Minutes of the Advisory Board Meeting
Austrian Economics Golden Opportunities Fund
October 1, 2014

Highlights of the conversation:

Jim Rickards:

- We are seeing growing deflationary pressure in the Incrementum Inflation Model and in my own model. From my point of view, the only reason the Fed will raise rates is inflationary pressure.
- If there would be one economic number that is important for the Fed at the moment, it would be real wages. Yellen looks at real wages as the thermometer of inflation.
- Right now, we have the most hawkish FOMC in a very long time, but in January this will change.
- My expectation is that the Fed will launch QE4 in spring 2015 or a little later. That will not only be a reversal of policy, but it will come as a shock! This will result in a rally in US stocks and emerging market stocks, a weakening USD and rising commodities.
- For the next 4 months, I expect a continuation of the current trend: weak gold, higher rates, strong dollar, weak emerging markets and further deflationary pressure.
- The Fed will not rest until they get inflation. Therefore, they will have to print a lot more, which will be quite positive for gold.

Heinz Blasnik:

- If we look at what central banks have done since 1987, they have become much more activist and have continually increased the size of their interventions. This means: not only has the amplitude of asset bubbles increased, but also the probability of crash-like events.
- With regards to leverage of investors, it's at a record high. The likes of margin debt and hedge fund leverage are at record highs. Having a look at the Shiller P/E, valuations are at the 93rd percentile since 1870. In terms of price/sales, the market is the most overpriced ever.
- We have to consider that monetary calculation is actually falsified and therefore much of the profit that is reported is only illusory. Much of this profit represents capital consumption. Sooner or later there will be a point when it all comes up.

Frank Shostak:

- I believe that it is quite likely that, based on the falling growth momentum of monetary aggregates, the US economy is heading for a slowdown or even a recession.
- China will be an important trigger. Money supply was once growing at 40%, currently it's roughly 4-5%. All the misallocated activities are struggling at the moment and this might trigger a lot of trouble, for example, in commodities.
- I view the whole central bank system as one central bank that is guided by the Federal Reserve. It's one system with various branches. So if things are going to get nasty and deflationary in the US, it will be very hard to imagine that other central banks will not struggle.

Zac Bharucha:

- In the last 35 years, we have periodically seen market interventions by central banks. But we have never experienced permanent distortion of asset markets to micro manage markets. It is very difficult to understand how this new regime affects markets. So from your point of managing a fund, it is definitely a very challenging environment.
- Yes, we had a weak yen, but nobody has achieved a significantly weaker currency. Why? Because they are all copying what is coming out of the Fed. They name their programmes slightly differently but it's all the same.
- I'd really love to say that gold has found its bottom, that it's a screaming buy bla bla bla, but I don't have that confidence.
- Fact is, that money is parked, malinvestments are built up but if the economy weakens, then the "magic hand" will come up and help us to some more malinvestments further down the track. So I find it's a very kaleidoscopic world, where the mixture of technical and fundamentals makes me, as an absolute return investor, think that having lots of cash is not the worst idea.

Mark Valek:

- Based on our inflation model, it seems that the tug-of-war between inflation and deflation is very intense these days. At the moment, we can see quite a lot of signs that this current disinflationary move is fully intact right now and that it will continue. We are actually not ruling out the possibility that disinflation is going to turn into outright deflation with knock-on effects on asset prices. We therefore hold some out of the money puts on the Nasdaq 100 in the tactical book of our fund.

TRANSCRIPT OF THE CONVERSATION

Ronald Stoeferle:

Gentlemen, it's a great honor to welcome you to the third advisory board meeting of our Austrian Economics Golden Opportunities Fund. Unfortunately, Rahim Taghizadegan is not able to join us today.

It is a great pleasure to announce that **Dr. Frank Shostak** will be joining our Advisory Board. Let me give you a brief overview of his background:

Frank has over 35 years of experience as a market economist, central bank analyst and builder of large-scale macro-econometric models. His analysis covers stock, bond, currency and commodity markets. He is highly regarded in the financial community for economic framework, which places heavy emphasis on monetary data and its effects on various markets.

Frank holds a PhD, MA and BA honours from South African universities as well as BA in Economics from the Hebrew University in Jerusalem. He was also professor of economics at the Witwatersrand University in Johannesburg and the University of Pretoria. He is one of the world leaders in applied Austrian School of Economics. He is also an adjunct scholar at the Mises Institute in the US.

From 1974 to 1980, Frank was head of the econometric department at Standard Bank in Johannesburg, South Africa. In 1981, he headed an economic consulting firm Econometrix in Johannesburg for 5 years. Frank has been an economist and market strategist for MF Global Australia and AAS economics. Since July 2012, he has been chief economist at MMG Zurich.

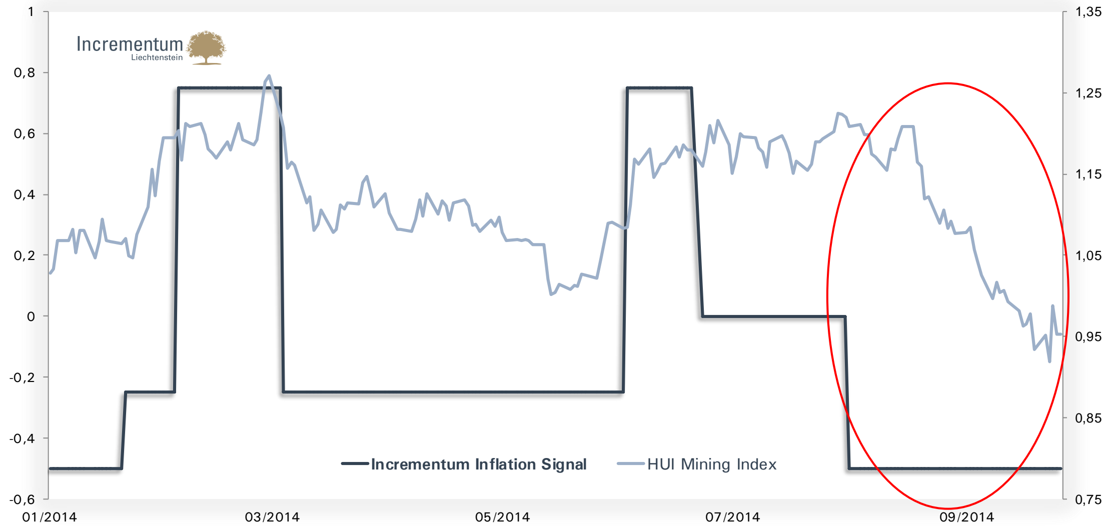
Frank, again, many thanks for joining the board and a big WELCOME!

Mark Valek:

Let us start with a short description of our fund's inflation signal. I depict a graph of our inflation signal as well as the Gold Bugs (HUI) Index since January 2014. We are very happy with our signal so far, even though the signal has been quite volatile this year. Usually, the signal is rather long-term and should not switch too often, **but it would seem that the inflation/deflation-tug-of-war is very intense these days.**

The signal switched to "neutral" at the beginning of August and then very quickly it indicated "disinflation" once again. A rather dramatic move in the USD, commodities, gold and silver followed. As can be seen on the following chart, we are glad that the signal works so well in real-time and provided us with downside protection.

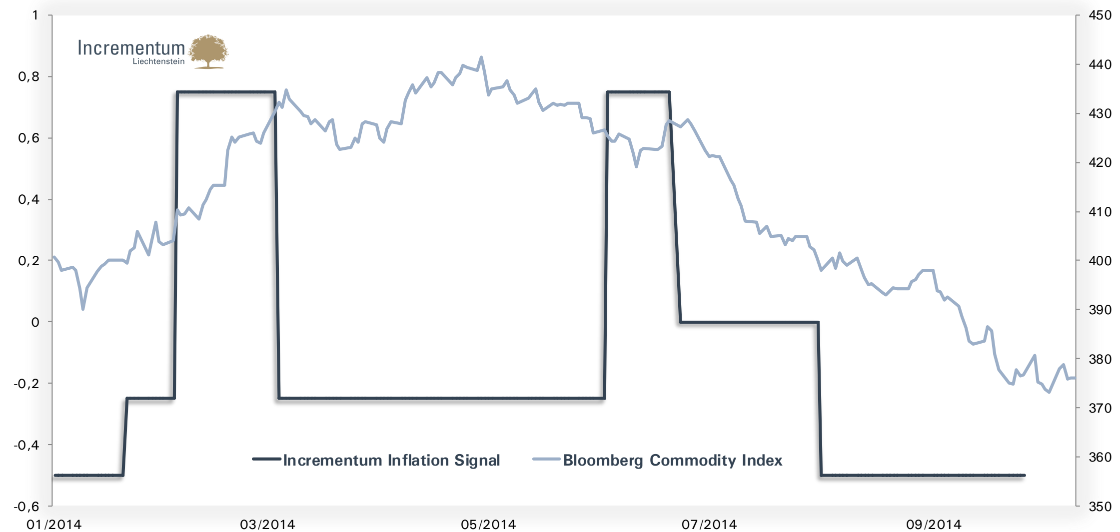
Development of Inflation Signal and HUI Mining Index



Source: Incrementum AG

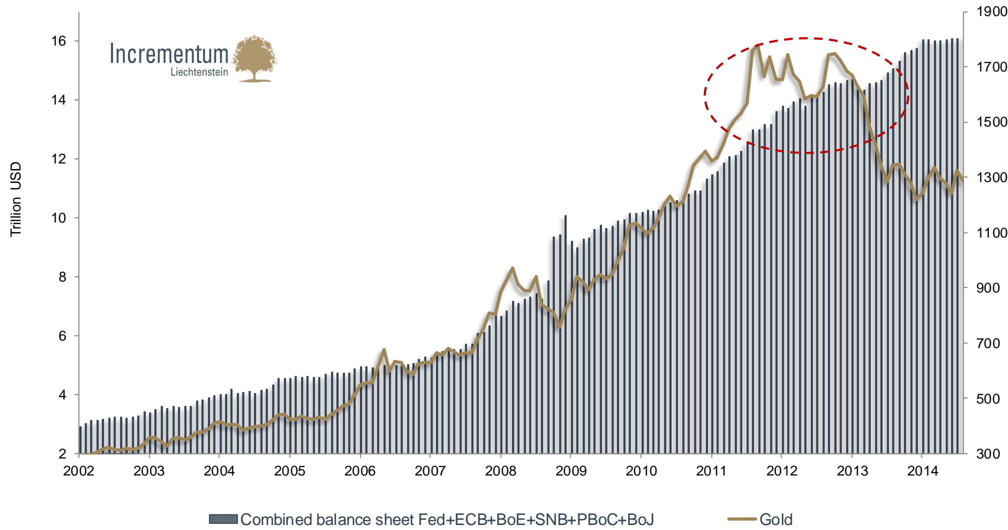
The second chart that we want to highlight is the Commodity index. Fortunately, we were able to profit from the move.

Development of Inflation Signal and Bloomberg Commodity Index



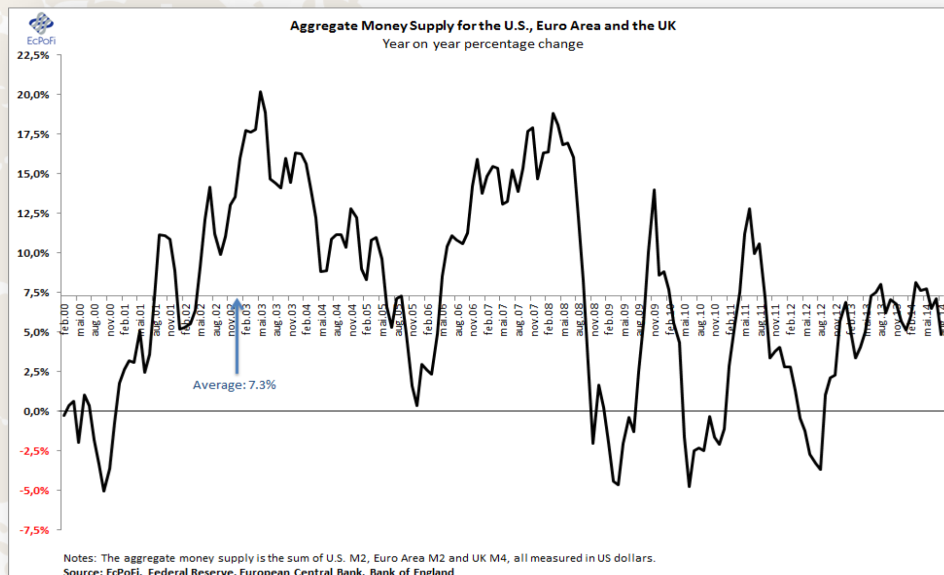
Source: Incrementum AG

We also want to point out that the growth of monetary inflation is currently slowing down dramatically, as can be seen in the next chart. The bars in the chart represent the combined balance sheets of the Federal Reserve, European Central Bank, Bank of England, Swiss National Bank, People's Bank of China and the Bank of Japan.



Source: Incrementum AG

One can also see that monetary inflation is losing momentum in the broader monetary aggregates:



Source: EcPoFi.com

And finally, our last chart shows that High Yield spreads are actually widening.

Source: Yahoo Finance

Therefore, we can see quite a lot of signs that this current disinflationary move is fully intact right now.

So, let's start with the first question: According to some metrics, the pace of monetary inflation is cooling down. Could there be a significant correction/crash looming for asset markets?

Heinz Blasnik:

First of all, we have to say, that by its very nature, a crash is a very low probability event. However, if we look at what central banks have done since 1987, they have become much more activist and have continually increased the size of their interventions.

This means: Not only has the **amplitude of asset bubbles increased, but also the probability of crash-like events.**

The money supply metric that is most important is US money supply. Every other market is – to some extent – following the US. If we look at the broader money supply growth, it has slowed quite a lot recently but it is still historically high.

In detail, narrow money supply (AMS) has actually increased recently, as banks have increased their lending, while the Fed has tapered QE. Therefore, US money supply growth is not that negative.

However, we have to consider that in an inflationary bubble, it is bad news when the momentum of monetary growth is slowing down. Moreover, we cannot state a

priori what level of money supply growth is necessary to support an asset bubble. So, the ***demand to hold money*** has increased considerably. However, I believe that it is decreasing slightly in the US, as general economic activity has increased recently.

Investor sentiment is extremely bullish. However, we do not have a situation like in 2000 when every Tom, Dick and Harry became a day trader, simply because retail investors have been hurt too much by the bubbles. First, they lost a lot of money in stocks in 2000 and then in stocks and houses combined in 2008. So they are not as easily enticed to invest in stocks anymore.

However, investor sentiment amongst professional traders is very positive at the moment. I think this is a very strong warning signal, but definitively not a timing indicator.

With regards to leverage of investors, it's at a record high. The likes of margin debt and hedge fund leverage are at record highs. Having a look at the Shiller P/E, valuations are at the 93rd percentile since 1870. In terms of price/sales, the market is the most overpriced ever.

Regarding the recent weakness in high yield bonds: central bank policy has led to another yield-chasing rally. These bonds pay interest that is not really rewarding the holders for the risk that is taken. But investors are taking these risks anyway, as according to rating agencies, the expected default rate is at an all-time low! So investors feel that they are actually not taking too much risk.

The most important point: banks are no longer making the market anymore, because of legislation, the likes of Frank Dodd, etc. **Banks do not do any prop trading in high yields anymore. This means that it has become a very vulnerable market. While there has been a huge amount of issuance, liquidity levels have fallen. This will have a major influence if the market goes down.**

And the last point; the market internals. Small cap stocks (Russell 2000) have started to underperform and break down and this suggests that market liquidity is not high enough anymore to lift all boats. So, the danger of a severe market correction has increased further. This is clear. When it is going to happen, I am not sure. But it's probably not too far away.

Mark Valek:

Give us a call the day before, please (laughs).

Zac Bharucha:

Let's have a look at hedge funds this year. Whilst long only funds have performed quite decently, hedge fund of funds have performed 2.5% year-to-date. Global

macro funds have not performed at all. And a typical hedge fund across all strategies has returned only 3.8% this year.

So the conditions, as you have probably also experienced, have been very difficult this year. The whole term structure is so low, and stock buybacks have propelled equity markets very strongly. So for people trying to hedge risks, this year has been very tough.

In the last 35 years – for the more senior gentlemen on this board – we have periodically seen market interventions by central banks. **But we have never experienced permanent distortion of asset markets to micro manage markets**. It is very difficult to understand how this new regime affects markets. So from your point of managing a fund, it is definitely a very challenging environment.

Jim Rickards:

I totally agree with Zac. I am talking to very, very experienced fund managers every day and they all agree that it's the most challenging and difficult investing environment that they ever had.

We have this dynamic tension between inflation and deflation and people do not know which way to go. Many fund managers are betting on falling bond prices. However, real rates are quite high at the moment. If we look at Spanish 10 year bonds at 1.75% and US notes at 2.5%, there's something terribly wrong. So I think we are experiencing a deflationary rally in bonds and hedge funds have been on the wrong side.

Frank Shostak:

I believe that it is quite likely that, based on the falling growth momentum of monetary aggregates, the US economy is heading for a slowdown or even a recession.

If we were to have a scenario with slowing economic activity and disinflation, then we can be sure that the FED would become very loose again and reactivate QE. The FED will probably be pushing on a string again, as the banks will probably not play the game of re-leveraging again during a soft period of the economy.

Regarding the crash: there is a possibility for a crash. The bottom line of the economy is in very poor shape. **Let's metaphorically say that we are running a company with 10 activities and 6 are profitable and 4 are losing money.** As a CEO, you have to restructure the four loss-makers in order not to bleed the profitable ones. But central banking activities are in play, they are allowing the unprofitable business activities to prevail and they are hurting the business.

Therefore, we may be in the situation where we are on the verge of having 4 profitable and 6 loss-making companies.... At the end of the day, money printing only creates the illusion if the bottom line is simply not there. The pool of wealth is under pressure. Money printing will definitely not help.

Heinz Blasnik:

Let's take a look at corporate profits. Even if corporations report good earnings for a while, as many have recently, this happens against a backdrop of vast monetary growth and monetary pumping. **We have to consider that monetary calculation is actually falsified and therefore much of the profit that is reported is only illusory. Much of this profit represents capital consumption. Sooner or later there will be a point when it all comes up.** In 2008, the big mortgage lenders and building companies looked very profitable but their profits were only an illusion. So we are awaiting the moment when the illusion will be unmasked again.

Frank Shostak:

That's the point and we are on the verge of it. Many symptoms point to this outcome. We should not forget the Chinese. **China will be an important trigger. Money supply was once growing at 40%, currently it's roughly 4-5%. All the misallocated activities are struggling at the moment and this might trigger a lot of trouble, for example, in commodities.**

Mark Valek:

Jim could you share your thoughts regarding currency wars and the latest disinflationary move with us?

Jim Rickards:

Sure! The market expects interest rates to be raised by mid 2015. This leads to all kinds of dynamic outcomes, including a strong dollar, capital outflows from emerging markets, unwinding of the carry trade, weak commodities and so on.

So those are the expectations. **We are seeing growing deflationary pressure in the Incrementum Inflation Model and in my own model. From my point of view, the only reasonthe Fed will raise rates is inflationary pressure.** We don't have to agree with her opinion, and my opinion is irrelevant, but I try to think like Janet Yellen does. She wants to address the labour issues in the US. **If there would be one economic number that is most important for the Fed at the moment, it would be real wages. She looks at real wages as the thermometer of inflation.** If labour markets are tight, wage pressure should increase and this would be a leading indicator for the Fed. Right now, real wages are not going up and labour market participation continues to decline.

So let us put all that together: the market is discounting that the Dollar will continue to strengthen, deflationary pressure is increasing and the data suggests that the Fed has tightened into weakness. Remember, Janet Yellen didn't start the taper. Ben Bernanke started to taper as he wanted to leave with a legacy.

Right now, we have the most hawkish FOMC in a very long time, but in January this will change. The two hawks Fisher and Plosser come off the FOMC and will be replaced by super-doves Evans and Lockhart. So hawks will be replaced by doves among the presidents. Moreover, president Obama will replace the vacancies with Stanley Fischer, who was Janet Yellen's mentor. And, lastly, Yellen will have been in the job for one year in January and she will feel that she's in charge and that it's her board.

The FOMC becomes significantly more dovish next year:

2014 Members of the FOMC	Dove = 1	2015 Members of the FOMC	Dove = 1
Members	Hawk = 5	Members	Hawk = 5
Janet Yellen, Board of Governors, Chair	1	Janet Yellen, Board of Governors, Chair	1
William C. Dudley, New York, Vice Chair	1	William C. Dudley, New York, Vice Chair	1
Lael Brainard, Board of Governors	2	Lael Brainard, Board of Governors	2
Stanley Fischer, Board of Governors	2	Charles L. Evans, Chicago	1
Richard W. Fisher, Dallas	5	Stanley Fischer, Board of Governors	2
Narayana Kocherlakota, Minneapolis	1	Jeffrey M. Lacker, Richmond	3
Loretta Mester, Cleveland	4	Dennis P. Lockhart, Atlanta	1
Charles I. Plosser, Philadelphia	5	Jerome H. Powell, Board of Governors	3
Jerome H. Powell, Board of Governors	3	Daniel K. Tarullo, Board of Governors	2
Daniel K. Tarullo, Board of Governors	2	John C. Williams, San Francisco	2
Average ranking >	**2.6**	**Average ranking >**	**1.8**

Source: Deutsche Bank

So, you have a very hawkish FOMC today and we will have a very dovish FOMC starting in January. So the whole world is set up for a stronger dollar, a strengthening US economy and rising rates. The data and politics are showing deflation, a very weak recovery, a dovish board. **So my expectation is that the Fed will launch QE4 in spring 2015 or little later. That will not only be a reversal of policy, but it will come as a shock! This will result in a rally in US stocks and emerging market stocks, a weakening USD and rising commodities.**

There is no chance that they will raise interest rates in 2015. Tapering has failed twice and it will fail again. For the next four months, I would expect a continuation of the current trend: very weak gold, higher rates, strong dollar, weak emerging markets and further deflationary trend. But at the first meeting in January 2015, the FOMC will signal for the next two or three meetings that they might reverse their strategy. This may come as a shock to the market, as the market will realize that the Fed has no way out.

They will not rest until they get inflation. Therefore, they will have to print a lot more, which will be quite positive for gold.

Frank Shostak:

How is it possible that they will create inflation if, for instance, the banks will not cooperate and increase lending?

Jim Rickards:

I did not say that the Fed will cause inflation, but they will keep trying to create it. Unfortunately, your view and my view do not count, but we rather have to understand what Yellen thinks.

Frank Shostak:

I view the whole central bank system as one central bank that is guided by the Federal Reserve. It's one system with various branches. So if things are going to get nasty and deflationary in the US, it will be very hard to imagine that other central banks will not struggle.

Zac Bharucha:

If we think back to the major currency realignments in the past, like the Louvre accord, or the Plaza accord, we had cases there, where there was a massive shift in a relative parity and we have not had that since the financial crisis. **Yes, we had a weak yen, but nobody has achieved a significantly weaker currency. Why? Because they are all copying what is coming out of the Fed. They name their programmes slightly differently but it's all the same.** The only measure that you can compare it to are real assets like gold as an alternative currency.

Greece and Spain cannot print their way out of their problems; the adjustment comes out of domestic prices, namely the rate of labor.

Mark Valek:

Zac, would you please share your technical views on the markets with us?

Zac Bharucha:

Of course, Mark. Let's start with the S&P500. This market has frustrated anybody who tried to short it. It's holding up extremely well, above the 200-day moving average and every correction was a buying opportunity. At the moment, we are in a seasonally weak period, as can be seen from the recent weakness. But, in general, I expect a further run up into the year end.

I regard the high yields as a derivative on equities. Low duration as they tend to be shorter-dated and they have equity-like characteristics. **But the big question is – am I getting enough reward for the risk that I am taking?**

On the 10-year bond, I cannot get too bearish. Hedgies have been quite bearish, but the sell-off has not happened and it will not happen.

I think we got gold wrong at the last meeting, as we all agreed that it looked well set to rally. It did, but then it failed very quickly. I think at the 1,200 level it will find support and will bounce.

But if gold goes back to the 1,200 level a fourth time, then it could get dangerous as it might fall to 1,050. This should bring in some major support. But currently gold is still in an ongoing bear market. **So I'd really love to say that gold has found its bottom, that it's a screaming buy bla bla bla, but I don't have that confidence.**

Just to recap. There is a seasonal correction. Is it going to develop into a major crash? I don't know. **Fact is, that money is parked, malinvestments are built up and if the economy weakens, then the "magic hand" will come up and help us to some more malinvestments further down the track. So I find it's a very kaleidoscopic world, where the mixture of technical and fundamentals makes me, as an absolute return investor, think that having lots of cash is not the worst idea.** If you don't find a decent risk-return, don't do it.

Ronald Stoeferle:

That's exactly what we are doing at the moment, Zac. We are heavily in cash and just hold some put options on the Nasdaq 100 (NDX), which developed extremely well. On the other hand, we are glad that we can play inflation-sensitive assets not only on the long side, but also on the short side.

Zac Bharucha:

You have to be careful. Yes, the majority of stocks are rolling over and the market might be in a topping process. But still, I have seen markets where breadth was incredibly negative and the market was rising on the back of 8 stocks out of a 100. So the overall market might still go against you.

Mark Valek:

Gentlemen, we are very pleased with our third meeting of the Advisory Board and look very much forward to our next meeting in January. Thank you very much and take care!

Appendix: Members of our Advisory Board:

Zac Bharucha

Zac began his career in finance at the investment bank Kleinwort Benson and later became an equity portfolio manager at Philipps and Drew Fund Management. He then moved to AMP Asset Management where he was responsible for managing more than GBP 1bn of institutional assets. Since 1998, he has developed absolute return strategies and specialized in equities and commodities. After 25 years in asset management, he retired from professional life in 2011 and wrote his first book about market timing.

Heinz Blasnik

Heinz is an independent trader and market analyst for the consulting firm Hedgefund Consultants Ltd, as well as a regular publisher for the Independent Research House Asianomics in Hong Kong. Heinz primarily is responsible for his blog www.acting-man.com, on which he analyses developments in the financial markets from an Austrian point of view.

James G. Rickards

Jim is the author of the international bestsellers *Currency Wars* and *The Death of Money: The coming collapse of the international monetary system*. He is portfolio manager at the West Shore Fund. During his career, Jim has held senior positions at Citibank, Long Term Capital Management and Caxton Associates.

Dr. Frank Shostak

Frank is chief economist at MMG Zurich. He has over 35 years experience as a market economist and central bank analyst. He holds a PhD, MA and BA honours from South African universities. He was professor of economics at the Witwatersrand University in Johannesburg. He is one of the world leaders in applied Austrian School of Economics and an adjunct scholar at the Mises Institute in the US.

Rahim Taghizadegan

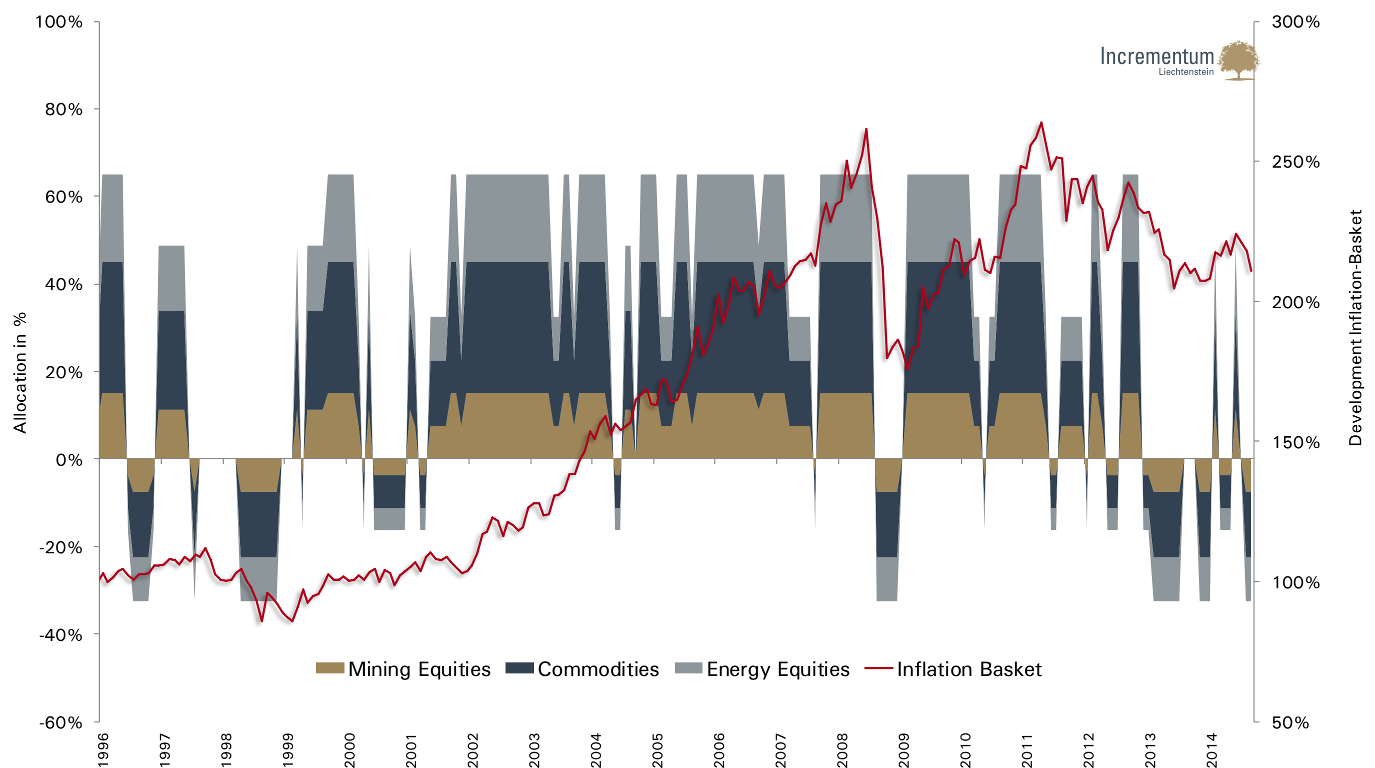
Rahim is the founder and director of the institute for value based economics, an independent research institute in economical and philosophical issues in Vienna. He is bestselling author and a popular speaker internationally. Rahim studied Physics, Economics and Sociology in Vienna and Lausanne. He has worked in the fields of economics, space research and journalism. He has also taught at the University of Liechtenstein, the Vienna University of Economics and Business Administration and the Universität Halle an der Saale.

Incrementum Inflation-Signal

At Incrementum, we are convinced that inflation is a monetary phenomenon. Because of the dynamics of "monetary tectonics", inflationary and deflationary phases can alternate. **To measure how much monetary inflation actually reaches the real economy, we utilize a number of market-based indicators** - a combination of various quantitative factors including the Gold-Silver Ratio - which result in a proprietary signal. This method of measurement can be compared to a "monetary seismograph", which we refer to as the **"Incrementum Inflation Signal"**.

In the fund we manage, our Incrementum Inflation Signal gauges the inflation trend and we position the fund accordingly. Historically, we observed periods of between 6 and 24 months during which disinflationary forces were dominant. These phases were particularly painful for the holders of inflation sensitive assets. Right now it looks as disinflation might continue for a while. **Our inflation seismograph triggered a "falling inflation signal" in August.**

Incrementum Inflation-Signal



Source: Incrementum AG

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