

Supplemental Notes:

Twilight's Last Gleaming

Where are we headed?

Can we do anything to halt the downward spiral of our once-great nation?

Chuck reviews the “state of the union” and the results of the liberal agenda. We take our lead from Jeremiah and Hosea: we can see the storm coming—we may not be able to divert or stop it, but we *can* warn others. Our prayer throughout this crisis is that the lessons won't be wasted.

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Twilight's Last Gleaming

Two Most Frequent Questions

- Where is the United States in Prophecy?
- Why hasn't God judged America?

Our Trade Balance

We buy more than we sell (we always have). We finance our purchases with debt currency, and our current imbalance (deficit) = > a \$1,000 billion per year!

The Tip of the Iceberg?

Auto Industry: Auto sales in the U.S. in the month of November were down 37% year-over-year, to an annualized rate of 10.2 million units. This is a level not seen since 1982. Last year at this time (during a recession) cars were being sold at a 16.4 million unit annual rate. Throughout this decade, 16-18 million cars have been sold in the U.S. each and every year like clockwork. Now it's 10 million. That's a *depression-sized* decline.

Unemployment: U.S. jobless claims for the week ending December 6 were 573,000, the highest in 26 years. Mass layoffs are making headlines on a daily basis—in finance, in manufacturing, in retail, in construction, in transportation, in services, in tech... you name it. Challenger Gray reported 182,000 layoffs from big corporations in the month of November, the worst month since the months following the 9/11 attacks. All sectors are in steep economic decline and laying off workers en masse.

Industrial Production: U.S. industrial production was down 5.5% in November over the year before, making the 4th quarter the worst since 1980. Little wonder that consumer confidence continues to fall off a

cliff: University of Michigan consumer sentiment index recently hit a 28-year low.

Interest Rates: Some may point to plunging interest rates, already at zero in the U.S., as a “data point” indicative that things are about to turn around soon. We believe the opposite to be the case. Zero percent interest rates are an ominous *symptom*, not the cure. In a recession, zero interest rates are highly stimulative. In a depression, they are not.

A Delayed Confession

The National Bureau of Economic Research officially announced, albeit almost a year after the fact, that the U.S. has been in recession since the 4th quarter of 2007. But if Q4 of 2007 was an economic contraction, then Q4 of 2008 is an outright economic collapse. The data points are showing that economic activity, right here and right now, is falling off a cliff in unprecedented fashion.

The Blunt Truth

Any belief that this will be a short and shallow recession, or even a relatively long and deep recession (but still a recession), is, in our opinion, woefully misguided, wishful thinking. This is a depression—one that has only just begun, and one that the vast majority of us have never experienced in our lifetimes.

Investment Survival

In 2008 there were four investment strategies that paid off and “survived,” at least for the time being.

- 1) Cash, specifically the U.S. dollar;
- 2) Government bonds (not munis, state, or county, but only Treasury bonds);
- 3) Gold (the physical, incorruptible store of wealth).
- 4) Shorting, specifically the stock markets (but any risky asset would have done nicely).

Which of these strategies will be winners in 2009, a year when the financial crisis will have morphed into an *economic* one as well? Having started the year at U.S. \$800, as we go to press gold is now flirting with U.S. \$1000. In other currencies, gold has performed even better.

Gold has done exactly what it was supposed to do—protect portfolios against the carnage that was experienced in almost all financial assets around the world. Going into the depression of 2009, gold may well be the only safe harbor asset.

Tremors Continue

- Citicorp (until recently, America's largest bank) and General Motors on the brink of collapse;
- Downey Savings and Loan (one of America's largest S&Ls) collapsing;
- Home prices falling in 30 U.S. cities at the fastest rate in U.S. history;
- Multi-trillion Fed/Treasury bailout having absolutely no effect;
- IMF's chief economist warning that the worst of the financial crisis is still to come.

Bailing Out Wall Street

Fed/Treasury bailout funds now in the pipeline exceed \$8 trillion (more than the entire world's foreign currency reserves of \$7 trillion). The lion's share went to save Wall Street giants: Citigroup (\$306 billion); Goldman Sachs; Morgan Stanley; JP Morgan Chase; Bank of America; AIG; and, greed-driven corrupt executives who precipitated the global crisis in the first place!

Good Money After Bad?

Since October 2008, the federal government has deposited \$165 billion into 8 of the nation's largest banks: these

banks are now worth \$418 billion *less* than they were 4 months ago. The government's preferred shares are worth at least \$20 billion less: rate of return: -1096%!

Desperate Prognosis

It has been estimated that continued loan losses will force U.S. banks to come up with an additional \$1.4 Trillion just to stave off bankruptcy.

—Nouriel Roubini, NYU
Economics Professor, Time Feb 9, 2009

FDIC

Insurer of \$13.3 trillion in U.S. bank deposits in 8,451 U.S. Banks, the FDIC had less than \$35 billion in insurance funds at the end of 3rd Qtr (down 24%); this is only 76 cents for every \$100 of insured deposits; less than 1%. This is simply cosmetics to defer bank runs.

It Gets Worse!

The data have only gotten worse in 2009:

- U.S. housing starts fell a further 15.5% in December to 550,000, the lowest on record.
- U.S. industrial production fell a further 2.2% in December, to a 7.8% year-over-year decline.
- European industrial orders (a leading indicator of industrial production) are down 26% year-over-year, the largest decline on record.
- Japanese exports plunged 35% in December.
- Global steel production was reported to be down 24% in December.
- All over the world dramatic rates of decline in economic activity are being reported.

“The Tip of the Iceberg”?

The U.S. stock market is off 50% (so far); European markets are off 55%; Emerging markets are off 65%; the Russian market is off 70%; Earnings for all S&P

500 corporations dropped 22% in 3rd Qtr (vs. year earlier).

...What this crisis reveals is a broken financial system like no other in my lifetime. Normal monetary policy is not able to get money flowing. There has been leveraging in the economy beyond imagination...The trouble is, that even with all the government intervention, the market is not moving again.

—Paul Volker, Former Chairman of the Fed, speaking in London 11/21/08

Global Merchandise Trade

Global merchandise trade is now experiencing a steep setback: The Baltic Dry Shipping Index (a statistical barometer that economists use to track world transportation rates for ocean-going ships) has shockingly collapsed 90% in less than a year. As consumer spending declines, so will corporate sales, leading to further layoffs, resulting in fewer customers and even weaker sales, etc. It is a vicious circle.

How Much Is “a Trillion”?

If you were paid \$1.00 per minute, 60 minutes per hour 24 hours per day, 365 days per year, it would take you *2 million years* to earn \$1 trillion.

Jerome Corsi, a trained economist (and KI Gold Medalion Holder) uses this illustration: If you had gone into business on the day Jesus was born, and your business lost a million dollars a day, 365 days a year, it would take you until October 2737 to lose \$1 trillion.

How Did We Get Here? The Debt Debacle

In the Community Reinvestment Act of 1977, Fannie Mae & Freddie Mac were encouraged to subsidize sub-

prime loans. Attempts to repair the impending disaster was blocked by Congressional corruption for 30 years (mainly by Barney Frank, Chairman of the House Financial Services Committee, and Christopher Dodd, Chairman of the Senate Banking Committee).

Glass – Steagall Act

The Glass-Steagall Act of 1933 established the Federal Deposit Insurance Corporation (FDIC) in the United States and included banking reforms, some of which were designed to control speculation.

Arguments for Preserving Glass-Steagall

1. Conflicts of interest characterize the granting of credit (lending) and the use of credit (investing) by the same entity, which led to abuses that originally produced the Act.
2. Depository institutions possess enormous financial power, by virtue of their control of other people’s money; its extent must be limited to ensure soundness and competition in the market for funds, whether loans or investments.
3. Securities activities can be risky, leading to enormous losses which could threaten the integrity of deposits. The government insures the deposits and could be required to pay large sums in a collapse as the result of securities losses.
4. Depository institutions are supposed to be managed to limit risk, in contrast to the more speculative securities businesses. An example is the crash of real estate investment trusts sponsored by bank holding companies (in the 1970s and 1980s).

Glass-Steagall Repealed

Some provisions such as Regulation Q, which allowed the Federal Reserve to regulate interest rates in savings accounts, were repealed by the Depository Institutions De-

regulation and Monetary Control Act of 1980. The Garn-St. Germain Depository Institutions Act deregulated the Savings and Loan industry in 1982, but *provisions that prohibit a bank holding company from owning other financial companies were repealed on November 12, 1999, by the Gramm-Leach-Bliley Act.*

The Debt Debacle

- \$8 trillion in stock values lost;
- Availability of subprime loans inflated the biggest real estate bubble in history;
- In 5 years U.S. residential mortgage debt tripled from \$4 trillion to almost \$12 trillion: 300%.
- **Securitization leverage** led to the biggest credit bubble in history.

Structured Investment Vehicles (SIVs)

Funds borrow money by issuing short-term securities at low interest and then lend them by buying long-term securities at higher interest, profiting from the difference. But, they can become insolvent when the value of the long-term security falls below the value of the short-term security that was sold. Dangers include the fact that SIVs are issued with no regulation; no listing on public exchanges; no standards; no open market (bid/ask, etc.); no clearing house; private contract arrangements; and are unfunded, with no guarantees. Their specific performance is dependent on the balance sheet of the loser! Over \$20 trillion in notional value is now in default.

Collateralized Debt Obligations (CDOs) are loans repackaged as securities. First issued in the 1980s, they became the fastest growing sector of asset-based synthetic securities market and are held by thousands of the largest financial institutions of the world. There are dozens of varieties that defy categorization.

Derivatives Debacle

These bundled packages of subprime loans are now effectively worthless. They were based on the premise that markets would expand indefinitely and never contract and were completely unregulated and massively (fraudulently) overrated by the rating companies: Fitch, Moody's, and S&P. (False "Triple-A" Bond ratings given to specialized default insurance companies: Ambac, MBIA, CIFG, and FGIC.) Nine major insurers of over 80,000 corporate, municipals, and mortgage backed bonds are now in trouble and having their *own* credit ratings cut.

Derivatives Exposure

- JP Morgan Chase \$90.4 trillion
- Bank of America \$38.1 trillion
- Citigroup \$38.1 trillion
- Wachovia \$4.9 trillion
- HSBC \$4.4 trillion
- Wells Fargo \$1.5 trillion

—FDIC/IRA Bank Monitor, Q1 2008

Transition to a Debt Economy

We shifted to a *consumer* economy from a producing one. Thus: materialism funded by debt. Result: Excessive debts—personal, corporate, and government. Total collapse due to excessive debt. Remedy: **More debt?!**

Government Meddling with Free Markets

- 1) Central bank attempts to keep interest rates far lower than what free markets would have warranted (especially post-9/11), supported by the lie that inflation was non-existent;
- 2) The existence of government-sponsored enterprises such as Fannie Mae and Freddie Mac, fueling ridiculous excesses in mortgage finance and credit availability from ever-rising housing prices;

- 3) The moral hazard that ran amok as it became obvious that financial institutions can take egregious risks partly because they became “too big to fail”;
- 4) The existence of an unprecedented current account deficit in the world’s reserve currency, financed by government-run foreign institutions (central banks and sovereign wealth funds).

The Travesty Continues

Governments the world over are taking an increasing role in the functioning of the economy and the financial markets. But are they trying to solve the main problem: namely, too much debt? Quite the contrary, every single solution they’ve adopted has been trying to get “the good old days” back. Cutting interest rates to zero. Throwing money at the banking system so it can lend again. All these solutions have one goal: to bring back debt. They are ignoring, at least for the time being, the paradigm shift.

But the markets aren’t buying it... literally. Debts continue to implode. Every bailout is being followed by an even more massive bailout down the road. The government’s solution has been to shift debt from the financial markets to the taxpayer. Is there a difference? Instead of individuals living beyond their means, we now have governments living beyond their means. Substitute taxpayers for governments and you will quickly realize how the whole thing is a farce.

Unintended Consequences (Andrew Gelman)

The law of unintended consequences is what happens when a simple system tries to regulate a complex system. The political system is simple. It operates with limited information (rational ignorance), short time horizons, low feedback, and poor and misaligned incentives. Society, in contrast, is a complex, evolving, high-feedback, incentive-driven system. When a simple system

tries to regulate a complex system you often get unintended consequences.

—Andrew Gelman

Entrenched government bureaucrats are simple. They show no indication of knowledge or expertise in American history or rational financial theory. The President, Congress, Federal Reserve, and Treasury try mightily to direct our economy. It is an impossible task. With a GDP of \$14 trillion, there are thousands of inputs and outputs that feed the system. Their hubris leads them to believe that they are in control and can manipulate the gears of capitalism in a way that will produce their desired outcomes. If a desired outcome occurs, it is simply due to dumb luck. The more likely result of their manipulations of our complex system is a set of bigger problems that never occurred to them.

Let’s Focus

But let’s not waste time digging for causes—the economic blunders of Washington, the financial greed of Wall Street, or the big debts and risky bets by almost everyone. Let’s also not waste time pointing fingers—the Clinton administration for creating the tech bubble, the Bush administration for creating the housing bubble, or the Obama administration for giving us what promises to be a whole new government debt bubble.

Most important, let’s not waste our breath debating whether the plethora of government actions and programs since 2007 are philosophically right or wrong: the fact is, they have failed.

The Scorecard

In addition to the \$152 billion Bush stimulus package in the spring of 2008 and the \$700 billion Troubled Asset Relief Program (TARP) in the fall, the U.S. government has loaned, invested or committed:

- \$200 billion to nationalize the world's two largest mortgage companies, Fannie Mae and Freddie Mac;
- over \$42 billion for the Big Three auto manufacturers;
- \$29 billion for Bear Stearns;
- \$150 billion for AIG, and \$350 billion for Citigroup;
- \$300 billion for the Federal Housing Administration Rescue Bill to refinance bad mortgages;
- \$87 billion to pay back JPMorgan Chase for bad Lehman Brothers trades;
- \$200 billion in loans to banks under the Federal Reserve's Term Auction Facility (TAF);
- \$50 billion to support short-term corporate IOUs held by money market mutual funds;
- \$500 billion to rescue various credit markets;
- \$620 billion for industrial nations, including the Bank of Canada, Bank of England, Bank of Japan, National Bank of Denmark, European Central Bank, Bank of Norway, Reserve Bank of Australia, Bank of Sweden, and Swiss National Bank;
- \$120 billion in aid for emerging markets, including the central banks of Brazil, Mexico, South Korea, and Singapore;
- Trillions to guarantee the Federal Deposit Insurance Corporation's new, expanded bank deposit insurance coverage from \$100,000 to \$250,000;
- Up to \$500 billion in Fed purchases of asset-backed securities;
- Plus trillions more for other sweeping guarantees...

Grand total: Over **\$9 trillion** ... and counting!

These efforts were designed to stimulate the economy, avoid a housing bust, restore public confidence, contain the credit crunch, reduce the danger of a global debt collapse, and shore up sinking banks. But based on the overall net results to date, every single one is an outright, unambiguous, proven *failure*: the economy was *not* stimulated. Quite the contrary, it plunged at an annual rate of 3.8% in the fourth quarter and is expected to shrink by a whopping 5.2% in the first

quarter, according to a survey of economists published by the Philadelphia Fed. The housing bust was not avoided; the S&P-Schiller Index of average home prices in 20 metropolitan areas has been falling nonstop for 28 months, with the most recent declines the worst on record. (See S&P's home price spreadsheet, column W, rows 237-266.)

Public confidence was *not* restored; it has been sinking nearly nonstop, with the University of Michigan's Consumer Sentiment Index now hovering close to its lowest level in 28 years.

The credit crunch was *not* contained; we've seen the biggest contraction in credit availability in recorded history—new home mortgages shrinking at an annual rate of \$327.5 billion, commercial mortgages shrinking \$56.7 billion, commercial paper tumbling \$272.6 billion, and corporate bond financing plunging \$291 billion. (See Federal Reserve's Flow of Funds, pdf page 18.)

The danger of a global debt collapse was *not* reduced; it has actually gotten far worse. The evidence? The nation's 25 largest banks have upped their bets on the single most dangerous form of derivatives: credit default swaps. On average, the nation's five largest banks—JPMorgan Chase, Bank of America, Citibank, Wachovia and HSBC—have increased their exposure to defaults. At year-end 2007, their average credit exposure to derivatives was 264% of their capital, already extremely dangerous. Nine months later, it had risen to 317% of their capital. (OCC, pdf page 12, bottom line.)

Similar risks are rising dramatically in Western Europe, Japan and emerging market economies. In other words, a global debt collapse is even more likely today than it was before the U.S. government began its massive interventions.

The finances of the nation's banks were *not* shored up; they have actually gotten much worse. Just look

at what has happened and you'll understand why. Ever since the nation's banks were told last year that the federal government was planning to buy up their rotting assets, they've been holding on...waiting...hoping. In the interim, dozens of banks have turned down bids from investors to buy their bad assets at deep discounts. They have strenuously argued that their assets are "worth much more than buyers will offer." They have flatly refused to accept fair market prices. And government officials have nodded in agreement.

The Result: As the housing bust has progressed and the foreclosure epidemic has spread, the value of the banks' assets has plunged even further ... the banks' losses have multiplied ... and the banks' balance sheets have sunk into an even deeper hole. Meanwhile, by accepting \$45 billion each in federal bailouts, Bank of America and Citigroup—two of the three largest banks in the U.S.—have tacitly admitted that they are failed institutions. They are living on government life support. *They are insolvent.*

The Objective Evidence

The massive Bush Administration actions to save the economy have failed. Now, the same evidence shows that the massive Obama efforts are likely to meet the same fate: Failure! Never forget: Everything you see today—the collapsing economy, the failing banks and the continuing danger of a global debt collapse—is happening despite the most numerous, most radical and most expensive government rescue efforts in history.

Frenzied Neurosis

Yet, rather than recognize their futility, the Obama administration is pushing forward with even larger actions, always with the same general goals ("to prevent collapse") and forever using the same blunt instrument (more government money). The Obama stimulus

package is "\$787 billion," over five times larger than the Bush package just one year earlier. They promise larger attempts to save the sinking housing market; more money to avoid an even broader credit crunch; more money to prevent a more catastrophic debt collapse, and more money to shore up banks that have now sunk into an even deeper hole: "The 1st Law of Holes: Stop Digging!"

The Chasm Deepens

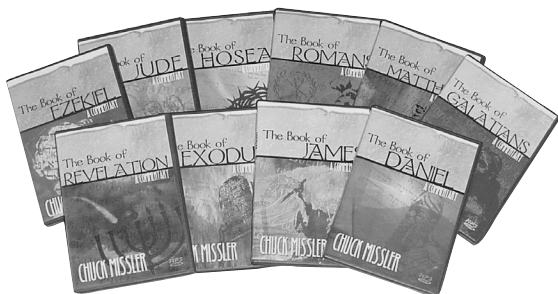
Before this bill was signed, actual federal obligations were already \$65.5 trillion—exceeding the gross domestic product of the entire world. The Obama administration's "economic stimulus package" is going to force the Treasury to borrow approximately \$2.5 trillion in 2009 and another \$4 trillion in 2010, with the result of increasing the current \$10 trillion national debt by 65 percent in just two years. Where are we headed? Hyperinflation? The Amero? Facism?

Our Personal Agendas

We take our lead from Jeremiah, Hosea, et al. We can see the storm coming. We can't divert or stop it, but we *can* warn others. We can each prayerfully discover our own specific calling and get on with it!

Remedy

- Back to basics: Hard work (no shortcuts).
- Self-reliance vs. entitlements. Earn before you yearn (spurn debt).
- Living *virtuous* lives: real values vs. covetousness.
- Reconnect character with destiny. Behavior matters—especially in spiritual issues.
- Reverence the God of our heritage.
- Prayer: That the lessons won't be wasted.
- Depressing horizon? Only to the *uninformed!* Have the "Birthpangs" begun? *Bring them on!*



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