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MELLON ON THE MARKETS

By Jim Mellon

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I was going to write this piece in Brussels, but decided against going – and so I write from Hamburg. The incompetence of the Belgian police makes it difficult to feel safe in the city of waffles and Eurocrats, so I will defer visiting for a bit.

When I made my decision not to go, it struck me that lots of others will be feeling the same; wary of Brussels, Paris, maybe even German cities. Surely this just adds more gravitational pressure to the downward trajectory of European “growth”?

The ECB‘s latest ruse to counteract the appalling economic malaise – one of its own creation – is to PAY banks to lend, to increase the amount of bond buying, and to widen buying of bonds to some corporate issuers as well.

Will the next step be to deliver so called “helicopter” money to the European economy? This basically means that the Central Bank would finance national treasuries by delivering newly created money to National Central Banks, without adding corresponding assets to its own balance sheet. This would be a crazy move – and one that would be highly resisted by the Bundesbank – and if badly done, or overused, would certainly lead to high inflation in due course.

But, of course, these are desperate times for the Euro Zone. Sure, Hamburg appears prosperous – although it was evident that a lot of migrants are hanging around the railway station with little to do.

But Hamburg isn’t Athens, or Rome, or Lisbon, where times are as tough as they have ever been. And it isn’t Paris, which on successive visits looks shabbier and shabbier compared to London.

The ECB is trying to counteract the zero productivity growth of its enslaved territories, the persistent and pernicious unemployment, and the excess savings which represent an unwillingness to invest by pursuing what are, in my opinion, the wrong policies.

A modicum of QE was appropriate at the depth of the Financial Crisis; but today QE has more limited effects, and as above, helicopter money could just turn the whole of the Euro Zone into a type of Zimbabwe or Weimar republic.

In what is now a *stagnation* crisis, the most important thing is to fix the banks – and that probably means recapitalising them with state or Euro funds. Euro Zone banks, in many cases, have high non-performing loans, inadequate capital, and even when bribed or cajoled into lending, can't find enough borrowers of quality to lend to.

The sectors that are best performing from a return point of view are generally unproductive, like real estate, or share prices buoyed by buybacks. This is because money is going to wherever there is a positive yield, without sufficient discrimination. Zombie companies are being kept afloat, while across the whole continent good companies are unwilling to invest in new capital equipment because the returns on that equipment are just not compelling when external and domestic demand is so weak.

In those circumstances, the ECB should be focussing on delivering substantial capital to the banks and encouraging the immediate recognition of non-performing assets. At the same time it should *raise* interest rates, certainly above the zero bound, because without a proper cost of money, and *especially* with a negative cost, the wrong economic decisions are made. In those circumstances, even a Japan type slump lasting over more than twenty years would appear to me to be a good outcome.

But of course, the response of the arch Federalists at the ECB and the EU generally is to use a self-generated crisis to advocate ever closer union. But the European Union isn't Japan or the US; it has no common language, highly divergent levels of income, and stridently different national priorities. Herding fish into a common purpose just won't happen.

So in the meantime, the Euro Zone plods along, inching ever closer to its next and major crisis. I would imagine that the Euro itself will remain range bound, because Europe isn't the only place on earth that wants to lower its currency; it isn't the only place that has imposed negative rates to try and stimulate demand and inflation; and it isn't the only place that is trying to export its deflation.

More on all that at the Master Investor Show on April 23rd.

But in the meantime, what do we do? Well, as I keep on saying, shorting negative yield bonds (Bunds, Swiss and JGBs) is the best trade I have ever seen. If that's not possible for some investors, look at the other side of the trade. Gold and silver are moving up – and this is just the beginning.

If you impose negative interest rates on cash (i.e. tax it) you do two things: one, people look at hoarding money at home; and two, they look to genuine stores of value (gold is no longer the Barbarous Relic of John Maynard Keynes!).

And because ultimately the central banks will get what they want – inflation! (and probably not in a good way) – gold and silver will rise to reflect this.

I am always a bit wary of gold, because I prefer to invest in things that are not static, but on this occasion I am very bullish indeed.

I think you buy gold and silver outright, or look for a good play. **Fresnillo (LON:FRES)** in silver and a big gold play like **Franco Nevada (TSX:FNV)** or **Barrick (TSX:ABX)**. There are smaller ones out there too, and I will talk about them at Master Investor.

Among markets, I am still most bullish on Japan; the yen will most likely be range bound, but the total aggression of the Bank of Japan in flattening the whole yield curve in negative territory will drive people to a yield based stock market strategy. I will have specific recommendations at the Show.

I also like some beaten up biotech stuff, including **Medivation (NASDAQ:MDVN)** and **Gilead (NASDAQ:GILD)**.

I hope to see you at the Show. We are closing at 10,000 delegates and every stand is sold. I imagine it is by far the biggest investment show in Europe. It's a great place to get ideas.

Happy Hunting!!

Jim Mellon

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