

FIRST PRINCIPLE OF SOUND INVESTING

THERE IS NO SAFE INVESTMENT

Government bonds may not be paid back as promised

Bank deposits may not be paid back as promised

Paper money loses its value through inflation

Real estate values may suffer enormous declines

“There is no such thing as a perfectly safe investment...

A radical change in conditions may render bad even investments commonly considered perfectly safe.”

Ludwig von Mises, *Human Action* (1949)

The notion of safe investments has powerful supporters

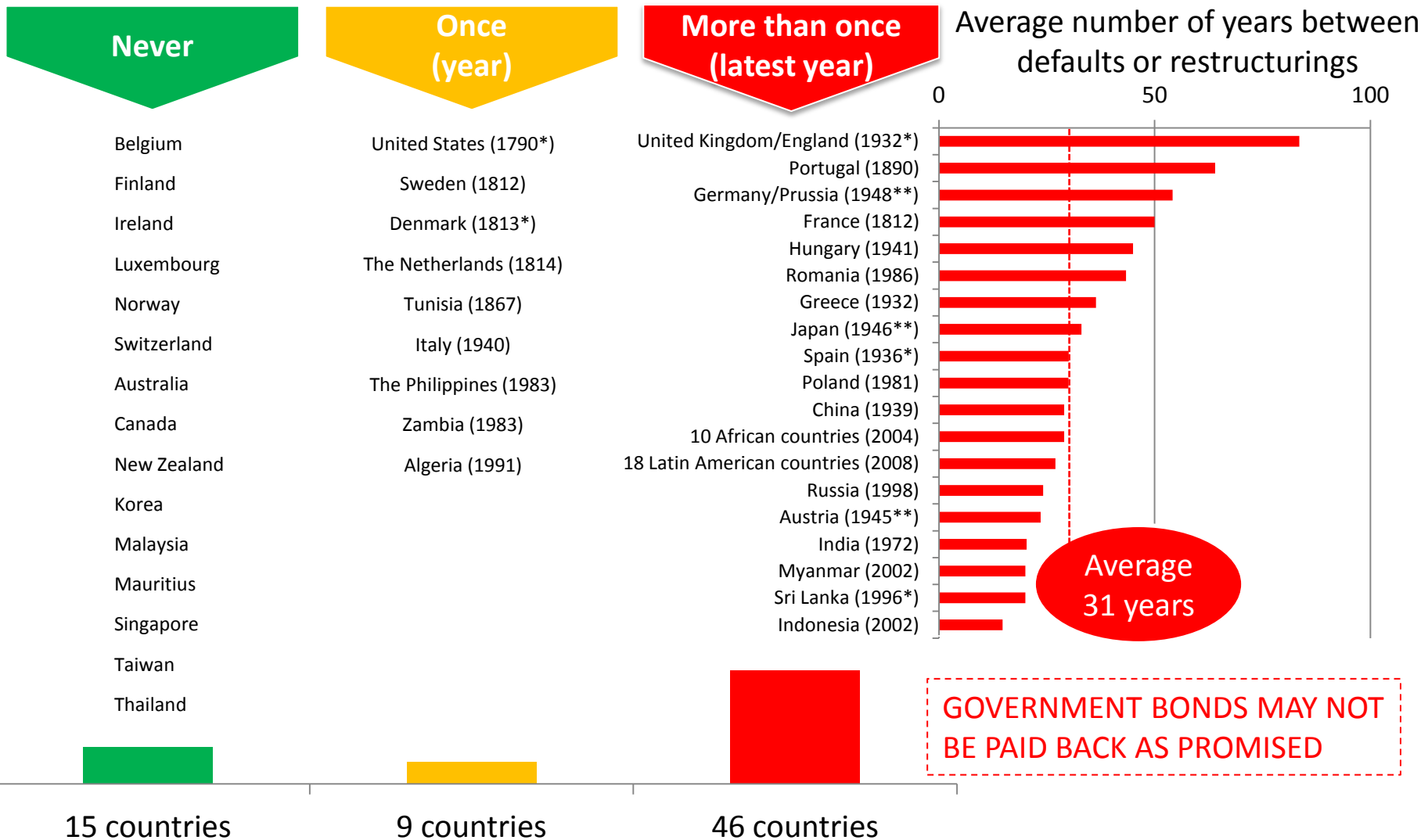
STATEMENTS REAFFIRMING SAFETY OF INVESTMENTS

INVESTMENT	SAFE?
GOVERNMENT BONDS	<ul style="list-style-type: none">• “Though a truly risk-free asset exists only in theory, in practice most professionals and academics use short-dated government bonds.” (<i>wikinest.com</i>)• “Both [current European banking regulation and plans to implement Basel III in the EU] treat government bonds of member states as risk-free, highly liquid assets and exclude them from capital requirements and large exposure regimes.” (<i>DIW Berlin, October 2012</i>)
BANK DEPOSITS	<ul style="list-style-type: none">• “We want to tell savers that their deposits are safe.” (<i>Angela Merkel, Chancellor of Germany, 5.10.2008</i>)• The “Central Bank of Cyprus wishes to stress that any action aimed at reducing, depriving or restricting the property rights of depositors, contradicts ... the Constitution of the Republic of Cyprus and ... the European Convention of Human Rights ... Hence, any suggestion to the contrary is not only legally unfounded but it cannot merit serious consideration.” (<i>Central Bank of Cyprus, 11.2.2013, six weeks before bank deposits were partially confiscated</i>)
CASH	“We can be proud to have a stable and credible currency . There is no crisis of the euro. Instead, what we are currently observing in parts of the euro area is first and foremost a fiscal crisis.” (<i>Jean-Claude Trichet, ECB President 2003-11, 15.5.2011</i>)
REAL ESTATE	<ul style="list-style-type: none">• “We’ve never had a decline in house prices on a national basis. So, what I think what is most likely to happen is that house prices will slow, maybe stabilize.” (<i>Ben Bernanke, FED Chairman 2006-13, in July 2005, one year before house prices started declining by 30%</i>)• “Nobody ever lost from investing in real estate.” (<i>Greek folk wisdom widely believed until 2009</i>)

Most countries have defaulted or restructured their debt at least once

NUMBER OF DEFAULTS OR RESTRUCTURINGS OF PUBLIC DEBT (EXTERNAL AND DOMESTIC)

Until 2008



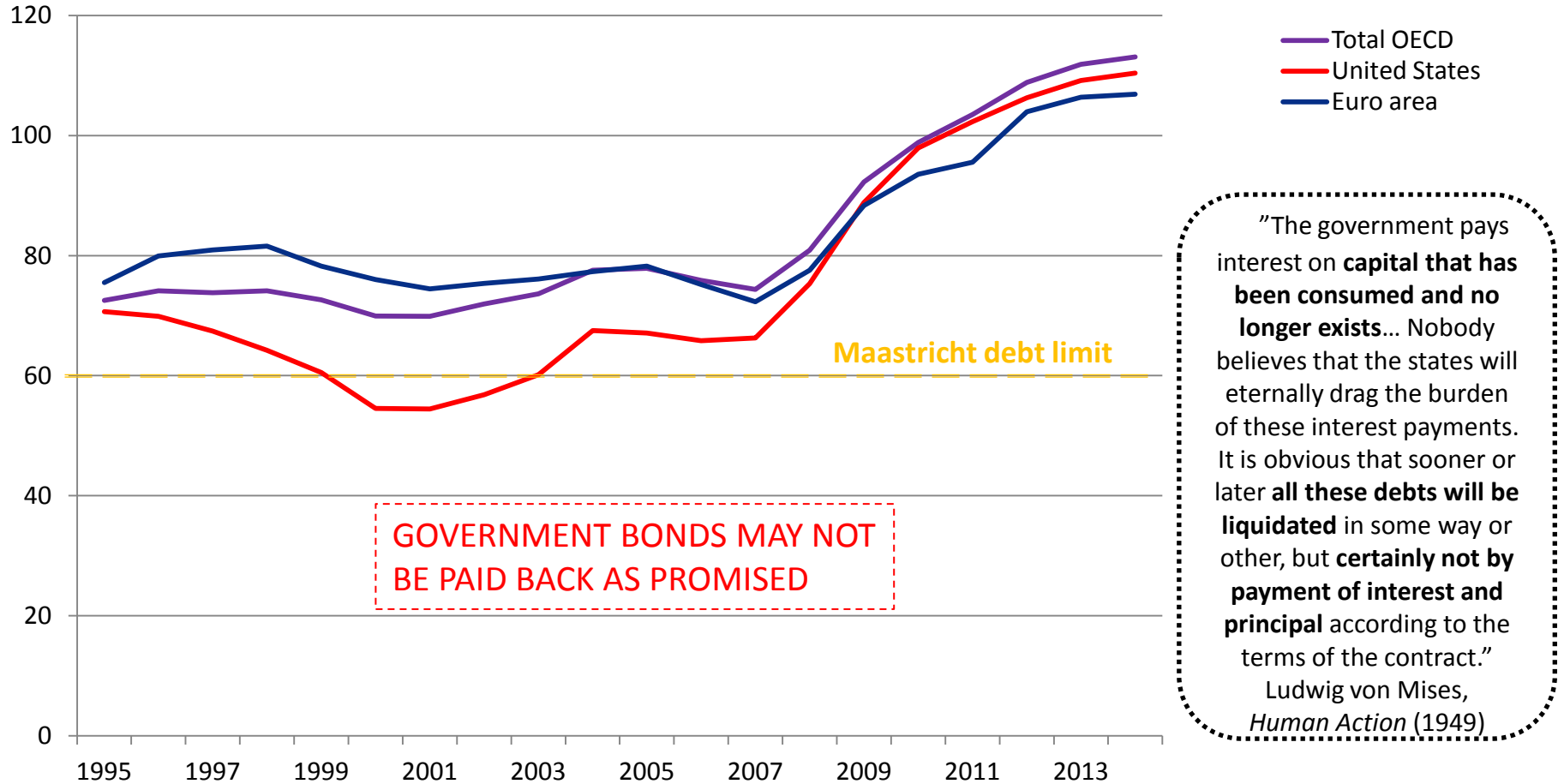
Source: Reinhart/Rogoff (2009, chapters 6,7); own research and calculations

* Domestic debt only ** Currency reform

Strong growth in government debt makes future defaults more likely

OECD GENERAL GOVERNMENT GROSS FINANCIAL LIABILITIES

In % of nominal GDP



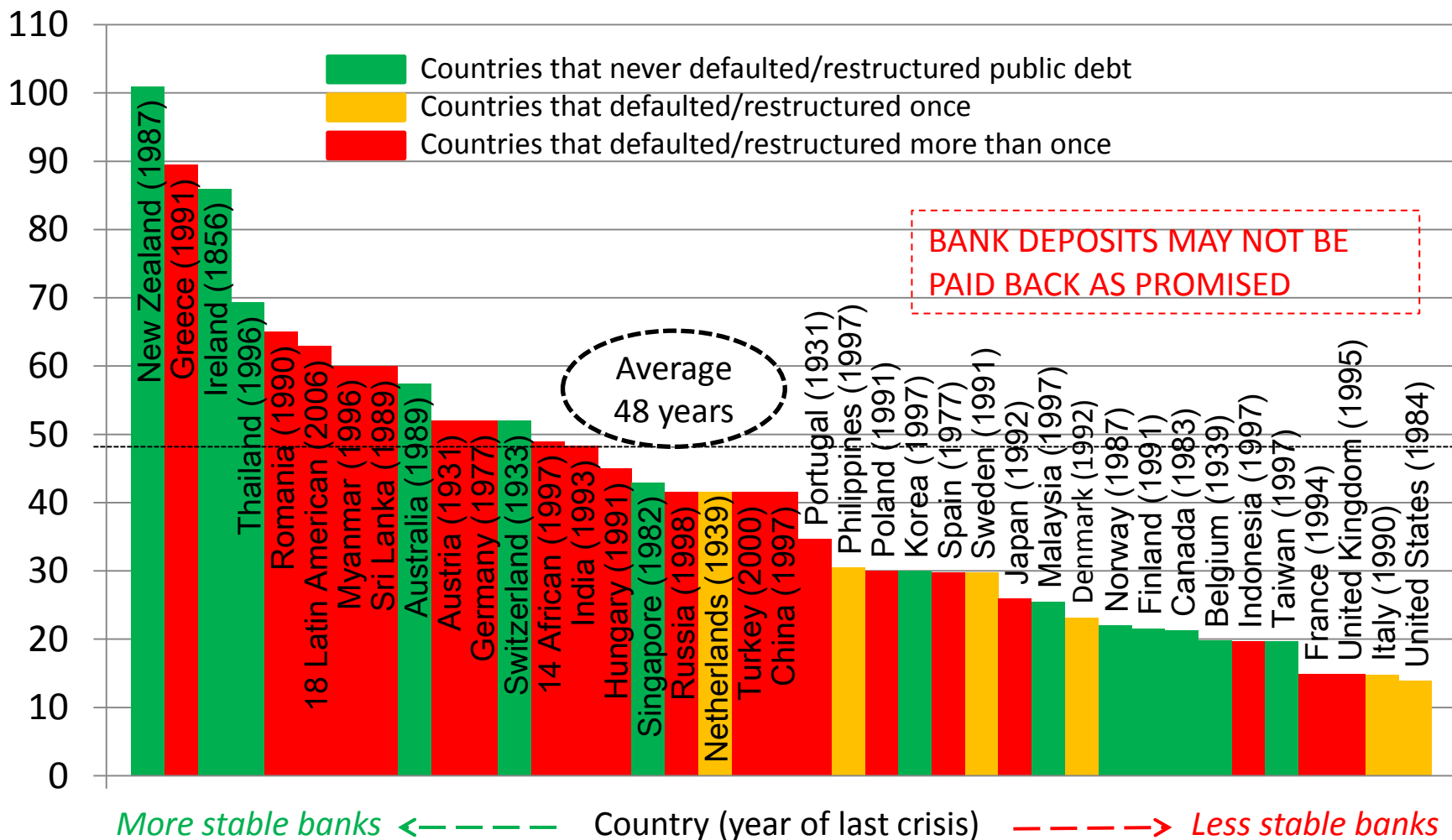
Source: OECD Economic Outlook database

Even the most solvent countries suffer regular banking crises

AVERAGE NUMBER OF YEARS BETWEEN BANKING CRISES*

From 1800 or independence until 2008

SAME SAMPLE AS DEFAULT DATA



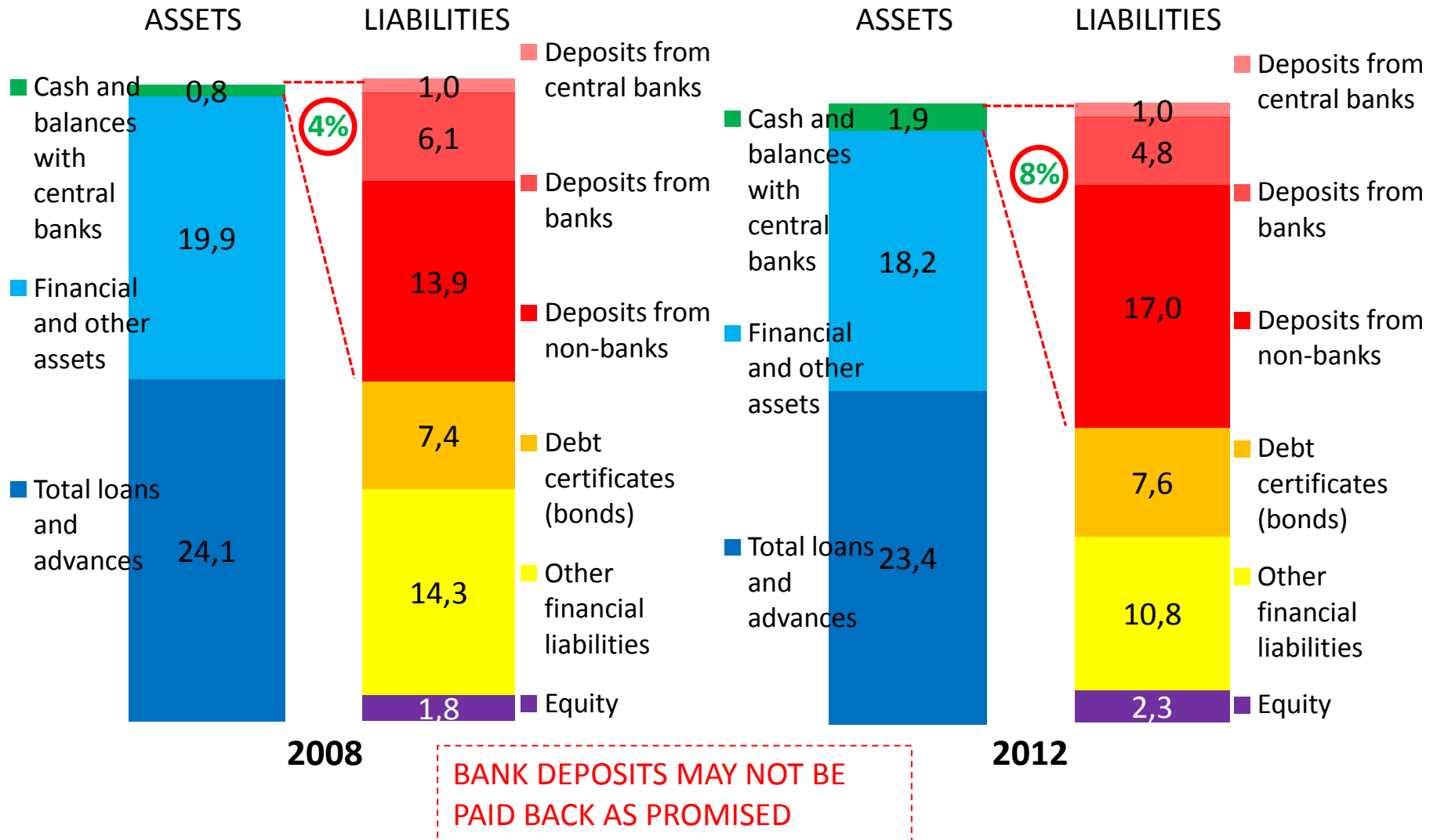
Source: Reinhart/Rogoff (2009, appendix A.3); own calculations

* Involving bank runs or closure, merging, takeover or large-scale government assistance of important financial institutions (RR, p. 10)

Only a small fraction of deposits is covered by cash

CONSOLIDATED BALANCE SHEET EU BANKS

In trn EUR



Source: ECB Consolidated Banking Data 2008-2012

All countries have suffered high inflation in the past

MAXIMUM ANNUAL INFLATION (COUNTRY, YEAR)

HYPERINFLATION

< 10%	10 - 20%	20 - 40%	40 - 80%	80 - 200%	200 - 500%	> 500%
	Panama (1974) New Zealand (1980)	Netherlands (1918) Hong Kong (1949) Malaysia (1950) Singapore (1973) Canada (1917) United States (1864) Switzerland (1918) Côte d'Ivoire (1994) Central African Republic (1971) Taiwan (1973) El Salvador (1986) Sri Lanka (1948) Mauritius (1980) Honduras (1991) United Kingdom (1800) South Africa (1919) Sweden (1918)	Egypt (1941) Guatemala (1990) Kenya (1993) Denmark (1800) Belgium (1812) Dominican Republic (2004) Colombia (1802) India (1943) Australia (1854) Morocco (1947) Myanmar (2002) Algeria (1947) Tunisia (1943) Nigeria (1995) France (1946) Thailand (1919)	Portugal (1808) Iceland (1983) Costa Rica (1982) Ecuador (2000) Venezuela (1996) Spain (1808) Uruguay (1990) Turkey (1942) Ghana (1983) Mexico (1987) Paraguay (1952) Philippines (1943) Norway (1812) Zambia (1993)	Korea (1951) Finland (1918) Chile (1973) Italy (1944)	Japan (1945) Indonesia (1966) China (1947) Austria (1922) Brazil (1990) Argentina (1989) Angola (1996) Peru (1990) Bolivia (1985) Nicaragua (1987) Russia (1923) Poland (1923) Greece (1944) Germany (1923) Zimbabwe (2008) Hungary (1946)

PAPER MONEY LOSES ITS
VALUE THROUGH INFLATION

Source: Reinhart/Rogoff (2009, chapter 12)

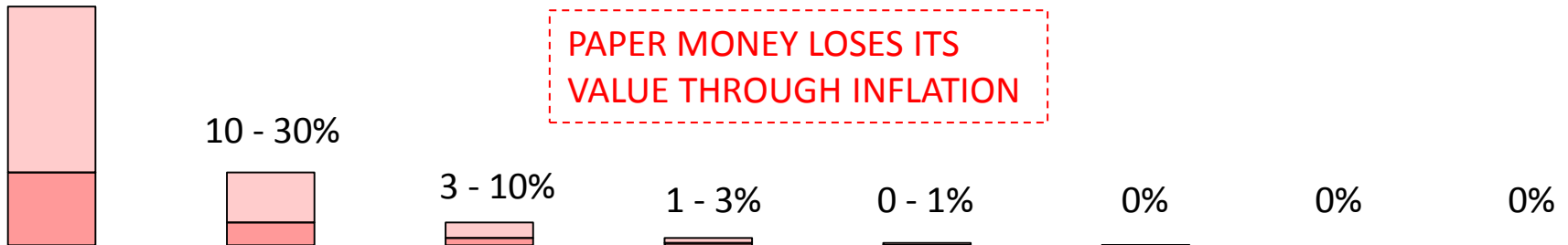
In the stable post-war period, all countries experienced significant inflation

AVERAGE ANNUAL INFLATION 1951 – 2010 BY COUNTRY

0 - 2%	2 - 4%	4 - 6%	6 - 8%	8 - 12%	12 - 20%	20 - 40%	> 40%
	Panama Switzerland Malaysia Belgium Luxembourg Japan Netherlands Austria United States Canada	Germany Thailand Tunisia Morocco France Denmark Norway United Kingdom Sweden Australia Finland New Zealand Italy	Mauritius India Spain El Salvador Guatemala Sri Lanka Hungary Egypt Portugal South Africa Honduras Philippines	Greece Kenya Dominican Republic Costa Rica Myanmar	Columbia Paraguay Iceland Venezuela Ecuador Mexico Poland	Zambia Ghana Turkey Indonesia Chile Uruguay	Bolivia Peru Nicaragua Argentina Brazil

PURCHASING POWER AFTER 60 YEARS (1951 – 2010)

30 - 100%

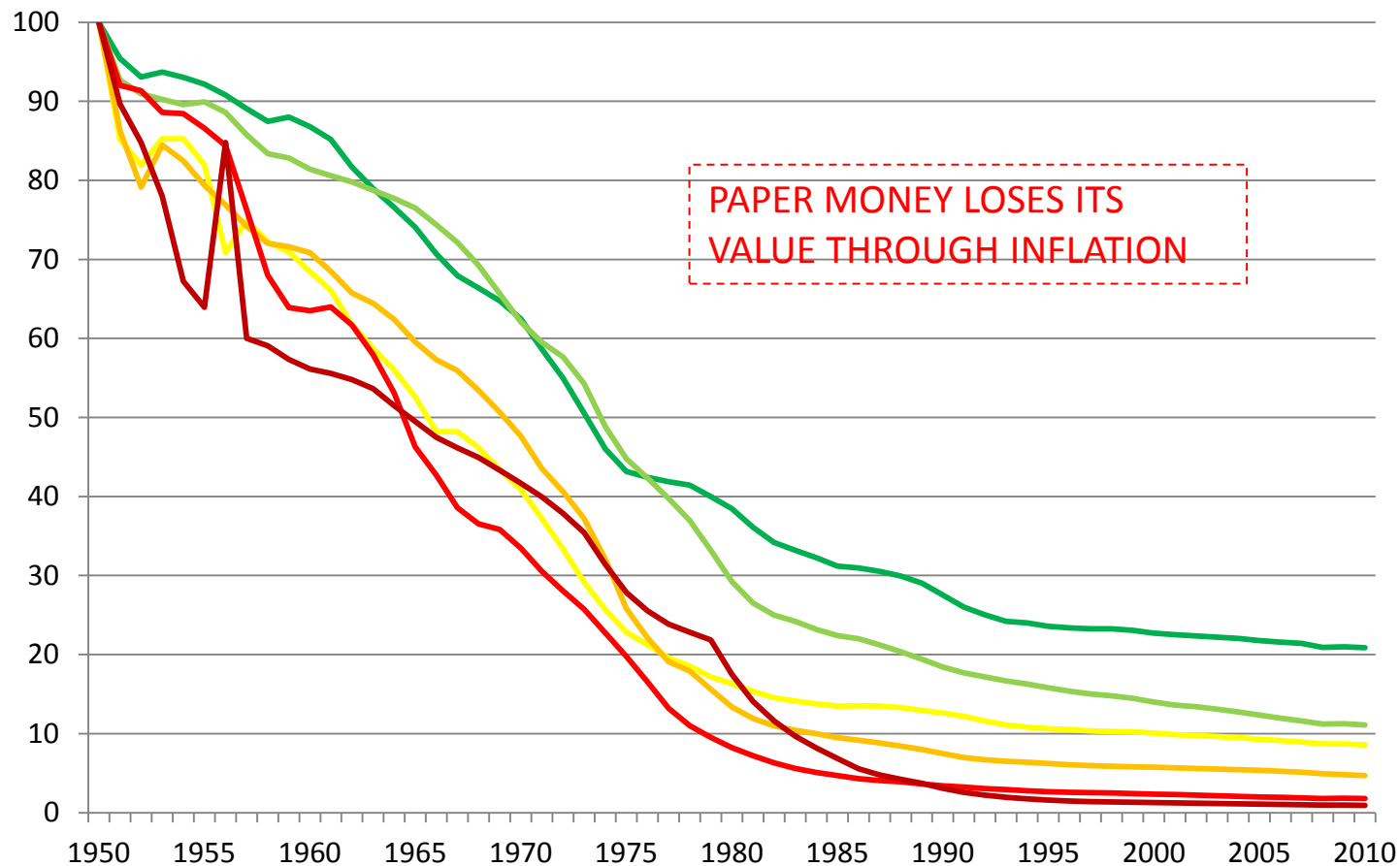


Source: Reinhart/Rogoff database; own calculations

Even the most stable currencies lost at least 80% of their purchasing power

PURCHASING POWER 1950 - 2010

1950 = 100



PAPER MONEY LOSES ITS VALUE THROUGH INFLATION

"All governments are firmly committed to the policy of **low interest rates, credit expansion and inflation.**"
Ludwig von Mises, *Human Action* (1949)

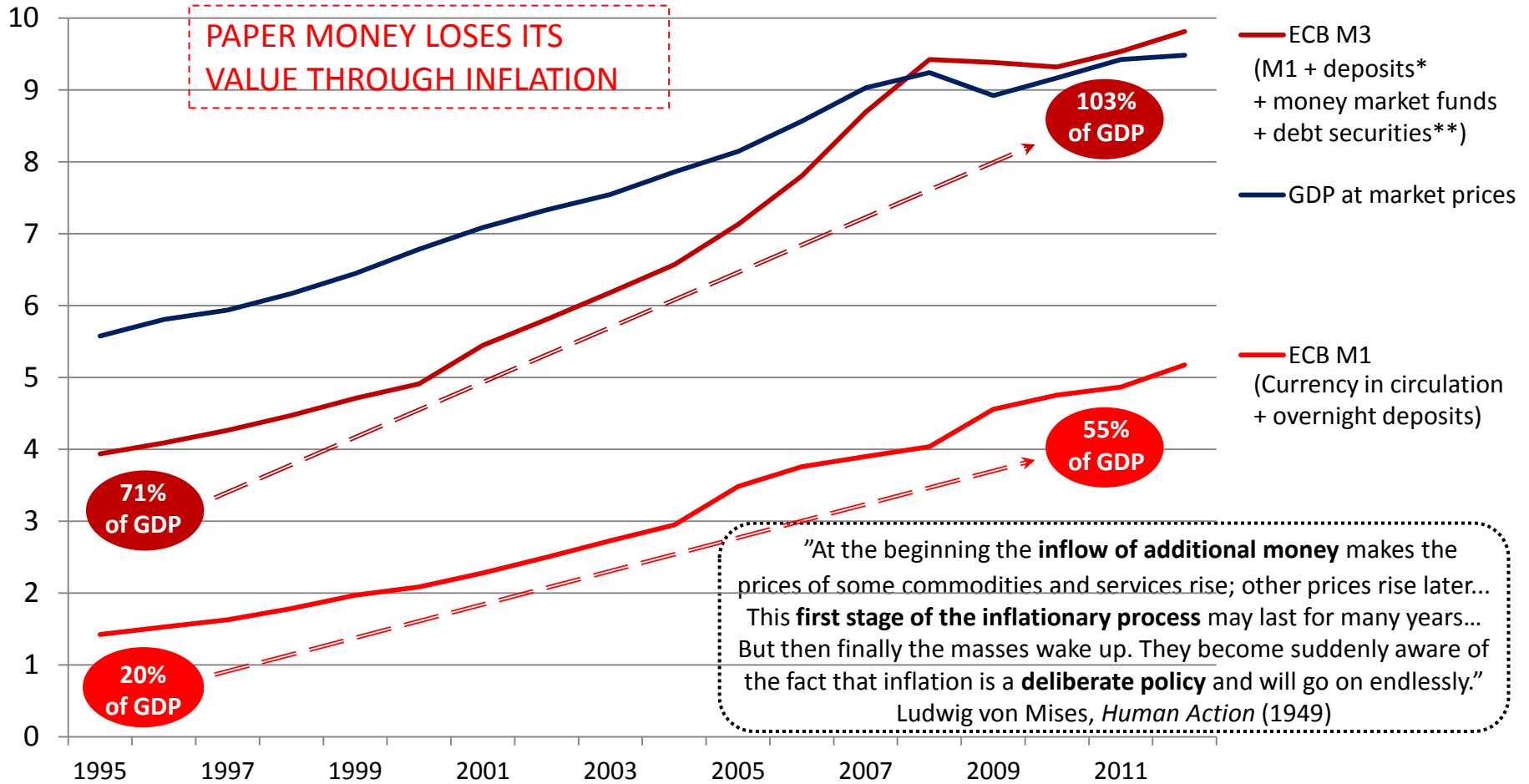
- Switzerland
- United States
- Germany
- United Kingdom
- Spain
- Greece

Source: Reinhart/Rogoff database; own calculations

Strong growth of monetary aggregates makes future inflation more likely

ECB MONETARY AGGREGATES AND EUROZONE NOMINAL GDP 1995-2012

In trn EUR

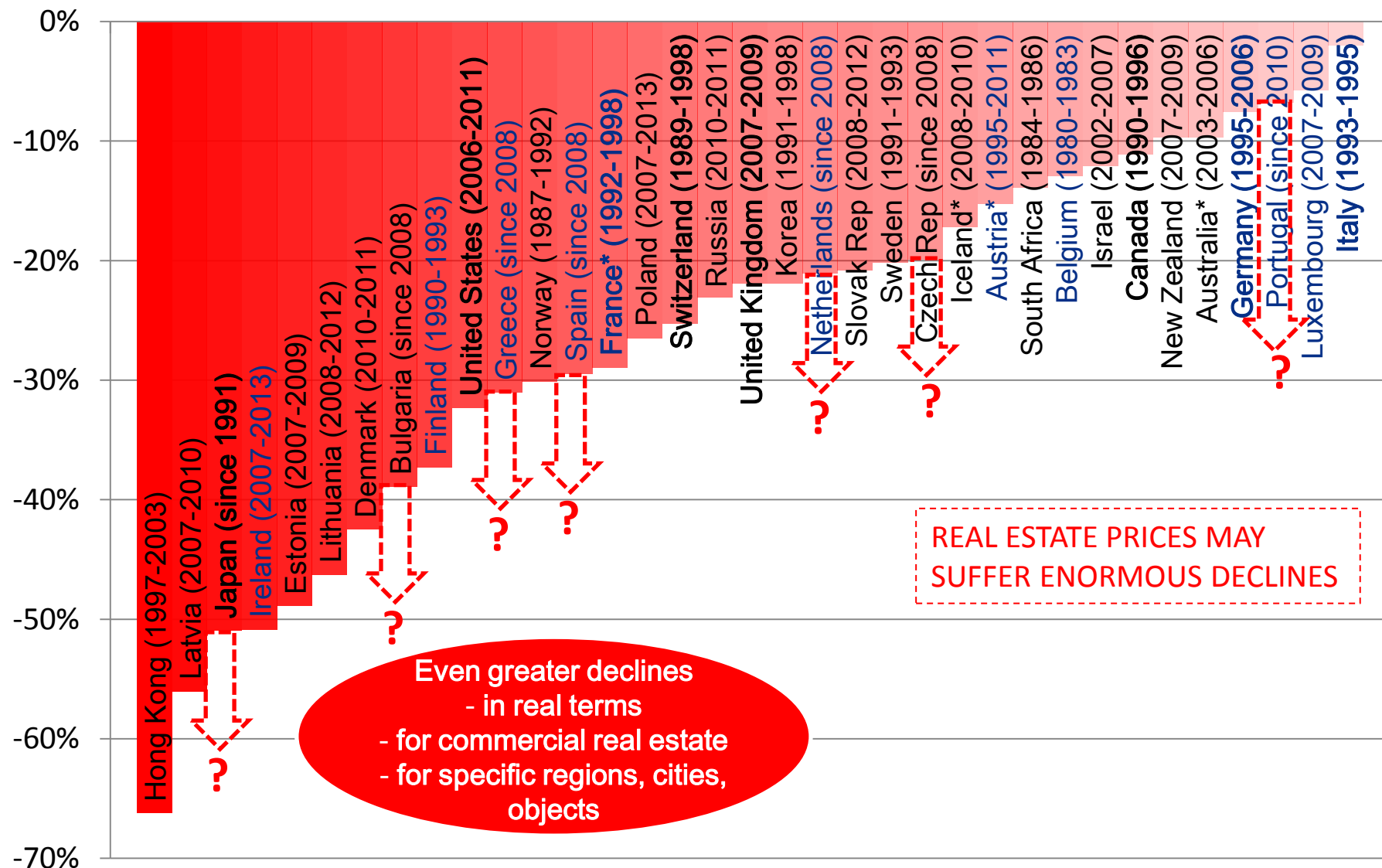


Source: ECB Statistical Data Warehouse

* With maturity up to 2 years or redeemable at notice up to 3 months ** Up to 2 years

Most countries have experienced at least one real estate crash since 1980

GREATEST NOMINAL DECLINES IN RESIDENTIAL REAL ESTATE AFTER 1980**



Source: BIS Property Price Statistics

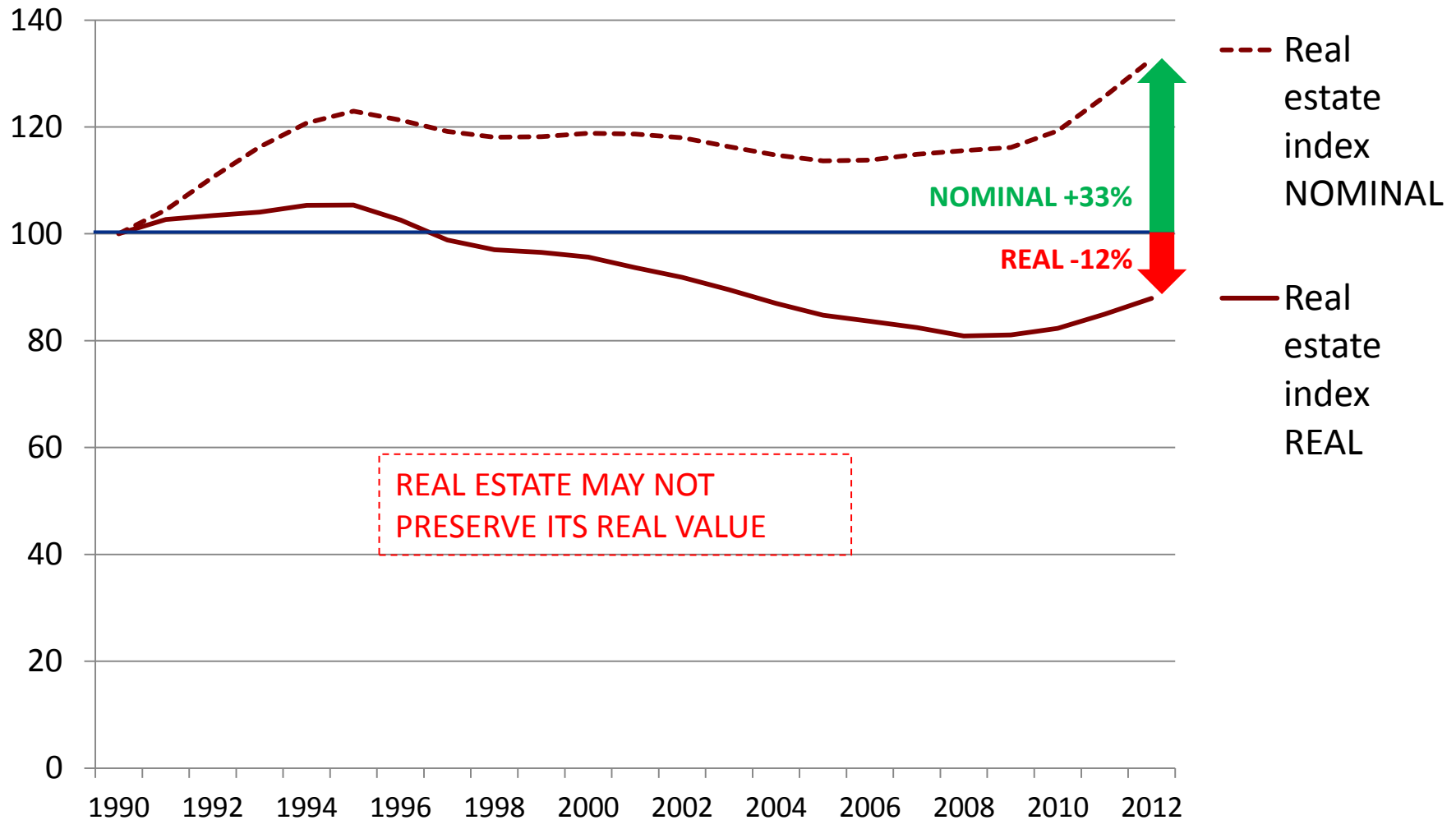
* Major city

** Subject to data availability - only countries with data for at least 7 years included

German real estate bought at reunification did not preserve its real value

NOMINAL AND REAL PRICES FOR GERMAN RESIDENTIAL REAL ESTATE

Real estate index 1990 = 100; nominal and real in 1990 prices

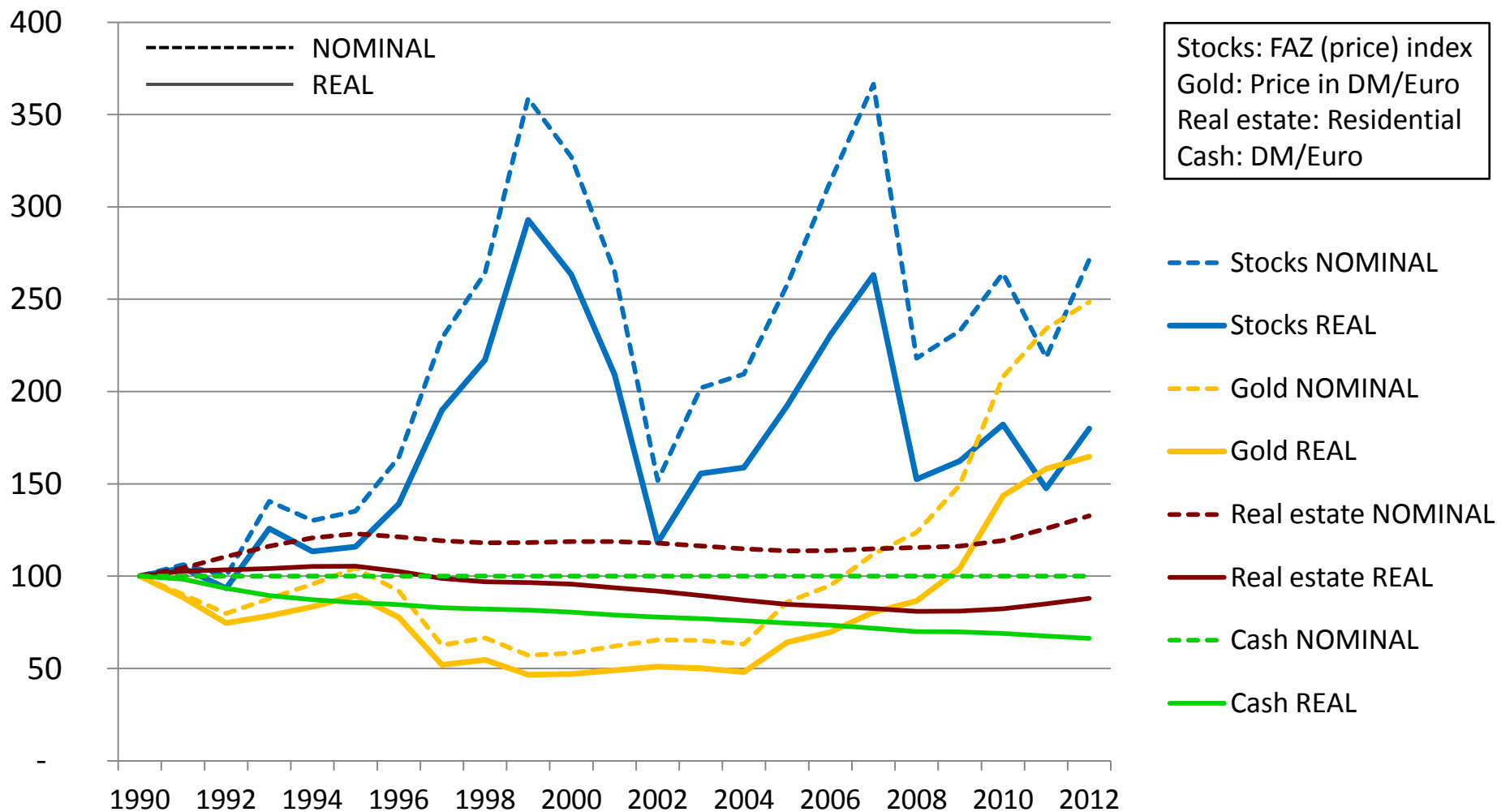


Source: Deutsche Bundesbank with data provided by Bulwien Gesa AG; own calculations

Over the same period, stocks and gold achieved real gains

NOMINAL AND REAL PRICES FOR GERMAN REAL ESTATE, STOCKS, GOLD AND CASH

Index 1990 = 100; nominal and real in 1990 prices



Source: Deutsche Bundesbank with data provided by Bulwien Gesa AG; own calculations

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