

A FLIGHT TO SAFETY IS IMMINENT

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All economies worldwide, almost without exception, are teetering on a mountain of debt. Nowhere is it more evident than in Europe. European banks, which are levered to the gills (some as high as 32x), are facing huge losses from the sovereign debt of Greece, Ireland, Portugal, and Spain. Several U.S. banks are also at some risk, but nowhere near as high as those in Europe. Who are at serious risk in the United States are money market mutual funds. Some have estimated that as much as 44% of their assets are in short-term loans to European banks. For the life of us we cannot understand why money left at short-term awaiting investment or withdrawal would be worth picking up a basis point or two of extra interest. Money market funds are not a place to take any risk at all. It makes absolutely no investment sense.

It is not only Europe that is facing huge losses. For example, Chinese banks are also heavily levered with real estate collateral of dubious quality. We also all know that U.S. too big to fail banks are nowhere near out of the woods. Why are we so concerned? Although the stock market fails to get the message, the global economy is slowing at a gathering pace. If one is highly levered and the only thing that will ultimately pay off debt is income and there is no income, then guess what? You are in trouble. We are not there yet, but we are moving that way and the complacency in the financial markets is astonishing.

All of the talk recently is about our debt limit and the possibility of default. This is absolutely not a problem. All this daily headline attention is all to the good. It demands action. Do you really believe any political party will want to let a technical default happen? Absolutely not. However, if the truth be known it actually makes no difference. We have plenty of wherewithal to handle our debt service. The countries that are in real trouble are those that have their debt denominated in some currency other than their own; for example, those

in Europe whose debt is extremely high and denominated in Euros. They have no monetary control as the Fed does in our country. They are at the mercy of the stronger European countries - particularly Germany. As we have said before, we are the best looking horse at the glue factory. When push comes to shove we will be the last man standing.

Jim Rogers, the world's first class perma dollar bear, has just become a high dollar investor. He joins Jim Grant of Grant's Interest Rate Observer, also a long-term bear currently in the bull column concerning the U.S. dollar. Jim Rogers says he became a bull as a recent poll indicates investors were 97% in the bear camp, and he was one of them. Speaking of big names in the investment markets, earlier this year the world's largest bond manager, Bill Gross, turned bearish on U.S. Government bonds. Gross has joined 93% of investment analysts as a bear on the highest quality of all bonds. We would suggest that Bill would do better by his clients if he faded away from the overwhelming majority of his peers just as the two Jims have done concerning the dollar.

World economies are slowing and many may be facing outright recessions. Under such circumstances debt levels are too high to service, which tells us that a flight to safety is in the works. It's only a matter of time before the two most hated assets in the world, the U.S. dollar and U.S. Government bond come to the fore. Just think of the buying power coming their way when today less than 10% think they are a good investment.

Another interesting point regarding the longer maturity government bonds (10 years and longer) is that only 10% of outstanding governments are that long. Ten years ago it was 20%. The point being that when Wall Street wakes up to the attractiveness of U.S. Government securities in this environment there will be a stampede through the eye of a needle out on the yield curve (long maturity). Many will be left behind. On a historical basis, using interest rate

spreads between the 2 year and the 30 year, never in the last ten years or so has the 30 year been more attractive. It pays to go long.

Final Notes

When is the right time to buy and hold? Is it when the whole investment world loves an asset or is it when this same world wouldn't touch it with a 10 foot pole? The answer is obvious, but one of the most difficult rules to follow. Swimming upstream against the overwhelming consensus is difficult to do.

End of quarter (2Q 6/30/11) window dressing hurt our performance for the year to date. In our Bison Bond I accounts we had a 6% gain going into the last four days of June. The stock market gains were close to zero so it appears that the traders shorted the long government and bought stocks in mass. Sometimes these quarter end machinations hurt short-term (as it did this time) and sometimes they help. The important thing is that the fundamentals get better and better for us and it's these that win out in the long run.