

Answering Your Questions

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BIG MONEY & THE ECONOMIC DEPRESSION

There appears to be a gross misunderstanding about how money moves and whether we face **DEFLATION** or **HYPERINFLATION**. In Physics, we are searching for the illusive *Grand Unified Theory* where the behavioral laws of Physics and Quantum Mechanics will be unified. The laws that govern our world at our level do not apply in the micro world at the atomic structure. The same division exists in Economics and unless you understand that there are two worlds that operate differently, don't worry, you will never gravitate to an institutional advisor and you will probably lose your shirt expecting that all money will move the same. This appears to have been elevated to the point of extreme nonsense surrounding this S&P Downgrade. Those who keep betting on the collapse of the United States are impatient and fail to realize that even on a Debt to GDP ratio, the USA is by no means at the top of that list but is only #38. But these are statements they hate to hear. Some are so wrapped up in the destruction of the United States, they will probably lose everything they owned insisting they are right but fail to realize you can win the war, but lose all the battles to the point at the end, you have nothing left. The *CIA World Factbook* that at least compares apples to apples, albeit omitting unfunded liabilities in all countries, places the 2010 debt-to-GDP ratio in the US at 53.9%. The worst on that list of major countries is Japan where in 2010 debt-to-GDP ratio was 225.8% of GDP. The level of public debt in Germany stood at 78.8% of GDP. This shows on an equal comparison basis, the US has the largest debt and economy making it capable to servicing its debt far better than either Japan or Germany. This is vital to understand or you will become lost in the alleyways of your mind trapped by your bias.

Debt to GDP Ratio		as Percent
1	Japan	225.80
2	Saint Kitts and Nevis	185.00
3	Lebanon	150.70
4	Zimbabwe	149.00
5	Greece	144.00
6	Iceland	123.80
7	Jamaica	123.20
8	Italy	118.10
9	Singapore	102.40
10	Belgium	98.60
11	Ireland	94.20
12	Sudan	94.20
13	Sri Lanka	86.70
14	Canada	84.00
15	France	83.50
16	Portugal	83.20
17	Egypt	80.50
18	Belize	80.00
19	Hungary	79.60
20	Germany	78.80
21	Nicaragua	78.00
22	Dominica	78.00
23	Israel	77.30
24	United Kingdom	76.50
25	Austria	70.40
26	Malta	69.10
27	Netherlands	64.60
28	Spain	63.40
29	Cote d'Ivoire	63.30
30	Jordan	61.40
31	Cyprus	61.10
32	Brazil	60.80
33	Mauritius	60.50
34	Ghana	59.90
35	Albania	59.30
36	World	59.30
37	Bahrain	59.20
38	United States	58.90
39	Seychelles	58.80



When you have a major portfolio of \$50 billion and up, the rules of management change just as a battleship cannot turn around as quickly or as easily as a speedboat. I had advised private portfolios that were as large as a trillion dollars. When you are at that level, you need cycles because you have to start to shift direction ahead of the turning point and in a gradual manner. You cannot pick up the phone and say **SELL AT THE MARKET!** How you manage money at the upper echelon of finance is completely different than managing your own personal portfolio. People who judge the **BIG** money the same as they would a personal account simply have no idea of how the global economy is structured. They are looking at the TV images and have no clue what exists behind the curtain.

Between 1980 and 1985, the fundamental movement behind the markets was **PRECISELY** opposite of the bias. This period proved beyond a shadow of a doubt that sometimes being so **BEARISH** and convinced the USA was going to default, the opposite takes place driving the dollar to record highs into 1985. The more **BEARISH** Europeans became, the more the **BULLISH** dollar became! How was this possible? The number **ONE** question I received at seminars throughout Europe during that period was: Would the US adopt a two-tier monetary system? The US national debt in 1980 hit \$1 trillion and that sent shockwaves that fueled the bears on the USA which surfaced when Nixon closed the gold window on August 15th, 1971. The sentiment was that the world would not survive the floating exchange rate system and this would lead to hyperinflation giving a boost to the bull market in gold into 1980. However, as the debt reached \$1 trillion, Europeans became convinced that the US would create two dollars and default on the dollars held **outside** the USA in the **Eurodollar market**. Since both were now \$1 trillion, in their mind the US could default on foreigners at no expense to its domestic citizens. An example was South Africa which had the **Financial Rand** (*external*) and the **Rand** (*domestic*) at that time.

Europe judged America by itself and its own domestic biases. I had to explain numerous times that if I even asked an American about a two-tier dollar monetary system they would look at me like I was crazy. Americans **NEVER** experienced a two-tier currency and the dollar except a brief period during the 1870s when there was an

international Trade Dollar minted at 420 grains of silver compared to domestic silver dollars at 412.5 grains. These Trade dollars facilitated trade with Mexico and China and the coins had to weigh the same as foreigners used or else the dollar would not be acceptable in payment except at a discount.



US Trade Dollars 1873 - 1878
420 grains (trade) v 412.5 grains (domestic)

Other than this brief issue, Americans are traditionally ignorant of monetary systems other than the dollar and nothing else. This has been caused by the distinct difference between

American history and European. The dollar is still legal tender from the birth of the nation. That is not true in Europe. French francs are not valid pre-World War II and that is even the case in Britain where old issues are simply cancelled. The USA has never cancelled its currency. Consequently, talking two-tier monetary systems in America will only produce strange looks and may get you carried off to the funny farm for examination.

Fiercely biased that the US would default, Europeans convinced themselves that a two-tier monetary system would be the answer to the debt by paying off the debt with a new external dollar. It made sense to issue an external dollar that was red and the green dollar would still be domestic. That being the popular belief, capital shifted from the Eurodollar deposits to domestic dollar deposits. The Eurodollar market collapsed by about 50% and the more convinced they became the US would default in this manner, the more they bought the dollar and moved capital into domestic deposits. The dollar rose to record highs driving the pound down to \$1.03 and German currency down to about 4 to the dollar (*in today's terms about 4 euro to the dollar*).

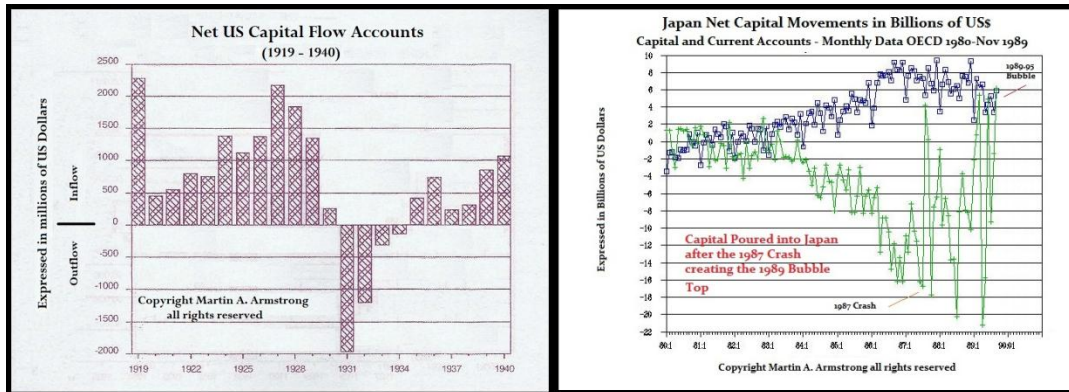
This obsession with the US collapsing has been going on a long time. If you just want to listen to the nonsense that supports your bias, then there are plenty of street hawkers out there that will tell you what you want to hear. If you are trying to comprehend what **REALLY** makes the world tick, then stick around. This just ain't Kansas anymore Dorothy.

There is a danger of a **MASSIVE WORLD DEPRESSION** perhaps far greater than the **HYPERINFLATION** scenarios. The presumption of hyperinflation is based (1) that money is not backed by gold, and (2) somehow government will print uncontrollably. There are rising forces in the wings that counter-balance that notion. In Germany, the national philosophy is etched in its soul by its hyperinflation of the 1920s just as everything Americans believe is etched into their soul by the Great Depression. The USA fears a depression and monetizes to desperately try to stimulate, while Germany imposes austerity to prevent a hyperinflation that is evident in the economic decline in growth just released. However, the core of the Republicans are echoing the same policies of Herbert Hoover to return to a balanced budget, cut spending, and throw the baby out with the bathwater. The Democrats want stimulation as they did under FDR and had been the battle cry of the Silver Democrats of the later 19th Century. We are all defined as a nation by our collective experience.

There was a net selling of US Treasuries by foreign holders leading up to the infamous August 2nd date. But this is the "**hot**" money, not the **BIG** money. You simply **CANNOT** park the big money in just anything overnight. You cannot abandon the dollar easily for to do so would mean you cannot engage in commerce (buying oil) or trading in the markets. You cannot put up Swiss bonds for collateral at COMEX. There is an infrastructure that requires dollars and will continue to do so **UNTIL** we revise the world monetary system. That is what I am talking about

when we are forced to a **ONE WORLD RESERVE CURRENCY** to replace the dollar. That is inevitable. However, we have to experience a lot more pain before the politicians will consider the loss of such power.

If you want to know when the world is coming to an end, then you better start to learn that there is the **BIG** money and then there is the small time **HOT** money that can swing back and forth quickly and acts like the speedboat that can sail circles around a battleship. But when that battleship turns, the speedboat will be crushed if it tries to keep sailing ignoring the battleship.



THE ECONOMIC DEPRESSION

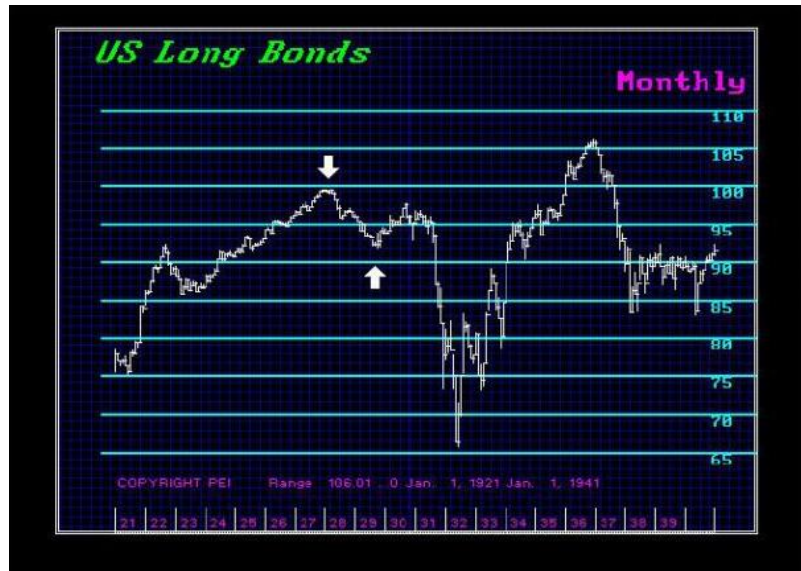
The key to understanding the world is that capital flows like water to the lowest spot but in finance it is the lowest risk and right now that is the dollar. Here are the illustrations of capital flows for the Great Depression and the 1987 Crash focused on Japan. Note that the capital inflows peaked in 1927 when the Fed cut US rates trying to deflect capital back to Europe. The capital outflow peaked in 1931 with the **Sovereign Debt Default**. The capital flows switched back to a positive inflow **AFTER** the Roosevelt devaluation of the dollar in 1934 and the threat of war was building. Looking at Japan-US capital flows, we can see how highly volatile they became going into 1987 and the fears then also of a further dollar devaluation of 40% imposed by G5 market manipulations. If you ignore global **BIG** money and understanding how it moves differently, you are asking to be slaughtered.



Bonus Army 1932

The greatest problem during the Great Depression was this idea that to solve the problem meant austerity to restore confidence in government and the dollar. That creates economic contraction. This will lead to civil war and strife as we are watching in Greece and England, just as it appeared in Washington, DC in 1932 with the Bonus Army. In San Francisco government proves America is no different than Syria or any other dictatorship. The first US government agency cut off cell phones to thwart a protest. This is precisely what Congress is doing with the **SWITCH** to be able to shut down the internet they claim to thwart a terrorist attack. The terrorist definition is now **you** if you dare to disagree with government. San Francisco's **Bay Area Rapid Transit** blocked a planned protest on Thursday August 11th that was being organized against the latest police shooting of an unarmed man by cutting cellphone service. This proves my point. The government does whatever it wants when it wants and it is **ALWAYS** the burden of the citizen to prove in court **AFTER THE FACT** that he has any rights at all including free speech and the right to assemble peaceably. Until government has to go to court to ask **PERMISSION BEFORE** it acts, the Constitution is a worthless piece of paper that has **NO** force of law and when government stacks the courts with former prosecutors, there is **NO** rule of law to hold society together anymore. All governments turn against their people **WITHOUT** exception! <http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2011/08/16/MNGT1KNJU1.DTL>

The long bonds in the US peaked in 1927 and collapsed into 1932. There was the initial flight to quality we always see when the stock market began to crash in 1929. However, as it began to become clear there was a looming **Sovereign Debt Crisis** brewing the bonds began to collapse as we can see from late 1930. Even though the USA did not default, the bonds fell in **ANTICIPATION** that it might. This demonstrated what I have stated many times – **SELL THE RUMOR, but BUY THE NEWS!**



It does not matter what at times the reality of economics might be. If everyone **BELIEVES** something, they will act on that belief even if it is dead wrong. The counter-balance against the **HYPERINFLATION** scenario is the same risk of balancing the budget. We are seeing this in the Republican rhetoric and it is why Germany is fighting a single debt for Europe. The threat we face in a **Sovereign Debt Default** scenario is more of the destruction of capital and that is **DEFLATIONARY** rather than inflationary. So people cheering the downgrade of the US debt had better be careful what they wish for. If the debt structure collapses **BEFORE** reform (*more likely than not*), this will wipe out the pension funds, insurance companies, and banks. The debt will be suspended and at that point the challenge will be putting it back together before **CIVIL WAR**. But then again, San Francisco has shown what government will do. This is just a dry run for the ultimate confrontation. Just remember – you elected these people that enact laws against you and refuse to reform a system that is patently defective and is going to collapse as certain as we will all die.

The assumption of **HYPERINFLATION** is government will respond with printing. The rising alternative is the crowd calling for a balanced budget honoring debts at the expense of eliminating social spending. In any event, we are headed into an economic storm where the sun doesn't shine on the horizon. For all the conspiracy theories that convince the world some brilliant men are planning everything, when my phone rings, why are they asking me what's happening? The sad truth is far worse. When you pull the curtain back, you suddenly find smoke and mirrors with nobody in charge and the whole thing is really just a runaway train and there is no conductor. That is much more dangerous than some enlightened group with a plan. The system is out of control and we are headed into a death spiral that leads nowhere you want to go. Gold will rise in value either way. For when capital is destroyed, then we are back to a barter system where gold still holds value. So it does not require **HYPERINFLATION** to create a bull market in gold. That can also take place during **DEFLATION** where assets values decline against gold. Hence, the leaders of France and Germany are pushing all 17 nations that use the euro to enshrine balanced budgets in their constitutions and want greater collective governance of the eurozone. This is the same austerity that created the Great Depression. They are obsessed with trying to maintain confidence of the big money. They will fail in the end. For the Dow to retain some strength, it needs to close above 11228 today and to just stay neutral. Resistance in gold today stands at 1785 and a failure to close above that will keep it in a neutral position.