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In this Issue:

What's a Quadrillion?
Gold is Money and Nothing Else

Printer Friendly

What's a Quadrillion?

Better get ready for them... they're coming and they're coming fast! At the rate fiat money is being created these days, very soon Quadrillions will be taking over the Trillions. Doh! What's a 'quadrillion'?

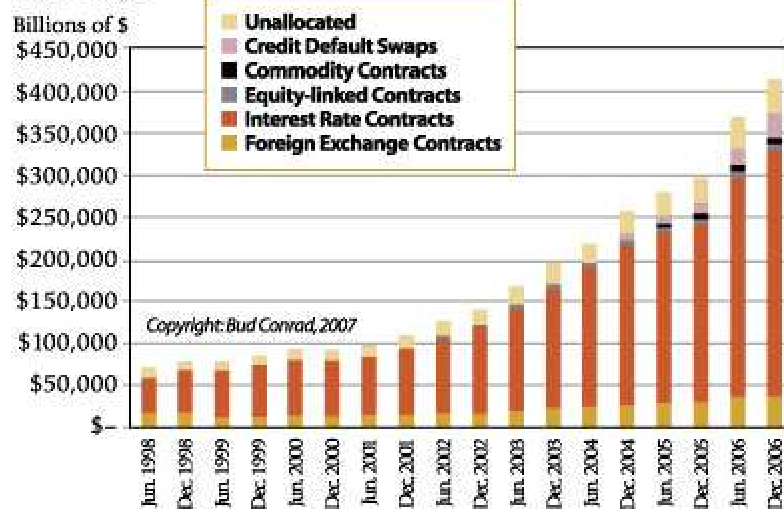
A quadrillion is a thousand trillion… or a thousand million million… or a million billion... Sounds like a lot? Well, it is. If a trillion is 1,000,000,000,000 then a quadrillion is 1,000,000,000,000,000. That's a lot of zeros... 15, to be precise. Now, zero is a lovely number. But this is getting seriously out of hand!

Welcome to the Wonderful World of Dis… eh, sorry, Money! Disney, Money: same thing really. We've been living in a world of fantasy and illusion for so long that we can't tell what's real from what's not any more. So we keep

making more of the unreal stuff so it keeps looking real and hopefully we'll all live happily for ever after…

The Dream Is Over

Take a good look at this chart and tell me honestly that you are not afraid of the trend at least.



Source: Casey Research, LLC.

In 1998, the last time the derivatives market nearly blew up; there were "only" US$80 trillion in derivatives outstanding worldwide, according to the BIS (the Swiss based central bank of central banks). That was already huge. Now (or at least as at the end of 2006, since that is the latest date at which official statistics of the huge derivatives market have been released by the BIS so far... we've probably reached past US$500 trillion by now, which is HALF A QUADRILLION), the total amount of derivatives outstanding jumped to US$415 trillion, or over FIVE times more! And just from 2005 to 2006, it surged by a whopping 39.5%, about TEN times faster than the growth in the global economy. At this rate, we'll reach ONE QUADRILLION very soon and most likely in 2008!

If the risks were spread among thousands of institutions, each with plenty of capital to back up its bets, this derivatives balloon might not be such a threat. But the US Government's Office of the Comptroller of the Currency (OCC) reports that, in the US … Just FIVE banks control 97.1% of the derivatives in the entire US banking system. Worse, among these five banks, none - not ONE - has the capital to cover its net credit risk, the primary measure the OCC uses to evaluate the risks these banks are taking in their derivatives trading. Whew! Starting to get nervous now? Stay cool!

Central Banks to the Rescue

On 9-10 August alone, central banks around the world (European Central Bank, Bank of Japan, Federal Reserve, etc) injected no less than one-third of a Trillion US dollars, or the equivalent, into the money systems of the world. In 2 days!! Their goal was to stave off a spreading panic at bond trading desks and in the capital markets of the world. Did it work? Time will tell. But I don't think so for even a second or… even a week or two.

Why? Well, for a start, isn't 'money' supposed to be scarce? It takes more than 10 years of hard work gold mining to produce the equivalent of what was created in two days… That 'stuff' which is instantly created as "extra liquidity" and injected into the system only dilutes your purchasing power ultimately. It's nothing else than another debt obligation. It's not real money.

"Gold is money and nothing else"

- J P Morgan
(1837 - 1913)
American financier; Founder of one of the oldest financial services firms in the world, now known as JP Morgan Chase, currently the 3rd largest banking institution in the US

In 1913, the Pujo Committee was blaming banking instabilities on the country's leading bankers instead of the regulation that caused it. When banker JPMorgan testified before the committee, he was asked about the role of gold in the financial system and whether it might be the source of problems. The answer was succinct (the above quote).
(Source: Gold Wars, by Ferdinand Lips, a Swiss Banker, published by The Foundation for the Advancement of Monetary Education, 2001, p25)

The Pujo Committee was a US congressional subcommittee which was formed between May 1912 and January 1913 to investigate the so-called "money trust", a small group of Wall Street bankers that exerted powerful control over the nation's finances. The committee found that a cabal of financial leaders was abusing their public trust to consolidate control over many industries. JPMorgan died shortly after.

Time Out or Bail Out?

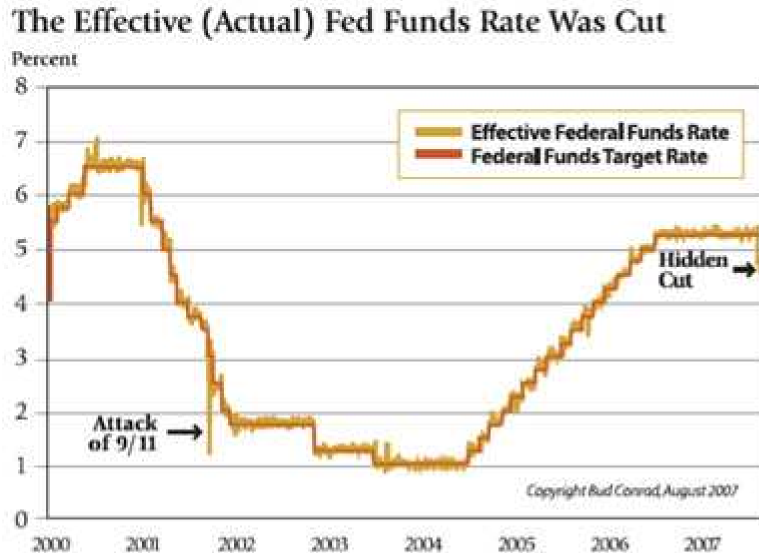
There have been so many events in financial and monetary markets that have occurred and come to my attention since I last wrote for you, dear reader, that it is extremely hard for me to know just where to begin with this issue… Most importantly, I think, is for you to realise the conflict between official pronouncements and official action coming out of the US in particular.

Remember US Secretary of Treasury Hank Paulson's confident statements that the economy was doing fine and that the sub-prime troubles were contained? These kept being repeated in the mainstream media well after the reality of a crisis was undeniable by anyone but a professional denier.

Remember Fed Chairman Ben Bernanke's refusal earlier this month to cut US interest rates and to assure bankrupt speculators of a bailout? Bernanke was still talking last week about fighting inflation, indicating no cuts in interest rates. St. Louis Fed governor William Poole said they wouldn't cut

the Fed funds rate before the next regularly scheduled meeting in September unless there was a "calamity".

Well, dear reader, that's all just talk (and deceit). The chart below shows the action. Surprise: we have already had a cut in the US Federal funds rate!



Source: Casey Research, LLC.

Here's how Bud Conrad, Chief Economist at Casey Research explains the meaning of the action already taken by what he calls 'The Paulson-Bernanke Bailout Team' as depicted in his chart above:

"The operational significance of the official target for the Fed funds rate (the number you often hear about) is that it serves as a general instruction to the trading desk at the New York Federal Reserve Bank – an instruction to buy and sell securities during the day as needed to keep the rate on actual Fed funds transactions among commercial banks close to the target rate.

The trading desk is very good at this, as you can see in the tiny fluctuations in the actual rate around the stated target. The difference is usually less than 5 basis points. But the trading desk can't control the Fed funds rate and independently choose the amount of cash it adds to the system. That's why there was such a big gap between the actual rate and the official target just after 9/11, when the Fed decided it would add a big bucket of cash regardless of the effect on interest rates.

Just before the recent big infusion of $24B and then $38B, the Fed funds rate had spiked up. Since then the actual rate has been about 4.75%. The Fed has in fact cut, it just hasn't told us – because right now there is no real target rate. The actual rate has been below 5% for 8 days so far. The commentators are debating what the Fed will do in September. It has already done it.

The cash infusion wasn't a bailout of anyone in particular, it was meant as a

bailout of the entire system. It was the next move that played favorites.

The business of the Federal Reserve's so-called "discount window" is to make secured loans to commercial banks in need of cash. The discount rate normally is set 1% higher than the Fed funds rate and hence is seen as a penalty rate that a borrower would only pay if it were in some kind of difficulty. The facility is almost never used; the August 16 balance on all outstanding discount window loans is only $264 million.

On August 19, the Fed took the unusual step of cutting the discount rate by a half percentage point. It also stretched the term of discount loans to 30 days, made it clear that time extensions would be available and told bankers not to fear the stigma of using the facility of last resort. In addition, the Fed said they would accept a wide variety of collateral for discount window loans, including the most problematic of mortgage-backed securities. This is a targeted bailout for the most damaged part of the credit system. By the August 23 report, only one week into the new policy, $2 billion had been loaned out through the discount window. This is still a tiny amount in a several-trillion-dollar collapsing credit market."

Peer Steinbrück, German Finance Minister, called top banking executives earlier this month to discuss a bailout of a domestic lender (IKB) that suffered heavy losses on sub-prime investments. According to people who took part in the conference call, Jochen Sanio, head of Germany's financial regulator, is said to have warned of the worst banking crisis since 1931, wrote the Financial Times.

Gee… things must be getting really bad, as even PIMCO's Bill Gross was asking last week none other than US President Bush to bail out US homeowners! You don't believe me? Take a look at this article: Pimco's Gross Urges Bush to Bail Out U.S. Homeowners or read this one "Where's Waldo? Where's W?" which is straight from the horse's mouth. But not everyone thinks that bailing out is the solution…

"While obeisant governments bail out dodgy plutocrats, it is ordinary people who foot the bill", was the sub line of an article on Sunday in The Observer. Here's an extract, which is pretty crude:

"One of the most inequitable and amoral acts in modern times is happening in front of our eyes and in Britain there is hardly a murmur of protest. The multi-billion dollar bail-out of global finance after one of the most reckless periods of lending and deal-making since the late 1920s is extraordinarily one-sided.

Little people's taxes are underwriting the mistakes of big people, who in the process have made riches beyond the dreams of avarice. Globalisation, it is now clear, is run in the interests of a global financial class which has Western governments in its thrall. This class does not give a fig for the interests of savers, clients or wider workforces."

You can find the full article here： Curb the greedy global financiers

Surviving the Markets

There’s an old saying that goes something like this: “If you owe a banker a little money and can’t pay, you’re in trouble. But if you owe a lot of money, he’s in trouble.” Well...that’s exactly what’s happening right now. A lot of new home owners, especially those who will have been lent upwards of 100% or even more of the appraised value of a house, are already having trouble paying their mortgages. As interest rates go up, their ranks will swell. Higher rates and more distress sales will in due course take housing prices lower which, in turn, will encourage more people to leave their keys in the mailbox and walk away.

With repossessions of US homes at a 37-year high (it was reported that last month as many as 179,599 homeowners receiving foreclosure notices) and housing starts at a 10-year low (home builders' monthly sentiment gauge fell this month to its lowest level in 16 years), political pressure is growing on the US central bank (the Fed) to take stronger action to ease the credit crunch. It is now widely expected that Ben Bernanke, the Fed chairman, will actually do just that and so move in the opposite direction to all other central bankers and lower its official interest rate.

Source: The Economist

Last week’s Economist magazine’s leading editorial concluded: *“Because this crisis taps so deeply into the newly devised structures of finance, anyone who says the worst is definitely over is either a fool or someone with a position to protect. As risk has become bewilderingly dispersed, so too has information. Nobody yet knows who will bear what losses from mortgages—because nobody can be sure what those loans are really worth. Nobody knows if tighter lending standards will oblige borrowers to raise more capital, triggering more sales in stock markets and more pain. Nobody knows how messy the inevitable bankruptcies will turn out to be. What markets need now is time to piece that information back together. Time before the next wave strikes.”*

Did you say: “Nobody knows”?! And some pundits would have us believe that this is not a financial crisis in the making? Oh, please, give me a break!

"Few people are capable of expressing with equanimity opinions which differ from that of their social environment."

- Albert Einstein

(1879 - 1955)
German-born theoretical physicist; best known for his ‘$E=mc^2$’

When Cash Is No Longer Cash...

The US Securities and Exchange Commission filed civil fraud charges on 20 August against Sentinel Management Group Inc, the cash management firm serving the US futures industry that filed for Chapter 11 bankruptcy protection late on 17 August.

In a complaint filed in US District Court in Chicago, the SEC accused Sentinel of defrauding clients by improperly commingling, misappropriating and leveraging their securities without their knowledge in violation of the Investment Advisers Act.

According to the complaint, the SEC alleged that Sentinel transferred at least US$460 million in securities from client investment accounts to Sentinel's proprietary "house" account. Sentinel also used securities from client accounts as collateral to obtain a US$321 million line of credit as well as additional leveraged financing, the SEC alleged.

The SEC also accused Sentinel of not disclosing to its clients it practices of "commingling," which involved transferring and misappropriating their assets. Sentinel failed to inform them that their investment portfolios were highly leveraged as a result of the financing activities, the SEC said.
"To the contrary, Sentinel provided its clients with daily account statements that did not reflect the improper activities," the SEC said in the complaint.

The severity of the unfolding credit crisis can be clearly seen in how the US 90-day Treasury Bills securities market behaved last week. It provides indisputable evidence of credit anxiety. Here’s Bud Conrad, Chief Economist of Casey Research, again, commenting on his chart below:

“The urgent, pervasive desire for something safe has driven the rate on 90-day T-bills down to 3%. It’s a rate that usually stays close to the Fed funds rate. But now, as nobody trusts anything except genuine U.S. Government-issued paper, the demand for T-bills has gone to an extreme, and their yield is 2% below the Fed funds rate. The difference between T-bills and Fed funds hasn’t been this wide since the 1987 meltdown. (The chart below shows the rate on T-bills times 10, so ‘50’ means 5% and ‘36’ means 3.6 %.)”

Source: Casey Research, LLC.

So if savings invested in cash management funds are no longer 'safe' (at least in the US, it seems), then what is?? Can we really believe that US Treasury securities are 'safer', when there is so much of the stuff floating around? Gee, I wonder… Hummm, let's see: bricks and mortar? I don't think so.

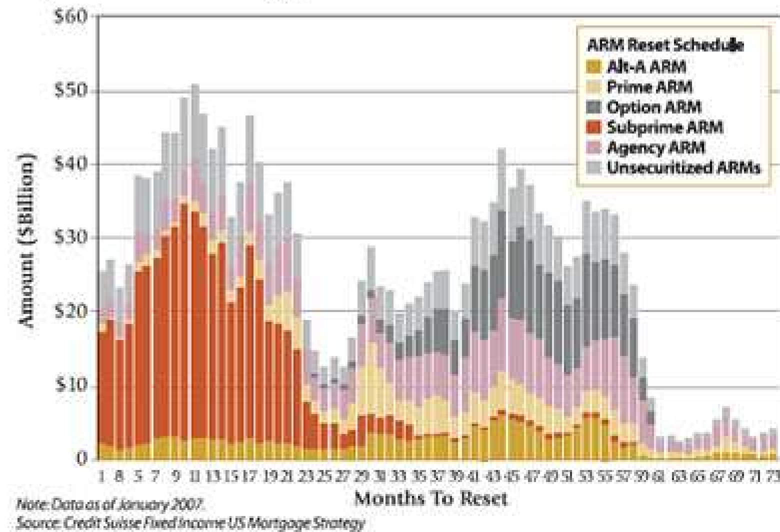
No Housing Market Rescue This Time

The question now is whether this financial nightmare relates only to the recent past or is about things to come. If what we've seen so far is an inch, is the real credit crisis a yard long? Well it sure looks like it may be a lot longer still...

Approximately US$515 billion of Adjustable Rate Mortgages (also known as ARMs, which makes these toxic concoctions sound even more like weapons of mass destruction... of wealth) are scheduled to reset in 2007, followed by approximately US$680 billion in 2008. Of these, sub-prime loans make up fully US$400 billion of those scheduled to reset in 2007 and US$500 billion of those scheduled in 2008.

Resets following a period of rising short-term rates are followed by higher monthly payments, which to a substantial but unforeseeable degree are followed by defaults. Defaults are followed by foreclosure sales. In short, the Credit Crisis may be $500B in size and will be accompanied by a commensurate amount of forced real estate selling.

Take a look at this next chart. If that does not confirm or convince you of the forecast of many more defaults yet to come in the US mortgage market, I don't know what will or can.



Source: Casey Research, LLC.

That is NOT a pretty picture for what's coming in the US housing market over the **next few years**, let alone weeks or months. Here's Bud Conrad again: "There is nothing that can pull the wooden stake out of the heart of the housing market anytime soon. The magic transformation of sub-prime mortgage loans into safe and AAA bonds and commercial paper is no longer believable. Marketplace confidence and trust in the quality, safety, and liquidity of mortgage and mortgage-related securities are shattered. You'll find the pieces sitting next to Humpty Dumpty."

Yep, that's right. The industry that shamelessly brought us 'no down payment, no income verification, adjustable rate loans' just to get as many people as possible into homes they could not afford is DEAD!

Creative Accounting to the Rescue?

I've seen some pretty silly accounting standards being introduced in my time. But this one is beyond belief. What in the world is happening to the accounting profession? If it keeps on like this, I guess we can ultimately trust the accountants to make it ever more possible for deception to prosper in financial reporting. Here's the latest to catch my attention: **Level 3 investment gains**. What's that? Well…it is pure make believe stuff, dear reader. Here's an extract of a recent article from Bloomberg:

"There's the kind of earnings investors can take to the bank. And then there's the kind the bank can show to investors. Word to Wells Fargo & Co. investors: Beware the second kind.

Last quarter Wells Fargo reported record net income of $2.28 billion, up 9 percent from a year earlier. Read the footnotes to its latest quarterly report, though, and you will see a new term in accounting lingo called "Level 3" gains. Without these, the financial-services company's earnings would have

declined.

So what are Level 3 gains? Pretty much whatever companies want them to be.

You can thank the Financial Accounting Standards Board for this. The board last September approved a new, three-level hierarchy for measuring "fair values" of assets and liabilities, under a pronouncement called FASB Statement No. 157, which Wells Fargo adopted in January.

Level 1 means the values come from quoted prices in active markets. The balance-sheet changes then pass through the income statement each quarter as gains or losses. Call this mark-to-market.

Level 2 values are measured using "observable inputs," such as recent transaction prices for similar items, where market quotes aren't available. Call this mark-to-model.

Then there's Level 3. Under Statement 157, this means fair value is measured using "unobservable inputs." While companies can't actually see the changes in the fair values of their assets and liabilities, they're allowed to book them through earnings anyway, based on their own subjective assumptions. Call this mark-to-make-believe.

"If you see a big chunk of earnings coming from revaluations involving Level 3 inputs, your antennae should go up," says Jack Ciesielski, publisher of the Analyst's Accounting Observer research service in Baltimore. "It's akin to voodoo."

That is voodoo finance! That's what it is, pure and simple. Abracadabra! For the full article, go here: Wells Fargo Gorges on Mark-to-Make-Believe Gains Boy oh boy, a few issues ago, I wrote about the 'mark-to-model' financial engineering invention called CDOs and now it looks like we'll have to investigate a bit more closely this 'mark-to-make-believe' accounting engineering.

The only rescue possible now rests with you. It's during times like these, dear reader, that you need to bring yourself into the moment wherever you are, take a good hard look at the facts, keep a cool head, gather your courage and take any corrective action necessary to protect your financial situation. The earlier you face the truth; the better off you'll be financially. And then there's even a chance you and your loved ones might prosper!

Mobs, Messiahs and Markets

The next book from Bill Bonner, the founder and creator of Agora Financial, is coming out soon: *Mobs, Messiahs and Markets*. It has not even been released yet (the official release date isn't until 31 August) but already it's at No. 1 on the Amazon business best-sellers list… Hummm...

I ordered my own copy last month (not through Amazon, but another web source and better place in my view - maybe because it's Canadian - Chapters Indigo or www.chapters.indigo.ca which I now use), so I really

can't wait to get it! What's all the fuss about? Well for a start none other than Dr Marc Faber is quoted as saying:" *If I had to name just one book investors should read; this is the one I would select…"* Some have even suggested that this is the book that George Orwell would write if he were alive today!

Now, I haven't read it yet, so can't say if I agree or not... yet. But if it's even just as good as his previous book *Empire of Debt*, which is one of the key books to have started to open my eyes a few years ago about the coming financial and monetary crisis (which now seems to have begun), then I expect it'll rank up there with Jim Rogers's and Marc Faber's books in my library. If you wish to find out more about this book, you'll find it here: Mobs, Messiahs and Markets

"We are apt to shut our eyes against a painful truth and listen to the song of that siren, till she transforms us into beasts... I am willing to know the whole truth; to know the worst, and to provide for it."

- Patrick Henry
(1736 - 1799)
1st & 6th Governor of Virginia; a prominent figure in the American Revolution; known and remembered primarily for his "Give me liberty or give me death" speech.

So am I. Are you?

Please note that all past issues of Prosper! are available Here for your convenience.

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Gold Is Money and Nothing Else

In the remaining space for this issue, I want to come back to the main thesis behind these letters, which is that gold is money, even today. After all, the man who dominated banking and corporate finance during his time and continues to be a legend among his peers, himself, said it in 1913: JP Morgan!

Gold Wars

Studious readers will recall that I wrote this in the very first issue of ***Prosper!***

"According to Ferdinand Lips, a respected Swiss banker who authored a book entitled Gold Wars and who passed away in September last year, all of the bad things happening in the world today can be traced back to two specific events: the establishment of the Fed (1913) and the abandonment of the Gold Standard (1914). These have given rise to the most troubling issues of the 20th century and now of the 21st century, including political dilemmas, wars, monetary crises, economic emergencies, widespread poverty, and racism, the Holocaust, mass migration and terrorism. All of these things, he argued, are overwhelmingly attributable to the above two

developments of the early 20th century."

Issue 1, 15 September 2006.

Well, the book *Gold Wars* - the Battle against Sound Money as Seen from a Swiss Perspective is not easy to find. But it is available at Chapters Indigo (which is where I got my copy) and I am reading it now. I have to say that it is an amazing book and should be read by anyone who wishes to understand the genesis of the unfolding debacle in the financial markets. Prof. Dr T Abt of the Federal Institute of Technology in Zurich, Switzerland, has this to say about the book: *"It is the great merit of this provocative book by Ferdinand Lips to bring back a wider understanding of why gold was a solid base for economic stability in many societies"*.

Here are a few extracts from the book, to give you some sense of how much Mr Lips makes the history of gold as money come alive and so, how much 'unlearning' and 'undoing' we need to be prepared to undertake ourselves if we are to ever again enjoy economic freedom.

1. Opening paragraph, page 1:

"To understand today's monetary situation, it is important to understand what has been going on in the gold markets since the collapse of Bretton Woods in 1971, or, even better, what happened since the end of the gold standard of the nineteenth century. Bretton Woods, actually, was not a gold standard but a 'gold exchange' or 'dollar exchange' standard. It was, as Wilhelm Roepke called it, a denatured gold standard, and, as such, a dangerous surrogate whose implications plunged the world economy into precarious inflationary, and subsequently deflationary, crises twice during this century [Note: he wrote this in 1999]. The consequence of the first version of the gold exchange standard, as a result of the conference of Genoa in 1922, was even worse. It helped produce not only the Florida real estate crisis of 1925, but also the stock market boom of the twenties and the subsequent crash of 1929, which was followed by the depression of the thirties and, eventually, World War II."

2. On the end of 19th century gold standard, page 20:

"In 1914, at the beginning of World War I, the gold standard was thrown overboard within a few weekends. In order to finance wars, the world resorted to deficit financing and paper money. Had the gold standard not been given up, the war would not have lasted more than a few months. Instead, it lasted four years and ruined most of the major economies in the world and left millions dead in its wake.

After the end of the gold standard, sound monetary policy was a thing of the past. The duration and the extent of the War forced the nations involved to neglect all monetary discipline using the war efforts as an excuse.

Based on 50 years of experience and study of the markets and the history of money, it is my conviction that the abandonment of the gold standard of the nineteenth century is the greatest tragedy of all time. It is an event that has led the world into almost 100 years of monetary no-man's land and could ultimately lead into total loss of freedom for mankind. Since then, most

economists have blinders over their eyes, but whoever takes the time and work to study the decisive events in history will find that gold is the decisive fulcrum of the world economy and world destiny. The monetary standard is closely linked to the moral standard and, as such, determines the fate of humanity."

3. On central banks, page 126:

"One purpose of this book is to inform and to draw attention to a number of significant changes and developments in central bank activities and their influence on the gold markets and the world economy. The theoretical role of an independent central bank is to protect the integrity of the currency of its country. At least that is what the public is told. The true role of central banks, especially the Federal Reserve, is to liquefy bank balance sheets when they become impaired. They are the so-called 'lenders of last resort' - a bailout facility. Time and again, fiat currencies have collapsed all over the world. The examples of Russia, Mexico, Indonesia, Thailand, South Korea, Turkey and elsewhere have proven that sufficiently, yet the central banks continue."

Mr Lips was not an economist, but a Swiss banker. His book is much more than a chronicle of gold wars. It is also an account of the historic failure of paper or fiat money. What is a 'gold war'? It is an attempt by the government upon the constitutional rights of the individual. Why do governments resort to gold wars? Here's Antal E. Fekete's answer to that question: *"Sometimes they want to wage shooting wars without raising taxes; at other times they want to indulge in 'social engineering' through the redistribution of income. But in every instance there is one common thread: governments have correctly identified gold as the only antidote against their effort to build the Tower of Babel of irredeemable debt."*

Think about it. Your window of opportunity to buy gold and silver at a most reasonable price will not last forever. It could even come to an end quite abruptly. Who knows what tomorrow will bring? The only time to act is now.

Here's another picture worth a thousand words...

Source: The Privateer, www.the-privateer.com

That, right there, is this millennium so far... So, what do you think is more valuable: gold or dollars? You be the judge. But here's some more food for thought on the monetary inflation going on, from an anonymous but not clueless source:

"You will never hear the Fed declare we are in the midst of hyperinflation, a depression, or a derivatives wipeout. Alan Greenspan's remark of his inability to spot a bubble until after the fact was a tacit admission that you will go broke listening to Fed mumbo-jumbo. What the Fed knows so well about containing inflation expectations is it produces a slow ride to economic hell. I wonder if one day the Fed might inject 10 trillion dollars in a single day. Pundits and analysts will still claim the Fed is vigilant on inflation. And bananas will be $5 a pound, and a 4 year state college degree will cost $400,000, and core inflation will remain tame.

The heavyweights in the financial arena have yet to check in on their derivatives status. They must be so shocked at the losses that they've gone into total paralysis. A 10 trillion injection is not out of the question. We just saw 1/3 of a trillion in a blink of the eye. Let's see, if there's one quadrillion dollars of derivatives out there then 10 trillion is just 4% of the total. Better make that 20 trillion... ah hell, let's budget 100 trillion. Predicting a future gold price is impossible with such huge paper liquidity hitting the system. At last week's CB injections $20,000 an ounce could be cheap.

Gold will always be loathed by central bankers. Gold's freedom will come at a terrible cost to them."

A member of www.LeMetropoleCafe.com

The last word in this Issue goes to two wise men. The first lived a long time ago, but remains well known even today for what he said then. The second is less well known today, but may be better know in the future at some stage for what he is now saying.

"In effect, there is nothing inherently wrong with fiat money, provided we get perfect authority and godlike intelligence for kings."

- Aristotle
(384 BC - 322 BC)
One of the most influential of the ancient Greek philosophers; teacher of Alexander the Great

"Ownership of gold is not about lust: it is about liberty of the individual. The gold standard is not a 'game': it is the embodiment of the timeless principle "pacta sunt servanda" (promises are made to be kept)."

- Professor Antal E. Fekete
Born and educated in Hungary, he immigrated to Canada in 1956. In addition to teaching in Canada, he worked in Washington DC on monetary and fiscal reform till 1990. Now he is consulting professor at Sapientia University, Cluj-Napoca, Romania.

Your freethinking investment strategist, continuing to search for the truth and to be inspired by great men in the process,

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