

Today's Notes:

- 1. Nary a Twitch
- 2. The Tipping Point

1. GOLD: NARY A TWITCH

We watched closely as gold was sold down after the announcement of a discount rate hike by the Federal Reserve on Friday. While this is the first of many tightening moves, we think the Fed will not pursue raising the Fed Funds rate just yet – in fact that aspect of the Fed’s “Great Money Draining” efforts is likely months away. The movement of gold from two events (IMF’s announced gold sale and the Fed’s discount rate hike) in more ordinary times would have had a major negative effect on the monetary metal. It had no immediate effect last week. In short, gold ended last week where it began the week at \$1119.30 up 87 basis points (\$9.00) of Friday. On Friday Gold traded between \$1,100 and \$1,127. The fact of the matter is that gold closed higher than it has closed for the past 4 1/2 weeks –in the face of the IMF’s announced sale and the surprise hike in the discount rate (not to be confused with the Fed Funds Rate). The discount rate increase was designed to sway public opinion on the Fed’s plans to rein in inflation. Very little money has been lent to the banks through the discount window. What conclusions can one draw? As we suggested Friday this is more evidence that gold’s role is morphing into the money necessary to restore the international monetary system.



There were market anomalies coincident with gold's strength in the face of the IMF's announcement. Most evident - the trade-weighted value of the dollar soared on Friday. The U.S. currency opened above Thursday's close, increasing by 75 basis points to close at 81.25.



The dollar can strengthen relative to its paper peers but it cannot strengthen relative to its US dollar gold counterpart. In fact gold prices increased in almost every major currency (flat against the Loonie and Brazilian Real) on Friday. Certainly the threat of sovereign debt contagion may have trumped the IMF's announcement. The fact of the matter, in our view, is that gold is morphing into a store of value under dire global circumstances that fiat currencies cannot match.

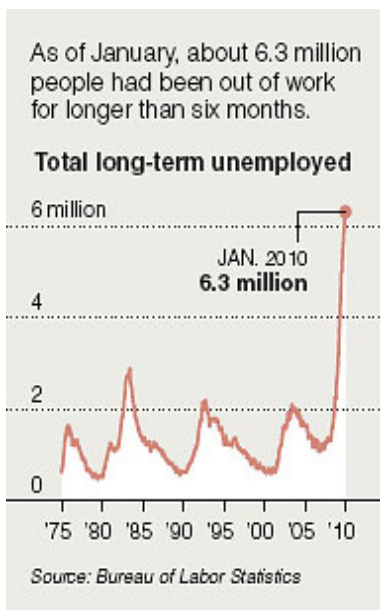
While silver was equally impressive on Friday, copper signaled globally that the base metals can move against the dollar's strength. Copper prices increased an impressive 2.2% to close at \$3.37 per pound despite the U.S. dollar's strong showing. We hypothesize that this signals the very early stage of emerging market upward mobility and eventual ascendance. If emerging markets ascendance is a function of OECD country high debt to GDP ratios, monstrous deficits and imprudent multi-decade overspending, then this move is understandable. On all these points the larger BRIC emerging countries seem less susceptible. Copper, for example, will be essential for their quality of life (infrastructure) build out. Many people, your truly included, are beginning to feel like we have entered a very new world. PIMCO's management has called this the "new normal." The developing nations of the world have many serious economic headwinds yet to navigate.

One day's market activity does not make for a sea-change and gold may indeed have more downside. Then again, one does sense that a new currency regime is being born and precious metals, at least for the time being, must be integral part of that new system.



2. LONG TERM UNEMPLOYMENT AND CREDIT

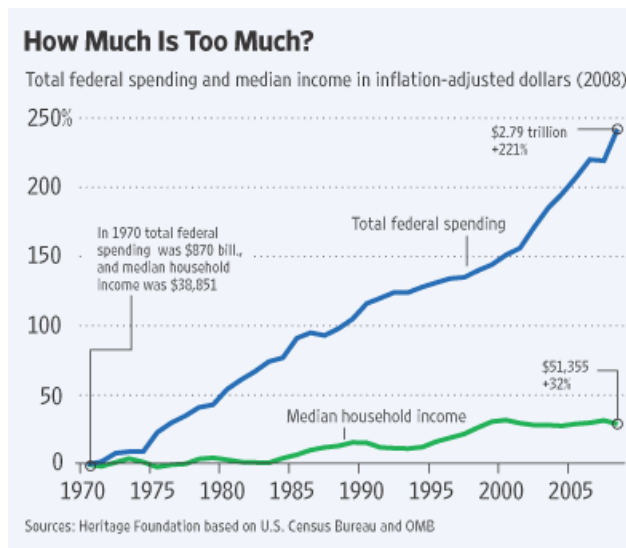
The New York Times published some very interesting data this AM. In part it testified to the fact that this time it is different. One look at the tenure of America's unemployed and you can see that the structure of U.S. industry has changed. Each recession in the past 3 decades has returned workers to work with longer delays. But we have recently experienced the Great Recession. Officially according to the national Bureau of Economic Research it is over with. According to the St Louis Federal Reserve it ended in July of last year (see Multiplier Chart Below). I am certain it does not feel like that to the 14 million unemployed in the United States. More to the point there are, by BLS statistics, 6.3 million who have been out of work for more than 6 months. This is the killer that bespeaks a radically new environment for labour.



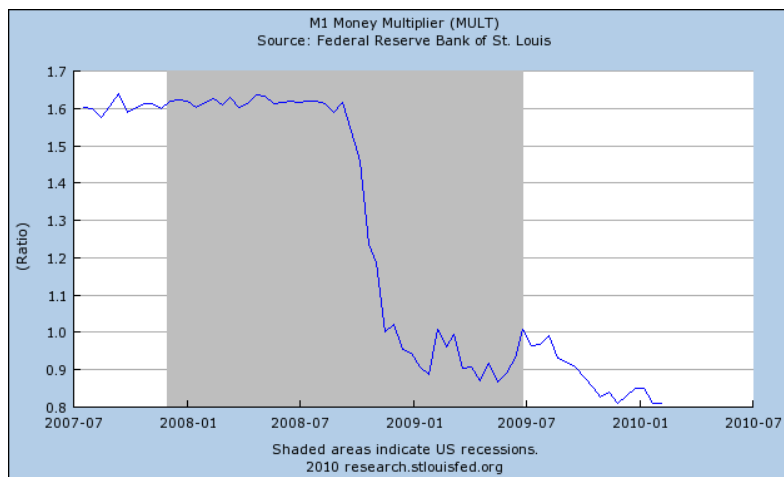
Naturally, unemployment benefits are running out. States can borrow from Washington to supplement unemployment insurance but must pay these funds back. This is becoming less likely as more States seem to be insolvent. This fact alone has put a crimp in any U.S. consumer-led recovery. In fact we are so far down the line now that the new Governor of New Jersey suggested, *“The days of Alice in Wonderland budgeting in Trenton end.”*

The Wall Street Journal remarked appropriately about the spending binge.

“We’ve been grinding toward this moment since 1932. It has always been a question of political physics just how high government could go in the U.S. before it arched over and down. Now we have Washington, California, New York, New Jersey and others all arriving at the same time of reckoning. And all for the same reason, public spending by the public sector—its politicians, its unions, its massive schools of pilot fish.” Here’s why.



The St Louis Fed’s M1 Money Multiplier (effective February 19, 2010) is at an all time low mark of .809. There may be inflation in the future but now this economy is struggling. It appears to have reached its tipping point so aptly described recently by Harvard’s Professor Niall, Ferguson. The ideal allocation may be 10% in discovery and 90 % in safe assets. The real question is not the composition of the discovery portfolio; it is “how to invest 90% in a “safe” asset.”



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