

# The Long Wave Analyst

‘An Opportunity and Strategic Investment Approach’

Volume 1, Issue 6

December 1998—February 1999

**WRITTEN BY:**

**Ian A. Gordon**  
**Canaccord Capital**  
**Suite 1200**  
**595 Burrard Street**  
**Vancouver, BC**  
**V7X 1J1**

The Long Wave Analyst is an investment strategy based upon historical analysis and interpretation of the “Kondratieff Cycle”. Fax interpretation available between publications on significant market developments.

Ian Gordon is a licensed Registered Representative and a Vice-President of Canaccord Capital, a Vancouver-based brokerage firm. He was educated at the Royal Military Academy, Sandhurst, U.K., and has a B.A. (History) from The University of Manitoba.

*Ian Gordon*

## Pinpointing our Position on the Kondratieff Wave

When Nikolai Kondratieff presented his study of the Long Wave Cycle he was concerned solely with the apparent economic ebb and flow within capitalist countries. This approximate 60-year cycle was based upon an economic expansion, which lasted roughly thirty years, and an economic contraction, which lasted about another thirty years. Interestingly, the first phase of this contraction is not synonymous with an economic downturn, but rather a period of disinflation coupled with an era of robust speculation. Kondratieff emphasized that the long cycle was an international capitalist phenomenon; that is, all capitalist countries would experience it starting and ending at approximately the same time.

As inflation raged during the 1970s, Kondratieff’s work received much attention from the economic fraternity. Many of these economists failed to recognize where exactly the world was positioned on the cycle. When their anticipated deflation failed to occur following the inflation peak, Kondratieff’s work fell out of favour. These economic experts failed to understand that the cycle called for a period of disinflation following the inflationary peak. During this period of disinflation, the world experiences a growing speculative orgy coupled with massive debt accumulation. Though this stage of the cycle is commonly referred to as the Plateau Period, I prefer to call it the Autumn period.

The Kondratieff Wave now attracts little attention. That is a pity, because it is a very reliable economic forecasting tool. Dr. Joseph Shumpeter, who undertook an extensive study of economic cycles at Harvard University during the 1930s and authored the definitive book on Business Cycles wrote, “The Kondratieff Wave is the single most important tool in economic forecasting.”

Kondratieff never hypothesized that an investment cycle might be concurrent with the Long Cycle,

## Table of Contents

Pinpointing our Position on the Kondratieff Wave	1
The New Era Economy	4
Can Europe and North America Escape?	4
The End of the Bull Market	5
Wall Street in 1929	5
Wall Street in 1999	6
Misplaced Confidence	7
The Credit Bubble	7
Money Going Home	9
Go leave the fire ashes, what survives is gold.	10
Last Minute Notes	11
Footnotes & Credits	12

but it is. Furthermore, because the Kondratieff Cycle is such a dependable economic forecasting tool, it follows that it is a trustworthy investment guide. It can keep us in appropriate investments during each season of the cycle, but also, and more importantly, keep us out of those investments which are likely to underperform, or worse, seriously undermine our wealth.

For those who refuse to be blinded by the current stock market hype and apparent prosperity, the Kondratieff Wave provides a clear indication of what lies in store for us in the very near future. Winter follows Autumn and, in the Kondratieff Wave, the Plateau period always precedes deflation and depression (Winter).

The goal of this newsletter is to provide our readers with a clear roadmap of the Kondratieff route. I am convinced that we are about to turn down a road that is fraught with the hazards of winter.

How can I be so sure of our position within the Kondratieff cycle? The evidence is overwhelming and I believe I have given many convincing examples in previous issues. Nevertheless, to understand the gravity of the situation, bear with me as I once again present a summary of the main characteristics of each of the Long Wave seasons and why, given this summary, I am convinced that the chill of Winter is upon us.

## The Kondratieff Spring

(Present cycle dates: 1949-1966)

Many people think that it is only a matter of time before the economy sinks back into a depression. From this delicate state of confidence the economy starts a new life and, very slowly, confidence starts to build as more and more people become employed. Consumer purchases are made with cash, because people are too frightened to borrow. Those banks that have survived the winter have money to lend for capital expansion and the building of factories to provide for a growing demand by consumers. At this time of the cycle, consumers, corporations and governments are risk-adverse.

## The Kondratieff Summer

(Present cycle dates: 1966-1980)

The main characteristic of Summer is the rapidly expanding rate of inflation, which ends in a speculative blow-off. The peak of inflation in this Cycle occurred in 1980, when the CRB Index reached 338 and Gold prices climbed above \$850. Interest rates also peaked at this time. In 1980, long-term US Treasury yields were at 15% and Canadian short-term rates were over 20%. This Summer peak was very similar to its predecessor of 1920. Following that peak there was a bear market in stocks and a primary recession, similar to the period between 1981 and 1982. "Bloated stocks, commodities, and inventories were summarily excised in 1920 as super-inflation turned within months into the worst deflation since the post-Civil War period. The violent reversal from boom and wild inflation into recession and deflation would be repeated in 1981-1982." <sup>1</sup>

## The Kondratieff Autumn

(Present cycle dates: 1980-1998)

The recession and bear market at the end of the expansion or Summer phase of the cycle pave the way for the Plateau period or Autumn phase of the cycle. There is a growing speculation in stocks, bonds and real estate, which invariably culminate in a stock market crash. (Previous letters have indicated why Autumn is a period of such rampant speculation.) So it was during the Autumn of the Roaring 20's when the stock market ran from that bear market bottom in 1921 with the DJI at 64 points to a DJI high on September 3<sup>rd</sup> 1929 of 381 points; a gain of 595%. The crash that followed took the Dow Jones Industrials down to 42 points by June 1932 for a 90% loss. The rise in US stocks during the current plateau period is unprecedented and significantly more speculative than the bull

market of the 1920s. From the bear market bottom of 777 on August 12<sup>th</sup>, 1992, the Dow has risen to an astonishing 9643 on January 8<sup>th</sup> of this year, for a gain of 1240%.

## The Kondratieff Winter

(Present Cycle dates: 1999- )

Winter is the season of death. Its primary function is to wipe out the massive debt built into the economy during the past three seasons and in particular the major debt accumulation that occurs during the ‘feel-good’ times of Autumn. Debt is eliminated through bankruptcies and foreclosures. This leads to plant closures, high levels of unemployment, banking problems, and rapidly falling prices.

Given the foregoing, it should be impossible to doubt where we are currently positioned in the cycle. We can be confident that we are in the very late stages of Autumn. Why? Quite simply, because the US stock market is at valuations never seen before and the breadth of the market is already telling us that we have seen the high for US stocks. Excessive speculation and stock market valuation is characteristic of the end of Autumn. We also know that the onset of Winter is usually signaled by a stock market crash.

I do not see how Western Europe and North America can escape from the devastation of Winter. Nor do I see the magician, Alan Greenspan, continuing to walk the tightrope, maintaining his balance with interest rate cuts and excessive increases in the money supply. Something has to give, and that is likely to be consumer confidence. It gets more and more difficult to maintain public confidence in anything as bogus as a stock market that is overvalued as that in the US. Read Charles Mackay’s great classic, Extraordinary Popular Delusions and the Madness of Crowds, to better understand the extremes of crowd psychology and how excessive speculation is rationalized at the time as being justified by the new circumstances. And so it is today, as we are told by the experts that that the enormous values of US stocks are appropriate given the ‘new era’.

## “The New Era Economy”

In a recent article, published in the Wall Street Journal and later in the Financial Post, titled “This market bubble won’t burst,” Wayne Angell, a former Federal Reserve governor and now chief economist at Bear Stearns, argues for a continuation of the present bull market in stocks and growth in the economy. “But the evidence that I see does not suggest a bubble; rather, it indicates that we have at last arrived in a new-era economy, one which information technologies and sound money fuel long-term, non-inflationary growth.” Before returning to Mr. Angell’s thesis, I present views of some prominent Americans just prior to the onset of the last Kondratieff winter.

?? “The outlook today is for the greatest era of commercial expansion in history.” Herbert Hoover, President of the United States, 1929.

?? “The industrial condition of the United States is absolutely sound, and nothing can arrest the upward movement of stock prices.” Charles E. Mitchell, Chairman, National City Bank. 1929.

?? This is truly a new era, in which formerly well established standards of value for securities no longer retain their old significance.” Leonard P. Ayres, Vice-President, Cleveland Trust Company, 1929

?? “We are apparently finished and done with economic cycles as we have known them.” E.H.H. Simmons, President, New York Stock Exchange. 1929.

?? “There is no reason why there should be any more panics.” M.G. Alexander. 1927.

The confidence was as misplaced then as Mr. Angell’s is today. Knowing that Mr Angell is a

former Federal Reserve governor, it is easy to understand his belief that the Federal Reserve undertakes a sound money policy. However, his blind faith in that institution belies the fact that it is increasing the money supply at an unprecedented rate: that is not 'sound money'. Mr. Angell continues on his thesis of a Federal Reserve adopting a sound money policy when he writes: "In contrast, when rapid economic growth emanates from confidence in the stability of money, less government regulation, and lower marginal tax rates on economic gains, then faster growth actually helps to reduce inflation because it results in more goods to be chased by the same amount of money." Rapid growth in America is not the result of a confidence in the stability of money; rather, it stems from excessive monetary expansion being used to inflate prices in the stock market. These high stock prices then translate into misplaced consumer confidence and increased consumer demand for goods and services. Reduced inflation in the US has little to do with US monetary policy but rather a growing worldwide deflation, which emanated out of Asia.

Mr. Angell fears that "bears may yet scare too many investors out of a very good market." But why should they? It is not the bears that will scare the bulls. There are in fact very few bears anyway. Bulls will only be scared if they begin to appreciate the absolute absurdity of values placed on US stocks. Mr. Angell anticipates a Dow Jones Industrial Average in excess of 22000: "So far the bears have missed the 135% rise in the Dow Jones Industrial Average over the past four years; they may yet miss the next 135% rise." I think that Mr. Angell will have to eat his words.

## Can Europe and North America escape?

I think not, because all the symptoms indicative of the shift from Autumn to Winter are present in their respective economies and stock markets. Since its economy is the largest in the world, I will examine the US position,

- ? ? An excessive debt bubble, which in total (government, corporate and consumer) is more than \$20,000,000,000.
- ? ? A stock market bubble evidenced by unprecedented values and multiples far higher than those in 1929.
- ? ? The bubble in the stock market is dwarfed by the massive exposure that US banks have in the derivatives markets. For example, a 10% - 12% loss in the derivative books at J.P.Morgan and Chase Manhattan would wipe out their respective capital bases.
- ? ? A massive and continuing US balance of trade current account deficit which is financed by foreign countries, principally Japan and China. This year, it is anticipated that this deficit will exceed \$300 billion.
- ? ? A negative savings rate on the part of US consumers, which means that they must incur more and more debt to keep the US economy going.
- ? ? An illiquid international debt system, which requires more and more IMF intervention to forestall national bankruptcies.

## The End of the Bull Market

**"Sooner or Later a Crash is Coming, and it may be Terrific"<sup>2</sup>**

I have long maintained that the key to continuing American prosperity rests on a rising stock market. What I question is how much further this market can go up. I think that the stock market is teetering on the edge of a cliff, and all that is required is something to push it over the edge. What that something is I do not know, but it has usually been rising interest rates. I do not think that it will be rising interest rates this time, at least in the short-term debt market, because Mr. Greenspan is obviously aware of the perilous state of the US stock market. But the Federal Reserve Chairman has no control over US long-term interest rates and much of this debt is owned by foreigners who can force the issue by selling their US

bond holdings. This would drive up long-term rates and create a crisis of confidence in the US debt market, which would likely spill over into the US stock markets. Or it may come as a result of another currency devaluation. The recent drop in the Japanese Yen increases the pressure on China to devalue to maintain its export competitiveness. Perhaps, the US stock market will fall simply as a result of its own excessive weight. Whatever the catalyst, all the signs are in place to indicate a massive top in US stocks. Donald Hoppe cited the following as precursors to a top in the stock market.

- ? ? Record-breaking trading volume.
- ? ? Heavy sales of mutual funds.
- ? ? Increase in margin loans to all time highs.
- ? ? Great public interest in speculation.
- ? ? Focus of public's attention.
- ? ? Front-page news stories about market gains.
- ? ? Euphoric attitude towards speculation, with unrealistic expectations and predictions.
- DJIA sells at more than 20 times estimated earnings. (Currently selling at more than 30 times)
- ? ? Excessive issues of new securities.
- ? ? Sharp breaks quickly recovered.
- ? ? Widespread delusion about the future.
- ? ? Price advances turn exponential (stock prices appear to be going straight up).
- ? ? Warnings about speculation will be ignored. Those who warn of such dangers will be ridiculed or accused of "sabotaging the recovery." (Wayne Angell's warning about bears scaring investors out of the market).<sup>3</sup>

*... a Crash is  
Coming, and it  
may be Terrific*

## Wall Street in 1929

The following extract from 101 Years on Wall Street gives a dramatic picture of Wall Street in 1929 and provides us with a valid comparison to Wall Street of 1999. –

*"Sensitive to the public's enormous appetite for stocks, Wall Street expanded its bill of fare, cooking up nearly \$12 billion in new shares for sale. Well over \$2.3 billion of that was in investment trust paper (mutual funds). Hundreds of funds were promoted, many of them highly leveraged.*

*This "professional management" would be the last great sales cliché of the 1920s. By the record, it worked only as long as the market kept going up. United Founders, a flagship of one group, with assets of over \$300 million, saw its stock fall from \$75 to 75 cents during the next few years.*

*By the end of the summer, stock prices, margin debt, and speculative fever were all at record levels, as were price-earnings ratios. Banks a cozy part of pools, and investment underwritings, were seen as the best "play" on the great securities boom, since brokerage firms were not publicly owned. National City was valued at over 100 times earnings, and ratios of 50X were common for the money-center banks.*

*Despite the lofty level of stocks, there was a good feeling about the "new era". Cars were more affordable. A radio in every room seemed probable. TV was rumored to be just around the corner. Commercial transportation was coming of age and movies were talking.*

*The good feeling started to end shortly after September 3 when the 1921-1929 bull market had crested at Dow 381.17. A panic arrived in October and the collapse of prices over the next few weeks remains awesome. Morgan's \$240 million banking pool was drained. Aurburn Auto careened from 514 to 120. Alcoa from 540 to 180. Advance Rumely, a*

former pool favorite that had peaked at 105 in May, traded down to 7. Wright Aero, 299 in February, plummeted to 60.....

The bearish convulsions had not been sparked by any specific bad business news. Rather, the financial press remained full of splendid earnings reports, extra dividends, stock splits, and glowing forecasts. The Dow earnings for the year would be \$19.94 versus \$15.76 in 1928 and the composite dividend would be up 45 percent from the previous year.....

The agony of the 1929 panic ended November 13 with the Dow at 199. What lay ahead, after a deceitful recovery into April, was worse – a depthless world depression.”<sup>4</sup>

## Wall Street in 1999

There are two very important indications that US stocks have already made their highs in this bull market. The first is that the breadth of the market made its highs in April of last year. Even when the Dow Jones Industrials and the S & P subsequently made new highs in July last year and January of this year, market breadth was nowhere near where it had been in April 1998. This is a very serious divergence, suggesting the formation of a massive top in stocks. The only other time that breadth failed dramatically to confirm a new stock market high was in 1928.

The second divergence pertains to the non-confirmation of the Dow Jones Industrial peaks made in July 1998 and January 1999 by the Dow Jones Transportation Average, which last confirmed a DJI high in April of last year. This divergence is attributable to the venerable Dow theory developed by Charles Dow in the early 1900s which states that a new high in one of the two averages, the Industrials or the Transports, must be confirmed by the other. A non-confirmation indicates a coming change in direction for the overall stock market.

As obscene as the values for stocks were in 1929, the values seen today are without precedent. I repeat my warning to readers. Stock prices are vulnerable to a substantial decline.

## Misplaced Confidence

**Boast not thyself of tomorrow, for thou knowest not what a day may bring forth.** <sup>5</sup>

What makes North Americans and Europeans so blasé with respect to the economic devastation that is all around them? Do they really believe that they can somehow escape from stock market crashes that have affected so many other countries and the resulting economic disasters that have afflicted so many people? Do they believe, like so many Americans – displaying extraordinary temerity even for Americans, that the impoverished American consumer can buy the remainder of the world out of its depression? Does the US stock market have unlimited upside in spite of values that are already at levels never seen in the past? Will foreigners continue to respect the US dollar when the country’s printing presses print new paper dollars at a pace not seen since the late 1960s? And what about the enormous debt bubble that must be kept afloat in America? Perhaps they are blasé because they do not want to be bothered with such



Source: The Notley Information Service

petty trifles while they reap the benefits of a stock market that reaches for the sky. We are reminded once again of Thomas Grey's, On a distant prospect of Eton College (see inset). The vast majority of people are unaware of what might lie in store for them when the Winter stage of the Kondratieff cycle hits – most have never even heard of Kondratieff. They have been lulled into a false sense of security by market pundits, economists, politicians, and the like, who postulate ever-increasing wealth.

How is it possible for the economy to move into a rapid decline from such strength as Winter overtakes Autumn? The strength of the economy in the waning days of Autumn is almost entirely attributable to 'feel-good' consumers buoyed by paper gains in the stock market. When the market breaks, as it invariably does, consumers stop their spending and the economy slumps. This happened in 1929 and will likely be the case this time.

For those who do not understand the impending economic change and who are heavily invested in the stock market, the change is likely to prove devastating. Just like the last Winter which started in 1929 and the current Winter which has already started in Asia, Russia and Latin America, our Winter is likely to be signaled by a crash in the stock market. The most dramatic change in the Kondratieff seasons always occurs at the onset of Winter because the transition from wealth to penury occurs within such a short period of time. There seems little doubt that the first snow of winter has already fallen and it is only a matter of time before we are confronted by the icy blast of a mind-numbing blizzard.

## The Credit Bubble

**"The causes of all panics, crashes and depressions can be summed up in only four words: the misuse of credit."**<sup>6</sup>

Obviously, the industrial world could not survive without credit. Problems start when credit is expanded beyond the point where it has any relationship to real wealth. "The final years of the long wave Autumn are characterized, not only by a reckless expansion of fiat credit, but by a widespread delusion that there is no limit to the availability of such credit."<sup>7</sup>

The most obvious recent example of unsustainable credit expansion is Japan. By 1989 Japanese banks were lending enormous amounts of money on all kinds of questionable investments and the Japanese were borrowing in record amounts in order to finance these speculations. The principal problem facing the Japanese was that they viewed most foreign assets, and in particular US real estate, as being vastly undervalued in comparison to their own real estate values. They failed to understand that it was Japanese values that had become hugely overvalued due to the enormous expansion of credit. When the Japanese central bank began to raise interest rates in an attempt to contain the excessive speculation, the credit bubble burst and the Japanese Winter began, signaled as usual by a stock market crash, which started in March 1990.

In America, the huge explosion of credit is fostering unparalleled speculation in the stock market, causing the prices of equity investments to appreciate far beyond reasonable values. Encouraged by the large paper gains in the markets and easy credit, consumers are living way beyond their means and have depleted their savings. Corporations have borrowed heavily and recklessly, principally to buy other companies at enormously inflated values. In 1998, the global value of mergers was a record \$2.4 trillion. Even municipalities have taken advantage of the public's insatiable demand for securities by financing such questionable projects as sports stadiums. Banks have expanded their loan portfolios and have become less and less concerned with the quality of loans on their books. Furthermore, many of these banks have become caught up in the mania of speculation and are heavily engaged not only in the stock market but also, and more

*Alas, regardless of  
their doom,  
The little  
victims play;  
No sense have  
they of ills to come,  
Nor care beyond  
today.  
Yet ah! Why should  
they know their fate,  
Since sorrow never  
comes too late,  
And happiness too  
swiftly flies?  
Thought would  
destroy their  
paradise.  
No more: where  
ignorance is bliss,*

frighteningly, in the derivatives markets as well.

It is enough to understand the vulnerability of the banking system in a severe downturn in the economy – in particular, a banking system that has a huge amount of questionable loans on the books including loans offshore or is heavily invested in speculative markets like derivatives or even the stock market itself. One has only to reflect upon the recent Japanese experience. In 1989, the ten largest banks in the world were all Japanese, but now only one Japanese bank enjoys this distinction. Japanese banks are carrying the equivalent of more than a trillion dollars in non-performing loans on their books – a huge black hole that the Japanese government is trying to rectify. Many Western banks are in a similar position to their Japanese counterparts of 1989, and a bear market in stocks would likely put enormous pressure on their loan portfolios. The International Monetary Fund has so far effectively bailed them out of their non-performing foreign loans. But the IMF is not a bottomless pit and further currency problems such as in Latin America or in Asia again, will severely strain the IMF's resources.

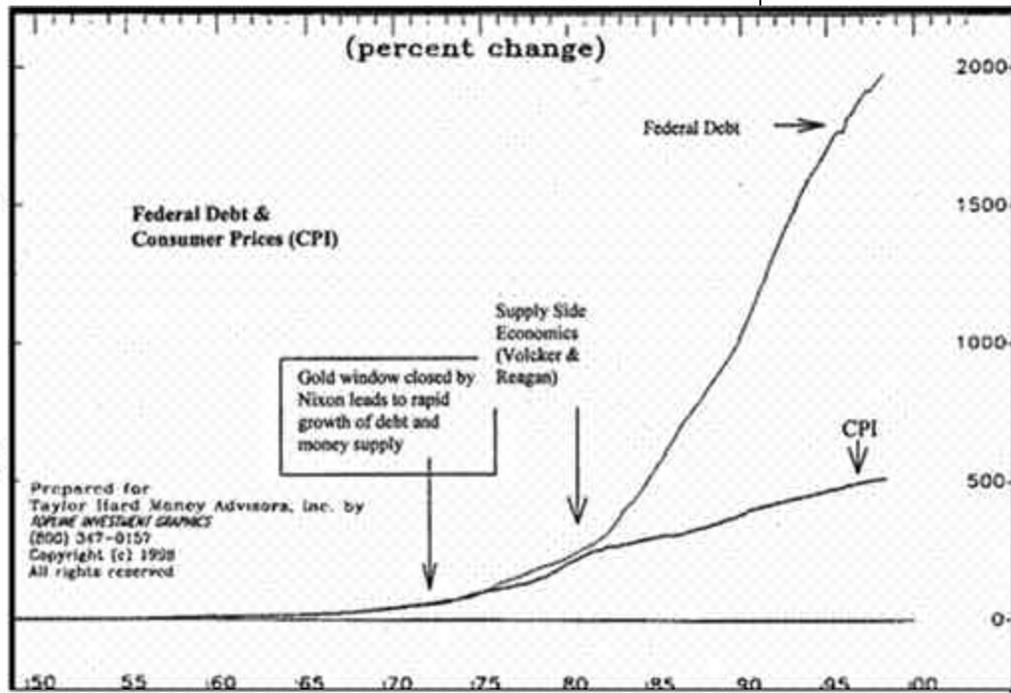
Following the 1929 New York stock market crash the US banking system all but failed. Between 1929 and 1932, more than 6000 banks in the US failed, including almost 1000 Federal Reserve Member banks. In 1933 alone, another 4000 banks, including 2734 Federal Reserve members, went bankrupt. This effectively shut down the United States banking system and destroyed more than US \$9 billion of depositors' money.

## Money Going Home

In May 1929, Ramsey Macdonald won the British general election for the Labour Party, and in so doing replaced the Conservative Government of Stanley Baldwin. This

*The huge expansion of US Federal debt starts immediately following the closure of the gold window by President Nixon in 1971.*

*Obviously, governments do not respect the discipline that is imposed by a gold standard. That is why they persistently run down gold as an alternative to paper money.*



Source: Taylor Hard Money Advisors, Inc. <sup>10</sup>

precipitated the move of large sums of British investment income out of London and across the Atlantic to New York. This, coupled with funds from elsewhere in Europe, made Wall Street, in the words of a London weekly newspaper, 'the financial capital of the world.' But behind the scenes in London forces were at work that would soon have the effect of reversing this large outflow of funds to America.

This reversal came about as a result of the failure of a British financier named Clarence Hatry. This disaster shook not only the London Stock Exchange, but other European bourses as well, effectively reversing the flow of European funds to America. Today, history is repeating itself with a different player and under different circumstances.

The present-day Wall Street party-poofer is Japan. For most of the past ten years Japan has been sending money abroad through portfolio flows and direct foreign investment. This has supported high valuations in western markets and indirectly has helped fund the US trade deficit.

This money is now returning home. Japanese net purchases of US securities, which includes bonds and equities, fell from US \$54 billion in 1996 and US \$35 billion in 1997 and to only US \$0.6 billion in the first three quarters of 1998. Over this latter period, Japanese turned net sellers of US equities to the tune of US \$3 billion.

Any further interest rate cuts and increases in the already inordinately high money supply figures in order to support a sagging stock market would lead to increased US dollar sales and a subsequent increase in interest rates at the long end of the curve. Furthermore, this would no doubt open the floodgates not only to foreign sales of US equities but also to US Treasuries as well.

*The present-day Wall Street party-poofer is Japan.*

The net effect of the Japanese repatriation of assets is a rising Yen. Since last summer, the Yen has strengthened from nearly Y150 to Y120 against the US dollar. The problem has been compounded by the unwinding of the so-called Yen carriage trade, where investors borrowed in cheap Yen to buy overseas assets. The strengthening Yen could prove disastrous for an already ailing Japanese economy. On the other hand, a weak dollar reduces the attraction of US assets, making it more difficult for the United States to finance its rapidly growing current account deficit.

## Go leave the fire ashes, what survives is gold.<sup>8</sup>

Bob Boaz, a good friend who manages funds for the University Avenue Funds group, recently wrote an article titled [Gold Does not Make Cents](#) to promote the Financial Forum. In spite of my admiration for Bob's work and his undoubted ability as an economist, I have taken exception to his findings. I present Bob's main arguments for a \$250 gold price and mine for what I believe to be a gold price in excess of \$400 before the end of 1999.

Our readers can draw their own conclusions. I am confident that gold will replace paper as a true store of value – and that this psychological change will dramatically contribute to significantly higher gold prices.

## Last Minute Notes

### Dow Jones Industrial Index

Although the Dow has surged to new highs, I believe the elation this has brought investors will be short-lived. There are numerous divergences such as non-confirmation by the Transport Index and Market Breadth, and even the MACDI shown on the chart. The days of this Bull Market are numbered and I suspect that by the next cycle bottom, due in late July 1999, the Dow Jones Industrial Average will be considerably lower than the 7400 low of last October. How does 5200 sound?

5200 is based on the 48% decline experienced by the Nikkei in 1990 and the two-month crash of the Dow Jones Industrials between September and November 1929.

### 30-Year Treasury Bond Yields (US)

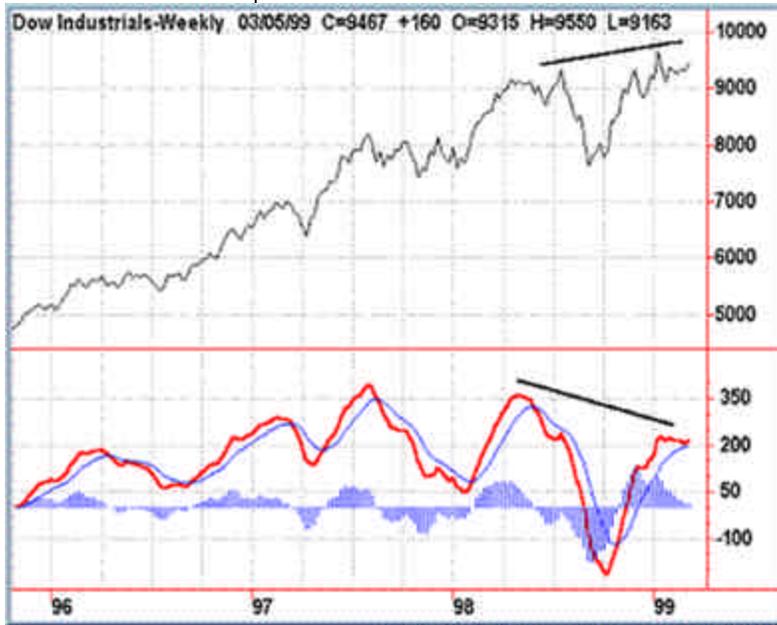
Interest rates on the Long Bonds are rising as foreigners begin to liquidate their US Bond

GOLD DOES NOT MAKE CENTS	THE LONG WAVE ANALYST
<p>Since the US dollar is no longer backed by gold as it was in the early 30's, the panic buying that we saw then is unlikely to be repeated.</p>	<p>Why was there panic buying if the US dollar was backed by gold? In the early 1930s, anyone could hoard dollars knowing they were instantly convertible into gold. Today the only thing backing the dollar is debt. It makes far more sense to buy gold today as a hedge against banking failure and dollar depreciation.</p>
<p>Gold no longer retains a monetary role in the world.</p>	<p>If this is true, why are North Americans buying gold coins (Eagles and Maple Leafs) at a record level? "We are now seeing the re-monetization of gold and silver coins in preparation for the de-monetization of electronic promises to pay. Garynorth.com/y2k/detail-cfm/3834</p>
<p>Central banks are selling their gold reserves and, specifically, the IMF is going to be selling its gold.</p>	<p>European banks have stopped their selling. What we would like to know is who bought all the gold that was sold. As for IMF selling – we see this as a typical smokescreen to talk down the value of gold – Germany has refused to give permission for the IMF to sell any gold.</p>
<p>There is little historical evidence of gold demonstrating safe haven status in times of deflation.</p>	<p>I have shown that James Davidson and Lord Rees-Mogg have evidence that in five previous deflations gold rose an average of 8% in real terms above the price it had achieved in the inflationary peak prior to the onset of deflation. This would translate to \$2000/oz. for gold during the coming Kondratieff Winter.</p> <p>During the 1930s deflation and the earlier 1870s deflation, the gold price was fixed by the 'gold standard'. However, at least during the 1930s deflation, there was a huge appetite for gold, which Bob acknowledges when he refers to the panic buying for gold in the 1930s.</p> <p>In fact, not only was there panic buying for the physical metal itself, but there was a huge move to own gold stocks even though the gold price itself was fixed. By purchasing gold shares, investors were buying 'gold in the ground'.</p>
<p>The supply of gold far exceeds demand.</p>	<p>The latest figures are as follows: The supply/demand deficit is 1600 tonnes (4130 tonnes of demand versus 2529 tonnes of mine supply).</p>

holdings. This selling could turn into a panic and these foreign holders have a lot of bonds to sell (\$500 billion approximately). The 6% yield offers some resistance to the developing upside move. 6.6% is another resistance point.

I believe that rates will move beyond 7% sometime this year. Rates could move

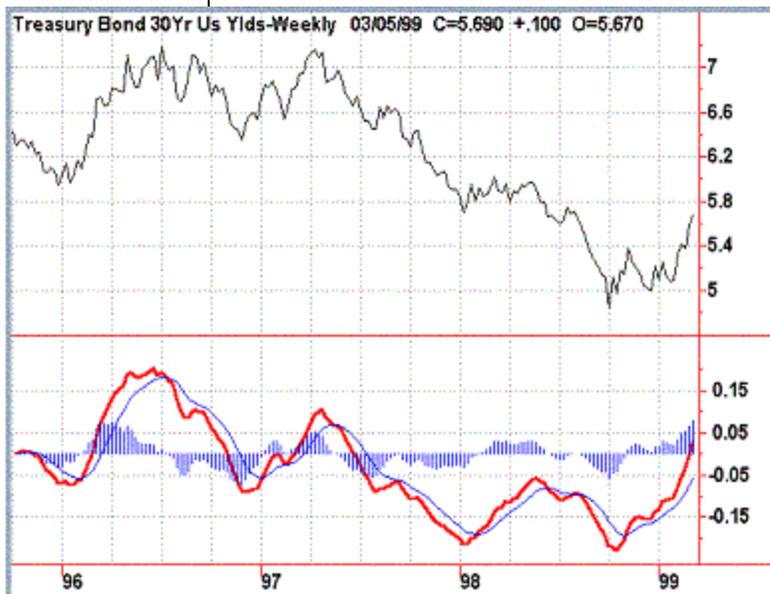
substantially above 7% in the event that foreign selling of US bonds turns to panic.



### XAU Gold and Silver Index

If the MACDI has failed to confirm the new high on the Dow, so too has it failed to confirm the XAU low of last August. This is a bullish non-confirmation, which gives us confidence to project a new bull market for gold stocks which should commence shortly. 60 on the XAU has held three times and offers considerable support to an eventual lift off in prices, which must initially overcome 75 and 80 before hitting more meaningful resistance at 90.

If 90 is overcome, it would confirm the bull market for gold equities and suggest a move to at least 110. Sometime this year, I believe that this Index will make an attempt on the old highs just above 150.



*If you can keep  
your head when  
all around you  
Are losing theirs  
and blaming it  
on you;  
If you can trust  
yourself when all  
men doubt you,  
But make  
allowance for  
their doubting  
too;  
If you can wait  
and not be tired  
of waiting,  
Or being lied  
about, don't deal  
in lies,  
Or being hated  
don't give way to  
hating,  
And yet don't  
look too good,  
nor talk too  
wise.<sup>9</sup>*



## Footnotes and Credits

- 1 Brown, John D., *101 Years on Wall Street, an Investors Almanac*, Prentice Hall, 1991. P46.
- 2 Babson, Roger, addressing the National Business Conference on September 5<sup>th</sup>, 1929.
- 3 Hoppe, Donald. *The Donald J. Hoppe Analysis*, March 23<sup>rd</sup>, 1983.P.53
- 4 Brown, John Dennis. *101 Years on Wall Street, An Investors Almanac*, Prentice Hall 1991.Pps 57-58.
- 5 Proverbs 27/1
- 6 Hoppe, Donald , *The Kondratieff Wave Analyst*. July 1986, P.76.
- 7 Hoppe, Donald, *The Kondratieff Wave Analyst*. July, 1986. P.76.
- 8 Browning
- 9 Kipling, Rudyard, *If*

**10 Jay Taylor will be happy to send you a complimentary copy of his newsletter, Taylor Hard Money Advisors. Please contact me at Canaccord Capital for Jay's telephone number.**

This newsletter is solely the work of the author for the private information of clients. Although the author is a registered investment advisor at Canaccord Capital Corporation ("Canaccord Capital"), this is not an official publication of Canaccord Capital and the author is not a Canaccord Capital analyst. The view (including any recommendations) expressed in this newsletter are those of the author alone, and are not necessarily those of Canaccord Capital.

The information contained in this newsletter is drawn from sources believed to be reliable, but the accuracy and completeness of the information is not guaranteed, nor in providing it do the author or Canaccord Capital assume any liability. This information is given as of the date appearing on this newsletter, and neither the author nor Canaccord Capital assume any obligation to update the information or advise on further developments relating to the information provided herein. This newsletter is intended for distribution in those jurisdictions where both the author and Canaccord Capital are registered to do business in securities. Any distribution or dissemination of this newsletter in any other jurisdiction is strictly prohibited. The holdings of the author, Canaccord Capital, its affiliated companies and holdings of their respective directors, officers and employees and companies with

Canaccord Capital Corporation  
Member of all Canadian Stock Exchanges and the Investment Dealers Association of Canada

VANCOUVER TORONTO CALGARY MONTREAL