

Part 3 - 2014 the year of truth! A US dollar crisis, interest rates spiking and worldwide debt growing out of control and gold and silver through the roof!

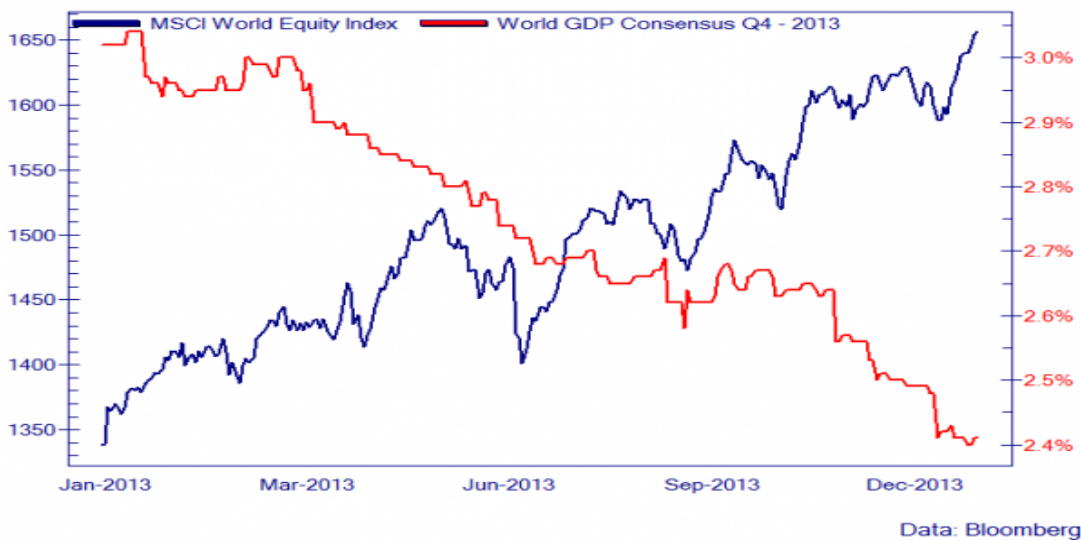
Conclusion:

In my opinion also Europe is not really improving despite some positive published economic figures. We don't see employment improving, we witness continuous country downgrades and real estate, the cornerstone of household's wealth, is also declining. Even Scandinavia, which attracted investors during Europe's sovereign debt crisis, is now coming under international scrutiny on concern that record household debt levels from Denmark to Sweden aren't sustainable. Sweden and Denmark boast public debt loads that are less than half the euro-zone average. Norway's \$820 billion sovereign wealth fund means its government has no net debt. Yet in all three nations, stable AAA ratings have driven down borrowing costs and fed consumer borrowing sprees that the International Monetary Fund and Organization for Economic Cooperation and Development argue pose a threat to stability. In Denmark, consumers owe their creditors 321% of disposable incomes; a world record that the Paris-based OECD said in November demands a policy response. In Sweden, debt by that measure is close to 180%; a level the government and central bank say can't be allowed to rise. Norway's central bank has struggled to find a policy mix that addresses its 200% private debt burden. We saw the same dynamic in these countries as in other countries where historic low interest rates fuelled the housing market and a subsequent spending spree which is now coming back to bite consumers.

Again it puzzles me why people in the US believe that Europe is improving, one swallow doesn't make summer. Perhaps they have recently been a little too high in the Colorado Mountains! Improvement isn't better figures for a few months, that doesn't signify a real improvement, what you need is sustainability for a longer period and then of course without the life support of the central banks. Mrs. Michael White and Borio who worked or work for the BIS, a much more independent institution than the Fed, give a much more realistic picture of the state of affairs than some people who just want to believe! Wall street will be in for quite awakening.

We are already printing like crazy and there is no velocity of money (there is no confidence) and no wage inflation because the unemployment levels are too high. In order words wages are kept low, and there are no increases, and live is getting more expensive, and the economy is not growing in real terms. And therefor the real question we should ask ourselves is how much higher can the stock markets rise whilst neglecting the real fundamentals. The stock markets have gone up by 30% whilst EPS growth has risen by 6%, you see any disconnect? Also see a chart below of 2013 stock prices versus economic growth expectations in the US.

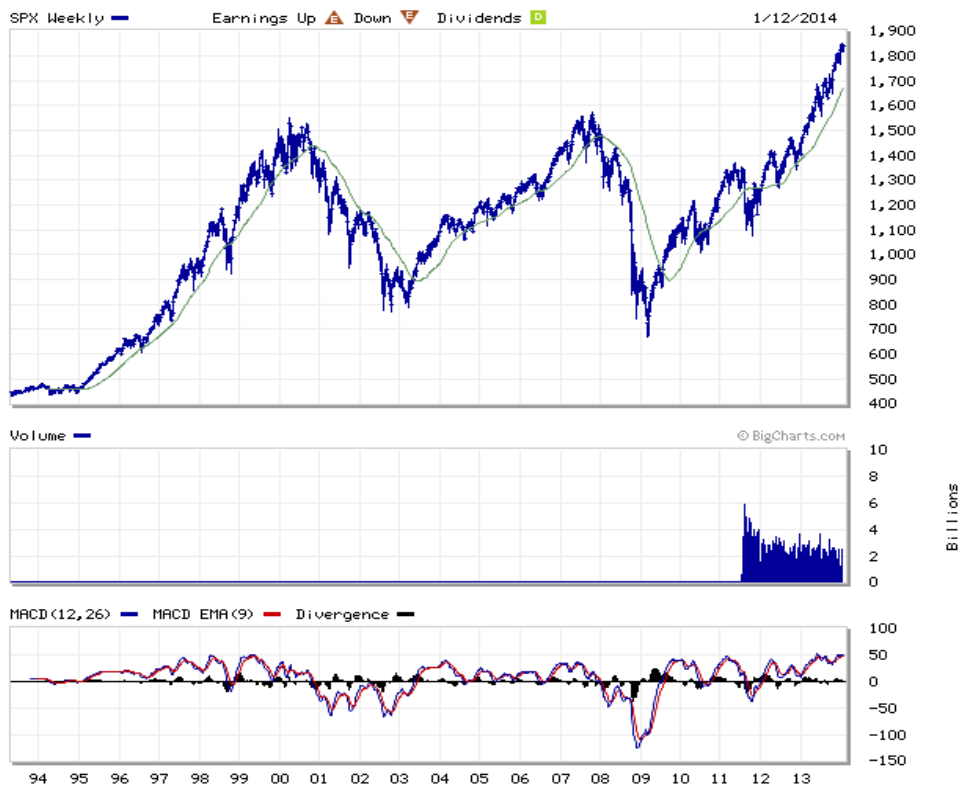
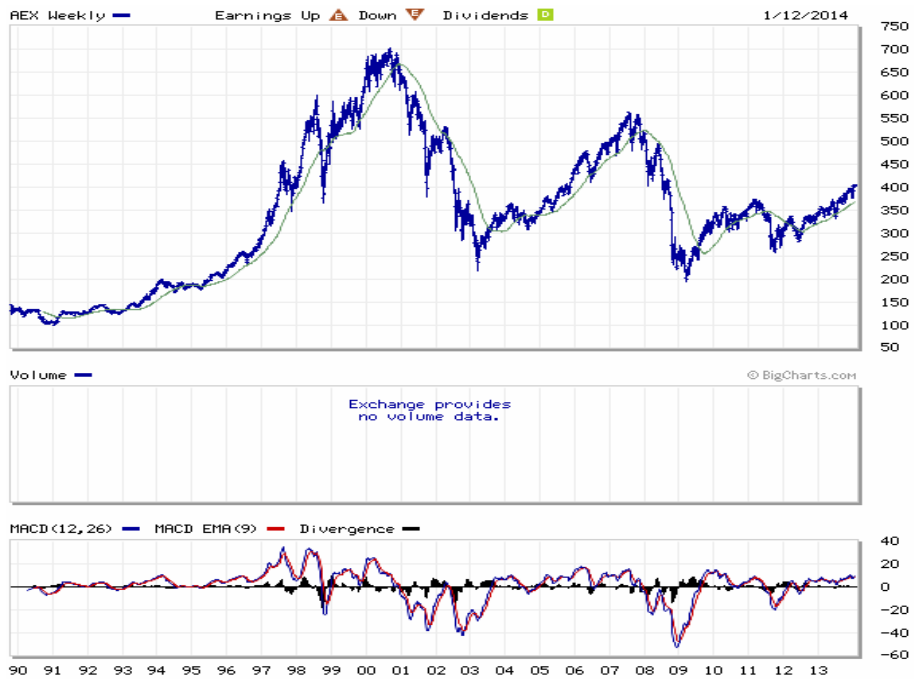
2013 Stock Prices vs. Economic Growth Expectations



Though some people such as Prof Siegel have the opposite opinion. Removing interest-rate environments of 8% or higher, Siegel calculated an 18 to 19 P/E ratio for the market. "That's what I base my fair market value for the Dow and the S&P on," he said. "We are going to have higher interest rates, no question about that. But they're still very low on a historical basis." Again what he is misjudging in my point of view is it is more about the fact that interest rates are on the verge of breaking out of their 32 year downtrend than that they are still historically low! Next to that we are now living in a world that has total debts in excess of \$220trn growing 11% per annum and where an average interest increase from 3% to 4% means additional interest costs of \$2.2trn or \$2,200bn! Siegel said that his 2014 outlook was based on earnings growth of 5%, "and that very well could be quite conservative. I actually think we're going to get GDP growth north of 3%, even 4% is possible. And when you include the buybacks, the leverage, etc., we could have another 8% to 10% earnings," he said, adding that those factors could put the Dow between 18,000 and 19,000, "maybe a little bit higher."

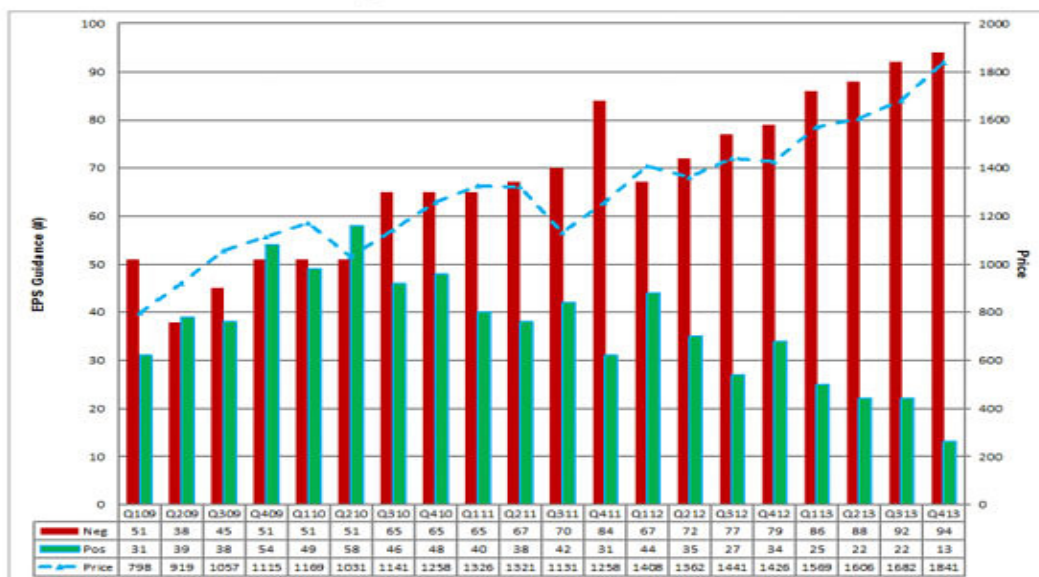
We know that US GDP is also QE-induced. US GDP adjusted for real inflation is down 6% since 2007, and it looks set to fall further in real terms. So the nominal growth that official figures show, are just credit-and-QE-induced and have nothing to do with real growth. It's the same with industrial production and retail sales, which are down 20% in real terms since 2000." Again we have to face reality, the economy is on life support.

In my point of view the difference in performance of the AEX index (the Dutch stock index), which tends to have a high correlation with the S&P500 or Dow Jones index, and the S&P500 gives us a pretty good insight what a difference Quantitative Easing makes. The AEX index is down 42% from 702 to 409 whilst the S&P500 is up 21% from 1,527 to 1,850



The Fed has sowed the seeds of the destruction of the economy it tried to rescue. There is no way out and the Fed will continue with the QE (the Chicago Fed President Evans just confirmed that QE could be \$1.5 trillion next year or \$125bn per month) as long as the market plays along, till investors don't buy it any longer and you could get, as indicated here above, a run on the US dollar causing the bond, equity and housing markets and thus the economy to collapse. The world's central banks not only now own record amounts of government debt, the value of that debt—if marked-to-market—is significantly lower than nominally priced; and, if interest rates rise, central bank balance sheets could be wiped out theoretically resulting in the bankruptcy of central banks themselves.

S&P 500 Negative & Positive Preannouncements: 5-Year



According to John Butters, senior earnings analyst at FactSet, 94 out of the 107 companies on the S&P 500 Index that have issued an earnings outlook for the fourth quarter have fallen below Wall Street consensus. That's a negative rate of 88%, the most pessimistic reading since FactSet started tracking the data in 2006. It also marks the seventh quarter in a row that the number of companies issuing negative earnings guidance has risen, Butters said. By his count, the estimated earnings growth rate for the S&P 500 in the fourth quarter is 6.3%.

Over at Thomson Reuters, corporate earnings outlooks are at “the most negative guidance sentiment on record,” according to analyst Greg Harrison. By their count, 108 companies have given earnings outlooks that fall below the Wall Street consensus, compared with 11 companies that have given an in-line figure, and 11 companies that have provided an estimate above the consensus. Just taking the negatives and the positives yields a negative forecast rate of nearly 91%. Thomson Reuters expects fourth quarter S&P 500 earnings to grow by 7.6%.

At S&P Capital IQ, they're counting 100 companies reporting earnings guidance for the fourth quarter, with 80 of those forecasts falling below consensus, 10 in-line, and 10 that are

above the 15-year average. Again, that places the negative forecast rate around 88%. S&P Capital IQ sees fourth-quarter earnings growth of 5.7%.

And the markets at all-time highs!? The question is how much further can you increase the PE multiple following more quantitative easing despite higher interest rates long-term rates. You decide what makes sense but when stock markets rise 30% when earnings only rise 6%, there is something out of kilter. January 15, 2014 January 15, 2014 Some see the 1,810 level on SPX and 14.50 on the VIX as clear demarcation lines. See also below what the HUI and gold charts could be telling us! Especially look at the MACD lines turning upwards.





January 17, 2014
 Gijsbert Groenewegen

g.groenewegen@goldarrowpartners.com

www.groenewegenreport.com