

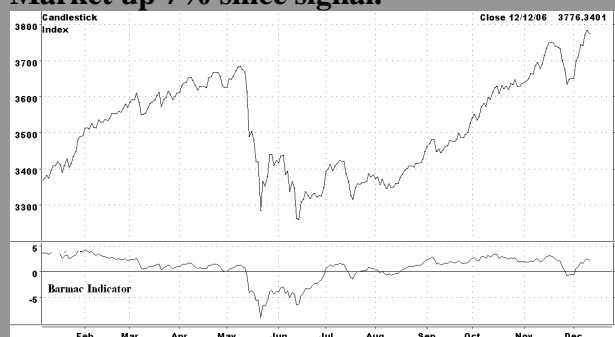
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## THE DOLLAR IS OVERSOLD BUT BEWARE LEST A PANIC EMERGES.

### BARMAC MARKET DIRECTIONAL INDICATOR:-

**BUY SIGNAL** -issued on 28<sup>th</sup> August  
Market up 7% since signal.



As can be seen from above the Barmac indicator remains in "buy" despite a temporary "wobble" in late November as the market continues its advance. Stops have been raised to 6000 on Ftse.

The Barmac Castleton OEIC continues to advance steadily whilst the Barmac Indicator remains in "buy" mode and has outperformed Ftse 100 since launch

**CASTLETON GROWTH TRUST @106.05**  
Since launch 11/07/06



Despite our long-standing bear view of the US dollar based largely upon the fundamental problems of both a huge (in absolute, relative and international terms) trade deficit and an equally stupendous fiscal deficit (ie the US Govt spends much more than it raises in tax) we suspect that the current declines are overdone for the time being. A two-dollar pound is of course hugely attractive to those fancying a shopping trip to New York or a visit Disneyland but to Britain's exporters it is disastrous. The thought of the dollar weakening further will keep many CEO's awake long into the night.

However, if we use the tried and tested front page contra signal then the dollars decline is nearly over. We can be sure of this fact due to the excessive TV and press coverage and a nice front cover on the economist!

The above are all signs of a tired trend as the media only latches onto any trend as it peaks out. This is a perfectly natural phenomenon as money market trends are only news worthy to the general public once it has become extreme.

Equally relevant is the significant historic chart support at two dollars and deeply oversold technical and momentum levels. Thus we suspect that the ongoing decline and the draw of "roundaphobia" will lead to a "pop" of the ten bob dollar level and then find support and reverse.

Market sentiment is universally bearish and thus a rally must be due soon and as such anyone currently short the dollar needs a tight stop.

BUT remember there is no room for hubris because the dollars problems are our problems because the Dollar is the world reserve currency

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**A very interesting and thoughtful essay about paper money by the ever entertaining and informative Addison Wiggin.** This essay highlights beautifully why we should never trust politicians with anything so serious as our money!

### **THE DISMAL HISTORY OF PHONY MONEY by Addison Wiggin**

History has shown that money - not counterfeit, but official money printed by the government - has been known to lose value and become virtually worthless. Examples include Russian rubles from pre-Revolution days, 50-million marks from 1920s Germany, and Cuban pesos from pre-Castro days. In all of these cases, jarring political and economic change destroyed currency values - suddenly, completely, and permanently.

What kinds of events could do the same thing to the U.S. dollar?. In the 1930s, 20 percent of all U.S. banks went broke and 15 percent of life savings went up in smoke. After the emergency measures put into effect by President Franklin D. Roosevelt through the Emergency Banking Relief Act of 1933, confidence was restored with another piece of legislation: the 1933 Glass-Steagall Act. This bill created the Federal Deposit Insurance Corporation (FDIC), insuring all U.S. bank deposits against loss.

The severity of the growing situation had been seen well in advance. The financial newspaper Barron's, established in 1921, editorialised in 1933 that: "Since early December, Washington had known that a major banking and financial crisis was probably inevitable. It was merely a question of where the first break would come and the manner of its coming."

Two weeks earlier, the same column cautioned its readers that when the dollar begins to lose value, this leads to a series of "flights" - from property into bank deposits, then from deposits into currency, and finally from currency into gold.

We can apply these astute observations from 1933 to today's currency situation. The government, anticipating a flight from currency into gold, had

already made hoarding gold or even owning it illegal. The second step - insuring accounts in federal banks - helped to calm down the mood. By preventing the panic, currency stabilized. But in those times, the US was still on the gold standard. The currency in circulation was, in fact, backed by something. Remember, that the gambler who keeps asking for ever-higher markers will eventually run out of credit. At some point the casino boss realizes that his ability to repay is questionable. Maybe those markers are just a heap of IOUs that can never be cashed in.

In the 1930s, the causes of the Great Depression were complex but related to a series of obvious abuses in monetary, financial, and banking policies. History has simplified the issue by blaming the Depression on the stock market crash (which takes us back to the explanation that "wet sidewalks cause rain"). The stock market crash, one of many symptoms of policies run amok, has lessons for modern times. The unbridled printing of money - expansion of the "IOU economy" - is good news for those who recognize the potential for gold.

We hear experts on TV and in the print media shrugging off the deficit problems. "the US economy is strong and getting stronger" is the mantra of those with a vested interest in keeping dollars flowing: Wall Street brokers and analysts, for example. But we cannot ignore the facts. The federal deficit is growing by more than \$40 billion per month. It is not realistic to point to this economy and say it's doing just fine.

Gold is the beneficiary of reckless monetary policies and the War on Terror. Check the average value of an ounce of gold over the past decade.

It has been rising steadily since the end of 2001. The cause of this change in gold's price may be attributed at least partly to the attack on the World Trade Centre. But it reflects equally on the Fed's monetary policies and spiralling debt-based economic recovery. During the same period that gold prices have begun to rise, we should also take a look at the trend in money in circulation.

This is troubling for the dollar but - again - great news for gold.

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Remember what the world economic and political situation was like in the early 1970s: a weakening dollar, easy money, and international unrest. Sound familiar? We're back in the same combination of circumstances that were present when gold prices went from \$35 to over \$800 per ounce.

The numbers prove that gold is going to be the investment of the future. World mining in gold averages 80 million ounces per year, but demand has been running at 110 million ounces. So if central banks want to hold the value of gold steady, at least 30 million ounces per year must be sold into the market. This creates a squeeze. As the dollar weakens, central banks will want to increase their holdings in gold bullion, not sell it off.

This is maybe why gold's price has started to rise and must continue to rise into the future. As long as that demand grows - and it will rise as the dollar's value continues falling - the price of gold simply has to reflect the forces of supply and demand.

But, you might ask, why do central banks want to hold down the value of gold? We have to recognize how this whole money game works. Most world currencies are off the gold standard, following the U.S. example. So as gold's value rises, it competes with each country's currency. Of course, the trend toward weakening currencies and the continuing demand for gold mean that the growth in gold's value could continue strongly for many years to come.

When the United States removed its currency from the gold standard, it seemed to make economic sense at the time. President Nixon saw this as the solution to a range of economic problems and, combined with wage and price freezes, printing as much money as desired looked like a good idea.

Unfortunately, most of the world's currencies followed suit. The world economy now runs primarily on a fiat money system.

Fiat money is so-called because it is not backed by any tangible asset such as gold, silver, or even seashells. The issuing government has decreed by fiat that "this money is a legal exchange medium, and it is worth what we say." So lacking a gold backing or backing of some other precious metal,

what gives the currency value? Is there a special reserve somewhere? No. Some economists have tried to explain away the problems of fiat money by pointing to the vast wealth of the United States in terms of productivity, natural resources, and land. But even if those assets are counted, they're not liquid. They're not part of the system of exchange.

We have to deal with the fact that fiat money holds its value only as long as the people using that money continue to believe it has value - and as long as they continue to find people who will accept the currency in exchange for goods and services. The value of fiat money relies on confidence and expectation. So as the US (and GB) continue to increase twin deficit bubbles and as long as consumer debt keeps rising, our fiat money will eventually lose value. Gold, in comparison, has tangible value based on real market forces of supply and demand.

The short-term effect of converting from the gold standard to fiat money has been widespread prosperity. So the overall impression is that U.S. monetary policy has created and sustained this prosperity.

Why abandon the dollar when times are so good? This is where the great monetary trap is found. If we study the many economic bubbles in effect today, we know we eventually have to face up to the excesses, and that a big correction will occur. That means the dollar will fall and gold's value will rise as a direct result.

The sad lesson of economic history will be that when the gold standard is abandoned, and when governments can print too much money, they will. That tendency is a disaster for any economic system, because excess money in circulation (too much debt, in other words) only encourages consumer behaviour mirroring that policy.

Thus, we find ourselves in record-high levels of credit card debt, refinanced mortgages, and personal bankruptcies - all connected to that supposed prosperity based on printing far too much currency: the fiat system.

The unwind will be painful but why should politicians care? They forever feather their own nests, be it fancy pensions or numerous "grace and favour"

homes. They certainly can only be trusted to duck the hard decision and therefore should not be allowed to control any nations monetary decisions. The two greatest weaknesses of democracy are the type of people attracted to being in power and the fact that elections are a “popularity” contest! Still it is better than any alternative.

**Barmac’s advice is buy some gold or other physical assets** as a long term hedge against the profligacy of the global political elite which will never end!

### **Do we trust politicians with our money – NO!**

In fact what clearer indication of the intentions of all governments irresponsibility when in control of paper money than last weeks statement by the ECB and the Autumn statement by “Mr Prudence” himself.

Firstly, the ECB was heavily leaned upon by the clearly nervous French imply that tightening by the ECB may be ending. The French economy is getting slaughtered by the weak dollar that is killing exports and an even stronger euro boosted by further rate hikes is seen as disastrous by the French and many of the Latin members of the euro-club. Thus the principal of an Independent Central Bank for Europe that follows the strong DMark policy of the old Bundesbank has been fatally undermined.

In the UK Gordon Brown has continued strategy of dragging the country into penury with yet more uplifts to Government spending to be met by debt. Brown really has become a classic “tax and spend” labour chancellor and is busily running up a huge fiscal debt that will have to be repaid eventually (along with the debts on PFI, Govt pension schemes and the cash burn from the war on terror).

Mr Brown boasts of quarter upon quarter of economic growth without once referring to the global “goldilocks” economy and he does not blush at the thought that you can have a great party for a while if you borrow a load of money and spend it. – But one day all that squandered money has to be repaid.

## **DOLLAR/STERLING (30 years)**



**The above chart of the Dollar highlights the 25 year highs for sterling.** There is long term resistance at \$2 due to “roundaphobia “ and resistance from previous tests, notably in the early 90’s. However if the pound can smash trough this resistance then there is the chance that the advance could reach \$2.40.

The converse however is that yet another failure at \$2.00 may open the way for a sterling fall back into the long-term trading range.

The key support levels for Sterling are \$1.95 and \$1.89, if the pound trades below the latter level then it would be reasonable to assume that the rally is over. Traders could draw the same conclusion on the tighter and higher stop if wishing to protect profits.

**If you think the above is a worry the good doctors thoughts about the US housing market may make you wish to remain under the duvet in the morning.**

Although the US homeowner may not appear to be a major concern to UK investors he should be! If the American housing downturn gathers pace then it may usher a recession which will have a major implication to all UK investors.

## **A Dangerous Addiction**

By Dr. Kurt Richebacher

*It has become customary in the United States to speak of "asset-driven" economic growth. "Asset-driven" is, of course, a euphemism for bubble-driven, because it requires particularly large rises in asset prices.*

*Many modern economists consider asset-driven growth a valid alternative to the traditional growth*

pattern, nowadays called "income-driven" economic growth.

Mr. Greenspan gained high regard in the late 1990s for nourishing the rising stock values that provided such a massive "wealth effect" and, therefore, such a massive boost to consumer spending. Plainly, this inspired him to subsequently nourish the housing bubble. A new, indirect and apparently more efficient method of stimulating consumer spending through intermediation of an asset bubble was invented.

It seems to have two great advantages. Rising asset prices can boost "wealth" much more quickly than income growth, while also providing facilities with high leverage. But if these are advantages, they cannot be regarded in isolation. For obvious reasons, the bullish publicity concentrates on the two best-looking statistical aggregates as the key measures of economic performance. That is, real GDP and productivity growth. As a rule, they are in line with what people actually experience in the incomes they earn and the prices they pay in the shops. But this time, there is an unprecedented gross discrepancy between the very good looks of these two aggregates and what they experience in actual life. It is an open secret there is extensive statistical spin.

Frankly speaking, we liken asset bubbles and associated credit bubbles with drugs. Just like human bodies can become dangerously addicted to drugs, economies can become dangerously addicted to these bubbles. Of course, drugs cause severe damage to body and soul, and so do asset and credit bubbles to the economy and its financial system.

In the U.S. case, these damages are highly visible. See the collapse of saving, the monstrous trade deficit, the capital spending crisis, miserable employment and income growth and, on top of that, the debt explosion devastating balance sheets.

These are definitely the attributes of pathological, unstable and unsustainable economic growth. These are more than just symptoms, because they exert their own malign effects. The decisive problem is that credit bubbles do not evenly distribute their effects across the economy. They concentrate on one or two areas, which expand out of proportion to normal trend growth. In the U.S.

case, the latest credit excess has centered on durable goods, housing and financial speculation.

Put differently, asset and credit bubbles distort the economy's demand and output structure in an unsustainable way. At some point in the future, the related spending excesses flag, either under the pressure of credit tightening or on their own accord. Depending on their size, the bubble economy slides into recession.

Have the borrowing-and-spending excesses of the past years in the United States been of a size to make a severe adjustment crisis and deeper recession possible or probable? That is today's most important question, not only for the U.S. economy, but for the world economy. A crucial related question, of course, is the U.S. economy's resilience and flexibility to resist the coming adjustment shocks.

According to forecasts, the consensus economists expect the U.S. economy to see little more than a brief and minor economic slowdown from the housing blow. Basically, it is still in their eyes a "Goldilocks" economy, its outstanding emblem being low inflation interest rates.

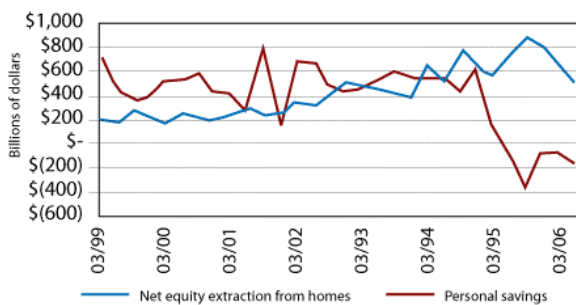
For American economists, it is dogmatic that low inflation rates are the infallible indicator of economic health. The Great Depression of the 1930s, and also Japan's prolonged economic malaise, both having followed many years of a stable price level, should have taught a lesson about the inadequacy of this aggregate as a measure of health and a guide for policy.

The key point about the U.S. economy, really, is that the forces that caused the 2001 recession never went away. They went from bad to worse. Business fixed investment has not really recovered from its slump in 2000–02. Its recovery in the following years has been far too weak to offset the prior loss. The counterpart and implicit cause of this capital spending crisis are the spending excesses on consumption and housing absorbing a growing share of GDP.

In 2005, consumer spending and the housing bubble accounted for 90.1% of real GDP growth. Now consider the following two figures: Real disposable income of private households grew 1.2%. This compared with an increase in real consumer spending by 3.5%. That is, spending rose three times as fast as disposable income!

## The Death of Savings

U.S. household savings versus the equity extracted from residential real estate



*It is no secret what made this incredible discrepancy between the two aggregates possible: equity extraction against inflating house prices. Over the four years 2001–05, outstanding mortgages of private households have jumped from \$5,292.9 billion to \$8,888.1 billion, or 68%. Apparently, the housing bubble was not only the icing on the cake. It was the cake.*

*While U.S. real economic data overwhelmingly keep surprising on the downside, comments by economists and the media keep surprising on the upside. According to a count by Kleinwort Benson (Dresdner Bank), the frequency with which the word "Goldilocks" is mentioned in the financial press has risen to its highest level since the word came into vogue as a description of the ideal U.S. economic environment.*

*This is grotesque. Compared with 2000, when the last downturn started, the U.S. economy's growth fundamentals — savings, investment and the trade balance — have dramatically worsened. Debts, in particular of private households, have escalated as never before.*

*And now comes the housing bust — a bust that has barely started. The housing-driven wealth effect that Americans have been enjoying has disappeared. And now that home prices are falling, the wealth effects will become anti-wealth effects. Rising home values have been supporting the U.S. economy's recovery. Any significant fall in home values will abort that recovery and send it in reverse.*

## Equity bull to continue?

**The Global equity markets have enjoyed a fantastic run since March 2003 and we have to begin to wonder when and where will it all end?**

We have now experienced an unprecedented 44 months without a correction in excess of 10%. Since WWII there has never been such an unbroken advance. Statistically it is almost certain that at some stage markets will experience a correction of between 15 and 20%.

Added to this "statistical certainty" is market volatility as measured by the "Vix" at 10 year lows and thus investors appear to be very relaxed/complacent about risk.

Just the environment for a shock correction to occur! However, the timing of any such correction is far from clear because of some very favourable seasonal and cyclical factors.

Firstly, until April the equity markets traditionally maintain their advance powered by seasonal money flows. Indeed, the old adage of "sell in May, go away and don't come back 'till Ledger day" has worked wonderfully as a rule on both sides of the Atlantic since the war! Certainly with the exception of 2003 we have witnessed a positive confirmation throughout recent years.

Secondly, 2007 is the third year of the US presidential cycle and has historically proven to be the most positive year for equities throughout the past 25 presidential cycles. It makes good economic sense, as the incumbent will be hell bent on creating as sweet an economic background as possible to enable re-election. Thus, 2007 ought to be a positive year based on the election cycle. So what might happen?

We hate having to guess but at this time of year it is an expected chore so after a deep breath we will unleash our prognostications! We suspect that markets will hold up until early spring as per the normal seasonal influences. However, statistically a deep 20% correction is way overdue and could well occur through the summer with a recovery building

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into the Autumn fuelled by US presidential cycle spending.

Thus we look for a market that could well advance 5 to 10% by year end after a summer decline of perhaps 15+% or so.

***In other words -a return to market volatility.***

Having made the above loose prediction we must warn all readers that in our humble opinion we are probably wrong and reserve the right to change our tune as and when we feel like it!!

Good hunting

Regards

AndyMc and AndyB