Lessons From a Kindergartener

By The Mogambo Guru

11/20/06 **The Daily Reckoning PRESENTS:** All the Mogambo really needs to know about life…inverted yield curves…and gold, he learned in kindergarten. Read on…

LESSONS FROM A KINDERGARTENER

The yield curve is still inverted, in that investors are mysteriously demanding to be paid higher interest rates for holding short-term debt (when the risks are more easily predicted), but they will accept lower interest rates to hold long-term debt (where the risks are unknowable with any degree of precision).

This is very weird, and that is why an inversion of the yield curve is such Big Freaking News (BFN). In that regard, Bloomberg reports that European government bonds now have an inverted yield curve for the first time in six years. "A so-called inverted yield curve hasn't been seen since August 2000 during the ECB's previous series of rate increases," they say.

But apparently neither the fact that the yield curve is historically uncanny in predicting recessions (and even the very few times when it is wrong, the performance of the stock market ain't nothing to get excited about, as it is usually nothing) nor that the curve last inverted right before the crash of 2000, made any impact whatsoever on Martin Price, the director of fixed income portfolios at Sarasin Chiswell, who says, "Some people talk about recessions, but I don't see it as a sign of one." Hahahaha! I laugh!

Apparently Richard McGuire at RBC Capital Markets loves to hear me laugh, too, and so he obligingly adds, "I don't think it's a recessionary signal, it's a bit simplistic to look at yield curves as a sign of recession." Hahaha! Thanks for the chortle, Richard!

To add to the convivial scene, even Bloomberg seems entranced by the musical qualities of my charming laugh, and they quote, for my obvious enjoyment, Alan Greenspan, the world's leading economically clueless bungler, saying that a yield curve inversion as a portent of Something Very, Very Bad (SVVB) is "a misconception", and that the yield curve's "efficacy as a forecasting tool had diminished very dramatically."

But pay attention! What he is actually admitting is that the yield curve inversion used to have oodles and oodles of efficacy, and thus back then you could take it to the freaking bank that when the yield curve went into inversion you were going to have a tough time pretty soon because the Federal Reserve had screwed up, again, and inflation was going to eat somebody's guts out. But nowadays it ain't got so much, as he says, in terms of "efficacy" in forecasting economic performance.

I was, probably like you – on the edge of my seat, anxiously waiting to hear what Greenspan thought was causing an inverted yield curve that was so benign in its effects. Blabber jabber yammer. And then, when I finally found out, my contempt for Alan Greenspan went up a few notches, as he says it is a "conundrum," which is Greenspan-speak (when you read between the lines and interpret how his lips curl in a sneer when he says the word "conundrum") for "I refuse to believe the sheer tonnage of evidence that says I am the world's leading economically clueless bungler, just like that stupid Mogambo idiot (SMI) says I am!

"Now I am reduced to comically saying that I somehow have no idea why the yield curve is inverted, and that yield curves are not so significant nowadays, anyway; which is probably because the world's central banks, thanks to their own fiat currencies, fractional-reserve banking systems and outright lying and fraud, can do anything we, and they, want, including saying preposterous things with a straight face, like saying that a yield curve inversion is a 'conundrum' when it is obviously much, much more than that, and all of it is ugly, ugly, ugly! Uglier than even That Idiot Mogambo (TIM) envisions. And I, Alan Greenspan, cruelly laugh and impatiently await the sublime delight of hearing your screams of unbearable pain and tormented anguish as inflation eats you alive, as I am the True Living Satan (TLS)!"

Okay, I admit, I got carried away there at the end, and I made up that whole last part, and pretty much everything else too, but I think you get the drift. Conundrum! Ha!

Larry Edelson of Money and Markets apparently doesn't care about either me or any drift, and with breathtaking brevity says, "In just the past week, the price of the 30-year benchmark Treasury bond swooned by two full points." The upshot is that, he says, we can "expect a disaster in the Treasury bond market."

Troy Schwensen, of The Global Speculator newsletter, has taken a look at the price of gold in Australian dollars versus inflation and interest rates during the 24 years from 1982 to 2006. "We can see that in this period where high interest rates eventually tamed core inflation, the actual price of gold fell below the theoretical value, as people regained confidence in the financial system and interest rates eventually declined. This consequently fueled unprecedented gains in financial assets."

It's the next part that gets our attention when he says, "We can see now in 2006 that a massive disconnect again exists between the actual and theoretical prices," and that the difference this time is that "Actual is just 33% of Theoretical".

So in trying to understand what is going on, it seems that somewhere along the line, the high price of gold fell to its theoretical value, and then overshot on the downside. And that's where we are now. And now the actual price is 300% below its theoretical value!

My sensitive Mogambo Investment Opportunity Sensors (MIOS) spring to alert, and an inner voice says, "Hmmm! This reverting to the mean thing seems intriguing to me for some reason! But why? Why? Why?"

Being a real stupid kind of guy, I missed the obvious conclusion that gold will again revert to the mean by going up in price until it reaches its theoretical value. Fortunately, there was a kindergarten class taking a field trip through Mogambo Galactic Headquarters (MGH), and

Larry, one of the smart-aleck little kids, saw me laboring over this an said “Hey! Stupid Mogambo Idiot (SMI)! It means gold will rise 300% and then overshoot to the upside, dork!”

My intense gratitude at learning this valuable piece of information directly offset my supreme irritation at being addressed so rudely by a little five-year-old brat that I could have easily beaten up if I wanted to (so watch it punk). Successfully throttling my rage, I ended up letting him off by sticking a “kick me” sign on his back, but he saw me and started running.

I had a big grin on my face and was just starting to take off after him when Larry’s teacher imploringly looked to Mr. Schwensen for help in controlling what appeared to be developing into another Unfortunate Mogambo Incident (UMI), who saved the day by putting it into a pithy nutshell when he went on to say, “Rising interest rates and high levels of debt are obviously not a good combination.”

Immediately spurred to action by his words, I change course, and run out of the door to get more money (probably by begging from total strangers) as my “friends” are all tapped out (so they say, the liars!), and I use the money to buy more gold. But as I am leaving, I stop in my tracks when he says that I may be making a mistake by not begging for money with which to buy platinum instead!

“Hmmm!” I say to myself! “Tell me more!” So they do, and it seems that John Ross Crooks at Money and Markets wrote, “The automotive and jewelry industries account for roughly 80% of annual demand for the metal. These days, about half of the world’s platinum goes into jewelry. Mines in South Africa and Russia account for 90% of the world’s platinum. All told, about five million ounces of the metal get hauled out of the ground annually. In case you’re wondering, that’s nothing compared to annual gold and silver production of 82 million ounces and 547 million ounces, respectively.”

I raise my hand, interrupting to ask, “Now, this is all very interesting, dude, but what is the point of it all to someone who is just interested in making a whole lot of money as fast as he possibly can so he can get out of this stupid town and away from these stupid people?”

Apparently he lives a very sheltered life, and I guess he has never seen a sociopath consumed by raw, naked greed before, but, obviously repulsed, he nonetheless graciously replies, “This year, stocks of platinum are expected to fall short of demand for the eighth year in a row”, which assumes I know how the supply/demand dynamic works. And brother, do I ever!

Until next week,

The Mogambo Guru
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Mogambo sez: The next question is: “They kept the market up through the election. Can they keep these markets up until January 1, 2007, so as to lock in the profits and thus lock in the taxes people must pay?”

Who knows? They'll try. But gold and silver and oil will continue to go up, and that's enough for right now.