

BULL MARKETS BULLSH*T & BUBBLES

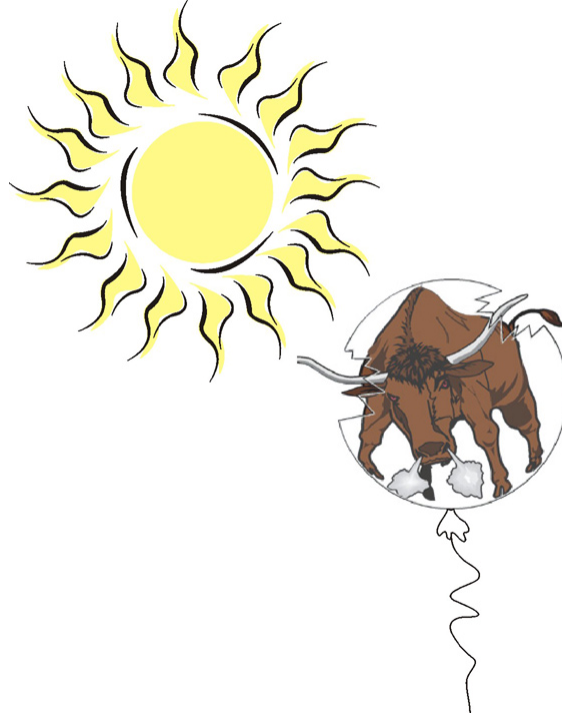
When credit growth is positive, bull markets result. When credit growth is excessive, bubbles result. When credit growth slows, recessions result and when credit growth contracts, all hell breaks loose.

In free markets, supply and demand determine price and profits. Capitalism's paper-based markets, however, are not free markets. In today's capitalist markets, price and profits are determined by credit flows emanating from government central banks.

Under capitalism—or more appropriately, under *credit-based debtism*—the supply and demand for credit is as important as the supply and demand for goods and services. The critical supply and demand dynamic that exists in free markets is distorted under capitalism, a distortion that will destroy capitalism just as communism was destroyed by a similar systemic distortion.

In credit-based capital markets, investors need credit like addicts need heroin; for just as addicts cannot survive without heroin, investors cannot profit without central bank credit. But more credit, like more heroin, becomes increasingly dangerous with continued usage.

It was the increased availability of credit in the 1980s that was responsible for the historic bull market from 1982 to 2007. In truth, the twenty-five year bull market was but a slow-building bubble in disguise, a bubble the Fed is now frantically trying to resuscitate in the hopes of preventing capitalism's imminent collapse.



Today, when it looks like a bull, walks like a bull and acts like a bull, it's probably a bubble.

Bubbles and busts have now replaced the expansions and contractions common to early stage capitalism. We are now in late-stage capitalism, where debt instead of credit is the critical factor and the bond markets, not equity markets, determine the economic future.

The serial dot.com and US real estate bubbles so distorted the global demand and supply dynamic that memories of the 1930s depression have now been re-awakened, memories that will soon become reality as deflation spreads around the world.

Deflation arises in the wake of extraordinary speculative bubbles and is caused by a collapse in demand which happens after such bubbles pop, when producers/sellers chase buyers hoping to turn inventories and soon-to-be illiquid assets into cash in order to pay down ever-compounding debts.

Deflation happened in the 1930s in the US, in the 1990s in Japan and is now again spreading in the US, the UK, Japan and other overly mature late-stage capitalist economies; and akin to a deadly economic cancer, deflation, once metastasized, is exceedingly difficult to eliminate.

PROFITS, BUBBLES & FROTH

In capitalist economies, constant credit fuels constant inflation which, in turn, results in constantly rising prices. This process was erroneously mistaken for wealth creation after the 1980s when inflation was contained to asset classes. But such asset gains are only temporary and become losses when speculative bubbles finally collapse.

Hoping to prevent a systemic deflationary collapse, central bankers flooded the US economy with credit in 2001, US central bankers slashing the Fed lending rate from 5.25 % down to 1 %. It was, however, a massive infusion of credit that only delayed and exacerbated the inevitable.

If you keep goosing the golden goose...

From 2002-2005, the Fed's 1 % rates revived global demand but inadvertently created the US real estate bubble, the largest speculative bubble in history, a bubble underwritten by global investors who bought hundreds of billions of dollars of subprime mortgages that are now virtually worthless.

But the revival of demand was only temporary and the cure brought back the dreaded deflation that central bankers feared; and now, today, US rates are even lower, 0.25 %, but this time, low central bank rates will not have the desired effect. Lower rates will lead not to an increase in demand but to a depression.

THIS TIME IS DIFFERENT

When the US Fed cut rates in 2001, it gave rise to a massive bubble which drove global demand to new highs—which is what the Fed wanted. What the Fed didn't want is what happened next.

When the bubble collapsed, credit markets also collapsed when bondholders suddenly realized that their AAA rated subprime bonds were more subprime than AAA; and, when credit markets froze, the über-sophisticated Ponzi-scheme known as capitalism began to slow.

A constant expansion of credit is absolutely necessary for capitalism to function. Capitalism is like a Ponzi-scheme in that expansion is critical to its on-going survival. When capital markets slow, debt markets collapse as any slowdown in economic activity negatively impacts the ability of debtors to pay compounding debts.

The credit collapse in August 2007 is continuing despite the best efforts of governments and central banks to provide more credit to the markets. Such efforts are futile because banks and investors are increasingly reticent to loan when the odds of being repaid decrease as economic activity slows.

THIS TIME IT IS REALLY DIFFERENT

The road to hell is not a straight line and neither is the path towards the next deflationary depression. The recent stock market rally is a case in point. Hope springs eternal until it doesn't.

The recent stock market rebound is like a tan on a dying man.

The real conundrum faced by central bankers is how to convince investors that the economy is improving when it isn't. A slowing descent is not the same as ascending although many investors are willing to bet their last dollar that it might be so.

Hopelessness is an indicator that another Great Depression has arrived. The recent rally is an indicator that it is not yet here. When it does arrive, stock market rallies will be a memory of times past, times when it was believed that bubbles were real and that markets could be manipulated *ad infinitum* without consequence.

The easy part is over
The hard part's yet to be
The credit has been spent
And we have yet to see

What the reckoning will require
What bills are at our door
Will our children survive a future
That's been indebted by needless wars

The bankers are still in power
Politicians at their beck and call
The system's broke and bleeding
And night's about to fall

I dread tomorrow's awakening
What the light will show to be
A tomorrow spent and indebted
A wasted legacy

Buy gold, buy silver, have faith

Darryl Robert Schoon

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