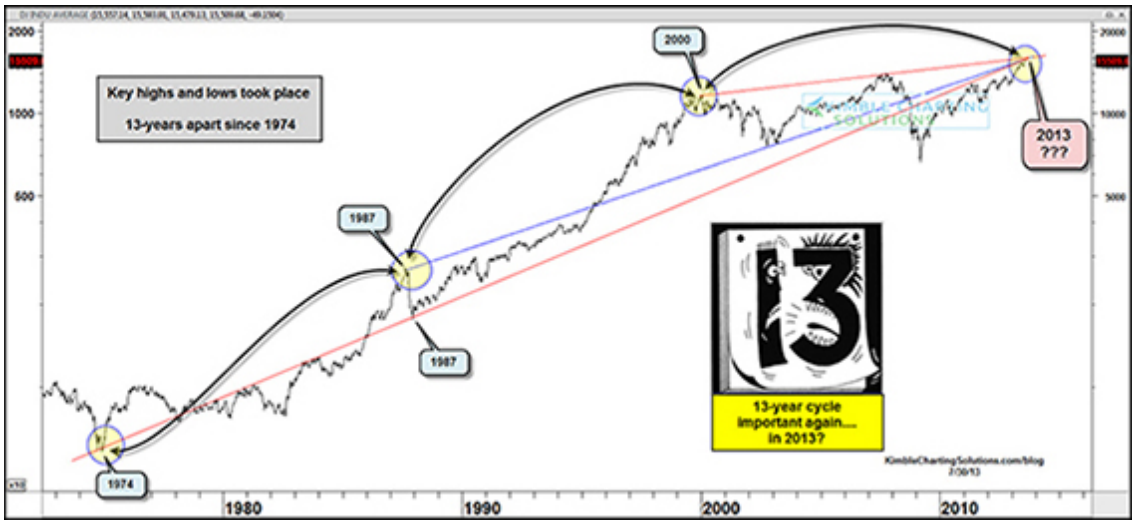
We are in the twilight zone! We live in a make believe society.

The 13y cycle is telling us we are close to a top, in 2013!

At present the US stock markets defy gravity either because: 1. The monthly $85bn Fed purchasing program; 2. The "improving" economy with 1.7% GDP growth for 2Q13 and bullish expectations for the remainder of the year; 3. The lack of alternatives to invest in in addition to all the money on the sidelines. The investors take their pick of these reasonings; whatever suits them, as long as it justifies them to invest in the US markets.

Check out the below chart from Kimble Charting Solutions which makes the case that since a 1974 low for the Dow key highs and lows have rolled around every 13 years. If this cycle repeats, then another historical price point is due this year. Kimble noted in April that the pattern was suggesting the Dow could hit the 16,000 level, which is becoming reality more and more by the day. The achieving of new highs also coincides with the divergence with the other markets around the world that don't attain new highs. By lack of alternatives a huge bubble is being created in the US markets!



People don't want to hear bad news but if you continuously put your head in the sand whilst there are huge structural problems that need to be addressed urgently you will ultimately face far more unpleasant consequences in the end and we are racing fast towards that situation. The markets have been rising since March 2009 or 4.5 years!! And not because the economy has been doing so well. It has been mostly a function of flow of funds.

All figures are BS so your guess is as good as mine!

Anyway at present I believe the markets are confusion all over. The CNBC reporters are asking investors more than ever "where do you put your money!" Why? Because they don't know it themselves. The Fed revised the 1Q GDP growth rate down to 1.1% from 1.8%. Figures are being restated the whole time. 2Q13 GDP growth figure was reported at 1.7% (we are due for revised Q2 numbers, August. 29th, 2013)! Estimates for 2Q13 corporate earnings were all massively

downgraded just before earnings season and suddenly earnings are exceeding expectations. What are people smoking? How good or genuine you believe Wall Street analysts really are if the majority of results continuously exceed the Street's estimates? How much do you want to be fooled by the artificial maneuverings in order to present a rosy picture to keep the rally going for Wall Street till reality catches up in a big way? Next to that small improvements on bad figures are being interpreted as hugely bullish signs. On Marketwatch the heading of one article was "Why do so many people hate this bull market". You want to know why! Because there is nothing real about this market anymore, it is as manipulated as can be. Wake up! **Italians have the right expression "Che Casino" translated "What a Mess".** Despite the trillions of stimulus and ultra low interest rates these second quarter results are at best mediocre with disappointing/negative top line growth. Nevertheless people might still argue that the housing market is strong.

Housing market strong? Look below the surface. Citizens are not benefitting. Again it is a make believe market.

Nationally, home values rose by 5.8% in June from one year ago, according to Zillow Inc., the real-estate website, the largest gain since 2006. So far this year, prices are up 2.7%, the strongest year-to-date gain in June since 2005. Strong housing market? Nonsense! If you look at the improvement in housing, which has been significant over the past year or so, mortgage originations really haven't picked up. Why? Because a couple of private equity/hedge funds have been buying up repossessed houses from the banks and done them up to rent them out and subsequently want to securitize them to sell them off with a hansom profit before interest rates start to increase. 2008 revisited! Next to that the banks are holding back selling off repossessed houses keeping supply tight aiding price rises so that they also reduce the losses on their repossessed homes. Homeownership at 65.1%, the lowest since 1995, is illustrating this point and we have to ask ourselves who is really benefitting here from the securitization? Well it is definitely not the US citizens; it is the hedge funds and equity firms. Spending for U.S. construction projects unexpectedly declined in June (how odd!), the Commerce Department reported Thursday August 1. Construction spending fell 0.6% in June to an annualized rate of $883.9bn its lowest rate since 2006. The biggest declines were seen in government related construction projects and residential construction numbers were flat for July. Strong market? This economy, with its debt structure, could not support a 4%-plus Treasury yield. Traditionally, a 100-basis-point move in the 10-year Treasury will be reflected fairly quickly in a cessation of any rise in home sales. We still have way too much vulnerability in the housing market, as clearly illustrated, to name one sector. Overall there is too much debt relative to income and therefore in my point of view this economy will not tolerate high rates without a lot of things breaking down. Just keep in mind the $400trillion+ in interest derivatives and the so important rate of change (ROC) in interest rates that could have a devastating effect on the financial system. This time it would not only affect the housing market but also the huge bond market with all its consequences.

It should be stated that auto sales figures were also not as rosy as figures people want to believe. Why were Ford, General Motors and Chrysler share prices up whilst they all reported, "disappointing" July sales. Ford U.S. vehicle sales were up 11%, estimate was 17%, GM U.S. vehicle sales up 16%, estimate was 20% and Chrysler U.S. vehicle sales were up 11%, whilst the estimate was 16%. Although auto loans seems to be the exception for credit usage in our economy people are buying fewer cars than forecast.

What should investors believe? We are in the ultimate twilight zone, "nobody knows". Most economists and the Fed members seem to anticipate (and want everybody to believe) that growth in the U.S. economy will accelerate in the second half of 2013 and that it will gather more steam in 2014, and that Europe may be close to reaching its bottom. Dream on.

My guess is that a meaningful upturn of growth in the U.S. is unlikely, given the current mix of failing fiscal and economic policies that are not really working. And neither is the situation in Europe. The Europeans are on holiday; wait till they are back in September! We just have to look at Greece.

Greece is not improving and needs again more money

According to an article in the NYT on August 1, 2013 the International Monetary Fund warned in a report **that a persistent recession and the government's failure to accelerate overhauls may create an €11bn hole in Greece's finances over the next two years!!** The latest financing gap may require Greece's European creditors to consider giving it debt relief and more money again so that it can meet the requirements of its current €172bn bailout program, which came on top of a €110bn bailout program given in 2010, the I.M.F. said. The Fund also cautioned that investment and growth were unlikely to resume in Greece if investors were not convinced that Greece's creditors had a credible policy to deal with its debt crisis.

The rest of Europe is also slipping from recession to depression, confirmed by the continuous round of rating downgrades as felt by France and Italy (Italian government debt is close to junk!). Italy's €2trn in outstanding debt accounted for 127% of GDP in 2012, the highest level since Benito Mussolini won elections in 1924, and is projected to rise to 130.8% in 2013. We have also seen how the possible fall of a government can easily threaten to derail the bail out agreements as we have already witnessed with Italy and Portugal. In history recessions/depressions are often followed by currency and real wars.

The strong culture of dependence in terms of social security entitlements bodes poorly for the prospects of a strong economic rebound in Europe, it hampers the flexibility needed to turn things around. These are structural issues and not turned around in just 3-4 years. Europe has to transform itself from its entitlement society, social security burdens, the un-fundability of these programs and its deficit and debt problems. And nobody is willing to give their entitlements up freely unless they are forced to, a process that has clearly started (Greece, Spain, Portugal). We are at the end of an era; Europe and many other regions are due for a generational transformation. The entitlement system is unrealistic and broke.

I see more and more a similar trend developing in the US where the ratio of full time workers versus those collecting disability payments fell from 50:1 in 1968 to 13:1 in May 2013 (116.1 million full-time workers and 8.9 million collecting disability). The world is converging.

China's economy is not improving, different figures give different stories, and neither are the other BRIC economies

China and Asia are faced with overproduction, having expanded production capacity over the year and now faced with much slower world GDP growth, and logically they have no choice but to

export their overcapacity and thus lower prices to the rest of the world because they have to keep their workforce employed in order to prevent unrest and chaos.

July trade figures published on August 8 showed that Chinese exports beat expectations, rising 5.1% year-over-year in July after a 3.1% fall in June. Imports were also strong, up 10.9% year-over-year compared with a fall of 0.7% the previous month. "Finally, some good news from China," said Qu Hongbin, an economist at HSBC Holdings PLC. The Shanghai index ended -2 at 2,045! Economists though say it is too soon to conclude that the worst is over for China. Other measures of manufacturing that place greater emphasis on small- and medium-size businesses continued to show conditions deteriorating in July.

A privately by HSBC compiled gauge of China's manufacturing activity sank to an 11-month low fell from 48.2 in June to 47.7. The result contrasted with an official version of the manufacturing PMI, which unexpectedly rose to 50.3 from June's 50.1. Any reading above 50 indicates activity is expanding, and the July data marked the third straight month the HSBC registered contraction, and also the third month the two PMIs differed on whether factory activity was rising. HSBC's PMI covers a smaller number of firms and focuses on smaller manufacturers, while the official PMI includes more of the large state-run firms (and thus more prone to manipulated figures). Anyway it is clear that people only want to read the information that suits them, information that makes them believe that things are honkey dory as was by the US stock market performance when these figures were reported.

Another piece of information that confirms the unreliability of the official Chinese figures, such as the 7.5% GDP growth figure for the second quarter, is the fact that the 10 largest US-China trading partners confirmed that business was down 4%-4.5% in the second quarter. In other words the Chinese GDP growth rate is much lower than officially reported. What is the chart of the Shanghai Stock Exchange Index (see below) telling you? Also closely watch the copper prices. China accounts for about 40% of all hard commodities.

The other BRIC countries (Brazil, Russia, India) are neither improving they have run into the

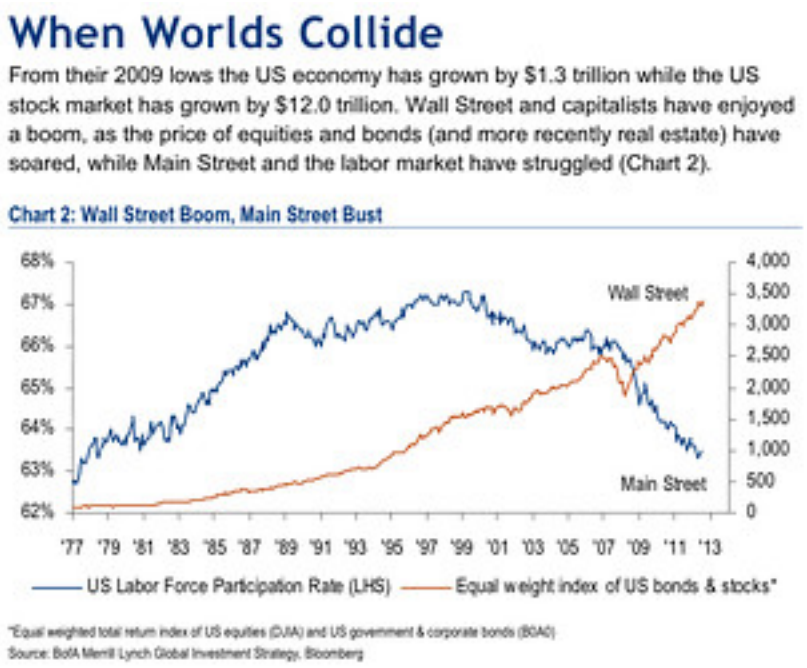
limits of their growth.

And thus as discussed earlier "everybody' is investing in the US stock markets (and Japan) by lack of alternatives. Isn't it a great way to invest! It is called "creating a bubble" underpinned by Wall Street. Moreover we have to wonder where the topline growth for US companies will come from going forward! Hence the question is if the P/E expansion can sustain higher prices because of the funds flow despite the threat of higher interest rates or lower earnings.

The short-term reality is that we are experiencing a situation that is highly manipulated towards maintaining the very delicate confidence in the markets whilst the long-term reality looks dire to say it at the least (see below the BoAML note about the discrepancy between Wall Street and Main Street).

The discrepancy between Main Street and Wall Street couldn't be bigger

According to a note of Bank of America Merrill Lynch from the 2009 lows, the U.S. economy has grown by $1.3 trillion, whilst the U.S. stock market has grown by $12 trillion (9.2 times). US stocks have been on a tear this year with the S&P500 at 1690 rising 21% to date, which has mainly benefited the top 5% of the population, who own 60% of all individually held stocks. Five years after the crash, the labor recovery is still extraordinarily weak. The absolute level of nonfarm payrolls today is basically the same as it was in 2005 a significant percentage of recently created jobs are low-wage and/or part-timers. With most of the newly created jobs being part-timers it illustrates the vulnerability of the "recovery".



Corporate profits account for 12.6% of GDP, the largest percentage since the 1950s while wages and salaries account for the smallest share of GDP (54.9%) since 1955. So what will propel this

economy forward?

I believe the moment of truth for the economy will arrive in the second half of the year. We should ask ourselves how long can the disconnect between Wall Street and Main Street go on!

Another example of the huge disconnect between Wall Street and Main Street is the issuance of so called coco (contingent convertible) bonds

According to an article in the Financial Times Credit Suisse has just issued a $2.5bn 'wipeout' bond as banks across Europe prepare to do the same, in an attempt to appease regulators eager for more loss-absorbing capital. The 10-year **contingent convertible – or coco** – bond yields 6.5% per annum, meeting the strong demand for yield, and is one of the biggest such deals in Europe coming after Barclays $3bn coco in 2012.

Unlike some cocos, where bonds automatically convert into equity if a bank's capital falls below a certain threshold, the Credit Suisse deal is a 'sudden death' or 'wipeout' version where investors stand to lose everything if the Swiss bank breaches its 5% tier one capital ratio (which could happen in case of a one-off trading loss or fraud) or if the national regulator deems it is near default.

While UK and Swiss banks have been among the most eager coco issuers – such as Barclays, UBS and Credit Suisse – Belgium's KBC issued a $1bn coco at the beginning of the year while in April Spain's BBVA issued a $1.5bn bond. These bonds have been under fire because under the conditions of the "coco" the KBC and Barclays bonds will be written down to zero once the bank's common equity tier 1 ratio falls below 7 per cent even if the bank remains a "going concern".

So whilst there is a lack of normal yielding instruments the banks, which for a large part have maneuvered us in this position of almost indefinite QEs because of their mismanagement (MBS), are now issuing products that basically bet on their own financial demise. This in my point of view is ethically so disgraceful and in breach of the social economic spirit that banks have to look after the stabilization and security of the financial system. Banks have this socio-economic responsibility, hence why they were rescued by the central banks and treasuries (the taxpayers), and then they speculate, using one of the crucial BIS guarantee ratios that should make banks safer, issuing bonds to investors to strengthen their capital ratios with as benchmark their own demise!! **Again "Che Casino"!** Wall Street looks more and more like Las Vegas "What happens in Wall Street stays in Wall Street". A lot of investors don't really understand the investment products and often there is no good comparison for the investment products enabling the investment banks to charge huge commissions as we saw with the mortgage backed security products.

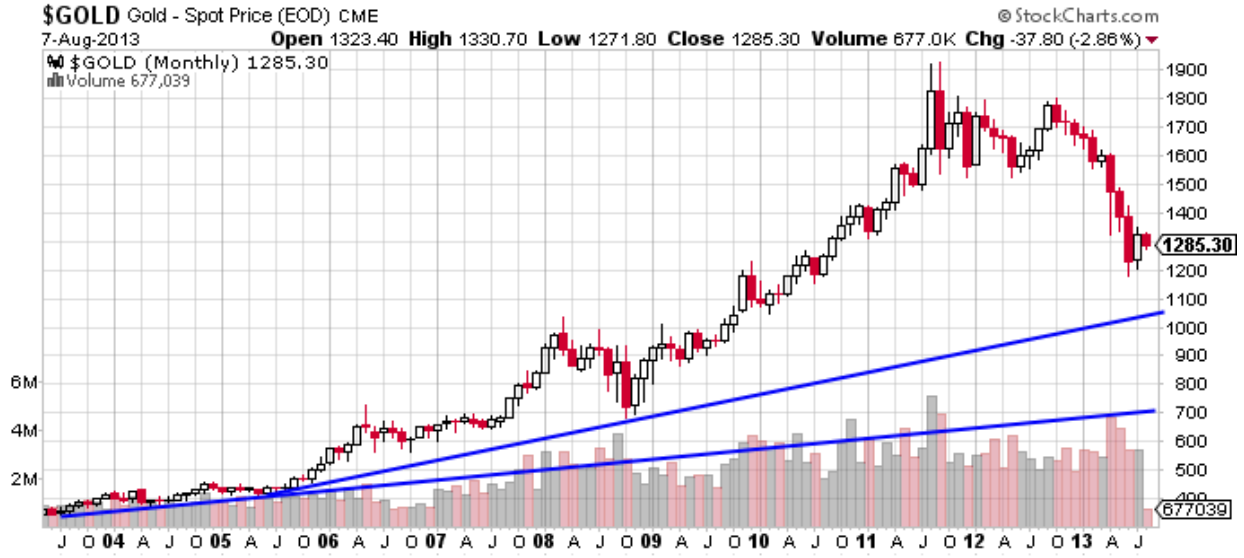
Contrary to the $, Yen and Euro, gold is the only currency not being diluted!

Anyway paper has been thrown and will continue to be thrown at the system like it has gone out of fashion without achieving any tangible results. Commentators might argue that without the

stimulus the situation would have been much worse. Short term that could be true but at one stage one has to analyze and decide if things are not getting worse as a result of the good intended measures and start to be counterproductive. To me it is clear we need an urgent reset of the system.

In order to get back to basics strict discipline, sobriety, a strict adherence to moral commitment and a complete open mind towards old concepts (f.e. entitlements) is needed to maintain the store of value and credibility of paper money. Though the globe's major central banks and politicians have long since abandoned such discipline and sobriety and thus there is no reason why investors and citizens should have any confidence that paper money or claims on paper money (bonds) will actually maintain their value.

And therefore I believe that gold remains the only real insurance policy against the inevitable decline of the fiat paper standard because it can't be printed (diluted) ad infinitum. As we know there is far too much debt in the world that can never be repaid in constant dollars. This debt can only be repaid in one of three ways: (1) partially, which means through defaults and restructurings (see, for example, Greece, Cyprus); (2) through inflation; and (3) through currency devaluation (hence why the Chinese are accumulating gold and people started talking about a gold backed Yuan). The global economy is simply incapable, and this is at historic low interest rates, of generating sufficient income to service and then repay the trillions of dollars of debt on the balance sheets of the central banks not to mention all of the other public and private sector debt, nor the hundreds of trillions of dollars of future entitlement obligations of its governments. In the end, paper money will continue to be devalued and gold will ultimately have to be the beneficiary of that phenomenon. **I can't emphasize enough paper money ($, Yen, Euro) can be printed whilst gold can't be printed hence its inherent value.**



Gold and silver might have one more leg down, with a possible low in November/December this year, on the false belief that the economy is improving. Though as I have said many times we have passed the tipping point with unsustainable debt levels that can't be served much longer, especially not when interest rates start rising! It should perhaps come as no surprise that, in anticipation of higher rates, the just completed 10 Year auction on August 7 was done at the lowest Bid To Cover

(BTC), or 2.44, going all the way back to March 2009 (see chart below)!

Although investors in the US are expecting higher rates on the back of potential tapering because of stronger 'perceived" growth I don't see where the growth or demand in the world will be coming from to spur the US or German and UK markets further! Definitely not from China, Europe or the emerging markets and Japan is a special situation on its own in my point of view with the Nikkei and the Yen strongly inversely correlated. The month of September is most likely to show us if we have seen the peak in the market(s) or not. It is my believe that we will have to brace ourselves for some challenging times ahead with the markets revisiting the 2009 lows by next year. I also would like to remind you of the 13y cycle mentioned at the beginning of the article. The make believe markets are not sustainable and will come down to reality. And when it happens everybody at CNBC will say, "we knew it was going to end badly", they are like the Kardashians; they tell people what they want to hear or what they want to identify with! Anyway insure yourself for rough times ahead.

g.groenewegen@goldarrowpartners.com

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