Government is living in a state of denial
They speak, see & hear nothing of a debt crisis

The world just keeps coming unwound with amazing speed. Unfortunately, because this is a Sovereign Debt Crisis that strikes at the very heart of HOW government has functioned since World War II, this is like an individual who is in severe pain but is diagnosing himself. Government has been following the philosophies of Karl Marx and John Maynard Keynes who jointly advocated that government was capable of altering the Business Cycle and thereby cut the ties of boom and bust that marked history unfolding as a vicious repetitive cycle. There were to be no more recessions or depressions. Government was in FULL control with the pedal to the metal. Interest rates on Italian bonds have cross the 7% level and banks are bragging how they have sold their bonds to prevent a run on themselves. Italy is the third largest bond issuer and nobody in government has figured out that this a Sovereign Debt Crisis yet? This plan of waiting out the storm and it will all go back to normal ain’t working!
What Government FAILS to understand is they are the PROBLEM! They enjoy power to imprison anyone with whom they disagree and thus they lack the normal understanding about conducting their own behavior because they REFUSE to consider what is best for the PEOPLE rather than themselves! Two heads of state have fallen and this is supposed to be stable news giving confidence to capital? Government seems to think they can pass a law and everyone must do as they say. Democracy is just a bullshit slogan. They have no intention of letting the people decide anything.

Public Debt began after the Dark Age not as a voluntary purchasing of government debt, but as FORCED loans imposed on the rich in the city of Venice as well as Florence. Merchant trade fairs evolved into lending centers and kings/queens would send their agents to try to borrow money. Sir Thomas Gresham may be famous for Gresham’s Law that debased money drives out the old better quality money, but how did he come to understand money flows? He was actually such a treasury agent representing Queen Elizabeth I in Amsterdam to borrow money for England. Her father, Henry VIII, was so desperate for money, he debased the silver content of his coinage dramatically and even his gold coinage by 20%. Gresham found it impossible to borrow being criticized for repaying loans with far less metal content than what was lent. Hence – Gresham’s Law.

Because government is the PROBLEM, they live in a state of denial and cannot correct the situation for they cannot objectively look at themselves. Instead, they attack the people. Fannie Mae asks for $7.8bn as losses continue. Morgan Stanley has been accused over mortgage bond issues and MF Global goes bust exposing the truth that SEC & CFTC never audit the NY banks and are incapable of detecting that they may be trading with client’s money.

Meanwhile, the whole theory upon which the banking system has been constructed is unsound. Banks take short-term and demand deposits and lend long-term. When a financial crisis unfolds, a run on banks emerges because people want their money. Since the bank’s obligations are short-term to demand but their assets are loans of medium to long-term, they don’t have the cash and fail. For you see, banks were not supposed to lend out your money. That was part of the scam. The first central bank founded in 1609 so to speak was Wisselbank which secretly lent money both to the government in the City of Amsterdam as well as to the government sponsored Dutch East India Company. This became public in 1790 causing a real panic that forced the bank to be taken over by the City of Amsterdam in
1791. Eventually, the bank was forced to close by 1819. Banks began as merely a place to store your assets. They were not intended to lend your money out to someone else. When they realized they could make profit doing so, the scam eventually became the standard operational procedure. Formulae were then devised to calculate at any one time how much “reserves” did they have to retain for normal operations. That was worked out with experience settling on 6%. So if they retained 6% of deposits as cash, they could cover normal business withdrawals with no problem. The problem became during a crisis and everyone wanted their cash and the bank simply does not have that cash and you end up with a bank run. It is ironic that what began as a scam simply became institutionalized. This is WHY the entire financial system is dependent upon CONFIDENCE!

Now Credit Suisse has agreed to hand over US clients’ names as the US is desperate for taxes ensuring what made Switzerland the safe haven through two World Wars has shown what armies could not do, desperate politicians can – destroy a sovereign nation very character. The giving up of names by Credit Suisse is the final nail in the coffin for Switzerland, yet they too are in a state of denial. Switzerland began as a safe haven against taxation. It was born of a tax revolt. Walking with its tail between its legs, the tall and mighty have fallen to the greed of the taxman after all. Switzerland tells itself it is above this when in fact it has lost its soul thanks to the Sovereign Debt Crisis.

Meanwhile, China’s gold imports have jumped six-fold as confidence in the Western style financial system crumbles to dust. China sent its central bankers to actually work on dealing desks in London, New York, and Tokyo. They have learned well and China has become a keen trader unlike any other government in the West that is dominated by academics.
The ECB, in contrast, wants struggling nations to reform their way out of the debt crisis without any comprehension about how such a transition can be orchestrated. The structural changes on this magnitude take considerable time but the crisis is now. The markets will not wait! On top of this, they continue to try to work within the current system whereby politicians will be able to borrow perpetually with no intent of ever paying off anything. This is so far from reality, it is no longer funny. These people are destroying Western Civilization as we know it. The assumption that the ECB can save the day is up there with Santa Claus.

In France, SocGen scraps its dividend to meet a capital shortfall it has suffered while the Greek precedent of taking a 50% haircut exposes European banks to the **Sovereign Debt Crisis** and now brag how they are selling Italy. Not even the ECB can save Italy and Europe now. Europe’s **Sovereign Debt Crisis** has expanded with the yield on Italian 10-year bonds exceeding the 7% level. The Eurozone is severely destabilizing the global debt situation as Italy is now the world’s third largest bond issuer and one of the original six founders of the modern European project that created the Euro. This is a debt that is now **TOO BIG** to be bailed out.

Greece and Italy have now descended into the realm of political uncertainty at a time of a devastating global **Sovereign Debt Crisis**. The idea that a new political leader will shepherd these countries to rehabilitation lowering their debts and eliminating deficits, while at the same time increasing economic growth, is simply just fantasy. Government is simply trying to save their own skins – not society! The entire debt structure on a global scale is collapsing but politicians refuse to accept that they are the **PROBLEM**! Just where did they get this idea that they can promise everything to personally win elections, borrow perpetually and indefinitely with no plan of ever paying anything off, and this is somehow presented to be “normal” perhaps not even God knows; for surely, the Devil is in the details.

What is unraveling even more quickly is the fear that banks will be hit with panic runs because of their holdings in sovereign debt. After a 50% haircut in Greek bonds, now it has become trendy not only to sell Italian bonds but also to publicly announce they have done so to try to maintain **CONFIDENCE** of their depositors. The very reason politicians have suppressed the right of the people to vote and have forced austerity upon the people, has been to maintain the confidence of their bankers. But in the end game, the bankers exist based upon the confidence of the people in their sound management of their deposits. Bankers are finding it increasingly difficult to maintain that **CONFIDENCE** after the Greek haircut and now Italy is the **THIRD LARGEST** debt in the world that is **TOO BIG** to be bailed out even at a 50% off sale.

Bankers are being forced to respond to the free market judgment and in the end the people get to vote with their money if not at the polls. Banks are rushing to announce that they have actively reduced the holdings of Italian debt. Then come Spain and Portugal. This is introducing greater volatility and instability. Margin requirements are increasing at the major clearing house while the CDS market on sovereign debt is proving to be more of a fraud than a viable hedging instrument. This is eliminating the ability to hedge that can only lead to greater volatility.
Those who even think the European Central Bank is competent and capable of addressing this crisis are plain nuts. The ECM has appeared very hesitant in recent days to step up and publically buy Italian bonds. They attempted to do so but they know this is beyond their ability. This not a question of whether it is an issue of willingness, they simply lack the ability to buy €2 trillion in debt. Those who think a central bank can smooth out all wrinkles are unrealistic.

November was a Panic Cycle Month. We are seeing the uncertainty developing and the bad news is we see generally choppy markets and high volatility extending into June/July next year. Politicians left to their own devices, will only act in their own self-interest and cannot see that they are causing this nightmare. They will inevitably hold hearings and lock up people trying to blame them for their own failures, but the outcome of such a crisis of this magnitude is off the Richter scale. This is an economic earthquake of giant proportions where one bad outcome raises the probability of another that is even worse as the Sovereign Debt Crisis then spread like the plague becoming a financial pandemic.

There is no one institution capable of standing up to this economic pandemic and politicians will no doubt support some sort of united central bank front standing shoulder-to-shoulder. However, while such schemes may at first be seen as brilliant flashes of light and moments of gold, the downside is when they fail, as has been the case with the Greek bailout, then the emperor is exposed having no clothes.

The European summit on October 23 only showed that there is no immediate fix. Europe’s crisis has entered a new global Contagion as illustrated by the sharp drop in the Euro today. The Euro has continued to trade according to the angle established either side of the January 2011 low. The people may be shut out of the polls denied democracy when it is needed most, but the FREE MARKETS will respond as capital votes in its own self-interest that does not match the political nonsense.
SEQUENCE OF AN ECONOMIC PANDEMIC

At first blush, how capital responds depends entirely upon the (1) monetary system and (2) the freedom of capital movement. In a closed economy, the first reaction is to buy ALL tangible assets. These tend to be everything from durable commodities (metals), art, coins, stamps, and gold (assuming it is not a gold standard of some sort). This is the category I refer to as “moveable assets”. The second tier of assets tend to be real estate that I refer to as “fixed non-movable assets” meaning their value is limited to the territorial jurisdiction of the nation. In a non-communist nation, stocks and corporate bonds will also attract capital as a safe place to park funds.

In an open-economy where capital is free to leave, then the first blush is to FLEE to a different land in which case the local assets, including stocks and corporate bonds, will initially crash. This is typically indicated most pronouncedly in the collapse of the local currency against world currencies or in this case rise in the dollar v decline in euro. They eventually swing back ONLY after the crisis manifests in a new currency or a debased/devaluation of the local currency takes place. The capital-flows will the swing back in the opposite direction.
Presented here are the stock markets of Italy, France, Germany, and United Kingdom. France did not default and while even the US devalued the dollar relative to gold in 1934, France was holding to its currency backed by gold causing tremendous deflation as assets decline and the value of money rose in purchasing power. We can see that Italy peaked in 1926 and only retested the high going into 1929 and its percentage drop was by no means a mirror of the US market that fell by nearly 90%.

In Germany, there had been the hyperinflation of the early 1920s. The economic conditions were one of austerity forced upon it by the Reparation Payments and you can see the different outcome where the stock market just shut down. The Reichsmark had been the new German currency following the hyperinflation from 1924 that lasted until June 20, 1948. The official exchange rate from the hyperinflation to the new Reichsmark was 1 trillion to one. There was actually a transition currency called the Rentenmark, that was really backed by industrial and agricultural real estate assets. It was the Reichsmark that returned to a gold backed currency.

The UK market peaked in 1928, retested into 1929 avoiding a bubble and then fell only by about 50% rather than by almost 90% as was seen in the USA. The UK abandoned the gold standard in 1931 and this saved the nation from the wave of devastating deflation as experienced in the USA. Clearly, each country performed according to their unique status. Thus, we cannot make plain general statements. Each market will rise and fall based upon its unique set of facts even though this is a PRIVATE v PUBLIC wave that governs the overall tone.
Under today's circumstances, the first blush response will be for capital to flee Europe and run to the United States as a safe port parking in US government paper. This is likely to further the deflationary effects within the United States by ensuring interest rates remain low as they did during the Great Depression for the same reason. However, banks are living off of the largest spreads perhaps in modern history so while rates of interest on cash will decline further and move in real terms NEGATIVE after inflation, banks should NOT be expected to lend money more easily. They will maintain their huge profit margins. Therefore, the first blush of the Sovereign Debt Crisis in an open society tends to be currency based rather than even movable assets.

Note that the capital flows reversed in 1931 after the Sovereign Defaults. People needed cash and then moved it back to Europe. We must also understand that during this period there was a gold standard. This means gold responded OPPOSITE to what people expect today. During the inflationary boom into 1929, gold declined in purchasing power for assets were rising against gold. During the collapse, the value of money rose (gold) as assets declined. Under a gold standard, the value of gold in fact DECLINES with inflation and RISES with deflation. This is simply the way MONEY performs regardless what it is you call money. Therefore, under the current conditions, gold need not rise on the first blush for the bulk of capital will flee to the dollar. On the second swing where capital flees all currency, then we will see the Private v Public assets manifest meaning they will rise as expressed in terms of currency.

So for now, we are in the first blush mode where capital will flee to the dollar rather than assets and that may confuse the hell out of a lot of people. Keep in mind that this is a two-phase transition.
A number of people have inquired what did the computer do on the Dow Jones Industrials given it indeed closed below 1220400 last week. It is what it said. It took profit selling all long positions but has not yet reversed into a short position. Even the technical analysis on the daily level shows the three main channels (GREEN) Downtrend Channel, (BLUE) Uptrend Channel, and (PINK) is the Breakline Channel. The Dow broke back up into the GREEN Downtrend Channel but must sustain that. The BLUE Uptrend Channel is being tested from above. It too must now provide support to sustain any rally. The PINK Breakline Channel has provided the resistance showing there has not yet been a reversal of the downtrend in motion currently. If the Dow is unable to now exceed last week’s high, it should retest support. A daily closing BELOW 162000 will warn the Dow will retest support down at 1057000.

**WEEKLY
COMPUTER RECOMMENDATION**

On the Weekly level of our model we remain LONG 2 positions. The last LONG position was taken on the close for the week of 10/21 at 1180879. We would look to add another position by buying a Weekly close above 1288600. We would look to COVER all outstanding LONG positions by selling a Weekly close below 1204400 during the week of 11/04. We would reverse into a short position on a weekly closing below 1075000.

**CONCLUSION**

This is all about saving government – not your ass!