

COOKING DUCKS WITH COGNAC

December 7, 2010

As most of you know, we lost John in August. Along with the profound personal loss to our family and friends we also lost a talented, eloquent and humorous writer. Over the years his insightful and thought-provoking commentaries brought enjoyment to many, many readers. Recently I was looking at our website www.hamiltonadvisors.com where many of his commentaries are posted and marveled at their very clever titles. Over the years the inspiration for these titles came about for various reasons. Frequently we would be together when someone would say something and a catchy phrase would pop into his head and I might remark "That would be a great title for your next commentary." In fact his final commentary done shortly before he passed away was titled "*Subito Finito.*" That came about when we were in the Italian region of Switzerland visiting some friends and one of them used that phrase.

Awhile ago Brock and I were laughing about a story that John recounted several times over the years about a duck hunting weekend with two friends many, many years ago when John was a young man. They had a successful day of duck hunting and that evening cooked a few ducks. No wives were along for this weekend and the three men were inexperienced cooks. A bottle of cognac presented itself and one of the men had the brilliant idea of throwing a little cognac in with the ducks. *Sounds good, doesn't it?* Being a little culinary challenged he wasn't sure of the correct amount so why not err on the generous side? He doused the ducks with cognac! As the evening progressed the three had more than a little cognac themselves and basically forgot about the time until an enormous explosion occurred in the oven which literally blew the door off the oven and splattered smithereens of duck all over the kitchen.

A couple of hours after Brock and I were laughing about this story he called me into his office as he was watching all four of his computer screens showing financial market information around the world – charts of every type - stocks, bonds, currencies, commodities, gold, economic activity, etc., etc. We discussed the current activities of the Federal Reserve Bank and the Treasury. Brock remarked "What the Fed is doing is sort of like cooking ducks with cognac." Hence, the title of our commentary. What the Fed is doing might sound good but we wonder when something is going to explode. Although we do not possess John's great talent for writing and cannot begin to fill those shoes we will from time to time attempt to write something interesting and meaningful. The following is our first attempt.

On Sunday night I watched Ben Bernanke on *60 Minutes*, an unusual venue for a Fed Chairman as he discussed quantitative easing or "QE2" as it has come to be known. I immediately wondered how many Americans know the name Ben Bernanke or the term "The Fed" or have any idea whatsoever what he or it does. If one were to ask the average American "What is QE2?" the answer would most likely be "A ship?"

The concern over QE2 is deep and widespread. Bernanke attempted to smooth the waters and defend his actions and his rationale for purchasing \$600 billion dollars worth of Treasury bonds to keep interest rates low. He even went on to say there could be further easing in the not-too-distant future. The thinking behind all this appears to be that with interest rates so painfully low (Pimco's Mohamed El-Erian actually called them "confiscatory") the average investor will be prompted to buy apparently riskier assets such as stocks and then when these stocks rise in price they will feel richer and then go out and spend which in turn helps the economy. Again, *sounds good, doesn't it?* When asked about the Fed's ability to act fast enough to keep inflation from getting out of control Bernanke responded that his degree of confidence in his ability to do so was 100%. Really? Again, *sounds good, doesn't it?* Bernanke hasn't exactly been right lately. Also, our government's claim that there is no inflation makes us wonder what planet they are living on. Have you looked at commodity prices lately? Here is a sampling of the price increases of a few commodities in the last year:

Corn +49%
Cotton +78%
Sugar +32%
Coffee +40%

On November 19th Andy Kessler's article "What's Really Behind Bernanke's Easing?" appeared on the Opinion page of the *Wall Street Journal*. In it he makes a good argument as to what is really behind the Fed Chairman's thinking. Kessler's explanation is "Without another \$600 billion floating through the economy, Mr. Bernanke must believe that real estate (residential and commercial) would quickly drop, endangering banks." Later in the article Kessler goes on to say: "Mr. Bernanke is clearly buying time with our dollars. If real estate drops, we're back to September 2008 in a hurry. On Wednesday, the Fed announced that all 19 banks that underwent stress tests in 2009 need to pass another one. This suggests central bankers are nervous about real-estate loans and derivatives on bank balance sheets."

So, what to do? Kessler's idea is to detoxify and recapitalize the big banks by moving "the toxic debt onto the balance sheets of the FDIC and Fed, and refloat the banks with fresh capital." That is a topic for another commentary.

We used to think in millions, then billions and now trillions. So what is a trillion dollars? This is from Art Cashin of UBS: "To get a billion dollars you would have to set aside \$500,000 dollars per week for 40 years. And a trillion that would require \$500 million every week for 40 years. Even with these examples, the enormity is difficult to grasp."

The first decade of the 21st century has been a difficult one for America – September 11th, two lengthy wars, high unemployment, collapsing real estate prices, foreclosures and bankruptcies, volatile financial markets, a shaky dollar, corruption and runaway greed in government and on Wall Street (nothing new there), and we could go on and on.

A word about gold. Frequently we are asked about it. We began accumulating it when the price per ounce was about \$600. We don't have to tell you what has happened since. Attached to this commentary is a chart showing the price of gold and the S&P 500. Gold throughout history has been a store of value, a safe haven and sometimes a way out of danger. We are seeing today the same rationale for its accumulation as we have seen many times throughout history. In Felix Rohatyn's most recent book *Dealings* he begins with the well-known tale of his harrowing escape in 1940 from Nazi-occupied France as a twelve-year-old Jewish boy traveling by car with his mother, grandmother and Polish cook. And what did his mother whom he describes as "ingenious, fearless, and tenacious" have hidden in her toothpaste tubes? GOLD COINS. People around the globe are once again buying gold coins along with gold ETFs in an attempt to protect themselves from a very uncertain world. When one adjusts the price of gold for inflation we are still nowhere near its all-time high. We continue to be bullish on the price of gold.

John was sometimes, actually often, criticized for being a little "doom and gloom" and as we reread this commentary it is pretty gloomy. However, last night Mr. Bernanke expressed great faith in the American people and their resiliency and we tend to agree with Ben on that one. America is a great nation in many ways and there is great comfort in reading our history and the greatness of the individuals who shaped it.

The esteemed author and historian David McCullough was a great and long-time friend of John's. They went to school together for nine years and were roommates at Yale. David's affectionate nickname for John was "Ham" and David was probably the only person in the world who could have gotten away with calling him that and better yet, John even liked it!

David's most recent book is a beautiful little gem titled *In the Dark Streets Shineth*. Along with the book comes a DVD which is David's narration with the Mormon Tabernacle Choir. In December of 1941 just days before Christmas and just days after Pearl Harbor (the 69th anniversary of which just happens to be today), Churchill secretly crossed a dangerous Atlantic for a meeting with Roosevelt. On Christmas Eve as a nervous America prepared for war the two leaders addressed a crowd of 20,000 from a balcony at the White House while a beautiful crescent moon hung in the sky. This book is an uplifting story in a time when our country faced great danger and is something positive for families and friends to read as we gather together at this beautiful time of year.

We would like to take this opportunity to wish you and yours a very happy holiday season and many blessings in the New Year.

Most sincerely,

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Click below to see our national debt clock:

<http://www.usdebtclock.org/#>

Below is a 10-Year Chart showing the performance comparison of Gold vs. the S&P 500. The S&P is down over 8% and Gold is selling for more than 5 times what it was worth in December of 2000.

