BFI
Capital Group

On the Brink of a New Era – Are You Prepared?

Big Picture Review
September 2020

PREFACE

Dear Reader,

As we stand on the brink of a new decade, we are entering a period of high uncertainty and considerable challenges – economically, politically, technologically, and socially.

In view of the current economic crisis and under the assumed power to force an economic recovery with more "cheap money", central banks and governments around the world have loosened their fiscal and monetary reins most spectacularly. The common consensus appears to be that this can continue indefinitely. We agree insofar as we do indeed expect big government spending and quantitative easing to be anything but a temporary measure. They will be with us for the foreseeable future. However, these policies are NOT sustainable indefinitely.

We consider the immense and continuously growing level of public debt as the number one enemy to your freedom, wealth and prosperity. The aftermath of it all will serve to crystallize one thing: it is dangerous to tinker excessively with a complex system such as the economy and financial markets. The increasing interventionism of governments and central banks in a free-market system creates all kinds of moral hazards and imbalances. Well-intentioned policies "in the interest of all" are generally not in the long-term interest of anyone. At most, they may serve the temporary interests of some.

"I can scarcely contemplate a greater calamity that could befall this country, than be loaded with a debt exceeding their ability ever to discharge. If this be a just remark, it is unwise and improvident to vest in the general government a power to borrow at discretion, without any limitation or restriction."

Brutus

With this report, we want to alert you to the fact that we are coming to the end of a secular business cycle with impressive global economic growth and even more impressive advances in asset prices, all largely fueled by a mix of globalization, continually declining interest rates, unprecedented central bank induced liquidity and credit, and with consumer price inflation nowhere in sight. We are convinced that this economic model is running its course and we need to buckle up for a very different cycle ahead. Most of all, we recognize two risk factors that deserve particular attention: debt and financial repression, combined with inflation that will ultimately be the main measure to reduce the formidable mountain of debt that the world faces today.

Moreover, the crisis appears to have accelerated the rise of increasingly radical ideology and the decay of traditional values and strengths of Western culture. The implications are manifold, and the uncertainties resulting from all of this need to be considered thoroughly.

We are very optimistic that in the longer-term, things will rebalance and return to a more positive trajectory overall. Humankind has proven, again and again, that we eventually succeed at improving our lives and we keep progressing over time. However, history also tells us that this progress will not be achieved without periods of pain and suffering. All facets of nature and life are subject to cycles, to ups and downs.

Throughout BFI's history, we have focused our activities on solutions and strategies that afford our clients solid wealth preservation and asset protection. The overall landscape ahead looks somewhat confusing at best and treacherous at worst. In light of this, asset protection and wealth preservation should be at the very top of your investment and wealth planning priorities.

It is in this context that we are sharing our thoughts and recommendations, hopeful that it may provide some clarity and guidance, and that you may be able to better formulate and implement your wealth planning and investment strategy as a result.

Sincerely,

Frank R. Suess
Founding Partner and Executive Chairman

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EXECUTIVE SUMMARY

The analysis is quite simple: interest rates are at or below zero. We are coming to the end of a "cheap money era". Under America's leadership, excessive money creation has allowed the West to indulge in the many temptations of prosperity. It has resulted in a huge misallocation of capital and excessive debt levels. Quantitative easing is the name of the game. Over time, the measures have become more and more extreme. As the printing goes on, we are moving closer to the end game, step by step.

The biggest problem and threat in all of this is found in the mountains of public and private debt that have been growing for many years. The COVID-19 induced crisis is not the cause of the problems we face today. But it did certainly accelerate and augment the issues within a very impressively short period.

The signs of the times are found in the political and societal changes and uncertainties we find in western societies. The growing dissatisfaction and "blame culture" we are witnessing are partially founded in the fact that, while globalization has helped improve key progress statistics – child mortality, literacy, poverty, hunger, etc. – around the globe, the gap between rich and poor has been growing in western developed economies. Many feel left out and left behind. The recession now affords the grounds of all kinds of battles – on race, gender, demographics, wealth, climate change and more.

It all does very much remind us of the "fourth turning", as described by William Strauss and Neil Howe in their 1997 bestseller titled *The Fourth Turning: An American Prophecy*. To stave off the ultimate fallout of the negative trends and, somehow, somewhen, recover what threatens to be lost, central banks and governments appear to know one answer only: monetary and fiscal inflation, or debt and deficits.

Unfortunately, dealing with the issues of debt and reducing it is increasingly difficult. Therefore, in planning your wealth management strategy, from both a structural as well an asset allocation point of view, you must first and foremost consider the following questions:

1. What can governments do to reduce public debt levels?
2. How probable is the successful deployment of government measures? In other words, is a meaningful and sustainable debt reduction possible?
3. What are the critical implications for your wealth planning and asset allocation decisions? How can you best protect your wealth, structurally and internationally? Which investments and asset classes should you have? Which should you avoid?

Unfortunately, the answers to these questions point toward a new era that will be characterized by financial repression and inflation. Clearly, proper risk management and wealth planning is needed. Adding an international component to your wealth plan, properly executed, can provide considerable benefits in terms of long-term wealth protection and growth.

The need to think of globally and jurisdictionally diversifying wealth is particularly pertinent to Americans. They face a unique combination of US-specific risks ranging from excessive litigation to increasingly extreme policies, and to big picture tectonic changes in terms of America's geo-political status and economic strength.

The key elements of a solid wealth management strategy consist of both a strong and safe structure as well as a flexible and profitable investment strategy. Next to safety, other benefits need to be secured, such as long-term inheritance planning, tax efficiency and legal asset protection. Setting up and maintaining this kind of strategy is precisely what BFI does for its American clients.

If you have not already started your global strategy for wealth preservation and jurisdictional diversification, you need to do so now. The urgency is rising, while the options and access to solid solutions are not. We invite you to call on us and inquire. Even if we cannot help you ourselves, we will generally be able to point you in the right direction. In any case, this is not a time for procrastination.

A DIFFICULT AND UNCERTAIN RECOVERY

As we write this report, we have moved into the fall of 2020. And still, one topic dominates the news: the COVID-19 pandemic, the hope for a cure, or at least a vaccine, and of course, the myriad of government support and relief plans around the globe.

The health issues related to any pandemic are to be taken seriously. But the collateral damage resulting from the unprecedented government response to the coronavirus threat will far exceed the illnesses and fatalities directly caused by it. Someday in the future, we may look back at this time with astonishment and, quite possibly, with regret. We envision future history books describing this crisis as a sort of turning point, a "black swan" event that pushed us into a new era, one that will be particularly difficult to navigate.

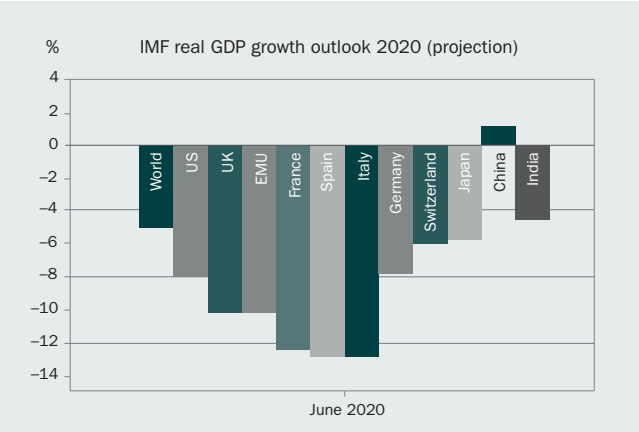
However, it is also noteworthy that despite the general chorus, the coronavirus is merely the pin that pricked the various "bubbles" that have been building for a long time. The fundamental issues did not arrive with the pandemic, and thus we should not expect the recovery to be as swift as we would hope for.

NO V-SHAPED ECONOMIC RECOVERY

The lockdowns in response to the virus have had a brutal impact on businesses, industries, and supply chains around the world. The IMF, in their June 2020 World Economic Outlook Update, described it as "A Crisis Like No Other" and they projected an economic contraction of approximately 5% for 2020, with an uncertain and "more gradual than previously forecast" recovery to follow.

Within just a few months of the lockdowns, unemployment spiked up around the world. In the U.S. in particular, where employment numbers had started looking increasingly positive, the impact on jobs was disastrous. Without a doubt, the crisis set off a deep recession. Now the most discussed question is: "What letter shape will the recovery take?"

Figure 1: IMF World Economic Outlook Projection for 2020



Source: IMF, World Economic Outlook Update, June 2020

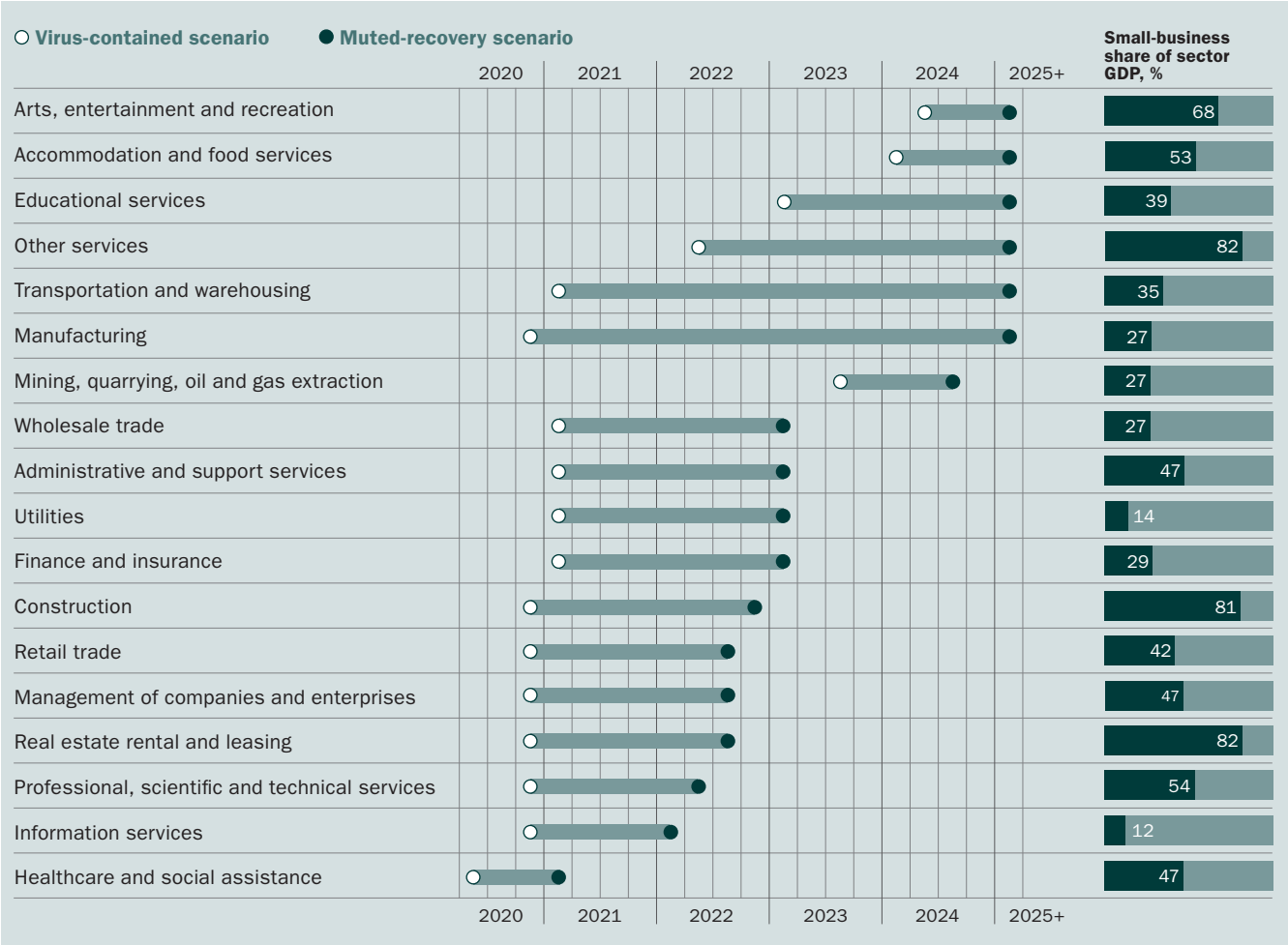
Some economists expect this recession to be with us for an extended period. Others even mention the potential of a long and painful depression. Everyone seems to have his or her favorite recovery shape: a "W", an "L", a "U", or maybe even a Nike Swoosh. Of course, the one everyone hopes for is the V-shaped version, which would mean a quick and steep return to the pre-COVID economic state. However, there are two key requirements for that V-shaped scenario to happen:

First, a steep up-and-down pattern, meaning the reversal would be quick and the economy would not spend much time skating along the bottom. If it did, that would make for a U-shaped recovery. Secondly, we would expect a level of symmetry, meaning that the downturn would be roughly equal to the uptrend in terms of timing and economic strength. It is particularly this second criterion that seems to make a V-shaped economic recovery unrealistic at this point. The U.S. economy's GDP, according to annualized Q2-2020 numbers, deteriorated by almost 33% and it certainly will not come back to the pre-COVID-19 rate, particularly considering that it would take a 49% gain to make up for a 33% loss.

The outlook of those who are more optimistic seems to stem from a deep and unfaltering confidence in the monetary and fiscal interventions of central banks and governments around the globe. However, the global economy has suffered an unprecedented single-quarter setback. COVID-19 still takes center-stage in the news, additional reported spikes are complicating the efforts to re-open the economy, and the incremental impact of each dollar "printed" appears to be waning rapidly.

Our expectation, therefore, is that we will see a muted and slow recovery. Some sectors may recover quickly. However, some very important sectors, such as transportation, manufacturing, or tourism, will have a long and difficult path ahead of them. According to a study conducted by McKinsey, based on data from June 15th, 2020 and excluding public administration, it could take more than five years for the most affected sectors to get back to 2019-levels of GDP contributions.

Figure 2: Estimated Time to Recover to Pre-COVID-19 Sector GDP



Source: McKinsey Global Institute, Oxford Economics

FINANCIAL MARKETS DISCONNECTED

While the V-shaped recovery described above increasingly looks like a pipe dream for the real economy, it has indeed occurred in the financial markets. Measured by the S&P 500, the US stock market is back to where it all started: the February 19th all-time record high of 3'386 has been long surpassed. Yet, while financial markets have roared back up, the real economy struggles with multiple disruptive developments:

- A pandemic that appears to be here to stay, including its collateral circumstances.
- An unprecedented global recession – the first of its kind since World War II.
- A growing backlash against globalization.
- Large-scale protests and social unrest.
- Political uncertainties in many countries, including the United States.
- Rising geopolitical tensions, particularly with China.
- Historic levels of excessive debt, growing faster and faster.

Financial markets interpret all of this in a remarkable way and their rapid recovery has raised investor optimism. In support of that positive sentiment, central banks are flooding the markets with liquidity and they seem willing to keep doing "whatever it takes" for the foreseeable future. Interest rates in several countries have been cut further and investors expect them to remain at very low levels for several years. Therefore, share prices are at record highs and credit spreads have declined rapidly, suggesting that, despite the increased risks and uncertainties, investors expect a relatively bright outlook. In other words, it appears that, due to the massive interventions, credit spreads may have lost their role as a risk measure.

All this shows an astounding disconnect, a drastic decoupling of financial markets from the reality of economic fundamentals. So, the question now is whether the markets are shifting towards the economic forecasts or vice versa. Unfortunately, we tend to veer on the negative side of the answer to this question. We assume that the current scenario of rising markets will likely go awry. In the coming months, the stock markets might succumb to the fundamental realities of the economy.

"We often refer to the economy and the stock market as the master and the dog. The master walks slowly but steadily in one direction whereas the dog runs ahead, falls back, but eventually moves in the same direction. At times, the two seem connected, and at times they appear disconnected. But they do belong together, and it is only a question of time, until the two reunite and move in the same direction."

Felix Zulauf

PRE-EXISTING TRENDS AND ISSUES

Clearly, the arrival of the coronavirus and the global response to the pandemic have inflicted substantial damage within an unbelievably short period of time – economically, financially, and socially. However, the pandemic did not change our world within the course of just a few months. Instead, it exacerbated and accelerated a variety of trends and systemic issues that had already been festering and growing beneath the surface for a long time. To argue this point, it is important to think back just a little.

Growing recession concerns

By the end of last year, almost all major central banks had returned to a path of monetary expansion. Interest rates were negative or ultra-low across the board, and QE had made a decisive comeback in the US. Despite the warnings of more conservative analysts and economists over systemic risks, such as over-indebtedness and monetary overreach, most investors and speculators stayed optimistic and preferred to focus on short-term rewards while ignoring the bigger picture.

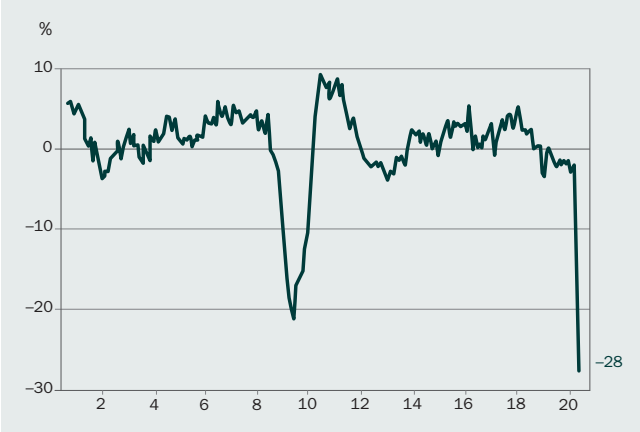
Meanwhile, global GDP had only grown from US$ 58 trillion to US$ 85 trillion since the financial crisis. Already prior to the arrival of COVID-19, fears of a possible "Japanification" of the European and even of the US economy had started to spread, a situation where deflation and weak growth continued to plague the economy.

Only a few weeks into the new decade, a number of events seemed to refocus market attention on the possible need for caution, raising investor anxiety: the sudden escalation of tensions between the US and Iran and worrying economic reports out of major economies. This was reflected in the market sell off and the volatility spike in the days immediately following the news of the US drone strike that killed General Soleimani. The VIX, the main market volatility gauge, saw a 17% surge.

In fact, recession fears had been on the rise for quite some time already. The performance of stock markets increasingly appeared divorced from the economic realities on the ground and from official data. Years of ultra-low interest rates had encouraged reckless corporate borrowing and massive stock buybacks that artificially inflated equity prices. U.S. corporate debt had increased by 50% over the past decade and stood near US$ 10 trillion. The cracks were already beginning to show. According to S&P data, 2019 saw the most credit ratings downgrades relative to upgrades since 2009. And this trend was certain to continue into 2020.

For several months prior to the COVID-19 lockdowns, reports and economic figures from key EU economies were consistently flashing warning signs. The German manufacturing figures, published in December of 2019, showed an output drop of 5.3%, as the country's industrial sector suffered its steepest decline in a decade. Andrew Kenningham at Capital Economics warned, "far from bottoming out, Germany's industrial recession may be getting worse. The latest data supports our view that a recession is still more likely than not in the coming quarters".

Figure 3: Euro Area Industrial Production
(12-month percentage change)



Source: ECR Research, Refinitiv Datastream

"No government ever voluntarily reduces itself in size. Government programs, once launched, never disappear. Actually, a government bureau is the nearest thing to eternal life we'll ever see on this earth!"

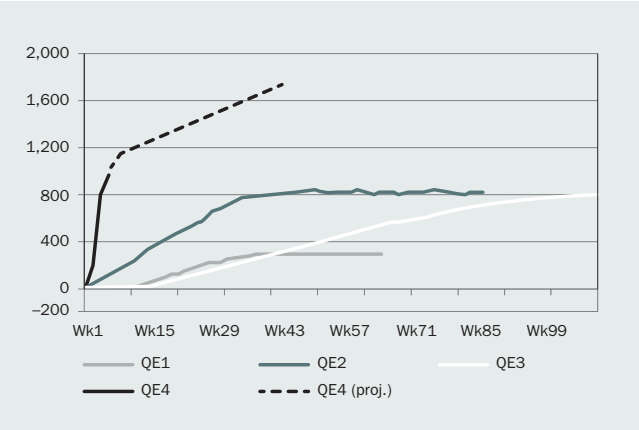
Ronald Reagan

Markets and politicians were hooked on "cheap money"

The addiction to quantitative easing and low interest rates did not start in 2020. Over the past 40 years, the world has become accustomed to increasingly low interest rates. In essence, this secular trend has allowed the world, and particularly the US and Europe, to live (and party) beyond its means for a very long time, on the back of a growing mountain of debt. Politicians and financial markets have gotten hooked on the drug of "cheap money". But, instead of reviving economic growth, the extraordinarily aggressive monetary and fiscal measures mainly fueled financial markets, increasingly negative yields, and the continuous growth of debt.

In fact, the policy of quantitative easing never really stopped since 2008. The US Federal Reserve attempted to normalize yields for a brief period, however, Fed Chairman Powell rapidly surrendered and turned dovish again in response to dire economic realities. Figure 4 portrays the past three US quantitative easing exercises, plus the fourth version currently underway, making 2008's QE look like child's play. The measures are getting more and more gigantic. And they are looking more and more desperate and destructive.

Figure 4: Progression of Quantitative Easing, Treasury Purchases In Perspective (in US$ Billion)



Source: BofA Global Research

Meanwhile, in Europe, Ms. Christine Lagarde, upon taking the lead at the ECB, promptly announced her intentions to follow the extremely loose monetary policies set by her predecessor, Mario Draghi. In other words, negative interest rates and QE were here to stay in Europe as well. The bank, after restarting its asset-purchasing program in November of 2019, has been buying €20 billion worth of bonds every month.

It can thus be argued that, by enforcing consistently and increasingly loose monetary policies for so long, central bankers have painted themselves into a corner, having largely depleted their monetary arsenal before this current recession had even begun. As US Treasury yields approach zero and several European countries have sovereign yields in the negative zone, the model may be running its course.

The Fed does have a slight advantage, as it did at least try to normalize its policy direction and increase rates starting in 2016, until it eventually capitulated and returned to the easing path. Thus, it has a little more "wiggle room" than the ECB, that never even dared to think out loud about a rate hike. Still, all the quantitative easing by the central banks around the world, so far, has not helped the fundamental economy nor has it achieved the often-cited inflation target of 2%.

A world drowning in debt

A good overview of the current aggregate of public world debt is provided by the Economist website with their global debt clock and the debt map (Figure 5) that portrays a globe that is deeply in the red. As we started to write this report in August of 2020, that debt clock stood at just about US$ 62 trillion. At the end of 2007, the aggregate stood at approximately US$ 29 trillion. It has more than doubled since the financial crisis!

The corona crisis has further accelerated the accumulation of debt. According to an estimate by the Financial Times, the OECD faces an additional US$ 17 trillion government debt burden. At the same time, the fall in tax revenues is estimated to push the average debt-to-GDP ratio to 137%.

"We must not let our rulers load us with perpetual debt."

Thomas Jefferson

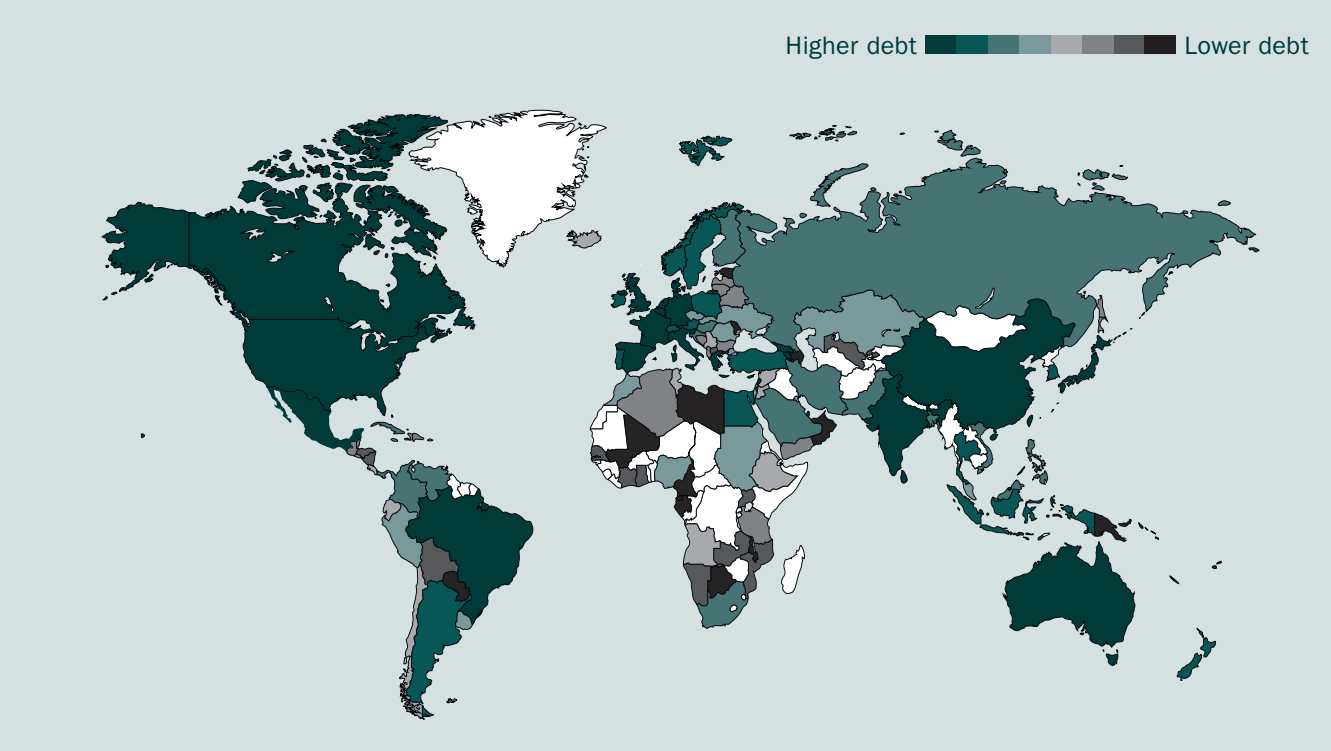
Ultimately, aggregate public and corporate debt now stands at historically high levels in all major economies. This poses a real and rapidly growing problem:

Unless interest rates stay low, financing the debt levels will become much more difficult very quickly. There are now many economies with high levels of debt that are confronted with an extremely sharp economic slowdown. Consequently, more debt is piled on top of the existing debt.

In some countries, asset-purchasing programs were started to support monetary policy; in other countries, the motivation was to support market liquidity. The programs have included purchases of a range of assets, including government bonds, state-guaranteed bonds, corporate debt, mortgage-backed securities and even junk bonds! Fiscal and financial policy measures have also helped support investor sentiment. Governments around the world have provided large emergency lifelines to people and firms amounting to nearly US$ 11 trillion (as shown in the IMF's Fiscal Monitor Database of Country Fiscal Measures in response to the COVID-19 Pandemic).

Keeping rates close to zero is no longer just a policy choice, but a necessity, as any increase could trigger a debt default domino in many sectors: corporates, real estate…The Fed seemed to be acutely aware of this threat even before the current crisis, as the minutes from its December meeting clearly showed. Some members openly expressed fears of a corporate debt bubble that could make this recession considerably worse.

Figure 5: Global Public Debt Comparison



Source: The Economist, World Debt Comparison, www.economist/content/global_debt_clock

China's drive to take the throne

China's economic prowess during the last financial crisis acted like a locomotive for the global economy. That will not happen during this crisis. China's economic engine is starting to sputter too, as its manifold economic and political problems have grown unchecked for too long. Therefore, China too joined the West with their own version of monetary expansion. On top of that, the country's image has been increasingly tainted, as other countries are regarding the "Dragon" with growing skepticism.

In response, and with the world in recession, President Xi Jinping is laying out a major initiative to accelerate China's shift toward more reliance on its domestic economy. On all fronts, the country is working hard to make its mark on the world. China has grown more powerful economically and more assertive politically on the world stage, especially since Xi Jinping took the lead.

Consequently, it has alienated allies and partners around the world, which had a serious impact on many delicate geopolitical balances. This trend did not start with President Trump, and it certainly did not start with the events that led to the corona crisis.

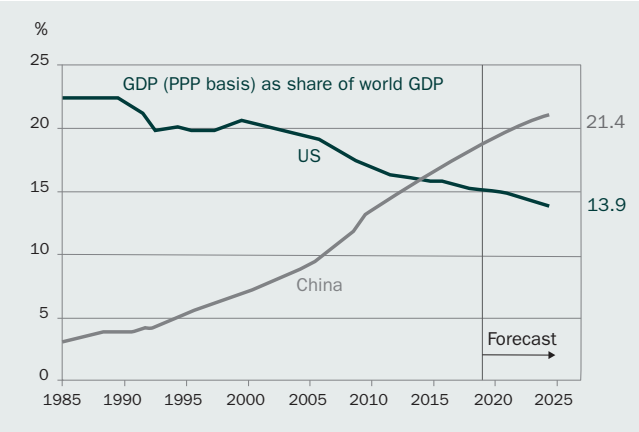
China's greater role in the world is clearly a direct challenge to the US, which is increasingly looking like a superpower, rather than *the* superpower. With its Belt & Road Initiative, Beijing is actually trying to make the entire world part of the Chinese export economy, by financing and building roads, ports, airports and other infrastructure wherever it finds an entry. It does this in order to strengthen and expand its own production chains and to create dependency relationships, trying to maneuver countries into its own political camp and sphere of influence.

China either believes that the international community considers the Chinese market too important to take serious measures against them, and/or that they can ultimately handle any sanctions leveled against them. In that spirit, China is establishing alternative institutions to international bodies, such as the World Bank and the Asian Development Bank. It competes with international trade treaties by establishing its own trade agreements (e.g. the Regional Comprehensive Economic Partnership). By using the 17 + 1 partnership, for example, it is trying to adjust the political line of Europe by establishing ties with countries in Central and Eastern Europe in particular.

Meanwhile, China's military capacity is increasing rapidly, on land, at sea and in the air. Beijing is still far behind the US, but it has built up considerable military forces to the extent where it is highly questionable whether the US would dare to intervene if China violently subdues Taiwan. After all, it is not about the US winning a war with China with considerable certainty, but whether it is willing to take the inevitable losses that such a war would entail. For the time being, Taiwan still seems to be a bridge too far for Beijing – even though the war of words between the two is heating up. That is definitely not the case for Hong Kong, where China's dominance has clearly been asserted lately.

Nevertheless, Chinese progress is not without growing pains. As unit labor costs continue to rise and productivity gains recede, the Chinese regime finds itself, to some degree, in the same "cheap money" rut as Western governments – continuously and increasingly forcing economic progress and growth with extreme monetary policies and growing debt burdens. In order to keep its people happy, the Chinese government is also finding itself in its own version of the make-or-break quantitative easing trap.

Figure 6: China's Rise to Dominance Likely to Continue



Source: ECR Research/Refinitiv Datastream

Figure 7: Competitiveness of China Meeting Growing Challenges

Source: ECR Research/Refinitiv Datastream

Consequently, as GDP growth has been continuously decelerating over the past years, China's fiscal position is starting to look much like that of its Western competitors. Official numbers report a debt-to-GDP ratio of 54%, but more realistic estimates put it close to 80%.

Geo-political tensions

President Trump's tougher stance on China did not start this geopolitical fire, although it may have fueled it and it certainly brought it to the public's attention. Some commentators have already announced the arrival of a new cold war scenario. US professor Graham Allison has been writing about the so-called 'Thucydides Trap' in recent years. According to him, there is great economic risk, and even a considerable likelihood of war, in a period in which a rapidly emerging power is competing with the ruling power, especially if such competition falls into times of harsh economic challenges.

In the past five hundred years, there were at least sixteen of these situations, twelve of which ended in war. In these cases, the interplay between the assertiveness of the new superpower and the fear of the incumbent power was often a decisive factor in the outbreak of armed conflict. In a few cases, the complicated entanglement of allies also played an important role.

China could, for instance, start testing the US security guarantees offered to countries such as the Philippines and Japan. This American commitment has been in doubt before. And these concerns will have increased rather than subsided with Donald Trump in the White House and the US having deployed a geopolitical taper in recent years by cancelling international treaties and undermining alliances.

Topping it all off, 2020 started with a variety of geo-political baggage and unfinished business unrelated to China. In Latin America, Chile, Colombia, Argentina, Ecuador, and Bolivia all saw their fair share of protests and intense public discontent with the status quo, with citizens demanding radical changes and political accountability. Venezuela continued to devolve into a failed-state status, with a crippled economy and ongoing demonstrations that often ended in violence by government forces.

Growing fragmentational forces in Europe have been a challenge for several years. There are still risks and problems stemming from the UK and Brexit. Italy continues to be the problem child of the Union. Apart from its huge public debt levels and ailing banking sector that still pose a severe threat to the entire bloc, its reignited political tensions have caused fresh headaches in Brussels. Meanwhile, France continues to be plagued by strikes and demonstrations that haven't really stopped since the Yellow Vests movement emerged in October 2018. In Spain, on top of the particularly steep toll of the coronavirus, the country also contends with the persistent aftershocks and the deep divisions of the Catalan referendum.

Finally, deglobalization forces have been on the rise. The end of the Cold War had given a massive boost to the opening and connecting of global markets. Previously, the world was roughly divided into two blocs, the Eastern bloc (the Soviet Union) and the Western bloc lead by the United States. However, from the 1990s onwards, suddenly everyone started doing business with everyone. There was this notion among Western countries, which in retrospect was possibly naive, that authoritarian countries would turn to democracy once they became more prosperous. That did not necessarily happen, and soon, globalization turned into "hyper-globalization".

Today, there is a far more critical focus on globalization, since the dark side of high-speed international trade and mass transportation and tourism have been exposed by the financial crisis, the euro crisis and the "democratic recession". For more than a decade, democracy has been losing ground to authoritarian trends worldwide. Although de-globalization is not (yet) evident, further globalization currently does seem to be on hold.

Social unrest and the strange return of marxism

No matter where you stand politically and ideologically, it is hard to ignore the growing social unrest and strange battle grounds of our times. Just when we thought we had done away with communism and had sufficiently proven that the Marxist model of society was dysfunctional and destructive, the same old ideas, based in collectivist hatred and envy, seem to be back in full force. During the last century, from Mao, Lenin and Stalin, to Mussolini and Hitler, the "grand" ideas of collectivists and centralist regimes, built on the foundation of tribal instincts, conformist censorship, and utopian egalitarianism, cost more than 100 million(!) human lives.

The democracies of countries like America and Switzerland, founded on constitutions that respect the inalienable rights and the sovereignty of each individual, irrespective of their race, class, religion, age, or sex, have flourished and progressed far more successfully. And yet, these flawed ideas are back, undermining Western cohesion, values, and culture.

Most of all, it should be a matter of grave concern that public and private discourse has become very difficult, if not impossible. Across the Western world, civilized con-

"One of the most pathetic – and dangerous – signs of our times is the growing number of individuals and groups who believe that no one can possibly disagree with them for any honest reason." *Thomas Sowell*

versation and respectful, constructive criticism and debate have been replaced by meaningless slogans and battle cries, and worst of all, prejudice, demonization, and blind hatred of anyone who holds a dissenting opinion.

Meanwhile, social media echo chambers are constantly fanning the flames, by augmenting the polarization and biases of opposing groups, culminating in a new-found "cancel culture" and censorship.

We are experiencing societal changes that should not be taken lightly. While our Western societies are by no means perfect, the current culture of victimhood and entitlement does nothing to truly address the issues and work toward solutions. All of these "movements", from #MeToo and #BLM to climate activists and Antifa agitators, do little to unify us as a people. On the contrary, they are laser-focused on dividing us based on some one-dimensional factor – wealth, the color of our skin, age, our religion, gender or sexuality – completely dismissing the complex and messy beauty of real diversity and of human nature itself, those very factors and dimensions that make us unique as individuals. Instead, they attempt to pit us against each other by playing on our worst instincts and by promoting and legitimizing hate, envy, and fear.

We all know, or at least should know, where this road leads to. Once reason and respect for our fellow man gets replaced by blind hatred of the "other" and collectivist dogma takes the place of individual critical thinking, civilization as we know it is at risk.

Widening economic inequality

The dismantling of Western culture, values and tradition comes at a time when other challenges also chip away at the competitive advantages we once enjoyed. For one, this is reflected in the deterioration of the Western share in world GDP, which is of course not all bad. It is, after all, also a reflection of the benefits globalization has instilled in other parts of the world.

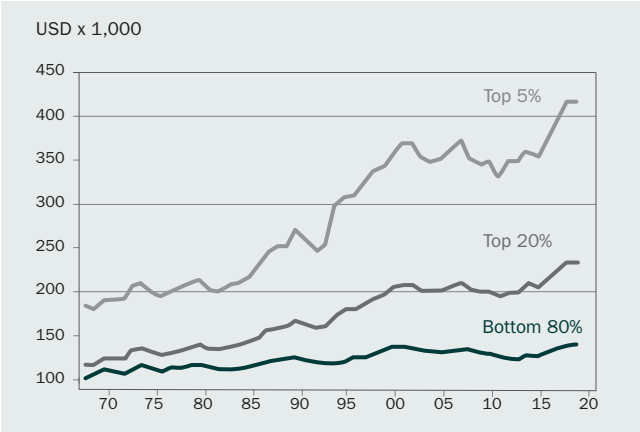
The fact is that, while it is generally ignored or not reported, many of the most important global quality-of-life metrics have been extremely positive over the past two decades. As discussed in Steven Pinker's book "Enlightenment Now", the world is indeed getting better in many very important ways, even if it doesn't always seem that way. The average quality of life for vast masses of people around the world, measured by factors such as child mortality rate, poverty, or literacy, has improved considerably.

Unfortunately, global improvements have not benefitted Western economies as much. Many once important industries and the jobs that came with them have been lost to emerging markets. Negative demographic trends in the West are putting great pressure on our social security and pension systems. Technological advances and the digitalization of the economy are having a rapid impact on the way we work, live, and interact in both our business and private lives. And finally, as discussed earlier, we are coming to the end of a very unique secular credit cycle.

As a result, there is widening economic inequality and a sense that the next generation is growing up in a more dangerous, less financially secure, and generally troubled age. The COVID-19 crisis has only exacerbated these concerns. To inspire trust, governments are doing all they can do to show that they are serious about fostering economic inclusion and making technology work for everyone.

However, in many countries there is a growing distrust of established institutions, fueled by a sense that the young, minorities, and low- and middle-income earners are being

Figure 8: US Income Inequality (Mean Household Income)



Source: ECR Research/Refinitiv Datastream, Fathom Consulting

"Sometime before the year 2025, America will pass through a great gate in history, commensurate with the American Revolution, Civil War, and twin emergencies of the Great Depression and World War II."

William Strauss

left behind and that the game is rigged against them. Large-scale protests were erupting worldwide before the corona crisis, as large groups of people did not benefit – or insufficiently benefitted – from the enormous progress and the gains of the top socio-economic layers in many countries.

It might be argued that the corona crisis has boosted confidence in governments in many countries. And governments are trying to hang on to this new-found but fickle trust, with all kinds of relief and support programs that are ultimately unsustainable. Yet this trust is entirely and strictly conditional and may quickly evaporate once the checks stop coming and the rent is due, and once it becomes clear that some jobs that were lost will not be coming back.

HEADED FOR THE FOURTH TURNING?

History has many examples of economic and political crises that originated in the realm of excessive debt and centralist policies. We have ample empirical evidence of societal failures that were born in "new and grand" ideas, most prominently the recurring phenomenon of collectivist and authoritarian ideologies.

The growing issues stemming from excessive fiscal and monetary imbalances, accompanied by intensifying civil unrest and bitter social divisions, bears the risk of severely damaging, if not destroying, the foundations of our Western economies and societies. The rise of forces in Northern America and Europe that are obsessed with tearing down the status quo at any cost and without a realistic model to fill the vacuum, threatens to destroy the values and democratic ideas of our free societies, as well as all the undeniable benefits that have come with them.

This eerily reminds us of a book that was written in 1997, by William Strauss and Neil Howe, titled *The Fourth Turning: An American Prophecy*. This most intriguing work provides a thorough analysis of the recurring cycles and trends of history, eventually building up a compelling case of how history can be referenced to predict the future.

Strauss and Howe base their ideas on a provocative theory. The authors look back five hundred years and uncover a distinct pattern: modern history moves in cycles, each one lasting about the length of a long human lifetime. Each is composed of four "turnings" that last about twenty years, and they always arrive in the same order. The authors illustrate these cycles using a brilliant analysis of the post-World War II period:

First comes a "High": a period of confident expansion as a new order takes root after the old has been swept away. The psyche of society is full of optimism, fortitude, and resilience. Society is in a rebuilding mode. Next comes an "Awakening": a time of spiritual exploration and rebellion against the now-established order. Then comes an "Unraveling": an increasingly troubled era in which individualism triumphs over crumbling institutions. Last comes a "Crisis": the Fourth Turning, when society goes through a painful and perilous stage in its history. Together, these "Four Turnings" comprise history's seasonal rhythm of growth, maturation, entropy, and rebirth.

The book provides excellent food for thought on how America, and Western societies in general, might evolve if the cyclical rhythm of history continues to hold up. At this point, the prophetic power of this book is looking increasingly uncanny. The world does indeed look like it's headed for the "Fourth Turning".

If the predictions of Strauss and Howe hold true and "this time is NOT different", then we should all fasten our seatbelts, get ready to toughen up, and do our best to do better than our predecessors did during the previous fourth turnings.

FACING THE CONSEQUENCES OF EXCESSIVE DEBT

"There is no means of avoiding the fiscal collapse of a boom brought about by credit (debt) expansion. The alternative is only whether the crisis should come sooner as the result of a voluntary abandonment of further credit (debt) expansion, or later as a final and total catastrophe of the currency system involved." *Ludwig von Mises*

The biggest enemy of all today, in our view, is the growing burden of public debt and deficits. The dangers of excessive debt and deficits are well documented. History tells us, again and again, that continually piling up more debt, under the pretense or well-intentioned hope of fixing economic and social problems, always backfires.

Total debt-to-GDP ratios have skyrocketed in 2020, mainly because governments have implemented massive fiscal stimulus in order to prevent the collapse of their economies. This kind of debt-mongering may not be too problematic as long as interest rates stay very low. However, public finances will spin out of control once interest rates start rising. That will be the moment when indebtedness turns into insolvency.

THE CONSENSUS VIEW: DEBT DOESN'T MATTER!

These concerns, however, are not shared by all. In fact, the received wisdom in policy and academic circles continues to cling to the notion that advanced economies, i.e. high-income countries, are different from their emerging market counterparts, that they operate under a different set of economic laws. At the core of this thinking lies the idea that debt does not matter in America, or Europe, because central banks can create sufficient money, at any given time, to pay off their debt.

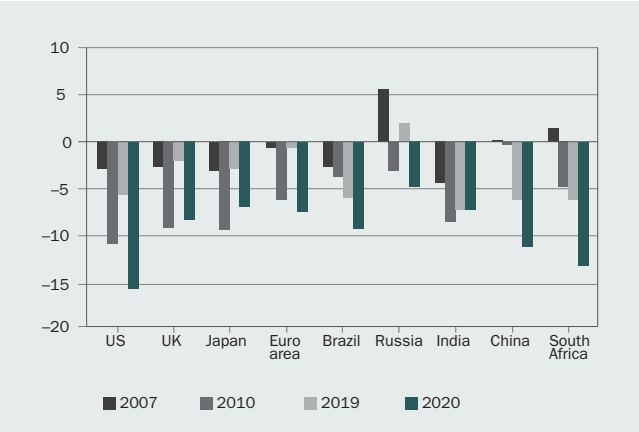
The current monetary and fiscal policies operate under that very assumption, pretending that debt sustainability in advanced economies can be achieved. In other words, no matter how extreme the policy measures, advanced economies do not need be concerned with the standard toolkits of emerging markets, namely those of currency reforms, debt restructurings and conversions, high inflation, and financial repression.

But is that really true? We have witnessed how the measures of our central bankers have turned increasingly extreme, if not desperate. Even before the arrival of this virus, central bankers seemed to operate on a very simple and one-dimensional policy: "Inflate or Die".

As of now, we are only partially through the COVID-19 crisis and the (arguably) radical lockdown policies that came with it. Yet, the aggregate amount of fiscal and monetary stimulus (see Figure 10), and the accompanying debt, has already surpassed the aggregates pumped into the global economy during the crises of 2008 and 2010, in their entireties.

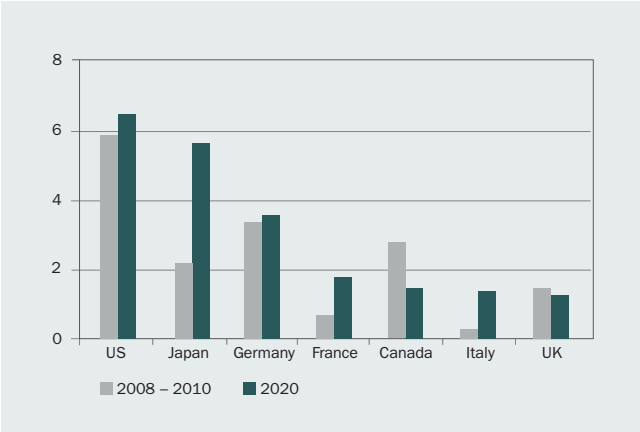
As portrayed in Figure 11, after rising steadily since 2008, the Fed's balance sheet has now gone ballistic within just a few months. Compared to the corona-crisis response, the amounts of money created by the Fed during the 2008 financial crisis looks almost like a non-event. And

Figure 9:
Government Budget Balances of Major Economies (as % of GDP)



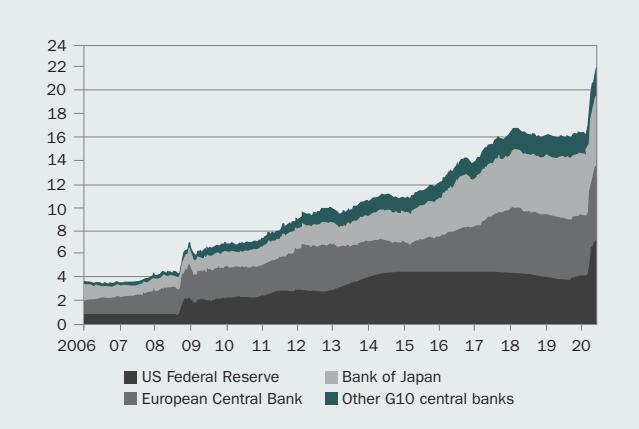
Source: ECR Research, Refinitiv Datastream, Fathom Consulting

Figure 10: G7 Stimulus Size as a % of GDP



Source: Brookings, IMF and BCA Calculations

Figure 11: Central Bank Assets (Trillions of US$)
Note: "Other G10 central banks" are those of Canada, Sweden, Switzerland, and the United Kingdom.



Source: IMF, Bloomberg Finance L.P.

this is by no means unique to the US, as the same pattern can be seen in literally every major economy on the planet.

It may be true that financing public debt is not a big problem when interest rates, i.e. the cost of money, are constantly reduced. As portrayed in Figure 12, the costs of debt-financing for governments have continually come down. When credit is available for almost nothing, the banking system and government treasuries can foot the bill for all that extra debt. Insolvency, under such conditions, might be nothing to worry about.

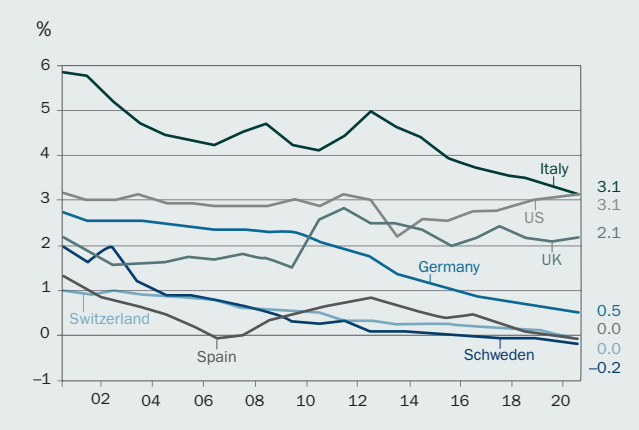
However, the pandemic may well crystallize the financial vulnerabilities that have built up over the past decade. First, in advanced and emerging market economies alike, corporate and household debt burdens could become unmanageable for some borrowers in a severe economic contraction.

Aggregate corporate debt has been rising over several years and now stands at historically high levels relative to GDP. According to the IMF, "this deterioration in economic fundamentals has already led to the highest pace of corporate bond defaults since the global financial crisis, and there is a risk of a broader impact on the solvency of companies and households".

In fact, an argument might be made that the arrival of the virus was merely the straw that broke the camel's back, or even possibly served as an unexpected but opportune scapegoat. Governments and central banks have been handed a legitimate "culprit", a welcome excuse, to extend and ramp up their quantitative easing strategy, a "carte blanche" of sorts to open their money spigots at will, for the good of the economy and the people, of course.

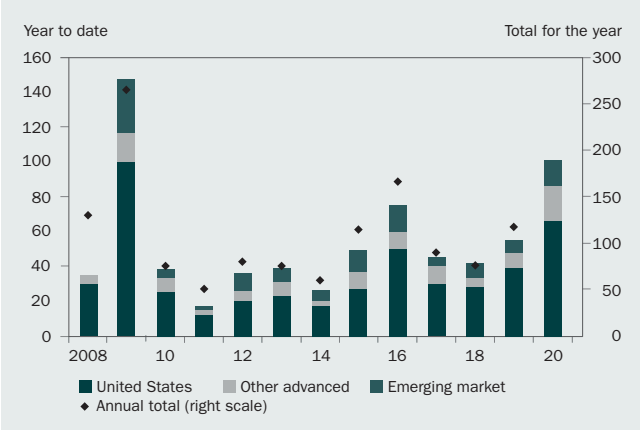
So far, the deflationary forces of the pandemic have been dominant. However, as we will discuss later in this report, the tide may be turning. Inflation expectations are up. Governments have used the corona crisis as a reason to bypass central banks and inject unprecedented amounts of money directly into the economy. This liquidity bazooka might lead to inflation sooner than most expected. Thus, with the arrival of rising inflation, it will be difficult, if not impossible, to avoid rising interest rates.

Figure 12:
Net Government Interest Payments as % of GDP



Source: ECR Research, Refinitiv Data

Figure 13:
Number of Corporate Bond Defaults Rising



Source: IMF, S&P Global

"Although economists' understanding of financial crises has considerably deepened in recent years, periods of huge financial sector growth and development (often accompanied by steeply rising private indebtedness) will probably always generate waves of financial crises."

Kenneth S. Rogoff

OPTIONS TO REDUCE PUBLIC DEBT

The claim that debt does not matter is at odds with the historical track record of most advanced economies, where debt restructurings or conversions, higher inflation, and all sorts of financial repression were common denominators of excessive debt overhangs. Ultimately, the unwinding of all the debt, public and private, will not occur without significant economic hardship, social upheaval and political interventionism.

Let's be very clear: We are witnessing the unfolding of one of the worst economic downturns ever. The probability of a worldwide debt crisis is growing by the day. The current crisis is widely described as unprecedented. While that may be true in terms of its overall global scale, debt crises, per se, have been quite common, even in recent history. This debt crisis is anything but unprecedented.

In predicting what might lie ahead, Carmen M. Reinhart and Kenneth S. Rogoff, in their research and their best-selling book, This Time Is Different, Eight Centuries of Financial Folly, have done us an invaluable service. They provided us with an incredible amount of historical facts and data. What they have also made very clear is that we are not sailing in uncharted waters. We have been here before, and we are able to learn from the past in order to prepare for the most probable future.

In essence, there are five ways in which excessive debt levels might be reduced:

- Growth
- Austerity
- Inflation
- Financial repression
- Default

Three of the aforementioned measures, namely growth, austerity and default, are debt reduction measures available to both the private and public sector. They appear to be just plain common sense: generate more income, tighten your belt, or go bankrupt. Inflation and financial repression, on the other hand, are of a different nature. These are measures available exclusively to governments.

Of course, the last of these debt reduction methods, default, is generally not considered a "solution" at all. For most of us, and certainly for most governments, an outright default, or even a partial, soft, or voluntary default, stands precisely for what one aims to avoid. Nevertheless, historically, sovereign defaults are surprisingly common. In the years from 2000 to present alone, we had 28 sovereign defaults and debt restructurings, with Greece and Argentina being the most well-known cases.

Growth – improve and grow the economy

For governments, higher growth rates translate into higher tax revenues. Ideally, economic growth, measured in GDP terms, should increase at a pace that would generate increased tax revenues to a point where a budget surplus results, so as to cover all spending and pay off as much debt as possible.

After reviewing the state of the global economy, and particularly the health of Western economies, we are in the midst of a recession (which might even turn into a depression) that most probably will stay with us for a long time.

So, how likely is it that we will be able to reduce debt levels through economic growth alone in the near future? It's very unlikely. At this point, the debt levels and annual budget deficits are simply too large. Even in the unrealistic scenario of double-digit GDP growth rates and a complete spending freeze, it would take decades before the debt-to-GDP ratios in economies like that of the US, EU, the UK, or Japan would see a meaningful reduction. It may be noteworthy here that the U.S., for example, achieved double-digit GDP growth rates for only three quarters since the end of World War II! And that was in the early 50's.

Fiscal austerity – tighten your belts and live with the consequences

Stabilizing or even reducing the current debt levels would require an incredible, largely unrealistic, reduction in spending. This, ideally, would of course be combined with an increased level of economic growth as discussed above. Since government spending ratios, the ratio of government spending relative to GDP, are so high (in

"In the absence of the gold standard, there is no way to protect savings from confiscation through inflation. ...This is the shabby secret of the welfare statists' tirades against gold. Deficit spending is simply a scheme for the confiscation of wealth. Gold stands in the way of this insidious process. It stands as a protector of property rights. If one grasps this, one has no difficulty in understanding the statists' antagonism toward the gold standard." *Alan Greenspan*

2019, for example, approx. 36% in the U.S., in the Eurozone 47% and in Japan approx. 37%), decreased government spending and stimulus would automatically also significantly reduce GDP, particularly in those countries where government spending makes up a considerable part of the economy. And the current mood in society will hardly entice politicians to choose this option, not if they want to keep their job and stay in power.

Current budget deficits exceed nominal growth rates considerably. As long as deficit spending is greater than government revenues, the debt-to-GDP ratios will continue to rise. The gap between growth and deficit spending as a percentage of GDP is greatest in Japan, followed by the US and the UK. It is fair to say that if these countries seriously pursued a reduction of their existing budget deficits, it would undoubtedly require significant cuts in spending for defense, social services, and other core activities.

Given the current levels of nominal growth and interest rates being close to zero, eliminating the main conventional tool to dampen the impact of the recession is likely to prove disastrous. At this stage, even small cuts in government spending in most countries would worsen and lengthen the current recession.

Inflation – print the debt out of existence

A very common means of reducing debt, historically, is monetary inflation – the creation of additional money supply. Inflation is a form of debt reduction that is also called "the silent default". Particularly if monetary inflation exceeds the growth rate and the rate of interest, it leads to a slow and somewhat covert destruction of both wealth and debt. Monetary inflation eventually depreciates the purchasing power per currency unit, penalizing creditors and savers alike for holding on to cash and bonds.

Governments and their central banks have a variety of tools to increase the money supply. A growth in money supply, over time, will raise the prices of assets and consumer goods as measured by the Consumer Price Index (CPI), even though the past years have proven that monetary inflation will not automatically result in immediate price inflation. Inflation often comes in two stages. First it appears as "good inflation". Asset prices go up and everyone is happy. Everyone is even asking for more of it. Then, it eventually drives up consumer prices, too. This is the time when inflation reveals its true and ugly nature and the happiness of the people fades. As previously discussed, the monetary measures so far have mainly benefitted asset prices.

Central banks have attempted to increase inflation for years now. But deflationary forces were too strong and their inflation goals of 2% were never reached. This has strengthened the seriously misguided belief that, particularly in response to the corona crisis, monetary expansion can be ramped up almost indefinitely without the negative consequence of getting price inflation. This misbelief was academically frameworked and packaged as "modern monetary theory" (MMT) and recently popularized by Stephanie Kelton's book *"The Deficit Myth"*.

Next to the erosion in purchasing power, inflation also has a severe tax impact called "cold progression". In inflationary times, taxpayers are shifted into higher tax brackets even when their real incomes have not grown.

Bondholders who earn a fixed coupon payment in return for their willingness to lend money to the government or to corporations are gradually penalized as inflation rises while their interest payments remain constant. Rising inflation means that the real return of a bond investment will decline and may become negative if inflation exceeds the yield of the bond at the time of purchase.

But inflation also implies lower real returns for all other assets that provide cash flows. As long as these cash flows do not adjust for higher inflation in the future, investors will face low or even negative real returns on their investments.

Governments most frequently choose the way of monetary inflation because it is the way that is least immediately felt. Monetary inflation is also the one option with adverse effects that are most easily blamed on others (financial speculators, undervalued currencies, greedy landlords, outrageous oil producers, cheap labor, etc.). In essence, ruling governments have the legitimate

"Financial repression occurs when governments implement policies to channel to themselves funds that in a deregulated market environment would go elsewhere. Policies include directed lending to the government by captive domestic audiences (such as pension funds or domestic banks), explicit or implicit caps on interest rates, regulation of cross-border capital movements, and (generally) a tighter connection between government and banks, either explicitly through public ownership of some of the banks or through heavy "moral suasion." Financial repression is also sometimes associated with relatively high reserve requirements (or liquidity requirements), securities transaction taxes, prohibition of gold purchases, or the placement of significant amounts of government debt that is nonmarketable. In the current policy discussion, financial repression issues come under the broad umbrella of "macroprudential regulation," which refers to government efforts to ensure the health of an entire financial system."

Carmen Reinhart

hope that their role as crisis-causer remains undiscovered by the majority of the people.

Governments often justify monetary inflation with the statement that they will withdraw excessive liquidity once the economy responds to the monetary stimulus to the desired extent. However, historically, this timely absorption of excessive liquidity was always wishful thinking that almost never found its way into practical implementation.

Financial repression – regulate in favor of government finances

Already before the coronavirus struck, there was a strong global tendency towards centralization and a greater role for the government. The perception has been growing that free markets and de-centralized systems were facing challenges that they would not be able to solve alone, including climate change and depletion of natural resources. The corona crisis has reinforced this notion, especially as it left countless citizens depending on governments for support.

Apart from the central banking power to print money, governments have the power to regulate. In fact, laws and regulations are entirely in the realm of governments, whereas monetary policy has traditionally been assumed to be under the independent control of central banks. That is not entirely true, however, as we will discuss a little later. In any case, financial repression is another debt reduction method that has been used frequently in history, is still being used today, and is highly attractive to governments. Similar to inflation, it is not quite as overt as austerity or default, while allowing governments to shape the rules in favor of public finances at the expense of the citizen and taxpayer.

In essence, financial repression occurs when governments flex their muscles to force down the real value of their debt and/or the cost of financing that debt:

First, governments push down real interest rates, with or without the help of rising inflation. Then they oblige domestic investors or institutions, such as banks or pension funds, to buy government debt at those lower rates. By means of their regulatory power, they resort to repression methods, which include directed lending to the government by captive domestic audiences (such as pension funds), explicit or implicit caps on interest rates, and tighter connections between government and banks. Finally, if all that does not work, the law can be used for more "creative", and often invasive, measures such as capital controls, bail-in regulations, or confiscation.

One characteristic of financial repression, as Reinhart and Sbrancia put it, is "a pervasive lack of transparency". Most citizens are slow to realize what is happening. Most of us do not actually read and consider regulatory frameworks such as the Bail-In rules. Yet, these regulations are real, and they are ready to be used. If you think that a bail-in situation was a one-time Cyprus exception, think again. The rules are in place across Europe, North America, and most other countries, ready to be deployed if needed. That is why the banks you use are best located in jurisdictions with healthy finances, i.e. low debt.

Default – make others pay, fully or partially

A default presents an outright and straight-forward form of wealth destruction. Basically, someone else – the creditor – will bear the losses and suffer the consequences of the debtor's default. For the debtor, a default has significant consequences too. For individuals, it will be difficult

to get future credit. And for governments, a default can lead to an extended phase of high financing costs. Trust can take decades to rebuild. When Russia defaulted on its debt in 1998, it took them over ten years to raise money on international bond markets again.

Government defaults are not unusual. Greece has been in default 50% of the time since 1800, while Russia has been in a state of default almost 40% of the time. A couple of prominent and relatively recent cases of default, beyond that of Greece, are Russia (1998) and Argentina (2002). In fact, there are very few countries that have never defaulted, most notably the US and the UK, but also Switzerland and Australia.

Default is generally avoided at all costs. It will be no different this time around. Most countries will try to avoid defaulting on their debt obligations for as long as they possibly can, as they realize they would then be forced to resort to other means of financing their budget deficits, such as soliciting aid from organizations like the International Monetary Fund or guarantees from high quality debtors like the U.S.

WHAT TO REALISTICALLY EXPECT

You do not need a crystal ball to know what to expect under the current circumstances. The details of how this will all play out are unknown. The big picture playbook, however, is not. While economic growth will be sought "at all costs" by central bankers and governments alike, forcing a fundamental economic healing – real and sustainable growth – purely by means of monetary and fiscal intervention, i.e. more debt, is highly unlikely to work. Instead, what we can all expect is a cocktail of financial repression measures and, over time, also consumer price inflation. Those are the factors, as investors, we need to plan and prepare for.

Financial repression – already underway!

The situation in America and Europe will be most relevant to our readers, but it's worth considering other regions as well. Despite the undeniable effects of globalization, the world is not a single homogenous block. The political system and climate, demographics, private debt levels, saving quotas, current-account balances, unemployment rates, strength of the industries, and a host of other factors differ from country to country. These factors will be relevant to the ultimate outcomes, regionally and globally. However, the general global trajectory is already pretty clear, particularly in America and Europe.

Austerity is off the table at this point. It would be considered irresponsible by most in the current day and age. In the aftermath of the corona lockdowns, no politician will dare go down that road. In America, Trump and Biden do have one thing in common: they are both "big spenders". Equally, default is not an option and will of course be avoided at all costs. Emerging markets will also attempt employing their monetary and fiscal tools to avoid default but may find it difficult to do so when the global economic slowdown or rising interest rates hit them. America – and Europe too – should be able to avoid this path, although ultimately it cannot be ruled out completely. We need to keep a close eye on the finances of all countries.

As soon as interest rates start rising, advanced economies too may end up in a precarious solvency situation. Moreover, rising interest rates will quickly translate into a blood bath in the fixed-income heavy balance sheets of insurance companies, pension funds, banks and government treasuries. Equally, the European PIGS (Portugal, Italy, Greece and Spain) continue to require heavy support by the EU's financial coffers. America too is exposed. It will cost A LOT to stave off the collapse of the financial system and government default, in a country that is already overly indebted. The trillions of unfunded liabilities of Social Security, Medicare and Medicaid (a multiple of U.S. GDP) will become a considerable burden. As social unrest and frustration grows, it will be difficult to cut costs there without fueling the desperation of the people.

So, two items are left on our list: financial repression and inflation. As discussed earlier, we are currently witnessing enormous deflationary forces. Therefore, it may be considered reasonable to expect inflation to remain low for the foreseeable future. However, financial repression is already here, and it will be the number one choice of politicians everywhere, America included, in terms of dealing with the issues of growing debt and deficits. In fact, a recent IMF update articulately prescribes, in black and white, the policy priorities and recommended recipe for governments and central banks:

"With the relentless spread of the pandemic, prospects of long-lasting negative consequences for livelihoods, job security, and inequality have grown more daunting. Further effective policy actions can help slow the deterioration of those prospects and set the stage for a speedier recovery that benefits all in society across the income spectrum and skills distribution. At the same time, considering the substantial uncertainty regarding the pandemic and its implications for different sectors, the policy response will have to adapt as the situation evolves to maximize its effectiveness – for instance, shifting from saving firms to facilitating resource reallocations across sectors."

"The way to crush the bourgeoisie is to grind them between the millstones of taxation and inflation." *Vladimir Lenin*

The writing is on the wall. Without a doubt, these policy prescriptions reflect the desire and expectations of the mainstream consensus. And they are the reality we must prepare for as investors and citizens. For wealth planning purposes, the challenges we will face will emanate from more and higher taxes, less freedom in an increasingly regulated landscape, and an increasingly creative variety of wealth-transfer mechanisms and financial repression.

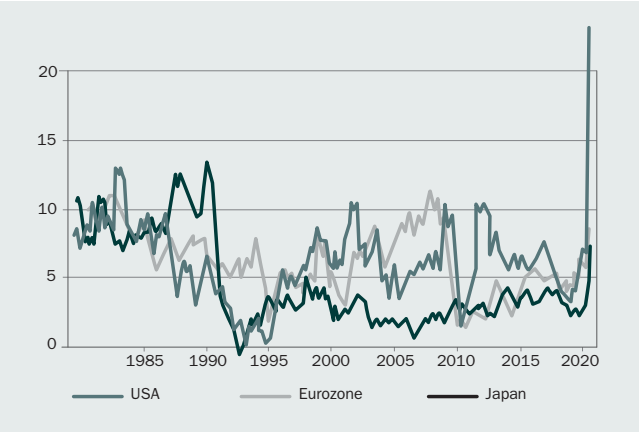
Inflation may arrive sooner than expected

After the last recession, everybody – well, at least those in the mainstream – thought central bankers had it all under control. They had proven to be capable of "saving the world" during the 2008 crisis. So, it appeared clear that the mounting debt was not an issue for industrialized countries. Central bankers, after all, were able to create money out of thin air, in unimaginable quantities.

But central bankers were not able to reach their economic growth and price inflation goals. We mainly experienced asset inflation. What a wonderful thing: the only direction stock markets seemed to know was up!

Until just a few weeks ago, that wisdom held true in connection to the bazooka response to corona crisis too. We are indeed witnessing the worst recession since World War II, but we are also witnessing the fastest growth in broad money supply in over thirty years. Especially in America, the broadest money aggregate available (M2), has been growing at over 20%. We don't know how far back you would have to go to find that kind of money growth in the US. And yet, inflation is nowhere to be seen.

Figure 14: Broad Money Aggregates Rising Sharply, Growth Rate of M2 (YOY in %)



Source: themarket.ch, Bloomberg

In fact, the US Federal Reserve does not appear worried about high inflation at all. To the contrary, Fed Chairman Powell, on August 27th, announced a policy shift and the Fed's new approach to inflation ("average inflation targeting"), which may presumably allow the Fed to keep rates lower for an even longer time. That means the central bank will be more inclined to allow inflation to run higher than the standard 2% target before hiking interest rates. In addition to the inflation change, the Fed shifted its approach to employment in a way that will focus on those at the lower end of the income spectrum. The Federal Reserve announced a major policy shift Thursday, saying that it is willing to allow inflation to run hotter than normal in order to support the labor market and broader economy.

So, why are we alerting you to the specter of inflation now? Because a number of variables have changed. Most importantly, in the wake of the COVID-19 lockdowns and the wide acceptance – if not expectation – that "Thy Government Shalt Take Care of Thee AT ALL COSTS", we have seen the emergence of a new kind of money creation. Now, it is the government, not central banks, that opened the liquidity faucets, and this time, that new money will be reaching "the streets".

The Trillion-Dollar Question is this: does the growth of broad money matter? The market does not seem to think so. After all, inflation rates on inflation-linked bonds are at historic lows. Most investors and experts believe the current level of broad money growth is a short-term phenomenon. But we beg to differ. We agree with the analysis of Russel Napier, as explained in an interview with TheMarket.ch in June of 2020:

"It's a shift in the way that money is created that has changed the game fundamentally. Most investors just look at the narrow money aggregates and central bank balance sheets. But if you look at broad money, you notice that it has been growing very slowly by historical standards for the past 30 or so years. There were many factors pushing down the rate of inflation over that time, China being the most important, but we do believe that the low level of broad money growth was one of the factors that led to low inflation.

"…This broad money growth is created by governments intervening in the commercial banking system. Governments tell commercial banks to grant loans to companies, and they guarantee these loans to the banks. This is money creation in a way that is completely circumventing central banks. So I make two key calls: One, with broad money growth that high, we will get inflation. And more importantly, the control of money supply has moved from central bankers to politicians. Politicians have different goals and incentives than central bankers. They need inflation to get rid of high debt levels. They now have the mechanism to create it, so they will create it."

As Mr. Napier points out, QE was a fiasco. All that central banks have achieved over the past ten years was the creation of a lot of non-bank debt. Their actions kept interest rates low, which inflated asset prices and allowed companies to borrow cheaply through the issuance of bonds. Not only did central banks fail to create money, but they created a lot of debt outside the banking system.

This led to the worst of two worlds: no growth in broad money, low nominal GDP growth, and high growth in debt. Most money in the world is not created by central banks, but by commercial banks. In the past ten years, central banks have never succeeded in triggering commercial banks to create credit and therefore to create money.

Now, politicians have discovered the money faucet. They are guaranteeing loans, so that commercial banks are willing to make loans to businesses they otherwise would not. Thus, this money will be impacting the economy directly and it will be hitting the streets. That, in and of itself, could be considered good news. But here is the catch: governments will probably recognize this as their way out of debt. They will bypass central banks and they are very unlikely to act with moderation and care. Chances are that, by the time they try to stop the tide they have created, it will be too late. Inflation, and high inflation, will have taken hold.

WEALTH MANAGEMENT IMPLICATIONS

From all that we have discussed, one key learning point should stand out: reviewing and possibly upgrading your risk management and wealth protection measures should be among your first priorities today. In order to properly prepare for the future, you will need to configure your wealth protection fortress in consideration of a new era characterized by financial repression and inflation, and the societal changes that will come with it.

While it will be important to stay nimble and alert in terms of your approach to asset allocation and investing, it will be even more important to ensure that your wealth protection plan, i.e. the structures and mechanics of your strategy, will protect you from regulatory, legal and societal threats. These threats are real and imminent, and particularly challenging to deal with in America.

THE SPECIAL RISK PATTERNS FOR WEALTHY AMERICANS

Americans with substantial wealth are subject to a set of very unique threats and circumstances that require equally unique risk management measures. We work with American clients daily and in consulting with them, we are very familiar with their particular concerns. These worries may have been around for some time, but what is new now is the widely felt sense that these threats are imminent and quickly closing in. Let's have a brief look at some of them.

Shifting tax rules and rising rates

Growing deficits, public outrage at inequality, and ideas like the Democratic Party's "Green New Deal" will inevitably lead to more taxes. The proposals currently on the table range from higher income taxes for the rich and higher estate taxes, to the introduction of a wealth tax. Depending on the outcome of the presidential election in November 2020, taxation will progress differently. However, even under another four years of a Trump administration, it is unlikely that you will see lower taxes in America. So, the odds are your tax bill will be going up – if you just sit still and let it happen.

As the last bit of budget discipline evaporates with the government's response to the pandemic, public spending will continue to rise. Meanwhile, the rise of government debt and deficit-spending coincides with a political shift of the US Democratic party to the Left. It may be coming wrapped in rhetoric about "fairness" and "equality", but it is really all about increased wealth redistribution.

Ultimately, all these forces will result in more regulations, more government bureaucracy, and more taxes. America already has a very complex tax code. We have worked with US tax attorneys and estate planners for many years and rarely have we received a clear and simple answer to our tax questions. Frequently, the answers will start with an extensive disclaimer and an "it depends" qualifier. Most Americans, without even realizing it, are exposed to the whim of the IRS. The rules are opaque, confusing, convoluted and treacherously arbitrary.

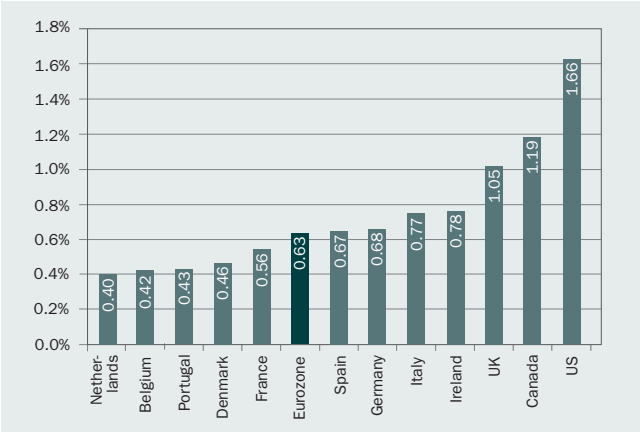
Litigation

Many of our clients are successful entrepreneurs and executives. One of their main worries is asset protection and the exposure to lawsuits. They have been concerned about frivolous lawsuits related to product liability, malpractice, or patent litigation for a long time. Today, however, they also need to protect themselves against frequently unfounded claims related to racial discrimination, environmental regulations, or sexual harassment.

Under current laws, there is almost no risk to trial attorneys or their clients for bringing even the most absurd of cases to court. While large companies routinely retain attorneys and have the financial means to protect themselves from frivolous lawsuits, small businesses are seriously exposed. Regardless of whether there is any validity to the plaintiff's claim, small business owners will have to hire attorneys to defend themselves and will typically incur substantial legal fees even if they win the case.

Over 50% of all civil lawsuits target small businesses. 75% of business owners fear being targeted by a frivolous lawsuit. And 90% percent of the cases are settled, simply to avoid higher court costs. A study conducted by the U.S. Chamber Institute for Legal Reform demonstrated that the US has the highest liability costs as a percentage of GDP of all the countries surveyed, with liability costs at 2.6 times the average level of the Eurozone economies.

Figure 15: Liability Costs as a Fraction of GDP



Source: U.S. Chamber Institute for Legal Reform

It is estimated that more than 40 million lawsuits are filed every year in the United States. According to a study conducted by Harvard's John M. Olin Center for Law, Economics and Business, the US has the highest number of suits filed per 100'000 people.

Clearly, America has long had a culture and a system that is prone to litigation. But especially now, in the aftermath of COVID-19, it's safe to assume there's a wave of lawsuits in the pipeline.

Asset seizures and bail-in

Civil forfeiture or asset seizures in the United States, also called civil asset forfeiture or civil judicial forfeiture, is a process through which law enforcement officers take assets from persons suspected of involvement in a crime or illegal activity without necessarily charging the owners with wrongdoing.

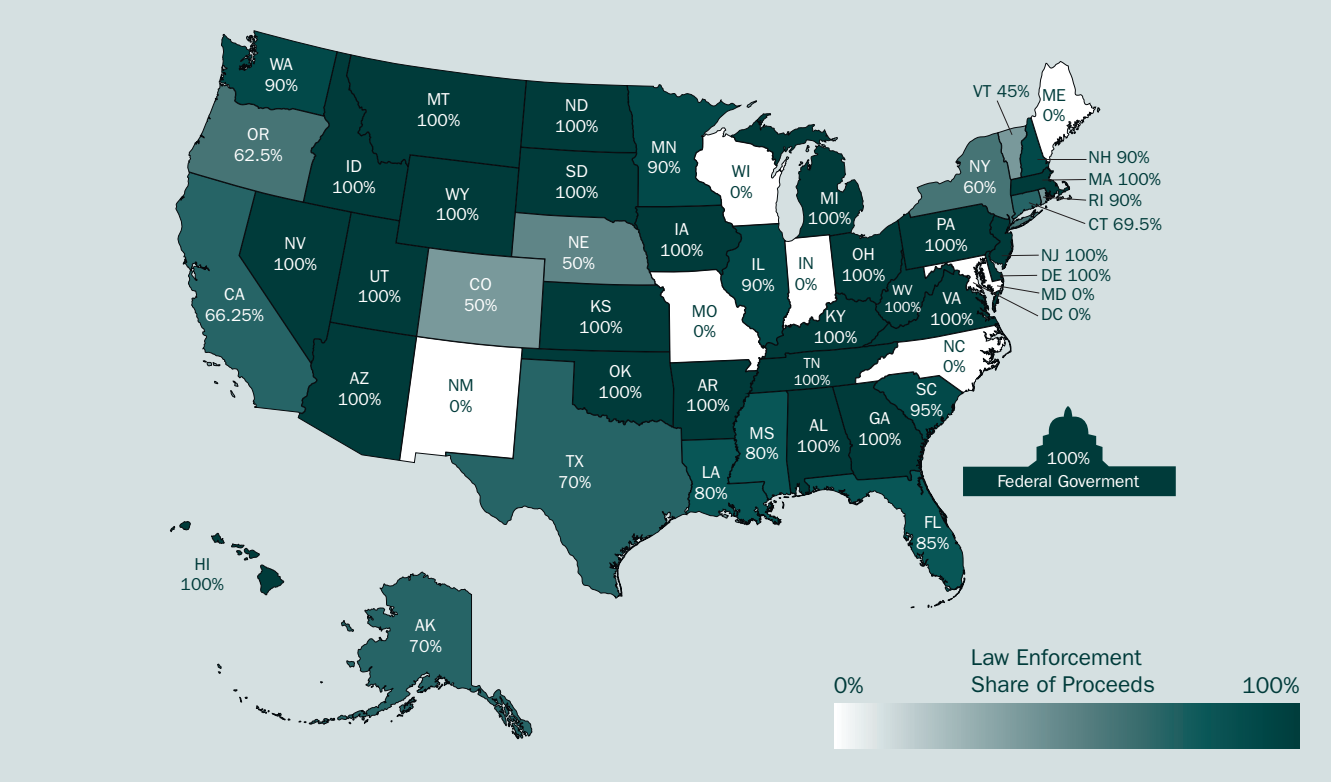
These situations are no longer rare, even though most people assume that this sort of problem will never be theirs. However, what they fail to realize is the level of exposure their wealth has to asset seizures by government agencies.

Figure 16 shows for each state, the District of Columbia, and the federal government the percentage of forfeiture proceeds allowed to flow to law enforcement. Only seven states and D.C. block law enforcement access to forfeiture proceeds. The remaining jurisdictions allow at least 45 percent – and in many cases, including the federal government's, 100 percent (!!) – of the value of forfeited property. Property may also be retained for official use. These allowances represent a significant opportunity for agencies to self-fund through civil forfeiture, and evidence suggests that they are taking full advantage.

American government agencies have become increasingly heavy-handed. Today, without warning, you could be locked out of your bank or brokerage account, your own business or even your own home. All it really takes is one government employee to express his or her concern that you are late on your tax bills, that you are somehow evading your taxes, or that you might be involved in some sort of money laundering activity, a term that has been increasingly broadened in recent years.

You may also be tagged as a national security threat, or someone possibly dealing with a country on some black

Figure 16: Financial Incentives in Civil Forfeiture Laws



Source: Institute for Justice

or grey list. Whatever the suspicion is and no matter how absurd it may be, you will not be given the chance to respond or set the record straight before your assets are frozen. Even if you have done nothing wrong at all, the burden of proof is on you, and you will have to prove your innocence, at your own expense.

Furthermore, if there is one law that all Americans should have taken notice of it is the one related to Bail-ins. The financial crisis of 2008 ushered in the term "too big to fail," which regulators and politicians used to describe the rationale for rescuing some of the country's largest financial institutions with taxpayer-funded bailouts. Heeding the public's displeasure over the use of their tax dollars in such a way, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of January 2010, which eliminated the option of bank bailouts, but opened the door to bank bail-ins.

Dollar depreciation

Whenever the Federal Reserve announces another round of quantitative easing, it is easy to imagine hearing the sound of high-speed printing presses or the rotors of helicopters filled with cash. With this expansion in fiat money, accompanied by trillions of federal deficits as the norm, it may be considered a miracle –and not a small one – if the dollar holds even half of its purchasing power over the next ten years.

The dollar has, for decades now, continued to lose value relative to other currencies. Even the "new kid on the block", the Euro, has appreciated considerably over the past ten years. For reference, the Swiss franc is even more impressive: 50 years ago, when some of the authors of this report were growing up in Switzerland, the US dollar was worth 4.3 Swiss francs. Today, a dollar is worth 0.92 Swiss francs – it doesn't even buy a single unit of the Swissy.

Figure 17: EUR / USD, as of July 2020

Source: ECR Research, Refinitiv Data

In view of the rapidly growing role of the Euro and the Yuan as challengers to the U.S. dollar for its international trade and reserve status, the value of the U.S. dollar will be difficult to defend. Moreover, while the U.S. dollar is still considered a safe haven currency by most, that status too may be challenged. As investors increasingly choose investing in Eurobonds and other government bonds not denominated in the U.S. dollar, it may become increasingly difficult for Treasuries to be placed in the market, an absolute necessity for America's continuously growing deficit and debt financing needs.

Capital controls

Historically, governments have passed rules from time to time that impose restrictions or special taxes on transferring capital internationally, or even owning foreign investments. Capital controls are common in various countries today and the US also did this in various ways in the 1940s and then again in the 1960s.

More recently, as discussed above, in its attempt to drag the economy to a full recovery, the US dollar has been rapidly inflated, or depreciated. As the greenback's competition grows from other currencies, capital controls of some sort may be re-introduced in America. In order to continue printing dollars without precipitating a collapse in the currency's value on foreign exchange markets, a restriction on dollar outflows is conceivable. Some commentators even envision a dual approach, i.e. the introduction of an onshore versus an offshore dollar.

Irrespective of what the method might be, when capital controls are imposed and the padlock clicks, it will become impractical, if not illegal, to send money overseas, or to buy and keep assets outside of the US. This will of course block your access to various opportunities and the benefits of international diversification. Without the freedom to acquire foreign currency or to spend dollars outside the US, you won't be able to protect yourself from the potential of hyper-inflation or dollar depreciation, nor will you be able to leave and take your wealth with you, thus locking up your wealth, and consequently you and your family, inside the US.

Gold confiscation

There have been some stunning examples of gold confiscation in the past; Executive Order 6102 tends to mostly stand out in people's memories. It was signed on April 5, 1933, by US President Franklin D. Roosevelt, "forbidding the hoarding of gold coin, gold bullion, and gold certifi-

cates within the continental United States". The government forced everyone to hand over their gold at the official price of US$ 20 per ounce. Then it raised the official price to US$ 35. As a result, the government basically confiscated 42% of everyone's gold.

It is unclear how a gold confiscation would happen today. There are alternatives open to governments besides outright confiscation or nationalization. For example, when the UK left the international gold standard in 1931, the devaluation of the pound put pressure on other currencies such as the Dutch guilder. In response, the Netherlands imposed a variety of restrictions on gold that stopped short of actual confiscation. Nevertheless, that doesn't mean one should ignore those risks. After all, over the last decades, we have seen a buildup of all kinds of restrictions, privacy violations, and limits on purchases and sales in many countries.

Overall, gold is a critical element of any effective wealth protection strategy. Unlike stocks, bonds, real estate, life insurance, annuities, paper money, or even your business, gold does not depend on any formal institution, and certainly does not depend on the government. It is therefore an invaluable hedge and protection against the growing systemic risks.

However, there is an important caveat: holding gold as a hedge should be done in a way that minimizes the chances of your government confiscating it, blocking your access to it, or manipulating its value. To do that, you need to keep it physically, and you need to keep the vast majority of it outside of US borders, in a safe and predictable jurisdiction.

Presidential crossroads

The COVID-19 waves of infections have monopolized media attention over the last few months. However, we should not forget the US presidential election is on the horizon. As we head into the fall and closer to November, investors worldwide, and wealthy Americans in particular, should start considering the implications of the different possible outcomes.

The last election had a marked impact on the markets. When Donald Trump surprised the world and took his place in the oval office, stocks, credit, and the US dollar rallied. Investors, of course, had high expectations, as they anticipated a combination of policies that could support the US economy, which would in turn be positive for the world economy. Lower taxes, deregulation, and increased fiscal spending were some of the factors that financial markets liked.

Indeed, as we headed into 2020, President Trump appeared to be unbeatable in the upcoming election. He seemed to have delivered on those promises and had a lot to show for it in his bid for reelection, with strong economic data and an unemployment rate the likes of which we had not seen in 50 years. Then the coronavirus hit and had a negative impact on President Trump's ratings in the polls. Even though the incumbent does historically have an advantage, it still looks like it's going to be a very tight race and, quite frankly, we don't know what to make of the odds.

Biden has announced a plan to "Buy American" with government purchases of US goods in the magnitude of US$ 400 billion, as well as research and development spending on US technology of US$ 300 billion, with a focus on such things as 5G and electric cars. It appears that Mr. Biden is countering President Trump's agenda of rebuilding America. However, while both candidates appear to be in favor of national infrastructure spending programs, policy similarities are hard to find elsewhere.

In fact, their platforms appear very different indeed. President Trump has focused his attention on "America-First" policies such as deregulation, energy independence, international trade (re-)negotiations, vocational training, and tax reductions. He clearly appears highly skeptical of any US commitment to multinational treaties and organizations. Biden, by contrast, could be expected to increase spending on international cooperations, as well as on things like climate change or an expansion of a federally funded healthcare system. It is also quite certain that he would raise taxes on corporations and high-income earners.

This is of course just a cursory and high-level policy comparison. It does highlight though that President Trump's policies are more conservative and nationalistic, while those of Joe Biden are more liberal, if not socialistic. While Biden himself is not a radical, his agenda has been strongly influenced by his party's move towards the extreme Left and his presidency is very likely to be tainted by these dangerous ideas too.

This policy divergence and its economic, geo-political and societal implications, in America and globally, should be factored into your investment and wealth protection strategy.

A FEW WORDS ON ASSET ALLOCATION

Generally, when discussing wealth management, the immediate focus turns to investing and asset allocation. In this report, we have focused on structure and planning

first, because the exact investment strategy and asset allocation we recommend today may well differ tomorrow, while it will also heavily depend on the precise circumstances, needs and goals of each investor. Nevertheless, we still want to give you a brief overview of the appropriate investment approach and some allocation factors worth considering in the future.

Our outlook, economically and politically, has been admittedly somewhat dire so far, but this does not mean that investors should despair. On the contrary, investing has been highly profitable over the past few years and even the losses suffered in the recent stark correction have already been erased by a truly perfect V-shaped financial recovery.

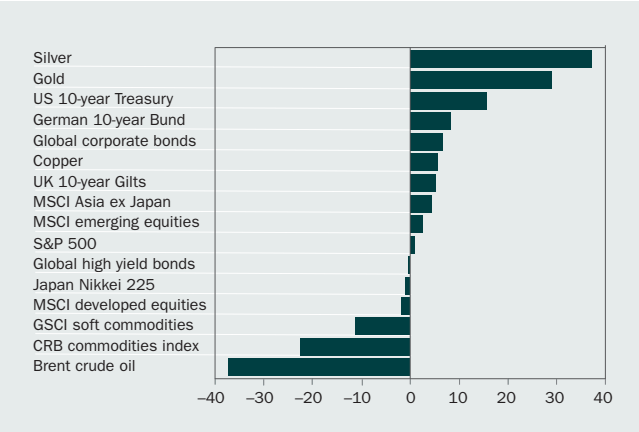
It is quite telling though that the asset classes that have outperformed all others this year so far, by a considerable margin, are precious metals and US Treasuries. Safe havens have been in high demand and for good reason.

The dilemma of investing in a "titanic" scenario…

Still, stock markets are in a strong rally and may possibly overtake the leading asset classes soon. It is also of interest that German Bunds have done quite well, mostly due to the fact the Euro has appreciated considerably relative to other currencies. Based on economic fundamentals and the geopolitical outlook, valuations of equities and corporate bonds appear too high and therefore unappealing. However, riskier assets continue to be attractive, based on the anticipated fiscal and monetary policies and the lack of alternatives.

This of course creates a real dilemma for investors, individual and professional, who recognize the disconnection of fundamental economics and financial markets. We at BFI continue to keep an eye on this mismatch, well aware of the downside risks. And yet, we are fully invested. As a countermeasure, we are actively protecting our client's equity exposure on the downside with put options. Our approach has worked very well, but it does require active management and continuous attention. We certainly don't recommend it as a "do-it-yourself" solution.

Figure 18: 2020 Year-to-Date Returns (% by Asset Class)



Source: ECR Research, Refinitiv Data

With equity markets having rebounded so strongly, it may now be tempting to take profits. We have certainly been doing this at the individual stock level in instances where valuations have become stretched. However, at the broader asset class level, history tells us that becoming contrarian too early can be a costly mistake. Whilst bears can point to rising valuations (on depressed earnings) in some parts of the market, asset bubbles can persist much longer than a prudent investor can imagine and for the most part, these bubbles have historically burst only once policy was tightened and bond yields rose. This was true in Japan in the early 1990s and in the Dot-Com bubble of the early 2000s.

The current backdrop is very different, as bond yields languish at all time-lows, with relentless downward pressure from quantitative easing, which will not end until 2021 at the earliest. At the same time, economies are gradually being opened up. We believe this will continue, even in the face of rising COVID-19 cases in many countries, as governments seem to have accepted that national lockdowns are simply too costly, particularly as the death rate from the disease is falling rapidly due to incremental improvements in treatment. For example, in Wuhan, the Infection Fatality Rate has fallen from 17% in the initial phase to nearly 1% in the latter stage. In other major economies such as India, where death rates are low and a significant proportion of the population are daily wage earners, there is arguably a greater risk from the lockdown than from COVID-19 itself.

Our investment approach for the foreseeable future

Given the increasingly low and even negative interest rate environment around the world and the huge fiscal stimulus coming through, we expect continued support for global equities. For the time being, we believe the old investment adage of "don't fight the Fed" will hold true, particularly as all the other major central banks are also providing ample liquidity support. Volatility around COVID-19 cases, vaccine progress and geopolitics will continue, but the trend should remain a positive one for equities **…UNTIL SOMETHING CHANGES**.

From our standpoint, no matter what the situation is in financial markets, we will continue to follow our investment process and methodology, continuously adjusting

"… I add and must emphasize again: diversify your political risk. I truly believe that increasingly desperate states will be the greatest risk to your wealth, going forward. The swelling masses of have-nots are going to turn their increasingly hungry eyes on the haves, and the politicians are going to pander to them – and these days, if you have any net worth at all, you're a have. When the food riots start in New York, LA, London, Paris, etc., I want to be good and far away."

Doug Casey

our strategic allocation to big picture realities, and continuously fine-tuning and improving our selection of securities through a very systematic, bottom-up filtering and selection procedure. We then overlay this methodology with tactical adjustments and downside protection.

In summary, while investing is never simple and the unprecedented global crisis we currently face is further complicating its challenges, we also think the appropriate approach to investing for our US-dollar-based clients is actually quite clear-cut and will, for the foreseeable future, look something like this:

- **Equity:** We will continue to overweight stocks, filtering and selecting those companies that are financially sound, strong enough to weather the storm we expect ahead, and active in the sectors that we find most promising, e.g. technology and health care.

- **Fixed Income:** We have reduced our exposure to bonds drastically. Our fixed income exposure is primarily to Treasuries, for liquidity purposes, and corporate bonds with the highest ratings. In consideration of the current low interest rate levels, bonds should not be seen as the safe asset class they used to be, no matter what your pension and insurance advisor tell you.

- **Alternatives:** In lieu of our bond allocations, we have increased our exposure to low volatility, moderate return investment strategies with a low correlation to general financial markets. We see this as a means of dampening possible corrections.

- **Real Assets and Commodities:** We do allocate assets to solid, income-producing real estate, mostly in the form of REITs. Moreover, we are starting to keep an eye on commodities like base metals and energy as the market progresses. We expect that, at some point, commodities, which have been beaten down for close to a decade now, will become very interesting.

- **Precious Metals:** Gold, and to some degree silver, is an asset class of its own at this point. It will remain our buy-and-hold hedge against the excesses of central banks and governments. Importantly, we make sure we are invested in physically allocated holding for most purposes. We are highly skeptical of investments in ETFs like the GLD.

- **Downside Protection:** Next to gold, our tactical investing in downside protection, options, and futures, serves the purpose of first, protecting against stark market corrections, and secondly, allowing us to stay invested in the stock markets, as discussed above.

OFFSHORE WEALTH PROTECTION

Before thinking of investing, however, we strongly recommend you consider structural asset protection measures. Over the history of our company, we have worked with a large number of attorneys and planners in the US. At this point, we have access to a unique network of experts and firms that understand both the options and strategies available onshore as well as offshore.

Very often, wealth strategies that involve an element of multi-jurisdictional diversification, in other words, keeping part of your assets outside US borders, can provide a considerably increased level of asset protection and safety. Depending on your circumstances and objectives, the options available will differ. However, contrary to the general belief, reaping the benefits of jurisdictional diversification does not need to be complex or expensive.

Simple options

The simple options mentioned here are a shortlist of first-step measures for building a personal "nest-egg" outside of your home country. These measures are available to most investors, even those that are not in the high net worth category.

- **Foreign bank account.** A foreign bank account is the simplest and most basic of all steps toward internationalization, but it does deliver an added level of flexibility and protection that is quite important. For instance, a foreign bank account enables you to retain the capability to wire funds and transact internationally, even in the case of capital controls or asset seizures in

your home country. Moreover, US banks have become highly suspicious of any international transactions, reporting and at times freezing accounts on the basis of very little.

- **Physical gold ownership and storage.** A variety of international precious metals programs are available, some online, some not. Some offer allocated and segregated storage, some offer only the collective storage version. Depending on what you are looking for, there are very good and reliable programs available, that can afford you protection from a possible confiscation or capital controls. Some international programs also allow you to transfer your existing holdings in kind and keep them more safely in high security vaults overseas.

- **Foreign company.** Some jurisdictions, such as St.Kitts & Nevis, or the Cook Islands, allow for the rapid and cost-effective set up and maintenance of an LLC or IBC (international business corporation) that will give you the possibility of holding bank accounts and investing in the name of the legal entity. The rules and regulations of some jurisdictions, even for the simplest corporate structures, can add a valuable, albeit not bullet-proof, asset protection shield.

More sophisticated options

The following list is again only a brief summary of common planning tools that may be used individually or in combination, depending on the situation. Importantly, none of them are overly complicated, can all be done legally and in compliance with all the rules and regulations.

- **Private banking.** The more reputable and top-tier private banking institutions in jurisdictions like Switzerland or Singapore come with a service offering that is second to none. The minimums tend to be higher and a "red carpet introduction" may be required for US persons, since most international banks are cautious about working with American taxpayers, due to their recent experiences dealing with the US DOJ. However, these private banks offer a wide variety of international banking services that can be very interesting.

- **Privately managed account.** In combination with an investment manager that, based on US regulations, must be properly registered with the US SEC, the custody and brokerage services of private banks give you access to a truly internationally diversified investment portfolio, one that is generally difficult to find in the US. The minimum for high quality services generally starts at US$ 1 million.

- **Foreign private placement life insurance.** Private placement life insurance (PPLI) or private placement deferred variable annuities (PPVA), which refer to international insurance policies that integrate a managed account tailored to your personal preferences, is one of the most effective international income tax planning tools available to US persons today. Properly structured and maintained, they can afford solid tax-deferred or even tax-free investing overseas. Depending on the insurance jurisdiction chosen, a high level of asset protection and privacy are achieved as well.

- **Foreign trusts and foundations.** A variety of jurisdictions provide legal frameworks that allow for considerable investments, flexible inheritance, and solid asset protection benefits through the formation of trusts and foundations. Depending on how these entities are structured and established, the use cases can vary widely and, again, can be combined flexibly with the other planning tools mentioned here.

- **Second passport.** For Americans, second passports might be considered a form of mobility insurance. Most Americans don't even have a US passport, let alone a second foreign one. Wealthy Americans, however, have been obtaining second citizenships and residencies in growing numbers. The purpose is mostly to retain the capacity to travel internationally, when and where US passports are either restricted or unwelcome.

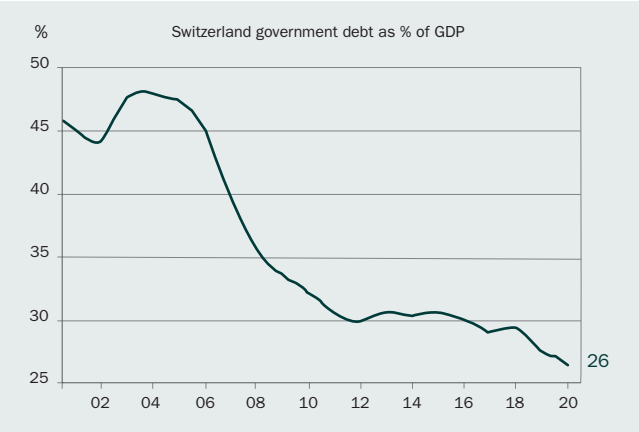
Moreover, some Americans also acquire a second passport as a first step toward renouncing their US citizenship. That, as is well known, is the only way of ending a US person's status as a taxpayer, even if he or she lives and works outside of America.

Key considerations

The above list of international planning options is a quick and dirty summary, we admit. And, quite frankly, we strongly recommend you work with a trustworthy and knowledgeable professional if you decide to explore and use any of these tools, even the "simple" ones. The rules continuously evolve and doing this yourself may result in costly mistakes and entirely avoidable headaches.

At BFI, we have been advising our clients on these matters for many years. In many cases, unless a client comes to us with an advisor that is knowledgeable in international planning, we can also involve qualified third parties as needed. Amongst the biggest benefits we can offer our American clients today are the expertise we have built and network of experts we have access to.

Figure 19: The Fiscal and Economic Health of Switzerland Makes It the First Choice for Custody of Assets



Source: ECR Research, Refinitiv Data

A few objectives and key considerations should stand out as you embark on your international planning journey:

- **Safety.** This may sound obvious, but it is the most important aspect our clients seek, and it comes in various forms and dimensions. As you set up your plan, look for the best possible combination of jurisdictional, institutional, and procedural safety. For example, the best international trust and asset protection jurisdictions today might be St. Kitts and Nevis and the Cook Islands. The best jurisdiction for asset custody and private banking is Switzerland due to its track record on property rights and its financial and economic health.

- **Longevity.** Your planning strategy should ideally achieve your objectives and protect your interests over the long-term. A plan that needs to be adjusted continuously is costly and impractical. While your investment strategy itself can, and should, be adjusted as the financial markets change, the structure of your plan should be stable and generally built to last for many years, possibly generations.

- **Inheritance.** Flexibly and efficiently passing on your wealth is a key objective. You must have a plan in place for your wealth to be transferred to your loved ones in case something happens to you. If all you have is a bank account, be sure to at least include it in your will. Moreover, if possible, consider avoiding probate via proper planning.

- **Investment flexibility and access.** If your investment strategy is limited to US dollars and US-based investments, not only are you missing out on a lot of great opportunities, but you are also increasing your risk exposure to US-centric issues and economic challenges. Your plan should grant you access to global investment opportunities and it should allow you to flexibly adjust your allocation and strategy. In this context, the best approach is to work with an international registered investment advisor who specializes in global investing and American clients.

- **Convenience.** Digitalization and modern telecommunications should make your experience frictionless, whether you hold your assets in an account in New York, Miami or in Zurich. At BFI, we offer a client portal that allows you to review your investment portfolio 24/7, we have privacy-protected and secure communications in place, while we are also used to working with modern-day conferencing tools such as Zoom or Skype for Business.

- **Tax efficiency.** The tax and reporting rules overseas will be similar to those onshore. Simply "going offshore" will not change anything about the taxation of your wealth overseas. To properly plan for income tax and estate efficiency, you need to follow the US tax rules. Obviously, the power of tax-free compounding of your investments or minimizing the tax burden on your inheritance is important and should be considered in advance, as it may be difficult to achieve later.

- **Compliance.** Whatever you do, onshore or offshore, you want to do your best to follow the (admittedly complex and convoluted) tax and reporting rules of the US. Even though you are "going offshore" that does not imply that you can leave US regulations behind. That assumption is wrong and could be very costly. As you establish your offshore nest-egg and investment strategy, you need to make sure that you stay within the rules and the reporting requirements of both foreign regulations and US regulations.

CONCLUSIONS

We hope this report provided some sound navigational advice for the uncharted waters that lie ahead and alerted you to the main risks and threats that should be factored into your planning process.

In summary, wealthy individuals and families will have to consider the threat of higher taxes and financial repression. Savers of all kinds should consider the growing probability and impact of inflation further down the road. While the current outlook – for the next few months at least – looks rather deflationary, inflation protection should not be neglected.

We should also recognize the possibility of a further increase in centralized power, bureaucracy, regulations, protectionism, and all kinds of state intervention. At this point, it does appear that our Western societies have been all too happy to accept and even demand more of all of the above, and to trade key elements of their freedom and self-responsibility for the illusion of a risk-free life.

Most of all, we hope we illustrated clearly enough that this is not the time for procrastination. And it is certainly not the time to "wait and see", to naively hope for the best, and to fall for political promises and mainstream narratives that assure us that everything is under control. Throughout history, it has been the power of independent thought and the courage of independent action that has borne progress, both individually and collectively.

"I have been impressed with the urgency of doing. Knowing is not enough; we must apply. Being willing is not enough; we must do."

Leonardo Da Vinci

In a world permeated by mass media and misinformation, this kind of independence and clarity of thought has become more difficult to attain. In order to keep up with what is going on in the world, you have to read and digest a lot of "stuff". Most of it will be nonsense, ranging from half-truths riddled with contradictions, to pure propaganda. It takes a lot of time and effort to decipher what the news story actually is, if there even is one behind the sensationalist headlines, and how it affects you. The passive news consumption of the old days, that relaxing experience of being informed about what's new in the world from the comfort of our couch, is long gone. It's been replaced by an intense, frustrating and exhausting hunt for the truth, with 32 tabs open in our browsers, all with a different version of the same story. It can be an infuriating and lonely pursuit, but unless we are disciplined and determined enough to read between the lines, to do our own fact checking and to come to independent conclusions, we will be marching to the tune of another's agenda.

This ability to distinguish fact from fiction and the courage to go against the grain and to reject mainstream myths is especially important for investors going forward. "Past performance is no guarantee of future results" in investments, but when it comes to human nature and politics, it's as close as it gets to a crystal ball. Politicians and central bankers have a long and consistent track record of making bad situations worse, of prioritizing blame-dodging over actual solutions, and of using fear and confusion to tighten their grip on power. In this sense, there's no reason to think this crisis will be wasted either.

At BFI, we've seen a lot of cycles, shifts and crises since we opened our doors in 1991. It might feel like "this time it's different", and of course, there are some particular challenges to navigate, but there's never been a crisis that was identical to the one before it. The lessons we've learned, the expertise we cultivated, and the experience we gathered along the way do provide a reliable blueprint, a strategic approach that's been proven to deliver superior returns, as well as the right tools to protect our client's interests, even in the worst-case scenario.

A lot has changed since 1991, we evolved and we adapted to all kinds of new threats and risks, but through the decades, our mission has remained the same: to help our clients protect and grow what is rightfully theirs.

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