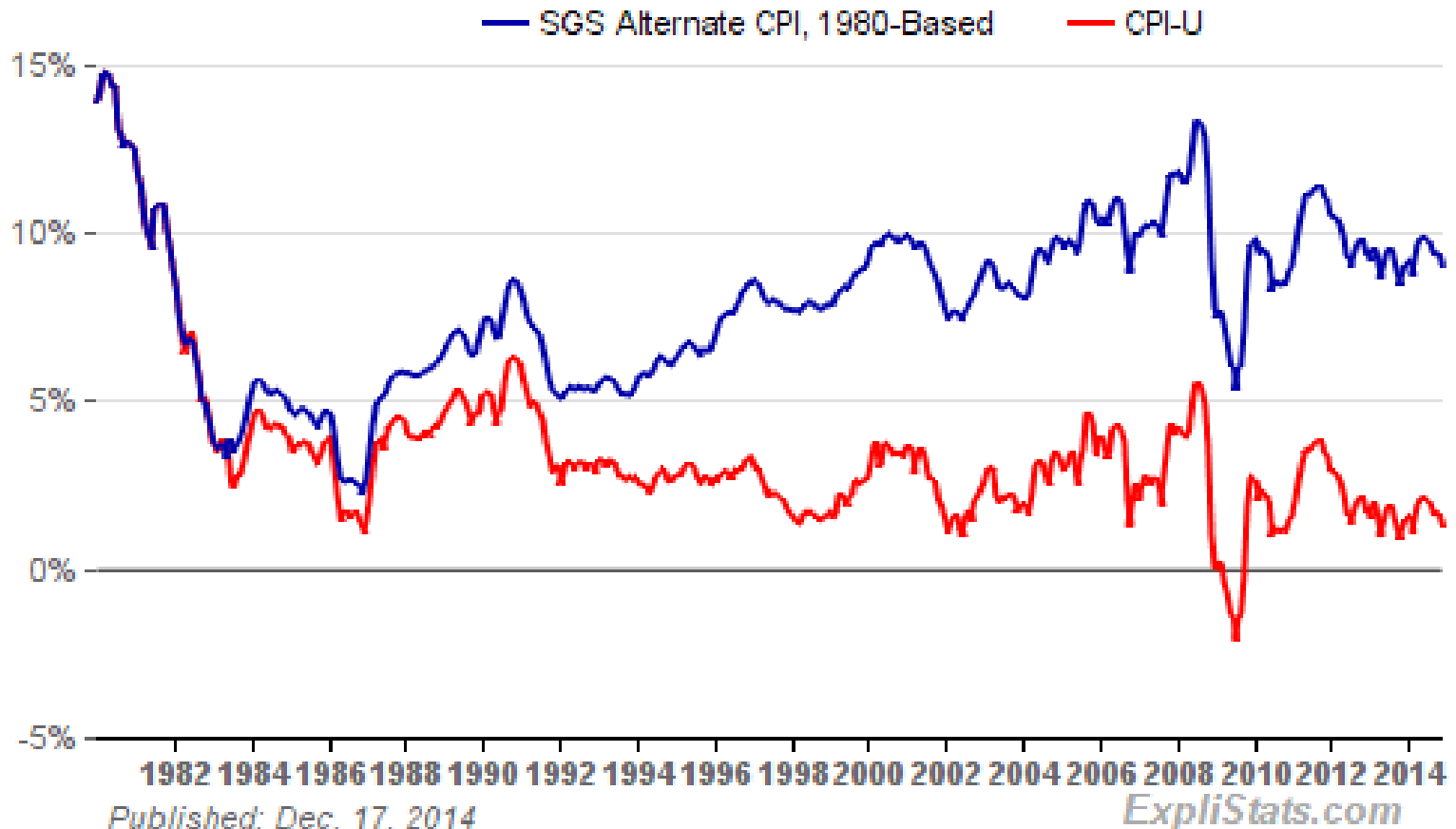
Annual Change through 2014q3 (ShadowStats, BEA)

— Official (BEA) — SGS Alternate



Consumer Price Index (CPI)

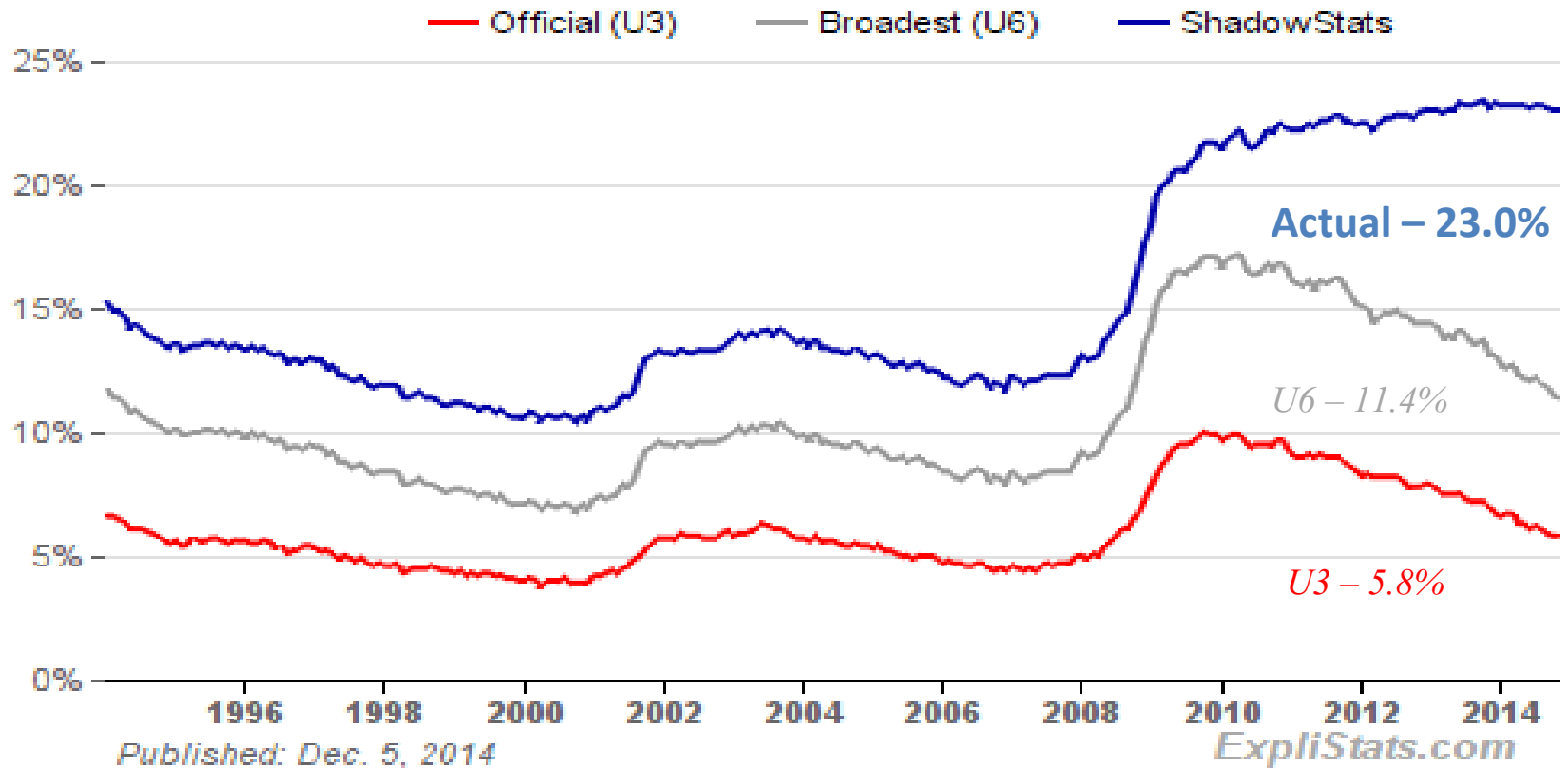
Consumer Inflation - Official vs ShadowStats (1980-Based) Alternate
Year to Year Change. Through Nov. 2014. (BLS, SGS)



Unemployment

Unemployment Rate - Official (U-3 & U-6) vs ShadowStats Alternate

Monthly SA. Through Nov. 2014 (ShadowStats, BLS)



Facts no longer Matter

- GDP growing 5%
- CPI at 2%
- Unemployment 5.8%
- US Debt - \$18 T
- GDP under 2%
- CPI 9-12%
- Unemployment 23%
- Debt + UL > \$100 T

Where has Truth and Transparency Gone?

Transparent Government

- Fast & Furious Guns
- Benghazi
- 501 (c3)'s
- Immigration policy
- Working Group on Capital Markets
- **Selective enforcement of laws**

Only Things that really matter!

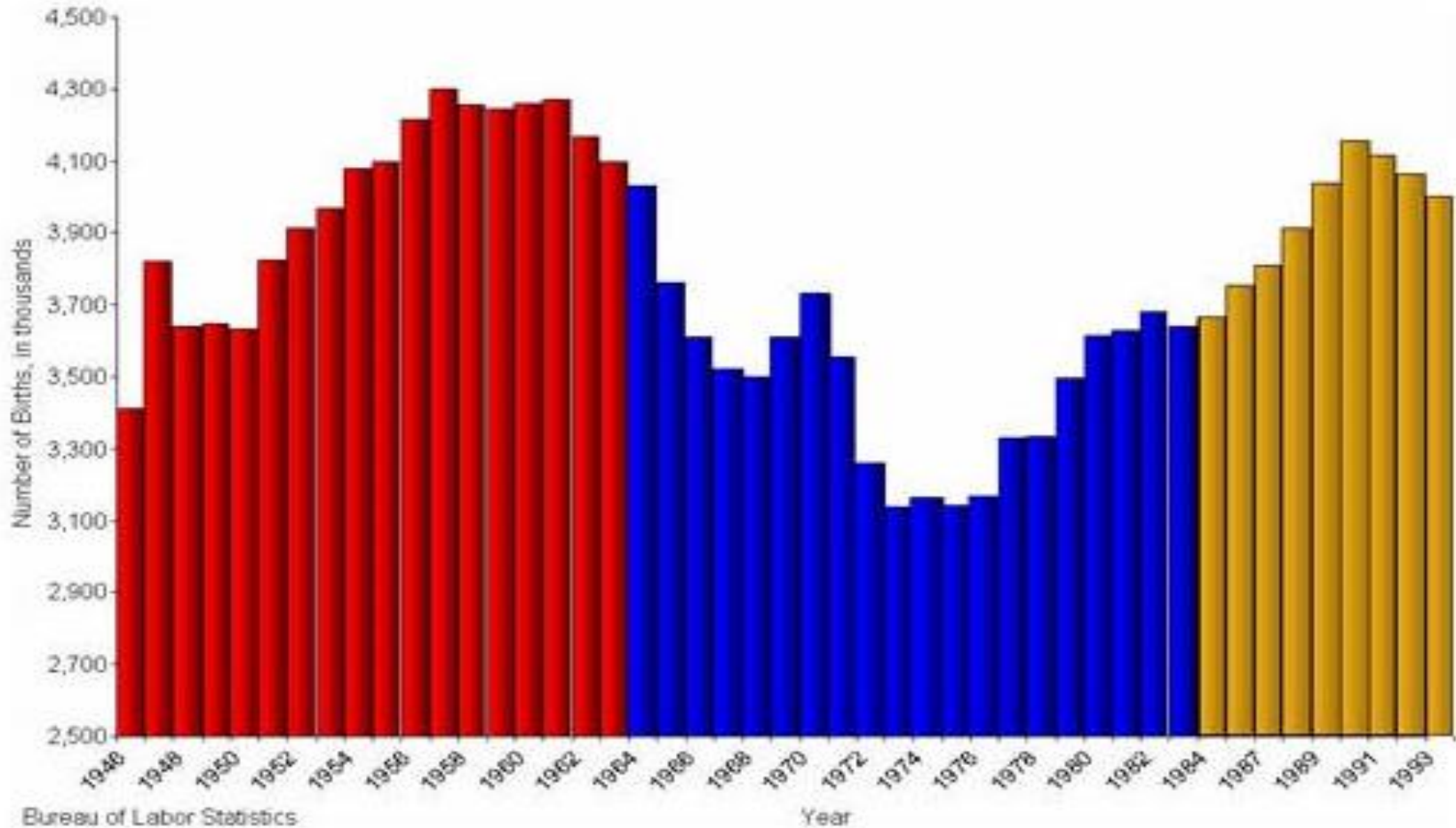
DEMOGRAPHICS, DEBT & DEFAULT

DEMOGRAPHICS

Basic Problems

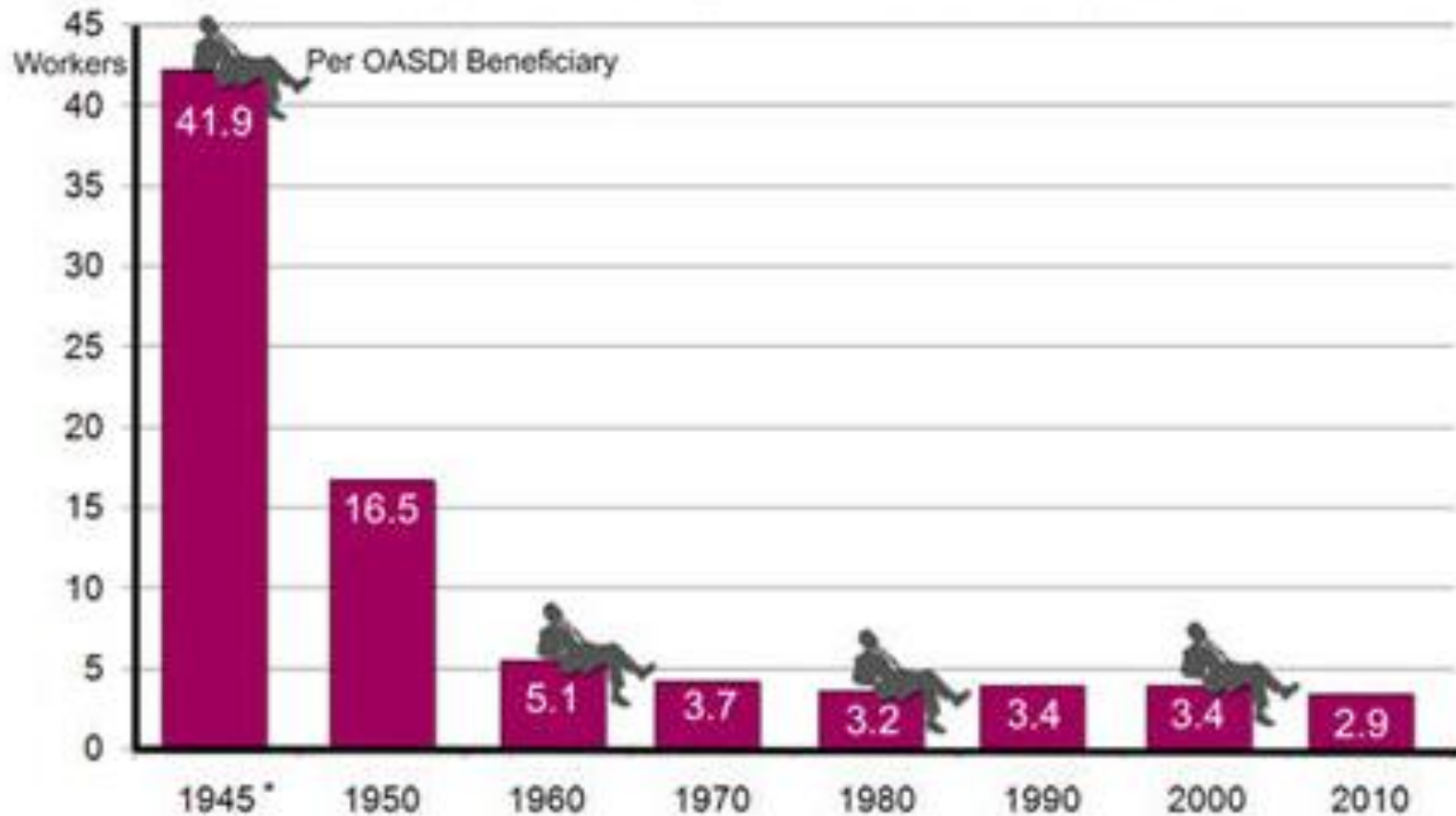
- U.S. births below replacement level since 2007
- U.S. citizen only 1.88 ... not 2.1 to replace
- Groups above 2.1 are immigrants and welfare recipients
- Fabric & Composition of society transformed
- Critical thinking vs. “Feel-Good” education
- Welfare benefits enable dependency

Baby Boomers moving out!



Bankrupts Social Security Funds

How Many Workers Support One Social Security Retiree?

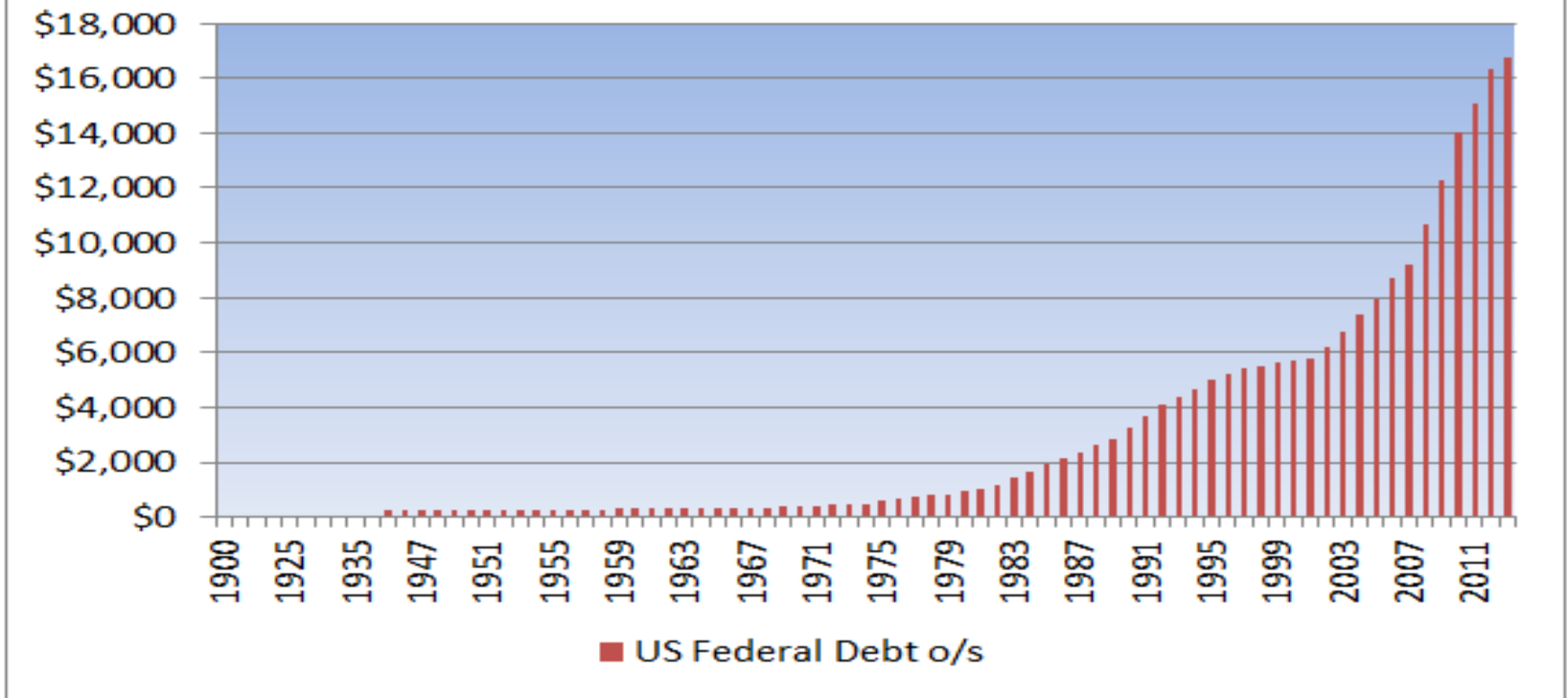


Age of Exceptionalism

Giving Way To

Age of Dependency

US Federal Debt owed in \$ billions



DEBT

Stated Cash Debt per U.S. Treasury

U.S. Government Annual Fiscal Deficits and Total Obligations

GAAP versus Cash Accounting. Sources: ShadowStats.com, U.S. Treasury

I	II	III	IV	V	VI	VII
Fiscal Year Ended Sep 30	Formal Cash-Based Deficit [Surplus] (\$Billions)	GAAP Ex-SS Etc. Deficit [Surplus] (\$Billions)	GAAP With SS Etc., Raw Deficit [Surplus] (\$Trillions)	GAAP With SS Etc., Consistent-Basis Deficit (\$Trillions)	Gross Federal Debt (\$Trillions)	Total Federal Obligations (GAAP) (\$Trillions)
2013	\$680.2	n.a.	n.a.	\$6.8 ^e	\$17.2 ^e	\$92.3 ^e
2012	1,089.4	\$1,316.3	\$6.6	6.6	16.2	85.4 ¹
2011	1,298.6	1,312.6	4.5	4.5	14.9	80.9 ¹
2010	1,294.1	2,080.3	[7.0] ¹	5.3 ¹	13.6	76.3 ¹
2009 ²	1,417.1	1,253.7	4.3 ²	4.3 ²	11.9	70.5 ²
2008	454.8	1,009.1	5.1	5.1	10.0	65.6
2007	162.8	275.5	1.2	4.2	9.0	59.8
2006	248.2	449.5	4.6	4.6	8.5	58.2
2005	318.5	760.2	3.5	3.5	7.9	53.3
2004	412.3	615.6	11.0 ³	3.4 ³	7.4	49.5
2003	374.8	667.6	3.0	3.0	6.8	39.1
2002	157.8	364.5	1.5	1.5	6.2	35.4
2001 ⁴	[127.0]	514.8	4.5	4.5	5.8	30.3
2000 ⁴	[236.9]	[39.6]	3.9	3.9	5.7	25.9

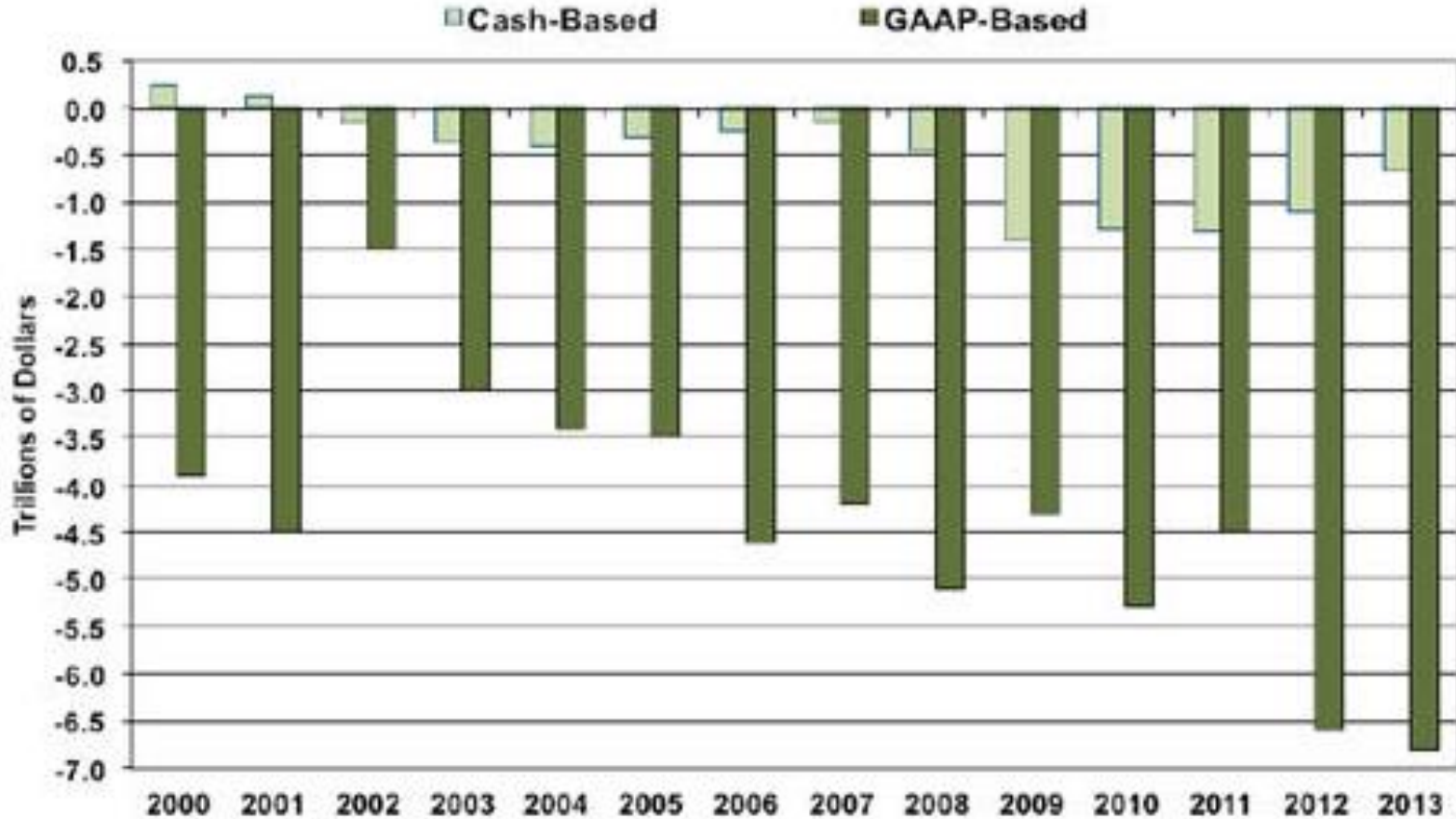
Last updated: December 31, 2013. (n.a.) Not available. (e) ShadowStats estimates of 2013 GAAP-Based data; release of the Federal Government's GAAP-based financial statement has been postponed until February 26, 2014.

GAAP- versus Cash-Based Annual Federal Deficit

September 30th Fiscal Year through 2013 (2013 Estimated)

GAAP Is Adjusted for One-Time Accounting Changes

(ShadowStats.com, St. Louis Fed, U.S. Treasury)



Programs Grow & Grow & Grow

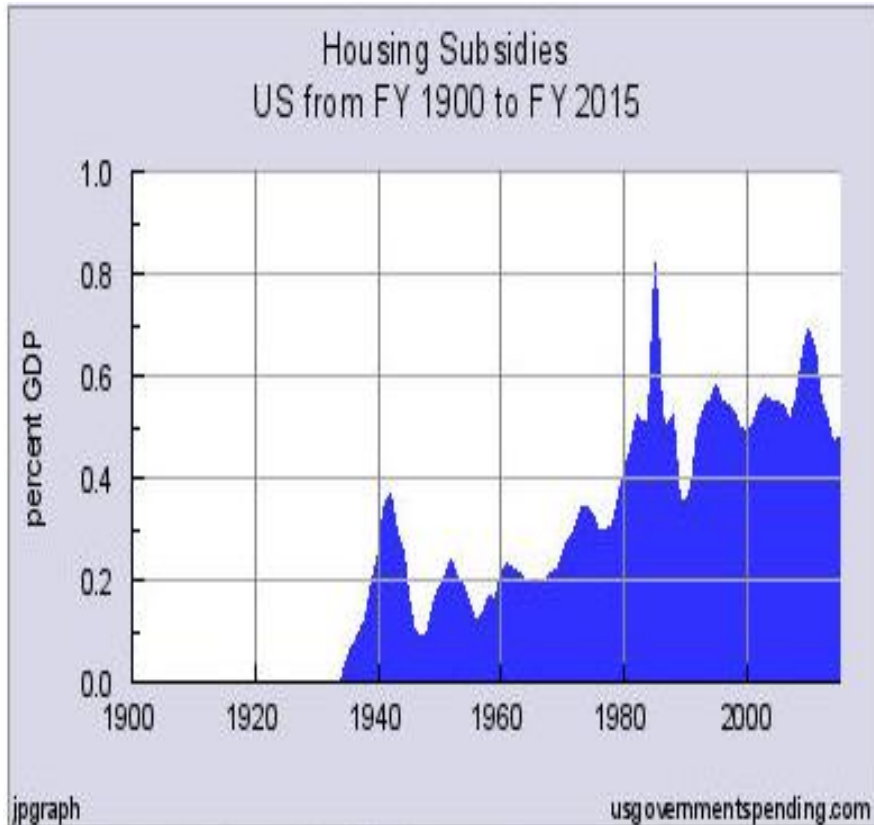


Chart 2.64: Subsidies for Housing

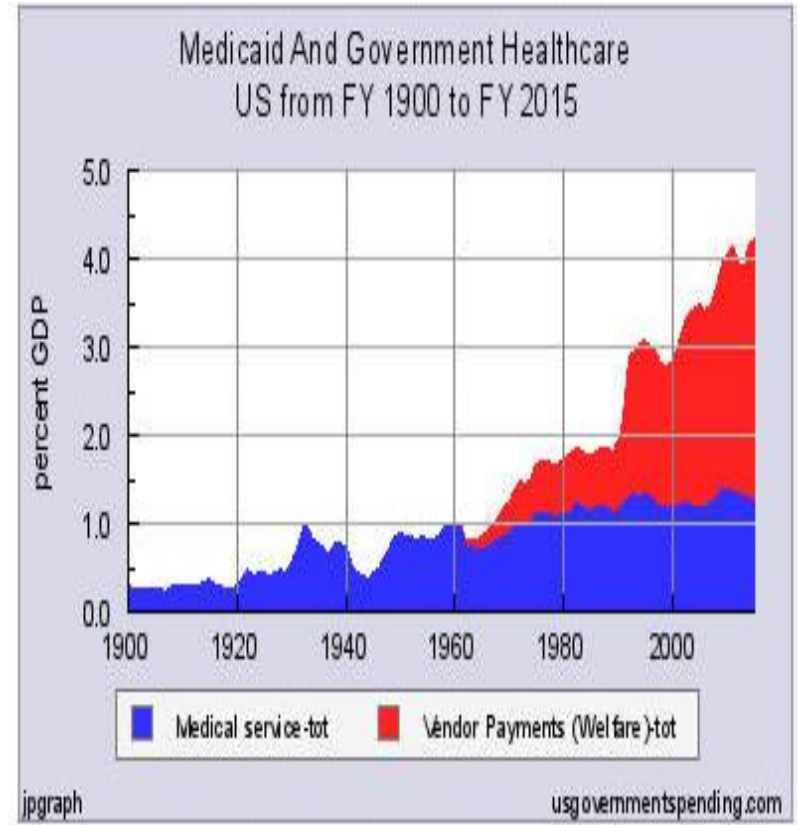


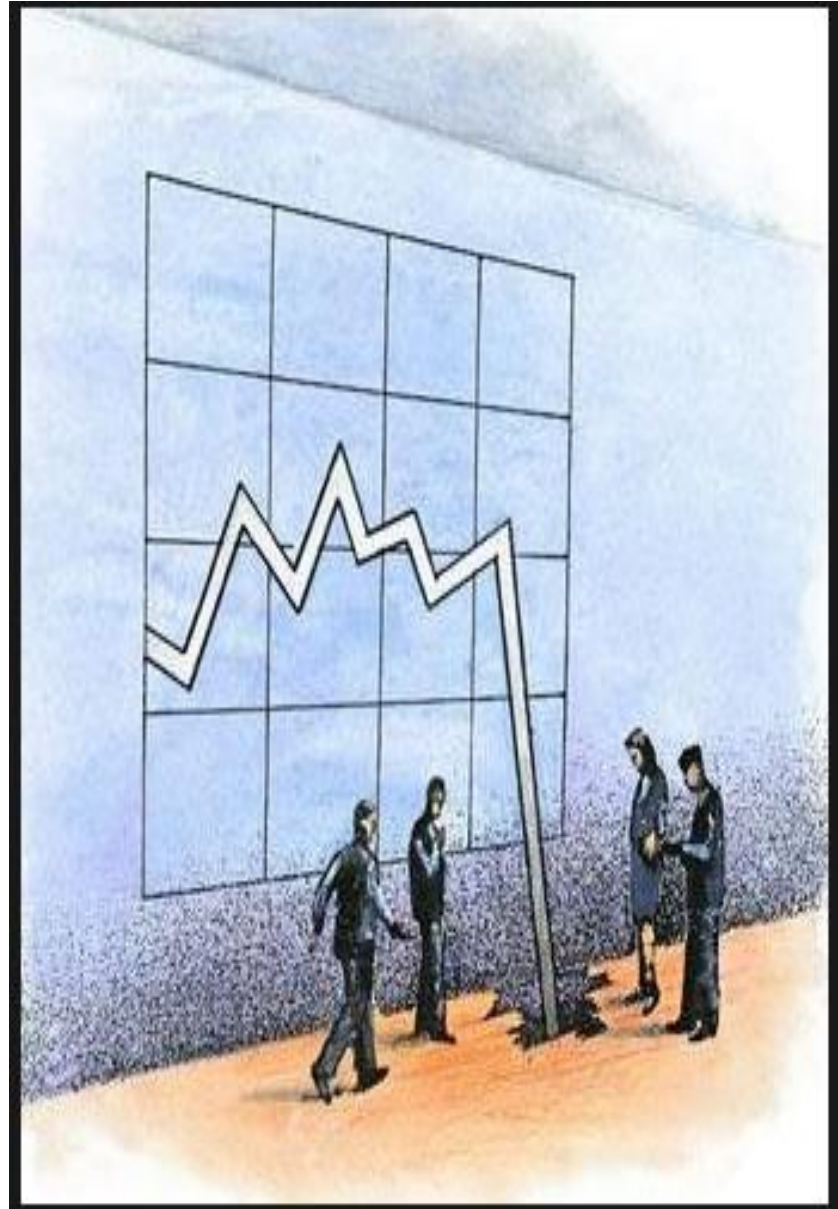
Chart 2.66: Medicaid and Government Health Care

Political Options

- Maintain the status quo and hope that a black swan event does not occur, or
- Devalue the US dollar through inflation in order to pay back debt in cheaper dollars, or
- Default on debt owed and renege on paying unfunded liabilities.

Can it happen?

DEFAULT



Won't be the 1st Time!

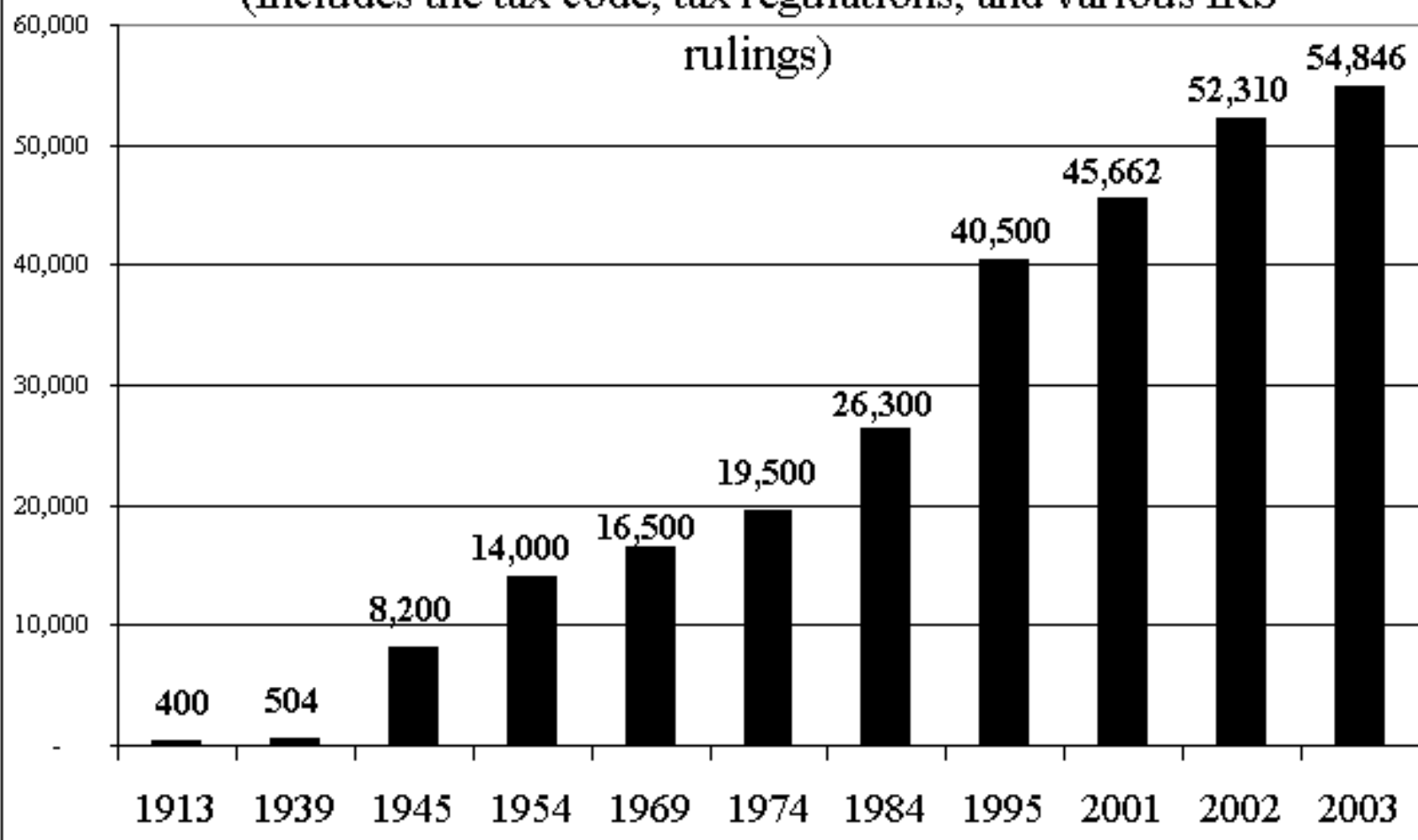
- **First Bank of the United States**
- **Second Bank of the United States**
- Panic of 1907 – Federal Reserve Act of 1913
- Roosevelt demands gold in 1933 - \$20.67/oz.
- Revalues 8 months later at \$35/oz. – “theft”
- Nixon closed Gold window in 1971 ...

Progressive ... to promote the “central goals of the constitutional system ... freedom and welfare.”

REGULATION

Total Pages of Federal Tax Rules

(Includes the tax code, tax regulations, and various IRS rulings)



Source: CCH Inc. Number of pages in the *CCH Standard Federal Tax Reporter*, www.cch.com.

Who can read it all?

- Pelosi said ... “Pass the law so we can find out what is in it.”
- Obama administration issued over 75,000 pages of new regulations on the United States in 2014, costing over \$200 billion, on the low end, if new proposed rules are taken into account.

Corruptissima republica plurimae leges.

[The more corrupt a republic, the more numerous the laws.]

-- *Tacitus, Annals III 27*

ZIRP

Quantitative Easing

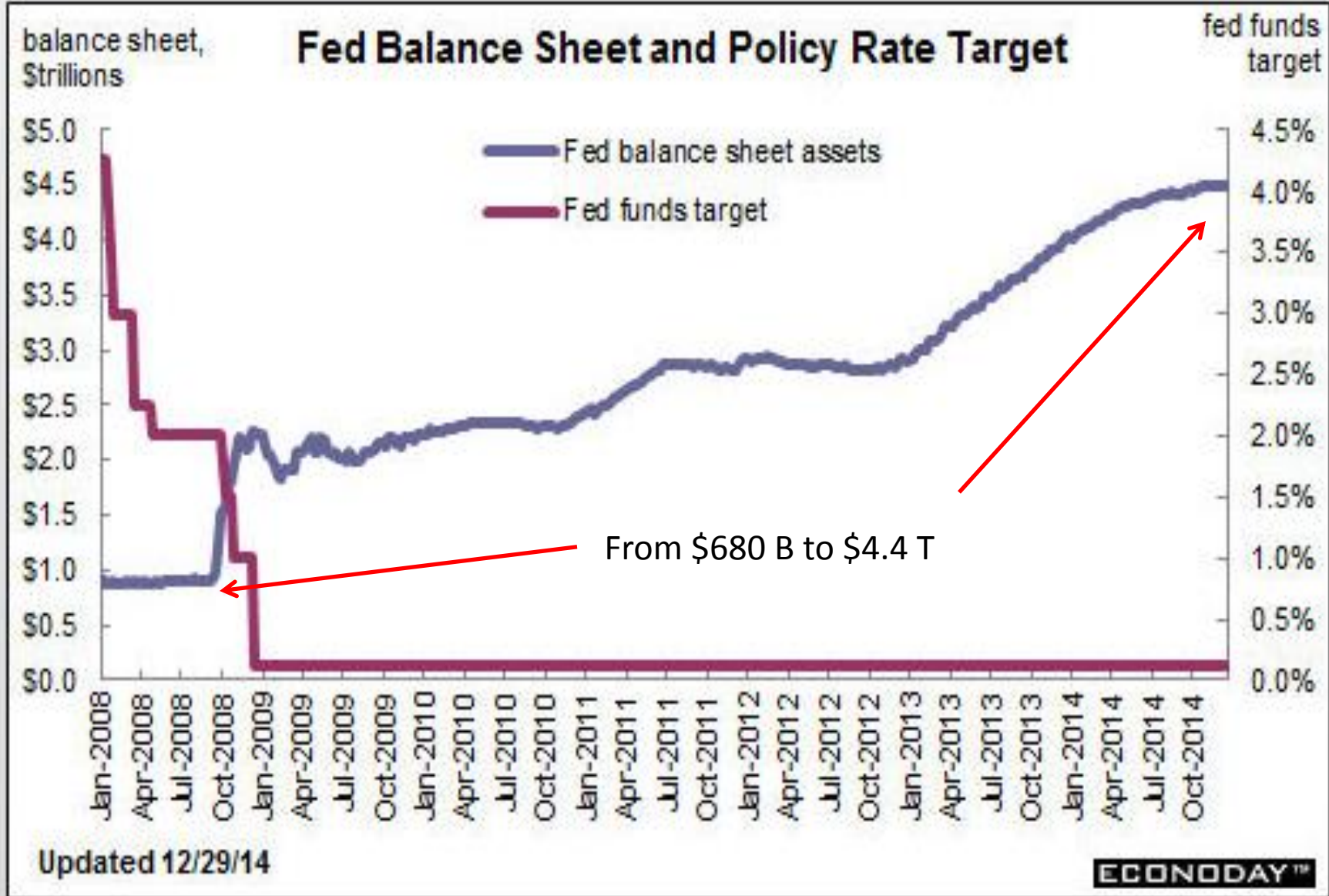
TWIST

REPO's

FEDERAL RESERVE MARKET MANIPULATION

Computer Ether

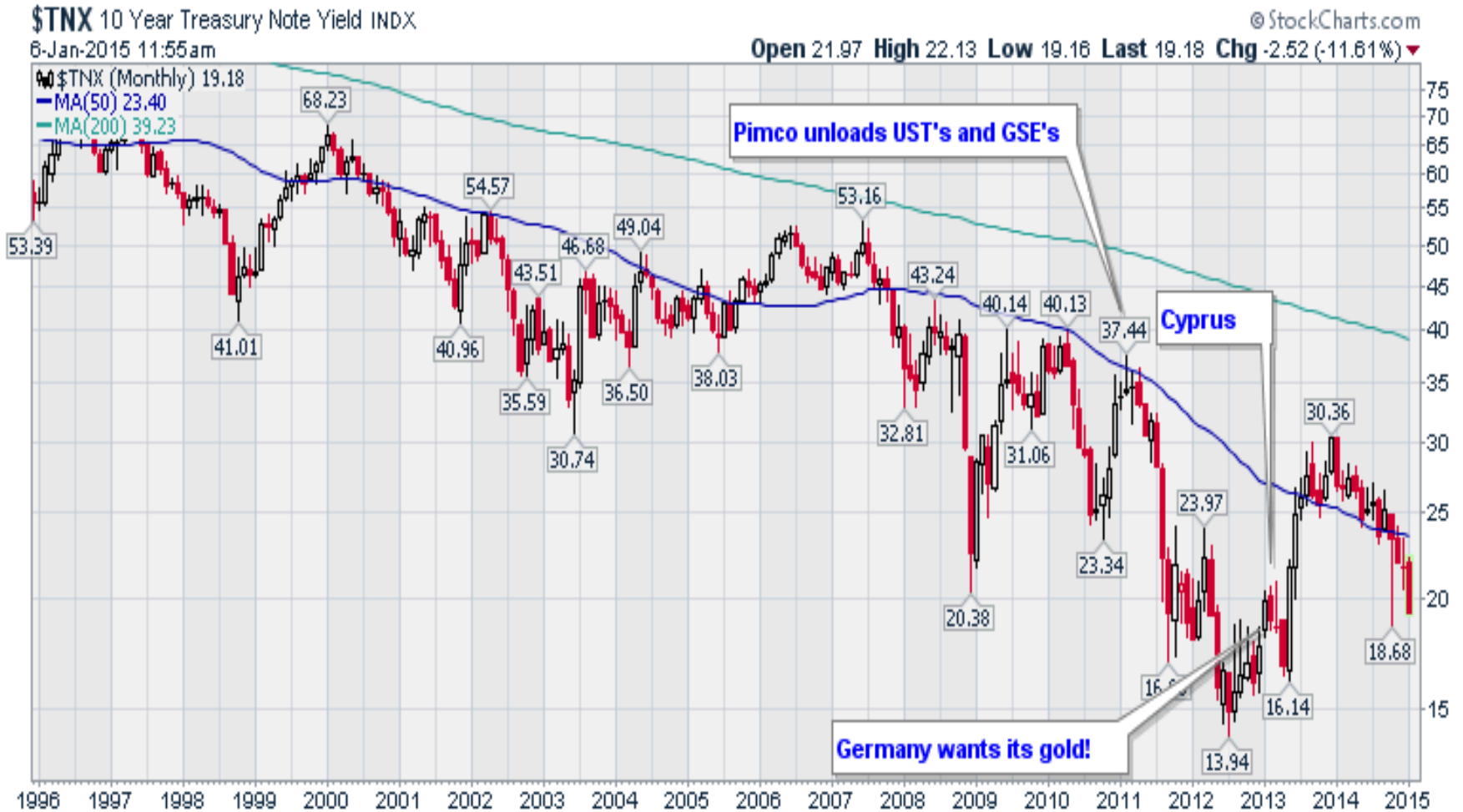




FED's Impact on Equity Levels



U.S. 10-Year Treasury



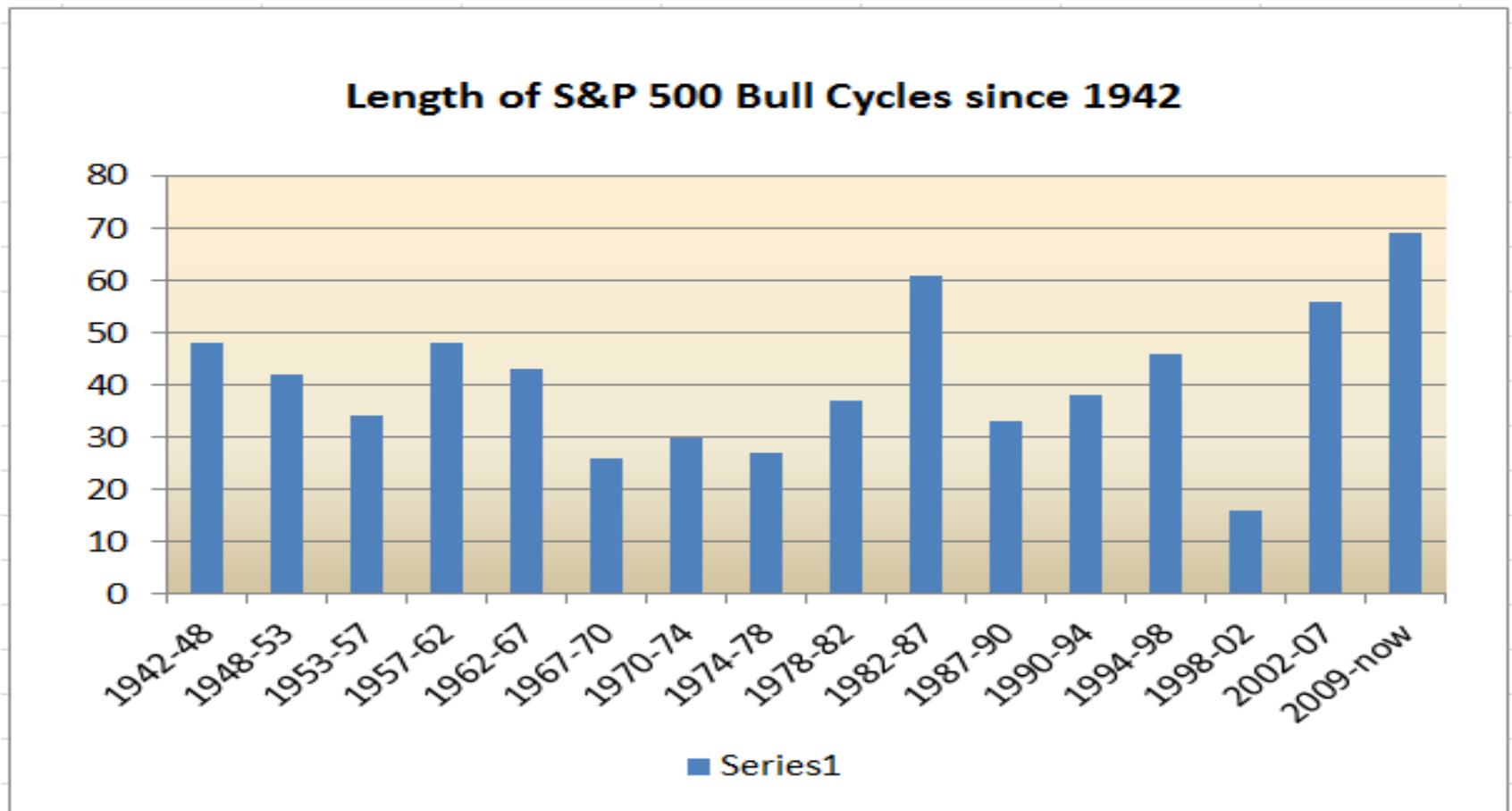
Historical Chart – 10 Year U.S. Note



Plunge Protection Team (PPT)

- The Working Group on Capital Markets, otherwise known as the Plunge Protection Team (PPT), was formed during the Reagan administration in response to the October and November 1987 market sell-offs.
- Members ...
 - U.S. Treasury Secretary
 - Chairperson of the Board of Governors of the Federal Reserve System
 - Chairperson of the Securities and Exchange Commission
 - Chairperson of the Commodity Futures Trading Commission

A Tired Bull?



Is it all just manipulation ???

- The PPT & the FED have managed to turn-back any meaningful sell-offs in the markets since November 1987.
- The stock market has now become the 3rd longest bull-market in history.

Gold Price Manipulation

- London “price-fixing” mechanism disappearing
- 2% upside/day allowance ... “prima-facie” evidence of manipulation
- Settlement of London gold contracts for cash rather than gold bullion.
- Unable to take delivery upon purchase



INVESTMENT CONCERNS

Possible World Flash Points

- Terrorist attack using poison gas or a “dirty nuclear bomb”
- Russia’s possible military response to economic sanctions and dropping commodity prices
 - If NATO responds
 - Russia’s support for ISIS & Muslim countries
 - Effect of shut-down of natural gas delivery to Western Europe

Flash Points (cont.)

- Growth of UKIP party in England could change ECM's basic makeup along w/ Greece's withdrawal
- Muslim population growth & demand for Sharia Law creating resentment among ECM native populations
 - France has passed the tipping point
 - England & Sweden now less-friendly to immigrants

Flash Points (cont. 3)

- Falling crude prices are damaging to Russia & producing nations ... is revolution the result?
- U.S. normalization of relations w/Cuba
- Will Russia try to encircle U.S. with Cuba & Venezuela

Far East Flash Points

- Japan's negative savings rate negates Abe's programs which will cause higher inflation rates.
- China's growth fueled by debt and a shifting from the agrarian economy.
 - Housing boom fueled by debt
 - One child policy now creating long-term problems
 - Shift from exports to consumer heavy economy not easy
 - GSE's have mountain of debt

China's Push Outward

- Expansion beyond the South China Sea
 - Philippines, Vietnam, Malaysia
 - Air Defense identification zone
- Westward expansion into Central Asia
 - Tajikistan – Energy pipelines
 - Uzbekistan
 - Pakistan
 - Iran
- Naval and Aircraft Military build-up

The Major Timebomb!

- Social Benefit Programs that based upon current spending levels and country demographics simply can not be supported.
- “Kicking the can down the road” is the only viable solution for politicians.

For education purposes only!

INVESTING IDEAS

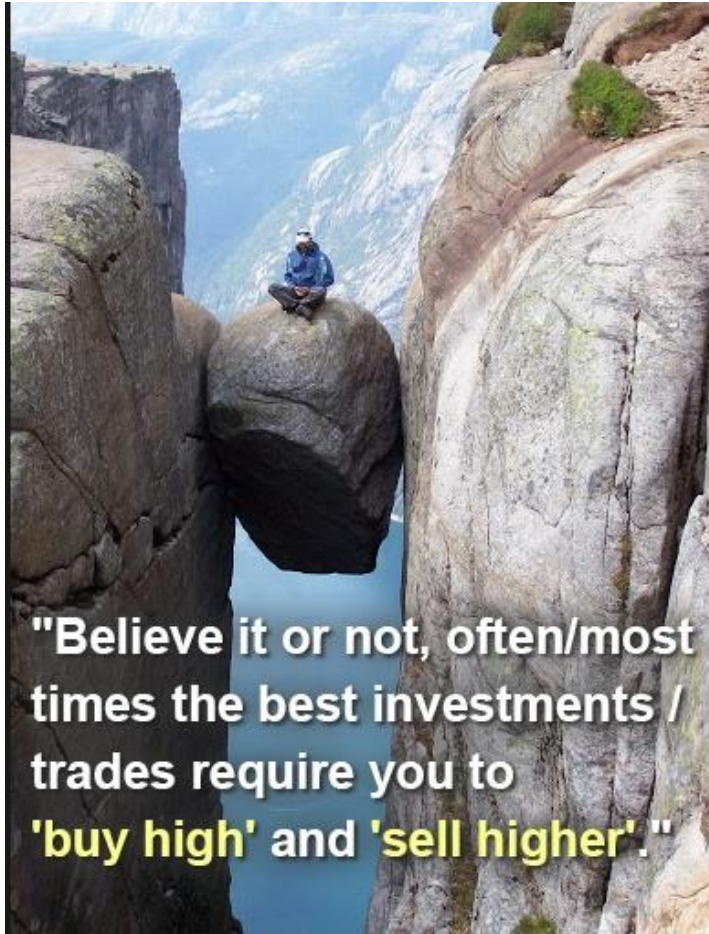
#1 Rule to Investing



Portfolio Diversification

- Physical gold & silver including “junk” silver
- Liquid stock equities
- Real estate
- Unique collectible assets –
 - Paintings
 - Commodities
 - Autos
 - Stamps

2nd Rule to Profitability



- Buy High
- **Sell Higher**
- Above all, don't get greedy ...
- Maintain your risk/reward criteria at all costs!

Bonds ?

- Useful only as short-term plays based upon the interest cycle.
- Holding a bond to maturity ... why?
-

Public Equities

- Companies with
 - Increasing revenues
 - Increasing earnings
 - Positive cash flow
 - Liquidity
 - “Moat” around the business plan
- Sectors that are leading or accelerating through the “pack.”

Dividends (?)

- See previous slide
- A long payout history is in the past ... you need to worry about the future.

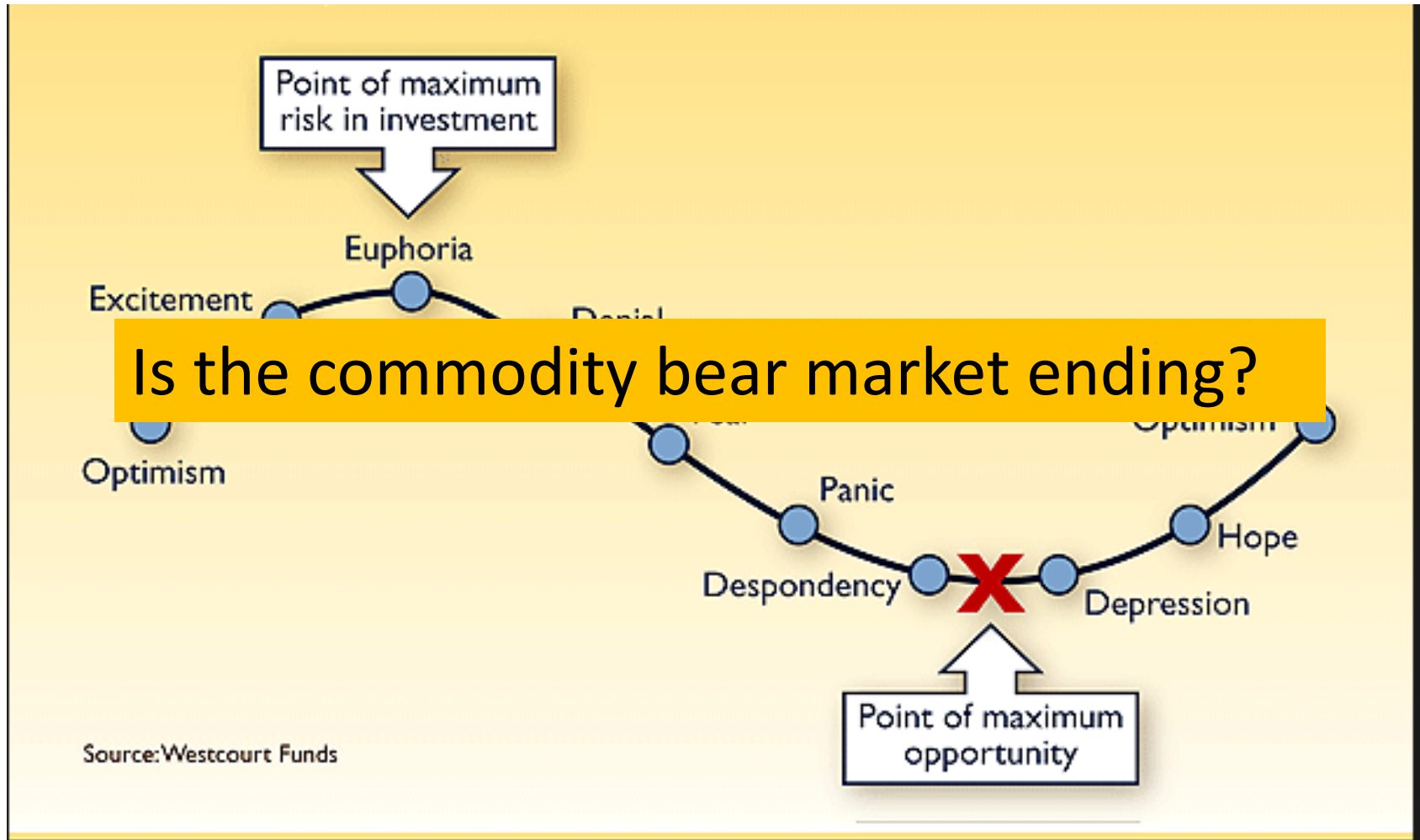
Current Sectors of Interest

- Airlines
- Energy Users
- Biotech
- LNG factories
- Cybersecurity
- Commodities

Stocks

- FED's QE has juiced the market higher.
- ECB QE last gasp?
- S&P 500 now 17.4 X 2014 LTM earnings.
& 16.3 X forward EPS ... above historical avg.
- Current stock valuations are high w/no margin of safety and 45% of earnings are overseas profits.
- Losing \$1T QE stimulus is a Big Deal!

Cycles



Brent Crude Oil

\$BRENT Brent Crude Oil - Spot Price (EOD) ICE
 6-Jan-2015

© StockCharts.com

Open 56.25 High 56.30 Low 50.52 Close 51.10 Volume 628.8K Chg -5.32 (-9.43%) ▼



West Texas Intermediate Crude



At the Margins

Oil Market Balance

<i>Million b/d</i>	2013	2014	2015	2014/13	2015/14
OPEC Production	29.9	29.8	29.7	-0.1	-0.2
Non-OPEC + OPEC non-crude Production	60.2	62.1	63.1	1.9	1.0
Total Supply	90.2	92.0	92.8	1.8	0.8
Global Demand	90.5	91.2	92.3	0.7	1.1
Surplus/(Deficit)	-0.3	0.8	0.4		

Sources: Diapason, EIA, IEA

Gold

\$GOLD Gold - Spot Price (EOD) CME

© StockCharts.com

6-Jan-2015

Open 1187.80 **High** 1223.30 **Low** 1177.80 **Close** 1219.00 **Volume** 323.6K **Chg** +29.20 (+2.45%) ▲



Silver

\$SILVER Silver - Spot Price (EOD) CME

6-Jan-2015

© StockCharts.com

Open 15.80 High 16.74 Low 15.63 Close 16.55 Volume 87.1K Chg +0.76 (+4.85%)▲



U.S. Dollar Index

\$USD US Dollar Index - Cash Settle (EOD) ICE

© StockCharts.com

6-Jan-2015

Open 91.73 High 92.05 Low 91.42 Close 91.82 Chg +0.39 (+0.43%) ▲



Corn Futures

\$CORN Corn - Spot Price (EOD) CME
6-Jan-2015

© StockCharts.com

Open 395.75 High 409.50 Low 394.50 Close 405.00 Volume 250.9K Chg +9.00 (+2.27%) ▲



Soybean Futures

\$SOYB Soybeans - Spot Price (EOD) CME

© StockCharts.com

6-Jan-2015

Open 1007.00 **High** 1057.00 **Low** 1006.25 **Close** 1056.25 **Volume** 208.4K **Chg** +49.25 (+4.89%) ▲



Wheat Futures

\$WHEAT Wheat - Spot Price (EOD) CME
6-Jan-2015

© StockCharts.com

Open 579.75 High 603.50 Low 579.00 Close 591.75 Volume 95.6K Chg +9.75 (+1.68%) ▲



Conclusion

- An \$18 Trillion economy w/ \$90 Trillion + in debt and unfunded liabilities lacking the political will to address its problems is simply a “Zombie economy.”
- Unless major spending cuts are made in the immediate future, the tipping point will occur.
- The U.S. “Age of Exceptionalism” will be replaced with the “Age of Dependency.”

For your information

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