

# INVESTMENT FOR WEALTH

General report

## Reflexion on 2012 and outlook for 2013

### Annus horribilis

With the gold price advancing for a twelfth year in a row (be it only 5.0%), the precious mining sector has fallen by near-bear-time percentages (-12.8%), stretching its underpricing towards a 30 year maximum.



Did we err in our judgment by placing our hopes for steady returns in an allocation of precious mining and especially of junior explorers?

Looking for answers.

First we reckon that it is indeed rare to see a bull market going on, un-interrupted, for more than 11 years. We have stated that the correction in the gold price that started in September of 2011 had the potential to linger on for a period of 8 to 18 months. Sideway corrections in a long term bull market tend to indeed respect this cyclicity. In hindsight, it now looks like this correcting gold cycle will go for the full 18 months. Because the mines were already underpriced in historical terms when compared with the physical gold price, we judged it inopportune to risk the long turn performance by playing bets on the duration of this corrective gold price cycle. We also took comfort in our vision that the long turn bull market in gold is far from over. We foresee prices of minimum \$ 3500 per ounce before the end of 2015. Furthermore we believed we would not see an equity crash in 2012. We have even stated that if the actual Keynesian central bankers (mostly ex-Goldmanites) wouldn't change their policies, we saw the

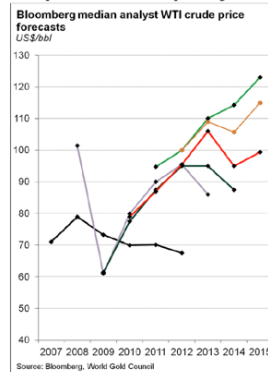
potential for a Dow Jones at 30 000 before the end of 2016. From this point of view we didn't had to expect much downside risks in gold equities either.

So what has caused the fall in gold equities?

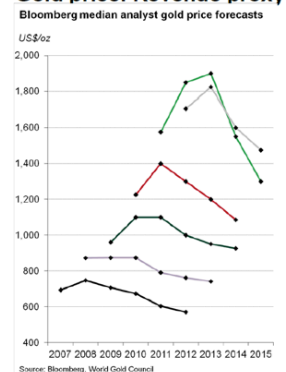
- Market analysts continue to underestimate the future gold prices
- Cost overruns in exploiting existing mines and building costs for new mines, for example the Wafi-Golpu Project (Papua New Guinea) between Harmony and Newcrest Mining and the Donlin Gold project (Alaska) between Novagold and Barrick.
- Mining nationalism and taxation risk in multiple mining countries. From Australia over South Africa to Latin America, even Mongolia joins the long list.
- Leveraged hedge fund players continue to play long gold short gold equities, even if it means illegal naked shorting, in the absence of any action by the control authorities.

#### Market analysts continue to underestimate the future gold prices

##### Oil price: Costs proxy



##### Gold price: Revenue proxy



Although all of the summed reasons are true, they are not sufficient to explain what has happened. We have to, at least in our opinion, relate to the general market feelings based on the perceived macro-economic and financial context.

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We continue indeed to insist that the next more virulent gold price move will be launched against an explosion of the government debt bubble, especially for the American treasuries, the German bunds, the British gilts and the Japanese government bonds (JGB's). Fear, induced by a lack of government credibility (literally no longer credit-worthy, certainly not at the actual levels of interest rates), will push for massive gold buying in the future.

Unfortunately (for our precious allocations) this fear hasn't concretized yet in 2012. So what are the chances that it starts in 2013?

Well, they are very promising.

In 2012 government bonds and in their shadow, in the search for yield, corporate bonds have had one of their highest returns of the last decades. When confronted with the bubble thesis on government bonds, the market has answered in a Pavlovian reflex : "no no it's a safe haven". When confronted with the conclusions of Reinhart and Rogoff on the impact of government debt-ratio's to GDP on future growth possibilities and with historical lessons on government defaults and hyperinflation, the market has again responded in total denial, amplifying the already-overextended bubble in yield baring financial claims.

Credit markets cheered all along 2012.

When Greece saw its second "non declared" and "voluntary" default in a year, with the private sector selling the Greek debt (that it had received at between 30 and 40% of its notional value after the first haircut), the market saw the Greek 10 years tumbling to its lowest rates for 2012. After consuming 1.3 trillion of LTRO's, the promises of the great bazooka from Draghi, the spreads of Italy and Spain with the bund have been tumbling as well. So toward the end of 2012, the euro seemed saved and while in recession during 2013, Europe will regain traction in 2014, so goes the popular refrain. No fears enduring in Europe, the Dax returned even more than 29 % in 2012.

The States saw Bernanke not only implementing unlimited QE3 but also the announcement of Twist 2 being replaced by 45 billion of extra non sterilized money printing per month from January 2013 onward.

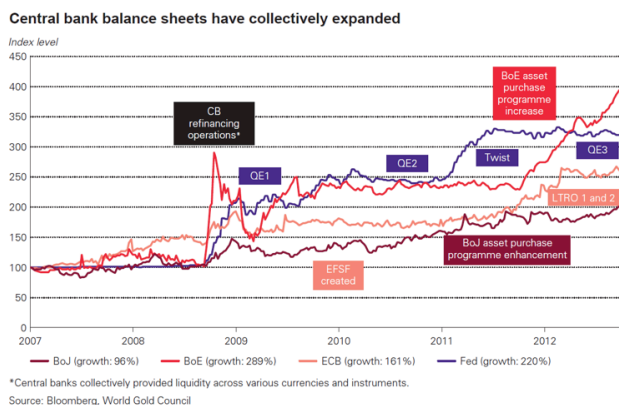
Ironically it must be because things are going so smooth that the Fed hasn't waited for a resolve of the fiscal cliff or the new debt ceiling limit adaptation by Congress shouted Mister Market, anticipating a growth around 3% for 2013 in the USA. An overconfident Bernanke has conditioned his ultra-lax money experiment with the faith of the US labor market. Zero rates and dollar debasement by an abundant Fed balance sheet expansion are here to stay until the US unemployment posts figures below 6.5%. That the official US Federal debt has already surpassed 16 250 billion and thus nominal US GDP, was a non-issue. Official inflation rates rose just a little bit, in his opinion only temporarily above the long term goal of 2% and were used to revindicate the Feds position. If a 3 trillion Fed balance sheet did not have consequences, why would a 4 trillion? Here we cannot resist to cite John Maynard Keynes 1920 : "There is no subtler, surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction and does it in a manner not one man in a million is able to diagnose." Even Alan Greenspan looks like a saint compared to Bernanke if you read his quote from 2000 : "We very much believe that, if you have a debased currency, that you will have a debased economy". And so yes, we along with some other market observers we pretend to be part of that one in a million man.

We believe that years of unsound "money" and the formation of a Credit bubble of epical proportions have corrupted our financial system beyond repair. We throw in badly maladjusted economic structures, non-existing financial deleverage based on the still expanding derivatives markets, over promising governments, ever more inequitably distributed economic rewards, ever more activist governments taking in a bigger share of GDP while justifying deficits ad nauseam, ever more taxation, ever more marginal debt expansion, if necessary fully monetized by central banks not even creating a whimper of additional wealth, ever more dysfunctional political processes in Europe, Japan and the States making it virtually impossible to attack the root of the problem.

One of the 'one in a million man' is Richard Fisher, president of the Federal Reserve Bank of Dallas who voted against Bernanke's latest initiative for more Fed

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balance sheet expansion warning for the risk of a ‘Hotel Californian’ style Fed policy. He meant paraphrasing from the famous Eagles song “you can check in any time you want but you can never leave”, that it will be quasi impossible for the Fed to normalize its balance sheet. Indeed doing so from 4 trillion will be much harder than from 3. Who remembers the Fed talking of offloading its balance sheet excess with the first ‘green shoots’ even testing reverse repos for that purpose in 2010? The Fed at the beginning of 2013 wants to force the private market to further leverage the US economy aggressively, expanding its balance sheet. Who can believe that once the inflation takes hold the Fed will act to sell treasuries at the moment the bond vigilantes already refuse to continue buying treasuries at ever more negative real rates? Remember this Fed move comes after 5 years of aggressive budget deficits and non-conventional reflationary monetary policy. When will it be the correct moment, when more distortions and structural flaws are induced every day in the world economy by our central bankers, that have pushed Adam Smith’s Invisible Hand ever more out of our economic functioning? Real capitalism is dying, our liberties and our democracies are offered on the altar of central banking planning. Can war be far behind ?



Yes we know the majority will object, that there is no consequence to more money printing. They say fear of default is misplaced in a fiat monetary system when the central bank can print limitless. They insist that by controlling the printer, government indebtedness is also limitless. To argument their position they use what we can call ‘the Japan proof’.

‘The Japan proof’

Japan’s public debt is rapidly approaching 240% debt to GDP. After more than 20 years of repeated deficit spending and Bank of Japan balance sheet expansion, where is the crack in the JGB’s market? Where is the rampant inflation in Japan? Where is the lost credibility of Japan and the yen devaluation to be observed.

Japan had a heavy current account surplus. The Japanese had a very high saving rate, some 19% in 1981. This sea of money would forever finance all government debt emission. Till recently the facts made these arguments plausible, quasi irrefutable.

In 2012 until the announcement of new elections for December, the JGB’s achieved still higher prices. They were ‘invincible safe havens’ yielding in November 0.68% for 10y durations.

Verbal interventions, sometimes accompanied by effective massif yen selling by the Japanese central bank seemed to never have a lasting effect on the yen.

What has changed?

The savings rate in 2012 was narrowly negative in 2012, what a difference coming from 19%. Why? Well they have zero interest rates since 2001. With their chronic deflation even a nominal rate of 0.75% offered some real returns of 2.75%. Their population is recently projected to decrease by more than 10% in the coming decades. Demographically the Japanese are growing old. Their intern market for adult diapers surpasses those for newborn children.

The pension gap in their social security system that has to be filled in by the government (with debt) will grow every year at a rate of 8 to 9%. In the budget for 2012 this gap was not filled with planned JGB’s emission. A brand new category named compensation bonds was invented. This can be compared to an off balance sheet debt. It was done as to not to disturb the JGB’s market ??? When you call a pig a horse you can still not ride on it, it’s still a pig.

The widely proclaimed self-funding of the Japanese debt, nowadays some 44.5 trillion yen, is no longer possible based on their shrinking current account surplus. Their trade balance was negative for 10 months during 2012. The bitter animosity between China and Japan for some rocks in the sea will certainly



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not help the trade balance in the near future. Look how rapidly Japanese automakers are losing market share in China. For the first time since 2012, the famous ocean of deposits with the Japanese Postbank from pensioners has started to shrink. In 2013 pension-institutes plan to sell more than 18 trillion of JGB's.

### Japan's Trade Balance pushes further and further south...



Only some 5% of JGB's in Japan are in retail hands, this is projected to decrease to 3.5 % in the next years.

Not only the trade surplus is vanishing at an increasing rate. Even their current account will become negative for the first time in the third quarter of 2013.

So who will buy the 44.5 trillion JGB's emission in 2013? Already in 2012, some 29 trillion was bought by government entities including the bank of Japan. The rest went to Japanese banks.

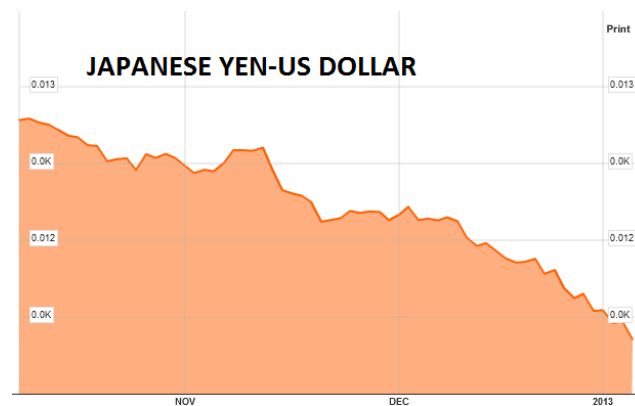
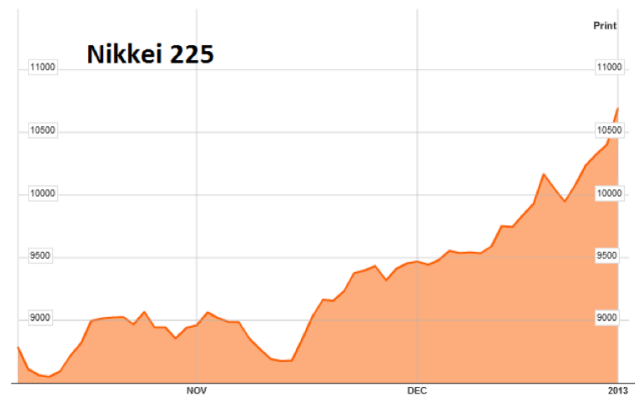
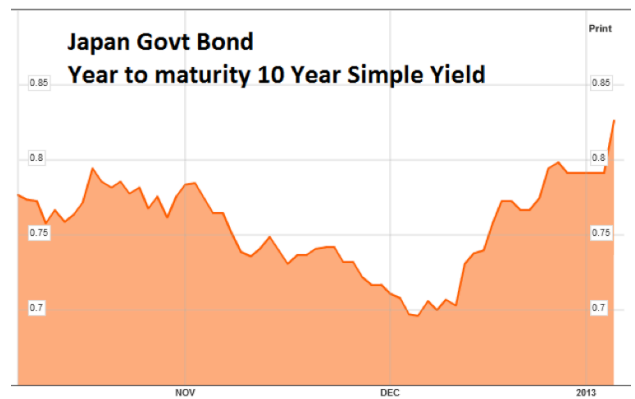
In 2012 the interest paid on public debt was some 10.5 trillion yen. Compare this with the forecast for a total tax revenue of 42 trillion yen in 2012.

Japan really enters a new stage in 2013. The new elect prime minister Shinzo Abe promised during and after the December elections to enforce an inflation rate of 2% as target for the Bank of Japan. He will also revive the economy with big infrastructure plans, so more debt financing and deficit spending to come. Before the election he even said he would completely cut the independency of the central bank if it refused to implement his reflation policies. His newly proposed finance minister is also known to be a big spender. By the way, when this man takes office in January it will be the eleventh finance minister in just over six years for Japan.

Even if Abe was just bluffing, the 1 quadrillion Japanese debt will amount to 26 times the planned Japanese tax

revenues in 2013. But the projected win from Abe already forced the hand of the central bank. After announcing QE8 in September and QE9 in October, Japan announced QE10 (just another 10 billion increase) on 20/12/2012.

We saw very sharp reactions in the yen, the JGB's from 0.68 to 0.84% for the 10 years and a soaring Nikkei, more than 18% in a few weeks.



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Japan really seems at the crossroads between inflation and a default for 2013.

If the central bank accepts an inflation target of 2% and the market believes them, the JGB's will start crashing. But Japan cannot afford to pay more interest. If it had to pay a reasonable interest of let's say 3% on its debt, a 100% of tax revenues would be affected to interest paying. All other government expenses would have to be printed or deficit financed. The yen would crash and Japanese banks and pension-institutes would flee the JGB's. Indeed, when your debt is already 26 times your revenues even a small interest rate hike makes the deficit explode. There is just a non linearity between the debt ratio and the possible growth of tax revenues coming into play. So beware for august 2013 if Abe's inflation target is implemented.

What if the market calls it a bluff? Even then, the status-quo is no longer sustainable for Japan. The foreseen current account deficit starting in the third quarter of 2013 makes Japan's self-funding of its public debt no longer achievable.

So either way, 2013 will be a defining year for Japanese Sovereign debt. If Abe is bluffing, we still expect this tragedy to unfold, only less violently.

In both cases we also see the treasury, bund and gilt markets affected be it not yet in a terminal phase. Remember the 'contagion effect' that played in the euro zone with the PIIGS.

You could see something as devastating on a global world scale beginning in the summer of 2013.

In front of this scenario we stay with our gold allocation.

## Performances and trading

### iW Alternativ SIF – Low Risk

The fund has decreased by 5% in December, NAV 11256,82 EUR.

### iW Alternativ SIF – Commodities

The fund has decreased by 6,7% in December, NAV 967,59 EUR.

### iW Alternativ SIF – Real Value Growth

The fund has decreased by 5,1% in December, NAV 98,72 EUR (I), NAV 97,79 EUR (P)

Best regards,  
The fund manager

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