The Long and Short of Bonds and Gold

By The Mogambo Guru

05/14/09 Tampa Bay, Florida John Stepek at Money Morning notes that Neils C. Jensen, in The Absolute Return Letter, reports that "using IMF statistics drawn from previous banking crises…the 12 most industrialised countries (including the US, UK and Japan) could need to issue a total of $33 trillion in debt to cover the costs of the crisis. And that's not even a worst-case scenario – that's based on the average rise in public debt in the three years following a banking crisis."

From this, he calculates that $33 trillion is equal to "about a third of total global savings," which is one hell of a lot of money, which is more than my wife can spend in a whole weekend.

Of course, this brings us to "Why You Should Be Worried About The Bond Market" by Dominic Frisby at Money Week, and instead of going over that old stuff about how bond prices move inversely to interest rates, I will skip right to the crux of the matter, which he notes is that "A collapsing bond market means higher interest rates," which is weird because I just said I would skip that part!

It must be more important than I thought!

Anyway, one of the Big Freaking Mysteries (BFM) that I ponder when I lock myself in the Big, Beautiful Mogambo Bunker (BBMB) while I am idly looking out of the periscope to survey the perimeter (and keep an eye out for my wife because that last fluorescent light in the bathroom burned out and she is probably wanting me to go to the store and get more bulbs and fix the damned thing and waste my Whole Freaking Day (WFD)) is, "How can bond yields can be so low? What kind of moron would be bidding up the prices of bonds so high that the yield is driven to insignificance?"

Jim Grant of Grant's Interest Rate Observer says, "The long bond is a better short than a long," to which he adds "and gold is a better long than a short."

Sure enough, the long bond fell and saw its yield jump 18 bps to 4.26%, and the 3.3% yield on the 10-year Treasury note is more than a full percent above its low, which corresponds to yields jumping by almost a third since the low!

The ugly side of this is that guys who already owned these kinds of bonds lost money. And with the incredible amounts of leverage that these guys use, where they buy the bonds by putting up only one dollar of their own and borrowing another twenty or a zillion dollars, they not only lost plenty, but are on the hook for twenty times or a zillion times more! Hahaha! What morons!

And it is not just bonds that are going to need a lot of money to be created with which to buy them, but corporations are issuing lots and lots of new shares to get (I assume) enough money to keep going and pay themselves princely sums until inevitable bankruptcy, and, so far, the leader seems to be General Motors, which "announced in a filing with the SEC that it is issuing 60 billion new shares, a move which, if it meets with US Treasury approval, would dilute common shareholders into oblivion."

Sixty billion shares? Sixty billion shares? That's ten shares of GM for everybody on the planet! Hahaha! That's going to take a lot of money!

And if it is money you need, Bill Bonner here at The Daily Reckoning reminds us that "Normally, in a correction, the supply of money – M1 – falls. Asset values are destroyed…borrowers default…money disappears into vaults and mattresses. But this time, so vigorous has been the authorities' response that M-1 is actually increasing at about a 14% annual rate."

He then ominously notes that all of this new money sloshing around already has significant portent, as "The money's got to go somewhere…" with an ellipsis at the end to add that subtle spooky undertone to the whole thing.

With nerves on edge because of that ellipsis thing, I gotta ask, "So what in the hell is going on? And I thought there was going to be a free buffet and an open bar!"

Ignoring my rude outburst, he noted, "Equity losses last year were worse than those of '29. It stands to reason that the next phase – the economic decline – will also be worse than the '30s," mostly because "the U.S. economy carries about $20 trillion of excess debt. Until that debt is eliminated, the idea of a healthy boom is a mirage."

To my horror, he went on, "Getting rid of that debt either involves a long, hard period of work and sacrifice – as debts are paid down. Or, it involves something much worse."

Now you suddenly remember his use of an ellipsis! "A long, hard period of work and sacrifice"! Yikes! What in the hell could be worse than "a long, hard period of work and sacrifice" you want to know?

Well, now that you ask, many things instantly come to mind, such as the inflation in consumer prices that all this new money will create, most of them highly reminiscent of the French Revolution, only worse.

And then there is the horror of having teenage children, to name two!

Mr. Bonner says that he figures that I have nothing to worry about because "the feds – who still have no idea what is going on – will choose the second solution…something much worse."

I gulp in dismay, as he did NOT rule out the possibility of more teenage children screaming at me that I am stupid, that I don't know anything about anything and I am wrong about everything.

But I am, secretly, not stupid, nor am I wrong about everything, as I can easily prove by just buying gold, silver and oil, waiting a little while until prices soar because of all this money being plowed into the world economy to produce Mr. Bonner’s “something much worse,” and then shaking all that money in their smarmy little faces and yelling into those same smarmy faces, “Who’s stupid now, ya nasty brats?”

Whee! This investing stuff is easy! And sometimes fun, too! “Nasty brats”! Hahaha!