

# Lurching Toward Gomorrah: More Signs of An Unstoppable Economic Meltdown

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Crisis denialists are still around but are slowly and grudgingly giving way to the reality that global capitalism is in serious crisis as recession lurches toward depression in a continuing downward spiral.

Nearly every new data release confirm it. On November 19, housing starts and permits hit record lows, according to the Commerce Department. At an annual 791,000 rate last month, they were the lowest they've been since number tracking began in 1959 and are down 4.5% from a revised 828,000 September reading.

Building permits were also worrisome at an annual 708,000 rate (down from 805,000 in September), breaking the previous 709,000 March 1975 low figure.

With supply way exceeding demand and prices in near free fall, no end of this is in sight for an industry perhaps facing its most challenging environment ever. The National Association of Home Builders (NAHB)/Wells Fargo November housing market index shows why. It fell to a seasonally adjusted 9 reading – its lowest recorded level since the index first began in 1985 and below its October reading of 14. Any number below 50 indicates contraction.

In addition, the Mortgage Bankers Association's (MBA) weekly purchase loan index fell 12.6% in the week ending November 14. At 248.50, it's at its lowest loan applications level since December 2000. This signals weak future home demand at a time when it's woefully weak and declining.

There was more bad news on November 20 as well as weekly initial jobless claims keep rising. This time by a higher than expected 27,000 to 542,000 in the week ending November 15 – the highest level since July 1992. The four-week average is its highest since January 1983 as employment keeps deteriorating at an increasing pace.

It's no surprise that the October 28 and 29 Fed Open Market Committee minutes showed the sharpest meeting-to-meeting sentiment drop in memory, according to one of its former governors, Lyle Gramley. It now predicts that the economy will contract for a year or longer and "agreed that the downside risks to growth had increased." Back in August, the Fed left interest rates unchanged at 2%, foresaw continued but lower growth, and said: "Although downside risks to growth remain, the upside risks to inflation are also of significant concern to the Committee."

Currently, the Philadelphia Fed's survey predicts that GDP will shrink by 2.9% in Q 4, a sharp downgrade from its last 0.7% growth prediction. It added that the economy entered recession in April. It will last at least 14 months and will be one of the longest ones since the

1930s. Its latest survey of manufacturing conditions decreased from -37.5 in October to -39.3 currently. It's now at its lowest point since October 1990 and falling. Its employment index also fell to -25.2.

Another distressing sign is the growing number of unsold goods in Long Beach, one of the nation's most active commercial ports. On November 18, The New York Times called them "A Sea of Unwanted Imports" and a reflection of growing inventory levels – up 5.5% in September from a year earlier and rising.

Long Beach accounts for about 20% of the country's container imports. It's second only to Los Angeles, and its volume is down 10% from last year. It's "where imported products arrive and filter through the tributary of trucks, trains and retailers into the hands of consumers. But now, products are just sitting" and turning the port into a parking lot. Nearly all other major ports are in similar decline as the current crisis worsens.

Veteran Long Beach port workers say the slowdown is like nothing they've ever seen. It's affecting other businesses and workers, and it's got them all worried. US consumers, too, and in the words of one reflecting the many: "I'm saving money, paying bills (and) hunkering down." It shows in declining retail sales.

The Architecture Billings Index (ABI) indicates future construction activity. In October, it hit an all-time low since the survey began in 1995. It's at 36.2, down significantly from 41.4 in September. Any number below 50 indicates contraction. In addition, new project inquiries were at 39.9, another record low.

Many other indicators are as bleak and show the economy in free fall, taking most others down with it. Clearly the verdict is in. At the least, it's the worst economic crisis since the 1930s. At worst, it may be far greater that only the fullness of time will reveal.

### Bellweather Canaries in the Coal Mine

Once a bellweather corporate icon and virtual proxy for the S & P 500, General Electric has fallen on hard times. In September 2000, its stock price traded at around \$60 a share. On November 20, it fell to \$12.84 for a net eight year loss of nearly 79%. Back in April, when the company badly missed its earnings target, the stock lost \$47 billion in market value that day, and The Economist remarked that "This is not what investors expect from one of the few remaining triple-A rated companies, famed for hitting its targets." Analyst Bob Chapman believes only gold deserves that rating at a time when no asset class is safe.

CreditGuru.com defines a AAA credit rating as follows:

"Bonds rated AAA are of the highest credit quality, with exceptionally strong protection for the timely repayment of principal and interest. Earnings are considered stable, the structure of (its) industry is strong, and the outlook for future profitability is favorable. There are few qualifying factors present which would detract from the performance of the entity, the strength of liquidity and coverage ratios (are) unquestioned and the entity has established a creditable track record of superior performance. Few entities (warrant) a AAA rating."

Why? Because of practices like these:

— living excessively off credit;

- an uncertainty of future earnings;
- playing fast and loose with accounting policies;
- lying to investors;
- diluting the market with recapitalizations; and
- having a history of these practices.

Government fiscal irresponsibility is no different than for businesses. As a result, America's credit worthiness is at risk.

In the late 1970s, 58 companies were rated AAA. In the 1990s, it was 22, and in 2001 nine.

Today, according to 247wallst.com, GE is one of only six corporations rated AAA by S & P (along with ExxonMobil, J & J, Toyota, Berkshire Hathaway, and ADP) but it's status is clearly jeopardized in the view of some analysts. One puts it this way:

"The legendary American institution is in deep trouble. Its PR machine has been in constant spin mode as the company sinks deeper into despair." Its "AAA rating is not worth the paper it is written on. One look at GE's balance sheet will convince you....AAA companies do not need to take the desperate actions that GE has taken in the last few months."

The first signs of real trouble appeared in April when the company missed its target. "It is widely known that they are masters of 'legal' earnings manipulation," so it came as a shock. "Accounting rules allow for wide discretion in reserves and estimates. GE Capital has always been a black box within the larger company," and the management used this division "as its backstop for meeting earnings estimates." It failed, and it's slide has been precipitous enough for the company to need Warren Buffett to invest \$3 billion as a psychological boost and have to pay him a 10% dividend and other incentives to get it.

"Credit default swaps (CDSs) protecting against GE Capital default now trade as if GE is a junk bond credit." And issuing \$12 billion in new common stock (at \$22.25 a share) was "an act of extreme desperation and brings into question whether GE has a lucid strategy."

Its divisions face problems across the board but especially GE Capital, its largest with three subdivisions – GE Commercial Finance, GE Money, and GE Consumer Finance. The company "is a bank disguised as an industrial conglomerate." In boom times, it did wonders for its profits. Today it's "a rocky path to destruction," and as GE goes, so goes the S & P 500 perhaps and the economy along with it.

Market analyst Robert Prechter calls GE a "bellweather for a global bear market," and when the August 1982 – January 2000 longest ever bull market ended, he said "GE is going to go way down (and it) probably heralds stormy weather ahead for the market as a whole; or should we say 'hole?' " Prechter maintains that view today as GE's valuation keeps falling at a time when it just secured government insurance for \$139 billion of GE Capital debt. If the company was strong, it wouldn't need it. Getting it is a sign of real weakness.

A condition also affecting Citigroup that's teetering on the brink of failing. No longer the nation's largest bank, it, too, has fallen on hard times and its stock price reflects it. At \$3.77 a share on November 20, it's down around 94% from its closing high and now trades at 15-

year lows. Clearly the company is in very big trouble. So are other major banks. They're all effectively insolvent and are only kept operating with billions in government aid and plenty more if needed under Paulson's no banker left behind scheme. At least none anointed too big to fail.

Perhaps in Citi's case, it's too big to save. It has \$2 trillion in assets, a \$37 trillion (notional value) derivatives portfolio (including \$3.6 trillion in credit default swaps), \$202 billion in troubled residential mortgages, huge numbers of shaky auto loans, and unknown amounts of other dead weight that may in the end sink the company. One analyst calls Citi insolvent and says its problems are double those of AIG. It plans 52,000 job cuts (14% of its workforce) on top of 25,000 previously announced and more to come as the company furiously restructures to survive.

On November 21, the Wall Street Journal highlighted the company's plight in a feature article titled: "Citi Weighs Its Options, Including Firm's Sale." It cites company executives considering the possibility of auctioning off pieces of the bank or selling it entirely after its worst ever percentage one-day drop in valuation. The board of directors will meet to decide what's next and may do what was "unthinkable only weeks ago." They must also deal with growing rumors that Citi is on the verge of bankruptcy and that Washington plans a takeover, AIG-style.

For now at least, a stopgap plan was announced on Sunday (November 23) for Washington to provide Citi with another \$20 billion infusion and will guarantee as much as \$306 billion of its troubled assets. The bank must absorb its first \$29 billion in losses and 10% of others beyond that. The Treasury will assume the next \$5 billion, the FDIC the next \$10 billion, and the Fed will take the rest up to the agreed on amount. This may provide some temporary relief, but given the extent of Citi's problems, it may in the end be short-lived.

Growing numbers of other companies face similar problems or may in the months ahead. The auto giants are already insolvent and a hair's breath from bankruptcy or even oblivion. Other companies fear a similar fate. It's reflected in their sinking stock prices and bond yields, especially the junk variety. As reported in the Financial Times:

"Average yields on US junk bonds have topped 20 per cent for the first time (over 50% for GM debt) amid rising concerns about a protracted recession and a wave of corporate defaults." It could have a "dramatic impact on economic activity" by making debt prohibitively expensive. These issuers comprise nearly half the corporate bond market, according to S & P. "The yield on the benchmark Merrill Lynch US High-Yield index hit 20.81" topping its previous 18.66 January 1991 reading.

Even worse, the risk premium spread over Treasuries is nearly double what it was then when the benchmark 10-year bond yielded over 8%. Today, it's ranging between around 3.0 – 4.0%. Moody's sees 14% of corporate bonds defaulting – an all-time high figure since it began keeping records, and it's likely the number will rise as the global crisis deepens and companies start falling like tenpins.

Maybe US Treasuries also according to analyst Martin Hennecke of Bridgewater Ltd, Hong Kong. He told clients that "The US might really have to look at a default on the bankruptcy reorganization of the present financial system," and a corresponding government one is very possible.

"In the United States, there is already a funding crisis, and they will have to sell a lot more bonds next year to fund the bailout packages that have already been signed off." He added that to solve or stem the current crisis, America will have to radically reduce spending across the board and recall all its troops from around the world. As for a stimulus package, "there is not much of an industry left to stimulate back to life," he believes. Others agree and see depression ahead – not whether but when it will arrive.

Then there's Asia with Bloomberg reporting (on November 19) that: "Asian stocks fell, extending a global rout, as Japan's exports declined the most in almost seven years (7.7% from a year earlier) and US consumer prices sank by a record" raising the specter of deflation. One analyst described it as "the end of the world as we know it" in the worst ever global slump he's seen and "no region (able) to help (others)."

AFP in Tokyo said "Japan (officially in recession) reported a rare trade deficit in October." Exclusive of the slow holiday-affected January period, "it was the first red figure in 26 years" and a sign of more trouble ahead. In America also with JP Morgan Chase predicting that the Fed will cut interest rates to zero by January, hold them there throughout 2009, and other central banks will cut as well. But hold the cheers.

So far, monetary policy has been ineffective and little more than pushing on a string in a liquidity trap climate. Further, perception is everything at a time confidence is at record lows and shows no signs of stabilizing.

Once nominal rates hit zero, "the Fed has run out of ammo" except for what innovative tools it may use – such as buying toxic debt more aggressively and transferring it to its balance sheet in unheard of and reckless new ways.

One analyst weighs in on this possibility as follows: It's a desperation-driven "course of action that is not working (and) not a sign of intelligence....If Fed funds at 1% (and huge liquidity injections aren't) inducing banks to extend credit, a further reduction....won't have any impact" either, so why do it and maybe makes things worse.

It's why analyst Tim Duy calls Fed policy "adrift" in a November 20 commentary. He cites "a distinct lack of leadership and believes Bernanke "has used up his bag of tricks" and doesn't know what to do next. He calls recent Fed speak "littered with confusing statements that leave the true policy of the Federal Reserve in question." For example, on interest rates, whether to lower them further or stand pat, and more debate on the target rate is "nothing more than academic masturbation."

That rate is a non-issue, and "policy needs to take a different direction....One can only conclude that Fed officials do not understand their own policies. Policy is adrift. Be afraid; be very afraid....Bernanke cannot elucidate a coherent policy strategy to his organization because no such strategy exists. What does exist is a potpourri of policy responses that amounts to providing liquidity at all costs....Beyond this, the Fed is stuck in a netherworld of dual policy targets – not ready to admit the loss of the interest rate target, not ready to adopt a formal policy of quantitative easing."

"I think it is high time some real critical attention was placed on Bernanke. How complicit was (he) with designing and implementing a clearly failed policy?" And while "Fed officials publicly debate the intent of their own policies, investor confidence is collapsing. Bernanke needs to step forward and define policy. We need to pressure him into providing that

leadership – or (have him) step aside for someone else to do it.”

It’s a sign of the times that another analyst describes this way: America’s problems “are trickling down from the top and devastating (people) at every level. A vicious cancer has materialized and every segment of the economy is suffering. Americans increasingly have nowhere to turn as funds dry up and unemployment skyrockets.”

According to The New York Times (on November 20), even New York’s shoeshine business is suffering. In Grand Central Terminal alone, one operator of five stands now gets 100 customers a day compared to 700 in good times. It’s a “s(h)ign” of the times.

#### The World According to Paul Volcker

At a November Lombard Street Research conference in London he said: “What this crisis reveals is a broken financial system like no other in my life. (He’s 81.) Normal monetary policy is not able to get money flowing. The trouble is that, even with all this (intervention and) protection, the market is not moving again....I don’t think anybody thinks we’re going to get through this recession in a hurry.” Leading up to this has been “leveraging in the economy beyond imagination, and nobody was saying we need to do something....Alan (Greenspan) was not a big regulator.”

It’s now payback time, and according to economist Paul Ashworth, business spending is in “meltdown.” And the same is true for maxed out consumers.

Market Watch columnist Paul Farrell sees depression ahead in 2011 and lists 30 reasons why. Here’s a sampling:

- America may lose its AAA credit rating; it already exists in name only;
- growing numbers of companies need bailouts;
- “Treasury sneaks corporate tax credits into bailout giveaway, shifts costs to states;”
- sinking state revenues and rising debts signal trouble;
- “state, municipal, corporate pensions lost hundreds of billions on derivative swaps;”
- “consumer debt way up, now at \$2.5 trillion; next area for credit meltdowns;”
- Fannie Mae, Freddie Mac, AIG, the big banks and other companies are bleeding cash and want more taxpayer dollars;
- bailout costs will be in the many trillions;
- all asset classes are sinking and signal a global meltdown;
- retailers are failing; “mall sales (are) in free fall;”
- unemployment (is) skyrocketing; and
- “government policy is dictated by 42,000 myopic, highly paid, greedy lobbyists” – exceeded only by Wall Street’s level of greed and corruption.



## Two Additional Shoes to Drop

The auto industry for one. They're so close to the edge that no amount of bailout may help, but consider the consequences of bankruptcy. The big three employ around 250,000 US workers and affect nearly three million others at suppliers, dealerships and other companies. Without this industry, unemployment will skyrocket to unimagined levels, and the economic fallout will be catastrophic – both at home and globally because these companies have foreign operations and America's problems resonate everywhere.

Alt.A loans are another issue, called by some "liar loans." Moody's recently warned about this less publicized part of the mortgage market, and they should. They've grown faster than subprime ones to borrowers with less than top credit.

Alt.A refers to people with A-rated credit who borrow with little or no verification of income, or so-called alternative documentation. They cut across all socio-economic lines, exist everywhere in the country, are in danger of imploding, and if it happens, they'll dwarf the subprime meltdown. Why so? Because they're higher-priced, higher-leveraged, and there are more of them.

In combination with so-called Jumbo Prime mortgages, over \$1 trillion in residential mortgages are at risk – much of it on balance sheets of the nation's largest banks (including Citigroup, JP Morgan Chase and Bank of America) and another reason why their stock prices are plunging.

As of October, Alt.A delinquencies of at least 90 days averaged 20.3% for those originated in 2006. For 2007 ones, it's 17.5%. According to Moody's, prepayment rates are at historical lows (in the mid to high single digits) and are expected to remain depressed in light of credit tightness and declining home equity. Moody's stated:

"Given the lack of pool seasoning, cumulative losses have not yet risen as steeply as delinquencies. However, many pools are starting to show a sharp increase in the rate of loss realization. As the pace of liquidations has picked up, the performance data suggests worsening loss severities."

Moody's added that when Alt.A loans include an option adjustable-rate mortgage, delinquencies outpace pools without option-ARMS. The reason is because negative amortization results in weaker loan-to-values, and downgrades are certain to follow.

## Corporate Director Resignations Increasing

It's another sign of the times and highlighted in the Wall Street Journal (November 21). The Journal states: "Departing board members cite too-frequent meetings and conference calls. (Thus) a small but growing number....are quitting or planning to quit corporate boards just when companies need them most."

They give the usual reasons, but not the more likely ones. Corporate directorships pay well for a limited amount of work – six-figure compensation, stock options, and various other benefits as well as gaining valuable interlocking relationships with other corporate officials.

So why give them up? Along with benefits comes liability at a time many companies are floundering. Growing numbers face potential insolvency, shareholder law suits, and other increasing downside uncertainties. Citing too little time is a smoke screen. Busy people are

rarely too busy for things they feel are important. Avoiding unnecessary risk is one of them.

## Gold - The Traditional Safe Haven in Troubled Times

On November 19, Market Watch.com reported that "Retail investors sharply increased their demand for gold bars and coins in the past few months as they struggled to find a safe place for their money amid the financial crisis...."

On the same date, a World Gold Council press release stated:

"Dollar demand for gold reached an all-time quarterly record of US \$32 billion in the third quarter of 2008 as investors around the world sought refuge from the global financial meltdown, and jewelry buyers returned to the market in droves on a lower gold price. This figure was 45% higher than the previous record in Q 2 2008. Tonnage demand was also 18% higher than a year earlier."

Record demand is showing up at retail and in exchange traded fund (ETF) inflows. They were also offset by "inferred investment" outflows by hedge fund liquidations to raise cash for redemptions.

James Burton, World Gold Council's chief executive officer stated:

"Gold's universal role as a store of value has shone through during this quarter helping (to) attract investors and consumers to all forms of gold ownership. Looking forward, given the uncertainty that surrounds the global economy, gold's safe haven appeal should continue," but so will the speculative side of the gold market.

Earlier in the year, spot gold reached \$1000 an ounce. The price then briefly fell below \$700, remained in the low to mid-\$700 range (until on November 21 it spiked to \$800), and reasons cited are that institutional investors are selling desired assets to meet margin calls on weaker ones. Perhaps so, but much more is going on as well.

Markets are heavily manipulated, and gold among others are targeted. For the precious metal, it's to hold down its price to make dollars more attractive at a time it should be soaring and likely will looking ahead with some forecasts of it reaching extremely high valuations.

Noted analyst Richard Russell of Dow Theory Letters has his view on gold and its price action. He believes "one way or another, gold is being manipulated by certain sources. What group would least want to see (it) heading higher? My answer is the Fed. (It's) exploding the money supply. This would ordinarily foment inflation. Surging gold is a red flag that the public understands. The Fed is doing everything it can to hide the fact that it is devaluing the dollar via its" explosion of the money supply.

Russell believes that gold is in a primary bull market. The longer its price is artificially depressed, the "greater the bull forces within gold will struggle to express themselves."

Even now, the New York Post reported (on November 18) that "Governments Can't Handle (the) Global Run on Gold Coins....as people around the world are demanding so many of the valuable coins that government mints are having difficulty filling orders."

The US mint is allocating them to restrict supply. It increased its dealer price for a 10-ounce



coin by 10% and one-ounce coins by 3%, and one dealer says that customers wanting 200 gold coins have to wait up to two weeks to get them. Six months ago they were available immediately. In addition, some dealers turn customers away, and those selling them demand a 10 – 15% premium over the Comex quoted price.

It hasn't curtailed demand and why not. Gold is a global thermometer that reflects monetary, political and economic stability as well as marketplace demand – for investment, jewelry, or as the ultimate hedge against uncertainty. When prices rise, it usually warns of trouble – geopolitical, inflation, deflation, the loss of confidence in fiat currency, or a possible looming depression so far not reflected in the metal's price, but watch out.

Gold's price may be resting for a time and is being artificially held down, but for how long. If conditions keep deteriorating and money creation remains too expansive, sooner or later gold may explode on the upside.

Petrodollar states may think so and are making large gold purchases. In November, Saudi investors bought \$3.5 billion worth, reportedly as a safe haven at a time of crisis and falling oil prices. Reuters said that Iran is converting some of its \$120 billion in foreign currency reserves to gold. Dubai dealers are running low on the metal as demand is high.

In China it hit 38.4 metric tons through September compared to 24 tons for all of 2007. Gold jewelry demand in China reached 241.6 tons through September compared to 302 tons in 2007 when jewelry demand grew by 26%. China is the world's second largest gold consumer.

On November 14, The Standard (based in Hong Kong) reported that "The mainland is seriously considering a plan to diversify more of its massive foreign-exchange reserves into gold (because of) fears about the long-term viability of parking most of (them) in US government bonds" at a time America's budget deficit and national debt are soaring.

Demand in India (the largest gold consuming market) is also growing (up 31% from Q 3 2007) at a time global gold mining production was 1133 tons in the first half of 2008 or 6% below the same 2007 period. Gold supply was down 9.7% over year-earlier levels due largely to significantly lower central bank sales. Those made under the Central Bank Gold Agreement (CBGA) totaled 357 tons in the year ending September 26 – the lowest annual figure since the first 1999 Agreement. Prices are falling, but Saudis and other Middle East investors are buying and for good reason.

World economic viability is sinking, and it's affecting oil prices. They've fallen around two-thirds from their all-time high, and producer states are worried. The Energy Information Agency projects that OPEC may earn \$595 billion in 2009 – way down from its earlier \$979 billion net 2008 revenues and lower than \$671 in 2007.

So today's gold weakness and dollar strength may turn out to be a shorter-term phenomenon than many observers believe. The 10-year credit default swap (CDS) spread on US Treasuries provides a clue. The cost of insuring against a US government default is soaring, and it's happening to Britain and Germany as well. It's now many fold higher than in late summer, a cause for worry, and likely because markets are pricing in massive bailouts that may far exceed the current levels. In the US, it already hit \$4.2 trillion, it's rising, and hinting at a possible future default or huge devaluation that's the same thing.

In this environment, gold may be the safest of all asset classes at a time none are safe, and no one can predict how bad things may get before they improve. What's likely, however, is that the road ahead will be painful, protracted, and unlike anything experienced before so all the old rules don't apply, and no one knows what, if anything, may work. This saga has a long way to run, and the path ahead is down.

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