John Williams'
Shadow Government Statistics
Analysis Behind and Beyond Government Economic Reporting

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To view all of the Newsletter, please visit `http://www.shadowstats.com/article/359`

MARKETS PERSPECTIVE

The accompanying table shows a snapshot of the passing roller coaster ride, where extreme volatility in prices has become the near-term norm for various markets. The systemic solvency crisis has roiled
investors' outlooks, triggering panicked market moves and flights-to-safety amidst heavy crosscurrents of distortions from portfolio liquidations of insolvent or illiquid entities, and overt and covert official market interventions and manipulations.

The systemic solvency crisis has undone much of the pro-dollar and anti-precious metals hype. The pending "bailout" will not end the crisis, so extreme market volatility and apparent irrationality in various markets likely could continue. The various near-term markets are as dangerous and unstable as I can remember.

Again, irrespective of ongoing market volatility in the days and weeks ahead, what is discussed below is based on the underlying fundamentals and from a longer term perspective. The markets eventually tend to catch up with the fundamentals. At such time as the markets reclaim some sanity, I still expect to see: intense selling of the U.S. dollar, with the greenback making new historic lows; heavy buying of oil and gold, with eventual new highs to be made (gold remains the best bet there); heavy selling of equities that will make the unfolding bear market one of the worst in history. With fiscal and monetary conditions deteriorating rapidly, intense dollar selling will help to boost long-term Treasury yields, particularly as foreign investors move to dump their dollar-denominated holdings.

U.S. Equities -- The equity markets are highly unstable, and almost anything is possible. Underlying fundamentals remain miserable. A severe and protracted inflationary recession means heavy hits to corporate earnings and increased business failures. Heavy dollar selling and increased flight from dollar-denominated assets eventually should drain liquidity from the equity and credit markets, hitting both stock and bond prices. Higher market interest rates generally act as an inhibitor to stock market exuberance.

General background note: I contend that stocks already have turned down into what will prove to be a particularly protracted and savage bear market (see the *Hyperinflation Special Report*). As equities catch-up with the underlying economic, financial and systemic fundamentals,

Closing Financial-Market Indicators as of September 26, 2008

Indicator	*3rd-Quarter-to-Date September 26, 2008* Level	*QTD*	*YTD*	*Yr/Yr*	*2nd-Quarter 2008* Level	*YTD*	*Yr/Yr*	*Year-End 2007* Level	*Yr/Yr*
Equity Market									
DJIA	**11,143.13**	-1.82%	-15.99%	-19.69%	**11,350.01**	-14.44%	-15.35%	**13,264.82**	6.43%
S&P 500	**1,213.01**	-5.23%	-17.39%	-20.48%	**1,280.00**	-12.83%	-14.86%	**1,468.36**	3.53%
DJ Wilshire 5000	**12,347.03**	-5.56%	-16.68%	-19.76%	**13,073.54**	-11.78%	-14.05%	**14,819.60**	3.94%
NASDAQ Comp	**2,183.34**	-4.78%	-13.55%	-17.68%	**2,292.98**	-13.55%	-11.92%	**2,652.28**	9.81%
Credit Market (1)									
Fed Funds Target	**2.00%**	0bp	-225bp	-275bp	**2.00%**	-225bp	-325bp	**4.25%**	-100bp
3-Mo T-Bill	**0.87%**	-103bp	-249bp	-286bp	**1.90%**	-146bp	-292bp	**3.36%**	-166bp
2-Yr T-Note	**2.11%**	-52bp	-94bp	-186bp	**2.63%**	-42bp	-224bp	**3.05%**	-177bp
5-Yr T-Note	**3.05%**	-29bp	-40bp	-122bp	**3.34%**	-11bp	-158bp	**3.45%**	-125bp
10-Yr T-Note	**3.85%**	-14bp	-19bp	-78bp	**3.99%**	-5bp	-104bp	**4.04%**	-67bp
30-Yr T-Bond	**4.36%**	-17bp	-9bp	-54bp	**4.53%**	8bp	-59bp	**4.45%**	-36bp
Oil (2) *US$ per Barrel*									
West Texas Int.	**106.90**	-23.64%	11.34%	33.11%	**140.00**	45.82%	98.04%	**96.01**	57.24%
Currencies/Dollar Indices (3) *US$/Unit*									
Pound Sterling	**1.8400**	-7.57%	-7.27%	-8.73%	**1.9906**	0.32%	-0.58%	**1.9843**	1.31%
Euro	**1.4596**	-7.32%	-0.05%	3.33%	**1.5748**	7.84%	16.48%	**1.4603**	10.65%
Swiss Franc	**0.9183**	-6.32%	4.03%	7.53%	**0.9802**	11.05%	19.98%	**0.8827**	7.64%
Yen	**0.0094**	0.10%	5.33%	9.05%	**0.0094**	5.22%	16.13%	**0.0090**	6.54%
Canadian Dollar	**0.9660**	-1.41%	-4.55%	1.29%	**0.9818**	-2.98%	4.41%	**1.0120**	17.92%
Australian Dollar	**0.8292**	-13.28%	-5.52%	-6.36%	**0.9562**	8.96%	12.61%	**0.8776**	11.31%
Weighted Currency Units/US$ (Jan. 1985 = 100)									
Financial (FWD)	**48.09**	7.08%	1.76%	0.80%	**44.91**	-4.97%	-9.34%	**47.26**	-7.64%
Change US$/FX	**--**	-6.61%	-1.73%	-0.79%	**--**	5.23%	10.31%	**--**	8.27%
Trade (TWD)	**53.42**	4.62%	1.33%	-0.96%	**51.06**	-3.15%	-9.79%	**52.72**	-10.00%
Change US$/FX	**--**	-4.41%	-1.31%	0.97%	**--**	3.25%	10.85%	**--**	10.01%
Precious Metals (4) *US$ per Troy Ounce*									
Gold	**902.00**	-3.04%	8.19%	22.76%	**930.25**	11.57%	43.01%	**833.75**	31.92%
Silver	**13.18**	-25.33%	-10.70%	-1.93%	**17.65**	19.58%	40.75%	**14.76**	14.41%

bp: Basis point or 0.01%. (1) Treasuries are constant maturity yield, U.S. Treasury. (2) Department of Energy. (3) Shadow Government Statistics, FRB (see Dollar Index Section for definitions). (4) London afternoon fix, Kitco.com.

the downside adjustments to stock prices should be quite large over some years, eventually rivaling the 90% decline in equities seen in the 1929 crash and ensuing four years. The decline might have to be measured in real terms, as a hyperinflation eventually will kick in, with the Fed moving to liquefy the system and monetize federal debt. Stocks do tend to follow inflation, since revenues and earnings get denominated in inflated dollars. Hence with a hyperinflation, a DJIA of 100,000 or 100,000,000 could be expected, but such still would be well below today's levels, adjusted for inflation.

U.S. Credit Market -- Short-term Treasuries actually sold at a negative yield within the last two weeks -- as they did during the 1930s banking crisis -- with investors willing to pay to have their assets held by the U.S. Treasury, instead of risking them in the commercial financial system. Real (inflation-adjusted) Treasury yields remain negative across the yield curve.

The ongoing financial crisis remains likely to suppress yields in the near-term, given ongoing safe-haven issues. The Fed is not likely to raise rates, unless it is forced to by a debilitating crisis with the U.S. dollar. Otherwise, the U.S. central bank may use an easing or two to help prop the equity markets, once the "bailout" euphoria has passed.

Aside from safe-haven effects, the forced investment in U.S. Treasuries of unwanted dollars held outside the United States continues to keep Treasury yields artificially low. Therein lies upside risk for Treasury yields at such time as dollar dumping becomes serious. Other upside pressures will come from the deteriorating fiscal and monetary (inflation) conditions. Treasury borrowings already have been spiked by the current crisis.

The longer range outlook continues for long-term Treasury yields to back-up by at least several hundred basis points, approaching a more-normal spread in long-term Treasuries over inflation. With a normal spread and annual inflation at 5.4%, the yield on the 30-year Treasury bond should be over 8.5%, not around the current 4.5%. With higher inflation in the year ahead, long-term yields should be even higher, still.

U.S. Dollar -- Stories out of the Bank of Japan have tended to confirm coordinated, massive covert intervention in the currency markets following the Bear Stearns failure in mid-March. The action by central banks was coordinated with heavy jawboning aimed at bottoming the U.S. dollar and turning it to the upside. At least one major, now-former investment bank invested heavily in rallying the dollar, including generating significant dollar support theories. The story put forth was that the economies of the major U.S. trading partners were turning down, while U.S. economy was holding up. Such nonsense was made possible by more-honest economic reporting outside the United States.

The weaknesses in the U.S. system increasingly have had very public and global exposure in the last couple of weeks, effectively killing many of bullish stories and jawboning points that had been used to goose the greenback. Further, unusually frank comments from other central banks and finance ministers suggest the day of broad dollar dumping and dumping of dollar-denominated assets may not be too far in the future.

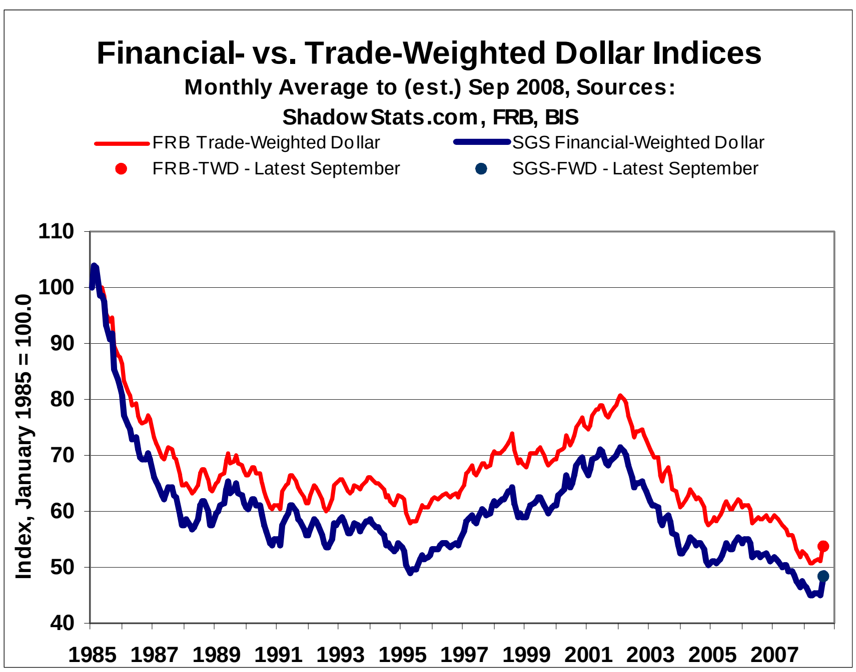
The effects of currency intervention, which remains the U.S. Treasury's primary dollar defense weapon -- handled by the New York Fed -- is short-lived by its nature, unless the intervention is being used to encourage existing market movements. The same limitations apply to any other central bank looking to support the dollar. On a fundamental basis, the Fed could raise interest rates, but such is a last line of dollar defense for when the currency crisis threatens the system. Aside from any relief rally organized in support of the purported systemic "bailout" package, the good news for the greenback is quite limited.

With the preceding factors being short-lived, by nature, the long-term outlook for the dollar remains for a massive sell-off, with flight from the dollar eventually evolving into a flight to safety outside the dollar. Contrary to market hype, the underlying fundamentals -- those factors that determine the long range outlook for the greenback -- still remain abysmal and are deteriorating.

The U.S. dollar's portfolio of underlying fundamentals could not be worse. Relative to major trading partners, the U.S. economy is much weaker; interest rates are lower; inflation is higher; rising federal deficit and relative trade-balance conditions are horrendous; and relative political/systemic concerns are high, with the President's and Congress's approval ratings bottom-bouncing at all-time lows. Neither presidential candidate (pocketbook issues increasingly favor a win for the Democrats) has any prospects for turning the markets or the economy.

The proximal trigger for a full dollar panic already may be in place, given the still-unfolding solvency/funding crisis and the Fed and Treasury's response to same. Otherwise it could come from a bad economic statistic, political missteps by the Administration, negative trade or market developments outside the United States, or a terrorist attack or expansion of U.S. military activity. When the trigger is pulled, what likely will be broad selling pressure will turn to an outright panicked dumping of the greenback, which should overwhelm any short-lived central bank intervention and roil the domestic financial markets. Generally, the greater the magnitude of the dollar selling, the greater will be the ultimate inflation pressure and liquidity squeeze in the U.S. capital markets, on top of an otherwise intensifying systemic and economic crisis.

As shown in the accompanying graph, the U.S. dollar has rallied strongly in recent months, although it has shown some faltering with the surfacing of the system solvency crisis, despite virtually certain massive covert central bank intervention in support of the greenback in the last several weeks. The latest data points shown for the financial- and trade-weighted indices are as of Friday, September 26th.



General background note: Historical data on both dollar series are available for download on the Alternate Data page of www.shadowstats.com. See the July 2005 SGS Newsletter for methodology.

U.S. Dollar Indices. The Shadow Government Statistics' Financial-Weighted U.S. Dollar Index (FWD) is based on dollar exchange rates weighted for respective global currency trading volumes. For August 2008 the monthly FWD rose by 5.29% after easing by 0.90% in July. September's average likely will show a further monthly gain of about 3.2%. The August 2008 average index level of 47.29 (base month of January 1985 = 100.00) was down by 4.26% from August 2007, while July 2008 was down 8.80% from the year before. September's monthly average likely will show a year-to-year gain of about 0.4%. As of September 26th, the FWD stood at 48.09.

Also rallying in August was the Federal Reserve's Major Currency Trade-Weighted U.S. Dollar Index (TWD). The August 2008 average rose by 5.29% from July, which had declined by 0.70% from June. The September monthly average likely will show a further monthly gain of about 1.8%. The August 2008 index level of 53.31 (base month of January 1985 = 100.00) was down 4.42% from August 2007, versus an annual 8.50% year-to-year decline in July. September's monthly average likely will show a year-to-year decline of about 0.7%. As of September 26th, the TWD closed at 53.42.

The differences in the two series can be accounted for largely by the much heavier weighting of the Canadian dollar in the TWD series.

Gold and Silver -- The currency market intervention following the Bear Stearns collapse and the Federal Reserve's related support of the system in mid-March likely also involved direct manipulations of the market in precious metals. The Fed and U.S. Treasury were looking to kill the bullish sentiment for gold and silver -- then at near-term highs -- along with attempting to sell the faux concept of a fundamental turn in the U.S. dollar. At least one major then-investment bank invested significant funds and took major positions to help topple gold and silver and to help rally the U.S. dollar.

Gold has been pummeled, falling from its all-time high London afternoon fix of $1,011.25 per troy ounce on March 17th, to a low of $740.75 on September 11th (with intervening extreme volatility and with prices approaching $700 at one point), a decline of 26.7%, before rallying 21.8% to $902.00 on Friday (September 26th). In like manner, silver plunged from its March 17th high of $20.92 per troy ounce, to $10.66 on September 11th, a hit of 49.0%, before recovering 23.6% to $13.18 on Friday (September 26th).

The savage beating in gold and silver prices has been accompanied by extraordinary price swings. Such volatility likely will continue, as should will official attempts to discourage investors from investing in gold and silver. Nonetheless, the underlying fundamentals for gold and silver could not be better. Current distortions in market prices have led to increasing physical shortages of gold and silver coins. Inflation and monetary/fiscal pressures, and systemic and political instabilities will tend to get worse, feeding into gold's value as an inflation hedge as well as a safe-haven investment. The long-term outlook for gold remains extremely bullish, with recovery to $1,000-plus levels and higher likely sooner, rather than later, with silver following.

For August (based on Kitco.com), the monthly average London gold afternoon fix was $839.02 per troy ounce and should average around $830 for September, versus $939.77 in June. Silver averaged $14.69 per troy ounce in August and should average around $12.40 for September, down from $18.03 in July. Respective closing prices on September 26th were $902.00 and $13.80 per troy ounce.

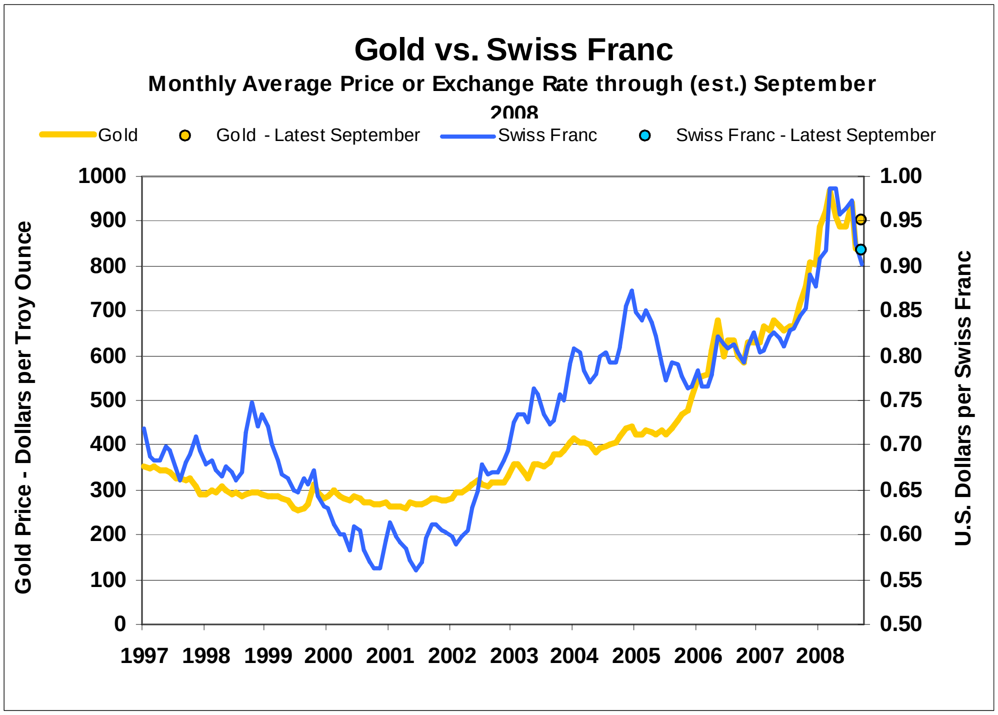
Inflation-Adjusted Historic Gold and Silver Highs. Outside of the current period's March 17th high of $1,011.25, the earlier all-time high of $850.00 (London afternoon fix, per kitco.com) of January 21, 1980 still has not been hit in terms of inflation-adjusted dollars. Based on inflation through August 2008, the 1980 gold price peak would be $2,394 per troy ounce, based on not-seasonally-adjusted-CPI-adjusted dollars, and would be $6,746 per troy ounce in terms of SGS-Alternate-CPI-adjusted dollars.

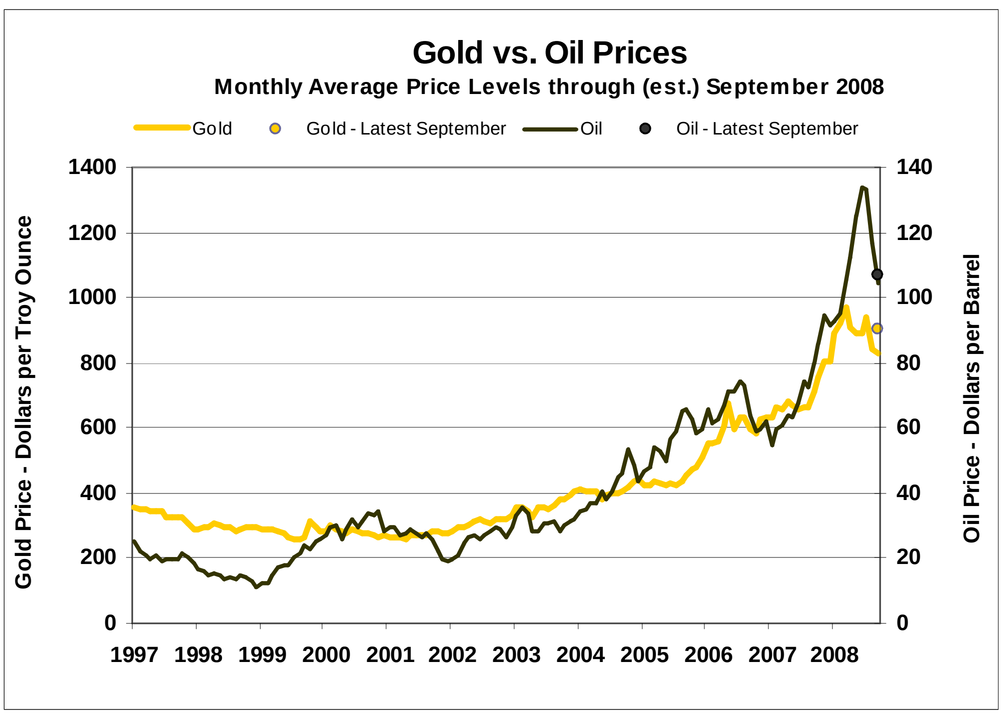
In like manner, the all-time high price for silver in January 1980 of $49.45 (London afternoon fix, per silver institute.org) has not been hit since, including in terms of inflation-adjusted dollars. Based on inflation through August 2008, the 1980 silver price peak would be $139 per troy ounce, based on not-seasonally-adjusted-CPI-adjusted dollars, and would be $392 per troy ounce in terms of SGS-Alternate-CPI-adjusted dollars.

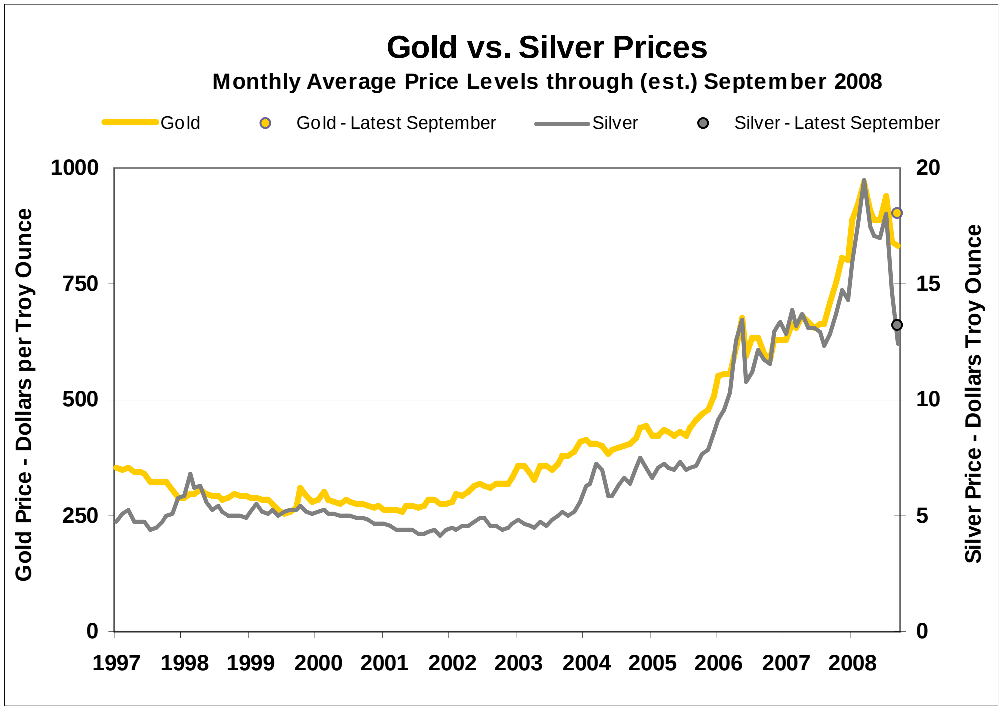
Extreme near-term gold and silver price volatility likely will continue. Upside price pressures from mounting inflation, loss of confidence in the dollar and increasing global political, financial and systemic instabilities, face offsets with bouts of profit taking and market distortions from intense overt and covert central bank interventions in the precious metals and currency markets, aimed at propping the greenback. Despite any central-bank machinations or intervention, the upside potential for gold and silver remains explosive.

General background note: As discussed in the *Hyperinflation Special Report (April 2008)*, the eventual collapse of the U.S. dollar -- the world's reserve currency -- will force the creation of a new international currency system. Gold likely will be structured into any replacement system, in an effort by those organizing the new currency structure to gain public acceptance.

The updated gold versus oil, Swiss franc and silver graphs show the estimated September monthly average price levels, as well as added points for closing prices on September 26th, with gold at $902.00, silver at $13.18, oil at $106.90 and the Fed's published noon buying rate for the Swiss franc at $0.9183. As current market distortions subside, all four measures should trade significantly higher in the months ahead, eventually breaking highs seen otherwise during the last nine months.


Gold vs. Swiss Franc
Monthly Average Price or Exchange Rate through (est.) September 2008
Gold
Gold - Latest September
Swiss Franc
Swiss Franc - Latest September
Gold Price - Dollars per Troy Ounce
U.S. Dollars per Swiss Franc
1000
900
800
700
600
500
400
300
200
100
0
1.00
0.95
0.90
0.85
0.80
0.75
0.70
0.65
0.60
0.55
0.50
1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008


Gold vs. Oil Prices
Monthly Average Price Levels through (est.) September 2008
Gold
Gold - Latest September
Oil
Oil - Latest September
Gold Price - Dollars per Troy Ounce
Oil Price - Dollars per Barrel
1400
1200
1000
800
600
400
200
0
140
120
100
80
60
40
20
0
1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008


Gold vs. Silver Prices
Monthly Average Price Levels through (est.) September 2008
Gold
Gold - Latest September
Silver
Silver - Latest September
Gold Price - Dollars per Troy Ounce
Silver Price - Dollars Troy Ounce
1000
750
500
250
0
20
15
10
5
0
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008