The Solari Report

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Fed Taper and Commodities

with Don Coxe

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C. AUSTIN FITTS: Well, ladies and gentlemen, it's my pleasure to welcome to The Solari Report Don Coxe of Coxe Advisors. Don has many decades of very extraordinary experience in the investment world. He's based in Chicago. His global commodity strategy team advises several commodities funds both in Canada and the United States, and internationally, and he's just launched a new strategy service, which is outstanding. I've just had a chance, Don, to read your new strategy journal and look at some of the Web cast transcripts. I can't recommend his journal and Web case enough. You can learn more at CoxeAdvisors.net.

So, Don, welcome to The Solari Report.

DON COXE: Pleasure. Thank you for inviting me.

C. AUSTIN FITTS: We want to talk today about both the Fed taper and commodities, but one of the things I think you covered very well in your new strategy journal is what the consequences of the Fed policies and quantitative easing is on the economy and what some of the risks are. Maybe we could start there and talk about what the extraordinary injection of Fed intervention is doing in the markets, what it's doing to investors and what you think it means to the commodities market.

DON COXE: Well, I'll begin by telling you three years ago I was speaking at a conference in Denver, and the speaker before me on the line was David Dodge, who has recently retired as governor of the central bank of Canada and followed by Mark Carney. We had known each other not that well for quite a few years, because I've been in Ottawa so much. He spoke first and he said that what had been done by the central banks was extraordinary, but it was important that they go back to conventional monetary policy as soon as possible because of the potential particularly inflationary risks of continuing to make injections on this scale and having these zero interest rates.

So while he was talking, the analogy occurred to me. When I spoke next, I said my father was a doctor in the Canadian army in World War II in the Italian campaign. He did more battlefield anesthetics than any other Canadian doctor, for which he received a citation. He said that for the severely wounded soldiers, what they absolutely had to have was heroin. That was the only anesthetic that worked, but he said it didn't take any skill to give them the heroin. The skill came in withdrawing them from heroin and putting them onto morphine or another analgesic as soon as possible, because if they stayed on the heroin, they would become addicted and their lives would be destroyed. Too many occasions of that did exist.

So then I paused. I said zero interest rates are financial heroin. David Dodge's head snapped and he said, "That is a great analogy." That was three years ago. We're still there.

Now, what is financial heroin? What it is, is it makes you feel good, and one of the things you certainly don't want to do is take on risks. What we've seen is that the S&P just keeps going in new highs, along with record highs for short-term borrowing for stocks. I call it the Fred Astaire-Ginger Rogers routine. They go up absolutely perfectly together. With this we have the approach that the way you value companies is not on the basis of long term, because the crash took away the idea that there was a long term we could count on. What we have is that companies must not be trying to tell their stockholders, "We have a five-to-seven-year plan and we've got capital spending for this." No. They're saying, "You've got cash in the treasury, so pay us higher dividends and buy back stock."

Well, that was an agreeable thing for managements, because they all have stock options. So what they discovered was something that made them rich and satisfied stockholders. The stocks performed well on the basis of doing this, but none of this has anything to do with capitalism as a system, where risk is done to assume rewards with a longer-term vision, and that is the central dynamic of capitalism. So, what we are doing here is operating a system for which we have no precedent, which is one for insiders and current investors who are very short-term in their orientation. So are we surprised that we're only getting two, two and a quarter percent economic growth? Well, if you take risk from the system, you're not going to get more economic growth.

> **"Are we surprised that we're only getting two, two and a quarter percent economic growth? Well, if you take risk from the system, you're not going to get more economic growth."**

C. Austin Fitts: I think the S&P was up 29 percent last year. Companies with major buyback programs were up 45 percent on the S&P, so it made an enormous difference, and my calculations show that if you add the buybacks to dividends on the S&P, they're paying out about 80 percent of their earnings. So, how can you have major reinvestment? One thing I thought you did a great job in the journal of pointing out is how much of this is being financed with borrowing cheap money? We have corporations really driving profits up from borrowing and reengineering their balance sheets, not from doing anything that contributes to the general economy.

Don Coxe: I used the illustration of what Apple did, where they had the most sought-after bond sale of last year, $450 million that they raised, and not one dime of it was to be invested in the business. All the money was being used to pay dividends and buy back stock. So here was the company that had sort of defined the changes that had occurred in our world, leading to revolutions in the Arab world and all of this. That was before we got the announcement at their meeting, in which the CEO announced that they're going to be devoting more of their energy to fighting climate change. Well, that's a nice thing if he's personally a member of the National Resources Defense Council and wants to block Keystone. That has nothing to do with creating great new products.

C. Austin Fitts: I couldn't agree more. Well, one of the things that I think was surprising for many of us was coming out of the beginning of the century, we had something called the commodity super-cycle, which I'd love for you to explain. Yet, during 2008 we saw commodities take a nosedive, then come back into 2011, but it's been dropping ever since, despite the quantitative easing. So maybe if you could talk about the commodity super-cycle and what's been happening. Are we still in a commodity super-cycle?

DON COXE: Well, thank you. The commodity super-cycle came after the end of a 21-year triple-waterfall crash. I wrote a book about that called *The New Reality of Wall Street*. If you go back to the '70s, which is when I came into the business, what you had was a commodity boom led by the quadruple price of oil, which was done not so much by oil demand increasing but by OPEC and to punish the Western nations for supporting Israel. Those were extraneous events, but when you had a quadruple price for oil and central banks printing money, what we had was double-digit inflation. So it took Paul Volcker in this country and Margaret Thatcher in Britain to come up with the tough monetary policies and high rates to knock down particularly the price of gold, which had gone from $35.00 an ounce to $800.00, and also to take the inflation furor right out of the system.

Meanwhile, a lot of capital spending was launched on the basis of ever-rising commodity prices. So it took two decades to finally get out of that system, and we came into this new millennium. What struck me (I started writing about it in 1999) is we got a whole new set of commodity buyers: the Chinese. They haven't figured in this, but China is now ready to reenter the world 500 years after the emperor of China stopped having their ocean shipping going around the world. They had actually circumnavigated the globe before Magellan, and he said, "No, our fleet will be kept here." China chose to stay at home, and then they of course got fouled up with wars, invasions, and then the various European countries carved up parts of China.

The most important single travel event of the last century was in 1978. Deng Xiaoping visited Britain at the behest of the Labor Party to see how the working classes were being devastated under capitalism, which drew exactly the opposite lesson. He couldn't believe how well off they were with their city housing, and they had cars and television sets. So, he came back and he made a small editorial change in the signs of Mao Zedong everywhere, which is, "To work is glorious." He changed it to, "To be rich is glorious." It took quite a while for this to work through the system.

C. Austin Fitts: Wow. I didn't know that.

Don Coxe: I was studying this and I realized their economic growth rate had been double-digit right through the '90s, which meant that we had more than a billion people who had gone from not being part of the global economic system because their average caloric intake was 950 calories a day, and they were coming up over the 2,000 mark.

I had formerly been head of the Ontario Federation of Agriculture and general counsel of the Canadian Federation of Agriculture. I knew that there just wasn't enough grain and food being produced. I could also see that there wasn't much chance of copper and iron ore being produced from what we had. It was apparent to me that one of the things that the commodity collapse had been related to was also a demographic decline across the industrial world, because with each new generation arriving and reaching, let's say, age 21, it was 40 percent smaller than the previous generation.

That meant there would be no embedded increase in commodity demand, so what we needed was a couple of billion more consumers. So, since my father had been born and raised in India, I was a fan of India and Manmohan Singh, when he was finance minister, had finally dealt with a license rash, I said we've got two billion more consumers, and we don't have enough commodity supplies. So I proclaimed in February of 2002 the birth of the greatest commodity boom of all time. A radical view at the time for which I was ridiculed, but it unfolded and then we had the crash. Now, the crash was not a commodity crash. It was a financial crash created by what I call the big bad bonus bailout bankers.

When you destroy the financial system, you cut down demand for everything. By that time a lot of capital spending had been launched, and when you open a new mine, it takes seven years or so. What happened was a lot of CAPEX (which was planned in the years 2005, 2006 and 2007) didn't come on stream until well after the crash, so it gave people the false sense, then, that the commodity boom was over.

Well, the fact remains that people's incomes were rising, not just in China and India, but Indonesia as well. They passed the 2,000-calorie point, so therefore the fundamentals of what had given us the first wave of the commodity super-cycle were in place. All that we needed now was to see that those economies continued and that the capitalist economies after coming out of the crash would revert to normal economic growth. We didn't get the second part of that because of the financial heroin, so we've had slower economic growth, and therefore slower overall growth in commodity demand.

But the fact remains that we bottomed out a long time ago in the commodity indices. What we have then is a situation, where now they are rallying. Only a week ago, finally, the CRB Futures Index climbed up through its 200-day moving average. So you looked at the rally that we've seen in gold, triple-digit prices for oil, record prices for coffee. Here and there what we're seeing is demand outrushing supply. Although it's not going to look as easy as it did the first time because that occurred at a time of the strong economies in the industrial world plus insatiable appetites from these emerging economies. Those appetites are now somewhat satiated, but we know that people then want to maintain their lifestyle. So, though there will be more demand for food and foodstuffs, and more demand for metals, it will not be as robust as the first time.

Two years after I said that, Chris Patton, the last governor of Hong Kong, said for the first 17 centuries of what we call the Christian era, more than half of global GDP was in China and India. They did not experience the Industrial Revolution. They fell back. He said in this century, they will resume, and by the middle of the century, they will have more than half of global GDP. That means that they are going to be consuming more and more commodities. He's right.

C. AUSTIN FITTS: It's interesting. Over a billion smartphones were shipped last year, so we now have, I think, 1.8 million people on smartphones and all those people are coming into the consumer society and the consumer economy. I'll never forget one of the best descriptions I heard of the phenomenon you're describing. I was at the gold conference in New Orleans and somebody asked Jim Rogers if he was concerned about peak oil. He said, "Forget peak oil. It's peak everything."

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DON COXE: Because the only place in which we've had a boom in CAPEX has been in fracking in this country, and the oil and gas exploration industry is behaving like true capitalists.

C. AUSTIN FITTS: That's true.

DON COXE: If it weren't for the growth we were getting from that and the reduction in energy costs that we're getting from that, our growth wouldn't be much more than that of the Euro zone.

C. AUSTIN FITTS: Although I do see a fair amount of reinvestment now starting in manufacturing with the gas price coming down as low as it has. There's a lot of investment in high-automation areas, manufacturing being one, so I'm hopeful, and of course continued investment in agriculture. One of the things I thought was very interesting, you pointed out the different obstacles China has to becoming a world power again. The biggest one being, of course, they don't have a navy. They just launched their first aircraft carrier, but I thought it was interesting in your discussion of their assertion of military rights in the South China Sea and the concern that they've become a military force as well.

DON COXE: That is scary, because there is, unfortunately, no precedent for a new major economic power coming on the scene to challenge the existing entrenched things without it leading to a war. The most recent example was, of course, when Bismarck reunited the German-speaking parts of Europe to create Germany. After he'd moved along on this and was industrialized following Britain and the United States, then he decided it was time to get a navy. As we know, what that did was scare the British enough so that they started building dreadnaughts. They then entered into a fateful treaty with Russia and France then aimed at Austria-Hungary and Germany. What triggered that then was when the Germans invaded Belgium, which was guaranteed neutral, the war that nobody wanted occurred.

But this was the first time Britain had entered into a permanent treaty of protection with a continental power. Britain had always managed to stay back, but the reason Britain did this was because they were getting scared by the growth in the German navy. When they opened the canal in Heligoland, which meant that they could get out of the North Sea and into the North Atlantic, that changed the dynamics of Britain's safety behind the Straits of Dover. So, that British fear was one of the things that led Britain to abandon its centuries-old policy, and because the French were so satisfied and the Russians, they could guarantee that Britain would join them in the war. Then we had World War I.

With China, what you see now is that they built up a huge army, but only recently have they really developed a navy, and that challenges the U.S. Seventh Fleet.

C. Austin Fitts: I assume that's why we're pivoting and moving more of our fleet out to Asia.

Don Coxe: Well, it's of course always difficult with this president to know. After all, he reset with Russia, and that really turned out well. He's changed his plans for his trip to Asia, the one that he postponed because he said he had to stay because of the sequestering battle in Washington, actually just sat in the White House through this. It was worked out by the Republicans finding Democrats to work with, but he didn't turn up at the Asian conference, and then he said, well, he's coming back in the spring. He's only going to spend one day in Japan, and that's where the treaty comes into effect, because U.S. has the treaty with Japan to defend it if it's attacked, which includes the Senkaku Islands.

The possibility, then, of the U.S. being dragged into a war that it doesn't want because China thinks right now, certainly seeing what's happening in Ukraine, that Obama is not going to do anything more than give the occasional speech, they might make a miscalculation. That's worrisome. At some point the reason why Hitler was so convinced that he could go into Belgium and start World War II was (when he started, he invaded) Hitler went into Poland, and he said there's no way that the British government is going to honor its treaty with Poland. He didn't allow for the fact that Neville Chamberlain resigned in the government to be replaced by Winston Churchill. He thought there would have to be a British election. He didn't realize the British parliamentary system meant it could be changed by the party in power. The next example of that was when the Tories dumped Margaret Thatcher without an election.

C. Austin Fitts: I was going to ask you what you thought had happened in the Ukraine, because certainly when it comes to commodities, the Ukraine is an extremely important area. What we see is Putin insisting on protecting his warm-water ports.

Don Coxe: Well, we shouldn't be as surprised as we were by this, but it's because Obama is so preoccupied with trying to do a deal with Iran and he's still getting his "cooperation" from Russia. He took his eye off the ball, and what Putin is using is a principle, which was introduced, oddly enough, by Woodrow Wilson at the end of World War I, which was the rights of peoples to be protected. Up until then, it was nations to be protected. Hitler picked up on that, and after his supposed deal with Neville Chamberlain, he went into the Sudetenland to protect Sudeten Germans from the other Germans there. That was the next example of applying this rule that we can protect our own nationals in another country.

So, Putin is going back to the same rule that Hitler used, which is to say, well, the German-speaking Ukrainians are under attack from these "fascists," so we are exercising our historic right of protecting Russians in territories, after all, we sent them there. Stalin sent those Russians into these parts as they were adding them to Russia, and he did that to make sure that they couldn't cause him a problem. So, it's the descendants of those people that were forcibly moved out of Russia into Ukraine that now are calling for help from Mother Russia. Stage 1 is the Crimea. We will know how serious he is if the next move he makes is to take Odessa, which will give them both Black Sea ports, and he will then have a chokehold on Ukraine.

C. AUSTIN FITTS: Well, it's certainly going to be interesting. Let's turn to Japan, because I heard you speak at the Casey Conference last fall, and you gave the most compelling argument in support of the Japanese equity markets and sort of took me by surprise. I hadn't heard it before. So maybe if you could talk about why you have so much confidence in the Japanese economy and the Japanese equity markets.

DON COXE: Well, aside from foreign policy things, which are probably a newer concern, what I did was I looked at the fact that Japan might be completing its triple-waterfall crash. I kept looking for the end of it, and it took the same time as the commodity crash: 21 years. What had happened, amazingly enough, was that at the time that they were the worst performing of the industrial economies and they had the worst demography in the industrial world, they had the strongest currency. The yen had gone all the way up to 75. When I came into this business, the yen was 450 to the dollar, so the idea that Japanese companies were still alive and competing with a hopelessly overvalued currency meant that once they dealt with that, they would be formidable competitors. That was Stage 1.

Secondly, the Japanese had been changing governments over the last 15 years or so like the Italians. This time Abe one, and then he also won the upper house. This was new, because even Koizumi, who'd given me some hope for this, was never able to get both chambers, so he eventually gave up that he was the only new liberal, shall we say, force in Japan, and he failed. So, I looked at what Abe was doing, the three arrow quivers, and I said, "Wait a minute. This is familiar."

I went back and looked at Japanese history from 1929 to 1935. During that time, Japan was the fastest-growing industrial power in the world by far. How was that done? They had a finance minister named Takahashi, who came up with a program. The first was to devalue the yen, took it off the gold standard. Secondly, he did budget deficits and found all sorts of ways of stimulating capital spending. He dealt with improvements for agriculture to make Japan self-sufficient in food. He had a full-scale program, and I looked at it.

I said Abe is taking a script for something that worked for Japan, and because the Japanese have such a sense of their own history, they recognized that this is the first time that a similar set of policies were being brought in. It happened that an ancestor of Abe's at the time of after World War I was one of the founders of the social democratic party in Japan, which was successful enough to prevent the communists from taking over Japan. The Japanese love to see lineage and power. There were three premiers previously with the name Abe, so he had the right blue blood. He was using a proven formula from Japanese history, when Japan became such a formidable power, and he reached back into the Japanese soul and he also, unfortunately, opened a part of the soul which would have been left alone, which was their military spirit.

"It happened that an ancestor of Abe's at the time of after World War I was one of the founders of the social democratic party in Japan, which was successful enough to prevent the communists from taking over Japan."

C. AUSTIN FITTS: Military.

DON COXE: So that's where we're at right now and I hope that he decides that he's done enough on that front. But the result is that you have these Japanese companies and it was the fact that they were able to survive at 75. So the one-third devaluation of the yen has meant that these companies are having the fastest profit increases in the industrial world, and this was the worst stock market in the industrial world for 20 years, and analysts on Wall Street had given up even following Japanese stocks. So it was a pretty easy call to make.

C. AUSTIN FITTS: One of the things that really struck me at the end of the year when we looked back and did our analysis of the different equity markets is that most of the rise of the S&P was explained by just an expansion of PEs, but a majority of the expansion of the Japanese market was explained by profits. I hadn't expected that. I had not expected such an extraordinary difference between the two, and you were the guy who got me to get off my prejudice and take a look.

DON COXE: Well, look. There's no question I have had a lot of that pushback from people. I've had a lot of pushback from people on that call on Japan, because there's a lot of people who have family members who suffered terribly under the Japanese. They kept coming back with, look, they've done nothing for 20 years, and so why would it be right this time? It's because he had a playbook and he had a playbook that the Japanese population could respect. They realized this time something serious was being done, and they started unzipping their wallets.

C. AUSTIN FITTS: Well, it's interesting. I also did a little review of innovation last year, and I was looking at who's developed the leading applications in three areas. One was fabrication technology. One was composite materials, and one was robotics. I kept coming back to clusters of Japanese companies, and it was extraordinary the extent to which we were buying back stock over here and they were investing in very hard, important developments.

DON COXE: You see, it's interesting, Catherine, because if you think about it, those policies were put in place at a time when their survival was at stake because of their wildly overvalued currency. Therefore, they had to find new ways of doing it, so what they were doing was they set in place these policies of making themselves more excellent than their competitors because of that. Now they have everything going for them because their currency is better valued and they have done the work and the research and they've done the investment in this, so they are great companies now.

C. AUSTIN FITTS: One of the things that I thought you did a great job of in the journal was talking about the extraordinary impact on the Western economies from both overregulation plus a response to the corruption, certainly the corruption in the financial system. You describe a population and at one point you call us war-weary, because, of course, part of it is we had the campaigns in Iraq and Afghanistan that, as you said, added $6 trillion to the national debt and basically had a miserable experience. You've got a very weary population and yet that weariness is going to hurt us again. At one point you discuss how the Fed policy contributes to this and you talk about what the Fed could do that could start to withdraw the heroin in a way that might help turn that population around. I wanted to ask you about that: what could we do?

DON COXE: Well, the first thing they need to do is get rid of the zero interest rate. That's the pure heroin. What's being done at the tapering end is a separate question. Everybody focuses on that, and I was interested. Henry Kaufman, last week in *The Wall Street Journal,* doubled me up on it. I said that what they should do is immediately raise short-term rates to 50 basis points. At the moment the irony is that the people who caused the crash have profited from it, because they're able to borrow from the Fed at 3 basis points and lend the money back to the Fed at 25 basis points. That's what they're doing.

C. AUSTIN FITTS: It's free money. It's not free borrowing; it's free profits.

DON COXE: Free profits. You're making eight times the money with no risk and so that the bank reserves are created every time the Fed at the tapering end buys a bond or a mortgage-back, it creates bank reserves. Now, according to Milton Friedman's theories, that money would be then used to make lending, and you get the multiplier effect, but when you just lend the money back to the Fed, all you do is you create profits for the very organizations that caused the crash. This is preposterous. It's as if after World War II we designed a system that said that the people we're going to reward the most to get a recovery in Germany are those that caused the war.

C. AUSTIN FITTS: Many of the smaller bankers I know say the pressure's really on from the regulators for them not to lend. In other words, they want the money in their investment account buying long treasuries and long Fannies and Freddies so that they're really under the gun not to put the money out on Main Street.

DON COXE: This is an example of what happens when you have regulation getting out of control, because they're trying to prevent these banks from going bust. But the bank crash was not a question of Main Street banks going down; it was the big bad bonus bailout banks. What you want is the Main Street banks making loans. So, the Fed was given the job in the 1990s of reinforcing the Community Reinvestment Act, and what they did was (Chicago's the one where I have the experience) they would look at where banks were making loans in the North End of the city, and they weren't making mortgage loans down on the South Side. In the Fed examination of the Main Street banks, they devoted the biggest part of their energy to reinforcing the Community Reinvestment Act. So Fannie and Freddie twinned up with that and said, "Okay, the banks are worried about taking these mortgages. We will take them on," and Fannie and Freddie grew.

The banks, as a result of making these loans, wouldn't keep them themselves, but were thereby allowed to merge and allowed to pay dividends and do things. But they couldn't do that unless they were shown to be not discriminating against people. So, there was an example with the regulations, which were set out with a good moral principle in mind, but they got out of hand. Then Fannie Mae got taken over by ex-Democrats like there's been in the Clinton administration, and they made fabulous amounts of money. The lady lawyer, whose name for the moment escapes me, made over $100 million in a few years coming out as an executive of Fan and Fred, and she would go out to their conference and say, "We want more subprime loans." Beautiful.

C. AUSTIN FITTS: See, I think you're being way too nice here, because actually in 1994 my company was the lead financial adviser to the Federal Housing Administration. If you mapped out where the originations were, FHA had basically the subprime neighborhoods. They've traditionally been the insurer, credit provider in those neighborhoods, and FHA promulgated a new affordable-housing policy, which basically required Freddie and Fannie to start doing much more in the same neighborhoods. What was interesting is if you looked at FHA's strategic plan in 1994, they were predicting that they would significantly increase originations in those neighborhoods, and they were then working with Freddie and Fannie to also get Freddie and Fannie into those neighborhoods in a big way.

I was privy to the FHA strategic plan, and then I saw the affordable housing, and I said to the comptroller, "Wait a minute. There are not enough houses or people to do this many mortgages." Because they were taking up their private prisons and arresting everybody in the war on drugs. I said, "People are going to have to refinance their mortgage two times a year for prison to make these numbers." She turned to me, Don, and she said, "Shut up. This is none of your business."

DON COXE: Wow.

"You had neighborhoods, where literally a house would be refinanced five times in one year."

C. AUSTIN FITTS: So, there's a deeper story here. I will tell you when I was assistant secretary of housing, it was in Chicago I first saw it. You had neighborhoods, where literally a house would be refinanced five times in one year. So it was a whole other story that was really going on. I think that's one of the reasons you see Americans who are so war-weary, because it's so out of control and in your face. I will tell you Chicago was the city that, when I was commissioner, caused me the most trouble. One of the reasons was the head of your Housing Authority came to me and said, "We were financing some new construction and rehab at Cabrini Green, and the cost was $250,000.00 per unit." He said, "Look, I can buy and rehab a single-family home for $50,000.00 to $75,000.00 in the same neighborhood. Let me take the money and I can get 3 or 4 homes for the price of 1."

What we discovered was under the law we couldn't do that. I tried to get the laws changed and couldn't and then tried to do it again when we came back in as the lead financial adviser. In fact, Chicago was one of the places, where I was able to document a four-block area. If we could move money around within a place, we could save a fortune for the taxpayers, get a much better result, a win-win for everybody. I took it to the assistant to the person who ran the public housing, and I said, "Look at Chicago, New Orleans, all these places. We can get four houses for the price of one." The assistant looked at me and said, "But how could we generate fees for our friend?"

Well, that's one of the great opportunities of America, Don, is if you could subject places to a place-based optimization and find a way to solve politically the fees for your friends, it's not just a moral issue. There are all sorts of serious business issues as well, but if you could do that place-based optimization, there is, in fact, a way to reengineer the federal budget that could save a lot of money for taxpayers and be much better for the economy. I agree with you. At one point in the journal you said, or maybe you were quoting somebody, "the addition of Euro-style regulation has soaked up a lot of the benefits of the stimulus," and I think that's fair.

DON COXE: Yes, because this is something that can be done without having to go to Congress. After all, Obama's training was as a community organizer on the South Side, and so what he's an expert at is seeing how you use power to promote these kinds of things you don't have to do through legislation. Remember that it was only three years ago that the guy in charge of the Dallas office of the EPA came out and bragged and produced a movie in which he said, "My policy of dealing with the frackers is I use the policy the Romans used in Israel. You crucify a few people and the rest of them get the message." Anyway, there was such a rebellion in Congress on that, that he's gone to one of the tax-exempt organizations. But their basic mindset was that fracking had to be bad. Well, if fracking hadn't boomed, we would be in serious trouble, so that was one case where they were able to stop the regulators.

Now we've got 10,000 pages of regulations coming with Obamacare, and that's because of the other group that is a real problem for this country: the tort lawyers. At the time that the Obamacare was first being introduced in Congress, the Republicans said they would cooperate on the drafting of legislation, providing that Obama continued the development of Bush's policy of the tort reform. Obama said, "I'll do that." Then the bill came. Nothing was done on tort reform, because one of the five top funding groups for the Democrats were the plaintiff's lawyers, and they saw that this was going to be heavy regulations of doctors and hospitals and caregivers. They suddenly saw, "This is going to be better for us than the tobacco things were. Because hospitals don't bulk up in staff and understand the regulations, we can bring these cases against them."

With 10,000 pages of regulations, hospitals are getting rid of medical staff and hiring legal and accounting staff to keep up with it. Now, there is an example of regulation just going out of control, but it's all about control.

C. Austin Fitts: Well, this is why I left Washington. What's happening is you have all these different forces behind centralization, and one of the things they all agree on is creating tollbooths centrally is good for them and markets are bad. Yet, the absence of markets is what's killing economies. I'll never forget, I was working on a plan to do venture funds. With new technology, there's tremendous opportunity to aggregate different functions for small business and create the equivalent of mutual funds or venture funds for a community, particularly REITs, where you turn around places.

The capital-gains opportunities is not small at all, and I'll never forget I had lunch with the general counsel to one of the authorizing committees in Congress, and he said, "Look, private-equity capital is not to flow into these neighborhoods at all. We will allow capital to go in through low-income housing tax credits, but that's a decision that's been made." They are basically saying no market economies and no market capital on Main Street. So it's shutting down one of the most entrepreneurial parts of the economy and the part of the economy that was creating new jobs.

Don Coxe: Neil Ferguson's book is wonderful.

C. Austin Fitts: I saw your reference to it. I haven't read it, but it's on my list.

Don Coxe: It's a short book, but he spoke in Chicago when the book came out last summer, and I was in the audience. I've known him not well but for quite a few years, and he stunned the audience with what he was saying about what was happening to society because of regulation being the fastest-growing industry. It's because I was at a conference also in Chicago, where representatives of the European Union were there and with their forecast for the coming year. I got up and asked a question. I said, "You haven't mentioned energy policy."

I said, "In this country, fortunately, the fracking boom came because the states have been able to do the regulation on it, not Washington. That got driven away, and so we've had this boom, and if it hadn't been for that, our economy wouldn't have grown much more than yours did." So, I said, "But meanwhile, look at your policies in Europe. France has the sanest policies and Germany's energy policies are absolutely insane." Well, the three Europeans there just burst out laughing at that, and all three replied to me. Then the British representative said, "Well, when it comes to energy regulation," he says, "I'm going to use Mr. Coxe's expression. I'm in favor of federalism in Europe."

So, we were lucky, but the point is that that's the only industry that went through massive deregulation in this period. Everybody else has been subjected to more regulation. So, why should we be surprised? Then when you can make the money so easily by just buying back your stock and borrowing money at near-zero cost, why take the risks and why have to retain the lawyers to right?

C. AUSTIN FITTS: If you can rig it through Washington or rig it through the Fed, why bother? There's one other thing I wanted to cover before we close, and that is you had several references to the LNG export policies. I've never been able to figure out what I think's going to happen there. Are we going to become an exporter in a major way using LNG? I would love for you to just give us an overview of exactly what you think is going to happen.

DON COXE: What I talked about was that there is a whole bunch of applications in line, but what we've got here is that the big business community, the one that represents them all, is deeply divided on this. The electricity companies and the chemical companies are saying, "No, don't export this cheap gas. This is the best competitive advantage we've ever had." That's what the chemical companies are saying, because European chemical companies are coming and opening up new plants here because they're getting natural gas at $4.25, and in Europe it's $10.00 in MCF. So, there's that, and the electricity companies are saying, "Look, we're being forced off coal, and we'll do that because we've got cheap gas, so it's a low-cost fuel and we win all these credits." Therefore, the business community is divided about free trade in gas. There's the one project that's been approved.

There's six more in line to be approved, all in the Gulf, and so we have the chance to be big-scale exporters of liquefied natural gas. Now, liquefied natural gas doesn't land in Europe at $4.25, but it does land in Europe at around $9.00, and it's not going to go up from there. Also it takes them off reliance on Putin, and they understood that even before most recent events that that is a good thing.

"Also it takes them off reliance on Putin, and they understood that even before most recent events that that is a good thing."

C. Austin Fitts: I would think the recent events would have certainly encouraged them to be a little bit more concerned.

Don Coxe: You bet. The understatement of the day.

C. Austin Fitts: Before we close, we have to talk about the road ahead for commodities. Let's look at oil and gas and then agricultural commodities and, of course, your old friend, precious metals.

Don Coxe: Well, as far as oil and gas are concerned, I think that in the case of oil we have gotten low triple-digit numbers there, but a lot of that is due to concerns about what's happening in Ukraine right now. We're getting enough production and we're growing our internal production enormously. If the Keystone Pipeline gets approved, then we'll take the lid off expanding the Alberta oil sands, which means access to virtually infinite supplies of oil. So, North America could become energy self-sufficient by the year 2018. So prices, frankly, we don't need $110.00 oil to make all these projects economic.

Oil prices, in my view, should be sideways, probably, as well as gas prices, while we've had this great winter, but I think we are going to have more cold winters, too. That's another story. So, oil and gas are attractive areas in it, because the market isn't paying in the multiples that they should for the earnings there, because they're not convinced they're going to last.

We go on to the base metals, and, frankly, that's a China story, and I am concerned that China is going to be dragged into doing something untoward. They've been loading up on iron ore and copper, buying more than they needed when they had the renminbi at an all-time high in price. They've let the renminbi suddenly drop in price. What worries me is that that means that they think they've got enough on hand to withstand any small-scale interdiction by the Seventh Fleet. So the base-metals area is attractive but not wildly attractive.

In agriculture, the prices got hammered down by the great crops, but now we have drought in Brazil, and the production is going to be well below forecast there. We have a really amazing situation unfolding. The upper Great Lakes are frozen over. According to the Navy, this is a record level of ice on the Great Lakes. Well, what that means is when the spring thaw comes, we're going to have pressure from water. Instead of the streams flowing into the Great Lakes, they're going to be backed up, and we also have snow on the grounds on the upper Midwest. So the Albedo effect is at work, which means sunlight, when it does come out, is being reflected back into space. What I think now is we have risks of severe floods in the upper Midwest, and then we have the Putin effect in Ukraine. So, the grain prices, which got driven down to really low levels, we're turning bullish on those.

As far as gold and silver are concerned, I believe I turned bullish on them early in January, because I believe they had bottomed out, that the speculators had made such a fortune. Also the effect that I have been watching for, which was that the selloffs were always occurring on the weekends. So you come to work in the morning on Monday and you'd find gold and silver were down and not much would happen during the week. That was being done because the speculators could trade their futures markets in the thin markets of Singapore and Hong Kong and hammer down the prices. Well, that game is pretty much over, and what we see is the Chinese have been buying vast quantities of gold. The Indians, when they can, are getting more, so we've got real people buying bullion, and the speculators who made money out of paper shorting have given the sidelines. So we've taken that off it, and now we have geopolitical risk coming in.

My view is that we've had a nice rally off the low. We're at about $1,340.00 gold now, and this starts to get to the level, where more and more goldmines, once again, are profitable. They had been devastated because there's not a goldmine of any size in the world that would be profitable at $1,000.00 gold now, because they've opened new mines with minute grades less than 1 gram per ton. They need higher prices. If you look at what's happened on a year-to-date basis, you can see how it's coming in, because gold is up 11 percent, and the gold-stock index is up 25 percent, but the GDXJ, which is the junior one, is up 36.5 percent, which means that belief is returning.

C. AUSTIN FITTS: Well, the concern was if this kept going that you'd just have to see a lot of mines shut down.

DON COXE: No question about it. So, it was a near-run thing, as Wellington said, a Waterloo, and we really got to just about that level last October.

C. AUSTIN FITTS: Well, before we close, I just want to thank you again. As I always say, you can connect everything with everything.

DON COXE: Thank you so much. I rarely had an interview which has been as much fun for me, so thanks for the invitation.

C. AUSTIN FITTS: Well, before I close, I want to underscore again that you've created the new strategy service, and people can learn more at CoxeAdvisors.net. Anything else you want to stay about the strategy service?

DON COXE: Well, I was for two decades the global portfolio strategist for the

BMO, Bank of Montreal, financial group, and I retired from that job. We've just been advising on commodity-stock portfolios, which are Bank of Montreal products, and we've opened up this new strategy service. It continues what I did for two decades for them, which is publishing a strategy journal, that developed a fair following. This is not just about commodities, as you could tell with the questions and everything. I'm an historian by training and development and bit of a classic scholar, so I love long-term themes. That's what I'm good at, and when I see something long unfolding, what I want to see is that the pieces are in place for it. That's what the strategy journal aims at, is for serious long-term investors. It's not aimed at short-term traders.

C. AUSTIN FITTS: Well, I will say this. Every time I get corruption- and war-weary, I read one of your pieces and I get all inspired to solve the real problems before us, so I can't thank you enough for your work, Don.

DON COXE: Bless you.

C. AUSTIN FITTS: You have a wonderful day.

DON COXE: You, too.