Interview With Commodity Expert Rick Rule: The Truth Behind the Global Economic Recovery

Description

Since 2009, the **S&P/TSX Composite Index** (^OSPTX) is up over 70%. Corporate profits for index members are nearing record highs. And retail spending and real estate prices are soaring. The biggest debate amongst investors is whether the current stock market boom we've experienced over the last five years real or just a symptom of cheap money from central banks.

Rick Rule, Chairman and Founder of Sprott Asset Management, is skeptical. He's a sought after speaker at resource investment conferences throughout North America and his talks at industry events are typically standing room only. After 35 years in the financial services business, Rick has developed an unrivaled insight into the commodity sector and investing.

Last week Rick and I met to discuss the state of the economy, investing in today's market, and where he sees the best opportunities. Below is the transcript of our conversation; it has been lightly edited for clarity.

Robert Baillieul: One of the themes you have talked about is this idea that the current bull market is a 'liquidity driven recovery'. Can you elaborate on what you mean by that?

Rick Rule: I don't understand the concept of a recovery with a lack of capital goods investment and flat employment numbers. I realize the U.S. unemployment rate as defined by the government is 6.6%. But this leaves out the fact that a record number of people have left the labour market. A recovery without an increase in capital goods spending and employment doesn't feel like a real recovery to me.

What you're seeing in the context of a recovery in equity prices really is a function of excess liquidity in the short-term credit markets and artificially low interest rates. People are being coerced, intentionally or not, away from savings vehicles and long-term bonds. They are taking more risks in their investments to generate dividend yields that are not extraordinary in a historical context but attractive versus other income alternatives available today.

What I really think you're seeing in equity markets and also the bond market is a function, not so much of economic recovery or animal spirits associated with economic recovery, but rather extraordinary short term liquidity and obviously manipulated low interest rates. This is a shift of power, if you will, from savers to spenders and borrowers.

Baillieul: Some commentators have argued that the current instability in emerging markets is the result of Fed's tapering. The second the Fed takes its foot of the monetary gas pedal, we see this whole recovery come apart at the seams. Do you agree with that assessment?

Rule: I do think that's accurate. I don't see it as coming apart at the seams in a historical context. But I certainly see a situation where as tapering is reduced and interest rates rise, then the attractiveness of the carry trade (borrowing money in U.S. dollars and lending it in allegedly riskier foreign and peripheral currencies) will began to fade. As that carry trade fades the hot money that has driven big deficit currencies, Turkey would be an example, will pull out of those economies and those markets suffer.

Baillieul: Last week Federal Reserve Chair Janet Yellen testified to Congress on the state of the U.S. economy. What did you think of Janet Yellen's testimony? I don't expect a positive answer, but is Ms. Yellen the defender of a strong dollar?

Rule: I don't think so. I'm not unattracted to Ms. Yellen personally. I think she is a thoughtful person. Relative to the type of people that they might chose from, she's probably a good choice.

My problem is the nature of the club from whom they chose Fed chairs. As far as I know, she has never had a job in the private sector. She has never produced a good. She has produced academic studies but she has never had to make payroll. And it seems to me that she is a continuation of that sort of academic mold.

It actually reminds me of a recent article I read in *Foreign Affairs* magazine by Alan Greenspan, who free market adherents would have at one point in time considered him one of their own. They asked Mr. Greenspan how he missed the housing bubble and the liquidity events that occurred in 2008.

What he said was very illuminating. He said that the insynchronous events that we experienced in the market didn't fit any recognized models. In other words the people who ran the Fed became so models-obsessed that they forgot to look out the window and see the market.

My fear is that Yellen, as a consequence of the fact that she has lived her life doing academic economic models, forgets about this wonderful model that exists everyday called the market. The disconnect between the market and the model is something that is very, very frightening to me. So while I think that Ms. Yellen is probably a very bright and competent academic economist, the fact that she doesn't take her leadership from the market is scary to me.

Coming up next…
The past year has been rough for resource investors. Many commodity markets – including corn, wheat, potash, gold, silver, and copper – are trading at or near 52- week lows. In part two of my conversation with Rick, we discuss why he's still bullish on commodities.

CATEGORY

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