The Central Bank Crisis 2020-2022

The Death of Keynesianism

Armstrong Economics

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By Martin Armstrong

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researching the past to predict the future

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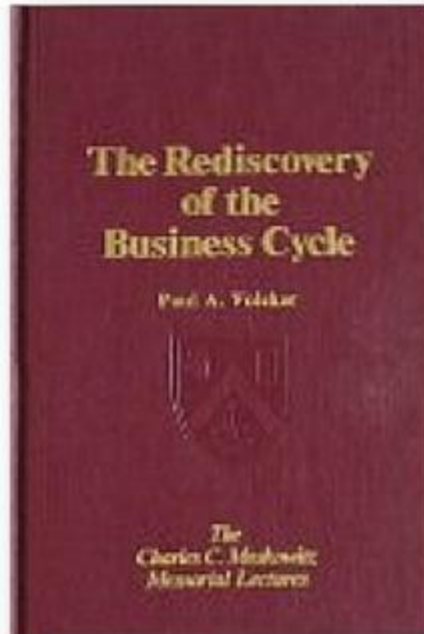
Preface

THe central banks are in the middle of a profound crisis that nobody seems to understand. There were cries that the Fed should lower rates to zero or negative as a solution and Trump should replace the head of the Fed all illustrating that nobody bothers to look at Keynesian Economics and how lowering rates has never worked even just ONCE! We have yet other solutions being proposed from handing out $1,000 per person as a stimulus package because Quantitative Easing failed and others are now proposing in Germany that as major companies are under stress the government should just nationalize them.

Every solution being proposed is all based upon Keynesian Economics. There is not a single proposal that suggests to step back, take a big breath, and just think what such proposals lead to in the years ahead and for our posterity. Even if Trump replaced the Chairman of the Fed because he mistakenly thinks rates should be lowered, the complete confidence in the capital markets will collapse.

The missing–link in Keynesian Economics is understanding credit risk. The assumption of Keynesian Economics was based on a theory of total spending in the economy and its effects on output and inflation. John Maynard Keynes proposed his theory as the solution to prevent future Great Depressions. Keynes advocated for increased government expenditures and lower taxes to stimulate demand and pull the global economy out of the depression. His entire focus was very sterilized insofar as he assumed the crisis in demand should simply be reversed by spending more and cutting taxes, but government ignored the second part.



Rediscovery of the Business Cycle
by Paul A. Volcker 1978

Consequently, Keynesian economics has been used to refer to the concept that optimal economic performance could be achieved and recessions could be prevented simply by influencing aggregate demand. Government suddenly was empowered, he argued, by actively creating economic intervention policies, it was possible to smooth out the economic business cycle by controlling demand. Hence, Keynesianism became a "demand–side" theory that focused on changes in the economy over the short run where later others would argue to focus of the supply–side of the economy.

Both theories still were constructed upon the idea that government could actively manage the economy and it would somehow possess the wisdom to foresee recessions and avoid them.


Paul Adolph Volcker Jr.
(1927–2019)

In 1978, former Chairman of the Federal Reserve made it clear in a publication the Charles C. Moskowitz Memorial Lectures, made the realization that Keynesian Economics had failed. He stated:

> *"The Rediscovery of the Business Cycle – is a sign of the times. Not much more than a decade ago, in what now seems a more innocent age, the 'New Economics' had become orthodoxy. Its basic tenet, repeated in similar words in speech after speech, in article after article, was described by one of its leaders as 'the conviction that business cycles were not inevitable, that government policy could and should keep the economy close to a path of steady real growth at a constant target rate of unemployment.'*
>
> *"Of course, some minor fluctuations in economic activity were not ruled out. But the impression was conveyed that they were more the consequence of misguided political judgments, of practical men beguiled by the mythology of the old orthodoxy of balanced budgets, and of occasional errors in forecasting than of deficiency in our basic knowledge of how the economy worked, or in the adequacy of the tools of policy. The avant-garde of the profession began to look elsewhere – to problems of welfare economics and income distribution – for new challenges.*
>
> *"Of course, the handling of the economic consequences of the Vietnam War was an obvious blot on the record – but that, after all, reflected more political than economic judgments. By the early 1970s, the persistence of inflationary pressures, even in the face of mild recession, began to flash some danger signals; the responses of the economy to the twisting of the dials of monetary and fiscal policy no longer seemed quite so predictable. But it was not until the events of 1974 and 1975, when a recession sprung on an unsuspecting world with an intensity unmatched in the post-World War II period, that the lessons of the 'New Economics' were seriously challenged."*

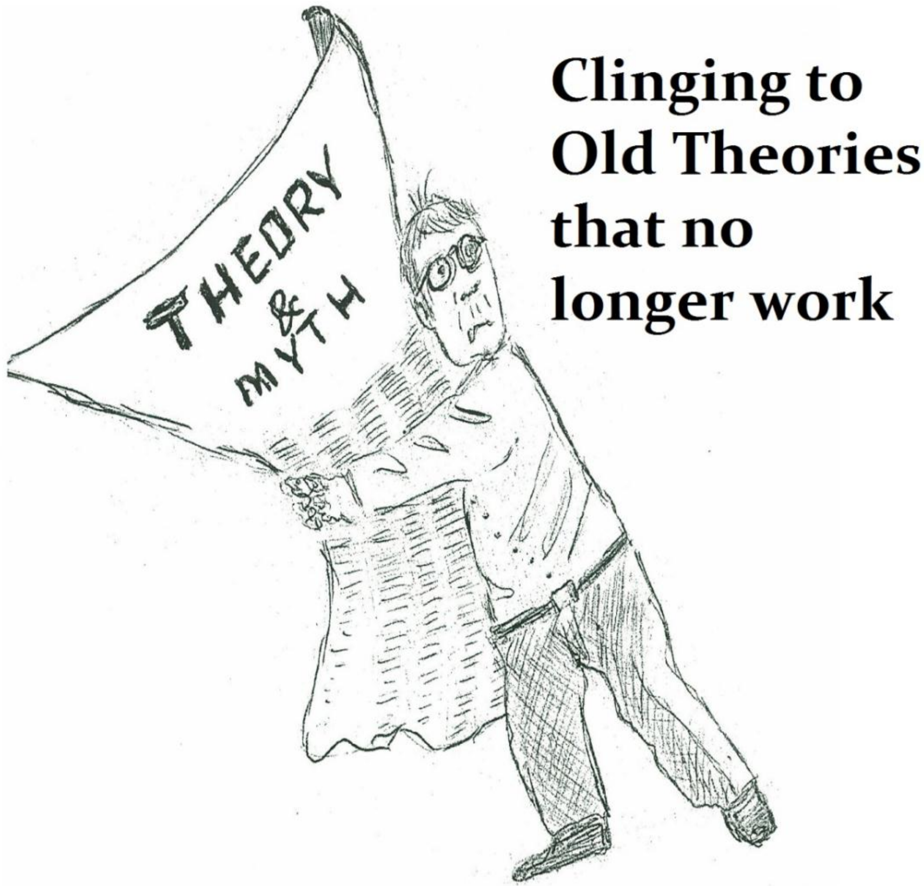
What is most interesting is that here we are more than 40 years later and we are still arguing over how the central banks should cut rates to help stimulate the economy. Nobody will bother to even look at the track record of Keynesian Economics or explain how negative interest rates have been the policy since 2014 with zero impact. All that was created was deflation stimulating nothing in the European or Japanese economies. Lowering interest rates failed, so like a medieval doctor who would bleed his patients, they never died because he took too much blood, but because he did not bleed them sooner.

The solution is not figuring out how to inject more money, but to restore confidence in how we manage and look upon the economy rather than pure demand, but emotionally driven by confidence meaning the tools must change.

If we do not confront the fact that Keynesian Economics has failed, the future we face is dismal at best. We are staring in the cold dark eyes of a Central Banking Crisis beyond contemplation. This is all about confidence and once the marketplace realizes that the central banks are powerless to stimulate the economy, we are looking at a panic that could bring down the entire financial system.

This is a time for reflection and honest review. We cannot continually try the very same tool over and over again and expect a different result. Mistakes are how we are supposed to learn in left in this quest for knowledge. Mistakes are not some script that we repeat endlessly as society.

The Economic Missing-Link



What we must begin to consider that our old economic theories are collapsing before our eyes and we must embark on a whole new path of forecasting and comprehending how markets and the world actually function. The clash between Keynesian Economics based on government manipulation of interest rates to control demand has completely ignored the human emotional element. Even the old world of fundamental analysis has failed where the attempt has been to always explain what happens reducing it to a simple cause and effect relies entirely upon opinion and personal judgment. The fundamentalists have tried so hard to create elaborate theories how markets are efficient and therefore government can manipulate society and steer us through the treacherous ups and downs of the business cycle.

Attempts to manipulate the world economy have failed and this has far too often led to finger pointing at the rich unleashing battle cry of class warfare. This is a return to Marxism which was the first to advocate government intervention to eliminate the business cycle. has been dividing the people and is creating the very seed that has been the destroyer of civilizations throughout history.

This presumption that government is capable of manipulating the world economy and thus the business cycle has been the core of every other economic theory to emerge ever since Marx. Even this new Modern Monetary Theory (MMT) is shrouded in the presumption that the government is all powerful and good-intentioned, no different than the beliefs that inspired the Communist Revolutions. But all governments die in a pool of corruption.

Former U.S. Secretary of the Treasury and past President of Harvard University Lawrence Summers, who was also an economic adviser to President Obama during the economic crisis from 2009 through 2010, wrote an article that appeared on December 6, 2015, in the *Washington Post.*

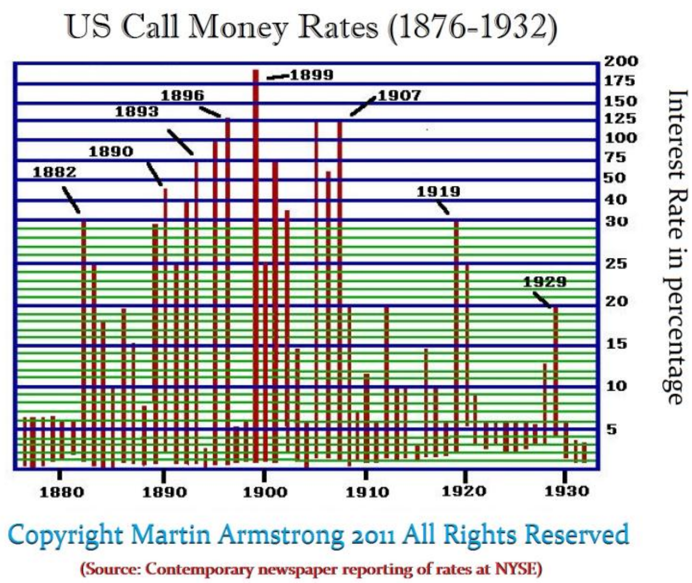
> *Washington Post*
>
> By Lawrence Summers December 6, 2015
>
> "While the risk of recession may seem remote given recent growth, it bears emphasizing that since World War II, no postwar recession has been predicted a year in advance by the Fed, the White House or the consensus forecast."

Subsequently, *Bloomberg News* interviewed Summers on this very issue. They asked:

> "Why it's so hard for smart guys like you to predict some form of economic slowdown?
>
> In part it's hard because the economy is an enormously complex system meteorologists turns out are not very good at predicting the weather that's a complex system too.
>
> In part there is something in the logic of economics if it were predictable that the economy was going to decline people would stop investing; people would reduce their spending and the economy would have already declined. So, there is a sense in which

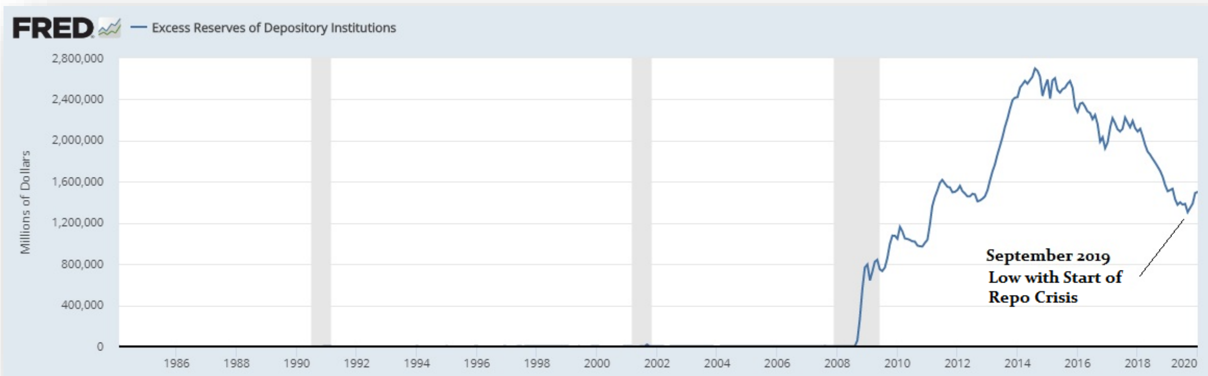
> in the logic of the system that once expectation of recession takes hold, you're in recession and therefore it's very difficult to predict in advance when that is going to take place. The argument is not unlike that at least there's a good approximation that speculative prices should follow random walks."

In the *Bloomberg* interview, Larry Summers again conceded it is **impossible** to forecast the direction of the business cycle because it is like that of the weather system — too complex. It was Summers who had supported negative interest rates. He had championed the role of what he has called **"secular stagnation"** in current economic conditions. Summers argued that the **"neutral interest rate"** had declined substantially and was likely to be lower in the future. He argued that the idea that real interest rates, which is defined as interest rates adjusted for inflation, will be lower going forward.



When we look at the call money interest rates from the New York Stock Exchange, there is something dramatic that emerges from the observation. This is effectively the Repo Market in a sense pre–Federal Reserve. Interest rates would rise during a crisis BECAUSE of the collapse in confidence like a Lehman Moment. It was not the question of lowering rates to stimulate demand, rates rose because of the fear factor of creditworthiness. The higher the rate the higher the risk that the borrower may not be able to repay.

This is the element that was totally missing from Keynesian Economics and it is why it has completely failed in the current situation. Lowering rates as has taken place has utterly failed to stimulate the economy as long as people lack the confidence in the future.



When we look at the 2008 Crisis, the Fed injected trillions of dollars through Quantitative Easing (QE) buying in long-term US Treasuries. However, the banks refused to lend. They demanded the Fed create an excess reserve facility which then jumped to $2.8 trillion. This alone proved that the theory of QE failed because they money never made it into the economy.

Now we see that deposits into this facility of Excess Reserves bottomed during September 2019 with the start of the **Repo Crisis.** The fact that deposits have been rising since September 2019 confirm that we have been heading back toward a major decline in confidence within the system.

This idea that the Keynesian Model can work is absurd. It completely ignores the collapse in confidence of creditworthiness and thus lowering rates simply fails. To further illustrate the extent of this crisis, the Fed cut rates drastically but the market still fell and then it was forced to expand its market-making in Repo to $1.5 trillion, which was more than it did in the first round of QE1.

In an emergency conference call Tuesday, March 10th, the Fed cut its Federal funds rate target by 50bp to 1%-1.25%, two weeks before its scheduled March 17-18 FOMC meeting. There were no dissents.

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Powell touts durable US economy

Fed halts rate cuts while watching virus outbreak

Martin Crutsinger
ASSOCIATED PRESS

WASHINGTON – Federal Reserve Chairman Jerome Powell said Tuesday the U.S. economy appears durable with steady growth and unemployment near a half-century low but faces some risk from the viral outbreak that began in China.

Giving the Fed's semiannual monetary report to Congress, Powell said that the Fed is content with where interest rates are, suggesting that no further rate cuts are being contemplated unless economic conditions changed significantly.

President Donald Trump said in a tweet during that appearance Tuesday that he was not happy with Powell's message on interest rates.

Fed Chairman Jerome Powell said the coronavirus "could lead to disruptions in China that spill over to the rest of the global economy." MANUEL BALCE CENETA/AP

the longest period of uninterrupted U.S. growth on record. Last year, the economy was being buffeted by a global slowdown and rising uncertainty sparked by President Donald Trump's trade war with China and other nations.

Powell said while the "global headwinds had intensified last summer," the economy proved resilient, with the economy growing at a moderate pace in the second half of last year and unemployment, now at 3.6% near a half-century low.

Powell noted that job openings remain plentiful and employers appear increasingly willing to hire workers with fewer skills and train them.

He said these developments mean the benefits of a strong job market are becoming more widely shared, with employment gains broad-based across all racial and ethnic groups and levels of education.

Powell suggested that the federal

The fears and unknowns about the coronavirus and its economic impacts have put the Fed in a very difficult situation. It acted decisively, taking what it perceives to be a cautionary step. The Fed's emergency easing followed an announcement from the G7 finance ministers and central bank governors that they were closely monitoring conditions.

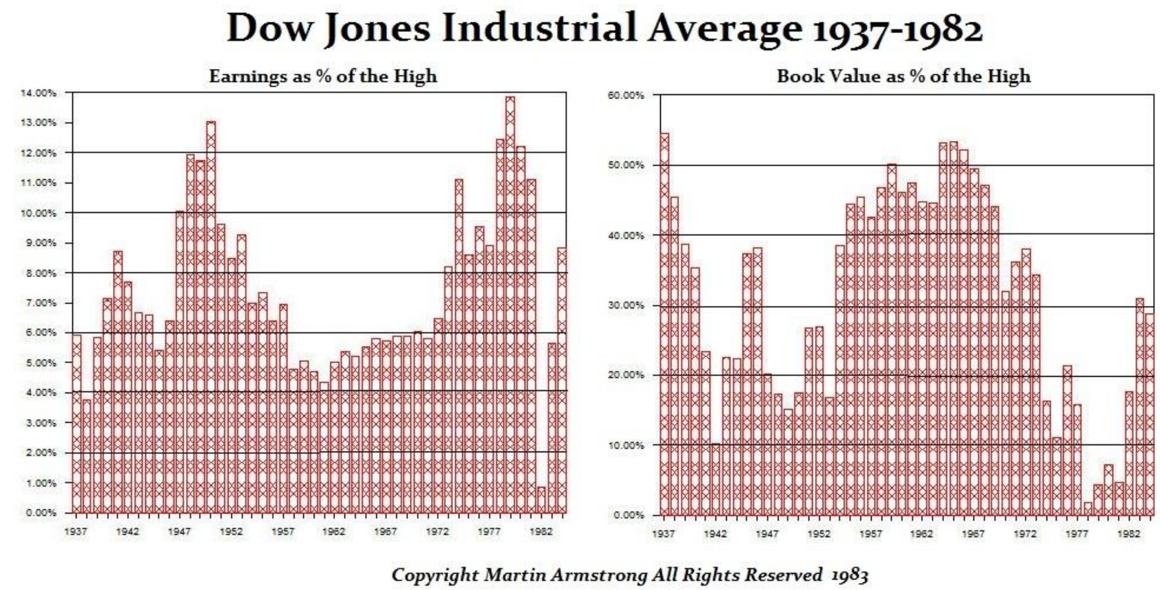
What academics fail to understand is that markets move in anticipation. It does not matter if what they think is happening is true or not. Markets do not move in such a plain, logical, or orderly manner. Theories such as Keynesian Economics may dominate how central banks respond only because they believe that **MUST** be seen to be doing something despite the fact, they remain clueless about the mechanisms and how people actually respond.

If the people believe the stock market will double, they will gladly pay 20% interest. If they do not believe the stock market will rise, they will not pay even 0.5%. This is what has been completely missing from all the academic theories on how to manipulate society. This is the presumption that the mouse will eat the cheese but if he is not hungry, he will sleep.

Understanding the Market Psychology

The interesting aspect of how markets move involves the distinction between collective behavior and individual behavior which many do not realize exist. We all have our individual free will. However, society is a collective state which produces the business cycle.

Some people have assumed that there is the **Efficient Market Theory** which is just a hypothesis in financial economics that states asset prices reflect all available information. Hence, the assumption is that it is impossible to "beat the market" consistently on a risk-adjusted basis because market prices should only react to new information. This seems to be nothing more than a clever excuse crafted by those who are unable to understand how and why markets move. The very foundation of market behavior is human anticipation. It does not matter if the information is even correct, the market will move based upon rumor, inuendo, and presumptions thereby the **Efficient Market Theory** does not work because markets always overshoot and undershoot their economic value based on anticipation.



Markets can remain undervalued for decades as was the case for the Dow Jones between 1934 and 1982. The book value of the Dow Jones Industrial index was 1977. Clearly, the market itself has proven that the **Efficient Market Theory** is nonsense. The takeover boom of the 1980s was when the markets played catch–up all of a sudden. It became glaring that you could buy a company, sell its assets, and double your purchase prices. That was far from efficient.

Even in phycology, there was the emergence of a theory of Collective Unconscious in terms of the Carl Gustav Jung (1875 – 1961), who disagreed with Sigmund Freud (1856–1939) and his sexual theory was his most important work. While many of Freud's early associates objected to the extreme and rather exclusive emphasis he put on sex. Freud insisted his sexual theory applied to all mental illness which never really has been a solid theory. Jung, on the other hand, believed his personal development was influenced by factors he felt were unrelated to sexuality. Nevertheless, Jung's work has led to many considering it to be a form of Collective unconsciousness that exists whereby we are all connected somehow and respond in a herd manner.

Timing models and cycle theory **DO NOT** take away the free will of mankind, nor does it suggest that the future of an individual is predetermined. Any psychologist can explain the collective behavior of a mob. While the individual within the group may be sympathetic to the actions of the mob, he still possesses free will to either leave or remain part of the crowd.

There is clearly some sort of collective unconsciousness that comes into play creating panics that may be described as mob or herd behavior. I tend to see it more as a herd of zebra. They are all clustered together and one on the fringe of the herd one animal sees a lion approaching or may have thought he saw a lion approaching. Whichever the case, he starts to run and the others all panic and run as well without knowing why nor did they see the lion. They run because everyone else is running.

This is the same behavior that dominates a panic in markets. At the end of the day, everyone sells because everyone else is selling. There is usually no solid reason that can be asserted as a fundamental. They are long an instrument and witness the price decline. They are forced to sell because they are losing money yet they may not understand why. The herd is running and there may not have been a lion to begin with.

There is a great difference between **Mob Psychology** (collective behavior) and that of an individual. The majority of people are followers – not leaders. People will react only when they see the majority moving in a particular direction. It is quite interesting for within this tendency to herd together giving birth to collective behavior, there is the cycle which emerges from the collective behavior of the mob that is distinct from the individual free will to rationally participate or move in an opposite direction.

The studies of Stanley Milgram (1933–1984) cracked the door on this interesting aspect of another dimension of **Mob Psychology** (herd mentality). His study began based upon a general assumption that emerged how Germans were somehow different and could kill Jews without remorse during the Nazi era.

Milgram conducted his experiment in the USA attaching wires to an actor and soliciting people off the street instructing them to ask a series of questions and every time the victim was wrong, give him an electric shock. The results themselves were shocking and he called it **Obedience to Authority**. People would torture another person if instructed to do so. They felt obligated to obey.

Milgram also conducted fascinating studies that revealed the herd mentality instinctive within human culture that is displayed by traffic jams. Let there be an accident on the left side of a divided highway and the right side slows down to look. We call such event – rubber-necking delays.

Milgram put one person standing on the street staring into the sky at nothing. People would walk by and probably just thought he was nuts. When he placed 5 people out there staring into the sky at nothing, a crowd would form to see what they were looking at – collective behavior.

Panic of 1792

Financial Panics have emerged since ancient times. There were many famous panics of the 18th century namely the 1720 South Sea Bubble and Mississippi Bubble as well as the first panic in the United States involving real estate in 1792. All panics have emerged from this **Mob Psychology**. It is like the zebra on the edge of the herd who spots a lion. Humans will sell a position because everyone else is doing the same assuming someone knows something they do not. This has often given rise to the idea that there must be some mythical huge short position that overpowers the market and forces the market to crash. Not a single investigation has ever uncovered such a plot. Nevertheless, with every crash comes the inevitable investigation.

1720 Mississippi Bubble

Herbert Hoover
(1874 - 1964)
(President 1929 - 1933)

> But when representative government becomes angered, it will burn down the barn to get a rat out of it.

memoirs p-130-131

Herbert Hoover later apologized for unleashing the Senate investigation on March 4th, 1932 into the decline of the stock market. Hoover admitted in his memoirs that "[t]here was some doubt as to the constitutionality of Federal control of the stock exchanges but I hoped that at least, when we had exposed the situation, ... That hope, however, proved to be little more than wishful thinking." Hover reported that on April 2nd, 1932, a group of New York bankers, headed by Thomas Lamont of Morgan & Company, protested his actions in a memorandum explaining the virtues of the Exchange. Hoover reported his response in his memoirs (id/p127 Vol III) as follows:

> My dear Mr. Lament:
> . . . Prices today [of securities] do not truly represent the values of American enterprise and property . . . [and the] pounding down of prices ... by obvious manipulation of the market... is an injury to the country and to the investing public. . . .
> . . . These operations destroy public confidence and induce a slowing down of business and a fall in prices.
> . . . Men are not justified in deliberately making a profit from the losses of other people.
> I recognize that these points of view are irreconcilable, but I hope you will agree with me that there is here an element of public interest.
> Yours faithfully,
> HERBERT HOOVER

Hoover also bought into this mythical idea that some sinister dark force shorts the market and brings the country to its needs. He admitted he was wrong for after subpoenaing everyone, no such ark force could be found. Most of the richest men on down were all long and lost a fortune on the decline.

Obviously, **Mob Psychology** is a branch of social psychology where there are several theories for explaining the ways in which the psychology of a crowd differs from and interacts with that of the individuals within it. Major theory in **Mob Psychology** is heavily influenced by the loss of responsibility of the individual and the impression of universality of behavior, both of which increase with crowd size.

There is limited research into the types of crowd and crowd membership and there is no consensus as to the classification of types of crowds. Sigmund Freud's crowd behavior theory chiefly consists of the idea that becoming a member of a crowd serves to unlock the unconscious mind. This occurs because the super–ego, or moral center of consciousness, is displaced by the larger crowd.

One cannot be a professional trader without encountering the impact or influence of **Mob Psychology** when it comes to the development of financial markets. We have some proverbs like ***buy the rumor and sell the news***. Effectively, people will act in anticipation of an event but when the event takes place, it is time to reverse your position because the "news" is already factored into the price.

One of the most significant observations to emerge from analyzing **Market Psychology** is very blunt an in your face. The first major statistical examination of financial market trends reveals that bull markets are **ALWAYS** longer trending affairs compared to bear markets. It does not matter what instrument we look at, with the exception of agricultural commodities subject to weather. All other financial markets, including economies, take a much longer time to mature than bear markets.

The reason for this can be explained rather simply. It takes a much longer time to convince someone that you are genuine whereas the slightest bit of doubt causes them to lose that confidence virtually overnight. Here we can see that the low in the Dow Jones Industrials following World War I was 1921. It took 8 years to reach 1929 but just over 2 years to fall about 90%. Panics always unfold in a fast-rapid manner whereas building bull markets takes a lot more time to win over the confidence of the general public.

When we look at the difference between investment sectors and those of commodities, a stark difference emerges. Equities tend to be longer in their cyclical duration than commodities. The difference is clearly the nature of the investor. Equity markets when they go into Phase Transitions where markets double in price or more, then to unfold in multiples of the 8.6 frequency. That means they will usually be 17.2 months in duration at minimum and have extended to three units of time bringing the total duration to 15.8 months, as was the case in the Japanese Nikkei 225 Index into the Bubble Top of 1989.

Markets are very fractal in nature which is part of the hidden order of things. When we look at the bond market, we see the same longer durations of time which even extent into the yearly time level. There were two great bond rallies since 1789. There was the 1862–1888 rally and 1981–2016. One was 25.8 years and the other 34.4 years. Both were multiples of the 8,6 years frequency.

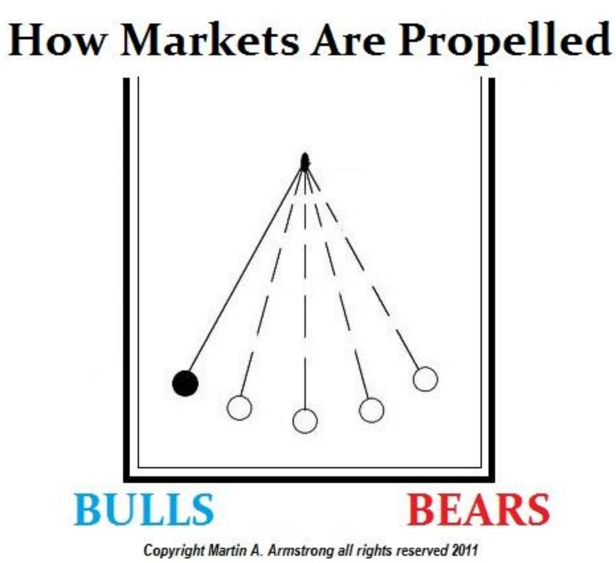
Now when we look at gold and wheat, for example, we can see that the Phase Transitions are uniformly shorter in duration. Here they still conform to the 8.6 level of frequency, but they normally take place in just one unit of time – shot sweet and to the point.

Obviously, there are different aspects between commodities v investment instruments. This tends to reflect the inherent link of commodities more directly to nature, but also that they tend to attract a different mindset of trader/investor.

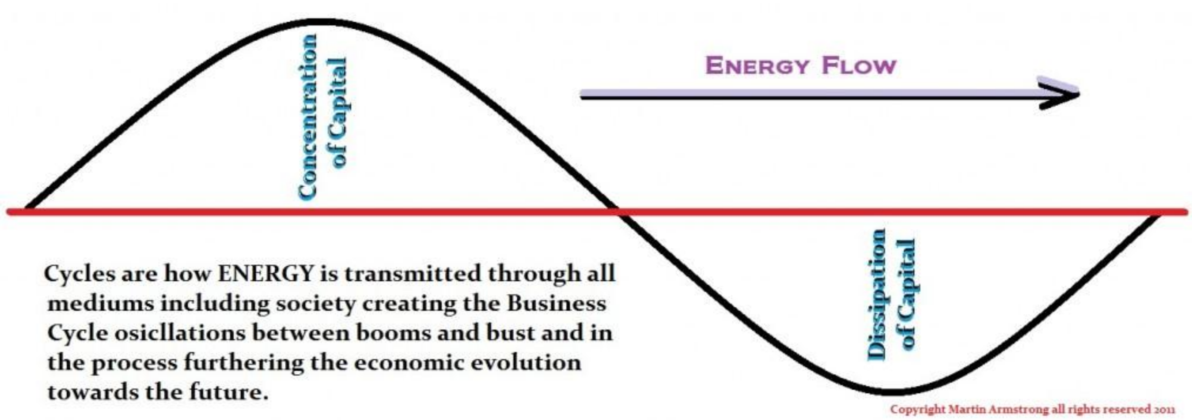
Imperial Hotel Tokyo

Even the Japanese Nikkei 225 had a major low in 1946 which retested the 1931 low. It made a rally for 43 years before it reached its bubble top in 1989. That was half the 8.6 frequency.

I have stated before that when I was doing an institutional conference in Tokyo at the Imperial Hotel, a man bribed his way in just to ask me what to do with his stock position. He had bought the Nikkei the very day of the high with $50 million and it was his very FIRST attempt at investing in stocks. He still had the position despite being down some 40% at the time. When I asked what made him buy the day of the high, he explained that the brokers had called him every year trying to sell him the market saying the Nikkei went up 5% every January. After watching it for 7 years, he said he gave it a try with $50 million and the market crashed. When you have finally sucked in the last person who had never bought the market, you have exhausted the buying power and the market has nowhere else but to decline.

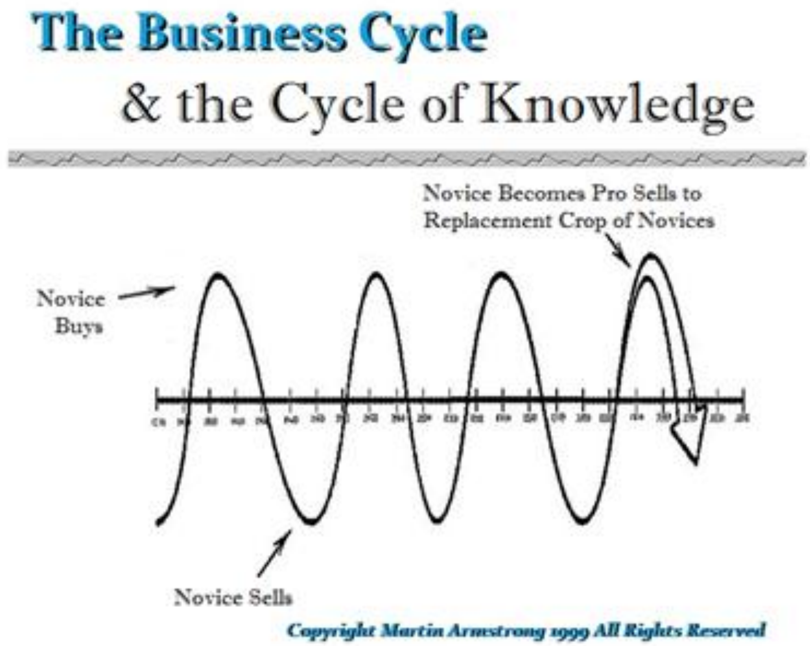


The majority must be trapped at the high or low, which then creates the panic in the opposite direction when the majority tries to sell or buy to exit a position but there is no bid. This is when we see sharp price gaps. The markets move the same as a pendulum where once the energy in one direction has diminished, its own weight and momentum carry it back to the opposite direction. It is imperative to grasp this basic principle in how markets move and why. The fundamental truly is irrelevant. It becomes something that simply scared the heard.

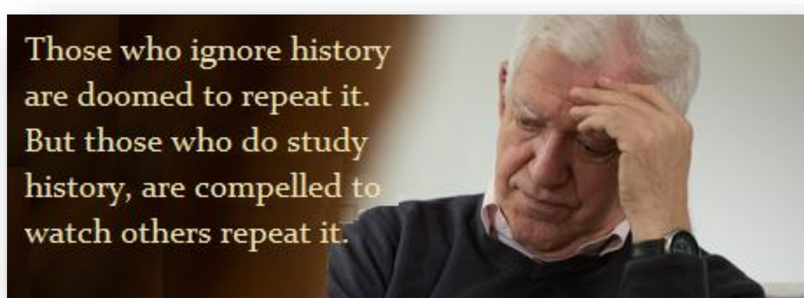


It is always a question of energy within a market movement. Fortunately, understanding **Market Psychology** is half the battle. When you realize all the many ways in which our minds create perceptions, weigh decisions, and subconsciously operate, you can see the psychological advantages start to take shape.

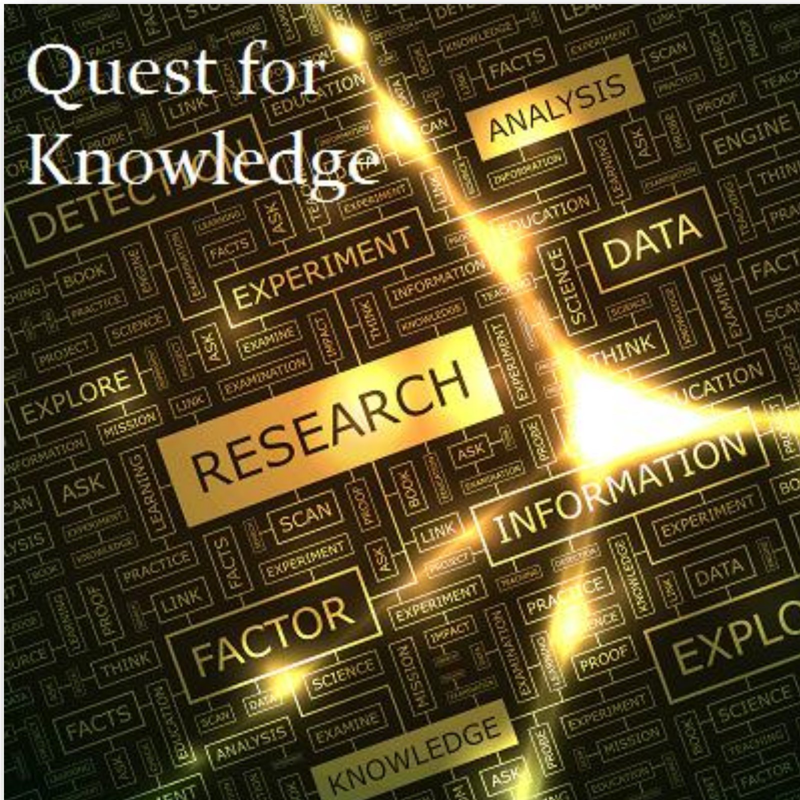
Understanding **Market Psychology** is like a backstage pass where you get to see how everything actually works. You get to step back and actually see firsthand WHY the majority must be wrong for they provide the energy behind all market movements. The constant bearishness in the US share market rally since 2009 has been the very reason why the market has rallied against the majority.



The Business Cycle is clearly driven by herd-instincts. Nevertheless, it does not mean that we are all captives and must respond like a herd of wild animals. We all have our own individual cycle in the life which is a journey to achieve knowledge. When we begin, we are the novice who buys the top because everyone else is buying and it looks like it will never stop. When the crash comes, we sell at a loss often at the low. If we are smart, we will learn from that experience and not do that again. Those who are not so smart, blame the world for their failure and demand investigations for they could never have been mistaken.

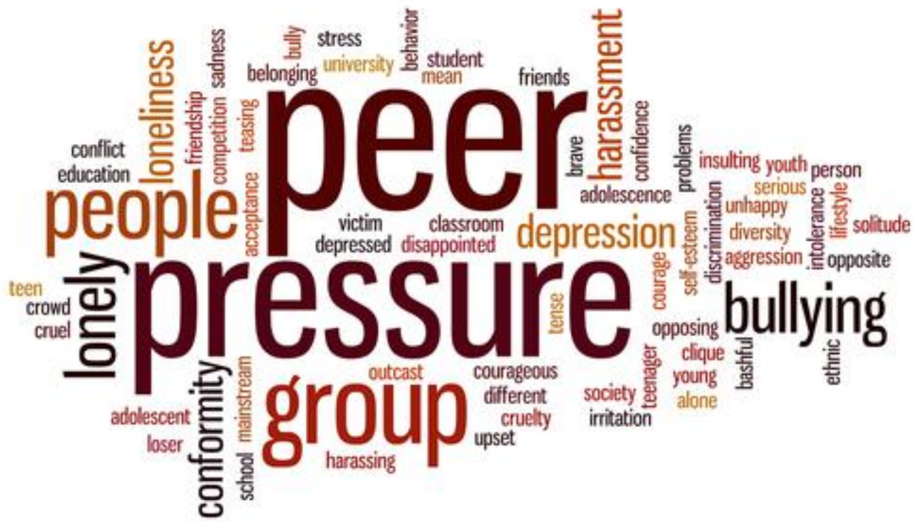


Those who ignore history are doomed to repeat it. But those who do study history, are compelled to watch others repeat it. Life is a journey, a quest for knowledge. Some of us understand and we cam step outside the herd and sell the high and buy the low once we have seen the behavior of mobs.



Life is a journey. Some of us get it, and others are just incapable of every learning. They will keep sticking their finger into the flame of a candle and do not understand that they will not get a different result. When we begin to understand that there is a herd–instinct within human nature, that is when free will comes to save the day.

Some are beginning to realize that the business cycle is really driven by human emotions which are not necessarily based upon fact but anticipation of things that may never take place. This is giving birth to **Behavior Economics** that is realizing that it is not always *"rational"* or even *"efficient"* in how the cycle unfolds. Every stock market crash in history has been followed by some investigation instigated by the assumption there was a conspiracy to force it down or some individual who has overpowered the market for sinister purposes. No investigation has ever revealed such a player.



If we want to understand the future and why the world is changing, we absolutely **MUST** eliminate the personal opinion and the bias of the observer. We must comprehend that as an individual we may possess free will, but that can be burdened by what some call peer pressure – the herd instinct.

Perhaps only some of us acquire knowledge as we move through life while others prefer to blame others for their own mistakes. Trading is no different. If we can survive our own trading decisions then we can reach a level of knowledge and understanding about how the markets actually function. Mark Twain perhaps said it best.

> *"When I was a boy of 14, my father was so ignorant I could hardly stand to have the old man around. But when I got to be 21, I was astonished at how much the old man had learned in seven years."*

The human brain seems to have some basic default settings. The key becomes how to best avoid common misconceptions about how markets function. Far too often people resort to conspiracy theories because they are incapable or unwilling to admit a mistake and examine why they made a particular decision. Instead, they prefer to claim a loss was caused by someone else rather than themselves.

To combat this effect of misconceptions about how markets move, it is important to remember to keep a realistic perspective, look at problems from many angles, and weigh several factors before making a decision. The reason most analysis tends to be wrong is because of what is known as the **Focusing Effect.** They are focused on whatever the last event was and assume the trend will remain in motion and thus the mistake emerges by predicting future outcomes will be the same. Some might call this **tunnel vision** and you can see it with just daily price action. A market rallies 1% and the presumption that will emerge is that trend will continue. To survive, we must understand the majority must be wrong to create the energy that propels market price movements.

Behavioral Economic Theory, which many are just now starting to realize, states that markets trade on anticipation, and not necessarily on facts — buy the rumor, sell the news. This is all behavior oriented. We panic not always understanding why, just following the herd. Investing becomes a herd mentality or **Behavioral Economics**.

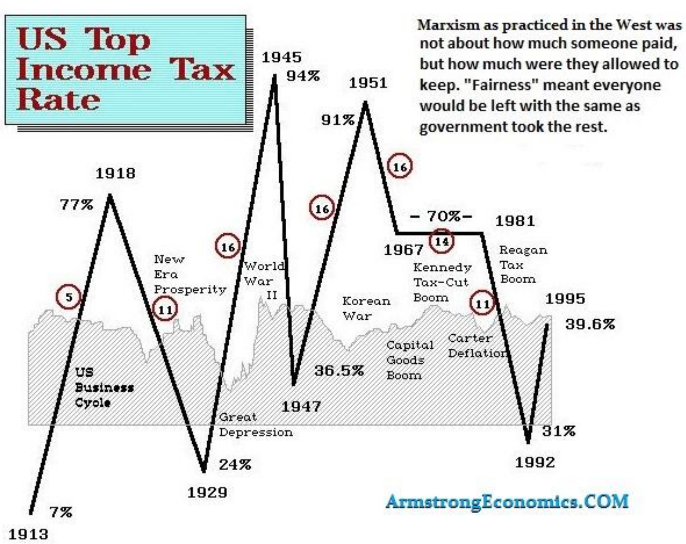
As we move through life individually, we mature and change our thinking based upon experience. This is why there are always Democrats and Republicans. There are some who understand the business cycle and move with I selling the high and buying the low, and others who act in a herd instinct buying the high and selling the low in a panic.

There is a difference between the individual and the collective cycle which we can call the business cycle. Understanding the psychology behind what makes humans tick might be an absolute critical factor when it comes to forecasting and why "opinions" are dangerous since they are driven by emotions. The majority takes refuge in the fact that the they are doing the same as everyone else and thus they are somehow safe. When they are proven wrong, they always blame some dark external force.

Behavioral Economics

The missing-link in Keynesian Economics has been the total ignorance of how market phycology operates and this idea that we can dangle a carrot in front of people to make them behave in a desired manner. If we simply look at the track record of raising and lowering interest rates, what jumps out at us is the total lack of a positive correlation.

At the same time, governments have completely ignored the second part of Keynes's theory. He suggested the lowering of tax rates to stimulate the economy. Governments have always assumed that they can raise taxes and people must pay whatever they demand. They failed to understand that capital can always fee offshore or hoard and refuse to invest, but the inidividual cannot hoard his labor nor move it offshore.



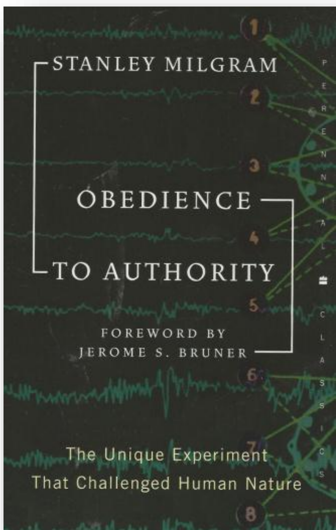
Behavioral Economics is the study of the effects of social, cognitive, and emotional factors on the economic decisions of individuals and institutions and the consequences for market prices, returns, resource allocation, and ultimately the madness of crowds and herd mentality we as humans truly possess. These

fields are primarily focused on trying to comprehend the rationality of markets and the economy incorporating psychology while blending this with microeconomic theory and market theory. By merging these disciplines, behavioral models begin to emerge covering the full scope of concepts and ideas that drive the economy as a whole. The study of **Behavioral Economics** includes how market decisions are made and the mechanisms that drive public choice and produce the boom bust cycle regardless of the instrument under observation. But the academics are still failing to comprehend human emotions while attempting to make this all neat and logical which is not the way decisions are made in a financial panic.

Therefore, as previously mentioned, the studies of Stanley Milgram (1933–1984) began with soliciting people off the street instructing them to ask a series of question and every time the victim was wrong, give him an electric shock. The results themselves were shocking and he called it **Obedience to Authority**. People would torture another person if instructed to do so. They felt obligated to obey.

Stanley Milgram
(1933-1984)

Milgram's studies revealed the herd mentality which is instinctive within human culture. This is why we have traffic jams we call rubber-necking when an accident on the left side of a divided highway results in people slowing down to look at it on the right side. When Milgram put one person standing on the street staring into the sky at nothing. People would walk by and probably just thought he was nuts. When he placed 5 people out there staring into the sky at nothing, a crowd would form to see what they were looking at.



When we begin to understand that there is a herd-instinct within human nature, there is a lot that can change giving birth to a much more realistic approach to **Behavior Economics** that is not always *"rational"*. Every stock market crash in history has been followed by some investigation instigated by the assumption there was a conspiracy to force it down or some individual who has overpowered the market for sinister purposes often touted as dominating the world. Those who have investigated these events have revealed their own ignorance of how and why markets even move similar as to burning people at the stake as heretics for daring to say the sun revolved around the earth or the earth was not flat.

Samuel Untermyer
(1858 1940)

John Pierpont Morgan
(1837-1913)

During the famous interrogation of JP Morgan by the notorious prosecutor who loved the limelight, Samuel Unitermyer (1858–1940) illustrated to the world the true depths of his lack of understanding how and why markets and banking even functioned. Unitermyer 's interrogation of J.P. Morgan in the Pujo Committee December 18–19, 1912 of the alleged Money Trust, demonstrated how ignorant he truly was:

> **UNTERMYER:** Is not commercial credit based primarily upon money or property?
> **MORGAN:** No sir. The first thing is character.
> **UNTERMYER:** Before money or property?
> **MORGAN:** Before money or anything else. Money cannot but it … a man I do not trust
> could not get money from me on all the bonds in Christendom.

The central issue in Behavioral Economics is explaining why market participants make systematic errors contrary to assumption of rational market participants.

The answer is this need to always blame someone reducing it down to a single cause and effect. Then, mankind runs amok driven by his passions and not logic.

Herbert Hoover admitted that he had received a telegram from a close friend in which it was alleged that a "billion-dollar bear raid" had been at work in the market designed to destroy the Republican Party. This conspiracy began perhaps the most vicious investigation in American history that became the model for McCarthy's witch-hunt search for communists.

October 29th, 1929

BLACK TUESDAY

NEW YORK, TUESDAY, OCTOBER 29, 1929

THE STOCK MARKET CRASH OF 1929

BY BARBARA SILBERDICK FEINBERG

NEW YORK, OCTOBER 29 — Another hurricane of liquidation hit the stock market today, as financial uncertainty fed on rumor and turned to panic. Frightened investors ordered their brokers to sell at any price, and the stock market crashed. Those on the floor of the Wall Street exchange waded in paper and tried to add up their losses.

It is believed those losses total billions of dollars. Thousands of accounts were wiped out as a record number of shares were traded. Some stocks were almost given away. Millions of shares traded hands.

Brokers on the floor of the Exchange have never seen a day like this. The shock on Wall Street spread to other exchanges and markets. It was a country-wide collapse of security values in which losses were the most disastrous and far-reaching in the history of the Stock Exchange. There was near-panic on the Chicago commodities exchange. Rumors spread from one end of the United

Crowds Gathered On Wall Street As The Market Went Into Historical Decline

The Washington Senate investigation of Wall Street became a nasty wholesale witch-hunt into anyone who dared to have a short position. Short players were demonized as traitors. The president of the New York Stock Exchange, Richard Whitney (1888-1974), was summoned to Washington by an urgent phone call – no time even for a subpoena.

Frederic Collin Walcott
(1869-1949)
(Republican Denator of Connecticut 1929-1935)

Once there, Republican Senator Frederick Walcott (1869-1949) directed Mr. Whitney to prepare a complete list of names of those who had sold short positions in the market. This was all based upon this theory that only a short player overcomes the longs and forces the market down. Contrary to popular belief, the worst of the worst were Republicans on Capitol Hill. This rumor that someone was out to destroy the Republican Party fed into a conspiracy with the backdrop most likely emerging from the rising socialist–communist movement. After all, the Russian Revolution was 1917 and there has been a similar revolution in Germany during 1918 that led to the hyperinflation.

The interrogation of Richard Whitney (1888–1974) who became president of the NYSE only after the crash began by the Republican Senator James J. Couzens (1872–1936) explains this behavioral misconception of how markets trade.

Richard Whitney
(1888–1974)
(President of the NYSE 1930-1935)

James J. Couzens
(1872–1936)
(Republican Senator from Michigan)

Senator Couzens: It has come to my attention that a broker may use his customer's stock to depress the value of that stock.

Mr. Whitney: Senator Couzens, I deny that!

Senator Couzens: How do you detect it?

Mr. Whitney: Our men check the brokerage offices.

Senator Brookhart: Do you think the rules you are constantly citing are enforced or evaded?

> **Senator Blaine:** Maybe he thinks they are enforced better than the Prohibition Law of the Federal Government.
>
> **Senator Brookhart:** You brought this country to the greatest panic in history!
>
> **Mr. Whitney:** We have brought this country, sir, to its standing in the world by speculation. You think you can affect the world by changing the rules of a stock exchange or board of trade?
>
> **Senator Brookhart:** Yes, we can change them by abolishing the stock exchange and board of trade so far as speculation is concerned!
>
> **Mr. Whitney:** And then the people of the United States will go to Canada and Europe to do those very things and pay their taxes there!

In reading over the dialogue of Mr. Whitney's interrogation, one begins to wonder whether or not he was before a committee of the Communist Party in Russia. Were these comments coming from elected officials in a so-called free society?

Before the Banking & Currency Committee, Mr. Whitney handed over the list of 24,000 names of those who had positions in the market. This was April 8th one day before the supposed "billion-dollar bear raid" had taken place. The Committee began to instantly sift through the list searching for the names of those who had shorted the markets. Many prominent and nationally well-known names were among the list. But Senator Walcot argued against the publication of any names.

Thomas Edmund Dewey
(1902–1971)

Richard Whitney was eventually arrested and had to plead guilty or face trial where he would have faced a lot more time for embezzlement. The prosecutor used him as a stepping-stone to further his own career – then New York County District Attorney Thomas E. Dewey (1902–1971). Dewey used Whitney to rise to Governor and then ran twice as the Republican Presidential candidate and lost.

That has been the game to always take down a famous person in a crisis to make a name for yourself to thereafter run for political office. Ferdinand Pecora (1882–1971) used his Senate prosecutions of Wall Street to rise to political power as well. The hearings were even named after him as the prosecutor rather than some Senator – Pecora Hearings.

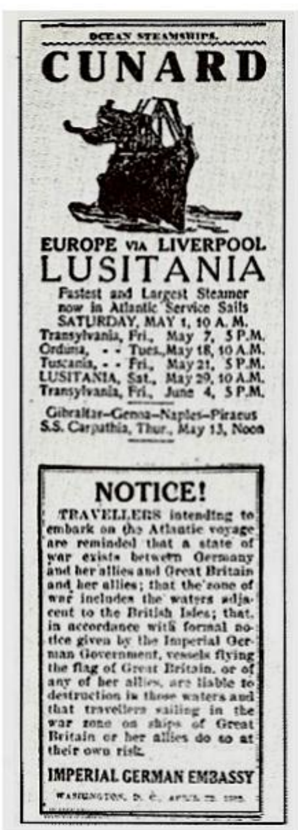
Richard Whitney's Brother George had also risen at J.P. Morgan and by 1930 had been anointed as the likely successor to the then bank president. The crash had even ruined Whitney's business and he borrowed from everyone trying to keep it alive. He then began to embezzle money from the NYSE fund trying to save his company.

Richard Whitney
(1888 – 1974)
President of New York Stock Exchange (1930-1935)

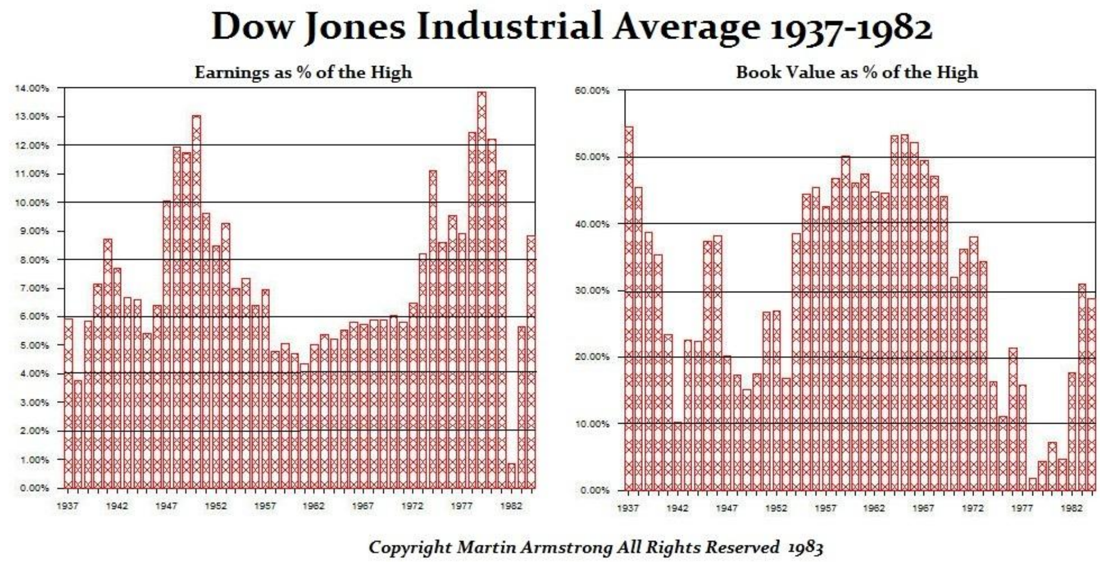
Whitney had become the symbol of Wall Street even though he took the job in 1930 after the market began to crash. Whitney was the face people saw between 1930 and 1935. He was sentenced to a term of five to ten years in Sing Sing prison, but received parole after 3 years. On April 12, 1938, 6,000 people turned up at Grand Central Station in New York City to watch as the image of the Wall Street Establishment was escorted in handcuffs by armed guards onto a train that delivered him to prison. People who self-surrender are not normally treated that way, but Dewey was very ambitious and wanted a show.

Senator Gerald Prentice Nye
(1892–1971)

Senator Gerald P. Nye (1892–1971), a Republican of North Dakota, illustrated that the hatred of Wall Street that was brewing carne from both parties, but particularly within the Republican Party. The conspiracy theory was someone was up to something to destroy the Republic Party so they took it very personal. There was also a distinct trend that was regional pitting the West and South against the banks and Wall Street of New York that always appears during economic declines.

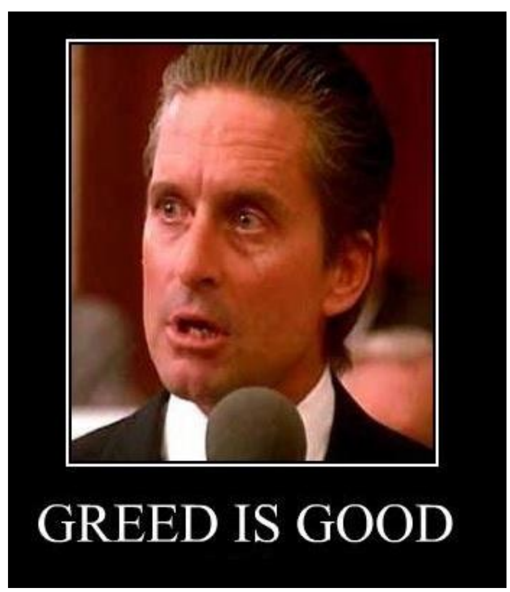


Nevertheless, just as Hoover began hearings on the mere phone call that someone was forcing the Stock Market to crash to ruin his administration, here Senator Nye began hearings into yet a new conspiracy that became dubbed the ***Merchants-of-Death*** based upon the conspiracy theory that now the NY Bankers had steered America into war (World War I) to safeguard their loans and to perpetuate a business in arms. Of course, facts never get in the way in Washington. The German's even took out advertisements warning people not to get on the Lusitania because the US was covertly shipping arms to Britain while claiming neutrality. It was Washington that lied to the people and used the passengers of the Lusitania to get into the war. Now 20 years later, Nye transformed the facts to blame Wall Street for that as well.

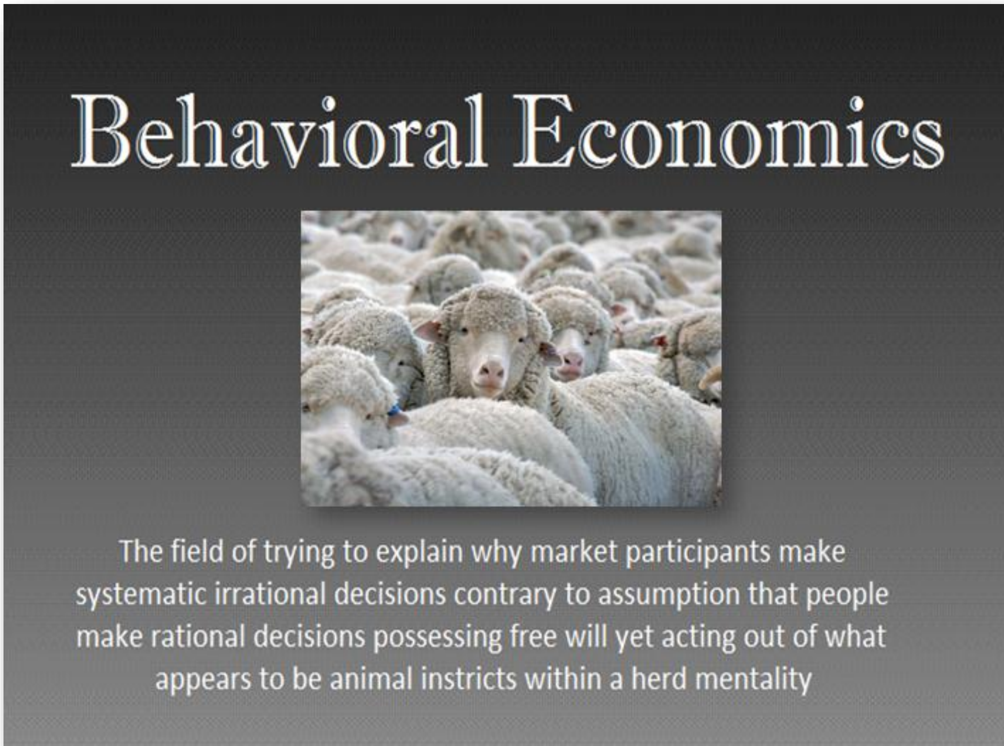


On January 20th, 1936, Time Magazine asked the question that was circulating in every corner: ***"Before the Committee for settlement was a scandalous question: should J. P. Morgan be hated as a war-Monger second only to Kaiser Wilhelm?'*** Once again, America had betrayed its own rewriting history to try to blame anyone other than Government. It was a bitter lesson for those who saw their own country turn against them to appease the American public for the madness of the crowd.

Behavior Economics must clearly incorporate the irrational behavior of market participants as well as market observers such as government who act like lions attempts to target one animal in the herd for personal glory and gain. It becomes their self-interest in the pursuit of glory and re-election or to rise to the Presidency over anyone they can crush into the ground. Such people are never trustworthy to say the least, yet their ambition drives them into public office for power and greed.



These trends affect market prices and returns, creating market inefficiencies that are not supposed to exist Nevertheless, this grandstanding coming out of the Great Depression not only turned the nation into the



open hands of Marxism with the social agenda, but it resulted in shifting the overall confidence in the economy into a Public Wave where people trusted government so much so the stock market as relative to book value, which did not bottom until 1978.

In conjunction with the low trading value of the US share market in the late 1970s we also see the peak in earnings. This set the stage for the mid–1980s Take–Over Boom. That too, was twisted into the famous movie Wall Street where Michael Douglas delivers his speech that greed is good. Of course, the fact you could buy a company and sell all its assets and double your money did not somehow illustrate how inefficient the markets can be.

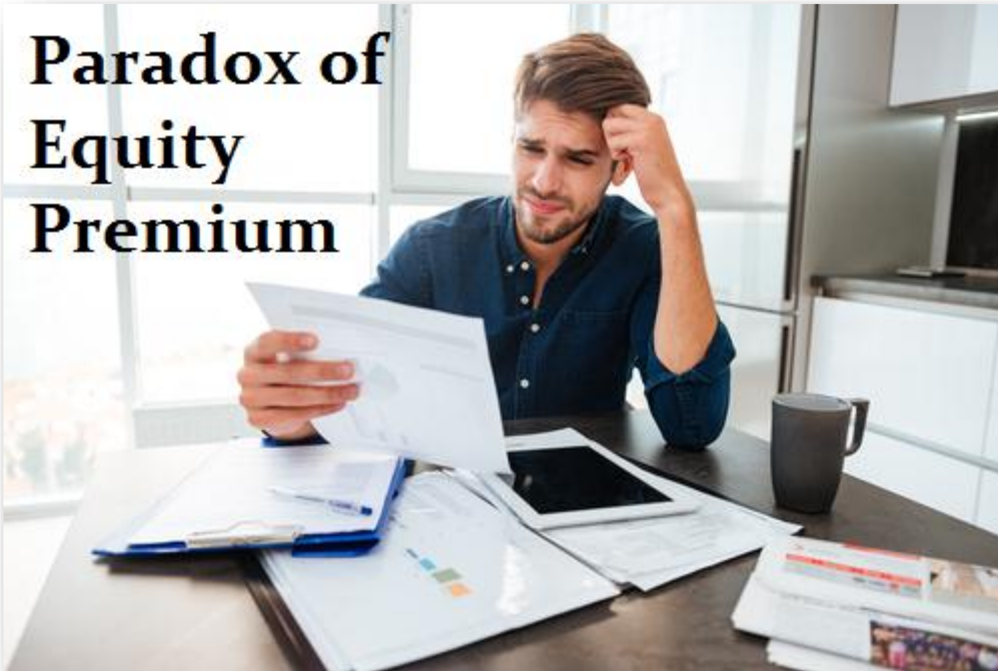
Behavioral Economics must fully highlight these inefficiencies where the market and the economy move to the extreme in both directions through under– or over–reactionary movements. There is definitely the madness of crowds and mob psychology at work within the herd mentality. This is where technical analysis comes into play. It is the major step toward distancing oneself from the emotional herd – to see things with the calm rational eye that in theory people are supposed to do, yet cannot without a guide-map.

Insider-Trading Theory

Even the whole idea of insider-trading is also greatly distorted and constructed upon the false idea that someone can make anything move counter-trend. Insider-trading began as directors selling their stocks withholding the facts that the company was bankrupt until they liquidated. That is substantially different from two people sharing information that may or may not impact the price. In a boom, even bearish news is ignored while in a collapse, the best news is ignored. So inside information remains a theory for prosecutors trying to become president – it is not fit for real analytical methods.

Bird in The Bush Paradox

There are other human emotional traits that vary in individuals, yet come into play within the boom & bust cycle. Some call it the **"Bird in The Bush Paradox"** where some have a loss aversion individually or as a culture as in Japan that is best described as the unwillingness to let go of a valued possession. Consequently, some people will continue to hold a losing position simply because they refuse to admit they made a mistake. This caused a prolonged and major economic decline in Japan where they kept waiting for a rally to break-even. This contributed to the massive decline in prices for holding on to losses precludes fresh buying and hence the downtrend trend is extended.



Paradox of Equity Premium

The **Paradox of Equity Premium** refers to the inability of an important class of economic models to explain the average premium of the returns on a well–diversified U.S. equity portfolio over U.S. Treasury Bills observed for more than 100 years. Clearly, conventional finance models completely fail for, they assume a just price and markets are efficient when they are subject to the "confidence" that rises and falls within the marketplace. People's decision–making process and behavior in financial markets is based solely upon what they **"believe"** which is not always rational. You cannot create fundamental rules or relationships that withstand the test of time.

If we refer that that chart of call money rates from the NYSE once again, what this also illustrates is that the stock market has never peaked with the same level of interest rates twice. It is always a question of what people believe at that moment which can also be just a rumor. They will act based not upon the present, but upon their future expectations. If they "believe" war will happen or a bank might fail, they act now in anticipation of the future. This is why interest rates have no empirical correlation with share prices and this is also why Keynesian Economics fails.

Therefore, attempting to adapt quantitative mathematical and statistical methodology to understand behavioral biases is by no means easy and will never offer consistency. The traditional research has been unable to produce evidence to demonstrate escalating biases impact marketing decisions because of the limited data sets involved. To embark down such a path, one cannot determine the future based solely upon the domestic past.

Some financial models used in money management and asset valuation incorporate behavioral finance parameters, for example by attempting to track price reactions to specific information. They again have wrongly assumed a flat cause and effect scenario reducing the entire global economy to a single domestic piece of news elaborately creating three phases of underreaction and overreaction movements but this concept at the very core has an assumption that the market is efficient with some fair value.

Capital Asset Pricing Model

The Capital Asset Pricing Model (CAPM) describes the relationship between systematic risk and expected return for assets, particularly stocks. CAPM is widely used throughout finance for pricing risky securities and generating expected returns for assets given the risk of those assets and cost of capital.

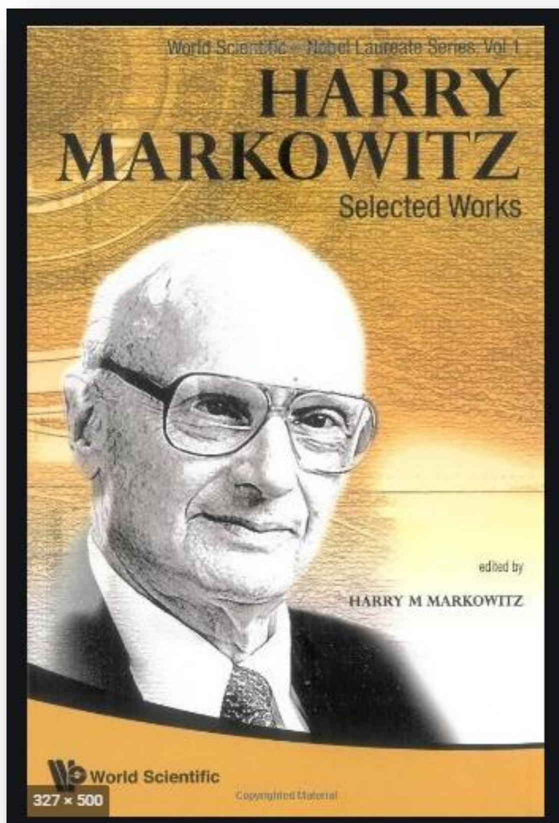
Institutional investors have long been in search of the Holy Grail in finance where they try to reason how much to diversify investments, in comparison to the risk. Naturally, investors seek a rate of return that compensates for that risk. The capital asset pricing model (CAPM) has been touted as the key to calculate investment risk and what return on investment an investor should expect.

The CAPM was developed by the financial economist (and later, Nobel laureate in economics) William Sharpe, set out in his 1970 book **Portfolio Theory and Capital Markets**. His model began with the proposition that individual investments inherently possess two types of risk Systematic & Unsystematic Risk.

The Systematic Risk is where market risks are described as general risks of investing that cannot be diversified away such as wars, recessions, and changes in interest rates. The Unsystematic Risk is classified as a "specific risk" that relates to individual stocks which is separate from the market as a whole. Hence, a company can move into bankruptcy while the rest of the market is unaffected.

Modern Portfolio Theory

Modern portfolio theory (MPT) emerged with the idea that risk-averse investors can construct portfolios to optimize or maximize expected return based on a given level of market risk. Therefore, they are emphasizing that risk is an inherent part of higher reward. According to MPT, the notion which emerges maintains it's possible to construct an "efficient frontier" of optimal portfolios offering the maximum possible expected return for a given level of risk. This theory was pioneered by Harry Markowitz (born 1927) in his paper "Portfolio Selection," published in 1952 by the Journal of Finance. He was later awarded a Nobel prize for developing the MPT. However, his ideas were all based upon a fixed exchange rates system which did not take into account the changes in the value of currencies will also impact investments in a domestic economy due to capital inflows.



The bottom line has been that **Modern Portfolio Theory** claims that specific risk can be mitigated through diversification of a portfolio. Once again, the decision required to make the portfolio diversified still does not solve the problem of systematic risk. It will only neutralize specific rise provided the portfolio is not concentrated in a single stock.

Efficient Market Theory

Then there was in 1970 the development of the **Efficient Market Theory** (EMH) or hypothesis that the market was "informationally efficient" also produced nothing that was in anyway even worthwhile from a trading and management perspective. According to the EMH, stocks always trade at their fair value on exchanges, making it impossible for investors to purchase undervalued stocks or sell stocks for inflated prices. Therefore, it should be impossible to outperform the overall market through expert stock selection or market timing, and the only way an investor can obtain higher returns is by purchasing riskier investments.

Eugene Francis "Gene" Fama (1939-)

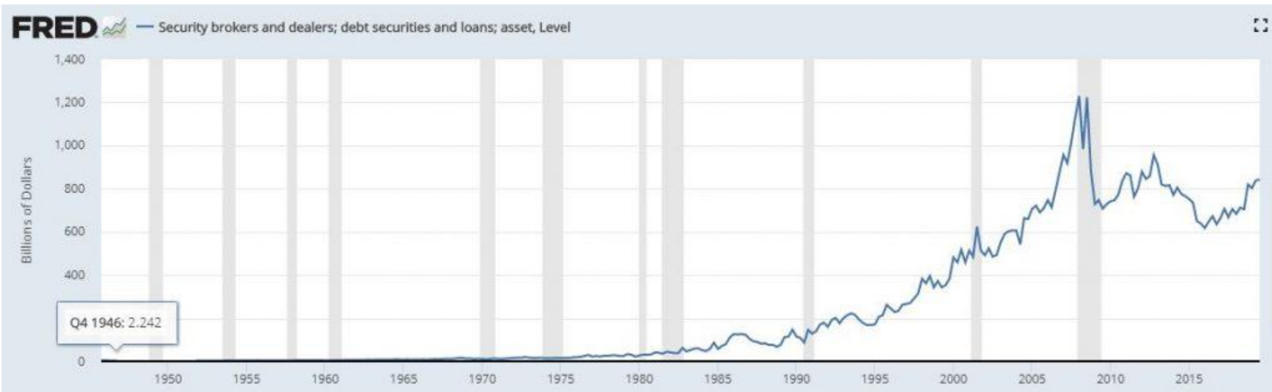
One could not consistently achieve returns in excess of average market returns on a risk–adjusted basis, given the information available at the time the investment is made, according to Eugene Fama (b 1939) who was considered the father of this "efficient market hypothesis".

Fama began with his Ph.D. thesis back in May, 1970 that appeared in the issue of the Journal of Finance, entitled "Efficient Capital Markets: A Review of Theory and Empirical Work."

The problem is once again the academic approach. Anyone in the market as a trader realizes that markets will always over shoot on the upside and the downside with respect to any fair value. The illustration I provided earlier that the Down as a percent of book value reached its low in 1977. The entire takeover boom of the 1980s was all about the fact that you could buy a company, sell its assets, and double your money. That proved EMH also failed.

Nonetheless, all of these various theories have eventually proven to be inefficient in themselves and led to the **Black–Scholes Model** attempting to price these under and over valuations within a given market. Of course, that blew up in the collapse of Long–Term Capital Management in 1998.

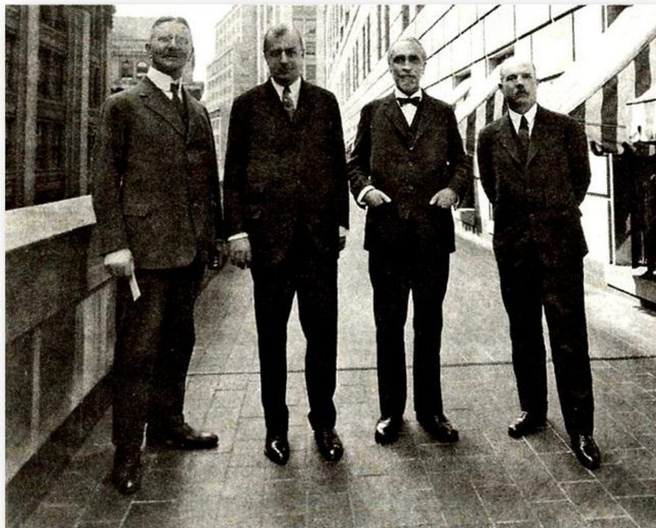
The End of Interest Rates Up Equities Down



The traditional view with respect to interest rates and share markets has been focused on the domestic economy to the exclusion of international events. The theory that cheap money means people will borrow to buy stocks sounds logical, but when we look at the evidence, that theory simply does not stand the test of time.

The entire theory that cheap money means stocks will rise is very naive. However, when we actually look at the data, that market myth evaporates in sunlight. We have been making lower highs in broker loans, which shows what I have been saying all along — this is the **MOST Hated Bull Market in History!** We are nowhere close to the highs of 2007. We only recently have begun to witness the NASDAQ rising in advance of the Down Jones Industrials and the S&P500 which is a reflection that retail is starting to show its head after 13 years. From a cyclical perspective, this is on time. We should begin to see the retail interest begin to rise going into 2022.

The market has risen **NOT** because of cheap rates but on a **capital flight** from just about everywhere into the US dollar. The Fed has been baffled because they initially were looking at that market myth that lower rates result in the traditional inflationary speculative booms. But the Federal Reserve has been forced to confront reality that there is no validity to that theory.

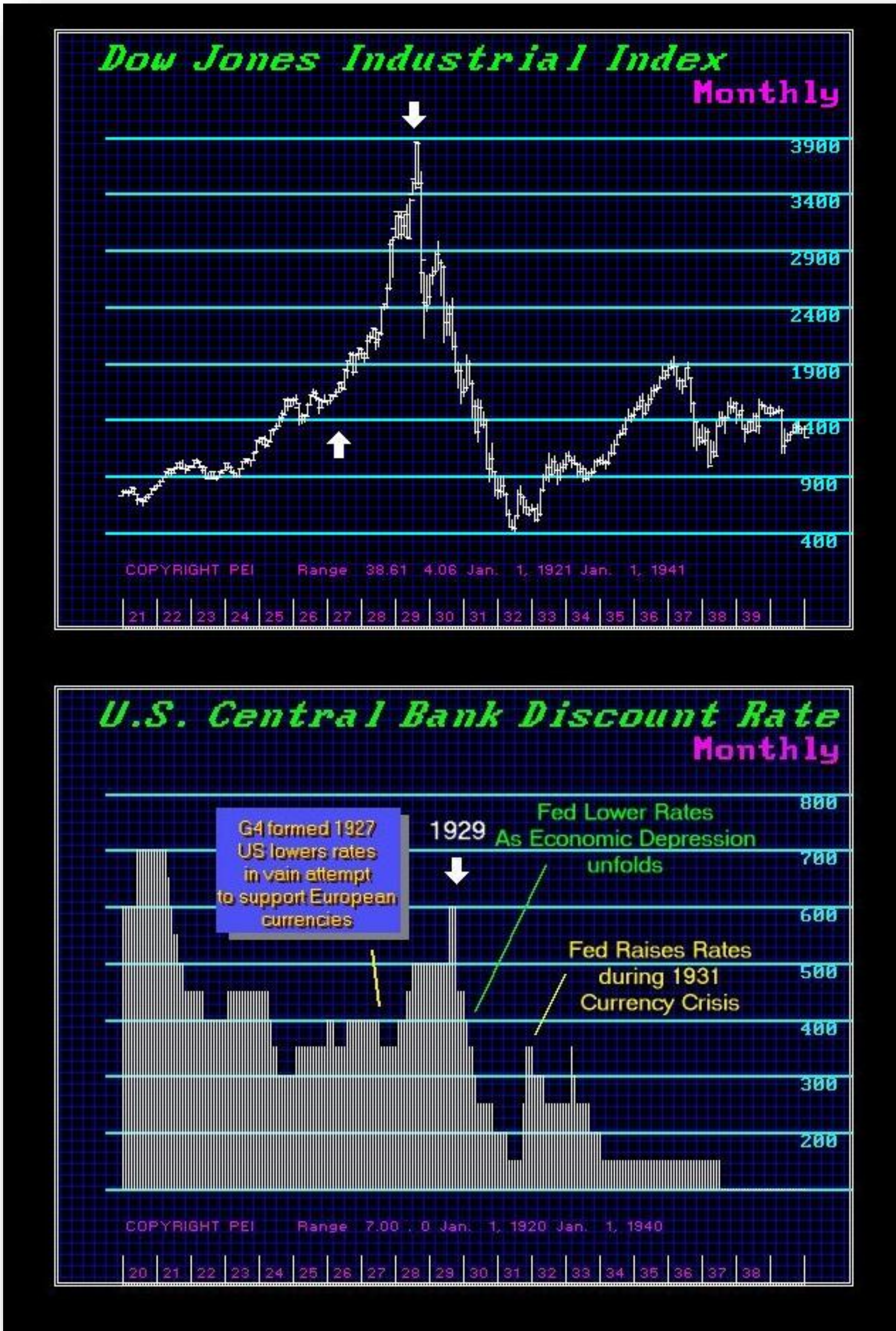


Secret Meetings of the Central Bankers Germany - USA - Britain - France

On July 1, 1927, Montagu Norman of Britain was accompanied by Hjalmar Schacht, head of the German Reichsbank. They were joined by Charles Rist, governor of the Banque de France. All three went into conference with Benjamin Strong to discuss the weak reserve position of the Bank of England and the capital flight from Europe to America. It was hoped that lowering US interest rates would deflect the capital inflows from Europe.

The Federal Reserves was attempting to lower rates into August 2019 to once again help Europe as it had attempted back in 1927. They also saw the inverted yield–curve and assumed the traditional interpretation means coming recession. That prompted them to lower the rates on August 1st, 2019. That backfired on the Fed with the start of the Repo Crisis in September 17th, 2019. Indeed, back in 1927, the USA lowered interest rates in a desperate attempt to send capital back to Europe as well. The Fed was then criticized for lowering rates that sparked the stock bubble into 1929. The Fed realizes that there is a crisis brewing outside the USA due entirely to the negative interest rates in Europe and Japan.

If we look at the charts provided on the next page, we can see that the Fed raised rates from 3.5% in 1927 up to 6% in 1929 and the stock market doubled on capital inflows. The attempt to raise rates to stop demand for equities had no effect other than attract even more capital to the United States from Europe. The entire Keynesian Model failed even back then **BEFORE** it was ever adopted. Raining interest rates to reduce the **DEMAND** utterly failed. Nevertheless, to this very day we have people who keep spouting out this theory and have been forecasting the collapse of this bull market all predicated on this stupid naïve theory.


Dow Jones Industrial Index
Monthly
3900
3400
2900
2400
1900
1400
900
400
COPYRIGHT PEI Range 38.61 4.06 Jan. 1, 1921 Jan. 1, 1941
21 22 23 24 25 26 27 28 29 30 31 32 33 34 35 36 37 38 39
U.S. Central Bank Discount Rate
Monthly
G4 formed 1927
US lowers rates
in vain attempt
to support European
currencies
1929
Fed Lower Rates
As Economic Depression
unfolds
Fed Raises Rates
during 1931
Currency Crisis
800
700
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COPYRIGHT PEI Range 7.00 . 0 Jan. 1, 1920 Jan. 1, 1940
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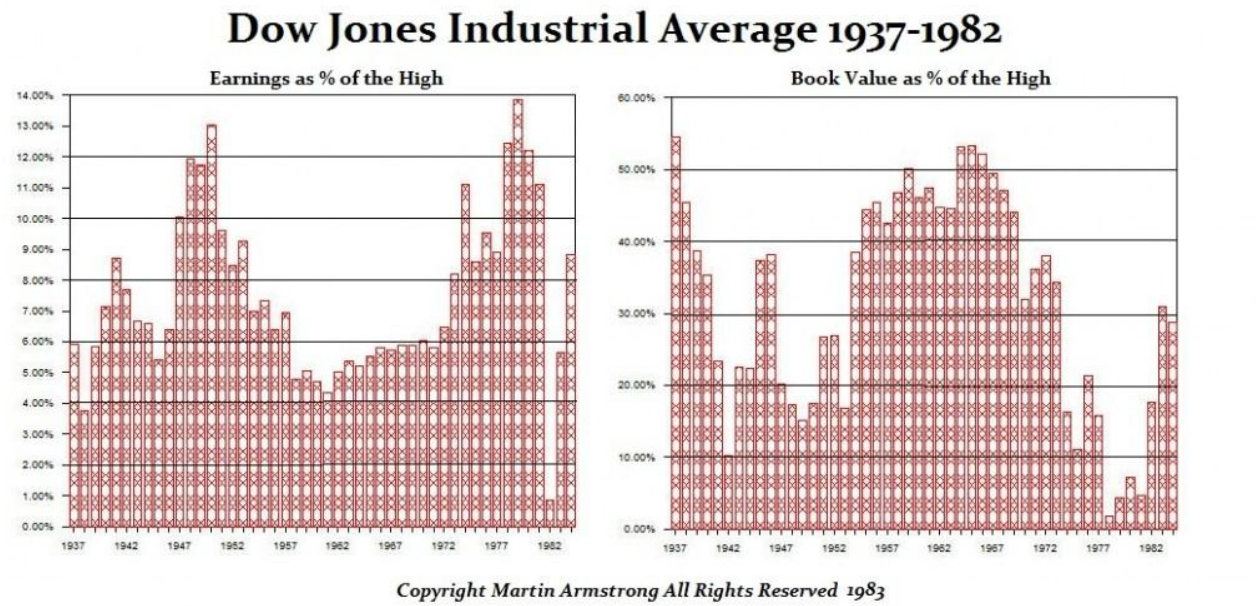
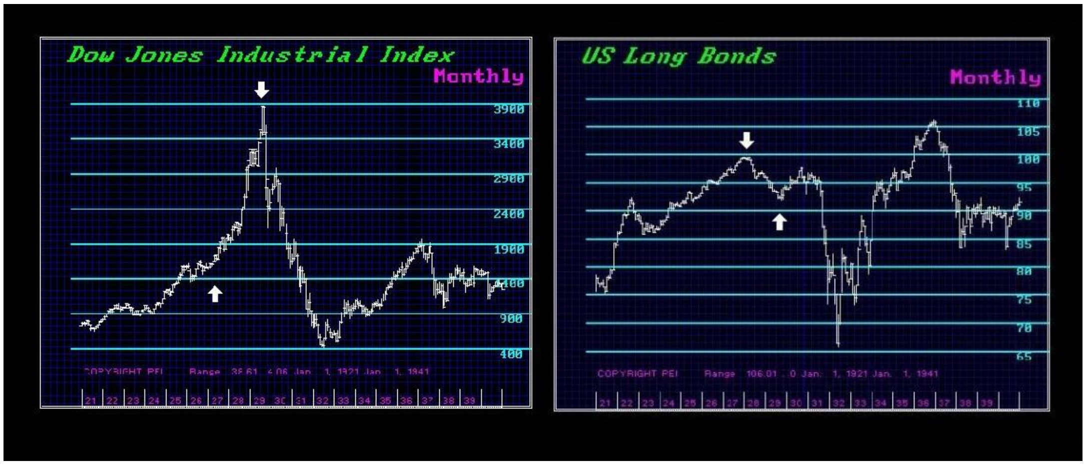


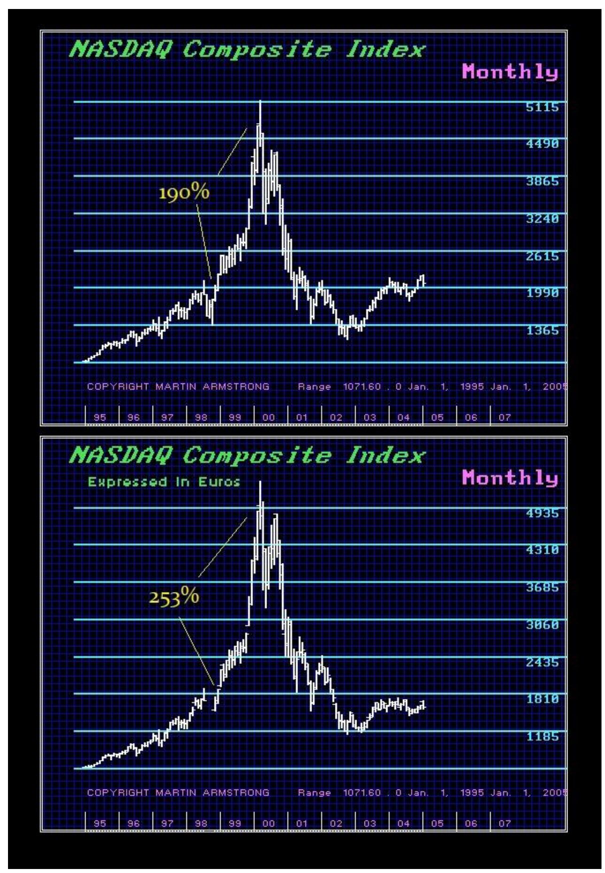
It has been very interesting how the vast majority of analysts have been calling for a major crash in the stock market up to 50% with interest rates so low and the dividends on the Dow twice that of interest rates. It does beg the question; Does anyone look at yield anymore?

The yield on the Dow Jones is about 2.34%, which is about comparable the 10–year rate. Back in 1983, I presented these two charts that show the earnings and book value of the Dow Jones Industrials. The majority were calling for a crash and our computer warned of a Phase Transition and a 600% rally in the Dow. I was blamed for creating the takeover boom because they always need to blame someone else when they themselves just cannot see the trend. It was clear that the earnings were at least 5% and the stocks were trading out of a major historical low on price v book value established in 1977.

So many people are just prejudiced by this Keynesian Model and interest rates as well as the central banks. One person on the blog had asked: *"I'm just wondering how the stock markets can go up into a rapid bubble in 2015 –17, if the bonds are going to collapse in Oct. of '15?"* This question from before the breakout illustrates just how this has been the **Most Hated Bull Market in History**. The vast majority of people have missed the rally and this is reflected in the broker loans being well below the 2007 rally levels.

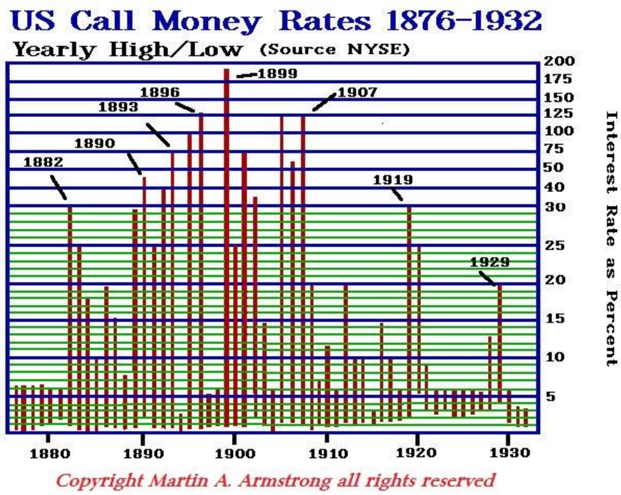


It is the rising interest rates that are a reflection of demand to borrow that is the hallmark of bull markets. We can see that the stock market rally between 1927 and 1929 with rates doubling by the Federal Reserve and bonds declined. Despite the hard evidence to illustrate that this market myth is totally bullshit, it prevails in the same manner that people clung to the idea of changing the calendar to the first day of the year became January 1st (the non-accepting people were called April Fools), or those that clung to the linear vision that the earth was flat.



The rise in the dollar is what attracts foreign capital and that is what makes a bubble as was the case back in 1919 as well as the bubble top in Japan in 1989. You do not get a bubble on simple domestic trends. A bubble like 1929 in the USA and 1989 in Japan or even the DOT.COM in 2000, were all driven by capital inflows into those nations and sectors.

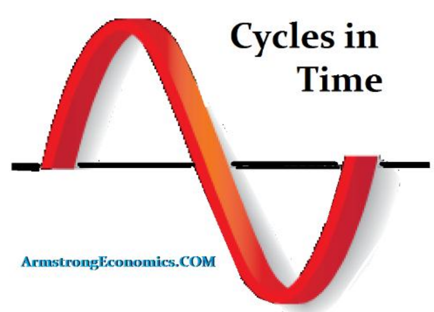
When we look at the DOT.COM Bubble, in US dollars the advance from November 1998 was 190%. In terms of Euros, the rally was 253%. This is what makes a bubble. The same was the case in Japan and 1929. Foreign investors make more than domestic.



Every time interest rates decline there is a bear market. When rates rise, there is a bull market. The stock market has **NEVER** peaked with the same rate twice because it is the difference between interest rates and expectations. If you expect the market to double, you will pay 25%. You do not see the stock market peak with the bottom in rates. That has **NEVER** happened even once.

I understand that this is not the norm. This is **NOT** my personal opinion or soapbox. This is simply how things function. We identify the **REAL** way capital moves and that is what our computer monitors. This is not a popularity contest or politically correct forecast. The majority of people will not read this report for they are incapable of opening their mind to try to explore how the world really ticks.

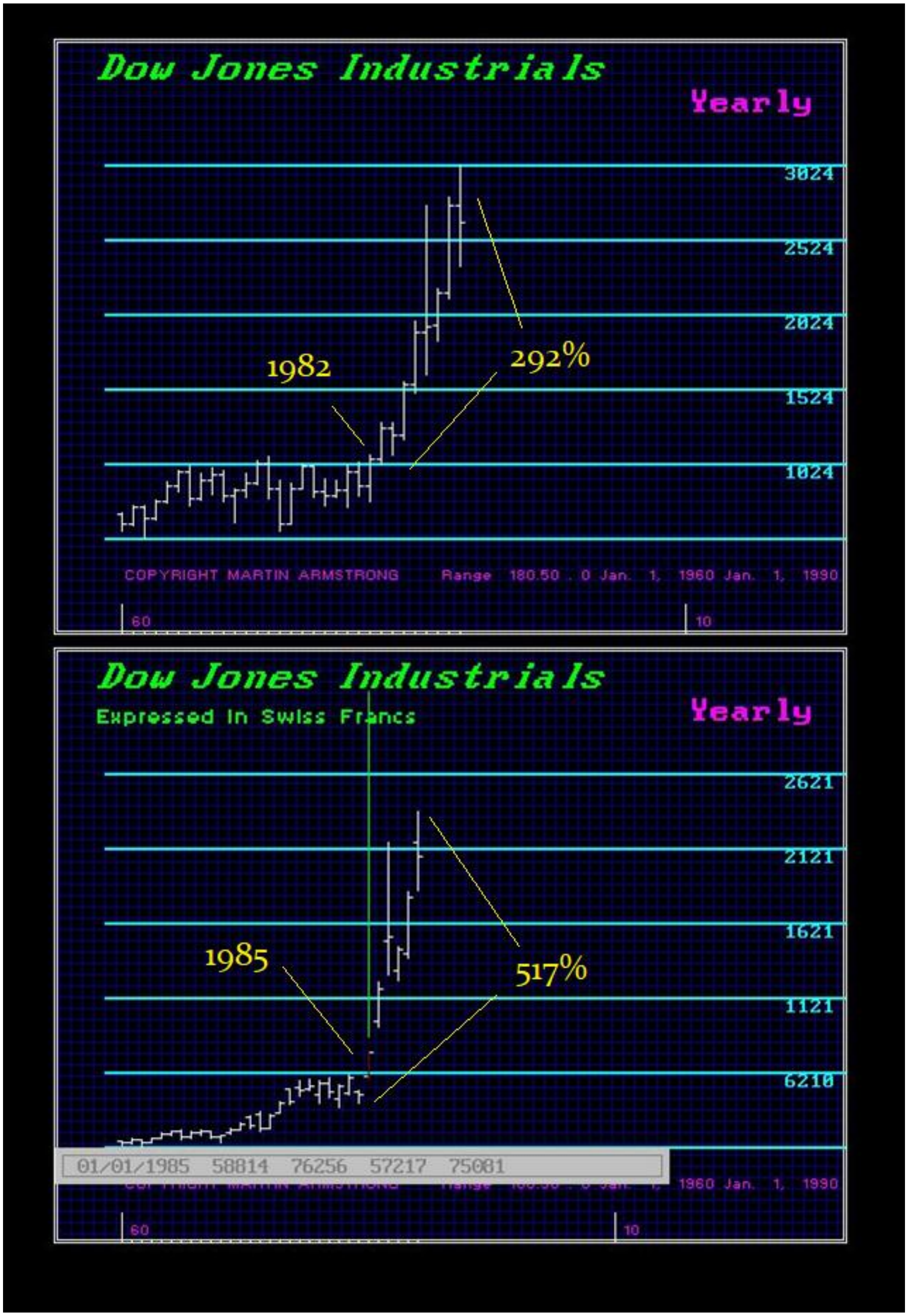
Many people confuse the business cycle with the individual concept of free will. Any deterministic framework applies only to the collective level of the economy. We all have our individual free will which is why there is always a left and right and the cycle flips back and forth. Some people eventually switch sides after time.

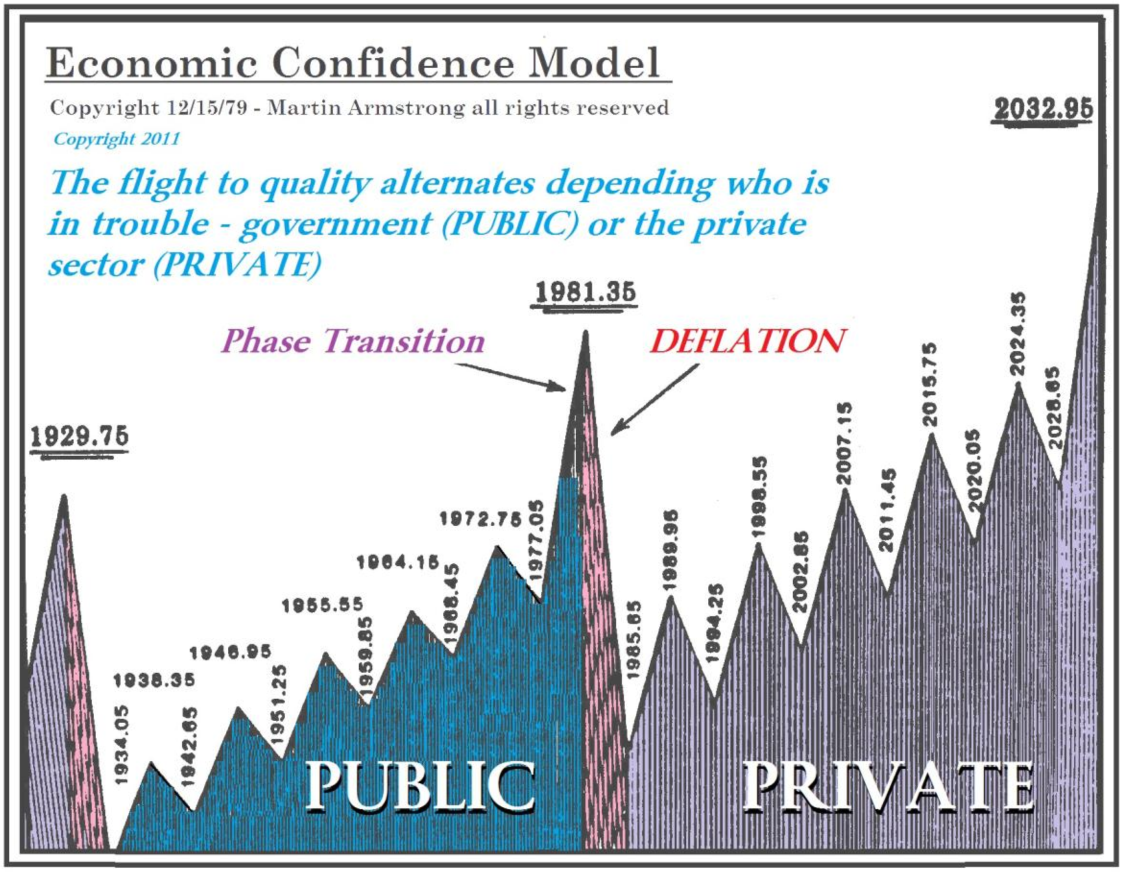


Society in a collective state produces the business cycle. As we move through life, we mature and change our thinking based upon experience. There are some who understand the business cycle and move with it, and others who act in a herd instinct. There is a difference between the individual and the collective cycle which we can call the business cycle.

Even if we look back at the Take-Over Boom in the 1980s from a global perspective, between 1982 and 1990, the Dow Jones Industrial Index rallied 292%

while in Swiss francs, the rally was 517%. There was more than just the take-over taking place. In September 1985 was the Plaza Accord where central banks decreed, they would push the dollar down by 40%.





The breakout in the Dow came with the turn in the **Economic Confidence Model** which was 1985.65 and the beginning of this new Private Wave that peaks in 2032.95. This turning point they call also the beginning of the Takeover Boom for price relative to book value reached historic lows by the end of the Public Wave.

It is during a Public Wave when people look at private assets as secondary class.

The low on the 30–year bond (high in rates) was precisely with the peak in the Public Wave 1981.35. That represented the peak in the power of government, and we have seen nothing but desperate attempts to regain that power.

We must avoid one-dimensional perspectives that always seek to reduce everything to a single cause and effect. We tend as a whole to ignore complexity and view everything in terms of domestic currencies and politics. The world economy is not as simple as traditional economists portray or the talking heads on TV. We must realize that both are the world's worst analysts. It is like Einstein says. You cannot solve the problem with the very same line of thinking that has created it. This is **WHY** the majority must always be **WRONG.** They are the **FUEL** that propels the swing into the opposite direction.

To understand the business cycle, go back to your childhood. Remember the day when we would get on a swing and propel it with our legs and body weight. You would swing it to the point of reaching a real high. Think back to that moment where you reached that high and for a brief second you were suspended in midair. Your momentum was halted by the gravitational pull of the earth. The two reached a balancing point and you were weightless as free as a bird. Suddenly, the power of gravity overcame your momentum and you were pulled back to reality.

In trading, we always need someone on the opposite side to trade against. That is what makes it all work – gravity v momentum. Rising rates are a reflection of inflation, perhaps, but they are a reflection of demand for money. As long as the anticipated gains are greater than the rate of interest, then people will continue to borrow.

This experiment with negative rates has upset the balance of the global economic system. Therefore, this entire REPO Crisis is all about defending Keynesian Economics. This has nothing to do with "stimulating" the economy any more. This is about defending the power of central banks. What is at stake here is the very existence of of the theory of Keynesian Economics. This experiment with negative interest rates has profoundly set in motion one of the most dangerous crisis we may every face. It is bring to a boil not only the entire myth of interest rates and the ability of central banks to manipulate society by lowering and raising rates, it has now trappend central banks for allowing rates to normalize will undermine at least $12 trillion of negatively yielding debt. The world will never be the same and this is what is bringing society into the final confrontation with Marxist philosophies.

The Role of Money

The Alternative to Force & the Great Enabler of Civilization

It has often been stated that ***"money is the root of all evil."*** In reality, money is the **Alternative to Force** that **Enabled Civilization** to take hold from the outset for it facilitated interaction providing a **Medium of Exchange** and has been the **Unit of Account** by which we measure value. It is in this respect that we must understand the true role of money.

Money is more than a **Medium of Exchange** which is agreed upon by all parties. It is also the **Unit of Account**. In this respect, money transcends to yet another level. It becomes the **mental language** by which we measure everything in terms of value. Money is the most important element to understand, yet it truly is the most common everyday construct that everything hinges upon in our daily lives, but simultaneously we only superficially understand its function.

Money is a mental language because it is the **Unit of Account** by which we compare values. When we look at anything and ask the price, we are using this Unit of Account as a mental language which creates the concept of value in our mind. We use this mental language of value comparing one item to another.

If one store has something at one price and another at twice the price, our mind immediate sees the disparity and translates that into a concept of value upon which we then are moved to some action.

Now, take that basic understanding into the international financial markets. We may look at assets in a foreign country but at the same time we translate that price into the value our mind understands based upon our home currency. So, an American will always translate it back to dollars, the Japanese to yen, the Brit to pounds, and the European to euro.

In 1985, I was in London when the pound fell to $1.03. Americans were buying property in London like it was on sale at Harrods. The Brits thought Americans were crazy buying at the high and could not understand the currency play. I have relayed the story before of flying the Concord. When the British began flying the Concord, tickets were at £2,000 which was about $5,000 in 1980. When the pound crashed to nearly par in 1985, suddenly the Concord was cheaper than first class TWA ticket out of New York. I walked into British Airways and asked how many open tickets they would sell me. They looked at me like I was crazy. They said 25 tickets maximum. I thought I just made a fantastic currency play. When I boarded the Concord, the plane was full of Americans who were bragging about how cheap it had become.

Everyone started flying the Concord and British Air finally called it a success after its first launch in 1969. They then raised the price to £4,000 pounds seeing all flights were booked. But then the pound rallied back to almost US$2.00 causing the price of the ticket to rise to nearly $8,000 and passengers returned to conventional flights.

Currency has always had a major impact upon markets and inflation typically because most have no understanding of currency in a floating exchange rate system. Western perceptions are prejudiced by linear thinking. They do not grasp that everything moves in a cyclical manner.

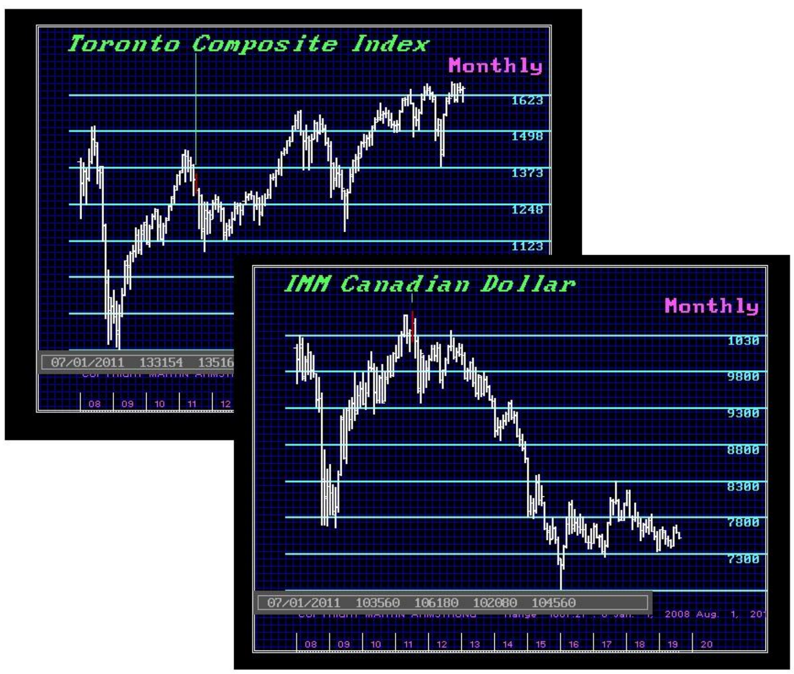
Richard E. Nesbett wrote a good book entitled ***"The Geography of Thought, How Asians and Westerners Think Differently … and why."*** He attributed his work to a Chinese student who said, ***"You know, the difference between you and me is that I think the world is a Circle, and you think it's a line."*** He goes on to quote him:

> *"The Chinese believe in constant change, but with things always moving back to some prior state. They pay attention to wide range of events; they search for relationships between things; and they think you can't understand the part without understanding the whole. Westerners live in a simpler, more deterministic world; they focus on salient objects or people instead of the larger picture; and they think they can control events because they know the rules that govern the behavior of objects."*

Indeed, Western thinking is prejudiced because it indeed sees everything as a straight line. It cannot get its head around the concept of cycles. It assumes that everything will remain the same and cannot see the cyclical nature behind events.

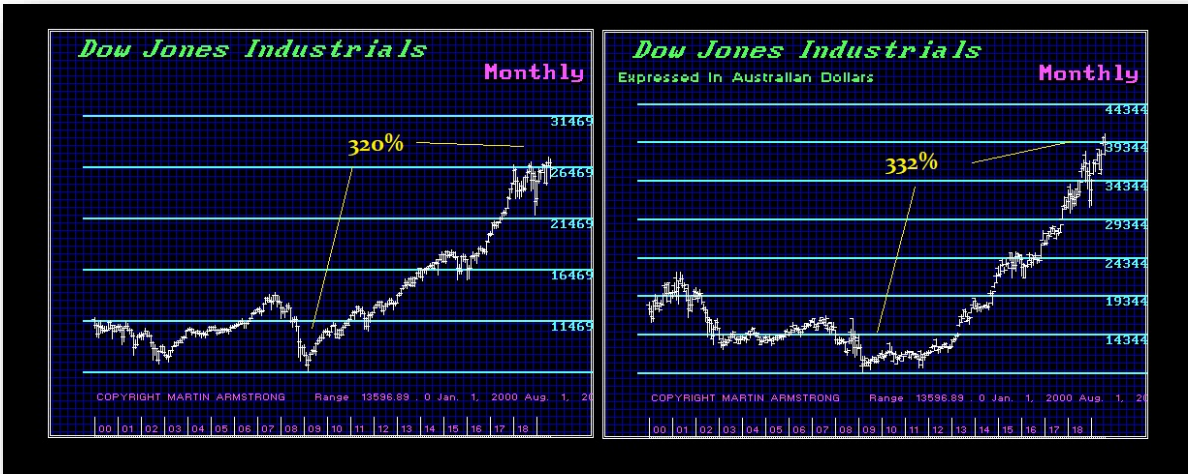
During the 1970s, I always bought German cars. A Porsche cost me $10,000 in 1970 and by 1980 it was $50,000. To this day, the Italian Ferrari is bought and held as an "investment" because people **CONFUSE** currency with the object. Is it really a Ferrari that is rising in value or is it currency? When the pound crashed into 1985, a 328 Ferrari, which was a £32,000 car when the pound was US$2.40 ($76,800) fell to about $32,000 when the pound dropped to US$1.03. I bought a Ferrari in London and drove it around for two years there.

Because the pound crashed, the Italians raised the price to £60,000, which was on par for what the car cost in the USA. But the pound rallied back to nearly $2 and after driving it for 2 years, I sold it for twice the dollars I had paid. Did I make money on the Ferrari? Or was I just playing foreign exchange? It was currency not the car! Companies have made that mistake in producing a product and then raising prices based upon the current value of the currency and then when the currency turns, their sales decline because the product is them over valued. Both Ferrari and British Airways responded to the short-term changes in currency and lost market-share.



International Value

Provided the confidence has not collapsed in the government, then the decline in the currency will normally result in the rise in asset values (currency inflation). This is how assets are arbitraged to maintain this perspective of international value where foreign investors look at the decline in the currency making the assets appear cheap in their view of value. They begin to look at the asset not realizing it is a currency play exactly and the Concord tickets and the Ferrari.



Everyone will invest according to their own perspective of value. The strength behind the US share market rally has been the fact that the dollar bottomed against the Euro in 2008 and it has been rising on the broader level ever since. The strong rally in the dollar has made the US market exceptionally attractive to foreign investors. While the market in dollar terms has risen 320% up into July 2019, in terms of A$, the Australian made 332%.

Indeed, the Dow bottomed in March 2009 at 6,469.95. The highest monthly closing for the Euro was also March 2009 at 1.787. The July 2019 closing for the Euro was 1.1075. The July high in the Dow was 27,398.68. On an intraday basis, the Dow rally was 323%. This means in Euro, the Dow bottomed in March 2009 at 3,620.03 and the high in July was 24,738,6 posting a gain of 583%. Smart European money has been playing the US share market and every dip they were there buying more saying thank you ever so much.

This is the real-world perspective through the eyes of currency. This is why the real definition of a Bull Market is something which rises in terms of **ALL** currencies, not just the domestic currency. Both the bull market in the USA for the Roaring '20s was a strong dollar. The Nikkei Bubble in 1989 rose with a rising yen. A strong rally coupled with a rising currency provides greater profits for the foreign investor than the domestic player.

The End of Keynesian Economics?

Perhaps the most overlooked aspect of the REPO Crisis is the fact that this is all about power and has **NOTHING** to do with Quantitative Easing. All the central banks are in the fight of their life. Their authority under Keynesianism has been to control the short-term rates. The whole **Quantitative Easing** theory was to try to reduce long-term rates buying in long-term government bonds reducing the competition in hopes the banks would start to lend long-term and thus "stimulate" the economy. The short-term rates has where their power resided under Keynesianism whereby they rise or lower rates to manipulate demand to manage the economy.

Therefore, this entire Repo Crisis is all about defending the Keynesian Economics lineage. This has nothing to do with "stimulating" the economy anymore. This is about defending the power of central banks. What is at stake here is the very existence of the theory of Keynesian Economics. In 1978, former Chairman of the Federal Reserve Paul Volcker made it clear that Keynesian Economics had already failed when the Recession of 1974-1976 unfolded and stagflation emerged causing confusion in the economic world

The New Classical school in economics emerged during the 1970s in response to the failure of Keynesian Economics to explain stagflation. Prices were rising, primarily because of the oil embargos which forced prices higher based on cost rather than demand. Therefore, like increases taxes, it merely reduced the net disposable income despite the gross amount risen they ended up calling "STAGFLATION" – rising prices that did not result in economic growth. Under the Keynesian Model, there was no such exception for that scenario because it was purely based upon a one-dimensional construct of the economy predicated entirely upon demand. Consequently, if prices rose the economy was also supposed to expand in growth based upon demand. Volcker realized back then that Keynesian Economics had failed, yet he still raised interest rates into 1981 based upon the Keynesian demand model lacking any other tool whatsoever or theory. Volcker's actions were still entirely based upon Demand Economics presumptions.


Robert E. Lucas Jr.
(born 1937)

There emerged what became known as the New Classical Economic movement led by Robert Lucas Jr. (born 1937) and Monetarist Economic theory criticisms of Milton Friedman (1912–2006) respectively which forced the rethinking of Keynesian Economics.

Lucas argued that it was impossible to forecast economic changes based on previous relationships such as Keynes' consumption function because such aspects were not **structural** and could vary with respect to changes in government policy variables. This simply became known as the **Lucas Critique** which he claimed explained the paradigm shift that occurred during the 1970s. Lucas saw that in macroeconomic theory that it moved toward establishing micro-foundations, which are simply the microeconomic behavior of individual agents including business firms and households. He believed that the key underlying foundation of economic theory was human behavior.

Lucas' arguments called into question the entire Keynesian model and led to the proposition that all macro models should be based on microeconomics. Yet, this complicated approach was still based upon presumptions of human behavior without understanding the overall trend set in motion by herd instincts. No every person acts rationally but will respond based upon what everyone else is doing at that moment– i.e. Milgram's **Obedience to Authority**.

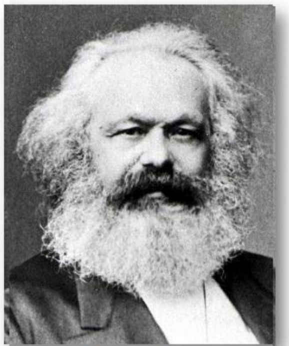
Milton Friedman
(1912 – November 16, 2006)

In the case of Milton Friedman, he is best known for reviving interest in the money supply as a major determinant of the nominal value of output. In other words, the **Quantity Theory of Money**. Monetarism has been what defines all this talk that we would see hyperinflation because of the **Quantitative Easing** by central banks. Here too, the failure has been its one–dimensional assumption. What it is missing is the confidence of the people. Even increasing the supply of money has utterly failed to produce inflation when the people have no confidence in the future and thus the hoard the cash for a rainy day.

Roman Bronze Hoard
Late 4th Century to early 5th century

We even find hoards of debased Roman coins during a period of political instability. People will simply hoard money, even when debased, if they have no confidence in what comes tomorrow. This has led to the cries by various economists to cancel the currencies and move 100% to electronic to stop people from hoarding cash which they recognize has defeated the **Quantity Theory of Money**. As always, instead of reviewing their theory and comprehend why it has failed, inevitably the solution they seek is to compel the economy and people comply with their ideas.

Now we face yet another change to the economic theories used to manipulate our lives. The new **Modern Monetary Theory** of money has emerged becausze they have witnessed the increase in the money supply with **Quantitative Easing** and concluded that they can just print money without restraint and there will be no inflation. They propose injecting Marxism whereby they raise taxes on the



Karl Heinrich Marx
(1818-1883)

John Maynard Keynes
(1883-1946)

upper class to create a new economic Utopia where recessions and market crashes are forever extinguished from our daily lives. They fail to look closely at Europe or Japan and observe while there has been no inflation, they have created anemic economic growth at best. They ignore the fact that the rich create jobs through investment whereas government created jobs siphon off wealth reducing economic growth.

After the 1970s and the apparent failure of **Keynesian Economics**, the rise of these other theories emerged in an effort to try to explain the development of stagnation which is a period of slow economic growth with relatively high unemployment that is accompanied by rising prices (inflation).

The development of these various economic theories all continued to be constructed upon the underlying proposition of John Maynard Keynes (1883–1946) that the government possessed the power to manage the economy which was in truth following Karl Marx (1818–1883). What emerged, has become known as the **New Keynesian Model**, which has been the merger of Keynesian Economics (demand) with the Monetarist view based on the **Quantity Theory of Money**. This merger has resulted in a major shift in the fundamental focus of how economic models have been viewed. There has been a move toward a monetary exchange economy perspective, as opposed to a barter economy. Hence, it became more about cash and credit controlled by central banks rather than the simple exchange of goods between individuals or businesses.

Therefore, under **Keynesian Economics** government bonds were the influential factor in long–term interest rates that led to the idea of buying in long–term government bonds by the central bank to lower long–term rates within the economy. The long–term rates are NOT established by a central bank but are set by the free market. The economic focus therefore shifted to the central bank to control interest rates on the short–term in theory to control demand under

RECESSION WARNING SENDS DOW TUMBLING

RICHARD DREW, ASSOCIATED PRESS
A board above the trading floor of the New York Stock Exchange shows the closing number for the Dow Jones industrial average on Wednesday.

BY DAMIAN PALETTA, THOMAS HEATH AND TAYLOR TELFORD
Washington Post

Recession signals intensified Wednesday in the United States and in some of the world's leading economies, as the damage from acrimonious trade wars is becoming increasingly apparent on multiple continents.

The U.S. stock market tumbled to its worst day of the year on Wednesday, after a reliable predictor of looming recessions flashed for the first time since the run-up to the 2008 financial crisis. The Dow Jones industrial average fell 800 points, or about 3%, and has lost close to 7% over the past three weeks.

Two of the world's largest economies, Germany and the United Kingdom, appear to be contracting even as the latter forges ahead with plans to leave the European Union. Growth also has slowed in China, which is in a bitter trade feud with the United States. Meanwhile, Argentina's stock market fell nearly 50% earlier this week after its incumbent president was defeated

Please see **RECESSION,** Page A8

Keynesian Economics. The central bank assumed the role of manager of inflation post–Great Depression. What has emerged recently post–September 2019 has been the assault on short–term rates within the free market forcing the Federal Reserve to intervene to defend its own power which is now the Repo Crisis. The original design of the Fed in 1913 was simply to manage the capital flows between the regions within the domestic economy with each branch acting independently to provide stability for the banking system. It was **NOT** the master of inflation.

While the Fed was considering lowering interest rates in the fact of an inverted yield curve into August 2019, they were also being lobbied to help Europe and Japan which were pleading for the Fed to lower rates because they are trapped. Hence, faced with the pressing inverted yield curve as long–term rates were pressing lower as capital was fleeing from Europe in particular, the free market had other plans with the Repo Crisis emerging on September 17th, 2019 which forced the Fed to halt its policy to lower rates in sympathy.

The Inverted Yield–Curve was being touted as a major indicator that a recession was upon us. This was why the Fed was lowering rates on August 1st, 2019. On August 15th, the St. Louis Post–Dispatch of St. Louis, Missouri was printing the story written by the Washington Post which was virtually cheering a recession to defeat Trump – their arch enemy.

We can see that the policy objectives of the Federal Reserve were viewing the inverted yield–curve as recessionary and therefore were lowering rates to accommodate Europe and Japan. Little did they understand that this was all being driven by capital inflows pouring into the dollar particularly from Europe. As the free markets showed, the fears rising from European banks set in motion the Repo Crisis by mid–September 2019.

A8 • ST. LOUIS POST-DISPATCH NEWS M 1 • THURSDAY • 08.15.2019

Recession

From A1

by a left-wing opponent.

Whether the events presage an economic calamity or just an alarming spasm are unclear. But unlike during the Great Recession, global leaders are not working in unison to confront mounting problems and arrest the slowdown. Instead, they are increasingly at each other's throats.

President Donald Trump has responded by both claiming the economy is still thriving while dramatically ramping up his attacks on Federal Reserve Chairman Jerome Powell, seeking to deflect blame.

Wednesday's sharp selloff was caused by an unusual development in the bond market, called an "inverted yield curve," that often foreshadows a recession.

For the first time since the run-up to the Great Recession, the yields — or returns — on two-year Treasury bonds eclipsed those of 10-year bonds. Normally, the government needs to pay out higher rates to attract investors for its long-term bonds. But with so many losing confidence in the near-term prospects of the economy and rushing to buy longer-term bonds, the U.S. government now is paying more to attract buyers to its two-year bond than its 10-year note.

This phenomenon, which suggests investor faith in the economy is faltering, has preceded every recession in the past 50 years.

"The stars are aligned across the curve that the economy is headed for a big fall," said Chris Rupkey, chief financial economist at MUFG Union Bank. "The yield curves are all crying timber that a recession is almost a reality, and investors are tripping over themselves to get out of the way."

RICHARD DREW, ASSOCIATED PRESS

From left, specialists Glenn Carell, John O'Hara and Robert Nelson gather at a trading post on the floor of the New York Stock Exchange on Wednesday. The Dow Jones Industrial Average sank 800 points amid warning signs of a possible recession.

It's the latest in a string of worrisome news about the U.S. economy. The government is expected to spend roughly $1 trillion more than it brings in through revenue this year, adding to a ballooning deficit. Business investment has begun to contract — largely due to the uncertainty surrounding Trump's trade war — and manufacturing hiring has receded. The big hiring and investment announcements that piled up at the beginning of the Trump administration have ceased, as have the announcements of bonuses and pay increases that came after a tax cut law was passed in 2017.

Several White House officials have become concerned that the economy is weakening faster than expected, but they are not working on proactive plans to try and change its course. The Treasury Department has had an exodus of senior advisers in recent months, and the White House just announced a replacement for its chairman of the Council of Economic Advisers.

Instead of rolling out new policies, Trump and other top aides have escalated their attacks on the Federal Reserve, trying to pin much of the U.S.'s problems on what Trump alleges is elevated interest rates that are strangling growth.

In a series of Twitter posts on Wednesday, Trump appeared to try and calm investors while also unloading vicious language aimed at Powell, whom he nominated in late 2017.

"China is not our problem, though Hong Kong is not helping," Trump wrote. "Our problem is with the Fed. Raised too much & too fast. Now too slow to cut.... Spread is way too much as other countries say THANK YOU to clueless Jay Powell and the Federal Reserve. Germany, and many others, are playing the game! CRAZY INVERTED YIELD CURVE! We should easily be reaping big Rewards & Gains, but the Fed is holding us back. We will Win!"

The Twitter posts reflected a growing anxiety within the White House about problems in the economy, which many advisers believe will determine whether the president wins reelection. A few hours earlier, Trump offered a contradictory assessment, saying the inverted yield curve was a good sign because there were "Tremendous amounts of money pouring into the United States. People want safety!"

In the past, Democrats and Republicans in control of the White House have scrambled when there were signs of an economic downturn, worried about the political fallout. They met and often consulted with Congress about ways to protect the economy or advance some kind of economic stimulus, either through tax cuts or spending increases.

But the Trump administration has already cut taxes and boosted spending, and there appears to be little political appetite to do more of either this year or next. White House officials have discussed a plan to make changes to the way capital gains taxes are levied, but that would only impact certain investors and has already faced criticism from Democrats as being a boon to the rich. Complicating matters, a number of investors and foreign leaders have blamed Trump's trade war for causing the contraction in business investment and forcing companies to pull back, an accusation that has caught White House advisers off guard.

The U.S. economy has shown signs of weakening in recent months, but high levels of consumer spending in the United States have helped enormously. Still, the escalating trade war between Trump and Chinese leaders has stopped many businesses from investing. And there are signs that the large tariffs he has placed on many Chinese imports is costing U.S. businesses and consumers billions of dollars.

In a rare admission of the economic consequences of his adversarial trade approach, Trump on Tuesday announced he was delaying many of the tariffs he had promised on cellphones and laptop computers until Dec. 15. That announcement brought the stock market up sharply higher on Tuesday, but all of those gains evaporated in minutes Wednesday amid fears about the inverted yield curve.

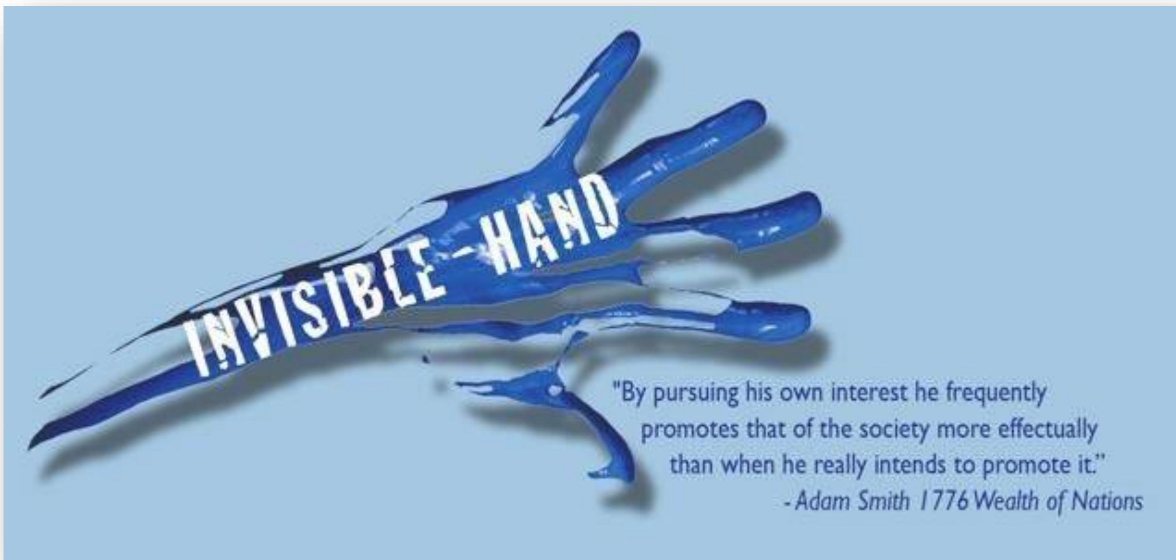
The Standard & Poor's 500-stock index, a broader measure of stocks, and the tech-heavy Nasdaq composite index both sank about 3%, matching the losses experienced by the Dow. Nearly all market sectors were in the red Wednesday, with energy, consumer staples and financial services leading the way.

Darkening skies overseas gave investors more to worry about. New data indicated Germany was slipping into recession with the country's economy shrinking 0.1% between April and June. If it experienced another contraction during this quarter, Germany officially would meet the definition of a recession. Officials blamed the drop-off on the U.S.-China trade war and the looming threat of a hard Brexit by the U.K.

"The big concern is around trade," said Dan Ivascyn, group chief investment officer at Pimco. "The longer we remain in limbo, the more damage to the global economy. You already have a fragile global economy, and with this trade tension you are beginning to see people shift into safer assets with almost complete disregard for what they are earning on those assets."

St. Louis Post-Dispatch, St. Louis, Missouri - August 15, 2019, Thursday • Page A8

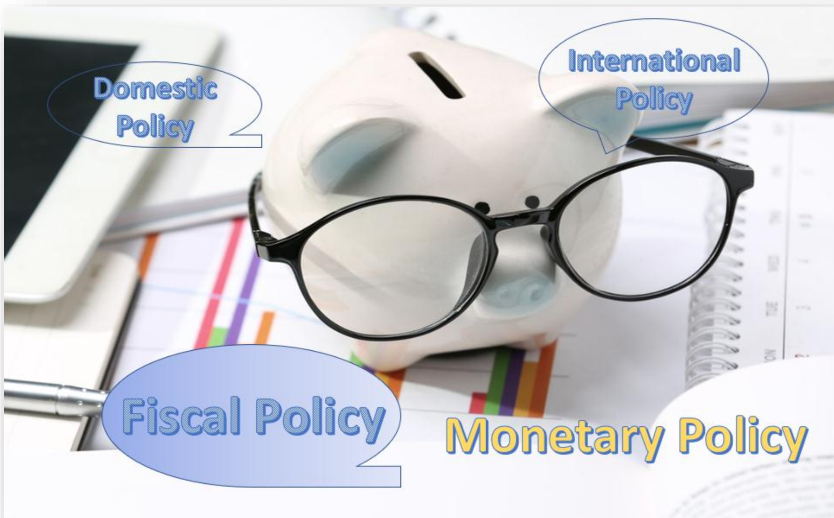
This shift in focus of the role of the central bank post-Great Depression under **Keynesian Economics** to manage "demand" through the manipulation of interest rates has come to a climax. The whole negative interest rates has killed Keynesian Economics and encouraged domestic hoarding of cash and capital flight to other currencies. This now also resulted in the free markets confronting that assumed power erupting into a Repo Crisis. Raising the interest rate is supposed to reduce demand for assets and result in making "Cash is King."



Therefore, we have already seen a shift from using government bonds as the main economic indicator to short-term rates on money. Consequently, the Fed was forced to intervene into the Repo market to maintain its only power over short-term rates. Its attempt to lower rates at the start of August resulted in a complete reversal of direction in September. Then the Fed funds rates were in jeopardy of rising by the **Invisible Hand** of the free market. The economy has shifted to very short-term central bank money which is precisely the crisis in the Repo market. Consequently, the Federal Reserve cannot lower rates as long as there is a liquidity crisis in the Repo Market.

The **New Keynesian Model** has emerged as a model based on a monetary exchange economy in contrast to a barter economy based on transactions. The rate of interest is the rate of interest paid on central bank money, rather than on government bonds. The free markets are raising the interest rate on short-term money which normally reflects a coming recession as the demand for cash rises against assets. However, we are witnessing a different version where there is a demand for US dollars in both cash and assets in contrast to the collapse in demand for the external currencies in Asia and Europe. Therefore, we have already seen the shift the old theory that interest rates up and stocks down. That has simply failed in this new version of a financial crisis.

Fed's Changing Focus



Once upon a time, the Federal Reserve was simply created to secure the banking system. Post-Keynesian Economics, the Fed was charged with managing the demand within the economy to control inflation. It was theorized that the Fed could control the business cycle completely and manage the economy eliminating depressions and recessions.

Suddenly, the Fed was then charged with Monetary Policy rather than the overlord of the banking system, yet it had no control over the fiscal policy spending of politicians. Then the Fed began to be impacted by external factors with the advent of World War I and the movement of capital flows globally even before it opened its doors. It has still been trying to figure out how to deal with external factors it cannot possibly control – namely international policy and fiscal policy objectives.

While the Federal Reserve has injected tens of billions to calm the short-term lending markets known as the Repo Crisis, it is totally powerless to influence the international policies of negative interest rates in Europe or Japan, As public confidence is declining domestically, the Fiscal Policy carried out through the U.S. Treasury Department has only complicated the job of the Federal Reserve.

The Treasury must raise the money that politicians are spending, and it too has no control over the politicians. The Treasury Department must cope with higher spending by Congress, which is also creating large swings in the amount of money it has on deposit with the Federal Reserve. Some argue that this which also undercuts the Fed's ability to keep bank reserves stable. During last year, there was a large shift in cash from the Treasury which drained liquidity from the banking system that some contend contributed to the Repo Crisis. Some maintain that this is putting greater strains on the Fed's reserve management and funding markets. However, the deficits have not ballooned upward to warrant this as a cause.

The Treasury General Account at the Fed operates as the government's checking account. Money comes in when taxes are paid out of bank accounts of individuals and corporations (which drains banks' reserves held at the New York Fed) and money goes out when the government pays its bills (which does the opposite).

Treasury Disinformation

It appears that there is a disinformation campaign taking place to try to place the blame on the rising deficits. Under the Obama administration, Treasury back in 2015 maintained a policy of keeping at least 5 days' worth of cash on deposit which was a minimum of $150 billion. By 2019, the balance has averaged $303 billion, versus about $240 billion in the prior four years. Arguing that the swings in the Treasury deposits between $450 billion to $112 billion is contributing to the Repo Crisis. I do not find any evidence that this is the source of the crisis.

Some have even proposed that the Treasury could help by shifting its deposits to the big commercial banks instead of the Fed. This seems to be a really brain-dead idea for the Repo Crisis is all about the fact that private banks do not trust other private banks and prefer to deal with the Fed. Even Treasury Secretary Steven Mnuchin has commented on that suggestion that it would only lead to even bigger financial-stability problems. Then the Federal government would depend on a private bank and obviously it would have to be bailed out or the government would fail and that includes Social Security checks. Fed Chairman

Jerome Powell last December 2019 was forced to respond to such a stupid proposal. He said that the Fed officials had not discussed the topic with their Treasury counterparts.

Milton Friedman
(1912 – November 16, 2006)

Monetary Policy

Milton Freidman's (1912–2006) criticism of the Fed during the Great Depression was their refusal to monetize gold inflows thereby failing to expand the money supply. Friedman reasoned that the Great Depression was caused by the Federal Reserve allowing the sharp decline in the money supply that took place during the period 1929–1933. In other words, the Fed turned a normal recession into a depression by failing to implement an expansionary monetary policy in the early 1930s – i.e. austerity!

The Fed's austerity led to over 200 cities issuing their own money just to be able to conduct business. This became known as Depression Scrip. The fact that we find such a wealth of private currency being issued during the Great Depression does confirm Friedman's point.


New England and Midwest Join in Widespread Bank Holiday Move

South Dakota Gets on List

Holiday Measure Recalls Bank Suspensions of 1907

Holiday Fails To Excite City

Wires Limited

'All in Boat,' Is Reaction

Gold Base Odds

Cash Is King For County

U.S. Banks-

Des Moines Tribune, Des Moines, Iowa - March 4th, 1933, Saturday • Page 4

Again, the Monetarist focus was purely on the supply of money in the system no doubt contrinuted to the crisis of the Great Depression. However, the bank holiday of 1933 undermined the entire confidence in the economy and banking system. People hoarded their cash and would not spend it. There were some 9,000 banks that failed. That was not an inspiration of confidence.

DOLLAR DEALINGS HALTED IN EUROPE

London and Paris Suspend Exchange Quotations as Crisis Result.

By the Associated Press.

Dollar transactions were suspended in the European capitals as a result of the American bank holidays. Tourists unable to cash checks were accommodated by hotels, travel agencies and some banks.

London—All foreign exchange quotations were suspended, and there was no quotation on gold. Currency rates in Europe are based on the dollar and there was some talk of the possibility of adopting the French franc or some other currency backed by gold as basis for exchange rates. The foreign exchange policy for Monday was not certain. American branch banks were open, the bankers praised the declaration of bank holidays in the States as a move in the right direction. The stock market closed dull after a quiet session.

Paris—Foreign exchange quotations were suspended here also. There was no quotation on the dollar and the banks declined to cash checks drawn on American institutions affected by the holidays.

Berlin—The official dollar rate was fixed at 4.196 marks bid, 4.204 asked. Since 1930 private dealings in dollar exchange have been forbidden. German bankers felt no apprehension regarding the situation in America.

Rome—There were no dollar transactions. The cable quotation on the dollar was 19.35 lire as compared with the recent average of 19.51.

Madrid—Saturday is a full holiday in Madrid. The dollar was offered off the exchange at 11.86 pesetas, but the quotation slid to between 11 and 11¼. There were no official quotations.

Brussels and Amsterdam had no official dollar quotation. The unofficial rate in Amsterdam was 2.46½ guilders.

Berne—The American dollar was unquoted. The Swiss franc dropped 10 to 14 centimes.

Copenhagen—Here only the pound sterling was quoted. Banks withheld payment for the time being on American checks and bills.

Havana—American branch banks were open all day. The government forbade publication of news concerning bank holidays in the United States.

All the Canadian markets, including the Winnipeg Grain Exchange were open. Dollar quotations were suspended.

The Sunday Star March 5, 1933, • Page 3

The New York Times.

LATE CITY EDITION

ROOSEVELT ORDERS 4-DAY BANK HOLIDAY, PUTS EMBARGO ON GOLD, CALLS CONGRES

HITLER BLOC WINS A REICH MAJORITY; RULES IN PRUSSIA

JAPANESE PUSH ON IN FIERCE FIGHTING; CHINA CLOSES WALL

BANKS HERE ACT AT ONCE

City Scrip to Be Ready Today or Tomorrow to Replace Currency.

The President's Bank Proclamation

The Bank Holiday was called following a month–long run on American banks based on rumors that Franklin Delano Roosevelt was going to confiscate everyone's gold which he denied during the election. Roosevelt proclaimed a Bank Holiday, beginning March 6th, 1933, which shut down the banking system and sent the US dollar into a turmoil internationally.

The Justice Department even sought to prosecute people for hoarding gold. A New York attorney named Frederick Barber Campbell had on deposit at Chase National Bank of over 5,000 troy ounces (160 kg) of gold. When Campbell attempted to withdraw the gold, Chase refused, and Campbell sued Chase (*Campbell v. Chase Nat. Bank of City of New York, 5 F. Supp. 156 (S.D.N.Y. 1933)*).

A federal prosecutor then indicted Campbell on the following day (September 27th, 1933) for failing to surrender his gold. This became the first attempt to criminally prosecute people for not turning over their gold. In the end, the prosecution of Campbell failed. Nevertheless, the authority of the federal government to seize gold was upheld, and Campbell's gold was confiscated. It stands as a warning about leaving your gold in any facility.

World War I & the Federal Reserve

On July 28th, 1914, World War I began with Austria-Hungary's declaration of war against Serbia. Three days later, on July 31st, the London Stock Exchange closed, and this left New York Stock Exchange vulnerable forcing it to close on the presumption that a panic would unfold in the financial markets because of European liquidation. Indeed, nearly all other world stock exchanges were already closed at that time. Eventually, the New York stock market was reopened on December 12th, 1914.

It was clear that European investors prepared to liquidate their holdings of U.S. stocks and bonds to transfer gold to Europe to pay for the Great War. The Europeans had already taken $83 million in gold since May 1, 1914, which was the largest outflow of gold over any consecutive three-month period since the Panic of 1899 when the Bank of England doubled its interest rates to fight speculation. There was considerable concern that a stock market would crash as Europeans were in desperate need of cash which would only increase the gold exports that would result in a financial panic and economic collapse. Keeping the Exchange closed was seen as essential to get the Federal Reserve up and going.

The coincidence of World War I taking place at the same time of trying to launch the Federal Reserve certainly caused a structural problem. President Wilson and Treasury Secretary McAdoo wisely saw the stock market as a serious threat in the face of foreign liquidation which would have jeopardized facilitation of the birth of the Federal Reserve System. Interestingly, John Maynard Keynes emphasized the importance of gold in establishing financial credibility. He argued that London's position as the world's leading financial center would surely be jeopardized if Britain suspended gold payments. It was Keynes who advised the

British government during this time period in his memorandum of August 3, 1914: "…the vital point is that we should not repudiate our external obligations to pay gold until it is physically impossible for us to fulfill them." Milton Friedman and Anna Schwartz wrote: "The Aldrich–Vreeland Act succeeded on the one occasion it was used, the outbreak of World War I." id/1963, p.441.

Indeed, on August 1st, 1914, Germany declared war on Russia. France declared war on August 3rd and Britain joined on August 4th. Austria–Hungary also declared war on Russia and Japan declared war on Germany also during August 1914. Great Britain and France declared war on Austria–Hungary on August 12th. By August 25th, Japan declared war on Austria–Hungary.

German Papiermark 1914

Germany abandoned the gold standard replacing the gold mark with the new German Papiermark as the official currency of Germany for World War I on August 4th. On August 7th, the Currency and Bank Notes Act in Great Britain gave wartime powers of banknote issue to the Treasury.

Benjamin Strong
(1872–1928)

The Federal Reserve Act had only been signed into law on December 23, 1913, and it required that gold be held as backing for Federal Reserve Notes. Congressional hearings on President Wilson's nominations to the Federal Reserve Board were still in progress when World War

I began, and the regional Federal Reserve banks had not yet been organized. Eventually, Benjamin Strong (1872–1928) became the first Governor of the Federal Reserve Bank of New York in October 1914.

ThomasWoodrow Wilson
(1856–1924)

In August 1914 the Wilson Administration demonstrated how to control a crisis without a central bank. Such financial crises frequently present a double threat: (1) a drain of funds from the banking system; and (2) capital flight from the country as a whole. The initial reaction was a capital withdraw from the USA to fund the war in Europe, but then as tanks began rolling down the streets in Europe, the capital turned to a flight back to the dollar.

William Gibbs McAdoo Jr.
(October 31, 1863 – February 1, 1941)
46th US Secretary of the Treasury (March 6, 1913 – December 15, 1918)

The Wilson Administration in 1914 was in a difficult spot as World War I emerged. The USA could not afford to allow its gold reserve to be depleted when it was in the midst of a major structural shift in creating the Federal Reserve. If the gold reserve was lost, then the credibility of the Federal Reserve would have come into question.

The regional Federal Reserve banks did open on November 16th, 1914, almost a month before the reopening of the New York Stock Exchange. President Wilson and Treasury Secretary William Gibbs McAdoo (1863–1941) invoked the Aldrich–Vreeland Act to justify lending freely. In order to stop the gold outflow, they shut down the New York Stock Exchange to prevent foreign liquidations which prevented any default of the gold standard thereby maintaining American financial credibility. Hence, the Wilson Administration suspended the convertibility of the dollar to further maintain the integrity of the United States in the face of a global financial panic.

Treasury Secretary McAdoo declared a financial crisis under the Aldrich–Vreeland Act, which provided the authority to issue emergency currency. This allowed the Federal Reserve to decide the timing and magnitude of securities to deposit as collateral for the issue of this additional currency. This measure was taken to address the liquidity crisis as people instantly began to hoard cash. It was this authority under the Aldrich–Vreeland Act that allowed for the success of this emergency issue of currency to ease the liquidity crisis.

When Congress created the Federal Reserve, a completely new currency came into existence. There were two types of currency issued under the Federal Reserve. The main system currency was simply known as the Federal Reserve notes. Then there were the Federal Reserve Bank notes which were issued by the independent branches.

Federal Reserve Notes of 1914

The **Federal Reserve notes** of 1914 were issued in all denominations from $5–$10,000. They were issued by the United States to the 12 Federal Reserve banks and through them to the member banks and the public. The notes were not issued by the banks themselves as were the **Federal Reserve Bank notes** (known as National Currency) and the obligation to pay the bearer was borne by the government and not by the banks. Hence these notes were not secured by the United States bonds or other securities.

Therefore, the **Federal Reserve Notes** were the emergency issue which was not secured by any certified means of backing. The Federal Reserve notes simply stated: *"United States of America will paid to the bearer on demand."*

The first issue of early 1914 had red seals. Then as World War I broke out, red ink could no longer be imported, and this the emergency issue appeared with blue ink seals. Notes with the red seals are rare and worth a lot more to collectors than the blue seal notes. This reflects the extent of the emergency note issue at6 this critical time of getting the Federal Reserve off and going.

Federal Reserve Bank Note - National Currency - Series 1915 Chicago Federal Reserve Branch

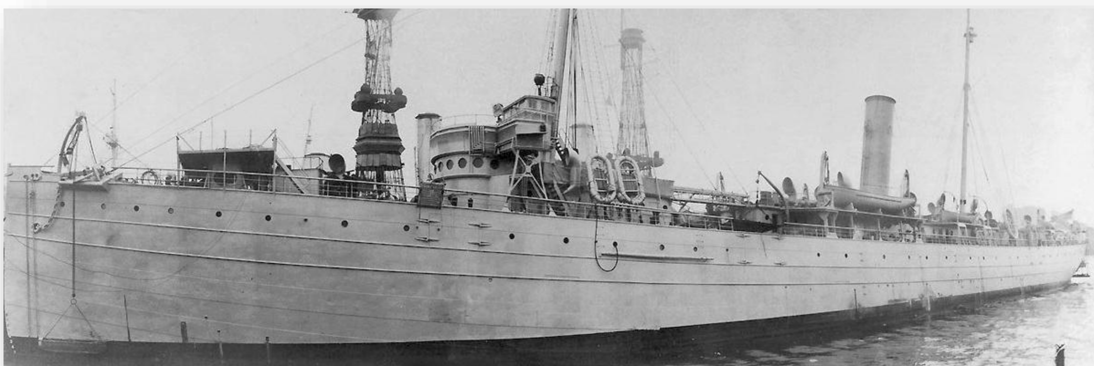
The Federal Reserve Bank notes are inscribed "National Currency." The first series to be issued by the independent lower level branch banks of the Federal Reserve was dated Series of 1915 and consisted only of $5, $10 and $20 denominations. They were only issued by the Atlanta, Chicago, Kansas City, Dallas, and San Francisco.

How these notes different from a banking perspective compared to the emergency issue is very interesting. The obligation of this issue was to pay the bearer on demand only by that specific Federal Reserve branch. The 1915 series stated it was *"secured by United States bonds deposited with the treasurer of the United States of America."*

The next later issue of 1918 stated, *"secured by the United States bonds or the United States certificate of indebtedness or United States one year gold notes deposited with the treasury of the United States of America."*

There were several important developments at this time as well such as on January 25th, 1915 telephone service began between New York and San Francisco for the first time enabling faster domestic communication. Then later that year, the New York bankers granted a 500 million loan to Britain and France at 5% on October 15th. 1915.

The following year, on September 8th, 1916, Congress enacted the Emergency Revenue Act which doubled income tax rates. It also added the estate tax (death tax) and munitions profits tax because Americans were supply Europe and that was perceived as profitable. They also established the Tariff Commission.



Wilson was reelected as President on November 7th, 1916. Then on February 3rd, 1917, the USS Housatonic was sailing from Galveston, Texas, on January 6th, 1917 with a cargo of wheat and flour on its way to Liverpool. It was stopped by a German submarine and inspected. The German commander ordered the crew to abandon the ship which they did, and they sunk it on the grounds that the vessel was carrying foodstuffs to an enemy belligerent. That was the excuse for the U.S. to break diplomatic relations with Germany.

On March 3rd, 1917, Wilson imposed the Special Preparedness Fund Act which provided for excess profit taxes and higher inheritance taxes. The next month on April 2nd, 1917, Wilson called a special session of Congress for declaration of war against Germany.

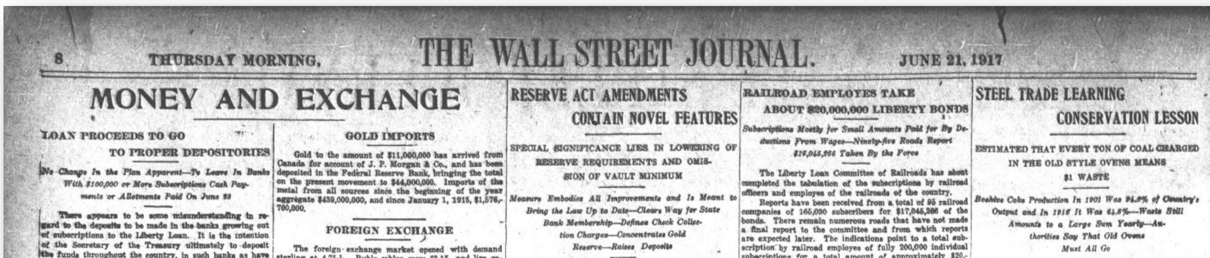
Fiscal Policy

The initial creation of the Federal Reserve was completely independent when it was enacted in 1913. Many conspiracy advocates point to the fact that the major banks are shareholders of the Fed. What they miss is that in 1913, the Fed was created to support the banking system and it was envisioned that the banks would become its shareholder and that was the funding any future for bailouts as J.P. Morgan (1837–1913) had arranged during the Panic of 1907. It was Morgan who a consortium of banks to lend to other banks in New York City to prevent a contagion bank run that would have brought them all down. It was Morgan’s model upon which the Federal Reserve was organized.

John Pierpont Morgan
(1837 - 1913)

The only manner in which the Federal Reserve would “stimulate” the economy was by purchasing short-term corporate paper to keep the economy stable when banks were unable or unwilling to lend. This enabled major corporations to find funding, so they did not have to lay off their work forces. With the passage of time and the changing economic theories, the structure and authority of the Federal Reserve continued to change with each passing financial panic.

World War I resulted in the first issue of government Liberty Bonds to fund the expense of "The Great War" on April 24th, 1917. The entire allotment of the First Liberty Bond issue of $2 billion worth was sold in denominations of $50 to $10,000. The $50 and $100 denominations enabled lower income groups to participate, while the higher denominations were purchased by high-income individuals, banks, and by U.S. corporations to pay dividends to shareholders. For example, U.S. Steel purchased $125 million in Liberty Bonds and the interest received contributed to its own dividends.


8 THURSDAY MORNING, THE WALL STREET JOURNAL. JUNE 21, 1917

MONEY AND EXCHANGE

LOAN PROCEEDS TO GO TO PROPER DEPOSITORIES

No Change In the Plan Apparent—To Leave In Banks With $100,000 or More Subscriptions Cash Payments or Allotments Paid On June 28

There appears to be some misunderstanding in regard to the deposits to be made in the banks growing out of subscriptions to the Liberty Loan. It is the intention of the Secretary of the Treasury ultimately to deposit the funds throughout the country, in such banks as have

GOLD IMPORTS

Gold to the amount of $11,000,000 has arrived from Canada for account of J. P. Morgan & Co., and has been deposited in the Federal Reserve Bank, bringing the total on the present movement to $44,000,000. Imports of the metal from all sources since the beginning of the year aggregate $439,000,000, and since January 1, 1915, $1,576,700,000.

FOREIGN EXCHANGE

The foreign exchange market opened with demand sterling at 4.75½. Ruble cables were 28.15, and lire ca-

RESERVE ACT AMENDMENTS CONTAIN NOVEL FEATURES

SPECIAL SIGNIFICANCE LIES IN LOWERING OF RESERVE REQUIREMENTS AND OMISSION OF VAULT MINIMUM

Measure Embodies All Improvements and Is Meant to Bring the Law Up to Date—Clears Way for State Bank Membership—Defines Check Collection Charges—Concentrates Gold Reserve—Raises Deposits

RAILROAD EMPLOYES TAKE ABOUT $20,000,000 LIBERTY BONDS

Subscriptions Mostly for Small Amounts Paid for By Deductions From Wages—Ninety-five Roads Report $17,045,266 Taken By the Force

The Liberty Loan Committee of Railroads has about completed the tabulation of the subscriptions by railroad officers and employes of the railroads of the country.

Reports have been received from a total of 95 railroad companies of 165,030 subscribers for $17,045,266 of the bonds. There remain numerous roads that have not made a final report to the committee and from which reports are expected later. The indications point to a total subscription by railroad employes of fully 200,000 individual subscriptions for a total amount of approximately $20,-

STEEL TRADE LEARNING CONSERVATION LESSON

ESTIMATED THAT EVERY TON OF COAL CHARGED IN THE OLD STYLE OVENS MEANS $1 WASTE

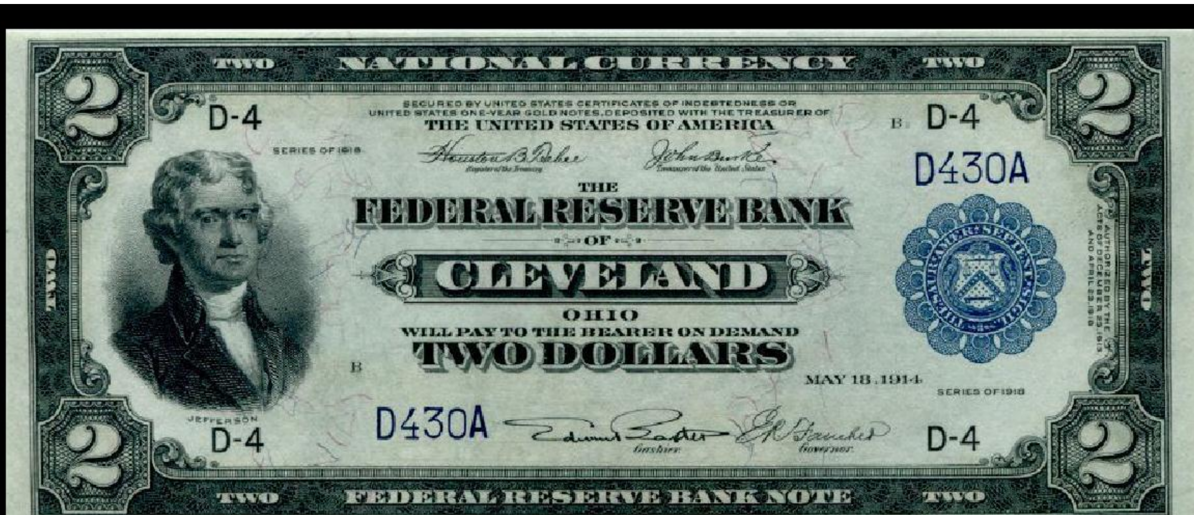
Beehive Coke Production In 1901 Was 94.8% of Country's Output and In 1916 It Was 64.6%—Waste Still Amounts to a Large Sum Yearly—Authorities Say That Old Ovens Must All Go

The **Federal Reserve Act** was amended on June 21st, 1917. The Wall Street Journal reported: "Reserve Act Amendments Contain Novel Features." Indeed, this change to the authority of the Federal Reserve directed the bank to establish branches eliminating any confusion with respect to whether it was a discretionary or mandatory directive of Congress.

The Act of 1917 also clarified that any state bank which became a member bank of the Federal Reserve would retain its corporate powers under state law respecting the Separation of Powers.

US Gold certificates were to be counted as part of the gold reserves of the Federal Reserve Bank. However, this amended version of the Federal Reserve act of 1917 authorized the Federal Reserve to issued notes on the security of the 15-day notes of member banks secured by any eligible commercial paper or by bonds or notes of the United States. Therefore, the **Federal Reserve Bank Notes** were allowed to be backed by private debt.

$1000 Federal Reserve Not Series 1918 "Will Pay to the Bearer on Demand"



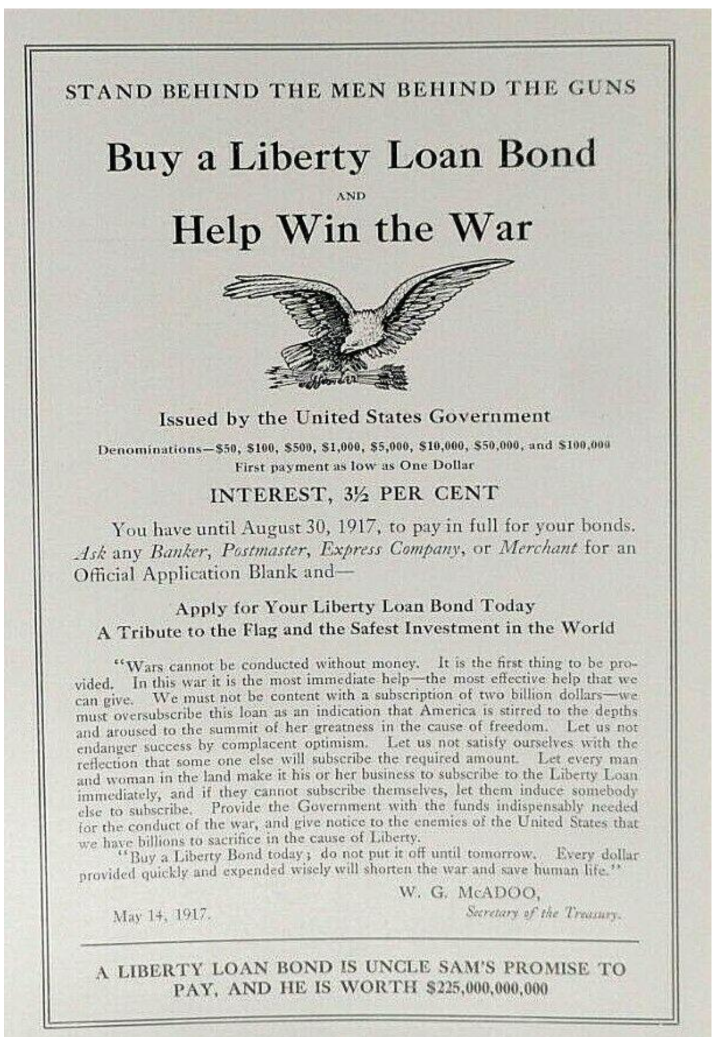
Federal Reserve Bank Note of Cleveland $2 Series of 1918

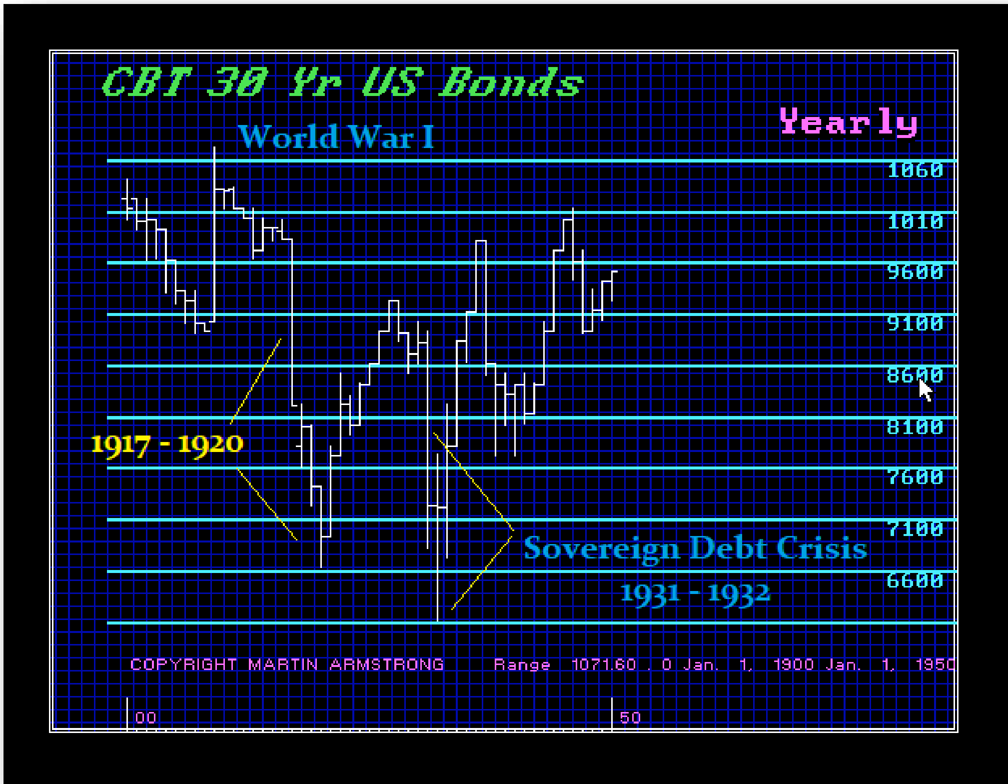
Secured by Uniyed States Certificates of Indeptedness or United States one-year Gold Notes, Deposited with the Treasurer of the United States of America

However, it also authorized the Federal Reserve to be able to have accounts in foreign countries as a correspondent bank. With respect to **Federal Reserve Notes**, they were to be backed by gold or gold certificates issued by the US Treasury, which was a distinct difference where they had no backing requirement whatsoever. Nevertheless, the 1918 series note makes no mention of such a change.

Section 17 of the Act was perhaps the most interesting. It repealed any provision of law requiring national banks to maintain a minimum deposit of bonds with the Treasurer of the United States. It also mandated that member banks had to then transfer all reserves to the Federal Reserve itself. Consequently, member banks were no longer allowed to maintain their reserves in their own faults. This was a major structural change.

Financing the war was greatly simplified by the Federal Reserve, which lent freely to banks at low interest rates. The banks, in turn, bought higher yielding government bonds or lent to borrowers who then bought the bonds. In the end, about half of all the American families bought war bonds, most between $5 and $100 worth, but half of the total sum sold were purchased by financial institutions for their own account in $10,000 increments.





Some complained that the interest rate of 3.5% was too low. This this was the same as other government instruments, and the interest on these bonds was tax exempt except for estate and inheritance taxes. Given the fact that with the maximum tax rate then of 67%, a bond paying a 3.5% federally tax-free interest rate was equivalent to a risk-free taxable 10.6% yield.

The wartime economy surged, interest rates rose, and bond prices fell. The crash in government bonds persisted for 3 years – 1917 – 1920. There were four issues of Liberty Bonds:

- Apr 24, 1917 Emergency Loan Act issue of $5 billion in bonds at 3.5%
- Oct 1, 1917 Second Liberty Loan offers $3 billion in bonds at 4%
- Apr 5, 1918 Third Liberty Loan offers $3 billion in bonds at 4.5%
- Sep 28, 1918 Fourth Liberty Loan offers $6 billion in bonds at 4.25%

There was a total of four Liberty Loan Bond issues and one Victory Loan Bond issue. Of the $24 billion in total subscriptions offered, $21 billion dollars of bonds were issued. The average purchase of five issues was $445. Analyzing the denominations of the war bonds still outstanding as of June 30, 1920, only $3.9 billion or about 20 percent, were issued in the denominations of $50 and $100, representing average Americans with modest means who supported the war effort. As a point of comparison, the financial cost to the U.S. of WWI was approximately $32 billion, or approximately $500 billion in current dollars.

Because of the collapse in the value of the bonds, most of the first two issues of Liberty Bonds were redeemed or "converted" to higher rate issues. Those bonds converted were exchanged into the **"First Liberty Bond Converted"** or "**Second Liberty Bond Converted"** issues. The first two Liberty Loan Bond issues that were not redeemed or converted are among the rarest of the bonds issued. Many of these bonds have not survived the last nine decades because they were redeemed due to the need for money during the Great Depression of the 1930s.

With World War I, the Federal Reserve began to buy government paper rather than corporate. They never restored that fundamental structure which was critical to the economy to provide support to corporations when banks could not or would not lend. Moreover, each branch of the Federal Reserve maintained its own interest rate prior to 1935. Therefore, at least that structure remained intact until Roosevelt took power.

Federal Reserve August 1927
Discount Rate

Atlanta	4.0%
Boston	4.0%
Chicago	4.0%
Cleveland	4.0%
Dallas	4.0%
Kansas City	3.5%
Minneapolis	4.0%
New York	4.0%
Philadelphia	4.0%
Richmond	4.0%
St. Louis	4.0%
San Francisco	4.0%

ArmstrongEconomics.COM

In 1916, as a debt–to–GDP share of the economy the debt accounted for just 2.7%. The surge in debt associated with World War I was financed largely by selling bonds to the US public. (By the time the US entered the war, pretty much all the other major powers were already in it up to their necks, and thus, didn't have any money to lend.)

In the aftermath of the war, the Uncle Sam hit a new record high debt-to-GDP of about 33%, with more than $25 billion in debts. But with a combination of budget surpluses, expenditures aimed explicitly at paying off debt early, and payments from the losers of war, the US made significant progress in paying down the debt. It fell by more than $9 billion by 1930, a reduction of more than a third.

June 16, Franklin D. Roosevelt
Signs Glass-Steagall (1933 Banking Act)

Clinton Repeals Glass Steagall Allowing 2007 Mortgage Crisis To Unfold
The Gramm–Leach–Bliley Act (the Financial Services Modernization Act of 1999)
(Pub.L. 106-102, 113 Stat. 1338, enacted November 12, 1999)

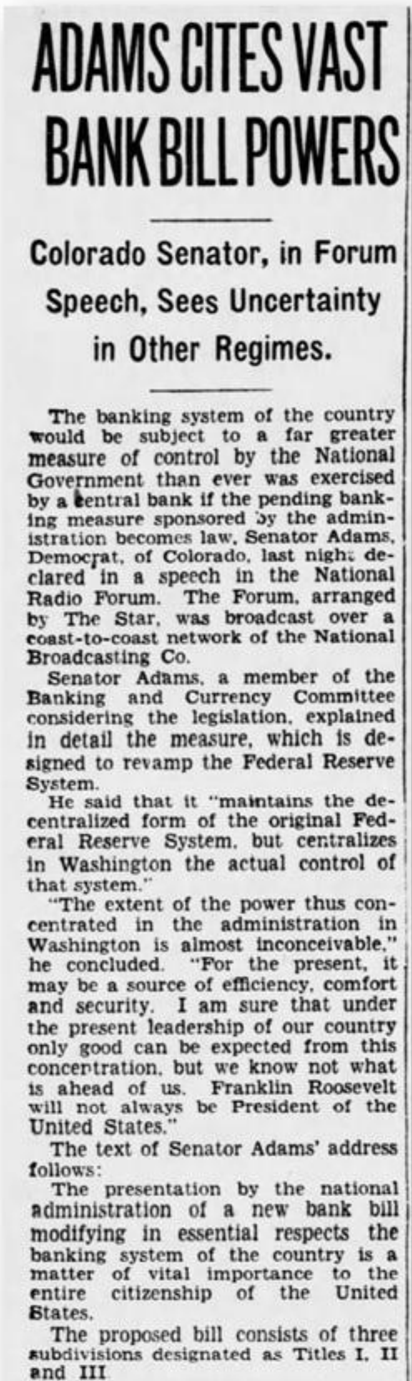
The 1933 Banking Act

The 1933 Banking Act established FDIC insurance. However, the most important aspect of this 1933 legislation was the separation of commercial and investment banking which became known as the Glass–Steagall Act. In the 1999, Goldman Sachs led the charge to overrule Glass-Steagall which was successfully done under President Clinton who signed the Gramm-Leach-Bliley Act.

The 1933 Banking Act also established the Federal Open Market Committee (FOMC) which had a direct impact on the Federal Reserve. However, the 1933 FOMC did not include voting rights for the Federal Reserve Board, which was revised by the Banking Act of 1935 and amended again in 1942 to closely resemble the modern FOMC.

The 1935 Structural Change to the Federal Reserve

The entire design of the Federal Reserve was predicated upon the experience that although the United States was one political nation, it was not a single economy. Some regions were focused on commodity production and other manufacture, with still others were money centers for international finance. The very deliberate purpose of the framers of the **Federal Reserve Act** was to secure **DECENTRALIZED** banking and currency control to prevent the centralization of banking and financial control in Washington or New York City.



ADAMS CITES VAST BANK BILL POWERS

Colorado Senator, in Forum Speech, Sees Uncertainty in Other Regimes.

The banking system of the country would be subject to a far greater measure of control by the National Government than ever was exercised by a central bank if the pending banking measure sponsored by the administration becomes law, Senator Adams, Democrat, of Colorado, last night declared in a speech in the National Radio Forum. The Forum, arranged by The Star, was broadcast over a coast-to-coast network of the National Broadcasting Co.

Senator Adams, a member of the Banking and Currency Committee considering the legislation, explained in detail the measure, which is designed to revamp the Federal Reserve System.

He said that it "maintains the decentralized form of the original Federal Reserve System, but centralizes in Washington the actual control of that system."

"The extent of the power thus concentrated in the administration in Washington is almost inconceivable," he concluded. "For the present, it may be a source of efficiency, comfort and security. I am sure that under the present leadership of our country only good can be expected from this concentration, but we know not what is ahead of us. Franklin Roosevelt will not always be President of the United States."

The text of Senator Adams' address follows:

The presentation by the national administration of a new bank bill modifying in essential respects the banking system of the country is a matter of vital importance to the entire citizenship of the United States.

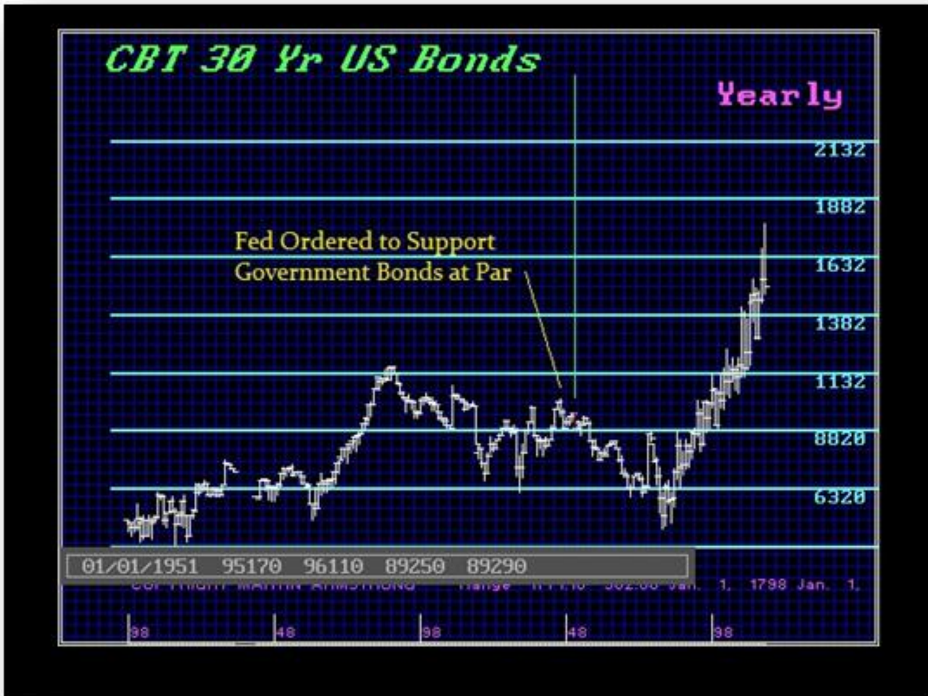
The proposed bill consists of three subdivisions designated as Titles I, II and III

Evening Star, Washington DC
April 2nd, 1935 • Page 30

Alva B. Adams (1875–1941)
Senator for Colorado (1923-1924, 1933-1941)

Although a Democrat, Senator Alva B. Adams (1875–1941) who had represented Colorado in the United States Senate from 1923 until 1924 and again from 1933 to 1941 was a man of integrity. He was perhaps the only one who spoke out against Roosevelt in the grab for power that destroyed the very design of the Federal Reserve transforming it to a centralized power ruled in Washington.

The Banking Act of 1935 gave the Board of Governors control over other tools of monetary policy. The act authorized the Board to set reserve requirements and interest rates for deposits at member banks. The act also provided the Board with additional authority over discount rates in each Federal Reserve district. There was no more independence among the branches. It became one size fits all.



It did not take long for Roosevelt to abuse the power he usurped in the 1935 Act. In 1942, the Us Treasury insisted that the Federal Reserve support the bond market during World War II. During April 1942, the Treasury requested that the Fed formally commit to maintaining a low-interest rates peg at 3/8% on short-term T-Bills to fund the war. The Fed complied and capped the rate at 2.5%.

At the time, in order for the Fed to maintain the peg, it was ordered to give up control of the size of its portfolio as well as the money stock. That is also what has happened today with **Quantitative Easing** among all central banks. Frankly, the Fed back then maintained the low interest rate by buying large amounts of government securities, which also increased the money supply domestically at the time. Because the Fed was committed to a specific rate by the peg, it was compelled to keep buying securities even if the members of the Federal Open Market Committee (FOMC) disagreed.

Everything exploded by February 1951. Inflation had soared reaching 21%. As the Korean War intensified, the Fed faced the possibility of having to monetize a substantial issuance of new government debt coming out to fund that war. This only intensified inflation. Nevertheless, **Harry S. Truman** became president in 1945 and it was his administration that continued to urge the Fed to maintain the peg agreement of 1945.

The conflict erupted in full view. The Fed revolted against the politicians. Shortly thereafter, the Fed informed the Treasury that as of February 19th, 1951, it would no longer ***"maintain the existing situation."*** The Treasury was caught in a crisis for it needed to refund existing debt and issue new debt, a situation all governments are still in today. **They never pay off debt, they simply roll forever.**

The government had no choice but to negotiate a compromise under which the Fed would continue to support the price of five-year notes for a short time, but after that the bond market would be on its own. It was on March 4, 1951, when the Treasury and the Fed issued a statement saying they had:

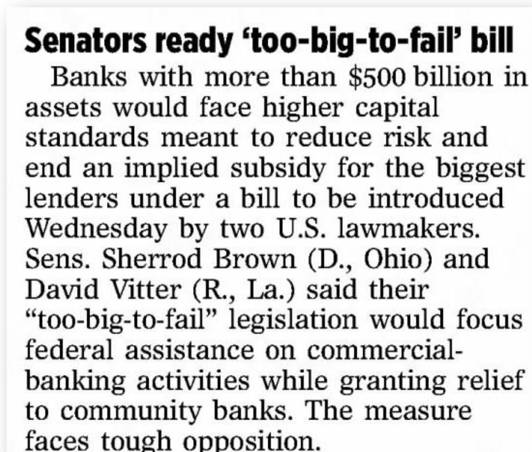
> ***"reached full accord with respect to debt management and monetary policies to be pursued in furthering their common purpose and to assure the successful financing of the government's requirements and, at the same time, to minimize monetization of the public debt."***

1985 Plaza Accord
From left are Gerhard Stoltenberg of West Germany, Pierre Bérégovoy of France, James A. Baker III of the United States, Nigel Lawson of Britain and Noboru Takeshita of Japan

If we look at the 1985 Plaza Accord, once again we see the US Treasury interfere with the Federal Reserve. The entire move to great the Group of 5 (G-5) was orchestrated by Secretary of the Treasury James Baker – not the Federal Reserve.

Paul Volcker was in charge of the Fed at that time. He bowed to the wishes of James Baker.

With each crisis, the politicians have interfered with central banks and have distorted their very purpose. So, while many spin the conspiracies that the bankers are somehow in charge of the Fed, they fail to see that the bankers have zero power. The major directives are always coming from the politicians and they have constantly changed the focus of what the Federal Reserve is supposed to looks at or even do within the economy.



Senators ready 'too-big-to-fail' bill

Banks with more than $500 billion in assets would face higher capital standards meant to reduce risk and end an implied subsidy for the biggest lenders under a bill to be introduced Wednesday by two U.S. lawmakers. Sens. Sherrod Brown (D., Ohio) and David Vitter (R., La.) said their "too-big-to-fail" legislation would focus federal assistance on commercial-banking activities while granting relief to community banks. The measure faces tough opposition.

The Philadelphia Inquirer, April 24, 2013 • Page A15

Then with 2007, the Federal Reserve was granted powers to bailout anything that was **too big to fail**. In 2015, pressure from Congress to limit its power to prop up a troubled financial institution, the Federal Reserve adopted a new rule that would limit its ability to bail out failing financial institutions. The Fed announced that its board of governors approved a final rule for its "emergency lending" program, criticized as recognizing that there are some banks that are simply **"too big to fail."**

Under the new rule, the Fed will no longer conduct "emergency lending" to specific companies. Instead, under the new rules, the Fed said that it will now only consider emergency lending for "broad-based" problems, affecting larger market troubles. This is where the Repo Crisis has emerged. The Fed is supporting the market to prevent a rise in interest rates rather than an individual institution.

The passage of the **Dodd-Frank Act** back in 2010, increased the Fed's authority to provide "emergency lending" to a failing financial institution which was limited to programs and facilities with "broad-based eligibility" that have been established with the approval of the Secretary of the Treasury. Under the new rule, this definition of "broad-based" to qualify as an emergency lending program has become qualified that "at least" five financial entities would be eligible to participate in. Under the new Fed rules, if five financial entities aren't concurrently failing, there are no bailouts. That means it will not bailout an individual bank. The crazy thing here is the fact that the very purposed on the Federal Reserve in 1913 was to secure stability in the banking system.

UNCLE SAM'S NEED OF AN ELASTIC CURRENCY

PRESIDENT ROOSEVELT: "You see, those galluses ought to have rubber in them, so that when Uncle Sam stoops to move the sheaf there won't be much strain on the buttons."

From the *Pioneer Press* (St. Paul)

Rules are not laws. This still leaves the Fed's new rule does open to future bailouts if we are still talking about a major money center bank that if it was allowed to fail would create a contagion among lesser smaller banks throughout the nation. The criticism that this leaves the door open for taxpayers to bailout banks we must note that the bank all repaid the $700 billion and the Fed has the authority to create **elastic money** which would not require raising taxes to bailout banks.

Clearly, "emergency lending" must as a practical perspective mean "discretionary lending." If this were not true, then ironically the very original creation of the Federal Reserve would be destroyed. Yet, the Fed's new rules also further prohibits bailouts to entities that are insolvent and cannot be rescued.

The Fed's rule also incorporates the requirement in the **Dodd-Frank Act** that the Secretary of the Treasury must also approve all Fed emergency lending programs. It also made clear that it must still find that "unusual and exigent circumstances" exist as a pre-condition to authorizing emergency credit programs.

Indeed, once upon a time, the Federal Reserve was simply created to secure the banking system. Post-Keynesian Economics, the Fed was charged with managing the demand within the economy to control inflation. It was theorized that the Fed could control the business cycle completely and manage the economy eliminating depressions and recessions. The very purpose of independence was killed by Roosevelt in 1935 and then we have a never-ending series of usurpations of powers and controls imposed on the Federal Reserve. The very idea that the president is not to intervene with the Fed decisions on interest rates is rather absurd. The Federal Reserve is no longer anything what it was designed to do.

The entire Marxists/Keynesian agenda has led to the usurpation of central banks and transformed them into merely another undefined branch of government.

The International v Domestic Perspective

When we look at markets, the most obvious realization from an international fund manager's perspective has always been the golden rule: Currency is everything! You will never be interested in participating in a country where there is **Country-Risk** from a political perspective or one where the assets rise **only** in proportion to the decline in the value of that currency. All great speculative bubbles take place when **both** the assets and the currency are rising. Then international foreign investors will pour into that market when they can make money on both the asset and the currency.

There are some exceptions which are major red flags. One of the famous forecasts we made was that the Japanese market would peak in December 1989 and that would be a major bubble top followed by a prolonged bear market for up to 26 years. I was often asked how I could make that forecast compared to other bubbles like 1987 or even the 2007 Bubble? The Japanese Bubble was unique. The price advance in yen was far greater than it was for foreign investors. The assets rose greater than the currency and that warned it was primarily a domestic bubble. This distinction warns of a more profound economic crisis unfolding.

Events such as the 2000 Dot.Com Bubble benefitted foreign investors more than domestic. In dollars, the NASDAQ Composite rallied 190% during the final stage. In terms of Euros, the rally was 253%. This is what I am talking about when the foreign investor benefits more from the currencies it reflects a global capital movement as compared to the Japan Bubble were the rally was greater in yen than in dollars.

We must understand that there is a significant difference in Bubbles being international v domestic. All such Domestic Bubbles never end well and will result in structural decline which may at times even lead to civil unrest. This is because the first sellers are based on currency rather than assets. In the case of Japan, the advance in yen sucked in everyone who ever thought of buying stocks in Japan domestically which fundamentally destroys the savings and fundamental capital formation. This is far more destructive just as a bond collapse wipes out more people than a stock market crash in normal markets where people have believed in their governments.

These subtle differences are extremely critical to the underlying foundation within an economy. Once that is undermined, it takes a very long period of time to rebuild that base. For example, with the Sovereign Debt Defaults of 1931 and over 9,000 bank failures, it took 25 years before the Dow finally exceeded the 1929 high in 1954. In the case of the Roaring 20s, the low in the US share market came in 1932 in just under 3 years. However, it was the collapse in the bonds markets which undermined the banking system and contributed to the defaults of 9,000 banks. That is what wiped out the capital formation, not the stock market decline.

In the case of Japan, it was a 19-year decline from the 1989 high with the low in the Nikkei finally unfolding in 2008. However, even 26 years later in 2015 the Nikkei still could only muster a rally back to 20952 or nearly 50% of the 1989 high.

I have often told the story of how a personal investor bribed his way into an institutional session at the Imperial Hotel. He apologized but said he just had to talk to me. He had invested $50 million and bought the market at the very day of the high. He said it was his first purchase ever and he was in his late 60s. He said brokers had called him every day for 7 years and said the Nikkei rose 3%-5% every January. He watched for 7 years and saw they were correct. He bought the very day of the high and watched it crash thereafter.

COUNTRY RISK

Most of the capital outflow from China has been its own people trying to get cash out. They were using Bitcoin to accomplish that. Country Risk centers upon a stable and important **rule of law** for without that, capital will never be attracted for investment. Once the **rule of law** crumbles into bias and corruption as we see today in the USA and Europe, this is part of the risk of investment that, with time, will destroy Western civilization.

GIBBON, Edward. **The History of the Decline and Fall of the Roman Empire.**
London: W. Strahan and T. Cadell, 1776-88. Six volumes. *Rare full first edition set*

Edward Gibbon wrote in his classic, 1776 Decline and Fall of the Roman Empire:

> *"...the intolerable weight of taxes, rendered still more oppressive by the intricate or arbitrary modes of collection; the obscurity of numerous and contradictory laws; the tedious and expensive forms of judicial proceedings; the partial administration of justice; and the universal corruption, which increased the influence of the rich, and aggravated the misfortunes of the poor. "*

Book III, Chapter 34

Country Risk is a critical part of international investment. In assisting international companies with decisions where to locate plants or open up operations, the first criteria are always "**Country Risk**" which is all about the stability of the **Rule of Law**. How can you invest in any country if there is no reliable legal system to secure contracts or property?

Contract Law began in Babylon. Hammurabi's legal code required all agreements to be written down. This put an end to false claims. When we talk about investing in Europe, we do not even consider "**Country Risk**" because it is assumed the **Rule of Law** is stable. That is gradually changing. The insane fines are part of the process of the decline and fall. In the USA, you cannot sue banks for manipulation in NYC. The conviction rate in the USA is federal court is 98.5%+++. They threaten and intimidate people and 98% takes plea deals because jury trials are rigged for the government. This too is destroying the foundation of the American economy in a slow gradual process.

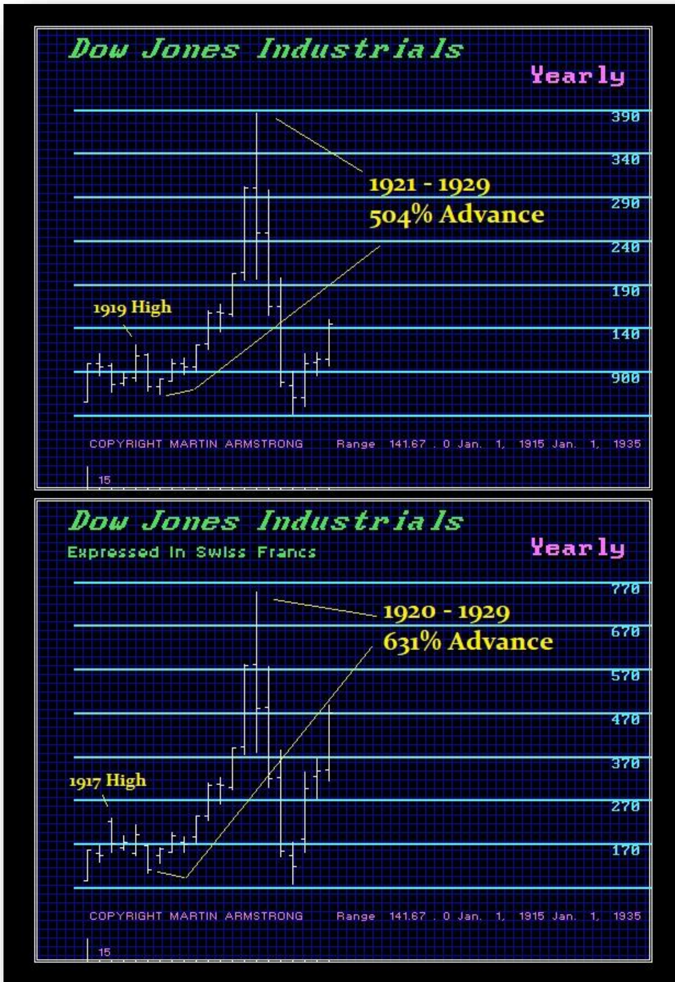
The Code of Hammurabi Black Basalt Stele - Louvre

Consequently, China will surpass the United States and the West because our **Rule of Law** is collapsing. Courts rule in favor of government routinely and once that happens, no property is secure anymore. They are just confiscating cash presuming it is criminal in some way be it taxes or otherwise and they do not have to prove anything. This is demonstrating that the West will not be able to survive long–term without security of property. Hence, you can see it coming. If China respects property rights, then capital will migrate to Asia and leave the West due to the lack of a **Rule of Law**.

Obviously, **Country Risk** is a factor that also determines the possibility of a bubble. Capital will simply not be attracted to a place where its capital is as risk. South Africa had created a Financial Rand all to prevent capital from moving out of the country. I was offered projects to advise on, but I would not be able to get the money out. Naturally, I declined.

After the Iranian Revolution, they simply nationalized the oil industry. American companies lost all their capital investment. As countries swing left, the **Country**

Risk will rise. This will begin to impact markets where you see legislation that seeks to curtain foreign investment as it has been doing in real estate.



Dow Jones Industrials during the 1920s, we can see that the highs and lows in terms of even Swiss francs differed greatly. In dollars, the high was 1919 with the commodity rally. In Swiss francs, the high was 1917 and the low was 1920 compared to the 1921 low in dollars. The rally in Swiss was 631% whereas the dollar rally was only 504%. International perspectives are critical to understanding the market timing. In this case, the country risk was Europe because of the war. Hence, the capital flight was from Europe to America. In this case, we have a stark difference between the US Bubble into the 1920s compared to the Japanese Bubble of 1989.

Therefore, we must assess the correlation of a currency to a Bubble as it is unfolding. In the current situation, we can see that the rally in dollar out of the 2009 low to the January 2020 high was 354%. When we plot this in Euros, that same period produced a rally of 442%.

This is why the rally this time around has been not only the **MOST HATED BULL MARKET** in history, but it has been entirely driven by capital inflows which is why the Dow Jones Industrial Index has been the leader on the way up.

Certainly, we have had those blaming the Federal Reserve for the cheap interest rates. Yet, if the Fed responded as they did in 1927 and doubled the interest rates, then they will attract even more capital inflows. With interest rates at virtual 5,000-year lows outside the United States thanks to Quantitative Easing which has failed and trapped both the Bank of Japan and the European Central

Bank, the Federal Reserve is in a position where domestic policy objectives have become hostage to international policy objectives.

The Federal Reserve has been focused on the problem of the **Negative Interest Rates** in Europe and Japan. They have come to realize that there is a very serious crisis brewing outside of the United States which will totally eradicate their domestic policy objectives. The slightest uptick will be devastating to those economies, not to mention the losses on the outstanding long-term bonds which negative yields.

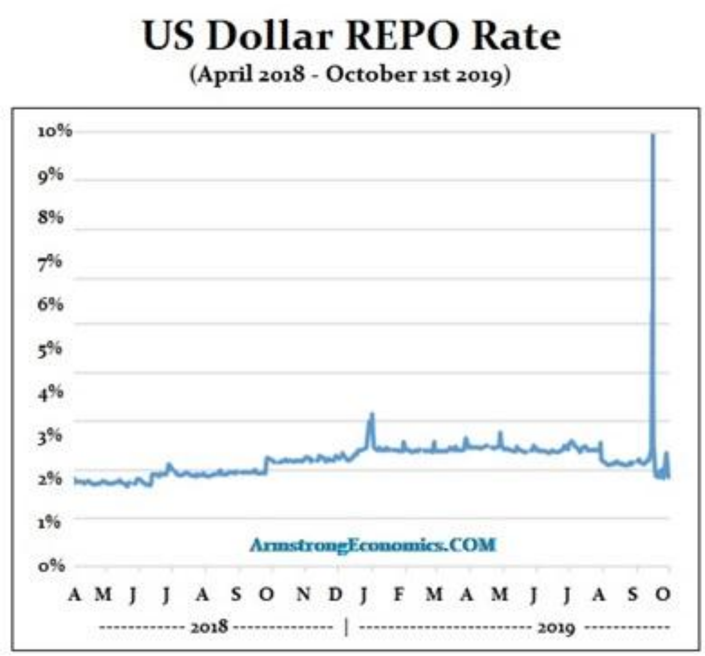
Therefore, to understand the crisis and the capital flows to the dollar, we must understand the Country Risk, the currency, and the movement of the assets. What it is creating is a future collapse in confidence with respect to the governments actually being in charge of the economy. This is why I wrote that book, **"Manipulating the World Economy."** This is all coming to an end. We are looking at, not inflation, but a massive shift in investment strategy from public to private. The Fed cannot raise interest rates to prevent a rally without undermining the sovereign debt globally. The game has changed. The politicians will brow-beat the Fed because the Democrats are really Marxists and will scream at the Fed because their low rates are benefiting the rich. They are beyond brain-dead. The politicians are incapable of understanding the problem and they have become so confrontational that we can guarantee there will be no understanding reached because they are absorbed by this class warfare.

Misconception of Who is in Control

A common misconception that prevails has been that central banks are actually in control of interest rates. Some do not understand how interest rates can rise when central banks are the only market maker. Others do not comprehend that if the debt crisis is outside the United States, then why is the Repo Crisis taking place within the United States? Some then wonder if there is an intense capital inflow into the USA, then why is that capital not financing REPOs in the United States?

These are interesting questions which are predicated upon the assumption that governments are all powerful thanks to Marx and Keynes. Central Banks do not control long-term rates. They set the short-term rate such as Fed Funds and Discount Rate. That is what **Quantitative Easing** was all about. The central banks began to **BUY** the long-term debt in hopes of "influencing" the long-term rates by reducing the supply of government long-term debt and in theory then the free market would have been willing to buy private long-term debt such as mortgages. That failed because banks had no confidence in the real estate market and were loaded to the gills with real estate debt which people were defaulting on.

The Repo Crisis has begun in the states **BECAUSE** this is the only viable free market to speak of. Both Japan and Europe have destroyed the bond markets. The Repo Crisis is the manifestation of our forecast that we would enter a liquidity crisis by September 2019. We listed that as one of the major points to take home from the **May 2019 Rome World Economic Conference**.



The Repo Crisis is a liquidity crisis because of the collapse in confidence. Banks are unwilling to lend to each other because they are deeply concerned about a crisis in the international banking sector. The Fed was lowering short–term rates because the yield curve inverted on the 10yr–2yr during the 3rd quarter 2019. Then the Repo Crisis hit on September 17th. The forced the Fed to stop its intended policy to lower rates for the Free Market dictated otherwise.
The image that central banks are in control is an illusion. They too are subject to the Free Market. They are not in

control of interest rates are they like to make everyone believe. If that were true, then there would have been no Repo Crisis to start with.

The Fed v ECB

The Federal Reserve does not need permission to create elastic money. It has the authority to expand or contract its balance sheet. However, it cannot simply print money out of thin air. The ECB is the only institution that can authorize the printing of euro banknotes. The Federal Reserve must back the banknotes by purchasing US government bonds. The Fed buys and sells US government bonds to influence the money supply whereas the ECB influences the supply of euros in the market by directly controlling the number of euros available to eligible member banks. This structure was created because of Germany's obsession with its own hyperinflation of the 1920s.

Each member state retained its central bank and those central banks issue the banknotes –– not the ECB. Therefore, the ECB works with the central banks in each EU state to formulate monetary policy to help maintain stable prices and strengthen the euro. The ECB was created by the national central banks of the EU member states transferring their monetary policy function to the ECB, which in effect operates on a supervisory role.

There are four decision-making bodies of the ECB that are mandated to undertake the objectives of the institution. These bodies include the Governing Council, Executive Board, the General Council, and the Supervisory Board.

The Governing Council comprises six members of the Executive Board and Governors of the national central banks of the euro area member states. The Council members meet twice a month at the institution's offices in Germany. Its primary function is the formulation of monetary policy for the Eurozone area. That means it makes the decisions on monetary objectives, interest rates, and the supply of reserves in the Eurosystem.

The Executive Board comprises the President, Vice-President, and four other executive members appointed by the European Council. The executive members serve for an 8-year non-renewable term. The role of the Executive Board is to implement the monetary policy as defined by the Governing Council and manage the day-to-day operations of the ECB, alongside the Chief Services Officer. Also, the board prepares the Governing Council meetings and exercises power delegated to it by the Governing Council. It holds meetings every Tuesday.

The General Council is a transitional body that carries out responsibilities taken over from the European Monetary Institute (EMI). It comprises the President, Vice-President, and Governors of the national central banks of the EU member states. The body will continue to exist until all EU member states have adopted the euro. As of 2017, only 19 out of the 28 EU member states have taken up the euro as their single currency. This body is charged with fixing the exchange rates of currencies for countries preparing to join the Eurozone.

The Supervisory Board comprises the chair, vice–chair, four ECB representatives, and representatives of national supervisors. The board plans and executes the supervisory function of the ECB. It also proposes draft decisions for the Governing Council through the non–objection procedure.

The ECB was granted a monopoly status on the issuing of banknotes in the Eurozone area. The ECB makes weekly announcements on the amount of money it wishes to supply and the minimum acceptable interest rate. Eligible banks that have provided collateral then place their bids for the ECB funds through an auction mechanism. Once the banks have obtained funds, they use them to advance loans to individuals and businesses all in theory.

The European Central Bank is also responsible for banking supervision in all the EU member states. The ECB carries out this function through the Single Supervisory Mechanism (SSM) that comprises the ECB and competent national authorities in the member countries. Therefore, the ECB has the power to grant and withdraw banking licenses, conduct supervisory reviews, and set higher capital requirements to counter financial risks. The ECB directly supervises 124 significant banks that hold 82% of the banking assets in the Euro area.

Willem Frederik "Wim" Duisenberg
(1935–2005)
First President of the European Central Bank
(June 1, 1998 – November 1, 2003)

The tensions within Europe have never abated between members. The first President of the Bank was Willem Duisenberg (1935–2005), who was the former president of the Dutch central bank. The French objected and demanded that the ECB should be headed by a Frenchman, Jean–Claude Trichet, because the ECB was to be located in Germany. A gentleman's agreement was finally reached whereby Duisenberg would step down before the end of his mandate and Trichet would become the head of the ECB in November 2003. He was replaced by an Italian, Mario Draghi, who became the head of the ECB between 2011–2019. Now we have Christine

Lagarde, who is French, taking over the ECB from Draghi.

Article 127

(ex Article 105 TEC)

1. The primary objective of the European System of Central Banks (hereinafter referred to as 'the ESCB') shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 119.

2. The basic tasks to be carried out through the ESCB shall be:

— to define and implement the monetary policy of the Union,

— to conduct foreign-exchange operations consistent with the provisions of Article 219,

— to hold and manage the official foreign reserves of the Member States,

— to promote the smooth operation of payment systems.

3. The third indent of paragraph 2 shall be without prejudice to the holding and management by the governments of Member States of foreign-exchange working balances.

4. The European Central Bank shall be consulted:

— on any proposed Union act in its fields of competence,

— by national authorities regarding any draft legislative provision in its fields of competence, but within the limits and under the conditions set out by the Council in accordance with the procedure laid down in Article 129(4).

The European Central Bank may submit opinions to the appropriate Union institutions, bodies, offices or agencies or to national authorities on matters in its fields of competence.

5. The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system.

6. The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.

AUTHORIZATION

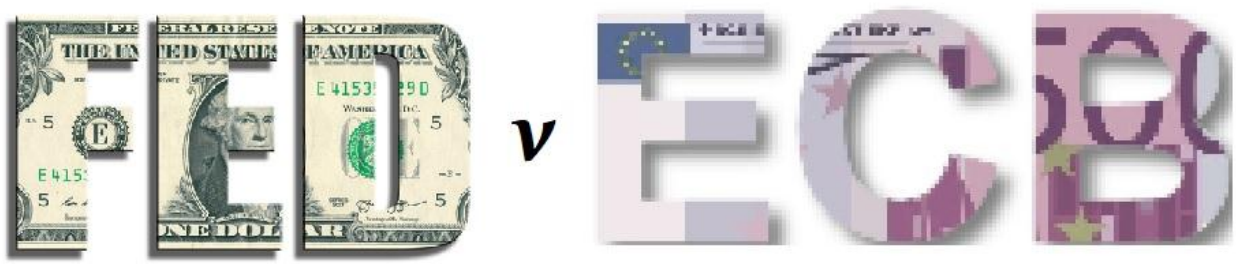
The primary objective of the European Central Bank was laid out in Article 127(1) of the Treaty on the Functioning of the European Union. That stated its authority was to maintain price stability within the Eurozone which is rather vague. The Governing Council in October 1998 took it upon themselves to define **"price stability"** as meaning inflation of under 2% on "a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2%." Therefore, the ECB was created differently from that of the Federal Reserve System which was intended to be simply an independent system where the banks were shareholders because that was a contribution to create the Fed outside of taxpayer money. Hence, the ECB has only **one** primary objective and it was envisioned as a division of the government. The **"price stability"** has never been defined in statutory law which leaves a very wide view of interpretation.

The Governing Council sought to confirm this definition of **"price stability"** in May 2003. They clarified that **"in the pursuit of price stability, it aims to maintain inflation rates below, but close to, 2% over the medium term."** Hence, all such lending to credit institutions had to be collateralized as required by Article 18 of the Statute of the ESCB. This so-called "clarification" is by no means a defined law. Therefore, this vague directive of maintaining "price stability" is further complicated because, under the Treaty, it also directs that **"the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union."** This leaves the door wide open for the ECB under Legarde to suddenly declare that climate change must be a policy of the ECB. This clearly makes the ECB an arm of the EU Commission and not independent as is the case with the Federal Reserve.

Since November 4, 2014, the ECB has been responsible for specific tasks concerning policies relating to the prudential supervision of credit institutions within the framework of the Single Supervisory Mechanism. As a banking supervisor, the ECB also has an advisory role in assessing the resolution plans of credit institutions.

European Parliament & ECB

The ECB President reports to the European Parliament on monetary issues in a quarterly Monetary Dialogue. The ECB also prepares an annual report on monetary policy which is presented before Parliament. Parliament adopts a resolution on this annual report. The new supervisory responsibilities of the ECB are matched with additional accountability requirements as laid down in the SSM Regulation. The practical modalities are governed by an **Interinstitutional Agreement (IIA) between Parliament and the ECB**. The accountability arrangements include the appearance of the Chair of the Supervisory Board before the competent committee; answering questions asked by Parliament, and confidential oral discussions with the Chair and Vice-Chair of the competent committee upon request. In addition, the ECB prepares an annual supervisory report, which is presented to Parliament by the Chair of the Supervisory Board.



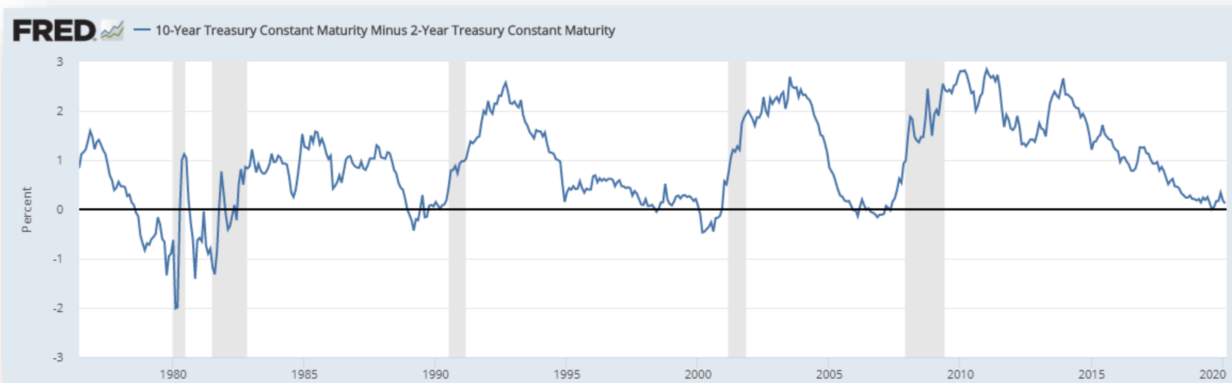
Structural Difference Between the Fed v ECB

The very structural design of the ECB v the Fed turns on the very fact that Europe rejected the basic idea of consolidating national debts from the outside. Therefore, the Fed buys government debt for back its currency and in Quantitative Easing, the Fed would buy federal government debt.

The ECB structure is substantially difference whereby it simply creates money for there is no federal debt to back the currency. Therefore, the measures used by central banks to deal with such crises as we saw 2007-2009 vary significantly. These differences have never been looked out by the vast majority of analysts because they just assume that all central banks operate in the same manner with the same authority. The Federal Reserve and the European Central Bank (ECB) may appear on the surface to be similar because theyu both engaged in Quantitative Easing, however they followed distinctly different monetary policies that employed completely diverse financial controls to manage crises.

As explained, there has been an evolution in central banking post-Great Depression as politicians have divested themselves of responsibility for even inflation shifting that responsibility to the central bank. Consequently, central banks have inappropriately become the authority responsible for a country's monetary policy and the only issuer of printed bank notes and minted coins in an economy. The original purpose of the central bank to support the banking system has devolved from bailouts to bail-ins all to allow politicians to avoid responsibility.

Many regard today that the main purpose of a central bank is to manage the stability of its currency and thereby controlling inflation through the supply of money in circulation. This, of course, has been the result of adopting Keynesian Economics but we are witnessing the failure of such models.



The structural flaw in baking is that the very design has been based upon the spread between short-term demand rates and long-term rates. The banks pay depositors the lower short-term rates and then lend out the money long-term and their profit is the spread. When an economy moves into recession, people need cash so they tend to save rather than spend and thus people borrow less so long-term rates begiun to fall. If confidence is shaken, then there emerges a bank run with people demanding to withdraw their cash. This forces the banks to call in loans to meet the demand for withdraw. Banks get in trouble when we normally enter inverted-yield curves when they are purely a domestic occurrence.

If it is perceived that the bank is in trouble, that is when we see what is known as a bank-run. People line up as a herd to withdraw their cash before the bank runs out and closes down. In some cases, the rumors can be unjustified. In 1931, a local bank had the name: Bank of United States. When people heard that bank would not cash a check, they assumed this was like the central bank of the country and a real bank panic was born. Eventually, the bank was closed. In the end, people recovered more than 90% of the money.

For this reason, when a crisis strikes and commercial banks cannot cover the shortage in supply of money, they turn to the country's central bank for additional funds. That was the original design to a central bank. The central bank must somehow provide these funds in order to keep the banking system from failing. That was the authority of the Federal Reserve to create Elastic Money allowing it to expand the money supply which would then contract when the crisis was over.

Buying v. Lending

The primary difference between the Fed and the ECB is structural. During such periods of a financial crisis, the Fed buys U.S. government debt (treasuries) to inject cash into the system. The the ECB is only authorized to lend money to governments and commercial banks within the Eurozone because there is no national European debt.

The Fed buys treasuries whereas the loans granted by the ECB were originally supposerd to be short term (up to three months) and were to be secured by collateral which tuyrned out to be their own debt. When the loan period expires, the banks have to pay the money back to the ECB. However, the ECB has admitted it cannot reduce its balance sheet and has to roll the debt it has

bought under its **Quatitative Easing** program. In other words, they are trapped eternally.

The Fed's Quantitative Easing

The Federal Reserve's main response to the I2007-2009 Financial Crisis was to increase liquidity in the market through large-scale asset purchases which became known as Quantitative Easing (QE). This QE program pumped cash into the marketplace by purchasing in government bonds. After the main crisis was over, the Fed announced the tapering of its monetary policy in December 2013, and has been slowly reducing its monthly purchases on the back of improved economic performance.

Because there is a United States bond market which did not go to negative rates, the Fed has been able to allow its debt holding to mature. This is exactly opposite of the position that the ECB finds itself in these days. The negative rates of the ECB has destroyed its bond market and that means there is no way to simply allow the debt holdings to mature thereby shrinking its balance sheet. The crisis faced by the ECB is that it has surrendered all its power and now is unable to extracate itself from its negative interest rates experiment. There are about $12 trillion of negative yield debt outstanding.

The ECB Extended Maturities of Bank Loans

The ECB's inability to extracate itself from its negative interest rate experiment has forced it to maintain liquidity in a futile attempt to repair its lending system to commercial banks by extending the maturity of its outstanding loans. Uf the ECB called in its loans to member states, interest rates would explode.

The ECB was force to change its monetary policy by increasing the maturity of its bank loans. What was three months eventually was extended to three years and even that has noi hope of resolving the crisis. These loans have been made available on a full-allotment basis, meaning that banks have unlimited access to the liquidity of the central bank, when providing adequate collateral. Definition of acceptable collateral has been eased in order to prevent a collapse of the entire financial system.

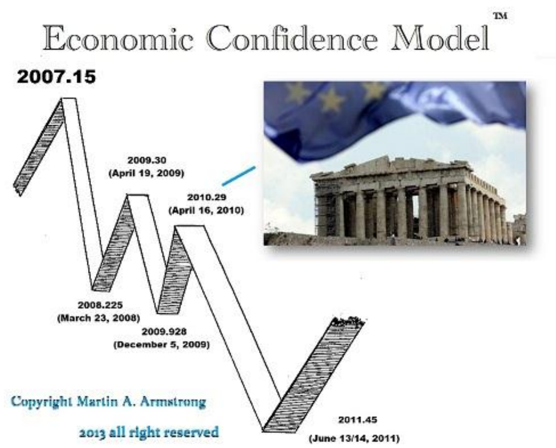
ECB's Securities Markets Programme

In 2010, when Greece was on the verge of collapse, the ECB introduced the Securities Markets Programme (SMP) and intervened intop the markets by buying Greek bonds. When traders saw the crack in the European debt markets, they turned on Spain. The programme had to be expanded to then also include purchases of Spanish and then Italian bonds up until its termination in September, 2012. The ECB justified the creation of the SMP through the need to ensure financial stability in the Eurozone. It has used vague language in its authority to expand its powers.

The EU rules prohibit the ECB from helping a country unless it has agreed to a rescue program of EU partners. Then, for example, the Euro-watchdogs could buy up Italian government bonds in order to contain a rise in yields. This provides for a monetary policy emergency tool adopted in 2012 – called "OMT". However, this has never been used before. The ECB, behind the curtain, fears that if they try to use this mechanism and it fails, as our model warns, then the CONFIDENCE in the entire EU system will collapse.

The **European High Court** ruled in 2015 that the ECB may buy government bonds of member states to rescue the Euro. This is in direct contrast to the German Constitutional Court, which ruled that the ECB violated German sovereignty. ***"The program does not exceed the monetary powers of the ECB and is not contrary to the prohibition of monetary financing of Member States,"*** said the European Court. However, this pitted the European High Court in direct **CONFLICT** with the high court of Germany.

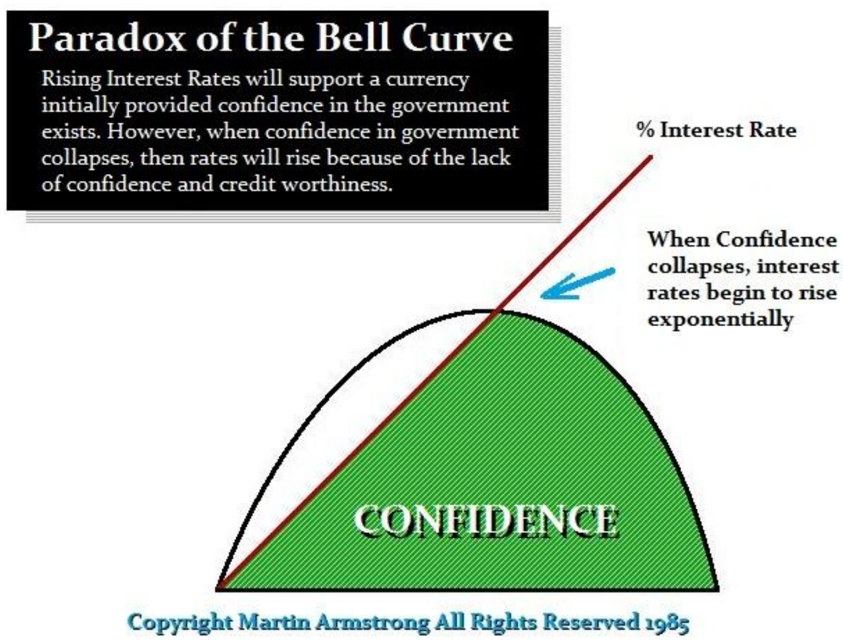
The ECB then started its own aggressive **Quantitative Easing** programme. After launching the Banking Union, designed to coordinate monetary policy in a more cohesive way within the Eurozone, the ECB committed to buying €60 billion euros worth of member state government bonds per month. The European Central Bank also introduced **negative interest rates** in 2014 as a way to encourage banks to lend and boost the economy, instead of keeping their cash stockpiled. That measure has completely failed and in the process has trapped the ECB for it cannot now allow rates to rise.



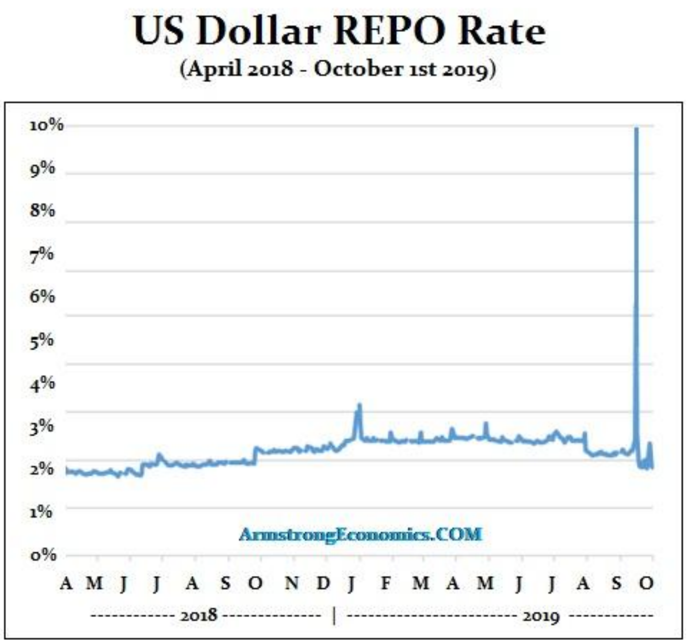
There is no question that there are stark differences between the FED and the ECB. The two banks are very different in nature and it remains to be seen whether the ECB will ever be able to escape its own madness.

What Are Interest Rates?

The common definition of an interest rate is the price of future inflation. A lender will secondly consider credit risk. He will also charge different levels of interest based upon his view of the risk presented with a particular borrower. Therefore, aside from the changes in the quantity of money, the primary factor is the credit risk. Therefore, if people distrust a government, bank, or a borrower, the interest rate will rise in proportion to the risk that is perceived. Therefore, interest rates are determined by (1) inflation and (2) credit risk.



This is what is behind the Paradox of the Bell Curve. Interest rates will rise exponentially when confidence collapses as the credit risk expands. This is why you will suddenly see interest rates rise dramatically when a country is perceived to be in trouble as was the



case in Argentina or Russia which ended up in the Long Term Capital Management collapse of 1998.

Therefore, the very reason the Repo Rate spiked to 10% during September 2019 had nothing to do with a shortage of cash, tax payments, or other assorted nonsense offered by people who seek air time to sell their products, but plain and simple a collapse in the confidence concerning who will be standing at the end of the day. It also really had nothing to do with the banks trying to force regulation

Interest rates are commonly used for personal loans and mortgages, though they may extend to loans for the purchase of cars, buildings and consumer goods.

Lenders typically offer lower interest rates to borrowers who are low-risk, and higher rates to high-risk borrowers. While lenders typically set their own rates, competition for borrowers means lenders within a certain area usually offer comparable numbers.

Aside from a borrower's risk assessment, several outside factors may influence current interest rates. These typically include inflation, lower money supply or a high demand for credit.

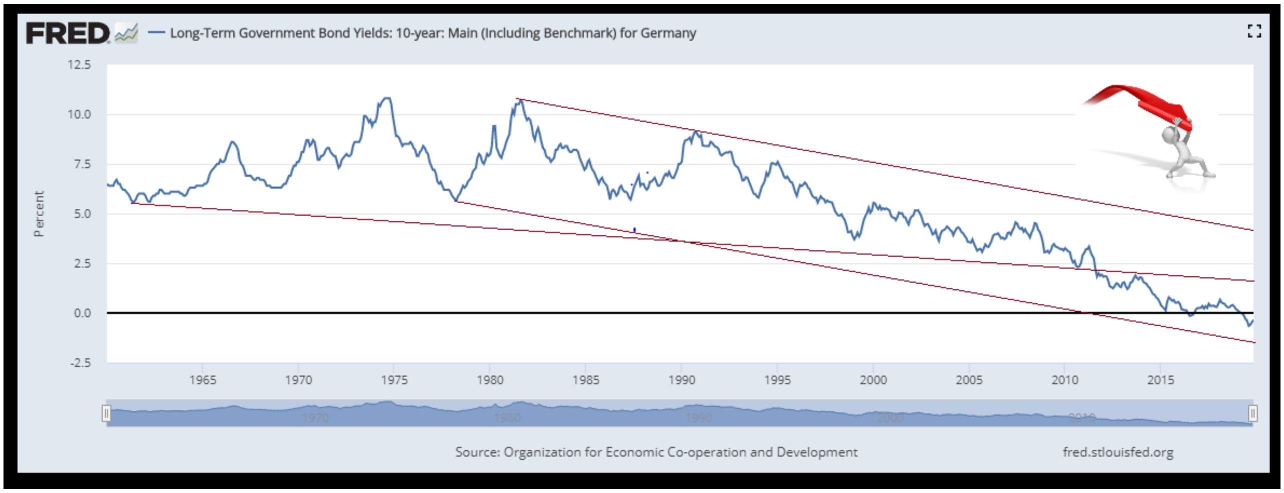
When interest rates rise, the economy may worsen due to a lack of affordable credit. Interest rates can influence corporate profits and government monetary policies.

changes.

The Great Experiment

When Larry Summers stood up and called for Negative Interest rates, many people were shocked while other called it brilliant. Negative Interest Rates were nothing more than an experiment on the economy much like a medieval doctor who bled people believing that all diseases were introduced to the body externally. Drain the blood and reduce the toxic poisons. If the patient died, it was never because they were bled too much, it was obviously because they did not bleed them soon enough.

Those seeking to manipulate the world economy never see themselves as perhaps the disease. The entire theory of negative interest rates began with the idea being floated by Larry Summers with absolutely no reference in history to support this experiment. The interesting aspect of this is how the governments all assume no responsibility and point their fingers at central banks. They love to pretend that they can spend anything, but the central bank will sterilize whatever actions they take.



August 2019 Key Turning Point

Now, we have already witnessed that the Inverted Yield Curve bottomed in August 2019 and the Liquidity Crisis which manifested into the Repo Crisis began on September 17th, 2019. Here we need to look closely at the German 10-year bund. This is the best or the best in Europe.

The German 10-year bond yield began to rise in August 2019 after establishing the major low one monthly **BEFORE** the Repo Crisis hit and in conjunction with the Inverted Yield Curve in the United States. The rate bottomed in August 2019 at a minus -0.65%. Our Monthly Bullish Reversals on yield stand at -0.135% and -0.01%. In January 2020 going into the ECM, the rate moved up to -0.26%. The 20-year yield became positive (0.03%), and it has pushed the 30-year yield further into the positive.

Germany's 30-year bonds are infamous for the government's efforts to sell them at a negative yield of -0.11% on August 21, 2019. The bonds were offered with a 0% coupon – so no interest payments for 30 years – and at a premium, in order to achieve the negative yield of -0.11%. This effort that mostly failed: €2 billion of these insane bonds were offered, but there were only enough brain-dead investors to actually buy €824 million worth of a guaranteed loss for 30 years. That day marked peak-negative-yield absurdity.

The French 10-year yield transitioned into the positive going into the ECM turning point of January 18, 2020 for the first time since July 2019 closing in the positive (+0.023%) level, up almost 50 basis points from -0.45% at the end of August 2019.

The Spanish 10-year yield which had come close to zero at the end of August 2019 rose to 0.39% going into the ECM.

The Belgian 10-year yield, which had declined to -0.38% last August 2019, also turned positive going into the ECM turning point for the first time since July 2019 and closed at 0.02%, up 40 basis points from August 2019.

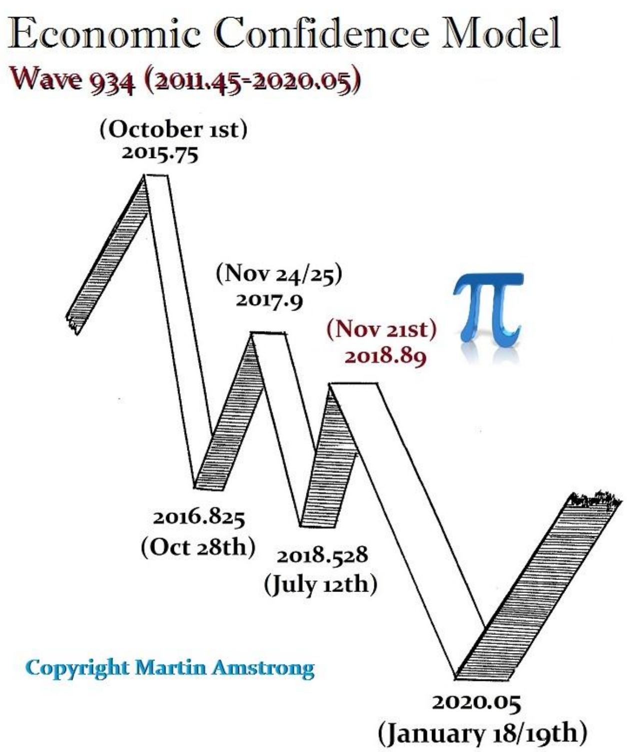
The Italian 10-year yield, which never made it into the negative despite Draghi's best efforts, rose some 30 basis points from 0.82% at the end of August 2019 reaching 1.18%.

Switzerland was the first country to actually sell new 10-year bonds with a negative yield back in April 2015. Here the yield on their 10-year had bottomed out at a negative -1.10% on August 16, 2019. Ever since August as this Liquidity Crisis has begun, the yield even in Switzerland has since soared 70 basis points to -0.40%. This clearly illustrates that the Repo Crisis has been a Liquidity Crisis which is causing interest rates to rise.

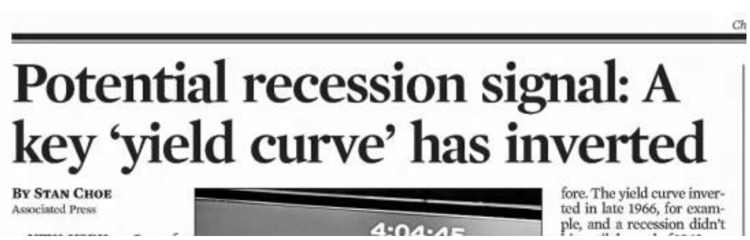
When we look at Japan, the second largest government bond market in the world which is no longer a free actual "market" since it is completely controlled by the Bank of Japan, here too we see that rates have risen even in the face of the government claiming their will buy unlimited amounts of government bonds. Since February 2018, the Bank of Japan has publicly announced it will buy unlimited amounts of government bonds to prevent interest rates from rising. Despite these pronounced, the 10-year yield on JGBs has risen from -0.29% at the end of August 2019 to -0.06% going into the ECM turning point.

The unimaginable mountain of negative yielding debt had peaked in August 29, 2019 at a staggering $17.03 trillion. Since then the outstanding negative yielding debt has dropped by $5 trillion, or by 30%, to $11.94 trillion going into the ECM turning point.

Negative Interest Rates Where did this Insanity Come From?



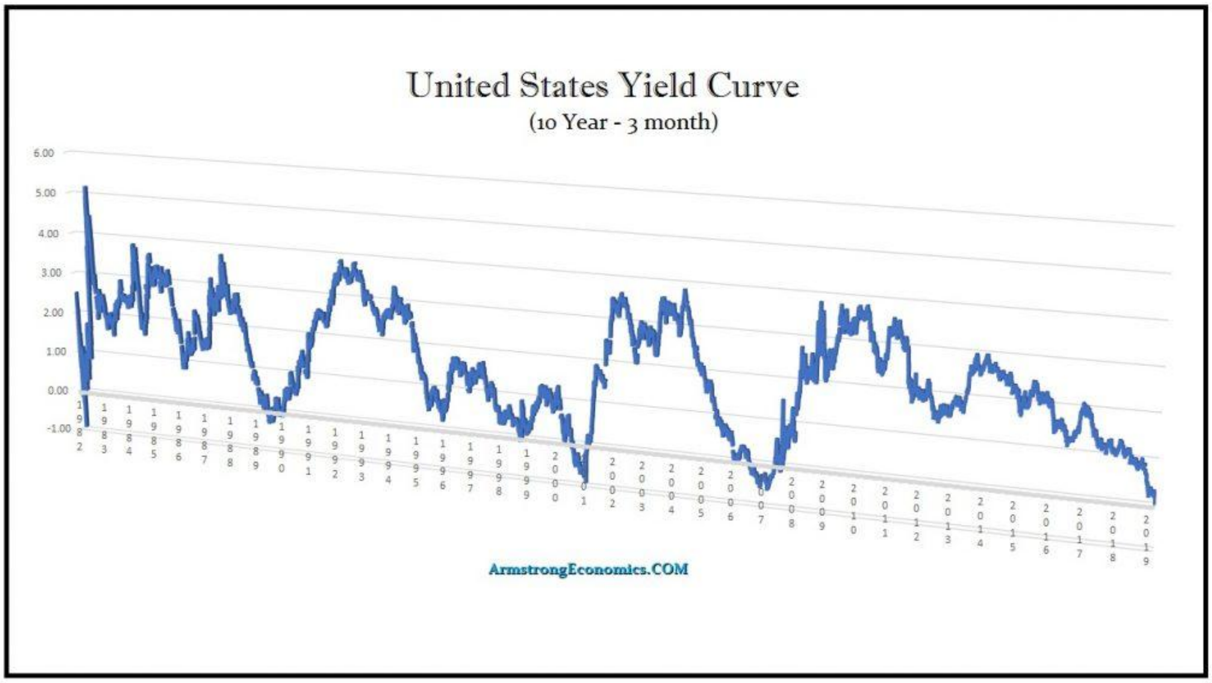
This turn in the **Economic Confidence Model** (ECM) may in fact prove with hindsight to be the end with perhaps the most absurd experiment ever attempted – Negative Interest Rates. This theory was unleashed on the world economy by people who have zero experience in the real world and have never ever traded a market to understand how they truly function.


Potential recession signal: A key 'yield curve' has inverted

By Stan Choe
Associated Press

fore. The yield curve inverted in late 1966, for example, and a recession didn't

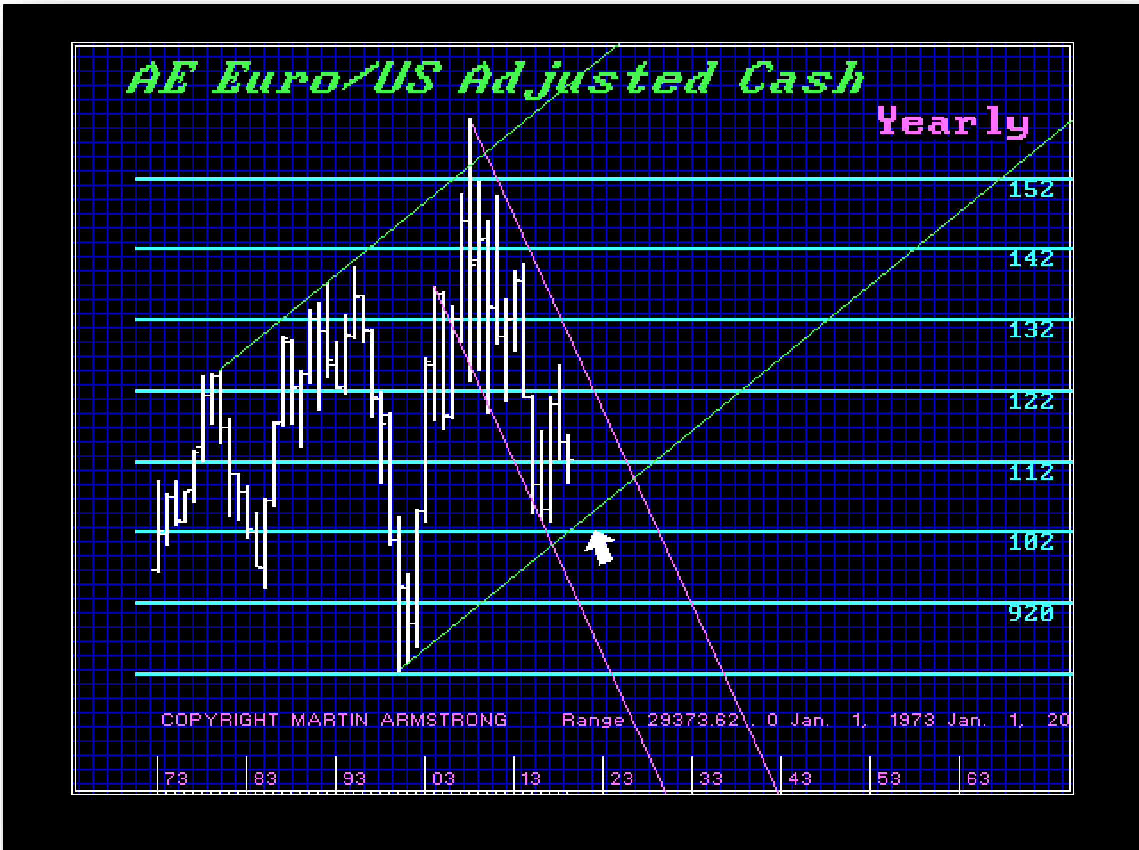
First, we have experienced the inverted yield-curve. As reported in the Chicago Tribune on March 26th, 2019, this warned of a potential recession coming. I wrote on March 28th, 2014, that despite the popular interpretation that this was foretelling of a coming recession, our model indicated there was no such threat.



The yield on the 10-year U.S. Treasury bill fell below that of the 3-month note for the first time since 2007 during 2019. This is what everyone calls an **Inverted Yield Curve** and has usually been touted as an early indicator of a recession. As always, it appears that people just cannot handle complexity and seek to create a one-dimensional relationship. There are so many other variables that are unfolding which can result in an inverted yield curve especially capital flows that this sort of analysis is just amateuristic.

What was very explicit was the fact that the Inverted Yield Curve was conforming to the **Economic Confidence Model** (ECM) which had been warning that as the global economy moved into recession post-2015.75, the capital flows were pointing to the United States. Consequently, U.S. economic growth declined, but it remained in the 2%-3% range only because of the intense capital inflows.

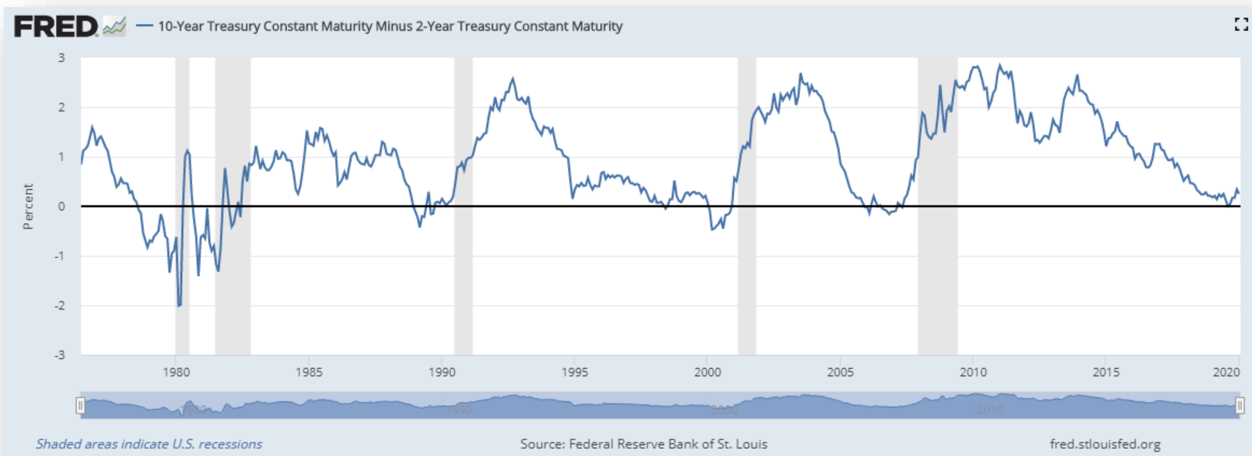
Based on the capital flows, it was clear that the dollar would rise in the face of an economic contraction in both Europe and Japan. For this primary reason, the yield curve has inverted particularly as Europe and Japan moved to negative interest rates. This external trend of negative interest rates created global uncertainty outside the USA.



This **Inverted Yield Curve** was confirming that as the political chaos emerged around the world, the more foreign capital became attracted to park in the dollar. This complexity in the global financial markets was behind our forecasts from 2009 that the US stock market would make new record highs.

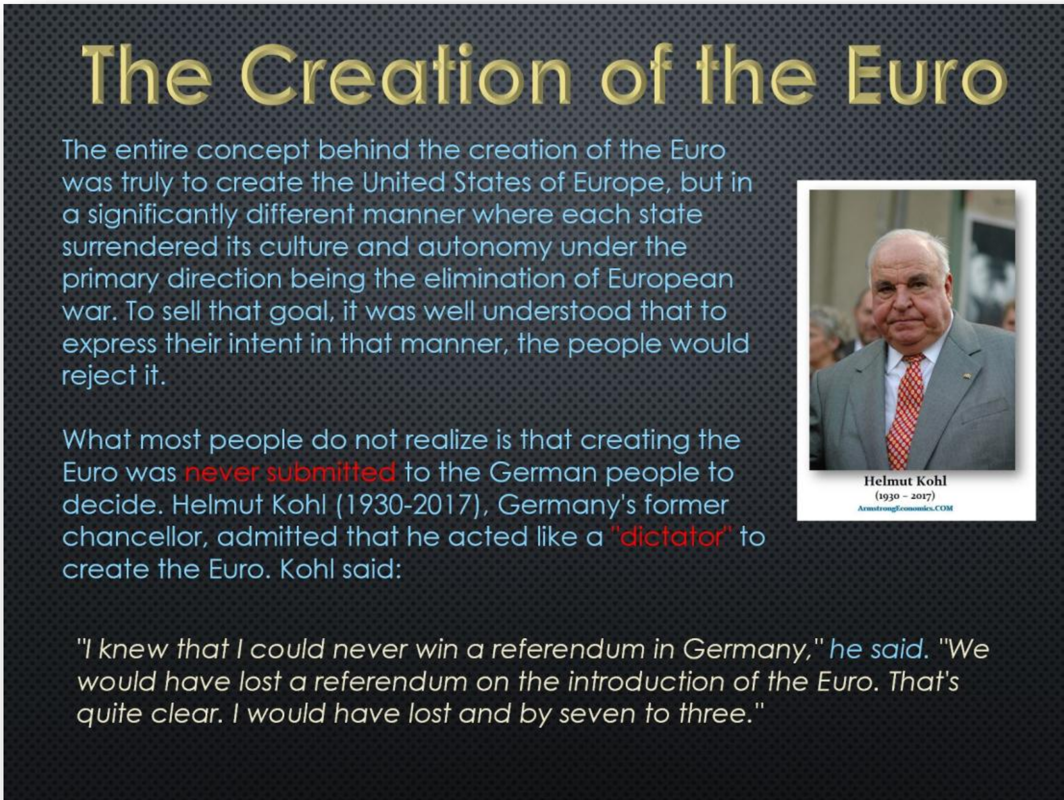
Indeed, the Euro peaked in 2008 and began its decline from $1.6036 to $1.0341 in 2017. The bounce into 2018 was merely followed by the drop in 2019 which even closed the year below the low of 2018.

The Repo Crisis is unfolding on schedule for the crux of it is emerging from a liquidity crisis driven by a combination of confusion as to what is going on and a distrust of the system which is becoming illogical.



We can see that the 10-year premium to the 2-year has been in a major decline ever since peak in March 2011 at 2.84. The **Yield Curve (10-2yr)** did not invert but it fell to **ZERO** in August 2019. This is clearly showing the capital flight to the dollar. This was not reflecting a major recession in the USA, but it was pointing to a capital flight to the dollar primarily due to regulation and negative interest rates combined with the refusal to bailout European banks.

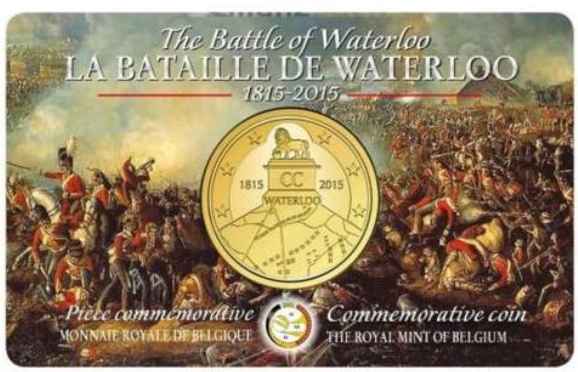
The Liquidity Crisis we forecast would begin in September 2019 manifested into the Repo Crisis as fear over European Banking escalated. With the no-bailout policy in Europe, this left American banks uneasy about dealing with any European bank which included HSBC. The fear that Europe would not cover losses would simply spread as a global contagion. The Fed could not bailout a European bank to stop the contagion. All it could do is cover loses in the USA encountered from a default by a European bank.



Creating the Euro

The real liquidity crisis hit in Europe during the 2008–2009 Financial Crisis. The US bailed out the banks by taking the bad assets off their books. In Europe, they would not do that because it would mean money might flow from one member to another to bailout banks. Helmut Kohl insisted that to get Germany to agree to join the Euro, there would be no consolidation of debts because he did not trust Greece, Italy, or Spain for starters. He never allowed the German people to vote on joining the Euro for he admitted he would have lost 7 to 3. The entire structural flaw behind the Eurozone Banking Crisis can be traced to this demand of Kohl.

To appease Kohl, the fundamental principle behind the creation of the Euro was to leave each state with its own debt converted to Euros, each state's central bank remained in place and would print Euros and mint coins for circulation. To then appease France, they insisted there would be a prohibition against issuing any coin that commemorated Waterloo and the defeat of Napoleon.



Interestingly enough, Belgium defied the rule by issuing a commemorative 2.5-euro coin but called it a commemorative which was **NOT** for general circulation.

Great Britain also issued a commemorative 2-pound collector's coin in 2015 also celebrating the victory at Waterloo. Both were for collector purposes and thus skirted around the prohibition included in the agreement for the Euro by the French.

NATIONAL POST, FRIDAY, JUNE 6, 2014 — FINANCIAL POST — financialpost.com FP3

Samsung heirs face US$6B inheritance tax when patriarch dies

The heirs of ailing Samsung Group patriarch Lee Kun-hee, right, face one of the biggest inheritance tax bills ever, and appear to have little option but to pay. By some calculations, Mr. Lee's son Jay Y. Lee, 45, the group's presumed heir, and his two sisters could be on the hook for about US$6-billion in tax under South Korea's top level inheritance tax rate of 50%. To put that in perspective, the U.S. expects to collect

RECORD AMOUNT

just $16-billion this year in estate and gift taxes — a levy that has long been a political bone of contention and which many rich Americans go to great lengths to minimize. Attempts by the Lee family to ease its tax burden could weaken its control over an empire it now runs through a complex structure of interlocking ownership — and risk stirring up public condemnation. The elder Mr. Lee's assets have a market value of about 13-trillion won (US$12.7-billion).

Reuters

ECB RATE CUT

BORIS ROESSLER / AFP / GETTY IMAGES

A photographer takes a picture of the graph of the German stock market index DAX at the exchange in Frankfurt before it rose to a historic 10,000 points on Thursday as the ECB unveiled new liquidity measures to support bank lending.

How can negative rates be positive?

Jason Heath
Comment

The European Central Bank has lowered its interest rates to unprecedented levels, to the point at which it actually costs money for private banks to deposit money with them. The rate they now pay on deposits is negative 0.1%. And Canadian GIC investors thought they had it tough?

While Denmark and Sweden have experimented with negative interest rates, ECB is the first major central bank to do so. Although rates in Canada have been described as "having nowhere to go but up" in recent years, Europe's decision potentially suggests otherwise.

This is a modern day experiment in central banking to discourage banks from hoarding cash. One of the key intentions of the rate move is to encourage bank lending, which would have a resulting impact on spending, economic growth and inflation.

A further impact of the cut should be to lower the value of the euro and make EU exports more competitive, a big win for European exporters.

The European economy has really not kick-started after the 2008 recession and, quite to the contrary, has experienced a ripple effect of economic setbacks.

It may come as a surprise to many investors that the Euro Stoxx 50 index is up 5.5% year to date and 21.6% in the past 52 weeks, after posting a 26% increase in 2013.

So what does this mean for Canadians? I'd say there are important lessons for borrowers (some of us) and investors (most of us).

Borrowers have got to wonder if low rates are here to stay or if they could get lower. Maybe 2.99%, five-year fixed rate mortgages aren't such a good deal; if rates are falling elsewhere, why not here?

The other side of the coin is to consider the fact that ECB has lowered rates because it's concerned about deflation, a decrease in prices when inflation actually goes negative. Deflation increases the real value of debt, making it harder to pay back debt when prices, incomes and asset values are declining. And given the precariously high debt levels in Canada, deflation could be particularly difficult if it ever came home to roost.

I'd say the most important lesson for investors is that double-digit portfolio returns can't be counted on when doing your retirement planning. Stocks have performed reasonably well in recent years, but low interest rates, low inflation and low growth are becoming increasingly prevalent within the developed world.

And while many Canadians would echo criticisms of the ECB move by Germany that low rates penalize savers, the short and potentially medium-term reality of fixed-income investing is a low yield.

In particular, those who are close to or into retirement need to evaluate what a sustainable withdrawal rate is from their investment portfolio to ensure they don't outlive their savings.

Financial Post

Jason Heath is a fee-only certified financial planner and income tax professional for Objective Financial Partners Inc. in Toronto.

Draghi-Yellen split spells more volatility

Diversity may activate becalmed markets

By Simon Kennedy

Central banks are poised to reawaken the financial markets they had hypnotized into a slumber.

The source of the stirring lies in signs policymakers are set to diverge from the united front they adopted following the financial crisis. The result will leave investors with more money-making opportunities after the ongoing easy-money era becalmed trading in everything from bonds to currencies.

European Central Bank president Mario Draghi added to global liquidity Thursday as ECB cut its deposit rate below zero for the first time and reduced its benchmark to a record 0.15%.

That's at odds with the trend elsewhere.

Federal Reserve chairwoman Janet Yellen is winding down the bank's monthly asset purchases and economists are pulling forward their forecasts for a rate hike from the Bank of England. Splitting the difference is the Bank of Japan as it continues with its asset purchase program unleashed in April 2013 while pushing against speculation it will expand it.

In a taste of things to come, the ECB meeting alone led U.S. dollar volatility to surge to the highest in a year versus the euro before the cuts were announced. Price swings in Treasuries rose to a two-month high.

The growing diversity is even more evident in Morgan Stanley's outlook for the 16 central banks it follows closely. Seven monetary authorities, mainly in emerging markets, have a bias to tighten monetary policy, while nine lean toward easing.

The policy divergences will widen even further over the next three years as the Fed and then the BoE raise rates, putting them on a course counter to ECB and BoJ, according to Andrew Kenningham, an economist at Capital Economics Ltd. in London. By 2017, he estimates, the gap between the U.S. benchmark and those of the eurozone and Japan could be nearing four percentage points.

Such divides, he says, are unusual although not unprecedented. The split between U.S. and Japanese rates has often exceeded four percentage points in recent decades and between the U.S. and Germany it topped three percentage points for much of the 1980s.

The end of unanimity would nevertheless "have a substantial influence on financial markets," with the gap in bond yields between the U.S. and elsewhere widening and the dollar probably rising, said Mr. Kenningham.

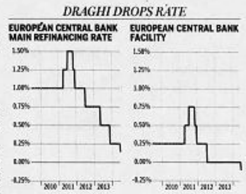
More market volatility may be something central bankers welcome after several turned vocal in recent weeks about the calm. The concern was it could provoke excessive risk-taking.

If policymakers can activate the markets they can perhaps quell the threat of asset bubbles and also keep interest rates low enough to boost economic growth, said Steven Englander, the New York-based global head of Group of 10 foreign-exchange strategy at Citigroup Inc.

"We are assuming that higher volatility will discourage yield grabs in asset markets more than it discourages activity," said Mr. Englander in a May 30 report.

Bloomberg News

DRAGHI DROPS RATE



SOURCE: BLOOMBERG NEWS — JONATHON RIVAIT / NATIONAL POST

Jobless numbers remain key focus

EURO
Continued from Page FP1

What Thursday's rate cut — and the promise of further action — did do was show "that the ECB will not stand idle as growth wanes and deflation threatens," Mr. Grantham said.

"We remain optimistic on the outlook for eurozone GDP, particularly in 2015, when we forecast a consensus-topping 1.9% growth rate."

The 18-nation eurozone grew by only 0.2% in the first quarter of 2014, while the unemployment rate has reached 11.7%.

Mr. Draghi, dubbed "Super Mario" for his "whatever it takes" stand in July 2012 when he promised to save the currency union from extinction as member countries — specifically Greece, Portugal and Spain — appeared headed for the exit.

Outlining his latest rescue mission, Mr. Draghi said the new measures should lift inflation to 1.1% by 2015, from an overall rate this year of 0.7%. For 2016, the ECB president expects annual price gains to reach 1.4%.

That's still short of ECB's inflation target of 2%, the same ideal level as set by the Bank of Canada.

"In pursuing our price stability mandate ... we decided on a combination of measures to provide additional monetary accommodation and to support lending to the real economy," Mr. Draghi told reporters.

Among those measures was to cut the bank's benchmark refinancing rate from an already record-low 0.25% to 0.15%.

Even more striking, policymakers restructured rates on money that banks deposit overnight at ECB: Instead of little or no interest paid to lenders, those banks will now be charged 0.1% interest on deposits — a move to encourage financial institutions to lend out that money rather than sit on it.

Along the same lines, ECB will offer long-term loans to banks at cheap fixed rates until 2018 to instill some confidence in their funding ability.

"If required, we will act swiftly with further monetary policy easing," Mr. Draghi said, but he stopped short of suggesting a program of asset purchases, or quantitative easing, as the U.K. and the U.S. have carried out.

"Most likely, we will see immediate effects in the money markets and we will see delayed effects in the real economy attributable to this program," he said, adding that "it will probably take three or four quarters."

The euro currency was little changed on Thursday despite ECB's initiatives, which many viewed as more aggressive than anticipated.

"The ECB has given the market a significant amount of action to digest," said Ken Wills, a currency broker at CanadianForex in Toronto.

The focus here will be on the monthly Canadian and U.S. employment numbers to be released Friday, he said.

"I think the market is likely taking some time to digest what the ECB did, but maybe not necessarily ready to go and short the euro, at least not against the U.S. and Canada, until they see what that employment data shows."

As for the new ECB measures, "I don't feel it will have an effect" on North America markets, Mr. Wills said.

"If they [Bank of Canada policymakers] can stay dovish to neutral, they'll be very happy to do that for the time being. And in the U.S., as well, things are pointing the right way."

Douglas Porter, chief economist at BMO Capital Markets, said, "The reality is that Canadian inflation isn't really particularly different from most of the rest of the industrialized world."

"We're not in the same league as Europe, but our inflation trends look very similar to the U.S., and you don't really hear the Fed talking too much the about the downside risks to inflation at this point."

Andrew Labelle, at TD Economics, said, "The impact for Canada via the exchange rate will be minimal."

Financial Post

gisfeld@nationalpost.com

Europe's energy security new worry

BACKTRACK
Continued from Page FP1

The draft is still being discussed within the EU executive and Canada's lobbying efforts to address concerns are continuing.

An annex in the draft still ascribes a value of 107 grams of carbon dioxide for the oil sands, compared with 93.2 for conventional crude. It proposes a review by the end of 2016 to again address the case for introducing higher values for individual fuel sources.

Environmental organizations that lobbied to punish the oil sands as part of an international campaign against development of the Alberta deposits are expected to be disappointed with the lighter version.

The debate started in 2009 when EU member states approved legislation with the aim of cutting greenhouse gases from transport fuel sold in Europe by 6% by 2020, but failed to agree how to implement it.

In 2011, the commission agreed the oil sands should be given the 107 grams of CO_2 value, but member states could not agree on the proposal; the commission has been reconsidering it ever since.

Canada's opposition was supported by many European states that have big investments in the Canadian industry.

The change is expected to remove an obstacle to Canada about shipping crude from the oil sands to Europe.

Some European countries have recently been looking to Canada's large energy supplies in a new light, or as an alternative to imports from Russia, a reaction to its aggression against Ukraine. Canada also wants to diversify its markets away from the United States.

"Ukraine for us — for the U.K. and the EU — is a wake-up," Michael Fallon, the British energy minister, said during a visit to Calgary last month to bolster energy ties.

"We have to look much more urgently at our own energy security. We got to encourage more indigenous sources of supply. We got to diversify our source of supply."

Prime Minister Stephen Harper told reporters after G7 talks in Brussels Thursday that Canada is "deeply engaged in a discussion with our allies on how we can make sure that globally our energy supplies are secure and stable."

Financial Post

ccattaneo@nationalpost.com

BLOOMBERG NEWS FILES

The eurozone is now looking somewhat more favourably at oil sands imports.

Refusal to Consolidate Debts

It has been this refusal to consolidate debts insisted upon by Kohl which has resulted in the destabilization of the Euro and the negative interest rates which began in June 2014. For you see, because bailouts were prohibited by the refusal to consolidate debts since capital could flow from one member to another, this meant that the toxic debts banks held on their books could not be purchased by the central bank to relieve the banks. The only other option was to employ negative interest rates in hopes that the banks could make enough money to cover their losses. However, since negative interest rates were adopted by the ECB in 2014, going into 6 years of this experiment and the banks have still been unable to recover.

European banks were left with all the toxic losses from the 2007-2009 Financial Crisis and this experiment to cut interest rates to negative, hoping the banks would make money on their own to cover their losses. That never happened. So, Europe has been unable to recover at all because of that policy which refused to consolidate the debts. To add misery to insanity, because of the negative interest rates on the Euro, other central banks do not want to hold Euros because they in effect see this as an international tax on holding Euros which is going back to the EU. Hence, this is an indirect means of taxing Euro holdings regardless where they are being held.

Structural Risk of the Euro

There arrives a time when the sins of the past come to demand their retribution. I warned that the structural design of the Euro was a complete disaster. The Repo Crisis is emerging because of this structural design flaw that has placed the entire world at risk of a financial disaster beyond all proportions of the 2007-2009 Financial Crisis. This is only enhanced by the insanity of this experiment with negative interest rates. With $12 trillion outstanding of negative yielding debt, the potential losses are off the charts.

Due to this structural crisis in Europe, there is nothing external international central banks can do to prevent this crisis, no less manage the fallout. The best they can do will be to stand behind their own local banks who may suffer losses from any transactions with a European bank that the EU refuses to bailouts.

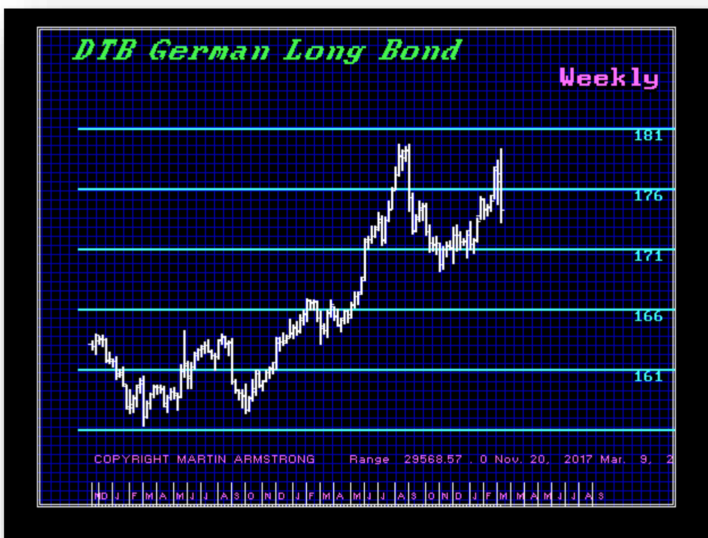
We face a global contagion never witnessed before in economic history. On top of that, we have fiscal irresponsibility clashing with monetary policy of central banks and there is no referee standing between this clash of titans. Furthermore, we have absolutely the worst possible political catastrophe unfolding where people who have true qualifications to manage a financial crisis of this magnitude have no interest in even coming close to politics.

The analysis of this Repo Crisis has been the traditional domestic focus spun by people who have zero experience in international world capital flow analysis, economics, or basic comprehension of how the world economy operates.

Germany has used the Coronavirus Scare to justify reversing its strict policies of anti-inflation. Germany has suddenly pledged to spend "whatever is needed" to assist the economic impact of the coronavirus. Merkel promised that new policy during a press conference and Scholz of the SPD effectively confirmed. Meanwhile, Federal Minister of Economics Peter Altmaier says that given the Corona crisis, state investments in strategically important companies are conceivable. In other words, they are using the Coronavirus as a possible justification to **nationalize** businesses (confiscation of private assets).

Peter Altmaier (born 1958)
German lawyer/politician & Federal Minister for Economic Affairs and Energy since March 2018

Behind the curtain, if the policies originally insisted by Germany under their view of austerity that bailouts must be prohibited, the only way this becomes possible is to nationalize companies since they cannot bail them out. This is an interesting solution.



Scholz and Economy Minister Peter Altmaier said in a joint statement released on Friday, March 13th, 2020, that their goal was to secure German companies. In addition, as we noted earlier, Scholz said there will be "no limit" to the money available, and that Germany may need to take on additional debt to finance the spending spree. The impact of the German bunds was sharply negative. This was bringing into question the rock-solid German image behind the Euro.

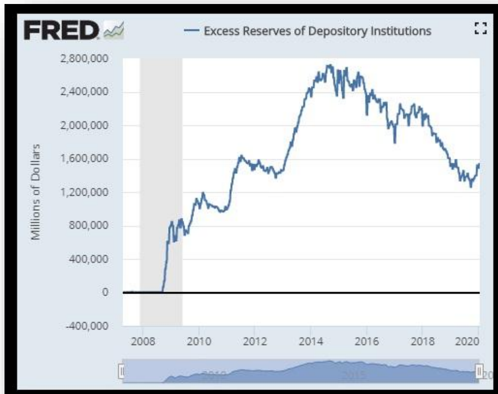
Larry Summers – Father of Negative Interest Rates

A speech delivered by Former U.S. Secretary of the Treasury and past President of Harvard University Larry Summers at the IMF Research Conference on Nov. 8, 2013, set in motion negative interest rates. It was being hailed as brilliant, succinct, and a ground-breaking presentation that explained what many say is the most pressing economic matter of our time. The speech was being widely praised of course by Paul Krugman who never saw other people's money as their property but really just a toy of the state for their manipulating pleasure.

Summers argued that over the past 50 years, the Federal Reserve has cut short-term interest rates during recessions to spur economic growth. However, the new problem has arisen where the Federal Reserve has lost its power to control society. Summers further argued that if another recession were to hit in the next couple of years, the Fed will have even less power to combat such a decline since rates were already at zero. Summers therefore warned in his speech at the IMF that the "real" interest rate should be **NEGATIVE**.

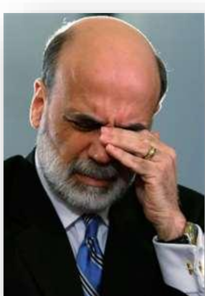
Summers has ascribed to the proposition of Karl Marx that Government can manipulate society to create Utopia. He has also ascribed to Keynesian economics believing in the proposition that raising or lowering interest rates will impact and manage the demand within society thereby steering the economy to eliminate the booms and busts.

Summers has adopted the position that manipulating investment and savings brings about full employment and that the devastation of the 2007-2009 Financial Crisis shifted the real interest rate should be **NEGATIVE** to stop people from saving. Summers then proposed that the problem was that the Fed cannot cut the nominal rate **BELOW** zero because people will choose to hoard money instead of putting it in the bank. He then stated that there was a zero-lower boundary on interest rates where people would hoard cash outside of the banks.



QE & Excess Reserves

To offset this zero-lower boundary, the Fed had employed unconventional programs such as Quantitative Easing (QE) to push long-term rates down to try to bring about greater investment. However, QE at the Fed buying billions of dollars of Treasuries failed to stimulate the economy for a simple reason. The presumption that the 30-year US bonds they would purchase were held exclusively by domestic investors. They failed to consider that about 40% of the US national debt was held outside the United States.

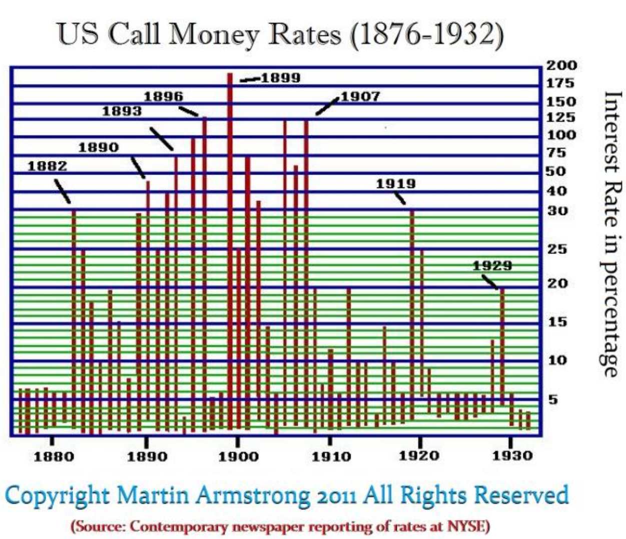


When the Fed finally realized that foreign governments also held 30-year Treasuries, they began to buy the mortgage-backed securities. The Fed again was only praying the banks will lower rates and lend to potential borrowers which they hoped would stimulate the economy. That prayer failed miserably. The Fed relied upon the banks which instead complained, and the Fed then created the Excess Reserves facility where they paid them interest on excess funds, they had refused to lend out which defeated the entire stimulation of QE.

Natural Interest Rate

Larry Summers maintains that the natural interest rate remained **BELOW** zero even with the QE measures sterilizing any action of the Fed. Reducing short-term interest rates is the Fed's greatest power, according to Summers, under Monetarism to bring about full employment during recessions. He has never considered that humans act no different than a herd of wild animals. We act primarily in a herd instinct. The bankers would not lend and parked money in excess reserves because they had no faith in the economy reversing. People would not borrow until they **BELIEVED** the future would be better.

I have done the studies seeking to discover that magic button with interest rates and discovered it does not exist. The stock market has never peaked with the same level of interest rates twice in history. Because it is all a matter of confidence. If you believe the stock market will double, you will gladly pay 20%. If you do not believe the stock market will rally even 1%, you will not pay 0.5%. It is always about the perspective of the future and that amounts to confidence.



Summers has viewed this as a larger problem that this is not a short-term issue but systemic. He has argued that should another recession hit; the Fed would be impudent. This is what Summers warned of in his speech at the IMF.

> *"Imagine a situation where natural and equilibrium interest rates have fallen significantly below zero," Summers said. "Then conventional macroeconomic thinking leaves us in a very serious problem because we all seem to agree that whereas you can keep the federal funds rate at a low level forever, it's much harder to do extraordinary measures beyond that forever, but the underlying problem may be there forever."*

Summers, who was also an economic adviser to President Obama during the economic crisis from 2009 through 2010, wrote an article that appeared on December 6, 2015, in the *Washington Post.*

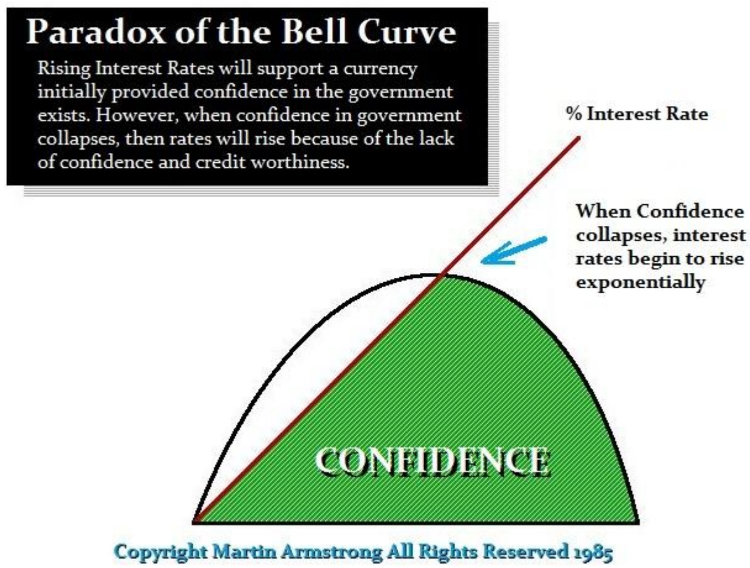
> *Washington Post*
>
> By Lawrence Summers December 6, 2015
>
> "While the risk of recession may seem remote given recent growth, it bears emphasizing that since World War II, no postwar recession has been predicted a year in advance by the Fed, the White House or the consensus forecast."

Subsequently, *Bloomberg News* interviewed Summers on this very issue. They asked:

> "Why it's so hard for smart guys like you to predict some form of economic slowdown?

In part it's hard because the economy is an enormously complex system meteorologists turns out are not very good at predicting the weather that's a complex system too.

In part there is something in the logic of economics if it were predictable that the economy was going to decline people would stop investing; people would reduce their spending and the economy would have already declined. So, there is a sense in which in the logic of the system that once expectation of recession takes hold, you're in recession and therefore it's very difficult to predict in advance when that is going to take place. The argument is not unlike that at least there's a good approximation that speculative prices should follow random walks."



Paradox of the Bell Curve

In the *Bloomberg* interview, Larry Summers again conceded it is impossible to forecast the direction of the business cycle because it is like that of the weather system — too complex. Nevertheless, Summers theorized that negative interest rates would reverse the economic decline relying on Keynesian economics. What he fails to understand that everything functions in a bell curve – not linear. Aspirin is a miracle drug but take too much and it can become a poison. Interest rates will explode when people believe the entity will go bankrupt be it government or a corporation.

Secular Stagnation

Summers has also championed the role of what he has called "secular stagnation" in current economic conditions which refers to a market economy with a chronic (secular or long-term) lack of demand. Traditionally, a booming economy with low unemployment and high GDP growth would normally generate inflation in wages and products. However, under secular stagnation, the economy behaves as if it is operating below capacity, even when the economy appears to be booming. In other words, inflation does not appear and it is argued that savings by consumers exceeds investment by businesses. Because savings increase and the available money supply increases for lending, interest rates to fall because there is a decline in the demand for money to invest.

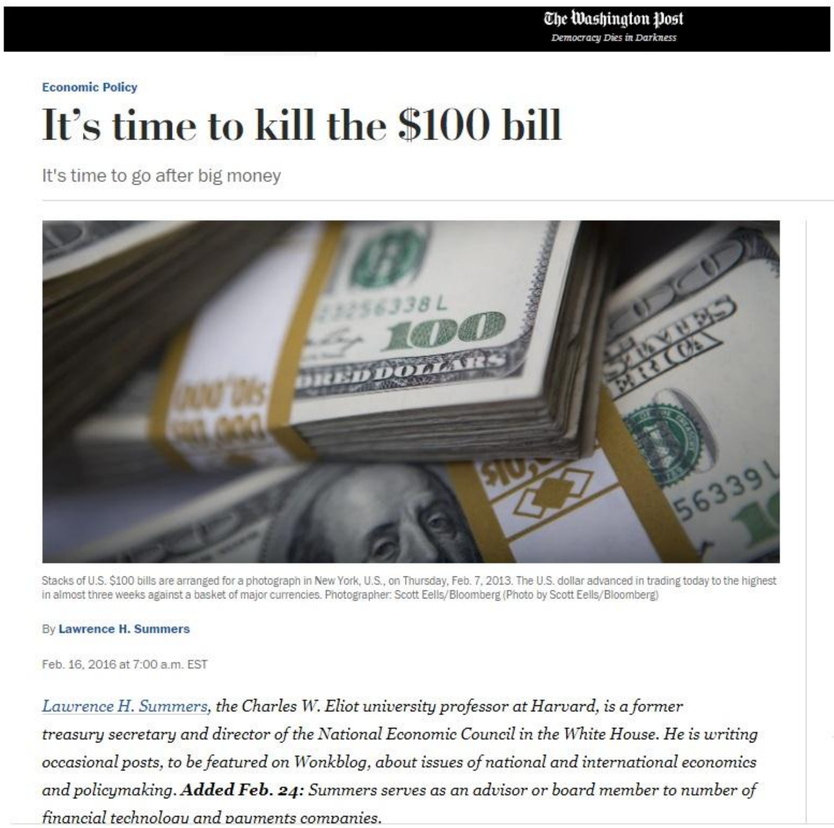
Summers came to the conclusion that facing secular stagnation requires an interest rate below zero to bring savings and investment into balance. In other words, to punish people for saving and to compel them to spend or invest in a future they obviously do not believe in. His theory that this surplus of savings over investment was not unlike what the United States experienced with low unemployment and low inflation during the years that preceded the Great Recession 2007–2009, although a massive housing bubble had developed. This merely provides evidence that Summers' analysis was purely domestic oriented and failed to take into consideration foreign capital which was especially buying real estate both in Canada and the United States.

Fiscal v Monetary Policy

While Summers has argued that the "neutral interest rate" had declined substantially and was likely to be lower in the future, the idea that real interest rates, which is defined as interest rates adjusted for inflation, will be lower going forward demonstrates his inability to forecast the business cycle.

Summers, like everyone else in government, has completely ignored what Keynes also said was a vital tool to manipulate society – taxes. He has utterly failed to understand that raising taxes diminishes the disposable income of consumers. Therefore, if wages rise and the tax rate rises at the same rate of higher, then there would also be no expansion in spending or savings and his theory of secular stagnation would still prevail. They never consider the cost of government as a factor in economic growth theories.

Interest rates are only the Monetarist side of the coin whereas Keynes was concerned about the fiscal policy – government spending. Keynes argued that it was **DEMAND** that declined during a depression and that could be overcome by government moving into a deficit. But deficits are now systemic and politicians have turned to the Fed to sterilize their fiscal mismanagement using Monetarism since the Fed is incapable of controlling fiscal spending – Keynesianism.



The Washington Post
Democracy Dies in Darkness

Economic Policy

It's time to kill the $100 bill

It's time to go after big money

Stacks of U.S. $100 bills are arranged for a photograph in New York, U.S., on Thursday, Feb. 7, 2013. The U.S. dollar advanced in trading today to the highest in almost three weeks against a basket of major currencies. Photographer: Scott Eells/Bloomberg (Photo by Scott Eells/Bloomberg)

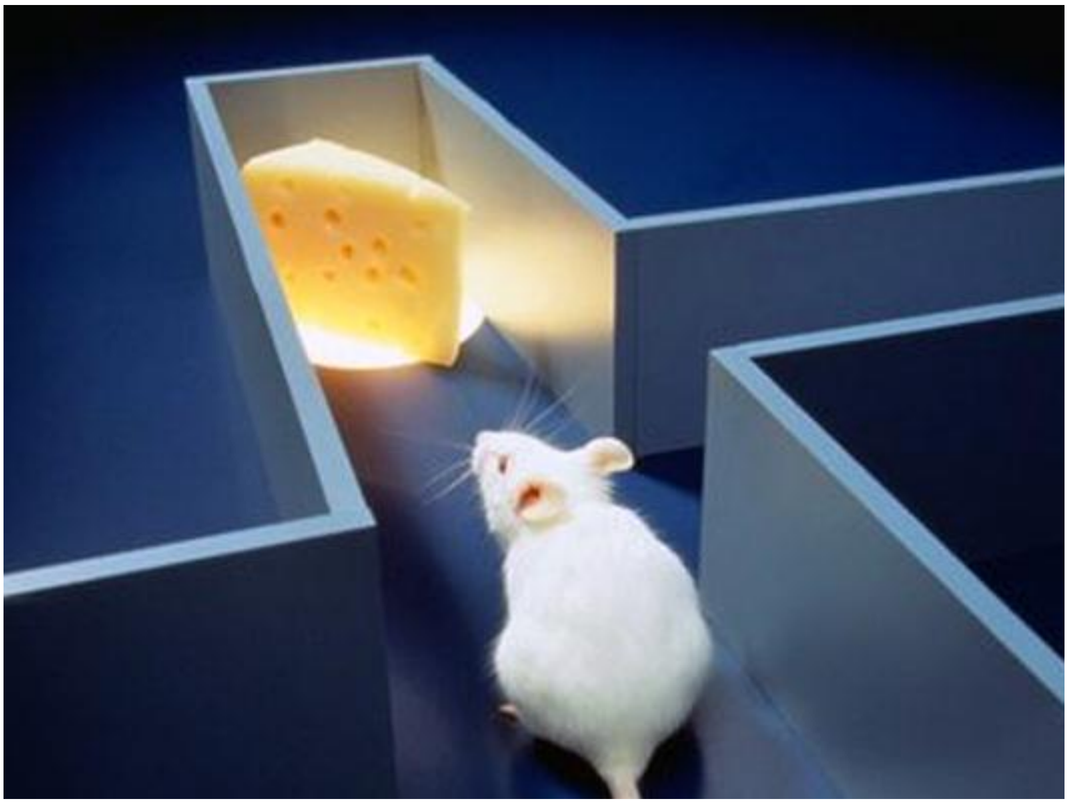
By Lawrence H. Summers

Feb. 16, 2016 at 7:00 a.m. EST

Lawrence H. Summers, the Charles W. Eliot university professor at Harvard, is a former treasury secretary and director of the National Economic Council in the White House. He is writing occasional posts, to be featured on Wonkblog, about issues of national and international economics and policymaking. ***Added Feb. 24:*** *Summers serves as an advisor or board member to number of financial technology and payments companies.*

Because his theory on negative interest rates completely failed to compel people to spend recklessly and stop saving, he presumed they were just hoarding cash and the way to then stimulate using his theories was to eliminate cash. He wrote in the left-wing newspaper Washington Post that it is time to kill the $100 bill. There was no consideration that perhaps his theory of negative interest rates was a flop, he then moved to the proposition to eliminate cash to forced people to keep their money in banks where they would be penalized with negative interest rates if they refused to spend their money.

Summers now assumes that the problem is systemic but has refused to ever look at government's role or responsibility in this crisis. He never addresses the issue of chronic deficits and borrowing perpetually with no intent of ever repaying the debt. Summers ignores the fiscal side of the balance sheet and only looks at the fiscal side and expects the Fed to manage the entire economy singlehandedly.

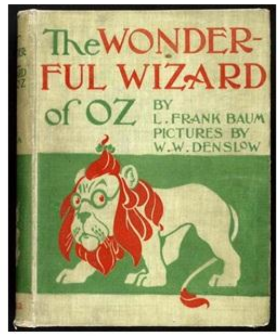


All of this is perfectly logical for the elites who see themselves as manipulating the economy enticing us like a mouse in a maze searching for the cheese. They ignore **TAXES** entirely, fiscal spending, and do not see that their own chronic systemic deficits have eliminated Keynesianism entirely. Now they see the solution as eliminating all cash and then penalizing savers with **NEGATIVE** interest rates. This has merely created a false expectation that manipulating the world economy is entirely possible and the duty of central banks.

The Repo Crisis That Surprised Everyone

During the ROME World Economic Conference (WEC) held on May 3rd & 4th, 2019, we warned that a major Liquidity Crisis was developing as a direct consequence of the **Negative Interest Rates** and the **Quantitative Easing** on the part of the European Central Bank (ECB) which was destroying the European bond market. It was quite shocking how those in power remain clueless as to how the global economy truly functions. All they have is the simplistic view of how to manipulate the masses with Keynesian Economics applied to their monetary policy of raising and lowering interest rates. They have ignored entirely the fiscal side of the books and disregard the impact of taxes upon the people. They assume inflation will take place if you merely increase the quantity of money, but do not consider that the person on the street looks only at net disposable income after taxes. If he does not feel secure, he will hoard his cash and never spend.

Lyman Frank Baum (1856–1919)



First Edition 1900

During the Panic of 1893, long before Keynes, there was a major economic collapsed which inspired a march on Washington which the author of the Wizard of Oz was inspired. The Tine man was Industry, the Scarecrow was Agriculture, and the Cowardly Lion was William Jennings Bryan. They followed the Yellow Brick Road which represented the austerity of the gold standard.

The Silver Democrats had sent the economy into nearly bankruptcy. It was at that time that President Grover Cleveland stood before a special session of Congress on August 8th, 1893 and said…

Grover Cleveland (1837–1908)
only President of United States to serve two non consecutive terms (1885–1889 and 1893–1897)

"At times like the present, when the evils of unsound finance threaten us, the speculator may anticipate a harvest gathered from the misfortune of others, the capitalist may protect himself by hoarding or may even find profit in the fluctuations of values; but the wage earner – the first to be injured by a depreciated currency – is practically defenseless. He relies for work upon the ventures of confident and contented capital. This failing him, his condition is without alleviation, for he can neither prey on the misfortunes of others nor hoard his labour."

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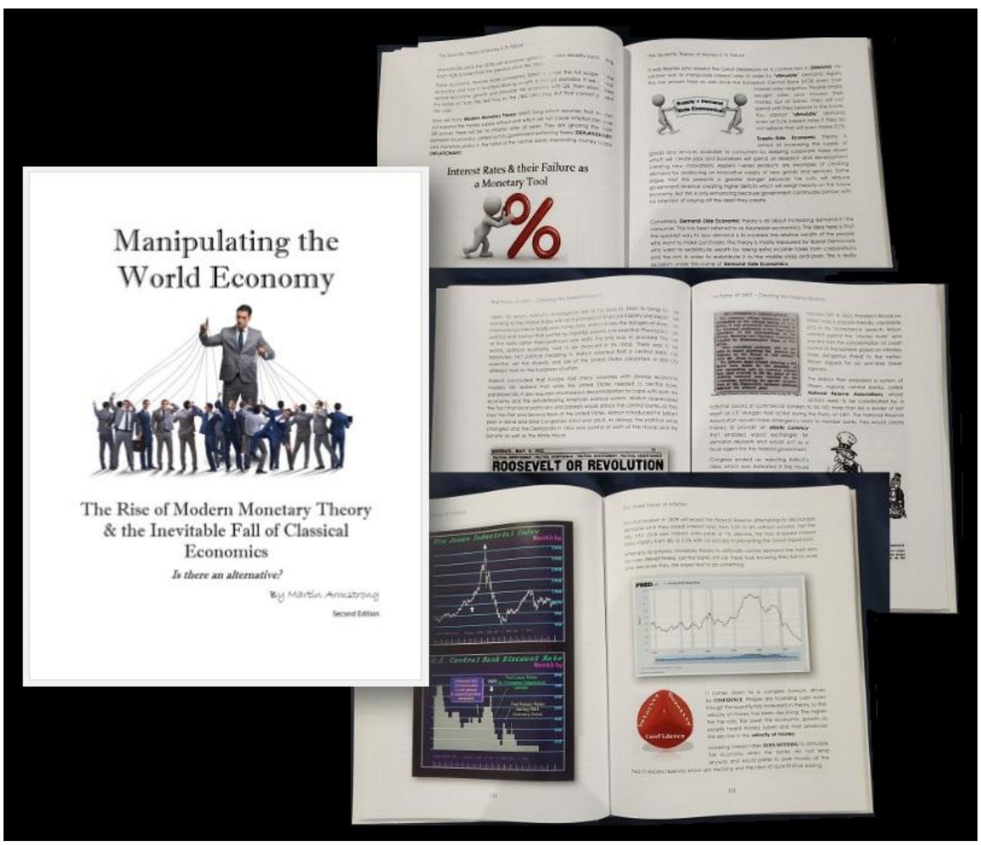
Because we lean individual from our mistakes, many wrongly assume that government knows what it is doing. Unfortunately, history repeats for the simple fact that collectively we NEVER learn the lessons from the past. That never applies to societies and at best only to the more dynamic thinkers individually.

We have entered a serious Liquidity Crisis and as a result, we have entered the "The Great Unknown" for we cannot ever learn from our past mistakes as a society. Then there is the problem of those in power will **NEVER** admit to a mistake for they fear they will be voted out. Thus, society remains doomed unable to ever advance from our mistakes that we deny making as a political society.

We are now entering a period of tremendous disparity between the artificial interest rates set by government's central banks and those of the independent free market. What has been unfolding is a major clash between the real world and the artificial world which the central banks have attempted to create.

Traditionally, the central banks have controlled the short-term rates. The long-term rates have always been set by the free markets. When confidence collapses, that is when the yield curve inverts, and analysis warn of a recession as they did during the summer of 2019. The very existence of the Repo Crisis is confirming that we have entered a new crisis, one where the central banks have even lost the ability to manage the short-term rates. The Fed is trapped insofar as it cannot lower rates as long as they must be the market-maker in the Repo Market which is under pressure to cause short-term rates to rise – not decline.

In order to attempt to control the long end of the yield curve the central banks engaged in **Quantitative Easing** where they bought in long-term debt in hopes of creating a shortage whereby, they would bring those long-term rates down. Of course, the Federal Reserve was only were buying government debt with no regard to credit risk. This maneuver demonstrated the difference between academics and people with real world experience. The Fed never considered the fact that banks were also not lending because the distrusted the **credit risk** given the prospects of the future.



The Repo Crisis is far more serious than most people understand. We are dealing with the **LAST VESTIAGE** of power that was once held by the central banks under Keynesian Economics. Ever since Karl Marx, this idea that government have the right, the knowledge, and the capacity to manipulate the world economy. While I have sought to collect the historical record of how governments have attempted to manipulate the world economy in my latest book, what we are facing is the clash of central banks desperately trying to remain relevant in the game.

The FED has been compelled to intervene into the Repo market in order to prevent short-term rates from rising. What is taking place is that the free markets are smelling risk ahead and that is being translated into greater caution in lending.

At the May 2019 WEC in Rome, we presented this slide and the #1 issue on our list of things to take home from the conference was the "Destruction of the Bond Markets & Liquidity Crisis" with a focus on both Europe and Japan. This 12 years of quantitative easing from both Europe and Japan have completely failed to stimulate and reverse the economic decline and deflationary mode. In the process, by purchasing government bonds under the Keynesian theory that if they reduce the supply of government debt, the banks would be willing to lend to the private sector and that would get the economy going again.

This theory required two factors. First, the bank would be willing to lend more when their portfolios were burdened with non-performing loans and the government had ruled out any bailout scenario. Secondly, they also presumed the people would be willing to borrow despite the economy and the future prospects did not hold out any vision of an opportunity.

Consequently, as I have explained, our forecast made at the May 2019 WEC was that we faced a liquidity crisis in the face of the destruction of the government bond markets. That liquidity crises first showed its teeth by capital flight to the dollar which drove the yield curve to an inverted position as capital moved to buy 10-year US treasuries with a positive yield against European 10-year bonds at a negative yield. On top of that, our banking clients in Europe were shipping cash to their US branches who were then depositing that in the Excess Reserve facility ta the Federal Reserve. They were not stupid. The ECB wanted to charge them a negative rate to park funds at the central bank so they simply wired their funds to their US branch which in turn parked capital at the Federal Reserve.

The Repo Rate reached a high of 10% by about 9am just before the stock market opened. The fed funds rate was testing the Fed's upper limit. The Fed was forced to intervene I believe for the first time since the 2008 crisis.

On Tuesday, the Fed offered $75 billion through its facility and received $53 billion of demand from borrowers who swap AAA Treasury holdings for cash at minimal rates. On Wednesday, the Fed again offered the same $75 billion facility and received this time $80 billion in bids.

Overnight financing (REPO Rate) is a basic function which holds the economy together. Those who trade on leverage rely on the REPO market (Broker-dealers, hedge funds, and institutional). It is rarely written about for it is not generally seen by the public. The events of the past few days is a clear warning sign of what I have been yelling about which is on the horizon. The central banks are TRAPPED and in Europe, they have destroyed their bond market with more than $15 trillion and perhaps up to $17 trillion in negative-yielding bonds ($1 trillion is corporate).

Before the 2007-2009 crisis, the Repo Rate was actually the only financial instrument which paid a rate of return that could become NEGATIVE under normal market conditions. NEGATIVE Repo Rates can happen when there is a shortage of cash or particular collateral security, like negative-yielding bonds, are put up to borrow against. Therefore, trying to borrow against a negative-yielding bond can present a crisis. The standard Repo contracts, such as the Global Master Repurchase Agreement (GMRA), have been drafted under the implicit assumption that general collateral (GC) Repo Rates would only ever be positive.

What has transpired is the buyers of these negative bonds have been simply traders. They have not bought this stuff to actually hold to maturity. They have been happy to trade them assuming rates would continue lower so it would be a bond rally. We are looking at **SERIOUS** credit risk once again but instead of the time bombs being mortgage–backed securities, this time it will be negative–yielding bonds issued by governments. The bond markets have been converted into a child's game of musical chairs. When the music stops, someone will be left holding negative–yielding bonds that will only be salable at even deeper discounts of perhaps as great as 50% in a few years.

About 30% of the bonds issued by governments and companies worldwide are trading at negative yields which is now about $17tn of outstanding debt. This unprecedented reversal of normal practice has raised profound questions about the outlook for bonds. This is seriously impacting core holding for institutional investors.

The interest rate risk that negative–yielding bonds carry is beyond unbelievable. It is totally artificial supported only by punters. The financial system simply doesn't work with negative rates and this is also contributing to shortages of cash for Repo markets. A slight rise in interest rates will create a massive debt crisis and if you undermine the bond market, that is what creates great depressions. Negative yields have been confined to places outside the USA and the intervention of the Fed implies they are not prepared to allow negative rates to undermine the US economy as they have done in Europe.

Unlike the 2008 crisis where the time bombs were private debt, Tuesday's abrupt rise in short–term rates wasn't obvious that the financial system was in trouble because sovereign debt is assumed to be AAA and risk–free. Not sure whoever started that huge lie.

Nevertheless, we have a convergence of forces which are creating the perfect financial storm on the horizon. Immediately, corporate tax payments are due so corps have less cash to sell overnight. Then there are big Treasury auctions as deficits continue to rise for governments always borrow, yet never pay off the debt as if this can continue without end.

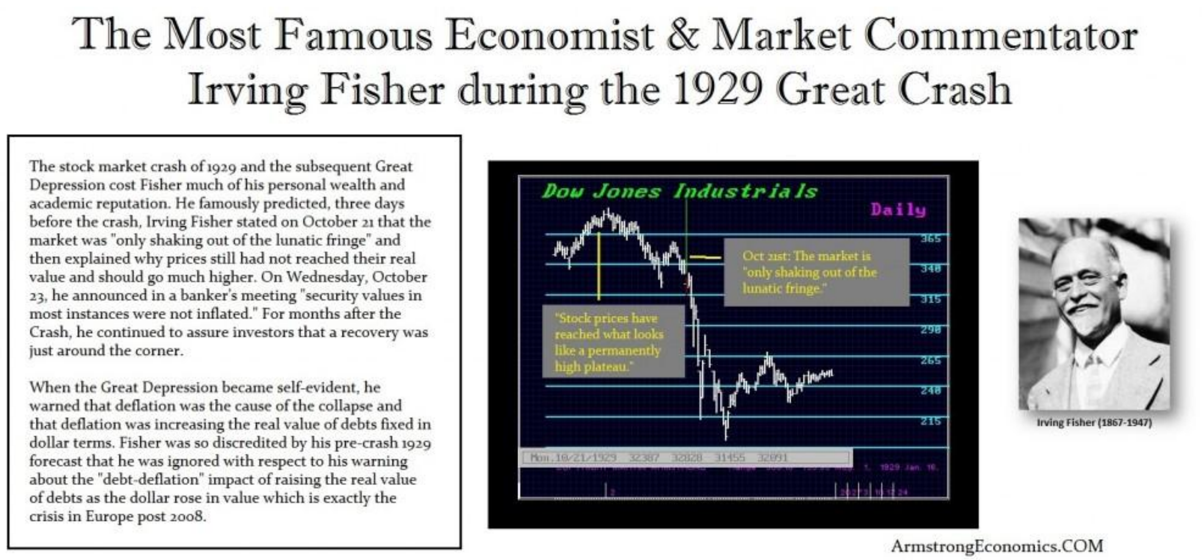
Can the Fed Exit the REPO Market?

It is stunning how after more than several months, the analysis on the Repo market is still nowhere close to reality. The Fed cut rates during the crash but then they have to pour in $1.5 trillion into the Repo Market. Had they not done so, then short-term rates would have naturally exploded as they **ALWAYS** do in a crisis because of rising credit risks – i.e. the Lehman Moment.

The popular explanation in September 2019 was repeated by the Wall Street Journal: ***"For one, Monday marked the deadline for companies to submit their quarterly federal tax payments."*** This was standard analysis put out by the countless pundits the press relies upon and they have to come up with some explanation and quick. When analysts spout out their explanations to mainstream media it is because they are trying to get business. Hence, the analysis put out in the press about the Repo Crisis is coming from people who have no real clients in the area and lack the expertise in the field to start with.

Not even the central banks understand what was going on because even they tend to be domestically oriented. The Fed cut rates because of pressure to appear to be doing something yet it knew that rates would rise if it did not provide the liquidity for the economy. The Fed did what people expect it to do, but it had no effect. Perhaps the Fed is starting to see the light from this darkness. But that remains to be seen.

In order to **SAVE** the system, we **MUST** abandon Keynesian Economics right away! Despite the obvious fact that we live in a global economy, all the economic theories, analysis, and experience have been domestically focused. Unless someone has been in the trenches globally, they will never see the wildcard coming from external sources. The coronavirus has presented what many will view as a systemic risk. However, our model was forecasting a top and I warned at the October 2020 World Economic Conference that we were ready for a 20% correction and we provided the initial target in the 21000 level on the Dow.



The Phase Transition in the Dow going into 1929 ruined the reputation of the leading economist and market commentator Irving Fisher (1867–1947). Three days before the high he announced, ***"Stock prices have reached what looks like a permanently high plateau."*** The Phase Transition of the US share market into 1929 on a monthly level was 37.3 months (8.615 * 4.3). Likewise, on the weekly level, the overall final Phase Transition was also 13 weeks from 300.10 to 386.10. However, on the daily level, the final rally was a brief **slingshot** and from that low it was a 17.2-day rally (2 * 8.6) that created the major high at 386.10. Therefore, those final 17.2 days caused Fisher to proclaim a new permanent high level had been reached. This is the classic Phase Transition. Then, even as the market began to crash, precisely on the 34th day of that decline a temporary low formed which was four cycles of 8.6 days. He then announced that the market was ***"only shaking out of the lunatic fringe."*** He coined a saying that has long since remained.

When you reach these sorts of tops, inevitably there are those who assume everythi8ng has changed. Quite frankly, the market was growing tired after 11-years up and at that point, **ANY** news is enough to cash its demise. In the case of 1929, the rally was from 1921 and was only about 8.6 years. The current rally from the 2009 level has lasted 11 years because of the reluctance of many to accept a bull market.


Dow Jones Industrials
Monthly
27904
25404
22904
20404
17904
15404
12904
COPYRIGHT MARTIN ARMSTRONG
Range 29568.57 10404.49 Jan. 1, 2011 Feb.
11 12 13 14 15 16 17 18 19 20 21 22 23
U.S. Central Bank Discount Rate
Monthly
400
350
300
250
200
150
100
COPYRIGHT MARTIN ARMSTRONG
Range 29568.57 . 0 Jan. 1, 2009 Mar. 1, 20
09 10 11 12 13 14 15 16 17 18 19 20 21

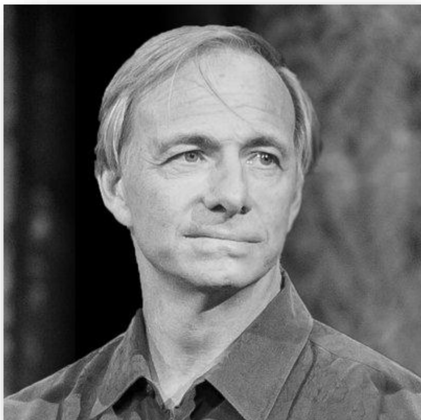
Bridgewater's Bob Prince declared that the Boom-Bust Cycle was over. This was indicative of the arrogance of fundamental reasoning. His theory was that the tightening of central banks all around the world ***"wasn't intended to cause the downturn, wasn't intended to cause what it did."*** Prince explained, ***"I think lessons were learned from that and I think it was really a marker that we've probably seen the end of the boom-bust cycle."***

The Bridgewater Associates boss, Ray Dalio, had just proclaimed that **"cash is trash"** and warned investors against ditching stocks for dollars in a CNBC interview on Tuesday, January 21st, just after the **Economic Confidence Model** turned on Saturday, January 18th, 2020. Dalio argued a weaker dollar and growing money supply would be eroded by the value of hard currency over the next few years as he has been an old-school gold bug. Ray Dalio said gold will be a top investment during upcoming '**paradigm shift**' for global markets back on July 17th, 2019.

Dalio argued his theory that gold would be king as central banks get more aggressive with policies that devalue currencies and are about to cause a "paradigm shift" in investing. He said that investors have been pushed into stocks and other assets that have equity-like returns. As a result, too many people are holding these types of securities and likely to face diminishing returns.

> *"I think these are unlikely to be good real returning investments and that those that will most likely do best will be those that do well when the value of money is being depreciated and domestic and international conflicts are significant, such as gold."*

On January 15th, 2020, the London Financial Times reported **"3 Reasons Ray Dalio's Hedge Fund Is Betting on a 30% Gold Price Surge."** Then on March 13th, 2020 in the heat of the panic sell–off, the order to sell $16 billion in gold was liquidated. That was been rumored to have been Bridgewater who is raising cash as people speculate that they lost over $30 billion on the decline during the week of March 9th, 2020.



What has been coming out of Bridgewater is essentially the theory all based upon the **Quantity Theory of Money** (QTM) which does not work. They have been saying is that the stock market rose even with higher interest rates and thus they have been assuming the Business Cycle had been defeated.

That is an interesting take, but it reflects the typical investment manager focus. They tend not to pay attention to history and always assume that the financial world started as far back as maybe 1971 if not 1990. The boom–bust cycle that they refer to has been the classical economic expansion and contraction in economic activity. However, the very book I just published, ***"Manipulating the World Economy,"*** deals with this very issue of central bank intervention and the failure of QTM. Bridgewater seems to think that the financial crisis and monetary easing has disrupted that cycle and economics has been changed forever. If the rumors are correct, Bridgewater could become the Long–Term Capital Management debacle of 2020.

This is why Bridgewater has had a terrible year in 2019. They have completely misunderstood the market and do not understand the role of capital flows and how they drive global markets. Indeed, Bridgewater Associates, the world's largest hedge fund firm, had a very difficult 2019 because of this view. The firm's flagship Pure Alpha strategy was essentially flat in 2019, with Pure Alpha 18%, the more leveraged version, falling 0.5% for the year, according to an investor in the funds.

It has been this fundamental focus at Bridgewater may become one of the biggest losers in the Crash of 2020. They are largest hedge fund. Ray Dalio who said **"cash is trash"** and his #1 guy pronounced that the central banks had defeated the Business Cycle, their fund is now facing huge losses at Bridgewater Associates. The firm's macro fund is down roughly 20% through Thursday, March 12th, 2020. Their view has been anti-dollar, bullish gold, and thought that the rise of cryptocurrencies was a structural change that ended declines like this.

Ray Dalio's is also widely known for his 123-page manifesto (Principles) where he gives readers a glimpse into his philosophies about living life and managing people and organizations. In the text's abstract he explains:

> ***"Truth, more precisely an accurate understanding of reality is the essential foundation for producing good results."***

Principles is a required read for all Bridgewater employees. Dalio released an expanded and revised edition of the manifesto on September 19th the day of the Repo Crisis. Just before the Crash of 2020, on February 13th, Bridgewater made its regulatory quarterly filing Form 13F. This revealed that Bridgewater's stock portfolio totaled $12.2 billion at that time. The list value of his stock holdings was already down -18.4% when compared to the last quarter. The S&P 500 was up 6.1% over the same period. This meant that Dalio underperformed the market by 24.5% based on the 13F filing.

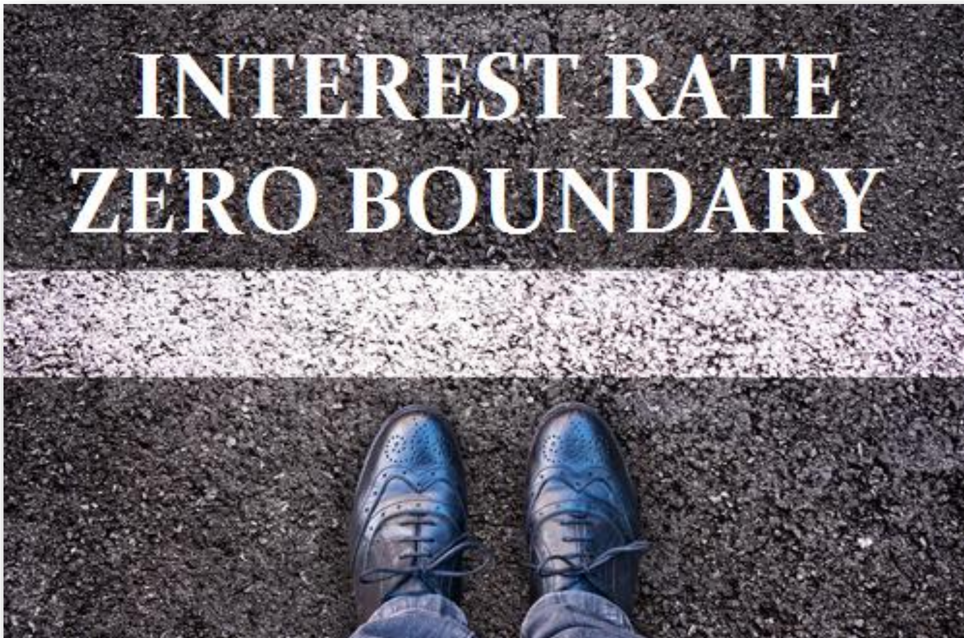
Moreover, Bridgewater's largest holdings were in ETFs[1] which is rather strange for a hedge fund that requires healthy management fees. Since then, the decline in the fund, Pure Alpha Fund II, comes nearly two months after Dalio told CNBC **"cash is trash"** in an interview held during the World Economic Forum in January 2020. The problem with such funds as Bridgewater is very clear – their strategy is based on human opinion. The **ONLY** way to survive the years ahead is to eliminate human opinion and stand objective between all the theories.

The Repo market is already disproving the idea that the boom-bust cycle is dead. Interest rates were pushing higher and the Fed had to intervene in a desperate attempt to prevent that rise in short-term rates which was a direct confrontation of central bank power.

Quantitative Easing was an attempt to influence the long-end of the yield curve because central banks only set the short-term rates. The Repo Crisis has proven that the very power of central banks is now being challenged and the marketplace, politicians, and even most central bankers remain clueless as to what is taking place.

[1] Market makers create ETF units by delivering a basket of underlying securities to the ETF provider in exchange for a block of units (typically 50,000 units) of the ETF with the same market value. These newly created ETF units represent an inventory that can be sold on the stock exchange to investors. When the market maker runs out of units (because the investing public has purchased them all), they simply repeat the process, beginning with purchasing and delivering additional securities.

Zero Boundary



The attempt to push beyond the zero interest rate boundary has proven to present tremendous risks that were never anticipated. The fact that there are calls for the Fed to lower interest rates to zero presents a tremendous risk to the world economy. As the market falls further and the economy plunges into stagnation, the credibility of the Fed evalporates. Not merely has **Keynesian Economics** been completely discredited as a viable economic tool, but the lack of any alternative leaves central banks with no power to manage future downturns. This undermines monetary policy to dig economies out of recession and it is becoming increasingly more obvious that as was the case with Dorothy in the Wizard of Oz, ***we ain't in Kansas anymore***.

When we look at the future under the **Keynesian Economic Model**, it is becoming widely recognized that we're likely to have great difficulty in the years ahead because of the zero–lower boundary in interest rates is far more serious than economists have previously even thought about. There is no monetary room to lower interest rates under the Keynesian Model.

Institutions and the elderly have for decades relied upon interest rate income. This is especially true about pension funds. This chronic use of the **Keynesian Economics** has caused many to desperately seek yield in emerging markets and even equities. Without interest income, institutions are going to have to rethink their entire investment strategy in a very different world when we have a black hole in interest rates which is zero to negative yields.

The failure of this **Keynesian Economics** to manipulate interest rates in hope of stimulating demand has utterly proven to be a disaster. We are headed into the economic abyss like Japan’s economy, which has experienced decades of economic stagnation. The Japanese central bank, the Bank of Japan (BoJ), embarked on its journey into negative rates in 2016, about two years after the European Central Bank (ECB) began in 2014. Both are now hopelessly trapped and cannot raise interest rates out of fear that the consequences under **Keynesian Economics** would predict a Great Depression.

Without major change in this economic thinking, the world economy is headed into a period of draconian measures in a desperate effort to make this failed model work. There’s little chance of policy rates being able to remain rational at the Federal Reserve when politicians, including Trump, are indoctrinated in **Keynesian Economics** and cannot see a way out. They constantly demand lower rates without any contemplation of the consequences.

Indeed, the expectations that the effort Federal Reserve Open Market Committee (FOMC) will reduce the target rate for the federal funds to zero has materialized on the Ides of March, 2020. However, the market will continue to decline and the rise will be that the Fed will lose credibility and that will undermine the entire confidence of the system setting the stage for the Monetary Crisis Cycle 2021–2022.

The economy will continue to implode into the end of the first quarter. Yet lowering rates to zero will not prove be a realistic solution and it has failed at the BoJ and ECB. Therefore, the greatest risk is the collapse in confidence. Once that is gone, then the volatility will rise and the chaos begins.

The marketplace is firmly brainwashed in **Keynesian Economics** and thus expect the Fed to maintain an exceptionally low policy rate for some time to come. That will wipe out pension funds and institutions not to mention the elderly. The market is expecting that the funds rate will remain at the zero lower bound level through year-end. The real danger is as the economy only stagnates as we see in Japan, the Fed also will become trapped as is the case in the ECB and BoJ.

There is little doubt that the central banks are constrained by the zero–lower boundary. They see this can be solves by eliminating paper currency. They have completely altered the yield curve and disrupted the entire pension system. But central banks are blinded by the Keynesian Economic Model and have lost all peripheral vision like a horse pulling a carriage with blinder. All it can see is the Keynesian Model and the economy by simply manipulating interest rates.

The Federal Reserve Risking It All on One Hand

The Federal Reserve is simply player a giant game of poker. It is all about playing your cards and trying to bluff you opponents. The greatest danger that exists here is that after cutting rates to zero and President Trump praising that bold move, then wake up and suddenly see the bluff did not work. We have reached the OMG moment in public confidence.

The danger of trying to respond basis the Keynesian Economic Model which has NEVER worked even one time, is that when the markets realize that the central banks cannot control or manage the economy, the volatility will rise even further. Caesar, beware the Ides of March! You may have just sealed you own fate.

The Repo Crisis

The Fed is taking every possible measure to try to manage with the Crash of 2020. It is also widely believed that the Fed will take aggressive measures to support market liquidity by even further being accommodating in the Repo Market to cope with the financial market stress. The Fed has been compelled to become the market-maker in short-term rates thereby underpinning the flow of credit. This was not by choice. The Fed was looking for an exit without success.

Because the hedge funds have been buying the treasury market and selling the futures, the unwinding of this popular spread threatens the functioning of the US bond market as a whole. This could force the Fed to increase its purchase of US Treasuries significantly as we see hedge funds implode. This will continue into at least the second quarter of 2020.

There has been a sharp decline in the liquidity of cash Treasuries compared to the futures market. Therefore, the traditional trade of buying cash treasuries and selling the futures demonstrates that there is indeed a serious liquidity crisis developing which is impacting the largest bond market in the world. The widening of the price between the cash Treasuries falling relative to the futures is indicative of the liquidity crisis and the further decline in the confidence of the financial markets. While that cash Treasuries have still rallied in the face of the climbing stock market with the flight to quality, it has lagged behind the futures making this traditional spread a losing bet. As this trade comes under pressure, we can see the sudden panic selling of cash treasuries to unwind this trait.

Relative Value Hedge Funds

The big players in this trade are "Relative Value" hedge funds. As this comes under pressure, they will be forced to start dumping these positions. These hedge funds have been using the Repo market to enhance their positions. The post the Treasuries and the take the cash and use that for trading derivatives. They are one reason why the Repo market has doubled over the past five years. There is no question that these value spreads by hedge funds are contributing to the Repo Crisis. This only further confuses many who do not understand the Repo market and have never paid attention to it to begin with.

The older benchmark Treasuries, known as **off-the-run**, tend to be cheaper to buy in the marketplace, but they are also harder to resell. There has been an increase in the selling of these older issues which is a warning sign with respect to liquidity. The Fed has moved by injecting more cash into the Repo market, but it also mentioned that it will purchase bonds to address what it called the ***"highly unusual disruptions in Treasury financing markets associated with the coronavirus outbreak."***

What we must take into consideration is the fact that these Relative Value hedge fund strategies have absorbed large portions of the debt coming to the market. They have certainly contributed to the doubling of the Repo Market in the past five years. The unwinding of this with huge losses will put counter-directional pressure of interest rates. The risk is that the Fed can be forced un Keynesian Economics to absorb government debt to prevent rates to rise.

The risk here is that as hedge funds lose billions, the market to absorb Treasuries as punters also shrinks. The same is taking place in the European bond markets and this is threatening the entire **Keynesian Economic Model** where government must realize that printing is cheaper than borrowing. But they are not at the point of realization

High-Frequency Trading

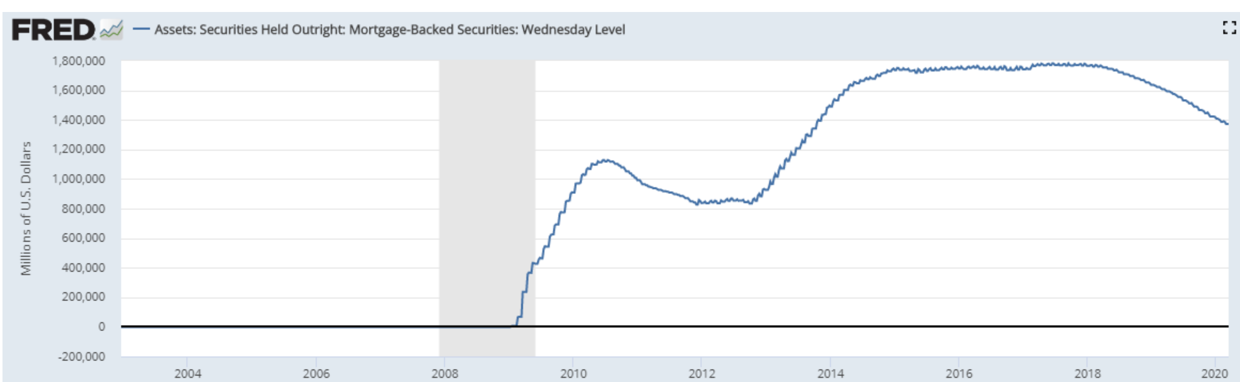
The higher volatility has wreaked havoc on high-frequency trading (HFT). However, collateral trading desks have experienced a lot of losses of late. One of the most common traits was to buy cash treasuries and sell interest rate futures. The treasuries have usually traded slightly cheaper than their equivalent derivatives because they carry a higher capital charge for banks. This means that the normal conditions investors will buy treasuries, sell the futures contract, and then pocket the difference during this immediate crisis this trade has been unwinding because of the increased volatility.

The high-frequency trading firms began to encounter serious troubles even before the Crash of 2020. This is not a temporary downswing, but a major shift in focus. The factors that allowed successful firms to trade latency arbitrage and liquidity provision. Latency arbitrage meant simply moving for an advantage by being faster. Therefore, the game has changed from pure speed to finding underpriced latency.

HFTs have been moving into other markets that are less liquid stocks, exchange-traded derivatives, emerging markets, bonds, and over-the-counter derivatives. The days of HFT providing liquidity in the major markets are gone. Some believe that this has also contributed to the decline in liquidity.

Mortgages Backed Securities

In addition, it is expected that the Fed will adjust its reinvestment policy for mortgaged backed securities. At present, the Fed reinvests up to $20 billion of ensuring mortgages backed securities principal into US treasuries. It's expected that the Fed will reinvest all maturing mortgage-backed securities principal into the mortgage-backed security market in order to support mortgage rates and provide incentive refinancing activities for households.



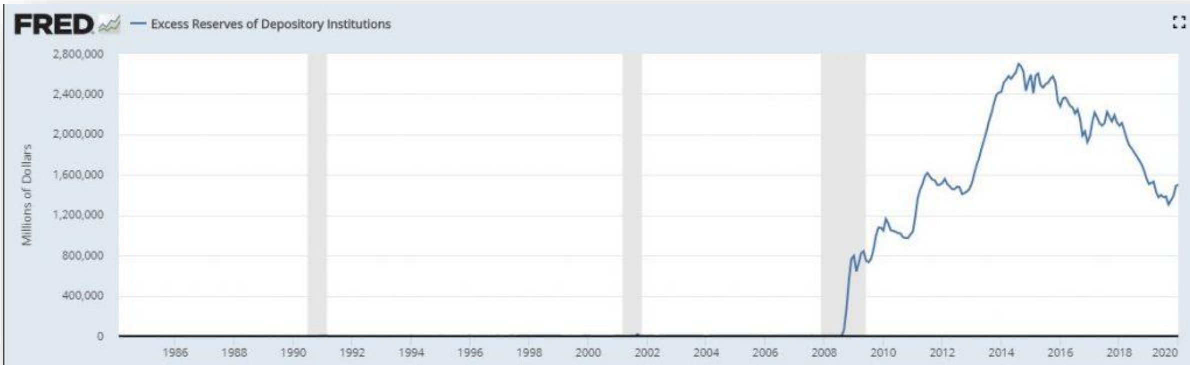
The mortgage-backed security market peaked on the rebound in the Economic Confidence Model in 2017. It has been declining ever since. The youth are not buying because they are saddled with student loans they cannot even go bankrupt on. The Fed may think it can stimulate this sector, but the only way to do that if forgive student loans for worthless degrees.

Commercial Paper Funding Facility

The Federal Reserve will return to its origin and it will do what it was originally designed to do. They will lend now on commercial paper rather than just government. The Federal Reserve created the **Commercial Paper Funding Facility** (CPFF) to provide a liquidity backstop to U.S. issuers of commercial paper. The CPFF was intended to improve liquidity in short-term funding markets and thereby contribute to greater availability of credit for businesses and households.

The Federal Reserve Board on October 27th, 2008 announced details regarding the Commercial Paper Funding Facility (CPFF), which it would begin to fund purchases of commercial paper.

As everyone knows, this has been my strongest recommendation and criticism of Quantitative Easing. The Fed was originally designed to create Elastic Money buying corporate paper to prevent a recession and job losses. World War I saw government interfere and directed the Fed should be buying government debt.



Injecting cash into the banks under Quantitative Easing **FAILED** because the banks lacked the confidence to lend money. The government bailout the banks with TARP without any strings hoping the banks would lend money, which they did not. The banks turned and placed money at the Fed in **Excess Reserves**. Not only did that bottom in September 2019 with the **Repo Crisis,** it has begun to rise once again as banks are not lending and prefer to hoard cash in times of uncertainty.

Lowering short–term rate **FAILED** because people will not borrow if they lack confidence in the future. Consequently, Europe and Japan have destroyed their government bond markets and now they talk about nationalizing companies and eliminating paper money while seizing cryptocurrencies. They have no monetary power left in the central bank. The zero–limit boundary has drained all the power from the ECB and BoJ under **Keynesian Economics**. All they can do now is turn to draconian measures and seal the fate of their economic future.

The Fed will take a different path and lend directly to corporations because the bankers will hoard the cash and **NEVER** help the economy. This has been my #1 recommendation to save the economy and the central bank. Because of the consolidated debt prohibition in the EU, they cannot bailout banks and the same will apply to corporations. This has led to the suggestion that they should just nationalize banks and corporation that need to be rescued.

This is the **REAL Crisis** – not the coronavirus which has been at best the catalyst to set everything in motion for the **Monetary Crisis** and the **Mother of All Financial Crises**.

Risk Management v Keynesian Model

The Federal Reserve needs looks at this from a **risk management** perspective instead of a pure **Keynesian Model** interest rate perspective. Only then will the Fed start to understand that by a prolonged policy of low interest rates, they would be undermining the economy rather than supporting it. This is clearly evidenced by the negative interest rates maintained by the European Central Bank and the Bank of Japan.

Therefore, a Fed policy must shift to **risk management** to survive. The Fed must see the economy as a dynamic whole and remove the blinders imposed by the Keynesian Economic Model. Monetary policy would then be able to move away from the extraordinary low interest rates paradox which has undermined institutions and destroyed pension funds. It is critical that the Fed understands this shift in how to deal with this immediate crisis for this will be absolutely critical for the survival of the Federal Reserve itself moving forward.

The world economy is under siege. Normally you would you see a collapse in the stock market and that typically moves to a flight to quality into US treasuries. However, the expectation now is that governments will flood the markets with more debt. They will have to buy it themselves for the marketplace will not absorb such debt at these low rates.

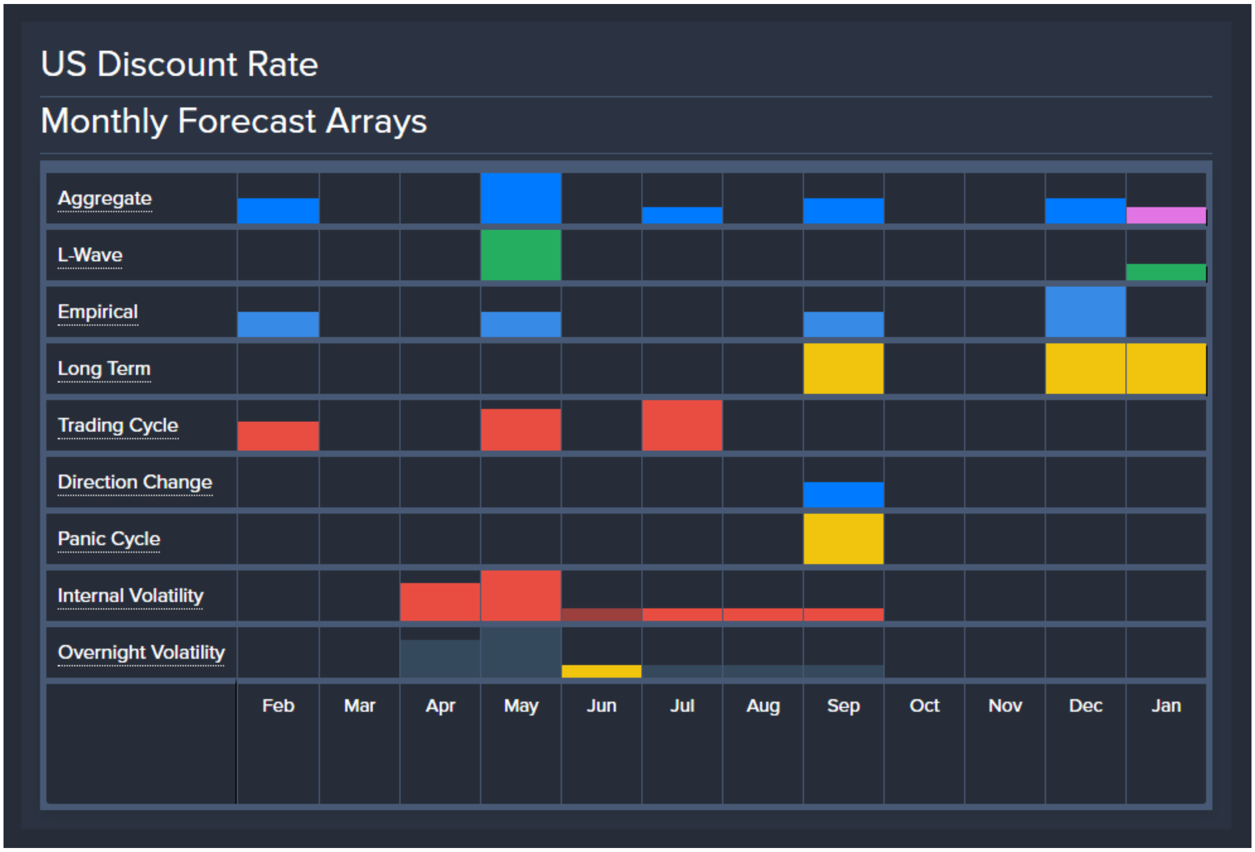
The Timing

The greatest risk that we face is the fact that the Fed has just bet all its chips. It is calling everyone's bluf and they are all–in. Virtually every newsletter guys is claiming this is another QE. They cannot escape their reasoning that increasing the supply of money will be inflationary. You would think they have learned their less given the world economy is still in a deflationary mode. But like the central banks, they are trapped in their thinking just like Trump and everyone else relying on **Keynesian Economics** rooted in the **Quantity Theory of Money**. They will never just step back and ask: Did it produce inflation before?

They cannot fathom why gold has fallen. They keep preaching the dollar is Trash like Ray Dalio. They do not realize that they are preaching what the majority believes. Dalio lost about 20% the week of March 9th. The Fed has gone all in, but it will fail. Then what? We are staring into the cold eyes of financial crisis that will wipe out the majority and send volatility screaming higher.

They do not even realize that there are about $12 trillion outstanding in negative-yielding debt instruments. With the Fed lowering short-term rates to zero, the Fed risks destroying the US bond market as has taken place in Japan and Europe.

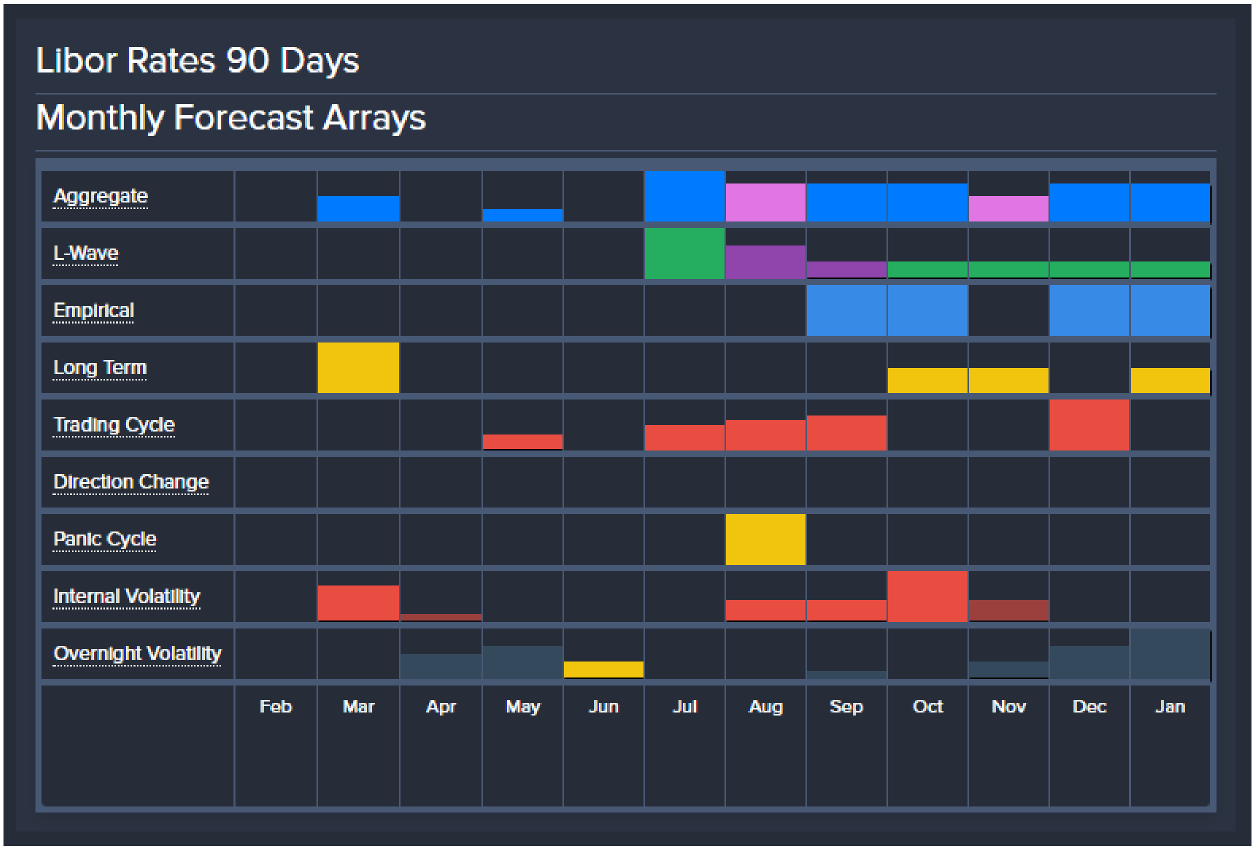
What is the real risk going forward? This entire theory of lowering interest rates to stimulate demand is absurd for it has never worked even once. As long as people are uncertain about the future, they will not borrow or invest. This is when cash rises in purchasing power and assets decline because the expectation of the future remains questionable. To all those like Dalio who really believe that the dollar was trash, they will not survive these moves yet to come.



Our models on the Fed directly have been correct. We see volatility rising during April and a big turning point in May. The propaganda over the Coronavirus has been off the charts. Now China, Russia, and Iran are all claiming that this is a biological weapon brought to China by the US Military.

This does appear that the virus will probably peak out in May. However, the Fed has gone **all–in** so as the markets fall into the end of the quarter simply because hedge funds need to raise cash so the sell whatever they can, we risk the collapse in confidence because the Fed will be unable to do anything more.

As market plunge despite the Fed's actions, there remains a risk that the powers that be could declare a national emergency to close the markets because there will be a run on many hedge funds which will then force liquidations on a wholesale basis.


Libor Rates 90 Days
Monthly Forecast Arrays
Aggregate
L-Wave
Empirical
Long Term
Trading Cycle
Direction Change
Panic Cycle
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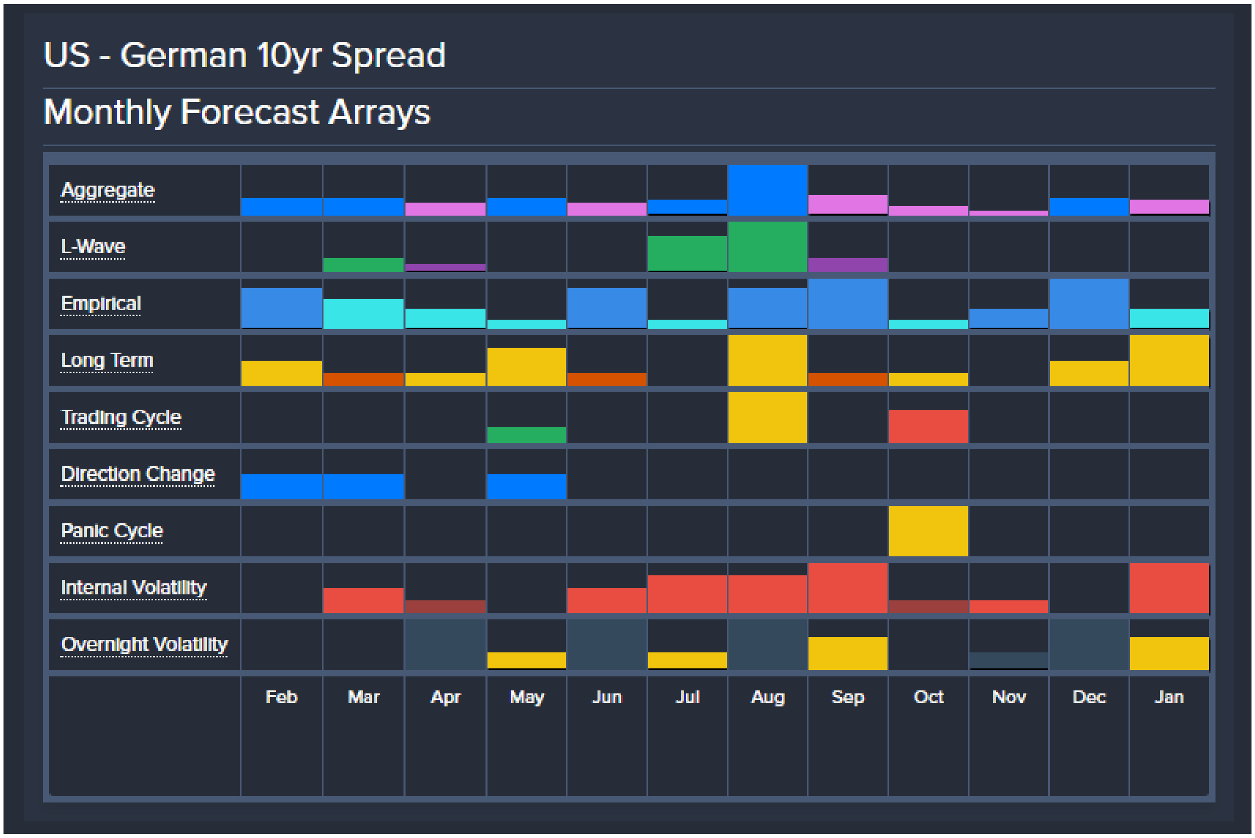
US - German 10yr Spread
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The Timing

When we look at the arrays for timing, we see generally May followed by July/August. The Democratic Convention is in July. There still remains a risk of rising violence as Bernie's supports reject the Democratic Party and there may yet be the draft of Hillary to come to the rescue.

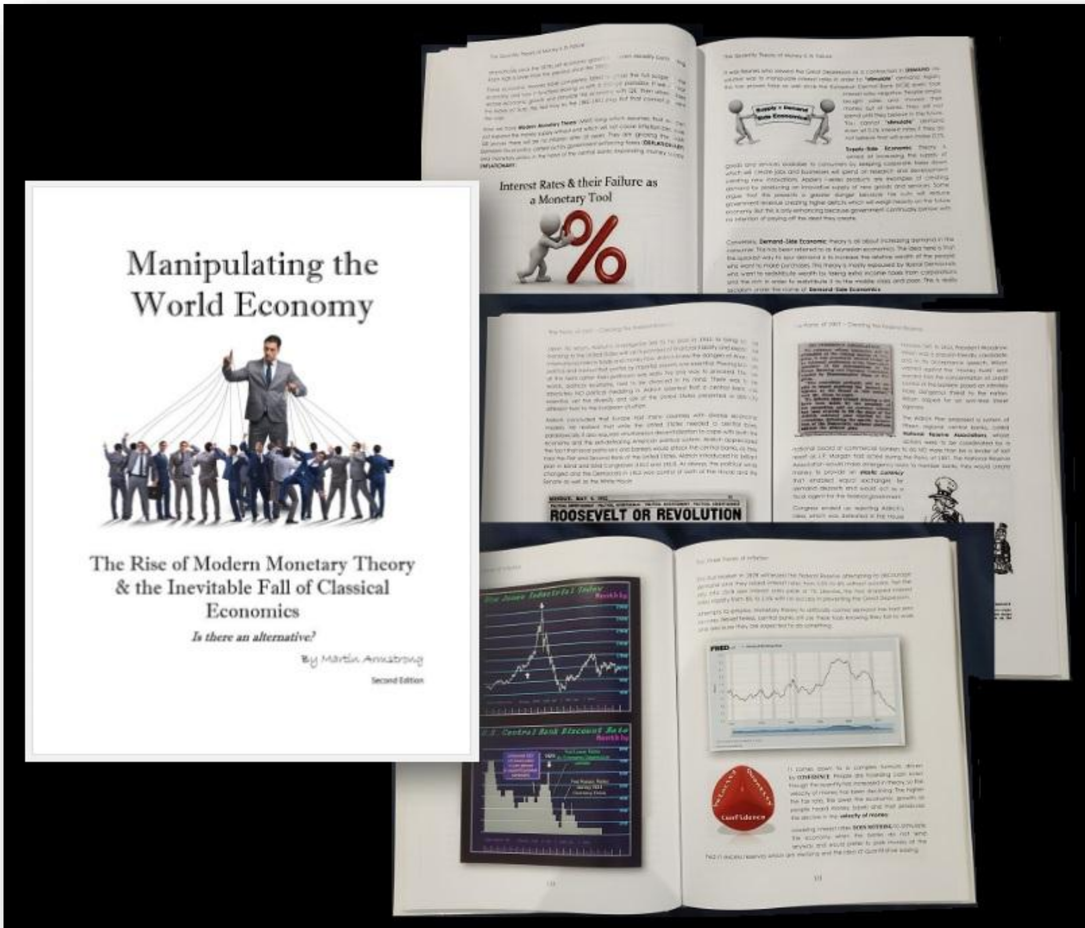
The second half of 2020 looks to be rather volatile and we expect some very interesting outcomes. The Central Banking Crisis will begin to emerge as a real major issue later this year as we head into the Monetary Crisis Cycle and it is now entirely possible that they will use this Coronavirus as the excuse to eliminate cash at least in Europe.

Conclusion

Governments are incapable of dealing with this event of the Coronavirus for all they have is **Keynesian Economics** which has never worked even once. Paul Volcker saw the flaw in his Rediscovery of the Business Cycle. The problem has been that there is just no other economic theory which has come forward. The Coronavirus is **COMPLETELY** irrelevant. Governments are using this for political power gains.

The conspiracy crowd spin their theories about the Coronavirus and how Trump will be defeated, some huge portion of the population will die, and civilization is coming to a dark end. The real crisis is that nobody seems to notice the fact that central banks are at negative rates and lack any monetary policy room whatsoever to combat this economic decline with further lowering interest rates. The Fed has dropped the Fed Funds back to 0%–0.25% which it stood during the 2009–2009 crisis.

This is what I have been warning about – the **Central Bank Crisis**. They have shot themselves not in the foot, but in heart. They have destroyed the **Keynesian Economic Model.** They have nothing left. They do not know what to do other than try to expand liquidity. The entire idea of manipulating interest rates is done.



I have laid out in **Manipulating the World Economy** that the solution requires political action. The central banks are dead. This is a far greater crisis than most expect.

The Repo Crisis has been greatly misunderstood with so many people insisting this is Quantitative Easing because they lack the understanding of exactly what the Repo Market even is. They failed to understand that pumping even $1.5 trillion into Repo did not mean they were replacing debt with cash on a long-term basis as was the case under Quantitative Easing. Typically, these people are gold bugs and the Quantity Theory of Money is their religion. They are also trapped in their thinking based on the same principle of Keynesian Economics used by the central banks. The problem was, they injected trillion in QE and nothing happened.

The Fed is grappling with the problem of trying to **PREVENT** interest rates from rising on the short-term level through Repo. The Quantitative Easing was long-term debt. The Fed cannot control the long-term rates, so they tried to "influence" that part of the curve buying in 10 to 30-year debt in hopes of creating a shortage there which in theory would lead to more lending into the private sector such as mortgages. That simply failed and central banks ended up with portfolios that at least the Fed allowed to mature but the BoJ and ECB had to keep rolling that debt or rates would rise.

The Bank of Japan has come out and said they will but government debt without limitation also desperately trying to prevent interest rates from rising. All of these attempts to manipulate the interest rates will fail because the **FREE MARKETS** are demanding a return to normal where the interest rate not only reflects the potential future inflation rate, but **ALSO** the future risk in a world with **ZERO** or negative rates of inflation.

The greatest danger we face is waking up to the realization that central banks can no longer control the economy. Once that is understood in the marketplace, the fun and games will begin.

Conclusion

The risk the Fed faces is that they are not in a position to control the damage when it is global in nature. The Fed will be unable to hold up the entire world economy through its shadow Repo Market (swaps between Central Bank uncollateralized).

This merely increases the flight to quality being the dollar. As Europe turns to more draconian political measures given the ECB can no longer act under the **Keynesian Model**, the entire system begins to come unglued. The mere talk of nationalizing European companies means shareholder lose everything. They are clearly beyond stupid if they think this is somehow a solution.

In the end, this correction will wipe out those that believe in the **Quantity Theory of Money**. This is how the market will set up for the inevitable slingshot up where we still see the Dow will reach the $40,000 level. With the US interest rates going to zero, after the dust settles, capital will turn back to the equities for they will be the only game in town. We are looking at a massive collapse in government debt.

Everything has changed right down to the old concepts of the **Quantity Theory of Money.** We have stood by and watched the central bank pour trillions of dollars into the economy with no inflationary impact. The old theories are giving way to new realities. Inflation did not engulf the world – deflation emerged instead. How is this possible? If you increase the supply should not the value of money decline? This new trend has led to a perplexing array of excuses with little understanding. Obviously, we have to dig deeper to comprehend what is really going on here.

Conclusion

We must begin where nobody else dares to look. A fundamental principle that is just not even considered because the majority assume this is the way we operate and the elite in government assume this is just the way to run government. Accordingly, what needs to be challenged are our most fundamental basic ideas of how to run a government.

The proposal needs to be revolutionary indeed. But if we do not confront the failure of Keynesian Economics, we will be doomed as government seek more and more draconian measures to force the Keynesian Model to work.

Central Banks cannot manipulate the economy with interest rates not with Quantitative Easing. Banks will not lend money in a crisis and people will not borrow without confidence in the future. Lowering rates is a fool's game. We must come face to face with the Keynesian Model assumptions.

The central banks are powerless. When the capital markets realize this fact, then confidence in the idea that Santa Claus exists and will make everything better will be exposed. At that point, government becomes irrelevant and will respond authoritatively for they will see their power slipping away. This is how our Free Society becomes no different than what existed once behind the Berlin Wall.

It is time we change our management of the economy and end this Keynesian Economic model that has always ignored confidence and credit risk.