

Myrmikan Research

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Derivatives

On October 7, Goldman Sachs's commodity research head Jeffrey Currie declared: "once we get past this stalemate in Washington, precious metals are a slam dunk sell at that point." Hours before the October 17 deadline to avoid a Treasury default, Republicans surrendered, and the stalemate ended. Gross federal debt jumped \$328 billion the next day, and gold surged \$40 per ounce.

More interesting than the fact that Goldman analysts demonstrate profound ignorance on what drives gold prices is the reason why the Republicans folded: derivatives. Clinton advisor James Carville famously said in 1992: "I used to think if there was reincarnation, I wanted to come back as the president or the pope or a .400 baseball hitter. But now I want to come back as the bond market. You can intimidate everybody." How quaint. Today, the \$82 trillion bond market is dwarfed by the \$632 trillion derivatives market, \$489 trillion of which are interest rate derivatives¹. Global GDP is only \$70 trillion. Derivatives don't intimidate, they terrify.

Financial professionals scoff at these numbers, pointing out the BIS figures are notional not net. To explain: let's say Bank A bets Bank B that interest rates will rise. This isn't like buying shares of GE on an exchange hoping the stock will rise; it is a bilateral bespoke bet between two parties about an exogenous event. If Bank B later wants to remove its exposure to higher rates, it can't simply transfer its bet with Bank A to another party. Instead, it must open up a new offsetting bet with Bank C. After placing the bet with Bank C, Bank B has no exposure to changes in rates. If rates go up, it owes money to Bank A, but it collects the same amount from Bank C. So, even though the notional value of the bets on interest rates has doubled (there are now two bets instead of one), the total exposure to rates hasn't changed: one bank is short and one bank is long.

This is why the pros say that notional exposure is not relevant; only the net positioning matters. To illustrate the point still further, assume that Bank C opens a new bet with Bank A that rates will rise. This third bet raises the notional exposure of the three banks another 50%, but actually reduces the net exposure to zero: all three banks now have a bet on higher rates counterbalanced by a bet on lower rates.

So, it's true that looking at the \$632 trillion notional value of derivatives has little relation to the net risk positioning of the banks – but there is a caveat. In the example above, when rates rise, Bank C owes Bank B; which owes Bank A; which owes Bank C. What happens if, due to some unrelated bet with Hedge Fund D, Bank B fails before it pays Bank A? Bank failures then cascade through the system, and the losses are far greater than just the amount Hedge Fund D extracts.

¹ These figures are taken from a June 2013 Bank of International Settlements report. Previous to a recent change in methodology, the BIS estimated total derivatives to be well over \$1 quadrillion, and some experts hold that the total notional value of derivatives is roughly double what the BIS currently measures.

The essence of the fractional reserve banking system is that banks borrow short-term credits to grant long-term loans, holding only a small fraction of their assets in liquid reserves. Small losses eat up their current assets and force the banks to sell illiquid, long-term assets. During a cascading bank failure, all the banks must sell simultaneously, sending prices plunging lower. The banks rapidly become insolvent, unable to pay their bond holders or depositors. Demand for immediate liquidity increases further in a positive feedback loop. This is what happened in the panic of 2008, in which AIG played the role of Bank B while Paulson and others played the role of Hedge Fund D: losses to the banking system were far greater than the profits of the winning hedge funds.

The notional value of outstanding derivatives may not accurately measure net positioning risk, but it does reveal the magnitude of counterparty risk in the banking system, and when counterparties fail, notional becomes net. Properly understood, this risk is not a liability of a bank, but rather an asset. The more intertwined the banks, the riskier it is for the state to let one fail. Regulators have attempted to simplify some of these structures, asking the banks to collapse some of their bets to the net exposure. But, the bets are difficult to aggregate because each contract has distinct terms, and the banks have an interest in keeping them complex.

The nature of these massive derivatives bets suggests that, contra many libertarian accusations, it was no vain threat when in 2008 the banks told Congress and the Fed that without a huge infusion of dollars they would not open and the ATM machines would not work. Worse, the derivative tentacles extend far beyond the banking system.

Most basic industries require large amounts of debt to obtain their capital equipment. Take an example from the shipping industry. Suppose a ship operating company obtains a 10-year contract to service a customer, say, a Chinese TV factory. Armed with this order, the company goes to a bank to finance the purchase of a new ship. The ship finance bank offers the company floating rate debt, the interest rate set to a defined spread above LIBOR, which is the short-term cost of capital for the bank. Whether rates rise or fall, the bank makes the spread above LIBOR since the bank's cost of capital and the interest rate on the loan fluctuate together.

Nevertheless, the financing bank remains exposed to very high rates, since there is a certain rate above which the borrower will be unable to pay. So, as a condition of closing, the financing bank will require that the borrower hedge its interest rate exposure with a money center bank. The shipping company makes a purely financial bet with this second bank that rates will rise. If rates do rise, and the shipping company owes its lending bank more money, it collects the difference from the money center bank, and vice-versa. In this way, the ship finance bank gets to issue floating rate debt, which is cheap for it to finance, but the shipping company has the reduced financial exposure of fixed rate debt. Both parties are better off.

But what about the money center bank? Big banks are exposed to bundled consumer debt such as mortgages, credit card and auto loan debt, most of which are floating. When rates fall, revenues fall. The money center bank wants the bet with the shipping company to offset this exposure to lower rates.

From a regulator's perspective, all of the derivative transactions are proper, serving to lessen each party's exposure to interest rate risk. The flaw in the system is that the end individual borrower has no hedge against changes in rates. When rates fall (as they must when the Fed and the banks manufacture additional credit to bid on bonds), floating rate debt becomes easier to pay: the money center bank profits as fewer borrowers than expected default on their payments allowing it reduce its loan loss reserves (and pay large bonuses). Conversely, when rates rise (as they must if the banking system fails to manufacture money at an accelerating rate), individual borrowers find it harder to make their payments and defaults proliferate.

The retrenching of consumer spending in a higher rate environment also tends to expose the malinvestments that were able to be financed only because of the artificially low interest rates. For example, imagine that Americans, unable to pay their credit card bills, decide that

having an average of 2.9 TVs per household is enough, and TV sales plunge. The Chinese TV factory that had given the shipping company the 10-year contract breaches, and the capital represented in the ship becomes fallow.

There is an inflection point for rates past which consumer debt default and declining collateral capital values would poke a big enough hole in money center bank's balance sheet such that it would be unable to fulfil its contract with its counterparties, including the shipping company. The shipping company must then default, losing its collateral and wiping out its equity holders. At least the ship finance bank can attach the ship as collateral, but what price will it fetch in this environment? The ship finance bank must also default to its creditors, including its depositors. The scramble for liquidity would topple the whole \$489 trillion (at least) interest rate derivative tower devouring the financialized economy.

The system is constructed such that when the derivatives market implodes, the banks will have a valid claim on the assets of borrowers, while avoiding liability to depositors, even when they are embodied in the same person. Under the U.S. bankruptcy code, the "automatic stay" requires bankrupt parties to halt all payments to creditors so that the court can reach an equitable distribution of assets. However, the banks convinced Congress that derivatives chains are too important to the integrity of the banking system to wait for judicial adjudication, and Congress revised the code to exempt derivatives from the automatic stay. This means that as a financial firm approaches insolvency, the derivative counterparties can loot the assets even while the other creditors, including depositors, are legally prevented from acting, revealing yet another reason why banks love derivatives so much.

Most interest rate derivatives either use LIBOR or various Treasury debt durations as their reference rate. In 2008, it was in the Fed's interest to have rates as low as possible, explaining why they ignored the LIBOR rigging scandal even though they were fully aware of it. In the approach to the October 17 default deadline, certain policy makers and bankers were terrified because the contractual architecture supporting the hundreds of trillions of dollars of derivatives is so complex that no one can comprehend how the system would respond to a temporary interruption in payments.

Similar to the threatened banking collapse of 2008, the collapse of derivatives is a valid fear, and no politician wants to be the responsible party. The stakes are so high that Republicans cannot credibly threaten a default, the reason Obama refused to negotiate. The last minute deal not only pushed the new negotiating deadline to February 7, it completely eliminated the debt ceiling until that time. The Treasury Department has since announced it will sell \$60 billion more Treasuries than required over the remainder of the year to bolster its cash balance. The government will enter the February 7 deadline with huge amounts of extra cash and the ability to rerun the extraordinary borrowing procedures, meaning the true deadline for the next potential default lies far into the future. No doubt February will bring captivating political theater, but which is guaranteed to produce no results.

The political threat to the \$600 trillion of contingent liabilities is avoidable: as long as Congress pressures the Fed to buy its bonds, it can delay a hard default on Treasury debt forever. This it must and will do. But, the economic risk is not containable. As von Mises demonstrated, an economy based on credit requires ever declining rates to remain stable. The interest rate ceiling above which defaulting consumers would topple the derivatives tower keeps falling. The Fed can print ever faster to maintain stability, but will face an eventual choice of financial collapse or hyperinflation.

The Fed is only dimly aware of the trap it has built because its artificially low rates have helped repair bank balance sheets, and from its perspective nearly all of the derivatives within the banking sector cancel out. But, the repaired holes in bank balance sheets represented losses already sustained, not losses to come. As a Fed official wrote during the collapse of Lehman Brothers: "Balance-sheet capital isn't too relevant if you're suffering a massive run." Beyond the regulators' purview lie the termini of the financial system: the consumer debtor

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and the saver depositor. The former cannot withstand higher rates, while the latter is having his capital eviscerated by the negative real rates.

The Fed may not yet realize the precarious position of the banks, but it understands that higher rates lead to unemployment, which violates its dual mandate. As Bernanke himself stunningly admitted last summer: “I don’t think the Fed can get interest rates up very much, because the economy is weak, inflation rates are low. If we were to tighten policy, the economy would tank.” And this follows five years of massive money printing!

Yet, as the broader markets continue to melt up despite a lackluster economy, the Fed is beginning to worry about asset bubbles: how to discontinue QE without letting rates rise? Bernanke has tried to convince the markets that QE is like hitting the accelerator, whereas hitting the brakes means raising interest rates. If this view were correct, then ending QE would not be a tightening, but merely a coasting to see what happens: rates should remain stable.

But, markets care about reality, not what government officials think, and reality mugged Bernanke’s theory last summer when Fed-inspired tapering chatter caused the 10-year Treasury rate to surge from 1.6% to 3% despite continued printing. Mortgage applications collapsed, and the Fed now realizes that 3% is the new interest rate ceiling. At least one official, St. Louis Federal Reserve President Bullard, has finally figured it out: “changes in the pace of asset purchases have a very similar financial market effect as changes in the policy rate during more normal times.”

For an economy that needs accelerating printing to survive, tapering is tightening, and the Fed faces an increasingly stark choice between market bubbles and economic depression. Yet if Fed officials are slowly realizing how QE mechanically affects the economy, they seem oblivious to the inevitable conclusions of their policy.

Last week Goldman Sachs’s Jan Hatzius trumpeted two new Fed studies by top researchers, the first of which suggests that the Fed should target policy to address not the reported unemployment rate, but the total employment gap:

. . . optimal policy should become even more accommodative if the central bank did not target the unemployment gap but instead aimed at keeping the employment-to-population ratio near the trend level that would prevail in the absence of hysteresis effects and exogenous (but ultimately transitory) shocks to the natural rate.²

The second study implies that if the Fed were to lower its 6.5% unemployment threshold required for the first rate hike, it could ease conditions enough to allow for a taper³. This idea plays on the fact that the Treasury yield curve is completely self-referential.

In a risk-free market (as the Treasury market is assumed to be), long rates can be nothing more than the average of short rates, for otherwise there would be an arbitrage opportunity offering free money. By pledging to keep short rates at zero for longer (the papers estimate 2017), then long rates must fall, assuming the market believes the Fed.

This has worked in the past. On August 9, 2011, the FOMC announced:

The committee currently anticipates that economic conditions — including low rates of resource utilization and a subdued outlook for inflation over the medium run — are likely to warrant exceptionally low levels for the federal funds rate at least through mid-2013.

² <http://www.imf.org/external/np/res/seminars/2013/arc/pdf/wilcox.pdf>

³ Goldman’s Hatzius writes with false modesty: “We have proposed such a move for some time, but have been unsure whether it would in fact happen.”

This promise to keep rates low for an additional two years sent the two-year yield from 0.27% to 0.19%, stocks surged over 6%, and gold reached a new all-time high of \$1770.

Here we are at in late-2013, and now Fed research papers argue that rates should stay at zero until 2017, even though – or perhaps especially because – this policy will cause inflation:

Under the commitment strategy, optimal policy, . . . the nominal federal funds rate is held near its lower bound well into a period of economic expansion. Of course, this commitment implies that the unemployment rate eventually falls below its natural rate and inflation rises slightly above its long-run target. It is the promise to remain accommodative and not prevent future above-target inflation and below-target unemployment that lowers current long-term interest rates and thereby stimulates activity today.⁴

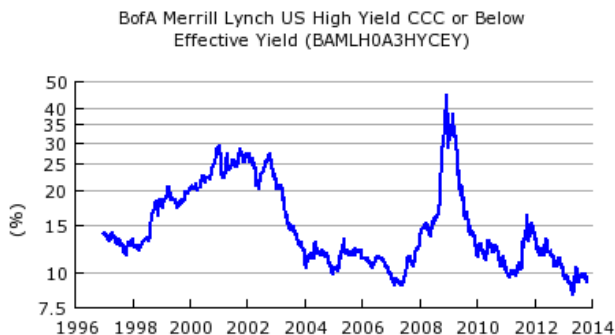
Goldmanite Jeffrey Currie says: “you have to argue that with significant recovery in the U.S., tapering of QE should put downward pressure on gold prices.” Yet, Goldman projects GDP growth for Q4 will be 1.5%, and Goldmanite Hatzius interprets the Fed papers as signalling that taper will only occur in the context of additional easing through another means. Which Goldman Sachs analyst to believe?

It is worth repeating from the last update Fed Chairman-designate Janet Yellen’s mantra: “To me, a wise and humane policy is occasionally to let inflation rise even when inflation is running above target.” The new Fed studies, designed by Goldman Sachs, give intellectual cover to this policy. Yet Goldman says sell gold, and Brutus is an honorable man.

For the past five years, the Fed has promised future tightening, even as it continually extended the time frame and loosened further to reflect “optimal” policy, a word that appears 112 times in the two papers. The misallocation of capital from the Fed’s false interest rates will eventually cause economic collapse in the real economy, conjoined with a market collapse, which will prompt even greater interventions.

Bizarrely, such a market correction, a new financial crisis, is forecast by the Fed itself in the first paper mentioned above:

In particular, policymakers may be worried that pursuing a highly accommodative monetary policy for a long time [*Ed.*, 5+ years?] could inadvertently sow the seeds for a future financial crisis. Such a development might occur if persistently low short-term interest rates were to prompt firms to take on increasing amounts of leverage—thereby decreasing the stability of the financial system—or prompt investors to take on an inappropriate amount of risk in a reach for yield. . . . [*Ed.*, see chart below]



4 <http://www.imf.org/external/np/res/seminars/2013/arc/pdf/english.pdf>

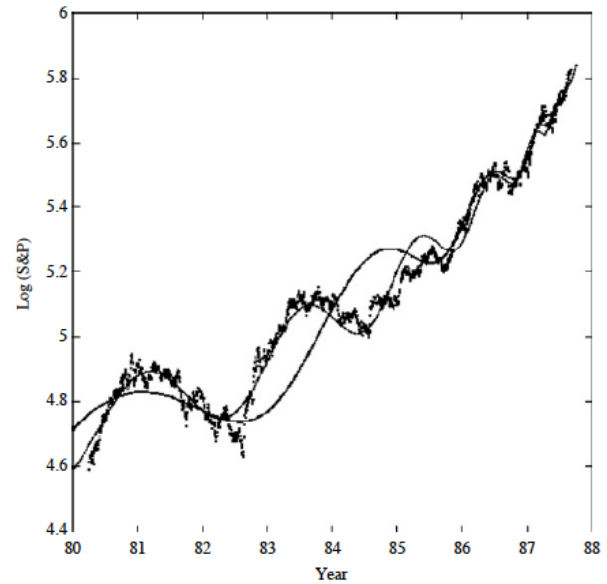
Nevertheless, the threat of a second financial crisis does not mean that policymakers necessarily eschew driving short-term interest rates to zero for a time. Even though policymakers can avoid the second crisis altogether by always keeping the funds rate above 1½ percent, that strategy exacerbates the macroeconomic impact of the first round of shocks by more than enough to make the overall loss appreciably worse than the alternative optimal policy that allows the funds rate to fall temporarily to zero.

In other words, since the Fed assumes the next financial crisis will only be 60% as bad as the last one, it projects that the benefits of loose policy in the interim periods outweigh the projected damage from the next crash. But, the history of financial crises over the past 80 years, and particularly over the past 30 years, shows that contrary to the Fed's models financial crises have been getting progressively more serious, not less (not to mention the ethical considerations of the central bank pursuing a policy they know will lead to another crash).

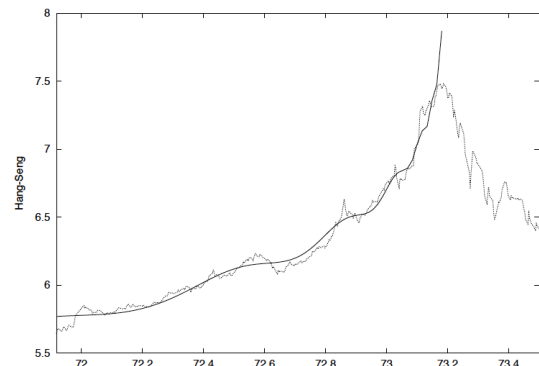
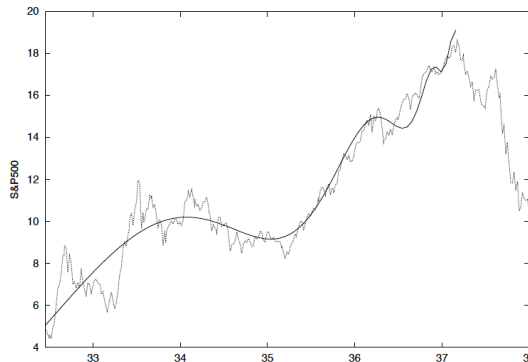
And what happens if the next crash occurs in year 6 instead of year 10, as assumed by the Fed paper? These pages engage in fundamental analysis of values and avoid addressing technical analysis of prices, a practice akin to seeing faces in the clouds: how many technical analysts are in the Forbes list?

Nevertheless, it is difficult not to be impressed with a series of graphs presented by market commentator John Hussman based on by 2002 paper called Critical Market Crashes by Didier Sornette.

Sornette noticed that markets commonly follow a log-periodic power law in the bubble stage before a major crash. The chart at right is his formula produced in 1997 applied to the 1987 market crash. So accurate was the model, that a February 2008 paper looked at other markets before major crashes, and saw similar attributes.

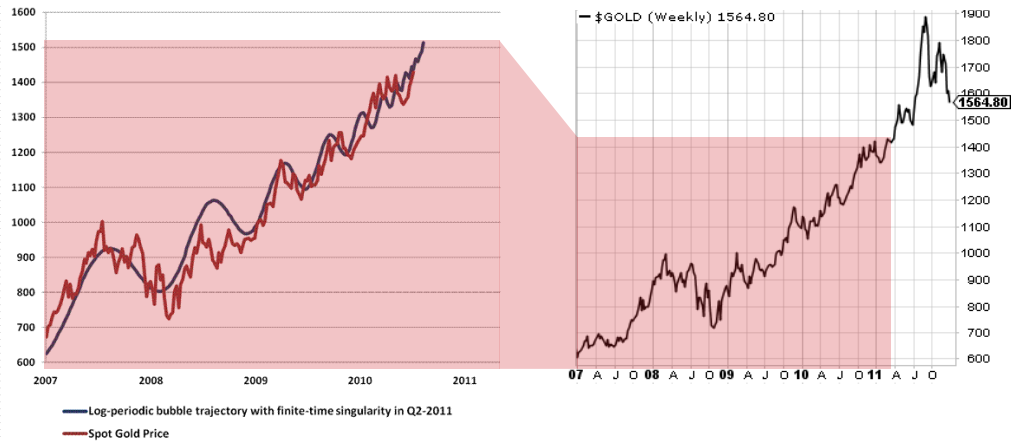


The charts below are a sampling.



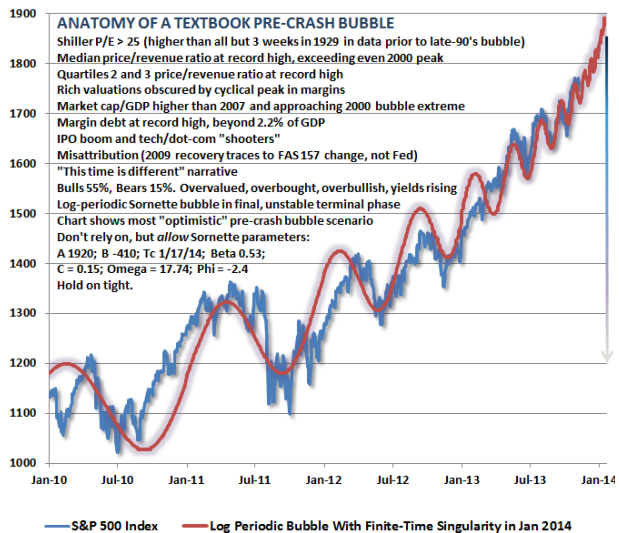
In each case, and there are many more in the various papers, when the log-periodic function nears singularity – that is, when the model heads vertical – the market is set to crash. Sornette notes that rational actors, even if the model were to be true and they believed it, would find it difficult to sell because as the market approaches singularity, and the likely time before a crash nears, the gains to be had by waiting to sell increase commensurately.

Producing accurate models to predict past markets may not impress. The graph below left, included in Hussman’s March 14, 2011 commentary, does not suffer from this defect.



Gold hit singularity in mid-2011 as projected when it blasted through \$1500, and began its correction shortly thereafter. It is important to note that Sornette’s crashes do not necessarily mean the end of a bull market: stock plunges in 1937 and 1987 were relatively early in their full bull markets.

Hussman is back with the chart of the S&P 500 at right. It is projected to hit singularity in January, meaning that a crash is near, but major gains are in store beforehand. Even if one knew, for certain, that a crash will occur, it would be unwise to short, since the most likely outcome would be a margin call. Even put options would be left behind as the market powered higher, although at least buying options offers protection while avoiding margin calls.



How will gold react? Market crashes always involve a shortage of currency, driven by margin notices and forced selling. A shortage of currency implies the sale of any and all assets available to gain currency, including gold. From this perspective, gold should move lower during the actual crash.

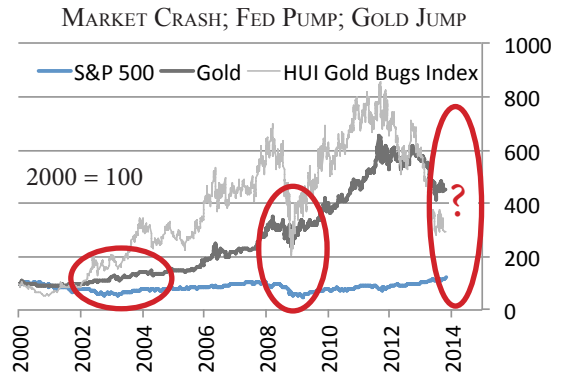
However, any significant market decline must be met with policy easing, for otherwise the impaired collateral of the banks, which are tied together with derivatives, would destroy

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the financial system. How does the Fed ease further when the baseline is printing \$85 billion per month? There are a variety of ways: a) broaden the definition of unemployment to mean the employment-to-population ratio, b) lower the threshold this new unemployment metric must meet before rates will increase, c) raise the inflation threshold above which rates will be raised, and, of course, d) increase the size and scope of QE (the next crash will see the Fed buying corporate bonds).

All four of these possibilities are very gold friendly. Since gold has already been through a two year correction, along with the rest of the commodity complex, it will likely be the prime beneficiary.

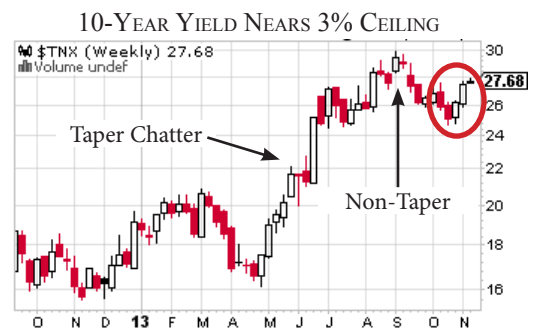
Market participants learn, and all are now familiar with the pattern of market crash, Fed pump, gold jump from the previous two episodes, as shown on the chart. It is possible that the market has already anticipated this sequence, pushing gold lower, but will bid aggressively during the crash, anticipating the next Fed pump job. Meanwhile, the broader markets will languish in correction mode. As commodities rise, the prices of goods will shoot higher, exacerbating the real losses of holding stocks.



Gold stocks are properly viewed as call options on the inevitable results of Fed policy. Owning an unlevered call option means that no matter how low they go before paying off, no one can send a margin call. It is precisely this feature that made shorting housing in 2006 a terrible bet, but buying credit default swaps (which were cheapest right before they paid off) hugely successful.

It is difficult to predict how gold stocks will behave in the short term. Last Friday gold got knocked down \$20 to \$1289, but gold stocks were actually up. On Monday, gold fell further, and gold stocks rallied again. Perhaps they are being sucked higher in the wake of a stock market approaching singularity. Or, perhaps the market has anticipated the cycle.

The market will not be satisfied with esoteric promises of Fed policy in 2017. It needs fresh printing now to keep rates below the 3% threshold. In fact, given the recent performance of gold and now oil, it's possible that rates in the upper 2% range are already too high. If the Fed does taper, rates will blow higher, emerging markets will unwind, and the stock market will crash (perhaps after one last vertical move higher). It will be a major policy error that will require immediate reversal.



Ultimately, even when the Fed's policy objectives fail utterly, interest rate derivatives are the gun the banks have at the Fed's head: keep lowering rates, hand over the money, and no one gets hurt. But even this threat has its limits: at some point, the money will be worth so little, no one will want it. By then, it will no longer be possible to price gold in dollars.

Afterward: Daisy Chain of Debt

In 2011 an e-mail made the rounds that purported to solve the Greek debt situation. In short: a German tourist places a €100 bill as a refundable deposit on a Greek hotel room one morning. During the day, the hotelier repays his debt to butcher, who pays his debt to the farmer, etc., until finally a debtor of the hotelier repays his debt with the same bill. The German returns, decides against spending the night, retrieves his bill, and leaves. There has been no economic activity, but the miracle of the velocity of money has unburdened everyone of his debts. Amazing!

The obvious flaw is the story give no account of capital values: the hotelier likely has some mortgage to pay, which perhaps represents the savings of some retired couple living off the income of the capital they saved during their working years: if they get the €100 they consume it. Or perhaps it is his own capital he expended to build the hotel. When the German goes home instead of spending the night, the income from the capital represented by the hotel room is forever lost. Or perhaps the deposit is gone when the German returns. Or both. Someone must suffer.

This parable, in fact, did not originate in 2011, but during the previous global credit collapse of the 1930s. Freeman Tilden explores the flaws in his 1936 masterpiece: *A World in Debt*:

To meet this absurdity of relation between the growth rate of interest and the faltering pursuit of production, some of the current economists have had recourse to a “theory” of debt in terms of money, which considers money as independent of wealth. J.M. Keynes is the shepherd of this flock, and the flock is a vast one, because Keynes is telling them what they ardently wish to believe. Nothing is more annoying to a profligate world that has squandered its substance than to be told that when it spent money it consumed goods; contrariwise, nothing could be more cheerful than to learn at the feet of a pundit that “debts cancel out.” If debts cancel out without the help of any existing goods to support the transaction, a new and beautiful world opens before us. Mankind can give up producing altogether, and subsist upon promises to pay. There is no exaggeration in this. It is the logical conclusion from Keynes and Company’s theory of money as a “closed” or independent system. Also, it is no wonder that the Keynes optimism was (by report) the abiding faith of the Roosevelt administration that came to power in 1933. The cry of a disillusioned populace was for magic: and the magic has so far (1936) taken exactly the form of creating fifteen to twenty billion dollars of new debt on the theory that debts will cancel out.

Unhappily for debtors, debt do not cancel out debts. Debts cancel out wealth; or, wealth cancels out debt. Those who think that debts cancel out debts are confusing book debts with net debts: or, if you wish to state it differently, they are confusing proximate debt with ultimate debt. Strangely enough, the most ignorant people, when dealing with each other, never confuse the two. Smith, a simple workman, who has saved money and invested it in a house, rents the house to Green. Green, a carpenter, makes some small repairs on the house by agreement. In settling their accounts, Smith does not say, “You owe me twenty dollars for rent. I owe you ten dollars for work. You give me twenty dollars, and I will give you ten dollars.” What Smith says is: “You owe me ten dollars.” The only debts *paid* are net debts, or ultimate debts.

Suppose Peru owes Ecuador one million dollars, and Ecuador owes Peru one million dollars. These debts cancel out. But *what* debts are they that cancel? They are book debts. The real debts are not there. Where did Peru get the credit necessary to contract the debt? From her banks. Then the debt remains – but now it is a debt owned by the government to its banks. Where did the banks get the money? From “depositors” of the banks. Where did the depositors get the money to lend the bank? By creating wealth – by production.

Very well; now at last we are facing the ultimate debt. Some persons, somewhere, have wealth to the amount of one million dollars; and those persons are the net creditors. Those persons must be swindled if the cancellation of the books debts is to be taken as the end of the affair.

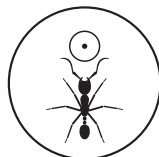
Bassett Jones says truly that Keynes *et alii* are merely repeating in a ponderous way the fallacy of the brain teaser that has amused so many social gatherings. In this “puzzle” A owes B ten dollars; B owes C ten dollars; C owes D ten dollars, and D owes A ten dollars. In all, four men owe a total of forty dollars. But if A pays B ten dollars, and B hands it to C, and C hands it to D, and D hands it to A, forty dollars of debts have been settled with ten dollars, and A still has ten dollars. This happy solution leaves most people open-mouthed and ready to praise Allah that he is so kind to the indebted. Only a curmudgeon would take the joy out of life by introducing another character, E, into the circle. E owes nobody, but A owes E ten dollars. Let A, who *has* ten dollars, pay E first, and let E put the money in his pocket and go home. Now see if the members of this circle of penniless optimists can “pay” their “debts” – if they owe any debts. But do they owe any net debts? Why not get together, like a group of cleaned-out gamblers after a bad day at the races, and just agree to tear up the IOUs? Where there is no *payment* finally due, there is no debt in any sense that need concern us.

The little brain-teaser, however, suggests something quite different from what was intended. In this debt-cancellation, A starts with a creditor position and ends with one. In real life, if A fell into the company of a group like this, A’s ten dollars would never get back to him. The world is cluttered with chains of debt-kickers who are looking for an A. The introduction of a solvent singer into a glee-club of debt creates a sense of relief similar to the appearance of a man with actual cigars and matches at a marooned party that has been smoking Barmecide tobacco.

The world is full of net debts of unpayable magnitude: national debts of importer to exporter; private debts of borrowers to savers; government mandated debts of young to old and now healthy to sick. The banks, lead by the Federal Reserve and enforced by the SEC, are a legalized cartel that profits by collecting these debt. But the banks’ book debt claims come first, ahead of the ultimate creditor, and the chain of now liquid but ultimately insolvent banks ensures that the assets seized from debtors will be lost in transmission: final creditors will not be paid. As Tilden wrote elsewhere in his book:

The natural remedies, if the credit-sickness be far advanced, will always include a redistribution of wealth: the further it is postponed, the more violent it will be. Every collapse of a credit expansion is a bankruptcy, and the magnitude of the bankruptcy will be proportionate to the magnitude of the debt debauch. In bankruptcies, creditors must suffer.

This debt debauch is the largest in history. The only way to be an A when the debt bubble finally collapses is to hold gold or, better yet, to hold an asset that produces gold.



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