



## Global Financial Landscape February 2008

Pop! The bubble has burst. The global economic picture has never been so murky to so many people in so many sectors of the economy. We pay half again as much for gas and groceries as we did two years ago. We have lost thousands in our 401's and pensions. Our homes have lost on average 10% of their worth. Problems abound and just keep coming. However, with every problem comes opportunity. When faced with problems Jack Welch always had a terrific question, "What is the reality?" Viewing the current financial landscape and asking that simple question, we come to some truths.

Our once vibrant industrial/service based economy has morphed into a finance-based economy, where all profits are generated from financial engineering. In addition, a paper-based currency as opposed to a commodity-based currency, has become the underpinning of our new society. This is the reality. Whether or not the Federal Reserve engineered it, or simply allowed it, will be debated for years. Nevertheless, it is a structural change we add to the growing list of major changes underway in society.

Changes, like the shift in economic power from the west to the east, the shift in investments from paper to tangible things, and the shift from a service based economy to an information based economy, all conspire to suggest cataclysmic changes coming for every person and every sector of the economy around the globe. No part of the existing financial system is adequate to address the current environment. Economic models are being tossed. Even the ratings industry has to retool. They never saw the sub-prime problem. They never saw that monolines (bond insurers) were insuring \$trillions of debt with only a few \$billion in assets.

Here are a few clips from prominent financial minds that may help you attain that defining moment - that moment when you face reality, and reallocate your resources before more is lost.

George Soros: We are seeing an unwinding of the great credit bubble that began building after World War Two. "The current crisis is the culmination of a super-boom that has lasted for more than 60 years".

Alan Greenspan: The era of low interest rates is coming to an end I am beginning to see some symptoms of stagflation.

Gary North: "We appear to be in the early phase of a financial earthquake that will get into the history textbooks."... "The bad news is just getting rolling."

Bill Gross: (Pimco) "A critic can find numerous examples of incredible, bubble-popping asset structures - from sub-prime mortgages to structured investment vehicles to collateralized debt obligations squared - that are threatening to reverse the expansion of the shadow banks and break our finance-based economy's back."... "The modern finance-based economy has a striking resemblance to Barney Fife, guaranteeing global prosperity without the productive industrial-based firepower to back it up."

Felix Zulauf: "The markets are going to be influenced by dual, opposing forces: the deflating consumer economy and the reflationary efforts of the central banks. That will make for a lot of volatility, with a downward trend in the first half...Home values probably are five to six times the size of GDP, and if home prices rise by 10%, that creates new assets and borrowing power equal to 50% of GDP. Asset prices have a dramatic multiplier effect on the economy, something that has worked extremely well for a long time and now is reversing. Home prices are down around 10% on average and there may be another 15% to 20% to go. The excesses aren't as big as they were in Japan but the same process is at work.

Fortunately for us we were early in seeing much of this transition and shifted our assets accordingly. All of our investments excluding one have done extremely well and we continue to stand pat for 2008 minus the one rotten egg, Japan, which we have de-listed. Japan has been a huge disappointment, but interestingly, one we will review again once we get through this economic downturn. We purchased gold and silver in the mid nineties so you know we are "Sittin on Top of the World".

We continue to like gold and silver as more and more investors lose faith in the current system. We still like index funds that track the commodity indexes particularly DJP and GSP, although we expect some good buying opportunities later in the year. We still like commodity-based currencies purchased through the online bank, Everbank. ( [www.everbank.com](http://www.everbank.com) ) We expect the dollar to drop another 10 to 15 percent this year. And, we like cash.

Our main emphasis remains, capital preservation.

Cheers,

R. Van Hudson

vanhudson@www.beechislandinvestments.com