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Emerging Trends Report
Bridging the Business Intelligence Gap

Credit and Credibility

by Richard Karn/ETR: ***01.07.2009***

Introduction:

By early November of 2008, the Emerging Trends Report (ETR) had been inundated with so many enquiries regarding the viability of our themes in light of the global financial crisis that we embarked on a review and re-evaluation of all nine of our themes in this fluid and decidedly hostile environment. Eight months on, this book-length tenth report is the result.

So many institutions have imploded, so many practices have been exposed as morally and ethically reprehensible if not blatantly fraudulent, so many lives have been shattered, so many longstanding agendas have been exposed as having served special interest groups at the expense of the American taxpayer that one could be forgiven for thinking the sky is falling. And to a certain extent that sentiment is warranted, for there can be no mistaking that 'things' will never go back to how they were but a year ago. The collective delusion of riskless gain has been dispelled, and the irritable hung-over sobriety that is replacing it will likely prove to be less docile and easily gulled than our leaders imagine. ***Too much has gone too far—and has still farther to go before our future takes shape in the murk, not least because politicians supposedly acting on our behalf are using the cover of crisis to affect wholesale changes throughout our country that if unchecked will have tremendous, lasting effects on our lives.***

These changes are the subject of ***Credit and Credibility,*** and the report has two distinct parts. The first five chapters deal exclusively with our 'Big Picture' assessment of what we consider to be the five most pressing issues facing the US and global economy. The remaining ten chapters and appendices concern the shift our assessment of these issues has precipitated in our investment approach, and how each of our themes will be affected in the years ahead. We found that the most concise and effective way to present the material was to simply include complete copies of our original reports, including stock recommendations and source material (which we have consolidated in a separate appendix), followed by an update contrasting our view on these themes today in light of these five over-riding issues, and the investment opportunities and approach attendant to each.

The issues explored in the first five chapters may be summarized as follows:

- Although dramatic, the unprecedented interventionist policy responses to the collapse of the credit bubble have been entirely consistent with previous efforts in that they ***do not, and are not intended, to address the cancer of the fiat dollar but to treat the symptoms of the opportunistic sicknesses that have preyed on the financial system's weakened condition.*** Clearly, a policy of doing more of what has not worked, only harder, is not the answer, which leads us to the conclusion the Fed, Treasury and various sectors of the economy are making a desperate bid to inflate yet another asset bubble, though whether politicians will succeed in *mandating* that it is in all things 'green and sustainable' or if it will manifest itself in emerging markets or the commodities that feed them or in something entirely unpredictable is anyone's guess.

- It is our contention that it was a ***global fiat currency glut, not a savings glut,*** at the heart of the financial crisis, which will have profound implications for the global economy—***because we have come to the conclusion that despite the rhetoric all fiat currencies today are but derivatives of the US dollar, which means one way or the other it will not be allowed to fail or be discontinued from use as the world's reserve currency.***

- Our findings suggest the collapse of the credit bubble means ***there will be less decoupling by emerging markets from the US and OECD than projected by the purveyors of hype but a more natural and sustainable, internally-generated growth rate for those economies;*** and China will indeed be the litmus test.

- ***No matter how we look at it, one thing appears certain: henceforth the USA is going to have to rely on the production, innovation, cultivation and extraction of real goods and tradable services the world wants to buy, for it has clearly had its fill of our 'financial innovations.'*** A rebalancing of the US economy is underway and gathering momentum: the decisions we make at this critical juncture will overwhelmingly determine the kind of recovery America experiences and will have lasting repercussions on what we bequeath to our children, and theirs**.**

- If carbon legislation is enacted in its current form, the American economy will be irreparably undermined: despite propaganda to the contrary, the US still has the largest manufacturing sector on the planet, bar none, and it is both one of the most efficient as well as one of the cleanest—in fact surpassing Kyoto Protocols. ***Cheap electricity and high productivity help US manufacturing remain competitive in a world where our labor is not***. ***Anyone, including the President of the United States of America, who contends America can remain competitive today with expensive electricity and expensive labor is either delusional or furthering a specious agenda at America's expense.*** If carbon legislation is enacted this fall, the cleanest examples of manufacturing and industry on the planet, which are universally located in the US and the OECD, will relocate to countries unbound by such restrictions—***arguably resulting in increased carbon emissions not less, for it would be far more profitable to employ fewer of these technologies and to pollute more.***

We make no apology for our interpretations of the dollar, global support of it, or our views regarding the threat carbon policy poses to Americans' well-being. If our assessment seems cynical or conspiratorial, we submit the behavior of both governments and the financial industry worldwide warrants our suspicion, for they no longer merit the benefit of the doubt as both have become serial betrayers of the public trust.

Curiously, however, we are guardedly optimistic about the future because of a growing trend in our reading. The Culture of Cheating has run amok so thoroughly for so long that the country is slowly building toward one of those *"I'm mad as hell and I'm not going to take this any more"*[1] moments that may precipitate both corruption investigations and anti-trust legislation on a

[1] Chayefsky, Paddy: ***Network***; MGM: 1976. The "Mad as Hell" soliloquy may be viewed here: http://www.youtube.com/watch?v=90ELleCQvew&feature=related

scale surpassing that of Watergate—and as far reaching. It may well signal the dawn of an Age of Skepticism in which the onus of proof will be shifted onto those attempting to persuade the public of the validity of their apocalyptic claims and proposals rather than being given free rein to act unilaterally 'in our best interest.'

In times like these it is difficult to be optimistic about anything, but the ETR would like to point out that over the last two centuries the United States has suffered numerous end-of-the-world financial collapses as a result banking excesses and has subsequently remade itself in each instance, evolving from client state to resource giant to industrial behemoth to financial capital of the world—we have in fact, never stopped changing. This maelstrom of crises presents Americans with the opportunity to again demonstrate our resiliency—and that is what we have voted for: change, in both our lives and in our economy. We are not as quick as those on Wall Street to write off the US economy, nor do we subscribe to the notion of a V-shaped recovery that amounts to resetting the Monopoly board and starting a new game, all extrapolated from "less bad is good" rationales emanating from their utterly discredited computer models—the same models, we are compelled to add, that did such a good job of mitigating risk right out of their business models that it precipitated the largest financial crisis in living memory.

There will be no divine intervention. The Obama administration, Fed and Treasury will not succeed in bringing the financial sector back to life, but rather like Dr. Frankenstein may be undone by their diddling, for everything we are seeing in the financial sector amounts to but encouraging the monster they have created to run amok again. No, the rebalancing of the US economy and its recovery will be affected *despite* their efforts. Americans are going to realize they have to put their heads down and go back to work—just as we have always had to do in such circumstances. We are fortunate in that we have a youthful, competitive population, historic resilience, and a geographically superior economy that affords us many advantages enjoyed no where else on earth. We regret however that President Obama has chosen to emulate the wrong Roosevelt: ***what we need is a trust-buster carrying a big stick.***

Chapter 1: *"Pay no attention to that man behind the curtain!"*[2]

Americans' willful ignorance of all things economic combined with a blind faith in our elected officials has made us all complicit to one extent or another, even if by omission, in the financial crisis rocking our country. Most of us have been viscerally aware of the economic problems our country faces, but as with health check-ups after a certain age we've become loathe to visit the doctor for fear of what all those warnings we've been studiously ignoring really mean. And the truth is that you do not need a doctorate to know that our economy is displaying the pathology of a critically ill patient that has been so badly, and we would argue purposefully, misdiagnosed that the disease itself has escaped real treatment while those treatments administered to the symptoms have only served to accelerate the progress of the disease.

We all want to believe that our government is acting in our best interests, that its shortcomings and failures are a matter of well-intentioned incompetence and not something more sinister. But political pandering to special interest groups routinely takes precedence over the common good and is largely responsible for bringing us to the brink of economic collapse today. In what has become an all too familiar scenario, successful lobbying resulted in the de- or self-regulation of another segment of the financial industry, which was accompanied by the concurrent

[2] Langely, Noel (screenplay): ***The Wizard of Oz***; Metro-Goldwyn-Mayer: 1939.

elimination, subversion, or de-fanging of agency enforcement, and has culminated in another financial crisis rife with corruption, the cost of which is once again being borne by American taxpayers. ***It strikes most of us as perfectly obvious that politicians cannot serve two masters, especially when one pays better and arguably preys on the other, but the practice continues unabated***—as is witnessed by the financials sector's continuing influence in Washington despite the revelations of the last 18 months.

The sheer scale of the debacle guarantees it will be the subject of myriad forensic dissections regarding what went wrong in the US and why, but the ETR submits historians will eventually point to the root of the problem being the very nature of the US dollar itself. The dollar has been a purely fiat currency since August of 1971 when President Richard Nixon ended its convertibility to gold. We support the contention that it is the inherent lack of fiscal restraint attendant to the subjective administration of a fiat currency regime rather than a rules-based currency accessible to all, such as a gold standard, that has by design or default culminated in the problems extant in the US economy today; that the dollar is the world's reserve currency has startling implications for the global economy well beyond the heated rhetoric its mismanagement has provoked amongst our allies, trading partners and rivals alike.

Let us not equivocate here: ***the economic failure we are witnessing today is not with capitalism as many would have us believe but with the abuse engendered by the interventionist policies that have been put into practice since the US dollar became a purely fiat currency.*** It is not a coincidence that since ending the dollar's convertibility to gold America has been transformed from the largest creditor nation on earth to the largest debtor nation, nor that it has fallen from one of the most admired nations on earth to one of the most reviled. Any economic system whose foundation rests on the shifting sands of a fiat currency is destined to collapse: this has been the case with every single fiat currency in history, twenty failing during the 20th century alone,[3] and the reasons are not difficult to fathom. ***When a government holds its currency—literally its stock in trade—in low regard, which history tells us a fiat currency regime invariably does when it can conjure money at will to spend as frivolously as it dares, inevitably certain of its citizens will too, giving rise to a Culture of Cheating.*** No longer restrained by such quaint notions as sound money of tangible lasting value or living within our means, the unbridled expansion of credit has witnessed a corresponding increase in the frequency of financial crisis, each of escalating magnitude and attended by ever more pervasive corruption.

Interventionist policy responses implemented ostensibly to resolve one crisis serve as well to foster the development of the next because the 'solution' never addresses the root of the problem, only its latest chaotic manifestation. Despite demonstrating time and again that low interest rates combined with massive liquidity injections invariably lead to asset bubbles that also invariably collapse,[4] that accurately summarizes the Fed and Treasury's uniform response to crisis: promote the assumption of more debt as the means to restore economic growth. But artificially stimulating growth through the creation of debt has been proven over the years to diminish the effect of each effort due to the increasingly debilitating economic drain attendant to servicing the accumulated debt, the misallocation of easy credit toward consumption rather than production, and the specious growth attendant to siphoning off 'profits' from transactions that merely shuffle the new paper hither and yon. The growing imbalance between the service and manufacturing industries is reflected in the persistent deterioration in results: in 1966, each dollar borrowed

[3] Kotlikoff, Laurence J.: "Is the U.S. Going Broke?"; Forbes: 29.09.2008. http://www.forbes.com/forbes/2008/0929/034.html
[4] Altman, Roger C.: "The Great Crash, 2008"; Foreign Affairs: January/February 2009. http://www.foreignaffairs.org/20090101faessay88101/roger-c-altman/the-great-crash-2008.html

produced ninety-three cents of GDP growth; by 2007, a borrowed dollar produced less than twenty cents of GDP growth.[5] (Please refer to the charts on page 5.) In other words, each new effort requires more 'stimulus' than its predecessor in order to produce a similar result: we term this policy rut, which we believe has spilled over into many aspects of American society, the doctrine of ***'more of the same, only harder'*** *because the desired outcome is not to cure the problem but to perpetuate it by deflecting it in a new direction.*

Nearly four decades of experience with the fiat dollar is plainly telling us that this doctrine has failed, and until the fiat dollar is rejected, the progression of financial crises will continue to accelerate until our economy, and indeed quite probably large swathes of the global economy, is hopelessly gutted and lay in ruins. We see this reflected in our vulnerable household finances which have deteriorated to the point we increasingly rely on revolving credit instead of savings as the most important source of liquidity after our jobs.[6] We see it in the uncontrolled growth of US trade imbalances, military adventurism, deficit spending, un- or underfunded entitlement programs, and ever more debt issuance and monetary expansion that have culminated in American taxpayers ultimately being responsible for more than $70 trillion dollars of debt,[7] not including that which we are currently assuming ostensibly to stave off financial collapse— ***a debt so large in fact it is literally only possible under a fiat currency regime.***

Spurious interventionist arguments that the fiat dollar regime has bettered Americans' standard of living have proven to be a statistical mirage that applies primarily to those employed in the very sectors that have been manipulating the system for fabulous profits at the expense of the rest of the country. As can be seen on the following charts, three decades of the 'financial innovation' attendant to the fiat dollar has generated so much profit for the financial industry that its share of total US corporate profits rose from 10% in 1980 to 35 % in 2007[8] at the same time the vast majority of Americans have suffered the indignity of working more hours but earning roughly 20% less in real-dollar terms than their fathers did in 1970—and having a lower standard of living to show for it[9]:

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[5] Welsh, James E.: "The Financial Commentator on the Economy"; Welch Money Management: Vol. 5, Issue 28, 04.05.2009. (subscription required) http://www.welshmoneymanagement.com

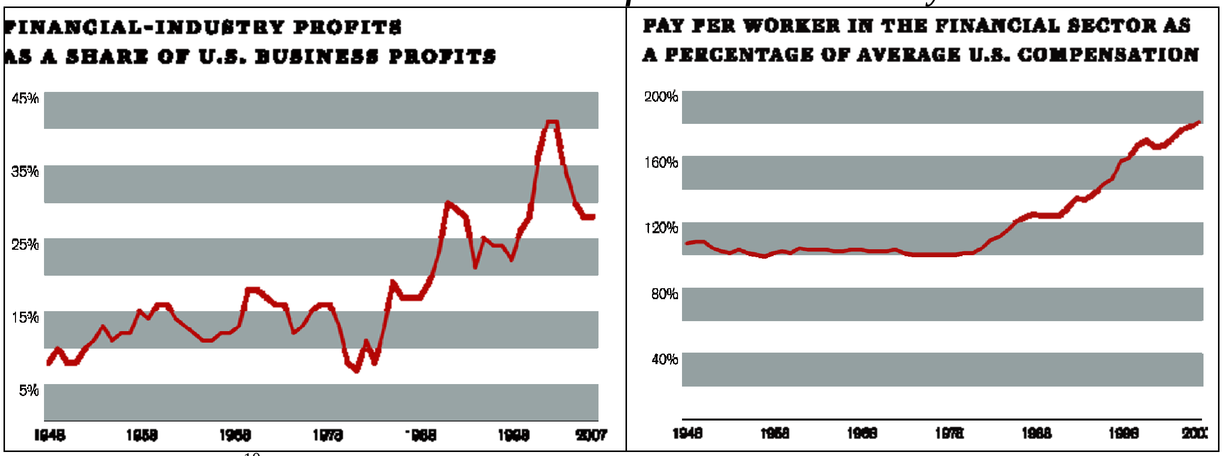
[6] Whitney, Meredith et al: "Consolidated Lending Market Poses Risk to Overall Consumer Liquidity"; Oppenheimer: pp. 1: 30.11.2008. http://www.opco.com

[7] Kotlikoff, Laurence J.: "Is the U.S. Going Broke?"; Forbes: 29.09.2008. http://www.forbes.com/forbes/2008/0929/034.html

[8] Laise, Eleanor: "Some Consumers Say Wall Street Failed Them"; The Wall Street Journal: 29.11.2008. http://online.wsj.com/article/SB122791328588265155.html

[9] Williams, Walter J: "Still-Intensifying U.S. Inflationary Recession…"; Shadow Government Statistics: No. 47, pps. 45-6, 14.11.2008. http://www.shadowstats.com

Chart 1: The Rise of the Financial Industry



Source: Johnson[10]

The inevitable disequilibria produced by a fiat currency regime has far more to do with greed than with political ideology or economic system, but collectivists, arguably even more prone to fiat excess than capitalists, hypocritically use it in promoting their cause nonetheless. In its simplest form, a fiat currency regime enables a well-connected educated class to utilize the financial system to prey on the ignorance of less sophisticated classes for whom it is difficult to conceptualize the notion that one can earn increasing amounts of nominal fiat dollars over time that actually have significantly less real purchasing power, resulting over the course of decades in less real dollar wealth and a lowered standard of living.

This has turned what used to be called “The American Dream” into a nightmare of failed aspirations for many working families. Work hard, pay your taxes, and save money to buy your family a home, to pay for your children’s education, to fund your retirement, and to eventually enjoy your golden years with your family: that’s the formula many Americans were brought up to believe was the right way to live. What most Americans have not been able to grasp since the dollar became a purely fiat currency, however, is that the dollar’s loss of purchasing power is an intentionally administered policy to confiscate by inflation[11] the 2-3% of taxpayers’ money the government believes Americans will either tolerate without complaint or simply not notice being taken from them year in and year out for their entire productive careers. Then, when you finally retire and find the time to consider the way that first $100 you saved early in your 40-year career has only retained roughly $17 of its purchasing power,[12] not including the taxes you have paid on the interest earned over that time (see below), and grow indignant over the way you have been defrauded by those you elected and trusted to protect your interests while you were busy earning a living, a whole new generation of innocents is so intent on pursuing the American Dream that they have no more patience with your bitter conspiracy theories than you did with your parents’ stories about how the dollar didn’t buy what it used to. That is the insidious nature of a fiat currency

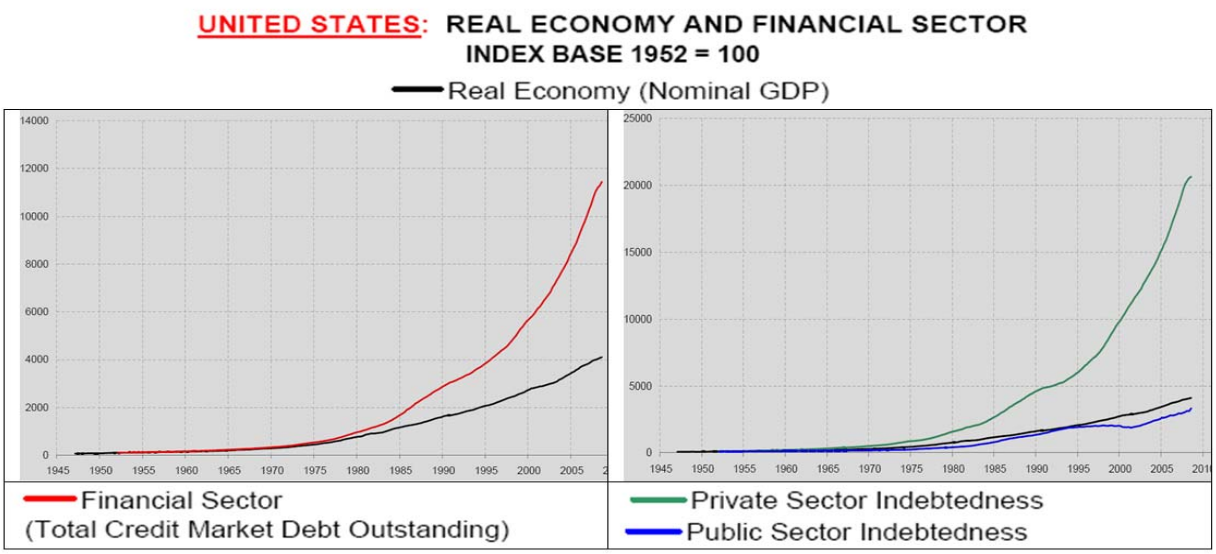
[10] Johnson, Simon: “The Quiet Coup”; The Atlantic: May, 2009. http://www.theatlantic.com/doc/200905/imf-advice

[11] Greenspan, Alan: “Gold and Economic Freedom”; the Objectivist: 1966. http://www.financialsense.com/metals/greenspan1966.html

[12] The Federal Bank of Minneapolis: “What is a dollar worth?”; undated. http://www.minneapolisfed.org/index.cfm

regime: it is a slow, parasitic process that gradually drains economic vigor from a society much the way a cancer slowly consumes its host.

Interventionist policymakers supported by entire university faculties and numerous Nobel Laureates tell us that a little inflation is a good thing in that it provides the fiat dollar with flexibility, and it is this flexibility as managed by the interventionists themselves that has enabled the US economy to become the dynamic, adaptable bastion of capitalism it is today. ***The ETR humbly submits this is utter malarkey: it is exactly this 'flexibility' of not having a currency bound by any rules whatsoever that has enabled the gross excesses and corruption that created the whole string of crises.*** The oft touted 'Great Moderation' enabled by low interest rates and subdued growth that has been held aloft as proof positive of interventionist acumen has been but a façade masking 25 years of debt growth averaging 8.9% per year while GDP growth averaged but 5.9%: during that time, as can be seen on the following chart, debt growth rose by a cumulative \$45.1 trillion while GDP only rose by \$10.9 trillion.[13]



Source: Kemp/Reuters[14]

What the combination of these charts and the ones on page 3 show us is that since the US government implemented a fiat currency regime the economy grew a little and debt grew a lot, and the financial industry profited disproportionately from both.

The imposition of a fiat currency regime enables politicians to profit by expanding their power base because it affords them the opportunity to curry favor with voters by promoting programs our country cannot afford. Financiers profit from the unbridled extension of credit to fund these and ancillary spending programs. Then, when cumulative imbalances and the latest wave of corruption topple the economy into crisis, usually as the result of an asset bubble deflating, the very same interventionist policymakers that put the enabling legislation in place declare themselves indispensable to its solution and put forth reactionary remedies that merely

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[13] Grant, James: "The Confidence Game"; Wall Street Journal: 18.10.2008. http://online.wsj.com/article/SB122428355436946301.html

[14] Kemp, John: "U.S. & UK on brink of debt disaster"; Reuters: 10.01.2009. http://www.reuters.com/article/reutersComService4/idUSTRE50I4BU20090119

deflect the problem in a new direction, invariably creating a new, larger one that will eventually self-destruct and require fresh ministrations.

This can be seen today in another longstanding justification for the use of a fiat currency, namely that, unlike its antithesis gold, the fiat dollar earned interest income for depositors. Put your fiat dollars in the bank and watch them grow. That notion is founded on the slippery assumption that the interest you earn on your deposit exceeds the expense of saving; that is, after subtracting the loss of purchasing power due to inflation and the taxes paid on the interest earned, saving money still earns you a profit. It often doesn't. This argument, which has become increasingly contentious in recent years, has been rendered moot today by the Fed lowering interest rates effectively to zero, officially sanctioning the negative real interest rate environment numerous commentators submit has been extant since at least 2001.[15]

The Fed's policy today amounts to punishing prudent Americans by directing what meager profits their savings should be earning to the very same profligate bankers that have rewarded themselves so lavishly for managing said savings so abysmally.[16] A negative real interest rate environments is designed as a means to discourage you from saving, in effect driving you to speculate or otherwise keep your money circulating through the economy in an effort to overcome your savings' loss of interest income as well as its loss of purchasing power; should you insist on depositing your money in a bank for safekeeping, your money will help serve to make the financial sector whole again by positioning it to profit from the use of your money. ***The cumulative failure of interventionist policies has produced the distortion today in which you are charged for the act of saving money while the financiers storing your money, who did nothing to earn it, in turn loan out multiples of your money to others for a profit***.

Another excess engendered by a fiat currency regime is deficit spending. For years Americans have been assured that we do not need to be concerned about the amount of debt the US has been accumulating, and to our discredit we simply couldn't be bothered to rein in such patently delusional thinking. It was easier to be gulled by cockamamie notions such as 'deficit spending is like borrowing from ourselves' than it was to demand our government behave in a financially responsible manner reflecting our position in the world economy. The justification for deficit spending may be summarized as the "implicit inter-generational contract whereby any new generation inherits a debt, but also a safe place to live and functioning public services… and the benefits of living in a highly developed society."[17] This apologia presupposes a large portion of deficit spending is in fact directed to the betterment of America, its infrastructure, social safety nets, and public services, making America a better place to live and work and raise a family as well as improving our economic competitiveness internationally. As is explored throughout this report, this simply has not been the case—in fact, it is primarily the failure to honor this implicit compact that has resulted in the dilapidation of large portions of America's infrastructure. We are just today, in a fit of Depression era work programs, borrowing even more money to embark on the infrastructure repair, replacement and expansion that has been postponed by generation after generation of spendthrift politicians who could find money for every hare-brained program imaginable but not for those needing to be done to keep America well. Today the Congressional

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[15] Williams, Walter J.: "Government Economic Reports: Things You've Suspected But Were Afraid To Ask! The Consumer Price Index"; Shadow Government Statistics: 01.10.2006. http://www.shadowstats.com/article/56

[16] Associated Press (not attributed): "Despite Crisis, Bankers get $1.6 Billion"; Associated Press: 22.12.2008. http://moneynews.newsmax.com/streettalk/bailout_executive_pay/2008/12/22/164409.html

[17] Mares, Arnaud & Cailleteau, Pierre: "How Safe are Safe Havens?" Moody's Global Sovereign: April 2009. http://www.moodys.com

Budget Office places the interest payments on our national debt at $172 billion; by 2019, it anticipates our annual interest payments will more than quadruple to $806 billion each year—which means our interest payments alone will surpass the GDP of Australia, the twentieth largest economy in the world in 2008.[18] Your take on the effectiveness of deficit spending is as valid as ours, as is your judgment of whether we will indeed bequeath a better America to our children than the one we inherited from our parents—the promise implicit in deficit spending.

Such statistical slight of hand, obfuscation and rhetorical subterfuge has always been part and parcel of a fiat currency regime—nothing is new with the fiat dollar other than its global reach and that it is supported by unparalleled marketing. Strangely enough, however, the financial sector itself is not the problem. Banking is an integral, fundamental aspect of capitalism in that it facilitates the efficient pricing and distribution of funds critical to economic development. ***The problem always arises not so much from a lack of oversight as a failure of agency enforcement on the part of government because the rewards of corruption are, and always have been, irresistible***; this is why, to paraphrase Thomas Jefferson, our founding fathers feared bankers more than standing armies and took steps in the Constitution to protect us from them.

Today nearly forty years of interventionist policies in service of the fiat dollar regime has resulted in what many commentators refer to as the replacement of the business cycle with the bubble cycle. Policymakers have been immensely successful at masking the naturally occurring tendency of a fiat currency to inflate itself toward worthlessness with one nominal asset bubble after another, if not providing then certainly exaggerating the boom-and-bust illusion of prosperity; however, each bubble cycle's phony prosperity, by misallocating resources away from the substantial toward the ephemeral, also masks the perpetual erosion of the integrity of the economic system as a whole. This amounts to a clear rejection of the Fed's purview of providing monetary stability and controlling inflation in favor of maintaining a distorted status quo that is extremely rewarding for politicians and financiers alike; consequently, it should come as little surprise that the financial media fall over themselves with praise for Fed interventionism. American taxpayers, on the other hand, in placing their trust in these institutions are behaving like chickens that keep going back to foxes for more advice about why the chicken population is declining.

Be that as it may, the Fed and US Treasury are frantically attempting to use taxpayer money to affect a "System Restore"[19] on the financial sector. Under the guise of avoiding a collapse should these 'too big to fail' money center banks in fact do exactly that, ***they have managed to shift literally trillions of dollars of speculative losses from the financial industry to the American taxpayer, without implementing so much as a single change to prohibit such behavior in the future or issuing a single indictment for fraud.*** In fact, a case can certainly be made that they are actively encouraging more of the very behavior that precipitated the financial crisis.

Hell-bent on re-inflating the credit bubble and propping up the stock market, they have unleashed such a plethora of bailouts,[20] rule changes, and controversial 'strategies' that it takes the interventionist doctrine of 'more of the same, only harder' to previously unimagined heights. Although it is too early to tell if any of these programs have had much effect, other than in rewarding financiers for their malfeasance, ***the dollar amounts involved serve, if nothing else, to delineate the extent to which the financial sector erred with its computer models of risk***

[18] Central Intelligence Agency (CIA): ***World Fact Book: 2008***; CIA: last update 14.05.2009. https://www.cia.gov/library/publications/the-world-factbook/rankorder/2001rank.html

[19] System Restore is a software program that returns a computer's setting to a time when the system was operating properly.

[20] For a chronicle of programs extant through early June 2009 when we go to press, please refer to Appendix 2.

mitigation: between the asset purchases, hard guarantees, implicit guarantees, and soft guarantees the Fed and Treasury have committed American taxpayers to potentially spending between $22.4 trillion dollars and $29.1 trillion dollars to bail out the banking sector.[21] To put the size of the speculative losses these financial professionals have incurred in perspective, and using dollars adjusted to reflect 2008 prices, *one way to think of their losses is that they amount to more than three times the combined costs of every war America has fought since the Revolutionary War began in 1775.*[22] Another way to think of it is to simply do the math: ***the debt the Fed and Treasury have volunteered us to pay works out to between $73,000 and $95,000 for each man, woman and child alive in the US as of January 1, 2009.***[23] That's in addition to the $70 trillion, or more than $220,000, we each owe for various and sundry entitlement programs, which conjures images of sentencing our descendents and theirs to indentured servitude.

A significant portion of the money committed to date was clearly used to facilitate the forced selling and deleveraging at money center banks in late 2008, which should not be confused with engendering a renewed appetite for risk or compelling banks to extend fresh credit to the real economy.[24] Widely assumed to be intended to protect bank equity valuations from further decline, which they finally managed to arrest in the spring of 2009 by rescinding mark-to-market accounting (see below), the Fed and Treasury have been sued twice to date but refuse to divulge to whom or for what collateral they have loaned more than $2 trillion of taxpayer money so far,[25, 26] though speculation is rampant (Please refer to Chapters 2 & 3). As it stands, if the banking industry were as well-capitalized as they have been reporting in their financial statements, how could they require the $2 trillion Treasury Secretary Geithner claims is needed to plug the hole in the banking system? It is simply not possible for both the financial sector and the Secretary of the Treasury to be telling the truth, which suggests fraud on a grand scale.[27]

Curiously enough though, money does not seem to be enough to solve the problem. What appears to be of more concern to the Fed is the decline in securitization, the packaging and resale of predictable revenue streams such as mortgages, credit card debt and car payments, which is the specialty of these money center banks. It seems that no matter how much money the Fed and the US Treasury throw at the money center banks to keep them solvent, it is offset by the plummeting value of the securitized loans they kept on their books instead of peddling to foreigners, ***which was akin to a drug dealer starting to use his own product,*** and explains part of what has gone wrong.

The vital role securitization has come to play in the financial system cannot be overstated, for it represents the primary corridor through which US private sector debt is transferred to the rest of the world, an arrangement interventionists are eager to maintain. Why foreign central banks and

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[21] Please refer to Appendix 2 for Dalio, Ray: "1Q 2009 Client Conference Call"; Bridgewater Associates: slide 7, 22.04.2009. http://www.bwater.com

[22] Daggett, Stephen: "Cost of Major U.S. Wars"; Congressional Research Service Report (RS22926): 24.07.2008. http://www.history.navy.mil/library/online/costs_of_major_us_wars.htm

[23] U.S. News & World Report: "U.S. Population, 2009: 305 Million and Counting"; U.S. News & World Report: 31.12.2008. http://www.usnews.com/articles/opinion/2008/12/31/us-population-2009-305-million-and-counting.html

[24] Nolan, Doug: "Debt Trap"; Credit Bubble Bulletin/Prudent Bear: 06.11.2008. http://www.prudentbear.com//index.php/creditbubblearchivedisplay?art_id=10149

[25] Pittman, M., Ivry, B, & Fitzgerald, A.: "Fed Defies Transparency Aim in Refusal to Disclose"; Bloomberg: 10.11.2008. http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aOngFPgq7r3M

[26] Wutkowsky, Karey: "Fox Business sues Fed for information on bailouts"; Reuters: 12.01.2009. http://www.reuters.com/article/bondsNews/idUSN1235009220090112

[27] Willoughby, Jack: "The Lessons of the Savings-and-Loan Crisis"; Barron's: 11.04.2009. http://online.barrons.com/article/SB123940701204709985.html?page=sp

financial entities continue to purchase US debt is discussed in the next chapter, but any decline in securitization represents a significant threat to the system, which was succinctly voiced by Jim Bianco thus: *"The banks are lending, but with less leverage off their reduced capital, and their critics fail to recognize that in recent years securitization replaced bank lending, and (it) has virtually stopped with little likelihood of coming back any time soon."*[28]

With the securitization market still constrained, a larger portion of what non-mortgage loans banks are making must be kept on their books, increasing risk and risk aversion in equal measure. On the one hand, it means some of these banks are unwilling to lend except to those who clearly do not need it, which improves the quality of their loan book; and on the other hand, *some of these civic-minded banks are more than willing to sit on the taxpayer money lavished upon them by the Fed and Treasury*. This latter group knows full well the longer they wait the deeper the credit crisis will become, and some banks have every intention of not using taxpayer money to lend but to acquire depressed assets[29] their current inaction will in fact make cheaper the longer they wait. As it stands, according to the most recent Treasury data, the twenty money center banks that have benefited from taxpayer largess made or refinanced 23% fewer new loans in February than in October when the Troubled Asset Relief Program (TARP) was instituted.[30]

The matter of banks' reduced capital has been deftly overcome by the Financial Accounting Standards Board (FASB) succumbing to financial industry and political pressure and effectively rescinding mark-to-market accounting, despite both the SEC and FASB opposing the move on the grounds it would "hurt the quality and transparency of financial reporting and further diminish investor confidence in the markets."[31] Mark-to-market accounting is by its very nature pro-cyclical in that it affords a company's management the opportunity to value an asset whose worth cannot be determined objectively based on a financial model of their own design, known as mark-to-model, which as Enron pioneered and demonstrated time and again can be virtually any value management programs their model to deliver. As has been made clear by the financial crisis, this is the accounting recipe for understating liabilities and overstating both equity and earnings. What was not anticipated, however, was the way the thin or non-existent markets for illiquid assets like derivatives and mortgages can also completely disappear during a severe downturn such as the one we are experiencing, amplifying the opposite effect. Without an end to mark-to-market accounting, the derivative and loan positions of at least sixteen of the aforementioned twenty money center banks currently on taxpayer-funded life support would be insolvent.[32]

In any case, market-to-market was rescinded, and ***banks can now assign a loan or an asset on their books the value they think someone might pay for it sometime in the future when the credit markets ease sufficiently and there are more bidders—in other words, any value they choose.***[33] This invites banks to engage in all manner of 'financial innovation' again, such as discounting the cash flows from assets that may not actually be performing or simply deciding that its bad debts are only temporary and choosing to take no charges whatsoever. The rule change is

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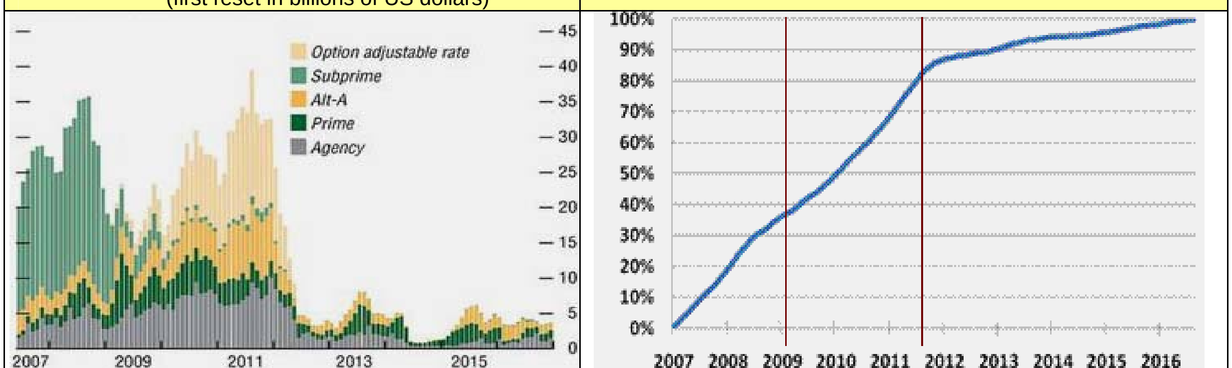
[28] McAvity, Ian: "Deliberations on world markets"; IRIS Ltd: Vol. 37, No 8, pp. 3, 28.01.2009.
[29] Nocera, Joe: "So When Will Banks Give Loans?" New York Times: 25.10.2008. http://www.nytimes.com/2008/10/25/business/25nocera.html?_r=1&adxnnl=1&oref=slogin&ref=business&adxnnlx=1225573836-P4AC/5+GMKdbpCJdiBKrVA
[30] Enrich, David, Crittenden, Michael R., & Tamman, Maurice: "Bank Lending Keeps Dropping"; The Wall Street Journal: 20.04.2009. http://online.wsj.com/article/SB124019360346233883.html
[31] Younglai, Rachelle & Wutkowski, Karey: "U.S. nears mark-to-market accounting guidance"; Reuters: 11.03.2009. http://www.reuters.com/article/businessNews/idUSTRE52A55920090311
[32] Hale, Clive: "Debtor's Prison"; FullerMoney Daily Comment: 30.04.2009. http://www.fullermoney.com
[33] McTeague, Jim: "Marking Down Honest Accounting"; Barron's: 04.04.2009. http://online.barrons.com/article/SB123879929537288311.html

particularly helpful in this latter case because a May 2009 report by the Federal Deposit Insurance Corporation (FDIC) found the overall loan quality at American banks was the worst since 1984 when they began keeping records and it was deteriorating at the fastest pace on record.[34] Thankfully, the rule changes were implemented in time for the first quarter earnings season, which allowed Wells Fargo to report its most profitable quarter ever,[35] and Citibank to claim that a $2.8 billion dollar loss before the rule change was in fact a $1.6 billion dollar profit after.[36]

As can be seen on the following chart, the end of mark-to-market is also just in time for banks to dodge what may have proven to be a new round of impairments to their balance sheets as the next wave of Alt-A and option-ARM mortgage resets gets underway. Not having to recognize the write-downs associated with non-performing mortgages and foreclosures alleviates concerns regarding the lack of 'orderly transactions' altogether.

Chart 3: The Mortgage Reset Schedule

Monthly Mortgage Rate Resets (first reset in billions of US dollars)	Reset Schedule (Percentage of Mortgage Resets Completed)



Source: Hussman/Credit Suisse[37]

Perhaps it will also slow an accelerating trend currently being ignored by a host of regulatory agencies which sees *banks simply walking away from houses they have foreclosed on because they are increasingly finding themselves in a negative equity situation on the property*, effectively dumping the houses on municipal governments and in some cases back on the very people they have evicted.[38]

So now that banks have been put into a position to start lending again, however reluctantly, the trick for the interventionists at the Fed and Treasury becomes how to convince a population suffocating under what may prove to be unsupportable debt loads to take on more debt. This may prove to be something of a feat for a number of reasons, not least being that it does not appear all of the players on the same page: a Fair Isaac Company (FICO) study released in April found that

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[34] Norris, Floyd: "Troubled Bank Loans Hit a Record High"; The New York Times: 29.05.2009. http://www.nytimes.com/2009/05/30/business/economy/30charts.html?_r=1
[35] Weil, Jonathan: "Wells Fargo's Profit Looks Too Good to Be True"; Bloomberg: 16.04.2009. http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a6sv0hG.nW7g#
[36] Welsh, James E.: "The Financial Commentator on the Economy"; Welch Money Management: Vol. 5, Issue 28, 04.05.2009. (subscription required) http://www.welshmoneymanagement.com
[37] Hussman, John P., PhD: "On the Urgency of Restructuring Bank and Mortgage Debt, and of Abandoning Toxic Asset Purchases"; Hussman Funds: 30.03.2009. http://www.hussman.net/wmc/wmc090330.htm
[38] Saulny, Susan: "Banks Starting to Walk Away on Foreclosures"; The New York Times: 29.03.2009. http://www.nytimes.com/2009/03/30/us/30walkaway.html?_r=4&th&emc=th

11% of U.S. consumers, some 22 million people, saw their credit lines cut or accounts closed even though they possessed solid credit ratings and had been paying their bills on time.[39] Revolving credit has contracted for seven months running, and consumer credit for six of the last seven, with the last three months (April, March and February of 2009) experiencing the most severe decline since 1980.[40]

Then there is the matter of overcoming consumers' newfound resistance to the sound-bite slogans of our elected and appointed officials, who contributed to the fix Americans now find themselves in. Certainly, we are each ultimately responsible for the state of our finances, and we are all going to be wearing our speculative losses for some time, but our political and economic leaders cannot shirk responsibility for shamelessly promoting a number of patently ludicrous ideas. Vice-president Dick Cheney used the 'Buy an SUV for your country' sales pitch; President George Bush trumpeted the wonders of an 'Ownership Society'[41] in which we could spend our way to prosperity; and chief interventionist Alan Greenspan, a latter day John Law,[42] extolled the virtues of those wonderful financial innovations, variable rate mortgages, mere weeks before embarking on a campaign of interest rate hikes that eventually punctured the housing and credit bubbles and precipitated the financial crisis. The marketing campaign, however, was brilliant: from 2001 to 2007 virtually all of America's GDP growth was fuelled by debt[43]***…which we appear to be having problems servicing: today, one out of seven consumer loans is classified as "troubled."***[44]

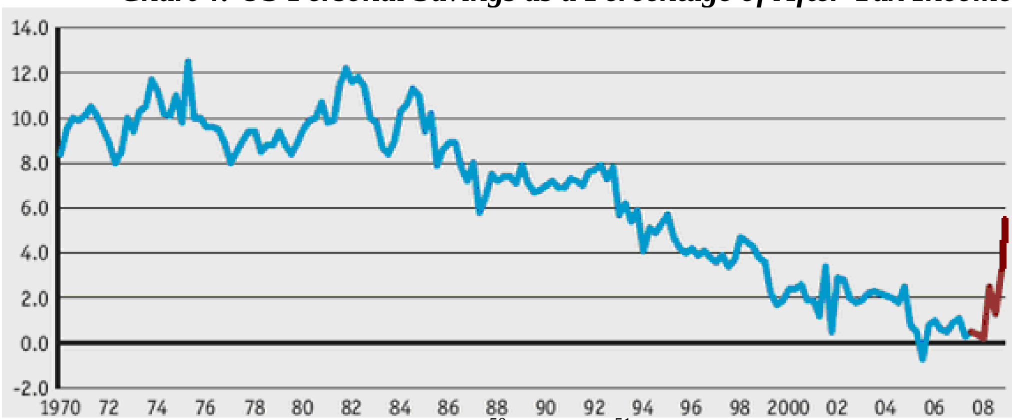
Just as a Ponzi scheme needs fresh infusions of cash to keep the façade of wealth creation and distribution operational, asset bubbles have become the most salient feature of the fiat dollar regime and require regular fresh infusions of credit. Credit expansion is absolutely critical to the fiat dollar's survival because each bubble must be larger than the last in order to keep money circulating so furiously that it masks the systemic rot by providing the illusion of nominal wealth creation. This leaves the Fed and Treasury today facing the daunting challenge of keeping over-indebted consumers borrowing and money center banks solvent and lending when ***the former is running low on credit and the latter on credibility*** so the debt can then be sold to increasingly reluctant foreign buyers.

Finding themselves in a serious financial bind, American consumers are either unwilling or unable to answer the government's call to spend. According to the Fed, 40% of American families spend more than they earn.[45] That after a fifteen-year credit binge Americans are now both saving money and reducing their debt load for the first time since records began being kept in 1952,[46] despite the negative real interest environment, is an unalloyed threat to the reflation effort as well as ultimately to the fiat dollar regime. Just as borrowing money affects GDP, so does saving: because consumer spending accounts for 70% of the economy, each dollar saved reduces that

[39] Rosenberg, David A.: "North America: Morning Market Memo"; Bank of America/Merrill Lynch: pp. 6, 06.04.2009. http://www.ml.com
[40] Mady, Levente: "BondWorks"; Institutional Advisors: 09.06.2009. http://www.insitutionaladvisors.com
[41] Bush, George W: "Fact Sheet: America's Ownership Society; Expanding Opportunities"; White House Press Release: 08/09/04. http://www.whitehouse.gov/news/releases/2004/08/20040809-9.html
[42] The father of modern fiat currency abuse. http://en.wikipedia.org/wiki/John_Law_(economist)
[43] Quinn, James: "The Great Consumer Crash of 2009"; Prudent Bear: 19.08.2008. http://www.prudentbear.com/index.php/commentary/guestcommentary?art_id=10098
[44] Norris, Floyd: "Troubled Bank Loans Hit a Record High"; The New York Times: 29.05.2009. http://www.nytimes.com/2009/05/30/business/economy/30charts.html?_r=1
[45] Quinn, James: "The Great Consumer Crash of 2009"; Prudent Bear: 19.08.2008. http://www.prudentbear.com/index.php/commentary/guestcommentary?art_id=10098
[46] Forsyth, Randall W.: U.S.Wealth Plunges—Before Madoff Scam"; Barron's: 13.12.2008. http://online.barrons.com/article/SB122912490384002951.html?mod=djemWR

dollar's potential contribution to GDP by $.70.[47] Frugality, sobriety, and low cost communal activities like picnics and pot luck dinner parties are on the rise, and have seen Americans up their savings to 5.7% of their disposable income in April 2009,[48] which represents perhaps the largest obstacle to Fed and Treasury designs to reflate the economy. As The Times' Anatole Kaletsky puts it, and the following chart shows, "consumers and businesses have started to see recession as a moral retribution for past excesses:"[49]

Chart 4: US Personal Savings as a Percentage of After-Tax Income



Source: Economist/US Dept. of Commerce[50]/Mutikani[51]

As if this task were not daunting enough, it appears set to grow even more complicated now that the financial sector, politicians and the Fed can no longer deflect blame for the financial crisis to hedge funds and have started squabbling like crows amongst themselves. None of the excesses that have come to light would have been possible without the active co-operation of US policymakers, ***who accepted roughly $1.7 billion in campaign contributions over the ten-year period beginning in 1998 from Wall Street alone***,[52] so politicians' self-righteous indignation over what their own policies, derelict of duty, and lack agency enforcement has wrought is wholly disingenuous. Over the last ten years politicians have championed policies that have resulted in:

- the unrestricted movement of capital across international borders;

- the repeal of the Glass-Steagall Act separating commercial and investment banking operations;

[47] Welsh, James E.: "The Financial Commentator on the Economy"; Welch Money Management: Vol. 5, Issue 28, 04.05.2009. (subscription required) http://www.welshmoneymanagement.com

[48] Mutikani, Lucia: "U.S. manufacturing shrinks at slower pace in May"; Reuters: 01.06.2009. http://news.yahoo.com/s/nm/20090601/bs_nm/us_usa_economy_5

[49] Kaletsky, Anatole: "Market fundamentalism took us close to disaster in 2008"; The Times: 29.12.2008. http://business.timesonline.co.uk/tol/business/economics/article5409126.ece

[50] Economist Intelligence Unit (not attributed): "Manning the barricades: Who's at risk as deepening economic distress foments social unrest"; The Economist: pp.6, March 2009. http://a330.g.akamai.net/7/330/25828/20090318195802/graphics.eiu.com/specialReport/manning_the_barricades.pdf

[51] Mutikani, Lucia: "U.S. manufacturing shrinks at slower pace in May"; Reuters: 01.06.2009. http://news.yahoo.com/s/nm/20090601/bs_nm/us_usa_economy_5

[52] Taibbi, Matt: "The Big Takeover"; Rolling Stone: 19.03.2009. http://www.rollingstone.com/politics/story/26793903/the_big_takeover/

- a congressional ban on credit-default swap (derivative) regulation;
- a tripling of the amount of leverage allowed by investment banks;
- the curtailment SEC regulatory enforcement;
- an international agreement to allow banks to measure their own level of risk;
- and the diminished capacity of international regulatory bodies to stay abreast with the rapid pace of financial innovation.[53]

Without these policies having been put in place, as well as those designed to pressure banks to extend loans increasing home ownership, there can be little question the financial excesses we have witnessed could have reached such as extreme. But interventionist policymakers' greatest failure has been the persistent, some would argue purposeful, lack of oversight of the Over-The-Counter (OTC) derivatives market.

Briefly, the OTC derivatives market contains the entire alphabet soup of financial instruments that have been the source of so much 'innovation' over the last decade. Defended by the likes of Greenspan, Rubin and Summers, the derivatives market has fought regulation and oversight for a decade, not least because its opaque operations have produced as much 40% of the profits for the money center, or dealer, banks that control it.[54] Estimated to be in the vicinity of $450 trillion globally, the US is by far the largest market and is dominated by JPMorgan, Bank of America, Citigroup and Goldman Sachs Group,[55] who operate with an utter lack of public disclosure in terms of pricing, transparency, and accountability—*to anyone*. As we go to press, Christopher Whalen, the founder and managing director of Institutional Risk Analytics, has just made a statement before the US Senate which reflects the behavior of the financial world today:

- "…the reform proposal from the Obama Administration regarding OTC derivatives is a canard; an attempt by the White House and the Treasury Department to leave in place the de facto monopoly over the OTC markets by the largest dealer banks led by JPM, GS and other institutions."
- "Without OTC derivatives, Bear Stearns, Lehman Brothers and AIG would never have failed, but without the excessive rents earned by JPMorgan, Goldman Sachs and the remaining legacy OTC dealers, the largest banks cannot survive and must shrink dramatically."

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[53] Johnson, Simon: "The Quiet Coup"; The Atlantic: May, 2009. http://www.theatlantic.com/doc/200905/imf-advice

[54] Leising, Matthew & Runningen, Roger: "Brooksley Born 'Vindicated' as Swap Rules Take Shape"; Bloomberg: 13.11.2008. http://www.bloomberg.com/apps/news?pid=20601109&sid=aXcq.r6xLf4g&refer=home

[55] Abbottt, Charles & Drawbaugh, Kevin: "U.S. regulators seek OTC derivatives crackdown"; Reuters: 13.05.2009. http://news.yahoo.com/s/nm/20090513/bs_nm/us_financial_derivatives_5

- "Seen from that perspective, the rescues of Bear Stearns and AIG were meant to protect not investors nor the global markets, but rather to protect JPMorgan, Goldman Sachs and the small group of dealers who benefit from the continuance of their monopoly over the OTC derivatives market." [56]

So much for the 'systemic risk' story used by the Fed and Treasury to justify their actions. If this were not sobering enough, there is a growing chorus of allegations that Fed and Treasury have broken myriad laws and regulations during the course of the financial crisis. From a taxpayers' point of view, perhaps the most serious of these would be their utter disregard of the Prompt Corrective Action Law put in place in the aftermath of the Savings & Loan crisis for exactly this purpose: had it been enforced, a number of these money center banks would have put in receivership instead of being bailed out with trillions of dollars of taxpayer money.[57]

In light of this behavior, the House Committee on Oversight and Government Reform investigation of the Fed and Treasury for their role in the Bank of America take-over of Merrill Lynch amounts to but a carnival sideshow to divert attention from the real criminal behavior being transacted behind the scenes. Revelations regarding the transparency of the TARP program, corporate governance and disclosure policies are the result of the CEO of Bank of America making accusations that he was threatened with being fired if he made public concerns regarding undisclosed Merrill Lynch's losses that may well have terminated the back-room deal engineered by the Fed and Treasury.[58] It was nicely summed up in a question by the chairman of the panel: "Why did a private business deal, announced in September, and approved by shareholders in December, with no mention of government assistance, end up costing taxpayers $20 billion in January?"[59] Although the Fed denied any wrong-doing, it initially invoked the bank examination privilege to avoid providing requested documents first to the New York Attorney General who initiated the investigation,[60] and then to the House Oversight Committee, which prompted it to subpoena the Fed for only the second time in its history.[61]

The matter is unresolved as we go to press, but is unimportant in the grand scheme of things. The far larger issue is that while the Senate is making a spectacle of these shenanigans, the Obama administration and Treasury are moving to perpetuate these money center banks' monopoly on derivatives not to control them, or better yet to ban their use entirely, which belies any notion of affecting substantive change and is clearly reflective of interventionists' 'more of the same, only harder' approach.

But it does raise the interesting question of the extent of the Federal Reserve Bank's power. Where financiers ultimately face the wrath of their shareholders and politicians the wrath of their constituents, which may in fact be growing in both cases, the Federal Reserve Bank has long

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[56] Whalen, Christopher: "Statement to the Senate Committee on Banking, Housing and Urban Affairs, Subcommittee on Securities, Insurance, and Investment"; pp. 10, June 22, 2009. http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=1f354557-7b1f-4ffd-9014-e80435bc55b8
[57] Willoughby, Jack: "The Lessons of the Savings-and-Loan Crisis"; Barron's: 11.04.2009. http://online.barrons.com/article/SB123940701204709985.html?page=sp
[58] Crittenden, Michael R.: "House Panel to Probe BofA's Merrill Deal"; The Wall Street Journal: 07.05.2009. http://online.wsj.com/article/SB124165134448493413.html
[59] Crittenden, Michael R. & Fitzpatrick, Dan: "Lewis Takes Heat but Defends Merrill Deal"; The Wall Street Journal: 12.06.2009. http://online.wsj.com/article/SB124472321695405977.html
[60] Ibid.
[61] Farrell, Greg & Braithwaite, Tom: "Bernanke e-mail claim in Merrill sale saga"; The Financial Times: 11.06.2009. http://www.ft.com/cms/s/0/3fb98672-5614-11de-ab7e-00144feabdc0.html?nclick_check=1

insured that they are, and will remain, above reproach and not subject to either oversight or audit by Congress or anyone else. To say the Fed has prepared for any contingency would be an understatement: the Accounting and Auditing Act of 1950 effectively provided them with a "Get Out of Jail Free" card to trump any and all criticism or the threat of legal action,[62] essentially rendering them above the law.

As much as these interventionist policymakers and banks would have us believe in the resiliency of the financial system and 'green shoots' and 'resetting' the economy, ***we remain wholly unconvinced that fixing a global economic system that has just been traumatized by the loss of an estimated $50 trillion dollars,[63] not including derivative losses,[64] is as easy as setting up the board for a new game of Monopoly and encouraging players to roll the dice again.*** We have grave misgivings about such hubris, not least because the Culture of Cheating has played such a significant role in what has passed for success that for all intents and purposes the interventionist 'game plan' amounts to encouraging even more cheating—just cook the books and defraud some more. It's one thing for managers of 'other people's money' to be ready to play again, for they have amply demonstrated over the last decade that the money in their care may as well be Monopoly money, but for investors who have just seen their retirement plans shattered or their child's educational aspirations dashed the losses are real, very personal, and likely to leave lasting scars—after all, they have been visited by two black swans in less than a decade. It will be interesting to see how far the former can push the market without the long term support of the latter; after all, investors are unlikely to simply overlook the fact that these are the same interventionists, financiers, brokers, analysts, money managers and ratings agencies that were so busy aiding and abetting the development of the credit bubble for personal profit that they were blindsided by the severity of its collapse.

If the dollar were not the world's reserve currency, the extent of the malfeasance, duplicity and fraud on the part of borrower and lender alike, which was clearly facilitated by political pandering and a lack of over- as well as foresight, we would conclude things had gone too far, that the system was hopelessly broken, and that the dollar was on the verge of collapse, hopefully signaling a return to sound money. For at the end of the day, the more than $70 trillion national debt we have accumulated since straying from the gold standard would not have been possible if we were still on it simply because our creditors understand there is not enough gold on the planet to back that much paper money***—and if there were, they would undoubtedly prefer gold to such a criminally mismanaged currency.*** In short, international markets would impose the fiscal discipline our politicians and central bankers could not. France and Germany attempted to do exactly that by demanding gold for their accumulated trade surpluses of dollars when they determined that the US was not honoring its commitment to the Bretton Woods Agreement, which resulted in President Nixon ending the dollar's convertibility to gold—and incidentally putting an end to centuries of close relations with France. But the dollar ***is*** the world's reserve currency, and that changes everything, including its ability to seemingly defy both gravity and logic.

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[62] Taibbi, Matt: "The Big Takeover"; Rolling Stone: 19.03.2009. http://www.rollingstone.com/politics/story/26793903/the_big_takeover/

[63] Loser, Claudio M.: "Global Financial Turmoil and Emerging Market Economies: Major contagion and a shocking loss of wealth?"; Asian Development Bank: pp. 7, March 2009. http://www.adb.org/media/Articles/2009/12818-global-financial-crisis/Major-Contagion-and-a-shocking-loss-of-wealth.pdf

[64] Mogato, Manny: "Global financial market loses $50 trln—ADB study"; Reuters: 09.03.2009. http://www.reuters.com/article/companyNewsAndPR/idUSMAN46777220090309

Consequently, the ETR believes a return to the gold standard, or some rules-based derivation thereof, is highly unlikely without either a grassroots US taxpayer revolt or an utter collapse of the fiat dollar precipitated by global consensus to end its use as the world's reserve currency. Neither appears likely at this juncture. ***The groundswell of popular dissent needed to achieve the former seems to have been largely bred out of Americans over the last generation, replaced by a distracted, self-absorbed apathy that seeks easy salvation in a president that emulates the wrong Roosevelt: what we need is a trust-buster carrying a big stick, not an interventionist appeaser masquerading as an eco-warrior.***

And as is explored in the next chapter, the reflation efforts of the Fed and the Treasury are likely to be heartily, even desperately, embraced by geopolitical friend and foe alike, for despite the dyspeptic rhetoric and economic saber-rattling there is no other currency in which to hide from the ravages of the financial crisis sweeping the world, for ***it is our contention that all of the world's currencies today, which are universally fiat, have become but derivatives of the US dollar.***[65] In a world of fiat currencies, we believe dollar strength will ebb and flow with the advance and remission of the cancer at the heart of the global financial crisis, its strength attributable to the notion that the so-called senior currency at the center of the global economy will be the last to collapse.

So strangely enough, despite the unparalleled monetary inflation being wrought upon the dollar that will have tragic consequences sometime in the future, we see the dollar strengthening against all other currencies, not by dint of US economic strength but by the comparative weakness in all other currencies, for a less well-publicized tidbit is almost every country on earth is also inflating their currency just as fast as they dare. ***The only currency against which the dollar will ultimately not appreciate is gold, which is gradually re-emerging as arguably the most senior of all currencies.***

This is why the Emerging Trends Report has been advocating since we began publishing in 2005 that you can speculate with dollars all you want, but if you wish to actually save money long term, be it for retirement or a child's education or just to protect your hard-earned money from the relentless depreciation of monetary inflation, put it into physical gold or silver. In 20 years' time, you can rely on an ounce of gold or silver still being an ounce of gold or silver—who can honestly say what the real value of a fiat dollar, euro, yen or yuan will be?

History suggests less, quite probably substantially so.

* * * * *

Credit and Credibility presents the Emerging Trends Report's comprehensive assessment of today's financial turmoil and what we consider to be five of the most pressing issues that stand to impact the global economy in the years ahead. Each of these issues are explored in the first five chapters:

- fiat currency, the financial abuse it engenders, interventionist policy response to perpetuate it, and the role of the US dollar going forward;

- our contention that all fiat currencies today have become derivatives of the US dollar has stunning implications globally;

[65] This concept was originally raised in 2006 in discussions with John Trudgian, our business partner and Managing Partner, Austral-Asia, for the Williams Inference Service. http://www.williamsinference.com

- the extent to which emerging markets *can* decouple from 'consumer' economies, and the role of China as the litmus test for both the regional and the emerging market thesis;

- our contention that the world has had its fill of 'financial innovation,' and the only way the US economy can recover will be through its traditional strengths in agriculture, manufacturing, invention, and hard work; and,

- our assessment of the issues attendant to the anthropogenic global warming debate and pending legislation.

Credit and Credibility then delineates the investment approach demanded in this 'brave new world,' identifying potential pitfalls to recovery, asset classes likely to become candidates for bubble-dom, a set of leading indicators likely to mark the true bottom, and how these five issues will affect each of our investment themes.

In order to facilitate the comparison and update of our nine themes within this context, we are including complete copies of our original coal, gold, water & food, nuclear energy, silver, electric grid, transportation fuels, material science, and natural gas reports and have appended substantial commentary regarding the performance of each going forward, including stocks positioned to outperform as well as a ranking by viability in the current environment. The heavily annotated eBook runs to more than 430 pages of text, not including 200+ pages of source material and suggestions for further reading.

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