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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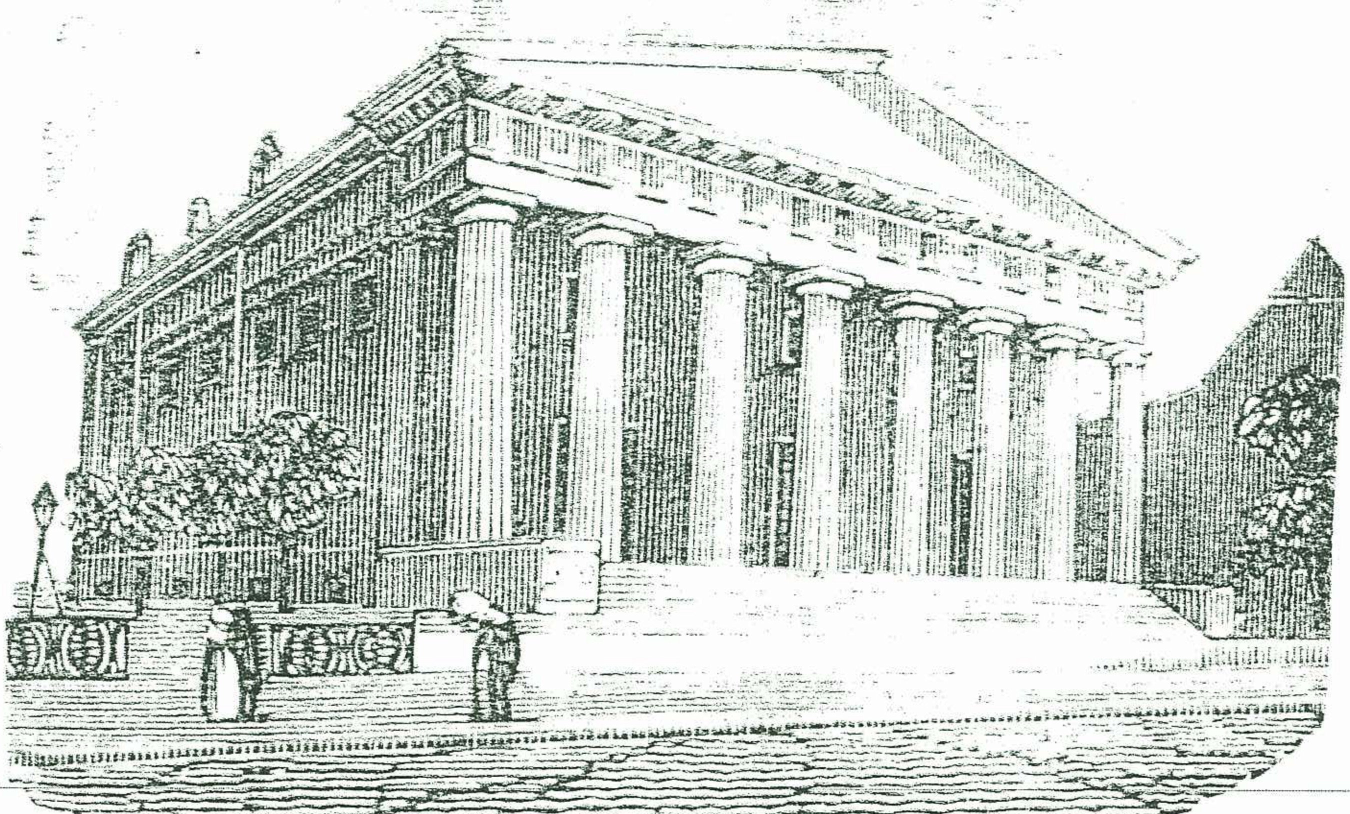
Is America On The Verge Of Another Bank War?

Should We End the Fed or Goldman Sachs?

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



Bank of the United States, Phildelphia

 October 30th, 2009

Comments Welcome: ArmstrongEconomics@GMail.COM (Internationally)

PROLOGUE

There is a brewing storm over the **Federal Reserve** and whether or not we even need a central bank. Many blame the **Fed** for the current economic crisis and are calling for its execution.

Ron Paul has written a book entitled **End the Fed,** while many others see conspiracy lurking in its secret halls and its private ownership by commercial banks.

Then we have those who are at the center of the storm, pretending that the crisis was caused by the **Lack of Transparency** and the failure of the regulators to comprehend the "risk" underlying the transactions. **Lloyd Blankfein,** head of **Goldman Sachs,** wrote a piece in the **London Financial Times** on October 13th, 2009, claiming:

> "At Goldman Sachs, we calculate the fair value of our positions every day, because we would not know how to assess or manage risk if market prices were not reflected on our books. This approach provides an essential early warning system that is critical for risk managers and regulators."

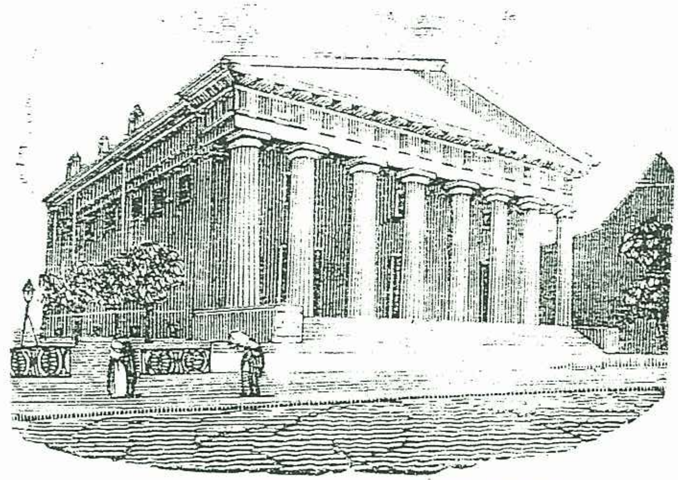
Quite frankly, calculating "fair value" of risky positions after they have been established is sort of like closing the barn door after the horse ran away. The question that needs to be asked, is from the outset, **Is this product even appropriate to be involved in?** Goldman Sachs needed to be bailed out just like every other bank involved in CDS products. When **Long Term Capital Management** had blown up in 1998, the **Fed** did **not** bailout a hedge fund, they were bailing out the banks who **LTCM** had positions with and would have defaulted. To "cover-up" who was being bailed out on that one, including Goldman Sachs, they claimed to be bailing out the hedge fund. They were not protecting the investors in that fund, it was the banks who took the "risk" for calculating daily "fair value" obviously does nothing to prevent an economic collapse. The best that can do is tell you you are going to collapse - **NOW!**

Hank Paulson when he was the head of Goldman Sachs, testified before the SEC asking to raise the very leverage that has caused the entire problem. I find the ability to rewrite events incredible. Is it any wonder why there will **never** be any solution as things stand now?

Madoff himself has been revealed on tape coaching another on how to deal with the SEC portraying them as stupid and easily fooled. This is the whole problem. The government hires young attorneys who **never** had a real job, who run to them to get some experience, so they can then get a real job. Anyone who has had to hire staff can tell you education degrees are really worthless. No matter what school they are from, you have to take that person and still train them in the real world. Degrees only show interest. It is like reading a book on sex, and then you go around teaching people to have sex, but you have never had sex.

We are entering into a **Bank War** that has been raging since the beginning. Do we need the **Fed?** Or is the problem with firms like Goldman Sachs? That is the key!

Is America On The Verge Of Another Bank War?



Bank of the United States, Phildelphia

by: Martin A. Armstrong

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

ONCE UPON A TIME, the United States Government had no debt. This was the reason why President Andrew Jackson could even engage in what has become known as the **Bank War.** Today, the United States borrows from China. About 29% of the total National Debt is funded by foreign sources. The USA has lost any of its ability to be independent in world politics anymore. Do you really think that the USA can do anything if China invaded another nation and still turn to them to buy its debt to fund its domestic agenda including military? It is time to get real. Because we have "career" politicians and not a true "democracy" as it was in Athens, the combination of Marx and Keynes has wiped out any hope of our future. The dependency upon debt has immobilized the nation and the Primary Dealers now control the state like never before. What is now at risk in the **Debt Crisis,** is a collapse that has always taken place whenever debt has risen to control the state. The dog no longer is capable of wagging the tail. The flee at the end of the tail, now wags the the dog. We are headed into the eye of the storm and the end result will be the state once more waging **War on the Banks.**

The Crisis Begins When The Banks Cannot Sell The Debt

I have spoken to journalists who will state up front, they do not believe in the so called "conspiracy theories." The sad part of this bias, it prevents them from even seeing the real crisis that is brewing under the nonsense. Whether it has been a deliberate plot (conspiracy) to get the nation addicted to debt, it does not matter if this was a conspiracy plot, or it was the product of evolution politically. The end result is still the same.

The **Bank War,** as it was known, took place between President Andrew Jackson and the **Second Bank of the United States.** At that time, there was only <u>one</u> national bank operating nationwide and it had as much of the power then over the financial system that one could argue the NY Investment Banks have today. In 1832, Andrew Jackson vetoed the renewal of the **Second Bank of the United States'** charter. Jackson viewed the bank as a monoply that was managed by private board of directors rather than government appointed officials. He had singled out its president Nicholas Biddle arguing he had far too much influence over the nation's economy.

The **First Bank of the United States** was the child of Alexander Hamilton over the objections of Thomas Jefferson who foresaw this would lead to a national debt. The bank charter expired in 1811. Due to the War of 1812 and inflation, it was revived in 1816.

It was President Madison who revived the Bank in 1816 due to the rising level of inflation on the heels of the War of 1812. It was at this time that Nicholas Biddle was appointed the head of the bank. Jackson had personal problems with banks and credit. The election of 1828 was quite bitter. Personal attacks were now part of the game, and the unfortunate death of Jackson's wife he had blamed on these slanderous attacks that had deeply affected his wife, causing him to believe they effected her health.

Nicholas Biddle joined forces with Henry Clay (1777-1852) to apply for renewal of the Bank Charter in order to make it a Presidential campaign issue. When Jackson won, he took this as a mandate to destroy the bank when in fact the charter was not due for renewal until 1836. Jackson's big defeat of Clay who was the Whig candidate, set the stage for the **Bank War**.

Jackson was a debtor to banks in his youth and was against paper money in favor of coins only. Jackson's veto message to Congress set out his objections. Jackson stated that "some of the powers and privileges possessed by the existing bank are unauthorized by the Constitution" suggesting that the bank was a dangerous monoply. There was a fierce debate over Jackson's views and Henry Clay tried to have him impeached by alleging "Jackson claimed powers greater than European kings." Even Daniel Webster viewed Jackson as a monarchical president. In 1834, the Senate censured Jackson over his vetoes. It was 1833 that destroyed the bank.

Jackson saw the way to finish the bank would be to remove the Government deposits. To accomplish this, he had to replace not one, but two Secretary of the Treasury posts until he found the right man - Roger Taney. On October 1st, 1833, Jackson announced that federal funds would no longer be deposited at the bank.

Biddle retaliated by calling in loans from across the country. Biddle deliberately wanted to create a financial crisis in order to demonstrate his point that a national bank was needed in the country. Biddle's move backfired, and businessmen as well as the farmers blamed the bank, not Jackson. The politicial pressure rose and the bank lost its charter in 1836. By 1841, it was out of business altogether.

When Jackson withdrew the money from the **Bank of the United States**, he placed it with private state chartered banks that the press had called "pet" banks. This led to wider acceptance of paper money issued by state banks and caused widespread inflation.

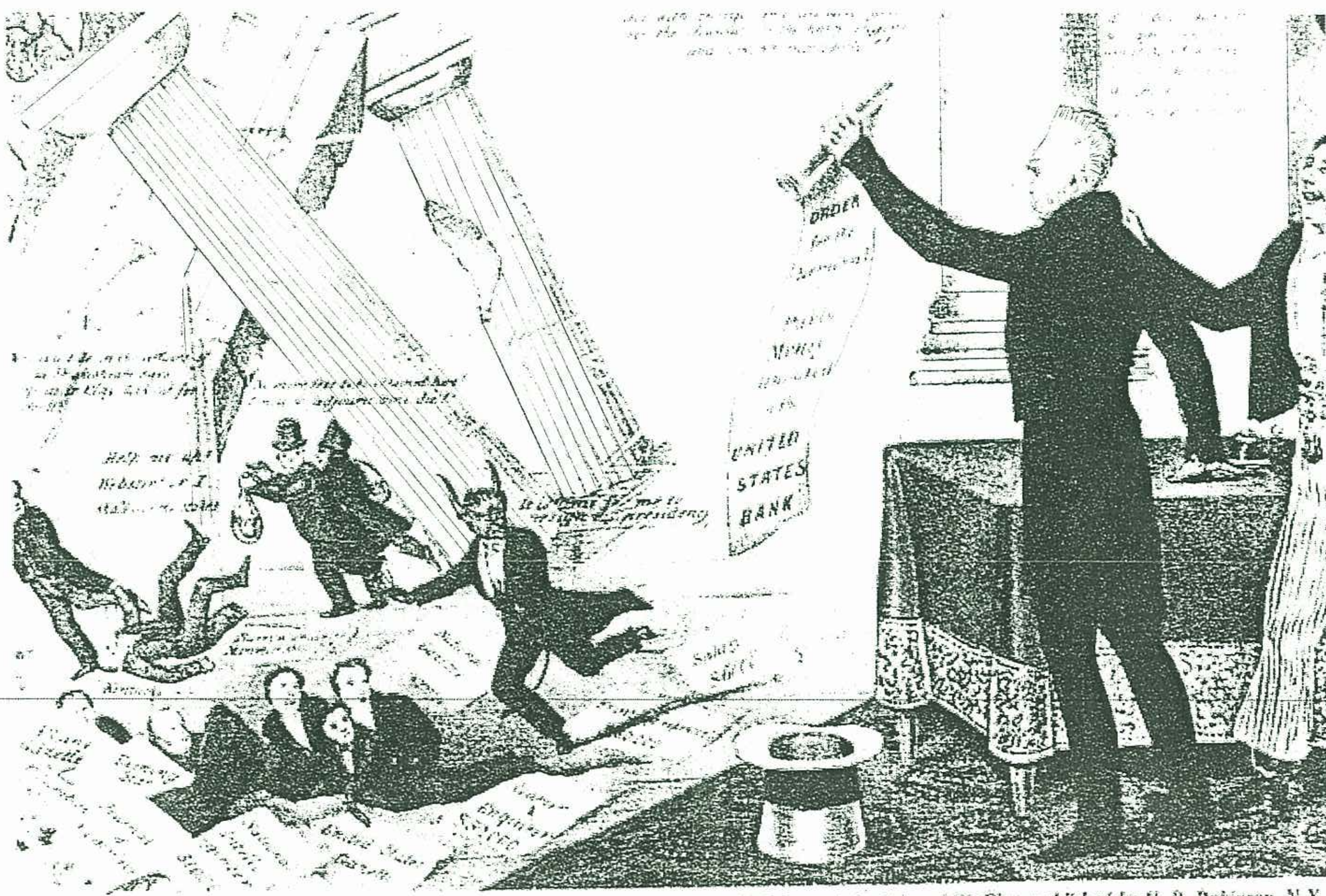
Jackson's **Bank War** set the stage for the **Panic of 1837.** By withdrawing the deposits of the federal government from the **Bank of The United States,** he placed them in the hands of his "pet" banks that was indirectly a vote of confidence in these "wildcat banks" that issued their own paper money that were in effect promissory notes.

The great speculative boom in those days was the sale of public lands. People were buying land from the federal government and were making a fortune. The crisis came when Jackson in 1836 prior to the Presidential elections, issued the **Specie Circular** that required the payment for such lands to be paid only in coin issued by the federal government and not the paper money of all these state chartered banks.

The effect of the **Specie Circular** in the economy was one of throwing cold water on the red hot speculative boom. Land values dropped, and the value of coin rose. This created the **deflation** and the **Panic of 1837.**

The public land sales were fixed at $1.25 and acre and were sold to anyone with no limit on the amount purchased nor was there any requirement that the purchaser had to settle on the land. This created a real estate bubble. Between 1820 and 1829, the annual average was $1.3 million. In 1830, sales jumped tp almost $2.4 million and it exploded thereafter; 1831 $3.2 million, 1832 $2.6 million, 1833 $3.9 million, 1834 $4.8 million, with the exponential **Phase Transition** coming in 1835 with $14.7 million and 1836 with the staggering $24.8 million. The **Bank War** that resulted in the creation of the "pet banks" was an endorsement of their paper currency even though Jackson did not intend that effect. Thus, the **Specie Circular** illustrated by these figures gives some idea of the scope of the real estate bubble at that time.

Keep in mind, however, that while this land was sold by the government for $1.25 an acre, during the 1930s, land values fell to about 30¢ an acre 100 years later.



An 1833 lithograph by Edward W. Clay, published by H. R. Robinson, N.Y.

Defenders of Jackson in the destruction of the **Bank of the United States** in a vain effort to exonerate the government from the cause of creating the **Panic of 1837,** point to the fact that the deposits during 1833 were slightly less than $10 million. Since there was no national debt, the land sales were pure profit so by 1836, the government deposit in the "pet banks" rose to almost $42 million.

The Defenders argue that these "pet banks" amounted to a small fraction of the more than 600 state banks. What they ignore is the endorsement factor that the federal government itself was using these **"wildcat"** banks chartered by states and that the bulk of the national deposits was not in gold, but was in the paper money of these banks from all over the nation. This is the primary reason for the 1836 **Specie Circular** that now demanded only coin. This burst the bubble of just printing money and buying land that had created a glut of land owned by speculators, not farmers and settlers.

Because the monetary system was built upon paper money issued by banks, not the government, these issues were expanding tremendously. Just between 1830 and 1834, the paper money growth soared from $61 to $200 million, as reflected in claimed bank capital. The loans during this same period grew from $200 to $324 million, while the actual notes in circulation rose from $61 million to almost $100 million.

The period between 1834 and 1836 shows that the banking capital rose from $200 to $251 million, the loans jumped from $324 million to $457 million, and the notes that were in circulation rose from $95 million to $140 million.

The speculative boom that many would like to ignore as the cause for the **Panic of 1837,** created a wave of inflation that went into every sector of the economy. On February 14th, 1837, thousands of people gathered in protest before New York City Hall all over the inflation issue. The chant reported by the press was "Bread, meat, rent, fuel! Their prices must come down!" The press called the protestors "Jackson Jacobins" suggesting they were the supporters of a king no longer in power. A riot broke out and they stormed the flour warehouse gutting it entirely. The government sent in troops to suppress the riot.

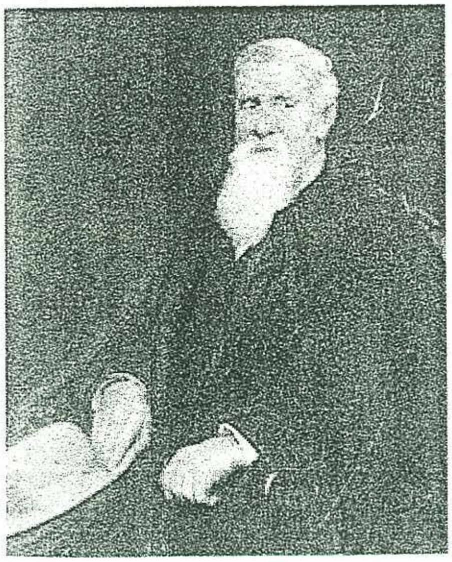
Commercial failures began shortly thereafter about April 1st. Within just 1 week, over 100 business failures took place. The collapse of the paper money even caused 5 foreign exchange brokers to collapse that same week. Some 28 firms who had been the real estate brokers servicing the speculators failed. Even 8 stock brokers failed along with 30 commodity houses. As the second week of April began, another 28 failures all in New York City took place. The **Contagion** now spread causing firms to panic and began to cut wages, provisions, and even rent prices collapsed. The **New York Herald** announced everything was coming down. Within days, the failures became too numerous to even bother to report. Commodities in general fell by 50% just because.

The history of this period has been so manipulated by many to extract support for particular agendas. Jackson's destruction of the **Bank of the United States** has been used to support the need for a central bank. We have others pointing to the paper money and using this to support the **GOLD STANDARD.** We have others who point externally to Mexico who demonetized silver and their coin came rushing to the United States where silver was still legal tender. Defenders of the banks used the Mexican silver as the influx that created inflation. They argue that the silver value declined because the British were buying goods from China and began to pay in opium they obtained in India, causing their need for silver in international trade to decline during the 1830s.

Defenders of the banks also point to the British who had a huge trade deficit with America and thus began to extend credit to Americans in order to sell more product. This has also been highlighted as the start of the funding for the big boom in railroads and the construction of canals. Looking at the customs duties collected in 1839, they were in excess of $23 million about on par with 1836. The **Panic of 1837** saw revenues drop to $11 mil. But hard times was hitting Britain and this caused their credit lines to also contract so customs revenues in America now dropped to $13 million in 1840.

There is no doubt that the effects of external forces aided the trend, but they did not cause this one. Jackson may have pricked the bubble, but he did not create it either. This was a Real Estate Speculative Bubble that burst.

Jay Cooke & Company



Jay Cooke
(1821 - 1905)

Because the Federal Government owed nothing, they were largely free from the need to have a direct relationship with a bank. Thomas Jefferson's objections to Alexander Hamilton proved to be correct. However, with the introduction of the Civil War, everything changed.

The **wildcat** banks were over. The money supply was coin, aided by the California Gold Rush of 1849. This influx of **GOLD** had created a massive wave of inflation that was furthered by the Australian gold discoveries in 1851. We then have this speculative boom reach its bubble top in 1857, and this time it would be truly the first **Global Contagion** due to the influx of **GOLD.**

Nevertheless, it would be the Civil War that re-established the need for a banking relationship. It was **Jay Cooke & Company** who became the first **PRIMARY DEALER** in that this was the first firm to use the telegraph to create a nationwide network of sales agents that were able to sell stocks and bonds. The Feds turned to **Jay Cooke & Co** to sell a huge bond issue - $500 million to fund the war. **Jay Cooke & Company** became over extended when it could not sell a vast holding it had underwritten in Northern Pacific Railroad. This led to its collapse in 1873.

Nicholas Biddle
Second Bank of the United States
(1786 - 1844)

Where Nicholas Biddle was perhaps the first American Banker to flirt with Government and lost, when Jackson refused to then renew the charter in 1836, Biddle turned to Pennsylvania. His bank then became a state bank. Biddle helped to establish Girard College and his bank building still stands today a few blocks from Independence Hall. The economic downturn after 1837, led to the collapse of his bank in 1841. Biddle died shortly thereafter, still arguing that a central bank was necessary for economic and long-term stability.

John Pierpont Morgan
(1837-1913)

The third and perhaps the most famous of the American bankers in history, was non other than **John Pierpont Morgan** ("JP") who was born ironically during the **Panic of 1837.** He began his career as an accountant at the

NY banking house of Duncan, Sherman and Co, which was the American agent of the London firm **George Peabody & Co.** In 1861, J.P. Morgan became the American agent for his father's banking firm in New York City. Between 1864 and 1871, he was a member of the firm named **Dabney, Morgan & Co.** In 1871, he became a partner in **Drexel, Morgan & Co.** With the 1873 Panic that brought the collapse of **Jay Cooke & Co**, the firm soon became the **Primary Dealer** for the Federal Government to sell its bond issues.

George Peabody
(1795 - 1869)

It was actually **George Peabody** who was the Founder of the famous Banking House of Mogan. **George Peabody** was born in Devons Mass and worked with his brother whose dry goods store burned down in 1811. **Peabody** then moved to Georgetown in Washington, DC to work in a wholesale dry goods warehouse. He became a partner in 1814 when it relocated to Baltimore. By 1829, **Peabody** became the senior partner expanding branches now to Philadelphia and New York City.

It was the dry goods business that led Peabody to travel for trade purposes to then England, who was very much interested in now expanding trade and provided lines of credit to fund that trade to America. On one of these trips, he negotiated an $8 million loan for the State of Maryland taking no commission at the time. Peabody was attracked by the vast amount of **Capital Concentration** in London. When the **Panic of 1837** hit, Peabody moved to London. There he established a merchant banking house that now specialized in my personal favorite - **foreign exchange.**

Peabody amassed a fortune of at least $20 million. He became well connected and had a inherent talent for trading currency. He became a great philantropist creating in Baltimore a library, art gallery, and a music academy. He funded the natural history museum at Yale and the museum of archeology at Harvard. He helped to fund many of the colleges in America and he established the Peabody Education Fund to provide an education for Southern children of all races. In 1862, he donated a vast amount of money for the construction of apartment settlements in London for the working people. In 1868, the town where he was born, changed its name to Peabody, Mass. in his honor.

Junius Spencer Morgan
(1813 - 1890)

Peabody took in a partner in 1854, the father of J.P., **Junius Spencer Morgan.** Junius was at first a partner in a foreign trade firm with **James Beebe.** Peabody was looking for a partner, and Beebe recommended Junius. Peabody offered a partnership on a silver platter. Junius did not jump at the idea of moving to London. In London, Peabody's firm was considered second to Baring and Rothschild. In October 1854, he agreed to join. In 1864, Peabody gave Junis the firm, but took his name with him. The firm then was known to history as J.S. Morgan and Company in 1864. Peabody was legendary for his just nasty attitude and sheer mean streak. Many assumed that his spectacular gifts was an effort to buy his reputation to the contrary.

JP had struck out on his own and had shown his personal "feel" for trading when he purchased a literal boat load of coffee that arrived with no buyer. JP purchased the entire lot and quickly sold it for a profit but his firm only saw the risk and when it became clear he scared the partners, he left Duncan, Sherman and set up his own firm in New York under his name **J.P. Morgan and Company** located at 54 Exchange Place, with his cousin James J. Goodwin. At the tender age of just 24, he was now an agent for Peabody. By 1864, His father disapproved of his risk taking and his wife. His father orchestrated a partnership for his 27 year-old son with **Charles H. Dabney** and the firm now became known as **Dabney, Morgan and Company,** with Dabney being 30 years JP's senior. In 1871, Dabney retired, and again his father moved to find his son another partner to temper and control him.

Multinational dealing was very much a part of the times. Junius wanted to expand the Morgan family beyond just the traditional London-New York route for capital. The trend was not branching, but international partnerships. This would allow for cooperation with no management responsibility between nations. Trying to manage employees and deals in all different nations, was a task that was just impossible back then, if not truly even now.

Before the collapse of **Jay Cooke,** the second largest bank in Philadelphia was that of Anthony J. Drexel. Drexel was looking for a relationship with London to compete with **Jay Cooke** (who would go bust in 1873). Junius was already doing business with Drexel acting as his London correspondent. Junius suggested Dexel take his son as a partner and he then encouraged his son to travel to Philadelphia to meet with him. The two met over diner and JP returned to New York with a partnership agreement. The financial center was shifting to New York City from Boston and Philadelphia because of its link to trade and finance with London. The firm now became known as **Drexel, Morgan and Company** in 1871, just 2 years before the **Panic of 1873** that took down **Jay Cooke.**

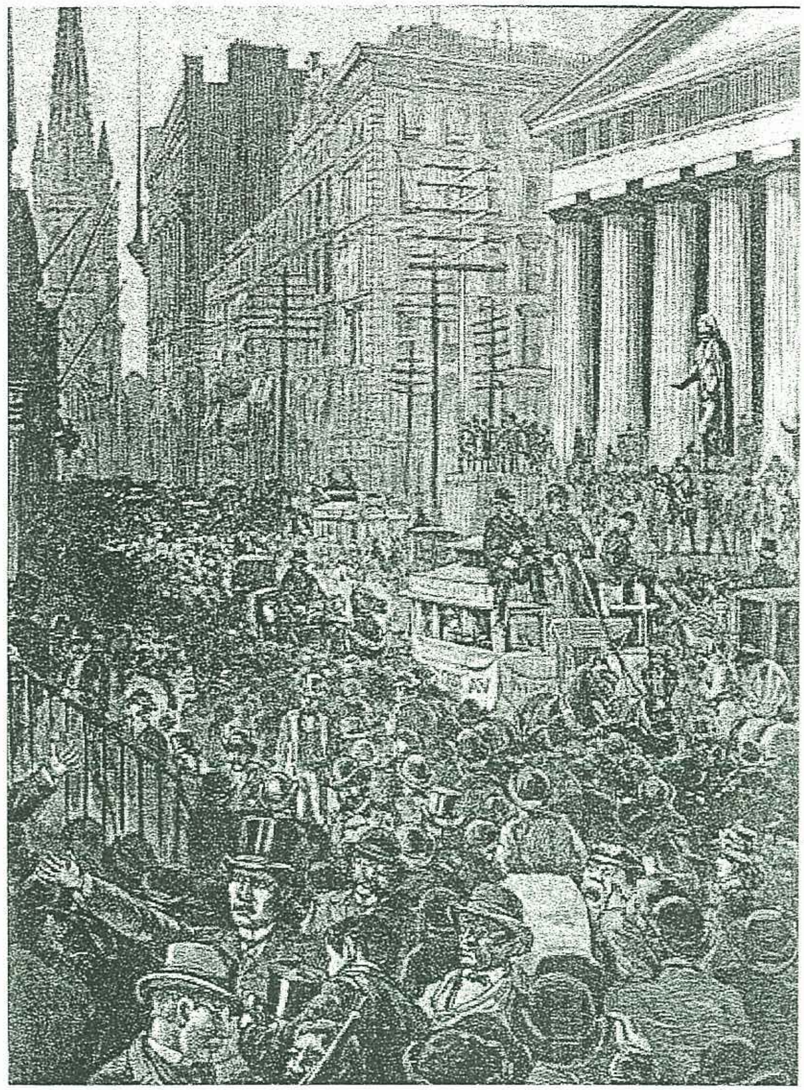
JP was a brilliant man who had little time for fools. He often remarked that the scarcest commodity was brains. Yet this was a man not greedy for power, for he was chained to his role and lamented about not being free to retire. He was truly a man who was exhausted by his success more so than thrilled by it. He was a natural trader who could "feel" blood flowing through the whole market. He was a man of his word, and always well respected in business as an honest and important counterparty. If you did a deal with JP, he did not try to get out of it the next day if prices went against him. He was a man who valued his reputation more than a dollar. This was not always common to find among such dealers.

Junius died a few days after being thrown from his carriage on April 3, 1890. It was after Junius' death that JP began to amass the largest art collection in private hands buying everything in sight. Merchant Banking was built at that time upon the family name and reputation, unlike corporate dynasties. In 1893, Anthony Drexel died. By 1895, there was a splitting of the ways. The Drexel family retained **Drexel and Company** in Philadelphia, **Drexel, Morgan** became **J.P. Morgan and Company,** while the Paris office of **Drexel, Harjes** now became **Morgan, Harjes.**

With the death of Junius, the four main partnerships had only one common partner - JP. This also shifted the balance of power from London to New York. The London firm had retained his father's name for 20 years. It became **Morgan Grenfell** in 1910 adding the British partner to ease the English pride for the financial capital was shifting to America.

Grover Cleveland had worked on Wall St as a lawyer next to Morgan's office. With Cleveland becoming President, he was very much sensitive about being in the pocket of the Wall Street boys. In 1894, the US gold reserve fell below $100 million. The over valuation of silver led to international arbitrage causing gold to flee America and silver to pour in. By 1895, gold was just pouring out of the US at an astonishing rate. Gold was being loaded onto ships in New York and could be visibly seen setting sale for Europe. The common bet among the professionals was when the US would go into bankruptcy - not if!

Panic of 1884



The economy on a global scale was undergoing a profound change that no one seems to have honestly understood. Just as we can see how **Capital Concentrates** among the individuals, it does so also on a sector scale within the economy and then among nations and regions. What was beginning was more than just the shift in power at the house of Morgan from London to now New York, but this was taking on the entire force of the worldwide economy.

The **Panic of 1884** was a short-lived event. But it was hinting at the flow of capital among nations that was emerging. Here we find the sharp decline in European GOLD reserves. This began to set in motion some capital withdrawals by foreign investors. In a act of preparation for the worst, New York national banks began to call in loans made to the west to boost cash with the tacit approval of the US Treasury. More than 10,000 firms failed. Two of the major failures were **Penn Bank** in Pittsburgh and **Grant & Ward, Marine Bank** in New York. Everyone was now judging "panics" as all the same and did not have a clue that the cash was now starting to flow around back and forth between Europe and America.

This birth of international capital flow that had first appeared with the **South Sea** and **Mississippi Bubbles** in 1720 that created the first true speculative bubble post-Dark Age, was now manifesting in full-blown moves of capital that honestly was undermining the whole foundation of economic theory that was built upon isolated domestic fundamentals. Now, fundamental changes in a distant land could spark net capital outflows and selling of domestic assets even when there was no such change whatsoever in the domestic economy. We saw this as late as the 1987 Crash. Despite this development, both the field of politics and economics remain as a retarded ability to ever learn from plain oberservation of what is actually taking place. No one seemed to observe and explore as Adam Smith himself had done.

Consequently, as this trend of capital flow was reversed by the **Sherman Silver Purchase Act of 1890**, politicians remained ignorant of the implications of setting now silver at a ratio to gold of 16:1 compared to Europe's 15:1. The European gold reserves now began to explode and the US began to fall at an alarming speed. This would have been a dream trade for any trader of foreign exchange - the guarantee profit.

Cleveland was a Democrat. Morgan was a Republican. Still Morgan voted for Cleveland because he was a man who believed in sound finance. Congress sat on its hands and just refused to give the authority to replenish the gold reserves. The conspiracy theories of the day made it impossible for Cleveland to turn to Morgan leaving him politically paralyzed. By January 24th, 1895, the US gold reserves fell to $68 million. Gold coin was now being hoarded as many saw the federal government headed for complete disaster.

Cleveland could not be seen to now be turning to Wall Street. Instead, Cleveland turned to the Rothschilds in London. The Rothschilds turned in London to **J.S. Morgan and Company**, who then agreed to participate only if J.P. Morgan handled the American end with the Rothschilds representative at that time who was August Belmont, Jr.

Belmont and Morgan met at the US Treasury office in New York. While nothing was then settled, over $9 million in gold on ships headed to London was taken off and returned to the city vaults that night. The meeting also fueled the conspiracy theories of the Wall Street-Washington league.

Morgan's correspondence at this time revealed his contempt for European opinion, his distrust of politicians and Jewish banks and his distain for unsound finance. In a matter of weeks, the flight of gold had in fact resumed and now default appeared to be absolutely certain by February.

The politicians clearly knew nothing about what they had done. A bunch of absolute idiots destined to destroy the entire US economy because of their political favors to the silver miners and farmers. The cabinet informed Morgan and Belmont that they now rejected their proposal for a bond issue to raise gold.

Morgan and Belmont hopped on trains for Washington. They were met by Daniel Lamont, Secretary of War, who informed them that the President decided against a private syndicate and would not see them. JP is said to have replied: "I have come down to see the president, and I am going to stay here until I see him." (Allen, **Great Pierpont Morgan, p90**).

Cleveland was holding out in hopes of making a "public bond" issue rather than a private one. As the politicians delayed, it took a clerk to inform the White House that all that now remained was $9 million left in gold coin in the government vaults. JP told the politicians that he knew of a $10 million draft that would be presented and by 3 o'clock, the country would be completely bankrupt. Finally, Cleveland for the first time asked JP, "What suggestions have you to make, Mr. Morgan?" **(**Satterlee, **J. Pierpont Morgan, p289);(**Chernow, **The House of Morgan, p75)**.

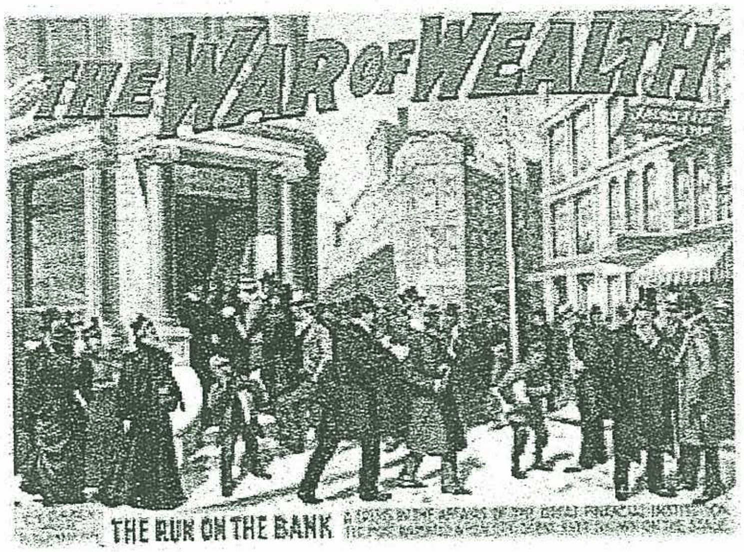
J.P. Morgan replied to Cleveland that the combination of Morgan and Rothschild firms in New York and London would now put together 3.5 million ounces of gold with at least half coming from Europe in return for $65 million worth of gold backed 30 year bonds. Yet the boldness of the proposal went even further. He guaranteed to rig the gold market so that at least temporarily, no gold would leave the United States in the foreign exchange markets.

The proposal was bold indeed. It was certainly worthy today of 25 years in jail. Nonetheless, Secretary of the Treasury John G. Carlisle relied on the 1862 statute that had been enacted during the Civil War for Lincoln granting emergency powers to buy gold during the war.

Cleveland had seen the light. He still sought to get Congress to enact a public bond offering to raise Gold. Nevertheless, he knew that if they failed for political reasons, he could turn to Wall Street. The Congress defeated the bill to allow the US Treasury to sell long-term bonds to the public. News broke about the Morgan-Rothschild operation. On February 20th, 1895, the bond sale in London sold out in 2 hours. In New York, they were sold out in just 22 minutes.

The conspiracy theorists used this rise in demand for the bonds to argue that they had cheated the government. They sold the bonds at 104 and they rose to 119 on the open market. Now the uproar expanded to include anti-Semitism because Rothschild was involved. This is the backdrop to the 1896 Presidential elections and the Democratic Convention where **William Jennings Bryan (1860-1925)** ran for President and delivered his infamous speech that **Thou shalt not crusify mankind on a cross of gold.**

JP saved the nation that day. He had suffered the arrows of every possible sort when the politicians refused to yield and were destroying the country with their silver madness. Morgan's view of politicians was certainly well founded. They were like taking a cab ride driven by a monkey. They will never listen and will lash out at any person who dares to criticize them. Even when the end was in their face, they still would not yield.



War of Wealth - 1896 Broadway Play

This was also the era of **American Marxism** that had taken hold of much of the nation. The conspiracy theories against Morgan reflected this class struggle, yet it was ironic that Morgan was not really interested in money, he lamented over his duty he felt he owed to his country and more than anyone else, he aided the shift in power from London to New York. Above, is a poster from a play that appeared on Broadway - **The War of Wealth.** This was then inspired by the **Panic of 1893** and we begin to see the **Marxist** tone had gripped the nation.

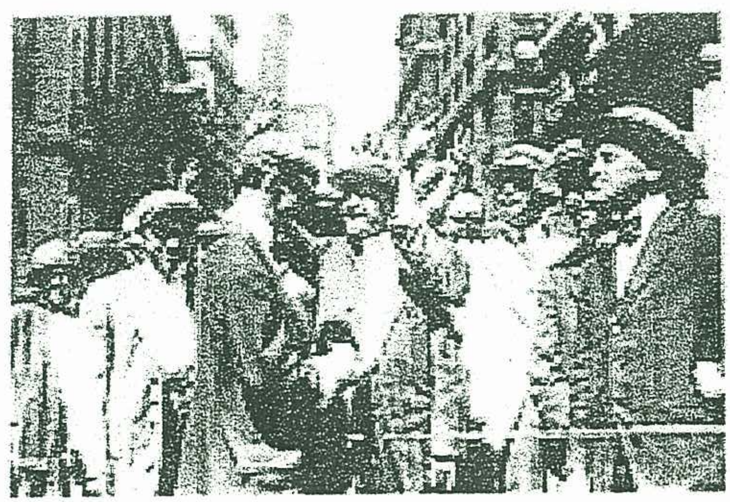
The unsound finance and the attack upon business with the whole Anti-Trust Act in 1890 set a tone of caution. Capital remained uneasy and thus it was quick to take flight. The **Panic of 1899** sent interest rates soaring on the New York Stock Exchange reaching almost 200% - their historical high.

There was a huge merger boom. Countless small railroad were being merged and bought-up to form bigger ones. Again, there was the **Panic of 1901** where the New York Stock Exchange fell in part due to the struggles now between E.H. Harriman, Jacob Schiff, and J.P. Morgan/James Hill for the control of the Northern Pacific Railroad. The titons thus formed a compromise and banned together to to create **Northern Securities Company.** The Supreme Court ruled this now violated the Anti-Trust Law in Northern Securities Co v US, 191 US 555 (1904).

Jacob Schiff (1847-1920) attracked the conspiracy theories of the day casting him in various plots with other famous Jews to dominate the world. He was said to have funded the Bolsheviks in the takeover of Russia. Schiff had in fact lent money to all nations during World War I except Russia. He would not lend money to the Tsar because of the oppression of Jews. There did not appear to be true support for the overthrow of capitalism. During the 1904-5 Russo-Japanese War, he lent Japan $200 million that aided its victory over Russia.

J.P. Morgan in 1892 arranged for the merger of Edison General Electric and Thomson-Houston Electric Company creating General Electric. He financed the creation of Federal Steel Company that he merged with Carnegie Steel Co and several other companies to then create United States Steel Corporation in 1901. These efforts made him a hated target of the Teddy Roosevelt Administration. With US Steel, he had now two-thirds of the market. In 1902, his firm financed the formation of International Mercantile Marine Company.

PANIC OF 1907



NY Curb Market in 1907

The **Panic of 1907** had actually began with the attempt to create a short squeeze manipulating the stock price of **United Copper Company** where the majority shareholder was F. Heinze who colluded with others. The scam was to force the shorts out and then they would have to buy shares from Heinze. The squeeze failed, and set off a domino effect.

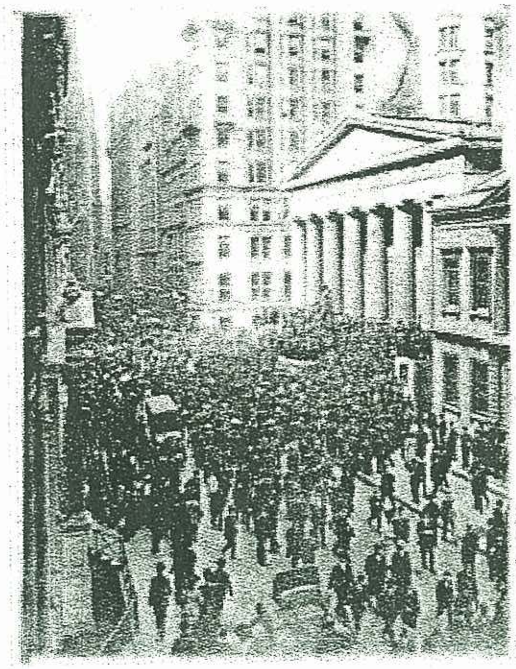
The idea was to start a short squeeze buying the shares and thus force the shorts to then cover. They borrowed money from Knickerbocker Trust Company.

They began to buy on October 14th, 1907 driving the price of the share up from $39 to $52 per share. On the following day, a call was issued to return the borrowed shares owed by the shorts. The share price jumped further to $60. But they covered their loss with plenty of shares made available from other sources. The short squeeze was over and the stock began to collapse. The stock closed back at $30 that day and by the time the market closed on third day, October 16th, 1907, the price collapsed to now $10.

This trading took place on the "curb" and not on the NY Stock Exchange. The Wall Street Journal reported: "Never has there been such wild scenes on the Curb, so say the oldest veterans of the outside market."

The brokerage firm they used went belly up. On October 17th, the NYSE suspended all of the firm's trading privileges. What was now unleashed was the classic **CONTAGION** and the bank in Montana owned by Heinze, was now forced to announce its insolvency. The bank was using United Copper stock as collateral against its lending. Heinze was also the president of Mercantile National Bank in NY and they were now under pressure and asked Heinze to resign by mid-day. The rumors were flying and a run on Mercantile National Bank began in force. Runs began on any bank that was connected to the players. The Panic was contained for the first week to just those banks and funds were removed and placed with other banks.

The bank run did hit the Knickerbocker Trust starting on the 18th of October. News of events reached Morgan, who was in Virginia and decided to get back to New York leaving of October 19th, 1907, the very date of the Panic low in 1987. On Monday the 22nd, a full sclae run began on the Knickerbocker. In just 3 hours, some $8 million was withdrawn. By noon, it was forced to suspend operations. Call Money rates soared and now broker loans were being called. This fueled an outright stock market crash. Stocks quickly gave up all gains made since 1900. The Panic spread as a **CONTAGION** to all banks and now by the 24th of October, there was a chain of major bank failures.



The Panic of 1907

J.P. Morgan gathered his associates to examine the books of the Knickerbocker Trust but found it was insolvent and decided not to intervene to stop the run. When it began clear the Knicherbocker Trust would fail, the run spread to other banks. The Trust Company of America asked Morgan for help. Morgan now brought in First National Bank and National City Bank of New York (later Citi Bank), and the US Secretary of the Treasury. Morgan had a quick audit of the bank and declared that this was where to defend. As the run began, Morgan worked with his associates to sell the assets of the bank to free up cash for the depositors. The bank survived the close of business. Morgan knew this was not the end.

Morgan now summoned the heads of various banks in New York and kept them until mid-night until they agreed to provide loans of $8.25 million. Morgan convinced the Treasury to deposit $25 million in NY banks. John D. Rockefeller, the wealthiest man in America, deposited $10 million with City and called the Associated Press to announce his pledge to help the NY banks.

The banks then, as now, proved to be their worst enemy. Despite the efforts of Morgan to create this infusion, they were relucant to lend any money for short-term stock trading. The stock market crashed. By 1:30 pm Oct 24th, the president of the NYSE went to tell Morgan the exchange would close early.

Morgan would not allow it. He warned that if the NYSE closed early, it would be catastropic to say the least. Morgan again summoned the banks who arrived by about 2pm and Morgan pretty much yelled at them and warned that as many as 50 stock brokerage firms would fail unless $25 million was now raised in 10 minutes!. By 2:16 pm, 14 banks pledged $23.6 million to keep the stock exchange alive. The money even reached the exchange by 2:30 pm, to finish trading at 3pm. The sum that was actually needed was $19 million. Morgan himself hated the press, but this time he gave a rare comment.

The next day, the NYSE needed more money and Morgan this time could only raise $9.7 million. Morgan directed the NYSE that the money could not be used for margin sales. The exchange made it to the close.

Morgan knew he had to turn the minds of the people and to restore their critical **CONFIDENCE** to stop the Panic. Morgan now directed two committees to be formed to (1) persuade the clergy to preach calm to their congregations on Sunday, and (2) to sell the idea of clam to the press.

Morgan was desperately trying to hold the nation together. Unknown even to his associates, the City of New York could not raise money through its bond issue and it informed Morgan that it needed $20 million by November 1st, 1907, or it would go into bankruptcy. Morgan himself contracted to purchase $30 million in city bonds.

On November 2nd, one of the largest stock exchange brokers, Moore & Schley, was heavily in debt using the Tennessee Coal, Iron & Railroad Co stock as collateral. The stock was thinly traded and the stock was under pressure. Their creditors would now surely call their loans.

Morgan called another emergency meeting and a proposal was put forth that US Steel Corp, would acquire the stock in bulk. Yet another crisis was looming. Runs were now likely to hit two banks on Monday. Morgan summoned 120 banks and told them he would not proceed with the US Steel deal unless they supported the banks. Morgan now locked them in his library and told them they had to come up with $25 million to save the banks.

It took almost 2 hours. Morgan finally convinced them that they had to bailout the banks to save their own skins. They signed the agreement, and he unlocked the doors and let them leave. Morgan was saving the nation again, single handedly.

Morgan turned back to save the NYSE. He knew the problem would be the damn anti-trust laws, and the crusading Marxist, old Teddy Roosevelt. Breaking up companies was the main focus of Roosevelt's administration. To save the day, he would have to see that the anti-trust laws must yield.

Two men thus traveled to the White House to emplore Roosevelt to set aside his anti-trust laws to save the nation. As typical, Roosevelt's secretary refused to let them in to even discuss the problem.

The two men, Frick and Gary of US Steel turned to James Garfield who was Secretary of the Interior. They pleaded with him to go to the President directly. Garfield had convinced Roosevelt to at least review the proposal. Roosevelt was for the first time forced into a corner. He had to realize a collapse of the NYSE would take place if he did not yield. Roosevelt later lamented:

> **"It was necessary for me to decide on the instant before the Stock Exchange opened, for the situation in New York was such that any hour might be vital. I do not believe that anyone could justly criticize me for saying that I would not feel like objecting to the purchase under those circumstances."**

Cartoon Morgan Bigger than Uncle Sam Rowing the Boat through the Storms

Feb 2nd, 1910 Cover of Puck
The English Magazine
"The Central Bank - Why should Uncle Sam establish one, when Uncle Pierpont is already on the job."

John Pierpont Morgan was a man whose passion was not money, but accomplishment. He lamented over his life and had thought many times he should retire. But always his duty called him to action. He was at the very front of the **Capital Shift** from Europe to America taking the financial center with it. Here we have a cover of the English Puck magazine in 1910, showing Morgan protecting his kingdom.

Europe had a central bank. America did not. Morgan filled that role, and received nothing but conspiracy theories and slander always trying to cast him as some greedy man motivated solely by money. His vast art that be spent about $50 million collecting, was his gift that became the NY Metropolitan Museum.

Morgan was a man often hated by his own country, and certainly betrayed by it. In November 1910, a secret conference was held on Jekyll Island Club just off the coast of Georgia to discuss the monetary policy of the nation. The group of financiers produced a plan for a central banking system, they called the **"National Reserve Bank."** A final report was published on January 11th, 1911 as the National Monetary Commission. But for 2 years, Congress debated the question and the real problems. On December 23rd, 1913 the Owen-Glass Act became law creating the Federal Reserve.

Politicians were jealous of Morgan's power. Here was a man who saved the nation while the politicians would have destroyed the nation by their sheer self-interest and greedy stupidity. The efforts of Morgan had exposed the incompetence of politicians, and for that, they wanted to re-write events and crush him into the dust.

They twisted the US Steel deal into his greed to circumvent the anti-trust laws. Some even accused him of creating the whole Panic of 1907 just to accomplish that goal. Never mind that Morgan personally lost $21 million in Panic, they refused to believe anything he would say in his own defense.

Careers were made in politics by bashing Morgan. Louis D. Brandeis won national attention for attacking Morgan and his control of New Haven Railroad. Brandeis was appointed to the US Supreme Court. It was Charles A. Linbergh, Sr, who became famous for beginning the Wall Street probe, giving his son the aviator, a head start with a famous name. They tore Morgan apart, showing how very ungrateful a nation could be when run by a bunch of crooks anyway.

Samuel Untermyer
(1858-1940)

The ruthless prosecutor in the Congress working for the House Committee on Banking & Currency, assumed the main role of trying to take down Morgan. The Committee was Chaired by Arsene Pujo (D La), to investigate what they were now calling the "money trust" as as monoply.

All the efforts of Morgan to further America over that of Europe and to protect the whole economic system, meant nothing to the politicians who only are seeking glory by tearing down those who contribute more to the nation than they will ever be able to accomplish. They had summoned Morgan whose health was now starting to fail, mostly out of the realization that his life meant nothing to these people in Congress. The ingratitude was his deepest blow and struck his core sense of dignity and purpose.

John Pierpont Morgan arriving at the Pujo Hearings with his daughter and son

One of the most often cited parts of Morgan's testimony in the Pujo Hearings that were very hostile and bent upon trying to paint his whole life as being a crook and scam artist, the ruthless Untermyer was doing the interrogation.

Untermyer: Is not commercial credit based primarily upon money or property?
Morgan: No, sir. The first thing is character.
Untermer: Before money or property?
Morgan: Before money or anything else. Money cannot buy it ... a man I do not trust could not get money from me on all the bonds in Christendom.

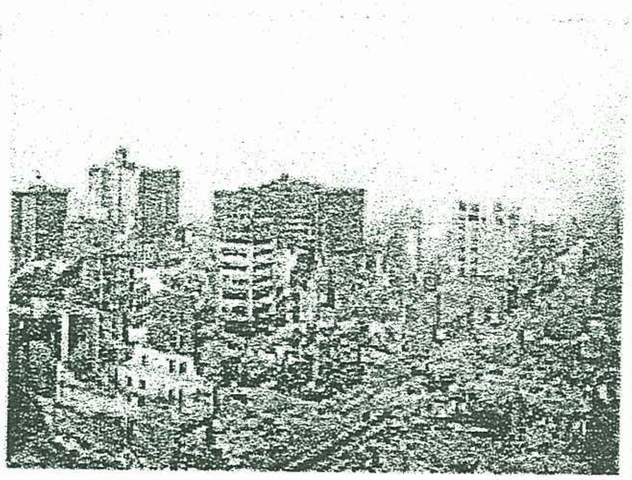
Everyone blamed his continued decline in health on the hearings. They did far more damage. They destroyed his faith in his own country. He was betrayed and the old saying that **No good deed, ever goes unpunished,** was made manifest by the ruthless Untermyer and the politicians involved, including Linbergh.

Morgan left the country, truly a broken man in heart. He died on March 31st, 1913 in Rome. What the politicians did to this man should never be forgotten. It was the greatest blow that a nation could inflict upon such a patriot.

The firm continued led by his son they called "Jack" yet there was a deep resentment that had been fueled by the press and the depraved politicians of the day. Following World War I, another financial panic hit. This was far worse - the **Panic of 1919.** This was the bubble top in commodities and the low would not be found until 1932. Sectorial capital shifted from the railroads with the 1907 Panic to commodities in 1919, and then to Industrials for 1929. In September 1920, the restentment fueled against Morgan, led to a bombing of his office long after his death. Two Morgan employee died. The politicians had succeeded in turning Morgan into a very much hated man. This is what truly killed him in 1913.

Panic of 1907

CAPITAL FLOWS where the key to the **Panic of 1907.** While the New York news focused upon naturally the events in the New York Stock Markets and the banking, there was something else that was undermining the entire economy. Just as **J.P. Morgan** aided the capital flows from Europe to America and more than anyone else contributed greatly to making New York the Financial Capital of the World, there was a capital flow that was now emerging also internally within the nation. Just as **J.P. Morgan** also contributed to the moving of the financial center from Philadelphia that had been dominated by **Jay Cooke & Co** during the Civil War, there was something else in the undercurrent than just capital flowing from Philadelphia and Boston to New York. The railroad had indeed opened up the West and allowed the land bubble of the 1837 period to now take the form of actual settlement. Within just 51.6 years of the **Panic of 1837,** capital was now also flowing within the nation from region to region. Where capital had been hoarded for so long after the fall of Rome in 476 AD, as capitalism was flourishing and blossoming through the industrial revolution, the age of **Capital Flow** had arrived.



1906 San Francisco Earthquake

If the **Panic of 1907** was created by merely a failed short squeeze, then why was it so devastating? The answer lies in the regional **Capital Flows.** Cash was also at that time moving west. The insurance companies were in New York and the victims were in San Francisco when the Earthquake hit in San Francisco on April 18, 1906. The city burned for 3 days and over 25,000 buildings were destroyed - some 490 blocks were simply leveled. The damage at that time was a staggering $350 million. This had created a cash flow problem. One can see that the US Treasury throwing in $25 million to help New York, was nothing compared to the damage in San Francisco.

While focusing only on the events in New York make great reading, we must also understand the impact of the Earthquake. There was also rising unrest thanks to Marxism. In Atlanta, Georgia, there was a race riot that resulted in the city being placed under martial law. The Rev. Crapsey was put on trial for teaching Marxism by the Protestant Episcopal Church. And this was the birth of the first **wireless transatlantic** communication between the US and Ireland conducted by Lee De Forest.

There was a need for a Central Bank. But to suggest that it was only necessary to lend money to banks when in trouble, missed the economic revolution. This is why when the Federal Reserve was born in 1913, it had 12 regional banks with each capable of raising and lowering interest rates wholly independently.

The capital flows were more than just between New York and London, they were now everywhere internally as well. The cash flow to California left New York vulnerable so that the short squeeze set off a chain reaction that was far more devastating than anyone had realized at the time. It would take years of debate behind closed doors before it was understood that this was now a far more dynamic economy than anyone had suspected. The structure of the central bank had to now fit the dynamic of economic growth that no one understood at the time.

The Aftermath of '07

In the aftermath of 1907, there was a rising tension within the nation. **Marxism** was becoming dominant within the United States. This went beyond Roosevelt's insane miscomprehension of the economic evolution process and how there were many small corps formed that are always bought up amd merged into the more dominant company. We would see this during the 1920 in the auto sector. In fact, General Motors was precisely such a merger of independent manufactures. Even in the computer filed, we have seen Microsoft battle both in the United States and within Europe against this concept of a monoply. No one has ever proven this theory - it has always been a dream from the dark side of the mind of Karl Marx.

Several companies have from time to time agreed on non-competition in a field. But there is no evidence that one company has bought up competitors to deliberately prevent competition. Yet, this boogie-man was Teddy Roosevelt's pet dream.

During the 1908 Presidential Election cycle, on May 10-17, 1908, there was even the **"Socialist Party"** who held a national convention who nominated Eugene V. Debs for President and Benjamenin Hanford for VP. The Democrats nominated William Jennings Bryan again and the Republicans nominated William Howard Taft, who won the election The **Socialist Party** took 420,820 votes to Taft's 7.6 million. There was also the **Prohibition Party** and several other fringe parties that ran that year.

On February 3rd, 1908, the Supreme Court held in Loewe v Lawlor, that the **Antitrust Act** applied now even to labor combinations as well as capital. So we can see how judges will take one law intended for one thing, and suddenly now expand it on their own far beyond what the actual legislature began with.

The seed for the 1920's auto boom was now just starting to sprout when Henry Ford began to sell his model T in 1908 for $850. His invention of the assembly line allowed him to reduce the price to $310 by 1926.

On July 12th, 1909, Congress passed the 16th Amendment to the Constitution to allow income taxes. While it would take until 1913 to have the state ratify this enactment, it still gives the flavor of how dominant **Marxism** became during this period in American history. By 1910, 8 states all enacted **Prohibition** with all being in the South with the exception of Maine. Congress passed the **Mann Act** on June 25th, 1910 to criminalize the transportation of women for "immoral purposes" what was dubbed as "white slavery" at that time.

The sudden turn to religion was also caused by many believing it was now the end ofthe world because **Halley's Comet** now appeared. Despite the fact that it had a regular cyclical path and was first discovered in 1682, there were documented sightings in 1531 and 1607 and appeared once every 76 years or so. There were people even selling comet pills to ward off the dangerous effects.

On May 15th, 1911, The Supreme Court ordered the break-up of Standard Oil under the **Antitrust Laws.** For 1912, the election for President was now a three-way race with **Taft** running as the Republican, **Teddy Roosevelt** now the candidate for the new Progressive Party, and **Woodrow Wilson** the Democrat. The major issue was still the break-up of big business. **Roosevelt** promised a Square-Deal and a New Nationalism an wanted more regulation against the huge industrial monopoly as he saw it. **Wilson** spoke of a New Freedom and promised to now break-up big business to create competition.

In 1913, the **Income Tax** was ratified, on May 14th, 1913, John D. Rockefeller then started the **Rockefeller Foundation** with the largest donation in history, $100 million while Wilson now promised bank reform that became the Federal Reserve.

In August 1914, World War I broke out. The primary income of the Federal Government had been tariffs. The combination of the World War and the reliance upon tariffs for income, clashed. The US had a very tiny army at the time and it was unprepared for engaging in war.

It was on April 16th, 1914 that we saw the march of the unemployed upon Washington known as **Coxey's Army** who had made his first march back in 1894.

World War I - Dependency Upon Debt

On January 28th, 1915, Congress enacted the U.S. Coast Guard and was placed under the US Treasury because its primary function was to catch smuggling when the majority of tax revenue was tariffs. On May 7th, the Germans sank the **Lusitania** off the coast of Ireland. This disaster in 1915 saw of the 1924 passengers aboard, 1198 drowned including 63 infants that included 114 Americans.

It was 1915 that the Victor Talking Machine Company brought out the phonograph. By 1919, Americans were now spending more on records than books or anything else more or less.

There was still rising racial tensions that was illustrated by After the Supreme Court commuted the sentence of death for Leo Frank for the murder of Mary Phagan, the mob stormed the jail, dragged Frank out and hung him. This was largely seen as bias because he was a Jew. It would take 70 years to overturn his conviction when evidence surfaced it was the wrong man afterall. On July 22, 1916, a bomb went off in San Franciso over rising Marxism's influence in labor. The leader of the movement Tom Mooney was sentenced to hang but again there were doubts. President Wilson commuted the sentence to life imprison and then it was shown that the testimony of the government witnesses was coached and perjury resulted in the conviction that was later pardoned in 1939.

On January 31st, 1917, Germany informed it would renew its submarine warfare against even neutrals. On February 3rd, the Germans sank the US ship **Housatonic** and Wilson had no choice, The Senate voted for war 82 to 6 on April 4th. On February 24th, a coded message was intercepted from the Germans to Mexico proposing an alliance against the US. On April 24th, Congress enacted the **Liberty Loan Act** authorizing raising money from the public pay 3½% in gold bonds with a total issue of $2 billion. By June 26th, the first American troops arrived in Europe.

The economy had been doing quite well. By 1917, there were 4.8 million cars now registered in just 8.6 years! Yet the religious right was gaining and it was also on December 18th, 1917 that Congress enacted **Prohibition** that was ratified by the States on January 29th, 1919 in time for the 1919 Crash.

World War I came to an official end on November 11th, 1918. Yet America showed its lack of respect for the Constitution once more as Congress enacted on May 16th, 1918, the **Sedition Act** creating stiff penalties for anyone who even spoke out against the war.

The War Industries Board was established on July 28th, 1917 imposing rationing on food and fuel with increased taxes. The government nationalized the railroads by proclamation on December 26th, 1917. The European war had created a vast boom in the US and even the steel production had doubled between 1914 and 1917.. The Post Office had begun the first Air Mail on May 15th, 1918. The great health panic also took place where as many as half a million Americans died of **influenza** that reached its peak around October 1918.

In 1919, they saddled Germany with the impossible war reparations of $56 billion. This only set the satge for Hitler and the Second World War. Wilson's **League of Nations** was drafted February 14th, 1919.

Nevertheless, it was the development of World War I that gave birth to a rising debt level and widespread taxation that of course did not magically come to an end with the war. We even find the beginnings of Solomon Bros and other investment banks that would become the network of **Primary Dealers.**

The **26 Year Cycle** in War did not allow for the subsiding of debt. With the Great Depression on the horizon, the United States emerged into a debt dependent nation.

New York Becomes the New Financial Capital of the World

World War I changed the course of the world in so many ways. Europe was in ruin and as always, the European politicians did more to undermine Europe than rebuild it. There were living in a dream world to even think that Germany could make $56 billion in reparation payments and serve their debt to the United States.

Prior to **World War I**, there was a core disrespect for politicials that J.P. Morgan retained. France had paid reparations to the Germans in 1819 and 1871. So it was viewed also as what goes around, comes around. It was **John Maynard Keynes** who wrote **The Economic Consequences of the Peace** that was quite anti-reparations that contributed to the German feeling that they were being harshly penalized. This would ultimately fester into a turn toward Hitler for Germany went into hyper-inflation during the early 1920s.

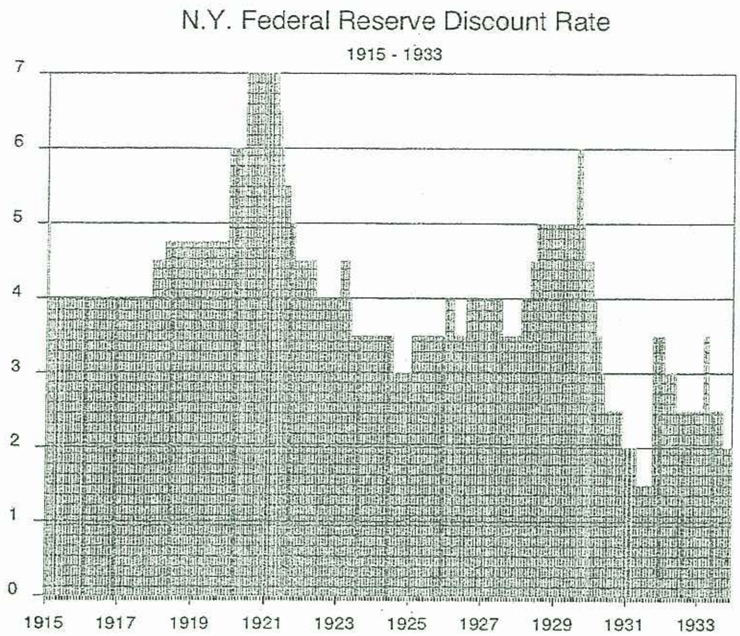
While "Jack" Morgan took the reigns of power and Thomas Lamont became the debonair partner at J.P. Morgan. The war shifted the power from the dominant European Jewish banks to the Protestant Americans - J.P. Morgan - National City Bank (now CitiBank) - First National Bank. The anti-Jewish rival contest in banking still lives on today in New York in even the legal industry. There has always been and undercurrent of Jewish/Protestant confrontation in New York City that behind closed doors is called the New Jerusalem.

The financial capital of the world that had been London, now shifted to New York and with that began a new era between the banks and government. In 1917, Treasury Secretary Carter Glass appointed Tom Lamont as a new financial adviser to the US Peace Conference in Europe. Lamont became perhaps the first banker from Wall Street to pave the political roads to Washington. Yet, by November 1919 the Treaty of Versailles was dead in the US Senate and the USA never joined the League of Nations, Wilson's dream. America was very much a nation of isolationists. The demands that the war debts be paid by Europe, was part of that isolationism whereby Americans viewed themselves as always being looked down upon by the Europeans.

Lamont was also publisher of the New York Evening Post and he directed the paper adopt a pro-Wilson stand for the League of Nations. While the average American and most bussinessmen were very provincial in their views, by bringing in Lamont to the inner circle of politics, this in itself had the effect of marking American banking far more cosmopolitan with worldly views.

The Republicans were far more isolationist at that time and it was the Democrats who were more worldly under Wilson. Warren G. Harding won the 1920 election putting the Republicans back in power taking once more the isolationist views to Washington. Jack Morgan was very anti-German, yet the bank was now trapped into the political dance and lending had to reflect the policy of the nation, not the personal views of bankers. Gradually, the New York banking center was starting to in fact follow the political agenda. Morgan was now providing loans that made the German reparations possible, when Jack Morgan himself detested the Germans and felt that General Pershing should have wiped out Berlin before entering into a peace treaty. Meanwhile, the Russians seized power led by Trotsky and Lenin who had Czar Nicholas II and his family all murdered. They also defaulted on all foreign debt and Russia now tried to move its deposits from Barings in London to Guaranty Trust in New Yorkm only to have all funds frozen. We also see the Mexican Revolution unfold and they too defaulted on all foreign debt, and were now proposing to nationalize all American oil interests.

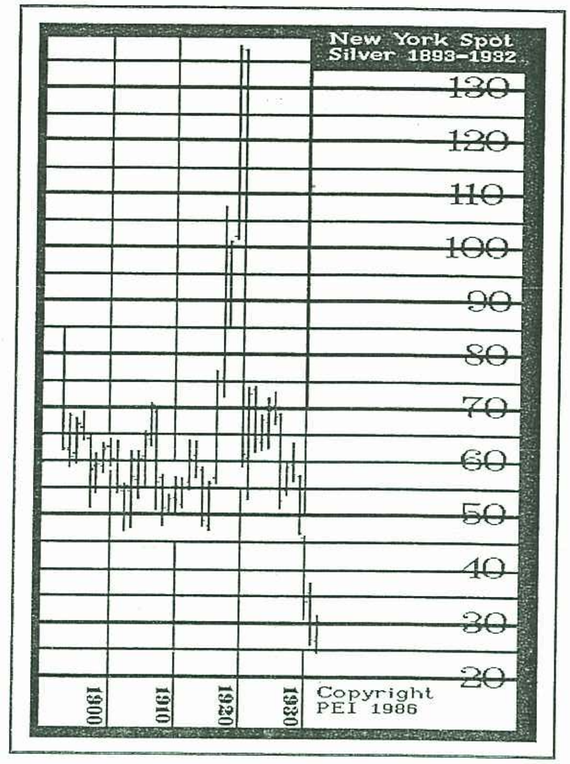
The Marxist contagion was spreading. In Germany, the new government came in 1919 known as the **Weimar Republic** that lasted until 1933 when Hitler came to power. These revolutions created what became known as the **"Red Scare"** with visions that revolution would spread to America. Indeed, in 1919, over 4 million went on strike. Attorney General A. Mitchell Palmer set out on a mission to hunt down the "Reds" and Massachusetts Governor Calvan Coolidge rose to fame for suppressing a major strike in Boston of the police force. This puts in context the birth of the **Red Scare**, the shift in power from London to New York, and the first use of banking by politics.



The **Panic of 1919/1920**, was perhaps the first such chaos deliberately created by any Central Bank. The man in charge was **Benjamin Strong** who was governor of the New York Fed. Keep in mind that as I pointed out, the **Fed** original design was to establish 12 branches with each forming an independent role. Thus, each branch had the power to raise or lower interest rates in their district - not on a national basis. That would come under **FDR.**

Clearly, the **Federal Reserve** under **Ben Strong** seemed to merge the role of central bank with guardian of the economy. While we can see that the **Fed** raised rates during the war from 4% to 4.5% in December 1917 and then to 4.75% in March 1918, it was its actions in January 1920 after the war that deliberately created the recession and Crash. The **Fed** was concerned with the sharp rise in commodities. During **WW I**, most commodity prices were fixed. For example, there was the **Sugar Equalization Board.** Herbert Hoover recommended to President Wilson that the crop of 1919 should remain under controls until Europe got back on its feet. However, Wilson relied upon **Frank Wm. Taussig** (1859-1940) who had lovely creditials, Harvard degree from 1879 and went on to get his Ph.D in 1883 and then a law degree in 1886. He immediately began teaching economics at Harvard in 1892 until he retired in 1935. He had no real world experience. Yet he was the main Presidential advisor to Wilson and was even chairman of the US Tariff Commission between 1917-1919. He wrote the **Principles of Economics** in 1911, but sat in his ivory tower never observing the real world.

Wilson rejected Hoover's warnings and listened to his acedemic with no experience. **Taussig** recommended dropping the controls and sugar for example, soared from 9 cents to 25 cents in 1919. This set in motion the insane reaction by the **Fed** who raised interest rates now significantly in January 1920 from 4.75% to 6%. The **Fed** still did not understand its role and then raised rates again to 7% in June 1920 creating confusion and the Crash.



The **Panic of 1919/1920** set in motion the entire process that would lead to the **Great Depression.** It was (1) the assumption of powers by the **Fed** in New York under **Ben Strong** that were at best questionable, (2) it set the stage for massive selling of foreign government bonds in small denominations that would wipe out American savings, and (3) it created the peak in commodities as shown above by the silver chart. Industrial stocks made ne highs in 1929 - not commodities. This **Panic** wiped out two major players the founder of **General Motors,** and **Jonathan Ogden Armour** whose father founded **Armour** meats in Chicago and during this **Panic, Jonathan** lost about $1 million per day for 130 days straight. That was more than even Rockefeller gave away. No individual has ever lost so much money is such a brief period of time. Adjusted for inflation the loss was probably twice the wealth of Bill Gates at his absolute peak.

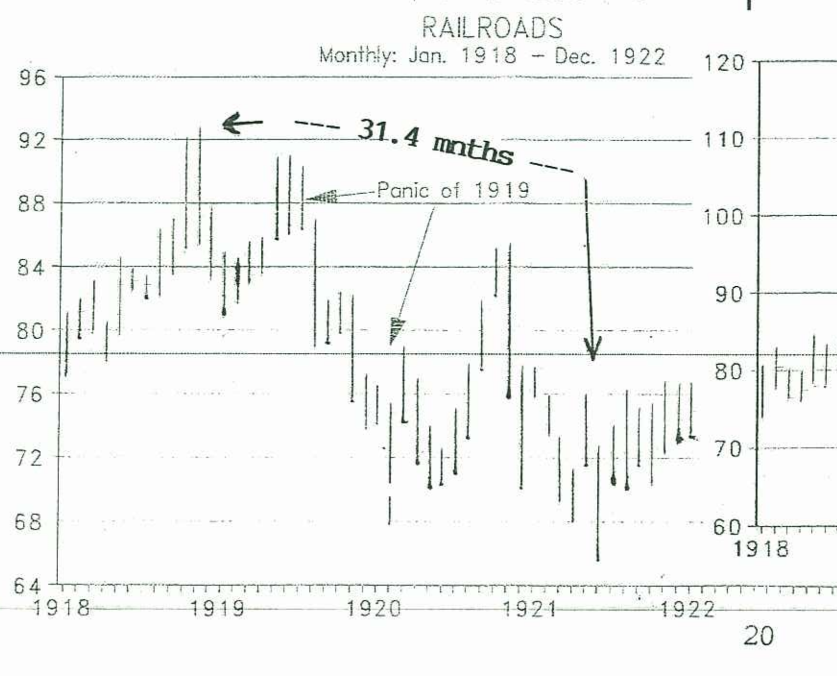
In 1908, **William Crapo Durant** had began to build his vision of an automobile company with a variety of brands to offer the consumer a choice. **Durant** was a wealthy buggy manufacturer who instead of fighting the new innovation, he decided to embrace it. **Durant** was a man of vision - a builder. He was not a CEO to run the company. His lack of management skills led to his losing control of the company he formed known as **General Motors.**

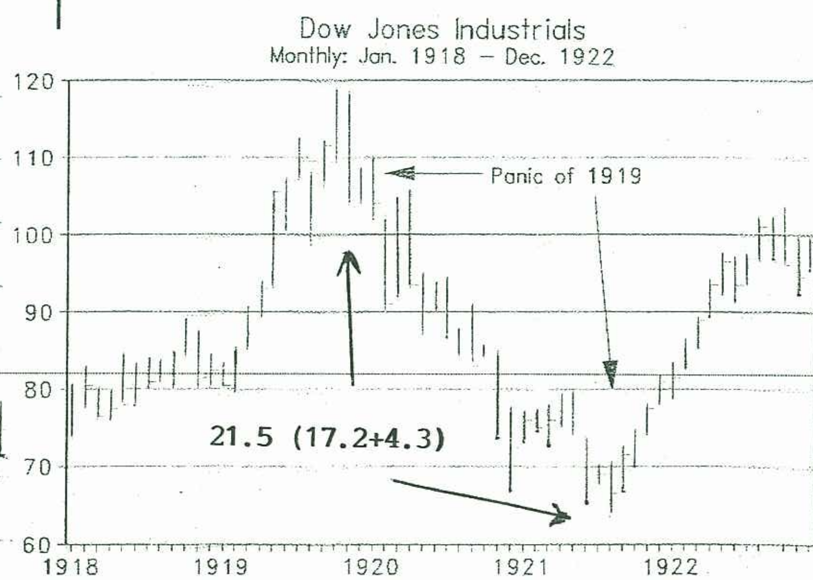
After losing **GM** with the **Panic of 1907, Durant** entered into a partnership with **Louis Chevrolet** and began the key **Chevrolet Motor Company**. In 1915, **Durant** then used **Chevy** to buy and take control of his beloved **GM,** which became the largest manufacturer and in 1916, he paid the largest dividend in the NYSE history. **Durant,** perhaps more than any other person, put the auto industry in the minds of all Americans. Henry Ford did not believe in going public, and had believed his workers were the natural shareholders. So it would be **GM** that set the new tone for American Industrials.

Durant was a visonary, not a manager. **Durant** did not understand ,arkets. Perhaps like the Japanese government ried to hold the Nikkei from collapsing after the top in 1989, **Durant** tried to support his stock at $20. When it fell to $12 and he could no longer meet margin calls, the dark clouds appeared on the horizon. His Morgan bankers went to his office on 57th Street only to be a witness to a mob scene of creditors. **Durant's** debt had reach $38 million - a incredible amount of money when you realize J.P. Morgan lost $21 million in the **Panic of 1907** and the US Treasury had only $25 million to lend the NY bankers.

With visions of the **Durant** default now creating another **Panic of 1907,** J.P. Morgan & Co and Pierre du Pont bought up **GM** stock at $9.50, a steep discount to the closing price of $12. They covered $20 million in margin calls and formed a new company to buy the **GM** shares. The du Ponts took 40%, Morgan 20%, and **Durant** 40%. But the Morgans were not happy to discover that **Durant** had been trying to support his stock with a pool they knew nothing about. So the Morgan partners insisted he resign, and Pierre du Pont came from his retirement to assume the role of President of General Motors that he held until replaced by Alfred Sloan, Jr. 3 years later. **Durant** would lose most of his fortune during the 1929 crash and ended up running a bowling alley in Flint Michigan. He died virtually pennyless in New York in 1947.

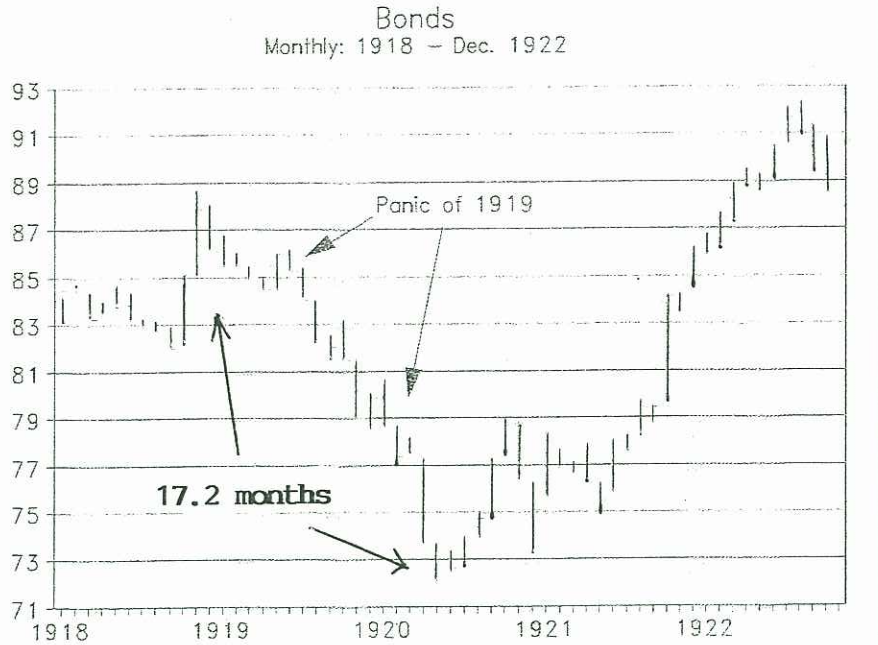
As illustrated below, you will find the comparison of the Industrials with the Railroad stocks. This **Panic of 1919** illustrates the shift from the **Age of Railroads** to the dawn of the **Age of Industrials.** Note that the Railroads peaked in May 1919 and made a perfect **Pi Cycle** decline 31.5 months into the major low for 1921. Now compare that to the Dow **Jones** Industrials, where we have a December 1919 high with a 21.5 month drop into 1921. In 2007, Feb 27th marked the high in Financials while the broader march made new highs into October. The banks crash on '07 and like the railroads in '19, they peaked first.





Source: Greatest Bull Market In History

Bonds
Monthly: 1918 – Dec. 1922



The brokers were now marketing debt to the general public that had continued to show demand after the war. They were now shown that they too could be mini-J.P. Morgans and participate in worldwide markets. The national banks were prohibited from engaging in securities business, and thus they set up subsidiaries in Guaranty Trust, Chase, and City Bank, to mention a few. They were now following the model of **Jay Cooke & Co** and had agents spreading out all over the country marketing debt.

The product was now foreign bonds and they were sold with the new image of J.P. Morgan saving Europe. There was risk, but that was played down. National City Bank had gone into Russia following the 1913 reform of banking, only to find that all its operations were seized by the Bolsheviks. The American bankers now saw themselves as global bankers opening up branches even in China as well as throughout South America.

The foreign bonds being sold to the mom and pops was staggering. You can still buy many such bonds at antique stores and framed making nice wall decorations. The American banks had begun to displace the British. Even Barings was surpassed by the New York crowd.

The politicians and the **Fed** were simply taken by all the activity. They were trying to figure out a way to create politcal capital and muscle. They did not see the danger that they were undermining the stability of the American economy for what was really taking place was a vast pouring out of wealth from the average American and when foreign governments defaulted in mass in 1931, whoever did not lose money in the stock market, was wiped out by the collapse of the debt market.

Strong's manipulation of the interest rates to fight "inflation" set in motion a new idea that cast government bonds as the alternative to what was looking to be the riskier stocks and commodities. Keep in mind that prior to this **Panic**, there was no real flight to quality toward government bonds. The emerging government debt was creating a another competing tier in investments.

The bonds fell **17.2 months** (2 x 8.6mo) compared to the 31.4 month decline in the Railroads and 21.5 months in the Industrials. This was a entirely new field for the average American. What you must also keep in the front of your mind during this period, was that the US was near bankruptcy in 1895. The capital flows poured into the US fleeing **WW I** and to buy raw food and materials. The Americans where now the rich boy on the town whereas that had long relied on Europe for capital to fund ventures.

To fund the war effort, the US began this trend to initiate the average citizen to become a holder of government debt, the government sold $50 **Liberty** and **Victory Bonds** creating a market for debt. Americans had traditionally invested in savings accounts, insurance policies, and stocks. Now, they were becoming the market for government debt that profoundly set the stage for the true core that would create the **Great Depression** - the emergence of the **Debt Crisis**.

During the 1920s, three Republican administrations assumed the power now to veto foreign lending. This was perhaps contrary to **laissez-faire** principles, but there was a debate about allowing foreign governments to raise money from the American people with no restrictions. It was ironically the Secretary of Commerce, **Herbert Hoover**, who who was not entirely comfortable with the trend.

Herbert Hoover (1874-1964), was not one of those acedemics nor a career politician. He was a man who was an engineer in mining and

Herbert Hoover
(1874 -- 1964)

worked on four continents. When I was in Austalia visiting Western Mining, there was an oil painting of Herbert Hoover. He had been a CEO down there well before he became President of the USA. In fact, **Hoover** worked for about 18 years before getting involved with politicians. He had vast experience and was in China during the **Boxer Rebellion** in June 1900 (killing of foreigners) and he was in London in 1914 when the war broke out and was asked to head up the Allied relief operations. This led him to be appointed as the national food administrator in the US during 1918. Wilson rejected his experience for the academic that proved to be a disaster, but in 1921, he became Secretary of Commerce. He oversaw the expansion of radiobroadcasting and he was Chairman of the Colorado River Comm'n that culminated in the "Hoover" dam. When Coolidge decided not to run for a third term, Hoover won the nomination and the Republican Party support and the election in 1928 taking office in 1929. His **Memoirs** are most enlightening for this period and were published in 1951.

Ironically, the Democrats saw rebuilding the world while the Republicans viewed all this money going to foreign nations as debt that would have been better spent in the local economy. This created a strange conflict with the NY Bankers who were now looking at having to get approval first before marketing any foreign debt in America. The pro-business party was conflicting with the bankers who did not like being cutrailed from a market that was a real boom. President Harding thus took the position that war debts were owed, and should be paid back to America. Harding believed that if the debt was repaid, taxes could be reduced on Americans.

The opposing Democratic view was that the war debt should be foregiven and they saw this debt retarding world trade. They also believed that this would undermine the new status of America and prevent relations with Western Europe from developing.

This new requirement that foreign bonds required US Government approval to be sold in America, had the effect of also giving the stamp of approval of the federal government to any foreign government bond sold. The brokers spun this image creating the real illusion that this debt was sanction by the government itself.

The year 1923 saw Germany default on its reparation payments and there was even a failed uprising known as the **Beerhail Putsch** in Munich were **Adolf Hitler** was sentenced to 5 years in prison. On September 1st, 1923, the worst earthquake in modern times hit Japan wiping out most of Tokyo and Yokohama. The chaos of 1923 led to stock declines. It was the Jewish bankers **Kuhn, Loeb** were just too small to handle a $150 million loan to Japan. In February 1924, J.P. Morgan & Co created a syndicate to hand the vast amount of public dent to a foreign nation.

It was perhaps **Ben Strong** who became the new powerful man behind the **Fed.** He had made contacts with the European central bankers and and where the Republicans Harding and Coolidge declined to assume leadership in any reconstruction role in Europe, **Strong** assumed this role without any formal authority. Thus, **Strong** cultivated his relationship with J.P. Morgan & Co and was seen by many as linked at the hip with Europe. The **Fed** could not lend money directly to Europe, and thus he needed J.P. Morgan & Co to achieve his goals. He tried to turn the **Fed** into the the U.S. image of the **Bank of England** founded in 1694. He aspired to near royal dignity for the **Fed.** He developed a very close relationship with **Montagu Norman,** governor at the Bank of England that it often sparked rumors. **Monty** was a bachelor and **Strong** was divorced. The two would secretly take vacations together and both shared a distrust of politicians. They sought to thus forge an independent central bank untouchable by politicians. **Monty** himself had come from an Anglo-American merchant bank **Brown Shipley & Co** (known as **Brown Brothers** in New York). The idea of **Fed** independence can thus be traced to **Strong** and **Norman.**

The United States had completely just amassed tremendous debt. The calculations of loans made to Allies (most never repaid) exceeded $10 billion. The theory was that this massive debt would be repaid by the Germans. Britain proposed that the debts should all be just canceled at Versailles. Wilson refused. Congress established the Foreign Debt Commission on February 9th, 1922 to study the problem. The final settlement was agreed that they would repay the US with $11,5 billion over 62 years at the interest rate of 2.135%. When it became clear that Germany would never be able to pay now suffering hyper-inflation, the debt was then scaled down in 1925 and again in 1926.

The government couldn't figure out how to audit no less even manage its budget. In 1921, it established the **Bureau of the Budget** within the Treasury. The size of the federal government just kept expanding.

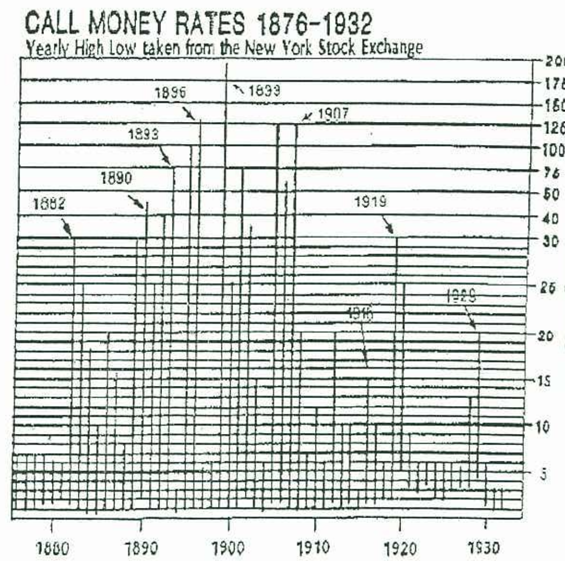
In 1919, the Commodity Bubble caused by the War, burst. The richest man perhaps ever became Johnathan Ogden Armour who lost in this bubble at least a few million dollars per day for about 130 days straight. He was the supplier of food to the Allies during World War I. He lost everything, including the company, and died pennyless in London, living off the charity of old friends.

During the 1920s, the two greatest issues were the War Debts and Prohibition. The later was truly an attempt to punish the Catholic immigrants pouring in from both Italy and Ireland. As a result, between 1920 and 1930, 500,000 Americans were arrested. Gun wars and crime exploded by making this a new crime.

It was William Jennings Bryan who in 1923 called the theory of evolution just a "program of infidelity masquerading under the name of science." This 1923 speech he gave in Saint Paul, Minn., created the term "fundamentalist" for the religious group and "modernist" for those who believed in this "mad" science. In July 1925, John T Scopes was criminally put on trial in Dayton, Tenn. for teaching evolution.. Now even Texas had made it a crime to teach evolution.

The next great land bubble was also taking place, but this time in Florida. The prices peaked in October 1925, setting the stage for a distinction between real estate and stocks that continued to rise going into 1929 as well as the difference between purely domestic investment (land) and that of stocks that was far more international.

The Dow Jones Industrials peaked in 1923 and consolidated into 1924. The stocks took off and rallied as real estate began to get soft. In fact, while the stocks had been moving largely sideways, domestic cash was moving into Florida creating the big boom. That peaked in about 8.6 months creating a spike high. Cash then migrated to stocks concentrating in the financial sector.



We can see from the Call Money Rates on the New York Stock Exchange, that the birth of the Federal Reserve in 1913, had the impact of reducing the spike highs during panics. This would prove to be a beneficial aspect of the Fed as time went on.

Nevertheless, as time went on, the flight of capital from Europe was misunderstood. It was no different than the flight of capital to Japan going into the bubble top there in 1989. The US tried to deflect the capital on an agreement with Europe to lower its interest rates to try to make it beneficial to retain funds in Europe. However, this backfired and when it was seen that the central banks were coordinating, this confirmed the rumors of the day that there was a crisis brewing. Still, academics just **NEVER** get it. Sometime you have to leave the Ivory Tower and mingle. It is **NOT** the empirical difference between rates that moves capital, but the expectation of profits one must measure against.

Austria	12.0%	Japan	8.0%
Belgium	5.5%	Holland	5.0%
Bulgaria	7.0%	Norway	7.0%
Czechoslovakia	6.0%	Poland	12.0%
Denmark	7.0%	Portugal	9.0%
England	4.0%	Rumania	6.0%
France	6.0%	South Africa	6.0%
Germany	10.0%	Spain	5.0%
Greece	7.5%	Sweden	5.5%
Hungary	18.5%	Switzerland	4.0%
India	7.0%	United States	3.5%
Italy	5.5%		

In June 1924, the New York Fed cut its discount rate to 3.5%. What **Strong** was now trying to do in league with **Norman** of the Bank of England, was to deflect capital back to Europe to support their economies and the British pound. This manuver illustrated quite a lot. It illustrated that the United States had indeed emerged as the new Rome displacing Europe and that New York itself was the new financial capital of the world.

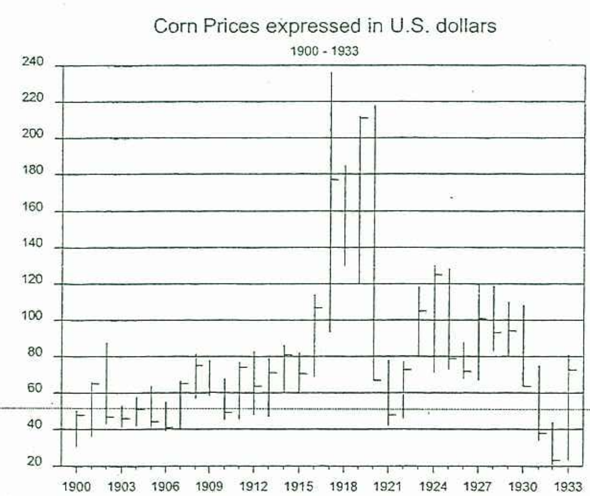
Keep in mind that the **Federal Reserve** was 12 independent branches. **Ben Strong** had no power over the other branches. The other branches did **not** follow suit and then again on August 7th, 1924, **Strong** cut the rate to now just 3%. This contrasted not only with the entire world, but Boston, Philadelphia, Cleveland and San Francisco left their rates at 3.5% while the other 7 branches maintained their discount rate at 4%.

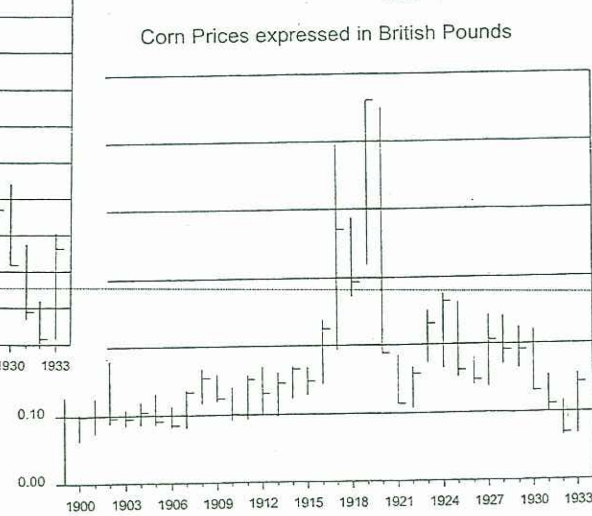
The **NY Fed** is where the gold reserves were stored. Suddenly, gold began to move to other countries and capital would flow from New York to other regions as well in the United States. The cut in the rates in NYC left May 1924 as the low for the year. The Dow Jones Industrials rallied from just below 90 to about 120 by the end of 1924.

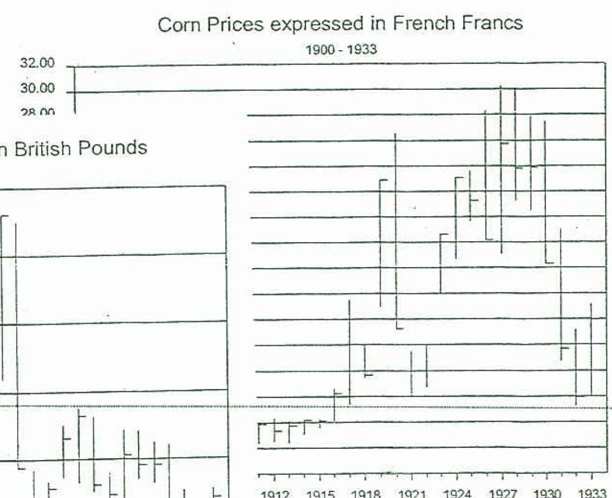
The sharp reduction in the **NY Fed** rate began to start rumors in Europe that there was a serious economic problem. A lot of the money being lent to Europe was going to rearm the countries. There was concern that the debt levels were excessive and that if the **NY Fed** had lowered rates so drastically, it began to be taken as a negative confirmation about Europe. Meanwhile, capital had rushed into the stock market and there was also some concern about domestic inflationary boom.

The **NY Fed** raised the discount rate back to 3.5% to match the other branches to stabilze the internal domestic capital flows. This incident would later play a part in arguing for a single discount rate.

Many have criticized the actions of the **Fed** on this move and have tried to blame the bull market into 1929 on these events. That is a real stretch to say the least. What is clear, is that virtually all of the foreign debt sold to mom and pop investors who believed it was sanctioned by the Government and less risky than the stock market, lost everything in 1931.



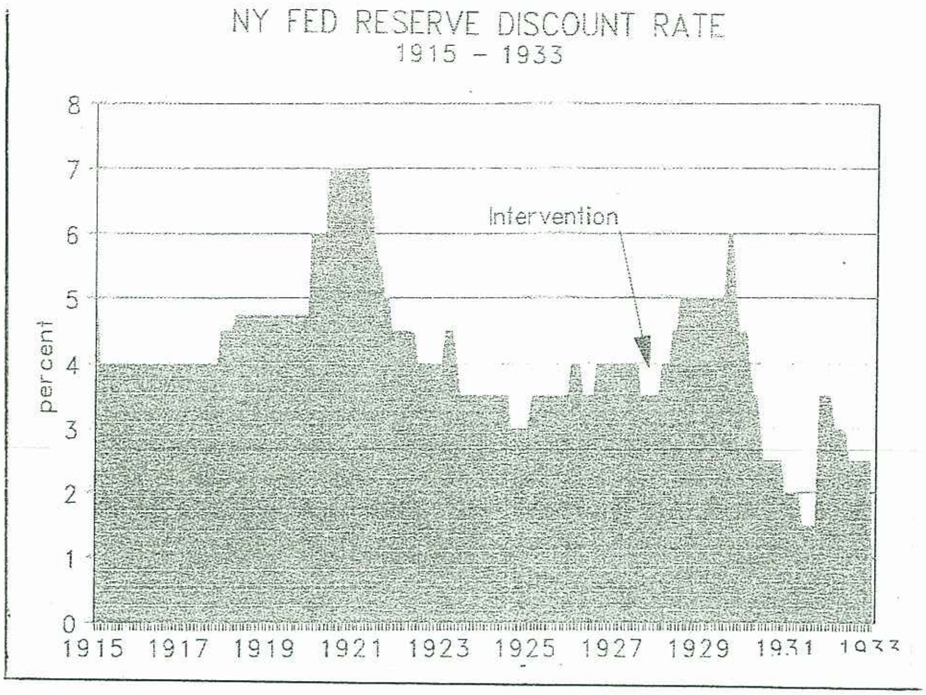




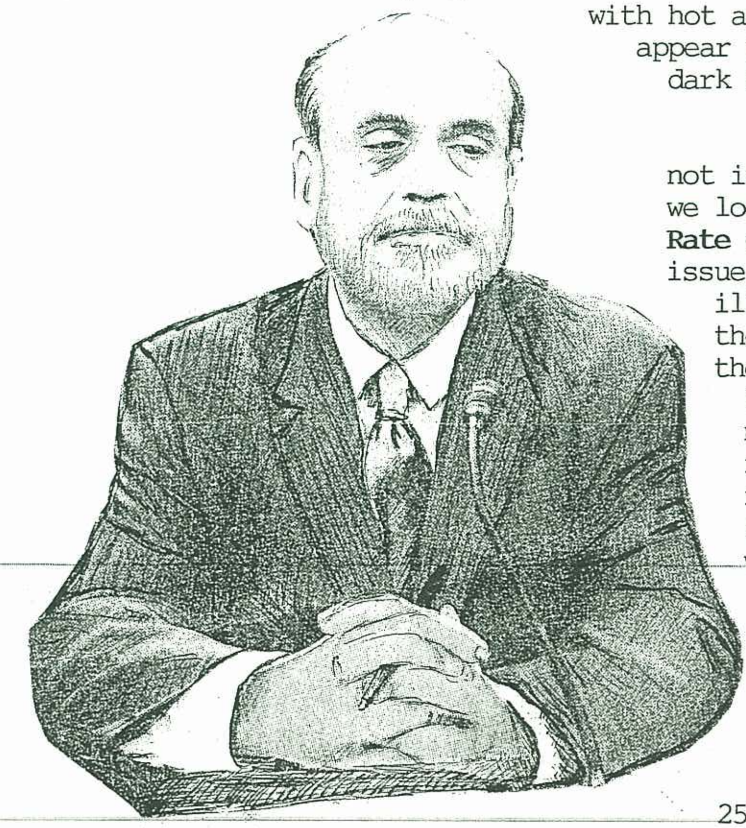
The credibility of farmers, priests and prostitutes – and bankers?

In August 2009, the **China Daily** published an article that reported a national survey on credibility. They asked people what professions were the most trusted. Indeed, we live in a world where the Investment Banks are either so shameless in their pursuit of profits, or they are sublimely stupid. The survey in China was conducted by the Research Center of the Xiokang Magazine. The people thus voted and the remarkable results speak for themselves. Not only are bankers not to be found among the honorable professions that are trustworthy, but the survey of more than 3,000 ranked those professions of the top five as:

Farmers - Priests - Prostitutes
Soldiers and Students



Bankers have just been linked with corruption from Roman times. Being a banker in Rome was not considered to be an honorable profession. The tempation for corruption seems to be too great and in fact the term **"Black Friday"** reflects not a shopping day, but the **Panic of 1869** when they had to send troops into Wall Street because the mob was dragging bankers out of their offices and hanging them on the streets. Perhaps the banking field is just filled with hot air that they are trying to make themselves appear to be honorable when there will always be the dark doubts lurking in the corners.



Nevertheless, the pretense of secrecy does not in the least boost the image of credibility. If we look at the above illustration of the **Discount Rate** of the **NY Fed (1915-1933)**, there is a striking issue that jumps out from the chart. Here we have illustrated proof that during the 1929 Bubble, the high in rates was 6% whereas the 1919 Bubble the rate was 7%. Clearly, raising or lowering the **Discount Rate** is a subjective human judgment. This means there is human error. The low rates for the **Fed** compared to Europe and the rest of the world illustrate that capital will flee if it (1) smells danger of default, or (2) when its expectation of profit is greater else where. The **Fed** was keeping rates low trying to deflect the foreign capital flows back to Europe. That did not work. Europe defaulted in 1931. The US was the new financial capital of the world in the 1920s. It was the place to be. Capital moved to the USA regardless of the interest rates.

Roosevelt's Usurpation of the Federal Reserve

Franklin D. Roosevelt was a serious socialist with very pronounced **Marxist** views toward Government being the salvation. **FDR** even tried to alter the Supreme Court that was opposing much of his **New Deal** notions. Even the Democrats rejected this effort of July 22nd 1937. Meanwhile, Justice Willis Van Devanter retired and this allowed **FDR** to now appoint Justice Black and swing the court to his philosophy.

FDR signed the Securities Exchange Act on June 6th, 1934 creating the SEC. Just as the weather cycle went into extreme shock waves of incredible volatility in 1934 with records cold spells in February and then scorching heat in July setting in motion the **Dust Bowl**, the same was taking place in the political world.

Nevertheless, thanks largely to the mix of political intrigue and conspiracy theory that somehow it is the private banks who now control the **Federal Reserve**, the truth about the banking system has been lost in the deep cracks of time.

Before 1934 and the **FDR** usurpation of the **Federal Reserve** (here the **"Fed")**, the currency was actually issued by the Treasury for prior to the Civil War, money was only coins offically. Private banks issued paper money that represented their assets, but the private notes were just that - private. The Treasury began to issue paper notes after the Civil War. It was **FDR** who changed the entire system.

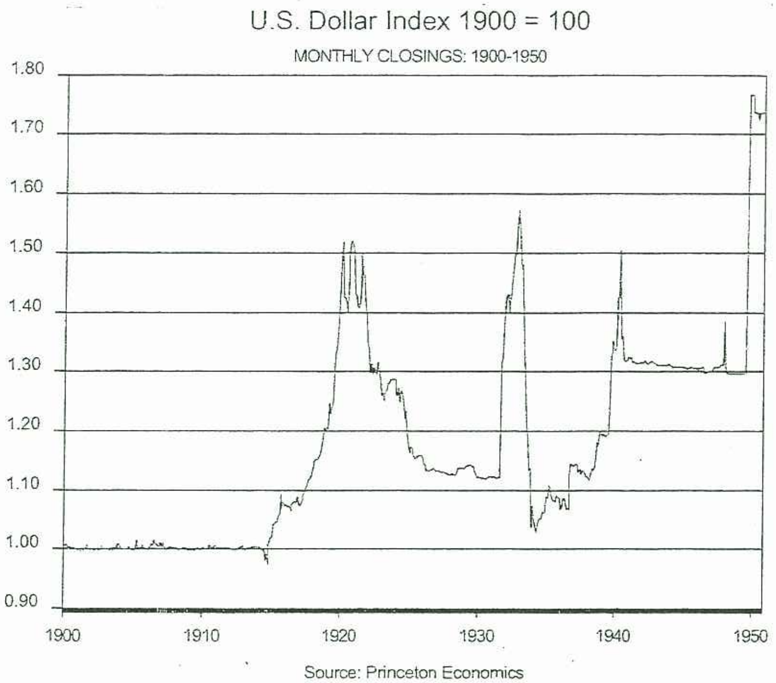
It is true that the **Fed** was set up in 1913 to be the custodian of reserve accounts of commercial banks and effectively clear transactions. Because of the events in 1907 that saw how J.P. Morgan organized the banks collectively, the purpose of the **Fed** was to fill that role. This was the core of model proposed at **Jekyll Island** in 1910. However, as I have explained about the San Francisco Easthquake of 1906, this brought to light regional capital flows. This problem was now dealt with by creating 12 branch system of the **Fed** but what is overlooked by most, is that prior to **FDR**, each of the 12 regional banks were independent. Each established its own interest rate to manage the capital flow nationally.

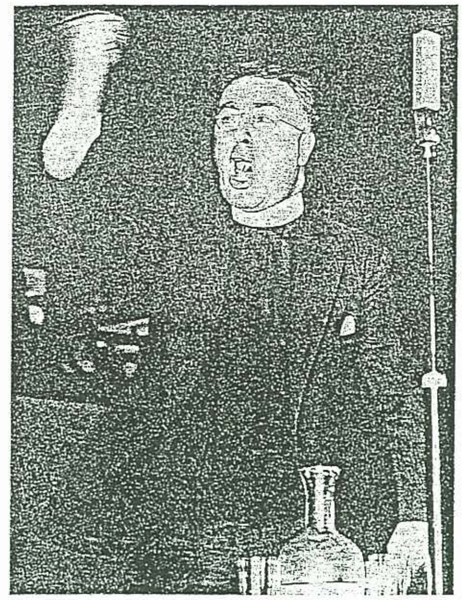
Another critical point of the **Fed** that is overlooked is the fact that the way the **Fed** functioned was wholly private. It would "buy" commercial paper to stimulate the local cash flow problems. It was the development of World War I and then **FDR** who completely altered the entire system. This is where the conspiracy theories create confusion.

It is true that the original design of the **Fed** was a private clearing operation that would buy commercial paper and hold the reserves of banks. It was privately owned to serve the public interest. It was governed by 9 directors, 6 of whom were elected by the banks and 3 were political appointments. As it was originally designed, there was no threat to the economy or anything else. It was a vital link in the chain of economic evolution.

Where things start to get messed up is once the US began to get involved with being a debtor nation. As debt started to be issued, it was the politicians who now directed the **Fed** to support their bond issues. With the **FDR** usurpation and then World War II, forget everything that the **Fed** was suppose to do in the "public interest" for now it was order to support the US debt at **par** to prevent interest rates from rising. That mandate lasted until 1950.

But it gets worse. **FDR's** determination to change the economy led to the fundamental change in 1934 usurping the power of the 12 independent branch-system into a single one size-fits-all agenda. The entire capital flow lesson learned from the 1907 Panic, went out the window entirely as Washington set one rate for all.



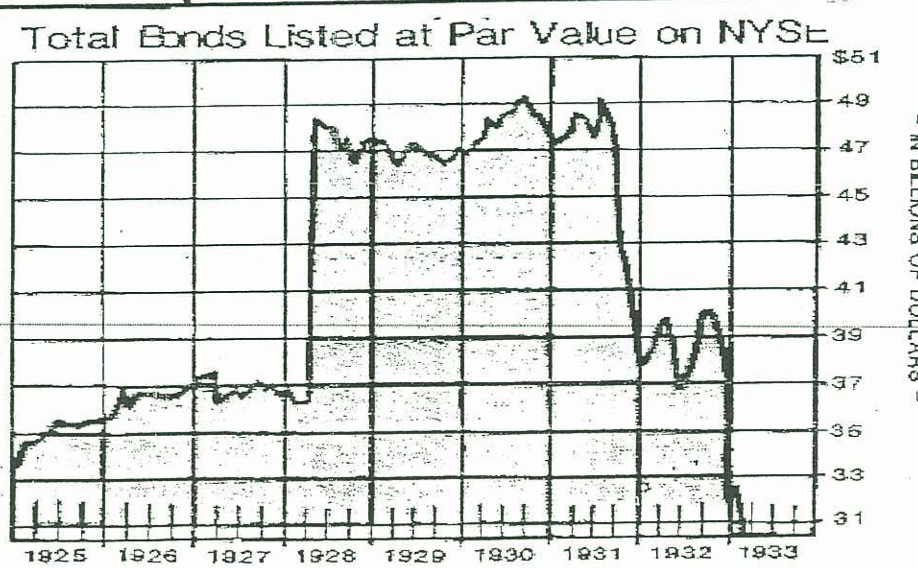


Father Charles E. Coughlin, 1891-1979

The entire atmosphere was one as always - targeting Wall Street and the bankers as causing the **Great Depression.** The Catholic priest **Father Charles E. Coughlin (1891-1979)** played a big role in getting **FDR** elected. He created more unrest by always portraying this as a class war and it is **"us versus them"** with the **"them"** being the demonized **"grinning devils"** of Wall Street. This public blame coming from a priest had a major impact. Then in the South there was the notorious **Huey Pierce Lond (1893-1935)** who in fact advocated his plan to confiscate all such estate worth more than $1 million and "share the wealth" as it became known. **Long,** however, was assassinated after becoming a senator in 1932 for his political views. This was the atmosphere and FDR's own people were also quite extreme.

The historians and economists of the times were very pro-**FDR** and as such, what has been taught in schools for so long is about as truthful as the Germans taught regarding Hitler or the Japanese taught in respect to their invasions. To the victor, often lies the right to alter history and to the loser, he assumed the right to just ignore history.

The massive wave of selling foreign debt to the retail public throughout the the 1920s that was encouraged under Wilson and regulated under the Republicans, had a profound impact upon the economy. For those who were conservative and had purchased those foreign bonds lost everything. At least the majority of stocks that fell, did not go to zero. Most did eventually returned so those who could hold, had somehow survived. As you can see by the illustration of the listed bonds on the NYSE, there was a complete collapse and delisting of most bonds.



Henry Morgenthau, Jr
(1891 -- 1967)

Mr. Henry Morgenthau (1891-1967) as Secretary of the Treasury, was the ruthless man who probably set the stage for a problems today. **Morgenthau** went after **Andrew Mellon (1855-1937)** who had also been the former Secretary of Treasury. His relentless desire to punish the rich for simply being rich was a disgrace to the foundation of the United States. His personal hatred of the rich was only matched by that he also displayed against German citizens as a sheer whole.

Being Jewish, **Morgenthau** drafted his plan for Germany. It became known as the **Morgenthau Plan** that was simply beyond description. He proposed the outlawing of ever allowing Germany to rebuild any industrial capacity. He wanted to drive Germany into the stone age completely and prevent any economic development thereafter. His **"Plan"** revealed more about the inner hatred of this man that confirmed his actions in attempting to go after the "rich" and since **Mellon** had been the Secretary of the Treasury before him, he was also attempting to go after Republicans while overlooking the Democrats.

When **FDR** died, **Morgenthau** then discovered he had few real friends in Washington. His ruthless nature was scary. **Morgenthau** thus resigned and returned to private life in New York. His actions toward the rich would illustrate to many that political contacts were just not enough.

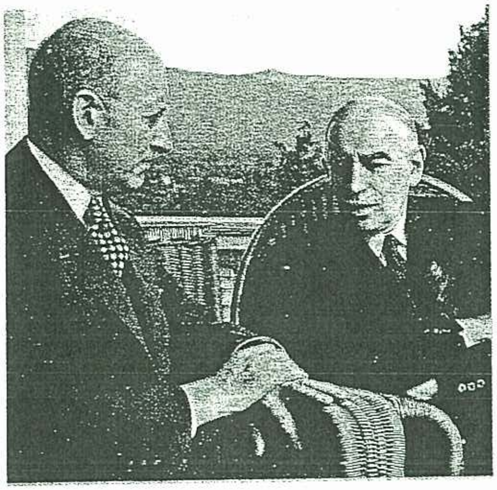
Meanwhile, Washington was brewing with resentment and blame fearing that the people were looking at the politicians. It became their primary goal to now look for all sorts of conspiracies to deflect the blame from none other but themselves.

Senator Gerald P. Nye, a Republican of North Dakota, illustrated that the hatred of Wall Street that was brewing came from both parties and was distinctly also a trend that was regional pitting the West and South against the banks and Wall Street of New York. Just as Hoover began hearings on the mere phone call that someone was forcing the Stock Market to crash to ruin his administration, here Senator Nye began hearings into yet a new conspiracy that became dubed the **Merchants-of-Death** based upon the conspiracy theory that now the NY Bankers had steered America into war **(World War I)** to safeguard their loans and to perpetuate a business in arms.

On January 20th, 1936, **Time magazine** asked the question that was circulating in every corner: **"Before the Committee for settlement was a scandalous question: should J. P. Morgan be hated as a war-monger second only to Kaiser Wilhelm?"** Once again, America had betrayed its own rewriting history to try to blame anyone other than Government. It was a bitter lesson America can't be trusted.

Lamont - Whitney - Jack Morgan
Before Senate Hearings of Gerald Nye
The "Merchant-of-Death" Hearings
of January 1936

The confiscation of gold by **FDR** also meant that what was "legal tender" had to change. It was 1934 that we find the new smaller paper currency known as the Federal Reserve Note. The currency previously was about 33% larger. You will find these old notes in collector stores today or perhaps in a movie interested in being historically accurate. Now the paper currency was just a Federal Reserve Note and not a note that was issued by the Treasury and redeemable there in gold. Nothing was redeemable in gold in the United States any more.



John Maynard Keynes (right) with Treasury Secretary Henry Morgenthau, Jr

The entrance of **John Maynard Keynes** to the mix, in effect added the seal of his approval to **Marxism.** I do not mean that **FDR** and **Keynes** advocated communism. What **Marx** did advocate was that government should be the salvation. In communism, he saw the new state should own all property. **FDR** did not go that far and neither did **Keynes.** What they did advocate was the central position that the government knows best and had the power to control the economy.

Once we added **Keynes** to the mix, this also changed the role of the **Fed.** Instead of managing the cash flow to prevent the collapse from temporary shortages in cash, politicians assumed that meant that the **Fed** controlled "money" and thus it would be the supply of money that would control the whole economy. This only further usurped the role of the **Fed** from a private clearing bank to the assumption that it could control the whole economy. The **Fed** role was now to hold power over the "direct" and "indirect" control of the economy.

The "direct" control was the ability to alter the reserve ratio of member banks. In other words, demand that the bank must have 6% or 10% of all its deposits as the reserve. This is seen as the "direct" means of reducing the ability of a bank to make loans. Since **money supply** is defined by the **velocity** of money, not the actual empirical amount of money, then the alteration of the reserve ratio impacts **money supply** for if a bank lends out $10,000 you have in your account to another, now that generates a new deposit and both of you have $10,000 and thus the **money supply** is defined **not** by the actual printed notes, but by the **"velocity"** meaning how many times the same $10,000 is multiplied in the economy and is changing hands.

The other **presumed** means of "direct" control is by the **Fed** setting the discount rate of interest it is charging member banks and thus in **theory** if the rate rises, this will reduce demand and also lower the **money supply. However, this must have been a dream by some academic with no live experience. It sounds nice, but is completely nonsense. If you compare interest rates to the stock market you will see the bull markets take place with rising interest rates - not lower interest rates!**

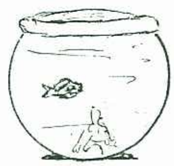
Anyone with half a brain and a few bucks in their pocket can figure out this one. If you think a stock will double, you will pay any amount of interest that leaves you with a good "profit" between the **expected** gain and the cost of the money. So if I loan you $100 at 20% per month and you are sure you can make 100% in that time period, you will pay the 20%.

Interest rates rise in bull markets and decline in bear markets (like now) because it is not the empirical direction that matters, it is the plain differential between the rate of interest and expectation of future profit.

The **Fed's** power over the reserve ratio has more of an impact than merely altering the discount rate of interest. The problem has been that the politicians have felt it is the **Fed's** job, and not their's to curtail their spending to effect the economy.

Fed's - Indirect Powers

The **indirect** powers of the **Fed** to control the economy is claimed to be through its **Open-Market Operations** that were first employed during the 1920s. Today, this is the daily tool that the **Fed** prior to the immediate crisis, believed it could adjust the money markets on an incremental basis. The **Fed** buys or sells securities in the open market and this is purported to manage the size of commerical-bank reserves. If the **Fed** buys securities, it adds cash to the system and if it sells securities in the open market it is draining excess cash from the system. Again, this is a wonderful **theory** but it has lost all meaning in a global economy.



Fish-Bowl Economy

All of these ideas are fundamentally flawed because the economy has simply just evolved far beyond the concepts of limited international experience. They are based on what I call the **Fish-Bowl Economy**. What I mean by that is the world as we know it is limited to the confines of an isolated and wholly self-sufficient and contained world. There is no external contact. You live in a world just as a fish is confined by his bowl. He has no concept of the ocean and the ability to swim around the world. His world is only within that bowl.

If you take Rockefeller Plaza in NYC and you sell it to an American, his bank sends to the other bank the money. There is no change to the money supply at all assuming this is a cash deal. Now if you sell it to the Japanese, they convert their yen to dollars and hand you the pile of cash. Now you take that to the bank. You just expanded the money supply because the Japanese brought in cash from outside the system expanding the local money supply. This is the **Fish Bowl Economy** and someone just put another fish in the bowl. The theories are all wrong because they are only based upon the presumption of a domestic isolated economy. The economy evolved as a child. We need to reassess its growth.

Dependency Upon Debt

Once you realize that the Government in following **Keynes**, they made the assumption that inflation is the problem of the **Fed** and not the politicians. Their definition of an inflation is the rise in the price of goods relative to the money supply. Therefore, it became the **Fed's** problem - not Congress.

Roosevelt's usurpation of the **Fed** and the government dictating that the **Fed** had to support the US debt at par until 1950, was effectively the nationalization of the **Fed**. While member banks may own shares nominally, they have no effective control over the **Fed** for it is firmly a political entity. All the conspiracy theories miss the point. The **Fed** can no longer even control the money supply and its **Open-Market Operations** have now been transformed from commercial-paper to manage the cash flow, into the buying and selling of **Public Debt**. That means, in the real world, if the **Fed** were to decide to buy $1 trillion in government securities, in a **Fish-Bowl Economy** it "should" add cash to the system increasing the money supply. However, in the real world, that $1 trillion could be owned by China. If China sold its paper to the **Fed**, the cash would be exported to China and there would be no domestic impact whatsoever!

The problem we have today, is about half the national debt is funded inter-agency. If the Government had to raise that money from the private sector, it could never sell that much. They rely on almost 30% of the debt being bought outside the **Fish-Bowl**. Every aspect of our world today has been turned on it head. There is **hardly a economic theory** that survives outside of Smith and Ricardo for everything is based upon this **Fish-Bowl Economy** with no consideration for the new way capital flows globally like the currents in the ocean. **It is our Dependency on Debt that has changed everything!** Not only is the **Fed** powerless to honestly steer us out of a major depression, neither can the politicians. We are on auto-pilot and the true mover and shaker is the **Free Market** and by that I mean that capital will flow and we need to understand **how** things honestly work by good old **OBSERVATION!**