THE GREAT SUPER CYCLE

PROFIT FROM THE COMING INFLATION TIDAL WAVE AND DOLLAR DEVALUATION

DAVID SKARICA

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WILEY

John Wiley & Sons, Inc.

Published by John Wiley & Sons, Inc., Hoboken, New Jersey.
Published simultaneously in Canada.

Library of Congress Cataloging-in-Publication Data:

Skarica, David.
The great super cycle : profit from the coming inflation tidal wave and dollar devaluation/David Skarica.
p. cm.
Includes bibliographical references and index.
ISBN 978-0-470-62418-0 (hardback); 978-0-470-94024-2 (ebk);
978-0-470-94023-5 (ebk)
1. Investments—United States. 2. Investment analysis—United States. 3. Business cycles—United States. 4. Inflation (Finance)—United States. 5. Dollar, American. 6. Debts, Public—United States. I. Title.
HG4910.D53 2010
332.60973—dc22

2010032267

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

To my late grandfather, Miroslav Skarica, who had the courage to start a new life in the new world and give me the opportunity to write this book and the late great John Templeton who taught me how to be a true contrarian and spot value and big time long term trends.

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Preface

Economic Armageddon

How Super Powers Fall and Empires End and Why It Is Not *the End of the World*

We all know that bad news sells. I am in the investment newsletter business. The only people I know who see more doom-and-gloom types than myself are owners of funeral homes. The crash of 2008 saw doom-and-gloomers spread over the globe like a biblical locust swarm. We were all helpless in preventing those naysayers from invading our homes via our TVs and computers. They worked their way into every nook and cranny of our screens in a frenzied feeding of media hysteria. Every expert who had claimed to have predicted the crash and meltdown (where were they before?) brashly proclaimed that the crash was not only the end of Wall Street as we know it but the end of the world. However, you and I are still here. I am sure you are very weary of this type of thing, even if you are not a whole lot poorer. Very few gurus have a great track record over the long term. Many of the people who called the economic crash had been calling it for *years and years*. At some point a downturn was going to happen. As the old saying goes, even a dead clock is right twice a day.

Investment gurus such as David Rosenberg, Gary Schilling, and Robert Precther told us (with some glee on occasions) that the world was going to enter another Great Depression and the Dow would sink back to 5,000. Of course, this did not come to pass and the Dow bottomed around 6,500 in March 2009 before entering a huge rally that took it to over 10,000 by early 2010 (as I am writing this book).

The truth is rarely as devastating as those Nostradamus lovers would like us to believe. On the other side of the coin, remember those who in 1999 were telling us that the Dow was going to 40,000 and we were in some sort of Goldilocks economy? Isn't it ironic that with unemployment in the double digits as I write, we never hear that term anymore! (*Note*: The *Goldilocks economy* was a theory that the economy had entered a perfect combination of high economic growth, low inflation, and low employment, which many pundits in the late nineties were telling us we were in for the long term.)

Things are never as bad as the doom-and-gloomers say and they are never as good as the Goldilocks crowd says. I take a middle ground when I do my research. I make my predictions based on sound reasoning backed by decades of historical precedents.

In the past 10 years, we have seen the stock market go virtually nowhere and lose over two-thirds of its value when adjusted for inflation. Many attribute this to the Iraq war, the disastrous presidency of George W. Bush, higher oil prices, and the financial crisis of 2007–2009. They see the market not going anywhere and see events as part of a stream of random occurrences. However, what they fail to understand is that most of these random events occur within the realm of a Great Super Cycle.

For some reason, markets move in major cycles. It is the cycles that drive these events, not the other way around. Since 1900, the U.S. stock market has seen numerous 15- to 20-year periods where equity prices have been strong and 15- to 20-year periods when they have been weak. In up-cycles, stocks start out cheap; they climb in price; the economy is strong, and eventually this leads to what Alan Greenspan referred to as "irrational exuberance." There are usually new technologies that capture the imagination of investors during this time period, along with peace and low unemployment. This cycle then travels in this direction for too long; the market tops, becomes overvalued, and then collapses and does nothing over a long period of time. This long period of underperformance scares investors out; the market again becomes cheap and the cycle starts all over again.

We all too often blame the key actors during the cycles (e.g., Bush, Obama, etc.). However, they are mere pawns in the larger game of cycle chess. What goes up must come down and it is these periods of cycles (which have always occurred throughout history) that drive markets.

Why Should You Listen to Me?

Why should you listen to me? What makes me different? Do I have a track record? Is it any good? These are basic questions that are never asked about many of the experts that you see in the media.

A bit about myself: I like to believe that I am not like most talking heads on TV or university professors. I have to make my living in the trenches. I write two investment newsletters: *www.addictedtoprofits .net* and *Gold Stock Advisor*. I live comfortably in the Bahamas. If I do not make good calls for my subscribers, I will lose my readership and be forced into eating death-burgers and microwave dinners before the inevitable heart attacks that always kill that lifestyle. Therefore, I must make accurate calls on a consistent basis or go back to freezing my butt off in my native Toronto, Canada.

In 1999, at the tender age of 21, I had my first book, S*tock Market Panic! How to Prosper in the Coming Bear Market*, published by Productive Publications, a small publisher in Canada. The book was not a commercial success (mostly due to my age and my lack of experience and name recognition in the financial industry). However, the predictions in it were remarkably accurate. How was I able to be so accurate? In the late nineties, I pored over the history of bubbles and the cycles of booms and busts. I devoted myself to endless research. I began to fear that the stock market and Internet bull market of the nineties were turning into huge bubbles. This sparked my initial interest in cycle research. This research told me that markets trade in cycles where they do nothing for a long period of time. I discovered that certain assets go into a bull market cycle at the same time as other assets go into a bear market cycle, and so on.

After countless hours of work, I came to the following conclusions and made a number of predictions in *Stock Market Panic!* that I believe have proven to be uncannily accurate.

The book made the following predictions:

- **U.S. stocks were peaking and would be in a bear market for years to come.** This was a valuation readjustment as stocks had to come down from overvalued to undervalued. The Dow, which traded near 10,000 at that time, 10 years later trades near 10,000 and has lost much of its value on an inflation-adjusted basis.
- **The real estate market was a bubble that would burst.** The real estate boom went on longer than I thought it would. I thought real estate would bust with the tech bubble. However, the interest rate cuts and loose money that were initiated by the Federal Reserve to bail out the economy after the bursting of the tech bubble caused a leverage and real estate bubble far greater than I ever imagined. I thought real estate would collapse but even I never envisioned subprime mortgage–backed securities leveraged at 30 to 1 or greater.
- **Bonds would top and interest rates would move much higher, and real estate in rural and exotic areas around the world would outperform urban real estate.** This is the one prediction that has not yet occurred. It looks as if the interest rate market made an important low and bonds an important top in December 2008. However, rates have remained low on a historical basis. But you have to think that, with all of the debt the United States is issuing, rates will ultimately be headed much, much higher. Although some rural and exotic real estate has crashed with the rest of the real estate market, much of it has held up. There is still a willingness by investors to pay a premium to move to exotic locales away from society. In addition, many small Caribbean and South Pacific nations did not use the reckless borrowing methods used in the United States and are positioned favorably to take advantage of future economic recoveries.
- **Inflation would head much higher.** Shawdowstats.com, which is run by John Williams, measures the rate of inflation. To do so, Williams takes into account real inflation (e.g., not the jaded inflation numbers we see released by the government today that try to repress inflation due to the increasing entitlements that the government is

on the hook for) and calculates inflation the way the government did 20 years ago. Williams calculated that inflation in mid-2008 hit 9 percent; this is the highest inflation since the seventies.

- **Gold would become in vogue again and move much higher in price.** Gold, which began the decade hovering around $300 an ounce, climbed to over $1,000 an ounce by the end of the decade.
- **Other commodities—such as oil, wheat, corn, and soybeans—would also be headed much higher.** All of these agricultural commodities saw spikes in price during the 2000s.
- **The U.S. dollar would fall in value**. The U.S. Dollar Index (an index of the U.S. dollar versus a basket of currencies) began the decade trading at 100 and now trades at about 78 as we go to press. This represents a loss of 22 percent.
- **There would be major wars between the United States and the Middle East.** In 2001, the United States began a major campaign in Afghanistan, and in 2003, the United States began a major campaign in Iraq. It is still involved in both.

As you can see, virtually all of the main predictions I made in *Stock Market Panic! How to Prosper in the Coming Bear Market* have come to pass in the past 10 years. As I stated earlier, and as you will read in later chapters, the one prediction that has not yet happened is the collapse of the long-term bond market. I feel very confident this prediction will be realized in the coming years. With the amount of debt the United States is planning on issuing in the coming years, it is fairly obvious that foreigners are going to ask for a higher rate of payment on this debt as it will not be the safe investment it was in past years.

The bottom line is that over the past 10 years I possess a fairly accurate track record. My research has led me to make accurate predictions. Therefore, any investor who wants to make profits during the inflation tsunami needs to read this book.

What Is This Book About?

The Great Super Cycle looks at what we can expect in global economics by looking at the history of political shifts in power. The United States is becoming increasingly socialistic with the government running many of the banks and mortgage and car companies. *The Great Super Cycle* is an intriguing look at shifting economic power and the relationship between Washington and Wall Street.

The underlying theme of this book is that everything moves in cycles, from the megacycle of world powers, to economic cycles that can last for decades, to mini-cycles that usually last 10 to 20 years. The market will move much lower in the coming years in inflation-adjusted terms. Cycles are the most important and also the most powerful tool we have to make money in the coming years. The megacycle that we are in will feature the coming debt bubble, a commodities boom, and a major economic shift from west to east. Some sectors and some countries will benefit from these shifts and will outperform. In this book, I will show you how you can profit from specific key sectors—gold, oil, the growing Asian markets, and offshore accounts. (I believe that more regulation and taxes will make the U.S. economy less competitive and will cause funds to move offshore.)

Accordingly, the dominant theme of this book is this simple but irresistible revelation: Market cycles are the most powerful of all influences that prevail on capital markets. A thorough understanding of market cycles is an essential tool for any investor who wishes to successfully trade and make money in the capital markets. Market cycles are like gravity—you can't see them but they bind your fate regardless.

In the coming chapters, I tell you why, after the tech bubble and housing bubble, the next and final bubble has now turned to debt instruments. This debt bubble is at the heart of our investment philosophy for the next 10 years. The debt bubble will lead to bull markets in commodities, such as oil and gas, wheat, corn, gold, and silver, and a shift of economic power to emerging economies such as China and India. It is this crisis that will lead to opportunity!

Overview

Much of this book focuses on *stock market cycles*. These are the 10- to 20-year bull markets that are followed by 10- to 20-year bear markets. However, the particular bear market cycle in which we currently find ourselves also falls in the context of a larger cycle. The larger cycle will see the end of America's reign as the world's superpower. Economic downturns can often see shifts in power.

For example, the Great Depression hit the United States and Great Britain equally hard. However, the British had to support their Empire, which at one point covered nearly a quarter of the world. The financial constraints of Empire, the Great Depression, and then World War II cumulatively produced a shift from Great Britain to the United States as the world's superpower. We should note, too, that the demise of the United States bears many similarities to the demise of the British nation. Both are English-speaking, democratic capitalistic western nations. Their populations, politics, and policies have much more in common than, say, the British and Romans had.

The Shift from Great Britain to the United States as the World's Superpower

The very simple lessons learned from the rise and fall of empires are usually very similar. A nation usually builds itself based on an advanced legal and political system. Then, from this system, which creates prosperity and wealth at home, the growing world power is able to build up a military and spread its influence around the globe. It then benefits from the reach of its empire. However, the nation usually then becomes dependent on this reach, overextends itself financially, lives beyond its means, becomes indebted, and then is forced to shrink the scale of its global influence. It happened to the British in the mid-twentieth century and this is where the United States is heading.

Britain overextended itself financially, and actually much of the pressures leading to the fall and dismantling of its Empire came from within. We must remember that the first calls for dismantling imperial Britain did not come after the empire was bankrupt post–World War II. Many British just did not feel the justification of ruling the world when so many Britons during the Great Depression were struggling at home. The calls for less empire came when the British themselves wanted more help at home for relief from the Great Depression. Remember that when London crashed in the early twentieth century, it was still London, not Wall Street, that was the financial capital of the world. The Brits wanted the expansion of a welfare state and wanted their resources to be used for the support of British citizens and not the empire. After World War II, the British passed the National Health Act, which brought in a universal government-run health-care system at a time when the British economy was heavily indebted.

We can see the same mentality prevailing in the United States with the recent health-care bill and the call for more social spending at home in light of the Crash of 2008. At some point, like the British, the United States will probably shrink the size and scope of its military around the globe to pay for social expenditures at home.

People marvel at America's current military presence, massive sports stadium expenditures, and massive amounts of wealth and are in awe of the size and strength of the country's economy. In reality, the American Empire is, by historical standards, short-lived and relatively weak. The British Empire, at its peak, ruled a quarter of the world and the British were the preeminent power in the world for most of the seventeenth and eighteenth centuries as well as the first 40 years of the twentieth century. That's a period of over 200 years. Compare that with America, which has been the preeminent power from post–World War II to the present and possibly for another 5 to 10 years to come after the publication of this book. That is all of 70 years or so. The United States is following the path of the British but they found a much quicker path to collapse as a superpower!

Even the French and the Spanish empires, which were ineptly administered and constantly on the brink of bankruptcy, were able to keep intact for roughly 100 years.

Despite amassing the greatest amount of wealth the world has ever seen, Americans were also able to waste it and dispose of it almost as quickly. With the U.S. republic just over 200 years in age, the United States seems to be following Fraser's megacycle (there is that word again: *cycle*) of falling into complacency and back into bondage. Whether the average American is aware of it or not, the United States got complacent because it was the world's sole superpower for so long. (Yes, the United States had the Cold War with the Russian empire, but really the Soviet Union never came close to approaching the economic power of the United States. Even at its peak, the Soviet Union had an economy less than half the size of the United States.) With the continued increase in the size of the welfare state, Americans are falling into dependence upon the government. The United States now has two rivals, mega–emerging economies in India and China, that can seriously challenge its economic superiority.

However, I am not telling you all this to scare you. America's decline in power will not result in the end of the world. Just because you lose your empire or superpower status does not mean that you lose your country. In the long run, the United States may be better off without its empire draining trillions of dollars from its treasury.

In addition, the loss of the empire could be good for the United States because it might get the United States back to the roots of the country's core beliefs, such as individual rights, freedom of speech, limited government, and limited involvement in foreign matters. When the United States followed these beliefs much more closely in the middle of the twentieth century, it was revered for its freedom. There was nowhere near the anti-Americanism that there is today because the younger United States was much more selective in the wars and conflicts it would participate in.

In addition, after France and Britain lost their empires, their cultures thrived. Perhaps America's will, too. It could be argued that in the postwar period Britain has led the world in cultural exports with its superbly skilled movie directors, actors, musicians, and so on. In addition, London is still one of the main financial centers of the world. Similarly, the French have produced great music and writers (think Alexander Dumas). Both also have extremely high standards of living. Regardless of which publication you look at—the CIA's *World Fact Book* or The World Bank—both of these two nations still rank in the top 20 in the world in GDP per capita. Their empires have disappeared, but despite ups and downs, both remain prosperous first-world countries with strong democratic traditions. I suspect that, in the years to come, the United States will be the same. It will not be the ruler of the world, but America will still be a prosperous country playing an important role.

The Land of the Not-So-Free?

With that said, until the United States enters its post-empire renaissance, I see some very difficult times on the horizon. A major problem with the current United States is the loss of freedom. Most notably, its economic freedom is disappearing as government largesse and taxes eat up more of the national economy.

All the talk of U.S. political and economic freedom has become just that—talk. I will not vent or rant about politics in this book. In the next two chapters you will see statistics and facts to back up the brutal trend—that there is an ongoing and serious economic decline of the United States. Here is a quick example just to start. Most nations in Europe and Canada have a simple law that states that if you move from that nation and become a nonresident you are no longer taxed in the nation in which you are nationalized but rather are taxed in the nation you are domiciled in. Therefore, if you are Canadian (as I am) and you become a nonresident (so you are still a citizen but do not live there any longer) and move to a tax-free or low-tax jurisdiction such as the Cayman Islands or Bahamas, you are taxed in that jurisdiction in which you reside. The Caymans and the Bahamas have an income tax which is zero. However, as an American you must still file with the IRS wherever you reside. If your income is $139,000 or greater in the United States, in the five years before you file and you expatriate, you must pay an expatriate tax.

These U.S. policies are a major restriction on residing and working where you like. In the future, this law will hinder many who wish to move to the United States and become American citizens. Individuals who get their American citizenship will always be obligated to pay the government income tax regardless of whether they down the line decide to reside outside of the United States.

This may seem a minor trifle at this time because most Americans choose to reside within the United States. However, it just shows how an American in terms of living abroad is not as free as citizens of other nations of the world. Non-Americans have more global mobility if they choose to move and become a nonresident from their country of origin. They only have to pay taxes in the jurisdiction in which they reside, whereas Americans must pay U.S. taxes on their global income no matter where they reside. This one law, in one respect, is just a small example of how economic freedom is being stifled by the U.S. government as the U.S. nation declines economically.

The Fall of America's Dominance

As stated in the beginning of this chapter, the United States took over from Britain as the world's superpower. However, there was also a bit of luck involved in this shift of power. In the post–World War II period, the United States had a head start—much of the rest of the world was bombed out, flirting with communism, or being freed from imperialism. Asia did not have a manufacturing base and was flirting with communism. Asia's leading economy, Japan, was sifting through rubble. The United States, in contrast, had its industrial base built up due to the expansion in the Military-Industrial Complex during World War II.

However, during the sixties, the United States started to lose its advantage in industry to the Japanese. For example, according to the International Monetary Fund (IMF), the average Japanese per-capita income as a percentage of an American's was 10.31 percent in 1950, meaning that an American made about 10 times what the average Japanese did. By 1990, this had changed to 105.82 percent. This means that in 35 years, the average person in Japan went from making just over 10 percent of what the average American did to making 5 percent *more* than the average American! In lay terms, the average standard of living of a Japanese person from 1955 to 1990 increased at 10 times the pace of the average American! (As a quick side note, the average Japanese person now makes 85 percent of what the average American earns; the economic downturn in Japan in the past 20 years has taken its toll on the Japanese economy.) Japan's economy was in ruins after World War II and it took it a while to rebuild. However, after it did rebuild, Japan caught up to the United States quite quickly.

In 1950, India and China, which were economic powers in the Middle Ages, had been deindustrialized. India's industry was dismantled by the British, who moved manufacturing back to the U.K. during its rule of India. China was ruined by the brutal rule of Mao and communism. Both countries became quite xenophobic and turned within, thereby closing themselves off to foreign investment.

In the past 30 years, that has begun to change. Both of these nations have opened themselves up tremendously (China in 1979 and India in 1991). It is only natural that the rise of these historically powerful nations is going to threaten Americans' standard of living. It is important to remember that before Mao took over the Chinese economy and India was deindustrialized by the British, China and India were two of the leading economies in the world for hundreds if not thousands of years. The twentieth century was a short-term situation, where they were basically out of the global equation. These countries are returning to their historical role of global leaders. Americans did not have to compete with these two giants during the fifties, sixties, and seventies. The reemergence of these two nations as major competitors is a prime reason we have seen declining living standards in the United States over the past 30-plus years.

This Collapse of 2008 Did Not Breed Change, But the Next One Will!

Despite Obama's hollow slogans of change, his administration, in terms of financial and economic policy, has been one of a virtual freezing of the status quo.

Most collapses breed a change in the system, but the 2008 crash did not. Right now there is a convoluted connection between Wall Street and Washington, whether they admit it or not. Hank Paulson, former treasury secretary under Bush, was the former chairman of Goldman Sachs. The $700 billion bailout package to recapitalize the banks did not save the economy as so many said it did. History is full of bank collapses and the like and the world did not end. The financial bailout was a result of the system of cronyism that exists between Wall Street, the White House, the Fed, and Congress, which keeps the average person in the dark. If the system collapsed, it would have been restructured into something new and different to ensure that the current crony system could and would no longer exist.

However, instead, Goldman Sachs and other investment banks were allowed to get funds for free, turn around and speculate in markets near the bottom (as the Fed was pumping billions of dollars into the system), and turn those funds into huge profits. Therefore, instead of changing the system by letting it collapse, the bailout created an even bigger intertwining between Wall Street and all levels of the government.

We can begin a period of sustainable economic growth only when the current system is destroyed. That destruction will come when the debt that has now been shifted from the private sector to the government results in the near-bankruptcy of the nation and the government *cannot* bail out its buddies because it cannot bail *itself* out.

At the end of declines, tough decisions must be made. I cannot agree with everything that FDR did; however, I agree with his decision to fire nearly everyone at the Federal Reserve Board in 1933. This ushered in a new era and helped to end the most severe part of the Great Depression.

I also agree with the tough decision made by Ronald Reagan. In the early eighties, the President allowed Paul Volker to raise interest rates to near 20 percent and cut off the money supply to strangle inflation. This was a tough decision (and in fairness was started under Jimmy Carter in 1979) and many people went bankrupt due to the high interest rates and deep recession of the early eighties. However, this strategy choked off inflation and led to a significant economic boom for the rest of the decade.

For the next major economic boom to start, we must end the current cronyism system and start making tough decisions. Hopefully, this will occur before the nation is on the cusp of bankruptcy.

All of This Is Part of the Long-Term Cycle

Let me state that I am not blaming a political party or free trade, or using any sort of that jingoistic-speak. The decline of the U.S. economy and political power all falls within the context of cycles and mega-cycles. Like all of the world's superpowers, the United States has gone through its cycle of building its power, overextending itself, and then going into slow decline.

I do not expect that we are going to see a collapse in the United States into third-world status. That is just foolishness. There are great minds in the United States, and a relatively great amount of freedom; it will continue on as a center of technology, culture, and wealth.

However, due to current policies, which are increasing debt at a rapid pace, and the scar that the recent financial crisis has left on the United States, I do see U.S. prosperity decreasing compared to other nations. I see a shift of power going to Asia.

Asia is the creditor; Japan and China own huge amounts of U.S. debt. The United States is now the largest debtor nation in the history of the world. In the forties, the United States was the world's creditor; it even gave an emergency loan to the United Kingdom in 1946 after the war so the United Kingdom could survive. Power shifted from the U.K. to the United States. Now Asia is the creditor, so I see the power shifting there in the coming years.

Interesting enough is the curious fact that ever since the days of the Mongol Empire of the fourteenth and fifteenth centuries, which controlled much of Asia and Europe, prosperity has moved westward like some kind of economic tsunami. After the Mongols, it was the

French and Spanish Empires, followed by the British Empire, and then the United States. Much like we saw a movement in prosperity over the Atlantic from Europe to North America, we are seeing a movement in prosperity westward over the Pacific from North America to Asia.

Remember what I told you earlier: This is not a doom-and-gloom book. The United States is in slow decline. It will not see a significant recovery until it makes the tough decisions, which means ending its empire around the world and cutting government spending. Until that happens, it will slowly deteriorate under a mountain of debt. We will see a shift toward Asia as the economic center of the world.

The Chinese symbol for crisis is the same as the symbol for opportunity: Crisis = Opportunity. Therefore, as the United States declines in the coming debt bubble, there will be great opportunities. When the British Empire fell in the forties and fifties, the global economy boomed. There was merely a shift. Those who positioned themselves to profit from this shift made fortunes.

The same goes today; if you position yourself to the coming boom in Asia, or inflation-related investments, which will prosper as the United States devalues its currency, you will be able to make a fortune. This book will help you to position yourself.

Part One

THE NEXT BUBBLE AND BOOM