Bond Market Bozos

By The Mogambo Guru

04/17/06 The Daily Reckoning PRESENTS: The Mogambo is confused. Why are people still buying bonds, he wonders, when the prices keep falling and falling? Read on…

BOND MARKET BOZOS

I notice with dark dismay that the horrid U.S. Federal Reserve is now back on track to destroy the dollar as soon as it can, as evidenced by the fact that Total Fed Credit shot up by $6.4 billion, last week. With the current insanely low fractional-reserve ratio of the banks set by the Fed (literally zero for new deposits), this means that the banks can create (let me re-check the calculations again) 64 zillion-kajillion dollars out of thin air, all of which devalues the rest of the dollars already in existence.

At this point, I notice that I am getting kind of numb to these constant, insane increases in Total Fed Credit, seeing that it really started exploding way back in 1997 – although $6.4 billion still has the family kind of edgy that I am going to go berserk again, like I usually do, and they are all cowering under the table. But, the thing that really got me up and sprinting out to the Mogambo Bunker Of Screaming Panic And Fear (MBOSPAF) is that there is a new, ominous wrinkle in all of this U.S. Federal Reserve monetary insanity. It's an obscure, usually low-figure account at the Fed labeled "Other F.R. Assets." Suddenly, out of the blue it registered a whopping increase of $4.3 billion, last week! It ain't bonds and it ain't cash, things a bank normally gobbles up. So, what could the Fed be accumulating – and why?

As I am slamming the door shut and arming the Mogambo Intruder Intercept System (MIIS), I am thinking to myself that I am not sure what in the hell that Fed is up to, but it is getting really, really weird. As a guy who is weird, I certainly know what I am talking about when it comes to weird, although I will probably be the only one in the police lineup, standing there with all the rest of the creepy (and smelly) scum of the Earth ("Hi, Mogambo!" "Hi, Bob! Yo, Willie!"), when the cops soothingly say to the witness behind the two-way mirror, "Do you recognize the weird, lying little pervert, ma'am?" I will start yelling, "Weird? You want weird? Then get that weird old bat up here with me, because the Federal Reserve is destroying her money and yet, she is down here complaining about me screaming at her to wake up and prepare to die a horrible economic death because of it! Now that's weird!"

And speaking of weird, lying little perverts (being gratuitously disrespectful and nasty), even foreign central banks are tiptoeing back in the game of trying to keep the dollar from collapsing into nothingness, and they also increased their holdings of U.S. debt by another $1.7 billion, last week. Not much, considering their long record, but enough to show polite interest.

Of course, we can always count on the loathsome Congress to sell us down the river, and so it comes as no surprise that the U.S. Treasury gross public debt has ballooned ("BoooOOOOooing!") to an obscene $8.402 trillion, up $31 billion in just the last 10 days, and up $232 billion since January 1,2006! It will get worse and worse, as the U.S. Treasury feverishly prints up and sells more and more bonds so that Congress can spend, spend, spend us into the poorhouse – further crippling the dollar.

So, I am laughing in Loud Mogambo Scorn (LMS) at not only bond market bozos who are still buying bonds even as the prices fall and keep falling, but also the complete clods who are buying stocks at the same time, even as central banks are tightening, the Congress is spending outrageous amounts of borrowed money, the dollar is falling, but also (and I have to rub my eyes in disbelief) even when crude oil is nearing $70 a barrel! What kind of complete idiots are these jerks? I'll tell you wh idiot Americans who keep plowing their money into mutual funds and retirement plans loaded with non-gold equities and bonds, thinking that portfolio managers are some kind of magical wizards who will produce gains when nobody else can.

I mean, these bond market chumps are standing around, scratching their thick heads and muttering, "Huh? What? Huh? What happened?" These bond-buying morons are losing money and yet, are still intent on locking their money up for up to 30 years by buying long bonds so that they can get tiny, less-than-inflation yields! What kind of stupidity is that? And when yields continue to rise and rise (and they will, as all central banks are starting to react to the inflation that is rising in their countries as a result of all of this creating of excess money and credit), they will get exactly what they deserve for their stupidity: really huge losses.

The bad news is that this, as I keep yelling about, is your money that they are managing, and all the bond portfolio managers will get for their laughable incompetence are huge salaries and outlandish bonuses. But, they can't hold back the tides, and millions of people are going to get whacked for it. It's like Mother Nature said: "It's not smart to be so childishly trusting!"

Their bigger losses may come sooner than they think! In a GATA (Gold Anti-Trust Action Committee) dispatch of an article in the Financial Times, they have forwarded the news that says, "The U.S. dollar extended losses in European morning trade on Tuesday amid a call from a Chinese politician for China to stop buying U.S. Treasuries. Cheng Siwei, a vice chief of China's National People's Congress, was quoted as saying that 'China can stop buying dollar-denominated bonds, and gradually reduce its holdings of U.S. bonds'."

The central banks are (and have been) doing everything they can to prevent the dollar from rolling over, but that may soon be history. Paul van Eeden writes, "Mr. Hu Jintao, the Chinese President, is scheduled to visit Washington later this month while the United States continues to put pressure on China to let its currency appreciate against the dollar. It seems China is going to comply: In December Mr. Yu Yongding, who is a member of the monetary policy advisory committee to the People's Bank of China, said that China should weaken the link between the yuan (renminbi) and the U.S. dollar."

If you notice that you heart has stopped and people around you are furiously dialing 911, then congratulations! You correctly realize that this means that if China starts reducing its holdings of U.S. debt and assets, or even slow the pace of buying more, then who is going to finance our current account deficit and the federal budget deficit? Net result? The dollar goes lower and things that we import (like oil and nearly everything else) will cost more – much more.

The good news about a falling dollar is, they say (and as a "Mogambo Heads Up (MHU)," they are wrong), that this lower dollar thing will make U.S. exports cheaper on the world market. So, the trade deficit will automatically shrink because we are exporting more and importing less. Hahaha! Convulsed as I am with laughter, I am almost too incapacitated to tell you that when you have been around capitalist swine as long as I have (with all their precious "rules" about coming to work on time (every day!) and not harassing the secretaries and blah, blah, blah), as soon as these greedy corporations find that their prices are lower than the competitor's, they will raise prices! I've seen it a million times!

So, we will have the worst of both worlds: higher import prices and higher domestic prices! Nice work, Federal Reserve jerks!

And speaking of GATA, Alex at Leg2Capital.com shows that not only was he was paying attention in physics class while me and my stupid hoodlum friends were poking each other with pencils in the back of the room and giggling about how we wish we were drunk (or more drunk), but that he can extrapolate classical physics to the eye-popping rise in the price of gold.

"For every action," he starts off, quoting Newton, "there is an equal and opposite reaction." Then he takes that and says that the rise in gold is thus foreordained. "It's now obvious the central banks have done a terrific job of suppressing the gold price. It's now out there for everyone to see who cares to look at the information (thanks to Bill Murphy and GATA). Therefore, an extraordinary suppression of the Gold price well below the inflation-adjusted price of $1800 has created an equal and opposite reaction of an extraordinary rise. Hence the move on the gold chart." And before you think that it is too late to get in on some of this action in gold, he says not to worry because the big moves are "yet to come."

And in talking about Newtonian physics and "big moves," Robert Prechter, of Elliott Wave fame, says that the recent huge (>40%) losses in Middle Eastern stock markets is just prolog. "This year the U.S. stock market is shaping up to drop at least as fast. Generally when stocks levitate into a market cycle, they make up for it by crashing. In 1929, stocks rose for 2.5 years into the 2.7-year cycle. Then they lost 50 percent of their value in 2 ½ months. In 1987, stocks rose for 3.1 years into the 3.3-year cycle. Then they lost 40 percent of their value in 7 weeks."

If you think you got the guts to weather a 40% drop in your portfolio, maybe you ought to re-think that optimistic assessment when he goes on to say, "But given that the bear market is of Grand Supercycle degree, the largest in nearly 300 years, the coming drop should dwarf both of those crashes."

What happens in crashes? People run to gold in sheer panic. Peter Spina, at the GoldForecaster.com, says that the time to buy gold is still here, and that they have "elevated the gold price target to $720 an ounce." This is their anticipated price before anything crashes!

Until next time,

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for The Daily Reckoning