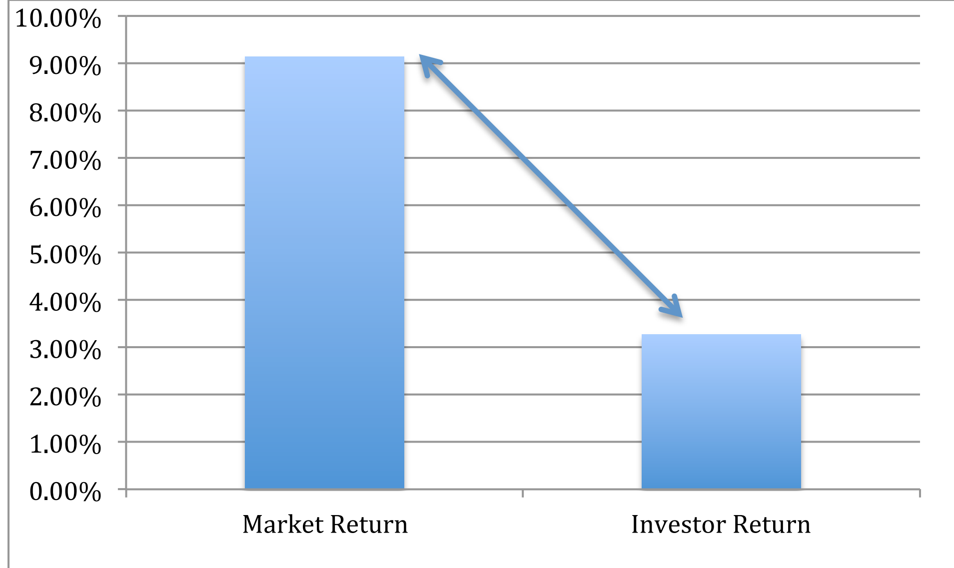
The Starboard Side Report

The week ending June 28, 2013

As we discussed in our comprehensive report on gold last week, we remain convinced that gold is in a mid-cycle corrective episode within a long-term bull market. At this final liquidation phase, it really just comes down to psychology. The market is famous for making people do things at major tops and bottoms that in hindsight look foolish. A recent study by Dalbar & Associates showed that individual investors gave away 5.87% per year of performance due to poor timing and decision-making between 1990-2010. During this period, the average ***long-term*** equity mutual fund investor returned 3.27% versus a 9.14% annual return for the S&P 500. This chronic underperformance is known as the "behavior gap" due the roll that emotions play in the discrepancy.

S&P 500 Annual Return vs. Average Investor Return (1990 – 2010)



The behavior gap comes from a lack of focus on the big picture and not being able to see the forest through the trees. Take the following chart of gold for instance. Everyone is focused on the past two years and extrapolating 40% losses as far as the eye can see. This makes investors panic out of positions at the worst possible time because the media convinces them that their losses are going to be permanent. The irony is that the only way to make losses permanent is to actually panic out at a major bottom. In the chart below, we have decided to focus on the positive aspect to gold having its worst quarter in the past thirty years. First, gold is still in a bull market uptrend and 380% above its 2000 low. Second, the only other time that gold lost more than 20% over a three-month period was in November 2008. The next three years would see gold prices skyrocket by 170%.

Gold Price in US Dollars (1990 – Present)

The main difference between the 2008 gold price decline and the current episode is that the whole world was falling apart in 2008 and US stocks were crashing along with the price of gold. From a psychological perspective, this made the 2008 decline easier to stomach because the whole ship was going down together. Ralph Wanger, of Wanger Asset Management, had a good way to describe this herd mentality that makes Wall Street afraid to venture outside the pack. He likened investors to a herd of zebras in lion country: "They must settle for meager pickings by sticking in the middle of the herd, rather than seek richer rewards at the outer edge, where hungry lions lurk. A portfolio manager for an institution such as a bank trust department cannot afford to be an Outside Zebra. For him the optimal strategy is simple: stay in the center of the herd at all times. As long as he continues to buy popular stocks………he cannot be faulted. To quote one portfolio manager, 'it really doesn't matter a lot to me what happens to Johnson & Johnson as long as everyone has it and we all go down together.' But on the other hand, he cannot afford to try for large gains on unfamiliar stocks which would leave him open to criticism if the idea fails." Despite gold being 380% above its 2000 levels and the S&P 500 being only 3% above its 2000 levels, the majority institutional investment herd bashes gold and cheers its decline because they have missed out on the majority of its bull market and will forever be afraid to own it for fear of being different/eaten by the lions.

We talk about gold a lot in these reports, but thought now it might be a good time to check in on gold's more volatile cousin, silver. Whereas gold has declined 38% from peak to trough, silver has fallen a staggering 63% from its 2011 peak. The first chart shows that, like gold, silver is

still in a bull market uptrend (375% above its 2001 low point). Second, silver had reached a very important inflection point because it is at a major confluence of support. Both the 2010 breakout point and the bull market uptrend intersect just above $18. Interestingly, this is the level from which a big rally occurred this Friday.

Silver Price (1993 – Present)

The second chart of silver is the same one that we have of gold above. It illustrates that big three-month percent declines in silver have occurred near major bottoms and been great buying opportunities. May 2004 and November 2008 were the only two times silver has lost over 35% in a three-month span. The resulting bull cycle after the panic bottom led to a 300% and 500% advance over the next three and four year periods respectively.

Silver Price in US Dollars (1990 – Present)

We have made the point several times that the global economy has been weakening since 2011. Below is the breakdown of global asset class investment performance since May 2011

#	Symbol	Name	Performance %
1	SPX	S & P 500 Index	11.62
2	EWJ	iShares MSCI Japan Index Fund	11.09
3	EWL	iShares MSCI Switzerland Index Fund	5.84
4	EWM	iShares MSCI Malaysia Index Fund	1.89
5	EWN	iShares MSCI Netherlands Index Fund	1.58
6	EFA	iShares MSCI EAFE Index Fund	1.19
7	EWG	iShares MSCI Germany Index Fund	0.78
8	EWQ	iShares MSCI France Index Fund	0.65
1	EIDO	iShares MSCI Indonesia Investable Market Index Fund	-3.17
2	EWT	iShares MSCI Taiwan Index Fund	-4.26
3	VEU	Vanguard FTSE All-World Ex-US Index Fund	-4.57
4	EWH	iShares MSCI Hong Kong Index Fund	-5.75
5	EWX	SPDR S&P Emerging SmallCap	-6.04
6	EWP	iShares MSCI Spain Index Fund	-6.6
7	HAO	Guggenheim China Small Cap ETF	-7.11
8	EWI	iShares MSCI Italy Index Fund	-7.94
9	LQD	iShares iBoxx $ Investment Grade Corp.	-7.99
10	EWA	iShares MSCI Australia Index Fund	-8.32
11	EWC	iShares MSCI Canada Index Fund	-8.32
12	EWS	iShares MSCI Singapore Index Fund	-8.33
13	THD	iShares MSCI Thailand Index	-8.4
14	GMF	SPDR S&P Emerging Asia Pacific ETF	-9.66
15	TIP	iShares Barclays US Treasury Inflation Protected Securities	-9.73
16	GCC	GreenHaven Continuous Commodity Index	-10.45
17	TLT	iShares Barclays 20+ Year Treasury Bond Fund	-10.79
18	ELD	WisdomTree Emerging Markets Local Debt ETF	-11.52
19	INDY	iShares S&P India Nifty 50 Index Fund	-12.46
20	YAO	Guggenheim China All-Cap ETF	-13.27
21	TUR	iShares MSCI Turkey Index	-13.49
22	RSX	Market Vectors Russia	-14.54
23	EWW	iShares MSCI Mexico Investable Market Index Fund	-14.89
24	VWO	Vanguard FTSE Emerging Markets ETF	-15.46
25	EMB	iShares JP Morgan USD Emerging Markets Bond Fund	-15.64
26	DEM	WisdomTree Emerging Markets Equity Income Fund	-16.4
27	BKF	iShares MSCI BRIC Index Fund	-16.75
28	FXI	iShares FTSE/Xinhua China 25 Index	-18.4
29	EWY	iShares MSCI South Korea Index Fund	-18.5
30	ILF	iShares S&P Latin American 40 Index	-18.93
31	CNDA	IQ Canada Small Cap ETF	-20.17
32	EZA	iShares MSCI South Africa Index Fund	-21.21
33	EWZ	iShares MSCI Brazil Index Fund	-21.45
34	GLD	SPDR Gold Trust	-22.84
35	BRF	Market Vectors Brazil Small-Cap ETF	-24.79
36	SLV	iShares Silver Trust	-34.45
37	SCIF	Market Vectors India Small Cap ETF	-36.49
	UP	8	4.33
	Down	37	-13.76

Of the 45 most popular global equity and bond funds that we track, only 8 are higher and 37 lower since May 2011. The average gain among the eight positive funds is 4.3% and the average decline among the 37 negative ones is 13.76%. Again, this is both bonds and stocks, so there have been very few places to hide other than US stocks. This lends credence to the theory that it has been money printing rather than solid global economic fundamentals that has driven US markets higher. Furthermore, it is why we believe the gains are not sustainable. It is not a coincidence the two best performing countries, the US and Japan, are also printing money the most aggressively. Interestingly enough, the US Dollar Index is 2.8% higher over this span, so US dollar cash has outperformed 93% of the comprehensive list of global assets we have shown above.

In conclusion, corrections are a part of investing that all *long-term* investors have to face at one time or another. Some are definitely steeper than others. The main issue that separates successful long-term investors from the rest is how those corrections and the emotions they elicit are managed throughout the FULL market cycle (measured over the span of many years). The two questions that have to be asked when faced with a long-term decision on a rapidly falling asset class is: 1) is the long-term trend still intact, 2) are the long-term fundamentals underpinning the asset class still strong in support of more upside? In the case of gold and silver, the answer to both is still yes. The fact that every major financial media outlet will be discussing what a terrible quarter gold had is not reason to sell. In fact, as we have shown on this report, it could very well mean that a major turning point is close at hand.

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