FINANCIAL PREPAREDNESS

"One of life's most painful moments comes when we must admit that we didn't do our homework, that we are not prepared." ~ Merlin Olsen

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Hyperinflation Is Coming

Money from Heaven will be the path to Hell. ~ Robert Wiedemer

This week I'm going to discuss the greatest threat that you will probably face in your lifetime, which I now believe is imminent. For your sake, please heed my words.

As the book This Time Is Different by Reinhart and Rogoff illustrates, history can be described as the story of governments debasing their currency and defaulting on their debt. Paper currency has become worthless in the United States twice before. As Voltaire observed in 1729, "Paper money [currency] eventually returns to its intrinsic value…zero."

There are several reasons why governments do this. First, the provenance of the institution of government was not based on good intentions. Gangs of marauders eventually figured out that, instead of raiding and plundering settlements on an ad hoc basis (which involved a lot of hard and dangerous work), it would be easier and less risky to just hang around and extract tribute (in the form of taxes) on an ongoing basis, thus converting pillage into an annuity.

Debasing currency and defaulting on debt is just a more modern form of plunder. Currency printing is particularly insidious because the vast majority of the victims don't even realize that they've been robbed, much less who did it. Recall the 1974 Whip Inflation Now campaign, in which the federal government (which was causing inflation by having its partner the Federal Reserve print currency to help pay its bills) disingenuously asked its hapless and clueless citizens to help "whip" inflation by taking irrelevant actions such as carpooling, lowering their thermostat and growing a garden. What a cruel joke!

Second, government's primary method of funding--collecting taxes—has always been problematic, mostly due to tax evasion. People tend to get angry when some of the hard-earned fruits of their labor get taken from them (especially when they're already poor and living close to the edge) to pay for government boondoggles. Even kings had to worry about becoming too unpopular with the people.

Further, governments often get involved in wars, which are usually ruinously expensive. In order to finance the war, the government goes heavily into debt or prints massive amounts of currency. This happened during the Revolutionary War, the War Between the States, the Vietnam War and the War on Terror. The U.S. military has been in Afghanistan for nearly 20 years; there's a reason it's called "the graveyard of empires."

Additionally, in order to curry favor with their citizens, governments—especially democratically elected ones—often promise to provide more future benefits than what they will actually be able to afford. Just like we like to talk about what our future selves are going to do, politicians like to get credit now for making promises that future politicians will be expected to keep. See, the time horizon of a politician is short—two to six years at most. By the time the benefits come due, he/she will probably have a lucrative job as a lobbyist.

It is not a coincidence that the start of the New Deal coincided with the ban on the ownership of gold (and the subsequent massive devaluation of the dollar versus gold), or that LBJ's "guns and butter" programs (the Vietnam War and the Great Society) preceded the removal of gold's final link to the dollar.

As Alexander Fraser Tytler wrote, "A democracy cannot exist as a permanent form of government. It can only exist until the voters discover that they can vote themselves largesse from the public treasury. From that moment on, the majority always votes for the candidates promising the most benefits from the public treasury with the result that a democracy always collapses over loose fiscal policy, always followed by a dictatorship."

There is nothing new under the sun. Currency debasement has been going on since the time of ancient Rome, when the government gradually replaced silver with base metal in its coins. I would imagine that that played a role in the collapse of the Roman empire. Imagine how you'd feel if you were a Roman soldier fending off the barbarians on the frontier, and you started getting paid the same number of coins, but less silver. You might decide to abandon your post and head for home.

Spain's version of money printing involved enslaving natives in the Americas to mine silver and gold, and then shlepping it back to Spain on galleons, where it could be spent on wars and its empire. That was a lot of work, and the hurricanes in the Caribbean could be nasty. Despite this massive haul of treasure over many years, Spain has defaulted on its debt 14 times.

In the novel The Sun Also Rises by Ernest Hemingway, a character is asked how he went bankrupt. He replies, "Gradually, then suddenly." This is how the U.S. government will go bankrupt. Coincidentally, it mirrors the physics of a "phase transition" that I wrote about last week.

The national debt is almost $28 trillion, and the federal government faces unfunded liabilities (for Social Security, Medicare, and the military and civil service pension systems) with a present value of $159.4 trillion to $220 trillion or more (depending on what assumptions you use). As time passes and we get closer to those liabilities coming due, their present value will increase. All of this is before any new spending programs that will be enacted in the future.

As the national debt has risen over the last few decades, interest payments have comprised an increasing percentage of the federal budget. In an attempt to reduce these payments, the Treasury has increasingly rolled over maturing longer term bonds (e.g., 30 years) into short-term bills, which have a lower interest rate. This practice has accelerated since the Great Financial Crisis of 2008, both because of rapidly increasing debt, and in order to take advantage of artificially low interest rates (thanks to the Fed's bond buying program).

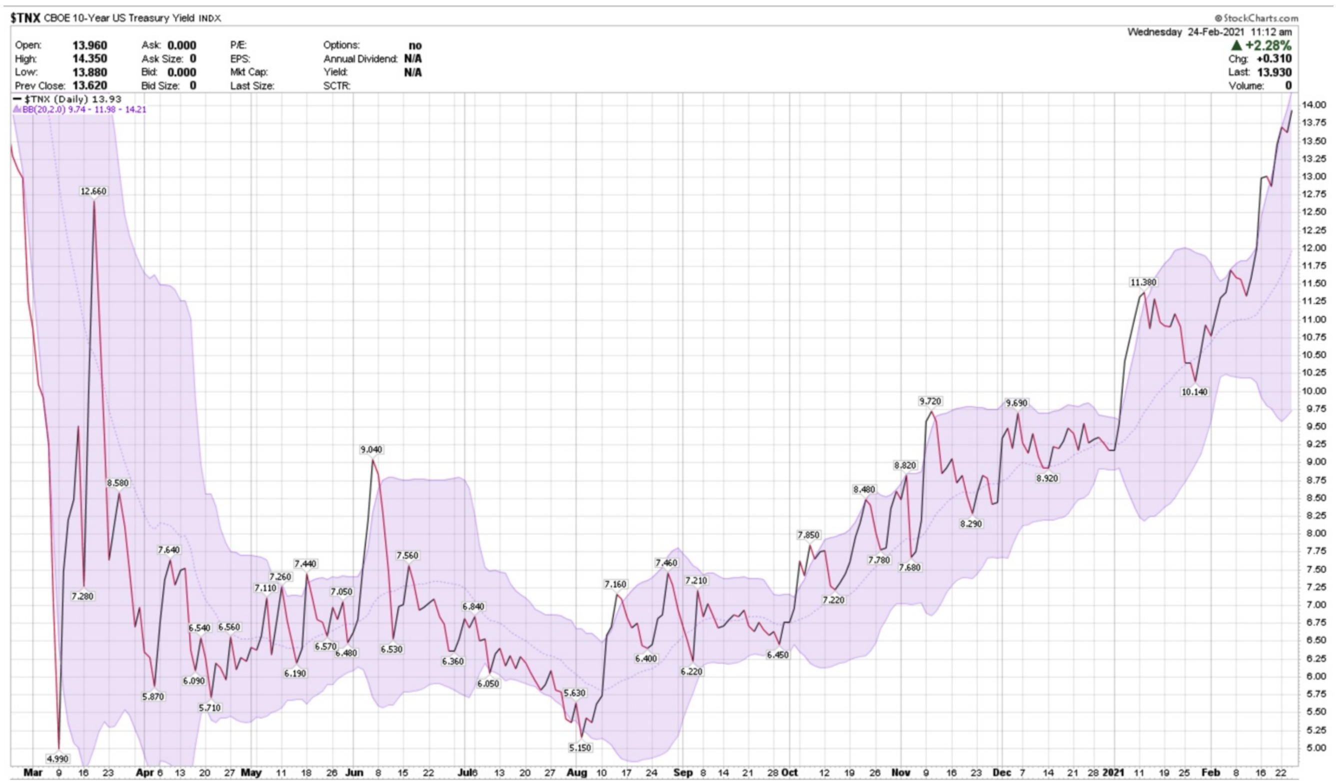
As a result, the federal government has become heavily dependent on short-term funding and now must refinance about 30% of its debt every year at current interest rates, whatever those may be at the time. This is the mother of all adjustable-rate mortgages. What could go wrong with that?

If interest rates start to rise, the game is over. The government would have to refinance 30% of its (rapidly growing) debt at higher interest rates. The national debt is so large that even if the government tried to pay off some of it in order to reduce interest payments, it wouldn't move the needle. (For example, as of the start of 2014, even if all other government expenditures stopped immediately and the government completely shut down, and all federal tax revenue went into a fund to cover its unfunded liabilities and pay down the national debt, it would take about three decades to do so.)

Higher interest payments increase the ratio of interest payments/national income, making Treasury bonds riskier to own. (Traditionally in finance, Treasury bonds have been used as a proxy for the "risk-free rate of return," but Jim Grant says they have become "return-free risk.") In order to attract enough buyers, riskier debt has to offer higher interest rates. That starts a debt death spiral, especially since the government has to refinance 30% of its debt every year at prevailing (higher) interest rates.

If investors suddenly lose confidence (a phase transition) in your debt because they think you'll go bankrupt soon, then there will be "no bid" for your debt at affordable interest rates, and you either have to accept exorbitant, loan shark rates that will soon lead to your demise, or default on your debt. This is what happened to Bear Stearns, Lehman Brothers and the government of Greece, all of which were heavily reliant on short-term funding.

The chart below shows the interest rate on the 10-year Treasury note. For the last seven months, the rate has been rising; since late January, it has been spiking. If it continues to rise (as I expect), the game will be over. Like an object caught in the gravitational pull of a black hole, we are well past the event horizon and are now just circling faster and faster into the maw of financial and economic ruin. No amount of austerity, no Congress full of Ron and Rand Pauls, will be enough to prevent us from meeting our imminent fate.



Ah, you say, "But the U.S. government has a technology, called a printing press," said Ben Bernanke in 2002, like some Wizard of Oz who had discovered a wondrous invention like a time machine that was going to make us all wealthy. (BTW, I was reading about his background, and although he is highly intelligent, he belongs to the group of people that Nassim Taleb calls "the intellectual yet idiot.") Additionally, the U.S. dollar has been the world's reserve currency since the 1944 Bretton Woods agreement, so governments and businesses around the world need to own lots of dollars (and U.S. Treasury bonds) in order to trade, etc. Let's take a look.

Bretton Woods established a global currency regime where the U.S. would hold the bulk of the world's gold (much of which had been basically stolen from the American people by FDR)—which would back the dollar—and there would be a fixed exchange rate between the dollar and the rest of the world's currencies. Any time they wanted to, foreign countries could redeem a fixed number of dollars for a fixed amount of gold.

Towards the end of The Great Society and the Vietnam War, foreign countries—especially France and Switzerland—began to suspect that the U.S. was creating more dollars to pay for these programs than it had the gold to back. (This became known as America's "exorbitant privilege"--its ability to pay for goods and services from foreign countries using little green pieces of paper that it had just printed up. Naturally, this would eventually create a lot of resentment.)

So they began to present increasingly larger amounts of dollars for redemption into gold. This became the largest "bank heist" (an exchange of gold for worthless paper) in world history, and only ended in 1971 when the U.S. defaulted on its international obligations by ending the redemption of dollars into a fixed amount of gold (probably because nearly all of the gold in Fort Knox was gone, which explains why there has never been an independent audit of it), thus taking the entire world off the gold standard.

In order to continue its exorbitant privilege, the U.S. had to create a new reason for foreign countries to hold a lot of dollars and Treasury bonds (which also helps keep U.S. interest rates low, allowing the federal government and its citizens to continue to spend beyond their means). So it got a number of oil-producing countries in the Middle East to agree to price and sell their oil for dollars, and to use many of those dollars to buy U.S. Treasury bonds. In return, the U.S. would sell advanced military hardware to those countries and also protect them from military threats such as the Soviet Union. This became known as the petrodollar system.

Since most countries needed to buy oil, most needed dollars to buy it. And since oil is such a big part of international trade, and most countries had dollars, the dollar became the default currency for international trade. So the petrodollar allowed the U.S. to continue to enjoy its exorbitant privilege.

Former CIA asset Saddam Hussein made two fatal mistakes in his life. The first was believing the U.S. ambassador to Iraq when she told him in July 1990 that the U.S. had no opinion about Iraq's dispute with Kuwait. (I came extremely close to being involved in the aftermath of that little misunderstanding, both before the Gulf War and after.) The second was when he started selling oil for euros in 2000 (the euro was created in part to compete against the dollar as a reserve currency). The U.S. invaded Iraq about 2.5 years later, ostensibly to search for weapons of mass destruction. Of course, none were ever found, but from then on, Iraqi oil was priced and sold in dollars.

Colonel Muammar Gaddafi of Libya (which has the largest oil reserves in Africa) made a similar fatal error. In 2009, when he was the head of the African Union, he proposed that African and Arab countries (which also sell a lot of oil) adopt a new dinar currency that was backed by gold (Libya had about 150 tons of gold to back it with). The primary objective was to remove the dollar from the oil trade. Countries such as Nigeria, Tunisia, Egypt and Angola got on board with the idea.

But then in March 2011, NATO led a military intervention in Libya, and CIA-backed rebels killed Gaddafi in a way that is too gruesome to mention here. When it comes to protecting its exorbitant privilege, the U.S. government and the elite who control it don't mess around. Remember that, because that message will soon apply to you (more on that in a future issue).

Other countries—especially China and Russia—would also like to replace the dollar as the world's reserve currency. These countries have been accumulating massive amounts of gold to back their currencies (thus making them more attractive versus the dollar) and negotiating bilateral trade agreements that do not involve the dollar. But the U.S. can't invade these countries like it did Iraq and Libya.

Global dollar hegemony is ending, and as it does, many trillions of dollars (and U.S. Treasury bonds) will no longer be needed. These dollars and bonds will return to the U.S., flooding the market and causing prices and interest rates to skyrocket.

I'll now discuss the Federal Reserve and its magical printing press. Central banks (such as the Fed) are created to allow governments to spend money they don't have, and to allow the financial elite to goose/game the system to create (note I didn't say "earn") even larger profits.

Politicians want to please/buy off a lot of voters, and have a very short time horizon. They will kick the can down the road until they run out of road. They can always be counted on to take the least painful path. And when it comes to funding their spending, that path is currency printing.

Since the Fed was created over a century ago (the plan was hatched in a secret meeting by a cabal of bankers on Jekyll Island), the Fed (together with its partner the federal government) has subsidized federal spending by buying Treasury bonds with dollars created out of thin air. Although the government pays interest and principal on these bonds, the Fed returns all of it to the government less a small handling fee for its counterfeiting services.

Thus the national debt is "monetized" and the federal government gets to spend that new "money" first in a market that isn't really expecting it, so it has outsized purchasing power. This is a form of theft, and it has created powerful and deep-rooted special interests that will go to any length to keep that gravy train going. All of this currency printing has gradually debased the dollar. By the time of the Great Financial Crisis (GFC), the dollar had lost about 95% of its value since the Fed's creation.

During and following the GFC, a conscious political decision was made to print massive amounts of currency, which is one of the six phases of hyperinflation. Government borrowing and spending and Fed currency printing exploded in order to bail out the banks, businesses, investors, local governments and even much of the rest of the world. This was the financial equivalent of crossing the Rubicon. There was no going back; the die was cast and our fate was sealed: We would have hyperinflation.

The government's extreme overreaction to COVID-19 came close to national economic suicide. Between 100,000 and 200,000 small businesses went bust and tens of millions of employees lost their jobs. Economic activity (as well as tax revenue) plummeted. Once again the federal government started spending trillions of dollars it didn't have. Last December, Congress passed a $2.3 trillion, 5,593-page bill ($900 billion of that was for "COVID relief"). Now Congress is about to vote on another $1.9 trillion "COVID relief" bill. The Fed's currency printing enables this profligacy.

The Fed has been buying $80 billion of Treasuries and $40 billion of mortgage-backed securities per month. I came across a headline from December that read, "Fed Commits to Keep Buying Bonds Until the Economy Gets Back to Full Employment." That's like saying the beatings will continue until morale improves. As long as the Fed keeps distorting prices and debasing the currency, the economy will never get back to full employment.

The Fed's printing press is a doomsday machine. The more the Fed prints, the less useful the dollar becomes as money and the less people want to hold it. Owners of dollars start to lose purchasing power as prices rise, prompting them to get rid of them faster, which increases the velocity of money through the economy. Massive currency printing combined with high velocity results in hyperinflation.

Prices are a crucial signal to market participants. They help suppliers determine what and how much to produce and consumers to determine what and how much to buy. The Fed heavily manipulates the most important price, which is the price of money (interest rates). Like a Soviet politburo using a five year plan to determine how much wheat to grow and how many tractors to produce, it leads to a similar result: distorted prices, malinvestment, surpluses and shortages, and ever larger booms and busts.

Without accurate prices, economic activity becomes inefficient and increasingly difficult. A constantly depreciating currency discourages savings and thus hinders capital formation. It also makes long term planning much more difficult, and greatly increases the risk of long-term contracts (including loans). Shortages appear, losses mount, businesses start to go bust and employees get laid off. A collapsing economy creates political pressure for government relief programs at the same time that tax revenue is plummeting, making the lure of the printing press irresistible.

I just finished reading the book When Money Destroys Nations: How Hyperinflation Ruined Zimbabwe, How Ordinary People Survived, and Warnings for Nations That Print Money. Not only is it a Must Read, you need to stop what you're doing and read it ASAP, because you need to understand what's about to happen to you.

Hyperinflation is one of the worst catastrophes that can befall a society. It destroys the economy, impoverishes nearly everyone (except the political and financial elite who benefit from inflation), and requires ever greater surveillance and tyranny by the government in order to coerce people into continuing to use its currency (so the elite can continue to enjoy their exorbitant privilege of creating currency out of thin air and spending it first).

One thing I learned is that hyperinflation is a *process* that occurs in six phases that can take between four to eleven years to work through from the time of the initial shock. (For Zimbabwe, the shock came on Black Friday in 1997 when the currency lost 75% of its value in one day (a phase transition). Even when the currency ceases to be used as money (even by the government), the misery doesn't end because a dictator often comes to power who then gets the country into a war (e.g., Hitler), and the economy must be rebuilt from scratch.

As Jim Rickards points out in the article below, hyperinflation doesn't really destroy your wealth because by the time it occurs, about 95% of your wealth has already been destroyed by plain old high inflation. Hyperinflation merely destroys the remaining 5%.

During Zimbabwe's hyperinflation, millions of people—mostly educated professionals, entrepreneurs and skilled workers—left the country, creating a massive brain drain. The vast majority of businesses went bankrupt, yet many were required by law to remain open even though they had nothing to sell. Production stopped and economic activity came to a standstill.

It became incredibly difficult to find basic necessities, such as clean water, food and fuel. The country, once known as the Breadbasket of Africa due to its prolific farms, became full of hungry and gaunt people. The government came to control the supply of food, and used it as a political weapon. An estimated 200,000 people—mostly in areas that opposed the government--starved (or were starved) to death.

When supplies were available, people had to wait in long queues, often for days at a time. The government imposed price controls, a system of surveillance, and many new laws in an attempt to get the Dead Hand of Government to work like the Invisible Hand of the Market. Despite the risk of stiff penalties, people had to break those laws and trade in the black market in order to survive. All municipal services stopped except for the police (and the military), which were used to coerce the population. Due to lack of maintenance, systems broke down and important equipment deteriorated.

The currency was redenominated three times, removing 25 zeroes in all. It was difficult to use the currency because of the quantity of notes required, the large numbers involved, the inability of calculators and accounting systems to handle such large numbers, the time it took for counting machines to count bricks of notes, the confusion surrounding redenominations and expiration dates (which were added to some notes), and its rapidly declining purchasing power.

Generally, it wasn't a target of thieves, and beggars didn't pick it up in the streets. The printing presses ran continuously, producing about three million new notes per day. Banks paid an interest rate of 8,000% on deposits, but that was still woefully inadequate, and naïve customers who left their savings in a bank lost everything. It was particularly devastating for senior citizens.

One of the book's takeaways was that the only way to survive hyperinflation (besides leaving the country) is to have a deep and extensive network of people who you can trade with and rely on for support and mutual aid. That's what you should be “investing in” right now. Ironically, that is what has suffered the most during the last year of lockdowns and isolation.

Another point of interest was that precious metals weren't really used in trade, but were primarily hoarded and used to purchase other currencies (which were then used to trade). That makes sense because of Gresham's Law, which states that bad money drives out good. In other words, you want to spend your Zimbabwe or U.S. dollars, not your silver or gold, so the former are used in trade, while the latter are hoarded. Of course, toilet paper (AKA "mountain money") was used as money, as were food, fuel, whiskey, postage stamps, etc.

Does any of this sound familiar? "For years Zimbabwe's government borrowed excessively to pay for war [Iraq, Afghanistan] and welfare entitlements....International lenders [China] withdrew funding, forcing it into a debt spiral. The government responded by printing money [QE] to pay its debts....As inflation accelerated, the government had to increase its control over the population to monitor transactions [Total Information Awareness] and to plunder the nation's assets. It fiddled with inflation statistics [fake CPI] and used obscure language [quantitative easing] to conceal the true nature and extent of its money printing. A host of new laws were enacted, particularly in controlling bank transactions, prices and everyday trade. The state increased the police and military presence [tens of thousands of National Guard troops in D.C. with no clear mission], and the justice and penal systems were skewed heavily in favor of the ruling party. The media...were infiltrated and controlled."

The book concludes, "The lessons from Zimbabwe's struggles are clear. When nations enact irresponsible economic policies and then print money to fix their problems, the inevitable result is economic ruin. This pattern has been repeated over and over in history, always with the same results....Money printing and the collapse of confidence in your nation's currency may be the greatest risk...you could face in your life....Make sure you are prepared."

What You Should Be Doing Now

I plan to cover the why and how of these in future issues (if I haven't already), but here are some actions I recommend you take (or at least start thinking about) now:

1. Make sure your passports are current (it takes weeks to get one) and come up with a plan for where you would go if you had to leave your country, and what that would involve.

2. If you don't have one, start developing an extensive network of trustworthy people who could help you get through a crisis. Start buying food and developing relationships at a farmers' market, with local farmers or ranchers, or even just with people who have chickens.

3. Continue to accumulate food and basic necessities that could also be used to barter or help people in your network.

4. This morning (2/26) gold hit a post-election low of $1,757.70. The optimism score for the GLD ETF (which I don't actually recommend) is currently 32 out of 100, and the risk level of gold is 2 out of 10; both of these are bullish for gold. Most people

should have at least five to ten percent of their portfolio in gold, preferably physical. If you don't have any, now is a good time to begin accumulating. Use your “stimmie” check to buy some gold. Try APMEX or McAlvany ICA.

5. Find a way to obtain, purify, store and heat water (much more on that later).

6. Start making a list of all of the things you'd still like to be able to do if the economy collapses. Start thinking about how you would make those things happen.

7. If you receive a pension, annuity, Social Security or any other payments from the government, think about how you could replace that income or do without it.

8. Be leery of “government retirement plans” such as 401(k)s and IRAs. These types of accounts have much greater political risk because (1) the government has many more rules for them that could be changed at any time and (2) the 1% political and financial elite don't have their wealth in these plans, so they will have no qualms about eventually plundering them. I predict that very soon the government will require more paternalism in the form of fewer investment options (probably after the next stock market crash), and nearly all of the offered funds will invest at least some of their money in U.S. Treasuries (e.g., target maturity funds). Eventually, when the government gets desperate enough, these plans will be nationalized/confiscated or converted into “guaranteed investment accounts” that “invest” in U.S. Treasury bonds yielding a low fixed rate while inflation rages out of control. Congress has already heard testimony about this idea.

9. Realize that even if your insurance companies survive high inflation (their portfolios are loaded with bonds, including U.S. Treasuries), any benefit that you receive from a life, disability, long term care, homeowners, auto or umbrella liability policy will probably be inadequate by the time you receive it. Plan accordingly.

10. Start thinking about what you could do to earn money (or toilet paper) if you lost your job. Think about more primitive, basic needs, something you could do without supplies, electricity, etc.

11. Books to read: When Money Destroys Nations by Philip Haslam and Russell Lamberti
The Controlled Demolition of the American Empire by Jeff Berwick and Charlie Robinson. I don't necessarily believe or agree with everything in this.
Meltdown: A Free-Market Look at Why the Stock Market Collapsed, the Economy Tanked, and Government Bailouts Will Make Things Worse by Thomas E. Woods
Hormegeddon: How Too Much of a Good Thing Leads to Disaster by Bill Bonner

Preparedness News

A Frenzy of Speculative Excess

Michael Burry Warns Weimar Hyperinflation Is Coming

Is Hyperinflation on the Horizon?

Hyperinflation Can Happen Much Faster Than You Think

How the Fed Juices Stocks

Fed Suffers Massive Outage of Interbank Payment System Was this a cyber warfare dry run?

Your Questions Answered

A reader asked (paraphrasing): "After the SHTF, how would I use a gold bar to buy a loaf of bread?"

Answer: You wouldn't. Gold is a vessel or a time machine in which you can transport a large amount of wealth to some point in the future when hopefully we'll have sane financial and economic policies once again. It's a long term play for a lot of wealth. You may not live to benefit from it, but your children or grandchildren could.

When Jews fled Nazi Germany, they sewed their gold into their coats. When the South Vietnamese fled Vietnam on boats, they took their gold with them.

If you want to buy something after the SHTF, use a barter item or silver.

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I would love to hear from you! I thrive on feedback from readers. If you have any comments, suggestions, insight/wisdom, or you'd like to share a link to a great article, please email me.

Generally, I don't have time to answer questions about your specific situation, but if you have a general question that I think other readers also have, let me know and I will provide an answer in a future issue.

Feel free to forward this to a friend. If you would like to subscribe (it's free!) or unsubscribe, email me with either "subscribe" or "unsubscribe" in the subject line.

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Before starting a new diet or exercise regimen, you should consult with a doctor, nutritionist, dietician, or personal trainer.