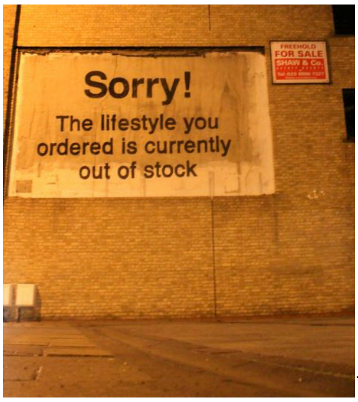
Black Swan Plc

People who say it cannot be done should not interrupt those who are doing it" George Bernard Shaw



[1]

Black Swan New Year Letter 2014

Confiscation: from the Latin *confiscatio* which means “joining to the fiscus” or “transfer to the treasury”

Confiscation 1

On 4th December 2013, Barack Obama made a major speech on the US economy. The main plank of this was that “income inequality is the defining issue of our time”. Not global warming, or the world food crisis, nor the spread of cancer among children in the Third World. So obviously he was talking about the huge gap between himself and a child in Africa who is so far down he can’t even see the poverty line? No, he wasn’t, his point was about the inequality of incomes IN THE WEST, in America and Europe.

Now that's interesting. Is society really more unequal than it was in say the 16th century when 30% of the European population was at or below starvation level? The 19th century, the era of the workhouse? I cannot find definitive data on those periods so have to go with historical anecdote but it seems unlikely. We do however have data on the 20th Century and in fact the gap was as large as it is now quite recently in 1928 and almost as much in 1913. So why would he say such thing? He says it because the real challenge facing governments (not "society") is that people are expecting them to keep their promises. People believe, because they have been told, that they are entitled to a vast range of benefits covering social security, unemployment, pensions, education, healthcare, housing etc. Indeed these are now called “Entitlements”. But what is entitlement? At the simplistic level it is easy to understand in the law of contract that if you sign an agreement to do a certain amount of work for a specified payment if you do the work you are entitled to the pay. But roll this out into the larger society and it becomes more complex. What about the "right to work"? It is hard to imagine a more ludicrous concept. Nobody has a right or entitlement to a job, they are entitled to payment if they are contracted to perform a task.

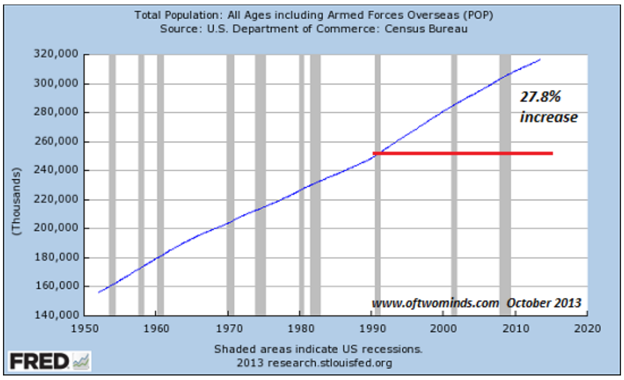
In the West successive governments have bought power for themselves by making promises. This can be seen as a contract of sorts: vote for me and I will give you the following. And it kind of worked, well for the governments anyway, as they got voted into power, hung around for a few years and then sloped off with a massive pension. But let’s look at what has been happening behind the scenes.

Rather than beating up Europe yet again this year I am gong to focus on the United States, but the lessons are pretty much the same except that Europe is, as usual, worse.

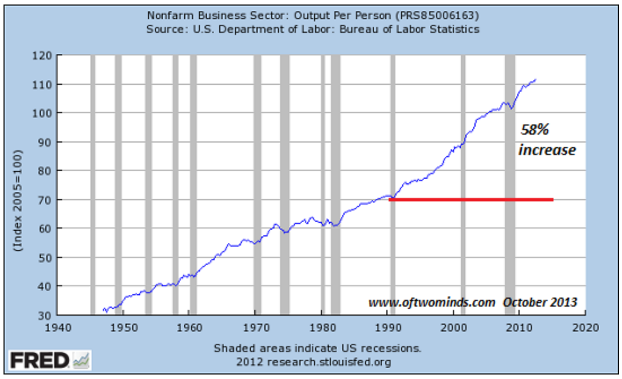
In the normal run of things one expects GDP to rise as population grows. One would also expect GDP to rise as a result of productivity increases within that population. Sure enough, if we look at population and inflation adjusted GDP from 1990 to 2013 that is what happened.

---

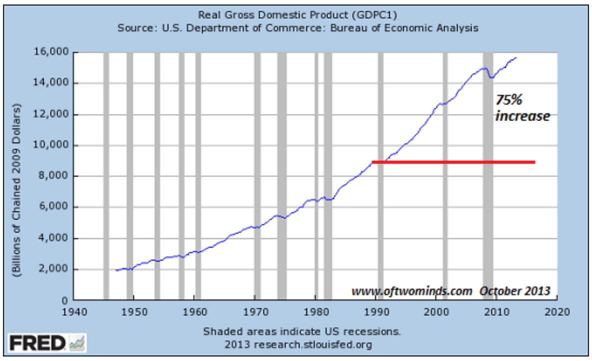
[1] Banksy, Street Art, London 2013

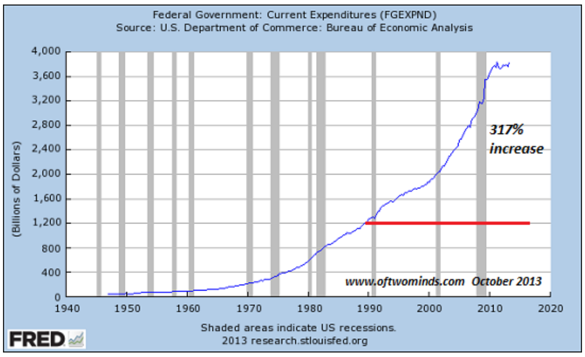


[2]

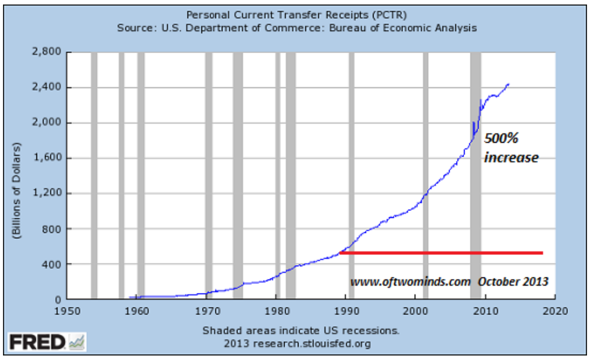


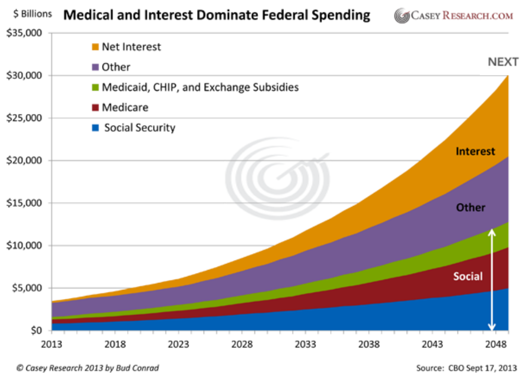
Population rises by 27.8% and productivity rises by 58% and this produces a very healthy 75% increase in real GDP. Pretty good huh? Well it would have been great but for the fact that government expenditure grew 317% in the same period.





Oh and then remember the things they were using to buy the votes? The promises about your retirement, health care etc etc? Those grew by 500%! Those are what are rather misleadingly called “Entitlements”.





[3]

All of this was funded with debt and as I hope readers of last year’s letter will remember the bulk of this debt is held within the US itself. China holds only around 7.5% of US debt. So actually the government sold debt to the population as “savings” to enable them to bribe the voters with “entitlements”…is that a virtuous circle or a death spiral?

It’s breath taking isn’t it? How could anyone think that this was even remotely sensible or sustainable. But now look at the chart on the right from Casey Research. This is data from the Congressional Budget Office. This is what these clowns are planning for the future in a kind of “you ain’t seen nothing yet” moment. Forget the horror on the extreme right: that will never happen. But in 10 years time alone they are assuming that Entitlements will rise to $7tril: a completely impossible concept in 2013 dollars.

[2] FRED is Federal Reserve Economic Data

[3] Casey Research working with data from Congressional Budget Office

But they have a plan, right?

Yes they do: it is called taxing the "wealthy". Now before you think this doesn't apply to you, think again. I would be astounded if there is anyone reading this newsletter who is not squarely in their sights. So what Obama is *really* doing when he talks about "income inequality" is softening everyone up for the next big theft and he is not alone.[4] The IMF has already come up with the phrase: "Revenue Maximising Top Income Tax Rates". This is a calculation they have done for the tax rates necessary to begin to balance the books. They have then gone on to work out what those rates should be: for OECD countries an average of 60%; for the USA 56-71%; for the UK 72% and so on. For the Eurozone the IMF has worked out, with disarming candour, that a 10% "one-off" levy on all households would bring debt back to pre-crisis levels.

France of course is already at a 75% top rate with a wealth tax on anyone with over €1.3m. In Britain the Lib-Dems continue to mutter about a "Mansion Tax" on anything worth over £1m: with a small puff of inflation that will be any property bigger than a bedsit in Balham. Always remember in these calculations the graphs I presented last year on the decline in the value of fiat currencies through inflation. Today's higher rate tax to "soak the rich" is tomorrow's middle income tax.

Now none of the above calculations take account of the fact that many people will not pay. Those that are able to, will move themselves, their assets and their businesses to friendlier shores. That will have a devastating effect on GDP and employment. So, although Obama talks about the "top 1%" of earners he is not really targeting them: they are the ones who will avoid it. No, he is talking about taxing the $50,000 dollar earner out of existence to pay for the profligacy and stupidity of government promises.

In all of this the voters who elected these clowns have to bear some of the blame. It never ceases to amaze me how ready people have been in the late 20th and early 21st centuries to surrender their freedom and accept what they are told by governments as unalterable truth. Now they are heading towards that Animal House moment when they guys have totally trashed Flounder's brother's car. As they all survey the wreckage, John Belushi slaps him on the back and says: "Face it Flounder you fucked up. You trusted us." The Flounder moment is coming.

Confiscation 2: The Bail-in

In a remark often attributed to Butch Cassidy but in fact made by Willie Sutton, when asked why he robbed banks, he famously replied "because it's where the money is". So unsurprisingly there is also a focus on people with cash in banks. Do not think that the Cyprus incident was a one-off.

As Europe inches towards banking union they have already put in place the Bank Recovery and Resolution Directive which covers "Bail-ins" or to us ordinary mortals, confiscation. This claims that the €100,000 insured deposit structure remains in place but that Bail-Ins have to happen *before* any government funded intervention. This places deposits over €100,000 at best, at the level of senior creditors.

Once a banking system moves down this path it is almost unstoppable. Essentially regulators are saying: "we are not competent to control the activities of these institutions or to regulate them effectively so when we fail (which we will) we are going to take the depositors money".

At least now the rules of the game are clear so as advised previously the Swan would not hold any deposits, investments etc. in any European bank which falls under this regime. Switzerland and Monaco of course are outside this, as is the UAE where bank deposits are de facto insured by Abu Dhabi and where, like Monaco, you do not have to be resident to open a bank account.

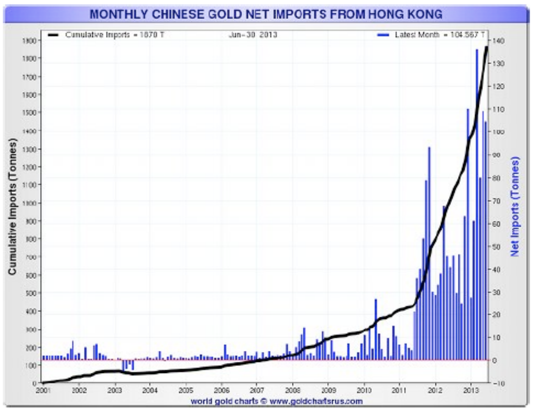
---

4 Romain Hatchuel: The Coming Global Wealth Tax, Wall Street Journal

2014

The scenarios set out above will not happen tomorrow and they may unfold in various forms other than total collapse but the fundamental points are sound. The growth necessary to fund the Entitlement programs will not happen but inflation or hyper-inflation could which would destroy assets but also debt.

Gold has looked weak throughout the year but guess who has been buying: China.



The chart on the left is China's imports of gold from Hong Kong. They will also have been buying through Shanghai and other areas but this remains a good proxy for what is happening overall as it is the data least likely to be faked!

We can be sure that China has a plan here so it is still a sensible move to have a decent exposure to the yellow metal. Apart from that the markets look very "toppy". The Swan has an exposure against the Dow which may yet come good but the only sectors looking like strong buys are miners: the China boom has NOT ended.[5]

Rays of light? Well the Baltic Dry Index is at a 3 year high. Theoretically this suggests that commodity shipments should be on the rise but at 2,330 it is well below even the 2010 level of 4,500. Dubai is doing well again: with the economy running at 5% growth and the win of the Expo 2020 bid it seems that once again Dubai cannot put a foot wrong. So, plenty of opportunity here and still in Asia.

The morning after the EXPO win, the Crown Prince waves the UAE flag from the top of the Burj Khalifa

EXPO 2020
DUBAI, UAE
CANDIDATE CITY
Bid Supporter

The Black Swan Group is a Bid Supporter

In closing I wish everyone all the very best for 2014 and the up coming Year of the Wood Horse on 31st January.

RP

5 Source: Worldgoldchartsrus.com