SPECIAL
REPORT

A Phoenix Capital Research Publication

Preparing For the US Debt Crisis

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Preparing For the US Debt Crisis

The US is heading towards a debt crisis.

Whether it be through the Government Shutdown failing to raise the debt ceiling or some other event down the road, we've passed the point of no return.

Today, the US's Debt to GDP ratio stands at over 105% (debt of $16.7 trillion on a GDP of $15.68 trillion). The only other time we've had more debt relative to our GDP was during WWII when the Debt to GDP ratio hit 112% (see the chart below).

Now, debt is not inherently evil. Debt that doesn't create growth *is*.

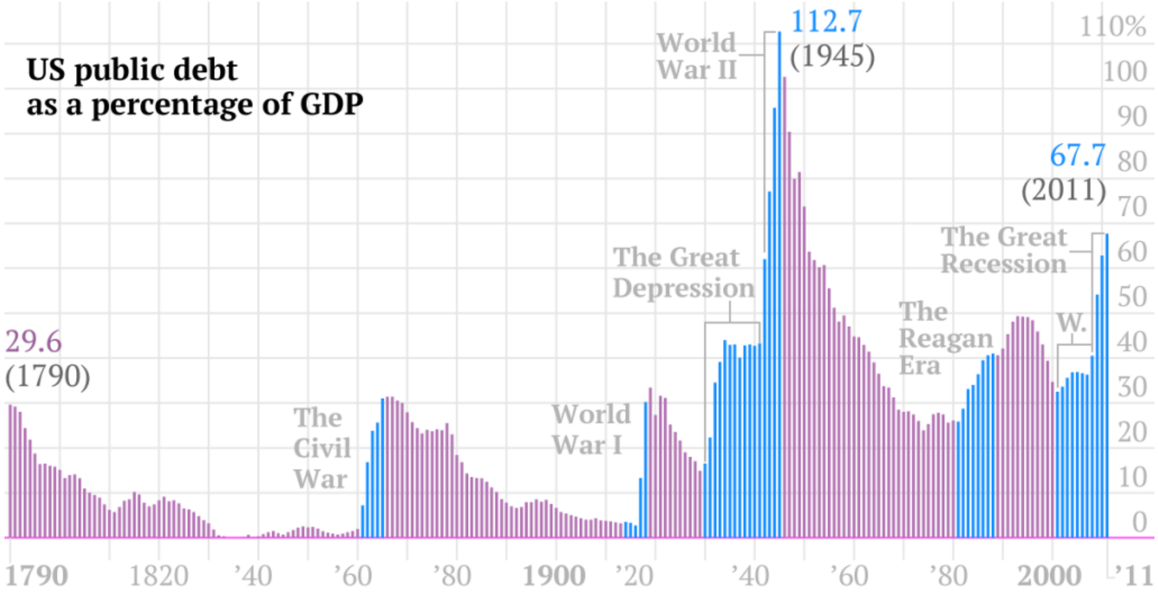
In the 1960s every new $1 in debt bought nearly $1 in GDP growth. In the 70s it began to fall as the debt climbed. By the time we hit the '80s and '90s, each new $1 in debt bought only $0.30-$0.50 in GDP growth.

And today, each new $1 in debt buys only $0.10 in GDP growth *at best* (see the chart on the next page).

Put another way, the growth of the last three decades, but especially of the last 5-10 years, has been driven by a greater and greater amount of debt. As you can see, after the Crisis began in 2007, the US moved into the point of debt saturation at which each new $1 in debt generates no additional growth.

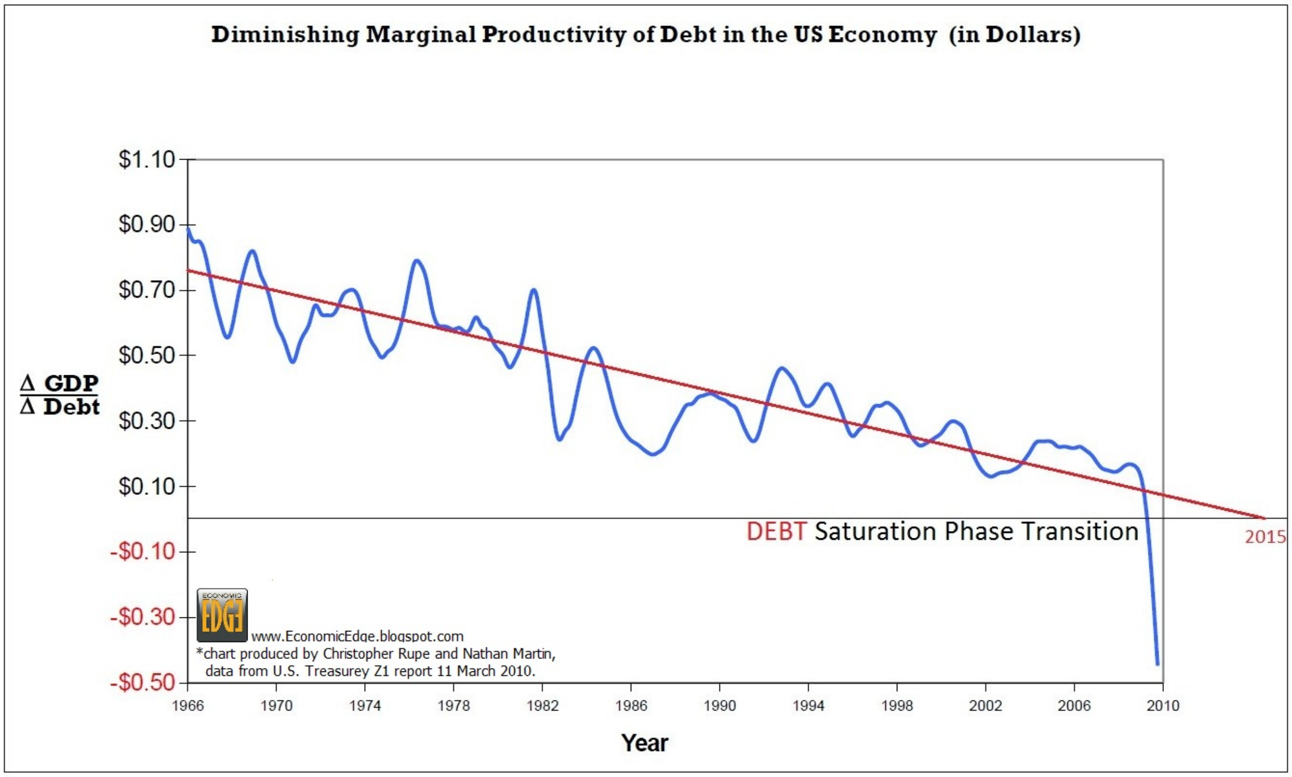
This is why the Fed has been so concerned about interest rates. With a debt load of this size, every 1% rise in the US's debt payments means another $100 billion in debt payments.

Unfortunately for the Fed, rates will eventually rise. It is guaranteed. As you can



Ritchie King | Quartz

Data: Congressional Budget Office



www.EconomicEdge.blogspot.com
*chart produced by Christopher Rupe and Nathan Martin, data from U.S. Treasurey Z1 report 11 March 2010.

see in the chart on the next page, rates have fallen almost nonstop since the early ‘80s. This is not sustainable. At some point rates will rise again. I cannot state expressly when, but that point is coming sooner rather than later.

With that in mind, investors should take steps today to shield their wealth from the impact of this. They can do so by focusing on the following areas:

1. Precious metals (bullion).
2. Hedges against interest rates rising.

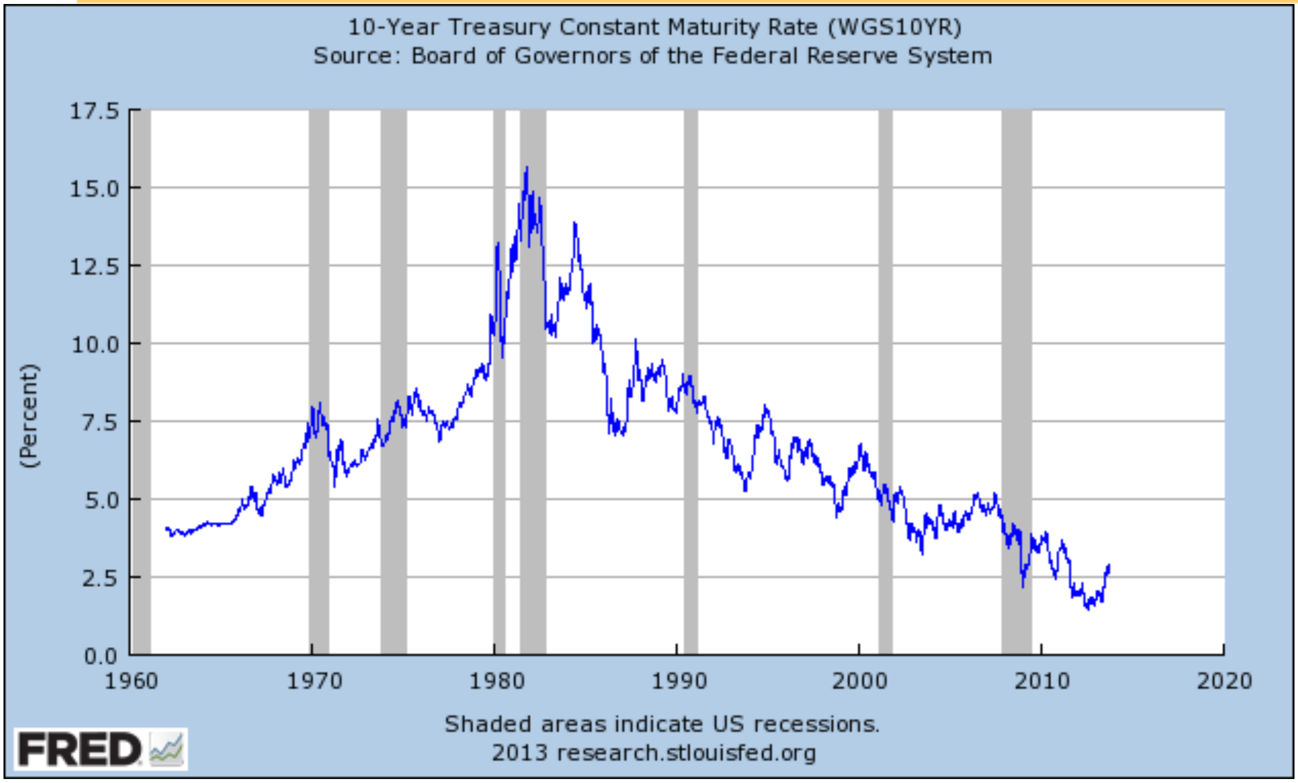
As far as precious metals go, investors should consider

1) Owning Bullion
2) Store it themselves (not in a bank)

I do not recommend owning a paper gold-based ETF because frankly the custodial risk is high (that is, there’s no telling if the Gold is even there or who would get it if the ETF is liquidated).

In comparison, physical bullion, stored outside a bank, is literally money in hand. You know where it is and you can find out what it’s worth very easily. Compare that to a Gold ETF in which you’re hoping that the bank actually has the Gold and that it could actually send it to you if you requested.

In terms of buying coins, you want to focus on those coins that are both popular and fairly liquid. This is because if you ever need to sell the coins to raise cash you want to be able to sell them quickly; the last thing you want is to have to wait while a dealer finds a buyer.



In terms of actual gold coins, there are three coins that comprise the bulk of the bullion market. They are Kruggerands, Canadian Maple Leafs, and American Gold Eagles. All three of them are liquid and easy to buy or sell.

However, I've been told to avoid Maple Leafs by both a trader and a bullion dealer as they can easily be scratched which damages the gold and reduces the coin's value. So if you decide to buy some Gold coins, focus on Kruggerands and American Gold Eagles.

In terms of silver, the easiest way to get it is via pre-1965 coins (often termed "junk" silver). You can buy these through a dealer or through a private transaction from a collector.

I personally know of individuals who gave acquired large quantities of Silver coins at a huge discount because they bought them from collectors who simply saw them as old coins and didn't realize that they contained actual Silver.

Other liquid forms of Silver bullion are silver one-ounce rounds (coin-like medallions) and 10-ounce bars. There are also Silver Eagles coins, which contain one ounce of Silver.

These are all standard Silver investments that are quite liquid.

When it comes time to buy, I cannot tell you which dealer to go with, but look for someone who's been dealing for years (not a newbie). You should always ask for references from the dealer (former clients you can talk to about their purchases/ experiences).

Some warning signs to avoid are dealers who try to store your bullion. Never store your bullion with someone else as you can never be certain if they actually hold on to your bullion.

> *The South Florida company had a grand name — Global Bullion Exchange — and boasted it was a leader in the precious metals industry.*
>
> *Hundreds of customers from North Pole, Alaska, to Miami — many seeking a safe investment harbor in uncertain economic times — sent the company money so an advertised "team of experts" could guide them through the gold and silver markets.*
>
> *But when the Lake Worth-based company closed overnight, its books showed that at least 1,400 clients were out about $29.5 million. Some people saw their retirement nest eggs wiped out.*
>
> *"It was 40 years of investment I lost," said social worker David Gruber, 72, who lost about $400,000 he put into precious metals. "It was 40 years of scrimping and saving. ... Nothing has been the same since."*
>
> *http://articles.sun-sentinel.com/2010-05-12/news/fl-global-bullion-20100427_1_precious-metals-gold-and-silver-markets-commodity-and-financial-futures*

Again, always store it yourself.

Also, be sure to talk to the dealer for some time and ask him or her numerous questions about the industry, the coins, etc. (feel free to test him or her on the information I've provided you with e.g. the three most liquid Gold coins, etc.). If they can answer everything you ask in a knowledgeable fashion, their references check out, and you verify everything they say with a 3rd party, you should be OK.

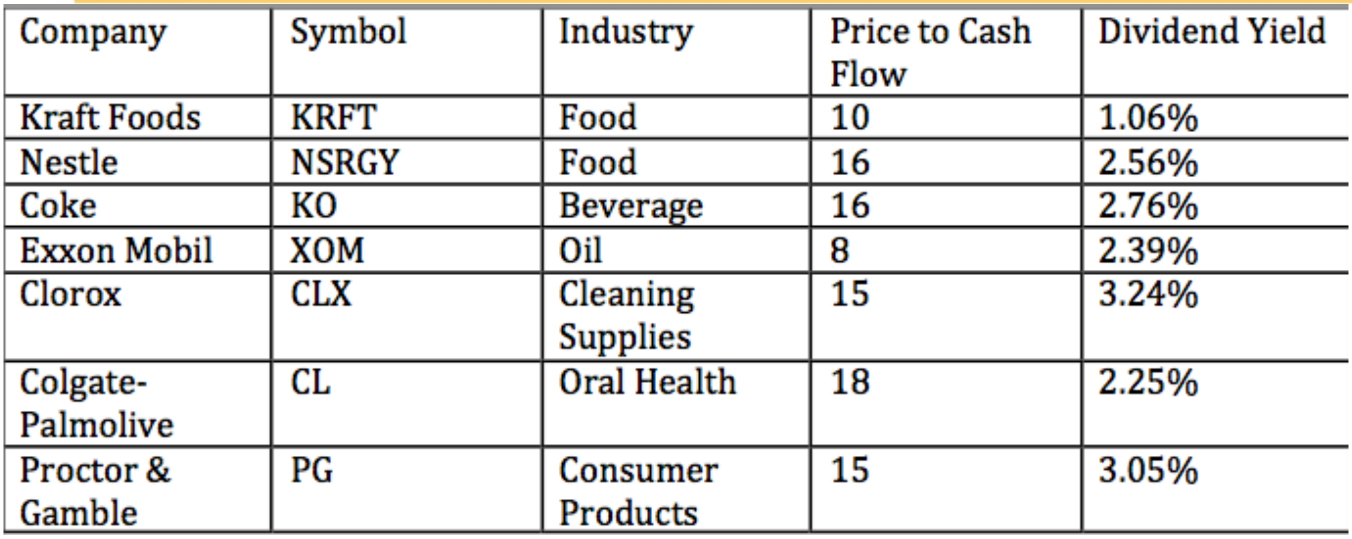
In terms of how much Gold or Silver bullion to buy, we cannot offer specifics as every investors' needs and risk appetites are different. However, Marc Faber, who is one of the gloomiest, most bearish investors on the planet claims to have 25% of his net assets in Gold.

We are not suggesting you do the same. We are simply stating that Faber who is one of the most bearish investment managers on the planet (he believes the financial system will one day collapse) has 25% of his net assets in Gold. So it wouldn't make sense to put more than this. And remember, Faber is a *professional* money manager (one of the best) so his views and approach is very different from ordinary individual investors.

In terms of hedging against rates rising, there are a number of ways to do this. They are:

1) Owning productive assets outright
2) Owning stocks that with dominant pricing power.

Regarding #1, a productive asset is anything that throws off significant cash flows. This could be a manufacturing plant, a lead mine, or anything else that is actively engaged in producing a steady stream of cash.



Company	Symbol	Industry	Price to Cash Flow	Dividend Yield
Kraft Foods	KRFT	Food	10	1.06%
Nestle	NSRGY	Food	16	2.56%
Coke	KO	Beverage	16	2.76%
Exxon Mobil	XOM	Oil	8	2.39%
Clorox	CLX	Cleaning Supplies	15	3.24%
Colgate-Palmolive	CL	Oral Health	18	2.25%
Proctor & Gamble	PG	Consumer Products	15	3.05%

In terms of publicly traded companies, the quest for steady cash flows inevitably leaders well-defined brands that offer goods and services which consumers are willing to pay more for as prices rise due to increased operational costs and commodity prices.

This inevitably leads to defensive non-cyclical industries: tobacco, beverages, medicine, energy, etc. In the large-cap space, the companies outlined in the table above are worth considering.

I want to stress that even though these companies all have considerable pricing power, during a rising interest rate environment all companies will be hit as costs rise. So be aware that although these companies are cheap and have pricing power, this doesn't mean their share prices won't be hit when rates rise.

I am not recommending any of these companies here. But if you need to have exposure to stocks to the long side, these are some of the companies I would consider. As always be sure to do your own diligence before investing in anything.

A final hedge against rising rates to consider is the **UltraShort 20+ Year Treasury ETF (TBT).**

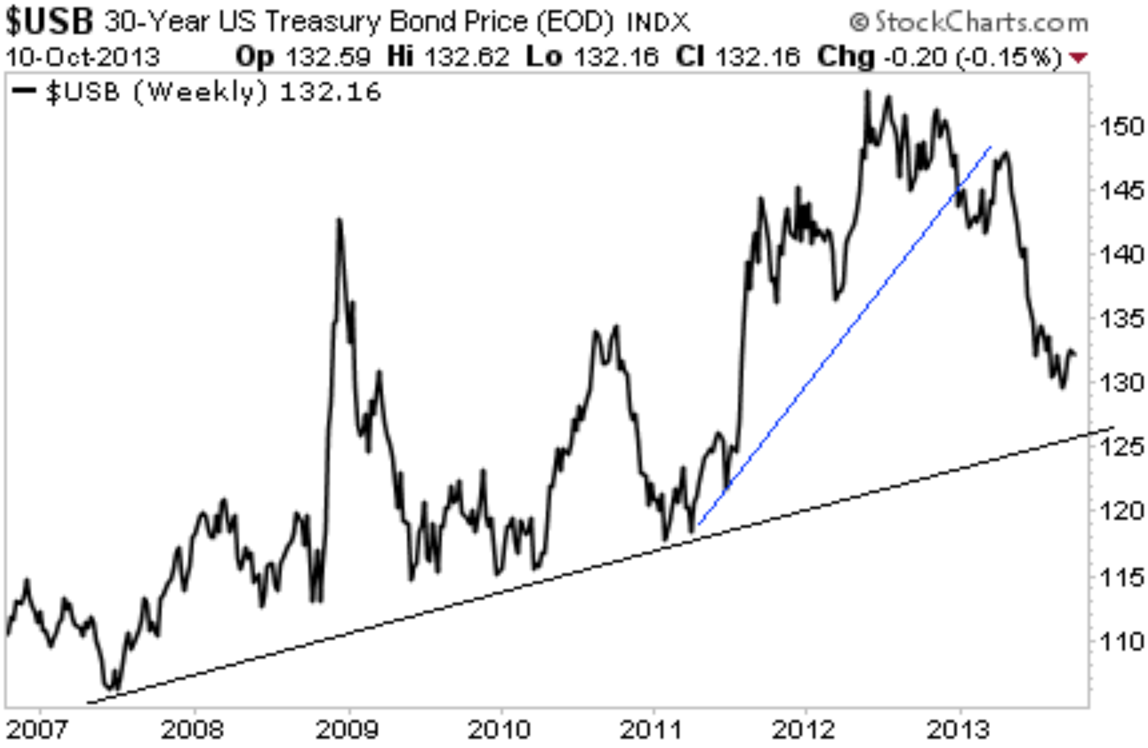
TBT trades 2X the inverse of an ETF that tracks the performance of long-term (20+ years) Treasuries.

So if long-term Treasuries fall 5%, TBT should to return 10%. And if long-term Treasuries fall 10%, TBT should to return 20%. As such it's a great means of playing a drop in long-term Treasuries (accompanied by a sharp rise in interest rates) with a little extra "juice."

In terms of timing I suggest looking at the lines in the chart on the next page.

This chart shows the performance for the 30-year Treasury over the last decade of so.

As you can see, we are getting perilously close to testing the long-term trendline that has maintained the bull market in bonds (or the bear market in rates) since the Crisis began in 2007 (see the black line below).



This is THE line every investor needs to be watching for a signal that the bull market in bonds is over.

QE 4 broke the rapid rise in bond prices in late 2012 (see the blue line above). Since that time, the 30-Year Treasury has been falling steadily. It is now coming close to testing its long-term bull market line.

Either the Fed needs to taper QE or the financial markets need to experience a major scare to get Treasuries to bounce here otherwise there could be *real* trouble (rising interest rates which will have a very negative impact on mortgage applications, debt defaults in the consumer space, and more).

Whenever rates really begin to rise rapidly (US Treasuries fall) TBT will be an excellent way of profiting from this.

This concludes this Special Report. Thank you for reading.

Best regards,

Phoenix Capital Research