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Answering Your Questions

GOV'T HIDES ITS HEAD IN SAND, DIRECT V INDIRECT INTERVENTION, & THERE JUST AIN'T NO MIRACLES ON 34TH STREET

People keep thinking that someone is actually in charge. This false belief is where conspiracy theories also emerge portraying some secret group who is pulling all the strings. The problem with this theory is **Princeton Economics** would never have gotten off the ground if it were true. If those in power really possessed such supreme control, why did they ever call us?

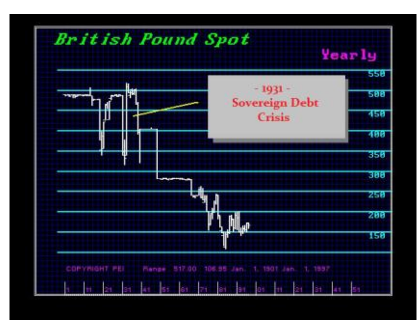
To me it has always been much worse than any **CONSPIRACY** theory can conjure-up. What if we are in the back of a cab and the driver is a kangaroo? There are a lot of people who want you to think they are in control to give you confidence that some demigod exists. Unfortunately, it is just an elaborate illusion. There are people who group together and manipulate the markets. There are people who rig the game to win. But that does **NOT** mean they can actually control the direction of the global economy. Nor is it possible to stimulate the way out of this mess. The **VERY BEST** we can hope for is to reduce the volatility lessening the decline in magnitude but it is impossible to reverse the direction of the economy. It would be like trying to turn all the fans on in a city to try to stop a hurricane blowing it out to shore.

The Federal Reserve Chairman Ben Bernanke came out today in Jackson Hole, Wyoming on his much anticipated speech where people expect way too much as some ***Miracle on 34th Street***. During financial panics such as the 1989/90 turn in the Nikkei, I had the Central Bank of Canada on one phone while the US Treasury was calling on the other. What you get to see is that those who people think are in charge are no different from any of us. They were shaken. Concerned it would be another 1987 or a Great Depression. They have **NO** models and are flying blind when such events hit.

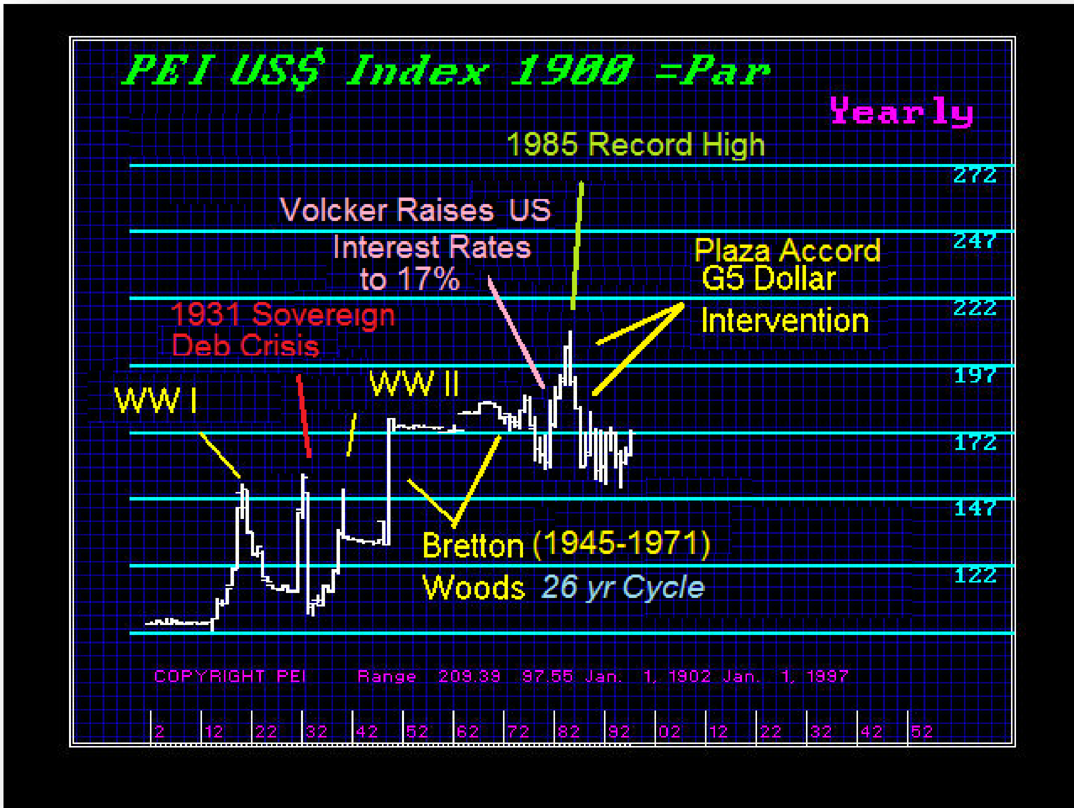
Optimism had been building on Wall Street as always this time for some desperate kind of announcement from Bernanke that additional steps will be taken to get the economy going again. Bernanke failed to meet those absurd expectations which underscored how fragile the U.S. economic recovery truly was, since it is **NOT** what these people say, but what they are trying so hard **NOT** to say. Friday the government did lower its already feeble estimate for how fast the economy grew in the April-June period. The Commerce Department estimated that the U.S. economy grew at a miserable annual rate of just 1 percent in the second quarter. That is much worse that the original estimate of 1.3 percent. This recession is **NOT** over and I warned that a real estate decline is the **WORSE** type of decline because the recovery process is the longest of **ANY** sector. The economic rally has been a dead-cat bounce and **NOT** a recovery. The first half of the year grew about .7%. It is true that nine of the past 11 recessions since World War II have been preceded by a period of growth of 1 percent or less. But this empirical level of growth is **NOT** the key factor. The most important aspect is **WHICH** sector collapsed and real estate is **ALWAYS** the most problematic in a recovery of this nature.

BIG Money continues to just park in the short-term of US securities helping to keep the yield on the 10-year Treasury note declining further to 2.20 percent from 2.24 percent late Thursday. With Japan being downgraded for its own **Sovereign Debt Crisis** and Europe unable to really cope with the **Sovereign Debt Crisis** underlying everything there, the demand for US Treasurys continue to rise for there is ***no place*** to put the **BIG** money right now. You can't buy the Euro or the Yen and Swiss is not a deep market. Germany and France are being dragged down the rabbit hole while the Greek bonds have fallen to record lows this week on fears that the bailout will fall apart. November is looking very dicey. Interest rates in the US are collapsing because the economic uncertainty is just worse elsewhere.

Consequently, like that driver on an icy road who panics and stands on his breaks only careening the car out-of-control, the Fed's pledge to keep short-term interest rates low until mid-2013 has illustrated they lost and are simply standing on the brakes just as did Japan but once again expecting a different result. This is simply the triumph of hope over experience. Low rates in theory are supposed to make higher-risk bets such as stocks more attractive. But as I have stated, there is just **NO** correlation to show this absurd theory worked even just once. However, by making that statement, there is the underlying presumption that they are actually in charge. Implicit within that statement is the idea that THEY lowered the interest rates rather than the market. Interesting concept, but that is simply not true.



In truth, it is the **Sovereign Debt Crisis** that is causing this trend. Capital is fleeing the immediate areas of concern, and Europe heads that list. Capital is pouring into the dollar and parking. This is the **REAL** reason for the decline in rates both domestic and international for a variety of reasons. It is the proverbial Flight to Quality that began domestically with the banking crisis and has continued for a number of reasons, Europe to be the latest. After Europe breaks down and Japan finds itself in crisis, then capital will turn against the dollar as it did in the last 1931 **Sovereign Debt Crisis**.



It is at that time when capital has abandoned everywhere else, clustered in the United States, that it will then turn and we should see the explosive rally in **PRIVATE ASSETS** with gold perhaps leading the charge on a percentage basis. Not even the gold market is big enough to absorb the excess dollars in the world at any price level that is cognizable in modern terms. This is the **PRECISE** pattern of the 1931 **Sovereign Debt Crisis**. The dollar rose to record highs, then after everyone defaulted, capital assumed the USA was next and then the dollar was hit driving gold and stocks up from 1932 into 1937. The whole world does not collapse in a single brief moment. It is a **CASCADE** failure one domino leading to the next.

Those who constantly rant about gold standards simply do not know their history. Just because gold has been a recognized **MEDIUM OF EXCHANGE** and a **STORE OF VALUE** for the long-term (*not short-term as evidenced by the decline from 1980 to 1999*), does **NOT** make it a "***gold standard***" of some agreed upon **FIXED** value. That was tried in 1945 with Bretton Woods and it quickly collapsed after 26 years perfectly in tune with the **Monetary Crisis Cycle**. **MONEY** is an intangible exchange medium and thus it has **NEVER** had a fixed agreed upon value. It fluctuates rising in value during periods of recession/depression and falling in purchasing value in period of inflation and speculative booms. That is what the business cycle simply does. **MONEY** itself is not a store of value because it fluctuates.

We are plagued by theories espoused by so many in countless areas, but it is like that little old lady in the TV commercials who said with the hamburgers – **WHERE'S THE BEEF?** There are no studies showing **MONEY** is a constant value any more than stocks rise with lower interest rates and decline with rising interest rates since if that were **TRUE** the Dow should be testing 25,000 by now and the Nikkei didn't decline into a 26 year bear market. That must be propaganda and lies as well. Those who resist reality are so married to their ideology that they will find themselves dead broke the victim of a **Pyrrhic War** against the reality of markets. It historically has just been government against the people making it always a **PUBLIC v PRIVATE** battle to the finish. **This is why since 6000BC, all governments default of their national debts. This time will be no different.** (*except Romania 1980*).

Every action taken by the Fed is within the context of old economic theories that no longer work. This failure to update the theories to the modern world economy is devastating. At last year's conference in Jackson Hole Bernanke signaled that the central bank would buy more US 30 year bonds to lower long-term interest rates. People assumed that the stocks rose steadily during the period because the Fed bought up $600 billion of Treasurys and hence it should do that again. However, this **QE2** failed completely and has actually increased the danger of volatility. **WHY**? The Fed thought buying the 30 year paper would increase money for mortgages and kick-start the real estate. All that took place was everyone shifted their maturity horizon selling the 30 year paper and replacing that with 90-day bills. China shortened its debt horizon of US securities. Money is still not available for mortgages without guarantees. Sorry! It just didn't work. Once again it was **INDRIECT**. It is like fining your wife for not nagging you to take out the trash.

DIRECT v INDIRECT

I wrote in the ***Rise & Fall of the Euro*** an example of **DIRECT** intervention rather than **INDIRECT** that would mitigate the decline and would have helped to actually stabilize the economy and real estate markets. As always, we benefit only the lobbyists and the expense of the economy as a whole.

> *"In the US Mortgage Crisis, government **ONLY** concerned itself with the bankers, and not the borrowers. Lending money to the bankers **FAILED** to restart the economy because it was one-sided. The solution would have been easy. Revalue all property, shave 25% off the mortgage price, use the funds to accomplish that end, which would have left the majority of people in their homes reducing the supply of real estate coming to market, and thus stabilize the two ends and the economy. The political solution was motivated **ONLY** by the bankers and this created the propaganda of "**too big to fail**" implying that they somehow were more important than the economy."*

The Fed always operates **INDIRECTLY**. It raises interest rates in theory to reduce demand **INDIRECTLY** by making borrowers think twice. But bankers get rich for they raise rates on everything they can and as long as expectation of profit exceed the rate of interest, it has no effect since interest rates rise in a bull market because of demand. Changing regulations insisting on more collateral would be a **DIRECT** effect to restrict lending. The Fed then lowers rates thinking the opposite will unfold **STIMULATING** the economy but that requires (1) banks to lend and (2) people who think they will make a profit. Stop the yo-yo policies with taxes for that only creates more uncertainty. Companies are not hiring for they are uncertain about the future costs and the trend. Why should someone hire and build plants if the politicians can alter taxes on a whim? The lack of stability in the tax code drives jobs overseas. Would you sign a contract with a person who claims he can change your rent whenever he needs more money? Capital will stay put, **ONLY** if it knows the rules are fixed! Bernanke blamed the politics of the summer for impacting the economy. In this score, he was right. Politics is undermining economic confidence.