# Challenging conditions for banks ahead!

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Banks face "challenging conditions", says Fed governor Donald Kohn. Many are watching their revenues decline as debtors fail to meet payments, while the value of their collateral goes down. We have all seen the news showing many bank stocks dropping like a stone, Citibank fell to its lowest level in nine years.

Bankruptcy filings are going up, reports the *LA Times*, which it regards as a "grim omen". Delinquencies are increasing in Alt-A debt, a step above sub prime.

Is the United States in recession already? "Yes", says Warren Buffett, who finally agrees with my predictions even although three years later. Across the board, indicators are signaling a big turn down in the US economy, as I predicted but for which provision was made so that RIO Funds would be unaffected by the downturn in the US and fall in the Dollar. One reason why I decided to establish both the RIO Fixed Income Bond and RIO Prestige Performance Fund in Sterling both fared well to date. They have proved to even more beneficial to those members who took our advice and sold US Dollars to invest in these entities.

The Fed's remedy is to lend the banks more cash on better terms, and it is expected that interest rates will be further cut for a sixth time today, with traders looking for a big cut of 75 basis points. The US stock market will have already priced this in; if the cut is less than this, there will be large negative repercussions for the US stock market.

Fed Chairman Bernanke insists that the economy is not well and needs the kind of medicine the Fed usually dispenses. One should remember that the Fed is not exactly a U.S. government agency. It is a cartel of big banks, which regularly conspires to set the price of credit at a level that is agreeable to its members.

Of course, the Fed has a duty to the U.S. government and also to the American people. It is a duty that has evolved over time, from supposedly protecting the value of the U.S. Dollar to helping to provide conditions to maintain full employment. The prevailing economic theory is that a steady rate of inflation is needed to keep industry working and shops full, but these two goals are never directly compatible. Now, faced danger on both fronts – rising unemployment on one side, rising prices on the other – Ben Bernanke has left no doubt in which direction he is leaning. He's fighting the slump.

However, Ben Bernanke is being blamed for everything, while his predecessor, Alan Greenspan, is collecting nice emoluments from issuing interfering remarks. Reports from Wall Street have said that it was Bernanke's fault that stocks fell, his recent remarks not being seen as sufficiently upbeat. The former Professor of Economics at Princeton is not yet so good at obfuscation as his predecessor!

Ambrose Evans-Pritchard, writing in the Telegraph, has branded him a failure, saying that the Fed's rescue attempt is not working. Not only are the rate cuts failing, they're actually 'doing more harm than good,' says a report on Market Watch.

Are the Fed's efforts really futile? Are they worse than nothing? The answer depends on who you are. If you have been holding euros, instead of Dollars, you might want to thank the Fed. The euro has been rising steadily, ever since Bernanke began fighting recession with more cash and credit.

RIO members who bought Gold should be happy with the Fed's anti-recession program. Gold has dropped a few dollars, but it has already risen by a third since the first rate cut last September when we recommended 'buy'. I bought Gold for members who still await the maturity of Hansard Pinnacle holdings, the regular investment promoted which used to be promoted by RIO many years ago. **The RIO Professional Investors Fund also benefited from holding the yellow metal; members who invested in this Fund should be well pleased with the Fund's recent performance. This fund is currently well positioned for further USD weakness which is likely to continue.**

Wheat farmers or rice planters might feel that things are just fine? Rice just hit a 20-year high. Many wheat growers are buying shiny new tractors. There is also the oil industry, which did not rise to $100 a barrel on its own; it had the Fed behind it every step of the way. In addition, platinum has gone up 46% since the beginning of this year.

Last, but not least, there are the bankers themselves. Among the Fed's efforts to relieve the bankers' pain has been the setting up of a new line of credit – the Term Auction Facility, and what a handy tool this is as well! It allows the banks to borrow against the same infected collateral that caused them problems in the first place. Private lenders would not touch it for obvious reasons, but the Fed is taking this position of last resort, all funded with the US taxpayer's money, credit card in hand and accepting it as if it were lost Rembrandts or un-circulated gold coins.

My comment is that we all know bakers don't bake us bread merely because they want to see us with fat rosy cheeks, and bankers do not bank merely because they want to see us with money in our pockets. We must take it for granted that bankers look out for themselves. I am thus suspicious of the latest initiatives to save homes from foreclosures. Bernanke himself urged "banks to forgive portion[s] of mortgages," says a Bloomberg report. There is also another strange rather unbelievable idea around, a proposed act of US Congress, whereby the government would step in and buy distressed mortgages itself.

Readers should understand the problem of interest rates, which are artificially low and below the rate of inflation. This forces investors, including individuals, institutional investors, and state and private pension funds, into risky investments which, as we have now seen, can also lead to widespread losses. In fact, the losses are now so large that they threaten the entire US financial system, as I have said many times. I estimate that, when all is said and done, the losses experienced by the US financial sector and investors through Mr. Greenspan's and Mr. Bernanke's irresponsible monetary policies, will exceed several trillion US dollars when adding up the combined capital losses on homes, non-governmental bonds, and equities. It can be calculated that the total wealth of the US has already shrunk by at least 40–50% since 2000.

I would further cite a problem of artificially low interest rates that is seldom discussed, namely that many individuals depend on interest income in order to meet their living expenses. Equally from a fund manager's point of view pension funds depend on a certain annual income to meet their present and future liabilities. Moreover, high interest rates provide investors with a cash flow, which can cushion downturns in asset values. Say, an individual or a pension fund owns a balanced portfolio: 50% in equities and 50% in fixed income securities of various maturities. Let's assume that, in a given year, the stock portfolio declines by 20%. If interest rates average 10% on the fixed income portfolio, the total loss on the portfolio will "only" be around 10%.

**The above is perhaps one reason why our RIO Fixed Income Bond has remained the bedrock holding of our retired members. More especially today with interest rates in US Dollars set at 3 % and almost certain to drop below 2.5% at the Fed's meeting today. The current UK Sterling rates**

**are set at 5 %, which is almost half the rate offered today by the RIO Fixed Income Bond which has the added advantage of a maturity date of five years from the inception date.**

**<u>This week's recommendation</u>; strong buy RIO Prestige Performance Fund. The fund is likely to benefit from the main holdings new marketing campaign which is already underway when coupled with the added advantage of the funds current weighting in fixed interest holdings which reduces the risk and to top it all off the fund is based in Sterling. This funds shape ratio is also excellent witnessing 24 gaining months compared to 7 losing since August 05 which is excellent in today's market place.**

Next week I will make recommendation on which market will exit this crisis first and why?

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