For the Record

God, Gold, the Fed and Capitulation

"O SON OF BEING! Busy not thyself with this world, for with fire We test the gold, and with gold We test Our servants."
— Bahá'u'lláh, from The Hidden Words

This article has been in production now for 2 years, it has been that long since I first started researching our financial system – and ever since then I've been promising myself that I would get it all down on paper. The impetus for my research came from the bursting of the Internet bubble – an event that radically changed my life. As an Internet company CEO of 6 years standing (having founded and grown my own company) my company, the employees, shareholders, customers, creditors and my family were all ultimately impacted by the dramatic implosion of first the dot.com segment and then the entire technology industry.

As I write this the market has just plummeted (nearly 400 points today alone), people are starting to panic, Johnson and Johnson has just been added to the list of scandals and over six trillion dollars has been wiped out. Several family members have lost more than half of their retirement funds and life savings and many friends are wondering what has hit them, how, why and where from.

Now I am no financial analyst, but I'm no dummy either. As a CEO of a 40-person company that grew from nothing - and actually produced revenue and created value for its clients, I became pretty good at understanding trends, people, events and the truth. My entire career has been in financial services and high technology companies, so I know a thing or two about investment banks, venture capitalists, boards of directors, shareholder value and most importantly business ethics.

On the path to becoming a CEO I witnessed a number of interesting business events, and surmised quite a bit about real events behind what was told to the public in publicly traded companies. Like you, I've known of the deep-rooted corruption within the political system for most of my adult life – and understood that corporations were fueling the perversity with their campaign contributions.

But like you I was really naïve about the depth of the depravity, the number of people involved, the propensity for situational ethics and just how easily the highest paid corporate leaders in this great country could get away with crimes that would send the likes of you and I to the big house for many years. Once I started my research it really surprised me just how easy it was to discover how we got to where we are today, the information is all out there for you to read and research for yourself - you just have to be prepared to get your head around the grim science of economics, and to not be shocked and surprised at just how manipulated you have been!

Anyway, hopefully this article will serve to enlighten you to the point that you feel that your own independent investigation of the truth is warranted – perhaps if enough of us get educated on these matters we may in some small way mitigate for the huge mess that we are now in? But that would be no small task, as you will discover as you read.

God Bless America, and God Bless the World! Sincerely, Richard J. Lancaster

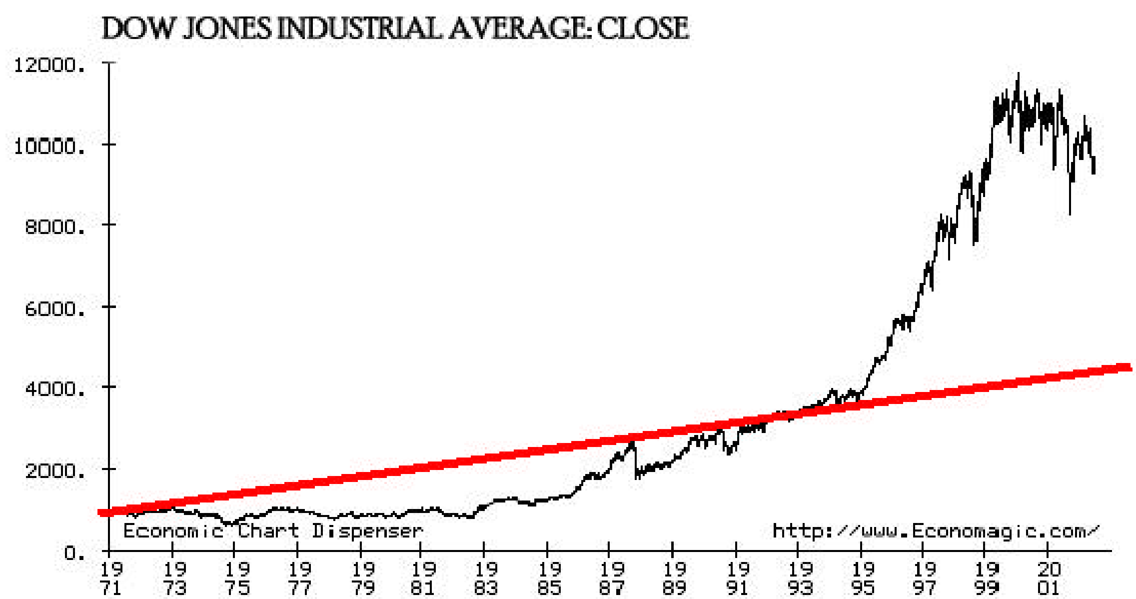
"Science without religion is lame, religion without science is blind.'
— Albert Einstein

The Science of the DOW Jones Industrial Average!

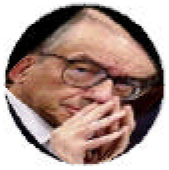
In January 1971 the Dow was at 760, in July of 2002 the index was at approximately 8,000, having peaked at over 11,000 in 1999. The rise of the Dow from '71 to '99 was over 1200% - while GDP over the same period rose 150% (see below for more details on GDP, etc.), Industrial Production rose approximately 150% and the monetary supply (MZM) rose approximately 600%. Clearly the rise of the market had more to do with loose monetary policy and "irrational exuberance" than the overall increase in production of the nation!

Eventually the DOW will return to somewhere close to the red line (see below) – its natural level given the real state of the US economy. We are starting to see now that there is no "new economic miracle," just a huge bubble in equity and asset values. The bubble was inflated deliberately through pumping up the monetary supply (making "money/debt" cheap – as has been done many times in the past) and then priming the pump of the corporate controlled media with the story of an economic miracle which in turn got the people spending feely and raising their debt levels rapidly.

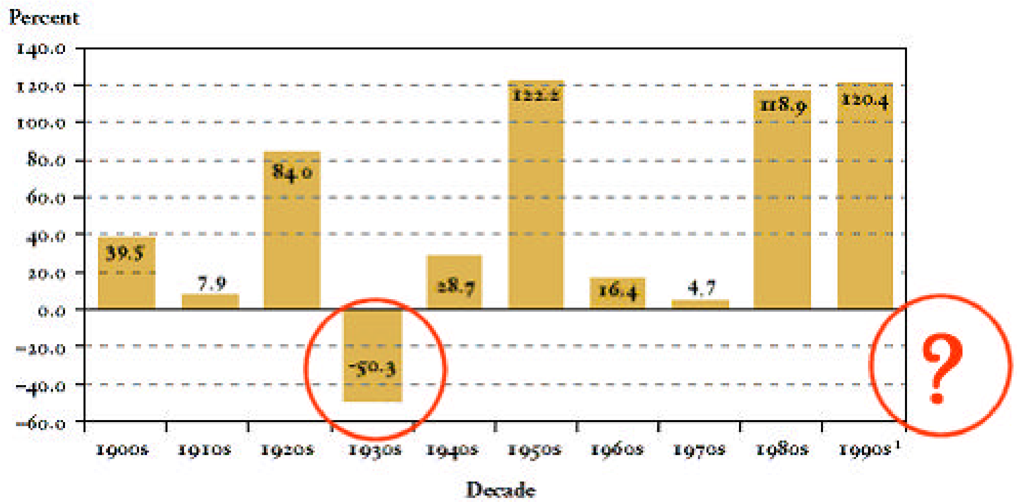
By giving Americans the feeling that they were truly enjoying a new-found wealth (even though overall economic performance did not prove this out) the market manipulators have been able to suck an unprecedented amount of our savings in to the markets and therefore at risk for the first time. Collectively we have leveraged ourselves way beyond what we know is prudent. Our propensity to "follow the experts" wherever they lead us is about to cost us a large part of our retirement funds, college funds, and for many pensioners their day-to-day income. This is a travesty, it is the biggest financial fraud of all time and its roots grow long and deep under the foundation of the privately owned and controlled Federal Reserve system and its major shareholding banks.



"An infectious greed seemed to grip much of our business community."
— Alan Greenspan (Yes indeed Alan! Ed.)



The DOW for the past 100 years in terms of the Percentage of Growth per Decade:



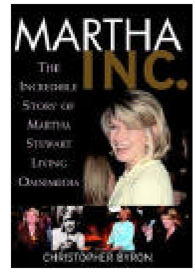
The above chart helps to depict the unusually long and high rise of the Dow over the last two decades. Unfortunately we are about to see an adjustment that will show a significant downturn towards historical valuations during recessions. Typically over the 200-year history of US equities markets the P/E ratio through a recession has been between 5 and 10 – currently the P/E is still around 40! Expect to see something akin to the drop in the NASDAQ (which isn't over yet) happening to the DOW soon.

Bob Chapman, of International Forecaster fame, recently had this to say regarding the DOW, "When the DOW cracks 8200 the average investor will finally recognize that we have just had a bear market rally and that there is no recovery. We expect that break will mark the beginning of capitulation, which will last for some time."

It turns out that you'd better have the "DOW Religion" if you want to hang on for the long haul! The road ahead looks a little more than bumpy, it's more like cratered with the implosions of WorldCom's, Kmart's, Enron's, Global Crossing's, et al. Attempts by the Fed to remedy this situation are for naught. You can't cut interest rates much lower than they are already! As I write this, the DOW closed around 8000 and is heading south daily – with some wild up ticks occasionally just to keep the herd guessing!

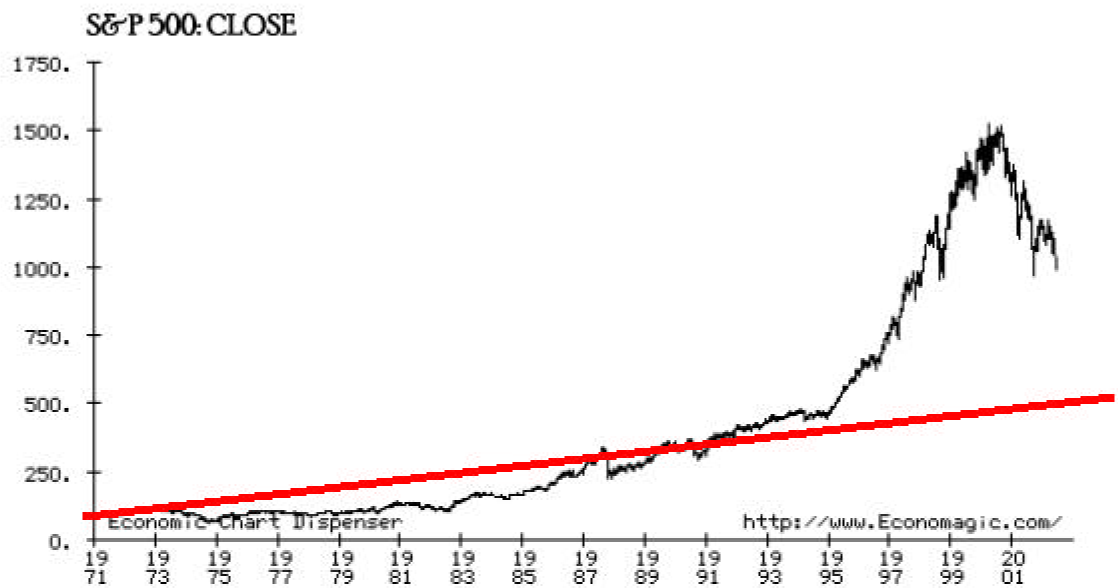
The smell of panic is starting to fill my nostrils as I see that there are the first signs of even the mainstream media starting to speak out about the potential of there not being a "recovery." More and more articles are being written regarding the appalling state of affairs, and some even dare to mention that we may be heading towards a deeper recession or even a depression. Of course the powers that be need to get all of their upside out of harms way before the real panic starts – so the corporate owned financial media is not about to start showing historical evidence that a crash is imminent quite yet – but the inevitable march of the markets back towards something resembling real value is now underway and is unstoppable.

*"Let **me** eat cake."*
— Martha Stewart (OK, I made that up! Ed)



The S&P 500 Summit and Descent

Just take a look at the rise of the S&P since the early nineties immediately below, of course this was attributed to the "new economy" and a commensurate increase in GDP and Industrial Production, which clearly were *not* commensurate with this markets rise, and far lag the markets in terms of real increases. As you can see there is some way for the S&P to fall before it reaches its real value, and gets back in line with where it should be historically. No amount of manipulation, whether it be inflating earnings, receiving generous tax kickbacks by the government, or falsifying business deals with offshore entities, is going to make a difference at this point. The dye is cast, the market will return to its natural place – and potentially will go lower than it should as an adverse reaction to all of the fraud drives most of us to never want to invest in another public company again!

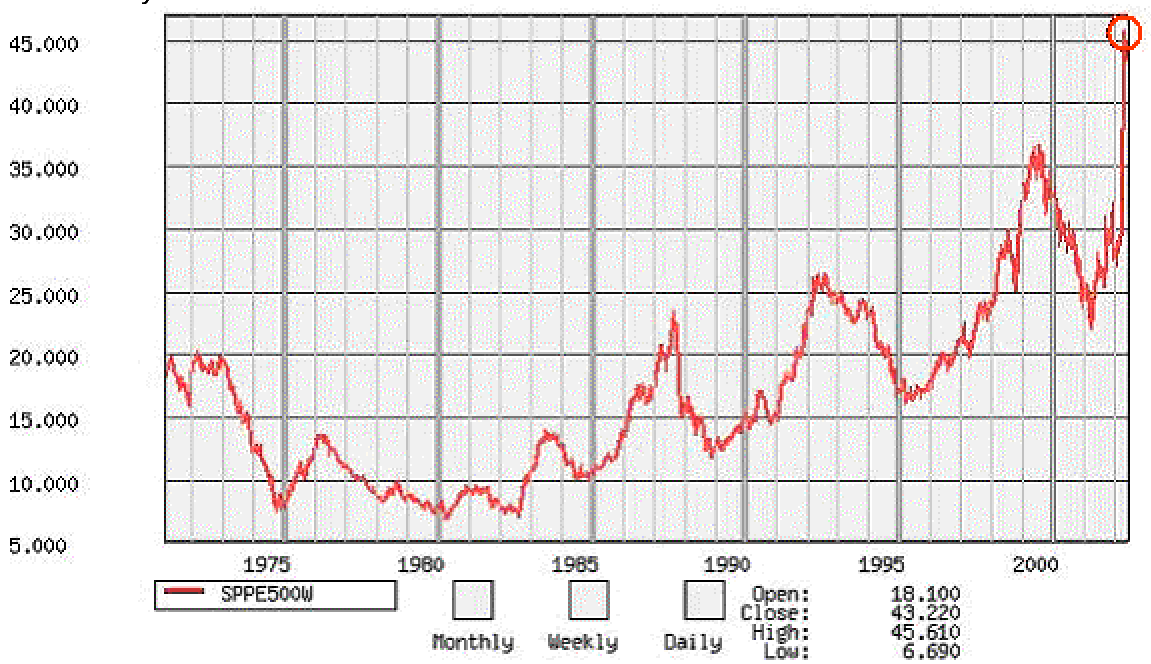


The S&P 500 P/E Ratio since 1971 (Below)

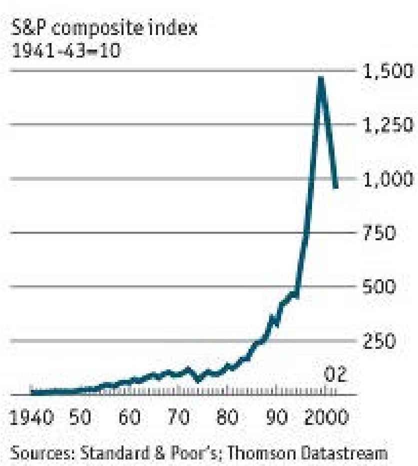
Once you've consumed the rise of the S&P 500 in real terms, then take a look at the rise of the S&P P/E ratio below, and the enormous spike in the most recent years as earnings have fallen off dramatically. The P/E has topped at around 45. Historically, as you can see from the chart that shows the recessions of the 70's, 80's and 90's, the market has traded in the 5-10 P/E range through "official" recessions. This evidence makes the current advice we all receive from the financial media and financial "experts" to be a huge anomaly. How can these journeyman experts not see what is so apparent – the S&P is massively overvalued based on any metric you care to measure! Simply put, what on *earth* can justify this current situation?

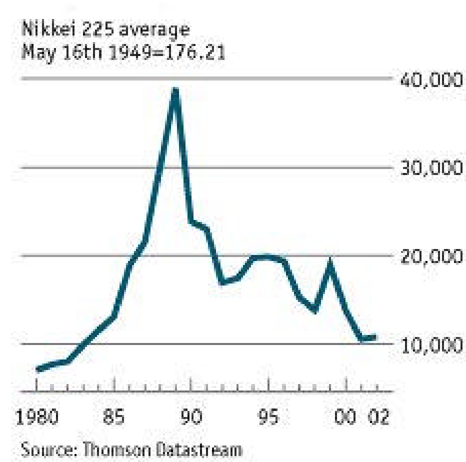
Either **E**arnings have to rebound at record levels or the **P**rice of the stock has to come down to reflect the *lack* of earnings.

Which do you think it will be??

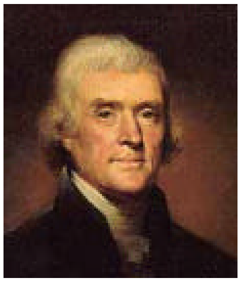


I found these next two charts fascinating and somewhat predictive of pending events. Look at the rise of the S&P since 1941 on the left, and then the demise of the Nikkei since 1980 on the right. The Nikkei has plummeted from a high of nearly 40,000 to a low of nearly 10,000. The S&P has already come down 35%, but based on the performance of the Nikkei in what would appear to be better economic circumstances in Japan during the 80's and 90's than what appear to be the case in the US in the 00's, then you can get a visceral feel for where we may be headed? I know its ugly, but sometimes you have to clean up the mess after the party is over!





As I was trying to finish up this section on the S&P a new piece of evidence came to light. Clive Maund, an English technical analyst and trader living in Bavaria, published the following chart in his short and prescient article “The Great Crash of 2002.” Clicking on the chart will take you to his essay. Basically Clive is calling out the classic Head and Shoulders Reversal that is underway with the S&P, and where the likely sell off will end. I agree with his analysis!



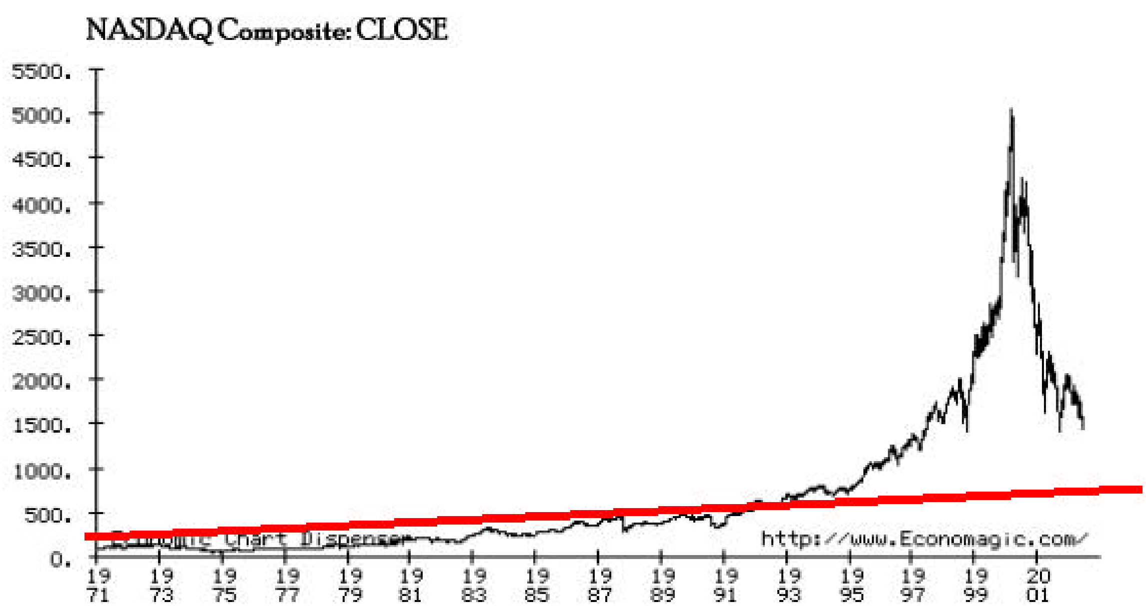
"Indeed I tremble for my country when I reflect that God is just."
— Thomas Jefferson

The NASDAQ Crash and Aftermath

On February 8, 1971, the Nasdaq began trading for the very first time. As you can see (below) the market trudged along at a reasonable clip, staying slightly ahead of inflation and providing a pretty good annualized return on investment to the more tech-inclined investor. Then the early nineties happened and things got out of control! Never before in the history of financial markets has there ever been a bull so strong or a crash so deep as has been seen with the Nasdaq through the course of the last decade or so.

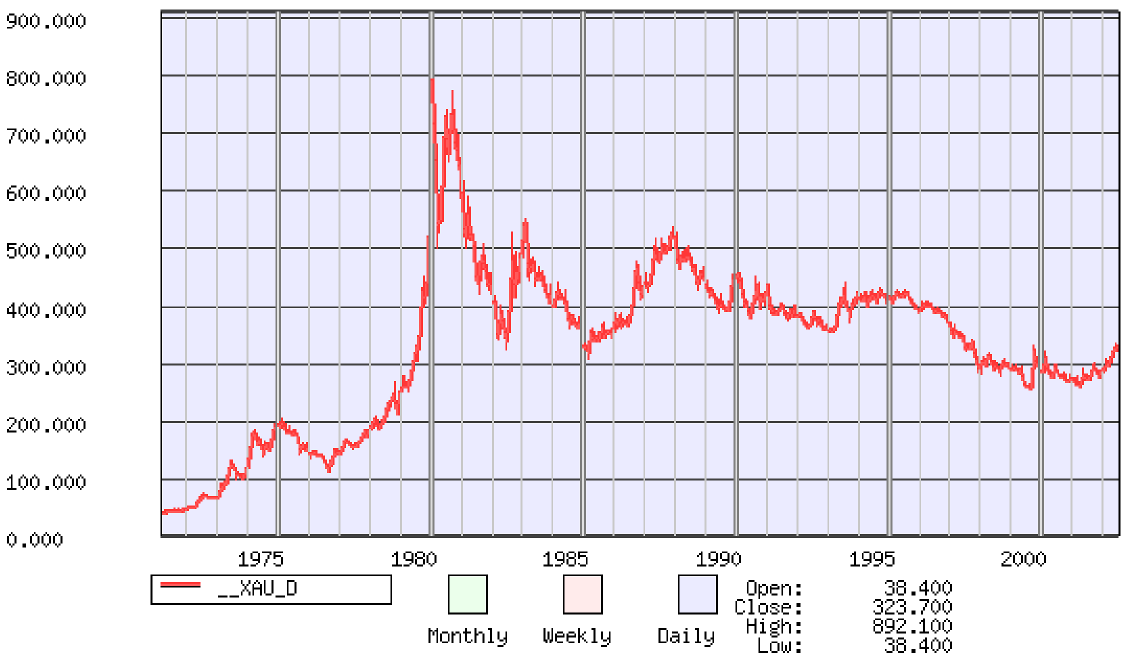
At its peak in early 2000, the Nasdaq had a market cap of more than $6 trillion. Today, its value has crashed to less than $2 trillion, and that is still $1 trillion too much! Surely with the resources of the free worlds central banks the public could have been informed of the likelihood that they were witnessing one of the biggest bubbles of all time and that a crash was inevitable? Instead what we were Fed (so to speak) was "irrational exuberance" – a diversion from the real reason - incredibly loose monetary management by the Fed that led the people to believe they could all be rich by throwing everything they had at the Nasdaq. Now, we all know that ignorance is no defense in the eyes of the law, so the people have to take their lumps for being manipulated. But what about the manipulators? What price should they pay for destroying the wealth of a nation, and pocketing billions for themselves in the process?

And what are we going to do to return this nation, and the world, back to a sound monetary system? That dear reader is the $150 Trillion question ($150 Trillion is the current size of the Derivative Monster that I will address later in the essay). The Nasdaq lesson is evidence for all doubters that we have already lived through a massive crash, now if you doubt that lesson take another look at the fundamentals and you will see that the DOW and S&P are analogous to the Nasdaq and will ultimately (and soon I believe) suffer the same fate – if they aren't already.



"Why then, is gold the unmentionable, four letter word of economics? Why, even today, does serious mention of gold brand the advocate in many circles as an ignoramus, a crank? The answer is threefold: A misunderstanding of the role of money; a misreading of history; and finally, visceral revulsion to the notion that a metal can do a better job of guiding monetary policy than a gaggle of finance ministers, central bankers and well-degreed economists."

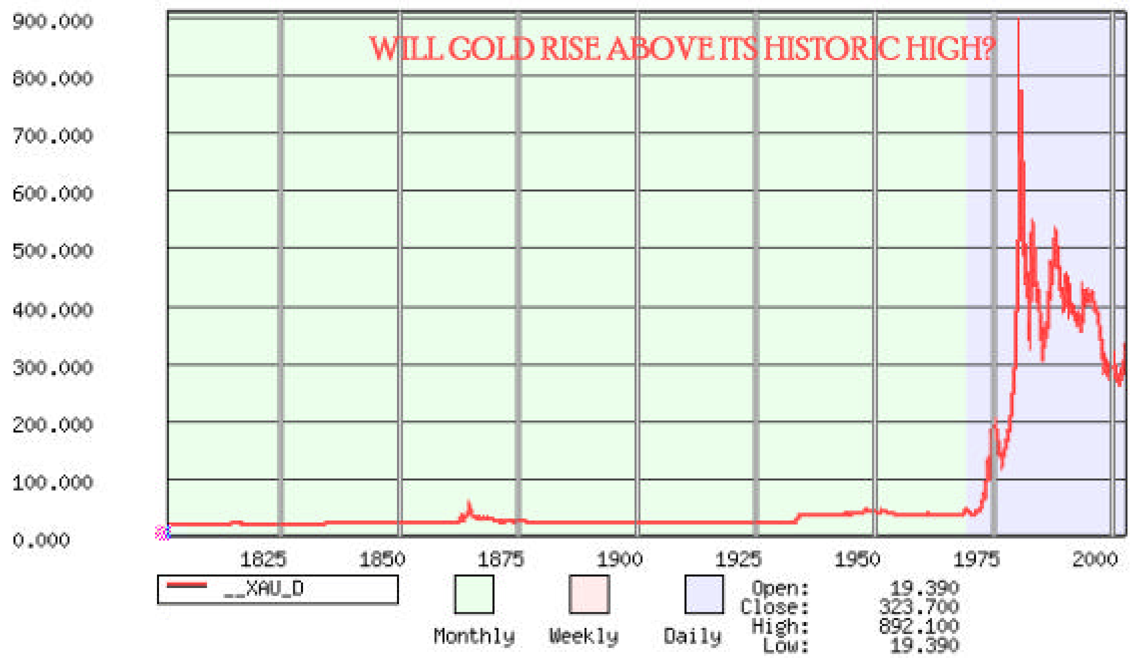
— Malcolm Forbes



The Price of Gold, the "Archaic Relic," since 1971

On August 15, 1971, humanity entered the first era in its 5,000 year recorded history in which no circulating paper anywhere was redeemable in gold, by anyone. From 1933 until 1974 it was even ***illegal*** for a U.S. citizen to own gold bullion! Gold was confiscated as the United States was bankrupt and the citizens' gold was needed in order to bale out the US Government that was in debt to the Federal Reserve. President Richard Nixon closed the "gold window" in 1971, an action which broke the last tie between gold and circulating currency, resulting in our modern financial system that is called a "floating

Gold is as good as cash, liquid but non-interest-bearing. Through 200 years of American history, equities appreciated at a compound annual rate of over 8%, bonds at roughly 5% and gold at over 1%. In the past decade all of those historical trends have become temporarily irrelevant as we are told by the US government, the Federal Reserve, Wall Street and institutional economists that the entire historical context is meaningless as we are in this "New Economy."



There is a massive controversy raging within the gold industry, many insiders believe the gold mining industry has been manipulated by the financial community, and that the price of gold (POG) has been kept artificially low through the strategic buying and selling of gold futures/swaps/certificates by the worlds dominant central banks, the Bank of International Settlements, gold bullion banks, the Federal Reserve, US Treasury and some of the largest mining companies who are a part of this cabal.

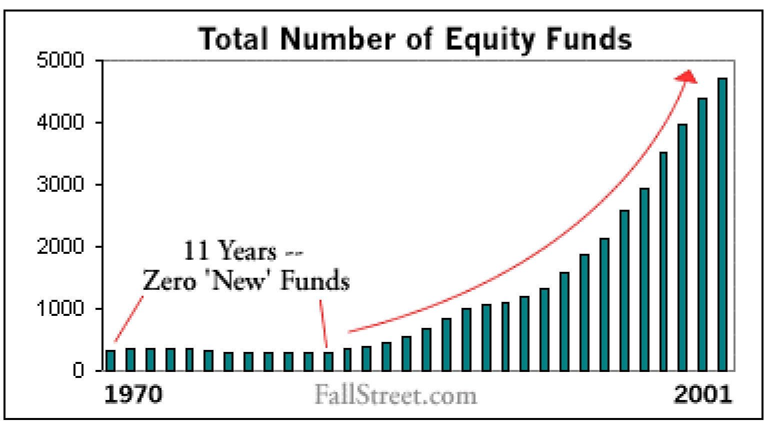
The lowering of the POG is an attempt to guarantee the return on certain interest rate derivative contracts that number in the tens of trillions of dollars of notional value. The cost of controlling the POG is miniscule compared to the upside gained by making interest rate contracts more predictable. Basically, we are seeing insider trading by the elite on a scale that is almost unimaginable. The magnitude of the manipulation is gigantic, nothing of this scale has ever been seen before and will probably never been seen again – at least lets all hope not!

For a full understanding of how this manipulation has been perpetrated it is important to study the material available from GATA (www.gata.org). Adam Hamilton has also written extensively about this subject (www.zealllc.com/), and one of the best websites to study is Gold-Eagle (www.gold-eagle.com). Some of the most revealing commentary is based on Lawrence Summers "Gibson's Paradox" essay of the mid 1980's, and another great read is Alan Greenspan's essay from 1966 "Gold and Economic Freedom" – somewhere along the road Alan "turned" and became a fiat currency believer, read the essay.

Gold plays a very intriguing role in the history of humanity, and its role is far from over. I have a feeling that we are heading towards a Global Dollar currency (fiat-based of course), controlled by the same families that hold the reigns on the International Monetary Fund, the World Bank, the Fed and many of the largest banks. The challenge coming up will most likely include a battle over whether a new global monetary system will be backed by gold or not. During the ensuing battle you can be sure that an education on the history and perceived value of gold will be critical if “we the people” are to influence the outcome.

The bottom line for me is that gold appears to be undervalued in these current circumstances, and perhaps quite dramatically so. With each dip in the equities market, and weakening of the US dollar, it is reasonable to expect a commensurate increase in the POG. However, of late, we have not seen any evidence of this at all. Indeed on a few occasions lately the markets have declined with the dollar, and gold has followed them down too! This to me is clear evidence of manipulation.

There is so much that can be said about the position of gold in a recession/depression, and its value as a standard for a stable monetary system free of the kinds of manipulations we are experiencing with the current Fed cabal. However, time and space are limited! To get a much clearer picture research some of the sites and links mentioned above….Oh yes, and it might be worth taking a little risk on some gold mutual funds, unhedged mining stocks and having a little physical gold in the closet for a rainy day. Bare in mind though, I am no financial advisor and you invest at your own risk.

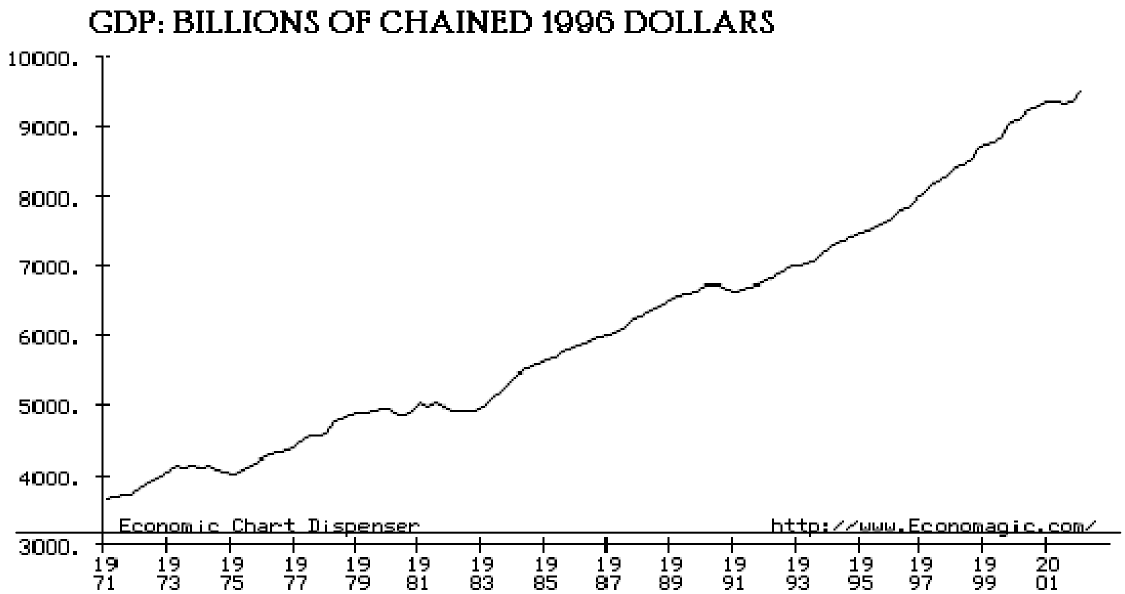


Thanks to www.fallstreet.com for the above chart. I think this chart should act as a warning to many of you who choose not to believe me - and who are heavily in to new equity funds. According to www.lipperweb.com, more than 99 percent of equity funds investing in U.S. stocks lost money in the second quarter of ‘02- nearly 14 percent on average. That was the worst quarterly performance since 1987's third quarter (the last major stock market crash). By contrast, "Gold funds, infinitesimal in scope compared to overall mutual fund assets with just $4 billion spread across 41 class shares, scooped up gains of roughly 18 percent for the quarter and are ahead 59 percent year to date."

"The sense of responsibility in the financial community for the community as a whole is not small. It is nearly nil."
— John Kenneth Galbraith

The Gross Domestic Product Revolution?

There has been some significant growth in GDP over the past 3 decades, but this ain't no revolution.



GDP has risen from under \$4 Trillion in '71 to nearly \$10 Trillion in '01 – a rise of nearly 150% over 30 years. This is a great achievement in and of itself and Americans should be proud of their progress. However, when GDP is compared to the rise in the stock markets (5000% in the case of the NASDAQ), the rise in real estate prices, the rise in currency in circulation and the rise in debt, it becomes eminently clear that there was no revolution in productivity - - just a revolution in how the numbers were spun to make us all believe there was a miracle underway.

I read Bill Bonner's work most days, and the rest of the contributors to "The Daily Reckoning." He and his cohorts have been saying it "as it is" for some time now. Here is a part of what they published in January 2002, from "Predictions for 2000 and beyond:"

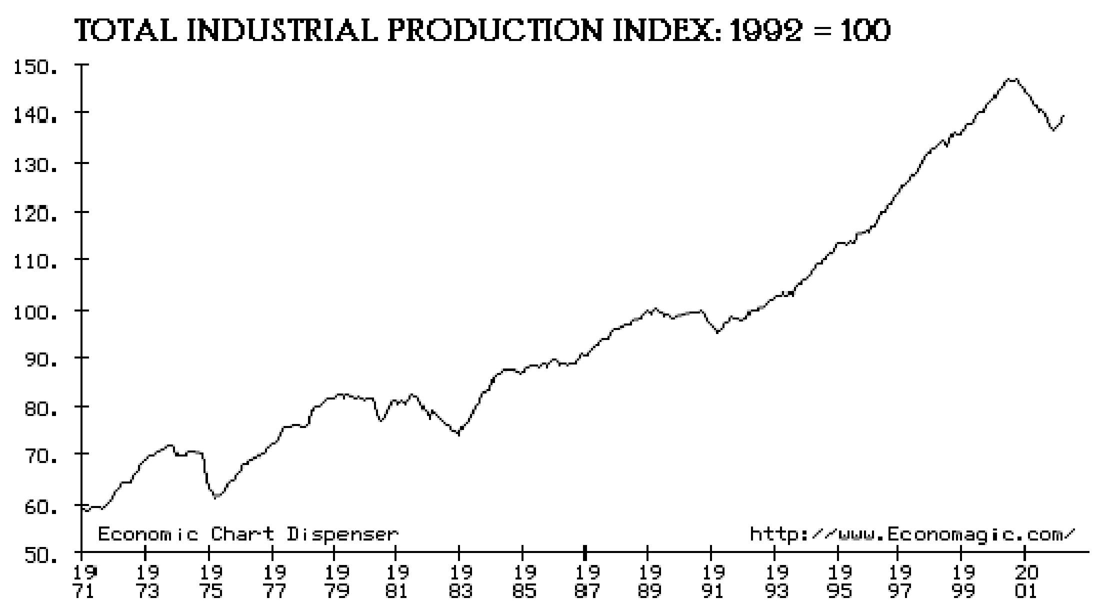
"….the American economy, supposedly the main creator and principal beneficiary of the New Era, still looks a lot like an ordinary economy -- with one major difference -- one heck of a lot of credit. When the US economy was compared to Japan and Germany by the Economist, for example, it looked anything but extraordinary. Measured in GDP per capita, from '89 to '98, the US performed about as well as Japan and both did worse than Germany. And compared to it's own recent past the US economy has been far from spectacular. GDP increased by 5.5% in 1992. The figure is only 4.7% in '99. What's more, as Dr. Kurt Richebacher has shown, 78.5% of that GDP figure for this year is computers.

Uh... do you think computer sales really account for 78.5% of economic growth? Not a chance. The whole thing is a fiction, if not a fraud. The computer figures are enhanced -- because the statisticians adjust the numbers for computing power. What they're really figuring is not economic activity in dollars and cents -- but in gigabytes per second. If they did the arithmetic the way they did in 1992, computers wouldn't make up 78.5% of economic growth, but only 2.3%.

"Putting it straight," writes Dr. Richebacher in his December issue, "the exploding computer power... has accounted entirely for the US economic 'miracle' since 1996..."

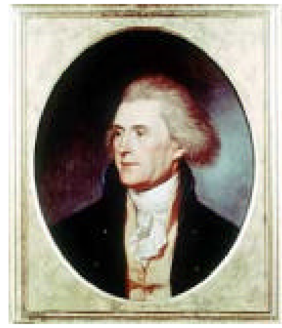
What caused this “virtual revolution” in valuations across almost the entire US asset base was far less the growth of GDP and far more the saturation of easy credit released in to the system by the Fed. As I have said, I was a high tech CEO through most of this period and had absolutely no idea that we were inside a credit bubble until it was too late – I was not alone.

Total Industrial Production is up, commensurate with GDP, which is pretty intuitive eh!? This next chart shows the economic downturns in the 70’s, 80’s and 90’s quite adequately, and the beginning of the large decrease we are in right now. The big question we need to answer going forward is: Just how much industrial production are we likely to see in the future with so many manufacturing jobs already exported to China, Mexico and other area’s of cheap labor? Just how many American’s can thrive in what is rapidly becoming a service-based economy remains to be seen. We have already put our wives/mothers to work in order to sustain our lifestyles – perhaps we should return to Victorian England and put kids back to work as well – but this time as central bankers, financial analysts, investment bankers, stockbrokers and other service-based professionals (let’s be honest here, how could they do any worse than the bunch we have right now?). I’m sure Charles Dickens would see kids working in boiler-room trading positions as an improvement over the dark satanic mills of Lancashire?? (Oh, did I mention, I’m English. But like Englishmen before me, I believe I am a true Patriot).



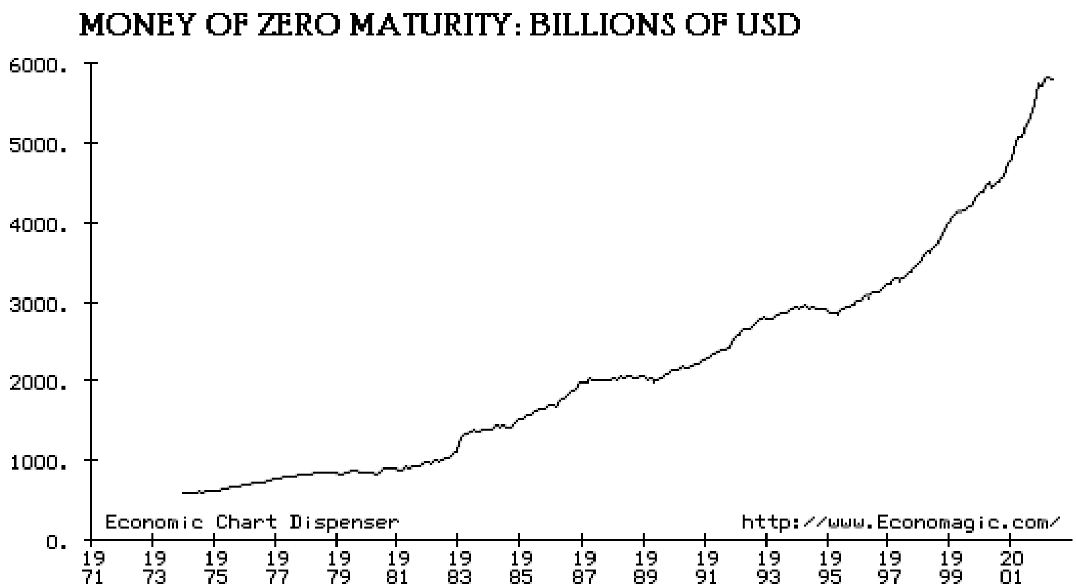
"I believe that banking institutions are more dangerous to our liberties than standing armies. Already they have raised up a monied aristocracy that has set the government at defiance. The issuing power should be taken from the banks and restored to the people to whom it properly belongs."

— Thomas Jefferson



Inflationary Monetary Policy and the US Dollar

Money of Zero Maturity (MZM) is one of the most useful measures of just how inflationary current Federal Reserve policy is. There has been a 600% increase in MZM since '71, whilst productivity has ramped at 150%. Clearly, cheap credit is the fuel driving asset valuation higher and not productivity.



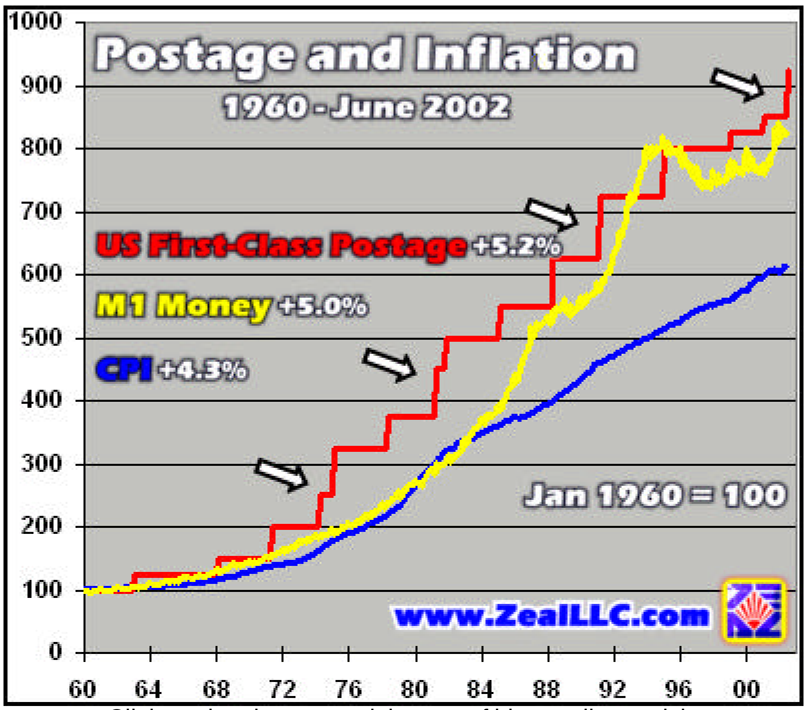
Adam Hamilton has been a constant inspiration to me whilst on my quest for the truth in all things economic, I find his prose to be so easy to read – and his style is so fluid and punctuated with satire and ironic comedy. As I was trying to put the finishing touches on this article he published yet another wonderfully germane piece on inflation. Below I have reproduced a quote from the essay ("US Postal Inflation Proxy") as well as one of the charts, which describes the huge increase in inflation (a hidden tax the American people simply do not understand) in terms of the rise of first class postage.

I have added this at the last minute because Adam counts the number of postage rate hikes since the 1971 period, so this addresses a theme that runs throughout this research – that of the gold standard. Anyway, apparently the cost of postage hardly rose at all for over 75 years, then rose only slightly until the 70's:

"Since 1960 however, there have been an almost unbelievable 15 first-class postage rate hikes in this relatively short period of time. The vast majority of the hikes, 12, came after Nixon's dollar gold standard default in August 1971, when the inflationary floodgates were blasted open that allowed the Federal Reserve to ravage America's hardworking savers with an endless deluge of rampant monetary growth.

In the opening days of 1960 it cost only 4 cents to mail a first-class letter anywhere in the States. Today it costs 37 cents, an enormous 825% increase. The graphs in this essay tell the story of the first-class rate hikes since 1960 and offer some insights into their potential usefulness as a general price inflation proxy.

All the data in this essay is monthly. It is all indexed to January 1960 to make that month equal to the 100 level so everything is growing off a common base for comparability. In both graphs, the white percentage numbers after the data-series labels are compound annual growth rates for each respective data series. The comparison between US first-class postage rates over time and the CPI as well as various money supply growth rates is an interesting sight to behold."



Click on the chart to read the rest of his excellent article

The people of the world have so little knowledge of the function and dynamics of money. Our banking fraternity and their cohorts feed off this naivety. Politicians are dependent on us not finding out their dirty little money secrets. The Fed will disappear overnight if the people wake up to the gigantic scam that this fiat currency system is burdening them with. Going forward we need to find a way, once we've been through the mess that is coming at us, to educate future generations on the need for a sound monetary system – one that is not so easy to abuse by Philosopher Kings who lust for power and have more money than they could possibly spend in several lifetimes.

One of the outcomes of US Fed monetary policy has been a dramatic weakening of the dollar in recent months. The Euro is now, as I write, at parity for the first time in 2 years. Arguably the dollar needs to go lower to reflect its real value, and to help the US economy in terms of the balance of trade and the current account.

However, psychologically, for the USD to sink much below the Euro would be a dent in the pride of the US, as well as a signal to foreign investors that their money may be safer in Europe not America. Any major move by foreign money out of the US, even a large-scale downturn in the amount of foreign investment daily in the US (which needs to be around $1.3 billion a day in order to fuel current debt repayment – i.e. just to make interest payments) will be disastrous to the stock market and the economy as a whole.

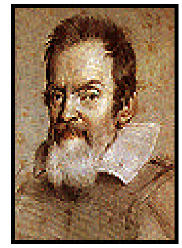
Unfortunately such an exodus of foreigners from a belief in the US is starting to look inevitable, not only are they unconvinced that the President is the right man for the job (too much unilateralism for most Europeans (I would guess) but they are shaken by the fraud, corruption, scandal and continued over-valuation of US companies. In general European companies are trading at P/E's far below their US equivalents.

At the heart of this entire mess is the Federal Reserve and their manipulations of the economy through monetary policy. A radical and fundamental change in policy to a sound monetary system, away from fiat currency and back to the Gold Standard, or something similar, is now essential.

www.ino.com is an excellent tool for charting; here below is a chart of the US Dollars performance over the last 12 months – not a pretty site if you are a dollar investor – but it is necessary for the dollar to fall in order to try to balance the US economy against the rest of the world's – currently it is still over-valued. This is a paradox for sure, we need the dollar to fall, but if it does so does everything else.

"I do not feel obliged to believe that the same God who has endowed us with sense, reason and intellect has intended us to forgo their use."

— Galileo



The Derivatives Monster

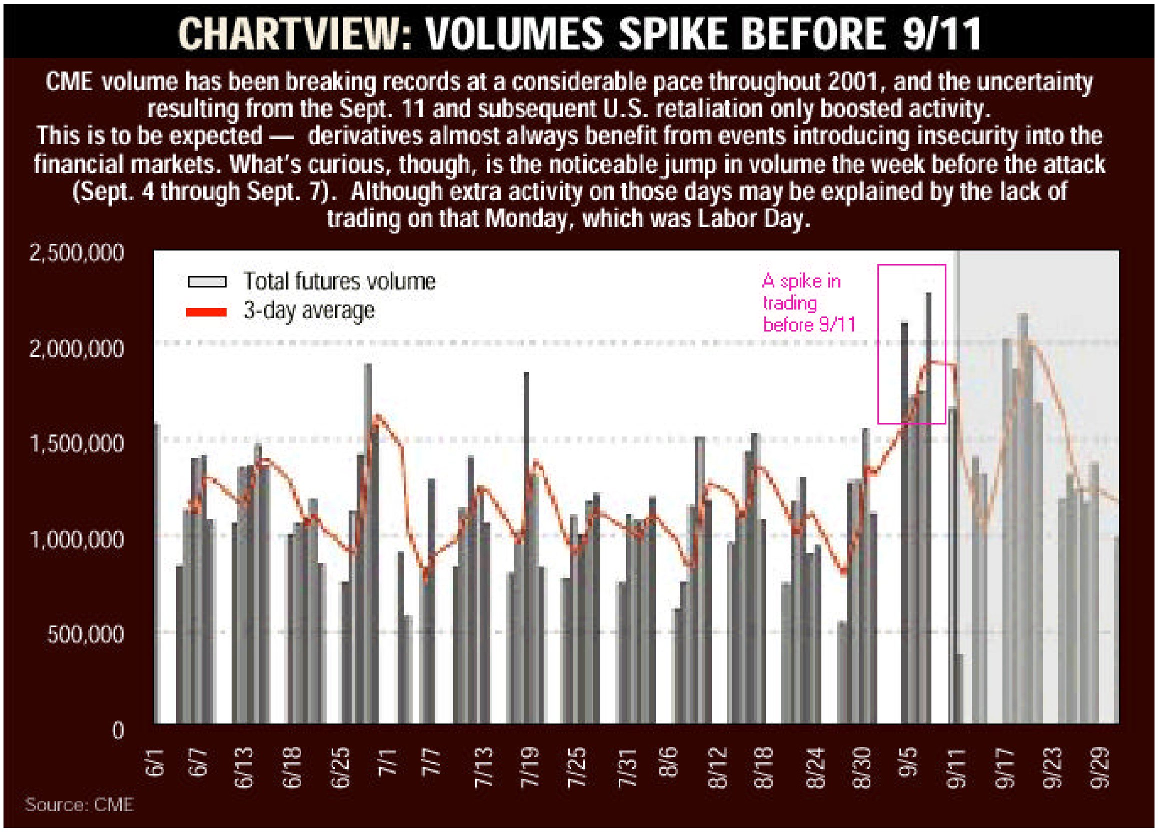
Off-balance-sheet liabilities in the form of derivatives contracts are a relatively new financial mechanism, the least understood and the most toxic of all financial instruments ever invented by the dubious genius of Wall Street. Derivative trading, whereby major banks securitize packages of debt in to interest rate contracts (or other types of securities) worth trillions of dollars, really took off around the mid-1980's. This type of mega-trading is considered too important for government oversight and so is left unregulated. This to me is absolute proof of the power of the banks and the puppet-like status of politicians. The policing of this trading system is left to the participants – primarily the major banks and corporations of the world. How convenient.

Ironically although the system is unregulated by the US Government, and therefore "we the people" – it is we the people who will be taxed in order to pay for any mistakes these bankers of dubious genius actually make. The most horrific scandals in our financial history have been brought about by derivatives traders who got it all wrong, usually to the tune of billions of dollars, and occasionally trillions of dollars.

Some recent notable examples of derivative debacles include Orange County ($1 billion), Barings Bank ($1.5 Billion), Metallgesellshaft ($1.5 Billion), Long Term Capital Management (which carried contracts with a notional value of $1.3 TRILLION) and Enron ($3+ billion). What has been learned by the public through the course of these rolling financial catastrophes is that derivatives are inherently unstable, and require some of the world's most sophisticated financiers to be bailed out by the likes of the New York Federal Reserve, the US Treasury and the largest banks of the nation. Several times the global financial system has been close to collapse based on the instability of these investment vehicles – luckily the folks that schemed this stuff up were able in the past to stop a global financial meltdown and return the markets to stability, but we've been very close as recently as 1998 to a complete financial collapse.

Ironically the men most responsible for these massive meltdowns rarely are punished, in fact in the case of Long Term Capital Management the company's founders actually were paid handsomely for their help during the bail-out of the company, and then went on to become economists at the nations elite universities, presumably so they can teach future generations how to avoid causing global financial meltdowns?

"Derivatives are part of the vital machinery of the bank. We have put it at the heart of the business," said Saman Majd, Global Head of OTC Derivatives at Deutsche Bank, recently. No doubt this is the case. But if derivatives now play such a vital role in world banking then isn't it time we the people had a little more say-so in how they are managed, how much leverage a bank can take on (JP Morgan Chase has currently leveraged its equity over 750 to 1!! This is unheard of in the past, no bank of the importance and position of a JP Morgan Chase should be allowed such leverage, after all they are FDIC insured, if they fail…….you got it…….. we the people pay).



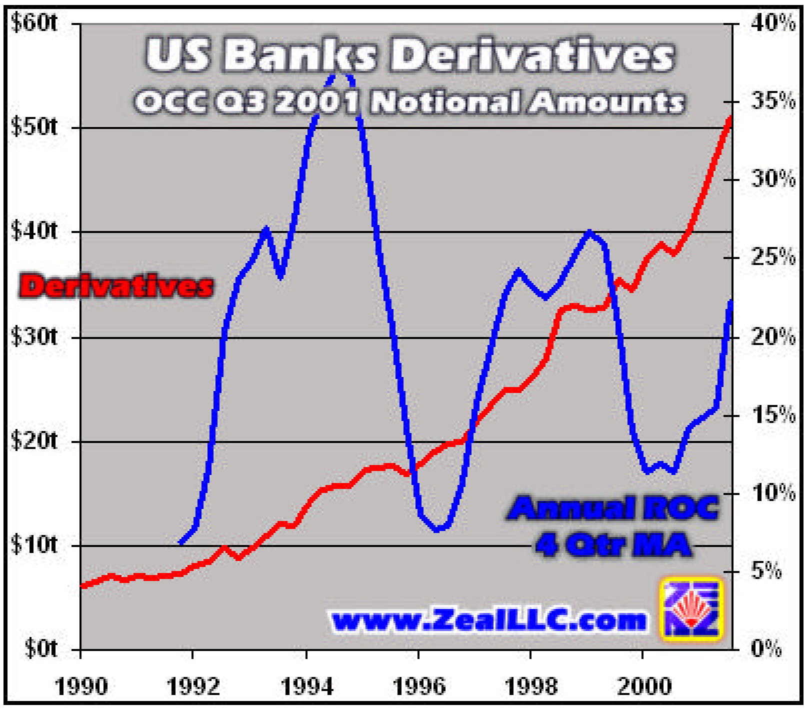
When you realize what has been mentioned above is but a small percentage of the overall liability we face within our financial system, and that J P Morgan Chase Bank has derivative contracts with a notional value in the range of $30 TRILLION all to itself (see www.FDIC.org for the latest numbers), then you begin to wonder just how the financial system is going to perform through the perpetual War Against Terrorism we have been led in to. Adam Hamilton has noted: "How will the massive inverted derivatives pyramids fare in brutal and unforgiving bear market environments? Only time will tell."

No one knows how these new financial vehicles will weather a major bear market. Derivatives have really only been traded since the beginnings of the bull market which began in 1982. We are at the beginnings of potentially one of the longest and ugliest bear markets of our lifetimes, and possibly of all time – just how derivatives will fair?

Derivative trading data is very difficult to come-by as derivative trading is unregulated. Therefore I have reproduced here (above) a chart from the Chicago Mercantile Exchange (CME) - the big granddaddy of derivatives trading, and where it all originated. There is a curious note on this chart which questions why there should be a major spike in trading in the week before 9/11. Apparently derivatives thrive on uncertainty, which makes it almost appear as if some of the major derivatives traders may have had some forewarning of the impending catastrophe that was 9/11. Whether the same people who shorted United Airlines stock prior to 9/11 were connected to these derivatives trades we may never know, as the government in its infinite wisdom has declined to pursue these potentially critical pieces of evidence of terrorist activity. I guess the fact that some of the world's most respected companies performed the trades is something too poignant to discuss?

Given the very dirty history of certain New York banks, with the financing and support of Nazi Germany prior to and during WW II, and their hands in almost all of the recent financial scandals – from Enron to Kmart to Argentina – the very close association with Big Oil (coupled with the trillions in derivative contracts) I think it may be time to investigate the nature of this spike and who placed what trades with whom, etc.

Some of the best commentary and analysis available on the "Derivatives Monster" comes from Adam Hamilton. Below you can see the phenomenal growth of derivatives from approximately $7 TRILLION in 1990 to over $51 TRILLION in 2001 with just the major US Banks (of which JP Morgan Chase is by far the largest holder with nearly 60% of the total – an amount too staggering to even imagine).



Adam explains, "The red line below is the US banks' total notional derivatives exposure on a quarterly basis. The blue line is the four-quarter moving average of the annual absolute rate of growth in the total US banks' derivatives holdings. For example, to get the Q4 2000 data point the Q4 1999 total notional amount is subtracted from Q4 2000's, and the difference is divided by Q4 1999 to determine the absolute year-over-year growth rate for each quarter. The four-quarter moving average of this quotient is the blue line shown below, representing the annual growth rate in banks' derivatives exposure. The US banks' derivatives holdings literally exploded in the 1990s, up over 721% from Q1 1990 to Q3 2001 to the current unbelievable $51 trillion with a "t".

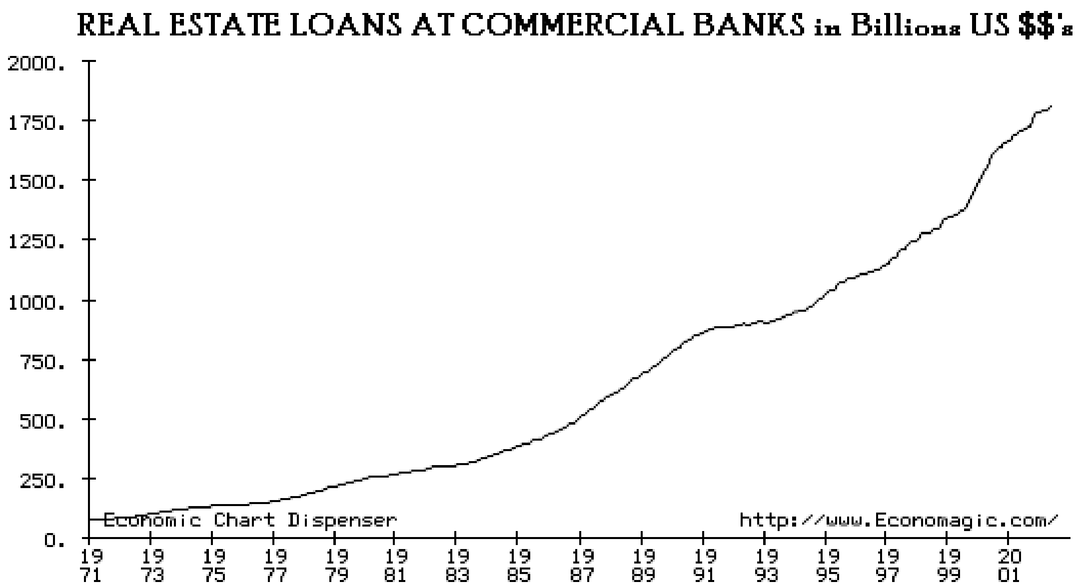
The bottom line appears to be that unregulated derivatives trading is in massive growth mode, way beyond what industrial production and gross domestic product would indicate should be the case. It appears that the derivatives marketplace is a phantom, barely visible to the masses, understood only by Wall Street and with no oversight – but with the ability to bring us all to our knees. This defines the term "rogue," we'll be very lucky if this situation doesn't bring us to our knees in the very near future.

"I can measure the motions of bodies, but cannot measure human folly."
— Sir Isaac Newton, who lost a fortune in the South Sea Bubble of 1720

The Real Estate Bubble and Rising Bankruptcies!

Clearly we are now witnessing gravity at work (pun intended, Ed), and what will likely be the end of the current real estate bubble. Interest rates for home loans are at 40-year lows, prices have risen over the past 30 years. The real estate bubble is now arguably the only major financial mechanism for continuing to drive the US economy spluttering forward. Rental occupancies have fallen dramatically as low-income families race to buy their first home while rates remain so low. Fannie Mae and Freddie Mac have recorded their best years ever in 2001 and the first half of 2002. Clearly the low interest rates are driving more people in to home ownership, driving prices higher and providing some much needed confidence to consumers that their net worth is actually growing, but its an illusion!

This home equity-fueled "confidence" in turn is driving homeowners to take out second mortgages in record numbers. These home equity loans are being used to service existing debt, and fuel consumer spending. As of June though, the spending binge is starting to falter as household debt reaches new highs, unemployment remains high and financial scandals rock the equity markets.

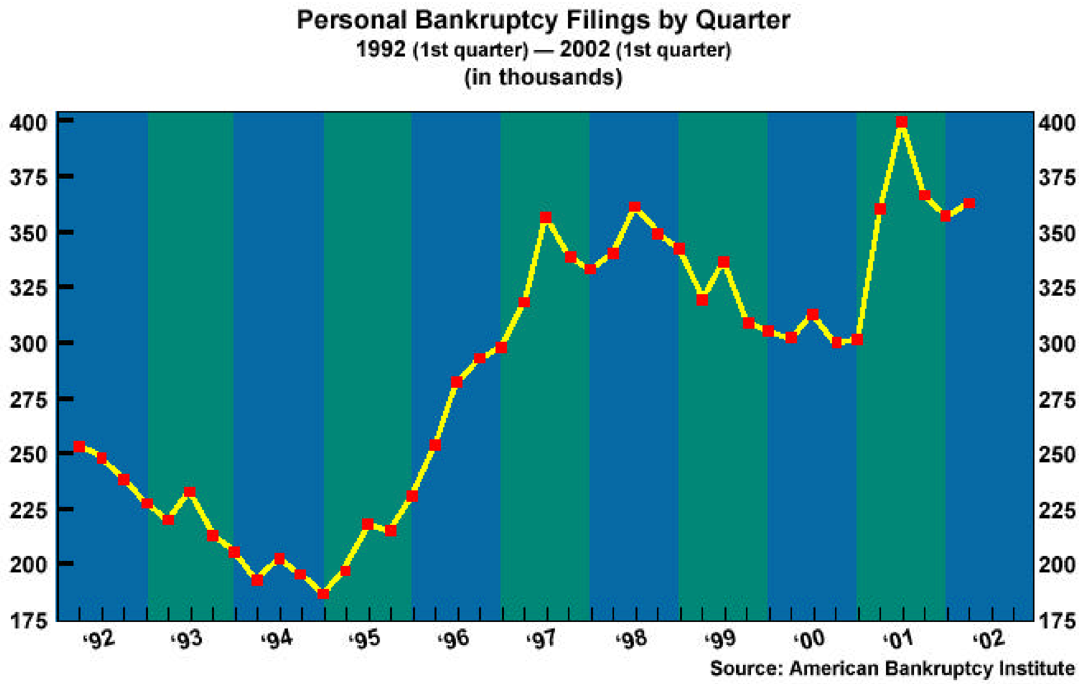


"Housing prices in 14 major markets throughout the country are out of whack in relation to household incomes and mortgage payments," according to industry consultant John Burns, in an article, published in www.realtytimes.com on July 10th 2002. Apparently 20 of the 44 markets surveyed were already overvalued. "In the near term, this leverage is boosting real estate, but on the other hand, it sets up the sector for a possibly painful correction," says Martin Weiss of the Weiss Ratings, Inc.

The simple fact of the matter for me is that people with lower income levels are now able to jump on the home ownership bandwagon for the first time by putting zero down on a house, taking out an adjustable rate mortgage and making low payments in at least the short term based on historically low interest rates. But when interest rates rise this sector of the market will be hit the hardest, as they are already *reaching* beyond their means to get on the first rung of the housing ladder in the first place.

Additionally, when interest rates do start to rise, and house prices start to stagnate and then go lower, with the stock market already in full retreat, most people will enter in to a form of paralysis. All wealth creation vehicles will be broken down on the economic highway for the first time in nearly 20 years. John Kenneth Galbraith has said that is takes approximately 20 years for the collective sub-conscious to completely forget the last downturn, so we will be right on track to be horribly surprised by the speed, depth and painfulness of the coming crash.

Of course when you have record amounts of debt, sooner or later you get record amounts of loan defaults followed closely by rising bankruptcies. Personal and Corporate Bankruptcies in 2002 are heading "for a second straight record year," reports Bloomberg most recently.



Over 250 companies, with $250 billion in assets, were put in to bankruptcy in 2001, beating a 10 year-old record by over 200%. Over 100 publicly traded companies have filed so far this year, representing nearly $50 billion in assets, which does not include WorldCom's over $100 billion of assets currently in bankruptcy custody. The potential for an acceleration in the rate of corporate bankruptcies going forward is all too likely, especially now companies are being scrutinized by the very politicians and government watchdog's that not so long ago were turning a blind eye to their every shenanigan!

Here's a little ditty off the Tele from when I was a kid in England, this was meant as a public safety message and was accompanied by a cartoon. I guess it can be viewed that way today! I wish I could remember the entire rhyme – I think it's a classic!

> *"Sir Isaac Newton told us why an apple falls down from the sky,*
> *And to this day it's very plain all other objects do the same,*
> *A bolt, a bar, a brick, a cup invariably fall down not up."*

"We're living in a North Sea Bubble
We're trying to spend our way out of trouble
You keep buying these things but you don't need them
But as long as you're comfortable it feels like freedom
My American friends don't know what to do
But they'll wait a long time for a Beverly Hills coup
War! What is it good for?
It's good for business"

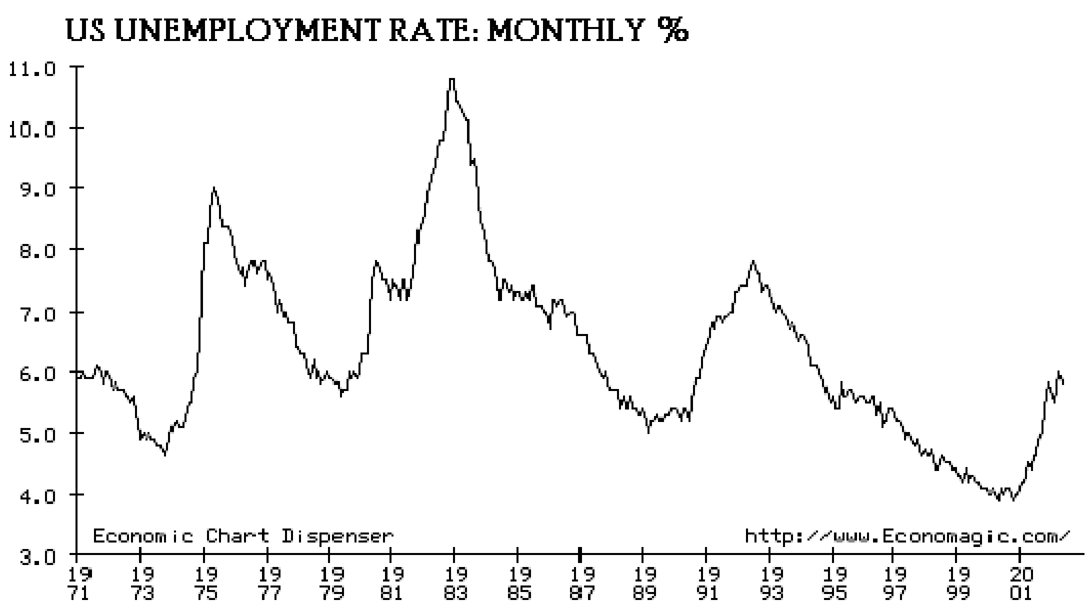
— Billy Bragg (British musician)

Unemployment

Of course the unemployment rate pretty much moves inverse to the major markets, at the troughs in the major markets you typically see spikes in the unemployment data. It is these types of correlations that consistently and logically repeat themselves decade after decade that make the kind of financial analysis I am presenting here kind of hard to refute! But that's just my opinion!

Without a doubt we have lived through a glorious period of very high employment, and for that we should all be thankful. Growing up around the high unemployment rates in England during the 60's and 70's was quite painful, nothing strips meaning from life more than the inability to find meaningful employment.

As is evidenced by the chart below we are now climbing an unemployment spike that is alarming to most of us. Clearly we are not in record-setting territory yet, and lets hope for all our sakes we don't get there, however the indicators are not good unfortunately.



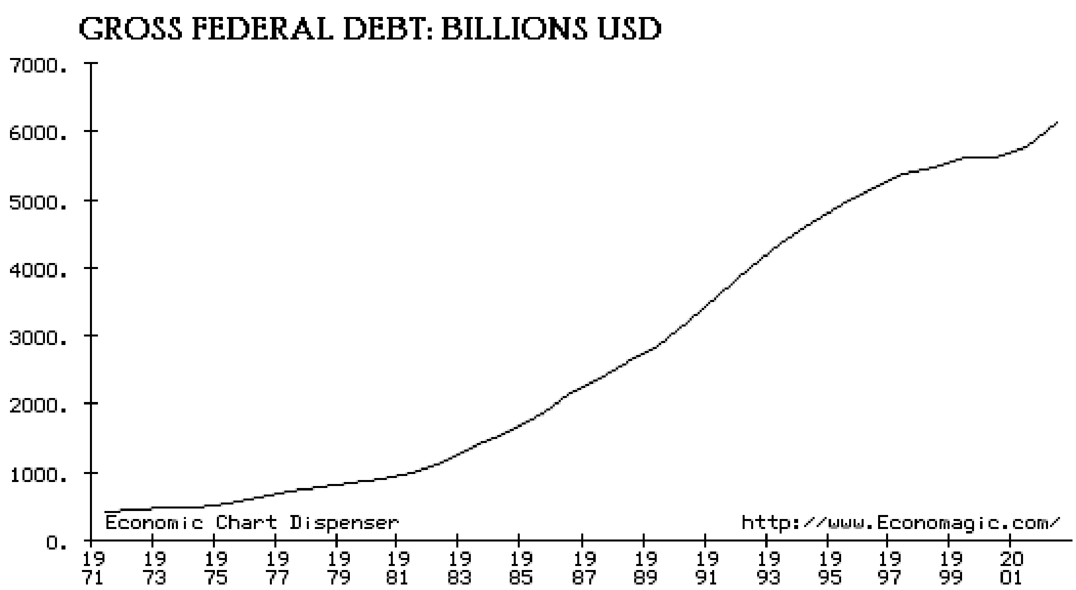
“Capitalism without failure is like religion without sin. Bankruptcies and losses concentrate the mind on prudent behavior.”

— Allan H. Meltzer

Total US Federal Government Debt

Federal Debt has risen nearly 700% since 1971 while industrial production has risen a more serene 150%. Clearly more disposable income is needed annually by the government in order to come close to balancing its budget. It’s either “tax the people” directly or print money in order to pay for goods and services “needed” by the government (an *invisible* tax on us). This inflationary monetary tactic, of printing more money to cover inept government fiscal management, is the biggest hidden tax still little understood by the people. When the US population eventually wakes up to the simplicity of the frauds perpetrator against them by a handful of elected officials they will undoubtedly want to exact some revenge. I believe during the French Revolution, and at other periods in human history, usury bankers and their flunky government bagmen have been publicly executed! Lets hope for the current crowd that the masses, when they figure out that they have been so easily manipulated, do not chose such a course of action!!

Michael Hodges on his very easy to understand website plots government debt way back in to the 1800’s. He see’s the debt “soaring 10 times faster than the economy’s growth since 1913” – I think the reference to 1913 has something to do with the creation of the Federal Reserve that year (hehe! Ed), an institution owned by private banks which controls the setting of interest rates and the flow of credit. It appears that the more the government spends the richer the Federal Reserve banks get, the higher our tax burden becomes, the poorer the poor get and the more unstable the world becomes in general.



Federal Debt fuels the “virtuous loop” between Federal Reserve banks and the politicians and government employees. For anyone who dips in to government funds to make a living there is an inherent conflict of interest in exposing this little understood area of our nations financial life. The Fed encourages the government to overspend, which requires the creation of more debt, as government is spending 10 times faster now than the nation is producing. The Federal Reserve banks themselves own nearly $500 billion of government debt, which of course is interest bearing – so the people managing the store are also the stores main customers! There is something inherently mal-adjusted about this arrangement.

Of course the people who are in place to regulate this incestuous and unnatural relationship are themselves paid from the nations coffers, so as long as their income and benefits are rising commensurate with the amount of money being printed and debt being consumed then they are satisfied. Fundamentally the Federal Reserve Act of 1913 is unconstitutional and represents the largest fraud in the financial history of the world. When you consider that the world is now running itself on a fiat based currency system with the US dollar as the core symbol of value – then you can begin to grasp the absolutely awesome power of the Federal Reserve and their current Chairman Alan Greenspan – but of course Alan has his masters too, its not like he dreams these schemes up all by himself.

All of the nations on earth are forced to accept the US governments promise that the US dollar will continue to be valued at or near its current level. If you were a foreign entity looking at the current machinations of the US markets, the frauds, scandals, lies and cheating, and yet were forced to accept a “promise” that the US dollar would continue to be worthy of its pre-eminent status as the worlds “store of value” would you continue to invest in the US equities market, continue to hold US dollars, and to believe in the ability of this government to keep its promise? This is the situation we now face in America.

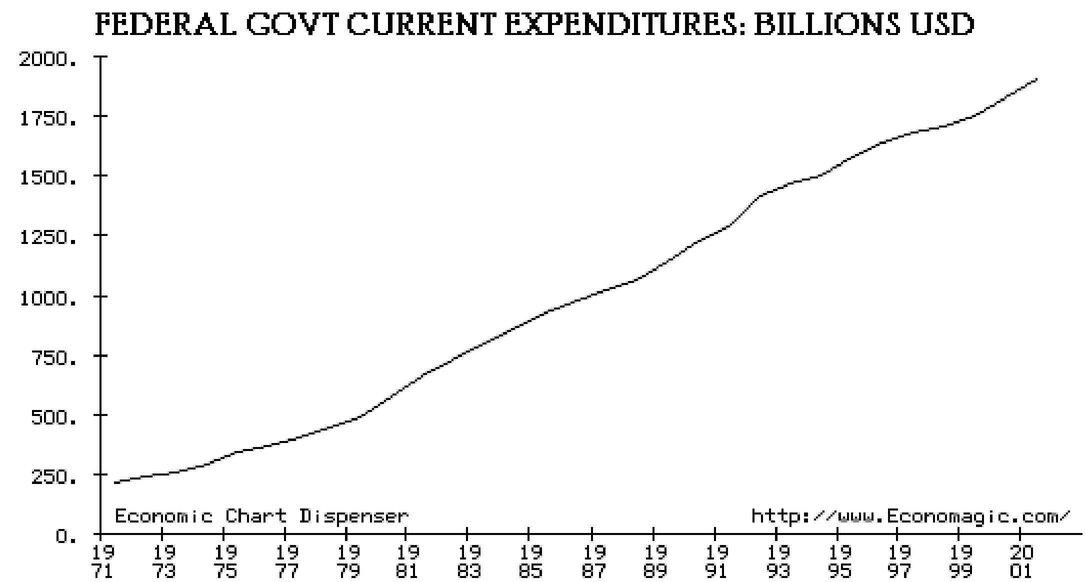
To make matters worse we need to attract $1.3 billion+ of foreign cash in to the United States *everyday* in order to stay solvent. We are dependent on foreign investment to sustain our current lifestyle, and that level of foreign investment is predicated on the confidence that the US government will keep its promises, and that the US will continue to be “investable.” Unfortunately we are finding out, around about now, that foreigner’s confidence in us has dropped dramatically; we are attracting only a few hundred million dollars a day at this point. Pushing us closer to the edge of capitulation of the markets and the entire financial system.

"You have a choice between trusting to the natural stability of gold and the honesty and intelligence of the members of government. And, with all due respect for these gentlemen, I advise you, as long as the capitalist system lasts, vote for gold."

— George Bernard Shaw

Federal Government Expenditures

Federal government expenditures continue to rise unabated; in fact *any* sign of recovery in the US economy is mostly a function of hugely increased government spending on the War Against Terrorism (aptly shortened to WAT?). Without the massive infusion of freshly printed US dollars in to the US economy the recession would be seen to be that much deeper. The false economy of government spending is forcing the ultimate rehabilitation of the economy that much further out – and therefore to be that much more painful later. Clearly there is no political will left that could begin a program of economic rehabilitation in an honest and orderly fashion.

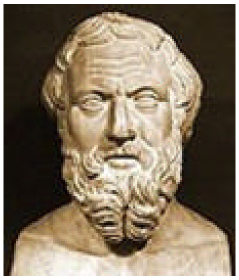


Needless to say the rise of government expenditures far outpaces the rise in GDP or Industrial Production. The inevitable conclusion to such a predicament is one day waking up inside a political system that is more analogous to Communism! We already have a centrally controlled economy; if you can call what the Fed is doing "controlled." Maybe I should re-phrase that and call it a centrally uncontrollable economy? Clearly our financial masters believe they can control this runaway locomotive, after all they've been pulling the strings since 1913 and the Federal Reserve Act.

However, in my humble opinion, their ability to get their arms around this mess is minimal. Chaos in the Universe has a way of leveling the best-laid plans of rats and men! The Lord moves in a mysterious way, and it isn't towards the corporatization of the world.

Globalization is essential to all of our futures – and I believe it is the natural evolutionary path of humankind (we have evolved from the family unit, to the tribal unit, then to the city state, then the nation state and now we need to evolve in to a World Commonwealth of Nations). But this should not happen with corporate interests being the only driver, there are human reasons way beyond materialism and profit that should be in first place here. For one, the people need to be in first place, not corporations. Then, the environment needs to be way ahead of business interests. “Unity in Diversity” (protecting the unique cultures and individual forms of governance in the unique countries, needs to be a priority), universal education, the creation of a universal language so we can all communicate more easily, the emancipation of women globally, the elimination of extremes of poverty (and of incredible wealth) – these are all the things our leaders should be driving our nations towards. But instead we have the WTO, NAFTA and GATT.

The secular agenda has run its course for nearly 100 years now and is failing badly.



"Of all men's miseries the bitterest is this:
to know so much and to have control over nothing."
— Herodotus

Federal Government Surplus or Deficit

In the not too distant past the country was trending in the right direction in terms of the Federal Government surplus (even as the total amount of government debt was rising quickly and the politicians were stealing from Social Security, etc.), but as this chart shows in a few short years spending and income have caused a massive reversal in fortunes. By the end of 2002 we will be firmly in to Deficit territory again.

Today we are told by the Fed that the government expects to run a surplus over the next ten years of nearly $1 Trillion, revised down from $5 Trillion in the last couple of weeks. That's a serious revision indeed, and is it believable? You decide. Herodotus was so right about the miseries we have to endure today, to know what is happening, to understand the manipulations but to have no control or even influence over the outcome is perfect misery to some of us.

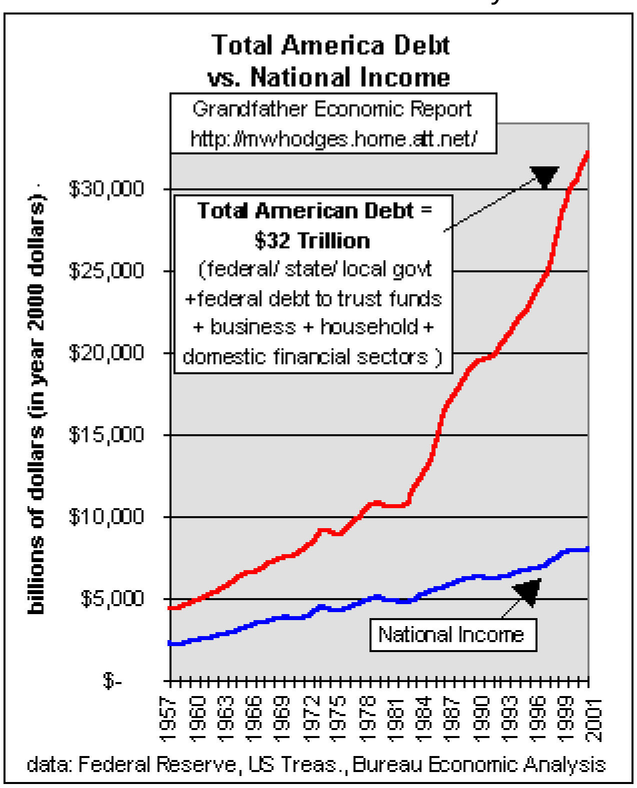
"It rests with men whether they will make the proper use of the rich treasure with which this knowledge provides them or whether they will leave it unused. But if they fail to take the best advantage of it and disregard its teachings and warnings, they will not only annul economics; they will stamp out society and the human race."

— [Ludwig von Mises]

Total Debt Summary

One of my favorite graphs put together by Michael Hodges and his "Grandfather Economic Report" is the one below where he depicts Total American Debt, including household, corporate and government, over the growth of our National Income. As has been stated several times above, debt has grown at a far greater rate than income. When this happens to you or I we go broke pretty darn quick! But thanks to the "perpetual motion money machine" controlled by the High Priests of the privately run Federal Reserve, we as a nation are able to spend with impunity – but there are limits.

What we have all been experiencing in the past 2-3 years is the testing of those limits to the expansion of the paper money machine. Clearly we are beginning to see the end of the current system. What is such a travesty is that so few people are educated that this is really the case. Monetary systems, fiat currency limitations, fractional reserve banking, usury lending practices, Federal Reserve ownership, etc. are not things taught in High School, and rarely taught in post-graduate courses either. Keeping the American public naïve as to how these institutions and systems work I believe is fundamental to their longevity – and to the continuation of the current elite establishment.



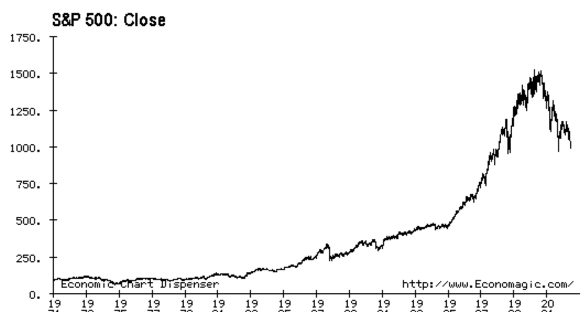
From where I sit, we would all be better off if we were functioning inside of a responsible, honestly governed, sustainable financial system which was not predicated on usury banking for its medium term survival. I guess the outcome to the messe we are now in will to some extent dictate whether "we the people" are going to break the backs of the monetary monopoly we are only just beginning to understand?

The bottom line on this chart is that we have reached the point where we can no longer afford any more debt to fund our lifestyles; we will not be able to pay the interest, let alone the principle! This truly is the "Limit to Growth."

"The rumors are untrue and irresponsible." (7/16/02 Reuters)
— A spokesman for J.P. Morgan said in New York referring to the bank being unstable and likely to tip over soon.

JP Morgan Chase Stock Price Compared to the S&P 500 and the DOW, since 1971, of course!

What is so interesting about the price of JP Morgan Chase stock is its correlation to the S&P 500 and the DOW, the movements of the indexes are so close to those of the bank – its almost as if they are somehow mysteriously connected? Of course there are some variances, but they appear minor to me in the grand scheme of things.



When you consider that JP Morgan Chase has consistently been implicated over the past few years in many of the major financial scandals (LTCM, Enron, Kmart, Argentina) and is the largest shareholder in the New York Fed, then it is worth trying to understand this correlation.

JP Morgan Chase needs to be singled out for special consideration because it is so vital to the US economy and many of the Fortune 100 companies who bank with it. The extraordinary leverage, 750 to 1, of its derivative contract value to equity base (derivative contracts for the bank are approximately $30 TRILLION and equity is currently $40 BILLION) is unheard of in financial history, and to the objective outsider appears to be a train wreck of global proportions just waiting to happen.

The political activities of the banks chief advisor over time, Henry Kissinger, and the central role in American economics and politics of the Rockefeller family – who have controlled the bank for nearly 100 hundred years, add an intriguing twist. Just what will happen over the months and years ahead as the global economy tries to unravel and make sense of itself is yet to be seen.

What is apparent to me is that the role of this bank, and its Philosopher Kings, will be critical to the overall stability, or lack thereof, going forward. One comment that has been making the rounds of late is that the bank is simply; "too big to fail and too big to bail." Where exactly that leaves us is anyone's guess then.

"…as the king by his prerogative may make money of what matter and form he pleaseth, and establish the standard of it, so may he change his money of what matter and form he pleaseth, and establish the standard of it, so may he change his money in substance and impression, and enhance or debase the value of it, or entirely decry and annul it…"

English Court Decision, 1604

Conclusion

Through the process of writing this article I have been reading four books concurrently, which is typical for me – I am rarely reading less than two books at any given time, some kind of attention deficit thing I guess. The four books I am currently almost done with are as follows:

Call to the Nations, Shoghi Effendi – a spiritual perspective on what happens next in the world, from a Baha'i viewpoint. This is a short compilation of letters and writings of Shoghi Effendi (the pre-eminent interpreter of Baha'i scriptures) from the 1930's to the 1950's and was published in 1977.
The Clash of Civilizations, Samuel P. Huntingdon – a secular viewpoint that "predicted" a clash between Christianity and Islam. This book was written back in 1995 – Kissinger and the current establishment heavily support this book.
Stupid White Men, Michael Moore – a funny attempt to tell everyone about who is running the show and what they are all about, and what can be done about it – this book has been a New York Times Bestseller for the past 13 weeks but has never been reviewed by the "serious" press, ever. It was published the week before 9/11.
Conquer the Crash, Robert Prechter – a highly professional and complete perspective on what is happening in the world of economics and what you can do about it. This book is hot off the press, the ink is still fresh.

As a group these books represent a phenomenal resource for anyone interested in the 6 billion inhabitants of this beautiful planet, and their welfare. The views contained in all of the books are very diverse, and they all approach their chosen subjects from a unique perspective in my opinion.

The bottom line for me in all of this research though, is the intuitive sense I get from all of the material that the *only* salvation we can hope for is a spiritual one. As a race of beings the human race has lost its way. Rampant secularism in the form of consumerism/materialism has run its course, and is now failing very badly. Secularism failed in the form of Communism, National Socialism and is now about to fail with Capitalism. Don't get me wrong here; I'm not anti-capitalist or anti-globalist, I believe in globalization (but of a more benign variety – I actually believe globalization is inevitable and a natural part of our evolution) and I believe in a form of capitalism (but not one that consumes relentlessly and without care).

By reducing the role of Faith and belief in God to something purely private, modern society has become lost in its own material consumption. There is nothing to rally behind now other than cultural, national and racial biases – a destructive force. Without a quick return to "In God We Trust" our society will most likely implode. I am losing faith that our society has the ability to make that adjustment by itself, without the cleansing power of God to show us the error of our collective way and point us towards the correct behavior.

I am very bullish on the overall outcome for humankind, and have a firm belief that we will learn, one way or the other, that we are indeed all One Race and completely interdependent. Whether our current institutions and leaders can peacefully move us towards a global federation of independent, but interdependent, states without a major conflagration – as the global financial system creaks and cracks – is the $150 trillion question.

In the past the money power has chosen aggression to resolve systemic financial problems, I fear that will be the case again, but hope and pray this can be mitigated for.

Regardless of whether I am correct in terms of my geo-political interpretation, I remain convinced that the current financial system is near the point of total collapse, that the US markets will capitulate within a matter of months not years and that a new monetary system will be needed – and that the one probably being planned already is another fiat-based system that will be doomed to fail before it gets off the drawing board! I am also convinced that we are destined to be managed by bankers unless and until we stand up for what is right and reduce bankers to their rightful position – being servants to the people, not the other way around.

Usury banking is the scourge of our race and needs to be extinguished once and for all. Statesmen and women need to come forward; honest, decent folk who currently wouldn't go near politics or finance for all of the opium in Afghanistan, Vietnam, Cambodia and Burma combined (or all the oil in Saudi Arabia, Iran, Russia and Iraq combined!!). The only way we will attract decent folk back to our institutions is to clean house, and quickly. But how we can do this while the house is being run by war profiteers, oil barons, banking moguls and media giants who are all in cahoots with each other is why I believe there is only a spiritual solution to this most complex human issue.

Via con Dios!

"O SON OF MAN! The true lover yearneth for tribulation even as doth the rebel for forgiveness and the sinful for mercy."

— Bahá'u'lláh, from The Hidden Words

Thanks to the following resources, I have used these online sites and commentaries variously throughout my research:

www.depression2.tv
www.bigcharts.com
www.economagic.com
www.zealllc.com
www.gold-eagle.com
www.kitco.com
www.ino.com
www.stockpoint.com
www.fallstreet.com
www.fdic.org
www.bahai-library.org/
www.lemetropolecafe.com
www.gata.org
www.dowtheoryletters.com
http://mwhodges.home.att.net/
www.dailyreckoning.com
www.comstockfunds.com
www.elliotwavetheory.com
www.thestreet.com
www.lipperweb.com
www.realtytimes.com/
www.weissratings.com/
www.ronholland.com/
www.investmentrarities.com
www.mises.org/
Bob Prechter "Conquer the Crash."
Clive Maund "The Crash of 2002."
Bob Chapman, "International Forecaster," email: bif4653@comcast.net.

"Of all the enemies to public liberty war is, perhaps, the most to be dreaded because it comprises and develops the germ of every other. War is the parent of armies; from these proceed debts and taxes. And armies, and debts, and taxes are the known instruments for bringing the many under the domination of the few. In war, too, the discretionary power of the Executive is extended. Its influence in dealing out offices, honors, and emoluments is multiplied; and all the means of seducing the minds, are added to those of subduing the force of the people. The same malignant aspect in republicanism may be traced in the inequality of fortunes, and the opportunities of fraud, growing out of a state of war...and in the degeneracy of manners and morals, engendered by both. No nation could preserve its freedom in the midst of continual warfare."

— James Madison, April 20, 1795