Supernovae, Market Manipulation & Other Crises

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November, 2014—Who can say that autumn in Appalachia is not magnificent? This is my favorite time of the year, and it always makes me wish I could just park the earth here in the sweetest part of its orbit. It's all about our relation to the sun—not too close, not too far. I've always been fascinated by the celestial interplay of our solar system, and indeed that of the whole universe.

The falling of leaves and the changing of the seasons reminds me of the universal cycle of birth, life, death, and rebirth. Even our sun, the small to medium-sized star on which our very lives depend, is a third generation star. It was born from an immense gaseous cloud of what had been an explosion of an earlier star, itself reborn from an even earlier star.

The death of stars is something special, and the mass of a star during its life will dictate its death, which can be spectacular to truly inconceivable. A star is essentially a struggle between nuclear fusion pushing outwards and the forces of gravity pushing inwards. When the fusionable material is finally exhausted, gravity will eventually win. It always does. And this is when the mass of the star chooses its destiny.

"Ordinary" stars like our sun will sort of hemorrhage toward the end and then fizzle out into what's called a "white dwarf." "Super massive" stars, greater than 260 times our sun, will completely collapse upon their own weight, and rip the very fabric of space-time, becoming super-massive black holes. Scientists now believe there is one of these massive beasts at the center of every galaxy. And our solar system, two-thirds out on a spiral arm, is just being tugged along its immense gravitational spin.[1]

"What does any of this have to do with anything at all related to my investments or the economy?"

Great question. But please bear with me, as the answer lies in another type of stellar death that occurs when stars aren't too small or too large, but just right. The Goldilocks star.

These stars go supernova. Which means that once they begin to collapse from their own weight, molecules are fused together to create completely new elements—heavier and heavier—until eventually iron emerges. Once this stage is reached, mere moments elapse before an explosion—the likes of which you can't imagine—spews pure energy, light, gas, and dust for light years in every direction.

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[1] Gsfc.nasa.gov. National Aeronautics and Space Administration.

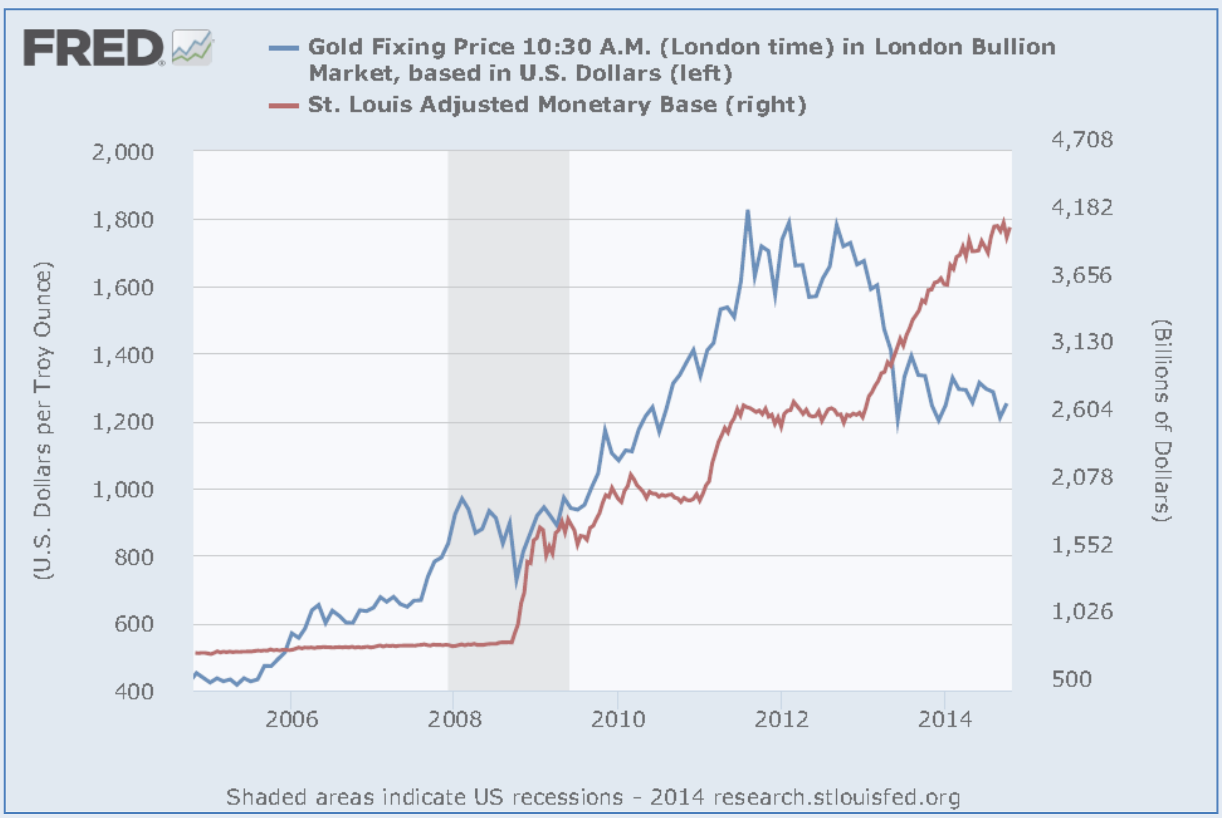
During this massive explosion, with pressures too immense to properly measure, the remnants of the star's iron are produced. Slammed together at nearly the speed of light, the shards of iron produce all of the universe's heavy (and sometimes radioactive) elements—lead, mercury, even uranium.

But this intergalactic explosion also produces something else. Something heavier than iron, but not radioactive: gold, silver, and platinum. The precious metals group.

And so there, in the death throes of a 4 billion year old star—not too big, not too small—is where silver and gold are created. Something special for sure, and not easily duplicated. This is the main reason gold and silver have historically been a preferred form of storing wealth.

This history was certainly known to our nation's Founders, who had witnessed many paper currencies devalue to nothing, as the phrase "ain't worth a continental" can attest. In fact, Article I, section 10 of the U.S. Constitution provides that "*[No State shall] make any Thing but gold and silver Coin a Tender in Payment of Debts;*" Unfortunately, this rule has been interpreted to include all of the states but not the federal government itself.

Gold is therefore one of the chief indicators the Federal Reserve (and everyone else) monitors to gauge the current level of inflation. The following chart compares the price of gold (in dollars per ounce) to our monetary base. Note that they tracked along more or less in tandem. But then on Wednesday, October 3, 2012 gold prices started to tumble. And three months later, on January 4, 2013, the Fed started pumping more money into the economy. Which is to say, creating it from nothing.



Finally, the price of gold and the monetary base crossed over on Friday, May 24, 2013. It has remained upside down ever since.

Theories abound as to the true cause of this price anomaly, but most agree that "something is rotten in the state of Denmark." A dramatic price drop in gold as we've seen would seemingly indicate a likewise dramatic decrease in gold demand. But the opposite seems to be the case. In fact, China's net imports of gold in 2013 were about 1,160 tons, double the amount they imported in 2012.[1] That's over 37 million ounces. And this is *in addition to* all the gold that China refines domestically, which is unreported and unverifiable.

In any event, the sharp drop in the price of gold after October 3, 2013 runs counter to the historical trend of increasing prices as the money base is expanded. Something doesn't add up.

Perhaps what has been going on in the silver market can help us understand what may be going on in the gold market. The silver market is more transparent because it is much more thinly traded, and more difficult and less affordable to transport globally, or even domestically.[1]

But like many commodities, one does not need to buy or sell the actual silver to profit from its price movement. There is an entire industry betting on the future price of many commodities like gold and silver, wheat, orange juice and even bacon.

A futures option "call" allows the buyer to pre-choose a maximum price at which she may buy, and likewise an option "put" allows the buyer to pre-choose a minimum price at which she may sell. Of course, on the other side there is the seller of the option, who must honor his side of the contract, to buy or sell when the option holder's price is reached. Futures options contracts can seem confusing because you're buying and selling the right and obligation to buy and sell, at some point in the future.

Even more confusing is the ability to "sell short." That is, to sell something *now* that you don't actually own—yet. Let's say I sell 100 tons of wheat at $500 per ton to be delivered in 1 year. I've already sold the wheat, but I don't actually have it. In fact no one does, it hasn't even been sown, much less reaped. Next year when the wheat is due, I'm hoping the wheat will be selling for less than $500 per ton, say $400. In this way I have made a profit by selling at a higher price something which I can later substitute for a lesser price.

This is similar to what has been going on with silver. Someone, or perhaps several "someones," has been selling silver short in massive quantities using these paper contracts. Meaning, they have been selling contracts representing physical silver that they don't own, and that doesn't even necessarily exist. And they haven't been selling just a little, but nearly 172,000 contracts, each contract representing 5,000 ounces of silver bullion. So that's over 860 million ounces being traded when only 60 million ounces are actually registered and available for delivery.[1] The system works because very few contracts are ever actually "filled" or delivered. Most are closed out or expire worthless.

To this author, the manipulation of silver (and gold) is so blatantly obvious it would be comical except that *any* manipulation, real or even perceived, undermines the credibility of the futures marketplace, and indeed the entire financial infrastructure.

But manipulation cannot go on forever, and sooner or later these short contracts will unwind, and the price of gold and silver will "correct" against the ever-devaluing dollar, with little to no advance notice.

Movements in the dollar vis-à-vis other currencies is an illusory indicator of the "true" value of the dollar in the sense that it does not establish a true base line, as all major currencies are devaluing simultaneously, so any movement is merely *relative*. Only gold and silver are finite in their supply, having been born in the death throes of a Goldilocks supernova somewhere in a galaxy not too far, far away.

Magellan Planning Group is well-known for adhering to the Austrian School of Economics, which is best represented by the Mises Institute, a non-profit economic think tank named after the patriarch of the school, Ludwig von Mises.[2] The Austrians believe in sound money, backed by gold and silver, and not the "funny money" that is so easily manufactured by those who have the exclusive license to do so.

But this is the economy in which we find ourselves, the economy in which we grew up. Not just domestically, but globally. We can be Austrians and believe in the value of a hard currency, but this is not what's accepted at McDonald's, or the IRS, or available in our 401k. And so, we have to play the Keynesian, fiat game with the resources that are available to us. Which is to say, what do we do with our dollars?

Some Austrian school proponents would recommend dumping all dollars for the physical stuff, or to invest everything in stocks and funds that are based on commodities. We do not subscribe to either of these drastic plans of action. In fact, there may be plenty of life left in our Keynesian economy after all, so there is no need to take any drastic action anytime soon.

So with the price of gold and silver being so low, is it wise to hold onto it? Should we sell it, take our lumps and move on? On the contrary, what I see is a buyer's market. If silver and gold prices truly are being held artificially low, would you not expect the manipulators to be buying?

When buying gold or silver, don't pay a numismatic value ("collector" prices)—only pay the value of the raw bullion. I would recommend buying some "junk silver", which is pre-1965 US minted dimes, quarters, and half-dollars. These coins certainly aren't "junk", but have a silver content of "only" 90%. They are usually available on-line or from bullion dealers.

So what about ISIL? Or Ukraine? Or Ebola? Or Syria? Or Gaza? Or Iran? Or _(insert crisis here)_?

With apologies to CNN and FOX, these events are indeed sensational, but temporary and largely immaterial to the long term trends of the financial markets. Take a look at the chart on the next page—the S&P 500 since 2010. How many downward turns can you count? And yet, overall, where do we find ourselves?

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[2] I hope you will visit their site at www.mises.org.

Our preeminent Austrian professors tell us that a market crash follows a market boom because monetary and credit expansion eventually either devalues to nothing as in the case of the Weimar Republic or reverses and collapses as in the case of the Great Depression and the Great Recession of 2008.

As of now, neither of these scenarios seems imminent, though one or the other seems eventually probable. In the meantime, we will have to contend with increased volatility as ever larger international pools of money enter and leave the market, often driven by geopolitical events, and sometimes exacerbated by high speed trading.

Though less publicized, there is always some good news that comes along with the bad. Oil prices have dropped significantly recently and this will certainly be felt in next quarter's earnings reports for many U.S. companies. You may have already felt some relief yourself at the gas pump.

In addition, sharp price drops in emerging markets have created investing opportunities abroad. And a new asset class has emerged on the scene: "frontier markets," such as Morocco, Kazakhstan, Nigeria, and Oman. We hope to soon include this exciting asset class into some of our portfolios.

Certainly, some geopolitical risks are greater than others, and in our estimation the situation in Hong Kong merits close monitoring. China now plays such a large part of the global economy that a large scale disturbance there may cause a significant global financial crisis. Ironically, westerners who have been calling for revolution in the Communist country are now wondering what they are really wishing for. It seems that our tolerance for communist trade partners has never been higher.

With the entire world so economically interconnected, surely we will always feel disturbances here to crises elsewhere. But again, our Austrian economists remind us that throughout history, overall growth trends have continued as monetary expansion has continued. And with more than $9 trillion still languishing in cash, waiting to be invested, there is no sign of the situation reversing any time soon.

About J. Kevin Meaders

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Kevin Meaders graduated from Oglethorpe University in Atlanta with a double B.A. in Philosophy and Political Science, and then obtained a law degree from Georgia State University College of Law, focusing on estate planning and trust law. He has earned the designations of Certified Financial Planner (CFP®), Chartered Financial Consultant (ChFC) and Chartered Life Underwriter (CLU). He holds a General Securities Principal and Registered Representative registration and Investment Advisor Representative registration through Voya Financial Advisors (member SIPC).

About Magellan Planning Group

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Magellan Planning Group was established in 2000 to provide a service uniquely tailored to the needs of our affluent Atlanta community. We concentrate on *personalized* retirement planning through tri-disciplinary coordination:

- Financial planning with our Certified Financial Planner™ to prepare a retirement plan that takes into account your needs and expectations. We are a fee only asset management firm.
- Estate planning with our in-house Attorney-at-Law to determine and prepare the documents needed to minimize family liability and maximize privacy. (www.magellanlegal.com)
- Tax planning through a relationship with our in-house CPA to manage tax obligations throughout the year and prepare a tax return that takes into account current tax laws. (www.magellantax.com)

Our relationship doesn't begin and end with the preparation of a plan and the appropriate documents. We establish close personal relationships with our clients and their families and maintain those relationships through regular 'check-ups', market commentaries and educational Lunch & Learns.

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