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When Complex Systems Fail

Jim Willie CB

Sometimes, unfortunately, a complex system fails. Despite the best efforts to keep an evolving system together through coordinated management, and attempts to provide fail safe mechanisms along its evolutionary path, the system can weaken, degrade, and fail. Due to its enormity and multi-faceted nature, changes occur slowly and are perceived to evolve in an orderly manner. A strange public trust is instilled along the pathogenesis of breakdown, but official statements, encouragement, and assurance of constant tweaks to controls put aside public concern. The consequential impact from the potential failure can be beyond measure. Hyperbolic words such as "enormous" or "magnificent" or "staggering" really fall short in their description of the fallout damage. **Experience through past crises, and reactions to them, tend to render the system more fragile and weakened, not more secure and efficient.** It becomes more subject to stagnation and a pathetic state of near breakdown, which ironically comes to be accepted as the "normal" situation. Successive crises have indeed worsened over time. A worthwhile exercise might be to review a clinical treatise on the nature and evaluation of systemic failure.

The US Economy, stock & bond markets, futures contracts leveraged to them, and great derivative gears hold together the USDollar, the US Treasury Bonds, mortgages, major metals & energy commodities, and more. Many devices are designed to keep a limiting cap on prices and rates, like a huge rooftop atop a house or giant pyramid shrubs surrounding it. The entire system grows to become tremendously complex. It has evolved over several decades, and has responded to numerous unintended disturbances. **Central banks provide the backdrop fail safe in a highly visible overt fashion. Derivatives provide the foundation underpinning in more secretive collusive fashion.** System foundations date back to the post-Depression, post-WWII era. Latent growth and solidification took place until the gold anchor was abandoned, as the Bretton Woods Accord linking the USDollar to gold was defaulted in 1971. Most crises date back to that key event in their origins, a simple fact almost uniformly overlooked by a corrupted economic advisory function to this day. Shocks have been endured in many recent years. Small shocks occur almost on a monthly basis. The system continues, so the public regards the system as functionally capably. How many times must we hear "the system has not broken yet"?

Black Monday 1987 delivered a serious shock to stocks after the USDollar fell as directed by the 1985 Plaza Accord. Their joint international accord plan was to reverse the dangerous situation whereby the US manufacturing base had seen significant abandonment in the early 1980 decade. The USDollar had appreciated from monetary colossal stimulus to lift the economy from its recessionary shackles. **The inflation and its effects attracted too much foreign money, an unintended consequence. The age of currency aggravations and distortions had begun to wreak its havoc!** Huge trade gaps had delivered capital flows to Asia. The entire US Economy over-invested in stocks, real estate, and military industrial equipment. In 1989, Japan stock and housing markets completely collapsed.

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The risks of a crash in the financial system are mounting as imbalances become both more widespread, with an increasing number of unsustainable bubbles, and more extreme regarding the sheer magnitude of those bubbles. An implosion becomes more likely when investors are lulled into a false sense of security that their backs are covered, just as they get increasingly offside as far as their exposure and leverage is concerned. The lack of analytical abilities, and basic knowledge of economics, leaves the masses, both public and professional, susceptible to be led astray from even a modicum of financial good sense regarding investments and the deployment of capital. Meanwhile, the stewards of our economic future such as Alan Greenspan, who do in actuality know better, have long ago sold us out in favor of the ruling elite. Investors and the media hang on his every word as he programs those so entranced that any problems that arise will be handled. His manner increasingly can be likened to whistling past the graveyard as he more frequently drops just a hint

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that in fact is a bombshell. The latest example was his recent proclamation that at some point foreigners will no longer be willing to add to their dollar debt. Ya think? We have to wonder when he first came to that conclusion. This seems similar to his recent comments that those that haven't yet prepared for higher rates must wish to incur losses, and this only months after practically ridiculing those that chose fixed rate mortgages over adjustable rate mortgages. I think a more appropriate statement would be that anyone that pays any attention whatsoever to what Alan Greenspan is saying must wish to incur losses. His monetary policy resembles Donald Trump; borrow so much money that you have the creditors at your mercy.

When the vast majority of investment advisors and financial professionals lack the knowledge to arrive at a reasonable conclusion when observing data, what hope has the average American? There have been many financial writers that do understand basic economics that have ridiculed Greenspan, calling him arrogant, irrational, boneheaded, and other similar such terms. I think they are missing the point as he has amply displayed his substantial understanding of basic economic concepts over the past 30-40 years. If this is so, they might ask why Greenspan has taken actions that have encouraged dangerous leverage, while hollowing out the U.S. economy and creating

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The system continued to pour US exported inflation to Asia in response, essentially ignoring the Japanese experience almost completely. We reasoned that Asia was bigger than Japan, whose island powerhouse had gone crazy with speculation. "They got what they deserved" was the battle cry in rationalization. Hardly a competent analysis was directed toward true effective change. Instead, roughly $600 billion in Japanese capital hit the shores of the USA. **We repeated Japanese errors, only with utter arrogance of superiority. The only thing superior is the size of our bubbles and the intricacy of its machinery.**

The 1997 Asian Meltdown delivered a more serious worldwide shock to currencys and stocks. Mindlessly and with incredible bravado mixed with childlike naïvete, most US so-called sophomoric experts (like the oaf Barton Biggs) regarded the Asian hardship as serving the US supply needs like to a "sweet spot." One year later, the Russian Default combined with the leveraged hedge fund LongTerm Capital Management failure to threaten seizure of the entire New York City megacenter bank system. So much for the sweet spot service from Asia. **Back then my view of the meltdown was more of a financial virus encircling the globe, a direct systemic response to the complete yield to irrational exuberance in search of icon hero status.** Yet these experts continue to ply their trade. The likes of Biggs, Galvin, Yarmeni, Garzarelli, and AbbyJo Cohen provide extremely high-priced guidance with no discernible track record of excellence.

The 2000 stock and telecom bust was the most recent shock delivered to the system. Greenspan succumbed to irrational exuberance in 1996 almost immediately after correctly labeling it as such. His policy focused on world economic growth, and the premier role of the US Economy with its advanced financial engineering machinery. Liquidity was the watch word, the stuff of fortunes. It was inflation and nothing more, well, except for accounting fraud and advanced gamesmanship with pro-forma techniques. Earnings were exaggerated to conceal a decline in corporate profits since 1985, amidst a great technology dawn. What followed was the worst financial market collapse in world history. The Federal Reserve acted as the great monetary spigot for the complex system, in yet another misjudgment. Even easier monetary supply was the response, which has created the Treasury bond and mortgage bond and housing bubbles. **A weak system continues to weaken further, even as fail safe devices are deployed at a more rapid pace than ever envisioned.**

After each tremor, the system responded, as a system should. The typical change was greater magnitude in money supply infusions and lowered interest rates. Also, greater magnitude in derivative gearing was provided to prevent damaging bond and currency movement, as directed by the largest of the world banks. At the same time, vast central bank support (mostly Asian, but also from Europe) occurred which began to take on the appearance of subsidy for the entire US Economy. The system has grown in complexity, under the rubric of normalcy and flexibility. This was a dangerous development and change to a large unstable system. Its risks were NOT assessed, either to the system or to the US Economy, whose currency has been totally and unequivocably subverted. The USDollar and its side-kick USTBond had become worldwide insurance money. Today, we sit with regular and routine accidents occurring, seemingly a new event with each passing week. The system has come to accept them as, well, "acceptable and routine." The most feeble of reasons for justifying the inherent effectiveness is often given: the system still stands with no obvious collapse.

The United States has fully embraced the mantle to underwrite any and all international financial or economic accidents. We do not seem to adapt to change. Instead, we apply old methods to new situations and expect similar outcomes as in the past. **The system has been forced to adapt during a time when the normal business cycle has been altered, if not broken. The presence of China stands clearly as the greatest new wrinkle within the system.**

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Large complex systems can be identified with human biochemical organisms, with natural ecosystems (the earth itself), with computer networks, with telecommunication networks, with business supply chains, with regional bank centers, and with international financial systems. They can and should be analyzed and viewed as complex systems, with much in common. Along those lines, an interesting and illuminating document came to my attention recently from the Cognitive Technologies Laboratory at the University of Chicago on the subject. When spotted, *"How Complex Systems Fail"* struck me as just what the doctor ordered for a review by the curious in a clinical light. Its relevance to the US Economy and financial network gave me pause, even prompted a deeper realization of the scientific dynamics at work. Feedback, risk assessment, post-crisis analysis, policy effect, political interference, these all work to alter the system as though an organism unto itself. Although originally directed at human patients, the parallel to societal systems is unmistakable in the following list of factors.

1) Complex systems are intrinsically hazardous systems.
All of the interesting systems (e.g. transportation, healthcare, power generation) are inherently and unavoidably hazardous by the own nature. The frequency of hazard exposure can sometimes be changed but the processes involved in the system are themselves intrinsically and irreducibly hazardous. It is the presence of these hazards that drives the creation of defenses against hazard that characterize these systems.

Economic recessions used to occur every 8 to 10 years. In the modern era, a bubble formed every time a new recession is due. Stock busts like 1987 and 2000 are deemed unacceptable. Therein lie the hazards, with recessions and stock busts, where people lose jobs and lose investments. Entire pensions are blown away. People at one time would jump out of tall buildings during stock crashes. Now, in a more constructive vein, they go shopping with money they do not have, to purchase things we do not make, which often are not needed at all, only to end up in basements, attics, and garages. Our banking system and federal relief system have responded to enact measures such as monetary stimulus (lower interest rates) and fiscal stimulus (tax breaks). The investment community has grown dependent upon them.

2) Complex systems are heavily and successfully defended against failure.
The high consequences of failure lead over time to the construction of multiple layers of defense against failure. These defenses include obvious technical components (e.g. backup systems, 'safety' features of equipment) and human components (e.g. training, knowledge) but also a variety of organizational, institutional, and regulatory defenses (e.g. policies and procedures, certification, work rules, team training). The effect of these measures is to provide a series of shields that normally divert operations away from accidents.

We call it "off-loaded risk" in the banking world. Derivatives ratchet the rooftops with levers and gears so that the weighed down roof does not collapse. With a small amount of money, even counterfeit money off the electronic printing press, large amounts of bonds can be bought in order to prevent rapidly rising interest rates, or to prevent a disorderly decline in the USDollar, or to prevent a frightening alarm with a shooting gold price. Foreign central banks provide the subsidy necessary, so as to preserve the international imbalances and ward off natural corrections, much like tectonic shifts would to create earthquakes. The Working Group for Financial Markets (aka the Plunge Protection Team) operates to save the day with stocks. Training comes in the form of indoctrination and outright propaganda, to teach Orwellian chapters from economic textbooks on topics ranging from inflation, legitimate income sources, and flexibility. Economic aggregate statistics serve as the final shield. Unfortunately, they are more a prism of deception.

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enormous imbalances.

It must be understood whom the man really works for. It is not the people and it is not the government, but rather the international bankers and the power elite. His true job is to set up money making opportunities for the international banking machine. The power elite have an agenda that would not be so easily followed if people had a choice. So how do you control the masses? The answer is elementary. How do you enslave someone? Overload them with debt and then put them in a position where they are at the mercy of the creditor. This is where we have arrived as insiders unload equities at an unprecedented pace. Meanwhile, the public with record levels of debt may soon be forced to accept whatever deal is offered when they can no longer pay back their borrowings with just a slight hike in interest rates.

Dr. Kurt Richebacher points out in hard numbers the failing U.S. economy in his monthly newsletter "The Richebacher Letter". He points out that U.S. working-age population is growing 1.2% which requires an additional 2 million in job creation a year. Despite this, overall wage and salary income in real terms remains below the levels of December 2000! This clearly points to the fact that we are losing high-paying jobs in favor of inferior and part-time jobs. He also points

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out that a lot of the profit rebound of corporations in recent years have come from inventories, as commodity prices have surged, and financial engineering. It has gotten to the point that corporations can report whatever profits they fancy through selective use of derivatives as we have seen all too clearly with Fannie Mae. Yet that stock remains firm despite this. This week it was reported that a Chinese company lost over a half trillion dollars in oil derivatives trading. These are the types of risks that are being undertaken to create a financial profit. It just so happens this example involves the airline industry attempting to cope with uneconomic jet fuel costs. Expect more occurrences moving forward as we believe this is just the tip of the iceberg.

By far the most incredible in subterfuge is the not widely understood practice of hedonic pricing. This practice adjusts the real price of a product for quality adjustments and is widely used for high tech products, particularly computers. By this method if a computer has more power for the same price in previous years, the sale of the computer is counted as more in GDP. For example, if an $800 computer you bought this year has three times the power as the one you bought for $800 last year, then it is reckoned this should count as $2400 to GDP. Mind you, the company counts it as an $800 sale while the economy counts it as a $2,400 sale. So since about 1986,

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3) Catastrophe requires multiple failures - single point failures are not enough.
The array of defenses works. System operations are generally successful. Overt catastrophic failure occurs when small, apparently innocuous failures join to create opportunity for a systemic accident. Each of these small failures is necessary to cause catastrophe but only the combination is sufficient to permit failure. Put another way, there are many more failure opportunities than overt system accidents. Most initial failure trajectories are blocked by designed system safety components. Trajectories that reach the operational level are mostly blocked, usually by practitioners.

Since 2000 many detrimental events have occurred, none of which can singly bring down the system. They sure make their mark though. Fanny Mae & Freddy Mac accounting fraud combined with massive bond hedge losses and probable executive indictments. The USDollar bear market stands as a gradual failure in mega-trend shift. Sharply rising commodity prices, most notably in energy, drag down the economy as a direct effect. Colossal trade gaps and federal deficits put great strain on the international dependence which the United States has come to rely upon. Stock index declines invite PPT response. The World Trade Center attack itself was a very visible shock, met with action. Each represents a failure of sorts. Disturbance to the insurance business (bid rigging), mutual fund business (after-hours pricing), brokerage business (IPO kickbacks), and countless corporate accounting fraud makes for financial sector strife. The FDA corrupted process for drug product approval is the latest link in the chain of failures. Through all these, we trudge on.

4) Complex systems contain changing mixtures of failures latent within them.
The complexity of these systems makes it impossible for them to run without multiple flaws being present. Because these are individually insufficient to cause failure they are regarded as minor factors during operations. Eradication of all latent failures is limited primarily by economic cost but also because it is difficult before the fact to see how such failures might contribute to an accident. The failures change constantly because of changing technology, work organization, and efforts to eradicate failures.

Flaws are omnipresent and fully minimized in importance. We have failed derivative "houses of cards" right before us, treated by sanitization procedures behind closed doors. We have households with negative savings, after putting aside moronic adjustments like self-paid homeowner rent and self-paid checking account services. We have inflation raging to keep an entire nation afloat when all contrived measures say the opposite. We have a nation requiring almost $2 billion per day of foreign subsidy. We have trends toward inefficient cars and heavy gasoline usage while energy prices rise. In most cases, additional debt and new leverage to supply credit are the technological tools we use in reaction, which are from the wondrous evolving financial engineering toolbag.

5) Complex systems run in degraded mode.
A corollary to the preceding point is that complex systems run as broken systems. The system continues to function because it contains so many redundancies and because people can make it function, despite the presence of many flaws. After accident reviews nearly always note that the system has a history of prior 'proto-accidents' that nearly generated catastrophe. Arguments that these degraded conditions should have been recognized before the overt accident are usually predicated on naïve notions of system performance. System operations are dynamic, with components (organizational, human, technical) failing and being replaced continuously.

The 1989 Savings & Loan debacle came and went, with the Fanny Mae "new & improved" mortgage centrifuge put to work. The 1998 LTCM fiasco came and went in delayed reaction to the Asian

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Inflation Disinformation

Benson's
Economic & Market Trends

December 28, 2004

Now that the Pentagon has won the domestic war over the United States' intelligence services, our blinders have been removed and we are allowed to see the real reason that the Pentagon wants to control intelligence: to run "disinformation" campaigns against America's enemies around the world. If our military industrial complex is serious about understanding disinformation, they should become students again and participate in a case study to learn how to get disinformation right.

The Federal Reserve has done a masterful job of distributing disinformation. Last year, they were scaring Americans by announcing that deflation was a threat. This year, they continue to announce "inflation is contained" so interest rates can be raised at a "measured pace". The Federal Funds Rate has moved up from 1 percent to 2.25 percent while the CPI has risen from 2 percent to 3.5 percent! The real interest rate - the Federal Funds Rate less inflation - remains clearly negative. "Loose as a goose" as in continuing to "goose the money supply" might be a good analogy. Meanwhile, everyone is fighting deflation and totally focused on the core inflation rate, which is running at about 2 percent. *The reason the core rate goes up so slowly is because it is carefully designed to leave out the key expenses that really affect our lives and go up in price such as energy costs, food, and housing.* The essence of disinformation is basically to get everyone to look the other way when something like inflation is really big and in your face constantly.

Critically, the mainstream press has been a big help to the Fed in this endeavor. For the most part, they simply print what they are told without doing any factual digging or additional research, or actually examining the "real" inflation numbers. When the Fed claims that all that matters is the core rate, you really need to go to the BLS and find out what the year-over-year rate is. Price increases are downright ugly and the last thing the government wants you to do is take a closer look.

Well, let's peek anyway at some of the government's numbers on prices, courtesy of the Bureau of Labor Statistics ("BLS"):

Price Increase
November 2003 to November 2004

Producer Price Index ("PPI")	
Gasoline	**47.5 percent**
Crude Materials	**25.9 percent**
Intermediate Materials	**9.7 percent**
Groceries at Supermarket	**6.1 percent**
Finished Goods	**5.1 percent**
Consumer Price Index ("CPI")	**3.5 percent**

Price Increase
Office of Federal Housing Enterprise Oversight "OPHEO"

National Housing Prices

Third Quarter '03 to Third Quarter '04	**13 percent**
Third Quarter '04 to Annual Rate	**18.5 percent**

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Meltdown, with the much larger derivative pyramid built constructed, primarily by JPMorgan and its three lesser accomplices. The 2000 stock bust came and went, with the much larger bond & housing bubbles, justified as dealing with the stock loss effects but not the cause. To be sure, our financial system is degraded, runs as a broken system, and enjoys frequent, regular fixes, some with newfangled devices.

6) Catastrophe is always just around the corner.
Complex systems possess potential for catastrophic failure. Human practitioners are nearly always in close physical and temporal proximity to these potential failures - disaster can occur at any time and in nearly any place. The potential for catastrophic outcome is a hallmark of complex systems. It is impossible to eliminate the potential for such catastrophic failure; the potential for such failure is always present by the system's own nature.

In 1998 a common view was held, the next US Economic recession would bring down the system. In 2002 a common view was the US current account deficit over 5% of GDP would lead to a currency correction likely to cause system collapse. The raging derivative monstrosity, now at least five times larger than 15 to 20 years ago, could tip over and crush the financial system with sufficient triggered provocation. Fed Governor Poole in 2003 stated his concern that failure by Fanny Mae could set off an economic meltdown, as is capital foundation was entirely

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the GDP numbers have been accumulating and compounding sales and growth that never happened. Now I have only been around since 1957, but since the first caveman rolled a log and made a wheel to move a rock there have been quality improvements in products. Only in 1986, some genius decided we have to get more credit for quality improvements that have ALWAYS been the case.

That point marks the time when government statistics have increasingly had little relationship to reality. They were adjusted to defraud you and make you believe things are better than they actually are. So now when an economic number is released, do what I do; view it, digest it, and if it's bad, say to yourself, "Holy cow, is that the best number they can make up?" Managing money in a fiat money system gone mad is a challenging task. The one question that cannot be reckoned with is, "how much longer are investors and providers of capital going to believe in this complete and utter fraud?"

The US economy has depended on financial engineering and the housing bubble for equity extraction to a tremendous degree over the past few years. What can be done going forward? Already in the media we can detect the initial stages of building the case to attack Iran. With Iraq, it was weapons of mass destruction and when Iraq felt the walls closing in, and began to relent, Bush pushed forward to

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inadequate. Now Roach of Morgan Stanley sees threats to the USDollar and the need for fast rising interest rates as a trigger for economic catastrophe. We seem to live on the edge constantly.

7) Post-accident attribution accident to a 'root cause' is fundamentally wrong.
Because overt failure requires multiple faults, there is no isolated 'cause' of an accident. There are multiple contributors to accidents. Each of these is necessary insufficient in itself to create an accident. Only jointly are these causes sufficient to create an accident. Indeed, it is the linking of these causes together that creates the circumstances required for the accident. Thus, no isolation of the 'root cause' of an accident is possible. The evaluations based on such reasoning as 'root cause' do not reflect a technical understanding of the nature of failure but rather the social, cultural need to blame specific, localized forces or events for outcomes.

Debate rages over the root cause of the Great Depression. Was it too much debt and leverage and speculation? Was it too little response with lower interest rates and floods of liquidity? This accident stands as the event of extreme primacy studied, explained, and revised according to political motives and agenda pushed upon policy makers. It might be argued that the USA does not bother to analyze accidents much at all. Reform conflicts with the power structure and the ruling elite. We simply move to the next accident merrily, and boast of flexible response.

8) Hindsight biases post-accident assessments of human performance.
Knowledge of the outcome makes it seem that events leading to the outcome should have appeared more salient to practitioners at the time than was actually the case. This means that ex post facto accident analysis of human performance is inaccurate. The outcome knowledge poisons the ability of after-accident observers to recreate the view of practitioners before the accident of those same factors. It seems that practitioners "should have known" that the factors would "inevitably" lead to an accident. (Hindsight bias remains the primary obstacle to accident investigation, especially when expert human performance is involved.)

In hindsight, most analyses of past accidents appear to this analyst to be justified as a small price to pay for our capitalist system, chock full of opportunity, freedom to invest and apply credit, and a remarkable showcase to our innovation and flexibility. Our official analyses seem to be corrupted by the current agenda and by those in power to influence and dictate policy. We are too busy inflating, speculating, and building the next financial contraptions to be bothered with much objective expert post-accident analysis at all. Greater future opportunity lies over the horizon. Why waste time with the past?

9) Human operators have dual roles: as producers & as defenders against failure.
The system practitioners operate the system in order to produce its desired product and also work to forestall accidents. This dynamic quality of system operation, the balancing of demands for production against the possibility of incipient failure is unavoidable. Outsiders rarely acknowledge the duality of this role. In non-accident filled times, the production role is emphasized. After accidents, the defense against failure role is emphasized. At either time, the outsider's view misapprehends the operator's constant, simultaneous engagement with both roles.

Are the Federal Reserve and Chairman Greenspan the cause of the problems or the primary agents of remedy? Most benefiting participants see them as agents of remedy. Most victims see them as causes of the problem. Greenspan ignored his own warning of irrational exuberance in 1996, yet is assigned little blame for the greatest stock bust in world history only four years later. The same

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villain & hero roles go with Franklin Raines of Fanny Mae (still there) and with John Meriwether of LTCM (in new hedge fund), even Robert Rubin of the Dept of Treasury (now at Citigroup). On a systemic level, the same goes for the Bank of Japan which perpetuates the grand imbalances. Toss in some villainous practices, not people, such as zero percent finance deals. They led to sustained retail sales but also to gargantuan trade gaps. Also, the wizards controlling vast derivative gears on bonds and currencys tinker with their levers, contribute to the problem, yet are called upon to offer counsel and to enact the cures.

10) All practitioner actions are gambles.
After accidents, the overt failure often appears to have been inevitable and the practitioner's actions as blunders or deliberate willful disregard of certain impending failure. But all practitioner actions are actually gambles, that is, acts that take place in the face of uncertain outcomes. The degree of uncertainty may change from moment to moment. That practitioner actions are gambles appears clear after accidents; in general, post hoc analysis regards these gambles as poor ones. But the converse: that successful outcomes are also the result of gambles; is not widely appreciated.

When Greenspan bailed out LTCM in 1998, he took a gamble that failed. When Greenspan released huge liquidity in the face of the new millennium Y2K bug threat, he took a gamble that failed. When Greenspan took down interest rates in 2001, he took a gamble that is the process of failing, not fully recognized yet. When he compounded the policy by urging down the long-term rates, he doubled down on the gamble, only to double the ultimate damage. Outcomes were indeed uncertain. Permitting bond & housing bubbles seemed the desired and urged approach at the time. After these bubbles give off gas, the perception on the policy will not be so forgiving. On the other hand, the Resolution Trust Corporation which gathered, sold, and administered the bankrupt dissolved banks from the S&L debacle in 1989 turned out to be an excellent risk and successful cleanup. It made Bill Siedman's career, who headed the Federal Deposit Insurance Corporation. At the local level, people gamble with their home equity, their savings, and their pensions.

11) Actions at the sharp end resolve all ambiguity.
Organizations are ambiguous, often intentionally, about the relationship between production targets, efficient use of resources, economy and costs of operations, and acceptable risks of low and high consequence accidents. All ambiguity is resolved by actions of practitioners at the sharp end of the system. After an accident, practitioner actions may be regarded as 'errors' or 'violations' but these evaluations are heavily biased by hindsight and ignore the other driving forces, especially production pressure.

Changes in Fed policy, to begin tightening cycles, to begin easing cycles, to enable high profile rescues, these are actions at the sharp end. There is no ambiguity when interest rates change course. If the Fed is forced to raise interest rates sharply in response to a USDollar in freefall, again actions would contain little ambiguity. It is my firm belief that the Fed would, however, attempt to muddy the waters of perception with claims of a stronger US Economy at the same time of policy change. Actions taken by prosecutors directed at fraud are unambiguous. Actions taken to remove drug products from the marketplace are also very clear. Again, objective examination of root violations is sorely lacking. Watch the FDA process to change not at all.

12) Human practitioners are the adaptable element of complex systems.
Practitioners and first line management actively adapt the system to maximize production and minimize accidents. These adaptations often occur on a moment by moment basis. Some of these adaptations include: (1) Restructuring the system in order to reduce exposure of vulnerable parts to

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The prices above surely indicate there is a whole lot of inflation going on now and in the "price pipeline". The magnitude of real inflation is around us everywhere. An example of this could be seen in New York where taxi cab prices increased by 25 percent, while nationwide college tuition, health care, insurance, drug prices and property taxes are, in most cases, running near or above double digit annual rates of price increase.

So, why does the CPI rate of increase look so low? Ah, the genius of disinformation. First, many of the items going into the CPI are adjusted for quality changes, referred to as hedonic adjustment. The idea is that since a new computer has twice the memory and processing speed for the same amount of money, the price actually fell in half. Even Bill Gross at PIMCO has caught on to this hedonic scam and estimates that these convenient but false hedonic adjustments pull the CPI down a full percentage point from where it would otherwise be.

However, our favorite disinformation trick in the CPI is the grand assumption that everyone in America rents their house. In calculating the CPI, a full 29.5 percent of the index is related to the direct costs of housing. Looking at the price weights, 6.2 percent of this fraction relates to people who rent, while 23.4 percent of the total CPI relates to the total costs associated with home ownership *but the CPI assumes these homeowners rent, not own*! As you can imagine, rents have not been moving up as fast as housing prices. If the national housing prices as published by OFHEO were used in the CPI, that 23.4 percent

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carry on his plan of oil asset control. The foreign press presents a much different view of what is transpiring. As the paper pushing industry wanes, the current leadership of the US may see only one industry as its future. Hint: It should be good for employment as we will need many soldiers. Alan Greenspan knows all too well the job of holding up the economy gets ever more difficult. Desperate times call for desperate measures yet the mainstream media would have you believe that the future is ever so bright.

As the day of reckoning approaches I have but one bit of senior advice, **own: gold and silver!**

Richard J. Greene
Clearwater, Florida
Thunder Capital Management
December 14, 2004

Debt and Trade Deficit Counter

National Debt:
7,547,385,675,509.47
The estimated population of the United States is **295,228,260**
so each citizen's share of this debt is **$25,564.58**.
The National Debt has continued to increase an average of
$1.77 billion per day.

US Trade Deficit:
150,000,000,000.00

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failure. (2) Concentrating critical resources in areas of expected high demand. (3) Providing pathways for retreat or recovery from expected and unexpected faults. (4) Establishing means for early detection of changed system performance in order to allow graceful cutbacks in production or other means of increasing resiliency.

The Federal Reserve has reportedly, in clandestine fashion, taken over JPMorgan and its dangerous, potentially catastrophic derivative book. The merger agreement between JPMorgan and the giant Japanese bank Sumitomo in 2003 constituted a restructure along the lines of item #1, a marriage ordered complete with a $1500 million cash dowry. The Dept of Treasury and SEC are in the process of assisting Fanny Mae with its mortgage books. The high demand for mortgage financing requires a concentration of resources to sustain the important housing market along the lines of item #2. Without the housing boom, the US Economy would go into deep recession. Big dangers currently loom in bogus economic reporting (item #3) and early detection for cutbacks (item #4). A pathway for retreat is difficult with false aggregate data, which typically justifies current policy and overwhelms the need for prudent cutback at all. Therein lie great risks.

13) Human expertise in complex systems is constantly changing
Complex systems require substantial human expertise in their operation and management. This expertise changes in character as technology changes but it also changes because of the need to replace experts who leave. In every case, training and refinement of skill and expertise is one part of the function of the system itself. At any moment, therefore, a given complex system will contain practitioners and trainees with varying degrees of expertise. Critical issues related to expertise arise from (1) the need to use scarce expertise as a resource for the most difficult or demanding production needs and (2) the need to develop expertise for future use.

When Veneroso departed his role as consultant to Western central bankers, great expertise was lost in managing the gold versus currency versus bonds complex. When former Treasury Secy Rubin left his role in managing the USDollar, great expertise was lost. John Snow is but a shadow of Rubin in specialty skills. His predecessor O'Neil was replaced due to competence, honesty, and outspokenness. The USDollar has begun its frightening decline. When professionals accept new jobs in the lucrative hedge fund business, and leave behind their speculative desks on Wall Street, again expertise is lost. Responsibility for juggling in the great game falls on less skilled, less experienced, and less connected individuals. Variation in competence grows tremendously, putting the system at greater risk to respond.

14) Change introduces new forms of failure.
The low rate of overt accidents in reliable systems may encourage changes, especially the use of new technology, to decrease the number of low consequence but high frequency failures. These changes maybe actually create opportunities for new, low frequency but high consequence failures. When new technologies are used to eliminate well understood system failures or to gain high precision performance they often introduce new pathways to large scale, catastrophic failures. Not uncommonly, these new, rare catastrophes have even greater impact than those eliminated by the new technology. These new forms of failure are difficult to see before the fact; attention is paid mostly to the putative beneficial characteristics of the changes. Because these new, high consequence accidents occur at a low rate, multiple system changes may occur before an accident, making it hard to see the contribution of technology to the failure.

Derivative contracts, heavily used in risk offload, stand as the quintessential high risk financial security instrument in today's financial world. With such new technology comes low frequency but

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When Complex Systems Fail

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high consequence failures. Mortgage bond derivatives known as real estate mortgage investment conduit (REMIC) apply leverage to contain mortgage rates. They employ "strips" and "floaters" which conjure up images of nightclub bondage more than financial securities. Years ago, the mortgage backed security (MBS) was a new device to sell into the bond market large portfolios of homeowner mortgages. The technology has advanced. Numerous other examples exist as change occurs, crises are averted, and new devices become invented. The newest device is the gold exchange traded fund (ETF). Could it assist in ushering the arrival of the upcoming USDollar crisis?

15) Views of 'cause' limit the effectiveness of defenses against future events.
Post-accident remedies for "human error" are usually predicated on obstructing activities that can "cause" accidents. These end-of-the-chain measures do little to reduce the likelihood of further accidents. In fact that likelihood of an identical accident is already extraordinarily low because the pattern of latent failures changes constantly. Instead of increasing safety, post-accident remedies usually increase the coupling and complexity of the system. This increases the potential number of latent failures and also makes the detection and blocking of accident trajectories more difficult.

In the wake of Black Monday, S&L debacle, Mexican Peso crisis, Asian Meltdown, LTCM fiasco, Tech/Telecom stock bust, as well as the Great Depression, measures were put into place to protect the system. Little resistance is laid in the path of new tinkering to install safety measures. Coming in the form of leveraged futures contracts, bond derivatives, exotic contracts linking at least two commodities, government teams for market reaction, trade protection, such safety measures surely increase the coupling and complexity in hidden ways. Detection of accident pathways is rendered almost impossible.

16) Safety is a characteristic of systems and not of their components
Safety is an emergent property of systems; it does not reside in a person, device or department of an organization or system. Safety cannot be purchased or manufactured; it is not a feature that is separate from the other components of the system. This means that safety cannot be manipulated like a feedstock or raw material. The state of safety in any system is always dynamic; continuous systemic change insures that hazard and its management are constantly changing.

The mere claim of risk assessment in today's complex economic and financial system is not possible. Gold miner firms hire external consultants just to assess their own risk from hedge books, otherwise known as derivatives. The Dept of Treasury in all likelihood was unable to assess the risk or even the current status of the Fanny Mae derivative book contraptions. Warren Buffet required two years to assess the risk and financial status of his acquired General Re insurance firm, beset by derivatives which he himself labeled as "financial sewage." Safety is the byproduct of managed risk. It is not measurable, nor can it be manipulated with assurance of safety. Our system reacts. It must be constantly administered and managed. External change is too regular and constant. Breakdowns are too regular and constant. Unwise human behavior is too regular and constant.

17) People continuously create safety.
Failure free operations are the result of activities of people who work to keep the system within the boundaries of tolerable performance. These activities are, for the most part, part of normal operations and superficially straightforward. But because system operations are never trouble free, human practitioner adaptations to changing conditions actually create safety from moment to moment. These adaptations often amount to just the selection of a well-rehearsed routine from a store of available responses; sometimes, however, the adaptations are novel combinations or de novo creations of new approaches.

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Inflation Disinformation

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weight of the index for prices rising at 13 percent a year would alone have added 3 percent to the CPI (t*hat is if gasoline, groceries, and everything else had not increased in price and only rising housing prices were affecting it).*

What is the "real" CPI? If we assume that housing prices are only increasing at three times the rate of the cost of renting, and the hedonic adjustment is only 0.5 percent, I think we can safely assume the following:

Real Consumer Price Index

Reported	**3.5 percent**
Including Housing Prices	**2.0 percent**
Hedonic (Fudge Factor)	**0.5 percent**
	=====
Real Consumer Inflation	**6.0 percent**

In looking at these numerical facts and the actual world around us, we can truly appreciate the magnitude of disinformation on the inflation front. The Fed needs inflation, wants inflation, and is getting inflation. Without inflation to inflate away a massive amount of personal, corporate, and government debt, our financial system could collapse. A lower dollar and higher inflation will ease the federal deficit while the foreign central banks, that have purchased U.S. Treasuries, will end up paying for the war in the Mid East as America's debt is inflated away. To make the disinformation plan work, it is critical that even if inflation is not contained, *the knowledge and perception that inflation is kicking up,* is *contained.*

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Inflation Disinformation

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Unfortunately for savers, they are being slaughtered by inflation very silently but at least they are alive to work like a wage slave for another day. The average American is so busy trying to make ends meet that when it comes to inflation, they don't even know what's happening. We can only hope that the Pentagon will learn from the masters at the Fed how to have that soft touch when it comes to propaganda.

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The Dollar Tumbles…..

Taken from The Wall Street Journal year-end review.

Betting on currency movements can be a lot like skating on a frozen pond: It's great gliding along smoothly...until you fall through the ice. Indeed for the past three months, traders and international investors have made a bundle wagering. Now they are wondering if the antidollar bet can continue to pay off. Nearly all think it will, even though many remain wary of a temporary dollar rebound.

Tony Norfield, global head of foreign-exchange research at ABN Amro Bank in London says "On everybody's mind now is whether early 2005 will be a

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Derivatives Update

Chris Laird

In articles I have written, Mexican stand-off, Subsistence Crisis, Deflation Unavoidable, et all, I have painted a scenario that is frankly drastic... And if I was off base, then you know what? I would be happy But, I'm not off base and I'm not happy about our future. I think we have a high probability of seeing a UNPLEASANT world that we don't recognize in the future... but let me get to the point. Derivatives are a major factor in the risk facing our financial world today, and they are relatively new since about 1990

I am commenting on two articles today that illustrate the fragility of this modern leveraged paper world economy...

The first article I'll get to is the case of the Chinese Oil monopoly that lost about 600 million dollars in oil derivatives recently. And get this...this is CHINA, the supposed world gangbusters economy that's going to bury the world; Well, they are going to go down in a monstrous financial collapse one day not far off.. but that is another article in itself...

China Aviation Unit Broke Rules, Gets More Time for Debt Plan

" Dec. 10 (Bloomberg) -- China's government will punish officials who broke rules and caused $550million of losses at China Aviation Oil (Singapore) Corp., the monopoly jet fuel importer to the mainland, the state assets commission said. ....

The decision gives China Aviation Oil protection from creditors while it negotiates support from its Beijing-based parent and Singapore's state-run Temasek Holdings Pte. The oil trader is being investigated by Singapore's police, central bank and stock exchange after the island's biggest derivatives loss since Nick Leeson lost $1.4 billion at Barings Plc in 1995...."

Gee, doesn't that sound like successful self regulation! People talk about China's incredible growth, but there is another China story, the incredible speculation and real estate bubbles going on there, the DERIVATIVES losses at the China Aviation Unit are just one of the latest examples of the extreme losses that can happen in a matter of days or hours to enterprises that mess with derivatives no matter where they are...

The second article talks about one of the recent fiasco's at our GSE's: What lurks under the surface at Fannie Mae / Freddie Mac? well, it just so happens that Fannie Mae had to make a correction to its balance sheet to 'recognize' 9 billion in, guess what? derivatives losses!... It reminds me of my Gold-Eagle.com editorial Derivatives Wild Card, where I stated that I suspected that many enterprises are hiding substantial derivatives losses... Come to find out, the granddaddy paper dragons, the GSE's were doing just that!

FANNIE MAE TO RESTATE EARNINGS BY 9 BILLION....

"Note: Wednesday, the SEC's senior accountant ruled that Fannie's derivative accounting was not in accordance with FAS 133 and recommended it stop the practice and restate 2001-2004 earnings by $9 billion. The SEC did not say Fannie violated the rule deliberately to inflate earnings...

"Then there was another. I guess the other part of this is the director of OFHEO said it was black and white that (Fannie Mae's) accounting under FAS 133 wasn't accounting properly for derivatives. Then there was a major, as we know, hullabaloo on that. The bottom line is that they were hard-hit and (the) stock was knocked down quite a bit in late September. "

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GOLD MANIPULATION IS A BLESSING

Todd Stein & Steven McIntyre

December 10, 2004

In late 2002, as the US stock market was making new lows on a daily basis, it looked like there was no end in sight to the carnage. The NASDAQ bubble had been popped, and it seemed like the invisible hand of the market was doing its work and punishing overvalued tech stocks. All of the sudden however, out of nowhere, things started to change. It seemed that the market couldn't go down anymore and many suspected that Treasury Undersecretary Peter Fisher and his "Plunge Protection Team" were bailing out the markets.

The PPT, also known as the Working Group on Financial Markets, was created in response to the 1987 stock market crash. The powers that be in Washington decided that the prevention of a market panic was a national security issue, similar to a prevention of an oil shortage. Almost every floor trader on the NYSE, NYMEX, CBOT and CME will admit to having seen the PPT in action in one form or another over the years. By the end of 2003, it was once again proven that shorting overvalued tech stocks based on valuation was not a winning trade. Shorting these stocks can be very dangerous as XYZ.com could run from 40x earnings to 4000x earnings before it files for chapter 11 bankruptcy. Even though these stocks would eventually collapse and go bankrupt, there could be powerful interests in place that would make sure the bubble would be prolonged as long as possible. Many skeptics often point to the powerful interests who benefit from rising stock prices - General Electric, Dow Jones, incumbent politicians, every major bank, every major retailer…etc.

The same people who have been accused of manipulating the stock market have been accused of capping the price of gold & silver. It seems that every day at 8am, some mysterious trader in New York or Chicago comes in and kicks the teeth out of the price of gold or silver. There have been accusations of a conspiracy between money center banks such as JP Morgan, the various commodities exchanges and metal producers who hedge forward production. Now some are saying that the new gold ETF (GLD) is the just latest step in the gold-rigging scheme.

Whether or not you believe all or some of these conspiracy/rigging theories, we are here to tell you that this manipulation (if it exists) may not a bad thing. We are tired of all the gold & silver bugs complaining every time the metals suffer a large correction. If you are a true long-term believer, then be thankful that these forces are keeping the prices low for all of us to buy physical metals. If you are a greedy paper trader looking for a short term gain, then you will continue to be agitated by the choppy behavior of the metals prices. Maybe this alleged "scam" will continue to go on for many years, but sooner or later, market forces will win out.

December 10, 2004
Todd Stein & Steven McIntyre
Texas Hedge Report

Todd Stein & Steven McIntyre are internationally known analysts and editors of *The Texas Hedge Report*, a market newsletter that highlights under and overvalued securities in the equity, bond, currency, and commodity markets.   www.texashedge.com

Derivatives Update

Chris Laird

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I am sure that there are a lot more unrecognized US derivatives losses outstanding, not only at Fannie Mae, but in many large enterprises. With interest rates rising, and over 80 pct of all derivatives contracts being interest rate swaps. We'll be seeing more of this kind of news... See Derivatives 101 Big Bets

Also in Derivatives Wild Card, I stated that central banks are relying on SELF GOVERNANCE by entities that use derivatives... so much for self governance in these two examples! In the China Aviation case we find that "China Aviation Unit Broke Rules"... and in the GSE case we find that "director of OFHEO said it was black and white that (Fannie Mae's) accounting under FAS 133 wasn't accounting properly for derivatives."

As we can see, these are examples of the magnitude of possible losses by enterprises that use derivatives, and that they really cannot self govern themselves, as the central banks say they can.

Happy Holidays,
December 21, 2004
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The Dollar Tumbles…..

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replay of 2004, or whether the dollar will crash."

Many speculators are carrying big short-dollar positions—bets that the dollar will keep tumbling. With so much money lined up against the greenback, any dollar recovery—no matter how temporary—could be exaggerated as traders would have to scramble to buy dollars to lock in profits or cover losses.

The dollar weakened about 4% to 8% against major currencies last year. On Dec. 31, Europe's common currency, euro, was trading at $1.3567, compared with $1.2579 at the end of 2003. The dollar also stood at 102.37 yen on Dec. 31, compared with 107.37 yen at the start of 2004. The British pound strengthened to $1.9185 from $1.7859.

During the past five weeks, the dollar hit its lowest level since the debut of the euro in 1999, has hit a five-year low against the yen, a 13-year low against the Canadian dollar, its lowest point in 12 years against the pound and a nine-year nadir against the Swiss franc. The U.S. currency also touched a near-eight and 13-year lows, respectively, against the Australian and New Zealand dollars.

Weighing on the dollar this year will be many of the same factors that contributed to its weakening in 2004, especially the burgeoning U.S. budget deficit and the deficit in the U.S. current account—a wide measure of trade in goods and services. Because Americans don't save enough, the U.S. relies on foreigners to fund the latter shortfall, mostly through direct investments, the purchase of U.S. assets and bank loans. Thus, dollar bears argue, U.S. investments must yield enough to persuade foreigners to keep buying them, or the dollar will weaker further.

When Complex Systems Fail

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When my newsletter was contemplated, a concern rose over adequate material to cover each and every month. A light bulb went on. Ongoing events require our wizards to provide a safe environment for commerce and investment, as change unfolds day to day. My new online business is free to analyze the steady parade of crises, poor analysis, vested interest promotion, widespread deception, and the burlesque that has become our economy. As policy makers and captains of industry work to keep the system within the boundaries of tolerable performance, the disorder grows and safety grows more elusive. There is plenty to write about and analyze, even as investment opportunity grows in magnificent fashion. My own research is part of the adaptation.

18) Failure free operations require experience with failure.
Recognizing hazard and successfully manipulating system operations to remain inside the tolerable performance boundaries requires intimate contact with failure. More robust system performance is likely to arise in systems where operators can discern the "edge of the envelope". This is where system performance begins to deteriorate, becomes difficult to predict, or cannot be readily recovered. In intrinsically hazardous systems, operators are expected to encounter and appreciate hazards in ways that lead to overall performance that is desirable. Improved safety depends on providing operators with calibrated views of the hazards. It also depends on providing calibration about how their actions move system performance towards or away from the edge of the envelope.

That should not be a problem. Plenty of experience with failure to go around.
We as a collective nation tend to minimize the risks, falsely identify the boundaries.
Is that the edge of the envelope or the edge to the abyss???
Prepare your own life, and that of your family, by building your own safety pillbox.
Ignore the mainstream. Purchase mining and energy stocks, or physical supplies.
The coming storm will provide real shock & awe. So be ready.
Listen to those who can guide you through the inevitable storm, which lies directly ahead.

By:
Jim Gale
www.goldenjackass.com

Editor's Note: Until next time…. happy investing and thank you for allowing us to service you – Nancy Villa

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