



The Solari Report

October 25, 2018

3rd Quarter 2018 Wrap Up: Equity Overview & Blockbuster Chartology



Catherine Austin Fitts



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C. Austin Fitts: Good evening and welcome to The Solari Report. This is the 3rd Quarter 2018 Equity Overview. I am Catherine Austin Fitts, and am delighted that you could join me this evening here in Zurich. I've had some very inspiring meetings with some of the Swiss money managers that I have worked with in the past and now, and it's always interesting looking at the global markets from the perspective of Switzerland being a tiny country that does business with everyone everywhere. It's a very global perspective and a very grounded one.

I wanted to start today by looking at where we are. We have a web presentation with the Rambus Chartology up. It's part of the 3rd Quarter 2018 Wrap Up web presentation – the financial charts and the Rambus Chartology. I would encourage you to look at it as we are talking. The web presentation is a great resource. We develop it as we do the four segments of the Wrap Up, and then place in a pdf and a hard copy. We hope to have the pdf to you sometime towards the end of November.

Please look at the Rambus Chartology and the charts, and let's start with where we are now – the charts and the end of the 3rd Quarter. I also want to look at market prices as of 2:16pm central time.



The US dollar index is now up 4.74% for the year. We have a ‘sea of red ink’ everywhere. One of the few places that people are not losing money is putting it in cash. Fixed income is also a ‘sea of red ink’. We have the long treasury TLT now down 7.71% for the year. The intermediate is at 2.79%. The bond aggregate is down 2.21% for the ETFs and then the jog is holding steady at 11 basis points up. So, it’s one of the few that is not losing money, if you will.

One of the challenges of the time, given what is going on in the bond market, is we are watching stocks and bonds both go down together. The old practice of leaving stocks and going to bonds is not going to be a strategy that works this time, which is part of what is so unnerving for the markets.

Equities: The US markets is the only one still in the black for the year. The S&P is now up 0.72%, less than 1% for the year. To give you a sense of how bad the sectors are, homebuilder is down 25.76% for the year.

We often talk about corrections being anywhere from 10-25%. More than 25% starts to get you in bear market territory, so clearly the homebuilders are technically in a bear.

The European ETF (VGK) is now down 12.36%. Germany is really slotting as the market slid this week, and is now down 18% for the year. The developed markets, minus North America, are down 11.39%.



China's large caps are down 14.99% and the small caps are down significantly more. That is going to be the smaller and younger companies – the tech companies – and that is down 21.84%, falling at the same time that the NASDAQ was falling here.

Then the emerging markets are down 18%. So, China is now below the emerging markets. One of the things that we have been watching is the divergence between China and the US markets. That divergence, as the US's fell, is closing. It was up as much as 26 points, and now on the small caps, it is a little more than 22 points. But remember that at the beginning of the year, China was pulling ahead of the US markets. Exactly when the Chinese stock markets started to pull ahead of the US, is when Trump started to pour on the trade tariffs. So, part of this is clearly the war about who is going to have the cheapest cost of capital. If there is anything that Donald Trump is going to do, he is going to make sure that the US cost of capital is significantly cheaper than China.

In commodities, it was flat for the year. The commodity index was up 31 basis points for the year.

Gold, which improved a bit this week, is still down 5.65% for the year. Silver is down 13.76%. The only bright spot, of course, is oil, which is up 24% as of this afternoon. As you can see, if you are in cash, you are not making much money, but you are not going down. If you are the S&P, you've had quite a wild ride, but you are not down for the year yet. Everything else is a real 'sea of red ink' with the US homebuilders being at the bottom of the barrel. So, it's not a good week for investors.



The big question on everybody's mind is: Are we in a correction, or has the market really turned and we are in a bear market?

Regarding the Rambus Chartology, Rambus took a very big, strong look at the big picture, and whether or not the bull continued, and what the technical analysis said about whether the bull market is still on or not. What he shows is that a lot of stocks and a lot of indices are breaking through the moving averages. The charts, in the short run, are quite ugly.

One thing that he does make clear is that we are in an inflection point, and it is impossible to tell if this is a correction or more than a correction.

I also added something from one of his posters. A poster, whose nickname is 'Plunger' posts, had a much more bear-ish report than Rambus's, and he is certainly more bear-ish than I am. I wanted to put it up with Rambus Chartology because I thought that it was an interesting look, considering some of the fundamentals and what the bear case is. So, I wanted you to have that, but please note that it is much more bear-ish than I am.

My guess is that Mr. Global is very much trying to move the planet towards a planetary equity model. We have seen dramatic securitization of equity around the world, and that is going to continue. I think that the leadership pushes to continue to promote growth of the equity markets, but the reality is that, if you look at the amount of changes that are happening all at the same time, much can go wrong; anything can happen.



We have multiple s-curves. I talked a great deal about these with Harry Blazer in the show that we did last week, 'Learning to Walkabout'. I would recommend it to you because I think this is going to be a time when finding and following what has value is going to be quite challenging, and we really need to build our intuitive skills to do it.

Look at the multiple s-curves. We are going up at the same time as space. I think that space has been going on for a long time, but now it is going to be happening overtly.

In AI and robotics, there is a major, major change. I just did a review of Kai-Fu Lee's book, *AI Superpowers*, which I recommend to you.

The shift from Global 2.0 to 3.0; we talk plenty about that. You can find out more regarding that in the Core Concepts if you are a new subscriber.

The Shift to the Multi-Polar World, The Rise of Asia, and the Land Empire, and, of course, we have our old friend, 'Peak Everything', meaning there are more and more people, and getting the natural resources out is getting tougher and tougher. For example, a couple of years ago when I was at a mining conference and listened to the miners, they have to dig deeper, and go further, and deal with more political risk to get the same amounts of metal. So, Peak Everything is making it harder and harder, and we have covered Peak Everything over by throwing plenty of fiat currency around. At some point, Peak Everything will peak back through. Then, of course, there is the Arms Race and the possibility of war.



One of the arguments for the bear case is that we have had tremendous destruction of the pricing mechanism in the markets by constant political intervention, which is financed with massive subsidies that is created by the fiat currency machineries – both in the United States and in Europe, and to a lesser extent in Japan.

I put up a link in the commentary for this Solari Report tonight. There was a speech given at the Grant's Interest Rate Observer Conference/ Anniversary Celebration by a Swiss money manager, Tony Dedon, who I used to work with before he kicked all the Americans out. You can thank the American government for the change in laws for that.

He was writing about how difficult it is to do investment strategy when the pricing mechanism has been destroyed and enormous amounts of subsidies are running the markets. He closed with the following:

I believe that in the fog and distorted noise of a world of booms and busts, the sanctity of our savings demands an escape from what is merely financial. The only one I know is that of seeking to find what is scarce and valuable to me.

And so, it is, subjectively, for each one of us, in his own judgment, and commensurate with his duty to his family and to others – subjective value about what is real and what is enduring.

That is very good advice when there is massive subsidies rocking around the markets and prices really don't tell you much of anything about value.



You have to figure out for yourself what has value and what you trust. What I always say is that you have to know what you own and why you own it.

That comment very much goes to the heart of the bear case in the market, which is that as the subsidy gets pulled by the end of quantitative easing, the fundamentals will come out, and they won't look pretty.

I also put up a quote from Jeff Bezos who made a speech recently discussing his involvements with space. The bull case is really the power of new technology and the extraordinary opportunities that we have if we really do engage in space travel in a major and effective way. Bezos wrote:

We have the resources to build room for a trillion humans in this solar system, and when we have a trillion humans, we'll have a thousand Einsteins and a thousand Mozarts. It will be a way more interesting place to live.

So, Bezos is basically saying that far from being out of space, we have the entire solar system and beyond.

The absence of an effective pricing mechanism and the large amounts of subsidies in the market means that a week with this kind of drop is particularly unnerving. There is an old saying, "Elevator down; escalator up," which means that when the market corrects or has a deep correction, it can go straight down, and then, of course, ———



— it takes a while to slowly ramp back up. Of course, we are, as Rambus would say, “At the inflection point,” and wonder if we finally have our long overdue correction, or are we in a bear?

I want to walk through ten issues that are worth thinking about when you look at the global markets and ask the question of: Bull or bear? These go to the heart of deeper trends that are happening, and what they are doing to the stock market, and they integrate some of the different dynamics that Dr. Farrell and I talked about in *News Trends & Stories Part I* and *Part II*. So, let’s dive in:

Issue #1, which I think is the most important on investors’ minds and should be on your mind when you look at the markets, is that we are approaching the end of the end of quantitative easing.

During the financial bailouts, the Fed built up a \$4.5 trillion bond portfolio; about \$2.5 trillion of treasuries, and \$2 trillion of mortgage-backed securities. Late last year they started retiring \$50 billion a month of the bonds. That was October 2017. Then, of course, since 2015 they’ve been raising interest rates. They’ve raised interest rates eight times and have indicated that they are going to continue to raise, including in December.

In the meantime, the ECB has continued to buy bonds, but has now indicated that it is going to stop buying bonds by the end of the year. So, whether it’s rising interest rates, or the liquidation of the Fed’s portfolio, or ECB now stopping, it is certainly growing its bond portfolio. We are talking about a significant shrinkage of the subsidy going into the markets for monetary policy.



We really are approaching the end of the end of QE. The question is: Is this entire market simply bubbled by massive amounts of loose monetary policy? If you take away the punchbowl from the party, what will happen?

We don't know what will happen. There are many arguments that would say the bull market can continue without QE, but the reality is, whether it does or not, fundamentals start to become much more important.

You've had a surprising lack of spread in returns on values between the really strong companies and credits and everybody else. I think that divergence is going to start to grow as we see the end of the end of quantitative easing.

It was an enormous experiment in monetary policy, the likes of which we have never seen before. So, we really can't say what is going to happen.

One of the reasons I put Plunger's piece from Rambus Chartology in was because he looks at these kinds of credit contractions that have happened. He says that it has been five times since the 1600's, and it is one of the reasons for his more bear-ish outlook. It's an enormous experiment, and the experiment is coming to an end, and the punchbowl is getting taken away from the party. If there is any argument that we are in for big change in the financial markets, that is it.



Issue #2 is: We now look around the world and see many different sovereign governments, particularly in the emerging markets, and corporations, and individuals who have too much debt. The planet is swimming in debt, and it is swimming in debt at the same time when growth is slowing down and interest rates are rising, which means that there are more and more people who have that debt who can't afford it and can't afford to make their debt service payments. The question is: How are we going to manage that debt? Are we going to struggle, or are we going to write it off? How do we handle the debt, and how do the countries that can keep on printing and maintaining high levels of debt keep a lid on inflation when they just keep printing paper and rising interest rates?

If the stock market folds and money pours into fixed income, maybe that offsets a little, but I see interest rates continuing to rise. I don't think that the Fed is inclined to back off. The reality is the word 'divergence'. We are going to start seeing a much greater divergence between the people who are financially solid in this environment and the people who aren't.

Issue #3 relates to slow growth outside of the US and Asia. The US, because of capital repatriation and massive fiscal subsidy, is doing rather well. The latest GNP numbers indicate that we are growing at about 4%, which for an economy this big, is quite remarkable. But Asia continues to be strong. India is at 7.3% for the year, China is at 6.6%, Pakistan is at 5.8%, and Indonesia is at 5.1%.



Europe is rather slow. We have Germany up 1.9% for the year, France 1.6, and UK 1.4. So, it's slower in Europe, but we have indications from global institutions that they expect growth to continue to be slow outside of America.

They always say that, and China keeps growing at 6.6% and India at 7.3% above. The reality is that what 'Make America Great Again' was really about 'Fortress America'. We are drawing capital back home, we are drawing operations back home, we are drawing people back to the US, and it's all designed to produce greater self-sufficiency, greater resiliency, and more economic military strategy.

Ultimately, ten years from now, the US can project power by drones and through space from behind the oceans. The greatest strategic advantage that the US has is that it is protected by two oceans with Canada to the north. Its problem in this day and age is that it puts it far from Eurasia, which is where the big economic explosion is coming as Asia rises and the biggest consumer market in the world is Europe. With Eurasia right in the middle, the opportunities to develop the Silk Road and the rise of the land empire are great, as we discussed in the 2nd Quarter Wrap Up: The Rise of the Asian Consumer.

But America wants to make sure that if they lose reserve currency status, they are in great shape from a military and economic resiliency standard. If you look at their situation, vis-à-vis many countries around the world, right now the US is relatively stronger than many people seem to understand to continue to hope for a collapse to get them out of the Orwellian nature of our situation. So that was Issue #3, slow growth outside the US and Asia.



Issue #4: We have serious risk issues in the sovereign bond market, and that is the old event that I have been talking about for many years – the danger of the US bear trap and emerging markets.

When the financial crisis occurred, you had significant debt in the developed world, and, of course, the US stuck the debt to the taxpayers and the central bank, and relieved the banks. Europe never relieved the banks, so they are still struggling with the bank debt there. But what we did from the financial crisis on is levered up the emerging markets and lent big, big dollars – pretty loose money – throughout the emerging markets.

Now that we are repatriating dollars back to the United States and interest rates are rising, that debt is getting more expensive and it's getting a lot harder to get those dollars. Add to that the trade war, and you make it very difficult to get those dollars. So, you are throwing China and the emerging markets into a bear trap. Sure enough, we see the weaker credits like Argentina or Venezuela really exploding – both in terms of inflation and unemployment – and really struggling.

I had a couple of risks in the sovereign bond market. I've been in Europe for several weeks, and Italy had put in a new budget that ignored the austerity rules. It has a 2.4% budget deficit and was rejected by the EU. Italy announced that they didn't have a 'Plan B'. EU has given them another three weeks to reconfigure a new budget. I don't know what will happen, but I am assuming that Italy is going to stand firm along with Spain and the other southern European countries, for something that really makes sense regarding maximizing their GNP.



In the meantime, Italy is struggling with way too much debt. The Italian debt and any of the southern European sovereign bond markets could really throw the EU into a ‘tizzy’. You combine that with a US dollar bear trap emerging in the emerging markets, and, on top of that, you have a fiscal stimulus and global arms race in combination. Who knows where that could lead to, but the reality is that we are seeing blow-ups at the periphery of empire, and that is going to worsen in 2019.

The US is going far out of its way to market itself as a safe haven, and certainly, for the time being, it is. The big question, of course, is that at the heart of this is China and the US rebalancing their relationship and engaging in a trade war. With China in a US dollar bear trap, that could get very ugly – not just for the US and China, but for everyone involved.

Issue #5: The US stock market and the diversions with Europe and China. I am going to grossly oversimplify to make a point, and that is you see the United States stock market, and since the financial crisis, it has significantly outperformed, not only Europe and China, but it has outperformed its own GNP. So, you have the stock market significantly outperforming the underlying economy. The result is that US companies have the lowest cost of equity capital, and with that, often comes the lowest cost of fixed income capital. That is a tremendous advantage globally, in terms of acquisition and access to capital. That performance has come as a result, I believe, of massive political intervention and subsidy coming through the Federal credit mechanism, and it is not unrelated to the bailouts and the \$21 trillion that is missing from DOD.



The US has bought that superior performance with an extraordinarily expensive subsidy. The question for anybody in the marketplace is: How long can it last? How long can the US produce almost-infinite steroid power?

I think the missing money mechanism is important, and the answer is: No one knows. No one knows how long they can do it. Ultimately it's a military question.

If you read Kai-Fu Lee's book, *AI Superpowers*, or listen to the interview that Harry Blazer did with Hugo de Garis about AI, we are moving into a world where AI, and robotics, and new technology will have explosive value creation for the organizations and entities that really master them and apply them in the marketplace. As that happens, there is going to be a tremendous divergence between the superpowers that have AI, which is the US and China very much in the lead, and everybody else.

When you combine that with the trade wars, many different things could happen. One of the things that I would say is, "If the US can keep that steroid power going, don't underestimate the ability for the US stock market to maintain what is a remarkable divergence."

That is a challenge for investors because, if you are looking at one market, which is very strong but highly subsidized, and another market that is very weak but the stocks in it are excellent companies that can deliver cash flow dividends and be strong in a world where the subsidy disappears, you are, basically, talking about, on one side, political value and, on the other side, real value.



Real value can be very attractive if you don't mind underperforming the indices on the theory that you never know when that subsidy goes away. It's one of the critical things that you are going to have to think about in terms of investment strategy: Do I want to go with a subsidy, or do I want to go with real value, or do I want to do a combination of both? It is a military question when the subsidy goes away – if it ever goes away. I think that it will go away, and that is one of the reasons I prefer real value. I just don't know what the subsidy means, which gets us to the next issue.

Issue #6: Neverland accounting and the end of price discovery. As I said, and I will just keep saying it, never underestimate the US capacity to deliver steroids. Certainly, if you are a Solari Report subscriber, you know that Dr. Mark Skidmore and I have worked on trying to define the amount and nature of the \$21 trillion of undocumented adjustments in the US Federal budgets. The latest outrage – and you can see this at Dr. Skidmore's latest report if you go to www.MissingMoney.Solari.com – the Federal Accounting Standards Advisory Board has now announced that the Department of Defense, and possibly some other government agencies, are free to completely ignore the Constitution and the financial management laws of the United States by classifying whatever project they want by whoever they decide to put in charge of this by some secret process that we are not allowed to understand. They are, basically, allowed to put whatever they want into classified books, which means that they are free to cook their books, which means that their financial statements are wholly and completely meaningless.



In addition to the Federal government running its books on a completely mysterious and cooked basis, the National Security Advisor can provide a waiver to corporations doing business with the government on classified projects so that they can be free from not having to comply with the SEC requirements for financial transparency.

Basically, what you are seeing now is the government and all the corporate contractors who feed off the government, and run the space program, and run the military programs, and run the money and information systems related to those things, can do whatever they want and run multiple sets of books and keep everything secret and completely defy the financial management laws and the Constitution of the country, which, essentially, puts you in ‘Neverland’. It means that you don’t know what any of their books mean and, also, it means that for all the big defense contractors, you have no idea what their books mean. We are literally in Never-Neverland; it’s Never-Neverland accounting, and everything is meaningless.

Certainly, if you can steal \$21 trillion and use it to intervene in the markets, market prices are meaningless. So, we have created a government that now has become a transfer mechanism to collect individual taxpayers’ money and to attract individual taxpayers’ 401k and pension fund savings, and transfer that money – along with technology – to private corporations.

In theory, you are simply giving it away out the back door. In exchange, the taxpayers end up with a liability of their own for the pension funds.



It is outrageous because you are turning an asset into a liability, and the government has become a laundry mechanism that steals assets and replaces them with an empty liability or a liability of the beneficiaries who have now lost the assets.

This is one of the reasons the politics in Washington have, not only gotten so ugly, but they have gotten so bizarre. You are talking about a mechanism that can create an award – unbelievable riches almost beyond imagination. The whole edifice depends on secrecy. That means that when you fight, you can never fight about what the fight is really about. So, instead of fighting about what the fight is really about, such as when it comes to approving Kavanaugh for the Supreme Court, you can't fight about that; you have to fight about something that is much more entertaining and much less dangerous to threaten the secrecy of the entire system.

What does that mean? It means divergence. Stocks that enjoy the subsidy are going to outperform stocks that don't, but stocks that don't enjoy the subsidy are going to have businesses, and incomes, and cash flows that have a much better chance of surviving, when and if the subsidy goes away. This gets us back to fundamentals. Fundamentals continue to be much more important than they have been for this last boom period since the financial crisis.

Issue #7: We may be in for a long period of lower investor returns. Part of this is that interest rates are historically low. Even as they rise, there is no indication, I think, that they are going to begin to rise anywhere near enough to put people back at the 1980's levels where they were, once upon a time, enjoyed.



The reality is that we are also dealing with the ‘Peak Everything’ phenomena and plenty of effort by the leadership to claw returns off the top.

If you look at the private equity game, private equity is really clawing returns that normally or, once upon a time, would have gone to stock market investors. Insiders are, essentially, getting the inside deal and being able to skim profits out of the entire market.

Don’t be surprised if we are in a period where investors simply make less. Given the sneaky, hidden, but very real inflation, that is painful. The question for every investor – whether you are investing your time or money – is how can I beat that burn of low returns but high inflation on my expense?

Issue #8: Expect volatility. Because of the subsidy, we have been in a period where we have had relatively low volatility. Now we can expect to have higher volatility and many wildcards.

One of the big wildcards in my mind is ETFs. We have seen the growth of Exchange-Traded Funds or ETFs over the last ten years. They have really exploded in size, but they have never been tested by a real correction, let alone a turn to the bull. So, I am going to be interested to see how they perform. There may be a lot of bumps in the road to be worked out.



Issue #9: The governance issue. I believe this one is the most important, but the most disturbing. You see more and more things happening around the world that make you feel like global geopolitics have become mob wars. We see the *Washington Post* reporter, Jamal Khashoggi, murdered at the Saudi Consulate in Turkey, and Jimmy Diamond and Steve Mnuchin cancelling their participation in the Saudi investment conference. They are simply sitting on too many petro dollars to be putting themselves in danger by Saudi intelligence agencies.

One tweet caught my eye this last week, “China probably killed the head of INTERPOL and nobody cares. Story totally vanished over the weekend. What does this say about Beijing’s influence over the American press? Why are no editorial boards demanding answers?”

We have been posting some of the links on this story. The head of INTERPOL is Chinese. He went back to China and has disappeared. It’s remarkable how little is being said about it.

These are examples of the extraordinary lawlessness upon us. Paul Volcker, former Chairman of the Federal Reserve, at the age of 91 said recently, “Respect for government, respect for the Supreme Court, respect for the President – it’s all gone. Even respect for the Federal Reserve. I’m really worried about this governance thing.”

That is hard for me to just ignore it. If you look at some of the things that Paul Volcker has done, he has made some mighty contributions to the destruction of the rule of law and the double-standard application of the rule of law.



It certainly happens when the central banks print money and give it to one class of citizens, while the other class of citizens are targeted by the Department of Justice and rounded up for prison in neighborhoods where they are drowning from drugs with money laundered by the New York Fed and the Federal Reserve. I could go on and on.

The reality is that the barriers are coming down, and the lawlessness is now working its way through the elites. I'm sure Mr. Supreme Court Justice Kavanaugh now understands what it's like to have the shriek-o-meter turn on you. The elites are no longer protected from the organized crime that is plaguing the general population. Of course, that was inevitable. The inevitability is that once you let that financial addiction roll through the economy and grow, at some point you can't stop it. I think it is one of the challenges of the current geopolitics because you have a Federal credit mechanism that is throwing off trillions of dollars of subsidy, and the tactics that you need to control it grow evermore mob-like.

The biggest governance issue is the question of: Are we an open or closed society? That means an open or closed economy. Are we simply all trading with people on Earth? If so, then the people who own the bonds that we are levered up with are other people on Earth, so it is a closed system. The reality is that there is more and more evidence to suggest it may be an open system. That means that we are not optimizing an economy only on Earth; we are optimizing an economy that goes into worlds that we have no understanding or idea of, and the economy is open.



That is a very big wildcard – not just for the economy or the stock market, but for the entire governance question related to what it's like to live on a planet where the governance system is secret.

If the economy is open, then it would explain a lot of what we have seen over the last 20 years. If it's closed, it's a very different set of assumptions. I think one of the reasons that many people are thinking the economy is going to collapse and it doesn't, is because they are assuming that it is closed. One reason I thought the chances of the slow burn continuing was much greater was because I thought there was a reasonable chance that the economy was open. The more that I watch how the economy functions through these different changes, the more it looks to me like it's open.

One of the reasons the governance question is so very important is because financial markets need liquidity. For liquidity to work, you need trust. For trust to work, you need to be able to depend on the rule of law. Increasingly, what we are seeing with the two big superpowers, China and the United States, is there is not much confidence in the rule of law in either. That is a critical issue for the Anglo-American Alliance. If the Anglo-American Alliance is going to stay on top, they have to stay on top of providing financial liquidity. Deciding to do financial sanctions of the kind that we are doing really threatens our financial liquidity.

I brought this up when I did 'Planet Debt', which was the Quarter Wrap Up sometime in 2015. I took a very serious look at the debt system and who owned the debt, and I couldn't find the figures. . I'm convinced that the debt system is not a financial system anymore; it's simply a control system.



The question that we all have to answer is: Who really owns the debt? As far as I am concerned, that is one of the big secrets in the governance system.

The big wild card is: How are we going to affirm financial liquidity in the rule of law when that is deteriorating, and who is really in charge? What is the governance system? Is the governance system part of an open system or a closed system?

Issue #10: The big question on everybody's mind is: Are we in a correction or a bear?

Everything that I see indicates that, generally, many of the independent media underestimate the arguments that the bull market can continue. I think that planet equity is the plan by Mr. Global. I've made 'no bones' about that.

For the US market – not the emerging markets or foreign markets – if we make it through to the other side of the election in the United States, I think there is a 75% chance that the US market settles back into correction mode after the election and then proceeds to return to the bull in due course. We are many, many years overdue for a 25% correction. A 20-25% correction would be exceptionally healthy. I think that we are only 10-12% off the peak on the S&P, but we are far from a deep correction, and, certainly, far from a bear in the US market.



The reality is that if you look at what is going on in terms of all the different risks that we have talked about tonight, there is no doubt that things could continue to spiral down, and we could move into a bear. Certainly, trade wars – if they get big enough – could get us there.

I think this could go either way. Part of it is that when you have a market that hasn't had corrections, and doesn't have price mechanisms, and asks, "Is this political and is this dependent on secret cash flows?" You will have a mess and people will go with the momentum, but at some point the momentum can turn and go the other way.

I think you have to be prepared for a continued bull market or a bear. The challenge, of course, is that it's not so simple that you can only go to bonds. In the bond market, the long-term bull in the bonds is over, and there are very serious and significant credit issues in the bond market. You have to be exceptionally careful.

There are some important trends that are essential to remember. Some of this, I am going to repeat. Never underestimate the ability of the US financial mechanism right now to produce financial steroids. If the dollar should stop being the reserve currency – which is not anywhere near on the horizon, in my opinion – that could all change in the 'twinkling of an eye'. Until then, don't underestimate their ability to produce financial steroids.

Never underestimate what new technology can do – both potential divergence between companies, between countries, between sectors, and the creative destruction that it can bring. It can be highly deflationary.



I've discussed with Harry Blazer what Amazon has done when we did The Solari Report on the Amazon-Whole Foods deal. We talked about how very deflationary it can be.

New technology can create enormous amounts of equity market capitalization value. It's one of the reasons the discussion of the AI superpowers is so important. There is a potential divergence between both the companies that get deep AI learning right in the next year or two and apply it successfully, and those that don't. That applies to countries as well. So, China and the United States are way ahead in the lead of artificial intelligence, and there is a tremendous potential divergence that can happen there.

If you look at what can happen with what is coming with new technology, it's just dazzling. So, don't underestimate the ability of new technology to put wealth on the table.

Never underestimate the 'Chuck Lorre phenomena'. I put up a quote several years ago from Chuck Lorre. It was very lovely the way that he wrote it, but he essentially said that seven billion people only get paid if they get up in the morning, and make things work, and that is a very mighty force. I don't care how crazy and mob-like the geopolitics are. Seven billion people only get paid if they make things work.

Finally, I want to remind you again of Jeff Bezos' quote because it speaks, not only to the fact that new technology can add tremendous value, but that the economy may be open. Maybe this is Jeff's signal that it is.



We have the resources to build room for a trillion humans in this solar system, and when we have a trillion humans, we'll have a thousand Einsteins and a thousand Mozarts. It will be a way more interesting place to live.

I note that again. We have the 'resources' to build room for a trillion humans in the solar system. Just contemplate that. This is Jeff Bezos, who runs a trillion-dollar company, although it may be down today after his earnings announcement.

"We have the resources to build room for a trillion humans in this solar system." We have the resources. Whoever got the \$21 trillion certainly thinks they have plenty of resources. That is why it is so important to give up on the theory that we are going to have a significant collapse and everything will get back to normal; that is not going to happen. Close to the opposite is going to happen.

I keep getting questions on the Great Reset. You have to understand that the Great Reset started in 1994 with the re-engineering of the global governance system. I think that the question is: Are we going to have a big bang solution of writing off debt and reconfiguring the global currency system? I don't see that any time soon. What I see is that debt is going to continue to be used for control, and they are implementing major mind control systems and trying to figure out how to do a digital currency. That is what all of the different bitcoin and blockchain is figuring and sleuthing out, and there is a tremendous amount to be done there before you have anything that could be a useful system.



Until then, the dollar is clearly dangerous and dominant. That is one of the things that the world is struggling with.

Let's talk about how you cope in an environment like this. I shut down my investment advisory individual practice earlier this year, but I continue to do investment screens.

As an investment advisor, the reason I consistently recommend active managers instead of passive managers or index funds – with some exceptions – is that if you look at many strategies that you need when things go sideways or down, they call for active management. One is that if you are going to stay away from the subsidy stocks and stay in the 'value', you need some old-fashioned underwriting. One of the dangers of index funds and index markets is that it depends on some of the markets to be good, old-fashioned underwriting and due diligence. If nobody is, then the whole pricing mechanism falls away – which is part of the problem.

The second thing is that the investment strategy that has worked, if you do the math and go back through time, is a 'modified buy and hold'. A modified buy and hold means that as soon as you hit a bear market, you sell and go to cash, and you stay out. Then when the market comes back, you go back in.

You don't ride the market all the way down and all the way back; you, basically, sit in cash. The challenge of that is figuring out when you're not in a correction – when you're in a bear market and really moving out. It can get very expensive as the market is very high.



That is another reason I like a third strategy that requires an active manager, and that is you ‘hedge’ your equity. Hedged equity (not the ‘hedge’ as in ‘hedge fund’) means that you write ‘puts’ on the market. If the market goes down, the ‘puts’ go up, and that gives you the profit you need if you come out of the hedged to buy stocks cheap, or if you stay in the hedged just to limit your downside. Hedged strategies are certainly a way to deal with maintaining your positions now and continue to get dividends.

Investing in what you find ‘valuable and enduring’; one of the screens that I do is an ESG screen. Basically, if you read our criteria, we are trying to screen out companies that have a business model which I would describe as ‘criminal’. The difference is not that they are perfect, or not that they don’t make mistakes, but they don’t have a model where, intentionally, they are doing things that are criminal. Unfortunately, I would suggest that there are more than a number of companies that do.

Another reason to deal with active management – whether you do it or you have somebody do it for you – is to make sure that you are investing in things that are valuable. If you want to stay away from subsidized stocks, you can do it.

Finally, ‘fundamentals’. With the phenomena that we are seeing in the marketplace, fundamentals are going to reassert themselves more and more. It’s going to matter that whatever you are invested in, whether it’s a stock or a bond, it’s a security and an operation that has the ability to make it through ‘thick and thin’ in this environment. You want to go with companies or issuers that are fundamentally sound in this environment.



I'll run through that list: Value, modified buy and hold, hedged, investing in what you believe is valuable and enduring, and the fundamentals. So, there are many reasons to use active or conscious management right now. If you are managing your own money, you certainly want to look into how you can do some of these things from the modified buy and hold to hedged.

I recently read an interesting book. I was hoping to do a review of it when I did the Equity Overview on *Dual Momentum Investing*, which is, basically, a methodology for how you do the modified buy and hold. You can look at it and I will try to get a review of it up sometime before the end of the month. It's another way of saying how you are going to calculate the modified buy and hold.

The interesting thing about all the strategies that I just described is that, generally, they are underperforming when the bull market is flying, but suddenly, they are looking a lot better when it's not. You are staying much more grounded, but you give up some of the benefits on the returns when things are flying.

So, what is the key in this environment? The key in this environment is: I don't care what you are putting your money in – cash, bank deposits, real estate, your own business, other people's businesses, stocks, bonds – you have to stick with what you believe has real and enduring value. You need to understand what you own and why you own it.

I keep bringing up the word 'divergence'.



What I mean is that the strong are going to diverge from the weak, and you need to be with the strong. Of course, what is strength and how to measure strength is a whole other thing, but you need to keep it simple, and you need to be able to understand it. You need to understand where your money is, and you need to make sure that it is strong.

On the cash side, one of the things that we have done in the archive that could be very helpful is a report in 2016, 'Where to Stash your Cash'. It was one of the Wrap Ups, which I think was the 1st Quarter Wrap Up 2016. That would be very helpful to read.

Whatever you do, stick with quality, stick with integrity, and stick with enduring value. That is it for the 3rd Quarter 2018 Equity Overview. Check out the Rambus Chartology; there are many great charts and technical analysis.

You know his colleague, Plunger, has given us the bear case. He is more bear-ish than I am, but I wanted to make sure that you had a very interesting description of the 'bear case'. Also check out the 3rd Quarter charts on the web presentation, and stay tuned for the final segment: Megacities and the Growth of Global Real Estate Companies. It's a great presentation on real estate companies divided into three segments. One is REITs, one is service companies, and then general companies. You will find those in the real estate section of the web presentation.

Thank you for joining me for the 3rd Quarter 2018 Equity Overview. Ladies and gentlemen, good night, and good luck.



MODIFICATION

Transcripts are not always verbatim. Modifications are sometimes made to improve clarity, usefulness and readability, while staying true to the original intent.

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