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Kenneth Coleman's Investment Tracker Newsletter

Welcomes AAII Sun City Members

February 12, 2011

What We Will Discuss Today

- The Difference Between a Recession and a Depression
- Why the Length of the Current Recession Outlasted the Average of all Others
- Whether or not the Recession is Completely Over
- What it will Take to bring the Recession to an End
- The U.S. Government's Strategy to End the Recession
- Whether or not their Strategy will Work

Definition of a Recession

- A recession is a periodic contraction of the economy caused by our nation's central bank—the Federal Reserve
- A recession happens when the Fed raises interest rates to a point where bank lending contracts, corporate profits plunge, the stock market implodes, and unemployment soars.

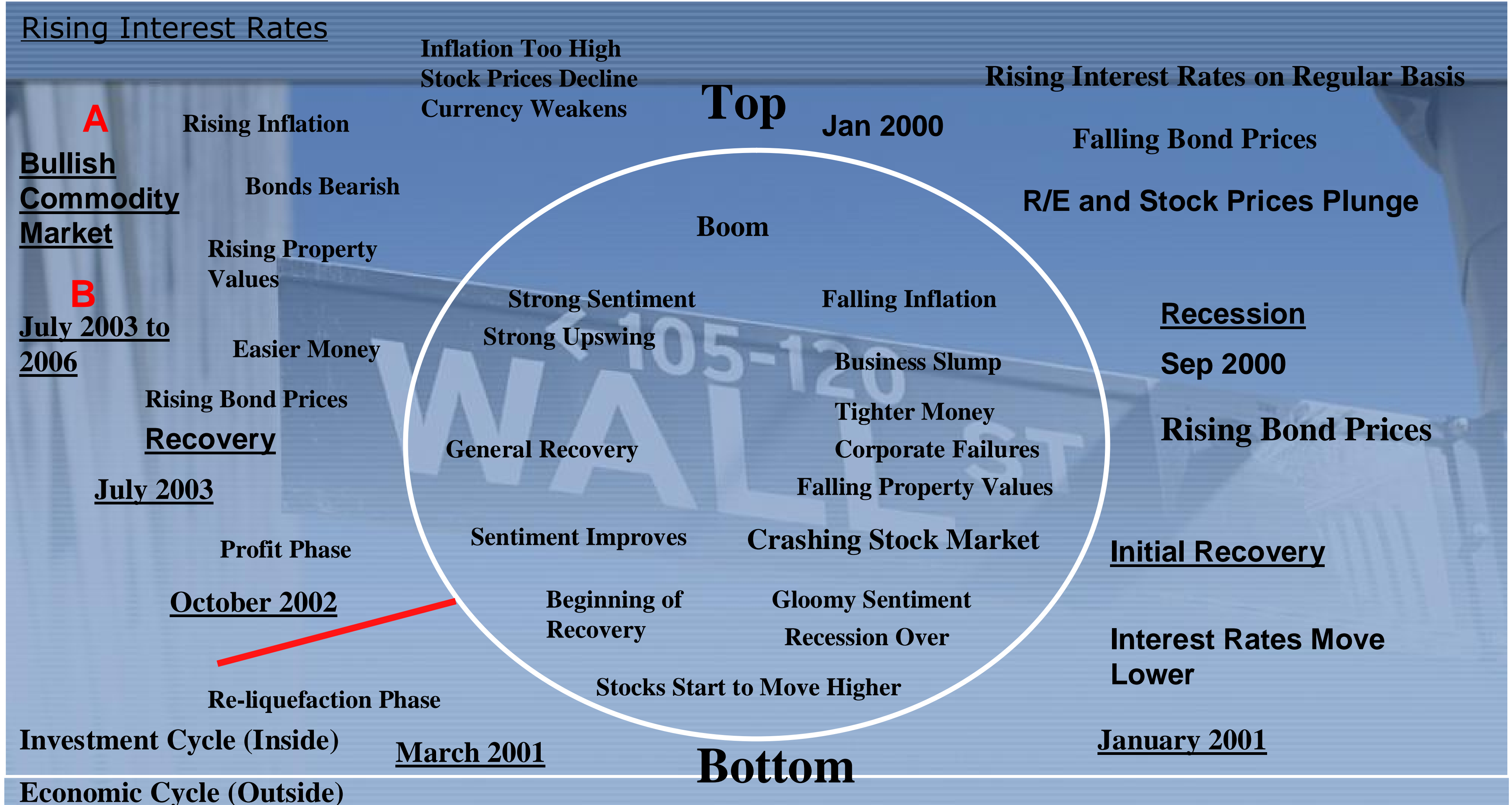
Definition of a Recession (continued)

- The Fed sees fit to cause the economy to contract when it overheats (too much price inflation).
- This happens about every 4 to 4-1/2 years.
- A recession lasts generally about 9 months.

Definition of a Recession (continued)

- During a recession, banks will lend to only the most credit worthy customers, but the cost is high.
- Consequently, few individuals and businesses borrow when borrowing costs are too high.
- A recession ends when banks start to lower interest rates.

The Economic & Business Cycle
The 4 to 4-1/2 Year Business Cycle



You are looking at a classic business cycle. When you learn how to understand and use the business cycle for your investment strategies, you will know the type of investments to buy/sell and when to buy/sell.

Global Depressions

- Depressions are global because they involve the currency or currencies that provide the world with reserves and trade currency.

Global Depressions (continued)

- There have been four depressions during the life of the Federal Reserve Banking System
  - The Bear Market (1929-1932)
  - The Great Depression (1932-1940)
  - The Inflationary Depression (1974-1981)
  - The Current Global Credit Crunch (2007-?)

What is the difference between a recession and a depression?

- A recession is a periodic contraction of the economy brought on by our nation's central bank. It is caused by rising interest rates and ended by lower interest rates.
- A depression is caused when there is a shortage of global currency. This can happen when the nation supplying the world's reserve and trading currency can no longer do so.

The Bear Market (1929-1932)

- The DJIA lost 89% during this period of 1,039 days.
- The stock market didn't recover its nominal loss until 1954.
- Investors in the market in 1929 would have needed an interest rate of 1.5% compounded for 25 years to recover their losses.
- They would have also needed money to offset the loss of purchasing power.
- Taking interest and inflation into account, it would have been around 1959 until investors were even.
- Cause: Global Monetary Crisis

The Inflationary Depression of 1974-1981

- Caused when our government used about two-thirds of our nation's gold reserves during the 1960s
- The dollar was devalued to pay for the Vietnam War and the War on Poverty
- The gold was spent to support the devalued dollar
- To keep the country from spending all its gold, President Nixon shut the gold window and ended the Gold Exchange Monetary System

The Bear Market of 1973-74

- The DJIA lost 45% over a period of 694 days.
- Cause: Global Monetary Crisis

The Bear Market of 2007 to May 2010

- The DJIA lost 53% (as of March 2009) in 556 days (as of April 17, 2009).
- Cause: Global Monetary Crisis (dollar weakness

What's Causing Today's Global Credit Crunch?

- In 2007, China brought an end to the U.S./China trade agreements when they invested their surplus trade dollars in things other than U.S. Treasuries.
- Rising interest rates, in order to attract U.S. buyers, soon pushed subprime flexible rate mortgages higher.
- Caused the bulging real estate bubble to implode as a growing number of recent home buyers could no longer afford rising mortgage rates.
- As the real estate bubble burst unemployment skyrocketed.
- As a result the stock market imploded taking banks, financial institution and auto manufacturers with it.

What's Causing Today's Global Credit Crunch? (continued)

- The subsequent subprime mortgage defaults pushed real estate values lower.
- When real estate values plunged more than 20%, it triggered credit default swaps to default.

What Are Credit Default Swaps (CDS)?

- They are a form of derivative insurance.
- They were used in 2000 to insure subprime loan debt.
- The CDS insurance acted in a similar manner as adding “FDIC Insured” to a certificate of deposit, thus making an investment a “no brainer.”

What are Credit Default Swaps (CDS)? (continued)

- The "safety" of the CDS was the reason so many responsible institutions, banks, investment banks, and insurance companies turned to subprime investments insured by CDS.
- CDS were thought to be fail safe.
- But there was one caveat and no one bothered to give it a thought.

What are Credit Default Swaps (CDS)? (continued)

- The only way CDS would default is if real estate values nationally dropped more than 20 percent.
- Almost no one considered this to be possible—at least not without substantial warning.
- But once interest rates started to rise, the subprime flexible interest rates (the adjustable rate mortgages, or ARMs) started to skyrocket.

The Stimulus (or Bailout)—Will It Work?

- The economic stimulus bill recently passed will only treat the symptoms of the global depression.
- We are in a global liquidity crunch.
- The credit crunch will not end until banks start to lend again.
- Banks cannot start to lend until BIS (the Bank for International Settlement) eases up on the reserve requirements (stress test).

The Stimulus (or Bailout)—Will it Work? (Continued)

- What is BIS? It is the central banks' bank.
- When will BIS allow banks to lend again? When it gets what it wants—a new and fairer global trading currency and system or when the current bailout manages to fully shift toxic assets from banks to investors.
- In the absence of that desire, BIS would settle for a strategy by the U.S. Federal reserve that would force China to value its currency at current market rates.
- The current covert U.S./Chinese Trade Agreement will attempt to force China to revalue the yuan.

Global Currency Systems

- There has been weakness in every global currency system established in the 20th century.
- The fiat global currency system established in the 1970s has been in danger of failure almost from the start.
- It has been kept afloat by schemes intended to buy time.
- It would appear that time is ending for the current fiat currency system.

What Does BIS Want?

- BIS wants G-20 industrial nations to come together and fix or replace the current global fiat monetary system.
- Who would probably play a major role?
- The U.S., Eurolands, China, and Japan.

Will What BIS Wants Work?

- I feel central banks are using a similar tactic as did President Reagan in bringing down the Soviet Union.
- President Reagan engaged the Soviets in a high tech arms race. The cost eventually bankrupted the Soviets when they ran out of dollar reserves.

Will What BIS Wants Work? (continued)

- Central banks are doing the same thing to G-20 industrial nations by purging them of U.S. dollar and Euro reserves.
- Without sufficient global trading currency and reserves, G-20 nations can’t trade or pay bills.
- Many G-20 nations are now running low on dollar reserves.
- Eventually, central banks hope to force G-20 nations’ politicians to negotiate with them.

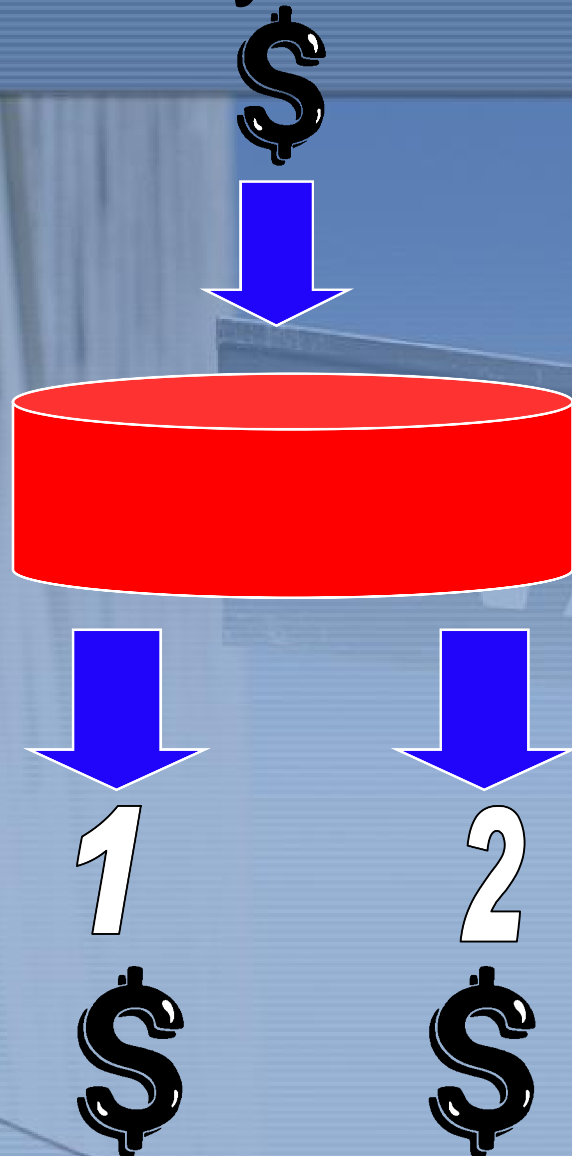
Will What BIS Wants Work? (continued)

- This is why there were four central bankers (Geithner, Volcker, Summers and Bernanke) aiding the Obama Administration.
- The economic stimulus plan will make it possible for the U.S. to outlast the majority of G-20 nations.
- It will end when the world finally gets a new and fairer trading system and global currency.

The Economy, Currently

- The difference between a bullish economy and one that is contracting is liquidity—the flow of money into and out of the economy.

Money Into and Out Of the Economy

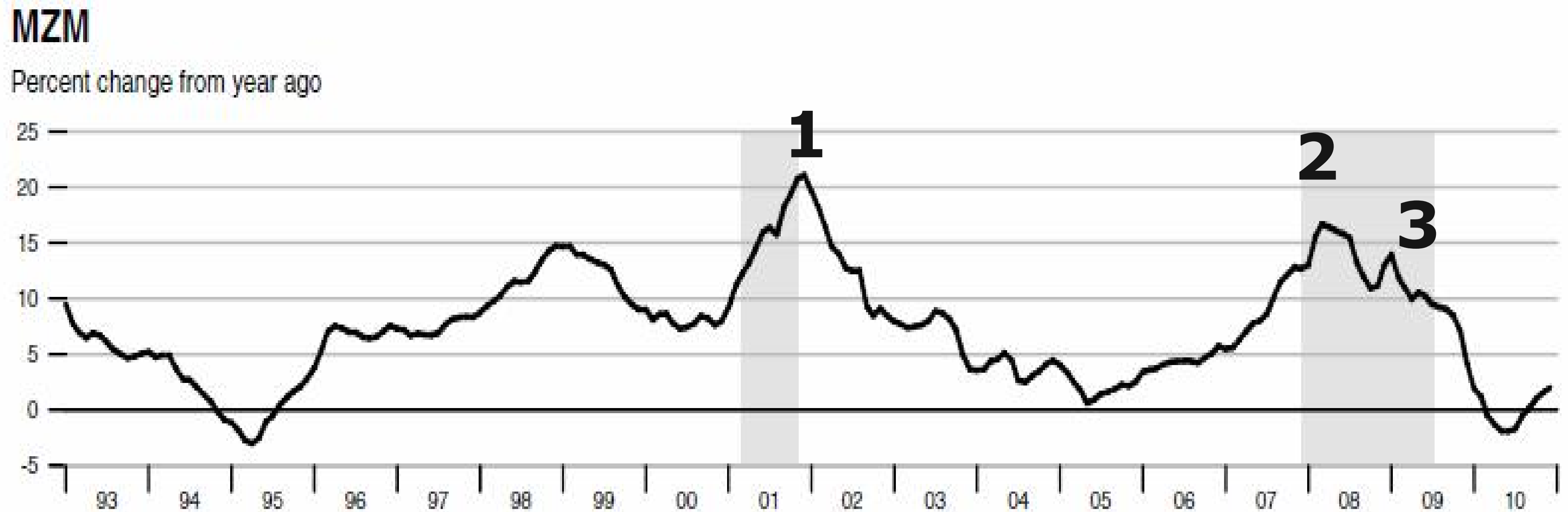


The top arrow represents money going into the economy (red barrel), while the two bottom arrows represent money moving out of the economy. The majority of money into the economy is derived from loans (private and government). Arrow #1 represents default and paid-off debt. Arrow #2 represents money leaving the economy in various ways.

Money Zero Maturity (MZM)

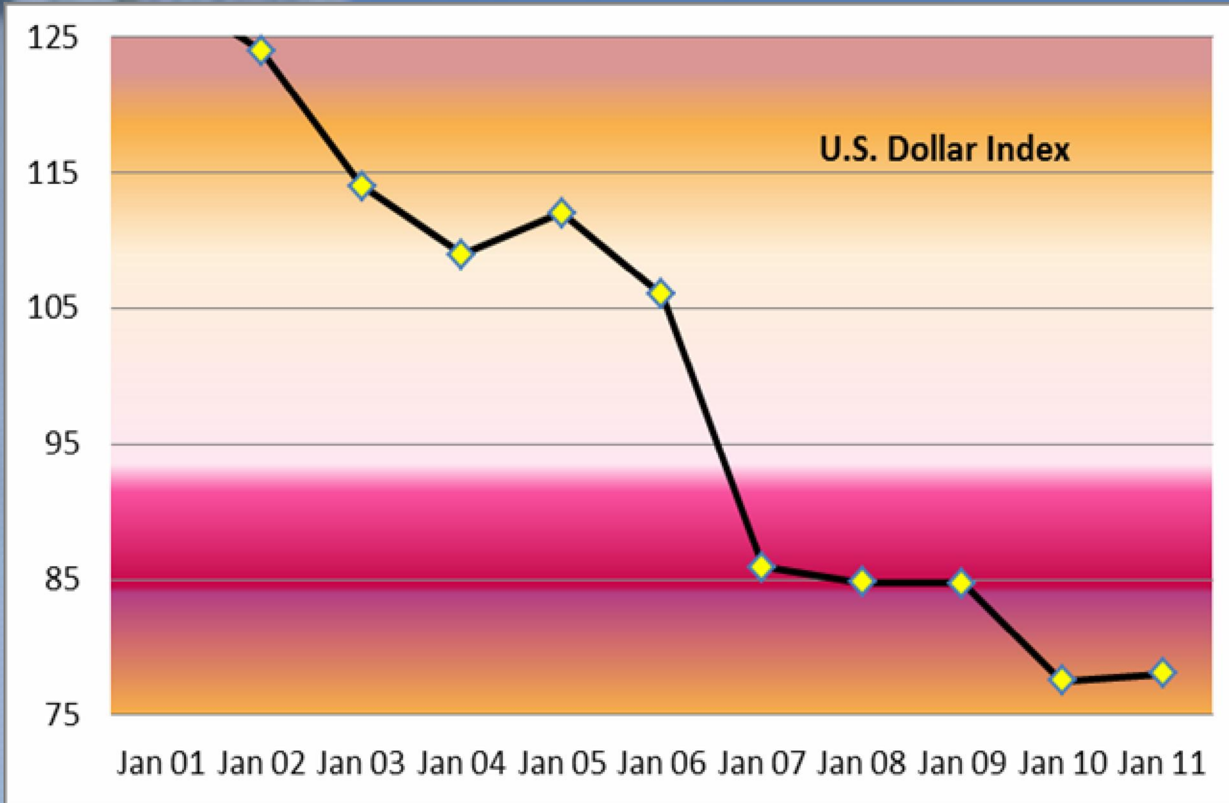
- M3, the nation’s broadest measure of money, used to provide a good picture of our nation’s liquidity.
- The Fed stopped reporting M3 in early 2006.
- Now, we must depend on MZM to give us an idea of broad money supply liquidity.
- Private research indicates M3 rose 9.6% in 2008 (after defaults).
- Now, we must depend on M3 reports from a private source (Shadow Statistics by John Williams) and MZM (Money-to-Zero Maturity) as an indicator for money supply liquidity.
- M3 Currently:

St. Louis Federal Reserve, Research Division
MZM as of January 2011



Note the numbers 1, 2 and 3 on the chart. These are points in MZM measurement when the vast majority of stocks and other investments were losing money. Consequently, investors fled to safety via MZM investments. These numbers signal an almost historic high amount of money waiting on the sidelines for a profitable sector to emerge. MZM proved to be an early signal of increasing monetary liquidity to buoy the economy.

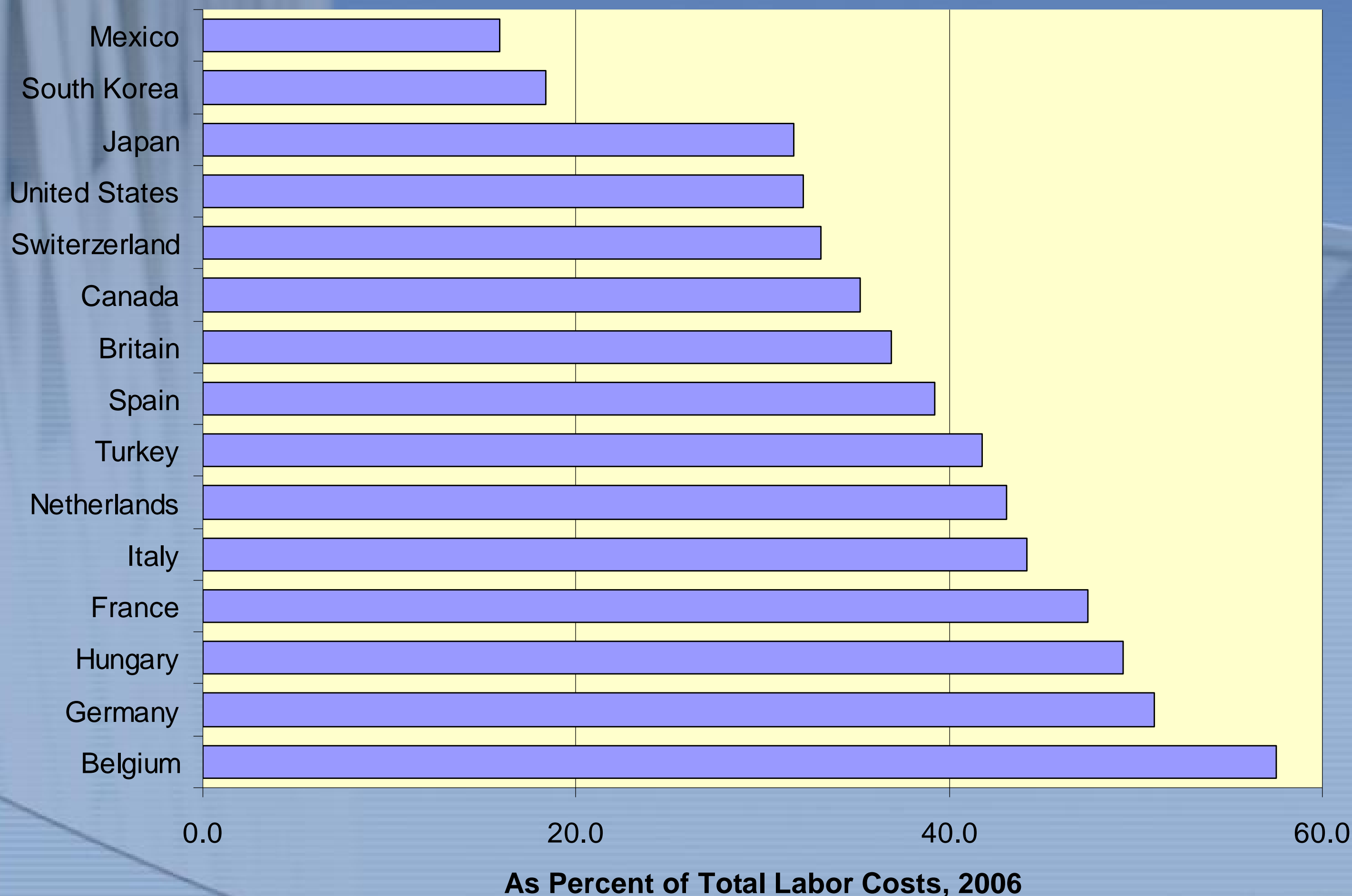
U.S. Dollar Index



Sources: Federal Reserve, Global Insight, BusinessWeek

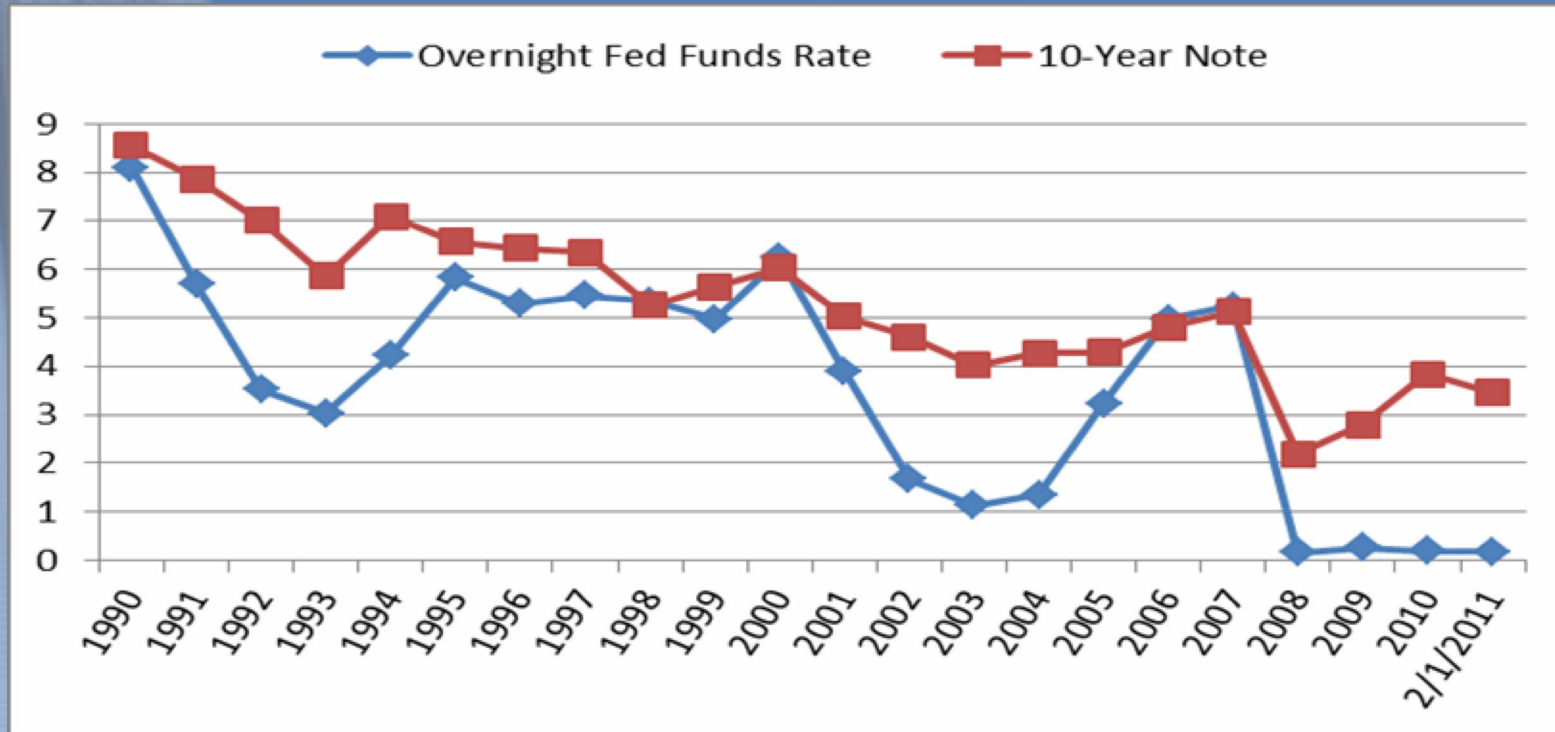
The dollar fell rapidly into August 2008. The low came at 72.50. The defaulting subprime debt and subsequent CDS insurance payouts started taking dollars out of the economy. The payouts also caused financial institutions and insurance companies to go bankrupt or need a bailout.

Gap Between Labor Costs and Take Home Pay



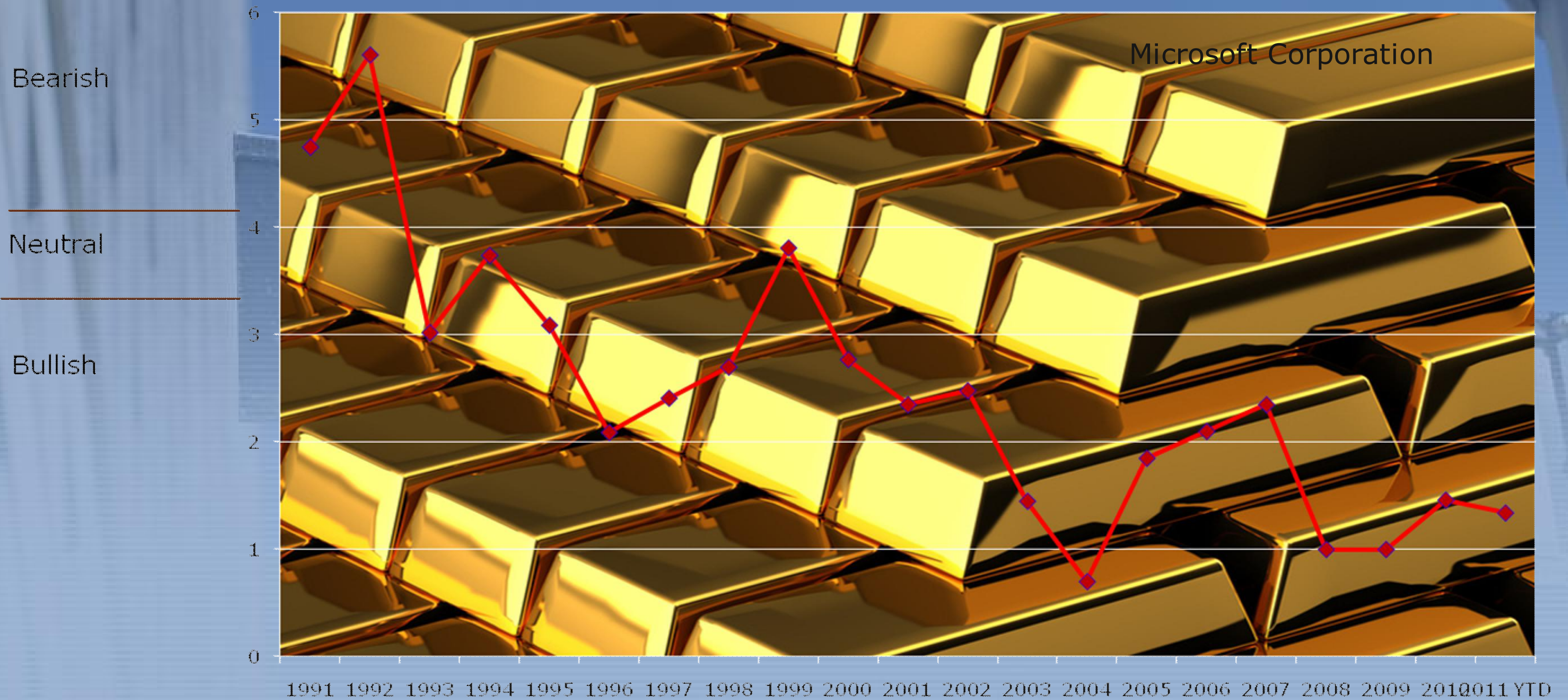
You are looking at the tax wedge--the gap between what employers pay for labor and employees take home as pay. The wedge is made up of income taxes and the social security contributions of both firms and workers. The bigger the wedge, the greater are the barriers to job creation.

U.S. Monetary Policy Since 1990



Update chart Info Here

Gold Money Flow Index



M3 Money Supply

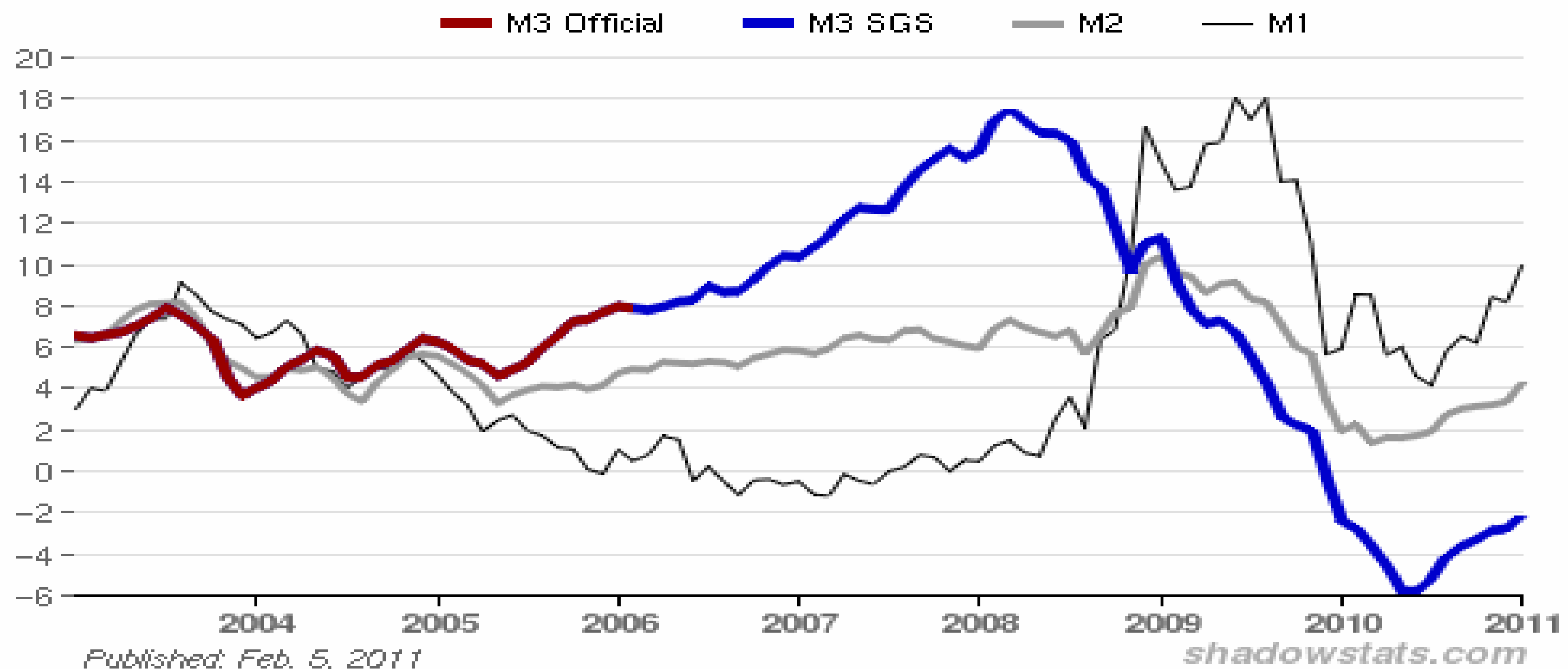
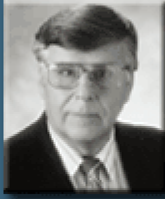


Chart courtesy of Shadowstatistics.com

My Portfolio Records

Portfolio	Return
1999 Portfolio (Blanchard)	+129.00%
2000 Portfolio (Blanchard)	+201.00%
2001 Portfolio (AAII)	+14.72%
2002 Portfolio (AAII)	+17.20%
2003 Portfolio	+137.78%
2004 Portfolio	+27.27%
2005 Portfolio	+21.88%
2006 Portfolio	+38.76%
2007 Portfolio	+13.78%
2008 Portfolio	+14.69%
2009 Portfolio	+3.27%
2010 Portfolio	+35.86%



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The Future of Our Nation

- Requires undoing the U.S./Chinese Trade Agreements
  - The secret Goldilocks treaty between China and the U.S. provided our government unlimited credit and liquidity.
  - It ignored most of the Federal Reserve's traditional credit controls.
    - Traditionally, when the economy overheats and Congress over spends, the Fed raises interest rates to grab a hold of investors' money, thus intentionally triggering a mild recession.
  - The Goldilocks treaty required China to buy U.S. debt that could not be sold to private investors or foreign central banks.
    - This allowed interest rates to remain way below market value for as long as the economy held together.
    - It also gave Congress a blank check on spending (that was until China stopped buying our debt).