Paper: Investments of capital

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1. Introduction

We are living in very interesting and dangerous times. 2008 the world was very close to a financial meltdown of epochal scale.

On the 15th September 2008 one of the most famous investment banks in history, Lehman Brothers went bankrupt (http://de.wikipedia.org/wiki/Lehman_Brothers) and nobody know about the consequences for sure. However, the financial markets went into panic mode and the Dow Jones dropped more than 5000 points or about 50% of its value in the upcoming months (http://www.finanztreff.de/kurse_einzelkurs_uebersicht,i,2303555.html).

Of cause the end of Lehman Brothers was not a singular fact. Therefore we have to analyze what happened in the years before the financial crises and what caused it. We have to see how

the different markets reacted and then get a bigger picture of the events. Finally we can explain how the different markets interact and draw some interesting and fearsome conclusions regarding our all future.

2. Debt markets / bonds

Former United States financial minister Robert Rubin once said:
"*In my next life I would like to be reborn as the bond market, because the bond market is more powerful than the president and the pope together"*.
(http://www.hartgeld.com/filesadmin/pdf/Art_2009-140_SuperzinsenBen.pdf)

So what are debt markets and what makes them so powerful?

Basically, the governments or bigger companies need money for different purposes. Since a bank is often not big enough to handle the loan, a structured financial product, a so called bond, is issued on the financial markets.

Depending on the rating of the issuer and the market interest rates an auction is organized and the bond is so sold to different investors. These investors get an annual interest payment and their money back at the end of the contract. Normally the money the lender once became is never paid back, and so the bond is rolled on for another X years, especially in the state sector.

So debt markets are increasing every year, like a tumor.

For example Germany, one of the most solid economies in the world, increased its debt every year since 1969 and never paid something back.
(http://www.tagesspiegel.de/wirtschaft/Staatshaushalt;art271,2456309)

For 2010 Germany plans to issue 343 billion euro of new debt. 2008 it was just 213 billion euro of new German government bonds. That is an increase of 61% in just two years. (http://www.faz.net/s/RubF3F7C1F630AE4F8D8326AC2A80BDBBDE/Doc~E070E7C03A99C489180DC5C01172D1BAE~ATpl~Ecommon~Sspezial.html)

These figures seem to be pretty high but still are nothing compared to the debts of the United States. Right now the United States makes 1 billion dollar of new debt every four ours. Romania had a total GDP of about 270 billion dollar in 2008. That means the United Stats need just 45 days to make the equal amount of debt like the complete GDP of Romania.
(http://www.brillig.com/debt_clock/)

Under George W. Bush the United Stats created in eight years more debt than in their 220 year history.

So we can see that the bond markets are increasing very fast and that is a very dangerous development.

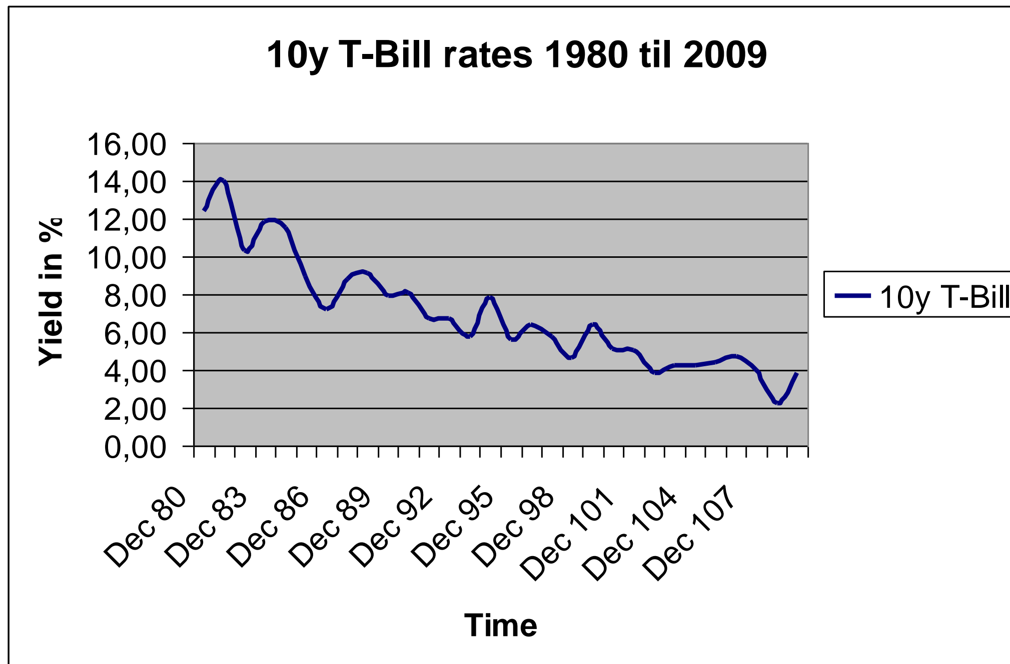
The value of bonds is based on the change of interest rates. If the rates go up, bonds fall in value and if the rates go down the value of bonds increases. Right now, interest rates are kept down to a very small level. So governments still can pay interests. But what is going to

happen in an environment with higher inflation? Where the interest rates have to go up? Will the governments still be able to pay interest rates of 8% or 15% as it was in at the beginning of the 80s?

The United Stats have now 12,1 trillion dollars of outstand public debt, plus another 50 trillion dollars of unfunded liabilities in the future. These are debts that can never be repaid.

However, for the bond investors the last 30 years were extremely successful.

Graphic 1: Yield Development for 10 year bonds in US



(http://finance.yahoo.com/q/hp?s=^TNX&a=00&b=2&c=1980&d=11&e=28&f=2009&g=m&z=66&y=0)

As Graphic 1 shows the yields for T-Bills (10 year US government bonds) went down from about 15% in 1980 to an all time record low of just 2,07% on 18th December 2008. So we had a 30 year rally in government bonds. That means somebody, who bought 30 year government bonds at the beginning of the 80s got an excellent annual return of about 15% in US Dollars. So a bond investor was clearly outperforming all other major investment classes in the last 30 years.

However, around Christmas 2008 we had an event of historical importance. Investors, shocked by the financial crisis, fled in the "save" bonds and accepted an interest rate of just 2, 07% for the next 10 years. If we now estimate an annual real inflation of just about 5% for the US Dollar (the real figure should be much higher) these investors (click-monkeys) accept an annual 3% lost of buying power for a period of 10 years.

That was a very clear sign that the bond markets were in a boom and therefore clearly overheating.

According to the cycle of Kondratieff, which we are going to discuss more deeply later, the bond markets entered now a bear market that will last for about 20-30 years. So investors can make money in the Bond market only at the short side, maybe with some interesting swaps. However, I would not take the counterparty risk of derivatives, like swaps, right now.

3. Equity Markets / Stocks

Equity markets pretend to be the most interesting and fascinating financial markets. Everybody dreams of his personal investment of lifetime, where he buys a stock and that afterwards skyrockets. Still the reality is (as usual) a bit different. Most of the people who buy stocks do it at the end of a bull-market, where everybody on the streets is getting an investment expert. Taxi drivers, farmers, nurses, basically everybody is interested in stocks. And normally at this point the market is overbought and a historical crash occurs. We have seen such developments 2 times in the last century.

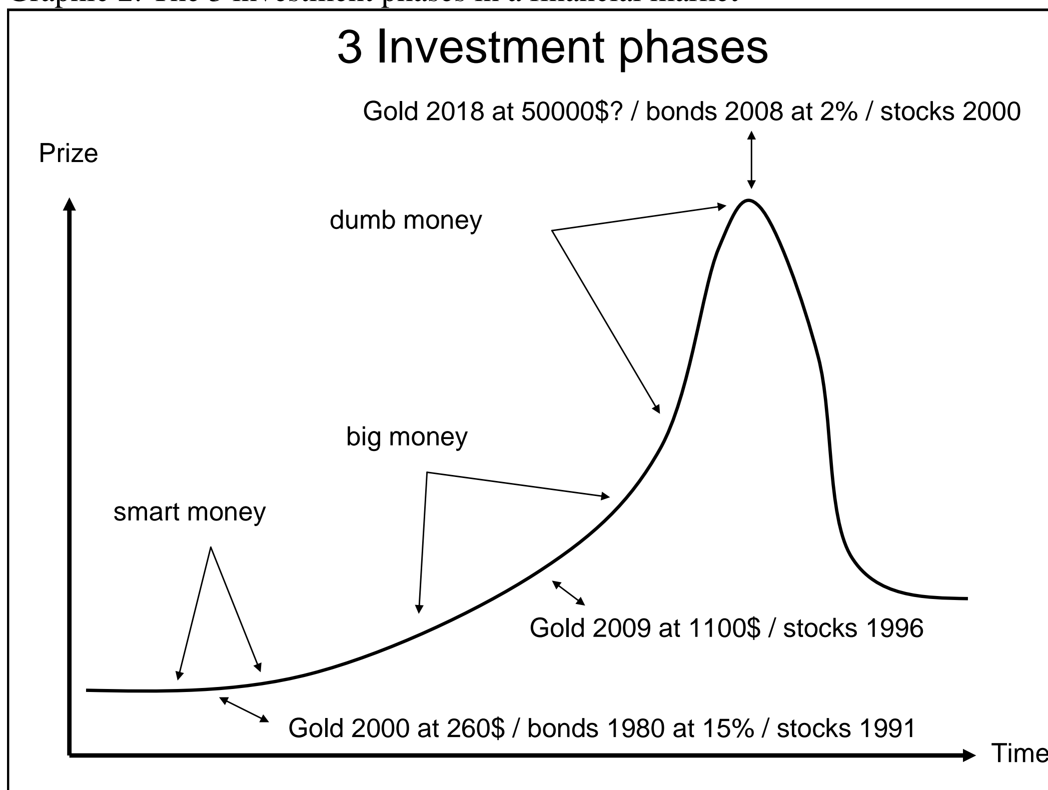
The first one was the so called black Friday in October 1929. Sometimes we can still see in the television people jumping out of skyscrapers in New York, people who lost everything and mostly bought stocks on credit.

The second big-bear market started in March 2000, exactly 70 years after the first one. The so called "New Economy" that should revolutionize the world went under. At these strange times small internet companies with 4-5 employees were traded sometimes at a few billion dollars.

Basically nobody understood the business models and new evaluation concepts as the so called "money burning rate" occurred. Companies were valued after how much money they burn in the smallest timeframes.

However, it is very important to understand the 3 different investment phases that repeat in every market and every cycle. These cycles are a long term approach that will develop for time periods of about 20-30 years and is closely related to the so called Kondratieff cycle.

Graphic 2: The 3 investment phases in a financial market



As the graphic 2 shows us we can divide a market in three general phases. This approach is also very often used by Mr.Eichelburg on www.hartgeld.com.
In a first pretty long period an asset class like stocks, bonds and commodities has a very low price and is kind of forgotten. In this period a small group of people, the so called "smart money", discovers this market opportunity and begins to buy this asset class.

Usually these people are heavily criticized by their environment. They are called fools, idiots and conspiracy theorists, whatever. Almost nobody understood why somebody should buy a barbaric relict like gold in 2000, when stocks were skyrocketing and we were living in the best of all worlds.

However, the price of this asset starts to increase slowly, but without any big headlines. This period takes between three and seven years, until the so called "big money" discovers this asset class and starts slowly building up long positions. The "big money" are large funds, like mutual, pension or hedge funds or foreign governments with high trade surpluses.

Now, for example we can see China or India getting active in the gold market or we saw pension funds increasing their stock percentage in their portfolios during the mid 90s.

The price of the asset class starts to accelerate its increasing at this point a little bit and we can see the first significant press coverage. Still the majority is usually very skeptical, but here we have the point of no return. Normally their can be some corrections, but these last just a short period of time and are used by the "big money" to further increase their positions.

In the last phase, this is also the shortest one but with the biggest increase in value of the respective asset class the "dumb money" enters the market. These "dumb money" are mostly individuals lead by their greed to get rich in a short period of time.

Basically, this asset class is then very trendy and everybody wants to get in the market and of cause everything is covered by a high media spectacle.

I personally can remember the two dental technicians of my father or our neighbor trading exotic stocks on the telephone every 15 minutes in the fall of 1999.

The "smart money" is now getting out of the market and sells their positions to the "dumb money" and the "big money".

Another very important aspect of the end of a bull market is the significant increase of leverage. This leverage seems at the first sight very logical and attractive. Instead of being in a bull-market just with its own money, it makes sense to borrow some capital of a bank for let's say 5% of interest and invest it in the bull-market that had annual returns of 25-30% in the last couple of years.

However, there is one rule, maybe the most important rule in investments. Bull markets that go in the bubble phase always burst at the end. And when they burst they tend to fall double digit % figures in hours or days and it is very hard to get out the market.

Of cause the mass media, which normally belongs to people behind of the "big money" category tries to play down the burst of the bubble and next you can hear hundreds of reasons why to stay in that asset class and why that asset class still has a future and that this small lost of just 30% in three weeks was just a one time event and that the recovery will start soon and

you should not think about selling your assets, but instead even buying some more and use this “small” setback to buy something at 70 that everybody wanted to buy three weeks earlier for 100.

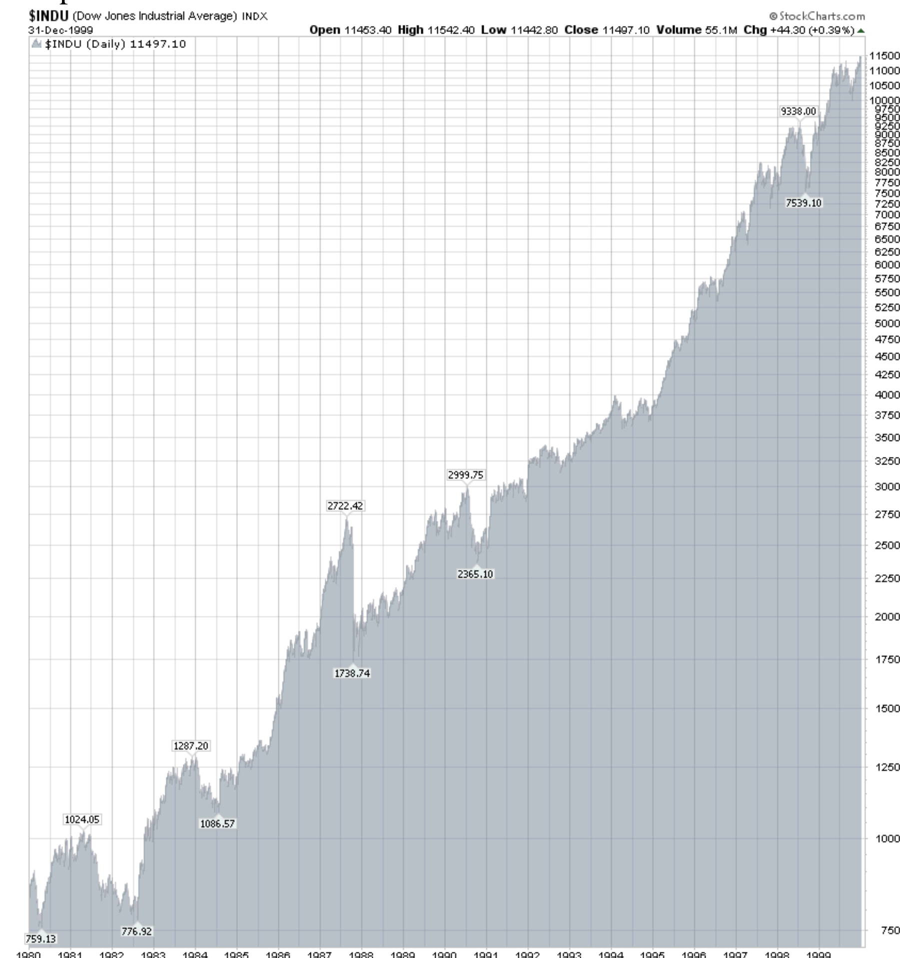
The end of the story is that “the big money”, that also built up its asset positions a few years before the bubble gets out of the market with some respectable gains, but the “dumb money” stays in the market until the former star stock has fallen from 100 $ to lets say 1,37$.

At this price the “dumb money” is than selling their assets and promises never ever to touch this asset class, until the next bubble.

Of cause we have at this point also people who used a leverage of let’s say 20:1 in the final phase of a bull market. These people can then choose between jumping of a skyscraper or a bullet.

The equity markets were in a large bull market from 1980 to 2000 as Graphic 3 shows us.

Graphic 3: Dow Jones Index from 1980 to 2000



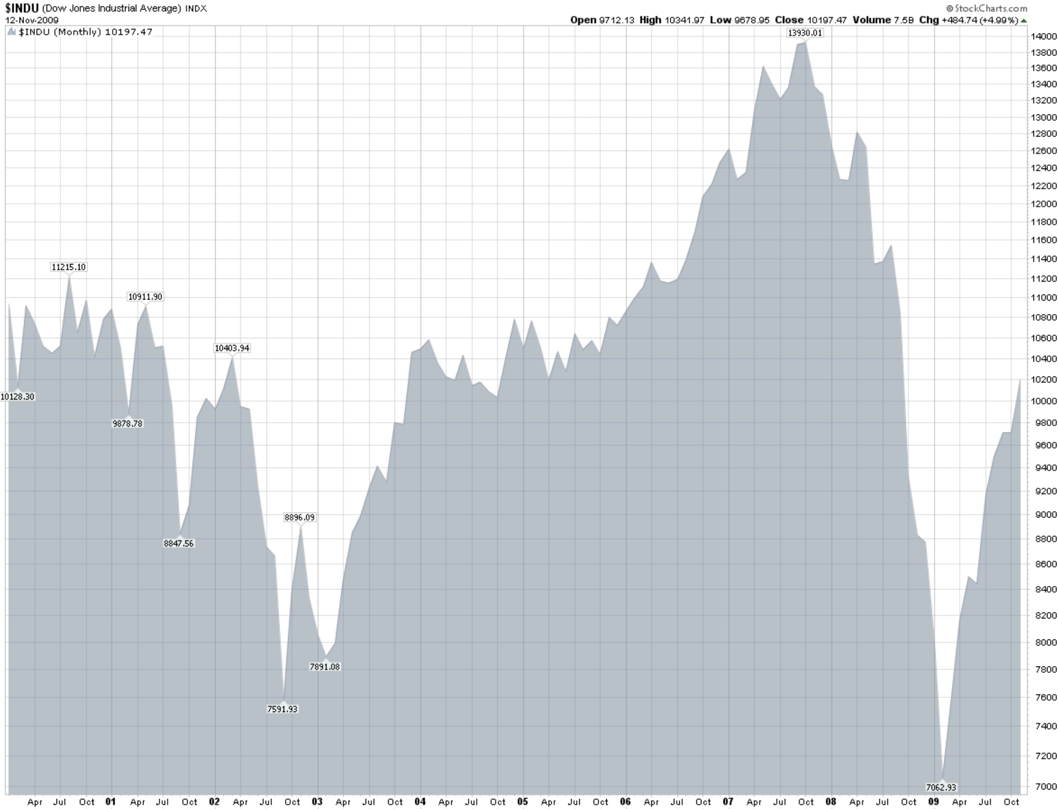
(http://stockcharts.com/charts/historical/djia19802000.html)

As the Graphic 3 shows us the Dow Jones increased from around 750 points in 1980 to more than 11215 points in 2000. That means the Dow Jones went up about 1500% in 20 years. Very interesting is also the fact that the Dow Jones traded at about 1 ounce of gold in 1982, when the gold bull-market ended in 1982 and stocks ended the bear-market of the 70s.

In 2000, 20 years later an investor had to pay more than 40 ounces of gold to buy the Dow Jones Index. As we will see later, when we discuss the cycle of Kondratieff, the years 1982 and 2000 were very important because they represent the starting points of the so called Kondratieff fall in 1982 and the starting point of the Kondratieff winter in 2000.

As Graphic 4 shows the Dow Jones had a major setback from 2000 to 2003.

Graphic 4: Dow Jones Index from 2000 to 2010



(http://stockcharts.com/charts/historical/djia2000.html)

In 2000, according to the cycles and the circumstances the equity markets were ready for a large correction together with a hard, but still manageable recession in the western economics.

However, we are living in a so called democracy and modern politicians want to be reelected so they do everything to fight the laws of the market and to avoid a recession, when it is necessary. So thanks to people like Mr. Greenspan and his friends in Frankfurt at the ECB we had a period of extreme low interest rates in the last decade.

This long period of low interest rates, together with some other factors, like the emerging of new industrial in the emerging markets like, China, India, Russia, Brazil, the so called BRIC countries or the termination of the Glass Steagall act. under the Clinton administration lead to a very fast recovery of the stock markets beginning in 2003 and a global economical boom in the so called "Fire economics", that means in the financial, insurance, real estate sector. (http://de.wikipedia.org/wiki/Glass-Steagall_Act)

Principally, the boom that we saw in the first decade of the 21st century was not a healthy development based on real consumer demand, new products and industrial optimizations, but instead it was mainly a credit based artificial recovery from the small recession at the beginning of the decade based on highly increasing asset prices.

According to Mr. Doom, investment legend Dr. Marc Faber it was a historical one time event that we had increasing prices in almost all asset classes. We had a boom in stocks, bonds, commodities, and housing prices, almost everything.

So the Dow Jones index, representing the most important stock index in the world reached a new all time high at almost 14000 points at the beginning of 2007.

Nevertheless, measured in real money and that is in my opinion only gold, the Dow Jones lost 50% of its value because in 2007 an investor had to pay about 20 ounces of gold to buy the index, 8 years earlier it were still 40 ounces.

From 2008 to 2009 the Dow Jones dropped about 7000 points or roughly 50%.
In 2009 the markets were extremely oversold and started a new recovery. From the lows in March 2009 the Dow Jones rebounded about 3000 points.

Yet, I can not recommend anybody to invest in bear-markets and stocks are in a bear-market since 2000, the problem is that just only a few people understand that this bear-market started in 2000 and not in 2008. Only a few specialists can do some successful short time trading in bear-markets, but long-term investors will lose money.

Right now we are in a very hard recession, if not already in a depression. Only by massive government stimulus and record low interest rates could the situation be stabilized for a short period of time.

But quoting Prof. Bocker: "in the long term nothing is stronger than the market". And this market needed a deep recession. A recession is just the natural selection process that has to occur in capitalism to clean the market, punish the mismanagement and reward the flourishing companies.

As a good example for this we can see the auto market. Clearly we have to many companies in this market that fight with cars that are getting more expansive every year for customers, who are constantly losing a part of their net buying power.

Under the "fire economy" 2000 to 2008 where most of the income was generated with financial and real estate speculations it was still easy to sell high end sport cars and so almost every company in this segment started to increase its output. But who will buy these Ferraris, Porsches, Maserattis, Lambos, Aston Martins, Audi R8s, Bentleys and Mercedes CLs & SLs and so on in the upcoming years?

So in 2009 the governments all around the globe started stimulus programs to help the automotive industries. For example in Germany every 7th job is closely connected to the automotive industry. But buying cars or other goods on credit can not be the solution for long term economic growth and flourishing landscapes.

We have to see a credit as what it is; a credit is always a theft of the future. And nobody can steal from the future because the future is coming nearer by every minute. Therefore goods bought by credit are weakening the buying power of future periods.

Analogical to the bond markets the equity markets are clearly not attractive at the moment and they need a large setback to be at a fair value. According to this we can take a quick look at the valuation of equity markets by the PER ratio. The PER ratio is not a very sophisticated

tool or rocket science. It simply takes the current valuation of a stock or an index and divides this by the actual profit of the stock or an index. For example we have a stock trading at 100$ and this stock has an annual profit of 10$ per stock. So the PER ratio would be 10.

Ten is also a quite solid PER. In this case the company could pay an investor an annual dividend of 5$ and use 5$ for R&D, expansion, whatever.

Now comes the funny part: In average the S&P 500 index, which consists of the 500 most important companies in the USA has a PER of about 10-15. In the second quarter of 2009 the S&P 500 reached an all time PER high of 144!!! And that is extremely negative. Either, the companies have to increase their profits 10-15 times in the next years or the market is about 10-15 times overvalued.
(http://www.mmnews.de/index.php/200908213607/Borse/SP-KGV-150.html)

The rally that we have seen from March 2009, when the S&P500 bottomed at 666 points to about 1100 points is in my opinion a classical bull trap. This rally was not based on economical recovery nor had any logical approach; it is simply the result of extreme cheap money pumped into the markets by the central banks around the globe combined with a Dollar carry trade. The money that should reach the economy and help to normalize the situation is held within the banks to speculate in the financial markets.
Basically, the world and the bankers, today often also called banksters, referring to the word gangsters, repeat the same mistakes that led to the financial crises in the last decade.

A carry trade is herby also something very dangerous. A lot of people, especially in Eastern Europe used this credit form to get “cheap” mortgages. Hereby they hold a credit in a foreign currency, which has very low interest rates. The classical candidates for this operation were the Japanese YEN and the Suisse Frank. At first, like with leverage, everything works out and the burrowers can pay their rates. Nevertheless, if the currency rate of the money in that the credit has to be paid and the currency rate of the money in that the burrowers gets income begins to fluctuate the results are catastrophic.

Right now we have the same carry trade in US Dollars, investors burrow Dollars at a very small interest and buy commodities, stocks, bonds and so on.
(http://www.bueso.de/news/china-greift-spekulativen-dollar-carry-trade-an)

This carry trade will end someday, and will stop the artificial boom that we have seen in most markets since March 2009.
As a conclusion, we have to say that stocks entered into a long bear-market, not in 2008 but already in 2000 and the actual boom is created as a reaction to all time lows in interest rates, a course of action that will not go on forever.

On a PER base evaluation stocks are far too high and the market needs a recession and will get its recession, but because of the delay it will not be a strong recession, it will be the worst depression in the history of mankind. Compared to the upcoming depression and its follow-ups the great depression in the 1930s will look like a children birthday party.

On the other hand, in a hyperinflation, and we will get one because Mr. Bernanke and his central bank friends are money-printers and the only reaction to this crises so far was to print, stocks will skyrocket, in Zimbabwe or in Germany in the 1920s stock markets gained a billions of percent, but people had or in the case of Zimbabwe have to use bags full of money to buy a piece of bread.

4. Commodities

In the upcoming decade commodities will be by far the best investment compared to all other investment classes.

Graphic 5 shows us the development of gold in the last decade.

Graphic 5: Gold price in $ per ounce from 2000 to 2010

(http://www.kitco.com/scripts/hist_charts/yearly_graphs.plx)

As we can see the gold price went up from its 20 year lows at about 250 $ per ounce in 2000 to a new all time in 2009 at 1200$ per ounce, so gold had approximately a 400% increase in the last decade and the good news for gold-bugs are that the bull-market in gold is by far not in its final phase.

However, if we adjust the all-time gold high from 1980 to real inflation the price of gold would match its all-time highs from 1980 at about 6000$ today. There is a rule that at the end of a bull markets the prices of an asset reach about 10 times the levels of the all-time high of the precedent bull-market. In the case of gold that would mean something between 8000 $ (without the inflation factor) and 60.000 $ if we adept the gold prices to real inflation.

By the way, the US Dollar lost 97% of its buying power in the last decade and the Euro about 50% since it was introduced. Inflation and the steady shifting of wealth from the middle class to the elite are typical for a currency system based on FIAT money and the payment of interests. Actually all currencies in the world are FIAT money, that means money without any underlying, like gold, silver, whatever. Money created out of thin air.

A financial system that bears compound interest has to destroy itself after a certain period of time, based on the exponential function.

As an example, if Josef the “father” of Jesus would have put a cent in a bank in Bethlehem 2009 years ago, and if this 1 cent would have lead to an interest payment of lets say 3% for

the last 2009 years, and the bank would still exist, the compound interest rates would have lead to an amount of money that equals 180 billion earth sized orbs full of gold.

Nevertheless, if we go back to the gold market we can see on Graph 5 that in the period from 2000 to 2006 only the “smart money” started to invest in gold. So the prices started to increase slowly, but without further notification by the mass media.

In 2006 than the big money started to build up its first long positions and together with the financial crises gold reached a new all time high in 2009.

In these days we can see that central banks of powerful emerging markets like China or India are accumulating gold and giving their people the advice to invest in gold and silver.
(http://www.wirtschaftsblatt.at/home/396216/index.do)

For example China plans to accumulate 10.000 tons of gold in the upcoming years and India recently bought 200 tons from the IMF, so gold has still a long way to go until the “dumb money” gets into the market and gold makes a bubble. This will occur maybe in the middle of our new decade.

Gold and other precious metals are very rare on or planet. All the gold gained by humanity in the last 10.000 years, from the mask of Tutankhamen to the wedding ring of your neighbor, is roughly just about 150.000 tones or a cube with an edge length of 18 meters.

Besides gold, a lot of other commodities seem to be very interesting, first of all silver. These days silver is rarer then gold, because most of it was already used by the industry. So, all the silver that is available for investment purposes has a value of just 20 billion USD.

If an investor thinks about the fact, that the US government needs just about 4 days to make enough new debts to equal the value of all existing silver in the world, it becomes clear that something is absolutely not right. Gold has more a monetary function and not a real economic value, but silver is one of the key elements for a high number of future killer applications, like very efficient electric power transportation, RFID chips and so on.

Furthermore, a lot of commodities are unique and once there are gone, humanity can not replace them anymore. Basically all metals, oil and natural gases are running out and it will be impossible to replace them. The media is often talking about Peak Oil, and that is going to be a serious problem, which is also closely connected to an exponential function. Peak Oil means that humanity reached the point of maximal oil exploration. As an example, oil consumption is increasing by about 7% per year. That means humanity uses each decade more oil than in its entire history up to this new decade together!

So one of the most elementary economic formulas is the connection between offer and demand, and in the commodities sector we can see a constant increase in demand led by the emerging markets and also a constant shortage in offer. That will automatically lead to higher prices for almost all commodities.
Besides of the famous commodities gold, silver and oil, we have a large number of other commodities that are still very cheap in the moment. For example wheat is at its 200 years low and with a constant increasing population together with a higher demand for food; also wheat would be an excellent investment.
So we can be very bullish for the commodities sector in the new decade and commodities will outperform equity markets and surly bond markets.

5. Cycle of Kondratieff

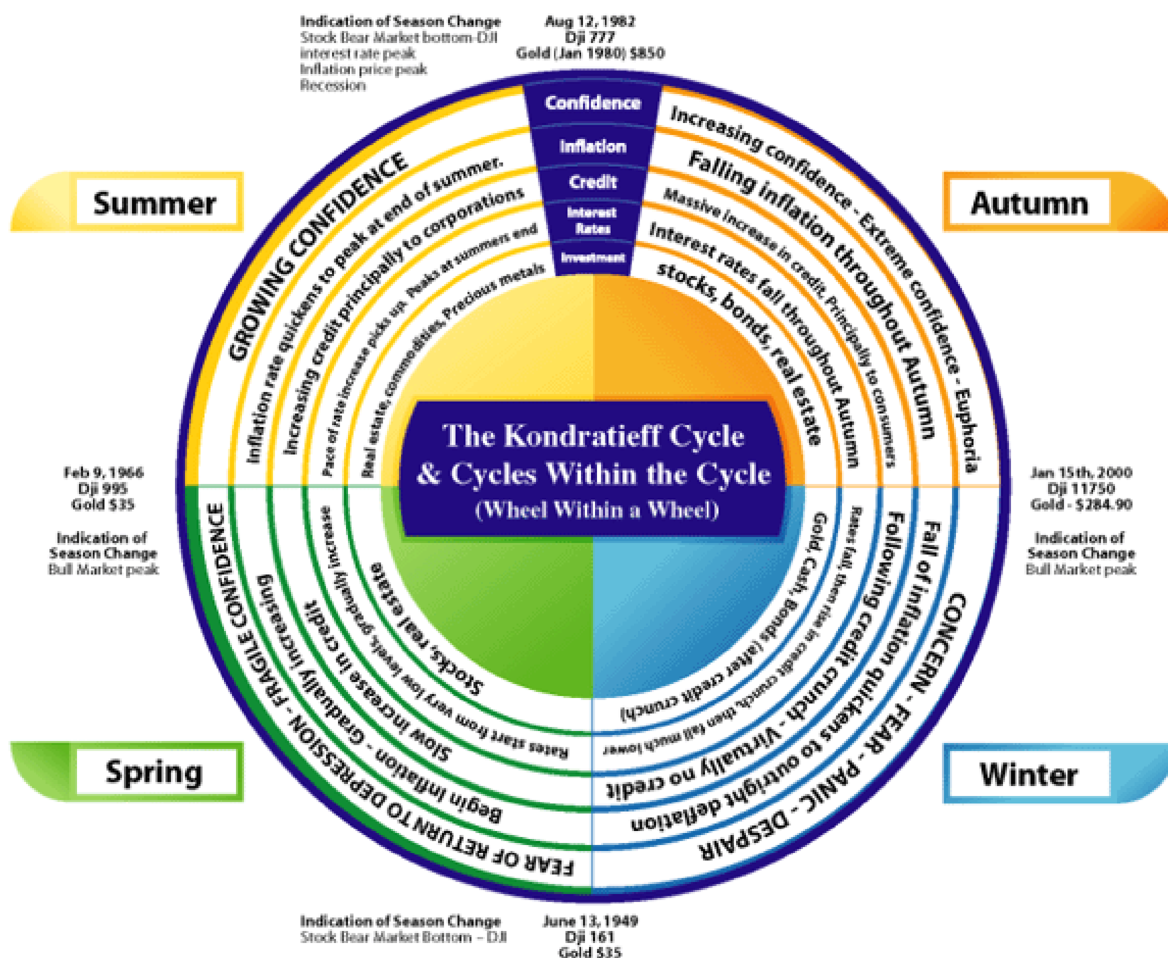
After we have analyzed the 3 main financial markets, the debt, the equity and the commodities market we have to ask ourselves how these markets are linked together and if we have some waves of cycles that help the investor in its long term decision making process.

Nikolai Dmitrijewitsch Kondratieff was a Russian economist who lived at the beginning of the last century and published 1926 a scientific work about large economical cycles. According to Prof. Bocker, originally Kondratieff was asked by Stalin to work on the scientific proof of why the communism is superior to the capitalism from an economic point of view. After a few years of research he was not able to give an answer to this question but analysing all available data of the western capitalistic economies he was able to develop a long cycle that goes about 60-70 years (2 generations). This long wave (1 Kondratieff) can be divided in 4 sub cycles, similar to the 4 periods of a year. So we have the Kondratieff spring, summer, autumn and winter.

Unfortunately Stalin was not satisfied with his works and Kondratieff was executed in 1938.

Gladly, economists these days have not such a high work pressure, maybe which explains why their forecasts almost never tend to be related to the future development.

Graphic 6: The Kondratieff cycle



(http://www.anglorandcapital.com/newsletters/2008_Q1/index.html)

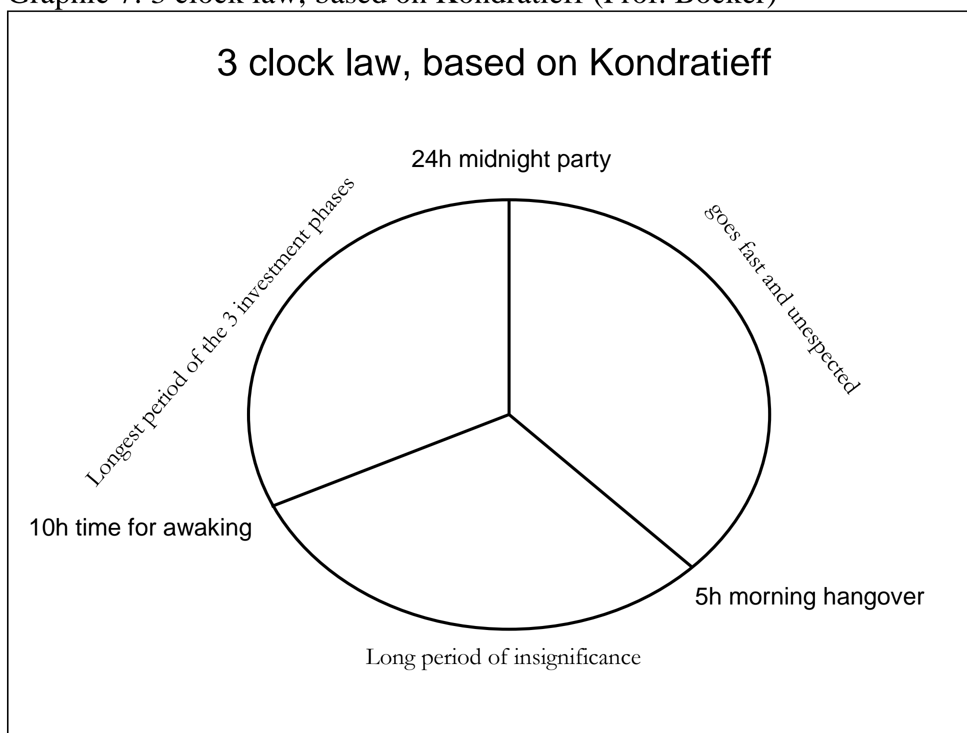
As Graphic 6 shows we entered the so called Kondratieff winter in the year 2000 and according to this graphic we can deflect certain information to five factors for each period:

- Confidence
- Inflation
- Credit
- Interest rates
- Investments

In the actual Kondratieff winter, that we entered 2000 and will leave at about 2018 we will see a lot of fear, panic, despair and concern on the confidence level together with a high harsh change between deflation and inflation, this time maybe even hyperinflation. The best investment will be gold according to the cycle and investors can think about long positions in equity and debt but just at the end of the cycle. This Kondratieff winter will due to the enormous debt levels lead to total system destruction and changes that we can not imagine yet.

Graphic 7 shows us how to invest according to the Kondratieff cycle to significantly outperform the markets on the long run.

Graphic 7: 3 clock law, based on Kondratieff (Prof. Bocker)



As we can see in Graphic 7 an asset class has a kind of inner clock, highly similar to the inner clock of a human person that is going to a party. This approach is also closely related to the so called egg of Andre Kostolany, maybe the most famous speculator of the 20th century.

The three important points in time in the graphic represent major events at the end or beginning of a cycle. For example we take the year 1982, which was the beginning of the last Kondratieff autumn. At this point Gold was at 24h; it was the absolute star under the asset classes and had an enormous increase behind itself. Stocks were at this point at the end of a very long bear-market and so the ratio between Dow Jones and gold was in support of gold as

with 1 ounce of gold u could be the entire Dow Jones Index 1.1 times. Bonds were also still at the very beginning of a long bull-market. So basically gold was at 24h, bonds forgotten somewhere at 5h after a long bear-market and stocks slightly ahead, maybe at 6-7h.

As the Kondratieff autumn went on from 1982 to 2000, gold entered a long bear-market and stocks and bonds started to rally. At the end of the Kondratieff autumn and the beginning of the winter gold was completely forgotten. Gold was just an unnecessary relict from a barbaric time, with now real us, without interest rates. So gold was at 5h, just like a person after a party who drunk too much and has a serious handover the next morning. Stocks however were at all time highs and everybody, the so called "dumb money" wanted to enter the market at any price. So the bubble in stocks exploded and the "dumb money" had a very high lost.

Due to the low interest politic by Mr. Greenspan the rally in bonds went on and the rally at the real estate /housing markets went into its final phase.

Here we have to point out that real estate markets these days are very similar to bonds. If the interest rates are low the prices go up and vice versa.

For a successful investor just two things are important. Firstly, to enter an asset market together with the "smart money" at a point in time when the cycles indicate a long-bull market and then to be able to sell this asset close to the peak of this bull market and afterwards to swift in the next asset class. So basically, an investor has to try to stay about 10-15 years in an asset class, during the period that this asset class goes from 10h to 24h. Nobody can hit the bottom of an asset class and then to get out at the exact peak, but if an investor is in the right market during the right period of time, the performance will be significant.

As an example lets take the Dow Jones and gold and simulate a portfolio starting with 1000$ shortly after the second world war in 1949, when the Dow Jones was at 161 points and gold was still fixed at 35$.

At these times the US Dollar was underlined with gold, which means the US Dollar was as good as gold. However, Nixon had to end this underlining in 1971 when the costs of the Vietnam War began to destroy the gold standard and France under Charles de Gaulle sent a military navy to New York to bring the French gold home to Paris. According to this we have to say that since 1971 no currency in the world is underlined by gold and all currencies are technically worthless FIAT money. So humanity is living right now in a very interesting new experiment. Of cause it is clear how this experiment will end. To quote Voltaire: *"each paper currency is going back in the long run to its intrinsic value, ZERO".*

But let's go back to our calculation. According to the Kondratieff cycle the ideal investment in the Kondratieff spring from 1949 to 1966 would have been stocks. The Dow Jones index went up from 161 to 995 points. So our initial 1000$ would have been gone up to 6180 $.
In the now upcoming Kondratieff Summer from 1966 to 1982 the sophisticated investor should have switched from equities to gold. Gold then went up from 35$ to 850$, an increase by 24.2 times. So our 6180$ would have gone up to 149500$. In 1982 it was again time to switch from gold to stocks as the Kondratieff autumn begun. In this time the Dow Jones went up from 777 points to 11750, an increase by factor 15.1. So our portfolio would have reached 2.260.000$ dollars. In the year 2000, with the final switch back to gold from stocks our portfolio would have made another factor 4. So at the end with 1000$ starting capital an investor would be up to 10.000.000$ in about 60 years. Of cause nobody can hit exactly the

bottom or the peak of the markets or the exact entry points but if an investor does it about 80% correctly his portfolio will outperform almost everything.

6. Analysts against gurus

In the investment world we have two kind of groups that have a large influence on the investors, on the one hand we have the analysts and on the other the so called gurus.

The main difference is that analysts together with rating agencies work for different interest groups like banks, insurances and governments and gurus are totally independent. An analyst or somebody working for a big rating agency receives a salary, and this salary is not based on his forecasts but on the success of the company. Let's take an example. A few years ago the prices of oil were skyrocketing and at about 150 $ per barrel. The "big money" like Goldman Sachs was in this market and wanted to sell its positions without doing to much pressure on the market and with keeping its profits. So an analyst at Goldman Sachs predicted a price of 500$ per barrel in the near future and more and more money from the "dumb money" category went into this market. After a few months the price dropped from 150$ to 40$, an excellent example of analyst work. The same happened at the end of the last Kondratieff autumn at the end of the 90s, where stock market analysts predicted future gains for internet stocks that already increased by factor 10-50 in the years before. By the way Abby Cohen from Goldman Sachs is still waiting for 40.000 points in the Dow Jones.

The three big rating agencies Moody's, S&P and Fitch do approximately the same quality in their jobs. As an example Fannie Mai and Freddy Mac had the best possible rating of AAA, until the day before they went bankrupt. Everybody who has still some brain left knows that the USA and Japan can never pay their debts back and will go bankrupt in the near future, but of cause this countries still have an AAA rating, that means this assets are considered to be under the safest ones on our planet.

On the other hand we have some gurus, people who know about the Kondratieff cycles and who made a fortune with trading the markets, not by salaries.

In this category I would include people like, Jim Rogers, Marc Faber, Bill Bonner and Prof. Bocker.
Prof. Bocker published a paper in august 2004 where he exactly describes the upcoming burst of the real estate bubble in the United States, and the bankruptcy of Fannie Mai and Freddy Mac four years before that happened. I heard the names of these now famous companies the first time in my life reading Bocker paper, but however it is important to point out that these companies had the best possible rating just one day before they went bankrupt.
Another example is investment legend Jim Rogers, who together with his partner George Soros, managed a commodities fund in the 70s, the so called quantum fund, where he had a performance of 4200% in just a decade.
(http://de.wikipedia.org/wiki/Jim_Rogers)

Right now all these gurus have something in common, they are all very pessimistic about the future and they are bullish for gold and bearish for bonds and stocks.

On the other hand the analysts tell us that the markets will continue to recover, the recession is over and investors should buy bonds and equities and sell the barbaric relict gold and take the profits, because their was really no reason why gold increased.
However, it is recommended for a sophisticated investor to listen to the gurus and use the analysts as a contra indicator. Today via the internet an investor can find publications and interviews from these people and should adept his portfolio strategy to it.

7. Three ways out of the crisis

According to Prof. Bocker, Dr Marc Faber or Jim Rogers the current crises will go on for another 5-10 years until the Kondratieff winter is over and we are entering a new spring cycle, and there will be one or more of the following 3 developments.

- Hyperinflation
- Currency reform
- Big war (WW3?)

Hyperinflation:
With the actual fiscal policy of the large central banks (FED, ECB, BOE, and BOJ) together with the so called quantitative easing we are heading to a hyperinflation like the one of the Weimar Republic or in Zimbabwe. The increasing amount of money in a FIAT currency system will lead after a certain period to inflation and the people will lose their faith in FIAT money and bonds and will look for the save harbour of precious metals. A Hyperinflation is extremely negative and destroys the middle class and leads to wide poverty.
During this period precious metals will increase to astronomical levels. For example, an investor could buy a big mention in the best neighbourhood of Berlin during the Hyperinflation period with just 1 ounce of gold. For 10 ounces of gold an investor could buy an entire street.

Currency reform:
Nobody can imagine a world without the US Dollar or Euro, but this world will come sooner than expected.
During the last century Germany had 4 different currencies. The advantage of a currency reform that normally occurs after a hyperinflation is that the government eliminates some zeros of its debt, but on the other side also the depositors lose a large part of their fortune.
However, only a new currency that is underlined with gold or other real assets will gain the trust of the population after a currency reform.

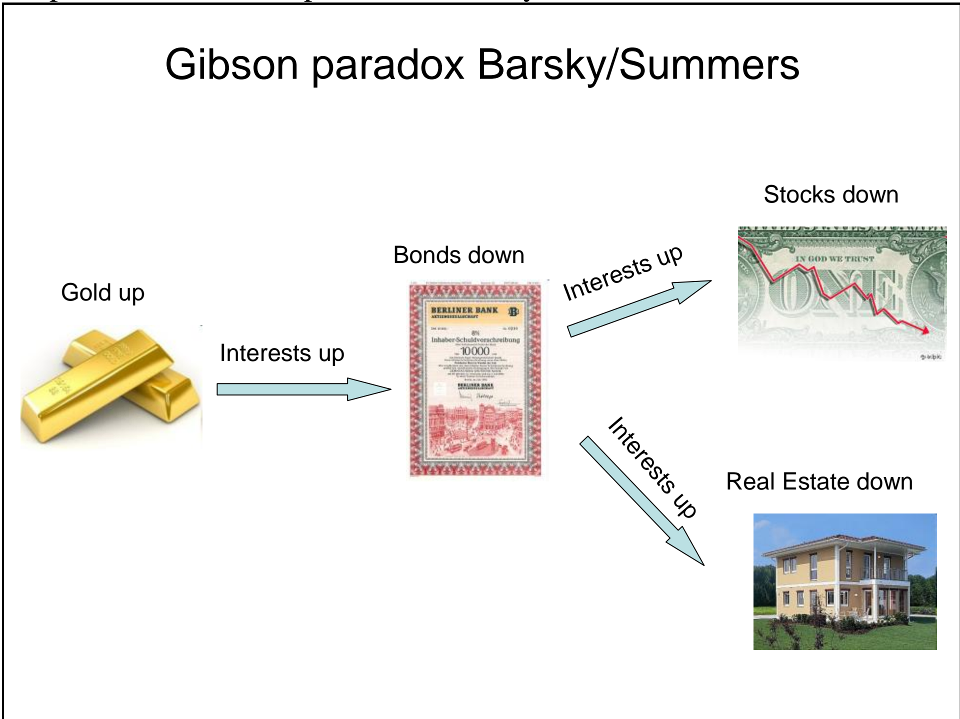
War:
During times of war, nobody is interested anymore in the exchange rate of the dollar or the development of the bond market. The only thing that counts is to survive. Right now a big war seems unrealistic, but history shows that during the Kondratieff winters, governments tend to start a war to mask their interior problems. As an example we can take the Second World War. The United States had the great depression and only the millions of new jobs and the massive investments in the war industry lead the Unites States out of their economical depression. Furthermore, after defeating Nazi Germany the biggest theft in history took place when more than 40.000 patents, thousands of scientists and hole factories has been moved from Germany to the United States and partly also to Russia. Today, the only asset that the

United States have left is their military. The United States have a higher military budget than all the other states in the world together and with China the upcoming superpower of the 21st century an opponent that is getting stronger every day. These days the United States and China depend strongly on each other, but with the further decline of the United States and the rise of China combined with the fight for influent and raw materials the situation will escalate.

8. Conclusion

The markets and the world have reached a very critical point. According to Graphic 8 the increasing price of gold will start a chain of catastrophic events, based on the Gibson paradox and the paper of Barsky and Summers upon it.
(http://papers.nber.org/papers/w1680.pdf)

Graphic 8: The Gibson paradox & Barsky/Summers conclusion



We had in the last decade an increasing gold price together with a low or zero interest rate policy by central banks. So the question is why a sophisticated investor should buy bonds with a yield of 2-3% when the gold price is increasing with annual rates of 20% and with absolutely no counterparty risk. Of cause there is no reason to stay in bonds and therefore an investor should switch into gold and that would afterwards lead to a further increase of gold and higher interest rates, which would decrease the bond prices further.

Summers as a former financial minister discovered this connectivity and therefore everything was done to decrease the gold price. On the one hand in the London physical market a high amount of central bank gold was sold and on the other hand the gold price is manipulated by naked future contracts by 2-3 important Banks at the Comex in New York.

Nevertheless, the market is on the long run to strong and therefore these manipulations will end in the near future. Also the “big money” like China discovered gold and just by a slightly

switch of its 2.000.000.000.000 $ reserves into the gold market the prices would reach the moon and the naked short positions at the Comex would ruin the involved short banks.
China alone could buy all the gold that exists in the world for investment purposes with its dollar reserves several times. It is estimated that all existing gold in the world is worth about 4 billion dollars, but the gold that is available for investment purposes is just a small fraction, maybe 25-30% of this.

As Graphic 8 shows the increasing interest rates that should follow the increase of the gold price will have a very negative impact on bonds, stocks and real estate. At an interest rate of 25% (and that is still the minimum, that the actual gold price requires) all governments, and a majority of companies would be bankrupt and the Dow Jones would trade again for under 1 ounce of gold.

So as a conclusion to the perspective of the financial markets we can say that the actual decade will be very positive for raw materials and extremely negative for stocks and bonds. We will see great changes and unfortunately not very positive ones for the majority of the population.

And it is not important in what place of the world you live, because almost all countries will be affected.

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