Private Wealth Advisory

Investment Research That Converts

The Most Misunderstood Asset in the World

The Most Misunderstood Asset in the World

Perhaps the single most misunderstood asset in the financial system is the $USD.

As the reserve currency of the world, the $USD draws some of the strongest reactions from investors: they either love it or hate it… no one is neutral.

Every day I see articles by "experts" proclaiming that the $USD is either about to completely collapse or about to rocket higher, triggering a deflationary implosion.

While both of these statements will ultimately prove correct (we'll get a major deflationary bust as well as an eventual currency failure at some point), I sincerely doubt either of them will occur within the coming months… if not years.

Let me explain…

From a philosophical perspective, the $USD *is* doomed (just as ALL fiat currencies are ultimately doomed), but that process is years and years away.

The Japanese Yen, and most certainly Europe's Euro will implode before the $USD does as both currencies and economies face larger structural issues than the US.

However, when it comes to currency failures, these things can take considerable time. By all standard measures, Japan has been totally bankrupt for years (if not decades) and yet the Yen continues to plug along just fine.

November 30 2016

SHORT-TERM ISSUES

- Japan exporting deflation.
- The $USD is sharply overbought.
- Markets ready to correct… again.

INTERMEDIATE-TERM ISSUES

- Precious metals to begin their next major leg up.
- The Euro primed for a move to 121 as ECB ends QE.
- Emerging Markets ready for new bull market.

LONG-TERM ISSUES

- Excessive debt, bad demographics, and little if any deleveraging.
- Eventual market collapse of 50%+ in real terms.
- A scramble for high-end collateral to bring about derivatives collapse.

Phoenix
CAPITAL RESEARCH

Consider the following:

1) Japan's Debt to GDP ratio first cleared 100% in the mid-1990s.

2) Japan's official Debt to GDP has since risen to **229%.**

3) The Bank of Japan first implemented ZIRP and QE in 1999 and 2000, respectively. Thus it has been using ZIRP for **17 YEARS** and QE for **16 years.**

4) Regarding QE…

    a. The Bank of Japan is currently a top five shareholder for more than **ONE IN THREE of the Nikkei's 225 companies** and on track to be the #1 shareholder for 25% of them by year-end.

    b. The Bank of Japan owns nearly **60% of all assets managed** by Exchange Traded Funds or ETFs in Japan.

    c. The Bank of Japan is currently buying roughly $750 billion in Japan's sovereign debt per year. **This comes to roughly 50% of ALL of Japan's debt issuance.**

Let's be clear here… as far as monetary madness, Japan "crossed the Rubicon" nearly two decades ago.

If you'd sat down a group of professional money managers in 2000 and asked them what percentage of a given country's stock and bond markets its Central Bank could own before the system imploded, I guarantee you NONE of them would have predicted numbers anywhere near as high as Japan is today.

Moreover, I guarantee that if you'd asked that same group of professional money managers what levels of Debt to GDP a country could hit before the bond markets would revolt, NONE of them would have suggested Japan's current level of 229%.

And yet, here we are, with Japan having hit ALL of those numbers and investors are still keen to buy Japanese stocks and bonds.

What does this have to do with the $USD?

My point is that those proclaiming that the $USD will collapse, while technically correct, are in fact years if not decades too early on this call. Based on similar thinking, **the Japanese Yen should have collapsed AT LEAST 10 years ago.**

Similarly, those gurus who are calling for the $USD to erupt higher causing systemic deleveraging are correct, but also wrong in that they are far too early.

Now, I myself have noted previously (many times) that the $USD has broken out of a massive 40+ year falling wedge pattern.

Ultimately, this chart predicts the $USD will go to 120-130 if not higher. However, for this to occur **the entire financial system would have to implode.**

An astute observer would look at the above chart and say, "*wait a minute, the $USD has been at 120 as recently as 2000. Moreover, it was at 160 in the early '80s. Why would a move to this level result in systemic collapse today when it didn't then?*"

The answer is: **different debt levels.**

In 1984, when the $USD was at 160, the US's Debt to GDP was only 37%. Similarly, in 2000 when the $USD last hit 120, the US's Debt to GDP was only 57%.

Today it's a whole other issue. The US's official Debt to GDP ratio is north or 100%.

"But wait a minute," you're thinking, *"Japan's Yen rallied massively from 2007 to 2011 when Japan already had a Debt to GDP ratio WAY over 100%... and the system didn't go bust."*

This is true… **<u>but the Yen is not the reserve currency of the world; the $USD *IS*.</u>**

The $USD comprises 86% of all currency transactions globally. So if the $USD soars, 86% of ALL transactions in the currency markets will involve serious deflationary consequences.

This is not merely an issue for the currency markets either: 60% of global reserve holdings (what countries choose to park their extra cash in) are in *DOLLARS.*

Moreover, bulk of the global debt bubble is priced in *DOLLARS,* not Yen. According to the *Bank of International Settlements* non-banks (meaning corporations and sovereign countries) own over $9.6 TRILLION in US-dollar denominated debt globally.

$9.6 TRILLION= an amount greater than the economies of Japan and Germany combined. And this is just for *non-banks.* **<u>When you include bank holdings the amount is even greater.</u>**

Asia, ex-China, has over $4.5 trillion in US-Dollar denominated debt. Throw in China and the amount is well over $5.3 trillion. Europe has $2.2 trillion in US-Dollar denominated debt. For Latin America the amount is over $1 trillion.

ALL OF THIS IS AT RISK IF THE $USD SKYROCKETS.

Let me explain…

When the $USD rallies, any currency against which it trades *FALLS*. By way of example, let's take the Euro.

Currently the Euro is trading at 1.06 $USD. So Europe's $2.2 trillion in US-Dollar denominated debt translates to roughly €2.07-2.0 Trillion.

But what if the $USD did in fact rally to 120 as many $USD bulls forecast? Now the Euro is worth 0.73 $USD. So Europe needs to come up with an additional €810 BILLION more to pay off that same $2.2 trillion debt (at this conversion rate $2.2 Trillion is now equal to €3.01 trillion).

This is why if the $USD goes to 120, it is a SYSTEMIC ISSUE. ALL of that $9.6 TRILLION in US-Dollar Denominated would be at risk of default (at some point the conversion rates would be so bad that foreign borrowers would start defaulting).

To top it off, if the $USD were to go to 120, the impact on bond yields would implode the derivatives market of which 80%+ are based on interest rates (bond yields). **Globally you are talking about $555 TRILLION in derivatives.**

Again, with these levels of debt and debt based derivatives in the system, for the $USD to rally to 120 would mean complete systemic collapse. That will one day happen, but Central Banks will fight it tooth and nail for years to come.

Is the $USD doomed? Will the $USD likely spike to 120 resulting in systemic debt deflation? The answer to both questions is "Yes."

But will either of these items happen soon?

Not likely.

So what is likely to happen?

The $USD needs to fall from current levels, particularly relative to the Yen.

You see, from a BIG PICTURE perspective for the financial system, the single most important currency pair today is the Yen/ $USD pair.

There are other issues that have become systemic in nature (Europe's banking crisis in 2011-2012, China's stock market crash/Yuan devaluation in 2015, etc.) but generally speaking, the Yen and $USD are what drive the inflation/deflation trends of the post-crisis world.

Why is this?

Historically, the Yen has been the only major world currency at zero interest rate policy or ZIRP. However, once Financial Crisis of 2008 hit, the Fed cut interest rates on the $USD to ZIRP as well.

Thus the world now had TWO major currencies in which to borrow money. And to top it off… **one of them was the reserve currency of the world!**

From this point onward, the Yen/ $USD pair was THE inflation trade for the financial system.

When the Yen rose relative to the $USD it was GOOD for the inflation trade. When the Yen fell relative to the $USD it is deflationary and bad for the system.

I realize this runs completely counter to what 99% of people say… so let's let the markets do the talking. When the Yen falls relative to the $USD, the Yen/ $USD pair drops. This has been the general trend for the last five years.

During that time, the entire commodity complex has imploded, tracking this trade almost week by week.

Let's look at this in percentage terms: since 2011, because Japan has aggressively devalued the Yen against the $USD, commodities have fallen OVER 54%.

I want to be clear here. This was the single worst commodity bear market in 40 years if not longer.

Peak to trough this collapse was actually GREATER than the 2007-2009 collapse… which is widely considered to be the worst episode of deflation in 90 years.

Even the **20-year bear market** in commodities from 1982 to 2002 wasn't as bad!!!

Again, when the Yen devalues against the $USD, it spreads deflation.

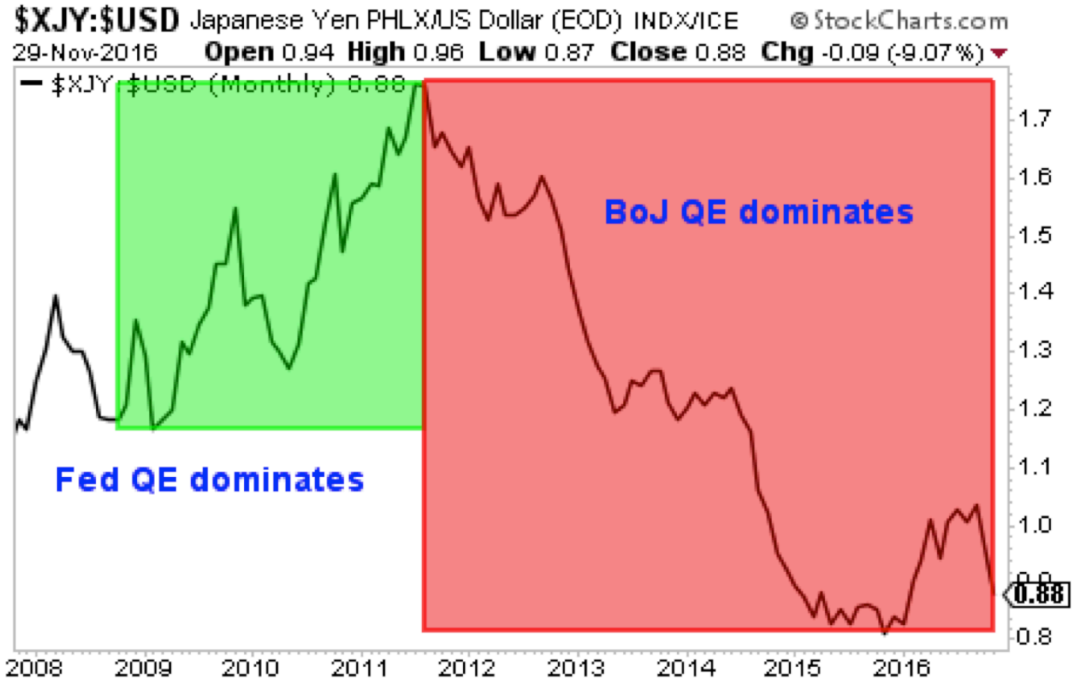
Now let's add QE to the mix.

As you'll recall from last week's market update, **the single biggest currency moves post-2008 have been the result of Central Banks announcing or ending major QE programs.**

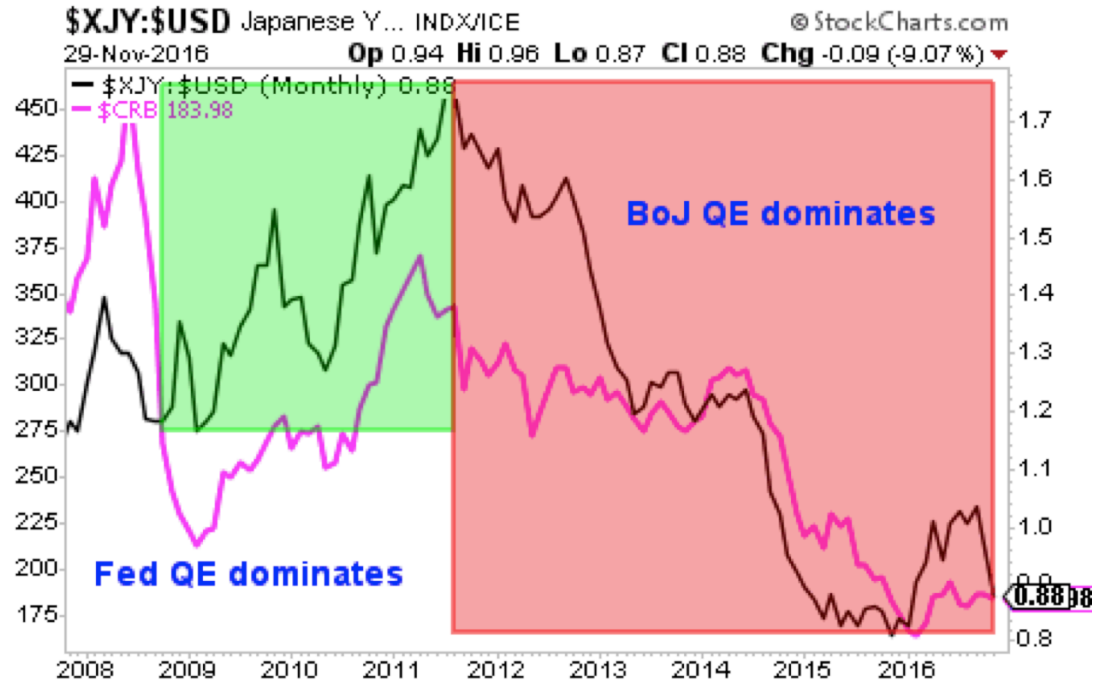
In terms of global inflation, THE SINGLE MOST IMPORTANT QE PROGRAMS CAME FROM THE FEDERAL RESERVE.

From 2008 to 2011, the Fed's QE and QE 2 programs drove the reflation trade pushing the Yen/ $USD pair higher. Then in 2011, as the Fed ended QE 2, the Bank of Japan (BoJ) began to aggressively devalue the Yen against the $USD culminating in the single largest QE program in

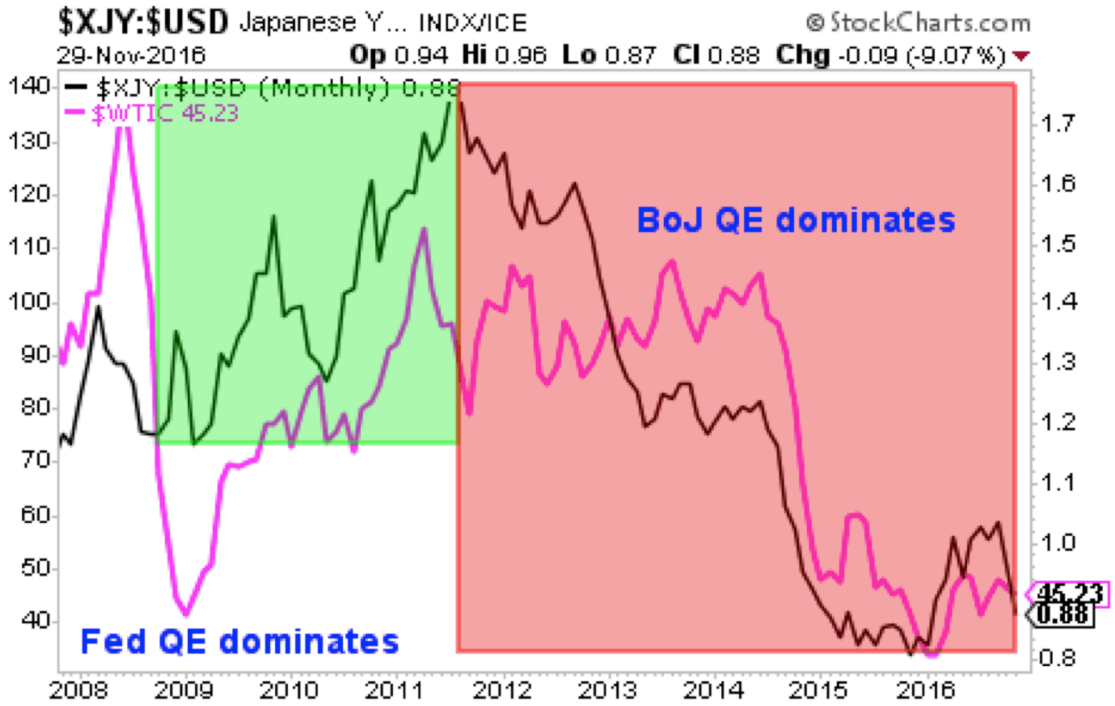
history relative to GDP in 2013.



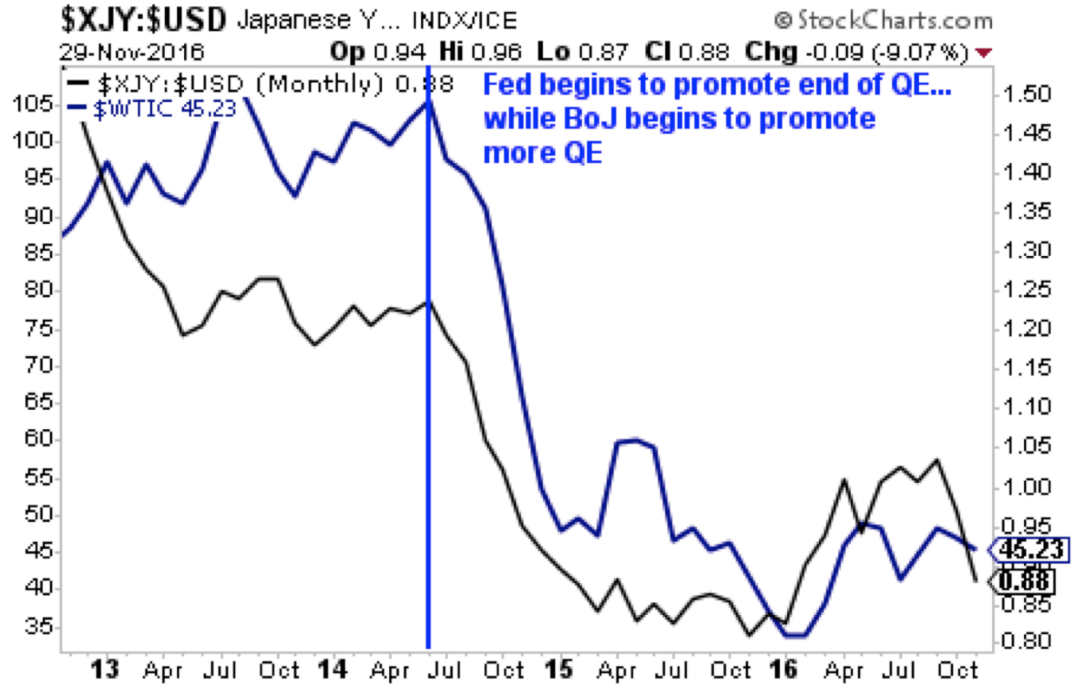
During this period is when the deflationary collapse hit Commodities.



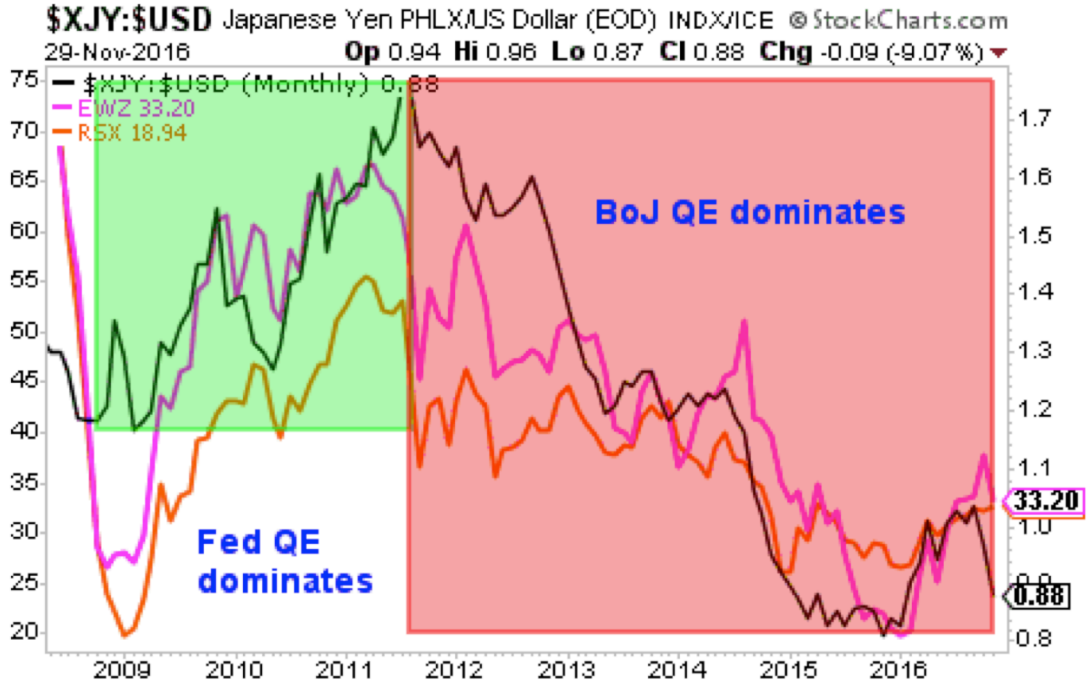
The Yen/ $USD collapse post-2011 is also what ultimately triggered the Oil Crash of 2014. Oil initially held up relatively well due to political machinations and investor sentiment but eventually the deflationary pull of the Yen/ $USD pair destroyed it.



I particularly want to note that the Oil crash happened roughly around the time that the Fed completely abandoned QE in 2014 while the BoJ was aggressively expanding its own QE program.

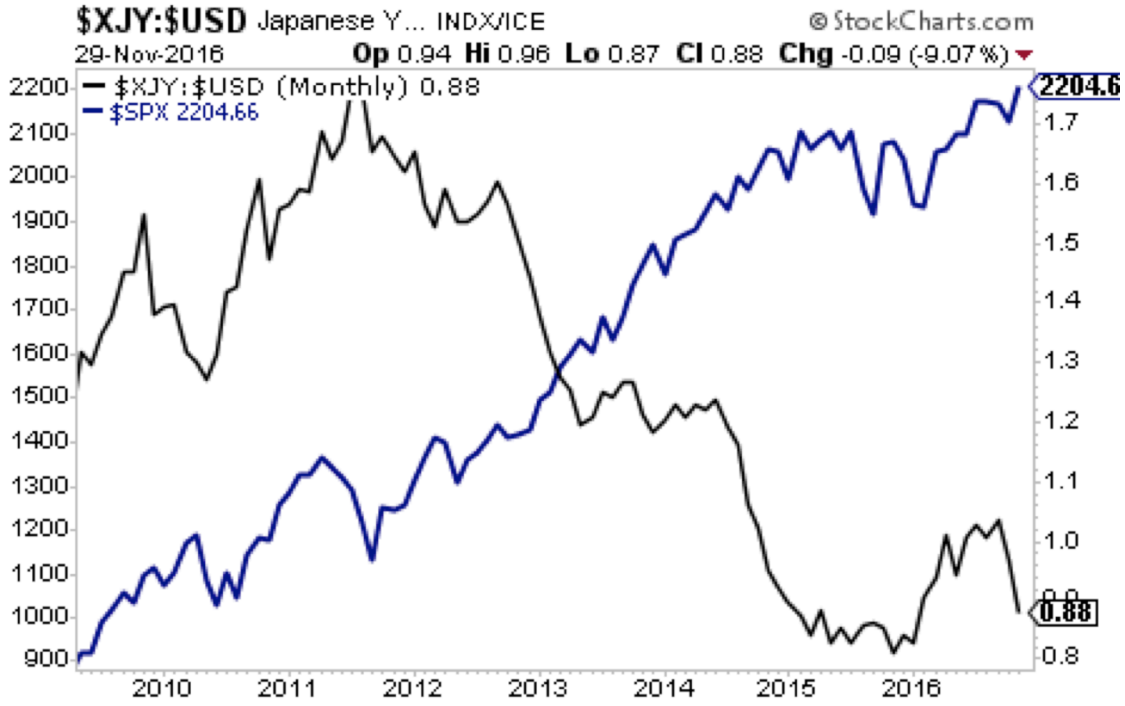


The deflationary Yen/ $USD trend period was also a disaster for emerging markets like Brazil (EWZ) and Russia (RSX).



BIG PICTURE: in a world in which the most systemically important currencies are at ZIRP if you want inflation in the system you want the Fed engaging in QE that *DRAMATICALLY* devalues the $USD relative to the Yen while the BoJ is standing pat.

Some of you are no doubt asking yourselves, "if the post-2011 Yen/$USD collapse was *DE*-flationary… why has the S&P 500 continued to rally during this time period?"

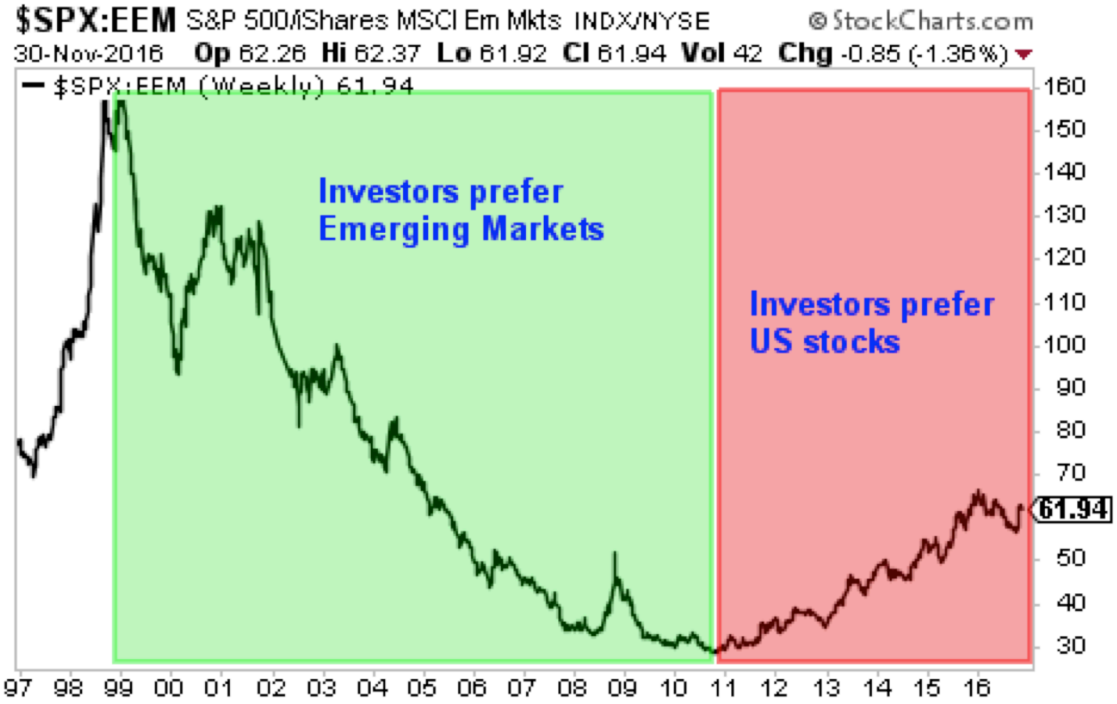


The S&P 500 has benefitted from several key features, namely:

1) Capital flows from Emerging Markets into US stocks.
2) More transparent accounting standards.
3) A relatively strong US economy.

When the Yen/ $USD pair began to implode Emerging Markets and commodities in 2011, capital fled to the "safe haven" of US stocks. Put simply, investors have been willing to pay a premium to own US stocks while the Emerging Market world collapsed.

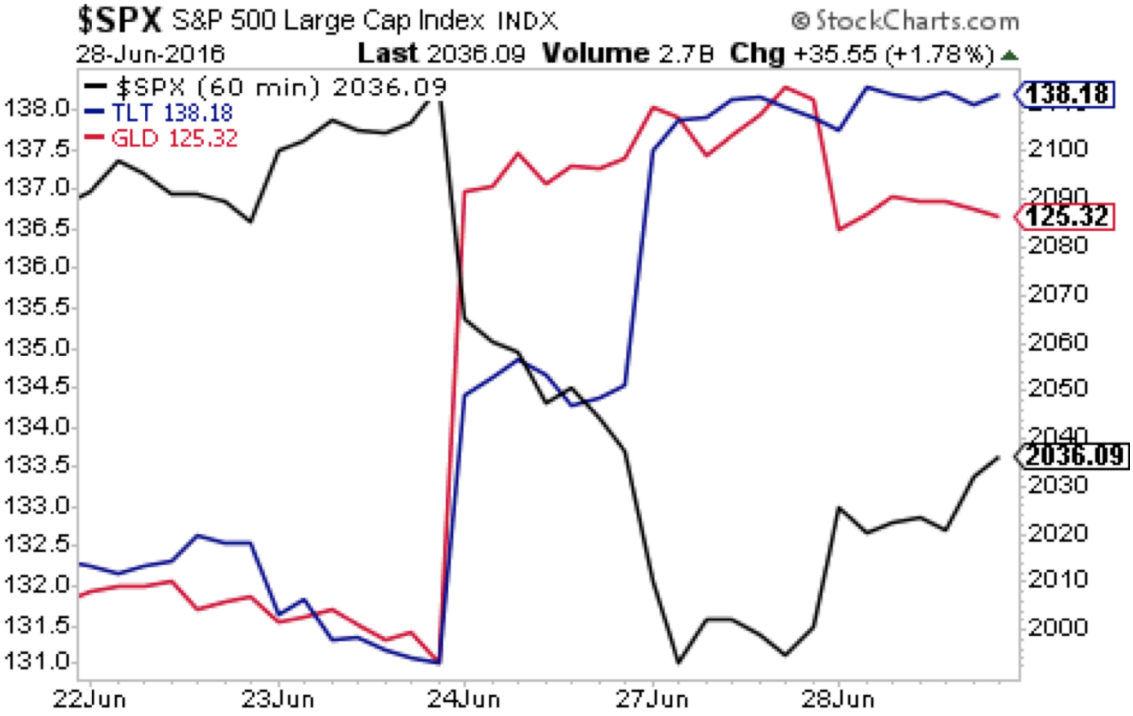
You can see this in the below chart pricing the S&P 500 relative to Emerging Markets.



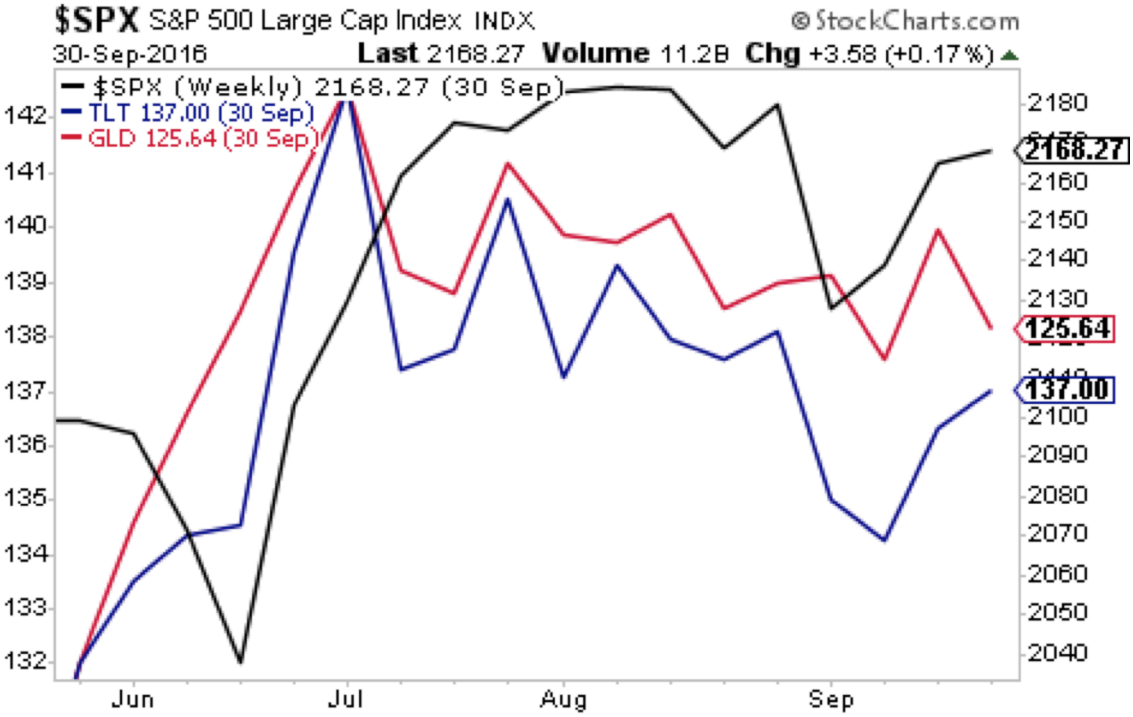
Which brings us to the Yen/$USD pair today.

The Trump Presidential victory has triggered a massive move in numerous asset classes that reminds me of the BREXIT back in June 2016.

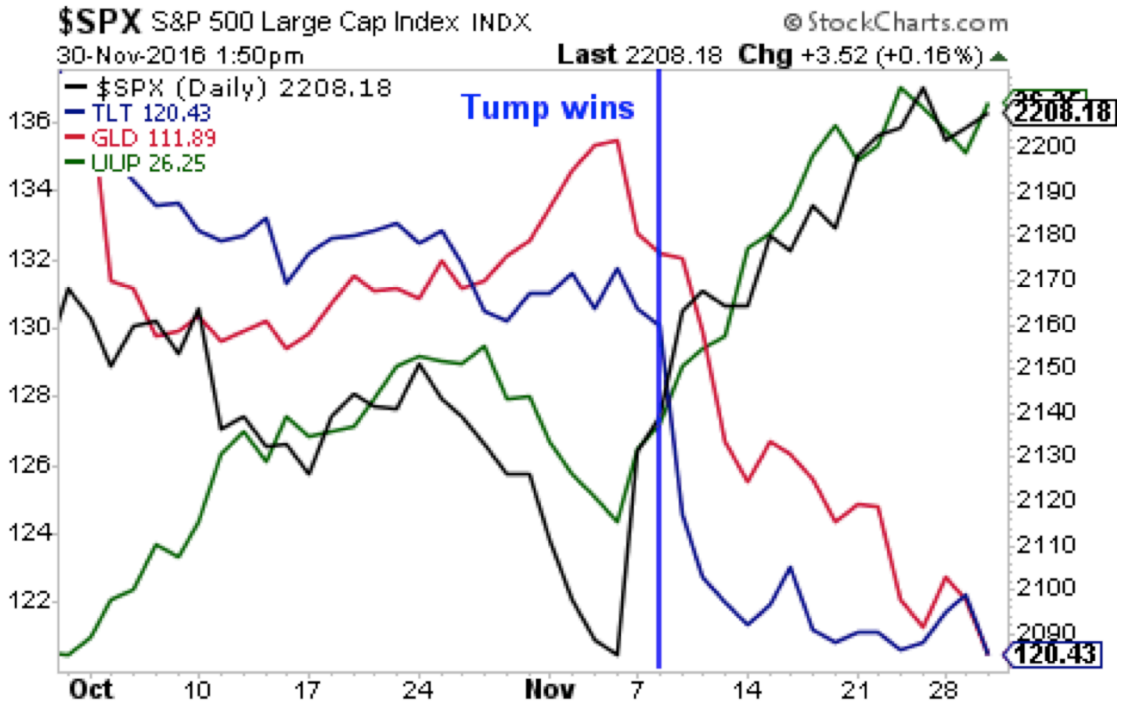
For those of you who don't recall, after BREXIT occurred on June 24, we had a severe move in multiple asset classes (stocks down, bonds up, Gold up) that lasted about 3-4 days



The market then reversed ALL of these moves (stocks rallied, bonds fell and Gold fell) sharply.



I have a sneaking suspicion that the "Trump effect" on the markets is going to prove to be a similar phenomenon. Since it was announced that Trump had won the US Presidency, stocks and the $USD (black and green lines) have soared while bonds and Gold (blue and red lines) have collapsed.



What's striking about this is that ALL of these moves are based on **expectations**. Trump won't take office until January 20, 2017. And he cannot implement ANY major budgetary changes/ new stimulus plans until roughly this time next year due to how Congress implements budgetary changes.

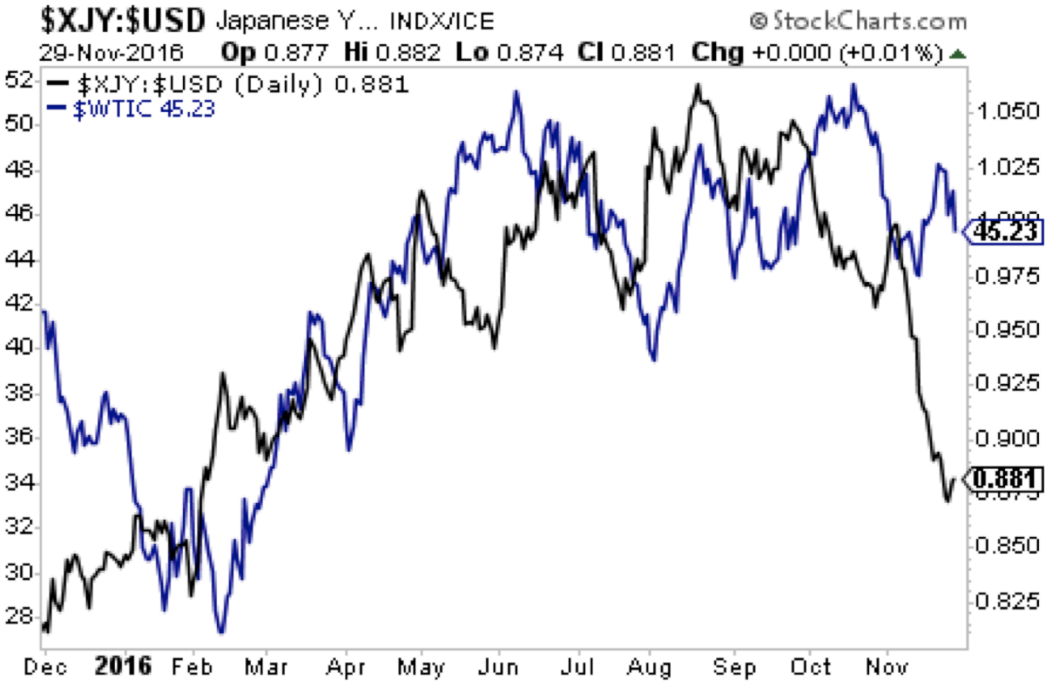
So… the market has basically moved based on what could *possibly* happen 12 months from now?

I'm not buying it. I think the reality is that this move is going to reverse and do so sharply. Sentiment is certainly there with the mass of investors believing that the bull market in bonds and Gold are over and that stocks and the $USD will never fall again!

Indeed, if anything it looks as though this move in the $USD has been largely driven by the BoJ aggressively devaluing the Yen. As a result of this, the Yen/$USD pair has collapsed some 13% in the last few weeks and is now BEYOND oversold.

THIS is what caused Gold's collapse.

It will ultimately collapse Oil as well as soon as we get past the current round of OPE's "deal or no-deal" nonsense.



Indeed, the $USD is severely overbought with an RSI that is usually associated with major tops.

Moreover, we are beginning to get signals that the $USD rally is causing significant problems in Emerging Market land (remember what I wrote about $USD-denominated debt earlier). What are the odds the Fed will risk letting this situation get completely out of control?

> *A perfect storm of macro and market forces could generate a dollar crunch next year, Deutsche Bank AG analysts warn…*
>
> ***<u>Evidence of dollar-funding pressures are already emerging in funding markets in the Philippines, South Korea, Malaysia and India</u>*** *most notably over the past month, although there may be local forces at work too, according to Deutsche Bank, updating their warning earlier this month that de-globalization in money markets could roil emerging markets next year.*

https://www.bloomberg.com/news/articles/2016-11-29/asia-is-about-to-face-a-significant-dollar-stress-test

More importantly for the Fed, the $USD strength is ALSO putting pressure on the derivatives market… which are dominated by the TBTF banks that the Fed has been so actively supporting.

> *It's getting expensive to buy U.S. dollars.*
>
> ***That's showing up in the market for derivatives used to swap cash flows between currencies, while hedging the foreign exchange risk into the future.***
>
> *The increased cost of using such hedges is one sign that foreign investors are again clamoring for exposure to U.S. fixed-income markets after Treasury yields rose sharply following the U.S. presidential election.*
>
> *http://blogs.wsj.com/moneybeat/2016/11/29/one-measure-that-shows-the-high-cost-of-buying-dollars/*

This has gotten the Fed's attention I can assure you. I expect that between this stress on the derivatives system, along with the $USD being severely overbought, we're about to see a sharp $USD correction very shortly.

This will be accelerated by the ECB ending QE (something NO ONE seems to believe will happen). Remember, ending QE programs results in MASSIVE currency moves. And as I've noted in the last few market updates, the ECB is broadcasting that it will be pulling back from QE shortly… though somehow CNBC and others haven't taken note.

Indeed, earlier this week ECB President Mario Draghi stated the following:

> ***A lengthy period of low rates has created 'fertile terrain' for financial-market risks, the central bank chief says***
>
> *European Central Bank President Mario Draghi issued a blunt warning over the risks that low interest rates pose to the eurozone's €10 trillion ($10.6 trillion) economy****—just as the ECB prepares to decide whether to hold rates down for longer.***
>
> *The warning underlines the dearth of policy choices central banks face as they seek to further stimulate their economies after years of aggressive easy-money policies.*
>
> http://www.wsj.com/articles/draghi-ecb-stimulus-key-ingredient-of-recovery-1480344351?mod=e2tweu

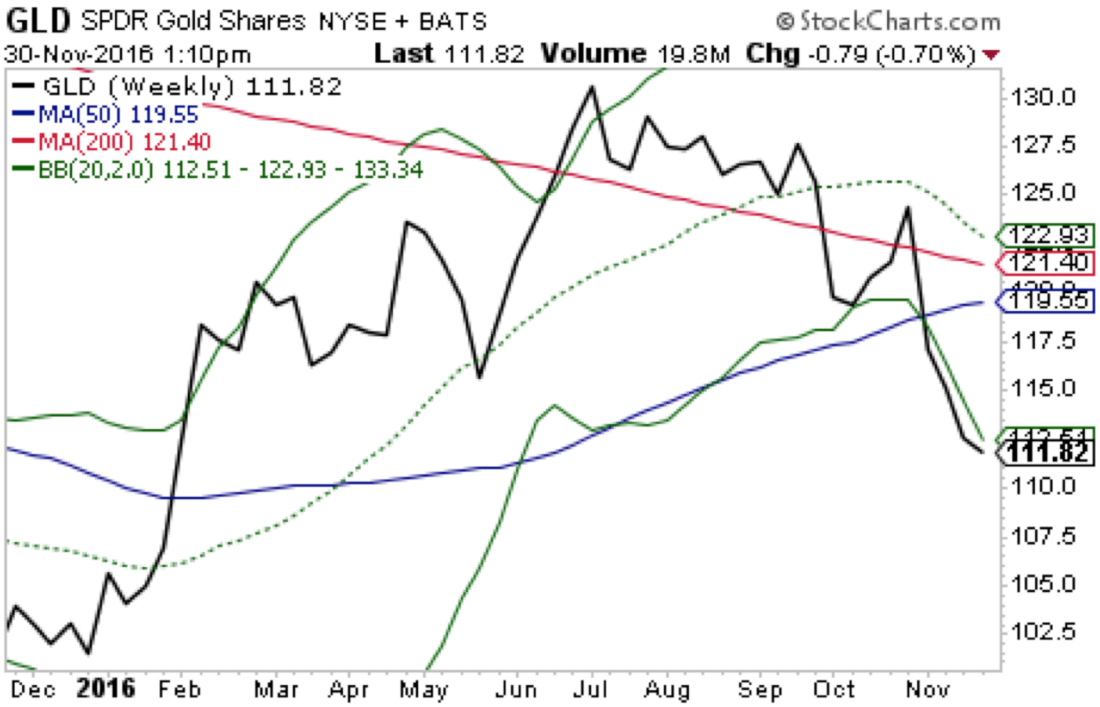
A Central banker admitting that loose monetary policy is a problem?!?! Few things are as bullish for a currency.

On that note, the Euro is massively oversold having fallen below its lower Bollinger band. It also has an RSI reading at levels that usually mark significant bottoms. I believe that as the market begins to realize the ECB is ending its QE program in March 2017, we're going to see an extraordinary run to 121 here.

The Fed would *gladly* welcome a move like this in the Euro as it would trigger a sharp sell-off in the $USD (the Euro makes up 56% of the currency basket against which the $USD trades). This would alleviate $USD funding pressure for the big banks AND benefit corporate profits, which the $USD's strength is currently killing.

Action to Take: Buy the Euro ETF (FXE) if you have not already done so.

A reversal like this ($USD down, Euro up) will send Gold through the roof. Indeed, Gold is BEYOND oversold and primed for a very sharp snapback rally.

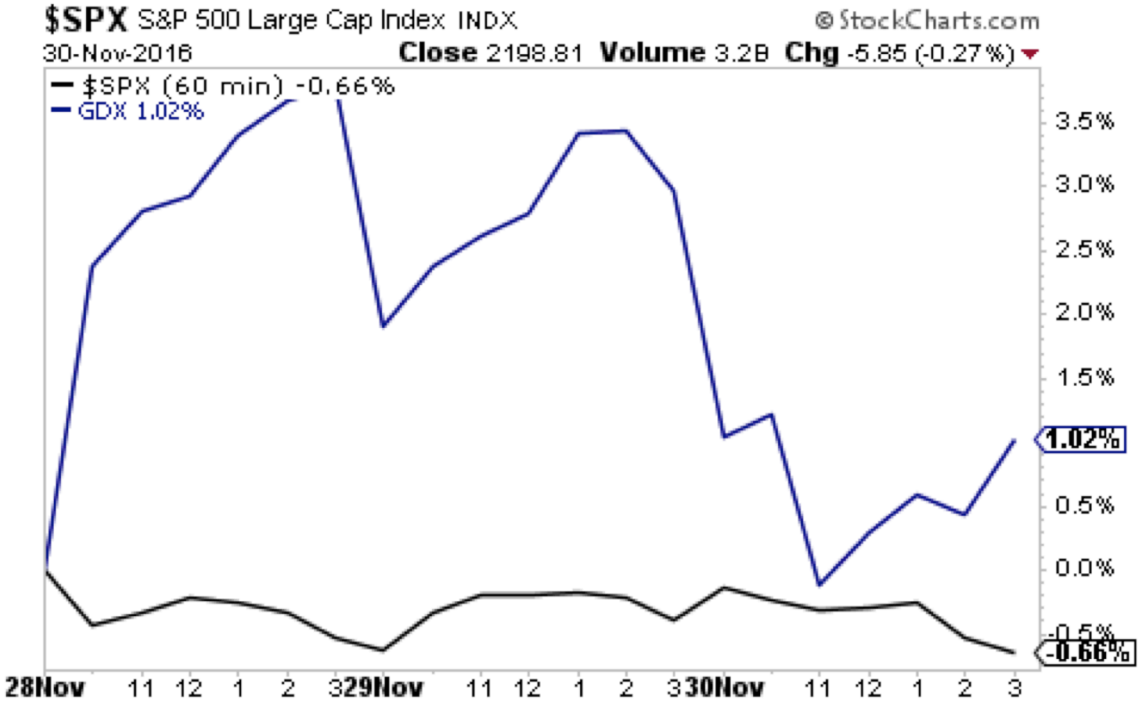


We get evidence that this move is coming from the mining sector. If *any sector* should be getting killed by a strong $USD it'd be miners as a strong $USD lowers gold prices (lower revenues). A strong $USD also is VERY dangerous for a debt-laden sector like the miners.

And yet…both Gold miners and Silver miners have flatlined in the last two weeks.

Indeed, the one-hour chart shows both Gold and Silver miners actually **bottomed** on November 14th are actually up (albeit modestly) since then! This suggests a base is forming. When it's complete, the next leg up will be absolutely massive.

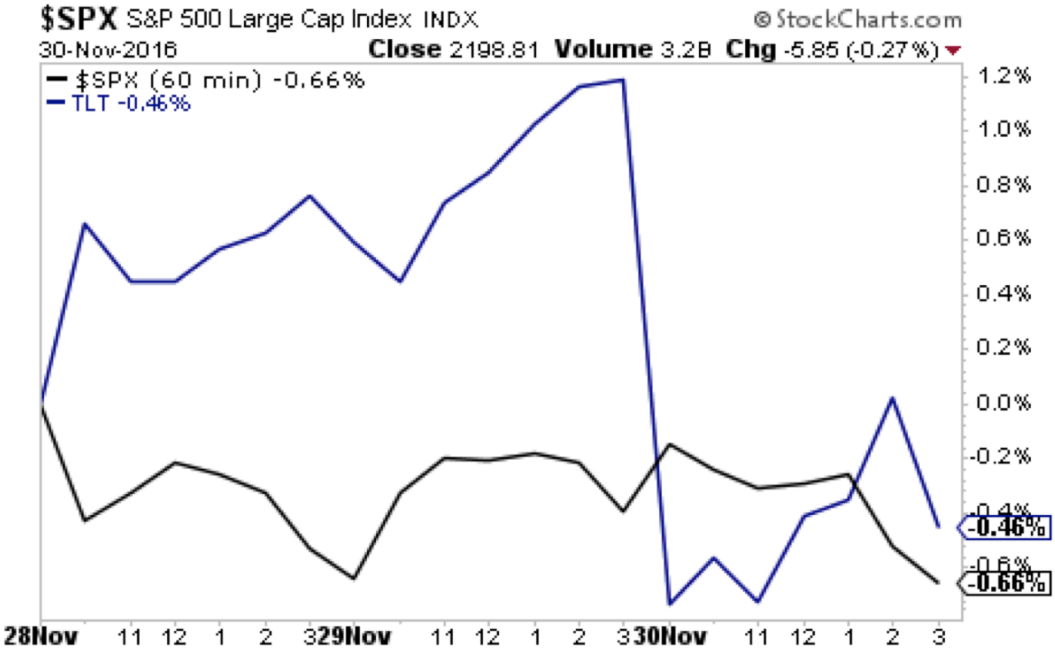
In fact, if you want to see something EXTRAORDINARY, consider that Gold miners are actually outperforming the S&P 500 so far this week. If you want to talk about lopsided sentiment, this is it. Everywhere you look investors and the media are proclaiming that stocks will never go down while Gold is done for!



The same is true for US bonds. Today I see article after article claiming that rates are about to skyrocket as bonds collapse. In reality, Treasuries have stopped falling and have been roughly flat since November 23rd!

This looks a lot like a double bottom is trying to form here; if it holds, TLT will be reversing and going sharply higher to new highs (think above 132).

Also, long-term bonds, (TLT) while down are ALSO outperforming stocks thus far this week!



If you asked the average investor today whether Gold and Bonds were beating stocks thus far this week, I guarantee you 100% of them would answer "no." **This is a hallmark of major turning points: when sentiment shifts away from facts.**

To summate the above: the single most important currency pair in a ZIRP world is the Yen/ $USD pair. In the last month this pair has been highly deflationary, pushing the $USD to new highs while collapsing Gold and Bonds.

I think this move is about to reverse in a similar fashion to what happened in the week after BREXIT. I am getting multiple signs this will happen within the next few days.

We are prepared for this with exposure to bonds and precious metals. If you currently do not have exposure here, **feel free to buy any of our current positions in these areas now**.

Elsewhere in the markets, I'm increasingly interested in Master Limited Partnerships or MLPs.

MLPs are publicly traded investment partnerships that avoid paying income tax provided they pay out 90% of earnings to shareholders. Typically, these companies are based in the energy field, specifically Oil and Gas pipelines.

The industry as a whole looks like it's bottomed and is starting a major bull market.

We've broken above the 50-week moving average and are holding. If the next round of inflation is coming soon (when the $USD collapses) we should see AMJ breakout to new highs.

One play I'm particularly interested in is **Enterprise Products Partners LP (EPD).**

As you can see, EPD broke out of a two-year downtrend in early 2016. It has since completed its first leg up and corrected. It is now bouncing off support and preparing for the next leg up to $32. And at current levels it yields 6.5%!

Action to Take: Buy Enterprise Products Partners L.P (EPD)

This concludes this month's issue of ***Private Wealth Advisory***. Barring any new developments you'll next hear from me next Wednesday in our usual weekly market update.

Until then…

Best Regards,

Graham Summers
Chief Market Strategist
Phoenix Capital Research

OPEN POSITIONS

STOCKS PORTFOLIO

POSITION	SYMBOL	BUY DATE	BUY PRICE	CURRENT PRICE	GAIN/ LOSS
Exxon	XOM	9/24/14	$95.82	$87.30	-2%
RPX Corp	RPXC	8/5/15	$15.48	$10.45	-32%
China ETF	ASHR	11/7/16	$24.80	$25.88	4%
Emerging Markets ETF	EEM	11/25/16	$35.25	$35.50	1%
Ambev	ABEV	11/25/16	$4.96	$4.99	1%
Cemex	CX	11/25/16	$8.07	$7.81	-3%

BONDS PORTFOLIO

POSITION	SYMBOL	BUY DATE	BUY PRICE	CURRENT PRICE	GAIN/ LOSS
Nuveen Muni. Fund	NVG	1/2/14	$13.12	$14.02	27%
Emerging Market Bonds	EMB	11/21/16	$109.82	$109.31	0%
Long US Treasuries	TLT	11/21/16	$121.05	$120.24	-1%

Prices as of market's close on 11/30/16
Price include dividends

PRECIOUS METALS/ MINERS PORTFOLIO

POSITION	SYMBOL	BUY DATE	BUY PRICE	CURRENT PRICE	GAIN/ LOSS
Gold		3/17/10	$1,120	$1,174.00	5%
Silver*		3/17/10	$16.23	$16.55	2%
Uranium ETF	URA	6/8/16	$15.49	$12.45	-20%
Gold Miners ETF	GDX	10/5/16	$22.83	$20.83	-9%
Gold Mining Juniors ETF	GDXJ	10/5/16	$37.52	$34.32	-9%
Silver Wheaton	SLW	10/5/16	$22.59	$18.23	-19%
Silver Standard Resources	SSRI	10/5/16	$10.30	$9.86	-4%
Barrick Gold	ABX	10/5/16	$15.54	$15.02	-3%
New Gold	NGD	10/5/16	$3.88	$3.58	-8%
Natural Gas Trust	UNG	10/5/16	$8.71	$8.43	-3%

SPECIAL SITUATIONS/HEDGES/SHORTS PORTFOLIO

POSITION	SYMBOL	BUY DATE	BUY PRICE	CURRENT PRICE	GAIN/ LOSS
Santander (SHORT)	SAN	2/3/16	$4.13	$4.52	-9%
Barclays (SHORT)	BCS	7/5/16	$7.92	$10.75	-36%
France ETF (SHORT)	EWQ	9/16/16	$23.38	$23.45	0%
Italy ETF (SHORT)	EWI	9/16/16	$21.56	$21.75	-1%
American Eagle Outfitters (SHORT)	AEO	5/26/16	$15.36	$16.56	-8%

Prices as of market's close on 11/30/16
Price include dividends
***Average price of $17.50 and $14.97**

CASH/ CURRENCIES PORTFOLIO

POSITION	SYMBOL	BUY DATE	BUY PRICE	CURRENT PRICE	GAIN/ LOSS
Euro Trust	FXE	10/5/16	$108.80	$102.98	**-5%**

Prices as of market's close on 11/30/16 at market's close
Price include dividends

RECENTLY CLOSED POSITIONS

POSITION	SYMBOL	BUY DATE	BUY PRICE	SELL DATE	SELL PRICE	GAIN/ LOSS
Gerdau	GGB	11/7/16	$3.36	11/22/16	$4.18	**24%**
Copper Miners ETF	COPX	11/7/16	$17.90	11/22/16	$21.10	**18%**
Conoco-Phillips	COP	11/2/16	$43.46	11/25/16	$45.38	**4%**
Schlumberger	SLB	11/2/16	$77.93	11/25/16	$80.96	**4%**
Chevron	CVX	11/2/16	$105.53	11/25/16	$110.76	**6%**
Apache	APA	11/2/16	$58.46	11/25/16	$62.86	**8%**