

What Will a Rotation Into Hard Assets Look Like?

In "The Power of Gold", Peter Bernstein wrote that "In 1959, the amount invested in gold was about one-fifth of the market value of all US common stocks. In 1980, the \$1.6 trillion invested in gold exceeded the market value of \$1.4 trillion in US stocks". After a period of extremely low inflation and massive growth in financial assets this ratio has changed dramatically. The value of stock and bond market investments now vastly exceeds gold and other hard asset investments. In a 2005 study, Tocqueville Asset Management found that 'the market cap of all above-ground gold - including central bank reserves - equals about 1.4% of global financial assets.'" Where will hard assets prices go when the rotation out of financial assets begins in earnest and this ratio returns to previous levels?

Freddie and Fannie Update

Between the two of them, these organisations either own or have guaranteed \$5 trillion dollars of US mortgages - 70% of the market. Their solvency is in serious doubt due to accelerating mortgage defaults. The US government is attempting to bail them out to the current estimated tune of \$125 billion. Does anyone believe this will be the final figure?

- **March 2001** – "Executives of Fannie Mae and Freddie Mac assured Congress yesterday that the companies, which dominate the U.S. mortgage finance business, are **run soundly and pose no risk to the global financial system.**" *Washington Post*
- **February 2004** – "The heads of mortgage giants Fannie Mae and Freddie Mac assured senators Wednesday that their **collapse was unlikely.**" *Washington Post*
- **November 2007** – "Freddie Mac, which **reported a record loss of \$2.03 billion in the third quarter this week,** may have underestimated when it projected that 0.11

percent of the debt it guarantees will go bad in the next two years." *Washington Post*

- **July 2008** – "William Poole, former president of the St Louis Federal Reserve, believes **both are insolvent as a result of heavy losses,** pointing out that Freddie, the smaller of the two, owed \$5.2bn more than its assets were worth at the end of the first quarter. "Congress ought to recognise that these firms are insolvent, that it is allowing these firms to continue to exist as bastions of privilege, financed by the taxpayer," he said." *The Telegraph*

On the hunt for farmland in Russia:

Companies listed on European exchanges have been acquiring large amounts of farmland in Russia:

- Trigon Agri (market capitalization of \$287.8 million - Denmark). The company was set up in 2006 by Trigon Capital investment group and controls 100,000 ha of farm land in the Penza and Samara regions;
- Agrowill Group AB (market capitalization of \$76.7 million - Lithuania). Purchasing land in the Penza Region and plans to secure up to 50,000 ha in the Black Earth area before the end of the year;
- Black Earth Farming, controlled by natural gas producer Vostok Nafta and which manages more than 300,000 ha of farm land in the Central Black Earth area; and
- RAV Agro-Pro (IPO'ing) which controls 82,000 ha.

The Russian Land Code forbids foreign nationals and companies, as well as Russian companies more than 50% owned by foreigners, to own farm land.

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Brief History of Paper Currency

China: The Mongol currency was the world's first true fiat currency. The Mongol government attempted to prohibit all transactions in or possession of silver or gold, which had to be turned over to the government. Inflation in 1260 caused the government to replace the existing paper currency with a new paper currency in 1287 but inflation caused by undisciplined printing remained a problem for the Mongols until the end of the Dynasty." Wikipedia Marco Polo was a first hand witness to this period and in more lively terms wrote "Population and trade had greatly increased, but the emissions of paper notes were suffered to largely outrun both...All the beneficial effects of a currency that is allowed to expand with a growth of population and trade were now turned into those evil effects that flow from a currency emitted in excess of such growth. These effects were not slow to develop themselves...The best families in the empire were ruined, a new set of men came into the control of public affairs, and the country became the scene of internecine warfare and confusion."

France -- Livres, Assignats, and Francs

- Attempt 1: 1716 - John Law introduced paper money to France in the form of fivres. Louis XV required that all taxes be paid in livres. Ostensibly, the currency was backed by coinage. The new paper currency was rapidly inflated until nobody wished to hold worthless paper and demanded the coinage. After making it illegal to export any gold or silver, and the failed attempts by the locals to exchange their paper currency for something of actual value, the currency collapsed.
- Attempt 2: 1791 - In the latter part of the 18th century, the French government tried fiat currency again - called "assignats". By 1795, inflation of assignats was running at approximately 13,000%.
- Attempt 3: In the 1930s, the French government took over the Bank of France and introduced the paper "franc". It took only 12 years for them to inflate their currency until it lost 99% of its value.

Weimar Germany – Mark: Post-World War I Weimar Germany is one of the greatest and most famous periods of hyperinflation in history. The Treaty of Versailles imposed heavy reparations on Germany. The German government took the expedient view that the only way it could make repayment was by physically printing the funds. Inflation went so high that it was cost effective for German citizens to burn marks to heat their homes. Here is a brief timeline of the marks per one U.S. dollar exchange rate:

- April 1919: 12 marks
- November 1921: 263 marks
- January 1923: 17,000 marks
- August 1923: 4.621 million marks
- October 1923: 25.26 billion marks
- December 1923: 4.2 trillion marks.

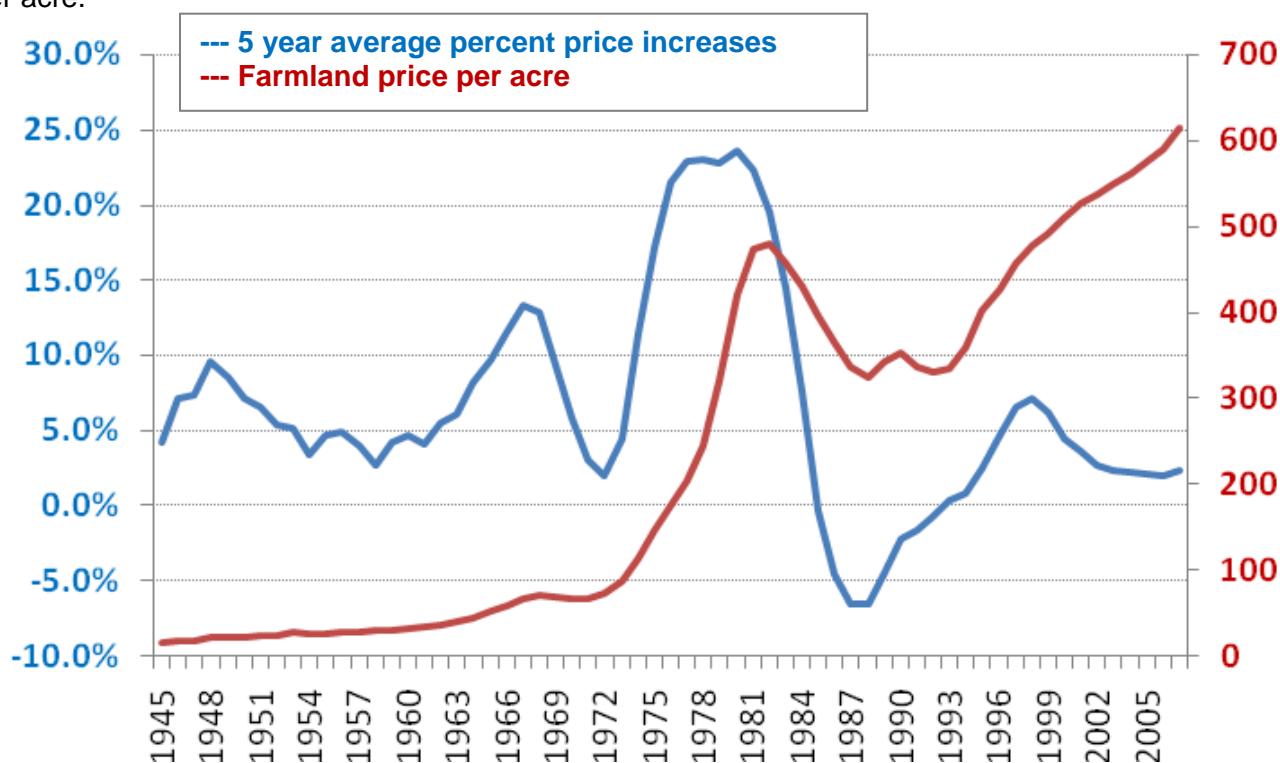
Some More Recent Examples:

- **Argentina** – 1932 – Paper currency and central bank launched. Currency collapses in 2001
- **Mexico** – 1994 - Mexico went through the infamous "December Mistake," triggered by the sudden and massive devaluation of the peso which spread economic hardship throughout Latin America, particularly in Brazil.
- **Thailand** – 1997 - The Thai baht collapsed and the effects spread to Malaysia, the Philippines, Indonesia, Hong Kong, and South Korea.

- **Russia** – 1998 - The Russian ruble was devalued and domestic sovereign debt was defaulted causing a general collapse in the Russian stock, bond and currency markets.
- **Zimbabwe** – Present - Zimbabwe, once considered one of the wealthiest countries on the continent, now has price controls, combined with hyperinflation, caused by unbridled expansion of the money supply.

Farmland Prices in Western Canada

During the last commodity bull market, roughly the period from 1970 to 1980, the average price of Canadian farmland rose over 550% (approximately 20% pa ungeared) – from around \$100 per acre to around \$550 per acre.



Annual price increases in the mid-twenty percent were not uncommon during this period as can be seen from the chart of Stats Canada data above.

Peak Wheat Defined

"Peak wheat is the concept that agricultural production, due to its high use of energy inputs, is subject to the same profile as oil and gas production." *Wikipedia*

Inflation Watch

Hey Mister, Wanna Buy Some Mortgage Backed Bonds?

"Receivers for Cheyne Finance Plc, the first of the structured investment vehicles to auction assets after collapsing last year, accepted bids at **43.9% of face value**. Deloitte & Touche LLP asked banks to bid for \$2.29 billion, or 30.9%, of the SIV's debt holdings this week. The auctioned holdings include asset-backed securities and collateralized debt obligations, according to Moody's..." *Bloomberg*

Diamonds are Forever...

"Diamonds, like art, are a commodity that is gaining attention as an alternative investment. Increases in the price of the rarest colorless and colored diamonds are attracting wealthy investors and structured funds as stock markets and real-estate values decline. **The price of 5-carat gems with the potential to be sold at \$1 million or more has risen 76.5% in the year** to May 2008, according to... the Web site of the International Diamond and Jewelry Exchange... Five years ago, dealers were paying \$70,000 per carat for colorless diamonds of 10 carats and more... 'Now we're paying over \$200,000 per carat...' *Bloomberg*

Inflation as far as the eye can see

"The main driver behind rising global inflation pressures is well understood: a very lax global monetary policy stance, particularly in the U.S. and in many emerging-market countries. This has fueled higher food and energy prices, and other prices are likely to follow -- especially as most central banks around the world are unlikely to tighten policy sharply anytime soon. So it is not

surprising that inflation is rising everywhere." *Wall Street Journal*

"New Zealand's consumer prices rose at the fastest pace in 18 years in the second quarter, fanned by fuel and food costs, adding to signs the economy is facing stagflation as it slips into recession. The consumer prices index rose 1.6% from the first quarter..." *Bloomberg*

"Money supply in India grew 20.5% in the two weeks ended July 4 from a year earlier..." *Bloomberg*

Mexico Tries Food Price Controls

"Felipe Calderón, the president, announced that prices for goods such as cooking oil, flour, canned tuna, fruit juices, coffee, ketchup and canned tomatoes would remain fixed until the end of the year. "This reflects the commitment of Mexican businessmen to the country and to price stability," said Mr Calderón. He has blamed rising global energy prices, soaring food demand in China and India and the use of corn for ethanol production for high food costs which have caused political unrest in many parts of the world. "This is a measure that will positively and directly benefit the finances of millions of Mexicans," he said. Food prices have reached historic highs almost everywhere in the world, with governments under pressure to ease the burden on shoppers." *The Telegraph*

Quotable Quotes:

Just How Bad is Citigroup?

"At an investor presentation in May, Citigroup Inc. Chief Executive Officer Vikram Pandit said shrinking the bank's \$2.2 trillion balance sheet, the biggest in the U.S., was a cornerstone of his turnaround plan. Nowhere mentioned in the accompanying 66-page handout were the additional \$1.1 trillion of assets that... Citigroup keeps off its books: trusts to sell mortgage-backed securities, financing vehicles to issue short-term debt and collateralized debt obligations, or CDOs, to repackage bonds... 'If you start adding up all

the potential exposures, it's a huge number,' said Sam Golden, a former ombudsman for the U.S. Office of the Comptroller of the Currency... 'The banks will say that it was disclosed. Investors are saying, 'Yeah, but it was cryptic. We really didn't know what you were telling us.'" *Bloomberg*

Farmland Best Recession Hedge

Reza Vishkai, head of alternatives at fund manager Insight, says: "From an investor's standpoint, equities are the long-term asset – that's where you get the higher rates of return. But you can hit periods like now that wipe out the returns". He adds: "Diversification makes a huge amount of sense. **The single best recession hedge of the next 10 or 15 years is an investment in farmland.**" he says. "Demand is going up very strongly on a global basis." *Independent*

Inflation and Currency

In "Economic Consequences of the Peace" John Maynard Keynes wrote: "Lenin is said to have declared that the best way to destroy the capitalist system was to debauch the currency. **By a continuing process of inflation governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens.** By this method they not only confiscate, but they confiscate arbitrarily and, while the process impoverishes many, it enriches some. The sight of this arbitrary arrangement of riches strikes not only at security, but at confidence in the equity of distribution of wealth. Lenin was certainly right. There is no subtler, no surer means of overthrowing the existing order of society than debauching the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose."

Commodity Price Changes (as of July 23rd)

	Today	1 Year Ago	Change
Corn	5.22	2.84	84%
Natural gas	9.95	5.60	78%
Barley	7.25	4.15	75%
WTI Crude	123.69	75.99	63%
Soybean Oil	0.56	0.35	61%
Gold	934.75	677.25	38%
Platinum	1771.00	1317.00	34%
Silver	17.59	13.18	34%
Cocoa	3064.00	2362.00	30%
Wheat (KC)	8.14	6.34	28%
Coffee	1.31	1.08	21%
Aluminum	1.36	1.19	15%
Cotton	0.65	0.57	13%
Beef	148.67	131.86	13%
Sugar	13.80	12.31	12%
Cheese	205.25	185.50	11%
Chicken	0.89	0.81	10%
Wool	3.05	2.85	7%
Copper	3.71	3.57	4%
Eggs	0.81	1.07	-24%
Milk	145.00	193.00	-25%



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