



## PRESERVING WEALTH

*"I'm not so much interested in the return on my money as I am the return of my capital." --Will Rogers*

Driven by low interest rates and easy credit, businesses and consumers have been taking on excessive leverage and ignoring downside risk. That same leverage is now being unwound and financial asset prices are falling dramatically. In this extraordinary environment, preserving your personal wealth becomes priority one. Or, in other words, return **of** capital and not return **on** capital is becoming priority one.

There are 3 key courses of action available to those who wish to safeguard their portfolios from further damage. The 1st is to bolster portfolio diversification *beyond* stocks, bonds and cash (the three traditional asset classes). The 2nd is to understand the *true* size and cost of inflation and fully hedge against it. And the 3rd is to recognize where we are in the *investment* cycle so as to take advantage of a generational opportunity. Let's examine these three keys in more detail.

### **KEY 1: TRUE DIVERSIFICATION**

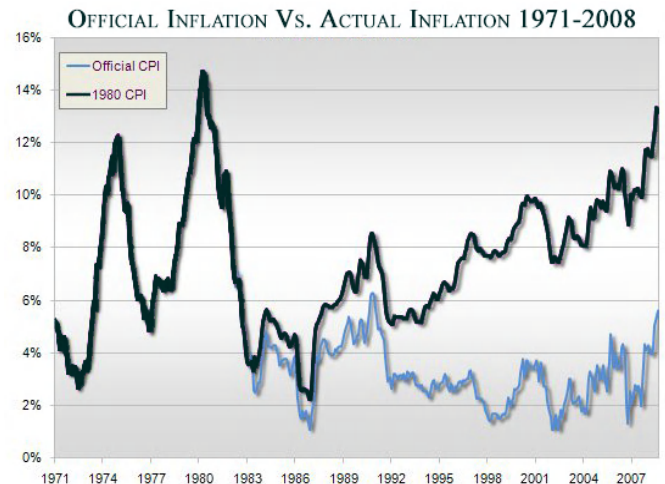
If you're like most investors, you know your portfolio should be fully diversified. But it is hazardous to your wealth to include only stocks, bonds and cash. Cash may seem to be a safe haven but it won't protect against rising inflation, and as we have seen with money market funds, it can actually lose money in nominal and real terms. Adding bonds to your portfolio does not provide true diversification because according to Ibbotson Associates, a leading authority on asset allocation, stocks and bonds have been *positively* correlated since 1969. Why is this so? Because today's sophisticated financial markets are,

for all intents and purposes, globally integrated.

Modern portfolio theory tells us that having the right mix of *uncorrelated* assets reduces risk and improves return. Yet few investors take advantage of all the available asset classes, and fewer still realize that **Gold and Silver are the most negatively correlated asset class to stocks and bonds**. That's why truly diversified portfolios should always include the additional class of HARD ASSETS in the form of Gold, Silver, Real Estate, and Colored Diamonds. Key 3 will discuss what allocations to use.

### **KEY 2: TRUE INFLATION**

Inflation has always been an important element in financial planning, but now it is moving to centre stage. The Consumer Price Index (CPI), the most common measure of inflation, has risen to an official startling 5.6%. But many experts, including Bill Gross, manager of PIMCO, the world's largest bond fund, say America's CPI understates true inflation.



Today's CPI is calculated using a complex re-weighting formula that is riddled with substitutions, exclusions, hedonic adjustments and geometric weighting. If we were to recreate the CPI using the original 1980s formula, we would discover that inflation is running above 13%. The above figure shows economist John Williams of *Shadow Government Statistics*, data of Official CPI vs. 1980

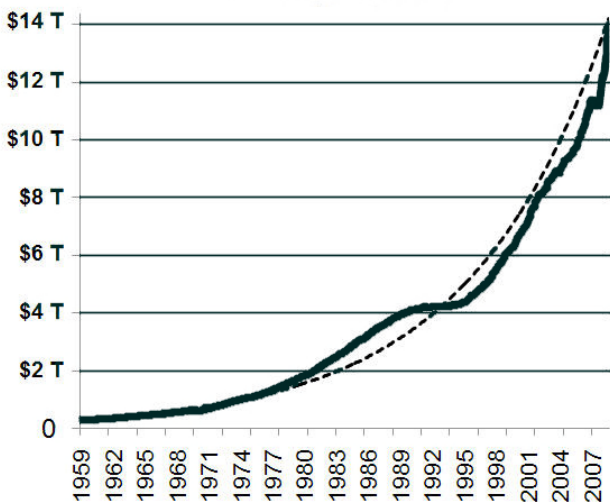
CPI. For more information on this visit [www.shadowstats.com](http://www.shadowstats.com). In Canada, there is a similar understatement of inflation.

Intelligent investment decisions can't be made without knowing if we are in a high or low inflation environment. In a 5% inflation environment, bonds paying 5% won't lose money to inflation. But what if real inflation is running closer to 13%, as many experts think? Then that 5% return bond is a guaranteed 8% loss. In recent years, the money supply issued by central banks globally has been growing at an alarming rate.

Most people think of inflation as a rise in the price of goods and services but in actuality price rises are the effect, not the cause, of inflation. The increase of the amount of currency in circulation is the cause of inflation. The Money Supply chart above shows how the US money supply has increased from 777 billion in 1971, when the US dollar was taken off the Gold standard, to today when the M3 money supply is now \$13.7 trillion – an over 17 fold increase. Nobel prize-winning economist Milton Friedman said that “inflation is always and everywhere a monetary phenomenon.”

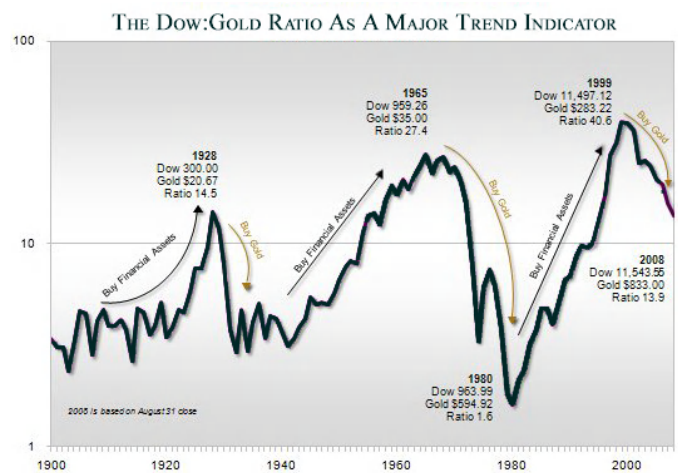
**US money supply has increased from 777 billion in 1971 to 13.7 trillion-Over a 17 fold increase!**

US MONEY SUPPLY 1959-2008



### KEY 3: THE INVESTMENT CYCLE

A good way to understand the investment cycle is to look at what is called the Dow:Gold ratio. The Dow:Gold ratio (shown in the chart below) calculates the number of ounces of Physical Gold bullion it would take to ‘purchase’ one share of the Dow Jones during any given time period. When the ratio rises, as it did in the 1920s, 1960s and 1990s, it tells us that portfolios should be overweight stocks. When the ratio slumps, as it did in the 1970s and today, it tells us that portfolios should be overweight Precious Metals.



The three major stock market bubbles ended with the Dow:Gold ratio above 18:1, while the two major bear markets in 1933 and 1980 ended with the ratio at 1:1. At the height of the equities bull market in 1999, the Dow:Gold ratio peaked at nearly 40:1.

As of December, 2008 the Dow:Gold ratio is approximately 10:1 and falling. This means that now is the time to increase your portfolio allocation to Gold and other Precious Metals. The current trend favouring hard assets such as Gold, Silver and Colored Diamonds is expected to last another 10-12 years.

## ***CONCLUSION***

Deleveraging is devastating the financial markets right now, and unfortunately it is likely to get much worse. For example, a financial institution with a net worth of \$30 billion and assets of \$600 billion can become insolvent if the value of its assets fall by only 5%. Without doubt, these are extraordinary times. Today, preserving wealth should be priority one and to accomplish this you should:

- 1) Bolster your portfolio by adding other asset classes, especially ***Hard Assets***, like ***Gold, Silver*** and ***Coloured Diamonds***
- 2) Understand and hedge against ***True Inflation***
- 3) Recognize where we are in the ***Investment Cycle***

Hard Assets such as Physical Gold, Silver and Coloured Diamonds preserve your wealth in both deflationary and inflationary cycles and remain the only asset class that protect wealth from a systemic financial crisis. As an example a modest allocation of 10% to 20% and slightly higher if you are including a Coloured Diamond, into Gold and Silver not only diversifies, but adds assets that keep their value because they are unaffected by the explosive growth of continually depreciating printed money from the world's central banks. Finally, the investment cycle, as indicated by the Dow:Gold ratio, is telling us to be overweight Precious Metals because true inflation is not only rising, but is substantially higher than officially reported numbers suggest.