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Metamorphosis

Once on a flight from Chicago to San Francisco, I (miraculously) was upgraded to business class and was seated next to a very tall man who was on the phone from the time we entered the plane to take-off. Overhearing the conversation, I picked up some "puts" and "calls" recommendations, which obviously piqued my interest. When we were in the air, I asked him if he was an options trader. He said he used options only to protect his portfolio, which he managed for a large East Coast firm.

As we spoke, he said he had gone to the University of Illinois, where he had played football. It turned out he was the quarterback and a stand out until sustaining a debilitating injury. He said during those dark days when he was reevaluating his life goals, he had a real gut check. He eventually went on to become a doctor and then an asset manager, where he focused on health/medical stock funds.

Although Illinois friends were excited I met one of their former football stars, I was most impressed with his ability to reinvent himself successfully. Moving from athlete to doctor to asset manager is quite a curvy path, but he seemed to do it easily.

I remembered this when reading our cover interview with Ben Davies (see **"Ben Davies: Turning adversity into gold," by Associate Editor Michael McFarlin, page 14**). Davies had been on deck to go to the Atlanta summer Olympics to play field hockey when he was sidetracked with a back injury, which basically ended that "career." However, a chance meeting led to a stint at Man Financial, which was at that time a private commodity group. Eventually he came to work for one of the top primary dealers, Greenwich Capital, where he really cut his teeth both in trading and devising his worldview of free markets and the importance of hard assets.

Today Davies manages a multimillion dollar long-only gold fund for his firm, Hinde Capital. Granted, it's been a tough year for gold, and yes, for Davies' fund, but he says his fund has done better than gold. He also reminded us that the gold fund is only one part of a client's overall portfolio.

Change is inevitable and often not easy. Moving from an old to new media platform has been long, tedious and sometimes exhilarating for us at *Futures*. However, seeing how the above traders/managers used their competitive skills and smarts to change is a testimony to being agile and opportunistic in markets and in careers.

One of the sea changes for the futures industry was its move off the floor into electronic trading. It was long in coming and then seemed to happen overnight. In early September, FuturesMag.com will host the web premier of the movie **"Floored."** Originally released in theaters in late 2009, the director's cut will be available for the first time on the Internet, and, for now, only at FuturesMag.com.

The documentary shows how the waning days of the floor affected many traders; some of them had made their money and left, while others planned to be the last man standing. It's poignant, troubling and funny, but captures the trading industry and some of its players well and, of course, solidifies the incredible legend of the trading floor.

Director James Allen Smith, like many successful traders, also learned to adapt to his environment. He started off as a painter but became a web designer, which landed him a job with a former trader who ran an upstairs business. Smith then became a filmmaker, something that never was in his original game plan, when he saw how life on the floor was changing and how many traders weren't adapting.

No doubt the skills of the floor are different than the skills needed upstairs. But perhaps only the best traders are able to adapt to adversity, both in life and in trading. That shouldn't be surprising as volatility is the lifeblood of this business.



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Q & A

BEN DAVIES: Turning adversity into gold

INTERVIEWED BY **MICHAEL MCFARLIN**
PHOTOGRAPHY BY **JORDAN HOLLENDER**



It was a chance encounter after a back injury that turned Ben Davies' attention from sports to the markets, but the same competitive spirit still drives him in advocating for monetary reforms. Cutting his trading teeth at Greenwich Capital, he saw firsthand the events and conditions that led to the 2008 financial crisis.

Now having started his own firm, Hinde Capital, Davies is a champion for free markets and allowing them to [function] independent of central bank intervention, all while operating a long-bias gold fund to protect investor purchasing power. We caught up with him to get his view on the gold market and the role of central banks.

FUTURES MAGAZINE: Ben, you went to school to be an athlete and came very close to competing in the Olympics. Can you tell us how you went from athlete to trader?

BEN DAVIES: I was born in Cambridge and went to first school in Cambridge. That was a very academic school. I think it is fair to say that I enjoyed the academic rigor but my real passions [were] sports and psychology. I came to appreciate academia years later because of trading as I wanted to learn for learning's sake, not because of the enforced nature of exams.

So, I made the decision when I was 18 that I wanted to follow my true passion, which at the time was sports science. I focused on exercise physiology, sports psychology and biomechanics. I became a sports science and finance student at Loughborough University, which is very well known for its sporting programs. Early on, it was really psychology and sports that attracted me to competition and developing winning strategies that comes with that, which is very pertinent to trading today.

At that time I was a field hockey player, and being a sports psychologist and going to college there, I was able to devote a lot of my time playing for Loughborough, Wales and Great Britain. As you said, I was on the Atlanta Olympics squad, but I had to pull out because of a serious back injury early on. I will say that my passion had probably since passed, and if you are going to do anything well, then you need to be authentic and have integrity, otherwise you're not going to give your best for it. It made me rethink my career, and I made that move from athlete to trader.

It was a chance discussion that lead me to a few days' work at Man Financial, which at the time was a private commodity group, and I've been bitten by the bug ever since. I think it was a manifestation of 'Could I do it? How would I have coped with some of the famous crashes?' I wasn't trading in 1987, but how would I have adapted to it? That led me to make that shift. It was part forced, but part that desire to pit myself against the market.

FM: Where did you get your break into trading?

BD: It's interesting having come from the back-



Competition always has been a way of life for Ben Davies, only his opponents have changed. Now he's facing his biggest foe: Central banks and their fight for survival.



ground I had as an athlete just how many people wanted to hire me more for my sporting prowess than perhaps my academic capabilities. Ultimately it was Greenwich Capital. That was my breakthrough into trading markets at the macro fixed-income level. I also was very fortunate to meet my now work partner, Mark Mahaffey, who co-founded the London office of Greenwich Capital. For people who don't know, Greenwich Capital was the No. 1 primary dealer in U.S. government bonds, agencies and to some extent mortgages. [Mahaffey] was the chap who really instilled in me the inquisitive nature you need to pursue the truth in developing your rigor and understanding of the markets.

FM: What were some of the important trading lessons you learned throughout your time at Greenwich?

BD: I started off as a market maker, and I think that's a great place for any young trader to start because you get an appreciation of risk. Often you're put into positions that are not conducive [to] a positive outcome, the risk/reward isn't necessarily conducive to a successful trade there and then. It was very much about mitigating loss rather than turning it into profit. The time horizons for a market maker are very different from [those of] a macro proprietary sort of longer-term investor where you can determine the timing of your trades, but nonetheless it gave me a huge appreciation for risk-taking.

Trading for me ultimately is about having conviction and flexibility, which in many ways are at odds with each other. If you allow your conviction to boil over too much, it can border on hubris, but if your flexibility is too much that you can't risk at the first sign of trouble, then that's not successful either. A lot of the subjective and discretionary risk-taking that I first learned at Greenwich Capital, and [from] my partner since, has been codified in [the] systems, we use as our parameters to ensure we have very good risk and dynamic money management.

FM: You just mentioned Greenwich's position in the global securities market What did your time at Greenwich teach you about the global economy?

BD: It gave us a very unique, inside track as to what one of the largest players in capital and trade flows was doing, and that was China. In regard to the U.S., being the No. 1 dealer in bonds, agencies and mortgages, I was able to see firsthand this buildup of FX currency reserves, and see how they were impacting and driving down long-end rates. By driving down long-end rates, the U.S. was supporting mortgages and consumer credit, while at the same time creating a dearth view for pension and endowment funds, the symptom of which was financial engineering.

The sub-prime crisis really was a product of Bretton Woods II, which I refer to as a semi-fixed exchange rate where the U.S. is centric . In essence the Asian countries are more or less pegging their currencies to the dollar without the backing of gold to maintain their relative competitive ability to sell things cheaply to the U.S. The defining nature of this whole international monetary system is financing the United States' huge deficits, both fiscal and trade, and has done those at low interest while allowing them to finance the export boom of China. Really, it's helped build up a huge amount of credit in the system. If we had been under a gold conversion or standard, there would have been restraint on that build-up of reserve currency, that would have been the natural equilibrating mechanism of the trade balance, but we haven't had that. So, we've had this egregious proliferation of credit as a consequence.

In many ways, this is what led us to setting up Hinde Gold Fund. It was our macro insight that led us to believe there is going to be an unraveling of the financial system or this credit bubble, and that the re-balancing of this vendor financing relationship ultimately would lead to the collapse of the credit bubble and the recapitalization or monetization by the private sector of gold. That's what we are witnessing.

FM: Was this view pervasive among other traders at Greenwich?

BD: No, definitely not. Don't get me wrong, I do think there was an inordinate [number] of people that understood there was something wrong with the financial system. All asset prices were rising, and they hadn't necessarily put the macro picture together, which I felt that we had. And, certainly we had the conviction to set up a business. We created a unique long-only managed gold fund that was backed primarily by allocated gold held outside the jurisdiction of the banking system, and it garnered a lot of interest at the time. You have to remember that for CNBC and Bloomberg at the time, gold wasn't even a ticker on the TV screen when we started, despite it being in a stealth bull market probably for about five years. Certainly the reaction from others suggested that this was a rather unique and insightful thought process, but I would say there were many who understood that

something was fundamentally wrong.

FM: You've already mentioned that government securities are some of the largest and most-traded assets available; what made you go from trading bonds and securities to the comparatively much smaller gold market?

BD: We perhaps were intellectually correct but commercially naïve. We thought that the boom of the gold market would create sponsorships of very big gold funds, and we wanted to be part of that. But primarily, we wanted to protect investors' assets from what we saw as potential fallout from the financial crisis, either from default risk or policy responses of central banks and governments, which would be to increase the money supply to such a significant extent that they would try and underpin the credit system. That's what we're continuing to see today. That policy prescription probably is the definition of insanity; we'll keep repeating the same state over and over again.

But it wasn't about moving from a big market to a small market. In fact, I would argue that we are in the process of witnessing the great bond bubble, which is at the center of our financial system. You have to think about how fractional reserve banking ultimately is collateralized with sovereign debt. When you undermine the credibility of sovereign debt by getting to a level where the country doesn't have the income to service its debt repayments, then you have to look to the growth of a new monetary system. I certainly think that gold is part of that new mechanism.

FM: Obviously these views led to your forming Hinde Capital. Can you tell us a little about your fund?

BD: We started Hinde Capital in 2007 and we set up a long-only managed fund. It garnered enormous attention both from the media and from investors in our first few years, but ironically the 2008 crisis and forced deleveraging — all the reasons why people should have gone into our fund — suddenly meant that it wasn't available to them because they were putting out fires. It was a very difficult couple of years.

As people came to understand that gold is growing as an asset class, we started getting a lot of interest from pension funds and sovereign wealth funds, and the firm grew in accordance. Despite the recent correction in the gold market, the fund has returned more than 40% [since inception] and we've outperformed our benchmark gold price, perhaps not by as much as we had hoped because we had an allocation to mining. Thankfully 18 months ago we had the foresight to reduce that almost to a zero holding because we saw a cost issue where, let's just say, the banking and mining industries were being disingenuous about what the true costs were. Our biggest macro expression is a belief that the crisis is ongoing, and the distortion in market rates is creating all sorts of opportunities and hence why a lot of our investors asked us to set up a global macro fund, which is what we are in the process of doing.

FM: So your gold fund only trades in the gold markets?

BD: We trade allocated precious metals — gold and silver primarily — and we can choose to have up to 20% in the mining sector as well.

FM: You recently made some astute calls in the silver market, predicting both the market's takeoff and subsequent decline. What's your trading methodology?

BD: It's interesting you should mention those; when you're able to make those sort of accurate calls, it does tend to put you on the map. It was more important for us actually to create a return out of both of those situations, rather than just be a mouthpiece for what was happening. Thankfully we were able to achieve that with a very good risk vs. reward setup.

We center everything around macro analysis, all in conjunction with understanding the market dynamics. It doesn't matter what our macro conclusions are on a potential trajectory of an economy or marketplace, we have to wait for a signal generation of whether to deploy risk in that asset class. As you know, if the marketplace isn't in a dynamic state to facilitate your view, you end up losing a huge amount of capital in terms of time premium, opportunity costs and mental capital associated with that. We always feel we need to know what phase the market is in — is it trend ready, exhausted or in homeostasis?

All of this is assessed within the bigger picture of Breton Woods II, which is a highly imbalanced currency system. It drives imbalances right across the global economy, and it impacts right down to the micro level, like the silver market. Take the vendor financing relationship under Breton Woods II, which financed the U.S. housing boom, and because that arbitrage of interest rates was the same across Europe, it was why we had a housing boom there. So we like to look at and examine supply and demand imbalances both at the macro and micro level. That can be a trade in capital accounts or all the way down to these inconsistencies that we refer to in silver where there seems to be a huge imbalance, and definitely in my mind proves the efficiency of markets under [the efficient market hypothesis] (EMH) is a complete fallacy. It's fair to say that is a disproven theory. We tend as a firm to observe more heterodox economic theories, highly polarizing doctrines that are in development of each other. In many ways it's distasteful and perhaps born out of egotistical posturing, but we can learn a lot [from] other economic theories.

When we go through the macro observations, there are premises that business cycles are propagated by excessive growth in banking credits, vis-à-vis fractional reserve banking. This obviously is being encouraged by central bank interest rates remaining below the natural rate of interest, i.e., this is where individuals would truly lend or borrow based on consumer or temporal preferences. It is this monetary intervention in the market that has created a distorted signal of demand, and has led to the misallocation of capital in various sectors like precious metals. The facts don't support or match consumer preferences. What people see as a rising price and think is rising demand in fact is an inflation dynamic of that business cycle or that industry.

FM: So how do you model this in your trading?

BD: When it comes to modeling, we look at the macro side, as I've alluded to, from the concept that the business cycle is the credit cycle. In terms of the market dynamics, Albert Einstein used to say a theory is more impressive the simpler its premises,



so my mantra is 'keep it simple, stupid' or KISS. So, we distill every complex notion down into its component parts, ask the obvious questions and build a hypothesis from there. For me, markets are like nature — they definitely are a complex system, which exhibits complex organizational behavior and similar dynamics to nature. You end up with ruptures brought about by plate tectonic shifts and earthquakes; it's the same principle when you see volatile cracks appearing in markets before a crash. Yet, systems are very holistic. You have these observations where you can see stresses as the precursors for a rupture or movement in the market.

The way theory is today and the way people model today is based on trying to find order and equilibrium, which is an innate desire within people. One area that we use particularly is fractal analysis and market behavior, i.e., that which has discredited EMH and the random walk concept. All these participants are solving for the wrong question. Trying to understand why we are here — why we're on this planet or why the market is where it is — is an insolvable question. Markets for me are just a function of life. It comprises decision-making by myriad people; it's a combination of interactions and reflects as either rational or irrational in the eye of the beholder. So any crowd maintaining order is extremely difficult.

So, what we do is look to the market to tell us the state, rather than comprehend all the reasons it is in that state. We don't try and assign cause; we ignore our innate desire for order. We tend to look at the market in a more three-dimensional way. For us, markets look the same on every time or scale. Most people look just at price and time; we tend to look at four-dimensional components. We want to look at the phase changes that occur before a change in the state of the market.

FM: Speaking of market states, the bear market in gold that began after the 1980 peak lasted for about 20 years. Where do you see us in the lifespan of the current gold bull market?

BD: We're more interested in what the present state and dynamic of the market is. Certainly the four-dimensional components of the market that led to the down trade showed a scaled invariance to different time scales. The market was exhibiting some stress. Looking at participants in the market, there were some that had been in the market for a long time, and ultimately the market was trending and was ready to make a move in one way or another. In this case, stale longs or whatever the trigger we can debate, but the market had to release lower. I personally believe markets move from fair value, and that isn't a mathematical value based on intrinsic values of cash flow, but is based on supply and demand of participants in the market having satisfied the conditions for exchange until such time as the market becomes out of balance with one or more of those economic agents perceiving that economic value needs to be higher or lower. Then the market will start to trend. Now, when I talk about the market trending here, it was in regard to a short-term trend that was corrective in nature to the primary trend, which is still higher. This is a very healthy correction, and the market on our models has now reached trend exhaustion, it has exhibited all of those signs.

When we talk about the gold market, it's actually two markets — a physical market and a paper market. There is no doubt that there is a fractional reserve banking-esque element to the gold market whereby for every ounce that is traded, many multiples of that are leased out or traded in some OTC construct. That leads to an unfair amount of potential supply at some points on the marketplace that is not reflective necessarily of fundamentals. Right now, we've satisfied the conditions of the short sellers, and if anything the long-term holders in the market are extracting new value. As you can see, the market has started to rebound and probably will find itself at a new trading range in the next six months at around $1,400 to $1,600 [an ounce].

FM: You've already talked about some of the factors that are really affecting gold, but do you see traditional supply and demand factors at play or is gold being moved by larger geopolitical concerns?

BD: Ben Bernanke pays very little lip-service to gold, he almost doesn't mention the word at any point in any of his directives or speeches. It's almost as if [it would] give some acknowledgement to an alternative currency, which let's face it, it potentially is. [Gold] was once money, and it could be again. It could be a way of recollatoralizing the system either through a government gold standard or through the private sector creating some kind of payment system that uses gold as a backing for transactions, and perhaps in some countries, like the East, using it to exchange their U.S. dollar holdings. That definitely is the dynamic in play. China and the rest of the BRICS probably couldn't believe their luck when they were able to purchase gold at these levels for some of the U.S. Treasuries and agencies that they already owned. So, yes, it's part of a bigger dynamic indeed.

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FM: And how have all of these dynamics affected your fund's performance recently?

BD: We've continued to outperform the gold price. Fortunately, because we had the foresight to sell out our mining exposure, which is a leveraged play on the gold price, we have maintained outperformance to the gold price. We certainly had a difficult run. Models are based on human input, and there's always in long-only funds an innate bias when you see value to be over-allocated. The way our system works is that when the market is trend ready, we have to get under-invested. We did that, but not to the allocation that we would have liked.

One dynamic of the gold market that is very difficult to explain to investors is that because of this dichotomy between the paper market and the physical market, it sometimes is hard to read the real cues as to what is going on. Typically, when local London is trading at a premium, it means that there's normally a dearth of metal in the system and that normally leads to a significant price reversal. Now in this case, we saw that come much earlier, and the price of gold probably dropped another 20%. So, there are not any absolute levels that necessarily could have given us a warning of that. You can see that it's perhaps not as simple as other markets. Suffice [it] to say we are the leading gold fund over the last five years, and although I'm pleased with that, we have higher performance aspirations and perhaps have not been good as we had hoped considering the skill sets and modeling we have.

FM: Being a long-only fund in the gold market, do you primarily express your views on the physical markets, or do you use futures to hedge also?

BD: We have a construct where ultimately the bedrock of the fund is 75% physical allocated gold stored in Switzerland outside the traditional banking system, but we have futures and OTC forward hedges that we lift through the futures market to give us exposure to the upside or we sell more futures to get under-invested. We look at all the dynamics within the COT data; you have to as a gold fund manager.

FM: Your fund is down about 20% year-to-date; what are some of the things you could have done differently to improve that performance?

BD: You have to remember that it is a long-only managed fund. We're advocating it within asset allocation. We subscribe to the theory that you have X amount in equity, X amount in real assets, X amount in fixed income and maybe X amount in cash or property. What we're trying to achieve by you allocating to us is to outperform our index, which is what we achieved. So if the market goes down, we will lose a certain percent of the gold price. If it went straight down, we typically would lose 75% of the gold price. But by capturing the waves in the market over the course of a year or two, we start to create outperformance and, until the recent six months, we have outperformed the gold price 8% annualized. That is what we're trying to achieve for our investors.

FM: You mentioned that you store all of your fund's gold outside of the banking system in allocated form. Can you talk a little about why you decided that was necessary?

BD: We felt that the credit bubble and the bursting of it would expose financial institutions to default, which we witnessed, and it's often very difficult to determine what the systemic fallout from that would be. So, it's essential that we mitigate all the risks associated with that default. Also, it's just cleaner to have that gold held outside that default risk. It's that simple. When Man Financial went down, there was all the rehypothecation that occurred in the banking system through repos of bonds, and to some extent we've even seen that in the gold market, which is why the bedrock is almost entirely physical bullion in allocated form. That means it is in our name and no one else has rights to it.

FM: Switching gears a little, you've written a fair amount about what 'money' actually is. Can you talk a little as to what constitutes 'money?'

BD: Money is in the eye of the holder. It was Nelson Mandela who said 'Money won't create excess, but the freedom to make it

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will.' So, my premise for how I look at money is based on my views being a classical, liberal economist. Not to sound too pompous, but that's the order that I bring to my own personal life.

Talking about chaos and order earlier on, I'm definitely an advocate that the pursuit of society [should be] property rights are observed, the rule of democratic law is observed, the role of government is limited and you have institutions that are supportive of freedoms such as speech, religion, thinking and political persuasion. All of those are parts in my mind of a free market enterprise. If money is a statement of the day through centralization, taxation and de jure money, then we have fiat currency and debt creation that ultimately only helps fund political votes. It's not a democratic process; it's not conducive to a free market enterprise. For me, pursuits of democracy, political or social freedoms are totally inseparable from economic freedom, and economic freedom comes from having money that is chosen by the free market.

History has told us over the last 6,000 years that gold and silver were commodities that had intrinsic value. The reason why it works so well is because it isn't corruptible, and you can't print it like you can on the printing press. It is limited in its annual supply to 1.5%-2.5%, which incidentally is what the population growth is each year. So it meets that supply/demand dynamic of population growth, which is helpful, but maybe that will change 50 years down the line as we see a tapering off of demographics. A pure gold standard provides a constraint on governments to fund welfare and largesse and to build up a credit system. It just provides more stable prices. It's not ideal, but at the moment it's probably better than the system that is highly volatile based on credit proliferation that we have right now. You just have to observe that wealth creation from credit is not permanent in any stretch of the imagination. You just have to ask a Spanish householder what the value of his house is — next to zero right now.

FM: So is gold a commodity, a currency or both?



BD: It's not money in legal terms right now, but it has all the [elements] that make it attractive as a means of exchange. Certainly it can be a store of value. The excessive volatility that we've seen of late is more representative of a leveraged futures market, which I don't think is necessary for gold. It gives potential for governmental bullion banks to be coercive of the gold price. You might say, 'Well, why would they want to act in such a fashion?' At the end of the day, gold is the proverbial canary in the coal mine and a rising gold price signifies there is stress or a lack of faith in the currency of a country or certainly in the faith of that government. Any distrust of fiat currency takes away the engine that drives those economies and drives the government machine. I certainly think that in that regard gold fits the remits that you need to be money. It is a commodity-money at this point, but it's not in fact legal tender.

FM: Does the same hold true for silver?

BD: That's a very good question. Gold has a more representative supply/demand dynamic relative to population growth than potentially silver, but let the free market decide. Ultimately, you can have competitive currencies. I don't have to assign all my value to gold being the alternative currency. I'm sure we might have a debate later, but [I'm for] alternative currencies, limiting of fractional reserve banking or free banking itself, anything that allows the free market to express what it thinks holds value. The market is very efficient at doing that. It might be that by a metallic standard, silver at times holds a certain amount of value. It's when you see excessive price movements that you tend to see hoarding, and then that causes deflationary escapades. That is definitely a drawback that if it becomes more speculative in nature rather than a currency, then you have problems. The reason you get hoarding at the moment is because people are fearing the fiat currency system. If we allow a competing system to take place, which government is not interested in doing for the obvious reasons that I just mentioned, then we probably would see less of that hoarding because we would spend it, or spend electronic payments backed by gold or silver.

FM: You've been quite a champion for monetary reform around the globe. Can you explain your platform briefly?

BD: I'm a classical, liberal economist. I believe that credit proliferation due to state manufactured money has allowed us to view most commodities as too speculative. For example, our houses are no longer our homes. [They're] no longer a store of value. Housing globally has started to collateralize the financial system. It misdirects production and savings away from more innovative and productive areas. I find that such misallocations like we've seen into housing ultimately are very disruptive to the social and material wealth of a nation.

That's why I feel rather strongly about

being an advocate for sound finance. It also allows a level playing field in terms of wealth equality. There is no doubt that perhaps the next bubble, the bubble we're exhibiting now based on this credit proliferation, the rich or those closest to government through plutocracy have enriched themselves at the expense of those who have not had access to that. So you end up with a potential bubble for the ruptures in the fabric of society. Social cohesion is going to unravel, and we're already witnessing that. Clearly that instability is more egregious the greater the credit system is. It seems to me that when we had a sound monetary system, namely gold, we had far less wars under a 200-year period, or certainly not as significant an inflationary bias so people could afford to live with less and their disposable income actually bought them more of the amenities they required. But when those are stretched, as we're seeing in the Middle East, and food, shelter and water come at a premium, that leads to a revolt, which is an inevitability.

FM: So what sorts of reforms are you advocating?

BD: First and foremost, [we] need to limit the availability of credit. There needs to be a check on that. Unfortunately the system is built up so much, and policy makers are very fearful that a collapse of the credit bubble would lead to a more permanent retraction of prices and growth. [Conversely], I see a reduction in prices and growth as part and parcel of any correction that leads to healthy growth. For example, fire suppression in California: They realized that allowing a certain amount of controlled bush fires actually regenerated green growth. Ultimately, there was more green growth around, less tinder and fewer bush fires.

It's exactly the same if you suppress the marketplace and suppress money. If you do it in a wholly constrictive manner, then you are just sowing the seeds for a greater calamity, which is what I believe we are in the midst of doing now. We need to dial back the credit in the system. If we are going to have centralized banking and money, then we need appropriate regulatory reform, but that does not mean coercive constriction of capital and forcing these banks to have far too much government debt, which probably isn't worth the paper it is on because they are all so in debt. We need tax reform, and to provide education both vocationally and intellectually to the masses so they understand the purpose of a sound economic system. The list is endless, but that for me is the core; that will drive everything else.

[We need] institutions that foster this, the rule of law and most importantly property rights, which protect individuals when governments are desperate to pay for services and are highly indebted. That is when they are desperate to take capital from the private sector, and they will pursue any means to do it. The financial transaction tax and off-shore tax havens weren't the issues that caused the banking crisis, but nonetheless these are the regulatory outcomes as governments go seeking private savings to pay for their own largess.

FM: What do you see as the role of central banks under your proposed reforms?

BD: My belief is that the free market ultimately will move toward a money born out of a crisis situation. Technology is allowing people to understand the importance of money through the World Wide Web, I call this the 'Internet Reformation.' Payment systems are going mobile and borderless. They are allowing people to almost circumvent the current fiat currency system. With bail-ins and perhaps bail-outs on the horizon in Europe, people are going to look for ways to protect their money as a store of wealth and circumvent the traditional system.

Although I see all those things happening, in a crisis situation, which I still see as highly likely globally, central banks will have to consider and already are considering backing their systems with something stable. The BRICS, and particularly China, have a great affinity to gold, and have the potential to back their systems with gold. In the death throes of a monetary collapse, which I don't rule out, this is when a new system perhaps would occur, and likely would be some kind of commodity standard or gold standard, or a change to the banking system itself, which probably would maintain a central bank but in reality would be gold as the constraint on the system. It would constrain trade flow through the balance of payments process, and it would constrain the ability of banks to create credit by having a certain amount of currency backed by gold — say 40% as it was traditionally.

FM: So then related to the things you've been talking about, lately there has been a lot of talk about currency wars developing. Do you see this as a real possibility?

BD: It's happening, isn't it? What is a currency war? Ultimately, it's where you have 'beggar thy neighbor' tactics to try and improve your export market to steal growth from other countries. The question right now is if it is more coordinated? It's almost like countries are going around one after another — the United States does quantitative easing, followed by the European Union's [Outright Monetary Transactions] and now we've had Japan beginning a huge QE process, which wasn't unexpected because there's no one left in the world to purchase their debt.

I wonder if at some point it will be of more pertinence and value for someone to break away from that coordinated attempt to reflate the banking system. All these central bankers and government officials realize that a coordinated effort is better than a single effort because it spreads risk. It would impact demand too much across the world if one, two or three countries go down.

So, we're seeing a subtle currency war starting to develop, and certainly Japan has upped the ante because it has to. What's really interesting is that there have been 500 interest rate cuts [globally] since the crisis. That really has a huge impact on trade and capital flows. It's only going to lead to more financial repression as people realize that as other nations manage to steal some of their growth, [those nations] have to find capital from somewhere, so they have to conscript capital from the private sector in any shape or form they can. That can lead to capital controls, currency controls; all of those are at risk.

FM: What will the man on the street see as a result of these "subtle" currency wars?

BD: This is where there is huge debate, and it is binary and there won't be a muddle through. I certainly feel that central banks have tried to maintain the balance of credit in the system as it is, and what they do is adjust the money supply and volatil-

ity, but they do so by circumventing the necessary adjustments that you need within the monetary system. You need market failures, but they are not allowing this market failure to take place. They pump up the monetary side, which you think would lead to inflation, but credit matters more than money. It is this overhang of credit, and ostensibly the system hasn't delevered to the extent that people think it has.

There has been a redistribution perhaps in the way debt is organized, maybe from private to public sectors. All of that has gone to underpin nominal GDP. You can argue that there should be an inflationary impact, and perhaps in some ways there has been because without that money supply increase, prices would be a lot lower. Right now, because of the unraveling of imbalances between China and the United States, China is beginning to finally break down from its own credit largess. This imperils the world to a very deflationary outcome and it will be interesting to see how central banks ratchet up.

For me, it is very binary. There is the deflationary outcome of full credit retraction, which would lead to a resetting of the system, or there is a hyper-inflationary phenomenon that might occur in places like Japan where if all the reserves that have been created to buy their bonds end up in the economic system, that will cause prices to rise dramatically. If I was arguing any country might see hyper-inflation, that would be it. It's not an easy dynamic to comprehend, but it's basically pumping up the system with money and the overhang of credit, which if you notice has continued to rise or stayed at the same pace it has and is phenomenal. As a consequence, for every bit of credit that is pumped into the system, the margin utility, or the 'bang for your buck,' is less and less. That's not good for growth; that's not good for taxes, so we won't be able to repay the system. I feel the system has to reset — it's just which way I'm not sure as of yet, but it will manifest itself.

FM: If you see those as the two possible outcomes, how would you suggest people prepare themselves?

BD: If I was to think from a wealth allocation perspective, I would say there is no holding of fixed-income debt at the levels we've seen. Under an inflationary or insipid economy, you are looking at guaranteed real losses. Under a deflationary spiral, or even just the rate of inflation goes up, that will be significantly negative for long-end interest rates. Either way, the bonds sector is just not a sector that will yield compensate you in any way. It's a guaranteed capital loss of a significant amount — we're talking 20%, 30% even 40% depending on the credit spectrum.

Equities have definitely benefited from this portfolio channeling effect. Because of the environment created by central banks, yields have been driven so low that capital is forced to circulate by looking for yields. In equity, it's almost like it is driving up all asset prices so that the return on your investments will by $0 at the wrong price. So, equities in large parts, particularly in the U.S. and emerging markets, have come back. Again, they are very risky, and you have to reduce your holdings.

At these levels, would I be advocating shifting into the precious metals sector? Absolutely. It provides a base here for a default or deflationary fallout, and if you want to earn equity, then it provides a significant diversifier that mitigates that downside risk over a long tenure of 10 years — not necessarily a couple of years because any year can have increased volatility.

FM: It sounds like you really believe you need to have the physical asset to protect your wealth then.

BD: You cannot be participating in paper constructs because you leave yourself open to counterparty risks. However much some of these providers say they are backed by allocated gold, why take the risk? The ultimate cost is so much cheaper to store gold with an allocated provider, and if you have the economies of scale, then it becomes much cheaper than an ETF, which to me is a more speculative vehicle.

FM: With the macro perspective that you've already discussed, how realistic do you see a return to the gold standard at this point?

BD: First off, it is not in the interest of governments to want to do that. Obviously there is a growing groundswell in the United States, but it has not happened, which isn't to say it won't happen. More importantly, the development of technology and the awareness that has been created by the Internet is creating problems for governments around the world in how people perceive the intentions of that government, whether it has their best interests [at heart] or not. I always encourage my step-children that they should hold their politicians accountable. That largely has been forgotten today — they are representatives of ours. They are seen as too powerful and important to talk to, but in reality they are elected officials. We seem to have lost that point of view.

We would have to go to an extreme crisis scenario, which I assign a much higher probability. I'm one of those people that doesn't believe in absolutes. The exponential rate of growth in the monetary system has been so manifest even to energy creation and population that I think the stresses are very manifest. We've had one major shock in 2008, and I don't believe the solution to the problem will be a prescription of more of the same. This system needs to readjust lower, and that could be very volatility. That's typically when the system is questioned, and the propensity for a new alternative currency could come into play. It is incumbent on the free market to make it felt that there is an alternative. I'm a big proponent that we create online, mobile payment systems that potentially are backed by gold. The private sector can start to create that, but obviously that runs into the regulatory and legal nightmare the state will throw at you, but it needs to be addressed through [government] by asking for banking reform.

FM: You alluded to Fed Chairman Ben Bernanke earlier; in his most recent testimony to Congress, he mentioned at one point that 'No one understands gold prices.' Do you?

BD: Yeah, his statement barely mentions gold. He almost was forced into a comment on it, and by being dismissive of it, he's not providing any validity to gold being a potential alternative to what he sees as the best system or mechanism for running a complex monetary system. I don't know him personally, but through degrees of separation I have some insights into his psyche and beliefs, and I believe he is far too dogmatic in his doctrine and he should, as I am, be open to all sorts of ways to prevent the

catastrophes we have witnessed over the last few years. I don't think I can be more fair than that.



FM: You've talked about alternative currencies throughout this interview. Can you talk a little about some of the different ones that have been proposed such as Bitcoin?

BD: Oh Bitcoin. Absolutely fascinating, that is a great example of what we're talking about. I notice it is referred to as a 'virtual currency,' almost as if to invalidate it. I believe in the principle of Bitcoin; it meets many of the requirements of an alternative currency.

Just to say what Bitcoin is, it's a decentralized, censorship-resistance, digital, peer-to-peer currency that was created by someone with the pseudonym Satoshi Nakamoto about four years ago. You can use that currency to buy goods and services over the Internet without having to pay bank fees or government tax. In many ways, it's theoretical roots do come from the Austrian school. The inception of it was the fear of the current fiat monetary system and all the interventions that have taken place by the government. So, it follows up from the belief you should have competitive currencies, and certainly this is a competitive currency, although it's not one with any intrinsic value like gold. But, it's very clever because it has this data-mining principle that creates supply just like gold is produced, but it limits it each year. It has something called a block chain that creates a public record of all the transactions in the system, so it has that ledger that prevents you from spending it twice. In that regard, it absolutely is fantastic.

More importantly, whether or not it becomes a real challenge to the fiat currency system, which I suspect it won't, it is technologically too complicated — unless you are programmer, you don't understand the open source code that is part of its credibility in theory because everyone can look at it. I'm not convinced that the cryptology used to secure it is not perhaps open in some way to the issuer or issuers of the limited number of Bitcoins a year, which could be inflationary. There's no constraint on currency proliferation like you would have if you were backing the system with gold, which is why I still believe gold is the best fit for an alternative currency. It has created good debate, though.

The other issue with it at the moment is Bitcoin is more a speculative instrument. I'm not sure how many people really see it as an alternative currency. Obviously, it doesn't have a store of value yet. Security and integrity of its system, there has been embezzlement, but that's more at the exchange end. There are exchanges where you can convert Bitcoins into fiat currency, and interestingly this is where regulators have really gotten ahold of them. Again, it's not in governments' interests to have potential alternative currencies vying with the official state currency that ultimately people have to pay taxes in. They want people to pay taxes to pay for the welfare system with that.

Ultimately, it's a natural progression that payment systems that historically have been arcane and very slow are now moving to new methods of payment. We're going to have a cashless society. I really think biometric identification is going to come in and remove all this password nonsense that you can never remember. This is a really helpful evolution in both currency usage and the debate about who should determine what currency should be and where the counterparty risk is. At the end of the day, the bearer is the U.S. government at the moment, but why shouldn't it be a free market concept? Why shouldn't we decide what we choose as long as the supply of it is constrained by something that is naturally in constraint of its own supply, i.e., gold? Where I differ is gold could be the bedrock to that electronic payment system. It is fascinating and I'm learning more about it all the time.

FM: Looking specifically at Bitcoin, do you see it has a viable alternative that will have staying power and will still be around in 10 years?

BD: Sometimes you think 'First-mover advantage,' but as an alternative, borderless currency, I plead the Fifth Amendment. I'm not sure how it's going to pan out. I suspect there will be systems that are better maybe in some way will work within the current system. Once that happens, that changes the dynamics of it. I really watch its base. If Bitcoin can convince people this is not just a speculative investment, and it's more about facilitating free trade, then it's a real possibility.

FM: Going back to gold, Jim Sinclair recently was quoted as saying he could see it going as high as $50,000 an ounce. Do you have any projections?

BD: If I'm consistent in what we've been talking about, I certainly can envision outcomes based on macro analysis, but we always wait for a signal generation. I don't believe in absolutes; I believe the Gaussian curve descriptive is not representative of complex systems. Why it would get to $50,000 an ounce is in my mind

because these fiat currencies have completely collapsed. At that point it's not about value anymore but complete distrust of the system, although I would question at what point supply would come on and lead to dishoarding at a level where there would be an arbitrage opportunity whereby you could divest yourself of physical gold assets to buy other assets at lower prices. I don't know if he was saying all prices will be at that level, or whether just gold will be at that level.

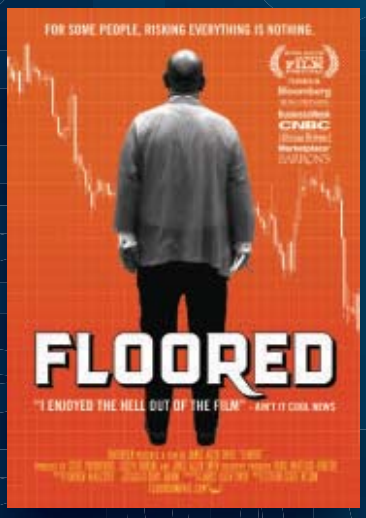
I would say for gold to be at that level, everything else will be much higher in price. With the technological advances in energy, barring a complete collapse of the monetary system, I find that difficult to see. I've been very consistent in saying, all things equal, $6,000 based on the backing of the monetary system as it stands and all the credit. If you look at the $220 trillion market capitalization of all assets, clearly that has been way in excess of the growth of gold. I suspect that credit will rescind and gold value will go up to somewhere in between, which for me is around $5,000-$6,000 an ounce. As a visionary of monetary changes, I'm not sure I can bring myself to envision $50,000 yet.

FM: We've talked about a lot of different topics here. Finally, what are the next steps for you professionally and for your firm, Hinde Capital?

BD: The most exciting development for us is we have received huge recognition; even being in this magazine is fantastic. We're not one of the big boys and to have recognition more and more over the last five years from lots of major publications means that our message is getting across. We have a unique fund; we have a unique message. In terms of staying within the bounds of traditional investment management, we're setting up a global macro fund. The distortions that have been created by central banks and governments at this point will lead to far more ruptures and trends within the marketplace that we will look to exploit because we want to create a capital return, hopefully adjusted for inflation a real return, that protects their purchasing power. That's our aim. It's very exciting that I feel I can complement my promotion of monetary reform while focusing more clearly on my first love — trading and investing. Developing a new fund is very exciting.

From my own personal perspective, I've wanted to create a business that aligns itself heavily with investors. I do think the hedge fund model is likely over for the institutional players. The days of upfront fees after a period of poor performance and not having to return them are over. There's a disproportionate payout, and in conversations with friends who reminded me of my integrity, fund businesses will have less of a short life and can be more about building investor value if they align themselves with long-term investors, private equity firms or family offices that take a stake in thier businesses. They help with the operating capital, because it is very difficult for a mid-size firm to survive beyond five years. The average shelf-life of a hedge fund is very short, probably under four years, and we've been going seven years, which is a testament to our investors and how we structure our funds. It's about being aligned with our investors, changing the fee structure for longer-term performance. That's a much more authentic approach, and is one you either embrace or be forced upon anyway.

Additionally, I'm in the process of putting all these thoughts we discussed today into a more succinct format in a book , which will depict how we got here and where we may be going, and have a proper debate about alternative and virtual currencies and solutions rather than just knocking how we got here. Maybe that's for my own edification, but it is also about the education process, because a lot of people don't understand what's happening with money and why it's so important for our belief systems and generational sustainable wealth. People need to understand sound money.



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