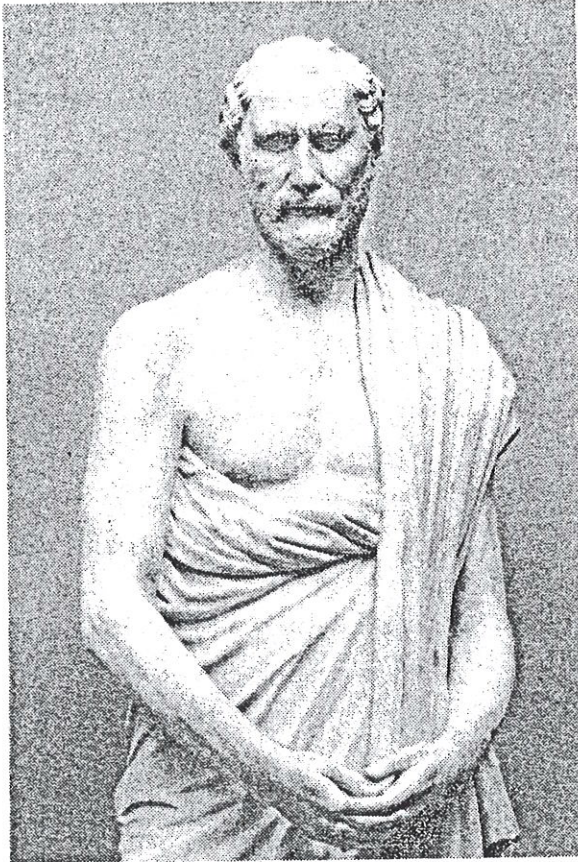


Armstrong Economics 阿姆斯特朗 经济

Forecasting the World



Demosthenes (384-322BC)

The Athenian

Real Estate Panic

& Banking Crisis

How Trading Bankers

Always Collapse - A Guide to the Future?

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

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

I would like to thank all the former employees, associates, sources, and contacts for their ongoing support and efforts to contribute to the writings I have been able to continue through their great efforts. I would also like to thank those who have looked after not just myself, but my family, and shown them support and kindness.

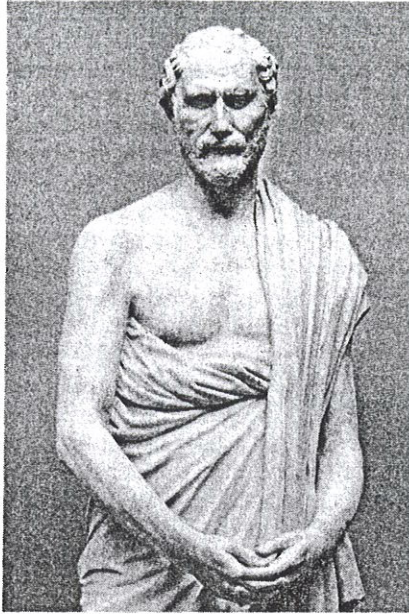
The purpose of these reports is to broaden the understanding that is so vital to our personal survival. Government cannot save us, and will only assist the very economic disaster we face. This is a **Sovereign Debt Crisis** that threatens our core survival. There is no plan to ever pay off debts. The majority of debt increase is paying interest perpetually to roll over without any long-term plan. What you see in Greece and in the States, we have run out of other people's money. The socialists keep pointing to the rich. But to fund the deficits, we need to borrow now from foreign lands. We ran out of money domestically and to support the current system like Greece, we need foreign capital. But all governments are facing the same crisis and we are on the verge of another widespread government default. Adam Smith warned in his *Wealth of Nations* that in 1776, no government paid off their debt and had always defaulted. We will have no choice either.

There is no hope that politicians will save us, for they only form committees to investigate after the shit-hits-the-fan. They will NOT risk their career for a future problem that may hit on someone else's watch. There was a politician and an average man standing on top of the Sears' Tower when a gust of wind blew them off. The average man being a realistic-pessimist, immediately sees he is about to die and begins praying. The politicians, the ultimate optimist, can be heard saying "Well so far so good!" as he passes the 4th floor.

At Princeton Economics, our mission was simply to gather global data and to bring that together to create the world's largest and most comprehensive computer system and model that would monitor the world capital flows. By creating that model, all the fallacies of market and economic theories were revealed. The world is far more dynamic and every change even in a distant land can alter the course of the global economy. Just as has been shown with the turmoil in Greece, a **CONTAGION** takes place and now capital begins to look around at all countries. We can no more comprehend the future but looking only at domestic issues today than we can do so in every other area, such as disease and the spread of flus.

We live in a **NEW DYNAMIC GLOBAL ECONOMY** where capital rushes around fleeing political changes and taxes just as it is attracted by prosperity. All the people who migrated to the United States in the 19th and 20th Centuries, came for the same reasons as those still coming from Mexico - jobs and prosperity. In the 19th Century, America was said to have so much wealth, its streets were paved in gold. We must now look to both the past and the entire world to understand where we now are today,





Demosthenes (384-322BC)

The Athenian Real Estate Panic  
& Banking Crisis  
How Trading Bankers  
Always Collapse - A Guide to the Future?

By: **Martin A. Armstrong**

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

**A**RE WE HEADED INTO ANOTHER BANKING CRISIS? People generally know that there were almost 7,000 bank failures during the Great Depression. What they may not realize, banking crisis events are not modern by any means. There are two problems concerning banking that ALWAYS and without exception lead to economic collapse. (1) There are merchant banking operations that make their money historically from trading, as is the case with Goldman Sachs, which by no means is a traditional bank by any stretch of the imagination. (2) There are normal banking operations that have taken deposits and lent them out to others willing to borrow. This has been going on since ancient days as well, but in modern times, the idea of profit has emerged from the yield-curve by paying less for short-term demand deposits while lending long-term at higher rates of interest. When economic crisis strikes, the bank is flooded by what we call a "run" meaning the short-term demand depositors are trying to withdraw their deposits but the bank lent the funds long-term and this creates a "credit crunch" as a result of the crisis in liquidity.

Corruption between government and the bankers is nothing new. During the 4th Century BC, money that was donated to the gods became the temple treasure. Typically, the government would borrow from this hoard of cash. In Athens, there was one of the early banking crisis events involving what we would call the Secretary of the Treasury so to speak and his banking friends. While there may be some parallels to Hank Paulson helping Goldman Sachs, the events that took place are different, the ethics are the same.

The Temple kept its donations in the Opisthodomos. The Temple was not earning

interest on its hoard of cash. The treasurer agreed to lend the money to personal banking friends who would then pay the treasurer interest that he could then personally put in his pocket. When the banking crisis hit and there was a liquidity problem, the banks could not repay the loans to the Temple.

Demosthenes (384-322BC) tells us that banking transactions were completely confidential in Athens. He tells us that the rich could "conceal [their] wealth ... in order that [t]he[y] might obtain secret returns through the bank." Dem 45.66.



The banker Aristolochos was said to have taken substantial deposits and owed many a significant amount of funds (Dem 46.50). The bankers Sosinomos and Timodemos failed with many others and were unable to meet demands for withdrawals (Dem 36.50).

With a banking crisis in full bloom, now the treasurer was exposed. To try to cover-up the scandal, they set fire to the Opisthodomos. Nevertheless, the scheme was detected and the Treasurers of Athena were seized and imprisoned, about 377-376BC.

In 1989, government ministers of Crete pulled the same scam. They were depositing government funds in the Bank of Crete and interest was being diverted to themselves. It was the failure of the Bank of Crete that exposed the scam (See NY Times, 9/21/89, A14; 9/27/89, A3).

Aristolochos' bank failed it appears due to real estate prices collapsing, (Dem 36.50). When the bankers failed, all of their funds and property were seized. What is interesting is that Demosthenes warns his fellow Athenians of the dire consequences for all of Attica should the banker Phormion be forced into bankruptcy. "Don't throw [him] away! Don't allow this piece of filth to bankrupt him!" (Dem 57-58).

What Demosthenes sees in the midst of one of the earliest banking crisis in all recorded history, is that the lending of money was clearly a leverage that indeed had supported the entire economy. The drop in real estate in ancient Athens is not unlike that of the 2007 crisis. The deep corruption on the part of the Treasurer is something that sets off a public crisis in the collapse of confidence in banking.

Demosthenes does make it clear that the people should be angry at the bankers who failed (Dem 49.68). Reading between the lines implies he is trying to counsel the people that they should not panic and then withdraw their funds from all bankers. They should be justly concerned and outraged by the bankers who have failed, but do not by any means attribute that to all bankers.

These are words that have been repeated countless times in the midst of every panic throughout every century. They are repeated once again today, with record huge bailouts.

Demosthenes focuses on the individuals and tries to dispel the CONTAGION that was then spreading throughout the entire economy.

There appears to have been a second period of a bank failure about 336BC that involved a banker by the name of Herakleides. There is no doubt debates over these serious accounts. The 370BC decade was one of a major Athenian banking crisis that seems to have involved government officials that should come as no surprise.

Aristotle in his "Politics" argued against the idea of supply and demand insofar as he saw the problem from the demand side disconnected from supply. Aristotle thus saw the problem that demand would rise and fall and sometimes exceed the supply without just cause.

Athens was making a transition from a predominant agrarian society to one of trade that included manufacture and finance. He called this the "monied mode of acquisition" that was driving the economy fed by businessmen concerned purely with profit that he described as "making money from one another." The predominant economy was the villa that produced and consumed what it planted. Thus, his *Politics* (1256a-1257b) was describing the changing economy as Athens was rising as an economic power. The old "oikos" had been this model of a self-sufficient, producing for its private consumption was fading. By the time we reach the 4th Century BC, agriculture is being raised and sold for cash. This, no doubt, caused land prices to rise. As people could now sell their crops for export, suddenly land prices would have now increased in value. This was one of the earliest bubble events in real estate that naturally resulted in a banking crisis no different than we have seen today and even in terms of the DOT-COM Bubble. Prices will always rise to reflect EXPECTED potential earnings, and then reality sets in. Hence, history repeats because the passions of man simply never change.

Xenophon (430-355BC) wrote his major work *Oikonomikos* (how to regulate the household = ECONOMICS) touting the virtue of the estate and a self-sufficient system. But by 355BC he had reversed himself in *Poroi* and now promoted a market economy, encouraged immigration for labor, and to increase the money supply that was raising the living standards of all Athenians.



There is little doubt the banking crisis is far from over. This is merely the pause between storms. Most pension funds and banks rely upon government debt. Because we are in the midst of a sovereign debt crisis, we are in very serious trouble. The banks that typically will get hit the worst are in fact those engaged in trading. The merchant banks throughout history will be hit so hard that there will be no time to run. They will simply fold in the middle of the night. No matter how much political clout they may have behind the scenes, it will not help.

Throughout history, those bankers who always go down in flames and have destroyed the economy to varying extents, have always been those who are traders. They are also touted as the best, brightest, and richest. However, these laurels are often short-lived. Today we have Goldman Sachs who has pursued political control no different than all the famous merchant bankers before them. The one firm that was on top of the world was indeed Solomon Brothers. They were king of the hill and Goldman Sachs yearned for their power from the shadows. The downfall of Solomon was linked to the collapse in commodities when gold crashed from \$875 to under \$300 between 1980 and 1985.

The some 6,000 bank failures of the Great Depression had a common theme. They were speculating and trading. That was the entire purpose of the regulations that had separated banks, brokers, and insurance. It was former Chairman of Goldman Sachs Robert Rubin who worked to repeal that in 1992 that has enable the economic crisis to unfold by blending trading, banking, and insurance causing the bailout of AIG.

These events are by far nothing new. We have banking crisis after crisis from ancient times through medieval, which all have the same root cause - trading and corruption of government.

There was the Riccardi, the merchant bankers of Lucca who got caught in a serious liquidity crisis of 1294. Edward I of England seized the bankers, imprisoned some and in fact defaulted upon them. But one must always dig just a bit deeper. The king's debts owed to the Riccardi have gained attention in most accounts of the events of 1294. However, we also see debts owed to the Riccardi or 5 earls and at least a dozen important men in the

the administration of the king. The claim was that the Riccardi owed the crown 29,609 pounds, but failed to deduct 18,924 pounds owed them by the king. Using the government profits made from the seizure of their wool alone, the net outstanding amount would be reduced to 3,324 pounds. The debts owed to the Riccardi from the king's ministers was 6,927 pounds. In this case, The scheme was hatched by Laurence of Ludlow who ironically sailed from England with 227 sacks of wool seized from the Riccardi merchant bankers to be sold on the continent, but the ship was so overloaded to save on shipping, that it sank in the Channel taking Laurence with it to the bottom.

In France, Philip IV had seized his merchant bankers from Siena, the Bonsignori. The credit crisis of 1294 was monumental. The next merchant banker to go down was the Frescobaldi. Under Edward II (1307-1327), the English Parliament passed the Ordinances that was directed at alien merchant bankers blaming inflation and just about everything else upon their presence.

There was the collapse and bankruptcy of the Bardi and the Peruzzi during the 14th century. The 15th century saw the collapse of the Medici merchant bankers and the 16th century the Fuggers. There was the collapse of the Baring brothers. The bank of France that collapsed with John Law. The list of merchant bankers biting the dust hold NO exception. Each one thought they found the magic formula - political control. Yet, not a single firm has survived.

The Medici and the Piccolomini had two Popes. Other merchant bankers attempted to control government and failed. In the final accounting, they begin to believe their own bullshit and in the end, fall no different than any other speculator.

The market sense is always that the most aggressive trader is the victor and others reside in their awe, just as Goldman was in awe of Solomon Brothers and Lehman Brothers. Everything has its time and its place. No matter what the firm, you can't win all things, every time.

Often, the key to these major economic events throughout history is also to study the rising star. When they fall, so do all others. Just as Demosthenes tried to explain



that the public should not throw all the bankers into one cauldron, unfortunately, the public never distinguishes. You can bet that if Goldman Sachs loses again, we will see the same CONTAGION effect all other banks even those who had no trading. The public will not distinguish between a real bank and one that makes its money from speculating. The lesson of preventing the blending of speculation, banking, and insurance from the Great Depression, has been lost. Goldman now represents the USA more than any other entity internationally.

I seriously doubt that we will be in a position that government bonds will simply vanish. It is much more likely that we will have a currency cancellation and a swap that tries to hide the truth. Whether this is even successful is debatable. Whatever the government can do wrong, they are doing it now.

Congress recently passed the new act that is reviving protectionism. History is always going to repeat because those who will grab the brass-ring of power just want to dictate to us why should be done because they have some ego problem and want to be famous yet lack any understanding of what the hell they are doing. Congress now claims they will impose tariffs upon the goods of any nation that they BELIEVE the price of their currency is undervalued. If I were running China, I would sell every US government bond and run everything in 90day paper only, if not 30day.

Politicians' view of economics is only as far as they next election. There is no planning whatsoever long-term. They do not even understand the concept. This is like trying to run a public corporation with no planning, not budget, and no concept of what is being produced will even sell. We are in such serious trouble, the only solution may be to dig a hole and bury your head at least.

Every student of American history has heard about how protectionism helped to create the Great Depression. What they do not know, is that was only the tail-end and not the full story. To understand those very serious events, you need to go back to 1917.

The origin of protectionism was NOT the Great Depression. That lies back in 1917 and the Russian Revolution. That event was a major debt crisis for Russia defaulted on everything owed by the state to anyone, external and internal. That would have been a major event by itself. However, the economic crisis did not end with public debt. All private debt and equity ownership was also wiped-out.

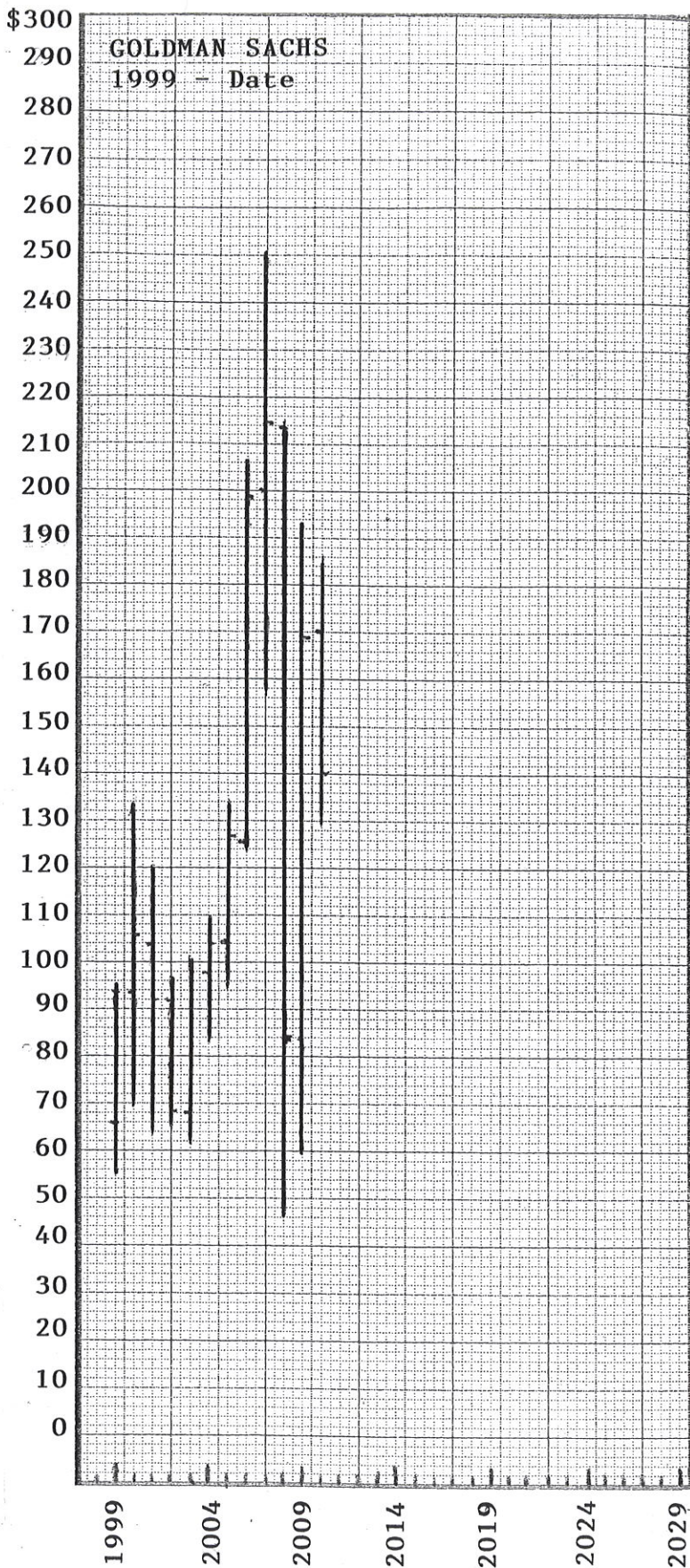
The amount of defaults both public and private set in motion a real crisis. Russian trade was eliminated and many countries had depended upon them more so than other nations. Once Russia ceased to participate in the world economy, the economic consequences of this event spread throughout Europe. Investors lost a fortune. This tended to contribute to the capital-flow concentration of wealth into the United States that made the 1920's the "Roaring 1920's" from every aspect. Like the wave of capital that concentrated in Japan going into 1989, the same thing took place during the 1920's.

Instead of looking at the crisis in our debt and realizing that the nation cannot in any way sustain this program of borrowing each year with no intent of ever paying anything off because of the advice of the NY bankers who are only interested in their immediate profits and to hell with the nation, we are headed into the darkest debt crisis perhaps in the history of civilization.

When I testified in 1997 before the House Ways & Means Committee, the question being asked was why no American firms were getting contracts in China on big construction projects. I explained that ONLY the US and Japan taxed worldwide income and a German company was already about 33% less because they did not pay taxes on overseas income.

Our politicians only see money and want their cut. They refuse to look internationally or comprehend that they have to be competitive just as the states have to compete against each other. The typical US response is to create a law, suppress what they do not like, and blame everyone else for their Draconian laws that have been costing American jobs for decades. They prefer to blame corporations and refuse to look in the mirror to see if by the slightest chance, perhaps they might be the source of the problem.





Since Goldman Sachs is the trading banker of today, it is most likely the leading indicator for the next crisis. For year-end 2010, a closing below the 2007 low of \$157.38 will warn that this stock is still in a downtrend. The close for September was \$140.18, so Goldman remains vulnerable. The main support lies at \$123 and should 2010 close below this area, next year will see a retest of the 2008 low, which was at \$47.41 after the 2007 high at \$250.70.

From the high in October 2007, the crash was sharp and swift reaching the low in 13 months. The recovery rally was a perfect 11 month rally. That is a perfect bull-cycle move. Goldman then fell about 8.6 months dropping back to \$129.50 for July 2010.

Goldman may be the the most frequently charged firm for securities fraud (2003 \$119 million fine for illegal stock trading with inside info and advice; 2004 IPO violations; 2005 IPO violations; 2007 short-selling violations; 2009 securities fraud \$550 million fine), but its performance has been nothing unusual. The highs and lows are following normal cyclical patterns and they may be able to violate the law more than anybody else and get away with it as many believe, it is clearly unable to manipulate its own stock prices for the long-term.

The yearly turning points when correlated with other markets appear to be 2012-13, 2015-16, followed by 2020. In the short-term, Goldman may be far from out of the woods. A low in the 2012-13 period, may be followed by a rally for 2015-16, but thereafter, Goldman looks like it will fall off a cliff.

This is only a manual correlation. I will need to get my computer up and going to do a full international work-up. That will run the stock in a host of currencies. However, from this very primitive correlation, 2016 is not at all looking good and it appears that Goldman will not get bailed out on the next loss they take. Historically, the big flying trading company goes down with the ship. The next one looks like it will be Goldman's turn.



There is no indication that real estate has any possibility of recovering. Corporate cash is at a record high and the instability in tax policy precludes economic expansion that will create jobs any time soon. Taxation in the United States is too unstable for long-term planning. Companies are not going to expand and they will not hire people as long as their future expectations remain anything but confident.

Now the House vote of 348 to 79 to return to protectionism regarding China is a very dire prospect. It is like the nation is being led by dumb and dumber. For far too long, currency has been seen as the excuse to cover-up inept economy policies that have done nothing but cost jobs and resulted in lowering the standard of living for the majority of Americans. Once upon a time, the wife could stay home to raise the kids. Now, most cannot afford that luxury. What use to take one wage earner to support, now takes two. And they call this socialism? It is more like having public servants that are consuming more than half your income while they are really giving you the orders. The lunatics are in charge of the asylum.

The states are imploding and they do not stand a chance in hell of coming out of this crisis intact. They cannot print money. Like Greece, they cannot devalue the currency. In all reality, as revenue declines, real debt rises, and the interest is consuming the states as is taking place federally.

The United States will only hurt the average American by placing tariffs on imported goods raising the cost of living within a economic downturn. Where does it do anything to increase American jobs? Absolutely no way! The problem is far beyond the mere cost of labor. It is the add-ons of health costs, all the pensions, benefits, and then taxation. If a foreign worker gets the same as any such American, it is still cheaper.

When we were advising Japanese companies trying to set-up in Europe before the EURO, those who needed skilled manufacturing labor went to Britain because the cost of labor was 40% cheaper than Germany. There is much more at stake than just the hourly rate. And then if you have two products of equal quality and one is 33% less because it is made overseas, the consumer will buy the cheaper version.

Gold has exceeded \$1300. It still has not yet tested the top of the PRIMARY CHANNEL but there is time up until about November. If we see gold pull back into a June 2011 low, a retest of the \$1000 level will prove to be a major buying opportunity. There is still no guarantee of that development. If Gold can get through the top of that PRIMARY CHANNEL and fall back to retest it finding it is then support, this commodity is going to take off like never before.

The agricultural markets are also now shaping up to be very interesting. This year was exceptionally hot. Russia had to stop grain exports. What is looking rather dire is the possibility that we face a PLATEAU MOVE as a result of perhaps a coming serious drought that may last for up to 7 years. I will provide a report on this prospect, but there is a serious possibility of food shortages in the future as well going into the 2016 target. The key is that if we have another hot one next year, this will confirm we have also a weather cycle coming that is similar to that what followed the 1932 low known as the Dust Bowl.

The Dow Jones has been recovering and avoiding the anticipated collapse. It made a high the week of August 2nd, fell into a low for the last week, and then has moved upward on schedule opposite of the last event in August. We still have the 11,000 level to watch as well as the year-end close. The US stock market is going to become the ALTERNATIVE to government debt. Watch also the trend between corporate bonds and government debt. The more capital becomes concerned, the more you will begin to see smart money shifting from public to private debt.

The yen is still in a crisis mode for as capital contracts due to further economic declines, the higher the yen. The dollar also peaked in 1932 with the low in the market. In Europe, the rebound in the Euro is also now placing more pressure on the lessor members with their debt. The cost to pay is rising as economic growth declines.

The banking sector still looks dodgy. JP Morgan made its low in 1990 at \$3.25 and rallied for about 8.6 years into April 1999 reaching \$60.75. It crashed into October 2002 falling to \$15.26, rallied into May 2007 at \$53.25 and crashed to \$14.96 in March 2009.



There is a possibility that the 2009 low in JPM may in fact hold. This bank has tended to be far more stable than most others and that includes Goldman Sachs.

Citibank has always been the wild horse of the bunch. It has been highly aggressive and tended to follow the trend often running head-first into the latest default or economic crisis. Its lows in 1981 at 33¢ in December that year will always be a memorable event. It rose to \$12 in August 1987 and continued to slide into September 1990 showing its lack of ability to learn a lesson. Thereafter, Citi rallied into the 2000 Bubble Top reaching \$59.1250 in August that year. It fell to \$24.42 for September 2002 followed by the rally for this bull cycle into December 2006. It was the first to peak and began its latest move falling back to 97¢ in March 2009.

Citibank has always rushed into a crowd following whatever trend is in motion be it lending to South America in the 1970s or having the biggest real estate mortgage portfolio just in time for the 1987 Crash. The one thing you can say about Citi, it has been a follower, not an innovator. It is the last to show up and the first to pay the price. One can only guess when they are going to learn their lessons.

#### PUBLIC v PRIVATE

This shift between Public and Private Confidence is significant. It reflects so much of human nature that goes well beyond mere economic analysis. It reflects the rise and fall of civilizations both on a macro and micro level. For Example, on a macro level, people came together to form great civilizations like that of Rome. When corruption gets to be too much, they start to migrate leaving the cities.

Indeed, the United States was born of a similar trend of migrations from Europe before the World Wars of the 20th Century. People picked up an left Europe for the grass looked greener in America. Yet all governments become corrupt for man allows those in power to abuse them. Once when the burden reaches that level of the straw that broke the camel's back, then migration or revolution erupts.

When confidence in government declines as we are witnessing today, investment trends also shift. Ask yourself a question. Do you really think government will take care of you anywhere close to the same benefits that your parents received? If you are honest, you can answer that only with a no!

We simply borrow with no plan of ever paying-off anything. We assume that we can just imprison and confiscate the property of anyone with impunity. The states are starting the realize that there are limits to their taxation. The Feds have to learn that lesson yet.

In the battle between Public and Private Confidence, what is happening is that people will begin to shift their investments away from government debt. This means that movable assets will rise (not real estate per se) and that will include stocks as well as corporate debt, gold, commodities, collectibles, gems and art. Real estate has its problems on this cycle.

The 30yr mortgage came into being with the last depression. It was the brainchild that if we took the cost and gave people a lot of time to pay it off, the government could stimulate real estate. The problem this cycle created was it leveraged the price of real estate. Houses that reached big prices are at least 3 times what they would have been without 30 yrs of leverage. This is a unique problem that did not exist on previous rallies. This is why real estate has inherent risks far beyond anyone's imagination. What if there were no mortgages? If real estate could only be sold for cash, prices would be maybe 10% of their peaks. This is the problem we face in this market and why I stress it MAY NOT afford the best hedge against public sector declines.

The Public v Private is distinguished between those used by government to fund its agenda and those of the people that are public neutral. Gold is the classic neutral item for it is the same in all countries. The other issue is the depth of the public bond market has allowed for the parking of vast amounts of money at least 10:1 compared to private. If there was no public debt market, all that cash would be privately invested. That is not likely either. But there will one day come the middle of the road and a return to sound government after the crash.