PRIVATE WEALTH ADVISORY

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The "C" Word

This is not going to be your usual investment newsletter.

This week I am going to devote this entire issue to explaining how the global financial system *really* works. Before we delve into things, I have to warn you in advance that what follows will be both extremely dense as well as extremely worrisome.

I am doing this because you need to know the real risks being posed to your wealth today. However, in order for you to understand this, you first need to understand how the financial system really works. Over 99% of people, including investment professionals do not understand what I am about to write. But I can assure you, that before this issue is done, everything that's happened in the world since 2007 will make a lot more sense.

So let's buckle up and get started.

Everything that has happened since 2007, every Central Bank move, ever major political decision regarding the big banks, every trend, have all been focused solely on one issue.

That issue is collateral.

What is collateral?

Collateral is an underlying asset that is pledged when a party enters into a financial arrangement. It is essentially a promise that should things go awry, you have some "thing" that is of value, which the other party can get access to in order to compensate them for their losses.

You no doubt are familiar with this concept on a personal level: any time you take out a bank loan the bank wants something pledged as collateral should you fail to pay the money back. In the case of property, the property itself is usually the collateral posted on the mortgage. So if you fail to pay your mortage, the bank can seize the home and sell it to recoup the losses on the mortgage loan (at least in theory).

In this sense, collateral is a kind of "insurance" for any financial transaction; it is a way that the parties involved mitigate the risk of their deal not working out.

As many of you know, our entire global financial system is based on leverage or borrowed money. Collateral is what allows this to work. Without collateral, there is no borrowed money. And without borrowed money, money does not enter the financial system.

In this sense, collateral is the "reality" underlying the "imaginary" or "borrowed" component of leverage: the asset is real and can be used to back-stop a proposed deal/ trade that has yet to come to fruition.

On a consumer level, our bank deposits (cash), homes, and other assets are the collateral pledged when we borrow money from a bank to finance something. This applies to everyone in the US all the way up to the multi-billionaire bracket.

> **How Larry Ellison Actually Funds His Lavish Lifestyle**
>
> One of the mysteries surrounding Larry Ellison is how he can afford so many mansions, islands, yachts and planes, all while retaining his shares in his company.
>
> Yes, the Oracle CEO is one of the richest men in the world, worth over $30 billion. **Yet he sells only small amounts of stock under a schedule stock-sale plan.** And last I checked, yacht builders don't take Oracle stock for payment.
>
> Now we have some clues as to how Ellison funds his acquisitive lifestyle.
>
> According to Oracle's proxy, filed this month, **Ellison has pledged 139 million shares "as collateral to secure certain personal indebtedness, including various lines of credit." In other words, he's got over $4.2 billion worth of stock pledged for personal loans.**
>
> http://www.cnbc.com/id/49194482/How_Larry_Ellison_Actually_Funds_His_Lavish_Lifestyle

On a corporate level, companies pledge various assets as collateral for their corporate loans. For manufacturing firms, this might be the actual steel inventory they own. For property companies, it's portions of their real estate portfolios.

And for finacial firms, at the top of the corporate food chain, it's sovereign bonds.

Modern financial theory dictates that sovereign bonds are the most "risk free" assets in the financial system (equity, municipal bond, corporate bonds, and the like are all below sovereign bonds in terms of risk profile). The reason for this is because it is far more likely for a company to go belly up than a country.

Because of this, the entire Western financial system has sovereign bonds (US Treasuries, German Bunds, Japanese sovereign bonds, etc) as the **senior most asset** pledged as collateral for hundreds of trillions of Dollars worth of trades.

The "hundreds" of trillions of Dollars of trades stems from a 2004 SEC ruling in which the SEC ruled that broker-dealers with capital bases above $5 billion (think Goldman, JP Morgan, etc) could increase their leverage above previously required levels while *also* abandoning market to market valuation methods (a methodology through which a security was priced at the value that a market participant would pay for it).

So, after the 2004 ruling, large broker dealers were permitted to increase their leverage levels dramatically. And because they could value their trades at whatever price their in-house models chose (what are the odds that these models were conservative?), the broker-dealers and large Wall Street banks are now sitting on over $700 trillion worth of derivatives trades.

Now, every large bank/ broker dealer *knows* that the other banks/dealers are overstating the value of their securities. As a result, these derivatives trades, like all financial instruments, require collateral to be pledged to insure that if the trades blow up, the other party has access to some asset to compensate it for the loss.

As a result, the ultimate backstop for the $700+ trillion derivatives market today is **sovereign bonds.**

When you realize this, the entire picture for the Central Banks' actions over the last five years becomes clear: every move has been about accomplishing one of two things:

1) Giving the over-leveraged banks access to cash for immediate funding needs (QE 1, QE 2, LTRO 1, LTRO 2, etc)
2) Giving the banks a chance to swap out low grade collateral (Mortgage Backed Securities and other crap debts) for cash that they could use to purchase higher grade collateral (QE 1's MBS component, Operation Twist 2 which lets bank their long-term Treasuries and buy short-term Treasuries, QE 3, etc).

By way of example, let's first consider Greece.

Lost amidst the hub-bub about austerity measures and Debt to GDP ratio for Greece is the real issue that concerns the EU banks and the EU regulators: what happens to the trades that are backstopped by Greece sovereign bonds?

Remember:

1) Before the second Greek bailout, the ECB swapped out all of its Greek sovereign bonds for new bonds that would *not* take a haircut.
2) Some 80% of the bailout money went to EU *banks* that were Greek bondholders, *not* the Greek economy.

Regarding #1, the ECB had just permitted EU nations to dump over €1 trillion worth of sovereign bonds onto its balance sheet in exchange for immediate financing needs via its LTRO 1 and LTRO 2 schemes dated December 2011 and February 2012.

So, when the ECB swapped out its Greek bonds for new bonds that would *not* take a haircut during the second bailout, the ECB was making sure that the Greek bonds on its balance sheet remained <u>untouchable</u> and as a result could still stand as high grade collateral for the banks that had lent them to the ECB.

So the ECB effectively allowed those banks that had dumped Greek sovereign bonds onto its balance sheet to avoid taking a loss… and not having to put up new collateral on their trade portfolios.

Which brings us to the other issue surrounding the second Greek bailout: the fact that 80% of the money went to EU banks that were Greek bondholders instead of the Greek economy.

Here again, the issue was about giving money to the banks that were using Greek bonds as collateral, to insure that they had enough capital on hand.

Piecing this together, it's clear that the Greek situation actually had nothing to do with helping Greece. Forget about Greece's debt issues, or protests, or even the political decisions… **the *real* story was that the bailouts were all about insuring that the EU banks that were using Greek bonds as collateral were kept whole by any means possible.**

Now, Greece was always the small player in this mess. It's entire sovereign bond market is a mere €300 billion.

Spain and Italy, by comparison, have €1.78 trillion and €1.87 trillion in external debt respectively.

I do not have an exact figure for how much of the derivatives market uses Spanish and Italian sovereign bonds as collateral, but I can create an estimate using the US bank data I have available.

In the US, we know that the top four banks have over $222 trillion in derivatives exposure with just $7 trillion in total assets. So the leverage here is roughly 31 to 1.

Using this as a ballpark estimate for derivatives leverage, it is very possible that Spain and Italy's sovereign bonds are **pledged as collateral for well over $100 trillion worth of derivatives trades ($1.78 trillion X 31 + $1.87 trillion X 31).**

This is why Spain is dragging its feet about asking for a bailout: the mess of trying to sort out the collateral issues for **€1.78 trillion** in collateral that is backstopping what is likely tens of TRILLIONS of Euros' worth of trades is capable of causing systemic failure.

To explain this, let's go back to Lehman's collapse.

Countless pages have been written about why Lehman caused the system to almost implode. However, the reality is that Lehman nearly took down the entire financial system for two reasons:

1) Lehman's $155 billion worth of bonds were used as collateral in hundreds of billions of Dollars' worth of trades.
2) Lehman's 8,000 clients who were all using Lehman to make trades saw the collateral that they had placed with the firm (to backstop their portfolios) **frozen**.

Lehman's client list included some of the biggest names in the financial world. Remember that before the 2008 collapse, the big broker-dealers (Lehman, Merrill, etc) were all standalone entities (the Merrill/ BofA merger and the others had yet to happen). So all of the big banks, with few exceptions, had their collateral *parked* with broker dealers like Lehman.

The below story reveals that both Bank of America and Dubai's sovereign wealth fund both saw collateral frozen when Lehman went bust. I can assure you many other big names were caught in a similar situation.

> **Lehman: One Big Derivatives Mess**
>
> It turns out that Lehman, like other big dealers, was running a perfectly legal but highly risky game moving money from firm to firm. **It used the collateral from one trading partner to fund more deals with other firms.** The same $100 million collected in one deal can be used for many other transactions. "Firms basically can use [the money] as their own collateral for anything they want," says Kenneth Kettering, a former derivatives lawyer and currently a professor at New York Law School. **But when the contracts terminate as the result of bankruptcy, the extra collateral is supposed to be returned.**
>
> As part of those transactions, buyers had put up collateral in the event of losses**. But weeks after Lehman's demise, large sums of leftover collateral have yet to be returned to the trading partners. Bank of**

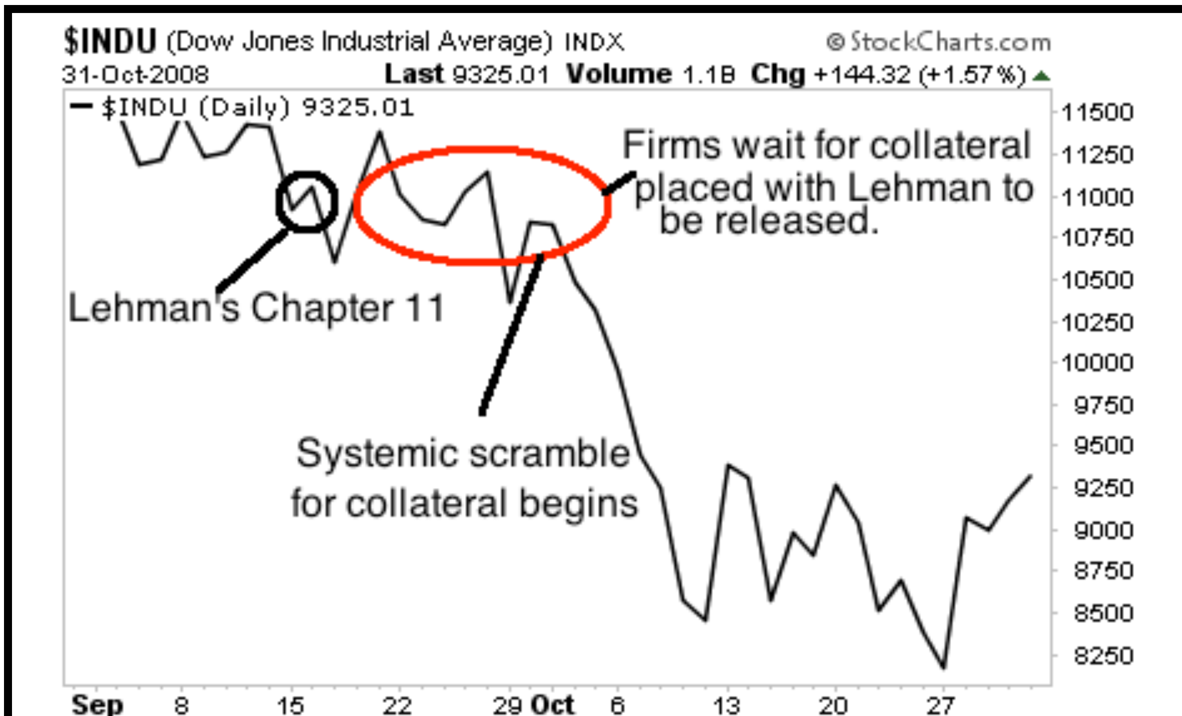
America (BAC) executives tried several times to persuade Lehman officials via e-mail and phone calls to fork over funds, according to a suit. But BofA was rebuffed. In one e-mail exchange, a Lehman employee wrote to BofA: "All activity has been suspended until further notice."

Nasreen Bulos, a lawyer for one of Dubai's sovereign wealth funds, got the same chilly response. The Global Strategic Equities Fund of Dubai, part of the gulf state's $12 billion investment portfolio, **gave Lehman $40 million in June as part of a deal pegged to energy giant BP's (BP) stock. According to an affidavit, Bulos started contacting Lehman on Sept. 15 to get back $27 million in collateral. Four days later, Lehman told Bulos it would not honor the request or say anything further on the matter.**

http://www.businessweek.com/stories/2008-10-07/lehman-one-big-derivatives-mess

Normally, a client's collateral would be unfrozen soon after the bankruptcy of a broker dealer. In Lehman's case it wasn't. And that, combined with Lehman's $155 billion worth of bonds becoming worthless, created a *severe* collateral shortfall in the system.

This is why the market held together for a little over a week after Lehman went bust: the players who had collateral with Lehman thought they'd get the money freed. When they didn't, the system imploded as collateral calls were issued. What followed was widespread liquidation as banks did everything they could to free up capital to meet funding needs or to buy new higher grade collateral (hence the skyrocketing rally in Treasuries at the time).



This is the reality of what happened in 2008, though few know it. And this is why a default in Spain or Italy (whose €1.78 and €1.87 trillion in sovereign bonds are collateral for likely more than €100 trillion in trades) would bring about a collapse that would make Lehman appear minor in comparison.

Remember, if Spain goes bust, they over €1 trillion in collateral would vanish triggering a chain reaction in at least €50 trillion if not €100+ trillion in trades at the large banks/ financial institutions.

Timing when this will happens is impossible because it involves timing a political timeline for an economic reality. As I found out the hard way earlier this year, economics and finance can point to an ultimate outcome (the collapse of the EU banking system) but the exact timing is nearly impossible because politicians and central banks will do anything and everything they can to draw out the process for the simple reason that as soon as the system fails again, most will be out of jobs (the fall-out coming from the fact that most financial promises will not be met is going to be huge).

In a region as dependent on social spending as Europe, there are tremedous incentives for the political and financial elite to avoid dealing with financial realities. This is why no one wants to address the real issues in the system (excessive leverage, too little quality collateral, and far too many funding promises that cannot possibly be met) but instead focuses on items like austerity measures and the like.

All of this is a grand delusion meant to draw attention away from the fact that the financial system is on very, very thin ice due to the fact that there is very

little high quality collateral backstopping the $700+ trillion derivatives market.

Indeed, if you want further evidence that the financial elites are already preparing for a default from Spain and a collateral crunch, you should consider that the large clearing houses (ICE, CEM and LCH which oversee the trading of the $700+ trillion derivatives market) have ALL begun accepting Gold as collateral.

> **Gold as Collateral Acceptable for Margin Cover Purposes**
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> **From 28 August 2012 unallocated Gold (Loco London) will be accepted by LCH.Clearnet Limited (LCH.Clearnet) as collateral for margin cover purposes.**
>
> This addition to acceptable margin collateral will be subject to the following criteria;
>
> Available for members clearing OTC precious metals forwards (LCH EnClear Precious Metals division) or precious metals contracts on the Hong Kong Mercantile Exchange. Acceptable to cover margin requirements for all markets cleared on both House and 'Segregated' omnibus Client accounts.
>
> http://www.lchclearnet.com/member_notices/circulars/2012-08-21.asp
>
> **CME Clearing Europe to Accept Gold as Collateral on Demand**
>
> CME Clearing Europe will accept physical gold as collateral, extending the list of assets it's prepared to receive as regulators globally push more derivatives trading through clearing houses.
>
> CME Group Inc. (CME)'s European clearing house, based in London, appointed Deutsche Bank AG (DBK), HSBC Holdings Plc and JPMorgan Chase & Co. as gold depositaries. There will be a 15 percent charge on the market value of gold deposits and a limit of $200 million or 20 percent of the overall initial margin requirement per clearing member based on whichever is lower, Andrew Lamb, chief executive officer of CME Clearing Europe, said today.
>
> "We started with a narrow range of government securities and are now extending that," Lamb said in an interview today. "**We recognize there will be a massive demand for collateral as a result of the clearing mandate**. This is part of our attempt to maintain the risk management standard and to offer greater flexibility to clearing members and end clients."
>
> http://www.bloomberg.com/news/2012-08-17/cme-clearing-europe-to-accept-gold-as-collateral-on-demand-1-.html

Is it coincidence that this began ONLY when the possibility of a sovereign default from Greece or Spain began? Nope. This actions show that the large clearinghouses see the writing on the wall (that defaults are coming accompanied by a mad scramble for collateral) and so are moving away from paper (sovereign bonds) into hard money.

The reason?

They know that when Spain defaults the system will be rocked even harder than it was with Lehman in 2008. And they are doing everything they can get access to *real* collateral (Gold) when paper collateral (Spanish bonds) becomes worthless.

Remember, history has shown us time and again that defaults come in waves. So when Spain defaults, it will be only a matter of time before the rest of the PIIGS, the UK, Japan, and then the US do as well.

However, for now Spain is the biggest issue. As a result of this, Treasuries, Japanese bonds, German bunds and even French sovereign bonds remain attractive to the big banks as collateral… for now.

Indeed, it is the search for high grade collateral that has caused such periodic spikes in Treasuries, German Bunds, French sovereign bonds, and Japanese bonds (all of these have yielded 0% or even negative yields in the last five years). Big banks are moving away from PIIGS bonds into safer havens.

This is also why the Fed *isn't* touching Treasuries with QE3 and why it won't touch short-term Treasuries with Operation Twist 2 (this program sees the Fed selling short-term Treasuries to buy long-term Treasuries): the Fed wants to keep as much good quality collateral in the system as possible (long-term Treasuries are problematic because institutions know it's highly likely the US will default within the next 30 years).

However, even this move is problematic because much of the Treasury market is locked up with governments both foreign and domestic.

Total US Sovereign Debt	$16 trillion
Foreign Nation holdings	$5 trillion
Intergovernmental holdings	$4.8 trillion
US Federal Reserve	$1.5 trillion
Remaining	**$4.7 trillion**

Again, this is why clearinghouses (which oversee the derivatives markets) are now allowing Gold as collateral: they know that eventually sovereign bonds will be worth less or even worthless. And they want access to their clients' Gold for when this happens.

With that in mind, the countries that will ultimately be considered safe havens when the BIG collapse starts are those with the largest Gold reserves.

Country	Gold Holdings	% of Foreign Reserves in Gold
The US	8,133 tonnes	75.1%
Germany	3,395 tonnes	71.9%
Italy	2,451 tonnes	71.3%
France	2,435 tonnes	71.6%
China	1,054 tonnes	1.6%
Switzerland	1,040 tonnes	14.2%
Russia	918 tonnes	9.2%
Japan	765 tonnes	3.1%
Netherlands	612 tonnes	60.2%
India	557 tonnes	9.8%

I can assure you that the financial and political elite are aware of everything I'm writing about here. It is no coincidence that Germany floated the idea of accepting other EU nation's *Gold* in exchanged for bailouts back in May 2012 when Europe teetered on the brink of collapse:

> **Europe's debtors must pawn their gold for Eurobond Redemption**
>
> **Southern Europe's debtor states must pledge their gold reserves and national treasure as collateral under a €2.3 trillion stabilisation plan gaining momentum in Germany**.
>
> The German scheme -- known as the European Redemption Pact -- offers a form of "Eurobonds Lite" that can be squared with the German constitution and breaks the political logjam. It is a highly creative way out of the debt crisis, but is not a soft option for Italy, Spain, Portugal, and other states in trouble.
>
> http://www.telegraph.co.uk/finance/financialcrisis/9298180/Europes-debtors-must-pawn-their-gold-for-Eurobond-Redemption.html

It's also not coincidental that Germany is performing an audit of its Gold holdings today, either.

> **Bundesbank Says NY Fed to Help Meet Gold Audit Request**
>
> The Bundesbank said the Federal Reserve Bank of New York will help it meet auditing requirements related to its gold reserves that were demanded by Germany's Audit Court.

> "We have been in discussions with the Federal Reserve Bank of New York about the Bundesbank's holdings of gold," the Bundesbank said yesterday in a letter to the German parliament's budget committee. "The discussions have been fruitful and the Federal Reserve has expressed a commitment to work with the Bundesbank to explore ways to address the audit observations, consistent with its own security and control processes and logistical constraints."
>
> The agreement is part of a compromise between the German central bank and the Audit Court, which has called on the Bundesbank to take stock of its gold holdings outside Germany, saying it has never verified their existence. The Bundesbank distributed the letter to reporters after board member Carl-Ludwig Thiele and the Audit Court's head Dieter Engels testified to budget committee lawmakers in the lower house of parliament in Berlin.
>
> http://www.bloomberg.com/news/2012-10-25/new-york-fed-to-help-bundesbank-meet-gold-audit-requirements.html

I realize that the last 10 pages have been pretty dense. So I'll summate everything here:

1) The #1 issue for the financial world is too little quality collateral backing too many trades.
2) The search for good collateral has lead investors to seek high grade sovereign bonds (Treasuries, German bunds, French bonds, Japanese bonds) as a safe haven between 2008-the present.
3) The folks who monitor the derivatives market (the large clearing houses) realize that sovereign bonds are not going to be a safe haven for much longer and so are looking at Gold as a new form of collateral for trades (this has NEVER been the case before).
4) Germany and other nations will be increasingly looking to audit and accumulate their Gold holdings.

Keep all of this in mind at all times going forward. This is the BIG picture for the financial world.

Some other items to consider as we prepare for the eventual BIG collateral call.

I would steer clear of *any* bank with large derivative exposure. When the big collateral call happens these banks will likely be on the hook for hundreds of billions of Dollars.

Here's the top 25 US banks by derivative exposure:

Bank	Total Assets (in Billions)	Total Derivatives (in Billions)
JP Morgan	$1,812	$69,238
Citibank	$1,347	$52,150
Bank of America	$1,445	$44,405
Goldman Sachs	$114	$41,580
HSBC	$193	$4,535
Wells Fargo	$1,180	$3,590
Morgan Stanley	$69	$2,481
Bank of NY Mellon	$259	$1,296
State Street Bank	$196	$867
PNC Bank	$291	$392
Suntrust Bank	$172	$273
Northern Trust	$94	$225
Standard Chartered	$48	$145
US Bank National	$342	$121
Regions Bank	$121	$120
Keybank National	$83	$81
BB&T	$173	$77
Fifth Third	$115	$72
TD Bank	$195	$69
Union Bank	$87	$58
RBS	$106	$36
BOKF National	$25	$35
Capital One	$158	$33
BMO Harris	$92	$30
Ally Bank	$87	$28

All of these will be at risk to some degree if a systemic collateral call (due to a sovereign default from Spain or another large EU country) hits.

Indeed, the market is already telling us via the charts that this will be case. Consider the charts for the four banks with the largest deriavtives exposure.

JP Morgan: downside target if the H&S is confirmed is sub-$10 if not ZERO:

Citibank (C): when this wedge breaks to the downside C will go to ZERO. We could, in the meantime, see a false breakout to the upside. But I would be *very* wary of this.

Bank of America (BAC): if and when we break this wedge to the downside, we're going to ZERO. Much like Citibank, we could see a false breakout to the upside first.

Goldman Sachs (GS): if Wall Street's finest breaks to the downside of this chart, it's going to sub $10 if not ZERO.

A collapse in Europe or in the big banks banks would also trigger a major flight towards the US Dollar:

I'm not a huge fan of the greenback, but it *is* the least ugly girl at the prom. The above chart forecasts a move north of 120. So, whenever things start to get really hairy in the EU (Spain defaults) I'd be shifting money into Dollars and away from the Euro.

The best time for this would be whenever the Euro finally breaks below 120. This is the line in the sand. When the Euro breaks below this level, it's game over and we're going to 90 if not lower:

Speaking of troubled currencies, the Yen is on the ledge of a cliff:

Will Britain be considered a safehaven if the Euro goes? Hard to tell. But if if breaks its wedge to the downside, we’re going to sub 120:

If and when the Swiss franc breaks its trendline, it could easily halve:

Speaking of trouble, let's take a look at some EU banks:

Our favorite sewer of Spanish debt, Santander (STD) continues to float around $8. Everything here is illusion. When the trendline gets taken out STD will go to ZERO:

Credit Suisse (CS): we broke the trendline and are in the process of failing to reclaim it. Once we turn back down we're going to sub $15:

Barclay's (BCS): not a pretty sight. Whenever we break down here it's ZERO time.

How about EU stock markets themselves?

I've mentioned many times that it will be Spain who takes down the EU and the Euro. Indeed, one could easily argue that the Spanish IBEX is possibly the single most important chart in the world.

Whenever we break back below the trendline then the great EU collapse will begin in earnest. At that point all of the items outlined in this issue will begin. How fast it will all unfold remains to be seen. But as you can see, we're not far off from it starting:

Italy (EWI): 10 is the line in the sand. When it's taken out, systemic risk takes down the market.

France (EWQ) won't be a safe haven for long when things get messy in the EU:

Germany's Dax will be the last man standing in Europe. But it things get *really* bad it could go to 2,000:

As for the Emerging Markets…

China is in BIG trouble:

Same with Brazil:

And Russia:

How about the US?

If the S&P 500 takes out 1,400 with conviction, we're easily going to 1,200. And if we take *that* line out… LOOK OUT!!

I'm sure you've noticed that the market leaders are rolling over:

Apple (AAPL) is on the ledge of a cliff. $500 is below. And it that is broken…

Amazon (AMZN) has also rolled over. It's in BIG trouble if it takes out $220.

Google (GOOG) has rolled over sharply. If we break below $650 we could go to $550. And below that…

When the market leaders roll over and the market holds up temporarily… big trouble is brewing. I want to alert you that the Russell 2000 (the risk index) is on the ledge of a cliff:

Check out the chart for the VIX. Whenever we break above 30 we're going to ALL TIME HIGHS (this will be accompanied by the collateral call I mentioned before):

Also… it's often believed that if stock fall Treasuries will rally. Bernanke better hope this is the case, because if Treasuries start to fall when the Fed is already buying 70% of all US debt issuance then stocks will be the *last* of everyone's worries.

To summate: the very Crisis I wrote about back in May-June remains in play. The Central banks have bought time by promising "unlimited" and "open-ended" buying programs. However, the charts don't lie… something VERY bad is approaching.

I cannot definitively say when this will happen. But the Spanish Ibex indicates it could be quite soon. Whenever Spain gets back into serious Crisis mode again, then the Great Crisis will have truly begun.

Here's that chart again:

Watch this chart very closely. Whenever we head back down, it has begun.

Now I cannot say exactly how things will unfold. There is literally no telling what the Central Banks will try if the system gets shakey again. And similarly, there is no telling if the political elite will opt to kick Greece out or if Germany will walk, or if Spain will go for a bailout or simply default or what.

But the facts remain that the system is under severe duress (why would the Fed launch QE 3 now if they weren't?). And at some point, very likely in the not so distant future, we could start to see things come unhinged.

Whenever this happens, we'll need to see how the following questions are answered by the markets:

1) If things come unhinged, will the Central Banks be able to hold the system together via some new intervention (liekly not given that QE 3 is open-ended so the Fed has already promised non-stop support).
2) If not, will Treasuries *still* be considered a safe haven or will they fall along with stocks (a Treasury collapse would be BIG trouble as Treasuries are the collateral for hundreds of trillions of Dollars worth of trades).
3) Will a systemic event impact Gold and Silver or will they hold up?

I cannot answer these questions now. But as things progress we'll get those answers.

In the meantime, I see little if any reason to be long stocks. I see many many red flags. And I see that the clearinghouses are moving to get access to Gold for the first time.

This is the BIG story in the financial world. No one gets it. But it tells us point blank that those in charge of the derivatives market want to get access to GOLD.

This concludes this issue. I hope you now understand why I've been warning that 2008 was the warm up for the last few years.

Best Regards,

Graham Summers

OPEN POSITIONS

Inflation Portfolio (OPEN BUYS NOW)					
Company	**Symbol**	**Buy Date**	**Buy Price**	**Current Price**	**Gain/ Loss**
Gold bullion	N/A	3/17/10	$1,120	$1,722.00	54%
Silver bullion	N/A	3/17/10	$17.50	$32.38	85%
Centamin Mining*	CEE.TO	5/25/11	$2.01	$1.55	-15%
Corn ETF	CORN	8/8/12	$51.61	$48.14	-7%
Rogers Agriculture ETN	RJA	8/17/12	$9.80	$9.43	-4%
Vista Gold	VGZ	9/24/12	$3.66	$3.33	-9%
First Majestic Silver	AG	10/1/12	$23.17	$23.20	0%

*** Averaged in second price of $1.64 on October 17 2012.**

Deflation Portfolio (OPEN BUYS NOW)					
Company	**Symbol**	**Buy Date**	**Buy Price**	**Current Price**	**Gain/ Loss**
Dollar ETF	UUP	5/23/11	$21.79	$21.89	0%
Rydex Dollar 2x Strategy	RYSDX	12/14/11	$14.39	$13.36	-7%
UltraShort Euro ETF	EUO	6/25/12	$21.45	$19.76	-8%
UltraShort China ETF++++	FXP	6/25/12	$28.97	$21.98	-24%
Russia ETF (SHORT)	TRF	6/25/12	$13.21	$14.65	-6%
UltraShort Consumer Goods*	SZK	7/25/12	$72.96	$65.55	-10%
Italy ETF (SHORT)	EWI	9/28/12	$12.03	$12.47	-1%
France ETF (SHORT)	EWQ	9/28/12	$20.98	$21.59	-1%

++++ Averaged in second price of $26.77 on July 5 2012 at 10:57AM
*** Announced a four to 1 reverse split on September 20 2012.**

Previous Closed Positions

Investment	Symbol	Buy Date	Buy Price	Avg. buy price	Sell Date	Sell Price	Gain
UltraShort Euro ETF	EUO	7/28/11	$17.32		9/12/11	$18.87	9%
UltraShort China ETF	FXP	8/9/11	$36.58	$34.63	9/21/11	$37.60	9%
(Added to)		9/2/11	$32.68				
UltraShort Emerging Markets ETF	EEV	8/9/11	$40.30	$37.27	9/21/11	$39.60	6%
(Added to)		9/2/11	$34.23				
UltraShort Brazil ETF	BZQ	8/9/11	$23.40	$20.72	9/21/11	$21.90	6%
(Added to)		9/2/11	$18.03				
IamGold	IAG	5/25/11	$20.95		9/21/11	$23.10	10%
UltraShort Russell 2000 ETF	TWM	8/9/11	$62.75	$57.36	9/22/11	$58.79	2%
(Added to)		9/2/11	$51.97				
UltraShort Real Estate ETF	SRS	8/9/11	$19.50	$17.31	9/22/11	$17.33	0%
(Added to)		9/2/11	$15.11				
UltraShort Financials ETF	SKF	8/9/11	$88.73	$82.59	9/22/11	$87.63	6%
(Added to)		9/2/11	$76.44				
UltraShort China ETF	FXP	9/28/11	$41.04		9/30/11	$45.02	10%
UltraShort Emerging Markets ETF	EEV	9/28/11	$42.90		9/30/11	$46.00	7%
UltraShort Brazil ETF	BZQ	9/28/11	$24.07		9/30/11	$26.28	9%
Bank of American (Short)	BAC	9/28/11	$6.46		10/3/11	$6.06	6%
Citigroup (Short)	C	9/28/11	$26.84		10/3/11	$24.90	7%
Goldman Sachs (Short)	GS	9/28/11	$98.97		10/3/11	$93.60	5%
JP Morgan (Short)	JPM	9/28/11	$31.64		10/3/11	$30.19	5%
Bank of America (Short)*	BAC	11/1/11	$6.48		11/14/11	$6.09	6%
Citigroup	C	11/1/11	$29.19		11/16/11	$27.46	6%

(short)*							
Goldman Sachs (Short)*	GS	11/1/11	$106.64		11/14/11	$98.73	8%
JP Morgan (Short)	JPM	11/1/11	$32.65		11/17/11	$30.84	6%
Deutsche Bank (Short)*	DB	11/1/11	$37.45		11/21/11	$34.90	7%
Santander (Short)*	STD	11/1/11	$7.91		11/17/11	$7.32	8%
HSBC (Short)*	HBC	11/1/11	$42.03		11/16/11	$38.95	8%
UltraShort Emerging Markets ETF*	EEV	11/1/11	$34.78		11/21/11	$38.12	10%
UltraShort Real Estate ETF*	SRS	11/1/11	$40.09		11/21/11	$44.03	10%
UltraShort Financials ETF*	SKF	11/1/11	$65.13		11/21/11	$71.41	10%
UltraShort Emerging Markets ETF*	EEV	11/1/11	$34.78		11/23/11	$39.50	14%
UltraShort Brazil ETF*	BZQ	11/1/11	$19.04		11/23/11	$21.37	12%
UltraShort Real Estate ETF*	SRS	11/1/11	$40.09		11/23/11	$46.04	15%
UltraShort Financials ETF*	SKF	11/1/11	$65.13		11/23/11	$75.23	16%
UltraShort Brazil ETF*	BZQ	11/1/11	$19.04		11/25/11	$22.40	18%
UltraShort Real Estate ETF*	SRS	11/1/11	$40.09		11/29/11	$44.45	11%
UltraShort Financials ETF*	SKF	11/1/11	$65.13		11/29/11	$71.47	10%
UltraShort Emerging Markets ETF*	EEV	1/1/11	$34.78		12/14/11	$37.16	7%
Ultrashort Silver ETF	ZSL	12/14/11	$15.57		12/28/11	$17.60	13%
UltraShort Euro ETF	EUO	9/12/11	$19.13		1/5/12	$20.80	9%
Ultrashort Silver ETF	ZSL	3/6/12	$10.27		3/15/12	$10.75	5%
MSCI Euro Financial Fund (Short)	EUFN	3/21/12	$18.37		3/29/12	$17.48	5%
BNP Paribas (Short)	BNPQY.PK	3/21/12	$24.99		3/29/12	$23.70	5%
Societe General (Short)	SCGLY.PK	3/21/12	$6.34		3/29/12	$5.83	9%
Credit Agricole	CRARY.	3/21/12	$3.27		3/29/12	$3.08	6%

(Short)	PK						
Societe General (Short)	SCGLY.PK	3/21/12	$6.34		4/2/12	$5.64	12%
Credit Agricole (Short)	CRARY.PK	3/21/12	$3.27		4/2/12	$2.97	10%
MSCI Euro Financial Fund (Short)	EUFN	3/21/12	$18.37		4/3/12	$17.34	6%
BNP Paribas (Short)	BNPQY.PK	3/21/12	$24.99		4/3/12	$22.78	10%
Santander (Short)	STD	12/14/11	$7.11	$7.63	4/4/12	$7.21	6%
(Added to)		1/27/12	$8.15				
BNP Paribas (Short)	BNPQY.PK	4/13/12	$19.96		4/23/12	$18.73	6%
Societe General (Short)	SCGLY.PK	4/13/12	$4.67		4/23/12	$4.38	6%
Credit Agricole (Short)	CRARY.PK	4/13/12	$2.55		4/23/12	$2.33	9%
UltraShort Brazil ETF	BZQ	5/2/12	$16.26		5/10/12	$17.85	10%
Deutsche Bank (Short)	DB	12/14/11	$35.33	$39.89	5/15/12	$37.24	7%
(Added to)		1/27/12	$44.44				
Santander (Short)	STD	4/13/12	$6.44		5/15/12	$5.85	9%
MSCI Euro Financial Fund (Short)	EUFN	4/13/12	$16.19			$14.88	8%
UltraShort China ETF*	FXP	11/1/12	$32.64	$27.93	5/17/12	$30.89	11%
(Added to)		1/27/12	$23.22				
UltraShort Materials ETF*	SMN	11/1/12	$20.23	$17.48	5/17/12	$19.00	9%
(Added to)		1/27/12	$14.73				
Barclays (Short)	BCS	12/14/11	$10.65	$12.37	5/18/12	$11.28	10%
(Added to)		1/27/12	$14.09				
UltraShort Russell 2000 ETF	TWM	5/16/12	$33.53		5/21/12	$34.88	4%
Spain iShares (Short)	EWP	5/2/12	$25.16		5/21/12	$23.56	6%
UltraShort Euro ETF	EUO	1/27/12	$19.78		5/23/12	$21.32	8%
Banco Sabadell (Short)**	SAB.MC	5/16/12	$1.55		5/29/12	$1.34	14%
Banco Popular (Short)**	POP.MC	5/16/12	$2.00		5/29/12	$1.63	19%

BNP Paribas (Short)***	BNPQY. PK	5/16/12	$16.59		5/30/12	$15.51	7%
Credit Agricole (Short)***	CRARY. PK	5/16/12	$1.90		5/30/12	$1.76	7%
National Bank of Greece (Short)	NBG	5/16/12	$1.55		5/30/12	$1.45	6%
Credit Suisse (Short)	CS	5/30/12	$19.34		6/14/12	$18.02	7%
PowerShares Double Short Oil	DTO	6/12/12	$53.78		6/21/12	$58.93	10%
Junior Gold Miners ETF	GDXJ	6/12/12	$21.10		6/21/12	$19.52	8%
Deutsche Bank (SHORT)	DB	6/25/12	$34.23		7/13/12	$31.38	9%
Santander (SHORT)	SAN	5/30/12	$5.25	$5.77	7/20/12	$5.20	11%
Average In		7/9/12	$6.29				
Spain ETF (SHORT)	EWP	6/12/12	$23.28		7/20/12	$21.39	9%
Italy ETF (SHORT)	EWI	7/11/12	$10.61		7/23/12	$9.52	11%
Credit Suisse (SHORT)	CS	6/25/12	$18.09		7/23/12	$16.46	10%
UBS (SHORT)	UBS	7/11/12	$10.79		7/23/12	$9.90	9%
Barclays (SHORT)	BCS	7/11/12	$10.25		7/24/12	$9.42	9%
Societe General (Short)	SCGLY. PK	5/16/12	$4.00		7/24/12	$3.64	9%
Rogers Agricultural ETN	RJA	6/12/12	$8.19	$8.79	8/8/12	$9.80	-10%
			$9.39				
Soybeans ETC	SOYB	8/8/12	$26.03		8/23/12	$27.80	7%
UltraShort Gold	GLL	12/14/11	$19.76	$19.61	9/5/12	$15.58	-21%
HSBC* (short)	HBC	12/14/11	$37.07			$46.34	-14%
UltraShort Brazil+	BZQ	5/23/12	$85.47			$65.74	-23%
UltraShort Emerging Markets++	EEV	5/23/12	$31.33			$24.72	-21%
EU Financials ETF (SHORT)	EUFN	6/25/12	$14.59			$18.16	-24%
Goldman Sachs (SHORT)	GS	6/25/12	$91.22			$119.99	-32%
Citigroup (SHORT)	C	7/11/12	$25.87			$34.08	-32%

Spain ETF (SHORT)	EWP	7/25/12	$20.15			$29.42	-32%
Italy ETF (SHORT)	EWI	7/25/12	$9.49			$13.19	-27%
France ETF (SHORT)	EWQ	7/25/12	$18.18			$22.14	-14%
UltraShort Russell 2000 ETF	TWM	7/25/12	$32.51			$25.75	-21%
UltraShort S&P 500	SDS	7/25/12	$16.09			$13.41	-17%
Credit Suisse (SHORT)	CS	8/22/12	$19.07			$22.46	-18%

- **Opened 12/14/11 at 11:13AM, averaged in second prices on 1/27/12**

** **Opened 12/14/11 at $19.76 averaged in second price of $19.46 on 5/23/12 at 11:50AM**

+ Averaged in second price of $78.31 on July 5 2012 at 10:57AM

++ Averaged in second price of $28.24 on July 5 2012 at 10:57AM