John Williams'
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MARKETS PERSPECTIVE

Wall Street's pitches that the economy had dodged the recession bullet and that the worst of the banking solvency crisis had passed, had helped support the equity markets and the U.S. dollar in recent months.

That fairy tale began to show cracks last week, and the more-negative underlying reality that has started to surface likely will continue to gain broader market acceptance in the weeks ahead. Indeed, the underlying fundamentals of an intensifying inflationary recession and a still unfolding banking-solvency crisis continue. Accordingly the longer range outlook for the markets has not varied.

The equity market already is in the throes of what should prove to be a severe and protracted bear market. Long-term interest rates will rise in response to inflation fears and in particular to heavy selling of the U.S. dollar. As dollar selling mounts to near-panicked levels, and flight from the dollar becomes flight to safety, U.S. financial markets will face significant liquidity problems. Moving counter to the dollar, with buying pressure intensifying from mounting U.S. inflation concerns and domestic and global political instabilities, gold and silver should rally strongly.

Such is the outlook for the longer term. Extreme volatility in the equity, currency and precious metals markets has been seen recently and likely will continue. Key to the unfolding of the market difficulties ahead remains the behavior of the U.S. dollar, and that circumstance may explain the sudden and increasingly vociferous jawboning by the Fed Chairman and Treasury Secretary in support of the dollar. Jawboning and any related intervention, however, do not have lasting impact on the currency markets, unless the artificial pressures are applied in the same direction as suggested by the underlying fundamentals, or unless the counter-direction of underlying fundamentals can be reversed.

Unfortunately for the U.S. dollar, the underlying fundamentals could not be much worse, and the chances of meaningful shifts in those fundamentals over the near term are virtually nil.

Closing Financial-Market Indicators End of Year 2007, First-Quarter 2008 and June 6, 2008

Indicator	*Second-Quarter 2008 to Date June 6, 2008*			*First-Quarter 2008*			*Fourth-Quarter 2007*		
	Level	*QTD/Qtr*	*Yr/Yr*	*Level*	*Qtr/Qtr*	*Yr/Yr*	*Level*	*Qtr/Qtr*	*Yr/Yr*
Equity Market									
DJIA	12,209.81	-0.43%	-9.33%	12,262.89	-7.55%	-0.74%	13,264.82	-4.54%	6.43%
S&P 500	1,360.68	2.87%	-10.33%	1,322.70	-9.92%	-6.91%	1,468.36	-3.82%	3.53%
DJ Wilshire 5000	13,924.63	4.45%	-9.25%	13,332.00	-10.44%	-7.48%	14,819.60	-3.53%	3.94%
NASDAQ Comp	2,474.56	8.58%	-4.35%	2,279.10	-14.07%	-5.89%	2,652.28	-1.82%	9.81%
Credit Market (1)									
Fed Funds Target	2.00%	-25bp	-325bp	2.25%	-200bp	-300bp	4.25%	-50bp	-100bp
3-Mo T-Bill	1.85%	51bp	-295bp	1.38%	-118bp	-366bp	3.36%	-46bp	-166bp
2-Yr T-Note	2.40%	78bp	-257bp	1.62%	-143bp	-296bp	3.05%	-92bp	-177bp
5-Yr T-Note	3.20%	74bp	-174bp	2.46%	-99bp	-208bp	3.45%	-78bp	-125bp
10-Yr T-Note	3.94%	49bp	-103bp	3.45%	-59bp	-120bp	4.04%	-55bp	-67bp
30-Yr T-Bond	4.65%	35bp	-43bp	4.30%	-15bp	-54bp	4.45%	-38bp	-36bp
Oil (2) *US$ per Barrel*									
West Texas Int.	138.55	36.38%	110.02%	101.59	5.81%	54.20%	96.01	17.56%	57.24%
Currencies/Dollar Indices (3) *US$/Unit*									
Pound Sterling	1.9695	-0.81%	-1.10%	1.9855	0.06%	0.72%	1.9843	-2.68%	1.31%
Euro	1.5731	-0.47%	16.60%	1.5805	8.23%	18.18%	1.4603	2.70%	10.65%
Swiss Franc	0.9768	-3.09%	18.94%	1.0080	14.20%	22.23%	0.8827	3.02%	7.64%
Yen	0.0095	-5.20%	14.95%	0.0100	11.88%	17.74%	0.0090	2.92%	6.54%
Canadian Dollar	0.9816	0.86%	3.92%	0.9732	-3.83%	13.34%	1.0120	0.79%	17.92%
Australian Dollar	0.9603	5.16%	14.21%	0.9132	4.06%	12.71%	0.8776	-0.89%	11.31%
Weighted Currency Units/US$ (Jan. 1985 = 100)									
Financial (FWD)	44.95	0.54%	-6.94%	44.71	-5.40%	-10.62%	47.26	-0.92%	-7.64%
Change US$/FX	--	-0.53%	7.45%	--	5.70%	11.88%	--	0.93%	8.27%
Trade (TWD)	51.05	0.91%	-9.52%	50.59	-4.04%	-12.70%	52.72	-1.51%	-10.00%
Change US$/FX	--	-0.90%	10.52%	--	4.21%	14.55%	--	1.54%	10.01%
Precious Metals (4) *US$ per Troy Ounce*									
Gold	890.50	-4.61%	27.27%	933.50	11.96%	38.97%	833.75	12.21%	31.92%
Silver	17.19	-4.45%	25.57%	17.99	21.88%	34.76%	14.76	8.13%	14.41%

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

As a general strategy under the current circumstances, looking to preserve wealth and assets needs to be a primary concern, along with the liquidity and safety of investments. The approaching financial maelstrom already has come over the horizon and appears to be making landfall, albeit slowly. When it hits with full force, those investors who have taken shelter in cash or near-cash outside the U.S. dollar and in gold will be the ones with the wealth and assets available to take advantage of the extraordinary investment opportunities that should follow.

U.S. Equities -- A severe and protracted inflationary recession is not good for equities, despite any inflation play. Slowing business activity and higher costs (particularly where a company is slow to raise its prices) should hit earnings. Heavy dollar selling eventually should drain liquidity from the equity and credit markets, hitting both stock and bond prices.

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 -- The Fed has been signaling nervously that the string of panicked rate cuts has run its course. Such remains to be seen, as Wall Street increasingly buys the concept of a severe recession and the banking solvency issues likely surface anew. Nonetheless, the perceived shift in Fed policy, combined with mounting inflation fears and a pick-up in selling of the greenback has started to push Treasury yields a little higher.

Even so, the 30-year Treasury bond remains the only regular Treasury security that has a positive real (inflation-adjusted) yield at 4.65%, versus the government's reported CPI inflation rate of 3.94%. With even official CPI inflation likely to spike in the months ahead, however, that circumstance will disappear shortly, shy of a sharp rise in Treasury yields.

Given the Federal Reserve's latest numbers (Flow of Funds June 2008) suggesting that seasonally-adjusted foreign buying of U.S. Treasuries more than absorbed the rising net issuance during the first quarter, the vulnerability of domestic interest rates to a major sell-off in the U.S. dollar could not be much greater. In fairness, though, the Fed numbers are not of particularly good quality.

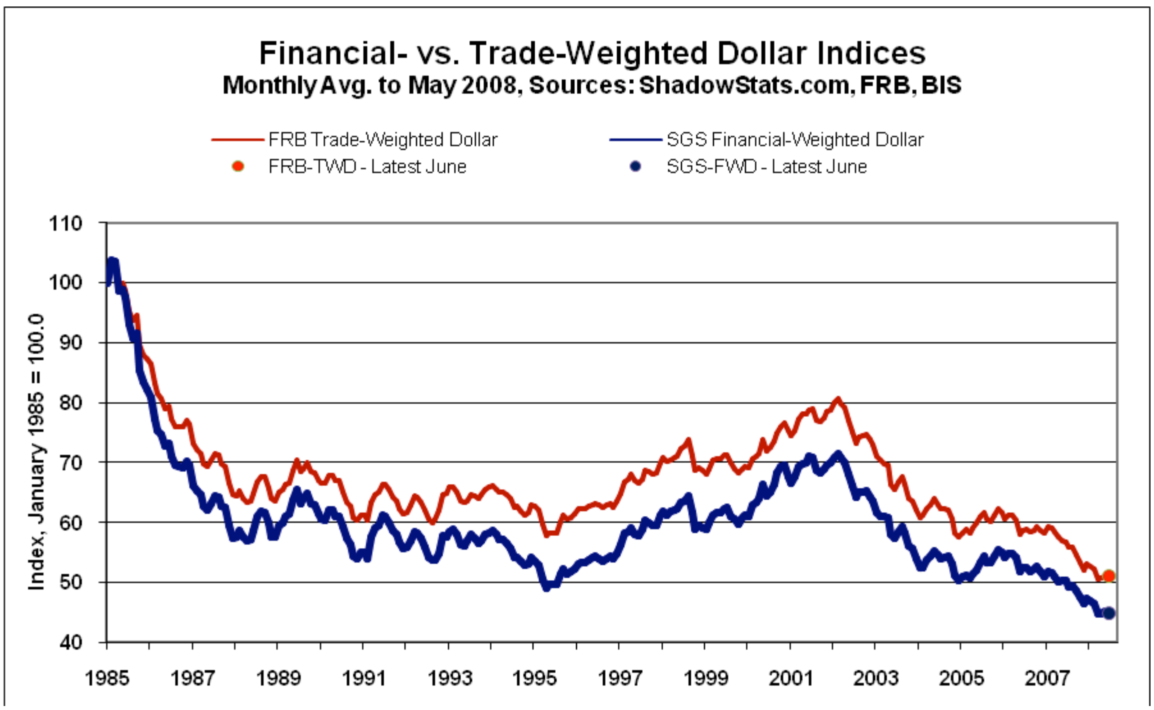
With rapidly mounting inflationary pressures, rapid money growth, explosive federal deficit growth (and borrowing needs), and a soon-to-be-seen flight from the dollar that evolves into a flight-to-safety outside the dollar, the longer range outlook continues for long-term Treasury yields to back up by several hundred basis points, approaching a more-normal spread in long-term Treasuries over inflation. With a normal spread, the current 4.65% yield on the 30-year Treasury bond should be over 7.50%.

U.S. Dollar -- Jawboning by Fed Chairman Bernanke and Treasury Secretary Paulson has given the U.S. dollar short-lived boosts, as has likely covert central intervention. Otherwise, the underlying fundamentals -- those factors that determine the long range outlook for the U.S. currency -- remain abysmal and are deteriorating. 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.

In terms of underlying fundamentals that drive relative currency values, the dollar's portfolio could not be worse. Relative to major trading partners, the U.S. economy is much weaker; interest rates are lower and anticipated possibly to go lower still on a relative basis (i.e., foreign rates rising); inflation is higher; rising fiscal and trade-balance conditions are horrendous, with the fiscal deficit exploding; and relative political/systemic concerns are rising sharply with President's and Congress's approval ratings bottom-bouncing at all-time lows. Neither presumptive presidential candidate (pocketbook issues favor a win for the Democrats) has any prospects of turning the economy.

General background note: Beyond renewed capitulation by the Federal Reserve to the solvency/funding crisis, the proximal trigger for a full dollar panic 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 in the Middle-East or South America. 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 deteriorating systemic crisis.

As shown in the following graph, the U.S. dollar inched higher in May from historic lows, but it resumed something of a tumble late last week. The latest data points shown for the financial- and trade-weighted indices are as of Friday, June 6th.



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 May 2008 the monthly FWD rose by 0.63%, after easing by 0.04% in April. The May 2008 average index level of 45.13 (base month of January 1985 = 100.00) was down by 10.14% from May 2007, while April was down 10.47% from the year before. As of June 6th, the FWD stood at 44.95.

Also rising in May was the Federal Reserve's Major Currency Trade-Weighted U.S. Dollar Index (TWD). The May 2008 average gained 0.40% from April, which, in turn, was up by 0.21% from March. The May 2008 index level of 50.91 (base month of January 1985 = 100.00) was down 10.67% year-to-year, versus an 11.77% annual decline in April. As of June 6th, the TWD closed at 51.05.

Gold -- In the midst of significant ongoing volatility, the price of gold was down about 12%, as of Friday (June 6th), from its record-high London p.m. fix of $1,011.25 per troy ounce on March 17, 2008. In terms of annual perspective, gold is up by about 27% from a year ago, while the S&P 500 is down about 10% over the same period. The long-term outlook for gold remains extremely bullish, with recovery to $1,000-plus levels and higher likely sooner, rather than later, given the continuing, extraordinary strength of the underlying fundamentals.

The underlying fundamentals generally have improved during the last month or so, with explosive oil prices, high monetary growth, some resumption of dollar-selling pressure and mounting global political tensions. Gold buying pressure should intensify significantly, along with heavy dollar selling that remains likely in the long run. Downside pressures ranging from jawboning to possibly covert market intervention remain in the short-term camp, with no lasting impact.

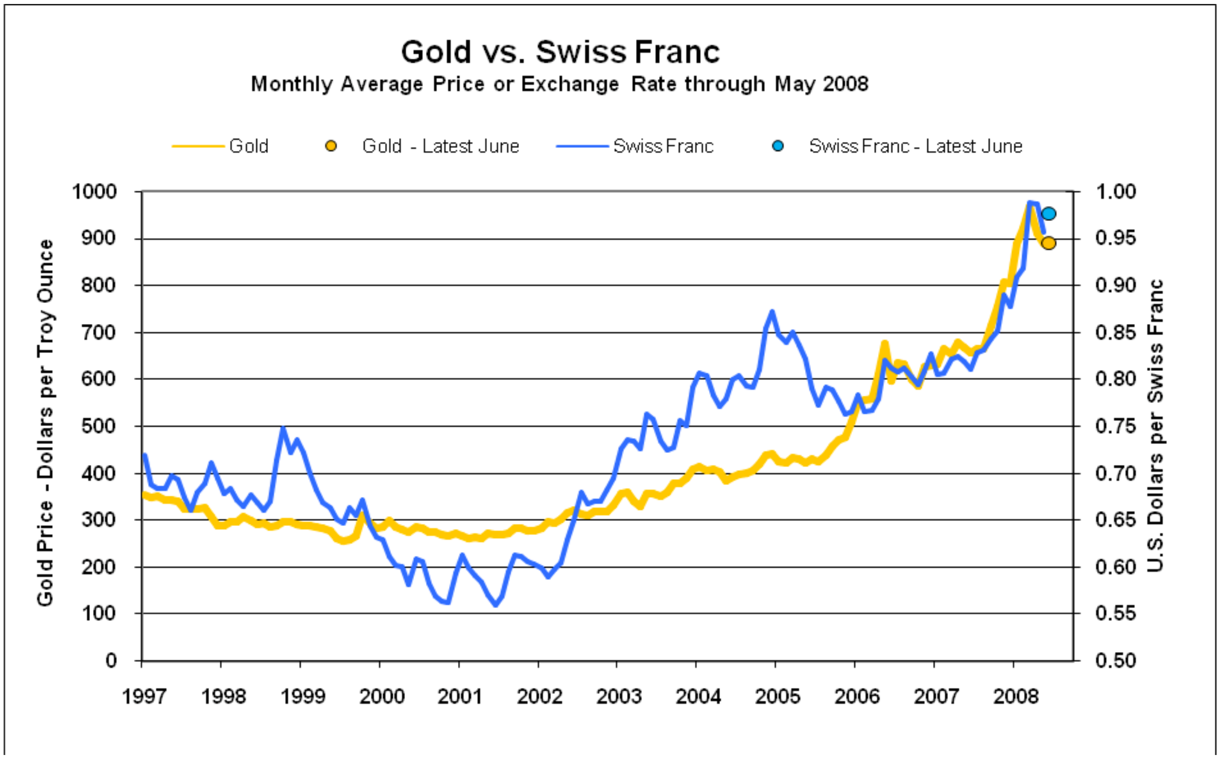
For May (based on Kitco.com), the monthly average London gold afternoon fix was $886.66 per troy ounce, versus $909.70 in April. Silver averaged $17.05 per troy ounce in May, down from $17.50 in April. Respective closing prices on June 6th were $890.50 and $17.19 per troy ounce.

Inflation-Adjusted Historic Gold High. Outside of the current period's March 17th high of $1,011.25, the earlier all-time high of $850.00 (London afternoon fix) of January 21, 1980 still has not been hit in terms of inflation-adjusted dollars. Based on inflation through April 2008, the 1980 gold price peak would be $2,347 per troy ounce, based on not-seasonally-adjusted CPI-adjusted dollars, and would be $6,484 per troy ounce in terms of SGS-Alternate CPI adjusted dollars.

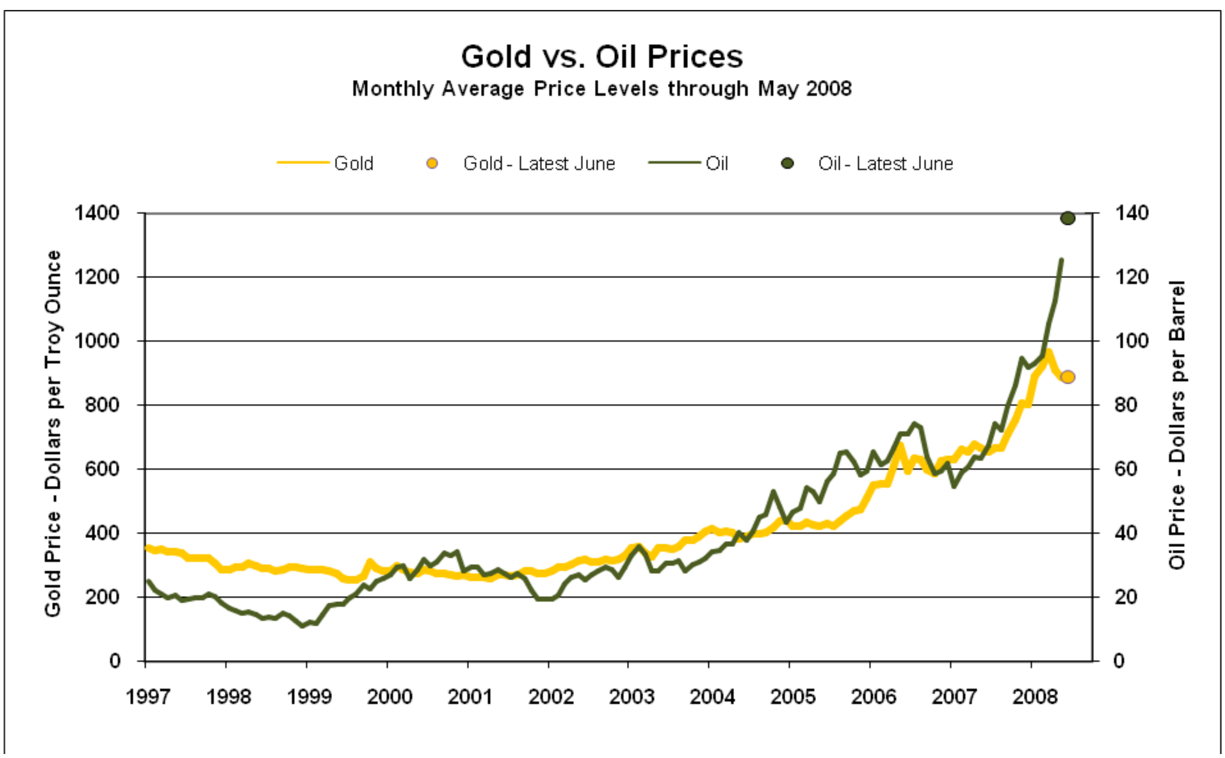
General background note: Near-term gold price volatility likely will continue and could be significant. Upside price pressures from mounting inflation, a weakening dollar and increasing global political, financial and systemic instabilities, face offsets with bouts of profit taking and with intensified overt and covert central bank interventions in the gold and currency markets, aimed at propping the greenback. Despite any central-bank machinations or intervention, the upside potential for the precious metals 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 and Swiss franc graphs show the May averages, as well as added points for closing prices on June 6th, with gold at $890.50, oil at $138.55 and the Fed's published noon buying rate for the Swiss franc at $0.9768. Again, all three measures should trade significantly higher in the months ahead.



Gold vs. Swiss Franc
Monthly Average Price or Exchange Rate through May 2008
Gold
Gold - Latest June
Swiss Franc
Swiss Franc - Latest June
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 May 2008
Gold
Gold - Latest June
Oil
Oil - Latest June
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