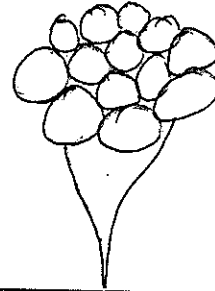
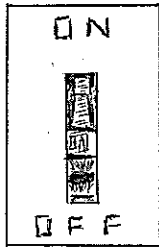
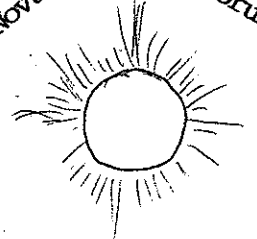


Armstrong Economics™

Is it The Time To
TURN OUT
the Lights?

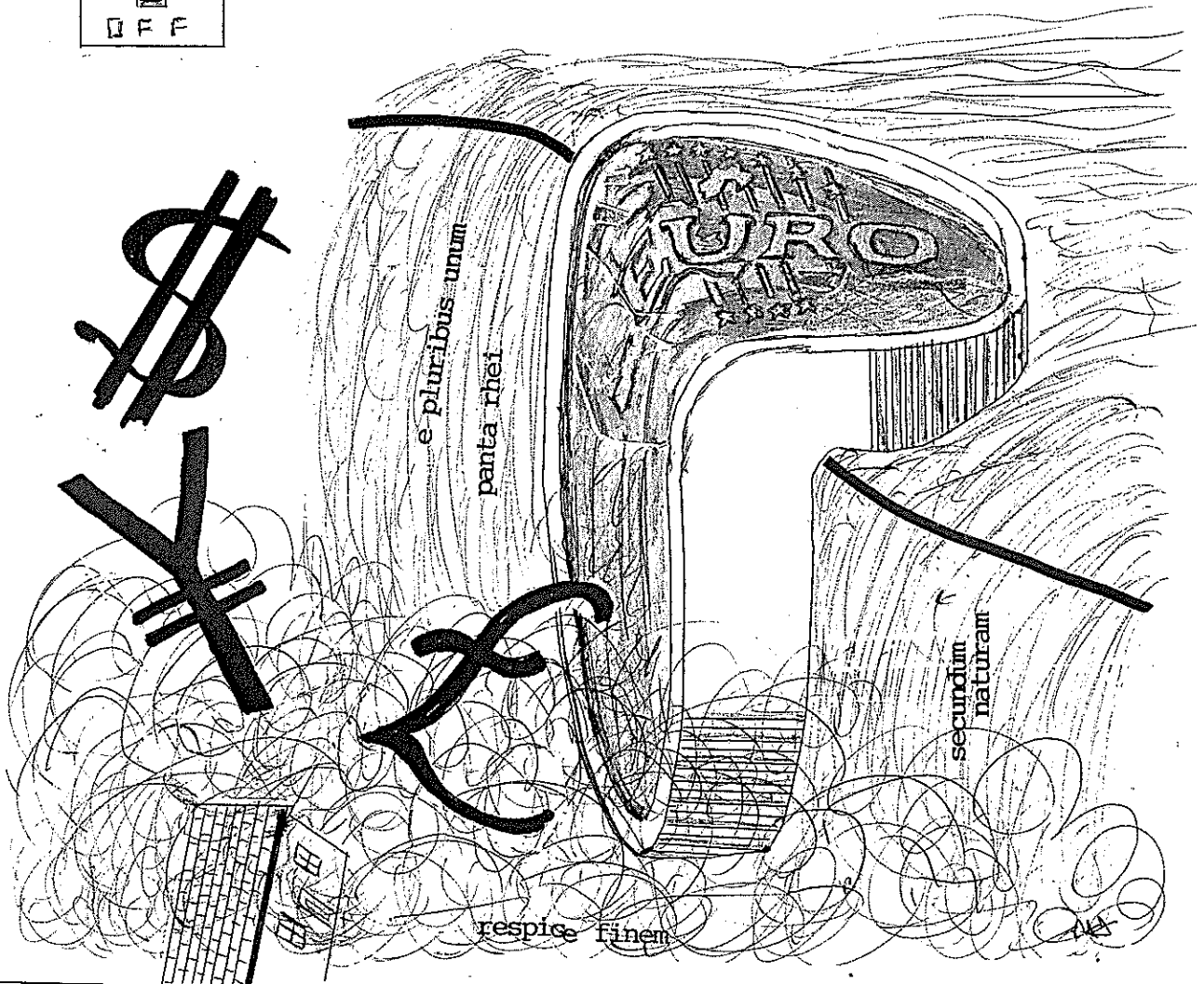


Novus ordo seclorum



WARNING
THE WORLD
ENDS—HERE
↓

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



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This Report may be forwarded as you like without charge. It is provided as a Public Service at this time without cost. The contents and designs of systems are in fact copyrighted. At a future date, a book will be released **The Geometry of Time**. The charts are often reproductions of an earlier publication from 1986 also to be soon republished **The Greatest Bull Market In History** covering from 1900 up to the 1980s. Additional updating is underway to complete the Century and into the current time, providing a month to month history of the financial development of Western Society.

Is it The Time To Turn Out the Lights?

by Martin A. Armstrong (former Chairman of Princeton Economics Int'l, Ltd)
and the Foundation for the Study of Cycles

February 19th, 2009

Everyone has expected either two outcomes. (1) the election of Obama would spark a recovery and the worst would be over saved by his stimulus package, or (2) we are going to see a major wave of rising interest rates to pay for the Obama Spending-Spree that would spark serious inflation. But there is a much darker side to these shallow views. To put it mildly, it may just be a far more complex outcome than anyone has dared to guess. The burning question is we may be in the midst of a "Waterfall Effect" that could undermine the very structure of Western Civilization. Historically, it has always been the **debt crisis** that destroys the greatest plans of men and dictators. It may be something we need to understand to survive. For this could just be phase two of the collapse of Marxisim after phase one reshaped Russia and China, phase two may just be our turn. Is it the Time to Turn-Out the Lights?

Despite the Anglo-Saxson/Puritan need for retribution, this **Economic Depression** is far more complex than meets the eye. I believe that the **Investment Bankers**, not Wall Street, in their own greed, used the final days of the Bush Administration to try to grab as much as they could while there was an ex-Goldman Sachs' boss in the driver seat. I believe they needed to scare Bush into giving them everything that they dreamed of, and Congress was stupid enough to hand-over a pile of cash with no strings attached. This scare-tactic worked. They got what they wanted and even settled scores getting rid of their competition like Leman. But in the process, they pricked the bubble in which everyone lived. They set in motion a collapse in confidence that is the critical key to a contraction for once people lose confidence, they get "depressed" which is why we call such events a "Depression."

This Depression has centered on the most vulnerable of markets - real estate. It is the least economic force of production, yet it is the most visible sign of wealth in the minds of the average person. They will hoard cash whenever they feel that wealth is impaired. Yet this trend is intermixed with the additional economic evolution to the internet that is causing the old-world to give way to the new age of electronic shopping that is causing a contraction in the largest employment sector - services. Not merely are retail stores losing shoppers, all services are declining right down to lawyers who are being replaced for basic things like wills and contracts by the much cheaper internet. Even things like the **Yellow Pages** are dying. The concept of the

office at home from a laptop, is also reducing the need for real estate. The Internet is also causing a contraction for the first time since the first postage stamp was used in the U.S. back in 1847. The Post Office will be now closing 1 day extra per week.

States are in crisis and their way of doing business just tax them til they die is also facing reality. As the real estate base collapses, so does the tax base and the states cannot print cash without limit like the Feds. What use to be safe like **Muni-Bonds** is no more. The end of borrowing for everything is now here.

"The Waterfall Effect"



"The Spike Effect"



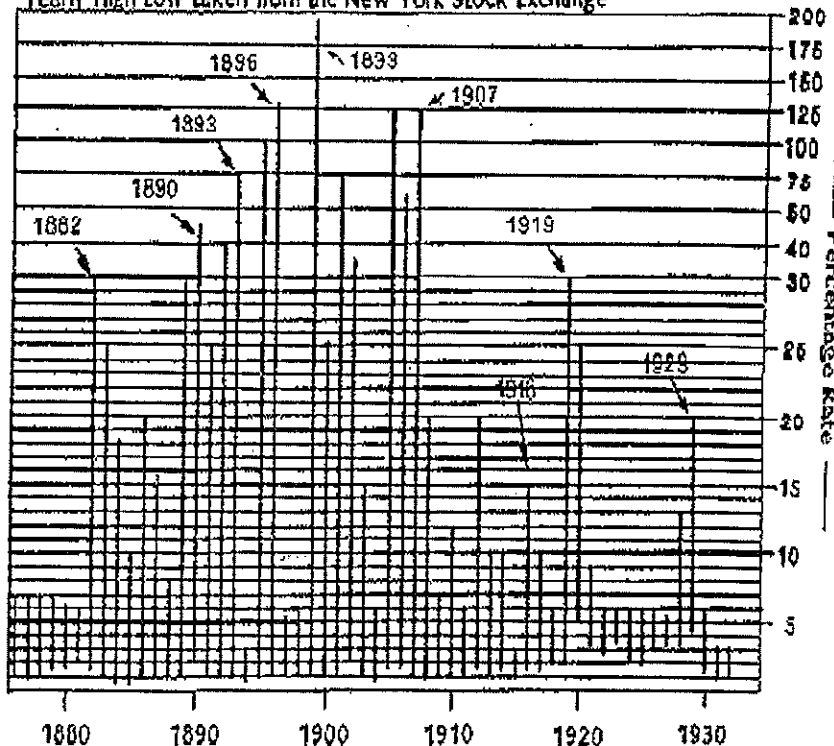
Debt has always been the great destroyer of civilization. There have been many **Debt Crisis** events in history. All are responsible for the destruction of the political government no matter what the form. We are faced with a serious **Debt Crisis** that has engulfed Western Civilization including Russia leaving the only society that may have the last laugh - **China!** Even Japan could not survive for its debt structure is overwhelming. Yet we are also reverting to the age old problem of **Regional Capital Flows** and disparities within each nation. This is a critical issue that is taring Europe apart placing the **Euro** at risk, while at the same time, the disparity among regions in the United States is also percolating beneath the surface and is about ready to split the nation asunder.

The Disaster of One-Size-Fits-All

Just prior to the formation of the Euro, I was giving numerous seminars on the subject and warning that the "one-size-fits-all" policy will not work and may be the undoing of the European union. Some people believed that just because I was an American I was naturally pro-America. But that was certainly not true. The key warning I was illustrating at that time is starting to come to the surface. Let me make this perfectly clear. I believe Europe can survive and reverse the trend if it listens to reason!

Politicians have no long-term view for their self-interest under Adam Smith's **Invisible Hand** is to merely win the next election. No one will run for office on a claim that they prevented a disaster. You just don't know what could have happened! Just as President Obama is taking every possible wrong step that will ensure that this global economic disaster gets farworse, his advisors truly know nothing about history, trends or have any practical real world experience from the private sector to draw upon. How can we expect them to understand when such people have only lived within the bubble of government and convince themselves they have all the answers?

CALL MONEY RATES 1876-1932
Yearly High Low taken from the New York Stock Exchange



Before there were central banks, the perpetual swings in the economies of the world rose and fell not in unity, but diversely according to the local economic mix. In the United States, these regional capital flows do create localized booms and busts. For example, during the Gold Rush of California, inflation in that region was running at multiples of that on the East coast. There were even \$50 gold coins being privately minted in California whereas the largest denomination in the east was \$20.

When the San Francisco 1906 Earthquake hit, the insurance companies were in the East and the claims were in the West. The flow of capital left cash shortages in the East that contributed to the **Panic of 1907** causing **Call Money** rates to rise to 125% on the NYSE.

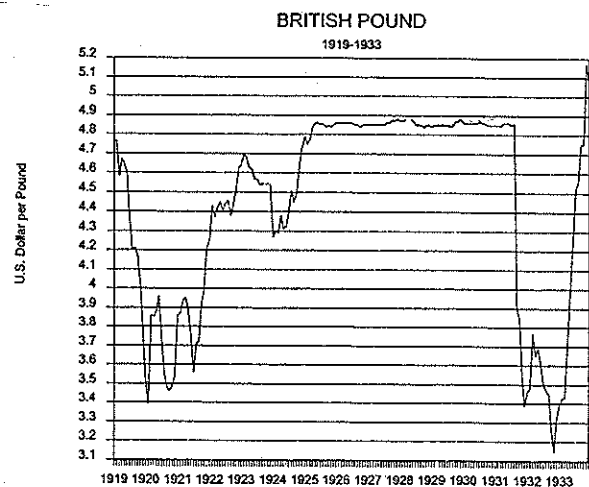
The analysis that followed the Panic of 1907 came to the realization that there had been a capital flow problem. The answer led to the creation of the Federal Reserve Bank in 1913 with its 12 branches. Why were there so many branches? What is not widely known today, is that each branch operated independently. In other words, there could be 12 different interest rates. If cash was tight in California, that branch could raise rates by 1% and that would attract capital flows for investment.

The mistake of the Euro that is now starting to pull apart the entire system, is that the model used was that of the United States post-World War II. Because of FDR and World War II, central power seemed to be the main goal. The independent status of the 12 branches was usurped into Washington and never given back. This usurpation of power completely altered the ability to manage the economy and thus, the Europeans based their model upon the mistakes of the United States. Just as there were regional distinctions in the United States, the same exists in Europe. The Euro is being torn apart by the ignorance of the economy.

The way to save the Euro before it is too late, is to allow interest rates to float independently within each nation. This is necessary to allow capital to flow naturally to the regions that need it the most. Unless the Euro is fundamentally restructured, it is following the path of destruction that has been tearing apart the US economy not to mention others. For example, in Canada, the central bank was raising rates to fight real estate speculation in Toronto. At the same time, it was putting farmers and miners into bankruptcy in Vancouver. There can be no **one-size-fits-all** and unless we start to get some people with real live experience outside of the governmental bubbles, we may see the total meltdown of Western civilization for everyone will then blame the next guy and that leads only to war. Already both Russia and China blame the global meltdown on the United States. This is perhaps rightly so since the legal system is so corrupt, regulators like the SEC & CFTC can be bought easily since the people they were to regulate, can hire them as well. No politician can act in such an unethical manner. Yet this is why we have the problems we do now because those Investment Bankers, not Wall Street brokers, have been manipulating the system so long, we forgot what real "free" market was all about. Just look back at how many Secretaries of the Treasury were ex-Goldman Sachs' chairmen.

Currency is still the Key!

We must understand that currency values may still prove to be the key. Often forgotten is the international and regional capital flows that dictate the overall trend and the outcome of what we face. The Free Market will always prevail. It even forced the collapse of communism and no matter how much politics may want to burry it or call a Republican dream, it cannot be suppressed. Here we have the British Pound between 1919 and 1934. It fell from \$7.50 in the 19th Century to about \$5 for the start of the 20th and it has flirted with \$1-\$2 going into the 21st. No matter what system, the Free Markets always prevail as this now shows even during the Gold Standard. This is a safety-valve that the currency absorbs economic stress in a complex relationship with interest rates. This is a dynamic between capital concentration and capital flow internationally and even regionally.



Today, we have the same interesting trend emerging. Despite the fact that the Debt Crisis has emerged from the United States, or more correctly, the London office of AIG is the epic center, capital is still fleeing to the dollar in this flight to quality. But how can there be a flight to the dollar that is a flight to quality in a rational world?

The underlying strength of the dollar is also geopolitical. From a conventional perspective, the United States is still a very difficult place to land troops. There is also the maturity factor. The dollar is one currency that has remained intact. If you have a note printed in 1934 or 1864, it is still legal tender. That cannot be said even for the British Pound.

Yet there is something more profound. So far, the United States remains the key Super Power and the largest economy. Hence, what we are really looking at is the similar effect that Rome had in ancient times followed by Constantinople. When the Roman Empire in the West fell in 476AD, the Byzantine Empire of the East became the leading world economy. Its gold coin the "solidus" became the world currency even in Western Europe when no other states existed with the economic power to issue gold coinage. The coin began to be called the "byzant" much the way the dollar is called the "buck" or "greenback" in slang terms.

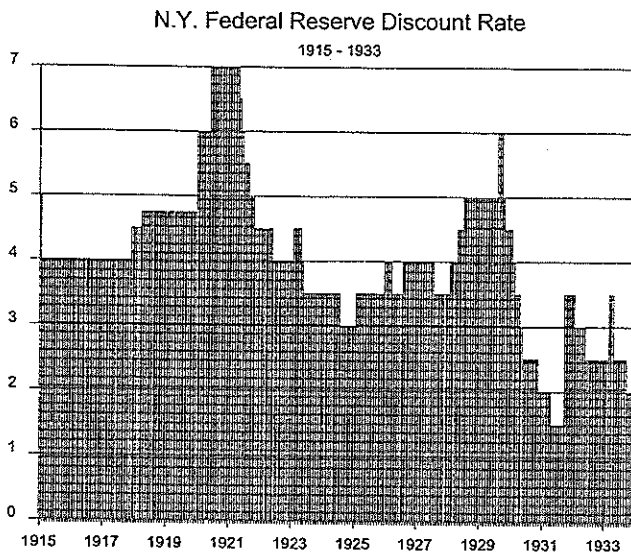
For better or worse, the dollar is still the reserve currency of the world. It may not deserve that status, but that is another story. There is only one primary world currency at a time, and the dollar may be humbled by internal stress and the political split of the nation. But when that day comes, we will see it fall. For now, the world currencies have been few and far between.

Daric	-	Gold of Darius (Persia)
Tetradrachm	-	of Alexander the Great (Greek)
Denarius	-	Roman Republic (silver)
Solidus	-	Gold of Byzantine Empire
Ducat	-	Venice
8 Reals	-	Spanish silver "dollars" (Piece of 8)
Pound	-	English (Post Elizabeth I)
Dollar	-	United States



Silver Denarius of Julius Caesar 44BC

Currency has always been a safety value to relieve economic stress. This is not always understood, yet it is a vital component of global economics. When an economy comes under great stress where confidence collapses, people then hoard their cash. This is why Roosevelt confiscated gold, and it is why there was a Dark Age after the fall of Rome for there was no real capital flow nor banking, leverage, or borrowing - just hoarding. This drives the purchasing power of the currency higher (deflation) and when it declines, it does so against tangible assets (land, etc). The decline in the value of a currency is in reality a Free Market tax taking away wealth that is overstated. So currency can also be an indirect tax to compensate for the poor management of the state.



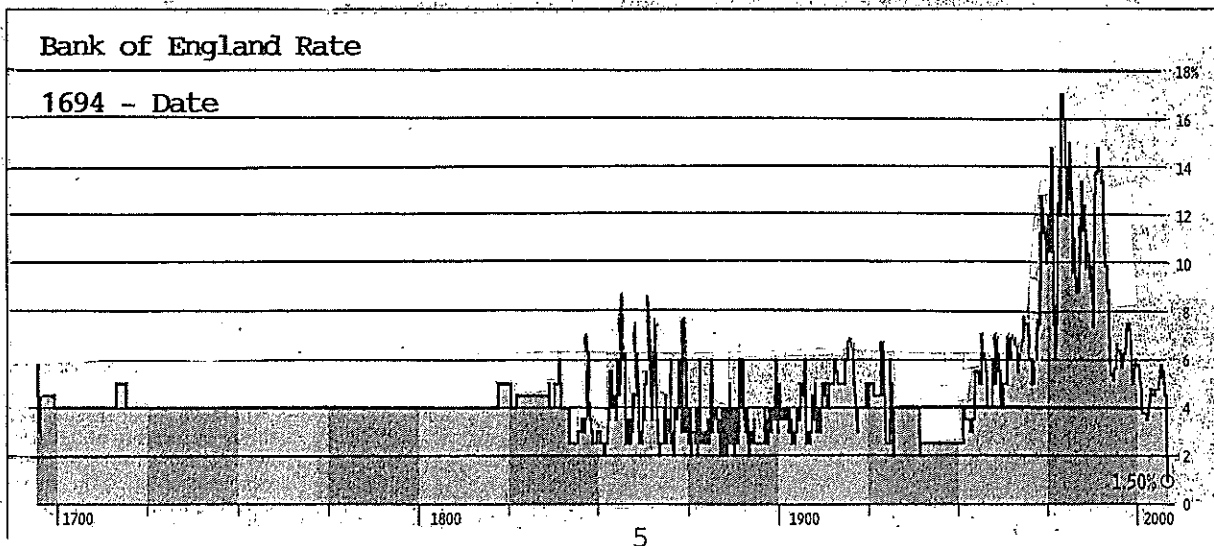
To illustrate the difference that capital concentration and capital flows will have on an economy, we need only look at the discount rate at the NY Federal Reserve between 1915-1933. Note that the worse economic decline was surely the '29 Great Depression. Yet when we look at the real world effects, we come up with a different perspective.

The high at the NY Federal Reserve on the Discount Rate came during the Panic of 1919's aftermath - not the Panic of '29. We can see the earlier high was 7%, yet in the Great Depression, the peak was only 6%. If we refer back to the Call Money chart from the NYSE, the peak was 1899 and in 1919 the high was 30% compared to 20% for the so called Roaring '20s in 1929.

If the 1929 Crash was the worst in history and it was sparked by shoe-shine boys even speculating in stocks, then why did the Call Money rate reach the lowest level compared with every other crash going back to 1882? The answer is simple. Show me the Money!

The key to understanding the Great Depression is not speculation and Wall Street any more than what is going on today. There was a currency crisis in 1931 that you can see illustrated by the British pound that was the least European nation effected. Yet the pound crashed and burned from \$4.86 dropping to about \$3.15 - a 64.8% decline. It cannot be emphasized enough that the contagion spread then like today, but Europe all defaulted except Switzerland and Britain went into a moratorium and eventually honored its debt. This created an intensive capital outflow from Europe to America. We can see that the Fed lowered interest rates (discount rate) from 6% to 1.5% very rapidly. It did not matter, for capital was still pouring into the US seeking a flight to quality driving US rates down, but driving the dollar to record highs. We can see that the British pound had fallen in the Panic of 1919 to \$3.40, and recovered going into 1925. Therefore, despite lower interest rates in the US during the Great Depression compared to the crash following the Panic of 1919, the dollar rose to higher highs. So we can see that there is no linear direct relationship that can be drawn. This is a complex dynamic interrelationship that must be understood. Interest rates even in England have collapsed to new historical lows going back to 1694.

England Cuts Rate to Historic Low

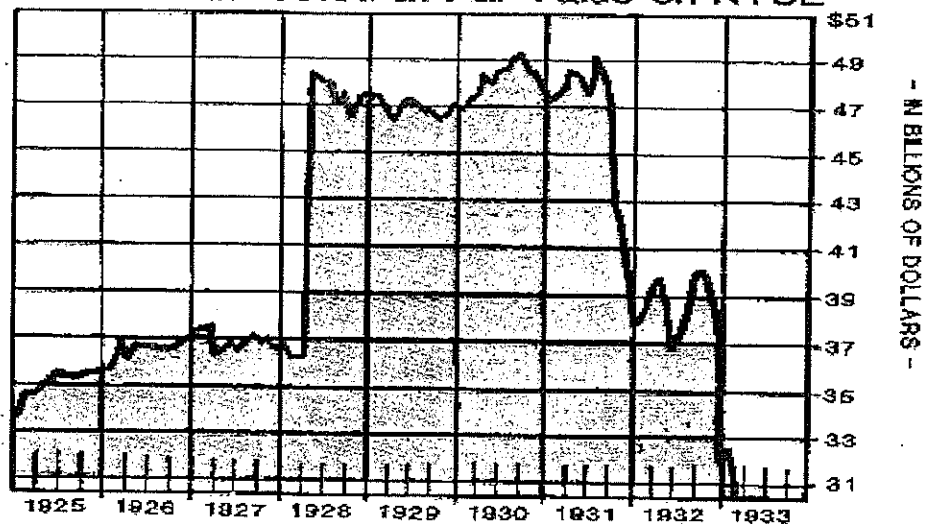


One would have expected interest rates to rise where there is a Debt Crisis. Indeed, most are now expecting interest rates in the United States to rise sharply in the face of Obama's Stimulus Package. This is a rather simplistic view that we may not see unfold as many expect. This one-dimensional aspect of the problem is counter-balanced by the massive contraction in leverage at the core of the Great Depression of the 21st Century.

It would appear that adding \$1 trillion in spending will be inflationary and send interest rates higher. This assumes that there is an alternative to investment not just domestically, but internationally. We are also looking at a counter-trend causing the collapse in the avenues for capital to seek shelter. As I mentioned earlier, what use to be regarded as the safest bet - Municipal Bonds - for they were seen as backed by revenues, collapsed during the Great Depression. The City of Detroit defaulted on its bonds, but to be precise, it did eventually pay them off with much cheaper dollars in 1963.

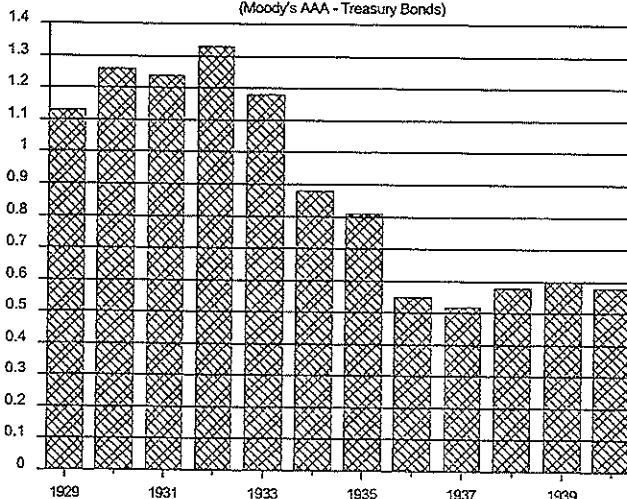
Another aspect of the Great Depression that has been lost in the details, was that foreign nations who defaulted on their debt, also resulted in a collapse of the money supply in the United States. Back then, the investment banks sold these bonds in small denominations to the average people. The irony of the Great Depression has been often buried in history. Those who lost the most, tended to be the most conservative. Those who stayed away from the "risky" stock

Total Bonds Listed at Par Value on NYSE



market, were wiped out by the bond markets. For decades, there were groups of women who were children whose family fortunes were wiped out by the collapse in the bond markets. We can see from the above chart, the total amount of debt listed on the New York Stock Exchange exploded in 1928 and collapsed at the end of 1932. Another detail lost in history, the Fed lowered interest rates in 1925 in order to steer

Differential Between Corp & Treas Yield (Moody's AAA - Treasury Bonds)



the capital flows to Europe. It was then presumed that lowering interest rates in the US would shift the capital flows and relieve the crisis building in Europe. Yet the defaults in 1931 wiped out conservative investors who stayed away from stocks contributing to a collapse in US money supply by one-third. We can see that the premium of AAA corporate debt over federal even reached a peak of more than 1.3% in 1932. The State and Municipal Debt also collapsed so the Flight To Quality did not subside until after 1932 and took place both domestically and internationally not unlike what we see again today.

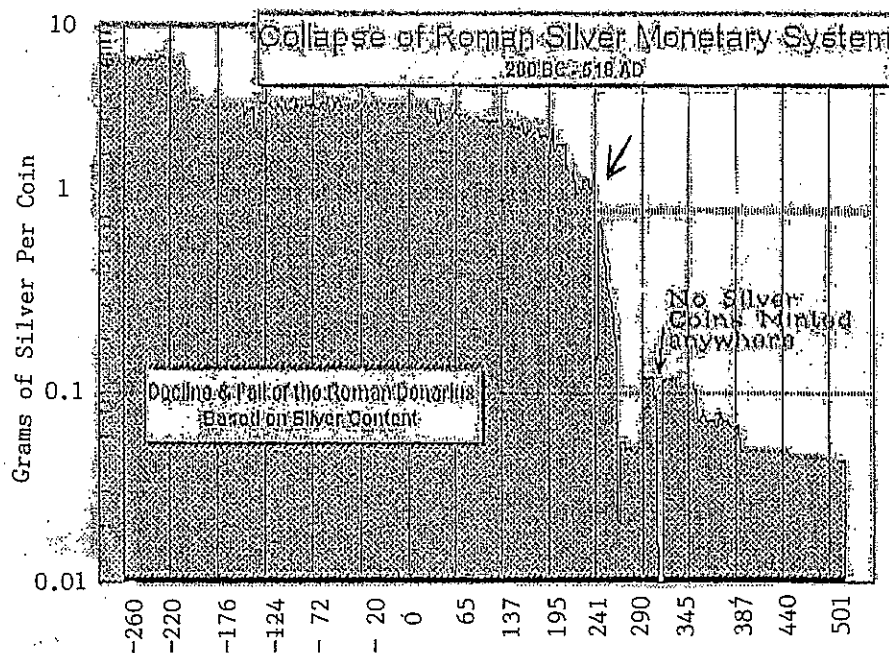
Capital Protectionism?

There is a rising concern mostly in Europe that we will enter a age of **Capital Protectionism** that will emerge as nations nationalize their banks, or pretty much will do so indirectly. What may be more likely, is an outright assault you may never have thought about - foreign exchange. The bulk of global capital flows takes place through the **Interbank Market** that also lacked a central clearing house. These were collateralized trading that banks stood behind and settled everyday. The problem of just writing paper like CDS and taking in revenues, was not really a daily settled market. The performance was more akin to an insurance policy rather than a trading instrument and when AIG could not perform, the world came to an end.

The rising concern is emerging from the thought that government will nationalize the banking system and then they will outlaw lending in other nations - i.e. - the new term **Capital Protectionism**. This is likely even if the banks are not nationalized since even with the South American defaults in the last century and the Southeast Asian Crisis of the late 1990s, major banks contracted without Government direction.

What we must be far more concerned about is the destruction of the free markets by Government that knows not what it is doing. It was the efforts to raise excessive taxes in the final days of the Byzantine Empire that destroyed not merely itself, but also destroyed **Capitalism** and individual liberty. The taxation became so excessive, that the peasants were forced to sell their labor to landlords in return for shelter and a portion of crops that they raise. They also bound their children to the land magnates and this set the stage for the **Dark Ages**. Taxation destroyed civilization. We must come to face the facts that Government has its own survival instinct and it will turn against its own people as it always has for thousands of years. When it comes to making a decision between the survivability of the political state and power and the liberty of the people, guess who comes first?

The Waterfall Effect



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What we must understand is there are two primary different patterns of how markets collapse. Typical speculative bubbles are the spike form whereby there is a sharp rise that becomes even exponential, that is followed by sharp and steep decline whereas the chart pattern appears more like it is a heart-beat. This is the short-term panic that does not lead to ruin. The far more dangerous pattern is the rolling over of an economy that is less dramatic, but suddenly you just wake-up & everything is changed. We saw this with China and Russia that shocked the world in 1989. There was no spike, just what I have called the "Waterfall Effect" that appears to be how a political state simply dies with no flare nor big bang. The spike formation is dramatic and highly volatile.

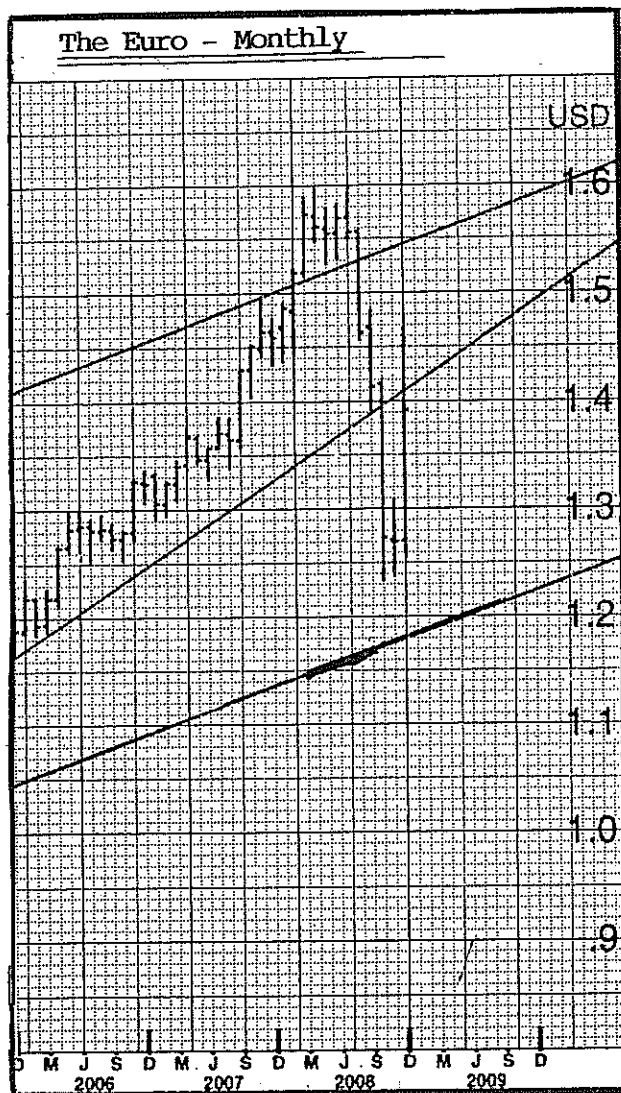
The greatest concern that we should have is that the sheer degree of volatility is off the charts. We are looking at nearly an outside reversal to the downside of the Euro on an annual basis! This degree of sheer volatility is truly amazing on an annual level. We have not seen this type of volatility on an annual level since 1933. Just look at the previous chart of the Pound. Note that in 1933, the Pound fell to new lows, but then reversed and even exceeded the \$5 level, due to Roosevelt's 60% devaluation of the Dollar and the confiscation of gold domestically. The sheer level of volatility is clearly back to the days of the Great Depression.

The highest monthly closing for the Euro came in March 2008. The April high was exceeded slightly on July 15th, 2008 when the high was established at 1.5988 US. This is a clear double top that could yet be exceeded. The March 2008 highest monthly closing was in line with 2008.225, which was the first minor turning point after 2007.15 on the Economic Confidence Model where the US real estate peaked and made a major high that may last for several decades to come.

From the high on July 15th, 2008 in the Euro, there was a bold collapsed that so far constitutes a reaction amounting to a 3 month decline. While the Euro penetrated the low of 2007, it did hold its major closing support that remains at \$1.26. A monthly closing in the Euro beneath this area, would signal the end is near. For now, the Euro could still survive if the right steps are taken and Russia keeps its weapons harnessed. The greatest problem for the Euro long-term remains the geopolitical problems on the horizon in Russia, that still lives in the world of empire, rather than the age of production.

In order for the Euro to show some sign of strength, it must first accomplish a monthly closing back above \$1.4215. This is the minimum threshold level from a technical perspective to show some sign of survivability. The next level of key monthly closing resistance will be at \$1.4315. As long as the Euro remains below this level on a monthly closing basis, then a test of the major long-term support is still possible at \$1.1680. A monthly closing below that area and it will be very unlikely that the Euro will survive in its current form.

We must comprehend that the value of a currency is now determined solely by the free market no matter how much the politicians try to control it. The Dollar by far is not the best bet from an economic perspective. There is still a very real risk that the United States could divide along the lines of the Civil War, not so much because Obama is black, but that could become an excuse. The real problem is the deep desire of the Religious Right to set up government imposing their will upon all other religions no different than the extreme right Taliban. Just as the Taliban find un-veiled women offensive, the Religious Right in Christianity finds abortion



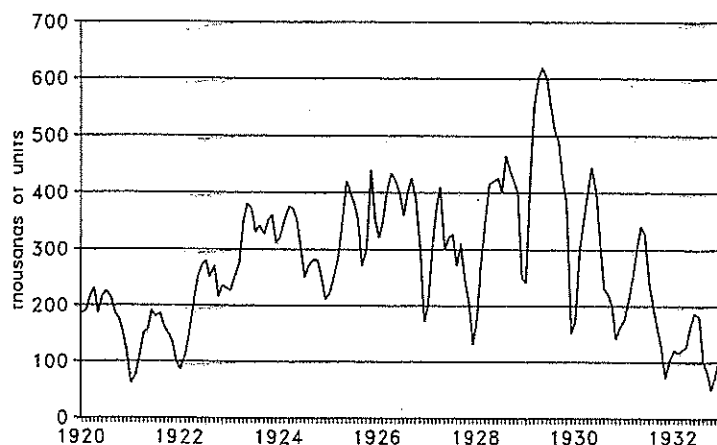
equally offensive. Unfortunately, there is no other sort of political instability that topples nations than **Religion**. The Muslim World sees this as America against Islam and a new Crusade. This is a clash of cultures that is not foreign to history. Even within Christian faiths, we have the clash of left and right. During the rise of the Religious Right during the 1600s, they killed the King of England, seized all power, and under the Puritan reign of Oliver Cromwell, kissing your wife in public became a felony. All plays were outlawed as were sports, because they in particular led to cursing. Of course, Christmas dinner was also outlawed. So much for religious freedom, that in America has always been manipulated to mean the faith of those now in power, to the prejudice of all others. In America, it has been he who controls the laws and the courts, can enjoy the **Religious Freedom** to oppress all others. This is why there is always such a battle over the Presidency to control the Supreme Court to reshape the law to the personal desires of those now in power. The danger facing America, is the split along the same lines as the Civil War, but using the beat of religious drums. This was also the fate of Rome - the split between the Roman Church and what is still known as the Greek Orthodox today.

The Rise of Volatility

We must understand that Obama will try to blame Bush for the problems. He will even claim it is not his fault, for he inherited the crisis. No matter what he says, it is now his problem and how things develop will be his legacy. At least Hoover was in charge from the 1929 to 1932 period when Roosevelt was elected. Here, Bush had no real time to even correct the problem, and he was manipulated by the Investment Bankers and his own advisors expecting to grab as much as they could before it was too late. They believed \$700 billion would set them on top of the world, and settle scores letting competitors die like Leman. Don't expect criminal charges against Goldman Sachs, J.P. Morgan, or AIG. That would reveal the manipulation of the SEC, CFTC, and Justice Department and their policy of - "You don't shit where you eat!" Government attorneys decide who gets prosecuted, so you can bet there is going to be thousands put in jail who cannot embarrass the Justice Department, SEC, and CFTC. The Obama "**stimulus plan**" will fail, no different than Bush's Investment Bail bailout that also did nothing. So hold-on. We are ready for a real ride.

What we must understand is the truth at least about what took place during the Depression. Roosevelt's confiscation of gold was targeted at the same reason why there is a risk that Obama could nationalize major banks. The gold confiscation was a targeted measure to cut-off hoarding of capital. The velocity of money declined by about one-third during the Great Depression as people saved rather than spent money.

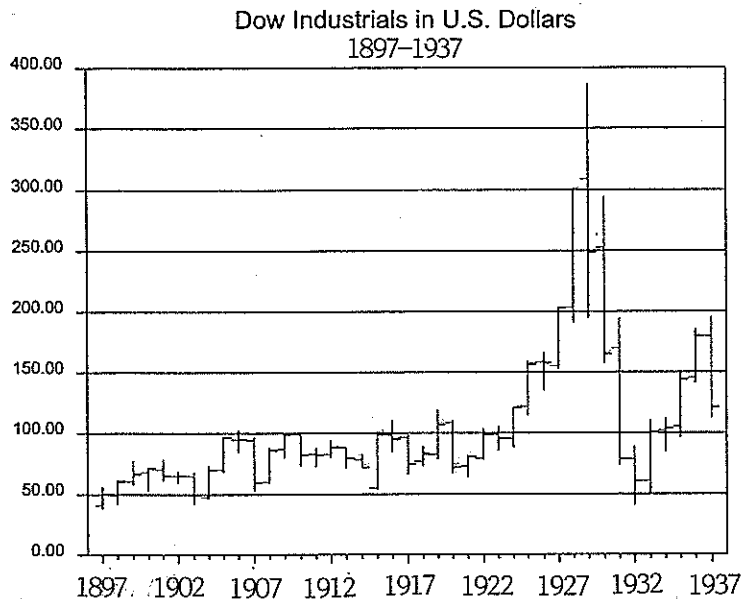
US Total Motor Vehicle Production
Monthly (cars-trucks-taxicabs)



Nevertheless, the productive forces imploded. As we can see from the **Total Motor Vehicle** production, there was a collapse of more than 90% from about 620 thousand cars to about 60,000. This type of massive collapse in productive forces combined with the **Dust Bowl** that hit after the 1932 low in the US Dow Industrial Index, shows just how bad things really did get.

Obama can fund all of the infrastructure he wants, but the WPA was focused upon taking the farmers and making them skilled not in taking computer programmers and teaching them to build roads.

I cannot stress enough that the level of volatility that we are experiencing during this financial crisis is just well beyond even that experienced during the early stages of the **Great Depression** and is more akin to the collapse of Rome. That is a stark comparison that tells me this is nothing to fool around with and try to gather political power and install the life-long dreams of solicialization. I find it extremely ironic that the nation poised to explode as a rising star of the new age of capitalism is China. The likelihood of either Europe or America doing the prudent economic policy to save our free economies, is about as likely as myself running for President.



As we can easily see from the annual chart of the Dow covering the **Crash of '29**, the decline does not reflect even an outside reversal in the first year of the decline. We can see that 1929 formed a spike high but it did not penetrate the low of 1928. The Dow Industrials did close lower than 1928, but it held the 1928 low.

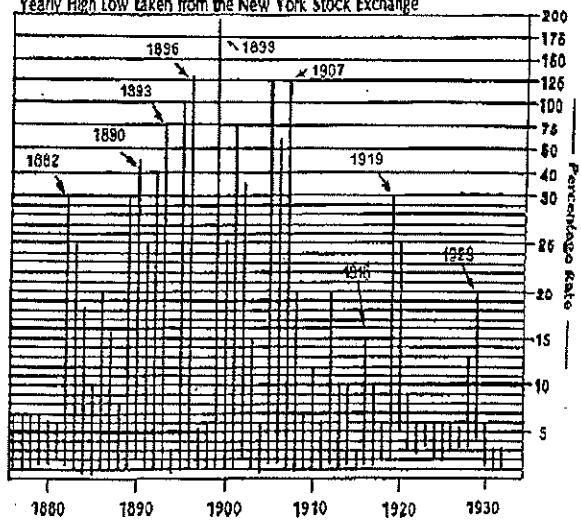
In 1930, the high remained below that of 1928, and it did not penetrate that low and closed well below it. This provided a major annual sell signal, and indeed we find the low 3 years from the 1929 high in line with the reaction rule duration of a maximum duration of 2 to 3 years.

When we look at the Dow Jones Industrials between 1897 and 1937, we actually do not find a single annual outside reversal to the downside until 1937. There was the **Rich Man's Panic** of 1903, the famous **Panic** of 1907, the **Panic** of 1919-21, the **Panic** of 1929 and then there was the **Panic** of 1937. Notice that none of these financial chaotic periods took place with the degree of volatility we have seen today, except 1937. The rise from the 1932 low into a 1937 high came with rising unemployment. Primarily, as gold was confiscated, capital was attracted back to stocks insofar as this afforded some tangible value for your cash. The stock market became in a way a hedge against the deliberate inflation that Roosevelt was creating. But keep in mind, Europe was still quite unstable economically and don't forget that this economic instability also brought to power Adolf Hitler at the same time as Roosevelt. **Change** was the battle-cry of politics in 1933.

The high degree of instability in 1937 was due to the fresh memories of the Great Depression. The press was filled with negative comments and the fear was that there would be another Great Depression. The fact that we can see the reflection of that degree of instability in 1937, illustrates that there was a deeply seated lack of confidence. This is the beginning of a **Public Wave** where the **Private Wave** peaked with 1929. Therefore, the growing lack of confidence in the private sector is reflected in the sharp volatility seen in 1937 compared to the previous panics.

One must be concerned as to why we are seeing such highly unusual swings in prices. If we look at the **Call Money Rates 1876-1932**, notice that there were much greater highs pre-1913 and the creation of the Federal Reserve. We are also looking at a period in time of a **Private Wave** where the US government went nearly bankrupt in the late 1890s.

CALL MONEY RATES 1876-1932
Yearly High Low taken from the New York Stock Exchange



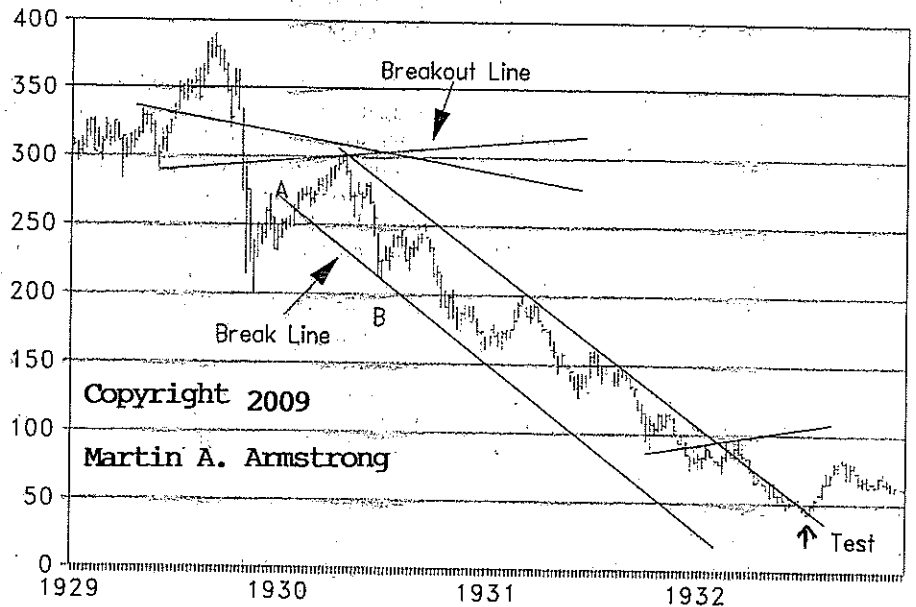
Looking at the Call Money Chart, we can see that the pre-1913 period displays a much greater period of volatility. The end of the previous Public Confidence Wave peaked in 1878.15 and it bottomed in 1882.45. This is precisely the year we see the first spike to the upside with Call Money Rates reaching the 30% level.

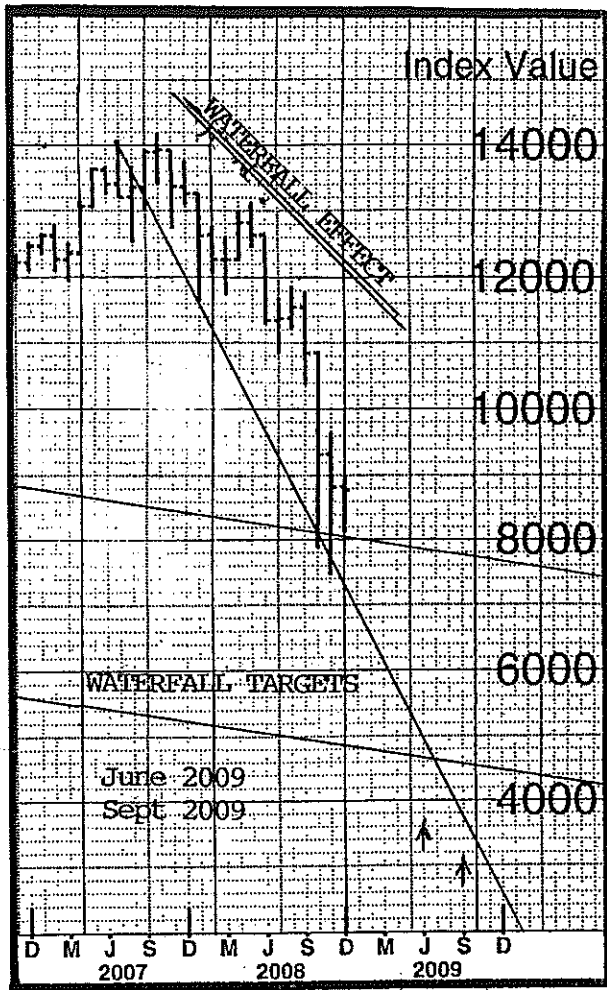
The Private Confidence Wave marked the near bankruptcy of the US Treasury in 1896 and we can see that the major high in interest rates actually takes place in 1899 at nearly 200%. It is this Private Confidence Wave that peaked in 1929 that ended with the Great Depression. The next 51.6 year cycle reached its peak 1981.35 marking the high in interest rates once again as the Government began to battle inflation due to its collapse of the Gold Standard in 1971. Hence, that Public Confidence Wave peaked in 1981 giving rise to a new Private Wave.

For years, I have warned that the greatest degree of volatility comes during a 51.6 year Private Confidence Wave. This is a period that government, fearing losing power, becomes most aggressive. For example, the Public Wave that peaked in 1671.75, was followed by a Private Wave that was marked by tremendous upheaval including very serious spreading wars that included the early stages of revolution both in Britain that spilled over into Russia during 1689. This is the period of Oliver Cromwell, the beheading of Charles I, that all culminated in the South Sea Bubble as well as the Mississippi Bubble both in 1720. This gives way to a Public Confidence Wave that began in 1727.65. This wave reaches its peak in 1774.95 and that began the great period of revolution that overturns the idea of monarchy both in America and France. So we can see, we are now in a Private Confidence Wave and the degree of volatility is certainly extremely high.

Even when we look at a weekly chart of the Decline and Fall of the US Share market during the Great Depression, although this was about a 90% decline in three years, it was still very orderly from a technical analysis perspective. From the initial low that was made from the September 1929 high, there was about a 50% recovery as the Dow rose from about 200 to about 300. We do not see even this degree of strength in the current trend. To match that reaction rally, the Dow would have had to rally to 11,000. The first decline from the 1929 high was about 48%. So far, the decline from 14,198 to about 7400 was also about 47.8%. Yet the recovery is nowhere in sight. Even the election of Obama has had virtually no impact upon the whole world economy.

Dow Jones Industrials
Weekly Spot (1929-1932)





If we look at the current monthly chart of the Dow Jones Industrials, we see a very different sort of pattern from 1929. The main panic decline in 1929 took place in 3 months from the major high, with a 5 month reaction recovery from about 200 to 300. What we are confronted with currently, is what I have throughout the years defined as the "Waterfall Effect" that is a complete type of collapse from what one might call **Exhaustion** following a curved decline. Penetrating the Nov. low, could lead to a drop to 4,000 by 6/09 or 9/09.

Throughout the years of research covering all major economies and civilizations back to the beginning of recorded time, what has always distinguished the end of an era is how the decline unfolds. Spike sharp drops are indicative of corrections within a long-term trend that ultimately survives. When we see the "Waterfall Effect" the decline tends to mark the end of that organized state as we once knew it.

We are confronted with a major shift that could lead to the same mistakes that caused the fall of Byzantium and did destroy individual liberty and **Capitalism**. We are in a battle that may be far greater than anyone dares to think. The fall of China and Russia was phase one of the collapse of **Marxism**. We may be facing the fall of **Socialism** in a battle to the end.

In building databases of all civilizations and using computers to correlate both global interactions and domestic trends, there are certainties that do emerge. It is clear that civilization emerges time and again because mankind is a social animal and seeks the benefit of bannng together in sort of a tribe of nations. But there is also the downside, and that is that civilization created leaders and the self-interest of those in power always is pitted against its own people to exercise and extend its own powers. Civilization is destroyed by the inability of all governments no matter the form it may assume, to spend only what it earns. Every state in history has fallen into a **Debt Crisis** and that has always led ultimately to higher taxes. In the Byzantine Empire, the taxes became so outrageous, they forced the average person to become serfs seeking shelter and to retain a portion of their crops for protection from the state. It was taxation that created feudalism, drove people from the cities to the suburbs, and just led to the **Waterfall Effect** whereby the state became so weak, it could no longer defend itself or sustain its economy. Taxation destroyed civilization and **Capitalism**. There has to be some middle ground before it is too late.

This "Waterfall Effect" was evident also in the Roman economy going into the full collapse that took place between 253 and 266 AD in just 13 years out of 1,000. The economic decline that changes the face of society forever, takes place in the shortest amount of time. The likelihood of Western Society listening before it is too late, is nil! This economy peaked with real estate precisely at - 2007.15. The stock market made a brief rally thereafter, but it was not sustained. However, American real estate has been a unrealistic market funded purely by debt that strangely produces no real national wealth. Purchasing a house creates dead capital. It does not create jobs after its construction, yet consumes capital through financing. Because mortgages have been available for 30 years, the price of a home is significantly higher than in other nations where there is no such a deep market available for borrowing.

The End of Real Estate?

Real Estate has been hailed as the greatest investment of all time - at least post-World War II. During the 1970s, a Porsche 924 was a little as \$10,000 in 1970. By 1980, a Porsche was going for more than \$50,000. People saw suddenly foreign cars as a good "investment" because you could drive them around for 2 years, and still get your money back. The same thing took place in England in 1985. A Ferrari that was \$50,000 in the US, could suddenly be purchased for \$30,000 in Britain when the Pound fell nearly to par with the dollar - \$1.03. Because Ferrari could not afford to sell their cars in England at a substantial discount, they raised the price of the car to 40,000 pounds. However, the pound then rallied back to nearly \$2 as the G-5, formed in 1985, manipulated the dollar lower by 40% to increase trade. Suddenly, that same Ferrari was now selling for nearly \$80,000.

The point I am illustrating with these European sports cars was that the plain fluctuations in currency of 30-40% in a short time period, created the illusion that it was the cars that were the "real" investment, not that it was the indirect swings in the value of currency. The rise in foreign car values throughout the 1970s instilled the image in American minds that a good German car held its value and was thus better than American. This image, created by the decline in the dollar after 1971, produced the age of inflation added to by OPEC. This period in time created the "brand" names for foreign cars and this did more to destroy the American car industry than any other event.

What we must also come face-to-face with, is that the same source of capital appreciation in foreign cars caused by the decline in the value of the dollar, has been the steadfast momentum behind Real Estate. A home purchased in 1955 for \$14,000 at the peak in 2007 rose to \$300,000 in an average town - not the elite. At the same time, a Cadillac was at best \$2,500. The question becomes, after excessive property taxes, does real estate really provide a good long-term investment? Most would just answer yes. But you are being paid with dollar that are far less in purchasing value. Add up the taxes paid, and you find out in real net terms, the same fluctuations in currency that make cars appear to be investments, do the same to housing.

Of course, there are segments of the real estate market to outperform the drop in currency and exceed other areas by 50% or more in "capital appreciation" so to speak. This is the natural business cycle that takes place. You will notice that the rise in real estate after a setback, starts typically in the city. It spreads from that center to the less central portions of the city, and then to the suburbs. As the suburbs are still rising, you will begin to see the core city district peak. That will be the first sign that the cycle is over. This manner in how real estate rises and falls was something that emerged from our studies at Princeton Economics monitoring real estate trend from Europe, America, Asia, and Australia. It always was the same pattern.

But what if the current economic decline is running much deeper and is along the lines of the Great Depression insofar as the total collapse in real estate values? Today, the cycle is far more volatile because of the widespread loans on real estate that did not exist during the Great Depression as it does today. The length of debt on mortgages post-World War II is far greater than what existed in anytime during the past. As banks were willing to lend for 30 years, this drove the price of housing up to meet the available cash. If there were no mortgages and property could trade only for cash, the value would drop substantially. So it has been the availability of money that has also accelerated the value of real estate.

It was the S&P Real Estate Index that peaked precisely with the **Economic Confidence Model** on 2007.15. This is the target market that will see the greatest fall. We are now

facing a very serious possibility that the decline in real estate may not be over for at least 4.3 years into 2011, but the more likely scenario of a minimum of 10 years with the outside shot it will never again be an "investment" as we know it.

How could real estate decline for so long? The two contracting factors that are conspiring against real estate is (1) the **Debt Crisis** cutting off available capital to keep the bubble expanding, and more importantly (2) the collapse in state revenues. The states and municipal districts rely upon property taxes. The greater the mortgage crisis, the greater the foreclosures, and that suspends the tax revenues as well. This causes the collapse in state and local revenues forcing states to raise taxes even higher and this is precisely the combination of a **debt crisis** that ends societies and has been the destroyer of civilization. When it goes to extremes as it did in Byzantium, it even destroyed **Capitalism** reducing the average worker into a peasant who was forced to sell himself, his family, and future children into servitude just to survive.

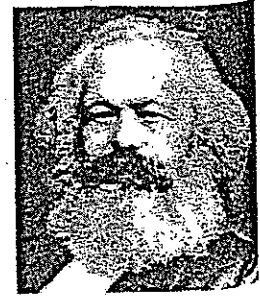
I am not yelling "fire" in a movie theatre. If we understand the possibilities and how things fall apart, we can exercise a choice and correct them. If we live in total ignorance, then we will make the same mistakes as everyone else who went before us. It is time to be responsible. But that does not mean dismissing out of hand any argument against raising taxes as being "**Republican**" and as Obama has pronounced, those theories have proved to have failed. To set the record straight, failing to police the police has caused this problem, not lowering or raising taxes. The system is corrupt to the core and when you allow Government Attorneys to be immediately hired by those they are supposed to be regulating, there is no regulation. This has nothing to do with "**Republican**" failed theories of lowering taxes. The Republicans failed because they abandoned the economic conservatives and adopted the Religious Right that is nothing more than the same old policies of the South.

Corporations have left because (1) taxes have been too high, and (2) Congress has been filled with too many lawyers who block tort reform that has allowed the health care costs to rise to insane levels. These mistakes were made along with persistent deficit spending that depreciated the value of the currency giving rise to the sheer image that foreign products are better, and then we have the insane policies of the Federal Reserve that began under President Carter to raise interest rates to fight inflation of the 1970s. The one small problem, they had to repeal usury laws that allowed credit card debt to rise at interest rates of 20% or more. This has led to profound economic long-term decline for it took from the consumer a greater proportion of income and diverted that toward the banking industry. The more than doubling of interest expenditures in household income is the root cause of economic decline. Just in the last 20 years, consumer debt rose from 50% of GDP to 100%. And now we want to blame Republican tax policies? Let us stop the bullshit! Fess up to the real issues and we need less lawyers in Congress and more practical people. What about those term limits that were suppose to restore a citizen government ending the us against them?

The **Obama Stimulus Package** will fail. It is not likely to cause inflation and we may not even see interest rates rise. The economic implosion is running in the trillions of dollars and even if we spend \$1 trillion, it will not accomplish much more than pissing in the ocean. We are not living in a gold standard. We are still facing the economic implosion that may not see a rise in interest rates due to the **Stimulus Package**, but if there is going to be a rise, it will be because capital is being cut-off so rapidly, that economic implosion sending interest rates higher as mortgages reset.

We must also understand that borrowing capital will take funds out of the economy depriving capital formation from restarting the economy. If capital still flees to the Government bonds rather than invests, this will be strangely deflationary. Additionally, if the dollar continues to rise, this will signal international flight to quality and the interest expenditures will be exported and even that will not stimulate the economy in the United States.

We are standing on the edge of a cliff in the middle of nowhere. The hatred that spilled out of the mouth of Karl Marx has led to this battle between freedom and the control of individuals that is **Capitalism v Communism/Socialism**. We must ask our politicians a very important question - **Quo Vadis?** (Where are you going?) To date, the answers have been more of a riddle, or in latin - **lucus a non lucendo**. In other words, we get a paradoxical explanation that is of something that is the opposite of what it suggests. What we must fear the most, is also what the Romans called - **lex talionis** - the law of retribution. We must now also ask, **quis custodiet ipos custdes?** (who shall guard the guardians?)



Karl Marx

Laissez faire (doctrine that opposes government intervention) is dead. We will not hear this again until Western Civilization collapses. The idea of smaller government and the dream of Thomas Jefferson, Benjamin Franklin, James Madison and others, has expired and vanished into the night suffering what Horace called - **Pallida Mors** - the pale death. Any solution that somehow excludes government, will never be even attempted. What Marx failed to realize, it was not a battle of classes, it has always been the battle between government and the people. No matter what happens, Government will always blame the private sector and never admit mistakes. Out of self-interest, it will hunt down those in the private sector to sacrifice in the public square.

Any solution must include Government because it is not going to go away no matter what happens unless society itself expires. The best we can hope for, is a brief moment of enlightenment. This **Economic Depression** is unstoppable, regardless what government says. I remain **nil admirari** - unimpressed with the nonsense of the **Stimulus Package**. Even if it did work, by the time it has any effect, it will be election time. Jobs are not created out of thin air. It requires something different in the private sector than working for government. It requires a demand and confidence that increasing production will find a willing buyer. Government policy is to hire, but the quality of the work means nothing.

Unless we restructure the taxes, restore our international competitiveness, jobs will continue to leave. Unless tort reform is imposed, there will never be a national healthcare service and corporations can no longer afford the benefits. Even states and cities are starting to implode for they have promised much to workers, but always ran their own **Ponzi** schemes taking money currently to pay past obligations. We are facing a harsh reality that governments have expanded assuming resources would always be there, but that day has now arrived. Horace also once said:

naturam expellas furca, tamen usque recurret

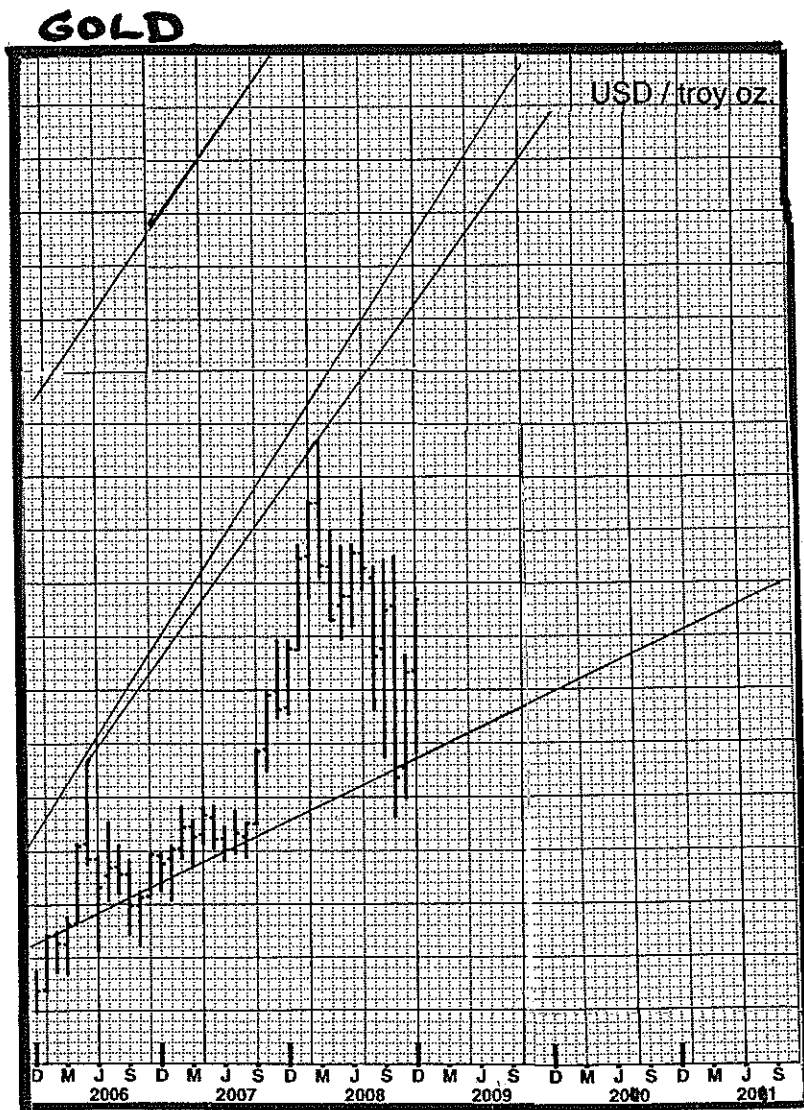
(Horace 65-8 BC)

Horace said though you may drive nature out with a pitchfork, she will keep coming back. The same can be said of the nature of mankind. We can cling to **Marxism** for it points the fingers at the so called rich, who are always defined strangely as the guy next door who just has a little more than I. This is no different than Nero (37-68AD), who blamed the Christians for the burning of Rome beginning a period of the next 300 years or so of presecution - that just happened to be good sport to keep the people occupied establishing the policy **panem et circenses** (bread & circuses). Marx has been responsible for more deaths than even Hitler. Don't forget the millions who died in Russia under Stalin and those in China all in the name of forcing **Marxism** down the throats of the people. **Socialism** is a form of **Marxism** that Western politians have used to further their own power. We can create the benefits of civilization and cooperative alliances without destroying our liberty. We are on the edge where the way of life may

be altered forever. We must open the door to all solutions and judge our future without bias and prejudice. It is time we recognize **Marxism** for what it is - the most dangerous theory of all time that may destroy now Western Civilization. The more Byzantium could not cover its debts, the more it became aggressive against its own people that in the end, destroyed capitalism and freedom itself. Marx gave us the only alternative to **Capitalism**, and that he called **Communism** that was just a false dream of utopia where everyone works for the government, the government takes care of everyone, and in the process, you not merely sell your soul, you give up your right to be an individual. The Western Culture has flirted with **Marxism** because politicians see the power belongs to them. **Socialism** is no different, for it is trying to be just a little-bit pregnant. It still involves centralized planning of the economy that cannot be done by people who have never worked in the real world.

Is Gold Trying To Speak?

Gold has been the best performing investment on the board. It has continued to make new highs in all currencies but the dollar, but even there it is holding on like a politician in his right to control the lives of others. While production of gold was expanding dramatically going into the 1980 high of \$875, today, South African production has been dropping like a stone. South Africa is no longer the leading producer in gold and just as demand is rising, the production is falling.



From a pure technical view, the breakout line from the 1999 low stood precisely at \$718 last October, and provided the closing support. Once exceeded, it was penetrated only during Sept/Oct of 2006 on a monthly closing basis and has held nicely for this '08 reaction low. This technical line moves up to about \$810 by the end of 2010.

Near-term, if we see a real **Waterfall Effect** in the Dow Jones industrials going into June 2009 where a collapse takes place back to the 4,000 area, we may see a corresponding high or a major key turning point in gold also for June 2009. This does not appear to be the major high, but we may see a shocking punch upward with a new thrust. If gold breaks-out to new highs going into June 2009 as the Dow makes a major low, there could be a 5 month reaction low forming by November 2009, with a rally thereafter into about April 2011 for the intraday high, but leaving 2010 as the highest close annually. Gold would then reverse perhaps, but this may be due to Government intervention at that point in time.

Gold still appears to be headed to at least the \$2,500 level by 2011. Exceeding that area before the end of 2009, would open the door to a potential rally even up to the \$5,000 level. Please keep in mind, this is a relative forecast. That means the dollar would be little of its former self. What we are honestly talking about is the collapse of our Governmental infrastructure not so different from Russia. In plain words, Russia could no longer sustain its control of the economy because it was broke. We are approaching the same problem. Just because we have been always able to borrow and never worry about what would happen when the day comes that the well is dry, does not mean we have a bottomless pit.

A very minor technical projection shows resistance for gold scaling in from the 1,100 to 1,200 level for 2009. Breaking through this technical resistance area will signal that we are in a very serious economic implosion.

C O N C L U S I O N

The reverse side of the Seal of the United States has a interesting Latin saying that was part of our inheritance from the **Founding Fathers**. They recorded their belief in the history of man - **Novus ordo seclorum**. What they recorded there was what they believed they were creating - a new cycle of the ages. The men who had the courage to stand against the tyranny of Government, believed that the American Revolution was a dawn of a new age where the cycle of fortune had completed its revolution and it was now **Just Time** to establish a new world order without kings. And what was the saying that more than any other reflected their wisdom?

No Taxation Without Representation!

Thomas Jefferson believed in cycles. He doubted that the United States would even survive beyond 100 years. He was correct. The dream they created fell with the theory of Karl Marx that was adopted by the American Government with the passage of the Income Tax in 1909 that required amending the Constitution to say, Jefferson, we disagree and it shall no longer be in our people and God that we believe, but in the self-interest of Government and Karl Marx. The prohibition against direct taxation was eliminated in 1913. With that came uncontrollable borrowing, spending that always exceeded revenues, and interest paid to foreign lands no different that Spain to its Italian bankers that wiped out both nations and shifted the core economy in Europe to the North, eagerly seized by the Dutch.

Jefferson even believed that revolution was a necessary part of the long-term cycle, for he wrote that the **Tree of Liberty** required to be fed with the blood of tyrants and patriots. We have so far avoided that outcome. But the cycle is still very young.

I believe that our future remains ours. History repeats because we ignore the lessons it offers. To look into the flame and know that its power to burn exists, does not mean we have to stick our finger into it just to see.

We must stop the bullshit. We must open our minds and understand the nature of mankind cannot be altered by passing laws. Marx is dead, and his ideas have to be allowed to die. The class-warfare must stop. Ironically, China has no debt, nor does it have an income tax. Yet China has been exploding in economic growth rising to the second largest economy faster than the United States ever did. This is part of the cycle of volatility. The very design of the **Founding Fathers** is by default alive and well. All China has to do, is pay attention on domestic growth and expansion, and it is now ready to replace the West and assume its historic moment to emerge as the center of the world economy. China has rejected Marx. It is now our turn to learn the same lesson.