



# MONETARY & ECONOMIC REVIEW

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## The Coming Financial Wipe-Out *How and When Will It Occur?*

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The bad news is, we find ourselves in a perilous economic fix due to factors we had no control over and probably never participated in. However, the good news is that in periods of economic turbulence, downturns, or outright economic collapse, wealth is not destroyed (except in cases of civil disorder, riots, etc.) but is simply transferred. Money is the transfer agent.

### **System Problems**

Our current financial predicament could only occur in a debt-based money system. This problem is a worldwide problem and not isolated to the U.S. economy.

Since 1971, when the U.S. repudiated the Bretton Woods Agreement that previously allowed central bank holders of U.S. dollars (the world's reserve currency) to redeem dollars for gold, every financial crisis. No exceptions.

Almost ten years ago, I spent 30 days in Asia conducting economic briefings to help people in six Asian countries understand what was happening and why it happened. I just returned from Asia, where I conducted another round of briefings on our current impending crisis triggered by the real estate bubble and the sub-prime mortgage fiasco.

### **Liquidity Crisis**

Unlike ten years ago, this crisis is centered on Wall Street, not in Asia. The resulting economic carnage will be similar, but more devastating to more people. More than fifteen years ago, we began warning our readers about the risks surrounding the expansion of the derivatives markets (highly leveraged financial instruments, whose value is derived from an underlying security, currency, or commodity). Today's massive growth of debt derivative products is central to the current debt bubble. It is estimated that the notional value of this bubble is six to seven times the world's Gross Domestic Product (GDP). Putting the notional value in terms of dollars, these debt derivatives have grown to over \$400 trillion, which is three times as much as all the total domestic debts in the world. Leverage upon leverage upon leverage.

In a world of debt-based money driving a debt-based economy, a false perception of excess liquidity grows a debt bubble of historic proportions. At some point, we reach a tipping point and lack of real liquidity triggers the bubble to burst. The bursting of the real estate bubble – and more specifically the bursting of the sub-prime mortgage bubble – hints at what we can expect in the coming months and perhaps years.

### **Strong Similarities, but More Perilous**

Remember the dot.com bubble, where the IPO markets were “blowing and going”? We saw a lot of companies issuing new stock IPO's (Initial Public Offerings) that was in turn used as “currency” to buy other companies. Kind of like the man who came home one day and explained to his wife that he had sold the family's dog for \$100,000. She replied, “You got \$100,000 for that old dog?” Whereupon the man replied, “Well, sort of...I got two \$500,000 cats for the dog.”

That is well and good as long as the investing public is content to accept “dogs and cats” as money. We all know how the story of the dot.coms and IPO's ended – with a lot of people losing a lot of “money,” or asset value.

The current situation is even more onerous, as in addition to current IPO's, many hedge funds are only putting up a small amount of equity of corporate take-over transactions and borrowing the rest. They make this investment attractive by offering perceived diversification by using a new hedging vehicle called “credit default swaps.” However, most of these new products are not very liquid. Many of these investment banks are creating funds in-house with other people's

money to buy such products. Investment banks are the tip of the iceberg that represents the derivatives bubble that is on a collision course with the “ship” of the world economy.

### **Bordering on Fraud?**

I saw a lead story in a financial publication that touted how the manager of a “successful” hedge fund had just received a \$600 million-plus bonus for “good performance.” This is where the financial fraud comes in. These derivative products are sold to small hedge funds. Such products are not liquid, and the price of the product is determined largely by the managers of the hedge funds. The hedge funds that own these “exciting new products: just mark up the prices, send the “good news” to their investors, and then write themselves a check as a bonus for “good performance.”

This price inflation flows into many other areas. Many of these hedge funds acquired big chunks of stock in smaller companies. Common practice is to price the stock at whatever level they want. Again, the hedge fund managers reward themselves with huge bonuses for “good performance” without ever liquidating the shares. The bubble has its origins in the ability of big name financial institutions to sell hard-to-understand derivative products to investors at inflated prices. The institutions invite these unsuspecting investors to seminars on “wealth building,” where most don’t understand a word of what they just heard from the fund managers – other than it is a new and sophisticated, high-tech way to make easy money. The widespread ignorance of these investors is the impetus behind the bubble.

### **Federal Reserve to the Rescue**

The recent action or inaction by Fed Chairman Ben Bernanke has been somewhat academic, or “decision by committee.” This is far different from what we saw with former Fed Chairman Alan Greenspan when he dealt with the stock market crash of 1987 and other events in between. This leads me to believe that this debacle is so huge that central banks around the world, like the Federal Reserve, have actually lost control over monetary policy. We saw the Federal Reserve add just under a \$100 billion of liquidity to the markets, along with lowering the discount rate by one half point. The European Central Bank (ECB) put in over \$300 billion of liquidity. This is but a “drop in the bucket,” when viewed against the \$400 trillion bubble. We know there is a concerted effort to shore up the world economy. These financial markets have been busy creating their own liquidity under the false perception of security in the derivatives market. As reality sets in, this credit bubble begins to burst, and when these funds that hold derivatives have liquidity problems, they go from “good performance” to default in a New York minute. This credit bubble will then burst and dry up liquidity, affecting financial markets everywhere, perhaps creating a U.S. recession and eventually, a global recession.

### **When?**

This is the big question. The only “glue” holding our debt-based economy and money system together is the reassuring “babble” coming from the mouths of public officials, central bankers, and the Wall Street crowd.

Economics is but human action applied against a background of available money, credit, goods and services in an economic unit. All of the purveyors of “babble” are hard at work reassuring us that “the problem is isolated to a small sector of the economy,” and is no big deal. If they are successful, we may delay the “big one” for 12-24 months. Meanwhile, a terrorist attack, natural disaster, or simply widespread loss of confidence could trigger an economic meltdown in a matter of days or weeks.

### **What We Know**

We can deal all day long in conjecture about when this financial meltdown will occur. However, we know that in just our U.S. economy, which is debt-based and has debt-based money, we pay off debt with newly created debt money (Federal Reserve Notes). Our total domestic debt has risen to estimates of between \$35-45 trillion. The available currency of exchange to pay the debt or even service the debt (M2) is just a bit over \$7 trillion. This means one or two things will happen: 1) default (which will lead to collapse of the entire U.S. economy, or 2) creation of more money and credit to inflate our way out of this current mess (liquidity crisis). Such a remedy is precisely what got us into this mess in the first place.

### **How Will It Affect Me?**

If you are prepared, you can be a recipient of huge amounts of wealth transfer. Liquidity will be the key. In other words, cash at the crash will be “king.” That’s cash in your deposit accounts and cash in the form of gold and silver coins. A by-product of such economic malaise will be the human misery surrounding those not prepared.

You must, without delay, warn those you care about and help raise their understanding of how our economy works and how the monetary system works. *MER* readers may order the teaching videos, *Your Money Your Future* (one hour) and *Perilous Times Conference* (three-hour, three DVD set) by calling 1-800-336-7000. You may also order the free economic education packages for friends and family by calling 1-800-325-0919.

The economic storm clouds are on the horizon, and it remains to be seen whether the central bankers can do their “magic” and regain control of monetary policy. My view is they may temporarily delay the big collapse, but the only tool they have to temporarily “fix” the mess is massive money creation. In other words, problems beget solutions that beget bigger problem.

You, my friends, are a select few who understand our situation or have had the opportunity to understand it. The problem may be delayed, but it is not going away.

**By Design**

Some of you may wonder – how do you know? That’s simple. I read the writings of the architect of our modern day economic system. His name is John Maynard Keynes, a British economist. He wrote a book in 1920 entitled, *The Economic Consequences of the Peace*. In the book, he writes “by a continuing process of inflation, governments can secretly and unobserved, confiscate an important part of the wealth of its citizens. There is no more sure nor subtle way to overturn the existing basis of society than to debauch [or destroy] the currency. It engages all the processes of economic law that comes down on the side of destruction, and does it in a manner that not one person in a million can diagnose it.”

Move quickly to get you and your family’s financial houses in order. This is no time to be unprepared.