



**TEDBITS**  
THE ECONOMIC & FINANCIAL NO SPIN ZONE!  
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Hello, My name is Ty Andros and I would like to show you how to capture the opportunities discussed in my commentary. Click here and I will prepare a complimentary, no obligation custom-tailored set of portfolio recommendations designed to specifically meet your investment needs. [Click Here.](#)

## Foreword

For greater insight into our publication, have a look at the [Overview of Tedbits](#). It helps current and potential subscribers understand our mission in serving you. It also gives a broad description of what's unfolding globally and what you can expect from Tedbits as a regular reader.

## Fingers of Instability, Part XIV

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**Special Report: Gold is Money, by Paul Mylchreest**

### Introduction

The "fingers of Instability" series will be wrapped up next week (in the months and years ahead we will bring you short vignettes). It's been a fun and enjoyable mental exercise but it has now unfolded pretty much as outlined since it began. It is prelude to the next chapter in the unfolding demise of the G7 and its financial and monetary systems. But it has a long way to run (several decades in my estimation) and the opportunities are generational in scope. Wealth will shift from one group to another and change the face of the Globe.

"Fingers of Instability" will always be with us as good fundamentals combine with fire hoses of hot money in specific investment sectors to create rolling bubbles which then implode because of irrational exuberance. It will always be so until the G7 asset-backed economies and the "something for nothing" social trends of the developed world bring them to their demise and end the empire. Of course, Tedbits will be there to read the tea leaves and show you the signposts to the opportunities to embrace and pitfalls to avoid as they emerge.

I am almost giddy at the tremendous opportunities which lay directly in front of us as astute and informed investors. Massive new investment opportunities are in their infancy. After years of EXTREMELY low volatility, the global economy is "ready to rumble" and volatility is set to expand at a pace which will boggle the mind. The NEW investing dominoes has just begun and you must position yourselves to catch them and turn them into opportunities as the fall towards your portfolios. Volatility is set to rise to levels that will be equally extreme. Do not be frightened, "Volatility is opportunity" for the prepared investor and as the pitfalls arise in the unprepared it presents investment opportunities to YOU! This week we will have three fingers and a special link to a must read report by Paul Mylchreest entitled "Gold is Money."

**Moral Hazard, Herding Cats and Shades of Japan!**

This Finger has the laws of unintended consequences written large. It harkens back to Japan and the consequences of its asset-backed economy running off the rails. A week or two ago Governor of California Arnold Schwarzenegger saw the problem and as is his style “tackled” it. Someone REALLY explained to him what was in store for the California real estate market and, by extension, its economy by the real estates bubble and sub-prime debacles. Seeing his political demise painted into the picture he sprang into action. Arnold is an interesting character to me, a conservative at heart but a realist as well. To thrive politically ONE MUST cater to the ‘something for nothing’ and socialist elements in the state. He has done so with a vengeance.

He called the 4 biggest mortgage lenders in the state into his office and hammered out a plan to soften “Arm”ageddon’s impact by getting the lenders to agree to postpone the “interest rate” resets in the coming year. He was driven to this because those who service the loans were not helping troubled borrowers towards solutions. They had no incentive to do so, they made more money letting the homeowner GO DOWN, and also because they no longer held the mortgages. They had been packaged up into those testaments to WALL STREET and banking greed and QUANTITATIVE” stupidities known as CDO’s, CMO’s, MBS’s (collateralized debt, mortgage obligations, mortgage backed securities - see Roach Motels in Tedbits archives at [www.traderview.com](http://www.traderview.com)). And because handling these problems one at time would be an impossible task, as there are 10’s of thousands of homeowners who need this done RIGHT NOW, the details of one-off solutions would take years to work through and the financial authorities only have a short time to do so.

Refinancing is not an option to these borrowers as they are ALL under water (owe more than the asset they hold is worth) and no lender is going to take a bombshell (ready to blow up) off somebody else’s balance sheet and move it onto theirs. Complicating the picture is the fact that the lenders are scattered around the globe in the securitized investments they have purchased from the financial wizards at the big investment and money center banks. So in an effort to postpone (not avoid) the firecrackers exploding he got them, in general, to agree to freeze the resets.

It will never work. It only postpones the inevitable as the criteria to qualify are perverse in nature and try to only save the borrowers if they are in trouble. Thereby pushing everyone, including borrowers not in trouble, to move toward that “definition”. Under the terms being outlined, lower interest rates would be frozen for:

- Those who cannot afford higher rates but might avoid default if they keep their current rates (these people are likely to include those who have missed 1 or 2 payments)
- Those who would be unable to keep up even if their rates were frozen
- The plan would exclude those capable of making payments at higher rates

It appears that the hurdle of missing a couple payments will trigger the ability to move into the program and freeze the rates. Setting up a great big game of chicken between the lenders, those who service the loans, government bureaucrats, er bureaucrats and the borrowers. If you are a borrower in this group who gets left behind in this SOLUTION you only have the incentive to default in order to get the relief. Can you say “MORAL HAZARD”?

There is also the issue of “HERDING” cats as the homeowners are scattered everywhere, and the lenders are scattered around the world holding the “securities” in their investment portfolios. These aren’t lenders in the traditional sense, they are investors and they bought what they believed were passive income streams serviced and maintained by the issuing investment or money center bank. What do you do? Call them up and say you have a choice, either take less return on your investment or face the task of working through the foreclosure process and see what you have left? Have you ever tried to herd cats? This is the definition of it!

Treasury secretary Hank Paulson who always likes any solution which saves his buddies at the banks and in the financial community has now embraced this idea and is pushing it on a nationwide basis. Knowing the dire

conditions the nation's banks and investment houses are in (nothing left on the balance sheets) Paulson and FDIC chairman Sheila Bair met this week with reps from: JP Morgan Chase, Washington mutual, Wells Fargo, and Citigroup to hatch the new plans. As we go to press Hammer-ing Hank is announcing the national version of the Governors plan:

WASHINGTON -- The Treasury Department is "aggressively pursuing a comprehensive plan" to aid as many homeowners as possible, Treasury Secretary Henry Paulson said Monday, offering fresh details about a nearly complete government and private-sector effort to stem a huge number of foreclosures next year.

"We are leading the industry to develop a systemic means of efficiently moving able borrowers into sustainable mortgages," Mr. Paulson said in a speech to the Office of Thrift Supervision's housing forum, according to prepared remarks....

... "As volume increases, we will need an aggressive, systematic approach to fast-track able borrowers into a refinance or mortgage modification," Mr. Paulson said. "This third element does not, and will not, include spending taxpayer money on funding or subsidies for industry participants or homeowners."

Mr. Paulson said Treasury was focusing on a large group of borrowers who can afford low introductory rates on loans but could not afford higher monthly payments once these loans reset higher. Roughly 1.5 million sub-prime ARM's are expected to reset higher in 2008. A record number of homeowners have already entered the foreclosure process this year.

Not to be left out of any vote-buying opportunity and secure stable 2008 reelection conditions, Public Servants Charles Schumer and Barney Frank expressed reservations about leaving anybody out of the BAILOUT. Presidential candidate Hillary Clinton is proposing a 90 day freeze on foreclosures, this would make the asset-backed securities even more worthless. I hope you all have stock in "printing press" makers? LOL. You can count on them printing the money, as we have seen it for the last several decades and you will see it here. GOT GOLD?

### **Ghosts of Christmas "Future"**

Dear Reader, please understand that the financial sectors of the G7 are the main locomotive of growth in these countries as they inflate the assets. The financial sectors and the government are primarily the only things growing. Investment and money center bank's primary revenue streams are gone for now. Bond issuance has slowed to a trickle, securitization revenues are gone, credit card and receivables are deteriorating in a rapid manner. Earnings for the most recent quarter were down over 5%, year over year showing the devastating blow to the profits of the financial sector, and they are going lower. You can count on it. Sarbanes Oxley looms as yearly statements are on the near horizon and will force bloodbath recognition of current holdings collapse in value.

Personal incomes are stagnant to negative if properly accounted for with REAL inflation. The consumer has gone into debt, extracted money through "mortgage equity" withdrawals and sold their investments to maintain their lifestyles after inflation for decades. But the consumer shows no signs of deviating from decades of behavior they have been taught and have learned well.

The only thing underpinning demand is asset inflation, allowing equity withdrawal and the ability to borrow money easily and cheaply. But, as the balance sheets of the lenders are vaporizing it creates a new problem. How can you lend if you don't have the fractional reserves required to do so? Goldman Sachs chief economist, Jan Hatzius (this guy is good, maybe better than Bill Dudley), is predicting that current balance sheet issues will prevent over 2 trillion dollars of new lending to be done over the next year. Two trillion dollars of demand that is not going to hit the streets to power the "consumer" economy of the US. Financing for new business

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and capital investment are set to fall victims to this as well. In a 13 trillion dollar economy where consumers account for over 70% of GDP do you think this could be a problem?

In Japan, when their asset backed economy collapsed in 1989-90, the banks did not let bad debt die, they kept lending to ZOMBIE companies in an effort to avoid the write-offs and robbed themselves of the ability to create new lending to qualified borrowers. Growth promptly went negative where it still is today. They tried to postpone the reckoning day of the previous bad lending and held the poison loans on their balance sheets and ended up in a deflationary depression which has endured to this day. They hobbled the bank's ability to make new lending to qualified borrowers, only now are their banks finally able to really create new lending which creates new profits for themselves. Can you say ZOMBIE homeowners? Walking financially dead people? LOL. Bernanke and Co. know this and will do everything in their power to stop new lending from disappearing, it is imperative to do so or face a deflationary blood bath. Instead, they will ignite an inflationary bloodbath.

The financial and banking industry lending underpins the G7 economies and nothing else. Manufacturing has been tortured to the point where wealth creation now occurs in other places outside the G7. The de-industrialization has now robbed the developed world of the other wealth-creating sections of their economies. The collapse of the paper economy and its re-flation is set to be the focus of the next several years.

### **Shocking News!**

Last week E-trade was recapitalized by Citadel, a Chicago hedge fund with 2.5 Billion dollars. That IS NOT the shocking news. E-Trade was in trouble because the value of the securities they held as regulatory reserves had plummeted in value and no longer met SEC (Securities Exchange commission) requirements. When they sold the securities it created a mark to market valuation for their 3.1 billion dollar portfolio of asset-backed securities. They received 11 to 27 cents on the dollar!!!! Using a mark to market value of \$.27 cents on other sub-prime holdings and asset-backed securities would cost Merrill Lynch another \$9 billion dollars in losses and Citigroup another \$26 billion dollars. As we surmised last week: Now we know why Citigroup paid junk rates for a cash injection. Simply put, their reserves are toast and they are dead men walking until they can sell enough new equity to recapitalize themselves. They will get the money, but it's way too early to buy them!

But the big news is that this moves Tier 3 assets (see Marking to Myths in Tedbits archives at [www.TraderView.com](http://www.TraderView.com)) to Tier 1. To see the implications of this let's take a look at an excerpt/table from a recent missive by John Mauldin (John can be reached at [john@frontlinethoughts.com](mailto:john@frontlinethoughts.com)) outlining Tier 3 assets as a percentage of reserves as some major money center and investment banks:

#### **Citigroup**

Equity base: \$128 billion

Level three assets: \$134.8 billion

Level 3 to equity ratio: 105%

#### **Goldman Sachs**

Equity base: \$39 billion

Level 3 assets: \$72 billion

Level 3 to equity ratio: 185%

#### **Morgan Stanley**

Equity base: \$35 billion

Level three assets: \$88 billion

Level 3 to equity ratio: 251%

#### **Bear Stearns**

Equity base: \$13 billion

Level three assets: \$20 billion

Level 3 to equity ratio: 154%

#### **Lehman Brothers**

Equity base: \$22 billion

Level three assets: \$35 billion

Level 3 to equity ratio: 159%

#### **Merrill Lynch**

Equity base: \$42 billion

Level 3 assets: \$35 billion

Level 3 to equity ratio: 38%

Based upon the marked-to-market price of the E-Trade liquidation these players are now BANKRUPT. And Sarbanes Oxley looms dead ahead. Will they survive? Of course, they are powerful money making machines and franchises, but they will go through convulsions en route to survival and any customers who do not have their assets properly segregated from theirs will lose parts of their investments in the reorganization.

### **Gold is Money and Nothing Else - by Paul Mylchreest**

Here is a link to the finest gold report on the planet titled "Gold is Money and Nothing Else" by Paul Mylchreest of Redburn partners, an institutional brokerage in London. Paul even references some of my work on the "Crack up Boom" that is unfolding before our very eyes. This is must read material. Yes, I do believe in the K winter he speaks of, but it is still a long way off, as this will be a global Kondratieff cycle not a national one, and first I believe we will have the "Crack up Boom". This is must reading for informed investors and you can access it from this link: [Gold is Money and Nothing Else](#).

In conclusion: There is only one solution to the problems I have outlined and it is: **They will print the money!** It is the only course they can take and we know they will do so as that is what they have been doing for over 5 decades and the party's not over yet. Some people call me an inflationist, others call me a doom and gloomer. I am neither, I am a realist. There will be deflation in some sectors of the world economy and inflation in others, it is not one or the other, it is BOTH! In order to thrive you must embrace reality and position yourself to capitalize on it. If you don't you will be consumed by it. The opportunities are enormous, equal too or bigger than anytime in history!!

Paper is deflating and to re-inflate it will take exponentially more of it now, just as it did in the last deflationary G7 episode of 2001-2002. Elections loom in the US and public servants will agree to and do anything to secure their reelections. In fact, they will insist upon it. You can see central banks throughout the G7 printing money: Over a trillion Dollars, Euros, Pounds, Yen, and Canadian Dollars since the initial deflationary salvo in July and August. Why do you think commodities and precious metals impaled higher against all currencies since August and the dollar broke to multi-generational lows. It is set to continue ad infinitum. So the financial industry, over inflated PAPER assets and investments are DEFLATING! Anything but government bonds are in freefall and the markets they are in are frozen. These are the "most important and powerful" constituents of the G7 economies so we know they will be rescued at any cost!

Conversely, inflation is rampant in things that can't be printed as all the money creation is creating the definition of inflation: Too much money chasing too few goods. Everybody has money, its everywhere; it is why investment returns are being pancaked. It's why thirty-year bonds return 4.5% in a world where REAL inflation is approximately 7% or more, there is too much money chasing them. It is why there is over 3 trillion dollars sitting in money market funds of one sort or another - in 2002 that number was 2 trillion, it's up over 50% in 5 years. You can rest assured that all measures of paper investments are up approximately an equal amount since that time. It is why we have CDO's, CMO's, and leveraged products, the demand for them is enormous in a world awash in cash, it is the fire hoses of money seeking ALPHA, aka profits and returns.

Do not think you can run from one piece of paper into another no matter how high the quality. For example; from Dollars into Euros or Pounds. That safety is an illusion as the financial industries in those countries are also in dire straights and their balance sheets are toast as well. The financial authorities, industry and public servants in those places will do what they are doing in the US to secure their futures as well. **THEY WILL PRINT THE MONEY!** You can expect REAL interest rates to go further negative, and nominal interest rates to go to 1% in order to facilitate the transfer the wealth of depositors to the balance sheets of the banks as they take the spread (borrow at 1% from their depositors and lend it at 6 to 30% "credit cards") away from the public they fleece and transfer it to the masters they serve (financial and banking industry and politicians). It is exactly what Greenspan did to fix the balance sheets of the banks in 2001-2006, only this time it will be exponentially more. **They will do everything necessary to reflate the paper and save their financial systems and asset backed economies!**

In order to thrive you must take these things into account when investing, as the G7 Public servants, Central banks and financial authorities work to underpin their paper castles and futures. The money you hold no longer performs the “functions of money” as a store of value, medium of exchange and as a means to transfer wealth into the future. And its ability to do so in the future will increasingly be impaired. Don't despair; *These are enormous opportunities!* Recognize this fact and turn your future from bleak to bright! You must avoid their follies and step into HARD assets and units of production in order to “short circuit” their confiscation of your wealth through “fiat currency and credit” creation. I will bring you the tools and thoughts to protect your wealth and grow it in the emerging “CRACK UP BOOM”, as it is in its infancy.

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