Why Buy Gold Now?

A Sober Economic Analysis of the Looming Financial Crisis

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Contents

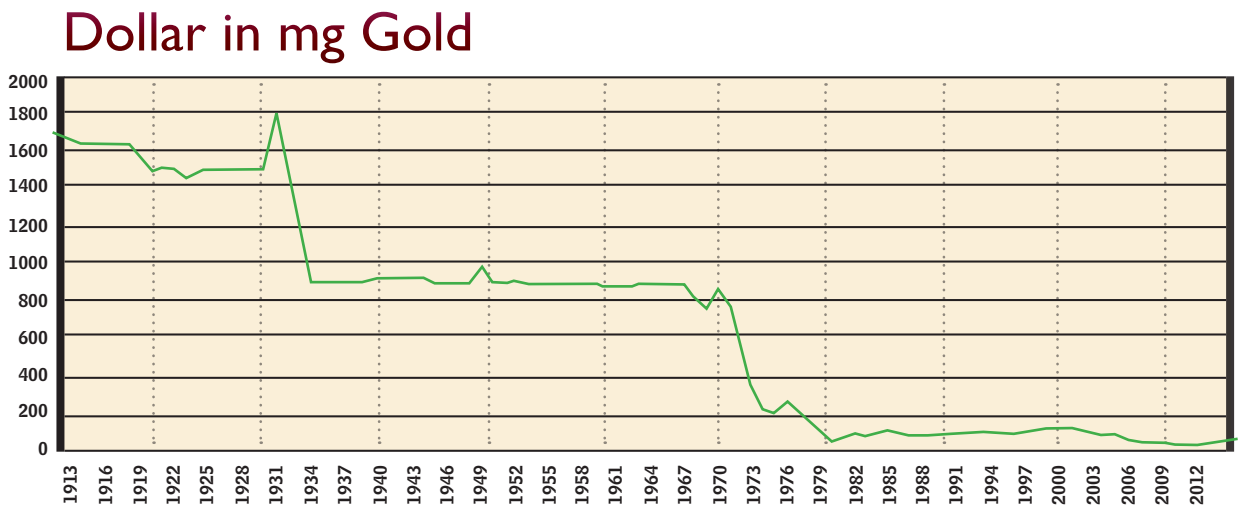
Note: *This treatise is an in-depth, financial analysis of the coming global economic crisis. It is not light reading. It will take some time to read and understand the concepts covered herein. Yet this understanding is critical to preserving your wealth in the years to come.*

About the Authors

This report was researched and written by SchiffGold's Precious Metals Specialists, a team of knowledgeable analysts with backgrounds in finance, economics, and business. Of SchiffGold's seven Specialists, three have economic degrees, two have masters degrees, two graduated from Ivy League colleges, and three have degrees in business. They share a deep understanding of Austrian Economics, as well as years of industry experience in precious metal markets. This report builds upon Peter Schiff's economic analysis of the current global economy to determine the intermediate and long-term effects on gold and silver.

I. Introduction

We see the symptoms of a broken economy all around us. Reckless governments create an ever-increasing debt burden, with neither the means nor the desire to ever repay it. We have a 30-year trend of falling interest rates, with negative rates now becoming the new normal in Europe. We've seen huge breakthroughs in innovation and technology serving to lower the costs of production. That trend should correlate to a general decline in consumer prices, but they've done just the opposite. Instead of paying less, today we pay much more. When we get to the heart of the broken economy, we find a pathology of irredeemable fiat currencies. We are all forced to use money printed on government paper, backed by nothing. These fiat currencies continue to lose value year-over-year-over-year, squeezing American families and undermining their ability to save.



As if that weren't enough, boom-and-bust business cycles now plague the world every five to seven years or so. Engineered primarily by central bank distortion, each recurring cycle leaves a terrible path of destruction in its wake. The impacts include bankruptcies, defaults, bailouts, and stomach-wrenching volatility, with 50% losses occurring within months, or even weeks. Speculative gains that look so good at the time are wiped away in an instant. These aren't just numbers in an account — we are talking about real people's retirement funds, pension plans, inheritances, and life savings!

We not only see these symptoms in increasing frequency, but in expanding magnitude as well. Each recurring crisis is more generalized, more painful, and leaves behind more collateral damage than the one before. More and more capital is destroyed, while less and less is produced.

In today's economic climate, asset speculation has all but replaced savings. This is a zero-sum game, putting precious capital into higher-risk/lower-reward scenarios. Yet people who want to save for the long-term can't afford to take those risks. As a result, waiting to earn a few more percentage points from equities could prove a costly decision in the long run.

Tragically, the chief culprits driving these trends show no signs of reversing course. Instead, central planners and big-spending governments are plowing recklessly ahead, seemingly committed to wholesale economic destruction.

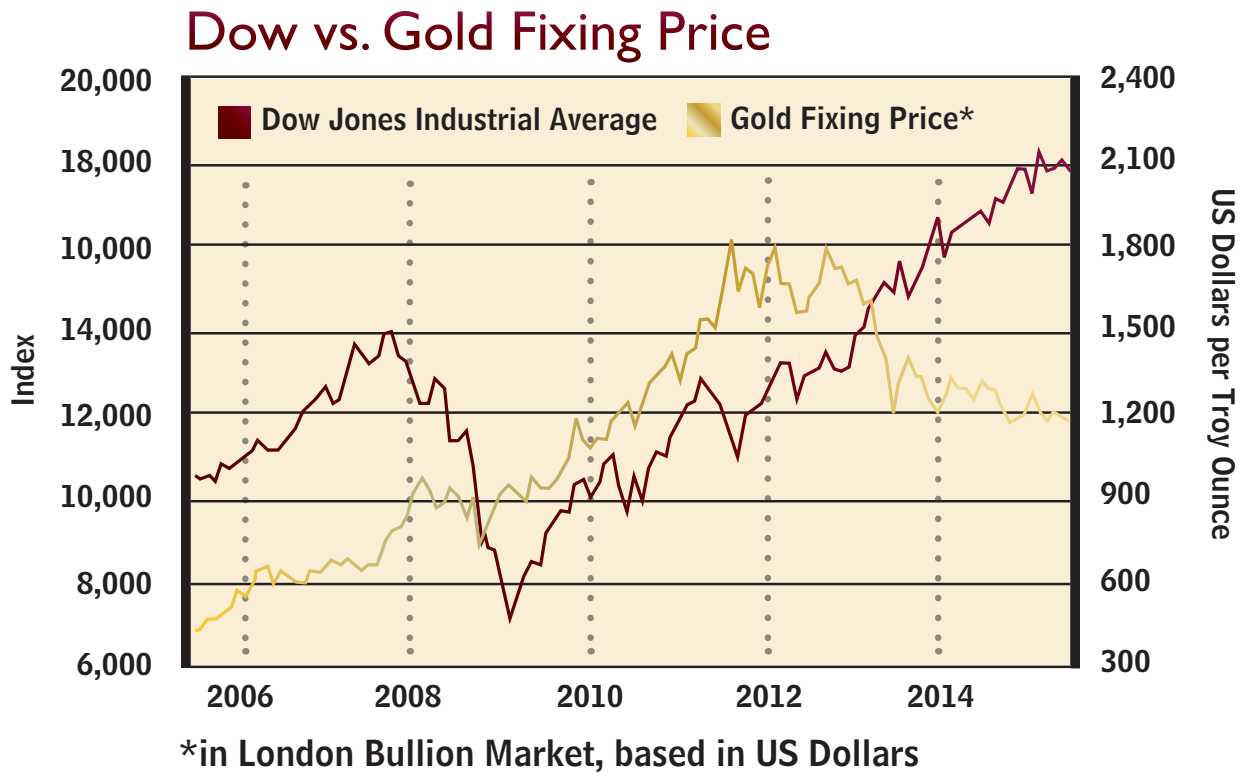
In light of this, owning hard assets has become increasingly essential, as they offer protection from the growing risks inherent in the modern financial system. Of the hard assets, physical gold is the most liquid. It is easy to store and trade. You can hold it outside the banking system – hedging your capital against bank bailouts and bail-ins, sovereign government debt default, and currency collapse. Physical gold has no counterparty risk, meaning the owner doesn't have to rely on anyone else to redeem or deliver the asset – or even to stay solvent. A bullion coin just is what it is – a piece of valuable metal desired the world over.

If you have considered the merits of owning gold, but have never taken the first step, or if you already own gold and are considering adding to your holdings, then this report is for you. Read on and you will learn powerful reasons why right now is the best time to invest in physical gold.

II. Why Now? Because Right Now Is a Superb Cyclical Buying Opportunity

The stock market is now in the rising phase of the financial boom-and-bust cycle. The tail end of the boom phase usually represents a superb opportunity to take gains in stocks and convert them into gold. We are already over seven years into the current financial cycle. No one knows the specific day or the specific event that will signal the top of this cycle, but we do know a severe correction in credit and equity markets is overdue. When it arrives, we expect to see a rapid and substantial flight into the safety of gold. As a result, waiting to earn a few more percentage points off equities now prove a costly decision in the long run. Just like in Las Vegas, winning is only half the battle – the other half is knowing when to cash out.

The financial media will vehemently disagree. Ignorant of monetary economics, mainstream pundits are perennially convinced that *this time* the US markets have reached sustainability, and therefore that gold investment is unnecessary. Frankly, it goes a bit beyond this. Wall Street hates gold because it is the only asset that doesn't require their "management" and that lays bare the market distortions of their central banker allies.



But however much they believe in the goodness of inflation and the evil of gold, reality always catches up with them – and with any investors foolish enough to believe them. The good news is that investors wise to this dynamic can increase their profits by buying while the mainstream is reaching peak mania. Now is the time to buy gold, while the mainstream still perceives it as a weak, underperforming, and undesirable asset. If you wait until this perception changes, you will pay a substantially higher price as gold starts to gain mainstream favor. We believe this is almost a certainty as the economy's underlying structural problems come to light.

III. Why Now? The Madness of Central Bankers: No One Knows What They Will Do Next!

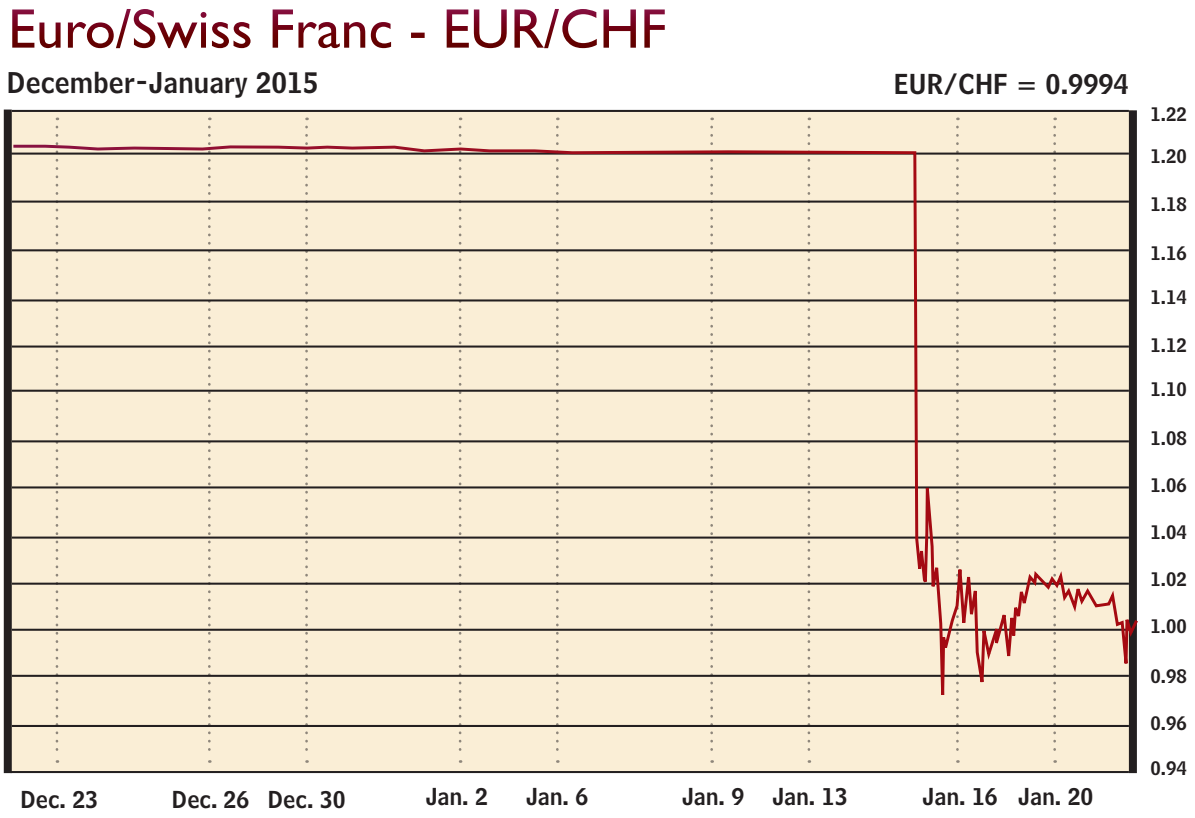
While central banks were ostensibly introduced to prevent financial panics, they actually introduce the ultimate uncertainty – a group of fallible human beings whose arbitrary decisions have the power to radically alter the entire economy. The truth is that no one can possibly know or predict what central banks will do next – not even their own colleagues! The only certainty is that they will always print more money. The last two years provide countless examples of monetary madness wreaking havoc on the markets, and the balance sheets of individuals and companies.

Cyprus and Switzerland provide two of the most recent examples.

Protestors in Cyprus rally against austerity measures imposed by the ECB and IMF.

The Cypriot financial crisis in 2012-2013 was part of a domino effect as the 2007-2008 financial crisis in the US spread into the eurozone. Cypriot banks were simultaneously overleveraged and overexposed to toxic foreign government debt – primarily Greek. The end result was a €10 billion bailout by the ECB and IMF. The plan implemented by these institutions involved closing down Cyprus' second largest bank and imposing a one-time bank "levy" on all uninsured deposits above €100,000. While it was technically called a "levy," it actually amounted to an outright seizure of funds. Those holding deposits in excess of €100,000 at the bank thought their money was safe and secure, but they literally saw their savings vanish before their eyes in just a couple of days. The central bank seized depositors' money with no intention of repaying it. These events didn't happen in a third-world dictatorship. They happened in a modern democratic country located in the eurozone. What's worse, the announcement was made during a bank holiday. Depositors couldn't withdraw their funds even if they wanted to. They were blindsided and paid dearly for trusting the banking system.

The Swiss central bank provided us with the most recent example of monetary madness when it removed the Swiss franc-euro peg. As late as December 18, 2014, the Swiss National Bank (SNB) publicly maintained its willingness to maintain the peg at all costs. Less than a month later, the SNB Chairman came out with a surprise announcement: *"The SNB has decided to discontinue the minimum exchange rate of CHF 1.2 per euro with immediate effect and to cease foreign currency purchases associated with enforcing it."* [Emphasis added.]



Afterward, the franc spiked, the euro fell, and anyone who had taken the SNB at their word saw their fortunes plummet. Some currency trading firms went bust within hours of the announcement. Others took huge losses and are fighting an uphill battle just to stay in business.

Welcome to the central bankers' economy, where investors can go to sleep rich and wake up penniless.

No one knows what kind of disaster central bankers will cook up next. Fortunately, precious metals offer protection against central bank madness. Gold can't be printed and its value is determined purely by the marketplace.

IV. Why Now? The Next Bust Could Be the Mother of All Busts

We believe the next crisis will be much worse than the last, because it will involve sovereign debt defaults and collapsing currencies.

The Federal Reserve swallowed up all of the malinvestments of the 2008 financial crisis and plastered them on its balance sheet, expanding it to a historically unprecedented size.

When any central bank loads up the asset side of its balance sheet with illiquid, undesirable assets like these, it endangers its own solvency, along with the credibility of its currency. The dollar still functions as the world's reserve currency, so when the Federal Reserve flirts with bankruptcy and default, it takes the entire world one step closer to the mother of all economic busts.

10-Year Treasury Constant Maturity Rate

In every cycle, a percentage of distorted capital from the preceding boom phase lives on. This ensures further distortion in the next phase. Any asset class with a rising price becomes a target for the contagion of easy money flowing from the central bank.

The cumulative effect of this decades-long trend means every subsequent crisis is more powerful than the previous, and comes with more destructive baggage.

The market for government debt serves as a prime example. US Treasuries have been in a 30-year-long bull market. In other words, interest rates have been falling for over 30 years. This is clearly unsustainable.

Eventually, Treasuries will reach a tipping point, and the consequences will no doubt be much more grave than the end of the housing or dot-com bubbles.

Imagine what will happen when interest rates start rising again, against a backdrop of the most government debt on record in history!

Current interest rates stand near historically low levels – 2.5% on a 30-year Treasury bond. Interest payments alone already make up 6% of the federal budget. If interest rates merely return to historic averages around 4-5%, and we factor in no increase in the federal debt load (which is fanciful), interest payments would balloon to 12% of the annual budget.

Which popular programs will Washington cut to service these Treasury notes? Medicare? Social Security? Defense? More likely, it will continue the current path – also popular among all other developed nations – of taking out ever more debt to pay back the existing debt. If you do that with a credit card, you know where you'll end up – bankruptcy. The same goes for governments.

For more on sovereign debt and interest rates, please see the appendix at the end of this report.

A number of municipalities have already declared bankruptcy, including Stockton, Calif., San Bernadino, Calif,, Harrisburg, Penn., Jefferson County, Alab., and Detroit, Mich. Now, whole states – including New York, California, and Illinois – are in danger. Next will be the federal government itself.

Renowned Austrian economist Ludwig von Mises understood the dangers we face today. His words are both instructive and prophetic: *"There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as a result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved."*

Despite Peter Schiff and others repeatedly warning that further central bank intervention will serve only to postpone the day of reckoning a little longer – and make it much more painful when it comes – central bankers around the world refuse to listen. They continue to intervene in unprecedented ways. Now we find the fundamental problems much worse.. The debt is bigger; the risk is greater; and the consequences are more dire. Unfortunately, if you own paper currency, you are a creditor holding this bad debt. That puts you at grave risk when it eventually defaults.

V. Why Now? The So-Called "Economic Recovery" Is a Ticking Time Bomb

There can be no true economic recovery unless the fundamental problems outlined in the introduction of this report are honestly and meaningfully confronted. To this date, this hasn't even begun to happen. That means today's so-called "recovery" will prove illusory.

Central bankers are masters of deception, and the engineering of the phony recovery has been a masterful work on their part. By shifting everyone's focus to peripheral metrics, like CPI numbers, unemployment, and housing starts, they've taken the focus away from the real issues: the ever-expanding debt problem, and the artificial boom-and-bust cycle.

Keynesian economic theory is the Kool-Aid of choice for central bankers. They favor active Keynesian top-down policies as they attempt to engineer a perpetual boom.

Booms create a *wealth effect*: nominal asset prices rise, and everyone feels richer when they look at their portfolios and bank account deposits. When reality inconveniently interrupts this effect, the prescribed response is to re-stimulate the economy and attempt to kick off another boom period through further aggressive money-printing and spending.

However, to call this re-engineered boom phase a "recovery" is deliberately misleading.

Ultimately, when the central bank floods the market with new currency, it does so at risk to its own credibility. This was true of the boom preceding 2007-2008, and it's all-the-more true now. Though many Americans are enjoying the peak of the latest wealth effect bubble, there will be a time soon where they will pay the piper.

VI. Why Now? Eventually Gold Owners Will Be Unwilling to Accept Dollars for Gold at Any Price

Let's imagine that the dire predictions described above come to pass. Imagine what will happen to the gold market. As the dollar starts to collapse, there will be a rush of people trying to trade their paper dollars for as much gold as they can buy. As the situation deteriorates, gold owners will demand ever-higher prices. Eventually, no amount of dollars will be high enough to give up what has become the only reliable form of money: precious metals. Think 1920s Weimar Republic.

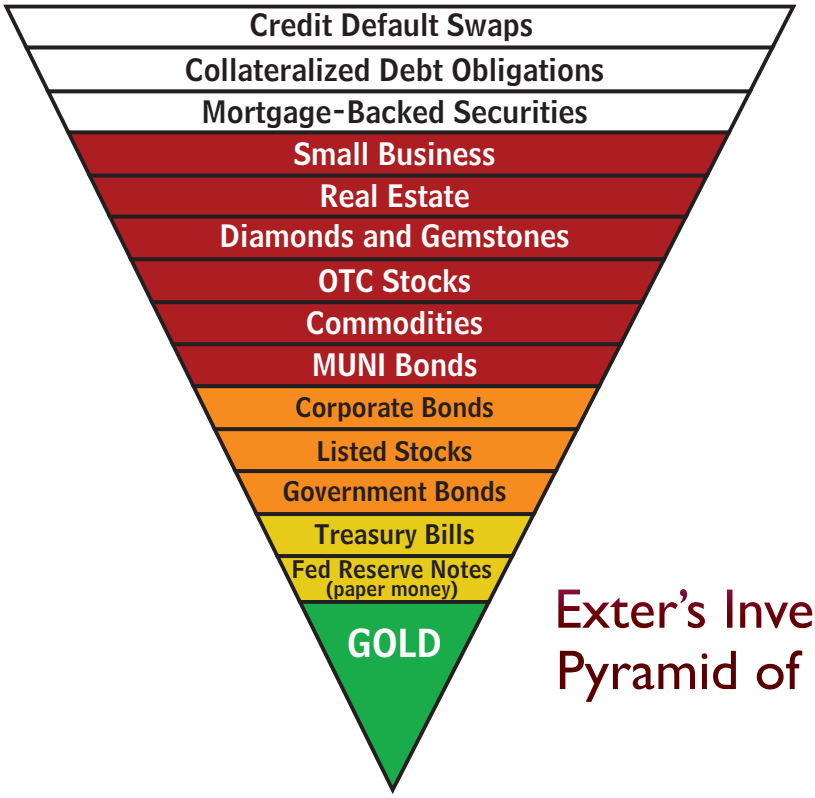
A number of events could trigger this cascading default, and history shows it often happens without warning or announcement. As James Rickards points out in *The Death of Money*, *"The International Monetary System has collapsed three times in the past century – in 1914, 1939, and 1971. Each collapse was followed by a tumultuous period."*

The Weimar Republic's currency was more valuable as a children's toy than a means of exchange thanks to hyperinflation in the early 1920s.

How the gold market functions normally compared to periods of financial crisis

Since the vast majority of investors still don't think there are grave problems to worry about, the market settles normally most of the time. However, we are not in a normal economy at all. When the distortive and destructive effects of central bankers begin to manifest themselves in earnest, the increased demand for gold will be swift and strong. In our debt-based system, it only takes a couple of key companies or countries to default in order to start the dominos falling. When it happens, we'll see a scramble for assets with no counterparty or third-party risk, e.g. physical gold.

As Exter's famous *inverse pyramid of risk* shows, during periods of crisis, capital moves further and further down the chart. As things deteriorate, capital flies away from high-risk, low-liquidity assets, into low-risk, high-liquidity assets. Gold sits at the narrow base of the pyramid because it represents the only liquid asset not simultaneously someone else's liability – and because it is much scarcer than the other asset classes. When a liquidity crisis erupts, this pyramid collapses as investors sell the higher order assets to rush to safety. As you can see, there are a lot of paper assets that will be chasing a limited pool of hard assets.



Exter's Inverted Pyramid of Risk

VII. Conclusion: Buy Gold Now

The right asset, for the right reasons, right now.

For most of human history, gold served as the cornerstone of every household's wealth. It was never a "trade" or a "play." It was money. People saved it. While legal tender laws and other pernicious legislation have pushed gold out of circulation, it has never stopped performing the function of storing value. It continues to do so today, evidenced by people's desire to own it, even as its price has climbed some 300% over the last decade. In fact, the world's central banks still hold large amounts of gold as their ultimate reserves – and many are stockpiling once again.

In today's world, what we call money represents someone else's liability and carries the counterparty risk inherent in insolvent central banks and governments. Gold offers security and protection for your precious capital against the instability and destruction brought on by interventionist monetary policy. Gold is not an empty promise to pay something in the future. Gold is gold. Gold is money. An ounce is an ounce. You either own it or you don't.

In light of this pure and simple reality, it doesn't pay to get distracted by daily price movements, or trying to time the market just right. You may believe you will sell and get a bunch of dollar profits when gold rises to $5000. This is dead-end thinking.

No, the economic problems we face today are much more serious and systemic, and the dollar sits at the very heart of them. There is no overestimating the devastation the looming global monetary crisis and the collapse it will bring with it. As a result, it is no overstatement to say that buying gold might be the single most important financial decision of this generation.

During normal market conditions, Peter Schiff recommends putting 5-10% of your capital into physical precious metals, and maintaining that allocation as your portfolio grows. Since we have not experienced normal market conditions for some time, a higher allocation may be more suitable for you. Right now is a great opportunity to take out the best financial insurance policy available: physical gold delivered to your door or stored in a high-security domestic or international vault.

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APPENDIX: SIGNS THAT THE FIAT SYSTEM IS COMING TO AN END

The Central Bank Becomes the Sole Buyer in the Bond Market

Government bonds represent government promises to pay out currency at a future date. Central bankers are quickly becoming the sole buyers of government bonds. The more they buy, the closer we come to the monetary system's unraveling.

If there is no market for government debt outside the central bank, it follows that the underlying asset is becoming less and less liquid. That means it's less marketable. This implies the treasury is in danger of illiquidity and insolvency. If the central bank continues to buy bonds to keep the treasury afloat, this becomes a vicious cycle that leads to hyperinflation.

In Japan, this is already occurring. The Bank of Japan's recent stimulation (10/31/2014) includes language that would allow the bank to buy up to 100% of the bonds at new issuances. Japan is much closer to the end of their system than most people realize.

The US isn't far behind. During the various QE programs, the Federal Reserve purchased as much as 90% of treasury issuance at auction. It averaged around 60-70% of the total market. The Federal Reserve now owns around 13-14% of all outstanding Treasury debt, and around 18% of all mortgage-backed securities (MBS). The Fed has expanded its balance sheet by close to *$4 trillion* in the last five years. Monitoring how much government debt the central bank accumulates is a good indicator of how close we are to a currency crisis.

Long-Term Interest Rates Go to Zero: The Illiquid Central Bank

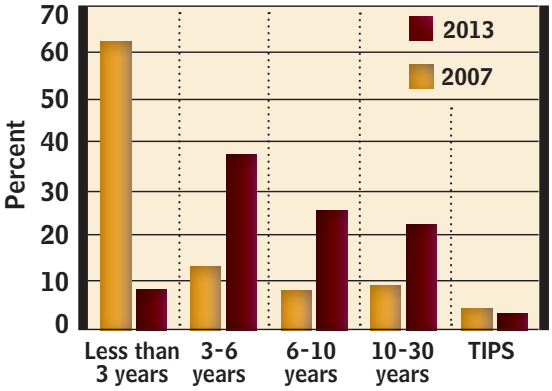
Illiquidity, and it's closely related cousin insolvency (total liabilities > total assets), can creep into a bank long before it comes under selling pressure. Consider the following statement by famous economist Melchior Palyi of the University of Chicago:

"A liquid structure never liquidates; only the illiquid one comes under the pressure of liquidation. 'Perfect liquidity' means that, for any length of time, all financial obligations are fulfilled without net liquidation of capital. A liquid society has adjusted its obligations to the flow of its income, both in amounts and in maturity dates, so that forced sales should not occur."

Illiquidity can arise from a number of different factors, but a typical cause is borrowing short to lend long. This is a classic duration mismatch, meaning the revenue generated from long-term assets is used to service short-term debts.

This works only for a time. Once the spread compresses – and it always must – the bank comes under liquidation pressure, as the revenue from the long end of the curve is no longer sufficient to pay the short end. A close look at the balance sheet of the Federal Reserve reveals that the average duration of its assets falls in the range of 108 months, or 9 years (as of Q3:14). This is a much longer maturity timeline than the Fed has historically had for its assets.

Maturity Distribution of SOMA Treasury Holdings



Source: Federal Reserve Bank of New York
Notes: Figures are as of year-end. Maturity buckets apply to nominal Treasury securities.

Considering that nearly all of the Fed's *liabilities are short-term,* this poses a significant problem, especially if rates start to rise again, or if longer term yields continue to fall. In other words, the Fed has a big problem on its hands with no exit strategy. Daniel Oliver Jr., President of the Committee for Monetary Research and Education, put it succinctly:

"The enormous maturity mismatch between the Federal Reserve's assets, which are now mostly long term, and its liabilities, which are all current liabilities, promises large losses when interest rates finally rise."

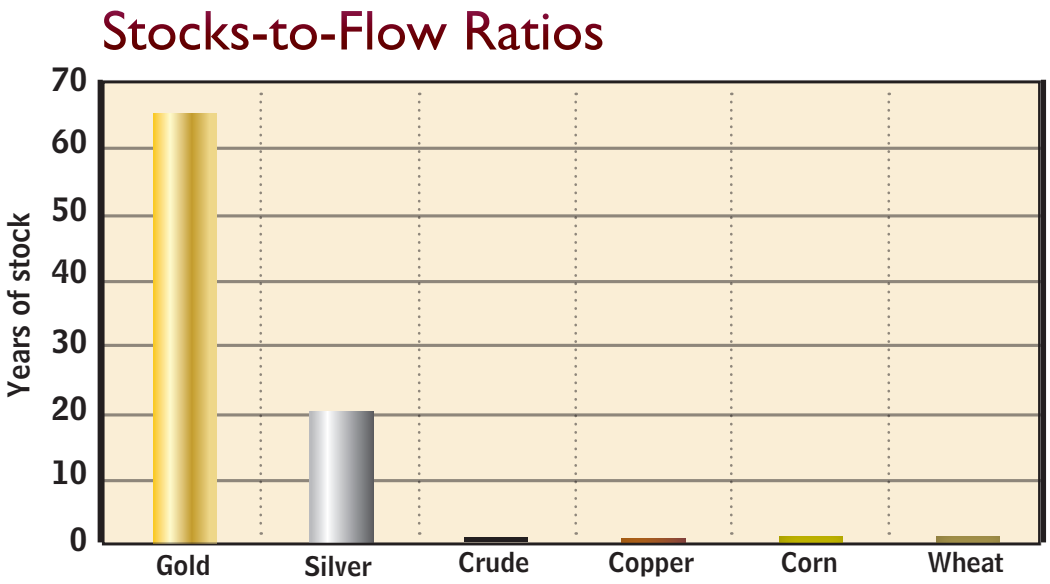
Through this strategy, the Federal Reserve has put itself, and the entire monetary system of the world, on a dangerous trajectory. Monitoring long-term yields is a good gauge as to how close we are coming to the Fed's day of reckoning.

A Growing Stocks-to-Flow Ratio in Gold Market

There is no commodity on earth like gold. Yet despite the seemingly infinite number of commentators who pontificate about it, gold is the most misunderstood market. The majority of pundits fail to take into account gold's unique *stocks-to-flow ratio,* which compares current above-ground inventories of the metal (stocks) to the amount of new metal brought into the market annually (flow).

This ratio demonstrates that the demand for gold has been historically consistent, and continues to be so. The gold market absorbs decades of additional annual production without any problem. Compared to the total above ground supply, annual production represents only a proverbial drop in the bucket.

Since gold is only saved and not consumed – unlike, say, oil or grain – newly produced metal from mines does not drive dramatic swings in price.



Stocks refers to current inventories. Flows refers to annual production. To obtain the stocks to flow ratio, you simply take current available inventories and divide that by the annual production. The estimated total above ground supply of gold is around 172,000 tons (roughly 5.5 billion ounces), which is the stock. The estimated annual production of gold from miners is about 2,700 tons (2012), which is the flow. Dividing flows into stocks you get 64 years.

Gold's price is more likely to be determined by the volume of buyers and sellers in the market. The demand for gold to hoard for the future is called *reservation demand.* As the dollar continues to decline along with other fiat currencies, reservation demand should increase. Because gold's stocks-to-flow ratio is so high, this preference for hoarding over selling by existing gold owners will likely have a dramatic effect on price levels.

This is already starting to happen now!

Many investors aren't aware that hoarding isn't some far-off, future phenomenon. It's already happening today. There are a growing number of people buying physical gold with no intention of selling it for dollars, or any other broken currency for that matter. Foreseeing what's to come, they are wisely storing the metal for the long term. They understand the fundamental problems of the economy, and they are taking the appropriate and available steps to protect and preserve their capital. As more and more of these fundamental buyers come to market, more and more gold is being taken off the market. This is a strong bullish signal for gold in the years to come.