Investment Overview of Year 2018
And
What to Expect in 2019?

By David Mitchell - 4th January 2019

It has been quite a year for 2018, volatility has returned like a hungry bear, fuelled by a number of major themes including very late cycle fiscal stimulus in the USA lead front and centre by the Trump government instigating the rapid expansion of deficit spending, while the USA Federal Reserve is not just raising interest rates, it is at the same time shrinking its balance sheet by $50bn a month, draining more liquidity from global financial markets than was intended?

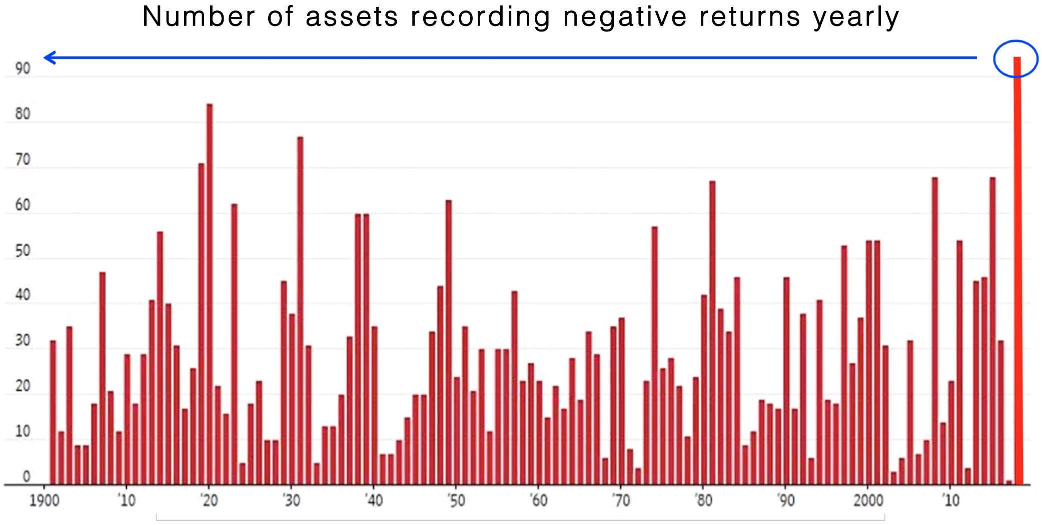
The 'global debt crisis' is now very much biting hard into the world economy, as the 'Great Monetary Inflation Experiment of 2011-18' enters its late cycle hazardous phase where the economic potency of new debt has collapsed by over three quarters since the early boom years of the early 2000s. The balance of risk and reward has turned plainly negative.

Nomura the Japanese bank has warned in its 2019 outlook that China is leading much of east Asia into a severe 'credit crunch' as global liquidity drains away, with property slumps and outright deflation in several countries over the next few months and years.

The China official PMI survey for December slumped below the boom-bust line to 49.4. New export orders slid to crisis levels of 46.6, which was last seen in the depths of the Chinese currency scare of 2015.

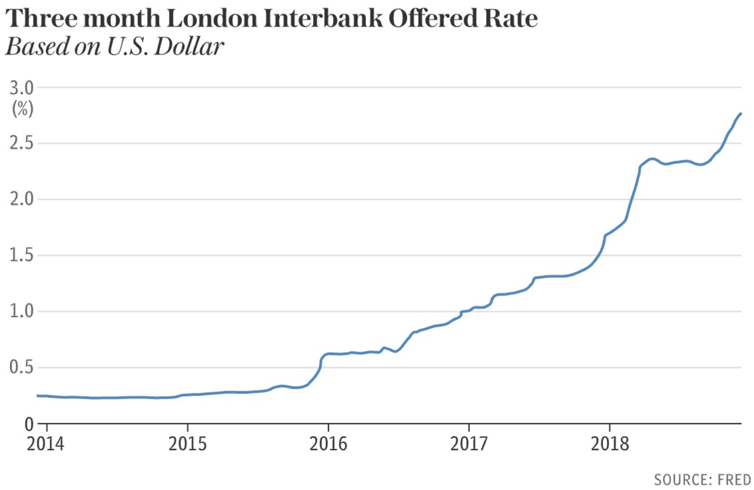
This is all but fully understood by the 'global macro' hedge funds and money managers, but not yet understood by the broader general public and invariably news outlets who always arrive late to a trend change, or indeed all too often by the policy making classes in the West who still rely on old 'pre-China' notions of how the world works.

A "fascinating statistic" by Deutsche Bank has been raised, as of the end of year 2018 a whopping **93% of a far-reaching basket of assets had a negative total return year to date 2018 in US dollar terms.** This was the highest percentage on record based on data going all the way back to the year 1901, eclipsing the 84% hit in 1920. Putting this in context, in 2017 just 1% of asset classes delivered negative returns.



Emerging markets and Europe are being squeezed by the strong US dollar and Fed rate rises (10 Trillion US$ carry-trade is unwinding). Carry-trades develop when borrowers across the world succumb to credit booms while money is loose and cheap in a particular currency (this being the case since 2008 was in US$) they borrow in US$ and convert to their domestic currency for use and investment, the 'carry trade' in full bloom. They always spiral into busts when confidence evaporates, capital flows dry up in the borrowing currency and rates rise. This is the classic 'sudden stop' faced by states that do not borrow in their own currency.

Three-month US LIBOR rates have doubled to 2.78pc over the last year.



Europe is facing recession in its core, Italy is the worst of the lot at the moment, but Germany and France at the core are facing recession and a banking crisis, while France's budget deficit is going to blow far past Italy's proposed fiscal deficit. "It is quite obvious that the budget deficit will be at least 3.5pc of GDP next year, and probably 4pc because the economy is heading for a light recession," said Professor Jacques Sapir from the École des Hautes Études en Sciences Sociales in Paris.

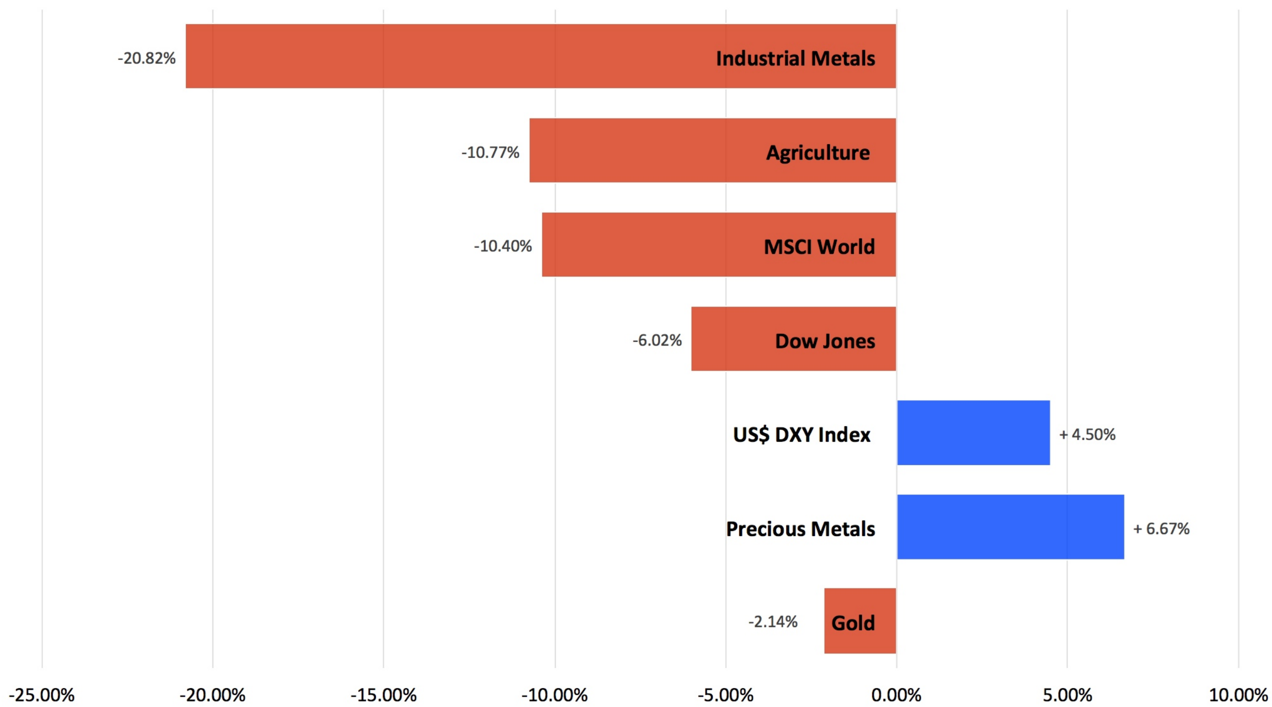
I would suggest however that a light recession in France is only possible if deficit spending explodes in a panic policy move and central banks go back to money printing.

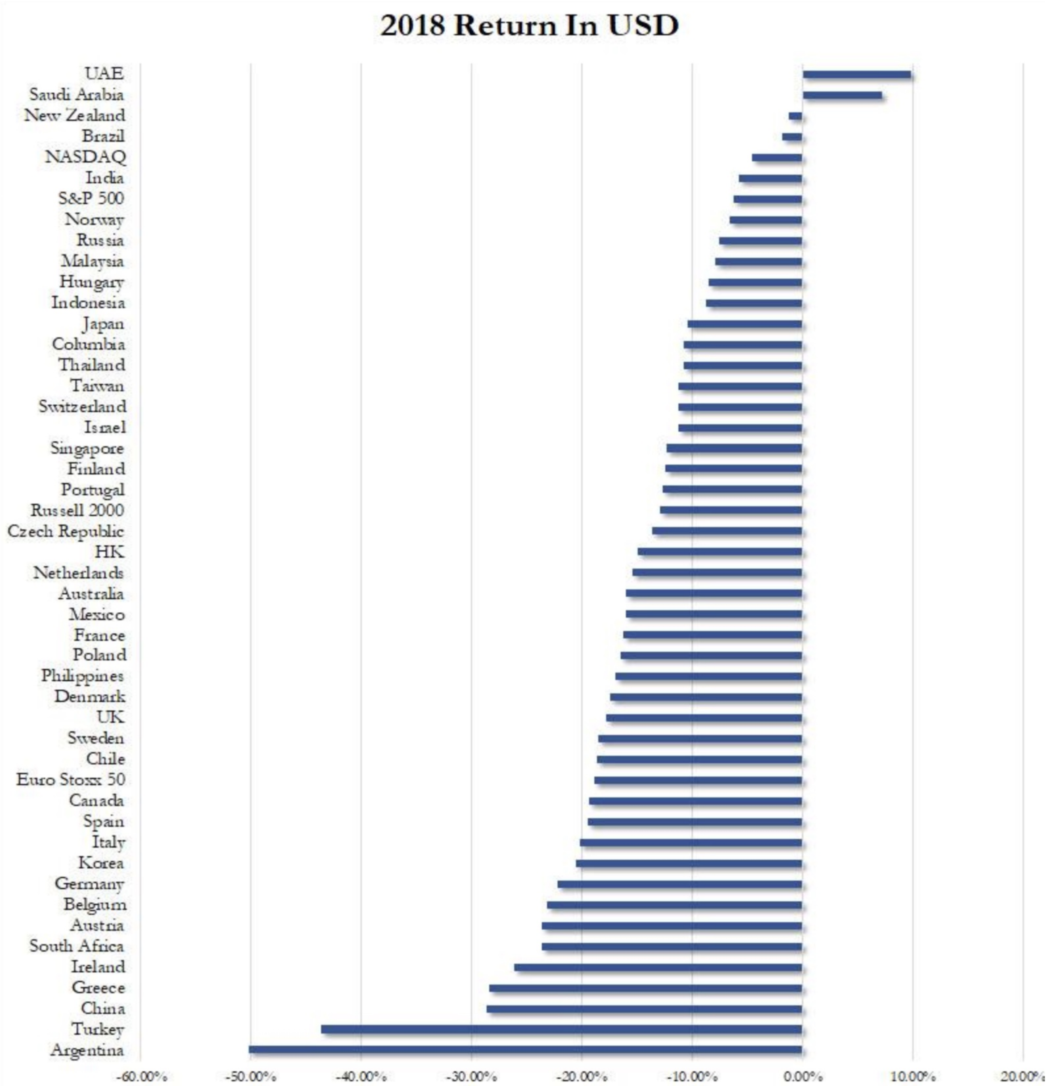
Debt-to-GDP ratios in a string of very vulnerable countries within Europe are far closer to the danger line now they were at the onset of the global financial crisis a decade ago - up from 68pc to 125pc in Portugal, 36pc to 98pc in Spain, 99pc to 131pc in Italy, 65pc to 99pc in France, 54pc to 96pc in Cyprus, and 103pc to 176pc in Greece (despite debt forgiveness).

ECRI said the European Central Bank might have made a serious mistake by shutting down quantitative easing into the teeth of a worldwide cyclical slowdown.
The IFO index of business expectations in Germany fell below the boom-bust line to 97.3 in December, a four-year low. Manufacturing and export orders are near contraction levels.

Surging borrowing costs for companies in the United States and Europe threaten recession within months and resemble events leading up to the global credit 'heart attack' in August 2007.

As you can see in the diagrams below and on the next page, the dramatic falls in the major asset classes alongside falling global property markets (also covered below), the asset classes that have shown any growth have been the US$ and Precious Metals (a category including gold, silver, platinum, palladium and rhodium).





Property markets are falling hard or breaking lower, the last of the global property bubbles are bursting one by one, from Sydney to Melbourne, Shanghai onto Beijing, Hong Kong, Singapore, London to USA and Canada. The great debt leverage bubble and extreme monetary inflation of the last 7 years had pushed these markets to valuation extremes versus average income that was never thought humanely possible in more sober times.

As the crushing cash liquidity tide pulls back from shore, it simply exposes a naked banking sector that has serious balance sheet problems alongside domestic debt leverage that is increasingly difficult (read hopeless) to fund even at globally low interest rates.

What to Expect in 2019 ?

Forecasting markets at present within strictly the short to medium term is fraught with danger due to the extremes at which governments and central banks are willing to go too, extend and pretend to keep the wheels of the car from falling off. However saying that, mathematics has now overtaken us all, **debt dynamics is now the tail that wags the dog**. Obvious long-term repercussions are now relatively easy to forecast, even to individuals who are not macro-economic experts.

Steen Jakobsen (Saxo Bank) has succinctly framed what we are facing globally and I could not have put it better myself, he is betting on a "global policy panic" and another round of massive money printing and debt creation stimulus from central banks and governments, although only after equity markets have hit lows in February. The Fed will then be forced to abandon interest rate rises. China will once again throw the kitchen sink at the problem.

"The mood in Europe, Middle East, Africa and Asia is the worst I have seen – including the conditions leading into 2008. There is a new sense of urgency everywhere," he said.

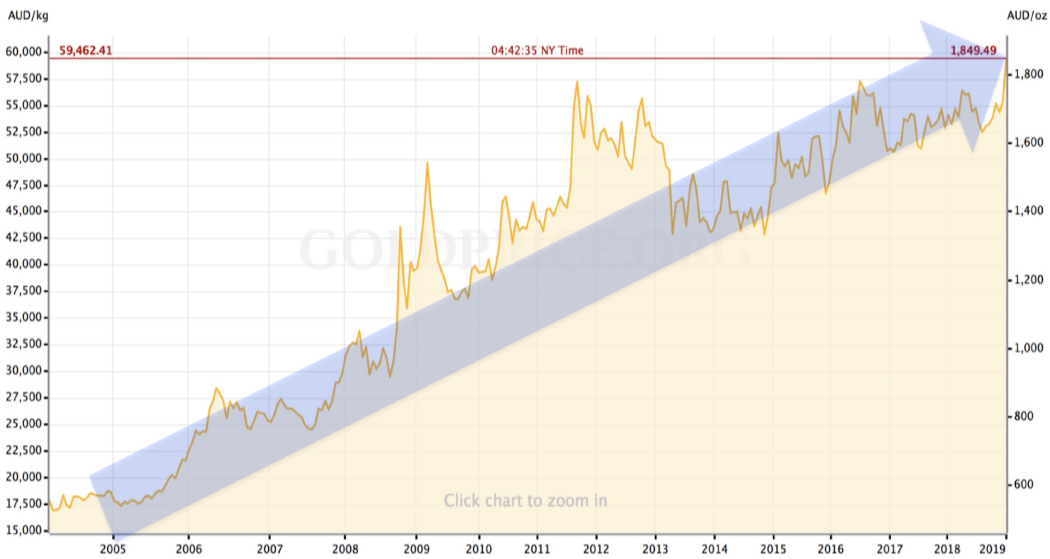
"Europe is sliding back into recession despite a negative ECB policy rate. Germany and its marquee names suddenly look a far greater risk than Italy's populist government. The UK has suffered the biggest credit impulse contraction of any country."

"**Welcome to the Grand Finale of extend-and-pretend, the worst monetary experiment in history**," he said.

Or as Jeff Gundlach stated recently (Jeff is the co-founder of mutual fund company Double Line Capital, which manages more than $115 billion in assets). During his December 17th interview on CNBC reflecting on the year ahead 2019 on CNBC he stated: "**This is a 'capital preservation environment'. Unsexy as this sounds**, a short-term, high-quality bond portfolio is probably the best way to go as you head into 2019."

I understand where he is coming from as a fund manager with enormous exposure of capital under management, very short term bonds seems the most obvious route for a man in his position due to the sheer size of that market which can effectively support his funds under management. But wealth preservation requires assets with zero 3rd party liability and considered globally as a tier one asset class and highly liquid. Hence global central banks, wealth managers and high net worth individuals are accumulating gold and precious metals.

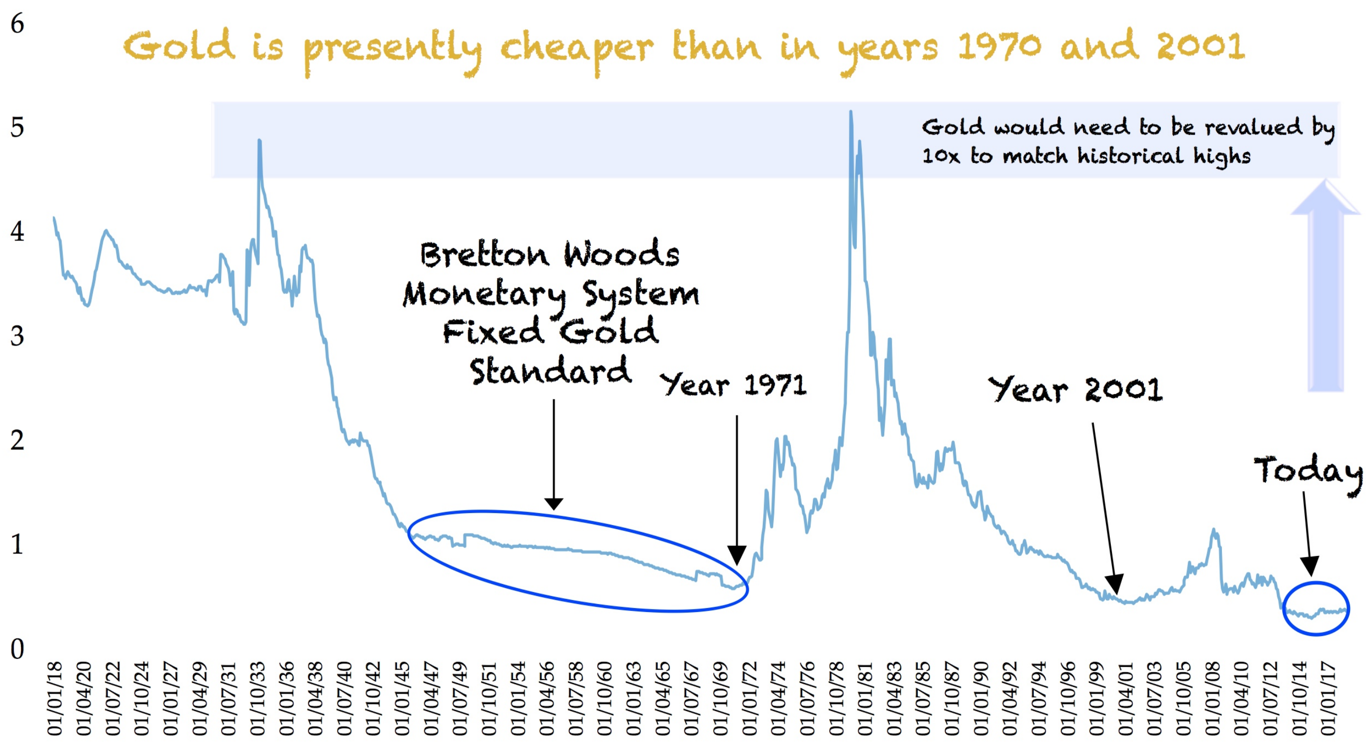
In fact gold against a major commodity currency the A$, the metal has just broken to a new all time global high - see below….



But how cheap is gold exactly ? With the enormous expansion of credit and monetary inflation since the global crisis, gold is in fact the cheapest it has ever been historically as measured against currency and debt in circulation ….

Ratio

Of the gold price to the USA Fed St. Louis Adjusted Monetary Base - back to 1918



Has there ever been a more important time in protecting your wealth using a highly liquid asset tier-one asset ? Investing through a well-managed 'basket' of precious metals with a team of experts has never been more important in my view.