HINDE CAPITAL

June 2008

Commodities: Death Taxes & Bubbles

Beam me Up Scotty

Short Selling & Socialism

Phony Mae & Fraudy Mac

Hindenburg Omen

Dirt Digler & the Dong

Money Disorder & Confiscation of Gold

It's Just a Flesh Wound

Commodities: Death, Taxes & Bubbles

Death & Taxes are a given but can we add "& Bubbles"

The Dollar has substituted gold for half a century & foreign countries have accepted in good faith (on the whole) the greenback as a trusted monetary unit. There has been a tacit belief in the status of the US government. A status premised on the dual powers of economic and military might. This nation would stand for sound finance; growth with price stability; to such an extent that no other nation could compete for such a hegemonic crown. Recent events have awoken foreign nations to the suspect nature of US finances, and the credibility of the US is now under severe scrutiny by these nations. We are witnessing the bursting of the largest Credit Bubble in modern economic history.

Manias, Panics and Crashes, a History of Financial Crises by Charles Kindleberger is a brilliant account of the way that mismanagement of money and credit has led to financial explosions over the centuries. In the opening chapter Kindleberger debates whether when manias occur in financial markets authorities should interfere or whether manias should be allowed to run their course, even at the risk of financial crisis that may propagate throughout broader markets. Should there be a lender of last resort, who comes to the rescue, and provides "stability" that the private market is unable to produce itself?

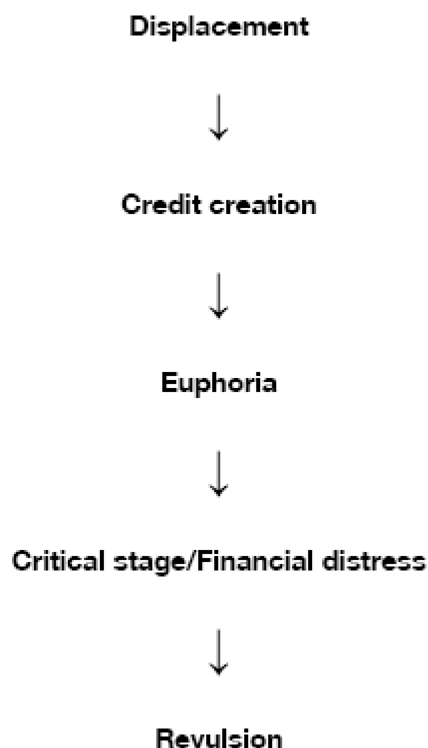
Extraordinary Popular Delusions and the Madness of Crowds by Charles Mackay, first written in 1841 is considered one of the finest accounts of market/human psychology, covering the episodes of three infamous manias, John Law's Mississippi Scheme, the South Sea Bubble and Tulipmania.

If you ever doubted that greed and fear have always been the driving forces of financial markets, then these books are must reads. Furthermore they highlight that even sensible intellects get caught out. In Manias many are mesmerized by the allure of a popular craze- "its real, it's different this time!" Manias have always been synonymous with "evil" speculators. We have heard reference to these scurrilous individuals rather a lot recently. Indeed they have cropped up with the phrase "Commodity Bubble". In the commodity space whether its agriculturals, such as wheat and rice, the energy complex, or precious metals, prices have been rising. In some cases this has been dramatic, in others less so. But trust me, bubbles and manias do not burst when the mainstream press think we have them. We do not as yet. If anything the only Mania like behaviour we have is "hysteria" about the Commodity Bubble.

Bubbles: a framework for analysis

Using Montier's depiction of 5 steps in the rise and fall of a Bubble we outline our Minskyian view of present economics. (as addressed in November Letter)

(http://www.hindecapital.com/downloads/investoroct07.pdf)



Displacement - The birth of a boom

Displacement is generally an exogenous shock that triggers the creation of profit opportunities in some sectors, while closing down profit availability in other sectors. As long as the opportunities created are greater than those that get shut down, investment and production will pick up to exploit these new opportunities. Investment in both financial and physical assets is likely to occur. Effectively we are witnessing the birth of a boom.

Credit creation - The nurturing of a bubble

Just as fire can't grow without oxygen, so a boom needs liquidity to feed on. Minsky argued that monetary expansion and credit creation are largely endogenous to the system. That is to say, not only can money be created by existing banks but also by the formation of new banks, the development of new credit instruments and the expansion of personal credit outside the banking system.

Euphoria

Everyone starts to buy into the new era. Prices are seen as only capable of ever going up. Traditional valuation standards are abandoned, and new measures are introduced to justify the current price. A wave of over optimism and overconfidence is unleashed, leading people to overestimate the gains, underestimate the risks and generally think they can control the situation.

Critical stage/Financial distress

The critical stage is often characterised by insiders cashing out, and is rapidly followed by financial distress, in which the excess leverage that has been built up during the boom becomes a major problem. Fraud also often emerges during this stage of the bubble's life.

Revulsion

This is the final stage of a bubble's life cycle. Investors are so scarred by the events in which they participated that they can no longer bring themselves to participate in the market at all.

Apply this to the Commodities market and I would contend we don't have a bubble.

The Worldwide Press has become a diluted form of news content from one or two major agencies that distributes to national and regional networks. As a consequent it is rare that we have diversified or controversial viewpoints. To boot Politicians manipulate the Press to their own end, with some success. This is more a reference to the US than the UK

There has been a growing chorus of Government officials and regulators most notably in the US who blamed rising prices on speculators, with accusations of manipulation. They are intent on curbing the activities of this "evil investor" class. To why they do this is evident. Most public officials, with few exceptions are self-serving and ego centric. Power is an alluring aphrodisiac for most. Elections are looming and a stagnating economy with rising commodity prices is not a good recipe for the retention of power. Better not to take responsibility for this mess, but deflect it onto "evil" doers. In this case the Speculator.

Oil Speculation

Before assessing the real cause of these price rises I want to examine the role of participants in commodities; most notably in the futures market.

Commodity markets refer to the actual physical commodity itself and its futures market. Very simply a futures market is one in which participants can buy and sell commodities and their future delivery contracts. A futures market provides a medium for the complementary activities of hedging and speculation, necessary for dampening wild fluctuations in the prices caused by gluts and shortages.

In the WTI crude oil market many questions have been raised concerning the role that speculators and fund index investors have played in rising prices. The role of speculators is to bring new information to the market on forward supply and demand fundamentals. Consequently, speculative buying and selling moves commodity prices to the extent that other market participants believe it is revealing new information on forward fundamentals. However, it is important to note that the empirical evidence shows that the size of the implied commodity price changes due to speculative buying and selling are well below those sometimes suggested by market commentators. David Greely and Jeffrey Currie of Goldman Sachs in their excellent piece "Speculators, Index Investors, & Commodity Prices" dispelled much of the myth behind higher oil prices. The Oil price has not been driven by excessive speculation or indeed manipulation. A reality agreed even by Ben Bernanke and Alan Greenspan in recent speeches.

For example, when we first wrote about the impact of speculators on oil prices in May 2004, the level of net speculative length was a relatively high 195 million barrels. Since then, however, net speculative length has increased by only 11 million barrels while WTI crude oil prices have increased by $100/bbl. Thus, since the last time speculators faced such intense scrutiny, the increase in speculative positions explains almost none of the rise in WTI crude oil prices. Even if we take a more neutral starting point in the recent run up in prices, regression analysis would indicate that the increase in net speculative long positions since January 2007 accounts for only $12.60/bbl of the $70/bbl increase in WTI crude oil prices since then (see Question 10). This strongly suggests that it has been the failure of the oil market to find adequate new supplies and/or sufficiently slow global demand growth that has been the key driver of price action.

The role of index investors is to supply a pool of stable, passive, unleveraged capital to bear commodity price risk. Unlike speculators who buy and sell on new information, the index investors buy and sell mechanically. Consequently, the buying and selling of index investors does not "move the market" in the same manner that the buying and selling of speculators does. Instead, by allowing commodity producers to transfer their inherent commodity price risk exposure to long-term investors who are better-suited to bear it, the participation of the index investors in the commodity futures markets lowers the cost of capital to commodity producers, and by lowering costs helps to lower commodity prices over the long run.

Who are the financial participants in the commodity futures markets?

Answer: The financial participants are divided into two broad categories: speculators and index investors, or more accurately, active and passive investors.

The commodity futures markets are comprised of physical and financial participants. The physical participants are commonly called commercial participants, or hedgers. They are the producers and consumers of the physical commodities, and they are part of both the commodity futures markets and the underlying physical markets for the commodities. The financial participants generally participate

in only the commodity futures markets, not the underlying physical commodities markets. The financial participants are comprised of both speculators who actively trade the commodity futures markets and commodity index investors who passively hold a commodity futures position in their portfolio as part of their overall asset allocation strategy.

Why does each of the above participate in the commodity futures markets?

Answer: Commercials participate in order to hedge their inherent commodity price risk exposure, speculators to profit by anticipating commodity price movements, and index investors to earn a return for bearing commodity price risk.

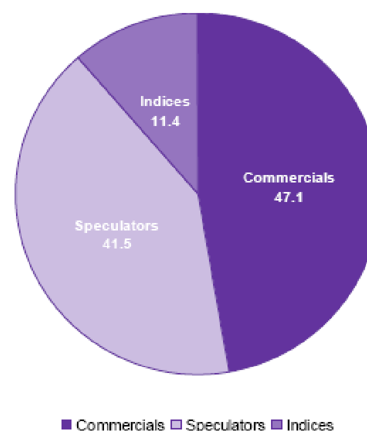
The commercials participate in the commodity futures markets in order to reduce their natural exposure to commodity price risk. This is why they are also known as hedgers, as they seek to hedge through commodity futures their exposure to commodity prices due to their role as producers and consumers of the physical commodities. The speculators, or active investors, trade in the commodity futures markets because they believe that they can profit by successfully anticipating movements in commodity prices. The index investors, or passive investors, hold a commodity futures position as a part of their asset allocation strategy. Index investors seek to earn returns on these positions as a payment for bearing the commodity price risk that the physical participants want to hedge. Index investors also seek diversification and to protect their portfolios against inflation and adverse movements in equity and bond prices.

What type of commodity futures positions do these participants hold?

Answer: Commercials tend to be net short commodity futures, index investors are long only, and speculators can be long or short depending on their view of the market.

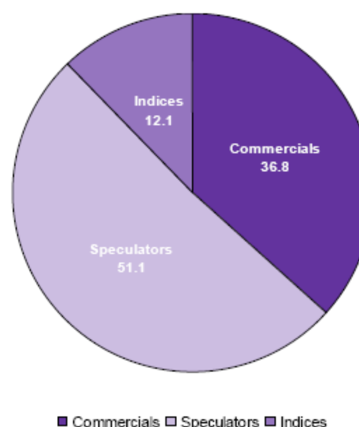
In the commodity futures markets the desire of commodity producers to hedge generally exceeds that of commodity consumers. This is because commodity production is typically concentrated among far fewer participants than is consumption, leaving each commodity producer exposed to far greater commodity price risk than each consumer. For example, a relatively small number of petroleum refiners supply all of the motor gasoline to hundreds of millions of drivers. This leaves these refiners far more inclined to hedge motor gasoline sales than drivers are to hedge purchases. Because of this underlying mismatch between the willingness of producers and consumers to hedge, commercials as a whole tend to be sellers of commodity futures. Commodity indices were designed to be long-only investment vehicles in order to create a stable supply of passive buyers to balance the commercial selling. Put simply, the index investors are the buyers of the commodity futures positions that the commercials want to sell in order to hedge their natural exposure to commodity price risk. Speculators will be either long or short, buyers or sellers, depending on the direction they anticipate commodity prices will move.

Exhibit 1: NYMEX crude oil: composition of futures and options positions (May 2008)
percent of total positions (which is twice open interest)



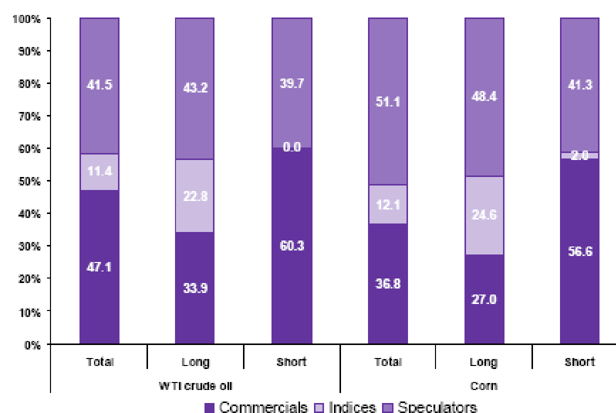
Source: CFTC and Goldman Sachs Commodities Research.

Exhibit 2: CBOT Corn: composition of future and options positions (May 2008)
percent of total positions (which is twice open interest)



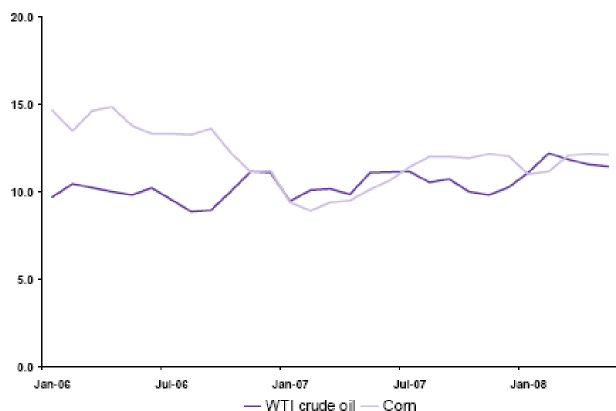
Source: CFTC and Goldman Sachs Commodities Research.

Exhibit 3: Index investor long positions offset natural short position of the commercials
percent of positions (which is twice open interest)



Source: CFTC and Goldman Sachs Commodities Research

Exhibit 4: The share of total positions held by index investors has been generally declining since 2006
percent of total positions (which is twice open interest)



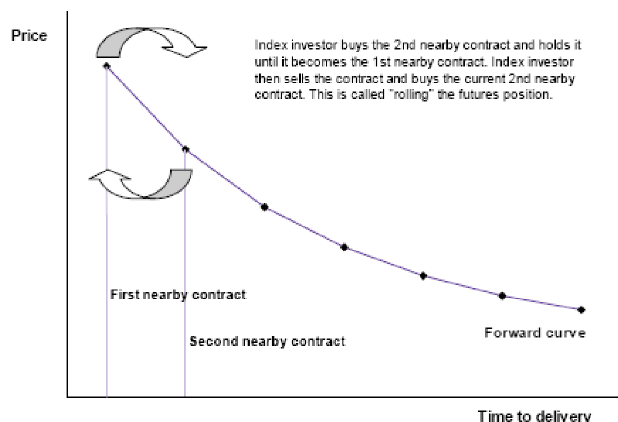
Source: CFTC and Goldman Sachs Commodities Research.

Backwardation & Contango- Normalised curves. Evidence of no speculation:

Index investors and speculators alike roll forward. For index investors using the S&P GSCI the index, the mechanical structure of the commodity index means the index will roll the futures contracts forward so as to avoid delivery, automatically. This helps maintain the index investor at a fixed point on the forward curve at all times.

Speculators rarely take delivery of the commodity but by buying futures this is not the equivalent of hoarding physical inventory. If they did one would observe an enormous backwardation in commodity forward curves. One does not. holding physical inventory provides benefits to the physical producers and consumers that commodity futures do not provide, producers and consumers are willing to pay a premium to obtain the physical commodity now relative to commodity futures contracts, which would deliver the physical commodity at a later date, in order to have the physical inventories on hand when inventories are low. Conversely, because storing physical inventory incurs costs to the physical producers and consumers that commodity futures do not, producers and consumers are willing to pay a premium for commodity futures contracts relative to the physical commodity in order to avoid these storage costs when inventories are high.

Exhibit 6: Commodity investors "roll" futures positions back out the forward curve instead of taking delivery
Price (vertical axis), Time to delivery (horizontal axis)



Source: Goldman Sachs Commodities Research.

If speculators can move prices, wouldn't removing them from the commodity futures markets allow for less volatile and perhaps lower prices?

Speculators impact prices by bringing to the market views on forward supply and demand fundamentals that change the price at which the rest of the market is willing to trade. They are a part of the market's price discovery mechanism.

Further, there are two characteristics of the commodity futures markets that make them much less vulnerable to the formation of speculative bubbles.

*First, commodity futures contracts are simple to short, and **the restricted ability** to sell an asset short is a common feature of markets that have undergone periods of excessive speculation. For example, comparisons have been drawn between rising commodity prices and the speculative bubble that formed in technology stocks in the late 1990s. A common characteristic of the technology stocks that were influenced by "excessive speculation," however, was a limited float of stock that created a difficulty in selling the stock short. When it is difficult to sell an asset short, those speculators who think the price is too high are unable to express that view in the market and have difficulty influencing prices. Unlike the new technology stocks, however, commodity futures are derivative assets, with longs and shorts not restricted by the number of shares outstanding. Therefore, if market participants truly believed that the forward supply and demand fundamentals do not support commodity prices, they could easily sell commodity futures.*

Second, an investor can be led to buy shares of a technology stock even when they believe the shares are fundamentally over-priced on the expectation that the shares can be resold at a higher price to another investor (i.e. the "greater fool" theory). In the equity markets the passing of shares from investor to investor continues indefinitely. In the commodity futures markets, however, the long futures contracts must be passed (on net) to physical consumers. The physical consumer is not interested in finding a "greater fool" but on consuming the physical commodity. Consequently, the price of the commodity futures contract is forced back to a level consistent with physical market fundamentals.

The only way for a similar bubble to develop in the commodity markets would be for the physical market participants to begin focusing on finding the "greater fool" by putting the physical commodities into inventory. Once again, a speculative bubble would require the building of physical inventory, this time as physical market participants begin hoarding the physical commodities.

However, as we have seen neither physical inventory builds nor the hoarding of physical commodities, the concerns of a speculative bubble seem unfounded.

(Greely & Currie June 2008)

Regulating Speculators will only hurt us-

http://www.rossputin.com/blog/index.php/2008/07/10/john-lothian-regulating-speculators-will

An Open Letter to Congress

When futures prices go up, they are advertising for selling. When prices go down, they are advertising for buying. With futures prices going up for crude oil and many other commodities, a truth has emerged in the cash markets that we have not grown our farming, drilling, mining or

processing capacity to meet the increasing demand of a developing global economy. High commodity prices are sending an important message.

We need to listen to that message and respond.

We need to respond to higher prices with more selling. We need to find a way to meet the growing global demand with real production of oil, metals, grains, fibres and many other commodities. We need the higher prices to spur the investment in that production. This is a demand pull rally in prices, not a supply shock. We should not be shocked that millions of Chinese who work in factories in cities (rather than in agriculture in the country) need to buy food, transportation and clothing. This change in lifestyle has created a change in demand with higher wages and a rising living standards. Look at the label on the goods you buy and the clothes you wear and you can find similar economic /human migration stories in other countries around the world.

Laws artificially muting market prices will only make the problem worse. And messing around with a global problem in a narrow nationalistic way, especially in a way that exacerbates the problem, is the kind of thing that can lead to wars. People need to be fed, clothed and kept warm. They need transportation to get to work and move their goods and services around the world. History has shown free markets are the best mechanism by which this can be accomplished.

One of the tragic economic errors after World War I and causes of World War II was the rent control laws in Germany in the 1920s. With an upper bar on rent prices due to a well-intentioned but tragically flawed law, it was difficult to find housing. People would not move because they were locked in to a rent-controlled apartment. Landlords were forced to accept less than the open market would yield, and as a result they would let the apartments fall into disrepair because they could not afford to pay for the upkeep. New housing was not built, because the return on the controlled rents was less than the cost of capital to build it.

Listen to what the higher prices are telling us. We need more selling. More selling can come from new supplies, or from consumers switching from one choice to another. Higher prices spur changes in consumption. They create the economic conditions for new technologies, systems and ventures to emerge and compete. These are the ingredients of economic growth. Government should not pick the winners, the market should.

Some investors figured all this out before others. This spurred the development of an investment class in commodities, using futures contracts as proxies for the underlying physical products. Long-only commodity index funds have emerged as a major fundamental factor in the futures markets. Billions of dollars are linked to indices of commodities.

While traditionally these participants would be classified as "speculators," they are in fact investors. Many of these funds fully fund each and every contract they buy. Margins on a $16 contract of soybeans might be $3000, but these investors are putting aside the full $80,000 to invest in these commodities on an un-leveraged basis.

These investors are putting their capital on the line, daring the market to find the selling to match their buying. There is nothing wrong or illegal in the way these market participants are using the futures markets. In fact, there is a lot that is right about it. Millions of investors use similar investing strategies to invest in other asset classes, including equities, fixed-income and real estate funds. The free flow of capital into this area is delivering an important message we need to heed. We need more selling. We need more production, processing and refining capabilities. We need to spur the market to allow alternatives to develop. We listen and respond to the market every day. This is no time to stop listening.

Proposals in Congress to raise the margins on futures contracts would have no impact on many of the long-only index funds as they have 100% in cash or equivalents of the contracts' value. On the other hand, increased margins would reduce the number of traditional speculators. That would lead to less efficient markets, higher execution costs and generally higher prices.

When Treasury Bonds were introduced in the 1970s, the bid-offer in the cash market for Treasuries was regularly a full basis point wide, or $1000 between the bid and offer. The successful introduction of Treasury bond futures allowed that bid-offer to narrow to 1/32 or $31.25. Investors offered transparent, liquid markets can do more with their money.

Speculators come in different shapes and sizes, the same is true with hedgers. Commercial concerns are impacted by these higher prices and the accompanying volatility. Some hedges are held for months on end, and spiralling capital costs can kill a company. Some grain elevators have stopped taking forward-priced contracts because they can't afford to finance the hedges for the farmers. This is a concern. Increased margins on market participants would only make this situation worse. We need more sellers, not less.

Speculators have often been vilified through the ages. In the current real estate crisis, many of the worst impacted areas for foreclosures were where the highest level of speculative activity occurred. Politicians publicly stated about how they wanted to help fix the problems in real estate but did not want to reward the speculators.

The first Treasury Secretary of the United States, Alexander Hamilton, was faced with a similar speculative situation in the early days of the republic. It seemed that many debts had been issued by the 13 colonies during the Revolutionary War to fund it. Original owners of the debt were often soldiers themselves, merchants or others. After the war, convinced these bonds would never be repaid by the colonies; many holders sold their holdings to speculators who paid pennies on the dollar.

Hamilton's great plan was to nationalize all that debt of the new states and to issue new USA debt to replace it, thereby establishing a national debt market. By repaying the state debt, some owed to foreign holders too, he also raised the credit rating of the country in the world's markets. However, in order to execute his plan, he had to handsomely reward the speculators who had accumulated the debt from the original buyers. Lucky for us that Hamilton did the right thing for the country and the hard thing to do politically.

As Congress contemplates how to respond to the political and economic risks we are faced with globally because of the jump in commodity prices, let's remember the tragedy that sprung from German rent controls, the value of transparent, efficient and fair markets and the wisdom and political courage of Alexander Hamilton. Let's remember higher prices mean we need more selling, not more regulation. Let us remember to listen to the market.

Stop Oil Speculation Now

An Open Letter to All Airline Customers

http://www.stopoilspeculationnow.com/uploads/An_Open_letter_to_All_Airline_Customers.pdf

An Open letter to All Airline Customers:

Our country is facing a possible sharp economic downturn because of skyrocketing oil and fuel prices, but by pulling together, we can all do something to help now.

For airlines, ultra-expensive fuel means thousands of lost jobs and severe reductions in air service to both large and small communities. To the broader economy, oil prices mean slower activity and widespread economic pain. This pain can be alleviated, and that is why we are taking the extraordinary step of writing this joint letter to our customers.

Since high oil prices are partly a response to normal market forces, the nation needs to focus on increased energy supplies and conservation. However, there is another side to this story because normal market forces are being dangerously amplified by poorly regulated market speculation.

Twenty years ago, 21 percent of oil contracts were purchased by speculators who trade oil on paper with no intention of ever taking delivery. Today, oil speculators purchase 66 percent of all oil futures contracts, and that reflects just the transactions that are known. Speculators buy up large amounts of oil and then sell it to each other again and again. A barrel of oil may trade 20-plus times before it is delivered and used; the price goes up with each trade and consumers pick up the final tab. Some market experts estimate that current prices reflect as much as $30 to $60 per barrel in unnecessary speculative costs.

Over seventy years ago, Congress established regulations to control excessive, largely unchecked market speculation and manipulation. However, over the past two decades, these regulatory limits have been weakened or removed. We believe that restoring and enforcing these limits, along with several other modest measures, will provide more disclosure, transparency and sound market oversight. Together, these reforms will help cool the over-heated oil market and permit the economy to prosper.

The nation needs to pull together to reform the oil markets and solve this growing problem.

We need your help. Get more information and contact Congress by visiting www.StopOilSpeculationNow.com.

Robert Fornaro
Chairman, President and CEO
AirTran Airways

Bill Ayer
Chairman, President and CEO
Alaska Airlines, Inc.

Gerard J. Arpey
Chairman, President and CEO
American Airlines, Inc.

Lawrence W. Kellner
Chairman and CEO
Continental Airlines, Inc.

Richard Anderson
CEO
Delta Air Lines, Inc.

Mark B. Dunkerley
President and CEO
Hawaiian Airlines, Inc.

Dave Barger
CEO
JetBlue Airways Corporation

Timothy E. Hoeksema
Chairman, President and CEO
Midwest Airlines

Douglas M. Steenland
President and CEO
Northwest Airlines, Inc.

Gary Kelly
Chairman and CEO
Southwest Airlines Co.

Glenn F. Tilton
Chairman, President and CEO
United Airlines, Inc.

Douglas Parker
Chairman and CEO
US Airways Group, Inc.

Airlines have been effectively nationalised for years. So no surprise to hear these CEOs bleating. I'm sure it's more out of concern for their share option packages than the welfare of their staff or customers.

I am relieved to see that the head of the CFTC (Commodity Futures Trading Commission) told Congress on Thursday that there is no evidence that market traders are working together to push up crude oil prices or that oil supplies are being hoarded.

http://news.yahoo.com/s/nm/20080710/pl_nm/congress_cftc_dc_3

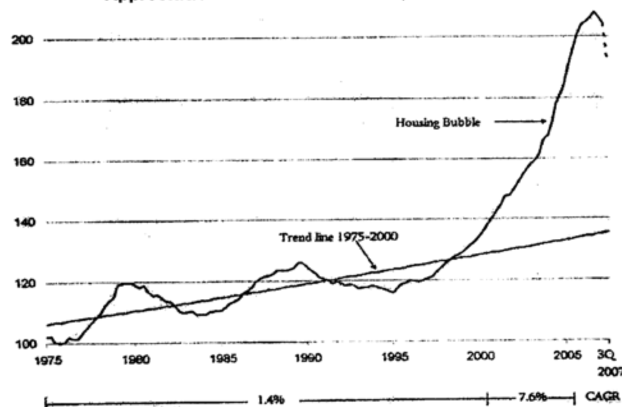
What is a speculator?

It appears perfectly acceptable for speculation to occur in some asset classes and not others. This entirely confuses the cause and effect of speculation in the main. It seemed perfectly acceptable for the Fed and regulatory bodies to allow the Nasdaq to soar from 2000 to over 5000. It was positively welcomed. Illusionary wealth or not, people were feeling richer. The same applies to house prices. It's perfectly acceptable for prices to run up far in excess of their long-term price trend and any sane income or loan ratios! God forbid though that commodity prices adjust to the upside where supply and demand come into balance. Indeed I would point out courtesy of the two charts below from Paulson & Co, and Barry Bannister, Stifel Nicolas (Marc Faber Report)

Source: Marc Faber 2008

Note: This chart is premised on the fallacy that is the CPI, if we adjusted to a more appropriate rate of 10%, then would look extremely undervalued.

If pricing power doesn't establish itself for commodity producers in a typical resource cycle, let's say 15-20 years then they have no means or incentive to improve infrastructure. A poor infrastructure, for example a "rusting oil industry" will see lower supplies and price will move higher to provide margin for better investment in the infrastructure.



Source: Marc Faber 2008

The two books I mention on speculative excesses, booms and investment manias depict a lurid and vivid history of human behaviour that has not changed to this day and undoubtedly will never change. By definition we are to short-termist in outlook. After all each of us are only here for a very short-time in life's history. We are selfish by definition. Survival of the fittest and moral constructs don't easily go hand in hand. Make the "most" for yourself. As Faber points out *manias usually occur when one sector of the economy or a region promises great future opportunities. Even a gold standard doesn't prevent speculative excesses in one or other sector of the economy.*

It seems easier to define a "speculator" in commodity markets but not in other asset classes? Okay so it is possible to excuse the authorities for not stepping in soon enough on "Pump & Dump" behaviour of tech stocks. Sure! In the housing market am I an investor or speculator if I purchase a house borrowing 120% of the value of house. Am I then an investor or speculator if I borrow 120% and invest the balance of 20% in a foreign currency deposit as I believe it will appreciate versus the currency I borrowed in. This example used by Faber to my mind is evidence of a savvy investor, who has used the profligate monetary behaviour of the Central Bank's to utilise capital. If they are going to inflate the money supply and potentially debase my holding of cash I am going to protect my assets accordingly. Hence the switch into gold is not speculative but an investment. An investment because if other assets depreciate relative to price of gold then as an investor I am financially better off.

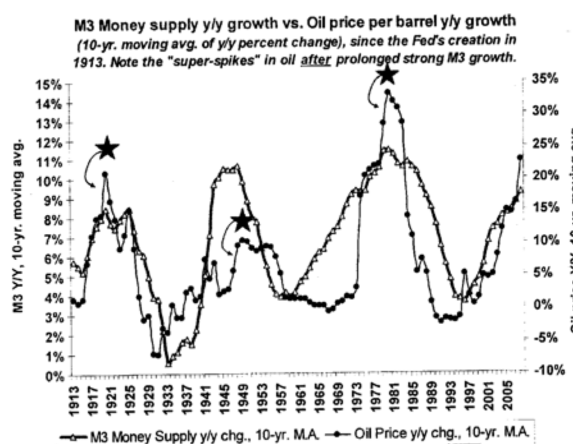
In reality as was highlighted in "Regulating Speculators will only hurt us" An Open Letter to Congress (above) a speculator is one that borrows on margin and is hence open to the risk of losing all his capital when prices move against them. Speak to many, particularly those, who came late to the housing boom. They are now wiped out sitting on negative equity struggling to service their debt, and in many cases have defaulted, as their houses have been foreclosed upon. No different to the speculator who sold oil futures (on margin) too early and was forced out of their positions when oil traded to record highs. They had no more capital.

The point about speculation is that prices cannot remain out of equilibrium for long periods of time, no one individual or group for that matter can be bigger than the MARKET. Fundamentals will always win out. Undoubtedly global property markets have seen "Infectious exuberance" as Robert J Shiller (prominent professor of economics at Yale University) writes. He is right the Housing boom was a speculative bubble fuelled by social contagion, the "new era argument ruled. It's different this time.

I fundamentally believe that "protestant" work ethics of the 80 and 90s transformed themselves into "investing hard to make money" ethics. This was a symptom of excessive money and credit growth. An artificial lowering of interest rates by CBs and the subsequent increase in the rate of growth of money supply gives rise to a misallocation of resources- it gives rise to non-productive activities. Bubble activities. We do not have a bubble yet in commodities but the policy response to offset the asset deflation of the housing market and financial sector will be to activate money supply and will deepen the misallocation of resources. Commodities will rise further in a possible MANIA outcome. Certainly I do not mean to diminish the importance of demand/supply factors but for me this is the root cause of our problems.

The weaker dollar is a symptom of the Fed's "inflation" and because commodities are priced in dollars, when the value of the dollar falls, the nominal prices of these internationally traded goods must rise.

Figure 7 **Money Supply Growth and Oil Prices, 1913–2007**



Source: Barry Bannister, Stifel Nicolaus

Source: Marc Faber 2008

Even if aggregate demand falls at these high levels for oil, do not bet the ranch on much lower oil prices. Medium term we believe $140/45 caps prices but on the mean the range is 120-145 for next 4-6 months.

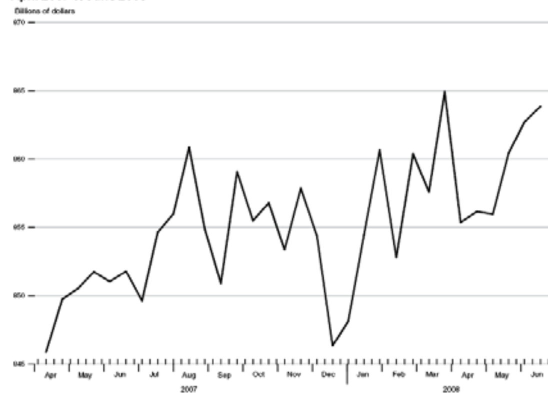
Real Rates are negative. As Jonathan Tepper, our analyst highlighted, most yield curves in the world are inverted. But most importantly most long end yields are lower than inflation rates. Global Central Banks, not just the Fed are fuelling and accommodating the rise in food and energy prices. Asian rates are too accommodative. Brazil is really the only one of the BRICS who has a proper real rate term structure.

Beam me Up Scotty!

"We have a problem Jim… well beam me up Scotty" It might as well be Ben Bernanke talking to Hank Paulson rather than Jim and Scotty from the Star Ship Enterprise.

Don Coxe of Basic Points encapsulates the Fed's issues through examination of the Adjusted Monetary Base (July 2008)

U.S. Federal Reserve
Adjusted Monetary Base
Averages of Daily Figures, Seasonally Adjusted
April 2007 to June 2008



Source: June 26, 2008, Weekly U.S. Financial Data, Research Division, Federal Reserve Bank of St. Louis

For those who've forgotten how the Monetary Base works, a few pointers:

This is, essentially, the Fed's Balance Sheet, and it's ordinarily made up of

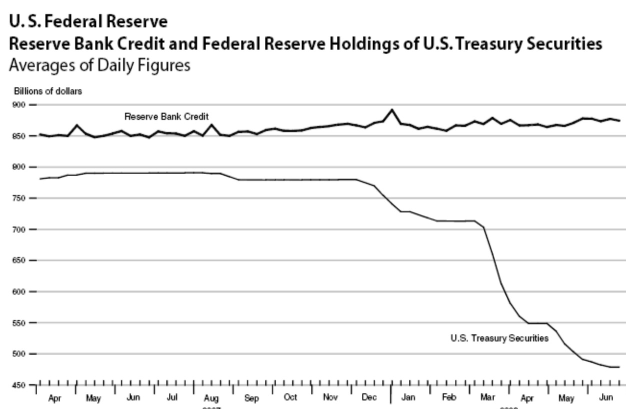
(1)Securities, including T-Bills, Treasuries, paper from Federal Agencies—mostly Fannie Mae, Freddie Mac, Federal Housing Authority and Tennessee Valley Authority;

(2) Reserves, being deposits of cash made with the Fed by commercial banks that are members of the system. Banks that are short of cash, borrow from other banks that have excess reserves; the interest rate on those loans is the fed funds rate—probably the best-known interest rate in the world.

Monetary policy operates through the Monetary Base like some great accordion: it goes out and in. When it is going out, liquidity expands, sending beautiful dance music to the markets. When it comes in, the sound shifts to a dirge in a minor key.

When the Fed grows its balance sheet faster than the growth of real GDP, that ordinarily means that the excess liquidity reduces interest rates. When—as in the past year—its growth rate is well below the growth rate of nominal GDP, that is historically a sign of Fed tightening, and is associated with inverted yield curves and rising interest rates.

Not this time. Interest rates fell 325 bps, despite tiny growth (1.4%) in the fed funds rate. The Bernanke Fed has had to throw caution to the winds because too many major US banks threw caution to the winds years ago.



Source: June 26, 2008, Weekly U.S. Financial Data, Research Division, Federal Reserve Bank of St. Louis

Consider the uniqueness of this convulsion:

1. The Fed's balance sheet has barely grown in a year.

2. The bank reserve component of the Fed's balance sheet is Net Borrowed, and has been that way for many weeks. Historically, this has also been a rare event, and a sign of tight monetary policies and a Fed-induced squeeze on the banking system.(see Baldric's Bollox Jan 2008 Hinde Investor Letter)

http://www.hindecapital.com/downloads/HindeGoldFundInvestorLetterJan2008.pdf

3. Not only is the Fed not squeezing the banking system, it is showering the banks with its own most precious asset—liquidity—in the form of Treasuries and T-Bills. Historically, such massive dumping of Treasuries would have triggered skyrocketing interest rates.

4. For the first time ever, the Fed isn't dumping Treasuries for cash or against pledges of Treasuries and other government-related paper—it is lending them out, secured (insecurely) by the same illiquid, dubious or outright toxic structured products that the banks created in their own Frankenfinance labs based on mathematics and risk formulas that Nassim Taleb (Black Swan) has long ridiculed as spurious. The banks prospered mightily by selling these smelly spawn to greater fools, but then they ran out of greater fools and so the banks were forced to keep these fast-rotting wonders on their own fast-eroding balance sheets. That meant levering up bank balance sheets and creating Enronesque off-balance sheet vehicles designed to borrow short and ingest the longest and most loathsome paper that the banks couldn't sell elsewhere. Somewhere, the ghost of Enron's Ken Lay, who died suddenly just before he was headed for prison, is shaking his head. As he doubtless ponders, what's the difference between what we did and what they did? And why are those ex-CEOs rich and on the most exclusive of golf courses when I was sentenced so harshly?

5. The banking crisis has backed the Fed into a corner in which fear of financial collapse drives away fears of inflation. Before the banking crisis took centre stage, Bernanke mused aloud from time to time about the risk to the Fed's credibility in using Core Inflation as its reference if Nominal CPI were staying significantly higher. (Core Inflation has routinely been dismissed by sceptics as "The measure for economists who neither eat nor heat," or by a dry British economist as "The measure appropriate for anorexic pedestrians.") Bernanke's 2% fed funds rate is less than half the CPI, and is now well below even Core Inflation. Central banks who keep their target rates in negative real terms invite serious inflation. Bernanke, a cautious student of monetary history, would hardly take that risk if he weren't so terrified by the fallout from the banking disaster.

Nonetheless, politicians are all to concerned with blaming "Short Sellers" for the demise of our banking institutions. Financial Short sellers are again the evil doers. The reaction of Government and regulators such as the FSA in UK and SEC in US has been to either ban short selling, in certain circumstances or restrict such normal market practice. Complete double standards. Let the Nasdaq rise, but stop the financials diving.

Short Selling & Socialism

Short selling is the selling of a stock that the seller doesn't own. More specifically, a short sale is the sale of a security that isn't owned by the seller, but that is promised to be delivered. That may sound confusing, but it's actually a simple concept. For the uninitiated-

When you short sell a stock, your broker will lend it to you. The stock will come from the brokerage's own inventory, from another one of the firm's customers, or from another brokerage firm. The shares are sold and the proceeds are credited to your account. Sooner or later you must "close" the short by buying back the same number of shares (called covering) and returning them to your broker. If the price drops, you can buy back the stock at the lower price and make a profit on the difference. If the price of the stock rises, you have to buy it back at the higher price, and you lose money.

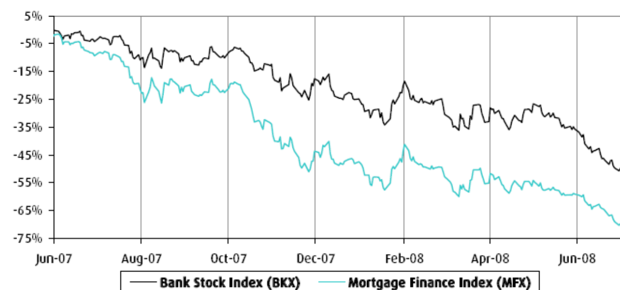
Most of the time, you can hold a short for as long as you want. However, you can be forced to cover if the lender wants back the stock you borrowed. Brokerages can't sell what they don't have, and so yours will either have to come up with new shares to borrow, or you'll have to cover. This is known as being *called away*. It doesn't happen often, but is possible if many investors are selling a particular security short.

Short sellers historically have been viewed with disdain, but more and more they have become recognised as an appropriate manifestation of free and sound markets. It's tough to deny that short selling makes an important contribution to the market. It provides liquidity, drives down overpriced securities, and generally increases the efficiency of the markets. To my mind short sellers are often the first line of defence against financial fraud.

While the conflicts of interest from investment banking keeps some analysts from giving completely unbiased research, work from short sellers is often regarded as being some of the most detailed and highest quality research in the market. Its been said that short sellers actually prevent crashes because they provide a voice of reason during raging bull markets. However in bear markets they are accused of doing “Short & Distort”. Rumours, usually false, are circulated that may be detrimental to a stocks price, but profitable for the short.

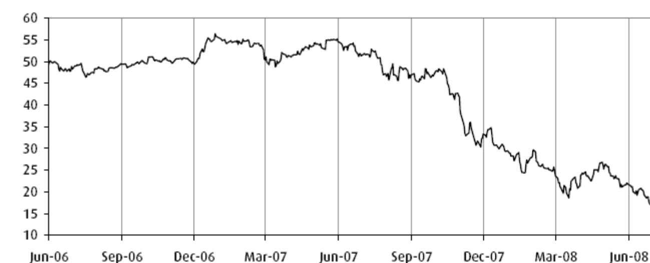
The US National Banks

Bank Stock Index (BKX) vs. Mortgage Finance Index (MFX)
June 2007 to June 2008



Bank of America (BAC – NYSE)
June 2006 to June 2008

Citigroup (C – NYSE)
June 2006 to June 2008



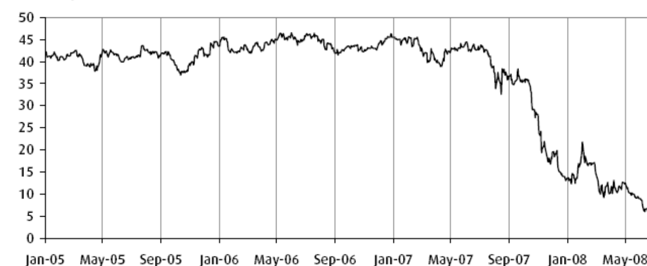
Source: Don Coxe 2008

The Regionals & S&Ls & FDIC

Source: Bloomberg. IndyMac equity collapses on run on bank and bail out by FDIC. De facto nationalization

I believe the US administration would like to be seen not to bail out the banks. So the orderly failing of the S&L IndyMac was seen as a "success". However if a really big financial entity goes under then FDIC funds are not enough. If that happens we need a RTC II. The US administration is trying currently an orderly failing i.e. let shareholder equity go to nil then have a rescue of big institutions. There is no way they will let a big US bank go totally under without any intervention. However in the savings and loan crisis early on 1000 small banks failed. So there is a lot more coming; there are 93 on the FDIC watch list and IndyMac was not one of them, nor was Fannie and Freddie!

Washington Mutual (WAMU – NYSE)
January 2005 to June 2008



Source: Don Coxe 2008

The above charts are examples of Asset Deflation DUE TO POOR FUNDAMENTALS. But regulators and Congressmen are saying “evil” speculators are attacking the viability of our banking system.

Below was the edict calling for a temporary halt on “Naked Short selling” (which incidentally was already illegal?!):

SEC Enhances Investor Protections Against Naked Short Selling

FOR IMMEDIATE RELEASE
2008-143
Washington, D.C., July 15, 2008 - The Securities and Exchange Commission today issued an emergency order to enhance investor protections against "naked" short selling in the securities of Fannie Mae, Freddie Mac, and primary dealers at commercial and investment banks.

The SEC's order will require that anyone effecting a short sale in these securities arrange beforehand to borrow the securities and deliver them at settlement. The order will take effect at 12:01 a.m. ET on Monday, July 21. In addition to this emergency order, the SEC will undertake a rulemaking to address these issues across the entire market.

"The SEC's mission to protect investors, maintain orderly markets, and promote capital formation is more important now than it has ever been," said SEC Chairman Christopher Cox. "Today's Commission action aims to stop unlawful manipulation through 'naked' short selling that threatens the stability of financial institutions. We will continue our vigorous commitment to investors by working within the SEC and in close cooperation with our regulatory counterparts to promote the continued health and vibrancy of our markets."

The Commission's emergency order, pursuant to its authority under Section 12(k)(2) of the Securities Exchange Act of 1934, will be effective at 12:01 a.m. ET on July 21, 2008 and will terminate at 11:59 p.m. ET on July 29, 2008. The Commission may extend the order to continue it in effect thereafter if the Commission determines that the continuation of the order is necessary in the public interest and for the protection of investors, but for no more than 30 calendar days in total duration.

The securities identified in the Commission's order:

Company	Ticker Symbol(s)
BNP Paribas Securities Corp.	BNPQF or BNPQY
Bank of America Corporation	BAC
Barclays PLC	BCS
Citigroup Inc.	C
Credit Suisse Group	CS
Daiwa Securities Group Inc.	DSECY
Deutsche Bank Group AG	DB
Allianz SE	AZ
Goldman, Sachs Group Inc	GS
Royal Bank ADS	RBS
HSBC Holdings PLC ADS	HBC and HSI
J. P. Morgan Chase & Co.	JPM
Lehman Brothers Holdings Inc.	LEH
Merrill Lynch & Co., Inc.	MER
Mizuho Financial Group, Inc.	MFG
Morgan Stanley	MS
UBS AG	UBS
Freddie Mac	FRE
Fannie Mae	FNM

http://www.fsa.gov.uk/pubs/other/Shortselling_faqs.pdf

Such behaviour by authorities and the Senate shouldn’t surprise us, as they have been accusing China for years of manipulating their currency for trade advantage. Even last year the Senate Finance Committee and the Banking Committee passed separate bills that gave the White House new tools, the right and even the obligation to bring pressure upon countries that “*manipulate their currencies for a trade advantage*”.

Phoney Mae (FNM) & Fraudy (FRE)

The authorities got really vocal when these two stock prices “came under attack” from “evil” short sellers. P.S. Didn’t hear any noises about the implosion in UK and US house builders?

So what’s the big deal?

(see our Dec. 07 Letter Return of the Wombles for more detail on Fannie Mae and Freddie Mac)

http://www.hindecapital.com/downloads/investordec07.pdf

The United States economy is in the early phase of its worst housing price collapse since the 1930’s. No end is in sight. Fannie Mae and Freddie Mac, as private stock companies, have gone to excesses in leveraging their risk, mostly as many private banks did. The financial market bought the bonds of Fannie Mae and Freddie Mac because they bet that the two were “Too Big To Fail,” i.e. that in a crisis the Government, that is the US taxpayer, would be forced to step in and bail them out.

The two, Fannie Mae and Freddie Mac, either own or guarantee about half of the $12 trillion in outstanding US home mortgage loans, or about $6 trillion. To put that number into perspective, the entire 27 member states of the European Union in 2006 had an annual GDP of slightly more than $12 trillion, so $6 trillion would be half the GDP of the combined European Union economies, and almost three times the GDP of the Federal Republic of Germany.
In addition to their home mortgage loans, Fannie Mae has another $831bn in outstanding corporate bonds and Freddie Mac has $644 billion in corporate bonds.

Freddie Mac owes $5.2 billion more than its assets today are worth meaning under current US “fair value” accounting rules, it is insolvent. Fair value of Fannie Mae assets have dropped 66% to $12 billion and may as well go negative next quarter. As the home prices continue to fall across America, and corporate bankruptcies spread, the size of the negative values of the two will explode.

As one financial commentator noted: “On July 14, symbolically the anniversary of Bastille Day, US Treasury Secretary Paulson, former chairman of the powerful Wall Street investment bank Goldman Sachs, stood on the steps of the US Treasury building in Washington, a clear attempt to add psychological gravitas, and announced that the Bush Administration would submit a bill proposal to Congress to make taxpayer guarantee of Freddie Mac and Fannie Mae explicit. In effect, in the present crisis it will mean nationalization of the $6 trillion agencies.”

The bailout by Paulson was accompanied by a statement from Bernanke that the Fed stood ready to pump unlimited liquidity into the two companies.

The Federal Reserve is rapidly becoming the world’s largest financial garbage dump as for months it has agreed to accept banks’ securitised assets including sub-prime real

estate bonds as collateral in return for US Treasury bond purchases. Now it agrees to add potentially $6 trillion in GSE real estate debt to that.

Source: Bloomberg. FNM equity price

Source: Bloomberg. FRE equity price

Http://nakedshorts.typepad.com/nakedshorts/ accredited for names Phoney Mae & Fraudy Mac (July 2008).

We are about to witness the nationalisation in coming months of the Freddie Mac and Fannie Mae, and instead of allowing free "Smithsonian" markets to transfer good assets, from weak hands to strong and allowing market equilibrium, government will gorge taxpayers with unwanted debt. A misallocation of their wages:

"Goodbye Capitalism" FT.com by Joshua Rosner a must read in my humble opinion:

http://www.ft.com/cms/s/0/93f0da74-5269-11dd-9ba7-000077b07658.html?nclick_check=1

Rosner states that in a capitalist economy, losers are expected to take losses and winners to gain, but that's not what is happening today. The US and UK has begun to nationalise bad assets and is thus a small step to nationalization of good assets. He asserts that Govt. has lost faith in the free market. I would contend the market has found government wanting. However he is right when he says we have lost faith in our creative destruction which is at the core of the market process. Forget Schumpeter roll on Marx and Keynes…No.

The new social democratic order wants a world without failing corporations or banks. It is no wonder, then, that step-by-step they have ringed the market with "protections." Today's social democrat (and compassionate conservative) wants the benefits of the market without the pain of market process. The Austrian economist Ludwig von Mises once wrote: "Men must choose between the market economy and socialism. They cannot evade deciding between these alternatives." No pain, no gain.

Ludwig von Mises went further, "every step a government takes beyond protecting the smooth operation of the market economy against aggression is a step forward on a road that directly leads into the totalitarian system where there is no freedom at all."

We have nationalised the losses from Bear Stearns through a transfer of risk on to the federal government's balance sheet and have now ***nationalised the losses*** *generated by Fannie's and Freddie's poor management and functionally taken $5,000bn in obligations on to the government's balance sheet. This has been done even though every equity or debt offering of Fannie and Freddie explicitly states that these "are not guaranteed by the US and do not constitute an obligation of the US or any agency or instrumentality thereof other than" of Fannie or Freddie.*

By the time we are finished with this tragic period in US economic history, the government is likely to have to choose whether to do the same for at least one more large bank, investment bank, bond insurer, mortgage insurer, multiple large regional bank, airline or car manufacturer. Given the choices we have seen from officials, who obviously have little faith in the ability of capital markets or our system of law, we will see the continued nationalisation of bad assets, placing the burden on the shoulders of the already overburdened American taxpayer.

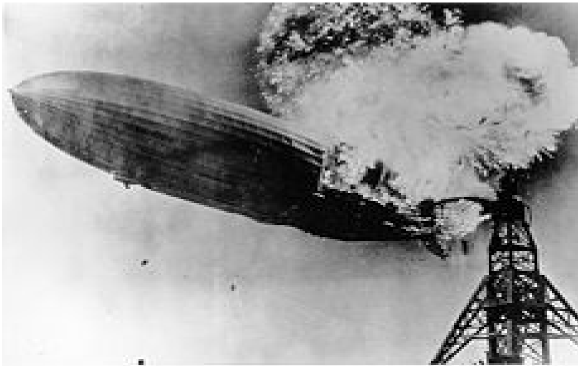
This commitment by misguided officials to print more money, to stoke the embers of inflation and to debase further our already hobbled currency invites foreign investors to pick through our assets and buy our remaining strong businesses (Anheuser Busch) on the cheap. As the strength of our remaining industries is further weakened, along with taxpayers' buying power, it will become increasingly necessary, as a matter of survival, for American workers to demand increases in their wages.

In reality FNM & FRE have never played on a level playing field to the other financial intermediaries of the free market, because of their privileged funding situation. That was the "privilege" of an "Implicit government entity". But where will this nationalization stop and who and how will the US government pay for it. Nationalization may take this route and in no particular order- Major and regional banks, airlines, auto companies (GM & Ford), gasoline & diesel refineries, some transportation systems including trucks, railroads, home rental and the steel industry. The Fed is all out of Ammo so will the Treasury issue more bonds? But as we will see foreign nations will require higher rates to compensate them for the debasement of the dollar and the US government credit risk. It's already underway. The only answer for Ben is to fly is helicopter in. M=PV. He has to crank on his printing press.

Hindenburg Omen

Understandably when Financials make up over a quarter of the main indices, like the S&P500, the threat of a spill over from the Credit crunch manifests itself in lower stock prices. Indeed markets have observed the makings of an alarming crash indicator. The Hindenburg Omen.

The **Hindenburg Omen** is a technical analysis that attempts to predict a forthcoming stock market crash. It is named after the Hindenburg disaster, the crash of the German zeppelin in late May 1937. The Hindenburg Omen is the alignment of several technical factors that measure the underlying condition of the stock market - specifically the NYSE - such that the probability that a stock market crash occurs is higher than normal, and the probability of a severe decline is quite high. The rationale behind the indicator is that, under normal conditions, either a substantial number of stocks establish new annual highs or a large number set new lows - but not both. However, this indicator mainly tracks new lows and downside risk. A healthy market requires some degree of internal uniformity, whether the direction of that uniformity is up or down.



Source: Wikipedia Google Images Hindenburg Crash May 6 1937 LZ 129

http://www.youtube.com/watch?v=9suH3GFJZ74&feature=related

The traditional definition of a Hindenburg Omen has five criteria:

- That the daily number of NYSE new 52 Week Highs and the daily number of new 52 Week Lows must both be greater than 2.2 percent of total NYSE issues traded that day.
- That the smaller of these numbers is greater than 75. (this is not a rule but a function of the 2.2% of the total issues)
- That the NYSE 10 Week moving average is rising.
- That the McClellan Oscillator is negative on that same day.
- That new 52 Week Highs cannot be more than twice the new 52 Week Lows (however it is fine for new 52 Week Lows to be more than double new 52 Week Highs). This condition is absolutely mandatory.

The occurrence of all five criteria on one day is often referred to as an unconfirmed Hindenburg Omen. A confirmed Hindenburg Omen occurs if a second (or more) Hindenburg Omen signals occur during a 36-day period from the first signal.

Looking back at historical data, the probability of a move greater than 5% to the downside after a confirmed Hindenburg Omen was 77%, and usually takes place within the next forty-days. The probability of a panic sell out was 41% and the probability of a major stock market crash was 27%. However, the occurrence of a confirmed Hindenburg Omen does not necessarily mean that the stock market will go down, although every NYSE crash since 1985 has been preceded by a Hindenburg Omen.

(Because of the very specific and seemingly random nature of the Hindenburg Omen criteria, it is possible that this phenomenon is simply a case of over fitting. That is, if one back tests through a large data set and tries enough different variables, eventually correlations are bound to be found that don't really have any predictive significance. However, the fact remains that out of the previous 25 confirmed signals only 8% (two) have failed to predict at least a mild (2-4.9%) declines.)

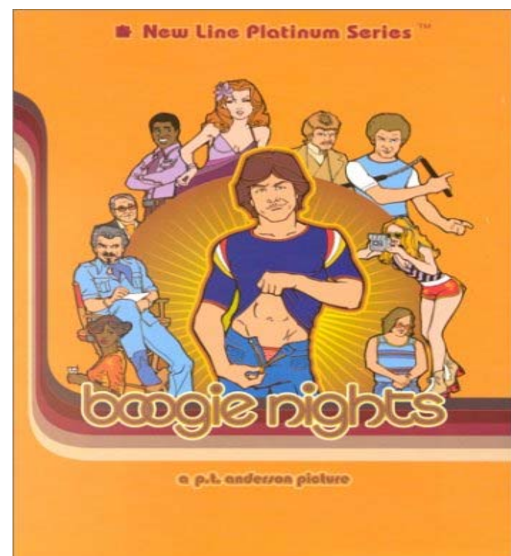
The authorities will do all they can to prevent this eventuality, but the bursting of the credit bubble, has extenuated a potential growing bubble in commodities. Further asset wealth destruction is not an option; the only option is really only one of inflating the monetary aggregates. Are we or have we seen the seeds for the spread of hyperinflation. This will be the debate for the July Investor Letter “Inflate or Die” a tribute to the live and kicking Richard Russell. Mr Russell is author of the fabled Dow Letters.

Dirty Digler & The Dong

Hyperinflation or just plain ol’ inflation the US is exporting higher prices in to those currencies pegged to the dollar. In our piece Pork Pies and Lies Nov 2007 we spoke about the Asian and Middle Eastern PEGs. Vendor-financing is over.

http://www.hindecapital.com/downloads/investornov07.pdf

No more evident is this than in Vietnam. Its main asset the Dong just plain went wrong.



Everyone's born with one special thing, and Eddie Adams uses his humongous "asset" to take the world of film pornography by storm.

Vietnam’s big asset ain’t the Dong any more! It’s GOLD

See this link on Gold & Property transactions.
http://english.vietnamnet.vn/biz/2008/07/792484/

This country was the next Asian miracle, with GDP of 7% year in year out, and a young demographic, growing in prosperity as property and the Ho Chi Minh Stock Index soared. This was a new Tiger economy based on sound finance, higher productivity and lower wages (half that of China.) Just like Greenspan’s reign. It was an illusion. The Vietnamese stock index has since collapsed and is the worst performer this year, -51% YTD. (And that’s with an inflated Dong- sorry excuse me.) The falling dollar has handcuffed the Vietnamese currency (the Dong) to a loss of 37% in paper terms, i.e. versus Gold. As of June of this year CPI was running at 25%. So when the fed stimulates

the US economy, an already hot (growing) pegged country such as Vietnam with a balanced global export and import market to boot, quite literally lights up and then burns out.

Like Thai Lady' Boys it would seem nobody wants a Dong, in Vietnam. The response of Vietnamese investors was to grab gold. Imports have more than double in the last year to 60 tonnes, valued at $1.8bn.

The response of the Government was to ban imports of gold. Nguyen Tan Dung the premier "temporarily" withdrew licences for further imports. It seems Vietnam just borrowed a page from the U.S. financial history books. Irony of irony for it was Ho Chi Minh who after the 1945 August Revolution and declaration of independence stood tall and quoted Thomas Jefferson. "All men are created equal…they are endowed by their creator with certain inalienable rights; among these are life, liberty and the pursuit of happiness."

Seventy five years ago, Franklin Delano Roosevelt [FDR] issued Executive Order number 6102 and confiscated all gold privately held in the United States on April 5, 1933. But unlike FDR's edict, the Vietnamese can still hold or own physical gold. They just can't import any more.

By restricting gold purchases, the Vietnamese Communist Authorities are trying to hold down the local skyrocketing inflation. But inflation is already heading for Weimar Germany-style double-digit or possibly, triple-digit consumer prices. Officially, the government claims this new policy is to temper booming imports, which resulted in a record trade deficit for the first half of 2008. First-half imports surged 64% to US$45 billion while exports rose only 27% or US$28.6 billion. Yet the value of gold imports prior to the June suspension was US$1.8 billion or 3.8% of total imports. That's hardly a dent compared to heavy industrial machinery and machine tool imports used for manufacturing. That suggests the government is targeting gold to stop demand.

Thus far the Vietnamese Communist government has not confiscated gold, but if inflation continues to soar, it becomes a high probability.

Money Disorder & the Confiscation of Gold

The Fed is likely to be the back-stop the financial system and act as lender of last resort to the banks. At the moment, the FDIC currently has $53 billion set aside to reimburse consumers for deposits lost at failed banks.
(Frank Barbera 2008). Indymac will take up $4 to 8 billion of that fund, the agency estimates. That in turn could force the FDIC to raise more money from the banks that it insures.

However, with more and more ailing banks in danger of following Indymac, it appears that the Fed is fast approaching the "fork" in the road. Since the Fed first started down the road of monetary accommodation, it has become evident that the financial crisis would beckon the Fed to the rescue once to many times, only to have markets pull one on the Fed. After all, if a crisis in not allowed to unfold, and the Fed is the lender of last resort for one and for all, then at what point do markets begin questioning the solvency of the Fed?

In reality the market already has with gold bullion consolidating and moving higher in what is traditionally a very weak period for the metal. The money panic is in the early stages but make no mistake we have MONEY DISORDER. We have used the US Dollar as leader of the fiat currencies as the base case, but to all intent and purposes most fiat currencies are failing. Whether it be the fragility of the Euro construct, the PEGS or just the other Anglo-Saxon pegs no fiat currency is immune.

GOLD purchases are a MUST, they are not under advisement. But best we not forget history. The draconian response of Roosevelt could well be repeated under whole scale shift to precious metals by the populace.

Executive Order 6102 was signed on April 5, 1933 by U.S. President Franklin D. Roosevelt to prohibit the "hoarding" of privately held gold coins and bullion in the United States, in an attempt to address the causes and effects of the Great Depression. This Order was given under the auspices of the *Trading with the Enemy Act of 1917.* The government required holders of significant quantities of gold to sell their gold at the prevailing price of $20.67 per ounce. Shortly after this forced sale, the price of gold from the treasury for international transactions was raised to $35 an ounce. The U.S. government thereby devalued the dollar to 69.3% of its former value.

Image: Safehaven.com

The Gold Confiscation Of April 5, 1933
From: President of the United States Franklin Delano Roosevelt
To: The United States Congress
Dated: 5 April, 1933
Presidential Executive Order 6102

Forbidding the Hoarding of Gold Coin, Gold Bullion and Gold Certificates By virtue of the authority vested in me by Section 5(b) of the Act of October 6, 1917, as amended by Section 2 of the Act of March 9, 1933, entitled

An Act to provide relief in the existing national emergency in banking, and for other purposes~in which amendatory Act Congress declared that a serious emergency exists,
I, Franklin D. Roosevelt, President of the United States of America, do declare that said national emergency still continues to exist and pursuant to said section to do hereby prohibit the hoarding gold coin, gold bullion, and gold certificates within the continental United States by individuals, partnerships, associations and corporations and hereby prescribe the following regulations for carrying out the purposes of the order:

Section 1. For the purpose of this regulation, the term 'hoarding" means the withdrawal and withholding of gold coin, gold bullion, and gold certificates from the recognized and customary channels of trade. The term "person" means any individual, partnership, association or corporation.

Section 2. All persons are hereby required to deliver on or before May 1, 1933, to a Federal Reserve bank or a branch or agency thereof or to any member bank of the Federal Reserve System all gold coin, gold bullion, and gold certificates now owned by them or coming into their ownership on or before April 28, 1933, except the following:
(a) Such amount of gold as may be required for legitimate and customary use in industry, profession or art within a reasonable time, including gold prior to refining and stocks of gold in reasonable amounts for the usual trade requirements of owners mining and refining such gold.
(b) Gold coin and gold certificates in an amount not exceeding in the aggregate $100.00 belonging to any one person; and gold coins having recognized special value to collectors of rare and unusual coins.

(c) Gold coin and bullion earmarked or held in trust for a recognized foreign government or foreign central bank or the Bank for International Settlements.
(d) Gold coin and bullion licensed for the other proper transactions (not involving hoarding) including gold coin and gold bullion imported for the re-export or held pending action on applications for export license.

Section 3. Until otherwise ordered any person becoming the owner of any gold coin, gold bullion, and gold certificates after April 28, 1933, shall within three days after receipt thereof, deliver the same in the manner prescribed in Section 2; unless such gold coin, gold bullion, and gold certificates are held for any of the purposes specified in paragraphs (a),(b) or (c) of Section 2; or unless such gold coin, gold bullion is held for purposes specified in paragraph (d) of Section 2 and the person holding it is, with respect to such gold coin or bullion, a licensee or applicant for license pending action thereon.

Section 4. Upon receipt of gold coin, gold bullion, or gold certificates delivered to it in accordance with Section 2 or 3, the Federal reserve bank or member bank will pay thereof an equivalent amount of any other form of coin or currency coined or issued under the laws of the Unites States.

Section 5. Member banks shall deliver alt gold coin, gold bullion, and gold certificates owned or received by them (other than as exempted under the provisions of Section 2) to the Federal reserve banks of there respective districts and receive credit or payment thereof.

Section 6. The Secretary of the Treasury, out of the sum made available to the President by Section 501 of the Act of March 9, 1933, will in all proper cases pay the reasonable costs of transportation of gold coin, gold bullion, and gold certificates delivered to a member bank or Federal reserve bank in accordance with Sections 2, 3, or 5 hereof, including the cost of insurance, protection, and such other incidental costs as may be necessary, upon production of satisfactory evidence of such costs. Voucher forms for this purpose may be procured from Federal reserve banks.

Section 7. In cases where the delivery of gold coin, gold bullion, or gold certificates by the owners thereof within the time set forth above will involve extraordinary hardship or difficulty, the Secretary of the Treasury may, in his discretion, extend the time within which such delivery must be made. Applications for such extensions must be made in writing under oath; addressed to the Secretary of the Treasury and filed with a Federal reserve bank. Each applications must state the date to which the extension is desired, the amount and location of the gold coin, gold bullion, and gold certificates in respect of which such application is made and the facts showing extension to be necessary to avoid extraordinary hardship or difficulty.

Section 8. The Secretary of the Treasury is hereby authorized and empowered to issue such further regulations as he may deem necessary to carry the purposes of this order and to issue licenses there under, through such officers or agencies as he may designate, including licenses permitting the Federal reserve banks and member banks of the Federal Reserve System, in return for an equivalent amount of other coin, currency or credit, to deliver, earmark or hold in trust gold coin or bullion to or for persons showing the need for same for any of the purposes specified in paragraphs (a), (c), and (d) of Section 2 of these regulations.

Section 9. Whoever willfully violates any provision of this Executive Order or these regulation or of any rule, regulation or license issued there under may be fined not more than $10,000, or,if a natural person may be imprisoned for not more than ten years or both; and any officer, director, or agent of any corporation who knowingly participates in any such violation may be punished by a like fine, imprisonment, or both.

This order and these regulations may be modified or revoked at any time.
/s/igned
Franklin D. Roosevelt
President of the United States of America
April 5, 1933

The government held the $35 per ounce price until August 15, 1971 when President Richard Nixon announced that the United States would no longer convert dollars to gold at a fixed value, thus abandoning the gold exchange standard.

The limitation on private gold ownership in the U.S. was repealed by an act of Congress codified in Public Law 93-373 which went into effect December 31, 1974. P.L. 93-373 does not repeal the Gold Clause Resolution of 1933, which makes unlawful any contracts which specify payment in a fixed amount of money or a fixed amount of gold. That is, contracts are unenforceable if they use gold monetarily rather than as a commodity of trade.

Just in case you think it's different this time? Take a look at some of the quotes from the after the Great Crash of 1929.

(See the next page- taken From Marc Faber)

Final Note:

Authorities are all too ready to accept "speculative" behaviour when it comes to stocks and housing, but they can't condone it in commodities as it highlights their inflationary policies. The former two asset classes were evidence of asset inflation the latter merely was expressing a re-assertion of demand and supply dynamics based on irresponsible monetary policy. Investors are responding to this debasement of fiat currencies by buying real assets.

The process of monetary inflation we are witnessing results in debasement of the currency, causing the citizens to work harder and harder and run faster and faster to keep up with the loss of their currency's value and the concomitant rise of prices. Those prices namely being Oil and foodstuffs. It's slow at first but accelerates along an insidious exponential path. Ultimately it destroys everything the lower and middle classes works for.

John Mauldin writes that in 1980 every major bank in the US was technically bankrupt, as they all had large amounts of Latin American bonds on their books, at a size far larger than their capitalisation. When the Latin American countries defaulted, if the Fed had made the banks mark portfolios to market- there would have been no banks left standing. A deep US recession would have loomed.

The Fed is going to try and achieve the same this time. Steepen the yield curve, try and reignite the collapse in credit, help the banks build cash flows by re-capitalisation from equity investors. As much as I despise the "Visible" hand of government in free markets, in reality they haven't been free-markets for years. People speak of establishing an RTC2 and putting the 1000s of regional banks and Bear Sternesque entities into this structure. This way the pain is short and sharp. Surely that's missing the point maybe a drawn out affair is needed so authorities take responsibility for their actions. As for the populace, woe is us. It's not far, but we rode with the bubbles, some profiting handsomely, most not, so we must take our responsibility for our "infectious exuberance".

It's Just a Flesh Wound

The banking bill is going to run into trillions mark my words, the pain is most likely to be long drawn out. Just like Monty Python's belligerent Black Knight, Bernanke is the master of understatement when he said,

*The fragile economy is being confronted by **'numerous difficulties'** including persistent strains in the financial markets, rising joblessness, and housing problems – despite the Fed's aggressive interest rate reductions and other fortifying steps over the past year.*

He may as well have said "It's just a Flesh Wound" (Hilary could be replaced below for Ben and Obama replaced by the free market!!!

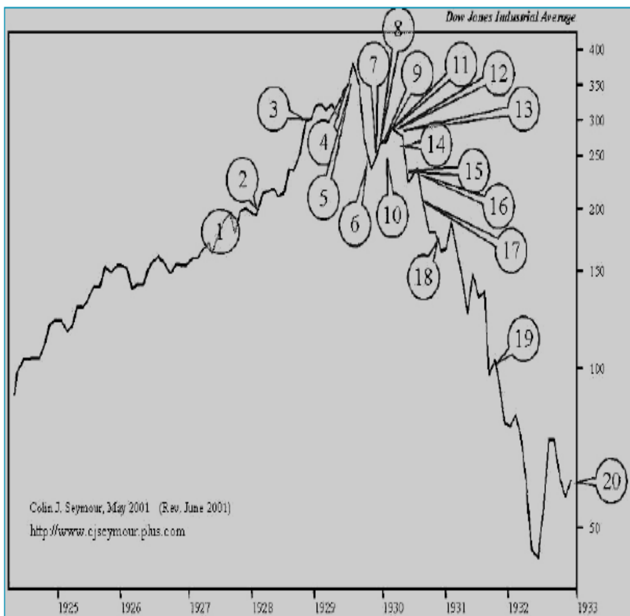
Source: Google Images Monty Python's Holy Grail The Black Knight

Winnebago WGO Industries Inc.

Don't fret, if it all gets too much you can always downsize your house. As you can see from the chart below, you can pick yourself up a nice little Winnebago on the cheap and just hit the road and go surfing. You'll have to run it on moonshine mind, but hey at least you will be FREE!

Source: Bloomberg. WGO Winnebago Industries Inc equity price

Source: Google Images. The Winnebago Sightseer



1. *"We will not have any more crashes in our time."* - John Maynard Keynes in 1927 [NB: The authenticity of this one is a little suspect.]

2. *"I cannot help but raise a dissenting voice to statements that we are living in a fool's paradise, and that prosperity in this country must necessarily diminish and recede in the near future."* - E. H. H. Simmons, President, New York Stock Exchange, January 12, 1928

"There will be no interruption of our permanent prosperity." - Myron E. Forbes, President, Pierce Arrow Motor Car Co., January 12, 1928

3. *"No Congress of the United States ever assembled, on surveying the state of the Union, has met with a more pleasing prospect than that which appears at the present time. In the domestic field there is tranquility and contentment...and the highest record of years of prosperity. In the foreign field there is peace, the goodwill which comes from mutual understanding."* - Calvin Coolidge December 4, 1928

"When the financial and business history of 1929 is finally written, developments of the past fortnight will occupy a prominent place in what will doubtless be the chronicle of an exceptionally brilliant twelve month period." - The New York Times, July 1929

"It becomes increasingly evident that, in many respects, 1929 will be written into the commercial history of the country as the most remarkable year since the World War in point of sustained demand for goods and services." - The New York Times, August 1929:

4. *"There may be a recession in stock prices, but not anything in the nature of a crash."* - Irving Fisher, leading U.S. economist , New York Times, Sept. 5, 1929

"Stock prices will stay at high levels for years to come, says Ohio economist" - The New York Times, II, Page 7, Col. 2, Oct 13, 1929

5. *"Stock prices have reached what looks like a permanently high plateau. I do not feel there will be soon if ever a 50 or 60 point break from present levels, such as (bears) have predicted. I expect to see the stock market a good deal higher than it is today within a few months."* - Irving Fisher, Ph.D. in economics, Oct. 17, 1929 ***The market went into decline until Monday, October 21st, 1929***

"He dismissed yesterday's break in the market as a 'shaking out of the lunatic fringe that attempts to speculate on margin.'" - Irving Fisher, The New York Times, Oct. 22, 1929

"Security values in most instances were not inflated."

"The nation is marching along a permanently high plateau of prosperity."

"Any fears that the price level of stocks might go down to where it was in 1923 or earlier are not justified by present economic conditions." - Irving Fisher, speech to a banking group, Oct. 23, 1929

"This crash is not going to have much effect on business." - Arthur Reynolds, Chairman of Continental Illinois Bank of Chicago, October 24, 1929

Flashback to "Black Thursday," Oct. 24, 1929: Stocks opened moderately steady in price, but traders whose margins were exhausted began selling heavily... at one o'clock the stock ticker was recording prices from half past eleven... stocks dropped 11% intra-day... After a bankers' consortium sent NYSE Vice President Richard Whitney to the stock exchange floor to offer to purchase in the neighborhood of twenty or thirty million dollars' worth of stock at the previous selling price [most likely above their quotations], the market eventually closed with only a 2% loss. [Ref: *Only Yesterday: An Informal History of the 1920's*, Frederick Lewis Allen, Chap. XIII.]

Not long after, the stock market plummeted in two days of panic: October 28 became known as "Black Monday" (13.47% decline in the Dow), and October 29 as "Black Tuesday" (11.73% decline in the Dow). Between October 23rd and November 13th, 1929, the Dow fell by 39%.

"There will be no repetition of the break of yesterday... I have no fear of another comparable decline." - Arthur W. Loasby (President of the Equitable Trust Company), quoted in NYT, Friday, October 25, 1929

"We feel that fundamentally Wall Street is sound, and that for people who can afford to pay for them outright, good stocks are cheap at these prices." - Goodbody and Company market-letter quoted in NYT, Friday, October 25, 1929

"The fundamental business of the country, that is production and distribution of commodities, is on a sound and prosperous basis." - President Herbert Hoover, October 25th, 1929

"They have lost a few tail feathers but in time they will grow again, longer and more luxurious than the old ones." - The Wall Street Journal, between Oct 24 and Oct 29, 1929

"The investor who purchases securities at this time with the discrimination that as always is a condition of prudent investing may do so with confidence." - New York Times, October 28, 1929

6. *"This is the time to buy stocks. This is the time to recall the words of the late J. P. Morgan... that any man who is bearish on America will go broke. Within a few days there is likely to be a bear panic rather than a bull panic. Many of the low prices as a result of this hysterical selling are not likely to be reached again in many years."* - R. W. McNeel, market analyst, as quoted in the New York Herald Tribune, October 30, 1929

"Buying of sound, seasoned issues now will not be regretted" - E. A. Pearce market letter quoted in the New York Herald Tribune, October 30, 1929

"Some pretty intelligent people are now buying stocks... Unless we are to have a panic -- which no one seriously believes, stocks have hit bottom." - R. W. McNeal, financial analyst in October 1929

7. *"The decline is in paper values, not in tangible goods and services...America is now in the eighth year of prosperity as commercially defined. The former great periods of prosperity in America averaged eleven years. On this basis we now have three more years to go before the tailspin."* - Stuart Chase (American economist and author), NY Herald Tribune, November 1, 1929

"Hysteria has now disappeared from Wall Street." - The Times of London, November 2, 1929

"The Wall Street crash doesn't mean that there will be any general or serious business depression... For six years American business has been diverting a substantial part of its attention, its energies and its resources on the speculative game... Now that irrelevant, alien and hazardous adventure is over. Business has come home again, back to its job, providentially unscathed, sound in wind and limb, financially stronger than ever before." - Business Week, November 2, 1929

"...despite its severity, we believe that the slump in stock prices will prove an intermediate movement and not the precursor of a business depression such as would entail prolonged further liquidation..." - Harvard Economic Society (HES), November 2, 1929

8. *"... a serious depression seems improbable; [we expect] recovery of business next spring, with further improvement in the fall."* - HES, November 10, 1929

"The end of the decline of the Stock Market will probably not be long, only a few more days at most." - Irving Fisher, Professor of Economics at Yale University, November 14, 1929

"In most of the cities and towns of this country, this Wall Street panic will have no effect." - Paul Block (President of the Block newspaper chain), editorial, November 15, 1929

"Financial storm definitely passed." - Bernard Baruch, cablegram to Winston Churchill, Nov. 15, 1929

9. *"I see nothing in the present situation that is either menacing or warrants pessimism... I have every confidence that there will be a revival of activity in the spring, and that during this coming year the country will make steady progress."* - Andrew W. Mellon, U.S. Secretary of the Treasury Dec. 31, 1929

"I am convinced that through these measures we have reestablished confidence." - Herbert Hoover, Dec. 1929

"[1930 will be] a splendid employment year." - U.S. Dept. of Labor, New Year's Forecast, December 1929

10. *"For the immediate future, at least, the outlook (stocks) is bright."* - Irving Fisher, in early 1930

11. *"...there are indications that the severest phase of the recession is over..."* - HES, Jan 18, 1930

12. *"There is nothing in the situation to be disturbed about."* - Andrew Mellon, Feb 1930

13. *"The spring of 1930 marks the end of a period of grave concern...American business is steadily coming back to a normal level of prosperity."* - Julius Barnes, head of Hoover's National Business Survey Conference, Mar 16, 1930

"... the outlook continues favorable..." - HES Mar 29, 1930

14. *"... the outlook is favorable..."* - HES Apr 19, 1930

15. *"While the crash only took place six months ago, I am convinced we have now passed through the worst -- and with continued unity of effort we shall rapidly recover. There has been no significant bank or industrial failure. That danger, too, is safely behind us."* - Herbert Hoover, May 1, 1930

"...by May or June the spring recovery forecast in our letters of last December and November should clearly be apparent..." - HES May 17, 1930

"Gentleman, you have come 60 days too late. The depression is over." - Herbert Hoover, responding to a delegation requesting a public works program, June 1930

16. *"... irregular and conflicting movements of business should soon give way to a sustained recovery..."* - HES June 28, 1930

17. *"... the present depression has about spent its force..."* - HES, Aug 30, 1930

18. *"We are now near the end of the declining phase of the depression."* - HES Nov 15, 1930

19. *"Stabilization at [present] levels is clearly possible."* - HES Oct 31, 1931

20. *"Executive Order 6102 Forbidding the Hoarding of Gold Coin, Gold Bullion and Gold Certificates...to provide relief in the existing national emergency in banking, and for other purposes", in which...I, Franklin D. Roosevelt...do declare that said national emergency still continues to exist and...hereby prohibit the hoarding of gold coin, gold bullion, and gold certificates within the continental United States...."* - Franklin D. Roosevelt, The White House, April 5, 1933

Source: http://www.cjseymour.plus.com/finan/prognost.htm