BUILDING WEALTH IN CHANGING TIMES

The Solari Report

OCTOBER 4, 2012

Equity Markets

with Chuck Gibson

Equity Markets

October 4, 2012

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C. AUSTIN FITTS: You all met Chuck Gibson, my partner at Sea Lane Advisory when we did *View From Silicon Valley*, an excellent background piece for these equity overviews that we're going to do quarterly with Chuck. It's the innovation and technology trends that have contributed to a surprising strength in the US equity market this year. Chuck is an engineer by training and began his career in the information technology industry and, of course, the office is out here in Silicon Valley and I'm speaking to you from there tonight.

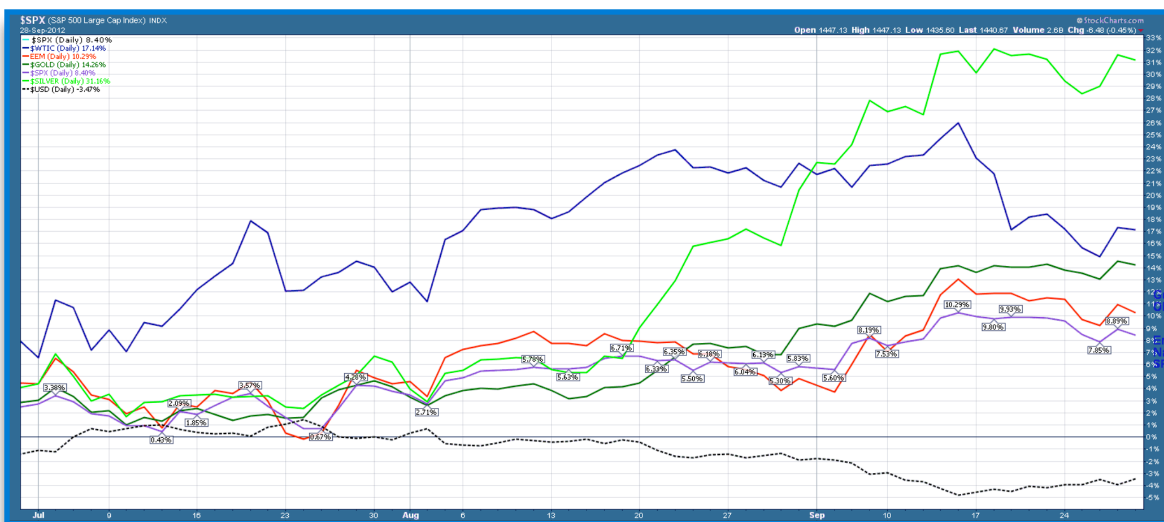
Chuck has been with me doing these "Financial Salons for Changing Times," The ones in Petaluma and Santa Cruz are coming up in October and November; and as I said, we just have great discussions. So if you want to get a chance to meet Chuck or want people you know to meet Chuck, there's the opportunity. We're going to be using charts tonight. Chuck does very impressive technical and fundamental analysis and he's prepared a series of charts that will be up on the Instant Teleseminar. So you can watch it on the web, but we will also have them on the blog.

They're posted at the subscriber's space on the blog post for this evening's *Solari Report*, so you can also download them there and look at them at your leisure. We've also put the outline for our discussion tonight up on the blog post as well. So the material is there for you. You can go back and listen again to this audio and study it and, of course, if you want to post questions for Chuck when we're doing these overviews, I would really encourage you to post them on those blog posts on *The Solari Report*. So Chuck, welcome again.

CHUCK GIBSON: Thank you. Happy to be here. Happy Thursday.

C. AUSTIN FITTS: Okay. Well, you've prepared amazing material for us and we appreciate it very much, so why don't we just dive in? You know me. I love those walls in the shopping mall where it says, "You are here."

Let's start with the third quarter. We've just ended the third quarter – September 30, end of the third quarter – so tell us what's been happening in the equity markets.



CHUCK GIBSON: Well, the third quarter was quite interesting. If you look at the charts, and for those who don't have access to it I'll try to give you a quick overview. I don't want to spend too much time because I could bore people to death that actually have visibility. Silver and precious metals in general had an outstanding quarter. Silver was up over 22 percent and just in general all risk assets, as you can see from the number of the lines there that they were all up dramatically, especially for a quarter. I think it went back. The best quarter we've had in the equity markets since before, I think, 2007. So if you look there real quickly, what we have – the green line is silver. The next line below that – I'm just going to go in order there – the blue line is oil and then follows gold.

The red line is the emerging markets and then the S&P 500 and then finally followed up with the US dollar there. I wanted to show the dollar because we're going to talk about that later in the correlation or the inverse correlation between risk assets and the dollar. So, as you can see, they all behaved relatively well because as the dollar rose slightly there in the early part of the quarter we saw assets starting to fall, and then as the dollar started to fall and Ben [Bernanke] started talking about more quantitative easing and free money the dollar started to fall as the equity in the risk assets started to rise.

So it was quite an interesting quarter. I will say, though, this: that I

expected to see a little bit more of a blast from the final announcement after Ben [Bernanke] spoke about unlimited -When I say unlimited I mean the $40 billion a month buying of mortgage securities for an unlimited period of time for whatever it takes. I figured we were going to have a better turnout than that. I don't know if that is just that the market is stalling and waiting and trying to digest this or whether we're starting to get the marginal utility of additional printing isn't really as beneficial as it had been in the past.

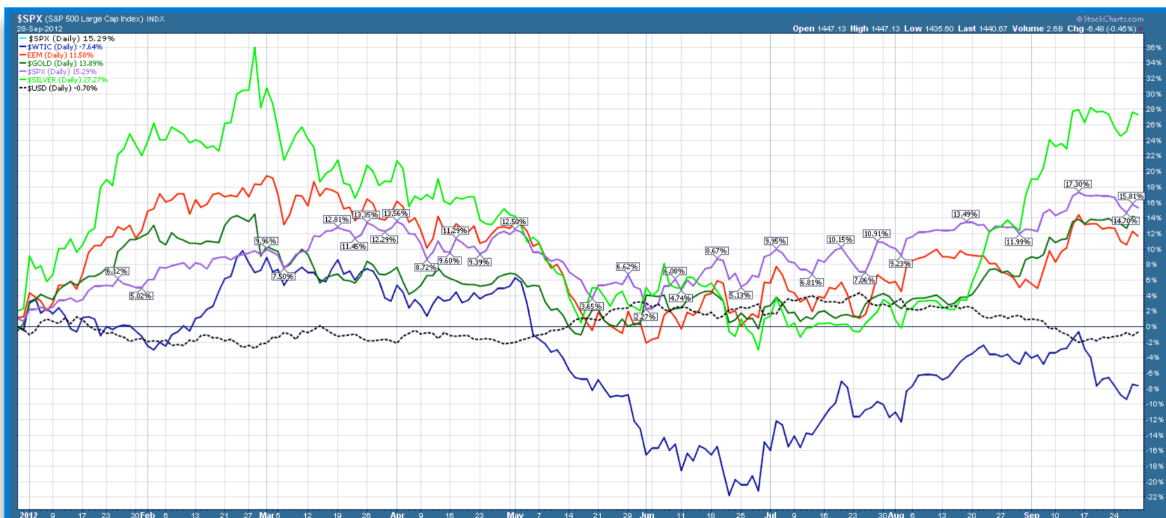
C. Austin Fitts: Well, it's fair to say I think QE3 as announced is much more generous than most people had anticipated. So this was a more aggressive quantitative easing than was expected, don't you think?

Chuck Gibson: I think from the standpoint that they put no time period on it. All the other quantitative easings and free money speeches were all about putting a cap on the amount and they had a defined period at which they were going to be for, starting this date and ending this date. Both Bernanke and Draghi in Europe have opened the door for basically whatever it takes.

C. Austin Fitts: Right. Okay. So that's the quarter.

Chuck Gibson: Let's take a look back at the whole year.

C. Austin Fitts: Okay.



CHUCK GIBSON: We looked back at the last three quarters. So if you look back, I kept the same color-coding and, of course, in this chart not much has changed. Silver has led the charge. If you look at the early part of the year it was leading the charge also, but it got smacked down pretty hard into the first quarter and into the second quarter and actually just stayed flat-lined until we saw the QE3 announcement. I think the one dislocation here that I think people might find interesting is that look at what happened to oil, or shall I say what didn't happen to oil. I mean, you would have expected over the quarter oil to be falling in relationship to the other risk assets and it really was dramatically down.

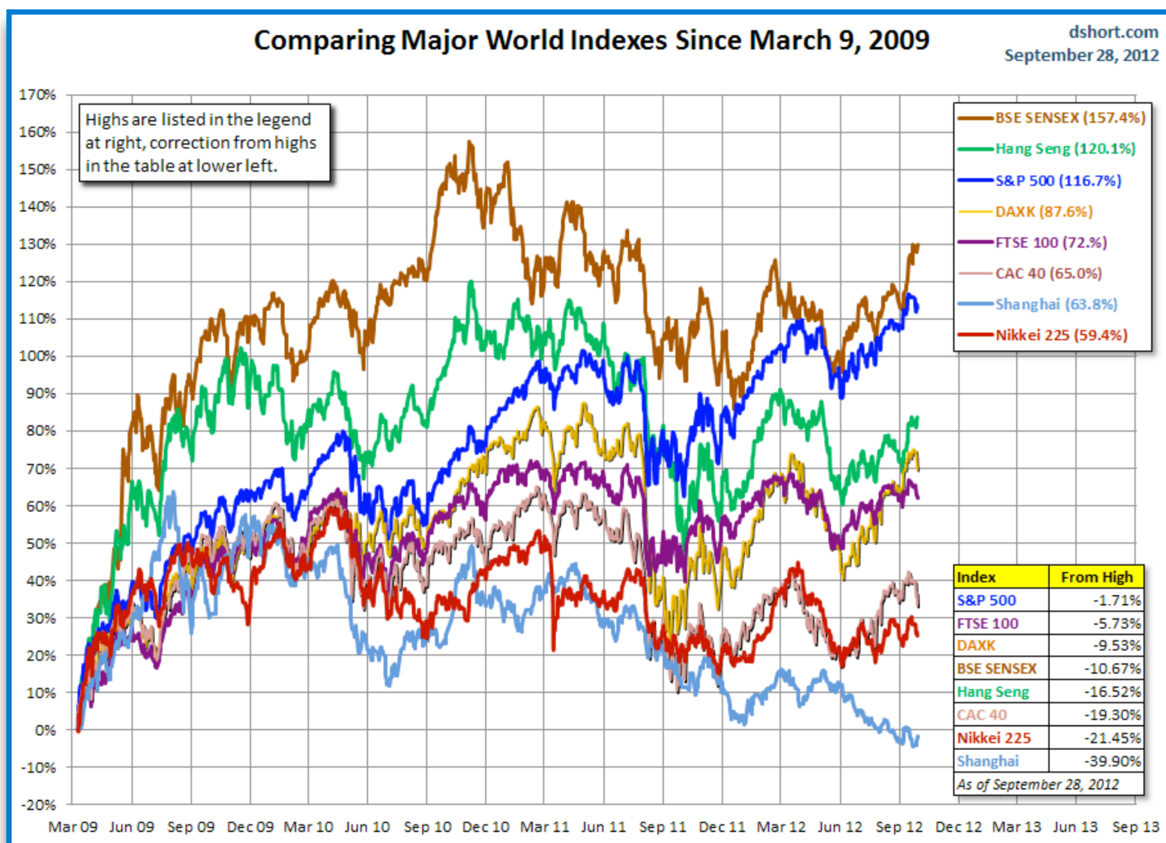
Oil is one of those animals that is very, very controlled by traders and institutions and I believe that it had run up. If you priced oil today based on supply and demand, the oil price wouldn't be at $90.00-plus a barrel or whichever you're using, West Texas Crude or Brent. It would be somewhere around $70.00 to $80.00 but what we have is we have some people that need – especially the Middle East – need money to be able to fund their expenses and they try and keep the price of oil stabilized and, unfortunately, they weren't able to do that so far this year.

C. AUSTIN FITTS: Right. Oil has been below where I expected it to be.

CHUCK GIBSON: Again, look at how the dollar's traded, that black dotted line. You can see it vacillating in between – I want to keep pointing this out, not because it's all that interesting in the chart, but as we go later into this discussion we're going to talk about the effect of money printing, quantitative easing and the dollar and what we think is going to happen going forward. I did want to just give a quick recap. I thought it was important that we take a perspective, not only a short term but a long-term perspective, to put a stake in the ground to see where the markets are since this is our first time that we've talked about this.

But then the second part of the discussion will be more of a look ahead to try and say where we're going or where we think we're going because we don't know for sure, but where do we think we're going and why?

C. AUSTIN FITTS: Right.



CHUCK GIBSON: You want to move on to chart number three?

This is a longer-term look back and this is a different chart. Keep in mind that it's a cumulative chart. It's a performance chart and it looks back since the bottom in 2009. So when the stock market hit a low in 2009, what this does is takes a look at all the different world stock market indices and compares them against each other. The one very interesting thing here is that – just an explanation so everybody can see it – but the top performer there is labeled the BSE. That's the India index; and that's followed by the S&P 500, which is the US index; and that's followed by Hong Kong, which is the Hang Seng. Follow it all the way down. You guys can follow it from there, but I think the interesting thing is look what happened to China. China is the only stock market since 2009 that hasn't had a positive return.

C. AUSTIN FITTS: I was amazed by that. I had not realized that Shanghai had fallen that much.

CHUCK GIBSON: The interesting thing is we're going to take one more look back in another chart going back to 2000. I mean, if you look technically at the chart itself, I don't see a change in that direction any time soon. There's nothing telling me that we're hitting a bottom yet.

C. AUSTIN FITTS: Right.

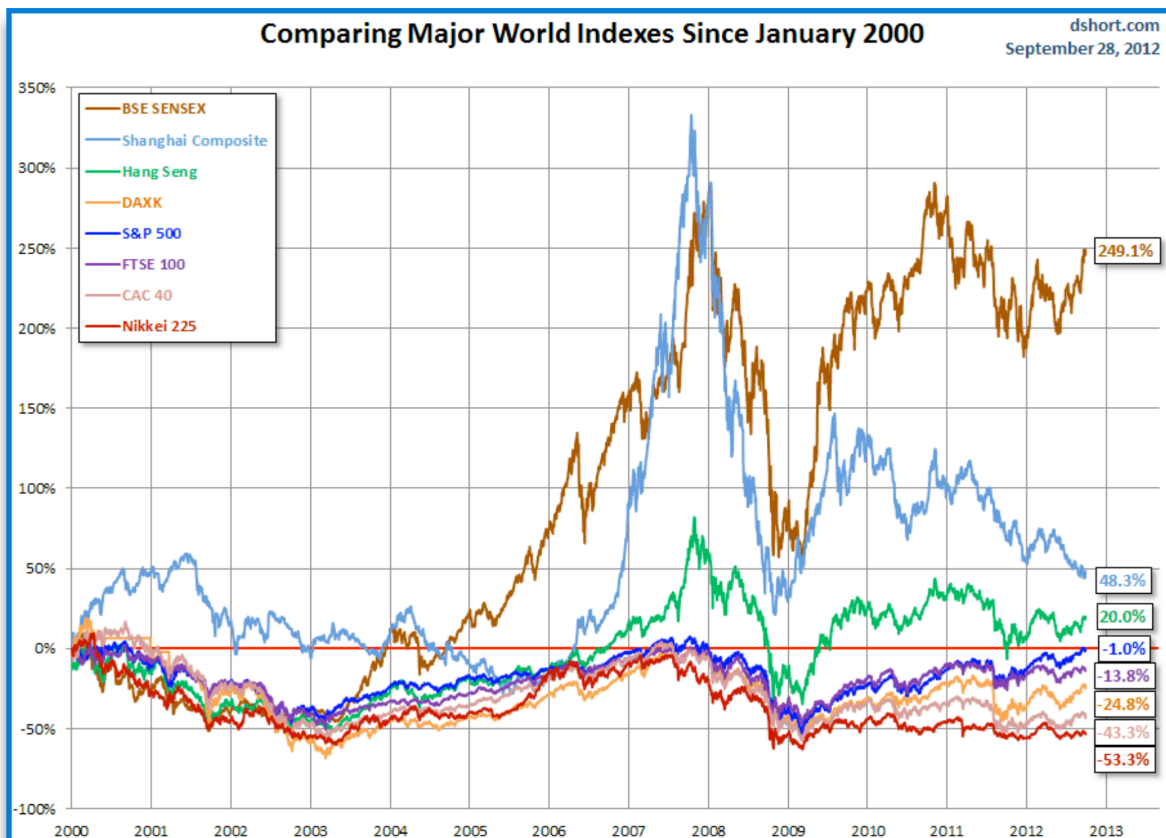
CHUCK GIBSON: So if you want to we can switch to the next slide, which is since 2000.

C. AUSTIN FITTS: And China looks much better.

CHUCK GIBSON: Yes, because of the huge run-up that it had in 2007.

C. AUSTIN FITTS: All right.

CHUCK GIBSON: So, again, I think this is even more compelling when you



step back and you say if you look at stocks in general, there are only three stock markets around the world that have had a positive return since January of 2000.

C. AUSTIN FITTS: Right.

CHUCK GIBSON: And that's Hong Kong, China and India; from a population standpoint, the greatest emerging-market countries that are out there. So it's a very interesting perspective.

C. AUSTIN FITTS: Right, although you've heard me say many, many times if you dive into the indexes, what you find is you've got a whole world that's dying and a whole world that's being born, all happening within the same index. So you have to be very careful.

CHUCK GIBSON: Right, and unfortunately, you're not able to have that granularity to be able to see that but you bring up a very excellent point. If you just parse the data for the S&P 500, for example, you're going to see that, for example, technology has done very, very well whereas manufacturing of course has done very poorly. So it does matter dramatically. It's not that stock markets are down. It's just in general, when you take a look at the entire market, it's down but there are sections that are doing very well, thank you.

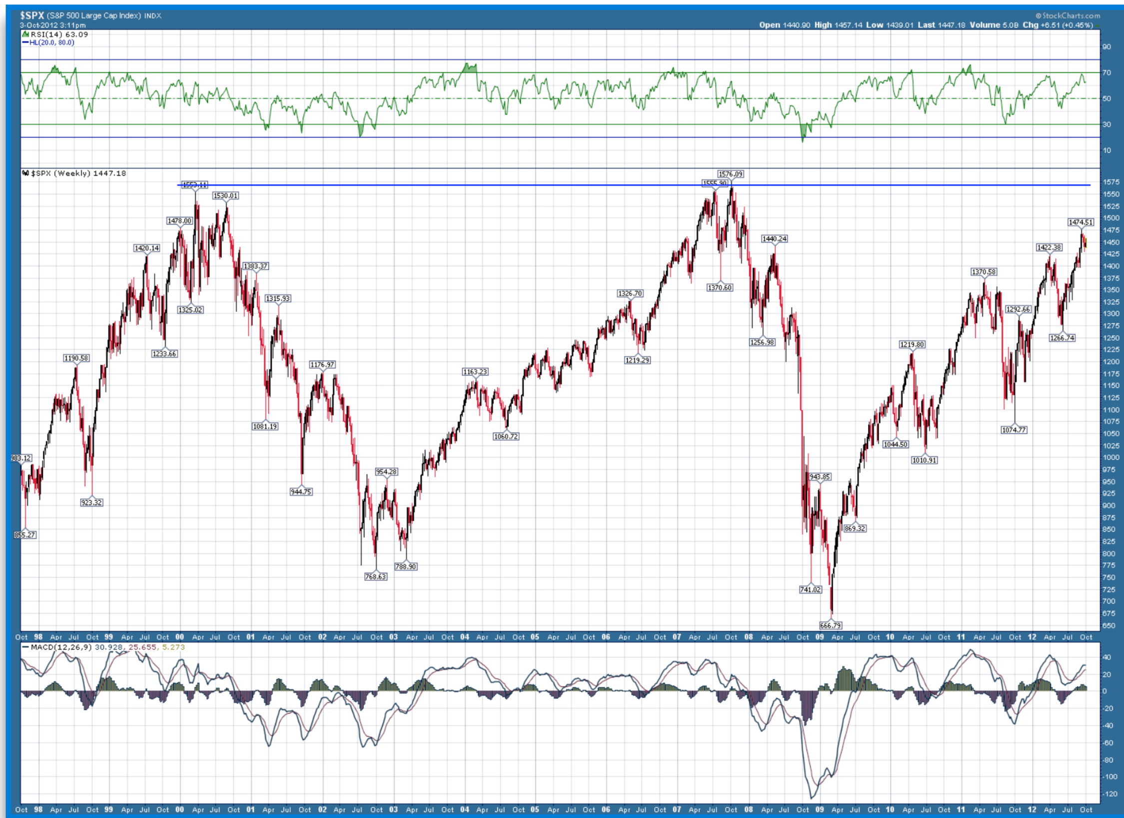
C. AUSTIN FITTS: Right.

CHUCK GIBSON: So we've taken a look back. This is the point at which we want to take a look at what we have that we see that are feeling the markets because I think people almost immediately think that quantitative easing is the driver in the market and when you look at the chart, if you don't mind pulling that one up for me.

C. AUSTIN FITTS: It's there.

CHUCK GIBSON: Okay. The correlation is unbelievable.

You look at the yellowed, highlighted areas and you can see where



$SPX (S&P 500 Large Cap Index) INDX
RSI(14) 63.09
$SPX (Weekly) 1447.18
MACD(12,26,9) 30.928, 25.655, 5.273

28-Sep-2012 Open 1459.76 High 1463.24 Low 1430.53 Close 1440.67 Volume 12.4B Chg -19.48 (-1.33%)
$SPX (Weekly) 1440.67
QE1
QE2
QE3
Operation Twist started 21-Sep-11
VTX(10) +VI 1.27 -VI 0.74
HL(1.0)

quantitative easing started and where it ended, and you can see the correlation of what happened to stocks both at the start and then when they ended. Now one could easily draw a conclusion, and I'm a firm believer in this, but you have to be careful that there may or may not be a direct correlation between quantitative easing and stocks, although we think that there is. It's just this is too perfect of an example as to a correlation as to ignore it.

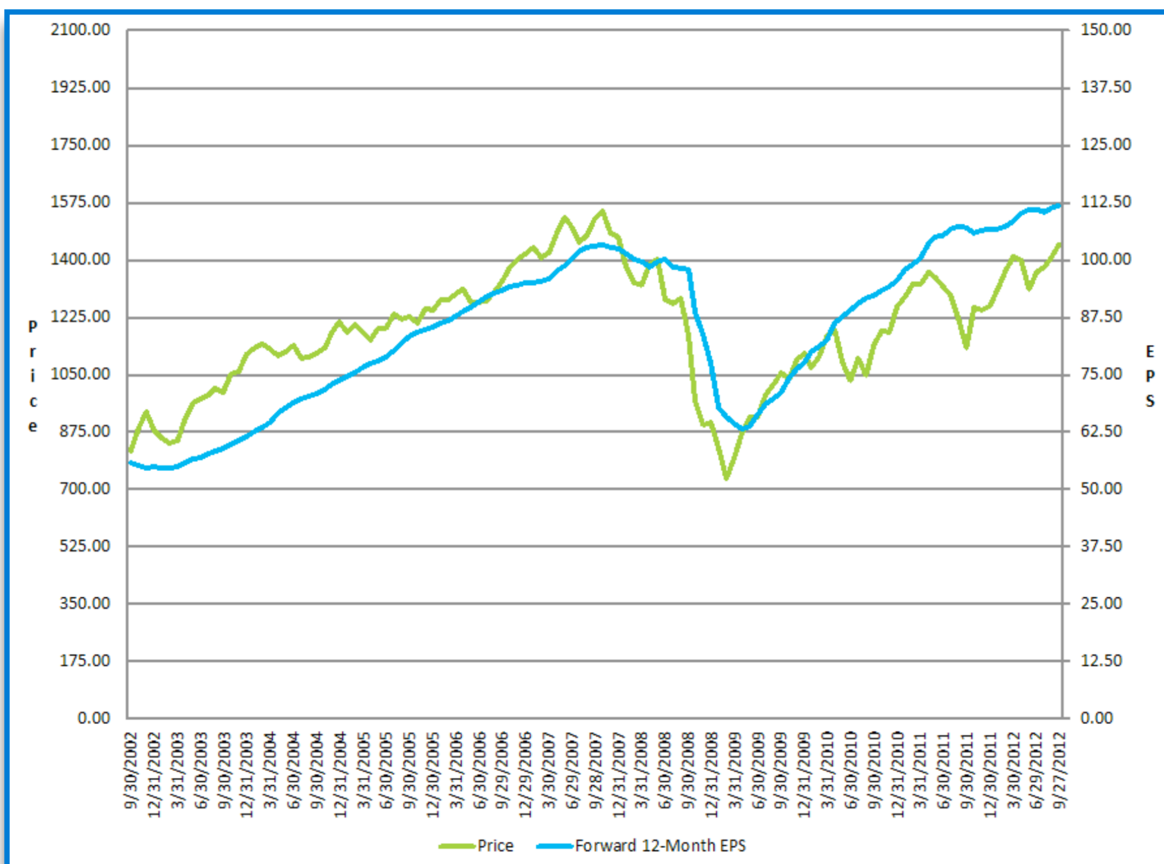
C. AUSTIN FITTS: I will never forget when you first showed me this chart. I felt like I'd been dropped from a see saw. It was just like, "Oh, my God. This explains." because the correlation is so amazing that you now understand why everybody has become a Fed watcher. I mean, I know teenagers who are reading books on how the Federal Reserve works. And I think that's because they intuitively understand how much of the economy right now is driven from Federal Reserve actions.

CHUCK GIBSON: Yes. The old axiom has never been more effective and true than it has in the past, which is, "Don't fight the Fed," because they are driving this market. But I do want to throw up another alternative for you, and if you can pull up the next slide, is it really all the Fed?

Is it the Fed that is actually driving this or is there an indirect correlation? Because if you look at the next set of data – and what this is, is the green line is actually the price of the S&P 500 and the blue line is the earnings per share of the S&P 500.

There's a wonderful correlation there that says that, as earnings growth, so do the prices of stock. We knew that intuitively but there is a really, really good correlation. For example, if you look at the bottom in 2009, from there until this chart ended, which was the end of September, you'll see that earnings have approximately doubled. They've gone from about $62.50 up to $112.50, but so has the price of stocks. The price of stocks has doubled. So is it the Fed that's actually driving stock prices or is it the earnings?

C. AUSTIN FITTS: So essentially, I think part of what could be happening – we don't know – is if you look at the Fed taking actions that inflate the



money supply, they're not inflating the money supply broadly. In other words, the money supply is not going up on Main Street. What the Fed is doing is taking a series of actions, which increase assets or economic activity for large banks and through government spending for large corporations.

And so it's literally as though you have a piping system, which is piping the money into certain sections of the economy but not into others and that could very much be how Fed actions are driving corporate earnings. So I don't think it's clear that it's just spilling into assets. It may be, in fact, moving through corporate earnings as well because you look at this chart and it's quite remarkable.

CHUCK GIBSON: Well, I think you bring up a really good point, and I was going to save this for later, but if you look at the earnings – for example, what drove earnings last quarter – 60 percent of the earnings growth in

the S&P 500 was driven by financials.

C. AUSTIN FITTS: Right.

So that shows you what buying $40 billion a month of fraudulent mortgage-backed securities and paying 10 times market value is going to do for the financials.

CHUCK GIBSON: Exactly.

C. AUSTIN FITTS: It's going to be very good for earnings.

CHUCK GIBSON: Exactly. So you bring up a really good point there. Well, I thought that was interesting to be able to throw that out because there's both fundamental and other reasons – we'll call them Fed reasons – to be able to see that stock prices have a future. What we have to do is watch closely, and we're going to talk about this in the next section, but we have to watch closely what happens to earnings because we do see the correlation. And whether it's driven by the Fed, who's driving earnings in the corporations, or the actual corporations themselves we need to follow that and I think that that is a potential headwind that we've got to see. If we could, we could now switch over to some of the headwinds that we've got ahead of us.

So we're trying to take a perspective, look forward and say, "Let's look at both bull and bear cases for equities and let's see which one is stronger." God, I've been in this business for 15 years and there has never been a period of time that I've ever experienced where there is such a strong set of arguments for both the bull and the bear case. It's unbelievable, but the markets keep going up independent of who's got the greater argument. But what I'd like to do is for the listeners to go through those arguments and let them see what they think the market's going to do after this. I'll reserve comment to the direction in the future until the end, but let's go through those if we could.

C. AUSTIN FITTS: Okay. The one thing I will say is, from my point of view, you're a youngster.

So I thought I had seen just about every good bull-bear argument on the market ever in the world, and we're not there yet, but we're going to come up to chart 11, and I'll just let everybody know ahead of time. I was stunned. Talk about a drop from the seesaw moment, holy cow. And this was the first time, Chuck, when you showed me that chart that I decided the presidential debates might be worth watching.

So I'm going to leave the suspense there and we'll come back when we get to Chart 11. Okay. So start us off on the headwind, Chuck.

CHUCK GIBSON: You touched it on both Europe and China, and I don't want to go a whole lot more in detail than what you said because I think you summarized it very well, but Europe is in a tough row right now and I personally don't see an immediate fix to anything in the near term. So with the austerity measures that are being imposed upon most European countries Europe is slowing down, both from a GDP and an economic standpoint. And as such, what you'd expect to happen, which is exactly what's happening – it's driving the slow-down in China because Europe is China's greatest trading partner. So I think it's really important to understand that the correlation as the European flu has taken hold, it's affecting China very strongly.

C. AUSTIN FITTS: Right. Well, the thing that I found to be remarkable is the extent to which the Chinese markets have dropped dramatically relative to the European markets, and one of the questions I have is there are so many tensions at this point between the American government and China. I wonder to what extent the backdrop is also a certain amount of economic warfare. What's interesting is I'm a great believer that part of managing the oil prices is check-mating China and as the Chinese markets have come down, so has the price of oil.

You almost wonder if they don't feel a need to jam it to them; but it's interesting that we've watched them come down together. At the same time, here's my feeling. If you look at the growth rates in China, I think China's here to stay. So the Asian consumer markets can continue to grow, and so I think this is going to be some indigestion but I don't think it's a change whatsoever in the primary trends that the growth in

Asia is going to be very, very significant for many decades to come.

CHUCK GIBSON: I agree 100 percent. There's one other thing you might want to throw out there for discussion and that is that I know as many investors have been burned by the initial Chinese onslaught of equity availability here in the United States, there was so much fraud. There was so much uncertainty. They don't necessarily have the same regulations for reporting and what we were finding is that in many cases what people thought was there as an equity company wasn't. And so I think that that's also driving some of the fall in the prices of Chinese stocks because people are wary. They're concerned about the legitimacy of what they're buying into so capital is going more towards, in this environment, something that's safer.

C. AUSTIN FITTS: Right. I would say that the Chinese have been the most aggressive about systemically trying to get us back.

CHUCK GIBSON: If they expect to get foreign investment to continue going forward, what they're going to have to do is they're going to have to clean up that market. It's going to continue to fall unless they do something because I know people are very wary of investing there, but you're 100 percent right. I think that's where the growth is going to come from. If they expect to participate in that, though, they're going to have to make some systemic changes.

C. AUSTIN FITTS: I agree.

CHUCK GIBSON: All right. Well, you touched upon the fiscal cliff and I think it's a very, very important subject. I don't know what kind of level of detail you want to go into. You did a great job. I have just some examples of what we're talking about. I don't know if it's worth everybody's time to know what they are.

C. AUSTIN FITTS: I would like to take some time on the fiscal cliff because I checked in with different members of the *Solari* team in our network this week, Chuck, and asked people, "What is the fiscal cliff?" And what I realized is that there is no understanding of the kind of potential

increase in federal expense or tax bite that might hit at the same time that we're going to get big food and other consumer good hits as a result of the quantitative easing. So I don't think people are beginning to realize the multiple things that are going to cascade down next year one way or the other, and so it's worth taking some time on it.

CHUCK GIBSON: Okay. Well, the one thing I will say after trying to gather as much as I could about the number of things, I can't see anybody that might not be affected in some way or another.

"After trying to gather as much as I could about the number of things, I can't see anybody that might not be affected in some way or another."

C. AUSTIN FITTS: Everybody will be. Everyone.

CHUCK GIBSON: Let me just rattle off and try and go quickly down this list. We have the Bush era tax cuts are set to expire and that will then push the tax system back to 2001 levels. The biggest one that people might know about is the estate tax exemption, and it is currently at $3 million. So you can have an estate up to $3 million currently this year and not have to pay any estate taxes if somebody passes away. Now if it reverts back to 2001 levels, the level becomes instead of $3 million, it becomes $1 million. So if you had a $3 million estate, you passed away this year, you're going to pay no taxes. Next year if you have a $3 million estate, you're going to have to pay taxes on that $2 million difference between your $3 million estate and the $1 million exemption. As such, state tax rates start at 35 percent and they go up from there.

C. AUSTIN FITTS: Right, and the other thing to point out is that $1 million sounds like a lot, but if you look at the purchasing power of $1 million when the Bush tax cuts went into effect it was a significantly greater amount of money than it is today.

CHUCK GIBSON: Right, and people also have to understand that that includes their entire estate, so that includes their home. In California, you could have an outhouse that's $1 million. The prices are so ridiculous.

C. Austin Fitts: Right.

Chuck Gibson: The second thing is that President Obama gave a two-percent payroll tax cut to all US citizens that are working and that's going to expire at the end of this year. So everybody that gets a paycheck will be hit two percent more taxes on payroll taxes next year, starting January 1. These are some enhanced dependent-care credits and some other credits that you're allowed on your tax returns that people with large families are able to take benefit of, and unfortunately, those are going to be negated also. We also have the repeal of the personal exemption phase-out. It's a tax savings that people have that are in a fairly large tax bracket that allow you to continue to take a personal exemption as a write-off and that's going to go away.

Also they're going to repeal the limit on the itemized deductions. So everybody that itemizes their tax returns is set to have – not everybody, but people that are in the correct tax bracket – expect to pay higher taxes because the itemized deduction is not going away; it's just that the limits are going to be changed. There's also student loan interest deduction that students were able to write off and not have to pay taxes on. There was also the mortgage debt forgiveness. So if you had to bail on your home and you actually made money by bailing – so, for example, if you walked away from your home, you didn't have to be taxed on the gain from the fact that you walked away and didn't have to make that payment on your house.

C. Austin Fitts: All right. So there's a forgiveness of indebtedness when the mortgage gets written off.

Chuck Gibson: That's right.

C. Austin Fitts: Right, and so the question is do you have to pay taxes on the forgiveness or not? Is that income to you?

Chuck Gibson: That's correct, and it isn't this year but it's going to be next year unless these changes are enacted.

C. AUSTIN FITTS: And that can be an enormous hit. I've seen people live through that. If you served as the FHA Commissioner, you've lived with that issue. People kill over that issue.We had all these Section 8 tax shelter partnerships and all sorts of forgiveness of indebtedness problems show up and then people who thought they were just getting a write-off 20 years ago are suddenly ready to kill everybody.

So if you walk away in a foreclosure situation that can turn around and come back and get you, and it's a very big tax bite.

CHUCK GIBSON: It can, and thank goodness there aren't that many people there affected, but the other tax that so many people are affected by are the AMT – you know, the alternative minimum tax – and they made an adjustment to that to allow some ratcheting up so they can minimize taxes, but that's going to be reverted back to prior year and that's going to impact a ton of people.

C. AUSTIN FITTS: Right.

CHUCK GIBSON: There are a couple of other things, like deductions for state and local taxes, and some IRA charitable donations for elderly people that they were able to write off. It doesn't affect a whole lot of people, but those are some other things that are going to revert back and be more onerous in terms of greater taxes owed. Then you go to your spending cuts, and I think this is what I think is going to be interesting. Remember the super committee?

C. AUSTIN FITTS: Yes.

CHUCK GIBSON: The supposed bipartisan committee that was charged with finding the way to slash the nation's government by $1.2 trillion over the next 10 years? And they were so bipartisan that they were able to be able to hammer out all this difficulty, and they never got anywhere? And since they weren't able to agree what ends up happening is that it triggers a $1.2 trillion spending cut which, again, is over the next 10 years. But the interesting thing is where it's being pulled from because before, if they would have been able to agree, they could have agreed on

where it would come from; but now, in the document that describes this, they don't get any flexibility. Half of it's coming from the Pentagon and half of it's coming from domestic spending.

C. AUSTIN FITTS: Right, because it's not going to come from interest on the public debt.

CHUCK GIBSON: That's correct.

C. AUSTIN FITTS: So one of the things that has been going on in the economy as globalization and automation have cut employment in the traditional areas and one of the ways we've seen the earnings rise on the S&P 500 and in the stocks and the equity markets – that's coming from cutting labor and automating, a lot of it, or globalizing and lowering labor costs. So corporate earnings are very much driven by decreases in corporate employment; and then what we're watching, Chuck, is we've seen government pick up a lot of the slack. So if you look at state, local and federal employment, that has generally been rising.

Now, if you're talking about these automatic cuts, you're talking about either cuts to government contractors or grants to state and local government or other activities that are going to basically take away that safety net for the employment. If you look at what's possible in terms of reengineering government employment, I'll never forget when I first got to FHA I said to somebody, "You know, I have 7,000 employees but if you want to reengineer this using the latest software," and this was in 1990, "I could run this with 250 people." So we're talking about spending cuts rolling through and coming back around and impacting people's incomes because to me there's going to be a big ripple-through effect that's going to affect businesses across the board throughout the country because government has become such a big sector of both employment and purchases and contracts.

CHUCK GIBSON: I don't know if those that watched the debate yesterday or not did, but we heard that Governor Romney had mentioned that Obama was going to raise taxes $3,700.00. And how he came about that was this was the estimate from the Tax Policy Center that said that if all

of these things are implemented or ignored or the spending cuts are implemented and the taxes rise, you're going to see $3,700.00 per household. That's how households are going to be affected and it's going to impact somewhere near 100 million Americans.

C. AUSTIN FITTS: Now if you look at that estimate, though, it doesn't include health care.

"I keep beating the drum. We don't need health insurance. We need health care."

CHUCK GIBSON: Correct.

C. AUSTIN FITTS: So if you add the health care changes, that can add up to another $2,500.00 because you're mandated to spend for health insurance. I keep beating the drum. We don't need health insurance. We need health care.

CHUCK GIBSON: Is that $2,500.00 next year?

C. AUSTIN FITTS: I can't remember when it hits, but it's coming and the costs come before the benefits. So I don't remember if it's next year, but if it's not next year it's the year after. It's $3,500.00 per household but, in fact, the number for most middle class households I think is about $2,000.00. So take that, add the health care of another $2,500.00. That gets you to $4,500.00. Now let's keep going because quantitative easing is going to push up prices of food and other essential goods because you've just essentially devalued the dollar but you haven't floated the *pro rata* share of that dollar to the people involved; and so let's say your taxes go up $4,500.00. The cost of food and other goods because of quantitative easing and the central banks' actions are also going to rise. So let's say your food bill goes up $500.00 to $1,000.00 as well. So that's a big hit all around on a household budget.

CHUCK GIBSON: Yes, where the average household income is declining.

C. AUSTIN FITTS: Right, and one of the things we should mention is the Fed also committed in QE3 to keep yields down to 2015. So that means savers – the incomes have dropped dramatically. So we're talking about a

squeeze where the value of your assets are being hit. Your income is being dropped. Your expenses are rising all at the same time and it's coming sort of from every direction. Now you just went through a very complete list of all the potential changes.

If you look at the deals that Congress has been negotiating to replace the automatic changes – so to avoid the automatic tax changes, to avoid the automatic spending increases – they've been coming up with packages. One thing you didn't mention is those packages all put Social Security on the table. So they're talking about changes in Social Security benefits and the terms and conditions of Social Security, and that's a big political change

CHUCK GIBSON: But wait a minute. Wait a minute. I heard the debate last night and President Obama said Social Security is no problem. It's secure. Sorry, that was me being sarcastic.

C. AUSTIN FITTS: Social Security is supposed to be separate, and we're not going to talk about it tonight, but I have this whole presentation on the pretzel talk on the budget, what is on and off budget. And what is on and off balance sheet is absolutely political and arbitrary, and the fundamental structural problems are far greater. So Social Security is supposed to be separate and it is as a budget matter – separate – but the reality is as a cash flow matter, the baby boomers have been putting the cash in and the Social Security system has been buying US treasuries. So there's no cash in the trust fund; there's just US treasuries. Now the problem is the system needs people to keep putting money in.

The problem is the people who put the money in are now saying, "I want it back. I'm ready to retire," and that creates a $2.00 problem because the system needs the fresh dollar and instead somebody's saying, "No. I want the dollar back." So that's a $2.00 problem because now you're short. You're not getting that dollar. So now if you have to give $1.00 back you're short $2.00. So, in fact, if you look at the budget not as a budget matter or a legal matter but simply as cash flow. Social Security has to be part of the change because, as a matter of cash flow, they can't afford to give the dollar back. They need the new dollar to

keep on coming. And the reality is one of the reasons I didn't watch the debate is right now there's no political constituency in this country for transparency and real solutions because I think real solutions are more shocking than most politicians who are trying to get elected have the courage to say.

CHUCK GIBSON: Yes.

C. AUSTIN FITTS: Anyway, so there we go. There's the fiscal cliff and there's a ton of stuff on the budget because I suspect that it's not possible to kick the can. And the one thing, Chuck, that I think it's very important to bring out is if you look at the earnings of the S&P 500 and even the global companies around the world, they are highly dependent on contracts, purchases and other cash flows coming out of the US budget, including the US defense budget. The stock market is very tightly correlated to the money pumping through the federal budget and when you radically reengineer the federal budget you could radically reengineer everything, including the stock market. When you and I as money managers look at the fiscal cliff, we take a deep breath and say, "This could get really wild," including for the equity markets.

CHUCK GIBSON: Yes. I'll just close it on one final data point. It's been estimated that if all these things take place and they're allowed to take place, it could impact the US GDP by two to four percent. We're currently running, if we're lucky, depending upon whom you believe, at just barely above two percent. We're at stall speed. If you took another two to four percent out of that, you're talking no question, flat out recession.

C. AUSTIN FITTS: Right. If the GDP is rising at two percent but the money supply's rising at ten percent, is the GDP really rising or is it falling?

CHUCK GIBSON: Well, doesn't it matter where that money is coming from and where it's going to? Because if it's sitting in a vault, as Ben has proclaimed, then it really isn't rising at all, is it?

C. AUSTIN FITTS: Right. To me it's rising on Wall Street. It's not rising on

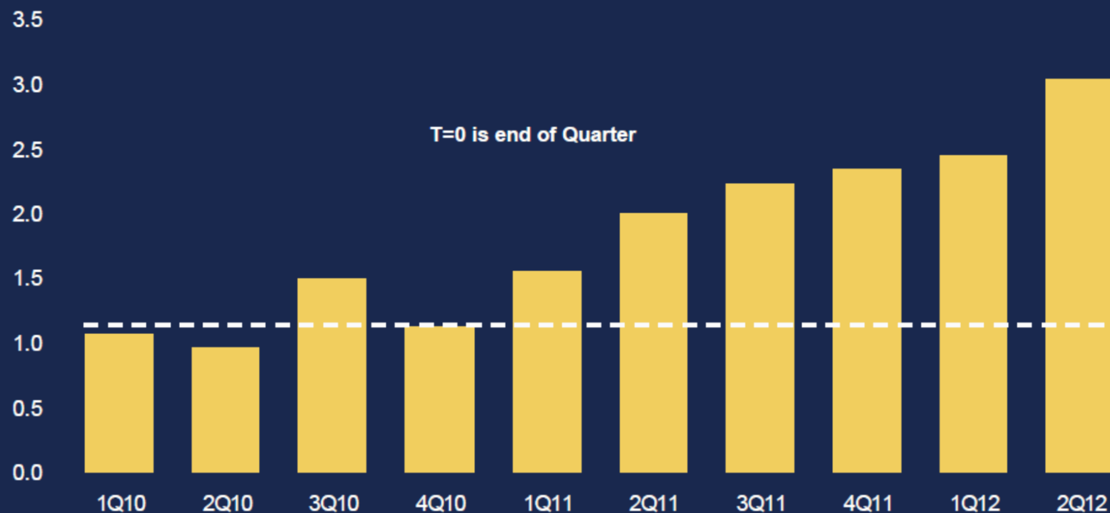
Main Street.

CHUCK GIBSON: Right, but I also have to say one thing. You know me well enough that a lot of what I say – well, not a lot – but quite frequently I'll say things tongue in cheek and you know when they are, so hopefully your listeners will understand that. There are some notes of sarcasm occasionally and I really don't believe some of the stuff that I'm saying. I'm just being a little bit smart-ass.

C. AUSTIN FITTS: Okay. So under headwinds we've gone through the economic slowdown, the global slowdown. Now we've just finished the fiscal cliff. Let's turn to shorter-term fundamental concerns.

CHUCK GIBSON: So I'll touch on these real quickly. There's the Dow theory. I don't know if everybody knows what that is, but Charles Dow, basically in summary and to simplify it, what he said is that if the markets are going to continue forward you have to have both the Dow Industrial and the Dow Transportation Index moving positively. They both have to be moving upward and what we're seeing today is that the Dow Industrials are rising in price, but if you look at the Down Transports they are declining. So there's a negative divergence going on there and, as such, that is a red flag saying, "Something has to happen." Either we're going to see a fall in the Industrials or we've got to see a turnaround and a turnaround pretty soon in the Transports. So that's one thing.

The other thing is market complacency. I look at this as a contrary indicator and we measure market complacency by the VIX, which is the fear index. I don't know if people have heard of that before, but it measures the amount of – let's call it hedges that the institutions are putting on the stock market. If a lot of people are hedging the market they're afraid that the market's going to go down, and what we've found is that that's a contrary indicator. So the more complacent it is, the more chance we're actually going to see a rise in the fear and therefore a fall in the stock market. We are at almost an all-time low as of this week, so that again is another potential. These are short-term headwinds because these can change reasonably quickly. The next one is, of course, the

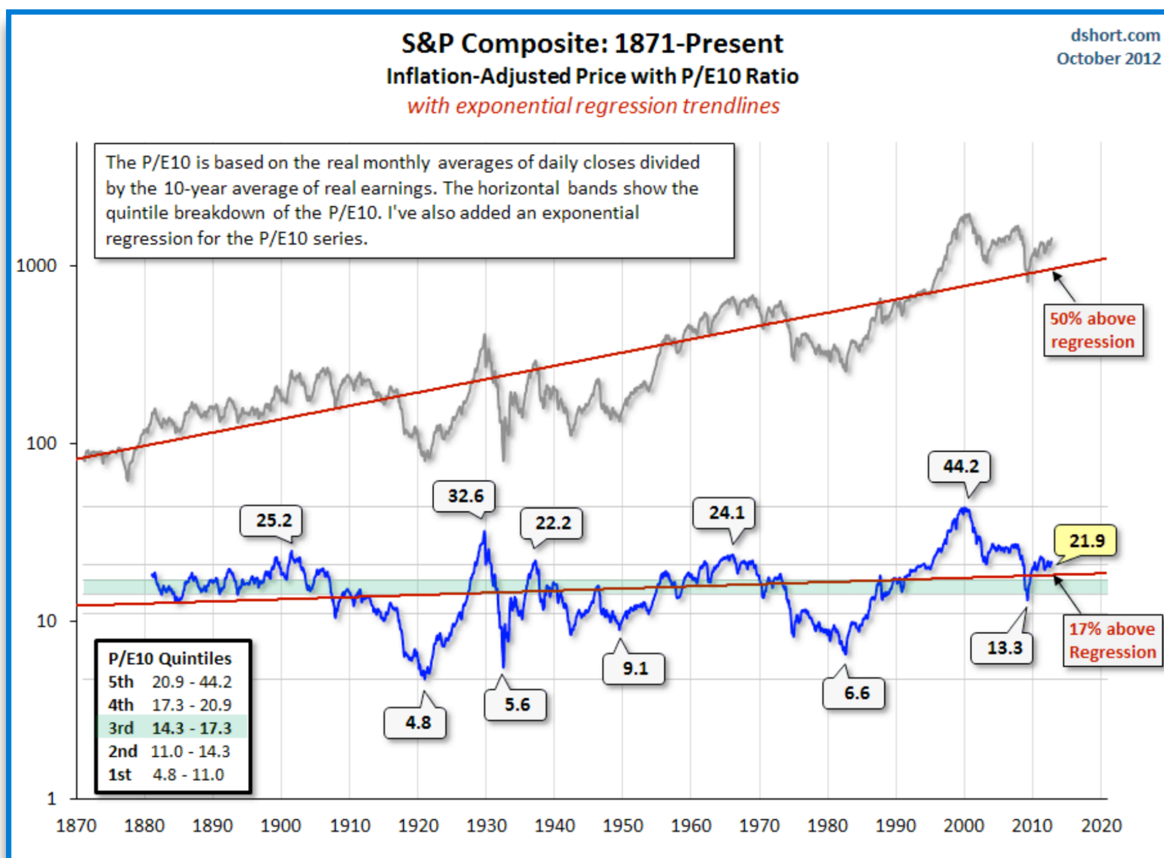


earnings pre-announcement, if you'll pull up chart number seven for me.

C. Austin Fitts: Okay. It's up.

Chuck Gibson: So just as an example just to name some big guys Intel, FedEx, Caterpillar and today Google all warned that they're going to have lower-than-expected revenues and/or earnings. And what this chart does is it is simply just the number of companies that have pre-announced negatively, so that they're saying that they're going to have a lower earnings and/or revenues than expected divided by the number of companies that are showing a positive or proclaiming a positive pre-announcement.

This only goes to Q2 and you can see it's been rising, but what we will see in Q3, they just did the analysis as of this week. It's up over a four, so the indicator on the left is up above four. It's not been higher than this since I believe it was the third quarter in 2001. Again, this is not a



positive sign if we think that stock prices are directly correlated to earnings because there are more companies by a ratio of four to one declaring that they're going to have a slow-down in earnings. So the next one, if you want to move to chart number eight for me.

C. Austin Fitts: Okay.

Chuck Gibson: Again, I'll try and simplify this. This is a valuations chart and you can look at either one of the two graphs that are on top of each other. It doesn't matter if you look at the top one or the bottom one. They're just different ratios. What you need to take out of this is that if the number today – if you look at either the blue line or the gray line – is above the red line that is cutting through the chart – if it's above that, that tells you that you are overvalued.

If you're under the red line that tells you you're undervalued, and what

it's saying though is that if you take that one step further you have a much higher probability of having a good return in the stock market the lower your valuations are.

You're going to have a better return if you're below that red line and the further you are below the red line the higher the probability you're going to have a good return, and the opposite is true, too.

C. Austin Fitts: Essentially, what it's saying is the PE ratios are above the historical averages?

Chuck Gibson: Yes. That's right, and not insignificantly, either.

C. Austin Fitts: Right.

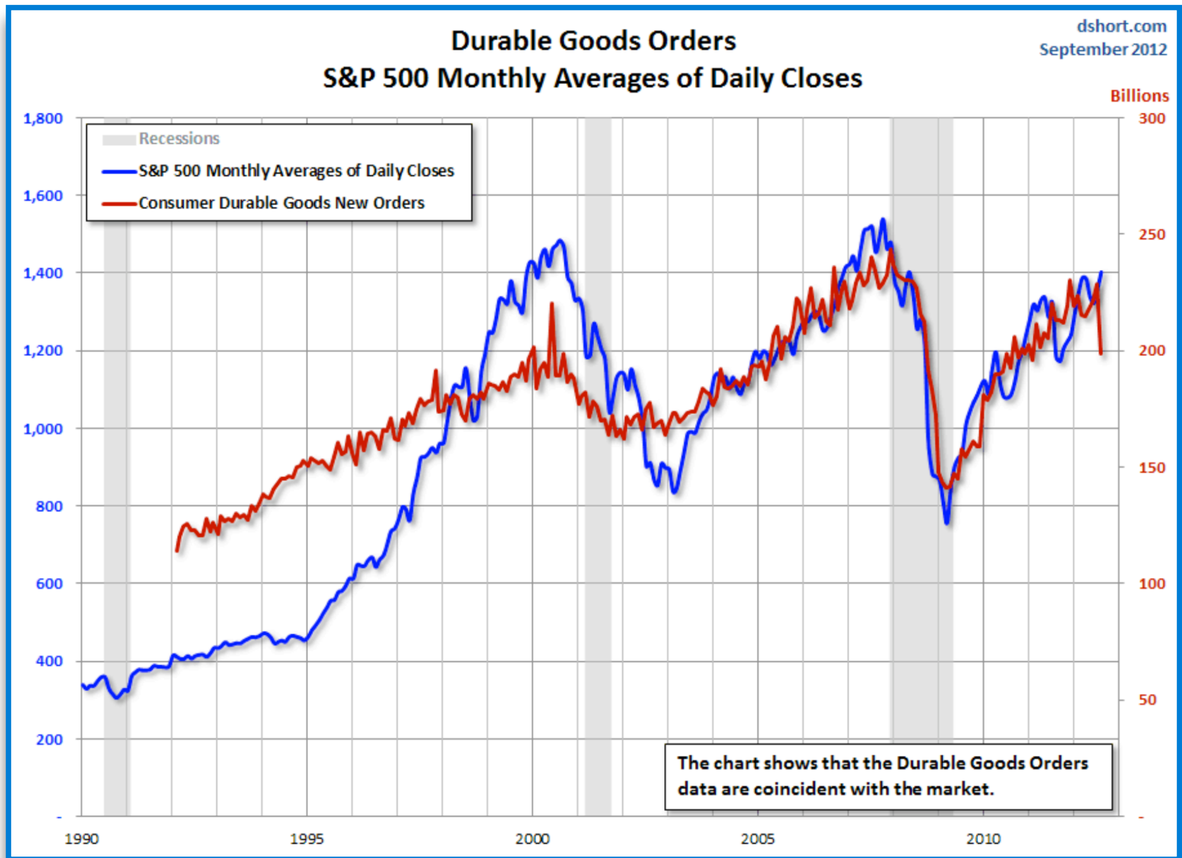
Chuck Gibson: That will expand, too, if prices stay the same and the earnings go down, right?

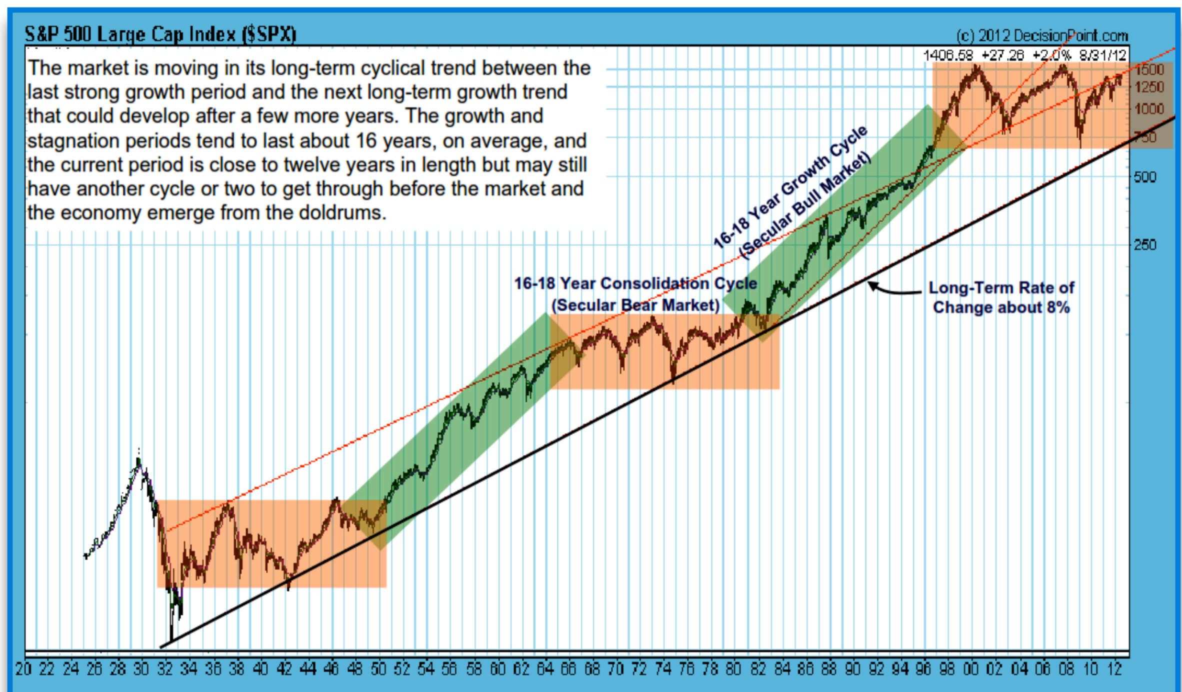
C. Austin Fitts: Right.

Chuck Gibson: Which is what we're saying is going to happen. That is not a very positive indicator going forward, and then if you go to chart number nine, I like this chart. It is kind of obscure.

It's looking at durable goods orders, but what you can see since around 2005 – durable goods and the price of the US stock market have been unbelievably well correlated. And what you're seeing there is the blue line is the price of the US stock market as indicated by the Standard & Poor's 500 and the red line is the consumer durable goods orders.

You can see the great correlation there, and look at what happened. If you go all the way to the far right-hand side of that graph, we've had a huge decline in the amount of durable goods orders that have been ordered this last quarter. Yet, the price of stock continues to rise. Again, that's a negative divergence and something has to change. Either we've got to have a quick turnaround on durable goods or we need to see a correction on the stock market if this correlation is going to continue.


Durable Goods Orders
S&P 500 Monthly Averages of Daily Closes
dshort.com
September 2012
Billions
Recessions
S&P 500 Monthly Averages of Daily Closes
Consumer Durable Goods New Orders
1,800
1,600
1,400
1,200
1,000
800
600
400
200
300
250
200
150
100
50
1990
1995
2000
2005
2010
The chart shows that the Durable Goods Orders data are coincident with the market.


S&P 500 Large Cap Index ($SPX)
(c) 2012 DecisionPoint.com
1406.58 +27.26 +2.0% 8/31/12
The market is moving in its long-term cyclical trend between the last strong growth period and the next long-term growth trend that could develop after a few more years. The growth and stagnation periods tend to last about 16 years, on average, and the current period is close to twelve years in length but may still have another cycle or two to get through before the market and the economy emerge from the doldrums.
16-18 Year Growth Cycle
(Secular Bull Market)
16-18 Year Consolidation Cycle
(Secular Bear Market)
Long-Term Rate of
Change about 8%
1500
1250
1000
500
250
20 22 24 26 28 30 32 34 36 38 40 42 44 46 48 50 52 54 56 58 60 62 64 66 68 70 72 74 76 78 80 82 84 86 88 90 92 94 96 98 00 02 04 06 08 10 12

C. AUSTIN FITTS: This one is a little scary to look at.

CHUCK GIBSON: Yeah. It is, especially since the fact that since 2003 there's a huge correlation coefficient. That's really the shorter term. You're going to get all kinds of noise in the market between now and the next six months, but let's take a look at longer term and take a look at the next chart, which is my favorite, actually.

C. AUSTIN FITTS: I almost had a seesaw moment on this one, too.

CHUCK GIBSON: Let me just explain this. The black line that you see that follows that line up – not the solid line but the moving line – that's the S&P 500 stock market prices. On the far left-hand side, that is when the Great Depression started and what you see is the secular bear market. So prices go sideways but from peak to bottom they are 50- to 60-percent rises to falls. And so you see a secular bear market from the start of the Great Depression until the end. You see then a secular bull market from that period of time, the end of the secular bear market until about 1964 and then we run right back into a secular bear market and then again a secular bull market. And right now, if you go all the way to the top, you can see we're in a secular bear market, which started in 2000.

At some point in time somebody's going to look at this chart and they're going to say, "Well, it's going to end at some point in time. Why is this a headwind going forward?" Well, it's interesting. If you go through and you do the analysis, the time periods are pretty close to being the same. It actually works out to be 17.2 years from the time that each one of these secular markets, whether it be bull or bear, left. Now there's some that go to 15 years and some that are 20, but there's a really very good correlation that's very close to 17.2 years from an average. If you look at where we started in 2000 and where we are today, 2012, we've only gone 12 years. Best case, the shortest secular bear market in the past has only been 15 years. If you believe these charts, we've got another three years minimum before we see the end of this secular bear market.

C. AUSTIN FITTS: Right, and if anything, you would expect a consolidation next.

CHUCK GIBSON: That's right. That's right. That's another chart coming up soon. That kind of summarizes the actual headwinds.

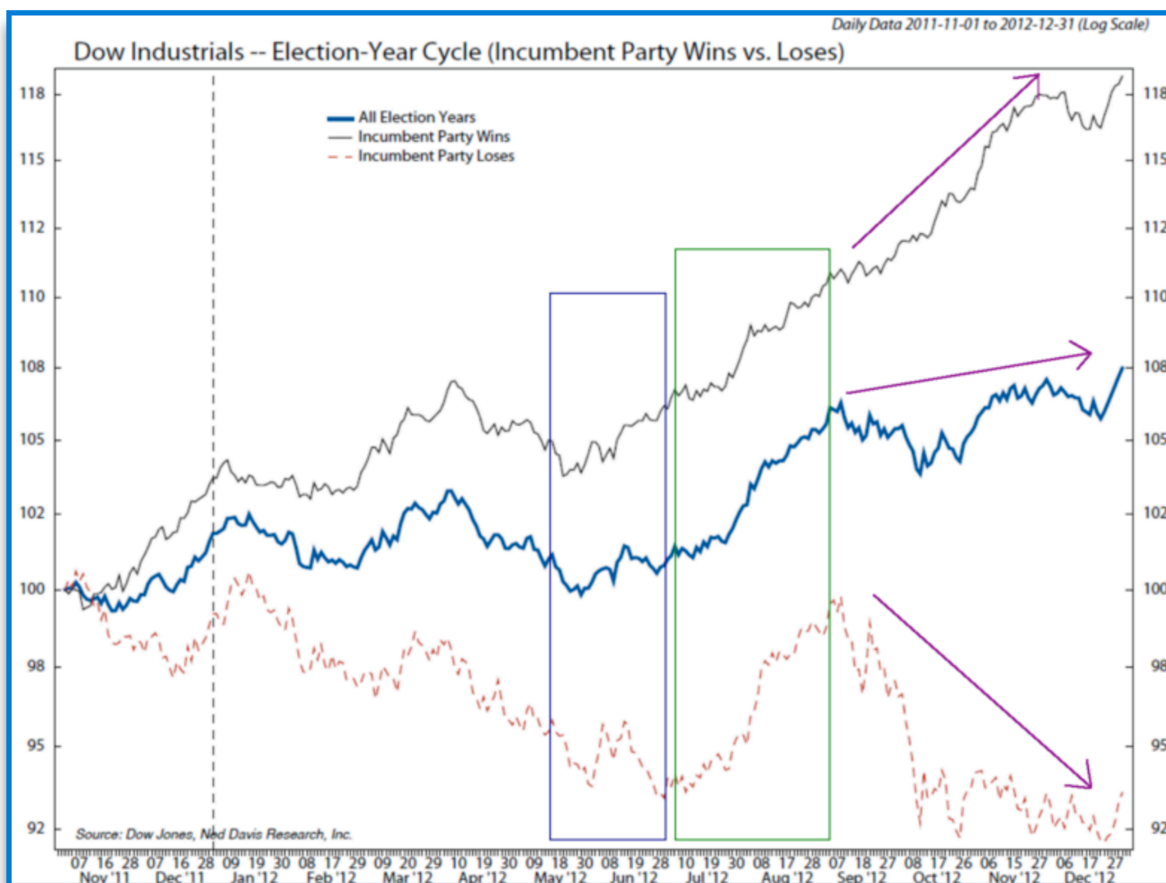
C. AUSTIN FITTS: Okay. Let me ask you some questions before I let you go forward into the tailwinds.

CHUCK GIBSON: Sure.

C. AUSTIN FITTS: Before we get to the good news, when does chart 11 come? Because that's my favorite chart.

CHUCK GIBSON: That's the next one.

C. AUSTIN FITTS: That's a tailwind but maybe we should do that first, and then I've got some questions I want to ask. Let me switch over to chart 11, and this is one you do not want to miss. Okay, Chuck, take it away.



Chuck Gibson: So we've switched from headwinds to tailwinds. Now the one thing I have to say with regard to tailwinds: there's a lot less of them but in my mind the ones that we have are extremely compelling. So I think people need to take note of this. So the first one and the only one we have that's a short-term one, which is the one you've got up posted, and I think this is actually pretty good. You see three lines there. The top line is what happens to the stock market during an election year if the incumbent wins.

The bottom line is what happens to the stock market during an election year if a new candidate wins and, of course, the middle line, which is the blue line, is what happens when you blend to two together. So this is unbelievably compelling from a standpoint of prior to last night everything that I had seen had Obama out in front, and it was going to be really hard for Romney to win. And so we were all sitting here waving the rally hats for the balance of the year, but I'm not so sure that's going to be the case anymore after what happened last night. So why don't you jump in and talk about the politics of this. I think it's great.

C. Austin Fitts: One of the things I find interesting about this chart is, in all years during the election, the market's up. Now we know 2008 was an exception to that because we had quite an extraordinary event, but generally in an election year the central banks are accommodative, usually particularly of the incumbent. And, of course, there's all sorts of analysis to show that the Republicans are not as bullish on the stock market for the stock market. So a switch to a Republican is going to not necessarily be as good as the Democrats.

The Democrats, in my experience, are traditionally more lenient towards the financial institutions, but I was amazed to see the divergence between a switch from the incumbent to keeping the incumbent. I never expected the divergence to be as great as what's shown here and it's quite remarkable. You can kind of understand why the central banks are supportive of the incumbents as they are. This one was quite a shock and I would encourage everybody to look at it.

Chuck Gibson: I think the other thing that's interesting, although it doesn't

show it – and remember, this is only for the election year. If Obama wins we would expect to see another huge increase in the market from now until the end of the year, what is interesting is what follows the year after. That may be another discussion for another call.

C. Austin Fitts: That may be another story entirely.

Chuck Gibson: This is why I'm saying make sure everybody understands this is a very short-term chart and it's good basically for the rest of the year.

C. Austin Fitts: Right.

Chuck Gibson: Do you want to take those questions?

C. Austin Fitts: Yes. I'll ask you this one, even though I should really wait until the precious metals market report, but one question is, "Are you surprised at the silver/gold ratio?"

Chuck Gibson: You want to answer that or do you want me to?

C. Austin Fitts: I want you to.

Chuck Gibson: Well, I'm not surprised now because I think silver's going to continue much higher and much faster a rise than gold will and for me, we had the consolidations. Silver got whacked much harder than gold did, so we saw a rise in the gold to silver ratio. And then what we're seeing now is that over-performance in the silver market and a very nice movement in gold, but nowhere close to being what we're seeing in silver. So I would expect to see that ratio continue to fall in my mind as long as precious metals continue their rise.

C. Austin Fitts: Right. What I will say is, given my concerns about corrections in all tangible assets next year, silver makes me very nervous right now because I think silver could be wildly volatile next year.

We got some great questions on derivatives and the shadow banking

system, which deserve *Solari Reports* of their own. I'm not going to ask them tonight, although I'll send them to you. A couple more comments. Looks to me that the market is stimulated with QE then QE stops and markets correct but then it reaches previous levels before more easing. This suggests markets went up without easing, that you get a boost with QE. I think that's what you were saying and this comment probably came in before they got an opportunity to see the earnings and hear what you had to say with earnings. Keep posting questions if you've got them at the webinar software. Let's keep going on tailwinds and let me switch to the next chart.

CHUCK GIBSON: Okay. Well, we're not on that chart yet. We're jumping to the longer term and, of course, it's just a topic that you've seen intermixed in all the discussion and that's the ongoing, continued money printing. The reason I want to emphasize the first couple of charts was to watch what the value of the dollar was doing and the impact on risky assets. I lump all of those oil and stock markets and precious metals into a risk asset bucket. So what we're seeing is this ongoing. It's not just in the United States. It's not just in Europe. It's not just in Japan. It's not just in China. It's all around the world. All the central banks are devaluing their currencies, which bode well. That's a huge potential tailwind for all "risky assets."

C. AUSTIN FITTS: Right. Now the thing to remember, though, from an investor's standpoint – your gold and silver and your stock market assets may be going up but their purchasing power is not necessarily going up anywhere near as much.

CHUCK GIBSON: That's right.

C. AUSTIN FITTS: So that's the thing to remember.

CHUCK GIBSON: But we'll get to that other chart that shows you it's much better than being in government debt or cash.

C. AUSTIN FITTS: Right. Okay.

CHUCK GIBSON: You want to jump to the next chart, which should be chart number 12?

C. AUSTIN FITTS: Yes.

CHUCK GIBSON: Okay. So this one, I apologize. This is a convoluted argument, but for me this is the strongest argument for equities long term and it's going to take me a second to get through it, but bear with me if I don't explain it very well. Hopefully, you can step in and help me out. I've come to the conclusion that, in spite of what I originally thought, I think bond yields – we've already been told they're going to keep bond yields low until 2015 at least.

C. AUSTIN FITTS: At least.

CHUCK GIBSON: What this chart is, is it's the greatest bull market that we've seen. This is the bond market and it's been going on for almost two-and-a-half decades and the question is that it can't go much lower. They can't go much lower.

C. AUSTIN FITTS: And this chart is showing the yields. It's showing the yields coming down.

CHUCK GIBSON: Yes. Correct. So you would flip this over if you wanted to

see the price of the bonds.

C. Austin Fitts: Right.

Chuck Gibson: Right, but here's my argument. We all know that they're going to keep rates accommodative for a long period of time. We also know that my guess is that they're not going to be able to come to a budget that's going to be balanced. So we're going to continue to add to the debt and as such, when you add to that debt, the cost of servicing that debt becomes greater and greater each year. They're going to have a greater and greater incentive to keep rates as constrained as they possibly can because here's an example. Just do the math, as they said last night in the debate. If you take a $16 trillion deficit and you have to pay interest on that and if interest rates rise just 1 percent. A 20-year bond is at 2.4 percent, let's just say it rises to 3.4 percent.

That's way below the average it's been over the last 20 or 30 years, but let's just assume it rises a simple 1 percent. That's going to cost the government another $160 billion each year and growing because we know that deficit's going to continue. So what's going to happen is if they don't keep those rates constrained they're going to have no way to be doing anything other than servicing the debt and all of the entitlements and all of the other federal budget issues and items that they pay for are going to have to be addressed even more. There's going to be more cuts coming, so my argument is that we're going to continue to see constrained bond prices. Now you take that one step further.

C. Austin Fitts: We just got a question. Someone wanted to know what is a non-risky asset?

Chuck Gibson: Well, I'm not going to say this tongue in cheek, but what people consider to be a non-risky asset is a government US treasury.

C. Austin Fitts: Right, although I think you and I think that there's real risk in the US treasury.

Chuck Gibson: Absolutely, and that's why I said it's kind of said tongue in

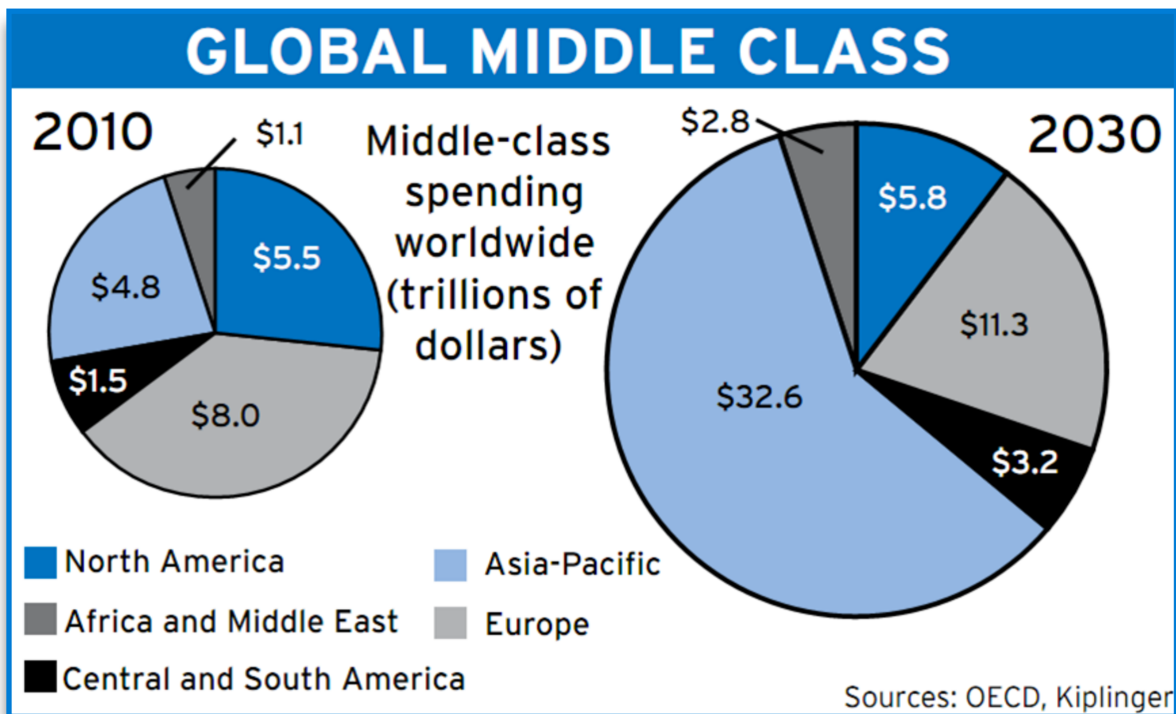
cheek. It's a piece of paper, but that is traditionally what our industry calls it. So let me just finish this last part of the argument. So the baby boomers control the biggest amount of wealth in the United States and as such, baby boomers are just now starting to retire and the baby boomers – and I've gone through this in my own practice of late. I can't tell you how many times that what they're finding is that the traditional model is you're supposed to be investing in less risky assets as you get older because you can't afford to lose money. So the traditional model has always been to invest in bonds.

Well, if you go and give the government $100,000.00 and let them borrow that from you, you're going to get $200.00 a month for that $100,000.00. That's not going to be enough for people to live, so people have to decide, "Do I need to cut my lifestyle back such that I can actually afford it and live within the meager income I'm making on my investments or do I need to take more risk?" And the only place that you're going to be able to boost your returns, either through a greater dividend or income stream or a rise in values of your assets is through stocks or hard assets – precious metals, land, things like that.

The other thing is that all it's going to take is a small amount of money of the baby boomers moving out of bonds into other assets, and a recipient of that is going to be the stock market. And remember, there's three times the amount of money in bonds than there is in stocks globally. So all it's going to take is a very, very small amount to be able to affect the prices of the stocks over time. While there's a very well known prognosticator out there saying just the opposite, I think in his estimation that his assumptions were based on a yield on a treasury bond of six percent. Right now a 30-year treasury for the next 30 years you're going to get 2.8 percent. That's not going to cut it, so people are going to have to take more risk.

C. AUSTIN FITTS: Right, and the purchasing power is dropping dramatically.

CHUCK GIBSON: Absolutely. I haven't even touched on that. I'm just making the argument for the sake that this is why I think long-term stocks are not going to – everybody is afraid. There's so much fear in the markets



right now that the world's going to collapse and I just see it as a viable asset, just as viable as everything else; in fact, more so. Then let's go to the next chart, and I think this is one that you like and I'll let you address this one if you don't mind because this goes back to our emerging market discussion of China, India and Hong Kong and why we think that that's the place to be.

C. AUSTIN FITTS: Right. Wait a minute.

For the Financial Salons we've been looking at projections of what the global middle class – how it's going to grow. And what we're seeing is that the middle class in the developed worlds and in North American Europe is not growing. I think in this presentation in this slide we've got 2010 middle class spending in North America's $5.5 trillion and by 2030 it's almost the same. It's $5.8 trillion. Europe as well. Europe is going from 8 to, I guess, 11. Europe has a little bit more growth, but what we see is Asia going from $4.8 trillion to $32 trillion. So dramatic, dramatic growth in the Asian markets, a doubling in Central and South America and growth in Africa and the Middle East as well. More than a double in Africa.

If you look at the percentage terms, the future looks very bright and, in fact, what's happening is the global middle class is growing and, in fact, growing dramatically. I'm always referring to various people describing the rebalancing of the global economy. The U.S. consumer is used to being the number-one consumer and driving the markets. In fact, that's changing and so American consumers are diminishing in importance and the rising middle class and the emerging markets are sort of replacing them in a rebalancing of the global economy.

And one of the charts that's in the Salon presentation that's not here is what that also means is that if you look at the percentage of the publicly traded equity markets that relate to companies from the developed world, the Asian companies and the emerging-market companies are growing in terms of market cap and will ultimately in this century surpass. Whether it's middle class or market capitalizations, we are watching a tremendous rebalancing of the whole global economy. The good news is there's a lot less poverty. The bad news is –We'd better get into the world that's being born if we want to take advantage of it.

CHUCK GIBSON: We talked in our last discussion on technology, so there's no sense in going into full detail on that, but besides the global middle class growing, there's an ever-needful and expanding technological element to our lives and that's going to be one of the driving factors.

C. AUSTIN FITTS: Right, and again, if you haven't listened to that *Solari Report* we did on the *View From Silicon Valley* I would really encourage you to. Okay, you ready to talk about volatility?

CHUCK GIBSON: Yes. Let's wrap this bad boy up.

C. AUSTIN FITTS: Okay. This is one of my favorite parts of the discussion.

CHUCK GIBSON: Yep. Do you have the chart?

Okay. So this to me is extremely interesting. I use this all the time to try and set expectation, not that this is a predictor of the future, but it gives you a snapshot into the past and what you have to understand and

A history of declines (1900–December 2011)

Type of decline	Average frequency[1]	Average length[2]	Last occurrence	Previous occurrence
–5% or more	About 3 times a year	47 days	November 2011	October 2011
–10% or more	About once a year	115 days	October 2011	July 2010
–15% or more	About once every 2 years	216 days	October 2011	March 2009
–20% or more	About once every 3 ½ years	338 days	March 2009	October 2002

Past results are not predictive of results in future periods.

Source: Capital Research and Management Company℠

[1] Assumes 50% recovery rate of lost value.

[2] Measures market high to market low.

accept or not is what you can expect going forward. I'll just give you a quick synopsis. This looks at the history of stock market declines from 1900 until the end of last year and what it does is it breaks it down into different categories. You can expect a five-percent correction in the market approximately three times a year and it lasts 47 days, and the last occurrence of this was in November of last year. Now, again, this chart hasn't updated through 2012.

It only includes 2011 and the prior occurrence of that was a month earlier in October, so you can expect five-percent corrections regularly. Most people don't get too bothered by five-percent corrections. Now let's go to the ten percent. That happens approximately once a year. It lasts for three-plus months and the last time that happened was in October 2011 and, of course, the prior time to that was a little bit more than a year before that. Now we get to the more painful subjects, which are a 15-percent correction and that happens approximately every two years. And again, I won't go through the details there but you can see the last correction that was more than 15 percent was, again, back in October of last year.

Then it comes to the gut-wrenching 20 percent and that happens on average every 3-½ years and it gives you the length of time that it takes. Look at that. That's almost a year and the last time this happened was 2009 and add 3-½ years. Well, if you can believe the chart and you want

to use averages, it's in our near future, one can expect. But, again, you have to be able to live through those levels of volatility and not react to them because they are just normal. As much as we don't like to go through them, as painful as they are, you accept them if you're going to be in the asset classes that are going to protect you against currency debasements.

C. Austin Fitts: Right, and if you look at precious metals it's even worse, particularly silver.

Chuck Gibson: Yes, particularly silver.

C. Austin Fitts: Right. Let me pull up the second chart on volatility because this is the one I love to use in speeches and presentations and it compares six different investments from the beginning of 2003 until mid-September.

And the first is it shows a five-percent bond, which could be a bond or a CD, and you put in $10,000.00. You get almost $5,000.00 of interest along the way and when it's over you get $10,000.00. I did another chart that's up on the blog in a commentary called "Positioning Your Assets," where I describe by 2008 your $10,000.00, Chuck, had lost 50 percent of its purchasing power when measured in gallons of gasoline. So in that five-year period alone your money in terms of gallons of gasoline

	Starting Price	Dividends /Interest	Ending Price	Low/High	Gain
5% Bond	$10,000	$4,850	$10,000	-	-
1% Bond	$10,000	$971	$10,000	-	-
ISRG	$10,000	0	$382,000	$7.50 - $588.30	3720%
PVD	$10,000	$27,903	$86,545	$8.90 - $96.80	765%
Gold	$10,000	0	$51,483	$343- $1,895	415%
Silver	$10,000	0	$74,176	$4.37- $48.70	642%

to drive your car around got cut in half just from sitting in a fixed-income deposit. Oh, my word. We left the four.

CHUCK GIBSON: Yes. I was going to mention that, but I was also going to mention in that last comment that you made, but when people get their statement this is always the argument for these bonds. When they get their statement it's the same value that it was last month and people like that. They like that paper consistency.

C. AUSTIN FITTS: Yes, and when real assets, whether it's precious metals or companies, are going down 20 percent it feels great not to be going down.

CHUCK GIBSON: Exactly. Exactly, until they have to go to the pump and, again, buy the gas. It's a covert way of taking your money. You don't see it in your statement and people just focus on the statement that they get of the value of their assets. So you've got to get yourself conditioned to that way of thinking, but you're right. I left the four in the next line. I apologize.

C. AUSTIN FITTS: When I was trading on Wall Street, everyone assumes you wanted to own real things and bonds were simply a way of getting other people to pay you to own and control real things. But the goal was we control the real things and we get you to finance us controlling the real things. That puts us doubly in the power position and what we're really talking about here is can we instead say, "Okay. I'm ready to own real things"? But that means we have to embrace the real world and the fact that Wall Street in the process of trying to keep everybody in the bond market has every reason to want everything else to be quite volatile. So with interest rates going down our second investment – we're now looking at one-percent bonds.

So $10,000.00, instead of getting almost $5,000.00 of interest during the period, a one-percent bond gets only $971.00. So you lose half your purchasing power and you get only $971.00 along the way. As you said, the drop in yields gets us to the point where this doesn't make very much sense. Let me drop to the bottom and then I'll come back to the

middle. *Solari* subscribers are pretty familiar with gold and silver. Gold during the same time kept the purchasing power. Silver even better that that. Gold was up 415 percent by September and silver up 642 percent.

So I think here at *Solari* we all understand the case for gold and silver. I always say gold and precious metals is a way to bridge. If you're trying to get money out of the world that's dying and over into the world that's being born, it's a great bridge. It's simple. It's clear. It's understandable. It's easy to use in that sense, but if you look at the two in the middle, the first one is the most successful maker of surgical systems, Intuitive Surgical. So if gold was up 415 percent, Intuitive Surgical was up 3,720 percent, which says to me that humans value human life a lot more than gold sitting in a vault, which I think is true. My father was a surgeon so I very much relate to this, but as you can see, the volatility and the spread in prices during the period was quite dramatic.

The second one is the Chilean pension fund manager, Provida. Chile has a very interesting pension-fund system and everybody has to participate in the national system but you can choose your pension-fund manager. PVD is the largest and, again, this was a stock that plummeted during the fiscal crisis, so tremendous volatility but this stock pays a quite significant dividend because of its near-monopoly position in Chile and also significant pension-fund management across Latin America. It can afford to pay a very high dividend, and not only is it paid that very high dividend but it's gotten a 765-percent gain, outperforming both gold and silver.

We have examples of companies, whether technology and innovation or emerging markets, that are very significantly in the world that's being born in the primary trend up and they're out-performing gold and silver. Of course, we picked two of them. I think the beauty of gold and silver for me is it's pretty simple to figure them out and monitor them. Trying to make sure you pick the right surgical-systems company – that's a very complex task but it's a perfect example of what you're describing as the risk assets, showing much more volatility and swing during this period but also protecting purchasing power in a way that the bond market simply can't begin to do.

What I hope to do in part with *The Solari Report* is help people leave the protection of the bubble where you had more certainty and go to the real world and learn to manage the volatility because it's by doing so that we can protect ourselves by getting much closer to what the tangible assets are and whether we're buying them and doing things for ourselves in our own lives or how we invest in the equities and the commodities markets. I think if we can all embrace the real world we have a much better chance of protecting our purchasing power and building wealth. That is our last slide.

CHUCK GIBSON: I have one final comment, and I always ask everybody the same question. If you take a snapshot, would you rather give $10,000.00 to the US government and earn 2.8 percent and have no volatility or virtually no volatility but get debased or would you rather put your money into a company like PVD that's going to pay you, depending upon when you buy it, 7, 8, 9 percent annually and also have the potential to have capital gains on that? So the value of your assets are potentially going to be greater than they would be at the end of the time period. Which one would you rather have? The only difference is it's pretty clear.

The only problem is can you live with the volatility? That's the only downside.

C. AUSTIN FITTS: Right. Well, I think that's a question we each have to come to each in our own way. I'll never forget when I first started to invest in precious metals the first time it took a major swing down I confess for three days I just went outside and talked to the cows and dug in the garden.

I couldn't look at the screen because that was a kind of volatility that was new to me. So I think we each have to come to this each in our own way. Well, Chuck, I can't thank you enough for all your good work on these charts. Again, ladies and gentlemen, the charts and the outline are also up in the subscriber space on the blog post and Justin will have the audio up if not tonight by tomorrow and the note shortly thereafter. So please take time and go through this again at your leisure and enjoy this

material at your leisure. Chuck, thank you so much. Have a great evening.

CHUCK GIBSON: Thank you. You, too. Have a great rest of the evening.

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Nothing on The Solari Report should be taken as individual investment advice. Anyone seeking investment advice for his or her personal financial situation is advised to seek out a qualified advisor or advisors and provide as much information as possible to the advisor in order that such advisor can take into account all relevant circumstances, objectives, and risks before rendering an opinion as to the appropriate investment strategy.