Cosmic Shifts

The series of recent Japanese tragedies is unprecedented and the consequences will also be unprecedented. The re-booting and rebuilding of the Japanese economy will require, and be achieved with, breathtaking increases in money supply. The global drift towards hyper-inflation will accelerate. Right or wrong, the world's nuclear industry has received a ten year setback. The fact that the earthquake actually caused a terrestrial shift in the location of the country by a few metres is very thought-provoking. And the noteworthy courtesy and industry, not to mention stoicism, of the Japanese people are remarkable. In time it's hard not to see them emerging the stronger as a result of these tragedies.

The Japanese situation has eclipsed other major developments. First, the further deterioration of the Eurozone. The downgrades and the relentless misrepresentations by Eurocrats that they are working on a "solution" are a joke. There can be no conventional solution – too many countries and too many banks are too broke. As some wag put it: there are not enough fish in the sea for Portugal to catch to pay down the debt. The only solution is the printing press.

Second, the winds of change in the Muslim world from Morocco to Pakistan. There are a lot of cross-currents; the quest for democracy and a better life are high on the list. Also, there is a redefinition of the military/civilian relationship. The biggest issue, however, will probably be the on-again, off-again battle between Sunni and Shia Muslims to win minds and influence people. The Gulf states are mostly Sunni controlling Shia, while Iran (Muslim but Aryan, not Arab) is Shia. Now, after shock and awe, Shia control Iraq. Afganistan and Pakistan, both train wrecks, are Muslim, mostly Sunni and mostly Aryan. The entire region looks like a Molotov cocktail.

Third, the mess in Ivory Coast is a serious mess, throwing a spike into both the economy and the concept of democracy. Will it be contagious? Some West African countries are Muslim and nearly all of them have Muslim populations in their northern regions. If the desire for a greater role in government spreads south across the Sahara from North Africa to West Africa, the Ivory Coast situation could appear tame.

Finally to Wisconsin and the public sector labour unrest. Is it/was it a harbinger? Harper's magazine recently had a long piece on tent cities in California, all reminiscent of Steinbeck's great novels. Frustration is no longer limited to the third world.

With the exception of Japan, what all these situations have in common is the sense amongst populations that, somehow, governments (at least what in their view are the "right" governments) can provide them with more. More this, more that. In many places the social media has whipped up expectations and aspirations, but the problem is that governments are generally unable to deliver. Nor will this change – the shifting of deck chairs in the above and other areas appears set to be part of the landscape for years to come. And now it's pretty clear that politics as well as economic forces are affecting oil prices, cocoa prices and God knows what else.

Society in general has a great craving for normalcy, for a return to earlier times when, for most, life seemed easier, better and more predictable. Times when markets moved up and down with good and bad news. But even before the sea changes mentioned above, oil was not going back to $70 and copper was not going back to $2½. The convulsions just hammer home the point. The other day on some business news broadcast a presenter innocently asked "How can the market be up in the face of all this bad news?" Well, the market is telling us, screaming at us, that the old order is gone and the new order is in. And the new order is that, the worse the news, the more certain it is that they will all print. Japan has good reason to print, but $600 billion (that's equal to four years' mine production of gold) in the first week after the tragedy is heavy duty stuff.

For reasons unknown to us the tumultuous events have been accompanied with a slight diminution of speculation. Perhaps it's this craving for normalcy. Silver hit $37 in what might turn into an old-fashioned corner and nobody cares. Interest in gold is down as well. Even though the price is knocking at an all-time high, ounces in the big gold ETF (a good measure of speculation) are down about 10% ($5 or $6 billion).

Speculation in junior gold shares is down as well. Not only is "the big move" not yet upon us, but lots of gold shares are dull because 2010 numbers are not meeting promoters' forecasts. The market is learning that it is a lot more difficult to produce gold than to say you are going to produce gold. And profits are somewhat ephemeral, even with the funny accounting some companies use. This is not surprising. Sure the gold price is up, but the exchange rate for Canada and many other producing countries is way up and fuel and labour costs are up 30% over the past few years. The hard reality is that, after years of Central Bank selling (suppression), cost inflation is now a serious problem and the gold mining industry is still in poor shape. As we have said before, gold royalty companies are a pretty safe way to play the group. No worry about fuel or labour costs, just hike over to the bank to deposit the royalty cheques.

It's hard to believe, but the real move into gold has yet to begin. The metal is still seen as a speculation, a region to enter only with an eye on the exit. The day when the majority of investors see gold as a core holding, as a sober one decision investment, is some distance away. But when it comes, investors will realize gold is scarce, tough to produce and its centuries-old reputation as a store of value is fully justified. The big capital gains will take place between now and that time.

Inflation will be the bigger story, though. The Western powers are trying to redress public sector excess by forcing austerity, but historically these situations are resolved by inflating the private sector. During Weimar, Krupp's steelworkers' wages kept up with inflation because Krupp had pricing power, but public sector people starved. Above all, Japan, the US, Euroland and China are locked into highly inflationary policies from which there is no escape. As this dawns on the investment community there will be cosmic shifts in attitudes.

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