



## **John Embry on Gold, Silver, Currencies and Commodities**

By Ron Hera

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The [Hera Research Newsletter](#) is pleased to present the following insightful interview with John Embry, Chief Investment Strategist of Sprott Asset Management LP, where he plays an instrumental role in the corporate and investment policy of the firm. Mr. Embry, who is a world renowned expert on the gold market and on gold and precious metals mining shares, currently focuses on the Sprott Gold and Precious Minerals Fund. Mr. Embry has researched the gold sector since 1963 and has more than thirty years of industry experience as a portfolio management specialist.

After graduating from the University of Manitoba with a Bachelor of Commerce degree, Mr. Embry began his investment career as a stock selection analyst and Portfolio Manager at Great West Life, where he later became Vice President of Pension Investments for the entire firm. After 23 years with the company, he became a Partner in United Bond and Share, an investment counseling firm acquired by Royal Bank in 1987.

At Royal Bank, Mr. Embry was named Vice-President, Equities and Portfolio Manager at RBC Global Investment Management, a \$33 billion organization where he oversaw \$5 billion in assets, including the flagship \$2.9 billion Royal Canadian Equity Fund and the \$250 million Royal Precious Metals Fund, which was the #1 ranked fund in Canada for its 2002 net performance of 153%.

**Hera Research Newsletter (HRN):** Thank you for joining us today. Let's talk about gold stocks.

**John Embry:** Gold stocks represent a tremendous value in relation to the price of gold and to the fundamentals of the sector. There has been tremendous shorting activity by hedge funds and, as a result, dedicated gold funds have experienced redemptions. Retail investors, who are natural buyers of these stocks, have been annihilated by the price action. This has created one of the finest opportunities, if not the finest opportunity, that I have ever seen.

**HRN:** Do you have a short term price target?

**John Embry:** I don't look at short term price charts for gold. In a market as heavily interfered with as this one, charts can be made to look any way you want in the short run. As I see it, if you don't like gold at these prices, then you must like currencies. My partner Eric Sprott often says, the U.S. dollar is the best looking horse in the glue factory. If the U.S. dollar is the world's strongest currency, that's the best endorsement for gold that I can think of.

**HRN:** Do you believe that currencies are losing value?

**John Embry:** The fact is that economies are slowly melting down. The problem is excessive debt in almost every corner of the world. The only way to deal with the debt is through aggressive growth, but fabricating growth through more debt won't work. The idea that you can get the economy to move forward by creating even more debt just doesn't wash. We can't service the existing debt, even at artificially low interest rates. I don't see any easy way out. We have to get the excessive debt out of the financial system. Either policy makers are going to create mounting inflation or there will be a deflationary debt collapse.

**HRN:** Europe seems to be a case in point. Do you think the Euro will break up?

**John Embry:** The Eurocrats who constructed the currency aren't going to give it up easily. The key is how much the Germans are going to go along with. They realize that there's a huge loss for them if the Euro falls apart. I wouldn't want to be in German Chancellor Angela Merkel's shoes. Germany is trapped in the Euro because it relies on exports and German banks hold the debt of other European countries. Despite the bailouts and the inflationary policies of the European Central Bank (ECB), Germany doesn't have much choice.

**HRN:** How can European governments solve their debt problems?

**John Embry:** The problem is that it would take a horrific debt collapse to set the stage for future expansion. There is no politician on earth that wants that to happen on their watch. Consequently, policy makers will resist deflation and we're going down the opposite road, which means mounting inflation or possibly hyperinflation. I don't think politicians will change the system. I think the system will change the politicians.

**HRN:** Can the economy recover in a high inflation scenario?

**John Embry:** Creating even more debt is not going to work. To me, high inflation is the most corrosive thing that can happen to an economy or to a country. I'm really worried that neoclassical, Keynesian economists like Paul Krugman, who are prescribing even more debt, will bring about a collapse.

**HRN:** Are these problems the result of Keynesian economics?

**John Embry:** If you really applied Keynesianism as Keynes originally envisioned it, the government was supposed to run surpluses when the economy was growing to pay for the deficits that would be created during downturns. That's been conveniently forgotten. We've had an astounding build up of debt. I don't think people fully realize how serious this is. I'm amazed at how complacent people are. We've never been in a position like this in the entire history of the world.

**HRN:** Why do you think people are so complacent?

**John Embry:** I think it's cognitive dissonance. When confronted with something that's really unpleasant, and to which there's no easy solution, the average person will basically block it out and look for somebody to tell them that everything is fine. The mainstream news media and the government are doing that as we speak. Consequently, the average person doesn't have a chance of understanding what's going on. The man in the street doesn't have a clue what's coming.

**HRN:** What about investment professionals?

**John Embry:** I have a lot of close friends who have been in the investment business for 40 years and they don't want to hear it.

**HRN:** Won't the Federal Reserve and other central banks simply bail out the system?

**John Embry:** They think that printing money will buoy the markets and that that's good, but it won't solve any of the problems. Although you may get a momentary lift in the financial markets, when it plays itself out we'll be back in the same situation, but with money that's being systematically destroyed.

**HRN:** Does printing money work in the short term?

**John Embry:** There are nominal prices and real prices. Printing money is very deceptive and people are confused by its effects. I am only interested in real returns, not nominal returns. If you have a nominal return that's caused by inflation, you're losing money because governments tax nominal gains.

**HRN:** Can governments inflate their way out of debt?

**John Embry:** The U.S. federal government, for example, has reached a stage where forty cents of every dollar spent at the federal level is borrowed and a lot of that money has been printed. There has never been a case in history where that hasn't led to financial disaster. If you study any empirical evidence, they're in a hopeless position. They've only been able to get away with it so far because the U.S. dollar is the world reserve currency. If the United States wasn't able to print money and was trapped in the European Union, it would just be a massive Spain.

**HRN:** So, governments can't inflate away their debt?

**John Embry:** Inflation is the easier, more expedient route to take, but I would not rule out an accident. For example, if policy makers push austerity too far they could trigger a deflationary spiral that would be impossible to reverse. I subscribe to the Austrian theory of economics. In his book *Human Action*, Ludwig von Mises wrote that there is no way to avoid the collapse of a credit boom and that more credit expansion simply destroys the currency.

**HRN:** Don't inflationary policies help banks and support the financial system?

**John Embry:** The ECB could do another Long-Term Refinancing Operation (LTRO) or the Federal Reserve could buy more U.S. Treasuries in the open market but that's not really solving the problem. If you actually evaluated the banking system and marked all the assets to market, the system would be insolvent.

**HRN:** And the basic problem is too much debt and leverage?

**John Embry:** The over the counter (OTC) derivatives situation is so surreal I can't begin to express it. Correctly calculated, the notional value of all OTC derivatives is in excess of one quadrillion dollars globally. The vast majority are related to interest rates. Central banks have to keep creating liquidity to prevent these instruments from collapsing.

**HRN:** What can the Federal Reserve and other central banks do?

**John Embry:** They're lost either way. They're running a massive lab experiment with monetary policy and don't have a clue what the outcome is going to be.

**HRN:** Do you think the U.S. economy can grow its way out of debt?

**John Embry:** When I was a kid back in the 1950's, most women didn't work. Americans maintained their standard of living by putting a second person to work. When that was expended they made up the difference by going into debt and, eventually, they used their homes as cash machines. Now student loans total more than \$1 trillion. I just don't see where the consumer demand is going to come from going forward. You can't get blood out of a stone.

**HRN:** What do you think the outcome is going to be?

**John Embry:** I believe that before this is over we'll have a new currency system, probably backed by gold.

**HRN:** Do you support the gold standard?

**John Embry:** One of the greatest periods of wealth creation was when we had a gold standard in the second half of the 19th century. It's hard to believe that it's going to be 41 years since there has been gold backing for any of the major currencies in the world. That is what has allowed the massive build up of debt that we have today. If there had been a gold standard, we wouldn't be in the position we are in. Western governments don't want the gold standard because it restricts their ability to dole out favors.

**HRN:** But the gold standard doesn't prevent financial panics.

**John Embry:** There are always going to be financial panics, but, under the gold standard they tend to be short term. If we had had a gold standard, there would have been a number of cleansing periods where excess debt was eliminated. The Federal Reserve allowed the build up of debt that led to the stock market bubble and crash of 1929 and to the Great Depression, which was followed by World War II. It took about a decade to build up the debt and more than a decade to deal with the fallout. It's taken more than 40 years to build up the debt we have today and I don't know how long it's going to take to correct it.

**HRN:** What does this mean for the average person?

**John Embry:** I think living standards of most people in the world, particularly in the West are going to decline precipitously. The Federal Reserve recently reported that the net worth of the median American family has fallen nearly 40% since 2007 after adjusting for inflation. Before this all plays out, I think the percentages are going to be far larger.

**HRN:** Do you foresee any wider impact on society?

**John Embry:** When I was growing up in the United States after World War II, I didn't realize how remarkably fortunate we were as a society to have such a strong middle class. Seldom in history has there been a middle class to equal what transpired in the U.S. and Canada from the 1950s to the 1980s. We basically took it for granted because that's all we ever knew. The middle class in the United States is disappearing. What happens is that you have massive poverty and a small wealthy class. It's one of the worst things that can happen to a society and it can lead to civil unrest. If there's no reason to buy into the system, people will act up.

**HRN:** Do you view gold and silver as commodities?

**John Embry:** I view gold and silver as monetary metals. The mainstream news media conflates gold and silver with industrial commodities, but they're really a competitor to the currency system. Gold is the antithesis of paper money.

**HRN:** I've read that central banks are buying gold.

**John Embry:** Confidence in currencies is misplaced. There is a strong flow of gold from West to East. The Chinese, Indians, Russians and Vietnamese know perfectly well what's going on with the U.S. dollar and the Euro. They are buying physical gold and the West has been stupid enough to sell it to them.

**HRN:** What's your view on China?

**John Embry:** I'm not optimistic on China in the short run. The People's Bank of China (PBoC) recently cut bank reserve requirements by 150 basis points to stimulate 1.2 trillion yuan (\$190 billion) of new lending because they don't want growth to fall from around 8% to 7%. As I see it, they've dined out on Western profligacy for 20 years and have become the most unbalanced economy in the world. An inordinate amount of China's economic activity is generated by exports and by all manner of capital spending on manufacturing, real estate, infrastructure and more. The slowdown in the world economy has revealed massive overcapacity in many sectors.

**HRN:** Can China develop a consumer-driven economy?

**John Embry:** The idea that China's economy can morph into a consumer-driven economy is preposterous. The very same consumers are employed in sectors like manufacturing where there is massive overcapacity. If the world slides into another global recession, which is not beyond the realm of possibility, I don't see how China stays out of it and if they don't then there's no engine of growth left in the world.

**HRN:** So, even with a rising middle class, China remains dependent on exports?

**John Embry:** The fact is that China has become the world's manufacturer but the ability of their two largest customers, Europe and the United States, to consume is being constrained. China is not going to be able to keep selling more year over year. The HSBC manufacturing index has fallen to recessionary levels.

**HRN:** It has been predicted that China will become the world's largest economy. Do you think that's true?

**John Embry:** I think China will probably dominate the 21st century. The U.S. dominated the 20th century but it went through some very tough times in the first half of the century.

**HRN:** With a slowdown in China, what's your view on commodities like copper or crude oil?

**John Embry:** In the short term, I'm worried about commodities. In a deep global recession, I expect there will be extreme monetary debasement, which will hold up the nominal prices of commodities more than supply and demand factors would suggest.

**HRN:** Do you foresee a bear market in commodities?

**John Embry:** We are in a short-term bear market that will be arrested by monetary debasement.

**HRN:** But there are value buying opportunities?

**John Embry:** Given my views on currencies, commodities that are already depressed could be decent repositories for wealth. I like agricultural products. As the global economy continues to develop, I think the supply of food is going to be a major issue.

**HRN:** How can investors protect their assets in a global recession?

**John Embry:** The only things I'm comfortable holding are precious metals and, because they are so cheap now, precious metals mining shares.

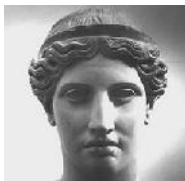
**HRN:** Where do you think the price of gold will end up?

**John Embry:** I'm more concerned with how many ounces I own than with how many U.S. dollars I can get for them at any given point in time. Gold and paper money are going in opposite directions.

**HRN:** Thank you for your valuable time.

**John Embry:** It was my pleasure.

### After Words



John Embry doesn't mince words and his track record speaks for itself. A defender of the gold standard, John Embry sees gold and silver as currencies competing against the U.S. dollar and the Euro, which are losing value because of extreme debt levels, weak economic fundamentals and policy induced inflation. According to John Embry, abandoning the gold standard has led to unprecedented debt levels that could take decades to unwind. In the mean time, inflation seems likely to wipe out the middle class. While his outlook for commodities is bearish, John Embry believes that gold and silver and related mining shares remain the best way for investors to preserve their wealth.

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