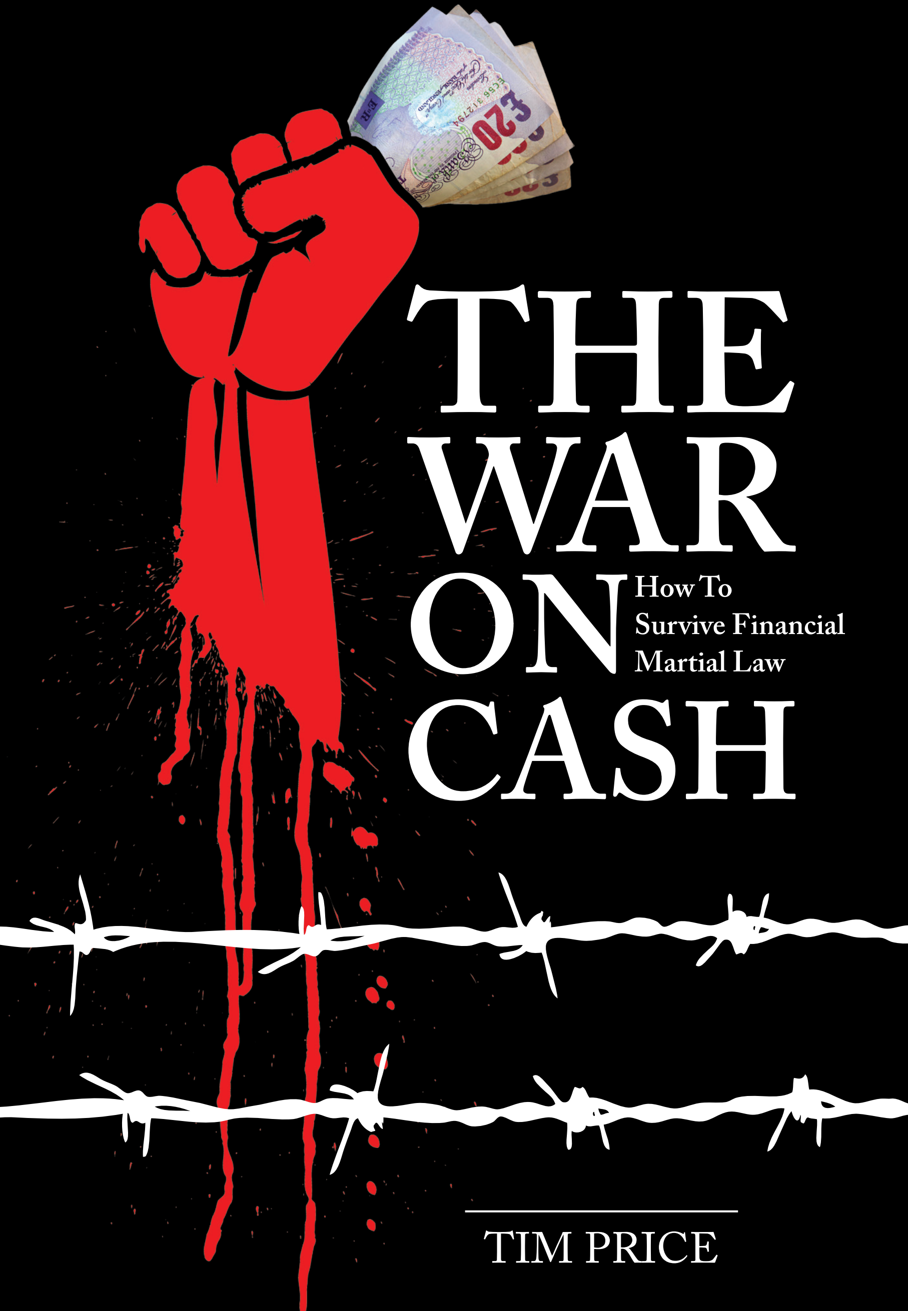

THE WAR ON CASH

How To Survive Financial Martial Law

TIM PRICE

Tim Price

THE WAR ON CASH

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About The Author

Tim Price has been based in London and working in the capital markets since 1991. A graduate in English from Oxford University, he began his career in investment banking (Paribas, Merrill Lynch) and latterly moved into private client portfolio management.

Since 2001 Tim has worked in the role of Chief Investment Officer for a number of private banks and wealth management firms.

Tim has been nominated for five successive years in the Private Asset Managers (PAM) awards programme and was a winner in 2005 in the category of 'Defensive Investing'.

Tim's investment approach has long been focused on capital preservation and the generation of absolute returns. This approach incorporates multiple asset classes – more specifically, the use of high quality bonds; unconstrained 'value' equity investments; uncorrelated funds; and real assets, including the monetary metals, gold and silver.

Tim also writes two investment advisory newsletters, *London Investment Alert* and *The Price Report*. Tim is also a regular columnist for *MoneyWeek* magazine and no stranger to twitter (@timfprice).

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In 1694, a consortium of English bankers made a loan of £1,200,000 to the King. In return they received a royal monopoly on the issuance of banknotes. What this meant in practice was they had the right to advance IOUs for a portion of the money the King now owed them to any inhabitant of the kingdom willing to borrow from them, or willing to deposit their own money in the bank – in effect, to circulate or "monetize" the newly created royal debt. This was a great deal for the bankers (they got to charge the King 8 percent annual interest for the original loan and simultaneously charge interest on the same money to the clients who borrowed it), but it only worked as long as the original loan remained outstanding. To this day, this loan has never been paid back. It cannot be. If it ever were, the entire monetary system of Great Britain would cease to exist.

David Graber, *Debt: The First 5,000 years*

It's one of those little quirks of history that the cash in your wallet can only exist as long as the Crown never pays back a loan. But that's the logic on which the Bank of England was founded, according to David Graber is his book, *Debt, The First 5,000 Years*. As much as we've come to view cash as something with real, intrinsic value, it's still someone else's promise to pay.

Yet in your everyday life, you use cash without a thought. That's precisely its biggest benefit. You don't have to think about what it is, or that it's actually someone else's debt. Neither does the shopkeeper or ticket seller or waiter you're doing business with.

Cash gives you the ability to do business with almost anyone, anywhere at any time. Economists call that ability 'liquidity.' I call it freedom. And that's what this book is about.

If your cash is taken away from you – *or it's taxed by the bank or the government with a negative interest rate* – it's not just an attack on the value of your money. It's an attack on your freedom. That attack is part of what my friend Tim Price calls Financial Martial Law.

Cash, freedom, and government control

If the claim above sounds alarming to you, it should. It may even sound unbelievable – not the sort of thing that could happen in a democratic country where our leaders are accountable to us at the ballot box. That's a fair point.

But in *The War on Cash*, Tim will show, point by point, how we got here. By 'here' I mean a situation where officials at the Bank of England are floating ideas on how to tax your cash or eliminate it altogether. Before we get into that, though, you may be wondering why Bank officials would consider something so unpopular with the British public.

The answer to that question is surprisingly easy: because it's the only option left when the financial system breaks down. To prevent you from taking money out of your bank or hoarding cash – two things that would bring Britain's economy to a screeching halt and usher in a financial calamity – you must be prevented from taking possession of your own money.

In a way, that's what the bank 'bail-ins' in Cyprus were about.

It's also why ATMs 'run out of cash' or flash 'system unavailable' signs in a financial panic. If you're from the government or the bank, you can't prevent a panic. But you CAN prevent people from doing something about it.

Of course, restricting, prohibiting or even abolishing cash is a symptom of a larger problem. The larger problem is that ordinary people are losing confidence in the economy and the financial system. It's a system that runs on enormous amounts of debt and credit creation.

The British government has large debts. The American government has large debts. And there is so much government and corporate debt in China that no one knows precisely how much there is. And around the world, individuals and households are burdened with large mortgages and credit card debts.

This system is good for people who loan money (banks) and bad for people who must borrow money (you and I). Look around you and you'll see how much of our 'prosperity' is based on debt. Much of our good fortune depends on people believing that you can get something for nothing, and that debt is the same as money.

It is not. As Tim's book will show you, *the War on Cash* is a way of preserving a badly-flawed financial system based on debt. To preserve that system (and the benefits that flow to the people who run the system), your freedom of action must be taken away from you. The most direct way to do that – when all other options have been exhausted – is to restrict your use of cash or abolish physical cash altogether.

Abolition by design, or by accident?

Helpfully, the Bank of England itself has published a report recently on the history of cash in Britain. It's called, *How has cash usage evolved in recent decades? What might drive demand in the future?* This paper serves as an excellent guide to why the Bank is so interested in cash right now, and what it might do with your cash in the future.

Now, if you read the paper, you certainly won't get the sense that the Bank itself is planning anything like Financial Martial Law. But that brings me to an important point. Financial Martial Law has the ability to destroy your wealth and ruin your life even if it's not explicitly designed by one organisation or a group of individuals. It can happen by accident or by evolution and be just as devastating.

Why is this important?

Well, if you're like me, you probably like to see the best in people. You find it hard to imagine that anyone – except a villain in a James Bond movie – would set out to destroy your life and ruin you financially. Similarly, I don't believe the motives of the people taking steps to Financial Martial Law are sinister. Nor do I believe those people are evil.

In fact, they probably think they are doing the right thing. That is what makes them so dangerous. They are trying to solve a real problem: a loss of confidence about the financial future and a genuine concern about the safety of your money in the bank.

But their solutions to that problem have one thing in common: they each involve you having less control over your money, less access to your cash, and finally, the abolition of your cash altogether and the removal of your financial freedom.

That may sound like an exaggeration now. Or a scenario that's so unlikely that it's not worth planning for. But as Tim will show you, the situation is playing out exactly as he's foreseen. Those who look furthest ahead to see where we're going will find the conclusions here almost inescapable.

Defining key terms

There a few important terms relating to cash that it's important you understand before reading the rest of this book. These definitions are not mine, by the way. They're taken from the Bank of England paper I mentioned above.

Let me share them with you and then show you why I think they confirm our worst suspicions: that negative interest rates could be used to tax your cash and force you to use 'digital cash' that can be monitored, controlled, and confiscated.

In addition, I'll share some facts presented in the paper. They show how cash is currently used. They also show why the payments system is so important to the modern economy. Indeed, without a reliable payments system, there would be NO modern economy. Let's begin!

- ninety-seven percent of the money belonging to people in the UK is held electronically as deposits. The remainder – just 3% of all wealth – is held in cash.

- Your bank 'creates' money when it makes a loan. **When a bank makes a loan, a deposit is created in the borrower's account**. The borrower can spend the money electronically, with a card. Or he can withdraw cash and spend it.

- The Bank of England does not, at present, try to influence the demand for cash. The public's demand for banknotes is left up to the public, for now.

- A Bank of England note is an IOU from the bank to the holder of the note. The note is known as a **'bearer instrument'.** That means the Bank will pay the bearer of the note the sum indicated on demand. No proof of ownership is required with a 'bearer instrument'. If you hold it, you're assumed to be the owner.

- Bank of England notes used to be exchangeable for gold. The United Kingdom left the **'gold standard'** in 1931. Since then, Bank of England notes have been **'fiat money'.** That means the bank notes are not convertible into anything else like gold. Bank notes are 'repaid' with other bank notes or electronic funds.

- The Bank of England has a monopoly on the printing of British money. It makes money on this monopoly by selling its notes to commercial banks like the one you have your money at. The money it earns from selling the notes is then invested in an interest-bearing asset like a government bond. In this way, the Bank can 'earn' money at virtually no cost. **This process of earning money by having a monopoly on printing banknotes is called 'seignorage'.** The Bank passes this money on to HM

Treasury. In the last fiscal year, the Bank paid the Treasury £506 million in 'seignorage'.

- As of July 2015, there were nearly 3.5 billion banknotes in circulation in the UK. The notes, in four different denominations (£5, £10, £20, and £50) totalled £62.6 billion.

- The printing of Bank of England notes is done by a private firm named De La Rue plc.

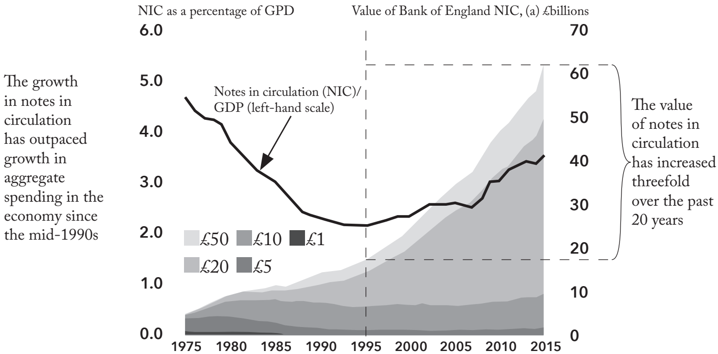
- Money has three traditional roles in an economy: a unit of account, a store of value, and a medium of exchange. For money to function as a medium of exchange, you must have a secure way of transferring it.

- Since 1921, the Bank of England has been the sole issuer of banknotes in England and Wales.

- Consumer credit at the point of sale (POS) was first introduced into the United Kingdom in 1961. Automated electronic payments followed in 1968. Debit cards were introduced in 1987.

- The present demand for cash has been driven by the demand for £20 and £50 notes. There were £362 billion in transactions on debit cards in 2014. The value of cash transactions was £166 billion. The ratio of banknotes in circulation to nominal GDP has been on the rise since the mid-1990s.

Bank of England notes in circulation have risen substantially over recent decades…



Source: *Bank of England*

- Cash is an 'untraceable bearer instrument.' Because of this, it is not possible to locate where banknotes are actually held, or by whom. Law enforcement officials are concerned that because cash use is both anonymous and undetectable, use of cash makes it hard to track down criminal enterprise, terrorists, and drug dealers.

- Untraceable notes held outside the official British economy are held overseas as a store or value or used in the 'shadow economy,' where the transactions for which they're used are not visible to tax and legal authorities.

- The majority of notes printed by the Bank of England do not circulate for use in everyday transactions. Notes not circulated but held by the public are **'hoarded'** according to the Bank. Hoarders may use a safety-deposit box, put their money under their mattress, or bury it in the garden instead of using a bank account.

- According to the Bank: *'Economic theory suggests that hoarding should not take place unless there is a risk of a negative return to the individual holding bank deposits,* ***either due to negative interest rates****, the possibility of financial loss due to the potential failure of the bank, or due to the inconvenience of depositing funds.'*

- The act of hoarding cash is only rational when the non-financial benefit of physical possession and safety of cash is of greater value to the cash holder than interest paid on secure bank deposits.

- Cash is a comfort against potential emergencies.

The Bank's paper concludes that cash is well liked by the public. Attitudes towards contactless payment systems evolve. But the Bank reckons the public, at least some portion of it, will continue to prefer the use of cash for the foreseeable future.

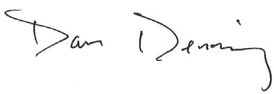
It's important to remember this: *no portion of the future is* ***ever*** *foreseeable.*

Just weeks after the banks cheerful paper on cash was published, its Chief Economist, Andrew Haldane, gave a speech in which he suggested negative interest rates could be used by the Bank to force cash hoarders into 'digital cash'.

It is much easier to force people to spend digital cash. You can essentially delete the value of that cash with pre-programmed inflation or even devaluation. Whatever the means, the result is the same: digital cash takes the security and control of cash away from you and gives it to your banker or the Bank of England.

That is the natural and logical conclusion of the road to Financial Martial Law. It's important you understand it now so you can prepare for it. The rest of this book is dedicated to that understanding and preparation. Read it carefully and do what you can, while you still can.

With regards,



Dan Denning
Publisher, *London Investment Alert*

The War On Cash

Part One: The mess we are in

If you thought 2008 was bad…

"How did you go bankrupt?"

"Two ways. Gradually, then suddenly."

- Ernest Hemingway, *The Sun Also Rises*

For the entirety of my lifetime, the Western economies have gorged on debt and stimulus. Our world has become dependent on borrowing. But as anyone who has over-borrowed on their credit card will attest, you cannot borrow your way to prosperity. Sooner or later the piper must be paid.

The first instalment of the piper's bill came due in 2008, as the US subprime mortgage crisis struck. Lehman Brothers, for one, was unable to pay. But as soon as Western governments realised the gravity of the situation, as banks refused to trust each other and the global financial system froze up, they rushed to the monetary pumps in desperation. A crisis caused by too much borrowed money was met with more borrowed money.

Few investors will mourn the passing of 2008 – the most extraordinary year that anyone currently working in finance has ever experienced. At the start of the year, the storm clouds gathering over the banking sector as the Great Asset Deflation rolled onward were clear enough. But few could have forecast the scale of fall.

Wall Street as we know it was put to death. The investment banking houses of Bear Stearns, Lehman Brothers, even Merrill Lynch, my alma mater, either ceased to exist or were subsumed within larger commercial banking groups. We saw colossal frauds such as Jérôme Kerviel's losses at Société Générale (roughly €5 billion, back in January 2008) and then Bernard Madoff's alleged $64 billion Ponzi scheme. There was unprecedented volatility across equity markets, bond markets, currencies and commodities – who would have foreseen oil trading in a yearly range between $33 and $145 a barrel?

Most notably, investors and taxpayers worldwide in 2008 looked aghast at the extent of government support for failing banking systems. Jim Bianco of Bianco Research has tried to put the US figures alone into context.

He concludes that the extent of the US bailout to date is currently bigger than all of the following US government expenditures combined:

- **The Marshall Plan. Cost: $12.7 billion. Inflation-adjusted cost: $115.3 billion.**

- **The Louisiana Purchase. Cost: $15 million. Inflation-adjusted cost: $217 billion.**

- **Race to the moon. Cost: $36.4 billion. Inflation-adjusted cost: $237 billion.**

- **Savings and Loan crisis. Cost: $153 billion. Inflation-adjusted cost: $256 billion.**

- **Korean War. Cost: $54 billion. Inflation-adjusted cost: $454 billion.**

- **The New Deal. Cost: $32 billion (est.). Inflation-adjusted cost: $500 billion (est.)**

- **Invasion of Iraq. Cost: $551 billion. Inflation-adjusted cost: $597 billion.**

- **Vietnam War. Cost: $111 billion. Inflation-adjusted cost: $698 billion.**

- **NASA. Cost: $416.7 billion. Inflation-adjusted cost: $851.2 billion.**

The aggregate total of $3.9 trillion is $686 billion ***less*** than the cost of the credit crisis. And as Bloomberg columnist Barry Ritholtz points out, the only event that comes close to the cost of the current financial crisis is World War II, with the inflation-adjusted cost borne by the US adding up to some $3.6 trillion. Bloomberg calculates that the crisis left the US taxpayer on the hook for a total of $7.76 trillion of liabilities – $24,000 for every man, woman and child in the country.

So it was perhaps doubly surprising that, when the crisis struck, people rushed to lend the US government even more money. One of the very few assets that rose in value during 2008 was US Treasury bonds (and to a lesser extent, high-quality AAA-rated government debt in other geographies, including the UK). Indeed, so great was the so-called 'fright to quality' that at one point the yield on T-bills turned negative:

paranoid investors were willing to pay the US government for the privilege of owning its debt. Now *that* is fear of the banking system.

But with such mind-altering Niagaras of government-financed capital flooding across the global banking system, investors would have been right to question the entire value system underpinning the concept of money itself. UK investors who travel abroad know to their cost just how much the value of sterling has been eroded since the crisis. In July 2008, a British pound was worth $2. As I write, in June 2015, it hovers around the $1.55 mark.

One of my biggest fears is that of sustained competitive devaluations across the international foreign exchange markets. This is a 'beggar thy neighbour' policy – protectionism, in other words, in all but name. And protectionism is one of the bogeymen of the 1930s that is to be earnestly avoided.

But for many investors, rather than protectionism, the real story of 2008 is a monumental and historic bear market for stocks. In local currency terms, the MSCI World Equity Index fell by over 40%. While hopes of decreasing correlation with the developed world, known as 'decoupling', led many investors into emerging markets, that turned out to be the wrong trade: the MSCI Emerging Markets Index fell by more than half. All the major US indices fell by more than a third. The FTSE 100 fell by 28%, its worst year on record, but a return which turned out to be the best showing of any major European index – many European indices more than halved during the year.

The seers who predicted the financial crash

The last few years have been an extraordinary journey for investors, one that has taken us from the implosion of the US subprime mortgage market back in 2007 and the subsequent failure of multiple banks, through the run on Northern Rock.

Then came coordinated government action to support the banking sector, including the effective nationalisation of RBS and Lloyds.

Then a global credit crisis, the worst financial panic in living memory, and a devastating recession. And as a result of all these factors, a rolling sequence of sovereign debt crises throughout the eurozone periphery and elsewhere. But subscribers to *The Price Report*, an investment advisory service I run alongside *London Investment Alert*, should not have been unduly shocked at these developments (I'll explain more about how *London Investment Alert* and *The Price Report* work together as we go on).

The point is that we anticipated and discussed these various global crises widely, well ahead of the fact. As far back as May 2007, for example, *Price Report* guest columnist Sean Corrigan of Diapason Commodities Management wrote on 'The growing risks beneath the surface of the global financial system':

"One can only view the extraordinary growth of the derivatives market with a growing sense of unease… that bodes ill for the overall financial system… the more leverage investors are carrying when the fun stops, the worse the end result will be."

And in June 2007, I wrote: "Once again, the bond market is threatening wider problems throughout the financial system." If there is one fundamental underlying problem facing the financial markets, it is that they are still, several years into this crisis, drowning in a surfeit of debt.

One early issue of *The Price Report* almost forensically identified the problems to come. In July 2007, my friend Michael Panzner, author of *Financial Armageddon: Protecting your future from four impending catastrophes*, examined "why we might be about to see a much worse version of the 1987 stock market crash".

The stock markets peaked just two months later, in September. Panzner's roadmap that we highlighted back in July 2007 looks astonishingly prescient now:

"Years of overly easy monetary policy (thanks in no small part to the extraordinary monetary accommodation of Alan Greenspan) result in an orgy of unrestrained lending. What is borrowed and lent out in haste will, of course, come to be regretted at leisure. As US residential property prices finally bow to the inevitable in the face of higher interest rates and a glut of supply, selling pressure becomes extreme, and default rates in subprime credits soar…

"Contagion from subprime ripples through to other sectors within the bond market (whether this now happens is the real trillion dollar question) and lending seizes up. The credit market feast suddenly turns to famine, leading in turn to a credit crunch and a deflationary crisis.

"The assets to own in such an environment? Only investment grade credit of unimpeachable quality, i.e. 'AAA' government debt, cash, and conceivably precious metals.

"Faced with a credit contraction and an implosion of the broader economy, the Federal Reserve finally and belatedly reverses course, and turns on the taps to the money supply, in the hope of inflating its way out of difficulty. In the face of an onslaught of supply from the printing presses (akin to Ben Bernanke's infamously proposed 'helicopter drop' of money to spur consumer spending), the US dollar collapses in an orgy of hyperinflation.

"At this stage of the cycle, it now makes no sense to hold cash, a rapidly devaluing asset; instead, investors would be best served spending their capital as rapidly as possible on real assets, again precious metals, and perhaps even (now more fairly valued) prime real estate assets. But as hyperinflation accelerates, the crisis escalates from the financial world into society at large. The world turns into Zimbabwe."

'Hyperinflation' may be a little on the strong side, but in just about every other respect, we were dead right in our fears about what lay ahead. Bear in mind, this was expressed, for the benefit of subscribers, even before the stresses in the credit markets were taking their toll on money-market funds, and long before the run on Northern Rock, let alone the acceleration of the crisis to come.

Before I move on, there is one last contributor whose role I would like to highlight, namely Tim Lee of pi Economics, who wrote in *The Price Report*, again with impressive foresight, in November 2007:

"There is little doubt, to my mind, that we are now at a defining moment in financial history, a time that, once it has passed will be referred by economic and market historians in much the same way as the Wall Street Crash of 1929 or the credit and banking crisis of 1973-4 are now.

"Unfortunately, as is becoming increasingly clear, this crisis is not really just about subprime mortgages. It is much more serious than that. It is the beginning of an inevitable realignment of credit and wealth with incomes and accumulated savings… subprime is merely the first part of the credit edifice to give way, rather than the whole story…"

As a non-economist (I read English at university), I found that the financial crisis was the ideal environment in which to make up for that supposedly 'lost' education in economics. If nothing else, it forced any gaps in my understanding of the nature of markets to be plugged – quickly. I swiftly came to realise that the practice of economics as an academic discipline is hugely overrated.

And today I am certain of that. Despite the reassurances of central bankers, the second instalment of the piper's bill is now coming due. I think we're in for an even greater crisis, and I think it's imminent.

This time though, it won't just be taxpayers footing the bill. It will be investors who suffer most.

Central bankers have taken over the world

There is something in medicine called an iatrogenic illness. Unlike every other ailment that might afflict us, an iatrogenic illness is one that is caused by the doctor…

How did we even get into this mess? The answer is, we changed the nature of our money. In 1971, US President Nixon, facing a disastrous run on his country's gold reserves, decided to sever, once and for all, the dollar's links with gold.

From that point on, the US dollar was backed not by precious metal reserves, but by faith in the US government alone. Given that the US dollar was then, and for the moment remains, the world's reserve currency (the currency in which major central banks choose to hold most of their spare capital), at a stroke all the currencies in the world were free to float against each other, and none required hard money reserves to back them up.

In the process, central banks discovered that there were no practical limits on the extent to which they could print money. Freed from any requirement to hold hard metal reserves, central banks could print with impunity. And they have duly done so. "Even in the US, where the wish for a stable currency is strong," wrote Warren Buffett in a letter to investors in Berkshire Hathaway in 2012, "the dollar has fallen a staggering 86% in value since 1965."

For decades, central banks have been printing money and devaluing their currencies, but the QE of the last few years has been the most audacious yet. I think it is a ruinous policy, as I'll explain in detail later.

First I want to tell you about groupthink. Because this concept is key to understanding how those in power come to make absurd decisions.

On 17 April 1961, a brigade of 1,400 Cuban exiles with the support of the United States Navy, the US Air Force and the CIA, invaded the swampy coast of Cuba at the Bay of Pigs. Their goal was to overthrow Castro. But nothing went as planned. Four ships were supposed to supply them with ammunition and supplies, but not one of them arrived. Two of them were sunk by the Cuban Air Force and the other two fled.

On the second day, the brigade was completely surrounded by 20,000 Cuban soldiers. By the third day, almost all of the insurgents that hadn't been killed were captured and led off to prison camps.

In his book *Groupthink: psychological studies of policy decisions and fiascos*, the psychologist Irving L. Janis writes that the Bay of Pigs plan "ranks among the worst fiascos ever perpetrated by a responsible government… all the major assumptions supporting the plan were so completely wrong that the venture began to founder at the outset and failed in its earliest stages".

How did such a disaster happen? There was no doubt about the technical qualifications of President Kennedy's policy team that dreamt up the plan. Dean Rusk, Secretary of State, had been recruited by the president himself from acting head of the Rockefeller Foundation. Robert McNamara, the Secretary of Defense, was an expert statistician who had worked his way up the presidency of the Ford Motor Company. The president's brother, Bobby, the Attorney General, was one of the most influential members of the team. McGeorge Bundy, Arthur Schlesinger, Jr. and Richard Goodwin, were Harvard men of impeccable reputation.

Janis points to six major miscalculations made by the president's team. The first was that the invasion would never be traced back to the US government. The second was that the Cuban air force could be knocked out completely before the invasion began. The third was that the 1,400 men would be willing to carry out the invasion without any help from US ground troops. The fourth was that Castro's army was too weak to counter the insurgents. The fifth was that the invasion would trigger support by the Cuban underground and set off armed uprisings that would topple Castro himself (sound familiar?). The sixth was that if the brigade did fail in its primary objective, the men could retreat to the mountains and reinforce anti-Castro guerrilla units. Each assumption was proven wrong.

Groupthink is the means by which humans make their worst mistakes. Because when power is concentrated among a small group their mistakes are bigger and more costly. When power is diffused across the population no one bad decision can lead to disaster.

Madness is the exception in individuals but the rule in groups

Janis also identifies the traits common to all groupthink. The group's discussions are often limited to a handful of alternatives – there is insufficient choice. The group fails to survey the objectives of the task and the values implied by the favoured plan. The group fails to re-examine the consensus choice in the context of risks and drawbacks never initially considered. And the group neglects courses of action initially considered unsatisfactory. They spend almost no time discussing whether they have overlooked anything. And members of the group make little or no attempt to obtain information from outside experts. Members of the group also disregard information from outside the group. And they spend little or no time considering how the chosen policy might be hindered by bureaucratic inertia, thrown off course by political opponents or derailed by accidents. So they don't make contingency plans that could help them cope with any setbacks.

Beating groupthink boils down to some common sense principles. Nobody is perfect, for example – easy to say, but difficult for a robust group, confident in its own ability, to accept in practice. And the decisions made by groups can be particularly imperfect. The more cohesive the group, the more resistant it becomes to external criticism.

In addition to the Bay of Pigs fiasco, Janis studied in depth four other American policy disasters: Pearl Harbour; Truman's invasion of North Korea; Johnson's escalation of the Vietnam War, and Nixon's cover-up of the Watergate scandal. He found that groupthink played a critical role in every one.

The history of the euro displays the worst of groupthink. The Delors commission was formed in 1985 and chaired by the most powerful man in Brussels at the time, Commission President Jacques Delors. The aim of the 17 senior officials on the committee was no less than to set out the path to monetary union. To say there was insufficient choice in the project is laughable: its creators never even got beyond Plan A. The eurozone was meant to be a permanent and irrevocable currency union – so there was never any provision for a member country leaving (voluntarily or otherwise).

By 1996, in the words of legendary hedge fund manager George Soros, the euro had become a “fantastic object”, imaginary but still tremendously attractive. Or take the second facet of groupthink as highlighted above in the ‘Bay of Pigs’ example: “The group fails to re-examine… risks and drawbacks never initially considered.”

The euro, probably like many births, was conceived in optimism, without any thought how this nascent currency would survive in a period of extreme financial distress, forced austerity and widespread economic slowdown.

Even now, members of the in-group in Brussels refuse to countenance critics and sceptics on the outside of their clique. “Globalisation demands more European unity. More unity demands more integration. More integration demands more democracy.” These are the words of ex-European Commission President José Manuel Barroso in his 2012 ‘State of the Union’ address (note how the fledgling superstate is already modelling its grandiose speeches on those from the Presidency of the United States).

But Barroso was barking up the wrong tree. The rioters in Athens and Madrid were not in pursuit of unity. Demonstrators outside the Greek parliament were shouting “EU, IMF out!” Unity; integration; democracy – when an EU bureaucrat voices these words, they suddenly become meaningless, an Orwellian ramble devoid of substance.

Take the story of Austrian Jew Leopold Kohr, who only just managed to escape from Nazi-annexed Austria in 1938 and who went on to warn about a Europe dominated by big countries. "We have ridiculed the many little states," he once wrote, sadly, "now we are terrorized by their few successors."

Kohr's magnum opus was a cautionary tale entitled *The Breakdown of Nations*.

What he warned about is inexorably coming to pass, over half a century later. From *The Breakdown of Nations*:

"… there seems to be only one cause behind all forms of social misery: bigness… If the body of a people becomes diseased with the fever of aggression, brutality, collectivism, or massive idiocy, it is not because it has fallen victim to bad leadership or mental derangement. It is because human beings, so charming as individuals or in small aggregations, have been welded into over-concentrated social units."

In the best traditions of groupthink, we can count on the eurozone's political class to pursue its grand project until the assets of Europe's very last taxpayer have been exhausted. But if recent popular protest has been any guide, the euro bloc will have messily disintegrated long before then. Which will ultimately be good news, in the same way that sterling's 'ethnic cleansing' from the exchange rate mechanism on Black Wednesday in September 1992 ushered in a period of economic revival for the UK, freed from a European fiscal straitjacket and ruinously high interest rates.

One can only hope that peripheral Europe today is as fortunate as Britain was in 1992. But just three weeks after ECB President Mario Draghi appeared to have saved European markets with open-ended bond purchases, the eurozone crisis took another dark turn. Hundreds of thousands of people across Greece and Spain took to the streets. A member of the Spanish governing party, watching the disturbances in Madrid, referred ominously to "an attempted coup". The Catalans voted to secede from Spain.

The Spanish prime minister, Mariano Rajoy, bowed to the inevitable and borrowed over 200 billion euros to bail out its banks – taking Spanish national debt to over 90% of its gross domestic product.

This is a triumph of circular logic and magical thinking: a crisis brought about by too much debt is met with more debt. This is like torching your own house rather than have it consumed by a forest fire.

In fact, the figures are worse than at first glance. Whereas Greece is ranked as the world's 44th largest economy according to IMF data, Spain is ranked as 14th, with GDP of roughly $1.5 trillion. Spanish federal and regional government debt now exceeds 100% of that GDP – and the debt load continues to rise.

Ominously, a report by R.R. de Acuña & Asociados, a Spanish property consulting firm, suggests that almost half of the 67,000 property developers in Spain are insolvent – but crucially ***not bankrupt*** – after being granted additional bank finance. The CEO of money brokers Tullett Prebon, Terry Smith, fears that Spain is following Japan into an economic "lost decade", or worse, courtesy of bailing out its zombie banks. I share those fears completely.

And that presupposes that the eurozone's problems end with Greece or Spain. France's share of eurozone exports has fallen over the past decade from 17% to 13%, and France's national finances, like so many others in Europe, are starting to show some significant strains.

President François Hollande has the unenviable task of cutting the deficit from 4.5% to 3% of GDP. Like any good socialist, his plan involves soaking the rich and raising the top rate of income tax from 45% to 75%.

Good luck encouraging entrepreneurialism with that approach.

The global threat of central planning

The main reason why investing is so difficult right now is politics. We know that asset prices are already heavily distorted courtesy of political manipulation. If we had the bedrock of Austrian school economics, i.e. sound money, then deposit rates would be significantly higher than they are today. You cannot have a sound economy without savings. Zero interest rates essentially punish savers, so it is no surprise to see our economy as weak as it is.

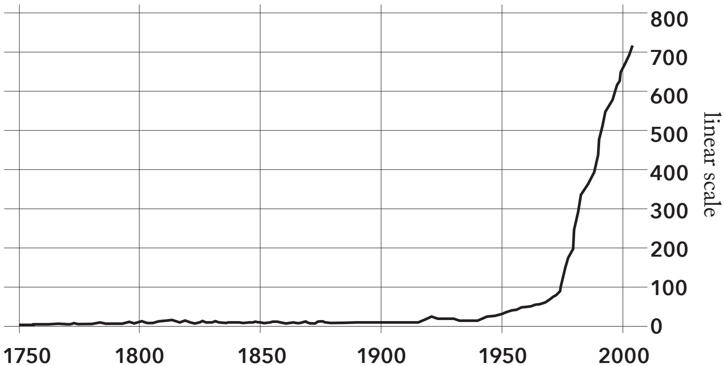
The 'magical thinking' of quantitative easing implies that through a mysterious trickle-down wealth effect, higher bond and stock prices will boost the economy. So far it doesn't seem to be working.

Within unfettered free markets, it's possible to invest on a rational basis. We can make objective assessments about value via the so-called 'risk-free rate' available on government bonds trading in free markets. What we have today, though, is a parody of a free market, in which central banks control not just the price of money (interest rates) but the prices of all forms of government debt, and currencies. Indeed, central banks have increasingly started to manipulate prices in the equity market. Bloomberg reported in 2013 that in a survey of 60 central banks, 23% said that they already owned shares or were planning to buy them, as part of their reserves.

When governments spend beyond their means, they typically resort to three strategies to keep the bandwagon rolling. One is to raise taxes. Another is to increase borrowing. And a third is to devalue the currency. With debt to GDP ratios already at uncomfortably high levels, option two is barely on the table any more. This means that, just as night follows day, governments will raise taxes and keep weakening their currencies.

We have already lived through an extraordinary period of inflation. The following chart shows the UK Composite Price Index from 1750 to 2003, with January 1974 at 100.

UK composite prices, 1750 to 2003



Source: *Consumer Price Inflation Since 1750, O'Donoghue et al, Office for National Statistics, 10 March 2004.*

For almost 200 years, UK inflation remained remarkably stable. The First World War triggered a sharp rise in prices but the damage didn't really start until after World War II. And ever since our economy was beset by the stagflationary disaster of the 1970s – with rising prices, a flatlining economy and high unemployment – the trend has been quite clear. You can view the chart in two ways. It shows the terrifying scale of recent inflation. And it shows the terrifying impact on the purchasing power of the pound.

The great economist John Maynard Keynes is widely associated these days with the sort of stimulus to which desperate governments and their central banks are now resorting. Although my sympathies are more in keeping with the Austrian school of Mises and Hayek, I think Keynes is being treated unfairly. Because Keynes was not just an advocate of deficit spending on the part of government in the face of severe recession. He also advocated that governments should put money aside during the good times as protection against an inevitable downturn. Neo-Keynesians who support policies like quantitative easing are behaving like children in a sweet shop: they are taking the policies from Keynes that they happen to like, and avoiding the ones that they don't.

This is what Keynes said about inflation:

"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 actually enriches some. [i.e. the banking and finance profession, which is always closest to the 'new money' when it's printed.] The sight of this arbitrary rearrangement of riches strikes not only at security, but at confidence in the equity of the existing distribution of wealth…

"There is no subtler, no surer means of overturning the existing basis of society than to debauch 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."

So yes, like my fellow asset management colleagues in Zürich, I fail to see how we will escape from this debt prison without a final disorderly collapse of confidence in currency.

Central banks have run out of conventional solutions and will resort to evermore unconventional stimulus measures to keep the financial system afloat.

The danger of mission creep

The world was watching on 28 January 1986, when America's mad government space programme went down in flames. The space shuttle Challenger exploded over Florida 73 seconds into its flight. The shuttle was to carry 'the first teacher into space', Christa McAuliffe, so it's estimated that almost half of nine to 13 year olds watched the disaster live in their classrooms. More people witnessed it than any other disaster in history.

The space shuttle programme was mad because it was justified only by mad bureaucratic logic. The shuttle programme had achieved 'a kind of Pyrrhic reusability'. The cost of refurbishing and repairing it after each flight vastly exceeded the cost of standard rockets. Every major component it had was continually redesigned and rebuilt. Every cost estimate offered to Congress was exceeded multiple times. Audits, never made public, uncovered fraud and spending abuses running into many billions of dollars.

And technically, the programme was a flop, too. The shuttle could barely achieve low orbits; high orbits were impossible. The shuttle never came close to reaching the moon. NASA systematically misled Congress and the American people about the shuttle's costs and benefits.

As physicist Richard Feynman put it, NASA found it necessary "to exaggerate: to exaggerate how economical the shuttle would be, to exaggerate how often it could fly, to exaggerate how safe it would be, to exaggerate the big scientific facts that would be discovered."

Supposed to fly once per week, the shuttle barely achieved a tenth of that rate. When it did fly, the shuttle ended up killing more astronauts than any other space vehicle in history. Out of five shuttles, two ended their missions in flames: a 40% failure rate that would not be tolerated in any other sector. Later, NASA would end up sourcing shuttle parts on eBay for the programme. And the shuttle was flimsy: one launch was aborted due to woodpecker damage.

Each incremental step in the failed space shuttle programme made sense at the time. But after 30 years of flight, NASA burned through more than $200 billion with little to show for it. That's just typical of how big government programmes tackle problems. It's called 'mission creep'.

Mission creep, ultimately, was what destroyed the Challenger and Columbia space shuttles. And that same mad bureaucratic mindset is in charge of the world's central banks today.

The good news is that we can take steps to protect ourselves from this madness. I've reserved a chapter at the end of this book to explain exactly how you can do that.

In the last few years, on both sides of the Atlantic, the world's major central banks have mobilised their big guns. In 2012, the US Federal Reserve pledged to buy $40 billion of mortgage-backed securities each month, in the hope that such monetary injections would soothe the labour market. Combined with its

'Operation Twist' purchases of longer-dated Treasury bonds, it added up to some $85 billion of cash injections, every month, until the end of the year. It is time for plain speaking – John Authers in the *Financial Times* called the Fed's announcement "an open-ended commitment to print money".

Closer to home, the European Central Bank announced that it would buy unlimited amounts of debt issued by troubled members of the eurozone. Germany's constitutional court gave a green light to the European Stability Mechanism, Europe's permanent rescue fund. And the European Commission set the wheels in motion towards joint European banking supervision, which is likely to be the precursor to full-blown banking union.

Markets have not been slow to greet what they perceive as good news. Somewhat ominously, Jens Weidmann, president of Germany's Bundesbank, was the lone voice of dissent against the ECB's bond purchase programme. As the last inflation hawk left in Europe, Weidmann's opposition to central bank inflationism is touching, but probably futile. While stock and bond markets cheered the commitment to stimulus and ongoing easy money, the gold price also firmed. I know which asset I trust more.

'Mission creep' is what happens when a project expands beyond the goals first set for it. This often happens after an early success, and often ends with a final catastrophic failure. The Space Shuttle programme is a prime example. The war in Afghanistan is another. And the Federal Reserve Bank of the United States is a third.

When the Federal Reserve was established in 1913 it was set up as a traditional central bank whose purpose was solely to avert banking panics by agreeing to lend to solvent institutions, backed by solid collateral, in times of need. It was a lender of last resort, set up to protect the banking system (and the gold dollar).

Note those qualifiers: solvent institutions; solid collateral; times of need. But over time, the Fed has slowly and surely spread its tentacles into every facet of the economy. It now formally acknowledges three key objectives: maximum employment; stable prices; establishing moderate long-term interest rates. But look at where it operates now. In the words of Jim Grant, the Fed is now in the business "of steering, guiding, directing, manipulating the economy, financial markets, the yield curve; it manipulates and pegs interest rates – it is all over the joint, doing what so signally failed in the old eastern bloc".

The third iteration of the Fed's QE programme was its boldest yet. It explicitly yoked monetary policy to developments in the economy, and promised to hold its course until it succeeds. Nor was such open-ended intervention limited to the US. Mario Draghi, president of the European Central Bank, pledged to do "whatever it takes" to save the eurozone from collapse. As demonstrated by the ECB's new €1.1 trillion QE programme, under way since the beginning of 2015, the eurozone bureaucracy is in no mood to deny him those powers.

With investors fixated on the unholy trinity of Yellen, Draghi and QE, global markets are decoupling from underlying economic reality. Traditional investment rules and analysis no longer apply. It strikes me that 'mission creep' is the perfect way to describe the policy dilemma facing our central banks.

We are now more than five years into ultra-loose monetary policy and a succession of extraordinary experiments in financial stimulus, and the global economy is juddering to a halt. Monetary policy is evidently doing a lot more for financial markets than it is for real economic activity.

The financial markets may be dysfunctional but the individual investor still has all the power. You have investment choices in abundance. If the thought of buying UK government bonds at yields lower than inflation troubles you (and it should), just don't buy them. More than that, don't buy bonds issued by ***any*** countries ravaged by debt – a category that includes the US and, of course, most of Europe.

I'll come back to these topics further on in the book. For now, let's look at what exactly can happen when central planners overreach themselves.

A lesson for market meddlers

In 1830 America was sozzled. The average person drank about two bottles of whisky per week – that's seven gallons of pure alcohol per year. So the temperance movement – comprised mainly of the long-suffering wives of American drunkards – lobbied to have the demon drink banned. In 1920, they finally got their way.

The Eighteenth Amendment to the US Constitution introduced a national ban on the sale, production and transportation of alcohol throughout the United States on 16 January, 1920. The ban – prohibition – lasted until it was repealed by Franklin D Roosevelt in December 1933. The intention of the 'dry' movement was to reduce crime and corruption, solve social problems, lower the tax burden caused by prisons and poorhouses, and improve health and hygiene in America. It failed utterly, on every level.

A strange coalition supported prohibition. It was backed by the temperance movement – religious types who were against alcohol on moral grounds. And it was supported by the bootleggers. Their thriving trade in illegal liquor was dependent on the ban.

Far from reducing crime and corruption, it boosted both. One New Jersey businessman claimed that there were 10 times more places to obtain alcohol during prohibition than there had been before. Al Capone, one of the most infamous beneficiaries of prohibition until his conviction for tax evasion in 1931, was by 1927 earning $60 million a year from alcohol sales alone. Some of those revenues were recycled back to the police and leading politicians, upon whom it is believed he spent around $75 million. But he could afford it: he had a thriving business. As he pointed out to his critics, with some justification, "all I do is satisfy a public demand".

Not only did spending on alcohol increase, so did spending on alcohol substitutes. Beyond patent medicines, consumers switched to narcotics, tobacco, hashish and marijuana. Not only were these products potentially more dangerous and addictive than alcohol, the act of procuring them brought consumers into contact with a criminal underworld. Far from improving public health, prohibition savaged it. The death rates from poisoned liquor were appalling. In 1920, there were 1,064 deaths from tainted alcohol. By 1925, the toll had risen to 4,154.

One of the 20s and 30s' most famous entertainers, Will Rogers, joked that "governments used to murder by the bullet only. Now it's by the quart". And the prison population exploded too. The homicide rate during the 1920s rose by 78% compared to the period before prohibition. Total federal expenditures on penal institutions increased by more than 1,000% between 1915 and 1932. Two thirds of all prisoners entering the penal system in 1930 had been convicted of alcohol and drug offences.

So what did prohibition really achieve? By making it illicit, it made alcohol more dangerous to consume. Crime increased and became *organised*. The courts and prison systems were stretched to their limit. Corruption of public officials grew markedly. There were no measurable gains in terms of either productivity or reduced absenteeism. Prohibition removed a potent source of tax revenue even as it increased government spending: the annual budget of the Bureau of Prohibition rose during the 1920s from $4.4 million to $13.4 million, while Coastguard spending on prohibition averaged over $13 million a year. More crimes were committed because prohibition destroyed legal jobs whilst creating black market violence.

This supposedly noble but actually dismal experiment finally ended in early 1933 when President Roosevelt signed an amendment to the earlier prohibition legislation, known as the Cullen-Harrison Act.

Having signed, he added: "I think this would be a good time for a beer."

Part Two: The threats to your money
unintended consequences of government interference

What politicians and bureaucrats so often forget is that actions have unpredictable consequences. The disaster of prohibition throws this into focus.

There are similar lessons yet to be fully learned in the hugely costly 'war on drugs'. But the dangers and surely unintended consequences of unparalleled government intervention in financial markets, upon the wider economy, and across society as a whole, are only now starting to become visible. Western governments are now acting as puppet-masters for their own stock and bond markets, in many instances replacing the core functions of banks by extending or guaranteeing housing loans, and manipulating prices throughout the capital structure of the entire economy. This cannot possibly end well.

Arguably, the global financial crisis had its proximate origins in the spectacular bursting of a housing bubble throughout the US, the UK and much of western Europe, together with abysmal lending practices that helped inflate – and widely distribute the cost of – that same bubble. So what is the latest policy wheeze of the UK government? To prop up already inflated property prices via its 'Help to Buy' scheme which pledges support for home purchasers with as little as a 5% deposit. As taxpayers, we are all on the hook for this scheme.

SocGen strategist Albert Edwards could barely contain his contempt:

"Why are houses too expensive in the UK? Too much debt. So what is George Osborne's solution for first-time buyers unable to afford housing? Why, arrange for a government-guaranteed scheme to burden our young people with even more debt! Why don't we call this policy by the name it really is, namely the indentured servitude of our young people.

"I believe it truly is a moronic policy that stands head and shoulders above most of the stupid economic policies I have seen implemented during my 30 years in this business. It ranks above some of Alan Greenspan's very worst blunders."

Just before the global financial crisis began, my worst fears were a global market crash affecting both bond and stock markets. Those fears were never fully realised, in large part because of government interference in the free market process. You may argue that it's a good thing we avoided such a crash. I would argue, by way of response, that all the central banks have really achieved is financial Armageddon deferred.

As I mentioned, I now have a deeply felt 'Austrian school' bias – an overriding belief in libertarianism, sound money, and small government. The tragedy of our time is that we have none of those things. Instead we have Orwellian government (take the Obama administration spying on its own citizens and their phone records, for example); grossly dishonest overly easy money, and a gigantic, Leviathan state.

Admittedly, my role is not to agitate for political change; my brief is a more modest one, namely to try and protect the capital of my clients and readers. But the rot runs so deep that it is now impossible to separate the world of finance from the world of politics. My fear now is that having injected trillions into the financial system and having become the prime movers behind both government bond and stock markets, Western governments and their central banks haven't really bought assets as such. They've simply bought a little more time before the stability of the entire capital markets edifice starts to slide away.

Market practitioners debated at great length the impact of 'tapering' down the Fed's monumental QE programme. Trying to anticipate the actions of a seemingly all-powerful central bank as it tries to support multiple different markets is like something out of *Alice Through The Looking Glass*. It subverts and distorts reality.

Investing used to be simpler… and for us, it still can be. The father of value investing, Benjamin Graham, once said that when challenged to sum up the secrets of sound investing in just three words, his response was: "margin of safety". But we have to abandon most of the tenets of modern portfolio theory. Thanks to central bank distortion of base rates, deposit rates, and the bond market, the traditional risk-free rate associated with short-term Western market government debt no longer exists. And because of the banking crisis and the eurozone debt crisis, the supposed safety and primacy of bank deposits can no longer be taken for granted.

But that just means we have to think laterally. Whatever we consider for use as 'safe-ish' investments, we should contemplate not from the top down (from a macro-economic perspective): there's so much manipulation going on across markets, profitable trading is now more difficult than ever, in my opinion. Rather we can identify a 'margin of safety' from the bottom up – from the perspective of individual securities or funds, and across as wide a variety of asset markets as makes sense.

The beauty of the 'bottom up' approach is that it frees us from a slavish dependence on market indices. We can simply spend our time choosing the investments that best suit our risk appetite and requirements for income and growth, free from the tyranny of market benchmarks. If we then spread our investment selections around varied asset types such as bonds or bond funds; equities or equity funds; uncorrelated/absolute return funds; and real assets, then we can in turn reduce our dependency on trying to market time our way through a period of extraordinary volatility and uncertainty. And notwithstanding the recent price weakness, gold in its various incarnations has a critical role to play in the event that my worst fears (widespread international currency collapse) come to pass.

It seems increasingly likely to me that rather than let government bond yields explode higher – which would imperil the property and banking sectors, thus negating all of their efforts over the last six years – central banks will take the path of least resistance. They'll simply keep printing money to support asset markets and paper over the cracks. Well-meaning economists and politicians will cheer them on… and so will the craven financial industry. The bootleggers and Baptists.

It will be less an issue of default (which would be the free market solution to the debt crisis) and more an issue of default by stealth via explicit inflationism and currency devaluation. So any sensibly diversified portfolio has to consider currency protection and insurance, and gold held in the proper form – that is, in a safety-deposit box outside of the financial system – is still the last word on the matter.

But whatever the final outcome, we can probably now agree it will not be the outcome that our central banks originally intended when they first started trying to support the price of financial assets. My hostility to QE is for the same reasons as my hostility to any other form of government intervention in free markets. Because ultimately, it doesn't work. About the only thing you can guarantee are innumerable unintended consequences.

QE is a giant Ponzi scheme

Just two days before Christmas 2008, a wealthy French financier committed suicide. Thierry de la Villehuchet was found dead in his Madison Avenue office having taken sleeping pills and with his left wrist slit. It subsequently transpired that he had invested $1.4 billion of client money, and much of his own, with a crook – Bernard Madoff.

De la Villehuchet was not, of course, alone. That would have been difficult, given that the Madoff fraud accounted for an extraordinary **$65 billion** of other people's money – the biggest financial fraud in history. Victims included the likes of John Malkovich, L'Oréal heiress Liliane Bettencourt and, ironically enough, former New York Attorney General Eliot Spitzer (the Sheriff of Wall Street).

It was fraud on a monstrous scale. But it doesn't come close to the scale and criminality of QE.

'Quantitative easing' is meant to sound reassuringly scientific, but it is nothing of the sort.

What exactly is QE? By buying government and corporate bonds, using newly-created electronic money, any central bank effectively injects capital into its financial system – giving that money either to commercial banks or to other large institutional investors – whoever was holding those bonds to begin with.

The hope is that this money is then recycled back into the financial markets, leading to a generalised improvement in the animal spirits of investors, and some form of magical 'trickle-down' wealth effect that mysteriously makes us all feel richer, and therefore more susceptible to going to spend on the high street.

Now you may have spotted some of the flaws in this process. The newly-created money effectively causes all existing money to be worth less, so if nothing else, QE immediately makes all existing holders of cash worse off. They're already badly served by the banking system, since interest rates have been driven down effectively to zero to try and force savers back into the financial markets – where their capital, of course, is at greater risk.

It's a different story for the banks: they can get effectively free money courtesy of the Fed (or in our case, the Bank of England) and then invest it 'risklessly' in longer-dated government bonds, and earn the resultant interest rate spread. So I think QE is really just a Ponzi scheme designed to suit one particular constituency: Wall Street. David Stockman was director of the Office of Management and Budget in the Reagan administration. In other words, he was a key member of Ronald Reagan's financial team. Here is what he said about quantitative easing and the Federal Reserve:

"An independent Fed is what we had when I was in the government. Today the Fed is scared to death that the boys and girls and robots on Wall Street are going to have a hissy fit. And these [QE] programmes, one after another, are simply designed to somehow pacify the stock market, and hoping to keep the stock indexes going up, and that somehow that will fool the people into thinking they are wealthier and they will spend money.

"The people aren't buying that. Main Street is not stupid enough to believe that engineered rallies as a result of QE2 stimulus are making them wealthier and so they should go out and buy another Coach bag. This is really crazy stuff… I think the Fed is injecting high grade monetary heroin into the financial system of the world, and one of these days it is going to kill the patient."

I personally think QE is dangerous for a number of reasons:

> It is forcing investors desperate for yield into markets that are being supported primarily if not exclusively by hopes of more QE – which is hardly a sustainable investment backdrop;
>
> It is, as I have said before, badly distorting the capital markets, particularly those for government bonds, and giving a false sense of market strength;
>
> It is inflating another bubble in assets when that is

> precisely the sort of thing that central banks should be preventing;
>
> It is devaluing the currencies of all those who are engaged in it – which is effectively the same as destroying wealth, rather than creating it.

A pity then that the mainstream media are particularly mule-headed about the malign effects of QE. Commenting on QE, a *Financial Times* editorial in November 2010 suggested that "… there is no sign that confidence in central banks is about to collapse: bond prices show that inflation expectations remain well-anchored."

The ignorance and wrong-headedness in that statement is breathtaking. In a more normal market environment, admittedly, the yield levels on conventional (i.e. fixed coupon) government bonds would tend to reflect the market's concerns about inflation. But we are not in that kind of an environment; rather, government bond prices are being kept artificially high (and their yields therefore artificially low) because the market anticipates further QE – more bond buying by central banks.

So making any assumptions about what the bond markets 'might' be telling us is absurd: the bond markets are positioned for more bond buying, plain and simple, and they are therefore not saying anything meaningful about inflation expectations.

The real problem is, of course, that all central planning is really just an attempt to fix the markets. And no matter what the authorities think, you cannot orchestrate something as complex as the world economy. You can try… but you will fail.

But central bankers everywhere are trying nonetheless.

How?

By fixing the most important price in the world.

The big fix

The most important thing you need to know about interest rates is that they, too, are a price, the price of money. The price of money is a signal.

If money is cheap, people and businesses tend to borrow. If it's expensive, people and businesses tend to save rather than spend and invest. The economy slows down, interest rates fall, credit gets cheaper and the cycle begins again.

That's the theory anyway. And that's why central banks use interest rates to 'manage' the economy. By changing the price of money, they believe they can give the economy a boost when it needs it (falling interest rates, or a lower price for money), or they can tap on the brakes if the economy is 'overheating' (rising interest rates, or a higher price for money).

You can find all of this explained in almost any basic macroeconomics text book. What you won't find is a simple fact: **it's all a big, fat lie**.

Price discovery and why the baker bakes

When I say lie, perhaps that's unfair. It's more like a myth that people believe because it's been repeated for so long. If you believe you can control a complex system such as an economy by adjusting the price of money on a daily basis, what you really believe is that the economy is a machine.

If the economy is a machine, or an engine, then getting 'optimal' performance would be simple. You'd want low employment, moderate inflation, the correct rate of interest, reasonable government deficits, and rising stock prices. Sounds good, right?

Not at all!

The economy most definitely isn't a machine. It's a vast market where people exchange goods and services voluntarily through trade. No one tells them to do this. No one designed it. It just happens.

The key to make it happen is 'price discovery'. It sounds complicated. But it's not. 'Price discovery' is what happens when supply and demand meet in a dark room. The price of anything is determined by producers and consumers agreeing on how much money to exchange for a given good or service.

Take bread. Do you decide how much you'll pay for a loaf of bread? Certainly not. When you walk in the grocery store, the price is the price. But how did it get that way?

The producer of the bread, the bakery, has some basic costs: flour, butter, wheat, plus things such as rent, electricity, equipment and, of course, the baker! He knows that when he adds up all those costs – both fixed and variable – what you pay him has to exceed his costs plus a little extra.

The 'extra' is profit. And without getting into a philosophical discussion of whether profit is good or evil, I'll just say it's good. Nobody would do anything if it didn't give them a chance to improve their circumstances in life, get ahead, provide for their family, and leave their children something when they die.

You can think of profit as 'surplus value'. It's what the baker earns after he's covered his costs. In an economy, if we all routinely create surplus value, we have savings. Those savings can be put in a bank to earn interest.

Once in the bank, those savings exist as 'loanable' funds. Because the banking system is based on fractional reserves, a bank can lend £10 for every £1 pound in savings. This is how credit expands in an economy, how small businesses get loans to start up, how mortgages are extended, and how money is created.

That last part is important. Despite central banks dominating today's discussion about money creation, it's actually banks that create the most money. They do this through a kind of financial magic (fractional reserve banking). When a bank makes a loan, it's usually creating brand-new money that didn't exist before.

Credit shouldn't exceed available savings

This is why saving and profit are so important to a healthy economy. In a healthy economy, the source of all credit is available savings. I don't want to get too technical here because there's an important point. The point is: in a normal, healthy economy, there is a natural rate of growth.

That rate of growth is determined by quality. By 'quality' I mean if businesses and entrepreneurs are creating 'surplus value' or 'profit', it creates savings for the banking system. Those savings, prudently allocated after proper risk assessment, become the capital for future growth.

Let me acknowledge that the financial world we live in today doesn't work that way at all. Far from it. And that's the problem.

The problem is growth for its own sake. A rising GDP tends to win elections. Politicians of every stripe pressure the central bank to make the price of money cheaper. By lowering interest rates, they can 'bring forward' growth.

Credit expands. Businesses invest in projects they hope will make money, or at least pay the interest on their loans. Ordinary people see house prices going up. Fearful of missing out on the gains, or simply waiting to buy until prices have gone up much further, they borrow large amounts of money they wouldn't normally have borrowed. Economic miscalculation abounds.

The immorality of central banking

Central banks think they're managing the economy for everyone's benefit when they lower the price of money. It entices people to borrow the money now. In my view, this is immoral. It's the ultimate false signal. It's a deliberate deception about 'risk'.

By artificially lowering interest rates, you mis-state the level of risk in the economy. It causes people to base important financial decisions (like buying a house) on information that's been distorted. Instead of saving, people borrow. Instead of investing, people consume.

Consumption and borrowing aren't evil things, of course. We all do them. After all, if there was no buyer on the other end of a sale, there would be no transaction. Without a transaction, you can't know the price of anything, or its value. Consumption is important... as long as it's based on valid price signals.

For your savings, there's a far more destructive point to make about lower interest rates. While the central bank is fixated on credit growth, inflation, and consumer spending that might benefit from lower interest rates, it's throwing your savings under the bus.

Even if you've never heard that phrase before, I'm sure you know what I mean. Imagine you're a pensioner in your retirement years. You've worked hard. You've done the right thing and saved for your retirement so you're not a burden to society.

Low interest rates are killing you. First, they reduce the amount of interest you earn on the money in the bank. That's money you spent a lifetime earning. Low interest rates might be good for borrowers. But for savers, it's lost income. Anyone on a fixed income is bound to suffer in a low-interest rate world. British savers have lost as much as £130 billion in interest income since the Bank of England began lowering rates six years ago, according to Hargreaves Lansdown.

In fact, it was so obvious that low interest rates were punishing savers that Chancellor George Osborne announced a change to the way savings were taxed. Under a new law scheduled to take effect in April of next year, you'll pay no tax on your first £1,000 in interest income. Previously, interest income was taxed at 20%.

Under the new law, up to 95% of UK savers will now be able to save tax-free. That sounds great, right? Two things.

First, if 95% of Britons are paying no tax on their first £1,000 in interest income, it means 95% of Britons aren't saving enough. Second, the 'hidden tax' of inflation, where you lose 2-3% of your money each year to inflation, isn't taken into account.

Even if you ARE earning interest on your savings, and even if that interest income is no longer taxable, you're still losing purchasing power to inflation. Allow me to elaborate.

Inflation is killing you too

And then there's inflation. Yes, I know official measures of inflation such as CPI and RPI are described as 'tame'. But you tell me: if you're on a fixed income, is life getting cheaper for you? Is your money keeping up with inflation? Or does your money seem to get you less and less with each passing year?

It's true, some things are a lot cheaper. TVs and mobile phones seem to get cheaper and better each year. And so do some clothes, biscuits, and household items, such as brooms and mops.

But what about the goods and services you buy every week? Fuel? Food? Insurance? Rent? Are they getting cheaper? I don't know about you, but for me, those items always seem to go up in price faster than the official rate of inflation.

That's my point. Low interest rates hurt savers. They hurt pensioners. And they lead to higher inflation. Higher inflation makes all the money you've saved less powerful. It doesn't go as far.

Economists say your 'purchasing power' has been eroded. That's just a complicated way of admitting that inflation leads to higher prices. If you're paying higher prices and you can't increase your savings and/or your wages, how do low interest rates actually create wealth and promote growth?

They don't. Or they do, in the way that cancer feeds on sugar. Cancer is growth. But it's unregulated, unrestricted growth. Unnatural growth. It kills you.

A 'natural rate' of interest is the subject matter of much intense academic debate. It's too technical to go into there. But let me define it for you: the price of money is determined by the free market, not by central banks.

A free market in everything but money

If you're an economist, I know that will disappoint you. But if you're for free markets, how can you be for a free market in everything else BUT money. How can you believe that price signals work well to regulate supply and demand everywhere else in the economy, but the price of money is too important to be left to the market place?

This is a subject I cover from time to time in *The Price Report*.

I'll leave it aside for now because that's not the point of this book. For now I have some important charts and figures I want to show you.

Before I get to them, one last point: manipulating interest rates and deceiving people about the real price of money is immoral. It causes bad economic decision making. It destroys real wealth. It also destroys values.

I know that's not the sort of commentary you'd expect to read from a broker or a fund manager. But I don't care. One of the great things about having my own alert service is that I can break the rules. It's important for me to try to get to the heart of the matter for you.

Low interest rates destroy values. When you tinker with the price of money, you make it hard for people to make rational, sensible economic calculations. So they don't. They make decisions. Hasty decisions. Bad decisions.

They stop thinking about the future. They stop saving. Why would you when it's punished? They live for the now. And while that may produce one or two quarters of GDP growth, the quality of that growth will be very poor.

And that's really the big point. It's not the quantity of growth that matters, just as it's not the quantity of your possessions in life that determines your wealth. It's the quality.

Money is not wealth

There's more to wealth than just quantity. If you're like me, your quality of life matters just as much as your net worth. In fact, experience tells me that there's no correlation between net worth and happiness.

Don't get me wrong. Money can make you comfortable. I'd rather have it than not. It's the whole purpose of my professional life to help you protect and grow YOUR money. And not to pat myself on the back, I think I'm pretty good at it. The results speak for themselves.

But I'd humbly suggest that part of my success – which I hope will lead to your success – is that quality matters. You don't want to live in a financial system that actively destroys value. That's why I feel so strongly about a subject so seemingly mundane as interest rates.

Interest rates are a price, the price of money. When you manipulate and distort that price you manipulate and distort people's lives. Some people – a very small elite at the top of the financial system – benefit from this manipulation. They borrow money cheaply and invest vast quantities of it in rapid-fire fashion, capturing small gains and 'leveraging' them up into big ones.

Truth be told, I believe that's why they like the monetary system we have. It favours them. They profit from it. And I'm sure that at some level, central bankers believe they are doing the right thing for people.

But I wouldn't be writing this book if I didn't think we were on the edge of a great danger. For the majority of Britons, lowering interest rates doesn't make you wealthier. It just exposes you to greater risks when the crisis hits.

I want to alert you to that crisis BEFORE it hits. Your savings are at risk. Your investments are at risk. Your quality of life in Britain is at risk. In a moment I'll show you exactly why I think it's inevitable that interest rates will rise. But first, an important question:

Should you fight the Fed?

There is one major risk to all my analysis. If I am wrong, it's a major risk to your investment strategy. Here's the risk: that you should never fight the Fed.

If you've been in the markets as long as I have, you'll have heard the phrase, 'Don't fight the Fed.' It means that no matter your intellectual or emotional understanding of what SHOULD happen in the markets, central banks are still the most powerful institutions in the financial world.

By the way, I'm applying 'Don't fight the Fed' to 'Don't fight the Bank of England', or 'Don't fight the Bank of Japan', or 'Don't fight the European Central Bank'. Why include all of them?

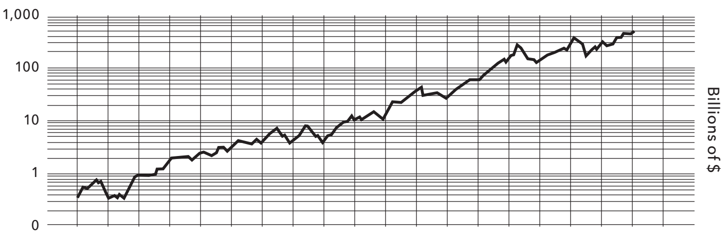
Between them, these central banks have the power to unleash a tidal wave of liquidity. They can print money to buy government bonds. They buy the bonds from banks and investment funds. Those banks and funds now have cash. Cash to buy stocks.

That's exactly how central banks can get stock prices to go up. That, in a nutshell IS quantitative easing (QE). After they lowered interest rates to near zero in 2009, QE was the next step. First, make the price of money cheap. Second, force cash into the market.

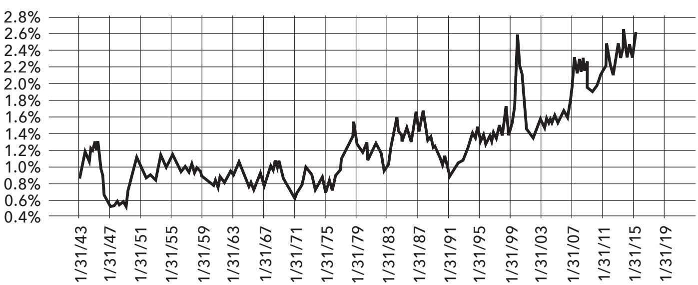
If you're a defensive realist like I am, you cannot afford to underestimate the power of central banks to move asset prices higher. In the long run, I believe the complete loss of liquidity is what actually causes a crash. In fact, it makes it worse.

You send a false signal that it's okay to buy stocks. People borrow money to do so. You can monitor this with margin debt figures. They don't make them easy to find in London. But see the margin debt figures for the New York Stock Exchange below. Notice anything?

Margin Debt on the New York Stock Exchange



Margin Debt (NYSE) as a % of Total Market Capitalization (NYSE)



Source: Thechartstore.com

Margin debt on the NYSE set a new all-time high in July of 2015. Margin debt as a percentage of the total market capitalisation of the NYSE also reached previous peak levels.

What's interesting, in terms of signals getting through the noise of stock prices, is that the Dow Jones Industrials made an all-time closing high in May of 2015 at 18,312. What that tells me is that increasing amounts of borrowed money failed to produce a new high in stocks.

That SHOULD have been a warning sign to investors. It put me on alert. It also leads to my next point. A 'margin call' can lead to a liquidity crisis in the market.

A 'margin call' is when your broker tells you that the value of your collateral (usually your stocks) has fallen. In order to keep your positions open, you either post more collateral or pay back your loan.

If you can't post more collateral, you pay back the loan. How do you pay back the loan? With cash. How do you get cash? By selling stocks.

That's why Hollywood made a movie called *Margin Call*. It showed how a debt-fuelled stock market rally can blow up quickly. But it doesn't answer the important question.

Why exactly does liquidity disappear in a market? It could be a major player goes bankrupt. It could be a geopolitical event (terrorism, war, and invasion). It could be economic cycles and human nature. Or it could be a simple margin call.

Either way, when it happens it happens fast. Confidence disappears. Credit disappears. Investors sell assets to raise cash. Eventually cash disappears. That's when you'll need the plans we talk about in the *London Investment Alert*.

But I'm not stupid. As I said, central banks aren't powerless. Even though interest rates are at all-time lows, there are at least four things central banks can do to try to keep the confidence game going even longer. Let's look at each one of them briefly. As you'll see, each one of them is a step on the road to Financial Martial Law.

CB stalling tactic #1: negative interest rates

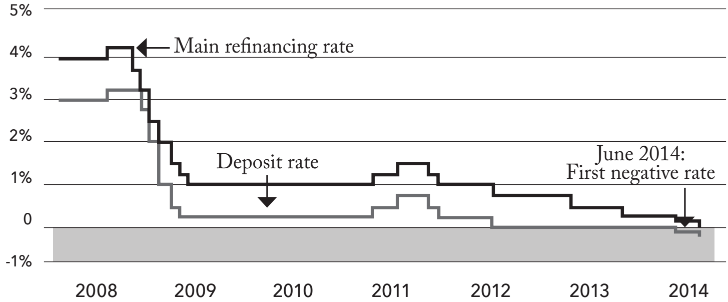
If you can't make people borrow money, then you have to make them spend cash. Especially the people – or banks – that are hoarding cash because there are no good investments in the economy. A central bank tactic already being employed in Europe is the imposition of negative interest rates. But what does that mean?

Negative interest rates mean that you are charged to hold your money in the bank. It's that simple. Whether you're a normal saver, or a large fund, or a commercial bank holding reserves with the central bank, you pay rent on your money.

Yes, it goes against the entire concept of saving and thrift. But that's the point, if you want people to stop hoarding cash and to spend it so you can produce growth and inflation, you have to punish those who hold cash. It's already happening in Europe. Check out the charts below. Rates began going negative in Europe last year.

Europe dives below zero

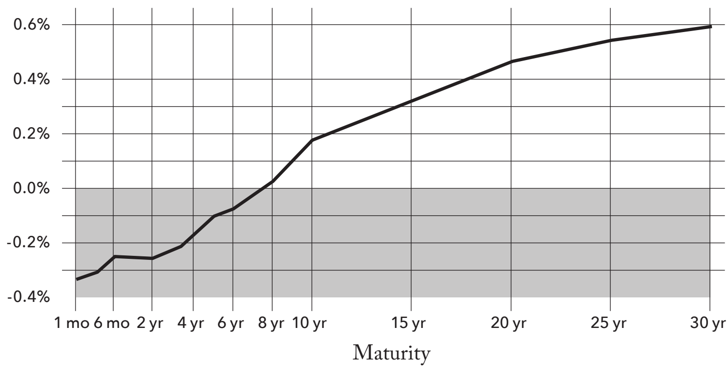
European Central Bank rates



Source: *Bloomberg*

Paying to save

Investors in shorter-term German bonds receive a negative yield



Source: *Bloomberg*

The first chart shows that rates went negative on deposits with the European Central Bank (ECB) last year. That's the ECB encouraging banks to get money into the economy. Those banks CAN choose to store money with the ECB. But they began paying for that 'safety' last year.

The second chart shows another point. German investors are ALREADY accepting negative interest rates on short-term debt. They're buying an investment guaranteed to lose them money if held to maturity.

Why would you do so such a thing? Well, it might be the best of a lot of bad choices. Sometimes investors with large amounts of money prefer the liquidity of a bond market to the constraints of the stock market. You can 'park' your money in short-term German bonds while you wait for something better to buy. Like any parking lot, you pay the price.

It's not just Germany either. Denmark introduced negative rates last year to protect its currency peg. So too did Switzerland and Sweden. All of them used negative rates as incentive for foreign investors to withdraw their deposits.

Those foreign funds were driving up the strength of Danish, Swiss, and Swedish currencies. Stronger currencies make exports more expensive. This is how currency wars work. And it's why negative interest rates are a powerful tool in the Fed and BoE tool box.

For example, if the Fed and the BoE targeted negative interest rates, it could drive money out of the bond market and into the stock market. You could conceivable get an enormous lift in stock prices – right before a massive collapse.

How it plays out is yet to be seen, but the imposition of negative interest rates is a key step on the road to Financial Martial Law. Look for it in an economy near you soon.

CB stalling tactic #2: currency wars

I could write a whole separate book about this. In fact, my friend Jim Rickards has! But before this book gets too out of hand, let me keep it simple. Another chapter in the plan for Financial Martial Law is a drastic devaluation in the currency.

Which currency? Take your pick. In August, we saw China resort to an explicit devaluation of its currency. It had a simple goal: revive GDP growth by making exports cheaper. You do that by weakening your currency against your trading partners. It makes your exports more competitive.

The Fed and the Bank of England could do the same thing, at some point. I don't know when that point is. It depends on how this currency war plays out.

In the short term, you could see China devalue its currency further. For Britain and America, stock markets might actually RISE. Money fleeing emerging markets – over £1 trillion pounds in the last 12 months – could find its way into British and American stocks. But beware!

Rising stock markets are themselves a FALSE PRICE SIGNAL. You will look at them and see that stocks have recovered. Headlines will say, 'FTSE shakes off China woes to make new high.' Pundits will congratulate Britain for showing those Chinese communists how capitalism is *really* done.

But it will be a false signal. As the pound strengthens with financial capital flows into Britain, exports will weaken. Britain's trade deficit will grow. The current account deficit as a percentage of GDP will expand to emerging market levels.

If some of these things don't mean anything to you now, don't worry. In future alerts, I'll explore them in greater detail. For now, the important point is this: at some point, in order to prevent the economy from falling into recession, the Bank of England may well have to devalue the pound.

This is what happens in currency wars: growth through devaluation. The countries that start it first get the first boost. Britain may seem to benefit from China's devaluation with rising stock prices. But eventually, the interests of the economy will force the BoE to act. Britain will enter the currency wars. When it does, the pound will fall. What happens next?

We're down the rabbit hole at that point. But I can guess: as the currency falls, prices will rise. Inflation will take hold. Interest rates will spike. The buy-to-let market could implode. Everything that once looked strong in Britain will become weak.

I could be wrong, of course. But if I'm not, or even if I'm just half right, aren't those things you should plan for? Do you see what's going on here? Every step that central banks CAN take to prevent a crisis just brings us closer to an even bigger reckoning later.

At some point, the crisis almost requires the imposition of Financial Martial Law. But before that point, expect the currency wars, inflation, and a crashing sterling.

CB stalling tactic #3: helicopter money

In a speech given on 21st November 2002, remarks by then-Governor of the Federal Reserve Ben Bernanke would make him famous/infamous. The title of his speech was *Deflation: Making sure 'IT' doesn't happen here.*

By the way, even the title of the speech reveals the danger we're now in. Central banks have always considered deflation to be their main enemy. They measure deflation by falling prices. But what they're concerned about is what happened in the Great Depression: a contraction in the money supply as a result of bank failures.

This is why the bailouts happened in 2008. Bankers successfully persuaded politicians that a collapse in credit would precipitate a collapse in the economy. 'Deflation' was the enemy because it evoked the ghost of the depression.

Another way of thinking of 'deflation' is falling prices. For consumers, falling prices are okay. Things you buy every day get cheaper. The purchasing power of your cash gets stronger. For consumers, the right kind of deflation is good. Bernanke acknowledged this in the notes to his speech and called it 'supply side' deflation and admitted China might cause it, which it did.

But what made Bernanke's speech infamous is that he referred to 'helicopter drop money'. He said the Fed could always avoid deflation (create inflation) by simply dropping money from helicopters. It was something economist Milton Friedman once suggested.

Bernanke wasn't being serious. Dropping money on the public from helicopters – making it rain – is a metaphor. But the implicit point is that there is no theoretical limit to the amount of money a central bank can create. With a digital printing press, you press a few buttons and you have new trillions.

In modern terms, and in the context of Financial Martial Law, helicopter money would come in the form of a new plastic card with a chip. You might get it in the post. Or you might be asked to come and turn in all your cash and collect your new card.

The card would be loaded with credits, units, or some new kind of currency. Those credits would expire within 30 days. If you didn't spend them, you lost them.

I'm just theorising here. But do you see what I mean? If you want to grow credit and people aren't borrowing and banks aren't lending, you have to take the logical next step. You have to put money in people's hands.

And it can't be money they can save or hoard. It has to be money with a 'sell by' date. They must either use it, or lose it.

That's when you've lost choice. You may feel richer, being given 'money' to spend. But if that's your only alternative, if you have no other recourse, no cash, no savings, no valuables, how rich are you?

I know. It seems extreme. But that's why I'm calling it Financial Martial Law. It's not just the attack on your cash. It's the attack on your financial freedom. On your whole quality of life. And it's coming.

CB stalling tactic #4: more quantitative easing

And the last shall be first. This is likely to be the next step, at least if we see a stock market crisis here in the UK. And truth be told, a stock market crisis will be the thing that triggers a broader crisis. Thus, preventing the stock market from signalling that danger is near will become the main mission of the authorities.

QE is not complicated. The central bank creates money to buy government bonds. It buys those bonds from banks and funds. The cash gets into the economy. Activity is stimulated. GDP grows.
If buying government bonds doesn't do it, QE can also be used to purchase private assets. You're already seeing this in Japan, where the Bank of Japan actively buys funds in the stock market. Why not here?

Well, direct government support for stock prices is, at the current moment, probably a bridge too far for politicians and central bankers. Why favour investors over workers. Why put the public's money at risk to prevent a stock market crash?

It's one thing to save the banks. All of us use them. All of us need them. But will the public hue and cry to save the FTSE? Should it? Would it make sense even to call it a market any more?

And wouldn't Bank of England (BoE) support of stock prices further increase bad risk taking?

Of course it would! You might get a 'melt up' in stocks but what you'd get is a bigger meltdown later. The crash to end all crashes. The crash preceding the imposition of Financial Martial Law.

Look for more QE. But take it as a signal. Have your plan in place well ahead of time. Be alert.

The catalysts for a crisis

The title of this book is '*The War On Cash*.' I hope you've seen by now that the direction of interest rates scarcely matters at this point. What do I mean by that?

You'd expect any future crisis to come from interest-rate rises. That's what happens after an enormous credit boom. The artificially cheap price of money leads to many bad investments.

Lenders, stung by losses and at the cautious point of an economic cycle, charge much higher interest rates to new borrowers. The economy contracts. Losses are taken. Previous mistakes are reckoned for.

That's what should happen. But we know now that central bankers don't want that to happen. Can they really prevent it? Can they hold back a natural economic tide and keep rates low indefinitely?

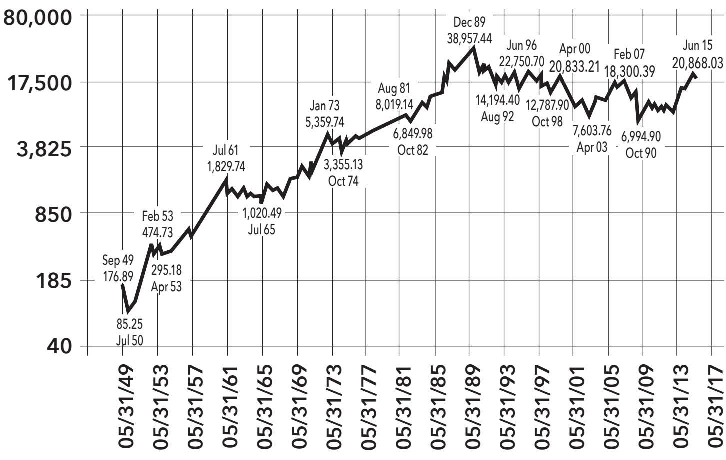
It's a fair question. The authorities CAN, in theory, suppress interest rates from rising for a very long time. They've been doing that in Japan for twenty-one years. The world hasn't ended. Is that so bad?

Japan an example of Financial Martial Law

Think about what happened in Japan. Real estate boomed. The stock market boomed. And then everything crashed. Take a look at the two charts on the next page. They show the same thing and tell the story.

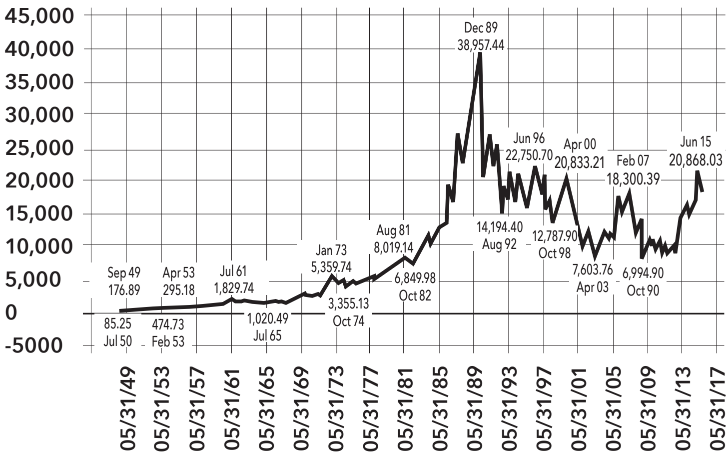
Japan's Nikkei Stock Exchange is down 53% from its all-time peak... in 1989. Think about that. Japanese stocks peaked a quarter of a century ago and are still down by over 50%.

Nikkei Stock Average (Monthly)



Source: *Thechartstore.com*

Nikkei Stock Average (Monthly)



Source: *Thechartstore.com*

That is the kind of wealth destruction that ruins even the best-laid retirement plans. Despite two decades of low interest rates, stocks have never recovered. That's exactly my point.

Under Financial Martial Law, you have no good options. Savings? Good luck with low interest rates. Stocks? At some point even they stop responding to more measures. Even when Japan's stock market almost doubled in 2014 thanks to quantitative easing, it barely made a dent in the long-term trend. Down.

I've shown two charts because charts can be deceiving. One is logarithmic (the top chart) the other is arithmetic (the bottom one). Arithmetic charts certainly look more dramatic. But logarithmic charts even out volatility and give you a better picture of long-term price trends.

Truth be told, no matter how you look at Japan's stock market, no matter what coloured glasses you have on, what you see is clear: real wealth can be destroyed by stagnant interest rates just as well as rising interest rates.

Japan's authorities have been steadily taking away financial freedom from the people for years. Their quality of life appears high, but people no longer have many good choices with their money. They're dependent on the government.

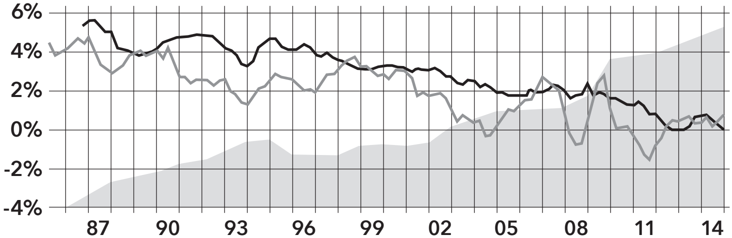
Maybe that's okay with them. Maybe it's okay with you. But if you're reading this now, I assume you're worried about your freedom.

I assume you're worried that Financial Martial Law is not just a threat to your wealth, but to the very way of life that you value so highly as a Briton. That's why the chart on the next page keeps me up at night.

Have a look...

A $57 trillion debt binge

Interest rates sink as debt soars



Lhs:
- Long-term index-linked bond yield [1]
- Real policy rate [2,3]

Rhs:
- Global debt (public and private non-financial sector)[3]

[1] From 1998, simple average of France, the United Kingdom and the United States; otherwise only the United Kingdom. [2] Nominal policy rate less consumer price inflation. [3] Aggregate based on weighted averages for G7 economies plus China based on rolling GDP and PPP exchange rates.

Sources: *IMF, World Economic Outlook; OECD, Economic Outlook; national data; BIS calculations.*

You would have thought a global financial crisis like we had in 2007 would have scared people off debt for a while. And for some people, it did. Those people paid down debts, they deleveraged and began saving again.

Meanwhile, the rest of the world went hog wild on borrowing. Total global debt has grown by $57 trillion since 2007, according to Mckinsey & Company. It's now over 250% of GDP.

Two things worry me about this. First, rising stock markets distort the danger of the rising debt. The chart above is a signal. But how many British investors are getting it?

Second is this: most of this debt is interest-rate sensitive. When interest rates rise, it will make paying off this debt much harder. If they rise dramatically and unpredictably, paying off the debt – for some borrowers – may be impossible.

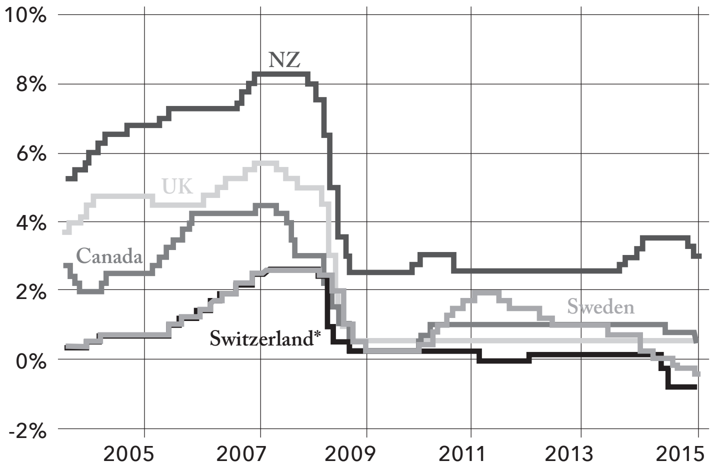
That's exactly when the imposition of Financial Martial Law will become obvious to most people. Normal trading on markets will be halted. Banks will be closed. Access to cash will be restricted. And by then it will be too late to do anything about it.

Why? Well, for one thing, other than negative interest rates, there is no more room left to cut rates. Check out the following four charts. They show 'policy rates' in the world's big economic zones – the US, Japan, the EU – plus the UK, Canada, Switzerland, Sweden, and New Zealand.

By the way, I excluded China because we don't know what's going on there. And in some ways, at least with respect to interest rates, it doesn't matter. When you look at interest rates in the advanced economies, you can see they are as low as they can go.

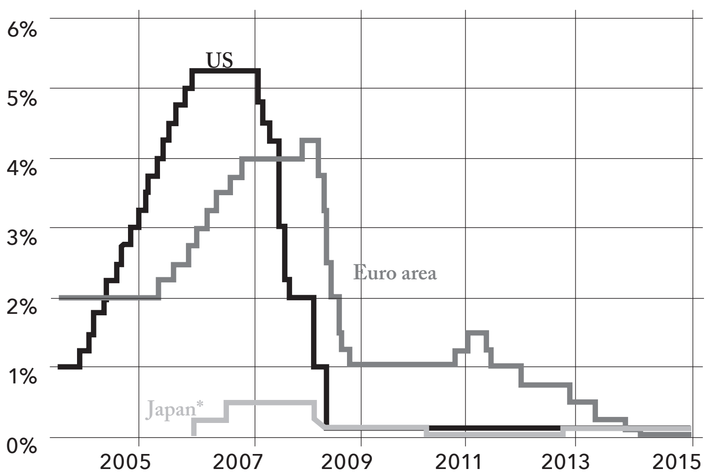
That means the authorities will have to resort to measures. That means currency wars, cash controls, and eventually, Financial Martial Law.

Policy Interest Rates - Selected Advanced Economies



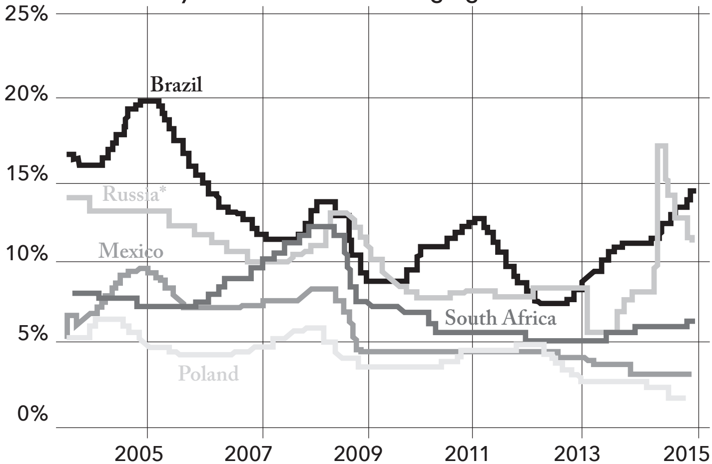
* Policy rate is the midpoint of the 3-month LIBOR band

Policy Interest Rates – G3



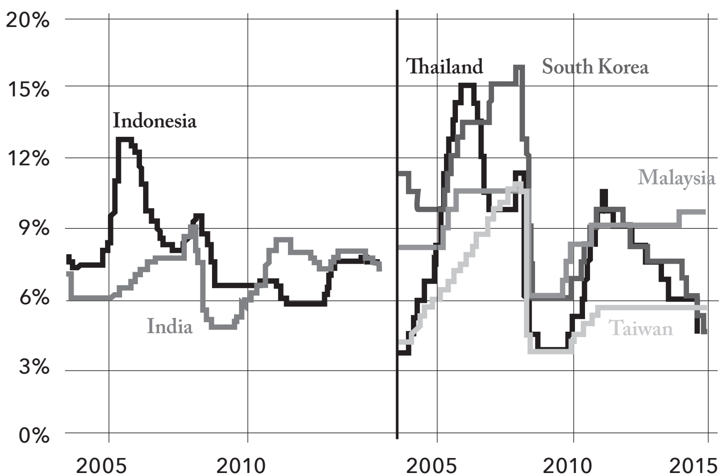
* Since April 2013, the Bank of Japan's main operating target has been the money base

Policy Interest Rates – Emerging markets



* On 13 September the Central Bank of the Russian Federation changed its official policy rate to the rate on its one-week open market operations, which was left unchanged at the September 2013 meeting

Policy Interest Rates – Asia



Source: *Central Banks*

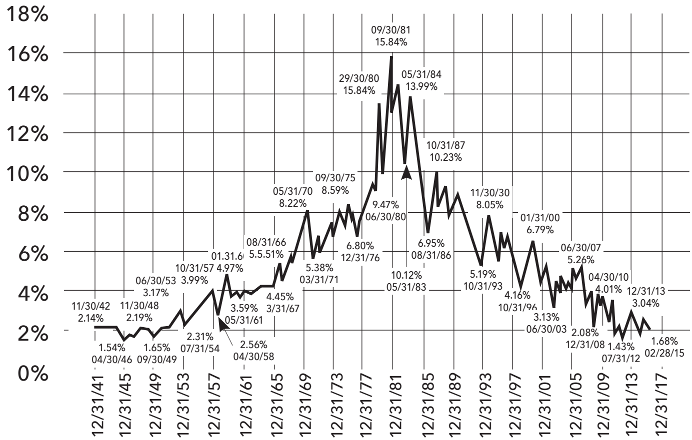
It's also possible that the authorities lose control of interest rates. This happens all the time in so-called emerging markets. The charts on the previous page show spikes in interest rates in Russia, Brazil, Thailand, South Korea, India, and Indonesia.

The reasons why this happens are beyond the scope of this book. It's usually related to the size of a country's current account deficit and the value of its currency. Rising interest rates are the price of keeping foreign money from fleeing your market.

But the point is: interest rates can rise too. In a normal economic world, they have to if you want to borrow money from people who think you're risky.

It's happened here in the UK. And for those with a short-term memory, it's happened in the United States as well. The chart below shows the yield on 10-year US Treasury notes going back to the end of World War Two. What do you see?

10 year U.S Treasury constant maturity (Monthly)



I see a grand credit cycle of sorts. Rates climbed for 30 years as inflation peaked in the early 1980s. Since then, powered by cheap energy, cheap credit, and cheap labour from China, we've been in a disinflationary boom. But all along the way, you can see that rates rise as well as fall. The question now is, what's next for Britain? What's next for you?

No one can predict the future. Not you. Not me. No one. But we can understand the natural forces at work in an economy. We can know that even the best laid and most well-intentioned plans go awry. And that when they do, the authorities must respond.

If you asked me to be precise about what could lead to a rise in interest rates when it's something hardly anyone wants, I'd say you don't have to look far.

An act of financial terrorism. War. Bad politics. Bad policy. Rising food prices. It could be any of them. It's likely to be some combination of all of them.

There are technical reasons for expecting the next crisis NOT to be a purely monetary crisis. I acknowledge that deflation – asset price implosion – is a real risk. Ben Bernanke was right when he pointed out that QE is not money printing in the conventional sense.

When the Fed – or the BoE, or the Bank of Japan, or the European Central Bank – prints money to buy bonds or other assets, it is not releasing that money into the economy willy-nilly (helicopter money). It can, it claims, soak that money back up through other open market mechanisms.

That's the plan. But I fear part of the plan is that, if none of it works, the 'kill switch' for the whole system will be hit. When you've lost control of prices, the only response left is either to let the whole system reset, or impose Financial Martial Law.

You know my feelings on the matter. But what are yours? Are they still unclear? Are you ready for what comes next?

A lot is at stake. Financially, everything is at stake: your pension, your savings, your investment, even the value of your house. An interest-rate shock will affect them all.

But beyond that, I don't believe you can truly be free if you're in debt or if your financial choices are tightly controlled. The time to prepare is now.

Three monumental financial threats

Threat #1: A second Great Depression

"We are at a wonderful ball where the champagne sparkles in every glass, and soft laughter falls upon the summer air. We know at some moment the black horsemen will come shattering through the terrace doors, wreaking vengeance and scattering the survivors.

"Those who leave early are saved, but the ball is so splendid no one wants to leave while there is still time, so everyone keeps asking, 'What time is it?' But none of the clocks have hands."

These words were written by George Goodman in *Supermoney*, his wonderfully witty study of the go-go years of the US stock market. The boom period Goodman describes ended abruptly in the chaos of the first Arab oil embargo in 1973.

His story feels familiar to me. As I write, it's been three-and-a-half years since the US market has fallen back by 10% or more.

That makes the current rally extraordinary, though not unprecedented. It happened before in the run-up to the Asian financial crisis and the failure of Long-Term Capital Management.

This time round, the euphoria in the markets is more peculiar because the problems are that much more visible. In the past year alone we've had three big shocks: the Russia crisis, China's credit bubble, and now a collapse in oil prices. At some point, something's got to give.

Those shocks didn't end the party. But I think I know what will.

The problem comes from Europe, and it can be summarised in just one word: *deflation*.

How deflation could spell disaster

Europe is sleepwalking towards an abyss.

Deflation is one of the most dangerous diseases in all of macro-economics. It hits rarely – only a couple of times in the last century – but it has a devastating impact. It can rot the economy from within. And that's why I'm so worried about what I'm seeing in Europe at the moment.

Deflation officially hit the eurozone for the first time in December 2014, when headline prices fell by 0.2%.

But a 0.2% fall scarcely does justice to the scale of the threat. To get a sense of the crisis requires a trip back in time to 1933, when the US economist Irving Fisher published his *Debt-Deflation Theory of Great Depressions*.

Fisher showed, step by step, how deflation destroys an economy:

> *Overleveraged companies and households pay down debts – distress selling ensues.*
>
> *As bank loans are paid back, the money supply contracts. Asset prices fall.*
>
> *The valuations of companies are impacted – business failures ensue.*
>
> *Business profits fall.*
>
> *Industrial output, trade and employment all fall.*
>
> *The public loses confidence.*
>
> *Money hoarding begins.*
>
> *Nominal interest rates may fall, but deflation-adjusted interest rates actually rise.*

Fisher's nine steps is the nightmare scenario. So how close are we to it?

Well, Oxford Economics reckons that when oil trades at $50 a barrel, at least 18 countries, including Germany and the UK, could see outright price deflation.

Money hoarding is already more likely to occur because bank interest rates are so low as to be meaningless. Why not keep your money under the mattress if you're not earning any interest in the bank (and you're worried about the solvency of the bank)?

And, thanks to QE and six years of financial repression, nominal interest rates can't realistically fall any further.

Or can they?

The fault lines in Europe run deep. Compare and contrast Germany and the periphery. German unemployment stands at a 23-year low of just 5%. Italy's unemployment rate is 13.4%, but amongst Italian youth it stands at 43.9%. These are the sorts of inequalities that fuel revolutions.

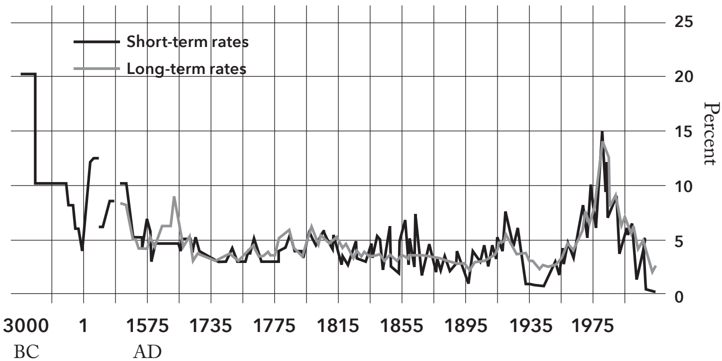
In January, Mario Draghi announced full-blown QE in an attempt to fight off deflation. But the 20-year experience of Japan suggests that once deflation sets in, it is all but impossible for governments to do anything about it.

The extraordinary state of the markets

Nowhere is the current state of the markets more extraordinary than when we consider interest rates.

Interest rates aren't just low by comparison to the current business cycle. Or in the context of the post-war period. Or in a lifetime. In fact, you could go back to the foundation of the Bank of England in 1694 and still never see interest rates so low.

The chart on the next page, courtesy of Andy Haldane – chief economist and executive director of monetary analysis and statistics at the Bank of England – shows the history of both short and long-term interest rates going back over a period of 5,000 years. Over that entire period they have never been lower than they are today.



Source: Bank of England, via *Business Insider*

What low interest rates mean for you

Clearly, we are living in extraordinary times. But why is this an issue for investments?

The problem that we all have is that everything in the financial markets is ultimately priced off interest rates. The supposed 'risk-free rate' arising from government debt is the benchmark against which all other financial assets are ultimately assessed.

So, when interest rates are at all-time lows in financial history, the implications for investors aren't that promising. Put simply, investors are unlikely to yield substantial returns.

All things being equal, the returns from stocks have to be seen relative to the likely returns from bonds. And since many bonds now offer negative yields, investors today in the stock market should manage their expectations appropriately. Especially since at some point, interest rates must rise – and the bond market bubble will likely explode, messily and dangerously.

Alternatively, rates could remain becalmed where they are for some time to come. Nobody knows for sure.

Financial repression has been disastrous for savers

So what has caused bond yields to fall so low? The answer to that question lies firmly at the feet of government policy. And in particular, to a specific two-letter acronym: QE.

Seven years after the financial crisis first erupted, central banks continue to keep interest rates and bond yields artificially suppressed, effectively keeping the banking system on emergency life support. Artificially suppressing bond yields also happens to have the happy by-product of making it easier for heavily indebted governments to continue to borrow.

But this financial repression – a government-led policy that deliberately holds down interest rates to below inflation – is a disaster for savers. That is especially true for those who don't want to take much risk.

Savers who would have been perfectly happy in a previous age to have secured a deposit interest rate of 5% or 6% per annum on their cash are now virtually forced to flee into the stock market in search of those sorts of returns – neither cash deposits nor most bond markets today come anywhere close.

And there are also investors other than central banks who are buying bonds with either puny or even negative yields – notably pension funds, who are pretty much forced by regulation to own government debt to the exclusion of most other types of assets.

Any investor who is buying government bonds voluntarily today must really believe in one particular outcome: outright deflation. The sort of economic conditions that last existed in the Western economies during the 1930s, and more recently in Japan.

But entrenched deflation is a mortal threat to indebted governments because it increases the debt burden on those governments for as long as it lasts. In extremis, deflation will bankrupt heavily-indebted administrations, because the very last of the bond market vigilantes will shun their debt entirely.

The threat of deflation is real and imminent

We've spent the last several years trying to assess which was the more likely outcome: deflation or inflation. Now the jury is in. While we still maintain that inflation is the thing to be most afraid of (or prepared for) over the longer term, it is increasingly clear that the deflationary threat is real.

Clearly, for any solvent consumer – ideally without significant debts – deflation is a joy. It provides cheaper prices for goods, assets and services. What's not to like?

But in a credit-driven economy like the one we inhabit, the economy requires ***constant growth and constant inflation*** in order to service the accumulated debts of households, corporations and, most of all, government.

Beware when an economist starts jabbering on about an 'optimal' rate of inflation. There is no optimal rate of inflation other than zero. To argue in favour of a positive inflation rate is to promote authoritarian bureaucrats who want to take your money away from you by stealth.

What makes our current predicament more worrying is the vulnerability of the banking system, particularly over the Channel in the eurozone. Government bond yields have now gone negative in at least five separate European countries, including Denmark, Switzerland, Sweden and Germany. In the words of the financial analyst and market historian Russell Napier: "There are now trillions of euros of financial assets which yield less than banknotes."

Take the bizarre situation of Eva Christiansen, a Danish entrepreneur who has just taken out a small business loan. The interest rate on her loan is ***minus*** 0.0172%. In essence, the bank is paying her to borrow money.

The flip side of Ms Christiansen's good fortune is reflected in the unhappy situation of Danish student Ida Mottelson. Her bank just wrote to her to tell her that it was now charging her 0.50% to keep her money on deposit (earning nothing). European banks are now paying their own borrowers, and punishing their own depositors.

If it costs you money to keep that money in the bank, there is a logical alternative. Take it out of the bank, and keep it under the mattress instead. In some instances – in the eurozone – you will be actively better off in doing so. This is a disaster in the making.

Elsewhere in his analysis, Napier alludes darkly to the risk of capital controls which occur when a government or central body limit the flow of foreign capital, either into or out of the domestic economy. It's a sort of market manipulation which effectively forces private savings to fund governments via the debt market.

To see this hands-on approach in action, look to Cyprus. In the very recent past, the country has given eurozone administrations a template for future bail-ins for bank depositors – taking away depositors' money in order to rescue the ailing banks.

This is not good news. It is now eight years since the run on Northern Rock. And especially in the eurozone, nothing has really been fixed.

The clocks are chiming

Not everybody lost their shirt in the stock market bust of the early 1970s. At least one investor heard the clocks chiming before everyone else and carefully made his exit.

By May 1969, a gentleman by the name of Warren Buffett had had enough. He wrote to advise the partners of the Buffett investment partnership that he was winding it up:

"I just don't see anything available that gives any reasonable hope of delivering a good year and I have no desire to grope around, hoping to 'get lucky' with other people's money. I am not attuned to this market environment, and I don't want to spoil a decent record by trying to play a game I don't understand just so I can go out a hero."

Back to George Goodman and his wonderful ball:

"The Black Horsemen did come, of course, and most of the guests were still at the ball. The market did not make sense to anybody with a sense of history…"

Threat #2: A massive American stock market crash

It is said that some time during the winter of 1928, the US businessman and politician Joe Kennedy (father of JFK) stopped to get his shoes polished before he started work.

When the shoeshine boy had finished he looked up at Joe and said: "Buy Hindenburg."

Joe Kennedy's almost immediate response was to liquidate his stock portfolio.

"You know it's time to sell when shoeshine boys give you stock tips. This bull market is over."

Times, and shoeshine boys, have moved on. But we can still make assessments of the market's condition through a combination of its qualitative and quantitative aspects.

Let's take the qualitative first.

Weird stories from the financial markets

The *Wall Street Journal* reported on 21 January 2015 that Carmine 'Tom' Biscardi is on the hunt for Bigfoot and is planning an IPO (initial public offering – i.e. a stock market listing) to fund the expedition:

"Mr. Biscardi and his partners hope to raise as much as $3 million by selling stock in Bigfoot Project Investments. They plan to spend the money making movies and selling DVDs, but are also budgeting $113,805 a year for expeditions to find the beast. Among the company's goals, according to its filings with the Securities and Exchange Commission: 'capture the creature known as Bigfoot.'

"Investment advisers caution that this IPO may not be for everyone. For starters, it involves DVDs, a dying technology, said Kathy Boyle, president at Chapin Hill Advisors. Then there is the Sasquatch issue. She reckons only true believers would be interested in such a speculative venture."

But the Bigfoot IPO isn't a one-off. Bloomberg (5 February 2015) reported that a grilled-cheese sandwich maker with four delivery trucks had started trading on the OTCQX market with a market capitalisation of $108 million:

"[The Grilled Cheese Truck Inc.] currently operates and licenses grilled cheese food trucks in the Los Angeles area and Phoenix and is expanding into additional markets with the goal of becoming the largest operator in the gourmet grilled cheese space [a market in which it may be the only company active].

"… according to the company's financial statements, it has about $1 million of assets and almost $3 million in liabilities. In the third quarter of 2014, it had sales of almost $1 million, on which it had a net loss of more than $900,000. The story is much the same for the first nine months of the year: $2.6 million in sales and a loss of $4.4 million."

Bloomberg columnist Barry Ritholtz commented:

"I can't think of a more interesting sign of the old irrational exuberance in equity markets than a publicly traded grilled cheese truck business trading at a $100 million-plus valuation. That sort of thing doesn't happen unless there is significant excess in the markets."

Analyst Jason Voss points out that art sales becoming front-page news is another anecdotal sign of market froth. On 6 February, *Barron* magazine reported that the value of fine art sold at auction had quadrupled from $3.9 billion in 2004 to some $16.2 billion in 2014.

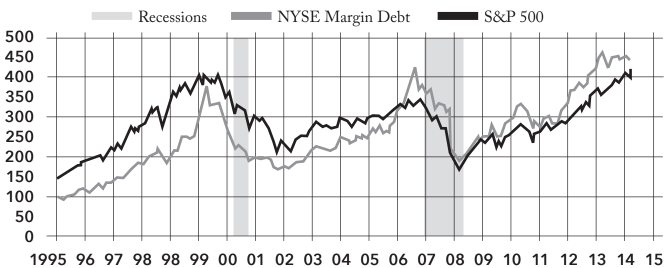
But you could respond that I have cherry-picked these news stories to prove the point. So let's take a look at more quantitative evidence of a possible market top.

… And weird numbers from the financial markets

A peak in **margin debt** (the dollar value of stocks owned on margin, i.e. with only a small amount of the purchase price laid down – with the rest lent to the buyer by the broker) is a time-honoured sign of an impending market top. The chart below, courtesy of Doug Short, shows that New York Stock Exchange Margin Debt, in real terms, is now higher than it was before the previous market peaks of 2000 and 2007.

NYSE Margin Debt and the S&P 500

Real Values (Adjusted to Present-Day Dollars)



Source: *advisorperspectives.com*

Another sign of potential trouble ahead is that interest rates have gone through the floor. This is a good time to be a borrower. In February, Germany issued a five-year bond worth nearly $4 billion, carrying a negative interest rate. Investors are paying money to hold German government debt.

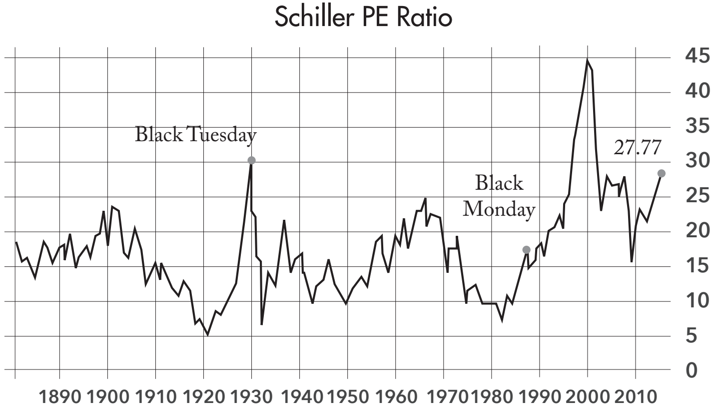
Bonds issued by Switzerland, Holland, France, Belgium, Finland, and even Italy are now trading with negative yields. **Bonds with negative yields now account for more than a quarter of the total market,** according to ABN Amro.

To be a depositor, times are not so good. A sign of potential trouble ahead is that the **velocity of money** – the speed with which money circulates through the economy – is also dropping through the floor.

The final piece in the jigsaw is both qualitative and quantitative. It relates to insider sales of stock: the ratio of corporate executives selling shares in the companies they work for versus the number of corporate executives buying shares in those self-same companies. Last month in the US, **insider sales of stock outnumbered insider purchases by 33 to 1.**

We would ordinarily assume that corporate insiders are best placed to assess the fundamentals of their businesses. That the ratio of sellers to buyers is so extreme speaks volumes about their assessment of value in the current market.

Just to round things off, let's return to our old friend, the Schiller price/earnings ratio. The Schiller PE ratio is simply a 10-year smoothed average of the price/earnings ratio for the broad US stock market.



Source: *http://www.multpl.com/schiller-pe/*

The Schiller PE now stands at 27.77 times. By way of comparison, the long run average for the Schiller PE stands at 16.6 times. If markets tend to mean revert (which I believe they do, over the long run) that suggests that the US stock market is now **67% overvalued**. (You'll note that we're already way above where we were on Black Monday 1987. And we're not far behind Black Tuesday of 1929. The only other point in history when US stocks were more expensive was in December 1999.)

One aspect of the Schiller PE ratio worth bearing in mind, however, is that its use for market timing is limited. I believe it's a great way of assessing the overall relative valuation of the market, but it doesn't give us a definitive guide on precisely when to buy or sell.

As Keynes commented, markets can remain irrational longer than we can remain solvent.

What does this all mean?

There seems to me now to be an overwhelming need for caution when it comes to stock market investing. Note, too, that many of these metrics relate specifically to US stock markets, which I consider egregiously overvalued. The good news here – if there is any – is that the US market does seem to be a particularly special case.

Valuations here in the UK are much less fraught – even as the media has become transfixed at the news that the FTSE 100 Index has finally broken through the high it last recorded 16 years ago.

As at June 2015, the forward p/e (incorporating analyst forecasts) for the FTSE 100 Index stands at 16.5, according to Bloomberg analytics. The equivalent metric for the US S&P 500 Index is around 18. The difference is marginal, but other metrics point to a more substantial variation in value between the two markets. Price/book for the S&P 500 stands at 2.9. Price/book for the FTSE 100 is just 1.9. The S&P 500 price/sales ratio stands at 2.2. The FTSE price/sales ratio is a comparatively lowly 1.3 (all figures courtesy of Bloomberg).

The reason I focus so heavily on the US market is not because *The Price Report* portfolio is significantly exposed to it. Far from it. It's rather because of something my friend David Fuller calls the 'Wall Street leash effect': when the US markets drop, the rest of the world has a tendency to crash.

To get a sense of the current valuation of global stock markets by way of market capitalisation by country, consider the table on the next page, again courtesy of Bloomberg. It shows that the US market makes up 34.2% of total world market capitalisation.

WORLD MARKET CAP					
WORLD	**CURRENT (MIL USD)**		**1 Month %Change**	**YTD %Change**	**Pct Of World**
World	73022102	06/10	+2.36%	+12.31%	100.00%
AMERICAS					
United States	24970899	06/10	+.17%	+2.28%	34.20%
Canada	2044567	06/10	-2.93%	-2.64%	2.80%
Brazil	729979	06/10	-8.20%	-9.77%	1.00%
Mexico	435060	06/10	-1.83%	-2.91%	.60%
Chile	227951	06/10	-7.01%	-2.72%	.31%
EUROPE/AFRICA/ME					
UK	3839279	06/10	-2.08%	+4.61%	5.26%
France	2110983	06/10	-1.54%	+9.09%	2.89%
Germany	1941150	06/10	-2.93%	+5.62%	2.66%
Switzerland	1717073	06/10	-.30%	+9.20%	2.35%
Spain	778633	06/10	-1.05%	+7.47%	1.07%
ASIA/PACIFIC					
Japan	4992365	06/10	-.02%	+12.41	6.84%
China	9798764	06/10	+30.29%	+97.34%	13.42%
Hong Kong	5133886	06/10	+.07	+23.68%	7.03%
India	1535669	06/10	-1.27%	-1.38%	2.10%
Australia	1186702	06/10	-4.59%	-3.08%	1.63%

Source: *Bloomberg, June 2015*

The reason I highlight what I perceive to be the significant overvaluation of US stocks is because the US stock market accounts for over a third of global stock market value. Any international equity fund manager, who is benchmarked, is simply forced to own more of the US stock market than any other. That's why a downturn in US markets is sure to drag down the value of most equity funds. After the US comes China (8.01%) which clearly overlaps with Hong Kong, Japan (7.1%), and then the UK (5.68%).

How I'm preparing for a fall in the US stock market

If you share my concerns that the US markets are headed for a fall, there are two logical ways of preparing for it.

One is to carefully manage exposure to equity markets full stop. Clearly, it also makes sense to carefully manage exposure to US-specific risk, given that the US is where valuations appear to have run well ahead of themselves.

The second is to be highly selective when it comes to stock-specific risk. So although the equity exposure of our portfolio has been chosen from a 'top down' perspective (taking into account the macro-economic situation and the relative merits and demerits of other competing asset classes), the underlying equities themselves have been selected on a 'bottom up' basis, favouring fundamental quality (of each company, and its management) matched by what we consider to be either outright defensiveness or compelling valuations, or both. These characteristics apply both to direct equity investments and to our equity funds.

Of course, we're in such an unusual and unprecedented market environment, current overvaluations can last for some time, and even grow from current levels. Let me print a few trillion dollars and I can show you a good time, too. But there's a time to take on risk, and there's a time to reduce it. I believe we're clearly in the latter environment.

And of course, 'bubble'-era mania in a world of QE and ZIRP (zero interest rate policy) and now NIRP (negative interest rate policy) is not limited to the US, or to US stocks in isolation. While the S&P 500 and the Dow Jones have both risen to all-time highs, and the Nasdaq surpassed its March 2000 peak, Germany's Dax stock index surged recently to a new all-time high. Japan reached a 15-year high.

But it is the US that is ground zero for signs of bubble-era excess. The evidence is all around. In Silicon Valley, and in prime real estate throughout the US. In subprime auto loans, and in record corporate debt issuance (which is logical, given the borrowing rates even subprime corporate borrowers can now achieve). In record stock and bond prices, and in record prices for anything that appears to offer a yield of any kind. In record ETF assets and newly resurgent derivative markets.

The great value investor Ben Graham once remarked:

> *The most realistic distinction between the investor and the speculator is found in their attitude toward stock-market movements. The speculator's primary interest lies in anticipating and profiting from market fluctuations. The investor's primary interest lies in acquiring and holding suitable securities at suitable prices.*

Bear in mind that phrase: '***suitable securities at suitable prices***'. That is all we should be concerned with. Whether in real or nominal terms, the US market is now at all-time high levels.

Threat #3: The UK gilt bubble bursts

When the UK government wants to borrow money, it issues gilts (UK government bonds). With a major economy like the UK, lending money to the government has always been seen as a very secure thing to do. The government will never go bust, right?

Traditionally, when you want your money to be nice and safe, you buy gilts. In fact, you may already own some. If you don't own gilts personally, I can tell you with more or less 100% certainty your pension fund does. So make no mistake – this affects you.

There's nothing you can do about it and, as I said, I'm not saying you should cash in your pension. My advice is simple: find ways to make money elsewhere to cushion any drop in your pension pot.

Because right now we have a problem. That problem is the scale of UK government debt. I've already talked about this with regards to the potential banking collapse. But there's another, even deeper problem it could trigger…

Our government has borrowed so much money it will probably never be able to pay it all off. It owes well over £1 trillion, more than half of Britain's annual GDP.

With this colossal debt to repay, you might think the last institution in the world people would want to lend to is our government. But the markets don't run on common sense. They run on instinct… and right now, the prevailing instinct is fear.

Investors (mainly the banks) are looking for 'safety' and they have nowhere left to turn. Stocks look extremely dangerous, given the problems in the eurozone. The volatility out there right now is vicious. That's why money is rushing into UK gilts.

In August 2011, UK gilt yields hit a record low. And they are still hovering around these depths right now. That means bond prices are near a record high, because there's so much demand for them. With the UK already borrowing record amounts of money, hordes of investors are buying up UK debt.

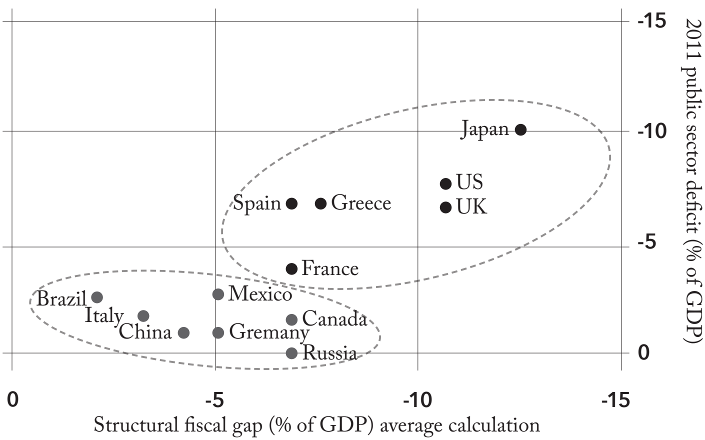
Market panic has created a gilts bubble, a weird situation where tens of thousands of investors are buying up an asset that will most likely lose them money.

I am convinced there will come a time – perhaps very soon – when investors stop playing this strange game. At that point, I believe the gilt bubble will burst, gilt prices will fall, and long-term interest rates will start to rise.

If that happens, I believe it's game over for the UK economy. The fundamental solvency of the United Kingdom could come into question. Gilts are a symbol of our national wealth. If the gilt market collapses, it could trigger a devastating loss of confidence in Britain.

The fallout from that situation is almost unthinkable. And I am worried that the moment when the gilt bubble pops may be fast approaching. Away from the madness of the crowds, there is a growing swell of opinion that the UK is fast becoming a risk. And if you need any further proof of that, remember that international ratings agency Moody's officially downgraded Britain's credit rating back in 2013. Confidence in Britain has certainly been stronger.

Have a look at this chart, published in a report by bond fund giant PIMCO, which perfectly demonstrates the dangerous situation the UK is in. It shows the sovereign debt 'ring of fire' – the countries which are most likely to be destroyed by their own debts. The further up you are, the more debt you have. And the further down you are, the quicker your debts are growing. As you can see, we are in a group of nations that right-minded investors shouldn't touch with a bargepole



Source: *IMF, BIS, OMB, PIMCO. As of July 2012*

Look at the debt-destroyed nations we are keeping company with: Spain, Greece and Japan, countries whose economies are either ruined or currently going down the pan. To me, this chart shows the REAL situation of the UK economy. A country which is so deep in debt that its bonds are just not worth buying.

Bill Gross, head of PIMCO says that America's bond market could be "burned to a crisp" if the US doesn't start to handle its debts. Look who is standing shoulder to shoulder with the US in this damning chart – it's the UK.

Once the world wakes up to this fact – as I believe it soon will – you will not only want to have your money out of UK gilts, but you will need to have taken steps to protect yourself from the potentially terrible fallout.

If gilt prices collapse, that drives longer-term interest rates higher. Since mortgages are also priced against longer-term interest rates, that could send mortgage rates soaring and destroy confidence in the property market, not to say property prices.

But there are some strategies that will help you chart a course through situations like this. Before I start though, just keep this in mind:

Surviving a crisis comes down to two things: protecting your wealth, and preserving your lifestyle and standard of living. Keeping your money safe is one part of that. But preparing on a personal level is just as important. I'll take each side of this equation in turn, starting with the financial…

Part Three: How to protect yourself

Preparing for financial chaos

Cockroaches are amazing animals. They can go without air for 45 minutes, survive under water for half an hour, and endure freezing temperatures. They are between six and 15 times as resistant to radiation as humans. So if we ever have a nuclear war, cockroaches will rule the planet.

So cockroaches are resilient. That's why they're awesomely long-lived as a species. The oldest cockroach fossil is 350 million years old – humans have been around for only 200,000 years or so. Cockroaches first appeared, according to the fossil record, after the second of the earth's five mass extinctions to date. They survived, in other words, the third, fourth and fifth mass extinctions (defined as an event that wipes out 75% of all species on our planet). That last, fifth extinction is the one that did for the dinosaurs. Their 'system' seems to be able to survive anything this planet can throw at it.

And that system is wonderfully unsophisticated. Author Rick Bookstaber points out that the cockroach behaves according to a crude but elegant algorithm: "Singularly simple and seemingly sub-optimal: it moves in the opposite direction of gusts of wind that might signal an approaching predator." So the next time you see a cockroach in your kitchen, show it some respect! It might have something to teach you.

My friend Dylan Grice has also been writing about the humble cockroach. Dylan worked on the global strategy team at French investment bank SocGen. He and his colleague

Albert Edwards have been ranked at Number 1 in the Extel survey of institutional analysts for the past three years. So what have cockroaches got to do with investing?

Twenty years of boom and bust

I began my career in the financial markets in 1991. At that time the economy was in recession, so the bond markets were booming. And then when the Fed started raising rates in 1994, the bond markets collapsed. Later that decade, equity markets surged higher as investors discovered the internet. And then the Asian crisis hit.

Russia defaulted and Long-Term Capital Management imploded, triggering a freeze in the capital markets that turned out to be an eerie premonition of 2008. Then we had the attacks on the Twin Towers in 2001, causing US stock markets to close for a week. In the week that they reopened, they lost $1.4 trillion in value. Then we had more recessions, a boom in property prices worldwide, the subprime mortgage bust, and a gigantic corporate and then sovereign bond crisis that lives with us to this day.

The two major asset classes – stocks and bonds – have enjoyed a wild ride over the course of the last two decades. Backing one or the other, depending on timing, will have jeopardised or destroyed huge amounts of capital. Investors in stocks in the late 1990s thought themselves heroes – until the dotcom bust. Investors in bonds will have made small fortunes – unless they backed the wrong markets, like Iceland, or Lehman Brothers, or RBS, or Greece.

And now I believe the risks for most bond markets (and not least UK gilts) are all on the downside, both for government and corporate debt. The yields on offer are simply too low, and the risks of rising defaults and inflation are simply too high (I make an honourable exception in the case of objectively high quality credits, from places like Hong Kong and Singapore).

So unless you were very, very good at market timing and switching from bonds to stocks to cash and back again, the last 20 years will have given you almost nothing but grief.

The cockroach portfolio

But Dylan Grice reckons it wouldn't have worried our friend the cockroach. The cockroach doesn't know where we are in the interest rate cycle. It doesn't know (or care) if capitalism is in rude health or about to collapse. The cockroach doesn't have a view on currencies, asset allocation, stock selection, or the fiscal cliff, or of the survival of the eurozone.

The cockroach, therefore, not having any fundamental view, would simply divide its assets across nominal and real assets. It would only be concerned with recoiling from those troublesome gusts of wind that might spell danger.

Dylan's cockroach would have 25% of its portfolio in cash; 25% in government bonds; 25% in equities; and 25% in gold.

Each of those asset buckets protects against a different type of risk. Cash protects against a market collapse in anything (provided it's cash held with a solid institution). Government bonds protect against deflation (provided your money's invested in solid government bonds and not trash). Equities offer capital growth and income. And gold, as we know, protects against currency depreciation, inflation, and financial collapse.

These are my preferred asset buckets, they're very similar to the cockroach portfolio:

- **Cash and bonds**
- **Equities**
- **Real assets, notably monetary metals gold and silver**
- **Absolute return funds**

The only distinction between my portfolio and that of Dylan's cockroach is that Dylan separates out cash as a holding in its own right. With deposit rates so derisory at present, I prefer to amalgamate cash (admittedly a useful source of liquidity and portfolio insurance) with high-quality bonds instead. And I specifically allocate to low-risk, diversified, absolute return funds. But the differences are trivial and the similarities are, I think, striking.

The beauty of a 'static' allocation across these four asset classes (and it need not be static, either, so long as there is always some commitment to each part) is that it removes emotion from the investment process. We all know how we should behave when the market throws opportunities at us. But human nature being what it is, we are more likely to flee the market in terror precisely when we should be wading in and scooping up bargains. With a more or less constant allocation to each asset class, emotion is less liable to get in the way.

For example, as a fund manager, I live in fear of a stock market collapse. But having given the topic much considered thought throughout my career, I've decided that the best way to protect against the eventuality is, like the cockroach, to be well hedged. Rather than attempt the impossible feat of market timing, the path of least resistance for me is to maintain an allocation to stocks at all times. That allocation can be tweaked in line with my assessment of the broader health of the market. If I'm feeling bullish, I can raise the allocation to stocks within the portfolio. If I'm feeling bearish, I can adjust the equity allocation lower.

But the trick is to maintain a meaningful commitment to each asset class at all times. If I'm feeling particularly bearish, I can do two things:

- Adjust the equity allocation down to the 'sleeping point' – the percentage allocation that doesn't keep me awake at night.
- Adjust the exposure to individual equities to reflect that bearish view, in other words, by concentrating on more defensive stocks in defensive sectors, such as tobacco, pharmaceuticals, utilities, or consumer staples. When I get more positive again, I can raise either the portfolio's equity weighting, or change the mix in favour of growth stocks, or both.

The point about the cockroach portfolio is that it protects us from ourselves. At precisely the point at which it makes sense to maintain an allocation to stocks (because a bear market valuation, for example, betokens the prospect of significant capital growth to come), we are most likely to be terrified of owning them. The cockroach portfolio neatly addresses that concern.

Or take bond markets. As you've read, I'm very concerned about the prospects for Western government bond markets. But that doesn't mean we don't have to own them. It's a good idea to have exposure to bonds in only the most creditworthy holdings in debt issued by the likes of Qatar, Hong Kong, Singapore and the UAE. If we can get a yield to maturity of roughly 5% from those markets – which we can – why bother with derisory returns in riskier bond markets like that for US treasuries and UK gilts?

My approach to asset allocation doesn't change, whether I'm writing *London Investment Alert*, *The Price Report* or working for a client in the City. The difference?

Well, in *London Investment Alert* we share the simplest, purest expression of my approach. It's easy for anyone, right down to a real investing beginner, to follow and put their money on sure footing. The investment ideas I recommend are easy to follow regardless of how much experience you have. Quite simply, I do this because I want to help as many people as possible prepare for what's coming. Because one thing is certain: now is not the time to be unprepared. That's true whether you have a £1,000 portfolio or a £1 million portfolio.

In *The Price Report*, we take a slightly more sophisticated approach. We write to our readers on a much more regular basis, and recommend some specific investments that may be a little harder to buy (you may need a fairly sizeable investment pot to get started, for instance, and your capital will be at risk). This means *The Price Report* isn't necessarily for everyone.

I think a slight variation on Dylan's cockroach portfolio is the ideal way to manage one's assets during such a tumultuous and confusing financial environment. Maintain an allocation to each of the major asset classes (cash and bonds; equities; absolute return funds, and real assets including gold) – and within those allocations, feel free to specialise.

So although I see the merit of using low-cost exchange-traded funds, for example, to get cheap exposure to specific markets, my preference is to commit to high conviction holdings that are either direct, or that use very talented active managers instead.

The reason I'm wary on ETFs is because I'm always in pursuit of absolute returns – I hate to track markets down when they fall. I much prefer to aim for capital preservation in tough markets, and capital growth in good ones.

I hope I'm wrong, but I have a grave fear that we are all in for a remarkable and sobering period in the financial markets.

Rather than bury our heads in the sand, taking a sensible and diversified approach to our portfolio management will be the safest and best way to navigate the volatile waters to come.

Together, we can do just that.

So what next?

Well, in your monthly issues of *London Investment Alert* we'll be helping you build your very own 'Cockroach Portfolio'. We'll recommend investment ideas – as I said, investments that anyone right down to a beginner can follow – that we believe will help you position your money to survive as the financial system unravels.

But first, let's take a look at the second half of the equation. Namely, how do you preserve your lifestyle and standard of living during a time of crisis?

24 tips for surviving any crisis

It's the 16th March, 1968.

It's a Friday.

A day like any other.

Except, in Britain, every single bank has shut its doors to the public.

Late last night, Prime Minister Harold Wilson gathered his Cabinet together to declare an emergency Bank Holiday. In the midst of a sterling crisis, Wilson did what the authorities always did: locked the system down, restricted the movement of financial capital and tried to 'fix' the markets.

Specifically, Wilson had to declare a Bank Holiday so that he could also shut the gold markets, thus protecting the value of sterling.

I'm not here to give you a history lesson.

The point of this story, if you need it pointing out, is that when the financial system is in trouble, the authorities always respond the same way. Whether you're talking about Britain in '68 or Greece in 2015, it's always regular people on the street who suffer under repressive, aggressive and restrictive financial policies.

Or, as we've come to call it, Financial Martial Law (FML).

As you've seen, it's almost impossible to fight FML. If the bank shuts its doors, there's very little you can (legally) do to get your money out.

But that doesn't mean you can't prepare. In fact, being thoroughly prepared is the number-one way to protect yourself from FML (or any other financial catastrophe, for that matter).

Which is why I'm going to share a series (24, to be exact) of simple, practical steps you can take today to prepare for a 'lock-down' in the financial system. Whether that's your bank shutting its doors, or a wider shut-down in the system doesn't matter…

This is all about preparation.

Don't let them destroy everything you have

The constant and unending practice of money printing and low interest rates by central banks is each and every day devaluing the purchasing power of the money in your pocket and bank account, and it's even devaluing your wages.

As an investor – heck, as a human being – it's time for you to do something about it.

These steps are those we believe will help ensure that governments and central bankers can't destroy everything that you've worked to achieve.

And just as importantly, to make sure that you're able to leave a legacy to pass on to your children and their children – without being made to feel like a common crook.

To be sure, I can't help you with everything. You may not be able to follow all of the steps I've laid out below.

But even if you're unable to follow any of these tips, I hope at the very least that it has got you thinking about what the government and the central banks are doing to your money.

You may not be able to stop them from doing what they're doing, but you sure can take steps to make sure that you won't suffer from it as much as others.

A lifeline – if you need it

In simple terms, it's your print-out-and-keep, practical guide to help you meet the potential financial, personal, and even health challenges of the future.

To be honest – and this may sound odd, given how much effort we've put into producing this book – I hope you never have to use any of the advice in this book.

I hope that you can just take a few of the precautions, and that with any luck, this book will just gather dust on your bookshelf or take up a few bytes of storage on your computer.

But, if the need arises... if you do need to take action, then these 24 tips could be your lifeline, helping you get through the next financial (and perhaps even social) crisis when it comes.

So, let's get into the details. Here is your practical guide to surviving the next financial crisis...

Own non-electronic assets

One major problem with standard retail and industry funds is that all the investments are held electronically.

In a non-crisis period, that's actually a benefit. Electronic investments are easy to transact and you don't have to worry about storing a paper certificate or a physical asset.

However, during a crisis period, it's far less desirable to own electronic assets. During a crisis, a government could immediately freeze or seize any and all electronic assets at the click of a mouse.

There would be absolutely no way for you to take possession of them. If you needed quick access to cash, no doubt black marketeers would agree to accept electronic assets as part of a legal asset transfer, but they would likely only pay you several cents on the dollar.

But in that situation, if you're desperate, because the government has frozen all your electronic assets, what alternative would you have?

It may seem an unlikely scenario today, but if I'm right about the worldwide trend towards the seizure of private wealth, this is something for which you need to prepare.

Hold some amount of cash at home

We like to call it run money.

Keep somewhere safe a small container holding a couple of months' worth of your salary.

This can serve a purpose under many scenarios.

Sure, it might come in handy if you find yourself out of work. But the real benefit to this is as an emergency supply of cash if your bank collapses, or if the government declares an emergency Bank Holiday.

In the immediate aftermath of a bank emergency, cash would become a rare and highly sought-after commodity. Think about it, how much money do you have in your wallet or purse right now?

If you're like most people, it's probably less than £100. Now think about how long that £100 would last you if the government has frozen all bank accounts.

In such a circumstance, prices would skyrocket. With £100 you would probably be lucky to buy a litre of milk at the supermarket (assuming the supermarket was even open, or hadn't already been looted of all its stock).

But look at the alternative. Your £100 may not be worth what it was, but in a crisis economy where others would have barely two pound coins to rub together, your private stash of several thousand pounds could be an important lifeline during the early stages of a financial collapse.

Own gold and silver

Cash should be fine for the immediate aftermath of a wholesale financial and social collapse. Remember, at that point, using bank notes is the only thing that most people will have known.

Even though paper money may have devalued to be almost worthless, for a while it would likely remain the accepted medium of exchange.

However, eventually, people will begin to see that paper money and even base metal coins are almost worthless.

It would soon dawn on the people that when (or if) things return to normal that the government would introduce a new currency.

This could even happen before things return to normal. In that instance, individuals would do all they could to avoid accepting money in transactions.

Merchants would begin to offer a dual payment system. The official system would involve the government's devalued legal tender, the unofficial system would involve barter, and eventually gold and silver.

Gold and silver aren't widely owned as forms of money. But many people do own gold jewellery, such as rings, watches and bracelets. The same goes for silver.

Over time, private gold and silver coins would appear as money changers melt down the precious metals in jewellery for more utilitarian use as currency units.

Anyone owning pure gold and silver in bars or coins will be at an immediate advantage once the 'new economy' enters the barter and hard currency phase.

Own gold and silver. It's a must.

Store your gold and silver securely, but have some on hand at home in a safe

You should store your gold and silver at a secure location. Ideally, this should be at a private vault rather than a bank vault.

For a start, it's not very secure to store your gold and silver at home. You may think that you've found a foolproof place to hide it, but burglars are in the burglary game for a reason – they're good at it.

One thing to consider is a non-bank storage facility. If you hold your gold and silver in a bank vault, the first thing any government would do in a crisis would be to impound all assets held by banks.

But aside from keeping your main stash of gold at a secure storage site, it would also pay to hold a small amount of gold and silver at home.

Keep it somewhere secure, but most of all, make sure your home is secure to begin with – because once inside your home it won't take burglars long to find your 'secret' stash.

Hold brokerage assets and bank accounts offshore

Let me just remind you that everything in this book, including all the strategies, is currently 100% legal.

Nothing I'm recommending that you do in order to prepare for a financial and social collapse is currently against the law. However, be aware that in the event of a financial and social collapse, a government may institute new laws that affect this advice.

In that circumstance you would have to judge for yourself the legality of this advice and whether you should follow it.

One of the solutions that investors can use today is to own foreign assets.

This is 100% legal.

In order to make sure your offshore assets remain legal you would need to declare to the taxman any income you receive from these assets.

The advantage of buying or storing property overseas is that it's much harder for the government to seize these assets in the event of a financial or social collapse.

And as long as you declare these assets and any income you earn from them to the taxman, it's completely legal.

Aside from owning physical property, an easier way to own offshore assets is through an international brokerage account or bank account.

Other alternatives include offshore gold and silver depositories.

Open an offshore 'bank account' right here in Britain!

Perhaps the simplest way to open an offshore 'bank account' is to open an international share broking account.

You can do this through some domestic broking firms.

You can then buy and own stocks in foreign-listed companies on various exchanges worldwide.

Again, this is 100% legal, providing you declare any income or realised capital gains from your investments to the taxman.

Buy and store gold offshore

These days it's pretty easy to buy gold online and have it stored in a secure vault overseas.

There are numerous options to achieve this, but one of the biggest gold and gold storage firms is UK-based BullionVault.

It's a neat set up. You buy the gold and then you get to decide in which of their secure sites you would like the gold stored. You can choose from Zurich, London, New York, Toronto, or Singapore. The company is a member of the London Bullion Market Association.

It has 50,000 customers worldwide, and stores US$2 billion-worth of bullion for its customers. You can check out BullionVault and the full terms and conditions of opening and maintaining an account.

Buy and own items of value

Many people look at expensive and luxury items, such as jewellery and watches, and consider them extravagant.

However, during a financial or social meltdown, items of value, such as a Rolex watch or Tiffany bracelet, could be a useful barter item.

Certainly, if you're desperate, and you need to exchange goods with someone, you're more likely to get a good deal if you can offer your Rolex Submariner watch, than if all you've got to offer is a cheap digital watch that you bought from the local petrol station.

The same goes for jewellery and other luxury items. Or you could be more creative. What about collecting stamps or old coins?

The good thing is, these serve a dual purpose – not only do they look good and you get to enjoy them now, but many of these items will hold their value over time as well.

Plus in the event of a crisis you'll have another financial fall-back plan to use to your advantage.

Buy and own property away from your current home

The common term for a 'home away from home' is a 'bolt hole'. Again, this is the type of solution that serves a dual purpose.

You can buy your 'bolt hole' now and perhaps use it as a holiday shack. A place where you can get away to relax.

But in the event of a financial and social crisis, your 'bolt hole' can become the place where you immediately retreat in order to take stock of the situation.

Avoid highly dense population areas. Pick somewhere using a night-time satellite image if possible. The brighter the lights the more people there are... the darker the place, the fewer the people.

Do you have a will?

No one likes to talk about death, but drawing up and keeping a current will is probably one of the most important things you can do.

Make sure the will is 'watertight' so that the people you've bequeathed your estate to get their rightful inheritance. You don't want the state government distributing your assets on your behalf due to an error with your will.

Keep a paper record of all of your important information and store it securely

In today's world, almost everything is electronic. Your bank and stockbroking firm do all they can to encourage you to 'think about the environment' and opt for emailed statements rather than paper statements.

That creates a problem. What if you lose access to your computer, or the internet is offline, so you can't check your bank balance or transaction history.

My advice is to resist the urging from your bank or broking firm to go 'paperless'.

If they don't provide you with a paper option, or they charge extra for posting paper statements and contract notes, make sure to print out and keep a paper copy each time you receive the soft copy by email.

But it's not just electronic documents that you should print out and keep.

It's important to have paper copies of every other important document.

That means driver's licence, passport, tax information, bills, phone numbers, insurance, bank details, vital medical prescriptions, etc.

I actually had a personal experience of this kind of situation. I found myself in an isolated position, with no power, no access to the internet... and in dire need of contacting family.

Shamefully, I couldn't remember one family member's phone number... meaning I essentially 'disappeared' from view (not in a good way!).

After this I decided to diligently keep hard copies of all the vital information I'd need in a crisis (I laminated the information to make double sure). I know that in a crisis, I only need to look in one place for all the information I'll need. I also keep several hundred pounds in cash there, as again I know how valuable easy access to cash can be in a pinch.

Many people these days can't remember their insurance provider, or access their bank account because they couldn't prove who they are without certain forms of ID.

Having easily accessible copies of documents won't magically open your bank account, but it will get the ball rolling quicker.

Keep a copy for yourself and give a copy to a trusted friend, family member, or legal adviser.

Two hard disks

Keep anything digital that's precious stored on a separate portable hard disk. Something you can grab and run.

Learn a 2nd, 3rd or 4th language

Many people today will tell you that the best language to learn is Mandarin Chinese. It seems logical. After all, China is currently the world's most populous nation, and within 10 years it could be the world's biggest economy.

However, contrary to popular belief, Mandarin Chinese isn't the most useful language to learn, either in a crisis or non-crisis situation.

The fact remains that there are three languages which you should learn.

One of them is a language you should already know well, English.

The two other languages may not seem as obvious. They are Spanish and French. I'll explain why.

English is the universal language. You can travel to most places in Europe, North America, parts of Asia and Africa and be able to communicate with the locals well enough to be understood.

However, there are places where English isn't the first or second, or even third language among locals.

If you plan on moving or escaping to Europe, English, French and Spanish will serve you well.

But what about if you want to escape to Central or South America? You could probably get by with some English, but if you want a better chance of being understood, Spanish is your best option.

As for parts of Asia and Africa, again, English should serve you well. But there are many places where French is the most popular second language.

Knowing at least the basics in these languages will be important if you ever find yourself offshore in either a crisis or non-crisis situation.

Breed your own food

This isn't possible for everyone.

But if you live on a reasonably-sized property on the city fringes, you could look at the potential to 'breed your own food'. Goats are probably the most versatile livestock due to their potential for meat and dairy products.

If you live on a smaller block of land, or in a more built-up area, you could consider chickens. Again, chickens are versatile for meat and eggs.

Create an emergency rations pack

This may sound crazy, but even in a relatively small-scale crisis situation, such as flooding or a City-wide riot (as we saw in 2011), this could be a lifesaver.

And in a larger-scale crisis, such as a full financial and social collapse, then you definitely won't want to be without a stash of emergency rations.

If you're worried about your family thinking you're paranoid (they'll be the first to apologise if you ever need to use the rations), it's easy to do this discreetly.

Keep your emergency ration pack in your car, or tucked away neatly – but easily accessible – in the garage or garden shed.

Emergency water supplies

Make sure you always have two bottles of water in the house, and a supply of empty bottles or flasks that you can fill at short notice.

In a full-scale crisis, the public water system may not collapse immediately. You will probably have time to fill flasks and bottles from the mains.

This should be one of the first things you do in a crisis.

If you have a water tank installed at home, make sure it's always at least half full. If necessary, use mains water regularly to top-up the tank for use in an emergency.

The 'supply depot' in your home

Ensure your pantry and cupboards always have a stock of key products and necessities.

These are all things you can maintain in your home without alarming family members.

This should include but is not limited to, chocolate bars, nuts, matches, lighter, candles, oats, oil, torch, batteries, scissors, tape, string, rope.

Get pickling

Take up a hobby such as preserving or pickling vegetables. The reason is obvious.

First of all, they're great to eat in a non-crisis situation, and a great source of food if you need to rely on stored provisions for an extended period of time.

Attention non-smokers: Even you need to carry this

Even if you don't smoke, carry a lighter or a set of matches. You never know when you might need them.

At some stage, if there is a complete financial and social meltdown, you will need to light a fire, whether it's for warmth or for cooking.

You may think that you'll just rely on your old Boy Scout fire-starting technique of rubbing two sticks together, but it's much easier if you can just light a match or flick a lighter.

Don't get caught naked!

Ask any emergency services worker, and they'll tell you they've lost count how many times they've turned up for an emergency only to see someone running around almost completely naked. The lesson?

It may sound basic – or ridiculous even – but always leave a set of clothes out at night... just in case you need to make a quick exit!

Prepare for the unexpected

These preparations will mentally prepare you for an economic collapse or some sort of natural disaster. However, you also need to prepare yourself for the dangers most people won't see coming.

You or others may lose access to prescription drugs. This could be fatal.

Find out if there are any natural alternatives to your prescription drugs. Is there something you could use in the short term until you can restock?

Neighbours could also become a threat. They'll be fighting over food and water. If they think you're prepared for something like this, they will ask you to help them or care for them.

You need to be prepared to look after your loved ones only. Any assistance you offer to people outside this group will drain your provisions.

Stock your library

Build a resource library at home. Create a hardcopy folder of certain tasks – a disaster checklist.

We keep so much info stored on the internet that you could

be helpless if you lose internet connectivity.
So, as a precaution, have a hard-copy folder of your plans for easy access in the event of an internet shutdown.

Mentally prepare yourself for the breakdown

Phase 1 – The warning comes.

Phase 2 – Shock and awe. This lasts around one to two days. Called the normalcy bias, it's actually a coping mechanism to help people deal with the changes. This is where people cling to habits until their brains accept the change.

This is where the unprepared start demanding the government meet their every need.

They don't realise that any government resources still available will be busy with basic infrastructure, distributing food and water and preventing chaos.

Here, desperate people will take to crime and looting to survive. You will need to defend yourself and protect your preparations. Only the prepared will thrive at this point.

Phase 3 – The breakdown. This lasts three to seven days. Once the shock wears off, the looting and crime beings.

Consider days three to five after a disaster as the witching hour. At the end of this period, illness becomes prevalent – due to lack of access to prescription medication, or because of cramped shelter conditions, water sources or exposure to the natural elements.

Phase 4 – Recovery. This lasts 30+ days. It can take one to two weeks to get to this part of the cycle. This changes based on what kind of disaster occurred.

For example, the Louisiana Recovery Authority says that even now, 10 years after the Hurricane Katrina disaster, "There is at least another 10 years of recovery".

Don't tell anyone about these preparations

The reason should be obvious.

Preparing for a bank run

I hope *The War on Cash* has shown you that there's a real threat to your financial freedom from a cashless society. The steps being taken are there for all to see. Some people will ignore them anyway. I hope you're not one of them. As economic historian Martin Armstrong has written:

> *Physical paper money provides the check against negative interest rates for if they become too great, people will simply withdraw their funds and hoard cash. Furthermore, paper currency allows for bank runs. Eliminate paper currency and what you end up with is the elimination of the ability to demand to withdraw funds from a bank.*

If you lose access to your money in the bank, you've not only lost your money. You've lost the freedom that comes from having your money at your disposal. This is why I'm concerned. The emergence of a cashless society is just one of the steps on the road to what I've called Financial Martial Law.

But as gloomy as that sounds, I wouldn't have written this book if I didn't think you could fight back. First, arm yourself with the facts. I hope this book has helped open to your eyes to what's going on. And even if you're not convinced of the argument I've made—even if you believe it could never get as bad I've suggested—I hope you'll take some of the practical steps I've outlined. If you do, you'll be ahead of most people if and when the next crisis hits, and they come for your cash.

In the meantime, I'll be writing about this and other important investment issues on a regular basis. In the UK, you can find my work published for free in the daily e-letter Capital and Conflict. If you'd like to dig deeper into these ideas, take a look at my fortnightly service, the London Investment Alert. And if you're a serious investor, I run a more advanced forecasting service, complete with a portfolio of stock picks, based on my own asset-allocation strategy as outlined in *The War on Cash*. That service is called *The Price Report*.

No matter what happens in your financial future, I wish you all the best. As I think you know by now, there's a direct connection between cash and your political freedom in the modern world. If you value your freedom, you'll keep yourself informed of this issue. What's more, the only way we can fight this trend is to alert those we care and love for so they, too, are not caught unawares by the direction our financial authorities have taken. If this books helps even one person preserve wealth by preparing now for an eventual crisis, I will consider it a success.

"This is a triumph of circular logic and magical thinking: a crisis brought about by too much debt is met with more debt. This is like torching your own house rather than have it consumed by a forest fire."

In this insightful series of essays, award-winning fund manager Tim Price reveals how the problems of 2008 haven't gone away… they've got worse. The real threat isn't just loss of money – says Tim – but a fundamental loss of freedom. As governments and central banks get more desperate to stave off disaster, they'll turn to you and your money. This is what Tim calls Financial Martial Law.

The first step to surviving? Understanding why – and how – the coming assault on your wealth will unfold.