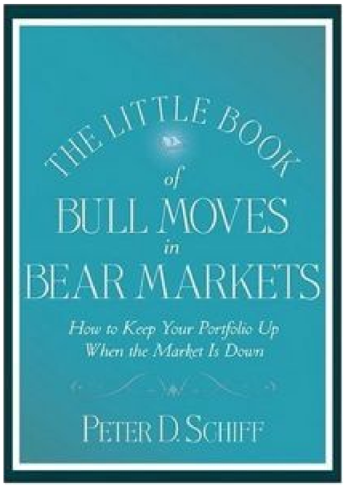

Book The Little Book of Bull Moves in Bear Markets

How to Keep Your Portfolio Up When the Market is Down

Peter D. Schiff
Wiley, 2008

Recommendation

Author Peter D. Schiff explains how he positioned his clients when he saw the current bear market coming, and warns you about what he sees as the imminent collapse of the U.S. dollar and the U.S. economy. He recommends that readers get their money out of the U.S. market, invest abroad, and even consider emigrating altogether and opening a business in a BRIC country (Brazil, Russia, India and China). Schiff elaborates on the risk of living in an American city “with an inner-city population.” This short book full of breathlessly long sentences explains Schiff’s end-of-life-as-we-know-it investment philosophy, including why he thinks that playing the commodities markets by investing in futures is safer and sounder than trusting the U.S. government and financial structure. *BooksInShort* recommends his book to readers who want to hear every point of view about the U.S. economy, including the very worst-case scenario. And even if the worst is occurring, says Schiff, you still have some investment options.

Take-Aways

- The U.S. economy is in terrible shape and the dollar is going to collapse.
- The government is deceiving the people, inflating the currency and weakening the country.
- America’s current economic plight is comparable to the Great Depression.
- Commodity futures trading may be the best hope for individual investors.
- Gold and silver both have promise for investors.
- Another strategy is to buy foreign stocks, but only from a trusted broker.
- The greatest returns go to those who take the greatest risks, so take a chance on investing directly in emerging markets.
- Certain industries will still prosper.
- Get trained to work in those sectors; for example, learn a foreign language.
- The U.S. economy is a dangerous place right now, but in the very long term, you’ll see a light at the end of the tunnel.

Summary

Bad News

The U.S. economy is falling apart. This is no mere cyclical downturn. This is the big one! Americans have loaded up on debt, spent beyond their means and lolled about in a fantasy world of imaginary wealth. Their government has betrayed them, especially the Federal Reserve. Now they must face the music. It won’t be pretty.

> “Skyrocketing gasoline and food prices, and plummeting home sales are...early symptoms of fundamental economic problems.”

In the 1950s, the U.S. was an exporting nation with a positive trade balance. The manufacturing sector was healthy. Consumers were buying and the U.S. had real economic growth. The dollar was as good as gold. Alas, look at it now! The trade deficit is a sea of red ink. America imports far more than it exports and is the world’s biggest debtor. What happened? America stopped working hard, saving and facing facts. America became an unemployed playboy living on the tab. Well, one difference separates America and a playboy. America can print its own money. But the money it prints is worth less and less. The subprime crisis, the consumer credit meltdown, the airline industry’s trials – all are symptoms of America’s economic woes.

> "[These problems] are too advanced to be reversible and grave enough to profoundly impact the living standards of most Americans for years."

The government is fighting recession with economic stimulus packages, which means printing more money. In fact, it is just creating inflation. Until Americans get back to the economic basics of working, saving and creating real wealth, the nation will be a bad place to invest. Desperate times call for desperate measures. Only the bold can hope to make money. You can't trust the government or the Federal Reserve. The dollar is doomed, and if you leave your assets in dollar-denominated investments – you'll be doomed, too. Get your money out of the U.S., and invest in a money market fund denominated in a nondollar currency or invest in foreign stocks. Sell your American bonds. Interest rates are low, so bond prices are unreasonably high.

> "The outlook for the American stock market has never looked grimmer, as deepening recession accompanied by higher interest rates and rising raw material costs depresses corporate earnings."

The American equity market has the worst prospects ever. As the recession worsens, interest rates and raw material prices are going up, and corporate earnings are going down. Inflation is destroying the value of the dollar. Even people with paychecks are able to buy less with them. The recession could very easily topple into a full-fledged depression, like the Great Depression of the 1930s. During the Great Depression, all but three Dow Jones industrial stocks fell. The exceptions were food and tobacco firms, which might now pose prudent investments.

> "The concept of demand destruction domestically and demand creation elsewhere, while causing domestic consumer prices to rise to levels that will force malls and big-box retailers to shut down, will actually bring prices down in other cases."

Will customers benefit from falling prices? Not likely. The government is doing its best to keep prices up by printing currency. Americans have been borrowing to close the gap between what they earned and what they spent. Now that the credit providers are not supplying as much credit anymore, many companies will have to reduce capacity or slash prices. However, growth in the money supply is feeding inflation, keeping prices up. This period has much in common with the stagflation of the 1970s, an era that united runaway inflation and economic stagnation.

How Bad Is Inflation?

Inflation is an enormous threat to U.S. investors. Although the government is pumping up the money supply, it won't tell you how bad inflation really is because it doesn't want you to get too upset. To get a better idea of the real course of inflation, look at the changes in gold pricing instead of reading the newspapers and following government statistics.

> "I'd reinvest any cash you don't need for walking-around money in a nondollar money market fund or foreign equity portfolio."

In addition to the inflationary pressure created by expansion of the money supply by American authorities, non-U.S. interests who hold dollars could also provoke inflation. A number of foreign countries have accumulated large dollar reserves. What will they do with those dollars? Some will buy American companies and, thus, inject more dollars into the U.S. economy. However, when the money supply increases, so do prices. When foreigners buy American companies, they not only increase inflation in America, they also capture the wealth of those companies, and the power that wealth brings.

> "Unload bonds (and TIPS) right now, while rates are still artificially low and prices artificially high."

The Federal Reserve is in a tough spot. On one hand, it can stimulate the economy by expanding the money supply and risk inflation. Or, it can address inflation by raising interest rates to protect the value of the dollar, which would worsen the downturn.

Productivity statistics don't seem to reflect the fact that America is producing less and unemployment is rising. Economists exaggerate gains in productivity by using "hedonics." If a computer is 10 times as powerful as the previous model, economists consider the manufacturer 10 times more productive. Unemployment statistics are similarly misleading – they exclude the long-term unemployed who have stopped looking.

Wall Street Hustlers

The term "Wall Street" includes all traditional fiduciary institutions, such as brokerages, mutual fund companies and investment banks, as well as hedge funds. Investment banks have a serious conflict of interest. They underwrite stocks for corporate customers, which means buying stock for the corporation and selling it in the market. But, they also offer an advisory service to investors. In fact, they have an incentive to defraud investors by selling stocks that don't deserve to be bought. Mutual funds aren't much better. Active fund managers reap rewards for outperforming other active managers, quarter to quarter. Thus, they take risks that are inappropriate for a long-term investor.

> "If foreign holders use their dollars to buy American companies...earning streams vital to the American economy are diverted to foreign owners, as is the political influence they represent."

Hedge funds are so secretive that no one really knows how much they have and what they are doing with it. Hedge fund managers get paid well even when investors lose money. Like mutual fund managers, hedge fund managers have an incentive to take big risks.

Investors in search of good information about industries often rely on statistics compiled by – guess who? – companies in that industry! Assuming that industry statistics are objective and unbiased is probably naïve. Yet, a reporter doing a piece on real estate still will ask people in the industry for expert opinions. Is it any surprise they say, "Now is the time to buy"? Be skeptical.

Go for Gold, Commodity Futures and Foreign Stocks

Commodities, which are now a bull market, are a great way to protect your portfolio against runaway inflation. Usually, commodities move inversely to the stock and bond markets. So a fall in the stock market means a rise in the commodities market. Creating commodities is not as easy as printing money. When commodity prices fall, producers cut back on capacity. Building capacity again takes a long time, so when the economy begins to move up, commodities will be in short supply and the prices will rise. With India and China on the rise, demand for commodities will see unprecedented growth. Six strategies can make money in commodities: three for skilled investors and three for regular investors. Skilled investors might consider:

- **"Nondiscretionary individual account"** – You make all the decisions.
- **"Discretionary individual account"** – Also called a "managed account," this approach puts all the decisions in the hands of a professional manager.
- **"Commodity pool"** – A manager combines several investors' accounts. This approach provides greater diversity and limits your potential losses to the amount you invested. (In the previous two approaches, investors can lose more than they invested.)

> "Low commodity prices cause overutilization of resources and underinvestment in capacity, resulting in low supply relative to demand – and...in opportunity for investors."

The approaches for less skilled investors are:

- **"Commodity Index Funds"** – These low-risk, economical funds, which are easily available as exchange-traded funds (ETF) or exchange-traded notes, try to mimic the returns of a commodities index.
- **Buying stock in commodity firms** – Investors can play the commodity market by buying stock in commodity producers and other companies with exposure to the commodities industry, such as oil service companies.
- **Buying stocks in countries rich in commodities –** You shop offshore for stock and buy on other nation's stock exchanges.

Precious Metals

Gold and silver are particularly interesting commodities. When former Federal Reserve Chairman Paul Volcker restored soundness to the dollar, the world presumed that inflation was dead. Alan Greenspan, the next Fed chairman, opened the money spigot. Inflation returned and, in 2000, people noticed. Gold jumped to $1000 an ounce. A bull market in gold is coming.

> "The secret is buying a combination of value and high dividends in developed foreign economies enjoying strong growth."

Silver also looks very attractive. It has many industrial uses, and consumption exceeds production; the supply is falling while the demand is not. Silver could do even better than gold – but the downside also is potentially greater. To invest in these metals, among other tactics, you could buy bullion, use the Perth Mint (a bullion storage entity backed by the Western Australian government), buy ETFs or exchange-traded notes, trade futures contracts, or buy stock in production companies, such as mining firms.

> "I strongly prefer conservative, dividend-paying foreign stocks to foreign bonds, because inflation prevails in all countries using fiat money and stocks offer inflation protection."

Investing in foreign stocks also can protect your assets from the collapse of the American markets and currency. Some people think that if the U.S. economy collapses, it will take the whole world with it. This ignores the fact that America depends on Asia, which has provided the debt financing that has supported U.S. consumption.

> "The United States will have no choice but to rebuild its manufacturing base, shore up its crumbling infrastructure, and support those few industries where it remains a world leader."

You can invest in foreign stocks by purchasing American Depository Receipts or by investing in mutual funds, though you may pay for the convenience of so doing. ETFs offer diversification, liquidity, relatively low expenses, tax efficiency and flexibility. However, with ETFs, dollar-cost average indexing is difficult, transaction costs may be high and a risk exists that the fund may not really represent the index.

> "Reducing or eliminating credit card debt should be one of your top priorities as you prepare for the coming economic downturn."

The best way to invest in foreign stocks is to buy them directly on foreign exchanges. However, beware of using Pink Sheets brokerage firms. Pink Sheets LLC publishes market makers' bids and offers for foreign stocks. These market makers trade for their own accounts and make enormous profits at your expense, so seek a reputable broker instead. Consider Australia, Canada, Norway, Hong Kong, Switzerland and the Netherlands as investment destinations. Promising sectors include agriculture, energy, forestry, mining, water, infrastructure, property, transportation, manufacturing and utilities. Investing in emerging markets also makes sense. The risk is high, but so are potential rewards. If you are not a professional investor, consider working through a managed account.

Emigrate as an Entrepreneur

Conditions in America are going to get so bad that you should seriously consider leaving the country. Almost every industry is or soon will be on the rocks. If you live in an urban area with a large inner-city population, you may have serious trouble. Before moving, research the immigration laws and banking practices. You may need to learn a new language. The fastest-growing economies are in the BRIC countries: Brazil, Russia, India and China. The best way to take advantage of their growth is to start a business there.

> "Stay out of the dollar until the coast is clear...if we wait long enough, our patience will be rewarded."

If you decide to stay in the U.S., start saving now – preferably in nondollar currencies. Get out of debt. Pay off your credit cards. To beat inflation, hoard products with long shelf lives. A carton of cigarettes or the box of cereal you buy today may be worth double or triple its present price in the very near future. You can barter these goods. Learn to fix things instead of throwing them out.

Eventually, America will figure out what it needs to do. Rebuilding its manufacturing center will be part of the recovery. Investors will find opportunities in engineering, construction, agriculture, merchant marine, commercial fishing, energy, computers, entertainment, tailoring, textiles, and auto and appliance repair. The service economy will probably shrink. Trade school may be a prudent option. College students should focus on learning skills, including foreign languages, which can suit them for employment in these fields. The U.S. economy is hazardous right now but given time and the right efforts, a light will emerge at the end of the tunnel.

About the Author

Peter D. Schiff is the author of *Crash Proof* and president of Euro Pacific Capital, Inc.