

WINDROCK'S 2016 FINANCIAL AND ECONOMIC ROUNDTABLE

Most financial publications have an annual roundtable or outlook from an expert panel. However, they tend to include only Wall Street economists or mainstream financial commentators, all of whom share very similar viewpoints. We have chosen to do something different.

The roundtable discussion is moderated by Christopher Casey, Managing Director at WindRock Wealth Management.

CASEY

Today we have assembled a panel of independent experts with unique perspectives. We are recording this in late January, and it has already been a dramatic year. After rebounding from a brutal start, the U.S. stock market is still down 5%, while Europe, Japan and China have all declined approximately 8%.

Bud, you went on record in a recent podcast with WindRock as well as in the Casey Report stating 2016 will witness a significant recession. Do you believe recent stock market activity indicates a worldwide recession is upon us and investors should expect future declines, or is this simply a momentary correction?

CONRAD

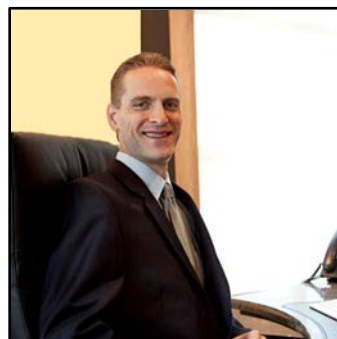
Oh, of course I'm in the camp that we are already in a recession. That's based on the way they actually define what a recession is as done by the National Association of Business Economics. One of the guys that does that is Bob Hall, a professor I know over here at Stanford. They look at things like employment and so forth, but pretty much after the fact. Sometimes they don't declare the beginning of a recession until after it's actually finished, and then they declare that it is finished later than that. So official recession dating is not much use to investors. The main reasons that I point to are that the world economies are slowing and the stock markets are falling, like our own. The Baltic Dry Index is at a record low indicating that nobody is demanding ships for trading. There are declines in all the important measures of our economy, starting with industrial production, retail sales, etc. Inventories have been rising, especially as compared to sales, back to a level that's definitely a recessionary warning, which is why GDP hasn't completely gone negative. GDP came in at 0.7% for the last quarter of 2015. This was with an inflation level that is extremely low and I don't think reflective of



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reality. If the inflation that I pay at the grocery store and California housing were properly calculated, I would say we are already at a negative GDP. When things like unwinding the inventories is added to what I suspect for the projections, we are going to have negative GDP quarters coming along.

In my book I spent some time on the fact that feedback loops are very important. When you have a falling stock market, people feel less wealthy. When they feel less wealthy, they spend less. When they spend less, the economy slows. When the economy slows, guess what? Earnings of companies decline so stocks decline. It's a feedback through the system that feeds on itself. Once you have the start of a rollover, as we now have for the stock market, it feeds back through the economy and the economy feeds back through the stock market in a vicious circle. The vicious circle we have been on with Fed printing, adding money to financial markets to drive up financial assets, namely stocks and bonds, stopped a year ago. It should be no surprise at all that stocks have not gone anywhere for a year either. In fact, earnings are down and even sales are down - only a modest 3% in the last year - but that is the sign of an economy already in recession.

KNIPPA

Do you know why Bud's right and we are in a recession? Because Janet Yellen just raised rates. Her record is untarnished. She is zero for however many times you want to go through this exercise. Her record at predicting a recession is zero. It is perfect. She hasn't done it not one time. One time, she said that we were in a recession, but by then, we had already starting coming out of it. When Ben Bernanke took over, Janet Yellen gave a speech saying that no person had ever taken over as Fed chairman with the economy being in such good shape; it was like a tennis racket with a massive sweet spot. That was in 2007. We were right on the front door of the single most important financial event of our lifetimes and she completely missed it. So if Janet Yellen says red I say blue, if she says up I say down. You want an indicator that we're going into recession: she raised rates. That is all you need.

CASEY

You should take her to Vegas!

KNIPPA

Regarding the stock markets, I wanted to really highlight this: what have American companies done, besides stock buybacks? They finance these stock buybacks. They're doing it with debt, and if you are sitting there forced to service debt as a public company and your top line growth starts to go down, i.e. we see a recession, we see sales slow, etc. Their balance sheets look worse now than they did then and that really troubles me when we start talking about what we think stock markets can do. On the other hand, as we start talking about recession, we naturally have to say that it is possible QE comes back, so is it possible that asset prices rise? The Japanese stock market's been rising and their economy has been dead flat now for 20 some odd years, so it is hard to believe but possible. Stock prices very well could go up.

RENTMEESTER

Recessions are notoriously difficult to call, but this period has all the writing on the wall of a global recession – so the odds are quite high in our opinion. The wildcard is whether central bank actions can continue to delay the onset. We think it's unlikely they can for much longer. The world economy is built on an increasingly unstable and interconnected tower of debt – much like the game Jenga. In Jenga, blocks supporting the tower are pulled out one by one until the whole tower tumbles. We are seeing key blocks being pulled from the global economy as we speak. We've had high valuations and weak global growth for several years already, but two additional blocks got pulled in 2015. It was the first year where company fundamentals turned down decisively with essentially flat sales and a contraction in earnings for S&P 500 companies. In addition, we also saw interest rates on junk bonds almost double from 4% to 8%. We believe soaring junk bond yields have often been a leading indicator that investors are becoming more fearful. This change in sentiment could be the final block that knocks the tower over. In the aftermath, central bankers will likely panic, and similar to 2008, re-inflate the system with money



printing, but will investors have lost faith in the power of their actions this next time around? The Fed will come back to QE and other easing measures, but likely not before we first see some serious losses in the stock market.

CASEY

Gerald, you have been spot on in predicting the last two recessions. In December 2007, you had an article entitled "The Panic of '08" in which you predicted failing banks, busted brokerages, etc. Where do you see the worldwide economy headed?

CELENTE

The stock market is disconnected from reality, and it has been since they started negative interest rate policy and quantitative easing. All that has done, and the facts prove it, is allowed companies to do massive buybacks of stock and mergers and acquisition activity and last year of course M&A activity was record breaking. So the only thing it did was to boost the stock markets and to also take that hot money and to push it into emerging markets and boost those markets as well. So, it has no reflection to reality because when you look at the real numbers, for example here in the States, what are we at? Basically a 2% GDP rate increase each year since the panic of 2008 and now you just saw the numbers come for the last quarter of 2015 and what was it: 0.7%? You call that an economy? And it stinks. So the realities are hitting home, and the reality is that there's no recovery and we are in the beginning stages of a massive global recession and you can also see it in declining commodity prices. You look at the Bloomberg Commodity Index back at its 1991 levels and why? It's because this is a global slowdown and there's too much product. Whether its raw materials or finished product and not enough money to buy the stuff whether it's by a company or individuals. So, this is real and the commodity prices don't collapse like this for no reason at all.

CASEY

I completely agree with your comment about commodity prices. Of course, we can cite a number of statistics pointing to economic weakness, but I think the dramatic fall in commodity prices may be perhaps the

most significant statistic since growing economies require natural resources. From their highs over the last few years, we have iron ore down 80%, copper down 55%, and oil down 75%. These are simply some examples as virtually every commodity is down significantly. Are there any commodities that look attractive at today's levels despite the economic deterioration?

KNIPPA

Crude oil for one, I'm a big advocate of starting to accumulate but I want to accumulate production. The way I would look at that is through some of these royalty trusts, and that way I am not buying one well or two wells. I happen to be in Texas, so you know I'd rather own a piece of a portfolio of wells. I like it. The Saudi Arabians right now are seeing capital outflows. There's been talk, mainly by Jim Rickards, of a potential trade where he sees Saudi Arabia unpegging the riyal to the U.S. dollar because they are having problems with their foreign currency reserves. So, the best way to do that would be to unpeg, and thus weaken the riyal. Now, there's clearly a bigger part to the story but the point that I am trying to make is that the Saudis are suffering here, with oil at these levels and they have been doing our foreign policy bidding for us. All along as crude oil was dropping, the United States asked them to not cut production. Well that's changing now. The Saudis are going to cut production. They are going to back off and I expect prices to start rising back up again. Let's remember that global demand is the highest it's ever been. So, global demand has not dropped. This has only been a supply story. So you will see the Saudis start changing policy. Now, do I expect crude to rally to \$60 next week? No. I think this is going to take time, but if you've got a reasonable time frame of 2-to-5 years, accumulating oil right now is absolutely a commodity I want to own.

RENTMEESTER

We've been avoiding all economically-sensitive commodities the last several years and have focused more attention on hard assets that serve as a store of value for purchasing power during difficult times – things like farmland, rental real estate and precious



metals. A global recession could further contract overall industrial metal mining activity. Since nearly 70% of silver's supply is as a byproduct of mining industrial metals such as copper and zinc, a slowdown in overall mining could create a supply shock in silver at the same time the demand spikes due to investors buying silver as an alternative currency that isn't being printed out of thin air. We also think oil is intriguing at these levels. At \$30 a barrel today, oil is priced near the generational lows seen in the 1980s, when adjusted for inflation. There could be more weakness ahead, but we'd plan to be aggressive buyers if oil approached the \$20 a barrel level.

CASEY

The fall in commodity prices has had a significant impact on emerging markets with their stock markets down around 15% so far in 2016 and some currencies off significantly such as the Canadian dollar, the South African rand, and the Brazilian real. These are all resource-based economies. Given how far emerging markets have fallen, is now the time to start making emerging market investments? If so, where and what type of investment?

CELENTE

You are looking at all of this hot money that flew into these emerging markets when they had quantitative easing and of course zero interest policy and now their commodities are declining. They're exporting less and now they have all this debt that is in dollars. Now, if there's the expectation of the dollar getting stronger, meaning interest rates are rising as emerging market currencies are collapsing, emerging market currencies then have to pay back this dough with more expensive dollars as they're making less money with their commodities and the currencies are crashing.

RENTMEESTER

Emerging markets have been battered and the good news is they look very cheap on paper and are already pricing in recession risks, unlike the U.S. markets; the bad news is that if a global crisis emerges, we are likely to see credit conditions get difficult for the emerging economies and we could see a default cycle around

industries in the commodity space. Thus, we think it pays to wait to see what transpires before making a big bet in emerging markets. However, these are the markets that will likely be the best performers for the decade ahead once they bottom.

CASEY

Emerging markets are down due to the lack of demand by China for commodities. The Chinese stock markets are down as much as 35% since last year's highs. They have instituted draconian measures to prop up their stock market, their economic growth has slowed considerably to multi-year lows, and they have devalued their currency. Do you think they will devalue the yuan in the near term future?

RENTMEESTER

From our perspective, the yuan and dollar are somewhat of a mirror image – the Chinese yuan could fall further while in the near-term we see dollar strength; but in the longer-term, it seems likely that yuan gains will come at the expense of the dollar. In the near-term, it's conceivable that the Chinese could devalue the yuan further, if global recessionary conditions accelerate, in a move to support their export machine and competitiveness on the world stage. If this happened, it would likely trigger further devaluations in Asia to match China's increased competitive position. The beneficiary would likely be the dollar. However, we see the dollar as having the most to lose in the longer-term and the yuan as having the most to gain for one simple reason – trade flows. China is already the second largest economy in the world and is increasingly building the plumbing to settle global trade in yuan. For the last 70 years, the dollar has been the beneficiary of being the only kid on the block, essentially serving as the sole trading currency of the world. If China bought oil from Kuwait in the past, they transacted in dollars. This is starting to change as more trades are occurring in yuan, putting the future of the petrodollar (oil traded in U.S. dollars) at risk. This doesn't mean the dollar will be completely supplanted by the yuan, but it loses on the margin, much like the British pound sterling did when the U.S. economy was on the rise.



CELENTE

They're afraid to because they're looking at the capital outflows. The capital outflows of the emerging markets now apply well over a trillion dollars in the last year. The money's pouring out of China. That thing is one big Ponzi scheme when you look at the real numbers. And the real numbers don't lie. China counts as 17% of the world's \$80 trillion of GDP. In two decades, the Bank of Japan expanded its balance sheet from \$40 billion to how much now? Four trillion. Go back 20 years ago. China has had about \$500 billion in public in private debt outstanding. You know what it is now? It's over \$30 trillion. The money is flowing out of that country. It's a lie that they want to devalue the currency so they can export more product. For guys like Cramer on CNBC, this is Toyota against Ford. It's bigger than that. They are afraid to devalue.

KNIPPA

I don't think so. The Chinese have capital outflows right now, and how do you battle capital outflows? You devalue your currency. The citizens of China are trying to get out so they are trying to sell yuan and buy anything and everything else to convert. So how are the Chinese policy makers going to battle that? They're going to devalue and they're going to talk about how they were trying to spur exports and all that nonsense. They're doing it to try to protect their foreign currency reserves. I see seven and a half to eight yuan to the dollar by the end of 2016 and eventually as high as double digits: maybe 12 or 13. They have to recapitalize their banking system. How are they going to recapitalize banks? They're going to do it with freshly printed yuan from the People's Bank of China. So, expect a lot more yuan coming into the market just like what happened with Japan – as Japan goes to negative rates, the yen drops. The yuan has a peg to the dollar so as the yen weakens that in theory just strengthened the yuan because now Chinese products cost more to Japanese consumers. Who is Japan's largest trading partner? China. So with one fell swoop, the Japanese have just made Chinese products cost more in Japan.

CONRAD

I would back you up with one other piece of data on that. We think our central bank is crazy, printing up all this money. The People's Bank of China is crazier or was crazier, especially since they papered over the last recession with money printing of their own that exceeded ours by a significant amount. I would add a little piece of local color from here in California: a lot of houses have been brought, sight unseen for the full cash price, by people who aren't actually living in them. What is going on here? It's another way of money laundering and getting money out of China to buy real estate whose ownership isn't tracked anywhere near as closely as things like stocks and bonds. So that has been happening, although it looks it is slowing right now. The point of this is I think a lot of Chinese are scared about their currency as well and are adding to this flight. It looks like another reason to add to the fact that they will have to let the yuan decline.

CASEY

Around the world, policy makers face the same economic circumstances: deteriorating economies, currency wars, and high debt levels. What course of action do you believe they will take, and what does it mean for interest rates?

KNIPPA

Remember, Janet Yellen is a believer in the wealth effect. I actually think that she will be data dependent on one single piece of data: the stock market. That is what will bring back QE. Because we already know what her record of predicting a recession is, it's horrible. So she'll actually start QE after the recession is over. Oddly, if QE 1 worked then why did you need QE 2? If QE 2 worked, why did we need 3 and then now 4? I find that puzzling. QE lowers the borrowing costs for the government. When you enable policy makers to keep borrowing, the politicians are going to keep borrowing. So while U.S. treasuries may be a grossly overvalued asset, it's going higher. It's not going down. Because we can't afford for rates to be higher and the Fed will make sure of it. Interest rates won't move until currencies do. When Bud talked about feedback loops, this is how it happens in bond markets. You don't come to a



crossroads and choose a bond crisis or a currency crisis. In actuality, one causes the other and typically it happens in the currency first.

So if the currency starts sliding, a bond holder who is holding a 10-year bond says, wait a second, I'm going to get paid back in a currency that's now dropping just as precipitously? Why in the world would I hold onto this asset? So then the bond holder starts selling because they've seen the currency risk of holding that bond, and then the central bank has to step in and print more money, which thus accelerates the drop in the currency and that's when you're off to the races. Let me give you examples from last two years: what did Brazilian rates do when the Brazilian real dropped? Rates went up. What did the rates do in Russia when the ruble cratered? Rates went up.

CONRAD

I agree with you that a stock market decline could be the trigger for the Fed to start a new QE. The problem though is that we started the 2008-2009 recession in relatively good shape. That is, they could drop interest rates a significant amount. The federal government stepped in with huge deficits at a time when it could be absorbed. This time around, we've got a problem in that the Fed is already at a zero rate. Sure, they might try to go to a negative interest rate. Sure, they could go back and expand QE, which I do expect, but if the federal government starts to ask for more borrowing to support new spending programs, you're going to find a problem with borrowing that amount of money unless the Fed buys that amount of debt. I think it's guaranteed that the Fed comes back dramatically to destroy the currency and it's only when the currency looks extremely weak that the Fed is forced to stop that program and I would say that's another, let's pick \$2 trillion more QE.

CELENTE

So just look what happened recently with the Bank of Japan and their now negative interest rate policy. I mean you can't make the stuff up. This never happened in the history of the world part one or part two. And they're getting away with this stuff. So the Europeans are doing the same thing with Mario Goldman Sachs

Draghi. Zero or negative interest rate policies. This is a screw the people, shaft them, we don't care about them. We're going to pump up the equity market, we're going to make inflation higher, make it cost more for everything that they make and by the way, they have no place to put their money in, other than the equity markets because if they put in the bank, we're going to charge them to put it in there. There is a criminal operation. Its "bankism". The central banks have taken over the world and people better grow up. Let's stop calling this capitalism. This is not capitalism. In capitalism, you rise and fall on your own merits. You don't have a bunch of shysters from the central banks rigging the game. People should be outraged at this because I am and any person with a brain between their ears could see what they're doing to screw the people.

RENTMEESTER

In short, if a global recession becomes acknowledged, U.S. interest rates can move down before they move up. We've been one of the few advisors suggesting this the last several years. Even though the 10-year U.S. treasury bond only pays 2%, that is still a tremendous premium to Switzerland (-.3%), Japan (.1%), France (.9%) and almost any other large developed nation. If investors get fearful, where will they park capital? We think in the U.S. dollar and the treasury bond, perhaps the 10-year bond yield could dip below 1.5%, maybe even approaching 1% if a recession ensues. If this happened, we may even see negative rates in the U.S. for short-term bonds, as hard as that is for many to believe today. The Fed has already discussed it as a potential tool and we just saw Japan take this action. However, bond investors, don't get too comfortable! Falling yields would push bond values higher and make them look like a good investment in the short-term, but there is a day of reckoning on the other side of this. How attractive is a 10-year treasury bond at 1.5% after paying taxes and factoring in inflation? We are likely to see a reflexive rebound in rates to much higher levels eventually as the world resorts to expanding the money supply and devaluing currencies, setting the stage for perhaps a bond bear market for the next 30 years. Investors saw this during 1950-1980 when investors lost



money in bonds (after inflation) for three decades. This will require investors to be very nimble ahead and realize that we may be nearing a generational turning point in interest rates, but we're probably not there quite yet.

CASEY

For 2016, what one investment category do you believe every investor should consider?

CELENTE

I don't give financial advice. Only speaking for myself, I am bullish on gold. You look at what we just went through in January. Virtually everything went down, virtually all the commodities and all the equity markets trended down. The only thing that went up is gold. About 3.8%, so to me gold is the safe-haven commodity not only in a time of socio-economic unrest and volatility, but also in geopolitical. And when you look around the world, what happy days over there in the Middle East now that the United States is announcing they're going back into Libya, they are in Syria, they are in Iraq and now you are hearing the rest of the countries get involved. Belgium is now sending jet fighters into Syria, I mean that's how bad it's gotten, and then you have Saudi Arabia destroying Yemen, there were four million Yemenis living in Saudi Arabia, so then you get more geopolitical unrest. The amount of refugees flooding into Europe is a crisis. And on top of the refugee problem and geopolitical unrest, you have declining economies. I like gold as a safe-haven asset.

RENTMEESTER

We like secured private lending. Shortly after the 2008 crash, forward thinkers like John Mauldin forecast the growth of private pools of capital lending money and stepping in where banks were failing to lend. With the Too-Big-to-Fail Banks facing increased regulation, they've left many profitable lending niches behind. In many cases, the regulations are keeping them out, but in other cases, the opportunities are just too small given their massive size. We know one trade finance group in Asia that was offered a \$100 million loan by a large global bank, but the bank wouldn't lend anything less as it was insignificant for this bank. Investors with access

to these opportunities can often find lending arrangements with low double-digit return projections. More importantly, their lending is often secured by real tangible assets or known income streams as further security beyond simply a borrower's willingness to repay. They also tend to be "spread" lending and not sensitive to the overall level of interest rates. If we see a global recession, expect banks to pull back lending even more and these opportunities to increase. However, the devil is in the details, so investors need to understand the risks and do their homework. These are niche plays that take an entrepreneurial mindset to identify.

KNIPPA

Short the yuan. The Chinese are going to devalue, there is no way around it.

CONRAD

My prediction is that the weak economy will bring a weak stock market. This six-year stock bubble could burst. So an opportunity is to find overvalued stocks, like some of the tech "unicorns" to short. The falling stock market will bring the Fed back to print rather extensively to try and reboot this weak economy that I think will get a lot worse. But I don't think new Fed actions will be as effective this time because people will lose confidence in the dollar and treasuries. If interest rates then rise, the value of the treasury bond purchase price decreases, so then you have an implosion in bonds and stocks together, but you would have a rise in other assets: physical assets like gold, like oil, like real estate, particularly productive agriculture.

CASEY

Thank you all, we look forward to seeing how 2016 plays out.



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