'Tis Only My Opinion!

January 2014 - Volume 34, Number 1

Outlook 2014

"Looking Ahead to an Uncertain Future!

The problems are growing and the electorate remains unable to see the difference between today's economy and the one that is about to make major upheavals to their situation. In the U.S., politicians are elected on promises that they cannot keep but are unwilling to set the record straight. If they do, their election prospects are nil. Unfortunately, it will take a major catastrophic event to change the electorate's differentiation between hype and reality.

Demographics, debt and default remain major impediments to resolving the economic problems confronting the world going forward. With automation and robotics continuing to expand in many areas, the most pressing task before each society will be to find **"meaningful and rewarding employment"** for their citizens.

Keynesian economists control the world's central banks and are responsible for creating booms and busts since the 1920's. Each cycle has accentuated the wave of destruction that has resulted in today's approaching tsunami that will shake the world's economic order to its foundations.

The Federal Reserves' guidelines before withdrawing further stimulus from the financial system are a 6% unemployment rate and an inflation rate of 2% to 2.5%. The inflation goal will destroy through inflation about 20% (2% inflation compounded for 10 years) of the country's wealth during the next decade. In concert with the Ministry of Truth's statisticians who are constantly revising economic series, the true economic conditions in the U.S. rarely are found in the main-stream media news.

Going forward, increased taxes and compliance with additional regulations will decrease the amount of capital formation that is necessary for a healthy society to function and grow. A continuation of the low-interest policy of the Federal Reserve will continue to reduce the income of many pension plans and individuals.

Obfuscation

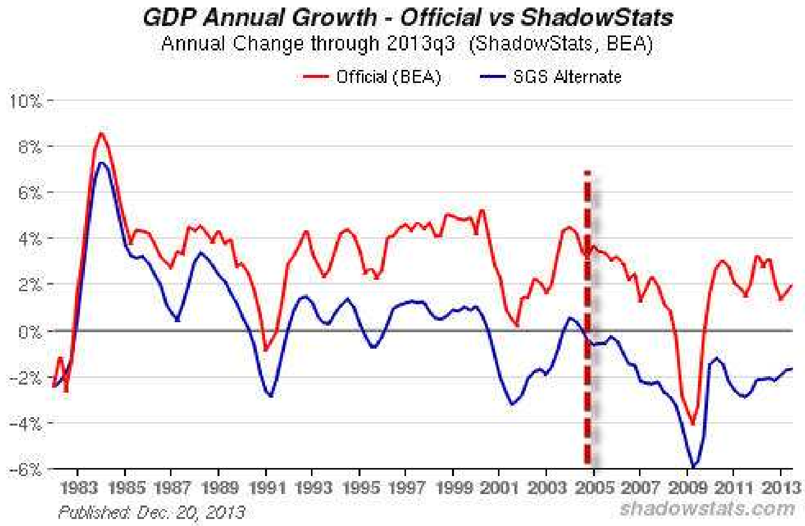
Throughout history, governments have found ways to prevent their citizens from learning the truth. By defining certain matters as national security risks or simply changing the methodologies for calculating economic data, the real situation and facts are often obfuscated.

Here are a few differences between tweaked Ministry of Truth seasonally-adjusted data and the raw data.

Gross Domestic Product

Gross Domestic Product (GDP) was recently revised by the U.S. Bureau of Economic Analysis to include changes to the way spending on research and development and the production of artistic goods like TV shows, recorded music, and movies is classified. The changes also includes changes in how defined benefit pension plans are treated. The net effect will add about 3% on an annual basis to the previously reported GDP data. Hence, the 3rd quarter GDP of 4.1% is actually only 1.1% on a non-revised basis.

If the 1980 criteria for calculating GDP is used, a totally different picture emerges of the U.S. economy. In fact, the downturn that began in the 3rd quarter of 2004 continues as seen in the following graph courtesy of Shadowstats.

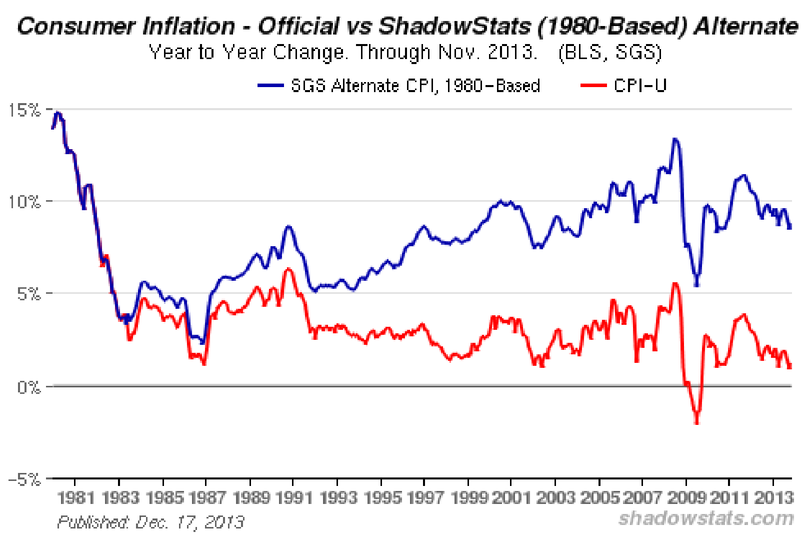


If you don't like the results, change the methodology! Unfortunately, the game goes on.

Consumer Price Index

Consumer Price Index (CPI) has undergone 20 changes in methodologies since June 1996. In the month in which a change was made, the effect was to reduce the reported calculation. At the end of November 2013, the reported CPI from the Bureau of Labor Statistics was 1.24%. **The government's baseline CPI measure known as the core CPI excludes items such as taxes, energy, and food. As explained, it is clearly manipulated and biased, therefore it is far from accurate.**

Shadow Government Statistics using the methodology of 1980 reported that the CPI was, at least, 8.8%, or about 7.3 times higher. The Chapwood Index which is compiled twice a year reports that inflation appears to be in the 8-12% range in its actual purchases in the 40 major metropolitan areas of the U.S.

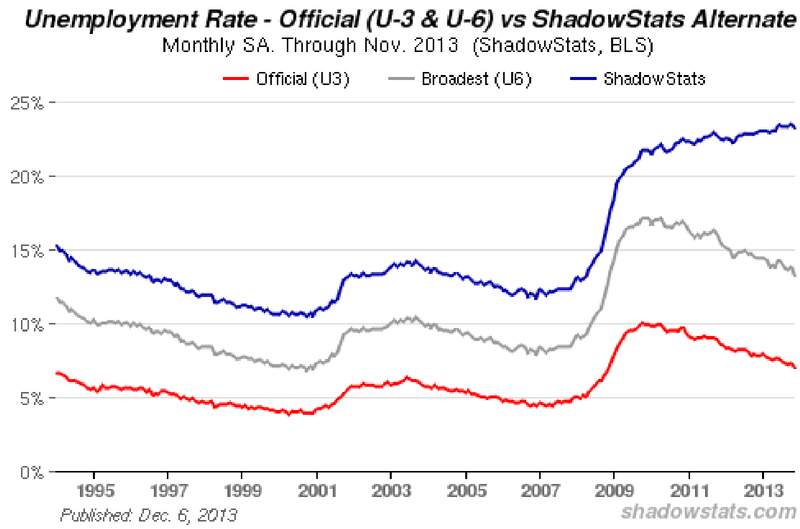


Unemployment rate

The **unemployment rate** has also undergone several redefinitions since the 1930's. The November 2013 unemployment rate of 7.0% trumpeted by the Federal Reserve and the Ministry of Truth is the U-3 number. November's unadjusted U.3 unemployment rate was 6.6%, versus 7.0% in October and 7.0% in September.

The U.6 measure includes short-term discouraged workers (those who have not looked for work in the last four-weeks, but have looked in the last year) and those working part-time for economic reasons. In November 2013, the U.6 unemployment rate was 13.2%.

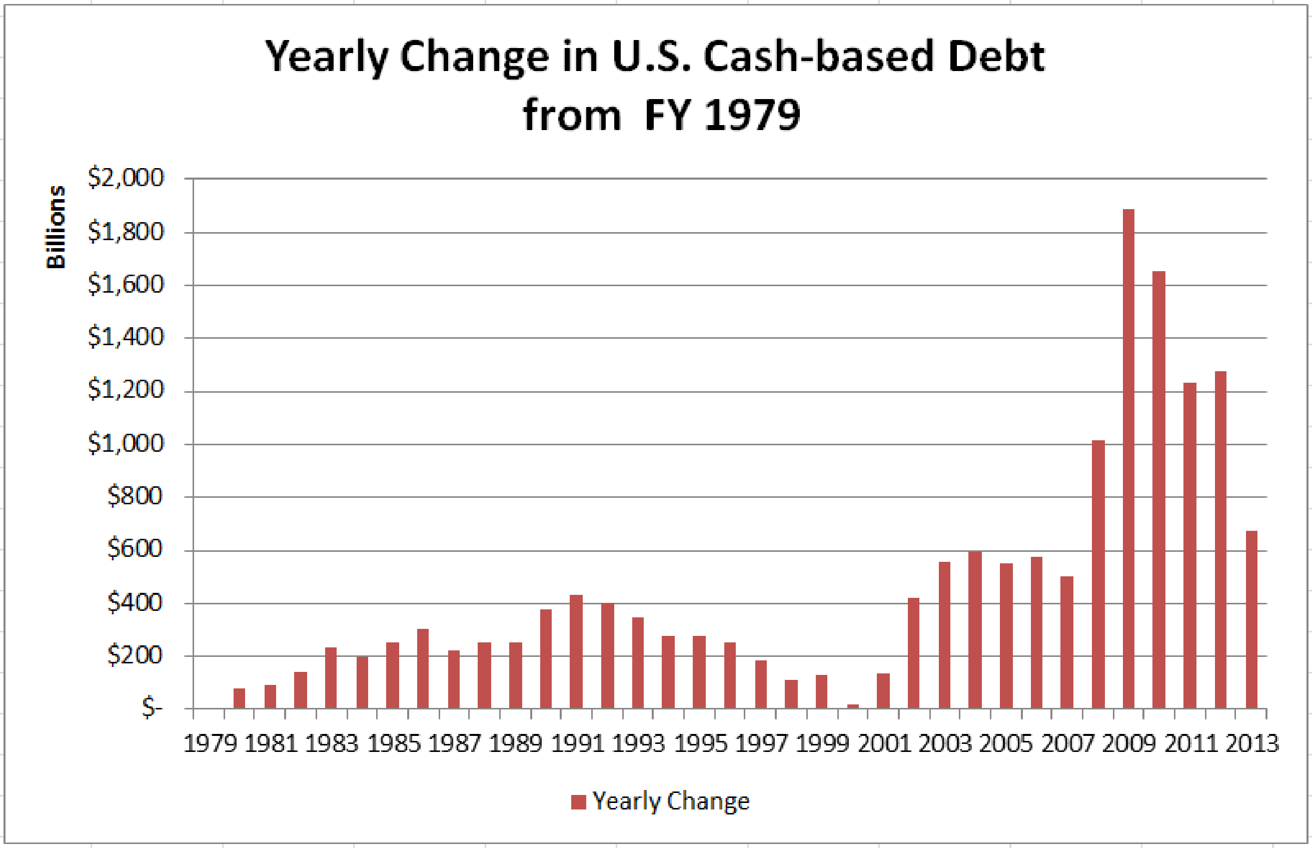
After being discouraged for a year or more, the short-term discouraged workers become long-term discouraged workers and move to the ShadowStats-Alternate Unemployment measure. In November 2013, the unemployment rate using the criteria for counting all unemployed according to ShadowStats stood at 23.2%.



DEBT AND DEFICITS

Politicians rarely talk about the Genenally Accepted Accounting Principals (GAAP) debt but rather try to use the Cash-based deficit and Cash-based debt to make the debt level more palatable to their constituents. Corporations and most businesses are required to use GAAP accounting techniques to report their income to the Internal Revenue Service each. The U.S. government only recently has been required to report once a year on a GAAP basis and it is often delayed beyond the required date. Moreover, the Government Accounting Office has been unable to give a "clean or unqualified" opinion letter in any year since the GAAP audits began in 1998.

The following chart shows the yearly change in the Cash-based debt since 1979 to date. The real data is significantly worse on a GAAP basis.



When a society through its electorate makes decisions on bad data, will the decisions solve the problems facing it? Moreover, when a society is dumbed down enough that it does not care about the real world but only its own "Roman circus", the time will come when that society will no longer exist!

Demographics

The population of the world continues to explode. At the beginning of 2014, there are estimated to be about 7.2 billion people on the plant and the number is growing at about 131,000 per day. In 2013, the world added about 81.3 million people. The top 20 countries by population as of December 2013 are shown in the following table.

Top 20 Largest Countries by Population (live

1	China	1,389,679,442	11	Mexico	123,066,283
2	India	1,259,778,299	12	Philippines	99,245,826
3	USA	321,318,046	13	Ethiopia	95,304,956
4	Indonesia	251,339,711	14	Vietnam	92,113,750
5	Brazil	201,198,395	15	Egypt	82,722,397
6	Pakistan	183,638,770	16	Germany	82,688,748
7	Nigeria	176,067,937	17	Iran	77,958,519
8	Bangladesh	157,554,535	18	Turkey	75,385,597
9	Russia	142,650,613 ▼	19	Congo	68,438,528
10	Japan	127,070,978 ▼	20	Thailand	67,116,244

The declining birth rate of the Western World means that its civilization will be changed significantly in the future.

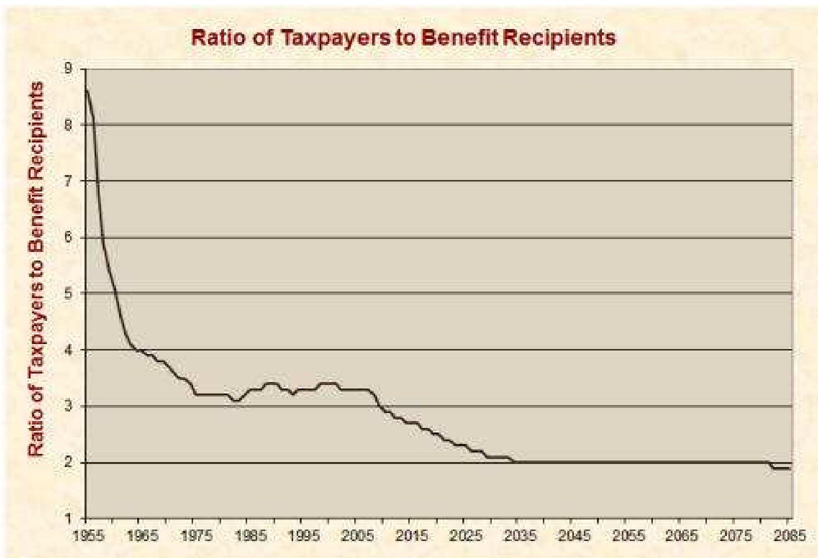
The U.S. fertility rate fell to another record low in 2012, with 63.0 births per 1,000 women ages 15 to 44 years old, according to the Centers for Disease Control and Prevention. That's down slightly from the previous low of 63.2 in 2011.

It marked the fifth year in a row the U.S. birth rate has declined, and the lowest rate on record since the government started tracking the fertility rate in 1909 when the rate was 127. In 2007, the rate was 69.3.

It takes 2.1 children per woman for a given generation to replace itself, and U.S. births have been below replacement level since 2007. Moreover, the reported rates do not discriminate between births of U.S. citizens and other nationalities.

Changes within the U.S. have also seen a sky-rocketing of the number of live births to unmarried women rising to over 40% of all births. In 2011, over 70% of all black births were to unmarried women. The effects on the family structure to the economy will be profound going forward in many ways.

Not only are people living longer but the "Baby-Boomer" segment of the U.S. is rapidly passing into the retirement category. The adverse effect upon the nation's social security and health care systems will only increase going forward. The ratio of taxpayers to social security benefit recipients in the U.S. is shown in the following table. In the near future, the working population will rebel at the taxes required or the system will simply fail.

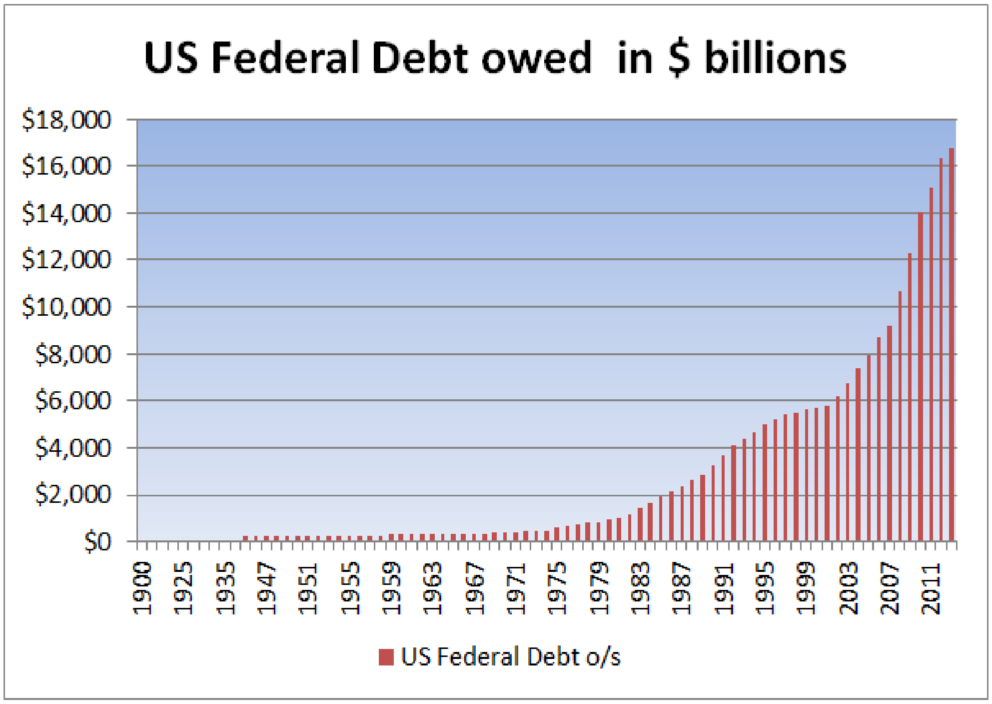


Source: Social Security Administration - http://www.ssa.gov/OACT/TR/2012/lr4b2.htm

The Fiscal Cliff

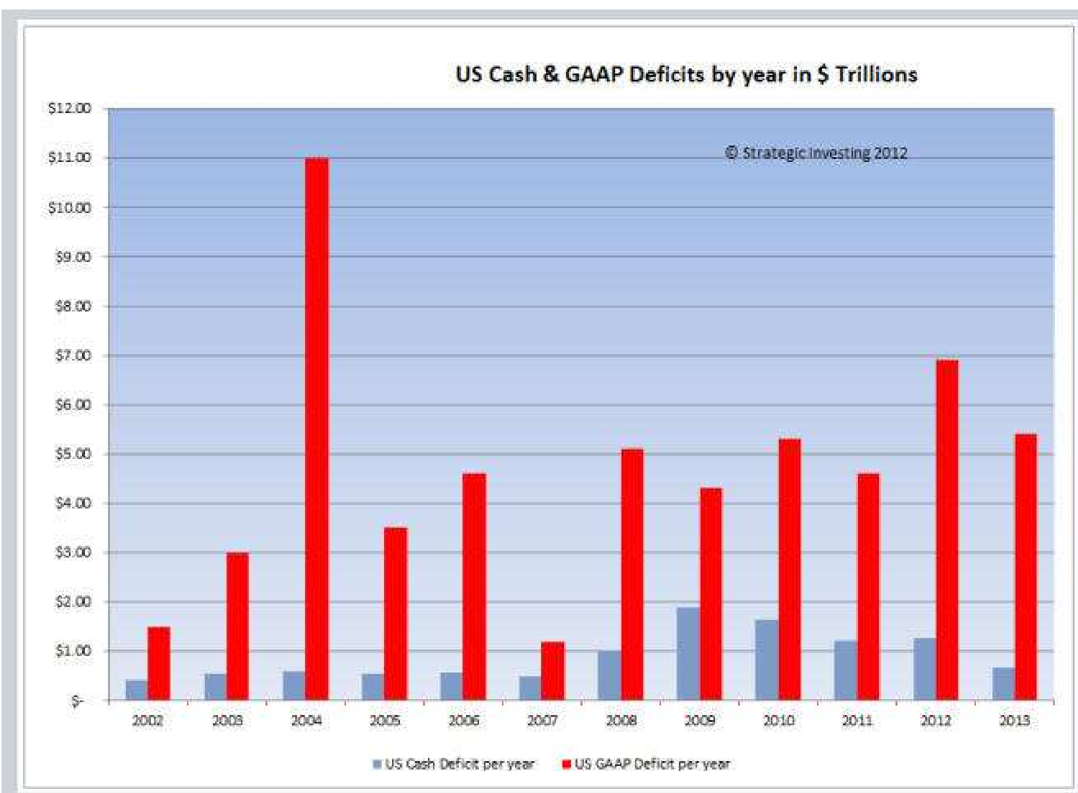
The recent budget deal shows clearly that the politicians are unwilling to take the necessary decisions to balance the budget, let alone decrease the deficit and unfunded liabilities that have been placed on the backs of their constituents. Even the highly-despised "sequester" was largely gutted during the recent negotiations.

The growth of the cash-based U.S. federal debt looks like a "blow-off top" as shown in the following chart.



As a result, both individuals and foreign governments who had been purchasers of U.S. debt have gotten worried and the status of the U.S. dollar as the world's reserve currency continues to shrink. Since the beginning of George W. Bush's administration, the growth in the U.S. cash-based debt has gone ballistic as shown in an earlier graph.

While the growth in the both graphs are shocking, when one looks at the yearly change in the U.S. GAAP deficits, it becomes simply unbelievable.



The Changing role of the U.S. dollar and its reserve currency status

Most global trade is conducted in U.S. dollars, and almost all oil is sold for U.S. dollars. More than 60% of all global foreign exchange reserves are held in U.S. dollars, and far more U.S. dollars are actually used outside of the United States than inside of it.

In the last three years, China has established swap agreements with its major trading partners and those transactions will no longer require payment in U.S. currency. China now accounts for more global trade anyone including the United States.

China is also the number one importer of oil in the world. In the first nine months of 2013, about 17% of China's international trade was settled in the yuan, compared with less than 1% in 2009, according to Deutsche Bank AG.

Whither interest rates?

Just before Thanksgiving 2013 the Central Bank of China decided that is **"no longer in China's favor to accumulate foreign exchange reserves."** This bombshell pronouncement was largely ignored in the mainstream media in the United States. Does this announcement mean that China will begin to reduce its holdings of U.S. Treasuries which amount to about $1.3 trillion?

During the six months beginning in May 2013, China added less than $7 billion to its holdings of U.S. Treasury securities. In the same period, Japan added $70 billion and the Federal Reserve Bank bought $510 billion.

U.S. interest rates will be higher despite any efforts by the Federal Reserve to keep them low. The following graph shows the doubling of interest rates since the 2012 low for the 10 year bond. Each 1% increase in the effective interest rate for the U.S. will increase the yearly deficit by $170 billion.

Fighting the wrong problem does not provide the correct solution.

The real problem facing United States is not one of the deficit but of insolvency. The country under any definition cannot pay it's stated cash debt and unfunded liabilities.

At the end of FY 2012, the US GAAP report stated that the country total of stated cash debt and unfunded liabilities stood at $85.4 trillion. However, the report could not give an unqualified opinion on three of the four largest departments of U.S. government. The real situation remains a mystery.

The 2012 fiscal condition of the United States suffered its worst annual deterioration in the history of the Republic. Based on generally accepted accounting principles (GAAP-based accounting), the actual federal deficit hit a record $6.6 trillion in the year ended September 30, 2012, a level that was fully 42% of the nation’s annual GDP.

The GAAP-based annual deficit differs markedly from the headline cash-based accounting version, which showed a $1.1 trillion cash shortfall in the government’s 2012 day-to-day operations.

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)
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: February 4, 2013.

Default or Inflation

There are only two solutions available to most governments including the United States going forward -- default or inflation. The prospect of default by the United States is considered by many politicians as an impossibility. As a result, the Federal Reserve economists and politicians believe that a solution involving debasing the dollar through inflation can continue the shell game for a few more years.

The risk to the economic system in the United States is that major creditors may decide on a different course of action which could change the outcome quickly. It either Japan and/or China decided to sell a significant portion of their U.S. Treasury holdings, the impact upon interest rates in the United States and the purchasing power of the dollar could be very detrimental.

As of October 2013, China held $1.304 trillion and Japan $1.174 trillion of U.S. Treasury debt according to the U.S. Treasury and the Federal Reserve Bank. The Hong Kong holdings of $136.3 billion will be heavily influenced by decisions made by China.

Although the Federal Reserve holds about $2.5 trillion of U.S. debt, it is doubtful that either country would accept U.S. dollars as payment for the debt.

MAJOR FOREIGN HOLDERS
OF TREASURY SECURITIES
(in billions of dollars)
HOLDINGS 1/ AT END OF PERIOD

Country	Oct-13
China, Mainland	1304.5
Japan	1174.4
Carib Banking Centers	290.7
Brazil	246.7
Oil Exporters	236.6
Taiwan	184.5
Belgium	180.3
Switzerland	174.3
United Kingdom	158.4
Russia	149.9
Hong Kong	136.3

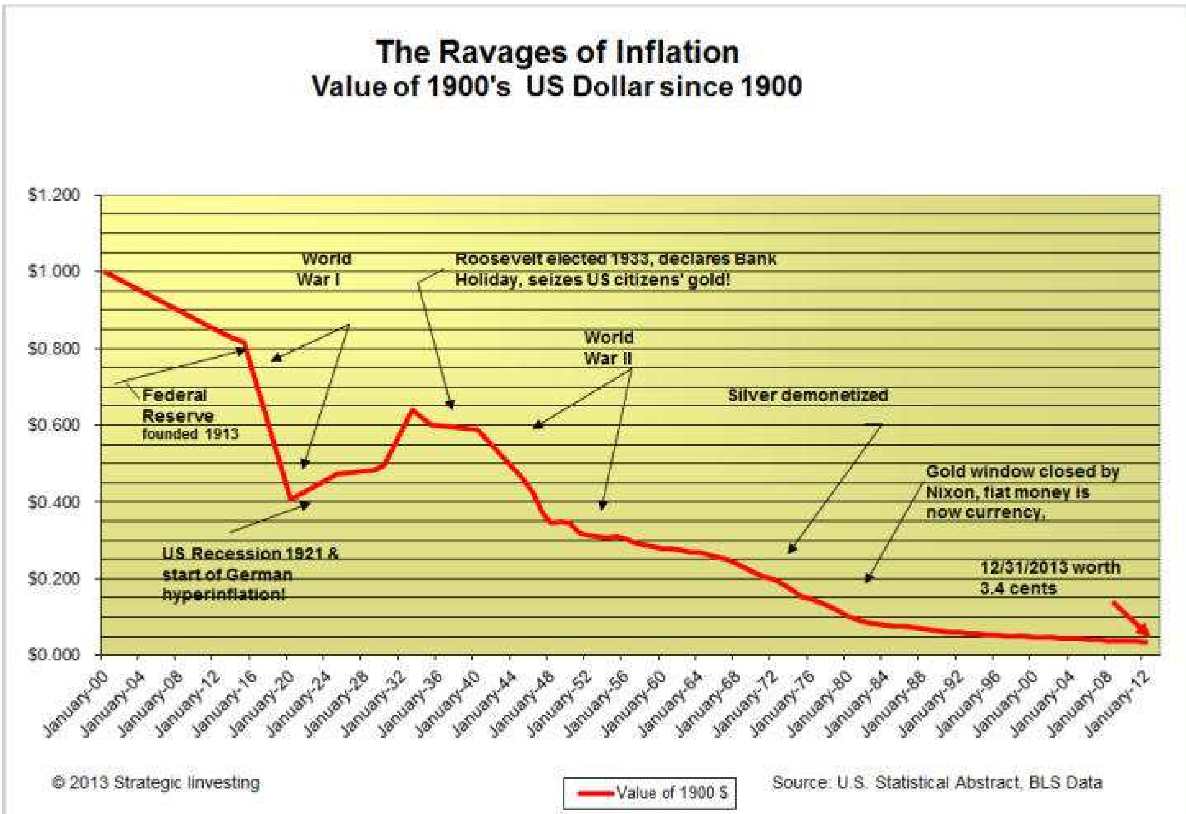
Luxembourg	133.3
Ireland	110.9
Singapore	86.3
Norway	78.4
Mexico	61.8
Germany	60.7

Department of the Treasury/Federal Reserve Board

16-Dec-13

The Federal Reserve has not lived up to its mandate!

The Federal Reserve's mandate is to promote stable prices and employment. The result of those policies over the last 100 years has not been impressive. The U.S. dollar is no longer convertible into gold and/or silver, and is worth in buying power less than 5% of its value in 2013 using almost any yardstick.

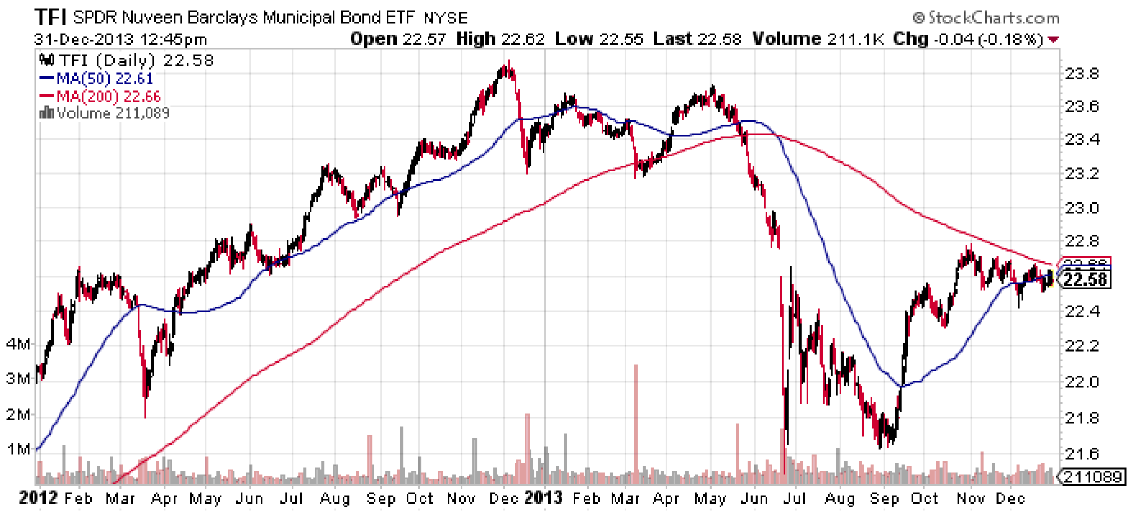


Under any reading of the above chart, it has been a tremendous loss of purchasing power for the U.S. electorate. Since the Bretton Woods agreement, the dollar's role as the world's reserve currency has shielded the truth of the decline from the electorate. However, when the Chinese dragon begins to breathe fire, the fiat currency house will crumble in a flash.

Default as an option ...

During the past year, the default option was used by several cities in California and the city of Detroit to shed themselves of promises made by their politicians which simply could not be met in today's environment. The use of the default option will continue to provide a method by which many cities and other tax entities will use to shed unwieldy burdens. However, as the default option increases in use, you will see the risk in tax-free municipals and other bonds rise, thus, increasing interest rates in these instruments.

The Nuveen Barclays Municipal Bond Fund has seen a significant loss of value during 2013 as shown in the following graph. Obviously, bond investors perceive that investment risks have increased.



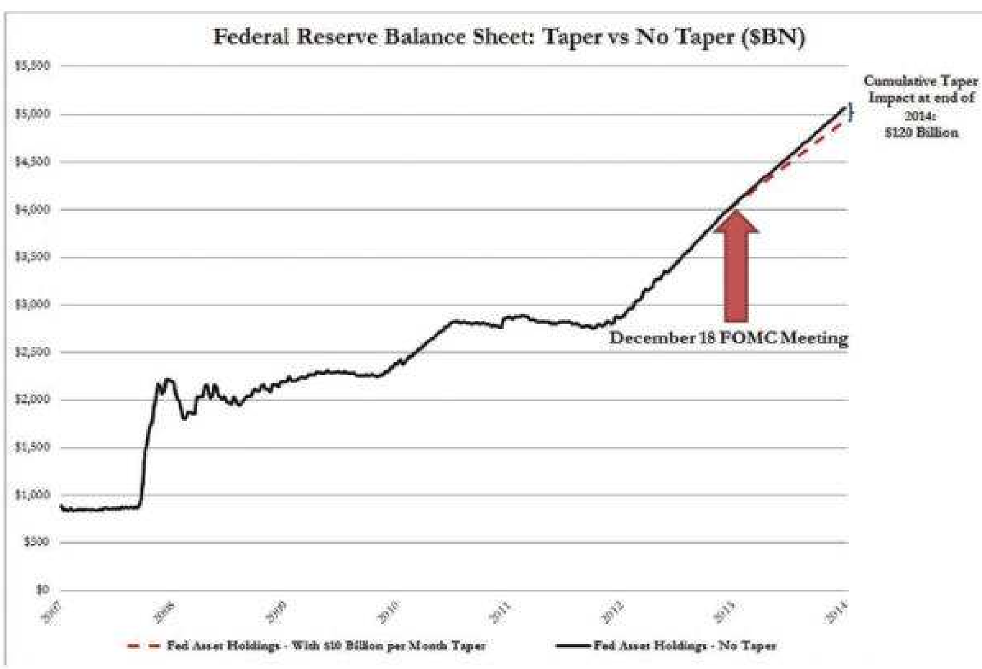
Despite all the rhetoric above the Federal Reserve being able to keep interest rates low, the pressures would seem to be building that during 2014 all rates on the yield curve will increase. If that is the case, bonds will become risky investments.

By creating an environment that forces those with capital to seek out additional risk due to the paltry returns afforded by zero percent rates, the Federal Reserve has steered investors to seek out the least-risky place to invest their money, and that has been equities.

Investment concerns

The market in equities in 2013 was assisted largely due to the $85 billion monthly infusion by the Federal Reserve during the year. A major proponent for quantitative easing (QE) was the new Chairman of the Federal Reserve Bank, Janet Yellen. While the last FOMC meeting saw a proposed taper of $10 billion per month to begin in January 2014 the FED reserved the rank to make changes either up or down as it saw fit based upon its reading of economic tea-leaves.

The reduction to $75 billion will still enable the balance sheet of the Federal Reserve to approach $5 trillion through its QE purchases by the end of 2014 as shown in the following chart courtesy of Zerohedge:



Source: Zerohedge

Of course, since the beginning of the Federal Reserve System over a century ago, the economists and governors of the FED have had an abysmal record in reading those tea-leaves. It is simply difficult for most investors to understand that since the

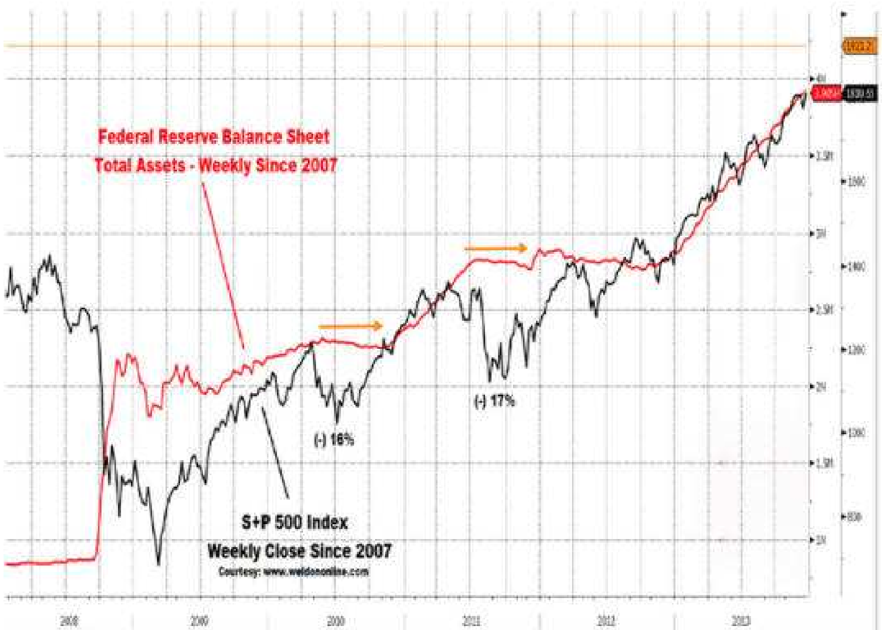
Lehman default in 2008, the assets of the Federal Reserve Bank have grown from $800 billion to $4 trillion in December 2013, all concocted out of absolutely nothing but "wealth from a far-off galaxy."

Why the citizens allow the FED to continue remains a complete mystery to me.

But for the foreseeable future, the FED will be the major elephant in the room until the Chinese dragon decides to destroy the system of fiat currency. *There is no doubt in my mind that is in the cards but when those cards will be played is unknown.*

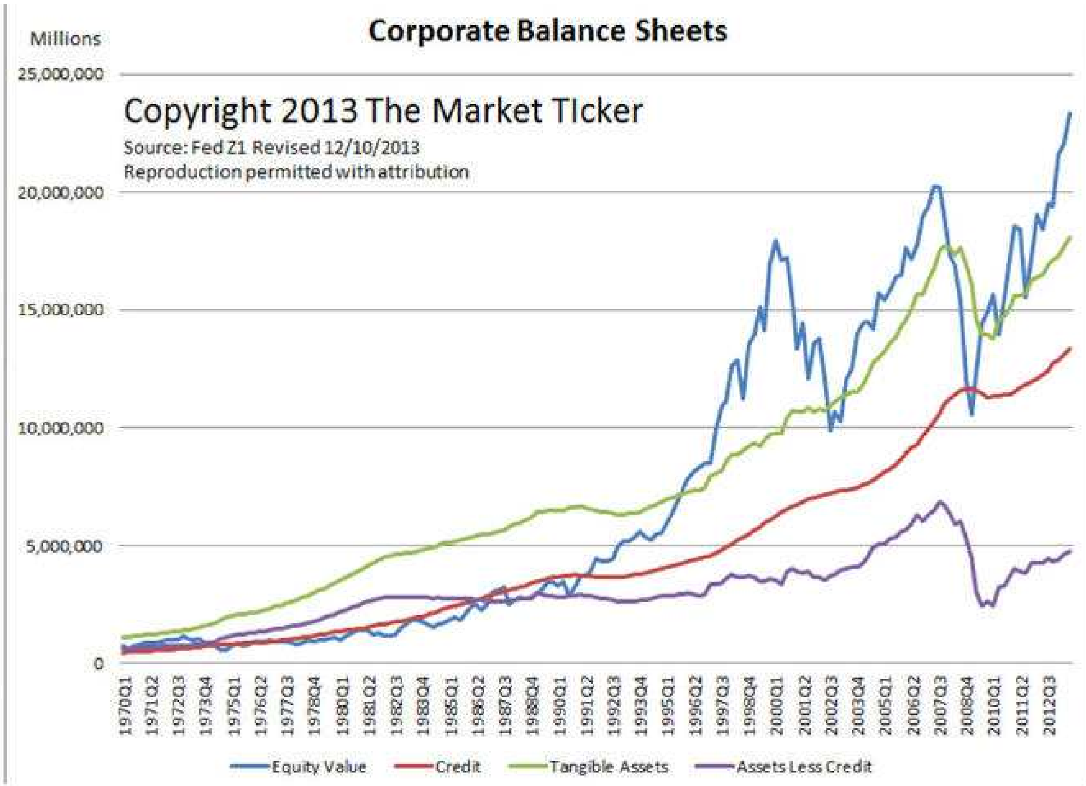
To prevent the market from nose-diving even with a $10 billion monthly reduction in QE, the FED promised "low-interest rates" until well into 2015 or beyond. *It remains to be seen if the FED will be able to deliver on that promise or will the bond vigilantes ignite a fire under interest rates.*

There is little doubt that the buildup in the Federal Reserve's balance sheet has had a major impact on the level of the stock market. Greg Weldon's graph of the comparison between the S&P 500 and the balance sheet of the FED clearly shows the correlation.



Source: Greg Weldon

In the past two years, while the equity markets have advanced thanks to QE and increasing stock buy-backs, the real problem lies in the fact that net tangible assets less offsetting debt is at an al-time record high .. even higher than in 2000 and 2007 before the busts. In fact, the following graph courtesy of Karl Denninger suggests that we are in "bubble territory."



Source: The Market Ticker

The U.S. and world economy continue to be undergoing deleveraging although QE by central banks have thrown a major smoke-screen around it. Until the deleveraging is completed, real economic growth will be contained at a relative low rate of less than 2%.

The big problem remains the fact that jobs are not available for many people and politicians desire to increase the minimum wage levels will only further increase the move to automation and robotics. As a result, the opportunity for jobs for many unskilled workers diminishes.

Investment opportunities

In any market, there are always opportunities ... sometimes you make money by being long and other times, the short side is where the gains occur. The best advice has always been to buy companies with increasing sales and increasing earnings.

The areas I like involve new technologies like nanotech and 3D printing. I am not particularly impressed with the long-run prospects of some recent IPO's like Facebook and Twitter. Stocks like Amazon which has never reported a profit also failed to excite me.

Tractor Supply, Costco, MasterCard and Google still look like long-term investments to me with further upside.


TSCO Tractor Supply Co. Nasdaq GS
© StockCharts.com
31-Dec-2013
Open 73.2500 High 78.1700 Low 70.8800 Close 77.5800 Volume 25.6M Chg +4.3700 (+5.97%)
TSCO (Monthly) 77.5800
MA(8) 65.5991
MA(20) 54.7940
MA(50) 37.4265
MA(200) 14.0652
Volume 25,647,460
Initial Buy -
Nov/Dec 2001 @
1.0625
A+190 Screen
Moat + Growth
1.63860
1.33520
1.13800
0.77370
0.39450
5.52270
3.56610
11.12290
8.10300
16.40750
9.89220
9.40660
14.00680
6.79950
11.53080
6.95970
35.82480
24.02660
49.86070
37.25460
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
20.0000
15.0000
10.0000
5.0000
1.2500
0.6250
0.3125
100M
50M
25M


COST Costco Wholesale Corp. Nasdaq GS
© StockCharts.com
31-Dec-2013
Open 125.66 High 125.69 Low 115.85 Close 119.02 Volume 43.4M Chg -6.41 (-5.11%)
COST (Monthly) 119.02
MA(8) 115.56
MA(20) 103.05
MA(50) 80.23
MA(200) 47.63
Volume 43,379,852
37.86
39.72
28.09
25.26
33.05
22.94
24.42
29.68
42.73
33.51
39.83
49.78
39.62
50.81
44.59
48.79
65.88
52.13
33.73
55.66
48.02
76.20
63.94
126.12
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
250M
200M
150M
100M
50M


MA Mastercard NYSE
© StockCharts.com
31-Dec-2013
Open 760.81 High 839.38 Low 744.06 Close 835.46 Volume 16.2M Chg +74.65 (+9.81%)
MA (Monthly) 835.46
MA(8) 667.96
MA(20) 552.11
MA(50) 389.57
MA(200) undef
Volume 16,180,207
Bot @47.74 w/in a week of
IPO
Added 50% to position
after selling Visa
223.44
315.48
111.52
267.31
258.76
191.42
359.83
291.30
465.00
411.43
533.73
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
125M
100M
75M
50M
25M

Going forward, it behooves investors to maintain Action Points at which they will take or delete positions from their portfolios.

As always, when trying to find "elephant stocks" like the above companies, investors must be on the lookout for those with "moats" around the business plan and barriers to entry.

U.S. and Global growth going forward

With the International Monetary Fund reducing its 2014 GDP forecasts for many countries throughout the world, it would appear that 2014 might be an interesting year. For 2014, the IMF chopped its growth forecast for China from 7.8% to 7.3% and from 2.8% to 2.6% for the U.S. With China making significant economic policy changes and worried about the debt levels of many of its state-owned enterprises and local governments, growth opportunities in 2014 are likely to be difficult to find.

Despite the recent budget deal between the parties in Washington, D.C., the fiscal drag upon the U.S. economy going forward is likely to be a hindrance to increased growth. The Obamacare health-care implementation will continue to create unintended consequences.

Gary Shilling points out that "there are many ongoing deflationary forces in the world, including falling commodity prices, aging and declining populations globally, economic output well below potential, globalization of production, growing worldwide protectionism including competitive devaluation in Japan, declining real incomes, income polarization, declining union memberships, high unemployment and downward pressure on federal and state and local government spending."

ETF's in the undeveloped world simply do not have a risk/reward ratio that I am comfortable with. However, certain ETF's surrounding basic necessities like energy, agriculture and technology do. Any ETF that could suffer from rising interest rates like REIT's and bonds would seem to be short candidates going forward.

Finding other investment opportunities

So where do we look? With gold and silver having terrible years, I feel that 2014 may well be a turn-around year for those commodities.

The key to improved gold prices going forward is the lack of physical. In the last 18 months, gold has been transferred from London and the U.S. to depositories in China and the Middle East. Some reports suggest that gold and silver contracts are being settled in cash in lieu of physical delivery.

Silver fell in 2013 closing under $10/ounce at $19.56. However, it is now near a major support level and if that holds, silver could move higher in the coming months.

With crop conditions in South America somewhat murky, corn prices, particularly, are not likely to return to the lofty levels of 2013. My expectations are that by the middle of 2014, the price of corn could be in the $5.25 to 5.50 range.

Soybean prices, however, could prove to be a surprise and remain near the current levels. My expectations are that soybeans may be in the $13.50 to $14/bushel range by mid-year of 2014.

Wheat, however, could be another story and remain under $6.00/bushel for most of 2014 as most growing areas have improved prospects versus 2013.

Conclusion

An uninformed electorate is not about to wake up and throw the current politicians from office without a major earth-shaking event occurring. The U.S. of our forefathers is about gone ... in its place is a government which barely resembles that of the founders. Perhaps, the first paragraph of the Declaration of Independence will once again become important ...

> ***"When in the Course of human events, it becomes necessary for one people to dissolve the political bands which have connected them with another, and to assume among the powers of the earth, the separate and equal station to which the Laws of Nature and of Nature's God entitle them, a decent respect to the opinions of mankind requires that they should declare the causes which impel them to the separation."***

A U.S. GAAP deficit in excess of $90 trillion simply cannot be serviced with a GDP of only $17 trillion. The numbers simply do not work! The basic problem remains insolvency and not liquidity. You can't borrow your way out of a debt crisis, whether you are a family or a nation.

However, investors must remember ... there is always opportunity ... you just have to be patient and decide when to be long and short!

But then - 'Tis Only My Opinion!

Fred Richards
December 31, 2013

www.adrich.com

www.strategicinvesting.com

Corruptisima republica plurimae leges. [The more corrupt a republic, the more laws.] -- Tacitus, Annals III 27

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Last updated - December 30, 2012