



## FORTUNE OR MISERIES

*“There is a tide in the affairs of men  
Which taken at the flood, leads on to fortune  
Omitted, all the voyage of their life  
Is bound in shallows and in miseries  
On such full sea are we now afloat  
And we must take the current when it serves  
Or lose our ventures”*

W. Shakespeare, Julius Caesar, Act 4

The current financial crisis will have a major impact on virtually every person in the developed world as well as in the developing world. We are today standing at crossroads in our personal lives and affairs. The decisions we take today will either lead us to “fortune” or “miseries”.

**Do not for one second believe that the worst is over or that government actions will remedy the problems.**

The current financial cataclysm in the world economy has a very long way to go before it gets better. We are talking about many years before we touch bottom and maybe a decade or more before we turn up.

We will all suffer in the coming years whatever decisions we take. But it is possible to take actions today “which lead to fortune”. “Omitted the voyage of your (their) life is bound in shallows or in miseries.”

For any thinking person, what is currently happening could easily have been forecast. But sadly there are very few freethinkers today since most people in financial markets have a vested interest. The worldwide credit growth and money printing of the last two to three

decades could only have had one outcome. We have been forecasting the current crisis for many years. We do admit that it arrived later than we expected as we underestimated governments' ability to print money and the markets unwillingness to accept that the Emperor Had No Clothes. **The collusive back scratching by governments and bankers based on power and greed has exacerbated manifold the problems we are now facing.**

In August 2007 every government official and banker stated that the subprime problem would be contained. At the time we told investors that subprime was not the only problem. Subprime was only the catalyst that started the bursting of the bubble. There could have been many other catalysts which would have started the inevitable collapse of the asset and credit bubbles.

Before we talk about how investors should protect themselves let us look at where we are.

## **Infinite Funding Requirements**

We forecasted a year ago that bank writedowns would reach at least US dollars 2 trillion excluding any major problems with derivatives. At the time the consensus forecast was US dollars 200 billion losses. Today the losses taken so far are USD 1 trillion and banks are daily finding more losses. USD 2 trillion now seems very conservative. Initially sovereign wealth funds injected new capital into some of the banks but as we projected last year they are now ceasing to throw good money after bad.

Virtually every single entity that has raised new capital is coming back for more, whether they be major banks, AIG, Fannie Mae etc.

And now it is only lenders of last resort i.e. governments that are injecting funds.

Since the beginning of September 2008 over **US Dollars 7 trillion have been printed out of nothing to support the financial system.** These are incomprehensible figures and debts that future generations will be saddled with. But with unmanageable levels of borrowings already before this crisis started we know that these debts can never be repaid with real money.

Let us look at some of the areas that will need massive and unfathomable amounts of funding:

- **Banks** – at least another USD 1-2 trillion losses excluding a derivative collapse
- **Derivatives** – the USD 1 quadrillion outstanding might net down to a lower amount but a substantial part of this, perhaps USD 50 - 100 trillion is worthless and will therefore not be settled. The biggest problem area is Credit Default Swaps which amount to USD 50 trillion or more.
- **Insurance companies** – AIG was the first to be nationalised but many more will require major funding since their assets are falling precipitously. We are probably talking about at least USD hundreds of billions but possibly more.
- **Money Market Funds** – are totally illiquid and not able to meet redemption demands. They will continue to receive substantial government funds.
- **Pension funds** – as with insurance companies, pension funds, both private and government are collapsing in value and the funding requirement will also be in the USD hundreds of billions at a minimum, putting retirees at risk of receiving no pension.
- **Strategic Industries** – Most car manufacturers in the world are on the verge of bankruptcy. GM and Ford are virtually bankrupt and it will not be long before the US government will inject major funds. It will start with USD 50 billion or so but this is nowhere near sufficient. Same thing with car manufacturers in other countries. Many other industries and companies will require state subsidies to survive.
- **Credit Cards, Personal Loans, Student Loans and Car Loans** – this is the next major area which will lose massive amount of money. People have not been able to repay but instead increased their debts in good times. Obviously they have no chance of repaying them in bad times. The requirements here will be in the USD 100's of billions.
- **Housing** – house prices are now falling worldwide and the real falls are well in excess of the published figures. Banks in the USA are now selling repossessed (foreclosed) properties in auctions at as low as 10% of original value, **a drop of 90%**. A major percentage of borrowers will end up with negative equity and not be able to service their loans. Governments will likely assist here also and the potential losses are in the USD trillions.
- **Commercial Property** is facing the same problems as housing with massive falls in values.
- **Unemployment and social security** – unemployment is increasing rapidly worldwide and the social security payments will increase exponentially.
- **Tax Revenues** – will fall dramatically and increase government deficits. US deficit in 2009 is likely to be well in excess of USD 1 trillion or almost 10% of GDP. Same in the UK and many other countries.

We could go on with list a lot longer but it gives a taste of the massive funding requirements over the next few years for which **there is no money available**. Thus governments which have declared that they are determined to save the system will be printing unlimited amounts of money.

## **Worse than the 1930's**

In the 1930's the depression affected mainly the USA and Western Europe. The USA was then a creditor nation and the world wide credit outstanding was considerably smaller in relation to the GDP at the time. There was no international money market and there was virtually no derivatives market.

Today we have a global financial market with virtually every country in the world being part of the financial web. **Also, the asset, credit and derivative bubbles worldwide are exponentially bigger than in the 1930's**

This interdependence has created a system which is only as strong as its weakest link. And when the weakest link is the biggest economy in the world, we know that we have a house of cards that is standing on extremely unstable foundations.

Iceland is bankrupt, the USA is virtually bankrupt and the list of countries under serious financial pressure includes most countries in Western Europe with the UK one of the worst but also Italy, Spain etc. Most Eastern European countries are in serious trouble so are the Baltic Countries, Ukraine, Belarus, Pakistan and Argentina. The Fed has extended its emergency funding to countries like South Korea Singapore, Mexico and Brazil. But also Russia and China are suffering.

**The list of countries is endless and proves that this is a global problem of unprecedented and unmanageable nature. Most countries in the the world is going into this economic recession/depression with record high debts and budget deficits. There are no reserves or funds available to stimulate the world economy. This means that any stimulus must come from borrowed or printed money. To borrow/print trillions of Dollars, Euros, Pounds etc at this point will make the eventual problem exponentially bigger by creating an even larger credit bubble that at some point will burst and create an even greater economic collapse.**

## **Consequences**

We might sound repetitive like Cato the Elder in the Roman Senate who ended every speech with “Furthermore, I consider that Carthage must be destroyed”, as in most of our reports we repeat the likely consequences of the current crisis:

### **We will have inflation/hyperinflation followed by a deflationary collapse.**

As we see it there is no other option. If governments fail in their current efforts to inflate the world economy, we could go straight into a deflationary implosion.

But our preferred scenario is that we will first have inflation or hyperinflation. Current consensus is that the current fall in asset prices and commodities is deflationary. Yes, it is correct that we currently see short term deflationary pressures. **But what most observers fail to understand is that monetary inflation i.e. the trillions of Dollars, Euros, Pounds etc. printed by governments inevitably will lead to inflation in the economy.**

It is important to understand that in a hyperinflationary environment there is also deflation taking place simultaneously. Also, without exception in history, when there has been hyperinflation there has also been a depression.

If we take the example of the Weimar Republic or Zimbabwe, most assets such as property or stocks declined in value in real terms. At the same time commodities, food, services etc went up exponentially. Gold for example went from DM 100 per oz to DM 100 trillion in the Weimar Republic.

In the next few years we are likely to experience a similar scenario with falling asset prices and rapidly rising prices in most other areas of the economy.

### **Iceland – a model of things to come**

To understand how all of this will pan out Iceland is a good current example. What has happened in Iceland in the last few months could be seen as a microcosm of what is likely to happen in the USA, UK and many other countries.

Iceland was a country living far above its means with a banking system much bigger than the country's GDP and with a massive current account deficit.

Before the start of the credit crisis international banks were unwisely prepared to finance this bubble economy. But as the international crisis continued Iceland could not borrow any more, the currency collapsed and the banking system collapsed. Thus Iceland is now bankrupt and totally dependent on handouts from the rest of the world and the IMF which might or might not materialise. Most Icelanders have lost all their savings, house prices and equity prices have collapsed. Prices of commodities, food, and all imported goods are surging and the currency has collapsed. Inflation in Iceland is now running at 20% and the forecast is that it will hit at least 75%.

**What happened in Iceland is what is likely to happen to the USA, the UK and many other countries. Eventually, the economies of countries which live above their means and on borrowed or printed money for extended periods of time will inevitably collapse.**

**The USA is bankrupt and can never repay its debt with the current value of their currency. The only way the debts can be paid is by printing trillions of dollars.** The only reason the USA has not gone under yet is that the US dollar has been the reserve currency of the world. Nations like Japan, China and the Opec countries have been happy to sell their wares to the US and to finance the American imports by buying US government debt.

**But this situation is likely to change very soon.** The dollar is temporarily strong for purely technical reasons. US investors are liquidating investments in foreign and especially emerging markets as well as commodities. This is putting temporary upward pressure on the dollar. This exercise is likely to finish in the next few weeks. **Thereafter the dollar will come under real pressure. So will US government debt. This will lead to a downward spiral of a falling currency, rising interest rates (as a result of foreign liquidation of US debt) and rising inflation.**

## **How do investors protect themselves?**

### **Inflationary or Hyperinflationary Scenario**

In this scenario, which we believe is the most likely outcome, money and bonds will be worthless. In real terms equities and property would also decline even though in inflationary terms they could go up in price.

Commodities will go up substantially and so will Precious Metals.

### **Deflationary Credit and Asset Implosion**

All governments are today doing all they can to avoid this scenario by borrowing and printing unlimited amounts of money. If their actions fail the credit and asset bubbles will implode which would lead to bank failures as well as a risk of a major systemic failure of the financial system.

In this scenario prices of virtually everything would decline and the most valuable asset would be money which would appreciate in value in relation to all other assets. Bonds would appreciate in value but the question is which bond issuer is safe in a world economy where everything collapses. With banks likely to fail, Precious Metals will be a safehaven.

### **“Fortune or Miseries”**

The coming years will probably be the most difficult and devastating since the South Sea Bubble in the 1720's.

Everyone will suffer. But if the right actions and investment decisions are taken some of the problems might be alleviated.

**In the inflationary/hyperinflationary scenario most assets will fall in value in real terms in money will be worthless.**

**In the deflationary scenario many banks will fail and funds and other assets in the banking system are at risk.**

To avoid “Miseries” investors should place an important part of their assets in physical Gold stored outside the banking system.

18 November 2008

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