Sea Change

JOHN MAULDIN | October 13, 2014

> You don't need a weatherman
> To know which way the wind blows.
>
> – Bob Dylan, "Subterranean Homesick Blues," 1965
>
> Full fathom five thy father lies.
> Of his bones are coral made.
> Those are pearls that were his eyes.
> Nothing of him that doth fade,
> But doth suffer a sea-change
> Into something rich and strange.
>
> – William Shakespeare, *The Tempest*

Did you feel the economic weather change this week? The shift was subtle, like fall tippy-toeing in after a pleasant summer to surprise us, but I think we'll look back and say this was the moment when that last grain of sand fell onto the sandpile, triggering many profound fingers of instability in a pile that has long been close to collapse. This is the grain of sand that sets off those long chains of volatility that have been gathering for the last five years, waiting to surprise us with the suddenness and violence of the avalanche they unleash.

I suppose the analogy sprang to mind as I stepped out onto my balcony this morning. Texas has been experiencing one of the most pleasant summers and incredibly wonderful falls in my memory. One of the conversations that seem to occur regularly among locals who have a few decades under their belts here, is just how truly remarkable the weather has been. So it was a bit of a surprise to step out and realize the air had turned brisk. In retrospect it shouldn't have fazed me. The air has been turning brisk in Texas at some point in October for the six decades that my memory covers, and for quite a few additional millennia, I suspect.

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But this week, as I worked through my ever-growing mountain of reading, I felt a similar awareness of a change in the economic climate. Like fall, I knew it was coming. In fact, I've been writing about it for years! But just as fall tells us that it's time to get ready for winter, at least in more northerly climes, the portents of the moment suggest to me that it's time to make sure our portfolios are ready for the change in season.

Sea Change

Shakespeare coined the marvelous term *sea change* in his play *The Tempest*. Modern-day pundits are liable to apply the word to the relatively minor ebb and flow of events, but Shakespeare meant *sea change* as a truly transformative event, a metamorphosis of the very nature and substance of a man, by the sea.

In this week's letter we'll talk about the imminent arrival of a true financial sea change, the harbinger of which was some minor commentary this week about the economic climate. This letter is arriving to you a little later this week, as I had quite some difficulty writing it, because, while the signal event is rather easy to discuss, the follow-on consequences are myriad and require more in-depth analysis than I've been able to bring to them on short notice. As I wrestled with what to write, I finally came to realize that this sea change is going to take multiple letters to properly describe. In fact, it might eventually take a book.

So, in a departure from my normal writing style, I am going to offer you a chapter-by-chapter outline for a book. As with all book outlines, it will be simply full of bones but without much meat on them, let alone dressed up with skin and clothing. I will probably even connect the bones in the wrong order and have to go back later and replace a leg bone with a rib, but that is what outlines are for. There is clearly enough content suggested by this outline to carry us through the next several months; and given the importance of the subject, I expect to explore it fully with you. Whether it actually becomes a book, I cannot yet say.

I should note that much of what follows has grown out of in-depth conversations with my associate Worth Wray and our mutual friends. We've become convinced that the imbalances in the global economic system are such that the risks are high that another period of economic volatility like the Great Recession is not only likely but is now in the process of developing. While this time will be different in terms of its causes and symptoms (as all such stressful periods differ from each other in many ways), there will be a rhyme and a rhythm that feels all too familiar. That should actually be good news to most readers, as the last 14 years have taught us a little bit about living through periods of economic volatility. You will get to use those skills you learned the hard way.

This will not be the end of the world if you prepare properly. In fact, there will be plenty of opportunities to take advantage of the coming volatility. If the weatherman tells you winter is coming, is he a prophet of doom? Or is it reasonable counsel that maybe we should get our winter clothes out?

Three caveats before we get started. One, I am often wrong but seldom in doubt. And while I will marshal facts and graphs aplenty to reinforce my arguments, I would encourage you to think through the counterfactuals presented by those who will aggressively disagree.

Two, while it goes without saying, you are responsible for your own decisions. It is easy for me to say that I think the bond market is going to go in a particular direction. I can even bet my personal portfolio on my beliefs. I can't know your circumstances, but if you are similar to most investors, this is the time to make sure you have a truly balanced portfolio with serious risk management in the event of a sudden crisis.

Three, give me (and Worth, whom I am going to draft to write some letters) some time to develop the full range of our ideas. To follow on with my weather analogy, the air is just starting to get crisp, and winter is still a couple months away. Absent something extraordinary, we are not going to get snow and a blizzard in Dallas, Texas, tomorrow. We may still have some time to prepare, but at a minimum it is time to start your preparations. So with those caveats, let's look at an outline for a potential book called ***Sea Change***.

Prologue

I turned publicly bearish on gold in 1986. At the time (a former life in a galaxy far, far away), I was actually writing a newsletter on gold stocks and came to the conclusion that gold was going nowhere – and sold the letter. I was still bearish some 16 years later. Then, on March 1, 2002, I wrote in *Thoughts from the Frontline* that it was time to turn bullish on gold. Gold at that time was languishing around $300 an ounce, near its all-time bottom.

What drove that call? I thought that the future directions of gold and the dollar were joined at the hip. A bit over a year later I laid out the case for a much weaker dollar in a letter entitled "King Dollar Meets the Guillotine," which later became the basis for a chapter in *Bull's Eye Investing*. As the chart below shows, the dollar had risen relentlessly through the early Reagan years, doubling in value against the currencies of America's global neighbors, causing exporters to grumble about US dollar policy. Then the bottom fell out, as the dollar made new lows in 1992. From 1992 through 2002 the dollar recovered about half of its value, getting back to roughly where it was in 1967. Elsewhere about that time, I predicted that the euro, which was then at $0.88, would rise to $1.50 before falling back to parity over a very long period of time. I believe we are still on that journey.

One of the biggest drivers of economic fortunes in the global economy is the currency markets. The value of your trading currency affects every aspect of your business and investments. It is fundamental in nature. While most Americans never even see a piece of foreign currency, every time we walk into Walmart, we are subject to the ebb and flow of global currency valuations, as are Europeans and indeed every person who participates in the movement of goods and services around the globe. In fact, globalization means that currency values are more important than ever. The world is more tightly interconnected now than it has ever been, which means that events which previously had no effect upon global affairs can trigger cascades of events that affect everyone.

I believe we are in the early stages of a profound currency-valuation sea change. I have lived through five major changes in the value of the dollar in the 45 years since Nixon closed the gold window. And while we are used to 40% to 50% moves in the stock market and other commodity prices happening in just a few years (or less), large movements in major trading currencies typically take many years, if not decades, to develop. I believe we are in the opening act of a multi-year US dollar bull market.

Chapter 1 – The Boys Who Cry Wolf

We all know the story of the boy who cried "Wolf!" once too often. I have been pounding the table about a dollar bull market for about three years now. I see eyes roll when I speak at conferences around the world and boldly forecast that the dollar is going to get stronger than anyone in the room can possibly fathom. All the signs have been pointing to it, and indeed we've seen the dollar move upward in a rather herky-jerky fashion off the lows of 2010, but not in a way that has been all that dramatic (except, arguably, against the Japanese yen). Indeed, the relative trading range of the dollar has been relatively constrained over the past six to seven years, pivoting around 80 on the DXY (symbol for the US dollar spot index).

This is in contrast to the true doom-and-gloomers, who are forecasting "the Demise of the Dollar." At the same time, they are calling for an unseemly rise in interest rates, and many of them believe the Federal Reserve will push us over the brink into hyperinflation. Needless to say, then, you should buy massive amounts of gold and get your money out of the country.

I have had long conversations with many who believe in such a scenario. I call some of them close friends, even if we disagree on something as fundamental as the future of the dollar. I've come to the conclusion that their conviction is a lot like a religious belief. I'm not going to change them, and so I make very little effort to try. So, fair and friendly warning: if you think the US dollar is headed to oblivion, you are not going to like this book outline or the next few months of my letter.

(Sidebar to those of you who, like me, own gold. You do not have to be a dollar bear to be constructive on gold and believe that it belongs in a diversified portfolio. But more on that front if we do a chapter on gold.)

Getting back to portents of winter, this week saw two side comments by Federal Reserve members that put a distinct chill in the air.

The first is from William Dudley, the president of the Federal Reserve Bank of New York and a permanent voting member on the FOMC. In a speech at Rensselaer Polytechnic Institute, he pushed back on the idea that it is time to raise rates. While acknowledging the relatively positive stance of the Federal Reserve in its forecast, he said:

> While I believe that the risks around this consensus forecast are reasonably well balanced, **I also believe that the likelihood that growth will be substantially stronger than the point forecast is probably relatively low.** [my emphasis]

He went on to cite weaker than expected consumer spending and the expectation that consumer durable purchases will be weaker in the future (by which I assume he means automobiles, which have been on a blistering, back-to-the-all-time-high pace due to supereasy credit, much of it subprime and with durations beyond five years.) He faults mortgage lenders for the substandard housing recovery, as if the last massacre of lenders was not enough to scar their collective psyche for decades.

(Sadly, he might have a point. Somewhat humorously, Ben Bernanke tells us he was turned down for a mortgage because his income is somewhat unsteady. He did not fit the "check-the-box" protocol of his local mortgage lender. I sympathize. I was turned down multiple times earlier this year before finding willing lenders who actually competed for my business. My business life does not accord with a standard check-the-box mortgage. I read about another business owner who noted that any of his 300 employees could get a mortgage, but he could not because his income was not stable enough. Go figure.)

Each of Dudley's points was covered in long paragraphs. And then he delivered a short, throwaway line that caught my attention. He cited the growth in the exchange value of the dollar over the last few months as a reason for downside risk. Really? Go back and look at the chart above and see the relatively minor dollar moves of the past few months. Why should dollar strength show up in a list of reasons for upcoming weakness in the US economy?

The next day saw the release of the minutes of the previous month's FOMC meeting. In the part labeled "Staff Review of the Financial Situation," the staff mentioned "… responding in part to disappointing economic data abroad, the US dollar appreciated against most currencies over the inter-meeting period, including large appreciations against the euro, the yen, and the pound sterling."

While there are precedents for the staff review to mention the dollar, it doesn't happen often. (In January 2002 the staff notes included concern about the strength of the dollar. That concern went away rather quickly. Coincidence? Hat tip, Joan McCullough.) The strengthening dollar is clearly on the minds of the members and staff of the Federal Reserve. Hmmm…

The key here is to note that the strength of the dollar (or lack of it) is not traditionally a Federal Reserve concern. The relative value of the dollar is the purview of the US Treasury, while the Federal Reserve is responsible for maintaining stable purchasing power (interest rates and money supply, etc.). Both organizations are careful not to tread on the other's territory.

What if we are at the beginning of another 10-year bull market in the dollar? Is it unthinkable that the value of the dollar could rise back to 120 on the index over that time? Let's look at that chart again:

From a very long-term perspective, 100 on that index is certainly a possibility, and 120 is not without precedent. But if the dollar rises to those levels, even in the very short-term, volatile patterns of the past, it changes everything it touches. And the value of the dollar touches everything. So let's think about some of the consequences over the long term of a rising dollar.

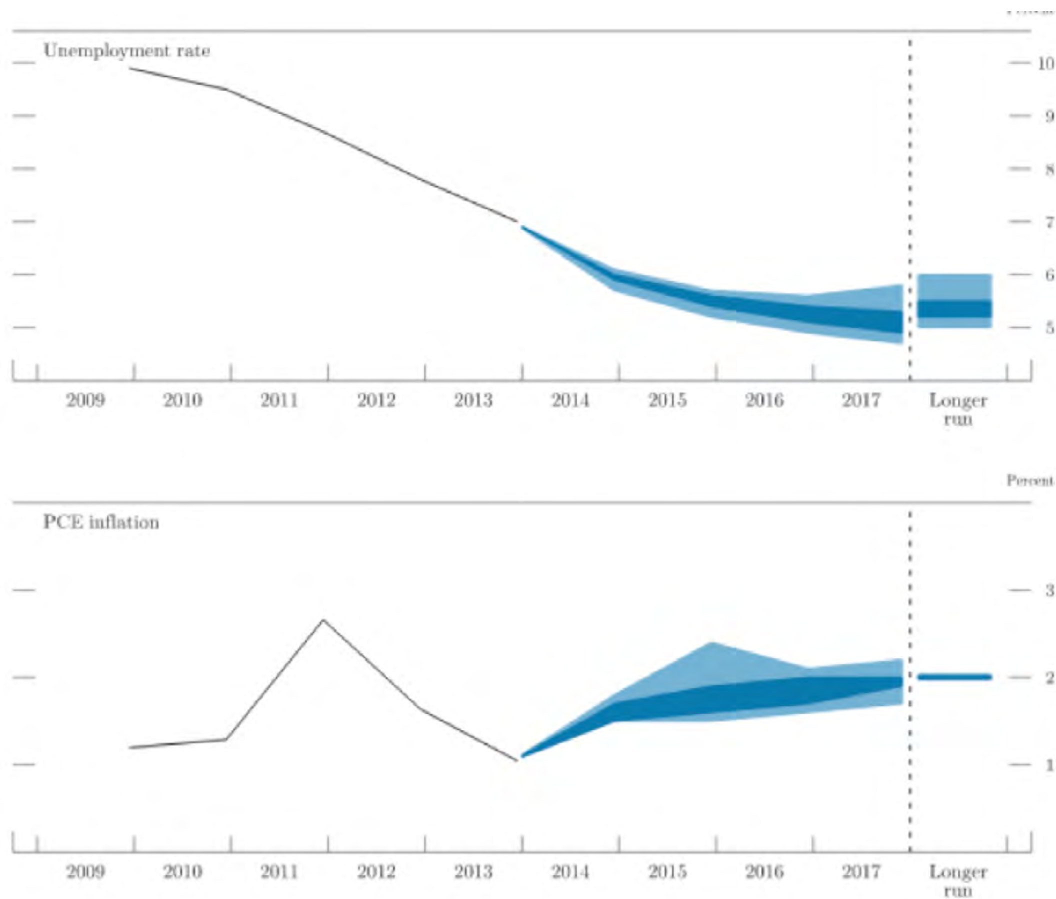
Chapter 2 – A Monkey Wrench for the Fed

A rising dollar is almighty inconvenient for a Federal Reserve that would like to eventually raise interest rates. Multiple regional Fed presidents and Fed governors would really like to see inflation in the 2% range prior to raising rates.

A dollar that is rising against the currencies of our major trading partners is inherently disinflationary, if not outright deflationary. (Pay attention to how often that word *deflation* occurs in this outline.) The current inflation rate is 1.7%. The Dallas trimmed-mean PCE inflation rate was actually negative in August and has been falling for the last five months, more or less coinciding with the rising dollar.

The makeup of the Federal Reserve FOMC voting membership next year is going to be decidedly "dovish." Dallas Fed President Richard Fisher will retire, and his voice will no longer be present. Yellen and the entire team (with two notable exceptions) have been out and about using the words *data-dependent*, with Minneapolis Fed President Kocherlakota arguing that raising rates anytime in 2015 would be a mistake.

Look at what Federal Reserve unemployment and inflation-rate predictions are as of September 17:



NOTE: Definitions of variables are in the general note to the projections table. The data for the actual values of the variables are annual.

Fourteen of the 17 members of the Fed (including the 12 regional presidents) anticipate that rates will be raised in 2015. Most observers think the first rate increase will happen at the June meeting.

What happens if unemployment continues to fall toward 5.5% and inflation drops below 1.5%? Can this Fed – not you or I, but the aggressively Keynesian members sitting on that board – justify raising rates if inflation is only 1.5% and falling? Which is the more important data number, unemployment or inflation? Or do they both need to click into place?

If the dollar were to continue to rise and thus allow Europe and Japan to export their deflation to the US, it is not clear that the Fed would raise rates in June.

A rise in the dollar from its current 85 on the DXY to 120 over the next six or seven years will throw a monkey wrench into the plans of the Federal Reserve.

Chapter 3 – Every Central Bank for Itself

A rising dollar presents all sorts of problems and opportunities for the central banks of the world. Japan has chosen the most aggressive monetary policy in the history of the world and will, I believe, work to see the value of the yen cut in half over time. Notice in the chart below that it was only 20 years ago that the yen was at 250. It touched 150 less than eight years ago. Forty years ago it was at 357. Is it so unthinkable that the yen could retrace half that move? Not to the Japanese. That would take it into the range of 200 to the dollar. I made the case for such a move in *Endgame* and doubled down on the prospects for Japan in *Code Red*. Japan is a bug in search of a windshield. The yen is embarked on a multi-year decline.

Europe would clearly like to see a weaker euro against the dollar and other major trading currencies. Ditto for almost every central bank in the world. But a rising dollar creates special problems for China and some emerging markets, problems we will look at in later chapters.

In an important speech on Saturday, October 11, Fed Vice-Chairman Stan Fischer outlined the mechanisms for the international transmission of monetary policy. Fischer says the international effects of monetary policy "spill back" onto the US, and the central bank cannot make "sensible" choices without taking them into account.

> [T]he U.S. economy and the economies of the rest of the world have important feedback effects on each other. To make coherent policy choices, we have to take these feedback effects into account.

He ended with an assurance to all that the Federal Reserve would provide liquidity to the world in the event of another crisis. Because it is in our interest, he says. This will be the ultimate test of game theory, where it might take years to find the Nash equilibrium.

The bottom line? It's every central bank for itself. No matter how much pleading there is from peripheral central banks, there will be no true coordination among the major central banks. (Hat tip to David Kotok for alerting me to Fischer's speech as I was writing. He also pointed out that the unintended consequences of the feedback effect means that policymaking can be dangerous.)

Chapter 4 – The Man Behind the Euro Curtain

Was it only a few years ago that Mario Draghi uttered his famous line, “We will do whatever it takes”? Interest rates in Europe have collapsed since then, as the European bond markets believed that Mario had their back. He has not had to do anything of true significance to back up those words, and what he has done has been lackluster.

This week Mario was up on the stage in Washington DC, where he essentially said that the problems in Europe cannot be fixed by monetary policy but are fiscal and regulatory and require actions from governments, not from central banks. The Bundesbank has clearly held sway, at least so far as the prospects for European quantitative easing go. While Draghi hinted that he would like to do €1 trillion worth of QE, it is not clear exactly how he would go about that.

Mario is like the Wizard of Oz. He talks a good game and puts on a good show, but it is soon going to become apparent that he really doesn’t have any magic, at least not until the Germans allow him to open up his trunk of tricks. Right now they’re keeping it safely stowed away in Berlin.

German intransigence is going to precipitate a crisis in Europe. Italy has been in a recession. France is crossing into one. Spain is barely holding on. Even German exports are slowing. France and Italy are balking at meeting the 3% deficit targets mandated by the EU treaty. Germany has drawn a line in the sand; France and Italy fully intend to cross it. This should be interesting; but however it turns out, I don’t think it will be good for the euro.

How long can interest rates in Europe stay at the irrationally low levels where they are today? We touched on that question in past letters, so I won’t cover that ground again, other than to say negative interest rates in Ireland and France are as indicative of dysfunctional markets as anything one might postulate.

When Draghi loses the narrative, or his ability to simply jawbone the market to where he would like it to be, all hell is going to break loose in the European bond market. Exactly what will the safe-haven currency be? The Swiss can’t print enough francs. Even Norway doesn’t have that many kroner. It will be the US dollar. Implications in a later chapter.

Chapter 5 – The Wrong Side of the Trade

Close to 50% of sales and profits for the S&P 500 come from outside the US. A strong dollar will put a strain on those dollar-denominated profits. Not an insurmountable problem, as Japanese businesses have figured out how to thrive in a rising-yen environment for decades. But old US business dogs are going to have to learn new tricks in a rising-dollar world.

But a strong dollar is not just a problem for US exporters. It is particularly a problem for countries that are financed by the dollar carry trade. Multiple trillions of dollars have left the US courtesy of quantitative easing and have ended up financing all manner of trades and investments around the world. As long as the dollar is neutral or falling, that’s a good thing for dollar carry-trade investors.

If you are a Chinese businessman and you can borrow dollars (which you certainly can) and you believe that your government is going to make the yuan stronger over time, you will be able to pay back cheaper dollars and make the difference on the carry (the difference between what US bonds pay and returns that can be earned in China). But what happens if the yuan begins to fall? That trade unwinds swiftly and negatively. And it unwinds at a time that is particularly inconvenient for China. Flood the market with too much money, and inflation becomes a problem. (The Chinese are in a different phase of the monetary cycle than the US is, so the problems are not the same.)

It is not just China. Those dollars have filtered into every nook and cranny of the world; and now, if those trades are unwound, investors and most specifically hedge funds are going to have to buy dollars to unwind their trades. That will force the dollar ever higher against various currencies; and while any one currency is not significant enough to create a structural difference that can impact global trade, together they will have a significant effect.

There is a crisis brewing in emerging markets. Most of the world's hedge funds and investors are on the wrong side of the dollar trade. Unwinding that trade is going to be a bitch (that is a technical economics term). Worth Wray will be writing about that very topic in a few weeks. You do not want to miss that letter.

Chapter 6 – The Texas Carry Trade

A rising dollar is going to put pressure on oil prices in particular and on energy prices in general. And falling oil prices have a strong secondary effect on Federal Reserve interest-rate policy. Pay attention, there will be a quiz.

Over at *The National Interest*, Sam Rines of Chilton Capital writes that Texas has been the engine of growth for the US for the past five years:

> Job creation might be a good place to start. Texas has created jobs – there is little arguing that point. For instance, we know the U.S. economy only recently gained back the jobs lost in the Great Recession. This is not true of Texas. While the United States dropped about 6 percent of employment, Texas lost 4 percent and recovered them all by August 2011 – nearly three years before the United States as a whole.
>
> Here is where the numbers get interesting. From its peak in January 2008 through today, the United States has created only 750,000 jobs. Texas created over a million jobs during that same period – meaning that the rest of the country (RotC) is still short 300,000 jobs. During the recovery, job creation has been all Texas or – at the very least – disproportionately Texas.

Choosing a different starting point – for example, in the trough of job losses – changes the extremity of the story. And there are all sorts of reasons for this disparity between Texas and the rest of the country, most of which miss the main point. In a conversation with Worth, Rines called the disparity the Texas Carry Trade. I like that.

The Texas story is by and large an oil story. We are far more diversified that we were in the ’80s, but oil is clearly the driver. Texas has been at the forefront of job creation because our borders happen to contain the mostly inhospitable scrubland known as the Permian Basin in West Texas, not to mention the coastal plays and those in East Texas. Much (not all) of the growth in oil has come from horizontal drilling and fracking. And while there are enormous amounts of energy in Texas, it is not necessarily cheap energy – not like it was in the “good old days.”

Seventy-dollar oil considerably restrains the enthusiasm of Texas oil companies, let alone the banks and individuals that finance them.

And it is not just Texas companies. The Marcellus play in the Northeast is responsible for hundreds of thousands of jobs. And it’s much the same story all over the US. Oil has been a significant portion of the growth of US GDP for the past five years. If you take the massive oil boom away, the US looks a lot like Europe in terms of growth and job creation. Which is to say, anemic.

Seventy-dollar oil starts to show up in the unemployment rate, which makes it more difficult for the Federal Reserve to raise rates.

I was talking with Joe Goyne, president of Pegasus Bank in Dallas. He is one of those entrepreneurial bankers who actually analyzes a loan personally rather than letting some computer determine whether it fits the criteria. (The country would be better off with a lot more Joes running the banking industry, but that’s another story.) Joe’s customers are a who’s who of Dallas. We were discussing my convictions about a strong dollar and what that would do to the price of oil. Joe offered, “You won’t believe the pain in Dallas if oil falls to $60.” We went on to discuss some details. Does $60 oil sound far-fetched? Joe and I both remember $15 oil. Texas has been through numerous oil busts. The running joke in the late ’80s was “Would the last person leaving Houston please turn out the lights?”

The late ’80s was an ugly time for Texas. Will the Saudis ever allow oil to dip below $60 again? Can they afford to cut their production that much? What will happen to Russia if Brent drops to $80, let alone $60? It’s not just Texas. And while the world might benefit from lower energy prices, they would create havoc in a few key regions. And throw another monkey wrench in Federal Reserve policy. And in terms of the oil price, gods forbid that peace breaks out in the Middle East. But, sadly, given current circumstances, it doesn’t look like we have to worry about that.

Chapter 7 – The Bond Bull Comes Stampeding Back

Many of us in the US look at Europe and wonder how interest rates can fall to such insane levels. And the answer is that bond markets have rationales all their own. The unwinding of carry trades means the demand for dollars will rise just as the Federal Reserve cuts off the spigot. Some people look at Japan’s flooding the market with yen as an antidote and hope that the ECB, too, will soon start printing; but that is not going to reduce the demand for dollars to unwind the carry trade.

Whatever Japan and Europe do, the growth of global liquidity is still likely to fall over the next few years; and that is an inherently deflationary event, especially in dollar terms.

In addition, when – not if – there is a renewed crisis in Europe, the flight to safety is going to put pressure on the dollar and further downward pressure on US interest rates. While it is not altogether certain that China will have a major crisis – although reasonable economic historians would suggest that is the probable case – if it happens it will put further upward pressure on the dollar as a safe-haven currency. God forbid those two events – crises in Europe and China – happen at the same time. Our necks would snap at the severity of the acceleration in the value of the dollar. The convergent crises would also trigger a global recession.

We're going to see a return of the bond bull market with a vengeance. Almost the entire world has hedged its bets for a rising interest-rate environment and assumes a benign dollar market. Almost no one expects a falling interest-rate environment, yet that is precisely what we will get if the dollar continues to rise and we have a crisis or two.

Chapter 8 – The Third Leg of the Secular Bear Market

I was writing about secular bear markets in 1999. I was early to the party, as usual (although my friends will note that I'm often late to real-time, real-life parties). I noted in *Bull's Eye Investing* that it typically takes three events to completely wash out a trend. We have had two significant corrections since April 2000, accompanied by two recessions. I think the next recession will give us that final third leg of the secular bear market, hard on the heels of another correction that tests (but maybe doesn't quite touch) the lows of 2009.

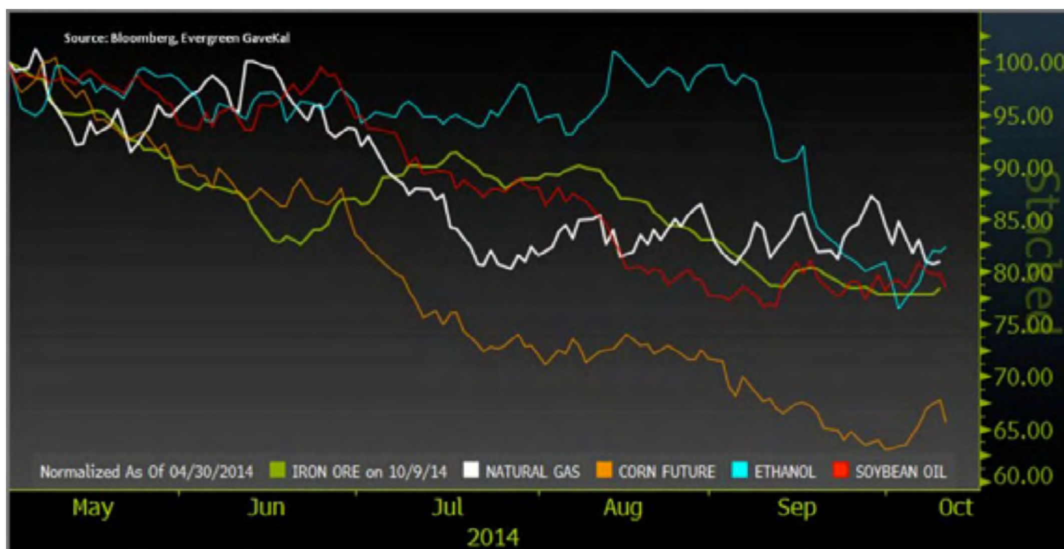
At that point I will trade my secular bear beret for a snappy new secular bull Panama. And while we may see a significant correction out of the current volatility, I don't think the final dénouement of the secular bear will come without a global recession.

Since most of you have been through this before, you can probably figure out what strategy you should choose; but I would suggest at least thinking about having some type of hedge/moving average/risk-dispersion strategy in your toolkit.

The point is to get through this next crucial phase with as much of your capital intact as possible, in order to be able to take advantage of the coming secular bull market, when it will be anchors aweigh. Remember, we always get through these things. It is almost never the end of the world, and betting on the end of the world is a losing proposition anyway. Specifics to come later (maddening, I know, but there are space limits).

Chapter 9 – Commodities in a Dollar Bull Market

This book outline is running a little long, but a quick word on commodities. In general, commodity prices are going to face downward pressure, at least in dollar terms. That includes copper, most of the base metals, oil, etc. Silver has clearly been in a very ugly bear market. I would continue to accumulate insurance gold, but I would invest in gold only in terms of yen or another depreciating currency. Bear in mind that precious metals – along with other commodities – can and will fall precipitously in the event of a deflationary shock… although the inflationary effects of an aggressive central bank response may ultimately drive the yellow metal far above its current price.



Chapter 10 – The Return of Volatility

The final chapter and conclusion pretty much end as you would expect: the demise of monetary policy's ability to soothe the soul of the markets and the return of volatility. We hopefully get a full-fledged restructuring of the sovereign debt markets. The Fed and sister central banks will try the same tired tools they have been using. Except they have already been to the zero rate boundary and have wasted the opportunity they had to increase rates so that they could lower them later. Another round of quantitative easing? Quite possible if we get a true deflation scare or a global recession. But I don't think it will have the same results. The unintended consequences and the unknown spillovers will only increase eventual volatility.

For new readers, I invite you to read my books (co-authored with Jonathan Tepper) *Endgame* and *Code Red*. They pretty much lay out the background you need in order to understand what will be happening in the future. We are seeing the end of the debt supercycle and the beginning of currency wars. We'll experience the throes of hyper-indebted nation-states trying to survive what they will see as irrational attacks by a bond market. "How can you not have faith in the government? We are doing our best to try to make everything work out just fine. As long as you cooperate." Which bond markets have a nasty habit of not doing. Oh, you can placate them in the short term, but ultimately they want to be paid back in risk-adjusted buying power. And that is the one currency that many nation-states will no longer have. Now without major reforms and a significant restructuring of the social order.

A final thought. Businesses will keep on doing what they do, in spite of the machinations of governments and monetary authorities. Entrepreneurs will adjust. New inventions will be made. Over the medium term, life on earth will get better. I honestly do see a return of the secular bull market and a pretty cool third decade, an updated version of the Roaring Twenties. Only this time there will be no need for speakeasies. I fully intend to be around to enjoy it and am looking forward to being relatively optimistic about the future. I really don't get much personal pleasure from writing these Debbie Downer letters. But my role is to not think about the world as it should be or as I want it to be, but to be as right as I can about the direction we are going. The ride could just be a little bumpier in the short term of the next few years. Fasten your seatbelts.

And for those of you looking for specific advice, let me point you to Jared Dillian, the new editor of my own *Bull's Eye Investor* service. He has been finding ways to trade and invest in this market. Last Friday he wrote:

> Guys, the price action has been bad for a while. And it is getting worse. The market is demonstrating repeatedly that it can't hold its gains. In my 15 years of doing this, I've only seen worse price action twice: 2000, and 2007.

You can read about Jared and appreciate his baleful glare of a photo right here. Want to sit on a trading desk across from him? I want him on MY side of the table. See if you might want him in your corner as well.

Chicago, Athens (Texas), Boston, Geneva, and Atlanta

I have one more week to enjoy Dallas, and then I'm back on the road. I will go to Chicago for a speech, fly back to a meeting with Kyle Bass and his friends at the Barefoot Ranch in Athens, Texas, and then fly out to Boston to spend the weekend with Niall Ferguson and some of his friends at his annual briefing. I am sure I will be happily surfing mental stimulus overload that week. I fly from Boston to Geneva for a few days and then more or less directly to Atlanta for a day (board meeting), before heading back to Dallas.

Next Saturday is wedding day. It has been years since I've been to a wedding, and next Saturday I will go to two. I fly to Houston to watch my young associate, Mr. Worth Wray, tie the knot with his lovely fiancée, Adrienne. You have to admire a young man for playing above his weight class. He gets married in the morning, and that afternoon we fly back to Dallas to attend the wedding of David Tice's daughter Abigail.

Next Monday evening I get to spend some time with Woody Brock here in Dallas before I launch my travels. I'll be back in time for Halloween.

It's time to hit the send button. I smell stir-fry chicken and vegetables simmering on the stove and need to find a piece of mindless entertainment with which to relax with family and friends. Have a great week,

Your ready to find his sweaters analyst,

John Mauldin

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