Foreword

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Introduction

This is the beginning of the third edition of the "Fingers of Instability" series. The first edition was in the winter/spring of 2007, the second in the winter/spring of 2008, and now the third in the spring of 2009. The Fingers of Instability are ANALOGOUS to nature as seen in a sand pile. In August 2006, John Mauldin (John@frontlinethoughts.com) commented on a study of sand piles by three physicists who created a sand pile with a computer program that dropped one grain of sand on top of another to study critical states: NON-EQUILIBRIUM systems and uncertainty. When I read this, I immediately realized the debt bubbles throughout the world were an analogy to these studies and explained a great deal about the last three decades of debt creation. It reinforced my observations about Ponzi finance and asset-backed economies. It explained quite nicely what was transpiring and what to expect at some point in relation to PILES of DEBT and the FAKE prosperity and growth caused by EASY MONEY and runaway credit expansion.

Let's examine some of John's comments from that letter:

In the study they learned some interesting things, such as: What is the typical size of an avalanche? After a huge number of tests with millions of grains of sand, they found out that there is no typical number. "Some involved a single grain; others, ten, a hundred or a thousand. Still others were pile-wide cataclysms involving millions that brought nearly the whole mountain down. At any time, literally anything, it seemed, might be just about to occur."

It was indeed completely chaotic in its unpredictability. Now let's read an an exceprt slowly. It is important since it creates a mental image that may help us understand the organization of the financial markets and the world economy.

> "To find out why [such unpredictability] should show up in their sand pile game, Bak and colleagues next played a trick with their computer. Imagine peering down on the pile from above, and coloring it in according to its steepness. Where it is relatively flat and stable, color it green; where steep and, in avalanche terms, 'ready to go,' color it red. What do you see? They found that at the outset the pile looked mostly green, but that, as the pile grew, the green became infiltrated with ever more red. With more grains, the scattering of red danger spots grew until a dense skeleton of instability ran through the pile. Here then was a clue to its peculiar behavior: a grain falling on a red spot can, by domino-like action, cause sliding at other nearby red spots. If the red network was sparse, and all trouble spots were well isolated one from the other, then a single grain could have only limited repercussions. But when the red spots come to riddle the pile, the consequences of the next grain become fiendishly unpredictable. It might trigger only a few tumblings, or it might instead set off a cataclysmic chain reaction involving millions. The sand pile seemed to have configured itself into a hypersensitive and peculiarly unstable condition in which the next falling grain could trigger a response of any size whatsoever.
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> Something only a math nerd could love? Scientists refer to this as a critical state. The term critical state can mean the point at which water would go to ice or steam, or the moment that critical mass induces a nuclear reaction, etc. It is the point at which something triggers a change in the basic nature or character of the object or group. Thus, (and very casually for all you physicists) we refer to something being in a critical state (or the term critical mass) when there is the opportunity for significant change
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> But to physicists, [the critical state] has always been seen as a kind of theoretical freak and sideshow, a devilishly unstable and unusual condition that arises only under the most exceptional circumstances [in highly controlled experiments]... In the sand pile game, however, a critical state seemed to arise naturally through the mindless sprinkling of grains."

Thank you, John, for this description of the critical state we now find in our economies and financial systems. When you think of grains of sand now, think of FIAT currencies and runaway debt creation. We suspected, but little did we know that the final morsel of currency and debt creation which could be piled on before creating a collapse of the whole pile was soon to happen. Think of all the illustrations this letter has shown you of mounds of debt over the last several years and NOW YOU KNOW what you are looking down upon, at which point a collapse of the whole pile of funny money and credit would be cataclysmic and create FLOCKS of BLACK SWANS!

Of course this hypersensitive and peculiarly unstable condition is a perfect analogy to the G7 financial systems TODAY. Additionally, the financial and central banking authorities are piling on infinite new amounts of SAND (i.e., printed money and credit) to try to stabilize the financial system and prop up FINANCIAL assets to their previous heights. And it will FAIL. It is now a game of dominoes until the final demise of these countries' financial systems unfold.

Ludwig Von Mises also described the critical state at which a financial collapse can no longer be avoided:

> "There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as a result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved."

Look around the G7 and weep. The only course being pursued is ADDITIONAL credit expansion, unfunded consumption and endless, mindless expansion of government. In NO DEVELOPED nation other than the BRICS (Brazil, Russia, India and China) are the policies of growth being implemented. NOTHING is being done to expand income growth, only attacks upon it are being implemented. As incomes collapse, the only source of FUNDS will be the printing press. Clueless public servants, Keynesian economists (the government is the solution) and the central banks have NO IDEA how to promote growth except through inflation (tax on your money while it sits in the bank).

Now we know the destination; only the path and timetable are unknown. "Fingers of Instability" are the paths to the final demise of the G7 and developed world financial systems. They, in combination with each other, will ultimately bring down the financial system as public servants, crony capitalists and banksters flail about trying to stop their fiat currency and credit house of cards from crumbling like the sand piles.

The piles of debt just keep on growing, piling up more and more, and there is not enough INCOME to service them. Since last summer, the United States alone has printed, borrowed or guaranteed almost $15 Trillion ($15 Million, Million) and written off virtually nothing of the unpayable obligations. My "Fingers of Instability" series will outline the absurd lengths to which public servants and crony capitalists will go, to AVOID spaying their bills which are now coming due, and give you a clear framework of the unfolding fingers as they lead to the final collapse.

There is always a bright side to life and reality, and in this case, it is the enormous opportunities which will be created over the next several years. Volatility will be immense in all markets as poorly informed investors ping-pong all over the place while the mainstream media and public servants throw illusion after illusion at them to deflect blame from their disastrous actions and policies. "Volatility is Opportunity", and we will have it in spades as they try to PRICE in the unfolding maelstrom into every market you can conceive of. Absolute return alternative investments which have the potential to make money in rising and falling markets using professional managers are part of the solution. (This is what I do.)

The G7 is now in sight of the FINAL cataclysm which will cause the public to WAKE UP, realize government is the problem, not the solution, and demand policies which lead to their previous years of wealth creation. So now let's get on with outlining these emerging NEW "fingers of instability."

The Crumbling "Rule of Law"

One of the greatest assets the United States and much of the G7 has had is the legal system which allows for private contracts that are UPHELD in the courts. As a lender, borrower or investor, you could expect agreements to be protected unless they are contrary to existing laws. NO MORE. The Obama Administration removes the security from secured bondholders and REWARDS unsecured lenders who are POLITICALLY connected. The CRAMDOWN legislation for mortgage modification was thankfully defeated in the senate, which would have allowed BANKRUPTCY court judges to rewrite mortgage balances and interest rates. The sponsors of this monstrosity were trying to up-end the Rule of Law and Contracts and substitute the whims of the trial judge. INSANE.

No sooner had the capital markets heaved a sigh of relief than Chrysler declared bankruptcy and the OBAMA Administration CAR CZAR stripped "secured lenders" of their legal rights. The Administration then elevated the claims of the UAW (United Auto Workers) and the government above that of secured lenders, awarding themselves almost 90% of the company and sweeping small crumbs to the actual owners of the senior claims.

Take a look at what Porter Stansberry (www.stansberryresearch.com) had to say:

> "Well, let's pretend you're GM's bondholders and the $200 I owe you is the debt in question. The government has come in and said, 'Look, we know Porter owes you $200... but for the good of the country... we want you to accept $20 instead. We'll take $100 for helping straighten out the situation. And we'll give $80 to the union.' Would you accept those terms?" "No way!"
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> "It never ceases to amaze me how generous people like to be with other people's money. Or how quickly people with no skin in the game toss around words like "fair" and "greedy." I don't care what you think of OBAMA!... What he said about Chrysler's secured bondholders was not only slanderous... it was the kind of political rhetoric that will destroy America's capital markets. You cannot vilify creditors – or else there will be no capital available to lend.
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> While many stakeholders made sacrifices and worked constructively, I have to tell you some did not. In particular, a group of investment firms and hedge funds decided to hold out for the prospect of an unjustified taxpayer-funded bailout. They were hoping that everybody else would make sacrifices, and they would have to make none. Some demanded twice the return that other lenders were getting.
>
> I don't stand with them. I stand with Chrysler's employees and their families and communities. I stand with Chrysler's management, its dealers, and its suppliers. I stand with the millions of Americans who own and want to buy Chrysler cars. I don't stand with those who held out when everybody else is making sacrifices. And that's why I'm supporting Chrysler's plans to use our bankruptcy laws to clear away its remaining obligations so the company can get back on its feet and onto a path of success.

> OBAMA's remarks are demonstrably false. A group of 20 creditors, the self-dubbed "non-TARP Chrysler lenders," refused the government's lowball offer for their secured bonds. Through a press release, the "non-TARP Chrysler lenders" said they offered to take a 40% haircut on their bonds, even though they were senior creditors and lenders lower down the priority chain were "being given recoveries of up to 50% or more and being allowed to take out billions of dollars."
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> And Obama's bit on standing "with Chrysler's employees and their families and communities" is nonsense. Who do you think invests in these hedge funds that refused the deal? Pension funds, teachers' unions, and school endowments to name a few... Should these "communities" be punished for the sake of Chrysler's employees... many of whom are union employees who stubbornly refused to take pay cuts until it was too late?
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> That's the big problem with socialism: Instead of allowing the market to decide who wins and who loses, you have politicians picking. Just imagine what's going to happen to the lending decisions of the banks that have taken TARP money... It's going to be a debacle. Welcome to Amerika.

I couldn't have said it better myself. Bravo, Porter. Now let's look at a notable and quotable from the www.wsj.com and http://blog.getliberty.org:

> In the Chrysler deal, the [United Auto Workers] were unsecured creditors and the Chrysler bondholders were secured creditors. The bondholders received 28% of the value of their $6.9 billion in bonds in cash; the Union will receive stock worth approximately $4.2 billion, and a note for an additional $4.58 billion, which represents 82% of the value of their claim. Either the government negotiators have dyslexia and have made a terrible mistake in their paperwork, or this is political payoff writ large. Is this not the equivalent of financial waterboarding? And thus we enter a brazen new era of government, when the White House is openly complicit in the theft of, as a matter of fact is directing, the looting of private property from investors. Welcome to the Rule of Man, or as the President calls it, change we can believe in!

The key is "Rule of Man", kind of like dictatorships. Now let's take a look at another notable and quotable written by Slate (a progressive website, i.e., liberal) on the subject of leaning on TARP recipients from today's www.wsj.com :

> "The rationale for the [auto] bailout was that a bankruptcy would kill car sales, so the government had to step in and negotiate all the bankruptcy-style concessions without actually having a bankruptcy. But Obama was unwilling to get the U.A.W. to make the bankruptcy-style concessions that would be necessary to have a viable Chrysler. And Chrysler wound up in bankruptcy anyway. Prediction: It will either fail or suck up continuing annual taxpayer subsidies in the billions. In the process it will keep flooding the market with cars and make it harder to save GM and Ford. It didn't have to be that way. . .
>
> And there is something creepy in the way many analysts simply accept that, of course, banks receiving TARP funds must now do Obama's bidding on unrelated matters like the

> Chrysler bankruptcy. This is a long way from JFK using his presidential power to face down a steel price hike -- a long way toward an unpleasant economic model that creates at least the potential for political thuggery that preserves capitalism's inequalities without its freedoms and efficiencies"

This is set to be repeated in the unfolding bankruptcy of General Motors, creating TWO new government controlled entities along the lines of Fannie Mae and Freddie Mac, AIG, Citigroup, etc. Why would anyone invest in America or any business involved with the government if the agreements are not worth the paper they are written on, and the private sector just becomes PAWNS of the public servants and their CRONY capitalist PARTNERS? Just like many who invested in the other GOVERNMENT controlled entities, they are now finding out the contracts are written in "DISAPPEARING INK"! This behavior can be seen in Venezuela; now we know why the chief executive so warmly embraced Hugo Chavez. Capitalism is on its DEATHBED in the US and G7.

The Clock is "TIC" ing on the US Dollar and Bond Markets!

Just last week, the $3.5 Trillion 2010 budget was passed by the US Congress, setting in stone the coming nationalization of the HEALTHCARE industry and CAP and trade energy legislation. Together they represent TRILLIONS of dollars of new levies on the private sector. The new administration, in conjunction with the public servants in Congress, have now FINISHED expanding the government by more than 95% in less than 10 months after being sworn in January 2009. The US now needs to raise $3.25 Trillion this fiscal year to cover its budget deficit and to ROLL past obligations coming due. This amounts to a staggering $21.95 BILLION PER DAY until the end of the fiscal year in October. Can you say ABSURD, INSANITY?

And to think, this DOES NOT include any private, state or municipal sector debt requirements. This level of borrowing virtually sucks the wind out of the private sector, misallocating precious capital needed by the private sector and entrepreneurs to rebuild the INCOME production in the United States and to create jobs. It now takes an astounding $6 of new DEBT to generate $1 of GDP (Gross Domestic Product). The new $3.5 Trillion deficit for 2010 is funded half from TAXES and 49% from NEW BORROWING.

The Treasury International Capital Report was released for February, and for the second month in a row, was negative to the tune of $97 Billion, marking the continued retreat of capital from US shores. As outlined above, this RETREAT from capital inflows signals the eventual WATERLOO for the US government; funding requirements will need to be shouldered increasingly by domestic savers and what else: "the printing press", aka Quantitative Easing. US savers are offered virtually NO return and immense capital risk buying the long end. Limitless money printing looms as you can expect the Fed to announce additional treasury purchases above the $300 Billion already announced. When the fed meeting ended without additional purchases being announced, the long end took it on the nose.

Helicopter Ben was on Capitol Hill today and pointed to the long end of the treasury markets as a signal that inflation was low and investor's appetites for US debt high, as illustrated by the lofty prices. NO, it's the feds and primary dealer purchases (primary dealers are choking on long-term inventory) that are holding it up and the longer they do, the farther away lenders will stay, waiting to be paid for the risks they entail.

The US deficit is set to RISE by $8.5 TRILLION over the next three years. That includes new revenues from CAP and TRADE TAX on the domestic oil industry, and projected growth rates which are fantasies in the extremis from the chief executive who is bent on destruction of the private sector to pay for his new INVESTMENTS. These are known as PERMANENT government expansion and runaway new entitlements. The FISCAL and MORALLY bankrupt Administration and Congress will only be stopped by one thing: A BUYER'S STRIKE. And one is emerging like a freight train coming straight at them; you can look for it to arrive someday soon.

In Conclusion: The dominoes continue to fall; do not expect them to stop anytime soon. The final destination is completely in view: the complete destruction of the G7 monetary and financial systems. The public servants and central banks may slow it down or postpone it with GOVERNMENT actions, but escape from this predicament is IMPOSSIBLE. As Von Mises stated: There is no escape from a credit induced bubble and the public servants REFUSE to embrace any solution that does not result in going back to where we came from.

Albert Einstein once said:

> "The problems we face today cannot be solved by the minds that created them."

Of course, the financial teams in DC, ALL from the Clinton administration, created the new laws and policies which have lead to this crisis. And of course, the dinosaurs in Congress NEVER change as incumbency is almost undefeatable; and if they ever are overcome, the entrenched POLS never allow CHANGE to TAKE ROOT. Now we can also see the Chicago machine politicians at work, making us understand why the last two governors have been deposed or jailed for corruption. Now they're taking DC to a new level.

Lots of talk about GREEN SHOOTS at CNBS and out of Washington and the Federal Reserve. How absurd. We are afloat on a sea of cash created OUT OF THIN AIR. This bounce is your chance to unload at higher prices before the next IMPLOSION caused by RECKLESS government policies as they hit the REAL ECONOMY, where private, REAL businesses have to produce more than they consume, also known as turn a PROFIT or go broke. Something you can never expect again from the likes of Fannie, Freddie, AIG, Citigroup, Chrysler and soon GM. A permanent drain on taxpayers, TO SAVE them. Unfortunately, it will be the public who pays by shouldering the costs of their follies through taxes and crushing NEW debt on themselves and their children.

There is only one good aspect to this and that is this will cause unimagined VOLATILITY in all markets and "Volatility is Opportunity" for the prepared investor. Currencies, commodities, stocks, interest rates, precious metals are going to ZOOM: "Up and Down" as this debacle of idiocy unfolds. Learn how to make money in two way markets and seek absolute return managers which can do so (P.S. This is what I do).

A wonderful SPECIAL ALERT overview of the US stock markets, both "short and long" term has been penned by my good friend Garrett Jones – you can access it here. I urge you to read it. Stocks could rally into the summer, but could top as soon as RIGHT now. The market is as overbought as anytime since the top in October 2007, and the banks are as insolvent as ever. The stress tests are headline pap and nothing more, trillions of dollars of losses are yet to be REALIZED and $60 plus billion in new capital will not cover them. Just wait until hope turns to FEAR, then things will really get interesting.

But as previous editions of this newsletter have expressed, this market is headed lower in earnings, fundamentals and technically. The only thing that could hold it up is the unbelievable amount of debasement now and in the future that could cause stocks to rise because of the LOWER PURCHASING POWER of the currency in which they are denominated. As quantitative easing unfolds, literally trillions of Dollars, UK Pounds, Swiss Francs and Japanese Yen are being released into the markets must have SOMEWHERE to go for shelter from the MASSIVE debasement.

P.S: My baby boy was born this morning weighing 7 pounds and 11 ounces. With all the hope that entails, these problems we face in the G7 will lead to a brighter day. I love you all and may God bless you. Don't miss the next edition of Tedbits and the 2009 "Fingers of Instability" series.

Tedbits is authored by Theodore "Ty" Andros, and is registered with TraderView, a registered CTA (Commodity Trading Advisor) and Global Asset Advisors (Introducing Broker). TraderView is a managed futures and alternative investment boutique. Mr. Andros began his commodity career in the early 1980's and became a managed futures specialist beginning in 1985. Mr. Andros' duties include marketing, sales, and portfolio selection and monitoring, customer relations and all aspects required in building a successful managed futures and alternative investment brokerage service. Mr. Andros attended the University of San Diego, and the University of Miami, majoring in Marketing, Economics and Business Administration. He began his career as a broker in 1983, and has worked his way to the creation of TraderView. Mr. Andros is active in Economic analysis and brings this information and analysis to his clients on a regular basis, creating investment portfolios designed to capture these unfolding opportunities as the emerge. Ty prides himself on his personal preparation for the markets as they unfold and his ability to take this information and build professionally managed portfolios and developing a loyal clientele.

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