



IS IT TIME TO PANIC?

The question above is clearly justified. Especially after the Fed has cut the discount rate by 1 ¼ % in the last ten days. This is undoubtedly panic action. And the cut is not due to the fall of the stockmarket. The reason for the cut is in the statement issued by the Fed on 30 January: ***“Financial Markets are under considerable stress”***. This statement is Fed speak for the fact that the financial system is fighting for survival.

Derivatives – Financial Weapons of Mass Destruction

We forewarned investors already in November and December about the looming problem of Credit Default Swaps (CDS), a **\$ 50 trillion** problem, and the fact that the Credit Insurance Companies (monolines) would be downgraded which would crystallise losses for the banks **of \$ 400-500 billion**. The market has now become aware of this problem that we forewarned our investors about two months' ago. So far bank writedowns are around **\$ 100 billion**. Sovereign funds have injected capital of circa \$ 70 billion into the banks to save them from bankruptcy. But we have only seen the beginning of the writedowns. The impending downgrades of the monolines will lead to another **\$ 300-400 billions** of bank losses. However the monolines only guarantee around **\$ 2.5 trillion** of the CDS market. Thus there is another **\$ 47.5 trillion** still at risk underwritten by banks, finance companies, hedge funds etc. And then there an additional **\$ 500 trillion** of other derivatives.

It must be stressed that these astronomical sums are all in Over the Counter (OTC) derivatives which are; unregulated, not listed, therefore no market price, and unfunded i.e. there are virtually no reserves provided against the risk of default. This makes them financial weapons of mass destruction.

Sovereign Funds

The Sovereign Funds that so far have supported the banks will not throw good money after bad. Once the bank writedowns run into the \$ 100's of billions they will come to their senses and stop investing.. At that point there is only one lender of last resort which is the government. Most governments and central banks are now doing all they kind to inject liquidity by printing money. But this will not be enough. The only way to save financial markets which as the Fed said ***“are under considerable stress”***, is for governments to recapitalise the failing banks, insurers etc. This would involve printing \$ 100's of billion if not trillions. The hyperinflationary effects of this would be mind-blowing.

Risk at Unprecedented Levels

The risk area we have outlined above is primarily linked to derivatives. But banks and finance houses have many more problems looming. There are many other areas which will lead to writedowns in the financial markets. The major ones being; mortgage loans (excluding sub-prime), personal loans, credit cards, car loans etc. The potential losses here is also in the \$ 100's of billion.

So are we predicting Armageddon and a collapse of the world's financial system. No, but what we are doing is to warn our investors of the current risks in the financial system. **The risks are greater than ever in the history of capital markets.** When what used to be the most conservative bank in the most conservative country namely UBS in Switzerland writes off **\$ 19 billion** in 2007 it is time to think about protecting one's investments. It is our responsibility to warn investors in advance of potential risks and to suggest the best way to protect their capital.

Investment areas

So what markets do we find attractive today?

Let's start with the ones to AVOID:

Stockmarket	- has started a major downtrend
Cash & deposits	- will depreciate quickly with inflation also high risk due to bank problems
Long Bonds	- long interest rates will go up due to inflation thus bonds will fall in value
Property	- overvalued, in a bear market (excluding fully paid for personal dwelling)

What we find attractive:

Gold	- the only real money and in short supply
Silver	- poor man's gold, substantially undervalued
Platinum	- also real money, with industrial use
Food stuff	- grains, sugar etc. demand increasing and supply problems due to climate cycles
Farm land	- especially in areas with low land prices like South America
Energy	- oil, uranium (the only real alternative to oil), alternative energy
Government bonds	- short dated government securities (12 months or less) is the safest place for any spare cash

Longer term, markets like China and India will be the real growth areas but they will suffer with the West in the medium term.

Asset Allocation

Due to the current risks in the financial markets we would invest a substantial amount in physical precious metals stored outside the banking system

We would suggest that **at least 50%** should be in physical precious metals. Any balance could be spread equally or invested according to preference in the other recommended areas.

Why do we recommend such a high percentage in precious metals?. Firstly, we recommended to our investors already back in 2002 to put 25-50% in gold and silver. The ones who followed our advice have made between 120-200% return depending on which is their base currency.

We have never seen a clearer **win/win** situation in investment markets. As we have stated many times, the money printing undertaken by all governments currently will lead to an accelerating stagflation/hyperinflation. This is very bullish for precious metals.

Alternatively, if governments fail to inflate the financial system, the massive amount of credit outstanding will implode leading to serious problems in the financial world with potential bank failures. This is also very bullish for precious metals.

Precious Metals – Inflation

The precious metals have not kept up anywhere near with inflation. In 1980 gold was \$ 850 and silver \$ 50. At the time total US government borrowings were \$ 900 billion. In 2008 government borrowings will reach \$ 10 trillion. Thus borrowings have grown more than tenfold and gold is about the same as in 1980. This situation will be rectified in the next few years. Silver was \$ 50 in 1980 and is today \$ 17. This makes silver one of the most undervalued real assets currently with an enormous upside potential of \$ 100 or more. But silver is also more volatile than gold and thus the bulk of the investment should be in gold.

Housing

The housing market in the US is collapsing. New home sales in December were down 40% year on year. Foreclosures are now up at least 50% but 15 States are showing increases from 200% to 3,900% in the foreclosure rate year on year. This is a serious housing problem that will lead to major problems for the banks and the consumers. European housing markets have also started to turn down (Spain already has a major problem). It is only a matter of time before the problem becomes serious in the most exposed European markets (e.g. UK).

Conclusion

So back to our question: *"It is time to panic?"* No of course not, it is never right to panic. But the risks are greater than ever in modern history and therefore investors should take cool and considered decisions in order to protect their wealth and take advantage of the outstanding opportunities now available for wealth protection and wealth enhancement.

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