

# Metals and mining commentary

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## Sentry Precious Metals Growth Fund Sentry Mining Opportunities Class

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*"The only mistake in life is the lesson not learned" – Albert Einstein*

As we enter fiscal 2012 (October 1, 2011 to September 30, 2012) for the US government, we can't help but wonder if the US Congressional Budget Office has learned anything from history about credit deflations. Apparently not, as the recent official budget forecast suggests.

### Fun with numbers: Is this budget realistic?

US FISCAL 2012 BUDGET (BUDGET TOTALS IN BILLIONS OF DOLLARS)

	2010	2011	2012	2013	2014	2015	5-YEAR FORECAST
RECEIPTS	\$2,163	\$2,174	\$2,627	\$3,003	\$3,333	\$3,583	65.6%
OUTLAYS	\$3,456	\$3,819	\$3,729	\$3,771	\$3,977	\$4,190	21.2%
DEFICIT	\$1,293	\$1,645	\$1,102	\$768	\$644	\$607	-53.1%
GROSS DOMESTIC PRODUCT (GDP)	\$14,508	\$15,080	\$15,813	\$16,752	\$17,782	\$18,804	29.6%

Source: Congressional Budget Office

Surprisingly, 65% government revenue growth over five years has been achieved once before, but it was underpinned by the double-digit inflation of the late 1970s. Is this forecast simply unwitting in its disregard for past performance? Or is there an irony here in the de facto recognition of the inflation rate needed to solve the problem?

Where did these projections come from? Let's look at some of the underlying assumptions:

- Real GDP to grow 3.1% in the next 12 months and then at 3.4% for 2013 to 2016
- Unemployment to decline to 8.4% in fiscal 2012 and average 6.4% for 2013 to 2016
- The Consumer Price Index (CPI) to grow 1.3% in fiscal 2012 and average 1.9% for 2013 to 2016

The forecast is off to a good start. Fiscal 2011 receipts were \$2,303 billion with outlays of \$3,600 billion for a deficit of \$1,298 billion - \$347 billion ahead of target. We suspect the outlays/deficit would have been higher, except for the five-month cap on debt issuance in fiscal 2011. The 3.8% CPI run rate was the main contributor to the 6.5% increase in receipts last year. Looking at fiscal 2012, just starting, a challenging 14.1% increase in receipts and 3.6% increase in outlays will drop the deficit to the targeted \$1,102 billion.

If the US has slipped into recession, as the generally accurate yield curve is forecasting, a bit of Quantitative Easing 3 (QE3) may be needed

to prevent a deficit uptick. However, if Federal Reserve Chairman Ben Bernanke's super-Keynesian monetary response of expanding the monetary aggregate M2 in excess of 20% per annum proves somewhat successful, recession could be avoided. Then we suggest the reader flip the budget assumptions to CPI>real GDP year after year. No problem... until the yield curve cracks.

Finally, to add perspective to budget accuracy, let's take a look back at the pre-credit contraction world. Fiscal 2007 receipts were \$2,540 billion (10.3% higher than now) and projected receipts for 2011 in the 2008 budget were \$3,104 Billion (34.8% higher than realized).

*"...\$580 billion in cuts in projected Federal spending."  
– US President Barack Obama*

Ah, if only cash-strapped consumers could pay off their maxed-out credit cards by making the tough decision to buy a new Mercedes instead of a new Ferrari! To the US government, a "spending cut" is similar – an actual increase in spending but at a lesser rate than they would like. Note that expenditures are planned to rise by \$734 billion over the 2010 to 2015 timeframe. Obama has proposed \$580 billion in reduced spending increases over the next 10 years. What is that likely to really mean in deficit reduction terms? Zero. What we do know is that government receipts have to rise 21% over five years just to keep up with currently planned spending increases, with no reduction in the deficit.

*“Ancient Rome declined because it had a Senate; now what’s going to happen to us with both a Senate and a House?” – Will Rogers*

Never mind the Senate and the House...how about a “Super-Committee”? A 12-member Congressional committee has been tasked with finding \$1.5 trillion in savings over the coming decade. This amounts to a tiny 1% of GDP annually from a deficit starting point of 8.7% of GDP, based on the \$1.3 trillion 2011 fiscal deficit divided by the \$15 trillion GDP.

Failure to achieve this goal will lead to automatic spending cuts of \$1.2 trillion over a decade commencing in fiscal 2013 – just before the November 2012 election. We don’t know what combination of job stimulus programs, pseudo-spending cuts, tax increases and entitlement changes will emerge from this process (which we will refer to collectively as “fiscal consolidation”), but we do know there will be a cost.

*“Those who argue that dealing with our deficit and promoting growth are somehow alternatives are wrong. You cannot put off the first in order to promote the second.”*  
– British Prime Minister David Cameron\*

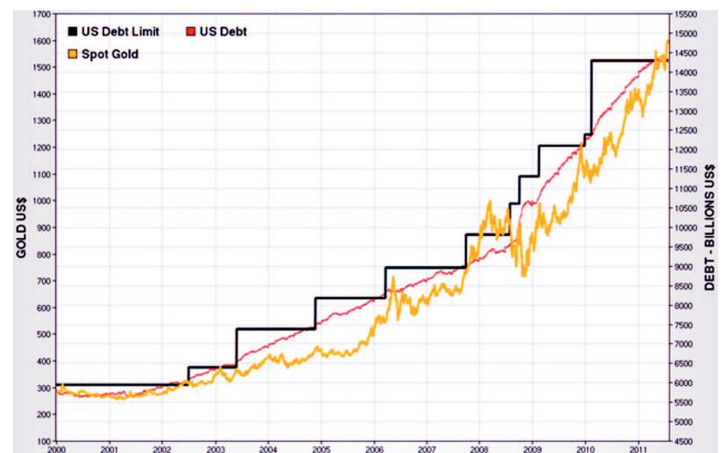
We concur. But fiscal consolidation is a distressingly sticky process when it comes to slicing the cash deficit. The International Monetary Fund (IMF) has studied this data over the past 30 years and concludes that fiscal consolidation lowers income in the short term, and raises unemployment in the long term. Within two years of a 1% fiscal consolidation, unemployment would be expected to rise by 0.5%, with GDP declining up to 0.8%. Check again the underlying assumptions for the budget. Note that tax hikes tend to have a more dampening effect

than spending cuts. So maintaining entitlements by raising taxes is not the best choice.

It will be interesting to review the revised budget numbers in just a few months time. We expect gold will be accurately forecasting the direction of US debt:GDP by reaching new highs. In the meantime, we strongly suggest that investors act on a rare opportunity to add or initiate positions in the deeply depressed gold mining equity sector in an ongoing bull market.

\*Quote and substance of paragraph is drawn from the article *Painful Medicine* by Laurence Ball, Daniel Leigh and Prakash Loungani, from the September 2011 issue of *Finance and Development*.

### US debt and debt limit vs gold



Source: ShareLynx Gold, www.sharelynx.com

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