

A Storm is Brewing

When the tech bubble burst in 2000, Greenspan tried to “fix” the problem by cutting rates and printing money. Fix the problem he did ... well sort of! What Greenspan did was create two new bubbles in the credit and real estate markets to replace the tech bubble that had burst. Millions of jobs were created in these two industries. Much needed jobs to replace the ones lost as the tech boom came to an end.

I think we will all admit it was one heck of a party, but like all good parties there's a price to pay. The Hangover!

The truth is the economic boom of the mid 2000's was built on a lie. Instead of a foundation of productivity the last bull market was founded on an ocean of liquidity. That ocean of liquidity fostered risky investments and massive speculation. It was only a matter of time before the house of cards came crashing down. And crash it did. The world suffered through the second worst bear market in history almost taking down the global financial system in the process.

Apparently the powers that be have learned nothing from this near death experience because they are back at it again, printing, printing, printing in another vain effort to create prosperity with the printing press. I dare say the average 6th grader can understand that the act of putting ink on paper does not create wealth. It's too bad our elected officials can't understand this.

So here we are, we've survived the credit crisis and all appears to be well in the world. I'm here to say that *all is not well*. We now have a cancer growing under the surface of the economy many times bigger than the one Greenspan created. This cancer isn't going to show up in real estate or credit markets, that bubble has already burst, never to be inflated again. No, this time I expect the cancer is going to flare up as inflation in the commodity markets.

Witness the strange resilience of oil at \$80 despite a very strong dollar the past 3 months. Gold has been holding over \$1100. Sugar is at multi-year highs. Copper is less than 15% from all-time highs.

The commodity markets are now poised to unleash a massive inflationary storm. I think there's a very good chance that storm will strike this spring.

The dollar is now deep into a counter trend rally and in jeopardy of putting in an intermediate term top at any time. When it does the flood gates could break and we will have to deal with the unintended consequences of Bernanke's actions.

Unfortunately, there are no painless cures for spiking inflation, especially in an ongoing recession. The cure is to let the market clean out the excesses. The cure is to raise rates and drain liquidity, to induce a recession. That course leads to 20%+ unemployment and a deflationary depression. Does anyone really believe our elected officials will choose the that course of action?

On the other hand, doing nothing leads to higher and higher inflation and running the presses faster and faster to stay ahead of rising prices, eventually culminating in a hyperinflationary event if government debt is allowed to spiral beyond the point of no return.

Unfortunately, I think it's probably too late to stop the storm. Let's face it, you don't start turning the Titanic when it's 100 yards from the iceberg. By then it's too late and the ship is doomed.

The same principle applies with our economy. If the Fed waits until inflation starts to pop up it is too late. The damage is already done and there's no going back. If the inflation Genie gets out of the bottle there's no easy way to get him back in. I would argue that the commodity markets are already trying to tell us there's trouble coming.

History has been crystal clear - every time oil spikes 100% or more within a year's time, it has pushed the our economy into a recession. We already have a spike from \$32 to over \$80 and this is against a backdrop of high unemployment. The last thing we need in an economic environment that's already under stress is surging energy prices again.

The question investors have to ask themselves is whether it's more likely the powers that be will do the right thing, raise rates, drain liquidity and force the world into a deeper recession before inflation gets out of control *or* will they continue to kick the can down the road making the problem bigger and bigger?

Knowing human nature, my bet is that our elected officials will do whatever they have to do to avoid short term pain - even if it means compromising our future.

The storm is brewing. It's time to batten down the hatches.

That means gold and silver!

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