US Treasuries=Sub-Prime Debt

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I began writing the Acamar Journal in 2004, warning that debt levels in the US were at record levels and unsustainable. Much of what has happened was predicted in previous issues of the Journal.

I warned of a financial crisis and a coming recession in November 2006, well before the financial crisis first began in July 2007. In June 2008, I highlighted an RBS report which warned that a stock market crash would occur by September, which it duly did. You can view these issues at www.acamaronline.com.

Now that the crisis has happened, what next?

Since this recession has been compared to the Great Depression of the 1930s, let's see what happened to the stock markets then. The Dow Jones peaked in Sept 1929 and then fell 48% by November.

It then rose 50% in a bear market rally off that November bottom. The rally lasted till April 1930.

The rally generated expectations that the worst was over. President Herbert Hoover told a group that had come to ask for a stimulative public works program in June 1930, "Gentlemen you have come sixty days too late. The Depression is over."

He was wrong. By June 1932, the Dow Jones had lost 89% of its value from the 1929 peak and the Depression lasted until 1939 when World War II began.

I cite this example to show how the current rally is generating similar expectations.There is talk of "green shoots" suggesting that the economy will resume growth in the last quarter of 2009 or early 2010. The banks have passed the stress tests conducted by the government, though I think the results are not credible.

The US has now committed to over $ 13 trillion in bailout packages, consumer stimulus, AIG, Freddie Mac and Fannie Mae guarantees, TARP and other programs. These are funds that the US Government will have to *borrow* to try to solve the crisis.

Here's my problem with this. The crisis was caused by excessive debt and leverage. The solution cannot be far more debt. That's like giving a drug addict more drugs to cure him. It won't work, and it will make the eventual problem worse.

The current US deficit is estimated at $ 1.75 trillion, which is almost four times larger than the record $ 485 billion from last year.

My question is: who will fund this?

China has spent the last 20 years accumulating massive foreign exchange reserves due to its massive trade surpluses. But it has only accumulated $ 1.9 trillion over three decades.

Even with oil around $ 60, there are not enough Petro-Dollars available to write this kind of a cheque.

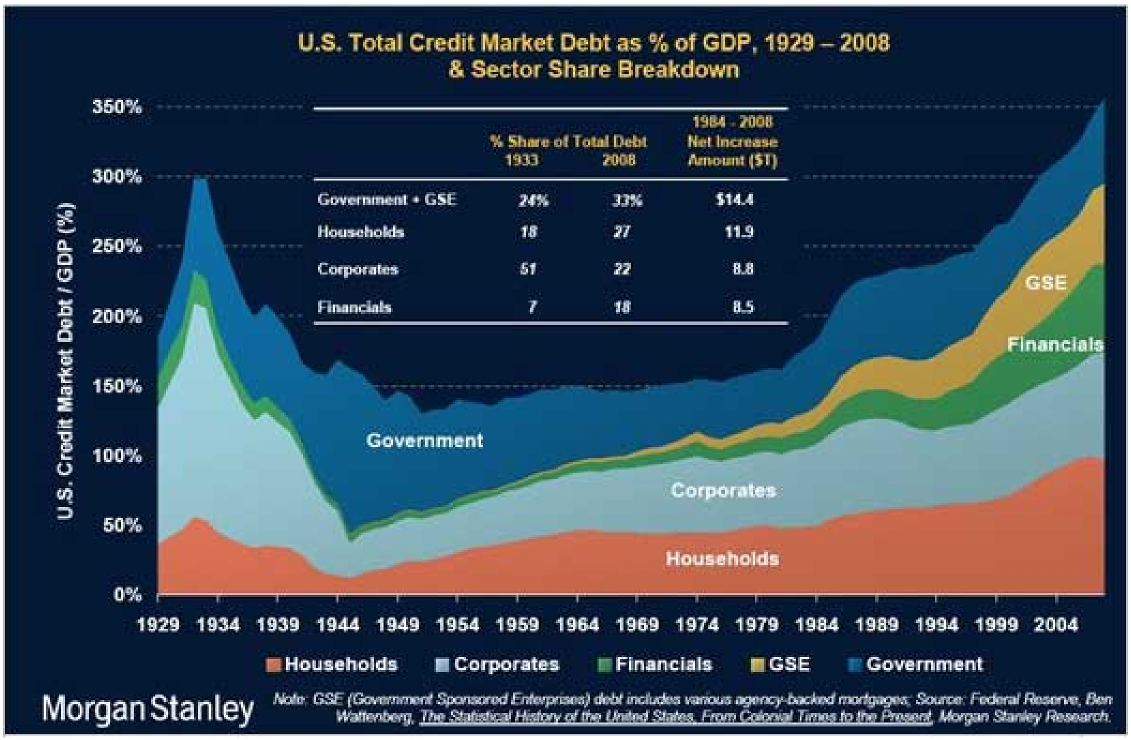
And here's the real shocker:

The head of the Federal Reserve Bank Of Dallas, Robert Fisher, gave a speech in May 2008 (Storms on the Horizon) in which he said that the

US government's **unfunded** liabilities are now **$ 99.2 trillion** (for future Social Security and Medicare obligations). This is in addition to the Federal debt of over $ 11 trillion.

With 111.6 million households in 2006, each household's share of this future debt is $ 888,750. For each family!

Total credit market debt (combined government, corporate and personal debt) is now an all-time record of over 350% of GDP, as of Q4 2008. This does not account for growing federal and state government debt this year nor does it take the unfunded liabilities into account.



The reality is that the US is essentially insolvent.

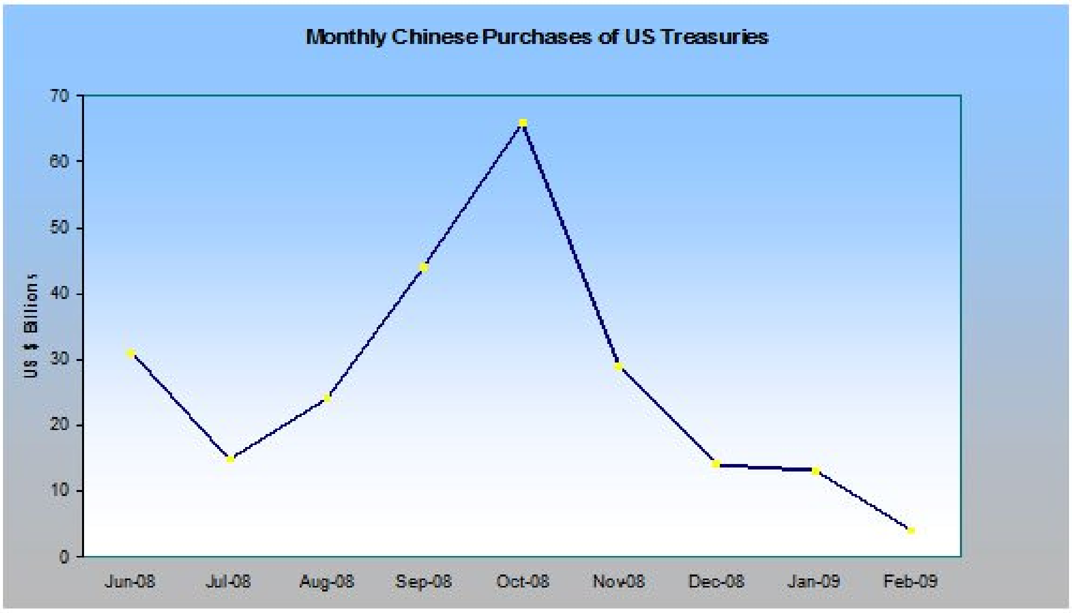
This brings us to Bernie Madoff. The former chairman of Nasdaq ran a $ 50 billion Ponzi scheme. For years he pretended to earn impressive returns for his investors; the reality was he didn't invest anything, he just took money from new investors to pay old investors and lived very well off the difference.

The US government is running a similar investment plan through its issue of new US Treasuries.

The US will never, ever repay its debt. It can't, the numbers are too large. Each year, it rolls over the principal and interest by issuing new bonds, with the debt growing ever larger.

The Fed announced last month that it will begin to "monetise" US debt, which means it will buy US Treasuries and Agency debt, ostensibly to keep interest rates down.

Here's one of the major reasons why:



The Chinese have virtually stopped buying US Debt, have warned the US to ensure that it protects the value of the approximately $ 800 billion it already holds in US debt and have proposed that the US dollar be replaced as the world's reserve currency.

This monetisation strategy, formally known as Quantitative Easing, has engendered sharp criticism from China's People's Central Bank. In a quarterly report, it says "A policy mistake made by some major central bank may bring inflation risks to the whole world. As more and more economies are adopting unconventional monetary policies, such as quantitative easing (QE), major currencies' devaluation risks may rise." It warns of its concerns of a **bond crisis** due to this policy approach.

Japan is a major holder of US bonds. And Japan's opposition party has announced that if it comes to power it will not buy US bonds if they are denominated in US$, only in Yen!

My concern is that the Fed's actions seems to indicate the last stages of a Ponzi scheme going bad, when there are no longer enough new buyers and the desperate con man has to improvise to keep the scheme going.

And another bubble appears to be OTC derivatives. These unregulated contracts were recently valued at $ 684 trillion, which is an unfathomably high number compared to global assets. Derivatives are what Warren Buffett once called "weapons of mass destruction" but he indulged in derivative contracts anyway, leading to Berkshire Hathaway's recent 96% profit drop.

And if this US Treasury or derivatives markets blow up, then the global economy will be decimated as these are the mother of all bubbles.

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http://www.kitco.com/ind/Alimohamed/jun172009.html