MARTIN WEISS' Safe Money REPORT

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S&P: Bearish
Nasdaq: Bearish
Bonds: Bearish
Most Foreign Markets: Bearish

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INSIDE...

Martin Weiss and Mike Larson

Starting now:

America's Second Great Depression

Next stop on the Dow: 5,500! Home prices to fall 20% further. Ultimately, could be as bad as — or worse than — the 1930s! Are you really ready? What to do now ...

Martin here, with a major new warning for all Safe Money *subscribers; Mike will join in a moment.*

After more than six decades of growth, America is sinking into its Second Great Depression of modern times. The place is every home, business, and community. The time is now.

America's Second Great Depression is not a typical 20th century recession that happens to strike a bit harder or linger somewhat longer. Nor is it merely a fictional scenario conjured up by economists with a murky crystal ball.

America's Second Great Depression is the probable consequence of a great housing bust, a massive mortgage meltdown and the biggest financial crisis in history.

It promises to bring the worst wave of bankruptcies, job losses and wealth destruction any citizen under 90 has ever experienced.

It challenges the smartest minds in Washington, defies the deepest pockets on Wall Street and threatens to rip through our lives with the force of a Cat-5 hurricane. And yet, among all those making the decisions that could forever change our future, no one has personal experience with a similar episode.

I don't either. I was born in 1946, just as we were leaving the final vestiges of America's First Great Depression behind. I've studied that historic period with books, charts and numbers, but that's not the same thing. What brings me closer to a visceral understanding of this crisis is the half century I shared with my father, J. Irving Weiss, one of the few economists who not only advised investors during the First Great Depression, but actually predicted it.

Dad was so proud of that unusual feat, he began telling me stories about it when I was just five years old. Vicariously, I lived through the Roaring Twenties, the Crash of '29, the massive bank failures of the 1930s and the many years of suffering that ensued. Through Dad's teachings, I felt as though I was there with him when investors lost fortunes, when we hit rock bottom in 1933, when we eventually recovered and brand new fortunes were made. Dad was not only a loving father, but also my mentor, partner and best friend.

I wish he could be here today to write to you directly and help you get through these tough times personally. But as soon as I was old enough, I helped him write his investment newsletters; and in 1971, soon after I founded Weiss Research, he helped me write mine. Although he's gone, I can feel his vibrant energy and calming spirit beside me; and from time to time, I will let him speak to you posthumously here in *Safe Money Report*.

He will tell you about his experiences and analysis during America's First Great Depression; Mike and I will tell you what it means for America's Second Great Depression and what you can do about it. A lot has changed since then. What hasn't changed is our passionate desire to help you through it.

Dad first went to Wall Street in 1924 to learn everything he could about money. Five years later, when the great crash struck, he did not own any stocks. His parents were recent immigrants from Eastern Europe with barely enough to keep food on the table. He had to save everything he earned, bring it home and give it to his mother. He knew how real estate had collapsed in Florida and he saw how America's farms were in disarray. He didn't want to gamble his hard-earned savings on another bubble.

After the crash, the stock market rallied for almost six months and nearly everyone on Wall Street thought the crisis was over. But Dad persuaded his clients and friends to sell everything, get the heck out of the market and pile up as much cash as they could. He was so convinced the market would fall again, he even borrowed $500 from his mother to sell short — to take a crack at profiting from the market's decline.

Sure enough, the Crash of '29 was just the opening act of the great bear market. All told, from its peak in 1929, the Dow Jones Industrials Average fell 89%. Dad explains it this way:

"Some people of my generation have fond memories of the family fellowship and sacrifice of the Great Depression, and I do too. But I also cannot forget the numbers I studied or the suffering they implied. In just three short years between the peak of the stock market boom in 1929 and the bottom in 1932, it felt like the entire world was falling apart.

The financial bubble burst. Big companies failed. America lost 13 million jobs. Unemployment surged to 25%. American industry cut its production nearly in half. Home construction plunged by more than four-fifths. Deflation — falling prices — drove the value of almost everything into the gutter. Over 5,000 banks failed and ultimately disappeared.

"During that entire period, I was there, tracking the data and the numbers as they were released — to figure out what might happen next. I was an analyst and that was my job. So I remember them well.

"But years later, economists like Milton Friedman and my young friend Alan Greenspan looked back at those days to decipher what went wrong. They concluded that it was mostly the government's fault, especially the Federal Reserve's. They developed the theory that the next time we're on the brink of a depression, the government has got to step in and nip it in the bud. Bah! Those guys weren't there back then. When I first went to Wall Street, Friedman was in junior high and Greenspan was in diapers.

"I saw exactly what the Fed was doing in the 1930s: They did everything in their power to try to stop the panic. They coddled the banks. They pumped in billions of dollars. But it was no use. They eventually figured out they were just throwing good money after bad.

"You didn't have to be an economist to understand what the real problem was. It was sinking public confidence, and money didn't buy confidence. To restore confidence would take more than just money. It would also take time.

"The roots of the 1930s bust were in the 1920s boom. That's when the Fed gave cheap money to the banks like there was no tomorrow. That's why the banks loaned the money to the brokers, the brokers loaned it to speculators, and the speculation created the stock market bubble. That was the real cause of the Crash and the Depression! Not the government's 'inaction' in the 1930s!

"In 1929, our economy was a house of cards. It didn't matter which cards we propped up or which ones we let fall. We obviously couldn't save them all. So no matter what we did, it was going to come down anyway. The longer we denied that reality and tried to fight it, the worse it was for everyone. The sooner we ac-

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cepted it, the sooner we could get started on a real recovery. In the future, the only way to avoid the pain of a great bust is to refrain from the excesses of a great boom."

I totally agree with Dad's desire for moderation.

Unfortunately, however, as Mike has so accurately pinpointed in recent years, our leaders encouraged *the most extreme* housing bubble of all time.

Mike joins us now.

Establishment Economists Finally Admit We Were Right

We first warned you of a severe and imminent recession in our issue of September 2007, with this headline:

"HOUSING BUST DRIVING U.S. TO RECESSION"

Wall Street said we were wrong. But now, 15 months later, they have finally recognized that the recession began *one year ago.*

Allen Sinai, one of the most respected economists among them, says, "We will rewrite the record book on length for this recession. It's still arguable whether it will set a new record on depth. I hope not, but we don't know." Dominique Strauss-Kahn, managing director of the International Monetary Fund, admits, "We are living through the most dangerous financial crisis since the one that led to the Great Depression." Alan Greenspan says it's a 100-year storm, which implies an event that's potentially as bad as — or even worse than — the crisis that struck the nation less than 80 years ago. Compare for yourself ...

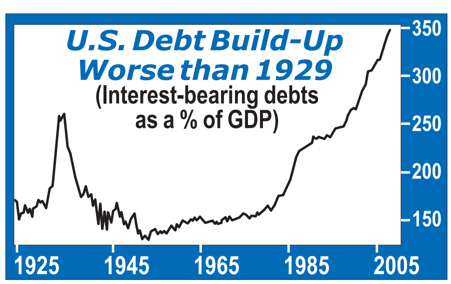
The Bubble: More Extreme This Time?

Prior to America's First Great Depression, the consumer economy expanded by leaps and bounds, with manic growth in the ownership of radios and automobiles; massive construction projects, including the Chrysler Building in New York City; and above all, rampant speculation in stocks. In 1927, stock margin loans surged by more than 26% to $2.82 billion. By the summer of 1929, margin debt had ramped up to almost $6 billion, a further increase of 113%.

Leading up to the current crisis, the boom has been no less exuberant: An artificially low interest-rate environment led to a debt-addicted economy — highly dependent on *daily* injections of $3.2 billion in new mortgages, $338 million in new credit card borrowings, $960 million in new government debt, $1.4 billion in new corporate debt, and a whopping $14.2 billion in new derivatives. *Per day!*

Comparison: Which bubble was more extreme? By one critical measure — debt — the answer is, unfortunately, the early 2000s. Although stock speculators were not able to borrow as much directly from their brokers as they did in the 1920s, the debt build-up in real estate and every other sector of the American economy was *larger* than that of the '20s.

Claus Vogt, co-editor of the German edition of *Safe Money Report*, shows how, prior to the 1930s, the total debt in the U.S. represented less than 160% of the U.S. economy. By 2008, it was close to 350%. (See chart.)



Moreover, Mr. Vogt reminds us that today's debt measure does not even include the high-stakes gambling arena of our time — derivatives. In the 1930s, derivatives barely existed. By contrast, at mid-year 2008, on the eve of a major new plunge in the economy, the Office of the Comptroller of the Currency valued these big bets at $182 trillion in the U.S. alone. It should come as no surprise, therefore, that they have become a major factor behind the largest financial failures in history.

Plus, based on another critical measure — cash and savings — the bubble of the 2000s was also more extreme.

- Americans have saved far less than they did in the 1920s. The savings rate of U.S. consumers dropped to zero or less, the lowest of any nation at any time in recorded history.
- Corporate America has also been running cashless, with most companies deliberately seeking to keep liquid assets on hand to a bare bones minimum while leveraging debt to the max.

Between 1910 and 1950, even in the giddiest of times, most of America's 10 largest companies kept at least 70 cents of cash or equivalent on hand per dollar of debts and bills coming due within one year. In the modern era, however, that practice has fallen by the wayside: They have often let their cash and equivalent drop to as little as 10 cents on the dollar.

So if you've been wondering why so many big companies have gone bankrupt so quickly, now you know one of the key reasons: *They ran out of cash to pay debts coming due.*

"No cash in the kitty? Big debts? How could they be so reckless? And how could they have kept that going for so many years without ever paying the piper?" you ask. Actually, business CEOs thought they were very smart — and their most clever invention of all was, in effect, their own no-limit commercial "credit card." Any time a big company ran a bit low on funds, it could use this supercard and grab nearly all the quick cash it needed. Its name: *Commercial paper*, short-term IOUs that companies printed up and sold to investors.

As it turned out, commercial paper didn't just act as a temporary stop-gap for cashless corporations. It became a permanent fixture for almost all major companies whether they needed the cash or not. It allowed them to operate with minimal cash and maximum debt — all until that one fatal day this past September, when Lehman Brothers went bankrupt and the commercial paper market froze up. The U.S. government jumped in immediately to revive it by making all kinds of guarantees, and it has made some headway. But that does not change the fact that Corporate America is drowning in short-term debt. Nor does it change the reality that American consumers are in the same boat, skating on the thinnest ice of cash.

The Catalyst: Stock Crash vs. Housing Bust

In 1929-30, the primary catalyst for the big decline was the stock market crash. Real estate, other sectors and the entire economy followed soon thereafter.

The Dow Jones Industrials plunged 13.5% on Monday, October 28, 1929, and then 11.7% on Tuesday, October 29. Measured from the previous year's close, the market fell 17.2% in 1929 ... 33.8% in 1930 ... a whopping 52.7% in 1931 ... *plus* another 23.1% in 1932. Total cumulative loss from peak to trough: 89.2% in 34 months.

On today's averages, an equivalent decline would take the DJI to 1533; the Nasdaq Composite Index to 309; and the S&P 500 Index to 170.

In 2007-2008, as we headlined in our September 2007 issue, the primary driver of the economy's decline is the housing bust.

Our exact words then: "The bust is sweeping through our nation's 20,000 cities and towns ... bankrupting or crippling 140 mortgage lenders ... gutting America's $13 trillion mortgage market ... creating a nationwide scarcity of credit ... shaking Wall Street to its core ... dealing a direct blow to the underbelly of the entire U.S. economy."

But today, nearly all of the housing market troubles witnessed so far have been caused by bad mortgages going sour. The more powerful causes — a contracting economy, surging unemployment and deflation — are still mostly ahead.

Comparison: Real estate markets are more entrenched in the broad economy and more difficult to revive.

Mr. CONSERVATIVE

A Portfolio For The More Conservative Investor

Last Chance to Get Your Money Out of Danger Before the Next Big Decline

Right now, the vast majority of Americans are holding on to their stocks and real estate properties. First off, they believe Washington can prevent further disastrous declines. Secondly, they either don't want to take a loss or they don't want to take a profit and pay capital gains taxes. So they're frozen into inaction.

But their hesitation is your opportunity — to get your money to safety immediately and continue to *build cash*. Here are the steps we recommend:

Step 1. In your IRA, 529 savings plan, or other investment portfolio, sell all stocks and stock market mutual funds immediately. Then place the proceeds in 3-month Treasury bills or a Treasury-only money market fund. The only exception: Special situations that you or your money manager are protecting from downside risk with hedges.

Step 2. In your 401k, move all of your funds to the safest option available. Typically, that would be a standard money market fund or an income fund focusing primarily on U.S. government securities. (Unfortunately, our first choice — a Treasury-only fund — is rarely available in 401k programs.)

Step 3. If you and your family are comfortable with the idea of selling your home or if you have investment properties, do not wait. Offer a special commission bonus of up to two percentage points to be divided between the selling and listing agents. Base your offering price on *truly recent, actual sales*. Then mark that price down by at least 10%, or as much as 20% if market conditions in your area are deteriorating rapidly. Remember: The best time to sell is soon after you put the property on the market. So avoid starting high and then marking your price down incrementally.

Step 4. When you get bids for your property, never say "no," regardless of how ridiculously low you may think they are. Your agent may have the opportunity to nurse the negotiations along and possibly warm the buyer up to a price that you may be able to live with. It will also give you a sense of what a buyer's typical objections may be, which could help you overcome those of the next buyer.

Mr. Speculator

Major Stock Groups to Get Hammered the Hardest

While the Dow sinks toward 5500, three stock groupings, especially vulnerable to the sinking economy, are likely to take the biggest hits overall ...

Sector #1. Finance. Citigroup, supposedly "well capitalized and liquid," has just leaped into Uncle Sam's protective lap to avoid imminent failure. Consider the enormity of this event: Without the government's massive $20 billion injection of capital and $306 billion guarantee to pick up losses, *our nation's largest megabank would be in bankruptcy today.* Amazingly, Wall Street seems relieved by the government's desperate efforts to stop the tsunami. What Wall Street seems to be underestimating is that:

- *Citigroup's problems are just beginning.* Still ahead are the losses that naturally strike when the economy sinks and unemployment soars.
- *Citigroup is not alone.* The Comptroller of the Currency reports that, at mid-year, JPMorgan Chase's exposure to defaults on derivatives was 430.2% of its capital — that's nearly twice as bad as Citi's, which was at 257.8% of its capital. Meanwhile, the FDIC reports a 46% jump in the number of banks on its problem list.
- *Banks are still getting slammed by real estate woes.* New home sales dropped 5.3% in October, pushing sales to the lowest level in almost 18 years. Commercial vacancy rates are on the rise, while leasing activity is cooling. Result: Net charge-offs of bad debts throughout the banking sector have surged by more than 156% from a year ago.

Recommendation: Hold firmly to your position in the **Short Financials ProShares (SEF)**, an ETF designed to rise by 10% for every 10% decline in the share prices of banks, insurers and real estate firms. Or if this EFT isn't already in your portfolio, buy 50 shares at the market.

Sector #2. Technology. Dell is cutting more than 11,000 jobs. Best Buy just took the scalpel to its fiscal 2009 profit target. Circuit City filed for bankruptcy. Meanwhile, the Semiconductor Industry Association predicts a 6% decline in chip sales in 2009, the first global drop in seven years. Taiwan Semiconductor, Texas Instruments and Intel are slashing their forecasts. But the industry is still not factoring in the depression-like conditions we feel are inevitable.

Recommendation: Hold your **Short QQQ ProShares (PSQ)** position; this ETF is designed to rise 10% in value for every 10% decline in the Nasdaq-100 Index. Or if you don't own it yet, buy 50 shares at the market.

Sector #3. Industrials. Durable goods orders are plunging. Manufacturing is falling off the table. And the few remaining bright spots in Europe and Asia are now fading. The starkest warning sign: The Baltic Dry Index, a key measure of demand for commodities and bulk shipping services, has collapsed by a whopping 94% just since May. It means that industrial demand is imploding virtually everywhere — and that industrial sector sales and earnings are in grave peril.

Recommendation: Hold tight to your **Short Dow30 ProShares (DOG)**, which moves in the opposite direction of the Dow Industrials. Or if you're not yet on board, buy 50 shares at the market.

Other positions: Rydex Inverse Government Long Bond Strategy Fund (RYJUX), designed to profit from falling bond prices, has gotten hit by a sharp bond market rally. But the government's outrageously large deficits are bound to drive bond prices back down just as sharply. Hold. Or if

(continued on page 7)

Whether or not today's stock market suffers declines similar to the 1930s is still unknown. But regardless of where the ultimate bottom may be on the Dow, that outcome cannot reverse a housing collapse that is *already* far worse than it was at the equivalent stage in the 1929-1932 decline.

Here's how my dad explained it to me: "One of the greatest blunders people made in the 1930s was to blindly assume that prices were already so low, they couldn't possibly go any lower. In reality, the value of their real estate, stocks, commodities and virtually every other asset didn't stop going down at some particular level that appeared to be 'cheap.' Nor did it stop falling just because it matched some historical price that was considered low. The end of the price declines came only when all of the natural economic forces driving them down were exhausted; when most of the bad debts were cleaned out and the economy finally stabilized.

"This was also true for home prices. But in the Great Depression, few of my clients owed money on their homes; and among my relatives, I cannot remember anyone who took out a mortgage until after World War II.

"In the 1920s and '30s, mortgages were not nearly as common as they were after the war. And I know for a fact that even the people who did take out a mortgage never paid a variable rate. The interest rate was always fixed. So they could plan on making the same exact monthly payments year after year.

"In those days, we had big troubles on the farms. But in the cities, most of the big speculation was tied to Wall Street, and Wall Street firms rarely got involved in housing. We didn't have a secondary mortgage market either. The big mortgage lenders which created that market, like Fannie Mae, didn't come into existence until years later. All told, the end result is that the housing bust in the 1930s was not nearly as bad. While the average stock price fell to a dime on the dollar, the average home price retained 70% of its value. And most of that decline came only after the economy shrank and after millions of people lost their jobs."

Our forecast for the Dow: 5500. However, it's too soon to say that will be the bottom.

Our forecast for median home prices: Don't be surprised to see an *additional* decline of 20% from current levels, with greater declines in hard-hit regions such as the industrial heartland, major financial centers, retirement areas and popular tourist destinations.

Your action: Unless you have solid protective hedges, you should own no stocks whatsoever, holding instead inverse ETFs designed to profit from the market's decline. Ditto for investment real estate. Not out yet? Then follow the steps we lay out on page 4.

The Economy: Then vs. Now

In the 1930s, science, technology and engineering know-how paled in comparison to what they are today. However, there has been no change in the fundamental laws of supply and demand that drive our economy today. Here are the specifics ...

First Great Depression: According to the National Bureau of Economic Research, the U.S. economy shrank for 43 months — from a peak in August 1929 to a trough in March 1933. The unemployment rate swelled from 3.2% to 24.1%. The total number of Americans out of work soared from 1.55 million to 12.1 million. Despite many false starts, the economy did not begin a lasting recovery until the onset of World War II, and it did not truly begin to grow until after the war. Total duration: Approximately one decade.

Second Great Depression: The downturn is already longer than the average 10.5 months for recessions since World War II; and economist Sinai admits that it's "hard to imagine that this downturn would have hit bottom within the next four months, which would make it all but certain to set a new record." Specifically ...

- The U.S. unemployment rate bottomed at 4.4% in October 2006 and has now been rocketing higher — to 6.5% last October, the highest since March 1994. Our near-term forecast: 10% unemployment.
- The Institute for Supply Management's key manufacturing index plunged to 36.2 in November from 50 a year earlier, the worst reading in 26 years. That same month, durable goods collapsed 6.2%, while orders outside of the volatile transportation sector fell at the fastest rate in almost seven years.
- Auto sales plunged 37% in November to an annual pace of 10.2 million, the lowest since 1982. Total retail sales tanked 2.8% in October, the worst decline since the government started tracking in 1992. A separate measure of personal spending plunged 1% in October, the biggest monthly drop since the 9/11 terrorist attacks.
- The economy as a whole shrank at a 0.5% rate in the third quarter, the worst in seven years, led by the biggest drop in household spending since 1980. And in the current fourth quarter, the economy is contracting much more quickly — probably by 5% or more.

Moreover, the vicious cycles we've been warning you about are just *beginning* to kick in:

Vicious Cycle #1. Home price declines cause more home foreclosures, more home fire sales and, in turn, still more home price declines.

Vicious Cycle #2. Corporate bankruptcies precipitate deeper stock price declines, which, in turn, make it impossible for other companies to raise capital and avoid their own bankruptcy.

Vicious Cycle #3. Surging unemployment sinks consumer spending, killing the revenues of employers, who, in turn, must lay off workers, creating even more unemployment.

Vicious Cycle #4. The reality of lower prices prompts everyone — consumers, businesses and local governments — to cut back spending in anticipation of lower prices. In response, demand sinks and prices plunge still further.

Vicious Cycle #5. Lenders cut back sharply on new lending; debtors can no longer borrow from Peter to pay Paul; default rates surge. And lenders cut back lending even more sharply.

Vicious Cycle #6. The meltdown on Wall Street sinks the Main Street economy — and the decline in the Main Street economy topples Wall Street.

Comparison: Not possible until years from now. However, there can be no question that similar vicious cycles were present both then and now, with three outstanding differences ...

Safe Money Model Portfolio

Company Name	Ticker	Reco Date	Entry Price	Quantity	Stop	Dividend Yield (%)	Current Reco	(What to do if you don't own it.)
Mr. Conservative: Approx. 4/5 of Model $100,000 Portfolio								
Gold & Silver Investments								
Gold Bullion	N/A	11/08/99	$289.75	4	N/A	N/A	Hold	
Cash and Equivalents — **1/3 of Conservative Portfolio**								
T-bills or Treasury-only Money Fund	N/A	12/31/00	N/A	$29,678	N/A	N/A	Hold	
Mr. Speculator: Approx. 1/5 of Model $100,000 Portfolio								
Reverse-Index Funds								
Rydex Inverse Government Long Bond Strategy	RYJUX	04/18/08	$17.39	300	N/A	4.84	Hold	*(Buy 300 shares at market)*
Short Dow30 ProShares	DOG	09/26/08	$68.04	50	N/A	1.45	Hold	*(Buy 50 shares at market)*
Short QQQ ProShares	PSQ	10/06/08	$74.32	50	N/A	1.40	Hold	*(Buy 50 shares at market)*
Short Financials ProShares	SEF	10/21/08	$80.00	50	N/A	0.15	Hold	*(Buy 50 shares at market)*
Stocks								
Lender Processing Services Inc	LPS	10/06/08	$38.08	25	N/A	0.44	Hold	*(Buy 25 shares at market)*

The table includes all open positions recommended in the monthly *Safe Money* newsletter or flash alerts. The model portfolio assumes a total investment of $100,000. If your portfolio is larger or smaller, you should adjust the specific recommendations accordingly. For any remaining funds not invested in our recommended stocks and mutual funds, we recommend a Treasury-only money market fund for safety and liquidity. New Subscribers: Follow the recommendations in parentheses.

■ In the 1930s, a major factor that deepened the Depression was a collapse in world trade. Each nation, in a desperate attempt to protect its domestic industry, jacked up import tariffs, which only led to retaliatory tariff hikes by competing nations. Collectively, the world shot itself in the foot.

■ While today's world leaders have vowed not to repeat the same mistake, they may wind up doing worse: As precious, desperately needed international capital flees their shores, many countries may jack up interest rates to attract it back — prompting a rate war that kills their economy much like the trade wars of the 1930s.

■ In the 1930s, the government intervened to stop the decline, but far less aggressively than now. And therein lies the last hope among economists that the worst can be avoided. The underlying problems: The government can buy stocks and bonds. But it cannot buy *confidence.* The government can print money. But it cannot create *wealth.* The government can cajole, entice and push consumers to consume, lenders to lend and investors to invest. But it has no law, mechanism or viable incentive that can force them to act against their own individual interests — to buy less, cut back lending and reduce risk.

Our forecast: The government cannot turn back the clock and reverse decades of overborrowing. It cannot repeal the law of gravity and stop investors from selling. Ultimately, it cannot change the reality that the financial conditions today are worse than they were in the First American Depression. Therefore, the most the government can achieve is to buy some time, ease some near-term pain and temporarily postpone the inevitable collapse in the economy. But we see little other alternative. Therefore, we forecast that, despite delays and differences, false hopes and false rallies, America's Second Great Depression will ultimately be similar to the First Great Depression in depth and breadth, but hopefully shorter in duration.

Nearly all establishment economists disagree with us. Who's right?

Your action: You can't afford to wait around to find out this time. There is now abundant evidence coming from all sides that *mandates* protective steps *immediately*. Seek to sell investments in residences, commercial buildings and land; business assets and interests; art, antiques, rare coins and collectibles; nearly all commodities and inflation hedges; and any other asset that you don't need. Then convert as much as possible into CASH.

You'll find more instructions on pages 4 through 6.

Speculator *(cont. from p. 5)*

you're not on board, buy 300 shares at the market.

Lender Processing Services (LPS): Hold. Or if you're not yet on board, buy 25 shares at the market. Just be sure you also hold the inverse ETFs recommended above. These help offset the downside risk that comes with almost *any* stock in a broad bear market.

PROFESSOR INVESTOR

Special Questions From Our Readers

Q. A couple of years ago, when you named companies like General Motors and Fannie Mae as candidates for bankruptcy, I thought you were crazy. Earlier this year, when you put Citigroup at the top of your "X-List," I thought you were even crazier. Now, I don't know what to think any more. But with the government rushing to the rescue, doesn't that negate your otherwise prescient forecasts?

A. For investors, no. Whether the government lets them wind up in bankruptcy court or puts them on life support, shareholders are wiped out and bondholders can get killed. For employees, it doesn't make that much difference either. With or without a bailout, these companies will have to drastically cut back on their staff and operations. And no matter how many leaks the government plugs, it cannot stem the tide of corporate bankruptcies in a sinking economy.

Q. I commend you on all the forecasts you got right, but what about the one you got wrong? Contrary to your expectations, Treasury bond prices are skyrocketing and their yields are in a tailspin. What gives? Can this continue?

A. Temporarily, we see two bullish forces pushing T-bond prices higher: (1) Investors abandoning riskier investments and rushing into Treasury bonds as a safe haven, and (2) the Fed's new promise to buy up long-term bonds, possibly including Treasuries.

But we also foresee two powerful *bearish* forces on the near horizon: (1) Huge, new bond supplies from the Treasury to cover the massive bailout costs and deficits, and (2) a rebellion by bond investors who don't want their money squandered on bankrupt companies. So far, only the bullish forces are impacting the market. But the bearish forces could strike at almost any time, driving bond prices sharply lower.

Q. Martin, you and Mike keep talking about the risk of global deflation. Meanwhile, Larry seems to think all the Fed's money pumping will lead to more inflation. Whom should I believe?

A. We all agree that the world economy is now in a deflationary phase. Larry believes it will end sooner. We think it will continue for much longer.

Q. What do you guys think about the dollar? Will this rally continue?

A. Yes. That's a key reason we recommended you close out all of your contra-dollar trades months ago. In a deflation, the purchasing power of the dollar improves and should continue to do so. That's one of the few major benefits of this crisis for the country's long-term future.

Q. Should I refinance my mortgage? I see that rates are down a lot.

A. We recommend you focus first on selling your property and eliminating your debts. If you are unable or unwilling to take those steps, refinancing at a lower rate makes sense. The Fed's most recent decision to buy hundreds of billions of dollars worth of mortgage-backed securities has helped drive rates down. Even if you refinance, however, unless you're short of cash, try to pay down your mortgage at a faster pace that what's required.

Q. Home prices and mortgage rates are much lower now. Why shouldn't I grab the opportunity and buy a new home now?

A. For several reasons: You could get stuck with a property that's sinking in value. You could suffer a decline in income, making your monthly payments far more onerous than you anticipated. And with your money tied up in property, you could miss out on far better opportunities when the markets truly hit rock bottom.

Q. Are you still sticking to your Dow 5,500 target? I just missed out on a 1,000-point rally!

A. Absolutely. A hallmark of big bear markets is big, sharp rallies that come without warning. But as long as the economy is continuing to sink, they don't change a thing. Use them as selling opportunities.

Q. Is Ben Bernanke off his rocker? What the heck is going on at the Fed?

A. The Fed is printing money out of thin air ... bailing out banks and brokers ... and buying everything except Bobby's baseball card collection to prop up asset prices. They think that's the only way to fend off another Great Depression, this time brought about by the housing bust. But the only way to prevent a painful bust is to prevent bubbles from inflating in the first place. Alan Greenspan didn't get it, and neither does Bernanke. Events have already been set in motion, so a nasty depression is all but certain at this point — no matter how much money Bernanke throws out of his helicopter.