

FALLING DOMINOES RISING GOLD

Gold is the leading indicator of systemic collapse

The failure of Windows Vista to improve upon Microsoft's accepted standard is an indication that an era is ending. Another indication—just as obvious and far more significant—US central bank credit is no longer automatically able to create economic expansion. Suddenly, cheap credit does not produce growth. An era is over.

THE ECONOMISTS' GREAT CONUNDRUM CREDIT, GROWTH & THE GREAT DEPRESSION

Putting more gas in a stalled engine doesn't work

...since August, when the real estate sector began to turn ugly, the Federal government – i.e., Joe Taxpayer -- has doled out nearly \$1 trillion in direct and indirect support to the credit markets in a so-far failed attempt to unfreeze them

Rick Ackerman, Rick's Picks, March 16, 2008

Credit, like steroids, can be classified as a performance enhancing drug. When introduced into an economic system, its effects are obvious and, in the beginning, positive. Like steroids, however, over time its effects become less positive and underlying problems more apparent and, in the end, are often fatal, e.g. deflation and the Great Depression.

THE END OF AN ERA

In 2008, we are at the end of an extraordinary era of credit set in motion by the Bank of England in 1694. Debt-based money, *sic* capital, issued by the Bank of England allowed England to tax its present and future citizenry *ad infinitum* in order to embark on its highly successful quest of global dominion known as imperialism.

As long as the captured wealth of conquered nations offset the costs of war, England's treasury and empire expanded. But by the end of the 19th Century, England's expansion ended and the keys to its kingdom were transferred to its surrogate successor, the US.

In 1913, banking and business interests transferred the English model of debt-based central banking to America. That year the US Federal income tax and the US Federal Reserve Bank became law and life in the US has never been the same.

Prior to the introduction of the Federal income tax and the Federal Reserve Bank, the lives of Americans were generally free from individual and collective debt. After 1913, everything changed

Seventy years later, in 1983, Nobel Laureate Buckminster Fuller made the following observations on the growth of US indebtedness:

Throughout its first 127 pre-World War I years, the U.S. government often had no national debt. World War I left the U.S.A. with a national indebtedness of \$33 billion.

The U.S.A. banking system went truly bankrupt in 1929, but the New Deal's 1933 Bank Moratorium postponed recognition of that fact

Since then the moment of acknowledgment that the U.S. government itself is financially bankrupt has been postponed first by further- and further-ahead postponements of the payoff dates for U.S. notes and bonds and by successive votes of the U.S. Congress to increase the national debt limit. By "money accounting" (in contradistinction to real-wealth accounting), the U.S.A. is now realistically bankrupt.

Since Nixon became president, the U.S.A. has been unable to pay even the interest on its national debt, let alone reduce the principal. Before Nixon, Congress assumed tax underwriting of ever greater interest-bearing on ever more postponed and greater national debt limits. For all the Nixon years and all the years of his successors the president has had annually to file a negative budget, meaning the U.S. cannot even pretend to be able to pay the interest on its indebtedness.

The implications of US debt cannot be underestimated; for just as global investors were once blind to the underlying credit worthiness of subprime securities, today, they are just as blind to the actual creditworthiness of US debt, *sic* US Treasuries.

SUBPRIME TREASURIES
BACKED BY THE FULL FAITH AND CREDIT OF THE US
WHAT'S THE COST OF INK?

(Not much unless you're buying it in cartridges
from Lexmark, Hewlett-Packard, Epson or Canon)

If, as Buckminster Fuller wrote, *the U.S.A. has been unable to pay even the interest on its national debt, let alone reduce the principal* and therefore is *realistically bankrupt*, its credit rating should reflect that unfortunate state.

But as long as US debt is rated AAA by the same agencies that gave AAA ratings to subprime mortgage-backed CDOs, US treasuries will continue to enjoy the same demand highly rated subprime securities once received. However, nothing lasts forever, not even collective denial.

What happened to AAA rated subprime CDOs will happen eventually to AAA rated US Treasuries. Values vanish overnight when risk is repriced and its effects are swift and draconian. This is what is happened to banks and hedge funds now invested in AAA mortgage backed securities.

Peloton Partners' ABS hedge fund achieved an 87 % return on equity in 2007 and on January 24, it was named the best Euro Hedge fund for 2007; but in February 2008, only one month later, the fund was declared insolvent and its assets seized. The same quick deleveraging will likewise happen someday to those now invested in US Treasuries.

That day will come sooner rather than later. The end of the credit era is near. The citadel of credit itself is under attack. The prime banks, the primary dealers used by the Fed to feed credit into the system are themselves now in trouble.

THE DOMINO THEORY REDUX BAILING OUT BEAR STEARNS

The decision by the Fed to bail out Bear Stearns is tantamount to Britney Spears bolting from rehab—it is now clear the Fed has no intention of cleaning up the mess. Instead, it's aiding the perpetrators.

Matthew Lee, Executive Director of Inner City Press, regarding the Fed bailout of Bear Stearns states:

The Fed has hit a new low with this, they did nothing to protect consumers from predatory lending and now their response is to bail out one of the most notorious enablers of predatory lending...

Investment banks such as Bear Stearns were the alchemists who invented the now toxic brew of subprime mortgage backed securities that investors will no longer buy. What the banks didn't expect is that they would get caught holding the bad debt. They assumed the AAA rated debt they kept was better than what they sold to others. It was—but it still wasn't safe.

To their collective surprise, banks holding billions of dollars of illiquid AAA rated mortgage backed securities are exposed to billions in losses. But, now, the US Federal Reserve has come to their rescue. This is because investment banks, *sic* prime banks, such as Bear Stearns are the very center of the mechanism by which the Fed feeds credit into the system. The citadel of credit is in danger.

The collapse of Bear Stearns is only the tip of the iceberg. Banks such as Morgan Stanley, Citicorp, Lehman Brothers, UBS, Bank of America, Wells Fargo etc. are all exposed to this rapidly imploding pool of mortgage-backed securities.

THE BANKERS' BEGGING BOWL

Bankers from Morgan Stanley, Citicorp, and UBS along with Bear Stearns have already made the rounds of sovereign wealth funds in Asia and the Middle East, asking for sufficient capital to remain solvent. All received promised infusions of billions in capital albeit at very high rates; e.g. 9 % - 11% but now one of them, Bear Stearns, involved in a now questionable \$1 billion investment by China's CITIC, has fallen. Which bank will be next?

Bear Stearns was temporarily rescued by the US Fed via a loan through JP Morgan Chase. This is because the US doesn't have a sovereign wealth fund of its own. Fifty years ago the wealthiest nation in the world, today the US is the world's largest debtor—its wealth now composed primarily of liquid pools of debt fed by a printing press.

GOLD—THE LEADING INDICATOR OF SYSTEMIC COLLAPSE

Against this background, gold again broke the \$1,000 per ounce price level. One year ago, gold was in the mid-\$600 range. Now, it's 50 % higher, a remarkably accurate measure of the rise in systemic stress in global financial markets.

Today's era of credit is built on a foundation of debt. The longer credit-based systems exist, the more debt is created, debt which must be serviced and retired (or rolled-over *ad infinitum* as the US hopes). The cycle of credit begun in England in 1694 has almost run its course; the mountains of debt created in its wake are increasingly unstable and are about to collapse.

The rising price of gold is the market's bet credit markets are in deep trouble. They are. You can bet on it—and should (and soon)!

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