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The World Gone Crazy & Your Gold Stocks

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Gold going up almost $90 on September 17th is not to be taken lightly. This is extremely unusual and bullish.

The global financial system led by the United States investment banks, insurance companies and commercial banks are now in a precarious and dangerous situation with asset values and balance sheets suspect.

The bottom line is that the precious metal mining stocks with economic resources in the ground will rebound dramatically led by the larger producers.

Financial institutions with various types of commercial paper, interest rate certificates, and packaged loan or debt portfolios insured by derivatives or some other contractual form of IOU's are now impossible to value or analyze. Here are the facts and my conclusions as where we are headed.

Financial Companies and Stock Markets

- Looking at the AIG and Lehman Brothers balance sheets, it appears that the Feds and the TV guys could be off target by $450 billion. I took the short and long term investment assets that supposedly are loaded with toxic paper and simply decreased the value by a conservative 20%. Comparing these new asset values to the liabilities shows a $458 billion shortfall.

- The above points to a possible $162 billion shortfall for Lehman and a $296 billion shortfall for AIG. This means that possibly in the next few weeks or months some other creditors (banks, insurance companies, investment banks) will have to write off hundreds of billions of assets they are carrying on their books (assets owed to them by Lehman or AIG). Bottom line: there is probably more bad news coming and the $85 billion from the Fed for the AIG bailout may be just the beginning of a flood of new money needed.

- Reports state that AIG had also provided $400 billion of debt insurance to banks all over the world. How can AIG possibly honor even a small per cent of this commitment if some of these debts default? If some of this debt goes bad then these banks will be stuck with zero protection on the toxic loans they foolishly made. Will the Fed or foreign central banks with a deal with the Fed honor all this paper?

- Reserve Fund, the nations oldest money market fund wrote off $785 million of Lehman paper as their Board declared these assets “worthless”

- Citicorp in 1991 with just a 5-7% decrease in real estate values was almost technically bankrupt because of over-leverage. With real estate today down 15-30% depending on what area of the country you live in, it is hard to imagine that we will not see similar financial stress with more financial institutions.
- Russia closed their stock and bond markets a few days ago for 24 hours due to a panic. Their stock market is down 54% in 60 days. The Hong Kong stock market is down to 19,327 from 32,000 last November. China's Shanghai "A" Stock Market is down from 6,200 to 2,179 in the past 11 months. The Japanese Nikkei is at 11,920 from 17,300 last October. These are Friday,19 September closing prices.

Globally stocks were getting battered and central banks have been adding massive amounts of bail out money over the last three months (I lost track when it went over $400 billion) including $200 billion in "liquidity" in just the last two days. This is highly inflationary medium to long term but will cause stocks and gold to move higher in unison until inflation is rampant, then interest rates will rise dramatically and stocks will head down and gold will soar. Remember an OK economy and an OK stock market are not always bad for gold or gold stocks. In 1980 when gold roared to $850 the Dow Jones was up 13.7%. All this money being injected into the economy will be a "fix" and in the short term should make gold and the stock market more buoyant.

The Bad News Regarding the Government Solutions

- The money supply (MZM - zero maturity or immediately available money) in the U.S. has already increased by $1 trillion in the past 14 months yet most commentators are fixated on M1 which is an obsolete measurement of money supply because money is swept from these M1 accounts every night into interest bearing money markets (not counted as M1). Therefore the so called monetary base is useless as an indication of the nation's money supply. Because of this huge confusion people are worried about a "deflation" because M1 is going sideways. On the contrary, we are being flooded with money and because of the stress on Wall Street much more is coming and this will be very inflationary.
- The bailout of the financial institutions Fannie, Freddie, AIG and the consolidation of investment banks like Merrill and probably Morgan Stanley into commercial banks will create institutions that cannot fail. Hence the entire professional hierarchy of these new giants will certainly lean towards investments and more financial gimmicks (some to be created in the future) as speculative as possible to make more year end bonuses. Top management who can now also make huge bonuses could care less as Uncle Sam will be there to bail them out. This is certainly a moral hazard concept that will cause taxpayers huge pain in the future.
- China and India have both doubled their money supplies in just the last 5 years! I am expecting 10-15% annual inflation rates in both these countries for the next 3-4 years. This will have a dramatic positive effect on gold demand and prices and will dwarf the U.S. and European demand for gold.
- The Inflation vs. Deflation debate is a debate between Knowledge and Stupidity. History and Fantasy. Understanding and Confusion. When a stock portfolio goes from $2 million to $1 million this is in fact a "deflated" value but this does not cause a deflation in the economy. Even with $10 trillion of stock market losses it has little effect on the general price level of goods and services in an economy. The crash of 1987 saw $15 trillion of stock and bond losses in the U.S. An historic loss of asset values at the time. Yet inflation in 1988 and 1989 averaged 3.2% and 4.3% respectively. **There was no deflation**. The same concept is true for real estate. Real Estate losses in 1990-91 were in the trillions and the inflation rates in 1990, 91, 92 averaged 4% annually. **There was no deflation.** There never is with paper money.
- Do not confuse financial assets, real assets and money ….they are very different animals. The deflation fears are promoted by the banking establishment economists as an excuse to print more money. In a paper

money system deflation is basically impossible. Yes, “deflated” prices of assets can take place but that is a market mechanism of asset prices and asset values and nothing to do with a deflation in the economy.

- The great deflation and Depression in the U.S. in the 1930's was caused by three factors. Treasury Secretary Mellon who was clueless on the theories and practices of money and credit thought that because the stock market was going up in the late twenties that the money supply would explode and we would have “inflation” so he instigated a horrendous margin increase to curb stock prices and liquidations then followed and got out of hand. He also raised taxes! On top of that the Federal Reserve actually drained money out of the banking system. This caused a panic and a true deflation. It was the work of government intervention. When Credit Anstalt (major Austrian bank) went under in May of 1931, it brought down many British and U.S. banks and started the banking crises of the 1930's.

- There will be no deflation. **If your adviser or broker or newsletter writer ever mentions this word…send him this article and wise him/her up.** Inflation is here to stay as prices have not gone down in this country in any year for the last 60 years despite the calls of the deflationists. During this time, despite market crashes, horrible recessions, and numerous real estate busts we have had no deflations. Paper money is inflationary and we are going to be flooded with more of it before the bailout of the global financial system is completed.

- Nancy Pelosi (Speaker of the House) and Barney Frank (Chairman of the Banking Committee) want to have Congress handle the current financial crises. This is almost as bad as it gets. There is only a handful of men in Washington that understand honest monetary policy. Friend Congressman Ron Paul is one of the few. The Congressional solution will be to flood the country with even more money and this will take the heat off the Fed and Treasury for debasing the currency. They will socialize Wall Street and under the guise of protecting people give the bankers carte blanche to speculate, take huge bonuses and never have to worry about losses as the Fed will bail them out. The real hidden price of all this is the destruction of the middle and lower income earners standard of living. There is no free lunch.

- Merrill Lynch every year does a very extensive and well known Global Survey of Money Managers. The results just announced are so off the wall that it made me add **another** $1,000 an ounce to my gold price projection. 7 out of 10 managers expect lower inflation in the next 12 months. This means that the so called best and brightest managing trillions of dollars have bought into the Great Lie.

- The Great Lie: For almost 75 years the Fed and the Treasury have promoted the following concept. **Inflation is caused by a strong economy***.* This, of course, is a smokescreen for the truth that all inflations are caused by an increase in money supply. But with this stable datum that a strong economy causes inflation, **the powers that be always had something else to blame for inflation.** Money managers therefore thinking that if a strong economy causes inflation then a slow economy or a recession will cause **less** inflation. Therefore they reason “why own gold or the gold stocks”. These were some of the guys selling the gold shares the last 3-4 months. They are so wrong.

- Ironically there are plenty of institutional money managers and investors that buy gold because they think a massive deflation will take place and money will disappear, therefore making gold a good hedge as a substitute currency. On the other hand inflation minded investors buy gold to protect themselves from higher prices. Gold is actually benefitting from the Great Lie. Unfortunately, the man in the street is not as inflation from more paper money ruins his take home pay purchasing power.

The Gold Mining Stocks

The last six months have seen total devastation of the junior and developmental precious metal mining stocks as well as huge share losses for the majors. This was caused by a series of events that added up to what can only be described as a once in lifetime phenomena when one considers gold at $800 and silver above $10. The events are listed below.

- Thousands of new mining companies came into existence from 2003 to 2008 taking investment dollars for these uneconomic and speculative ventures from the normal pool of gold bug or money manager investors.

- A gold ETF is formed and billions of dollars that normally would be invested in gold mining companies was diverted to bullion.

- Gold goes above the old high of $850 and new investors, momentum players and hedge funds pile in with even more money, many with margin leverage and buy anything in sight.

- Insiders and promoters of speculative companies issue thousands of press releases with bullish news that is mostly pie in the sky and sell their shares into these press releases - shares that they paid pennies for.

- Jim Dines turns the whole world onto the uranium stocks which go ballistic and many gold bugs sell gold shares and buy uranium stocks. Dines call on uranium was clairvoyant and he came in at the exact bottom. Nevertheless money is diverted from the gold and silver mining shares.

- Mining promoters jump on the uranium bandwagon and create approximately 300 new uranium companies that siphon off even more gold bug and gold managers assets.

- Gold and uranium prices have a normal pullback and people who came in at the top start seeing erosion in their portfolios and start to sell.

- Commodity prices go up dramatically and also have a natural pullback and pundits now are crying “deflation” totally ignoring the fact that prices are still up over 100% and more for almost every commodity in the world over the last three years.

- Many investors and hedge funds pile into the gold stocks and gold during the October 2007 - March 2008 high range. Prices start turning down in sympathy with gold and the momentum players with huge leverage and funds start dumping.

- Gold corrects from above $1,000 to $800 and then below and the “deflationists” convince the Street that because of all the real estate sub prime problems and mortgage problems that deflation is coming as well as a recession and gold will have to go down even further. Some pundits talk about $500 gold. More selling by investors.

- The summer rolls around and the Canadians are fishing, hiking and camping and no where to be found. The Europeans are on vacation and closed down for the summer. There are no bids for junior stocks. A 5,000 share sell order for a $2.00 mining stock knocks the price down 20 cents and wipes out millions of dollars of market value. Selling begets more selling.

- Stock markets globally are going down and people are liquidating blue chips as well as major gold stocks.

- Insiders of the junior mining companies in Canada are trying to sell some stock to pay for their kids tuitions and they are now part of the problem. Note, that inspections of junior mining companies income statements show these entrepreneurs usually take very modest salaries and justifiably sell stock to make ends meet. The “moose pasture promoters” do this with malicious intent and rip off investors.

- Insiders are now seeing their stocks collapse and the market makers in Canada and London have literally headed for the hills. Insiders decide to let the market take the stocks down to wherever they are going and will enjoy reissuing options to themselves and management at much lower prices and wait for the next upturn to cash in.

- Real assets-in-the-ground juniors and quality development companies are trashed with the thousands of “moose pasture” stocks that deserved to be zero in the first place.

- Investors who are gold bugs and visit all the usual gold sites are disgusted and now in fear. Their spouses are shocked at how bad these investments appear. Tough times on the homefront.
- Stock markets are in turmoil, the dollar is being debased by massive money supply infusions, trade deficits, budget deficits, etc. and yet gold and the gold stocks continue to go down. The impossible is happening.
- The gold stocks are so oversold that some of the sophisticated medium to short term technical indicators are the most oversold in history. My favorite NYSE gold stock that produces gold for zero cost (that's $0.00) because of copper credits is selling at 6 times next years cash flow. It is below $10. I expect it to reach $40 if gold just stays at $900. Unbelievable.
- It seems like it is all over for the gold bugs…..almost.
- Wednesday, September 17, 2008 arrives and gold soars $90 in normal and aftermarket trading in New York. The bell has rung. The great bull market to end all bull markets in gold has resumed.

What is Next

Current gold buyers are most likely split between investors that believe a horrible deflation is coming and money will be wiped out so gold should be a good substitute and other investors correctly understand that trillions of new dollars and foreign currencies are going to flood world economies to bail out the institutions and this will be very inflationary.

Both sides will have great conviction and this $90 move underlines those thoughts. Therefore, with the financial turmoil of this week gold and the quality mining stocks should move much higher with or without the stock market.

Moose pasture stocks will not recover….ever. Sell them, take your tax losses and buy companies with real resources and reserves.

The recent bail outs announced this week have turned Wall Street into Sweden. The large financial stocks are now backed by and socialized by Uncle Sam. This will create even more problems in the future. A list of the negatives on this is very long and would include such negatives as bureaucrats deciding on investment allocations, political favors used by politicians to get funding for pork barrel projects in their districts and red tape to choke a horse.

Socialism is a failure, but capitalism with a paper money system and a central bank manipulating interest rates, foreign exchange values and creating money and credit out of thin air is just as bad. Gold will now go much higher because of all this but it is a sad commentary on the banking elite and government fools that are responsible for our present condition.

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