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# Financial Crisis Report

Written by David M. Miyoshi

## Advancing in a Time of Crisis

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**Except for the Great Depression, economically we are experiencing the most unstable period in the history of the modern world. This period will be marked with extreme fluctuations in the stock, commodity and currency markets accompanied by severe and sometimes violent social disruptions. As is typical of such times, many fortunes will be made and lost during this period. After talking with many business owners, executives, professionals and government officials from around the world, the writer believes that for the financially astute investor, this is a time of unprecedented opportunity given the global trade unbalances and distortions in the commodity and currency markets. The *Financial Crisis Report* is a free compilation of the opinions of David M. Miyoshi as well as of those advisors he subscribes to (with appropriate credits given) on how to benefit during this time of crisis. The writer receives no compensation of any kind from any advisors whose articles or ideas may appear in this report. The reader is welcomed to check on all sources of information mentioned herein. Because the opinions and observations of this writer and other advisors are provided herein without charge, the reader is asked to make his/her own judgment on the contents.**

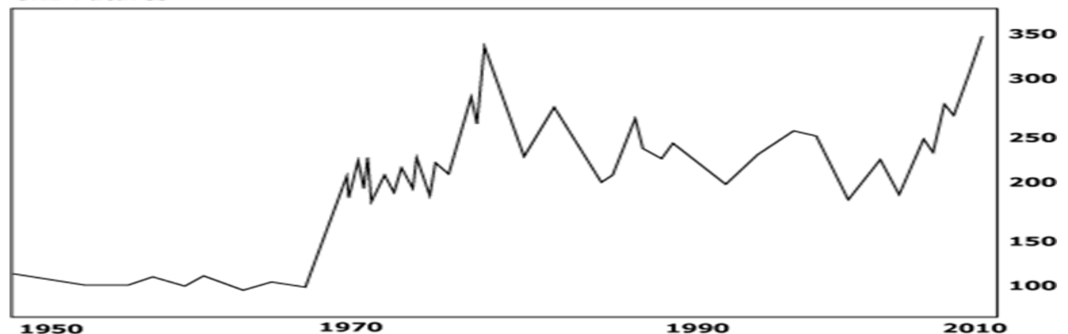
## GOLD IS GOOD

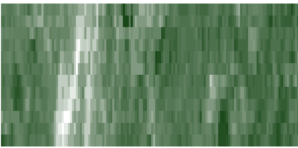
Gold is good…….. at least for some of us. Yes, in the short run it is volatile, as seen by the $120 drop on September 23, but in the long run where most investors make their profits, it has proven to be the most valid form of money

After all, if the bankers detest it and the government abhors it, then it must be good for some people, or at least have some economically redeemable quality for the average person. Since 1971 when President Nixon took the U.S. off the gold standard, we have been on a "fiat" currency (aka paper money) standard. That means we are required to trust the government to maintain the value of our currency. And how has the government done? Just about as expected……..for a government. Since that eventful year our public debt has skyrocketed, the dollar's purchasing power has dwindled to a pittance, and the real wages of employees have drastically declined.

Below is a chart of the CRB Index going back to the 1950's. The CRB Index is a mix of commodities that includes base metals, food, oil and the like. It's main strength is that it is consistent over time, unlike the usual government indexes that are constantly being adjusted. What is notable about the CRB Index is that it is actually a measure of the purchasing power of our dollar and not a measure of the supply and demand for commodities. As the index line goes up meaning the price of commodities are increasing, the value of the dollar goes down. So when you look at the chart and see how commodity prices have increased (and the dollar values have decreased), you can just about guess what year the U.S. left the gold standard. But some may ask why commodity prices fell during the period 1981 to 2004. The commodity prices did fall a bit during that period because that was the time Volker and Greenspan were in charge of the Fed. Both Fed chairmen specifically targeted the money supply which created a de-facto gold standard. Volker did it openly and publically while Greenspan was totally cryptic about it. But nothing lasts forever, and when Bernanke took over the reins of the Fed and forsook all monetary discipline, the dollar base tripled and the commodity prices have again resumed their skyward trajectory.

It is obvious that with the Fed having created the huge amount of credit (on the order of $45 trillion) to finance the government's appetite for public entitlements (through Quantitative Easing 1 and 2), we can be assured that in the near future there will be massive inflation in the U.S. economy. Simple economics makes it clear that printing that amount of money will lead to higher prices in goods (aka inflation). But printing more money, like taking higher doses of a narcotic, can forestall the inevitable crash. But more money does not create real wealth or invigorate an economy. All it does is make people borrow more and go deeper into debt knowing that the dollars they pay back in the future will be less in value. And the ultimate question is does paper money create real per-capita economic growth? Evidence on this issue is overwhelmingly no. Per family income in the U.S., measured in ounces of gold has declined since 1971 (again that date) retreating back to 1950's levels, even though we now have two-income families. In fact, household earnings, in real terms, have fallen 30%- 50% since the gold standard was abandoned.





| 80 Countries | GDP in trillions |
|---|---|
| EuroUnion | 16,282 |
| U.S. | 14,658 |
| China | 5,878 |
| Japan | 5,459 |
| Germany | 3,315 |
| France | 2,583 |
| U.K. | 2,247 |
| Brazil | 2,090 |
| Italy | 2,055 |
| Canada | 1,574 |
| India | 1,538 |
| Russia | 1,465 |
| Spain | 1,410 |
| Australia | 1,236 |
| Mexico | 1,039 |
| S. Korea | 1,007 |
| Netherlands | 783 |
| Turkey | 742 |
| Indonesia | 707 |
| Switzerland | 524 |
| Poland | 469 |
| Belgium | 466 |
| Sweden | 456 |
| Saudi Arab | 444 |
| Taiwan | 431 |
| Norway | 414 |
| Iran | 407 |
| Austria | 377 |
| Argentina | 370 |
| S. Africa | 357 |
| Thailand | 319 |
| Denmark | 311 |
| Greece | 305 |
| UAE | 302 |
| Venezuela | 291 |
| Colombia | 286 |
| Finland | 239 |
| Malaysia | 238 |
| Portugal | 229 |
| Hong Kong | 225 |
| Singapore | 223 |
| Egypt | 218 |
| Nigeria | 217 |
| Israel | 213 |
| Ireland | 204 |
| Chile | 203 |
| Czech Rep | 192 |
| Philippines | 189 |
| Pakistan | 175 |
| Romania | 162 |
| Algeria | 160 |
| Peru | 153 |
| New Zealnd | 140 |
| Kazakhstan | 138 |
| Ukraine | 136 |
| Kuwait | 131 |
| Qatar | 129 |
| Hungary | 128 |
| Bangladesh | 105 |
| Vietnam | 104 |
| Morocco | 103 |
| Slovakia | 86 |
| Angola | 85 |
| Iraq | 84 |
| Libya | 78 |
| Sudan | 66 |
| Ecuador | 61 |
| Croatia | 60 |
| Syria | 59 |
| Oman | 53 |
| Belarus | 52 |
| Luxemborg | 52 |
| Azerbaijan | 52 |
| Dom Rep | 51 |
| Sri Lanka | 48 |
| Slovenia | 46 |
| Bulgaria | 45 |
| Tunisia | 44 |
| Guatemala | 41 |
| Uruguay | 40 |
| Lebanon | 39 |
| Uzbekistan | 38 |

## Gold is Good (continued)

But paper money does have its advantages…..for the wealthy. This is because they have many ways to hedge their risk against a devaluation of the currency and have many opportunities to make huge asset investments using devaluing fixed rate loans. This advantage is not there for the middle class whose wages cannot keep pace with the declines in purchasing power due to inflation. This is the main reason there is great discrepancy in incomes and per-capita wealth in the U.S. It all comes back to paper money which results in economic volatility, gross income inequality and huge levels of public and private debt.

But why is gold good?

Nathan Lewis, author of the classic book *Gold: The Once and Future Money,* summarized the performance of gold to *Forbes* as follows: *In 1790, the population of the United States was 3.9 million, and there were 13 states with an economy based on subsistence farming. In 1970, the population was 203 million, with 50 states and the most advanced, wealthiest industrial economy the world has ever seen.*

During this entire period, with the exception of the Civil War when greenbacks were issued, the U.S. was on some type of gold standard. Historical proof exists that America became the wealthiest nation in the world while it was on the gold standard. Once that standard was abandoned, the country's debts have soared and the incomes have plummeted. During the Civil War while greenbacks were issued, the currency was not on par with the amount of gold in the country. Actually, it took 14 years following the Civil War of consistent economic growth and steady reductions in the amount of greenbacks in circulation to return the U.S. dollar to parity with gold, at the same price as before the Civil War. It was by 1879, that the U.S. government was ready to exchange greenbacks for gold. But this did not mean the government could exchange every greenback for gold. The government simply had enough gold in reserves to make such a promise of exchange. The actual gold reserve fluctuated between 10% and 40% but what mattered was that the government made the promise and had the ostensible capability to uphold it. On the flip side of that promise, was the constraint on the government against increasing the supply of money which also limited the banks from creating additional credit. Thus, from 1880, per capita GDP grew at its greatest rate in American history. In spite of high immigration, unemployment held at 2.5% and real wages rose 23%. Capital investment was being made everywhere and the country was booming. And in spite of this economic flurry, beginning from the end of the Civil War, prices continued to fall until the early 1890's when they finally stabilized. America's greatest economic growth occurred while prices declined. This phenomenon flies in the face of current economic theory based on paper money that touts the belief that prices only fall during economic depressions. But the simple reason for this is that with real money in place (currency backed by gold) investors were willing to make long-term investments. This type of economy is led by capital investments and not consumption…an economy fueled by real savings, not foreign loans. There was no need for a central bank to set interest rate policies or to safeguard us from inflation because the gold standard insured parity and fairness between borrowers and lenders. This led to large increases in productivity and production which resulted in wealth for everyone, not only the rich.

But why does the U.S. government (as well as the governments of all advanced countries) choose to issue paper currency? The frank but not very surprising answer is because paper money allows the wealthy and powerful vested interests in our country to manipulate prices, interest rates, credit and the money supply to their exclusive advantage. And how do they exactly benefit? Through converting productivity for their own benefit. Since 1971 when the U.S. went off the gold standard, there has been a tremendous revolution in technology in our country. The Dick Tracy radio watch is no longer a piece of science fiction. This revolution in technology caused massive increases in productivity which usually results in huge increases in wealth. But where did the wealth go?

Our currency did not increase in value as normally expected. Prices did not fall. On the contrary, all the productivity gains were consumed by the issuance of more and more currency through inflation. Thus, average wages in real terms declined and the productivity gains and wealth were consumed by the government, the financial sector and the debtors, all who benefit from inflation.

It is therefore no surprise that our legacy is a heavily indebted economy that is led by consumption that rewards debtors and punishes savers. This legacy makes long-term capital investment improbable because of the economic volatility and financial risks caused by inflation. The system forces us to become speculators on stocks, commodities and real estate because there is no other way to safeguard our savings.

To protect their position bankers who are always highly leveraged, media barons who continually borrow to buy more properties, and governments who can never balance their budgets all want to maintain our system of fiat currency. They loathe the idea of going on a gold standard because it would provide the level playing field in which they could not survive.

Credits: *The S&A Digest** from the desk of Porter Stansberry

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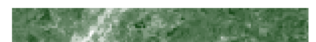

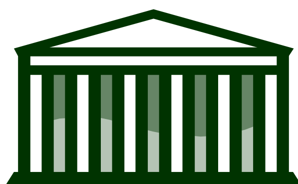

Advancing in a Time of Crisis

# EURO IS BAD

We are all witnessing the fall of the mighty U.S. Dollar. But there is another currency that's even worse off. That's right. It's the Euro. The currency that finances the world's largest economic zone is about to collapse. The European Central Bank (ECB) seems dead set on not allowing Greece, Italy, Spain or any large commercial bank from failing and is thus committed to securing bailouts for any and/or all of them. The primary focus to save the Eurozone is on developing austerity programs for each country. But since last year gold is up 55%, silver is up 140% and the European stock markets have collapsed. The cost of insurance against European sovereign debt defaults has reached all-time highs. UniCredit is Europe's largest lender to Eastern Europe and is the successor bank of Kredit-Anstalt whose failure in 1931 overwhelmed European governments forcing Austria Germany and England off of the gold standard. Well, history is about to repeat itself. The shares of Uni-Credit have collapsed 50% in just over three months. Additionally, the share prices of Europe's largest banks, Deutsche Bank, Barclays, UBS and Credit Suisse are also crumpling.

Germany, the economic locomotive of Europe is now challenged with dealing with the debts of its errant member states such as Greece and Italy. Its central bank is now holding more than $300 billion in IOUs from the outlying European central banks which obligations are now probably worth less than $100 billion. Will Germany continue to finance these bad debts? Probably not. Saddled by its own history of suffering a calamitous hyperinflation after WWI, Germany will be loath to print currency to pay these debts. It is highly likely that Germany will leave the Eurozone which will trigger a colossal devaluation in the Euro for the remaining members to suffer. As a tie in to our first article above, best-selling author Michael Lewis, whose books include *Liar's Poker, The Big Short, Moneyball* and *The Blindside* recently wrote an article about Germany's financial crisis for *Vanity Fair*. Lewis reports Germany's relying on its gold reserves to carry it through the crisis.

Financial Crisis Report

"*If Greece defaults on its debt, the E.C.B. will not only lose a pile on its holdings of Greek bonds but must return the bonds to the European banks, and the European banks must fork over $450 billion in cash. The E.C.B. itself might face insolvency, which would mean turning for funds to its solvent member governments, led by Germany. (The senior official at the Bundesbank told me they already have thought about how to deal with the request. 'We have 3,400 tons of gold,' he said. 'We are the only country that has not sold its original allotment from the [late 1940s]. So we are covered to some extent.')*"

In any case, if Germany leaves the Eurozone, it will be an economic disaster of unprecedented proportions. The Eurozone is larger in area and financial impact than the entire United States. Considering what recently happened just in the U.S. (the bankruptcy of General Motors, the fall of its investment banks, the receivership of the world's largest mortgage firms (Fannie and Freddie Mac), the downfall of the world's largest insurance company AIG, the federal debt explosion to $14 trillion and its total debt now exceeding $54 trillion), the fall of the Eurozone will certainly be an economic tsunami that will inundate many economies around the globe. One should be well invested in the proper commodities to weather this calamity.

Credits: *Steve Sjuggerud's DailyWealth Premium* and the *Economist*

## STOCKS VS GOLD, WHICH TO CHOOSE

Steve Sjuggerud, in his excellent DailyWealth Premium newsletter* shows that for the preceding 20 years from 1979 to 1999 stocks greatly outperformed gold as shown in the first table:

Stocks vs. Gold

12/31/79 to 12/31/99

| Stocks | Up 2,460% |
| --- | --- |
| Gold | Down 44% |

But in 2001 Steve insisted that the U.S. dollar was going to fall and that the men in control are no longer in control and that it would be advisable to invest in some gold. Apparently he was right. Since then gold has not had a losing year and if we take a look at its recent performance vs stocks across the world we see what has happened in the second table:

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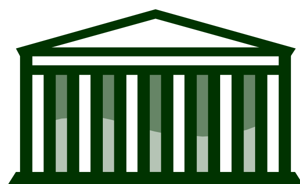
## STOCKS VS GOLD, WHICH TO CHOOSE (continued)



Advancing in a Time of Crisis

Stocks vs. Gold
Since Then: 12/31/99 to 9/23/11

| | |
|---|---|
| Greece (Athex Composite) | Down 80.7% |
| Italy (MIB) | Down 57.0% |
| Japan (Nikkei 225) | Down 39.5% |
| France (CAC Index) | Down 36.8% |
| England (FTSE 100) | Down 30.2% |
| United States (S&P 500) | Down 22.8% |
| Gold | Up 472.9% |

Today, with gold being up almost 500%, and stocks being down the last decade, investors now want gold. In a recent Gallup Poll, investors were asked “Which of the following do you think is the best long-term investment?” Thirty-Four percent of Americans answered “gold” with real estate being second at 19% and stocks/mutual funds third at 17%. Now if gold doubled, it would be over $3,000 an ounce. If the Nasdaq doubled, it would still be below its high over 11 years ago. That being said, with stocks being so low, it probably is a great buying opportunity for stocks. So, for the long term, gold will be the best medium to hold its value while stocks (at least at this point) may present a good buying opportunity.

*for subscription information contact “customerservice@stansberryresearch.com”

## Are U.S. problems more serious than Europe’s?

Renowned investor Jim Rogers says the US economy has more serious problems than Europe. "Europe has a few bad, bankrupt states, so does America. We've got Illinois which is bigger than Greece, we've got California, we've got New York, you know those are pretty big states that have serious economic problems. We have pension plans in America that are terribly under water," Rogers said. According to Rogers, the US has deeper structural problems than Europe as well as higher debt levels. "Europe's got some bad problems but the entity as a whole is not nearly as deep in debt as the US They don't have a huge balance of trade deficit, like we do." Investors have been worried about the lack of a unified response from Europe. Leaders in the single currency group have been accused of being behind the curve and not getting to grips with the crisis even as stock markets have swooned. But Rogers believes that America, despite having a single fiscal policy, is actually worse off in terms of its debt situation. Despite his bearishness towards the US economy, Rogers said he continued to hold onto dollars, which he bought earlier this year, when investors were extremely bearish on the currency. He said he might buy more if the situation in Europe worsened, driving more people towards the safety of the greenback.

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## USD is the only safe haven

If sentiment turns negative again, as it was at the end of the last week, there's only one place for foreign exchange investors to hide, according to David Bloom, the head of foreign exchange strategy at HSBC. “Last week’s gloomy outlook for global growth from the (Federal Open Market Committee), the (International Monetary Fund), and the World Bank has caused an exodus from risk assets such as equities and commodities,” said Bloom. “The main beneficiary of this repositioning has been the US dollar." This flight to the dollar comes despite the huge structural problems facing the United States, which has the world’s largest national debt and a huge trade deficit with China. “The only reason that the dollar has benefited is that no alternative safe haven exists. The other traditional safe havens – the Japanese yen and the Swiss franc – have been taken out of play by official Japanese and Swiss intervention to halt their appreciation,” said Bloom. Other nations with safe haven characteristics simply do not have sufficient liquidity to absorb safe-haven flows, according to Bloom.

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