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Prosper!

Dear Prudence, Won't You Open Up Your Eyes...
Investment Insights from Louis Boulanger

Louis Boulanger CFA
Office: +64 9 528 3586
Mobile: +64 275 665 095

louisboulanger now
Freethinking Investment Strategies

In this Issue:

Printer Friendly

Snap, Crackle... Pop!

Dear [FIRSTNAME]

> *"The Federal Reserve is totally out of it. They're destroying the currency and driving up inflation, which will result in higher interest rates and a worse economy. We now know the Fed doesn't understand markets or economics, but is just trying to bail out its friends on Wall Street at the expense of 300 million Americans, nay, of the whole world."*
>
> *- Jim Rogers*
> *(1942 -)*
> *American investor and author (Adventure Capitalist; Hot on Commodities; A Bull in China); co-founder of the Quantum Fund with George Soros in 1970; creator of the Rogers International Commodities Index (RICI) in 1998*

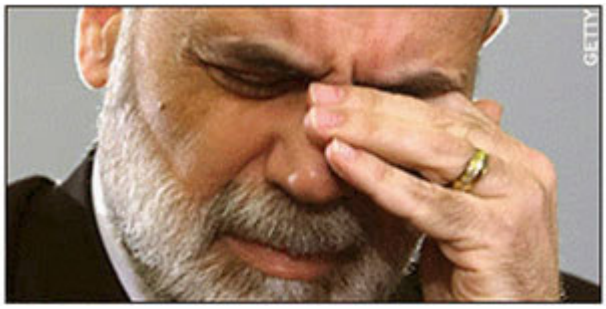
2008 started with a wake-up call of gold rising to an all time high (Snap), followed by a steady stream of bad news on the US economy and its glorious financial sector (Crackle...), which culminated with Ben and the gang at the Fed to come out all guns firing (Pop!) in a desperate attempt to maintain the illusion that they are still in control of the cost of money. Will it work? No. But wait, there's more to come...

Many market participants are counting on the Fed cutting interest rates yet again later this week and maybe even by as much as another 0.75%!!... That would mean a drop from 4.25% to 2.75% in less than a month! What is going on? That kind of action would be unprecedented. What does the Fed know that we need to know also? Or has the Fed simply lost it, as Jim Rogers suggests?

Fed chairman Ben Bernanke is proving quite capable of acting and quite willing to act as would suggest his moniker 'Helicopter Ben' (referring to his suggestion of some time ago that he could simply drop

money – that is, US dollar Fed notes – from helicopters, if necessary, just to keep the American consumer going). Indeed, there has not been as big an interest rate cut as 0.75% in the US since 1984.

Wow, that means not even Greenspan (who became Fed chairman in 1987) dared to cut the interest rate by that much in any one go, ever! So, if you happen to be in the US, maybe you should keep an ear alert to the sound of helicopters and an eye looking up to the sky... You never know! Poor Ben is not looking too well these days. He could open the floodgates wide open, in order to get some sort of relief...



Hey Ben, don't worry so much. It's not good for you. Call Alan Bollard, the New Zealand Reserve Bank Governor; I'm sure he'll be only too happy to give you some tips on how to keep interest rates high and the economy going. Failing that, have a bowl of Kellogg's' Rice Krispies for more inspiration...

Addicted to Debt

If you had any doubt that we're now addicted to debt and that without debt there is no global economy under the present monetary system, then the language used by US President Bush when he announced his latest so-called economic 'stimulus' package should help to convince you. He said the US economy (I presume he meant American consumers) needed a "shot in the arm"! So roll up your sleeves people and get ready for a rush... The US President looks like he just got his fix and if he holds his breath long enough; he may even stop all the financial bubbles from bursting. Let's wish him luck!

Beyond ridiculous...

Let's Get Serious

George Soros is famous for having made a billion dollars in one day betting against the monetary madness of Britain's elite back in 1992. When he speaks, I listen.

> *"The current crisis is the culmination of a super-boom that has lasted for more than 60 years,"* said the legendary investor recently. He went on: *"The current crisis marks the end of an era of credit expansion based on the dollar as the international reserve currency. The periodic crises [preceding the current crisis] were part of a larger boom-bust process…"*
>
> *"Credit expansion must now be followed by a period of contraction, because some of the new credit instruments and practices are unsound and unsustainable.""The ability of the financial authorities to stimulate the economy is constrained by the unwillingness of the rest of the world to accumulate additional dollar reserves. Until recently, investors were hoping that the US Federal Reserve would do whatever it takes to avoid a recession, because that is what it did on previous occasions. Now they will have to realize that the Fed may no longer be in a position to do so."*
>
> *"Although a recession in the developed world is now more or less inevitable,"* Soros continues on a different tack, *"China, India and some of the oil-producing countries are in a very strong countertrend. So the current financial crisis is less likely to cause a global recession than a radical realignment of the global economy, with a relative decline of the US and the rise of China and other countries in the developing world."*

"The danger is that the resulting political tensions, including US protectionism, may disrupt the global economy and plunge the world into recession or worse." That danger was all too obvious for anyone monitoring the panicky air around the "stimulus" package press conference in Washington last week.

George Soros

Gold is NOT an Investment…

Gold is not an investment any more than pure insurance cover is. Like insurance, it offers protection: protection from the risk that the finance capital of the world will default.

Now, I've been mentioning gold (and silver) a lot in these letters over the past year and a bit. So I thought I should make it clear that I do not consider gold (or silver) to be an investment. It is, in fact, the Anti-Investment par excellence. It is money and nothing else. It does not generate any income. But it is also nobody's liability, unlike any paper currency. There is no counterparty risk involved in owning or holding directly yourself the physical metal.

As I see it, gold is a bit like insurance; but only from the point of view of the one buying. You see, when you buy insurance, whether that's on your life, your house or whatever, what you are effectively doing is deciding that you do not want to take a certain financial risk or be left on your own to deal with it. In the case of life insurance, for example, that would be the risk of dying prematurely without leaving enough wealth behind to look after your loved ones.

So you pass that risk over to the insurance company by buying insurance cover and paying them a premium. What you get is peace of mind thanks to the principles of large numbers and of risk pooling, as your individual risk is pooled with many others' by the insurer. Now, this works well as long as the insurer prices the risk adequately and keeps sufficient reserves to remain solvent and pay all claims when they become due, of course.

When you buy bullion however, there is no countervailing liability in the balance sheet of someone else. That asset is yours to own. Nobody can default on it. You're covered, no matter what. It's as if you're buying insurance and you're the insurer as well: in other words, total economic freedom!

So, when you start losing confidence in the ability of central banks to manage the global money supply responsibly and therefore preserve the value of their respective currencies (in which all your investments as financial assets are based, whether that's US dollars, Euros, NZ dollars or whatever), as I have, you turn to gold and silver bullion for protection. When you no longer want to leave your entire investment portfolio exposed to the value of financial assets, you take some away and put it in bullion.

Bullion is the anti-investment portfolio. Bullion is a hedge against inflation, a hedge against currency debasement, a wealth preservation tool and a store of value, until this financial storm is over or until integrity is brought back into the global monetary system of today by recognizing gold and silver for the monetary metals they actually are.

So, bullion ownership is like having your own little insurance company for yourself. And what you're insuring against is… no less than the failure of, or even an ongoing 'elegant decline' of, the global financial and monetary system, as we seem to now be witnessing.

Of course, needless to say, if you are not worried about such risk and its consequences on your wealth, you will have no interest whatsoever in getting some insurance against it and so, no interest whatsoever in the anti-investment of bullion. And that's fine too; after all, it's your money! A lot of people actually don't bother much with insurance, especially here in New Zealand it seems (which I find quite amazing). But, you see, I'm an actuary and I see huge risks and a global financial storm coming. So…I thank God for gold!

... Gold Is a Global Currency

Hey, even the London Financial Times now seems to agree that gold is a currency! In a recent article entitled "Gold is the new global currency", its author writes: *"Gold's rise shows that investors are nervous. That is an important message for central banks contemplating interest rate cuts. The Fed must show it is not prepared to allow inflation to take off. Keynes called gold a barbarous relic. It has life left in it. But it is in the interests of business and consumers that its most bullish fans are proved wrong."*

I couldn't agree more. The problem though, is that things will unfortunately have to get a lot worse for both businesses and consumers, before they can get better again, sustainably. Because we're in such a mess: no pain now, no real gain. There is a lot of cleaning up to do to clear all the rubbish. Soros is right: Credit expansion must now be followed by a period of contraction, because some of the new credit instruments and practices are unsound and unsustainable - More on these types of instruments and practices in the second part of this issue below.

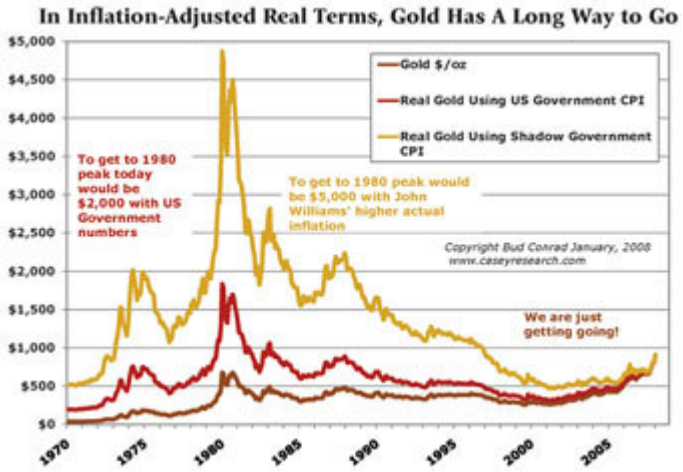
In ***Prosper!***'s second issue (back in September 2006) I wrote about the link between gold and silver and economic freedom. To give substance to my argument, I pointed out that Alan Greenspan himself seemed to be of that view once and proceeded to quote him from an article he wrote in 1966 (way before his long tenure at the Fed - from 1987 until 2006) which originally appeared in a newsletter called "The Objectivist" and was reprinted in Ayn Rand's Capitalism: The Unknown Ideal. Here it is once again:

> In the opening paragraph:
> *"An almost hysterical antagonism toward the gold standard is one issue which unites statists of all persuasions. They seem to sense - perhaps more clearly and subtly than many consistent defenders of laissez-faire - that gold and economic freedom are inseparable, that the gold standard is an instrument of laissez-faire and that each implies and requires the other. In order to understand the source of their antagonism, it is necessary first to understand the specific role of gold in a free society."*
>
> In the closing paragraphs:
> *"In the absence of the gold standard, there is no way to protect savings from confiscation through inflation. There is no safe store of value. If there were, the government would have to make its holding illegal, as was done in the case of gold. If everyone decided, for example, to convert all his bank deposits to silver or copper or any other good, and*

thereafter declined to accept checks as payment for goods, bank deposits would lose their purchasing power and government-created bank credit would be worthless as a claim on goods. The financial policy of the welfare state requires that there be no way for the owners of wealth to protect themselves.

This is the shabby secret of the welfare statists' tirades against gold. Deficit spending is simply a scheme for the confiscation of wealth. Gold stands in the way of this insidious process. It stands as a protector of property rights. If one grasps this, one has no difficulty in understanding the statists' antagonism toward the gold standard."

Gold rose from US$638 to US$838 an ounce last year alone. This year, it's already trading above US$900. Adjusted for real inflation (see Shadowstats.com), the gold price is still cheap. In other words, it is a long way from the purchasing power an ounce of gold achieved in January 1980, when it peaked one day at US$850. Take a look at this chart from economist Bud Conrad at Casey Research:



For more on the "real" gold price, I could do no better than direct you to read James Turk's brief and to the point article here. He concludes as follows:

"Rather than reduce inflation, the US government instead shot the messenger. By fiddling with the CPI, the US government wants us to believe that inflation is not as bad as it really is; which is the same strategy it has pursued with the other important inflation messenger – gold. Government interventions to cap the gold price prevent the gold barometer from alerting everyone that inflation is a growing menace.

To conclude, even though gold is trading at a record high in terms of nominal dollars, the real gold price is far below the old January 1980 record when adjusted for inflation. Gold is still good value, and more importantly, government interventions have kept gold cheap, thus enabling us to buy it at prices far less than would be the case if the government wasn't intervening. Therefore, continue to spend overvalued dollars to accumulate undervalued gold."

I'll be in Canada next month and I will be exploring ways to introduce in New Zealand a bullion fund for investors who, like me, feel they need some insurance against the growing monetary debauchery we seem to be subjected to, but unlike me, do not want to actually buy the bullion themselves and hold it. Stay tuned; more on this in the next issue…

Please note that all past issues of Prosper! are available Here for your convenience.

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You Call That Insurance?!!

Remember my epistle (in Issue 12 of ***Prosper!***) about Collateralized Debt Obligations (CDOs)? Well, as if that was not bad enough, I fear that Credit Default Swaps (CDSs) will do even more damage as this financial storm gathers strength...

From CDOs to CDSs

Don't get me wrong. We are not yet out of the woods with the 'unsound and unsustainable' CDOs and ongoing practices in the credit markets. There's a lot more pain to come on that front, eventually, when the subprime loans are renegotiated and/or when these instruments have to be marked to market. But let's put these horrible things aside for a minute, so we can have a look at the real monster lurking in the shadows: CDSs.

Actually, I'm not the only one to be seriously worried about CDSs... Oh no; far from it. In fact, as I was writing the contents for this issue, I received (as I suppose many of you did as well) John Mauldin's latest *Thoughts from the Frontline Weekly Newsletter*, which is entitled "What Does the Fed Know?" and is well worth reading. In it, he examines the suggestion (made by many) that the Fed was responding to the worldwide collapse in stock prices when it made its very rare inter-meeting rate cut of 75 basis points (0.75%) last week.

Even the London Financial Times wrote: *"The question being asked now by some in the markets is: was the Fed duped into a clumsy and panicked move by the clean-up operation for Jerome Kerviel's [AKA rogue trader at Société Générale] mammoth losses for the French bank?"*. Like Mauldin, however, I don't think that's why the Fed acted as it did. Instead, *"I believe the monoline insurance companies like Ambac and MBIA are in worse shape than most realize, the counter-party risk in the US$45 trillion Credit Default Swap market is much worse than we realize, and the exposure by various banks to their problems is much larger than currently understood. The Fed understands this, and realizes that they have been behind the curve but need to catch up."* Well put, John.

What's a Monoline?

Hold on a minute, I hear you say, dear reader; what the h... is monoline insurance? Good question. My vocabulary only recently included that

term... and I'm an actuary! So I consulted Wikipedia, once again, for some enlightenment. Here's what one can read at the top of the web page:

> *Monoline insurers (also referred to as "monoline insurance companies" or simply "monolines") guarantee the timely repayment of bond principal and interest when an issuer defaults.*

Ah... so monoline means credit default insurance. Simple! But there's more:

> *The economic value of bond insurance to the governmental unit, agency, or company offering bonds is a saving in interest costs reflecting the difference in yield on an insured bond from that on the same bond if uninsured. Insured securities range from municipal bonds and structured finance bonds to collateralized debt obligations (CDOs) domestically and abroad.*

OK, so if an issuer of debt has a lower credit ranking than desired, he buys insurance from a monoline and pays less interest. So far, so good; but I don't like seeing that CDOs too can get cover… What else does it say?

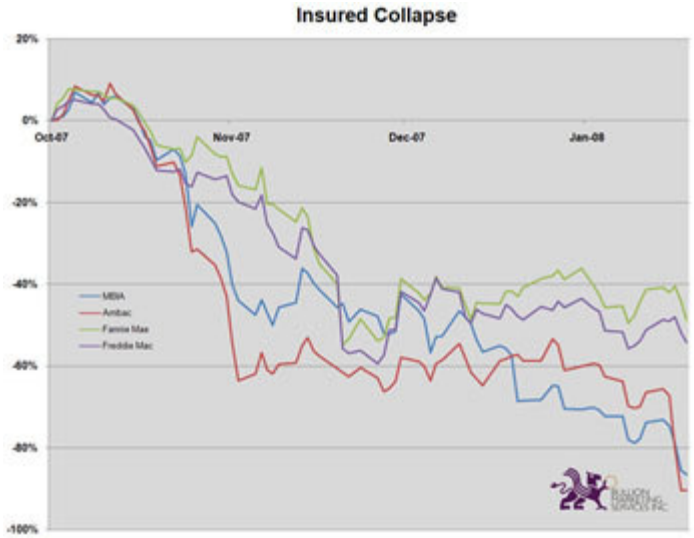
> *Insurance regulations prevent property/casualty insurance companies, life insurance companies, and multiline insurance companies from offering financial guaranty insurance. The monoline industry claims that it has the advantage over multilines of sole focus on capital markets.*

Oh, so now I get it. Insurance companies, as you and I know them, are called 'multilines'; those that insure against bond default are 'monolines'. No problem. But on what solid ground can the so-called monoline industry claim to be better placed than real insurance companies – who know a thing or two about reserving for future probable claims (and, of course, hire actuaries to help them stay solvent) – to insure people against such a risk? Does it have strong reserves, a solid capital base and good long track record of paying claims?

Well, let's see. The very next thing one reads on the Wikipedia web page for 'monoline insurance' is this:

> *The first monoline, Ambac Financial Group Inc, was formed in 1971 as an insurer of municipal bonds. MBIA Inc was formed in 1973.*

Whoa, Nelly! You just hold on a minute there, cowboy. You mean to say that Ambac and MBIA are the oldest firms going in this industry? If so, what's happening to the others, because what's happening to these two is NOT good?! Take a look at this chart and see what an insured collapse looks like:



Source: Bullion Marketing Services Inc, Canada (www.bmsinc.ca)

What that chart shows is that recent declines of more than 80% have already been posted by the largest US mortgage and bond insurers! Moody's has announced that it will likely downgrade Ambac and MBIA from their current AAA-rating. This will result in the downgrading of all the bonds Ambac and MBIA insure, making them ineligible for institutions and forcing their sale into a declining market.

In all instances the capital is inadequate to make good on the potential insured losses and a credit downgrade makes it difficult to raise additional capital. MBIA, the largest bond insurer, will have a capital base of only US$8 billion after the current round of financing to back up an insured portfolio of US$652 billion! Defaults of less than 2% would wipe out its capital base!!

Put simply: the vulnerabilities of these "insurers" have infected the banking sector. I have to wonder if this would have happened with 'multiline' insurers... *The Economist* newspaper had this to write recently about these so-called monolines:

> *"America's big bond insurers, which have underwritten some US$2.4 trillion of private and public-sector bonds, usually go about their business largely unnoticed. But now they are looking distinctly wobbly they have started to attract attention. If one or more of them were to topple over, there will be a huge knock-on effect on banks and other financial institutions that rely on their guarantees. This in turn will further worsen the credit crunch and cause an even bigger headache for policymakers already grappling with a sharp slowdown in the American economy.*
>
> *Bond insurers in effect "lend" their top-notch ratings to lower-quality debt, raising its value in the eyes of investors. Any cut in those ratings may make it impossible for the bond insurers to take on new business and would reduce the value of the securities they have already underwritten. Such cuts are now a distinct possibility because the insurers have underwritten billions of dollars of mortgage-backed securities, including those notorious*

collateralized-debt obligations (CDOs) that have now gone sour."

"There are already signs that the insurers' woes are contagious… The full extent of the 'counterparty risk' banks face in dealing with bond insurers is only now becoming apparent. Jamie Dimon, the boss of JP Morgan Chase, has said that the fallout from the bond-insurer crisis could be "pretty terrible" for the debt markets."

And we worry about global warming?! Dear, oh dear... There's a financial tsunami fast coming our way and what are we told to do? Stay on the beach and keep spending money you don't have; everything will be just fine. Well, I don't know about you, but I prefer the mountains to the beach and expect things will have to get a lot worse before they can get **sustainably** better in the world of global finance...

Gold as a Regulator of Debt

The most amazing thing to realise in all of this sad saga is that, under a gold standard monetary system (as we once had and unlike the current fiat only global monetary system – for more, see the very first Issue of ***Prosper!***), there would be absolutely NO NEED for bond insurance in the first place! The reason being that interest rates and, hence, bond prices would naturally be confined to such a narrow range that bond speculation would become unprofitable. According to Professor Antal E. Fekete, under a gold standard, *"capital and talent are freed to pursue socially desirable goals"*.

Here's more from Professor Fekete in a commentary he served at LeMetropoleCafe.com a few days ago, in reaction to a recent article by Anatole Kaletsky of GaveKal Research, based in Hong Kong:

"Gold is the indispensable regulator of debt in society. Kaletsky apparently believes that government bureaucrats should determine how much debt society is able safely to carry and they should regulate the level of debt accordingly. Well, we have just tried this and found that whenever irredeemable promises are to be liquidated by issuing more irredeemable promises, debt proliferates beyond any limit.

The derivatives monster and its bastard offspring, "bond insurance," is the beacon luring the boat of the national economy to its doom on the reefs. Clearly, debt existing in the world today will never be liquidated through the normal processes of debt-retirement, that is, without detours into deflationary or inflationary territory (i.e., through default or depreciation). It is lunacy to think that the debt-pyramid can continue to grow indefinitely without causing a major catastrophe further down the line. All debt will be liquidated in the same way as subprime mortgages: through default — or else, it will be inflated away."

So that's the really big story emerging in the financial media now; it's about the bond "insurance" market that's looking increasingly precarious for lack of proper reserves and for its poor risk management. It's not about gold. But that, too, could change, soon...

GATA Goes to Washington

GATA is the US based Gold Anti-Trust Action committee I mentioned a few times before in ***Prosper!*** For more information of this courageous non-profit educational organization formed by people who recognize the necessity of free markets in the monetary metals, please visit www.gata.org.

This week, GATA will place a full-page advertisement in *The Wall Street Journal (WSJ)* calling attention to the international central bank scheme to suppress the price of gold and to GATA's conference in Washington in April.

In the belief that this ad can strike a profound blow against the rigging of the gold market and all related markets, GATA will be paying US$264,000 (!) to the *WSJ* for them to print the full page ad… There may still be freedom of speech in the US, but it's certainly anything but free if you want to get your message across over there, when the media does not normally give you any coverage!! For those of you who don't get or read the *WSJ*, you can see the ad and what it's all about here.

The ad is entitled "Anybody Seen Our Gold?" and it's about raising awareness among the general investing public of the amazing fact that gold reserves of the United States have not been independently audited for half a century. Simply incredible; but true! How could that be? Why is it so?

GATA's aim is to expose the truth. *"Surreptitious market manipulation by government is leading the world to disaster. We want to expose it and stop it."* GATA is marching on the US Treasury Department to *"demand, via the Freedom of Information Act, that the US government come clean about its gold reserves and disclose how much gold is left and how much has been compromised by leases, swaps, and other encumbrances undertaken for surreptitious market intervention."* Good luck to them, I say.

If you are in Washington or can make it there in April, and you want to hear GATA explain how they believe the unfolding world financial disaster can be mitigated and better understand why free markets in the monetary metals are essential to free markets everywhere, then do yourself a favour and try to attend their conference on April 17-19.

GO GATA!

> *"Unlike an animal, man is not told by drives and instincts what he must do. And in contrast to man in former times, he is no longer told by traditions and values what he should do. Now, knowing neither what he must do nor what he should do, he sometimes does not even know what he basically wishes to do. Instead, he wishes to do what other people do -- which is conformism -- or he does what other people wish him to do -- which is totalitarianism."*
>
> *- Viktor Frankl*
> *(1905 - 1997)*
> *Austrian neurologist and psychiatrist; Holocaust survivor; author of Man's Search for Meaning*

Your freethinking investment strategist, liking the Yuan more than the Euro… and the Euro more than the Dollar… but still preferring gold and silver to any other paper currency!

Louis Boulanger, CFA
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