

February 21, 2005...

Commentary by John F. Wasik, author of "The Bear-Proof Investor," is a columnist for Bloomberg News. The opinions expressed are his own.)

(Bloomberg) -- In a perfect world, you would know if your pension fund's consultants are making money through conflicted side deals and how much it was eating into your retirement fund returns.

Although reports of myriad conflicts between brokers, consultants and money managers have surfaced over the last year, no government agencies have acted to force full disclosure of this information or curtail the practices.

The U.S. Securities and Exchange Commission, which began an investigation of pension consultants in December 2003, was expected to release a report last December.

Agency spokesman John Nester said that "we've never announced a deadline nor whether there would be a report. Most often there is no report, but referrals are made to the enforcement division of violations that are suspected."

Pension consultants are gatekeepers between money management firms and pension trustees or 401(k) administrators.

In recent years, pension consulting practices have gained attention since it was revealed that in addition to fees charged to pension funds, the consultants have reaped brokerage commission income and fees for investment manager marketing and conferences that cost up to \$50,000 a person.

February 14, 2005...**US core producer prices log biggest jump in 6 yrs**

WASHINGTON, Feb 18 (Reuters) - Sharp gains in the cost of cigarettes and autos helped push core U.S. producer prices up at their fastest rate in six years in January, while overall prices also edged higher, the Labor Department said on Friday.

The producer price index, which measures prices received by farms, factories and refineries, moved up 0.3 percent in the month, the department said. But the core index, which strips out volatile food and energy prices, shot up 0.8 percent, the biggest gain since December 1998....

Excerpt from Barron's February 14, 2005...

Alan Abelson's column - **Up and Down Wall Street**

RICHARD RUBIN IS A SMART YOUNG GUY who runs Hawkeye Capital, a New York-based hedge fund. And what separates Rich from a lot of smart young guys who run hedge funds is a) he's a canny investor, as evidenced by the fact that he has averaged an annual 17%, after the usual big bites that hedges funds take as fees, in the five years of the fund's existence; b) he has a decent appreciation of risk, as evidenced by the fact that Hawkeye's portfolio has been at times more than 50% in cash the past two years; and c) that, even in these picked-over markets, he has a nice knack of combing through a mess of unloved securities and finding

winners.

The point of this brief intro is that Rich is currently very high on the stock of Sears Canada, 54%-owned by Sears Roebuck, which, itself, is slated to merge with Kmart next month, a union that, once consecrated, will be known under the highly imaginative moniker of Sears Holdings. Headquartered in Toronto, Sears Canada lays claim to a fair-sized retail empire (sales last year topped \$6 billion in Canadian dollars) that includes 120-odd department stores, 219 off-mall outlets, three-score-plus home-improvement showrooms and many, many (we got tired of counting) catalog pickup outposts.

A solid retailer -- the chain accounts for a third of all appliance sales north of the border -- Sears Canada has a respectable earnings record, although profits seem to be stuck -- temporarily, anyway -- around \$1.30 a share, give or take a nickel. (Again, these numbers, as all that follow, are in Canadian dollars, which seems only right since that's where the company lives and does business.) But, in this case, earnings aren't the big attraction, Rich insists. Assets are.

On that score, Sears Canada has what Rich calls a "hard book value" -- by that he means a net worth devoid of fluff and air -- of \$18 a share. And book value seems destined to grow with a cheerful monotony in the future just as it has in each of the past 10 years. And, as it happens, there's more to those assets than meets the eye, or at least the market's not always unerring eye. The shares, traded on the Toronto Stock Exchange (symbol SCC.T), had been backing and filling in the mid-to-high teens, but they shot up over 20 last week on an analyst's mildly hyperventilating recommendation, suggesting a possible buyout.

For openers, there's real estate the company owns that likely would fetch a handsome price on the open market. Sears Canada also boasts a flourishing credit-card business and a tidy \$1.5 billion or thereabouts in unsecuritized receivables that could, if management were so minded, act as a comfortable reservoir of cash.

After subtracting \$678 million in debt, Rich reckons that the credit-card operation and the real estate are worth \$1.57 billion. Since the stock market values Sears Canada at roughly \$2.1 billion, the rest of the company -- the meat and potatoes part of the business -- is being valued at a measly \$500 million, or roughly \$4.75 a share. Put another way, investors are placing a value of \$500 million on \$6 billion of revenues and only some 1½ times fabled Ebitda (that mouthful, for the uninitiated, means earnings before interest, taxes, depreciation and amortization). Talk about bargain-counter merchandise!

You needn't be aburst with curiosity to wonder how the Sears-Kmart merger will affect Sears Canada. Rich figures two things can happen, both of them positive. One is that the company continues to operate on its own but under the guidance of a much bigger and savvier parent, thanks to the presence of Edward Lampert, the master investor who took over and rejuvenated Kmart and orchestrated the deal with Sears. Rich really digs Lampert and says he would be delighted to be a fellow shareholder.

The other possibility is that Sears Holdings makes an offer for the 46% of Sears Canada it doesn't own. By Rich's not entirely disinterested but still reasonable calculation, such a bid would be somewhere between \$27 and \$32 a share. Even the low end of that range would represent a premium to the current market price that only a chronic grump would complain about.

February 10, 2005...

TWO VIEWS ON THE SELF-IMMOLATION OF PAPER MONEY

Antal E. Fekete

Professor Emeritus, Memorial University of Newfoundland

Letter to a reader commenting on my criticism of Mises

Dear Mr. West:

Thank you for your interest in my work. Also thank you for giving me this opportunity to rethink my criticism of the monetary theories of Ludwig von Mises. Believe me, I did not take the task of criticizing Mises lightly. I, too, hold that he was a giant among the great thinkers of mankind. So was also Aristotle. Yet neither is above criticism.

I have criticized Mises on two points in my piece "The Gold-Demonetization Hoax". One concerns the question whether constant marginal utility exists as a limiting case; the other whether subjective value can be measured objectively. The two are closely related and cannot be separated. I quote from your letter.

"You state Professor Mises denies the constant marginal utility of gold because it implies infinite demand that is contradictory. I believe what Professor Mises is saying is that those who argue against a limited demand for money based on their belief in constant marginal utility are erroneously confusing cash holdings (the subject he is addressing) with wealth. He goes on to make a distinction between the two and argues only that the demand for wealth, as denominated in money, is indeed unlimited. But cash holdings are limited to their usefulness in acquiring wealth. Cash will be spent as quickly as possible, leaving only a sufficient reserve. Mises does not argue against constant marginal utility."

"The second item is your statement that Professor Mises denies that there is a unit of value. The section you quote is a lead-in to his argument that monetary calculation in a socialist society is impossible. His argument is that without free trade you cannot establish value because there is no scientific way to construct a unit of value. That money by definition is both a unit and a store of value is not argued;

only that value cannot be determined unless two parties agree on it.
There is no "extrinsic" unit that can be placed on an item."

I don't think it can be disputed that Mises in fact rejected the idea of gold or any other substance having constant marginal utility whether absolutely or, as a limiting case, relatively. For him a yardstick measuring value simply could not exist. Value was subjective and as such could only be compared but not measured. As a consequence, the material itself of which the yardstick was to be made would be subject to declining marginal utility so that two different specimens would have different values, even to the same individual.

Consider, if you will, an imaginary world we shall call Rubberland where no substances of solid state exist. The nearest thing is elastic state, the state of rubber-like substances of which Rubberland consists. In such a world there is no possibility to measure length or distance, as an elastic yardstick is an oxymoron. Physics would be a "subjective" discipline. Length and distance would still exist, subject to consensus and comparison but not to measurement. Anyone in Rubberland who believed that measuring distance was possible would commit a grave scientific error. Upon substituting "value" for "length" subjective economics is akin to the physics of Rubberland.

Mises' views on gold are based strictly on supply/demand considerations. Gold has been promoted by the market to the status of money because of its supply/demand characteristics, not because of its unique marginal utility. By the same token, governments could deprive gold of this status by denying it monetary demand, the lion's share of total demand. Mises thought that if gold was ever demonetized by the governments, then its exchange value would fall. He cited the example of demonetizing silver in the 1870's, followed by a sixty-year decline of silver's value by more than 80 percent. To suggest that a causal relation exists between the two events is a fallacy that in logic goes by the name post hoc, ergo propter hoc (after it, therefore because of it).

In any event, Mises was proved wrong. A hundred years after silver-demonetization governments, brow-beaten by the US, declared that they were demonetizing gold, too. Yet, lo and behold, gold's exchange value, far from collapsing, rose greatly in the wake of the announcement. By more than by 2000 percent, in less than ten years' time. It is clear that Mises misjudged gold, as a result of his dogmatic insistence that all values, without exception, were subjective. To say that the value of gold was an exception would be considered heresy by him. Yet the truth is that gold has a property that makes its value objective. Gold is the only substance that has constant marginal utility.

In Rubberland the analogous development would be if explorers and prospectors had discovered a (for them) unique inelastic substance we shall call "solid". Now it has become possible to construct a yardstick and start measuring lengths and distances, something that could not be done before. The subjective discipline of physics has now acquired an objective character. Needless to say, the discovery of solid has not changed the nature of other substances in Rubberland. Those of elastic state were still elastic after the introduction of the yardstick. What was different was that measurement has been made possible scientifically for the first

time.

Due to its constant marginal utility gold has become the "most hoardable" good. This means that the opportunity cost of hoarding gold is lower than that of any other. As a consequence the stocks-to-flows ratio (existing stocks divided by annual flows of new production) for gold is a high multiple, while for all other goods it is but a small fraction. This is what makes gold's value objective. The individual's trust in gold's value is not simply subjective as it would be in the case of other commodities. In the case of gold it is reinforced greatly by an objective fact, namely the stock of monetary gold in the world, the accumulation of millennia, reflecting the superb confidence in gold's value by generations that have gone before us. This also shows that governments are helpless in their effort to demonetize gold. To do so they would have to dissipate existing stocks of monetary gold in order to bring its stocks-to-flows ratio in line with that of other goods, a job that would take centuries to accomplish.

I myself treat every supply/demand argument, including the quantity theory of money (QTM), with the greatest suspicion. The notion of supply and demand does not stand up to scientific scrutiny. It is anecdotal, and has only metaphorical merit. Any argument using it is necessarily ad hominem. Conclusions are valid only in so far as the existence of speculation in the commodity under consideration can be ignored. Speculators never have a firm commitment either to the long or the short side of the market. They could, and often would, change sides at the drop of the hat, sometimes rationally, at other times not so rationally. Furthermore, they could sell short. That is, they could sell something forward that they haven't got, nor do they know how they will liquidate their commitment. Their motto is: "Sell now, worry later." Speculators on the short side of the market can be squeezed and, in the worst-case scenario, cornered by the longs (although not the other way round). Supply and demand, if they are to have any meaning, must include speculative supply and demand, as they also participate in the price-forming process. But this inclusion makes supply and demand bereft of any scientific merit, on account of the capricious nature of speculation.

The QTM is demonstrably wrong. In every historic hyperinflationary episode that ultimately reduced the value of irredeemable currency to naught the demand for money, far from vanishing, actually outstripped supply. When the rate of depreciation of paper money reaches a certain threshold, the government printing office can no longer produce, and the banking system can no longer deliver, the bank notes fast enough to the consumer who needs them if only for the purpose of buying food. Yet the short supply of, and the desperate demand for, paper money could not protect its value against further losses, nor could it avert its ultimate demise. Where does this leave the QTM? Well, it is not a scientific theory by a long shot. At best it is a mechanical metaphor that may work as long as fair weather lasts. But it is mercilessly swept away by the first storm. It is certainly not an adequate scientific tool with which to investigate the one hundred percent mortality rate afflicting irredeemable currencies through the sudden death syndrome. The QTM is a linear model that is entirely inapplicable in a non-linear world such as ours. If you really want to understand why an irredeemable currency is bound to lose all its value in due course, then you need a non-linear model.

I don't disagree with Mises that there is a confusion about "money" and "wealth", and that people limit their cash-holding to their actual needs for it. But I don't think this has any relevance to the problem of gold's marginal utility. Consider the proverbial man "who has everything". What can you give him on his birthday that would not make him even more bored? There is only one possible answer to that question: give him a gold coin. No matter how many he may already have, he would accept the additional coin on exactly the same terms as he has accepted the previously acquired ones, including the first. His cash-holding has nothing to do with it. Also irrelevant is whether he would keep it or spend it. What solely matters is the fact that if you gave him anything else, he would value your gift less than he would the previously acquired unit of the same.

I am sorry to say, Mises' stand on the unit of value is a case of one wanting to have his cake and eat it. On the one hand, according to Mises, it is not admissible to assume the existence of an objective unit of value as it would contradict the fundamental principle of subjective economics whereby all values are subjective. On the other hand, Mises wants to endow businessmen with the power to be able to calculate the probability of future prices and profits which is not possible without an objective unit of value. Free trade has nothing to do with it, unless we assume that under a regime of tariffs and quotas economic calculation was no longer possible as a subjective unit of value would only have validity between consenting adults, and as such would be useless in economic calculation.

I submit that a more consistent solution to the problem is to admit the existence of an objective unit of value, by virtue of the constant marginal utility of the monetary metal as it has spontaneously evolved through the well-known process described by Carl Menger. This admission does not contradict the subjective nature of value. The monetary commodity is the only exception. The value of everything else is subjective. Exchange takes place when the seller of a certain item values it less than the buyer who values it more, as measured by the unit of value. The fact that in the monetary economy this leads to the formation of a market price (or, more correctly, two prices: the lower bid and the higher asked price) will of course not invalidate the principle of subjective value.

The mathematician has no difficulty with the dichotomy of comparison versus measurement. He has always distinguished between two kinds of numbers. Ordinal numbers (subject to such axioms as reflexivity, symmetry, and transitivity) are only used for comparison. Cardinal numbers (subject to axioms such as commutativity, associativity of addition and multiplication, as well as distributivity of the latter over the former) are used for counting. In the barter economy values were expressed in terms of ordinal numbers. Measuring values was not possible, nor was their addition or multiplication. Only their comparison was. However, with the evolution of the monetary economy it has become possible to measure, add and multiply values according to the rules of cardinal arithmetic, while retaining the facility of comparing them as before.

I consider the contribution of Mises, that economic calculation in a socialist society without private ownership of the means of production is not possible, as one of the greatest, if not the greatest, result of twentieth-century economics. Values do exist in a socialist economy also, since individuals can exchange chattels just as they

would in a barter economy. But values cannot be measured for lack of an objective unit of value. (Illegal ownership of gold may carry the death penalty.) Still less can values be added or multiplied. As a result the socialist economy is ultimately doomed for lack of possibility to do economic calculation.

Mises did not live to see the collapse of the Evil Empire coming, as it did, hard on the heels of the collapse of the Soviet economy which he predicted, after three score of years of Bolshevik officials doing their level best to refute his theory through propping it up by hook or crook.

Mises also predicted another event, no less momentous, namely the demise of the regime of irredeemable currencies. However, he argued the case on the strength of the QTM, a non sequitur. Mises missed the fact that exactly the same argument applies here as well. No less than in the case of a socialist economy, under the regime of an irredeemable currency businessmen ultimately lose their ability to calculate for lack of an objective unit of value. Gold is prevented from fulfilling its foreordained function because of coercive legal tender laws domestically, bribe and blackmail internationally. For thirty-five years now central bankers have been burning the midnight oil to find ways to fend off the impending catastrophe threatening the world, as a result of the impossibility of economic calculation under a US-imposed regime of irredeemable currency. Their efforts are in vain. This Evil Empire, too, is doomed, and for the very same reason. The world economy, as the Soviet economy before it, will also succumb to the sudden death syndrome, because it has lost the faculty of economic calculation

It is amazing that the latter-day adherents of the Austrian School have all missed this point. They are preparing to witness the hyperinflationary self-immolation of the dollar, an event that may or may not take place. It may be well-worth noting here that hyperinflations so far, at any rate those which culminated in the total destruction of the value of irredeemable currency, have all occurred in the wake of wars (or civil wars) destroying supplies and production facilities. We have yet to witness a hyperinflation in peacetime with supplies and production facilities intact.

The Austrians and other hard money advocates are totally unprepared for the self-immolation of the dollar through economic paralysis due to the inability of businessmen to calculate. This would mean deflation in the form of business failures, imploding debt, domino-effect of bankruptcies, unemployment, destruction of wealth and values, a scenario more likely than inflation.

Self-immolation of the dollar? Certainly. Through inflation? Possibly but not inevitably. Then through deflation, perhaps? Yes indeed, if the dollar turns out to be a tough cookie, and refuses to roll over in a way prescribed by sycophants and cultists.

Yours, etc.

February 10, 2005

Flattening Home Prices Spell Trouble for First-Time Homeowners

PRINCETON, N.J., Feb. 15 /PRNewswire/ -- The end of the housing bubble could mean substantial losses in home value for millions of Americans, reports RealEstateJournal.com, The Wall Street Journal's guide to property. Housing prices, adjusted for inflation, are up 36% since 1995 -- the steepest boom in at least 50 years -- according to the Center for Economic and Policy Research in Washington, D.C.

Although the overall economy could bear a flattening or modest decline in house prices, many young Americans -- who were encouraged to buy homes because of low interest rates or government homeownership programs for low-income individuals -- could experience financial hardship when the housing bubble bursts. And, if interest rates rise, some buyers who stretched their purchasing power with adjustable-rate loans and interest-only mortgages could face financial problems. "As long as prices remain near today's levels, most homeowners will still have a lot of equity against which they can borrow to finance other types of spending," says Valerie Patterson, senior producer, RealEstateJournal.com. "However, if housing prices take a nosedive, many families would be unable to sell their home for enough to pay off the outstanding mortgage." RealEstateJournal.com offers this advice for potential homebuyers:..

February 10, 2005

By Kathleen M. Howley

(Bloomberg) -- Home prices have outpaced value in almost half of U.S. cities, which may lead to declines in some areas if the economy stalls, a National City Corp. report said.

In a study of 99 metropolitan markets, 46 areas had homes priced higher than their true value after controlling for differences in income, interest rates, population and historical price trends, according to a report issued today by Richard DeKaser, chief economist for Cleveland-based National City.

About one-fifth of the cities had homes that were priced more than 20 percent above their value, DeKaser said in the report. Eight of the 10 most overvalued markets cited are in California, led by Chico, Santa Barbara and Los Angeles. Chico is priced 43 percent higher than its true value, he said.

"There is a growing risk of 'bubblettes' in certain places," DeKaser said in the statement. "Speaking as a charter member of the No Housing Bubble in America Club, we believe the time has come to take a slightly revised position," especially with rapid price gains in California and Nevada, he said.

Prices in Stockton and Santa Barbara are 34 percent higher than they should be, Los Angeles' prices are 32 percent too high, and San Francisco is overvalued by 30 percent, the report said.

Also in the top 10, West Palm Beach, Florida, No. 8, has homes that are 26 percent overvalued, and Las Vegas, No. 10, is 24 percent above value, DeKaser said.

"While overvaluation in home prices presents a risk of future declines, these risks may well go unfulfilled," DeKaser said in the statement. "The true test of today's premiums in these markets will be the economic environment, especially incomes and interest rates, in the years ahead."

New York, Boston

New York, Boston and Honolulu, cities with rapid price growth, are not at risk for reversals because prices are less than 20 percent inflated, DeKaser said. New York has home prices that are 16 percent above value, Boston home prices are 14 percent too high and Honolulu's homes are 14 percent above value, DeKaser said. In other parts of the U.S. homes are under-priced, DeKaser said. Houses in Salt Lake City cost 23 percent below their value, the housing market in Memphis, Tennessee, is 20 percent deflated, and prices in Macon, Georgia, are 17 percent too low, DeKaser said.

Other undervalued areas include Little Rock, Arkansas, Beaumont, Texas, Syracuse, New York, Albuquerque, New Mexico, and New Orleans, according to the report.

February 7, 2005...

Confession Time

Stephen Roach (New York)
MORGAN STANLEY

At long last, Federal Reserve Chairman Alan Greenspan has owned up to the central role he has played in sparking unprecedented global imbalances. His confession came in the form of a speech innocuously entitled, "Current Account" that was given in London at the Advancing Enterprise 2005 Conference on the eve of the 5 February G-7 meeting. In the narrow world of econo-speak, his prepared text contains the functional equivalent of a "smoking gun."

Greenspan's admission came when he finally made the connection between the excesses of America's property market and its gaping current account deficit. To the best of my knowledge, this was the first time he ventured into this realm of the debate with such clarity. He starts by conceding "...the growth of home mortgage debt has been the major contributor to the decline in the personal saving rate in the United States from almost 6 percent in 1993 to its current level of 1 percent." He then goes on to admit that the rapid growth in home mortgage debt over the past five years has been "driven largely by equity extraction" -- jargon for the withdrawal of asset appreciation from the consumer's largest portfolio holding, the home. In addition, the Chairman cites survey data suggesting, "Approximately half of equity extraction shows up in additional household expenditures, reducing savings commensurately and thereby presumably contributing to the current account deficit." In other words, he concedes that a debt-induced consumption boom has led to a massive current account deficit. That says it all, in my view.

The obvious and most important point is that rapid growth of US mortgage debt did not come out of thin air. It was, of course, a direct outgrowth of the Fed's hyper-accommodation of the post-bubble era -- namely, short-term interest rates that have been negative in real terms for longer than at any point since the 1970s. As Greenspan's dryly notes, "The fall in US interest rates since the early 1980s has supported home price increases." That's putting it mildly. Suffice it to say, were it

not for the Fed's aggressive monetary accommodation -- especially the post-bubble easing of some 550 bps in 2001-03 -- the home mortgage refinancing cycle would have been in a very different state. But it wasn't just lower borrowing costs that spurred equity extraction. It was also the rapid rate of house price appreciation -- an outgrowth of what Greenspan notes has been the "unprecedented rate of existing home turnover" that he also attributes to sharply lower interest rates.

Equity extraction has been the pixie dust of America's post-bubble recovery -- the newfound purchasing power that has fostered the biggest consumption binge in post-World War II history. Were it not for this wealth effect, consumers would have been constrained by an anemic pace of labor income generation -- long the most decisive variable in the macro consumption equation. Lacking in job creation and real wage growth, private sector real wage and salary disbursements have increased a mere 4% over the first 37 months of this recovery -- fully ten percentage points short of the average gains of more than 14% that occurred over the five preceding cyclical upturns. Yet consumers didn't flinch in the face of what in the past would have been a major impediment to spending. Spurred on by home equity extraction and Bush Administration tax cuts, income-short households pushed the consumption share of US GDP up to a record 71.1% in early 2003 (and still 70.7% in 4Q04) -- an unprecedented breakout from the 67% norm that had prevailed over the 1975 to 2000 period.

These are the telltale footprints of what I have called the Asset Economy (see my 21 June 2004 dispatch, "The Asset Economy"). It's a story that began in the latter half of the 1990s with the equity bubble. And it's a story that involved the Federal Reserve as a key player at every subsequent twist and turn. Its role can be traced back to December 1996 with Alan Greenspan's famous "irrational exuberance" speech -- his first and only warning of the bubble-related perils to come. Unfortunately, the Chairman was quick to become a convert to the very excesses he warned of -- embracing the New Paradigm of rapid productivity growth as justification for why the central bank would be willing to stand by and tolerate faster than normal growth. That acquiescence -- putting the Fed Chairman in the dangerous role of a cheerleader insofar as the financial markets were concerned - (the great unanswered question is why? Why did Greenspan visibly change his course at the end of 1996, after a visit by Robert Rubin. - Jesse) - gave a green light to investors and speculators all the way to NASDAQ 5000. Then when that bubble popped, the Fed went into its well-rehearsed "Japan drill" -- unleashing the aggressive easing that gave rise to the excesses of the home mortgage equity extraction cycle. This is the grand continuum of the Asset Economy -- wealth effects that morphed seamlessly from the stock market into the property market.

Aided and abetted by the conscious policy tactics of the Fed, Alan Greenspan can hardly profess innocence in assessing the current state of global imbalances. By warmly embracing asset appreciation and the debt binge it fostered, the central bank has encouraged consumers to all but abandon traditional income-based saving strategies. Instead asset-based saving has become the "new new" thing of the Asset Economy -- as has the debt-induced equity extraction that has driven US consumption to unprecedented excess. This shortfall of income-based personal saving, in conjunction with outsize government budget deficits, has created the very shortfall of national saving that makes ever-widening current-account deficits

unavoidable. And that, of course, puts extraordinary pressure on the rest of the world to fund America's profligate ways. (A role to which Roach's and Morgan Stanley's good and BIG customer, China, stepped up to more than willingly to support their mercantilist policies. Jesse) At long last, Chairman Greenspan owns up to the central role he and his colleagues at the Federal Reserve have played in fostering these developments.

Alas, he offers a hopeful prognosis as to how this all works out. Greenspan's basic argument as set forth in his London speech is that we can all relax -- that "market pressures" are likely to play a key role in the coming US current account adjustment and in the global rebalancing that adjustment would spawn. In particular, he is optimistic both on the outlook for public and private sector saving. Undaunted by his mis-diagnosis of the fiscal outlook in 2001 -- he argued that tax cuts would be the wisest way to spend the government's budget surplus -- Greenspan offers hope that the "voices of fiscal restraint" will finally prevail in Washington. We'll know more on the fiscal policy front soon enough as the Bush Administration prepares to release its new budget. Suffice it say, a credible program of significant deficit reduction will be tough to pull off as the White House rules out tax increases and focuses, instead, on the 18% of federal expenditures that can be classified as nondefense discretionary spending (excluding homeland security).

Moreover, Greenspan also expresses the belief that "An increase in household saving should also act to diminish borrowing from abroad." This is a key assertion. What he is saying implicitly is that the Fed will need to withdraw support from the Asset Economy by restoring some semblance of normalcy to America's real interest rate structure. What he is also implying is the hope that the US labor market will now provide increased support to the American consumer -- in essence, spurring the long-awaited "hand-off" from the new asset economy back to the more traditional income economy. January's disappointing employment survey -- just the latest in a long string of subpar gains on the hiring front -- underscores how difficult it will be to execute this hand-off.

This may be the toughest nut of all to crack for the US central bank. It underscores the delicate tradeoff between real interest rates and saving as the Fed attempts to wean the American consumer from the excesses of the Asset Economy. Financial markets are presuming that the central bank will err on the side of caution in executing this delicate transition back to the income-based economy of yesteryear. The broad consensus of investors believes that the Fed wouldn't dare flirt with a meaningful shortfall of economic growth. Futures markets are quite explicit in validating this perception by now pricing in only two and a half measured tightenings of 25 basis points each, between now and midyear. That's hardly a move that would spur a spontaneous revival of personal saving, in my view. Nor would it be enough of a move to take away what I have called the "candy" of the carry trade that has spawned speculative excesses in a variety of risky assets -- including emerging-market, high-yield, and even investment-grade corporate debt. I continue to believe that it will take more Fed tightening than the markets are expecting -- in conjunction with a long overdue backup in long-term interest rates -- to spur a shift from asset- to income-based saving.

The Federal Reserve is trapped in a moral-hazard dilemma of its own making. It dates back to the Great Bubble of the late 1990s and the central bank's unwillingness to take away the proverbial punch bowl just when the party was getting good. The close brush with deflation that then ensued was a painfully classic post-bubble aftershock. That experience underscores the greatest shortcoming of modern-day central banking -- the inability of monetary policy to cope successfully with asset bubbles and the deflationary perils they engender. The history of the 1930s and Japan in the 1990s are grim reminders of that shortcoming. Alan Greenspan's confession finally sets the record straight on how he got us into this mess. But it is a confession that is still steeped in denial. The presumption that natural market forces can cure all ignores the lingering perils of an all-too treacherous endgame. Let's not forget that nearly five years after the equity bubble popped, America's imbalances -- to say nothing of the world's imbalances -- remain in uncharted territory.

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February 7, 2005...

**THE G-7 EFFECT:
Selling into Dollar-Strength**

The financial press sees the 2005 London G-7 statement essentially as a non-event and reports "no change" in China's Yuan policy. All of this is widely seen as "dollar-supportive."

Nothing could be further from the truth.

A. Sealing the Dollar's Fall from Grace Although there is some short to medium-term dollar support coming from the absence of a Chinese timetable on their revaluation efforts, the end-effect is only this: the rug is still being pulled from under the dollar's feet. The only difference is: the rest of the world's rear-end is being spared the dollar's hard landing.

Temporary dollar-strength is exactly what the rest of the world needs - particularly Asia and Europe. Temporary dollar-strength is exactly the opposite of what the US needs - despite all of Allan Greenspan's fluff about "market pressures, which appear poised to stabilize and over the longer run possibly to decrease the U.S. current account deficit." (Blah, blah, blah)

Vaguer words were never spoken. Yet, they predictably sufficed to reverse steep dollar-losses on Friday after the disappointing non-farm payroll figures were released. People are too lazy to look at the facts and think for themselves. We have all become "expert-junkies."

The reality is that continuing dollar-weakness now could be catastrophic for the entire world-financial structure. Asians and other countries desperately want to unload their tremendous dollar surpluses - but they can't, for fear that any larger-scale sell-off might cause a rush to the exit doors.

Therefore, what they all need is a temporary reprieve, a carefully engineered environment of apparent dollar strength that will allow them to quietly unload what they could never openly propose to sell:

Their dollar reserves.

Continued, incremental interest rate hikes by the Fed, although they showed next to zero effect until the beginning of this year, are providing the public rationalization for why the dollar is suddenly rebounding. This effect is bolstered by the ECB's decision to leave its rates where they are. The result is a climate wherein pressures on the euro decrease, Asians no longer need to convert so many of their dollar surpluses to buy US treasuries, the dollar temporarily "stabilizes" - and foreign countries can keep on selling their dollars into this artificial "strength" until they are home free, safely invested in euro deposits.

The final effect on the dollar is still as catastrophic, and still as inevitable as a sudden rush to the international exit-doors - but with far less deleterious consequences to the world financial system. For, once this artificial dollar-strength dissipates after all of the major players have decreased their holdings to below panic-levels, the currency traders of the world, those who bought into this strength to cover their previous dollar-shorts, will suddenly find themselves exposed to the icy winds of rapid-fire dollar-depreciation.

Whoever ends up selling euros or other currencies to these Asian CBs in return for their dollars will get stuck. The "good thing" (at least for the dollar-selling Cbs) is that they will no longer be exposed to a full-fledged dollar-flight when it finally occurs. But their "customers" (individual and institutional forex traders) will get stuck with the full weight of the dollar-bear as it collapses right on top of them.

B. The ECB and the Fed: Tortoise vs. Hare! I theorized long ago in an early issue of "Moneypulation Watch" in mid 2003, that the ECB will let the US Fed pass it up in lowering rates, trail the Fed all the way down the interest-rate ladder, then stay at a point above the Fed's low and let the Fed turn around, pass the CB up again, and then slowly, slowly, ever so slowly, follow the Fed's incremental hikes back up - and that's exactly what they did and continue to do!

The Fed began its rate-tightening cycle in June last year. The ECB has stayed the course and remained at 2% for nearly two years now while the Fed went through considerable rate-gyrations. The ECB now has the luxury of keeping its rates low in order to slowly reawaken the rather flattened business cycle in Europe's big economies, while the Fed rates climb and climb. Naturally, the rising rates will serve to choke off economic activity at home as US consumers watch their buying power being drawn and quartered.

At the same time, the rising US rates take pressure off the euro, which gives EU exporters a much-needed breather. Without having to intervene in the currency markets, and without having to lower its rates even further, the ECB is turning into a master of the tortoise vs. hare strategy. On paper, the US economy has been dancing circles around the EU while the dollar was falling. Now, the dollar is picking up again and is starting to do likewise. While the turtle-like EU economy is slowly

recovering and strengthening, the US hare's relative speed and agility is costing it much needed energy and resources. That will be its undoing.

When the Bush administration finally realizes that it has been "had," and that the apparent US strength advantage was simply a Judo trick designed to allow it to defeat itself, it will be too late. Once international CBs have safely unloaded their dollar-excesses into this current strength, the dollar-hare will be ripe for the grave that its feverishly active hind legs have already dug for it.

The ECB surely is a new breed of central bank. It obviously doesn't play this deadly game called "let's paper-over whatever difficulties that appear" - the game the US Fed has cherished for so long. Its more prudent strategy is now paying off. China's percentage of dollars accumulated as part of its \$112 billion world wide trade surplus during 2004 stands at just above 25%, a significant decline from the year before. The difference went mainly into euro-denominated assets.

C. Chinese Currency-Whiplash? China is undeniably on a path to diversification away from the dollar - and so are most other countries whose economies are of any consequence. For example in 2004, China's exports to the EU have increased by about 30% from those of 2003, as the EU's trade deficit with China has climbed from 32 billion euros in 2003 to 42 billion in 2004 - a direct result of China reducing its dependence on the already over-extended US export market.

In Davos on January 26, 2005, the director of the National Economic Research Institute at the China Reform Foundation named Fan Gang (not a part of the official policy-making circles) remarked that China was looking to move its currency peg away from a pure dollar peg to a basket of currencies, including the euro. This remark was later disavowed by actual Chinese policy honchos. As a result, the dollar recovered from its initial slump in reaction to that piece of news.

What has apparently escaped forex traders is that this policy was actually confirmed and re-confirmed by several Chinese officials in policy-making circles. In fact, a Reuters piece of February 3, 2005, stated that an unnamed G7 source "confirmed comments made by Italian Economy Minister Domenico Siniscalco on Wednesday that at previous summits the Group had discussed with China the idea of pegging the yuan to a basket of world currencies rather than the dollar."

This is the early stage of the realization of a prediction I made back in late 2003, in an essay entitled Gold, the Yuan, the Dollar, and Taxes. In that essay, I doubted that the Chinese would lift their dollar peg anytime soon, but will likely shift it to a euro-peg so its export-advantage can be shifted from the US to Europe - once the US consumer appears to have reached his purchasing limits. That is now happening.

Bottom line: The dollar's current move "up" the forex ladder only makes its eventual decline and exit-left from the world's reserve-currency stage an even greater certainty.

D. The Effect on Gold Since the gold price is currently still tied to the dollar's movements up and down that ladder, expect gold to continue to decline and then

stagnate for a while. But when currency traders begin to realize the trick being played on them for what it is, the ongoing fall will resume all the more ferociously. Even if a "ferocious" can be avoided (unlikely but possible), the worst factor weighing in against the dollar's long term prospects is the inevitable persistence of the fall.

The dollar will go lower, ergo gold will go higher. It's as simple as that.

Eventually, of course, gold will leave its dollar-dependence behind as international investors and institutions, lead by the Chinese, will use both physical supplies and trading instruments to hedge against growing fiat-currency risks. Gold investors should follow the international CBs' examples, take advantage of current fire-sale prices, and keep selling dollars into this contrived strength, except that they should sell dollars for physical gold - not for euros (or other fiat basket-cases).

Got gold?

Alex Wallenwein
Editor, Publisher
EURO versus Dollar Currency War Monitor

By Sumeet Desai and Stella Dawson

Reuters

Saturday, February 5, 2005

LONDON -- The Group of Seven wealthy nations pledged to increase Third World debt relief on Saturday but a deal struck after major disagreements fell short of proposals floated by British finance minister Gordon Brown.

"We are willing to provide as much as 100 percent debt relief on all multi-lateral debt for individual HIPC countries," Brown told a news conference, referring to dozens of Highly Indebted Poor Countries, most of them in Africa.

"It is the rich countries hearing the voices of the poor...showing that no injustice can last forever," he said.

Brown, who chaired the G7 talks, had pushed for a complete write-off of African debt and a doubling of aid to \$100 billion a year but the latter proposal ran into U.S. opposition and there was no agreement on it.

Sub-Saharan Africa owes around \$70 billion to multilateral lenders such as the World Bank and International Monetary Fund and Brown said these public agencies would now have to come up with plans on how to deliver on the debt relief pledge.

Washington had also objected to his proposal to use IMF gold reserves to fund the debt writeoff and to a new financing mechanism that would double aid. A G7 communique said the IMF would produce ideas on this front by April.

G7 nations are under intense pressure to deliver on promises to rid Africa of poverty by 2015, the so-called Millennium Development Goals.

"We will make particular efforts in the case of Africa, which on current rates of progress will not meet any of the Millennium Development Goals by 2015," the communique said.

Brown had wanted approval for his International Finance Facility (IFF) scheme to double aid to Africa to \$100 billion a year but got no U.S. backing and others were cautious too.

The compromise deal followed an emotional appeal from South Africa's Nelson Mandela in London, where he equated the fight against poverty to the struggle against apartheid.

"Do not delay while poor people continue to suffer," the 86-year-old former political prisoner said, demanding a full debt write-off and \$50 billion extra a year as Brown proposed.

U.S. Treasury Under Secretary John Taylor said he disagreed with the Brown plan, under which rich countries would provide guarantees to raise money in the capital markets and use gold reserves to fund a debt writeoff.

In the wake of the U.S. opposition, Italy and Germany pushed for something less ambitious but backed the principle.

The G7 comprises the United States, Japan, Germany, Britain, France, Italy, and Canada.

The bulk of the meeting was devoted to the Third World but the ministers also discussed ways of reducing volatility in the oil market after prices hit record highs last October.

They also discussed currency management and economic risks and did not stray from a year-old policy statement which called for less volatile currency markets and greater exchange rate flexibility.

The latter point is aimed mainly at China, which sent its finance minister and central bank officials to meet G7 members.

"We are determined to move toward a flexible exchange rate, but no timetable," Chinese central bank deputy governor Li Ruogu told reporters after breakfast talks.

Beijing says it is not going to rush into altering its yuan peg to the dollar, which many say keeps the yuan artificially low and makes life unfairly difficult for other trading nations.

"We discussed the issue of exchange rate flexibility with China," Brown said. "We are all interested in the role China is playing in the global economy."

February 5, 2005

ALL SIGNS POINT TO BUBBLE

By Kurt Richebächer

In its Jan. 10 issue, Business Week carried an article, A Gold Medal for the Fed's Inflation Fighters, from Glenn Hubbard, dean of Columbia Business School and former chief of the president's Council of Economic Advisers. The key point of this article is that "by holding inflation down, the Fed has boosted the economy." We mention this article because it is highly typical of the prevailing systematic disinformation about the U.S. economy.

Given a U.S. inflation rate of 3.3% during 2004, any talk of "ridding the U.S. economy of inflation" is, first of all, grossly misplaced. Even more absurd is the further assumption that the Federal Reserve has distinguished itself as a great inflation fighter.

In actual fact, in the past few years, the Greenspan Fed has systematically and deliberately fostered parabolic credit and financial excess with the explicit purpose of inflating asset prices. What manifestly is duping most people is the fact that the bulk of the credit excess poured into asset prices and the soaring trade deficit, rather than into the CPI, as had been usual.

As we have repeatedly stressed, speaking of inflation requires a distinction between cause and effects. It ordinarily has one and the same cause: excessive creation of money and credit. But its impact on the economy and its price system depends entirely on the specific purposes for which the borrowed money is used. Therefore, its effects may differ immensely.

Principally, credit excess may find three different outlets: first, rising prices of goods and services; second, rising prices of financial and tangible assets; and third, a rising trade deficit.

The conventional focus is exclusively on the first outlet: that is, on the movement of consumer prices, popularly called CPI in America. Amazingly, even most experts flatly deny a causal connection between a rampant credit expansion, rising asset prices and a rising trade deficit. The rampant inflation in U.S. stock and house prices is actually hailed as "wealth creation."

Historically, consumer price inflation has, indeed, been the regular key feature of credit excess. But this pattern began to change drastically in the course of the 1980s. For the first time, protracted, exceptionally sharp increases in stock and real estate prices occurred in various countries, while price increases for goods and services remained moderate.

At first, there was little inclination to see in soaring asset prices a feature of inflation, even though all countries concerned showed a simultaneous surge in money and credit growth. It irritated many experts that this monetary explosion did

not show in higher prices for goods and labor, as it had done in past booms. In the late 1980s, Japan had double-digit money, credit growth and soaring asset prices, yet virtually stable consumer and producer prices.

For years, this strange coincidence of soaring asset inflation and simultaneous moderate consumer price inflation was hailed as a sign of economic health and dynamism. It has long been one of Mr. Greenspan's favorite arguments that this unusual coincidence proved the existence of a "new paradigm" economy.

While stock prices have recovered from their lows in 2001, in general, their gains during 2004 were very limited. Instead, a developing property bubble has gone global. Full-blown housing bubbles with double-digit annual price increases now exist in many countries, for an obvious cause. Ultra-low interest rates introduced by central banks to fight threatening recession have triggered an explosion in borrowing for house purchases in many countries.

Observing this, it must be stressed at the outset that from a macro perspective, the crucial issue is not an asset price bubble per se. The key question is whether and to what extent asset owners convert the asset appreciation into higher borrowing and spending. Asset bubbles as such constitute little more than a temporary economic nuisance.

In France, too, where we live, house prices have soared at double-digit rates. But the key feature of a bubble economy - that is, the run of house owners for equity extraction, as in the United States and Britain - is completely missing, even though variable mortgage rates are at a historical low of 3.25%. Remarkably, nobody in France talks of "wealth creation." France certainly has a house price bubble, but it does not have a "bubble economy" in the sense that the rising house prices are used to boost consumer borrowing and spending for other purposes.

In the late 1990s, the U.S. stock market bubble went global. The same has happened in the last few years to the property price bubble. According to reports, full-blown housing bubbles currently exist in many countries around the world. As explained, their common cause is obvious: Ultra-loose monetary policy and ultra-low interest rates. In due time, sharply rising house prices added to the interest incentive.

Under these monetary conditions, it made sense to buy a house.

But to repeat, the pivotal hallmark of a "bubble economy" is that the ballooning asset prices are widely used as collateral for a general consumer borrowing and spending binge. In the United States, mortgage borrowing by households during the first half of the 1990s increased by an annual average of \$168 billion. This accelerated in the decade's second half to \$296.9 billion. But after 2000, it virtually exploded to an average annual growth rate of \$615 billion.

It is undisputed that the greater part of the escalating mortgage borrowing in the United States was for purposes other than house purchases. In short, it boosted consumption as a share of GDP at the expense of business investment and the trade balance. That is, it radically changed the U.S. economy's pattern of growth -

actually an unsustainable pattern of growth.

Yet America's consensus, amongst it Mr. Greenspan and the Fed, categorically refuse to see any proof of a "bubble economy." A recently published survey article by the St. Louis Federal Reserve - Monetary Policy and Asset Prices: A Look Back at Past U.S. Stock Market Booms - made a most amazing statement in its conclusion: "We find little indication that booms were caused by excessive growth of money and credit, though 19th-century booms tended to occur during periods of monetary expansion. The view that monetary authorities can cause asset market speculation by failing to control the use of credit has been largely discarded."

To quote a commentator: "The complacency of the central banking fraternity and their academic standard-bearers is a wonder to behold."

Regards,

Dr. Kurt Richebächer
for The Daily Reckoning

February 5, 2005...

Steven Saville - The best money for long-term investors

Below is an extract from a commentary posted at www.speculative-investor.com on 30th January 2005.

Ever since the current system of floating exchange rates came into being in the early 1970s the Swiss Franc has been moving back-and-forth within the confines of the channel depicted on the below chart. So, if we can assume that the pattern of the past 30+ years is going to persist then the Swiss Franc will peak later this decade at around 20% above its December-2004 high and then begin to head back towards the bottom of its long-term channel. The question is: can we reasonably make such an assumption?



We think it's the most reasonable assumption we can make at this time, given the huge amount of uncertainty involved in trying to guess where market prices are going to be several years from now, as long as we also make the assumption that the current monetary system remains in place. Why? Because the reason for the channel's existence is that the people in charge of monetary policy in the developed countries generally want to avoid excessive currency strength AND excessive currency weakness. In particular, after a currency has been trending higher for a few years a point is invariably reached where the currency's strength is perceived, by policy-makers, to be placing an unbearable burden on the country's exporting sector and steps are taken to weaken it. Alternatively, it is likely that drastic action will be taken to strengthen a currency once the currency gets so weak that inflation expectations begin to spiral out of control. In other words, the DESIRE of central banks to avoid having an excessively strong currency combined with the NEED of central banks to prevent their currencies from becoming excessively weak leads to a situation where the major currencies tend not to experience the huge bull and bear trends experienced by some other markets. Instead, the amounts they are able to gain during cyclical bull trends and lose during cyclical bear trends are restricted by the actions of central banks.

The desire of central banks to avoid excessive currency strength, in conjunction with these banks' enormous currency-weakening abilities, is the main reason we think the US\$ 'super-bears' -- the people who are forecasting a collapse in the dollar's foreign exchange value -- are going to be wrong. Those who believe that the dollar is going to collapse within the next few years are, we think, only looking at the US side of the equation. In particular, they appear to be drawing the conclusion that the Fed won't be able to prevent a sharp decline in the dollar but failing to account for the actions that would be taken by the ECB et al should such a decline become a high probability. Our view differs, though, because we have no confidence in central banks other than our supreme confidence in their ability to be able to devalue their own currencies.

All of which brings us to our main point: the euro, the Swiss Franc and several other currencies have proven to be very good hedges against US\$ weakness over the past few years, but in this regard they are unlikely to be effective in the future. This is because we are rapidly approaching the point where additional currency strength will be deemed excessive. So, even if the dollar hasn't already embarked on a lengthy recovery for non-intervention-related reasons we think its downside, relative to other fiat currencies, will be severely limited by the actions of foreign central banks.

Other than following non-inflationary monetary policies -- something they are always reluctant to do -- central banks can't, however, do much to limit the dollar's downside relative to gold. This is because they can't create gold. They can feed some of their gold reserves onto the market from time to time, but this just shifts existing gold from one place to another and actually has the long-term effect of increasing the gold price by reducing the amount of gold that underpins the monetary system.

The following chart shows how gold has performed relative to the US\$ over the same period covered by the above Swiss Franc chart. Note the differences

between the two charts; in particular, note that gold IS capable of making huge moves in both directions -- up when confidence in the dollar is falling and down when confidence in the dollar is rising -- and that gold's long-term performance has been vastly superior to that of the Swiss Franc (the US\$ gold price has gained about 1140% since the beginning of the 1970s whereas the SF has only gained about 260%).



In conclusion, if you expect that confidence in the dollar will continue to decline over the next few years then you really should accumulate gold and not the non-US\$ fiat currencies of the world.

By Ari Levy

Feb. 4 (Bloomberg) -- Joseph Granville, who accurately forecast in 2000 that U.S. stocks' bull market would end, is at it again. He expects the Dow Jones Industrial Average to suffer its biggest annual loss this year since the Great Depression. "We're in the critical portion of a coming collapse and the market's screaming to get out," said Granville in an interview from Kansas City, Missouri. "Everyone's bullish. There's going to be a tremendous surprise and it's going to be to the downside."

Granville, publisher of the Granville Market Letter since 1963 and a technical analyst for almost 50 years, also foretold a stock-market decline in 1976. He misfired in 1982 and 1995 by calling for losses before share prices surged. The 81-year-old analyst expects the Dow average to retreat to at least 7400 by year-end. The forecast amounts to a plunge of 31 percent. The last year in which the benchmark fell that much was 1937, when it lost 33 percent.

As a technical analyst, Granville predicts the market's direction by using criteria such as trading and price patterns, rather than earnings and economic growth. He started developing his stock market theory at what was then E.F. Hutton & Co., a New York-based brokerage, from 1957 to 1963.

'Pants Down'

Granville's main indicator is called on-balance volume, or OBV, which he developed. The idea "caught me, quite literally with my pants down," he wrote in "The Book of Granville," published in 1984. "One August morning in 1961 I sat on the toilet in the men's room, away from the hubbub of the research department, musing about the stock market."

OBV gauges a stock's momentum. If a stock rises, the day's volume will be added to a cumulative OBV figure. If the share price falls, the total will be subtracted.

Granville applies this analysis to all 30 stocks in the Dow each day.

"Volumes are pointing to declines based on what I've learned," he said.

The Dow average has dropped 1.8 percent this year to 10,593.10, led by Merck & Co.'s 12 percent slump. Granville predicted that the benchmark would tumble 12 percent in the first quarter, to 9500.

Granville also follows charts that track the daily number of advancing and declining stocks, the number of stocks reaching 52-week highs and lows, and investor sentiment. He compiles the measures into what he calls his "Net Field Trend Indicator." In his Jan. 20 newsletter, he wrote that his indicator had retreated to its level on Oct. 21, 1929, eight days before the Dow's two-day, 24 percent plunge.

"The Dow is technically on its last legs," he wrote.

Granville, who has written books on subjects ranging from stamp investing to winning at Bingo in addition to the stock market, has made accurate forecasts in the past. On March 11, 2000, the day after the Nasdaq climbed to a record 5048.62, Granville wrote that investors in technology stocks "will soon be burned." The index plunged 78 percent before bottoming on Oct. 9, 2002.

In 1976, in his book "Granville's New Strategy of Daily Stock Market Timing for Maximum Profit," he said a bear market would occur from 1977-1978. The Dow plunged 26 percent from the beginning of 1977 through February 1978 after a two-year surge.

1987

Granville has also been wrong. He was bearish from 1982 until early 1986, according to the Hulbert Financial Digest, a service of MarketWatch Inc. that tracks and ranks more than 180 financial market newsletters. Over that period, the Dow had a 17 percent annualized return.

During the Crash of 1987, he was bullish, Hulbert said. The average plunged 23 percent on Oct. 19 of that year.

Granville, who charges a \$250 annual subscription rate for his weekly market letter, was also incorrect in predicting a stock-market plunge in October 1995. He turned bullish in July 1996, after the Dow industrials climbed about 20 percent.

"Unlike most letter writers, I admit when I'm wrong," he said. On March 14, 2002, he published a letter entitled "I Was Wrong" that admitted to "staying cautious" for too long in February 2002. The Dow gained 5.9 percent between Jan. 31 and March 13, the day before his admission.

"He's very well respected as a market technician, but the bottom line is the bottom line," said Mark Hulbert, editor of the Hulbert Digest. For anyone who followed his advice during the past 20 years, "Would you be better off than putting your money in an index fund? The answer is no."

5 Percent

Granville's record as a market timer is better for the five years ended in December, according to Hulbert's data. Investors using his recommendations to buy and sell a fund mirroring the Wilshire 5000 Index would have produced a 5 percent annualized

By Michael Kosares
Thursday, February 3, 2005

I don't completely understand this obsession Gordon Brown has with the IMF gold. I'm sorry, but I don't believe for a minute that the chancellor of the exchequer is motivated by the stench of Third World debt. I think we all remember that the last time Brown stumped for IMF gold sales, he failed. The IMF opted for revaluation. The result was that the Bank of England let go of a good portion of the British people's gold reserve. Now Brown is at it again.

What is really behind all this volley and thunder?

In my view Brown's activity now signals the same thing it signaled in 1999 -- the beginning of a major move upward in the gold price. I would consider one of three scenarios:

1. One or more bullion banks are in trouble in London and gold must be found for the British government and central bank to fulfill as lender of last resort. (Brown is simply trying to get ahead of the curve.)

Or:

2. This is just another campaign (ala the Andy Smith scenario) in a larger war to keep the bullion banks supplied with enough metal to satisfy the needs of the huge gold carry trade (which goes on longer than I ever anticipated it would) and keep it from going bankrupt.

Or:

3. A combination of 1 and 2, in which case Brown sees himself as killing two birds with one stone.

Brown's hope is that he can steamroll gold sales. The talk about revaluation is just camouflage. The Bank of England's sales were directed inventory placements -- not sales but bailouts camouflaged as sales.

In a long talk with our sitemaster this afternoon on this subject, he pointed out to me that other members of the IMF might be very happy to receive their gold back in a revaluation/sales scheme, not considering the gold to be of much use to them at the IMF. Other members might get it back and want to sell. What Brown is hoping for is sales.

As for the London Bullion Market Association, I would not be surprised if this was

nothing more than a machination to free up gold to meet the demand requirements being faced by the bullion banks.

In other words, I'm going with No. 3.

This is not meant to be a comprehensive analysis of Brown's recurring obsession with the IMF gold but simply some groundwork to encourage discussion.

I would like to repeat a brilliant statement from the UK's Sir Henry Tapsell, which I have posted here before as well as in our newsletters and in my book, "The ABCs of Gold Investing":

"The whole point about gold, and the quality that makes it so special and almost mystical in its appeal, is that it is universal, eternal, and almost indestructible. The minister will agree that it is also beautiful. The most enduring brand slogan of all time is: 'As good as gold.' The scientists can clone sheep and may soon be able to clone humans but they are still a long way from being able to clone gold, although they have been trying to do so for 10,000 years.

"The chancellor may think that he has discovered a new Labour version of the alchemist's stone, but his dollars, yen, and euros will not always glitter in a storm, and they will never be mistaken for gold."

Tapsell made that statement in 1999, just before the Bank of England let go of Britain's gold at cyclically low prices (\$250 to \$300). My question is: What happens if Brown runs into a wall this time? What if the verdict is no sales, no revaluation. Then where will the price of gold go?

By the way, the chancellor Tapsell referred to was Gordon Brown.

The following article from today's New York Times is fascinating and so indicative of that real estate is the double bubble...

THE BUYING GAME Hopeful shoppers lined up last fall to see new condos in Brooklyn.

By MOTOKO RICH

Published: February 3, 2005

ANGELINA UMANSKY, a 39-year-old spa owner from San Francisco, was visiting a friend in Miami two weeks ago when she heard about a new condo development downtown. Hoping to find a vacation home, but worried that others were interested, too, Ms. Umansky arrived at the sales office at 8 a.m. the day after seeing some model units.

About 50 other buyers were already in line. Two hours later, a sales agent summoned her and said she had four minutes to decide which unit to buy. She

acted fast, offering \$350,000 for a two-bedroom, two-bathroom unit.

Ms. Umansky thinks she got a bargain; when she called on behalf of a friend less than eight hours later, she was told the asking price on a unit like hers had climbed to \$380,000, a nearly 9 percent price increase.

Just when it seemed as if the real estate market couldn't get any barmier, it has. With inventories lagging behind demand and prices for new homes rising seemingly by the hour in destination cities like New York and second-home markets like Miami and Orlando, home buyers are camping out overnight in front of sales offices, pestering brokers and developers and scooping up multiple units in the real estate version of scalping. "This is a perfect storm for a frenzied housing market," said Susan Wachter, a professor of real estate at the Wharton School of the University of Pennsylvania. "The economy is strengthening, the restrictions on development are increasing and long-term mortgage rates are still historically low." Ms. Wachter added that as interest rates start to creep up, more buyers tend to pile into the market, trying to lock in good rates.

Across the country, according to the National Association of Home Builders, the number of new condos sold jumped 32 percent to an estimated 115,000 in 2004 compared with a year earlier. And in New York the number of condo sales in the three months through December 2004 increased 8.2 percent over the same period a year earlier, and average condo prices were up 11.1 percent to \$1.29 million, according to Miller Samuel, a New York real estate appraiser.

The gold rush mentality has some economists concerned. Some buyers of new condos and houses are behaving like day-traders before the dot-com crash, said John Vogel Jr., a real estate professor at the Tuck School of Business at Dartmouth College.

In some cases, developers are actually creating the frenzy. In central Florida, Transeastern Homes, which builds subdivisions, asks prospective buyers to put down a refundable deposit of \$500 to \$5,000 to reserve a time slot to buy a house that has yet to be built, sometimes without knowing more than the general location of the subdivision and a price range.

Buyers review floor plans and maps first at a Web site or in a brochure. When they arrive at the sales "event," typically at a hotel or a convention center, they spend five minutes looking at a map and choosing a home before the next buyer moves to the front of the line. Price increases - up to 16 a day- are announced over loudspeakers.

"People get excited and get caught up in it," said Joel Lazar, a Transeastern vice president. "Even if they weren't planning on buying a home, they convince themselves to buy a home."

Last Sunday, Jeanette Gomez, a banquet server at a resort hotel, drove her mother, Maria Gomez, to her 11:12 a.m. appointment at a hotel in west Orlando. Although the senior Ms. Gomez wasn't planning to buy, she ended up making an \$18,500 down payment on a two-bedroom town house. "I pushed her," her

daughter said. "I said 'Just do it.' I think it's a good buy because the sales agent told us the price already went up \$20,000 since yesterday."

What's lost in the giddiness is a sense of history. "People have a belief that's not true: that you can't lose money in real estate," said Joseph Gyourko, a real estate professor at Wharton. "We know from the late 80's and early 90's that you can."

In New York, for example, median sales prices - the exact middle of all sales prices - peaked at \$375,000 in 1987 before plunging 45 percent to a low of \$205,000 in 1995. Median prices did not climb back up to their 1980's levels again until 2000, according to Miller Samuel. In the Northeast, the National Association of Realtors said median sales prices fell 11 percent from 1988 to 1989, and did not return to 1988 levels until 2001.

That doesn't stop some buyers from making impulsive down payments on condos that don't yet exist. In October, AnneMarie Alexander, then a broker with Prudential Douglas Elliman, took some brochures and parked her BMW 740 in front of a hole in the ground on 17th Street in Chelsea. She proceeded to sell five luxury condos - at prices above \$1 million each - from the back seat of her car. "I showed them the site through a hole in the fence," Ms. Alexander said.

Last summer, arguments erupted when 50 prospective buyers spent the night in front of a 16-unit building in Park Slope, Brooklyn, before an open house. As a result, the Corcoran Group, which marketed the property, now sells new condos only by appointment, said Jay Schippers, head of new development for Corcoran in Brooklyn.

Now buyers and their brokers are quarreling over viewing dates. Security guards at 56 Pine Street, a 90-unit condo in Manhattan, called the police to escort two brokers out of a sales office last month. "They said they were not leaving until they got an appointment," said Andy Gerringer, a managing director of Prudential Douglas Elliman, which is helping to sell the condos.

If all else fails, some buyers try bribery. When 3,600 people showed up for a party showcasing a 419-unit condo project in Arlington, Va., last September, the developers booked appointments through the end of January. Afterward, those who had missed out were "offering us lunch and tickets to baseball games," said David Klimas, a broker with McWilliams/Ballard, which was marketing the development. (Mr. Klimas said the buyers' tactics did not work.)

Hoping to beat out the crowds vying last fall for apartments in the Toy Factory Lofts, a new condominium in downtown Brooklyn, Jason Lynn showed up at 11 p.m. - 14 hours before the sales office opened. He was carrying a fold-up chair, his iPod, some tennis balls (for pick-up handball) and a book. Before long there were enough other early birds to start a card game.

Mr. Lynn says he was happy to stay up all night. He landed a 700-square-foot loft for \$314,000 - 15 percent more than he would have paid at an open house two days earlier.

"There is always a frenzy at the beginning of a development because the prices are lower," said David Behin, an executive vice president at the Developers Group, which handled sales at the Toy Factory.

Some excited buyers aim to get a jump on property before it is advertised. Kenneth Horn, president of Alchemy Properties, which is developing a 67-unit condo on 19th Street in Chelsea, said he already has more than 200 individuals and more than 300 brokers on a waiting list for the development, which has yet to receive approval from the attorney general's office, which regulates new real estate.

Brokers field calls from people poised to sign a contract the minute one is available. Some check in three times a day, said Michael Klein, an agent with Liberty Realty in Hoboken, N.J. A couple of times last year, he said, he called clients at 11 p.m. to share floor plans fresh from the printer. The buyers signed deals the same night.

Hoping to manage the crush, the developers of Maxwell Place, a luxury condominium project in a renovated coffee plant on the Hoboken waterfront, told interested buyers in November that they would need appointments, available only to 77 people and only by calling an 800 number at exactly 1 p.m. on a Tuesday. Within an hour, all 77 appointments were taken.

Mr. Vogel, the real estate professor, said the sales hysteria has troubling parallels. "We've now moved past the stage of people saying we've got to get in before it's too late," said Mr. Vogel. "Now we're at the speculator stage."

Indeed, Harold Gallo, director for marketing of the Related Group, a developer in Miami with a 1,000-unit condo that sold out in 36 hours last spring, said that about 50 percent of the buyers were investors - in other words, people who will never live in the apartments and often sell them before anyone moves in. Mr. Vogel said that the frantic buying was characteristic of the tech bubble before it collapsed, adding, "It speeded up."

The biggest threat to the housing boom is a sharp increase in mortgage rates. "That will quickly knock the wind out of these housing markets and the psychology will reverse as quickly as it appeared," said Mark Zandi, the chief economist at Economy.com, a private research group. For now, interest rates are expected to rise modestly throughout the year.

None of the naysaying bothers Kathleen Gillman, an interior designer, and her son Patrick, a real estate agent, who bought a \$200,000 town house in Orlando at a Transeastern sales event last Saturday. Four months ago Mr. Gillman bought another house nearby, his mother said, adding that it is now worth \$50,000 more. "It is interesting how many different viewpoints are out there about whether it's going to level off now, go on for 10 more years or one more year," she said. "Right now we're going to take the viewpoint that it's certainly not over yet."

February 3, 2005 ...

GORDON BROWN EYES IMF GOLD

He is at it again. Having upset the gold market back in 1999 through his action in dumping of some of Britain's gold stock, the British chancellor now wants to "use" the IMF's gold for his pet political project of debt relief – going after other people's money in order to cover himself in glory as the friend of the poor. This weekend he will be drumming up support among the finance ministers and central bankers attending the G7 summit for his proposal that the Fund should either sell or revalue its gold to finance debt relief. This could stir up the whole question of official gold sales all over again, just when the central bankers thought they had got it all nicely under control and out of the news. Trichet and other European central bankers didn't welcome Gordon Brown's initiative in 1999 and they will like his new proposal even less. It will probably eventually get kicked into the long grass by the Fund and the Europeans. Gold always causes politicians problems but they just can't keep their grubby fingers off the stuff.

WHY THE BUNDESBANK WILL NOT SELL GOLD

Better news for gold investors came from Germany, when Germany's central bank said had decided not to sell gold for the 12 months to this October at least. But what was behind this?

Most people think that this was just a show of independence by the Bundesbank, which was threatened by the public demands of the finance minister, Hans Eichel, that it had to sell the 120 tonnes a year for five years allocated to it under the current European central bankers' gold pact. Eichel needs the money desperately to help fill a yawning budget black hole. So he piled on the pressure. After all, he must have thought, I appointed Weber to be Bundesbank president less than a year earlier – the least the chap could do is pay back the favour!

Well, there may be some truth in that so far as it goes. But in fact Newsmakers understands that the Bundesbank would not have sold the gold even if Eichel had kept his mouth shut – Eichel's intervention just made it easier for its board, which had been dithering on the issue, finally to make up its mind.

The Bundesbank had always made clear that it would not sell just to finance the current expenditure of Germany's federal government. Board members felt that to sell an asset to plug a hole in the government's finances would have further undermined business confidence in current economic policies (currently at an all-time low) and in the Bundesbank as an institution. So the board came up with some reasons for not selling like "gold is of great symbolic value" and so on, which pleased the gold bugs no end.

WEBER'S STAND

The new boss of the Bundesbank knew he had to make a stand, like Thomas a Becket in 1170, against the politicians. But he had his reasons. It would not be surprising if his views on the impropriety of financing current government deficits by asset sales exactly coincided with those of the ECB's boss, Jean-Claude Trichet himself. If the ECB could let Germany get away with selling gold just to finance a

budget deficit, all hell would break loose – why, all European governments would start doing it! Goodbye to ECB independence! (Of course, France is selling, but then, France is different, isn't it?)

One should also remember that Weber, an academic economist who was only appointed last year when his predecessor, Hans Welteke, was sacked in a scandal also connected with gold, is still very much the new boy in the august company of Europe's central bank governors (NB to Britain's Gordon Brown – keep away from gold for the sake of your own health).

Weber hardly wanted to be given the cold shoulder from fellow governors for "rocking the boat" at his next ECB council meeting. Far better to offend his old pals at the finance ministry than his new ones at the ECB. You can imagine Eichel muttering, like Henry II of England, "Who will rid me of this meddlesome priest?"

Newsmakers nervously awaits news of Weber's current health.