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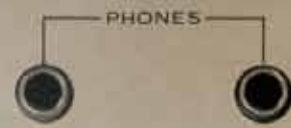
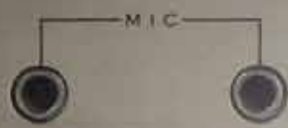
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DAVID MCALVANY & KEVIN ORRICK



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SEPTEMBER 3RD, 2010

OBVIOUS OR SUBTLE DEFAULT: POTENTIALLY BOTH

Kevin: Welcome to the McAlvany Weekly Commentary. I'm Kevin Orrick, along with David McAlvany.

David, you do a weekly wrap-up every Friday afternoon on the Internet, that you send to people. It is not verbal, it is typed out in print, to read, but this week's, in particular, people are calling about, and frankly, they really want to know what cereal you are talking about.

David: Kevin, we talked about hedonics, and we talked about how inflation is being somewhat obscured, and one of my favorite cereals, Rice Puffins, just got demoted from a 12-ounce box to a 10-ounce box.

Kevin: But the price is the same.

David: The price is still \$3.45. The issue is, the manufacturer knew very well that they had to obscure this change, and they changed it from a dark blue box to a tan box.

Kevin: So you can hide it by the color, but it is still a substantial percentage less cereal.

David: That is correct. That was just one issue we dealt with in the weekly wrap-up, Kevin. Each week we do those comments in written form, just as an addition to what we do here on the Weekly Commentary, the audio commentary – usually different subjects, but a good way of looking at the week in summary.

Kevin: If you have a listener, right now, who does not get that report, they can just give us a call, give us the email address, and they can get that every week.

David: We will send it to you regularly, or go to mwealthm.com.

Kevin: Your main point, though, was that inflation is being hidden in a lot of different ways. Inflation could be called, default, of a sort, on currency. That is one way to hide, by giving less for more money, or the same amount of money, but the real issue right

now that Ben Bernanke has been dealing with, is probably more overwhelming to him right now than what he is making it sound like, up in Wyoming.

David: It is interesting, he is in the process of having his cards called. He is not comfortable right now – very few options, and there is this spectre of inflation. What do you do with it?

Kevin, as I see it, the bottom line is in the bond market, and it is an issue that ultimately deals with solvency. When you look at Jeremy Siegel's comments this last week, and I am not a huge fan of Jeremy Siegel, who teaches at the Wharton School of Business, but his idea that the 10-year treasury is trading, if it were a stock, at the equivalent of 100 times earnings, is interesting. What it implies is that there is a lot more downside than upside from here, or we could just say, limited upside from here.

Kevin: Let's put that in perspective, because a stock that trades any more than about 14 times its earnings is starting to get too high, and he is saying, 100 times the earnings.

David: Yes, and if you are buying above that average of, say, 14-16 times earnings, over the next decade, you are going to have pretty mediocre, in fact, perhaps negative, returns. If you are buying something that is of value, then you probably have positive returns. In other words, over the next decade, to us, it is a given, that you are a loser – not personally, but your portfolio is – buying treasuries.

So we go back to the issue of solvency, and it really is the bottom line in terms of the bond market. We have had a massive shift in private balance sheets to public balance sheets, and a significant hit to tax revenues, which have been the result of what we know as the ongoing global recession.

Kevin: They are starting to call it the Great Recession.

David: It has left the national accounts unstable. The result is that you have both current and future liabilities, which have reached levels that cannot be maintained. So this is the issue: You have too many cash outflows, and not enough cash coming in.

Kevin: So the question is: Will we see debt default here in the United States?

David: That is a fascinating question, Kevin, because we have developing countries that regularly, or routinely, experience debt default. But it is developed countries, not developing, but developed countries, which are far more rare to see in that position.

In fact, if you look at the debt crises of the last century, there are some common characteristics, one of them being that the debt is denominated in a foreign currency, so they not only have the debt liability, but they also have the foreign currency exchange rate pressure as time goes on, and that is, in fact, what we saw in many Eastern European countries, and in Iceland, this last year.

Kevin: So how is this debt crisis different than those of the last 100 years?

David: The U.S. is the largest net debtor, and frankly, we may not default outright. As a developed country, we have the distinct advantage over developing countries, by borrowing in our own currency.

Kevin: Right. We can print it ourselves and then borrow it.

David: Yes, and that is a unique advantage. This is good, obviously for the debtor, and it is bad for the creditor. It puts power in our hands, and a weakness in terms of the structure of debt, in that of the creditors.

Kevin: Why have we gotten away with it? Most countries cannot do that.

David: It is not often that debtors call the shots, you are right. It is partially because we have the reserve currency status, partially because we are an unrivaled trade block. If you look at the United States of America, we are only matched in recent years by the Euro-Zone, collectively, in terms of volumes and size of trade.

The issue, really, is one of a subtle default. We have the ability to inflate away or devalue our currency, and that has become accepted monetary policy. When we target inflation of somewhere between 1% and 2-1/2% each year, we are at the margins – at the margins – of defaulting on that debt.

Kevin: Yes, that is an implied default on the debt. Now, maybe it is only 1-1/2% to 2% per year, but you are really just looking somebody in the eye and saying, “Hey, the money that I have today will only be worth 98% of what it was last year.”

David: On a compounded basis, I get to walk away from 2% of what I owe you, with no recourse.

Kevin: They actually say that that is economically healthy. We have been trained that way.

David: And our foreign creditors have not objected. This is a stated policy objective, and our foreign creditors just do not care, or they cannot do anything about it.

Kevin: The measurement of our debt to GDP – that is what we hear the most about right now. Where are we in comparison to the gross domestic product of our country?

David: The recent study by Reinhart and Rogoff put the current number around 80% here in the U.S. – our national debt-to-GDP.

Kevin: That means that of everything that we sell, everything that we make, if we were to pay our debt off – it would take 80% of everything in a given year.

David: Other studies have come up with more conservative numbers, roughly 56%, but the Rogoff study suggests that instability comes into play with a threshold of about 90%. Once you breach 90% debt-to-GDP, and actually, their expectation is to see about 93% by next year here in the U.S., then the debt markets begin to destabilize.

Kevin: Let’s face it, David, what we are talking about is debt-to-GDP. You can have high GDP and not really have much revenue, as

far as taxes coming in, or what the government is actually able to bring in, itself.

David: That is, I think, the more relevant measure. When you look at outstanding debt – you, compared to a neighbor, may have more debt, but the question is, if you have more income, then you have the ability to service it, right? And your neighbor may have less debt, but no job, and thus, an inability to service any debt whatsoever.

Kevin: Revenue becomes the critical issue.

David: Exactly. Revenue is what matters. Granted, you would not have the kinds of issues that we have if you had a zero debt balance, but in today's economy, that is really not plausible. What are the resources called upon to service the outflow of funds?

Kevin: Taxes would be one of them.

David: Exactly. When you compare multiple countries and look at their debt relative to their revenues, versus their debt-to-GDP, you find that the U.S., at 358%, is actually in a worse-off state than Greece at 312%, and Ireland at 248%.

Kevin: Wait a second, let's restate that – 358% above what the revenues are. This is why the revenue is such a critical issue.

David: Yes, because if anything changes, in terms of a revenue stream, if there is a decline in taxes – not because they would take away from taxes, but because the economy slows and you have less coming in, in terms of sales tax, or income tax, or the things that actually drive the government, and the payment of their expenditures.

When you begin to look at revenue, relative to GDP, we are in a far worse-off state than Greece, Ireland, and a whole host of other countries. In fact, if you look at Portugal, or Spain, it actually gets better for each of those countries, relative to the United States.

Kevin: We have talked about raising taxes. Obviously you cannot raise taxes too much. Perhaps the obvious question is: If you do not have the income, shouldn't expenses be cut?

David: That is what we did in 1921. We have talked about that on the program before. We were in the midst of a recession and they cut government expenditure in half. Lo and behold, the economy recovered by 1923, less than two years, and we went from a 12% unemployment rate to a 4% unemployment rate – an unprecedented move in terms of employment recovery, and it had everything to do with the government cutting expenditure.

Kevin: Obviously, that was the right thing to do.

David: But this is the issue today: There are stake-holders across the country who have expanded their interests in that tax-take. There are citizens all across the country with varying degrees of benefit from being a part of the system.

Kevin: They have a stake in the system paying.

David: Yes, look at various political constituencies, and you could say that, if we define them as stake-holders, these are people with a vested interest in the status quo. Let's look at the kinds of stake-holders we are talking about, to perhaps better understand the motivation of politicians in catering to the needs, or the expectations, of those constituency groups. I think this will remind us why simply cutting expenses is not an option. It is no longer politically feasible.

Kevin: I honestly think people would be surprised – I think most people do not think they are stake-holders in the system, but when you really read down the list of what the government has built into the system, almost everyone has a stake in the system paying out.

David: Are you receiving social security, paying into the social security system, or will at some point be receiving social security payments?

Kevin: That makes a stake-holder of each of us.

David: And if you are part of an aging population, if you are part of that demographic, then your monthly income is going to be dependent on that, and that is front and center for you right now. As a stake-holder, you care about receiving from the federal coffers. Also, as an aging population, you realize that you spend a significant part of your paycheck on health care and wellness. This administration has tipped their hand, clearly, toward this particular demographic, in passing the health care bill that was recently put through.

You have food aid recipients – this is now 41 million people, truly, between a rock and a hard place, not able to make ends meet, except by food stamps and other assistance programs that are currently in place. That is yet another form of stake-holder here in the United States.

Kevin: In yesterday's USA Today, it was talking about this recession actually increasing the stake-holders, not decreasing them. A quote from USA Today yesterday: It said, "More than 50 million Americans are on Medicaid, the federal state program aimed, principally, at the poor. That is up at least 17% since the recession began in December 2007. More than 40 million people get food stamps, an increase of 50% during this economic downturn." What USA Today is saying is exactly what you are saying. There is this stake-holder need to have these bills paid.

David: Another kind of stake-holder is the taxpayer. You are covering the vast majority of expenses, and you, as the taxpayer, represent the bulk of federal revenue.

Kevin: What population percentage actually pays taxes these days?

David: 10% of the population is covering the majority of the tax revenues. Nearly 50%, in America, who are stake-holders, do not pay taxes. They require something from the system, they benefit from the system, but they do not pay anything in. So, again, when you think about how politically feasible it is to cut expenses, you realize that it would be really political suicide for someone to come in and start cutting expenses significantly. What becomes very clear is that the vast majority of the population determines the direction of policy in that kind of political system.

Kevin: Whether you pay taxes or not, your vote still counts just as much. You even talked about that 10% that pays 90% of the

bills. Their votes count only as much as those who contribute less.

David: Right, but you have a majority whose interests are now running in conflict with the interests of those who fund the whole project. The 10% who are funding the majority of the revenues are running in conflict with the needs of 50% who pay nothing in, but do receive from. This is the political nightmare that we have in front of us.

We are running into conflict with the taxpayer, which again, is a minority interest group, and additionally, the bond-holder, which has been the loan apparatus keeping this whole game in motion, and really, the only thing that has made it sustainable.

Kevin: So it is a symbiotic, yet still, competitive relationship. If you are not going to have the revenue to cover your expenses, you really need the bond-holder as a stake-holder.

David: You do. The bond-holder becomes a stake-holder as well. You need the bond-holder, because if there is not enough in revenues to meet all of your expenses, then you have to put that in the form of IOUs and those IOUs become – yes, we know them as the bond-holders. So they now have a stake in the future, and they also have a call on a very limited resource – the national income.

It is interesting, Kevin, we have read Richard Russell for years, and he is fond of saying that in a bear market everyone loses. The winner is the one that loses the least. In relation to the bond market, what we are talking about is treasuries. What we are talking about is treasuries which are nothing more than a senior debt – a senior, unsecured debt, and up to this point, the holders of this unsecured debt, or these loans, have not experienced any pain.

Kevin: That is a critical, critical point. We do not think of U.S. treasuries as unsecured debt. I will tell you, what I think of as unsecured debt, is credit card debt. These credit cards – they are charging 18%, 20%, 25%, 26%, because default is already built in to the picture. Treasuries have no security.

David: What is the collateral on the debt? The assumption is that there is income from the tax base, but this is where you run into conflict. When you have a growing number of people who are calling on that national income as stake-holders, the beneficiaries of some sort of a political handout, then guess what? You now are competing over a limited resource, and the bond-holder's interest, and the stake-holder's interests, can come into direct conflict.

In an autocracy, or a dictatorship, this is where it gets interesting. You have stake-holders who are expecting government to deliver on their promises, to meet their obligations. If those expectations are not met, they are going to let you know at the polls. This is very different in a democracy, from a dictatorship or an autocracy, because if people complain too loudly in those alternative forms of government, guess that happens? You restrict their freedom of expression, or simply eliminate the voice of dissent, altogether.

Kevin: But in a democracy, the real problem is that you need the vote of the majority to stay in power.

David: If they are disenfranchised, you know the political landscape will change. The democrats are sensitive to the voting blocks that have everything to gain, and nothing to lose, by feeding at the federal welfare trough.

This is the key: Influential political constituencies are now running into conflict with bond-holders, and the bond-holders have a very simple priority: "Give us back our money. Make your interest and principle payments on time. That is all we are asking." The problem is, if you are dealing with a limited income to be redistributed, then your political constituencies and bond-holders are competing for the very same thing.

In other words, who do you think gets prioritized? For instance, the foreign holders of bonds? Do you think they are going to be prioritized in an election year like this? Or two years from now?

Kevin: Let's face it, China is not voting in this election.

David: (laughter) No. Do you think it is the institutional asset manager sitting in bonds that is going to be prioritized over political constituents?

Kevin: No, I don't think PIMCO is voting in this election.

David: No. Kevin, this one is easy. It is the voter who will determine the course of your political career. Stake-holders win in a democracy, at the expense of bond-holders, and this is the point: The pain has yet to be doled out to the bond-holders, but that, in our view, is inevitable.

Kevin: David, explain, just briefly, if you would, what that pain would look like. When you are talking about pain held by bond-holders, what are you talking about? Are you talking about just an outright default on the bonds? Are you talking about bond rates that do not keep up with inflation? What are you thinking right now, as far as pain?

David: I guess you could look at the current state of affairs as some sort of pain, where the government is paying, or the treasury is paying, rates less than the market warrants.

Kevin: That is an important point to repeat. The pain has yet to be doled out, but it is inevitable in the bond market. But what kind of pain are you talking about? Are you talking about an outright default where the bond-holder loses all their money, or is it some sort of diluted return based on inflation?

David: I think if you are imposing low, or negative, real rates of return, on a captive audience, you could argue that that is a form of financial oppression, and that is a form of "suffering." Though you may not be losing principle, if inflation is 1%, 2%, 3%, and your rate of return on a U.S. treasury is less than 3% – guess what? You have both interest rate and inflation risk, and you are not being compensated for it.

Kevin: You said captive audience. What do you mean by captive audience? Are you talking about the Chinese?

David: Look at Chinese purchases of treasuries. Frankly, they are a part of modern-day statecraft. They are not portfolio management.

Kevin: So you are saying that it is politics that keeps them buying treasuries.

David: Absolutely, politics. Dollar losses, interest rate spikes – these would not be triggers for a portfolio liquidation from the Chinese. They are triggers that may not exist, as they maintain a view to keeping their public as fully employed as possible, and this is my point. Their objective is full employment. Hasn't that always been the objective of a socialist or communist state? The ideal is, everyone receives, and everyone gives, on an equal basis.

Kevin, to your point, it is the U.S. treasuries which have, and will continue, to be issued – these debts, or IOUs – which are issued to a captive audience. They are captive because they continue to recycle their trade balances, as they continue to have trade surpluses. They have to do something with those dollars in order to keep the renminbi in balance with their foreign purchasers of products, whether that is Europe or the United States. They could equally buy Euros, as well as U.S. dollars, they just continue to buy U.S. treasuries. Again, it is not because they are buying them as a portfolio manager, either for fun, profits, or to impress their clientele. It is on a political basis.

Kevin: Yes, they definitely do not lead an isolated life, they have to have us for this full employment goal that China has. That incorporates buying treasuries that maybe are paying less than what the inflation rate is.

David: And it does not matter that the sovereign debt is not collateralized. Creditors have trusted that the revenue stream of the debtor is at their disposal, and this is the point: It is, up until it is not. We will continue to prioritize our bond-holders until it becomes our own decision, just like the Chinese decide to buy treasuries on a politically motivated basis. When we decide to redirect our cash flow toward our political constituencies, for our own political stability, and our own social stability, and our own social cohesion, the bond-holder ends up being a very secondary priority.

Kevin: David, let's go back to the main point. Our government owes an awful lot of money, not just to bond-holders, but to stakeholders, and it is overwhelming. So the main point is the growing competition for a scarce resource, which is revenue.

David: Yes. Why are we in trouble? It is not that the total debt is killing us, but our ability to service that debt, which is now moving us toward a terminal phase. When we are looking at our debt-to-GDP numbers, which we started by talking about, we leave out a few significant factors. Debt-to-GDP does not include our unfunded liabilities. It does not include our contingent liabilities. In factoring those in, we move north of 70-75 trillion dollars in liabilities and obligations – that is, present debts payable, and future requirements to pay. Ultimately, it is revenues that matter. What are the resources called upon to service the outflow of funds? As we stated earlier, it is taxes.

Again, when you compare multiple countries and look at their debt-to-revenue versus debt-to-GDP, you find the U.S. in a worse situation than Greece, Ireland, Italy, France, Portugal, the U.K. – they all have more debt-to-GDP than we do, but they have a better means of servicing the debts. In other words, their taxes are higher for everyone, not just taxes higher for a small percentage of the population.

Kevin: But that may not be an attractive solution for the U.S. The point is, the minority of wage-earners cannot, ultimately, support the majority of the population.

David: If you think about the Laffer curve, this is the idea that actually, as you are increasing taxes, you are taking away revenue from the government, ultimately by creating inefficiencies, or putting it in the government's hands, to be the most efficient factor in the economy, which we know is not – by practice, cannot be the case. When you are increasing taxes, you are making this whole cycle we are discussing even worse, so decreasing taxes may actually be helpful. Obviously, that is not politically tenable in this environment.

But as you say, Kevin, 10% of the population cannot support 90%, particularly when the 90% is requiring more and more, and we go back to the issue of this demographic shift toward an aging population, requiring more and more of health care, requiring more and more of social security, requiring more and more of what has been a future liability, which is now rolling into the present tense, as something that we have to pay today.

Kevin: David, what we are talking about right now is a case of national insolvency that has not been dealt with. Something has to give. Some stake-holder is going to have to suffer.

David: Yes, and in the case of national insolvency, is it the taxpayer who pays with a higher tax burden? Is it the entitled person, or beneficiary of public services? Is it the bond-holder, through some form of default? If you are a politician, imagine that for a moment – and then perhaps you can go wash yourself (laughter) – which promises are the easiest to renege on? Those to the bond-holder, those to the entitled person, or those to the taxpayer, where you are going to be taking more from their lifetime earnable income?

Kevin: Actually, the tough decision does not have to be made as much by the national authority, as it does by states or corporations. I was just reading in the Miami Daily News; it says that the city is broke right now. The state of fiscal urgency is at its highest point. It says, “The city of Miami is so broke, it is forcing its employees to take pay cuts, even though they are under contract,” and it says besides, “Miami Dade County’s plan to raise every taxpayer’s rates are up to 12.2% for operation.” So they are raising their taxes, they are cutting expenses. They are doing two of the three things that you talked about, but they cannot print their own money and default on their own bonds.

David: No, even if it is that subtle form of default through inflation. The taxpayer, perhaps, is front and center. This might take the form of higher taxes, which, again, as we stated a minute ago, is nothing more than a diminishment of the lifetime earnings of an individual or a business. There are limits, though, as we have seen here in the U.S. There is a certain threshold of pain, that can lead to revolution. Remember the Tea Party, going back several hundred years. It is inevitable.

We will see a rise in taxes. Rates have been double what they are today – 60% to 80%, as effective rates. Even though it crippled growth, destroyed business investment and personal spending, and personal investment and savings, the cost to the economy, frankly, when it comes to higher taxes, is not particularly relevant, because what you are dealing with is a collectivist mindset...

Kevin: Which is, buying votes of the majority of stake-holders.

David: ... that is far more interested in the vast majority of voters, than the minority who happen to be paying the bills.

Kevin: Speaking of stake-holders, though, are they going to get cut back? Welfare, social security, Medicare, those types of things?

David: Yes, as long as you are comfortable shortening your tenure in office. That is an option, but the biggest voter block out there is an aging population that requires constant social security payments, that is deeply concerned with other pension benefits – health care issues are front and center. Why? Nobody wants to die! The mortality fight is in full focus for these folks.

And lastly, they are concerned about inflation, in the form of a rising cost of living, particularly if there is no commensurate adjustment to income. The reality is, if you do anything with your stake-holders, and particularly, the growing stake-holder section of

the aging population, you are going to lose, politically.

Kevin: This really reduces the count down to the single and final vote, and that is, the bond-holder, who really does not have a vote. Yes, the American bond-holder does, but we are talking about the entire world owning U.S. treasuries.

David: And this is different, because the debt defaults of the 1870s, 1890s, the 1930s – they were far more dramatic than those of, say, the 1980s, or more recently, which were characterized by what you might consider classic default qualities – unilateral decision-making, and abrupt termination of interest and amortization payments. It was just, “Okay, we are broke, we cannot make payments, we are done.” Then, the rescheduling, renegotiation, absolution...

Kevin: Like France and Britain have done numerous times.

David: Right. You began to see a change in the nature of default starting around the 1980s, really following the 1930s, which were the last severe and dramatic, “Hands-off, we are not paying.” Since then, you reschedule, you renegotiate, you change the terms of the loan, and you do not really have a default.

It is almost like what Wall Street and Washington are doing today – extend and pretend. Pretend that solvency exists and extend the terms of the loan, change the interest costs, play with one variable or another so that you continue to recoup something of the debt obligation.

Kevin: It is like renaming default, but actually, David, a thorn by any other name is still a thorn.

David: Let’s just look at the most common form of default since the 1970s. It is what we would call default at the margins – default at the margins through the monetary policy tools, which have become regarded as acceptable, and as we said, in practice since the 1970s. If you target inflation rates of 1% to 3%, you eventually are going to alleviate your debt burden over time, and if inflation should turn out to be higher than the official numbers, then the benefit goes to the national account. You are paying off your debt with even cheaper dollars. Why not fudge the inflation numbers a bit?

This is exactly our contention through time is that the CPI understates inflation, so why not fudge the inflation numbers a bit, Kevin? You create an artificially low number, and then you get the Bureau of Labor Statistics to corroborate and confirm that, lo and behold, inflation is only 1-1/2%.

Kevin: By golly, it matched!

David: Even while real-world inflation hovers between 3% and 5% – just as an example – what you accomplish is that you keep your entitlement bills from being adjusted higher, again through the cost of living adjustments, and at the same time, you end up paying off your debts to the Chinese or any of your other creditors, with significantly smaller dollars.

Kevin: The loser is two-fold in this case. It is the bond-holder, but then also, it is just Joe Public, who is out there with a certain amount of dollars. He works all day long for a certain amount of dollars, and they buy less, and less, and less each year. It is a form of taxation that is just built into the system.

David: The interesting thing, and the ironic thing, is that the taxpayer, ultimately, does pay a higher price, and the stake-holder, ultimately does pay a higher price, though he does not know it, because he believes what he is told. The bond-holder ultimately pays a price, both through inflation, and potentially, a greater and more classic style of debt default, but if nothing else, the subtle default which we have been accused of already by the Chinese – default through inflation.

Kevin: David, summarizing this, what you are basically saying is that if you are a bond-holder right now, anywhere in the world, you had better be ready for some pain, because it is coming.

David: If there are three camps of people who, ultimately, will experience pain as a result of the financial crisis, it is going to be the taxpayer, it is going to be every stake-holder, to some degree, whether you recognize it, or it is advertised as such, and ultimately, it is going to be the bond-holder as well. Thus far, the bond-holder has escaped the pain, and has escaped paying into this, unless you consider, as we said, the low-to-negative yields, which really are a subsidy to the government financing scheme, then you would be participating in the funding.

Kevin: So somebody is sitting there right now, saying, “I really do not feel comfortable in the stock market right now,” and rightfully so, “I really do not feel comfortable in the bond market after listening to this program.” What should a person feel comfortable with right now? You talked about what Richard Russell said, that in a bear market, everybody loses, it is just the person who loses the least who wins. How can we become a person who, at least, loses the least?

David: Kevin, I would say there are two things that look to be of interest to me as an investment thesis, one perhaps more than the other. Looking at the fiscal and monetary imbalances in the country, knowing that there are only certain ways that a country can solve its problems, whether it is defaulting on its debt, raising taxes, inflating the currencies or nationalizing assets, and realizing that we will explore or experiment with one or all of those things here in the country – I would be betting against treasuries, or I would be betting for gold.

The reason I would not bet heavily against treasuries – it may end up being the greatest trade of the century – but the reason I would not bet against it is that somehow the money mandarins – the Fed and the treasury – have a rabbit factory, and they keep on pulling rabbits out of the hat. I do not know how they can do it, but they continue to. Can they do that for another 5-10 years before there is a collapse in the bond market? Or are we down to a matter of 5-10 days before there is a collapse in the bond market?

Kevin: That unknown is why you own gold.

David: It is one of the reasons why I am far more confident in the other investment theme. It has been 10 years now that we have been in a bull market in metals, and we are just getting to the cusp of being in the final stage. I think when we move above 1500 in the gold price, we will have launched ourselves into the last and final phase of the bull market in gold. That could last another 2-3 years, so what I am saying is we probably have another 3-4 years total, of a bull market in the metals. It is confirmed, it is historical, it is in context of a 10-year run up to this point from 250 to 1250.

Basically, what we are watching is a rotation from one asset class to the other, and the bear market is chewing up and spitting out that particular asset class, whether it is equities first, and then real estate, and then a return to equities for a second-course meal...

Kevin: And maybe bonds.

David: ... as a third-course, or a fourth course, or perhaps even dessert. The issue is, we are rotating from one asset class to the

next. Just as you see a rotation, and asset classes that benefit from a credit boom, there is also a rotation of asset classes that face pain as a result of a credit bust. At the end of the line, you end up having the bond market.

It leaves you with a very simple investment thesis in today's market. You have to maintain some liquidity in cash, even if you do not like the currency that you are stuck with, whether it is the Euro, the British pound, or the U.S. dollar, depending on where you live around the world. It leaves a very simple allocation to the metals as perhaps the only stable place to go in this environment.

Kevin: Speaking of gold, the Wall Street Journal, two weeks ago, noted a significant change in the perspective on gold.

David: That is right. August 21st, the Saturday edition, had a piece titled, "Rethinking Gold: What If It Isn't a Commodity, After All?" It redefined it, in terms of the public awareness of gold as the currency alternative.

Kevin: Not a commodity, but actually money.

David: When you are not interested in taking risk in the bond market, when you are not interested in taking risk in the real estate market, when you are not interested in taking risk in the equity markets, and you just want to go to cash, but you do not like your first currency of choice – your own currency – what becomes the currency by default? That is gold, in today's context.

Kevin: That has been the context for the last 4,000 years. This is not a new response to crisis.

David: No. You are right about that.

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