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THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

WINTER WARNING

Who's In Charge? – The Regulators

Big Brother is alive and living in Washington, D.C. but he is not well.

A malaise of weaknesses and failures, unearthed during the recent credit crisis, continues to permeate through various regulatory agencies such as the Federal Reserve Board, as well as the Securities and Exchange Commission (SEC) and threatens the very survival of the American financial system.

The U.S. Federal Reserve System was established by an Act of Congress in 1913, directly as a result of the banking crisis and stock market crash of 1907. While Congress had no constitutional authority to pass the Federal Reserve Act, its intent was to erect a central bank "as a lender of last resort" in order to protect the assets of the bankers. Indeed, in his book, "Secrets of the Federal Reserve," author Eustace Mullins purports that the Fed is actually owned by wealthy banking families, such as the Rothchilds, Rockerfellers, Goldmans, Morgans and other bankers. Naturally, this Act also established a fiat monetary system, empowering the Fed to create/print money out of thin air. Thus began the Federal Reserve's long history of acting, primarily, in the best interests of its owners an under a shroud of secrecy. Indeed, in their book, "A Monetary History of the United States, 1867 – 1960," authors Milton Friedman and Anna J. Schwartz argue that it was the Federal Reserve which actually exacerbated the economic situation at the outset of the Great Depression by maintaining tight credit conditions in early 1931 and raising its discount rate in two increments to 3.5% later that same year.

As another source, Dow Theory Letter publisher Richard Russell has recently unearthed the following excerpt of a manuscript from yesteryear. "Few Americans know of the betrayal that was plotted on Jekyll Island, Georgia, which was destined to defraud Americans of their wealth and opportunity, and would eventually lead to the subjugation of our great democratic experiment to a centralized global dictatorship. In November of 1910, after having consulted with the Rothschild banks in England, France and Germany, Senator Nelson Aldrich boarded a private train in Hoboken, New Jersey for his destination in Georgia; a hunting club owned by JP Morgan. Aboard the train were six other men: Benjamin Strong, President of Morgan's Bankers Trust Co., Charles Norton, President of Morgan First National Bank of New York, Henry Davidson, Senior Partner of JP Morgan, Frank Vanderlip, President of Kuhn Loeb's National City Bank of New York, A. Platt Andrew, Assistant Secretary of the Treasury, and Paul Warburg. The Secret meeting, as described by one of its architects, Frank Vanderlip, went as follows.

There was an occasion near the close of 1910 when I was as secretive, indeed as furtive, as any conspirator. I do not feel it is any exaggeration to speak of our secret expedition to Jekyll Island as the occasion of the actual conception of what eventually became the Federal Reserve System. We were all told to leave our last names behind us. We were told further that we should avoid dining together on the night of our departure. We were instructed one at a time … where Senator Aldrich's private car would be in readiness, attached to the rear end of the train for the South. Once aboard the private car, we began to observe the taboo that had been fixed on our last names. Discovery, we knew, simply must not happen, or else all our time and effort would be wasted. The goal was to establish a private bank that would control the national currency. The challenge was to slip the scheme to the representatives of the American people. Earlier, it had been called the Aldrich Bill and received effective opposition.

The planners of the revised bill titled it 'The Federal Reserve Act' to mask its real nature. It would create a system controlled by private individuals who would control the nation's issue of money. Furthermore, the Federal Reserve Board, comprised of twelve districts and one director (the Federal Reserve Chairman) would control the nation's financial resources by controlling the money supply and available credit, all by mortgaging the government through borrowing. The plan worked. The Federal Reserve Bill was held until December 23rd. (two days before Christmas) before it was presented to the House and Senate. Only those senators and congressmen who had not gone home for the holidays – those who owed favors to, or were on the payroll of the bankers – were present to sign the legislation. The name 'Federal Reserve Bank' was designed to deceive and it still does. It is neither federal, nor is it owned by the government. It is privately owned. It pays its own postage like any other corporation. Its employees are not civil service. Its physical property is held under private deeds and is subject to local taxation, unlike government property."

The U.S. Securities and Exchange Commission (SEC), established by the Securities Exchange Act of 1934, together with the Securities Act of 1933, was designed to promote stability in the American capital markets and to improve protection for investors, following the stock market crash in October, 1929. The Commission has a staff of 3,500 located in its Washington headquarters, as well as in eleven regional offices throughout the country. Within the Commission's mandate is the responsibility to oversee the inspection of securities firms, brokers, investment advisors and rating agencies. It is in this area where the commission has experienced the most difficulty in recent times. Since the resignation of Chairman Harvey Pitt in November, 2002, after only a15-month tenure, the Commission's effectiveness in this responsibility seems to have been steadily deteriorating. Indeed, this slippage culminated in the revelation of the Bernie Madoff ponzie scheme fraud of a year ago, wherein the SEC had been alerted to this situation many times, but neglected to investigate. The Commission's website asserts that "In the wake of the Madoff fraud, the SEC's Office of the Inspector General launched an internal investigation in December, 2008, to determine why the agency did not detect the scheme." Long Wave Analytics suggests that the answer to that question lies in the staffing of too many junior personnel, not enough staff with investment experience and too many lawyers who never worked a day of their lives in the investment industry.

The current commission Chair, Mary Schapiro, has instituted "decisive and comprehensive steps to reduce the chances that such frauds will occur or be undetected in the future", such as, revitalizing the enforcement division, revamping the handling of complaints and tips, as well as recruiting staff with specialized experience.

The Congress

In a recent confirmation hearing before the Senate Banking Committee, Federal Reserve Board Chairman Ben Bernanke was read the "riot act" by Kentucky Republican and major league baseball hall of famer, Senator Jim Bunning. Former Fed Chairman, "Alan Greenspan refused to look for (economic) bubbles, or try to do anything other than create them. Likewise, it is clear from your statements over the last four years that you failed to spot the housing bubble, despite many warnings. Instead of close supervision (regulation) of the biggest and most dangerous (U.S.) banks, Mr. Greenspan ignored the growing balance sheets and increasing risk. You did no better. In fact, under your watch, every one of the major banks failed, or would have failed had you not bailed them out. On derivatives, Mr. Greenspan and other Clinton administration officials attacked Brooksley Born when she dared to raise concerns about the growing risks. They succeeded in changing the law to prevent her or, anyone else from effectively regulating derivatives. After taking over the Fed, you did not see any need for more substantial regulation of derivatives, until it was clear that we were headed to a financial meltdown, thanks in part to those products. (Moreover,) you still refuse to provide details on the Fed's bailouts last year and on all the toxic waste you have bought.

Mr. Greenspan sold the Fed's independence to Wall Street through the so-called "Greenspan Put." Whenever Wall Street needed a boost, Alan was there. However, you went far beyond that when you bowed to the political pressures of the Bush and Obama administrations and turned the Fed into an arm of the (U.S.) Treasury. Under your watch, the Bernanke Put became a bailout for all large financial institutions, including many foreign banks. Then, you put the printing presses into overdrive to fund the government's spending and hand out cheap credit to your masters on Wall Street, which they used to rake in record profits, while ordinary Americans and small businesses can't even get loans for their everyday needs. You have decided that just about every large bank, investment bank, insurance company and even some industrial companies, are too big to fail. Rather than making management, shareholders and debt holders feel the consequences of their risk taking, you bailed them out. In short, you are the definition of moral hazard. Instead of taking that money and lending (it) to consumers and cleaning up their balance sheets, the banks started to pocket record profits and pay out billions of dollars in bonuses. Because you bowed to pressure from the banks and refused to resolve them, or force them to clean up their balance sheets and clean out the management, you have created zombie banks that are only enriching their traders and executives. You (have) also admitted that you do not have an exit strategy for all the money you have printed and securities you have bought. That sounds to me like you intend to keep propping up the banks for as long as they want.

You told us AIG and its creditors had to be bailed out because they posed a systemic risk, largely because of their credit default swaps portfolio. Those credit default swaps, by the way, are over-the-counter derivatives that the Fed did not want regulated. Well, according to the TARP Inspector General, it turns out the Fed was not concerned about the financial condition of the credit default swaps partners when you decided to pay them off at par. From monetary policy to regulation, consumer protection , transparency and independence, your time as Fed Chairman has been a failure. You stated time and again during the housing bubble, that there was no bubble. After the bubble burst, you repeatedly claimed the fallout would be small. You clearly did not spot the systemic risks that you claim the Fed was supposed to be looking out for. I will do everything I can to stop your nomination and drag out the process as long as possible. We must put an end to your and the Fed's failures and there is no better time than now."

Other members of the Senate Banking Committee suggested at the hearing that Chairman Bernanke is likely to be confirmed for a second term as head of the central bank. Some lawmakers said the Fed had "failed" or done a "horrible job" as a regulator and indicated they would push ahead with a proposal that would strip much of the Fed's regulatory authority. Mr. Bernanke acknowledged that the central bank had made regulator mistakes, admitting that the Fed had "certainly" not done a "perfect job" at regulating excessive risk-taking in the financial sector, a cause of the recent financial crisis. While Mr. Bernanke's initial term as Fed Chairman expires on January 31, 2010, Committee Chairman Christopher Dodd stated that he didn't know how soon the committee would hold a confirmation vote and whether or not it would occur before the end of the year.

Last month, the House Financial Services Committee passed a provision, sponsored by Texas Republican Representative Ron Paul, which would subject the Fed's interest rate decisions to broader audit scrutiny by the Government Accountability Office (GAO), an arm of Congress. Mr. Paul explains that provisions in his amendment would limit interference in monetary policy. The measure, co-sponsored by Representative Alan Grayson, a Democrat from Florida, would exclude any unreleased transcripts, or minutes of Federal Open Market Committee (FOMC) meetings. It calls for an audit of the Fed and its 12 regional banks by the GAO within a year after enactment. In a November 29th.commentary in the Washington Post, Fed Chairman Bernanke stated that curbing the central bank's authority to supervise the banking system and tampering with its independence would "seriously impair" economic stability in the United States. Furthermore, in a recent Bloomberg Radio interview, former Fed governor Frederic Mishkin argued that Ron Paul's proposal is "incredibly dangerous in terms of promoting inflation. If you make the central bank beholden to politicians on a short-run basis, you get very bad outcomes: high inflation and less of the ability to deal with shocks like the ones we had recently."

Taking his case to the next level, in his most recent book entitled "End The Fed", Mr. Paul argues that "It is and should be a mainstream cause to end the power and secrecy of the Fed. It's my own view that ending the Fed would address the most vexing problems of (the) politics of our time. It would bring an end to dollar depreciation. It would take away from the government the means to fund its endless wars. It would curb the government's attacks on the civil liberties of Americans, stop its vast debt accumulation that will be paid by future generations and arrest its massive expansions of the welfare state, that has turned us into a nation of dependents. If you solve the money monopoly problem by ending the Fed, you solve many other problems, too. Essentially, you take away from the government the capacity to use financial trickery to expand without limit. It is the first step to restoring constitutional government. Without the Fed, the federal government would have to live within its means. It would still be too big and too intrusive, just like all state governments are today, but the outrageous empire at home and abroad would have to come to an end."

The Banks

It is a well documented fact that a few big American banks have long fostered and enjoyed close relationships with U.S. regulators and agencies such as the Federal Reserve Board and the U.S. Treasury. History is also replete with Goldman Sachs executives attaining government postings such as the Secretary of the Treasury; including Robert Rubin and Hank Paulson of recent decades. These relationships of trust are developed and nurtured over time to the point where advice is sought and information exchanged regarding situations on a strictly confidential basis. It is difficult for Long Wave Analytics to believe, for example, that the Federal Reserve didn't send up a trial balloon last February musing about the prospect of initiating a quantitative easing program involving new Treasury bond issues. How else could Goldman amass $27 billion (U.S.) in trading profits in the first nine months of the year. A 50 basis point move in yield on a 10-year maturity, for example, translates into a price change of $4.20 per $1,000 bond. On a long position of $1 billion (U.S.) of a 10-year Treasury bond, this means a capital gain of $42 million (U.S.).

Who's in charge? We believe it to be the big American and European banks because, after all, they are the owners of the U.S. Federal Reserve.

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