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Global-Macro Tipping Points
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Market Research & Analysis

FULL REPORT

THESIS 2017 – ILLUSION OF GROWTH
1/16/2017

ILLUSION OF GROWTH

When Leverage Fails!

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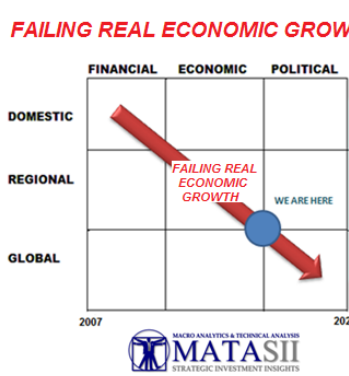

FAILING REAL ECONOMIC GROWTH
FINANCIAL
ECONOMIC
POLITICAL
DOMESTIC
REGIONAL
GLOBAL
FAILING REAL ECONOMIC GROWTH
WE ARE HERE
2007
2020
MATASII
STRATEGIC INVESTMENT INSIGHTS

EXECUTIVE SUMMARY

BRIEF

The Key messages of this year's 2017 Thesis are as follows:

2- WHY GROWTH IS THE STRATEGIC IMPERATIVE – *The Basic Capitalist System Underpinning*

1. Marx postulated that after Capitalist Systems reach peak economic profit growth, there was a concentration of capital associated with falling rate of profit. In turn, this would reduce the rate of investment and as such rate of economic growth.
2. Unemployment as a consequence increases. Class conflicts increase. Labor conflicts start and there are class revolts. Ultimately, there is a downfall of capitalism (in the form we know it).
3. Marx's predicted economic failure fundamentally stems from the *Crisis of Over-Production*
4. Monetary Policies of QE, QQE, ZIRP, NIRP etc have reduced the cost of money such that the world now has an Over-Production, Over-Capacity, and Under Utilization Problem.
5. Over-Production leads to the loss of Pricing Power, Market Share Wars which contributes to Global Deflation.
6. Developed Economies today have additionally reached the point of debt saturation whereby economic growth is insufficient to support the expense of the debt.
7. Our modern business culture no longer fosters massive business risk which historically has led to the creation of new industries which fostered increased wealth, jobs and consumption.

3- A FLAWED GDP FORMULA

1. In 1980 the Global Balance of Payments was changed to allow a Credit Balance. This allowed the global banks to become the conduit for an era of debt financed globalization.
2. As a consequence Japan's export lead Mercantile Strategy came into existence based on US Deficit Spending, Current Account and Trade Balance,
3. The foreign funding of US Debt by the global exporting nations (to the US), as well as through the mechanics of both the Triffin & Gibson Paradox's allowed for US Money Expansion while maintaining falling Interest Rates thereby fostered US Consumer Consumption to the obscene level of 70% of the economy.
4. Aggressive changes in Fiduciary accounting regulations fostered the acceleration of "Financialization" of the US Economy,
5. Real Inflation in the US now approaches 10% based on 1980 methodologies that don't include statistical aberrations such as "Hedonics", "Substitution" nor "Imputation" etc.
6. Real Global GDP growth is likely currently shrinking at a rate in access of 2% annually,
7. To maintain the Illusion of Growth the US is forced to maintain a "Strong Dollar" policy at all cost which controls US foreign policy and the US military strategy.

4-PRODUCTIVITY EXPOSES THE MYTH

- In a 70% Consumption Economy the current level of government transfer payments funding this consumption makes the historic GDP Formula misleading and therefore meaningless,
- The current level of government spending by all three levels of US government, financed by fiscal deficit financing versus tax receipts additionally makes the historic GDP formula misleading,
- The current level of Investment into Productive Assets is now so low that it makes the "I" in the GDP formula nothing more than a measure of the rate of money supply growth and debt creation. This also makes the GDP formula misleading and misrepresentative.
- The "M" in the GDP formula (Exports minus Imports) has become a Trade Deficit for the US over the last three decades (and most developed nations). Therefore developed economies now consume more than they produce. This is an unsustainable economic condition.
- The statistics of a falling 10 Year Corporate Rolling Compounded Annual Nominal EPS confirms that there is hardly any real growth occurring in the US, Europe or World Wide.
- Steadily falling Productivity is contrary to the basic premise of a Capitalist Economy.

5-UNDERSTANDING WHAT GROWTH REALLY IS – Capitalism versus Creditism versus Financialism

- The real yield received from debt loans or conversely the cost of debt borrowed are central to real economic growth
- The limiting factor to real economic growth is the debt burden relative to the economic growth rate,
- When interest rates rise, so does the Weighted Average Cost of Capital (WACC), which mathematically makes valuations, fall.
- We now "Consume More than We Produce" versus "Producing More than We Consume",
- We are now "Receiving Less for More versus Getting More for Less",
- Because of "Financialization" of the Economy we have now skewed Innovation such that it is now targeted primarily at Cost Savings versus new high risk, high growth industries.

6- THE GLOBAL POLITICAL CRISIS NOW STEMMING FROM NO "REAL" GROWTH

- A 'Growth first, Objectives later' strategy isn't working and as a result in the past fifteen years the growth process has actually destroyed more resources than it has created on a sustainable basis,
- Artificial Growth is unavoidably shifting the world from a Uni-Polar to Multi-Polar World due the US Dollar maintaining its Breton Woods era "Reserve Currency" status,
- Populist Politics is unwittingly promising to re-create false nation state socialism without Globalism,
- The Electorate in many countries is rapidly losing confidence in a "brighter future" due to No Real Economic Growth despite media reporting suggesting the contrary. A Crisis of Trust is being fostered with its attendant risks of "stagnation'.

7- CAPITALISM TO CREDITISM - *The Greenspan Legacy*

- Federal Reserve Chairman Alan Greenspan gave us a legacy of Economic Obfuscation
- Capitalism Requires Savings,
- Capitalism Requires Productive Investment of Savings,
- Capitalism Requires Gains in Productivity,
- Capitalism Delivers an Increased Standard of Living,
- Capitalism Requires a Free Market System which we have lost through Over Regulation in the US.
- Efficient Allocation of Capital IS NOT Happening
- Risk is Incorrectly Priced,
- There is a Lack of Price Discovery,
- We have experienced an excessive and too sustained a period of economic malinvestment,
- Household Savings IS NOT Happening. There is no Savings for Investment. Rather we have Credit Creation for Consumption
- Quarterly Corporate Results Reporting is potentially an impediment to long term economic viability of the capitalist system,
- We are penalizing longer term Investment which creates major breakthrough growth areas,
- We are penalizing Risk Taking,
- We are penalizing CAPEX expenditure,
- Corporations are predominately not Investing but rather simply "Stripping Out Costs",
- Cheap Money has created Over Supply rather than the Wealth Effect intended to create Demand Pull (Even if successful is limited in time and scope). Rather what we face will be a demand hole which will be deflationary as Pricing Power is lost.
- Leveraged Buyouts are now sought for Growth where costs are stripped. There is now little corporate organic growth.
- Corporate Buybacks are stripping investable capital from productive use. This occurs when Corporations Don't See Risk Free Growth.

8- FURTHER CONSTRAINTS & IMPEDIMENTS

- We have a Short Term oriented Corporate Culture that is Constricting Real Economic Growth
- We have Regulatory Shackles limiting growth,

- We have an Uneven Playing Field through the Advancement of Crony Capitalism,
- We have a Massive Inflationary Bleed of Capital from the Economy. Inflation is simply another form of Taxation,

9- WHEN GROWTH FAILS

- We have a Global Eurodollar Problem,
- We have a US Dollar Reserve Currency Problem,
- Leverage Will Fail Because of Cascading Rehypothecation,
- Leverage Will Fail Because Repos are not Sound Collateral,
- There is Now A Global Rush To Hard Assets and Away from "Digital" Representation of Assets

10- A NEW WORLD ORDER (NWO) COMING

- A Stealth, Secular, Structural Shift is Underway as Leverage is Beginning to Fail because of Collateral Shortages,
- The End of the Debt Super-Cycle is underway,
- The Baby Boomer Equity Bull Market is Coming to a Close,
- A great Debt for Equity Swap is taking shape

CONTRACTING REAL ECONOMY

We believe the Fed's much publicized "fear of inflation" (which is ostensibly driving the new rate hike regime) is a necessary public narrative that will let the Fed pursue its true objective – a stronger dollar and deflation amid what is in reality a *CONTRACTING REAL ECONOMY*.

Stock and bond markets in the advanced, financially-oriented economies, have devolved more into political imperatives necessary to maintain social services and the perception of wealth, rather than serving as the traditional means to build and price wealth and capital.

It is our current view that the public traded financial exchanges no longer serve societies or global trade as effectively as they might.

In over-leveraged economies, stock and bond markets become co-dependent. To sustain market prices, debt and equity require *nominal* output growth. To sustain market *values*, they require *real* output growth.

The only way to increase nominal output growth and raise nominal equity prices in a highly leveraged economy with leveraged currency is to raise the quantity of credit, which must eventually reduce real output and asset values. The question before us is whether "eventually" is occurring now?

The US and global economies have begun to experience necessary structural changes that directly impact:

- *Incentives to produce and consume,*
- *The fundamental manner in which the political dimension approaches monetary and fiscal policies, and*
- *The way in which investors think about assets, liabilities, economics and capital markets.*

Investors seeking to create wealth by investing in broad equity markets face a fundamental structural problem caused by the irreconcilability of:

- *Naturally occurring commercial deflation,*
- *Economies and political systems that rely on inflation, and*
- *The crowding out of consumption and investment by necessary debt service.*

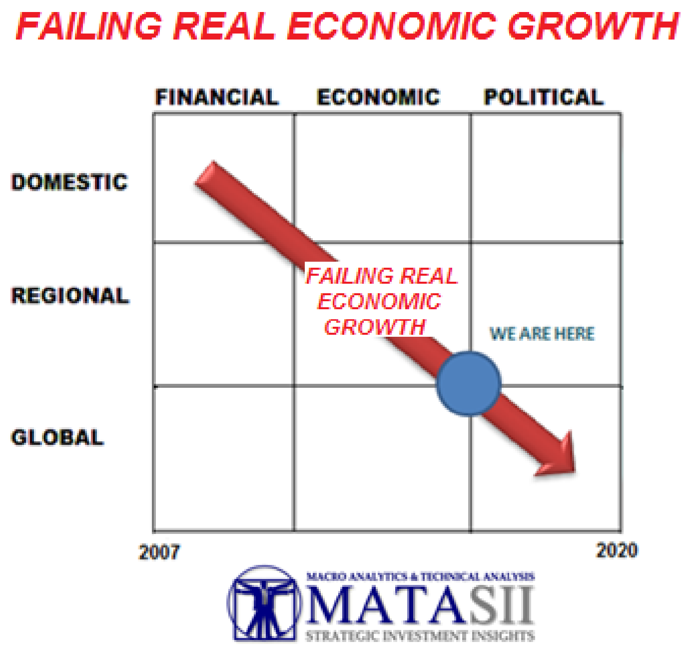
We believe the primary reason stocks and bonds are peaking is SCALE.

- *Aggregate market caps, valuations, revenues and earnings of public companies cannot be sustained by the level of real production in the underlying US and global economy.*

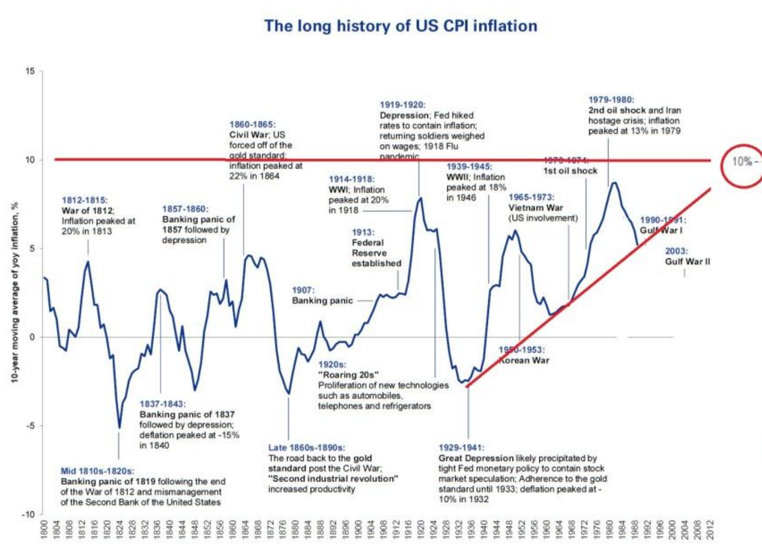
- *We think bonds are on the eve of reconciliation for the same basic reason.*
- *The scale of systemic leverage has already begun to reduce incentives to expand credit for capital formation, which, in turn, promotes debt deflation.*

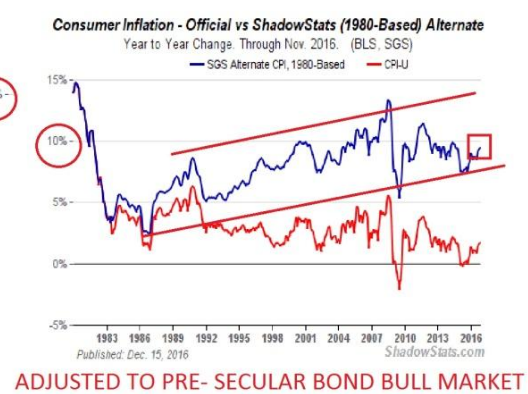
INTRODUCTION

The Road Map we have been following since the 2008 Financial Crisis is fundamentally driven by insufficient real economic growth relative to the rate of expanding debt interest payments.



As we illustrate in Chapter 4, if we use the economic methodology applied in 1980 by the US BEA (before we started misrepresenting inflation) we would currently be reporting US domestic inflation to be running at approximately an annualized rate of 10%. It has been compounding at over 5% for most of this period of time, and only weakening from more than 10% since the 2008 Financial Crisis to approximately the historic annualized mid-point.





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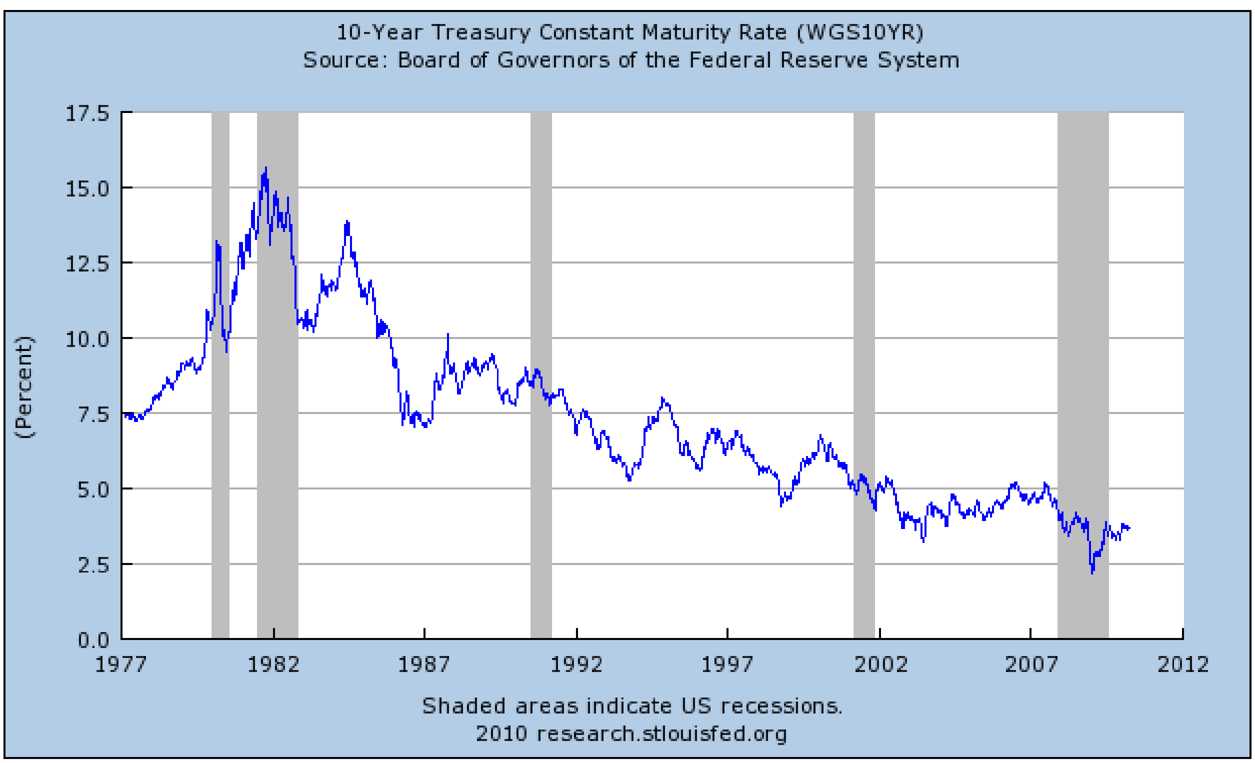
If we then analyzed global GDP growth and conservatively adjusted it for a more accurate inflation rate then the 1.8% Deflator currently used, we see that global growth has in fact been contracting since 1980.

It is important to fully appreciate that since 1980 a number of major structural "adjustments" have been implemented as a consequence and are presently underway:

1- **YIELDS**: Yields have steadily fallen, thereby reducing government debt interest payments and raising the price of bond assets which has increased collateral values for debt being used as collateral and banking capital ratios.



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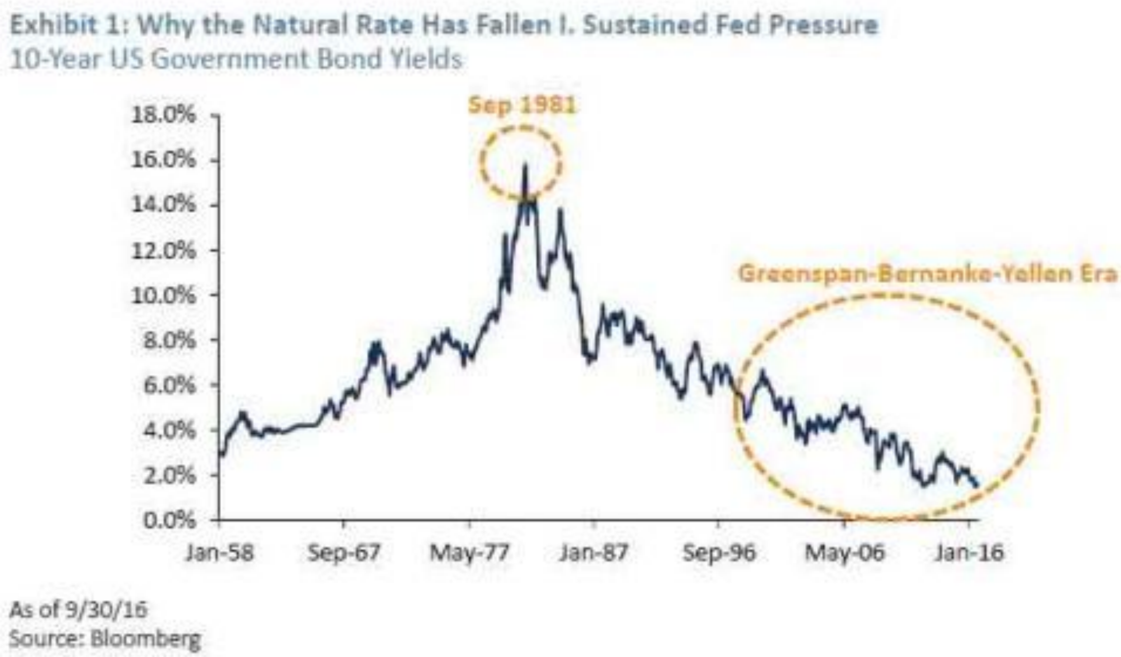
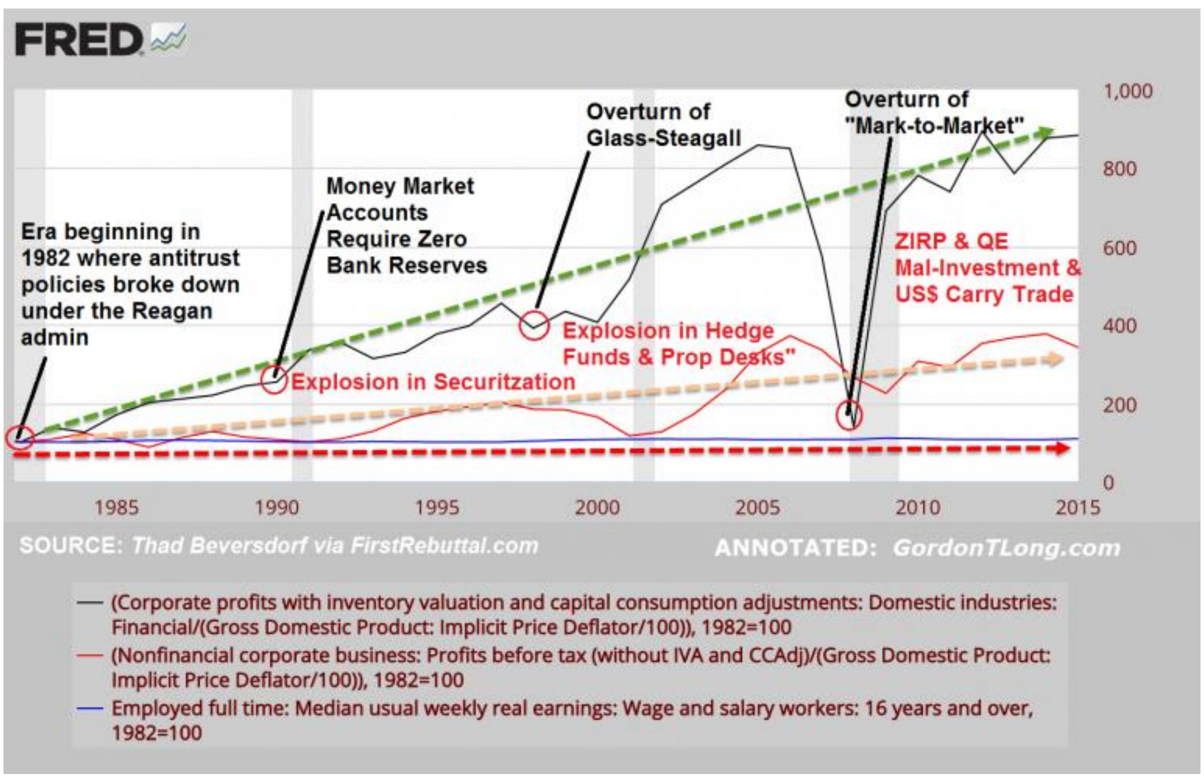


2- **REGULATORY FINANCIAL REPRESSION**: Regulatory laws, accounting and fiduciary requirements have been steadily altered to allow increased "Financialization" of the economy to support the lack of real economic growth through debt & credit creation.



A FAILURE OF LEVERAGE - A Shortage of Real, Unencumbered, Un-Rehypothecated Collateral

The limit to a debt/credit based economic growth is the ability to service the debt payments. The problem eventually shows itself by insufficient collateral being available to secure new debt. This is because collateral values start to fall due to non-performing loans, malinvestment and being already encumbered. When excess leverage is being employed to both create and additionally sustain debt, then the situation will become unstable very quickly.

People who have experienced bankruptcy often describe it: *"It was slow at first, then all of a sudden!"*

Going forward we expect to witness debt deflation coincident with central bank monetary inflation, which would offset the deflation…on paper (like feet in the oven, head in the freezer producing a reasonable average). Before this occurs, we expect a financial or economic event that focuses public attention on our massive leverage problem.

As liabilities without directly-linked offsetting assets, the purchasing power value of currencies is always susceptible to dilution. Dilution comes in the form of credit issued by banks (and, potentially, non-bank lenders) that is either not collateralized by assets or collateralized by assets that themselves are liabilities (like Treasury notes).

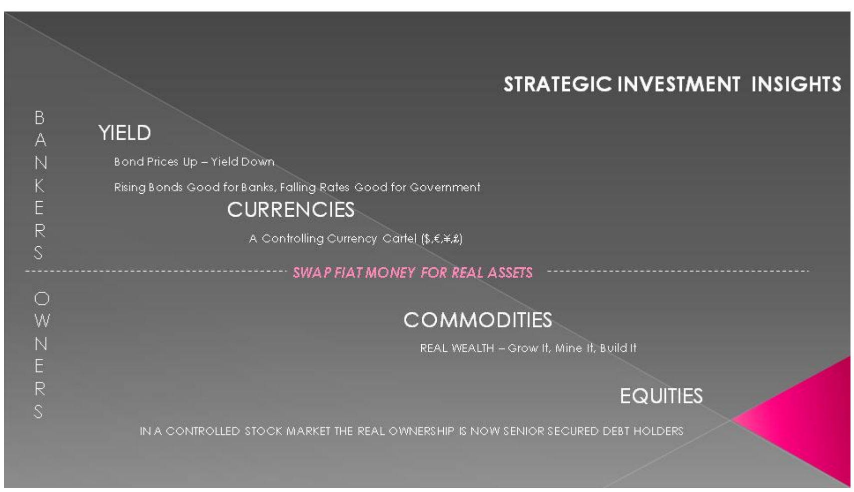
The wider the gap separating the amount of un-collateralized credit denominated in a currency from that currency's base money (bank reserves and currency in float) – the ratio that determines monetary leverage - the greater the amount of future monetary de-leveraging will have to occur. (De-leveraging must ultimately occur so that debtors can service or repay their obligations and so producers have incentive to continue to supply goods and services in exchange for that currency.)

THE GREAT DEBT FOR EQUITY SWAP – Real Ownership, Real Store of Value

We believe the above problem is well understood by the top 1% who controls most of the world's assets.

To protect themselves we believe they are presently engaged in a massive debt for equity swap. They are employing international banking control of yields and currencies to reposition their assets to be holders of real "hard" assets.

This involves the ownership of assets that have always been considered as representing wealth and are not held by paper, digital representation.



It is not the intent of this paper to explain the Swap underway but let me say that ownership of public companies is now not really through stock ownership. Rather in an era of debasement and lack of growth, ownership payout and control is through being the senior secured lender in the capital structure. *Anyone who has attended a board meeting of a major corporation quickly realizes whose opinion counts the most!*

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1- THESIS 2017

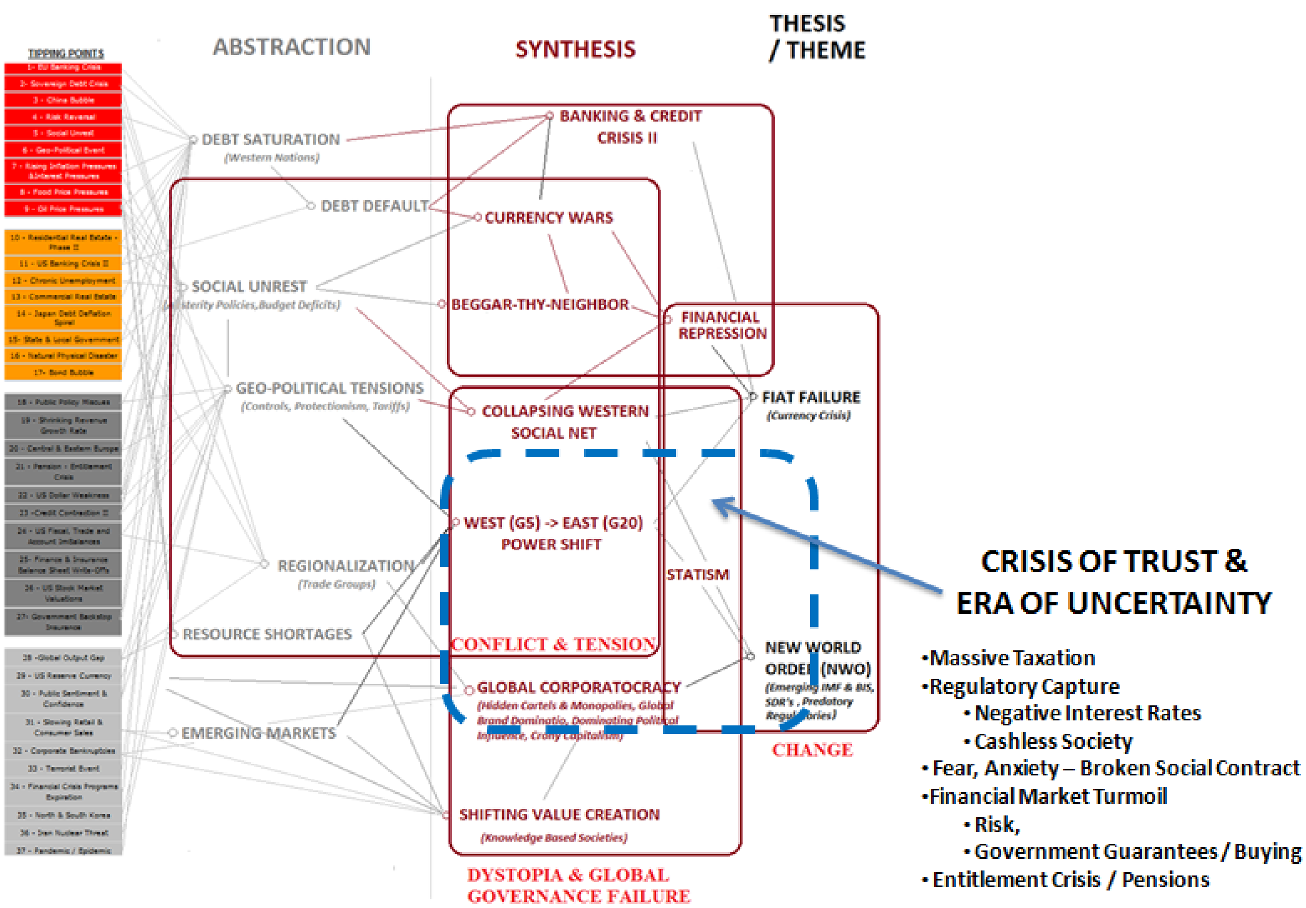
WHERE 'ILLUSION OF GROWTH' FITS

Previous Annual Thesis Reports:

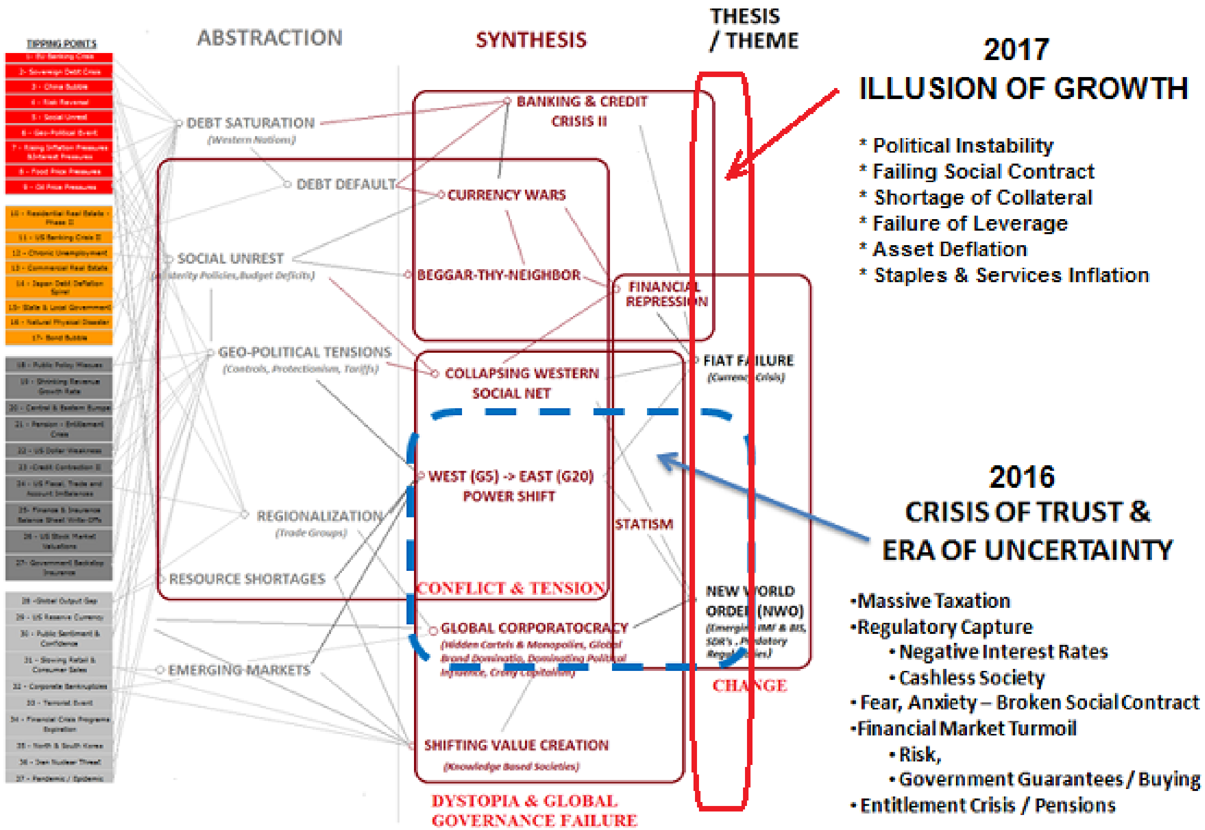
1. 2000 - Extend & Pretend
2. 2011 - Currency Wars – 'Beggar-thy-Neighbor'
3. 2012 - Financial Repression
4. 2013 - Statism
5. 2014 - Globalization Trap
6. 2015 - Fiduciary Failure
7. 2016 – Crisis of Trust

OUR ABSTRACTION PROCESS

Last Year

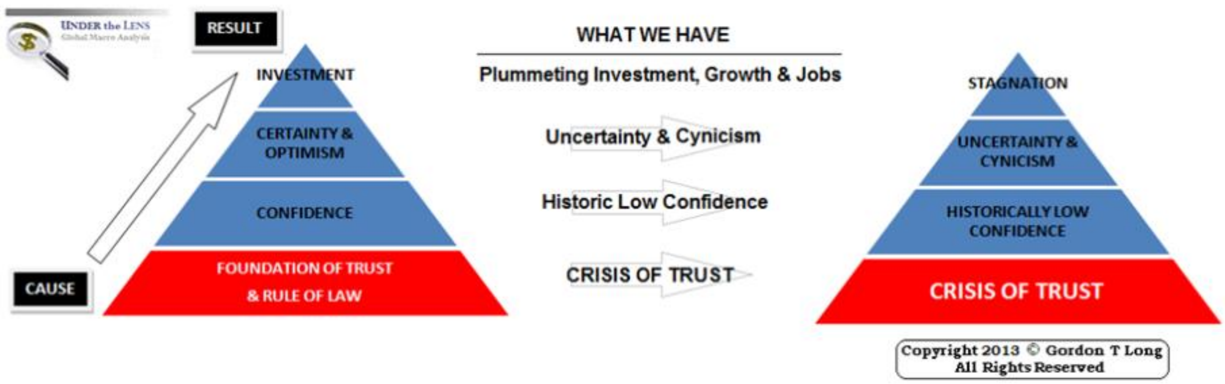


This Year



SPRING BOARDING FROM LAST YEARS 'CRISIS OF TRUST

Last year we spelled out the emerging Crisis of Trust of what it would mean going forward.



We believe it has unfolded as we predicted and continues to do so.

UNDERSTANDING HOW TRUST HAS FURTHER BROKEN DOWN

Confidence
TRUST ========→ OTHERS
Faith

Trust is about placing your confidence and faith in others

On the surface this is something everyone can understand. But there is more in it than that. This can be seen by considering the opposite or a antonyms of the above.

Confidence
TRUST ========→ OTHERS
Faith

Skepticism
UNCERTAINTY ←======== YOURSELF
Cynicism

There is a relationship between Trust and Uncertainty which comes from our personal way of thinking about things.

When we are centered on ourselves versus others we become more cynical and skeptical versus having confidence and faith in others. It is a feedback loop.

Trust inspires investment and risk taking. Uncertainty begets stagnation and decay

Stagnation and Decay quickly undermine the unwritten Social Contract.

THE SOCIAL CONTRACT – The Unwritten Understanding

The Social Contract is the unwritten agreement between the Citizenship and Government, that if a person does the right things, the government will create an environment such that they will be rewarded.

Instead what they now see is not only this not happening, but those closest to the government (such as Crony Capitalists, Government Employees, those living off the government), doing well but everyone else hurting.

Corruption is often tolerated by the citizenship until a person can no longer live the life they want. They then resent the government free loaders and demand change and or revolt. When they can't support their family they revolt. We are nearing that point in many developed economies.

We are seeing more and more fringe parties taking dominate positions around the world. The status quo and social contract is now under fire in most developed economies! Promised entitlement payouts are now being called into question as time has come for governments to deliver on their promises

ANTI STATUS QUO, ANTI-ESTABLISHMENT & ANTI-GLOBALIZATION

We believe that what the above is telling us is that there is a massive social change about to occur. A change being brought on by lost faith in the system.

Our Annual Thesis last year entitled "Crisis of Trust" and two years ago entitled "Fiduciary Failure" are telling us about an increasing degree of lost faith in the status quo.

The situation has only got worse in the last year as we see more and more populist parties dominating on Anti-Establishment, Anti-Status Quo, Anti-EU and Anti-Globalization platforms.

The citizenship now believes that the system is no longer working for them.

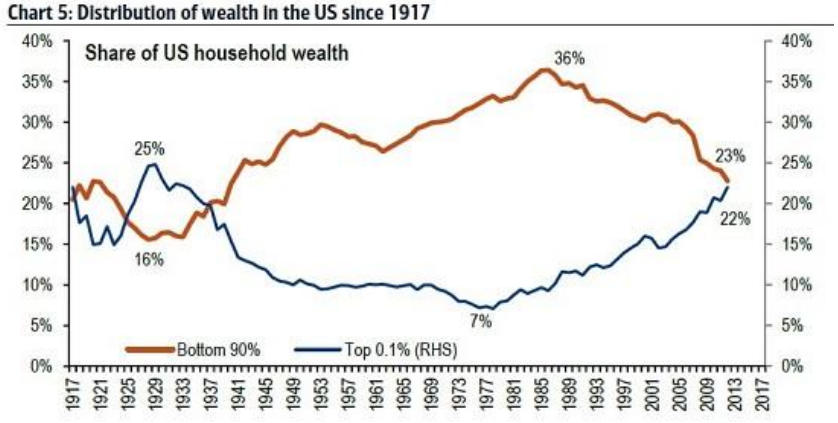
They see that when they do all the right things (go to school, train, work hard) it no longer delivers on expectations. The American Dream is no longer a reality to the vast majority of Americans. It is a broken dream.

A FAILING SOCIAL CONTRACT – The Telltale: Rising Political Movements

Inequality has become so blatant that the current US Presidential Primaries have been "set on their ear" by massive turnout for candidates who are talking about the degree of corruption, incompetence and ineffectiveness of the US government. People are frustrated and getting mad.

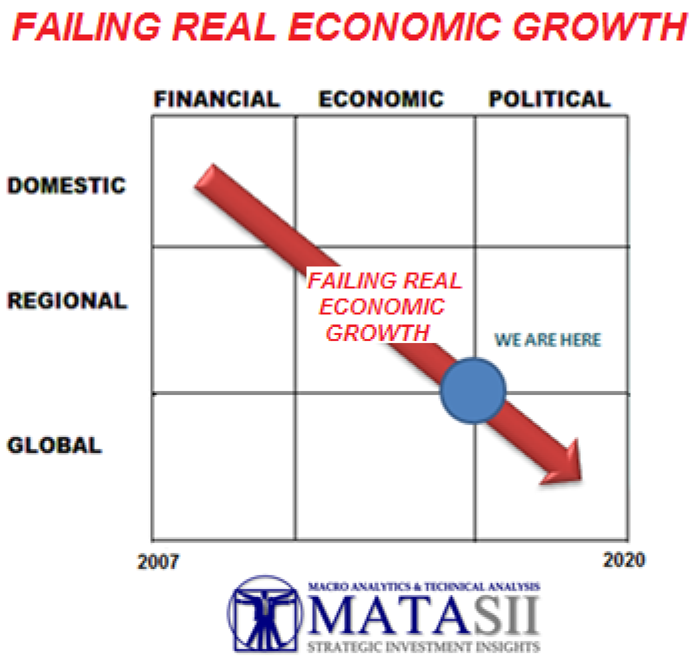
What has happened is that the Social Contract has broken down.

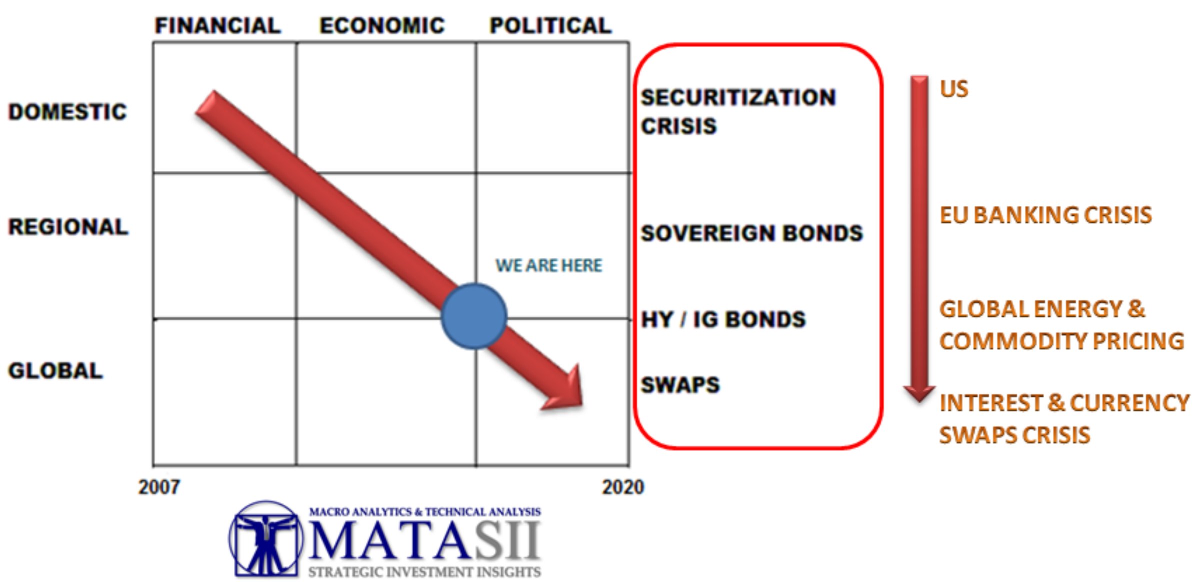
Chart 5: Distribution of wealth in the US since 1917



Source: BofA Merrill Lynch Global Investment Strategy, Emmanuael Saez & Gabriel Zucman - 2015

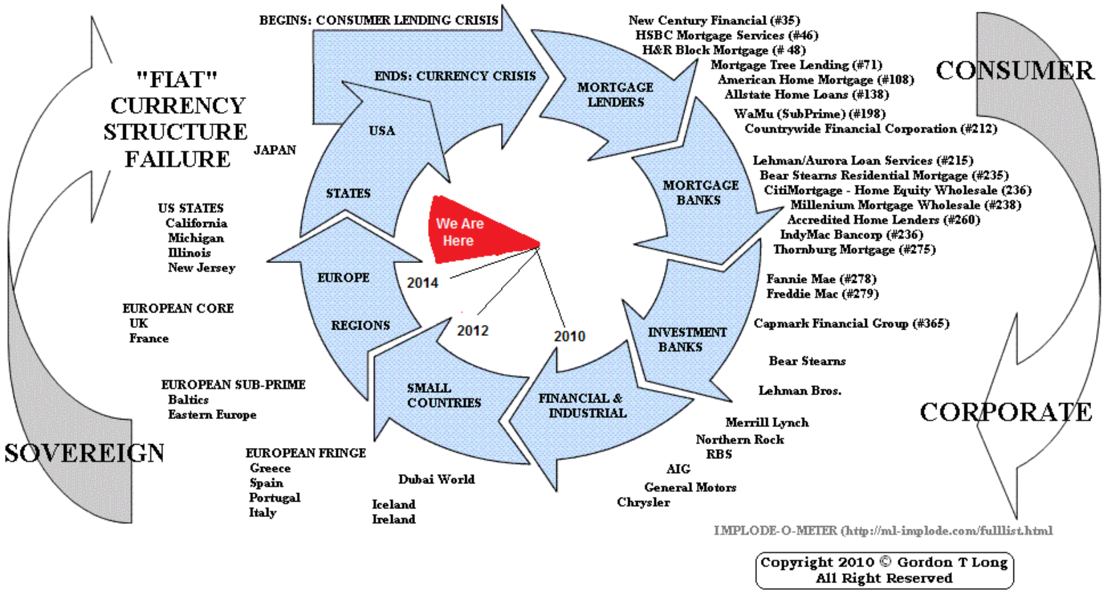
ROADMAP AHEAD





OUR INITIAL TIMING PROJECTIONS

The roadmap we laid out in 2008 is tracking to a "Fiat Currency Structure Failure" by late 2019 – early 2020.



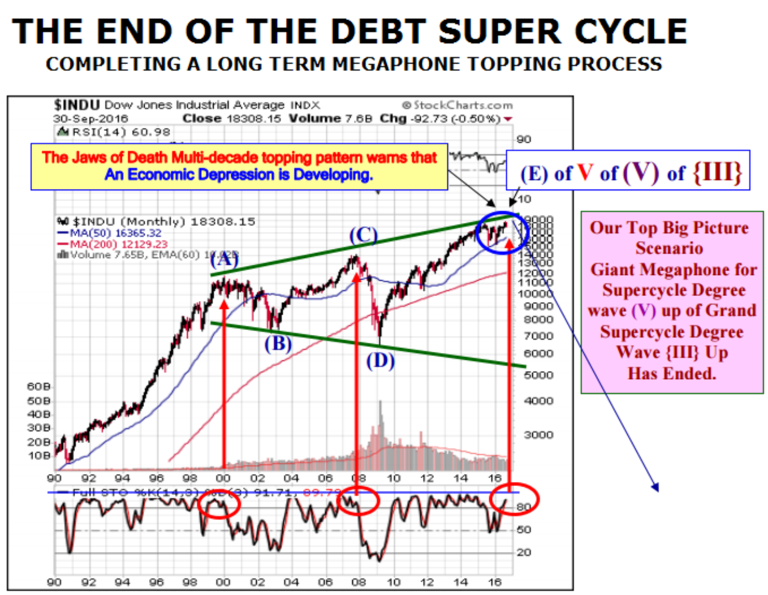
Look for the next Crisis to be:

1-Global,
2 Politically Initiated and
3- Implode from the Unregulated $700T SWAPS / $72T Shadow Banking Complexity

MAJOR TECTONIC FORCES "IN PLAY"

We have two Tectonic Forces at play

1- The End of the Debt Supper-Cycle



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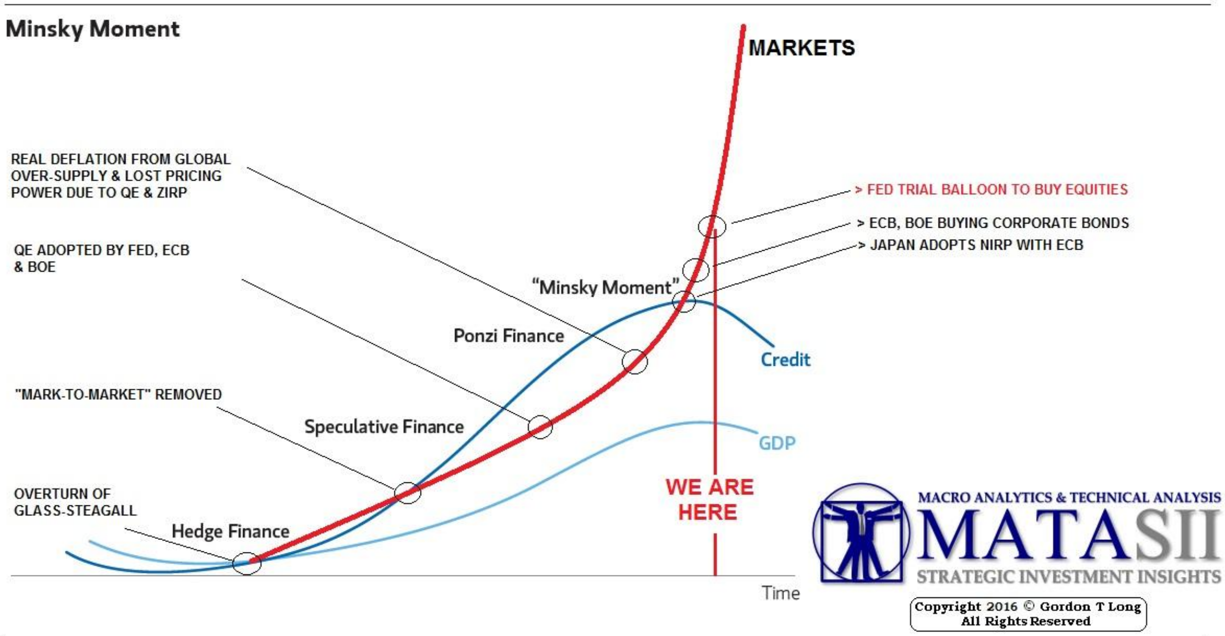
2- The Central Bankers Attempting To Delay, mitigate or Stop This from Occurring



VIDEO 1 – TWO TECTONIC FORCES

https://youtu.be/5HveeOcOmqg

VIDEO 2 – WHAT TO WATCH FOR IN EARLY 2017

https://youtu.be/16KiodF_iMw

2- WHY GROWTH IS THE STRATEGIC IMPERATIVE – *A Basic Capitalist System Underpinning*

KEY MESSAGES

1. Marx postulated that after Capitalist Systems reach peak economic profit growth, there was a concentration of capital associated with falling rate of profit. In turn, this would reduce the rate of investment and as such rate of economic growth.
2. Unemployment as a consequence increases. Class conflicts increase. Labor conflicts start and there are class revolts. Ultimately, there is a downfall of capitalism (in the form we know it).
3. Marx's predicted economic failure fundamentally stems from the *Crisis of Over-Production*
4. Monetary Policies of QE, QQE, ZIRP, NIRP etc have reduced the cost of money such that the world now has an Over-Production, Over-Capacity, and Under Utilization Problem.
5. Over-Production leads to the loss of Pricing Power, Market Share Wars which contributes to Global Deflation.
6. Our modern business culture no longer fosters massive business risk which historically has led to the creation of new industries which fostered increased wealth, jobs and consumption.

KARL MARX WARNED US

He is regarded as the father of communism who prophesied the decline of capitalism and the advent of socialism.

Marxian Concept of Economic Development:
In Marxian theory, production means the generation of value. Thus economic development is the process of more value generating, labor generates value. But high level of production is possible through more and more capital accumulation and technological improvement.

At the start, growth under capitalism, generation of value and accumulation of capital underwent at a high rate. After reaching its peak, there is a concentration of capital associated with falling rate of profit. In turn, it reduces the rate of investment and as such rate of economic growth. Unemployment increases. Class conflicts increase. Labor conflicts start and there are class revolts. Ultimately, there is a downfall of capitalism and rise of socialism.

In Marx's view, presented in his 1867 tome Das Kapital (Capital), a capitalist's profits come from exploiting labor—that is, from underpaying workers for the value that they are actually creating. For this reason, Marx couldn't abide the notion of a profit-oriented organization.

This situation of management exploiting labor underlies the class struggle that Marx saw at the heart of capitalism, and he predicted that that struggle would ultimately destroy capitalism. To Marx, class struggle is not only inherent in the system—because of the tension between capitalists and workers—but also intensifies over time. The struggle intensifies as businesses eventually become larger and larger, due to the inherent efficiency of large outfits and their ability to withstand the cyclical crises that plague the system.

Ultimately, in Marx's view, society moves to a two-class system of a few wealthy capitalists and a mass of underpaid, underprivileged workers.

As a consequence, Marx predicted the fall of capitalism

Keynesian Economics is an approach to economic policy that favors using the government's power to spend, tax, and borrow to keep the economy stable and growing

"We are all Keynesians now." So said Richard Nixon, the Republican and former President of the USA, in 1971.

Every economist and politician is for economic growth; life is much easier for the ruling class when the cake is getting bigger and a few more crumbs can be thrown in the direction of the masses. The problem is that growth under capitalism cannot be simply conjured up like a rabbit from a hat.

For these naive men and women in political positions of leadership, the solution to the economic crisis is simple – we must "stimulate growth". They see the economy as like a stalled engine that simply needs a spark to get it going again. But growth under capitalism cannot be turned on and off like a tap. If growth could be created on demand, then there would never be any recessions in the first place!

Keynes is most famous now for his advocacy of government intervention during the Great Depression of the 1930s, which hit a chord with leaders such as Roosevelt in the US, who implemented the "New Deal" in response to the crisis. The idea was simple: unemployment was high, and was acting as a drag on demand.

The "solution" was for the government to inject a massive stimulus into the economy by initiating large-scale infrastructure and construction programs, such as the Hoover Dam. The theory was that by reducing unemployment workers would gain wages that they could then spend in order to increase demand. The need for materials and tools in these public-works programs also helped to fill the order books of many private companies.

The reality is, however, that the New Deal did not solve anything. The Great Depression lasted all the way up until the onset of WWII. Nevertheless, politicians and economists nowadays once again look towards the idea of a New Deal.

The only problem is, however, that governments across the world don't have any money anymore with which to stimulate their economies. Having bailed out bank after bank, sovereign debt in the advanced capitalist countries is already too high for the nervous credit markets.

At the end of the day, government spending must be financed either by taxes or by running a deficit and borrowing. But credit markets are already worried about the ability of governments to pay back their debts, hence why austerity was forced upon populations in country after country. Meanwhile, any additional taxes must either be gained from workers or from businesses; but extra taxes on workers act like a cut into wages and thus bite into demand, defeating the original point of government stimulus (i.e. to stimulate demand), whilst higher taxes on businesses cut into profits, leading to a strike of capital and a fall in investment.

THE PREDICTED "CRISIS OF OVER-PRODUCTION"

Marx explained that it is investment in production by capitalists that is the driving force behind capitalism.

The competition between different individual capitalists forces each one to invest in production in the search for higher profits. By investing in new, more productive machinery and processes, a capitalist can increase the productivity of his/her workforce, and thus produce a greater mass of commodities with fewer workers.

This, in turn, allows the capitalist to decrease their costs and thus lower their prices below those offered by their rivals. In this way, an individual capitalist can gain market share and obtain super-profits. These profits are, for the most part, ploughed back into production by the capitalists, thus increasing productivity even further.

Marx also explained, however, that there are inherent contradictions in this process, arising from the fact that, on the one hand, workers are only paid back in wages a fraction of the value that they produce, i.e. the wealth that they create, but that, on the other hand***, these wages ultimately form the market, i.e. the effective demand, for the commodities that they are producing. This leads to what Marx called a "crisis of overproduction", in which capitalists cannot sell their commodities and thus realize their profits.***

Under capitalism, where the means of production are privately owned, production is for profit; therefore, when profit cannot be realized, production will stop and millions are consigned to unemployment.

This is the situation that the world faced during the Great Depression and that the global economy faces now. It was not the New Deal or any other Keynesian measures that pulled the world out of a depression in the 1930s, but rather it was the vast destruction of capital during WWII and the expansion of the global market following the war. These factors, amongst many others, paved the way for the "Golden Age" of capitalism in the 1950s and 60s, when the economy saw its fastest ever growth.

Ted Grant explained these factors behind the post-war boom in a pamphlet entitled "Will There Be a Slump?":

> "What then are the basic reasons for the developments of the post-second world war economy?
>
> The political failure of the Stalinists and the social democrats, in Britain and Western Europe, created the political climate for a recovery of capitalism.
>
> The effects of the war, in the destruction of consumer and capital goods, created a big market (war has effects similar to, but deeper than, a slump in the destruction of capital). These effects, according to United Nations' statisticians, only disappeared in 1958.
>
> The Marshall Plan and other economic aid assisted the recovery of Western Europe.
>
> The enormously increased investment in industry.
>
> The growth of new industry - plastics, aluminium, rockets, electronics, atomic energy and by-products.
>
> The increasing output of the newer industries - chemicals, artificial fibres, synthetic rubber, plastics, rapid rise in light metals, aluminium, magnesium, electric household equipment, natural gas, electric energy, building activity.
>
> The enormous amounts of fictitious capital, created by the armaments expenditure, which amount to 10 per cent of the national income in Britain and America.
> The new market for capital and engineering products, created by the weakening of imperialism in the undeveloped countries, which has given the local bourgeoisie the increased opportunity to develop industry on a greater scale than ever before.
>
> All these factors interact on one another. The increased demand for raw materials, through the development of industry in the metropolitan countries in its turn, reacts on the undeveloped countries and vice-versa.
> The increasing trade, especially in capital goods and engineering products, between the capitalist countries, consequent on the increased economic investment, in its turn acts as a spur.
>
> The role of state intervention in stimulating economic activity.

"All these factors explain the increase in production since the war. But the decisive factor has been the increased scope for capital investment, which is the main engine of capitalist development." (Ted Grant, "Will There Be a Slump?", 1960)

> Similarly, the global economy was able to grow during the 1980s and 90s due to a combination of other factors: the expansion of the market into Russia, Eastern Europe, and China; the cheaper workforce in these countries that became available to capitalism; the squeezing of the working class in the advanced capitalist countries following the defeat of the labour movement and the breakup of the trade unions; and the use of credit to artificially expand the market.
>
> These periods of boom are reflected in the figures for stock market returns, calculated by Credit Suisse and provided by The Economist in an article on asset returns (The Economist, 15th October 2011). Between 1949-59, real stock market returns globally were 562%. Thanks to the role of Marshall Aid and the other factors given by Ted Grant above, the figures for Germany and Japan over the same period were 4094% and 1565%. Global stock market returns were 255% in 1980-89 and 114% in 1990-99. Interestingly, The Economist does not provide the figures for 1931-38 or for 1975-79.

A MODERN CULTURE THAT DOESN'T SUPPORT MASSIVE INDUSTRY CREATING""RISK INVESTMENTS"

Nothing demonstrates the depth of the crisis today more than the complete lack of investment by the capitalists in real production. In the same article as above, The Economist highlights that capitalists are not investing, despite profit margins that "are close to a 50-year high". The reason for this is the excess capacity, i.e. the overproduction that already exists within the system. Why invest in real production when there are already too many commodities being produced than can be sold?

There is plenty of money in the world, but it is concentrated into relatively few hands; hands that are unwilling and unable to invest in production. As The Economist explains:

> "Almost every asset class seems to be fraught with danger. Equities have suffered two bear markets in just over a decade and remain vulnerable to a rich-world recession; government bonds offer little protection against resurgence of inflation; commodities are volatile and hostage to a possible drop in Chinese demand; property is still suffering from indigestion after the past decade's boom."

Instead of investing their wealth back into production, the bourgeoisie are putting their money into speculative activity. Hence we see the rising price of gold and of other precious metals, of the Swiss franc (leading to the Swiss government actively intervening to keep their currency low) and other currencies, and of commodities such as staple foods and oil. This speculation, in turn, contributes towards inflation.

In their desperation, governments have been forced towards a policy of printing money through "quantitative easing". They are throwing money at the capitalists, pleading with them to invest in real production, create jobs, and get the economy growing again. The capitalists, however, cannot be forced to invest their wealth. Under capitalism, investment will be done on the basis of making, increasing, and realizing a profit. If this cannot be done, investment in real production will grind to a halt.
The need for socialism

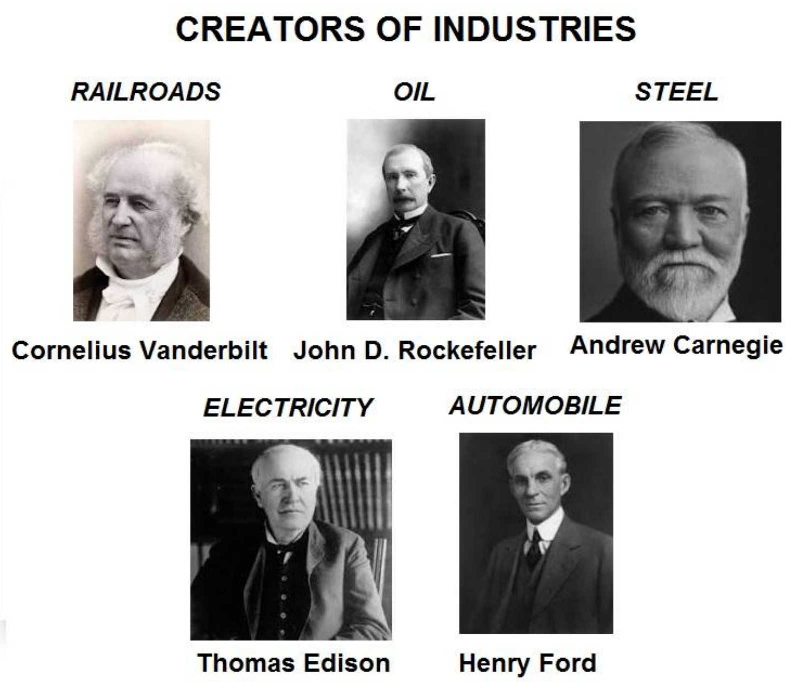
The senility of capitalism and the organic nature of this crisis – a crisis of overproduction – are aptly shown by this lack of investment that one sees in the economy today. In addition, one sees the objective need for socialism, i.e. the need to invest the vast amounts of wealth that exist in society for the need of people not profit.

Instead of looking towards Keynes and trying to "stimulate growth" in the economy, the leadership of the working class should look towards Marx and take control of the commanding heights of the economy. Concretely, this means nationalizing the banks and the major monopolies – without one penny of compensation for the capitalists – and using these assets to invest in what society democratically agrees is needed.

Under capitalism, the productive potential for society is hemmed in by two great contradictions:
the private ownership of the means of production and the nation state.

OBSERVATIONS

- Today we have a Lack of Corporate Risk Taking
- Today we have "Professional Managers" versus Visionaries
- Today "Board of Directors" are paid for Risk Mitigation not to encourage bold, long term initiatives.



Today We Have:

- Franchisees versus Creative Small Business Entrepreneurs - i.e. Chains versus "Ma & Pa" Small Business,
- The Steve Jobs (Visionary Genius) versus the Warren Buffetts (VaR Allocation Managers)

FURTHER READING

Wall Street Journal: [The Economy's Hidden Problem: We're out of Big Ideas]

Dwindling gains in science, medicine and technology hold back growth; is America too risk-averse?

> By all appearances, we're in a golden age of innovation. Every month sees new advances in artificial intelligence, gene therapy, robotics and software apps. Research and development as a share of gross domestic product is near an all-time high. There are more scientists and engineers in the U.S. than ever before.
>
> None of this has translated into meaningful advances in Americans' standard of living.
>
> Economies grow by equipping an expanding workforce with more capital such as equipment, software and buildings, then combining capital and labor more creatively. This last element, called "total factor productivity," captures the contribution of innovation. Its growth peaked in the 1950s at 3.4% a year as prior breakthroughs such as electricity, aviation and antibiotics reached their maximum impact. It has steadily slowed since and averaged a pathetic 0.5% for the current decade.
>
> Outside of personal technology, improvements in everyday life have been incremental, not revolutionary. Houses, appliances and cars look much like they did a generation ago. Airplanes fly no faster than in the 1960s. None of the 20 most-prescribed drugs in the U.S. came to market in the past decade.

The innovation slump is a key reason the American standards of living have stagnated since 2000. Indeed, absent a turnaround, that stagnation is likely to continue, deepening the malaise that has left the middle class so dissatisfied.

Economists hotly debate the reasons, but there are several clear forces at play. The hurdles for transforming ideas into commercially successful products have grown. The low-hanging fruit in science, medicine and technology has been harvested and new advances are costlier, more complex and more prone to failure. Innovation comes through trial and error, but society has grown less tolerant of risk.

Regulations have raised the bar for commercializing new ideas while directing a growing share of innovative effort toward goals with benefits, such as cleaner air, that don't translate into gross domestic product. Meanwhile, a trend toward industry concentration may have made it harder for upstart innovators to gain a toehold.

The innovation drought isn't insoluble. Capital is plentiful, and some of the hype is valid: Old-line companies and upstart entrepreneurs alike are making high-risk bets on cars, space travel and drones, and some policy makers are trying to tolerate more risk so that these bets succeed. READ MORE

REACHING UNSUSTAINABLE DEBT

A "Back of the Envelope" Over the Kitchen Table Explanation

A simple way to quickly grasp the problem of unsustainable debt is to consider the size of the global debt in relationship to the size of the global economy.

A global debt burden of $220T and assuming a minimal carrying cost of ~1.9% would suggest that approximately $4.18T would be consumed annually to just service the existing global debt burden.

With a global economy of ~$71T and using a currently aggressive economic growth rate of ~2.5% would mean the economy is only generating $1.78T of economic wealth to service the $4.18T of debt burden.

The annual gap of ~2.4T is presently being "plugged" by the Central Bankers increasing their balance sheets by $200B per month or the required gap of $2.4T annually.

Global Debt	~$220T	
Global Average Yield	~1.9%	
Annual Debt Burden	~ $4.18T	
Global GDP	~$71T	
Global Growth	~2.5%	
Global Wealth Creation	~$1.78	
	======	
Gap	~$2.4T	Annual
Central Bank ~ $200B/Mo	~$2.4T	Annual

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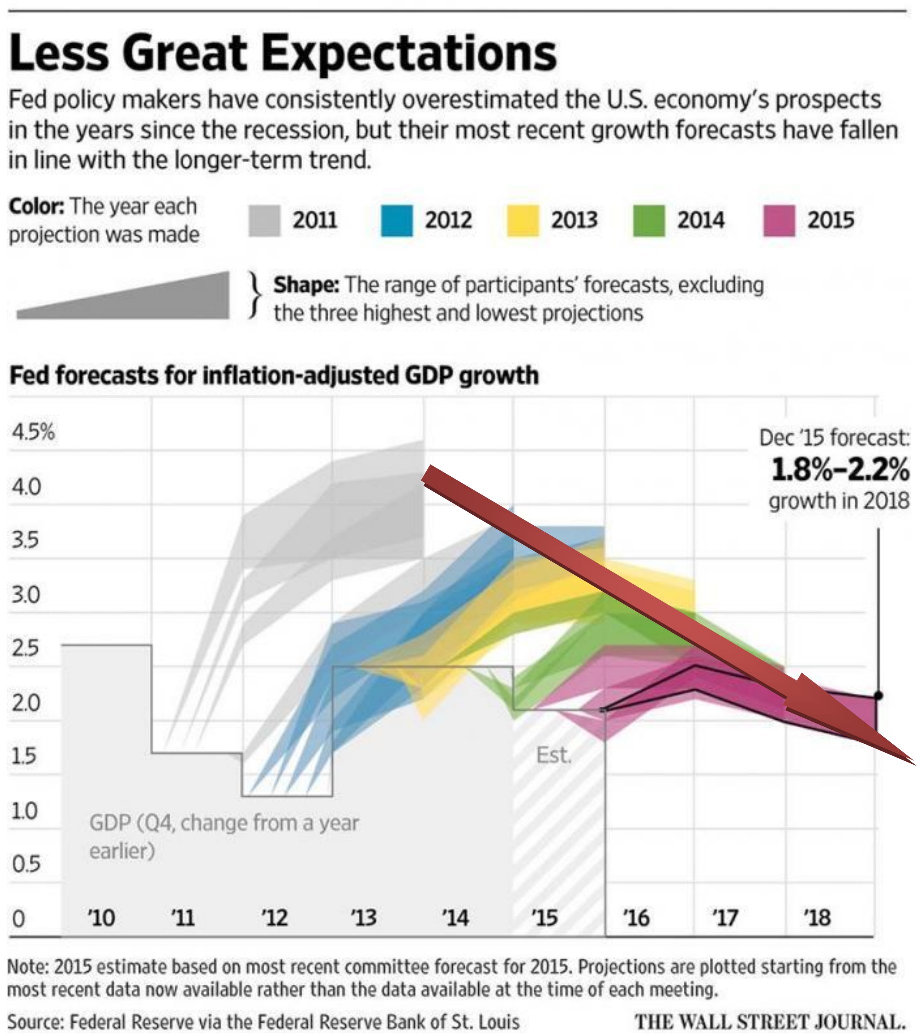
3- A FLAWED GDP FORMULA

KEY MESSAGES

1. In 1980 the Global Balance of Payments was changed to allow a Credit Balance. This allowed the global banks to become the conduit for an era of debt financed globalization.
2. As a consequence Japan's export lead Mercantile Strategy came into existence based on US Deficit Spending, Current Account and Trade Balance,
3. The foreign funding of US Debt by the global exporting nations (to the US), as well as through the mechanics of both the Triffin & Gibson Paradox's allowed for US Money Expansion while maintaining falling Interest Rates thereby fostered US Consumer Consumption to the obscene level of 70% of the economy.
4. Aggressive changes in Fiduciary accounting regulations fostered the acceleration of "Financialization" of the US Economy,
5. Real Inflation in the US now approaches 10% based on 1980 methodologies that don't include statistical aberrations such as "Hedonics", "Substitution" nor "Imputation" etc.
6. Real Global GDP growth is likely currently shrinking at a rate in access of 2% annually,
7. To maintain the Illusion of Growth the US is forced to maintain a "Strong Dollar" policy at all cost which controls US foreign policy and the US military strategy.



THE "DEFLATOR"

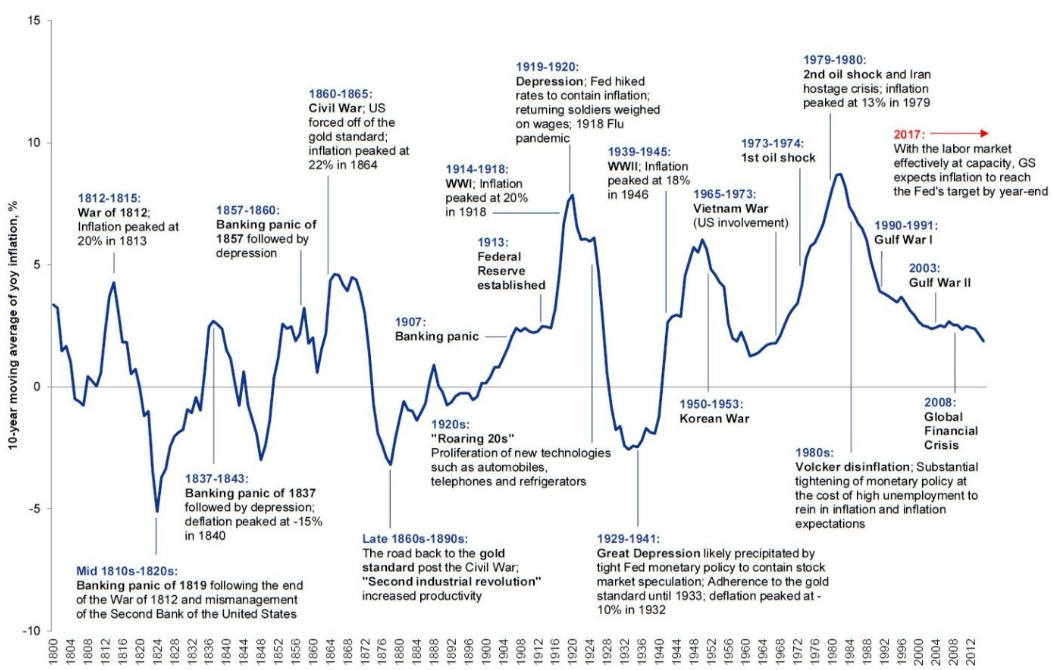
The nominal GDP is adjusted by the "Deflator" for inflation to give Real GDP.

If we accept that Nominal GDP is accurate then we must have confidence in the Deflator since GDP is typically reported as Real GDP. The Deflator (if you care to dig through the morass) is presently reported as ~1.8%. Does that even remotely sound reasonable to you as a representation of inflation?

Well it isn't! Let's examine inflation as represented by the CPI to give us a sense of what is going on here.

The following chart shows the long history of US CPI inflation. You will notice that starting at the end of WWII inflation begins to rise quite rapidly until approximately 1980, when it mysteriously begins to rapidly fall.

The long history of US CPI inflation



What exactly began happening in 1980?

THE GLOBAL BALANCE OF PAYMENTS BECOMES A CREDIT BALANCE

Interest rates were ~19% as Federal Reserve Chairman Volker fought US inflation aggressively. It is accepted that he broke the price inflation cycle and thereafter interest rates began to fall almost nonstop for close to 4 decades.

What isn't understood nor appreciated is that it was at this time that it was initiated that International Balance of Payments would no longer be settled on an annual basis by payments of Gold or other acceptable assets.

Though the gold standard had ended in 1968 by act of congress and the US gold window closed by Nixon in August of 1971, the annual Balance of Payments settlement system was still expected to be settled in some fashion up until 1980.

After 1980 "credit" was allowed as settlement for imbalances. If for example the imbalance between the US and China was a notional value of $200B of gold then the Chinese Bank was credited with $200B of assets.

With profound consequences this meant a country could now operate and settle financial accounts on effectively a "Credit Card".

EMERGENCE OF JAPAN'S EXPORT LEAD MERCANTILE STRATEGY

What followed was the emergence (by initially Japan), of an export led Asian, *Mercantile Strategy*.

- Cheap products were bought by the US from countries like Japan (today dominantly China and the Asian Tigers),
- The Credit to Japan allowed their banks to expand their credit through their fractional reserve banking system,
- This allowed Japans economic expansion capabilities and exploded its lending capabilities,
- Japan then strategically bought US Treasuries which helped finance the debt owed by the US, effectively a vendor financing plan,
- The buying of US Treasuries by Japan droves US interest rates down making it easier for Americans to consume more,
- Cheaper products from Japan also helped to reduce domestic costs and reduce price inflation,
- Reduced US Bond Yields also made US Treasury Bond Prices higher, increasing their collateral lending value and additionally increasing US banks ability (through capital ratio requirements) to lend more to US consumers for housing etc.
- This became the virtuous cycle we have experienced for the last 40 years. Until 2008.

Triffin's Paradox

The Trffin's Paradox which I have written extensively about and discussed with Charles Hugh Smith in numerous Macro Analytics videos is the about the mechanics of how an increase in the US Trade Deficit is actually positive for Foreign countries around the world. In fact, it has become their "economic life blood" for economic growth.

It also establishes the critical importance of what is referred to as the EuroDollar.

Gibson's Paradox

What we have described so far breaks down if the US Dollar becomes a problem because of inordinate trade balances. So how do you keep the US dollar from collapsing as debt increases and real US growth falls?

Removing the US dollar's convertibility to Gold is an initial step. Ensuring all oil in the world must be bought and sold in US dollars (the Petrodollar) is yet another. Both of these were implemented during the Nixon administration.

The less understood is the "General Price Level".

MV = PQ

- M is the Money Supply
- V is the Velocity of Circulation of Money
- P is the General Price Level
- Q is the Quantity of Goods & Services Transacted

Therefore:

MV = GDP   or V = GDP / M

P = GDP / Q

As simple as the above correlation is, it becomes quite interesting when we insert foreign deflationary pressures into "P" or the General Price Level.

Gibson's Paradox is the observation that the rate of interest and the general level of prices are positively correlated.[1] It is named for British economist Alfred Herbert Gibson who noted the correlation in a 1923 article for *Banker's Magazine*. The correlation had been noted earlier by Thomas Tooke.[2]

The term was first used by John Maynard Keynes, in his 1930 work, *A Treatise on Money*.[3] It was believed to be a paradox because most economic theorists predicted that the correlation would be negative. Keynes commented that the observed correlation was "one of the most completely established empirical facts in the whole field of quantitative economics."

The Quantity Theory of Money predicts that a slower money-growth creates slower price-rise. In addition, slower money-growth means slower growth of loanable funds and thus raises interest rates. If both these premises are true, slower money-growth should mean lower prices and higher interest rates. However, Gibson observed that lower prices were accompanied by a drop—rather than a rise—in interest rates.

This is the paradox that needs to be explained. For instance, in the 1873-96 depression, prices fell considerably while interest rates remained low. Economist S.B. Saul says that Alfred Marshall explained the paradox by saying that other factors might have been at play: a peace dividend and improving international system of banking and finance.

Economists generally thought that interest rates were correlated to the rate of inflation, whereas Keynes' findings contradicted this view. During the period of gold standard, he concluded that interest rates were correlated to the general price level, and not the rate of change in the prices. In fact, he thought that interest rates were highly correlated to the wholesale price index rather than the rate of inflation.[4]

Gibson's Paradox: Observed that i% was positively correlated with P. or Lower P meant lower i%

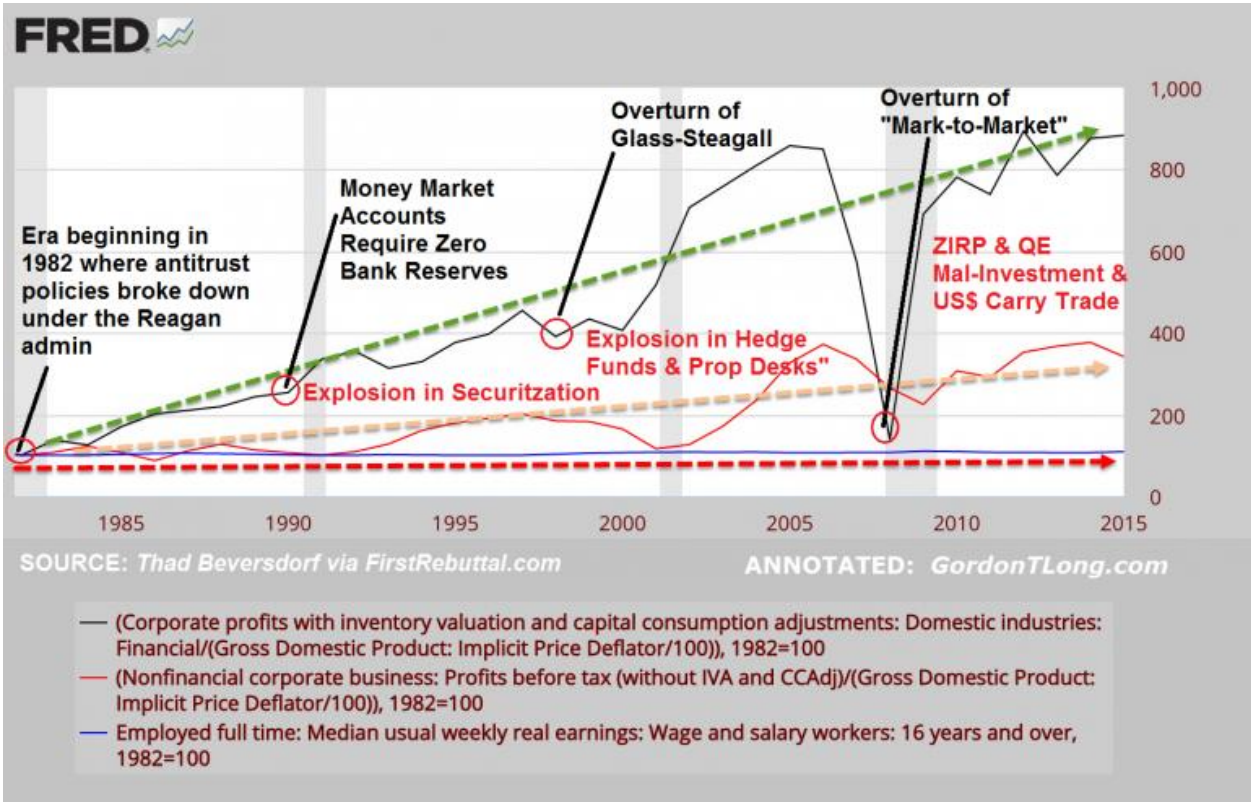
Therefore, if the US imported more from Japan then it would put downward pressures on "i%" because of effectively deflationary pressures. A drop in prices from cheap foreign imports further assisted in lowering interest rates (besides the buying of US Treasuries through the Mercantile Strategy) and thereby allowing the money supply to be increased which meant increased "loanable domestic funds".

Presto! We had a virtuous cycle as long as traders continued to accept the US dollar as stable.

"Loanable Domestic Funds" correspondingly exploded!

AGGRESSIVE FIDUCIARY ACCOUNTING CHANGES

Following the 1980 Global Balance of Payments change, the US began aggressive changes to the Fiduciary Accounting regulations.



THE MANADATORY "STRONG DOLLAR" POLICY

Of course this all works as long as the US dollar is accepted as fair compensation for Goods and Services supplied. Therefore it has been mandatory that the US maintain a strong dollar policy even if it hurt US exports or profits from foreign earnings declared on US Corporate earnings statements.

To maintain a strong dollar policy the US has had to distort the actual domestic inflation rate caused by the expansion of the money supply even with lower interest rates. Though lower interest rates helped finance growing US dollar deficit levels it still had to maintain the following illusions to maintain the value of the US dollar as at least a short term tradable "store of value" for exchange:

1. As Reasonably Low or "Managed" US Domestic Inflation rate,
2. Productivity Growth of the Labor Force and
3. Real Domestic Economic Growth.

We will discuss #2 and #3 later. Let's discuss Low Inflation further.

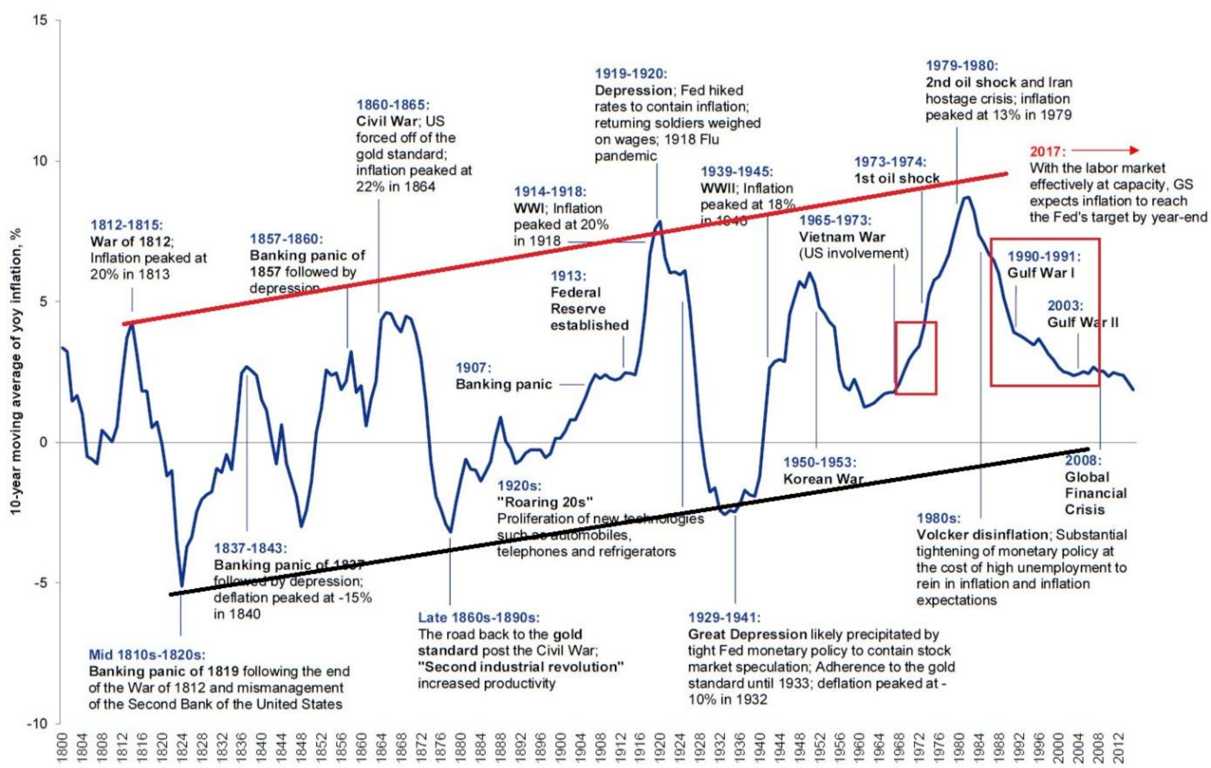
THE COSTS OF WAR – Putting it On the National Credit Card

To keep the US Economy growing (we will discuss the "G" in the GDP formula later) the government needed to aggressively spend and using the US "Credit Card"! Wars were an ideal way of doing this.

We can see that the Vietnam War was the first War the US funded by debt which forced it off the Gold standard and exploded inflation in the 1970's.

We see however after 1980 that the massive war expenses associated with the Gulf Wars apparently did not impact domestic inflation? We understand how they were financed but more was going on by then regarding the accounting and reporting of domestic inflation.

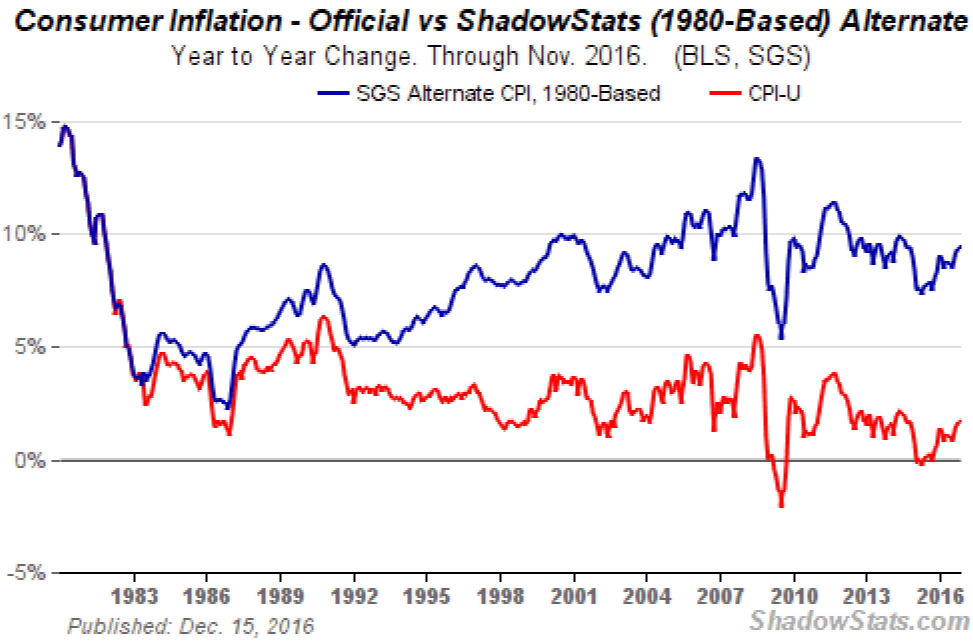
The long history of US CPI inflation



New statistical aberrations such as "Hedonics", "Substitution, "Imputation" and other "slights of hand" were wide spread in government numbers.

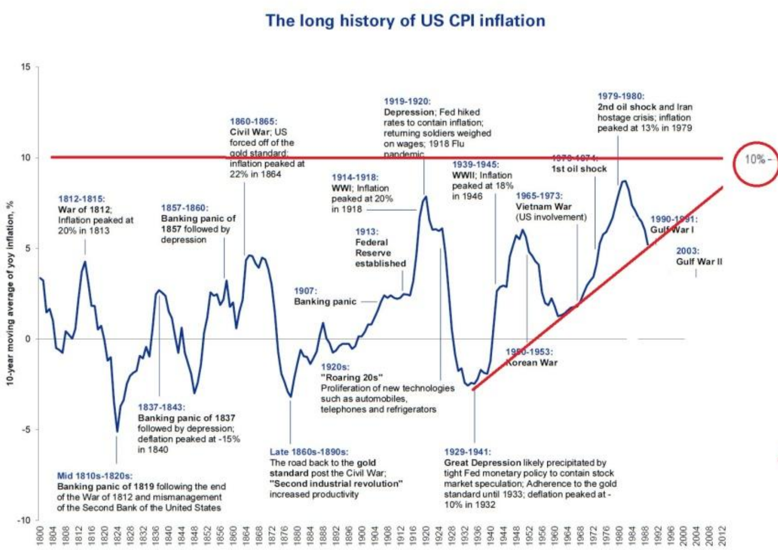
When we remove all these games and adjust accordingly we see the following chart which ShadowStats maintains.

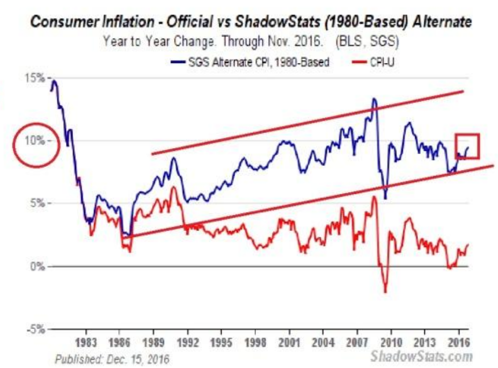
We see a completely different picture that frankly p[asses our common sense and what Amercians see on a daily basis.



Some simple overlays illustrate a completely different historical pattern!

We see US domestic inflation at a crippling rate approaching 10%





ADJUSTED TO PRE- SECULAR BOND BULL MARKET

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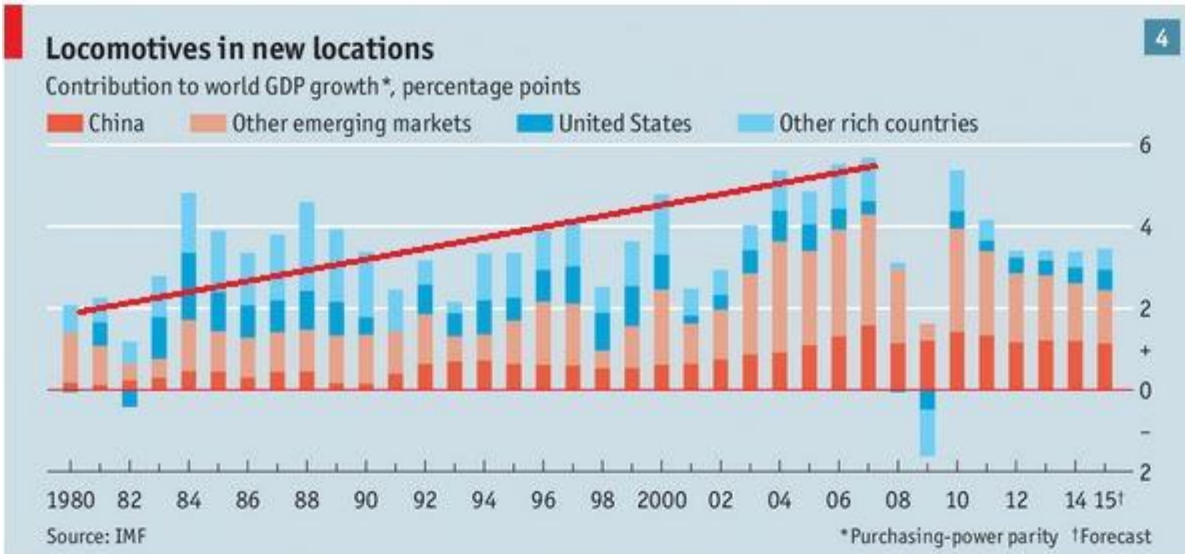
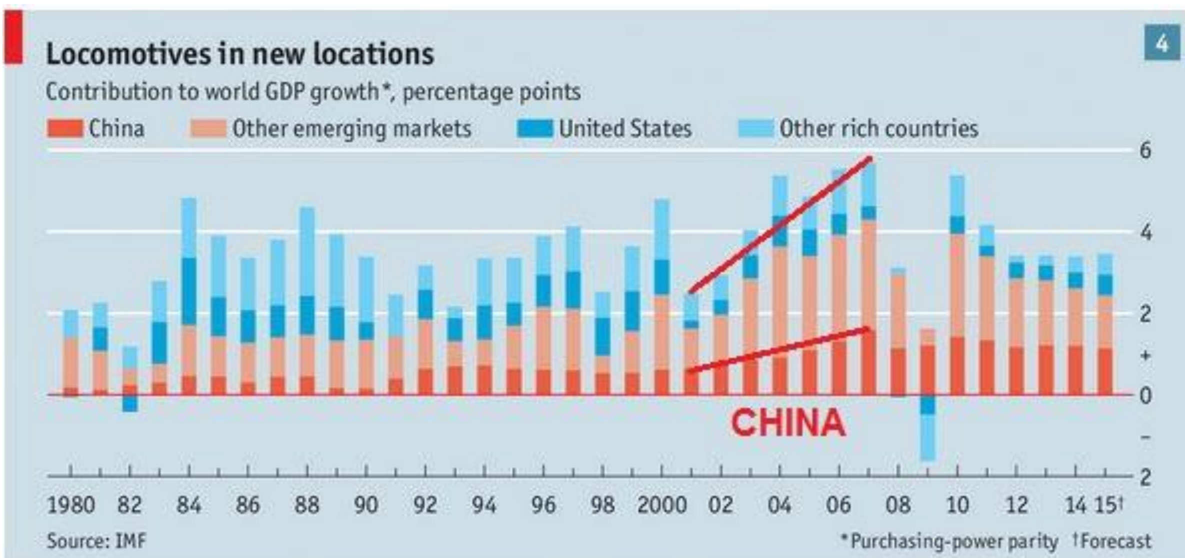
DEGREE OF ACCUMULATED DISTORTION

Let's shift from Inflation to GDP since 1980.

We see on the surface it has been reported as rising steadily until the 2007-2008 Financial Crisis.



We also see how since China entered the WTO it has become a keep contributor to Global GDP Growth



We can see the seriousness of the slowdown in the post Financial Crisis Era in Global GDP Growth.

When we overlay our previous analysis on inflation against the deflator used in Global GDP reporting we arrive at quite a different picture.

We stress we have been overly conservative in this chart.

We believe the situation is in fact much worse!

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4-PRODUCTIVITY EXPOSES THE MYTH

KEY MESSAGES

1. In a 70% Consumption Economy the current level of government transfer payments funding this consumption makes the historic GDP Formula misleading and therefore meaningless,
2. The current level of government spending by all three levels of US government, financed by fiscal deficit financing versus tax receipts additionally makes the historic GDP formula misleading,
3. The current level of Investment into Productive Assets is now so low that it makes the "I" in the GDP formula nothing more than a measure of the rate of money supply growth and debt creation. This also makes the GDP formula misleading and misrepresentative.
4. The "M" in the GDP formula (Exports minus Imports) has become a Trade Deficit for the US over the last three decades (and most developed nations). Therefore developed economies now consume more than they produce. This is an unsustainable economic condition.
5. The statistics of a falling 10 Year Corporate Rolling Compounded Annual Nominal EPS confirms that there is hardly any real growth occurring in the US, Europe or World Wide.
6. Steadily falling Productivity is contrary to the basic premise of a Capitalist Economy.

UNDERSTANDING THE GDP ILLUSION

The GDP number that is continuously touted to represent economic growth is an outdated aberration from an era prior to Globalization, Fiat Currencies and Balance of Payments which were not previously settled on Credit.

It is a completely distorted formula that no longer represents how an economy in a global economy operates.

Let me try and explain.

FORMULA BASICS:

GDP = private consumption + gross private investment + government spending + (exports - imports)

or, as it is commonly expressed in algebraic shorthand :

GDP = C + I + G + (X-M)

In the new report the values for that equation (total dollars, percentage of the total GDP, and contribution to the final percentage growth number) are as follows :

GDP Components Table

	Total GDP	=	C	+	I	+	G	+	(X-M)
Annual $ (trillions)	$17.7	=	$12.1	+	$3.0	+	$3.2	+	$-0.6
% of GDP	100.0%	=	68.4%	+	16.7%	+	18.0%	+	-3.1%
Contribution to GDP Growth %	2.18%	=	2.83%	+	0.83%	+	-0.32%	+	-1.16%

Example of GDP Formula *(end of 2014)*

What does this formula realistically tell you about economic growth?

CRIPPLING DISTORTIONS

Level of Transfer Payments versus Consumption

How can an economy exist in a global economy with 70% consumption?

Nominal GDP was $18.4T at the end of Q2 2016. This compared to $15.5T five years previously at the end of Q2 2011. This is a $2.9T increase while entitlements or government transfer payments now total over $2.5T.

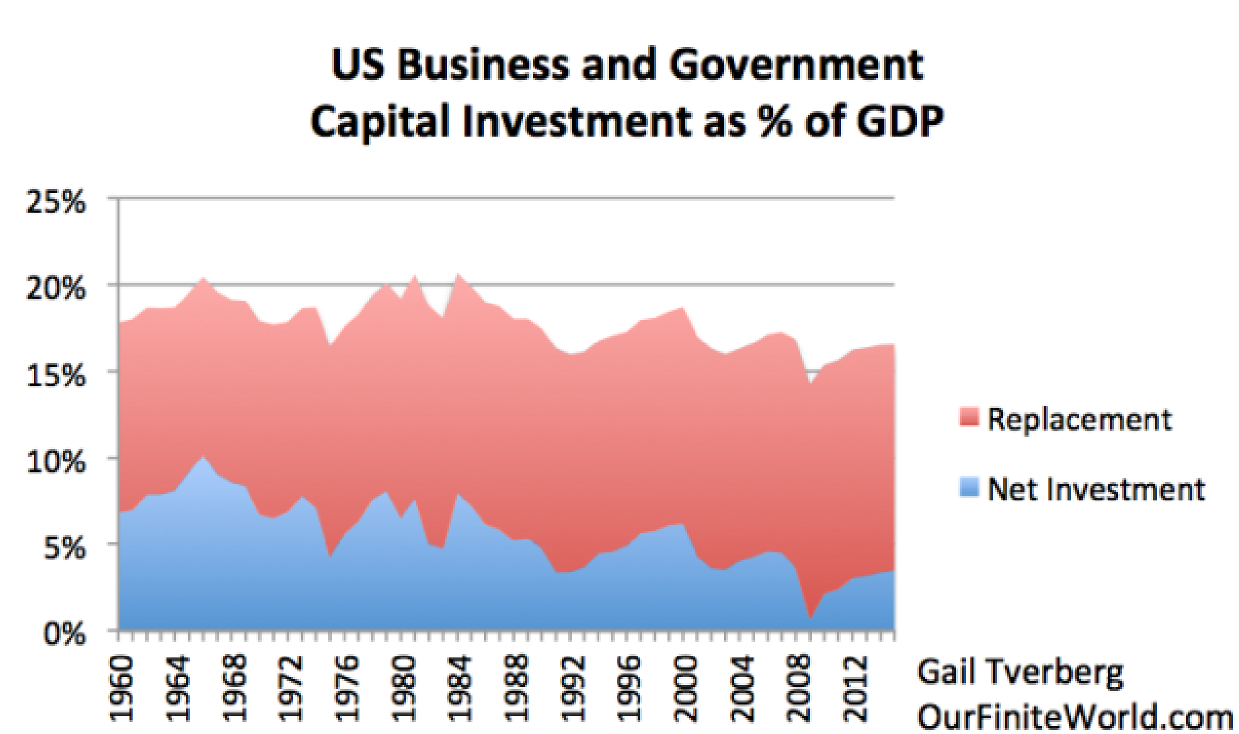
The "G" has become very large and is dominated by "Transfer Payments". These "Transfer Payments" are then added to the "C" as entitlement and welfare recipients spend for consumption. It's called double accounting or "double dipping". But who cares if it gives the impression that GDP has 1% growth

Level of Government Spending in the Economy

Government at the Federal, State and Local level is now a dominate part of the US Economy and has come to be primarily funded from Deficit Financing versus Tax Receipts. All levels of Government is now approaching 30% of the US Economy.

Level of Investment in Productive Assets

Investment in the formula is now leveraged & pyramided debt financing versus from the Savings of Investment in productive assets.



There no longer is Household Savings. Today a households FICO score is paramount with most families a single paycheck away from disaster.

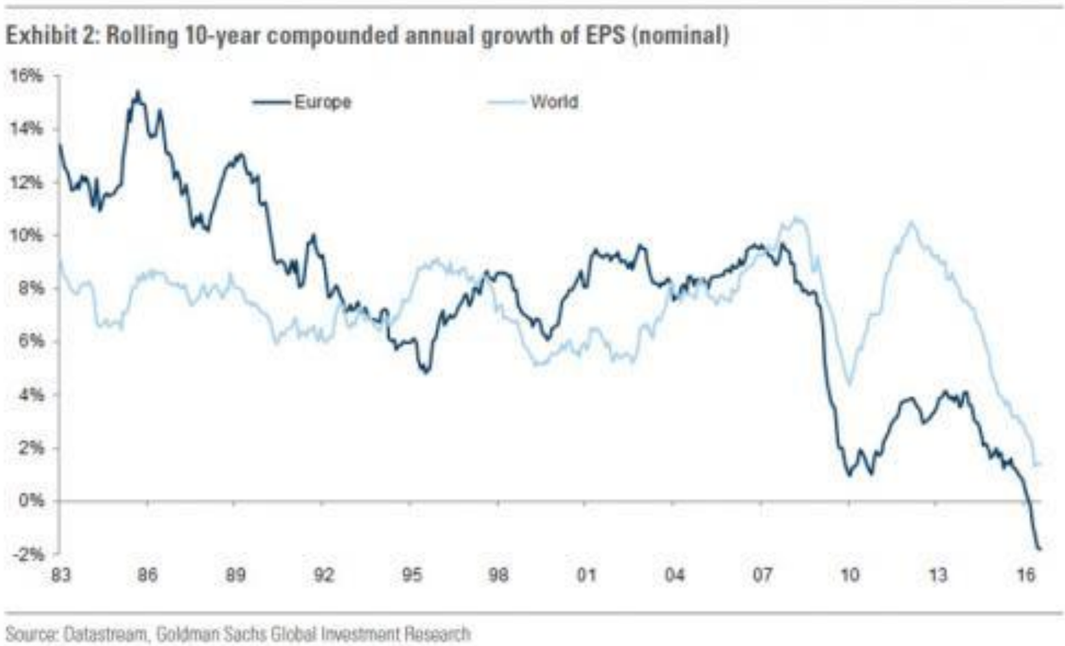
Level of Trade Deficits

The "M" or Exports minus Imports has become a Trade Deficit in the US and most developed nations since they now consume more than they produce.

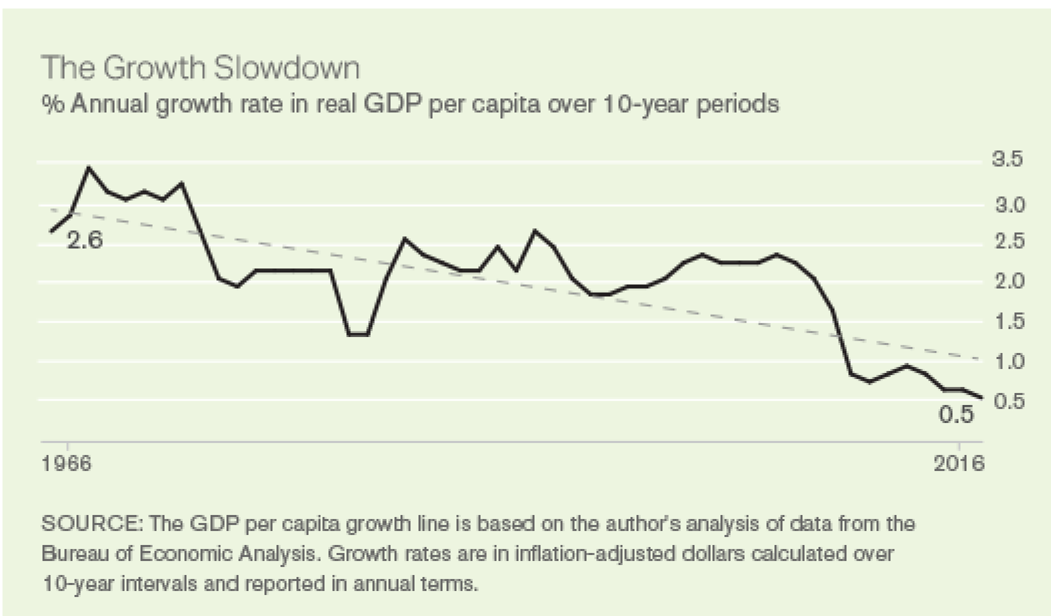
How does this any longer represent growth?

Level of Real EPS Growth

Goldman's Peter Oppenheimer (summarized here), shows something stunning. The 10-year rolling nominal earnings growth rate has collapsed to -1.8% in Europe and has fallen to record lows for the global equity market.



Level of "Real" GDP Per Capita



FURTHER RESEARCH YOU SHOULD CONSIDER READING:

Failed Transmission - Evidence on the Futility of Activist Fed Policy *John P. Hussman, Ph.D.*

The Matrix Exposed - Zero Hedge - TRADE AGREEMENTS A MAJOR CATALYST

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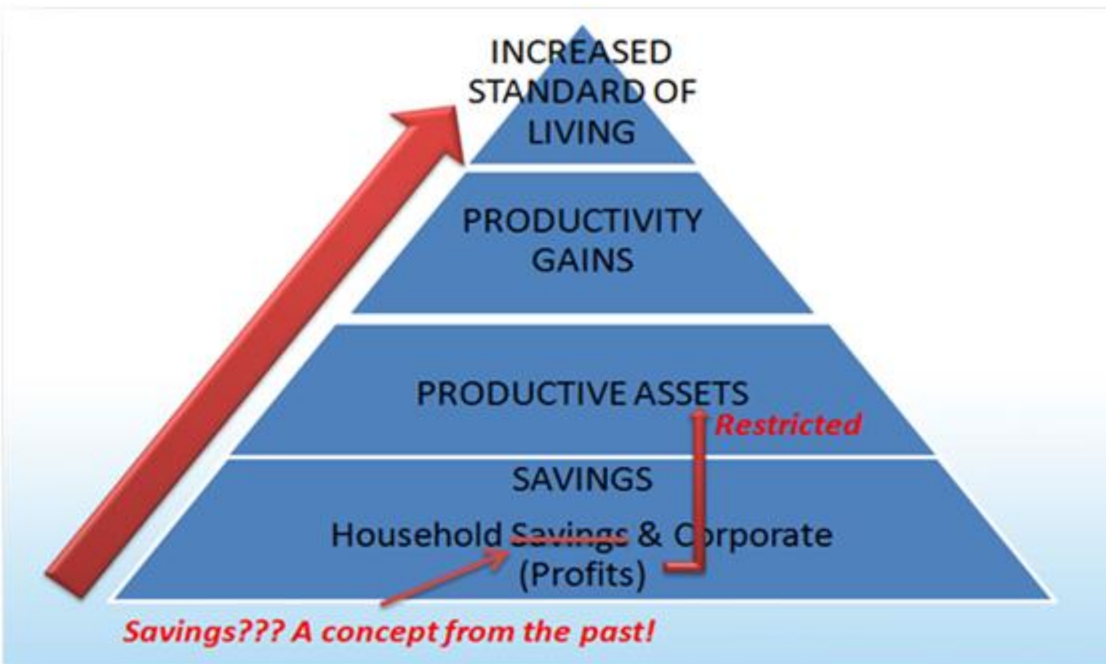
THE IMPORTANCE OF PRODUCTIVITY

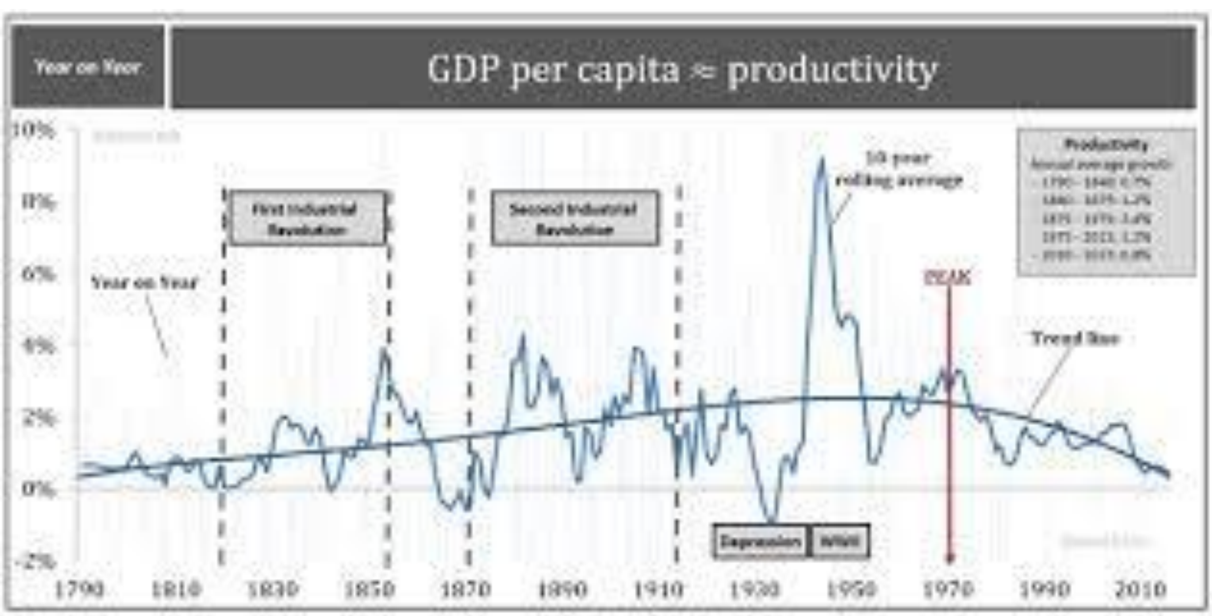
In a healthy capitalist environment we have this flow:

Savings > Productive Assets > Productivity > Rising Standard of Living



Unfortunately as I have written about previously, this is not what is presently occurring.

The key here is actually productivity. We actually have savings when we consider corporate profits being at record levels. It is about how this profit is being used.



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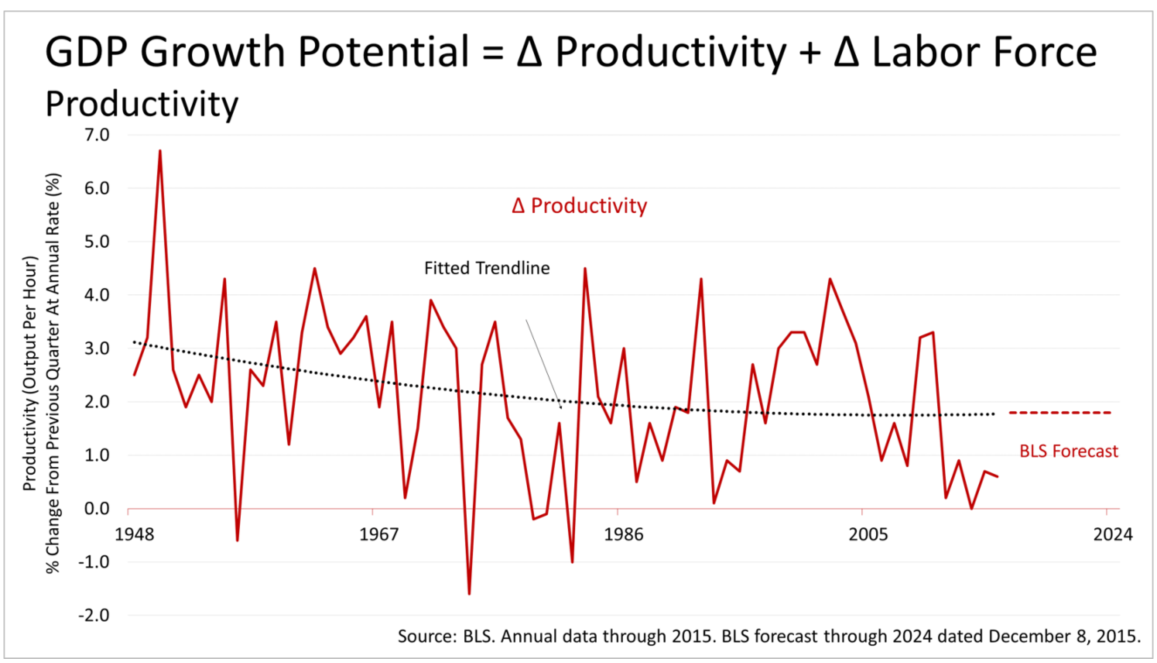
Productivity has been steadily falling in most developed economies for some time now

When you understand that the GDP Growth Potential is the addition of the change in productivity plus the change in the labor force you begin to see the compounding problem facing the developed economies.



... and it is getting worse at an accelerating rate.

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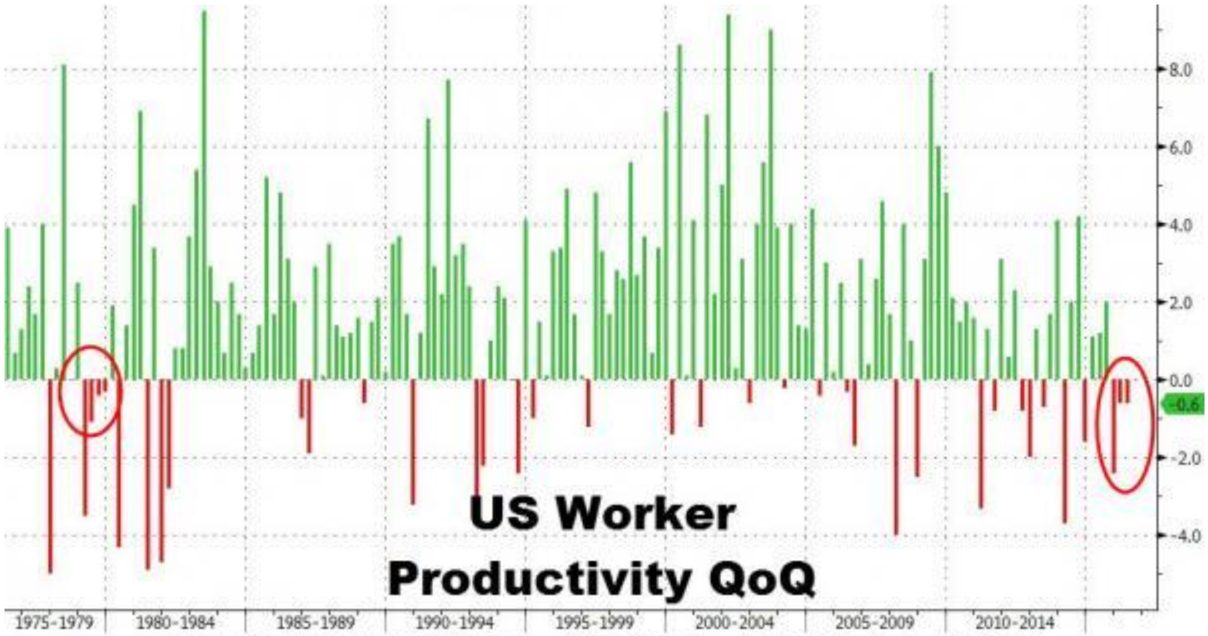
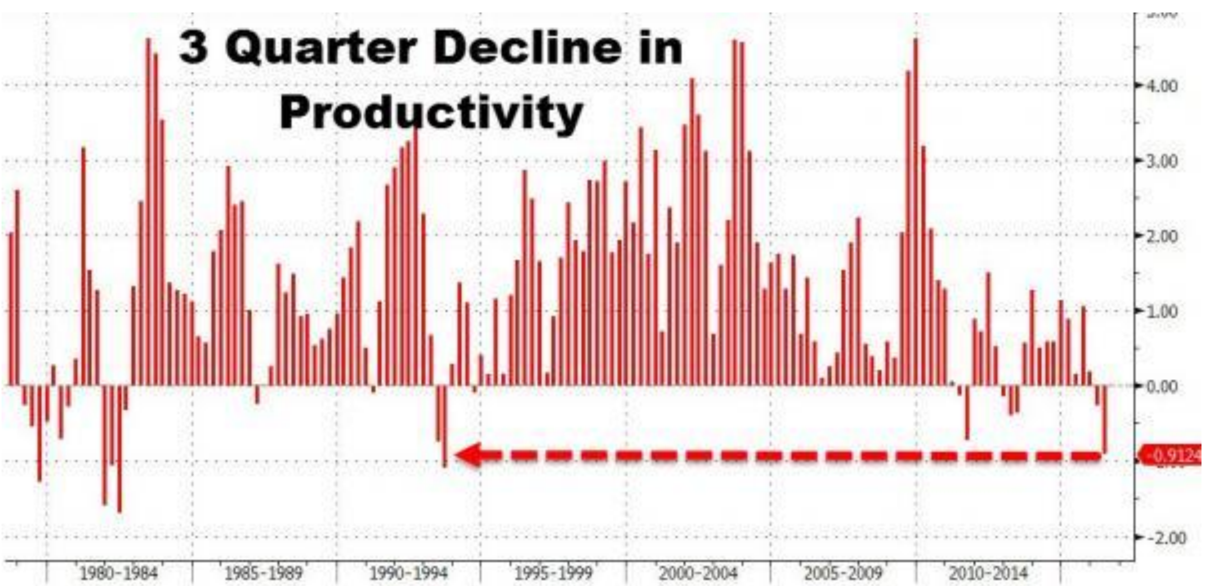
Though the previous charts were all longer term views on productivity we have witnessed acceleration with the last three quarters all falling. The 3rd quarterly decline - the first instance since 1979...And the last 3 quarters are the biggest plunge in productivity since 1993 (thanks to a doubling of unit labor costs from expectations of +2.1% to +4.3%).





We are now seeing the results of the failed use by corporations to effectively increase productivity by the use of their profits and the dramatic increase in their debt loads. It has become a game of financial engineering versus productive use of capital.

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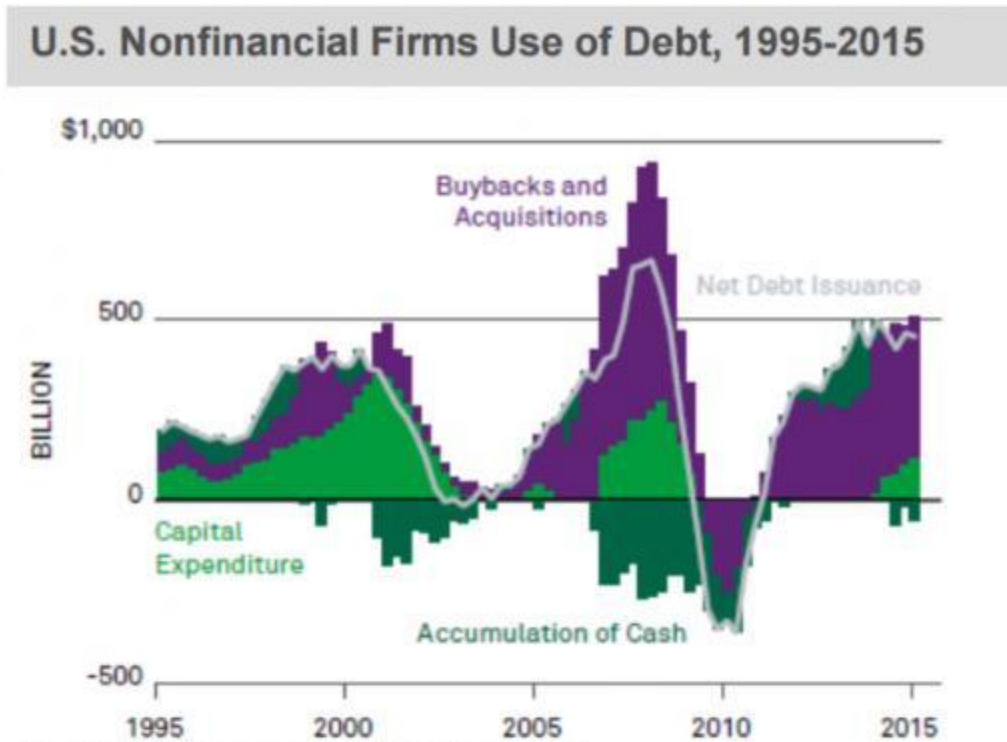
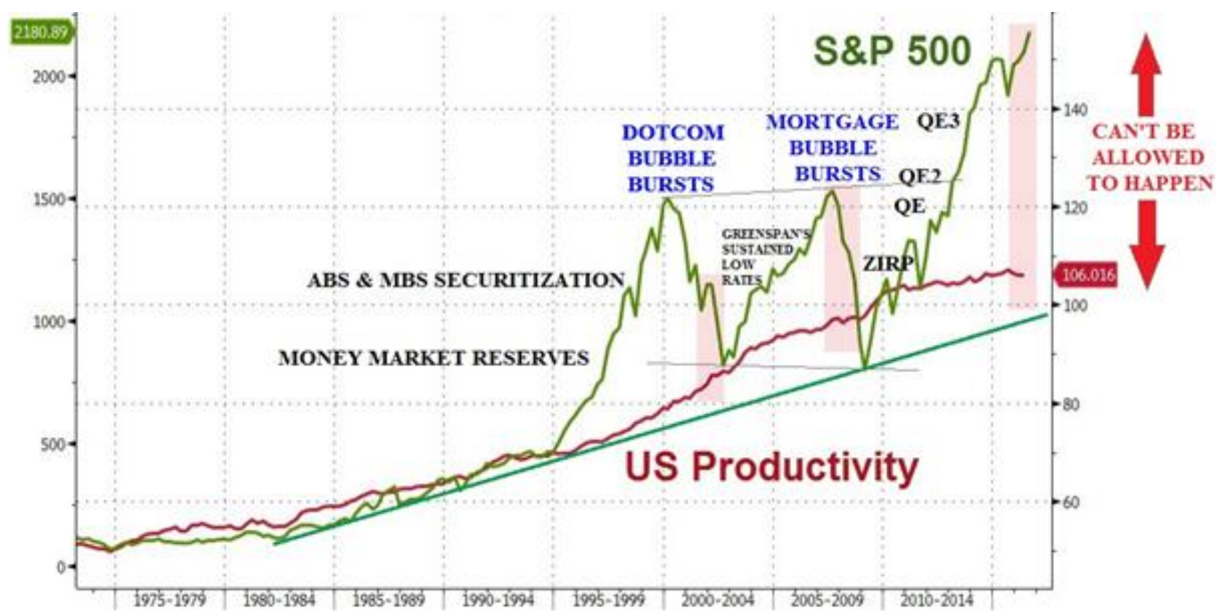
US Corporate debt was not used productively



Sources: BlackRock Investment Institute, Federal Reserve and IMF

This has led us to the point where in fact the central bankers are not being forced to prop up the financial markets because any draw down would be devastating. We effectively created a giant Ponzi scheme either intentionally through greed, or unwittingly due to lack of regulatory vigilance and governing neglect.



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As I said initially, if the world and US specifically has actually been experiencing an economic recovery for the last seven years, why would 14% to 15% of all Americans be dependent on food stamps to survive?

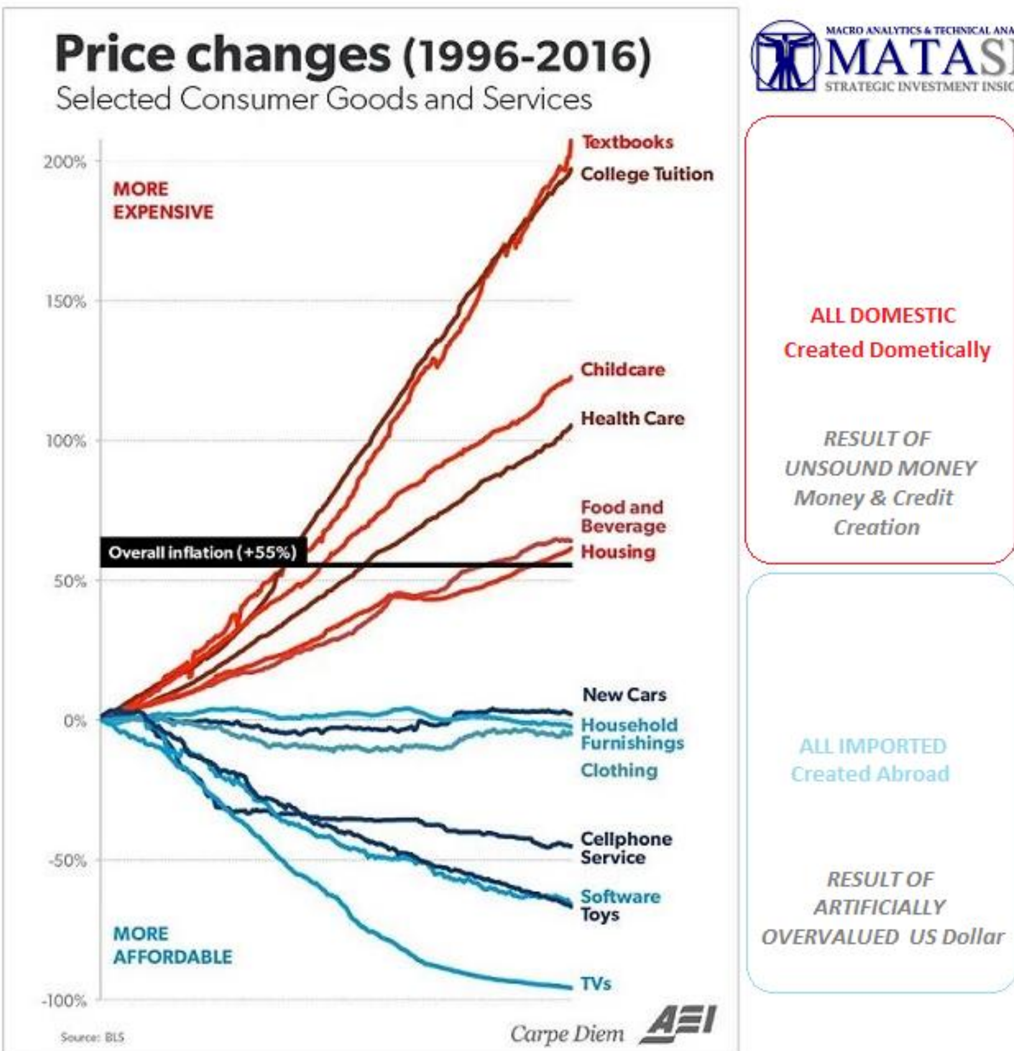
When the economy is actually growing and employment is really below 5%, the percentage of Americans on food stamps is below 8%. If the government economic data was truthful, there would not be 43.5 million people living in 21.4 households (17% of all households) dependent on food stamps.

More than 100 million Americans are now dependent on some form of federal welfare (not including Social Security or Medicare). If the economy came out of recession in the second half of 2009, why would 6 million more Americans need to go on welfare over the next two years?

CREATING WEALTH - Creating & Producing 'Things'

This graphic starts to get to real cause. We have massive global economic imbalance. It is evident when you consider we have dramatic inflation in the US on products and services we create. it isn't because Americans are smart or aren't working hard - because they are. It is the result of Unsound Money practices regarding Money and Credit Creation.

The products we buy or import are actually falling in this graphic and this is a result of a dramatically and artificially over valued US dollar!



My Macro Analytics guest Michael Snyder writes in a paper From An Industrial Economy To A Paper Economy - The Stunning Decline Of Manufacturing In America:

"In order to have a sustainable economy, you have got to have people creating and producing things of value. A debt-based paper economy may seem to work for a while, but eventually the whole thing inevitably comes crashing down when faith in the paper is lost.

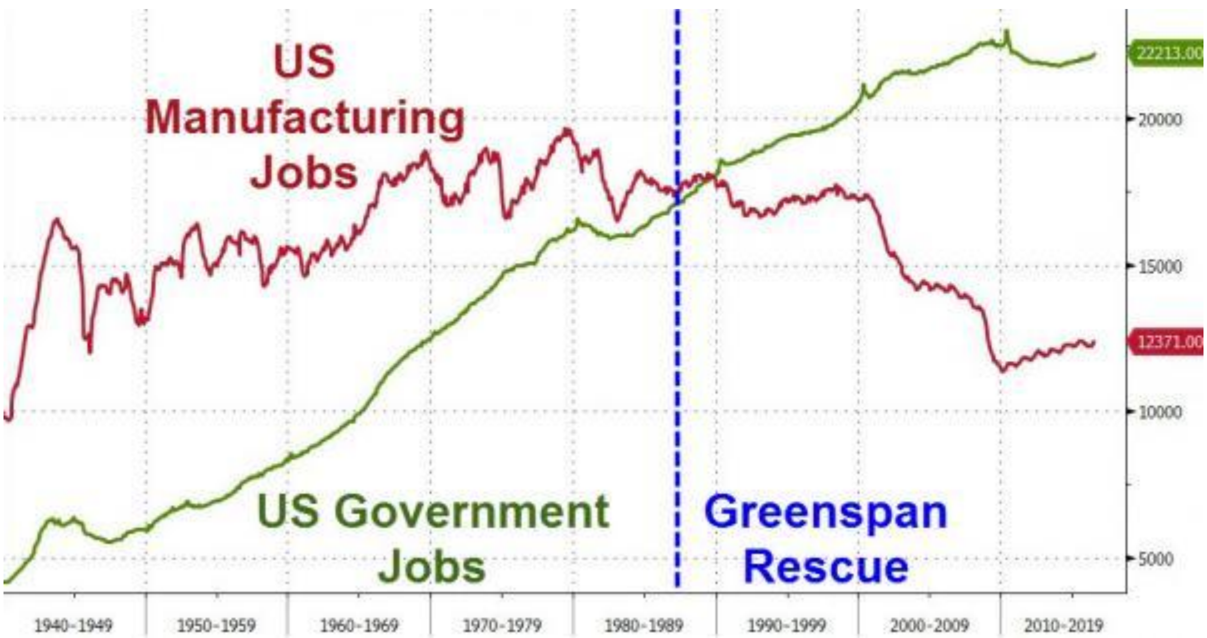
The total number of government employees in the United States exceeds the total number of manufacturing employees by almost 10 million…

Government employees in the United States outnumber manufacturing employees by 9,932,000, according to data released today by the Bureau of Labor Statistics.

Federal, state and local government employed 22,213,000 people in August, while the manufacturing sector employed 12,281,000.

The BLS has published seasonally-adjusted month-by-month employment data for both government and manufacturing going back to 1939. For half a century—from January 1939 through July 1989—manufacturing employment always exceeded government employment in the United States, according to these numbers.

You might be thinking that government jobs are “good jobs”, but the truth is that they don’t produce wealth.



Government employees are really good at pushing paper around and telling other people what to do, but in most instances they don’t actually make anything.

Back in 1960, 24 percent of all American workers worked in manufacturing. Today, that number has **shriveled all the way down to just 8 percent.** CNN is calling it “the Great Shift”…

In 1960, about one in four American workers had a job in manufacturing. Today fewer than one in 10 are employed in the sector, according to government data.

Call it the Great Shift. Workers transitioned from the fields to the factories. Now they are moving from factories to service counters and health care centers. **The fastest growing jobs in America now are nurses, personal care aides, cooks, waiters, retail salespersons and operations managers**.

No wonder the middle class is shrinking so rapidly. There aren’t too many cooks, waiters or retail salespersons that can ANY LONGER support a middle class family.

Since the turn of the century, we have lost more than 50,000 manufacturing facilities. Meanwhile, tens of thousands of gleaming new factories have been erected in places like China, India, Mexico etc.

As Bridgewater's Ray Dalio said recently:

"We have reached the limits" of [central banks] "ability to stimulate" the economy " and raise global asset prices.....there's only so much you can squeeze out of a debt cycle... we are there... you can't lower interest rates materially, and you are also at the limit on QE (because spreads are limited)..... Globally, those forces that were behind us are no longer there... we are at the end of a debt cycle... and everybody will have a lower growth rate than we are used to..... What I am contending is that there are limits to spending growth financed by a combination of debt and money. **When these limits are reached, it marks the end of the upward phase of the long-term debt cycle.**

In 1935, this scenario was dubbed "pushing on a string". This scenario reflects the reduced ability of the world's reserve currency central banks to be effective at easing when both interest can't be lowered and risk premia are too low to have quantitative easing be effective."

FURTHER READING

US COUNCIL ON COMPETITIVENESS: NO RECOVERY – An Analysis of Long-Term US Productivity Decline

> THE UNITED STATES HAS NOW had seven years to recover from the worst of the Great Recession. During that time, job growth has been steady, if unspectacular, and the unemployment rate has fallen from 10% to just under 5%, where it stands as of this writing. Stock prices, meanwhile, continue to reach and surpass new highs. Leading politicians and commentators reassure the public that everything is getting better. And yet, there is a pervasive sense that the economy is not working, as documented in Gallup survey data and many anecdotal media accounts.
>
> The people are right. The economy is not working well. But the problems did not start with the Great Recession. For decades, the nation's income, measured as GDP, has barely grown overall; on a per capita basis, median household income peaked in 1999; the subjective general health status of Americans has declined, even adjusting for the aging population; disability rates are higher; learning has stagnated; fewer new businesses are being launched; more workers are involuntarily stuck in part-time jobs or out of the labor force entirely; and the income ranks of grown children are no less tied to the income ranks of their parents READ MORE

WHAT ARE THE CENTRAL BANKERS SO AFRAID OF?

Why the Unprecedented Global Liquidity Pumping?

Global central bank liquidity injections have never been greater, and as of this moment, have surpassed all previous post-financial crisis central bank intervention.

As a matter of fact we are now pumping over $200B / month.

Why is this required after 8 years since the Financial Crisis and after a full apparent economic recovery???

The Fiat Currency Cartel

This following chart which was recently outdated by the UK's BOE announcements, pushed it over $200B as part of Bernanke's "Enrich-Thy-Neighbor" Doctrine to keep asset prices elevated.

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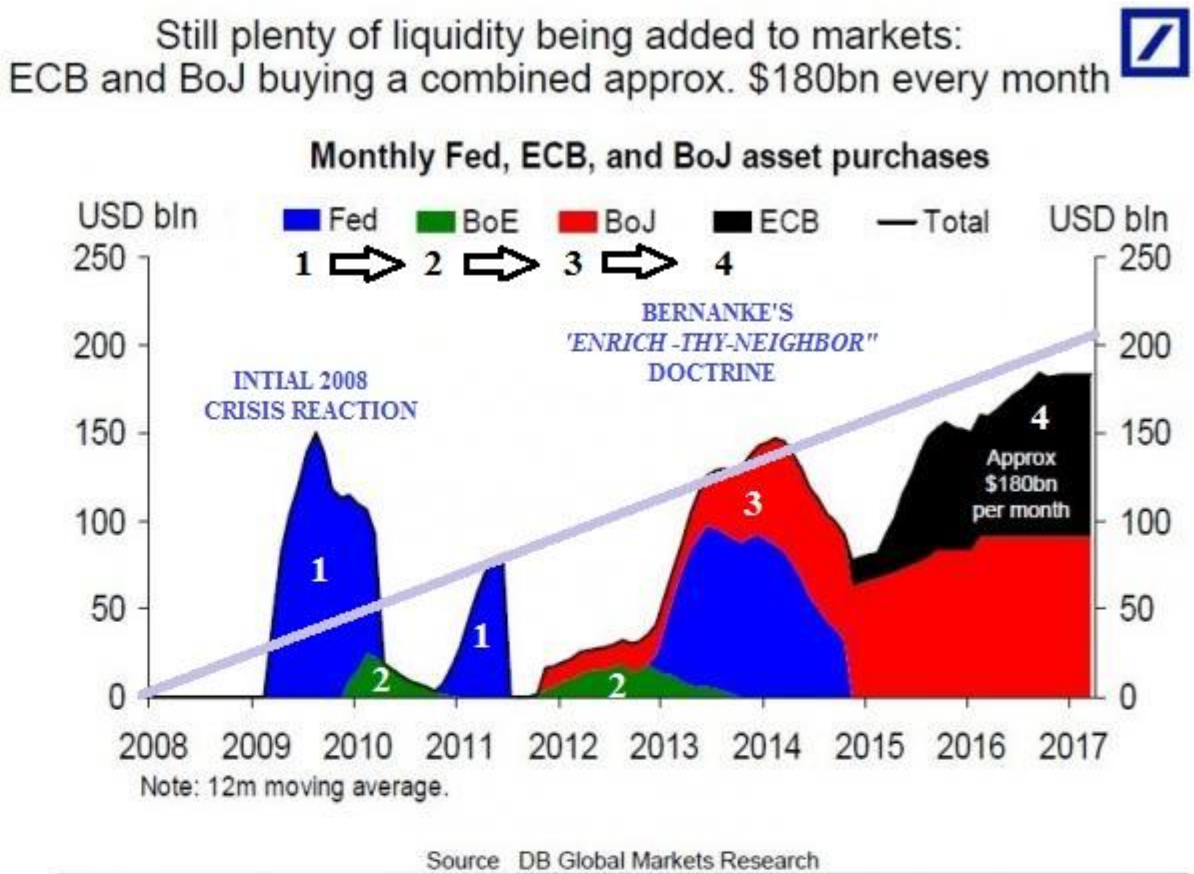


Collectively this means central bank liquidity is actually close to being as high as it's been at any point post GFC **even with the US Federal Reserve's QE program having been halted two years ago.**

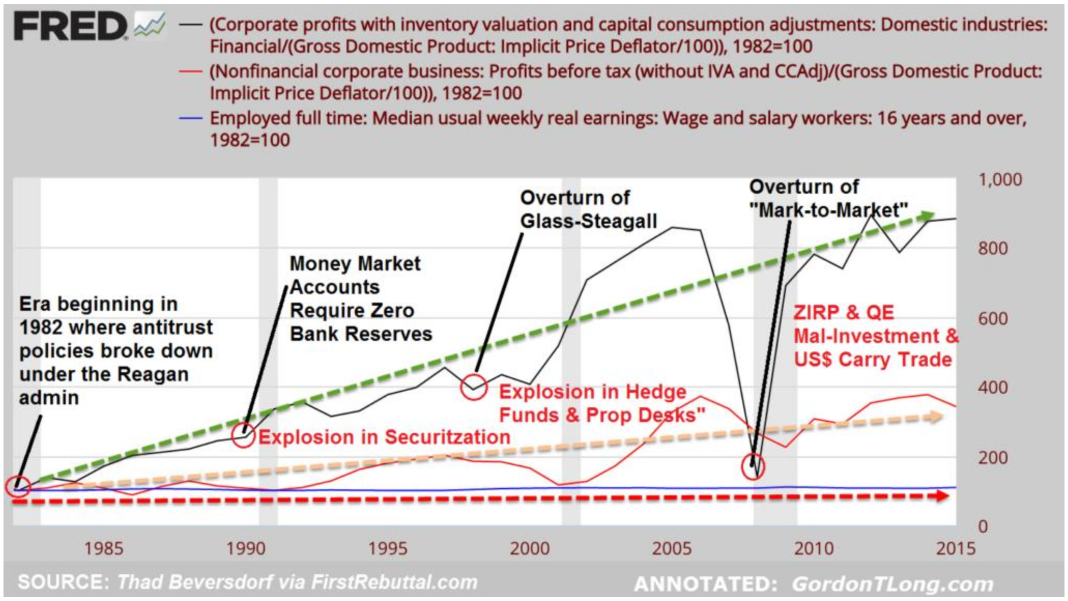
As Deutsche Bank's Jim Reid points out, "it's difficult at the moment to fight the central bank in the credit market, especially in Europe and the UK where they are a non price sensitive buyer of the asset class. Even outside of these asset purchase programs it's fair to say that global policy continues to be remarkably loose. Of the main central banks the Fed has been largely neutralized even if they manage to add a fresh hike in September or December, and the ECB and BoJ have increased and expanded the scope of their QE programs with the BoE recommencing theirs after a nearly four-year break."

The question is if we accept what we are told about the post 2008 financial crisis recovery, why after nearly 8 years we still need such unprecedented programs. Monetary programs which only get more aggressive by the day?

This Recovery is an Illusion!

The simple truth is that the recovery is a statistical illusion.

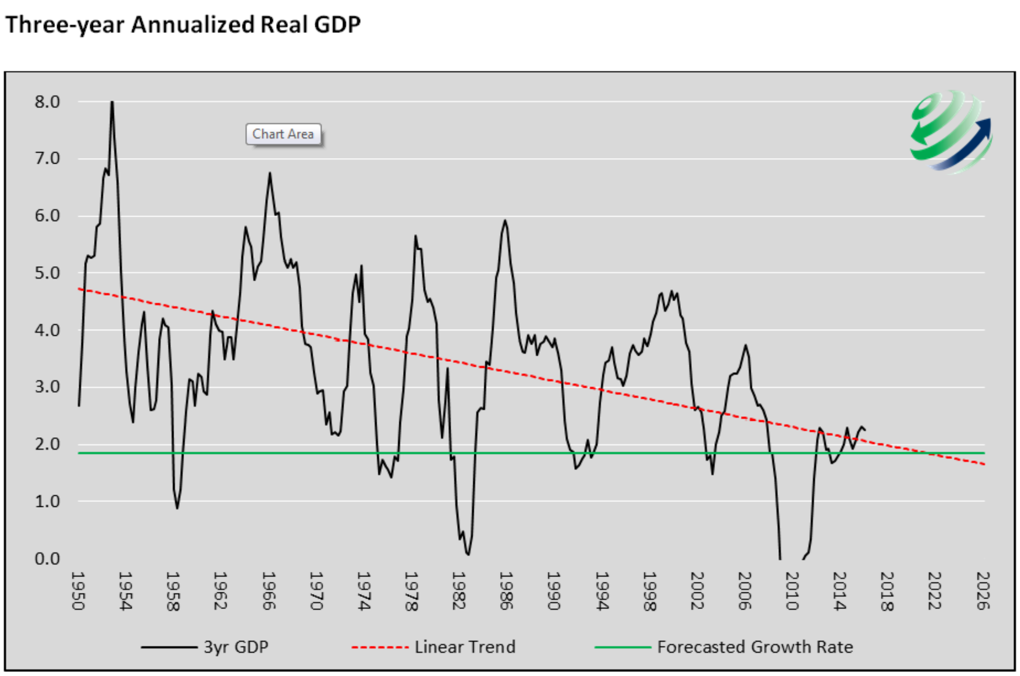
We buy it because our traditional "measures" of this like the stock and bond markets are suggesting this is the case. In actuality they are telling us the absolute opposite. The games that have been played to keep asset prices elevated have fooled us. Maybe we just wanted to be fooled? But as you will see in a moment there are 10's of millions of Americans who are not fooled as they face the realities of daily life. This is most evident in the political movements that have supported such unlikely Presidential candidates such as Bernie Sanders and Donald Trump.



An Illusion of Growth

What we need to fully grasp is that the chief trend around us is an ongoing permanent worldwide economic slowing and when properly analyzed with valid statistics is in fact a contraction.

The absence of this "growth," is defined by the employment and productivity statistics which I will also discuss in a moment.

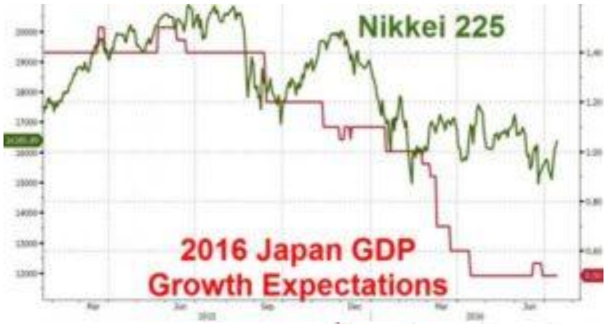


Data Courtesy: St. Louis Federal Reserve (FRED)

The charts I am showing here, as I talk are in fact much worse than they appear - as bad as they are!

As is usually the case with troubled, over-extended and corrupted societies, governing officials have begun to resort to magic to prop up failing economic policies.

This is why the Federal Reserve, once an obscure institution deep in the background of normal life, has become front and center, holding the rest of us literally spellbound with its incantations against the intractable ravages of debt deflation.



The rackets and swindles unleashed in our futile quest to keep up appearances have disabled the financial operating system that the ruling regime depends on. It's all an illusion sustained by accounting fraud to conceal promises that won't be kept.

All the mighty efforts of central bank authorities to borrow "wealth" from the future in the form of "money" — to "paper over" the absence of growth — will not conceal the impossibility of paying that borrowed money back. The future's revenge for these empty promises will be the disclosure that the supposed wealth is not really there — especially as represented in currencies, stock shares, bonds, and other ephemeral "instruments" designed to be storage vehicles for wealth.

The stocks are not worth what they pretend. The bonds will never be paid off. The currencies will not store value.

Global debt is over $200T. At even a 2% annual yield that is a bleed of $4T on the global economy. The global economy is reputed to be approximately $72T with a growth rate below 2%. That is $1.4T in growth annually to pay the $4T. Seeing the problem?

However this is yet only another symptom. Lets work ourselves towards the cause.

THE BAR-TENDER & WAITRESS ECONOMY

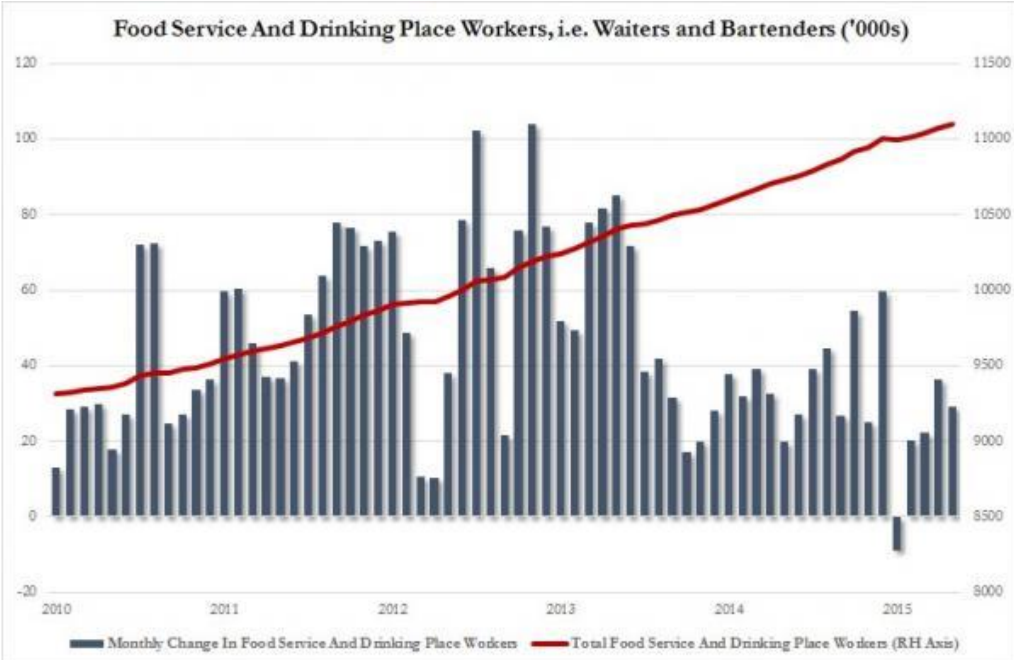
Since 2007 1.4 Million US Manufacturing Jobs were lost while 1.4 Million Waiter/Bartender Jobs were added. What we have is lost high paying jobs being substituted for low paying jobs. That is a reduced standard of living in everyone's eyes but the government statisticians!

Since the end of the financial crisis, economists, analysts, and the Federal Reserve have continued to point to the monthly employment reports as proof of the ongoing economic recovery. Even the White House has jumped on the bandwagon as the President has proudly latched onto the headlines of the *"longest stretch of employment gains since the 1990's."*

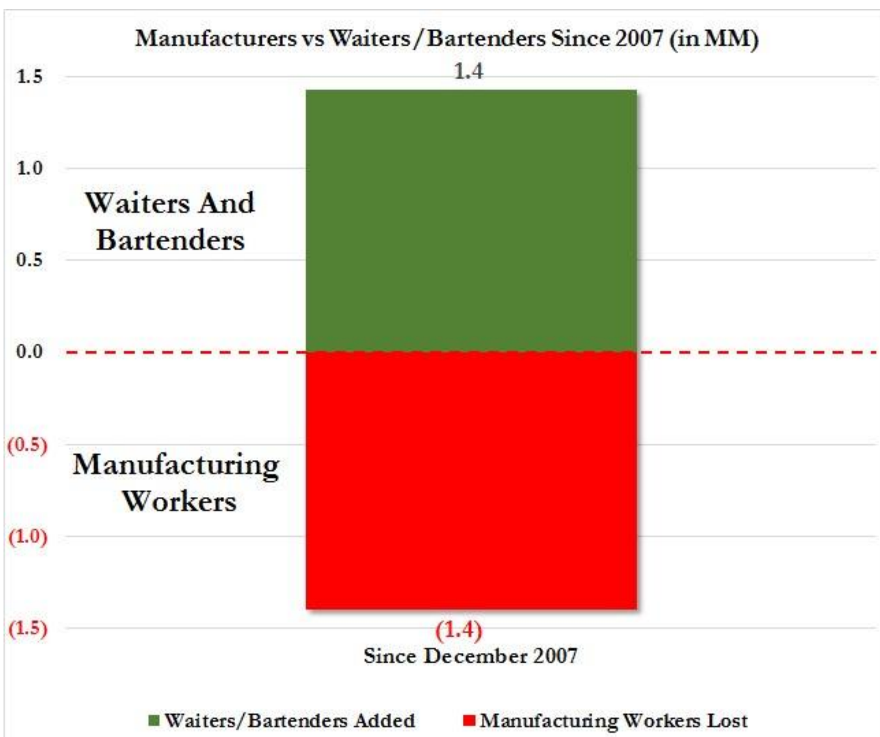
ZeroHedge continuously points out:

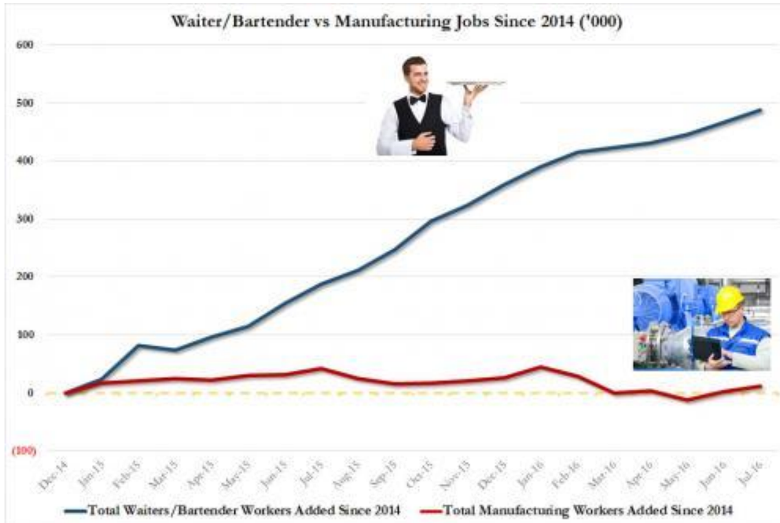
" ... in the past 65 months, or nearly five and a half years starting with March 2010, or when the jobs "recovery" really kicked in, jobs for waiters and bartenders (aka food service and drinking places) have declined just once. This is a statistically abnormal hit rate of nearly 99%, and one which we assume has everything to do with the BLS' charge of not so much reporting reality as finding loopholes in the goal seeked model to report that the US keeps adding over 200,000 jobs every month or bust.

Putting this number in context, the US has allegedly added 376K bartenders in the past year, and 3 million since March 2010.



And here is another, even more disturbing way of showing the "New Economy" - **since December 2014, the US has lost 1.4 million manufacturing workers. These have been replaced almost one to one, with new waiters and bartenders.** Win, win for everyone, especially the welfare state and of course, China.



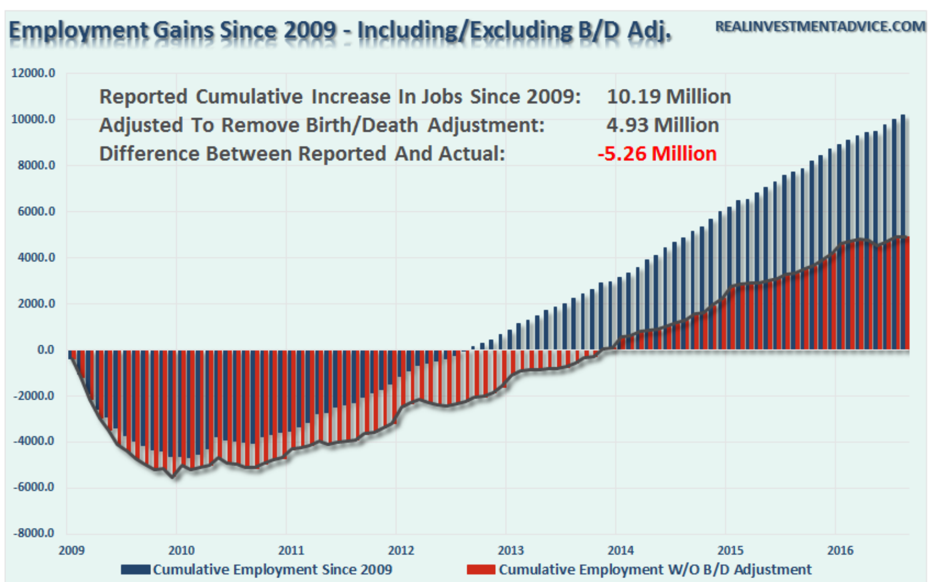


As [Lance Roberts reports]:

"This chart CLEARLY shows that the number of *"Births & Deaths"* of businesses since the financial crisis have been on the decline. Yet, each month, when the market gets the jobs report, we see roughly 180,000 plus jobs.

Included in those reports is an '*ADJUSTMENT'* by the BEA to account for the number of new businesses (jobs) that were *"birthed" (created)* during the reporting period. This number has generally 'added' jobs to the employment report each month.

The chart shows the differential in employment gains since 2009 when removing the additions to the monthly employment number though the *"Birth/Death"* adjustment. Real employment gains would be roughly **5.26 million less** if you actually accounted for the LOSS in jobs correctly"



THE ANSWER TO OUR QUESTION

So, what are the central bankers so afraid of?

I surmise they see that the global economic system is going to collapse under its own weight and there is nothing they can do about it except to try desperately to "kick the can down the road" by continuing with policies grounded in "extend and pretend"!

Our political leaders have failed us which is quite clear if you have had the stomach to follow the 2016 US Presidential race closely!

In over-leveraged economies, stock and bond markets become co-dependent. To sustain market prices, debt and equity require *nominal* output growth. To sustain market *values*, they require *real* output growth.

The only way to increase nominal output growth and raise nominal equity prices in a highly leveraged economy with leveraged currency is to raise the quantity of credit, which must eventually reduce real output and asset values. The question before us is whether “eventually” is occurring now.

The primary reason we think stocks are peaking is scale. Aggregate market caps, valuations, revenues and earnings of public companies cannot be sustained by the level of real production in the underlying US and global economy. We think bonds are on the eve of reconciliation for the same basic reason: the scale of systemic leverage has already begun to reduce incentives to expand credit for capital formation, which, in turn, promotes debt deflation.

We expect debt deflation coincident with central bank monetary inflation, which would offset the deflation…on paper (like feet in the oven, head in the freezer producing a reasonable average). Before this occurs, we expect a financial or economic event that focuses public attention on the leverage problem.

5-UNDERSTANDING WHAT GROWTH REALLY IS – *Capitalism versus Creditism versus Financialism*

KEY MESSAGES

1. The real yield received from debt loans or conversely the cost of debt borrowed are central to real economic growth
2. The limiting factor to real economic growth is the debt burden relative to the economic growth rate,
3. When interest rates rise, so does the Weighted Average Cost of Capital (WACC), which mathematically makes valuations, fall.
4. We now "Consume More than We Produce" versus "Producing More than We Consume",
5. We are now "Receiving Less for More versus Getting More for Less",
6. Because of "Financialization" of the Economy we have now skewed Innovation such that it is now targeted primarily at Cost Savings versus new high risk, high growth industries.

THE STRUCTURAL FLAW OF MONEY BEING LENT INTO EXISTENCE – An Achilles Heel

Most citizens do not fully appreciate that in the US "money" can only be "lent" into existence. That is, money is created when someone actually borrows money.

This is why the US Dollar "Bill" is a Federal Reserve "Note". These are debt instruments of the citizens of the US with the Federal Reserve Bank. Remember also, the Federal Reserve is a privately owned bank. The owners of the Federal Reserve being the US Banks with Reserves held at the US Federal Reserve Regional Banks.

If all debt were paid off there would be no money in circulation. Conversely, when money is not being created, debt is not growing.

If debt is not increasing the economy cannot grow because there would be insufficient liquidity to fund it.

We have a system that is predicated on debt and credit growth.

Therefore the cost or yield of this debt and the collateral available to secure it are central to real economic growth.

SUSTAINED CHEAP COST OF CAPITAL CHANGES BUSINESS INCENTIVES & BEHAVIOR

Equity versus Bond Yield -- Weighted Average cost of Capital (WACC)

My friend Adam Taggart who I have interviewed at the Financial Repression Authority recently outlined the problem of lending in **WACC Is Back: Getting Ready To Live In An Era Of Rising Rates** 12-05-16
Submitted by Adam Taggart via PeakProsperity.com,

> When I was fresh out of college in the mid-90s, I landed a job at Merrill Lynch. I was an "investment banking analyst", which meant I had no life outside of the office and hardly ever slept. I pretty much spoke, thought, and dreamed in Excel during those years.
>
> Much of my time there was spent building valuation models. These complicated spreadsheets were used to provide an air of quantitative validation to the answers the senior bankers otherwise pulled out of their derrieres to questions like: *Is the market under- or over-valuing this company? Can we defend the acquisition price we're recommending for this M&A deal? What should we price this IPO at?*
>
> Back then, Wall Street still (mostly) believed that fundamentals mattered. And one of the most widely-accepted methods for fundamentally valuing a company is the Discounted Cash Flow (or "DCF") method. I built a *lot* of DCF models back in those days.
>
> I promise not to get too wonky here, but in a nutshell, the DCF approach projects out the future cash flows a company is expected to generate given its growth prospects, profit margins, capital expenditures, etc. And because a dollar today is worth more than a dollar tomorrow, it discounts the

further-out projected cash flows more than the nearer-in ones. Add everything up, and the total you get is your answer to what the fair market value of the company is.

The Weighted Average Cost Of Capital

The DCF approach sounds pretty straightforward. And it is. But it's still much more of an art than a science. Your future cash flow stream is entirely dependent on the assumptions you bake into the model. The difference between a 5% or 15% assumed EBITDA compound annual growth rate becomes huge when projecting over 10+ years.

But one assumption in the model has far more impact on the final valuation number than any other. And it has nothing to do with the company's projected operations.

Recall that the DCF approach projects out the expected future cash flows, and then discounts them (back to what's called a "present value"). This raises a critically important question:

At what rate do you discount these future cash flows?

Well, to address this, you need to ask yourself a few questions. *How will the company be financing itself?* It will need to deliver an acceptable return to both its stockholders and bondholders. *What kind of return can investors get out in the market for a similar investment?* If they can get a better expected rate of return, or similar return with less risk, they'll put their money elsewhere.

Enter a calculation known as the **Weighted Average Cost Of Capital** (or "WACC"). Again, without getting too technical on you,

the WACC looks at how a company is capitalized (what % with debt, what % with equity) and what blended annual rate of return the investors who contributed that capital expect.

Once you've calculated the WACC, you put that number into your DCF model as the annual discount rate and -- *Voilà!* -- your model spits out the present value for the company.

It's All About The "Risk Free" Rate

So, to recap:

1. Companies (really, any asset with an income stream) are valued off of the present value of their discounted future cash flows
2. This present value is highly dependent on the discount rate used

We just talked about how the WACC is commonly used as the discount rate (or, at least, its foundation). So how is the WACC calculated?

Here's its formula (Don't let it scare you; I'm not going to get all mathy on you here):

$$\mathrm{WACC} = \frac{E}{D+E}(r_e) + \frac{D}{D+E}(r_d)(1-t)$$

Where:

E = market value of equity

D = market value of debt

r_e = cost of equity

r_d = cost of debt

t = corporate tax rate

I want to point your attention to two important factors in this equation: the cost of equity (r_e) and the cost of debt (r_d). The size of these variables has a big impact on the final number calculated for the WACC.

R_e, the cost of equity, is made up of two components: the market's current "risk free rate" + the "equity premium" that investors demand on top of that to hold stocks, which have more risk. Most folks use the current yield on the 10-year US Treasury bond as the risk free rate (which has hovered around 2% for the past several years).

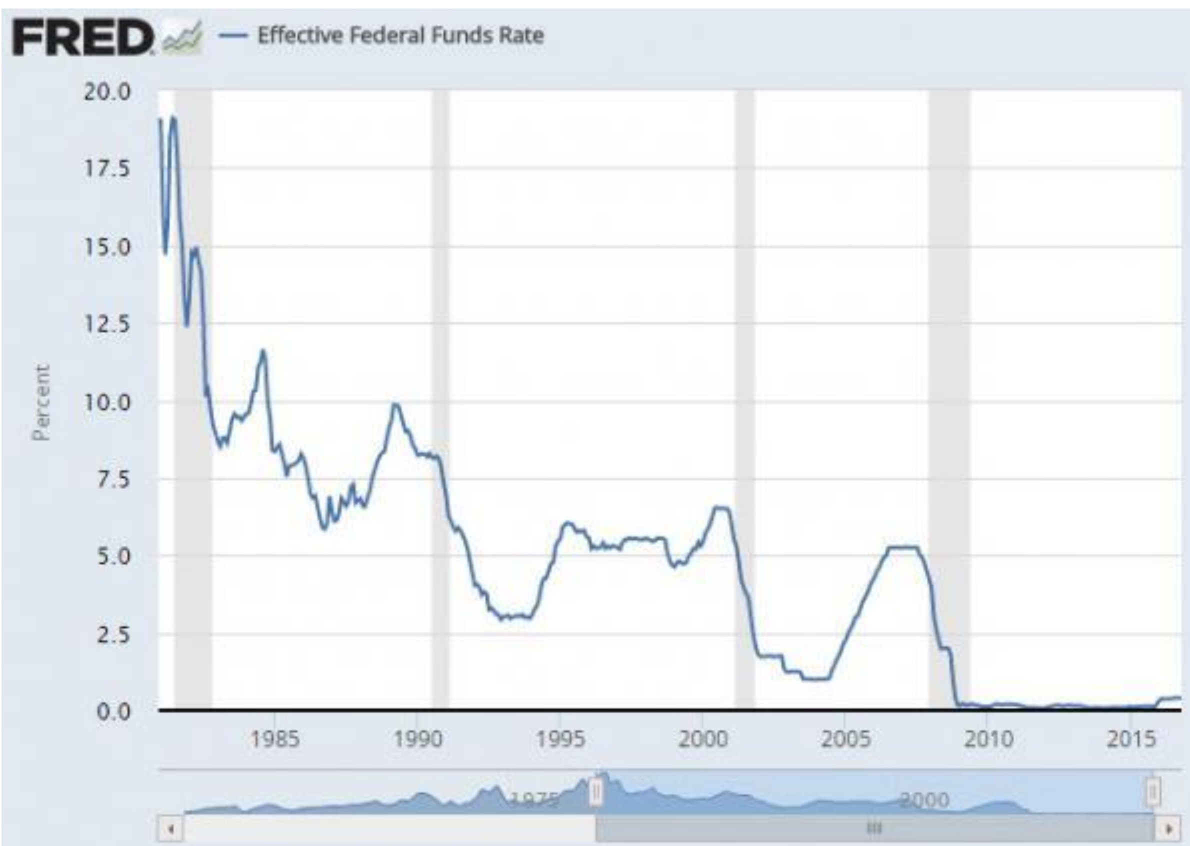
Similarly, **r_d**, the cost of debt, has two components: the market "risk free rate" + the premium that the company's bondholders are charging to hold debt riskier than a Treasury bond.

The really important thing to understand here is that both of these variables are dependent upon interest rates (most notably, the yield on the 10-year Treasury). As interest rates rise, the cost of equity goes up, and the cost of debt goes up, too.

Why is that so important? Glad you asked...

The Future of Rising Rates (And Falling Asset Prices)

Most reading this are aware that we've been living in a falling interest rate environment for most, if not all, of our adult lives. And since the 2008 financial crisis, interest rates have been held down at essentially 0% (or even lower) by the world's central banks:



While not the only reason, this decline in interest rates has been a huge driver behind the tremendous rise in valuations across assets like stocks, bonds and real estate over the past 30-odd years.

Which begs the question: *What will happen to asset prices if/when interest rates start rising again?*

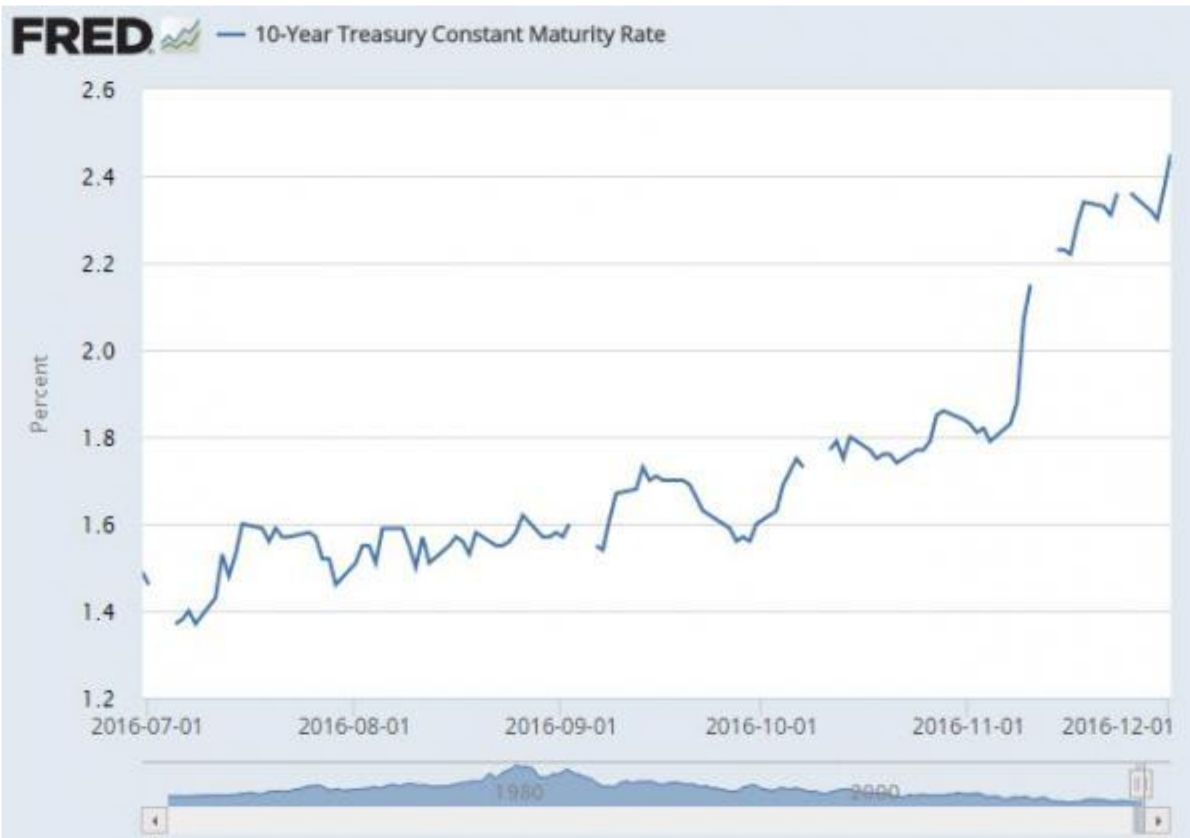
Well, as I hope the above lesson on the Weighted Average Cost of Capital hammered home, when the core interest rate rises, both the cost of equity and the cost of debt go up. Mathematically, this increases the WACC used as a discount factor, thereby reducing the present value of future cash flows. Or in layman's terms:

When interest rates rise so does the WACC, which mathematically makes valuations fall.

Now, we only need to care about this if we're worried that interest rates will start rising. Maybe the central banks have everything under control. Maybe we're at a "permanent plateau" of sustainable zero-bound interest rates.

Oops; or maybe not.

Remember how the "risk free rate" used in calculating the WACC is often the 10-year Treasury bond yield? Well, the yield on the 10-year Treasury started spiking last month, and is currently nearly double(!) what is was just five short months ago:



Now, it takes a little while for the higher cost of capital to ripple through the system. But we're already seeing some immediate effects, with numerous warnings of future price corrections multiplying in today's headlines.

Given their strict see-saw relationships with interest rates, bond prices are getting slammed:

[U.S. Government: Bond Prices Fall as 10-Year Yield Hits 2016 High]

Renewed selling pressure resulted in the yield on the benchmark 10-year Treasury closing at its highest since late December, wiping out the big drop earlier this year.

The yield premium that investors demanded to own the 10-year U.S. Treasury note relative to the 10-year German bund climbed to 1.99 percentage point, the highest since 1989, the year the Berlin Wall fell. The U.S. 10-year note's yield premium relative to the 10-year Japanese government bond also rose to the highest since January 2014.

(Source)

[Bond Market Slide Intensifies]

Rise in yields since July has pushed the 10-year Treasury note up by more than 1 percentage point

The worst bond rout in three years deepened, hammering debt issued in emerging markets and many U.S. states and cities, while sparing large companies the brunt of the impact.

The yield on the 10-year Treasury note rose to a 17-month high, at 2.444%, up from 2.365% on Wednesday. Yields rise as bond prices fall.

([Source])

The housing market has a similar see-saw relationship with interest rates, but given how less liquid homes are than bonds, it will take more time before the recent rate causes a noticeable effect on prices. That said, as expected, we are seeing an immediate impact on the market for home refinancing loans:

[Mortgage Refinancings Collapse To 2016 Lows As Rates Top 4.00%]

Mortgage applications tumbled 9.4% from the prior week as mortgage rates soared above 4.00% to the highest level since July 2015. The biggest driver of the decline in mortgage demand was a **16% crash in refinances - tumbling to their lowest level since the first week of January**

([Source])

And the industry is bracing for a pullback as "shocked" consumers react to the spike in rates:

[US Housing Market In Peril As "Increase In Mortgage Rates Has Shocked Consumers"]

Eventually, though, rising rates make houses less affordable, and that could lead to slowing sales, price growth and mortgage activity. Some analysts are now projecting home values will decline by the end of next year in many U.S. housing markets.

The MBA lowered its projections for next year's new mortgage loans by 3% last week, to $1.58 trillion. That would represent a 16% drop from the nearly $1.9 trillion in mortgages that lenders are on pace to originate this year, with refinancing accounting for all of the drop.

"The increase in rate has shocked consumers…I didn't expect it either," said Dave Norris, chief revenue officer at LoanDepot, the 10th largest mortgage lender in the U.S. by loan volume.

(Source)

Equities have yet to soften due to the rise in rates, but the recent rally kicked off by the recent Presidential election appears to have run out of steam. More importantly, an increasing chorus of venerated investors is warning that even higher rates are coming -- soon. And with them, a market correction:

Druckenmiller Joins Gundlach In Predicting 6% Yields; Expects Market Correction As Rates Rise

Druckenmiller joined Jeff Gundlach in predicting that **US 10Y yields may rise to 6% over the next year or two** (...)

(...) he echoed the warning made just last night by Goldman Sachs, according to which a 10Y above 2.75% would put pressure on stocks, **and said that if the 10Y rose to 3%, the S&P could see a 10% correction, but warned that the market could correct well prior to that in anticipation.**

(Source)

Even the newly-selected Treasury Secretary Steve Mnuchin agrees that higher rates are an approaching inevitability:

“We’ll look at potentially extending the maturity of the debt, because eventually we are going to have higher interest rates, and that’s something that this country is going to need to deal with."

(Source)

Prepare Now

The conclusion from all the above? Get ready to live in an era of rising interest rates. It's going to be unfamiliar territory for all of us...

What will likely happen? The unrelenting upward march in asset prices we've enjoyed over the past several decades is over. People won't be able to pay as much for stuff because the financing costs will be higher.

Falling asset prices should be in the cards**.** We're already seeing that with bonds, and housing and stocks should follow over the next few quarters. The higher rates go, the farther the fall should be.

The Fed will be in a tough spot as this unfolds. Right now, the Fed has little power to slow things down, as the core interest rate it sets is already nearly 0%. It will likely raise rates as it can along with the market, provided it can do so without killing the economy. There's a lot of precedent for this; historically, the Fed's interest rate has usually followed the market vs leading it. The Fed will want to gain some maneuvering room to drop rates at some point in the future if it feels it needs to.

At some point, if we risk entering a full deflationary rout, the world's central planners may well indeed pull out an arsenal of tricks similar to what we saw following the 2008 crisis. We may eventually see liquidity-injection programs so extreme that hyperinflation becomes a valid concern. But that time is not now.

For now, we recommend getting out of debt. Especially variable rate, non-self-liquidating debt (credit cards being a great example). As we've said many times, in periods of deflation, debt can be a stone-cold killer.

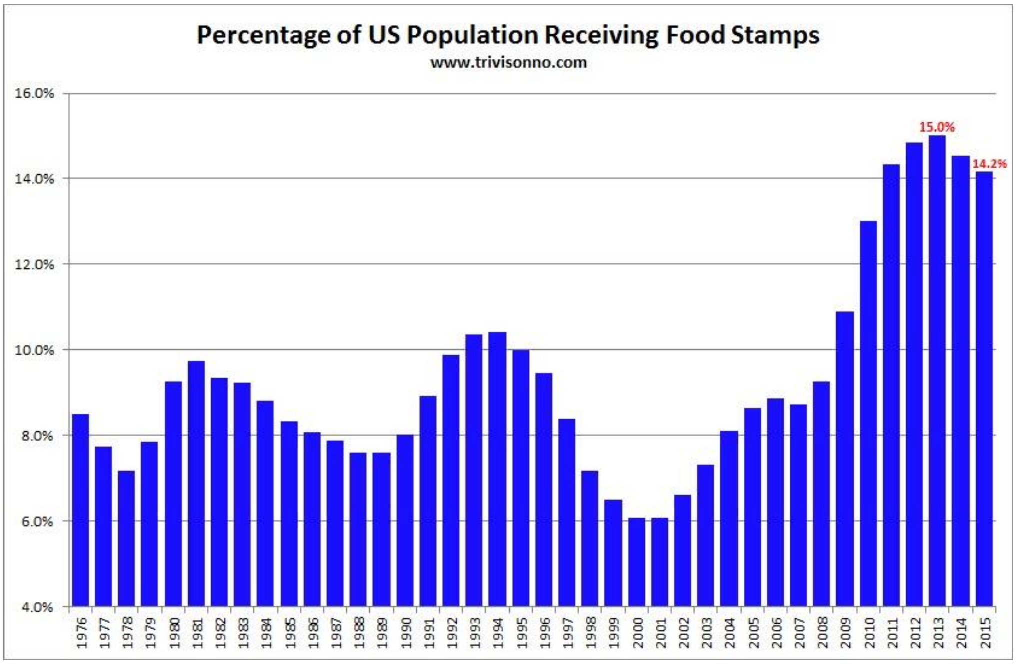
Be sure to have positioned your financial portfolio to take into account the risks to stocks/bonds/etc raised here. Read our primer on hedging. Read the Financial Capital chapter from our book *Prosper!* (we've made it available to read for free here). Talk with our endorsed financial adviser (again, free of charge) if you're having difficulty finding a good one to discuss this topic with.

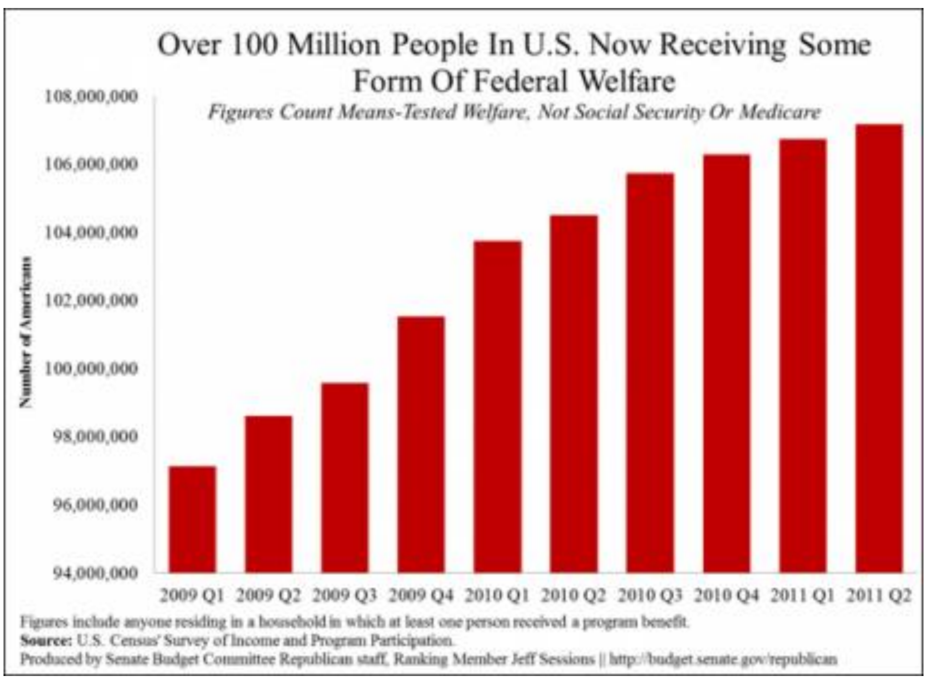
And to really understand what life will be like as interest rates turn from a tailwind into a headwind for the global economy, read this report we published earlier this year, when the markets first buckled in 2016.

Some Indisputable Statistics

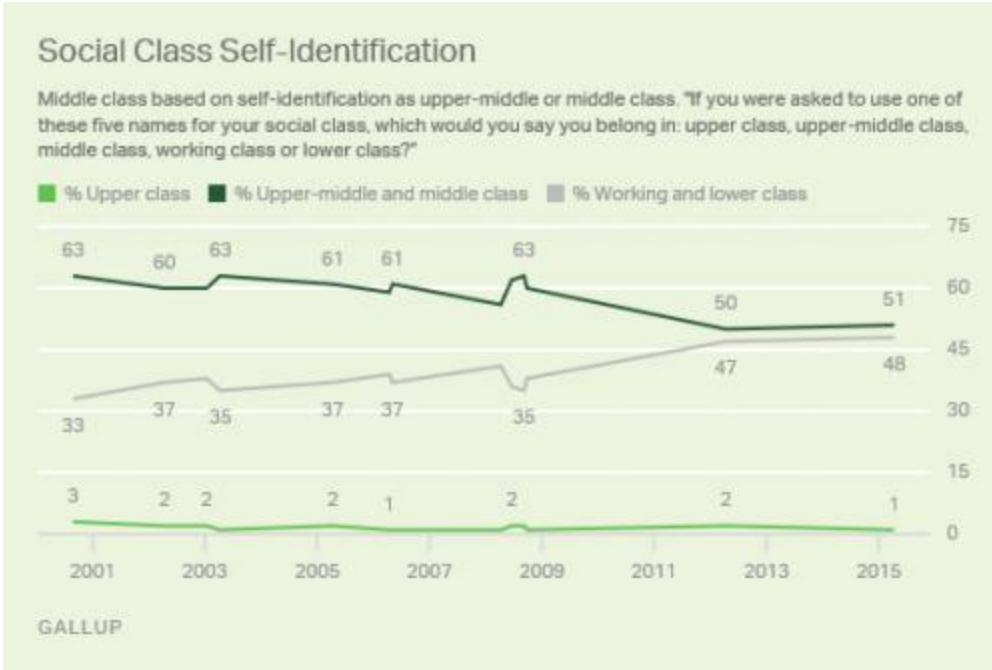
			In Millions
US POPULATION			318.9
Working Age (16 & Over)			253.9
Employed (62.8%)		151.6	
Part Time	27		
Self Empoyed	15		
Multiple Jobs	7		
Government	22		
Sub Total (46.8%)	71		
Not In the Labor Force		102.3	
Unemployed	7.8		
"Froliicking" (Subsidized)	94.5		
Entitlements			
Food Stamps			43.5
Households (17%)		21.4	
Food Pantries,Cupboards of Kindness			46
Government Dependencies (Not SS or Medicare)			>100M
Means Testing (21.3% of the population)			
Welfare		$1.08T	
Medicaid	$600B		
Other	$480B		

Participation Rate Suggests a Problem (see notebook stats from Quinn - 9/4)





The percentage of Americans who say they are in the middle or upper-middle class has fallen 10 percentage points, from a [61% average between 2000 and 2008 to 51% today](#).



Ten percent of 250 million adults in the U.S. is 25 million people whose economic lives have crashed.

What the media is missing is that these 25 million people are invisible in the widely reported 4.9% official U.S. unemployment rate.

Let's say someone has a good middle-class job that pays $65,000 a year. That job goes away in a changing, disrupted world, and his new full-time job pays $14 per hour -- or about $28,000 per year. That devastated American remains counted as "full-time employed" because he still has full-time work -- although with drastically reduced pay and benefits. He has fallen out of the middle class and is invisible in current reporting.

More disastrous is the emotional toll on the person -- the sudden loss of household income can cause a crash of self-esteem and dignity, leading to an environment of desperation that we haven't seen since the Great Depression.

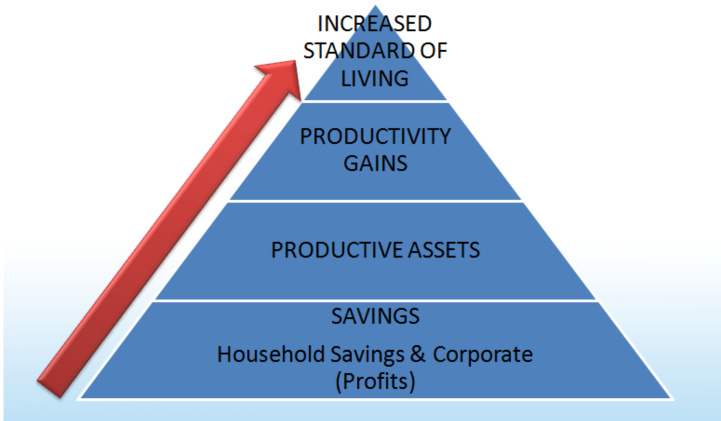
Millions of Americans, even if they themselves are gainfully employed in good jobs, are just one degree away from someone who is experiencing either unemployment, underemployment or falling wages. We know them all.

CAPITALISM – Now Creditism

In the April Monthly Market Commentary (MMC) I spelled out how we are Crippling the Capitalist System by not re-investing our domestic Savings and Corporate Profits back into truly productive assets which will generate productivity gains and thereby lead to overall increases in the standard of living. As a consequence we are seeing falling Standards of Living for the entire middle class in America.

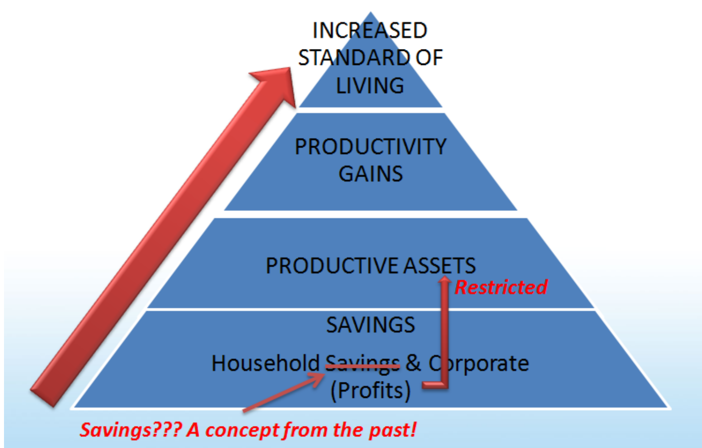
Simply said, a healthy economy "produces more than it consumes". A functioning Capitalist System is about "getting more for less" through competition and free markets.

This is no longer what we have in America.



We now "consume more than we produce" and as a consequence we are now "getting Less for more". This is what happens as a consequence of both insufficient savings, in lieu of consumption, and corporate profits being incorrectly allocated.

The misallocation of capital occurs when risk is not priced properly, there is ineffective price discovery and mal-investment becomes prevalent often due to moral hazard and unintended consequences of poor public policy.



Financialization & Risk Avoidance

The root cause of this behavior is the "Financialization" of the US Economy. When financial corporations begin to dominate the economy and financial engineering is perceived to be the shortest and easiest path to profits, then the game of risk avoidance becomes center stage.

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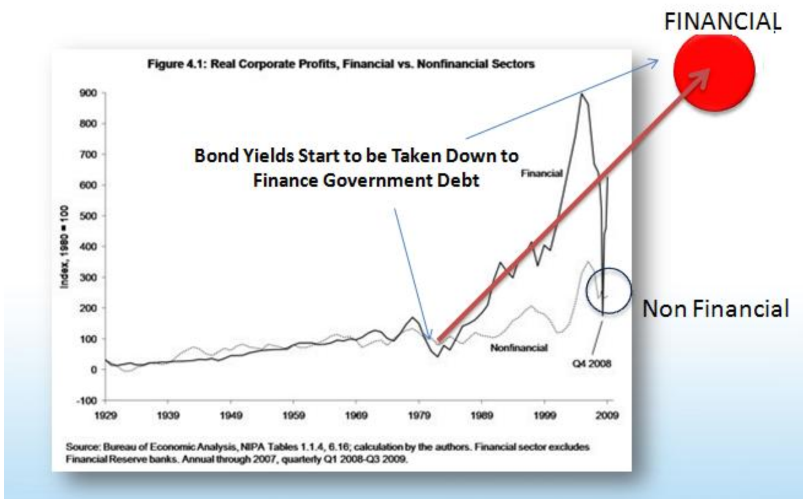
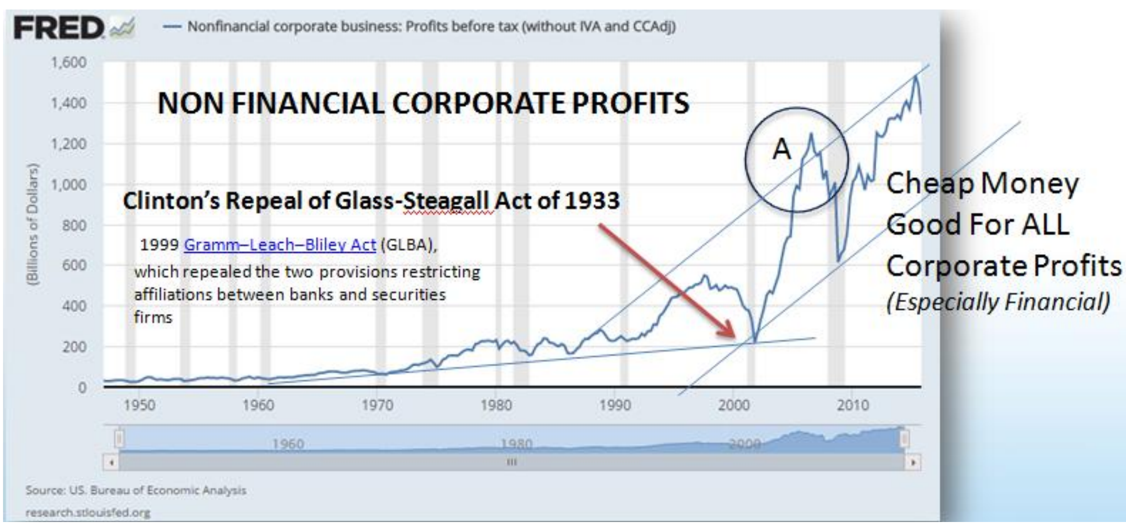
When this occurs, investing in productive assets becomes increasingly more risky and less profitable than investing in financial products using cheap money to facilitate leverage and the "gearing" of balance sheets.



Cheap Money

Even Non-Financial Corporation's become more profitable as cheap money removes interest expense and capital costs. It is the greatest of time for corporate profits. But the question is whether it is sustainable or is it really about steadily "killing the golden goose"?



Alastair Crooke is a former British diplomat who was a senior figure in British intelligence and in European Union diplomacy. He is the founder and director of the Conflicts Forum, which advocates for engagement between political Islam and the West.

THE END OF GROWTH'S "FAKE ELIXER"

10-16-16 ZeroHedge -- *Authored by Alastair Crooke, originally posted at ConsortiumNews.com,*

Raul Ilargi Meijer, the long-standing economics commentator, has written both succinctly – and provocatively: **"It's over! The entire model our societies have been based on for at least as long as we ourselves have lived, is over! That's why there's Trump.**

"There is no growth. There hasn't been any real growth for years. All there is left are empty hollow sunshiny S&P stock market numbers propped up with ultra-cheap debt and buybacks, and employment figures that hide untold millions hiding from the labor force. And most of all there's debt, public as well as private, that has served to keep an illusion of growth alive and now increasingly no longer can.

"These false growth numbers have one purpose only: for the public to keep the incumbent powers that be in their plush seats. But they could always ever only pull the curtain of Oz [Wizard of Oz] over people's eyes for so long, and it's no longer so long.

"That's what the ascent of Trump means, and Brexit, Le Pen, and all the others. It's over. What has driven us for all our lives has lost both its direction and its energy."

Meijer continues: **"We are smack in the middle of the most important global development in decades, in some respects arguably even in centuries, a veritable revolution, which will continue to be the most important factor to shape the world for years to come, and I don't see anybody talking about it. That has me puzzled.**

"The development in question is the end of global economic growth, which will lead inexorably to the end of centralization (including globalization). It will also mean the end of the existence of most, and especially the most powerful, international institutions.

"In the same way it will be the end of -almost- all traditional political parties, which have ruled their countries for decades and are already today at or near record low support levels (if you're not clear on what's going on, look there, look at Europe!)

"This is not a matter of what anyone, or any group of people, might want or prefer, it's a matter of 'forces' that are beyond our control, that are bigger and more far-reaching than our mere opinions, even though they may be man-made.

"Tons of smart and less smart folks are breaking their heads over where Trump and Brexit and Le Pen and all these 'new' and scary things and people and parties originate, and they come up with little but shaky theories about how it's all about older people, and poorer and racist and bigoted people, stupid people, people who never voted, you name it.

"But nobody seems to really know or understand. Which is odd, because it's not that hard. That is, this all happens because growth is over. And if growth is over, so are expansion and centralization in all the myriad of shapes and forms they come in."

Further, Meijer writes: "Global is gone as a main driving force, pan-European is gone, and whether the United States will stay united is far from a done deal. We are moving towards a mass movement of dozens of separate countries and states and societies looking inward. All of which are in some form of -impending- trouble or another.

"**What makes the entire situation so hard to grasp for everyone is that nobody wants to acknowledge any of this. Even though tales of often bitter poverty emanate from all the exact same places that Trump and Brexit and Le Pen come from too.**

"That the politico-econo-media machine churns out positive growth messages 24/7 goes some way towards explaining the lack of acknowledgement and self-reflection, but only some way. The rest is due to who we ourselves are. We think we deserve eternal growth."

The End of 'Growth'

Well, is global "growth over"? Of course Raul Ilargi is talking "aggregate" (and there will be instances of growth within any contraction). But what is clear is that debt-driven investment and low-interest-rate policies are having less and less effect – or no effect at all – in producing growth – either in terms of domestic or trade growth, as Tyler Durden at ZeroHedge writes:

"After almost two years of the quantitative easing program in the Euro Area, economic figures have remained very weak. As GEFIRA details, inflation is still fluctuating near zero, while GDP growth in the region has started to slow down instead of accelerating. *According to the ECB data, to generate €1.0 of GDP growth, €18.5 had to be printed in the QE*, … This year, the ECB printed nearly €600 billion within the frame of asset purchase programme (QE)."

Central Banks can and do create *money,* but that is not the same as creating *wealth or purchasing power*. By channelling their credit creation through the intermediary of banks granting loans to their favored clients, Central Banks grant to one set of entities purchasing power – a purchasing power that must necessarily have been transferred from another set of entities within Europe (i.e. transferred from ordinary Europeans in the case of the ECB), who, of course will have less purchasing power, less discretionary spending income.

The devaluation of purchasing power is not so obvious (no runaway inflation), because all major currencies are devaluing more or less *pari passu* – and because the authorities periodically steam hammer down the price of gold, so that there is no evident standard by which people can "see" for themselves the extent of their currencies' joint downward float.

And world trade is grinding down too, as Lambert Strether of *Corrente* rather elegantly explains: "Back to shipping: I started following shipping … partly because it's fun, but more because shipping is about stuff, and tracking stuff seemed like a far more attractive way of getting a handle on 'the economy' than economics statistics, let alone whatever books the Wall Streeters were talking on any given day. **And don't get me started on Larry Summers.**

"**So what I noticed was decline, and not downward blips followed by rebounds, but decline, for months and then a year.** Decline in rail, even when you back out coal and grain, and decline in demand for freight cars. Decline in trucking, and decline in the demand for trucks. Air freight wobbly. No Christmas bounce at the Pacific ports. And now we have the Hanjin debacle — all that capital tied up in stranded ships, though granted only $12 billion or so — and the universal admission that somehow "we" invested w-a-a-a-a-a-y too much money in big ships and boats, implying (I suppose) that we need to ship a lot less stuff than we thought, at least across the oceans.

"**Meanwhile, and in seeming contradiction not only to a slow collapse of global trade, but to the opposition to 'trade deals,' warehousing is one of the few real estate bright spots, and supply chain management is an exciting field. It's disproportionately full of sociopaths, and therefore growing and dynamic!**

"And the economics statistics seem to say nothing is wrong. Consumers are the engine of the economy and they are confident. But at the end of the day, people need stuff; life is lived in the material world, even if you think you live it on your device. **It's an enigma! So what I'm seeing is a contradiction: Less stuff is moving, but the numbers say 'this is fine.' Am I right, here? So in what follows, I'm going to assume that numbers don't matter, but stuff does.**"

Fake Elixir

Or, to be more faux-empirical: as *Bloomberg* notes in *A Weaker Currency is no longer the Elixir, It Once Was:* "global central banks have cut policy rates 667 times since 2008, according to *Bank of America*. During that period, the dollar's 10 main peers have fallen 14%, yet Group-of-Eight economies have grown an average of just 1%. Since the late 1990s, a 10% inflation-adjusted depreciation in currencies of 23 advanced economies boosted net exports by just 0.6% of GDP, according to Goldman Sachs. That compares with 1.3% of GDP in the two decades prior. U.S. trade with all nations slipped to $3.7 trillion in 2015, from $3.9 trillion in 2014."

With "growth over," so too is globalization: Even the *Financial Times* agrees, as its commentator Martin Wolf writes in his comment, *The Tide of Globalisation is Turning*: "Globalisation has at best stalled. Could it even go into reverse? Yes. It requires peace among the great powers … Does globalisation's stalling matter? Yes."

Globalization *is* stalling – not because of political tensions (a useful "scapegoat"), but because growth is flaccid as a result of a veritable concatenation of factors causing its arrest – and because we have entered into debt deflation that is squeezing what's left of discretionary, consumption-available, income. But Wolf is right. Ratcheting tensions with Russia and China will not somehow solve America's weakening command over the global financial system – even if capital flight to the dollar might give the U.S. financial system a transient "high."

So what might the "turning tide" of globalization actually mean? Does it mean the end of the neo-liberalist, financialized world? That is hard to say. But expect no rapid "u-turn" – and no apologies. The Great Financial Crisis of 2008 – at the time – was thought by many to mark the end to neo-liberalism. But it never happened – instead, a period of fiscal retrenchment and austerity was imposed that contributed to a deepening distrust of the status quo, and a crisis rooted in a widespread, popular sense that "their societies" were headed in the wrong direction.

Neo-liberalism is deeply entrenched – not least in Europe's Troika and in the Eurogroup that oversees creditor interests, and which, under European Union rules, has come to dominate E.U. financial and tax policy.

It is too early to say from whence the economic challenge to prevailing orthodoxy will come, but in Russia there is a group of prominent economists gathered together as the *Stolypin Club*, who are evincing a renewed interest in that old adversary of Adam Smith, Friedrich List (d. 1846), who evolved a "national system of political economy." List upheld the (differing interests) of the nation to that of the individual. He gave prominence to the national idea, and insisted on the special requirements of each nation according to its circumstances, and especially to the degree of its development. He famously doubted the sincerity of calls to free trade from developed nations, in particular those by Britain. He was, as it were, the arch anti-globalist.

A Post-Globalism

One can see that this might well fit the current post-globalist mood. List's acceptance of the need for a national industrial strategy and the reassertion of the role of the state as the final guarantor of social cohesion is not some whimsy pursued by a few Russian economists. It is entering the mainstream. The May government in the U.K. precisely is breaking with the neoliberal model that has ruled British politics since the 1980s – and is breaking towards a List-ian approach.

Be that as it may (whether this approach swims more widely back into fashion), the very contemporary British professor and political philosopher, John Gray has suggested the key point is: "The resurgence of the state is one of the ways in which the present time differs from the 'new times' diagnosed by Martin Jacques and other commentators in the 1980s. Then, it seemed national boundaries were melting away and a global free market was coming into being. It's a prospect I never found credible.

"A globalised economy existed before 1914, but it rested on a lack of democracy. Unchecked mobility of capital and labour may raise productivity and create wealth on an unprecedented scale, but it is also highly disruptive in its impact on the lives of working people – particularly when capitalism hits one of its periodic crises. When the global market gets into grave trouble, neoliberalism is junked in order to meet a popular demand for security. That is what is happening today.

"If the tension between global capitalism and the nation state was one of the contradictions of Thatcherism, the conflict between globalization and democracy has undone the left. From Bill Clinton and Tony Blair onwards, the center-left embraced the project of a global free market with an enthusiasm as ardent as any on the right. ***If globalisation was at odds with social cohesion, society had to be re-engineered to become an adjunct of the market.*** **The result was that large sections of the population were left to moulder in stagnation or poverty, some without any prospect of finding a productive place in society**."

If Gray is correct that when globalized economics strikes trouble, people will demand that the state must pay attention to their own parochial, national economic situation (and not to the utopian concerns of the centralizing élite), it suggests that just as globalization is over – so too is centralization (in all its many manifestations).

The E.U., of course, as an icon of introverted centralization, should sit up, and pay attention. Jason Cowley, the editor of the (Leftist) *New Statesman* says: "In any event … however you define it, [the onset of 'New Times'] will not lead to a social-democratic revival: it looks as if, in many Western countries, we are entering an age in which centre-left parties cannot form ruling majorities, having leaked support to nationalists, populists and more radical alternatives."

The Problem of Self-Delusion

So, to return to Ilargi's point, that ***"we are smack in the middle of the most important global development in decades … and I don't see anybody talking about it. That has me puzzled"*** and to which he answers that ultimately, the "silence" is due to ourselves: "We think we deserve eternal growth."

He is surely right that it somehow answers to the Christian meme of linear progress (material here, rather than spiritual); but more pragmatically, doesn't "growth" underpin the whole Western financialized, global system: "it was about lifting the 'others' out of their poverty"?

Recall, Stephen Hadley, the former U.S. National Security Adviser to President George W. Bush, warning plainly that foreign-policy experts rather should pay careful attention to the growing public anger: that "globalization was a mistake" and that "the elites have sleep-walked the [U.S.] into danger."

"This election isn't just about Donald Trump," Hadley argued. "It's about the discontents of our democracy, and how we are going to address them … whoever is elected, will have to deal with these discontents."

In short, if globalization is giving way to discontent, the lack of growth can undermine the whole financialized global project. Stiglitz tells us that this has been evident for the past 15 years — last month he noted that he had warned then of: "growing opposition in the developing world to globalizing reforms: It seemed a mystery: people in developing countries had been told that globalization would increase overall wellbeing. So why had so many people become so hostile to it? How can something that our political leaders – and many an economist – said would make everyone better off, be so reviled? One answer occasionally heard from the neoliberal economists who advocated for these policies is that people *are* better off. They just don't know it. Their discontent is a matter for psychiatrists, not economists."

This "new" discontent, Stiglitz now says, is extended into advanced economies. Perhaps this is what Hadley means when he says, **"globalization was a mistake." It is now threatening American financial hegemony, and therefore its political hegemony too.**

* * *

6- THE GLOBAL POLITICAL CRISIS NOW STEMMING FROM NO "REAL" GROWTH

KEY MESSAGES

1. We Consume More than We Produce versus Producing More than We Consume,
2. We are Getting Less for More versus Getting More for Less,
3. We have Skewed Innovation - Targeted Primarily at Cost Savings versus New Industries.
4. A 'Growth first, Objectives later' strategy isn't working and as a result in the past fifteen years the growth process has actually destroyed more resources than it has created on a sustainable basis,
5. Artificial Growth is unavoidably shifting the world from a Uni-Polar to Multi-Polar World due the US Dollar maintaining its Breton Woods era "Reserve Currency" status,
6. Populist Politics is unwittingly promising to re-create false nation state socialism without Globalism,
7. The Electorate in many countries is rapidly losing confidence in a "brighter future" due to No Real Economic Growth despite media reporting suggesting the contrary. A Crisis of Trust is being fostered with its attendant risks of "stagnation'.

THE CORE PROBLEM CREATED

1. We Consume More than We Produce versus Producing More than We Consume,
2. We are Getting Less for More versus Getting More for Less,
3. We have Skewed Innovation - Targeted Primarily at Cost Savings versus New Industries,

There are three serious metrics that need to be turned around urgently or we'll lose the whole US middle class.

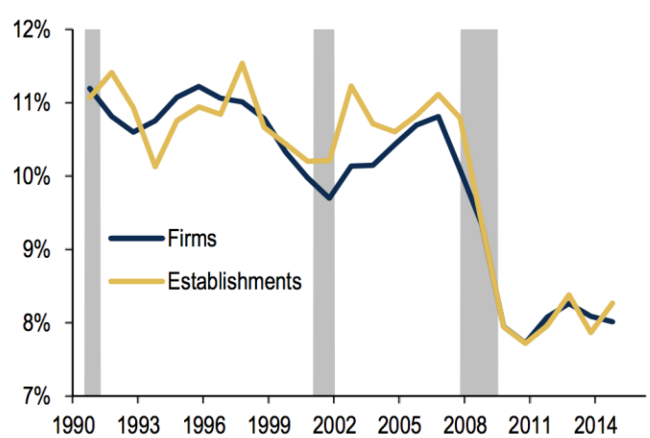
1. According to the U.S. Bureau of Labor Statistics, the percentage of the total U.S. adult population that has a full-time job has been hovering around 48% since 2010 -- *this is the lowest full-time employment level since 1983*.
2. The number of publicly listed companies trading on U.S. exchanges has been cut almost in half in the past 20 years -- from about 7,300 to 3,700. Because firms can't grow organically -- that is, build more business from new and existing customers -- they give up and pay high prices to acquire their competitors, thus drastically shrinking the number of U.S. public companies. This seriously contributes to the massive loss of U.S. middle-class jobs.
3. New business startups are at historical lows. Americans have stopped starting businesses. And the businesses that do start are growing at historically slow rates.

Free enterprise is in free fall -- but it is fixable. Small business can save America and restore the middle class.

Gallup finds that small businesses -- startups plus "shootups," those that grow big -- are the engine of new economic energy. According to the U.S. Small Business Administration, **65% of all new jobs are created by small businesses, not large ones.**

Here's the crisis: The deaths of small businesses recently outnumbered the births of small businesses. The U.S. Census Bureau reports that the total number of business startups and business closures per year crossed for the first time in 2008. In the nearly 30 years before that, the U.S. consistently averaged a surplus of almost 120,000 more business births than deaths each year. But from 2008 to 2011, an average of 420,000 businesses were born annually, while an average of 450,000 per year were dying.

Chart 1: Firms and establishment entry rates (% of existing)



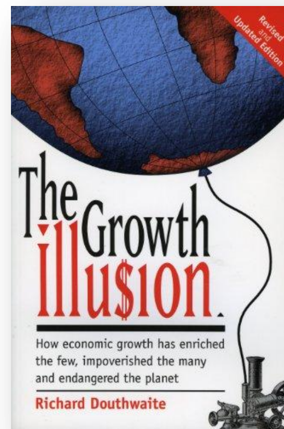
Source: BofA Merrill Lynch Global Research, Census Bureau BDS data

Bob Bryan via Business Insider explains the primary problem:

*"**Both the formation of firms and establishments, have dropped off precipitously since the financial crisis and remained low.***

*This is important because **new businesses typically hire faster and produce higher levels of productivity than firms that have been around for a while.** Thus the decline in business formation can explain some of the labor market's post-recession problems, and is at least part of the reason for the steep drop in productivity."*

CHASING MISUNDERSTOOD ECONOMIC GROWTH IS HARMING US



Since the 1950s, governments around the world have made economic growth their primary focus in the belief that by baking the biggest national cake, they are creating the resources needed to fulfill their political goals. Recent research in the USA, Britain, Germany and Australia shows that this 'growth first, goals later' strategy isn't working and that in the past fifteen years the growth process has actually destroyed more resources than it has created on a sustainable basis.

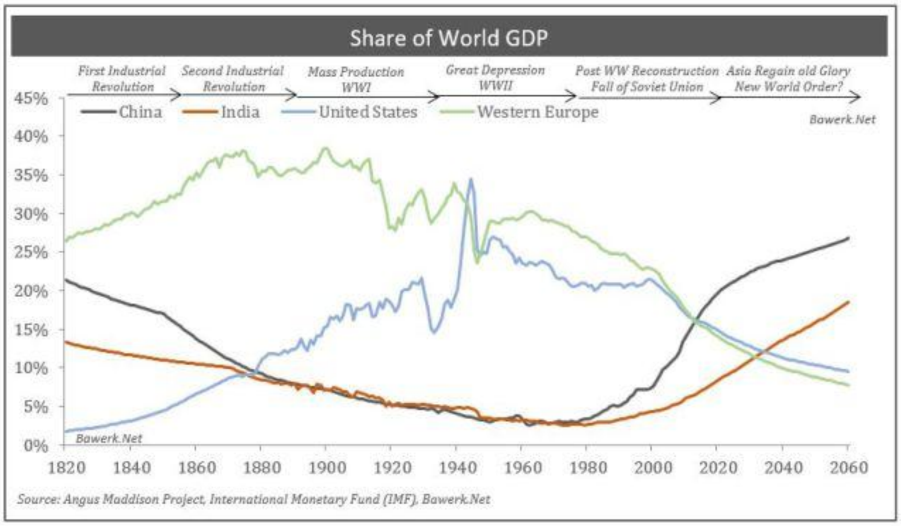
As these economies run backwards, their citizens become worse off. So why is growth still paramount? Like an aircraft maintaining a minimum airspeed to stay aloft, so an economy must maintain a minimum growth rate if it is not to plunge into a deep depression.

If demand fails to increase in any year, less investment will be made the following year, people will be thrown out of work and the economy will begin to unwind.

'Growth has pushed the economic system beyond safe environmental limits. The present revolution involves our acceptance that Earth is finite and the laws of nature apply to us.'

ARTIFICAL "GROWTH" IS UNAVOIDABLY SHIFTING THE WORLD FROM A UNIPOLAR TO MULTI-POLAR WORLD

As an experiment, assume, as most long term forecasters do, that both Europe and the US have reached a mature plateau where growth will average around 1.5 to 2 per cent over the long term, while China will slowly decelerate from the current 6.5 to 3 per cent and India from today`s 7 to around 4. In this scenario (which we do not necessarily believe in, as China is up for en epic crash) what will be the share of global GDP by, say, 2060? And what are the geopolitical implications?
Using data from Angus Maddison, the IMF and then extrapolating with our simple assumptions (which are just as good as any) we get the following picture.



In international dollar terms (PPP) China is already the world largest economy.

By 2060, under the above mentioned assumptions, China will constitute almost 30 per cent of global GDP, almost reaching the level Western Europe had when establishing the European dominance over the world.

The US and Europe will both be less than 10 per cent of the world economy. It is also interesting to note that India will surpass Western Europe already in 2030 and be close to 20 per cent by 2060. The two Asian behemoths will together constitute 45 per cent versus the US and Western Europe's mere 17 per cent in 2060.

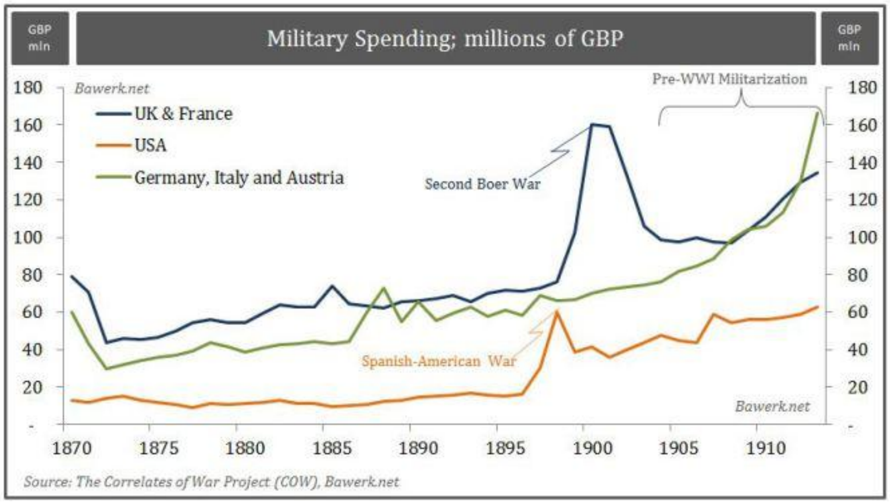
What happened the last time such seismic shifts in economic gravity took place? The first industrial revolution was all about Western Europe, with England and the Low Countries the predominant actors. The foundation for the British Empire was laid and the unipolar world that followed was relatively stable with Britain as the undisputed hegemon.

However, the second industrial revolution quickly spread to Germany and the US. Not long after, the British economy lost is preeminent place a manufacturer of the world. Britain understood that the unipolar world its empire represented would be lost unless the newfound players could be contained. Germany in particular was keen on an empire and started its exploits in Africa in the 1880s to the detriment of an expanding British empire. The straw that probably broke British patience was the German-funded railway to the Middle East. When completed the Brits, as the unquestionable global naval power, would lose control over German oil supplies. The Germans would also gain access to the port of Basra, avoiding the Suez Canal for access to the eastern part of the German colonial empire. German demand for more "Lebensraum" obviously did not go down well with Westerminister. The tragic end result was the industrial killing of Europeans on a scale never witnessed before.

By taking on Germany, Britain tried to bite off more than it could chew. Britain ended up bankrupt and the US emerged as the largest creditor nation on the planet. While it took some time to make the transition, by the end of World War II the US was the undisputable super power. However, this was merely a change of headquarter as the Imperial City of the British empire moved from London to New York. Culturally the two nations were and still are close; and to this day the special relationship between Britain and the US is cultivated more than any.

Still, the key take away from the period stretching between 1880s to 1914 (or 1945) is one where the world hegemon experience relative decline as its manufacturing base is outcompeted by technologically advancing competitors amid a deteriorating balance of payment.

The end result was a world in turmoil with legacy structures, be it political and economic, changing beyond recognition.

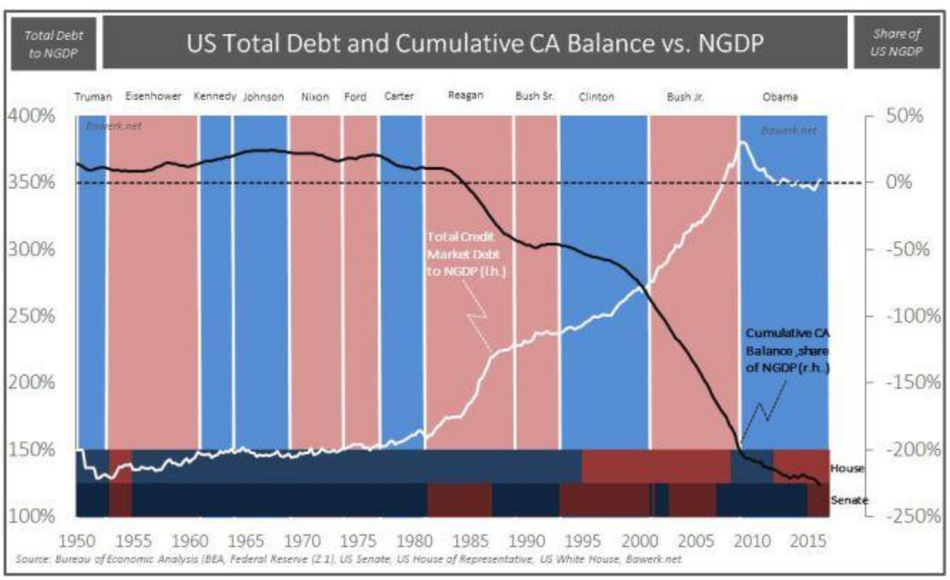


While history never repeats itself, it certainly rhymes and today's situation is in many respects quite similar to the pre-WWI period.

Once again, we have

- A global hegemony going deeper and deeper into debt.
- A balance of payment problem, funded by the "exorbitant privilege" of issuing the global reserve currency, has transformed the US from the world's largest creditor nations to the largest debtor.

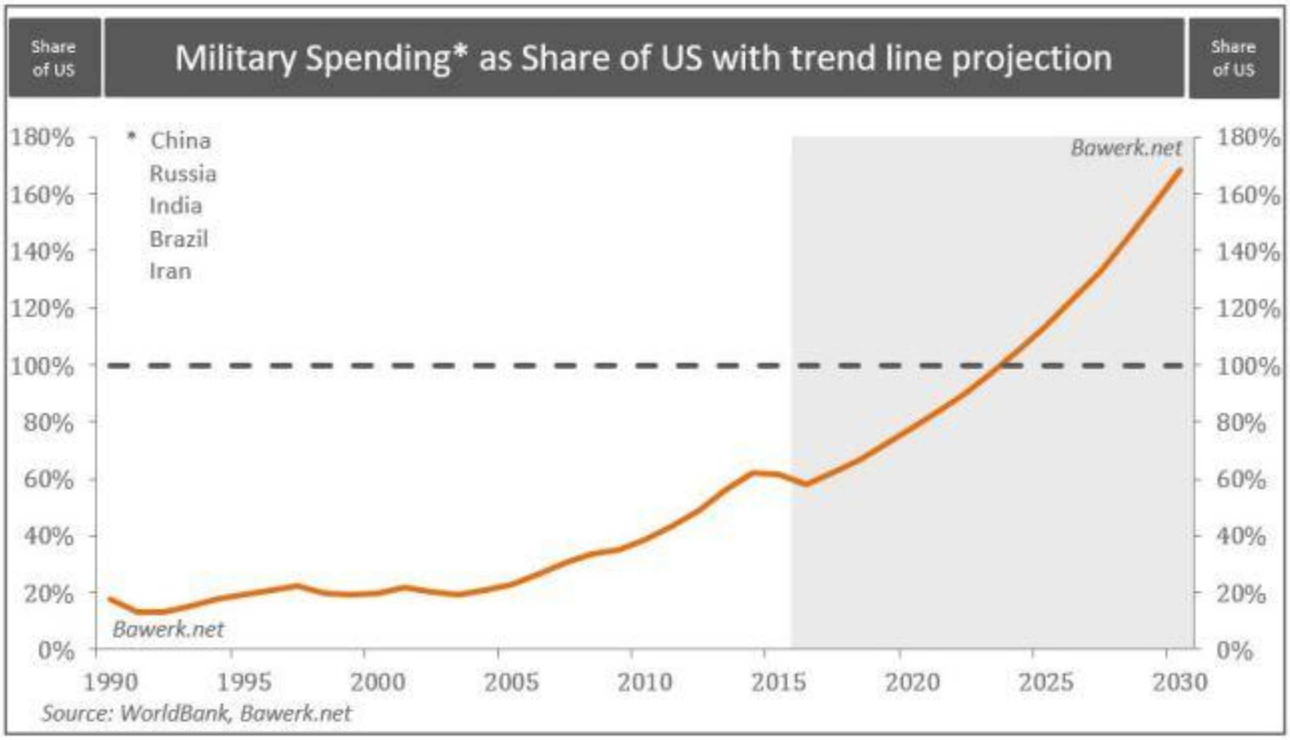
Emerging economies thus feel confident when threatening the US dominance by increasingly making their presence felt in what used to be US (or US satellite states) exclusive territory. China in particular claim surrounding waters as its playground and a more assertive Russia has started to fight back against NATO mission creep.



Just as in the pre-WWI era, military spending by potential adversaries is catching up with the hegemon.

Proxy wars are increasingly being fought as the world move toward a multipolar world order.

As history has shown, the transition from a unipolar to a multipolar world can be taxing and unfortunately bloody. It is also worth noting that the Beijing consensus is materially different from the London/Washington worldview. While moving the Imperial City from London to Washington was not all bad for Europe, another move to Beijing could be far more disruptive.



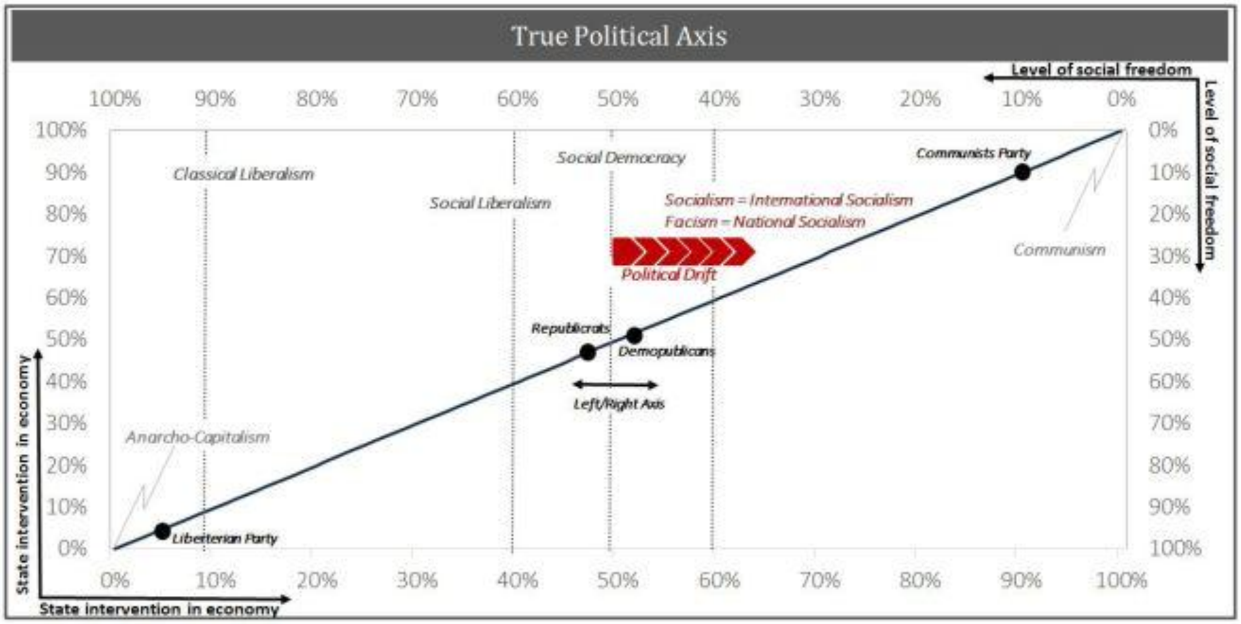
Bottom line, if you believe in the growth assumptions outlined above, the world economy and by extension, political constellations are due for changes unprecedented in later modern history.

Finally, it will be more than interesting to see the Trump presidency tread what will undoubtedly be very treacherous waters.

POPULIST POLITICS – UNWITTINGLY PROMISING TO RE-CREATE 'NATION STATE SOCIALISM' WITHOUT GLOBALISM

One of the most widespread misconceptions in the realm of politics is the notion of a left-right axis. This has been used over and over to explain political outcomes and paint the various factions as polar opposites. For example, in the US the two main parties, the Republicans (right) and Democrats (left), are often portrayed as a fight between good and evil. Which party representing good and which one is advocates of evil is highly subjective and obviously, "our" team is always considered good, while "they" are evil. Then there are factions to the right and left of mainstream parties which are then considered extreme versions of left and right. To the right of right-of-center you find somewhat confusing a hodgepodge of various totally unrelated groupings such free-market libertarians, racists and fascists. On the left of left-of-center we find the usual socialists and communists.

This makes very little sense and the chart below gives a much better description of the political reality.

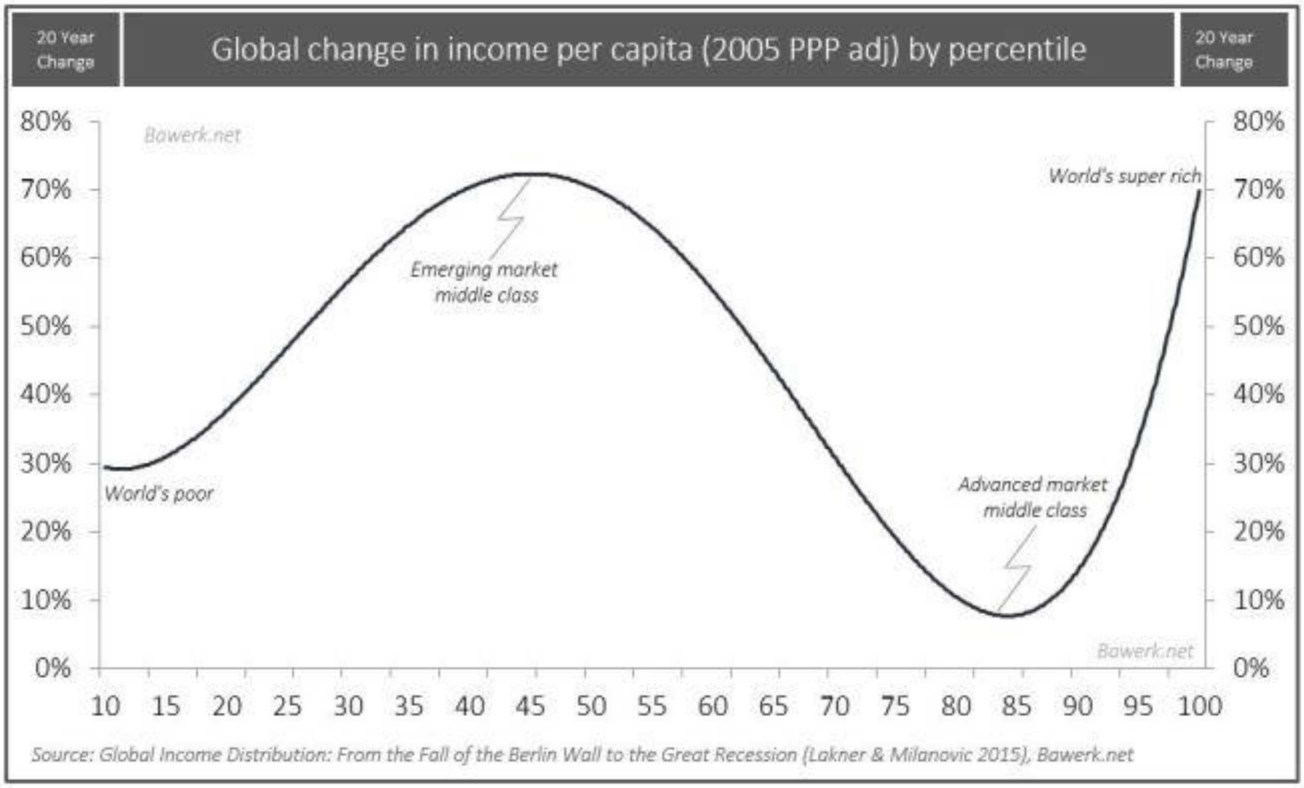


Libertarians are the polar opposite of fascists, but the left-right axis bundle them together on the far right side. By doing so libertarians are easy to dismiss as simple-minded racists. This blurs political concepts and directly baffles pundits and commentators alike when results such as Brexit and Trump “surprisingly” go against conventional wisdom. How can the “extreme” rightwing Trump win Democratic stronghold states such as Pennsylvania, Michigan and Wisconsin? They should, in theory, be diametrical opposite. One simple example should suffice to prove our point; an elderly gentleman with more than thirty years’ experience as a geopolitical advisor claimed that Ludwig von Mises, a Jewish libertarian living in Austria in the 1930s, was clearly a staunch fascist. Even the professionals or maybe them more than any, are fooled by this false dichotomy which help explain why people today are shocked by what is going on in the Western World.

We see things very different; to the northeast in our chart, we find political parties favoring ***more*** government intrusion to both economic and social life, while the southwest represents individual freedom. To make the chart complete there should be a third axis denoting ***international*** socialism/fascism and ***national*** socialism/fascism.

The current power elite support the welfare state, heavy regulation of economic activity and social control over the masses. It is true that some want more economic regulation (Democrats) and some want more social control (Republicans; gay marriage, abortion. Democrats; political correctness = stifling free speech, especially aimed at the attitudes in “Flyover America”), but there are consensus on the need to control and intervene heavily.

The current political elite also supports internationalism under the auspice of “globalism” where migration, trade and capital are relatively free to move as it sees fit. This has obviously led to higher wage gains for the world’s lower middle class and lower wage gains for the higher middle class as the world labor market have become more unified. In addition, asset holders throughout the world has also benefited, especially from a global monetary policy that has provided the impetus for a decoupling between underlying fundamentals and the price of securities that are supposed to represent an economy’s productive potential.



Listening to what Trump, Farage, Le Pen, Wilders and Grillo actually says one will soon realize that these are not libertarians. On the contrary, according to www.greatagain.gov the new Trump administration will expand fiscal policy by increasing infrastructure, military and other spending to the tune of USD2 – 3 trillion more than what is baked into the already unsustainable debt equation.

So we wonder what Mr. Krugman is so upset about? This is exactly the fiscal stimulus left leaning economist have wanted for years. Movements in bonds markets since Trump was elected suggest Mr. Market believe it will come. Right wing Le Pen, Wilders and supposedly their opposite left wing Grillo are aiming for the same. Not one of these so-called populists talks about dismantling the European welfare state and reinstating 19-century pure capitalistic market pricing and resource allocation.

However, there are one main difference between the new movement spreading across the US and Europe in comparison to the struggling ***status quo.*** While still socialists, the new movement understands why the once affluent middle class of the western world are upset.

They cannot make ends meet as they find themselves in a situation whereby the central bank target a **domestic** *price level in a world where prices are set on global markets.*

To achieve a two per cent CPI target when import prices are falling due to the "China-factor", it is given that non-tradable prices must grow far faster than two per cent. From this we can conclude that essentials, such as housing/rent, education, food and medical expenses will grow far faster than then ***aggregate*** CPI if the two per cent target is to be reached. Data from the Bureau of Labor Statistics substantiates this view.

While it is certainly nice to buy a new flat-screen TV imported from Asia on the cheap, it is not helping if housing, food and medical expenses already lay claim to all of household income. If these people dare vent their frustration, the urban elites call them racist bigots and effectively shut them down. Until 2008 Flyover America could effectively be silenced by giving them access to cheap and plentiful amounts of debt, which helped paper over the lack of ***real*** household income growth. When the credit channel broke down at peak debt, the harsh reality made itself felt.

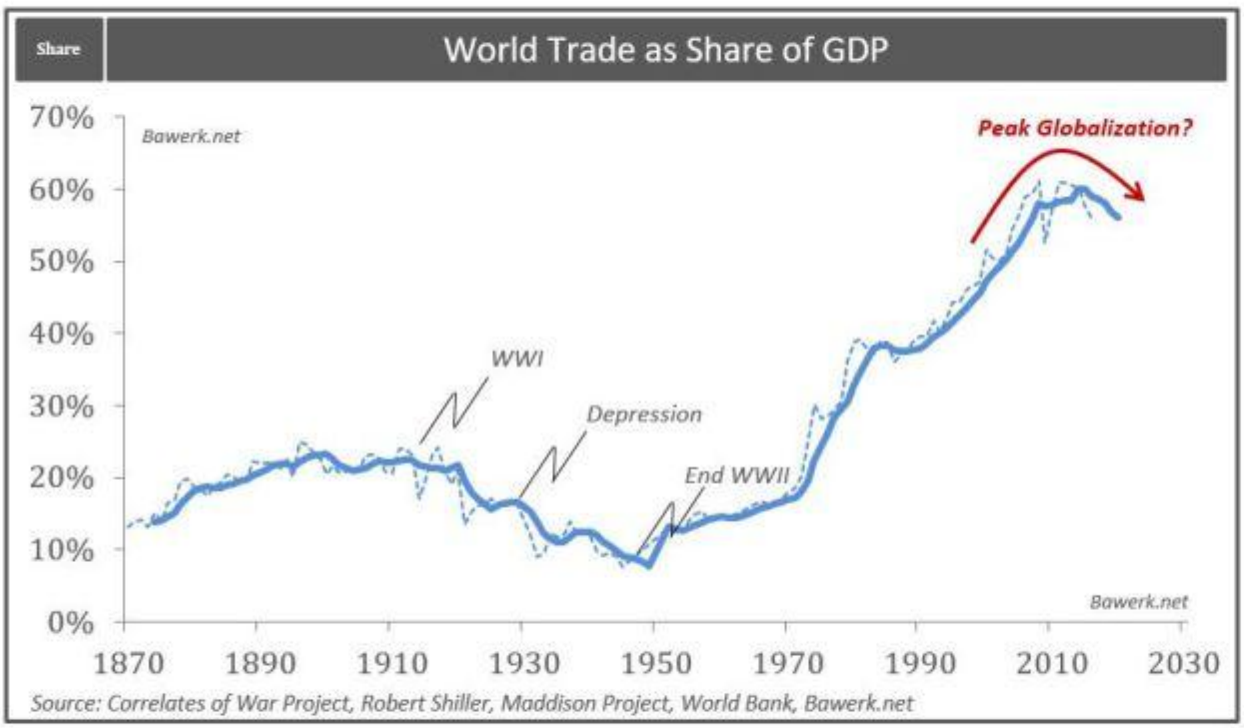
Within this economic, financial and political climate the ***international*** socialist are bound to lose. In enter the ***national*** socialists. They promise to return to the good old days when a union worker at the GM factory made USD100k plus full benefits. They tell people the welfare state will be there for them. They will force companies to bring off-shored jobs back home. They will stop immigration. Bottom line, they promise to re-create socialism without globalism. Socialism for the nation state.

The key point is that the political distance between a vote for the ***international*** socialist and the ***national*** socialist voter is miniscule. A blue-collar worker in Pennsylvania, downtrodden by years of hardship, will easily switch to the party that promises to restore old glory days. Pundits are obviously puzzled – how can a union man vote for the party for the rich? How can he vote for a party that are miles away from his political self-interest? The answer of course is that the union man is not. He is rationally voting for a party closely resembling the one he used to vote for, only this one comes with a slightly new rhetoric.

Which is exactly why we will see more shocks to the system as national elections will yield results that upset the ***status quo*** in the Netherlands, France, Germany and potentially Italy and the UK by the end of 2017. Be prepared for a new world order.

With that in mind, we close with a chart that perfectly sums up the world we see before us.

Not only are we at peak debt with subsequent peak asset prices, we are at the precipice of Peak globalization itself.



LOSING CONFIDENCE IN A BRIGHTER FUTURE DUE TO NO REAL GROWTH

A new world order is coming of age and the transition is painful to accept for a Western middle class with a deep-seated sense of entitlement.

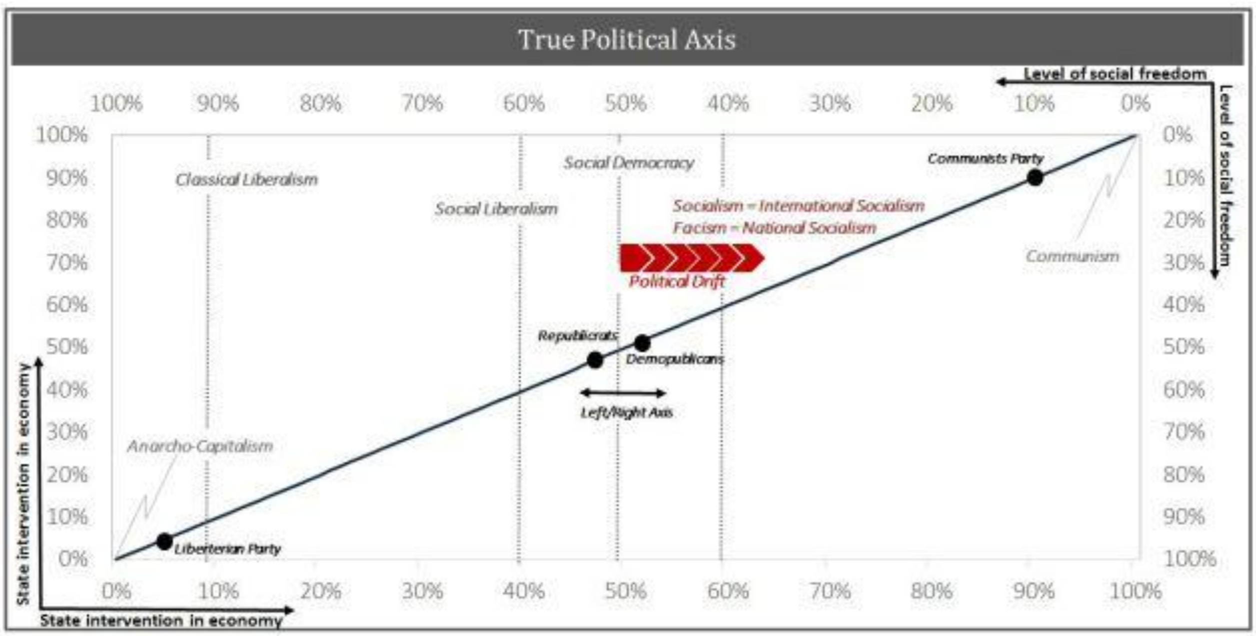
We have showed how the West feels threatened globally and how this translates into domestic politics. We will now show how gross economic mismanagement has created the new political class that we previously described. As we stated back then, a large and increasing part of the electorate, swayed by neither the political correct socialist/feminist/cultural relativist dogma presented by the left, nor the lip service paid to free markets by a corrupted right, have taken hold in western democracies. They form a directionless blob of potential voters which until recently have drifted aimlessly along the political spectrum. Now they have made up their mind and it is proving pundits clueless as to what is going on. The "worker" making millions on Wall Street or by helping Google refine their search engine is not the same "worker" we find in flyover

America. The young billionaire making apps to entertain confused millennials and snowflakes is not the same capitalist as the shale oil investor we might encounter in North Dakota. Political classes traditionally defined are useless as a tool to understand the world today. What is important to note though is that a growing minority of people with little to lose from the *status quo* is about to, or in many places have already become a small majority.

When people have nothing to lose and foresee a future of continued hardship they become desperate and are willing to change for the sake of change itself.

When the current leadership provide nothing but more of the same hopelessness, they will move politically toward to candidates with views counter to that held by the establishment.

Before we move on, let us examine the upcoming election in France to show what we mean. In the traditional way of viewing national politics in France, it will be impossible for Le Pen and her Front National to win. Why? Because the left will hold their nose and vote for right-wing Republican Fillon in the second round to strategically avoid Le Pen. While some undoubtedly will follow the traditional recipe of left-right politics, it is far from certain that enough will do so to avoid a Le Pen victory. On the contrary, this line of thinking is outdated and a better representation is shown in the chart below which we discussed previously.



Using our methodology, we come up with a far more likely scenario on how the French voters will vote come May.

With the center right representing everything the middle class loath, they will not migrate from the center-left to help Fillon to victory. Le Pen's vote base is not disillusioned UMP voters, but blue-collar workers that used to support the socialists and militant French unions. We do not draw this conclusion from some unique insight into French politics, but from observing a tendency across the whole of western society as a larger and larger share of the population have lost hope for the future.

One of the most primal driving forces in humans is the belief in a brighter future. Dirt poor in Africa or pampered by the European welfare state, it does not matter. What matters for the positive development of the human spirit is an expectation that next year will be better than the current one. If that belief is taken from them, they will most certainly force real change on the system as they feel there is little to lose.

So what went wrong? There are many answers to this question and we have tried to address several on them on these pages earlier, such as excessive debt levels, monetary policy gone awry and demographics. We would also add to the list that we have seen a general tendency toward destructive policies as a result from people losing purpose in life; in this regard, it is no coincidence that environmentalism appeared as a new form of religion on the "godless" continent.

In That 70s Show (part **I**, **II**, **III** and **IV**) we spelled out how things changed after Nixon took the US dollar off gold and gave the Americans the ability to exchange nothing for something. Obviously,

this created an irresistible incentive to consume more than the Americans could produce, which in turn artificially changed relative prices.

A new productive structure emerged because of the new set of prices, but unless the dollar issuance continued, and even accelerated, it would not be possible to sustain the ensuing capital allocation.

In other words, this road have taken us all down a very unpleasant path as every time the central bank, and/or the commercial banking system (including **global dollar claims dubbed Eurodollars**) is forced to retrench a recession must necessarily set in as the *nothing-for-something-transaction* have to be undone.

However, as long as the global community accepts dollar *claims* as money good the banking system can always gear up in time of crisis to avert the worst of inbuilt consequences stemming from past folly.

What made 2008/09 so special is the fact that the global dollar community had in fact reached peak debt.

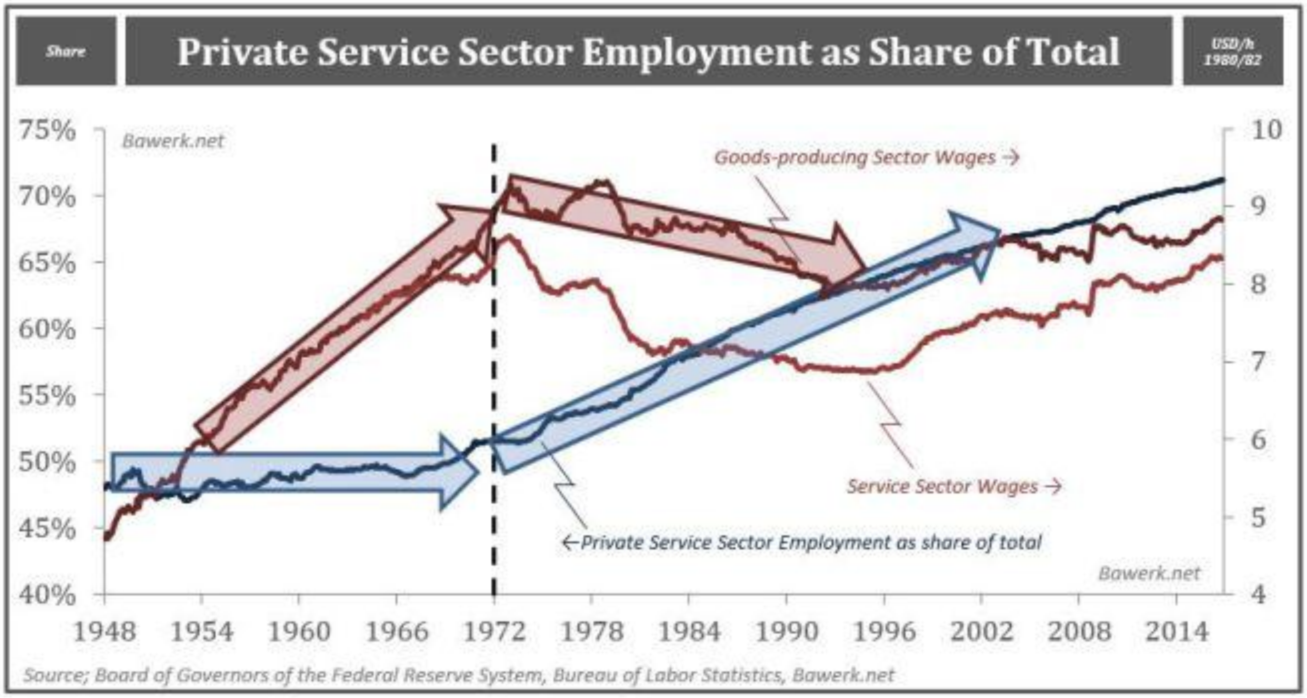
In other words, further dollar claims were *no longer* considered money good and the global banking system could no longer reflate the balance sheet, as this would have been unacceptable to their counterparties.

A different way of looking at this is through the capital structure.

At peak debt the current structure can no longer be funded as the pool of *real* savings is gradually depleted by the incessant *something-for-nothing-transactions*. We, as participants in a global economy, have essentially been consuming our seed corn.

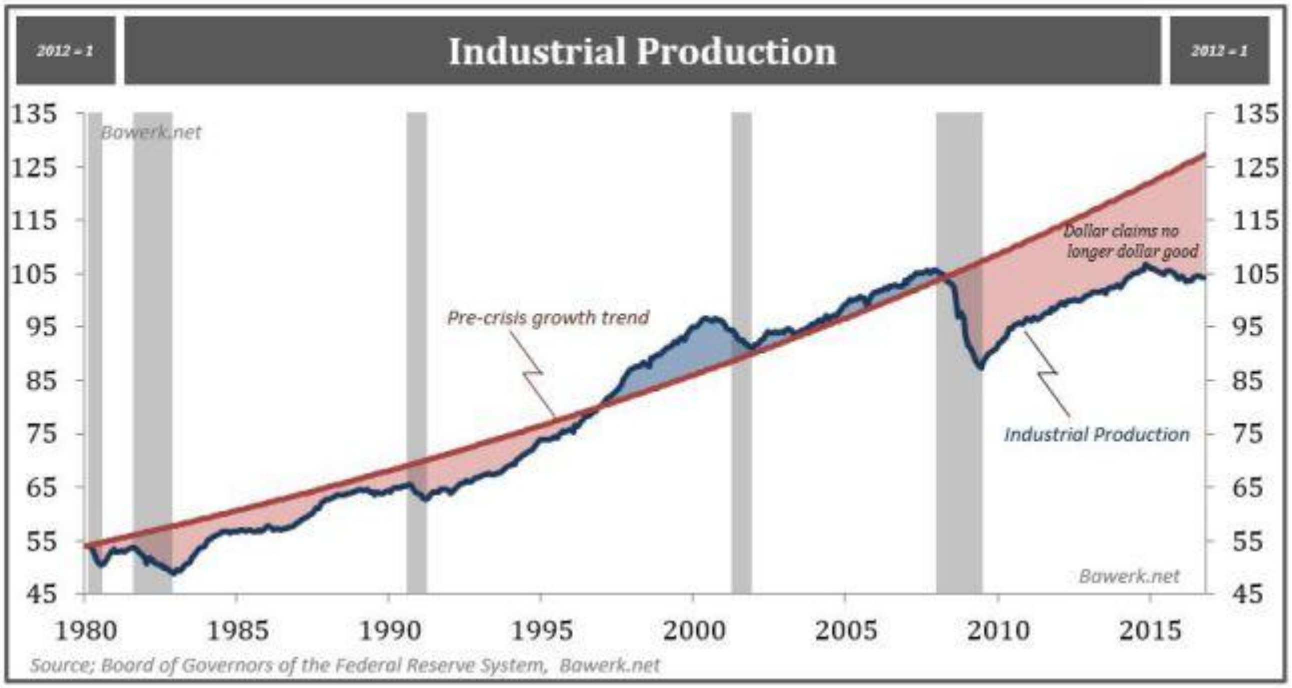
In the 1970s the US economy employed about 50 per cent of its workforce in private sector service occupations. However, as the nothing-for-something system got under way the share of service sector employment rose almost constantly to reach more than 70 per cent today. This transformation can be characterized as a move away from tradable sector toward non-tradable, and was inevitable since the US manufacturing sector essentially had to compete against foreign products that cost the American system nothing to procure.

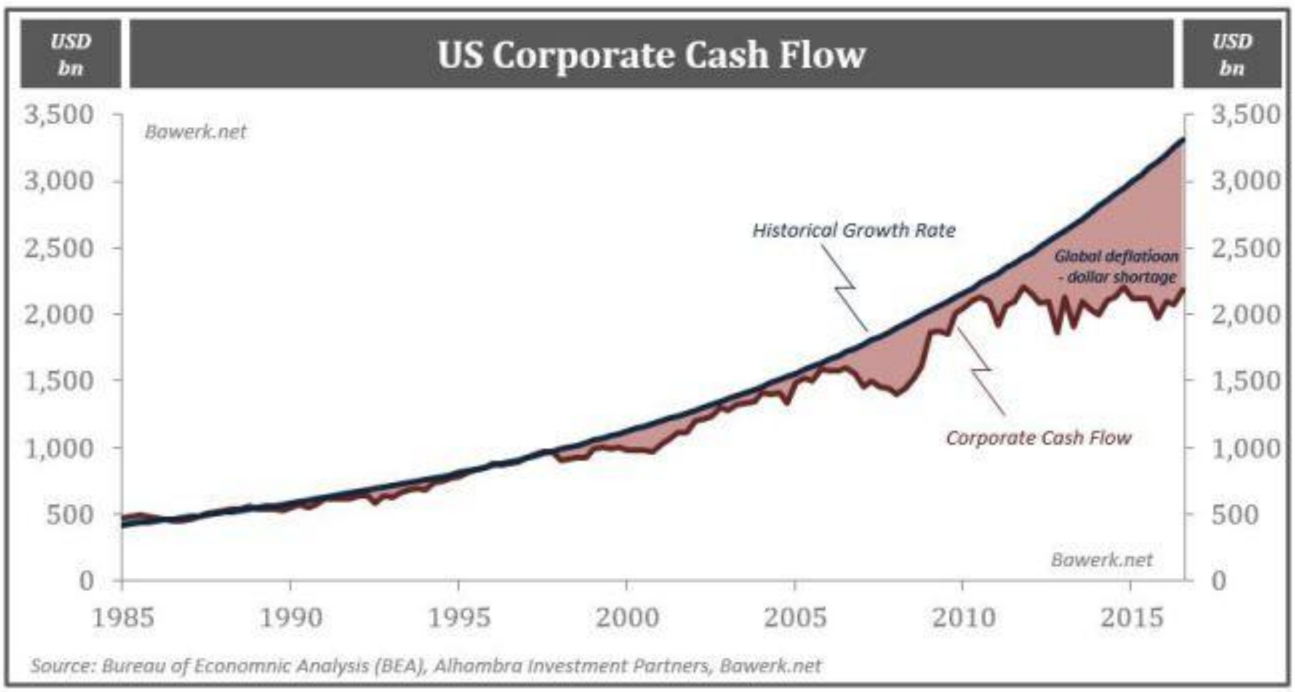
Service sector jobs have, or at least used to have, less scope for productivity improvements and hence real wage increases. Furthermore, goods producing sectors were clearly affected as they could no longer compete successfully against foreign producers. As a consequence, investments fell, thus dragging down productivity even more. Wages in tradable sectors naturally stagnated as a result. Amazingly, the real wage level in the 1970s for middle class workers is the same as today (using the BLS headline CPI index as deflator). Service sector wages must follow that of the goods producing sector and stagnated too.

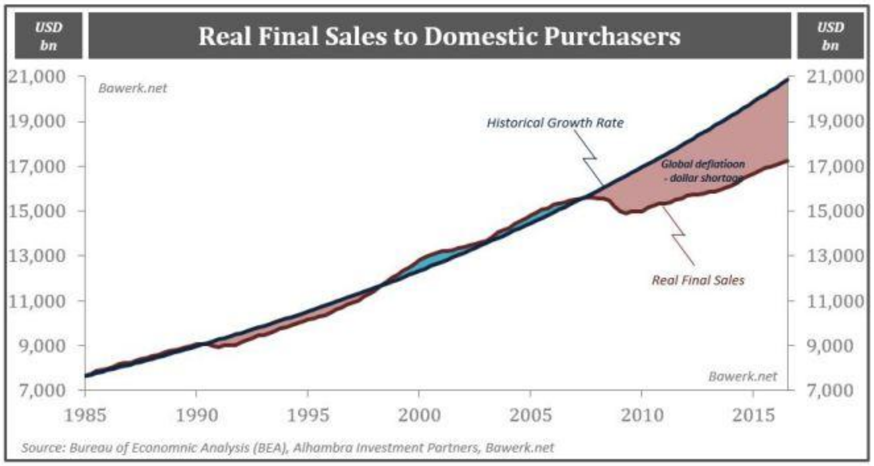


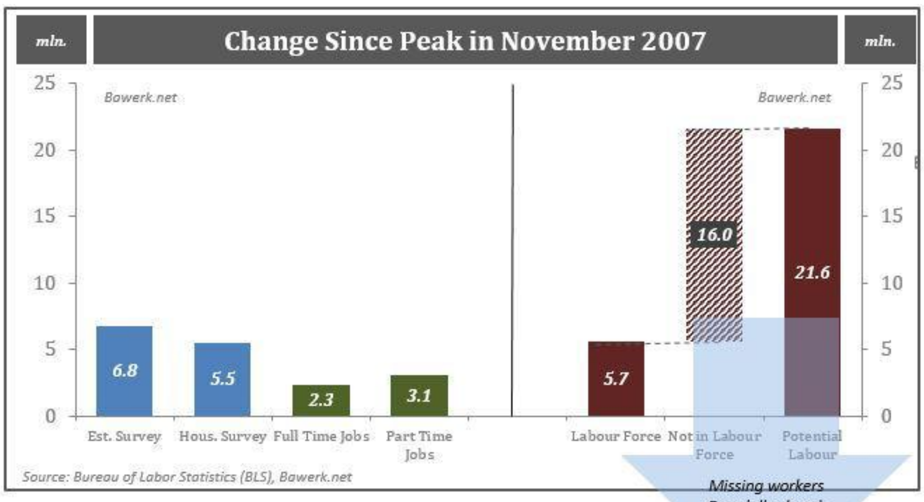
Why did this not create a political movement toward National Socialism decades ago? Simply because artificial dollar claims were still considered money good worldwide. An increasingly creative financial system, in no doubt cheered on by corrupt politicians, thus took the best and brightest and told them to create ever more dollar liabilities to satisfy world demand. The masses could thus leverage their balance sheet with ease as banks needed collateral to sell abroad. Until 2008 that is. From that point on it all came crashing down as dollar claims were suddenly deemed unsafe. Banks could no longer expand their balance sheet at will and therefore the households and business couldn't either.

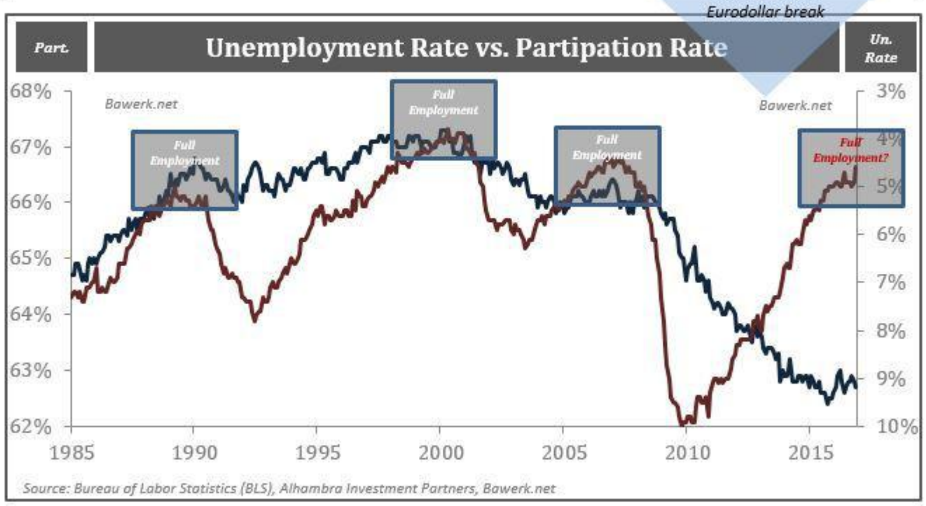
The real pain from a four-decade long boom was suddenly felt as the system moved away from its exponentially rising growth trend toward one allowed by a broken Eurodollar system. (Some of the charts below came to be with great inspiration by the excellent work of Alhambra Investment Partner economists Jeffery Snider).


2012 = 1
Industrial Production
2012 = 1
Bawerk.net
Pre-crisis growth trend
Dollar claims no longer dollar good
Industrial Production
Bawerk.net
Source; Board of Governors of the Federal Reserve System, Bawerk.net


USD bn
US Corporate Cash Flow
USD bn
Bawerk.net
Historical Growth Rate
Global deflatioon - dollar shortage
Corporate Cash Flow
Bawerk.net
Source: Bureau of Economnic Analysis (BEA), Alhambra Investment Partners, Bawerk.net







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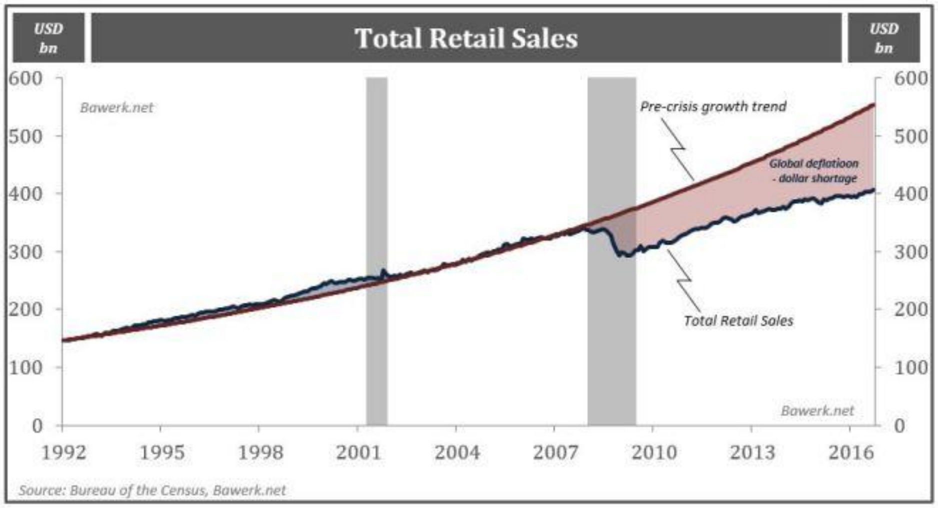
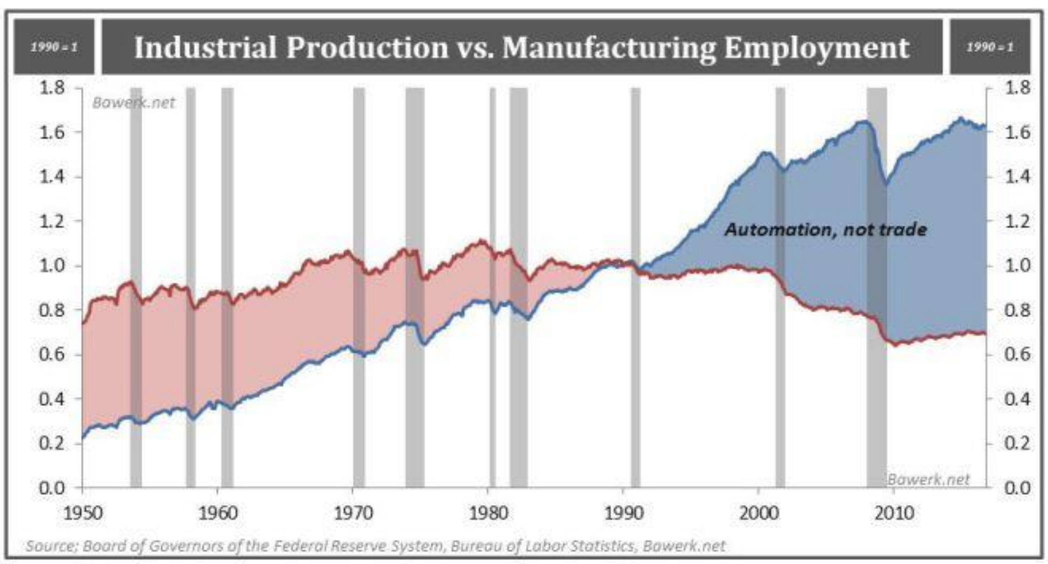


We could go on, but you get the picture. The recession of 2008 triggered a structural change in the global economy, and we are confident that the mechanism behind it is the breakdown of the Eurodollar system that came about at peak debt.

Before we end, we would like to highlight one more thing. As the American worker had to compete with zero cost foreign competitors, manufacturing businesses in the US were forced to move abroad, shut down or invest in automation. This pressured workers even more and helps explain why industrial output continued to rise even though the number of employees in the sector fell in successive waves. It is also noteworthy that this positive trend ended with the collapse of the Eurodollar.



Bottom line, the new world order that made itself felt in 2016 will be even more pronounced in 2017 with elections in the:

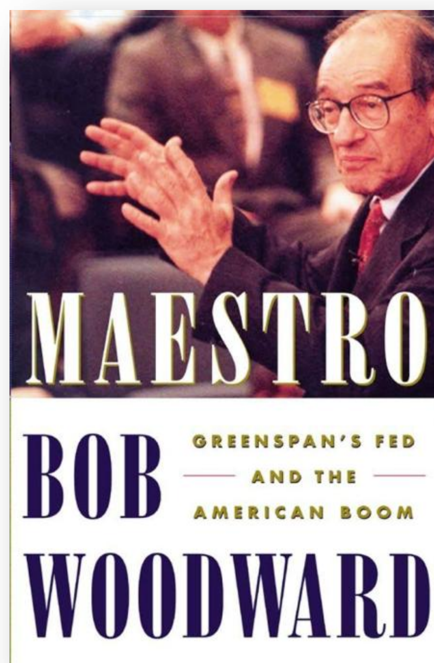
- Netherlands (Geert Wilders could end up kingmaker or even prime minister),
- France (we predict a Le Pen victory) and
- Germany (where AfD will surprise everyone).

7- CAPITALISM TO CREDITISM - *The Greenspan Legacy*

KEY MESSAGES

1. Federal Reserve Chairman Alan Greenspan gave us a legacy of Economic Obfuscation
2. Capitalism Requires Savings,
3. Capitalism Requires Productive Investment of Savings,
4. Capitalism Requires Gains in Productivity,
5. Capitalism Delivers an Increased Standard of Living,
6. Capitalism Requires a Free Market System which we have lost through Over Regulation in the US.
7. Efficient Allocation of Capital IS NOT Happening
    a. Risk Incorrectly Priced,
    b. There is a Lack of Price Discovery,
    c. Excessive and too sustained a period of Malinvestment
8. Household Savings IS NOT Happening. There is no Savings for Investment. Rather we have Credit Creation for Consumption
9. Quarterly Corporate Results Reporting
    a. Penalizes Longer Term Investment which would create major breakthrough growth areas,
    b. Penalizes for Risk Taking,
    c. Penalizes CAPEX expenditure.
10. Corporations are not Investing but rather simply "Stripping Out Costs"
11. Cheap Money has created Over Supply rather than the Wealth Effect intended to create Demand Pull (Even if successful is limited in time and scope). Rather what we face will be a demand hole which will be deflationary as Pricing Power is lost.
12. Leveraged Buyouts are now sought for Growth where costs are stripped. There is now little corporate organic growth.
13. Corporate Buybacks are stripping investable capital from productive use. This occurs when Corporations Don't See Risk Free Growth

"MAESTRO" GREENSPAN – A Legacy of Obfuscation



Like all 'Wall Streeters' for years I listened to every Bi-Annual Federal Reserve Chairman Alan Greenspan Humphrey-Hawkins Testimony. Anytime the "Maestro" spoke everyone listened. Few however understood what he actually said!

Greenspan himself acknowledged that he often resorted to obfuscation before Congress. It seemed to make it easier for the continuous revolving congressional committee members to better focus on the more salient points of his policies. The practice of Central Bankers to Greenspan was quite above the publics' comprehension, and certainly above what a politician could properly grasp.

I am not meaning to be facetious here, but stating the reverence given to Central Bankers and the magic they created during this era. But was there real magic, or like all magic, simply a great illusion?

Now after all the honors have been bestowed, we have a chance to consider Greenspan's legacy. What we see (chart below) is that during the era of Greenspan policies, Wall Street (as measured by the S&P 500) diverged and eventually completely separated from the realities of "Main Street" (as measured by the labor participation rate). What policies were so damaging or events so significant that occurred during Greenspan's tenure that would have caused or allowed this to have happened?

There is no single answer to this, but one that is little discussed nor recognized is the crippling of capitalism in America! To understand this we need to start with a basic consideration of what Capitalism is and then see how a steady cadre of poor public policy choices have lead us to a place few Americans would have believed possible in the mid 80's when Greenspan took the formal reigns of the US Federal Reserve.

CAPITALISM – Requires Savings

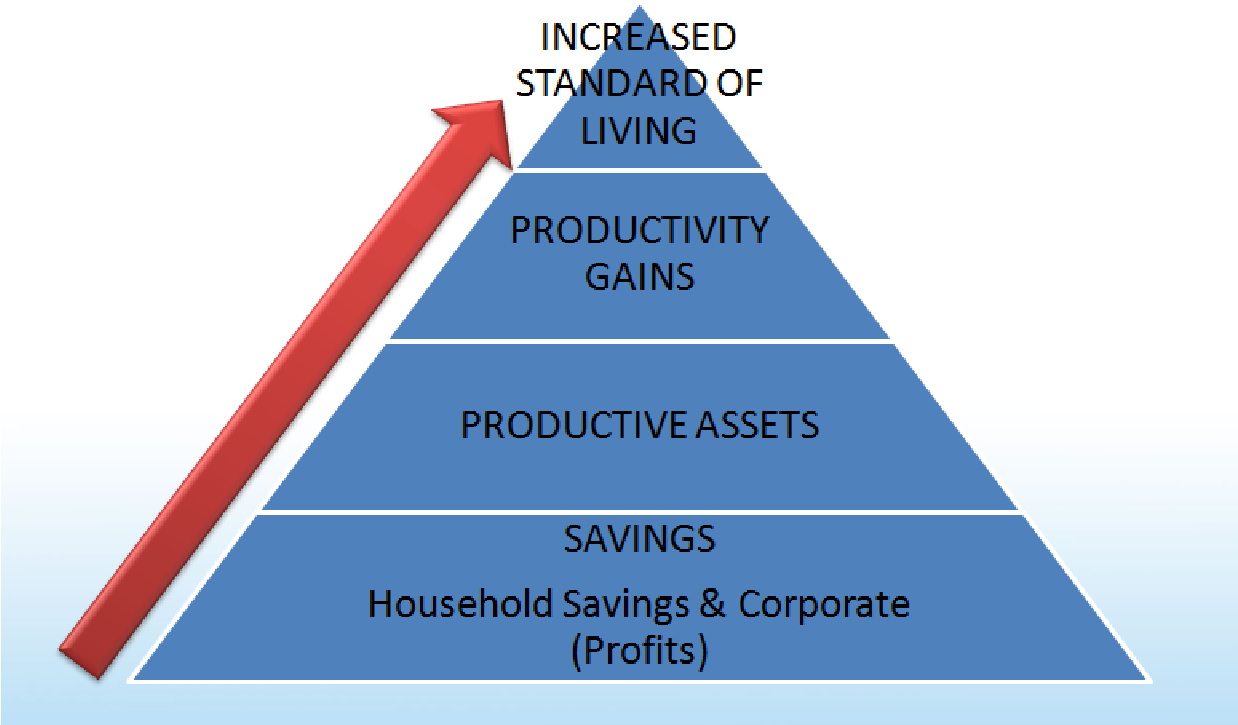
I am going to use a structure that Greenspan himself used in a recent interview (listen to interview). Asked whether he's optimistic going forward, Greenspan said:

> *"**No. I haven't been for quite a while**. And I won't be until we can resolve the entitlement programs. Nobody wants to touch it. And that is gradually crowding out capital investment, and that's crowding out productivity, and it's crowding out the standards of living where do you want me to go from there."*

As far as the US economy is concerned, Greenspan isn't optimistic:

> *"**We're in trouble basically because productivity is dead in the water**…Real capital investment is way below average.*

What Greenspan is articulating is the basis of capitalism represented in this schematic. How household savings and corporate profits have historically flowed to result in an increased standard of living for the American Society in whole.



CAPITALISM – Requires Productive Investment of Savings

The starting point for Capitalism is the creation of "Savings". These Savings come as a result of:

> Household Savings – Where consumption is delayed in lieu of keeping an element of current earnings for future consumption.
>
> Corporate Profits – After tax corporate income.

Both are available for Investment but for Capitalism to fulfill its role these investments must be made in Productive Assets or vehicles that will deliver increased productivity of the labor force.
Today, household savings are no longer a serious consideration for investment even including tax sheltered investment incentives such as IRA's & 401K's. My past Macro Analytics' and Financial Repression guest writer Michael Snyder recently pointed out the following when he wrote that: "American families are being economically destroyed".

> **#1** 47 percent of all Americans do not put a single penny out of their paychecks into savings.
>
> **#2** One survey found that 62 percent of all Americans are currently living paycheck to paycheck.
>
> **#3** At this point, more than 50 percent of all American workers bring home less than $30,000 a year in wages.
>
> **#4** According to the U.S. Department of Education, 33 percent of all Americans with student loans are currently behind on their student loan debt repayments.
>
> **#5** The poorest 40 percent of all Americans now spend more than 50 percent of their incomes just on food and housing.

#6 For those Americans that don't own a home, 50 percent of them spend more than a third of their incomes just on rent.

#7 After adjusting for inflation, median household income has fallen by nearly $5,000 since 2007.

#8 According to the New York Times, the "typical American household" is now worth 36 percent less than it was worth a decade ago.

#9 According to one recent report, 43 million Americans currently have unpaid medical debt on their credit reports.

#10 The rate of homeownership in the U.S. has been declining for seven years in a row, and it is now the lowest that it has been in 20 years.

#11 For each of the past six years, more businesses have closed in the United States than have opened. Prior to 2008, this had never happened before in all of U.S. history.

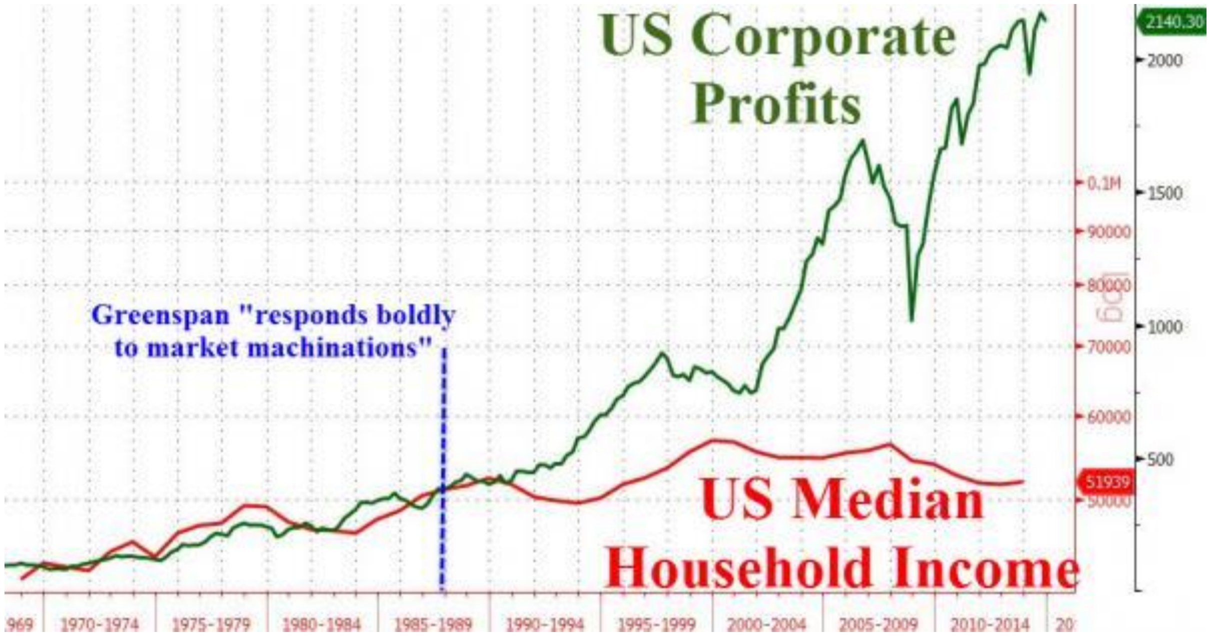
#12 According to the Census Bureau, 65 percent of all children in the United States are living in a home that receives some form of aid from the federal government.

#13 If you have no debt at all, and you also have 10 dollars in your wallet, that you are wealthier than 25 percent of all Americans.

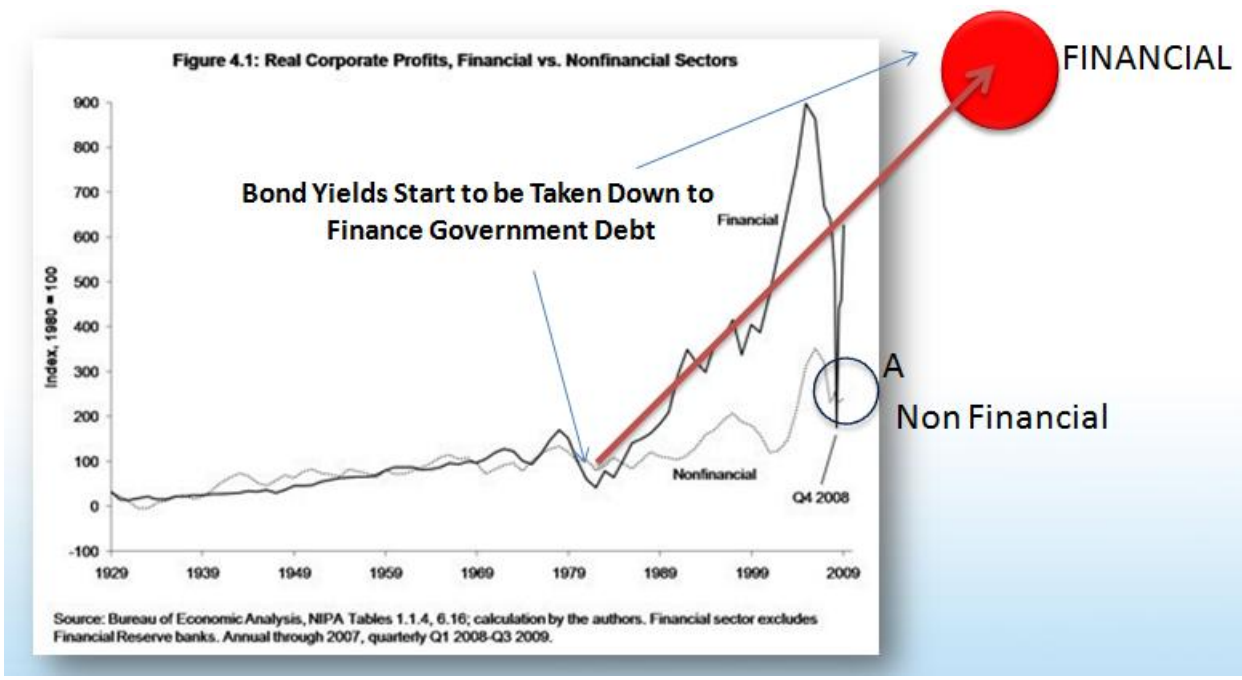
#14 On top of everything else, the average American must work from January 1st to April 24th just to pay all federal, state and local taxes.

Clearly savings by households has dramatically changed since Greenspan headed President Reagan's Council of Economic Advisors in the early 80's and the subsequently Fed Reserve Chairman.

Corporate Profits on the other hand have never been better!

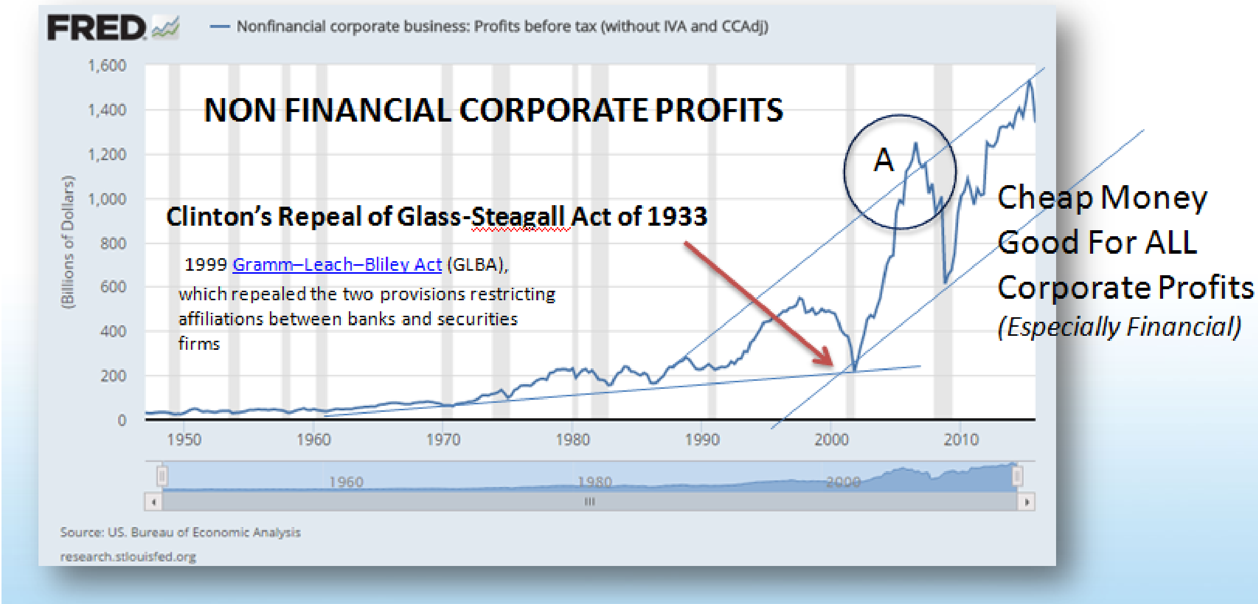


As great as corporate profits have been, the real story is in the profits of the financial sector which have been historic by any measure.



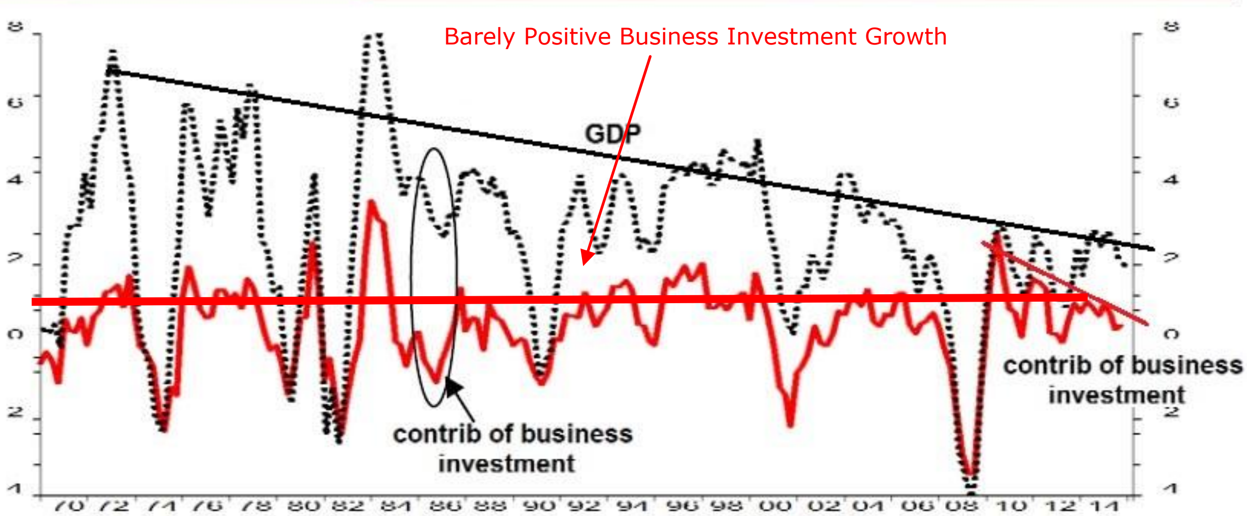
Never forget however that the financial sector doesn't produce anything but makes profits from the allocation of capital. In theory the financial sector allocates capital into the areas that will deliver the most productive use of that capital.

Since the early 80's bond yields have continuously fallen which has continuously made it easier for all corporations to make profits from reduced interest expenses. It has additionally steadily made borrowing for business investment cheaper.



So the question is: *were all these profits reinvested into productive assets?*

In an accounting sense it is ALWAYS business investment that "causes" recessions:
US GDP growth and the contribution of business investment to yoy GDP growth (both yoy%)



Source: Datastream

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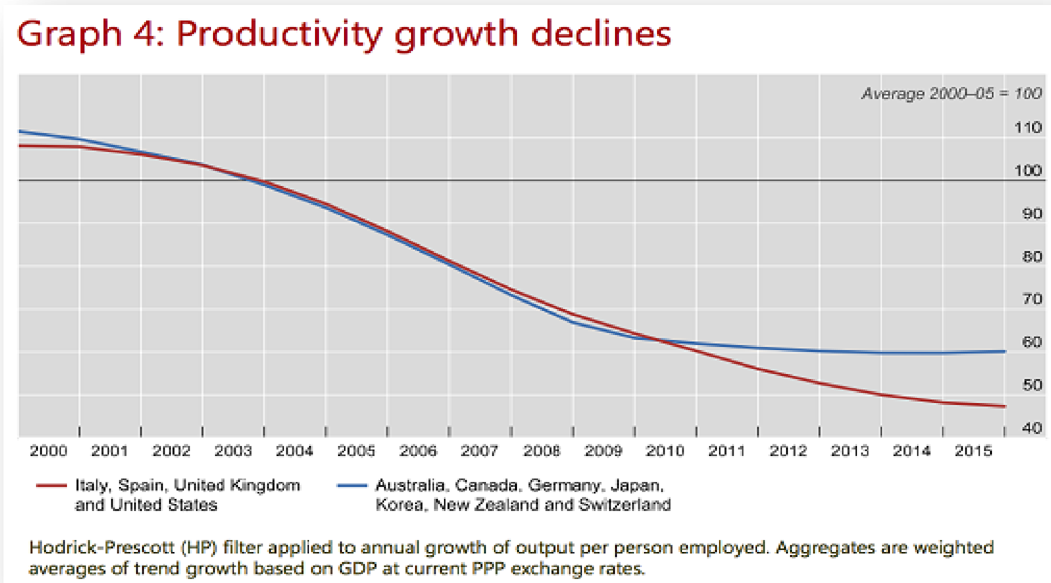
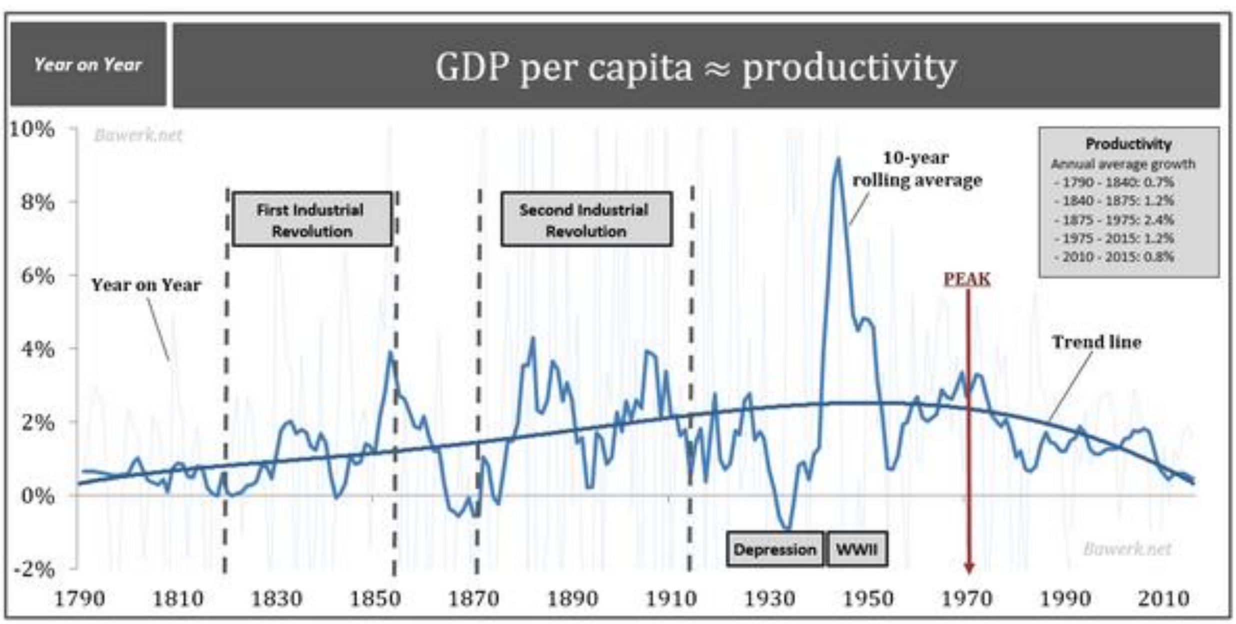
PRODUCTIVITY – The Investment in Productive Assets

CAPITALISM – Requires Gains in Productivity

To answer this question we look at advancements in productivity.



It would appear that minimally productivity is not sharing the dramatic increases which corporate profits have been realizing. Profits wherever they are going are being directed proportionally into productive assets. The productivity drop off in the developed economies mirrors the explosion in real estate values following the dotcom bubble collapse and Greenspan's dramatic reduction in interest rates, for what then was considered a sustained period of time.



Additionally, the productivity charts mirrors the investment explosion in China and Emerging Markets.

We would argue that similar to policies of Quantitative Easing, cheap money results more in ramped up Supply than Demand growth. Global supply growth has placed pressures on SU labor rates and accelerated global labor arbitrage. Investment in productive assets has been made – just not in America!

Capitalism is for all practical purposes no longer working for Americans.

Another issue with business investment is the difference in philosophy of Short Term versus Long Term Investment. No longer is business investment being made for the longer term. It is both too risky and too 'hard a hit' to short term quarterly reported earnings.

Today's obsession with quarterly earnings makes long term strategic investment something of an archaic thought and certainly not with any serious amounts of corporate capital. Accretive M&A using financial engineering is the order of the day.

The US was built on creating new industries where bold leaders took inordinate risk and employed massive amounts of capital into what was hoped would be productive assets. They produced results and America was the winner.

Vanderbilt	Railroads
Rockefeller	Oil
Carnegie	Steel
Ford	Automotive
JP Morgan	Electricity

Today's business Titans such as Bill Gates of Microsoft, employ 10's of thousands of people versus millions and produce products that remove labor, jobs and cost. There is tremendous value in this but not when it is the dominant theme as the Computer/Communications revolution was over the last 20-30 years.

In a recent Macro Analytics video, my Co-Host Charles Hugh Smith and I outlined how profits are being stripped, like a lawnmower cuts the lawn by methods that result in no new jobs, no gains in productivity, add no value to our society and the money all goes to wasteful consumption or back into non productive financial products. As Charles Hugh Smith writes:

> **THE RISE OF FINANCIALIZATION:** Financiers and financial corporations (broadly speaking, Wall Street, benefited enormously from neoliberal deregulation of the financial industry, and the conquest of once-low-risk sectors of the economy (such as mortgages) by the storm troopers of finance.
>
> **Financiers skim the profits and gains in wealth, and Main Street and the middle / working classes stagnate.** Gordon Long and I discuss the ways financialization strip-mines the many to benefit the few in our latest conversation (with charts): Our "Lawnmower" Economy.
>
> **Many people confuse the wealth earned by people who actually create new products and services with the wealth skimmed by financiers.** One is earned by creating new products, services and business models; **financialized "lawnmowing" generates no new products/services, no new jobs and no improvements in productivity**--the only engine that generates widespread wealth and prosperity.
>
> Consider these favorite financier "lawnmowers":
>
> > 1. Buying a company, loading it with debt to cash out the buyers and then selling the divisions off: no new products/services, no new jobs and no improvements in productivity.
> >
> > 2. Borrowing billions of dollars in nearly free money via Federal Reserve easy credit and using the cash to buy back corporate shares, boosting the value of stock owned by insiders and management: no new products/services, no new jobs and no improvements in productivity.
> >
> > 3. Skimming money from the stock market with high-frequency trading (HFT): no new products/services, no new jobs and no improvements in productivity.

4. Borrowing billions for next to nothing and buying high-yielding bonds and investments in other countries (the carry trade): no new products/services, no new jobs and no improvements in productivity.

All of these are "lawnmower" operations, rentier skims enabled by the Federal Reserve, *its too big to fail banker* cronies, a complicit federal government and a toothless corporate media.

This is not classical capitalism; it is predatory exploitation being passed off as capitalism. This predatory exploitation is only possible if the central bank and state have partnered with financial Elites to strip-mine the many to benefit the few.

This has completely distorted the economy, markets, central bank policies, and the incentives presented to participants.

The vast majority of this unproductive skimming occurs in a small slice of the economy--yes, the financial sector. As this article explains, the super-wealthy financial class Doesn't Just Hide Their Money. Economist Says Most of Billionaire Wealth is Unearned.

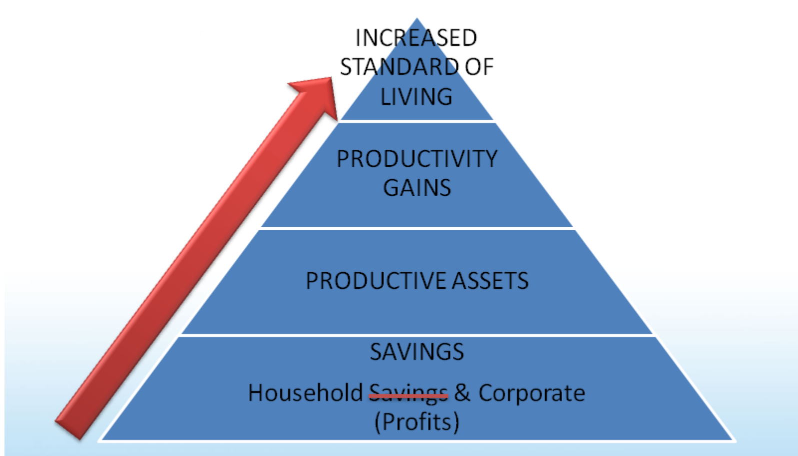
> ***"A key empirical question in the inequality debate is to what extent rich people derive their wealth from "rents", which is windfall income they did not produce, as opposed to activities creating true economic benefit.***
>
> ***Political scientists define "rent-seeking" as influencing government to get special privileges, such as subsidies or exclusive production licenses, to capture income and wealth produced by others.***
>
> ***However, Joseph Stiglitz counters that the very existence of extreme wealth is an indicator of rents.***
>
> ***Competition drives profit down, such that it might be impossible to become extremely rich without market failures. Every good business strategy seeks to exploit one market failure or the other in order to generate excess profit.***
>
> ***The bottom-line is that extreme wealth is not broad-based: it is disproportionately generated by a small portion of the economy."***

This small portion of the economy depends on the central bank and state for nearly free money, bail-outs, guarantees that profits are private but losses are shifted to the taxpaying public--all the skims and scams we've seen protected for seven long years by Democrats and Republicans alike**.**

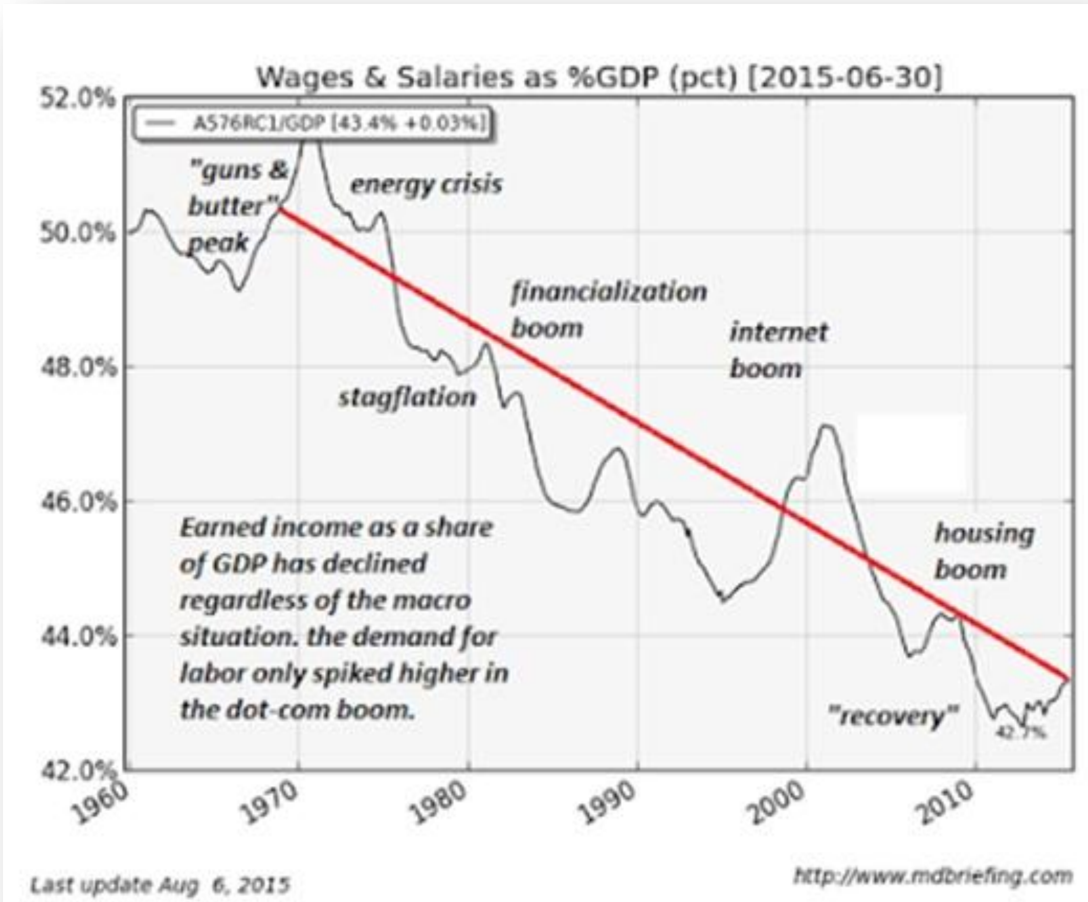
CAPITALISM – Delivers an Increased Standard of Living

So how does the US standard of living look after all this? Again from Michael Snyder

#1 For each of the past six years, more businesses have closed in the United States than have opened. Prior to 2008, this had never happened before in all of U.S. history.
#2 For those Americans that don't own a home, 50 percent of them spend more than a third of their incomes just on rent.
#3 The price of school lunches has risen to the 3 dollar mark at many public schools across the nation.
#4 McDonald's "Dollar Menu & More" now includes items that cost as much as 5 dollars.



#5 The price of ground beef has doubled since 2009.
#6 In 1986, child care expenses for families with employed mothers used up 6.3 percent of all income. Today, that figure is up to 7.2 percent.
#7 Incomes fell for the bottom 80 percent of all income earners in the United States during the 12 months leading up to June 2014.
#8 According to the U.S. Department of Education, 33 percent of all Americans with student loans are currently behind on their student loan debt repayments.



CAPITALISM – Requires a Free Market System

For capitalism to work effectively it requires a free market system. This is not the environment we any longer have in America. We now have:

Excessive Government Interference and regulation,

Restrictive & Disincentive Taxation Policies

Incentives for Financial Engineering versus Investment

The list is longer but this is not the purpose of this article.

What capitalism delivers:

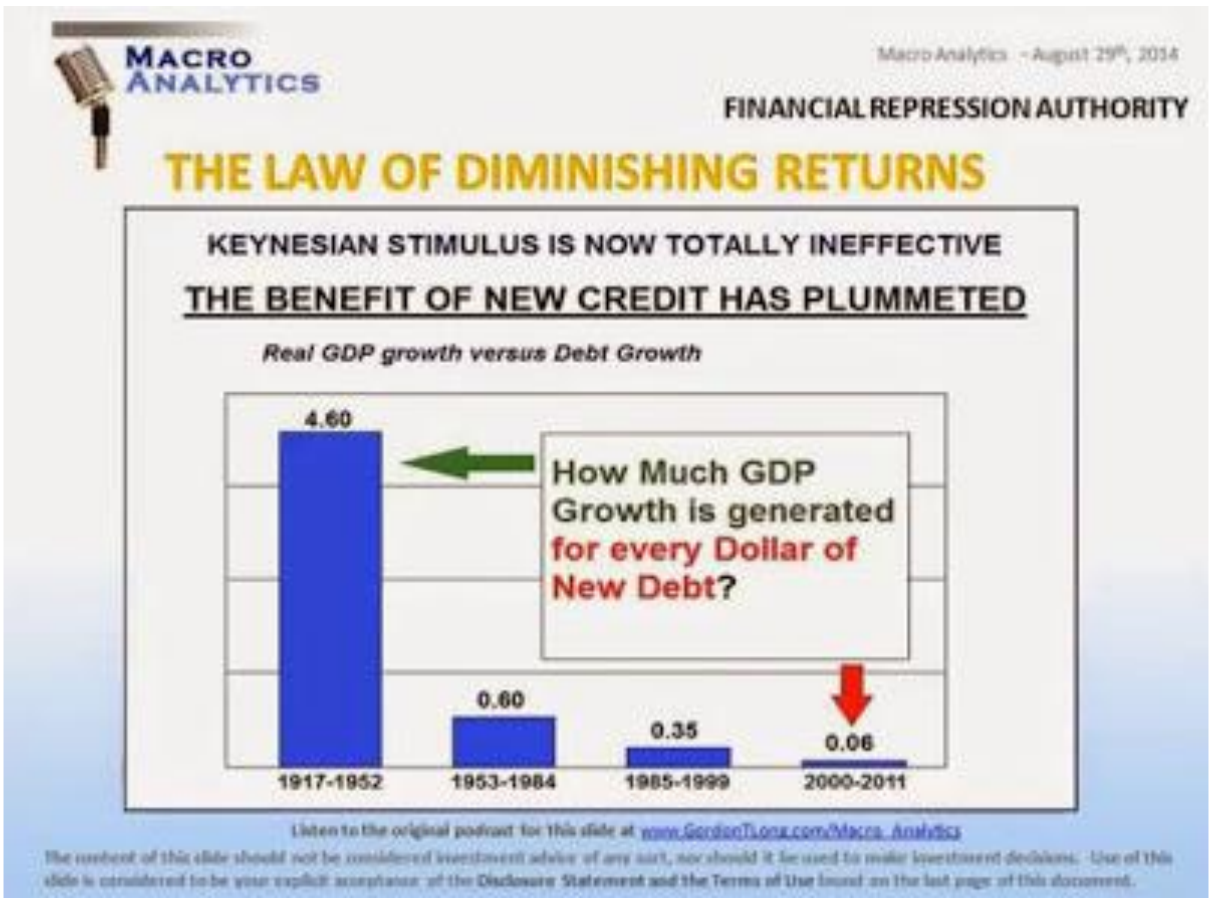
"Is MORE for LESS". What we have now based on the above is "LESS for MORE"!

Today Savings is penalized with ZIRP, NIRP, and government policies of "inflation targeting",

Money is pushed into consumption by the government (versus savings) to sustain a 70% consumption based economy.

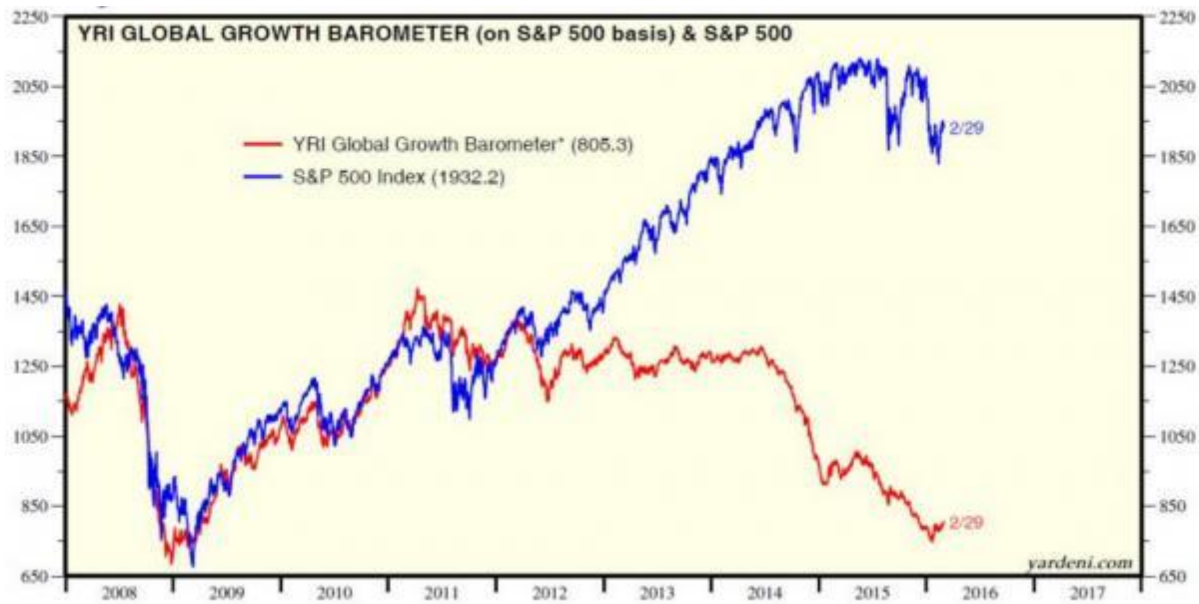
The government believes it has no choice but to follow policies such as Quantitative Easing though they are clearly counterproductive. This is the road that Alan Greenspan placed us on decades ago. First in the 1990s during the era of "Irrational Exuberance" and then following the Dotcom implosion.

We were very clear in 2011 that new credit was even then on the verge of becoming ineffective. We felt it would be convincingly negative by 2012.



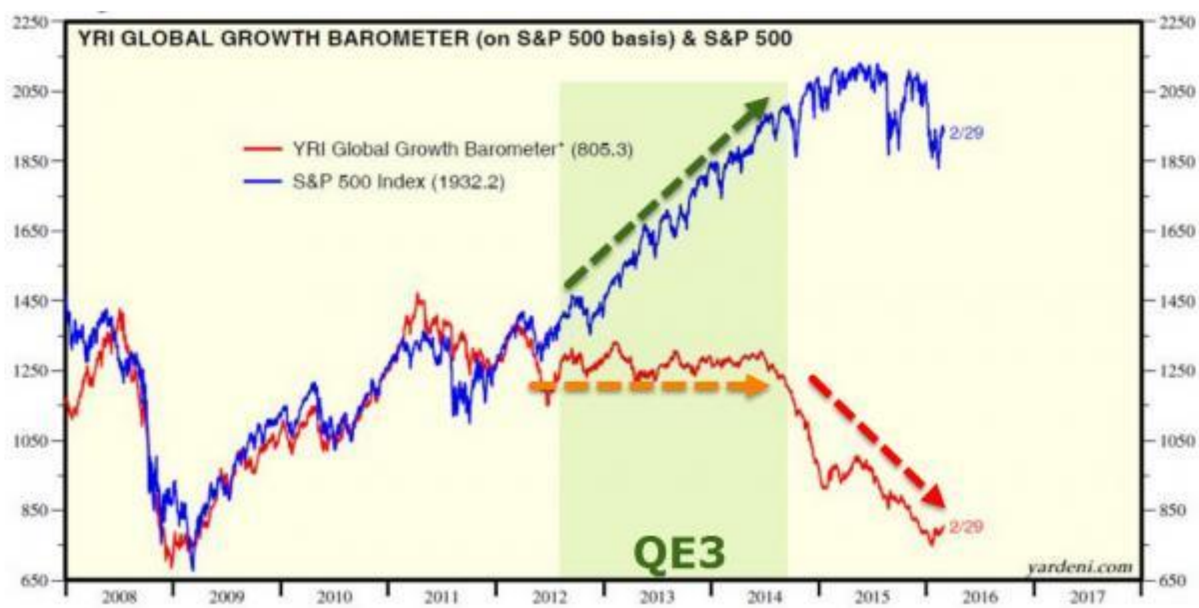
And if you need help spotting the moment when monetary policy became impotent...

Yardeni's YRI Growth Barometer versus S&P 500. Note 2011 / 2012 turmoil.



Source:Yardeni.com

Of course the Federal Reserve had no other option than to keep printing until the banks were solvent and loan collateral values were elevated.



This chart by Sprott Global is an approximation. It should be more accurately showing the drop in 2011 and 2012 but it tells the story effectively.

Chart B

This is all you need to know about Keynesian Economics in an era of Fiat Currencies (Keynes would have been shocked at the removal of the Gold Standard) and the Era of Financial Repression (George Orwell and Aldous Huxley wouldn't be shocked!)

MASSIVE SHIFTS OCCURRING – Reacting Wrongly

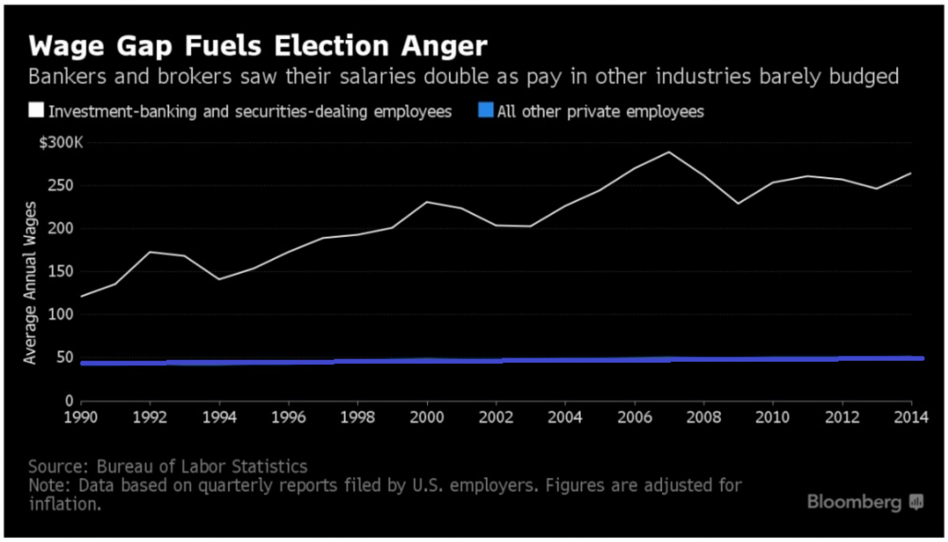
We now have massive headwinds which will stymie and frustrate continued government efforts. Three factors alone may prove insurmountable to create the inflation needed to manage the unsustainable US debt.

1. Technology - Information Revolution now "Kicking in"!
2. Demographics - Dent's Spending Cycle
3. Globalization - Corporate Labor Arbitrage

The problem in America and the Developed Economies of the world is too much debt and not enough growth. It is unsustainable and inextinguishable.

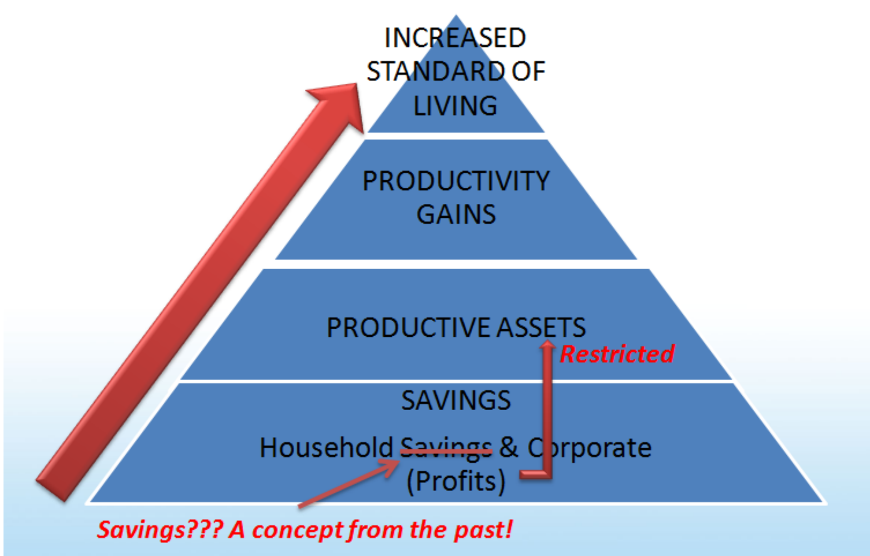
The problem will not be solved primarily because of a lack of leadership & true understanding by the political apparatus. Economies are manipulated and fragile while government must push for Inflation to cheapen debt burden unfortunately a crisis is inevitable at some point in the future.

CONCLUSION



Above is a visualization of how badly Main Street has performed vs. Wall Street. Here is what Mike Krieger of the Liberty Blitzkrieg blog has to say about this chart:

> The next question one should ask is, ***how has Wall Street helped the U.S. in order to deserve such incredible financial success?*** Well they mass produced fraudulent products, destroyed the global economy and then demanded a massive taxpayer bailout for starters. A year after the banker bailouts, Wall Street bonuses were at record highs, while Americans were still being kicked out of their homes. **That's about as close a link you're going to find between Wall Street and Main Street.**
>
> The reason I bring this up today is not to increase the public's rage against the bloated financial sector and the obvious harm it does to society, **but to highlight an example of how the status quo invents and propagates a myth in order to deceive the public.** The good news is that they always keep recycling the same myths, so once we understand their game plan, the potency of their lies diminishes. **Let's make sure they can't use the Wall Street/Main Street one ever again.**



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Capitalism:

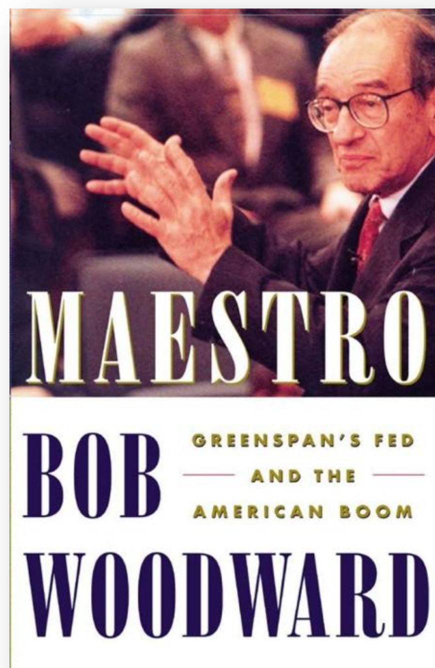
- Efficient Allocation of Capital IS NOT Happening
    - Risk Incorrectly Priced,
    - There is a Lack of Price Discovery,
    - Excessive and too sustained a period of Malinvestment
- Household Savings IS NOT Happening. There is no Savings for Investment. Rather we have Credit Creation for Consumption
- Quarterly Corporate Results Reporting
    - Penalizes Longer Term Investment which would create major breakthrough growth areas,
    - Penalizes for Risk Taking,
    - Penalizes CAPEX expenditure.
- Corporations are not Investing but rather simply "Stripping Out Costs"
- Cheap Money has created Over Supply rather than the Wealth Effect intended to create Demand Pull (Even if successful is limited in time and scope). Rather what we face will be a demand hole which will be deflationary as Pricing Power is lost.
- Leveraged Buyouts are now sought for Growth where costs are stripped. There is now little corporate organic growth.
- Corporate Buybacks are stripping investable capital from productive use. This occurs when Corporations Don't See Risk Free Growth

What we have is:

FINANCIALISM instead of CAPITALISM

CREDITISM instead of CAPITALISM

This is the legacy of the Maestro.



8- FURTHER CONSTRAINTS & IMPEDIMENTS

KEY MESSAGES

1. We have a Short Term oriented Corporate Culture that is Constricting Real Economic Growth,
2. We have Regulatory Shackles Limiting Growth,
3. We have an Uneven Playing Field through the Advancement of Crony Capitalism,
4. We have a Massive Inflationary Bleed of Capital from the Economy. Inflation is simply another form of Taxation,
5. Because we are Consuming More than We Produce we are now Getting Less for More versus More for Less. The latter normally occurs in a healthy economic society.

A CONSTRICTING SHORT TERM CULTURE

We created and fostered a short-term oriented corporate culture that is constricting real economic growth. There is little incentive for executives or Boards to take major risks that will take years to be realized, but have the potential to change the entire corporation, industry and potentially the world.

Shareholders want immediate results only. No one is any longer incented to take the risk that will create the 600 million new jobs the World Banks reports we will need within 10 years!

"OW! OW! OW! THIS RED TAPE WILL KILL ME!!"

REGULATORY SHACKLES

We have built a bureaucratic regulatory environment in the US and the developed economies which is shackling and highly restricting real economic growth. Every politically correct constituent must have their ideas 'baked" into law for the betterment of mankind, but not necessarily for the betterment of business enterprise.

THE INFLATIONARY BLEED

We have a massive inflationary bleed of capital from the economy through inflation. Few understand that Inflation is simply a hidden form of taxation.

UNLEVEL PLAYING FIELD & CRONY CAPITALISM

Because of limited growth, the size of government in the country and to avoid risk, corporations have oriented their strategies to regulatory arbitrage, using influence to alter regulations to their advantage and using the political process to gain advantage. What we have is advanced "Crony Capitalism" which is stifling real economic growth.

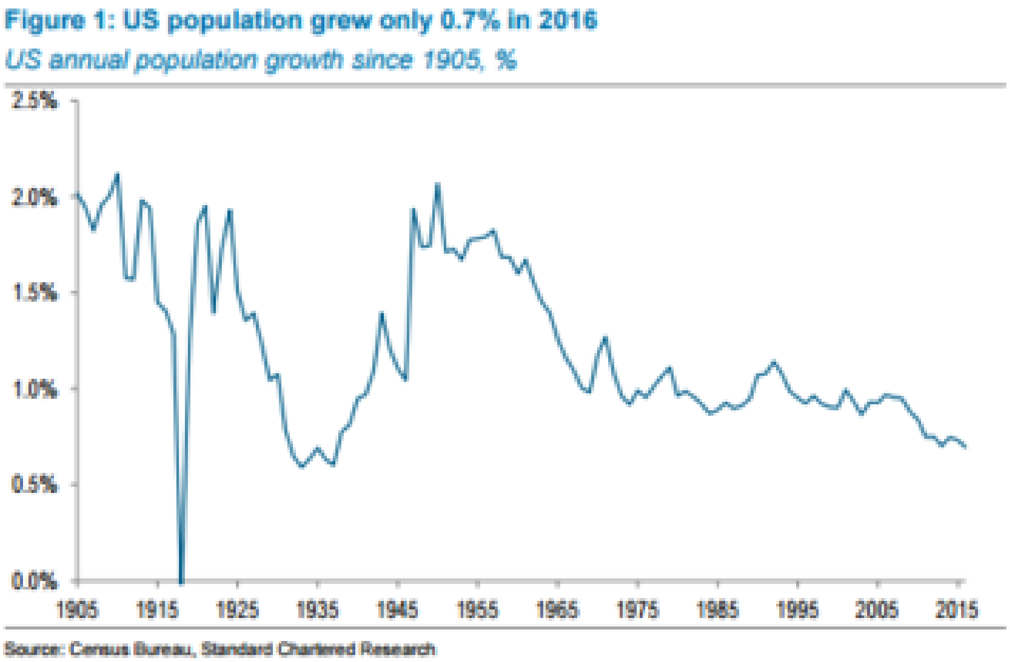
CONSUMING MORE THAN WE PRODUCE

The bottom line is the developed nations have reached the point where they now consume more than they produce and use debt financing in their own fiat currencies, with the emerging markets, to pay for it. How long does this last??

DEMOGRAPHICS IS CONTRIBUTING TO THE IMPEDIMENTS TO US STRUCTURAL GROWTH

Like many things, including business formation, productivity and capital spending, the expansion in U.S. residents shows sustained damage from the financial crisis of 2008-2009.

The American population rose by 0.7 percent to 324 million people last year, according to an estimate released by the Census Bureau in December. That matched 2013's figure for being the smallest rise since 1937, when the country was struggling with the Great Depression.

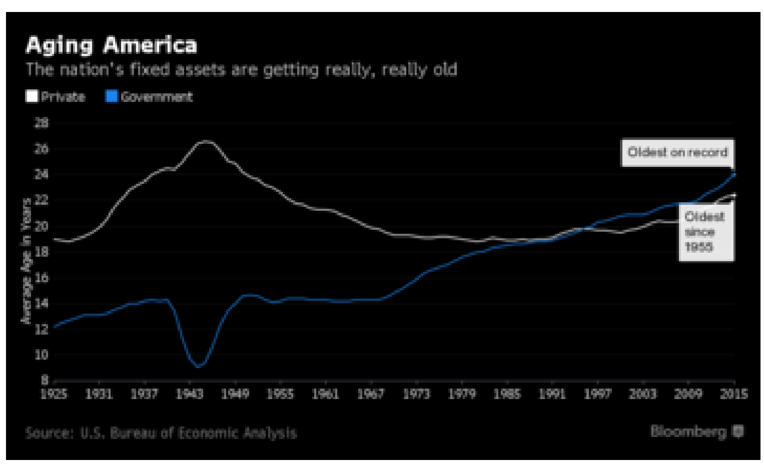


Source: Standard Chartered Plc

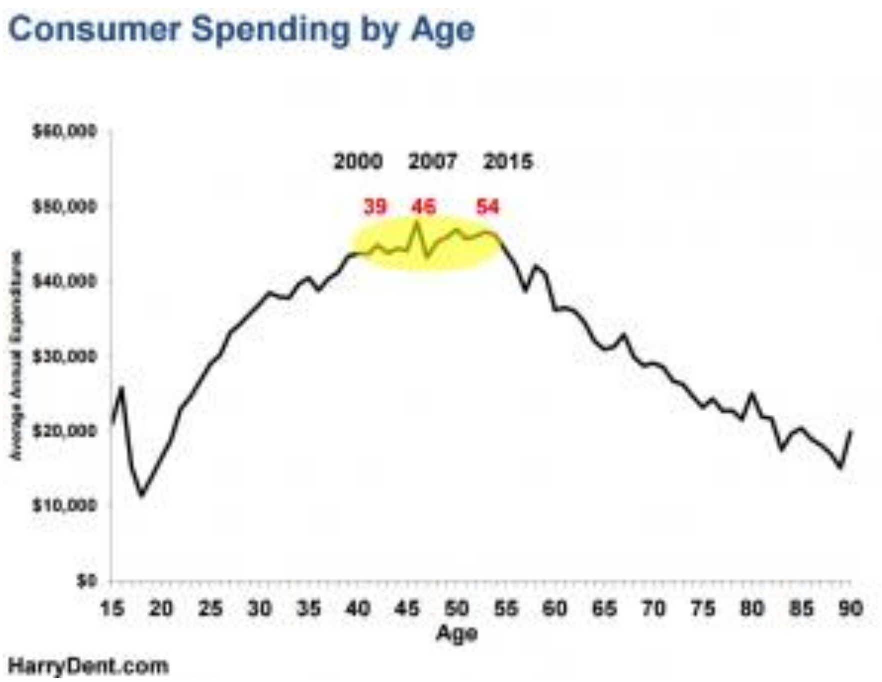
"This is a stark reminder that the ongoing productivity challenge seen since the global financial crisis is compounded by continuing demographic headwinds,"

Since the last recession ended in 2009, the U.S. economy has expanded about 2 percent a year while population gains averaged 0.76 percent — a slowdown from 0.93 percent in the 10 years to 2008.
The nation's real estate market is already feeling the hit. The number of new households has averaged 32 percent fewer in the past five years than in the decade to 2008.

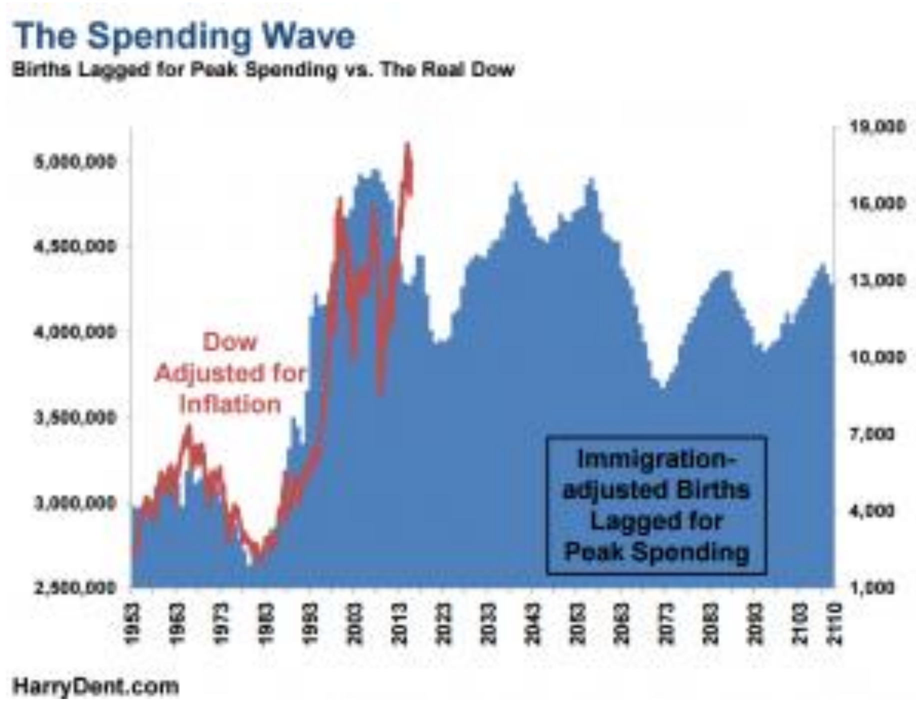
That means lower demand for everything from builders to painters to home appliances — reducing incentives for companies to boost investment in the U.S., despite aging plants and equipment:



This is significantly increased by the fact the US population is getting older and therefore is spending less.



Most people do not enter the workforce until they're 20 then they go on a huge spending cycle which eventually slows down at the age of 39 because people buy their largest home well before they peak in spending. We peak at age 46 and continue the trend because of automobile purchasing and especially with QE; the affluent people go to school longer which is followed by their kids and so on. Therefore peak spending for these people happens 6 years later, and it has been magnified due to QE since these are the same people who of the entire population are the ones who tend to own financial assets.



9- WHEN GROWTH FAILS

KEY MESSAGES

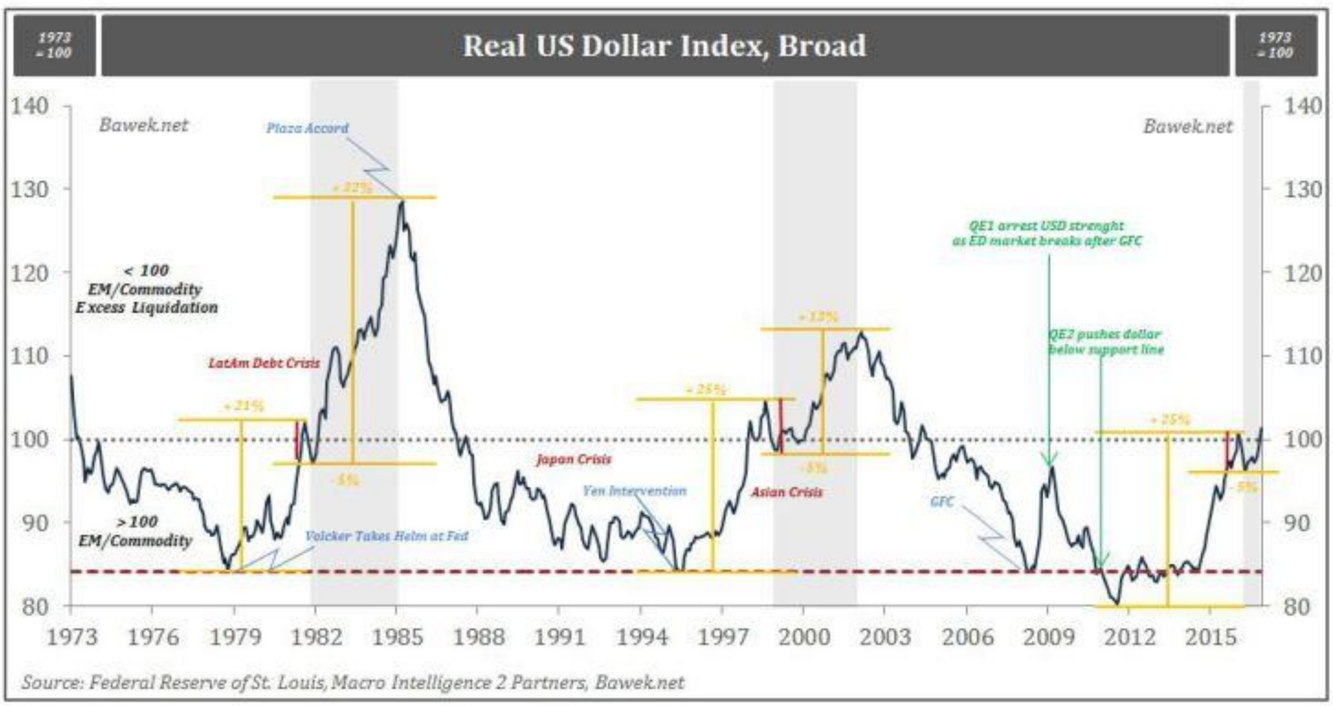
1. We have a Global EuroDollar Problem,
2. We have a US Dollar Reserve Currency Problem,
3. Leverage Will Fail Because of Cascading Rehypothecation,
4. Leverage Will Fail Because Repos are not Sound Collateral,
5. There is Now A Global Rush To Hard Assets and Away from "Digital" Representation of Assets

A GLOBAL DOLLAR – EURODOLLAR PROBLEM

Submitted by Eugen von Bohm-Bawerk via Bawerk.net,

While known to the investing public for years, the Bank of International Settlements (BIS) recently acknowledge that **the real risk-off / risk-on metric in global markets is the dollar and nothing else.**

In the chart below, which we recreated from an absolute brilliant presentation by Macro Intelligence 2 Partners via RealVision-TV, we **see the potential scale of the coming "dollar-problem".**



The dollar moves in cycles as most things. The lower extreme around 84, only broken when Bernanke pushed through QE2, means financial conditions for emerging markets and other commodity producing economies have gotten so out of hand that conventional risk-metrics finally lead investors to pull back. The trigger, as can be seen in the chart, is often policy driven, but the underlying structural imbalance has been building for years, if not decades, prior.

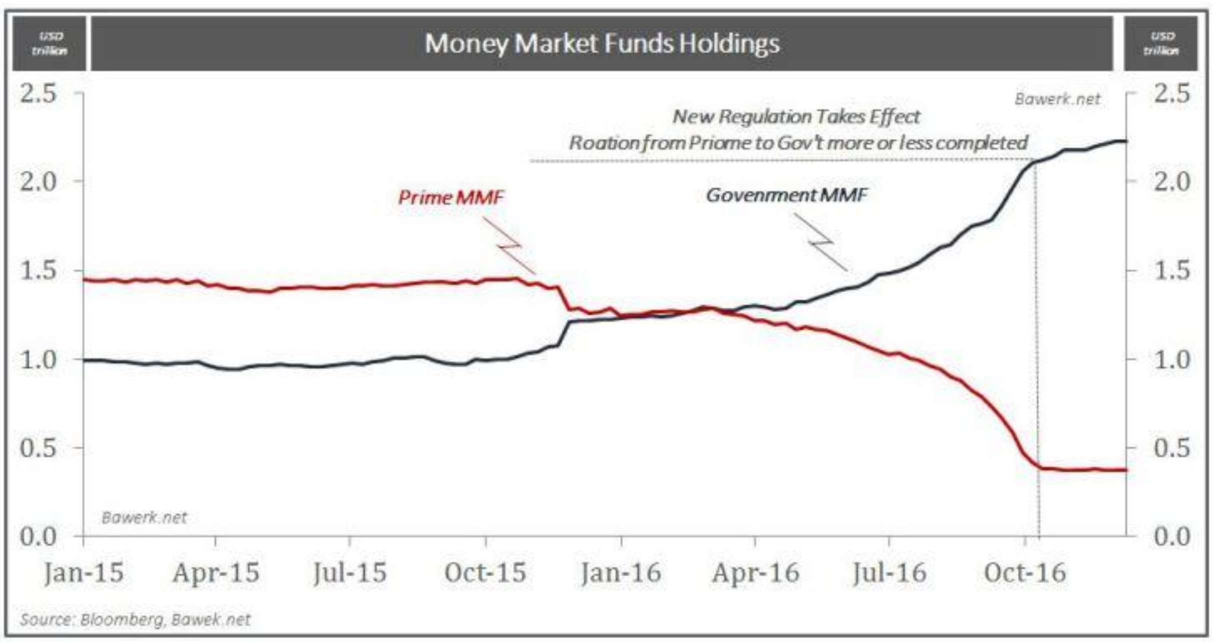
Before we move on it is of utmost importance to understand that many of the dollar liabilities accumulated outside the United States are not backed by actual dollars, but are rather claims to dollar proper. This is the infamous Eurodollar market whereby banks, mostly international European ones, fund various economic activities by issuing claims to dollars, but for which no such dollars exists. Think of it as another layer of fractional reserve lending on top of fractionally created money in the first place.

When risk metrics stray too far from what is considered prudent, investors start to pull money out from emerging markets, and obviously demand that their investments are paid out in

dollars. To comply, international banks scramble to get hold of as many dollars as they can in the shortest time possible in order to fulfil their part of the bargain. The value of the dollar jumps as demand suddenly outstrips supply. Financial conditions in emerging markets tighten significantly and it becomes impossible to fund further expansion. Emerging market banks, with dollar liabilities and LCU assets are particularly vulnerable. **The boom turns to bust as the Eurodollar market breaks.** If the cycle gets out of hand, as it did from 2008 onwards, banking solvency is not only limited to local emerging market banks, but to the international banking community at large.

Taking a closer look at the previous dollar cycles, as represented by the *real* broad based dollar index we find that the initial shock pushes the dollar 20 – 25% higher from its low. It then pauses, drops 5% before starting a second leg higher (we outlined this process back in October). **This is exactly where we are at now and if history repeats itself, which we believe it will, a new financial crisis is brewing just under the surface as the dollar moves into its second leg.**

There are also other compelling arguments for the strong dollar case. If President-Elect Trump moves forward with his policy promises, such as changing the tax-system in accordance with the principle of destination based taxation; exports will be tax exempt, while imports will fully taxed at the corporate rate. The dollar may strengthen as much as 10 – 15% on this tax alone. Furthermore, if American companies repatriate some of their trillions held abroad it will put additional pressure on the price of dollars. Some may argue that dollars held in Wall Street are just as fungible as those held in Tokyo, Hong Kong or London, but given new money market regulations that may no longer be the case. **Prime funds are starved of cash, while those investing in government bills are flush.** It is therefore highly likely that repatriated cash will be stuck in New York money markets and create additional pressure on Eurodollar markets.



In *Toward a New World Order, Part III* we showed several structural breaks occurring in US economic time series after 2008. Similar breaks can be found throughout the world. These are all directly related to a broad based funding problem stemming from Eurodollar scarcity and a higher price of the dollar. While dollar-QE interrupted this downward trend intermittently, it was never a solution to the problem, which is one of misallocation of capital and malinvestments. QE only help fund capital consuming economic activities, commonly referred to as bubbles, and as soon as QE injections stop, capital reallocation toward a sustainable economic constellation resumes. **QE is thus an extremely destructive policy as it depletes an already stretched pool of real savings available to fund economic projects.**

We created a proxy for the state of the Eurodollar by summing up balance sheets of major European banks and what that simple exercise reveals is not a recession and weak recovery, **but the ongoing depression that has been so detrimental to Western economies for the last ten years.**

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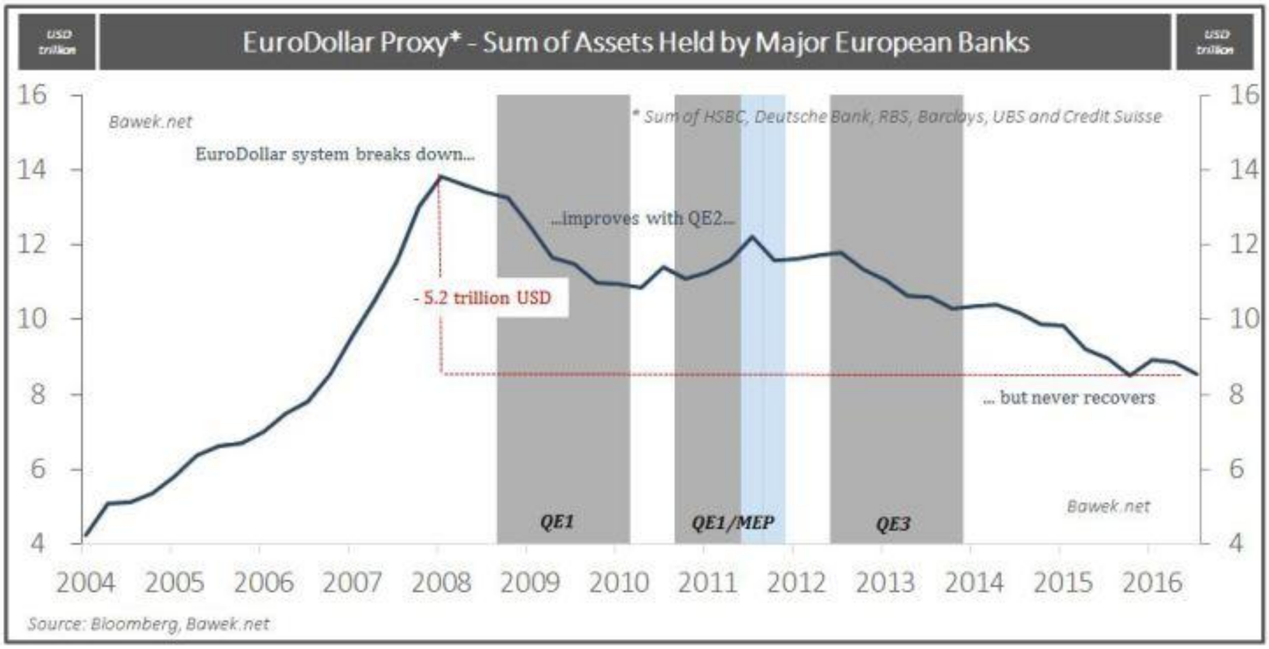
Our Eurodollar proxy peaks with the financial crisis, falls rapidly despite QE1 (which was a more technical program designed to fund shadow banks within the US and didn't really increase the supply of dollars globally), but recovers slightly during QE2 with its focus of pushing dollars into the global system. **It is interesting to note how different the proxy reacted to QE3, a program designed just as QE2.**



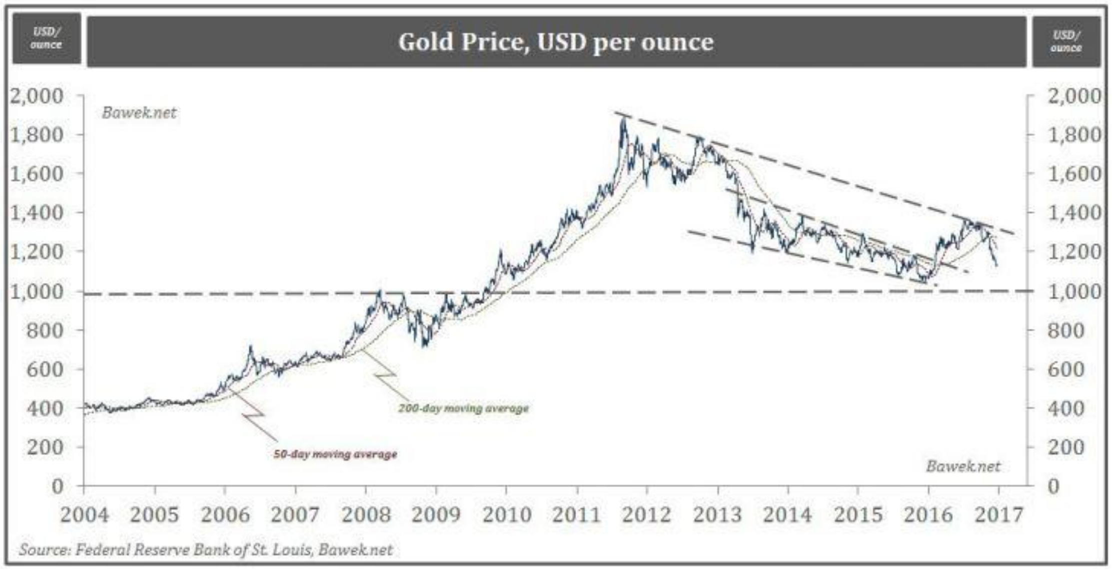
Our proxy showed tentative signs of a global financial system finally able to adjust to the new reality. By late 2015 the Eurodollar market had stabilized. Forced by unforgiving market forces and zealous regulators, banks increased their capital ratios and scaled down. **However, just as the system started to cope, our money masters in their infinite stupidity decided they wanted to force banks to re-leverage their balance sheets again in what can only be interpreted as a schizophrenic Leviathan**; regulators (often within the central bank itself) told banks to deleverage, while central bank policies tried to make banks leverage. We are of course talking about negative interest rates. By charging banks to hold their excessive reserves at the central banks, the idea was that banks would feel compelled to invest money in the main street economy.

As is now clear to all, maybe with the exception of the Ph.Ds. polluting the world central banking community, **negative interest are a deflationary force in itself.** Yield curves crashed, net interest margins were squeezed, and with Main Street at peak debt, there have been little appetite for more debt. It has been such an abject failure that the Bank of Japan have more or less admitted their mistake by introducing yield curve control. **That step was originally an attempt to steepen the yield curve, but has since backfired spectacularly as the JGB 10-yr rushed through the zero percent level with the election of Donald J. Trump for the US Presidency.** Now they are forced to put a lid on JGBs in order to maintain the zero target.

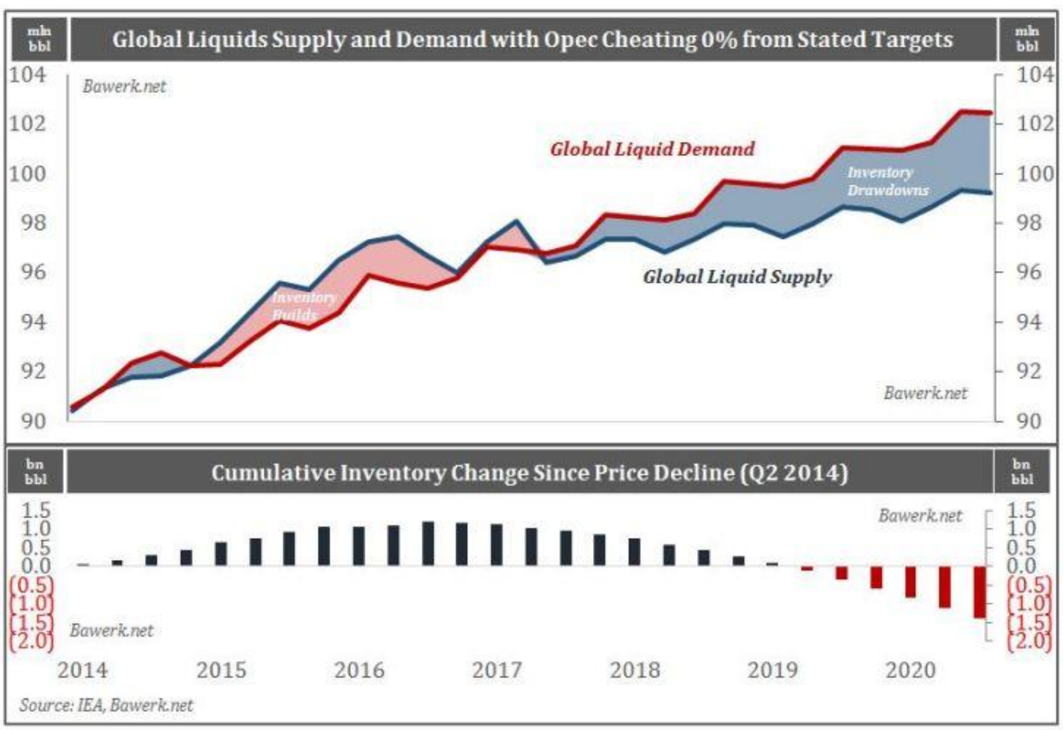
Lastly, if the US current account deficit shrinks, as tariffs and arm-twisting make US Inc. think twice about moving production abroad or even re-shoring some of their existing capacity and a resurgent shale oil industry increase oil production on back of OPEC jawboning, the global dollar supply / demand imbalance will only be aggravated.

In 2017 we expect the dollar to gain another 10 – 20%. This will create immense pressure in several emerging markets such as Turkey, South Africa, Indonesia, Brazil and India. While they have managed to reduce their current account deficits considerably, large amounts of dollar denominated liabilities need to be rolled over in 2017. The US, which currently experiences a mini-boom on the anticipation of Trump policies on top of large dollops government spending prior to the election, will head into recession as the Trump-amplifier turns out to be a dud. Deflation expectations re-emerge to the great surprise of most pundits, but a US led deflation will be nothing compared to what the inevitable Yuan devaluation (or stronger pace of depreciation) will create; in this respect, the German economy, with its heavy reliance on capital goods exports, looks particular vulnerable.

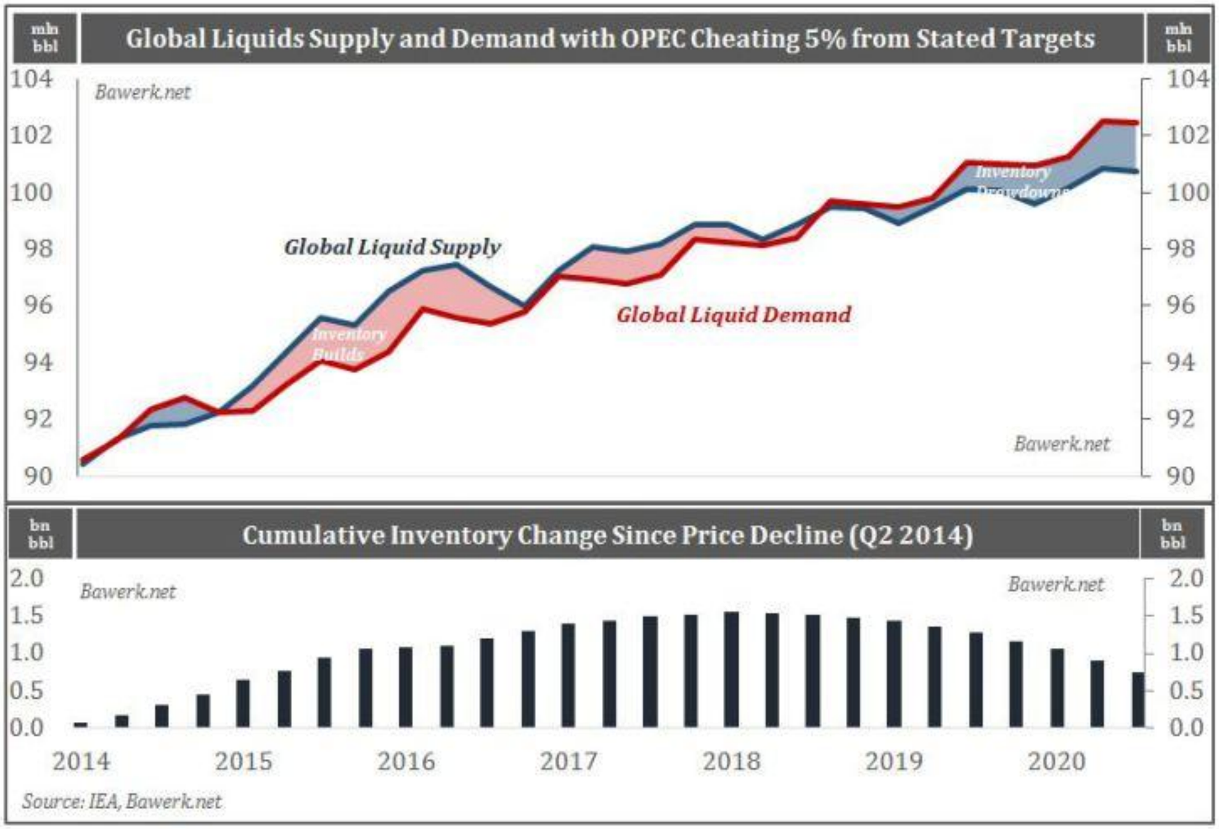
We expect gold to fall below USD1,000 per ounce (which will be a great buying opportunity).



Crude oil will probably fall into the low USD20s per barrel as the OPEC-deal fails to materialize and demand projections prove too optimistic. If OPEC fully comply with the announced deal inventories will start falling in Q1 2017 and provide data oil traders will justify further bullishness. In other words, short term, crude may move higher on OPEC and Trump, but in the medium term it is highly likely the glut will persist and pull the rug under all the bullish bets out there.



However, **if OPEC cheats only 5% from the announced deal the first inventory drawdown will be postponed one year**, and the cumulative inventory overhang will persist well into the 2020s.



Yield steepeners are in vogue today, but if the dollar thesis plays out as expected, you should load up on cheap yield flatteners in the "safe havens".

The most important and interesting question though is this; ***what will the Fed do when they realize that their hiking cycle triggers the global risk-off trade?*** QE4? At that point everything we just said changes. ***QE4 will probably be the sign that velocity is about to take off and create the dreaded deflation-inflation whip-saw we expect over the longer term.***

WHEN LEVERAGE FAILS

Cascading Rehypothecation

What few appreciate today is that ever since "Debt Instruments" became "Assets" we have been steadily pyramiding their use as collateral.

If for example you buy a car and finance it you are considered the owner of the car but also the owner of a liability (the debt).

You may possibly be allowed to borrow against the equity in your car but seldom is it sufficient and loans usually do not originate this way.

However, the debt you owe is considered an asset and can be used as collateral to secure a loan or increase leverage. In-turn, the institution that then extends credit to the initial institution that made the car loan can claim their loan as an asset and also secure a loan. In a fractional bank system this pyramiding is restricted by reserve requirements. Today in the debt market this "rehypothecation" of the car loan has no limitations.

Your car may actually be the collateral that is securing quite literally 100's of thousands of dollars in leveraged loans.

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Financialism is Not Capitalism – Repos are not Collateral

Taken From: [Financialism, Not Capitalism]
by Jeffrey P. Snider

The Fifth Amendment decrees, "No person shall be…deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation." Private property is central in this amendment because private property was understood then as a central check not just on government but as the primary tangible instrument of freedom. There was and is everything a man might think up and dream, but what he could do with such endeavors is as important in the plying of a just and stable social arrangement.

John Adams once wrote, "The moment the idea is admitted into society, that property is not as sacred as the law of God, and that there is not a force of law and public justice to protect it, anarchy and tyranny commence." George Mason himself had declared, "Frequent interference with private property and contracts, retrospective laws destructive of all public faith, as well as confidence between man and man, and flagrant violations of the Constitution must disgust the best and wisest part of the community, occasion a general depravity of manners, bring the legislature into contempt, and finally produce anarchy and public convulsion."

It wasn't just the Founding Fathers who called private property the "bedrock of capitalism", though of course they never used those terms invented later, as it had been very well understood especially as an outgrowth of the Enlightenment. Winston Churchill, the greatest of English statesmen, said in the 20th century that:

Personally I think that private property has a right to be defended. Our civilisation is built up on property, and can only be defended by private property.

As private property defines capitalism and freedom, it offends collectivism and socialism. Friedrich Engels wrote, "the slave frees himself when, of all the relations of private property, he abolishes only the relation of slavery and thereby becomes a proletarian; the proletarian can free himself only by abolishing private property in general." Hippy folksinger and little "c" communist Pete Seeger suggested,

"In a world of private property, if something isn't owned by somebody, it's going to be misused by somebody else."

To all sides, banking has been a subject of so much consternation because it is a basic offense to all these perhaps intrinsic ideals. To the socialists and collectivists, banks are a primary source of inequality and oppression; to the original principles of the Bill of Rights, they can be too much wiggle room. For many today, banks should be abolished; to the founding generation they were to be severely constrained. One of the ways in which the latter could be accomplished was private property under the Constitution and Bill of Rights, and the inclusion of money into that realm.

The argument for modern banking, however, is that the needs of modern economy cannot be so restrained. The most extreme example, for those that take this line of argument, was the Great Depression. Banking had become a vital, central instrument of trade and general commerce, and therefore pure emotions of the people who had by their rights as property owners deprived banks of necessary funds with which to maintain trade and the nation's economic welfare. Banks were increasingly removed from property law and placed more and more unto financial law that imposes this socialist view (the "greater" good).

I use the term "repo" exclusively not because it is shorthand but because it is altogether different from what the full term suggests.

A repo is not a repurchase agreement; it is a collateralized loan.

The way in which the latter became the former demonstrates a great deal about the overlaying of financialism in banking and modern money.

For a very long time as repo became more popular, there was no actual agreement as to what a repurchase agreement actually was. It was not only unstandardized, it was treated very differently under the law.

When the US Court of Appeals for the Fifth Circuit ruled on American National Bank of Austin vs. United States of America in January 1970, they overturned the District Court's ruling siding with the Bank of Austin against the IRS. The government had charged the bank with a tax assessment based on its own ruling that the Bank did not own the municipal bonds which it had claimed as generating untaxable interest. The District Court found that repurchase agreements as they related to collateralized loans did not transfer title of ownership; the Appeals Court found instead:

Since sale-versus-loan cases turn upon their own particular facts, United States v. Ivey, 5 Cir., 1969, 414 F.2d 199, **__the decided cases which have considered the precise question presented here offer little directional guidance toward a proper resolution of this case__**. We therefore take the route of ad hoc exploration through an expanse of essentially undisputed facts, see United States v. Winthrop, 5 Cir., 1969, 417 F.2d 905, to find that taxpayer was not entitled to the section 103(a)(1) income exclusion. [emphasis added]

In citing United States v. Ivey, the Appeals Court was reaching back to a similar case of ownership question vis a vis taxation (it's always taxation, i.e., the legitimate boundaries of government) in the collateralized arrangement of physical commodities. James L. Ivey was a cotton farmer in the El Paso Valley of Texas who throughout the 1950's engaged financial relationships with RT Hoover Company, a brokerage firm. Ivey appointed Hoover as his agent in the sale of his cotton for each planting season, and through that arrangement Hoover would warehouse the commodities until sales could be realized. Hoover would, at times, obtain loans collateralized by the warehouse cotton receipts and from time to time advance cash to Mr. Ivey from those loan proceeds for expenses related to the engagement of cotton farming.

Ivey had declared the advances from Hoover as income in the years in which they were still outstanding; the IRS determined that they were instead loans, collateralized by cotton, and that only the sale proceeds could be declared income. Ivey contended that it was his understanding that the transactions were ownership changes upon delivery, proceeds or not. Further, since he paid no interest on the advances it was his understanding that upon delivery the cotton was Hoover's. The Court concluded that, "to treat what are in fact loans as sales would distort the taxpayer's income."

The facts of United States v. Ivey do seem to confirm the Fifth Appeals Court's ruling in Bank of Austin v. US; that cases involving repurchase agreements had to be determined on their own merits rather than treated in standardized fashion. The reason for that seemed more obvious at the time, but has become, I think, lost as the connection of money to property and then to economy was systematically erased during this era.

I wrote *earlier this year* about a preceding case that had also recognized the obscured boundaries of repos and the clear establishment of title. In Union Planters National Bank of Memphis, TN v United States of America, there wasn't even uniformity among the repo counterparties as to what was going on in these several trades; some were booked as repurchase agreements and all the legal niceties that should be derived from it, including a transfer of ownership; others were accounted as repos, collateralized loans where the understanding of each counterparty is on those terms. The District Court in the Union Planters case wrote in what surely seems obvious frustration, "one dealer advertised for sale to its customers those bonds which had been transferred to the Bank." Thus, what does "sale", "transferred", even "bonds" mean under these arrangements?

My preface to all this in May was,

If the bedrock proposition of capitalism is private property and clear title to it, then repos have done little except make a mockery of it. First of all, the term "repurchase agreement" sounds abundantly clear and concise: one party sells something to another with an attached agreement to buy it back at some later date at some predetermined price. Legal title to the "something" should easily follow accordingly. But as with so many financial practices, the intrusion of "financial" changes everything.

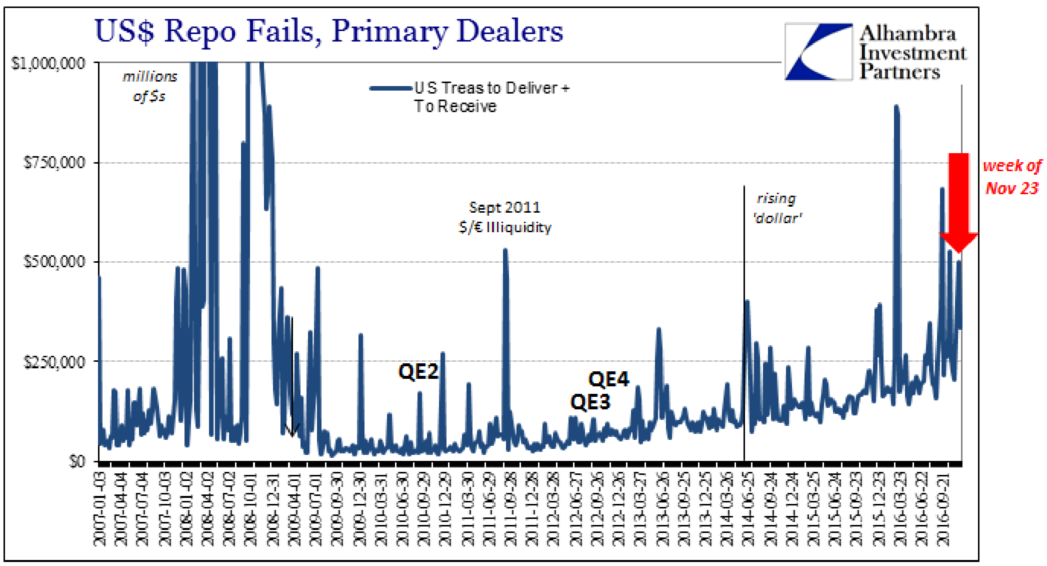
Repos would become standardized such that they were entirely understood as repos rather than repurchases. While that eliminated the individual concerns of case-by-case review of the facts, it also moved this form of money to become exclusively "money." With standardization came proliferation, of course, to which is always assigned a positive outcome for the "great good." It is only in these "later" years where these distinctions have been revealed as sticky and difficult for a great many good reasons.

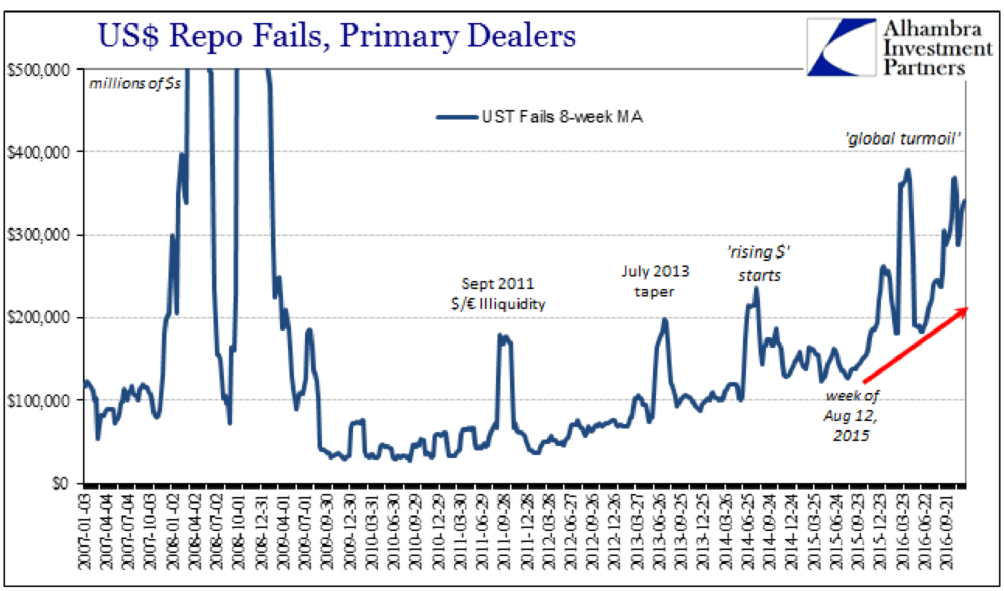
Repo fails, in particular, are an insult to the capitalist tradition. One of the primary imbalances that led to directly to panic in 2008 was the near total failure of the repo market, itself brought to that state by among several things the Lehman failure. In a world of fluid "fails" and rehypothecation, what did bankruptcy mean for these collateral chains where ownership was just this kind of fuzzy financial relationship? It was the ultimate form of unstable money, and the results of such monetary instability became very shortly thereafter obvious to everyone.

It wasn't just that one instance, however, as the whole of the wholesale monetary system had been unstable all along; it just had remained unchallenged prior to August 2007. A repo as distinct from a repurchase agreement is not reducible to defined terms. It is a peculiar instance of a system that works because it works. "Everyone" tolerates a certain amount of repo fails because that is just the cost of the "greater good" of fungible wholesale money.

Another way of writing that is to suggest that repo system participants tolerate a certain amount of embedded and often visible instability. No monetary system will ever be perfectly stable, of course, because money is a social construct subject to the ever-changing human condition. That was one reason why it was once given the protection as property, so as to better align our own individual interests with understanding these variable parameters.

Monetary policy is supposed to reduce instability through its various methods of currency elasticity, which is itself another form of socialism in money; to use more if intended instability to counter instability. The results have been predictable in just that way; central bankers for the most part satisfied that they had alleviated monetary issues in the banking system at least, while at the very same time the banking system became more and more unstable to the point of a global monetary shortage. We can see this very plainly through the conditions of the repo market:





It is perfectly obvious that repo fails had been rising almost steadily since 2011, marked by short but intense bursts of illiquidity in the middle of 2013 and again in the middle of 2014. That all changed the week of August 12, 2015, a week we should all know very well by what happened with the Chinese yuan; not because it happened with CNY and the global importance of China, rather due to how the Chinese *relate their system* to the "dollar" system. Since repo fails are a highly observable form of unstable money becoming more unstable, the financial and economic results of the past year and a half are wholly unsurprising.

Since the last week in August 2016, repo fails have not been less than $200 billion (both "to receive" and "to deliver") in any week. Of those fifteen weeks (thru the week of December 7), they have been greater than $300 billion eight times, including each of the past four weeks going back to the week after the election (which does not propose the election as the cause). Fails have been above the $500 billion level three times, and each of those weeks corresponding with a whole lot of Chinese money market instability (which does propose more than the contours of causation within a global monetary system).

In the 31 weeks of 2015 prior to that week in August, repo fails were more than $200 billion only three times; the highest level of fails was a spike to $285 billion the first week last March just before the Chinese starting pegging CNY for as long as they could. You could say that the repo market has become "used to" a higher degree of instability for operation over the past two years, but it is much harder to make the same claim for money markets and general economic function globally. To economists, the two are unrelated; understanding both EuroDollar operations as well as how they got that way reveals that not only are the two related, one does follow closely the other.

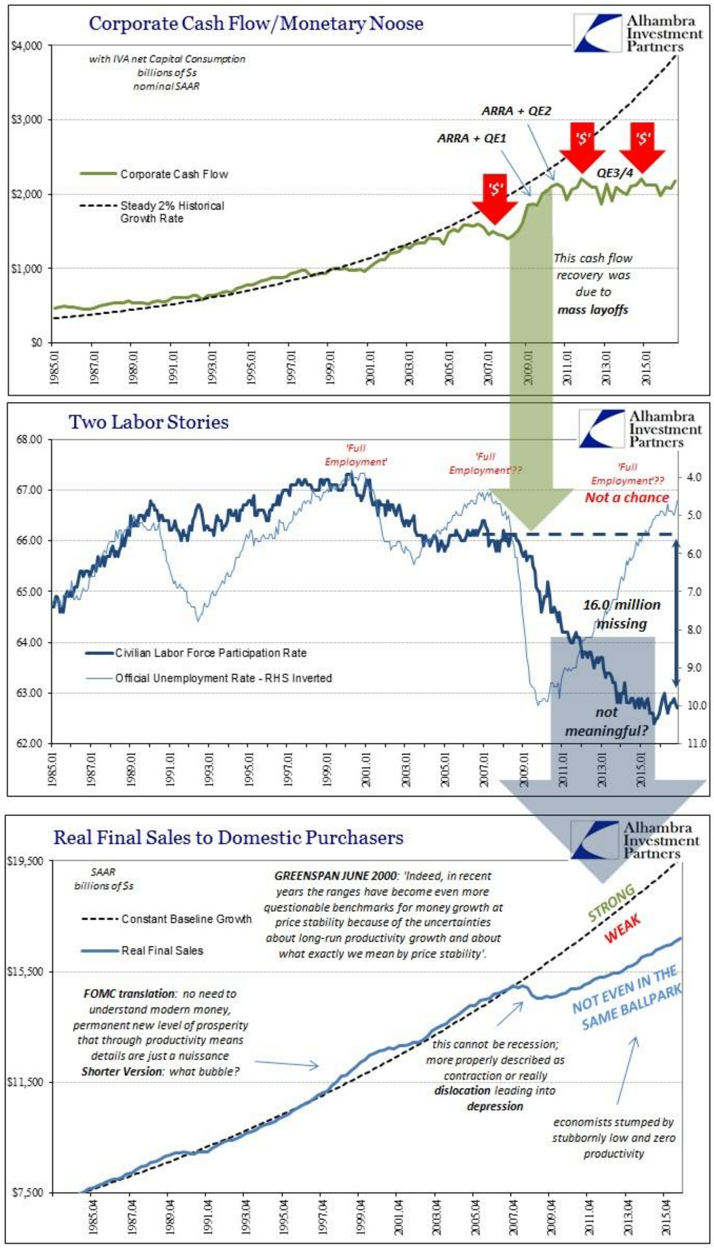
Repo fails are only one possible form of monetary instability, but they are emblematic both of the immediate problem as well as the disease of the whole system. This is not capitalism, full stop. You can add whatever other term you like in its place, I use Financialism not just because of the preference it gives to financial considerations above all else, especially economy, but also because the word embodies the balance of transformation from property law to finance law and all that has gone with it. The largest such drawback has to be not just the depression since 2007, but more so the derived inability of those who are supposed to know better, who claim they know better, but clearly *don't know any better* about what has *actually happened* *all this time*.

In short, we've wasted just about ten years calling a depression a recovery, and all because money is so unstable that it has become, for the mainstream as well as mainstream authorities, unrecognizable.

If you don't know what money is, you aren't going to know when money is a problem.

When money was property, we all had to know better because it was our own that was at stake.

In the "modern" version, it is left centralized to the cabal of ignorance and ego, a concern that motivated exactly the writing, ratification, and righteous enshrinement of the Bill of Rights.



THE RUSH TO HARD ASSETS

Because of the massive amount of global assets that today are now represented by digital means but are underpinned by misunderstood, mispriced and counterparty risk more and more investors want their assets in tangible form that cannot be "electronic" and instantly seized or frozen during a financial "freeze"! Assets that may turn out to never be returned to the owner or be so delayed that their original value has "vaporized' without the holder being able to do anything about it.

There is a flight from banks, institutions and exchange traded assets to real, hard, tangible assets.

10- A NEW WORLD ORDER (NWO) COMING

KEY MESSAGES

1. A Stealth, Secular, Structural Shift is Underway as Leverage is Beginning to FailBecuase of Collateral Shortages,
2. The End of the Debt Super-Cycle has Begun,
3. The Baby Boomer Equity Bull Market is Coming to a Close,
4. A great Debt for Equity Swap is taking Shape

A STEALTH, SECULAR, STRUCTURAL SHIFT UNDERWAY - Leverage Is Beginning to Fail Because of Collateral Shortage

THE END OF THE DEBT SUPER CYCLE

The secular US fixed income bull market,

- which began in 1981 when the Fed embarked on what would become a forty five-year credit easing regime that benefitted, treasury, mortgage, corporate, municipal, small enterprise and consumer borrowers, and would eventually spread globally to other advanced and emerging bond markets;
- which allowed the US government to deficit-spend (eventually without the expectation of recourse) its way to unrivaled military might that defeated and then contained potential hostile threats abroad;
- which provided primary funding for bank and shadow bank lending that gave the US dollar and financial markets status as the ultimate sanctuary of global wealth;
- which provided a platform on which global bank and non-bank counterparties could swap contingent liabilities amounting to many times the size of underlying cash markets without fear of regulatory interference; and which provided speculators across other asset markets (including real estate) to continually sponsor unsustainable valuations,

No longer produces capital or serves an economic purpose, and is almost over.

THE END OF THE "BABY BOOMER" EQUITY BULL MARKET

The secular US equity bull market,

- which not coincidentally also began in 1981 and served as the principal funding mechanism for great advances in digital technologies, communications, finance, logistics, health care, energy, retail, and other industries; which helped raise and maintain competitive trade advantages for the US and its allies;
- which expanded capital expenditures, productive output and consumer demand;
- which helped collateralize expansive public and private credit issuance and debt assumption, in turn creating a positive feedback loop that further increased nominal production, consumption and asset prices, and
- which created nominal wealth for US and non-US asset holders,

Is also in its evanescence.

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We think the Fed's much publicized "fear of inflation" (which is ostensibly driving the new rate hike regime) is a necessary public narrative that will let the Fed pursue its true objective – a stronger dollar and deflation amid a contracting real economy.

Stock and bond markets in advanced, financially-oriented economies, have devolved more into political imperatives necessary to maintain social services and the perception of wealth, rather than serving as the traditional means to build and price wealth and capital.

They no longer serve societies or global trade.

In over-leveraged economies, stock and bond markets become co-dependent. To sustain market prices, debt and equity require *nominal* output growth. To sustain market *values*, they require *real* output growth. The only way to increase nominal output growth and raise nominal equity prices in a highly leveraged economy with leveraged currency is to raise the quantity of credit, which must eventually reduce real output and asset values.

The question before us is whether "eventually" is occurring now?

US and global economies have begun to experience necessary structural changes that directly impact:

1. *Incentives to produce and consume,*
2. *The fundamental manner in which the political dimension approaches monetary and fiscal policies, and*
3. *The way in which investors think about assets, liabilities, economics and capital markets.*

Investors seeking to create wealth by investing in broad equity markets face a fundamental structural problem caused by the irreconcilability of:

1. *Naturally occurring commercial deflation,*
2. *Economies and political systems that rely on inflation, and*
3. *The crowding out of consumption and investment by necessary debt service.*

The primary reason we think stocks are peaking is scale.

> *Aggregate market caps, valuations, revenues and earnings of public companies cannot be sustained by the level of real production in the underlying US and global economy.*

We think bonds are on the eve of reconciliation for the same basic reason.

> *The scale of systemic leverage has already begun to reduce incentives to expand credit for capital formation, which, in turn, promotes debt deflation.*

A FAILURE OF LEVERAGE - A Shortage of Real, Unencumbered Collateral

We expect debt deflation coincident with central bank monetary inflation, which would offset the deflation…on paper (like feet in the oven, head in the freezer producing a reasonable average). Before this occurs, we expect a financial or economic event that focuses public attention on the leverage problem.

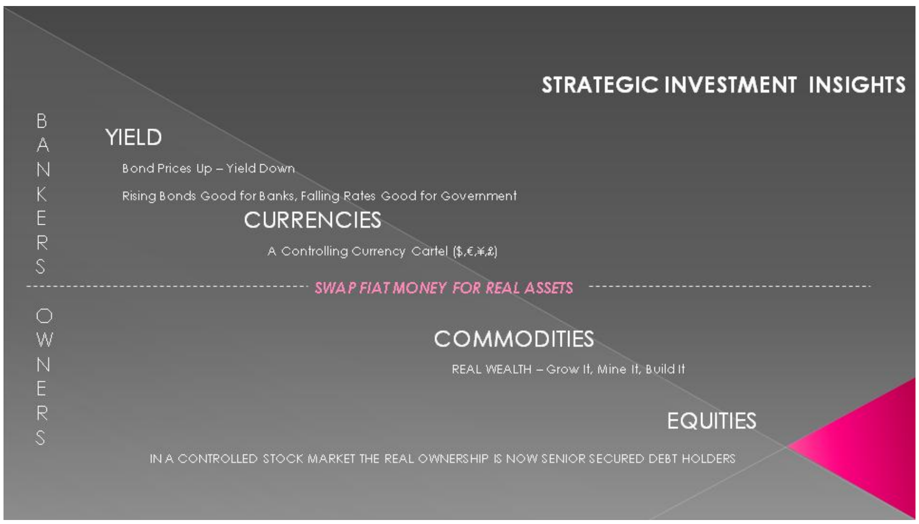
As liabilities without directly-linked offsetting assets, the purchasing power value of currencies are always susceptible to dilution. Dilution comes in the form of credit issued by banks (and, potentially, non-bank lenders) that is either not collateralized by assets or collateralized by assets that themselves are liabilities (like Treasury notes). The wider the gap separating the amount of un-collateralized credit denominated in a currency from that currency's base money (bank reserves and currency in float) – the ratio that determines monetary leverage - the greater the amount of future monetary de-leveraging will have to occur. (De-leveraging must ultimately occur so that debtors can service or repay their obligations and so producers have incentive to continue to supply goods and services in exchange for that currency.)

THE GREAT DEBT FOR EQUITY SWAP

We believe most of what is covered in this paper is well understood by the top 1% who control most of the world's assets.

To protect themselves we believe they are engaged in a massive stealth debt for equity swap. They are employing international banking control of yields and currencies to reposition their assets to be holders of real "hard" assets.

This involves the ownership of assets that have always been considered as representing wealth and are not held by paper, digital representation.



It is not the intent of this paper to explain the Swap underway but let me say that ownership of public companies is not really through stock ownership. Rather in an era of debasement and lack of growth, ownership payout and control is through being the senior secured lender in the capital structure.

Anyone who has attended a board meeting of a major corporation quickly realizes whose opinion counts the most!

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