Six years on, preparation is still the best policy: Part 2

Paul Gambles, Managing Director

In his 2010 article published by The Gold Report, Ian Gordon shares a very similar view to me on the outlook for China:[1]

“I think perhaps the Chinese Winter will be the worst of all, and again we have a parallel. China is the U.S. of the '20s. The U.S. came out of World War I as the world's largest creditor nation, with a major significant growth in its industrial prowess – all of which China is today. At that time, the U.S. government was paying down debt, and it wasn't that significant anyway. And now, the Chinese government doesn't have much debt; either. But in the U.S., corporations and consumers of the "Roaring '20s" built up huge amounts of debt. You see parallels in the housing market in the '20s to what we see today in China. A lot of suburbs were developed because people had automobile or railway access to the suburbs. At the same time, we had a major development of skyscrapers in city centres, monstrous buildings carrying monstrous debt.”

I have also previously drawn parallels between the 1920s building boom that spawned the iconic Chrysler and Empire State Buildings with the Chinese construction mania for ghost towns and empty shopping malls. Gordon explains how this can happen:[2]

“China is in that kind of process. What happens when you get so wealthy, you're exporting so much, particularly to the United States, the Chinese government takes the U.S. dollars and credits the bank with renminbi. The bank has all this money on hand. So a local businessman goes to the bank and says, "I want to build a factory and build toys for Toys 'R' Us in the United States." The banker says, "Fine." He has all this money; he makes the loan; the borrower goes and builds his factory. Somewhere across town, someone else goes to another bank and does the same, and again and again with different borrowers and lenders. It's the mal-investment that occurs when you have so much money floating in the system.”

China, above all, prevented the impact of the debt correction that started to occur from 2007 onwards by huge mal-investment in unproductive overcapacity across many sectors, to the extent that the scale on which supply now exceeds demand has rendered entire sectors totally uneconomic; as Gordon explains:[3].

---

[1] https://www.streetwisereports.com/pub/na/ian-gordon-ignore-the-illusion-of-spring

[2] *idem*

[3] *idem*

“Eventually, the United States, the biggest importer of Chinese products, cannot continue buying at that level. Despite the pace of growth in China's economy, it still takes probably at least 50 years, maybe more, to develop a middle class. Those are the people who have the wherewithal to spend. So, it's going to take China a long, long time; it's still very much an agrarian economy.

“For these reasons, I think China's banking system will go the way the U.S. banking system did in the '30s, and the whole economy will go into a collapse. But out of it, she will rise as did the U.S. as the greatest economic, financial and political power. She will be the world leader.”

Ian Gordon also shares my view about another huge vulnerability during the Kondratieff Winter[4] – the European single currency whose inherent instability has been papered over:

“For years I said the Euro was a cobbled political currency that would never survive a Kondratieff Winter. And we're starting to see that's likely to happen. Everybody is trying to pick the winner. Right now they're picking the U.S. dollar. Before they were picking the Euro. Except maybe the renminbi, all the currencies are vulnerable. Definitely the yen is very vulnerable because the ratio of debt to GDP in Japan is so massive already.”

He also echoes my view that gold is a form of insurance against the impacts of Kondratieff Winter on both assets and currencies and my warnings that gold itself does however retain some vulnerabilities to the whims of politicians:[5]

“One problem with that is we don't know how the government will respond to those who own gold. It's dangerous to put all of your eggs in one basket. You'd be trusting the politicians not to do what Roosevelt did in 1933. After he confiscated gold, Americans kind of got around it by investing in gold companies. They were very profitable, and all the money, all capital ultimately flowed to gold because it was the only thing people trusted. It was going to gold because that's where people wanted to be.”

But that doesn’t mean that gold miners will see the same outcome this time, which is why I’d see gold mining companies as a different kind of investment to gold itself. Ian Gordon also shares my scepticism about silver as an alternate currency:[6]

“As for silver, it didn't really work as a monetary instrument in the early 1930s. Although at that time U.S. coinage from the dollar to the dime was minted in silver, so there was certainly hoarding of silver coinage during the last

[4] *idem*

[5] *idem*

[6] *idem*

depression. During this depression, silver may well take on a monetary role, since the price of gold might take that metal out of reach of many people. I think only the precious metals work – again because of the stock market debacle that I see occurring. We know that investing in precious metals worked in the '30s. People were pushing their money into gold stocks because they wanted to be in gold in any shape or form."

In short, one of the leading market economist students of economic history viewed through the Kondratieff prison shares my views that:

1) Asset prices in general have been massively inflated by the huge debt bubble that has been created
2) This debt bubble and its associated mal-investment are a drag on real economic activity
3) The ever widening gap between economic reality and asset prices can only be bridged by ever-greater policy responses
4) Despite acting in concert in an unconstrained way during the first fiat currency global economic winter, policy-makers will ultimately run out of road
5) Because of the unprecedented scale and scope of this experiment, history can't really guide us as to when that will be
6) But we should suspect that it will be an extremely serious economic and financial event
7) It could well exhibit its most serious manifestation in China.
8) Gold may well be one of the better ways to insure against this but government responses to gold will dictate how effective it is and the best form in which to hold gold.
9) The Euro won't survive the next Kondratieff Winter

These points have really been MBMG Investment Advisory's mantra for quite some time and I think the real questions here are just how serious the ultimate event might be and what investors can do in the meantime. I believe that, so far, MBMG Investment Advisory has provided clear answers to these questions and intends to continue doing so.

For further information, please contact us by e-mail on info@mbmg-investment.com or call +66 2 665 2536.

Disclaimers:

1. While every effort has been made to ensure that the information contained herein is correct, MBMG Investment Advisory cannot be held responsible for any errors that may occur. The views of the contributors may not necessarily reflect the house view of MBMG Investment Advisory. Views and opinions expressed herein may change with market conditions and should not be used in isolation.

2. Please ensure you understand the nature of the products, return conditions and risks before making any investment decision.

3. An investment is not a deposit, it carries investment risk. Investors are encouraged to make an investment only when investing in such an asset corresponds with their own objectives and only after they have acknowledge all risks and have been informed that the return may be more or less than the initial sum.