

Today's Notes:

## 1. Elevator Learning

### 1. What You Learn on the Elevator

Last week was quite a long but a profitable for me. Monday I presented to the Federal Reserve in Washington D.C. Tuesday I visited Congress for consultations on natural resources, Wednesday I attended the Rare earth seminar at Dahlman Rose in NYC and Thursday through Saturday I presented 6 times in Saskatoon. That's just a little too busy.

Actually it was held at the FDIC "hotel" in Arlington Virginia. This is the 13th or 14th time I have been back to present to the Fed since 2004. It has been quite an experience certainly enough to write a book on. On Monday I presented to about 100 + or - top level regulators from across the country and from several branches of the Government.

These included reps from the Fed, FDIC, OTS, OCC, SLIC and NCUA all coordinated by the Federal Financial Institutions Examination Council. I usually kick off a three day seminar discussing the overall geopolitics of the world and how they relate to the US and North American markets and banking system. My topic has evolved to

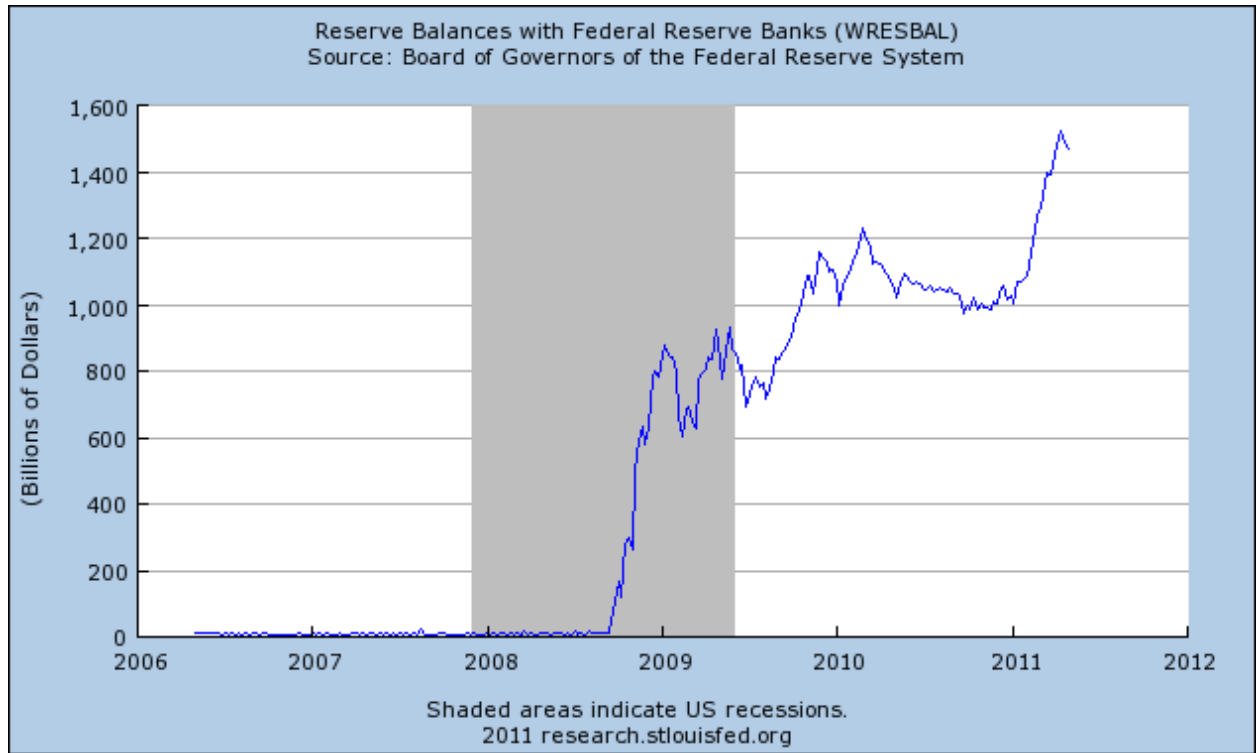
***"Emerging Issues in the US and Global Economies."***

My talk lasts 3 to 4 hours and I am usually quite exhausted at the end. But I do receive a significant amount of learning from the experience.

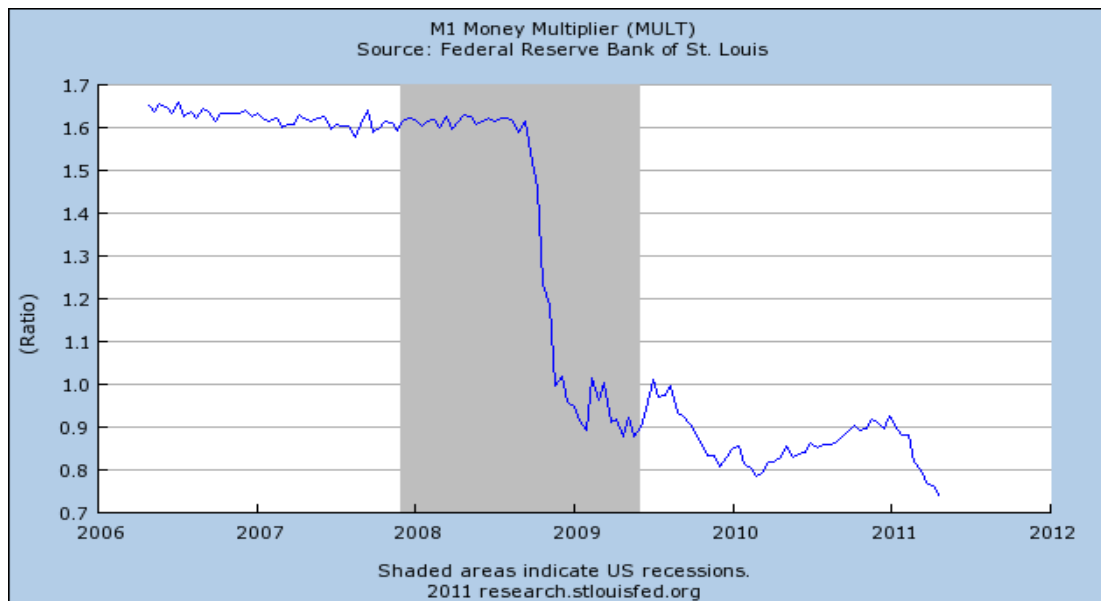
Based on these experiences over the past decade I believe it's safe to say that this has been one of the most "defining" decades in American history and perhaps, by extension, the history of the world, at least my world since 1950. Monday's presentation went very well, particularly when I think back to other such events. Take November 21, 2008 for example. That was a tough one. You may remember that we were approaching the bottom of a stock and credit market at the time. Not one of the 100 or so participants knew what was coming. In fact I received more intelligence than I gave in that presentation. It was very somber. When the markets approved in March 2009 the audience mood approved in the seminar as well. But last Monday everything seemed to revert to the gloomy side. The mood amongst the participants was quite dour.

Examining the banking system was most revealing. For example it is apparent that no matter how much fiat currency is printed and distributed to the banks, they are stuffing it (investing it) with the Federal Reserve to earn interest. You might expect that the Fed would want the banks to make loans and help revive the economy. But this is the great secret. The banks have not restructured their balance sheets. Take a look at the reserves held with the Fed. They totaled \$1.467 trillion on May 4th a level well above their previous levels – only \$72 billion actually required.

This in turn has helped to keep Treasury Bond yields low. The 30 year is yielding just 4.4% and has fallen for the past month. Higher yields could be disastrous in terms of rolling our \$14.3 trillion in debt forward.



Of additional concern, take a look at the M1 Money Multiplier. Historically this has run at \$2 to \$3 which means that for every dollar the Fed puts into the market the banking system makes \$3. No longer. The St Louis Fed tells us that the multiplier is now less than \$1 at a level of \$.74. This scenario is indicative of a non-functional economy and banking system.



The Velocity of money is also trending down. Velocity reflects the ratio of the GDP to the money supply and indicates how fast money is being transacted. Once again these signals are not signs of an economy in a sustainable recovery.

Add to these statistics the fact that real estate still must adjust downward another 20% or so, foreclosures are about to filter back into relevance now that the Government's HAMP program is terminating and we think there are very serious headwinds to economic growth.

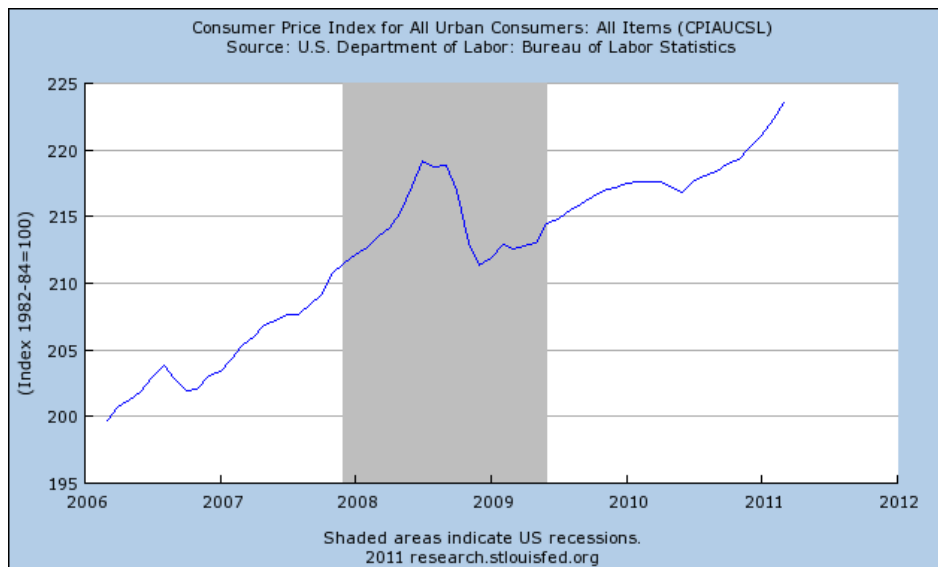
### A History of Home Values

The Yale economist Robert J. Shiller created an index of American housing prices going back to 1890. It is based on sale prices of standard existing houses, not new construction, to track the value of housing as an investment over time. It presents housing values in consistent terms over 116 years, factoring out the effects of inflation.

The 1890 benchmark is 100 on the chart. If a standard house sold in 1890 for \$100,000 (inflation-adjusted to today's dollars), an equivalent standard house would have sold for \$66,000 in 1920 (66 on the index scale) and \$199,000 in 2006 (199 on the index scale, or 99 percent higher than 1890).

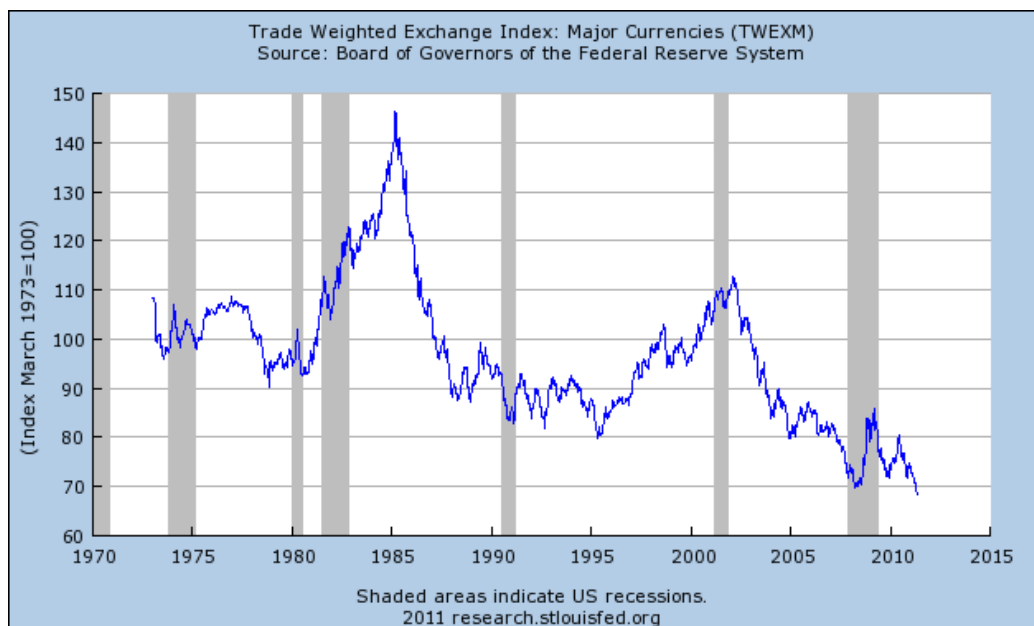


It is true that American's savings rates are back to about 5.5% and the stock market is roaring (due to the excess liquidity) but with inflation back (see graph below) and long term Treasuries at 4.4% there is little or no real return for bond investors. Unemployment is stubbornly at 9% once again as of Monday's announcement this week and underemployment well over 15%.



Then there is the US dollar. Its depreciation is a 30 year phenomenon. Of course there are really no other “easy” options for Washington (for example to cut entitlement spending now 50% of the budget). The Greenback is most definitely not a good store of value and has historically mitigated towards taking on debt to pay back in cheaper dollars.

The dollar has fallen more than 35% since we went off the ersatz postwar Gold standard of Bretton Woods. This dollar decline depicts an era of advantageous borrowing for Americans following WW II. Indeed it would appear that that era is about to end – with a bang. The US currency has now fallen from \$1.08 to \$.684 (through May 4, 2011) in the intervening 28 years since President Nixon repudiated the BW agreement to redeem other country’s dollars in gold.



Is it therefore any wonder why gold and silver have soared? Even the recent decline of the precious metals, so stimulated by CME trading limit increases, while probably welcome, is off the table now. In my speech in Saskatoon on Friday I ended with the following admonition:

“Take you dollars and buy gold and silver or their proxies.” No one laughed.

Post Script:

While on the elevator sometime after my presentation last Monday in Washington, I met one of the attendees. Often I have been scolded for being far too pessimistic. This time was different. The fellow said,

“Good lecture, but you were far too optimistic.”

I replied,

“Gee I thought I was very factual but probably negative.”

He countered,

“No, I am a bank regulator ... and I am much more pessimistic than you.”

Enough said. I hope you understand and take appropriate actions as I have oft advised.

Big things are about to happen before my next dialog with the Fed in July.

*The material herein is for informational purposes only and is not intended to and does not constitute the rendering of investment advice or the solicitation of an offer to buy securities. The foregoing discussion contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (The Act). In particular when used in the preceding discussion the words “plan,” confident that, believe, scheduled, expect, or intend to, and similar conditional expressions are intended to identify forward-looking statements subject to the safe harbor created by the ACT. Such statements are subject to certain risks and uncertainties and actual results could differ materially from those expressed in any of the forward looking statements. Such risks and uncertainties include, but are not limited to future events and financial performance of the company which are inherently uncertain and actual events and / or results may differ materially. In addition we may review investments that are not registered in the U.S. We cannot attest to nor certify the correctness of any information in this note. Please consult your financial advisor and perform your own due diligence before considering any companies mentioned in this informational bulletin.*