

**Minutes of the Advisory Board Meeting  
Austrian Economics Golden Opportunities Fund  
January 13, 2015**

## Highlights of the conversation:

### Heinz Blasnik:

- ▶ **Falling oil prices are more of a *symptom* than a *cause* of deflation.** I believe it is clearly a symptom of declining money supply growth worldwide.
- ▶ The effects of the collapse in oil are both positive and negative, because **what consumers are gaining, producers are losing.** The only problem is, about 1/7 of the junk bond market is related to energy, 10% of the earnings in the S&P500 are related to energy and a lot of capital expenditure and job growth was related to energy. It goes without saying that this collapse will cause some disruption. It comes down to the sequence of events; **we will first see the disruptions and only later the positive effects.**
- ▶ I believe that we are going to see new all-time lows in treasury bond yields.
- ▶ The decline in inflation expectations and yields is negative for stock markets. It has not reacted negatively yet, but volatility is already much higher since October. This shows that opinions are becoming more divided. **So if we assume that economic activity is slowing down, it's going to be more and more difficult to rationalize a very highly valued stock market. It is one of the most overvalued markets ever.**

### Frank Shostak:

- ▶ It would not surprise me at all to see economic activity start falling quite soon. So from my point of view, we are heading for difficult times in the US and this weakness may last well into 2016, based on my models. So I am expecting weaker growth and the stock market should start to mirror that. **After the first quarter of this year, I expect the emergence of a downtrend in the S&P 500.**
- ▶ **I also expect a continuation of the downtrend in treasury yields. This may last, based on our model, until the second half of 2015.**
- ▶ With respect to commodity markets, our model forecasts the underlying downtrend in oil will continue. **It would not surprise me to see oil prices below USD 30.** This would obviously be disastrous for various energy producers like Russia. Bear in mind that oil producing nations require foreign reserves. They will thus raise the volume of their supplies to generate some cash flow and try to survive.

### Zac Bharucha:

- ▶ I observe that the dramatic collapse of crude oil is not isolated. Copper prices have tumbled and that is noteworthy because it's a commodity sensitive to industrial demand. The price has broken important levels and seems poised to go much lower. **Copper looks like an excellent short trade at the moment.** Note also that sovereign bond prices are rising; I think they will remain well bid.
- ▶ I think we can say that there has been a topping out process underway in stocks and I am more bearish than at our last conference.
- ▶ My stance regarding gold is: be careful right now as it is overbought and hitting the 200d MA soon. However, on dips, **in the broad range between 1,100 and 1,200, gold should be accumulated, especially if you have a bearish view on the stock market. If you think the multi-year bull market in equities will end soon, it might be wise to accumulate gold.**

### Jim Rickards:

- ▶ Analysts, investors and mainstream media are starting to wake up to things like currency wars, the safe haven nature of gold, etc. I think the reason for that is that until you reach the zero rate bound, you can pretend it it's a normal cycle. Once you hit zero that pretence is gone and the currency war becomes more explicit.
- ▶ The US has a strong currency based on the view that the US has a strong economy and we can afford to let Europe and Japan to devalue. **The problem with that logic is that, the US economy is not that strong.**
- ▶ **The FED will not raise rates. That will be a shock. Right now everyone is on one side of the boat. The whole world is set up for a rate increase.**
- ▶ **Why would anybody buy gold during a Deflation? The answer is, deflation is a pretty good leading indicator of inflation.** Gold is also an interesting facet of the currency wars. If you think of gold as money gold can't fight back.

### Ronald Stoeferle:

- ▶ Gold is holding up extremely well. We are experiencing a major rally in the USD and gold traded basically sideways with a minus of only 2% in 2014. In every other major currency, price action looks constructive. On the other hand, the mainstream seems to think that the gold price actually got completely trashed last year, although it was only a sideways trend. **So there's a major divergence between what the market says and what market participants say.**

### Mark Valek:

- ▶ I really like Jeffrey Gundlach's statement that "all hell will break loose" as soon as oil reaches USD 40. **This corresponds with the concept of "hyperdeflation" that we wrote about in our book on Austrian Investing. What will happen if the inverse monetary pyramid implodes and central bankers don't start printing early enough?**

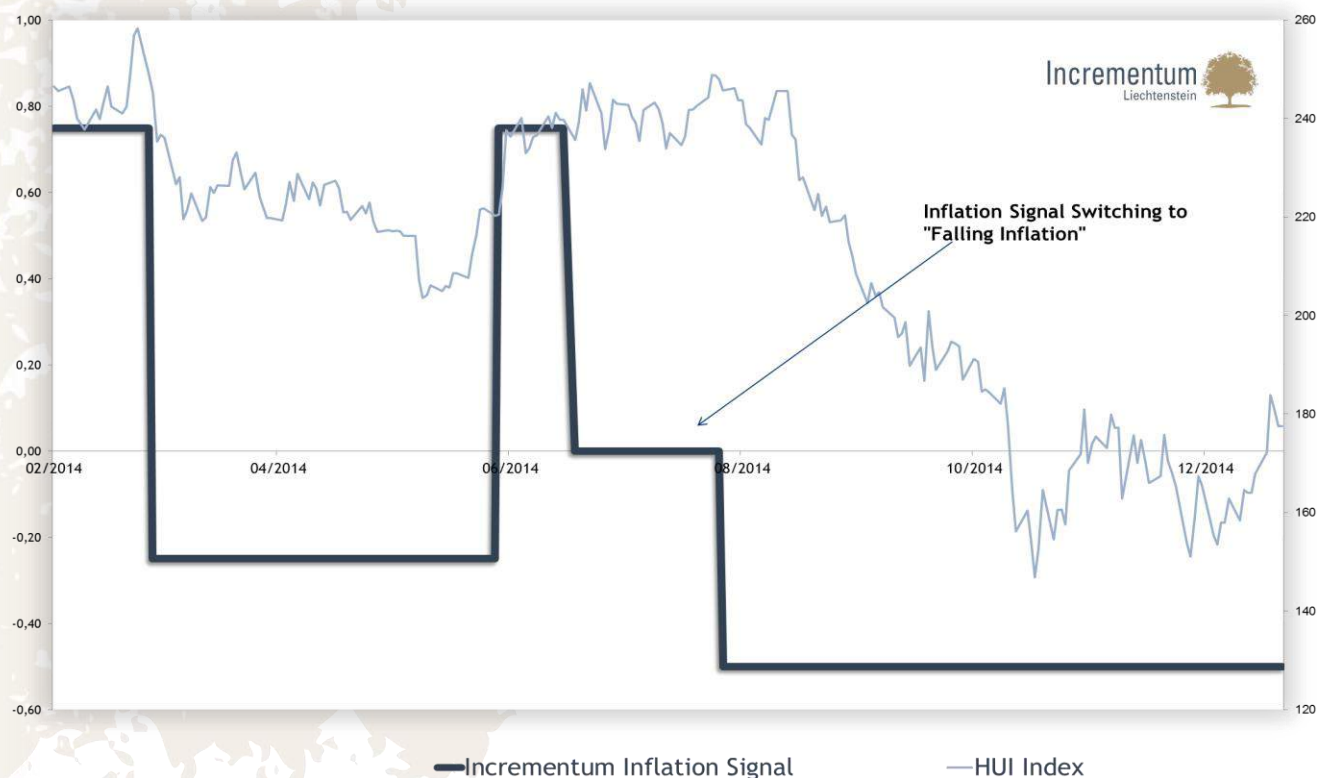
## TRANSCRIPT OF THE CONVERSATION:

Ronald Stoeferle:

Gentlemen, it's a great honor to welcome you to the fourth advisory board meeting of our Austrian Economics Golden Opportunities Fund and to wish you and your families a happy, healthy and prosperous new year. Unfortunately, Rahim Taghizadegan is not able to join us today.<sup>1</sup>

Let us start with a short description of our proprietary Incrementum inflation signal. I depict a graph of our inflation signal as well as the Gold Bugs (HUI) Index since January 2014. We are very happy with so far, as it switched to "falling inflation" in August when nobody was talking about deflation. However, a rather dramatic move in the USD, commodities (especially oil), gold and silver followed. As can be seen on the following chart, we are glad that the signal works so well in real-time and provided us with downside protection.

Development of Inflation Signal and HUI Mining Index

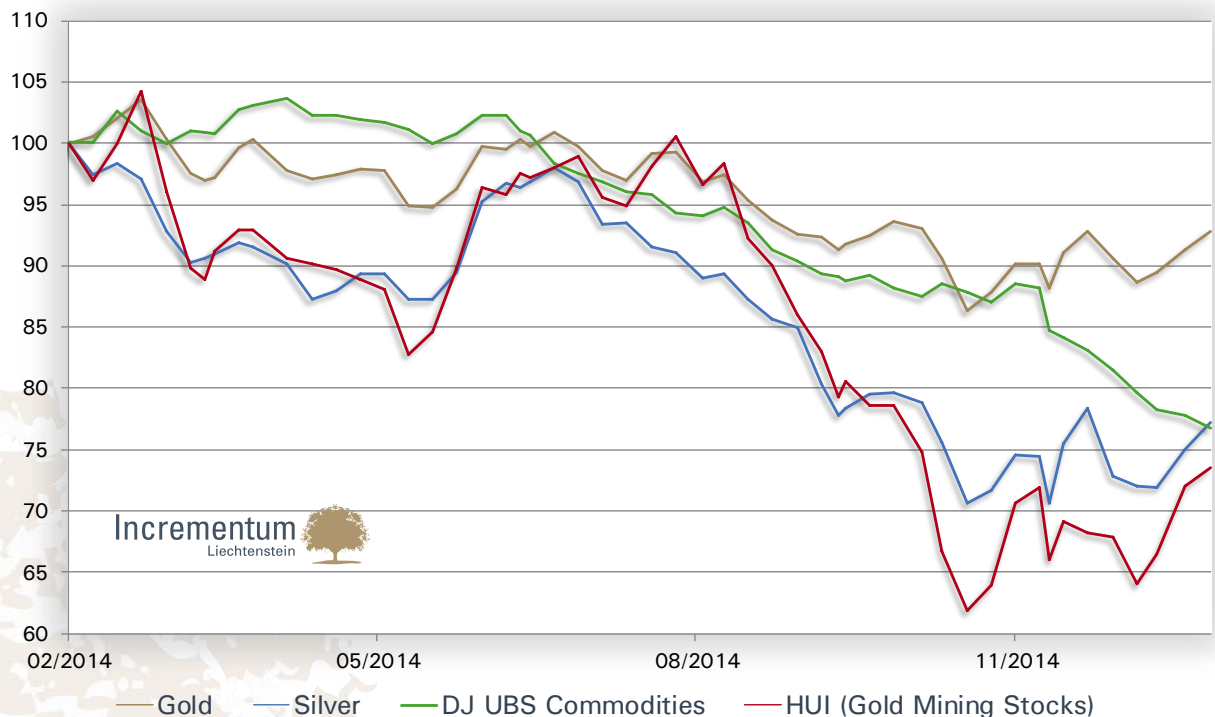


Source: Incrementum AG

<sup>1</sup> Jim Rickards was not able to attend the discussion on Jan. 13, but we held a conference call with him later on, that we included in this written transcript.

So we closed the year with a small plus of roughly 1%, which is quite a success considering the broad-based sell-off in the commodity space. We have thus achieved the most important thing for an absolute return fund: **avoiding major drawdowns**.

### Development of Inflation Sensitive Assets since Launch of our Fund



Source: Incrementum AG

From our point of view, we are excellently positioned going into 2015. We have already set up a few trades and look forward to discussing them with you.

**Mark Valek:**

**As we can clearly see, disinflation or rather deflation is the name of the game. The big picture of the market is screaming “DEFLATION” to us. Heinz, what’s your general market assessment?**

**Heinz Blasnik:**

Ok. Let’s start with energy prices. **Falling oil prices are more of a symptom than a cause of anything, although it will have massive consequences. And from my point of view, it clearly is a symptom of declining money supply growth worldwide.**

Sean Corrigan recently published a money supply measure that attempts to measure global money supply growth. He says that it is currently at the lowest level since

1998, so we clearly have a major slowdown. As a result, commodity prices have come under enormous pressure.

So the effects of the collapse in oil are both positive and negative, because what consumers are gaining, producers are losing. The only problem is, about 1/7 of the junk bond market is related to energy, 10% of the earnings in the S&P500 are related to energy and a lot of capital expenditure and job growth was related to energy. It goes without saying that this collapse will cause some disruption.

**Today we actually received the first major news from the banking system that Standard Chartered was forced to write off USD 4.4bn in commodity loans.** So there will be disruptions, but in the long term, consumers will gain what producers are losing. It comes down to the sequence of events; we will first see the disruptions and only later on the positive effects.

**Ronald Stoeferle:**

Heinz, one interesting example from a friend of mine who works in seismic technology for the oil industry in Canada: He mentioned that the major oil companies have cut their budgets by 50-70% for 2015. He thus expects major consequences for the real estate market that, due to Mr Carney's work at the Bank of Canada, looks quite 'bubbly' at the moment. Plenty of marginal buyers will no longer be able to buy or even forced to sell real estate. **Therefore, I think that many of the consequences of the collapse in oil prices will only be seen in the coming weeks or months.**

**Heinz Blasnik:**

I totally agree with Ronni. Canada is especially vulnerable due to their housing bubble and the same also goes for Australia, which is more dependent on iron ore, which is also in free fall at the moment.

It seems that the consensus right now considers the collapse in oil is mostly positive and not negative. I am not sure about that. Especially, if we assume that the high oil price was mainly a consequence of monetary interventions and strong money supply growth. This would suggest that this was a bubble sector of the economy with plenty of malinvestments. These will be liquidated, which will have knock on effects on many other industries. And only once this liquidation phase is over, we can expect some positive effects.

**Mark Valek:**

**I really like Jeffrey Gundlach's statement that "all hell will break loose" as soon as oil reaches USD 40.** This corresponds with the concept of "hyperdeflation" that we wrote about in our book on Austrian Investing. **What will happen if the inverse monetary pyramid implodes and central bankers don't start printing early enough?**



**Heinz Blasnik:**

It's always a possibility in a fractional reserve system. Central bankers can work against it, but it's the time lags that are most interesting.

**Frank Shostak:**

The US money supply - as we measure it as AMS (adjusted money supply) – has been trending up since the beginning of last year. So momentum is increasing actually.

In the Eurozone, money supply is bottoming but attempting a pick up at the moment. In China, the rate of growth has been declining but also seems to be bottoming. Thus, from my point of view, the global money supply's rate of growth is not collapsing.

I agree with Heinz' observations, that the fall in oil prices is not a cause but rather a symptom of falling money supply and therefore a symptom of monetary deflation.

**But it is important to stress that this is not a symptom of current money supply but rather previous money supply, as this operates with very long time lags. We had a significant decline in money supply growth from October 2011 until November 2013. I am suggesting that this decline is only now starting to assert itself.**

Based on this, it would not surprise me at all to see economic activity start falling quite soon. This might start with GDP numbers after Q1. **So from my point of view, we are heading for difficult times in the US and this weakness may last well into 2016, based on my models.** So I expect weaker growth and the stock market should start to mirror that. Money supply may reverse in a few months, as banks might tighten lending conditions.

**Zac Bharucha:**

There are two big trend in place; one is the integration of relatively open global markets with increased price discovery; a trend consistent with benign disinflation. The other is the emergence of China, although still under the yoke of one party rule, into the global trading system at breakneck pace. That second trend was the basis of the supercycle hypothesis for commodity prices as you will recall. After the financial crisis erupted commodity prices did not decline as might have been expected because economic weakness was concentrated in western economies; the leaders of China implemented rampant stimulus. With economic growth in China slowing after a recent policy shift, the first trend has reasserted itself. **There is no inflation in goods markets and no wage gain available to labour. Asset price inflation is self-evident as a direct consequence of QE, but there is no inflation in goods or services overall.**

**Mark Valek:**

I have the feeling, that the **mainstream financial media is starting to question the credibility of central banks**, especially in the light of the events that happened at the Swiss National Bank and the European National Bank in January, would you agree Jim?

**Jim Rickards:**

I agree with that completely. I don't actually think that the fundamental state of the world has changed. What has changed, it has become more visible. **Analysts, investors and mainstream media are starting to wake up to things like currency wars, the safe haven nature of gold, etc.** I think the reason for that is that until you reach the zero rate bound, you can pretend it's a normal rate cutting exercise. Once you hit zero that pretense is gone and the currency war becomes more explicit.

Going back to December 2012 that was made explicit in Abenomics, as of today I would say it has become explicit through European Central Bank policy. Right now you have people like Gary Cohen, president of Goldman Sachs saying in Davos today, "we are in a Currency War". So people are getting more honest about what in fact is going on. However the problem remains, there is no way out of the currency wars, it has to continue until something breaks, until the system breaks down or there is a global monetary policy conference. It doesn't have to be something like Bretton Woods, it also could be something informal like the Plaza Accord. However I don't see the leadership for that, so this means more volatility right now. The FED understands this but they took the view, that the US-economy is strong enough to bear the costs of a stronger currency.

So the US has a strong currency based on the view that the US has a strong economy and we can afford to let Europe and Japan to devalue. **The problem with that logic is that, the US economy is not that strong.** The FED is basing their strong outlook on their flawed models and we know the future course of policy will be data dependent. This is a big deal because what I expect by May or June, if the economic data comes in the way I expect for fourth quarter 2014 and first quarter 2015, it will be fairly weak and the FED will not raise rates. That will be a shock. Right now everyone is on one side of the boat. The whole world is set up for a rate increase. If we get to May and the FED begins to signal, that they're not going to raise rates any time soon, the whole thing could flip. **It could be a violent reversal were suddenly its "Risk-On", everyone goes back to emerging markets, the carry trade goes back on, USD goes down, EUR goes up.** Everything we saw in 2012, we would begin to move back into that direction, once the FED admits that they are not going to raise rates.

So for now I expect more of the same, a strong USD weak EUR, weak EM currencies and continued asset bubbles. **By June we should be prepared for a reversal for that trade. That could also be quite good for US stocks. Part of the risk on trade is going long US-stocks.**

**Mark Valek:**

Thanks a lot, Jim. This appears the perfect time to discuss some specific investment ideas. What is your view on 10y treasuries?

**Heinz Blasnik:**

We are at a very similar point to the last time we discussed them: Short-term, they are a little bit overbought, but for the longer-term there is plenty of upside. We still have speculators fighting the trend tooth and nail.

Speculators collectively hold a net short position of 364,000 contracts, which is not far from an all-time high. And they have been fighting this trend the whole of 2014. So based on the market structure, there is plenty of buying power from shorts closing out their positions, as it's getting more and more painful to hold up those shorts when prices are rising. **Therefore, from my point of view, we are going to see new all-time lows in treasury bond yields.**

And at the same time, the decline in inflation expectations and yields is negative for stock markets. They have not reacted negatively yet, but volatility is already much higher since October. This shows that opinions are becoming more divided. This is confirmed by certain momentum stocks like Google or Tesla that have already entered bear markets.

Biotech stocks have been the main driver of the Nasdaq. It seems that investors are following less and less stocks. This is typically a sign of a market that is in danger of breaking down. On the other hand, seasonal stocks should remain quite positive until April or May.

**So if we assume that economic activity is slowing down, it's going to be more and more difficult to rationalize a very highly valued stock market. It is one of the most overvalued markets ever.**

**Mark Valek:**

We talked about the inverse relationship of the USD and gold. Things seemed to have changed somewhat recently. What's your take on that?

**Jim Rickards:**

We had a fairly inverse relationship between USD and gold. If you look at the dollar-index and gold, the low point of the dollar-index was exactly timed to the high point



of gold. **So there has been this inverse relationship between gold and the USD for the past three years. This changed during the past weeks.**

Why is this breakdown happening? The answer is that today governments cannot have deflation. The structure of sovereign debt and central banking today is such that it cannot allow deflation to persist for a longer time. There is a long list of reasons why governments have to have inflation, therefore when you see deflation arising despite of central bankers wishes which it did in 1929 and it is doing today, central banks stop from nothing to turn it around. Investors start to buy gold during that environment. Why would anybody buy gold during a Deflation? The answer is, deflation is a pretty good leading indicator of inflation. In other words precisely because it has to turn, you buy gold even in the deflationary stage because you can see through it.

Gold was down in USD in 2014, but up in any other currency. This is not a gold story but a USD story, now the USD is the best performing currency of the world. **Gold is also an interesting facet of the currency wars. If you think of gold as money gold can't fight back.**

**Mark Valek:**

What about the probability of seeing a repricing of the yield curve? Due to the disinflationary pressure, it seems that the market is postponing the rate hike in the US and might already price in another round of QE. So why shouldn't that be positive for stocks?

**Heinz Blasnik:**

One would assume that this would be bullish for stocks. On the other hand, sentiment and positioning indicators are already very, very stretched. Therefore, there's a possibility that such a reappraisal of the situation could actually this time be seen as not unequivocally bullish, for the simple reason that such a reappraisal would also include a downgrade of economic expectations.

Experience shows that if a recession for instance would begin, then easier monetary policy does *not immediately* lead to higher stock prices, as the stock market first of all discounts the recession.

**Ronald Stoeferle:**

**Would you expect a flat or inverted yield curve in the US, before the market switches?**

**Heinz Blasnik:**

Not necessarily. Up until a few weeks ago, the yield curve was beginning to flatten. This has now been interrupted as the rate hike discussions have been postponed. But we know from experience, that when the central bank keeps the very short end of the curve at zero, you do not see an inverted curve before the recession.

If you look back at Japan for example; since 1989 they had six cyclical bear and bull markets and not once did the yield curve actually invert. It flattened and became less steep but never inverted.

**Frank Shostak:**

I totally agree. First of all, we all know that monetary pumping will not have any positive effect on the economy. **So after the first quarter of this year, I expect an emergence of a downtrend in the S&P 500.**

Regarding treasuries, I also expect a continuation of the downtrend in yields. This may last, based on our model, until the second half of 2015. In 2016, our model suggests another significant drop in yields.

**With respect to commodity markets, our model forecasts the underlying downtrend in oil will continue. It would not surprise me to see oil prices below USD 30.** This would obviously be disastrous for various energy producers like Russia. Bear in mind that oil producing nations require foreign reserves. They will thus raise the volume of their supplies to generate some cash flow and try to survive.

Regarding gold, the underlying trend is still down and it would not surprise me if it would be trading around USD 900 next year.

**Zac Bharucha:**

I would like to mention something about QE; it took some time for it to gain a following, but by now investors have had plenty of time to adjust their mentality and increase exposure to risk assets, exactly as the FED wanted. These are long-term processes and I am unsure that another round of QE can create another shift of assets towards the risky end of the spectrum. It could happen that participants think *"Oh hell, the global market economy is still in a stinky state and was masked over by cheap liquidity"* and we'd experience weaker stock markets.

Regarding gold, let's inspect the price action. We got a break at 1,200, a major break of support, but price did not get down to 1,050, a very important support level. At the moment, gold is \$1330/ oz, just below its 200d MA (which is still downward sloping). **So the chart leads me to hesitate; was the breakdown under 1200 a false break, or is their unfinished business in this bear market?**

The negative for gold is that the general commodity complex looks very shaky. However, as an alternative asset in a negative real interest rate environment, gold is a good investment. If stock markets roll over, market participants might switch into gold again after a long period of portfolio adjustment out of gold into risk assets, equities, high yield bonds and the like.

**Ronald Stoeferle:**

From my point of view, gold is holding up extremely well. We are experiencing a major rally in the USD and gold held up pretty well with a minus of only 2% in 2014. In every other major currency, price action looks constructive. On the other hand, the mainstream seems to think that the gold price got completely trashed last year, although it was only a sideways trend. **So there's a major divergence between what the market says and what market participants say.**

**In EUR for example, we just crossed the huge resistance at EUR 1,000. Our research shows that gold works very well in deflation, but suffers in disinflation. That might be a sign that we are already in a deflationary spiral. Based on the increasingly strong disinflationary trend, we are convinced that there will be no rate hike this year in the US. Perhaps gold is already discounting that?**

**Heinz Blasnik:**

I agree. In EUR, GBP and Yen, gold is definitely in an uptrend. In USD, gold has made a few higher lows but it is not out of the woods, yet.

I have been thinking about *who is buying gold at the moment and why?* The only thing I can think of is that many money managers have sold during the correction and that new buyers with strong hands, deep pockets and solid long-term views have accumulated.

Another reason might be that these people are looking forward and believe that there could be problems in the banking system, triggered for instance by the bursting of housing bubbles. That might be one of the reasons attracting lots of new buyers.

But I do agree with Zac that there might be one final low in the 1,050 region. We can definitely not rule that out. In other words, the current rally could be just another bear market rally. **However, gold stocks have held up very well recently. The decline in energy is quite important for miners, esp. for large open pit projects who are experiencing increasing margins at the moment.**

**Zac Bharucha:**

Mark mentioned the word "hyperdeflation". I found that very interesting and want to return to it. Right now that is a very improbable bet. However, we have become

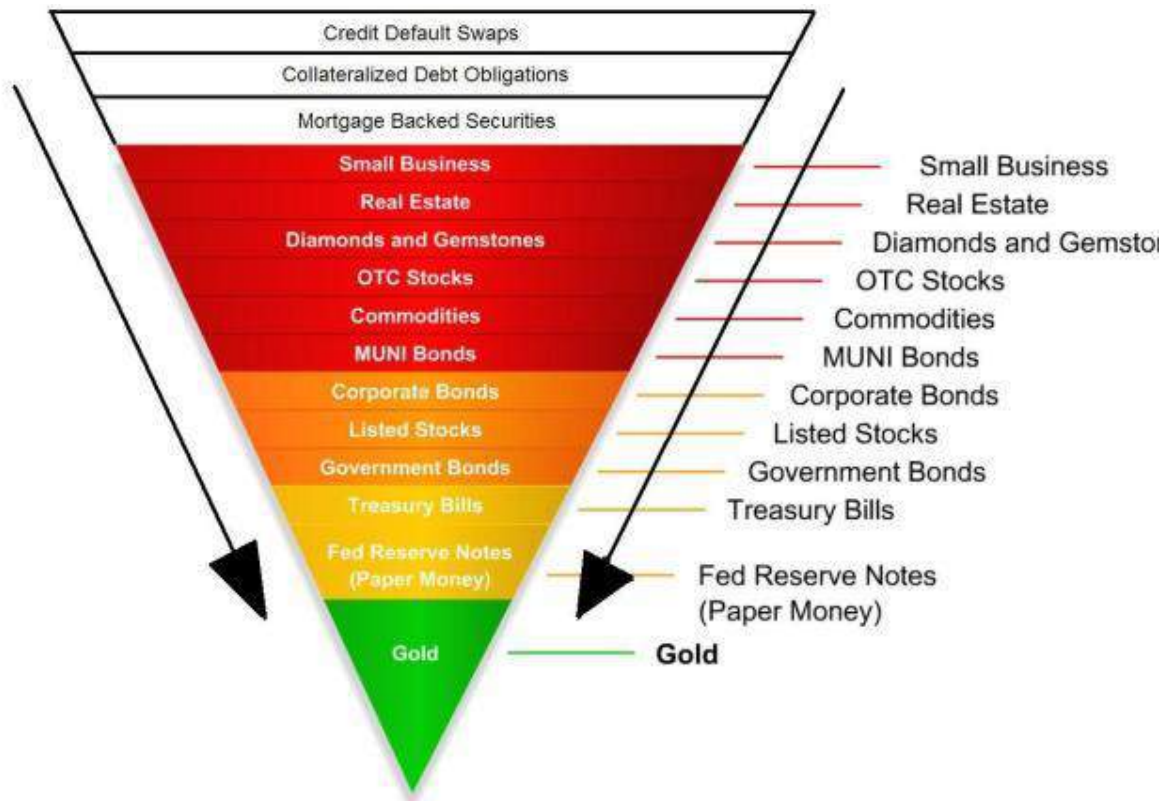
complacent about astronomical house prices in hot spots. **If we see a reversal in real estate prices, that would be something. If wealth in real estate and stocks is eroded simultaneously, the whole “wealth effect” that the Federal Reserve always refers to, would be eroded. If we saw that twin combination, hyperdeflation would be the right term.**

**These moves always start *at the margin*. Is it the fall in commodity and especially oil prices that takes the money out of the pockets of Russian/Middle-Eastern investors? As a consequence, they can't send their children to private schools in Britain, they pull back from multi-million apartments in London, New York wherever. There would be ripple effects; that's the way a hyperdeflation might start; but this is not my central expectation.**

**Mark Valek:**

Well this could be. We got the idea from the inverted pyramid that was invented by John Exter. It shows how liquidity spills from riskier and more illiquid assets down to lower risk, more liquid assets, once the money supply implodes. The big question is, what's at the bottom of this inverted pyramid? Exter stated back in the 60ies that gold was at the bottom of the pyramid. Right now, one could argue that treasuries and T-bills occupy the lowest ranks of this inverted pyramid and that gold is one layer above them.





*Source: Paul Mylchreest, Fulcanelli Report, ADM Investor Services*

**The question is, if this flips again and gold goes back to the bottom of the pyramid, what will happen?**

**Ronald Stöferle:**

**Gentlemen, we are very pleased with our fourth meeting of the Advisory Board and look very much forward to our next meeting in March. Thank you very much and take care!**

## Appendix: Members of our Advisory Board:



### Zac Bharucha

Zac began his career in finance at the investment bank Kleinwort Benson and later became an equity portfolio manager at Philips and Drew Fund Management. He then moved to AMP Asset Management where he was responsible for managing more than GBP 1bn of institutional assets. Since 1998, he has developed absolute return strategies and specialized in equities and commodities. After 25 years in asset management, he retired from professional life in 2011 and wrote his first book about

market timing.

### Heinz Blasnik

Heinz is an independent trader and market analyst for the consulting firm Hedgefund Consultants Ltd, as well as a regular publisher for the Independent Research House Asianomics in Hong Kong. Heinz primarily is responsible for his blog [www.acting-man.com](http://www.acting-man.com), on which he analyses developments in the financial markets from an Austrian point of view.



### James G. Rickards

Jim is the author of the international bestsellers *Currency Wars* and *The Death of Money: The coming collapse of the international monetary system*. He is portfolio manager at the West Shore Fund. During his career, Jim has held senior positions at Citibank, Long Term Capital Management and Caxton Associates.

### Dr. Frank Shostak

Frank is chief economist at MMG Zurich. He has over 35 years experience as a market economist and central bank analyst. He holds a PhD, MA and BA honours from South African universities. He was professor of economics at the Witwatersrand University. He is one of the world leaders in applied Austrian School of Economics and an adjunct scholar at the Mises Institute in the US.



### Rahim Taghizadegan



Rahim is the founder and director of the institute for value based economics, an independent research institute in economical and philosophical issues in Vienna. He is bestselling author and a popular speaker internationally. Rahim studied Physics, Economics and Sociology in Vienna and Lausanne. He has worked in the fields of economics, space research and journalism. He has also taught at the University of Liechtenstein and the Vienna University of Economics and Business Administration.

## Incrementum Inflation-Signal

At Incrementum, we are convinced that inflation is a monetary phenomenon. Because of the dynamics of “monetary tectonics”, inflationary and deflationary phases can alternate.

**To measure how much monetary inflation actually reaches the real economy, we utilize a number of market-based indicators** - a combination of various quantitative factors including the Gold-Silver Ratio - which result in a proprietary signal. This method of measurement can be compared to a “monetary seismograph”, which we refer to as the “**Incrementum Inflation Signal**”.

**In the fund we manage, our Incrementum Inflation Signal gauges the inflation trend and we position the fund accordingly.** Historically, we observed periods of between 6 and 24 months during which disinflationary forces were dominant. These phases were particularly painful for the holders of inflation sensitive assets. Right now it looks as disinflation might continue for a while. **Our inflation seismograph triggered a “falling inflation signal” in August.**

## Cautionary note regarding forward-looking statements

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