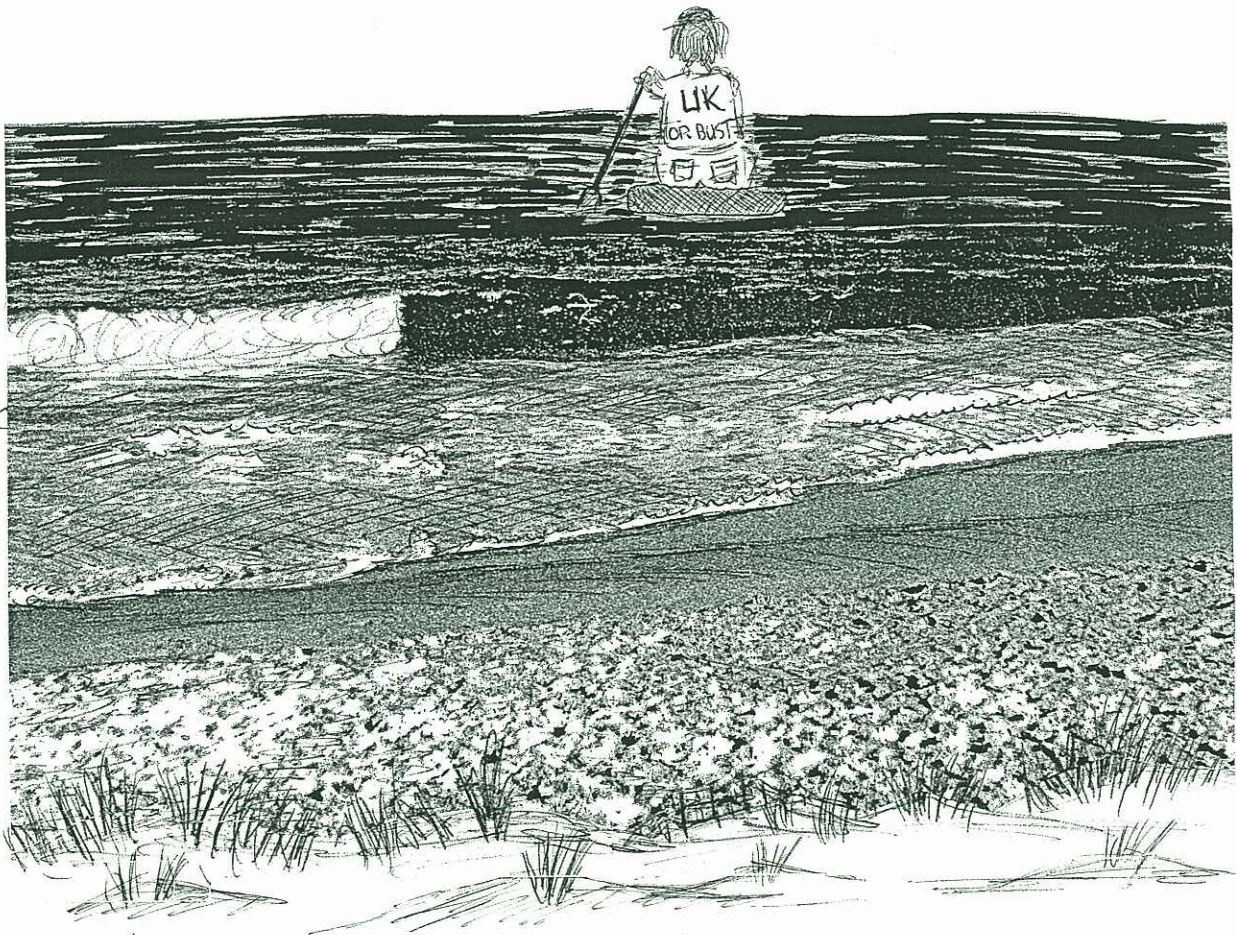


## Capital Flight

The USA Has Lost its stature  
As the Financial

Capitol of the World



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

## A C K N O W L E D G E M E N T S

I would like to thank the many people who have been writing from around the world. It is encouraging to know that there are so many people who are interested in uncovering the truth. I have also special thanks for so many providing valuable insight into trends around the world from China, Soviet Republics, South Africa, Brazil, Australian, and India. I believe we can survive the folly of governments even if they refuse to listen. The key is understanding the nature of events, and that allows us to correctly make the decision to be on the opposite side.

I would like to also thank all my old friend and former clients for their support and to know that they have continued to gather information that serves us all in times of crisis.

We are standing on the precipice of a new era in global-social-economics. How we enter this new age is of critical importance. Government is incapable to doing anything for any reform of its own abuse of power is not up for negotiation. We must weather the storm, and to do so we need to understand its nature. Just as the 1930s Great Depression set in motion profound changes that were even manifest in geopolitical confrontations, we have now reached such a crossroads. A debt crisis has its tentacles deeply embedded into every sector right into government. This is the distinction from a mere stock market crash that never alters the economy long-term. We are seriously still over-leveraged and some banks are still trying to be hedge funds and have to speculate to make a profit. That is a key warning sign that the worse is yet to come.

## Comments, Suggestions & Questions

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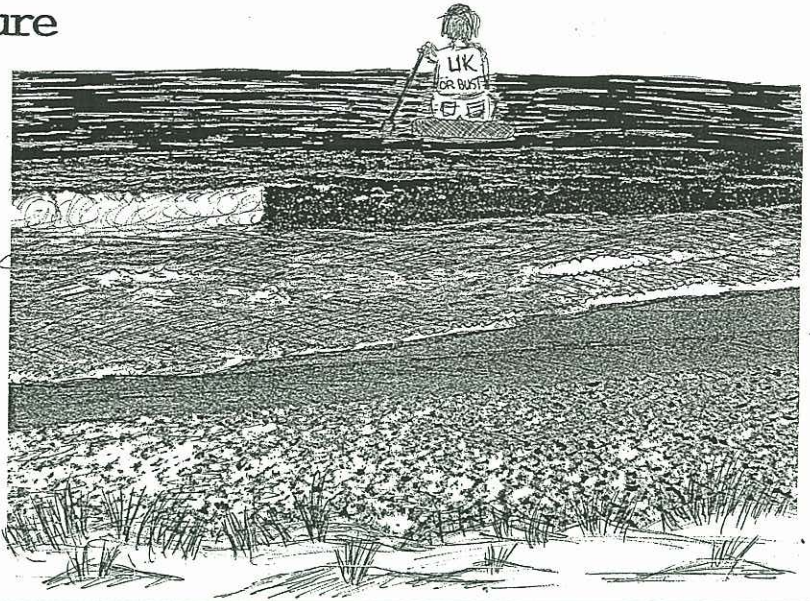
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This Report may be forwarded as you like without charge to individuals or governments around the world. It is provided as a Public Service at this time without cost because of the critical facts that we now faced economically. The contents and designs of the systems are in fact copyrighted. At a future date, a new edition of the 1986 The Greatest Bull Market In History will be released and a new book will soon be published on the model itself - The Geometry of Time. It is vital that we do not forget this is a world economy and the arrogance that any nation can dictate to the world is just insanity. Every nation effects all others no different than if one nation were to pour all its toxic waste into the ocean. Everything is interlinked and solutions are never isolated events.

# Capital Flight

The USA Has Lost its stature  
As the Financial

Capitol of the World



by: Martin A. Armstrong

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

**W**HERE HAS ALL THE MONEY GONE? IT TOOK A LONG TIME TO MAKE IT. WHERE HAS ALL THE MONEY GONE? TAKING JOBS ALONG WITH IT. WHERE HAS ALL THE MONEY GONE? NEVER TO COME BACK HERE AGAIN. WHEN WILL WE EVER LEARN?

The New York Times published a piece in 2007 written by Daniel Gross entitled "The Capital of Capital No More?" The report collected several studies and even groups that were forming to try to stop the flight of capital from New York and this was BEFORE the Crash. The New York Times reported that the **Committee on Capital Markets Regulation** noted that "the U.S. share of global initial public offerings - those outside the company's home country - fell from 50 percent in 2000 to 5 percent in 2005." The United States is hemorrhaging so bad, no one is noticing until it is going to be too late for government will not reverse its course and will only attempt to crush people even more.

Every nation in history has defaulted upon its debt as **Adam Smith** (1723-1790) in his 1776 **Wealth of Nations** made very clear. Indeed, since its publication, there is no government that has ever survived. Just as I explained with the slavery model, what happens is the population growth diminishes the value per slave on a supply and demand basis. But the cost to feed the rising number of slaves becomes self-defeating that drives the cost of production higher. What happens is an economic implosion.

Debt functions in the same manner. It grows exponentially doubling in less than 8 years. But the cost in interest rises for the pre-existing debt must be serviced. In time, the cost to service the debt rising steadily until it consumes the entire production. This is the future we face right now!

The more aggressive the government gets to hunt down its citizens to imprison them under the pretense of criminal law for tax evasion or failure to file, the more we will see capital become (1) hoarded, and (2) just pick-up and leave.

Marx in his absurd rantings had honestly focused upon only production. What he indeed failed to factor in was consumption. Like our politicians, he looked primarily at one side. He looked at the exploitation of labor, yet missed the whole point that if you raised wages, you raise the cost of living and then reduce consumption. These are balanced in a closed **Fish Bowl Economy**. Yet, companies are faced by consumer demands for lower prices and thus ship jobs overseas. The people are not willing to pay more just to support a union and thus the whole idea failed.

**Karl Marx** (1818-1883) I believe killed more people with his ideas than Hitler and Stalin combined. His model, if you can even call it that, was purely based upon hatred and presumptions that all workers are indeed exploited to only serve the rich as if this were still some sort of Egyptian monarchy. There are not enough "rich" among the common ranks of the population to exploit labor by consuming all that it produces. Just like taxes, all that is nonsense, for the greatest productive consumption remains the masses of the working people. How many TVs can the so called "rich" buy? Surely not enough to keep all the exploited workers employed.

**Marx** failed to produce any model that was useful, or could even be rationally tested once. The assumptions of class subordination were just not there. The biggest market was in fact the working people, not building pyramids for the rich while being exploited and whipped into submission.

It has always been the greed of the politicians, ministers, and kings throughout history that has exploited mankind and done far more damage to the pursuit of progress than anything else in the system.

In New Jersey, the democrat lost the election replaced by Christi the Republican ex-prosecutor who gave kick-backs to his old boss when he left office - Mr. Ashcroft by declining to criminally prosecute firms if the hired Mr. Ashcroft's firm at 10s of millions of dollars to monitor their behavior. No doubt he will go to Ashcroft for a job when he loses office. But that is the real game, and the people who rush out to vote and cheer and argue why their candidate is going to make it all better, to me is like watching a bunch of people high on drugs at some gathering like Woodstock. If they in fact honestly believe all the bullshit, they are no different than the Jews in Germany who kept arguing this will pass. Sometimes things blow out to the extreme and the flame dies.

Yet, the New Jersey election has shown the underlying discontent of Marxism. We are in a economic collapse with real estate the primary focus. Housing values collapsed and unemployment has been approaching a 26 year high on the bogus index at that. Still, the raw power of the state is being exposed. In every other industry wages are cut as well as

jobs. However, in the government, nothing has taken place and to make up for the decline in sales tax revenue, they have been raising property taxes. The politicians are just stupid for they cannot see that they are themselves destroying society. They will not reform and reorganize as they have even instructed General Motors and the banks to do. They will not reduce the size of the government and will never see that they are part of the problem. They are blinded by their own power.

While the new Republican Governor ran on lowering taxes, I seriously doubt that we will see any reversal in trend. This was a lawyer, turned prosecutor to get famous, so he could become Governor and hopefully run for President. What qualifications do any of these type of people have to solve the economic crisis? Absolutely none! I am no more qualified to be a doctor, so why pretend?

People are being driven from their homes because of taxes. On a million dollar home, the taxes are \$40,000-\$75,000 annually. Just where is all this money going? The lessor common housing still has people paying on average about \$10,000 in the middle class. This is the issue that turned the election. People cannot afford the tax rates and they are being driven from the homes. This is the real reason the Republican won. If it were a monkey, they would have voted for the opposite ticket. Enough is enough!

What **Marx** did was screw up the future and destroyed our posterity because he gave power to the politicians and they use brut force to ensure they retain power. There is nobody who has not been robbed of their full liberty thanks to **Marx**, who never even had a coherent plan - just hatred and words. Yet, **Marx** was elevated to a genius because of who he advocated handing power to - Government!

**Marxism** is largely behind the **Decline and Fall of the United States**. Capital has been pouring out of the country to such an extent, that the **Financial Capital of the World** is no longer New York City. Additionally it is the **Collapse in the Rule of Law** for the courts have been stacked with prosecutors who have never been on the other side and could never understand the scope of the full economic damage they have caused.

We are merely in the eye of the storm and about to come out the other side. What we must understand is the Global Economy is in dire straights and while everyone is now talking about the Maya and 2012, I would be far more concerned about the collapse of the very foundation of our social-political-economy.

I realize that there are those who are new to reading what I now write and believe that I am just bitter at the government. It is true to say the least I am pist-off at how corrupt the entire system has become. But this contest between **Public** and **Private Confidence** is not something new that came to me in a jail cell while sitting in contempt of court for more than 7 years. This is what I have named the overall model from the beginning of my publications on this back in 1979.

I am more pist-off at myself, for you see, I broke my own number one rule: Never presume anything - always explore with an unbiased perspective. It is my fault that I presumed the United States was honest. I was a victim of its propaganda. For you see, growing up with my father being a lawyer and a judge, it was obviously a different era. My father and his friends would sit and talk about the law, the Constitution, and I believe he even represented someone in the McCarthy Communist witch-hunts. So it was my mistake to judge the legal system by what I observed growing up. I self-surrendered assuming that would demonstrate I was innocent. When the government admitted that they never spoke to a noteholder and the charges were based upon what they "read in a newspaper" with the canned story put out by Republic National Bank, Judge Freda Wolfson's facial expression was one of shock. She released me on \$5 million bail. When I stood before Judge Richard Owen, you can feel the hatred pouring out of his nose and the presumption of guilt is overwhelming. My lawyers even said, "They practice law differently in New York." In effect, you have no rights at all, judges can change the very words you say in court to deny you any right to appeal, they can throw the press out and then alter the transcripts to hide from the public what the hell is going on. It is my fault, that I just made that mistake of presuming the system was honest. I did not investigate HOW the rule of law was being administered in the USA.

This experience has opened my eyes no doubt. But it has not influenced the view of the future because it is not the only reason why capital flees and the economy is more-likely-than-not just going to collapse. Politicians are in control, and they will not listen because they act only in their self-interest. That means, they will not act in advance to prevent a problem. Elections are not won by see, but for my own actions, you would now be broke. It is like someone coming up to you at the bottom of a hill in San Francisco and telling you he just saved your life because he discovered a car parked at the top of the hill was starting to roll so he jumped in and put on the brake. Would you give him a \$100 tip for saving your life? Or would you think he was trying to con you? So to be fair with politicians, they will never act to stop anything, they are only in their glory to fix something after it has happened. This is why we cannot expect any hope from government.

This experience has exposed me by force to mix with a group of people I certainly would not have met otherwise. From the positive side, it has completed the circle of my education. I have now looked at the world through the eyes of just about everyone from a group perspective.

In modern times, the two greatest true explorers outside of geography, have been Adam Smith (1723-1790) and Charles Darwin (1809-1882). I have always strived to follow their methods of investigation. Perhaps because they were embarking into a theory or just exploring the world to see what makes it tick, is hard to determine insofar as was their any sort of a predetermined expectation. It matters not whether they began with a theory or explored like a child caught in the wonder of all his surroundings. They both approached their core subject matter with unbiased methods of just see where it leads.

We are unfortunately headed into serious times. This is the very reason I began to write after receiving so many letters asking me to speak out from clients I knew for decades. It is true that I have been tortured, thrown into cells with no heat and you could see your breath, and into other cells with no air to the point I lost 10 pounds in one week from the heat well over 100° and honestly not even expecting to wake up again in the morning.

I have recently bumped into a inmate who was there the night I was attacked. He told me the officer would not push the panic button and would not enter the cell. He waited for Mr. George to come out and showed everyone my blood covering his hands and his arms as he held them up bragging that he had killed me with his bare hands. Yes, I find it very strange that the government who will prosecute anyone, did not prosecute him. So I have by force, learned what the meaning of those famous words spoken by Patrick Henry (1736-1799):

**"Give me Liberty, or Give me Death."**

I have now experienced the full circle of life. It has completed me, no doubt. In a very real way, I am grateful that I have looked into the eyes of such corruption and survived to write about it. This experience has broadened my understanding. I can see things now that I could only have read about and tried to imagine. There is no letter I could write to President Obama that would ever move him to do anything on my behalf. They will not expose the system, for you see, it is all bullshit. They do know what they do and Democrat or Republican, they are all the same. No Senator will ever dare investigate the Judiciary. Patrick Leheay, head of the Senate Judiciary Committee will never lift a finger to help the people of this country or to do his job and clean up the corruption in the Judiciary or Justice Department because it benefits government.

So, I am more pissed-off at myself for being so stupid, I failed to investigate the Rule of Law knowing it was the most vital key to sustaining the wealth of a nation. Even when Margaret Thatcher was asked in Princeton New Jersey at a conference, "Which country would you invest in, Russia or China?" Her response back in 1997 was: "I would not invest a dime in either because they did not respect the rule of law." I knew that law was the key and yet I did not investigate how it was being administered. Had I done so, I probably would not have been here for I would have resigned my American citizenship long ago.

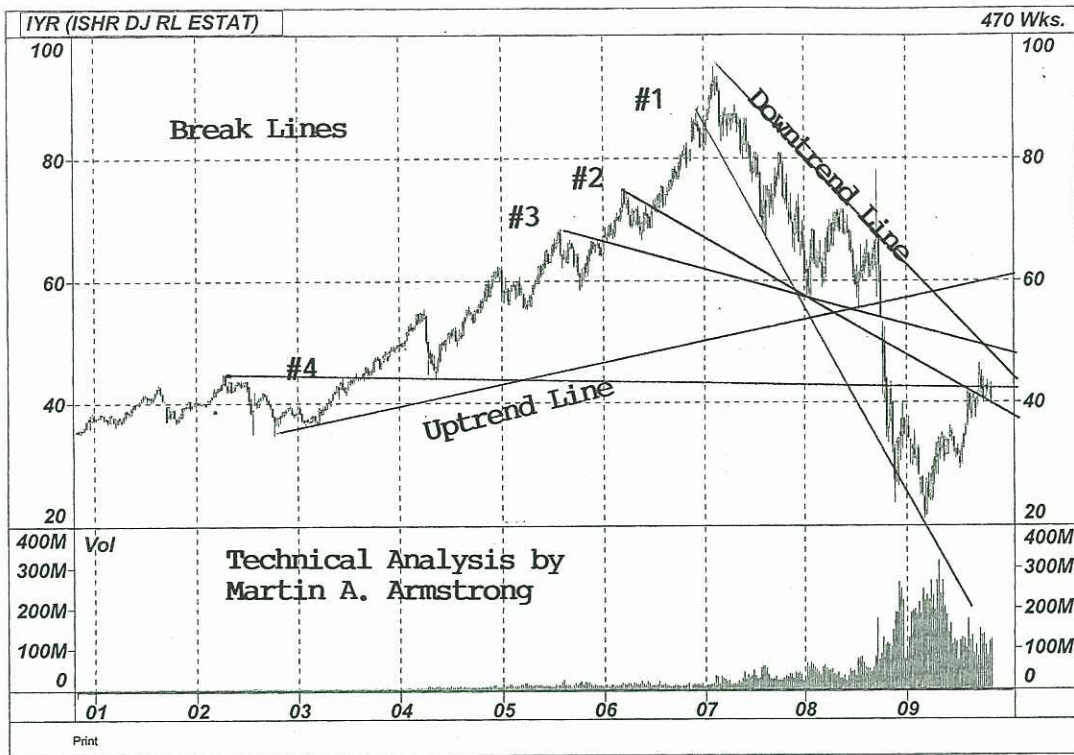
How I have been treated has not altered my expectations. It has forced me to see the world through another set of eyes, but that has only completed my education reinforcing trends that I knew pre-existed.

I have always been careful to separate by "belief" from my "observation" and will always identify any distinction. In this regard I have always been very disciplined. The reason why, is in this life, it has been a journey of exploration. I have followed the methods of Smith and Darwin, approaching a new subject-matter (Floating Exchange Rates) with no preconceived ideas, because this has been a new field that no one before me ever wrote about.

I was not embarking down this path to be an academic. I found it interesting to be a globe trotting fixer-upper. I was there at the dawn of the Floating Exchange Rate System in 1971. Because I was coming from the gold perspective, I was attuned to global movement because it was the same commodity in every country. Stocks tended to be domestic products and did not inspire global thinking. This is why we ended up with theories that are all wrong and why the fundamentalists are confused and the academic economists get it all wrong as well. They see the world only as that Fish Bowl and do not consider external forces that can change the system completely.

There are panics that are local, such as 1792, 1837, 1869, 1893, 1907 just to name a few and then there are those that are contagions that are global such as 1857, 1873, 1929, 1987, and 2007. Sometimes the contagion began in Europe as in 1873, and other times in the United States as in 1987 and 2007. It depends upon what is the focus of speculation that has caused capital concentration and where that is taking place. For example, the 1987 Crash was caused by (1) the manipulation of the US dollar by G-5 starting in 1985, and (2) the Democrats raising taxes on real estate that set in motion the S&L Crisis. This drove the capital from the US markets into Japan that created the Crash of '87 shifting the capital flows back to Japan causing capital concentration leading to the 1989 Bubble, and the lost decade as the LDP tried to keep prices high.

I have been trained by our clients. They are indeed my teachers -NOT school! There is still no university today that teaches International Capital Flows, how capital rushes around the globe creating Capital Concentrations that are booms and busts. They do not even teach about hedging! Yet they turn out PhDs and MBAs with no real world experience. This does not help. We have to realize that the economy evolved , destroying most theories still taught today.



**Real Estate:** It was real estate that peaked precisely with the **Economic Confidence Model** in February 2007 reflecting the **Capital Concentration**, on a Sectorial Perspective

Because I was not interested in being an academic but enjoyed the hands-on problem solving, in a strange way I was trained by all of my clients. Each group in each country looked at the world through only their currency. One could not provide forecasting by simply having a myopic view of the world. I could not give someone a forecast that buys some stock in Asia because it should rise by 100%, when in fact the currency it traded in would collapse by 60% relative to the currency in which a client mentally measured their profits. It became a profound fundamental that I was forced to look at every investment opportunity in terms of absolutely every currency because a client is going to judge you on the performance in his currency. You cannot simply say, "Well I was right. Gold rallied by 50%. But sorry about the loss because your currency rose 200% in terms of the dollar and you lost money. But hey! I was still right about that gold in US dollars!"

Having clients around the globe and in fact spending the vast majority of my time overseas, I was compelled to see the world in a much more dynamic perspective. I could see all the economic theories were wrong save Smith and Ricardo, for they had all been born under a world of fixed exchange rates. That made all the difference.

The economic theories of Keynes, could not even account for rising unemployment and rising prices (**stagflation**) because there was no consideration of (1) a floating exchange rate, and (2) external shock waves from events overseas (OPEC). In the world of Keynes, these things did not exist. The world was a Fish Bowl and nothing external existed.

Under a gold standard, not only is every aspect of the economy inverted because money is gold and thus it rises in value in deflation and declines with inflation, but capital does not migrate as fast around the globe because "profit" is then measured the same in every country. Therefore, for a German to invest in America, there has to be a "real" advantage of profit that is not attainable at home. In a floating exchange rate, the 20% swing in the currency can make a 5% loss in domestic terms still a profit to the German at home. The world as we knew it changed rendering the whole theory of market efficiency bogus along with most economic theories.

Above is the US Real Estate Index. This peaked precisely in February 2007 to the day with the **Economic Confidence Model** collapsing nearly 25.8 months thereafter. This illustrates the **Capital Concentration** in that sector and warns that real estate appears to have entered a longer-term depression with a drop in price.

Just from a technical view of Real Estate, we can see that there is a serious risk that we will see a downturn again and that the resistance is becoming formidable. A closing for 2009 below 62 keeps the momentum in a bearish mode to say the least. A closing below 43, will signal that indeed the bear market is alive and well.

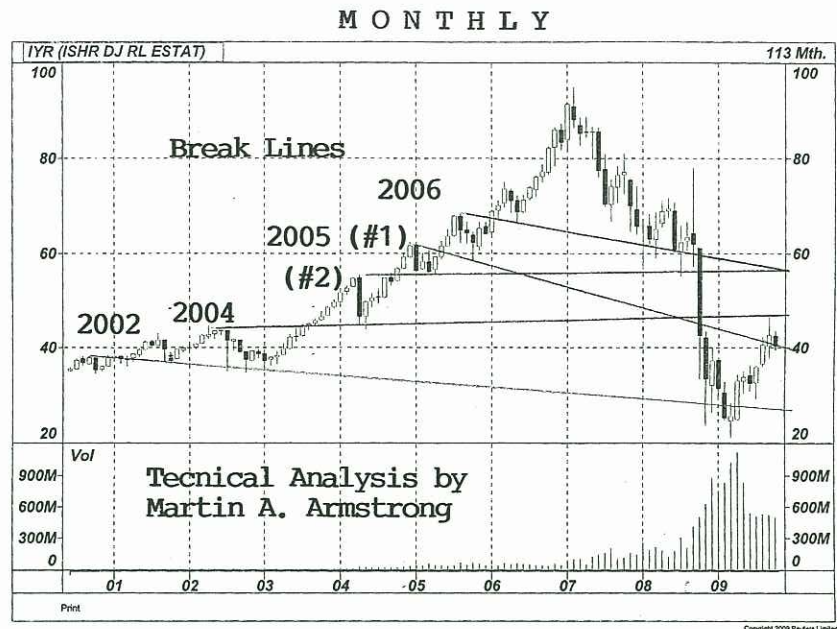
Throughout 2010, the major resistance will stand at the 58 to 62 level. There appears to be no hope whatsoever of any turn-around at all. Of course the politicians and the pure economic academics will claim the opposite. But they would never say the opposite even if they believed it. We are truly screwed.

I have provided the historical **Break Line** view of this index using a Candle Stick Chart. We can see that the 2006 and 2005 (#2) lines highlight the major resistance in the 58 area while 2005 (#1) provides the instant support near-term. The 2004 Break Line picked the high for this rally nicely and the 2002 shows us where the support is likely to be going into the broader future.

Now it is time to start to discuss the real estate market and the real leverage in the system. Anybody who has even gone just to Canada and looked at real estate will notice there is a difference in price. The same is true in Europe. Why has American real estate been higher in value than overseas?

The simple explanation is that there are 30 year mortgages. You are in reality taking your entire life and leveraging it. The more you can borrowing on future income and bring that forward to spend now, the greater the supply of money and that will cause the price of a home to rise in proportion to the money supply that is measured by the velocity - the number of times money within the system will change hands. Therefore, the value of homes in the United States are higher than they are in most other countries because they cannot bring forward potential future earnings. This introduces some very serious bubble aspects.

Are Prices still high or reasonable?



Real estate has been used as a piggy-bank by the average citizen. This is their life savings. What if prices decline because (1) states continue to demand higher property taxes and will not reform, and (2) money will leave because of increased legal persecutions and rising taxation? The net impact will be to keep real estate prices depressed.

The worst possible outcome would be for capital to continue to flee, causing a drop in lending based upon money supply shrinkage, and the refusal of government to reform. This combination could create the complete collapse in the Western economies focused in the good old United States.

For you see, it was the US real estate market that was bundled by the investment banks and sold to world banks. This had the effect of spreading the crisis globally. That reduced the global money supply by cutting the velocity. With Eastern Europe also hit hard, this contraction hit the European banks further shrinking the available money supply. Europe got hit from both sides.

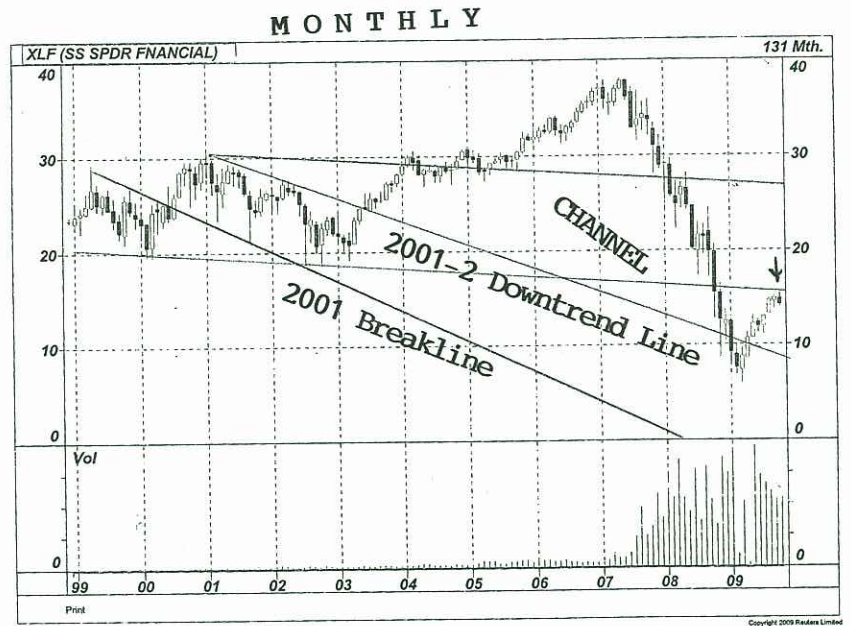
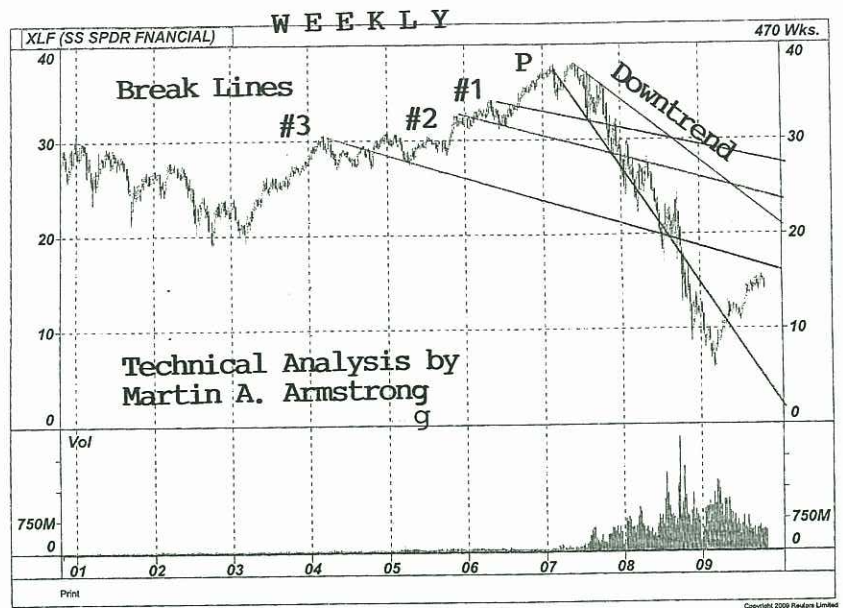
What appears on the horizon is a deep prolonged decline in real estate. This should spill over into the commercial side as well and the problem we have is the collapse in bank lending fueling the contraction in the prices. If we see this trend continue to now unfold, the national wealth will implode for you will wipe-out the perceived savings of the people in their homes. Once that happens, we are talking about the economic collapse.



Hopefully, you are starting to understand that the greatest sum of all possible economic fears possible, is a collapse in real estate. Stock Market drops do not create depressions. Such events take place with only a **Debt Crisis**.

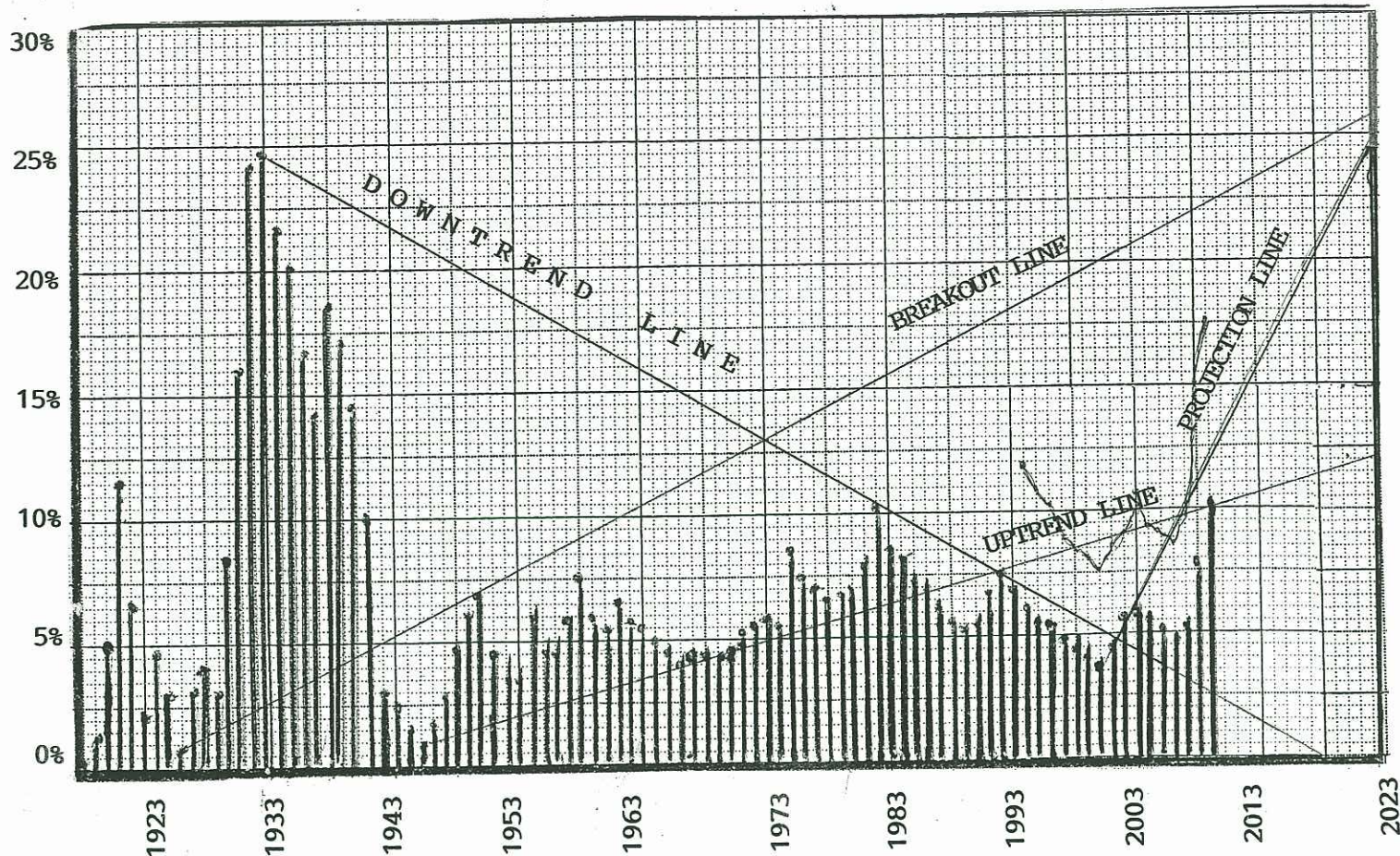
We always have two sides to a coin. The one side is the debt collapse in government. This will normally create an offsetting trend of inflation or rising in the value of all tangible assets. Therefore, real estate would be one area of appreciation. However we cut it, real estate is also an immovable asset. So in times of political instability, you just can't take it with you. Hence, the value of real estate is and always has been, linked and very dependent upon the political view of the nation - ie **Rule of Law**.

Because the banks have lent long-term in the USA for mortgage deals, this has created a long-term bull market in real estate creating the image that it is a safe bet long-term and thus it is transformed in the minds of the people as a savings bank. This depends upon the political views and the levels of taxation. If the future supply of funding is declining long-term, this will have a deflationary impact upon prices. The more politicians will not reform, the greater the whole political instability unfolds and that will create caution adding to the downward pressure on prices. Once this unfolds, we have the makings of a real live **Great Depression**.



Clearly, we understand creating a declining bear market in real estate has the greatest risk of creating long-term depressions because it destroyed the perceived wealth of the common man. Now let us look at the sector that created the mess - the Financial banks. Here we have a decline of 21.5 months (8.6 x 2.5). The major resistance stands at 27-28. If we close below this for 2009, which seems likely, the pressure points to decline even near-term into 2010-2011. The broad channel on the monthly chart appears to be forming resistance from the bottom. As long as this prevails, there is the risk that this industry is in serious trouble going into the years ahead. This formation appears to be lining up with a low in 2011 to 2012. Unfortunately, we may see a collapse of more banks, and we may then start to see that even government debt finds no bids for everything.

# US Unemployment Rate Annual 1919-2009



Copyright Martin A. Armstrong including Technical Analysis  
Source: The Greatest Bull Market in History; Post 1948 BEA

Now let us turn to the Unemployment Rate that is unfortunately seriously manipulated to fool the public. We no longer count people who gave up looking for a job. So, when you keep fooling around with how the number is calculated, you may start to believe your lies. Yet here I have taken the BEA numbers post-1948 and blended this with the numbers that were real from the **Greatest Bull Market in History**. Still, even with the manipulation, all we have is a seriously volatile indicator. From the 2000 low that corresponded with the bubble top in NASDAQ, we have seen a break above the old **Down Trend Line** from the Great Depression.

If we were looking at a chart of stocks, a technical trader would immediately proclaim this to be a bull market. The **Projection Line** I have provided, gives us a realistic rise in unemployment on the current index at the 12%-15% level going into 2012. If we exceed this

**Projection Line**, then we should expect a very serious economic decline driving this rate above 20% going into 2016.

You will notice that the 2000 low comes 17.2 years after the high in 1982, which is 37.33 years up from the 1945 low. The 1945 low is 12 years from the major high (2x6). From a cyclical perspective, the next major high in **Unemployment** will come in 2024. For now, there should be a rise into 2010, with perhaps a brief pause in 2011, and a sharp rise beginning in 2012 going into 2019.

I have drawn the shadow number post-1994 that includes those who stopped looking for jobs and those working part-time but are now looking for a full time job. This puts the 2003 rally above 10% and the 2009 level at over 17%. In other words, **Marxism** is leading to a complete economic meltdown as it did in China and Russia.

The degree of corruption taking place in the **Rule of Law** is having a tremendous impact on driving capital away from the USA to the extent, it has even lost its status of being the Financial Capital of The World. While my case shocked the international community that knew the notes were a bailout where we purchased portfolios, not soliciting cash to manage or were borrowing of yen on the then popular carry trade. The government lied about the structure of the transactions and then threw me in prison on contempt of court for more than 7 years attacking all my lawyers 3 firms in the US plus 2 outside in London and Tokyo, stripping them of all funds to prevent a trial. Clearly, no serious person should keep any account in New York if judges refuse to defend the law just so the government never loses!

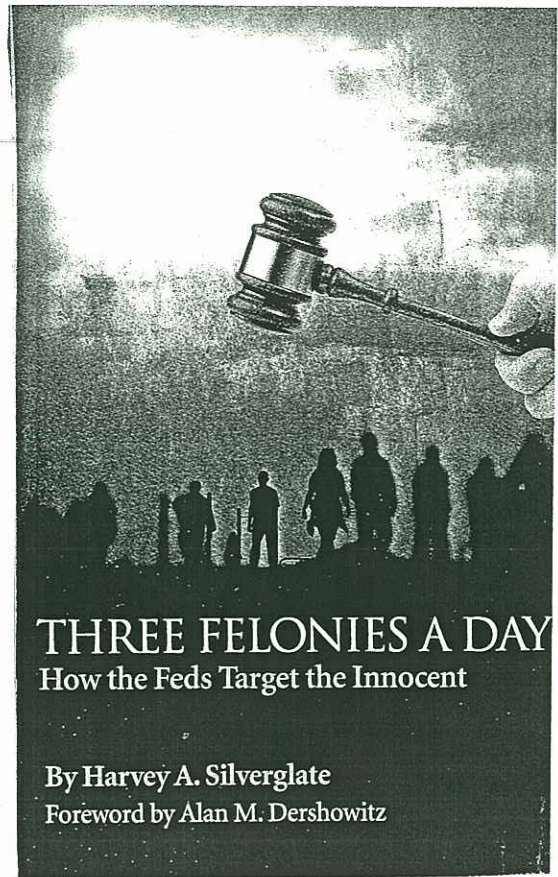
I have received so many letters from all various professionals informing me they are no longer doing business in New York because of my case. With judges like Richard Owen who is notorious, P. Kevin Castel, and John M. Walker, Jr., you should never have any such account in New York. As **Charles Dickens** wrote about the corruption of the English courts in 1859 **Bleak House**, "Suffer any wrong that can be done you, rather than come here!" **Chp I.**

For those who think I am bitter, you have not walked in my shoes, read letters from around the world, not witnessed the cruel procedures they inflict upon so many. All I can say is read this book that has just come out:

### **Three Felonies A Day - How The Feds Target The Innocent.**

This book is written by Harvey A. Silverglate with a forward by Alan M. Dershowitz. This book is the first I have read about the Michael Milken case among others showing that Milken was innocent and the courts again had constructively made up a crime to take down Drexel who was a major competitor to the New York Banks.

The problem America has is that the **Rule of Law** is so corrupt in New York City, this is destroying our economy. What people have to understand is that once the financial capacity to sell debt is diminished by the very corruption of the courts, then we will be unable to sell the debt and that will then signal the complete collapse is not far at that point behind.



While Silverglate was part of the Milken defense team and he explains how the government blackmailed him threatening even his 90 year-old Grandfather, people will do anything to protect their family. This is the number one means of extortion used in New York and Congress will never investigate nor will the Supreme Court supervise a damn thing. You have to be nuts to have an account in New York any more.

Silverglate's book even goes into Frank Quatrone who had the same judge, Richard Owen who he states is one of the most anti-citizen judges in the entire nation. These people are destroying the very fabric of our economy and what is going on is they are prosecuting any firm or person other than from New York. The Madoff prosecution took place because he blew up and they were forced to do so. New York will not prosecute any major NY firm, for as a lawyer put it - "**You don't shit where you eat!**"

Hedge funds are leaving. Capital is fleeing because it is too risky to deal in the USA under these conditions. London is still holding on despite the rise in taxes, and if the British get their nose out of Karl Marx's books just for once, they have the chance to regain the dominant role.

The weakness in the dollar and the low interest rates, is creating a dollar carry-trade (borrowing in dollars, converting to a foreign currency, and earning higher rates of interest). As evidenced by my own case, you cannot do that in New York because they do not understand a carry trade and will accuse you of trading somehow for someone else when you just borrowed money - that's it.

The dollar carry-trade is also contributing to the demise of the dollar just as we saw in Japan. In fact, the USA seems to be in fact making the very same mistakes as they did in Japan. That is not a warm and fussy feeling about our future.

The problem remains that the Justice Department, SEC and CFTC will not at any time ever criminally or civilly charge any of the big names that everyone knows created the big economic collapse. The relationship is far too incestuous for unbiased regulation. They can rig the game to protect the NY banks, but at the same time they are destroying the country.

The whole reason why there are hedge funds is because of the over-regulation of everyone other than the NY Investment Banks. If you had a fund that invested in everything, you go to jail under the SEC if you comply with the CFTC regulations.

The SEC prohibits performance. The CFTC allows performance if disclosed. The SEC will prevent management fees greater than 0.25% & they will prevent mixing funds. This is why there are so many types of funds pushing the requirement upon the average person to know what sector is the best to invest in at this moment. A hedge fund has to be offshore for there you are hiring a fund manager to do his job and make that decision.

The SEC, CFTC and Justice Department will persecute others to pretend they are doing their job, yet they do not regulate things that their friends create like CDS and blow up the entire industry. They regulate to such extremes, they are driving capital offshore as they did with the hedge funds.

We should have had one regulatory body like every other country. We have to stop the corruption within regulation to even now survive. The SEC and CFTC should be shut down and a brand new agency needs to be created. Stop hiring young lawyers and prohibit them

going to work for any firm that they regulate or for a lawfirm that represents them for a period of 5 years. Congressmen are prohibited from going to work for a lobbyist and here we are talking about a regulatory system that is so screwed up, the entire national wealth is at stake.

Barney Frank has proposed a bill that will allow the government to just seize any firm whenever they think it has reached a size that is "too big to fail." The idea is they can seize a private company with no problem on the theory they will be able to prevent a meltdown. Now there's good reason to stay in America!

Who will make that decision? Will it now be able to seize say a foreign bank because a New York Bank has paid off the right people to invoke that power? You have to be insane to have a business in America with these sorts of ideas floating around.

Congress does not have a clue what to do because they are lawyers with absolutely no practical experience whatsoever in the very field they are trying to regulate. So who do they call for help? The SEC just now hired a man from guess where? **Goldman Sachs** for their enforcement division.

Recently, it came out that Madoff was coaching another how to deal with the SEC on a tape recording. He explained how stupid the government is, and how to lie to them for they will not understand complex transactions. I hate to say it, but he is correct. I tried for 7 years to explain a carry trade and the eyes just glaze-over.

In the case of CBL, a Swiss firm that was seized by the SEC and criminally prosecuted in New York because they were taking too much business away from New York with the Swiss Banks, the SEC alleged fraud. At the end of the day, they claimed the "loss" was \$12 million, but the SEC took \$20 million to pay its receiver and the US director got 11 years in prison. Excuse me, but if the fraud created a loss of \$12 million out of \$1 billion, yet the SEC Receiver took \$20 million in fees, was there even a crime had not the SEC illegally seized the company?

Those who really hurt the entire world economy are protected by the US government at the expense of the whole world!

# Is the Next Bubble in ETF Emerging-Markets?

While ETFs have taken off in the past 5 years or so, there has been an exceptional growth in the past 12 months. Some people are warning that the ETFs on Third World markets is starting to be a bubble. While I intend to cover each market before year-end, what I did feel was necessary to warn about is how the US regulators are so brain dead, they are once more creating a problem that will blow up in their face.

This is another example why capital is safer outside the US than inside. The ETF (Exchange Trade Fund) is effectively an index of the market of another nation. There are domestic ETFs as well. But for the purpose of this discussion, let me illustrate the time bomb created by regulators who know not what they regulate.

The combination of US Internal Revenue Code and the SEC Investment Company Act of 1940, conspire to create a problem that will surface. While it may sound nice that a mutual fund may not allow their investment to at any point become concentrated in a small group of stocks. To be specific, they may not allow a single stock to exceed 25% of the investment portfolio. Half of the portfolio must be made up of stocks that no individual one can exceed 5%.

Now, what happens in some of these more limited emerging-market funds is that they do not have the broad array of stocks. Often a single stock can be the predominant value of a small index. Ironically, these rules can have the opposite effect and de-link the actual ETF from the underlying investment.

As money pours into the ETF emerging-market fund, the manager is compelled to buy more of the underlying stocks. However, as one stock rises in value, exceeding 25% of the portfolio can force the fund into being a seller in a bull market because the SEC has no real world experience.

What will happen is quite simple. The ETF will begin to lag behind the real core index it is suppose to track because the SEC has no clue what it is doing. It is now

time to realize that every major crash often is actually caused by government. The S&L Crisis was created by regulation that required the S&Ls to lend into the local community and after creating a bull market in real estate, they then decided to raise taxes and that ended the very reason why there was a boom to begin with. To escape blame, they then indicted **Charles Keating**, who was then convicted on the theory that when he sold bonds for his S&L he "knew" he would go bust 7 years later making that a fraud. Had he not known, it was no crime. He eventually had his conviction overturned after spending a few years in prison, and when the government tried to re prosecute, the case was thrown out as being "politically motivated."

The 1987 Crash was caused by the G-5 that was publicly manipulating the dollar down by 40% to improve the trade deficit. They did not understand that after selling 33% of the entire national debt to the Japanese, they might start to sell because they would lose 40% on the currency!

In the 1890s, the nation was brought to the brink of collapse within hours, because government did not understand that overpricing silver relative to Europe, would cause silver to pour into the country and gold to leave on an international arbitrage.

So forgive me if this may seem bitter. It is not. It is just the plain truth. There is nothing more dangerous than a politician who is just a lawyer with no real experience. These people have created wars, destroyed the foundation of civilization, and retarded our ability to progress all to fulfill their own desire for personal power.

## CAPITAL IS FLEEING & WITH IT OUR ECONOMIC SURVIVAL

I would like to BELIEVE by writing this there would be millions of people who get it and start to demand reform before it is too late. But, alas. That is a pipe dream that will never materialize. For you see, based upon historical OBSERVATION, politicians will not listen until it is too late. So we all can hope and dream. But at the end of the day, we just have to prepare to survive. Soon, we may see any worthy hedge funds moving off to other lands. The risk of being prosecuted as the Bear Sterns guys, is just too great.

# C O N C L U S I O N

**F**inancial World as we know it, has evolved greatly from the old pre-1971 days of the fixed exchange rate system. Everything that was conceived of in the social economic context, is mostly dead wrong. The brilliant work of Adam Smith and David Ricarco survives. For there will always be the self-interest that drives the **INVISIBLE HAND** and that is the foundation of the **Free Markets**. Socialists will disagree because they do not want to listen to anything that prevents them from doing what they want. They believe that they can create a world that they desire rather than understand what is the system and how it works. They are just economic tyrants to me. They wish to dictate to the people no different than any other tyrant who seeks personal absolute power.

What we must do is dissect the whole economic structure and study HOW it works in order to understand the solution. We CANNOT proceed on just opinion. Where's the proof! Where's the study? Where's the evidence of what you say is correct?

What has taken place over the years post-WW II, is that the **concentration of wealth** in the United States created a false sense of invincibility. The housing market has had a good run. From roughly the 1955 period, we have seen about a 52 year rally into 2007. It appears that we may have reached a major high in real estate and this is of great concern. For if this is the case, then what we are in fact looking at is a serious contraction in what people believe has been their long term piggy-bank.

This trend is converging with the retirement of the baby-boomers. It is also converging with the securitization of real estate pools that created the '07 high in February. This combines even still with the dangerous problem we have of the debt that is also starting to implode on a state and national basis.

Effectively, because we are **NOT** the financial capitol of the world as we were in the 1930s, the trend that emerges will be different as well. Where capital was fleeing Europe and rushed to the dollar driving that up in price so that we then turned to protectionism, the opposite is now taking place whereas the dollar is falling as capital is fleeing, so if we see anything, the high degree of imports will now be inflationary in the US not deflationary.

With the banking system still in deep denial and capital beginning to show signs of caution shortening its maturity even in sovereign debt, the long-term horizon will also collapse. The more difficult it becomes to fund long-term, the greater the deflation effect will be in housing.

Nevertheless, this will not be any such national trend. What we have is an inflation pressure in other sectors that we will see manifested in stocks and commodities. It is the real estate that is still leveraged and will take a serious impact upon exclusively real estate. If funds are not available to provide long-term mortgages, then prices in this sector will continue to fall. That is not the same fate that is shared by the rest of the financial markets.

It is the lack of liquidity in real estate that is the problem. Prices reflect the ability to borrow 30 years of future income. As that contracts, prices collapse. We do not have that sort of leverage in stocks or commodities.

Consequently, the future that lies ahead is not as easy as most would have you think. The core interrelationships shift and change. We are facing a serious problem with the real estate sector as a whole, and this will be reflected again in a second phase of the major crash that began 2007.15 precisely to the very day. The banking crisis is not over either. As this turmoil brews, you will see every fundamental idea of how markets function to be laid bare on the sidewalk in ruins. This is not time for opinions. This is time for serious work. Unfortunately, I am not allowed near a computer. I am not even allowed to use white-out to correct typos. What this all does I fail to see. But the worse may yet soon come.