INVESTMENT FOR WEALTH

General report

Comments for Jun 2013

Macro analysis after the first half of 2013

The most important event was the bursting of the 32 years old bond bubble.

The financial landscape has indeed changed with the fed QE tapering coming. The market has overpowered the fed and rates have shot higher from government to corporate bonds and from junk bonds to emerging market debt, even the intervened mortgage backed securities were affected.

This change is for real; whether the fed tapering starts in September 2013 or December 2013, the low in yields is behind us. The fed has been overpowered as the market laughed at the conditionality placed on the start of the tapering. On June 18 the fed explained that it sees the beginning of tapering in 2013 and the end of QE3 before the summer of 2014, both on the condition that the unemployment rate continues to improve and that inflation expectations continue to behave well around the 2% target.

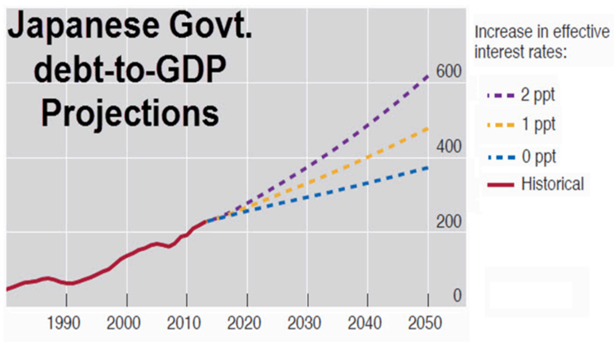
Why has the market changed its view on bonds? Mister market has simply shrugged of the fed's message that tried to link the end of QE3 with better sustainable growth in the US. Instead, they have interpreted the announcement of tapering as motivated by the fed's fear that the negatives of QE are annihilating the wealth effect created by QE3.

The fed started QE3 with the objective of making assets rise by forcing down yields. Higher valuations in bonds and equities were supposed to make the Americans feel richer. The low credit rates would also restart the housing appreciation by making loans more affordable. The lower the debt rate, the more interesting mortgages become compared to renting. It worked like a dream scenario; the Dow made new highs, yields on corporate debt and junk bonds fell to new lows and in many regions in the US, residential housing appreciated by 25% over the course of the last twelve months. The 'wealth effect' – or so goes the official theory – would incite the Americans to consume more and thus stimulate the economy. But isn't this a monetary illusion? How sustainable is growth based on QE if it affects the haves in detriment of the have nots? The Cantillon effect *(see footnote page 4)* of QE can be proven by America's Gini coefficient *(see chart by US Census Bureau)* which in 2011 surpassed the high from 2006 of 0.47, clocking in at 0.477. Could it be pure coincidence that the Gini coefficient is now surpassing its previous high from 1929, just prior to the Great Depression ?

Note: Gini coefficient measures the degree of income inequality. Source: US Census Bureau

The cantillon effect predicts that expansionary monetary policy transfers purchasing power from those who hold the old money to whoever gets the new money first. QE is extreme monetary expansion, as it sustains unpayable debt growth and provokes re-leveraging in the search for yield.

Indeed, QE as any other too-accommodative monetary policy squanders the lessons from Reinhart and Rogoff : too much government debt kills further growth expansion capacities; government debt exceeding 90% of GDP starts this phenomenon on itself. *(see chart of Japan)*



If – as the facts show – total debt (government, corporate and private) grows more rapidly than the GDP expansion, further QE will have diminishing returns. QE's halve life will become shorter and shorter and in the end a full blown systemic crisis will emerge.

In 2008 the US had 50.8 trillion of total debt, in 2013 57.

China had 124% of total debt in its economy in 2008, now different sources cite levels surpassing 256% when shadow banking figures are included. Because of too much indebtedness, China is now struggling with a too low marginal productivity of its debt expansion. So should it surprise us that a growth rate of 7%-8% is a thing of the past? The shibor (China's interbank lending rate) shooting up to 25% has given us a warning signal. China has no choice but to taper its liquidity provisions.

Thomas Hoenig, vice president of the FDIC and ex member of the fed board – someone you can trust to know a thing about banking – recently spoke about bank leverages still at ludicrous levels. Deutsche bank is still a full 33 times leveraged hedge fund, even while it complies with the Basel III norms. Adulterated bookkeeping and absent moral hazard…

Reuters (Emily Stephenson and Douwe Miedema): "A top U.S. banking regulator called Deutsche Bank's capital levels 'horrible' and said it is the worst on a list of global banks based on one measurement of leverage ratios. 'It's horrible, I mean they're horribly undercapitalized,' said Federal Deposit Insurance Corp Vice Chairman Thomas Hoenig… 'They have no margin of error.' Hoenig, who is second-in-command at the regulator, said global capital rules, known as the Basel III accord, allow lenders to appear well-capitalized when they are not. That is because the rules allow the banks to use complicated measurements of how risky their loans are to determine the capital they must hold, he said… Other banks with a low ratio, according to Hoenig, are UBS at 2.52%, Morgan Stanley at 2.55%, Credit Agricole at 2.72% and Societe Generale at 2.84%."

QE, suppressing the cost of credit, forces pension funds, hedge funds and individuals to forget about risk. For one, risk-pricing becomes more and more distorted until the bubble pops.

QE leakage also causes mispricing in the emerging markets contaging them also with social instability and uncontrollable Cantillon effects. An estimated $ 3.9 trillion of US QE monetary expansion was (partly?) malinvested in emerging markets. Brazil is a clear example. Less than 2 years ago they introduced a tax burden of 6% on foreigners in the domestic real bond market. They were afraid of overheating the economy with rapid debt expansion amid an overpriced currency in a rampant inflationary background. From hero to zero in just a couple of QE-tapering-months, considering that for now the tapering is only a promise!!! The Selic rate (Brazil central bank's overnight rate) was hiked twice to support the Brazilian Real and the tax burden was abolished while the growth prospects were lowered by the IMF, the government and the rating agencies. As a symptom of the Brazilian – partly self-induced and partly fed QE induced – economic disease, look at the wealth of Eike Batista, Brazil's richest man with the ambition to becoming the number one of the world : his fortune fell from an estimated $ 34.3 billion two years ago to less than $ 2.1 billion valued last week. Perhaps some over-indebtedness and over-leverage? As Buffet was once quoted : "you only find out who is swimming naked when the tide goes out." And in Emerging markets, that's what tapering is already doing.

The US will taper regardless of its unemployment rate or domestic inflation rate. Japan will continue its QQE as Abe and Kuroda have no going back to the status quo. Ultimately this will crash the yen and the JGBs market, creating the necessary conditions to hyper inflate the Japanese economy from where it can contaminate the rest of the world. The ECB will also have its QE program (bazooka) as it's only tool to preserve the euro from falling apart.

Time to conclude

Bond markets
Firstly, the change in all the credit markets is for real, the bubble has popped. Gradually risk readjustments will correct the market distortions. Expect the biggest effect on emerging debt, junk bonds and government debt of Japan, the Eurozone PIIGS (France more and more included) and not to forget the commodity exporters like Australia.

As the QE 'leakage' goes in reverse, money will flow to the US. As long as the up-cycle of the US business cycle lasts (expected August 2015), US bonds will be the best in comparison.

Equities
Money flows will support the US market. Also, a false temporary (until August 2015) perception of newly found sustainable growth in the US will add fuel to the Dow, S&P and Nasdaq. Outperforming all developed markets. Stay away from emerging market equities, they have more to correct. Even for the US we see a possible correction of 15 to 20% between August 2013 and February 2014.

Currencies
The US dollar will, as predicted, appreciate strongly. A USDX at 0.9 .96 before year end is likely. Further on, when the euro fights for its survival and the yen implodes, 1.30 to 1.50 on the USDX is coming (horizon August 2015). Only a new Plazza accord could try to change the course of things to come. We don't see this happening before 2016-2017. Instead, currency wars and even real wars are more plausible. Japan-China, Korea, Chinese regions, Brazilian unrests, Chavist regime implosions in Venezuela, Bolivia and Argentina to name a few, add Turkey, Iran, Iraq, Egypt, Israel, Syria and all the religious conflicts in Asia and Africa as detonators. Conflicts between the independent ex USSR states and the awakened Russian bear. Social unrest enflamed by Eurozone exit nationalism is another source. This list was not meant to be seen as exhaustive.

Gold
The end of QE will liberate the gold price. More than being money, nowadays, gold will rise to the extent that central banks lose control and governments extort their subjects with overtaxation. Both are starting to happen. Until the second halve of 2015, the stronger dollar will temper the up move in gold. Technically we think gold will bottom in the first halve of 2013 and that we could see a virulent rise as shorts cover if indeed the equity markets correct from August to February. After a possible ultimate retest of the 2013 low, the gold bull will commence a run to $3000 $3500 per ounce. With the down cycle for the US after August 2015, the gold price could launch to full bubble prices yet unpredictable to foretell.

Performances and trading

iW Alternativ SIF – Low Risk
The fund has decreased by 8,7% in Jun, NAV 8880,53 EUR.
iW Alternativ SIF – Commodities
The fund has decreased by 25,00% in Jun, NAV 369,84 EUR.
iW Alternativ SIF – Real Value Growth
The fund has decreased by 13,8% in Jun, NAV 64,13 EUR (I), NAV 63,30 EUR (P)

Best regards,
The fund manager

Footnote : Cantillon is widely credited as the first to show that changes in the MONEY SUPPLY and CREDIT have important impacts on the economy by changing relative prices. He showed that an increase in the supply of money would cause economic expansion, but that ultimately the process would be self-reversing as prices would rise and imports would increase, sending money back out of the economy. Cantillon further showed that monetary inflation does not affect all prices equally or at the same time, but in sequences that depend on the spending behavior of money holders all along the channels of monetary flows. These ideas have been adopted and extended by Knut Wicksell, Ludwig von Mises, and F.A. Hayek and others. Richard Cantillon (1680–1734) was dubbed by many as the founder of political economy. The key episode in Cantillon's life was his involvement with John Law and his monetary schemes. Cantillon was opposed to the inflationist theories of Law, but he understood how the schemes worked and what their fatal flaws were. Thus, he was able to create a large fortune from the Mississippi System and South Sea Bubble. *Richard Cantillon (1680–1734) was dubbed by many as the founder of political economy. The key episode in Cantillon's life was his involvement with John Law and his monetary schemes. Cantillon was opposed to the inflationist theories of Law, but he understood how the schemes worked and what their fatal flaws were. Thus, he was able to create a large fortune from the Mississippi System and South Sea Bubble.*