

John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

Number 51

July 20, 2009

Section Two of Four

MARKETS PERSPECTIVE

The three best bets I can offer remain: (1) The U.S. economy does not face imminent recovery. (2) The U.S. dollar faces an extreme sell-off against most major currencies. (3) The U.S. economy will see double-digit inflation, driven by factors other than economic demand; a circumstance that eventually will evolve into hyperinflation.

With a deepening recession and intensifying systemic solvency crisis, the news here is particularly bleak for the equity markets, which seem to be rolling along on the happy hype that all again is right with the world. A broadening weakness in the U.S. dollar, which should intensify, also should prove eventually to have a major dampening effect on U.S. equity values, to spike U.S. long-term interest rates and inflation, and to provide support for gold and silver prices.

General background note: I continue to argue that investors should be looking at the long-term and at preserving their wealth and assets in what eventually will become a hyperinflationary great depression. With severe economic, inflation and currency displacements ahead in the United States, those who can ride out the turmoil eventually should see tremendous investment opportunities. As to preserving capital and assets for someone in a U.S. dollar-denominated environment, holding some assets in physical gold (and some silver), and holding some assets outside the dollar (i.e. the

Swiss franc, Canadian dollar, *Australian dollar*) in high-quality, liquid assets, remain the best long-range hedges against all the real risks facing investors and the system.

Again, this is for the long haul. Short-term conditions still can show extreme volatility in the U.S. dollar and precious metals, as seen in the last year. Putting aside risks of political instabilities tied to the economic turmoil or any short-term liquidity concerns, real estate also remains a prime long-term hedge against the severe currency debasement that lies ahead.

With the ongoing crises in systemic solvency and in a severely contracting economy with pending inflation problems, the long-term outlook holds: 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 (and likely higher oil prices from a weakening dollar), weakness in the dollar, and as safe-haven hedges against increasing systemic and global political instability.

End of general background note.

Closing Financial-Market Indicators at June 30, 2009

<i>Indicator</i>	<i>----- Level</i>	<i>2nd-Qtr 2009 Q/Q</i>	<i>----- YTD</i>	<i>----- Y/Y</i>	<i>----- Level</i>	<i>1st-Qtr 2009 YTD</i>	<i>----- Yr/Yr</i>	<i>Year-End 008 Level</i>	<i>Y/Y</i>
Equity Market (1)									
DJIA	8,447.00	11.01%	-3.75%	-25.58%	7,608.92	-13.30%	-37.95%	8,776.39	-33.84%
S&P 500	919.32	15.22%	1.78%	-28.18%	797.87	-11.67%	-39.68%	903.25	-38.49%
DJ Wilshire 5000	9,424.90	17.78%	3.72%	-27.91%	8,001.90	-11.94%	-39.98%	9,087.17	-38.68%
NASDAQ Comp	1,835.04	20.05%	16.36%	-19.97%	1,528.59	-3.07%	-32.93%	1,577.03	-40.54%
Credit Market (2)									
Fed Funds (3)	0.00%	0bp	0bp	-200bp	0.00%	0bp	-225bp	0.00%	-425bp
3-Mo T-Bill	0.19%	-2bp	8bp	-171bp	0.21%	10bp	-117bp	0.11%	-325bp
2-Yr T-Note	1.11%	30bp	35bp	-152bp	0.81%	5bp	-81bp	0.76%	-229bp
5-Yr T-Note	2.54%	87bp	99bp	-80bp	1.67%	12bp	-79bp	1.55%	-190bp
10-Yr T-Note	3.53%	82bp	128bp	-77bp	2.71%	46bp	-74bp	2.25%	-179bp
30-Yr T-Bond	4.32%	76bp	163bp	-21bp	3.56%	87bp	-74bp	2.69%	-176bp
Oil (4) US\$ per Barrel									
West Texas Int.	69.89	40.73%	56.70%	-50.08%	49.66	11.35%	-51.12%	44.60	-53.55%
Currencies/Dollar Indices (5) US\$/Unit									
Pound Sterling	1.6452	15.05%	12.54%	-17.35%	1.4300	-2.18%	-27.32%	1.4619	-26.33%
Euro	1.4020	5.72%	0.73%	-10.97%	1.3261	-4.73%	-16.10%	1.3919	-4.68%
Swiss Franc	0.9202	4.85%	-1.78%	-6.12%	0.8776	-6.33%	-12.94%	0.9369	6.14%
Yen	0.0104	2.83%	-5.84%	10.11%	0.0101	-8.43%	0.71%	0.0110	23.04%
Canadian Dollar	0.8601	8.42%	5.28%	-12.39%	0.7933	-2.90%	-17.87%	0.8170	-19.27%
Australian Dollar	0.8055	16.32%	15.37%	-15.77%	0.6925	-0.83%	-24.17%	0.6983	-20.43%
Weighted Currency Units/US\$ (Jan. 1985 = 100)									
Financial (FWD)	49.98	-9.04%	-4.78%	11.29%	54.95	4.04%	22.14%	52.49	11.07%
Change US\$/FX	--	9.94%	5.02%	-10.14%	--	-3.88%	-18.13%	--	-9.96%
Trade (TWD)	55.91	-6.65%	-2.17%	9.50%	59.89	4.79%	18.38%	57.15	8.40%
Change US\$/FX	--	7.12%	2.22%	-8.67%	--	-4.58%	-15.53%	--	-7.75%
Precious Metals (6) US\$ per Troy Ounce									
Gold	934.50	1.96%	7.44%	0.46%	916.50	5.38%	-1.82%	869.75	4.32%
Silver	13.94	6.33%	29.19%	-21.02%	13.11	21.50%	-27.13%	10.79	-26.90%

bp: Basis point or 0.01%. (1) *Wall Street Journal*, dowjonesindexes.com. (2) Treasuries are constant-maturity yield, U.S. Treasury. (3) Current Fed Funds target is 0.00% to 0.25%. (4) Department of Energy. (5) Shadow Government Statistics, *Wall Street Journal*, Federal Reserve Board (see Dollar Index Section for definitions). (6) London fix (afternoon for gold), Kitco.com.

Closing Financial-Market Indicators at July 17, 2009

Indicator	----- Level	3rd-Qtr-to-Date 2009 QTD	YTD	----- Y/Y
Equity Market (1)				
DJIA	8,743.94	3.52%	-0.37%	-23.61%
S&P 500	940.38	2.29%	4.11%	-24.25%
DJ Wilshire 5000	9,634.82	2.23%	6.03%	-25.02%
NASDAQ Comp	1,886.61	2.81%	19.63%	-17.05%
Credit Market (2)				
Fed Funds (3)	0.00%	0bp	0bp	-200bp
3-Mo T-Bill	0.17%	-2bp	6bp	-126bp
2-Yr T-Note	1.02%	-9bp	26bp	-156bp
5-Yr T-Note	2.52%	-2bp	97bp	-83bp
10-Yr T-Note	3.67%	14bp	142bp	-40bp
30-Yr T-Bond	4.53%	21bp	184bp	-2bp
Oil (4) US\$ per Barrel				
West Texas Int.	63.56	-9.06%	42.51%	-50.84%
Currencies/Dollar Indices (5) US\$/Unit				
Pound Sterling	1.6345	-0.65%	11.81%	-20.09%
Euro	1.4099	0.56%	1.29%	-11.11%
Swiss Franc	0.9287	0.92%	-0.88%	-5.30%
Yen	0.0106	2.18%	-4.23%	12.14%
Canadian Dollar	0.8960	4.17%	9.67%	-10.24%
Australian Dollar	0.8018	-0.46%	14.82%	-14.96%
Weighted Currency Units/US\$ (Jan. 1985 = 100)				
Financial (FWD)	49.71	-0.34%	-5.30%	11.68%
Change US\$/FX	--	0.34%	5.59%	-10.46%
Trade (TWD)	54.87	-1.86%	-3.99%	8.63%
Change US\$/FX	--	1.90%	4.16%	-7.95%
Precious Metals (6) US\$ per Troy Ounce				
Gold	937.50	0.32%	7.79%	-2.90%
Silver	13.16	-5.60%	21.96%	-29.51%

bp: Basis point or 0.01%. (1) *Wall Street Journal*, dowjonesindexes.com. (2) Treasuries are constant-maturity yield, U.S. Treasury. (3) Current Fed Funds target is 0.00% to 0.25%. (4) Department of Energy. (5) Shadow Government Statistics, *Wall Street Journal*, Federal Reserve Board (see Dollar Index Section for definitions). (6) London fix (afternoon for gold), Kitco.com.

U.S. Equities -- While the broad Dow Jones Wilshire 5000 stock index is down about 40% from its record high level in October 2007, it is up about 40% from the current cycle low, hit in March 2009. Recovery to its prior high would require a further rally of about 67%. None of the underlying fundamentals in terms of economic growth, systemic stability, earnings, interest rates and foreign buying of U.S. stocks support such a recovery, or even current stock-index levels. Market perceptions eventually will move beyond the current tales being spun of systemic stability and recovering economic activity.

Despite extreme near-term fluctuations in equity prices, the long-range outlook remains for an aggregate downside adjustment to stock prices over a number of years that eventually will rival the total 90% decline in equities seen in the 1929 crash and ensuing three years. From current levels, that would be a decline in average equity prices of somewhat greater than 80%.

That decline might have to be measured in real terms, however, as a hyperinflation eventually will kick in, with the Fed moving further 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 (see the *Hyperinflation Special Report* of April 8, 2008).

U.S. Credit Market -- With the targeted fed funds rate at 0.00% to 0.25% and with the Fed buying longer-term Treasuries, the market remains heavily rigged. Nonetheless, 30-year Treasury bond yields have risen more than 180 basis points since the beginning of the year. Rapid inflation and dollar dumping (reflecting a growing lack of confidence in U.S. Treasuries and in the solvency of the U.S. government) eventually will intensify that move. Chances of Federal Reserve tightening should remain nil, until severe weakness in the U.S. dollar

reaches a point that could demand an interest rate response by the Fed.

General background note: If inflation rises strongly in the year ahead, as I expect (but before hitting hyperinflationary levels), it would tend to support double-digit long-term yields, again, assuming normal market forces are allowed to play out.

U.S. Dollar -- Dollar fundamentals remain terrible; and recent selling of the U.S. currency remains likely to intensify sharply over the longer term, irrespective of any near-term market volatility or central bank interventions. Central bankers have a pretty good sense of what lies ahead for the U.S. currency, and an increasing number of them have been expressing disgruntlement with U.S. fiscal and monetary policies. As calls mount for a new reserve currency, chances of central banks willingly holding more dollars or dollar-denominated paper will shrink. A pullback in foreign buying of U.S. Treasuries already is evident.

Any serious movements to replace the dollar as the global reserve currency, to denominate oil prices in something other than dollars, and/or to demand U.S. Treasury issuance of debt in anything other than dollars, should have immediate and devastating impact on the U.S. currency's value against other major convertible currencies.

General background note: 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. The U.S. dollar's portfolio of underlying fundamentals generally could not be much worse. Relative to major trading partners, the U.S. economy is much weaker; interest rates are lower; inflation has been and again will be higher; fiscal and monetary conditions are worse in the extreme; relative trade-balance conditions still are horrendous; and relative political/systemic concerns are high, with

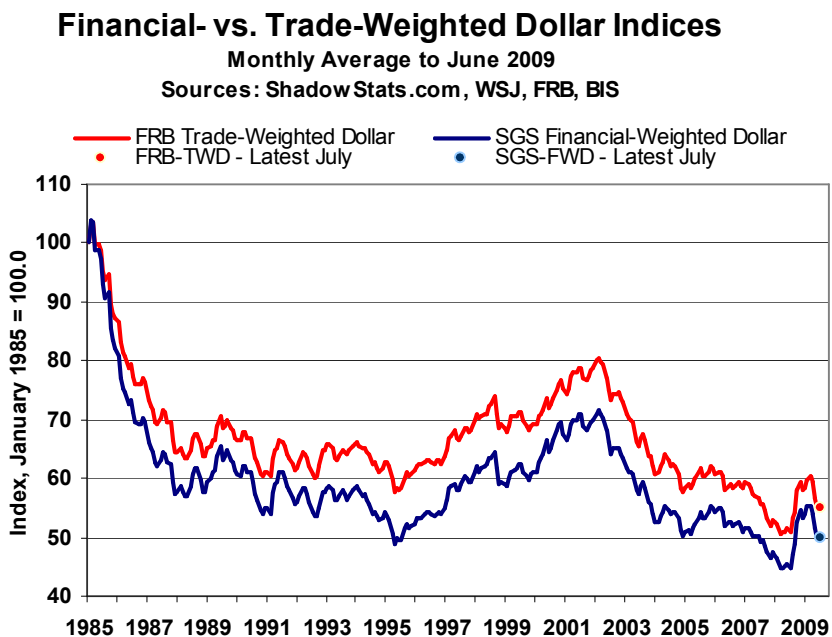
mounting disgruntlement among major U.S. trading partners as to the outlook for the dollar and its status as the world's reserve currency.

The proximal trigger for a full dollar panic already may be in place, given the Fed and Treasury's responses to the ongoing systemic solvency *and economic* crises. Otherwise it could come from a particularly 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 into an outright panicked dumping of the greenback, which should overwhelm any short-lived central bank intervention and roil the domestic financial markets, further. 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 ongoing systemic and intensifying economic crisis.

End of general background note

As shown in the accompanying graph, the strength in the U.S. dollar -- since the market distortions and interventions following the Bear Stearns crisis -- appears to have peaked in March. Amidst ongoing volatility, the financial- and trade-weighted indices declined in April, May and June, on average, and they have been somewhat softer through the U.S. market close on July 17th, from month-end June closing levels.

Please Note: As of January 1, 2009, the Federal Reserve ceased publishing its daily noon exchange rates on a timely basis. Where the daily rate or monthly average for a currency or index used in the newsletter or indices has been based on Federal Reserve reporting, such will continue when possible. Otherwise, the exchange rate or index will be based on daily rates published in the Wall Street Journal. When full Federal Reserve data are available, the monthly indices will be updated to reflect same in the regular postings on the Alternate Data tab at www.shadowstats.com.



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 June 2009 the FWD fell by 3.3% for the month after a 4.2% decline in May. The June 2009 monthly average index level of 49.43 (base month of January 1985 = 100.00) was up by 10.2% from June 2008, versus May's 14.4% annual gain. As of April 17th, the FWD stood at 49.71.

Also falling in June 2009 was the Federal Reserve's Major Currency Trade-Weighted U.S. Dollar Index (TWD). The March average was down by 2.4% for the month, following a 4.1% drop in May. The June 2009 index level of 55.40 (base month of January 1985 = 100.00) was up by 7.8% from June 2008, versus an annual 11.5% increase in May. As of July 17th, the TWD closed at 54.87.

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 -- The fundamentals remain extremely bullish for gold and silver, with a deteriorating outlook for the U.S. dollar, U.S. inflation and systemic stability. Physical holdings of gold and silver remain the best long-term hedges against all the craziness that will be unfolding in the U.S. markets in the year or two ahead. Over the short-term, however, extreme price volatility continues as a fair risk, as seen during the last year.

Falling from its all-time high London afternoon fix of \$1,011.25 per troy ounce on March 17, 2008, amidst extreme volatility, gold hit a subsequent bottom of \$712.50 in October. It closed July 17th at \$937.50. In like manner, silver plunged from its March 17, 2008 high of \$20.92 per troy ounce,

hitting a subsequent low close of to \$8.88 in October. It closed on July 17th at \$13.16.

For June 2009 (per Kitco.com for both and silver prices), the monthly average London gold afternoon fix was \$945.67 per troy ounce, up from \$928.04 in May. Silver averaged \$14.65 per troy ounce in June, up from \$14.03 in May.

Inflation-Adjusted Historic Gold and Silver Highs. Even with the March 17, 2008 historic high of \$1,011.25, the prior 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 June 2009, the 1980 gold price peak would be \$2,357 per troy ounce, using not-seasonally-adjusted-CPI-adjusted dollars, and would be \$7,095 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 June 2009, the 1980

silver price peak would be \$137 per troy ounce, using not-seasonally-adjusted-CPI-adjusted dollars, and would be \$413 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 June monthly average price levels, as well as added points for closing prices at July 17th, with gold at \$937.50, silver at \$13.16, oil at \$63.56 and the *Wall Street Journal's* closing rate for the Swiss franc at \$0.9287. As current market

distortions subside, all four measures should trade significantly higher in the year ahead, eventually breaking the highs seen otherwise during 2008.

