

"He that is of the opinion money will do everything may well be suspected of doing everything for money." – Benjamin Franklin (1706-1790)

MADMEN, GAMBLERS, ALCOHOLICS, THE US DOLLAR AND GOLD

BY RON HERA

If a lawless gang of madmen, gamblers and alcoholics seized control of a large company, how would you expect the business to perform? How would you expect the story to end? What if, instead of a company, they seized control of the world's largest economy, thus, to some extent, the world financial system?

Unsound monetary policy, reckless risk taking, and out-of-control spending are what characterize the US economy today. The proverbial madmen are central bankers, i.e., the US Federal Reserve, whose policies, inspired by Johannes Gutenberg, threaten to destroy the US dollar in the name of saving US banks from their own irresponsibility and greed. The compulsive gamblers are Wall Street investment banks, along with the largest US banks, which have gone so far as to speculate with government bailout money, having learned little from the near collapse of the world financial system in 2008. If money were liquor, the US federal government would be a band of raging alcoholics in charge of a liquor store. These are the tragic characters upon whom Americans depend for their jobs, for their college and retirement funds, for the financing of their educations, homes and business ventures, for the stability of prices and US financial markets, and for the value of their hard earned savings.

The triangle of dysfunction has not gone without notice. Foreign purchases of US Treasury bonds are being made, essentially, under duress while demand for Treasuries remains tepid and quantitative easing by the Federal Reserve continues. The US dollar has fallen from new low to new low and the skyrocketing price of gold is sounding the alarm, but between Washington DC and Wall Street nary an ear can hear.

The Madmen

The incurable incapacity of a central autocracy to accurately match interest rates and the money supply to the requirements of the diverse, complex markets that make up the US economy is a fundamental flaw in US monetary policy. While the ideology may be different, central economic planning under the name of central banking produces no better result than central economic planning under the name of communism. A series of ever larger economic bubbles coupled with an ever weaker currency is ultimately little better than the economic stagnation of the former Soviet system. Low interest rates may stimulate economic activity, for example, but they may also result in high inflation, unsustainable levels of debt, and asset price bubbles.

For every intervention in the free market, whether by government edict or monetary policy, there are unintended consequences. Government intervention in the US housing market, for example, intended to increase opportunities for home ownership among less successful members of society, played a key role in undermining lending standards. Combined with the Federal Reserve's policy of low interest rates, which fueled speculation in real estate and mortgage backed securities, government intervention ultimately proved disastrous.

Markets have existed since the dawn of human civilization without the blessings either of government subsidies and guarantees or of central banking. An economy is best described as an organic system rather than a machine. Interventions purporting to be the processes required to 'operate' the economy are at best futile if not inevitably

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ANNUAL PREDICTIONS FOR 2010. GOOD & BAD NEWS

BY ROGER WIEGAND

Will 2010 be a 1930 or, comparable to 1937? Is it different this time? When one nation state of a formerly high productive stature destroys itself with inflation, the untouched others can soften the blow and in time bail out the fallen one. This was Germany's fate in the 1920's. In our current instance, most all of the world's economies are on their knees with some hurting worse than others. Who can help with recovery this time? There is no one. It will not be China as some suppose as China shall suffer the same systemic collapse as the U.S. and all of Europe, Russia, and South America. China's neighbors Japan, Taiwan, Korea, India, Indonesia and others will join the fallen.

The interwoven complexities of international trade and finance have caught them in all in a spider's web of systemic collapse. Those who can shall attempt a massive inflationary rescue. While it might appear to work for a few months, eventually all implodes. Please note the following from John Pugsley's "Common Sense Viewpoint" as printed in "Golden Insights" by James U. Blanchard III 1997.

"Inflation will destroy debt. The end answer to all argument (inflation versus deflation) rests in the Federal Reserve and government. Both are absolutely committed to preventing a financial collapse or deflation. As long as they are willing to print dollars to support any failing creditors, the cycle will go on. What most deflationists fail to consider is that inflation destroys debt."

"Creditors win through inflation and lenders lose. The deflationists do not see that if inflation of the money supply continues, which it will, there needs to be a deflation. All the debt in the world can be wiped out just by creating purchasing power—and that's exactly what is happening—the debt problems will be resolved, but they will not be resolved by debt liquidation through bankruptcy and collapse. They will be resolved through debt liquidation via the creation of money. We are in for the greatest wave of inflation in the history of the world. You had better not be on the wrong side of the dollar." - John Pugsley "Common Sense Viewpoint."

We agree with Mr. Pugsley but, this was written years ago. We would suggest that this time with most formerly productive nations becoming victims of both inflation-hyperinflation and systemic collapse; the ending could be much worse than supposed. We

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\$GOLD (Gold - Continuous Contract (EOD)) INDX

27-Nov-2009 Op 1190.10 Hi 1191.80 Lo 1130.40 Cl 1177.80 Chg -10.50 (-0.88%) ▼



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forecast inflation first then hyper-inflation some time down the road.

What happens between here and there? While in our view, our forecast episodic adventure takes at least 2-3 years but, no one knows for certain. We forecast 2010 to be one of the very worst years of Greater Depression II; the year 2010 being the second cycle of several depressionary phases. The fall of Lehman and a surrounding crash was only Phase One. Before Phase Two terrorizes global markets, we suggest a short recovery arrives first.

Debts both public and private have not been paid down to any great extent. To make matters worse, new debts continue to plague central banks, nation's banks, consumers and commerce. In order to find a basing bottom and enable a recovery, these debts must be paid, repudiated or inflated away. For now all of these solutions are in play but as fast as old problems are resolved even more continue to pile-on aggravating the troubles.

While global governments are busy attempting to inflate away debts through monetization; i.e., printing piles of un-backed dollars, notes and bonds, the load is simply unsustainable on the math. Manipulators have gone past the point of no return. There will be no recovery until after a smashing correction arrives. This smash is the quick and dirty answer to final de-leveraging of all those debts. We think it comes in phases and in fits and spurts.

Japan is in the worst shape with public debt versus GDP now standing at 270%. With an aging population and not nearly enough young workers entering their workplace, deflation arrived again and the Nikkei Stock Market is taking big hits. The U.S. and Europe except for the U.K have 125% of debt versus GDP with the U.K's at 105%. (Source for percentages Societe Generale).

The U. S. Dollar plays a very important role in these problems. With the Dollar being 85% of the entire world's reserve currency; as the dollar goes, so goes the global system. Unfortunately, the dollar has much further to fall and for this month of December, 2009, the dollar can sink to an index low of 70.00-72.50 from today's prices. Look for the dollar's final support as a minimum low sometime during the next three years ranging from 40-46.

Stocks are peaky and will shorter term correct. We think the nearby correction will be mild and new buying can return in January, 2010 continuing through spring, 2010. The Dow could easily find an 8850 base and then return to a new rally. The S&P's might base at 950. Meanwhile, we could experience an 11-12% Dow and S&P haircut.

The blow-off top for primary stock markets could be later May through July, 2010. On this cycle, five extremely negative events hit world economies and markets simultaneously.

These are:

- (1) \$40-\$50 billion in U.S. credit card failures are reported;

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GOLD: WORDS ARE NOT ENOUGH

BY JOHN ING



"Increasing America's debt weakens us domestically and internationally. Leadership means that the buck stops here"
(Senator Barack Obama on March 16, 2006).

On that day, Senator Obama voted against raising the national debt limit. That debt limit at \$12.1 trillion was raised due to President Obama's spending policies that increased the debt of the United States to the same size of its gross domestic product. The buck stops where?

Inflation Is Back

For some time now, the economic community has declared that inflation is dead and its absence gives the US authorities the leeway to push liquidity into the system. Many believe that the lack of inflation is just the excuse for the Fed and other central banks to keep printing money. With interest rates at rock bottom, no one expects inflation to be a factor, especially when Fed Chairman Ben Bernanke says there's nothing to worry about. Indeed, the markets seem more concerned about deflation than inflation, and point to the fact that over a third of industrial capacity is idled. Also many point to the real estate market which has more unoccupied homes, foreclosures, and diminished demand despite cheap prices. However, economists overlook simple arithmetic in that comparisons are against a period of negative numbers and obviously, future numbers for the balance of the year will finally reflect normalized events such as a rising oil price and falling dollar. We believe coming numbers will show noticeable upward pressure.

Overlooked is that the trillions of dollars of liquidity is showing up in asset inflation, though without the leverage that made the bust so bad last time. And, the double digit growth in monetary base is due more to the significant monetization of that debt, rather than the green shots of economic activity. Inflation is a monetary phenomenon. We recall the seventies when Inflation was not simply increases in the consumer price index (CPI), but was preceded by increases in money supply. CPI was actually a lagging indicator. Today, inflation is already here with the so called new money already gone into asset prices.

New bubbles have been created in the stock market and asset bubbles are getting bigger. And yet, President Obama is another round of "quantitative easing", making the same policy mistakes as his predecessors. And despite unprecedented monetary and fiscal easing, like before the Federal Reserve is reluctant to prick the current asset bubble preferring instead to feed it more liquidity.

Liquidity seems to have found a home. Today gold has broken through all-time highs, oil is near \$80 a barrel and copper is over \$3 a pound. In Asia, the Shanghai market is up 80 percent this year. The real risk is asset inflation will soon show up in price inflation. After all, inflation is a tax on the economy which benefits governments' revenues, allowing governments to devalue debt away. America's economy remains deeply rooted in debt-fuelled consumption like the "cash for clunkers" programs or zero interest rates which has not brought on the much anticipated V-like recovery. To us it looks like another downturn is in the offing that will test the previous lows, cause the dollar to fall even further which will push gold beyond \$2,000 an ounce in a made in America hyperinflation.

Debt on Debt is Not Good

Our worry is that the system's balance sheets remains too leveraged, and while down from the peaks, are still too high, particularly since the commercial real estate and residential housing markets have yet to turn the corner. Despite big profits, Wall Street remains over-leveraged and undercapitalized. Needed is more equity capital, but that is lacking in an era of volatility and excessive debt. Debt on debt is not good because the trillions of spending to bailout the financial system has only added to the mountain of public debt. While we avoided the Great Depression, the cost of this tide of red ink may well be higher inflation and more economic problems.

At the heart of the collapse is that the American economy was found to be without clothes. Two decades of economic expansion, was built on a "house of cards". America's prosperity was dependent upon the American consumer who made up over 70 percent of US GDP. That consumer bought homes and financed cars with cheap credit. Housing and financial assets soared. Now one year after the meltdown, this heavily indebted consumer still has \$10.9 trillion of mortgage debt outstanding versus \$10.43 trillion at the end of 2008. Total gross household debt relative to disposable income remains

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disruptive and destructive. Like a living organism, the economy is largely self organizing and self regulating. When governments collapse, for example, currencies may fail but trade marches on. The behavior of an economy is an infinitely complex aggregate of individual human actions driven by self-interest and, while it may be characterized at different times either by rationality or by irrationality, it is self correcting (unlike interventions, which know no bounds). As a result, it is not possible for a small group of experts, no matter how intelligent or well intentioned, who have an imperfect understanding and incomplete, inevitably out-of-date information to successfully control the economy without unintended, unexpected and usually destructive consequences.

The notion that a central authority, even one equipped with sophisticated computer models, can successfully substitute a mathematically-based view from on high for the individual judgments of millions of businesses, entrepreneurs, and consumers across countless regions and industries is not merely the height of hubris but quite simply mad. Fundamentally, it is entrepreneurs deploying private capital, not bankers or economists that create the products, services, business, and jobs that make up the economy. Whether for the sake of social welfare or for the purposes of monetary policy, intervention in the free market invariably distorts the distribution of wealth, causes a net reduction of wealth for society as a whole, and misdirects entrepreneurs into activities eventually revealed as uneconomic. Perhaps the best argument for the futility of central bank monetary policy is that of Federal Reserve Chairman Ben Shalom Bernanke, Ph.D., who said to graduates of the Boston College School of Law on May 22, 2009:

"As an economist and policymaker, I have plenty of experience in trying to foretell the future, because policy decisions inevitably involve projections of how alternative policy choices will influence the future course of the economy. The Federal Reserve, therefore, devotes substantial resources to economic forecasting. Likewise, individual investors and businesses have strong financial incentives to try to anticipate how the economy will evolve. With so much at stake, you will not be surprised to know that, over the years, many very smart people have applied the most sophisticated statistical and modeling tools available to try to better divine the economic future. But the results, unfortunately, have more often than not been underwhelming. Like weather forecasters, economic forecasters must deal with a system that is extraordinarily complex, that is subject to random shocks, and about which our data and understanding will always be imperfect. In some ways, predicting the economy is even more difficult than forecasting the weather, because an economy is not made up of molecules whose behavior is subject to the laws of physics, but rather of human beings who are themselves thinking about the future and whose behavior may be influenced by the forecasts that they or others make."

Mr. Bernanke's comments are not remarkable only for their clarity and candor, or because they are a stark admission of the failure of central bank monetary policy, but because they echo the founding principles of the Austrian school of economics. In fact, Mr. Bernanke provides excellent reasons for the repeal of the US Federal Reserve Act. Despite common misconceptions of economics as a branch of mathematics or as a hard science, economics is in fact a social science, similar to psychology. For example, when we speak of economic incentives we are referring to the manipulation of human behavior through artificial means to achieve policy objectives such as increasing consumer spending, just as pairing the sound of a bell with the introduction of dog food will produce dogs that salivate at the sound of a bell when no food is present (of course the salivation response can eventually be extinguished if no food is provided for an extended period of time).

Psychology, it turns out, has a great deal to say about economics, investment banking, and public finance. Indeed, key psychological themes are common to all three areas of endeavor.

The Illusion of Control

There may be a simple explanation, rooted in human nature, for the ever larger disasters brought about by government interventions in the economy and by the institution of central banking. The illusion of control is persistence in the belief that a given outcome can be controlled when no demonstrable influence exists or where, as Mr. Bernanke stated, outcomes cannot be accurately predicted. Whether intervention is the result of central bank monetary policy or of government legislation, taxation or regulation, it is the inherent unpredictability of the outcomes of intervention that belies the philosophy of interventionism itself. Former Federal Reserve Chairman Alan Greenspan, Ph.D., grappled with this fact in the wake of the financial crisis when, in testimony before the US Congress on October 24, 2008, he said:

"...an ideology is [...] a conceptual framework with the way people deal with reality. Everyone has one. You have to — to exist, you need an ideology. The question is whether it is accurate or not. And what I'm saying to you is, yes, I found a flaw. I don't know how significant or permanent it is, but I've been very distressed by that fact. [That there is a] flaw in the model that I perceived is the critical functioning structure that defines how the world works, so to speak. ... I was shocked, because I had been going for 40 years or more with very considerable evidence that it was working exceptionally well."

Mr. Greenspan accurately refers to the dominant economic theory, not as a science, but as an ideology that ultimately does not conform to reality. In psychological terms, an irrational belief that cannot be modified by reason or evidence is precisely the definition of the term "delusion." Despite his having been confused for 40 years, Mr. Greenspan clearly recognized and acknowledged a limitation of his economic ideology. In retrospect, perhaps Mr. Greenspan regrets having departed from his original views. Sadly, the same cannot be said for the majority of economists, central bankers and US government officials who do not recognize, as Albert Einstein pointed out, that "the definition of insanity is doing the same thing over and over again and expecting different results."

The Gamblers

Gambling addiction and belief in the paranormal, e.g., psychokinesis, are examples of the illusion of control. When rolling dice in the casino game craps, for example, people tend to throw harder for high numbers and softer for low numbers when there is no connection between the force with which the dice are thrown and the result. Experimental subjects can even be made to believe that they can affect the outcome of a coin toss through their level of concentration. The illusion of control is a key factor in gambling addiction because it is reinforced by occasional successes and,

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- (2) Housing sales both new and used for the first half of 2010 fail so badly, this market is literally in free-fall. There will be 7-10 million new mortgage defaults with most of those in the prime paying (not sub-prime) category caused by job losses;
- (3) First half auto sales are reported. They will be so poor more car-makers file bankruptcy;
- (4) Commercial real estate loans bankrupt many developers and their projects among those existing, under construction, and planned.
- (5) Insurance companies are holding so much failing commercial real estate paper, they are in danger of defaulting with some running for government bailouts in TARP II. At one time years ago, the 20 top insurance companies could literally control the United States economy. They are huge asset holders of property and cash investments.

Housing valuations will fall on the average, nationwide in the U.S., another -30%. We figured about one year ago that 1980's prices would be the bottom. Now we potentially see a bottom at 1970's prices. More homes were foreclosed in the last 12 months than in an entire decade in the first Great Depression of the 1930's.

Inflation is now an unreported at 7% and rising. By May, 2010, it begins to bite very hard first on the lower 1/3rd of U.S. wage earners and the jobless. Most of their income is spent on food and energy. They top the inflation pain lists.

Consumers with newer bought and leased autos will do "jingle mail." They will return newer unexpired leased cars and trucks back to dealers' lots, give them the keys and quit paying. We saw this with houses over the past 1-2 years. Auto lots will overflow with new-used cars and trucks. Values will plummet. Many of these "returns" will be from the "Cash for Clunkers" program by those who got stuck with unaffordable car and truck payments.

Auto-maker GM projected total U.S. industry sales for 2010 of 11mm with a new recovery. There will be no recovery and sales could skid for the whole industry group down to 7mm or less in 2010. In 2011 it gets even worse.

Auto layoffs will escalate and unions will scream for help to president Obama. He will financially band-aid a dying industry. Consumers have no buying power, credit or cash to make any difference. Those with cash will save it and hunker down and wait out the troubles. Auto union membership declines rapidly. Most vehicle lending dries-up to a trickle.

The crude oil and energy sector has fundamentals pulling in both directions. Today we see oil price resistance at \$80 with a trading range slightly lower in the \$70's. Fundamentals show an over-supply on recession-depression lower demands. On the other hand, inflation of prices is rising on a weaker dollar and will escalate. Look for crude oil to visit the \$50's

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and then turn-around on inflation rising to \$100. Gasoline will follow as some refineries are closing on operating losses and no new ones are being built. Inflation ultimately wins on price escalation. Eventually, scarcity of product returns.

Depressions normally and historically last ten years. It could take consumers that long to pay down all of their debts before a return to normal conditions. Savings rates are up but with so much debt and few or zero salary raises in the face of new and rabid inflation, consumers will be economically slaughtered.

Credit and banks go through the wringer again. There are few bank ideas left to earn lender income except for trading. While Goldman Sachs makes millions weekly doing this, most banks are not set-up for it and there are only so many good traders available for the work. Since Obama's compensation guy is rankling big traders with income limits this makes things worse as these people leave for unrestricted pay in overseas trading positions.

The bond market is so huge it takes time for it to roll over and slide off a cliff. Asia and the U.S. Federal Reserve have been our larger paper buyers.

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insight

**FORECAST, VIEWS
AND ANALYSIS
ON THE
ECONOMY AND
PRECIOUS METALS.**

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at 120 percent. Total consumer credit outstanding is at \$24.6 trillion. With his healthcare bill still stuck in Congress, health spending alone will consume 16 percent of America's GDP. Americans continue to spend more than they earn. It appears that deleveraging is not so easy.

The rise in house prices and even stock prices gave an illusion of wealth, but this was found to be poorly based since debt for the most part financed this illusion. As long as homeowners and Wall Street could borrow cheap money to buy assets like homes or businesses, the rise in asset prices would continue. Growth was driven by financial leverage. Like a teenager given a credit card with a new limit of \$25,000 from \$5,000, that teenager might go wild at Abercrombie & Fitch but the illusion of wealth only lasts until Daddy or Mommy cuts up that credit card. Once that credit card was cut, that teenager felt definitely poorer. Of course, Daddy and Mommy would have to pay off the credit card as well as those interest payments. Similarly, faced with rising debts that funded overvalued assets with borrowed money, the US government is like that teenager who had been given an increase in their limit, but the illusion of prosperity ended with the meltdown which was equivalent to snipping of the credit card.

How Much Longer Can America Spend Money That Isn't Really Theirs?

Investors once sought the relative safety of the American currency now realize that the policy prescription of printing dollars only devalues existing dollars. Underlying the dollar's weakness is a growing perception that America has not solved its debt problem but only postponed it. Exacerbating the trend is the so-called carry trade where investors borrow in cheap dollars to invest in higher yielding assets. As Iceland and Japan found, as soon as interest rates rise or the currency shifts, there is a rush for the exits causing a collapse in the price of assets and currency. Once again the Americans are pumping an ultra-loose policy to inflate their economy and once again, they appear to have no understanding of the potential ill consequences of their actions.

After all, spending is the real burden on taxpayers. Either way, where is the money to come from? Take a guess. It must be either borrowed or taxed. Given the magnitude of the spending spree, swelling deficits and the replacement of private debt with government debt on an unprecedented scale, there is good reason to expect more borrowings and higher interest rates since no amount of tax increases can realistically begin to finance all of this. Borrowing is Geithner's first option but for how long?

Shadow Banking System Is Frozen

The central issue is that the shadow banking system created by Wall Street is still paralyzed. Deficits were once financed by Wall Street and today derivatives and debt securitization still provides almost sixty percent of all credit in the US. The alchemy of securitisation allowed Wall Street to create value and even money out of thin air replacing the traditional banking system that at one time provided three of every four dollars in the credit markets. Credit Default Swaps (CDS) for example were designed as insurance contracts that allowed investors to hedge or insure their investments from losses or defaults but were instead bought by speculators who discovered swaps were an easy way to bet on the demise of companies or countries with so little capital. Wall Street, giddy with the heights of the Dow, never imagined a default would happen, and happily collected fees. Those swaps soared to over \$90 trillion and even today stands at a formidable \$42 trillion. Credit default swaps were also highly concentrated among the big banks accounting for half of the CDS market. In the latest crisis, this concentration exposed a vulnerability of the system and the need for another government rescue.

Taxpayers continue to bear the costs of the global meltdown as central banks print money to prevent further losses. Already the United States underwrites eight of every nine mortgages and effectively owns Fannie Mae and Freddie Mac as well as controlling a good part of Wall Street. That price tag will go up since one in four mortgage holders are either behind in mortgage payments or in foreclosure. In 1990, the ten largest financial institutions had ten percent of financial assets in the United States. Today, Henry Kaufman points out that the ten largest institutions now hold over 60 percent of US financial assets.

And with that, systemic risk has increased with the Fed becoming an effective clearing house as it takes on the liabilities of Wall Street. And worse, with a frozen banking system, the Federal Reserve has replaced the shadow banking system by becoming buyers of the very structured products and complex instruments that triggered the crisis last year. Little is said of the government crowding out the private debt market, particularly at a time when some \$4.2 trillion of that comes due over the next few years. Re-financing this wall of debt is not a sure thing. AIG is a ward of the state and now GMAC has been nationalized. As such, the banks still too chastened by the meltdown, are reluctant to use their remaining capital. Instead the Fed's surrogates, the large banks have become big buyers of Treasury debt. In September, commercial banks bought \$25 billion of Treasuries and \$125 billion of Fannie Mae and Freddie Mac paper.

Stuck with their toxic securities, the banking system is left to lick its wounds and hope the Fed will take on even more paper. However even the Federal Reserve having spent trillions to buy back some of this paper must still purchase mortgage debt until the end of March next year. Of more importance, this "too big to fail" market has become bigger than the Fed's balance sheet. For example the commercial estate market has over \$50 billion of securitized commercial property loans due to be reset next year. Again, taxpayers will have footed this bill in essence, taking on the liabilities - debt has been transferred from the private sector to the public sector. The national debt consequences are troubling.

Yet Another Bubble

With the national debt rising according to the International Monetary Fund (IMF), the US deficit will hit 13 percent, while the UK deficit is close to a staggering 14 percent of GDP. Governments have borrowed so much that lenders are questioning whether this is sustainable. It is not. As a percentage of GDP, net public debt will increase in the United

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as has been long established by behavioral psychologists, behaviors conditioned by intermittent reinforcement are the most difficult to extinguish.

Warning signs of gambling addiction include defensiveness, secrecy, and desperation: precisely the attitudes exhibited by Wall Street bankers seeking bailouts from the US government in 2008. Like US banks transferring private losses to taxpayers, gambling addicts may hold others responsible for their financial problems and they may adamantly insist that they be trusted. Gambling addicts tend to be secretive about finances, while at the same time irrationally insisting on having control over money, just as Federal Reserve Chairman Ben Bernanke has insisted that Congressional review of the Federal Reserve's books. i.e., to find out what financial institutions received taxpayer dollars, would compromise its vaunted independence and harm the US economy. The more gambling addicts are in debt, the more they feel the need to defend gambling and they often defend a specific theory or model that "guarantees" winning (if only they can get more money to continue gambling).

A gambling addict's savings and assets may mysteriously dwindle, perhaps like crumbling bank balance sheets laden with sub-prime mortgages or bank losses associated with risky financial derivatives, and there may be unexplained loans or cash advances, perhaps like the Federal Reserve's Term Asset-Backed Loan Facility (TALF) program. Like banks jacking up credit card interest rates, gambling addicts become increasingly desperate for money to fund further gambling. The debts of gambling addicts may increase sharply, reflecting a "bet more, win more" mentality that inevitably leads to the gambler going bust. Gambling addicts seek money with increasing desperation, perhaps like former US Treasury Secretary (and former Chairman and Chief Executive Officer of Goldman Sachs) Henry M. Paulson's dire warnings of financial Armageddon in 2008. Items easily sold or pawned for money may mysteriously disappear, perhaps like the US government's Fort Knox gold, which is surrounded by rumors and speculation that a long sought (e.g., by the Gold Anti-Trust Action Committee) independent audit could easily dispel.

The Alcoholics

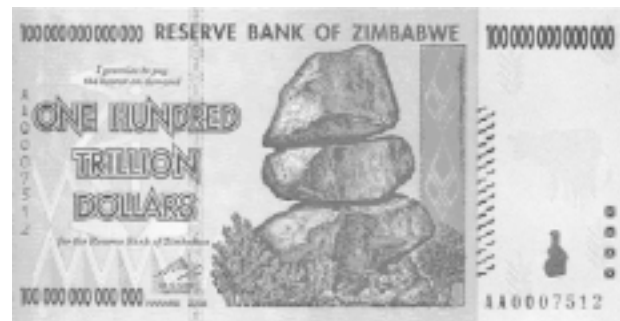
The original Twelve Steps published by Alcoholics Anonymous include admitting that one's life, or in this case the US economy has become unmanageable and that a power beyond one's self (i.e., beyond current economic theories and government policies) is necessary to restore sanity. Contrary to the views of current Goldman Sachs CEO Lloyd Blankfein, the Higher Power cannot be one's self. The self regulating dynamics of a free market, for example would certainly adjust US housing prices to sustainable levels and promote sound lending standards, but this has been prevented by the interventions of the Federal Reserve and US government. Not coincidentally, it was the Federal Reserve and the US government, respectively, that originally caused the inflation of housing prices and undermined lending standards.

Breaking the grip of alcohol addiction requires a searching and fearless moral inventory, admitting the exact nature of one's wrongs, and an unreserved willingness to change and to make amends with those who have been harmed. Sadly, neither Federal Reserve, nor Wall Street bankers, nor the US Congress, which is committed to borrowing its way out of debt, seem likely to repent.

The destructive behavior of alcoholics is often enabled by dysfunctional, co-dependent relationships. A dysfunctional relationship is one that creates more emotional turmoil than satisfaction, or in the case of the US economy, more destruction of wealth than creation. Warning signs of a dysfunctional relationship include, for example, addictive or obsessive attitudes, an imbalance of power, or a superiority complex on the part of one person. Co-dependency is a pattern of detrimental behavioral interactions within a dysfunctional relationship, most commonly a relationship with an alcohol or drug abuser, but equally possible in a relationship with a gambling addict. The co-dependent is a person who perpetuates the addiction or pathological condition of someone close to them in a way that impedes recovery.

The US government appears trapped, together with the Federal Reserve and Wall Street banks, in a destructive web of dysfunctional, co-dependent relationships. The US government is addicted to the easy money created by the Federal Reserve at the expense of taxpayers who eventually suffer a loss of purchasing power. According to Mr. Greenspan's 1966 article Gold and Economic Freedom, "deficit spending is simply a scheme for the confiscation of wealth." Wall Street bankers depend on US government bailouts and guarantees, as well as on the Federal Reserve's lax monetary policy, and the Federal Reserve depends directly on the US government for the legalization of its unaccountable monopoly and indirectly on the continuation of the largest US banks. While a dysfunctional triangle of co-dependency is merely descriptive, the interdependence of the Federal Reserve, the largest US banks and the US government and is a fact in reality.

Unfortunately, it is no more possible to spend one's way to prosperity or to borrow one's way out of debt than it is to drink one's self sober. Nonetheless, thanks to the Federal Reserve's 7 day per week, 24 hour per day money printing service, the US government plans to do precisely this. If creating wealth were as simple as printing money, the dominant school of economics would be led by Robert Mugabe, President of Zimbabwe, and Gideon Gono, governor of Zimbabwe's Reserve Bank (and winner of the 2009 Ig Nobel Prize in Mathematics), who share with Mr. Bernanke a love for the feel of crisp paper and for the smell of fresh ink.



As Milton Friedman once said "The real problem with government is not the deficit. The real problem with government is the amount of our money that it spends."

The wealth destroyed by the collapse of the US real estate bubble and the stock market crash of 2008 has not been and

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While they still buy some to keep markets glued together they are: (1) exiting the longer term paper for shorter terms and, (2) buying less of it turning to other ideas in the commodity markets.

With the higher Yen, Japan is increasingly engaged in hard asset shopping trips as is South Korea. They are both looking for grain, gold, oil, natural gas and other commodities they lack internally.

Junk bonds could lose 1/3rd of today's value just next year. Treasury bond and note buying continues until "full faith and credit" is repudiated on distrust. Eventually they crash but in slow-motion over years due to the magnitude of these markets. We think no bond is a safe bond. Municipal bonds are viewed as some of the safest. What happens when cities, towns, counties and states are so broke they cannot pay the interest? Their tax revenue is going off a cliff. Some are safer than others for awhile but for how long? Who can finger a top? It can't be done as it's too political.

Various states within the United States have or will be failing financially. Someone reported 1/3rd of the TARP money spent so far was used to bail-out bankrupt states. This will escalate as federal TARP money cannot help them fast enough and in large enough amounts to keep it all glued together. Watch for fire and police employment to get as thin as too be very dangerous in various communities. Ten states are going financially critical and 47 are on the watch lists.

New York, New Jersey, Connecticut, Michigan, Ohio, Florida, Arizona, Nevada and California are among the financially worst, hurting from falling tax revenue on broken businesses and consumers. Watch California as they could go out of control first within this group. They continue to contrive new taxes and not work on spending reduction. When some states face total collapse it will get very ugly very quickly. Michigan is among the worst of the worst. Most all of the states are spending themselves into the ground. They refuse to cut back as its political suicide. They will spend until there is nothing left to spend and then scream for help to the Federal Government.

China is in very serious trouble as the U.S. consumers have stopped buying their stuff. Their TARP for early this year exceeded that of the United States in both amount and rapidity of spending. It is estimated they spent in four months from January, 2009 to May, roughly \$600 Billion with most of it going into projects now at over-capacity. The U.S. lack of buying cut China's entire year of exports by -25%. Also, note the Chinese economy is 1/4th the size of the United States' economy.

There are hundreds of idle Chinese factories and millions of laid-off workers with no new factory employment and not much work of any kind. Further, millions sold subsistence farms to work in the city. Now that work is gone and so are the farms that would have fed them. Watch for a slow motion or, faster collapse of China with a descent into riots and other social problems in 2010. China need 24mm new jobs each year just to stay even and are remain far behind that job generation power curve; never mind new job growth gains.

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If the worry of China not buying our treasury paper suddenly became real, the U.S. government could stop most all Chinese exports into the U.S. with crushing tariffs. China would then have skyrocketing joblessness, goods piled-up with no sales and be stuck with a trillion dollars in crappy U. S. bond and currency paper having little or no value and no way to sell it. They would take a \$1 U.S. Trillion paper hit and be stuck with mountains of un-saleable merchandise. The social fallout would be catastrophic. China shall continue to buy U.S. Bonds to keep exports moving; albeit at a reduced level.

Should Chinese imports cease, American workers might find some lower paying employment in re-opened U.S. factories with the return of manufacturing to the states from Asia. After all, where would Wal-mart get all their goods to sell in U. S. stores?

We hope for the best and would prefer China keep it all glued together and endure only a mild recession. With global financials and markets so fragile and wrecked we give them a one in five of pulling it off. Rather, in a Chinese communist command economy, forthcoming dislocations could be legendary.

Ambrose-Evan Pritchard, the esteemed writer for The London Telegraph says, "The world economy is still skating on thin ice. The west is sated with debt, the East with (too much) plant. The crisis has been contained (masked) by zero rates and a fiscal (credit) blast, trashing sovereign balance sheets. But the core problem remains. The Anglo-sphere and Club Med are tightening belts, yet Asia is not adding enough (internal) demand to compensate. It is adding supply." (Editor: organic Chinese demand is barely beginning).

"My view is that the markets are still in denial about structural wreckage of the credit bubble. There are two more boils to lance. China's investment bubble; and Europe's banking cover-up. I fear that only then can we clear the rubble and, very slowly, start a fresh cycle."

We agree with Mr. Pritchard but contend China has other bubbles in autos, real estate, their stock market and major water shortages and pollution as well. If these bubbles pop one at a time, it goes easier. But, we might see multiple bubble-popping instead. In that instance, China might take-down the entire global system. Note the effects of the recent scare from Dubai on their \$80mm default.

Education, particularly among colleges and universities, has hit the money wall as students now debate if a \$40,000 to \$80,000 expenditure is worth it in this economy. Newly graduated kids with good degrees but no experience go to the end of the line for jobs.

Experienced people get what few jobs remain as employers have a wider range of choices and can be super picky. Further, employers have no time or money for training. Many kids are schooling on the

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cannot be brought back by bailouts, stimulus spending or outright money printing. While averting a deflationary spiral is necessary, propping up asset prices by dropping money from a helicopter redistributes wealth and interferes with the price mechanism of the free market. Devaluing the US dollar may help to hold up asset prices but it also prevents housing prices from falling to sustainable levels while at the same time adding the risk of eventually far higher prices, or, in the worst case, hyperinflation. There is no historical example of a successfully re-inflated economic bubble. What is more important, however, is that the unintended consequences of currency debasement, i.e., the result of an inflationary monetary policy marked by near 0% interest rates, are likely to outweigh the goals of the policy even if they are achieved.

Reducing the value of debts in real terms through currency debasement requires a commensurate loss of purchasing power, thus while housing prices may be prevented from falling further, savings will be destroyed and wages will lag behind prices once they inevitably begin to rise. Although consumer prices in the US currently lag behind the downward trend of the US Dollar Index (USDIX), an inflation tax will eventually be levied. Under the name "economic stimulus", wealth is being dissipated by the US government at an alarming rate with no sustainable benefit. US government programs like Cash for Clunkers only impact short-term economic data while, in reality, destroying wealth, increasing debt and diverting consumer spending into already bankrupt industries. At the same time, the US government is eager to increase tax revenues to offset deficit spending and it has all manner of businesses, as well as wealthy individuals in its crosshairs. German-born Presbyterian clergyman William Boetcker (1873-1962) wrote:

"You cannot bring about prosperity by discouraging thrift. You cannot help small men by tearing down big men. You cannot strengthen the weak by weakening the strong. You cannot lift the wage-earner by pulling down the wage-payer. You cannot help the poor man by destroying the rich. You cannot keep out of trouble by spending more than your income..."

Boetcker's words are profound. It is not possible to repair the US economy through stimulus spending or to increase the wealth of consumers by inflating asset values via currency debasement. Supporting asset prices, thus bank balance sheets, via currency debasement, in the best case, can spread debt defaults over time, perhaps delaying the collapse of bankrupt financial institutions. However, currency debasement promises to move Americans closer to the financial status of Zimbabweans due to the destruction of the purchasing power of the US dollar. A less valuable US dollar will reduce consumer spending in real terms, and reduced consumer spending will impact businesses and, therefore, jobs.

The US Dollar and Gold

The price of gold indicates a lack of confidence in the US dollar and in the US economy and it reflects poorly on the credibility of the Federal Reserve and of the US government. [See chart on page 1] The changing composition of central bank reserves, i.e., increasing gold holdings, is a direct effect of the currently weak US economy and US dollar, which has lost considerable value in recent months. In contrast, gold is the only financial asset, in fact a currency that has no counterparty risk. This simple, but often overlooked fact goes a long way to explain current investment demand for gold.

All other things being equal, strong economies offer investors superior returns and lower risk compared to weak economies, thus the currencies of stronger economies are always preferred over those of weaker ones and have a higher relative value as a function of supply and demand. Of course, monetary inflation and monetary deflation also influence the value of a currency in terms of supply.

In a world financial system composed entirely of fiat currencies, where no currency is redeemable in terms of hard assets, money is an abstract claim on production and the value of one national currency relative to another can only, ultimately be a reflection of the performance of the underlying economy that the currency represents (performance being inclusive of the consequences of its monetary policy), i.e., a claim on its production. Thus, if an economy is in decline, i.e., its production is falling, its currency, over time, must also decline. Conversely, there can be no doubt that if the US economy were exhibiting credible and significant growth, i.e., if production were increasing, the US dollar would certainly gain value, but that is not the case.

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GOLD: WORDS ARE NOT ENOUGH

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States from 42 percent in 2007 to over 85 percent. The inclusion however of public debt easily takes that debt ratio over 100 percent which has sparked many hyperinflations in the past. Debt is ballooning from already high levels. We have been here before, when repeated devaluations in the late 1970's, tight energy supplies and easy monetary was followed by hyperinflation ended by a vigilant central banker, Paul Volcker who sent interest rates to double digit levels. Gold went from \$35 an ounce to \$850 an ounce. This time Paul Volcker is older but Tim Geithner appears to be no Volcker pursuing a policy of ease that devalues away America's rising debt burden.

The value of any currency is determined by the supply and demand of that currency. Simplistically, if the Americans supply dollars to bail out Wall Street or tax cuts or fight wars, the amount of dollars obviously increases. Today, there is a much larger supply of dollars than there is demand resulting in the continuing fall of the greenback. Of course, central banks can always intervene in the markets and sterilize those dollars which results in purchasing dollars. However, the world's holders, particularly Asia, now find that holding dollars has become a risky proposition because they are being depreciated every day. And the credibility of central banks have been further strained by their collective acquiescence to print fiat money instead of acting as stewards of money.

Hyperinflation: The Consequence of Obamanomics

There are striking similarities between the events of today and yesteryear. As we wrote in our September report "Hyperinflation: Millions, Billions, Trillions", which examined five hyperinflation periods in the last century, there are too many similarities with the hyperinflations of the past from America's unprecedented printing spree in order to avoid a serious recession, to the nationalisation of America's banking system like the Chinese hyperinflation, to the seizure of private property like the French hyperinflation in the 1700's, to the rampant speculation a la Madoff similar to the Weimar Republic's speculative frenzy, to the politicization of the Federal Reserve as in Argentina's hyperinflation. The recent increase in monetary base also parallels other hyperinflations as all governments gave lip service that the printing presses would be reined in, but each time the printing presses ran overtime. Also in each period, government spending increased significantly.

America's deficit is due to Obama's spending which is set to grow to an all-time record at almost 30.2 percent of GDP, double the federal spending after the Great Depression. Equally disturbing is that Mr. Obama's sinking poll numbers as well as the continuing deterioration in the economy is causing his policymakers to consider extending the ill-fated TARP program involving even more debt. The mounting level of debt has caused the US dollar to slide to another fifteen month low as investors migrate to hard assets propelling gold, commodities and Asian stock markets to new highs. History does not repeat itself exactly but today there are too many parallels to ignore.

A China-centric World is Good For Gold

For the first time in two decades the world's central banks actually bought more gold than they sold. Central banks are accumulating gold, after running down their holdings. Gold's role as a risk diverser is just beginning. While the Americans are pushing China to float the yuan against the dollar, momentum is building for the replacement of the dollar as the currency benchmark. China may be the first. Facing deficits as high as the eye can see, Americans should be careful what they wish for.

China celebrated its 60th anniversary of Communism. China was once the world's most powerful nation in 1862 but wars, inflation and ironically Communism caused it to retreat into a century of isolation. Ironically the renaissance of the Chinese nation is due more to a decade of loosened restrictions and a liberal dose of capitalism has returned China to great nation status. Part of this growth is due to a "going out" policy, which is a form of globalization as China secures not only strategic supplies but acquires what they do not have today. China is believed to account for about 40 percent of demand in almost every commodity. And geo-politically speaking, China's influence in the financial markets is only now being felt. China is the largest investor to a heavily indebted US government. However, China rightly worries about the preservation about the value of its holdings so they have diversified by purchasing key strategic supplies, commodities, companies and gold, all denominated in dollars.

Since the Chinese cannot dump their dollar assets without hurting themselves, the "going out" strategy has lessened but not eliminated their exposure. China has also become a critic of US monetary and fiscal policies, issuing repeated warnings that the US should not inflate away its mounting debt burden. Yet America does not listen. China has signalled that it will allow the yuan to rise against the greenback, putting further pressure on the already battered dollar but allow for a freer flow of the yuan. In another sign of the "going out strategy", the Chinese government issued its first yuan bond sale in Hong Kong that was three times oversubscribed. The sovereign offering is part of the move to internationalize the yuan. Also, by loosening its ties to the dollar, China also paves the way for an alternative to the dollar such as gold or a basket of other currencies.

Meanwhile the Chinese are spreading their wealth by sending money to Africa and Latin America that not only secures strategic supplies but also creates demand for Chinese products. There is no need to occupy a country anymore, one only has to finance these countries' treasuries. Today, South Africa and Brazil have become China's biggest trading partners. China's exports to the US in the first nine months of this year was worth some \$185 billion, making up 18 percent of all US imports. China's exports to Japan totalled \$87 billion which represented about 22 percent of Japanese imports and exports to the European community totalled \$61 billion, accounting 17 percent of the EU's total imports. The new political reality in Asia is that China is increasingly on an equal footing with the United States in a relationship defined by economic interdependence. China lends, America borrows, China exports, American imports. China saves, America spends.

Golds lustre is also attracting Chinese retail consumption. Not only are there many ads on CCTV but Chinese banks are providing financing for bullion purchases. During the first six months a mid-size bank traded some

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internet and with on-the-job training while taking menial work for any kind of a pay check.

Public school teachers with longer years of experience, working in grades K-12 are being thinned out for some cheaper new grads. Foreign language teachers along with those in math and science are still preferred over the others. Watch for an increase in home schooling as laid-off teachers with their own children work at home and take in other peoples' kids for instruction-pay. The big public school systems are in trouble. They can no longer be afforded. Since the U.S. Government layered on piles of bureaucratic red tape some years ago, fully 1/3rd of public school budgets must be devoted to stupid, expensive politically correct type work. It's all a big waste as students and teachers must suffer for it.

Watch for more traffic accidents due to postponed road work and repairs. Bridges can fall and broken paving causes more wrecks. Higher tax communities will be abandoned especially by seniors with educated kids out of the house. New York City has lost over \$6 Billion in income taxes from those fleeing the city and the state.

This trend goes even faster. We see retired folks selling out as local real estate taxes are unaffordable. They are migrating to lower tax states and smaller communities offering fewer services. Much of the big city service stuff is not required and consumers cannot pay for it. Think of Detroit's city wasteland on steroids.

Gold And Silver Trading Is The Place To Be

Fund managers and traders are not married to markets and move to ideas that produce. Gold and silver shares can top and correct in the near term but then take-off in new 2010 rallies. Bigger funds have invested in long-only commodities baskets including gold, silver, grain, copper, platinum and others. They regularly buy the whole cycle from Labor Day to May, endure the dips and trade on 50 and 200 day averages. With a falling dollar these managers forecast stronger gains in these markets. December gold futures were trading near \$1,200 this morning of December 1. We see a near-term mild correction followed by more buying.

Administration's Politics Mostly Fail

The Obama left wing liberal agenda designed to transfer wealth is not working. The president's popularity is sinking along with his agenda. The primary problem is the administrations inability to claw out of the employment depression. Instead, they will continue to keep digging while installing the wrong ideas, creating more and deeper messes. This advances the desirability of precious metals, and other hard assets of all kinds. Joblessness is the primary economic problem.

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POST-IT NOTES

In 24 months, excess bank reserves (beyond what was needed for loans) expanded 500 times from the level they had been for the previous 30 years. **If the banks chose to lend these reserves they could multiply them into another \$10 trillion to add to the money supply. Instead, in the third quarter, the US suffered a record contraction of bank lending,** according to Federal Deposit Insurance Corporation. Lending to households and business is in a steep decline. Nothing like it has happened since WWII. Total credit outstanding is falling too. The banks are barely even lending to the US government from which they got the money in the first place.... **We remind readers that, despite the headlines, the US and much of the world is in a depression.** That is, it faces a long period of adjustment...in which the errors and illusions of the previous bubble period must be purged out. At the household level, **that means reducing debt levels.** Where debt can't be paid down - such as mortgages that are just too high to manage - there are delinquencies, defaults, and foreclosures..... The Huffington Post used Q2 2009 data from the World Bank to apply this measure and rank the top ten countries leading the way in running up gross external debt. In order of increasing debt, the biggest offenders are: #10 Luxembourg-\$1.994 trillion, #9 Japan-\$2.132 trillion, #8 Ireland-\$2.386 trillion, #7 Spain-\$2.409 trillion, #6 Netherlands-\$2.452 trillion, #5 Italy-\$2.567 trillion, #4 France-\$5.021 trillion, #3 Germany-\$5.208 trillion, #2 United Kingdom-\$9.087 trillion, #1 United States of America-\$13.454 trillion.... John Mauldin recently gave a "Thoughts on the Continuing Crisis" lecture where he showed **the US is entering a deflationary period much like the one Japan's been in for about two decades.** Here are 11 highlights from the presentation: 1. The US headline Consumer Price Index indicates deflation, 2. A record nine million Americans, more than at any other time, are working part-time for economic reasons, 3. **U6, the "real" unemployment measure, has hit new highs - when you include workers who've given up on finding a job, unemployment rises to 21.1 percent,** 4. 33 percent of the unemployed have been looking for jobs for over six months, more than ever before, 5. Available jobs continue to decrease at a much steeper rate than in an average recession... 18 million brand new jobs must be created over the next five years in order to return employment to 2007 levels, 6. US consumer borrowing is grinding to a halt and personal saving has turned sharply higher, 7. Prime mortgage delinquency rates are rising & are increasingly mirroring the subprime problem, 8. **The recovery is most likely to be a W-shaped... and we still have yet to hit even the first bottom,** 9. Bank lending to both consumers and businesses has fallen off dramatically, 10. Money supply, as measured by M2, has stayed flat and the velocity of money is way down, 11. Government tax receipts have tanked, and by almost any estimate the annual budget deficits are going to be in the trillions.... **California is the 8th largest GDP in the world. And traders got all scared when Dubai announced they couldn't meet their loan obligations? Dubai isn't anywhere close to the size and debt problems of California!** But why doesn't the financial media talk about this?..... **Did you see that a survey of money managers by Goldman Sachs came back with an average expectation that gold would reach \$4,000 in this cycle?... In order to meet global electricity demand, we'll need to build the equivalent of one large power plant every week for the next 20 years. And that says nothing for the infrastructure that goes with that - such as the miles of transmission lines....** When energy gets expensive, so does the price of gold. Which one would you rather invest in? Happy Investing - KDD

MADMEN, GAMBLERS & GOLD

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The fact that central banks are reducing US dollar holdings and increasing holdings of other currencies, as well as gold, is simply a matter of preserving the value of their reserves in the face of developments influencing the value of the US dollar, such as the burgeoning US dollar carry trade. Having gone "all in" to save the largest banks, the Federal Reserve and US government continue to assume that the crisis can be managed, despite the fact that their policies are making the situation worse in terms of sustainable housing prices, public debt and the value of the US dollar. In the mean time, Wall Street bankers have gone back to the casino, nonchalantly cashing in their bailout chips and pocketing the gains.

The rationale of buying time for US banks and of supporting US real estate prices seems reasonable on its face but this probably doomed policy is proving counterproductive. Despite the patina of economic recovery sprinkled over the news media like fairy dust, small business and commercial real estate failures, as well as ongoing residential mortgage and credit card defaults, are rippling through the weak US economy, while unemployment continues to rise undermining consumer spending thus, ultimately, bank balance sheets. Setting aside the understandable reluctance of US banks to make new loans, no amount of tenuous good news, no matter how exaggerated, has been able to rekindle the frenzy of consumer borrowing that formerly characterized the US economy.

The illusion of control is a temporary state of affairs. The triangle of dysfunction and co-dependency formed by the Federal Reserve, Wall Street banks, and the US government is like a story about a madman, a gambler and an alcoholic, where each traps the others in their respective downward spirals. The illusion of control, common to all three, is gradually bringing about a situation that will inevitably be entirely out of control, but, as with gambling addicts and alcoholics, the point where control is lost can only become apparent after the fact, just as the financial crisis of 2008 caught the vast majority of experts by surprise.

Investors, governments and central banks around the world are seeking safety outside the US dollar, particularly in gold, as well as outside of the US stock market, e.g., in emerging economies. The more borrowed money the US government spends, the more money the Federal Reserve prints and the longer zombie banks are kept on life support, the worse the eventual condition of the US economy, the weaker the US dollar and the higher the price of everything in US dollars will ultimately be, particularly gold.

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\$3 billion worth of gold for its clients on the Shanghai gold exchange or almost three times of an earlier period. While leverage is not allowed in China's stock markets, banks are permitted to provide gold customers with financing as much as ninety percent of the value against the gold contracts.

Today, China has become the world's biggest gold producer and jewellery consumption alone is spurring China to overtake India in consumption. Moreover, bullion purchases by its consumers will likely see China among the world's largest gold consumers. Today, the average per capita consumption globally is 1.2 gram. India's per capita consumption is .6 gram and China today is at .2 grams. We expect China's consumption to increase to as much as 1 gram per person, which would take up half of the world's gold production.

Gold: The New Currency

Gold bullion acts as a canary in the dark recesses of the market. Gold is portable and for thousands of years has been used as money as a median of exchange. Money is based on trust, more than anything else. Without that trust other forms of money that retains value will surface. It has happened before. Gold anyone? Gold has outlived governments, hyperinflation and during times of monetary upheaval is a store of value. Gold has surged through \$1,100 posting new highs amid worries about inflation and the stability of the US dollar. To us, we are not surprised and remain bullish on gold, expecting \$1300 an ounce near term and then \$2,000 an ounce.

This Bull Market Is Only Just Beginning

Our enthusiasm for gold is not because of its shininess, but because of its role as a protector of wealth. Investors no longer believe that the stewards of the dollar can protect the integrity of the currency and doubt whether they can. Central banks too, worry over the growing indebtedness of western governments and some are seeking alternatives by converting dollars into gold. State Street's gold ETF or the people's central bank are among the biggest holders of gold in the world today. And to meet demand, the American Mint has resumed coin sales while Britain's Royal Mint is quadrupling the production of gold coins.

Gold is also a good index of currency fears. Central banks around the world now view gold as a hedge against a devaluing dollar so by default gold has become a defacto reserve currency. When the US was on the gold standard, the Fed was disciplined by the reserves of gold. If they printed too much money, they had to buy more gold or risk a run on the dollar. That happened in the seventies, and when the US abandoned the peg, gold went from \$35 an ounce to \$850 an ounce. Gold prices today are soaring. As mentioned central banks have joined the gold rush, led by India that purchased 200 tonnes from the International Monetary Fund (IMF). China too has increased its holdings by 75 percent but still holds less than 2 percent of its reserves in gold, far below the world average of 10.3 percent and European country average of 15 percent. And tiny Mauritius has purchased two tonnes of gold from the International Monetary Fund raising its gold holdings to 5.69 percent from 2.34 percent. If China wanted to increase its holdings of gold to just 5 percent equivalent to half of the average major economies, it would need to purchase all the world's mine supply for the next two years.