INDEPENDENT TRADER NEWSLETTER

Independent Financial Portal
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In today's edition:

Who is behind the coup in Turkey?

In mid-July, there was an attempted coup in Turkey. After few days of the fight, president Erdogan regained control of the situation and media found other topics to focus on but what happened in Turkey has huge geopolitical weight.

Role of Turkey on the international stage

Many people treat Turkey as just another mid-sized country. In reality, this country occupies a very strategical position as it is a link between Europe, Asia and Africa. Zbigniew Brzezinski in his work "The Grand Chessboard" highlighted this fact. Through the Bosporus Strait, Russia can access the Mediterranean Sea and control Syrian situation and other Middle Eastern countries.

Turkey is a NATO member with nuclear warheads stored in Incirlik base, located very close to Russian border. You can say that this is the Eastern flank of NATO. Military and surveillance missions ranging from Libya to Pakistan are carried out from this garrison.

Turkey played a key role in the destabilisation of the Middle East. Most weapons that eventually ended up in ISIS hands were shipped through Turkey. Later it was used against Assad in Syria. The single biggest beneficiary of unofficial collaboration with ISIS was Erdogan's son. He was the middleman selling the oil from ISIS occupied territories of Syria and Iraq.

Give a terrorist organisation a solid stream of money and cooperative Turkish government and in just 12 months it will be the number one terrorist organisation in the world. This 'external hostile' was playing into hands of the West as it was easier to damage Syria and keep in check Iraq from where most of the US forces had left already.

Backstage dealings with ISIS gave Erdogan continuous support from the US and NATO in exchange for turning a blind eye to a huge scale of corruption, notorious human rights violations and atrocious position of Kurds. Economic problems were only getting worse while Erdogan had to face immigration problem much worse than this in Europe. Additionally, Turkey with two conflicts in their neighbouring countries – Iraq and Syria – had one inside, against Kurds.

Turkish dilemmas

The country gets into bigger and bigger troubles listening blindly to orders coming from Washington or rather Langley. Immigration crisis is a direct result of Turkish consent to destabilisation of the region. An attempt to dominate the Middle East through undermining competition backfired on top of losing control over ISIS. The West tried to fight them but to no avail.

After few months Russia joined the fight and the first step Putin made was to expose ISIS sources of financing and the role of Erdogan's son during the G20 summit.

Next airstrikes on oil transports intensified to cut ISIS from money. The whole operation took a month and cost 600 million USD (mere change in terms of military budgets). The effect was to hurt both ISIS and Erdogan's son financially.

Turkey responded quickly and in November we saw Russian aircraft being shot down with one casualty. Fortunately, we have not seen any military escalation but Russia already made a move to damage Turkey's economy.

Russia's authorities advised avoiding Turkish Riviera during holidays. Moscow banned any food imports from Turkey and most importantly, this move was not about Turkish food but intermediaries selling products from the EU (against sanctions). Ankara tried to match actions of the opponent and block the Bosporus Strait but with no success. To sum it up, relations between two countries are very bad. Turkey, NATO member with a nuclear arsenal and Russia stood on the edge of open military conflict.

Turkey-Russia, the reset

Subsequently, after few months a drastic change in Turkey-Russian relations happened. President Erdogan officially apologised to Russia and family of killed pilot. Surely, everything was already agreed upon by high-ranking officials before.

Russia answered with removing existing sanctions and both countries return to cooperate on Turk Stream – pipeline aiming to transport gas from Russia through Turkey to Greece. Also, talks about a nuclear power plant development were resumed.

According to Iranian sources, Ankara pulled back from Aleppo a majority of their intelligence assets working to remove Assad. Turkey refused a permanent presence of NATO fleet in the Black Sea to balance Russian forces (Crimea). For an unknown reason, we saw the Moscow-Ankara relations turning from cold to very warm and this was accompanied with isolation from NATO and the US.

And we did not wait long for a reaction.

Turkey's coup

On 15th July the world heard about the coup in Turkey. A part of the military tried to take control while Erdogan was abroad. Very quickly they pacified media outlets and internet cutting masses from any news streams. The Junta clashed with loyalists in many cities.

The turmoil lasted for hours. Finally, through Apple FaceTime and reclaimed stations, Erdogan's speech was broadcasted in which he encouraged people to take the streets to prevent the coup. "They cannot run this country from

Pennsylvania" and this sentence points out to the fact that a Turkish billionaire cleric, Gulen is behind the coup d'état. Gulen has resided in the US since 1999.

Gulen's influence over the media and judiciary in Turkey is no secret. The effect was instantaneous. People showing support for Erdogan left their homes and rebellion was stopped. The message was manufactured very carefully and analogies to Libya, Iraq, Egypt, Syria and Ukraine where revolutions ended up in a tragedy for societies there.

In the final count, there was 180 dead, 1470 injured and over 3000 arrested. Right now a 'purge' in judiciary, media and army is on its way. Erdogan uses the pretext of eliminating enemy forces to gain nearly absolute power. Formal request to extradite Gulen is just a PR move without any chances of success.

My opinion

A 180-degree policy change and an attempted coup are no coincident. The US and NATO have controlled Erdogan for years and he finally showed his teeth. Maybe he realised that following Western policies blindly is going to result in people rioting and requiring a regime change themselves?

What tends to support the version about the US and Gulen involvement is mass arrests in Incirlik base. The faction behind the coup openly admitted receiving help from NATO base. There are many theories on who was really behind this attempt from people directly connected with Clinton Foundation to staging the coup by Erdogan himself to remove opposition.

In my opinion, we have to focus on facts. The preparation of such operation was very poor. Without infantry, there was little chance of success. There are voices pointing to Russians giving Erdogan information about future coup and him allowing it to happen. At the end of the day he had many accomplices both in the loyalist group and in rebellion. Maybe he left the country to prevent his arrest or murder similar to Gaddafi's and returned only when the situation was under control. We may never know those details.

The information about Erdogan asking for asylum in Germany and being denied is ridiculous to me. Why Germany (vassal of the US) and not Russia or a dozen other countries? What is very interesting is the fact of John Kerry being in Moscow during the coup. Coincidence? I do not think so. It is possible that the conflict between Langley (CIA) and Washington (Constitutionalists) is worsening.

Remarks for the future

Seeing this small revolution, I believe, Turkey will soon start treating NATO similarly to how the UK treated the EU for the last year. For some time already we see frictions inside the alliance. Notwithstanding Washington's protest, France, Germany and Russia helped cutting ISIS from financing through airstrikes.

This can result in a decision-making paralysis of NATO. We may see the Czech Republic or Hungary starting to discuss their exit or at least a change in NATO operations.

Ultimately, I think Turkey will take NATO hostage to a vision of Ankara leaving the structures and joining the SCO (Shanghai Cooperation Organisation) - China, Russia, Kazakhstan, 3 former Soviet republics and soon also India and Pakistan.

The real game changer here is Incirlik base. NATO and the USA are going to do everything to keep it. Russia and China are in the opposite corner and Turkey will use this competition among superpowers to gain as much as possible for themselves.

Russia, China and Iran are going to tighten their economic cooperation. Turkey will, most probably, become a part of the Eurasian Economic Zone. Erdogan already stopped trying to get to the bankrupted EU.

If I am right and Russia indeed warned Erdogan about planned coup, the days of ISIS are numbered. They lost a majority of their funding from oil sales in Iraq and Syria. Unless Ankara hasn't done it already, they are going to cut their logistic support for ISIS. The question here is: will anyone offer help to ISIS when now they made a lot of enemies in Syria, Iraq, Iran, Russia and with relations between Washington and Moscow starting to warm up?

From an investment point of view, Turkish equities are very interesting with CAPE and P/E below 10 and P/BV at 1.2. During my lectures organised by SAXO and ASBIRO University, I mentioned that I keep an open eye for Turkey but did not open my position due to anticipated Russian retaliation (after shooting aircraft down). Revenge came around but from the opposite side. Now the equity's price is so low that I am beginning to consider opening my position. The problem I see is a big share of the financial sector and unfavourable global equity market situation.

Above article is based on sources coming from Europe, the US, Russia, Turkey and Iran. The amount of speculation is due to many self-excluding statements.

Trader21

Agricultural commodities – it is time to start paying attention.

The biggest central banks in the world are competing for being the best in destroying their respective currencies by printing. The process spans from Japan to Europe but in the US there is no official QE. Many observers talk about a very high possibility of returning to the printing press and this makes investors attracted to tangible assets. It is a very good option considering how low the price of most metals is today. Today we are at the level of 2009 bottom.

More people are interested in agricultural commodities today due to the phenomenon of El Nino/La Nina. The change of sea currents happens once per several years and causes severe weather conditions. Keeping a cool head about the catastrophic forecasts of El Nino this year, we have to acknowledge (based on previous years) the fact that commodity prices climb during this event. Last time it happened in 2011.

The price and its past

A major index showing how agricultural commodities are performing – GKX – takes into consideration different kinds of food products and grains. A chart below shows you history of this index from 1997 to 2016:

Above you can see two speculative bubbles in the agricultural market. First one, in 2008, pushed the price up to 500 points after which the GKX was trading at half of that price. Another rally, in 2011, was due to El Nino and then the level of 550 was broken. Since then we experienced nearly 50% drop and we are close to the bottom from the beginning of this year.

There are arguments to suggest that the level of 150 points (bottom of 1999 and 2002) is what we are heading for. Another factor to include in our evaluation is the depreciation of a currency. The rate of dollar inflation is higher than official data which confirms that main agricultural commodity index has bigger potential to gain than it has to lose.

When you analyse commodities, pay attention to ETNs investing in futures. One of them is RJA (Jim Rogers' ETN) based on a wider array of commodities than the GKX. This is how it looked during last decade:

If both charts show agricultural indices then why we see differences? As I mentioned before, Rogers is using a wider spectrum of commodities but their share better mirrors global supply. You still can see common trend – the plunge after 2011 and rally in the beginning of 2016. I want to highlight recent correction which made today's levels look very attractive.

Technicalities of agricultural commodities

Investing in commodities is much less popular than buying equities or bonds. This is why it pays to know some characteristics of this market. Firstly, prices of indices correlated with agricultural commodities are very dependent on investors' mood. It looks like a self-perpetuating cycle where the relation between supply and demand has no significant meaning. The perfect examples are events of 2008 and 2011. In the former, the weakened dollar played the main role. Historically speaking, the weaker USD is the better commodities are doing and vice-versa. When the dollar was losing during 2007-2008, investors expected higher commodity prices. This generated a speculative bubble which ended at the bottom of 2009. Anno Domini 2011, similarly to today, was the year of El Nino. The expectations of higher prices spread among investors and the market experienced the last boom in commodity markets.

A big share of equity investors knows from experience that a bull market is spread across time, unlike a slump. The mass panics making assets lose value in a very short time. When it comes to agricultural commodities it is different. When prices are going up in the back of the investor's head a thought emerges: "I have to buy now because it may be too late very soon". This makes rallies very strong, an example of doubling the price of coffee in just 4-5 weeks is one of many. When deciding to invest it is worth remembering this.

Comparison of commodity prices

I wanted to show you where agricultural commodities are today compared to previous years. I created my own index of seven commodities (from the top of the global supply list). Data compares the peak of 2008 bubble, bottom of 2009 and price today. Comparing prices from different periods is necessary for the situation where GKX, ETN RJA are distorted by a small margin due to contango. Comparison only based on the respective commodity price can lead to errors especially in the longer period of time.

My index is based on several commodities: Corn (22% weight), wheat (22%), cotton (18%), soy grains (14%), coffee (9%) and sugar (6%). On the left, you can observe how prices changed each year. On the right side, you see their index-weighted price.

Commodity	Commodity price			Weight	Price of the index		
	2008 peak	2009 bottom	Today		Index in 2008	Index in 2009	Index today
Corn	680	318	332	22%	149,6	70,0	73,0
Wheat	1033	261	417	22%	227,3	57,4	91,7
Cotton	80	36	73	18%	14,4	6,5	13,1
Soybean	1535	870	1024	14%	214,9	121,8	143,4
Coffee	166	106	148	9%	14,9	9,5	13,3
Cattle	115	80	109	9%	10,4	7,2	9,8
Sugar	15	11	20	6%	0,9	0,7	1,2
Total					632,4	273,1	345,6

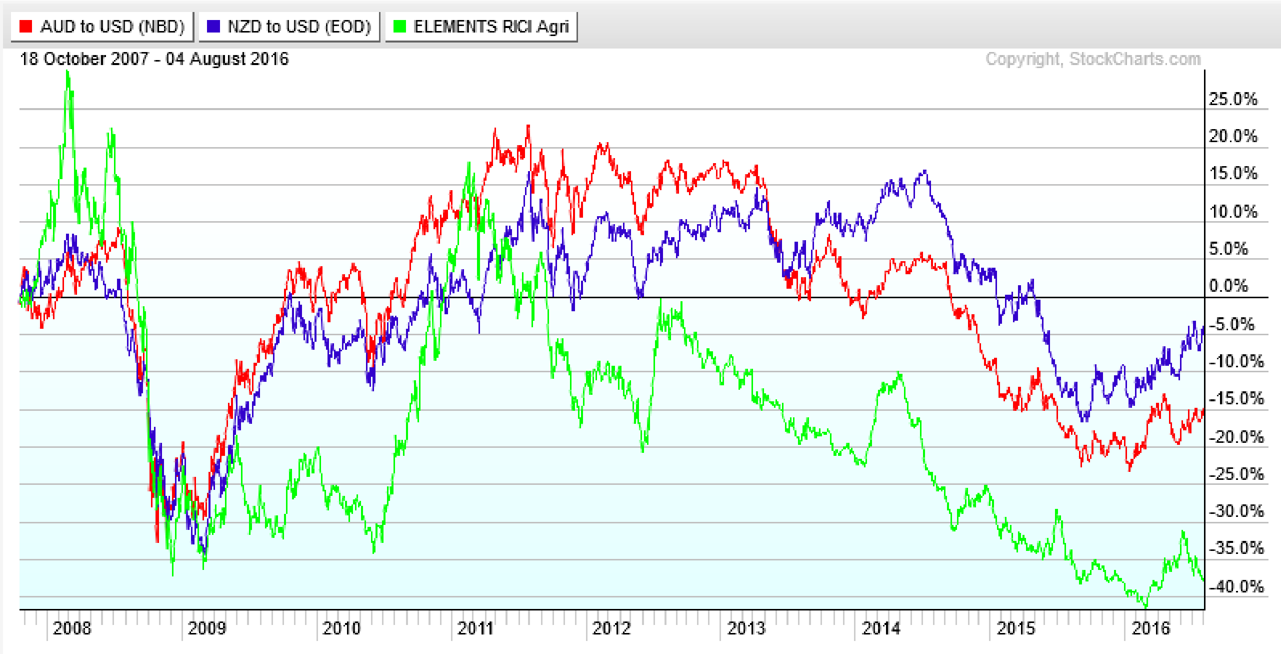
Source: Self-made

Above, the green field shows the index level of 2008 – peaking price. In the red, you can see prices from 2009 (57% drop from the maximum). Today, at 345 pts, commodities are closer to the 2009 bottom than to 2008 peak.

Our evaluation should also pay attention to inflation recorded between 2009 and 2016. According to shadowstats.com (calculating the rate of inflation with the '80s formula), cumulated (since 2009) increase in prices was equal to 89%. A similar rate of inflation gives us the Chapwood Index - a basket of 500 mostly bought products in various regions of the US. Factoring inflation into our analysis it seems that prices of commodities are very close to or even lower than their levels in 2009.

Summary

In case prices of commodities will climb as expected, investment in RJA is going to be very profitable. If this scenario materialises, I would also expect AUD and NZD (two currencies with the strongest correlation to commodities) to appreciate.



I invested in Jim Rogers RJA (37 most important agricultural commodities) in the beginning of 2016 and now I wait patiently for the price to go up.

More expensive agricultural commodities have also other consequences. Higher prices mean a catastrophe for poor countries. Wherever households spend 50-60% of their budget on food, hike in prices is one of the worst things that can happen. History shows that poorer countries can see riots and violent protests.

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Buy when there is blood in the streets.

You should know the title as it comes from Nathaniel Rothschild, the father of central banking. It is true, that during turmoil most investors are scared for their assets and many assets plunge to very attractive levels.

Normally this saying applies only to financial markets but the unstable situation in Turkey – when 200 people lost their lives – made Turkish equities very attractive. I bought ETF giving me exposure to Turkish stocks.

Do not get me wrong. Equities, for now, is by far my least favourite group of assets. In most developed markets we see a mature bull market and the risk of a nose dive is too big. What we see is central banks doing everything they can to continue this 'recovery' with printing and their interventions. As a result, free money still can find its way into tangible assets. Here we can see the disparity. On one hand, we have very expensive developed markets (85% of the global capitalisation of the global financial market) and very cheap emerging markets, on the other hand.

During first years of this bull's market, between 2009 and 2011, we saw equities gaining all over the world. Later different markets diverged and DM continues to grow (especially in the US) while EM experienced either horizontal movement or falls.

Turkey was a cheap market even when compared to the rest EM. This is mostly because of very weak Turkish currency.

Turkish stocks are at very attractive levels, I mentioned this before during my articles, lectures and webinars. Also, back then, I mentioned the risk of possible Russian retaliation for shooting down Russian plane. The revenge pushing prices down by 15% indeed came but from a different side. Now the potential for growth outweighs the risk.

Why Turkey?

We already know that equities in EM are cheaper than in the developed world. What is more, during last 3 years, Turkish stocks lost even compared to the index of emerging markets.

Despite the political situation of Ankara being unstable, the potential for growth should be rewarding enough to stomach it. P/E at 8.97; P/BV 1.18; CAPE around 9. The market here is not cheaper than Russian but it has a very good long-term prospect. Adding to this a very positive reaction to Erdogan reclaiming his position which, I believe, is going to continue in the following weeks.

Now let us analyse bigger picture. Turkey has very low public debt, only 33% of GDP and GDP growth of 4.8% while Turkish lira plummeted during last 5 years. From the geopolitical side, the situation may look better than expected. Authorities aim to put themselves as a beneficiary of the competition between Russia and EU, or rather SCO and NATO. Both sides count on good relations with Ankara and this gives Erdogan very healthy negotiating position. Demographic image of Turkey is its strong point.

What about risks? Turkish stock market is dependent in 44% on banks and insurance companies but seeing the level of interest rates in Turkey – 7.5% - and low debt, Turkey is much safer than Europe.

Source: www.ishares.com

Summary

The equity market in Turkey is attractive. Since 15 July, I strongly believe those assets are worth investing in. The overall outlook is good for this cheap market but in case central banks of developed world will not regain control over the situation with their printing attempts, all financial markets are going to experience the slump.

However, if central planners aim at lowering the level of global debt through the destruction of currencies, free capital in times of skyrocketing inflation should end up in cheaper emerging markets (e.g. Turkey).

This trend was visible in the first half of 20166 when the capital moved from developed countries to emerging markets. Brazil experienced 66% jump, Russia 25% and Turkey (even with a coup) gained 8% - better than even S&P.

Considering inflation scenario which looks more and more probable, the price of equities in developed markets are going to stand still or raise similarly to the inflation rate. Equities in EM have a potential to double in 5 years' time. Being careful, Russia and Turkey is my only exposure for now.

Trader21

How big is the inflation rate today?

In emails I received and discussions I saw and experienced there is a strong belief that independent measures of inflation (e.g. www.shadowstats.com, the Chapwood Index) are false and not trustworthy. I wanted to address this issue and show you how the rate of inflation is measured today - the CPI relied on by the most important institutions all over the world – historical background of it. Finally, I will compare different methods to find out which one is closer to the truth.

What are inflation and CPI and how are they measured?

Until 1980, the rate of inflation was reported as an increase of the money supply in circulation. The more means of payment the bigger inflation. It was very simple and transparent system. After 1980, a new way was introduced – an attempt to quantify a change in living costs. A Consumer Price Index (CPR) was created.

According to the government, more important than estimating inflation was to show an increase of citizen's living costs. Money is not distributed evenly in the economy and this is why a 10% increase in money supply doesn't need to push the price of milk by 10%. The CPI is not a measure of inflation but the difference in prices of goods and services, year to year.

Reason behind the change

After World War 2, the "Great Society" and the Vietnam War increased the expenditure of the US government and the amount of USD in circulation was growing faster than gold reserves. In the '60s, the jump was big enough that European leaders questioned the solvency of America.

The US gold stock was quickly disappearing when a massive rush to exchange USD for gold (at 35 USD/oz Bretton Woods rate). In 1971 Richard Nixon suspended convertibility of the USD to gold.

After the dollar was divorced from gold, it was never fixed again. Unfortunately for the American currency, the trust towards dollar was harmed and it led to quick depreciation. The answer came in a form of a deal with Saudi Arabia in 1973, when the US government created the petrodollar. The USD was going to be the only currency in oil trade. In 1975 OPEC was created and the new status of petrodollar was sealed. To stop the dollar from falling Paul Volker, chairmen of the FED, raised interest rates to 20%. This brought back the trust in the currency by changing the negative trend. To sustain the level of interest rates and keep the trust, the method of measuring inflation was changed and CPI came to life.

Controversy around CPI calculation

The Consumer Price Index (CPI) is nothing else than a basket (index) of goods with products of everyday use, food, private and public sector payments (bills etc.).

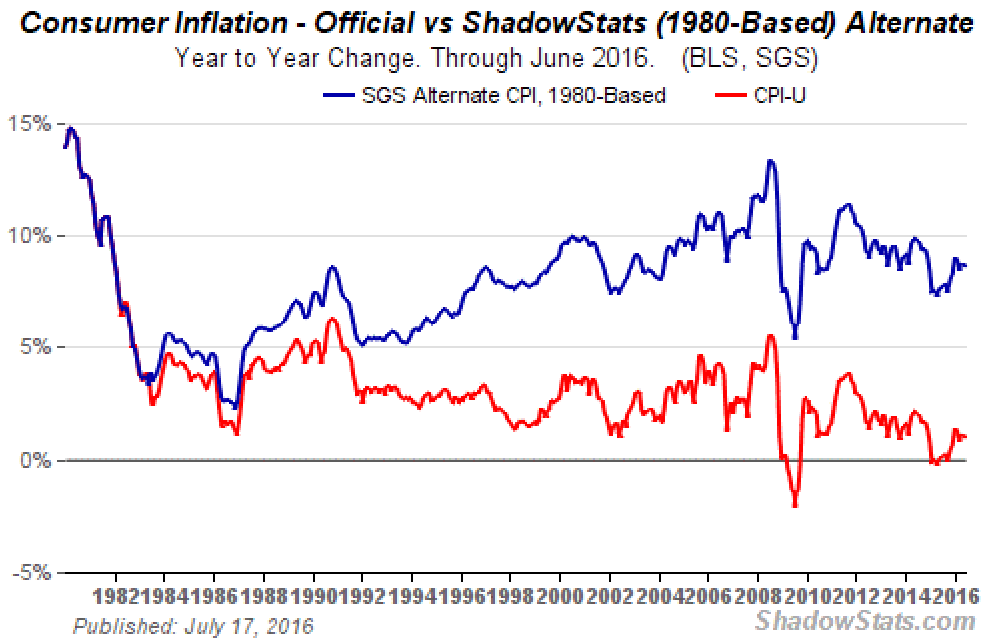
In order to count inflation with the CPI, we exclude the goods most prone to change. Every year a new basket is indexed. We remove the top 20% of prices that changed the most in the last month or year. What is left is cut again by 15% truncated mean. This translates into removing top 15% of those goods that climbed in price and 15% that lost the most. Then, we arbitrarily add substitutes having in mind rigidity of prices.

Using this method stirs a lot of discussions. When the supply of currency is increasing each year (quicker than the sum of goods and services in the economy) prices of those goods and services are also going up. This makes people responsible for the CPI to remove more goods that become expensive than goods that got cheaper.

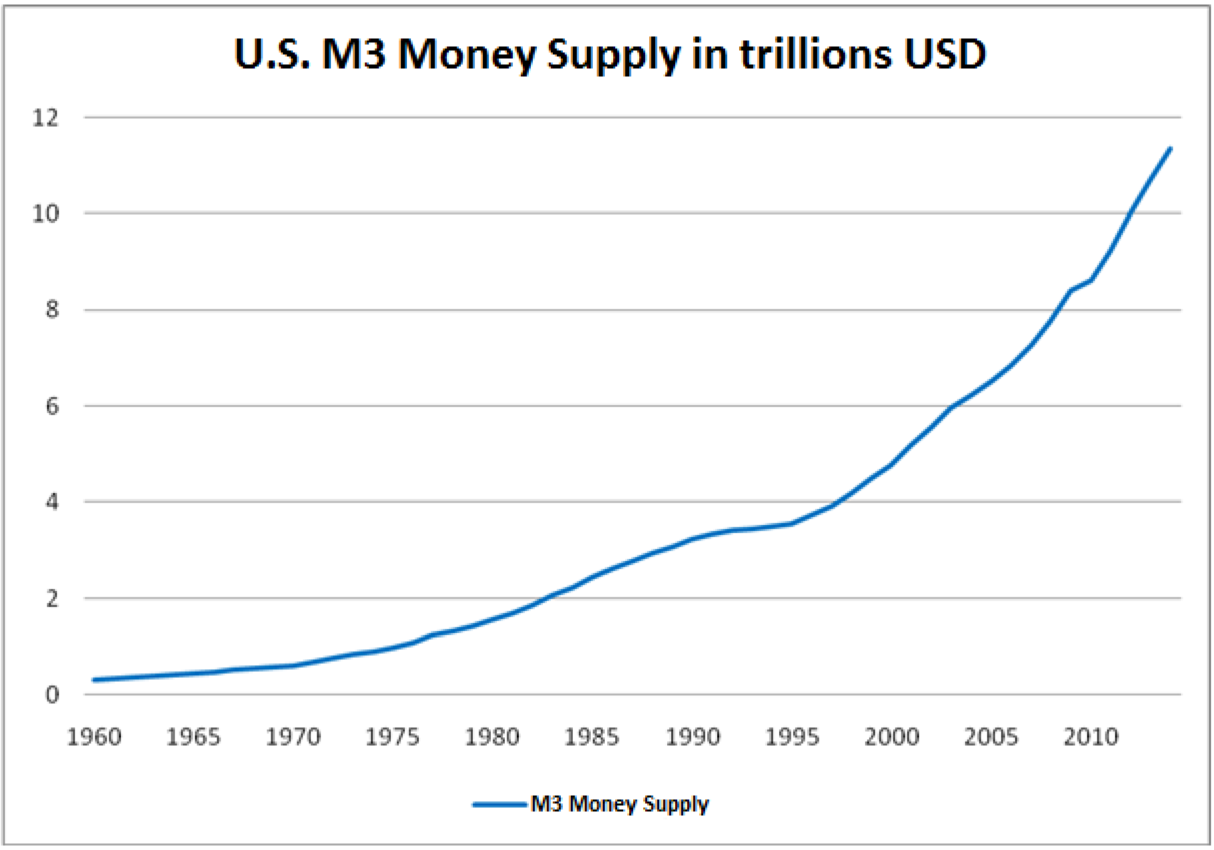
Another problem with the CPI methodology is wrong subsidiarity of goods. According to the assumption behind it, given a possibility to buy a cheaper substitute, the consumer is going to choose this product – and will not feel the price hike (so much). This is true but does not offer the big picture of the situation. If I can afford a good ham today but only canned spam tomorrow, am I not becoming poorer? Does it matter when as a consumer I have to compromise when buying goods because of the high price? Of course, it does. Even economists are far from saying that those two are substitutes but for clerks from the Bureau of Labor Statistics (BLS) which publishes the CPI, it works fine.

John Williams' index – an alternative for investors

The method of calculating John William's index is not available. From data presented on the Shadowstats website official numbers from the BLS are multiplied by a set of constants and give the result. Alternative numbers are visibly higher than the CPI (see chart below). Blue line is Shadowstats inflation and red is the BLS number.



Looking through the CPI scope, Williams' method of computation is wrong but its results are correct. Index presented on www.shadowstats.com mimics the increase of the M3 money supply in circulation (the original way of counting the rate of inflation).



Source: Self-made

Looking at numbers published by the FED, the amount of dollars grows geometrically and doubles every 9 years - similarly to Williams' index. Even with obscured methodology, numbers are correct. What about the cost of living? Does Shadowstats overestimate them? Fortunately, apart from the official CPI, we have another independent index to verify Williams' data.

The Chapwood Index

The Chapwood Index is a tool to estimate costs of living, very similar to the CPI. Creator, Ed Butowsky, decided to design a credible index without controversial factors of the BLS method. Especially with constant shares of products in the basket.

The shares and goods in the basket are based on data collected while surveying a representative group of the middle class. Over 500 goods and services bought most often by consumers create the basket.

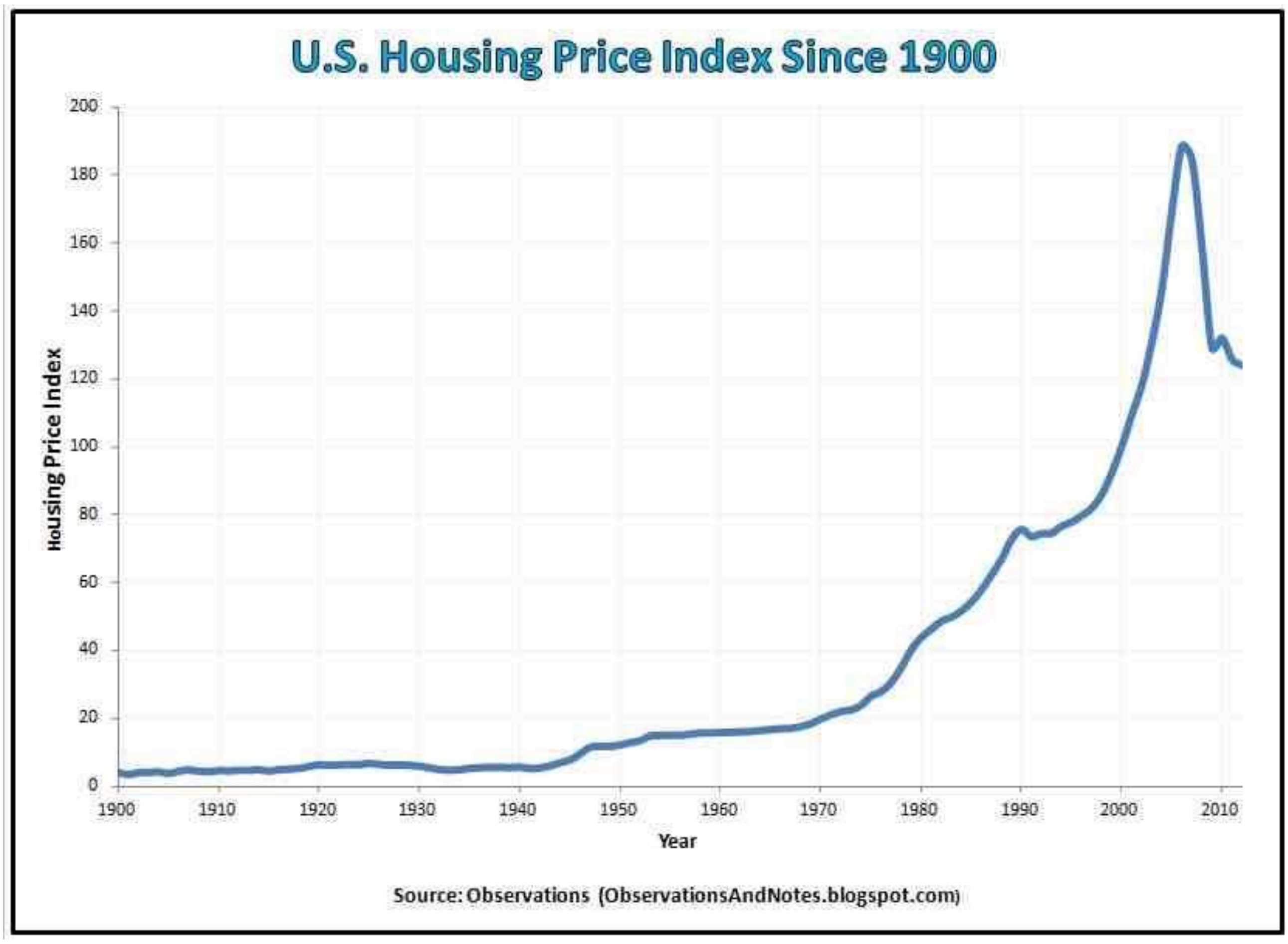
The Chapwood Index is sourced with information from 50 cities from the majority of the States. This is a compromise between cost of data acquisition and verifiable results from representative regions of the US. Butowsky's organisation updates database with fresh prices each quarter and after averaging the Chapwood Index is delivered as a y/y change. Thanks to this method everyone can follow the change in living costs in his State. In 2015 the rate of inflation ranged between 5.9% in Phoenix, Arizona and 13.4% in Portland, Oregon.

This confirms Williams' information - 8-10% inflation in the recent years.

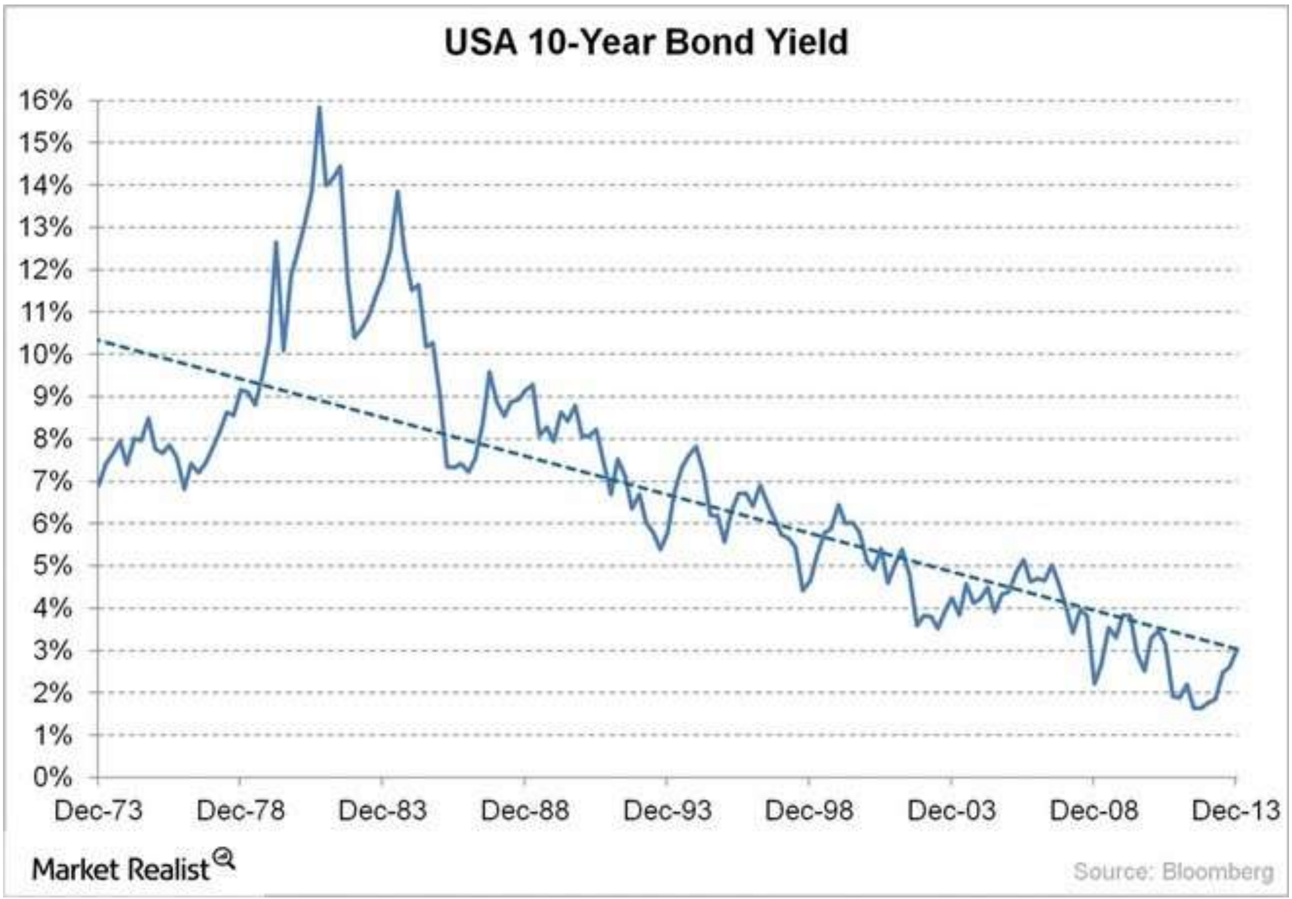
Uneven spread of the money supply in the economy

Consumers spend their money not only on everyday goods but also buying financial instruments – which are not included in the CPI basket. This is why measuring the rate of inflation by looking at the price of bread throughout the years is false.

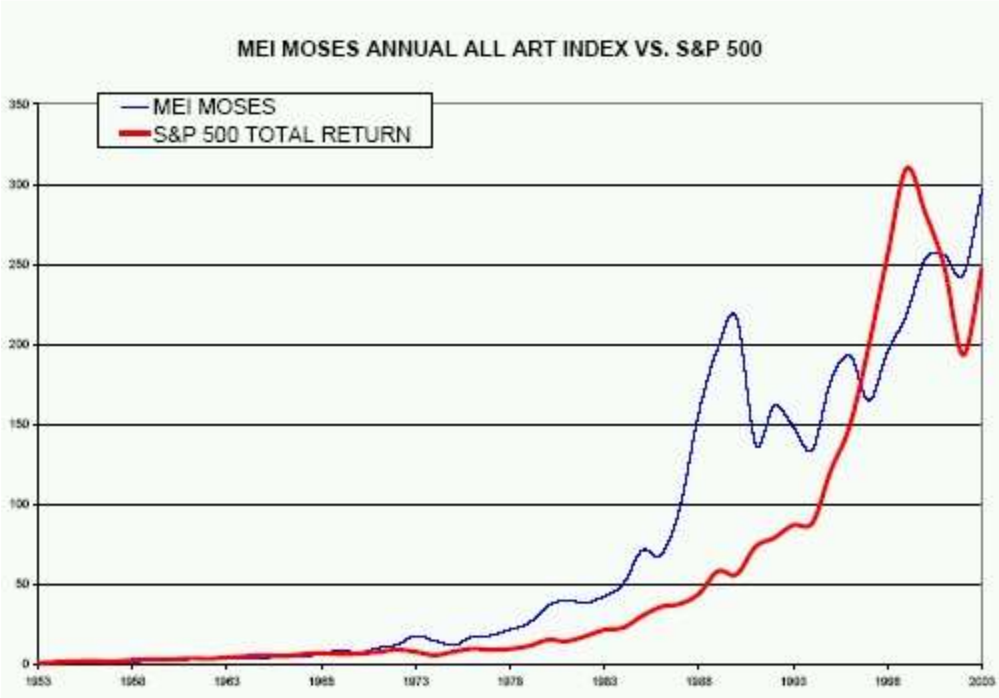
Oversupply of printed dollars found its way into several sectors of the economy. Prices of gold or oil are controlled by governments but assets – priced by the rules of (mostly) free market – give the true picture of devastating inflation. A good example is the real estate market, which grew by 300% since 1980 and experienced bursting bubble on the way, quintupling the price.



Apart from the real estate, there are also bond markets – in practice experiencing an ever growing price. According to the mechanism: higher price, lower yield; We can see that interest from owning government bond is falling (chart below).



Similarities can be easily found by looking at NYSE where S&P500 is at record heights. The chart below shows another correlation, this time between S&P and Mei Moses Index (index of art). In the last decades, due to low supply of physical gold (vis-à-vis dollar) and problems in bulk sales of gold, art became an equivalent of precious metals. Because art – just like physical metal – is not someone's debt.



Source: etf.com

You can find those proclaiming that technological progress lifts the equity prices up thanks to productivity improvements. This is false. Before the World War I, the US boasted the gold standard and supply of currency was limited, the industry was developing rapidly. Dynamite, power tools, bulb, radio, airplane, combustion engine. All those, and much more fuelled the economy but the equity prices were very stable for decades.

The chart above is an average capitalisation of equity in the USA since 1870 and over 50 years that followed. While economic growth was strong, equity market doesn't need to grow infinitely. If this happens it is due to printing presses of central and commercial banks. A great example of that is 1920s bubble initiated by very low-interest rates and high supply of money. After the burst, the stock market crashed and the Great Depression of the '30s started.

Summary

John Williams' methodology has few flaws. This doesn't change the fact that the result is parallel to the Chapwood Index. The increase of M3 money supply gives another proof to confirm what before 1980 was understood as the measure of inflation.

The M3 supply of money probably overestimates the average increase in prices – due to rising productivity, historically revolving around 1.5%. Knowing that the level of overestimation equals 1.5% we can subtract it from Shadowstats result (8-10%) and the end result of 6.5-8.5% is the lower end of Chapwood Index. Everything seems to check out. Everything, but the official CPI trying to convince us that inflation equals 1%.

To put it bluntly – there is no one perfect formula to calculate the rate of inflation or the difference in living costs. What Shadowstats offers is an overestimation but after comparison to other independent indices and the pre-1980 method of measuring inflation, this overestimation we are talking about is less than 2%. This is why official data is false and is not confirmed by the reality we live in. I am aware of the flaws Shadowstats and Chapwood Index have but they are more trustworthy than anything else out there.

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