

# INVESTING IN CHAOS THE STORM IS HERE

*All Swans Are Black*

*Saturdays and Sundays  
Used to be fun  
Weekends were holidays  
Perhaps time in the sun*

*But now it's all changing  
Changing for worse  
As bankers are draining  
The public's thin purse*

*Northern Rock Fannie Mae  
Freddie Mac and Bear  
What's next we all wonder  
Who will it be where?*

*Lehman's a lemming  
As was Bear Stearns  
WaMu AIG  
They're all gonna burn*

*Only one thing is for certain  
And that will be when  
The next bank that fails  
It'll be on a weekend*

Last weekend started early for Timothy Geithner, President and CEO of the New York Federal Reserve. At 6 pm, Friday, Geithner called an emergency meeting to discuss the possible collapse of Wall Street investment bank, Lehman Bros.

The troubles of Lehman Bros had worsened during the previous week and the current Fed playbook dictated a solution be found on the weekend to calm financial markets opening Monday; but, this weekend, the Fed playbook came up empty, Lehman Bros. declared bankruptcy.

It's official. The storm is here. In *How To Survive The Crisis And Prosper In The Process*, I predicted a global financial crisis would happen where real estate prices would fall 40-70%, stock markets would crash and a Great Depression would result.

Eighteen months later, the median price of housing in California is down 40 %, global stock markets are in disarray and although another depression has yet to begin, this

weekend's failure of Lehman Bros combined with the pressured sale of Merrill Lynch and the prospect of an AIG collapse are clear signs that we are now that much closer to the predicted end.

This is the end of a system. It is not a cyclical correction. It is not a market pullback and it is not a repricing of risk in an otherwise resilient marketplace. We are witness to the end of an economic system based on credit-based paper money that began 300 years ago in England. All beginnings have endings—and that we didn't expect it to end doesn't mean that it wouldn't.

### THE BANKERS' BEGGING BOWL

Because Lehman Bros.' CEO Richard Fuld received a \$22 million bonus for his "work" in 2007 or perhaps because Fed officials had been openly criticized at their annual Jackson Hole *soirée* for their continuing bailouts of US investment banks, last weekend US officials unexpectedly informed Wall Street bankers that a government bailout of Lehman Bros. was not possible.

*There is no political will for a Federal bailout...*  
Timothy Geithner, September 12, 2008

Geithner's statement really means that Wall Street no longer possesses the requisite political muscle to extract more US dollars from a bankrupt electorate. Last weekend, Wall Street bankers finally understood that their privileged position in the welfare line of US government largesse had come to an end. This time, the banker's begging bowl would remain empty.

With their co-conspirators in the US government no longer able or willing to provide additional US guarantees, the position of investment banks has now become increasingly fragile; and their newly hatched liquidity plan concocted by the bankers over the weekend is another indication of just how fragile their system is.

### THE BANKERS' NEW PLAN

Last Saturday when the bankers realized they could no longer depend on government money to bail them out, they came up with a plan. Granted, they did so with only one night's sleep but nonetheless there appears to be a significant flaw in their thinking.

This is the plan:

*Sept. 14 (Bloomberg) -- A group of banks including Bank of America, CitiGroup and JPMorgan Chase & Co. are putting up \$70 billion for a borrowing fund aimed at providing liquidity... Each participating financial firm will provide \$7 billion to establish the fund and have the ability to borrow up to a third of the total. Other banks include Barclays Plc, Credit Suisse Group AG, Deutsche Bank AG, Goldman Sachs Group*

*Inc., Morgan Stanley, Merrill Lynch & Co. and UBS AG. The pool could expand as other companies join.*

Now, let's get this straight. Ten banks put up \$7 billion for a total of \$70 billion. Because any bank can withdraw up to \$23.3 billion, if three banks take \$23.3 billion each, there will be nothing left for the others. Am I missing something?

There is nothing wrong with the plan, *per se*. The flaw lies in the flawed character of the participants. These are investment banks and if investment banks can exploit a situation, they will do so. That's what investment banks do for a living, they exploit situations for their own advantage in order to maximize profits.

Last year when two Bear Stearns highly leveraged funds were in danger of failing, Bear Stearns came to the "rescue" of one of its funds and lent it more capital, albeit with the *caveat* that Bear now had first claim on the fund's assets. Then, when the fund collapsed shortly thereafter Bear Stearns exercised its now first-in-line rights to all the assets.

Since self-serving behavior is common among investment bankers, it will be interesting to see how the bankers' \$70 billion fund will fare. After the first withdrawal, there may be a "bank run" on the remaining assets by the remaining banks—a real life version of what will be "the Banker's Dilemma".

#### A FRACTIONAL RESERVE SAFETY NET

The investment banks' \$70 billion liquidity fund is predicated on much the same premise that fractional reserve banking is based. While it is understood there may not be enough in the fund to cover all needs, it is assumed that not everyone one will need their funds at the same time.

This thinking/*sic* assumption is the basis of today's fractional reserve banking system; because, as in the banker's "liquidity plan", there is not enough money in US banks in the event of significant withdrawals by savers.

There is \$6.84 trillion on deposit in US banks; but US banks have only \$273.7 billion cash on hand. The banks cannot possibly pay back depositors all their money as only 4 % of depositors' funds are actually available. The rest has been loaned out, i.e. to real estate developers, etc.

The safety net of both bankers and depositors may prove inadequate in the days ahead. Be forewarned.

#### INVESTING IN CHAOS

Investing in these times is investing in a time of chaos; and gold and silver, traditional havens, appear to have failed in that role, both having sustained significant losses of late. But don't dismiss gold and silver so quickly. Their day is coming.

The recent correction of gold and silver was not unexpected. In my book, I noted that in 2006 UBS had predicted a commodities sell-off—*an avalanche sale of all commodities*—could occur and take down gold in the process.

Page 48, from *How To Survive The Crisis And Prosper In The Process*:  
*In the June 5, 2006 article, UBS also warned that while the long term outlook for gold was decidedly positive, there was an intermediate risk of a global economic downturn that would drag “gold down in an avalanche sale of all commodities”; an avalanche that gold would ultimately survive before embarking again on a strong upward path.*

The global turndown predicted by UBS in 2006 is underway; and the current sell-off of commodities, *an avalanche sale of all commodities*, may well be the event predicted by UBS. That such is occurring means we are now entering what I call *the third and final stage of economic-collapse*.

No one knows how long this stage will be. It is clear, however, from the recent takeovers of Fannie Mae and Freddie Mac, and the collapse of Bear Stearns and Lehman Bros. that there has been a seismic shift recently in the global financial landscape.

This stage is the last period in which investments can be profitably re-allocated to take advantage of what will soon happen, a financial tsunami the likes of which have never before been seen. A deflationary collapse with hyperinflation is only one possibility. There are more.

Professor Fekete’s final session of Gold Standard University Live will take place in Canberra, Australia, November 11-14. I will be joining Professor Fekete and Tom Szabo in discussing the gold and silver basis as a trading strategy in this critical period, see [feketeaustralia@yahoo.com](mailto:feketeaustralia@yahoo.com).

There are proven ways to prepare for what is to come. In matters of money trust in gold and silver; in matters of the world trust in the perfidy of man; and in everything, trust in God.

Until humanity changes, history will not.

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