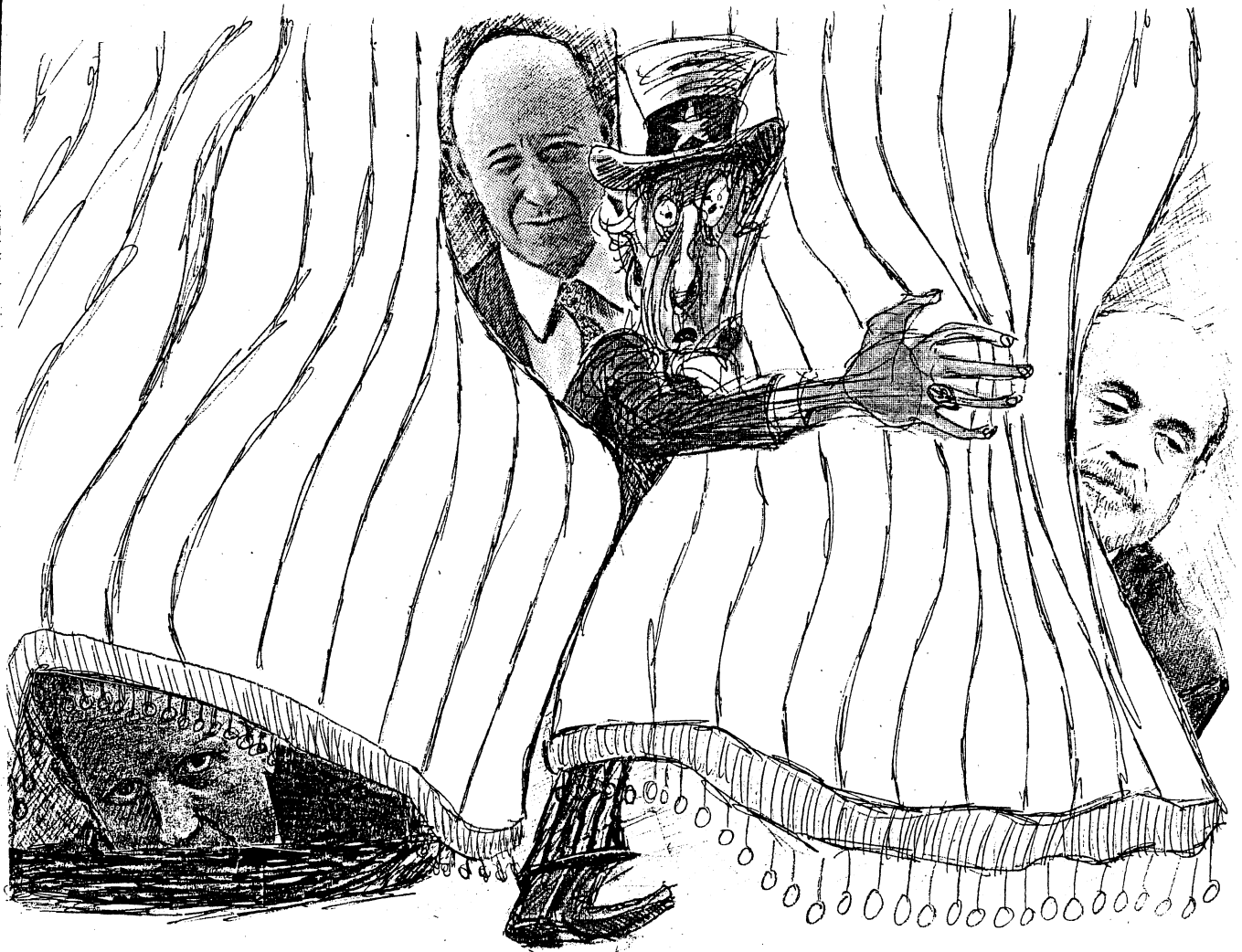


Behind The Curtain

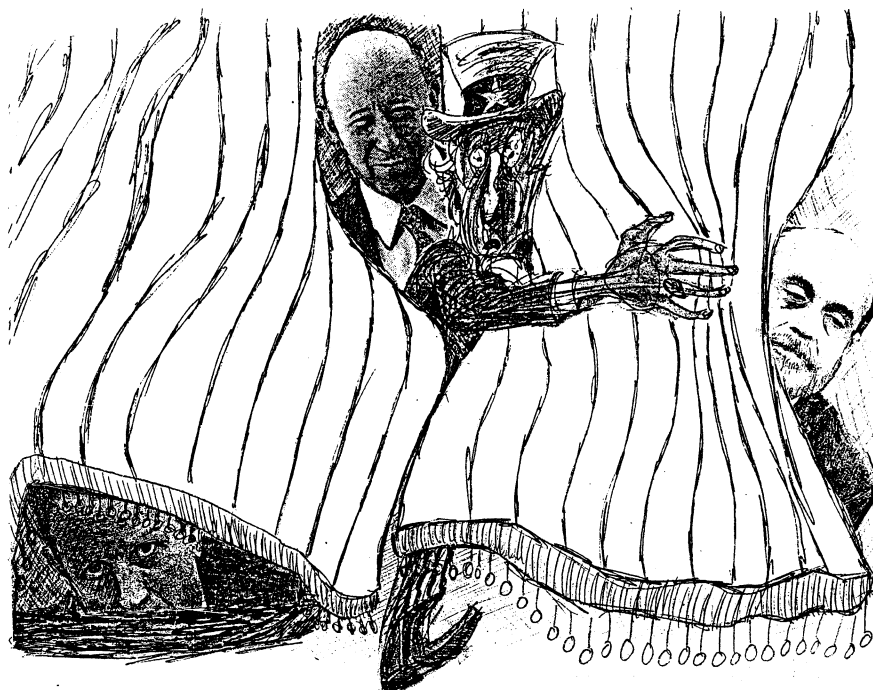


The Full Monty PART ONE

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

Behind The Curtain

The Full Monty



by: Martin A. Armstrong

Former Chairman of Princeton Economics International, Ltd.
and the Foundation For The Study Of Cycles

IS GOLDMAN SACHS THE EVIL EMPIRE? That seems to be the question that a lot of people have on their minds. There is far too many coincidences with ex-Goldman people in strategic political-appointed posts to just be overlooked. Congress and the nation are mad as hell at the Federal Reserve and at the very minimum, it will be stripped of its so called consumer-protection power that it never took very seriously anyway. Yet through all of this, remains a growing resentment outside of the professional community as well as inside, that wants to storm the castle walls of Goldman Sachs and destroy everything it stands for as if it were the creator of an evil Frankenstein. In the very least, this particular turn in the economy was centered directly within the finance industry that has been giving the rest of the more standard investment community a very bad name. For no matter who writes what, the whole lot is being thrown into the same bath-tub and labeled "Wall Street" as if it was pure evil. The Rolling Stone Magazine called it the Great American Bubble Machine arguing that Goldman Sachs has been behind every major bubble since the Great Depression. I have called it the "Club" that what has evolved is a persistent desire to just manipulate markets to create the perfect trade. It is time we explore this in detail for what has been going on Behind the Curtain is threatening everyone and even the future of our children. But make no mistake, it was NOT the Federal Reserve who was to regulate the Investment Banks, that was the Securities & Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC"). The Fed regulated commercial banks, not investment banks. They got involved in the bailout, but let us lay blame where it really lies - the SEC and CFTC who have wiped out your future.

You cannot fix something that is broken unless you understand what is broken. I have often warned of the Paradox of Solution that I have named a fascinating trend whereby the evil seen to create a economic event is then attacked and the solution created thereby establishes the cause of the next event and so the next solution is to go back to what previously existed creating a pendulum move

that becomes a natural cyclical swing back and forth between these two solutions. Thus, I have called this cyclical trend the plain Paradox of Solution. The solution for the Great Depression, was to create a separation between investment/speculation and banking. Thus, Investment Banks were regulated by the SEC and Commerical Banks by the Fed. This solution was reversed in this crisis.

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EVER in my wildest dreams did I ever expect to stumble upon such an inherent corruption that evolved without any true understanding of what it was evolving into. There existed this desire to rig the game of chance and to ensure that every trade would be a winner. Losses and speculation; well that was for the little guy. Yet in what I have witnessed over decades, began to bubble-up into the surface during the **Asian Currency Crisis of 1997**. I found myself in a position **BEHIND THE CURTAIN** where foreign governments were starting to notice and it was starting to appear that the United States had been

either sublimely blind, or completely ignorant of its own manipulation. My deep concern is that the vast majority of what people call **"Wall Street"** is getting a very bad name because of a small group of very sophisticated specialists in market manipulations. My purpose here is to bring to light what I, and others, had been watching progress for nearly two decades. I personally believe in the **"Free Markets"** and by that I mean a system that is also not rigged and manipulated by private or public interests. Russia and China tried their hand at Communism. That failed of its own inherent fallacies and that was the result of **"Free Markets"** that will always triumph. Nothing, public or even private, will ever prevent the natural course of events to unfold. Man can pass all the laws and regulation he desires, but he cannot change human nature by decree. No law will prevent a murder, nor a war, nor taking a drink, trying drugs, or engaging in premarital sex. Human nature cannot be changed no matter what. It can be suppressed by sheer tyranny and force, but it cannot be altered. We cannot progress as a society until we understand what our true nature is, how it will always gravitate to self-interest be it government seeking power against its own citizens, or private self-interest to rig the game. We must understand that it is not **"Wall Street"** as a whole that is the problem. We can regulate them to extreme, but the ones who created this mess control the real strings of power and will never be touched no matter what the propaganda claims. I am concerned about our future and do not wish to see my children and grand children lose their future for the real corruption of rigging the game will lead to the only resolution possible - war! If the US courts and government are now so corrupt and only care about the moment, then there are plenty of people around the world who are mad-as-hell at the United States and will reach that point of no return. It is time we face our demons and bring real reform.

The Age of Enlightenment

We cannot begin to fairly review what has taken place without understanding that the **Financial Industry** that is unfortunately just called **"Wall Street"** is far from one giant industry. Today, we have prolific industry that has truly evolved since 1971 in a dynamic way that has on one hand built the status of the United States, and on the other, has contributed to its diminished respect internationally. We have no choice but to take a phlegmatic approach and stop the name calling in order to step back and look at the industry that has emerged.

The socialists point to **"Wall Street"** as the paragon of capitalism. It is a thing that must be tempered and controlled, if not destroyed and subordinated. There is no

doubt that **Goldman Sachs** is at the center of this storm and is the image that is now becoming the most hated symbol of the full scale economic decline. But we must look at even **Goldman Sachs** within the context of the whole.

What I have never seen explained in any book or newspaper article, is the strategic difference that emerges from a trader who is nursed on commodity volatility compared to stock trading and banking.

There are THREE areas that are very distinct within the financial industry that are far too often all lumped together and called **"Wall Street"** where the ethics and thinking is substantially different.

- (1) Banking (Commercial)
- (2) Stock broker/Investment Banks
- (3) Commodity broker-dealers

These are the three areas of primary divisions that the press and public often lump into one giant category known as "**Wall Street.**" There are naturally subdivisions within each. One significant subdivision in each category is **FUNDS MANAGEMENT** that can range from estate trust management in banking to mutual funds with a host of divisions from bonds, tax-free bonds, stocks, with another multitude of smaller divisions thanks to the regulation that makes no sense. Then there is the commodity fund that can trade in futures that span the whole spectrum, and then there is a fourth international category.

- (4) Off-Shore Hedge Funds.

In this offshore world, there can be the freedom to cover all three primary areas that is illegal domestically thanks to over-regulation. For you see, there is no just one regulatory body covering these three primary areas, but three, Federal Reserve, SEC and CFTC. It does not end there. When you start to get into things like mortgages, there are about 7 regulators that now get involved. It cannot be forgotten that each state also now has a host of regulations and agencies. There are so many regulators, that the recent huge collapse demonstrates it is not the **LACK** of regulation, but the inability of regulators to even work together.

Then there is a fifth category that has emerged as also a player thanks to evolution of the entire industry - **INSURANCE**. Now we have the evolution of insurance that is in fact taking on the mantle of options and has mimics the derivatives until they became the derivatives CDS that collapsed the house of cards.

The knowledge base that emerges from each sector is very different. I was once a board-member of a state bank and that is really just administrative looking at loans. Stock brokers are immersed in fundamental analysis of PE ratios & Fed watching so we have "**insider trading**" emerging from the assumption of information creates winning trades.

It has been this idea that markets are driven by fundamental analysis that can be reduced to a single cause and effect, that dominates the stock industry and has led to the criminalization of possessing information that someone else does not have. Yet, I have seen so called **inside information** have no effect and at times they still lose money. **Inside Trading** was indeed turned on its head by Guilliani in order to prosecute Mike Milken. The real theory of "**insider trading**" emerged from the Great Depression. It was based upon a director who knew the company was bankrupt, sold his stock withholding that news, and after he was out, he then publicly announced the stock was worthless. To prosecute Milken, the theory was reversed claiming he had some advantage and would make a fortune taking over a company. But the fraud in the 1930s was that the people lost money while the director did not. To become famous and destroy a major competitor of New York Investment Banks, **Drexel**, the new theory was that Milken defrauded people out of the **same opportunity to make money!** The Southern District of New York Federal Court clicks their heels before walking to their bench and salutes the Attorney General giving him whatever he wants, even when it will destroy the very fabric of our society. Judge Kimba Woods, accepted Milken's plea knowing he was coerced by threatening his family including a 90-year-old grandfather. But judges do not care any more about the people or the country. They only further the goals of the political state no matter what. Thus, thanks to Kimba Wood, **insider trading** is now making money based upon some info they claim no one else has. Yet, there is no empirical evidence that even with such info, there is a 100% guaranteed trade.

The third area is **Commodity Trading** that includes currencies, bonds, stock indexes, metals, energy, agriculturals, and building materials such as lumber. Here we have a training ground for real experience. These are markets that trade globally and forces one to look outward rather than take a very myopic view of the economy. Where stock brokers are focused on domestic issues both in respect to the individual company as well as Fed watching, the commodity broker must be able to walk, talk, and chew gum while reading headlines globally to stay in touch with the pulse of the world. If he can't; he's history.

The banking, stock, and political areas all feed upon themselves. They live in a bubble and thus each of these booms and busts, indeed produce the same mistakes each time, just that the instrument they are hawking may change. I have been called in far too many times by both banks and stock brokerage houses around the world to help fix some disaster and it is just always the same MO. The instrument changes, but the effects never change. This I noticed cross-culture. From the Middle-East, Europe, Japan, Australia, Asia, it was always the same thing. Professionals buying the high every time. Why? I concluded they lacked the experience to "smell" a top when it was there. They would joke at the retail "little guy" yet they never got it right once. This crisis, is NO different!

Yet, while the most dynamic traders are emerging from the commodity side, we are seeing a lumping of presumptions of a quality of knowledge and experience that does not exist. It is like saying someone is a doctor, so here, operate on this brain overlooking the fact that he is a foot doctor. Calling everyone "**Wall Street**" is a huge mistake.

When we look at the fund industry, here too we find a landscape of so many different funds it may appear to be a used car lot. The domestic funds are specialized from bonds or commodities to stocks in all sorts of different categories. What the public does not realize, this has been caused by OVERREGULATION where we have the SEC, CFTC, and the Fed all with separate powers. A fund manager cannot do his job domestically by you hiring him and he then decides what is the best area to be in. The average individual has to have the expertise that most professionals lack themselves.

This is why the CFTC hated my guts. I have been advocating that it be merged into the SEC creating a single agency. That would have allowed a fully diversified public fund that in fact would have been an onshore hedge fund.

While the United States would never once listen to me, I agreed to do such a fund for the Australian government. I managed the first ONSHORE hedge fund in the world organized by Deutsche Bank and the Australian government monitored every trade as a test case.

Hedge funds are such diversified funds where you are hiring the manager because he has expertise that will make the decision of what to be invested in. Because of the over-regulation, if you obey the laws of the CFTC, you go to jail with the SEC. This is why I was warning that these competing agencies would drive the industry offshore back when the biggest future fund was \$100 million in 1985. Today, we have trillions of dollars in offshore funds thanks to overregulation. Now, the collapse of the rule of law making it impossible to get fair trials in New York and the crazy over-regulation that came out after **ENRON**, New York lost its status as the financial capitol of the world. With what is coming now and having so many agencies in public argument over who should get the power to regulate banks, you can bet on one thing - they will destroy Wall Street and the smart companies are starting to look at getting the hell out of here.

The socialists will never listen. They will laugh at the idea of over-regulation and argue there is not enough. But this is to be expected from fools who know nothing about an industry they claim needs more regulation. For you can bet on one thing, they will destroy what was not the problem, and leave loopholes for those who contribute to their campaigns. So the only one who will lose is the little guy who already has to have the expertise of a major international hedge fund watching every country around the globe on a 24 hour basis. **Good luck!**

Stock brokers no more deserve blame than commodity brokers or commercial banks for the most part. The blame rests squarely on the shoulders of the **Investment Bankers** who constantly come up with schemes to make a fortune, and always explode in disaster. This time, they picked the biggest sector of investment that effected everyone - the old mortgage market. By pooling mortgages, they removed the traditional restraint of caring about who you are lending to, and what is it you are lending on? That gave the front-line lenders the signal to "don't worry; be happy" for this is going into a pool and we expect some defaults, that's OK! The one-on-one relationship was destroyed. Then they took these pools and sliced-&-diced them so that nobody really owned a mortgage in the legal sense. A borrower could now demand to show him the certified mortgage, and in many key cases, it cannot be produced when pooled.

OVER-REGULATION

OVER-REGULATION has done far more harm to the public than the Government will ever admit. The average person has been stranded in an eternal sea of change in finance that has seriously diminished their capital for retirement. Many people have counted on the equity in their home to be their nest-egg. Now, that largest market has been wiped out because of the stupidity of the SEC who has persistently got down on its hands and knees and kissed the ground that **Goldman Sachs** walked on. But they did the same before that with noted **Salomon Brothers** because the government hires people who are generally incapable of getting first rate jobs in the private sector fresh out of school. The model for training is reversed. Fresh graduates gravitate to the government to get experience so they can look good when shopping for a real job. Those who remain in government service, are unable to capture one of those jobs and become embittered toward anyone who has made it in the real world. The big law firms will often hire former government attorneys more as a due payment than anything else. They buy influence with the departments and agencies and that will often translate into immunity for the big houses.

We have too many chiefs and no indians as the saying goes. One of the primary reasons the CFTC hated me was I advocated that they be merged into the SEC back in the 1987 Crash. I was asked does an agency really harbor resentment for decades? The answer is yes! Look at the case of Health-South where Mr. Scrushy beat the government and was acquitted of all charges. They then indicted him for giving \$250,000 to the Governor of Alabama they claimed was to bribe him to be made chairman of a committee that had no monetary gain, but prestige. The US Government remembers everything and you will never escape. Beat them, and they will hunt you down and call it something else. You are dealing with one of the most vindictive cultures in power in the world.

The greatest danger any prisoner faces is when he is about to be released. If there is anything else the government can try to charge you with, they do so on the last day to prevent you from ever leaving. Russia just followed the US model with the Yukos prisoner now charging him with money laundering after serving 8 years. They did that to Kondratieff. His first sentence was up, so they charged him with something else, found him of course guilty, but then just took him out behind the courthouse and executed him after sentencing him to 7 years, because they just didn't want to release him.

Look at John Gotti, Jr. He beat them on trial and walked out. He had at least a reasonable judge who saw the government was using him as a name to further personal car-

eers. This time, he will be tried by Judge P. Kevin Castle. He will not receive a fair trial in the least. The US Government is no different than Russia. They must always win and if you do beat them, they will hunt you down until they win on something, it does not matter.

A lawyer friend of mine Chris Lovell use to practice before the CFTC. He told me all the nightmares of how they treated all defendants. In 1987, I was asked to testify against the CFTC in Congress. I called Chris and told him I could get him before Congress and just tell them what all lawyers talk about behind the scenes. He declined telling me his business would be prejudiced for the CFTC would target anyone he represented to drive him out of business. He then advised me not to testify. If I did, he warned, they would never forget.

This is the real behind-the-scenes life with regulators. They are relentless, and will NEVER yield to the truth. It is all about winning and they WILL do whatever it takes to win.

In a SEC case of Mr. Schiffer tried before Judge Richard Owen in New York City, he was the first one who had his lawyers taken away by the SEC using the civil label to deny counsel. Judge Richard Owen has a reputation of being one of the worst judges in the country. (See Three Felonies a Day). Not only is this the tyrant that threw me in contempt for more than 7 years, but he was also the Judge in Frank Quattrone's case.

While I was in court and the discussion was about taking my lawyers away, Judge Owen kept making smart-ass remarks about Schiffer and how he never "took it upstairs" to argue what Judge Owen did was illegal. He would constantly make jokes and more-or-less then laugh. When I turned to my lawyer Martin Unger and asked "Who is this guy Schiffer he keeps joking about?" The reply: "You don't want to know." I insisted he tell me. It had turned out that Schiffer committed suicide after all his lawyers were taken away for he could not deal with the SEC and Judge Owen who together relentlessly tortured the poor guy in a CIVIL case until he couldn't take it any more, mentally.

It became clear to me that transcripts of court hearings were being altered. Then the Second Circuit Court of Appeals came out and was forced to address the fact that the judges in the Manhattan Federal Court had in fact ruled in their own favor that they could now create a "'standard practice' in the Southern District is for a court reporter to submit the transcript ... to the district court before releasing it to the parties. ... The district court is free to alter the transcript without disclosing such changes to the parties." US v Zichettello, 208 F3d 72, 97 (2nd Cir 2000) decided March 30th, 2000. The real amazing fact is that both the Supreme Court and the Court of Appeals are suppose to supervise the administration of justice. NEITHER of these high courts protect the people or the Constitution. This decision was appealed to the Supreme Court, and they refused to accept it. The Second Circuit had the audacity to indeed print in their opinion

"Nevertheless, whether we have the power to order a change in such a practice is unclear. ... However, we invite the judges of the Southern District to consider revision."

Id./at 98

They declined.

I began keeping track of what I would say in court. I would read specific things from notes laying on the table to ensure the words I spoke would be in the record. When I got the transcripts and found what I would say or object to to establish a right to appeal removed, I just gave up. It was clear I would NEVER receive a fair trial and I wrote a letter complaining about this sham to Dorothy Heyl, the SEC lawyer at the time. I told her, if you people can change the words I speak in court, why don't you just alter the transcripts and claim I had confessed and get it over with? She never replied. So being pist-off at how corrupt the entire process had become, I put in an affidavit sworn under penalty of perjury so if I lied they could have prosecuted me and given me 5 more years. I outlined each transcript that I believed had been changed and asked for the recusal of Judge Owen.

While we can never be a judge over ourselves, judges can be. The passage below is what Judge Owen said in court that day judging his own actions, and claiming while he did change my transcripts, he did not remember making any major changes so he acquitted his own actions. I appealed that to the Second Circuit, and they slapped it down admonishing me that they would never want to revisit this issue again. So much for unbiased courts.

But my allegations swirled around New York. That day in court, the place was just packed. I was told by the court appointed counsel in the criminal case, I was crazy. You can't accuse a federal judge of such things. I said I didn't give a damn anymore and let the truth come out. Judge Owen was so intimidated by so many people there he knew included the press. While no one had the guts to report those events since it seems even the press is scared to death about judges, they knew what was going on now for I was the first to ever get a judge to admit he was altering the public record.

JUDGE RICHARD OWEN:

"I don't remember ever making any change to a transcript of any substance whatever. I may have stuck in a coma, I may have stick in a dash. But I don't remember ever changing anything of substance."

(99-Civ-9667 SDNY; Tr; 9/23/03, p45, L7-11)

The courts are so dishonest, the SEC was able to get their cases before Judge Owen to ensure their victory. Judge Owen had also presided over First Jersey Securities, a brokerage house that had taken too much business away from New York. There, the SEC asked the court appointed staff to investigate First Jersey Securities to see if they could find anything else that should be then charged. This is totally illegal for the court is suppose to be impartial. The lack of any Rule of Law is illustrated by the reversal of Judge Owen and his investigation.

The SEC managed to get the criminal trial of Frank Quattrone of First Boston also before Judge Owen. Andrew Sorkin of the New York Times covered Quattrone's case and because of my confrontation with Owen, the press was paying very close attention to what Owen was doing with the transcripts. The Second Circuit had the audacity to even admonish the press for their critical coverage of Judge Owen claiming they misunderstood events in court that they reported which were not in the transcript.

Andrew Sorkin came to visit me in MCC to discuss Owen. I went over the whole thing about the transcripts. The Second Circuit was hit by even amicus briefs (independent groups) calling for the recusal of Judge Richard Owen. The Second Circuit will never rule against a judge and with all the public outrage over Judge Owen, they had the true audacity to write: "we do not find evidence that the trial judge made any inappropriate statements leading us to seriously doubt his impartiality." US v Quattrone, 441 F3d 153, 192-193 (2d Cir 2006). The Second Circuit nonetheless, stated, "[w]e conclude that the better decision is that the case be reassigned to another judge upon remand." Ibid.

While Federal Courts always protect the judges and they know they are free to do as they please, the Second Circuit also had the sheer audacity to criticize the press, who was even naming the offender, Mr. Sorkin at the New York Times.

"In attempting to argue that numerous media commentators noted the allegedly biased conduct of the trial judge, Quattrone cites only one newspaper article in the text of his Opening Brief ... However, the very article that Quattrone employs to establish

improprieties has at least one material mischaracterization of the court's trial management. The article claims that Brodsky testified upon cross-examination 'No' when asked 'Did you think he [Quattrone] had done anything wrong?' See Andrew Ross Sorkin, A Shift in Testimony in Ex-Banker's Trial, N.Y. TIMES, Apr. 23, 2004, at C3. This characterization was completely accurate ... What was inaccurate, however, was the next sentence of the article: 'The judge ... immediately struck the answer from the record' Sorkin, supra, at C3. The record clearly reflects that upon objection the trial judge allowed Brodsky to testify 'No' but instructed the witness to move on without providing further commentary."

Quattrone, 441 F3d, 192 n.41

I gave up trying to get Judge Owen recused. Finally, the Second Circuit would not recuse Owen directly in my case, but then on its own realizing that the world was looking at how ruthless the American Justice System had become, wanted to avoid any controversy and to my shock and others, recused Judge Owen merely stating:

"[W]e believe that on the seventh anniversary of Armstrong's confinement, his case deserves a fresh look by a different pair of eyes. We therefore direct the district court to reassign the case randomly to a different district court judge on remand."

Armstrong v Guccione, 470 F3d 89, 113 (2d 2006)

I remain convinced that the SEC controlled by favor who their cases were assigned to and that was Judge Owen. To make matters even more suspect, it was the SEC who requested that it wanted Alan Cohen to be appointed as receiver who was a personal friend of Judge Owen's and his personal former law clerk. If this was not a conflict of interest for anyone else, such conflicts are standard in courts of law.

The Senate Judiciary Committee will just NEVER investigate judges, so they know they can do as they like for they are above the law. The only judges to ever get prosecuted are those who defend the Constitution and the people. If they are pro-government, the government will never criminally charge a judge who rules only in their favor. Citizens have no right to file criminal charges in the Federal system.

The SEC also amazingly got their case against First Jersey Securities and Robert E. Brennan before Judge Owen and denied him a trial before a jury holding a bench trial before the notorious Judge Owen. Naturally, Owen ruled in favor of the SEC ordering that he be disgorged of profits he held were in fact excessive in selling 6 securities to the public in the sum of \$22.2 million and to pay \$52.6 million in interest, on conduct it alleged between 1982-1985. But the SEC asked the court to appoint its own judicial officer to investigate calling him a special agent. This was in complete violation of the Constitution, which the Second Circuit had acknowledged, but would not reverse the case. (see below).

There is a very distinct pattern that the SEC will bring cases in New York, not where the alleged offender actually resides, in order to win at all costs. In my case, the accounts in question were in Philadelphia, not New York. Drexel Burnham was a Philadelphia firm. REFCO, a Chicago firm, and Quattrone worked at First Boston. The First Jersey Securities case against Brennan was also a New Jersey entity. Don't forget Mr. Ebbers of WorldCom. He too was put on trial in New York.

Strangely enough, the ONLY big case brought in Manhattan against a Manhattan firm was Madoff. But he blew up and there was no choice. I have spoken to members of the Press who (1) know that judges in New York alter the public record to win cases, and (2) only prosecute outside firms. You will NEVER see any New York firm prosecuted like Goldman Sachs, J.P. Morgan, or any of the major firms unless a bigger firm has them tagged. New York will NOT eat their own and the best way to describe it is "You don't shit where you eat!". The editors of the major press will NOT let journalists even write about this. You would think that altering transcripts is significant enough to warrant front page coverage when you have

actual acknowledgement in writing, and it amounts to a Federal Crime meaning that the judges involved could all be arrested and put in prison themselves.

18 USC §1506 Theft or alteration of record or process;

"Whoever feloniously steals, takes away, alters, falsifies or otherwise avoids any record ... Shall be fined under this title or imprisoned not more than five years, or both.

The serious danger that lies in this collapse of the rule of law, is that it is just for sale. This gives many great concern that the Federal New York Courts protect the likes of Goldman Sachs preventing ever any case against them. Indeed, a major class action lawsuit was filed in New York against Merrill Lynch. It was taken by Judge Pollack who wrote a huge opinion dismissing the case preventing the little guy from ever having his day in court against a big New York firms.

Most of this is circumstantial evidence that nobody can prove without an investigation that the US Senate will never authorize. So where circumstantial evidence is good enough to criminally prosecute citizens and toss them in prison until they die like Ebbers, it is not sufficient to prove to the Senate that if it walks like a duck, talks like a duck, just maybe it might be a duck and not a cow.

Stepping outside of Manhattan destroys the conviction rate in questionable white collar cases. Look at the case of Keating of S&L fame was criminally prosecuted on the theory he sold bonds KNOWING that 7 years later he would have to file for bankruptcy. He was the sacrificial lamb for the S&L Crisis and when his case was overturned, the government tried to reindict him. There, the court held it was a political prosecution and dismissed the case. Rest assured, that would NEVER take place on the East Coast where the courts have been stacked with mostly former prosecutors acting as reborn judges.

"The district court... stated that it was convinced that the violations pleaded and proven with respect to the six securities ... were but 'the tip of the iceberg.' Citing its general equity powers, the court stated that a Special Agent would therefor be appointed to investigate ... the possibility ... that the SEC had not pleaded or proven [other frauds]. ... the court itself ... has authority to make appoints [but] [t]he appointment of a Special Agent ... is not for the purpose of assisting [the SEC]... We do not regard the appointment of an investigator, whose instructions are to unearth claims not previously pursued by the SEC, ... [Would] preserve for the court the appearance of impartiality." SEC v First Jersey Securities, 101 F3d 1450, 1478-9 (2d Cir 1996)

How Did We Get Where We Are?

WHEN people put this together with a major infiltration of government posts with former **Goldman Sachs'** partners, the image that emerges is certainly not one that is doing either the United States or Wall Street much good in the eyes both domestically or globally. But to understand if **Goldman Sachs** is the new **Evil Empire Within**, we must consider its origin, evolutions, and what it has now represented that has turned so many against it in the real world. Is **Goldman Sachs** at its zenith ready for the fall from grace? Or is it at the threshold of a new era? One thing for sure, if it were in the computer field, the government would be attacking it like Microsoft trying to tear it apart limb from limb. But **Goldman Sachs** is not Microsoft, it is a quasi-Commerical Bank with Fed borrowing power, Investment Bank when it smells a deal, Primary Dealer that has the Fed's hooked to the point they fear they cannot survive without it, and above all, it is a Proprietary Hedge Fund that roams the world economy looking for its next prey.

In The Beginning

Marcus Goldman left Bavaria, Germany in 1848 looking for a new life in the New World. This was during a period of serious political uprising in Europe that had led to a major Jewish migration to the United States. **Marcus** became a buyer & seller of what we would call today commercial paper. He was peddling such paper in New Jersey in the economic turmoil following the US Civil War when interest rates were high. **Marcus** was able to develop a business in this field because banks tended not to be national with massive networks of branches. I have written about J. Cooke who many had regarded as a showman for he was the first to develop agents around the country to sell corporate bonds. Cooke was in Philadelphia that tended to be the financial center during the mid-1800s. That would eventually move to New York City, thanks to J.P. Morgan after J. Cooke went belly-up during the Panic of 1873.

Marcus Goldman got married and he too settled in Philadelphia at first. He thus followed in the footsteps of J. Cooke and carved-out a small business buying and selling mercantile paper demoninated in small lots between \$2,500 and \$10,000. He would buy them at a discount and resell them to banks who lacked branch networks.

By the 1880s, **Marcus** was making a big fortune in those days, about \$50,000 per year that was tax free back then. It was 1882 that he took in his son-in-law as a partner by the name of **Samuel Sachs**, and

Marcus lent him \$15,000 so he could sell his dry goods store, which **Sam** repaid over the next 3 years. **Marcus** had issued 3 notes of \$5,000 each. **Sam** had repaid two notes and when his third child was born, **Walter**, the third note was forgiven.

By 1888, the firm became known as then **Goldman, Sachs & Co.** Thus, it remained for the first 50 years or so a family business. By about 1900, the firm was the largest broker-dealer in commercial paper with sales reaching about \$75 million.

London was still the financial capital of the world. **Sam** wanted to expand the firm and to do so, he needed to go to London much as J.P. Morgan had done. A informal relationship was arranged with **Kleinwort Sons & Co** was originally founded in Cuba in 1792 and established itself in London by 1830. It was a respected merchant bank dealing around the world with bills of exchange. This was a rival to **Peabody**, and that is what **Sam** needed. **Sam** sold the firm as an agreeive American correspondent that would be in a position to help **Kleinwort** expand its dealings into the lucrative foreign exchange business and to take advantage of the big arbitrage between the USA and UK markets. Don't forget, it was that very arbitrage that in 1896 caused J.P. Morgan to rise to national notice by leading a consortium to lend the US Treasury gold for it had been that arbitrage that emptied the US Treasury vaults taking gold to Europe and replacing it with silver.

Indeed, **Kleinwort -Goldman Sachs** paper was all over the London market. This produced some tension no doubt, but the firm pressed

forward establishing correspondent relationship outside of London. **Goldman-Sachs** was now starting to rely on deals that one would call self-funding so to speak. In other words they were not putting the firm's capital at risk itself. By the **Panic of 1907**, the firm was now up to half-million in the foreign arbitrage business (trading) between London and New York. The main thing, **Goldman Sachs** was developing a reputation in the European money markets and that meant they were now developing deep trading/credit lines.

Marcus Goldman had remained a partner until his death in 1909. The firm now was in the hands of family **Henry Goldman & Sam**. They continued to focus on commercial paper that they regarded as their core business. **Henry Goldman**, was the risk-taker and he had visions of expanding into the domestic securities business selling railroad bonds to savings banks. **Sam** was the conservative commercial-paper guy who also brought in his son.

Henry Goldman was on a mission to be as famous as **J.P. Morgan** and **George F. Baker** that was the origin of **Citigroup** today. It was the Christians v the Jewish firms and to this day in New York City, this rivalry has continued in every field from banking and brokers to legal firms. It is the great unspoken feud of the New York Hatfields v Mc Coys. **J.P. Morgan** and **George Baker** would not do business with the Jewish boys. So **Morgan** was the target of competition for **Goldman Sachs & Co.**

Just as **Michael Milken** created the new "Junk Bond Market" as it was called by his jealous competitors, **Henry Goldman** did the same thing with **United Cigar** that later was known as **General Cigar**. **Milken** took firms who had great earning power but not traditional mortgage quality assets upon which to borrow, and created an equity focused market that evolved also into venture capital.

United Cigar was a merchant and that type of business is different. It is a trading firm where it is buying and selling and was unlike a railroad with infrastructure. **Henry Goldman** did the very same thing and created financing based upon earning power not tangible assets. Eventually this would also be known as "good will" in valuing corporations. This is where **Henry Goldman** brings in another Jewish competitor, **Philip Lehman**.

Lehman Brothers was actually a Alabama coffee and cotton merchant. **Philip Lehman** was a friend of **Henry's** and was one of five brothers. **Philip** was eyeing up what **Henry** was doing in New York, and he was interested on expanding his business and making a bid to get into New York City. **Philip** was keen on getting into the underwriting business venture. The **Lehmans** were very rich and had tons of capital that attracted **Henry**. In those days, there was still not a fully developed underwriting business. It was a great opportunity to buy the securities to be issued from a corporation and sell them to the public as **J. Cooke** had shown could be done on a major scale. This effort to bring in the capital from the **Lehmans** and create a business with **Goldman Sachs** who brought the clients, was the basis of this arrangement that lasted until 1926.

The **INVESTMENT BANK** was thus born and the first deal being **United Cigar** proved to be a smashing success that the profit was said to have been about 25% of the offer price, the same thing **First Jersey** was charged.

Another deal emerged from distant family. From Germany came **Julius Rosenwald** who had at first boarded with the **Sachs** family, and then moved west teaming up with his brother-in-law **Aaron Nusbaum** who convinced him to buy 1/3rd interest in his operation with his partner a **Mr. Sears** in their operation **Sears Roebuck**. **Julius** bought out **Aaron** and went to **Sachs** to finance inventories they would purchase in New York. With only \$250,000 in capital, now **Goldman Sachs** arranged a \$75 million commercial paper deal. This helped the company explode in growth. By 1907, **Sears Roebuck** moved for \$5 million in long-term capital to build a mail order operation in Chicago. But **Henry Goldman** pitched a stock offering and joined with **Lehman Brothers** to underwrite this new stock venture. The formula of investment banking was taking off in spades.

Between the joint forces of **Goldman Sachs** and **Lehman Brothers**, they put investment banking on the map. Thereafter, they underwrote an explosion in retail companies all following the model of **Sears Roebuck**. They brought to the marketplace **F.W. Woolworth**, **May Department Stores**, **Brown Shoe**, **S.H. Kress**, and expanded into industrials such as **B.F. Goodrich**, **Studebaker**, **Underwood Typewriters**, **Continental Can** and **Jewel Tea**. By 1909, **Sears** had sold his personal stake in a \$9 million deal put together by **Goldman Sachs**.

It was 1907 that **Sam Sachs'** son **Walter** joined the firm, which was the same year that **Sidney Weinberg** joined the firm as a janitor. **Walter** opened the account with **J. Ogden Armour** who would become the richest man perhaps in history at the **Armour & Co** based upon the access to the London market to sell their commercial paper via the **Kleinwort** connection. Meanwhile, **Goldman Sachs** and **Lehman Bros** worked together, with the former specializing in commercial paper and the later commodities trading.

It was World War I that broke-up the family business at **Goldman Sachs**. As the story goes, **Walter Sachs** assured their old English correspondents at **Kleinworts** that all his family partners were supporting the Allies only to find that **Henry Goldman** supported the German view. **Henry's** views were becoming more public and the feud erupted in 1915 when **J.P. Morgan** offered a \$500 million Anglo-French war bond. Virtually every American firm now joined in, but **Henry** refused, and thus it was said that this incident broke the family. Two **Sachs** brothers went to **J.P. Morgan** to personally subscribe to show their support. When America joined World War I in 1917, it still did not tone down **Henry Goldman** and even the **Kleinworts** warned that the firm itself would be blacklisted for its support of Germany. The Bank of England even forbid **Kleinwort** from doing business with **Goldman Sachs**. The very day that **Goldman Sachs** began to sell US government Liberty Bonds for the war effort, **Henry Goldman** was forced to at last resign. He took with him, all his own capital undermining the firm's ability to do underwritings. The firm thus acquired the reputation of being "German" and this split in the family is said to have been permanent and that **Henry Goldman** and **Sam Sachs** never spoke again.

It was this break in the family that opened the door for a janitor to rise to the top - **Sidney Weinberg**. **Sidney** became a bond trader even though he dropped out of school after 7th Grade and was largely self-taught. He also created an over-the-counter stock business during the booming 1920s and by 1925, he purchased a seat on the NYSE. He was a natural trader. Someone who could feel the blood in the tape. By 1927, **Sidney** now became a partner in **Goldman Sachs**. He became truly a natural trader whose "feel" for the market saved **Goldman Sachs** in the Great Depression.

With the departure of **Henry** and the whole German thing, the relationship that had created a dynamic force between **Lehman Brothers** and **Goldman Sachs** came to an end. Both firms would evolve as competitors and the rivalry lasted until the demise of the remarkable **Lehman Brothers** with the Crash of 2007.

The events that began to follow World War I, was shifting the financial capital from London to New York. The credit for this belongs to **J.P. Morgan**. The 1920's was thus a boom that most failed to truly appreciate. It was a shift from railroads to industrials creating a new sector with great respect built upon the back of the automobile and the airplane. But this was a capital shift globally as well. Like everyone was running to invest in Japan for 1989, the same thing was happening with the United States. Foreign investors were now looking at America as the land of opportunity.

But the capital of the world has also shifted to the USA. The global concentration of wealth was extensive. This led to major offerings by China, South America and even Europe selling their sovereign debt in small denominations that the New York banks were marketing to the average person.

Goldman Sachs got caught up in the whole bull market just like everyone else. Under the leadership of **Waddill Catchings** who led the firm into joining the hot market by now creating an "investment trust" where he saw that a giant fund could maximize profits by buying and selling stocks. He promoted this as a business that was professional and the profession was investing.

The "investment trust" was sort of the domestic "hedge fund" of its day. Everyone was jumping into the game. **Catchings** just got caught-up in the whole thing and was very bullish going into the high of 1929. He gave this new entity the name: **Goldman Sachs Trading Corporation**. The deal was that **Goldman Sachs** would be paid 20% of the profit and the stock was offered at \$104 per share. It jumped to \$226 per share, that was twice its book value. This would be the very same mistake that became exposed in the Crash of 1966 when shares in mutual funds were then traded on the exchange allowing them to be bid up well beyond their asset value.

The whole bullish atmosphere was very intoxicating. Just three months into the fund, **Goldman Sachs** arranged for a merger of the trust fund with **Financial & Industrial Corporation** that controlled **Manufacturers Trust Company** that was a giant group of insurance companies. This doubled the assets of **Goldman Sachs Trading Corporation** taking it up to a staggering near \$245 million. This was huge money in those days. The trust now exploded and the assets under control are said to have exceeded \$1 billion back then.

Goldman Sachs expanded the leverage going right into the eye of the storm that was about to hit starting on September 3rd, 1929. In the summer of 1929, **Goldman Sachs** launched two more trusts **Shenandoah** and the memorable **Blue Ridge**. The shares were over-subscribed and **Shenandoah** was offered at just \$17.80 and it closed on the first trading day at \$36 per share. **Blue Ridge** was even more leveraged and the partners at **Goldman Sachs** put pressure on everyone to buy as a sign of support. The leverage was astonishing for with just about \$25 million in capital, now there was more than \$500 million at stake.

The disaster was monumental to say the least. **Goldman Sachs Trading Company**, whose shares had stood at \$326 at their peak, fell during the Great Depression to \$1.75. They fell to less than 1% of their high. The loss suffered at **Goldman Sachs** on a percentage basis was far worse than at any other trust. In fact, of the top trusts, **Goldman Sachs** had lost about 70% of everyone combined.

Goldman Sachs was a wash with lawsuits and it became the target of jokes in Vaudeville. This would fuel the anti-Jewish feeling in New York for decades to come. **Samuel Sachs** died in 1934 at the age of 84. He was devastated for what he had worked for was to build the firm's reputation. That is what had even broke the family in two.

Over the Years

Over the years that followed, **Goldman Sachs** struggled to climb back. They returned to their expertise building upon their old reputation in commercial paper. They were still second rate and the leader with all the prestige was **Salomon Brothers** who had an elitist view that they would deal only with the biggest and best. It would be this keen competition with **Salomon Brothers** that drove **Goldman Sachs** and effectively the industry.

Those who were in the industry back then will recall that **Salomon Brothers** was the big power around Wall Street and it was known by the name in the trading floors as "**Solly**" all over town. Yet, **Salomon Brothers** was not as old as **Goldman Sachs**. So from the beginning, **Solly** was a new rising star carving its way into the Jewish world of Manhattan. The firm actually began in 1910 as the combined force of Arthur, Herbert, and Percy Salomon.

Solly came at the right time. It was just after the 1907 Crash and thus the chaos that erupted at that time, opened the door for competition. When opportunity knocked, **Solly** opened the door.

Solly began specializing in short-term loans. With the reforms that began in 1913, **Solly** was more of the traditional type of bank just specializing in bonds. When World War I broke out, **Solly** had created a client base and thus became a **Primary Dealer** for the US Government selling their bonds to raise money for the war.

Where **Goldman Sachs** had been specializing in helping primarily merchant type clients who were different from railroads lacking the infrastructure assets, **Solly** was following more of the model that had first been struck by **J. Cooke**. Indeed, just as the Government turned to **Cooke** to sell its bonds during the Civil War, now **Solly** was following in that same footpath.

Solly survived the Great Depression in far better shape than **Goldman Sachs**. For decades thereafter, **Solly** did its business and **Goldman Sachs** could only watch in envy. The steady drive to beat **Solly** was always there. They were the "other" big Jewish firm that had the audacity to compete.

Solly, however, was a rising star with a short-life. It would peak perfectly just 72 years from its birth. Its demise also had lined up with the **Economic Confidence Model** that seemed to drive the firm more than any other force.

It was in 1978 that John Gutfreund rose as the head of **Salomon Brothers**. Right in line with the major high on the Public Wave that peaked at 1981.35, Gutfreund was now selling the firm to the huge commodity firm known as **Philips Brothers** of Marc Rich fame. They were the big commodity house known on the street as **PhiBro**.

PhiBro were great traders coming from years of commodity trading. But they still couldn't see that commodities had made a major high in 1980 that would last for the next 20 years or so. They were feeling like they had conquered the world, and thus were now trying to buy **Salomon Brothers** when they were at the top of their cycle. This was the wrong time to expand.

Gutfreund became a co-CEO with **PhiBro's** David Tendler. The commodities crashed and burned and the tables were turning. Gutfreund now seized control and started to expand the firm into the currency trading, and enlarged the firm's positions in underwriting and share trading. **Salomon Brothers** was now also trying to expand into Japan as well as Germany and Switzerland.

As commodities peaked in 1980 and the interest rates thanks to Paul Volker's decision to raise interest rates to insane levels, the decline on the **Economic Confidence Model** into July 1985, brought a collapse in prices of commodities hurting **PhiBro**, yet the high level of interest rates attracted capital from around the world. This drove the dollar to such record highs where the British pound fell to just about par and the mighty Deutsche mark fell to nearly 4 to the dollar. This had shifted the profit base from **PhiBro** now to **Solly**.

However, this catastrophe upset the whole world economy. Volker not merely removed the usury laws to allow for his drastic rate rise, which is why credit card rates are still high today, but he set in motion the entire bull market in the dollar.

Neither **PhiBro** nor **Solly** comprehended what was going on. They got caught in this new pendulum swing with extremely high volatility. This sparked Mr. Baker to now propose creating the G-5 in 1985 with the goal of manipulating the dollar down by 40% to help trade. So we have mistake **NUMBER ONE** Volker raising rates to absurd levels, and **NUMBER TWO** James Baker proposing to manipulate the currency markets by forming G-5. And these were Republicans who were suppose to believe in Free Markets. If you believe that one, I will tell the the one about how you can buy the Brooklyn Bridge.

On the first currency swing in the mid 1970s, it was Franklin National Bank that went down on a small 7% move. They were the bank who

started MasterCard. This swing was dramatic from a percentage basis. Suddenly, **Solly** needed to be rescued. It's white knight, was Warren Buffett. The firm that had risen to such heights, known as the "King of Wall Street" saw its profits peak precisely with the 1985 turn in the **Economic Confidence Model** at about half-billion dollars.

As the markets all turned in 1985 with now the dollar crashing and commodities were starting to rise, the stock market was exploding. The fixed income specialists at **Solly** were now in a bear market. **Solly** had expanded right at the top in 1985. They had increased their staff by 40%. So where it was **PhiBro's** turn at the 1981 turning point, it was now **Solly's** turn with the 1985 target.

This was a very important time where the shift from a **Public Wave** to a **Private Wave** was taking place. At Princeton Economics, we took the back page of the English Magazine named the **ECONOMIST** for 3 weeks running in July 1985 to go on record what the future would hold. Granted, we were well ahead of the crowd and had a fully functioning global computer model before anyone even started to hire computer programmers. But that was our comparative advantage. It was a time of very high volatility and also the birth of the whole take-over boom. This was the point that marked the breakout in the Dow Jones and in 2.15 years we had the 1987 Crash, S&L Crisis, and by the end of this first wave 4.3 years, Japan reached a bubble top and burst. All of this was set in motion by government trying to manipulate the **Free Markets**.

The competition between **Goldman Sachs** and **Salomon Brothers** was always there. When **PhiBro** and **Solly** were joining at the hip, **Goldman** began looking around to follow in the footsteps of this merger. They too wanted commodity exposure and bought the trading house of **J. Aron** that was clearly a competitive move given the **Salomon Bros.** merger with **Philips Bros.** **J. Aron** was a old commodity house that began in New Orleans in 1898. It moved to New York City in 1910 in time for the commodity boom with World War I. The firm was named after **Jack Aron** who was part of the Jewish community.

J. Aron expanded into the metals trade during the late 1960s after gold became a free market in London and the official line was that there was now a two-tier pricing in gold as of 1968. There was the fixed official

rate, and the open market rate. With the beginning of the floating exchange rate in 1971 and the closing of the gold standard, the 1970s became the decade of inflation and commodities that would rise into 1980 for the bubble that would last for about 21.5 years. J. Aron rose from a capitalization of less than \$500,000 in the late 1960s to \$100 million by the peak in 1981. J. Aron had become the largest trader in gold doing more volume in dollars than the biggest of any of the Dow stocks.

Being a commodity firm, J. Aron was actively trading currency futures that the banks did not understand. They were the first to arbitrage the currency futures against the cash currency markets at the commercial banks who back then did not understand the markets, but had to provide that service to keep commercial clients.

J. Aron's business in precious metals helped to bring in market-share. This is the beginning of gold lending. Banks holding gold would start to lend it to J. Aron at 0.5%. This was a business that was starting to explode. Myself, I was making markets in gold as well and with friends in key places, I was able to do over-night trading that competitors couldn't figure out what I was doing. I had a guy Francis Lee in Hong Kong where I would lay-off what I bought after New York markets closed. But delivery had to be made in London the next day. So I would borrow gold in London, make the delivery, and then swap them a COMEX New York contract I would buy that day. I later showed a London firm how to do this wild overnight trading, and finally got some sleep after the 1980 high. Those were the days of innovation and wild trading. They were the best days of my life with my kids who were still young and a real joy in all aspects.

After the whole 1980 Commodity Boom, everyone expected it to rebound and keep going. Oil hit \$40 and gold \$875. Everyone wanted to become a commodity trader for the Dow Jones had kept bouncing off 1,000 so why not go where the action was. It was October 1981 when Goldman Sachs purchased J. Aron & Co, for \$135 million. It was in fact the top of the game. Although they had bought the high, they were importing the commodity culture of trading that would in fact lead to the firm's trading reputation. Its current head, Lloyd C. Blankfein, came from J. Aron and has now focused Goldman Sachs as a mean, lean, trading machine.

It was this competition between these two Jewish firms that fueled the evolution process of Wall Street. Leading up to 1980, Sidney Weinberg at GS brought in his heir that perhaps began the desire to cultivate contacts within government. It was 1968 when Henry Fowler, former Secretary of Treasury, was recruited. It was Fowler who opened those political doors in a host of different nations. Yet it was Gus Levy who was the aggressive one pushing the firm into taxable bond dealing expanding from commercial paper. From 1969, Goldman Sachs now moved into the bond market.

Salomon Brothers was taking market share away from Goldman Sachs. The decision to get back into proprietary trading appears to have been from Steve Friedman and Robert Rubin to be competitive with Salomon. Goldman Sachs was still hesitant sitting to a large extent watching trading profits grow at Salomon, and that was the trend at Morgan Stanley, First Boston, and of course Merrill Lynch.

Friedman and Rubin took over the role of managing Fixed Income where they planned to expand into proprietary trading. Goldman Sachs moved into quantitative analysis in the late 1970s, relying still on academics.

It was Friedman and Rubin who changed the culture creating the trading profit bonus and starting in 1986, Goldman Sachs began to take talent from Solly offering a huge bonus structure and adopting the trading mentality it now acquired from J. Aron & Co.

It was 1985 when I wrote directly to President Ronald Reagan. I warned that this whole idea of manipulating the dollar would lead to a crash and dramatically increase volatility. Beryl Sprinkle, Chief Economic Advisor, responded. He pointed out that at that time Princeton Economics was the ONLY firm with such a model, and until someone else created a model agreeing with us that volatility would rise, he basically said they could not rely on just one model. Now we set the ball in motion with computers, and the game was now taking a new direction.

In 1986, Goldman Sachs hired Fischer Black of BLACK-SCHOLES fame for valuing the stock options. It was Rubin who brought in Black, and the problem they had was the new embedded options within debt. But the issue they did not understand that they were now walking into, was there is a great language problem between traders and programmers. You MUST be good at both, or you are screwed.

The Age of Computers

While Princeton Economics was more than almost 2 decades ahead of the crowd in this area, they were well aware that we were then emerging as the largest institutional advisors in the world. This is also clear from the standpoint that the regulators jump when one of the big New York firms makes a call.

In 1985, the Supreme Court ruled in a major case Lowe v SEC, 472 US 181 (1985) that held the publishing of analysis was protected by the First Amendment and did not require to be regulated by the SEC. Upon advice of my counsel, I withdrew my registration and we opened out first office overseas in London that year. However, it was the CFTC who tried to claim that the Lowe decision only applied to the SEC statute, and they would refuse to follow the Supreme Court.

The CFTC appears to have been told we had too much influence and they tried to subpoena a list of all our clients arguing I was manipulating the world economy. Their idea was that anyone who took our research did exactly what we said, and that was making the forecasts correct, not the model. They continued to harrass us for the next 10 yrs even though I fought them in court and won that they had no proof I was manipulating the whole world, and even if I was, where did they have the authority to police that jurisdiction?

Everyone was rushing out and buying IBM desk-top computers and trying to create models. Much of what was coming out was real nonsense. Trying to write a computer program is a completely different field. I was very fortunate insofar as I had gone to what was in the 1960s the equivalent of Microsoft University. RCA had set up a school only for mainframe computers. No school could afford one of these monsters that filled a room back then. I went through everything from the ground up - electrical engineering, hardware design, and software design. Today, someone taking up software need not go through the hardware. But in the old days, you had to do everything. This gave me a well-rounded idea of how computers functioned, and what could be done with them. I left the field for not being married, I was offered Greenland where NORAD was hidden back then, Guam, or Vietnam. The married guys got Paris, London or Hawaii. So I decided trading was my first love.

When computers began to shrink, now they were a tool I knew what could be done with them. I began working on a program in the late 1970s. Having experience in both trading and programming, I could see in my mind's eye the potential.

The greatest problem that Wall Street ran into with their attempt to model the markets, you have a huge gap between the trader and the programmer. They do not even speak the same languages. What the trader is trying to explain, the programmer is then trying to write in computer language. It is not easy. The trader does not comprehend how a computer operates, so he skips such basic steps that the programmer, not understanding trading, cannot fill in the gaps.

Teaching a computer to do something is like teaching a child but worse. Where the child will instinctively take that first step in walking, there is no such instinct in a computer. You have to teach it absolutely everything in such detail, and nothing can be left out.

Goldman Sachs and others hired physics majors and math wiz guys, and now they just introduced another dimension of chaos. Here you bring in guys competent at what they do, but they are not traders. They have no feel for a market. They cannot smell the blood. And they make the biggest mistake of all that the programmers could not fix for they also had no experience. Markets are NOT perfect and sometimes they will reach a void where liquidity disappears, and you just can't get the hell out no matter what you do.

When the 1987 Crash hit, it was one of those moments. Liquidity vanished. The market makers backed away, and trades were just being matched. If you were UNEXPERIENCED in trading, you were likely to put in a market order. You would have lost a fortune. I was trying to buy calls on the S&P at the low. One trade was 200 and the next 3,000. There were no market-makers. Everyone simply got scared. A market order would have been slaughtered.

The volatility I warned in 1985 would be unleashed once they started to manipulate the currencies came true. I was getting then requests to please provide research to the US Government. I told them to pound sand. I was too busy. Jack Swagger called me and made a good point. They were going to lock up the

computers for by 1987, everyone was trying to use computers for trading and the press was already now blaming computer trading. It had turned out, many who had crude models, simply didn't follow them. The computers were mostly correct - SELL. The professional stock traders did not listen.

I eventually provided the research only when it became clear that Paul Tudor Jones' partner Peter Borshe became a board member to the Brady Commission. I contributed and even wrote to several people pointing out that the entire event was caused by currency for when they wanted the dollar down by 40%, foreign holders of US Government bonds and assets, sold. The Japanese had purchased up to 33% of the US National Debt. They were net sellers. They took their funds home setting in motion a capital concentration in Japan that led to the bubble top about 2.15 years after that - 1989.95. When Nick Brady came out, he conceded that perhaps currency had something to do with it.

The Long-Term Capital Management Crisis of untold proportions

Over the next 8-9 years, computer models were getting more sophisticated, but at the same time, more myopic and dangerous. The new models were focusing on high leverage. Again, the weakness was they lacked historical back testing, and failed to comprehend the dynamic structure of the global economy.

The collapse of **Long-Term Capital Management** illustrated the danger between merging the fields of experience with no practical risk management. What was happening, was twofold. It was a blending of manipulation/inside info and sophisticated computer models that did not take into consideration what happens when the market goes into total illiquidity.

By merging the commodity field with the finance field, there was a culture clash to say the least. Commodity trading began with largely the agriculturals pre-gold. This was a field that was dominated by manipulations. There was only a few recognized storage warehouses that the commodity exchanges recognized and that let the games develop between moving product in and out to create swings in the market price. When inventories would come out, a sharp drop in supply sent prices soaring.

By merging the commodity firms of PhiBro and J.Aron & Co into the financial industry, this was a clash of cultures that soon introduced the Wall Street boys into how things can really be done.

The SEC was hell bent on **inside trading** from about 1985 onward as the takeover boom began. The SEC was convinced that possessing information of a takeover was now criminal in their mind even though it was opposite of the entire theory of **insider trading** from the Great Depression. One of the partners at **Goldman Sachs**, Mr. Freedman, found himself caught up in the whole mess. **Robert Rubin** took control for Freedman was a partner and if he went down, so would the firm. This, I also believe, contributed to the strategy of then building political alliances.

Where the stock boys focused on fundamental analysis that yielded to vision of merely possessing inside info was a guaranteed win, the commodity culture was more about how to manipulate markets that was born from the agricultural plays.

Where the stock boys focused on fundamental analysis that produced visions of possessing inside info was the guarantee to victory, the commodity culture was clearly not inside info as to what directors are doing or the latest takeover, but **WHO** was trading what and what was their next move.

In the movie **Wall Street** Charlie Sheen does not really get inside info. He follows a takeover tycoon and watches who he meets with for lunch and where he takes a plane ride. He puts it together in his head and assumes the target will be a US corporate. That is **NOT INSIDE TRADING**, but is more akin to the commodity culture, using reconnaissance to keep track of what the competition is doing in the market.

This is **NOT** criminal activity. **EVERY** field of business does the same. They are tracking the competition to know how to stay in the game. The target of who is now being tracked is different in commodities rather than stocks, because it is the players, not the corporate directors that now matters.

Going into 1980, the leaders of that commodity boom was none other than OPEC driving the price of oil up to \$40 in 1980, and silver where the battle cry was \$100 and a ratio to gold set by the old Silver Democrats that had bankrupted the nation when silver was set at 16 ounces to one ounce of gold. That rally was built upon the shoulders of the **Hunt Brothers** who every trading desk was following. However, what the **Hunt Brothers** walked straight into was this culture of watching the players. If the **Hunts** tried to sell one ounce, everyone would jump in front and assume they were now going to sell everything. The exchange rigged the rules and created a one-sided market more or-less. The **Hunts** never stood a chance.

You have to know how to trade and you have to know the game to survive. **Aristotle Onassis** was also a hard-money guy. He too bought precious metals like there was to be no tomorrow going into 1980. He put the whole lot into a bank he owned in Geneva as capital. But he would not let the board ever sell the metal. I was called in because he liked my work. He understood that I was then forecasting a bear market from 1980 into 1985 and he could accept someone who was short-term bearish, but still shared his view of the decline and fall of the monetary system as things progressed. So I was given the job of hedging this monster position. The platinum position was about 40% of the entire market at that time. I had to reveal the position to the CFTC and was not allowed to speculate in platinum, but to hedge the verifiable position only.

Now I was the 800 gorilla, and the real professionals knew. So how does one trade in a market where you are the new Hunt Brother? It takes skill and deception. I was able to trade silver and gold freely, but not platinum. Knowing how the market operated was the key. I understood they would watch my every move. So the only way to trade and not get killed, was to choreograph the precise opposite. I would have to call dealing desks and ask for a market in gold, then silver, and then do the opposite of my intended desire in platinum. I would do a small amount, but enough to be impressive. They would then see I was a buyer. When I went back for platinum, they would assume (reading me) to be a buyer. They would move the spreads to pick up some extra coin, and then I would sell. I would have to have several desks on line at the same time and then take a small loss on the gold

and silver. I couldn't do that every day, but it was used at critical moments. Knowing how they operated was paramount for survival.

With this backdrop in mind, you can get a sense of what it was to trade size in these sorts of markets. Everybody was watching the flow of orders; who was doing what; and what was their next likely move. One time I was trading and everyone thought I was short. The floor brokers paid close attention and relay that info back upstairs. I had used so many different desks that I was able to flip my position and was actually long. When they saw me buying, they assumed I was just taking profit. I had two trusted floor brokers in New York who knew I was now long. Both **J. Aron** and Republic National Bank had read me dead wrong. To show them they were wrong, I told the floor broker to bid size openly. Once they did, I could hear the screams yelling: "He's f--king long! He's f--king long! You never saw such a panic short-covering all because they try to read people to gain that added edge. It was the game of strategy.

So when I say there was a "club" that developed mostly in the 1990s, I know what I am saying. A number of desks would watch the big houses and what they were up to now. They would band together, or leak out what a big client would be doing to get interest. This was in the commodity field. But keep in mind that this culture was now infiltrating the financial markets as well from about 1985 onward with the merger of **PhiBro** and **J. Aron** into the Wall Street crowd.

The idea of proprietary trading that was dominant in commodities, was blended in with the financial sector. This blended well but then has transformed the likes of **Goldman Sachs** into a proprietary trading machine.

The **Long Term Capital Management** crisis was a direct result of the "club" relying on "inside information" that was suppose to be the IMF continuing the loans to Russia. As I have written before, **Edmond Safra** of Republic Bank paid for the IMF diner renting the entire National Gallery. I was invited to show me the quality of their contacts. They wanted me to join in with the "club" all then buying Russia. I declined and warned them that Russia would collapse. They believed that the best way to win was to rig the game. If they had the IMF in their back pocket, I would be wrong. But sometimes all the inside info in

the world and millions of dollars in bribes cannot prevent the free markets from doing what they do best. They refuse to comply with things that fundamentally were unsupportable and Russia was one of them.

The Blending of Cultures & The Development of the "Club"

The Great American Bubble Machine



Edmond Safra Republic National Bank

The blending of these two distinctly different cultures of commodities and stocks transformed the industry like no one could have imagined without commodity experience. **Edmond Safra** was deeply entrenched within the New York Jewish community. **Edmond** began as a coin/currency dealer. He bought the silver coins from the Arabs who wanted to get rid of them as fast as they got them. For you see, in the early days, the standard coin of one ounce of silver was **Maria Theresa's** (1717-1780) who was the wife of Francis I Holy Roman Emperor. She was the archduchess of Austria and Queen of Hungary & Bohemia. These coins bore her portrait and they were all over the place. You also have coins with Queen Victoria of England. The Arabs did not want coins with portraits of women. **Edmond** made his money buying these at a discount from the Arabs and selling them in Switzerland.

Edmond was another hard money guy. He did not "trust" paper money, despite being a huge dealer in physical currency for the US Treasury. **Edmond** was one of the first to exploit Russia and he had the contact there with the mafia that was run by also Jewish friends of his over there. **Edmond** had planes loaded with US \$100 bills by the pallet.

The **Long Term Capital Management** crisis that erupted in 1998, was centered on the collapse of Russia. Anyone who thinks that big money will just speculate is not only wrong, but is suspect insofar as being just a mouth piece for those they defend.

What was going on was the "club" was buying up Russian short-term paper paying huge rates of interest. **Edmond** rented the entire National Gallery in Washington and invited every politician you could imagine both current and past. Even Paul Volker was there despite he was nearly a decade out of the Federal Reserve.

I was invited to show me the influence that they had. I was being solicited to then bring over \$10 billion from Japan. They were trying to get me on board with Russia and to stop "fighting" the crowd. There are even emails on a lot of this. No doubt the court receiver got rid of those as well.

Nevertheless, I refused to join and warned them that my model was pointing to a crash in September 1998. But you see, the very attitude that the **CFIC** had taken with me that I was manipulating the world economy because of the scope of our clients, was the very thing that the "club" saw and judged me by their own aspirations. They believed our forecasts were usually correct not because of a model, but because of who I knew around the world.

That IMF affair in Washington was to show me that they had it in the bag. When I stood up and warned Russia would collapse in about 30 days in the late summer in London, and it made the front page of the second section of the London Financial Times, they believed I had more power than them and that is why they lost. Strange things then began to take place in our accounts. I was only in the USA about 6 weeks from late 1998 until the summer of 1999. We were preparing to go public and I was hoping to retire to get back to research that I wanted to do giving it one more serious shot at discovering some mysteries I felt were still behind the functionality of the world economy.

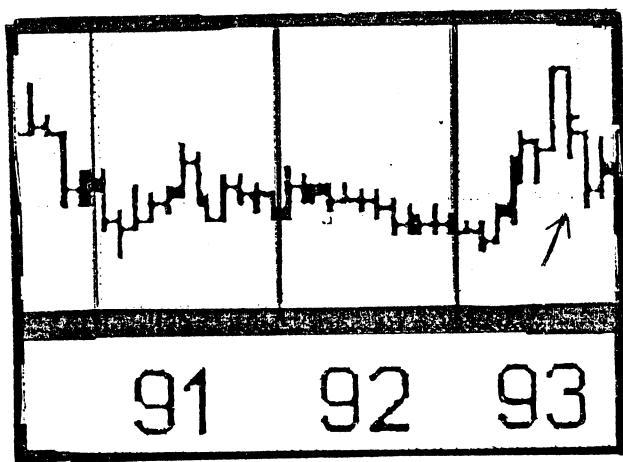
When Russia collapsed, the "club" was so invested in that trade that was illiquid lacking any tradable market, they panicked and began selling all positions creating a global **Contagion**.

The development of what became known as the "club" emerged from the blending of the commodity and the financial sectors. Instead of **insider trading** trying to infiltrate the interworkings of corporations, it moved on into commodities that was expanded into debt and currencies.

What began in the agricultural moving product the effect prices by creating the false image of a drop in supply, the same schemes were now being played out in big time markets. One of the most outrageous was the conspiracy with paying Russian officials to recall all their platinum to "take inventory" cutting off supply and sending prices soaring. **Ford Motor Company** ended up suing over that one. It was the same scheme that was played in agricultural for decades. Now it involved paying bribes to corrupt government officials. This would also fuel the idea that Russia, if it could be controlled, would be the long awaited red carpet to commodity profits to new levels.

The first time I began to hear the name Warren Buffett and commodities, was after he got involved to rescue **Salomon**. That had opened the door to **PhiBro**, who seems to have now introduced Buffett to the glories of commodity markets.

Silver Manipulation of 1993



The importance of this 1993 silver manipulation is critical to what has taken place even with AIG. When the CFTC became aware of excessive positions being taken in silver at **PhiBro**, they demanded to know who was their client. **PhiBro** refused to reveal that name, so the CFTC demanded that they exit the trade.



Warren Buffett

The secret client that **PhiBro** refused to reveal was none other than **Warren Buffett**. The amazing thing is how easily the **CFTC** backed down. If anyone else refused to do as they command, you will be thrown in jail for life on contantpt until you comply of die!

This is the incident that began to now shift these secret market manipulations overseas. This is why AIG set up their entire division that blew up the world to London. They wanted to keep everything out of the vision of US regulators. They were able to muscle the **CFTC**, but they were not sure if they could do that all the time.

Buffett got caught up in this whole game when he came in to rescue **Salomon Brothers**. It was from this time forward, that his name began to be associated with what some have called the "**Wall Street Bubble Machine**." In July 2009, the magazine Rolling Stone published an article written by Matt Taibbi entitled "**The Great American Bubble Machine**" where the opening line is:

"From tech stocks to high gas prices, Goldman Sachs has engineered every major market manipulation since the Great Depression - and they're about to do it again."

A magazine such as Rolling Stone will not publish an article of this nature just on wild speculation. There has to be sources verified even if they remain unmentioned in the article. The great bubbles it attributes to Goldman Sachs are:

- (1) The Great Depression Bubble in **Investment Trusts** where their shares in the trust fell from \$326 to \$1.75
- (2) Tech Stocks
- (3) Housing Mortgage Bubble
- (4) Gasoline \$4 a Gallon Scam
- (5) Rigging the Bailout
- (6) Global Warming

The interesting thing about this list, it is far too short. Indeed this is just now scratching the surface of the "**Club**" that I had spent about 10 years documenting and only to find that some magical way, Alan Cohen gets appointed receiver over Princeton Economics International, Ltd., a foreign corporation where no American court had any jurisdiction, he seized all this research, threatens my lawyers with contempt if they do not turn over everything, throws me in contempt of court for over 7 years lying to the court claiming there are losses when there are none, and then emerges as **Head of Global Compliance for Goldman Sachs**. This conflict of interest was sanctioned by the Federal courts who have protected **Goldman Sachs** at every possible turn.

This blending of commodity and the more traditional finance/equity Wall Street culture, led to the great expansion of the **Club** as it began to spread its scope. Because of the philosophy of **Inside Trading** being any privileged information became criminal, it had the tendency to drive the **Club** toward the cash markets and commodities.

INFORMATION WHO HAS THE INFORMATION?

There is a major crisis in America and an obsession by the Government over who has so called "**insider information**" that is not at all being prosecuted as it originally meant back in the 1930s. There is a broad assumption that the mere possession of some information in stocks is illegal. This is seriously flawed.

For you see, information is the name of the game in every other field from bonds and commodities, to economic statistics and the various reports ranging from unemployment to crop inventories and GDP. This presents a very serious crisis in a hedge fund. Where do you draw the line on info when it is in fact allowed in every other field but stocks?

The flow of information is more-often-than-not the precise opposite of what the SEC thinks it is. The 1987 Crash took place when there was an **ABSENCE** of information. Major portfolio managers called their broker for the latest info why the DOW was down 500 and the reply was - "**I don't know!**" Nothing had changed domestically. It was being driven by the perception that the dollar would fall

another 40% so the foreign investors were bailing out. Domestic analysts were confused so there was the assumption that somebody had critical **INFORMATION** nobody else had and it was really bad.

Possessing **INFORMATION** is not always a 100% guarantee that you will win. In the real world, the whole Martha Stewart case was in fact just claiming she lied to the FBI. She did **NOT** possess **INSIDER INFORMATION**, but her broker saw another client selling who was an insider and the presumption was that he must have had news that was negative. Martha then sold no different than a bird in the middle of a flock takes flight because the whole flock is taking off and nobody knows precisely why. This is a human characteristic as well. We panic because of an observation that everyone else is. They criminally wasted tons of money to put on a show to prosecute Martha Stuart claiming she lied to the FBI. Aside from the fact that it would be fantastic if those in government could be criminally prosecuted for lying to the people, what is really going on with this nonsense is creating a giant **DISTRACTION** to make the people think that the courts and the Justice Department are really protecting the public rather than the "**Club**" for by putting Martha on trial, they create the image that no one is above the law. The real problem is, judges, prosecutors, and their friends are **UNTOUCHABLE!**

Back in the mid 1980s, **Michael Milken** was at **Drexel Burnham Lambert**, a Philadelphia firm where I myself once had accounts. They were an outsider insofar as the tight New York houses were concerned. **Milken** was truly an original thinker and he created a major innovation that advanced financing and in fact contributed to the expansion of the US job market and economy. What he created was the opposite of how New York operated.

Where the traditional banking model was still hip-deep in the old railroad model that meant they lend only against assets, **Milken** took the opposite approach that was more of the mercantile system of turnover and profit rather than infrastructure meaning hard assets. By focusing on "profit" instead of assets, **Milken** created the innovative market that gave birth to many new companies that created jobs. **Milken's** problem, he stole the thunder from New York and that really pist-off the New York crowd.

The New York crowd had successfully for years convinced the Justice Department, SEC, and CFTC, that you shouldn't shit where you eat. You will find no major criminal cases against any of the big New York firms. And even when a major class-action lawsuit was filed against **Merrill Lynch**, Judge Pollack of the Southern District of New York wrote a huge opinion protecting the firm against the average American citizen and dismissed the suit. Had that suit been brought outside of New York City, it would have proceeded. New York protects New York. That's just the bottom line. **Madoff** proved that one. Nobody would dare investigate until he blew up when there were plenty of warnings, just not from any of the big **Club** members.

The **Club** no doubt complained about the junk bond market started by **Milken** for they had been shown-up, and missed the boat. The only way to compete in their book, is to use the Feds to go after a competitor and clear the decks. They did. **Milken** was innocent, yet they inverted the law where he did not need **insider information** from a company, just that now two people going to take over a company create their own **insider information**. But this was how the commodity and currency market had always operated. Monitor the competition and guess what their next move will be. There were no corporate boards to worry about.

Milken had vowed to go to trial. However, the Government had no case and they were set in motion by the New York Crowd. They included **Milken's** brother in the indictment trying to force him to plead to save his family. They then took it to the next level and threatened to indict his 90 year old grandfather. **Milken** was known to be a family man. He caved in and the US Government acted like some third world dictatorship ruthlessly extorting confessions because they will **NEVER** admit that they are ever wrong. The courts just sit there and let this go on. The Supreme Court takes the truly absurd position that the government need to prosecute criminally, means judges and the prosecutors must be absolutely immunity so they do not hesitate to prosecute. This view of course means that the Constitution has no real force for **Article II, §3** says they may only "faithfully" execute the laws, not with malice and total disregard for everything we fought and died for that the average person believes is the "**American Dream**" that was to be truth and honor first. We had a revolution

and **Thomas Jefferson** wrote in the **Declaration of Independence** the very complaint that the king was protecting his agents with mock trials. We do the same. You cannot sue any Government Attorney nor a Judge and because of that, you can have evidence that they were even bribed, but you cannot proceed for only the government, like the king, can criminally charge and it will not do so as long as that judge and prosecutor lied, manipulated, and cheated to benefit the government.

It was 1986 that the government went after **Ivan Boesky** on **insider trading** and compelled him to plead guilty paying a fine of \$100 million. They now turned to boldly destroy **Drexel Burnham** curiously prosecuted in New York. The firm pled guilty and paid a \$650 million fine in 1988. Over 50,000 jobs were lost, and the carnage did not stop there. The SEC was clearly doing a favor for the New York crowd. **Drexel** ended having to default on \$100 million in loans. Did this really benefit the public? When this very practice is how the entire rest of the industry works from commodities, bonds, and currencies, it made no sense. This was **not** the insider trading of the old Great Depression where directors knew the company was bust and sold their own stock before release that information. Real people lost real money - not opportunities. Did the \$650 million in fines paid by **Drexel** go to any victim? No!

Milken pled guilty in 1990. He was fined \$600 million. There was one small guy who went to trial on this theory of **inside trading**, and won. It was one giant shake-down. The government made more than \$1 billion and the New York crowd satisfied their ego. **Drexel** believed in competition. They were not part of the "**club**" nor was **Bear Sterns** and neither was **Lehman Brothers**. The outside firms are the ones who go down. This has only fueled many to become concerned about doing business in New York.

To destroy **Drexel Burnham**, the New York crowd had to turn more away from stocks and into the arms of commodities. For you see, **Mr. Freedman**, a partner at **Goldman Sachs**, was neck deep in the same activity. **Robert Rubin** personally began to manage the fall out because he was a partner and they feared in 1986 that they too could have gone down with **Boesky**.

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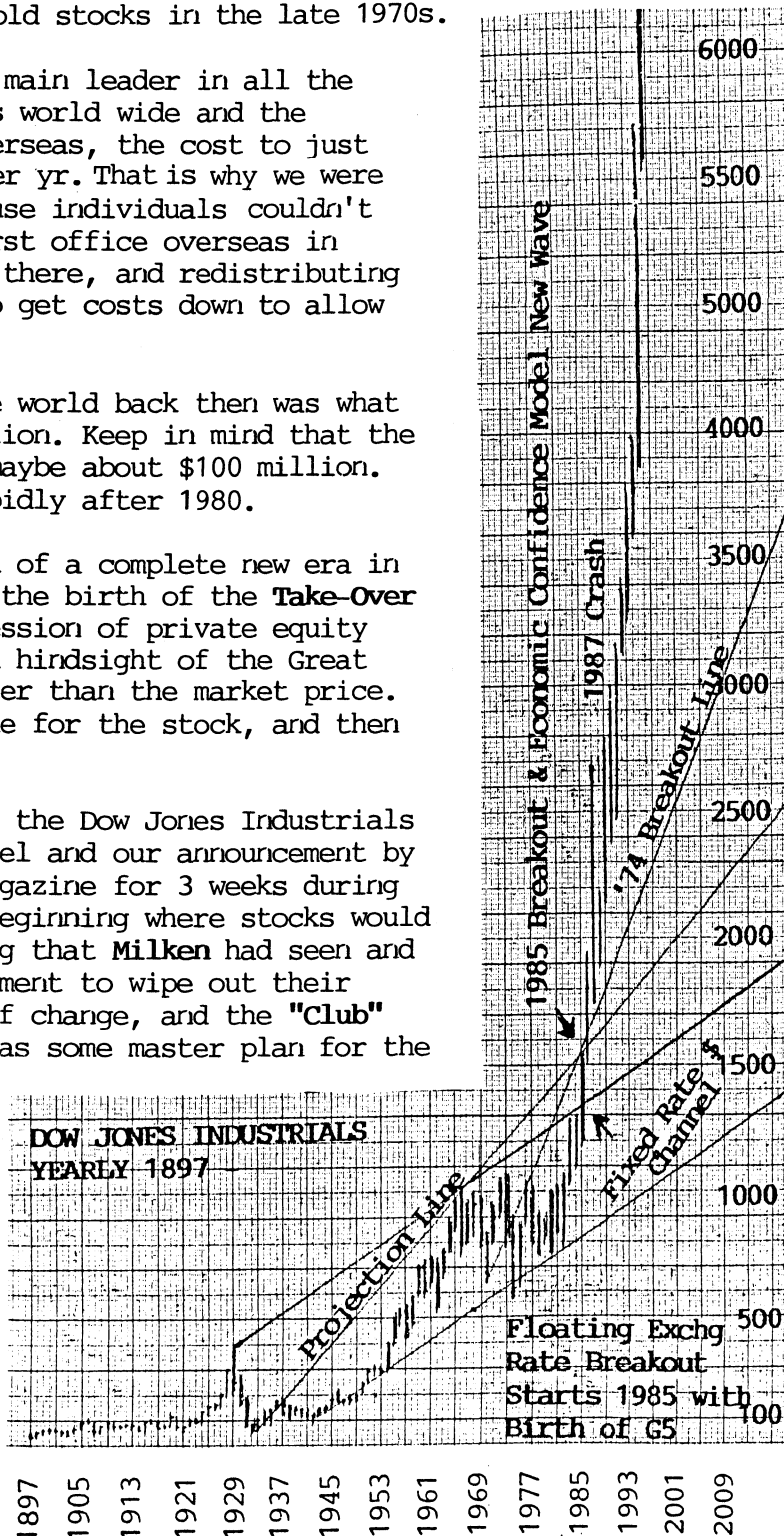
XPANDING THE CLUB was something that evolved. It was driven by the **Inside Trading** in equities, and by the fact that the merger of **PhiBro** and **J.Aron** into the financial fold, introduced a different way of doing business. You have to appreciate that the first half of the 1980s there was no really deep 24 hour currency trading. The banks largely provided foreign exchange as part of the overall service for corporate clients. The legalization of gold for trading in America that came in 1975 with the opening of COMEX futures contracts, began to expand the opportunities for trading on a 24 hour basis. Keep in mind, this was again commodity oriented for commodities were the same everywhere. Stocks were a typical domestic product, although foreign buyers would come in and out. Stocks tended to be listed in the country of their domicile. This also began to emerge with New York expanding its global reach. Foreign corporations began to list in the US directly or as ADRs, as many of the South African gold stocks in the late 1970s.

Princeton Economics was really the main leader in all the currency markets. We had so many clients world wide and the reports back then went out by telex. Overseas, the cost to just get the report by telex was \$200,000+ per yr. That is why we were primarily an institutional advisor because individuals couldn't afford the telex fees. We opened our first office overseas in 1985 with the idea of sending one telex there, and redistributing it in Europe and the Middle East just to get costs down to allow us to expand.

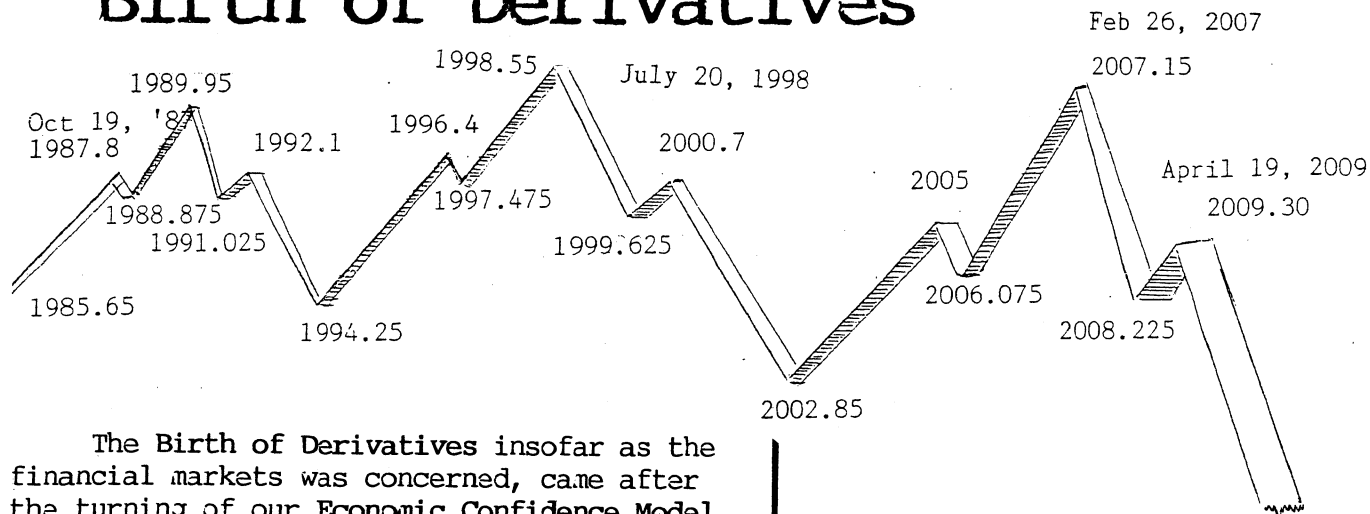
One of the biggest positions in the world back then was what we advised for one Arab client - \$1 billion. Keep in mind that the biggest futures/hedge fund in 1985 was maybe about \$100 million. The 24 hour markets began to develop rapidly after 1980.

What was taking place was the birth of a complete new era in the global economy. In stocks, this was the birth of the **Take-Over Boom** for after almost 52 years of suppression of private equity being looked at as just speculation with hindsight of the Great Depression, book values had become greater than the market price. You could buy a company paying full value for the stock, and then sell its assets and double your money.

Here is a yearly chart showing that the Dow Jones Industrials broke-out in 1985 precisely with our model and our announcement by taking the back page of the **Economist** magazine for 3 weeks during July 1985. This was a new era that was beginning where stocks would once again reflect profit, the very thing that **Milken** had seen and the New York crowd instigated the Government to wipe out their competition. This was a dynamic period of change, and the "**Club**" did not understand what they were doing as some master plan for the long-term, but they were in fact evolving with the flow. The focus would now become the commodity markets and thus we began to see organized manipulations beyond agriculturals. Manipulations began in small markets that were easily rigged like rhodium. They expanded into silver, platinum, and then crossing into the currency markets with the British pound and even the Japanese yen.



Birth of Derivatives



The Birth of Derivatives insofar as the financial markets was concerned, came after the turning of our Economic Confidence Model in 1985. From there onward, there was a mad rush to bring in computers and create models. Princeton Economics was very well known behind the public scene. We were primarily a institutional advisory for the biggest corporates and banks around the world. I would rarely grant interviews with the American press, for clients had long made it clear that they were paying the big bucks to us, and they did not want to see the same forecasts given out for free on the front page of the Wall Street Journal. So everyone knew we had sophisticated computer models long before anyone else, and I have been told this perhaps then fueled the rush to get into the field. I am not sure that is 100% correct. But there was a mad dash to suddenly get sophisticated. By the 1987 Crash, the press was blaming somehow computer trading portraying that the computers were trading on their own.

The truth of the matter is that all the firms were trying to use computers not to in anyway forecast the future, but to create a way to exploit the differences and arbitrage the markets as a whole. It was this initial drive that created the first round of disasters on a grand scale. There was Procter & Gamble as well as Gibson Greetings who lost fortunes. But nothing compared to the sheer collapse of Orange County, California.

The general scheme was you could take say \$10 million and through leverage, obtain an increase in interest yield. They played the yield-curve by pitting say 30 year bonds on one end against 10 year on the other. Picking up a small tiny difference in interest rates between the two instruments on transactions of say \$100 million, when reflected back to the \$10 million, your yield would double. This was the scheme dreamed up with no experience.

A friend of mine was Chairman of Temple University. This scheme was pitched to them by Merrill Lynch. Dick Fox told them to call me and if I approved, then Temple would look at the deal. A couple of young kids flew in from Merrill Lynch in Chicago to pitch the deal to me that they wanted to take the trust fund of Temple and enhance its yield.

I listened to the sales pitch, and then pointed out that the scheme was dependent on interest rates declining. I warned them that our model was point to rising interest rates and that the first uptick would wipe them out. They flew back to Chicago, and called me one more time. They flew out to Princeton again showing me that according to their study, a interest rate uptick would result in a break-even. I told them thanks, but no thanks. I could not recommend the deal to Temple.

They told Temple that I had been in the industry too long, and was not familiar with the "new way" of making money. Dick Fox followed my advice and declined. Orange Cnty blew up on that first uptick, and was forced into default. True, I was already an old-timer. But I came from the commodity side and knew volatility quite well. They made a fatal assumption. They assumed there would always be an orderly market to get out when wrong. Sorry - only in your dreams!

In 1994, Orange County went into default shocking the financial community. Merrill Lynch was now being sued for billions. The Federal Accountability Office recommended that such financial instruments be tightly regulated. It was Robert Rubin who in June 1998 went public denouncing the need for any increase in regulation. Neither the "Club" nor the regulators understood the problem.