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

Number 47

November 14, 2008

MARKETS PERSPECTIVE

Section Two of Four

The following table shows still another snapshot of the protracted financial panic's roller coaster ride, where extreme volatility in prices has become the near-term norm for various markets. The systemic solvency crisis has continued to evolve, roiling investors' outlooks, triggering panicked market moves and flights-to-safety amidst heavy crosscurrents of distortions from forced portfolio liquidations of troubled entities, a general deleveraging of the system, and ongoing overt and covert official market interventions and manipulations. Daily stock market movements in the U.S. have gotten so volatile, that large one-day swings are yawned at, where once they would have been considered stock crashes.

Except against the yen, the U.S. dollar generally has rallied strongly in recent months, counter to underlying fundamentals. Buying of the greenback reflects strong demand for dollars as various global entities have been forced to deleverage their investment positions. Market hype as to the relatively better U.S. economic or financial-system conditions, versus the rest of the world, is nonsense. The dollar's strength should prove to be temporary. At such time as heavy U.S. dollar selling resumes, affected markets in precious metals and oil should see significant rallies.

General background note: The broad outlook is unchanged, with still-intensifying crises in systemic solvency and in a deepening inflationary recession. Over the long-term: U.S. equities will continue to suffer in a severe bear market; long-term U.S. Treasury yields will spike in response to inflation, eventual dollar dumping and mounting Treasury borrowing needs against a market with weakening demand; selling will intensify against the U.S. dollar, evolving into dollar dumping and dumping of dollar denominated assets; precious metals, particularly gold, will rally against mounting monetary and inflation pressures (likely higher oil prices), weakness in the dollar, and as safe-havens against increasing systemic instability. Holding gold and holding assets outside the U.S. dollar (such as in Swiss francs ***and the Canadian dollar***) remain the best long-range hedge against all the real risks facing investors and the system.

Closing Financial-Market Indicators as of November 13, 2008

Indicator	*4th-Quarter-to-Date November 13, 2008*				*3rd-Quarter 2008*			*Year-End 2007*	
	Level	*QTD*	*YTD*	*Yr/Yr*	*Level*	*YTD*	*Yr/Yr*	*Level*	*Yr/Yr*
Equity Market									
DJIA	**8,835.25**	-18.57%	-33.39%	-33.60%	**10,850.66**	-18.20%	-21.39%	**13,264.82**	6.43%
S&P 500	**911.29**	-21.76%	-37.94%	-38.47%	**1,164.74**	-20.68%	-23.71%	**1,468.36**	3.53%
DJ Wilshire 5000	**9,120.05**	-23.20%	-38.46%	-39.00%	**11,875.40**	-19.87%	-22.70%	**14,819.60**	3.94%
NASDAQ Comp	**1,596.70**	-23.67%	-39.80%	-40.28%	**2,091.88**	-21.13%	-22.57%	**2,652.28**	9.81%
Credit Market (1)									
Fed Funds Target	**1.00%**	-100bp	-325bp	-350bp	**2.00%**	-225bp	-275bp	**4.25%**	-100bp
3-Mo T-Bill	**0.22%**	-70bp	-314bp	-328bp	**0.92%**	-244bp	-290bp	**3.36%**	-166bp
2-Yr T-Note	**1.24%**	-76bp	-181bp	-230bp	**2.00%**	-105bp	-197bp	**3.05%**	-177bp
5-Yr T-Note	**2.43%**	-55bp	-102bp	-141bp	**2.98%**	-47bp	-125bp	**3.45%**	-125bp
10-Yr T-Note	**3.84%**	-1bp	-20bp	-42bp	**3.85%**	-19bp	-74bp	**4.04%**	-67bp
30-Yr T-Bond	**4.34%**	3bp	-11bp	-27bp	**4.31%**	-14bp	-52bp	**4.45%**	-36bp
Oil (2) *US$ per Barrel*									
West Texas Int.	**58.24**	-42.13%	-39.34%	-36.13%	**100.64**	4.82%	23.23%	**96.01**	57.24%
Currencies/Dollar Indices (3) *US$/Unit*									
Pound Sterling	**1.4799**	-16.88%	-25.42%	-28.61%	**1.7804**	-10.28%	-12.68%	**1.9843**	1.31%
Euro	**1.2526**	-11.04%	-14.22%	-14.19%	**1.4081**	-3.57%	-0.97%	**1.4603**	10.65%
Swiss Franc	**0.8337**	-6.71%	-5.55%	-6.16%	**0.8937**	1.25%	4.32%	**0.8827**	7.64%
Yen	**1.0422**	10.41%	16.43%	14.97%	**0.0094**	5.45%	8.52%	**0.0090**	6.54%
Canadian Dollar	**0.8123**	-13.92%	-19.73%	-21.70%	**0.9437**	-6.75%	-6.02%	**1.0120**	17.92%
Australian Dollar	**0.6402**	-19.00%	-27.05%	-28.01%	**0.7904**	-9.94%	-10.74%	**0.8776**	11.31%
Weighted Currency Units/US$ (Jan. 1985 = 100)									
Financial (FWD)	**55.77**	12.55%	18.01%	21.18%	**49.55**	4.85%	4.93%	**47.26**	-7.64%
Change US$/FX	**--**	-11.15%	-15.26%	-17.48%	**--**	-4.62%	-4.70%	**--**	8.27%
Trade (TWD)	**60.24**	9.97%	14.26%	15.96%	**54.78**	3.91%	2.34%	**52.72**	-10.00%
Change US$/FX	**--**	-9.06%	-12.48%	-13.76%	**--**	-3.76%	-2.28%	**--**	10.01%
Precious Metals (4) *US$ per Troy Ounce*									
Gold	**713.50**	-19.33%	-14.42%	-11.28%	**884.50**	6.09%	19.04%	**833.75**	31.92%
Silver	**9.37**	-27.70%	-36.52%	-36.17%	**12.96**	-12.20%	-5.06%	**14.76**	14.41%

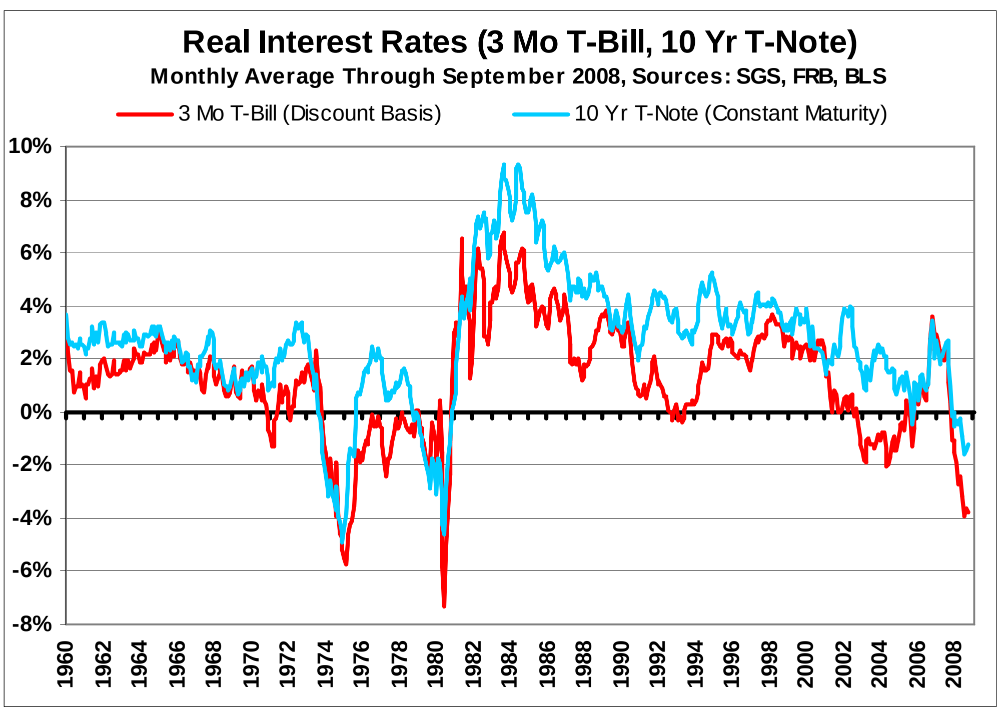
bp: Basis point or 0.01%. (1) Treasuries are constant maturity yield, U.S. Treasury. (2) Department of Energy. (3) Shadow Government Statistics, FRB (see Dollar Index Section for definitions). (4) London afternoon fix, Kitco.com.

U.S. Equities -- The equity markets have never been more unstable, with major indices down 33% to 40% year-to-year. Almost anything is possible, with underlying fundamentals remaining miserable. The ongoing nature of the systemic solvency crisis, a generally less-business-friendly Administration coming to power in about two months, and a severe and protracted inflationary recession that will mean heavy hits to corporate earnings, all weigh on the equity markets. Eventually, heavy dollar selling and increased flight from dollar-denominated assets should also drain liquidity from the domestic 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, 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 -- Despite heavy borrowing by the U.S. Treasury, ongoing flight-to-safety issues for both individuals and institutions and ongoing foreign investment have kept Treasury yields unusually low. With the Fed having lowered the targeted federal funds rate to 1.00%, the U.S. central bank has moved within in striking range of 0%. Accordingly, there is little further downside potential for Fed easing, although the lower rates generally are ineffective in stimulating current economic activity. The Fed, however, could be pushed into raising rates in defense of the U.S. dollar. At such time as intense selling of the greenback resumed, and if that threatened domestic liquidity, which it likely would, then the Fed would have little choice but to raise rates.

Net of inflation, Treasury yields remain negative, and negative real interest rates should remain the case following the release of the October CPI (November 19th). The exception could be for the 30-year Treasury bond yield, which might briefly show a slightly positive real yield. At subscriber request, the following graph of real interest rates is shown. It plots monthly average 3-month Treasury bill and 10-year Treasury note yields less annual CPI-U inflation.



The common pattern to periods of negative real interest rates is that they generally have been seen during inflationary recessions, when the Fed has eased despite ongoing inflation problems. When inflation exceeds interest rates, it makes more sense for individuals to buy products instead of Treasuries, since products will increase more in value than a note or bond. This circumstance encourages individuals not to hold cash, which in turn tends to increase money supply velocity.

The continuing financial crisis remains likely to suppress yields in the near-term, given ongoing safe-haven issues. Aside from the recent safe-haven effects, the forced investment in U.S. Treasuries of unwanted dollars held outside the United States generally has kept U.S. 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.

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 4.9%, the yield on the 30-year Treasury bond should be over 8.00%, not around the current 4.35%. Irrespective of any near-term softness in annual inflation, still-higher inflation looms in 2009, with corresponding upside risk to long-term interest rates.

U.S. Dollar -- Well beyond any coordinated, massive covert intervention in the currency markets to support the U.S. dollar following the Bear Stearns failure in mid-March, and related jawboning, it appears that the evolution of the solvency crisis has created an artificial demand for the U.S. currency. Troubled institutions have had to acquire dollars in the deleveraging process, along with the forced liquidations of various financial instruments. This process, by its nature, will be limited in its timing, but it has not yet run its course.

In terms of underlying fundamentals for the U.S. dollar, little has changed: they remain abysmal and are deteriorating. Accordingly, as the global financial system begins to stabilize, heavy selling of the U.S. dollar should resume, with the long-term outlook for the dollar remaining for a massive sell-off, and with flight from the dollar eventually evolving into a flight to safety outside the dollar.

The U.S. dollar's portfolio of underlying fundamentals generally could not be worse, but there have been some changes. 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.

What has changed on the plus side is that although U.S. rates are low, major trading partners tend to be moving their rates lower, too, in response to growing global recession concerns. While such narrows the interest rate spreads and can help the dollar, it would be much more powerful for the greenback if the narrowing were due to the U.S. raising interest rates. As to political change, there appears to be some positive reaction from major U.S. trading partners to the U.S. President-Elect. How that evolves remains to be seen.

On the downside, whatever limited U.S. fiscal and monetary discipline existed is gone. The U.S. is moving quickly to debase its currency in a manner unprecedented for the world's reserve currency. The U.S. economy also is in much worse shape than previously recognized by the rest of the world, and it is relatively much worse off than its major trading partners.

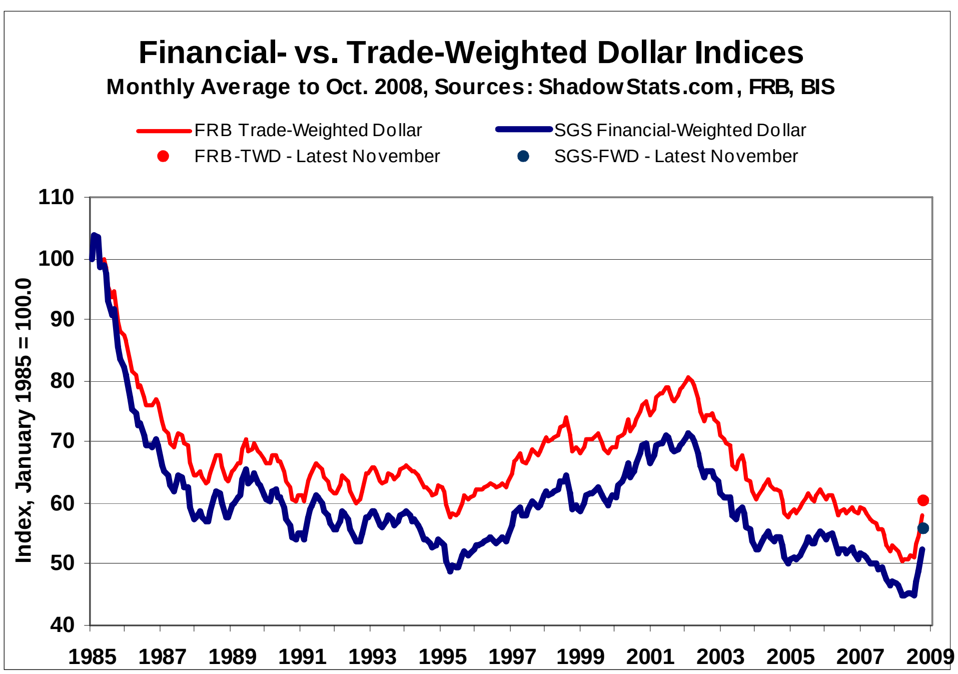
General background note: The proximal trigger for a full dollar panic already may be in place, given the still-unfolding solvency/funding crisis and the Fed and Treasury's response to same***, although dollar funding needs in the crisis likely will have to abate first***. Otherwise it could come from a bad economic statistic, political missteps by the ***current or incoming*** 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 since the Bear Stearns bailout, now turning positive on a year-to-year basis. The latest data points shown for the financial- and trade-weighted indices are as of Thursday, November 13th.

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 October 2008 the monthly FWD rose by 7.32% after a gain of 3.41% in September. The October 2008 average index level of 52.48 (base month of January 1985 = 100.00) was up by 10.31% from October 2007, while September 2008 was up 0.64% from the year before. As of November 13th, the FWD stood at 55.77.

Also rallying in August was the Federal Reserve's Major Currency Trade-Weighted U.S. Dollar Index (TWD). The October 2008 average rose by 6.49% from September, which was up by 1.92% from August. The October 2008 index level of 57.87 (base month of January 1985 = 100.00) was up by 8.77% from October 2007, versus an annual 0.53% year-to-year decline in September. As of November 13th, the TWD closed at 60.24.

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



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.

Gold and Silver -- Beyond the related factors that have rallied the U.S. dollar, and any forced liquidations of gold to raise cash, there has been no underlying fundamental reason for the sharp decline in precious metals since the collapse that began following the Bear Stearns bailout in mid-March. If anything, the fundamentals have gotten stronger for gold. While there likely was some direct manipulation of the market in precious metals, with the Fed and U.S. Treasury looking to kill the bullish sentiment for gold and silver -- at near-term highs in mid-March -- the faux turn in the U.S. dollar likely has been the major factor in the price declines of precious metals and oil.

For October (based on Kitco.com), the monthly average London gold afternoon fix was $806.62 per troy ounce, down from $829.93 in September. Silver averaged $10.44 per troy ounce in October, down from $12.37 in September. Gold has been pummeled, falling from its all-time high London afternoon fix of $1,011.25 per troy ounce on March 17th, to $713.50 as of November 13th (with intervening extreme volatility). In like manner, silver has plunged from its March 17th high of $20.92 per troy ounce, to $9.37 on November 13th.

When the dollar turns meaningfully to the downside, gold prices should rebound sharply and could regain $1,000 fairly quickly. Gold not only serves as a hedge against currency debasement, as seen with the U.S. dollar, but also functions as a safe-haven investment.

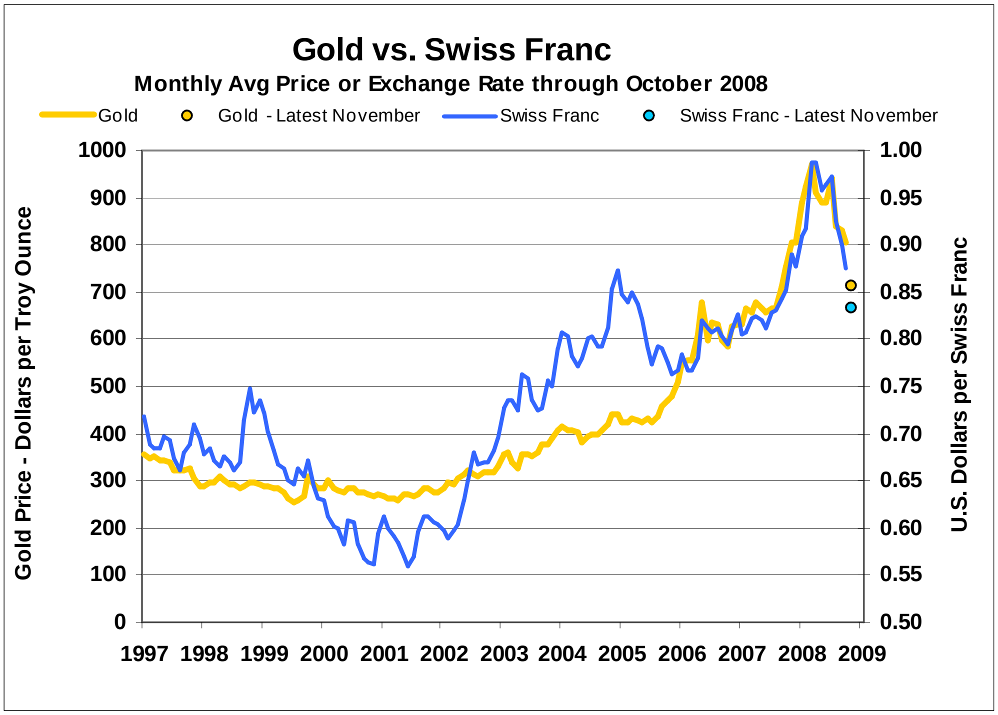
Extreme near-term gold and silver price volatility likely will continue. Again, key to a rebound in prices is renewed weakness in the U.S. dollar. Upside price pressures otherwise should be in place from the broad ongoing debasement of the dollar by the Fed and Treasury, along with implications for much higher inflation ahead. Beyond the negative impact of forced liquidations, increasing global political, financial and systemic instabilities can trigger safe-haven rallies in the precious metals. Such may 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 long-term upside potential for gold and silver remains explosive.

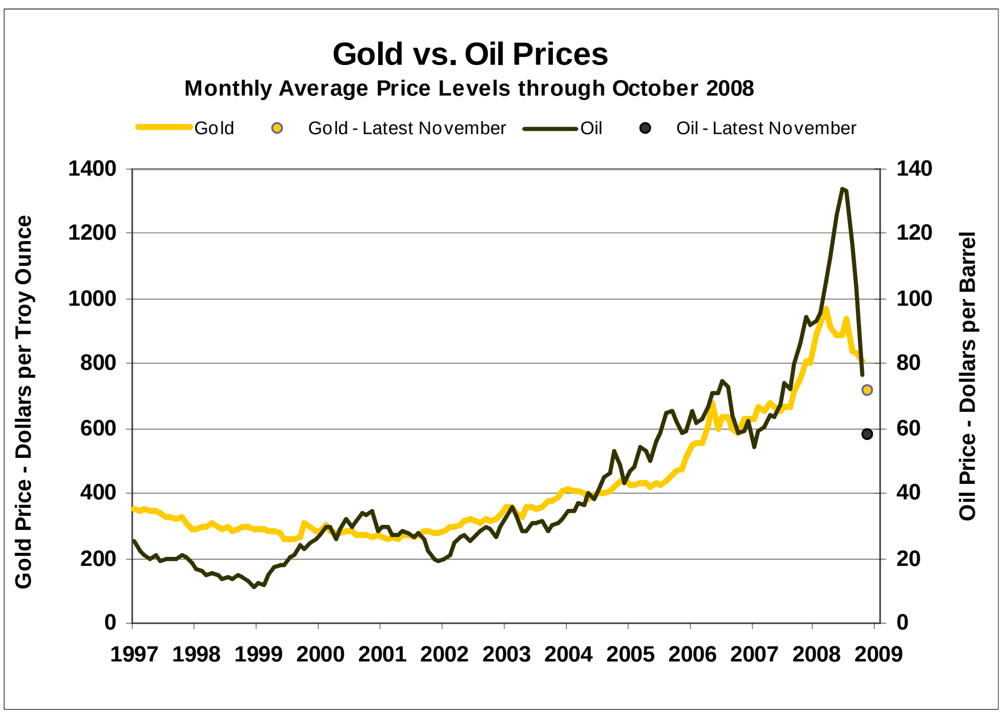
Inflation-Adjusted Historic Gold and Silver Highs. Outside of the current period's March 17th high of $1,011.25, the earlier all-time high of $850.00 (London afternoon fix, per kitco.com) of January 21, 1980 still has not been hit in terms of inflation-adjusted dollars. Based on inflation through September 2008, the 1980 gold price peak would be $2,390 per troy ounce, based on not-seasonally-adjusted-CPI-adjusted dollars, and would be $6,763 per troy ounce in terms of SGS-Alternate-CPI-adjusted dollars.

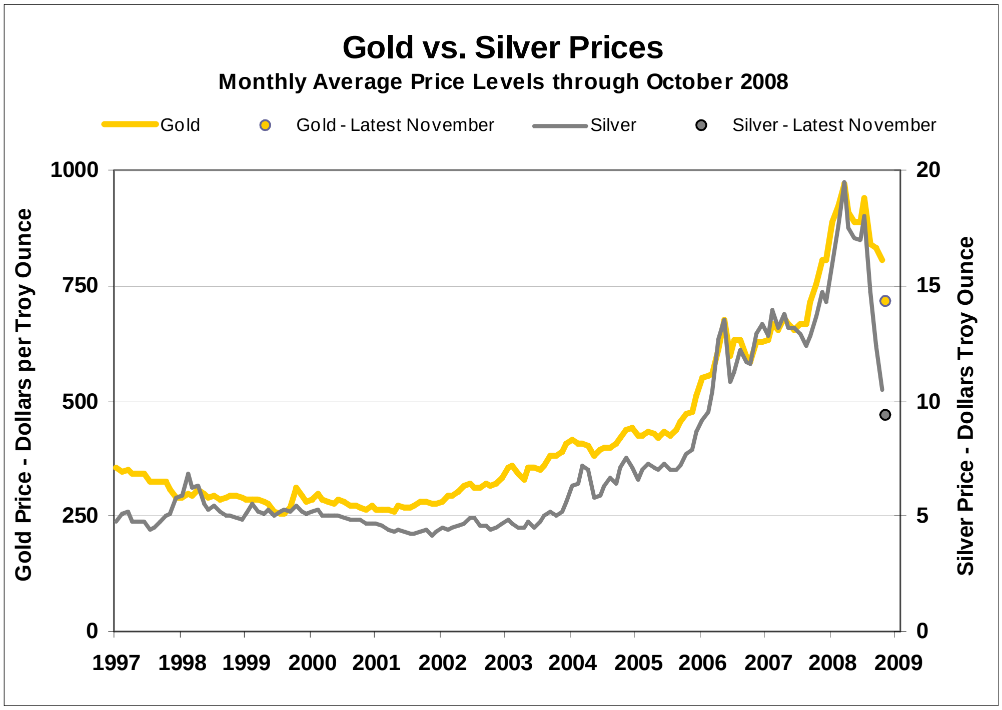
In like manner, the all-time high price for silver in January 1980 of $49.45 (London afternoon fix, per silver institute.org) has not been hit since, including in terms of inflation-adjusted dollars. Based on inflation through September 2008, the 1980 silver price peak would be $139 per troy ounce, based on not-seasonally-adjusted-CPI-adjusted dollars, and would be $393 per troy ounce in terms of SGS-Alternate-CPI-adjusted dollars.

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 October monthly average price levels, as well as added points for closing prices on November 13th, with gold at $713.50, silver at $9.37, oil at $58.24 and the Fed's published noon buying rate for the Swiss franc at $0.8337. As current market distortions subside, all four measures should trade significantly higher in the months ahead, eventually breaking highs seen otherwise during the last year.






Gold vs. Silver Prices
Monthly Average Price Levels through October 2008
Gold
Gold - Latest November
Silver
Silver - Latest November
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
2009