



Written by [Bob Adelman](#) on October 2, 2012

Bond Fund Manager Says Only Gold Will Survive the Coming Disaster

[In his October newsletter to clients](#) of Pacific Investment Management Company (PIMCO), founder Bill Gross summarized the coming disaster that faces the country, and noted that “only gold and real assets would thrive...” Noting that America is considered the “cleanest dirty shirt” among the major economies, he says that the country’s debt-to-GDP ratio, its excellent credit ratings, and its currency being the world’s reserve currency appear to stand it in good stead:



We have world-class universities, a still relatively mobile labor force and apparently remain the beacon of technology — just witness the never-ending saga of Microsoft, Google and now Apple.

Obviously there are concerns, especially during election years, but are we still not sitting in the global economy’s catbird seat?

As far as America’s imminent demise is concerned, he comments:

Armageddon is not around the corner. I don’t believe in the imminent demise of the U.S. economy and its financial markets. But I’m afraid for them.

Gross manages the world’s largest bond fund along with CEO Mohamed El-Erian, with nearly \$2 trillion of assets under management. His clients include individual retirees, pension plans, educational institutions, foundations, and endowments, each seeking safety of principal along with reasonable returns. Accordingly he must temper his words not to frighten away the very people he serves. But he’s courageous enough to tell the truth.

After reviewing reports from the International Monetary Fund (IMF), the Congressional Budget Office (CBO), and the Bank of International Settlements (BIS) on the state of the American economy, he says that the United States is no “clean dirty shirt” after all. It is, instead,

a serial offender, an addict whose habit extends beyond weed or cocaine and who frequently pleasures itself with budgetary crystal meth. Uncle Sam’s habit, say these respected agencies, will be a hard (and dangerous) one to break.

What is needed, Gross concludes, is something Congress cannot provide: sufficiently draconian cuts in promises and similar increases in taxes to avoid calamity:

These studies (when averaged) suggest that we need to cut spending or raise taxes by 11% of GDP ... quickly over the next five to 10 years.

An 11% “fiscal gap” in terms of today’s economy speaks to a combination of spending cuts and taxes of \$1.6 trillion per year!

This is four times what the failed Super Committee’s “Grand Bargain” recommended last year, which was promptly ignored by all parties concerned. Instead, the spending continues unabated, says Gross:



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“The U.S. and its fellow serial abusers [i.e., Japan, Greece, Spain and France] have been inhaling debt’s methamphetamine crystals for some time now, and kicking the habit looks incredibly difficult.”

Gross then starts calculating the amount the U.S. government really owes, as compared to the number usually mentioned in polite company. Most analysts refer to the \$16 trillion debt, which is increasing by more than \$1 trillion every year. Gross says that’s just the tip of the iceberg: It’s more like \$60 trillion if one counts the present value of the future benefits the government has promised to pay under Social Security, Medicaid, Medicare, and the prescription drug benefit signed into law under President George Bush:

Altogether, that’s a whopping total of 500% of GDP, dear reader, and I’m not making it up. Kindly consult the IMF and the CBO for verification. Kindly wonder, as well, how we’re going to get out of this mess.

Gross concludes that nothing will be done. And he is in a position where the impact of doing nothing will cost his company, and his clients, dearly. He highlights his conclusion just so no one misses the point:

Unless we begin to close this gap, then the inevitable result will be that our debt/GDP ratio will continue to rise, the Fed would print money to pay for the deficiency, inflation would follow and the dollar would inevitably decline.

Bonds would be burned to a crisp and stocks would certainly be singed; only gold and real assets would thrive within the “Ring of Fire.”

Gross fails to make mention of the [recent downgrade](#) of the U.S. government by a forward-looking credit agency, [Egan-Jones](#), a small but remarkably prescient reviewer, having been the first to downgrade WorldCom and Enron, and the first to cut its rating on the U.S. government back in July 2011. It cut its rating on U.S. securities again last month, explaining:

From 2006 to present, the US’s debt to GDP rose from 66% to 104% and will probably rise to 110% a year from today under current circumstances; the annual budget deficit is 8%.

In comparison, Spain has a debt to GDP of 68.5% and an annual budget deficit of 8.5%.

Gross also understates the actual size of the national debt. Claiming it to be \$60 trillion instead of \$16 trillion, he misses the mark [by a factor of four](#). According to Boston College economist Laurence Kotlikoff:

The U.S. fiscal gap, calculated (by us) using the Congressional Budget Office’s realistic long-term budget forecast — the Alternative Fiscal Scenario is now \$222 trillion. Last year, it was \$211 trillion. The \$11 trillion difference — this year’s true federal deficit — is 10 times larger than the official deficit...

But Kotlikoff’s solution is eerily similar to that proposed by Gross: huge increases in taxes, and gigantic cuts to government entitlement programs:

The answer for the U.S. isn’t pretty. Closing the gap using taxes requires an immediate and permanent 64 percent increase in all federal taxes.

Alternatively, the U.S. needs to cut, immediately and permanently, all federal purchases and transfer payments, including Social Security and Medicare benefits, by 40 percent.

That just simply isn’t going to happen. With the Fed’s continuing drive to keep interest rates low by



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buying up government securities, there is little incentive in Washington to fix something that isn't broken — yet. The coming election and the inevitable diddling over the “fiscal cliff” will happily keep Congress occupied and allow it to avoid doing anything substantial about the coming demise of the United States as a world-class economy.

In the meantime, Gross, speaking against his own interests as manager of the world's largest bond fund, says that gold and “real” assets will survive and even thrive. He sees that demise coming:

If the fiscal gap isn't closed even ever so gradually over the next few years, then rating services, dollar reserve holding nations and bond managers embarrassed into being reborn as vigilantes may together force a resolution that ends in tears.



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