Patient Capital.... Positioned for Profit

A PEEK AT THE WEEK THAT WAS - October 19, 2013

Under democracy one party always devotes its chief energies to trying to prove that the other party is unfit to rule - and both commonly succeed, and are right.
- H. L. Mencken -
US editor (1880 - 1956)

Well, it's been quite a week. Democracy…or what passes for it in the formerly great republic …raised its ugly head again when our fearless leaders (once more) rescued us from the brink of destruction. Never mind that they took us to the brink in the first place (yet again). Caesar was the clear winner. He gave the fat Republican elephants a whuppin' they will not soon forget, while the Democratic donkeys were hee-hawing all over the place. Add in the chattering media monkeys and it was a veritable political state fair…and pretty darned entertaining while it lasted. We can barely wait for the next act of this Greek-like tragedy, said to be occurring later this year or early next.

In the meantime, all is good again with the world…or at least America the beautiful. The monuments are once again monumental and readily viewable. The venerable vets are less vexed. The EPA is once again spreading cheer to industry and presumably, Empress Michelle has her full entourage enabling her to tweet and treat as Halloween approaches.

Of course, Club S&P is on fire. The 1700 sign is flying high and Mr. Market is atop two chairs atop the bar and seems to want to swing from the chandelier. Ms. Bond is quietly watching the action, nonplussed, while a few Chinese "observers" in the far corner have noticed that the bottom chair supporting Mr. Market is in danger of toppling and the drinks are increasingly expensive.

But who cares? Bartender Ben is serving out his shift with his famously generous pours. Zesty Janet Yellen is getting ready to come on the next shift and the crowd already knows that she can tip the elbow pretty well herself. And even better, the distillery in DC is, for the moment at least, operating without any capacity constraints. What's not to like?

Over at Bill Bullion's Gold Bar, the patrons had an eventful Thursday as a big crowd of drinkers…or maybe one drinker with a big thirst…decided to buy up big. Perhaps the burly bank thugs standing ominously outside Bill's place have lost their ability to intimidate would be entrants. As usual, we'll be watching carefully.

This week we'll take a mercifully quick look at the debt debacle and what it might mean going forward. As usual, we'll close with our chart of the week, which should cause concern to all those who are not totally fixated on Mr. Market's leap for the chandelier.

Travel schedules and varying time zones necessitate a relatively brief Peek this week. OK …if you must cheer, please keep it to a decent decibel level…and before you become overly chirpy, remember…"relative" is a relative term.

Let's get started…

"The ideas of debtor and creditor as to what constitutes a good time never coincide."

- P.G. Wodehouse, Love Among the Chickens -

Firstly, let's get back to those Chinese in the corner at Club S&P. Apparently, they are from some unknown ratings agency in the Middle Kingdom named Dagong Global...and they are not impressed.

> From Reuters, Oct 17, 2013 4:02am:
>
> **DAGONG DOWNGRADES US TO A- FROM A**
> *SINGAPORE - Chinese rating agency Dagong has downgraded the United States to A- from A and maintained a negative outlook on the sovereign's credit.*
> *The agency suggested that, while a default has been averted by a last minute agreement in Congress, the fundamental situation of debt growth outpacing fiscal income and GDP remains unchanged. "Hence the government is still approaching the verge of default crisis, a situation that cannot be substantially alleviated in the foreseeable future," Dagong said in a press release*

So…who cares. Apart from the Fitch rating service who mumbled something about the USA being on a credit ratings watch (Fitch is partially owned by Les Francais), the remaining recognized ratings agencies were silent. There was not a peep out of S&P. They learned their lesson in 2011 when they had the audacity to downgrade Uncle Sam. The empire was not impressed and hit back with a $5 billion lawsuit against S&P.

"Rate that" replied the Federales.

If you want to, you can read the whole Dagong clanger by clicking here. Given that China is our biggest creditor, it's akin to the rich uncle giving his nephew some serious hints that the time has come to rein in the good times and the high life.

And as tempting as it may be to ignore those impudent Confucians, their rationale does contain a few inconvenient truths…such as:

- *The partial U.S. federal government shutdown apparently highlights the deterioration of the government's solvency, pushing the sovereign debts into a crisis status.*
- *Since the outbreak of the U.S. debt crisis in 2008, the deviation between the federal government's sources of debt repayments and the country's real wealth creation capacity has been constantly broadened.*
- *The debt ceiling has been extended continually, increasing the total amount of the federal government debts. In order to avoid the sovereign debt default, it becomes an inevitable choice for the U.S. government to repay its old debts through raising new debts.*
- *The Democrats and the Republicans of U.S. do not have a consistent strategy target to solving the sovereign debt problem.*

But the following point is the biggie…and if you've actually read the Dagong release, you will realize that we have taken this one out of sequence but we've done so deliberately because we believe it is the crux of the matter.

- *Liquidity has been continuously injected into international financial markets from the U.S., which indirectly plays a key role in combating against the risk of government default. This* ***implicit debt default behavior infringes upon the benefits of creditors****. In order to avoid the debt default caused by the lack of debt repayment sources such as fiscal incomes, t****he U.S. government has been taking advantage of the international currency dominance of the U.S. dollar to monetize its debts*** *and has been taking quantitative easing monetary policy to maintain its government solvency since 2008.* ***The devaluation of the stock of debts hereby directly damages the creditors' interests.*** *Dagong estimates that* ***the depreciation of the U.S. dollar caused a loss of USD628.5bn on foreign creditors over the years of 2008 to 2012****.*

Wow…those canny Chinese have figured it out. They're onto the swindle and are far more aware of the inherent theft of value of their savings than the average American. We were once asked about who has the time and energy to possibly keep track of all these trillions of dollars of American debt. The simple answer is...the folks who are owed the money. The Chinese are owed the most and they are very accurate with their abacus.

Of course, the next biggest creditor, Japan, would not be nearly so rude to disclose the obvious, even though they are also very aware that the empire has no clothes. But then, the empire does have ships and planes and it does protect them from sometimes less than friendly neighbors. So they have no choice.

But perhaps the Chinese are itching for a fight…or more appropriately…a war. Currency only, of course, old sport. Those bloody encounters are so Middle Eastern, not Middle Kingdom.

Let's face it folks…the Dagong downgrade is not without Chinese government approval …nothing serious is in China. So let's see this for that it is…**another salvo in the battle to "de-dollarize" the global economy**. The Yankee dollar index is still hovering around 80…but for how long?

We sense the pressure is mounting and will continue to mount until the Great Republic finds fiscal religion…or at least is seen to be seeking it. Separation of chuch and state may be a worthy ideal but separation of the Chinese from their money will clearly not be tolerated forever.

"And thus I clothe my naked villainy
With odd old ends stol'n out of holy writ;
And seem a saint, when most I play the devil."

- William Shakespeare, Richard III -

So...what actually happened last week with the debt ceiling deal anyway?

Well...let's take a quick look and see what deception we find.

The fiscal deal passed by Congress on Wednesday evening to re-open the government and get around the limit on borrowing doesn't actually increase the debt limit. It just temporarily suspends enforcement of it. The government has a free ride and can spend, spend, spend. It's a bit like having a free EBT card with no limit.

Well, technically, they can't just go crazy like those lucky Walmart shoppers, but it does mean that the Americans (and the Chinese) will have little knowledge of how much debt their government is going to rack up between now and Feb. 7, when the limits are supposed to go back into place and presumably will have to be raised...because we just know that they couldn't possibly cut spending.

> *"Suspending the debt ceiling without a dollar amount is further proof that Congress is taking a major step backward in fiscal responsibility," David Williams, the president of the Taxpayers Protection Alliance, told The Daily Caller on Thursday. "A real dollar figure is a constant reminder to taxpayers and Congress that the country is broke. This was done to hide the real debt from taxpayers."*

So our courageous leaders under the guidance of Team Tan, Johnny and Nancy and the Wrinkle Brothers, Harry and Mitch, have gotten away with allowing the country to rack up more debt and avoid the threat of default without actually voting for the dreaded debt limit increase.

According to the Daily Caller, the conservative Heritage Foundation has criticized the practice as a "smokescreen."

We would call it "deception". The Chinese might call it "heresy". Gold will call it "Catch up time".

Check out the chart below which shows the shiny stuff's price performance relative to the debt ceiling. As you can see, it historically tracks it pretty darn closely but right now, it has fallen below trend...possibly because of those mysterious big sellers methodically invading the market.

We would bet on it catching up this time as well. So, just follow the money (debt) and watch as gold does what it does best...stores value.

Oh...and speaking of gold, it seems like Mario Draghi, head man at the ECB (European Central Bank), is also not inclined to sell. From ZeroHedge:

> *When asked this week, by the ironically named Tekoa Da Silva, his thoughts on precious metals as reserve assets (and central banks around the world increasing their allocations), none other than the ECB head himself Mario Draghi explained "I never thought it wise to sell [gold], because for Central Banks this is a reserve of safety." But Draghi did not stop there, and perhaps enlightened by the farce in Washington this*

week, the unusually truthful central banker explained, "in the case of non-USD countries, it gives you good protection against fluctuations of the USD." Perhaps that is why China continues to import gold at a record pace?

You can watch Mario in action in this video. Just click here.

CHART OF THE WEEK

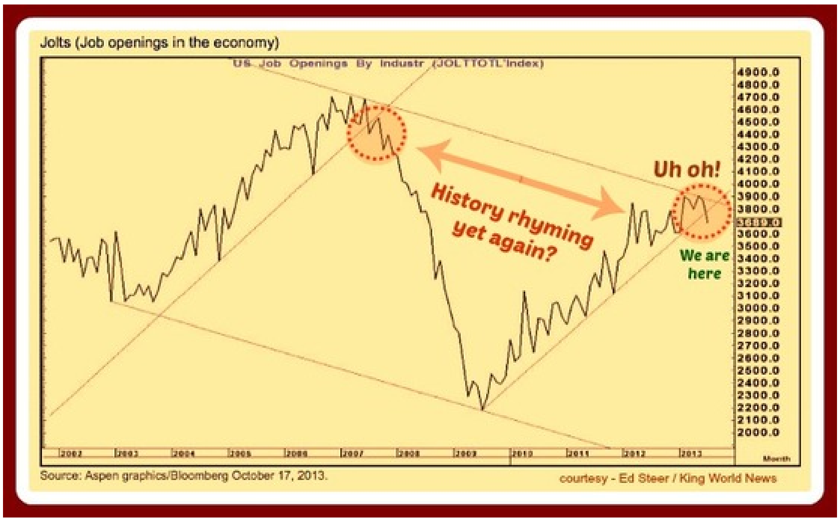
"When you took a man's job away from him, his ability to feed and clothe his family, that man was going to get angry."
- Darrin Grimwood, Destroy All Robots -

Our esteemed leaders know all too well that the quote above is all too true. And that's why the chart below is so scary to them. It also means that Zesty Janet Yellen, who sees unemployment as the biggest bogey man of all, will keep spending.

As you can see, the chart shows a disturbing break below the upward trend line, reminiscent of late 2008 / early 2009. This chart was prepared by a top Citibank analyst named Tom Fitzpatrick, who also prepared the preceding chart on gold and debt. Tom correctly points out, as we have, that we are becoming a nation of burger flipping baristas:

> *"Initial claims have been falling sharply ... At the same time there has been a huge surge in claimants for disability and food stamps over the last 3-6 years.*
>
> *A lot of jobs that are being created are in service and leisure/hospitality industry (Generally low paying) and part time jobs. So overall there is a very strong argument that the qualitative nature of job creation is very poor ... If we then add to this the fact that the dysfunctional environment in Washington is likely to continue to be a drag on confidence and the economy as we likely re-live the recent debacle again in 3-4 months' time, at which point can we expect that Senator Schumer be telling "Madam Chair" to "get to work?"*

And off to work shall our Janet go. Pouring drinks and getting everyone stoned on her own, stronger version of Ben's famous "Wealth Effect" cocktail...until all is well again...or until she feels a gentle tap on her willowy shoulder...from the Chinese observers, who are no longer in the corner.



Til next week...

"Ignorance is the curse of God. Knowledge is the wing wherewith we fly to Heaven."
William Shakespeare

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