



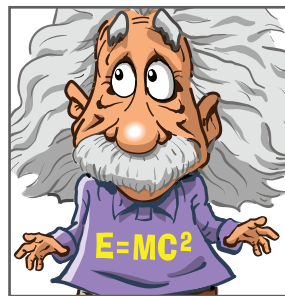
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Investment Outlook

from Bill Gross

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Breaking News!



Tired of reading about the Kardashians? Sick of egocentric politicians? Disgusted with endless war in the Middle East? Getting bored reading these monthly Outlooks? (not that bored or you wouldn't be reading this). Here's some "breaking news" that I find really interesting and I hope you will too. It's a recent summary of some things that scientists have discovered over the last few decades. Prepare to be amazed.

- 1) Velocity and gravity can make time stand still – relatively, that is. Einstein's concept of "spacetime" proposes that the gravitational pull at the center of a black hole freezes the stopwatch of time. If you could live there, billions of years in the universe could pass, and you would not have aged one second. Similarly, time stops if an object travels at the speed of light. Even by traveling at 450 miles an hour in an airplane, your "time" relative to a stationary friend on Earth would pass more slowly than hers. To be "relatively" immortal, forget about cryogenics – just go fast, or live in a dark hole.
- 2) The universe has trillions of identical but separate twins. Two different "particles" separated by light years in space – one at one end of the universe, the other at the opposite, can influence each other. If one turns "right", the other one will turn "left" and at exactly the same time. Quantumly spooky!
- 3) Scientists have shown that "particles" can suddenly appear out of nothing – even a vacuum – and then disappear again into nothingness. It seems strange that you could get something from nothing, but that there once was nothing 15 billion years ago, and now there is a universe, is evident proof that you can. One theory behind the creation of our universe is that a small "particle" showed up completely from a "void" and then "expanded" exponentially into the universe we know today. Big Bang? Yes – most know this – but the "singularity" from nothing? Mind blowing.

- 4) Something can either be here or not here, depending on whether you're looking. Remember the old twister about "if a tree falls in the forest and no one hears it, does it make a sound?" Science says "no". Observation matters. This is the puzzle of "Schrödinger's Cat". Hidden in a box, this quantum "cat" can be alive or dead depending on whether you look inside. Be careful then, about how you treat your own Tabby. Check on it often to make sure it'll be there tomorrow.
- 5) Carbon and all the heavier elements of which we are composed (a little gold by the way) were manufactured or cooked by Supernova stars at tremendous heat. Those stars eventually exploded and the elements somehow coalesced into other stars and planets, eventually to make us. So we are "golden – we are stardust" – Crosby, Stills and Nash were right. And by the way, you and I are composed of some of the identical atoms as Genghis Khan and Columbus were. Not Elvis though. Nature hasn't had enough time yet to spread him around.
- 6) Dark Matter – So 2/3 of the universe is made up of dark matter – matter that supposedly doesn't emit or reflect light. This one's mysterious to me but I'm going with it because scientists seem certain the universe couldn't stay together unless it was there. And God said, "Let there be dark matter!" Have to change a few verses in the Bible, I guess.
- 7) Global warming is a fact. Nah, I won't go there – they haven't really proved it, now have they? After all, if a cat can either be here or not here depending on whether you're looking, then global warming deniers just need to avoid looking for the signs, and it won't exist. See – science is on their side after all.

Some of this isn't actually breaking news, but then for Fox and CNN, everything is. So I'm just following their example. If you're incredulous or just mad by now, go back to the Kardashians. Caitlyn has a new wardrobe she is just dying to show off, and the war in the Middle East will still be going on.

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More breaking news – this time on the investment side: central banks are casinos. They print money as if they were manufacturing endless numbers of chips that they'll never have to redeem. Actually a casino is an apt description for today's global monetary policy. There is a well-known "foolproof" system in gambling circles that is sophisticatedly called the "Martingale". I used to call it "double up to catch up" at my fraternity's poker table where I was consistently frustrated (loser) – not because I used Martingale but because I wasn't a good bluffer. Today's central bankers use both tactics to their success – at least for now. They bluff or at least convince investors that they will keep interest rates low for extended periods of time and if that fails, they use Quantitative Easing with a Martingale flavor. Martingale theorizes that if you lose one bet, you just double the next one to get back to even, but if you lose that one you do it again and again until you win. Given an endless pool of "chips", the theory is nearly mathematically certain to succeed, and in today's global monetary system, central bankers are doing just that. Japan for years has doubled down on its QE and Mario Draghi's statement of several years past, "Whatever it takes" – is a Martingale promise in disguise. It vows to get the Euroland economy back to "even" and inflation up to 2% by increasing QE and the collateral it buys until the Euro currency

declines, the EZ economy improves, and inflation approaches target. Currently the ECB buys nearly 55 billion Euros a month, and this Thursday they will up the ante – Martingale or bust!

How long can this keep going on? Well, theoretically as long as there are financial assets (including stocks) to buy. Practically the limit is really the value of the central bank's base currency. If investors lose faith in a reasonable range for a country's currency, then inflation will quickly hit targets and then some. Venezuela, Argentina, and Zimbabwe are modern day examples. Germany's Weimar Republic is a great historical one. Theoretically, if the whole developed global economy did this at the same relative pace and stopped at the right time, they could successfully reflate and produce a little bit of inflation and a little bit of growth and save the globe from the dreaded throes of deflation. That is what they are trying to do – Quantitative Easing, Martingale style – and so far, so good, I guess – although no rational observer would call these post Lehman efforts a success.

That they haven't really succeeded is a testament to what I and others have theorized for some time. Martingale QE's and resultant artificially low interest rates carry distinctive white blood cells, not oxygenated red ones, as they wind their way through the economy's corpus: they keep alive zombie corporations that are unproductive; they destroy business models such as insurance companies and pension funds because yields are too low to pay promised benefits; they turn savers into financial eunuchs, unable to reproduce and grow their retirement funds to maintain expected future lifestyles. More sophisticated economists such as Kenneth Rogoff and Carmen Reinhart label this "financial repression". Euthanasia of the saver is the result if it continues too long.

But this is theorizing much like Schrödinger's cat. How many people care about the existence of a quantum feline? (A few, thankfully, but not many.) Market observers say "show me the money" and when they look inside the box, they want to see some, so let's get down to business.

How does all this play out? Timing is the key because as gamblers know there isn't an endless stream of Martingale chips – even for central bankers acting in unison. One day the negative feedback loop on the real economy will halt the ascent of stock and bond prices and investors will look around like Wile E. Coyote wondering how far is down. But when? When does Martingale meet its inevitable fate? I really don't know; I'm just certain it will. Doesn't help you much, does it. Except to argue that much like time is relative to the speed of light, the faster and faster central bankers press the monetary button, the greater and greater the relative risk of owning financial assets. I would gradually de-risk portfolios as we move into 2016. Less credit risk, reduced equity exposure, placing more emphasis on the return of your money than a double digit return on your money. Even Martingale casinos eventually fail. They may not run out of chips but like Atlantic City, the gamblers eventually go home, and their doors close.

-William H. Gross

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