



MARKET UPDATE

1. We are currently going through a correction in all markets. Dollar up, precious metals down and stockmarkets up. This is a typical thin summer market shake up with exaggerated moves due to the fact that most of the heavy investors and traders are on holiday. Therefore central bank intervention to boost the dollar and computerised, black box trading are currently managing to push the markets further than normal. But remember that central banks run out of ammunition very quickly and the black boxes are lemmings just following any short term trend.
2. The corrections in the precious metals, albeit always unpleasant to experience, are totally normal. We have seen it many times in this bull market since 2000 and we saw it in the 1970's. Remember that gold 12 months ago was \$ 645 and silver \$ 11. Time wise this correction should finish before end of August and possibly earlier. Price wise we have seen the biggest move but the metals could go a slightly lower in the next week or two.
3. Stockmarkets are also likely to finish their upward correction in a bear market within the next couple of weeks. We expect a major fall in the autumn.
4. Nothing has changed since our report in July. If anything, the financial system is deteriorating.
 - a. The banking system continues to weaken, especially with the US treasury having to underwrite the total debt of Fannie Mae and Freddie Mac. This amounts to a potential undertaking of \$ 5 trillion which is 50% of US mortgage debt and 40% of GDP. The government underwriting of this massive mortgage debt will eventually lead to major losses. The securitised loans that Freddie and Fannie have purchased from mortgage banks are very poor quality. These loans are almost all packaged with derivatives (credit default swaps etc). A big percentage of these derivatives are worthless with no market price. Also, when borrowers are in default, Fannie and Freddie have problems repossessing the properties since they were not the original lender. So we have a potential massive cost for the US government which is likely to exceed \$ 1 trillion.

- b. Many banks are still fighting for survival. As we have stated before many major investment and commercial banks would be bankrupt if they valued their assets to market. But since they can't afford to value to market, they are playing all kinds of window dressing games with the semi-official blessing of the authorities. All credit areas of the banks are deteriorating including residential and commercial mortgages, corporate credit, personal loans, car loans etc. Writedowns are currently around \$ 500 billion. This amount is increasing daily by drip feeding the writedowns in order not to panic investors. Writedowns will certainly reach \$ 1.5 trillion in the next 12 months. Eventually the only lender/investor of last resort will be the government. Thus a lot more money printing to come.
 - c. The \$ 1 quadrillion derivative mountain is still a disaster waiting to happen, especially the \$ 60 trillion credit default swaps. A major part of these are worthless. Again the only saviour is the government.
 - d. The consumer in most countries can no longer cope with the combination of massive debts and dramatically rising prices in food, fuel and energy especially. Spending will decline and unemployment will go up. This will further increase the already unmanageable deficits in most countries. The US government is bust and once China (after the Olympics?) and other holders of US government debt start selling these off, the US treasury will have to print money at a faster pace.
 - e. Thus the monetary inflation due to money printing (not to be confused with commodity price increases which is due to supply and demand) will accelerate. As we have forecast in the last few years, the US and many other countries will have stagflation with increasing costs and a declining economy.
 - f. The US authorities and financial community is doing everything in their power to hype the economy. But this is done mainly by unfounded bullish statements and manipulated economic figures. US GDP for Q2 08 was recently published at +1.9%. In order to arrive at this a deflator (inflation rate) of 1.1% was applied. But US inflation is currently 5%. If this real rate was applied the US GDP would be **-2%**. Thus the US is in recession and eventually this will be impossible to conceal. The consequence will be lower interest rates (even though they can't go much lower) and a lower dollar
 - g. Total US debt is \$ 110 trillion including unfunded liabilities. This is \$ 1 million per household. This amount of debt will never be repaid. Foreign countries will not continue to finance the US which is bankrupt. The only solution for the US treasury is to print money in order to repay the debt. This will lead to very high inflation and a weakening currency.
5. The effect on markets of what is outlined above, in our view, will be the following:
- a. Stockmarkets down

- b. US dollar down
- c. Precious Metals going to new highs against all currencies

15 August 2008

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