April 28, 2014

Dear Investor,

Play ball!

After a long cold winter, the rites of Spring surround us at last! As we welcome this change of seasons, the investment arena may have changed, too. 2014 may be a very different ballgame.

Unlike 2013, in which stocks more or less just pushed on upward, Q1 was a volatile quarter in which market declines and rallies alternated turns, needing one last spurt on the final day of the quarter just to finish in the green. The S&P 500 index closed out the quarter up a mere 1.2%. More importantly, as we write this letter, the S&P 500 has visited negative territory for the year once again, and while it dropped to -4% for the year, 213 of the 500 stocks that make up the index (40% of them) are in 'correction mode'. In other words, they are down more than 10%. Not only that, on average, S&P 500 stocks are down -10.5% on the year. Such a disparity, with the index down only -4%, but individual components feeling much more extreme movements, is yet another caution flag.

Why the change from 2013 when we just floated up … every quarter? As always, we need look no further than our friendly central planners. The 'Quantitative Easing' that lifted stocks to new heights in 2013 is now being reduced, or 'tapered' as the Federal Reserve likes to say. Interestingly, the Fed also likes to say that this 'tapering' will likely have no negative impact on asset prices, however, we beg to differ. Starting in January, the Fed reduced their monthly money creation from $85 Billion to $75 Billion. Judging from the Fed's original position that the Easing (money printing) would boost asset prices in the first place, and we saw that it did in fact do just that, that is a rather curious position to hold. For several years, we have worked to educate investors about the extreme nature of the strategies being employed by central banks. While it has worked to elevate asset prices, it has masked many realities. Most importantly, it has worked because several major countries have worked together to re-inflate the asset bubble. Meanwhile, underneath the surface, many very important factors have continued to deteriorate. In many cases, substantially.

When does the bubble-blowing cease to succeed, you ask? We believe the answer is when the non-Western countries refuse to accept the policies of the Western powers (U.S., UK, Europe and Japan). Unseen by most Americans, Eastern powers are moving aggressively away from using the dollar as the world's reserve currency. This is such an important issue, but it is understood by very few.

While Brazil, Russia, India, China and South Africa (known as the 'BRICS) move closer together and further away from dependence on the dollar, the U.S. has accelerated the process by choosing to meddle with Ukraine and to challenge Russia on their own doorstep. In this quarter's 'Behind the Curtain', we will discuss how, despite the bombardment of public statements by U.S. officials (and the complicit obfuscation of the truth by U.S. media), it is the U.S. and European Union that initiated the Ukraine crisis. This 'issue' relates directly to the topics we have written about for the past several years, and it, along with the theater in Syria, relates directly to energy, the 'petro-dollar', and U.S. attempts to control the deterioration of the dollar as the reserve currency. We will visit the significance of this issue and what Ukraine may mean not only to investments but our way of life.

Rising stock and real estate prices are masking the deterioration in many underlying areas. The U.S. is not immune from the fate of the many empires that preceded us. If this is a new topic to you, or one you have chosen not to study in the past, is time to pay attention! We will keep an eye on these matters for you. As always, call us if we can help with your allocations. Have a great Spring!

Best Regards,

Mike Sullivan,
President, Certified Financial Planner Professional ®

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Market Update & Backdrop

For the first time in a long string of quarters, there *was* a change in the storyline for Q1. The money spigots began to close, albeit only slightly, but the impact on stocks was noteworthy. Instead of the perpetual monthly float upwards, they alternated declines and rallies throughout the quarter with many indices ending near the unchanged mark. Bonds, alternatively, finally found some footing. 2014 has been a different story altogether, one we have been expecting. Here is the data for Q1:

INDEX	TYPE	Q1
Standard & Poor's 500	US Based Large Stocks (500)	1.2%
Dow Jones Industrials	US Based Large Stocks (30)	-0.7%
Nasdaq 100	US Based Large Stocks	0.5%
Standard & Poor's 400	US Based Mid-Cap Stocks (400)	2.8%
Russell 2000	US Based Small-Cap Stocks (2000)	0.8%
Dow Jones Transports	US Based Transportation Stocks	2.4%
Dow Jones Utilities	US Based Utility Stocks	8.3%
MSCI EAFE	International Large Cap	0.8%
Nikkei 225	Japanese Stocks	-8.4%
MSCI EM	Diversified Emerging Markets	-0.4%
Barclay Int Bond	Intermediate Bond	1.8%
3 Month Treasuries	Cash Equivalent	0.0%

- Rates of return for the quarter ended 3/31/2014, Data from Morningstar, yahoo.com

Risk appetite, which was relentlessly strong all throughout 2013 (when the Fed was printing $1,020,000,000,000 to be spread throughout the economy and the stock markets), not surprisingly cooled off in Q1 2014 … at the first incident of the monthly stimulus gradually being removed.

2014 looks like it is going to be the litmus test to see if the Fed can actually back off its relentless price pumping, to see if the economy and stock markets can stand on their own, or if the system is going to reveal itself as unsustainable without the constant inflows of Fed funny money.

The strategy, like it or not, has been working in one important aspect: businesses have strengthened and so has the economy. The harshest winter in years threw us a curveball in Q1, burying much of the country in snow and ice. The combination of the bad weather with the reduction in Fed stimulus seemed to matter a lot in January as stocks dove right out of the gate. Neither mattered in February though as the weather got worse and the stimulus was further reduced: stocks rallied all month instead on hope that the bad news would get the Fed to *stop* reducing stimulus! In March, when the Fed stated that they would keep their reduction plan *on track*, the markets stumbled to the finish. If you are a regular reader, you know stock prices are all about the Fed, almost all of the time.

At the Q1 final bell, mid-cap stocks led the way by rising 2.8%. The major large cap stock indices hovered between down -0.7% and up 1.2% for the quarter. Overseas, Japan sounded a potential warning bell as its massive stimulus program showed signs of failing: they succeeded in driving up inflation, but unfortunately did not bring wages along with them. Thus, most Japanese citizens are worse off than they were when the Japanese stimulus was started … not unlike in the U.S. In a potential warning sign of things to come in U.S. markets, the strongest group of stocks in Q1 was the Utilities sector. Often, but of course not always, Utilities are leaders right before markets reverse course and head south. The world of fixed-income securities finally got a reprieve and as yields declined and prices rose. The Barclays Intermediate Bond index posted a nice 1.8% gain, beating all of the major stock market indices. Cash equivalents once again delivered essentially zero returns.

At the U.S. corporate level:

While corporations are holding very healthy balance sheets (they have $2 Trillion in cash, roughly half here and half overseas), many began sounding warning bells revealing they were in a tough patch. Some attributed it to the horrible weather, while others were not so sure that weather was the stand-alone factor. In the non-weather categories, rising prices in food and other necessities and uncertainty due to the imminent Affordable Care Act deadlines seemed to capture the most blame.

The Q4 earnings season finished with a bit better results than it seemed destined to achieve earlier on, but corporate revenues were essentially flat once more. Q1 of 2014 seems likely to be a repeat, perhaps a bit on the weaker side, however, as we go to press there have been some spring-back improvements that may point to positive days ahead (geo-political issues notwithstanding).

- As we go to print, the Q1 earnings for S&P 500 companies have increased by a weak 0.2%.
- Revenue growth is also flat, as it has been for several quarters.
- Corporate forecasts are mixed. Last quarter, companies lowering forecasts outnumbered those raising them by an almost four to one margin. This quarter looks like it will be similar.

At the Macro / Big-Picture level:

The macro picture is still uncertain at the moment. Overseas, Europe seems to be gaining strength, while China and Japan seem to be cooling off. Domestically, some businesses have seen a bounce-back from the harsh weather, but some have not. There is more strong data lately than weak.

On the good-news front:

- Consumer Confidence surged to its highest level in seven years!
- Durable Goods orders rang in at 2.6%, a noteworthy bounce-back
- Home Prices rose 6.9% on average, year over year
- Several Purchasing Managers' Indices remained in growth mode
  - The National PMI registered 55.4 (although 56.3 was expected)
  - Philadelphia registered 54.2 (although 56.2 was expected
  - The Richmond Fed index jumped into positive territory at +7
- Industrial Production was a solid 0.7%
- Leading Indicators were up a strong 0.8%
- Retail Sales were up a surprisingly strong 1.1% after a weak January and February

On the not-so-great-news front:

- New Home Sales plummeted back to 385,000
- The Bloomberg Consumer Comfort Index weighed in at an abysmal -29.1
- The Jobs Report came in lighter than expected adding only 192,000 new jobs
- Jobless Claims rose again back above 300,000 to 335,000

Earnings are mixed as well with some notable misses including Proctor & Gamble and McDonalds. There were also some impressive beats by Apple, Netflix, Caterpillar and Chipotle. We mentioned last quarter that housing has been the strength of this rally. It took a bit of a stumble this quarter, much of that weather related we think as it pertains to the normal individual home-buyer. However, we need to understand that much of the support in the economy is provided by unconventional methods. A stunning amount of activity in the housing industry has been driven by 'all-cash' transactions, made by the Wall Street gang and their private equity friends. Those entities are now selling some of their supply, not buying any more, as this Fed-sponsored effort have once again driven asset prices upward and been a boon to Wall Street. Unfortunately, signs have appeared that Average Joe is again being priced out of the market. That is when trouble typically starts.

At the Global (and 'Currency War') level:

Many of the issues we have been writing about for the past few years are unfortunately proving to be quite correct, however, they have taken some time to manifest themselves. Nonetheless, since problems are constantly hidden under the surface by the Fed-sponsored market manipulations, they continue to develop under virtually no protest.

As we discussed last quarter, and will cover in great detail in this quarter's Behind the Curtain section that follows, the Reserve Currency status of the U.S. Dollar is potentially in more jeopardy than it has been in, possibly ever.

For the past several years, while the U.S. has been spreading itself thinner and thinner and increasing its debt more and more, our non-allies have been taking active steps to conduct more trade between themselves, without the involvement of the U.S. of the U.S. Dollar. They have also been acquiring hard assets, real estate and natural resources, assumedly as insurance against any loss of value in their dollar-based Treasury holdings.

The rate of change to the landscape is accelerating, too, and the steady accumulation by Russia and China in particular of trade agreements, gold, silver, energy, real estate, and other real assets have put them in a position of relative strength versus where they were just a few years ago.

Despite the Fed's success at hiding reality, the world is moving further away from the U.S. Dollar.

The economy has improved as it continues to respond to the games and tactics of our central planners. We would expect it to improve even further as long as debt continues to not matter to the world, and as long as our central planners can continue to do their thing.

Away from home, the recent developments in Ukraine are very different from what is being told to us via our leadership and the media. In fact, it is quite possible that for many of us, the situation in Ukraine may turn out to be the most significant geo-political development we have seen or will see in our lifetimes.

So, while things are holding their own for now, and the possibility remains that things recover further, the Ukraine situation has the potential to derail all progress. If everything holds together, the market rally can certainly continue. However, if the situation with Ukraine and more specifically, Russia, escalates, it will quickly be time to hunker down, and even the Fed's shenanigans will be unlikely to hold everything together. It is for that reason, that we cover Ukraine's significance as it pertains not only to Russia and China, but to the state of the U.S. empire and what may lie ahead.

If you have the time and are so disposed, we encourage you to read this quarter's Behind the Curtain section.

If not, keep an eye out for our Market Updates and have a great Spring!

Behind The Curtain

Fortune 500 companies continue to be the primary beneficiary of central bank backed government spending as cash on their balance sheets remain at record highs. The economy looks to be emerging from a rather damaging winter, and hope Springs eternal as stock prices continue to hover near record highs. If the central planners can continue to hold everything together, more good days can indeed lie ahead.

The biggest threat to investors, however, remains one that very few people see, the elephant in the room as the saying goes. For that reason, the topic of focus in this Behind The Curtain edition has to be one thing: Russia. Perhaps we should rename this edition 'Behind The Iron Curtain'??

First off, what is going on with Russia and Ukraine is unsurprisingly completely different from what is being presented to the American public. Second, it weaves together most of the topics about which we have written these past few years. Third, and most importantly for investors, it poses the biggest long-term threat to not only our investment returns, but to the American way of life.

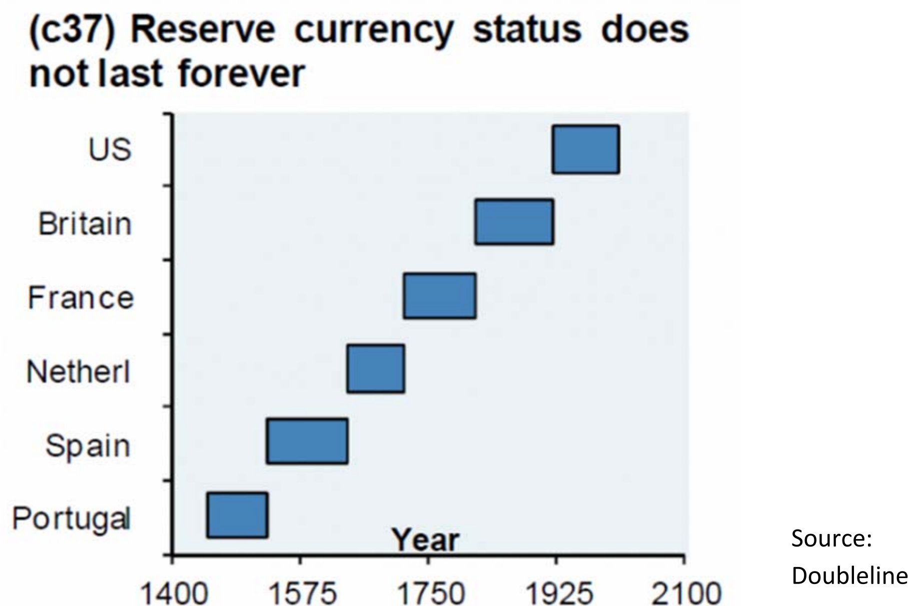
In order to understand it, you have to have a decent grasp on two topics:

1. The Reserve Currency, and
2. The Real Currency: Energy

For the benefit of our newer Clients, here is a brief recap of the Reserve Currency. For long-time Clients, feel free to skip past the next few paragraphs.

The Reserve Currency

First, a picture:



Source: Doubleline

The above graphic illustrates the history of the Reserve Currency, otherwise known as that currency in which most trade of goods and services is settled around the world. The Reserve Currency is held by the country in which the world has the most faith; that country whose debts are the best bet to be paid back.

Today, despite our preference to not believe it, the world is moving further away from using the U.S. Dollar as the Reserve Currency. As the picture above implies, our box may be closing in on the right side, something that has happened to all empires that preceded us. While the bottom left corner boxes may bring back vague memories of 'Ferdinand and Isabella' to many readers, the concept of the Reserve Currency tends to be an unfamiliar one … it is taught to very few American students.

One of the biggest challenges we have these days is communicating about not only the 'monetary system', but about the way it is being used, or rather misused. It is very difficult to convey the fact we may be approaching (or on) the right side of our box because so few know what the box even is.

Each empire that preceded us (and that is precisely what we have been, an empire) moved from the left side of their box (earned by initially being a fiscally responsible, self-restrained but militarily strong country) to the right side of their box after each one evolved into an globe-trotting militaristic juggernaut that went in pursuit of everyone else's resources as the means to sustain its growth.

As indicated previously, 'Ferdinand and Isabella' typically ring a bell for many, but the Reserve Currency lesson is rarely familiar because, by design it is never taught. If it were, we may not be where we are today, and Russia and the rest of the topics we'll cover today might not be occurring.

Energy

The real currency of the world is not paper money, it is energy.

Energy is the most powerful resource we have since it enables mass-production and rapid distance-traveling. Energy transforms the need to have hundreds of workers spending thousands of man-hours working in the fields into the need to have a few farm machines running, supported by a mere dozen workers. It transforms the speed at which we can produce enough food to sustain growing populations. Obviously, it increases the speed and scale of many other industries as well.

So, every country that wants to grow needs to obtain and harness energy successfully.

So, how does energy tie into the Reserve Currency, to the U.S., and to Russia's presence in Ukraine?

We need to go back to the days of the end of the Vietnam war, at which point the U.S. had essentially bankrupted itself. In jeopardy of being unable to pay its debts, the U.S. faced the likelihood that countries around the world would turn in their U.S. Dollars which at that time were redeemable in gold. By backing one's currency in gold, a country has to be somewhat restrained in its spending. That's the entire point of gold-backed currencies. Backed by nothing, spending is unrestrained and debts balloon to the point where they cannot be repaid. Thus, in the early 70's, the U.S. under Nixon removed the U.S. Dollar from the gold-standard.

As an alternative, arrangements were made by the U.S. with OPEC (Organization of Petroleum Exporting Countries) to establish the **Petrodollar** standard which thereafter required all countries that wanted to purchase oil from OPEC to do so with U.S. Dollars. So, effectively, the U.S. Dollar went from being gold-backed to being oil-backed. It was a brilliant switch, one that enabled the U.S. to outspend its means for more than four more decades and counting.

It also established the need for the U.S. to control relationships with energy-producing countries as much as possible, something we have been doing ever since. With the biggest military in the world, a homeland largely secure from border invasions and immediate regional threats, and a vibrant economy that has kept us thriving, that was not hard to do. Historically, however, most empires have ultimately failed at the task of controlling or exploiting the resources of countries across the globe because they reach too far, spend too much, and lose their ability to keep the game going.

That is where we stand today, and that is what the situation in Ukraine is all about, much like that is what it is all about in Syria, as it was in Libya and in Iraq.

Ukraine & Russia

What Ukraine and Russia are really all about and what that situation may very well evolve into *could* change the entire monetary system that Americans have enjoyed for their entire lifetimes.

Obviously, such a change would mean quite a lot to not only your investments, but your entire lifestyle. Ukraine and Russia are far more important that 'a harsh winter', corporate earnings, and cash on corporate balance sheets … far more important. Here's a recap of what has transpired:

After a coup in Ukraine in February, pro-Russian president Viktor Yanukovych fled the country while a new pro-Europe government took over. Crimea, the southernmost region of Ukraine is heavily populated by Russians, and more importantly it is the host to Russia's naval fleet on the Black Sea. Quite obviously, Russia does not want to lose control of Crimea, and soon after the change in government, Russian president Vladimir Putin sent in a few of his tanks to secure Russian bases. Soon after, Crimeans voted in a referendum to essentially secede from Ukraine and to rejoin Russia of which it had been a part numerous times throughout history.

The reporting on the matter here in the U.S. is disingenuous at best (as it was with Syria, Libya, Iraq and even Iran). First off, before we dig into it, let's make it clear that Russia is not 'the good guys'. As Americans, we would expect U.S. officials to take steps to maintain as best they can U.S. leadership roles in the world both economically and militarily. Of course, as has always been the case, this involves a large amount of story-telling and a steady amount of clandestine activity.

And so it has been that immediately after Putin's maneuvers into Crimea, U.S. officials began parading across TV screens making animated comparisons of Putin to Adolf Hitler, accusing Russia of 'interfering with the sovereignty of a nation state', and warning about Putin's likely intent to rebuild the former U.S.S.R. by conquering countries throughout the region. However, of course, the truth of what is happening at least initially is almost directly opposed to the theater on the 'news'.

We can know that the opposite is true due to the fact that Russia apparently has their own version of the U.S. 'National Security Administration' (NSA) and, like the NSA, their bureau apparently can both eavesdrop and record (without warrants) phone conversations otherwise believed to be entitled to privacy. Henceforth, there is a rather entertaining conversation between U.S. Deputy Secretary of State Victoria Nuland with the American Ambassador to Ukraine in which they discuss their efforts to 'unsettle' the existing Ukraine structure, as well as the various characters who they think should (and now do) run the show there. (If you are reading the PDF format of this letter, you can access the recording by holding the 'control' key and clicking HERE, otherwise you can pick up the link in the footnotes.[i] For some historical perspective on Ukraine and a look at the parties involved, look HERE and HERE or, again, pick up the links in the endnotes.)[ii] [iii]

Here is an earlier photo-op with Victoria Nuland, front and center, with her chosen cast of characters for the soon-to-be *new* Ukrainian government. In the back-center is Vitaly Klitschko who did not make the cut for top job. On the far right is Arseniy Yatsenyuk, who got the big post of Prime Minister, presumably because of his vast experience as … an international banker.

Source: Reuters

Anyway, despite the truth that the U.S., working with the European Union, arranged for or at least instigated the overthrow of the duly elected Ukrainian government and picked Ukraine's successors, we are fed the opposite message. That leaders and politicians on both sides of any issue and in any country would use mistruths to accomplish their cause is hardly a surprise to anyone anymore. If that was ever in doubt, all doubt was alleviated by the infamous statement during the heat of the financial crisis in 2009 when the matter of Portugal needing a bail-out arose. Jean Claude Juncker, prime minister of Luxembourg and Chairman of the Eurogroup's assembly of Finance Ministers stated quite matter-of-factly "when it gets serious, you have to lie!"[iv] So, there we have it.

Nonetheless, truth is discoverable and the very important truth for investors to understand about Ukraine is that the U.S. involvement there (and in Syria) is really about ***energy*** and about ***the Petrodollar***.

The U.S. is doing everything possible to control not only the energy in as many places possible, but to keep in place the requirement for countries around the globe to have to use ***U.S. Dollars*** to purchase oil for the reasons previously covered. Without the requirement that oil-consuming countries buy dollars first, then use those dollars to buy oil, the artificial support of the dollar that allows us to consume more than we should, would diminish rapidly. Thus, the situation in Ukraine and Syria is truly about maintaining our control over energy supplies as much as possible, about keeping that energy connected to dollars, and about weakening Russia to the greatest extent possible.

As we previously noted, the countries that held the Reserve Currency privilege before we did, *all* lost it. The path that our leadership is now traveling has been traveled many, many times before by those empires that preceded us … almost precisely. Most importantly, because of the way the Ukraine situation is playing out, any solution to save the Petrodollar may be moving out of our hands. Either out of necessity, or out of hubris, our leaders plod forward, ignoring the track record of history.

> "Those who cannot remember the past are condemned to repeat it."
>
> - George Santayana, 'The Life of Reason' (1905)

History is crystal clear that in relishing the benefits of holding the reserve currency, empires have always paraded around the globe seeking to acquire everyone else's resources. If the resources are not acquired directly, they are acquired indirectly by the injection of global corporations into the production processes. While profits may be shared, the empire's companies collect a nice piece of the pie. More importantly, they entrench themselves in other countries worldwide and work diligently to make sure they stay. Anyone that has seen old movies about the British Empire and its presence in Middle East and Far East countries (its British 'colonies') should be able to connect the dots.

The situation in Ukraine begs for Americans to look deeper into the matter, and to ask for answers. While there is absolutely no reason to take what the Russians say at face value, Americans should be questioning the Nuland tape. That the U.S. involvement not only risks World War 3 but threatens to accelerate the move away from the U.S. Dollar as the Reserve Currency, is worthy of more understanding. If more Americans could see the situation for what it is, we would likely be having that discussion. On the other hand, however, if we were having that discussion, everyone would know just how desperate the situation really is. And we might not like the answer.

Let's consider what it would look like if the Ukraine situation were reversed. Assume California was an independent country. Then consider Putin causing California to become unsettled, then working to put his troops (the equivalent of the U.S. and NATO personnel now in Ukraine) on our border. Certainly that would not be viewed to be a minor situation, and certainly we would not allow that to happen without a fight. Such are the stakes.

The reality is that Russia is not only a major energy producer (it supplies Europe with roughly 30% of its natural gas), but it has been recovering some of the international power it lost when the U.S.S.R. collapsed. Additionally, as we indicated in the Market Update section, with its role in the BRICS (Brazil, Russia, India, China & South Africa), it has been very involved in improving trade relations with various emerging markets countries, and in seeking to be less dependent on the 'Western' powers (U.S., U.K., Europe and Japan). Further, like China it has been procuring large amounts of gold and other assets, allegedly with the intent of at some point backing its currency or a joint currency with hard assets, or minimizing any damage to its U.S. Treasury holdings.

After Putin's recent involvement in Syria, during which he essentially turned back U.S. battleships in full view of the world stage, U.S. leaders may well have decided the time to weaken Putin is *now*. Increased unrest in Ukraine, or the presence of U.S. forces, NATO 'peace-keepers' or other non-

Russian countries would have the potential to impede Russian energy shipments to Europe (and elsewhere) and to threaten its recent progress back towards being a leading world power.

Some analysts have suggested that the U.S. might weaken Russia while simultaneously strengthening itself by using some of the U.S.'s newfound 'shale-boom' natural gas to fill any void caused by blocked Russian supplies. While that makes logical sense, it is not practically likely because the levels of stockpiles do not support heavy U.S. supply, nor does our current infrastructure.

Here is the major risk we face: In clandestinely promoting the unrest in Ukraine, then making Russia the sole villain, not only is the U.S. further harming its own credibility as it ignores the Nuland conversation (the pro-Russian countries can listen to the Nuland conversation on Youtube as easily as we can), we seem to be pushing the anti-Western countries closer together, and quickly.

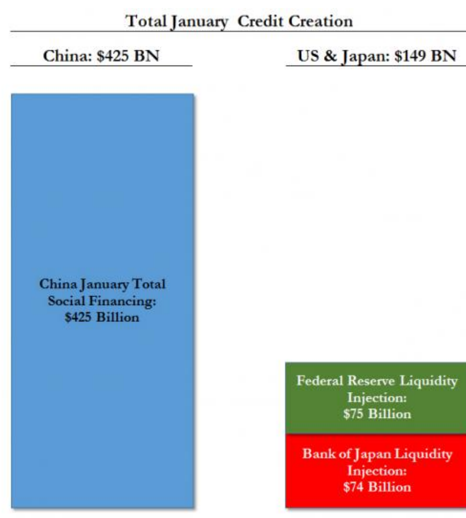
We should look at the Ukraine matter from another important angle, too. For the past several years we have pointed out the potentially reckless activity of the *Western* central banks. We have also recognized the success of those central bank strategies and attributed it to the fact that all of the Western G4 countries have been working together: Japan, U.K., E.U. & U.S.

More importantly, the *Eastern* central banks have accepted this activity since it has also allowed them to grow their own economies. In other words, as long as they are deriving more benefit than pain from Western actions, they will let them run. And, so they have. And it has suited them fine.

Of the Eastern central banks, perhaps China's is most important as China is our biggest competitor as a world and economic power, and increasingly as a military power. China has even out-printed the Western central banks. We have covered in the past the many empty cities that exist throughout China. With no one living in them, there are no incoming cash flows. That would be the equivalent of building entire neighborhoods in the U.S. and having nobody live in them. Nobody is paying the mortgages, nobody is paying rent. (Hey, didn't we just do that??) It is all supported by China's central bank.

While on the surface it seems the Chinese would have to be mad for doing that, in another sense it is brilliant. While central banks routinely misrepresent/understate the rate of inflation, one place it is undeniably exploding is in high-priced markets like high-end real estate (again), luxury cars, artwork and collectibles. If something is one-of-a-kind, it sells for a high price. One of the major acquirers of all of these high-end properties and toys is … Chinese nationals. A recent headline indicates the new leader in acquiring high-end real estate in Manhattan is no longer the *Russians*, it's the *Chinese*.[v]

So, while China is not only out-printing Bernanke and Yellen, the Chinese are acquiring real property with their funny money as fast as they can. For perspective, here is a snapshot of the money creation from the three biggest offenders in January of 2014:



Sources:
PBOC &
ZeroHedge

While the U.S. and Japan created $75 and $74 Billion respectively, China cranked out a whopping $425 Billion. And, as just discussed, they *are using it to buy high-end real estate in power-center cities around the world, not just* New York City, but London, Los Angeles, Chicago, etc.

So, at the moment, China may even be beating the U.S. at its own game. While the U.S. has spent much of its created money on government assistance programs, on Defense Contractors and on filling the role of World Policeman, China has been buying up everything in sight … while simultaneously consuming massive amounts of resources to build up its homeland.

Further, they continue to accumulate precious metals at break-neck speed.

So, what does China have to do with Russia?

When Russia stepped into Crimea to secure their assets in Crimea, then advocated for the Crimean's 'Secession Vote' to occur, China instantly backed them. In addition, so did India and of course Iran. More or less, the BRICS countries, all of whom have been implementing direct trade agreements and working to wean themselves from the U.S. Dollar, stepped quickly in line behind Russia.

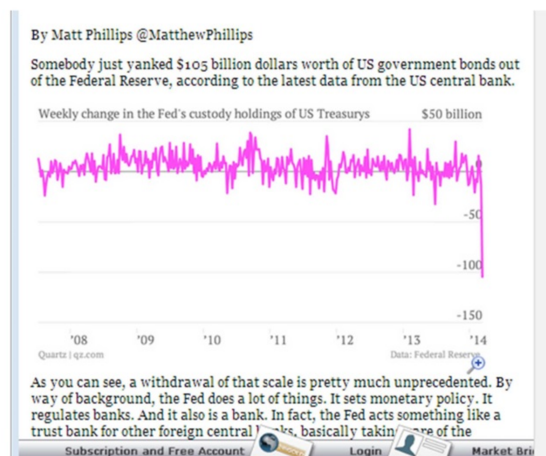
As the saying goes, 'Therein lies the rub'.

After Putin's excursion into Crimea, the U.S. and E.U. threatened Russia immediately with economic sanctions including freezing the assets of a number of Russian officials and oligarchs. Russian banks were blocked from doing business with Western banks. And VISA and Mastercard even shut down transactions with a number of Russian banks. Putin responded by opening up a personal account with one of the Russian banks, and one of Putin's economic officials threatened to 'dump U.S. Treasury bonds' and spark a financial crisis. The Obama Administration's Jay Carney then returned the verbal volley by threatening that it would likely be a very bad time to own Russian stocks.

So … here we are, with an escalating crisis that is accelerating the cohesion of non-Western countries. The economic and financial sanctions have hastened the view of Russia, China and others that a financial system *not dominated by Western countries* is in their best interests.

All of this may mean very simply that in an effort to weaken the other side, and to strengthen the Petrodollar in the process, we quite possibly just did the exact opposite.

Following Russia's statement that they would dump U.S. Treasuries, the biggest weekly outflow since 2008 hit the tape with a net foreign redemption of over $108 Billion. That compares with a typical net inflow or outflow of $10B - $15B. Obviously, having other countries begin dumping their US Treasury holdings is no small deal to the U.S., nor to the financial markets.



By Matt Phillips @MatthewPhillips

Somebody just yanked $105 billion dollars worth of US government bonds out of the Federal Reserve, according to the latest data from the US central bank.

As you can see, a withdrawal of that scale is pretty much unprecedented. By way of background, the Fed does a lot of things. It sets monetary policy. It regulates banks. And it also is a bank. In fact, the Fed acts something like a trust bank for other foreign central [illegible], basically takin[illegible] of the

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Source:

Matt Phillips

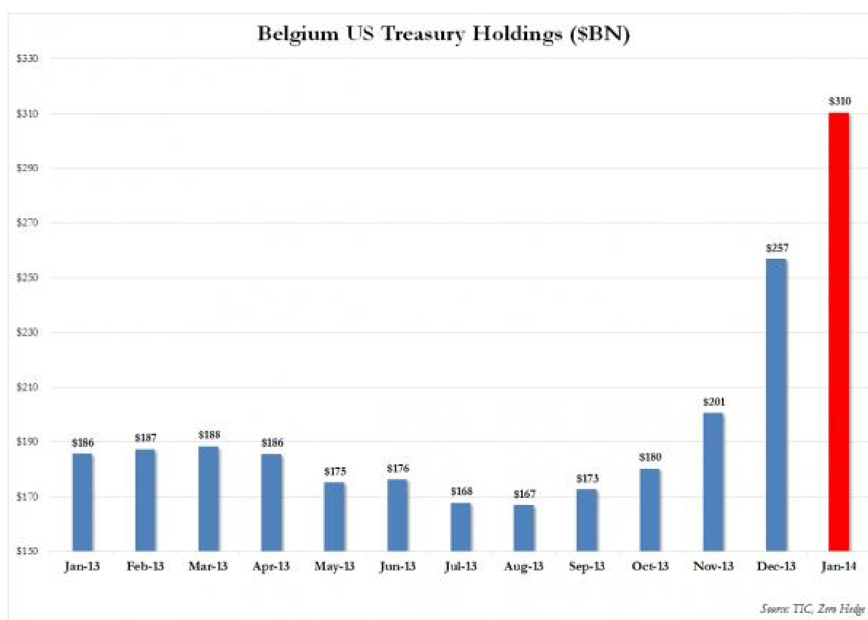
Russia only holds $250 Billion in Treasuries, so its action alone might not singlehandedly panic the markets, at least not initially. Thus, the Treasury dump depicted above did not spook the bond markets whatsoever. (That is only for the reason that the Federal Reserve prints enough money in 2 ½ short months to buy up all of Russia's supply, a bizarre concept by itself.) However, if other countries were to join Russia in dumping Treasuries, the U.S. would be in big trouble fast.

We already know that China is not only not a true ally of the U.S., it is clearly moving rather aggressively away from the U.S. Dollar. In fact, the only thing it is *not doing* presently is dumping its U.S. Treasury holdings. Consequently, the U.S. needs to be very careful that it does not drive China to take action faster than they are clearly already planning. As long as it is not in China's better interest to do so, it is hard to believe it would. Why spark a crisis until you are ready??

Pulling back the curtain once more on the essentially fictional nature of markets as run by the central banks, let's look at the most unlikely of parties now supporting the U.S. Treasury bond market. Bizarrely, the 3rd largest owner of U.S. Treasuries after China and Japan is … Belgium.

As we rolled into January 2014, concern was being voiced that the Fed's commitment to 'taper' its money-printing bond purchases down from $85 Billion per month might cause some problems in the market. Not to worry though, tiny Belgium has stepped in to save the day by buying over a hundred billions dollars in Treasuries during December and January.

Not only does Belgium not have that kind of money, the equivalent of 200% of the annual Gross Domestic Problem, if they did the sheer amount of the investment should be prompting questions about where they got it and why the aggressive urge to park it in U.S. Treasuries. Since the Fed is not subject into any audit of its transactions with foreign banks, we'll likely never know.



Source: ZeroHedge

When we put all of these issues together, we can see that central bank policies that finance the U.S. activities around the globe weave through many places and many current events.

They central bank's printed money weaves through the Defense Spending that finances our military presence across the globe. It weaves through our State Department's undermining of Ukraine's government as we do everything we can to maintain the upper hand on energy, the Petrodollar and over any foes to our system, like Russia. And in our view it almost surely weaves through the absurdity of Belgium becoming the 3rd largest owner of Treasuries.

With our U.S. central bank backing everything by its constant creation of new dollars, we dominate both the financial markets and the world stage.

There are considerable reasons for the non-Western world to wish to put an end to this advantage.

In 2008, driven by the Fed's low-interest rate housing boom, it was the biggest U.S. banks that precipitated the massive financial crisis through their creation and abuse of mortgage backed securities and derivative securities. The Eastern world knows that.

In 2014, it is the U.S central bank's money printing that has driven stock markets back up to new highs, held bond markets in check, and helped suppress prices in the precious metals markets. It is also pulling back the curtain to reveal how far from free nearly every market is now. As some point, the confidence game will end … or rather, it will be ended for us.

It would seem that, with our latest escapade, our excursion onto Russia's doorstep, the stakes are higher than they have ever been for the U.S. and the Western controlled financial system. And, the threat to Russia and its non-Western allies is at least as high as it has been since the Cold War. Almost all of the 'sanctions' that the U.S. has levied against Russia are financial restrictions, controlled by Western banking system. It is beyond clear to those familiar with this backdrop, that the non-Western countries want desperately to be out from under the thumb of the West.

The accumulation of gold[vi], land and real estate, coupled with the expansion of the energy business by the non-Western countries is a strong indication that the U.S. Dollar is in more danger than it has been in a long time, possibly ever.

It is this threat in our opinion that trumps everything else investors may be watching regarding the bond market, the stock market, and every other market. While in some sense, this type of topic may at a high level seem to have no great significance to investors, at a deeper level there is likely no more important factor that could negatively impact your hard earned assets.

In our view, it is as strong a time for caution as we have seen in a long time.

Let's hope cool heads prevail and this all ends nicely. But, let's respect history, too, and keep an eye on the real significance of the headlines we are fed.

As always, please call us if we can help with your allocations or strategy development. Have a great Spring!

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[i] https://www.youtube.com/watch?v=NTos0duooaU

[ii] http://www.boilingfrogspost.com/2014/01/07/us-ngo-uncovered-in-ukraine-protests/

[iii] http://www.globalresearch.ca/cold-war-crisis-in-the-ukraine/261

[iv] http://globaleconomicanalysis.blogspot.com/2011/05/jean-claude-juncker-luxembourg-pm-and.html

[v] http://www.zerohedge.com/news/2014-04-27/chinese-trump-russians-manhattans-top-apartment-buyers

[vi] http://kingworldnews.com/kingworldnews/KWN_DailyWeb/Entries/2014/4/22_Axis_Of_Power_As_Countries_Move_To_Link_Currencies_To_Gold.html