THE BILL BONNER LETTER

THE GREAT AMERICAN CREDIT COLLAPSE

PART ONE

BONNER & PARTNERS

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SPECIAL REPORT 2015

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Source: Wikipedia

We begin with a letter from a subscriber:

Bill: I just finished your book Hormeggeddon *and I am a recent subscriber to your newsletter. I agree with all of your predictions and everything you're saying. What is the best way to position yourself to profit and protect yourself from the upcoming collapse we all know is coming?*

I didn't intend to answer the question. But I found I had a few ideas…

First, though, I will take a crack at trying to picture the circumstances… the events that lead to the calamity we need protection from.

This is a calamity that your correspondent has seen coming for so long, he's beginning to feel he may be doing you a disservice by warning you. Like a podiatric surgeon who botched an operation, he looks at the dead patient and feels it is time to brush up on anatomy. Maybe the foot bone is not connected to the ankle bone after all.

The trouble is, the textbooks are written by people whose view of economic anatomy is mechanistic, not humanistic. They have fixes for every problem and wrenches in both hands.

Yes, we could go back to earlier tomes – by the great economists, Bas-

tiat, Say, Schumpeter, von Mises, and Hayek. There, we'd find the old-time religion… the real flesh and blood of real economics… with crime and punishment, sin and retribution, heavy hammers and swollen thumbs. But they lived in a different world… at least, that is what their critics tell us… before central bankers walked on water.

In previous issues, we've discussed why rusty nails are still rusty nails… and why the likelihood of stepping on one increases as the feds spread more of them around.

In this report, we'll take this analysis a big step further. What happens if they keep it up?

This report has taken longer to write than I wanted; it will surely take you longer to read too. For those who want a shortcut, here is the conclusion:

1. Central banks have several more tools up their sleeves; these could stretch this story out for years.
2. The economy is essentially deflationary… it "wants" to reduce debt levels.
3. Trying to hold off a credit contraction, indefinitely, will probably lead to a huge boom in asset prices (at least in nominal terms)…
4. Which will be followed by a terrible bust, marked by a sudden and almost absolute disappearance of credit.

As you can see, we admit that this report is premature. The feds could postpone the day of reckoning… perhaps for many years in the future. We also admit that since there are so many possible futures available to us, the odds that we have nailed the one we end up with seems remote.

Still, we try to look far ahead, to where we might be going, just to know how to pack.

For dramatic tension, let's explore what it might look like to the average unprepared American. Come with me. Not into the future, for we can't know what the future will be. But into *a* future.

"Temporarily Out of Service"

One day you will feel a horrible sick fear deep in your stomach… and a hot sweat on the back of your neck…

You will be suddenly, deeply upset with yourself. You knew there was something wrong with "the system"… You knew that at some level it just didn't make sense; you knew it couldn't go on like that forever.

You knew you should have done something to protect yourself. You knew it all had to come to an end somehow… sometime.

But it was always "too early" to make a big change. And now it is too late.

Everything seemed so normal for so long… you went along with everyone else… trusting… hoping it would all turn out all right. You didn't want to look like an alarmist… or a nut.

And now, standing in front of your ATM, you will be on the brink of panic. Because you have exactly $29 in your wallet. You need more cash. This is the third machine you've gone to. All say the same thing: "Temporarily Out of Service."

You knew the situation was spinning out of control. But the machines worked two days ago. Yes, they were already limiting the amount you could take out to just $200. Still, they worked. Why would they stop now?

And now, you need them more than ever. Everyone does.

This "financial crisis" is strange. Nobody wants cash… but everybody needs it! Cash is losing its value – fast. But how else can you buy things… and pay your bills?

There's been some talk in Congress of forcing stores to accept credit cards and checks… But you've tried the Food Lion. "Credit Cards Not Accepted… Because of the Financial Crisis."

You've tried the Whole Foods. Same story. "Cash Only." And the cash machine has a sign on it: "Out of Order." Someone has scrawled on it: BS.

You get back in your car. But you are down to an eighth of a tank. The gas stations stopped taking credit cards yesterday. They only take cash. Because they can take the cash out at the end of the day to one of the "money changers" who operate out of vans in mall parking lots. They just suddenly appeared a few weeks ago. Now, they're everywhere.

You are getting desperate. You have food in the house for about 24 hours. Maximum. You need to buy more. But how can you buy anything without money?

You thought you were sitting pretty financially. After the third big crash, the government came up with the "QE for the People" program. And now your stocks are higher than ever.

But you don't have any money! Yes, you could sell your stocks. You could get a check. Who will cash it? Well, the guy at the money-changer van will… for a BIG discount.

Still, there are long lines at the "money changers." Some people are desperate to get cash. Others are desperate to get rid of it. Really, desperation is what the whole thing is about. ***Everybody is desperate****.*

The "money changers" work like pawnshops… or outlaw banks. You take your

rings and other jewelry. They trade them for cash on the spot. Or, if you have cash... you take it there and buy whatever you think will hold its value. Merchants don't take their cash to the banks; they don't want to run afoul of the "anti-speculating" rules. So they take them to these money changers and get valuables in return.

And of course, the money changers are getting rich. Which people don't like very much. There are reports that some have been arrested by the police. Some have been robbed. At least a couple of them have been murdered.

The whole country is jittery... and scared... Strange things are beginning to happen.

And now this. You will have to go get some of your wife's jewelry and get in line. You know they'll give you only a fraction of what it is really worth. That's why you didn't do it before. You knew it was a rip-off.

So, you hesitated... because you thought the problem would be fixed. Instead, it got worse.

What's Anything Worth? Who Knows?

Who could have imagined a Dow at 50,000? You didn't... but it recently shot past 100,000. Yes, some guys are making a fortune in stocks... and in real estate.

The house down the block... it sold for $350,000 in 2014. Last week, someone paid $1.5 million... You thought he was crazy. But now, you're not so sure. It's beginning to look like a smart move.

The last time you filled your tank, gasoline cost you $20 a gallon. A Happy Meal at McDonald's was $19. If this keeps up, that $1.5 million house could seem like a bargain.

All this happened so fast. In just a couple of months, everything that you thought was stable... and solid... It all turned to mush and muck. You've got both feet on the ground, but the ground gives way. What happened?

But there's no time to think this through now. You barely have enough gas to drive home... let alone drive back to a money changer with your wife's jewelry.

What are you going to do?

What are others doing?

That's the trouble. There are about 300 million other people – in about the same boat. Everyone needs cash...

They need dollars to pay for gas. They need dollars to pay for food. They need dollars to pay for all the things we take for granted.

If you had the gas maybe you could drive to another ATM... or even another city... or go directly into the bank and ask for cash. But the banks have been closed because of the "emergency." And according to your car radio, it is worse in other places:

Crowds of people broke into convenience stores in two Detroit neighborhoods this morning. Police report a wave of similar robberies in several cities. In at least one incident, robbers left credit cards with a note: "Charge my account... I didn't have a choice."

In Baltimore, Maryland, police were out in force throughout the downtown area. Mayor Stephanie Rawlings-Blake told reporters that "snatch-and-run crime has become an epidemic." Most often stolen are food items from local convenience stores. One man was shot dead at Mondawmin Mall. Police believe the man was engaged in money changing.

If everyone needs cash, why won't the government just print more? It will. But it takes time. News reports will tell you the government is preparing emergency dollars that will be distributed through the banks.

But what is this new money worth?

No Exceptions

What's happening back here in the present that would cause that kind of breakdown?

What is going wrong?

In a nutshell, America does not run on cash. It runs on credit. In theory, America's line of credit is unlimited... but in practice... it can get complicated, fast.

The U.S. is the first and largest economy ever to function on credit.

Americans have 3.75 credit cards per person. They do some 60 million credit card transactions every day: 67% of gasoline purchases are done with credit cards, 62% of travel expenses, 67% of clothing. About 40% of low- and middle-income households use them to pay

basic living expenses – rent, mortgage, groceries and utilities. And more and more shopping is done online – 100% of it with some form of plastic.

Today, less than a third of all commercial transactions are settled in cash. The rest are on credit. **When the credit cards stop working, the economy stops**.

Listen closely to your car radio after the crisis begins:

> *The financial crisis took a turn for the worse today. Governor Christie of New Jersey and Governor Brown of California announced emergency measures to force gas stations to continue accepting credit cards. But commuters in Northern New Jersey as well as Southern California found local gas stations closed this morning. Whether they closed to avoid having to accept credit cards… or whether they actually have no more gas has not been established.*
>
> *Our news helicopters reported many abandoned vehicles along commuter highways. Apparently, drivers simply ran out of gas.*

When a money system breaks down, everything breaks down.

Again, let's listen to the radio of the future:

> *Las Vegas receives almost all of its food deliveries by truck and the truckers say they don't have the cash to pay for fuel. California governor Brown had ordered the gas stations to accept credit cards, but the stations say they don't have the fuel to sell.*
>
> *With food deliveries slowed… and in some places, stopped altogether… shelves of many grocery stores are bare. For the moment, it's calm here. Emergency supplies – usually made available only in the event of a natural disaster – are making their way to Las Vegas neighborhoods. But those will soon be depleted.*
>
> *The financial shock seems to have reached far beyond Las Vegas. Reports coming into the newsroom tell us of desperate people all over the country… food riots have broken out in several places. And in Denver, what can only be described as a "money riot" left two men dead, after a crowd stormed a money changer's van and overturned it.*
>
> *The worst thing is that the chain of supply that fills shops, supermarkets and gas stations seems to have come to a stop. Experts say the gas stations are running out of fuel because they can't settle their accounts. That is, they can't buy more fuel because they don't have the money to buy it. And the truckers don't have the money to buy the gas even if the gas stations had any. It looks like the whole system is breaking down.*
>
> *If this continues for more than a few days, we could be seeing some serious problems… the economy seems to be coming to a halt. And people need food.*

Is this over-the-top paranoia? Is my doom and gloom out of control? I hope so. Maybe it won't happen. Maybe it won't be so bad. **But history shows that financial catastrophes do happen**.

No one wants them. No one plans them. But no one can stop them. Every credit expansion ends in a credit contraction. No exceptions.

Then, how will the biggest credit expansion in history end?

When the Money Goes Bad

Approximately $1.5 trillion changes hands – not including investments – in the U.S. every month. People buy milk and pay babysitters. They pay their mortgages and their taxes. Consumer spending alone is $11.2 trillion annually.

But there is only $1.2 trillion worth of dollars – physical money – in the entire world. Approximately 50%-75% of that is overseas. And much of the stock of dollars is "dead money" – stuffed in mattresses, safe deposit boxes, and so forth. (Don't worry; it will come alive when the credit bubble bursts – and wreak more havoc.)

Credit is what makes the wheels turn. Without it, almost everything comes to a halt. The banks… the gas stations… the grocery and convenience stores, too. The delivery trucks stop, and we are all in very big trouble…

Credit depends on stable money. One person lends to another, expecting that what they'll get back will be worth roughly what they lent out. When the value of money begins to change rapidly, folks stop lending.

Impossible? Unlikely? Not going to happen? Well, as you can see in the table on the next page, it's already happened in other countries.

Something similar is happening in Venezuela. Inflation there is running over 60%. The *Wall Street Journal* reports the black market exchange rate is nearly 30 times the official exchange rate of 6.3 bolivars per dollar. At one point, speculators were giving the country a 91% chance of defaulting.

I'm intrigued… But I've been discouraged from visiting by the instinct of self-preservation. According to the U.S. embassy, foreigners – especially obvious gringos like me – are targeted for robbery and kidnapping. Apparently, the criminals think nothing about killing you, as they did the former Miss

Country	Dates	Peak Rate of Inflation
Chile	1973	88%
Hungary	1923-1924	98%
Peru	1988	114%
Zaire	1991-1992	114%
Azerbaijan	1991-1994	118%
Uzbekistan	1992	118%
Bulgaria	1997	123%
Austria	1921-1922	129%
Kazakhstan	1992	141%
Kyrgystan	1992	157%
Belarus	1992	159%
Bolivia	1984-1985	183%
Argentina	1989-1990	197%
Georgia	1992	198%
Tajikistan	1992-1993	201%
Georgia	1993-1994	211%
Soviet Union	1922-1924	212%
Soviet Union	1992	245%
Zaire	1993-1994	250%
Nicaragua	1986-1991	261%
Poland	1923-1924	275%
Ukraine	1992-1994	285%
China	1943-1945	302%
France	1795-1796	304%
Bosnia/Herzegovina	1992-1993	322%
Peru	1990	397%
Taiwan	1945	399%
Taiwan	1948-1949	399%
Turkmenistan	1992-1993	429%
Armenia	1993-1994	438%
Free City of Danzig	1922-1923	2,437%
China	1947-1949	5,070%
Germany	1922-1923	29,525%
Greece	1941-1945	138,000%
Republika Srpska	1992-1994	297 million %
Zimbabwe	2007-2008	8 billion %
Yugoslavia	1992-1994	313 billion %
Hungary	1945-1946	41.6 quadrillion %

Venezuela, if they think that makes their business transaction easier.

I am fully dedicated to providing you with the best information and commentary on the market, dear subscriber, but there are limits. We'll have to rely on published reports.

Here is one. The *Financial Times*, December 2, 2014:

> *"We are beggars of food, beggars of basic products, beggars of medicines, beggars of diapers for our children – right now we are beggars of everything... Inflation eats us up; we have hit rock bottom. We cannot get any worse."*

The person from whose lips these words came was standing in line in Caracas to buy food. A long line. And when she finally got to the counter, she found her options had been reduced. When the money goes bad, the whole economy goes bad. Prices go crazy. Government reacts with controls. The shelves empty. The economy sinks.

But you're probably thinking...

Oh, the U.S. is nothing like those countries... it can't happen here.

And you're right. It won't be much like any of those financial disasters. It could be worse. Much worse.

Why the Cash Disappears

All of the credit crises listed above might have been small potatoes... just a rehearsal for the big implosion of debt and credit that lies ahead.

Yes, financial chaos in Zimbabwe and Argentina and elsewhere was bad. People lost their savings. Some lost their homes and their retirements. Some even lost their lives.

But those foreign disasters were

nothing compared to the one coming right here in the U.S. Why?

First, this one is much, much bigger. The Argentine economy was only $610.3 billion – about the size of Chicago's metropolitan area. Its total outstanding credit in 2000 was only $132 billion. Compare that to the U.S. with a GDP of $17 trillion and total credit market debt of $12.6 trillion.

Second, this one is much, much wider too. Almost every modern economy is implicated. All have similar problems. All are reacting in similar – and similarly ineffective – ways. And the total debt worldwide is now more than $100 trillion. In 1980, before the big run-up in credit began, the total was just $900 billion.

Third, those are just numbers. The crucial thing to remember is that none of those countries depended on credit the way we do in the U.S. The Argentines and the Zimbabweans, for example, didn't have many credit cards… or mortgages… or ATMs… or automatic gasoline pumps.

In Venezuela today a few credit cards are still being used. And the interest rate on credit card debt is over 60%. You can see why the credit cards will soon cease working there. Inflation is expected to go over 100% next year. Desperate consumers simply postpone paying their credit card debt, realizing that the inflation will run ahead of the interest rate.

Compounding at 100% a year will turn a $10,000 debt into $160,000 in five years. In 10 years, it will be over $5 million. **You don't have to be a mathematician to see that the credit card companies will pull the plug long before that happens**.

Credit stops when currency values become unpredictable or uncontrollable. And the resulting disaster is equal and opposite to the amount of credit that preceded it.

That's why the Argentine disaster was peanuts. The Zimbabwe catastrophe was trivial in comparison.

In both countries, the typical citizen had no mortgage payment to make. He had no credit card either. He was used to using cash… and merchants were used to taking it.

And when their own cash went bad, they could switch to U.S. dollars… or British pounds… This time, it won't be that easy. Even if you could put your hands on euro, or yen, or renminbi… it probably wouldn't help you. Because the crisis is now global. (In fact, the spark will probably not come from the U.S… but from Japan. But we will come to that in a minute.)

Crucially… in Argentina and Zimbabwe… and Weimar, Germany… there was plenty of cash around… People were used to saving cash… holding cash… and using it, even for large purchases, such as houses. When the credit system broke down… it made little difference to most people.

And look again at the financial crisis that took place in Germany in the early '20s. Then, credit cards hadn't even been invented… there was no consumer credit to speak of in any form… and most people still lived on farms. People in the cities were devastated. But life in the country continued much as it had before. Almost. Gangs of hunger-mad city folk roamed the nearby countryside trying to find food. And woe to the farmer who stood in their way!

Now, in modern America, long, complex chains of production and distribution put food on your table.

More than 9 out of 10 people live in cities or suburbs. Almost no one – not even the farmers themselves – can feed themselves from their own gardens on their own land. Instead, they all depend on credit.

The farmer uses credit to buy supplies, fuel, fertilizer… everything. The wholesaler, too, relies largely on credit to buy the raw food, process and package it. The trucking industry uses credit to buy fuel. The retailer needs credit to keep the lights on and the stores open.

Six out of ten customers pay for their groceries using credit cards. And don't forget America's huge underclass. About 47 million people depend on electronic transfers from the government to their "SNAP" cards. Typically, these people have very little cash on hand… and almost no provisions of food. What happens when the food stores stop taking their SNAP cards?

Over half a century, credit has replaced cash in America. There was only $1 trillion of total credit in America in 1965. And very few credit cards; they were only invented in 1958. Today, I take out my wallet and count seven plastic cards. And the total amount of outstanding credit is 50 times what it was in the mid-'60s. Our whole economy… and our way of life… have been shaped by this explosion of credit. We live on it. We depend on it.

So what happens when the credit stops? The whole production chain stops with it. Which is why the coming financial crisis in America could be much worse than any the world has ever known.

But let me be clear. The disaster we're looking at is not the collapse of the dollar… as so many analysts have forecast…

No, it's not that simple. The dollar

will lose value. But as it loses value, people will be desperate to have it. Because they'll need dollars to pay their bills and to buy the things they need. They will be desperate to get rid of it, too… because a falling dollar is a threat to their wealth. Currencies have two main functions – transactions and savings. On both counts, the dollar will fail… but not immediately.

Economies breathe in and out. Inflation raises debt levels and prices. Deflation lowers them. Over the last 30 years, **the expansion of credit has pushed real dollars out of the economy**.

Today, the typical American has less than $20 in cash on hand. Women may carry giant handbags, but they have little cash in them – often less than $10.

I once boarded a plane for a round-the-world business trip with barely $25 in my wallet. I was confident that ATMs would work wherever I went. And they did.

But what if the ATMs no longer have the cash to give out?

The Road We're Following

The major economies are so reliant on cheap credit that they can't give it up. We look to Japan, as the leader of the pack, to see what will happen next.

For 25 years, Japan has managed to maintain the status quo by inputting huge amounts of credit and printing-press money. Government debt went from 60% of GDP in 1989 to 227% today. Government deficits have averaged about 3.4% of GDP, but are currently running at more than 9%.

While debt increased, GDP did not. So the ratio of debt to the ability of the economy to pay has gotten worse and worse. While it earned $1.40 (GDP) for every dollar of public debt in 1989, today the ratio is around 45 cents for every dollar of debt. And that is just the government debt. All together, the Japanese have debt equal to six times annual GDP – the highest in the world.

If the rate of interest on this debt were a "normal" 3% or so… it would pose a terrible dilemma. Nearly one out of every five dollars of output would be required just to pay the interest. The government, already running in the red, would see its deficits explode as 25% of its tax revenues would be required to service past debt.

Japan is going broke. First, because trade surpluses – Japan's traditional source of growth and funding – are now declining, from 612.7 billion yen to 11.4 billion yen. Savings rates are falling too – from 12% in 1995 to 1% in 2014. And to make matters finally and irretrievably catastrophic, the birthrate has fallen to 1.13 per woman, which is so far below replacement level that whole towns are being emptied out – not to mention the labor pool. By 2030, there will be only two workers for every retired person.

Under these circumstances, growing the economy faster than the debt is not possible. Debt will continue to grow faster than income. And it will have to be financed by the Bank of Japan, that is, by cash and credit from nowhere.

Japan is ahead of us. But the road is the same. While the U.S. and Europe could still turn off – by cutting spending, substantially – that is unlikely to happen.

The typical household now gets more money from the government than it pays in taxes; it will be opposed to cuts. And elite policymakers still believe that cutting government spending leads to reduced demand and slower growth (making it even harder to "grow" out of debt).

That is why, during the '07-'10 period, for example, U.S. GDP grew by only 4.26% while debt grew 61%.

No Exit

America, Europe and Japan all suffer from the same problems… and apply the same solutions. All are shackled to the ball and chain of debt, with their central banks adding to the weight.

To make matters worse, artificially low interest rates, bailouts, "back-stopping stock markets" and quantitative easing misdirect capital to inefficient and unproductive uses… further slowing real capital formation and prosperity.

These problems, in Europe and Japan, particularly, but in America too, are exacerbated by falling rates of household formation and fertility. While the debts… and cost of social services… go up, there will be fewer people to pay them. None of the three major economies – given reasonable assumptions – can work its way down from the ledge. They cannot "grow their way out" of their debt problems. They will either jump… or be pushed.

We have never been in this situation before. Never have so many people depended on so much credit. Never has the world had so much debt. And never have so many central bankers done so much to pump up the global supply of "money."

The classical economists would be staggered to see it. If you could tell them about it, they probably wouldn't believe you. Still, they might help us

understand where it leads.

Happily, we don't have to figure everything out ourselves. At least six generations of serious thinkers have studied, analyzed, and observed financial disasters. Ludwig von Mises, for example, was on the scene during Germany's hyperinflation of the 1920s. Here, he explains how the phenomenon develops:

> *If once public opinion is convinced that the increase in the quantity of money will continue and never come to an end, and that consequently the prices of all commodities and services will not cease to rise, everybody becomes eager to buy as much as possible and to restrict his cash holding to a minimum size. For under these circumstances the regular costs incurred by holding cash are increased by the losses caused by the progressive fall in purchasing power.*
>
> *The advantages of holding cash must be paid for by sacrifices which are deemed unreasonably burdensome. This phenomenon was, in the great European inflations of the twenties, called flight into real goods (Flucht in die Sachwerte) or crack-up boom (Katastrophenhausse).*

He could not comment on a breakdown in a credit-based system. No such system existed.

But note that the "flight into real goods" and the "crack-up boom" both anticipate the same thing: a big increase in the velocity of money. This is just what the central banks are hoping for.

They want you to spend your money rather than save it. And this is what they are likely to get, probably more than they were bargaining for.

Currently, prices are rising more slowly than the authorities would like.

Richard Duncan is chief economist at Blackhorse Asset Management in Singapore. He is also a friend of ours and an adviser to our family office. Chris Hunter interviewed him recently for our private *Investor Network* service.

Richard had an apt analogy:

> *The global economy is like a big rubber raft. Instead of being inflated with air, it's inflated with credit plus commodities, including gold, and 7 billion people.*
>
> *The problem is the raft has now become fundamentally defective, flawed because so much credit has been created that the income of the 7 billion people is insufficient to service the interest on the debt, and they keep defaulting.*
>
> *When they default, the credit leaks outside of the raft.*

People are not spending… not hiring… and not investing with much gusto. Just the opposite. There is no broad economic boom in any major economy. An increase in the velocity of money – which will lead to the kind of buying frenzy von Mises anticipated – is not even on the horizon.

Down… and Then Up

In 1978, Paul Volcker took over at the Fed. His plan was to jump. That is, he was willing to endure the pain of recession in order to bring inflation under control.

That was then. This is now. In 1978, the U.S. government owed $789 billion. Today, it owes $17 trillion. Then, interest rates were high. Now they are low. Then, money was turning over too fast. Now, it stays put. Then, stocks were low. Now, they are high.

Then, Volcker and the U.S. political establishment could grit their teeth, raise rates and get it over with. Now, the pain would be too much to bear.

Richard Duncan again:

> *There's only one possible policy response and that's to pump in more credit. That's what the QE is about. They pump in more credit and when they do the raft reflates. Asset prices all go back up again and the people have dry feet and they're all happy again.*
>
> *What happens if they completely cut off the money printing now and don't step in with some other policy like more aggressive fiscal stimulus again, then the raft would sink just like it did in 1930. We would get sucked into a deflationary whirlpool and the international banking system would collapse and global trade would collapse.*

Officials can't let the raft sink. Or they think they can't.

Paul Volcker was facilitating a natural turn in the credit market, from high yields to lower ones. Janet Yellen and her colleagues are desperately trying to prevent another major shift, from low yields to higher ones. No secret as to why. Were interest rates to go back to 7%, where U.S. mortgage rates were as recently as 2001, the interest on the government debt would take more than $1 trillion per year. It would be catastrophic!

The next phase of the drama is likely to come when stock prices fall heavily. U.S. stock prices have been going up for the last five years. They are now so high that our in-house model, called DAMA – based on a retrospective of market cap to GDP, adjusted for debt and demographics – predicts NEG-

ATIVE 7% per year from U.S. stocks over the next 10 years.

It hardly matters. We know stocks are always subject to occasional bear markets and crashes. We know that debt markets are subject to big losses too – even as the Fed holds down interest rates. (Just ask a lender to the energy sector! JPMorgan Chase estimates that if oil prices stay low, 40% of all high-yield energy bonds could default.)

This is the future the Fed is firmly committed to preventing. To that end, I see four measures coming:

1. Direct and indirect equity purchases, designed to imitate a "wealth effect."
2. Direct money funding of government debts; central banks will buy government debt… perhaps all of it.
3. "Helicopter money" – bypassing the banking system, the feds will give tax credits to individual households, financed – along with huge new fiscal stimulus programs – by central banks.
4. Finally, the central banks will write off the government debt.

All of these initiatives have the same goal – to keep debt expanding rather than contracting. The first is ongoing in Japan… beginning in Europe… and "on hold" in the U.S. The second is under way in Japan… still not engaged in other major economies. The third will only come out after a major negative shock to the system. The fourth will happen when the other options are exhausted.

The last of these was suggested by economist Richard Koo of Nomura Securities in Tokyo. It is his solution to the Japanese debt problem. Since so much of the debt is owned by the central bank… and since the central bank is an arm of the government… the debt can be written off, no harm, no foul.

At first glance, this seems to be a real solution. All of a sudden, the debt disappears. And nobody is worse off. Now, the government can borrow more money from the central bank… on and on… forever and ever. Amen.

It sounds too good to be true. And it is. What has actually happened? The government has absorbed real assets and paid for them without collecting taxes. It has simply printed pieces of paper (or the electronic equivalent). And nobody is the worse off?

If this really could be done, every country in the world would run its public finances this way. But von Mises tells us why central bankers who don't jump eventually get pushed off the ledge:

> *… then finally the masses wake up. They become suddenly aware of the fact that inflation is a deliberate policy and will go on endlessly. A breakdown occurs. The crack-up boom appears. Everybody is anxious to swap his money against "real" goods, no matter whether he needs them or not, no matter how much money he has to pay for them.*
>
> *Within a very short time, within a few weeks or even days, the things which were used as money are no longer used as media of exchange. They become scrap paper. Nobody wants to give away anything against them.*

Today's money won't even help you start a campfire. It is credit, not paper. In our imagined future, this credit will go bad when the breakdown occurs.

This is the future central banks are working so hard to prevent. It is where the can is kicked… the future no one wants. No one plans for it. No one is ready for it.

And yet, it is the future we should all be prepared for.

To Answer Your Question…

No one can know what will happen. But you should be prepared to meet the future the feds claim they can avoid.

Remember, a crack-up boom can send good assets up to hallucinogenic levels. Good companies survive, and can even prosper. Good real estate remains. Bonds – good and bad – do not.

The simplest and easiest thing to do today is to make sure you have a supply of real money – cash.

Have on hand some silver bullion coins for transactional purposes. Keep some for savings too.

Stay diversified, with 10% to 40% of your wealth in real money (gold)… and the rest in real estate and solid stocks.

Keep a healthy supply of food and necessities on hand too. If the supply chain breaks down – unlikely perhaps, but possible – many people will be desperate. You don't want to be among them.

I know it is not practical for everyone, but it is also a good idea to have a small farm or rural property where you can wait out a real crisis. Food, water, a fireplace and a woodpile… a few gold coins… friends and family…

Hey, what more do you need?

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