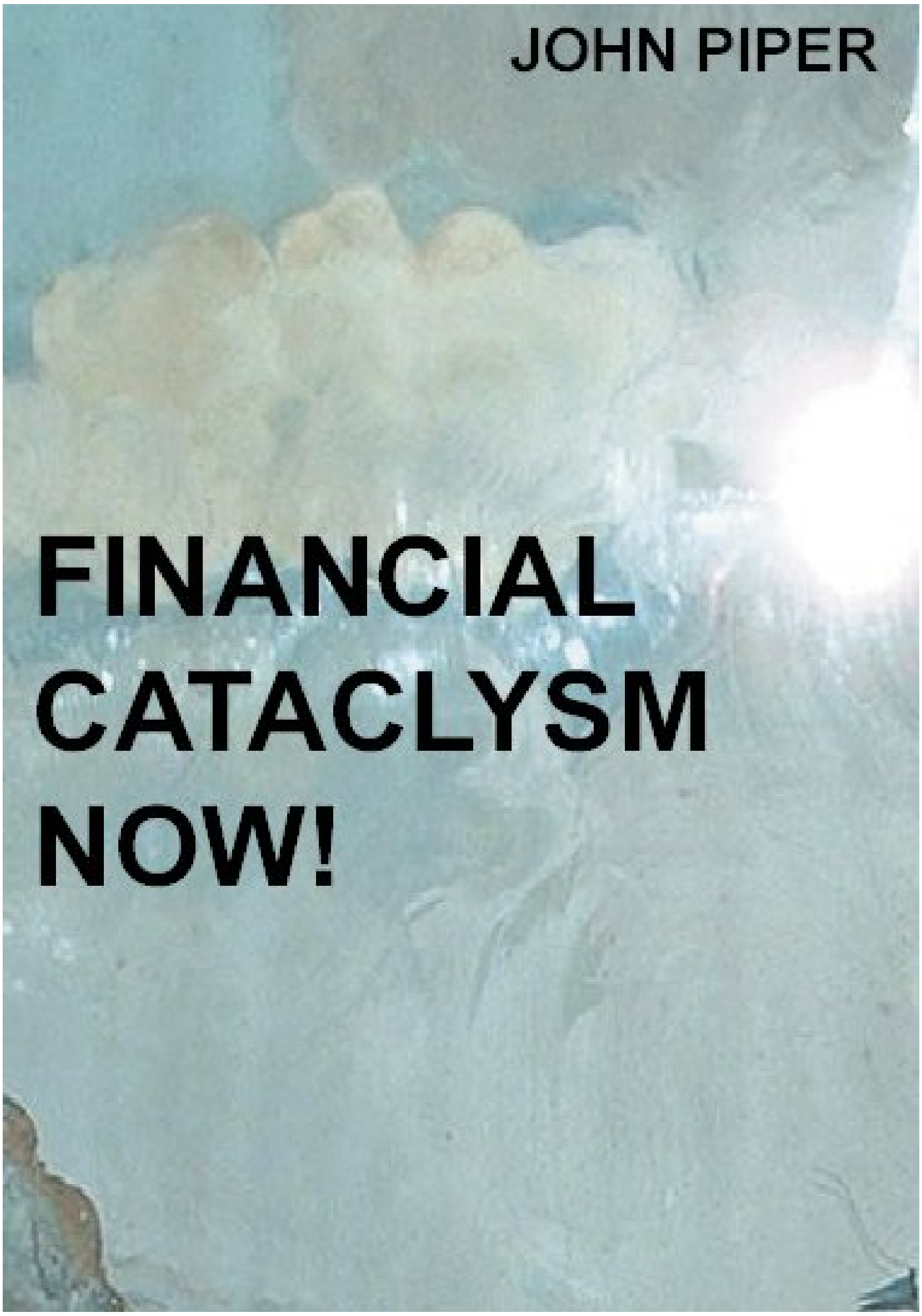
JOHN PIPER
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Why Global Stock and Property Markets are now going to fall faster and further than ever before – and How to Survive it

A practical Guide

John Piper

Email: john@john-piper.com

tt101@aweber.com (to join free service)

Webs: www.tradingintelligence101.com

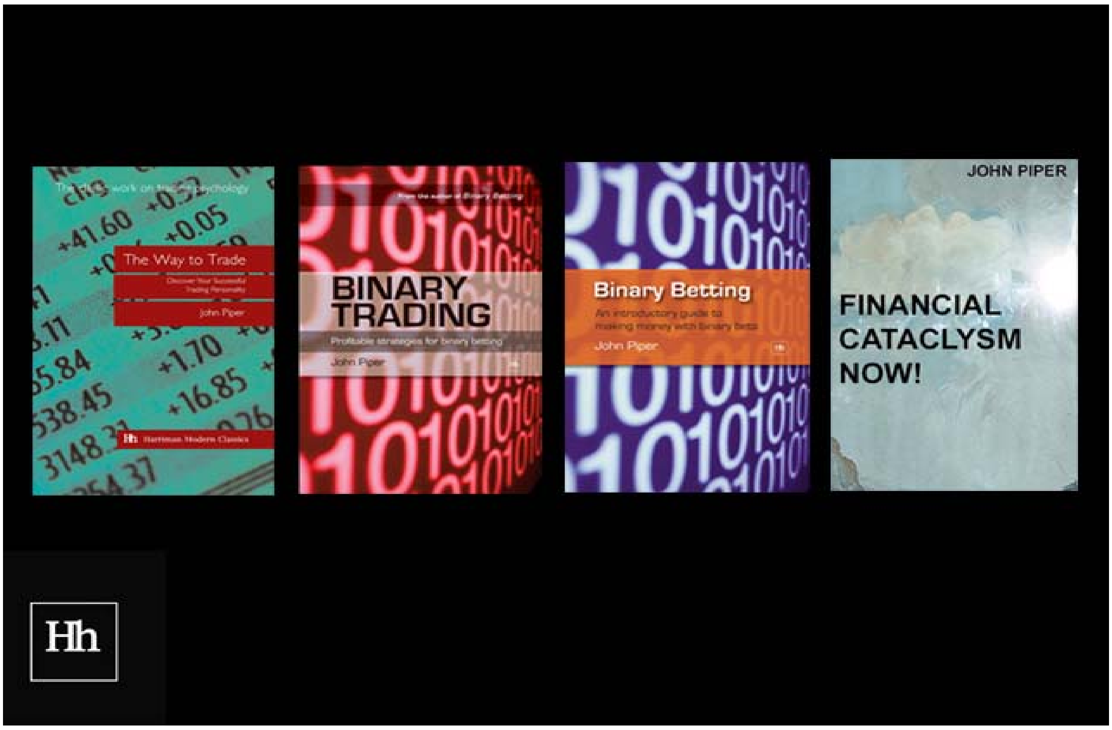
www.johnpiper.info

Published by:
Zena Press

First published in Great Britain in 2006

ISBN 0-9552768-5-3
978-0-9552768-5-9

British Library Cataloguing in Publication Data
A CIP catalogue record for this book can be obtained from the British library.



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INTRODUCTION

I have always been very positive in my outlook. Most call me a born optimist. I have a good life, nestled in the Surrey Hills, my daughter is at a top university, my girlfriend is beautiful and has a good job, my business is thriving. Everything is right in my world! So how come I am here writing that it is all coming to a sticky end?

Simply, because I cannot see any alternative.

Over many years the nations of the west have pursued policies which have brought short term benefits but created long term problems. These have not been pursued by evil men in the main but other nations have been exploited. Democracy may be the best alternative but that itself is a large part of the problem causing our politicians to adopt short-term views. Maybe it is unfair to blame democracy when it is human nature to look at the short term. Most of the problems today are brought about by the simple human desire to improve living standards and then to maintain them, to cling to the status quo – at any cost!

If this book has a higher purpose it is to make us think about how we live our lives and why we need to change if we are to build something that will stand the test of time.

Certainly we cannot tolerate billions of our brothers and sisters on this planet living in abject poverty while we drive our 4x4s down to the supermarket to stock up on the local delicacies, washed down with plenty of fine wine. Marie Antoinette was there before us and she ended up without a head!

If we are not to suffer the same fate we need to learn a few simple lessons.

We cannot hope to understand everything that happens in the world today. But what we can do is develop a template, a model that explains how things work and which we can use to give us a better understanding of the key threats we face.

In writing this book I have set myself three key tasks. First, to develop just such a model. Second, I have read too many books of this sort which are littered with such expressions as “in our opinion, x should happen” or “on the evidence this ought to occur.” I accept that it is not possible to predict the futures but I plan to be more definite than that. Third, I want this book to be accessible and readable to everyone. I have avoided overwhelming you with masses of statistics; instead I have only mentioned those of direct relevance. Only you, the reader, can judge how far I have succeeded in these three key goals.

Finally my ideal is twofold. First, that those reading this book will be prepared when the events I foretell actually occur. Second, and more importantly, that we, mankind, work together to avoid the worst of them.

My fondest wish is to be told that all my predictions were wrong because I did not take into account the actions we could take. Here’s to that!

John Piper – June 2006

Chapter 1 – MARKETS AND HOW THEY WORK

This is a book about markets but markets reflect the people we are. They reflect the lives we lead. They also definitely affect the lives we lead. The Depression of the 1930s is a good example having a huge impact on life and helping the growth of Nazism in Germany – Hitler became Chancellor of Germany in 1933. A rising market reflects the prosperity of the country and multiplies that prosperity but a falling market has the reverse effect and when the falls are severe the effect can be very, very destructive.

In this book I am warning of very severe falls to come. But without an understanding of how markets work it is not possible to understand why we are perched on the edge of a precipice right now. But we cannot even begin to understand markets until we understand ourselves and this is not simple. So the first matter to discuss is…

The Human Brain

Now we should all have one of these although this is not always obvious.

In fact, and this may come as a shock, we don't just have one brain, in effect we have three! What is more they all "think" different things – no wonder everything gets pretty confused!

This is how it is. From our reptilian ancestors going back millions of years we have an instinctive brain, it is this part of the brain which acts immediately to a threat. A more recent addition is the emotional part of our brains. Last, but not necessarily least is the neo cortex – the thinking part of the brain.

All of you will be familiar with all three. Instincts do not require thought, we simply act – but it is the brain that processes this action. Emotions are where we generally live our lives, I like that car, I do not like that one; I like that girl/boy, I do not like that one. There is often no clear logic to these feelings but they guide much of our actions. Finally there is the thinking part of the brain that can be useful but often gets it wrong.

All of us have a primary channel we use most of the time, but we are all influenced by all three; that is our instincts, our emotions, and our thoughts.

The structure of the brain is why we may plan things, using the neo cortex, but it does not work out in practice. As an example take the idea of approaching an attractive member of the opposite sex. The plan is simple, we approach, smile and say, “hello.” “Hello” is quite enough, if there is interest. A fairly simple plan but how many of us can carry it out? It can be done but most of us stumble at the first hurdle, even if we do make it to actually speak we may well stutter and fluff it. A more extreme example is rock climbing. We may have a simple plan but many of us are frightened of heights and we may well freeze. What is happening? Simple, the emotion of fear is over riding the neo cortex. There may also be a few stray instincts at work as well!

So when we talk about getting our heads straight it is really a question of…

Getting all three heads straight!

When something happens, perhaps we lose £1000 on a stock; it can have a different impact on the three different parts of ourselves:

1. The thinking part might well dismiss the loss as an event that is bound to happen quite often and therefore nothing to worry about. There may be another part thinking we may learn to invest more wisely next time.

2. The emotional part may be upset because we were looking forward to enjoying some champagne later if the stock had been profitable.

3. The instinctive part may have a problem on the grounds that money is important to survival.

With all these different things going on it is hardly surprising that so many of us have conflicting beliefs which can be difficult to deal with in a fairly large number of situations. The first dictum is “Know Thyself” but it should be “Know thy three selves!”

But how does this relate to markets? Simple…

Markets are a Manifestation of Human Psychology

I have been trading markets for twenty years both as a private trader and as a money manager. At the same time I have trained other traders and the first problem to overcome is to get away from trading emotionally. Indeed invariably the very reason an individual starts to trade is an emotional one. It is rarely a conscious decision to make money – otherwise why would an individual plunge into one of the most difficult games on the planet, often taking no advice at all.

But I am talking about traders here, people who try to profit from relatively short-term swings in the markets often using highly-geared vehicles to do so. It is different for investors, but not so different. The key factor when using highly geared vehicles is that this has an amplified effect on the emotions and instincts.

So if traders do not make a rational decision to make money why do they trade? Here are some reasons:

1. A typical trader has been successful in a different career, maybe as a doctor, a solicitor, and accountant or in business. But the challenge has gone out of that and he/she is looking for a new challenge. This is not a money thing; it is an emotional decision. A trader who starts to trade for this reason will tend to trade when bored as that will be when they most need is felt for a new challenge.

2. Another reason to trade is self-esteem. There is nothing like trading with mega bucks to boost your self-esteem, and think how you can brag to your cronies! But the self-esteem soon wanes as your money slides away. This sort of trader will tend to trade when self-esteem is ebbing – perhaps after an argument! I have done it myself.

3. Yet another is simply to spice up your life, maybe because you have a lot of free time on your hands.

If a conscious decision was made to trade to make money then there are steps that can be taken to much increase the chances of success. As a starter such a trader would seek expert advice on how to trade. They would paper trade any suggested method to ensure it has a chance of success. Compared to how much can be lost in markets the cost of the former is negligible and the cost of the latter zero – other than time spent.

The fact that many traders enter the market for emotional reasons is one factor but a more important factor is…

Markets trigger emotional and instinctive reactions all the time

It is a fairly well known fact that traders and investors panic. Markets slide away and people rush for the exits. Markets also rally strongly and people rush to buy – this is no less illogical. These are examples of the madness of crowds. Traders suffer from this all the time because their instruments are highly geared. As such small moves can take on enormous significance. But the key point is that investors feel fear when markets fall away and this is obvious. That the exuberance felt at tops is merely the reverse side of the coin is not always so clear. But the point I want to establish here is that most trading and investing is done as a result of our emotions and instincts, not as a result of rational thought. This is a fairly important point and it even extends to…

Fund Managers

Why? Because they are reliant on the investors in their funds. If those investors panic and sell the units of that fund, the fund manager is forced to sell stock to meet the redemptions. Similarly at tops when everyone goes mad buying the fund managers are forced to buy as well. OK, there is some discretion here and managers can cap their funds at a certain point, which does offer some protection. But the point remains valid on the way down even when there are time delays in place. So what is the effect of all this? I, among others, call it…

Sentiment

We need to differentiate between sentiment and value. Value we can quantify within certain limits, sentiment is a far more powerful force and is why markets swing from manic to depressive. Manic in 1999 at the top of the dot.com bubble; depressive around three years later after severe falls. Arguably manic again now after a three year rally. Sentiment is the measure of human emotion and instinct, it is why markets are a measure of human psychology.

Why have I spent so long establishing the point? Because it is necessary to understand that markets move from top to bottom, from “under-valued” to “over-valued” to understand why they are dangerous right now. I view what we have seen since the start of the new millennium as an impulsive decline followed by a corrective rally and I will be showing charts of the key markets in later chapters. If so we are closing in on a secondary peak before we see further falls – as I write this in May 2006 that secondary peak may now be in. This fits in with one of the fundamental principles of Dow Theory that…

Bear Markets go through three Phases

The three phases are:

1. Phase one when the excess is wiped away – this is what I believe we have already seen from the peak around the turn of the millennium until those lows in 2002/2003.

2. Phase two when the bad news hits the market and takes it down and sentiment falls with it – this is the phase which may now have started.

3. Phase three when the true panic hits and markets become truly under-valued. Fear is rampant and you will read that this is the end of the financial system as we know it – the UK saw such a move in the early 1970s.

If we do see a move from extreme “over-value” down to extreme under-value” then clearly these three phases will have to occur although they may not be separate moves, but might link up in some way. However the first phase down, which we have already seen, did not cause much economic damage and this is one of the reasons why I expect there is more downside to come – the structural problems are still there!

We will look at property markets in details later in this book but the property market is like all other markets; it is simply slower moving and it also has more obvious asset backing.

There is one golden rule which applies to all markets and this is that once people start to buy purely because they see appreciation in the future, then that is a time to start to be concerned. When I say “purely” I mean that value is long gone, price is already too high. It happened in the dot.com bubble, the fundamentalists, who some call the funnymentalists, could find no value although some pretended they could and got prosecuted for it! The only rationale for buying shares that were grossly overvalued was that they would go up. And they did! But then they collapsed. I believe this is true of much UK and US property at this time. So what happens if markets do fall away…

Deflation

The answer is that lots of money goes to money heaven. Bubbles are built on dreams and those dreams can evaporate very quickly. The problem is, as we discuss elsewhere, that we have economies awash with debt. Debt is not necessarily a bad thing and many thriving businesses have been built on debt. But it becomes a bad thing when the assets supporting the debt reduce in value as the borrower may become insolvent. Banks then get nervous and start foreclosing which of course further depresses the asset values.

The problem is not restricted to the borrower. As asset values fall the bank itself may find that it is also insolvent, especially if it has a large portfolio of property-based loans. Property can be dangerous in this context as few people understand how susceptible this market can be to market forces. “As safe as houses” is part of the language, it is part of our conditioning and decisions based on this sort of assumption can have devastating consequences.

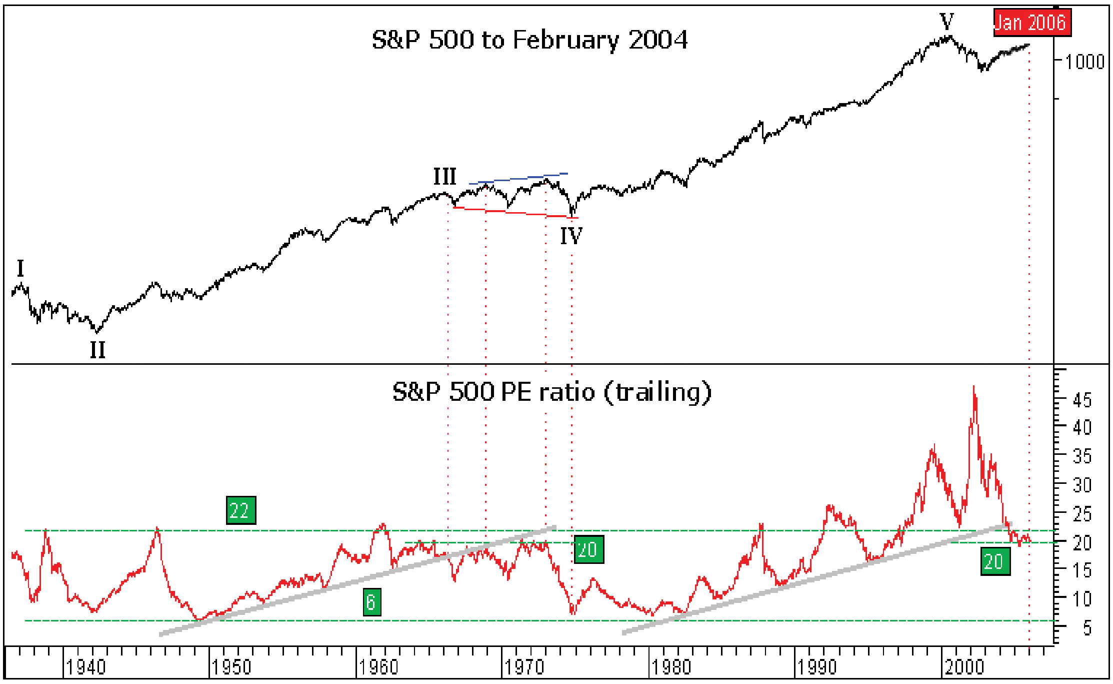
This is only one of the worries facing the West right now. By itself it has the potential to cause havoc but it is not our biggest worry. In my view markets are bound to fall back and fall back substantially – in Chapter 3 I am going to present a “proof” of this. But timing such events is extremely difficult. Often there is a cause that acts like a catalyst. Most commonly the cause is related to a strong move in currency markets and there are plenty of strong moves that might occur in the currency markets at this time. In fact it was a strong fall by the $ which caused markets to fall away in May 2006.

Indeed it has been said that the Iraq war was not fought for oil but because Iraq wanted to price oil in Euros. This threat to the dollar could not be tolerated.

But before we leave this chapter a word about...

Price Earnings ratios

At the bottom of a big bear market P/E ratios are generally below 10. Here is a chart of the P/E ratio on the S&P 500 since 1936. You will notice how it stayed within a "normative" range right through from around 1936 until the early 1990's. Then it went into hyper drive and this is one of the reasons why I, and others, were so sceptical about that huge bull run in the late 1990's – it was built on thin air! Hot thin air. (thanks to Tim Wood of www.cycleman.com for this chart and to Bill Adlard of http://www.chart-guide.com for the updating and annotations)



All the collapse that we saw between 2000 and 2003 has done is bring the P/E back to the top of the normative range. The long-term mean for this P/E ratio is around 15 and we haven't even got down to that level yet. Let along made it below 10 – traditionally where bear markets terminate.

So all that collapse did was wipe away the froth, we still have to go further down to complete a full bear market. We have seen phase I and I discussed this earlier. Phase II, when the bad news hits the fan, may now have begun and this is when earnings will also decline giving us a double whammy. Declining earnings will take price down but sentiment will take them down much further. Finally phase III will take the market into deeply oversold territory – at this point expect there to be a general distrust of equity investment as we saw in the 1940s and 1950s. There is also likely to be comment that the capitalist system has failed. But there is probably no need for concern, it has happened before and will happen again – the key thing is to be prepared.

I consider the P/E ratio to be one of the best guides to the real state of the market. By looking at where the market is in comparison to its **long-term** mean you know a lot about where you are and where you are going. Remember markets always go back to the **long-term** mean and beyond!

If we link this tool to a simple trend following system we will be right more often than wrong. We will be looking at the very big moves because the P/E ratio is no good for short-term timing purposes but as an indication of what is to come it is unparalleled.

SUMMARY OF THIS CHAPTER

- ❖ **How the human brain works**
- ❖ **We actually have three brains!**
- ❖ **Markets are a manifestation of human psychology**
- ❖ **Emotional Highs and Emotional Lows**
- ❖ **The three phases of a bear market**
- ❖ **Money heaven and Deflation**
- ❖ **Price Earnings Ratios are still too high!**

Chapter 2 – CURRENCY MARKETS

The currency markets are huge and we all have an impact on them. Every time we buy a new DVD player, a new dress, or a new computer you can bet that all or at least part of it comes from another country, very possibly China. To get that product into your country means that someone, somewhere bought some foreign currency.

International trade is a large part of currency markets but there is a lot more:

1. Any investment in a foreign country involves a transaction in the currency of that country.
2. Travel means buying the currencies of the countries you go to.
3. Foreign Currency loans.
4. Payments of dividends and interest to offshore investors.
5. Speculation and investment
6. Government intervention
7. Payment of offshore fees and commissions
8. Et al – I could go on for ever!

With all this happening, a currency is a…

Barometer of a country’s health

The only guarantee these days is change. We might include death and taxes. But life expectancy keeps changing and there is endless tinkering with tax rates, especially in the UK. Currency rates are no exception.

I will start with a hypothetical example as the real world can get extremely complicated. So we will say that County A is completely self sufficient except that it needs to import a supply of turnips and these are grown in abundance by Country B. Happily Country B is also completely self sufficient except that it needs to import a supply of back scratchers – a speciality of Country A. As it happens the value of the turnips and back scratchers are the same and so a simple barter system is sufficient. A merchant from A will travel to B with a load of back scratchers and he will return with a large number of turnips.

Then, disaster! Country A masters the art of turnip cultivation and the trade collapses. But Country B still wants their backs scratched and nothing quite hits the spot like a Country A back scratcher. So how do they get them?

They could take them. Wars have been fought over less ticklish problems in the past and this is an important point. Human beings will fight given the chance and an excuse – we have had years and years of evolutionary experience doing just that.

They could work for them. So men and women from Country B may go to Country A and work in the fields and come home bearing back scratchers.

But we will say that the solution here is that the National Bank in Country A lends money to Country B to buy the back scratchers. So a debt is built up and this simply grows and grows and grows over the years plus interest. So Country B becomes indebted to Country A and that debt is controlled by the loan agreement.

Another solution would be to try and sell other goods to Country A at a discount. But this would upset traders in Country A who already sell those goods – they do not want to see their trade disrupted. So they take "protectionist" measures.

It is slightly bizarre that such a simple example can give rise to thoughts of war, protectionism and long-term indebtedness!

But let us now look at…

The USA today

I chose the USA because it is the most spectacular example of the problem, but similar problems beset most of the western world in one degree or another.

It is also the biggest. The US annual GDP is in excess of $10 trillion; twice that of its nearest rival, Japan. Currently its exports are around $1.2 trillion and its imports $1.8 trillion. It is often referred to as "the engine of the world" and if it was forced to cut back on its imports it would create large problems worldwide and this could well happen. Plus it is the world's biggest debtor.

The USA has a twin deficit and both deficits are around $600 billion – that is $600,000,000,000! One is the annual trade deficit, ie the US is buying a lot of back scratchers! This is an apt analogy. The media and advertising builds up demand and desire. We then scratch this "itch" through consumption!

The other is the Budget deficit and means that the US Government is spending $600 billion more than it brings in. Its main source of income is taxes from the likes of you and I, or at least our US equivalents if you are not a US citizen.

I must say a word about this. In the past it has been considered important that Governments were seen to set an example, a good example that is. You can hardly blame the population at large for getting heavily into debt if they see their political masters doing exactly the same. Similarly there is a trend in public life for a low standard of morals. A simple example from the UK is that there are often road signs warning about speed cameras, but there are no speed cameras – it is simply a lie. Now I understand the reason for the lie, motorists will slow down because they think there will be speed cameras – although it will soon become obvious there are not and so any one who knows the road will know to ignore the sign – if that is their inclination.

But to lie is a serious matter, in my opinion, and the fact that the state should condone lying in such an unnecessary manner astounds me – again it is a question of setting an example to the population at large. I am no prude or moral crusader; but it is a short step from lying to others to lying to yourself and this can cause all sorts of trouble. My belief is that individuals often go down a road of excess at some point in their lives and they learn from that. But I do not think states are free to so the same. Images of Sodom and Gomorrah and the fall of the Roman Empire spring to mind. States that go down this road often fail to emerge at the other end. The speed camera example may seem innocuous but I believe it is the tip of the iceberg. But let's get back to those deficits…

The US Trade Deficit

The US is simply buying huge amounts from abroad and borrowing, in effect, on its credit card to do it – I'm sure many readers can relate to this! It is just that the figures are huge.

The US is the world's biggest economy but it currently imports around $600 billion worth of goods more than it exports per annum. For every $100 it exports, it imports $150. There has been huge growth in this deficit in recent years and back in 1998 it was around $100 billion – still enormous but a mere fraction of the current level.

This has two important effects. First it puts pressure on the currency, downwards pressure and this can exasperate the problem in that imports then cost more in $ terms, albeit exports become more competitive in foreign markets, at least in terms of price. It is not difficult to see from this that defence of the dollar must be a priority for the US, perhaps worth going to war for? A dollar collapse could cripple the US. The problem is of their own making but this does not mean they will not go down fighting.

The other effect is on Debt and this comes in a number of forms. First we will look at…

The US Budget Deficit

The total national debt in the US is now around $8 trillion, that **is $8,000,000,000!** It passed that level on October 18th 2005 and it grows around another $3.5 billion **every day!** Another $27,000 every minute!

That data was stated as at mid November 2005. The population of the US is just short of 300m, so the national debt is over $27,000 per person – man, woman and child! It is also over $1250 for every man, woman and child in the world – you can bet those starving in Africa would have loved to have been able to spend their share themselves.

This has spiralled out of control since Bush entered the White House. In 1999 Bill Clinton had proposed that the entire national debt should be paid off by 2015. In 1999 the national debt was between $5 and $6 trillion and growth had levelled out. But Bush reduced taxes and we now face a very different situation especially with the expenditure on the war. This illustrates one of the difficulties in this situation, the solution to one aspect of the problem often causes a ripple effect which makes other aspects of the same problem worse.

Of course as the debt grows so does the interest burden and that increases the annual deficit and the total debt. What it does not raise through taxation and its other earnings the US Government borrows through the Bond market.

The only thing that has saved the US so far is that its creditors, those who are owed money by the US Government, have been investing in the US, via bonds, stocks, property, businesses etc. Thus the currency effect has been muted as all those $'s that would have had to be sold to buy foreign currency have instead been retained in the US. At the same time all that debt that has needed financing has been financed by those same $'s!

But this is another accident waiting to happen. What happens if US markets start to tumble (as they are in May 2006), are all those foreign investors going to stay in there while they see their wealth dwindle away? It is a double whammy because as foreign investors sell stocks and bonds they may well repatriate their cash and the $ will also fall, thus foreign investors will be faced with a nightmare scenario, falling markets and a falling currency.

They may leave in droves and that would lead to further falls in the markets and the currency. But we must pause for a minute and wonder why did this did not happen when US equity markets fell sharply between 2000 and 2003. I believe the answer is because Bond markets rallied during that same period. Thus investors were able to switch out of equities into bonds. The next time equities fall bonds may well fall as well and that would be a very different scenario- in fact the T-Bond is in a confirmed downtrend as I write.

Another factor here will be derivative markets. Some investors will have hedged their exposure to the currency risk, and maybe also to the market risk using derivative products but you need to understand how this will work. Essentially someone would have to cover those losses – but say if that someone ran out of cash and that is likely to happen – we could be talking very big numbers.

We might say that these foreign investors have a vested interest in keeping their cash in the US as it supports their export markets – a virtuous circle. But that is only the case whilst their money retains its value in the US. When, not if, that ceases to be the case they will want their cash out before it is too late.

Even Alan Greenspan agrees and said “at some point investors will balk at further financing,” As it happens I recently read a report (mid-November 2005) that the latest US bond auction attracted foreign buying of only 21% when it is usually 50%. Bond prices are well down (and have continued to fall since then) so maybe this particular chicken is already coming home to roost?

I said earlier that the national debt is now $27,000 per person, so a standard two parent, two-child family is down for over $100,000.

Apparently Bush and a host of Republicans on Congress used to remind the US people at election time that the US Government needs to take care of its finances just like American families do. As one commentator said “If American families took care of their household budgets like Bush and company, we’d all be bankrupt!”

But the $8 trillion national debt is only part of the problem because there is also…

Private Sector Debt

How much? Wait for it… $30 trillion! Many figures in this book can only be estimated and this is one of them, they are also out of date as soon as the ink dries. It doesn’t matter because they may rise, they may even fall, but you can be certain of one thing… they won’t go away!

Add that to the Government debt and you get $38 trillion and it is probably nearer $40 trillion by now. Of this consumer debt alone accounts for around $10 trillion and one estimate reckons that has doubled over the last decade – that is quite a steep acceleration. I don’t think it is unsound to say that people today want what they want **now**, not tomorrow, and credit has become second nature, just one more bad habit to add to all the others like over-eating, over-drinking, and substance abuse.

Debt is cleared in three ways. It is either repaid, or it is inflated away, or it is cleared by default.

But first we need to look at whether it is a good idea to stop this growth. You see the US consumer is responsible for 70% of US GDP and 21% of the world’s GDP! So if you stop the growth in consumer debt you also make a big dent in the economy. Not just the US economy but the world economy.

This would almost certainly bring stock and property markets crashing to the ground and that would be dangerously deflationary. People would lose their jobs, be forced to sell their houses and businesses would see much reduced profits. Falling markets would prompt investors to get out of $’s and we would have created the very problems we are trying to avoid.

So many attempts to stem this tide seem doomed to failure. Maybe it could be repaid, yes it could, but only if the economy continues on an even keel for many, many years to come. History teaches us that this simply does not happen, markets move up and they move down and economies do the same. Repayment over a long period is fraught with worry.

So how about inflation? I don’t believe it’s an option. We have profligate monetary policy, yet very low inflation rates. This suggests that we are actually in a deflationary period that is being disguised by all that money flowing about.

Say we did enter an inflationary period or it was somehow engineered? It might help as far as reducing the real level of debt but it inflation would bring higher interest rates which would clearly not help. Plus once a market starts to move it usually over-shoots and this holds true for interest rates as with anything else – the Government may like to give the impression they have control of these matters but in reality they have no more control than a surfer does of the wave he is riding. Additionally all those countries who invest in the US $ may start to get worried.

So we are left with default and that is going to happen quite a lot anyway. With default comes risk to the banking system especially to those banks over-exposed to the property market.

Again we see a situation at which every turn is fraught with problems.

Now let’s look at one of those countries who is owed all this cash by the US. Let’s look at…

China

It was reported that a US trade official says he expects the US trade deficit with China to top $200 billion in 2005. If so it is well up on the 2004 figure of $150 billion. Approximately 35% of US national debt is in foreign hands with the big three being China, the European Union and Japan.

In fact the US runs a trading deficit with every trading bloc on earth and the motives of some of these countries may not be to the best interests of the US. If one of them decides it was time to upset the apple cart they have that power.

In gangsta rap terms the US is China’s bitch!

So how come the $ is still strong

Here are a few reasons why investors are still holding the $:

1. Security. The $ has the backing of its dominant military, dominant technology, dominant agriculture, and the US is mature financially. In a

crisis holding $’s would allow purchases into these factors, that could be vitally important. Smaller countries whose own currencies get knocked from pillar to post can take comfort in these factors which are not offered elsewhere.

2. Universal acceptance and wide usage. This is another vital point as you want to hold a currency you can use.

3. The US willingness to be spender of last resort and some see this as a good reason for the current deficit and debt situation. The US stepping in when it is needed, being a responsible world citizen

4. Inertia. The $ is king and who would dethrone it? In fact there is quite a long list of countries that would be delighted.

These are compelling reasons. If we look back at history we see that the £ used to be the world reserve currency and that it took two world wars, a global depression, and two episodes of currency devaluation for it to lose its throne.

There is little like that to threaten the $ right now but there is trouble at home. The profligate spending policies and those resulting deficits may be its undoing. It is one thing to invest in a business with a prudent approach to its cash and quite another to do so when that has changed.

To give this an historic perspective when the £ was king and just before World War I Great Britain had foreign assets totalling 140% of GDP. Right now the US has an equivalent **deficit** nearing 40% and expected to top 60% by 2010!

I see the real problem as one of opportunity. You can do something right day in and day out for years but if you slip up once then that can trigger the problem – that is what is called a catalyst. There is so much that might cause a problem and once it has there may be no going back. Once you have opened Pandora’s box the opportunity to close it again may be extremely elusive.

SUMMARY OF THIS CHAPTER

- ❖ **How we all affect these markets**
- ❖ **The Barometer of a country's health**
- ❖ **Back scratchers to war in one easy step**
- ❖ **The USA today**
- ❖ **The twin deficits**
- ❖ **A bad example to us all**
- ❖ **The US Government and its credit card**
- ❖ **US national debt now $8,000,000,000!**
- ❖ **$27,000 for every man, woman and child!**
- ❖ **US Borrowings funded by their trading partners**
- ❖ **But would this survive a falling market?**
- ❖ **Private sector debt in the US is $30 trillion!**
- ❖ **It just needs one slip and there may be no going back…**

Chapter 3 – THE PROOF!

I said I would give you proof and here it is. This is a little complex and I will try to make it as clear as I can.

We have already discussed P/E ratios and sentiment. There is an alternative way of expressing the same concept. **This is that price is value times sentiment.**

What I am saying is that if an analyst were to value a company he might calculate earnings, he might add or subtract a factor depending on whether the company was growing or shrinking and then he might make a statement like "I can get 5% by putting money on deposit, risk –free, this equity investment involves more risk thus I need a betetr return, maybe 7.5%." If the earnings calculation comes out to $750,000 pa then the company would be worth $10m as a 7.5% return on $10m is $750,000.

If this company had an issued share capital of 20m shares they would each be worth 50 cents – but only if the market agreed that $10m valuation. The P/E ratio would be 13.33 ($10m divided by $750,000) – not far adrift from the long term mean of the S&P at 15.

To put this in mathematical terms:

P/E ration = Price ÷ Earnings = A measure of Sentiment (S)

Price = Earnings (E) x Sentiment (S)

You will have noticed in my illustration above that the calculation of "value" assumes that an equity investment will earn more than a cash deposit which in our example is perceived as zero risk. But in recent years sentient has been such that stock prices have yielded far less than cash deposits. People are not fools and there are two good reasons for this:

- Investors learnt the lesson of the 1980s that inflation can be a very serious enemy to cash – and this lesson may not have been fully unlearnt. It is a fact that we often fight yesterday's wars today.
- In the latter half of the 20th Century equities saw phenomenal growth. Is something grows phenomenally than it is worth paying over the odds to buy it. The problem is this growth is not sustainable.

There are three separate points here:

- Although there is always increased risk attached to buying above the average of the long-term mean of the P/E there are times when this can be justified and times when it is extremely profitable to do so.
- It is important to realise that there are definite fundamental factors which have an effect on sentiment. Economic growth is one such factor and as markets rally there is support because the economy grows for most of the rally, but not necessarily all.
- But once sentiment has reached unsustainable levels, and this is a psychological phenomenon, it has to fall back. As it falls back stock prices decline, because sentiment has far more of an effect than "value," and this decline has a further depressing effect on sentiment. The relationship is reflexive.

We now come to the crux of this discussion. You should now have a fairly good idea of the relationship between a stock price, its earnings and the role sentiment plays between those two key figures. You should see why when stock prices have been rising for many years, as they had up to the change of the millennium, P/E ratios will become very extended. Although this can be blamed on the “madness of crowds” it can also be explained by the human tendency to think in linear terms – to think that because we have had x% growth over the last 5 or 10 years that that will continue. This may be even easier to understand if we remember that investment professionals who we may consider highly trained and expert encouraged us in such views.

Markets work in fairly mysterious ways and investment professionals do not always understand these matters, how can anyone expect them to be understood by the man in the street.

It should now be clear why the long-term mean of the P/E on the S&P is around 15 – because at that level investors get a premium over cash on deposit to justify the risk of owning equities. Sometimes the P/E goes much higher for reasons I have explained. At other times it goes much lower and this is just the reverse of the same coin. Sentiment falls sharply as investors run for cover, it falls further as investors see the negative returns experienced in the last x years.

Nothing has changed to suggest that the historic performance of the P/E ratio is no longer relevant. The P/E ratio has not reached a higher plateau where it will remain. It will go below 15 and it may well get as low as 5 as has happened many times in the past. At 5 equities are a bargain with earnings at 20% - at such a point there nmay well be “blood on the strest” and sophisticated investor overcome the fear which is keeping the market down and go in. But it would take years for the market to recover from such a level. Part of this service is a news sheet keeping you informed as events unfold and I would hope to give a major sell signal in the future – but one of the characteristics of such a low is that most of you will have stopped listening!

Before we go any further I must advise you to be careful when looking at P/E rations. They are now always what they appear to be. The cause of this problem is how you define and choose earnings. I would recommend historical earnings - those shown in the latest audited accounts of the company. But there is a tendency to use estimated earnings, based on the assumptions if analysts who are perhaps paid to boost a company's share price. This would service to inflate earnings and this has the effect of reducing the P/E ratio – thus it may look like the P/E is fairly conservative but replace estimated earnings with historic earnings and you see the true picture.

It is, in fact, not too critical what form of earnings you use as long as you compare like with like. But estimates are bound to be more unreliable

Additionally earnings are defined differently as new accounting standards are introduced. There is little we can do about trying to recalculate historic earnings on the basis of today's accounting standards but it is a factor to be aware of. However there are two very substantial changes that may come in in the foreseeable future which could have a profound effect on earnings for years to come. These are:

- The accounting of share options. There is strong support, especially from Warren Buffett and his partner, Charles Munger, that the "cost" of share option schemes should be shown in the Profit and Loss account

- In the UK there is a move to make the under-funding of the company pension scheme as an expense which must take priority and any such payments would be a deduction from the Profit and Loss account. It is estimated that if this is enacted the entire profits of all the FTSE 100 companies (being the biggest companies I the UK) would be eliminated for a number of years. There are two reasons for this, firstly that pension projections were based on unrealistic figures brought home when the markets fell back; and secondly because the Labour Government (Now almost completely discredited) decided to help itself to pension monies by declaring a new tax.

If either of these were written into a new accounting standard it could have a devastating effect on earnings as shown in the accounts of quoted companies. Stock markets would have little option but to collapse on such a move and the cynic inside me says that is precisely why they will not be enacted – however justified it may be to do so.

Right now the P/E ratio on the S&P is hovering around 20. So to get down to 15 would require a fall of 25%, to get down to 5 a fall of 75%. A fall of 25% off the May ’06 peak at 1326 would take the S&P down to 995, if earnings also fell by 25% the decline would take the S&P down to 745. Are earnings likely to fall? I would say highly likely for the reasons set out in this book. To a large extent the “boom” remains consumer driven on the back of easy finance and a hell of a lot of marketing. I cannot imagine that any more marketing is possible and consumers are already up to their gills in finance. My view is that the “boom” has been extended way beyond its natural life by clever marketing and financial engineering.

As investors start to realise that the boom years are over they will "re-rate" equities and be less keen to pay over the odds. This will cause share prices to fall which will reduce sentiment, and thus prices further – once the process begins it will continue. This is the process that will take P/E ratios on the S&P back to 15 and below.

A major bear market is likely to take the P/E of the S&P nearer to 5! If we stick with our assumptions that earnings will only fall by 25% which I suspect is unduly optimistic we get a low on the S&P around 250.

If we look at the Dow we find that it made a high in May 2006 at 11670, very close to the all time high seen in at 11750 in January 2000. If we assume the same fall we get a low on the Dow at 2188. In fact I would not be surprised to see the Dow fall below 2000 and there is long-term support at 1616 which marked the low seen after the 1987 Crash. On the UK FTSE 100 indeed the corresponding level is at 1515.

Let me be absolutely clear what I am saying here. This is summary:

- The P/E ration will again see 15 and will again get below 10 at the bottom of a serious bear market. Timing such a move is impossible.

- Such a move will be accompanied by serious economic problems, certainly a serious recession and maybe a depression.

- In May 2006 major stock market indices headed south fast and the pattern of these declines suggested a major turning point – we look, at these later.

- But it would be a mistake to be certain that these declines will turn out to be monstrous. They key is to be prepared if they are.

SUMMARY OF THIS CHAPTER

- ❖ **Price is value times sentiment**
- ❖ **Sentiment is affected by what has gone before and can take a long time to adjust to change**
- ❖ **Make sure the P/E ratio is based on historic, not estimated, earnings**
- ❖ **The effect of Accounting Standards**
- ❖ **We will see a continuing re-rating of equities and the lower prices thus produced will drive sentiment lower still**
- ❖ **Possible Market Targets**

Chapter 4 – THE COMING PROPERTY CRASH

In Chapter 1 I explained how markets work and the property market is exactly the same – a market. In the West we have been brainwashed to think property prices can only go up. **NOT TRUE**, there have been many property crashes in the history of the world and there will be many more. Indeed many experts, myself included, consider that we are building up to that right now. Let me give you one reason for this. What is the single most pressing reason to spend so much on your house? … Give up? The only reason to spend so much is because people think they are going to make even more and it is that mentality which is always followed by a crash. Think back to when the stock market internet bubble burst back around the turn of the millennium, how else could those silly dot.com prices be justified? Well it is just the same with property, it is just far less obvious. Now let me make a cast iron prediction: "Property Markets around the World will Crash – I just don't know when…"

If I was forced to make a clear prediction I would say that prices in 10 years from now, ie in 2015, will be substantially lower, in real terms, than they are now.

The reason they will crash is that once property owners understand that the days of guaranteed appreciation are over it will no longer make sense to pay such over-inflated price to buy property – I reckon a 50% fall is about the minimum but it will probably take years to happen. This is exactly the same process I have been talking about in the previous chapter. As buyers start to realise they are not buying an appreciating asset, in fact that they may be buying a depreciating asset, they will substantially re-rate values.

Consider this. You have your job, you work 9 to 5. You scrimp and save and put all your money into your property, your nest egg. Thinking that when you come to retire, if you live that long, it will be worth a fortune. But no, the property crash hits and you are wiped out. What would you have to show for all those years of hard graft? Not very much, perhaps just the property itself, now worth less than you paid for it in the first place. So when it comes to surviving the cataclysm property is a major consideration.

This book is a survival guide for an uncertain future. So what do you do…

Rent, don't buy

It is far cheaper to rent a property rather than buy it. I have felt that the UK property market is overblown for some years now and I decided to rent three years ago. I pay £1200 per month for a detached three-bedroomed house in the Surrey Hills – one of the most desirable locations in the UK. If I had bought that house it would have cost around £450,000. Now this is truly absurd. If I had to borrow £450,000 at, say, 6% it would cost me around £2400 per month. Twice what it costs to rent. Plus the landlord has to pay for any repairs, house insurance; he even pays for the gardener! And there is nothing special about this deal – you could walk into an estate agents and do the same yourself tomorrow.

You may say it is unrealistic to talk about borrowing the full price of the property but it would be equally unrealistic to ignore the money used to buy the property, at the very least it could be earning interest on deposit. In mid November 2005 the first web site I went to (http://www.egg.com) offered me 4.5% pa. So if mortgage interest at 6% would amount to £2400 pm, if we equate that cash to the savings rate at 4.5% it would be £1800 pm, still considerably more than I pay in rent. And if you want to get even more "realistic" we could assume a 50% mortgage at 6% and include the 50% of cash in the property at 4.5% - resulting in a figure of £2100 pm. However you look at it the rental figure is a huge saving!

Ok, I hear you cry – but you will miss out on the property appreciation and paying rent is just throwing money away.

TRUTH – I have been in the house for 3 years and there has not been any property appreciation to speak of – indeed some friends of mine who bought at the same time are either sitting on small losses, or even smaller gains. I am not saying that the entire UK property market has been in the doldrums for 3 years but parts of it have been.

TRUTH - paying rent is no more throwing money away than is paying interest on a mortgage. Sure the capital repayments can be seen as an investment, but not the interest. Work it out. I am saving between £600 - £1200 pm, that is between £7,200 - £14,400 pa - and that ignores all those repairs and all that gardening!

PLUS, yes they just keep coming, I have been running my own business for years now and guess what? I can claim the rent against my profits! Yes, I am actually saving a lot more than £1200 pm by renting this property.

Before we go further let me just summarise the advantages of renting, there are two biggies:

1. It is cheaper on a day to day basis by a considerable margin

2. You are no longer exposed to an overblown market and if prices fall you, and your loved ones, are safe.

Property markets differ around the world but I have rented property in the USA, in France, and in Italy and it has always been a good deal. But you will need to research your own location carefully to decide what is best for you.

Whether you should actually sell your home depends on a variety of factors. The primary factor is that you should not be over-exposed. If your financial situation is wholly dependent on property appreciation then you are playing “yesterday’s” game that worked beautifully yesterday but may cause you a lot of grief “tomorrow.”

In essence it is a question of mind set. Do not consider your home an investment, consider it a utility, like your car. You don’t expect to make a profit on your car, do you? Well the same goes for your house.

But you have to make your own decisions in life. I see my task as to present the evidence so that you can make a rationale and informed decision. So here is…

The Case for the prosecution

Is property guilty of being over-valued? I think we will start with another question. We can all understand how a business that grows over a 10 year period has a higher value at the end of that period than it has at the beginning. Do you feel the same about your property? In what way is your property going to be worth more in 10 years time than it is now?

Ignoring special situations the answer is that your property is liable to be almost exactly the same in 10 years time than it is now. As such there is no reason why it should be worth more.

But, I hear you cry, I will be improving my property, upgrading the kitchen and bathroom, building a conservatory and garage, redecorating, it will be transformed. Fine, but it is important to distinguish between a growth in value because of additional expenditure and a growth in value because of market conditions. All these things would probably have a beneficial effect on the value of your house but not every “improvement” works that way. Personal taste is involved and if this clashes with what a potential purchaser may want, can reduce the value of property. There are also cost overruns and building problems as many a reality TV program has shown. On the other side of the coin property requires upkeep and replacing the roof, for example, is a cost you may have to meet which will merely restore the property to its former value.

It is not universally true, but I believe that the growth in property values for many years past has given the impression that improvements always pay, by which I mean that they add more to value than they cost, whereas the truth is that the growth in values is the main, possibly the only, reason for any appreciation.

In any case this does not affect the main point I am making which is that there is no reason why the same house, unaltered but maintained, should have a higher value at the beginning of a ten year period than it does at the end. I believe that statement is un-deniable, it is the truth!

But prices have risen, so why is this? Simply because of market forces, supply and demand. But as I have shown these forces are fickle. They are not always going to be on your side.

Right now the big question is…

Who is left to buy?

In the stock market it is an obvious factor. Once everyone has bought the market has to fall back and the dot.com bubble is a good example. Everyone had rushed in, everyone was convinced it was a new dawn, but it wasn't, it never is, and prices came crashing down.

In the property market right now the biggest cause for concern is the number of people who have not just one house, but two, or even more. How many more houses can these people buy. In fact I am ignoring property owned overseas. The western world has gone property mad!

To start with let us look at the "buy to let" mania because this illustrates the point nicely. There is a rule of thumb in buy to let that monthly rental to value should be around or below 1:100. Around or below, not far in excess of! If you take my house, I pay £1200 pm and it is worth around £450,000, the ratio is 1:375!

That makes the annual return on the property 3.2%. But that is the gross return. There are expenses to come off that, like insurance, repairs and maintenance, agent's fees and that gardener.

It is clearly a lousy deal for the investor/home owner with a return of less than 3% - less than you can get from cash on deposit which is 100% safe (usually).

OK, in this case the property has been owned for years and is the family home. So they have done very nicely thank you and they would not want to sell anyway whilst they are abroad on business. This arrangement suits both parties. But contrast this with those who have recently, in the last 3 years or so, bought into the buy to let mania. They have probably overpaid for the property in the first place, new build normally sells at a premium, and as they never plan to live there they may not have been as diligent as they might about the location and facilities. The return is insufficient to cope with any setbacks – a key factor if you are in business – and the only rationale for many of these deals is future appreciation.

I must stress that there is a huge difference between those who run a business of letting out property and newbie investors. The former tend to buy very cheaply, they tend to do some development work and made a development profit, they know their business and often do very well. I am talking about investors who do not know this business but are simply jumping on the band wagon with the glitter of endless property appreciation in their eyes.

I spoke to an Estate Agent about the buy to let phenomenon and he said that most investors get around 4.5% which may be net of service charges. The house I rent does not attract such a high percentage rental as would a 2-bedroomed flat, for example.

He also said, how well you do depends on how well you buy. If you buy a flat in a property which has been advertised in the Middle East then you will probably pay over the odds and you may also have trouble letting as the whole block may be let. The problem with this being that there are liable to be voids quite often and thus potential tenants may have a choice of two of three flats which puts the tenant in a good bargaining position. Apparently blocks which are wholly geared towards tenants tend to need greater upkeep as well.

Building Societies are happy to lend up to around 80% on buy to let and with an income of around 4.5% the deal should just about wash its face, barring rental voids. Right now no one is selling, especially those who bought prior to 2000 who are sitting on very healthy profits.

But rather like all those foreign investors in the US that could change rapidly if property prices start to slide. There are a variety of factors that could cause this.

Finally I am going to finish this section with some anecdotal evidence. This concerns a friend of mine, a young woman, who owns a good-sized flat just south of London and runs a small business. For the sake of this discussion I will assume she earns around £60,000 (around $100,000) before tax and has a total worth of around £200,000 (around $360,000). So she does fairly well for herself.

Recently she went into an estate agents and enquired about a buy-to-let investment. She was told she would have to put 25% down for the first one but that if she wanted ten properties with a total valuation around £2m (approx $3.6m) she could have them within around 3 months – plus she would be able to borrow 100% in the other nine.

On that basis she would end up with £2m of property and mortgages on that property of £1,975,000. Anyone who has ever bought and sold anything will know that it is generally much easier to buy than to sell. So if she tried to sell them all a week later she would probably have found she was £100,000+ in the hole. A 5% fall in the property market would wipe out her entire worth, 10% and she would be heavily insolvent. Yet this madness was out to her as something that could be done and done quickly. That sort of lunacy spells the end to me.

Now we will look at…

The case for the defence

Not guilty m' Lord! Most people seem amazed that one can even think property might go down. But try telling this to the Japanese where some property has fallen in excess of 65% since the start of the 1990s.

Indeed history is peppered with property collapses. There was the great Chicago collapse in the 1830s, anecdotal evidence tells of an acre of land that sold for $11,000 in 1836 which would not sell for $100 four years later (building land becomes highly geared as it can carry the entire profit with it). Property prices collapsed in the UK in 1773, and then in Germany in 1870. The UK was hit again in the 1890s and between 1899 and 1904 the average price of residential land had fallen 85%. The 1920s saw a collapse in Florida with some prices down 90%.

More recently UK suffered a horrendous crash in the early 1970s but this was more to do with commercial and industrial developments. Then the early 1990s saw another very solid pullback and this era was marked by many home owners plunging into negative equity.

The recent experiences in the UK did not last that long, just a few years, and those who sat them out are now well up on the game. My fear is that the next decline could be very different! Markets like nothing better than to teach you a certain lesson, like sitting out declines, before hitting you with something that is far more prolonged.

This happened in the stock market up to the end of the old millennium. Do you remember all that talk of "buy and hold." You do not hear so much about it now that we have seen massive falls in excess of 50% in most markets!

Anyway I think we can dismiss the "safe as houses" brainwashing we are all exposed to. Property has crashed in the past and there is nothing new under the sun – it will crash again. The fact is every time any market goes up it is simply that little bit closer to some sort of massive peak – they always come around eventually. The fact that property has had an extremely good run is no reason why it should just keep on going.

Now let's look at the "they aren't making it anymore" argument about land. There are various points here. Given all the property being build in resorts around the world the evidence is that they are making it, indeed making a great deal of it! Also we are always seeing new houses built in even some of the most densely populated areas. There are large gardens to cannibalise, big houses to knock down and it is an endless process.

But the key point here is that this is already built into the price. Property is already way over the top.

The real question is whether demand is going to outstrip supply. We would probably all wish that it would but I cannot see how it can. It is not just a question of the will to buy a lovely home, it is also having the wherewithal to do so and that is where the economy is likely to let us down – for reasons set out in this book.

But at the end of the day we need to know the…

Causes for a fall in property values

I will list these as follows:

1. If it becomes accepted that house prices may spent sometime, say ten years, showing little or no appreciation then I would expect that to wipe some of the excess off the market. It is one thing to plough all your cash into an appreciating asset, quite another if that is not the case. Just this realisation could start a slide in prices.

2. The economy is quite capable of throwing a wobbly in here. If we hit a recession then those who are over-exposed, remember I said this was the one thing you should not be at this time, may be forced to sell. Or may have their house sold out from under them by the bank or the building society – these institutions are not renowned for handling crises well.

3. A recession could cause earnings to fall and this would have a direct knock-on effect on property prices.

Two final points…

The Property mind set

Property Crash imminent! I keep hearing this and it does worry me because I have analysed the situation above and I agree. It shouldn't really as I don't own any property. But I have many friends who I care about and I can see that a crash would hurt them. The one thing I do find bizarre is how many people with large equity in their house are always saying how poor they are – and they believe it! In my life I have often found myself paying for these people, buying them things, meals, drinks, whatever, yet they are sitting on this big lump of equity! But they really think they are poor. Now what is the point of all that asset value if you just feel poor? Odd isn't it.

And here are…

Some scary statistics

In 2004 US homeowners borrowed $600billion against their houses – that equals 7% of disposable income. In the UK it was 10% of post-tax income in the winter of 2003/04.

Some experts attribute much of US economic growth to such financing.

It is reported that many homeowners envisage never repaying their mortgage so they can never retire because they will never have any money.

But there is now so little equity that US homeowners have no capacity to withstand adversity.

If it is true that those borrowing against their properties are a cornerstone of US and UK economies at this time then **even stagnant property prices could upset economy and trigger a fall!**

Summary

Some, maybe many, will disagree but I view the fact that investors are prepared to buy into investment properties for a return of less than 5% as a sure sign that residential property in the UK is over-valued.

The fact that so many people now own property, some more than a single property, is another very worrying factor confirming that this is mature market.

It would not take much to make this market crack.

SUMMARY OF THIS CHAPTER

- **Yes, property values can fall**
- **Renting is much cheaper**
- **Many own 2 or more properties already**
- **Who is going to buy more?**
- **"Buy to let" generally show too low a return**
- **But even stagnant property prices could cause an upset**

Chapter 6 – ENERGY – IT'S RUNNING OUT!

Right now we get around 60% of our energy needs from oil and natural gas. But guess what? The oil is running out fast. The earth was formed 4.6 billion years ago and the earliest fossil dates back 3.6 billion years.

For the sake or argument we can agree that the oil reserves on the planet have been accumulated over 3+ billion years – a fair amount of time. It has also been estimated that total usable quantities of oil on the planet before we started to use it amounted to around 2000 billion barrels (Gb)! A goodly quantity!

We have managed to use half of that to date, and our oil demands are accelerating such that it is estimated we will have used a further two thirds of what is left by 2020! At that rate by 2030 there will be nothing left.

I will repeat that – **NOTHING LEFT!**

I find this shocking. Maybe I have been wandering about with my eyes closed and my ears shut but I had no idea it was this bad. It is hardly a surprise that the price of oil has been shooting up. But it would be to misunderstand the market mechanism if you were to conclude it will continue shooting up. Markets over-compensate and the current rally will fail and give way to a pullback. That is guaranteed. Whether the trend remains up remains to be seen and on the alternative energy sources we come up with.

But if you are looking for alterative investments I would forget about classic cars. Indeed any car that relies on petrol may soon be obsolete except to a few who don't mind paying £10 or $15 a litre! If only a few want something and the supply is enormous then price can only go one way and that way is down.

Conversely if the demand for oil is very high and supply is dwindling then that price has only one way to go and that is up. I do not expect £10 or $15 litres in the near future but it may happen in the next 20 years.

One other important aspect of the oil situation is the major consumer who is, of course, the USA. The USA, alone, consumes around 20 billion barrels every day – 7.3 Gb per annum. Yet the reserves of oil remaining in the US are estimated at only 22Gb.

So again it is clear that oil is of vital strategic importance to the US.

But there are two factors we must not ignore. One is what the EIA (Energy Information Administration – official energy statistics from the US Government – http://www.eia.doe.gov/) call "Reserve Growth" and the other what they call "Undiscovered." In the discussion above I have been talking about our proven reserves. But the EIA reckon there is reserve growth of 730 Gb and undiscovered deposits of 940 Gb. Clearly these would make a big difference adding 1,670 Gb to the pot. But it is not quite that simple. Reserve Growth assumes technological improvements that enhance a field's recovery rate. Such improvements are liable to come with a cost and thus may only be economic at higher prices – which of course we will have!

Undiscovered reserves are another issue all together. We have had oil survey teams scouring the earth and the oceans for decades. Can they have missed anything that is big? Perhaps, but again economic factors may have more relevance. At $20 a barrel some fields may be uneconomic but at $60 or $100 it is a completely different ball game.

As the price rises more oil will come on stream. But let's take the most optimistic estimate – that we have almost 2700 Gb available to us now, including "reserve growth" and "undiscovered fields". That is another 1700 GB beyond us running out in 2030. But with estimated consumption in excess of 40Gb pa, and rising, after 2025 that only gives us another 40 years or so before it is all gone.

When it has all gone, whether in 2030 or in 2070, the planet will still be here and we will have switched to an alternative power source, indeed this process has started. But that process is fraught with danger for the world. It is when resources get scarce, when prices rise unpredictably, when businesses go bust, that wars are fought. Iraq is the start of the process, not the end.

Now let's look at oil's cousin…

Natural Gas

As of 1st January 2005 "proved world natural gas reserves," as reported by Oil and Gas Journal were estimated at 6,040 trillion cubic feet (tcf). The EIA state that world natural gas reserves have trended upward since the mid-seventies although the 2005 figure did show a fall of 36 tcf (less than 1%).

Current consumption is around 100 tcf and expected to increase 50% by 2025.

75% of natural gas reserves are in the Middle East and Russia.

Natural Gas is not such an emotive issue as we do not drive around with it in our cars and the supply situation is not so severe. At current rates of consumption the world has 60 years of proven reserves, dropping to around 40 years if we build in the expected growth.

But it too will run out in time and different countries will decide they do not want to rely on those who hold the reserves, this includes the UK. So we need to consider the alternatives…

What is happening now?

Right now we get 60% of our energy needs from oil and natural gas, and 40% from Coal, Hydroelectric, Nuclear Power and others; with coal accounting for around half of that. It is these power sources, along with oil and gas, which drive our industries, fuel our cars and other means of transportation, and heat and power our houses.

I am going to discount coal as an energy source for the future as it is "dirty" and inefficient. The first "external combustion engine" used coal (or wood – another carbon based fuel) to heat water into steam and we got the steam engine. But this had nowhere near the efficiency of the internal combustion engine where fuel burns (in the case of a diesel engine) or ignites (in the case of a petrol engine) within the engine.

Hydroelectric power has a lot going for it but you need a fast flowing body of water and this is not available everywhere. Wind power and solar power are all well and good but have not taken off and I do not think they are going to solve the problems we are facing. I may be wrong on this and it would be good to see more progress made. Nevertheless we are left with…

The power of the Sun

Otherwise known as nuclear fusion. This has a bad name and it is not surprising. However I think we should consider the fact that the planet earth has been using nuclear fusion since it was created by that very fusion in the first place. Indeed we owe our very existence to this form of power! How can we knock it?

To answer that is simple, it is fine as long as it is 93 million miles away, as is the Sun! We are not so keen when it is in our back yard.

The problem is that nuclear power has a bad history. It has been used to kill hundreds of thousand of people when used in bombs, it is a threat to world peace in the same form, and the peaceful use has resulted in various disasters and much pollution and disease; either through the disasters like Chernobyl ands Long Island, or through careless, negligent, and/or criminal disposal of waste products.

None of this is good, indeed it very, very bad.

My answer to these very justifiable objections is two-fold:

1. One other lesson from history is that mankind is inventive and we do learn from our mistakes.

2. The Nuclear Industry is in its infancy, as it matures these problems will be dealt with.

3. I think it will happen anyway.

Bold, courageous men will take this forward. Many of you will say that these men are actually reckless maniacs and it will not be known which is correct until we see the future.

First I want to address a key point...

Uranium Supplies

Whilst researching this section I came across the following quotes, "The European Commission estimates that there may be only 2-3 million tonnes of exploitable uranium sources globally (IAEA Red Book)" and "If all the world's existing fossil fuel based power stations were replaced by nuclear, there would only be enough Uranium to replace for a maximum of 4 years! Game over? Back to wind, wave and sun?

I decided to check this out with the Uranium Information Centre (UIC – http://www.uic.com.au) and their comment? "This is the limits to growth fallacy, and I am amazed that they should publish such words. It is such obvious nonsense."

It is sometimes difficult to know where we stand as statistics can be manipulated or their calculation changed such that you never know whether they can be directly compared. Now we come across another problem. Misinterpretation of information and disinformation itself. To get to the actual facts is tough. Especially when some of the information has to be estimated to start with.

But it is as fact of life that those with a vested interest will often manipulate the data and employ "spin" to get across the message they want. As often there are two or more parties with very different aims, both using disinformation and spin, it can be very difficult to get to the truth.

I find it is helpful to employ logic and common sense. Some statements are obviously true. For example UIC has said that current mining capability only scratches the surface of the planet, as this improves it is very likely more reserves will be found deeper – but this is only one of their statements. Common sense dictates that as we go deeper we will find more deposits, albeit with greater difficulty.

But I think I will let the UIC speak for themselves on this key issue…

A Common Fallacy

Concerns about limitations on the Earth's resources go back more than a century. Although they appear intuitive and logical on the basis that mined mineral resources are clearly finite and physically not renewable, in most cases careful analysis shows that limits to the supply of resources are so far away that concerns have little practical meaning.

There are, however, examples such as oil, where prices and sophisticated projections may now be indicating that proven reserves are indeed beginning to run out. Concerns about resource depletion therefore deserve careful examination.

Characteristically, predictions of scarcity based on published mineral reserve figures do not stand up to close scrutiny because they fail to take adequate account of three key "resource-expanding factors":

1. **Gains in Earth Knowledge and Discovery Capabilities.** Not accounting for gains in knowledge of the mineral deposits in the Earth's crust and in technologies used to discover them.

2. **Gains in Mining Technology.** Not allowing for progress in mining and processing technologies used to recover mineral deposits.

3. **Changes in Mineral Economics.** Not taking into account what will be economic over time in light of price changes and technological developments.

This takes us to…

Resource Sustainability

To achieve sustainability, the combined effects of mineral exploration and technology development must create known resources at least as fast as they are being used.

Historic data teaches the important lesson that this has regularly occurred, and continues to occur, with most minerals. Reserve margins for metals, stated in terms of multiples of current use, have been continuously replenished or - more often - increased. On average, real prices for metals have tended to fall over time.

It is important to recognise - with any commodity at any time - that one should never expect to see known economic resources of more than a few decades because exploration will only take place if companies are confident of making a financial return. The prospect of return is usually dictated by strong prices flowing from the prospect of imminent undersupply. When this happens, there tends to be a strong surge of exploration effort yielding significant new discoveries.

The purpose of this part of the book is to set out the main problem areas that I see we face at this time. The choice for our main sources of fuel for industry and our homes would seem to be fairly clear but what is not clear is…

Fuel for our Cars

We are all very used to having personal transport ready at our whim. 99% of these use oil based fuels but these are running out, there is also the pollution aspect. I believe the planet will deal with the pollution problem and it is, in any case, not a problem that seems to worry the vast majority of us. If it does worry us we show absolutely no sign of giving up our precious cars to do anything about it.

When it comes to cars there are two types of user. The majority just want a means of transport but there is also a minority who enjoy cars and get a lot of recreational fun out of them beyond there being mere transport. These two groups are not mutually exclusive and much intermingling takes place but those who use cars recreationally will want fairly powerful machines and the current problem with cars using alternative power sources, battery packs for example, is that they do lack power. But given that we have 40 years or so in which to develop alternative sources I do not perceive this as a huge problem. Maybe we will all have mini nuclear packs in 40 years time.

Conclusion

We are primarily concerned with economic matters in this book but energy impacts hugely on economics. If oil is indeed running out that will push the price up having a possibly devastating effect on the bottom line of many businesses. Also if we then need to switch to an alternative source of power that involves a huge investment plus possible disruption as the switching takes place. Also this situation brings uncertainty which is never looked on kindly by investors.

It is counter-intuitive, and may be considered bizarre, that a factor as vital as energy is a very minor matter when looking at stock prices when compared to the wrecking ball that is sentiment – but that is the case. Nevertheless energy cost and disruption may well have their part to play and could provide one of those catalysts.

SUMMARY OF THIS CHAPTER

❖ Proven oil reserves will be exhausted by 2030

❖ "Reserve Growth" and "Undiscovered Deposits" may give us another 40 years

❖ Natural Gas does not suffer the same limitations

❖ The "power of the sun" is the main contender to take over

❖ Proven reserves of Uranium may seem limiting but this is a fallacy

❖ But what about our cars?

Chapter 7 – THE CASE FOR THE PROSECUTION – WHY MARKETS WILL KEEP FALLING

We have already discussed the P/E ratio on the S&P and how all the decline has done so far is to bring it back to the top of its normative range. The froth has truly been wiped away but no more.

It is also of note that as the S&P has rallied over the last few years the P/E has gone down – see chart below – (thank to Bill Adlard of http://www.chart-guide.com for this chart). This is because earnings have grown faster than the rally, or perhaps more accurately the S&P has rallied slowly as earnings have grown – almost as if it was going up against its will. In fact it is often a mistake to be too sure why markets rally, in this case the rally started because markets got deeply oversold, the fact earnings grew at the same time may have been a happy coincidence.

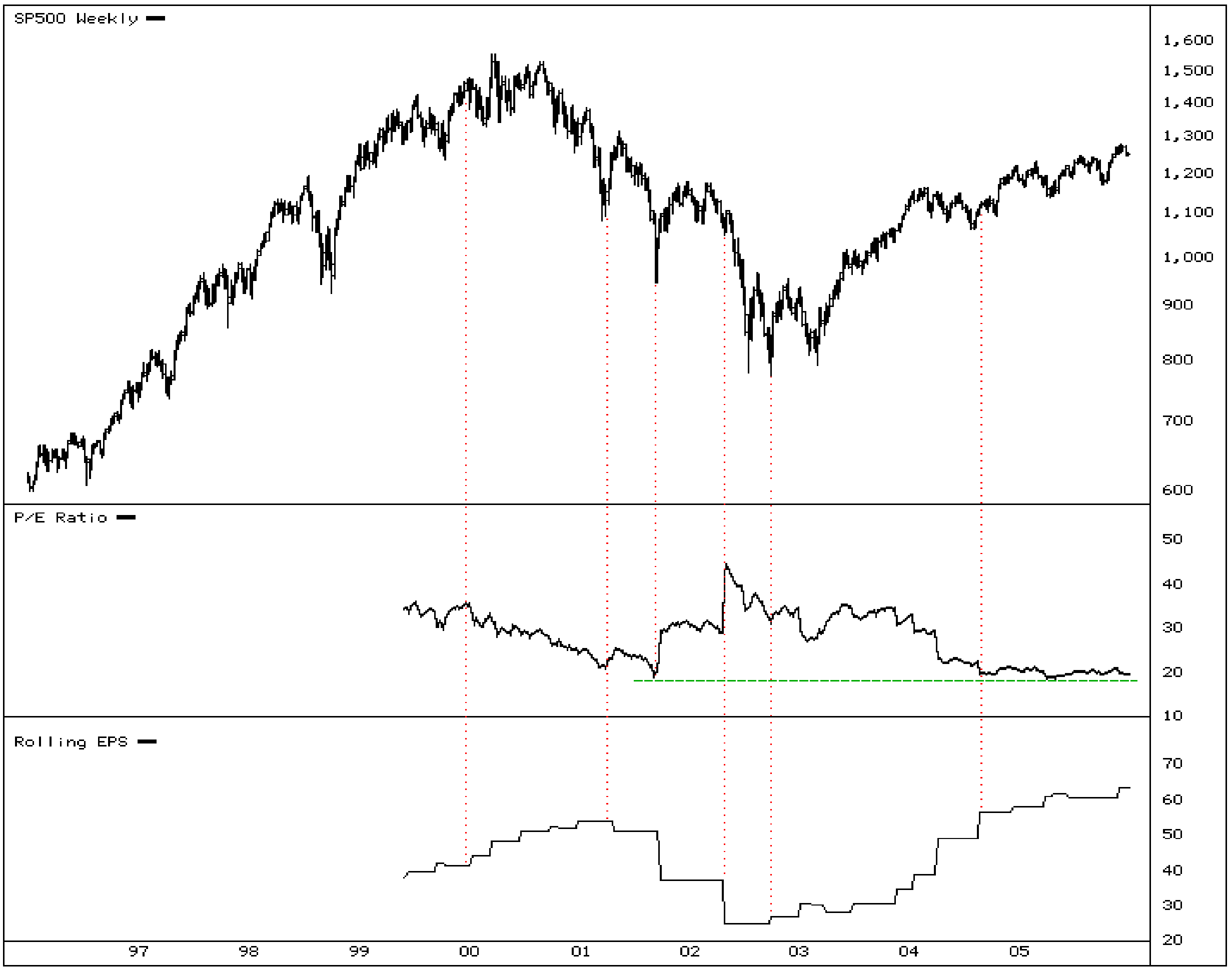
But the lack of any growth in the P/E ratio itself is very interesting. It means that as price has moved up there has been no increase in "sentiment" – in fact there has been a fall. I have discussed sentiment in some detail and explained why it is the key feature of price. The lack of growth can only mean one of two things – there are always at least two possibilities in markets rather like the two possibilities of price either moving up or down – that is what makes a market.

The two possibilities are:

- It confirms the "bear market rally" status of this rally. Indeed there is even "bearish" divergence, earnings have actually made a new high; but the S&P is far from doing so; or

- It means that the rally is far from over. Normally a rally peaks out when everyone is long and when everyone is long it tends to push P/E ratios up.

The chart below show this picture and I think it is an important one:

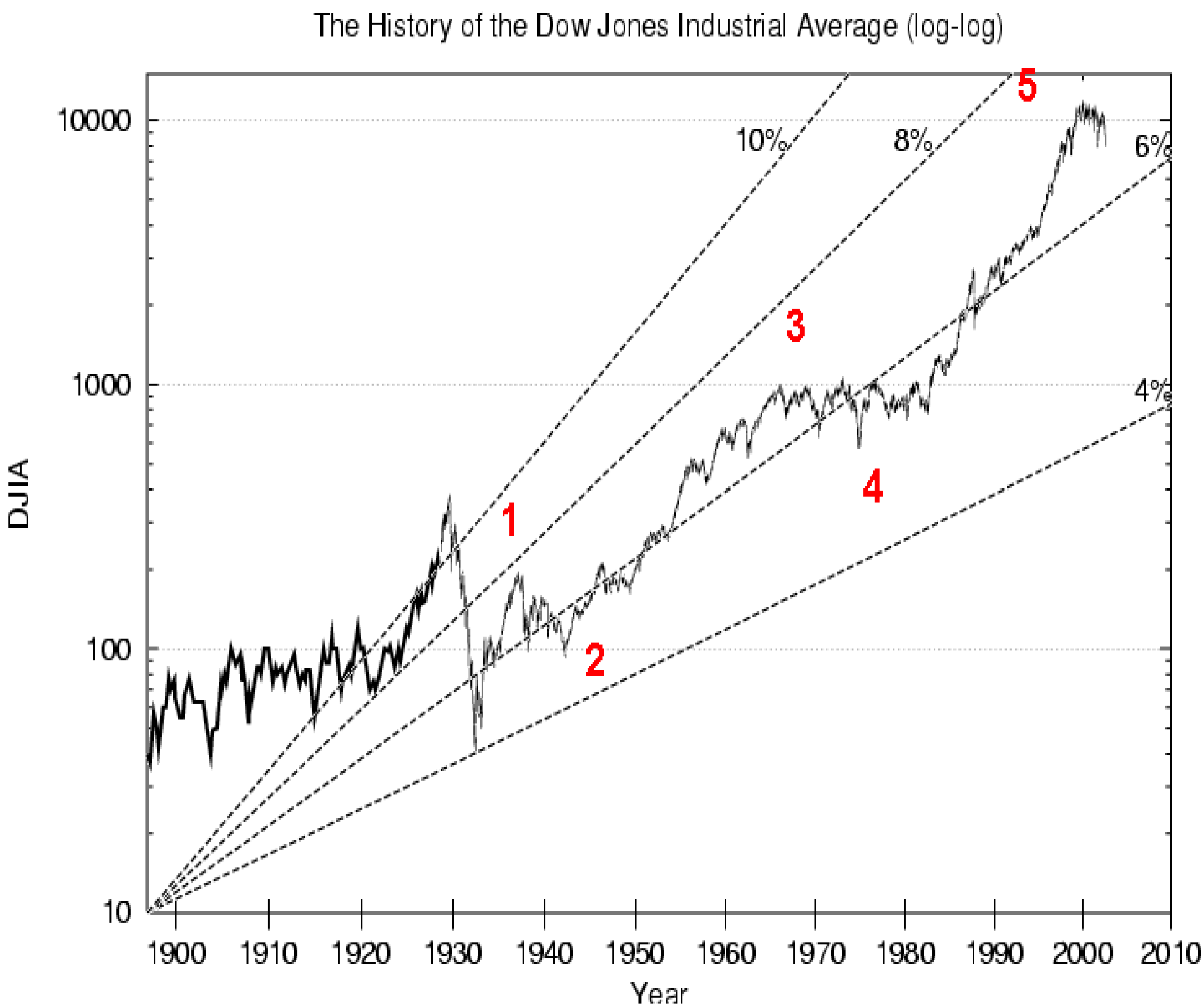


Interesting though this is I want to turn now to the background behind my forecast that we are going to fall further. Below you will see a chart of the Dow for the last 100 years.

This chart clearly shows the huge fall seen from 1929 to the early 1930s – aka The Great Crash.

I have labelled the moves up since the low following this devastating fall as waves 1, 2, 3, 4, and 5. This follows a system known as the

Elliott Wave Theory after its discoverer, RN Elliott who was active in the 1930s. There are only three rules I intend to mention. These are that impulsive moves, ie those in the direction of the main trend, tend to consist of five waves; whereas corrective moves, against the direction of the main trend, tend to consist of three waves and, sometimes, form



triangular formations. The third move is that these various forms are seen across all time frames – this is a concept recently "discovered" in the form of chaos theory, the concept of fractals. The originator of Chaos Theory is known as Edward Lorenz who discovered it by accident, this is often the case, when he entered a number to six decimal places to only three. To his amazement the result was hugely divergent and this became known as the "butterfly" effect – but Elliott had discovered some aspects well before this.

Wave counting is not a science, it is more of an art but it can still be extremely useful and has allowed me to make some startling market calls – see my earlier book ***THE WAY TO TRADE***.

In the case of the chart above we do not really need to count waves as the peak was confirmed very clearly by three factors:

1. The incredible euphoria into the peak especially in the case of the dot.com bubble.

2. The universal acceptance of equities, a factor I expect to be matched by a revulsion of equities once the bear market ends.

3. The large decline that followed the peak – this is the clincher, it is only when we see the decline we know for sure.

Incidentally this chart is shown on a logarithmic scale and the decline so far has hardly made an impact – this will change as the bear market develops.

There are a few other factors I want to point out:

1. If you look at the chart carefully you will see that each of the waves, 1, 3, and 5 themselves sub-divide into five waves. If we take wave 3 as an example not only does that wave sub-divide into 5, but its third wave also sub-divides into 5.

2. Wave 2 is a three part affair (normally labelled as an A-B-C) and wave 4 is a triangular double-diamond.

3. You will notice how the Dow has exhibited round-o-phobia (a fear of round numbers) at 100, 1000, and 10000.

To summarise the case that this was a key peak and not something that is going to be taken out in a few years time we have the following "evidence":

1. The five-wave form of the rally into the peak – see chart above.

2. The extreme reading on the P/E ratio.

Since we saw that peak we have seen impulsive declines and these declines ended in October 2002/March 2003. The lows have been followed by rallies – we now turn to:

The Case that we are now seeing key secondary peaks

For this we must look at the charts. First the NASDAQ 100.

This chart is made up to action on 31st January and the most obvious feature of the chart is the very sharp decline and the very feeble rally. In fact if you look at the figures the rally is not that feeble in itself, merely in comparison to what it followed

The NASDAQ peaked at 4816.34 in March 2000 and then fell 4021 points (83.5%) to a low at 795.25 in October 2002. The subsequent rally managed a peak at 1761.46 on 11th January 2006. So the rally managed 966.21 points, almost exactly 24% of the previous decline and it took over 3 years to do it – not impressive!

But why should the rally now be over. The first thing to say is it may not be over yet. As a trader I know that however good a trade may look it does not always work out. I know to cut my losses when it goes wrong. But here are the key points as to why we may now be right at the edge of the precipice once again:

1. It is absolutely clear that the bear market to date has only taken off the froth – The P/E ratio on the S&P is still too high by historical standards and no, it is not different this time!

2. It is also clear from the chart of the NASDAQ 100 that the rally we have seen so far is corrective – meaning it will be followed by further downside.

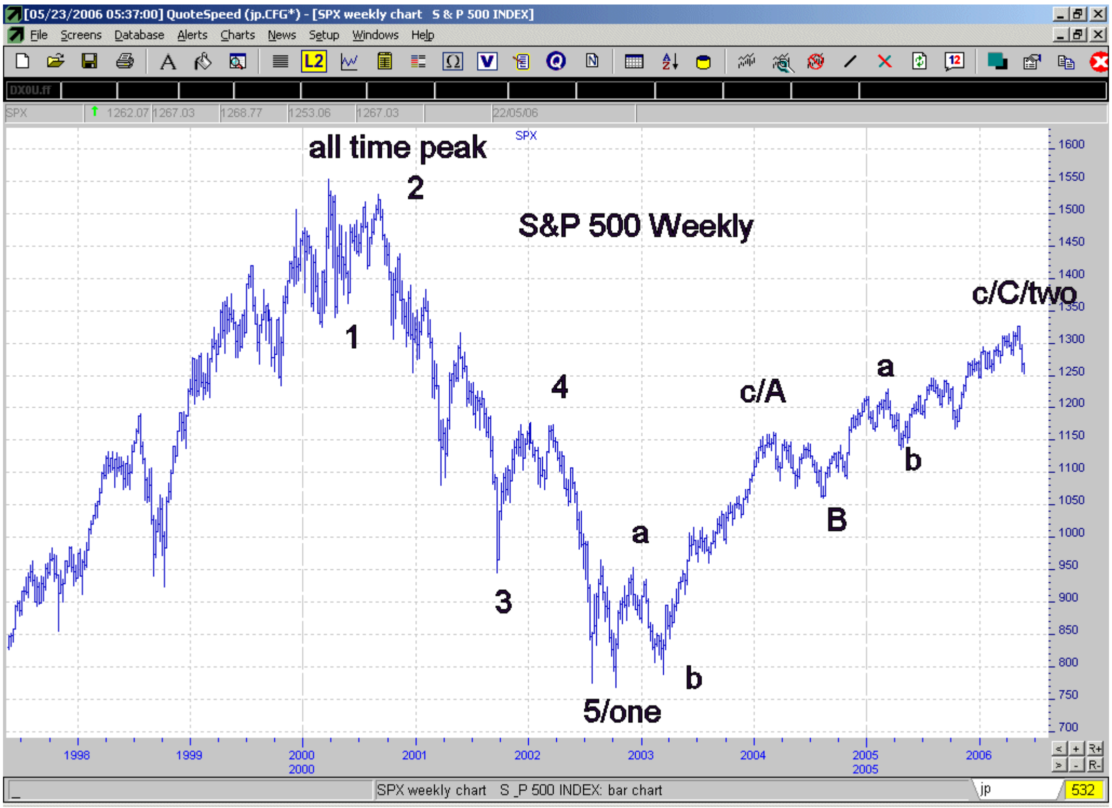
3. There is a complete Elliott Wave count into the peak.

4. We now have seen an impulsive decline but this still needs to be confirmed – this could happen any day now.

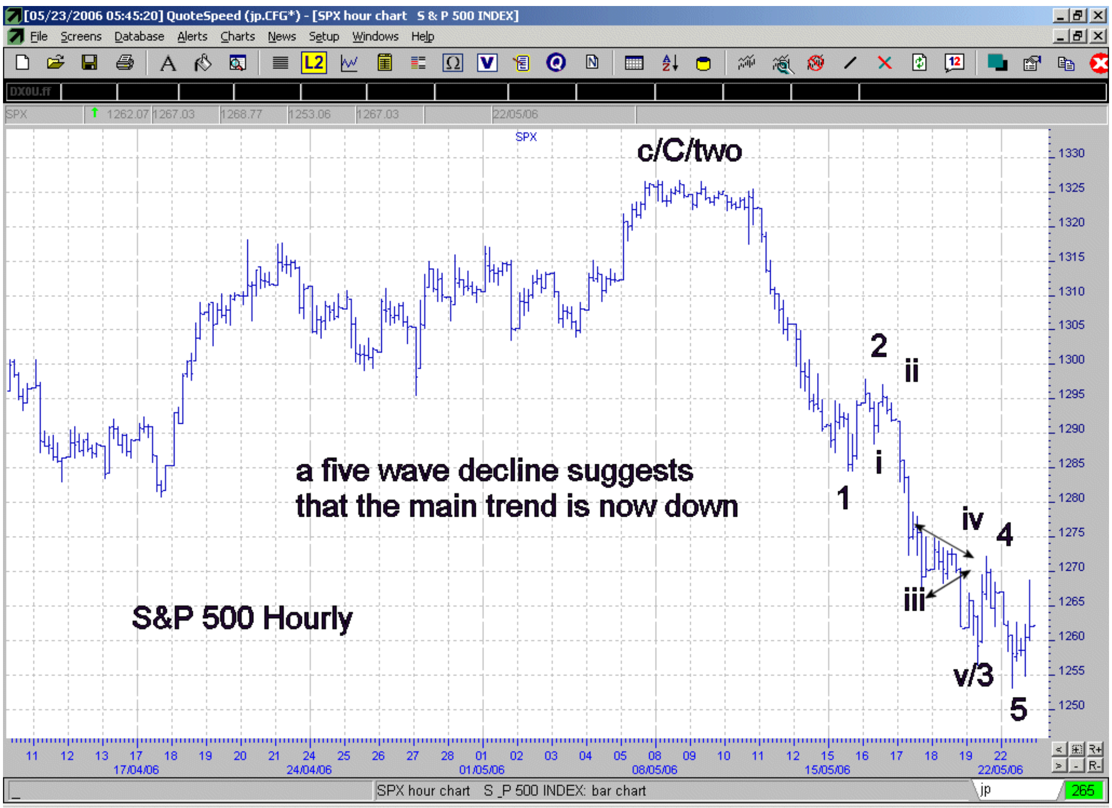
Now it is time for another chart. The S&P weekly – see below.

You will notice that the S&P has rallied more strongly than the NASDAQ 100 and has retraced 67.1% of the previous decline – it also only halved from the all time peak back in March 2000.

But we can sub-divide the rally into a big A-B-C and it counts as complete.



We also have an impulsive decline coming in – see Hourly chart below.



Targets

If the bear market is far from over and if the declines are starting again where might they go? We touched on this in an earlier chapter but here is another way of looking at it.

Elliott Wave Theory even has an answer for this. Declines normally find support at the lows of wave 4 of the rally which the decline is correcting. If we refer back to the long term chart of the Dow you will see that wave 4 took the Dow below 1000!

OK, that is shocking but is it completely out of court? Consider these points:

1. Major bear markets often knock 80% or 90% off the value of a bull market peak, just as the Nikkei Dow reduced its 1989 peak at 38957 down to 7995 in 2003 – a fall of 80%! I have already mentioned that the NASDAQ 100 was down 83.5% in just 18 months from its high in early 2000 – and that was just the froth coming off. So the first point I will make is that nothing has changed, these things still happen – this is not ancient history!

2. The Dow peaked at 11750 in January 2000 so a 90% fall would take it down to 1175, an 80% fall down to 2350.

3. But think also about those P/E ratios. The S&P P/E remains around 20, so if it were to go down to 5, which is "normative" behaviour at the end of big bear markets that would be a 75% decline all by itself.

4. But earnings will fall as well – this is a given in this scenario. Gloom breeds gloom. People stop spending, stop investing, it can

easily impact the bottom line by at least 50%. That would bring the fall down to 87.5%

I agree – it doesn’t bear thinking about – but I believe it is eminently possible!

Markets Now

As we go to press the S&P, the NASDAQ 100, and FTSE may have peaked but have yet to give absolute confirmation – not that there is anything which is absolute in markets. But what we do await is a corrective fro of rally following the sharp falls seen in May 2006.

The charts are shown in the next Chapter with suitable comments appended.

The situation will be updated in the news sheet as the pattern become clearer.

SUMMARY OF THIS CHAPTER

❖ The case for the prosecution

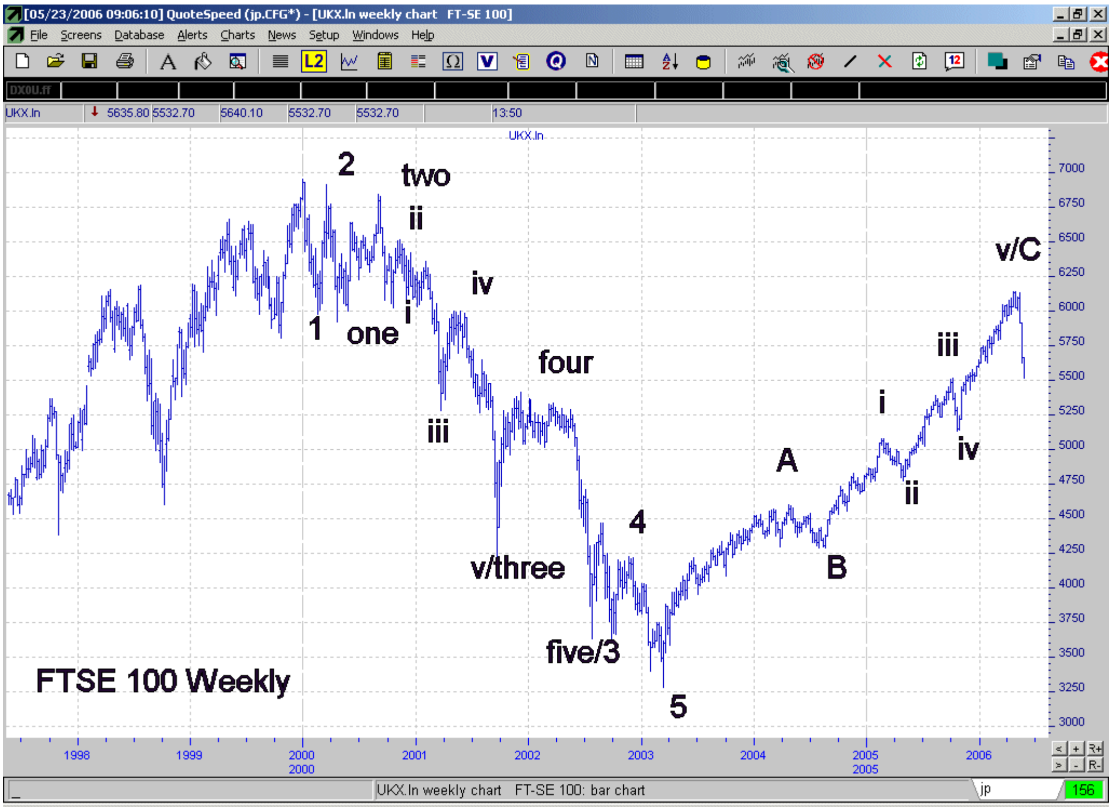
❖ Elliott Wave patterns

❖ Possible Targets

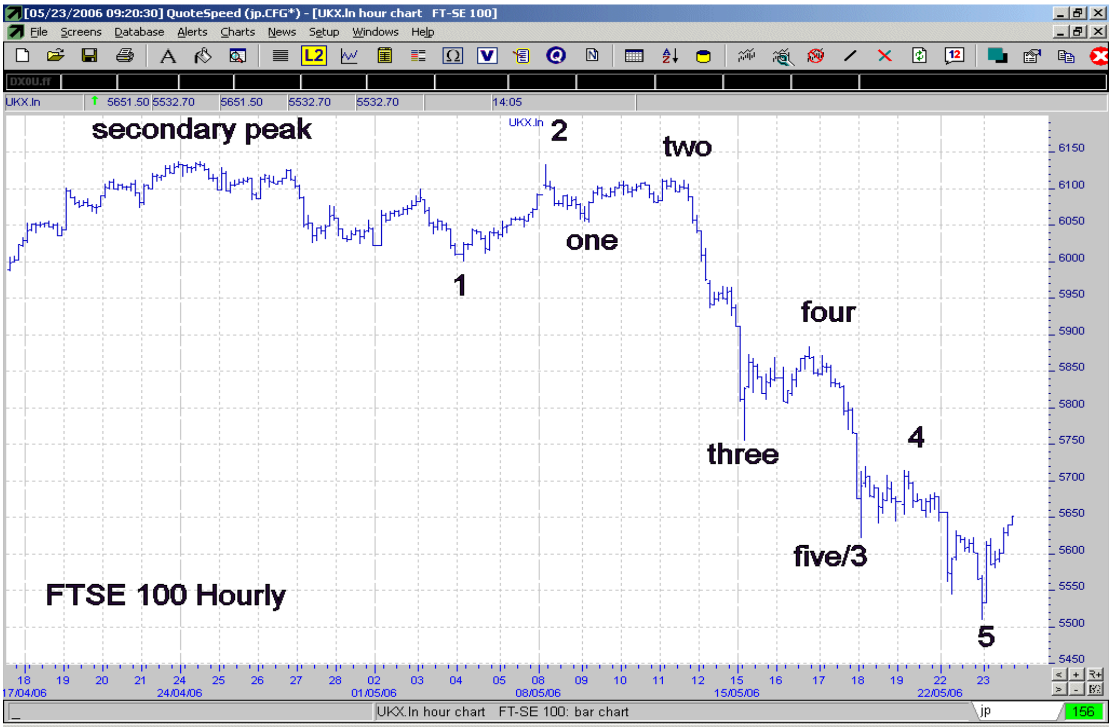
Chapter 8 - MARKETS – THE SELL SIGNALS

UK FTSE 100

The pattern into the peak at 6137 (27th April 2006) looks complete – see weekly chart below - although there is some technical difficulty with the count itself. However this is of secondary importance to the subsequent decline which is clearly impulsive.

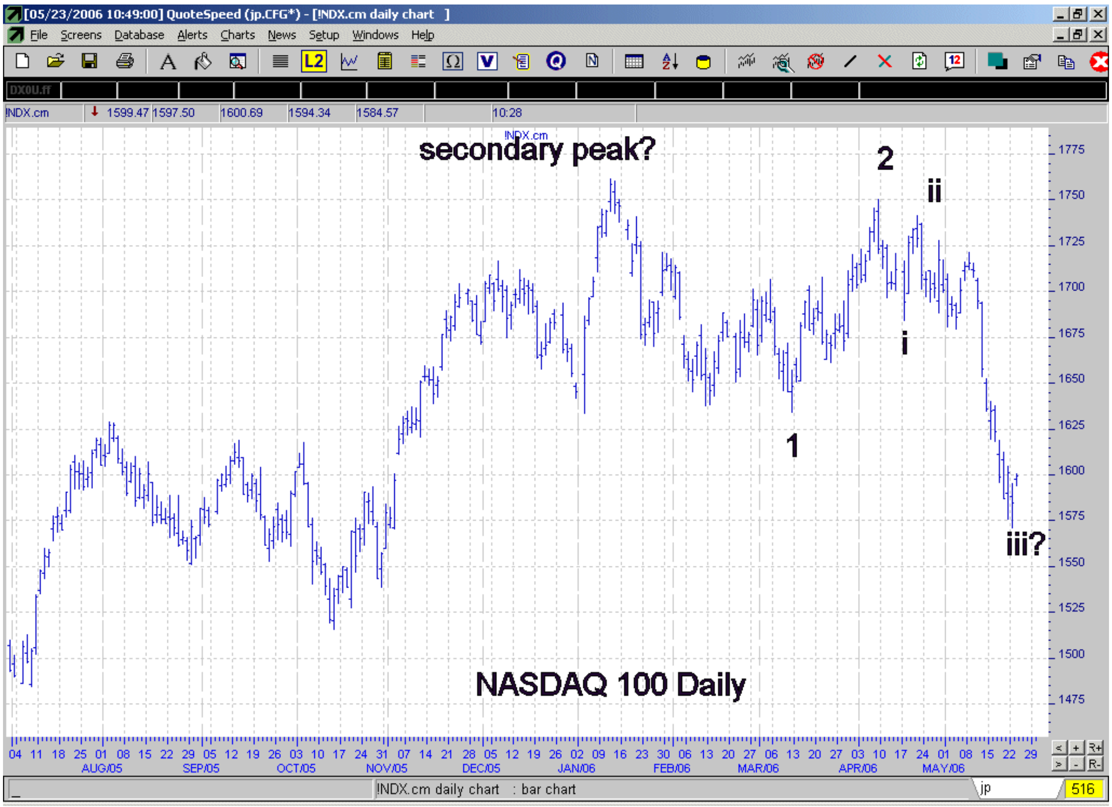


The chart shows the decline and this is clearly impulsive and shows a five wave form. We now await a corrective rally (maybe in an A-B-C form) to complete this picture. I issued a SELL on FTSE on 10th May when FTSE was around 6090 – with FTSE falling over 10% in May this was one of my betetr trades!



THE NASDAQ 100

I showed charts of the S&P and the Dow and here is one just more of the NASDAQ 100 – I am sure you do not want to be bombarded with charts!



The pattern on the NASDAQ 100 is not the same as on the Dow and S&P and this is because the NADAQ saw its peak on 11th January 2006. Because of this we have a decline which can be counted as an A-B-C and the NASDAQ is one market where we really need more downside fairly immediately if the bear signal is to be confirmed.

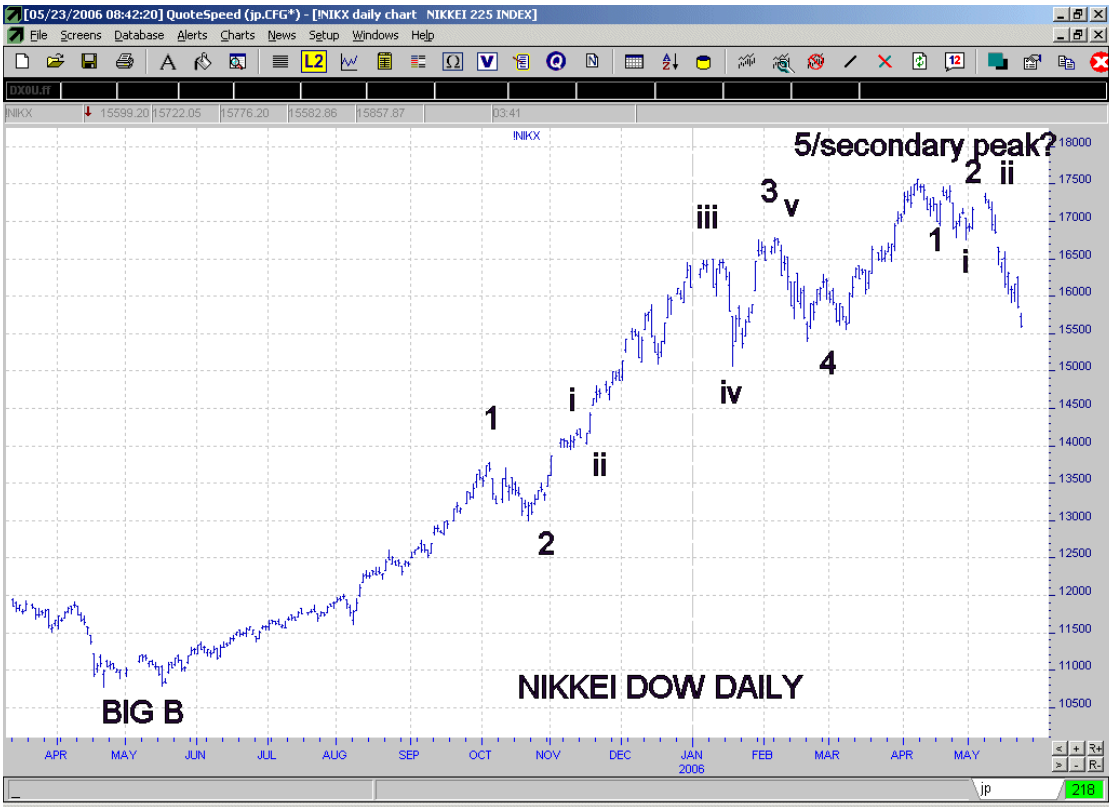
THE NIKKEI DOW

The Nikkei Dow is in a different position to western equity indices because it peaked 10 years before these other markets. The high was seen at 38957 in the last session of 1989 and it is not mere happenchance that the peak should be seen on that day. As I have said before markets are a manifestation of popular psychology and New Year's Eve is when human emotions are at their most positive – hence markets peak on that day (or as close as they can get) – FTSE did the same in 1999. Not only New Year's Eve but also the eve of the new millennium.

Here is the annual chart:

The key features of this chart are the major bear market seen since 1989 and the three-wave form (A-B-C) of the major decline. This is either a complete bear market or it is merely phase one. If the bear market is over then I would expect a limited decline now and then more upside. If it is only phase one then the decline due now could be savage – and this latter interpretation is supported by the position of western markets.

Here is a more detailed chart of the last half of the rally:



The key feature here is the five-wave form of the rally and also the impulsive decline following wave 5. These factors support the case that we have seen an important peak at the high of 17563 (7th April 2006).

Now look at the action since the peak, see again chart above. What we are looking for now is confirmation that the current decline is a major turning point and the technique I use is to see a five-wave form.

You will see that I have labelled the decline so far as having seen waves i and ii with wave iii in progress. So ideally I want to see wave iii complete and then to see a feeble wave iv rally before a final wave v decline.

If so we may then get a bigger corrective rally that may provide the ideal shorting opportunity.

Chapter 8 – THE ACTIONS YOU NEED TO TAKE

This is perhaps the most important chapter in this book. The most important factor in success is to make informed decisions. I have presented evidence on what I believe will happen. I have every reason to think it might happen very soon, but if the stock market recovers from the recent declines it will only mean a postponement, not a cancellation.

This will happen and you owe it to yourself and your family and friends to be prepared.

The first point I must make is that it is impossible to give individual advice in a book of any sort. I used to be an accountant, before I escaped, and you need to sit down with somebody and understand not only their financial situations, but their expectations and their future plans.

In this book I have tried to present evidence of what will happen and why. I have approached this from three distinct angles:

- From the viewpoint of market psychology and the fact that markets always move from boom to bust and the indications that tell us when those extremes are close.

- From the viewpoint of sentiment and how this reacts as more realistic perceptions are realised – reality shocks!

- By looking at charts and reading signal from those charts. I would mention that I consider this the least accurate and reliable of these three methods. As a trader, and this applies to any trader, I win on a percentage of my trades and that percentage is around, often below, 50%. A successful trader ensures his losers total less than his winners.

Property

Now you need to decide what action you want to take. The first thing is to ensure that you are not over-exposed. If a relatively modest 20% fall in property values would unhinge your capital base and/or an 2% increase in interest rates would destabilize your income/expenditure then you need to take action right now.

But a decision to sell your home is not to be taken lightly. It might be a very difficult decision to take. All recent history has shown that house prices go up in value – who am I to suggest otherwise? If you go and speak to your local estate agent, your friends, your family, they will tell you not to be stupid. That property always goes up. But don't believe them – because it doesn't. But there can be no guarantee that prices will not move higher in the short and medium term – even though the Governor of the Fed (US Federal Reserve Bank) said that the property boom was over only a few days ago (in May 2006).

What you decide to do might have a profound effect on your life so it is important that you carefully consider the options and come to a personal decision that suits you and your family. It is you whom will win or lose by your decision - make sure it is the right one.

Property is so wrapped up in life style and life enjoyment that it is impossible to consider to as a purely financial matter. Renting may be a lot cheaper but you may not want a landlord – mine is on the other side of the world in Singapore and that suits me fine. If you rent a house then there are restrictions, you may not be able to paint the walls bright orange for example – although some might say that is a good thing.

Then there is the location of your property, if you move it may not be so convenient. All these things need weighing up. But if there is a chance that you may be forced to sell because the economy lurches into recession then it is far better to bite the bullet now when you can play it your way.

Stocks

Investments are not so difficult. You need to weigh the risks and the rewards. What is the potential upside, what is the potential downside? When you do this do not forget sentiment - that is the key issue. What is the P/E of the stock now? Does that P/E make sense? What has to happen to make this stock a good investment? Is that likely?

One investment tool you might consider is to place stops on all your stocks. If the stops get hit you sell.

Another technique I find useful if I can't decide to is to sell half – reduce your exposure.

Pensions

If you have say in how your pension money is invested then consider switching it to cash for a while. Apply the same logic stated above to any stock holdings. Go for safety.

On this point I know people who have sold their assets and transferred their cash into a Swiss bank account. They have also ensured that the bank in question has no exposure to property or property loans. You may think this extreme but in a crisis you do not know what may happen, what action your Government might take. It may be betetr to be that safe and not sorry.

Currencies

If you have large amounts of cash you need to decide what currency they should be in. The $ may be at risk but so may other currencies. Also these markets will bounce around as markets always do, you don't want to sell out on a low. You may decide on a basket of currencies, maybe some Gold (although that has already become expensive). But these are expert matters which need to be considered carefully in the full light of all the facts at the time.

Banks and Cash

You need to be very careful where you deposit your money. Many banks have failed in the past for one reason or, another but dodgy property loans is well up on the list of causes of bank failure and you want to choose your bank with care. If you have an overdraft or bank loan it is less important but it might be worth considering what might happen to your loan if that bank failed. What does your loan agreement say regarding variance of interest charges and even calling in the loan in the event of their default – it might be worth checking.

You should also keep a good wad of cash at hand I case of an emergency. If the banks decide to take a holiday, ie close down for a while, you want to have cash on hand – it might save your life.

Beyond Safety and Security

Maybe you want to do more than play it safe. Perhaps you would like to profit as markets come tumbling down. There are many ways of doing this. You could trade futures, buy put options on stocks or the indices, you could put your money into bear (ursa) funds. But none of this is risk free and trading such instrument is best left along unless you know what you are doing.

For those who want to pursue this path there is a list of resources in Appendix I. I have been trading for 20 years and my first book ***THE WAY TO TRADE*** is an acknowledged classic on these matters.

I do manage money and if there is enough interest I would be happy to set up a fund geared towards declining markets.

Chapter 9 – SOME HISTORICAL PERSPECTIVE

This chapter was in fact Chapter 1 of a bigger book I had planned to write detailing not only financial problems but others potential disasters like viruses, meteorites, war, terrorism – to name a few.

This bigger book got derailed by events, in particular that we seem to have seen a peak in stock markets. Nevertheless I thought you might find this chapter and the next one of interest

A brief History of the Earth

The history of the planet earth is not one of sweetness and light. It is more a tale of greed and oppression. Throughout history there have always been those with the power doing the oppressing and those without who have been oppressed.

It is no different today but we do it more subtly, at least some do. The western nations use their power to enforce their wishes on those without the power and get rich in the process. In the less powerful countries those with the power are often corrupt and steal aid money sent to help with poverty and death and, they too, get rich in the process. At the bottom of the food chain are the poor who have no one to turn to and they have no opportunity for riches.

What is different now is that we see this every day in our living rooms. We cannot claim ignorance of the true situation. The world is a complex place and how did we get where we are now?

I think it is true to say that there have always been people who have secured a life of luxury and have time on their hands. It is said that the devil makes work for idle hands. The majority of people have always been too busy trying to make ends meet to create too much mischief. But this is not true of presidents, princes and kings. Having got to the top of their particular tree they have always had plenty of time to think about how to get even more and so they set out to conquer and plunder, dragging their loyal subjects with them. The history of mankind is littered with their stories. Alexander the Great, Caesar, Gengis Khan, Napoleon, Hitler, and Saddam Hussein are merely a few.

But let's start at the very beginning when…

A star is born

For the sake of brevity I will start 4.6 billion years ago when our Sun was created, estimated to have been 10 billion years after the "big bang" which gave birth to the universe. The birth of our Sun started off with a cloud of interstellar gas, dust and ice. That cloud collapsed to form the nebula from which our solar system developed. It is not certain what caused this collapse but it may have been a nearby supernova. Much of that material combined to form the Sun but some did not and over time this joined together to form the planets.

The Earth itself has its origins 4.6 billion years ago but its surface is quite young by these standards – estimated at 500 million years. The oldest known rocks are 4 billion years old and the oldest fossils of living organisms 3.9 billion years old.

It may, or may not, be true that the planet was relatively peaceful until man made his first appearance and this happened in Africa. The earliest signs of Homus erectus (standing man) or Homo habilis (handy man) date back 1,750,000 years. Africa became the earliest home for mankind because it escaped all five glaciations of the Ice Age.

Homo sapiens made an appearance around 100,000 years ago. With the earth dating back 4.6 billion years we have only been around 0.002% of the time, in fractional terms 1/46000.

Set against this pinprick of time and against the fact that the Sun is one of billions of stars we can only be humbled and realise that what happens on our Earth is probably not very significant. Nevertheless it is significant to us. This is why I am writing this book.

Mankind started out as…

Hunter Gatherers

The natural way of life was to take what was needed and other humans were undoubtedly as much prey as the lower animals. We then evolved and developed farming; we became tillers of the land. Settlements were formed and life became easier. Partly this had to do with the Ice Age drawing to a close 12,000 years ago at which stage forests grew, open planes contracted and the great herds of animals diminished.

It is worth noting that a Neanderthal site in what is now Iraq dates back 60,000 years and shows evidence of ritual practice and careful burial of the dead. So perhaps religion and a belief in an afterlife were already ideas at that time. Some of those buried were old or handicapped which shows a sense of civic responsibility or perhaps respect for the wisdom of the older members of the tribe. But anthropologists are divided as to whether Neanderthal vocal chords were capable of forming words.

History started around 3000 BC and what marked the end of the prehistoric age was that records were kept – we had learnt to write. It had only taken 97,000 years! But it meant that we had had 97,000 years with no records, all we have recorded is the last 5000 years.

But a lot has happened…

Competitive empires

As we developed we built on these foundations and hierarchies developed. There had to be a king pin – and then the trouble really started. For thousands of years kings caused trouble but it was localised. Then we started to get major problems and Alexander the Great was perhaps the first of the Kings to really put it about. Followed by the Romans and Attila the Hun. After that things quietened down a bit, although the crusades were fairly unpleasant, until Napoleon got started, as a direct result of the French revolution. Britain had started to build a worldwide empire and the seeds of our troubles today were sown at that time. Along with Britain; Spain, France, and Portugal also created empires and these all had one thing in common – the peoples of the empires were exploited – albeit in varying degrees.

Here’s an example…

Cortez the killer

Let's back track to 1485 when Hernando Cortez was born in Medellin, the son of small Spanish nobility. He studied as a lawyer but gave up his education in 1501 to drift around – in today's parlance we might say he took a gap year.

But he used his time carefully and in 1511 was made the chief magistrate in Santiago in Cuba. He soon amassed a fortune and many Indian slaves died extracting gold from his mines. At that time Mexico had just been discovered so it obviously needed to be conquered – this was the dot.com boom of the age but with real profits! Cortez was thus dispatched late in 1518 with 550 Spaniards, 300 Indians, a few negroes, 13 horses and 10 brass cannon. He had 10 ships and duly landed on the hot shores of Tabasco on 4th March 1519. He was met by hostile natives but they fled in terror from his horse and cannon. Indeed they later gave him a peace offering in the form of a beautiful slave girl who helped him enormously in his conquest of Mexico. The conquest did not take too long but the death toll was appalling.

Cortez initially pushed into the interior and was met by deputies of Montezuma, emperor of the Aztecs, an empire that had existed for 300 years! Cortez was told the Aztecs had gold and replied "Let him send it to me, for I and my companions have a complaint – a disease of the heart, which only gold can cure."

There was certainly never a truer word spoken. The pursuit of wealth is not inherently bad, it has many very positive aspects, but when it is pursued with a complete disregard for all other considerations, especially humanitarian and moral, then it is very much a sickness of the heart.

The rest of the conquest is a story of armed conflict, betrayal, duplicity, murder, even germ warfare - although this may have been accidental. Suffice to say that Mexico was conquered in less than 2 years. It is perfectly true that the Aztecs were very keen on human sacrifice, they had made many enemies locally with their insatiable search for victims and for one temple alone are reputed to have sacrificed 20,000 victims one after the other – it apparently took 4 days!

To return to our main theme this is an example of a powerful country, Spain, which benefited from “modern” weaponry taking control of another country that it then set out to plunder of slaves. gold and …

anything really.

This is how the world has worked since the beginning and if we look at…

The world today

We find it is fairly evenly divided between land masses where the “original” dwellers still retain control to those where they do not. I have to use the word original rather loosely as the true facts are lost in the mists if time. But it does seem fairly likely that there were not many invasions in the prehistoric ages and that most of those up to around 200 AD did not actually displace the native population.

But if we look at the world we find two large land masses, namely Australia and North America which have been totally colonised and are now controlled by immigrants of one sort or another. The USA and Canada are totally controlled by ex-Europeans with a good sprinkling of Mexicans and other South Americans. There are also plenty of black

Africans who originally had absolutely no wish to be taken to North America in chains as slaves. Australia started life as a penal colony for the UK and is now largely controlled by the descendants of those so punished.

Other large countries such as Russia, India and China would seem to have been left with their indigenous people at the helm, albeit this has not always been the case.

Europe is a complete hotch-potch with the English themselves being a combination of Angles, Saxons and Celts. Other European nations are similarly concocted after thousands of years of bloody wars and invasions. But at present there is no tyranny in Europe and most of the continent is governed by those who are representative of the majority populations.

So you can see from this that change is the order of the day. That yesterday immigrants are today's rulers. It is also true that descendants of yesterday's immigrants today look down on those who wish to immigrate today – but it was ever such.

So what are the problems…

Conflict in the World Today

The world is full of conflicts of one sort or another. There is civil war in a number of countries, there is revolution in a number of countries and there are tyrants and dictators. Generally these do not impact on the global situation.

But there are the following global problems.

1. The rich/poor divide. Right now the poor are so poor and desperate that they pose no threat to anyone but that might well change.

2. There is religious tension particular from the extreme Moslems who have resorted to terrorism to try and resolve certain matters.

3. Largely these matters may be described as the globalisation of US ideals. These ideals are also of concern to many who are not Moslems.

4. Immigration has become an epidemic and immigrants are now in such numbers in certain countries they are causing internal problem.

5. Counties which may be considered “less responsible” are building a nuclear capability.

I have given a brief description of the world and its people. But one of the biggest sources of conflict has not been dealt with. So here is…

The destructive power of religion

A man once said “We are all the children of God fashioned from elements forged deep within the furnaces of his stars” (Calvin J Hamilton). The second part is literally true. After big bang there were only two elements, hydrogen and helium. These formed the stars and the pressure at the centre of the star grew so high it started the process of nuclear fusion. This process created all the other elements of which we are formed.

But the first part of the statement refers to God and on this point we have a lot of argument down on earth. A lot of argument and a lot of bloodshed!

The ancient religions involving multiple Gods and human sacrifice have been supplanted and we now have four major world religions. In order of size these are:

1. **Christianity** – comes in a variety of guises, Protestants and Catholics for example, and dates back to Jesus Christ when BC turned to AD. The belief is one God, or a trinity of one God. It is not know for its tolerance of other beliefs but its tendency towards mass murder has become more limited in recent years. Current estimates are of around 2 billion around the world. Salvation and heaven are given for faith alone.

2. **Islam** – one quarter of the world's population (1.5 billion people) are Muslims. The religion dates back to around 600 AD and can be summed up by the word *"inshallah"* – by the will of God. The belief is that the one God is all knowing, all seeing and Muslims are said to submit to the will of God. The Koran is open to interpretation and there is no equivalent to the Pope to lay down the law. Thus we get Al-Qaeda who may have a few thousand followers who choose to interpret the Koran in a very aggressive and violent manner. The majority of Muslims live in South Asia (India, Indonesia, Bangladesh and Pakistan), the Middle East and North Africa but there are enclaves everywhere. Islam recognises Mohammed as the last prophet, but also counts many familiar to Christians as earlier prophets including Adam, Noah, Moses and Jesus. Salvation and Nirvana have to be earned.

3. **Hinduism** – claims in excess of 800 million followers and is dominant in India, Nepal and among the Tamils in Sri Lanka. Hindus recognise a single God and view other Gods and Goddesses as manifestations of that supreme God. The philosophy is tolerant of other religions but, as ever, political factors have seen fit to distort this and

violence has resulted on numerous occasions. Hinduism is far older than the other major religions dating back to 1500 BC. Salvation and Nirvana have to be earned.

4. **Buddhism** – "has the characteristics of what would be expected in a cosmic religion for the future: it transcends a personal God, avoids dogmas and theology, it covers both the natural and the spiritual, and is based on a religious sense aspiring from the experience of all things, natural and spiritual, as a meaningful unity." So said Albert Einstein about this religion which was founded in Northern India in 535 BC. It is estimated there are around 500,000 Buddhists in the world, with 10% of those being in the UK. Salvation and Enlightenment come after many lifetimes.

These are the big 4 but there are many others. Some of the more important ones are Judaism, Sikhism, Taoism, Shintoism, Spiritualism, and Wicca. But there are hundreds plus many more cults.

What does this all add up to:

A very divided world

Among people there are obvious divisions such as sex, race and colour. Over the years these have led to much discrimination and it would be naïve and ill-informed to think that this has stopped – it most certainly has not.

However on top of these natural differences mankind has created numerous countries and states plus numerous religions that cause further divisions.

Human beings can live in harmony especially when things are going well. But once things get tough it is a very different story. At the same time many are frustrated with their lot and tend to take this out on those who are different in one way or another. We only have to look at school children to see the same. Those who are different are often teased or bullied.

Conclusion

The world has ever been violent and aggressive and this has not changed. The many differences between the way we look, the way we act, what we believe, and, perhaps critically, what we have; have led to a great deal of conflict.

It may be true that 90% of mankind if tolerant of other ways and beliefs but there is a critical nucleus of those who are not tolerant and who can and will stir up the majority to act as they wish.

There is no easy answer to this as it is those who seek power who tend to be the ones who cause discord.

How can the silent majority suddenly become what they are not to change this?

SUMMARY OF THIS CHAPTER

- ❖ **A star is born**
- ❖ **Homo Sapiens took 97,000 years to learn to write**
- ❖ **Kings, princes and Cortez the killer**
- ❖ **The world today**
- ❖ **Conflict in the world today**
- ❖ **The destructive power of religion**
- ❖ **A very divided world**

Chapter 10 – FRUSTRATION WITH THE MEDIA AND CELEBRITIES

Mid way through the 20th Century a small revolution took place and this revolution has grown steadily ever since. The majority of people are now part of this revolution and some voluntarily, gladly indeed, worship at the altar for many hours each day.

This revolution has changed life as it was known by our parents and grandparents in a huge number of ways and its influence cannot be understated.

The foot soldiers of the revolution managed to gain entry to the homes of the people with no blood being spilt. Once in, they stayed and the only change was for a newer, better model to replace the one that had become worn out, or perhaps simply became out of date.

I am, of course, talking about television. These boxes entertain us but they do, and have done, so much more and here are just a few examples:

1. We now see events that happen around the world as they happen.

2. War, famine, atrocities are all available to us in our living rooms. We see all this and what do we do? Generally very little!

3. News and comment is reported very slickly and can clearly be opinion forming.

4. I think it is fair to add that we may be sleepy when we watch, maybe even asleep. The basis of some hypnotism is that the information goes straight to the subconscious mind when we are in this

state, uncontested by the conscious mind. This is potentially very dangerous.

5. And then there are all those adverts.

I am no Luddite and I view all technology as a positive, but I also appreciate that human beings can turn virtually anything to evil when they wish it. Television is very open in this regard and can, for example, be used by dictators and terrorists to get across their message.

But interesting though this be, it is not the programs that I am writing about. It is what happens between the programs that worry me – the adverts!

On all side we are beset with messages making us want things. The latest LCD TV, a new car, mundane articles like corn flakes, fruit bars, chocolate, make up, cosmetics, books, exotic items like yachts, holidays – you name it, we have it going into our ears and eyes at virtually every opportunity.

I feel like a guinea pig. Human beings have walked this planet for thousands of years; we have evolved to deal with life on this planet. But life has now changed out of all proportion. For the last 50 years we have been experimented on in a whole load of ways, not necessarily intentionally. The media is one of those, and we do not really know the long-term effect of many of these. Here are a few examples, pollution, global warming, magnetic waves from a whole heap of devices from mobile phones to computers to televisions, modern medicine and drugs, speed, et al.

I could probably go on all day and I believe 99% of these things to be as harmless as we generally believe them to be. I have a great belief in the resilience of the human body and indeed the resilience of nature. As an example I do not believe Global Warming is such a big deal, I think the planet will take this in its stride, although quite how that stride will affect the 6 billion human beings clinging to the mother ship as it hurtles through space at a speed of 67,000 miles an hour I do not know. On that point the speed at which we travel on the earth itself is relatively extremely slow!

But the human body is one thing…

The human mind is something else

Our body is resilient and, bar misfortune, will keep going for 70 years plus. But what will we do during that time? Do we want to live fulfilled lives or would we prefer to be full of frustration and find ourselves trying to express this through drugs, alcohol and violence with a bit of crime thrown into to support our habits?

To the vast majority of people the answer will be clear but consider the situation if you are born into the underclass that exists in all western countries today, especially in the US and the UK. Consider how you would feel having been given a sub-standard education in the UK thanks to the political manoeuvring of various political parties who, in some cases, have disbanded the very system that gave our top politicians their own education and the resulting chances in life that have taken them to the top.

You sit watching the TV with no real hope of ever rising above your current standard of living and you are bombarded with adverts showing what you could have and with celebrities showing off what they do have. Is that not going to make you want the same things, things you can probably never have?

Meanwhile your parents may not have instilled any discipline into you and the only real language you know is that of your fists.

I am not trying to be patronising in this, but I have seen people who have benefited from a good education travel the same road through different frustrations. For example, a good friend of mine was abandoned by his father when he was around 10. He has never been able to articulate this pain but is clearly very angry and has turned to drugs and alcohol to ease that pain; he is also given to violence. I can only imagine that in the absence of a good education and good parenting how much worse it must be and how similar pain must be expressed.

I say imagine, but every day I read reports in the newspaper which I see as expressions of just such frustration. We read about this frustration every day, drug addicts, violence, cats impaled on railings, happy slapping, racist murders, you name it, it is happening in the US and the UK today.

The US used to be way ahead of the UK in this but now it seems that the roles have reversed and why? Partly it is the lack of discipline in schools and the feeble response of the police and courts to crime in the UK today. This does not excuse parents who are primarily responsible for bringing up their children.

Also it is fair to say that the US may have got a better handle on preventing this sort of thing, but, as the recent events in New Orleans show, the same resentments and frustrations remain below the surface just waiting to come out when the opportunity arises.

There have been two incidents in particular in the UK recently which just defy my comprehension. Some teenage girls hung a small child by the neck. They did not kill him but it may have been close. Then a small cat, it may have been a kitten, was impaled on some railings – who the hell can do such a thing? And this is in the affluent west, not some dictatorship in Africa where people are regularly tortured, where wars are regularly waged – it is an established fact that wars are de-humanising.

In this book I am listing some of the things I see wrong with the world and charting an expected course as to how they will be resolved but my mind just stops in its tracks when I think what children are doing in the UK these days – what will these people be like as they get older? What sort of monsters are we breeding?

I said earlier that it was not our bodies I was worried about, but our minds – do you begin to see what I am talking about. These may be extremes, but I think they are the tip of the iceberg.

This goes way beyond the frustration that may be engendered by the media but I think that is a part of it. These people have been let down by their parents, and they are being let down by the system. It needs to be a lot tougher, there needs to be far more discipline, there need to be clear punishments when people breaks the rules.

Right now there are large parts of the community which live a semi criminal existence. They probably have no job, or at least no job they wish to declare to the authorities and who can blame them when PAYE (taxation) is at such a high level, apart from anything else. They steal to supplement this income and if they are caught they get a slap on the wrist. They have no visible means of support so if there is a fine the state ends up paying it – how absurd is that!

I can assure you I am no bleeding heart liberal. I may sympathise with the causes as I see them but behaviour like this should not be tolerated and I do not think punishment should be restricted to fines or prison or community service. Some corporal punishment may not go amiss.

We have a clear “class” structure in the UK these days; it has changed from the old structure of upper class, middle class, and lower class. Now it is the rich and the poor and those in the middle. This is what happens, the poor are often on benefits so they are OK, the rich, as ever, play the system to their own advantage (that is how they got to be rich in the first place) and the middle classes are left to pay the bills. There has been correspondence in the press recently about what happens when someone in the middle classes tries to make a fuss about taxes or TV licences or any such things. The full weight of the law falls on them like a ton of bricks! Of course, if the middle classes started to revolt the whole system would collapse – everybody else is living off them.

So where is all this leading…

A breakdown in Society

It has already happened! When the floods hit New Orleans the rule of law went flying out the window, or rather it was washed down the drain. OK, it has been re-established by use of the army and martial law but should a civilised country need the army and martial law to control its own citizens?

There was an article written at the time that contrasted this behaviour with what was seen in India when there were earthquakes and floods or in Thailand when the Tsunami hit. It was very different, people helped each other! They did not go around looting, getting everything they could get. Interesting concept! So what has happened to some parts of our society to reduce them to this state? Where has this selfishness come from, this inhumanity? Why is it that all these people can think of is themselves?

I don’t think this is a very large part of society but I could be wrong. Perhaps we are so used to having what we want, and so unused to having to go without that the animal in us comes out under pressure. This is different from the situation in the east where people do not have the same standard of living. Or perhaps some of us have become brutalised by what is seen on TV, maybe we are isolating ourselves in little shells with only the TV and film characters for company. Is this where the cult of the celebrity comes from, are they the only people some can relate to?

At the end of the day I believe this requires some very serious research. But perhaps the Governments in the west are frightened to start because they may find they are to blame in one way or another.

Meanwhile if am ever affected by a natural catastrophe I will try and engineer matters so that it happens in the East, not the West. It looks like I would get help from those I don’t know and aggression from those I do.

Problem rating

Of all the problem areas we discuss in the book this is perhaps the most insidious. The others can be viewed as external factors. Matters which affect the county but come from outside the country. There is an old saying that “united we stand, divided we fall!”

If the UK, or the US, is faced with dire problems as I believe will be the case, then if the country is united then it will come through those problems.

But if the populace at large react by rioting and looting then it will be a very different matter. The rule of law may well end. The rich in their security gated enclaves may be OK although a few security guards are not going to deter a mob.

The worrying thing is that it is already happening. New Orleans has shown what is simmering under the surface. The recent riots in France are still on-going as I write, and are another example of the same thing.

In that case it is immigrants who are rioting. Unbelievable in the sense that these immigrants rush off to pastures new expecting a better life and then when they don’t get it start to riot. But then why not, it is not their county in the first place, so why not mess it up. Indeed I have to wonder where the motivation came from and it would not surprise me if this was all planned as part of the terrorist threat to the west.

I don’t think countries have previously opened their borders in quite the same way as we are doing now. Yet again we are guinea pigs for the amusement of our political masters. Let’s do this and see what happens. Do these people ever think of the consequences?

We now have what may amount to whole armies safely within our borders - armies who we actually pay for through the benefit system, if the tabloid press is too be believed!

These armies outnumber our police and our armies. Guns seem readily available in the UK if you know the right people - and you can bet your arse that the right people are on hand.

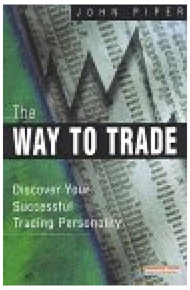
Now I know that 95%, and probably more, of immigrants are fine people who do want a better life and who will work for that. Plus they bring a lot to our country. But in any decision of consequence you need to weight up the risks and the rewards and the risks right now simply seem too high.

SUMMARY OF THIS CHAPTER

- **The revolution that affects us all**
- **Why we are all guinea pigs**
- **Media creates the desire**
- **That Desire turns to frustration when unsatisfied**
- **"Happy Slapping" just one symptom of this**
- **Police and Courts fail to do enough**
- **The semi criminal under-class**
- **What happens when crisis hits**
- **Have we allowed armies to enter our country?**

Appendix I - Resources

If you would like to receive my free **news sheet** and my free **101 part e-course** simply send an email to me at tt101@aweber.com – you should then receive an email asking you to confirm your wish to join this free service



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