The Investor's Mind: Anticipating Trends through the Lens of History

These are excerpts from the monthly emails we sent subscribers informing them of our most recent posts.

February 2008: The Long & the Short of It

If you are not aware of the *90% collapse* in trading in the Home Equity Backed Securities market, which has occurred *since November*, or the fact that in January the $13 trillion Credit Default Derivatives market saw trading slow to less than a tenth of the pace it was in a year ago, then you owe it to the safety of anyone depending on your insights to view the Weekly page of our site.

In this month's newsletter, The Long and Short of It, readers will learn why the seismic tremors in our financial system of late are no surprise to those who have studied historic junctures. For example, consider the fact that the Financial Stability Forum was "randomly" established by the world's central banks in October of 1998, which coincided with the final throes of Long Term Capital Management's demise. Or, if you prefer:

- What global developments today parallel Keynes discussion, regarding the bancor (the first attempt for a world currency), with world leaders at Bretton Woods, New Hampshire in 1945?
- What took place between the Saudi's and the US Treasury in 1974 [addressed in Islam versus Israel] that explains why oil has gone $1.39 a barrel in January of 1971 to topping $100 a barrel for the second time this year in February of 2008?
- Why don't most investors in the US equity markets realize that they've lost more than $2.5 trillion since the middle of October?
- Which collection of small, illiquid markets appear to be supporting the hyperinflation view, while two substantially larger markets show tops in November and January?

January 2008: Islam versus Israel

For years, we've watched the ongoing conflict between the Jews and "Palestinians." Yet the truth is that the conflict is much broader. On the "Palestinian" side, the media covers Gaza, Syria, and Lebanon, and groups such as Hamas, Hezbollah, and Fatah. At the November 2007, Annapolis conference, U.S. Secretary of State, Condoleezza Rice, stated that her goal was "two states, Israel and Palestine, living side by side in security." But in her next sentence, she says she hopes to achieve "a lasting peace between Arabs and Israelis." So the conflict broadens even more. When these same countries and terrorist organizations, who receive U.S. military aid, chant “Death to America,” we begin to see the perplexity of this situation.

In this newsletter, we examine current high-level speeches from both the US and Israel. We will look at everything from Palestinian Arab schoolchildren's textbooks to the 1974 oil negotiations between the US and Saudi Arabia. We pull from more than seven highly recognized figures on the Middle East, Israel, and Islam, viewing recent developments through the history of the Middle East surrounding Israel and even some specific writings from the Quran. After reading this 28-page newsletter you will understand the political power shift that occurred in the 20th century, where things appear to be heading, and why, whether we’re world leaders or common citizens, we need to closely monitor the developments regarding the Jewish state of Israel.

December 2007: The Grinch that Crunched Credit

The world’s financial leaders have not been preparing for holidays-as-usual this year. Consider the following comments:

> “The Federal Reserve announced Wednesday that it was lending $20 billion to banks in the first of four special auctions designed to help alleviate the credit crunch on Wall Street. The Fed said that it received requests for $61.6 billion in loans from 93 bidders – illustrating strong demand by banks that need short-term funds.
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> In a statement Tuesday, the [European Central] bank, which oversees monetary policy among the 13 nations that use the euro, said it allocated €348.6 billion ($501.74 billion) in its main refinancing operation, a process that also boasts a duration of 16 days, meaning it will not mature until Jan. 4.”

The most important thing for every investor, manager, trader, and advisor to understand is that the credit contraction started in July. The mood, regarding risk, in the upper levels of the financial markets has since changed dramatically. Across the globe, individuals are no longer willing to swallow high-risk, highly-leveraged debt instruments. They no longer believe these instruments are worthy of the insane triple-A ratings they were given. This is already having an impact on everything from bonds to commodities to currencies to equity markets.

November 2007: Untold Stories – Socialism’s Long Bull Market

The pre-Thanksgiving meltdown in the stock prices of the two largest government sponsored entities supporting the U.S. mortgage industry (Fannie and Freddie) signals the growing unrest in the U.S. equity markets. Though a downturn in Freddie and

Fannie was expected, I was surprised at how long it took for their prices to disconnect and awed at the extent of their moves – far outside of “normal” standard deviations. Both of these national institutions have lost over 60% of their value since we released our October newsletter.

In order to understand our current quasi-socialistic dependence on our government, and how this blindness keeps us from understanding the swift price adjustments that are yet to come in the months ahead, this month’s newsletter touches on the birth of financial capitalism and strings together a group of powerful individuals, ideas, and novels that opened the door to socialism in the U.S. In studying individual and crowd responses to various leaders’ comforting rhetoric during difficult and painful periods in history, we note that people often defer to “the experts,” believing someone far up the food chain has this all worked out, which allows them to continue in their own denial, until like the investors in Fannie and Freddie, massive amounts of capital are lost almost overnight. If you are reading this email and hold large amounts of Fannie or Freddie, outright or in managed portfolios or mutual funds, my comments are painfully clear.

We have also posted our third “Major Markets_Major Players” spreadsheet. Out of ten major global financial institutions and 35 major markets we follow, only one has yet to turn down from its seven year high. If last Friday’s price action in Europe holds, this last market will finally turn down from one of the most extreme bullish sentiments in market history. My comments on recent moves and sentiments in currency, debt, and equity markets can also be found in these spreadsheets.

October 2007: When Bailouts Fail?

By the middle of August, as the credit crisis came front and center, equity markets around the globe were convincing investors that maybe this July was going to be the final top. But with the Fed cutting both the Discount Rate and the Fed Funds Rate, market rallies convinced both bull and bear that the Fed was in control and higher equity prices were a given.

Our latest public article, TV Reruns vs. Real Manias, reveals that the markets' moves upwards, regardless of negative economic and financial developments, have convinced many that only more of the same will follow.

With the asset-backed portion of the commercial paper market contracting 21.8 percent from $1,151 billion to $917 billion, in a 10-week period, one begins to understand why Treasury officials and Wall Street's biggest banks met last weekend. In this month's newsletter, "When Bailouts Fail" we examine this meeting and compare it with the 1998 bailout of Long Term Capital Management. Could it be that the Fed and banking community don't have as much control over inflating market prices as we have all come to believe? The belief that the dollar will only fall and gold, commodities, and equity markets will only rise is predicated on the Fed's control over crowd psychology. Though unbeknownst to many, the extraordinary sentiment readings of late reflect a crowd that believes the Fed will always be able to inflate.

September 2007: Rate Cuts – To What End

Cycles end. Days end. Dot com bubbles end. Even real estate bubbles end. But lest you be tempted to think the current stock market cycle needs to end, know that the drive through window at your friendly Federal Reserve is open 24/7 to extend credit "to infinity and beyond." Notice I said extend credit, not buy your mortgage.

This month I review the various markets and sectors that have been rolling over since the summer of 2005 and explain why science and the operational issues regarding credit markets have led to extended hours at the Fed. To help our subscribers see some major trends, which are at extremes as I write, and sector tops that have been rolling in slowly for several quarters, we look through a number of markets and sectors with charts and a new spreadsheet, "Major Markets Major Players_Sept07." Since our innate tendencies to extrapolate the past and draw comfort from stories of investment successes can prove enormously destructive at major market turning points, I am sure you will find these educational tools very valuable.

August 2007: The Investor's Mind – Market Counsel, Not Marketing Hype

In the last two and a half weeks media headlines have reported the largest amount of liquidity ever introduced into the financial system by central bankers around the world. Those who believe that the proper role of the Federal Reserve, the Bank of Japan, and the European Central Bank is to supply money "virtually at will" should save this email and read it again around Thanksgiving.

The large, daily swings in world markets since July 19th, the day the Dow Jones Industrial closed above 14,000, reflect a rapidly increasing awareness of the substantial risks in global capital markets. As such, we will want to understand why the events of August are signaling massive changes ahead for investors and managers alike.

This month, I postponed yet again the material I intended to present. Instead I interviewed four individuals regarding liquidity – one of the most distorted terms in financial. This lack of understanding combined with bad advice is a recipe for a disaster that will impact far more than one's investment strategies.

In this newsletter, we will hear from the following individuals:

1. Dr. Larry Parks – Executive Director of the Foundation for the Advancement of Monetary Education, Chief Economist for the FreeMarketNews, has studied money issues for over 30 years

2. Jerry Flum – CEO and Chairman of CreditRiskMonitor, guest lecturer at MIT's Sloan School of Management Lab for Financial Engineering, with a JD in law from Georgetown, 39 year market veteran

3. Dr. Mark Thornton – Senior Fellow at the Ludwig Von Mises Institute, Book Review Editor of the Quarterly Journal of Austrian Economics

4. Ed Easterling – Founder and President of Crestmont Research, author of Unexpected Returns: Understanding Secular Stock Market Cycles, 25 year market veteran

Over the weekend, I was also able to ask John Williams, of Shadow Government Statistics, a question about the size of the recent liquidity expansion in comparison to the "normal" liquidity numbers. His answer will blow you away.

July 2007: The Investor's Mind – What Is & What Should Never Be

Evidence is mounting that we are in the final throes of this worldwide, credit-fueled bubble. The wobbling dominoes certainly merit the attention of all investors and advisors:

"Bear Stearns on Tuesday [July 16] evening told investors in the two stricken funds it manages that one had lost all its value and the other was worth about nine cents on every dollar invested. The funds had more than 20 billion in CDOs and other mortgage related investments, much of acquired using borrowed money. A vicious downward spiral could result, leading to the liquidation of other assets and positions, including the FX carry trade." *Bear Stearns Shock Wave Gain New Force*, July 18, 2007, Financial Time

"JPMorgan Chase & Co. Chief Executive Officer Jamie Dimon said demand for leveraged buyout debt is drying up and banks may be left holding more loans that they can't sell. There is 'kind of a little freeze in the marketplace,' Dimon said on a conference call with investors to discuss the New York-based bank's second-quarter earnings. 'If you see this continue you will see the Street taking on a lot of bridge loans and more aggressive repricing of those things.'" JP Morgan Dimon Sees 'A Little Freeze' in Lending for LBOs, July 18, 2007, Bloomberg

We are releasing this month's Investor's Mind early because a variety of technical indicators are pointing to an end to the bull market run that began in the fall of 2002. I thought it important to release this piece on three high-level financial meetings that have taken place over the last few months, which I believe makes it clear that those at the top of the money game have known for some time that the end of this period will bring massive shifts to the global capital markets. The resources we turn to for this issue of The Investor's Mind are as follows:

1. The Securities and Exchange Commission,
2. the Council of Foreign Affairs,
3. Grant's Interest Rate Observer,
4. Bob Prechter's Elliot Wave Theorist,
5. the Bank of International Settlement,
6. Dr. Larry Parks, Executive Director of the Foundation for Monetary Education,
7. and five of our former newsletters and two of our former public articles.

If you have not visited the Weekly or Research pages of our website in the last few weeks, I encourage you to take time over the next week and do so.

I urge you **not** to extrapolate the trend of the last 5 years out over the indefinite future, and **not** to assume that the Federal Reserve can always make people, businesses, and banks borrow more money. Numerous technical, fundamental, social, and economic signals are clustering, warning investors that something out of the ordinary is quickly developing. The historical record shows that prices leap and that big gains and losses concentrate into small periods of time. We do well to remember that fact. Dr. Benoit Mandelbrot, one of the most widely recognized mathematicians of the 20th century, notes:

"From 1986 to 2003, the dollar traced a long, bumpy descent against the Japanese yen. But nearly half that decline occurred on just ten out of those 4,695 trading days. Put another way, 46 percent of the damage to dollar investors happened on 0.21 percent of the days. Similar statistics apply in other markets. In the 1980s, fully 40 percent of the positive returns from the Standard & Poor's 500 index came during ten days – about 0.5 percent of the time." The (Mis)Behavior of Markets, Dr. Benoit Mandelbrot, (page 234)

June 2007: The Investor's Mind – Global Warming Bull

Since it appears that we are in the final throes of this worldwide, credit-fueled bubble, last month I stepped aside from our usual research-oriented focus to share some of my personal reflections on this period in history. Since the end of May we've watched the Dow move down sharply twice; we've seen several equity markets form what appear to be double tops; and we've noted monetary and political developments that look to be coming to a head. One such issue that has gained considerable steam in the last few quarters is global warming.

The June and July issues of The Investor's Mind will discuss global warming from the standpoints of science, politics, and finance. We'll examine various books, articles, and research papers, and will include personal interviews in July.

As the signs of a credit contraction continue to appear - most notably this month with Bear Stearns' hedge fund debacle - the intensity of rhetoric should mount. Those who've studied the financial and political landscape of 1929 to 1932 or 1973 to 1975 know this to be the case. There has never been a more critical time to slow down and take time to think.

May 2007: The Investor's Mind – Random Musings: Human Behavior in a Market Mania

This month, as we near the final throes of a worldwide, credit-fueled bubble, we take time to look at a few personal stories and experiences. Our fast-food, instant-gratification, pop-culture world's first thought is likely, "Yeah, but this could go on for a long time, and no one can call the top." While I could certainly agree with part of that statement, I continue to look to the science of parabolic rises, as revealed in our latest public article, Going Ballistic: The Hard Facts about Parabolic Spikes, which can be found under Recent Updates on our homepage.

What I find even more fascinating is how little attention is paid to how we think and react emotionally during parabolic spikes. For this reason, I decided that it would be wise to spend some time outside the daily noise and information and to reflect on a few stories that can help us clear our minds. Whether you're managing billions or asking questions about your personal investments, I think these three stories will prove to be enlightening and encouraging. And, for those who like to think outside the box, you'll get to read an investment newsletter that looks for the lessons in the experiences of a former POW, a Chinese warrior, and a father, who was a janitor, versus his son, a technology advisor to venture capital firms.

April 2007: The Investor's Mind – The Crisis of Money and Politics

This month we review Zbigniew Brzezinski's new book, Second Chance: Three Presidents and the Crisis of American Superpower, and his 1997 work, The Grand Chessboard: American Primacy and Its Geostrategic Imperatives. We then trace Brzezinski's history back to a world famous meeting in Kyoto Japan in 1975, which was not related to global warming. Based on an examination of his public life over the last four decades, he seems quite familiar with Machiavellian "principles." If you are unfamiliar with the powerful global political figure that Brzezinski is, his words below reveal a view of risk that is not presented by most major financial firms:

> "At some point we could see the emergence of a more pointedly anti-U.S. coalition led by China in East Asia and by India and Russia in Eurasia. It could then draw in Iran. Although that may seem far-fetched now, it is noteworthy that after the first ever Chinese-Indian-Russian summit in St. Petersburg in the summer of 2006, some Chinese foreign affairs specialists wrote nostalgically that Lenin had once advocated an anti-Western alliance among these three countries. They pointedly noted that such an alliance would embrace 40 percent of the world's people, 44 percent of its surface, and 22 percent of its GNP."

March 2007: The Investor's Mind – Machiavellian Ways: Half-Truths, Paltry Penalties, & Secrecy

The questions addressed in this month's issue are:

- Which highly visibly individual recently made this statement? "What's important when you are in that hedge-fund mode is to not do anything remotely truthful because the truth is so against your view that it's important to create a new truth, to develop a fiction..."
- What 1513 document have politicians studied that investors must understand to survive in today's capital markets?
- Why is fraud so lucrative?
- At what secret meeting did a high-ranking Fed official make this statement on Sunday, September 20, 1998? "During a crisis, the correlations always go to one."
- What public webpage are you using to check your stocks for backdating issues?
- What central banker confessed this month, "We knew that we had to push it to levels that could not be sustained in the medium and long term?"

February 2007: The Investor's Mind – A New World Order – Explorers, Speculators & Debt Managers

- What lessons can we learn from the years after the Dutch Tulip Mania?

- According to Sidney Homer's A History of Interest Rates, Charles MacKay's Extraordinary Delusions and the Madness of Crowds, and Edward Chancellor's Devil Take the Hindmost, what trends leads to sharp declines in global markets?
- Why did private banking take off during the 17th century and why is that important today?
- What are the parallels between 17th century England and 20th century America?
- Two different central banking models were started in the 17th century. Which one did America follow? What banking event should global investors monitor closely in 2007?
- How could last year's issues of The Investor's Mind have prepared investors for days like February 27, 2007? Since, outside of 9/11, this was the worst one-day drop in the Dow since the 2000 top, what evidence is there of a pending sea change?

February 2007 Special Edition: Expert Panel on 2007 Market Concerns

In addition to our regular monthly newsletter, four industry leaders have shared their insights with us by answering the following three questions:

1. What is the time span and breadth of your financial industry experience?
2. Based on your experience, what concerns you most about our financial markets today?
3. Do you believe that a historically significant top is unfolding, and if so, what have you seen in the last two quarters that would suggest that the top is imminent?

The individuals who've contributed to this Special Edition on are:

- Alan Newman – author of Crosscurrents, www.cross-currents.net, since 1990, with 27 years industry experience and 43 years investment experience.
- Dr. Janice Dorn – author of The Trading Doctor, www.thetradingdoctor.com, double doctoral, full time gold futures trader, trading mentor, and financial neurobehaviorist.
- Mike Arnold – co-author of professional trading course, Pairnomics, www.pairnomics.com, options market maker, local and off-floor trader in New York and Chicago with 15 years industry experience who runs a team that trades S&P futures and Stock Pairs.

- “Mr. Brillo” – institutional manager with 38 years experience specializing in short selling, provides research to hedge funds. Because of his position within his firm, Mr. Brillo is unable to publicly divulge his name.

January 2007: Persia – Fuel for the Fire, Part I

- What civilization was only held under the Greek Empire for a short time and was never conquered by the Romans?
- How does German, Russian, British, and American history come together in Iran during the first half of the 20th century?
- What does the Treaty of Versailles have to do with Iran in January of 2007?
- What was the Tehran Conference that took place in 1943?
- What was one of the first court cases brought before the newly formed United Nations?
- What effect has Dr. Mohammed Mossadegh had on the attitudes of Iranians today?

December 2006: MindGames

- A Mind is a Terrible Thing to Waste
- Jung: Change... Perceived as Death
- “Cocooned” Reactors vs. Non-Linear Thinkers in a Zero Sum Game
- Short-Termism & Closet Indexers vs. Awareness & Training the Brain
- Market Deception, The Art of War & History’s “Surprises”

November 2006: Hot Potato, Hot Potato

- Program Trading - 1987 vs. June 2006
- The SEC & NYSE - Wanting Less Collateral?
- Credit - Contracting & Expanding Simultaneously
- The Working Group...working harder
- And, the Crowded Door

October 2006: A Lie You’ve Got to Rise Above

- Taking advantage of 9/11
- Cheating: Tomorrow's Leaders in Today's Classroom

- Fraud, How Big is the Business? ACFE
- Ayn Rand's Objectivism: Is altruism evil?
- Us vs. Them

September 2006: Too Costly to Bear

- Nile Flooding and the Aswan Dam
- Mandelbrot’s Joseph Effect & Noah Effect
- Clustering: Mount St. Helen & Market Meltdowns
- Liquidity Risk in the 100-Year Flood
- Chaos, Self-Similarity & A Landslide in a Teacup

August 2006: Efficient Market Hypothesis: The Long Kiss Goodbye

- EMH vs. Market History
- Fractals in Nature & Markets
- Wave Principle & Market Calls
- Mandelbrot & Elliott: Rough Conclusions

July 2006: Who’s Got the Power

- Herding & Crowd Psychology
- Creeping Normalcy & Landscape Amnesia
- Complexity & Unsustainability
- Comptroller Walker on Government Spending & Entitlement Programs
- The Dam Story

June 2006: The Omnipotent Fed: If I Ever Lose My Faith in You

- All the Same Markets & the ‘Flation Debate
- Bernanke: Pay No Attention to that Man Behind the Curtain
- Greenspan & a New Look at America’s Great Depression
- Deflation, Japanese style
- The “New International Monetary Order”

May 2006: Between Two Worlds

- The BIS: Yesterday & Today

- The Dash to Trash
- Tulip Maniacs & Art Collectors
- Sammy Credit Card
- The US Treasury Establishes a Security Lender of Last Resort

April 2006: Losers: Why We Invest With Them

- Buffet & the Trip Down Memory Lane
- GMO, Dunn & Biggs
- Short-termism
- Patience, Independent Study, and Experience...Repeat
- The Zero-Sum Game

March 2006: Oil & Water Do Not Mix

- The Costs of Wars & Current US Military Expenditures
- The Dollar's Reserve Status
- Oil
- The UN Security Council's Contributions to Iran's Nuclear Program
- Caution: Contents Under Pressure

February 2006: The Proposed Iranian Oil Bourse

- Colonel's Liang & Xiangsui on Unrestricted Warfare
- The Beginnings of Petrodollar Recycling
- 1954 & Mossadegh, Pahlavi, the Ayatollah Khomeini
- The Iran Hostage Crisis
- Iran's Nuclear Capabilities: Nukes or No Nukes, That is The Question

January 2006: CalPERS & the Untold History

- Time, Extrapolation & Probabilities
- CalPERS: A Sign of the Times
- M3: The Real Slim Shady
- Art & Skyscrapers
- Now, About that Bubble