BUILDING WEALTH IN CHANGING TIMES

The Solari Report

JULY 16, 2015

Precious Metals Market Report

with Jordan Eliseo

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July 16, 2015

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C. AUSTIN FITTS: Ladies and Gentlemen, it's my pleasure to welcome to The Solari Report Jordan Eliseo, who is the Chief Economist at ABC Bullion, a very leading Australian precious metals and bullions specialist.

Jordan, I am very delighted that you could join us. His background brings a unique perspective to the role of gold and silver in an integrated portfolio strategy. He's worked in the financial industry in both Sydney and London. He's run a successful investment bank. He's the author of a new book *Dire Straits: Money for Nothing, Debt for Free*. He holds both a BA and a graduate diploma in investment and finance, but he also has a diploma in financial planning.

He can look at this from the point of view of an individual and their investments in balance sheet and see gold and silver as an integrated piece. That's very unusual in the precious metals market, to have someone who can command an executive position in a place like ABC Bullion and also have that background.

Because I've just come from Australia, and because he's there in the middle of everything going on in Asia, I've also asked him to talk tonight about the Australian economy, which clearly plays a very important role in the precious metals market, and he's prepared some slides. Before I bring him on, I want you to click and make sure you open the slides available in the *Subscriber* section because it will help you tremendously, and he's prepared quite a presentation for us.

Jordan, it's great to hear your voice again. Welcome.

JORDAN ELISEO: Thank you very much, Catherine. It's a real pleasure to join you. I've been looking forward to this conversation for a while now, and I think it's a good time to be having a chat. Obviously what's happening in China and the implications for Australia and Australian precious metals investors, it's very relevant to people all around the world.

We've certainly had a lot of people asking us about investment in gold and silver and holding it in a country like Australia, and I think there's always been a bit of a fascination with what's happening down here

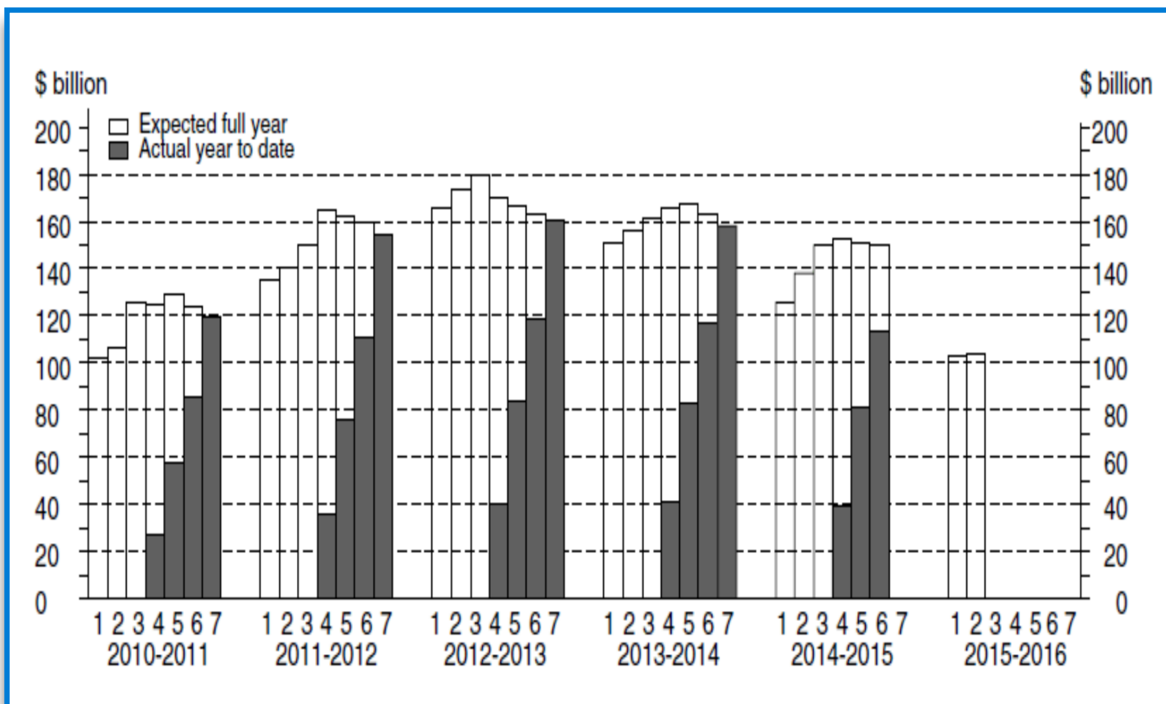
because we did seem to sail through the first part of the GFC, certainly in a much stronger fashion than most developed world economies.

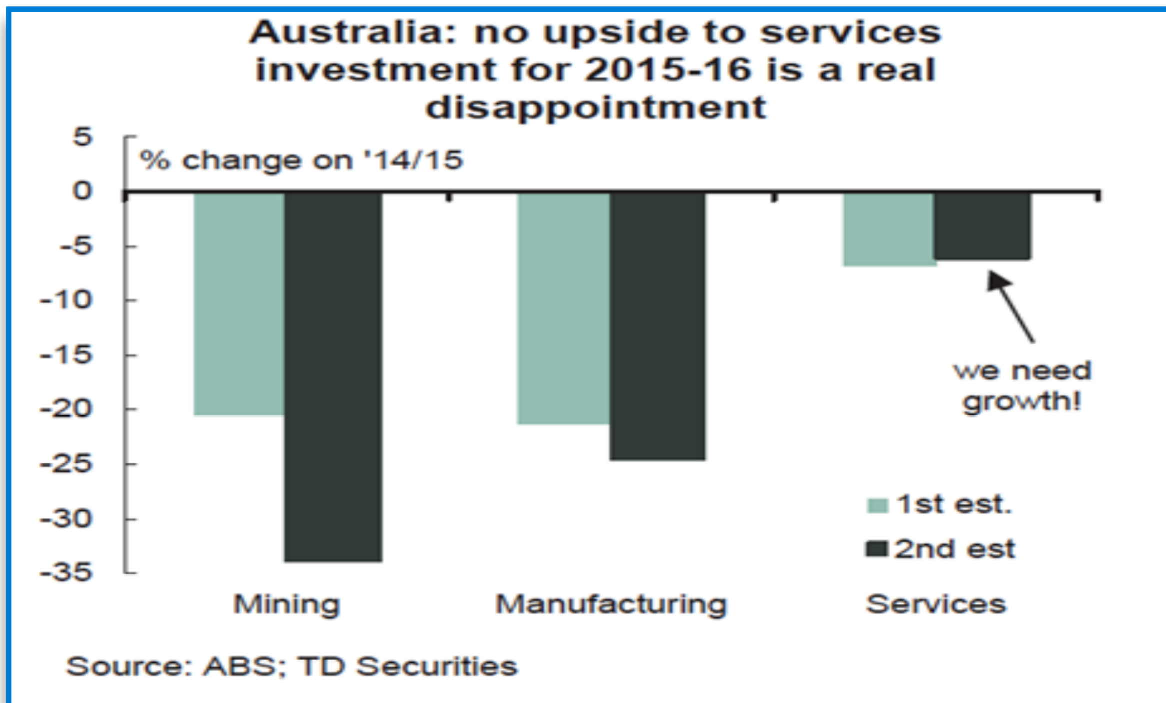
C. AUSTIN FITTS: Yes.

JORDAN ELISEO: If people see the wheels coming off down here, it's quite interesting and makes people pay attention.

C. AUSTIN FITTS: Let's start with the Australian economy. What's going on in Australia? How does it fit in with what's going on in Asia? Tell us. Walk us through Australia.

JORDAN ELISEO: Sure, Catherine. The things that single-handedly kept Australia out of going through a formal recession when the global financial crisis hit was the extraordinary stimulus that was deployed by China and the implications that that had – both in terms of trade and in terms of the prices we were receiving for our key commodity exports. But perhaps more importantly than that, also the impact that it had on business capital investment in Australia, particularly within mining sectors.





As I'm sure a lot of people would be aware of – perhaps for those people who aren't aware – the key commodity exports for Australia are iron ore, coal, gas, and actually gold as well. China for the last 15 years went from being less than ten to taking up more than 30% of all of our exports, and Japan is always an important export destination for us as well.

What we saw at the peak of the business capital investment cycle was that there was roughly $160 billion a year of investment happening by businesses in this country, more than half of which was just coming from the mining sector alone. Since our terms of trade came back in 2011 and since the price of iron ore, coal, and obviously gold as well has pulled back, we've seen a drastic reduction in capital investment plans – actual capital investment – in Australia such that by next year the number is probably going to be closer to $100 billion, and that might even end up being optimistic.

We're talking about roughly $60 billion decline, which is roughly 3.5-4% of GDP coming out of the economy. Plus we've also got now the decline in our terms of trade because the price we're getting paid for these exports has declined precipitously. So that is really the key

challenge that we are facing. The really troubling thing is that we're not seeing any kind of rebalancing in the Australian economy even though interest rates are at record lows at just 2%.

The great hope of the government and of the Reserve Bank down here was that as mining investment tiled off that there would be a large increase in investment in manufacturing and in services because Australia is a heavily services-focused economy. But as one of the slides that I've prepared shows, there is actually still very significant decline planned in manufacturing and in services rather than there being an uptick in business investment and certain parts of the economy.

For example, we've got the majority of the Australian car industry shutting down by 2017, and even housing construction – which had been something of a bright spot – is set to peak this year, and we're going to see decline in housing construction going forward.

The Australian economy faces a number of headwinds going forward, and what's going on with business investment is clearly the most alarming one.

C. Austin Fitts: I was amazed because I expected things to be slower when I got down to Sydney, and just from walking and talking with people it seemed much stronger than I'd suspected. The slowdown, I think, is just coming now. Is that the case?

Jordan Eliseo: It is, Catherine, and I think it's also important to separate Sydney from Australia.

C. Austin Fitts: Right.

Jordan Eliseo: I think most people are very well aware that London is not the United Kingdom, New York and Washington are not the United States, and Sydney is not Australia.

C. Austin Fitts: Right, and Sydney is a financial capital. It's got quite a housing bubble right now.

JORDAN ELISEO: That's right. It's the financial capital. It is also the helm for whatever foreign money is coming in from China and from other parts of Asia, and that is not an insignificant factor. So what you're seeing in Sydney is a very poor representation of what is going on in the broader economy.

I obviously work and live in Sydney, and I see it myself, but the truly amazing thing, Catherine, if you get outside of the CBD or even the inner suburbs, I live in a relatively affluent suburb called Balmain which is 20 minutes out of the CBD on a bad day and 15 minutes on a good day. What we're seeing there is house prices hit record after record in terms of what they're trading for.

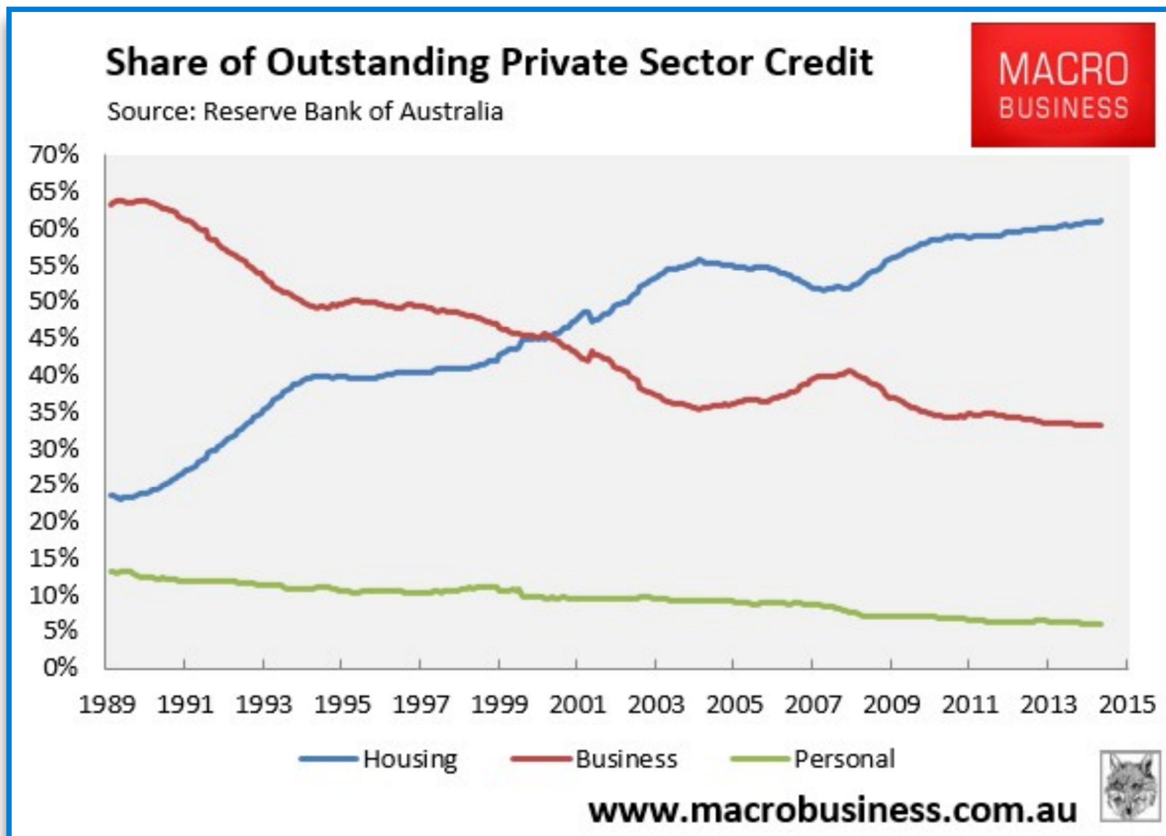
C. AUSTIN FITTS: Right.

JORDAN ELISEO: The second time, the heart of the actual enterprise which is a street called Darling Street in Balmain, almost every week there's a new business shutting down. We're seeing this colossal asset price inflation while at the same time the real economy is clearly declining, even in what is otherwise an affluent suburb.

C. AUSTIN FITTS: Right. Let's just follow along with your slides. Walk us through.

JORDAN ELISEO: We've obviously talked about business and capital investment. If we moved on, there is a great new site headlined out of Australia called MacroBusiness. They produce some fantastic slides on what is really happening in the economy. I've shared one here for your viewers which looks at a share of outstanding private sector credit, and it breaks it down between what's being lent to housing, what is being lent to businesses, and what is being lent in personal loans. We're talking credit cards and the like.

What is really clear if you look at that chart is how the composition of bank lending has changed over the last 25 years, pretty much since we last had a recession. Back then, back at the start of the 1990's, essentially $65 out of every $100 the banks were lending was going to productive



enterprise, and $25 was going towards home prices and asset speculation.

As you can see, over the last 25 years those numbers have almost completely reversed, such that the great majority of bank lending now is purely going to fund asset speculation and home ownership. Part of that has to do with the seemingly impregnable run that Australian housing has done over that period. It also has to do with how the banks were able to convince the regulators that any money they had lent towards housing was lower risk than business loans, and therefore they're effectively able to split their capital much harder if they push more of their dollars into housing. That's been another factor as well.

Either way, the implications in the Australian economy are quite troubling because we've got a banking sector that is overwhelmingly focused on lending to the Australian housing market which is already valued at well over $5 trillion. It's already the cornerstone of Australia's

wealth. And they're very hesitant to lend to private businesses, which is ultimately what we need them to do if we're going to have business investment and if we're going to have a pick-up in employment and in wage growth and the like.

That is a real challenge. It also poses a potential systemic risk to the Australian financial system if, for whatever reason there is a sort-of major downturn in our housing market, our banks are going to be completely reliant on government funding and/or emergency lending from their Reserve Bank to keep the doors open.

Here's something that might be of interest to your listeners. About a month ago there was a really interesting report out that looked at the big four banks in America and how their assets were now worth something like 50% of American GDP and how that number had increased since the Global Financial Crisis. So too big to file had become even bigger. It was the implication of it looking at America.

In Australia, the assets of our big four banks are well over 200% of GDP, so they are on a relative basis four times larger than what the four in America are. That's where the whole frets around systemic risk come in.

C. Austin Fitts: Right.

Jordan Eliseo: If, heaven forbid, there is some sort of major turmoil in the Australian housing market, it's a real issue.

C. Austin Fitts: I was struck at how centralized the banking system is.

Jordan Eliseo: In a way, it sort of reminds me of – and I'm not forecasting an imminent housing price collapse or anything like that. I do believe that it's a bubble, and I do believe investors are making the worst possible investment decision buying into the average house in Australia with the way yields are now, but that doesn't mean I'm forecasting a housing collapse or bust.

It sort of reminds me of what was happening in Ireland several years ago.

The implications and the scary thing is that if anything happens to our major banks, there is absolutely no question that they would have to be if not nationalized then their debts and their liabilities would have to be explicitly covered by Australia as a sovereign and by the government.

C. Austin Fitts: Right.

Jordan Eliseo: They are already implicitly covered. All the agencies are very clear on that when they talk about the Australian budget deficit and the Australian government gross or net debt to GDP and why if it goes over 30% there could potentially be a sovereign downgrade because it is so obvious that our banks are effectively riding on the health of the sovereign state itself.

That obviously leads to another area of concern, which is that most Australian gross or even net government debt are no major problem now. I've put a couple of tables in on the Australian budget to highlight what has been happening here in the last few years where it has now become the norm to run $48 or $35 billion deficits every single year.

Table 1: Budget aggregates

	Actual	Estimates			Projections	
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Underlying cash balance ($b)(b)	**-48.5**	**-41.1**	**-35.1**	**-25.8**	**-14.4**	**-6.9**
Per cent of GDP	-3.1	-2.6	-2.1	-1.5	-0.8	-0.4
Fiscal balance ($b)	**-43.7**	**-39.4**	**-33.0**	**-23.4**	**-9.2**	**-3.2**
Per cent of GDP	-2.8	-2.5	-2.0	-1.3	-0.5	-0.2

Table 2: Major economic parameters[(a)]

	Outcomes	Forecasts			Projections	
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Real GDP	2.5	2 1/2	2 3/4	3 1/4	3 1/2	3 1/2
Employment	0.7	1 1/2	1 1/2	2	2	2
Unemployment rate	5.9	6 1/4	6 1/2	6 1/4	6	5 3/4
Consumer price index	3.0	1 3/4	2 1/2	2 1/2	2 1/2	2 1/2
Wage price index	2.5	2 1/2	2 1/2	2 3/4	2 3/4	3 1/4
Nominal GDP	4.0	1 1/2	3 1/4	5 1/2	5 1/4	5 1/2

Forecast non-mining investment to grow by 2%, 4%, 7.5% in 2015-2017
Expecting to grow revenue by over 20% to $489Bn by 2019

As most governments do, Catherine, they tend to report their underlying deficit as a percentage of GDP. That doesn't sound too bad when you say it's 2% of GDP. But when you run a $40 billion deficit, the gap between taxes and the gap between revenue is actually around 15%, so that's the scale of it.

C. Austin Fitts: Right. You're building up an infrastructure of bad behavior and bad habits.

Jordan Eliseo: Absolutely, and, look, the government when they released their last budget in May made a real song and dance about the fact that they think they'll almost close the deficit by the end of the decade. They think they'll get the deficit down to about $7 billion. The underlying cash problems that you can see in those tables there, but the forecast that they used to come up with those numbers were wildly optimistic.

Obviously we spoke before about the decline in business capital investment in Australia. They're forecasting growth in the non-monetary sector at 2%, 4%, and nearly 8% by 2015-2017. That is just not going to happen. They also expect to actually grow central government revenue by 20% between now and 2019. That is simply not going to happen in an environment where unemployment is likely to rise and where real wage growth is negative.

When I look at those budget deficit numbers, they're already alarming. The reality is they're going to be far worse than what treasury has forecast. Like every sultan around the world with an aging population, if you look at the next chart, you can see the growth in spending is all in the wrong areas. I've highlighted the sizes of the health budget and the size of the social services budget as they stand today. They already make up – between the two of them – 45% of total expenditure. You can see particularly when we look at social services, spending there is forecast to grow by at least 15% between now and effectively the end of the decade.

Much like the rest of the developed world with an aging population, we're going to see massive increases in outflows that the government is going to have to honor with the pension, and the health burden will rise

Table 3: Real growth in portfolio expenses

	Nominal expenses 2015-16 Estimates ($m)	Percentage of total expenses (%)	Real growth 2014-15 to 2018-19 (%)(c)
Agriculture	1,710	0.4	-11.7
Attorney-General's	4,298	1.0	-13.6
Communications	2,164	0.5	-14.1
Defence (a)	32,779	7.5	1.7
Education and Training	28,892	6.6	6.0
Employment	2,916	0.7	5.1
Environment	2,327	0.5	14.8
Finance	10,167	2.3	-6.8
Foreign Affairs and Trade	6,001	1.4	-15.2
Health	48,034	11.1	5.9
Immigration and Border Protection	4,784	1.1	-39.9
Industry and Science	3,473	0.8	-30.5
Infrastructure and Regional Development	4,960	1.1	-11.2
Parliament	232	0.1	-2.3
Prime Minister and Cabinet	2,380	0.5	-13.4
Social Services	144,151	33.2	15.2
Treasury (b)	49,343	11.4	-4.2
Veterans' Affairs	12,178	2.8	-12.0

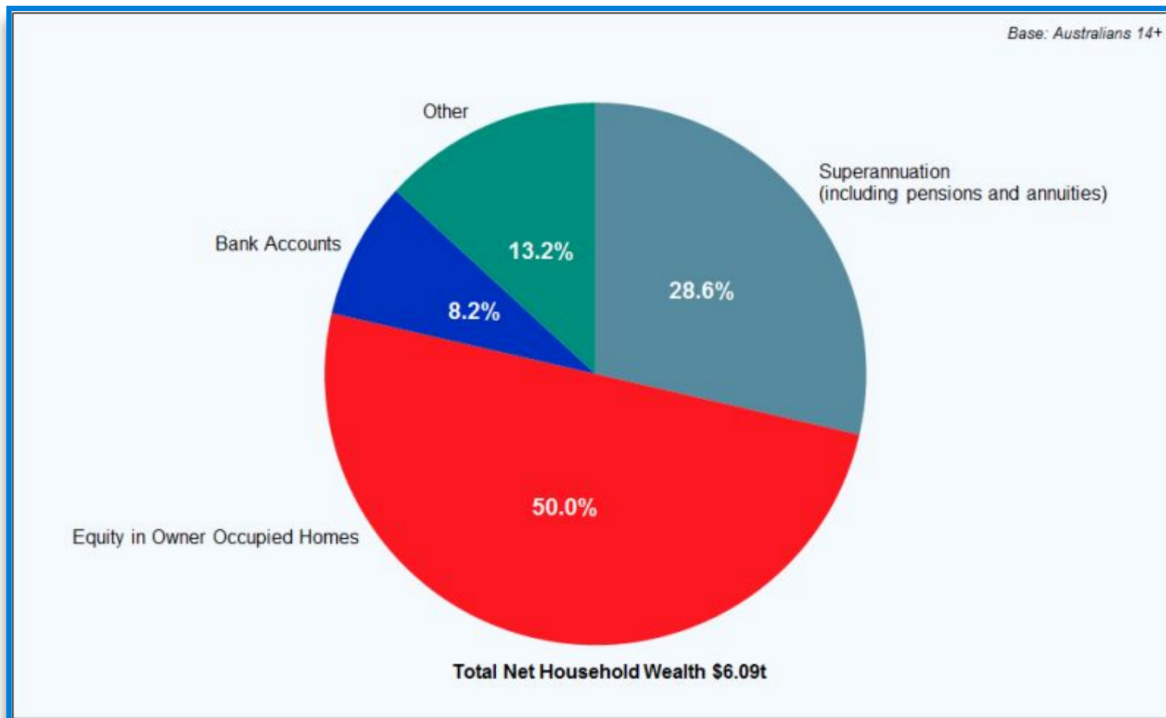
with an aging population as well.

You can see that we've got increases in spending on the environment. That doesn't really matter; it's such a small bar that it doesn't matter. But, the amount of money that they spend on the environment as a percentage of the total is largely insignificant.

When I look at health and social services, as I've tried to say here, the growth in spending is all in the wrong areas. It's not growth in terms of infrastructure or things like that. That's actually been quite interesting because the current government, when they ran for office were very keen, and Tony Abbot, our current Prime Minister, was very keen to be seen and referred to as the 'Infrastructure Prime Minister'.

The reality is that there hasn't been any noticeable increase in infrastructure spending, and what increase there has been has been – in many cases – poorly targeted in the traditional pork barrel-type that favors certain constituencies or key areas where the swing voter is more valuable. That's another concern for Australia as well.

I think probably the next couple of slides might be pretty interesting as well for the viewers. Just to understand the breakdown of what we call wealth in Australia, I'll share some information here and maybe a couple of anecdotes as well.



Slide #7 is titled 'Australian Wealth'. It highlights pretty clearly that nearly 18% of Australia's wealth is trapped either inside an owner-occupied home or inside a Superannuation. If we look at Superannuation first, then I'll talk about that in detail in a couple of terms.

Firstly, nobody can touch that until they meet what is called a condition of release, which is essentially when they retire. Pretty much anyone under the age of 65, once they're building up assets inside of Super, they can't actually go and spend any of that in the real economy. And, look, there are major problems with how that money is invested and the fees that they charge as well.

More broadly, the fact is that it's not having any major impact in terms

of spending in the real economy, and it is taking up 9.5% of everybody's wages. So by law, that is what people are forced to contribute into the system.

You can make the case that in the long run it's good for Australia to have a national pool of savings – and I believe that. I believe we should have a Superannuation system, but the amount of money that is being forced into it, the fees that are being charged, and the way the money is invested, absolutely none of it makes its way down to small business or private equity and the like. That is a real problem.

C. AUSTIN FITTS: Right.

JORDAN ELISEO: But the bigger issue is, of course, what is going on with owner-occupied housing. Australia is technically the wealthiest country on earth by median net worth. I think it's Credit Suisse who did a global wealth report. In their last report, which was in 2014, they had Australian median net wealth at number one. I think Belgium was number two, funnily enough. The average Australian is on paper three to four times wealthier than people in Germany and people in the United States and you name it. But the reality is it's not spendable wealth; it's just wealth that is trapped inside your house.

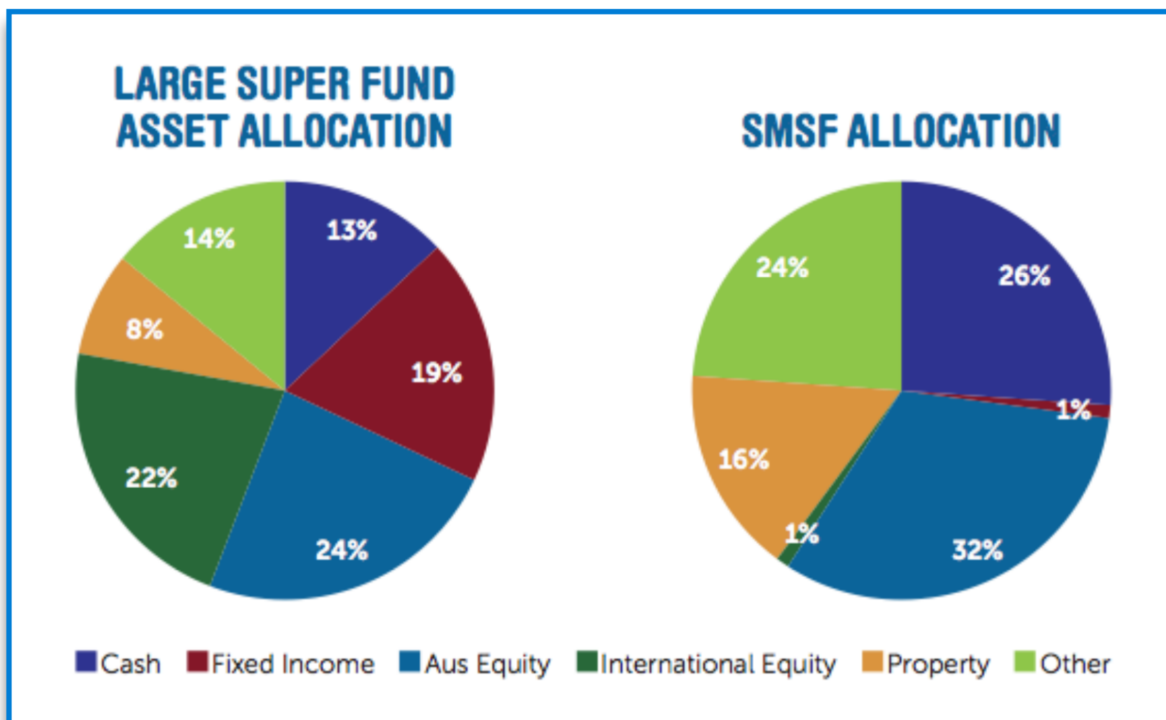
If I think of my family as a classic example, my Auntie and Uncle run a very successful business. They own some investment property. They obviously own their own house that they live in. The increase in the value of the house that they own on a day-to-day basis means absolutely nothing to them in terms of the actual decisions they make around investing in their business, around going out and spending money on a holiday or a new car or any kind of consumer discretionary spending.

So this wealth, 'allusion' is not the right word, but it doesn't actually do anything to go and stimulate the economy. As I'll touch on later, the flip side to it or the other part of it is, of course, record high private debt levels in Australia.

C. AUSTIN FITTS: Right.

JORDAN ELISEO: That is, of course, the other factor.

Just touching one more brief point, I want spend just a little time on this next slide which is about the Superannuation system. What it shows is how the money is invested, both with large superfunds, and also with self money super funds, which are the more self-directed retirement funds. That, for example, is what I have myself.



As you can see, the first and most obvious point is that when it comes to large super funds, there is absolutely no money that is being invested in precious metals. When it comes to self-based super funds, it might be 0.1 of 1% maximum has been invested in precious metals so far, and that's despite the fact that the gold in Australian dollars has outperformed all of the other asset clauses for the last 15 years at a hold.

Much like pension funds overseas, gold is still very much an undiscovered asset for Australian investors. To me, the great fear is when I look at how that money is being invested, the overwhelming majority is in stocks, bonds, and cash. All three of those markets face very, very

serious headwinds going forward.

If we look at cash, obviously we're already in a negative real rate environment. In Australia, there are much lower interest rates going forward. I'm sure most of your viewers are very well-aware of how richly valued equity markets are. The Australian market is just as richly valued as a lot of other developed markets. And, of course, fixed income bond yields are at the lowest level in six centuries.

So when you look at those three primary asset classes, you see a lot of risk going forward. I do worry that a lot of people who have their wealth – and most Australians have the majority of their financial wealth trapped inside this system – could face a pretty significant haircut, or at the very least, a very challenging time growing wealthy in the coming decades.

C. Austin Fitts: You know, every time you look at the Australian charts, it says the same thing that we're seeing here in the United States. In other words, you are not investing your money in things that will help you produce real returns over a long period of time.

Jordan Eliseo: That's absolutely spot-on, Catherine. It's the prioritization of asset cross speculation over productive enterprise. If I could make a point – an anecdotal point more than anything – you mentioned at the start of this program that I've published a book. I wrote that book using a piece of software called Tablo.

The gentleman who started Tablo was 19 years old when he started it. He's 21 years old now, I believe. He's a young fellow based out of Melbourne, Australia. He's a terrific entrepreneur – exactly the sort of person that we should want to be promoting and helping grow because he's now got a business that is employing Australians and paying real wages.

This guy, when he wanted to go and get more funding to take his business to the next level, didn't have a prayer of getting that money. He wasn't able to raise all the funds in Australia, despite the fact that we

have a $2 trillion Superannuation, and despite the fact that on paper we are the wealthiest country on earth. We was forced to go overseas and rattle the team internationally to actually raise capital to get his business to the next level. That is the great shame of our Superannuation industry.

When people put their money in, it's effectively being used to bid up the price of preexisting assets rather than any of the money being used to fund the next generation of Australian entrepreneurs and Australian small businesses.

C. Austin Fitts: Right. It's exactly the same here. You come into a neighborhood and all of the businesses are putting the equivalent of 9% of their money into a retirement fund that finances all the big companies who come in and take away their market share. So you're financing the destruction of your market.

Jordan Eliseo: Yes. That is not a bad way of putting it. It's very true, and it's really sad.

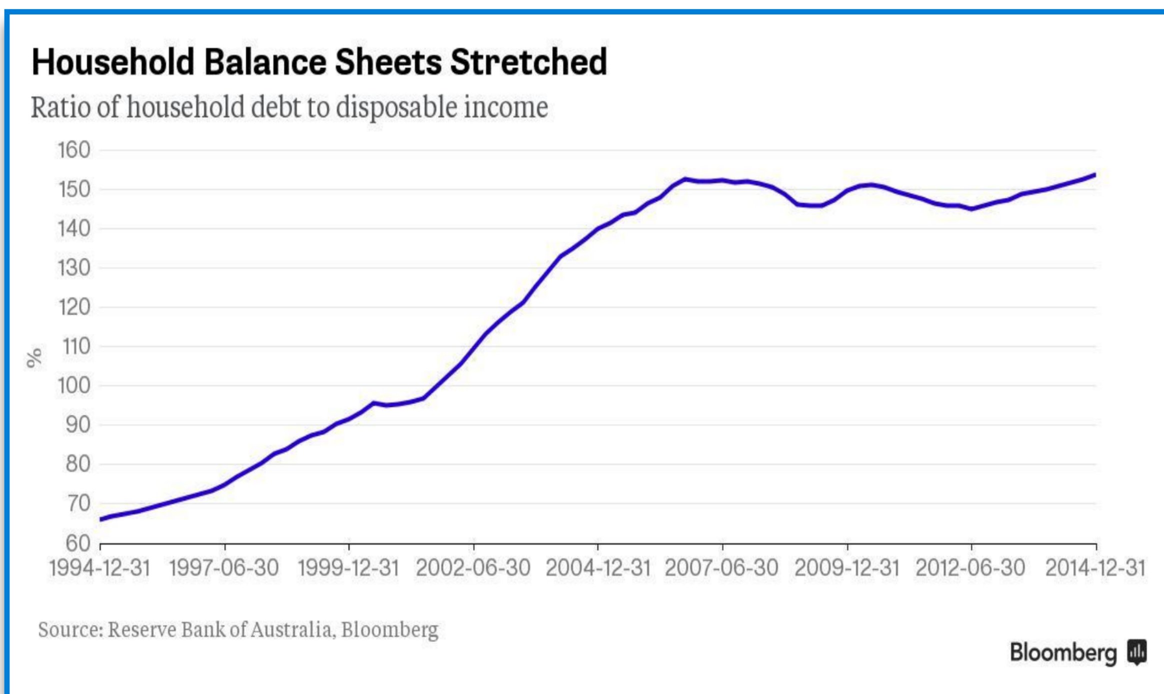
Look, as you mentioned, I've got a background in asset allocation, investment management, and financial planning. When I used to do more of that work on a day-to-day basis, I certainly didn't say to clients, "Look, you shouldn't have any of your money in blue chip stocks," or, "You shouldn't have any of your money in fixed income or even in cash," particularly in Australia. Really up until now you still were able to earn some reasonable return on a term deposit.

What is was about observing is that you shouldn't have all of your money invested in these places. At a national level – a sovereign level – I'm thinking about Australia as a country. There is absolutely no question that our Superannuation industry and our property industry are actually detracting from our ability to productively grow.

That's not to say that there shouldn't be any money in Super stocks. I think we shouldn't put any money in, but we desperately need to rethink how that money is invested and how much money people are forced to

put into this system because it is clearly inhibiting private sector growth, particularly at that entrepreneurial new business/small business level, which is the key to a prosperous economy.

You mentioned before smaller businesses losing market share and struggling. The reality is that is going to be a trend that is going to be in place, I fear, for some time in Australia. In the next three charts that I've prepared on the Australian economy explain clearly why.

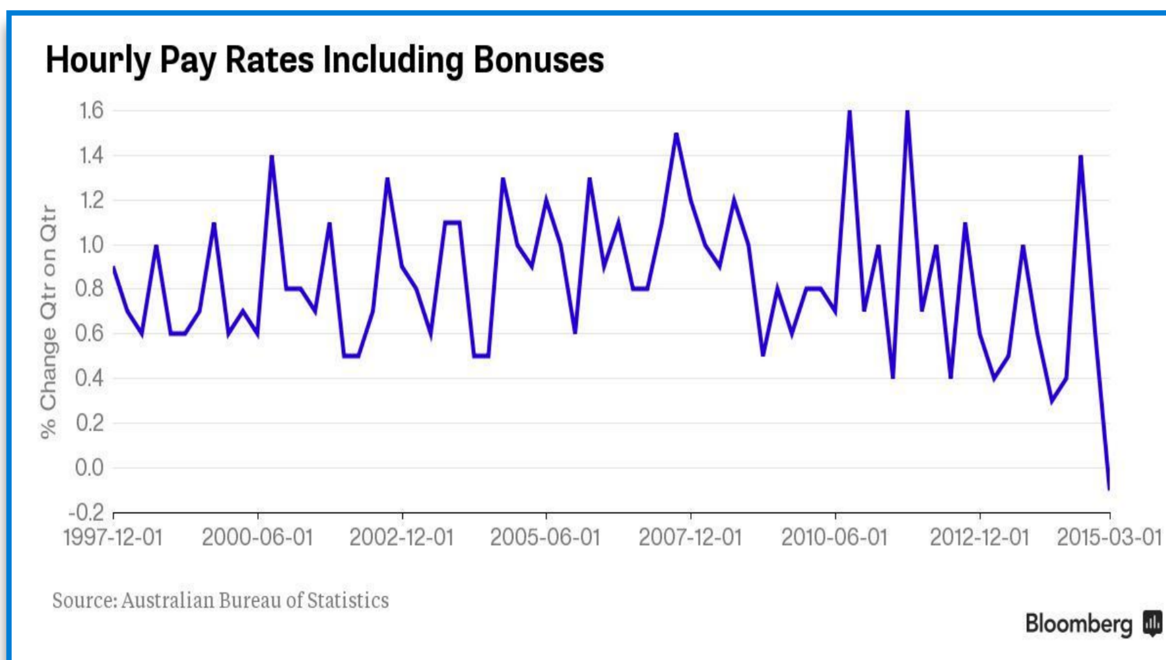


The first one, Chart #9, shows household balance sheets and the ratio of household debt to disposable income. Again, it basically goes back to the early 90's and the start of when we had our last recession. You can see how much it has increased. It has just about tripled over that time, and that's obviously been the key to rising house prices over this period.

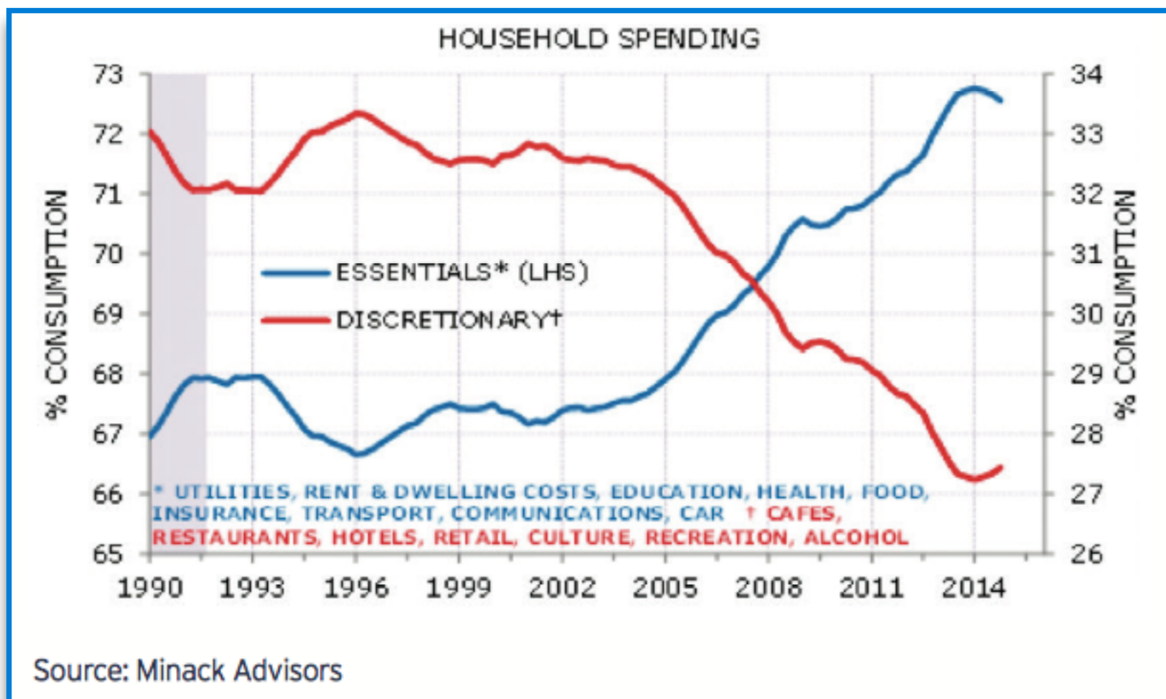
I haven't included a chart on it, but what is quite incredible, Catherine, is that in Australia now, even though interest rates are only 2%, the average Australian is spending a higher percentage of their disposable income servicing their mortgage than what they were back in the 90's when interest rates were above 10%. The amount of money that they've

had to borrow has gone up by so much that the only reason they're able to keep the mortgages that they've got is because interest rates are at record lows. That is why everybody – even last year – Bloomberg did a survey in November of last year of Australian economists, and 23 out of 23 of them were not forecasting any further interest rate cuts. They thought 2.5% was the low, and most of them thought the Reserve Bank would start hiking this year.

As we've seen, they've actually cut interest rates 50 basis points, and now the market has turned, and now say at least one more interest rate cut by Christmas time. My view is that they will at least be 1.5% by the end of this year or early next year, and I think they will fall as low as 1% in this cycle.



The reality is that households are so stretched now that there is no choice but to perpetually make credit cheaper. The other thing compounding that is highlighted with the next graph, which shows hourly pay rates including bonuses, and you can see what has happened in the quarterly changes. Really since 2011 there has been, despite the volatility on a quarter to quarter basis, there has been a sharp drop-off now such that real wage growth is, in fact, negative now.



If you look at further compounding the problem is the fact that the price Australians are having to pay for the essential items – healthcare, rent, health insurance, general insurance, and all of those things including petrol prices and you name it – most things are going up at a far faster rate than overall inflation. It's captured pretty blatantly in the next slide that I'll show, which looks at the breakdown of Australian household spending between essentials and discretionary spending. Again, it goes back to the start of the 1990's and our last recession.

You can see that by the middle of the 1990's Australians were having to spend roughly $67 out of every $100 on those essentials, leaving them around $33 on discretionary spending. That has now gone down to about $27.

If you think about your retailer, he's now got your discretionary retail account in Australia.

C. Austin Fitts: He's getting squeezed.

Jordan Eliseo: He's now got $6 less of market share to go after because that

Australian has to spend now over $70 just paying the essentials, and that is why we're seeing what we're seeing. As I mentioned before about where I live, almost every week or every month another shop is shutting down because there's just not enough demand for product.

That is what is happening in the Australian economy. We've got businesses refusing to invest. We've got government already running $40 billion deficits that are going to stay that way and are going to be far worse than what they forecast. We've also got the Australian consumer who is completely tapped out.

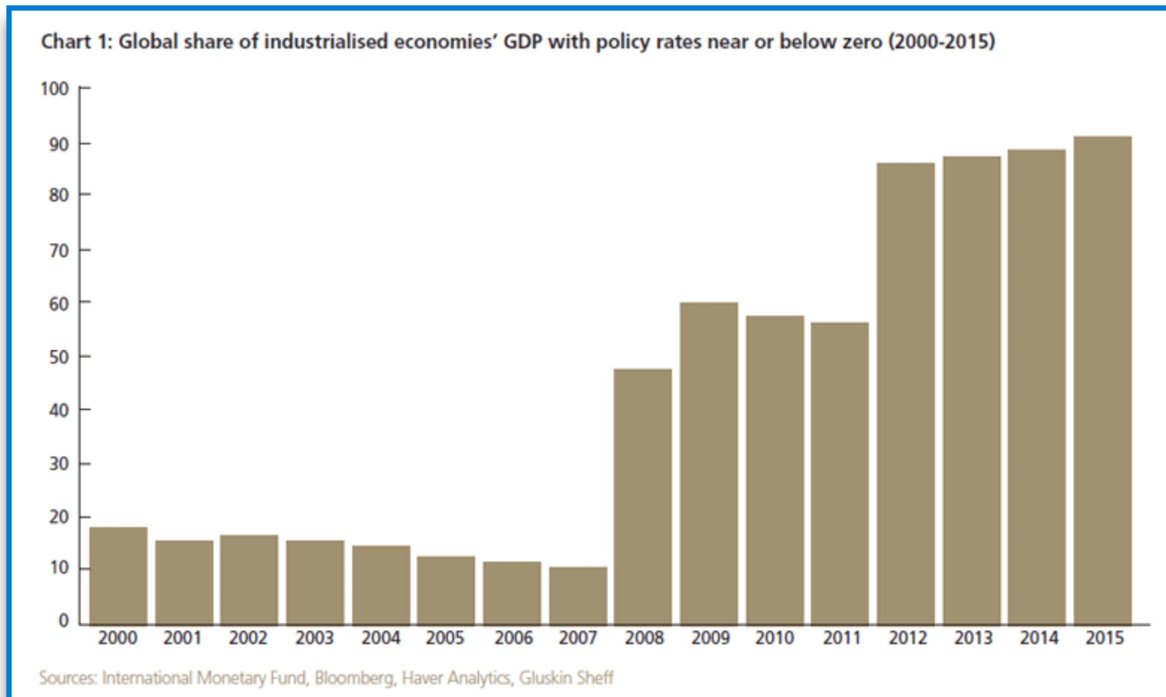
The only thing that is keeping headline Australian GDP numbers looking anything reasonable and taking us out of a formal recession is the fact that exports are flying as we continue to expand supply of our commodity exports. But even that is a real distortion of the underlying economic truth because the price we're receiving for those exports has absolutely collapsed and will probably continue to fall.

I've been doing a bit of media work lately with more traditional finance media in Australia here and as I've said to them, "If we don't go into a formal recession, we're going to experience recession-like conditions for years to come down here."

C. Austin Fitts: Right. That's the Australian economy. I can't tell you how much it's like the American economy, but we've eaten through a lot more fat and muscle than you have. Your middle class is still much better off than ours is on a per capita basis and in many other ways. Believe it or not, it's very similar except we're just ahead.

Let's turn to the gold market because obviously there's a relationship between how the economy is doing and why someone might want gold. Is this your next chart – the rate cuts?

Jordan Eliseo: That's right. I think that was a chart I included in my book, and it's one of the most extraordinary charts I think I've seen in the last six to eight years.



At the end of the day, I think even a lot of people who are bullish on gold and who would love to see a huge reduction in the interference of government in free market economies, I think there are plenty of people who understand why when the GFC hit there was an emergency slashing of interest rates and a move to these policies.

You can see that in terms of the jump in the percentage of industrial economies that move to right near or below zero, and it went from basically 10-50% almost instantly when the GFC hit between 2007 and 2009.

I think what that chart really conclusively highlights is that we are very, very clearly in even worse shape now than what we were in 2008, 2009, and in 2010 because if we weren't, we would have seen central banks around the globe start to formalize policy. But, of course, we haven't seen that. If anything, we've seen more and more countries having to continually cut interest rates. I know Canada cut rates overnight, and in Australia it's only a matter of time before we slice another 25-50 basis points up over our cash rate. I think it just goes to show or highlight how addicted we are to 'Money for Nothing and Debt for Free'. We're trying

to make money worth nothing – quite literally.

> “The biggest bubble out there is central bank credibility. If Draghi was a stock he'd be on a P/E of 200! Yellen's on 100. When that bubble pops, all hell will break loose again, and there you really just want to be in cash”
>
> **Gerard Minack - Minack Advisors**
>
> **ex Morgan Stanley**
>
> **Early 2015**
>
> "Nothing beats a little cash in a bear market, of course, and the oldest form of cash is gold."
>
> **James Grant**
>
> **Early 2014**

It hasn’t worked and it won’t work. I think that the next slide that I’ve included is probably my favorite quote of the year that I’ve come across so far from Gerard Minack who runs Minack Advisors. He’s ex-Morgan Stanley. He’s very, very well-respected. He said, “The biggest bubble out there is central bank credibility. If Draghi was a stock he’d be on a P/E of 200! Yellen’s on 100. When that bubble pops, all hell will break loose again, and there you really just want to be in cash.”

That obviously relates to the question mark then becoming: What kind of cash are you in? Are you in Aussie dollars? Are you in US dollars? Are you in euros, or are you in gold?

James Grant, one of my favorite commentators, his comment from early 2014 is very appropriate around nothing beating a little cash in a bear market. Of course, the oldest form of cash is gold.

Funnily enough, Catherine, a few weeks ago I was at an investment conference which was almost exclusively to do with Australian equity

investors. It was a handful of key fund managers and brokers and some very well-respected guys who have had fantastic track records – people whose opinions I respect and listen to. One of the guys in particular commented that he had moved his portfolio to over 40% cash now because they are expecting some blood in the streets. They do see the market as being overpriced.

My concern for people like that is: What if we don't actually see a huge market crashing nominal terms? What if we just see a continuation of this period where equities kind of jump around a bit, they continue to pay out some dividends, but they don't do too much in nominal terms. They don't crash, they don't really rally too much further either, but if we start to see inflation start to pick up, then that kind of value equity manager is going to be in a real bind because they're not going to want to go in and buy the market.

C. Austin Fitts: Oh, Jordan, they're in that bind right now. They've been in that bind for a year and a half.

Jordan Eliseo: I agree. It's a real question, and I wonder if at some point – because the numbers for including gold is part of the cash component of your portfolio in any currency – it absolutely stacks up. There's no question about that. I wonder if at some point some of the managers are going to start to say, "Maybe it's worth me holding a little bit of bullion in my portfolio as another cash holding."

C. Austin Fitts: I think I told you what's happening now. One of the biggest brokers here came out with a new intelligent portfolio – sort-of a robo-advisor. They say to just fire your advisor and just do robo. It had 5% precious metals, and I almost fell off my chair. I thought, "Well, precious metals has finally made it in."

It's in the robo-solution.

Jordan Eliseo: I think that's very interesting because a similar company down here that does very, very similar work – sort-of robo-advice where you fill in your dates and your risk profile and it sort of speaks out and

recommends a portfolio. They actually have a 10% allocation to gold in their funds. I've spoken to the guy who set that up, and he's an ex-equities guy but he realizes the value that gold brings to a well-constructed portfolio.

I think that's a really important battle to fight and to win because without wanting to mention names or anything like that, sometimes the gold industry can actually be its own worst enemy because it only talks about gold as being anti-fiat money, and people only talk about effectively financial Armageddon and saying to people that therefore they should sell everything and put everything in gold.

C. Austin Fitts: Right.

Jordan Eliseo: That's just not a practical way of engaging with the great majority of people, and it's also not actually necessary. I mean, if you look at the vast majority of the better gold market commentators out there – the ones who actually have border credibility – most of them will generally talk about having between 10-25% of your portfolio in precious metals. Certainly I find that when I speak to advisors, and we're increasingly talking to institutional fund managers down here, inevitably when we talk to them about gold we almost never talk about gold versus fiat money. We just don't broach the conversation in that way.

We broach gold as a natural currency hedge. We broach gold as a diversifier against the stock market. We broach gold as an alternative defensive asset in an environment where cash is paying you nothing and where bonds are at their highest price in 30 years.

When we talk to people like that from a portfolio construction perspective, that has much better cut-through but even with financial advisors and the likes. And for your average person who has traditionally had all their money in stocks, bonds, and cash, and who is starting to get a little bit uneasy and starts to say, "How does this whole gold thing work?"

If we were to try to tell them, "Look, everything else is going to crash so

you should give us all your money," they're going to run a million miles. Frankly, I couldn't blame them.

The Loathsome Truth About Gold And Why It Should Crash 40% More

Jordan Eliseo @JordanEliseo · 19h
Pretty decent headline if you like to buy assets unloved and when everyone is bagging it

I think that conversation about why gold and how gold is very important to have. I suspect it's going to end up being the profitable investment they'll have in their portfolio because as we all know – and I have a chart on that in the next slide – it talks about that sentiment is absolutely appalling toward precious metal. That headline came from *Forbes* from recollection. It's about a week old. You see a headline of the loathsome truth about gold and why it should crash 40% more. That's exactly the kind of headline you want to see when you want to buy it rather than sell it.

I guarantee we will not see that kind of headline at the top of the gold build-up.

C. AUSTIN FITTS: You see a lot of deflationary forces, Jordan. I never underestimate what a strong deflationary force can do to the price of any commodity.

JORDAN ELISEO: I couldn't agree with you more, Catherine. I think if you

look at what has happened to iron ore in particular, which is a real one here for Australia, and copper, all of these other commodities have already been absolutely beaten up.

C. Austin Fitts: They've been decimated, yes.

Jordan Eliseo: I also think it's worth considering Greece and China are in the news right now. A lot of people have been frustrated that gold hasn't rallied up the back of these events, but it's important to remember that both in and of themselves they are hugely deflationary events – what is happening in China and what is happening in Greece.

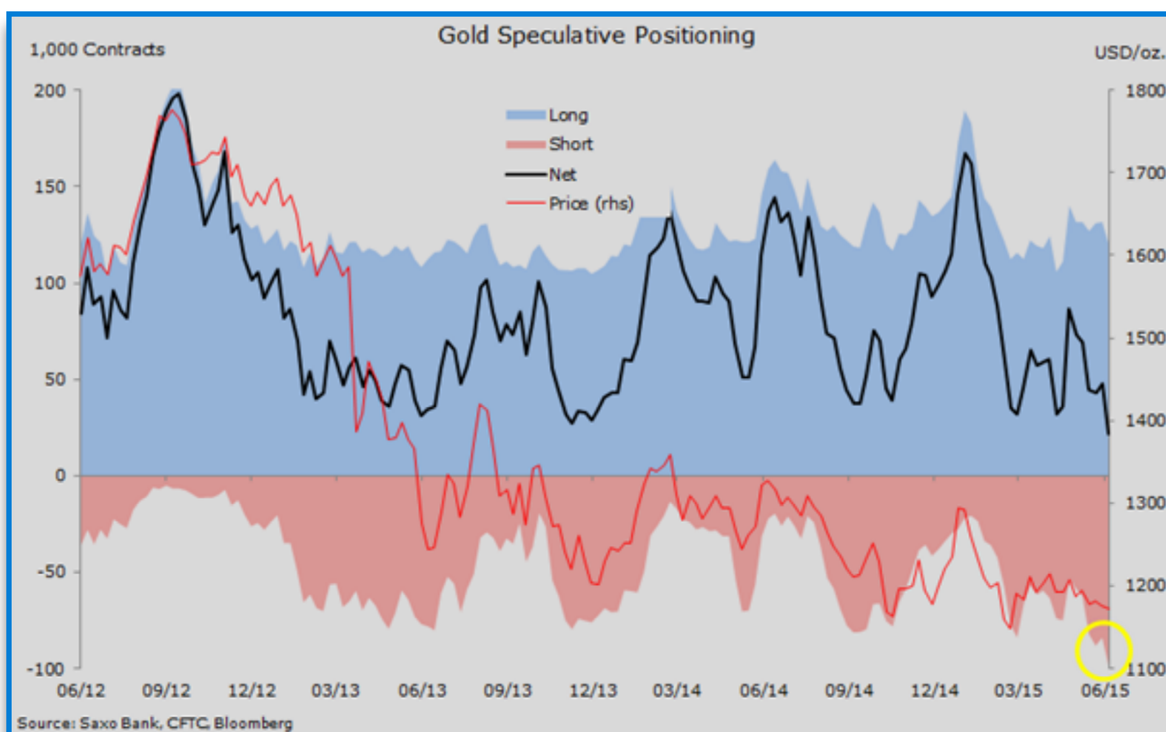
If you drill into each one individually, question marks around a potential 'Grexit', clearly bring up question marks over the euro itself and potential longer term implications there. That in and of itself is somewhat dollar-supported, which is clearly not a good thing for gold. Then in China gold is one of the most, if not the most, liquid assets on the planet.

When you've got every investor in deep with the margin call, it's absolutely likely that many of them would have been liquidated gold positions just to cover what they were owing on the margin side of things with their stockholdings. I actually think gold, while the price action hasn't been fantastic, and let's not pretend otherwise, it's actually held up okay in light of the fact that sentiment has been as bad as it has been.

I'll jump ahead a slide. If you look at slide #16, if you look at speculative position now, it almost could not be better from a contrarian perspective.

C. Austin Fitts: Right.

Jordan Eliseo: We've got net specs at their lowest level in nearly a decade according to Saxo Bank. You can see there when you look at that chart, when you look at where the shorts are, there are more people who are short-goaled now than what they were back in April 2013 to December



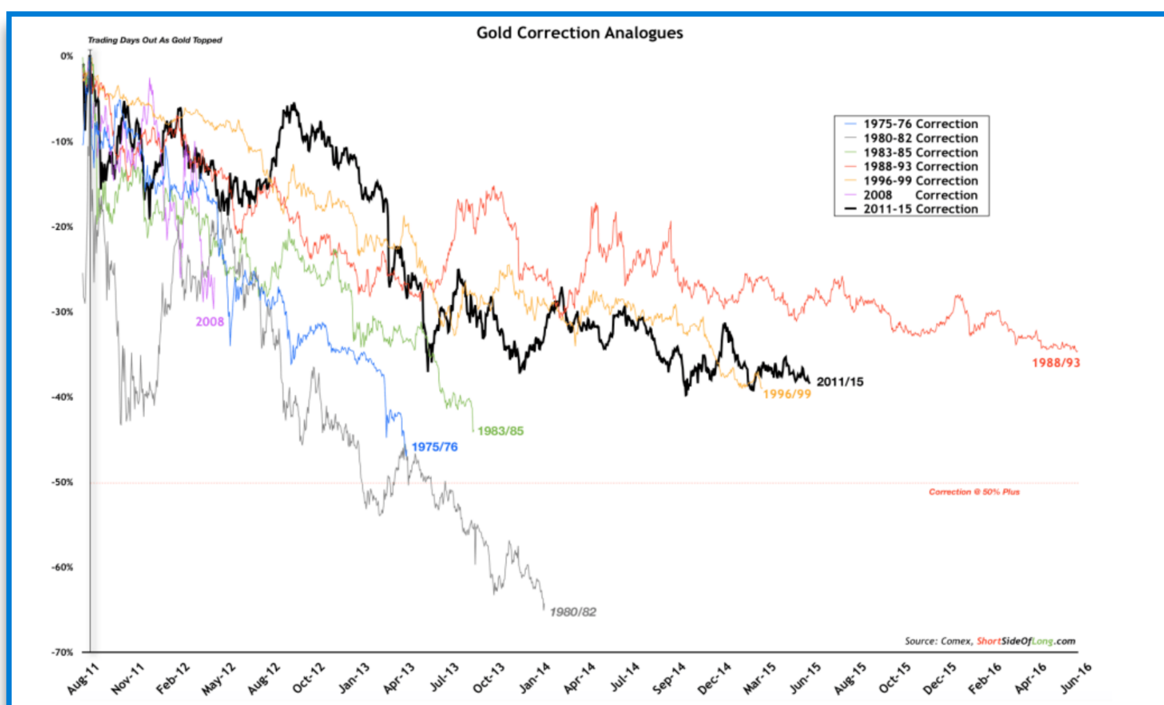
2013 united.

I think from that point of view, absolutely we could have one last washout in gold. If there is an arch deflationary event, of course we could see $100 come out of the price in US dollar terms. I think for all the instances we'd be cushioned by the currency, but I think gold is starting to look really interesting now.

Another chart that is worth pointing out is the gold bear is getting pretty old now, just in terms of time. We've been in effect now a four-year corrective cycle. It was August/September 2011 that gold peaked around the $1,900 mark. We're now basically four years into a cyclical correction. Again, that's another thing that is encouraging and I think investors should be looking at as an attractive thing rather than as a negative thing if you're looking to invest capital there.

C. Austin Fitts: Right.

Jordan Eliseo: That's my view on the market. What is it that you have in



terms of American investors towards gold right now, Catherine?

C. Austin Fitts: There are different perspectives. If you were buying in the early 2000's, you would see this as just a correction. If you got in at the top, there is a real effort to market into people and bring them in right before the top. They've had a very expensive experience, and I think a lot of the marketing here was not balanced; it was basically saying that you should put everything in gold, blah, blah, blah – exactly as you described.

I think the situation is now coming around to one of a lot more perspective, and the way I talk to subscribers is I describe positions as both a core position and an investment position.

The charts right now are beginning to look to me like something where you'd want to start to speculate. It's still early, so no bottom has been proved. But for a core position you want to have a core position no matter what the price is. It doesn't matter what the price is because you have a core position to protect against certain scenarios. Those scenarios

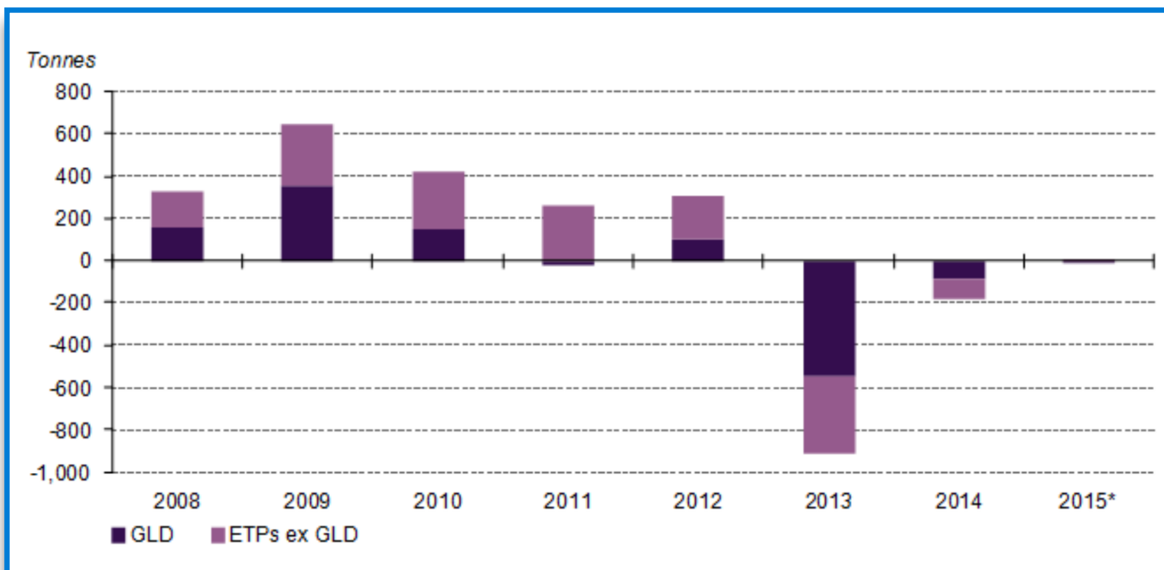
can happen at a moment's notice. There's no way to be prepared other than to be prepared all the time.

JORDAN ELISEO: Absolutely.

C. AUSTIN FITTS: I think you want to have a core position, and then for an investment position I think it's still early. I keep watching the charts daily thinking, "Is it yet? Is it yet?"

It's hard not to believe it's close, and the things that gives us a lot of confidence is if you look at the long-term buying from Asia at the retail level, the physical buying – to me – ultimately is going to contribute mightily, and I should add the Central Bank.

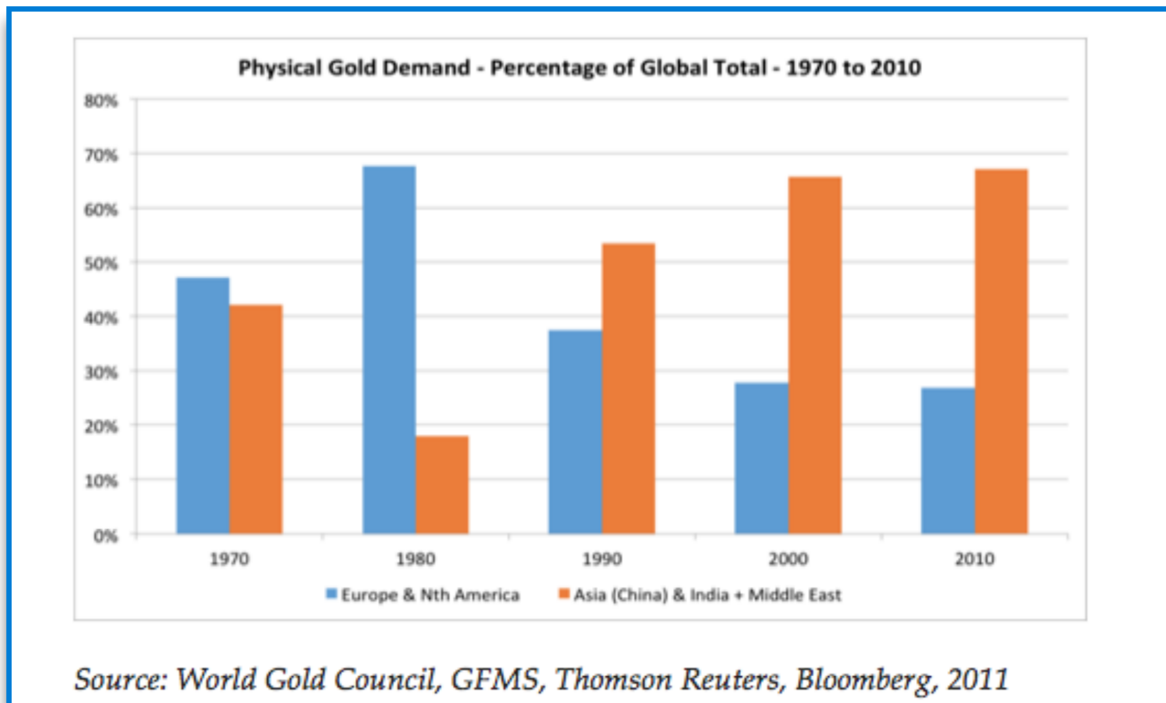
You have very strong long-term demand which is a support to the price.



JORDAN ELISEO: I couldn't agree more with you, Catherine. If we look at this, I have a couple more slides on this. Slide #19 on the presentation that I've prepared starting with ETF holdings, there is no major demand coming back into the gold ETF market, but holdings have stabilized there. Again, you can see the huge outflow – nearly 1,000 tons in 2013. There are another 200 tons in 2014, and then for the first six months of

this year we've basically seen ATF holdings flat.

Obviously Central Banks, as you spoke about, essentially switching from 400 tons a year of selling into the market to an average of 450 tons of buying. I think that helps add strength to the market.



Source: World Gold Council, GFMS, Thomson Reuters, Bloomberg, 2011

I think the more interesting slide is probably slide #21, which has to do with Eastern buying. What that chart shows is that the percentage of annual physical gold demands and how it's change from 1970 through 2010. If we go all the way back to 1970, there you can see that nearly 50% of the buy was coming out of Europe and North America. Just over 40% was coming out of Asia.

By 1980, which I guess was the last bubble in precious metals, nearly 70% of the buy was out of North America. Only less than 20% was out of Asia. You can see how that has changed over the last four decades in terms of where we are now.

We have effectively had a bull market in precious metals for the last 15

years that has outperformed every traditional asset and has been achieved without any widespread adoption of precious metals in Western investment portfolios.

C. AUSTIN FITTS: It's quite remarkable, isn't it?

JORDAN ELISEO: It is, and that's also why a lot of people say that our Central Banks are going to cause the gold price to fly. "Well, China is going to crash the US dollar and the gold prices will fly," or "China's retail buying will cause the gold price to fly."

I don't believe any of those things. I believe what you said. Central Bank and 'Eastern consumer procyclical demands' will provide support for the gold market that was not there in the 1980's, but it will ultimately be the adoption to some degree by Western investors that will get the gold market really moving again when it does happen.

C. AUSTIN FITTS: One of the things that I think is important to point out is the Western financial system did a very thorough job of persuading retail investors in the West to hold gold through paper and through their brokerage accounts.

JORDAN ELISEO: Sure.

C. AUSTIN FITTS: I just don't see that happening in Asia. I'm not saying that there won't be some ETF buying, but you have the Chinese very committed to physical possession of gold and silver – not through paper.

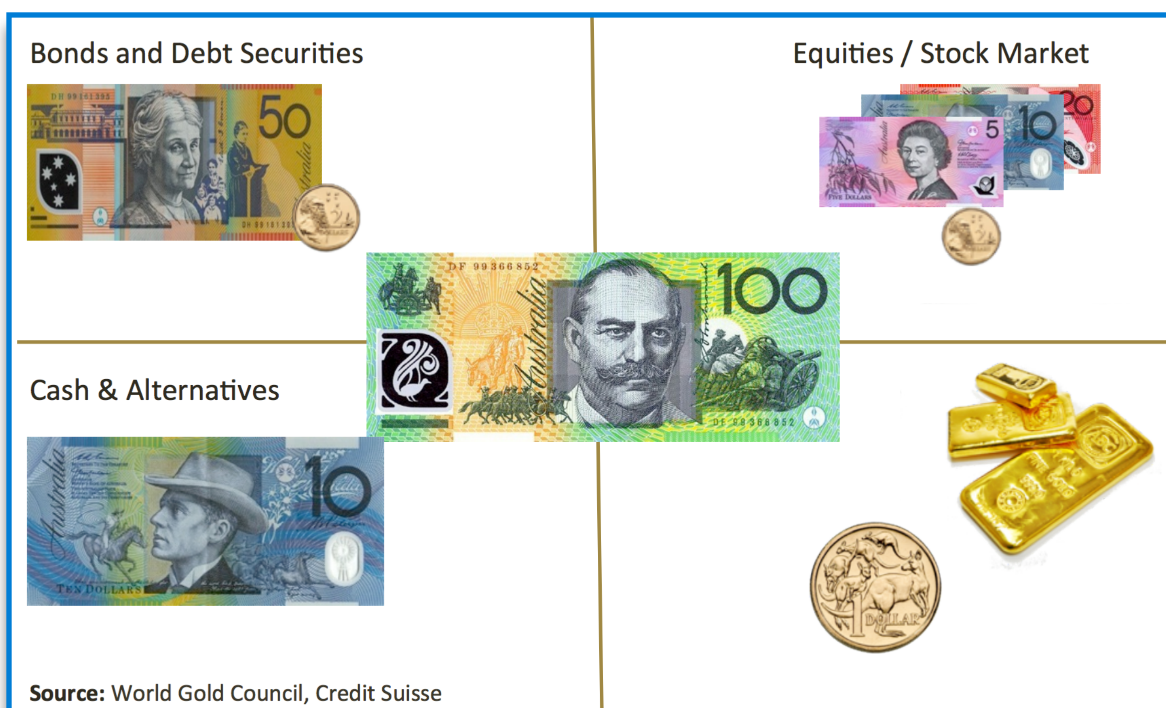
JORDAN ELISEO: Absolutely. For example, in Australia there are certain investors, particularly within a traditional Superannuation home, where they just can't buy physical gold. If they've got a self-made superfund, they can. If they've got a traditional Superannuation fund, they can't. They might be able to buy gold ETFs.

I actually think the existence of gold is good for the gold market, for bringing more investors than it otherwise would.

C. AUSTIN FITTS: Yes, absolutely.

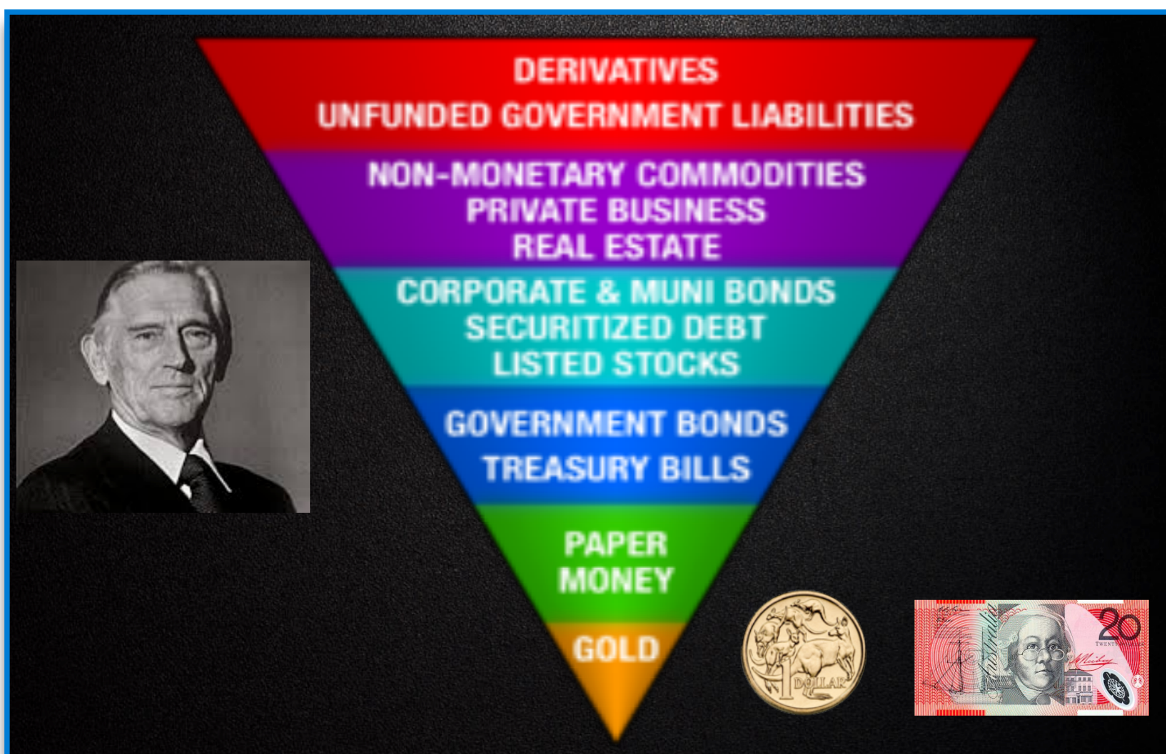
JORDAN ELISEO: I personally do prefer – and obviously it's a business we provide – real physical that we can put and allocate in storage or in private vaults depending on what the client wants. I clearly do believe and agree that is the superior way of having gold in your portfolio, and there is very clearly a difference between having gold exposure in your portfolio and having gold in your portfolio.

C. AUSTIN FITTS: Right.



JORDAN ELISEO: I couldn't agree with that more, but I think maybe just as a final talk around where precious metals can go and the concept of Western investors adopting gold, the last couple of slides that I've got there, one breaks down the global aspect for today – as if there were just $100 in the world. There's obviously more, but $250 trillion is a number that doesn't mean anything to anyone except Janet Yellen. So you have to break it down to a number that is easily identifiable, and I use Australian currency there.

If we look at the market – and this is based on a breakdown from increments of agra a couple of years ago. You can see that there is over $50 in bonds and debt securities, $37 in equities and listed stocks, about $10 in cash and alternatives, and it's actually less than $1 that's sitting in gold today, which is an extraordinary number when, again, we come back to the last 16 years of gold outperforming everything yet it's only – at best – 1% of investors' assets. At best it's at 1%. The reality is that it would actually be lower than that.



So you start to wonder, gosh, if 5-10% of the money goes into gold, where does the price go? I guess that then translates to the next slide that I've presented, which is John Exeter and Exeter's pyramid, which I think is one of the fantastic ways of visualizing the breakdown of asset markets and gold's low at the base of that pyramid.

If we really break it down, Catherine, by implementing negative interest rate policy, by printing or creating trillions of dollars of QE, what governments and Central Banks have effectively done is they've said,

"There is no longer going to be a risk-free rate of return in paper money itself. Therefore, we're going to make that a frying pan. We're going to make you go out into the fire. We're going to make you go up the pyramid into T-bills, into bonds, into listed stocks, into derivatives, into industrial commodities, and we're basically never going to allow you to feel comfortable with where your money is invested because it will never be safe. You're going to have to constantly take risk."

What I try to say to investors is, "Look, it's fine to do that with a portion of your portfolio, but rather than going out of the frying pan of paper money and into the fire of all of these speculative assets that have credit risk, why not put a portion of your money on the other side of paper money or below paper money on the pyramid into physical precious metals? As the slide highlights, as it stands today there is only one dollar out of every hundred in gold, but if a part of every other precious metal market, gold and gold mining companies have been roughly 20% of global financial assets."

If we can get a quarter of the way there, there is no other listed asset market that provides anywhere near that kind of bang for your buck or anywhere near that kind of potential return on invested capital. That, to me, is probably the final reason why investors should have that core exposure to precious metal now. The primary reason has been wealth protection, but there is actually a very good chance you're going to get a fantastic tie-up on invested capital, especially if you go cost-averaging into the market now when it has been completely beaten down.

C. Austin Fitts: Jordan, what do you think will happen if the Fed raise interest rates? Obviously I don't think they'll do much – say 25 to 50 basis points. What is that going to do to precious metals? How tough could that be on prices, and should we wait for it?

Jordan Eliseo: I think in the short term, Catherine, it's clearly detracting from sentiment, a little bit like all the talk of paper and the end of QE hurt gold as well. We would be actually able to talk about doing it that manifested itself into lower prices. The actual period through which they were doing it, and clearly in the last handful of months or year or so they

haven't been printing money in the US, gold has been sort-of range-bound rather than collapsing.

I think the talk of it is going to hinder it, but I think when it happens it actually won't have much of an impact on gold at all.

Funnily enough, Catherine, I was doing some research with a colleague of mine recently. We were talking about some myths around investing in gold, one of them being the obviously nominal rate hikes are the absolute bane of gold's existence because of rising opportunity costs.

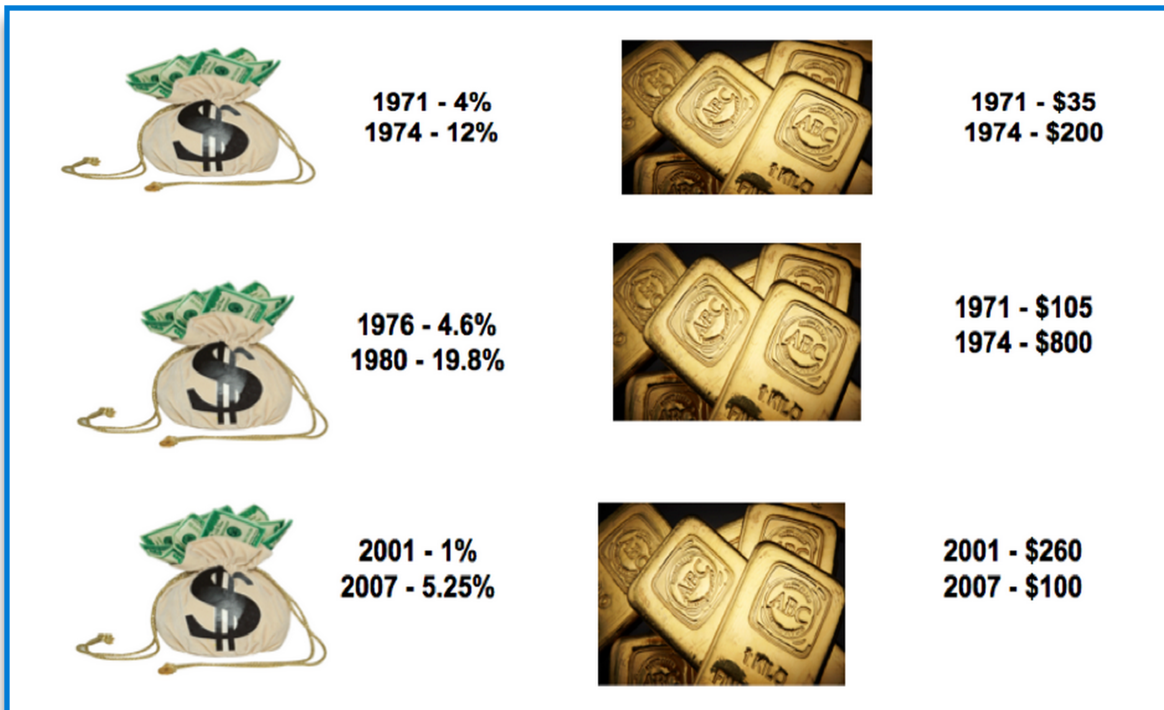
I want to encourage your viewers to actually go and get monthly gold price returns and also monthly moves in the Fed funds from 1970 through today. What they will find is that between 1970 and 1974, between 1976 and 1980, and between about 2002 and 2007, those are three of the most aggressive Fed rate hike cycles on record, and they are three of the most incredible periods of gold price appreciation on record as well.

This idea that nominal rate hikes are bad for gold, on the surface had a logic to it, but has been completely disproved by market history. I actually think that when we talk about black swans and unexpected events being catalysts for markets to move, I say bring on a Fed rate hike because I think it could be bullish for gold.

C. AUSTIN FITTS: Really? That one I hadn't considered, but I'm open. Jordan, you've persuaded me. I'm open.

JORDAN ELISEO: I will send you a slide which I'm very happy for you to include or provide to your members and your people who subscribe to Solari which will actually highlight those three periods, what the funds rate when from and to, and what actually happened to gold in those environments as well.

C. AUSTIN FITTS: I would love to see that. We will post that in the Subscriber area. Thank you.



We're running out of time, so I have to turn here. We do have some subscribers who are interested in learning what you offer – we're talking now about people who are in New Zealand, Australia, and the United States. What does ABC Bullion particularly offer in vaulted solutions?

JORDAN ELISEO: We do deal with clients, the majority of which are in Australia, from all over the world. We have clients up in Asia and North American and Europe. ABC Bullion can do one of two things to provide an allocated bullion solution.

The first is that the clients can obviously buy and store direct with ABC. As you may be aware, ABC Bullion actually owns its own gold refinery. We produce investment grade gold bars. Our kilobar, which is our signature product for investors, comes with its own serial number and its own certificate of authenticity. We work with some of Australia's largest gold mines in terms of where we get our gold from. A lot of overseas investors like buying gold bars, and then they put them in allocated storage with ABC bullion.

The second option, which is increasingly attractive to clients as well, is that we can provide through our private vault a sister company called Custodian Vaults, which is a non-bank purpose-built bullion vaulting facility located in Sydney, which is very attractive to international investors because they like the idea of having non-bank vaulted gold in Australia. What we can do for clients there is we can basically sell them precious metals that they want to invest in, and then we can also arrange a private box down there where they can actually have their metal stored. We have an independent party who can effectively act in terms of opening their box and putting their metal in there for them.

We've had a relationship with Grant Thornton there. Basically the client can effectively appoint them to act as the agent opening their box and making sure the gold is safely secured in there.

Those are the two ways we tend to work with international clients. Absolutely if you have people who would like to shoot me a note, you can provide them with my contact details. I would be very happy to talk through that in person.

C. AUSTIN FITTS: Can you just give your email and your contact information here, or would you like us to post it in the Subscriber area?

JORDAN ELISEO: We can do both. Absolutely. My email address is Jordan.Eliseo@ABCBullion.com.au. I'm very, very easy to find. I'm also relatively active on Twitter and LinkedIn and other social media. I'm a pretty easy guy to find if people want to talk further about our solutions for international investors.

C. AUSTIN FITTS: Obviously you don't have to come down to Sydney to do the vaulted solutions, which is wonderful. I would just say that I recommend a trip. It's so much fun to meet the ABC Bullion team.

Well, Jordan, I can't thank you enough for joining us. Can you just point us again to your website for the new book?

JORDAN ELISEO: Absolutely. The website for the new book is actually just

titled www.MoneyForNothingDebtForFree.com.au. It's available to purchase either via Amazon or via the Apple iBook store. It's basically $10 to download it, and I think people will find it a very interesting read.

It's tracking the number of debt in developed market, economies pretty much in the 1960's up until now, and how much of it went to housing, the roles that government played in that, how much of it was pure consumer credit. It then looks at the current state of the debt position, not only in developed market economies, but also in China, the role that the aging population will play, and what I call the 'challenge of big government', and then a real look at where the global economy is today.

There is a little special focus on Australia for Australian investors, and then the implications for investing and protecting and growing capital through what are going to be some very difficult years. It's full of practical tips as well as highlighting the challenges ahead.

C. Austin Fitts: A friend of mine always says, "Our circumstances are far too dire for the luxury of realism." Dire is the appropriate word.

Jordan, I can't thank you enough. This has been terrific. We will have your contact information and the slides up on the blog, and I'm sure if people have questions they can follow up directly.

You have a wonderful day in Sydney, Australia, and give our best to the ABC Bullion team.

Jordan Eliseo: Will do, Catherine. It's a pleasure to be here. Thank you for having me.

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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.