Patient Capital.... Positioned for Profit

A PEEK AT THE WEEK THAT WAS - November 2, 2013

Insanity: a perfectly rational adjustment to the insane world.
- R.D. Laing (1927 - 1989) -

What a wonderful wacky week it's been in our increasingly insane world. Another spectacle of silliness to be sure.

Health czar Sebelius both shuddered and spruiked while being grilled over the website that wasn't by our genius leaders in DC. Meanwhile, real life czar, Valiant Vlad Putin, was lauded as a more powerful Caesar than our own Barackus. The shame, the ignomy. But don't worry, Mr. President...there's always next year.

Pressure's on...Vlad! El Presidente is out to impale ya in 2014.

Over in the always fascinating Middle East, the Israelites bombed the Syrians but no one noticed...or let on, if they did. Mr. Market certainly paid little heed. He is focused intently on that gleeming chandelier at Club S&P as it glistens temptingly before him. He is determined to make a grab for it...especially after Bartender Ben once again assured the party goers on Wednesday that his pours would continue unabated. What a party!

Ms. Bond continues to be relatively relaxed amid the shenanigans, although late in the week she seemed a tad more perturbed. Her 10 year treasury jumped 3% or so on Friday and was up about 4.5% for the week. But really, who cares? It's just debt after all.

But really, we should possibly spare a moment and say a prayer for poor Bill Bullion. Things were looking good over at his Gold Bar until the paper money thugs turned up on Wednesday around 2 pm NY time and starting scaring the heck out of patrons and would be patrons alike. Those nasty thugs even intimidated Long John Silver back into his corner...and just as he was warming up to do a jig of his own. We wouldn't worry. Eventually Long John will have his chance to perform...probably about the same time that the chandelier comes crashing down on Mr. Market's head at Club S&P.

Anything else? Oh yeh...the NASDAQ options market crashed on Friday. Ho hum!

In a world like this, you don't have to be crazy...but it helps!

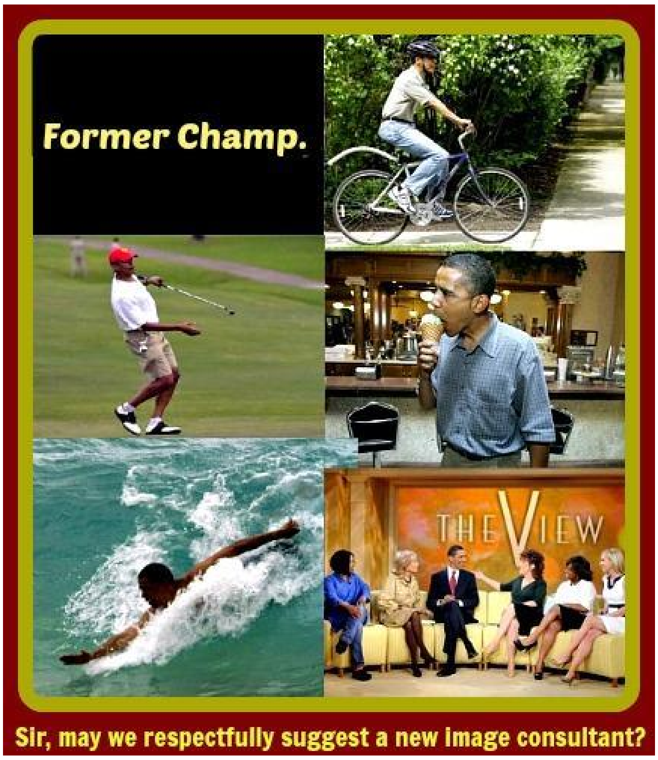
In quiet times, after another market day of madness, we wonder what drives Bartender Ben and Zesty Janet Yellen. We wonder...can't they understand that the solution to debt is not more debt? We wonder what their end game is? Or do they even have an end game? It is perplexing indeed.

This week, we'll take a look at that and suggest, actually steal, a reason for such insanity...from someone far wiser than us. And in the process we'll take a look at the stark reality of the place they call Money Heaven, which, of course is where our money goes when it dies. In so doing, we will take a peek at those former stars of Club S&P, Freddie Mac and Fannie Mae.

We were also going to take a peek at the chandelier in the ceiling of Club S&P and offer another reason why it may remain in place for a while to come, even when an apparently manic Mr. Market grabs hold and starts to swing. Unfortunately, we got caught up in Money Heaven so that will, mercifully, have to wait till next week.

Our chart of the week is a doozy. You won't want to miss it. Especially if you love geography, as we do.

Let's get started, shall we. Rght after we take a look at the world's former most powerful man.



And introducing the winner...and now officially (according to Forbes) the world's most powerful man!

The greatest obstacle to discovery is not ignorance -
it is the illusion of knowledge.

- Daniel J. Boorstin (1914 - 2004) -

We like the above quote from the brainy Mr. Boorstin...even though we have been accused of suffering from illusory knowledge way too often ourselves.

But in our current easy money illusory world. we submit that it is an entirely appropriate segue to a discussion of what drives Bartender Ben and Zesty Janet in their quest to intoxicate, rather than educate.

Way back in 1999, a very smart man named Peter Warburton published a book entited ***Debt and Delusion***: *Central Bank Follies that Threaten Economic Disaster.*

Dr. Peter Warburton (source: http://www.iea.org.uk/

As the title to the book implies, it was not particularly complimentary to central bankers but it did try to look inside their collective heads to determine why they tend to do those insane things they do.

Dr. Warburton updated this book in 2005 as his vison of a financial world turned upside down became all too real. He spoke of central bank credit begetting an out of control derivatives disaster. In his own words...

"Lamentably, this staggering collective flight from reason has been endorsed by the economics establishment."

Yes, Matilda, the inmates are running the asylum. But it is the following three paragraphs which we believe sum up the reasons behind Bartender Ben's beneficence and may explain why to many, he has become Bill Bullion's bête noire. You see...our Ben has not been merely pouring drinks...**he has been fighting a war**.

Read on...and remember, this is from 1999 when that great obfuscator, Alan Greenspan, was at the helm.

Central banks are engaged in a desperate battle on two fronts

> *What we see at present is a battle between the central banks and the collapse of the financial system fought on two fronts. On one front,* ***the central banks preside over the creation of additional liquidity for the financial system in order to hold back the tide of debt defaults*** *that would otherwise occur. On the other,* ***they incite investment banks and other willing parties to bet against a rise in the prices of gold, oil, base metals, soft commodities or anything else that might be deemed an indicator of inherent value****. Their objective is to deprive the independent observer of* ***any reliable benchmark*** *against which to measure the eroding value, not only of the US dollar, but of all fiat currencies. Equally, they seek to deny the investor the opportunity to* ***hedge against the fragility of the financial system*** *by switching into a freely traded market for non-financial assets.*
>
> *It is important to recognize that the central banks have found the battle on the second front much easier to fight than the first. Last November, I estimated the size of the gross stock of global debt instruments at $90 trillion for mid-2000.* ***How much capital would it take to control the combined gold, oil and commodity markets? Probably, no more than $200 billion, using derivatives****. Moreover, it is not necessary for the central banks to fight the battle themselves, although central bank gold sales and gold leasing have certainly contributed to the cause. Most of the world's large investment banks have over-traded their capital so flagrantly that if the central banks were to lose the fight on the first front, then their stock would be worthless.* ***Because their fate is intertwined with that of the central banks, investment banks are willing participants in the battle against rising gold, oil, and commodity prices****.*
>
> ***Central banks, and particularly the US Federal Reserve, are deploying their heavy artillery in the battle against a systemic collapse.*** *This has been their primary concern for at least seven years. Their immediate objectives are to prevent the private sector bond market from closing its doors to new or refinancing borrowers and to forestall a technical break in the Dow Jones Industrials. Keeping the bond markets open is absolutely vital at a time when corporate profitability is on the ropes.* ***Keeping the equity index on an even keel is essential to protect the wealth of the household sector and to maintain the expectation of future gains.*** *For as long as these objectives can be achieved, the value of the US dollar can also be stabilized in relation to other currencies, despite the extraordinary imbalances in external trade.* [Emphasis

ours, as usual].

There we have it. The Central Banks are at war to save the financial world. Unfortunately the only way they can do that is by maintaining the illusion that all that paper they've created has value...which, of course, without inherent belief and confidence...it doesn't.

But it certainly helps if you can eliminate or minimize anything else against which a reliable and relative comparison may be made.

In other words, Ben is pouring drinks so that the drunks at Club S&P will continue to think that there is real value in them. As long as he can keep real stuff, like precious metals and other commodities relatively cheap in Yankee dollar terms, no one will notice his monumental shell game. He almost lost it in 2008 but since printing a few more trillion, Ben seems to be winning.

But for how long? And at what cost?

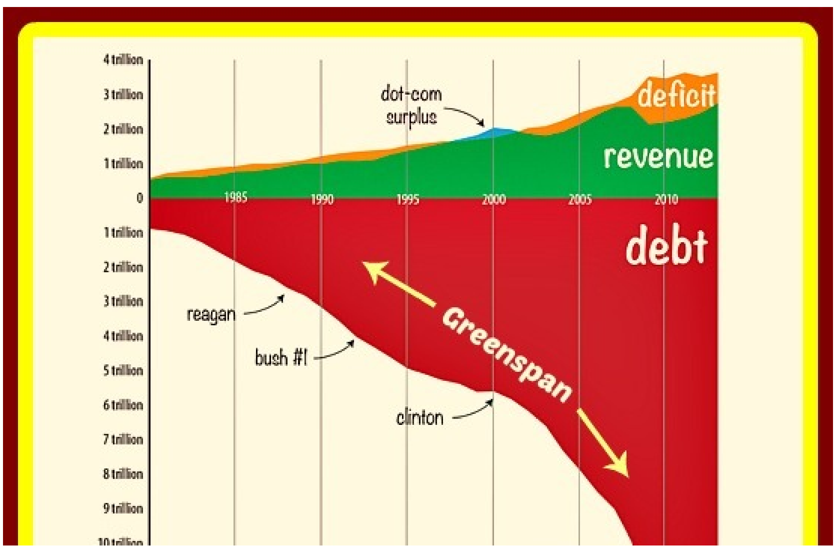
The graph below shows pretty convincingly that Mr. Market's party has Ben's fingerprints all over it. It comes courtesy of an interesting article in Forbes that you can read by clicking here. The title to the piece is:

You Can Thank Ben Bernanke for 100% of the Stock Market Gains Since 2009

...and sadly..."ain't it true".

If you look carefully at the highlighted box within the graph above, you will see how, while Mr. Market is up 104% or so, it is up almost 131% if you take just the period when QE was invoked. Conversely, **if you look at the market without QE, it was down over 27%.**

Yes...Ben wins this round. But again...at what cost? The graph below, courtesy of Grant Edwards (one of the greats), shows vividly how much we have been paying to maintain Ben's illusion.



And as the battle against reality wages, we will probably see more engagements like the one depicted below, in which the interventionists intervened to make sure that pesky real things like gold are not allowed to reflect their true value.

Notice in the graph below, the sudden slam down around 2 pm NYT.

Trust us when we tell you that these "interventions" are happening quite frequently. If you don't believe us, you can go to this site (Kitco.com) and check daily for yourself. It is so frequent and conspicuos, it is almost tradeable. Hey...what an idea! Why didn't we think of that? How much does one of those High Frequency Trading computer systems cost anyway?

Make money by making war...on reality. Oh...those guys are just too clever! But don't forget...reality bites. And it bites hard when it does!

And reality bites particularly hard on the sub-continent, where those interesting Indians, replete with a long and distinguished history of physical and spiritual riches...and unfortunately all too many useless politicians and bureaucrats...have opted for...you guessed it...REALITY.

And they are prepared to pay for it. From the Wall Street Journal...

> **Indian Buyers Paying a Premium Price for Gold**
> **Tight Supplies—Partly Government-Induced—and Diwali Demand Create a Squeeze**
>
> Oct. 25, 2013 4:39 p.m. ET
> *NEW DELHI—Gold buyers in India are paying big margins over the international price, with choked-up supplies and festival-season demand to blame. Wholesale buyers such as jewelers are paying up to* **$150 a troy ounce over the international price**, excluding taxes, local traders said, compared with about $3 a year ago and $50 a couple of weeks ago.

Yes...one day reality may bite hard in the West too. Best not to be a zombie if you can avoid it.

If you want to know what God thinks of money,
just look at the people he gave it to.
- Dorothy Parker (1893 - 1967) -

But let's have some pity for Bartender Ben too. This is a vicious war indeed. You see, while he prints fresh paper, a lot of already created money is ascending to **Money Heaven**.

What is Money Heaven you may ask? Well, of course, Money Heaven is where money goes when it dies. Fortunately, only paper money dies. Gold, for example, is immortal. Most of the gold ever mined from this good earth is still alive and kicking...and increasingly residing in China (but that's another story).

Paper money, on the other hand, is extremely temporal and dies frequently. Sometimes it is burned accidentally or intentionally (called Money Hell) but most of the time it just evaporates and ascends to Money Heaven.

No...we're not joking. And yes, we have admitted to being a little crazy...but only out of necessity to respond to current times.

But let's be serious for a moment because we sense you don't believe our story about Money Heaven. As evidence, we will refer you to a piece from our good friends at PF2 Securities, who inhabit an extremely complex world of menacing money gobbling monsters like Collateralized Debt Obligations (CDOs) and Residential Mortgage Backed Securities (RMBSs)...yes, those same creatures that almost cratered Ben's money mountain back in 2008.

The PF2 guys are numbers gurus. They are mathematicians and genuinely smart people, although certainly not the wildest bunch at office parties. In any event, their job is to follow the money and try to figure out how much has gone to Money Heaven (yes, they get paid to do that...mainly by lawyers of the former owners of all that dead money, naturally).

You can read the whole article, which talks about lost money and lawsuits, by clicking here. But we want to draw your attention to the rather complicated chart below. Please bear with us and trust us when we say our craziness in controlled. And to all the mathematicians out there who will complain that we have rabidly over-simplified an insanely complex area...mea culpa!

FHFA RMBS Purchase Litigation Matters

		Contested RMBS bought by Fannie/Freddie	Settlement	% of RMBS sold	Projected Settlements ($bn) based on Prior Rates: 12.12%	14.05%
Ally		$ 6,031,292,800	Settled	N/A	$0.73	$0.85
Bank of America	TOTAL	57,479,622,997			$6.97	$8.07
	Bank of America	6,031,637,714			$0.73	$0.85
	Countrywide	26,601,363,451			$3.22	$3.74
	MER/First Franklin	24,846,621,832			$3.01	$3.49
Barclays		4,884,965,000			$0.59	$0.69
Citigroup		3,531,306,595	Settled	N/A	$0.43	$0.50
Credit Suisse		14,125,978,280			$1.71	$1.98
Deutsche Bank		14,279,727,800			$1.73	$2.01
First Horizon		873,770,700			$0.11	$0.12
GE		549,679,000	Settled	N/A	$0.07	$0.08
Goldman Sachs		11,096,601,000			$1.35	$1.56
HSBC		6,238,480,000			$0.76	$0.88
JP Morgan		33,009,421,385	4,000,000,000	12.12%	$4.00	$4.00
Morgan Stanley		10,584,071,897			$1.28	$1.49
Nomura		2,045,929,000			$0.25	$0.29
RBS		30,400,000,000			$3.68	$4.27
SocGen		1,300,000,000			$0.16	$0.18
UBS**		6,300,000,000	885,000,000	14.05%	$0.89	$0.89
TOTAL		202,730,846,455			$24.7	$27.8

*Settlement amount undisclosed

**Originally $4.5b; now reported as $6.3b; http://www.bloomberg.com/news/2013-10-29/bofa-accord-with-fhfa-could-cost-8-billion-fitch-says.html

OK...let's try to explain what you just looked at.

This is an estimate of what both Fannie Mae and Freddie Mac (remember them...we'll come back to these two) might get back from those lousy bankers who sold them all those crappy pieces of paper (think... "securitized subprime mortgages") back in the heady days of the first decade of our new century.

In the left column, you have the bankers, who bundled up all those fantastically credit worthy mortgages made by highly qualified borrowers into nice securitized packages that were then sold to Fannie Mae and Freddie Mac.

Of course, only the bankers and their cronies really knew that much of this stuff was absolute crap but they still managed to sell over 200 billion (middle column) of it to Fannie and Freddie, who obviously had more (shareholder) money than sense.

Now, even a banker can figure out that there's a lot of fees to be made on 200 billion worth of transactions. Juicy indeed. And that's exactly why they did it.

It matters not that the once rich and powerful Freddie and Fannie ultimately became wards of the state and therefore, the responsibility of the taxpayers.

Fast forward to current times and with the wisdom of hindsight, Freddie and Fannie are back trading again (on the over the counter market...another story) and seeking recourse. They are screaming "we wuz robbed" to the courts and the courts are listening. Civil court, that is, not criminal.

Fraud of this magnitude is hardly criminal old sport, it's clever.

Now...look at the next column to the right titled "Settlement" (c'mon...stick with us...don't you want to know how money dies?).

As you can see, so far, only a few banks have coughed up settlements. The biggest confessor so far has been JP Morgan which has agreed to pay 4 billion or so to make this go away. Now, in fairness to JPM, a lot of this crap was foisted upon them through their acquisition of Bear Stearns (remember them?). But the important thing is that they settled for around 12% of what they sold, which was a better deal than UBS, who had to pay (gulp) 14%.

But, what happens to the other 86-88%?

Hmmm....well, not all those mortgages are crap. There may be some diamonds in there...you know...people who are actually paying on time or have an ability to modify or refinance?

Simply put, other smart (mainly) ex-bankers swoop in with funds to buy a lot of these once gleaming jewels...for around 20 cents on the dollar.

So do the math....the selling bankers settle for 12% while much of the remaining crap is sold for 20% of it's value to mostly ex-bankers turned hedge fund managers. That leaves 68% of the original "value" gone. Gone where? To Money Heaven, of course.

But it doesn't end there. Remember Freddie and Fannie, those former high flyers who were darlings of Mr. Market's Club S&P back in the day. Of course, they crashed and burned in the horrors of the Great Recession. Take a look at the charts below and see what happened to their shareholder value (with apologies for dredging up horrible memories of loss to those readers who had the misfortune to own either of these gems at the time).

People do not like to think. If one thinks, one must reach conclusions.
Conclusions are not always pleasant.
- Helen Keller (1880 - 1968) -

So, let's think about this. Ben is waging war on reality. He creates money. The bankers destroy money.

It must be getting pretty full up in Money Heaven right now, so how long can this continue? At what point does the money equivalent of St. Peter cry out "no mas" and close the gates to Money Heaven? As usual we have no clue. But that day must come.

Just to make sure that you've got it, we've illustrated in the following three slides what we see as the current cycle which we submit...is **not mathematically sustainable**. We suspect that the smarties at PF2 would agree.

Obfuscationist Alan & Bartender Ben create money

Bankers destroy money


Money ascends to Money Heaven

Yes Matilda. There is such a place as Money Heaven after all.

So, if you cherish your wealth, we suggest that while you reside on Mother Earth, you keep at least some of your money firmly on terra firma, ideally in something real that itself was formed in terra firma. Something solid...and heavy...and gravity defying. Call us if you want suggestions as to what that could be.

Paper money may grow on central bankers' trees but it can also blow away in the next tempest.

CHART / GRAPHIC OF THE WEEK

There is always something new out of Africa.

Pliny the Elder - Roman scholar & scientist (23 AD - 79 AD)

Our chart of the week is actually an interactive graphic that also comes courtesy of Grant Edwards and his terrific *Things That Make You Go....Hmmm*. Despite his British heritage, we like him because he actually writes more than we do...but unlike ours, his is simply brilliant.

Back to the graph. It is sensational because it shows the sheer enormity of the African continent.

Take a look and marvel. So much potential, so many problems.

But we remain ever optimistic about the potential of humanity.

If you want to see a classic example of man's unlimited potential for good, click here to view a video about how a father made a new hand for his disabled son.. . ON A 3-D PRINTER...FOR LESS THAN $5 .

Simply Amazing. Try to destroy that you bad bankers!!!

Til next week...

"Ignorance is the curse of God. Knowledge is the wing wherewith we fly to Heaven."
William Shakespeare

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