

# The Nifty Fifty

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By John P. Hussman, Ph.D.

“The 'new-era' doctrine - that 'good' stocks (or 'blue chips') were sound investments regardless of how high the price paid for them -- was at bottom only a means for rationalizing under the title of 'investment' the well-nigh universal capitulation to the gambling fever... Why did the investing public turn its attention from dividends, from asset values, and from earnings, to transfer it almost exclusively to the earnings trend? The answer was, first, that the records of the past were proving an undependable guide to investment; and secondly, that the rewards offered by the future had become irresistibly alluring ... The notion that the desirability of a common stock was entirely independent of its prices seems incredibly absurd. Yet the new-era theory led directly to this thesis. If a stock was selling at 35 times the maximum recorded earnings, instead of 10 times its average earnings, which was the pre-boom standard, the conclusion to be drawn was not that the stock was too high but merely that the standard of value had been raised. Instead of judging the market price by established standards of value, the new-era based its standards of value on the market price.”

- Benjamin Graham & David Dodd, *Security Analysis*, 1934.

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## ***Excerpted from the May 1998 issue of Hussman Econometrics:***

Suppose you own stock. You have decided to be a "long term investor." Stock prices rise to a new all-time high. You feel vindicated. The economy looks great. Although market breadth has deteriorated, your commitment is firm. "I can't afford to keep my life savings out of the stock market." "Buy-and-hold" is your motto.

Then, after a modest rise in interest rates, the market sells off -12.3% in just over 2 months time. Ouch. A correction. Buy on the dip. These things happen from time to time. You're a long term investor. Buy-and-hold is your motto.

Sure enough, prices recover. Somewhat. A 4.8% advance, but already, you think, you're on your way to new highs again. Then, you lose it all in a -10.2% decline. Two months later, you've given back your advance, and you're at a lower low. Alright, another correction. Maybe you buy on the dip. Bargain prices. Buy-and-hold is your motto.

And it's already paying off. A month later, you're up 7.8% from the low. But then a -9.1% selloff takes your portfolio even lower than the first two drops. The market is down -19% overall. You start to question the amount of risk you're taking, but how much lower can it go?

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Thank goodness. 15.8% advance over the next few months! Should have bought more on the last decline. Earnings are still growing strongly. You decide not to wait. You buy more on the advance, confident that you'll be rewarded by new highs. Then the market plunges -20% over the following 4 weeks. You stare at your statement and feel sick. You've held on for a year and your reward is a new low in your portfolio. This really is a bear market.

Now some volatility. Up 12% over a few months. Then you lose it all a few months later in another decline. Then another 11% advance, followed by a -12% plunge to a new low. Seven times now, you've seen your portfolio collapse by more than -10%. With every recovery, a fresh disappointment. And the months march on. It's a year and a half since the peak. You've lost nearly 30% of your wealth. Price/earnings ratios look low, but they looked low before the last decline, too. But maybe it's the bottom. After all, the average bear market takes stocks down about 30%. Holding your calculator, you realize how that works. A -30% decline wipes out a 43% gain. Didn't really consider that at the top.

Stocks rebound a little over the next month. Just 6%. You're still clinging to the bottom. Then, the bottom drops out. Not just 10%, or 15%, but a real free-fall. Over the next 6 weeks your portfolio plunges by -27%. You're another -23% down from the previous low! Almost 2 years of nothing but losses! Major ones. You've lost almost half your retirement, now. Half your life savings! And the economy has turned bad. Everybody knows that stocks were overpriced at the top! It was so obvious! Greed. Valuations were so high. Everyone was so optimistic. Why didn't you see it at the time? You decide you can't afford the risk. Sell half. See if things recover, then get back in.

Well, prices do recover. More than 15%. But then you lose it all in another selloff! Another new low! The market has lost half its value! Nine major plunges. Nearly every one to a lower low, and getting worse. This market has no support. Where are the buyers going to come from in an economy like this? People are unemployed. They don't have the income to invest! And certainly not in the stock market. The financial headlines trumpet "The Real Recession is Yet to Come", and "The Coming Dividend Crisis." Some of the less diversified mutual funds are down as much as -80% from their highs! 80%! Every \$100 has collapsed to \$20. If it could happen to them, it could still happen to you. This is too risky. After all, you think, "I can't afford to keep my life savings in the stock market."

"Better safe than sorry" is your motto.

You've just lived through the 1973-74 bear market. Actual figures. Actual headlines. Not pleasant. At the January 1973 market peak, earnings had hit a new high, and stock prices were selling at a P/E multiple of 20, which is extreme on the basis of record earnings. Over the next 2 years, corporate earnings grew by 56%, yet the market fell by half. The 73-74 bear market teaches that stock prices can decline from extreme valuations even if earnings grow dramatically.

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Imagine what could happen if both P/E multiples and earnings contract simultaneously ( $\text{Price} = \text{P/E} \times \text{E}$ ). Now suppose they don't. Suppose that earnings surprise everyone by growing by 12% annually over the next 4 years. Suppose the P/E multiple doesn't contract to the historical average 12 times record earnings, but is still a high 18 times record earnings even 5 years from now. Guess what. Even if this happy scenario comes true, stock prices will be at the same level 5 years from now as they are today.

The bottom line. It is uniform trend conditions, and only uniform trend conditions, that have kept us in a constructive position. This is, without question, a market that could fall by half. A 50% decline in the S&P 500 Index would put the P/E multiple at 14, still above the historical average P/E that has been applied to record earnings. Not even undervalued. It would put the dividend yield at just 2.8%, far below the historical average of 4% which has been attained at every bear market low. And as noted last month, even if dividend payouts were boosted to the historical average 52% of earnings, the current dividend yield would be only 1.8%. A 50% market drop would bring it only to 3.6%.

*[ Editor's note: In May 1998, the S&P 500 stood at 1112, with the DJIA at 9063. It is important to recognize that overvaluation does not require stock prices to decline. Overvaluation simply means that stocks are priced to deliver unsatisfactory long-term returns. Indeed, the market typically ignores valuation when trends exhibit what we call "favorable uniformity." This uniformity (which can be measured objectively) can sustain an overvalued market for months or even years. It is during those periods when valuations are unfavorable and trends lack favorable uniformity that overvaluation suddenly matters. When interest rates are rising as well, overvaluation generally matters with a vengeance. ]*

### **Excerpted from the December 1999 issue of Hussman Econometrics:**

"Near the top of the market, investors are extraordinarily optimistic because they've seen mostly higher prices for a year or two. The sell-offs witnessed during that span were usually brief. Even when they were severe, the market bounced back quickly and always rose to loftier levels. At the top, optimism is king, speculation is running wild, stocks carry high price/earnings ratios, and liquidity has evaporated. A small rise in interest rates can easily be the catalyst for triggering a bear market at that point."

- Martin Zweig, *Winning on Wall Street*, 1986

"The greed itch begins when you see stocks move that you don't own. Then friends of yours have a stock that has doubled; or if you have one that has doubled, they have one that has tripled. This is what produces bull market tops. Obviously no one rationally would want to buy at the top, and yet enough people do to produce a top. It is really quite amazing how time horizons and money

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goals can change when there are stocks around that are going up 100 percent in six months. Finally it all turns into a marvelous carmagnole that is great fun if you leave the party early."

- Adam Smith, *The Money Game*, 1967

Classic. Classic. The market is in the midst of what will undoubtedly be seen in hindsight as a fantastic speculative frenzy. We're glad to have our portfolios gaining on this advance, and we are keeping our put option positions relatively small, and out-of-the-money. That gives us protection against severe declines, but does not unduly hinder our gains if the market proceeds higher. One thing is certain. This market cycle will be completed by a bear market, and a potentially violent one. Of course, nobody thinks about market cycles anymore. Nobody imagines that stocks can do anything but advance. And in the mania of the present, it is easy to forget the nearly identical ones of the past, and their very, very bitter aftermaths. As manias go, the internet stocks are the most spectacular example. By and large, these companies have no earnings, so their stocks are being priced on the basis of revenues, and phenomenal multiples of revenues at that. The vast majority of these revenues are derived from advertisements. The vast majority of advertisers are other internet companies. And in classic Ponzi style, the vast majority of the money being spent on advertising is being derived from initial public offerings of internet stocks to investors. So the stratospheric prices being paid for internet stocks are ultimately being driven by... the stratospheric prices being paid for internet stocks. Talk about a feedback loop.

But while the internet issues remain the most obvious bubble, the most significant objects of speculation, in terms of market capitalization, are stocks which might be considered "blue chip" technology issues. Consider for example, some of the better growth companies on Wall Street (listed below in order of market capitalization), and you can see how profoundly future earnings growth has been impounded into current prices. While these companies are likely to perform very well as businesses, the performance of the stocks hinges much more delicately on the continued willingness of investors to pay exorbitant valuation multiples. Moreover, the fact that the current P/E multiples are based on record earnings should be some cause for alarm.

| <b>Stock</b>   | <b>Current P/E</b> | <b>10-Year Average P/E</b> |
|----------------|--------------------|----------------------------|
| Microsoft      | 70                 | 27                         |
| Intel          | 38                 | 14                         |
| Cisco          | 165                | 28                         |
| Lucent         | 59                 | 27                         |
| IBM            | 27                 | 14                         |
| America Online | 297                | NA                         |

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|                  |     |    |
|------------------|-----|----|
| Dell             | 67  | 18 |
| Sun Microsystems | 114 | 17 |
| Oracle           | 88  | 29 |

Similarly extreme valuations appear in other mega-capitalization stocks such as General Electric, Wal-Mart, Home Depot, MCI/WorldCom and Vodaphone. Why do these multiples matter? Because the market is currently displaying not only extreme valuations, but also poor market action and rising interest rate trends. That complete combination is what we characterize as a "Crash Warning", because that phrase has typically been descriptive of the subsequent market action.

There have only been two times in history that market breadth (as measured by the advance-decline line) has diverged so widely from the performance of the S&P 500: 1929 and 1972. The current breadth divergence now exceeds these previous instances both in extent and duration. With the S&P and Nasdaq near new highs, bonds, utilities, transports and the advance-decline line are all plunging. Indeed, the NYSE advance-decline line is now well below the lows of the late-summer 1998 selloff. In the week ended December 3<sup>rd</sup>, the Dow soared 297 points, and the Nasdaq vaulted nearly 73 points. Yet on the NYSE, AMEX and Nasdaq markets, more stocks declined than advanced on the week. Just 162 stocks on the NYSE hit new 52-week highs, while 780 hit new lows. So in addition to hypervaluation, the most overwhelming characteristic of the market is lack of uniformity.

Historically, the current combination of market conditions has ultimately led to unusually swift declines in Price/Earnings ratios. So even if earnings hold up, prices can endure harsh plunges. During 1973-74, stock prices plunged by half, even though S&P earnings grew rapidly. Given that the P/E ratio of the S&P is currently over 50% higher than it was at the 1929 and 1972 tops, it is clear that valuation multiples have a lot of room to decline. Herewith, a reminder of what those previous declines had in store for good, blue chip stocks.

### **Blue Chip Performance: 1929-1932**

AT&T -76.9%  
Bethlehem Steel -94.8%  
General Electric -97.9%  
Montgomery Ward -97.5%  
Nat'l Cash Register -95.1%  
Radio Corp of Amer. -97.5%

### **Blue Chip Performance: 1973-1974**

Du Pont -58.4%  
Eastman Kodak -62.1%  
Exxon -46.9%

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Ford Motor -64.8%  
General Electric -60.5%  
General Motors -71.2%  
Goodyear -63.0%  
IBM -58.8%  
McDonalds -72.4%  
Mobil -59.8%  
Motorola -54.3%  
PepsiCo -67.0%  
Philip Morris -50.3%  
Polaroid -90.2%  
Sears -66.2%  
Sony -80.9%  
Westinghouse -83.1%

The prelude to these devastating declines was extreme valuation, deep and extended breadth disparity, and rising interest rates. The final advances were dominated by extremely short lists of stocks. Investors didn't care then, either. As Forbes Magazine noted following the 73-74 collapse:

"The Nifty Fifty appeared to rise up from the ocean; it was as though all of the U.S. but Nebraska had sunk into the sea. The two-tier market really consisted of one tier and a lot of rubble down below. What held the Nifty Fifty up? The same thing that held up tulip-bulb prices long ago in Holland - popular delusions and the madness of crowds. The delusion was that these companies were so good that it didn't matter what you paid for them; their inexorable growth would bail you out."

You may recall that we printed that quote last July, just prior to the summer 1998 market plunge. Even then, there was a striking divergence between the broad market and the blue chips, but that divergence has now widened beyond its two most catastrophic predecessors.

Based on the model now in use, the market lost favorable market action in June of this year, by which time the bulk of the rebound from last summer's low had occurred. With valuations extreme, interest rates rising, and market action now strongly unfavorable, the characteristics which were present during the vast majority of the recent bull market are now completely absent.

*[ Editor's note: In December 1999, the S&P 500 stood at 1389, with the DJIA at 10878. The NASDAQ peaked above the 5000 level several weeks later. Because valuation and trend conditions may shift from time to time, we encourage clients and shareholders to review our weekly market commentary regularly. ]*

**Excerpted from the April 2000 issue of Hussman Econometrics:**

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In recent months, we have made the rather bizarre assertion that the Nasdaq is likely to lose somewhere between 65% to 83% of its value from its recent highs to its ultimate bottom. In the March letter, we reviewed the S&P 500 technology stocks, noting that the P/E on those stocks had reached 70, compared to a 1975-1995 average P/E of just 17. Meanwhile, the price/revenue ratio for those stocks had reached 6.8, compared to a 1975-1995 average of just 1.1.

The argument of the “new economy” crowd? Yes, but they're great companies (“good stocks”), you would have been wrong to be against them (“records of the past had proved an undependable guide to investment”), what drives stocks is not the valuation multiple, but only whether these companies beat earnings estimates (“from dividends, from asset values, and from earnings, to transfer it almost exclusively to the earnings trend”), a “new economy” warrants entirely different valuation methods (“the standard of value had been raised”), and anyway, a stock is worth whatever price investors are willing to pay for it (“the new-era based its standards of value on the market price”). “Hence”, as Graham & Dodd recounted about the run-up to the 1929 crash, “all upper limits disappeared, not only upon the price at which a stock could sell, but even upon the price at which it would deserve to sell.”

Every security price effectively boils down to assumptions about 1) the expectation of future growth rates, and 2) the expected long term return. Those expectations are embedded in the valuation multiple of the stock. A high valuation multiple may imply either unusually high growth expectations, or the willingness to accept very low long-term rates of return. But an excruciatingly high valuation multiple almost by necessity implies both. In a bubble, those two factors become completely detached from reality, and expectations about future returns become increasingly reinforced not by fundamental data, but by price action alone.

We have frequently noted the detachment of investor expectations from the underlying long-term return on stocks. While polls suggest that investors expect a 19% annual return on stocks over the next decade, the fact is that S&P 500 earnings have grown at just 7% annually, not only over the past decade, but as far back as 1950. If the current P/E of 34 on the S&P retreats to a still above-average level of 17 over the next decade, the S&P 500 will show zero price appreciation over the next 10 years. Recall that the Dow reached 1000 in 1966. In 1982, the Dow bottomed at 777. Zero stock market returns over a long period of time would certainly not be unprecedented.

After the Nasdaq plunge of recent days, the entire thrust of commentary has turned to whether a bottom has been set, or whether we might see a few more days of selling pressure. It is unlikely that Nasdaq investors will be treated so well. We continue to view stocks as being in a bear market, and bear market psychology typically evolves something like this:

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*"This is my retirement money. I can't afford to be out of the market anymore!"*

*"I don't care about the price, just Get Me In!!"*

*"It's a healthy correction"*

*"See, it's already coming back, better buy more before the new highs"*

*"Alright, a retest. Add to the position - buy the dip"*

*"What a great move! Am I a genius or what?"*

*"Uh oh, another selloff. Well, we're probably close to a bottom"*

*"New low? What's going on?!"*

*"Alright, it's too late to sell here, I'll get out on the next rally"*

*"Hey!! It's coming back. Glad that's over!"*

*"Another new low. But how much lower can it go?"*

*"No, really, how much lower can it go?"*

*"Good Grief! How much lower can it go?!?"*

*"There's no way I'll ever make this back!"*

*"This is my retirement money. I can't afford to be in the market anymore!"*

*"I don't care about the price, just Get Me Out!!"*

*[ Editor's note: In April 2000, the Nasdaq stood at 4572.88 ]*

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## **UNCOMMON COMMON SENSE**

**For People Who Think**

## **THE REAL ENEMIES OF CAPITALISM**

**Aubie Baltin CFA, CTA, CFP, PhD.**

**May 14, 2009**



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The Enemies of Capitalism are not the Socialists, Marxists or Communists because everyone knows who they are and what they stand for. I think it was Capone who said "Keep your friends close and your enemies closer." The real ENEMIES are the New Rule Neo-mercantilists, Neoconservatives (Neo-Cons), who should be charged with FRAUD if they call themselves "free market capitalists." People such as Bush, Paulson, Greenspan, Bernanke and Ben Stein are the primary threat capitalism faces. All of these compassionate Conservatives are the false prophets of capitalism. They are Harvard or of the other Ivy League graduates who are so steeped in Keynesian Economics that they don't know what capitalism is and end up being the greatest allies the Socialists and Communists could possibly have.

Many prominent American figures such as Warren Buffet and Bill Gates claim to believe in free markets, but in practice they are Socialist Democrats who advocate for higher taxes, neo-mercantilism Corporate Bigness (monopolies, oligopolies), government central planning and control. These policies always lead to inefficiencies and disastrous economic and social consequences due to the inability to foresee all of the "Unintended Consequences." Congress investigates everybody and everything, always with a political bent and puts people in jail for lying even if they had committed no crimes. But **nobody investigates Congress** who does not have to live under the same laws as the rest of us - especially the one against lying. The resulting economic and social catastrophes are then blamed on capitalism, free markets, and deregulation when, in actual fact, the fault lies with big government interference in the free market economy. At this point, Socialists are easily able to convince the distraught public that capitalism is a failed experiment and only continued massive government intervention can save them. Such is the way that capitalism dies, eaten away by a cancer from within. Would you believe that Greenspan was a disciple of Ayn Rand and a staunch proponent of the Gold Standard? He sold his soul for Prestige.

### DÉJÀ VU ALL OVER AGAIN

It happened in the 30's when a massive intrusion by government, managed to turn what should have been no more than a 3 year Recession (such as 1919 to 1921) into one that lasted 17 years. We are now in the process of repeating with pride the exact same follies of The New Deal.

The real mystery is not that some of the loudest proponents of free markets often institute policies that are antithetical to free markets, but that the general public, as well as our learned scholars, rarely challenge these claims. In general, the public simply accepts that if a person claims to believe in capitalism and private-property rights, then they are truly capitalists. In truth, most politicians who claim to be champions of free-market principles are anything but.

George W. Bush, for example, claimed to believe in free markets, but in practice he created the largest increase in entitlements (Prescription Drugs) in history and expanded the corporate-welfare system throughout his entire administration. It was towards the end

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of his second term that he did the most damage. Under Bush's watch, the financial and auto sectors have been the recipients of trillions of dollars, leading to the government running our banks, insurance and auto industries, on a scale never before seen in American history. In an interview on CNN, Bush stated, "I've abandoned free-market principles in order to save the free-market system." Only in the minds of Neo-cons and Keynesians can this claim seem to have merit.

As Obama prepared to attend the G-20 summit, he vowed to defend the free market against calls for global regulation. Yet he also stated, "I'm a market-oriented guy, but not when I'm faced with the prospect of a global meltdown."

Is there no one of influence or power out there who realizes that only Capitalism can create wealth, raise the world's standard of living and get us out of our malaise? Even a cursory examination of history will tell you that: Oh I forgot, it has to be an honest not a politically correct examination of history.

When the nation's most visible proponents of Capitalism claim that they have abandoned it because, without big-government policies, Capitalism itself would be destroyed, and when Ben Stein, a self proclaimed and renowned Conservative Capitalist Economist, calls for higher taxes and more government involvement, there remains little work for Socialists to do but to sit back and let it all happen.

For those who don't understand economics and believe Bush is really a true Conservative Capitalist, they are then easily persuaded to accept the propaganda that the free market has failed and that government must come to the rescue.

Now consider another "free marketer," Ben Bernanke. Surely he, of all people, is a *true* Capitalist. The Federal Reserve System is little more than a central-planning organization created to carry out the ever increasing power hungry desires of the government to effect social policy under the cover of an independent FED and more importantly, to enrich its owners, the Big Banks. If central planning the price of oil, corn and other goods and services is in violation of capitalist principles, then how can centrally planning interest rates and the amount of money in circulation be considered part of the free market? Bernanke's actions during the "crisis" is in direct opposition to free market principles as he, along with Paulson, used the ensuing panic to demand powers never before granted to the Fed: Brokering (and funding) mergers and nationalizing banks. Yet even before the "crisis," Socialists were holding Bernanke up as the apotheosis of capitalist ideals.

Hank Paulson distinguished himself at both Dartmouth and Harvard. He briefly worked in the Nixon (we are all Keynesians now) Administration before climbing to the top of Goldman Sachs. But don't confuse being an accomplished executive with being a capitalist: Usually quite the contrary. What they all understand is the use of centralized power (government) to enrich themselves. During the economic "crisis," Paulson consistently used the powers of his position as Treasury Secretary to save big business, especially his ex-company, Goldman Sachs (in which he still held a \$billion interest in a blind trust) from the consequences of their poor decisions and to save friendly institutions.

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He then used fear to force Congress into granting him unprecedented powers. Language for the \$700 billion bailout protects him from, "*Decisions pursuant to the authority of this Act are non-reviewable and committed to agency discretion, and may not be reviewed by any court of law or any administrative agency.*" That's better than being a Russian Czar! Paulson and Bernanke, orchestrated the largest government intervention in capital markets in history - can anyone, even vaguely familiar with the tenets of capitalism, believe their professions of faith in free markets?

Anyone who understands capitalist theory has an obligation to refute the claims made by those who falsely profess free market principles and they must be confronted at every opportunity. We must not become subject to the bystander effect and rely on someone else to take up the fight. We must all challenge the false claims, for the enemies of free market principles are many and vocal and the consequences will be disastrous.

### **GROUPTHINK**

In the book "Psychology of the Stock Market," it explains how follow the crowd reasoning carried the "nifty-fifty" to ridiculous extremes in 1972, and coined the phrase "groupthink." It illustrated how groupthink replaced competent analysis and conventional valuation methods causing portfolio managers and analysts to leave their senses and like lemmings, follow the crowd over the cliff. The same held true with the "Portfolio Insurance" craze that resulted in the 1987 crash and the Dot Com Bubble.

In the current era, once Glass-Steagal was out of the way (thanks to Clinton, Rubin, Paulson, Geithner and Greenspan) "groupthink" forced banks, brokers, insurance and mortgage companies to merge their way to a point of such bigness that no one knew what was going on. Each division was compelled and encouraged by ultra low interest rates to compete for ever larger profits without regard to risk and in the process, created the largest Financial Catastrophe in history. The brave new world of derivatives resulted in hedging simply for the sake of making easy money by ignoring risk and providing the ability to increase leverage to the point of absurdity, without any regard to fundamentals or risk analysis. They just bought and sold Credit and Interest Rate Default Swaps to the tune of over \$1.4 quadrillion.

**GROUPTHINK** is alive and doing its destructive damage in that there is now a firm belief by everyone that we must do something and that doing even the wrong thing is better than doing nothing. The printing presses are running full speed and we are all in a mad dash towards that cliff.

There is a Universal Keynesian belief that Recessions result from an insufficient demand for goods and services - and so the thinking goes, our central bank can remedy this deficiency by cutting interest rates. **DON'T FACTS MATTER?** We have been borrowing and spending like mad for the last 35 years. They even wrote a song in the 70's about just this, "A dollar down and a dollar a week you can have anything you seek." Well, we are about to find out the truth.

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If it is currently the universal belief that it was too easy credit, printing money and 1% interest rates that brought us to the brink of destruction in the first place, how can doing more of the same solve the problem? Does Common Sense now reside only with this letter and its readers?

**DOESN'T ANYBODY CARE ABOUT SAVINGS AND SAVERS?** Is high risk speculation the only way left to get a decent return on you savings?

### GOLD, A STORE OF VALUE

Governments, government economists, central bankers, and private mainstream economists have shown a complete disregard for one of monies' primary attributes; its "store-of-value" function. The resulting reduction in purchasing power can best be seen by comparing the cost of a typical market basket of goods and services over the past century in terms of the 1900 US dollar.

|                 |
|-----------------|
| 1900 - \$1,000  |
| 1975 - \$5,915  |
| 2000 - \$19,950 |
| 2008 - \$31,217 |

Cumulative inflation in the dollar over the past century has been staggering, especially the surge from the 1970s to today. The rise of inflation has clearly coincided with the staggered elimination of Gold's discipline from the monetary system, whose destruction began with the creation of the FED in 1913. William Jennings Bryan, in his famous 1896 Democratic Convention speech, set the mood towards Gold for the next 100 years. Bryan condemned the idea of a Gold Standard warning that, "You shall not crucify mankind upon a cross of Gold." It seems we have the same kind of FOOLS now as we had back then. However, Gold's place remained in the system and four years later (1900), the US moved from a Bi-metallic Standard to a pure Gold Standard.

The collusion between "frat buddy" bankers and politicians who formed the Federal Reserve System in 1913, represented the world's first major official negative influence on Gold and Fiat Money. In 1925, the Gold Standard was replaced with the Gold Exchange Standard whereby only dollars and pound sterling were redeemable into Gold.

John Maynard Keynes' New Socialist Economics introduced by FDR and his New Deal in the 1930s, had a profound negative influence on the Gold Standard, which Keynes also deemed a "barbarous relic." It reached its crescendo when in 1933, Roosevelt confiscated all of American's Gold and banned US citizens from owning it, but still allowed foreign governments to redeem dollars for Gold. The restriction on US citizens lasted 41 years. Oddly enough, until 1945, the Federal Reserve was required to hold Gold reserves equal to 40% of its outstanding notes and 35% of its deposit liabilities. In 1968, all Gold reserve requirements were dropped and a two-tier Gold system was put in place with both an official Gold price and a free-market price. The official US government Gold price

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began in 1797 at \$19.75 an ounce, was bumped up to \$35.00 in 1934, then to \$38.00 in 1972, and finally to \$42.22 in 1973. Each increase represented a devaluation of the dollar.

By 1971, our friend Charles DE Gaulle, who we put into power by allowing him to lead the Free French in our Victory march into Paris and who played virtually no part in the liberation of France, began cashing dollars for Gold because of our ballooning trade and balance-of-payment deficits. Nixon, realizing the US couldn't cover its foreign liabilities and fearing a European run, closed the Gold window to foreigners, placed a 10% surcharge on imports and imposed wage and price controls - not exactly what you would expect from a Conservative Republican during Peace Time. Nixon then declared, "*We are all Keynesians now*" and from 1971 to this day, the dollar and every other currency has been devoid of all ties to Gold.

### AN IMPORTANT LESSON FOR TODAY

In the late 1970s, William Simon, Secretary of the Treasury in his infinite wisdom, devised a program of US Treasury Gold auctions, which coincided with IMF Gold sales. Inflation had begun to pick up, the free-market Gold price was rising and the authorities wanted to squelch interest in Gold. Official Gold sales drove the free-market Gold price from \$200 an ounce in 1975 to \$103.50 by August of 1976. Bankers and economists were so convinced Gold was finished that Walter Wriston, head of Citibank, forecasted publicly that the free-market Gold price would be driven back to \$35 an ounce or lower. But in the face of oil shortages and long lines at the pumps, an 18% inflation rate and 20% Treasury Bond rates, Gold rose in spite of the regular Gold Auctions from its \$103.50 low to over \$850 in less than 3 ½ years, with the majority of the rise coming in the last 3 months. The increase in liquidity of Gold suddenly allowed the Oil Sheiks to convert billions of US dollars into Gold at one time without disrupting the market. What do you think the Chinese with their \$42 trillion in reserves will do should Gold auctions resume? But like all Blow-Off Bull Markets, it rose too high. Gold then began a twenty-one year Bear Market as Reagan ordered Paul Volker to break the back of inflation and the USA fell into a severe Recession that lasted from 1981 to 1983 when the Reagan Tax cuts took affect.

Despite continuous central bank Gold sales and forward-selling programs by the mining industry, Gold nevertheless made its double bottom in Feb.2001 at \$256. Once the bottom was in place and in spite of all the manipulated attempts at driving Gold lower, it worked its way higher into a near perfect Elliott Wave, Fibonacci Five Waves Bull Market until it hit \$1030 in March of 2008. The accelerated debasement of the dollar, in conjunction with enormous trade and budget deficits has finally brought the long-term reserve currency status of the US dollar into question. By creating trillions of dollars out of thin air, the dollar has lost its function as a store-of-value to all savers.

Moreover, the US dollar has become the cornerstone of what amounts to a global fiat paper money DEBT system. History is strewn with worthless, defunct fiat paper monies. History buffs will recall the US experience with the Continental dollar; the inflated currency rapidly became worthless and all we were left with was the expression, "Not

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worth a continental." France, during the French Revolution, saw its currency, the Assignat, become worthless and the Germans saw their Reich marks become worthless in 1923 and again after WWII. There are so many similar modern day examples that they are too numerous to mention. The latest being Zimbabwe, who just printed the first billion unit note.

Confidence in irredeemable paper money is very much a state of mind. Benjamin Disraeli described confidence in money as "**suspicion asleep**". Once suspicion has been awakened, it won't go back to sleep for a very long time. In periods of sound money, confidence in paper has been maintained by a Gold backing. However, not only the US, but the entire world has abandoned the natural stability of a Gold-backed currency. A look back in monetary history would conclude that a breakdown in paper money, including the dollar, is unavoidable at some point. The only question remaining is WHEN?

In the move to substitute paper for Gold, the Federal Reserve became a prisoner of its own expansionist policies, which have created domestic political demands for perpetual economic growth, regardless of the additional debt created. Consequently, total credit-market debt has ballooned disproportionately relative to the size of the US economy. It now takes over \$7.00 of new debt stimulus to produce only \$1.00 of GDP growth. Like trees that can't grow to the sky, a debt pyramid can only grow so much before imploding. Believe it or not, deflationary forces have now caused the Federal Reserve to lower short-term rates to zero thus setting the stage for a Treasury Bond Collapse that will end up destroying all savers.

The US is now saddled with world record budget and trade deficits and is dependent on record amounts of foreign sources of financing. Both the government and its citizens have been living far beyond their means. The final solution is likely to be the re-association of paper money with Gold, but only after a major monetary catastrophe.

In the interim, drawing from the history of how inflation-riddled paper monies have eventually fared, private citizens should be able to see the handwriting on the wall for the US Federal Reserve notes as well as the whole global paper money system. In the end, the impact on history's only enduring money, GOLD, should prove to be extraordinary. For Gold investors, it will be "*Déjà-vu all over again.*"

### **GOLD - WHERE TO NOW?**

Fortunately there is nothing new to report. Both the Gold Bullion and Gold Stocks are behaving almost exactly as I have expressly pointed out to you in my last few emails. We have as much as another 8 months of further consolidation or as little as one month, before Gold will explode up towards \$1500 to \$2000 area. So continue with the program as previously outlined. Sell one month out of the money calls against your positions into rallies and sell out of the money puts on stocks you would like to own into sell-offs. Should Gold explode past \$1060, cover all your short calls and go long.

### **LESSONS TO REMEMBER**

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I apologize for not issuing a Special Bulletin, but to tell you the truth I could not figure out what was happening and more importantly, why? The first lesson to remember is ALWAYS USE STOPS.

Although I had picked the top to the exact day, the sell-off was no where near to being what I expected and what's more, the rally has lasted longer and stronger and has become more overbought than is normally seen, even at the top of a major Bull Market. If there is one thing that I am sure about it is that we are still in a Major secular Bear Market.

### **So the question is: What is Happening?**

After first reviewing the 61% approval rating of Obama's first 100 days and then listening to some of my Jewish friends (as one by one extolled Obama's virtues in the face of his current policy towards Israel), it suddenly dawned on me what was and is happening. Up until his budgets were passed, Obama had been talking down the economy telling everyone how bad things were. However, once Obama returned from his world tour of apology and even though absolutely nothing was accomplished at the G-20, he was back on the full campaign form. Only this time his message became one of hope and optimism that was backed with positive expectations from all his followers and especially the media, just at a time when the people were begging for that kind of positive encouragement. For short periods of time, hope can overcome reality, both at bottoms and at tops, but not for very long. Whether we adhere to them or not, the Natural (God's) Laws of Economics always prevail.

The second lesson to remember: At times, the Market can act irrationally and will do whatever it has to do to make the majority wrong. DON'T FIGHT THE TAPE AND WHEN IN DOUBT, STAY OUT

### **HOW NOW DOW**

There is no telling how far the love affair with Obama can take us. So, for the time being, let's stay with the major trend. Do not take any new short positions. Since we only invested limited funds in buying puts on the triple short ETF'S knowing full well that we were trying to buck the trend, stay with these positions and wait for the sell-off to develop. Hopefully, it will come in time for our puts to be worth at least what we paid for them. We are, as I expected, in the Wave B up correction similar to the 1930 Bear Market Rally that trapped all the Bears pending the continuation of the Bear Market. You never know the reasons until after the fact, but this time around Obama may give us that 50% pullback rally with record bullish sentiment figures and trap all the Bulls just like in 1930. Only this time we will be waiting and prepared to take maximum advantage.

Stay with your long calls and short puts on the TBT's as well as your long puts on the TLT which has just recently broken down. Increase your positions on any 1-3 day FED engineered Treasury Bond Rally, it will NOT last. The Bond Market is on the verge of collapse and it is only a lack of transparency and fraudulent manipulation by the government and their captured Banks that's keeping it afloat.

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With the Arlen Specter defection and the continuing belief that Obama can do no wrong, there is now nothing that can stop the Recession from turning into a major Depression. I now have two weeks to ponder our next move - stay tuned. If any light goes on, I'll send out a Special Bulletin.

**Wake up call.** Stop chasing the News and the Market and start getting in ahead of the moves. Stop buying programs that are all set to take effect after the stock market moves are already half over and start learning how to anticipate those moves instead: By getting on board with the winning UNCOMMON COMMON SENSE team now:

### GOOD LUCK AND GOD BLESS

I have spent my entire career identifying major trends in the markets and helping others to profit from them. These are trends that will be happening in the near future; trends that most analysts and investors notice only after they have already been well established and we have made the majority of the easy money. In my newsletter, "UNCOMMON COMMON SENSE", once I uncover changes to the major trends, I then present specific, actionable recommendations that will help you profit even during the worst of times and before they become obvious to everyone else.

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