



Those who cannot remember the past are condemned to repeat it. Santayana

Volume 4 Issue 1, October 6, 2008

WINTER WARNING



It's Always Darkest Just Before It Goes Completely Black

With Ireland now officially in an economic recession and with a crisis of confidence threatening its financial sector, the Irish Government has issued a guarantee for about \$600 billion (U.S.) of six major Irish bank's debts and deposits over the next two years. Now that Greece has since followed suit, it appears that Germany and Denmark are preparing government guarantees covering all cash and savings bank accounts held by individuals. France has acknowledged that it is in recession and the economies of Spain, Denmark and the U.K. are on the brink of recession themselves. EU leaders from Britain, France, Italy and Germany attended an emergency meeting in Paris this past weekend to address their growing financial crisis. Europe's "big four" decided to establish a \$32 billion (U.S.) assistance package for small businesses across Europe. In a joint statement issued from the Paris meeting, the leaders said "We jointly commit to ensure the soundness in stability of our banking and financial system and will take all the necessary measures to achieve this objective." Instead, we ought to be hearing EU pleas for a return to a global financial system wherein currencies are backed by a reliable standard of value, such as, the discipline of the gold standard. Last week saw the Euro decline significantly against the U.S. dollar, in its most trying test since inception

and chinks are beginning to appear in its plating. Unless an effective and co-operative strategy is developed by the EU to solve the potential worsening problems in the banking system, Europe's monetary union could be imperiled.

In the U.S. over recent weeks, with huge takeover loans provided for Fannie Mae, Freddie Mac, AIG et al, and several sizeable liquidity injections into the banking system on a global basis, the Federal Reserve Board has increased the U.S. monetary base exponentially; which of course, is highly inflationary. I have long forecast the demise of the U.S. Dollar and believe its recent strength is only temporary, due to current weakness in the Euro. One only has to check the chart for the U.S. Dollar Future Index - Spot Price (DXY) to observe the potential formation of a classic double top. Foreign capital is becoming increasingly more difficult for Uncle Sam to attract and he needs a \$2 billion (U.S.) daily injection to stay afloat.

"O. What a Tangled Web We Weave. When First We Practise to Deceive"

This saying from the quill of the immortal poet Sir Walter Scott comes to mind with the revelation that the U.S. Federal Bureau of Investigation (FBI) has launched an inquiry into the business of the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), the late Lehman Brothers and the American International Group (AIG) and their respective corporate executives, for mortgage fraud. We further learn that the FBI has broadened its investigations to include as many as 26 financial firms, including Countrywide Financial and Indy Mac. What are the other 20 names, pray tell? Obviously, "it ain't over until the fat lady sings!"

The Fat Lady Won't Be Singing Anytime Soon

The Washington, D.C. financial elite of Henry Paulson, Secretary of the Treasury; Ben Bernanke, Governor of the Federal Reserve Board; and Christopher Cox, Chairman of the Securities and Exchange Commission, in co-operation with the U.S. Congress, having been unsuccessful with a \$700 billion (U.S.) Federal Government bailout plan, due to a huge voter backlash, managed to structure an alternative \$850 billion (U.S.) initiative which was passed by the Senate and the House last week. The purpose of this emergency legislation is to enable the Federal Government to purchase illiquid bad debts from Wall Street financial firms, i.e. those firms deemed too big to fail, over a two year period. Will this rescue plan prove successful in stabilizing the equity markets and unclogging the credit markets? Not by itself because it is not sizeable enough! Moreover, it is difficult to force bankers to lend money, when they are not in the mood to do so.

As stated in my previous newsletter, "*the reactionary rally in equity markets will be short-lived*". Why? One month ago, if there was any doubt that the United States was entering a period of economic recession, which doubt has now been erased. Indeed, the U.S. is on the verge of leading the world into a severe global recession. Not only have a total of 760,000 jobs been lost across a wide spectrum of the U.S. economy in the first nine months of this year, but most recent economic reports, from auto sales to house sales, reveal that the U.S. economy is now in a marked decline.

Now we are witnessing Governor Schwartznegger of California imploring the U.S. Treasury for a \$7 billion (U.S.) loan, due to the State's inability to obtain short-term forthcoming funding in the in the fixed income market. Meanwhile, both Maine and New Mexico have been forced to cancel financings recently for the same reason and New York State is projecting a \$1.2 billion (U.S.) deficit within its current fiscal year.



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Apparently, a total of 16 states are currently experiencing financial problems. Troubles are also rearing their ugly head in the municipal bond market where Jefferson County, Alabama (home to the City of Birmingham) is struggling to restructure \$3.2 billion (U.S.) of debt, having recently defaulted on an \$83.5 million (U.S.) interest payment.

The coming months will be no picnic for investors! Corporate 'earnings season' will soon be upon us and results should surprise well to the downside. Restoring confidence in the U.S. financial system will present a long and formidable challenge. Expect the Federal Reserve Board to lower the Fed Funds rate soon, coupled with expansion of the scope and size of its liquidity operations. Another gold buying opportunity presented itself last week and today its price has jumped \$30.00 (U.S.) to the \$865 (U.S.) level. Stay tuned for the eight Congressional hearings scheduled for the coming weeks, commencing today with an inquiry into the Lehman Brothers implosion.

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