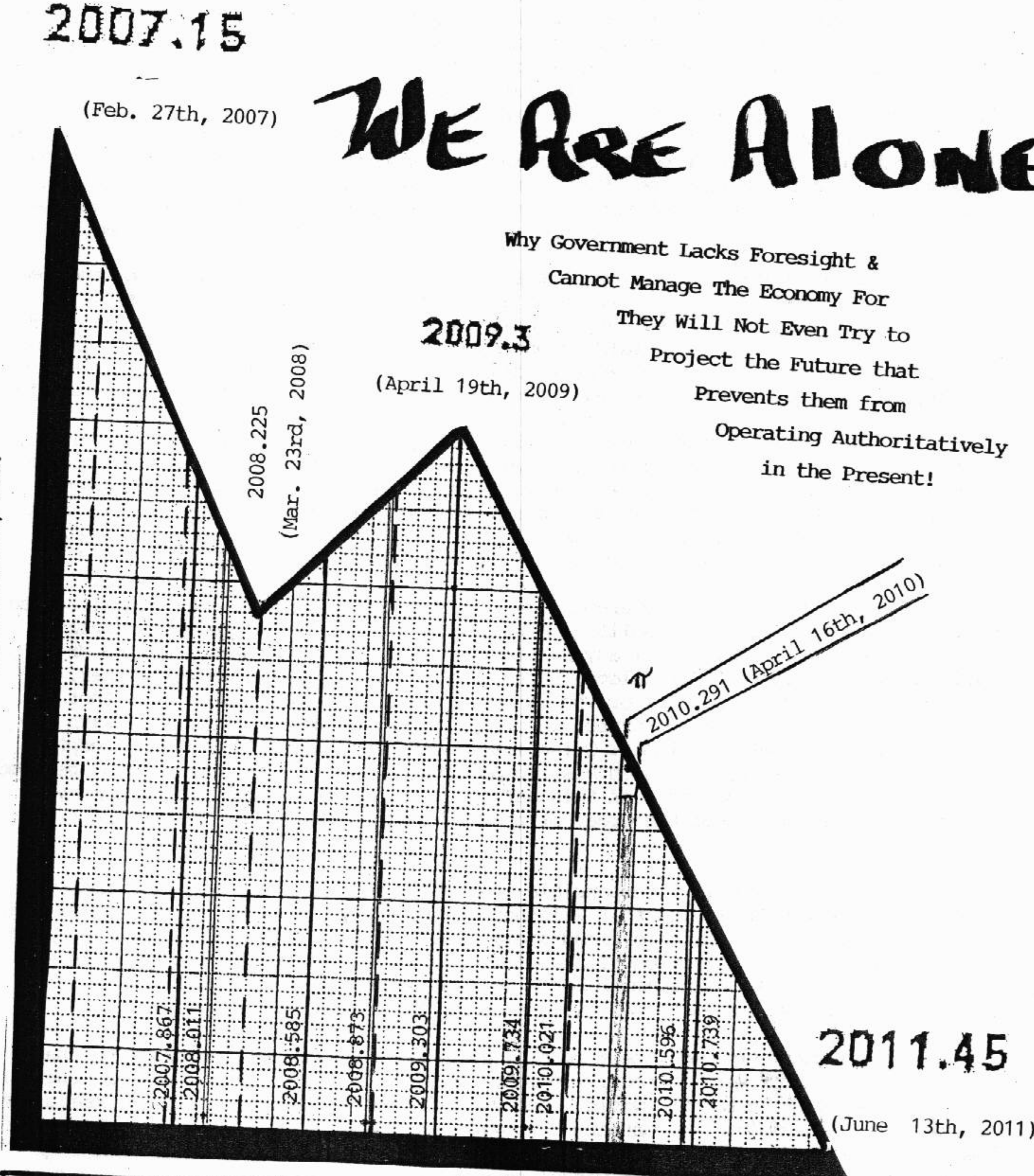
Armstrong Economics™

We Are Alone

Why Government Lacks Foresight & Cannot Manage The Economy For They Will Not Even Try to Project the Future that Prevents them from Operating Authoritatively in the Present!



Martin A. Armstrong
former Chairman of Princeton Economics International, Ltd.

Comments Welcome: ArmstrongEconomics@GMail.COM Internationally

Why we fly by the Seat of our Pants!

Most people believe in God because they cannot imagine a world where nobody is in charge. Historically, Governments fill that earthly function and perhaps the best form of Government is the benevolent dictator. Indeed, Xenophon (ca 431-352 BC) was horrified at democracy viewing it as a mob pretending to rule by law after it had sentenced Socrates to death because it did not like what he said. Rome developed a Republic with a Senate and two consuls that performed the executive role as a general. But Rome recognized that in time of crisis, one individual was necessary to avoid the endless debates. The office of Dictator could be appointed for 6 months. We are caught between a rock and a hard-place. For we have such a crisis, but no means to address the problem because elected officials have to also worry about their own future. We flirt with the idea of appointing czars, but we fall short of what Rome invented.

Barnie Frank was interviewed that aired on TV December 14th, 2008. He pointed out that this crisis could not have come at a worse time, during the transition between presidents. He pointed out, we have two men, but no president. He also made a very truthful comment. He said no one has ever won an election for anticipating any problem and avoiding it. It appears disingenuous for a politican to claim, "Vote for me, since if it had not been my foresight, you would have lost your home and job!"

We hire a fund manager based upon his past performance to foresee the future. However, we elect politicans like used car salesmen. We listen to promises, but we have no past performance and expect none. We do not vote based upon expectations of management skills. It is a vote at times like the Greeks prayed to their various Gods - it was not a worship, but a plea to just not torment them. Often they run for election merely yelling the other-guy is worse. That makes a lot of sense!

I have little hope in government ever making things better. The natural course of events invites crisis. No politician will risk his career to prevent a disaster because no one will believe him anyway. Handing piles of cash to people like Mr. Paulson who is former CEO of Goldman Sachs, obviously is not the answer either. We need perhaps an economic dictator who is not a banker, has vast experience (not a 35 year old), and who has no future job prospectives. He must be satisfied with the honor of saving the nation as Lucius Quinctius Cincinnatus (b ca 519 BC) who accepted the office of dictator, disbanded his troops after defending his country, and retired back to his farm. At the birth of this nation, Cincinnatus was revered, and many of the founders had joined the Order of the Cincinnati, who George Washington tried to imitate.

Most would regard it irresponsible if a politician came out and said that we were headed into a depression that will not end for 23 years. Yet, in the real world, if a corporate officer fails to immediately reveal how bad things are, that is fraud and warrants 25 years in prison. If a politican lies to the public about events and withholds the truth, he is responsible for we need not create a panic. The downside, obviously we cannot listen to politicians about the future events.

I have personally been the target of government misconceptions claiming that because my forecasts were correct, too many people were listenting to me, and that proved I was manipulating the world economy. The Commodity Futures Trading Commission actually issued a subpoena demanding I provide a list of all my client worldwide so they could prove that allegation. Recently, the Chairman of the Securties Exchange Commission was testifying before Congressman Waxman's Oversight Committe. He was asked by Congressman Issa "should the Congress bring to bear additional resources ... [to create] predictive modeling..." (Tr, p122, L2933-35), The SEC expressly stated.

they do not want to create any modeling for they, in their unique wisdom, would see this as manipulating markets if everyone then followed the model.

> "With respect to modeling all of the risk in the system, I suppose at some point you run up against the problem of trying to create such a level of exactitude that you rebuild the whole world in all of its complexity. That is probably an aspiration that we ought not to have."

SEC Chairman Cox, p124, L2999-3003.

Congressman Snow asked whether we should have some sort of a model instead of flying by the seat of our pants.

> "I share the basic thrust of your question here, which is can't we do better? Can't we find ways to do better? It seems to me, and this is retrospective, the question is leverage in the system. When loans and debt gets to be some fraction of GDP, it probably ought to send off some signals, because GDP represents the earning power, the debt represents the obligation.
>
> Congressman Cooper talked to us about future obligations that vastly -- that rise at a very significant rate relevant to the GDP of the United States. That sort of thing in rough and ready terms we should be able to model and have signals go off."

Congressman Snow, p125, L3016-3027

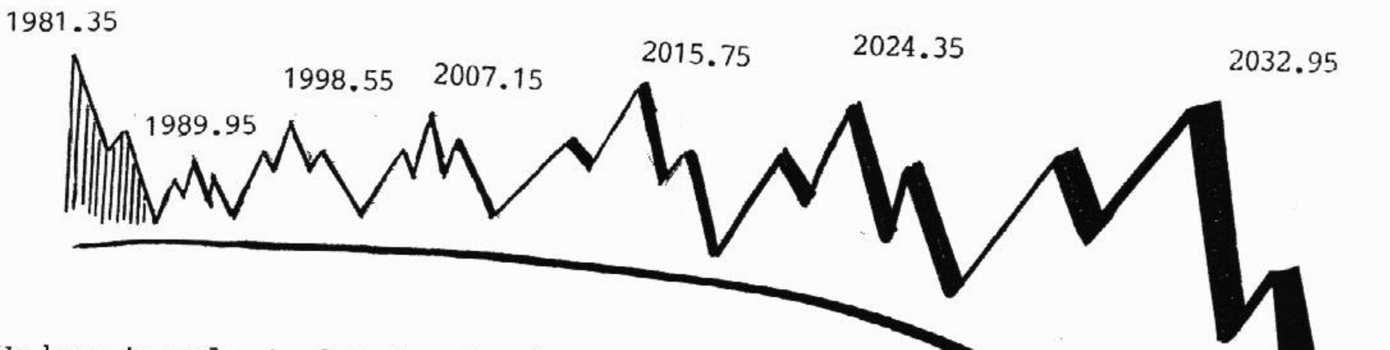
We have to stop hiring people from an industry with personal self-interests. The investment bankers were the largest market manipulators. They do not want any modeling any more than a casino wants people counting cards. If there was such a model, it would deprive them of the ability to manipulate markets. This is the self-interest that we cannot continue to endure if we expect to have a future. A six-year-old with that pocket calculator could have easily signalled the alarms and warned to bring back the leverage ratios. But that would have curtailed the trading profits of the investment banks. So when they stack political posts with former CEOs of the investment banks with huge stock positions, how is this any different than the corruption everyone is talking about in Illinois?

If government itself will not fund such a model, then how could any model ever manipulate the world economy? The excuse is absurd. No one would ever follow a model in 100% mass. The very cause of the boom bust cycle is the fact that there are two sides. Those who have never seen the cycle, buy the top, lose a fortune, but that experience prepares them for the next when they sell the top to the next new guy coming to the table.

The professionals create models that blow-up because they are operating under the presumption that they are manipulating the stupid masses anyway. The models that were used to create the leverage and derivative markets, expressly eliminated events like the Great Depression because they did not understand how to create a model for such events, and took the position that things were now different, and such events were no longer possible. So if you create a model assuming a collapse could never happen, then guess what; the model will fail to see such events and will afford no purpose anyway.

The investment banks are not traders. They manipulate markets to have that edge. It is an attitude they once attributed to Leona Helmsley: taxes are for little people. The investment banks view "risk" is for the little speculator.

Economic Confidence Model ™
8.6 Year Global Business Cycle



We have to understand that under the regulations that unfolded with the Great Depression, there was a dividing line between Investment Banks and Commercial Banks that could not be crossed. Commercial banks accepted deposits, and Investment Banks created funding and underwriting projects. The very nature of an Investment Bank was to make money on the markets, Why in all sanity would we allow any investment banker get in charge of a bailout? This is like handing a drug a bottle of wiskey and hope he can drink himself sober. Investment bankers do not want models for the same reason casinos do not want card counters.

There is perhaps no model in history that has the exposure of the **Economic Confidence Model.** This model has been published since the 1970s and I have given countless seminars around the world discussing this model. The peak of the last **Public Wave** on the 51.6 year major wave was 1981.35. That marked the peak in interest rates and the insane fight against inflation. That wave bottomed in 1985.65 that marked the peak in the US dollar (British pound fell to $1.03), and the birth of the G-5 that began with its stated mission, to manipulate the dollar 40% lower to ease the trade deficit. That created the 1987.8 Crash that came precisely to the day of the projected target, October 19th, 1987. This led to the outflow of cash back to Japan and the capital concentration that attracted capital in Japan creating the **Bubble Top** again precisely in line with the model - 1989.95 (December). The next low came 1994.25 that once more projected the precise day for the low in the S&P 500. This sparked a bull market into 19985.55 that once again projected to the day, July 20th, 1998 the high in the stock market. That was then followed by the collapse of Russia and the Long-Term Capital Management collapse. Of course, at the peak for the previous wave, 1989.95, we also saw the peak in Communism with Tiananmen Square on June 3-4, 1989 followed by the fall of the Berlin Wall by November 1989. This was perfectly in tune with a Private Wave.

From the 1998.55 (July 20th, 1998) high, we ended up with the collapse of Russia that instigated the collapse in Long-Term Capital Management for the very same reasons the Investment Bankers have collapsed today. This led to the final low in gold on the next minor turning point 1999.625 with the **Bubble Top** in the Dot.Com stocks NASDAQ on the half cycle target 2000.7 followed by the low in 2002.85 from which the current cycle period began. Once more, the precise day of the next peak was February 27th, 2007 (2007.15). This provided the economic high and peak in real estate and the exact high in the NIKKEI 225. So what is wrong with having some sort of map? Or is this the Dark Age where the Investment Bankers convince the Government don't create a model so you remain blind to what we are doing? Perhaps they believe they are like high priests and only they are worthy to see models - not the common investor or the common people? It seems they have done their best to keep the Government about as blind as can be. So how can we expect government to solve the problems we face when they are setting sail into the financial sea with no map, and no way to see even where land might be? Is this any way to run a country? Thank you Investment Bankers!

The SEC tried to regulate even those who merely commented on a market. They took the position that there should be no free speech regarding markets and thus the economy. They wanted to control what people even say. This is the same tyranny that just took place in Latvia - they rounded up all the economists that mentioned that the economy would decline. Far too often, those in power seem to think that they should be beyond any criticism and we should be just executed for disagreeing with their policies. Russia executed Kondratieff for discovering a business cycle, just as the ancient Greeks executed Socrates because they did not like what he had to say. Then there was Galileo (1564-1642) who was sentenced to life imprisonment for arguing that the earth travels around the sun and was not the center of the heavens.

The Supreme Court struck down the policy of the SEC in Lowe v SEC, 472 US 181 (1985). The Commodity Futures Trading Commission still adopts the same view and argues their statute is different and thus they can suppress free speech because the Supreme Court has not ruled against them.

Both the SEC and CFTC merely accomplish the same goals by indirect means. In the case of Princeton Economics, they lied about the nature of the transactions, froze all funds and would not even allow the companies to hire a lawyer, appointed a equity receiver who by law is supposed to be independent, but the Judiciary is as corrupt as Illinois politics. Judges for the most part only rule in favor of the government and will not defend the Constitution. Once they appoint their own people to run the company, they order him to just shut it down. So there is no right that we have anymore. The government has exceeded the conviction rates of the Star Chamber, Spanish Inquisition, and even Adolf Hitler - it is now virtually 99%. There is no right left to the Freedom of Speech.

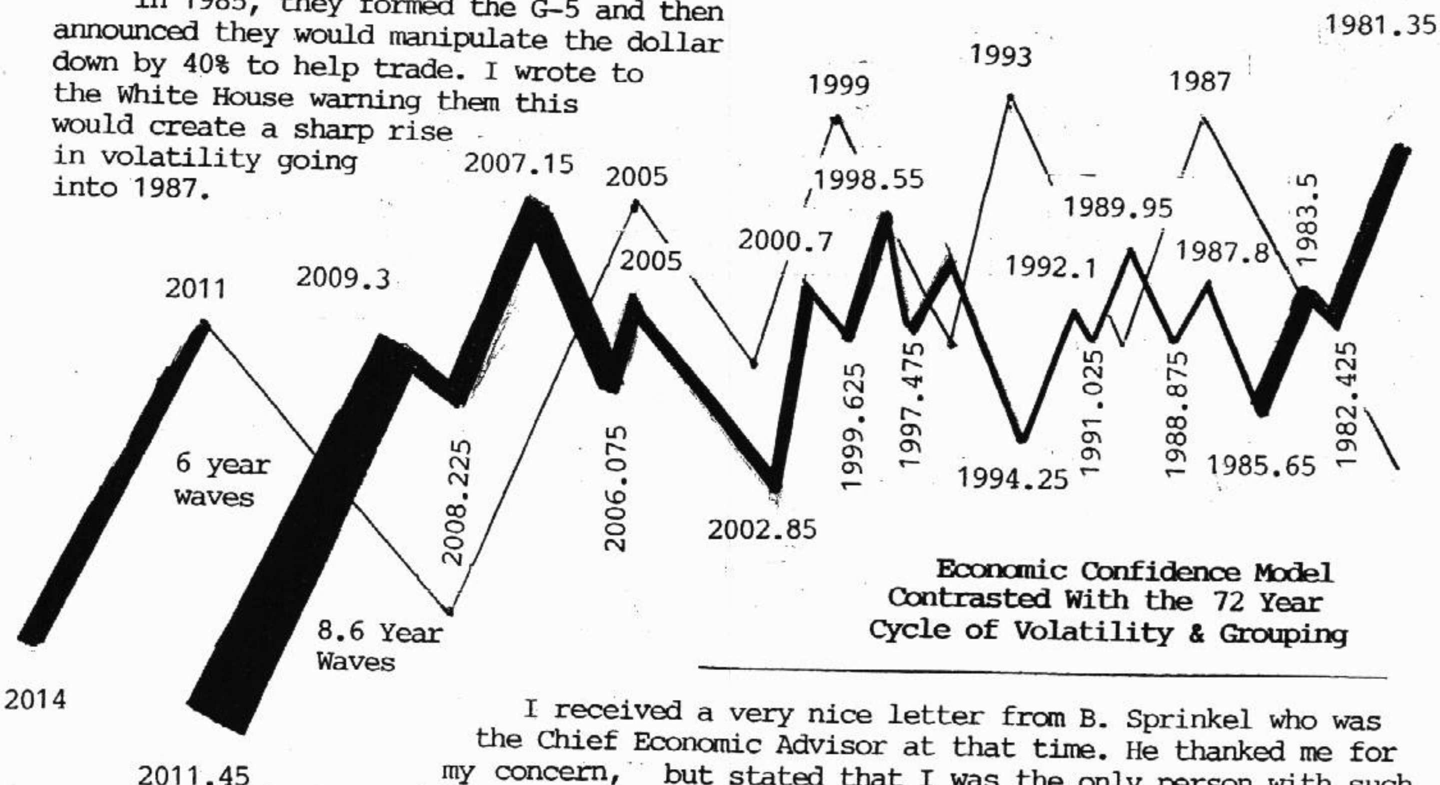
This is the real world. I find it curious that they criticize President Bush for rejecting all the science regarding Global Warming, yet when it comes to creating any science regarding our economic lives, that is too complex and we should bar anyone who dares explore such areas. This attitude of the SEC and CFTC that continue to discourage Congress from creating any science, is a clear effort to keep our society in the dark ages that only benefits the investment banks that have used their own models to manipulate the financial markets for personal gain. SEC Chairman Cox was well aware of the models we developed and stated precisely that such a model would need to be "create[d] [with] such a level of exactitude that you rebuild the whole world in all of its complexity. That is probably an aspiration that we ought not to have."

Everyone knows that was the basis of the Princeton model. Numerous countries contributed data and we built the complexity of the world because no individual could possibly analyze everything in his head. Just like the science of Chaos has emerged only when the computer was created to be able to see such complexity, why is the SEC & CFTC trying to act like the Puritains at Salem and execute people and stop progress because it must be the work of the devil in their mind? This is not in line with science and the evolution of man. What we face today is precisely this refusal of the SEC & CFTC to regulate their friends, the investment banks, and allow unprecedented levels of leverage while blocking any use of models by the government, ensured that a Great Depression was inevitable.

We are all alone!

Now that we understand that Government cannot help, nor offer any reasonable plan to mitigate the economic decline when agencies like the SEC & CFTC deliberately prevent any scientific advancement in the field of economics, we must confront the harsh reality that we are all alone. We can only survive through our own reasoning based upon unbiased and objective understanding of how the world really works. Those in charge have no incentive to avoid disaster, for no one will vote based upon a claim that "but for" their actions, life would be worse. This is the dark-side of Democracy. The system is designed to self-destruct in periods of economic collapses because we do not have even a role structurally for the temporary dictator like once existed in Roman Republican times. The SEC & CFTC will do their best to prevent any advancement in modeling and will seek to prosecute anyone who tries, no different than Stalin did regarding Kondratieff or Latvia is currently doing rounding up all their economists who warn of a decline. When people that work in the SEC & CFTC are allowed to impose their personal narrow-mindedness to suppress progress, Government has just nothing to offer but more chaos and will inevitably accelerate the the volatility.

In 1985, they formed the G-5 and then announced they would manipulate the dollar down by 40% to help trade. I wrote to the White House warning them this would create a sharp rise in volatility going into 1987.

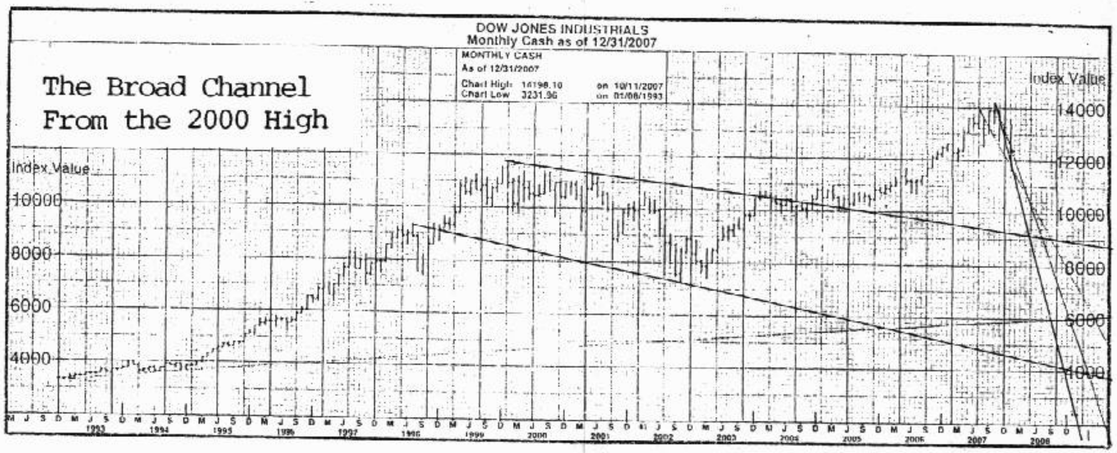


Economic Confidence Model Contrasted With the 72 Year Cycle of Volatility & Grouping

I received a very nice letter from B. Sprinkel who was the Chief Economic Advisor at that time. He thanked me for my concern, but stated that I was the only person with such model concerning volatility, and until someone else developed a similar model, they could not rely upon just one forecast. When the 1987 Crash hit, I was urgently asked for advise suddenly claiming that the number one problem was in fact volatility. So much for government forward thinking. We are once again at the same point on this model as we were in 1985. You can look at the archieve of the English Magazine, the **Economist**. We took the back page to show this model to the world I believe perhaps for the whole month in July that year so it could never be said that somehow this was made up with hindsight. Here in 2008, the model is projecting a sharp rise in volatility going into 2011 as it did in 1985 looking into 1987. The year 2011 is going to be a wild-ride and don't expect the Governments of the world to look ahead - it just won't happen. The SEC & CFTC prefer to destroy what they cannot comprehend even though their actions are illegal and contrary to a free society. But they just think they know best and if a hurricane is approaching, if the people know that, somehow it will make it happen. Their motto - destroy science for ignorance is bliss.

The Economy and Capital Markets

To get down to practical expectations, the market may be still in a state of shock and capital is contracting with interest rates in federal debt issues moving to about as close as you can get short-term, the economic team put together by the President Elect is not likely to adopt any policy that has not been in the standard bag of tricks. So all we can expect is like a doctor who just keeps trying every sort of cure until he finds something that works and when that does not work, he advises the family to just pray. We are in the same boat. The government has no model that says "If you do this, this will happen!" So it is more-or-less, try and see what happens. Because of this lack of economic expertice, the volatility should start to increase again after April 19th, 2009.



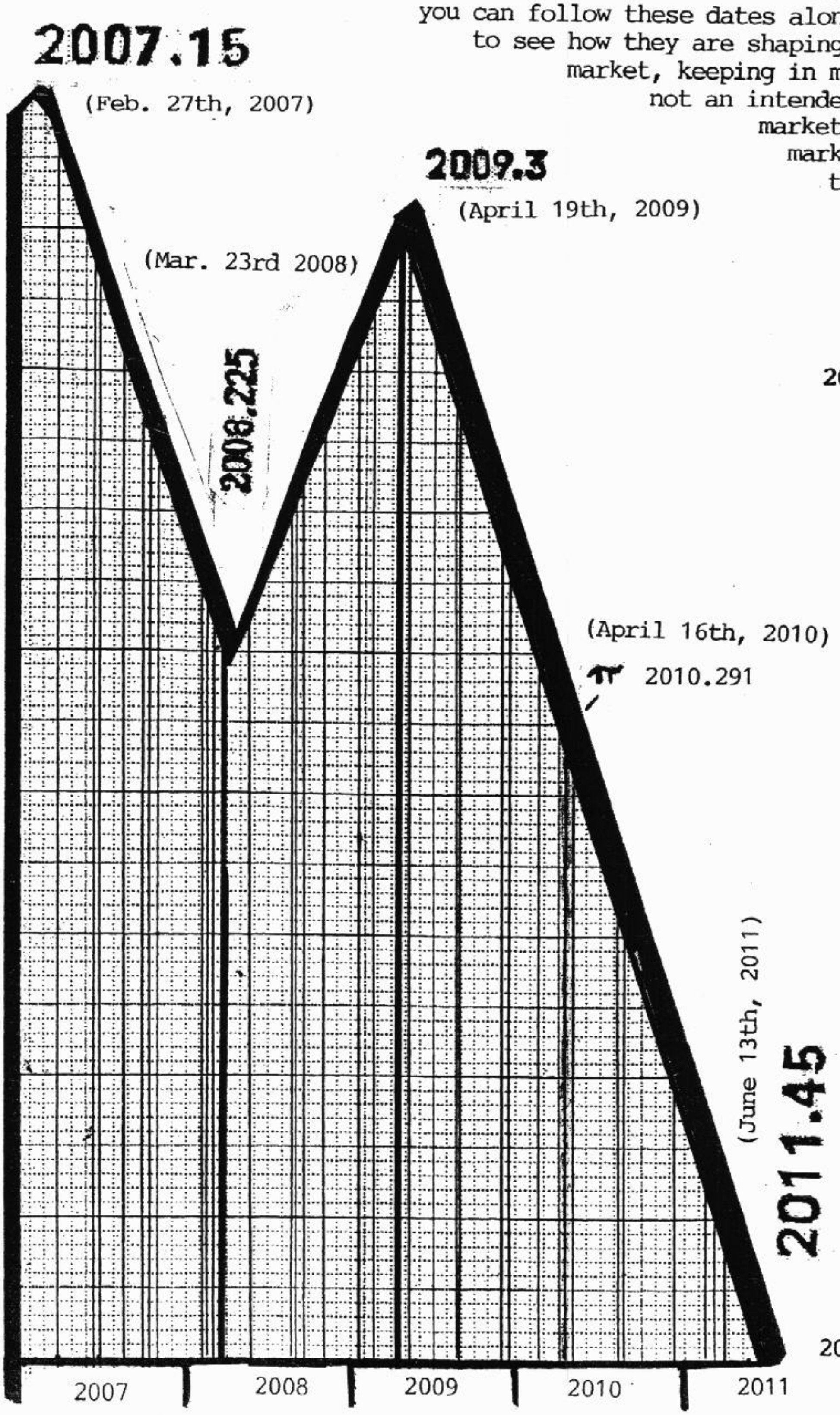
The technical perspective shows the potential for a serious **Phase-Transition** that can wipe out both sides of the market. There is a significant danger that we may find government act in the most irresponsible manner possible, That is, to open the window and just start throwing money out. The problem we have, is that this scenario is akin to the **Mississippi Bubble** and is more-likely-than-not going to produce **hyperinflation** that may lead to civil unrest and international war.

The above chart of The Dow Jones Industrials (Cash) provides a monthly look at how the US prime stock market has performed. The channel created by the 1998 high tied to the 2002 low is cyclically constructed using the model and the center point high of 2000 (the Bubble Top in Dot-Com). The top of this channel stood at the 9,000 area. That clearly failed to provide support and is now starting to form as overhead resistance. If the market cannot rally back above the 9,000 level and reconvert this into support rather than just fading it back and forth, then we may see a test of the bottom of this channel before this is over - 4,000 zone.

The **Phase-Transition** that is possible would embrace a sharp thrust downward to test the bottom of this channel and then bounce out of it to at first retest the top of the channel, with the possibility that exceeding the top of that channel and finding it provide precise support as what took place in 2005, we would then head off to new record highs of massive new proportions. Please keep in mind, that this type of pattern is the most volatile possible. It is typically unleased when the confidence in the government collapses. Given the Government will not even contemplate looking at a practical model as if that would be consulting witchcraft, this will be like driving a car without a steering wheel. There will be no possible way for the government to adjust before events happen, only in response to them.

Below, is the second half of the current 8.6 year wave going into the final wave bottom due on June 13th, 2011. To the right of the chart, please find all of the minor monthly turning points within the wave. The two key turning points will be April 19th, 2009 (Sunday) and April 16th, 2010 (π). So far, these targets have been working rather well. From the February high in 2007, the Dow declined into April, rallied into June/July, made a reaction low into August, and then rallied for the target October 11th. The next day, the Dow made a final high, but then collapsed penetrating the low of the 11th and closed lower starting the decline.

you can follow these dates along side all the markets to see how they are shaping up in each individual market, keeping in mind, however, this is not an intended model on any specific market individually. Those markets that line up with the model precisely, will receive the greatest impact economically.



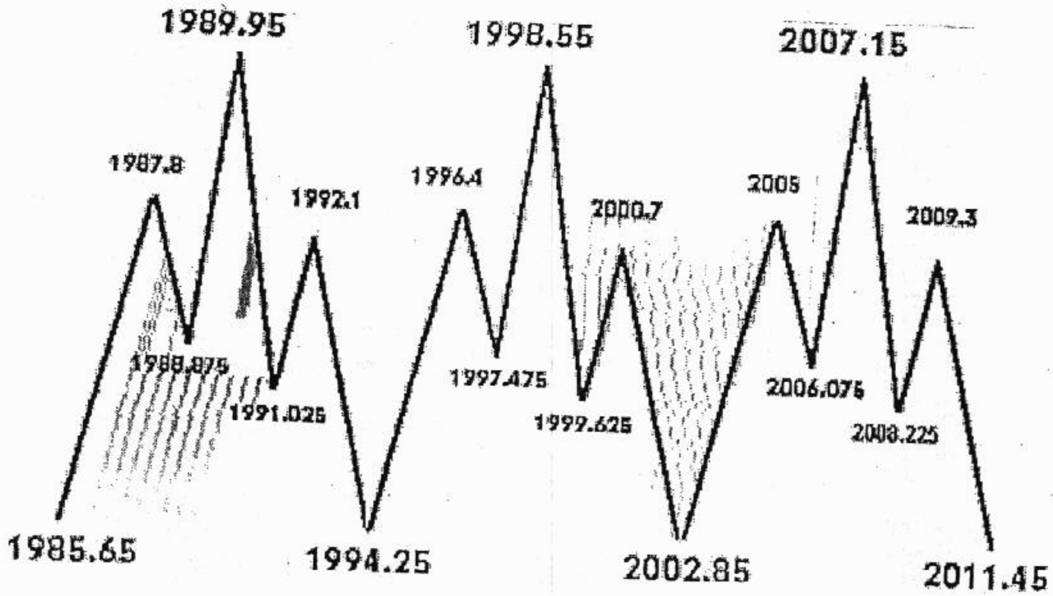
2007.15 (Feb. 27th, 2007)
2007.287 (4/27)
2007.464 (6/18)
2007.648 (8/24)
2007.778 (10/11)
2007.821 (10/27)
2007.867 (11/12)
2008.011 (1/04)
2008.092 (2/03)
2008.146 (2/22)
2008.235 (3/27)
2008.406 (5/28)
2008.585 (8/02)
2008.644 (8/23)
2008.720 (9/19)
2008.873 (11/14)
2008.991 (11/27)
2009.034 (1/12)
2009.142 (2/21)
2009.301 (4/19)
2009.348 (5/07)
2009.640 (8/21)
2009.662 (8/29)
2009.734 (9/25)
2009.976 (12/22)
2009.989 (12/27)
2010.021 (1/07)
2010.138 (2/19)
2010.595 (8/05)
2010.604 (8/08)
2010.636 (8/20)
2010.739 (9/26)
2010.918 (12/01)
2011.134 (2/18)
2011.232 (3/25)
2011.45 (Jun. 13th, 2011)

The primary concern will be that whatever spending the Government will adopt under the theory that it needs to stimulate the economy, they will borrow and that will escalate the debt exponentially. We can expect that the interest rates will rise when the markets begin to see unprecedented debt from all economies. This will tend to drive up interest rates during the second half of the year in 2009.

Because the government will continue to seek to borrow funds, they will not be able to stimulate the economy. They will compete against the home owner and will cause a greater proportion of defaults in mortgages. Already we have about 10% of mortgages in trouble. We can expect this to rise to about 25%. The more the interest rates rise, the lower housing prices, and that means that current mortgages will fall below market values.

With real estate falling below the original purchase price, we are in a major economic implosion. This may be similar in degree to the collapse in the economy of Rome following the Civil War (49-45BC), where Caesar took charge and had to revalue all the real estate and settled the debts at equal values to when the mortgage had been taken. All interest payments were reassigned to principle. This was perhaps the most brillant real estate crisis ever unraveled in history. Nevertheless, we cannot expect any foresight from Government and this one appears like a candle about to be blown out by the winds of fate.

1989 = The Fall of Communism
1998 = The Fall of Russian Economy
2007 = The Fall of Socialism?

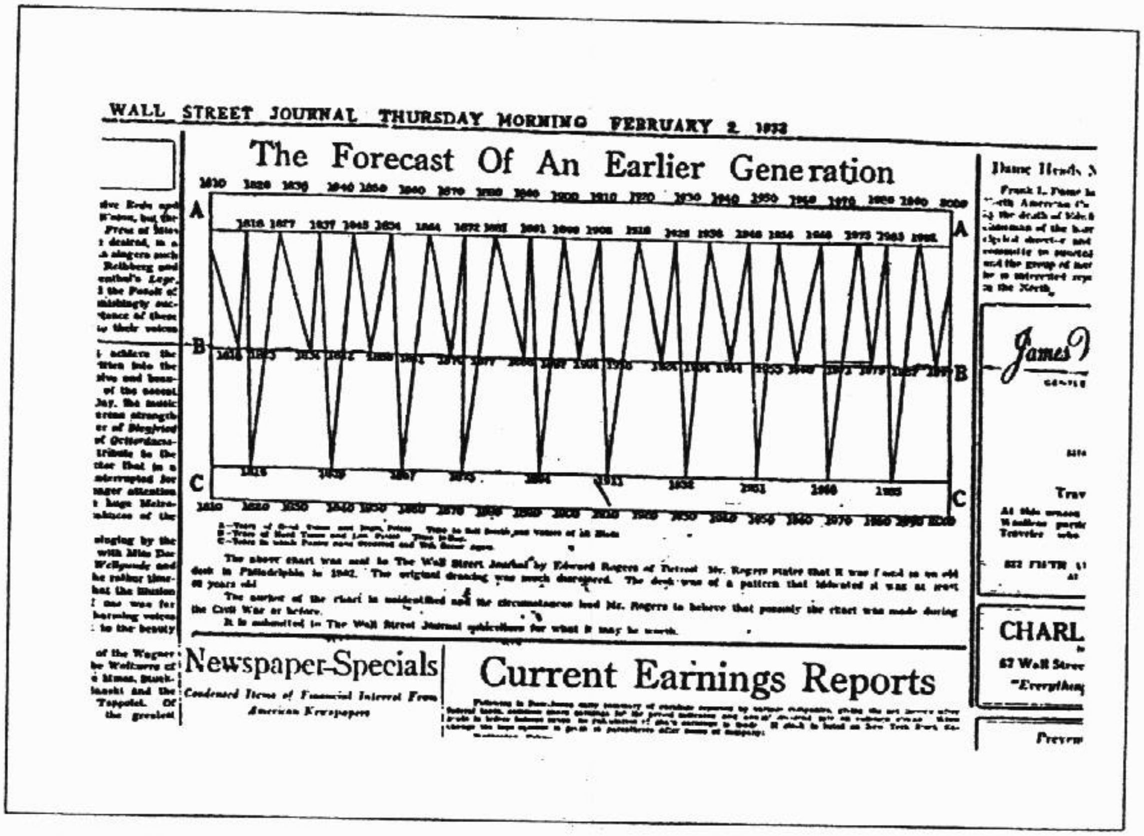


Since we are in a Private Wave, the volatility should be much greater than anything we experienced during the previous Public Wave (1934-1985). The Private Wave that preceeded (1882-1934) was laced with numerous panics, exceptionally high volatility, and the US Treasury going broke just 13 years into that wave formation during 1896. During this wave, the first bailout came with the collapse of Long-Term Capital Management in 1998. That was concerned with the collapse of Russia and the collpase of the IMF loan structure. We had the Richman's Panic of 1903 about 21 years into that Wave and that is about where we stood at the high in 2007. The major Panic of 1907 that was in part created by the San Francisco Earthquake, was the final straw that broke the Railroads ending the leadership of the transportation era shifting that distinction to the Industrials for the Panic of 1929.

From a timing perspective, the 1907 Panic would be in line with about 2011. This is nearly 26 years from the beginning of this current Wave being 1985.65. The danger is that we could see the fall of Socialism. That is not welfare and mere social programs. That is the entire structure of society. If Government continues to run by the seat of its pants, we are more-likely-than-not going to experience one huge meltdown economically.

Some people who may be alcoholics who have a problem different than one might expect. They are not void of responsibility. What the problem is stems from the fact that they are allergic and their body does not function normally causing them to stop - they keep drinking because they are compelled to do so. Unfortunately, Government is also addicted to borrowing. They cannot stop. No matter how much you try to reason with a drunk, they cannot stop. Government is no different.

Politicians can only see that the people expect them to make the pain go away. Lacking any other ability and models as well, their only solution will be to spend again what they cannot provide. They will borrow, thinking this somehow mitigates the spendthrift cycle, but they cannot borrow and stimulate simultaneously. So the future appears as stormy as ever. This has no relevance as to who is even President. Both Republican and Democrats fundtion with the same economic tool bag. So hold on, we seem to be headed for one heck of a ride.



When I was doing research for the Greatest Bull Market, I read virtually every newspaper on a daily basis through the boom and bust of that entire cycle. I read both domestic and foreign newspapers doing a lot of my research at the Royal British Newspaper Library in London. While I might be arguably the most qualified on the subject, that still does not mean I could call the next boom or bust without quantified models. In the course of that research, the Wall Street Journal published a curious cyclical chart on February 2nd, 1933 that they reported had been found in an old desk in 1902. It projected the low for 1932. They took no position on the chart and could not attribute the author. They published it for what it was worth.

The concept of a business cycle and modeling the boom bust inherent swings within our economy has been around for a long time. It seems strange that the Government listens to the SEC & CFTC and refuses to create any scientific modeling to help it understand what to do when and where rather than just opinions. I am not qualified to forecast the future by personal beliefs. How can we run a country on policies of hit-or-miss?

We can no more tolerate running an economy without quantified modeling any more than we can tolerate running investments based upon models that presume things are different so we need not account for major economic changes. Man has not changed at all. We can no more presume that we are beyond the historic mistakes that every society has made to date, than we will live forever.

April 2009 is shaping up to be rather important. If gold were to decline into an April low, things could get very interesting thereafter. There appears to be the possibility that we will simply collapse and get this over with pretty fast. If the stock market drops sharply and we see the Dow test the 4,000 area as early as April 2009 to June 2009, this could be the low for the stock market signalling that capital will flee from government debt later in the year driving interest rates higher. We must realize that the stock market typically bottoms first. It bottomed in 1932 while the WPA was not formed until 1935 as unemployment rose to 25% and almost 3,000 banks failed <u>after</u> the 1932 low.

Because Roosevelt was suspected to be planning to confiscate gold, the stock market began to rise in anticipation of a dollar devaluation. Capital needs safety, and while the dollar was <u>it</u> between 1929 and 1932, that changed driving the stock market up into 1937 making about a 50% recovery. We are likely to see the same type of bifurcated movement if we see the low in 2009 for the Dow.

The likelihood that Government will attempt to fund its bailout with debt as did the French after the Mississippi Bubble, the wave of new debt that is likely to appear during the second half of 2009 will be a tsunami. The problem we face is that all nations are in the same boat. We can expect the debt crisis to worsen and those driving this car, do not have a steering wheel. So hang on tight. We are most likely going to have one really wild ride. Below is the 72 year volatility model for the current wave formation economically focused. We have not yet seen what real volatility can be. The record decline in the DOw for a single day is almost 25% from late 1914. That is real volatility.