

The Solari Report

Year End Wrap-Up: 2008

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Bye-Bye Bubble

The global financial bubble burst in 2008 — and that's a good thing. It means that the bubble economy will no longer make it attractive to ignore our problems and drain the *real* economy. Instead of investing our capital in fraudulent mortgage securities, complex derivatives, and companies running black-box Ponzi schemes, perhaps we will see the merits of financing real people crafting real solutions to the problems before us. In 2008, the incentives grew to understand the real world and address real issues.

Alas, like the bubble, the collapse was engineered. The nature of the “pump and dump” financial model on planet earth is that the most powerful people on the planet will make more money on the dump than they did on the pump. In 2008, a strong dollar combined with global drops in commodities and equity prices created more buying opportunities for insiders who exited the bubble in time or enjoyed the largesse of bailouts.



Thousands of bankers and executives who created the bubble were unprepared for the events of 2008. They were left scrambling in a game of global musical chairs. The moral of the story is as old as the hills: there are a lot more people who think they are insiders during the “pump” than during the “dump.” The dump is when you find out who is really in and who is out ... or who your real friends are.

This cycle will be different. We are not witnessing just another bubble burst as we did in 1988-89. This is a fundamental re-engineering of the governance system — the culmination of a financial coup d'etat. I often quote the story of Clarence Dillon, the head of my old firm, Dillon, Read & Co. Inc., in 1929 at the beginning of the Great Depression:

Driving through New Jersey, Nitze [asked] Dillon if he thought the market decline an omen of hard times ahead . . . Dillon thought for a few minutes and replied, “I think it presages the end of an era.” By this Dillon meant that what lay ahead was not merely a period of retrenchment, after which affairs would be conducted as before. Rather, the world was in for a major overhauling of institutions.

—Clarence Dillon and Paul Nitze in 1929

We are not at the end of history. We are, however, at the end of the notion that the people in control want anything less than total control of *everything*.

How do we integrate powerful new technology in a manner that is human and civilized? How do we address population growth and align our economy and lifestyles with the health of our natural environment? How do we create and sustain communities in the face of invisible powers? Is a war economy the only kind of economy we can imagine?

The urgency of these conversations will grow as the bubble evaporates.

Where's the Money?

The big question of 2008 is “Where is the money?” It just keeps disappearing. There was \$4 trillion plus that disappeared from the U.S. government between 1998 and 2002 along with trillions more from the pump-and-dump of the Internet and telecom stocks, the Enron debacle, and other financial frauds. Since then and into 2008, funds keep disappearing into the Afghanistan and Iraq campaigns.

Now we have \$700 billion in bailouts and \$7 trillion plus in loans by the Fed, not to mention the \$5 trillion in mortgage market liabilities assumed by the Federal government with the passage of the Housing and Economic Recovery Act of 2008. The fraud in the U.S. mortgage bubble was clearly enormous. But, where did all the money go? Who's financial appetites demand this much money and what, if anything, will ever satisfy them?

This of course leads us back to “Cui Bono?” – “Who benefits?” And this, in turn, leads us to wonder who is really at the top of this pyramid scheme. What is the end-game for global governance?



Dollar Up, Gold Down

To recapitalize the U.S. banking system, it was necessary to have the dollar up and



gold down in 2008. Sure enough, this is what happened — although by the end of the year, the dollar was up 5% and gold was up 4%.

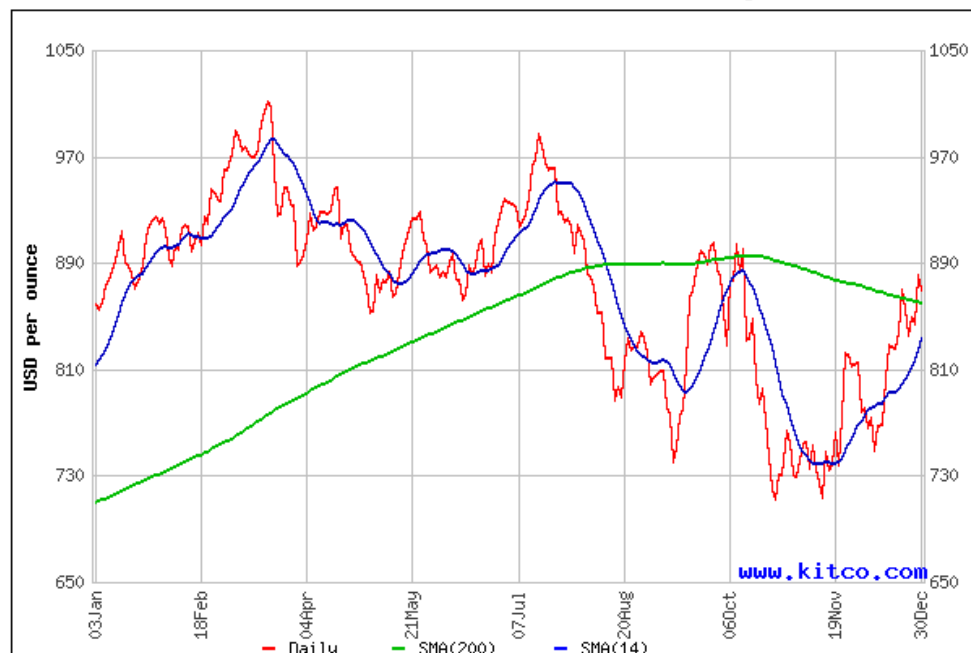
The ability of the "plunge protection team" (formally known as the President's Working Group on Financial Markets) and their agents to intervene in markets and suppress the gold price continued to surprise knowledgeable commentators.

We still do not adequately understand how the "management" of markets is engineered. Put this on a list of mysteries it would be wonderful to solve in 2009.

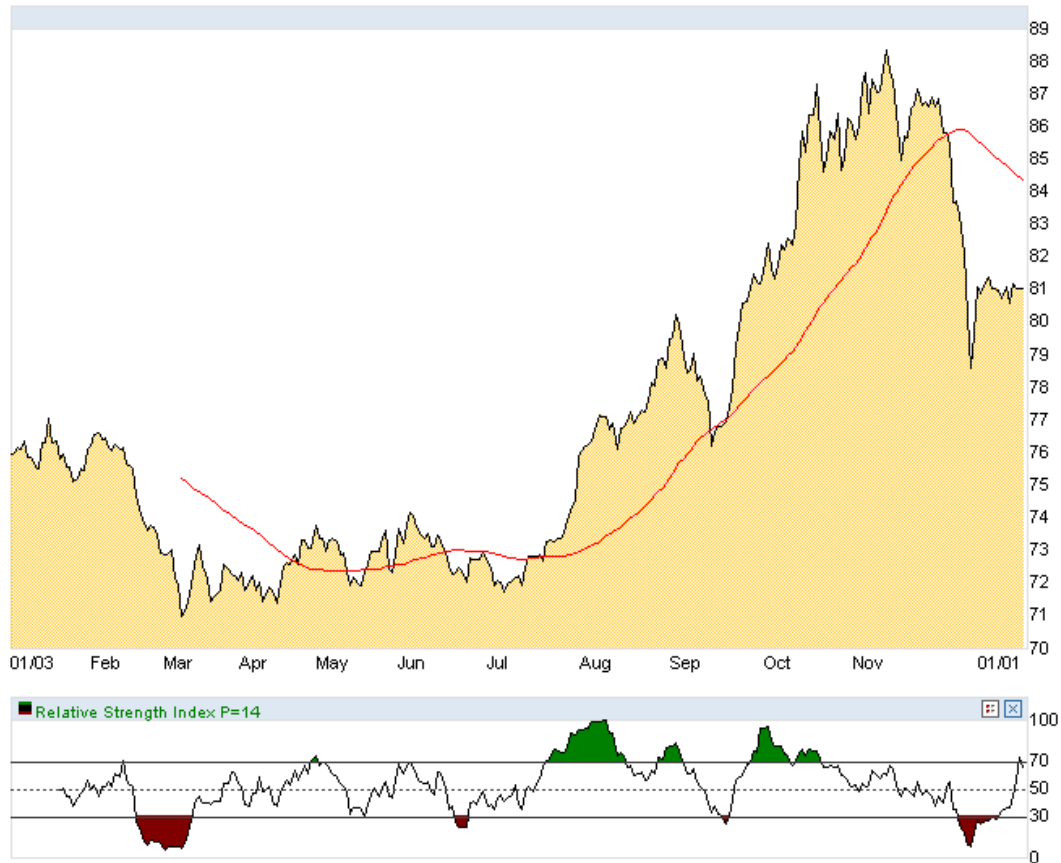
Interestingly, by year-end the precious metals market was tracking both the London spot price and premiums paid for gold coins on E-Bay, as the paper market and the physical market diverged.

2008 Gold: London Fix PM

High 1011.25 Low 712.50



U.S. Dollar Index: 2008



The Slow Burn

The global financial meltdown that some market pundits predicted hasn't happened. Instead, the "Slow Burn" continues albeit at a more rapid, scarier pace. Still, investor losses have been significant. After quite a run-up, the commodities markets crashed, the Dow dropped by 34% and global stock markets were down across the board. Financial institutions throughout Europe and Asia were hammered by losses and fraud in the U.S. mortgage and derivatives markets.

The division grew sharply between those with access to cash, credits and bailouts and the growing number of people losing businesses, jobs, savings, homes, health and lives. The division had little to do with talent or productivity. The personal pain is great and will grow greater. It is made greater by the realization of betrayal by political leaders, the mass media and communities.

The amount of human talent being drained and destroyed throughout North America and around the globe is incalculable. Supporting rather than destroying this talent remains our greatest opportunity (it is an invisible opportunity). It calls for a financial system which can generate profit from the education and well-being of families and communities and the reduction of wasteful consumption.





The Freezing Up of the Global Banking System

As financial losses grew throughout 2008, an outbreak of healthy distrust resulted in the freezing up of the global banking system. This is the evidence of markets working — not, as reported, of markets failing. Banks do not trust each other or their accountants or their lawyers for a very good reason: who can price an asset when the parties may be lying and regulators and courts will not uphold the law?

The Pension Fund Time Bomb

Because pension funds are not leveraged, reports on pension fund losses have been relatively quiet. Look for reports regarding pension fund performance to have a profound impact in 2009.

Unfunded pension liabilities will hit hard on state and local government. Indeed, municipalities are getting hit on all sides as tax revenues fall with dropping real estate values and the cost of capital rises.

The dependency of state and local governments on the central government is not widely recognized. Real trouble with the U.S. dollar, the integrity of tax systems, or the federal credit in 2009 could spell serious hardship for local governments, leaving the economy even more dependent on bailouts and military spending as the infrastructure of control grows.

The \$1 Billion Candidate

The American elections captured a great deal of attention this year, with the victorious candidate, Barack Obama, raising nearly \$1 billion. As the American economy centralizes with companies, states and municipalities, universities, health care and all aspects of life becoming increasingly dependent on the federal budget, the business of buying the White House and congressional seats becomes ever more expensive. We are not just electing representatives — we are electing the “managers” of markets, including an ever-growing percentage of private income and profits.

While some say President-Elect Obama is the face of hope and some say he is the face of the Rockefellers, I say he is a Harvard lawyer turned politician who is a prisoner of [the red-button problem](#), just as we all are. So far, his economic team includes the original engineers of the strong dollar policy and its component parts: the housing bubble and the gold suppression scheme. Let's face it. If engineering a financial coup d'etat is the goal, these guys are the victors.



Obama has announced a massive infrastructure program. Infrastructure is potentially better for the economy than housing bubbles. The devil, however, is in the details. The scariest idea? A centralized medical-records database. We will talk about this more in 2009.

Given the state of the economy and the intelligence of the Obama team, it should be possible to manage the program design and the contracting of a massive government investment such that the infrastructure created is cost competitive and creates net value in the economy, including contributing to, rather than destroying, the value of labor and communities.

So let's see what comes out of the other side of the Washington sausage-maker after the inauguration. My expectations are minimal, yet I am willing to be surprised. This is, after all, the seasons of miracles and the system is full of decent people who would like to see things work and are willing to work hard to make it so.

Russia, China, and the Middle East Rising

Of the many challenges facing the new Administration next year, none will be more pressing than managing rising power-bases and younger populations throughout the Middle East, China, and Russia. Perhaps the implosion of the commodities markets will ease this process, but our bet is that the shift from a financial bubble to a world of rising tangible asset values will continue.



The Anglo-American alliance “stuck” the world with massive losses from financial fraud. Now we are taking advantage of these losses by enjoying another global buying opportunity. In the process, we have vastly increased the incentives for world-wide competitors to collaborate in protecting themselves from us. Mr. Putin has said so publicly and one of his advisors reiterated this to me privately in chilling detail.

The Internet Inspires

Throughout 2008, the Internet provided an alternative to the continuing censorship of numerous stories that we need to know. These included not just stories that impact our finances but which concern manipulations harmful to our health including chemtrails, efforts to control food and seed supplies, and the ongoing suppression of new energy technologies. Watch for the failure of traditional media in 2009 due to a loss of market share to the Internet. Go, Wikileaks!

The Good News

One of the few good investment categories in 2008 was building personal and local self-sufficiency.

From the success of the Financial Permaculture conference in Hohenwald, Tennessee, to the spread of Transition Towns from the UK, participatory budgeting from Latin America, and community currency and barter systems around the globe, efforts by entrepreneurs and communities to re-localize and network are encouraging.

The logical response to uneconomic centralization is to look for ways to decentralize. Despite all the difficulties in the economy, entrepreneurs doing and teaching natural home building, farmers markets, starting farms, installing solar energy and weatherizing homes enjoyed a market moving their way. These efforts will continue to grow well beyond any shakeout, particularly if commodity prices head north again.

The great mystery is, what will be unleashed as the awakening continues in the face of continued reports of institutional corruption and failures? We think this awakening will have a very positive impact spiritually, culturally and economically in 2009.

The Shakeout Moves into 2009

We have started to hear that the shakeout in financial markets is over and that it is now a good time to invest in the stock market. Don't believe it. The shakeout in the U.S. is far from over. A great deal has been “held together” through the election and the inauguration.

Numerous companies and investors have disclosure obligations in the form of annual reports due in March. Many corporate taxes are due in March and individual taxes are due in April. Let's see what emerges during the disclosure and tax period and how the housing market responds in the spring and summer.

If we are lucky, Washington will produce real plans for real infrastructure investment that will have a positive total economic return. If luck is not with us, Obama will play Pharaoh presiding over the allocation of rigged profits financed with inflation and force. The real economy will continue to die as productive enterprises are starved of capital simply because they are not politically connected.

Can diverse networks of citizens switch their remaining capital in time to protect the productive enterprises that generate jobs and wealth and offer real solutions? We hope and pray that we can.

Our prediction? If you thought 2008 was wild, hold on to your seats— we ain't seen nothing yet.

Plenty of Opportunities

In my audio seminar, Positioning Your Assets for Growth in Uncertain Times, I identified eight areas of opportunity. Here is a recap of how these areas performed in 2008 and some thoughts on what we can expect in 2009.

Opportunity #1: Personal Self-sufficiency

The after tax yields on stockpiling household non-perishables was typically better than money markets in 2008. Investing to reduce your expenses or to build a business that would generate income sure looked better than leaving money in the stock market. Expect the same in 2009.

Opportunity #2: Family, Community, and Network Self-sufficiency

Collaborating with others can be time-consuming and complicated, but the opportunities in this area continue to grow. Expect the trend to continue for the foreseeable future. Big challenge in 2009? How do we find like-minded people who will respect our time and contribution?

Opportunity #3: Banking Intimate

The desire to find a bank one could trust was still overshadowed by the belief that big banks were safer because of massive Fed support. As the appalling behavior of the large banks becomes ever more apparent, let's hope that withdrawing to healthier, local institutions accelerates.

Opportunity #4: Precious Metals

Despite great expectations, gold and silver prices were flat in U.S. dollars for the year. Starting at \$840 per oz, the price of gold rose above \$1,000 until the Bear Stearns assassination, and then dropped to a low of \$700 in October before rising back to the \$840 levels before Christmas.

While disappointing for gold bugs, it is worth noting that precious metals performance was strong relative to oil and other commodities and when measured in other currencies, making the case that gold and silver would perform well in a deflation marked by untrustworthy fiat currencies.

Perhaps most notable was the divergence of the spot price from the coin markets, with dealers and E-Bay reporting rising premiums above spot on coin purchases and serious difficulties obtaining inventory. This divergence bears close attention in early 2009.

Despite the “managed” nature of these markets, the outlook is strong for precious metals in 2009.

Opportunity #5: Natural Resources

Commodities had a bad year. Oil down. Agricultural commodities down. Don't be fooled: de-leveraging can bring prices down a lot in a bubble economy. However, we still have 6 billion plus people competing for limited natural resources. Look for natural resources to grow more valuable over the long term.

My bet is that the smart money is taking advantage of the credit crunch and the strong dollar to buy up strategic resources around the globe — farmland, water, oil and gas.

Is this where some of the bubble profits and bailout money is going? To buy up your land at low cost? I believe so.

Opportunity #6: Countries with a Strong [Popsicle Index](#)

Place matters. As the yields on sovereign bonds approached 0% this year, it was interesting to watch who approached 0% first. Sure enough, it was typically countries with a strong [Popsicle Index](#) combined with a reputation for prudent financial management.

Opportunity #7: Enterprises that own or are excellent at:

- Serving high-Popsicle-Index places
- Precious metals
- Natural resources
- Infrastructure and essential services
- “No waste” new technology/real solutions

Ultimately, equity in enterprises that create real value is the source of much financial wealth. This area will be the greatest opportunity over the next decade. However, it is still early to move into equity. A few exceptions include your own or family companies as well as local and network investment that build up local capacity critical to your strategic needs.

If you have not done so already, start learning about these areas now. However, let the shakeout move through the market before investing. And even then, beware the pump and dump of “green investing” and other potentially fashionable investment trends.

Opportunity #8: Cash and Cash Equivalents in Strong Currencies

Looking for a strong currency in 2008 was like the search for the Holy Grail. If anything, this year proved that there are no strong currencies left. This means that community currencies are looking more and more viable. At the end of the Great Depression, there were more than 3,000 community currencies operating in America. To put that number in perspective, America currently has approximately 3,100 counties and county-equivalents.

The dollar soared, thanks to intervention, a flight to safety, and the rush to pay off dollar debts. For a large part of the year, the dollar was one of the few places to be. This, despite the fact that the St. Louis Federal Reserve reported in November that the aggregate monetary base was growing at an annualized rate of 785% (this is not a typo).

The inter-dependency of the global economy during 2008 seems to say that there is no de-coupling from the U.S. economy and no diversifying from the dollar into other currencies. Other central banks are printing like crazy too. It would appear that the real safety lies in shifting from fiat currencies to precious metals and other tangible things.

That said, we all have expenses and debts in fiat currencies, so we need to hedge. For U.S. citizens, where do we put our cash reserves? With money markets headed toward 0% yields and showing signs of credit problems, insured CD's at strong local banks, credit unions and savings banks still look like a better bet. Paying down debts and lowering overhead continue to be practical ways to lower risk in an uncertain world.

The dollar is headed back down. The question is how slowly or quickly will it fall and how many other currencies will fall with it?

A Word on Philanthropy

If you have money to donate, please shift it into activities that build local food supplies and economic self-sufficiency. There is no better philanthropic opportunity today than local venture capital that creates lasting jobs and skills or the education that supports them.

In Closing

For many years, I was teased about how sentimental a notion the [Popsicle Index](#) was. As our sense of personal safety diminishes, perhaps the possibility of living among individuals who care about and lift up the people around them will come back into fashion.

Avoiding and putting as many degrees of separation between you and institutions who do not behave honorably is not pie-in-the-sky ethics. It is dangerous to share your money and your data with people who cannot be trusted. Surely, the events of 2008 underscore this lesson.



Before making your New Year's resolutions, why not sit down and make a list of who and what will cause your Popsicle Index to go up or down. Estimate their contribution mathematically. Now look at how you invest your time. Are you giving time, money and energy to the people and activities that cause your Popsicle Index to go up? Or to those who cause it to go down? Get ruthless about giving energy only to those who return energy to you.

The way to build a new financial system which is supportive of human capital is to start with each person. *You* are the asset. So let's get your Popsicle Index rising.

My goal for The Solari Report in 2009 is to help you do so.

—Catherine Austin Fitts