Why is Economic Depression Imminent?

- Unprecedented Total U.S. Credit Market Debt Relative to Nominal GDP
- Unprecedented Level of Real Estate Overvaluation
- Unprecedented Level of U.S. Trade Deficit
- Persistent Stock Overvaluation
- Unprecedented Level of Resource Misallocation
- Intellectual Complacency
- Increasingly Destructive Monetary Policy
- Persistently Overvalued Dollar
- Increasingly Reluctant Foreign Purchasers of U.S. Debt
- Inept Government and Central Bank Leadership
- In recorded history, **fiat** currency has never lasted
- The herding nature of crowds when widespread fear follows their discovery of the massive asset illusions and misallocated resources

When will we succumb to the imbalanced forces above?

- 2008-2010 or *sooner*.

Why did we reach these conditions?

- Asset bubble blowing and easy-monetary policies are politically irresistible. The "rot" of irresponsible monetary management begins at the Central Bank, but spreads pervasively into our banks, brokerage, and financial firms.
- Artificial suppression of interest rates by major central banks of the world
- Shifting credit risks, thus creating an unprecedented level of "moral hazards"
- Key foreign trading partners engaging in mercantilist policies
- Fiat currency enabling unhealthy, unchecked monetary expansion

What can you do to protect yourself or profit from the collapse?

- Do Not Panic! Many years were required preceding the Great Depression to create the imbalances (the "Roaring 20's"), and it took more than a decade to reconcile them (the 30's and early 40's).
- Recognize we are in the early stages of a Secular Bear Stock Market that historically lasts 15-20 years. This one began in 2000. U.S. equity markets will be range bound + or – 50% from their current level notwithstanding a bout of hyperinflation. In that case the sky is the limit.
- Become a **"market timer"!** Most financial planners, economists, and the mainstream press strongly advise **against** market timing. The traditional message is: "Stay invested in something and diversify… There has never been a period in U.S. history where the market did not recover in 20 years…. So, don't worry, just stay invested!" How wrong can they be! If we have another market hit the magnitude of the Great Depression, it would take far more than 20 years to recover **real** market valuations considering the insidious effects of inflation.

What timing options exist? There are many. However, an effective limited-involvement approach is a very simple Seasonal Timing System refined by Sy Harding @ www.streetsmartreport.com . You invest "in" the market for approximately half the year and get "out" for the balance. See additional convincing seasonal statistics by William Hester and his logic here… http://austrianenginomics.com/ExpectedEventsandInvestmentStrategyfor2006.pdf The seasonal phenomenon is also addressed by Alan Newman of Crosscurrents www.cross-currents.net referring to the unfavorable season (May through October) as the "Dead Zone". He has calculated that only 2% of equity gains historically occur during the "Dead Zone" period. Therefore, why stay invested during the riskiest six months of the year with all of the imbalances and geopolitical risks in the world?

The important question is: What is the best investing methodology going forward? Never does a methodology always work for all economic conditions. Staying fully invested in a Secular Bull market (e.g. 1982 thru 1999) appeared to be a "no brainer", which created tremendous complacency and optimistic expectations of future gains. That same strategy will be devastating as we encounter very rough economic times ahead. At minimum, why not consider limiting your exposure during the high-risk season of the year?

Imminent Depression? (Ouch…!)

We are a nation in debt denial! The most damaging condition in all of the bullets listed above is the first… **Unprecedented Total Credit Market Debt (TCMD) Relative to Nominal GDP**. I've written extensively how Total Credit Market Debt in real terms cannot increase greater than nominal GDP growth[1]. With each passing month we have miraculously continued to increase Total Debt far greater than GDP. In 2005 the TCMD increased $3.34 trillion[2] and nominal GDP increased $743 billion[3]; an incredible 4.5 to 1 ratio! Unbelievably, the first quarter of this year (2006) TCMD has increased at a rate of 5.2 times our GDP output! The TCMD increased an astounding $1.004 trillion[2] accompanied by a seasonally adjusted $192 billion[3] nominal GDP increase. From Wachovia Securities publication, The Week, (Aug. 28th, 2006 issue) they state: "Mortgage Equity Withdrawals (MEW) amounted to almost $840 billion in the first quarter on an annualized basis, or 9% of disposable personal income (DPI). In contrast, the average MEW/DPI ratio has been 3.3% since 1986…" Yes, that's a record! Americans have never met a debt they didn't like expanding! We are in the final stage of this most horrific credit expansion blow-off phase.

Debt is one of the most misunderstood macro economic measures of all. Most economists, financial analysts, the mainstream press, and politicians believe extraordinary debt expansion is tolerable as long as the economy stays "strong and growing". This could not be further from the truth. In principle, if on average one cannot owe more than one can produce in his lifetime, then most people may intuitively deduct this one-sided American consumption binge cannot last. Those holding these debt

securities worldwide enabling this consumption binge are experiencing the most extraordinary illusion of wealth. Soon they will discover that illusion. They will not recover their principal in real terms, let alone interest!

2008-2010 or Sooner?

If one can accept the assertion that we are in the midst of a massive bubble in combined stock, real estate, and bond overvaluations, then what will pop or diffuse it? Yes, it is possible that a continuation of credit expansion could enable the bubbles to stay levitated for a while. Think of the poor soul who is activating new credit cards just to pay the minimum payments on existing saturated credit accounts, plus continue the consumption addiction on yet additional goods and services (I would assert his consumption is "strong", but his "economy" is not!). There will be a point when those who are on the credit side of the debt transaction will want to be paid back. In the real world, that will coincide with the Boomers retiring and leaving the work force. The first wave of Boomers (born from 1946-64) will turn 62 in 2008. Thus, the first critical wave of retirees attempting to cash in on their financial nest of illusive wealth will be in the 2008-2010 time frame. However, if the significant bondholders in the world become suspicious sooner about receiving full redemption plus interest in real terms, the collapse could happen any day…

The primary tool of our illustrious Central Bank to diffuse the debt illusion is through creating yet another illusion, the debasement of our currency (inflation). Unfortunately, the collapse of the credit monster that has developed will far outweigh any initial efforts of the Central Bank to diffuse it, once the illusion is broadly exposed. Once fear becomes widespread, people will tend to restrict their spending regardless of efforts from government or the Central Bank encouraging yet further credit expansion. However, after 2-4 years and significant asset valuation bloodshed, the Central Bank printing press will firmly move into the hyperinflationary mode to rescue the country (or is that destroy it???).

Batten down the hatches...!

[1] "Net Real Debt Cannot Exceed GDP" by Russ Randall www.austrianenginomics.com 3-3-06
[2] U.S. Federal Reserve Flow of Funds Report; First Qtr. 2006
[3] Bureau of Economic Analysis