

A Longer Term View

Following a year where US equity markets found the ability to overcome a Russian invasion of Ukraine, a tremendous decline in oil and commodity prices, and policy uncertainty in the major economies of the European Union and Japan, investors have to question whether the same resilience can hold through 2015. Renowned bond fund manager Bill Gross asked a similar question this week in his monthly [investment outlook](#), taking a look at the year ahead and then suggesting we are now at an inflection point where the western world's troubles of slowing economic growth can no longer be solved with debt creation and money printing. Consequently, 2015 will be a year for losses in most asset classes as capital looks for a new harbour that can produce positive returns.

The first full trading week of 2015 certainly complemented this story quite well. Violent selloffs in North American equity markets recorded the worst start for North American stocks since 2008. But it begs the question whether markets are destined for a year of negative returns as Mr. Gross suggests, or can they overcome the crippling factors of deflation in Europe and a weakening emerging market picture along with declining commodity prices.

It's difficult to imagine in such an interconnected global economy how the US is able to decouple itself, and avoid the perils of economic headwinds originating from outside North America. It is a much different scenario than a few years ago when North American markets were much more vulnerable to fragility of the European economies and the systematic risk of a sovereign debt crisis. Turmoil in peripheral European countries seemed to reap much more havoc than the effect we've seen recently. Perhaps that was because of the interconnectedness of the debt crisis. Whereas today, Greek snap election called for later in January do not raise as much fear because bailout loans to the IMF are close to being paid back and Greece's problems too many extents have been contained to Greece.

But as the European deflation fears once again present themselves (as was reported midweek for the first time in 5 years), the idea of a system wide issue now comes forward again. Mario Draghi and European Central Banks ultimate challenge will be preventing a deflation scenario in Europe, and time does seem of the essence. There has been no change to the fact that unemployment rates remain elevated across the peripheral Eurozone and particularly for the younger demographics. Investment suffers not only from the prospects of subpar returns, but also from the perspective of currency risk as the euro lost approximately 13 per cent in 2014. The paramount example is that German 10 year bunds are yielding less than half a per cent as the trend continues lower. Growth prospects continue to diminish.

Whether or not the North American markets perform in the short term will be determined by investors comfort with their volatility. At this point, six years into a bull market, it's about the longer term view. Above all else, the number one consensus call a year ago as 2014 began was that interest rates in the US were going to begin to creep higher. And perhaps to the surprise of many, longer term bonds were one of the best performing asset classes of the last year. The consensus was wrong. Interest rates were supposed to move higher because of improving prospects for long term economic growth. Instead, they moved in the other direction.

With all the caution and some pessimism from respected analysts such as the aforementioned Mr. Gross, gold is catching a bid and is moving somewhat in tandem with a stronger US dollar. This could very well be that the US dollar is in for a rest and a bit of a pullback from recent levels which would add to gold's punch. The biggest worry going into the second half of 2015 could very be the rekindling of the sovereign debt crisis and this time it will be much more difficult to paper over.

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