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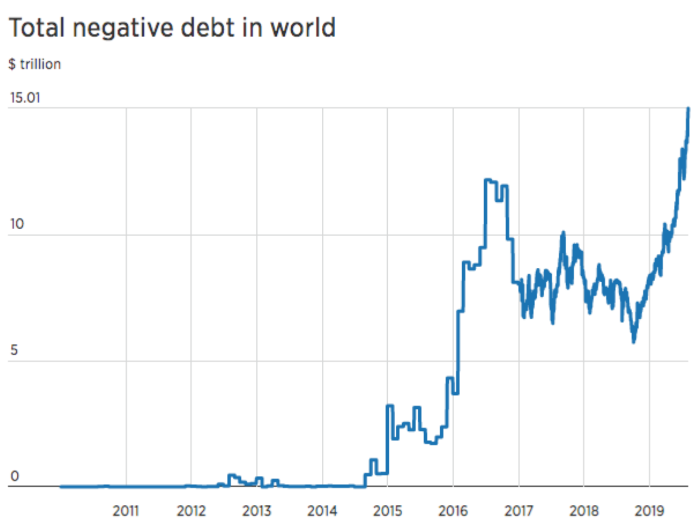
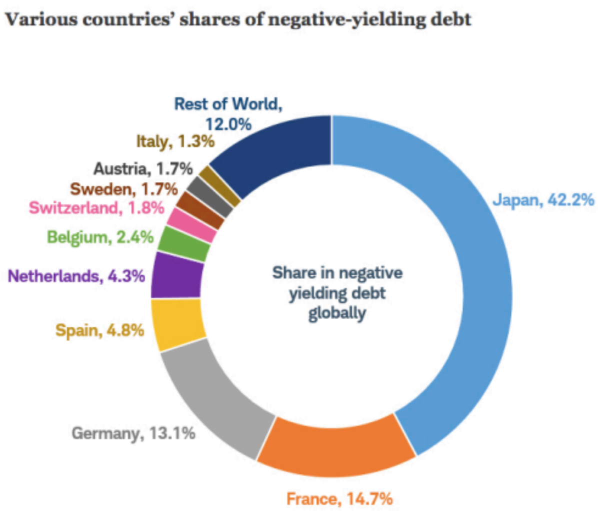
Disruption Everywhere

According to the Financial Times, America's executives and board members have sold a combined $19 billion of stock in their companies through to mid-September. If we annualize that, it puts insider sales at a two-decade high. There is good reason for such sales: on average, corporate earnings are now contracting. Elsewhere, things are worse. The global economy is slowing; some key European countries, such as Germany, the UK and Italy are probably in recession.

Of course, we've been there before. In fact, for the United States, the current expansion is the longest on record since 1854. Yet, what's different from other post-war economic cycles is that the Federal Reserve no longer has the tools required to counteract a serious slowdown. Ever since the slowdown of 2008, along with its counterparts in Europe, Japan and elsewhere, the U.S. central bank has recklessly pumped liquidity into the system, all along stating that the plan was to 'normalize' interest rates once the economy strengthened. Well, that normalization has now become impossible. In accommodating ever more unsustainable debt levels at the government, corporate and personal level, the Fed and its overseas cousins have created a situation where, to keep the economy from sinking, more and more stimulus needs to be administered.



The simplest way to create stimulus is to lower interest rates. In Europe and Japan, rates have been negative for some time. French investors buying a five-year government bond, for instance, have *to pay 0.65% per annum*, for the privilege of parking their money in a supposedly safe place. Germany, deemed to be a tad less risky than France, charges bond buyers 0.8% a year. It looks like this kind of arrangement may soon be coming our way. For the record, more than US$15 trillion of government bonds worldwide now trade at negative yields.



It's interesting how few North Americans are aware of the implications of this development, or even its existence. On my annual fall holiday to Aspen, I made a point of asking 15 successful, informed people about the topic. Only one, a big-oil executive who'd spent a substantial part of his life overseas, was on the case. The others were completely bewildered by the concept. "Why would anyone park money with someone else and want to pay for it," was the typical response. If you asked that question in Japan, where purchases of negative interest government bond make up a huge portion of overall investment, you'd be told that there is a good reason to do so. The answer would be something like, "If you don't buy 5-year bonds at negative 0.4%, you may soon have to pay 0.8%." That, of course, is the voice of what I call "stupid money", but let's not forget that stupid money can drive markets for extended periods of time.

<u>Less Expensive and More Prudent</u>

We believe there are less expensive and more prudent ways to invest than in someone else's paper promise. Shares in well-run corporations that carry an attractive and sustainable dividend are one alternative that will, in our opinion, provide far better long-term rewards. Given heightened economic uncertainties and fairly rich stock valuations, a robust cash position seems advisable, too. And, finally, physical gold should materially benefit in a world where bank deposits and bonds no longer pay interest. This combination of high-quality dividend stocks, cash and gold is our present portfolio mix.

I'd like to stress that the economy and the steady decline in interest rates are not the only reason why we are unusually defensive. I am equally worried about the many political and social stresses I have devoted previous client letters to. The table below sums up the most potentially disruptive of them. I urge you to look at them, line by line, and consider their implications.

DISRUPTIVE TRENDS EVERYWHERE

Geopolitical	Issue
Middle East	U.S. pressuring Europe to side with Saudi Arabia against Iran
Venezuela	Continued U.S. efforts to change regime
Turkey	Gradual shift away from NATO and towards Russia
Global	Spurred on by America's anti-China/Russia push, transition to multi-polar world is accelerating
Global	Rapidly growing reluctance by America's allies to engage in military adventures

Domestic Politics	Issue
U.S.A.	Deeply destructive dynamic; massive growth in polarization
EU	Debate over limits of sovereignty of member states now all-consuming
Britain	Brexit show in its final season; internal fallout is far from over
U.S.A., EU	Need to distract disenchanted electorate from domestic woes acute

Economic	Issue
Global	Global economy slowing, with key parts of Europe in recession and U.S. likely to follow
Global	U.S. initiated trade conflicts adding to economic woes and undermining historical relationships
Global	U.S. initiated sanctions on financial transactions adding to economic uncertainty
Global	Growing discontent with U.S.-run global payments systems and U.S. dollar as reserve currency
U.S.A., EU	Low interest rates boost already critical debt loads at gov't, corporate and individual levels

Social	Issue
Developed Economies	Low and negative interest rate policies are depriving armies of retirees from earning and income
Developed Economies	Low and negative interest rates are destroying public and corporate pension plans
U.S.A., EU	Political polarization causes deep social rifts and accelerates political activism
U.S.A.	America has largest wealth disparity in the developed world; odds for upheaval are rising

In short, unsustainable trends are evident everywhere. The question is whether we will face a series of confined crises, or whether an out-of-control calamity will quickly spread to other areas and cause multi-sector chaos. Either way, we expect financial and real asset markets to be subject to acute volatility. An ideal portfolio will have to be effectively hedged and, most likely, will require ongoing adjustment during the next several years.

Best regards,

Peter Cavelti