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PULSE ON THE MARKET

NEGATIVE INTEREST RATES, CASH BANS, & HELICOPTER DROPS

by Robert P. Murphy

Page 8

LIKE LEHMAN BROTHERS IN 2008, DEUTSCHE BANK—FIVE TIMES LARGER—IS IN TROUBLE!

by L. Carlos Lara

Page 17

THE IMPORTANCE OF SOUND THINKING

Interview With Nelson Nash

Page 27

THIS MONTH'S FEATURES

IN EVERY ISSUE

ABOUT LARA & MURPHY

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***"Capital is not a free gift of God…** nor of nature. It is the outcome of a provident restriction of consumption on the part of man."*
—Mises

Saving—the concept of putting away a portion of what we produce in order to increase our means of production—has gone completely out of favor in the present century. Today we live in a world of only spending and speculation. In that sense Keynesianism has fully blossomed on a global scale.

It is now believed by far too many of us that governments have unlimited means at their disposal and can provide for all of humanity's needs. But in order for governments to comply with this demand, it first takes all of the capital accumulated by previous generations, and then squanders it away with total disregard for the needs of the future.

Brushing aside classical *laissez faire* economic thinking as laid down by the likes of *Adam Smith* and *Jean-Baptise Say,* John Maynard Keynes totally ignored the *"Law of Markets"*—which Keynes caricatured as the simplistic "supply creates its own demand." With clever language and political pomposity he took it upon himself to reverse this law and unanimously won the approval of governments by justifying a policy of "deficit spending."

Keynesians, according to their forefather, believe that *spending* is the motor of the economy, therefore more money, and not more products, is what is needed to stimulate the economy back to health.

Is it any wonder why we have the inflationary money printing policies that we do? Is it any wonder that the world is drowning in debt? In America alone the national indebtedness as of February 2016 is *$19,030,024,473,091* and climbing. Since it is in "trillions," of dollars, no Keynesian knows, or cares, how we will ever pay it back. So the deficit spending continues. But how are you and I to deal with this?

"It is the masses that determine the course of history, but its initial movement must start with the individual."

— How Privatized Banking *Really* Works

What if there was a solution to this madness? Would you hesitate one minute in wanting to know what it is? Of course not! No one would. This problem is now so pervasive in the world that a solution also seems impossible and yet, there is a solution. It's called the *"Sound Money Solution."* It is not new. It's actually been around for centuries. Austrians economists spoke and wrote about it.

What is amazing is that a revolution or uprising is not required in order to change the economic insanity of the world around us. It can be implemented regardless of what government and the politically connected are doing right now. There is no need to picket the streets, hold huge rallies, or storm Washington demanding changes. Not a single shot needs to be fired.

The solution's only requirement is the action of a single person acting in a manner to help only himself, but in so acting ultimately helps all of society. It is the most natural and innocent action a human being can do, and yet the idea is so powerful that as it spreads from one individual to another, a massive movement silently develops and gains velocity.

Once it spreads to the masses, nothing will be able to prevail against it! Government and destructive monetary policy will be forced to change. History will be recorded differently.

The Sound Money Solution's key action is in *"Privatized Banking."*

If you are new to this idea, stay with us and learn all about it. We now have all the resources in place for your education and eventual implementation. If you know about it and are already a part of our growing 10%, then thank you for your support and please keep spreading the message along with us.

Yours truly,
Carlos and Bob

"It is the masses that determine the course of history, but its initial movement must start with the individual."

— How Privatized Banking *Really* Works

PULSE ON THE MARKET

Economists Make Oily Mess

THERE AIN'T NO SUCH THING AS A FREE BARREL

If you want to fill your head with economic nonsense, try spending a few days reading the mainstream financial press. For example, a Feb. 24 online article in Fortune is titled, "Here's Why Oil Could Be Headed to $0." Now of course that's utter nonsense, but in fairness to the reporter (Chris Matthews) the click-baitish title has some basis in reality.

Specifically, a Feb. 23 study published by economists from the St. Louis Federal Reserve develops a model in which expected future movements in the total CPI are broken down into (a) expected movements in the price of energy and (b) all other components of the CPI. The model makes specific assumptions (based on historical relationships) about what the non-energy component of CPI will do, and furthermore how the energy component will be affected by the price of crude oil. Then, using prices on regular Treasuries and inflation-protected Treasuries (TIPS), the authors back out the implied expected future path of CPI, which in turn allows them to back out a projection of future (spot) oil prices.

Using this approach, the authors conclude that the market is signaling crude prices will be $0 per barrel by mid-2019. Now, in a sane universe, this would be a good pedagogical device for graduate econ students, to show them the dangers of taking a model too seriously because it can always spit out nonsense. Instead, we get a Fortune article saying, "Here's Why Oil Could Be Headed to $0."

If you want to see a more sensible take on oil prices, one of us (Murphy) has a recent post at the Institute for Energy Research website, showing how the Fed's policies have intuitively influenced the strength of the USD against other currencies since 2009. In that light, the big spike and now collapse in oil prices makes a lot more sense. Remember that the "taper" ended in late 2014; from that point forward, the Fed was not adding more reserves to the financial system. Since that point, the dollar has strengthened almost 20 percent against a basket of currencies, and oil prices have fallen sharply. The IER post is available at:
http://instituteforenergyresearch.org/analysis/how-the-fed-affects-oil-prices/

PULSE ON THE MARKET

VOLATILITY RISING

VIX INDICATORS PICKING UP

One popular measure of stock market volatility—the so-called VIX—has been rising, reaching levels that prevailed back in early 2008. This by itself doesn't prove anything, of course, but in conjunction with our other lines of evidence, it supports our warnings that the major financial centers around the world are poised for another crash. Even casual investors have surely noticed the enormous intraday swings lately, and how the equity markets are utterly dependent on "good news" (meaning monetary inflation) from the world's central banks. It's all just another reminder that one can get far more tranquility by having a household portfolio that's not directly tied to Wall Street.

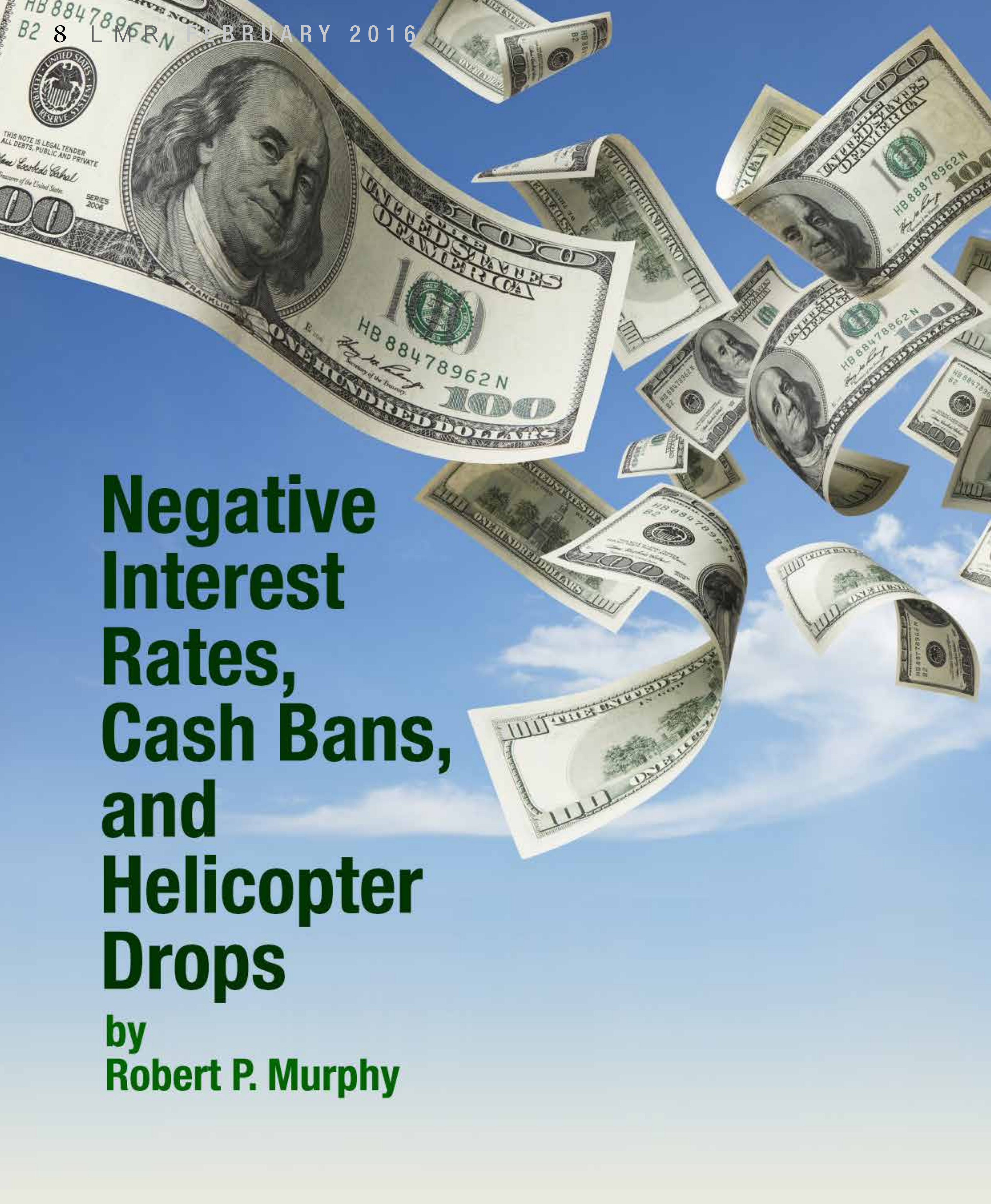
NO CONFIDENCE CON MEN

A CYNICAL TAKE ON THE ELECTION CYCLE

Naturally, none of the surviving candidates at this point in the 2016 campaign has a philosophically defensible agenda grounded in sound economics and civic liberty. Even so, there is something qualitatively different about this particular cycle. The American public knows deep down that something is truly *broken* with our system, and so they are rejecting the establishment candidates (Jeb Bush, Hillary Clinton) and giving serious consideration to ostentatious oddballs (Trump, Sanders) who originally were seen as jokes.

What is particularly intriguing is to see the conventional channels of establishment power recoil in rage and shock as they realize their power is ebbing. On the right, you have National Review devoting an entire issue to denouncing Trump, while on the left you have four former chairs of the Council of Economic Advisors writing an open letter lambasting the economic projections touted by the Sanders campaign. As we heard firsthand from people on the front lines during the two recent Ron Paul campaigns, do not for one minute think that the Republican and Democratic parties are empty receptacles waiting to be filled with the General Will. On the contrary, they have long been hijacked by powerful insiders who have cozy relationships among the big banks and media outlets.

Please do not misunderstand us: We are not pining for a Trump or Sanders presidency! Our point is merely that the economic and political system of the last few decades has painted itself into a corner in multiple ways. People on the street and in the corridors of power recognize it. The next decade is, unfortunately, probably going to be pretty ugly.



Negative Interest Rates, Cash Bans, and Helicopter Drops

by
Robert P. Murphy

Things are getting weird, folks. We can see it in the election—where this campaign cycle is qualitatively nuttier than any in my memory—but the weirdness is showing up in discussions of monetary policy. Normally this is just about the most boring thing possible, and yet button-down academic economists and central bankers are casually proposing ideas that are simply astonishing.

Button-down academic economists and central bankers are casually proposing ideas that are simply astonishing.

In the present article, I'll walk through the jargon to make sure laypeople understand what these economists are actually saying. We'll start with negative interest rates and move on to even more radical suggestions. The theme throughout is that Keynesian fine-tuning has utterly failed, and yet the interventionists want to keep hitting the economy until it's all fixed. Don't believe me? Then why do they keep assuring us, "The Fed's not out of ammo"?

Negative Interest Rates

In several major countries in Europe and Asia, investors are currently tolerating *negative yields* on government bonds, even long-term ones. To be clear, we are here talking about the nominal, market rate of interest; we are not adjusting for expected price inflation. Table 1 shows some quotes as of this writing. We've also included the U.S. for comparison.

Table 1: Select Yields on Government Bonds, circa February 2016

Government	2-year	5-year	10-year	30-year
U.S.	+0.72%	+1.16%	+1.71%	+2.58%
Germany	-0.54%	-0.36%	+0.14%	+0.81%
Switzerland	-1.079%	-0.862%	-0.412%	+0.158%
Japan	-0.23%	-0.21%	-0.08%	+0.84%

SOURCES: U.S. Treasury, Bloomberg, Investopedia.com

As bleak as things feel right now in the United States, we can see in Table 1 that things in Europe and Japan are a lot worse. It is a horrid financial landscape indeed when investors have so few options that they are willing to *pay their governments* to hold their money for years at a time.

As bleak as things feel right now in the United States, we can see in Table 1 that things in Europe and Japan are a lot worse.

Although world investors have now digested figures such as the ones in Table 1, I want to emphasize to the reader just how *extraordinary* they are. It was only a few years ago that professional economists would have confidently "explained" why negative interest rates were simply impossible, especially if we are talking about long-term bonds.

The reason economists (including me) thought negative rates were impossible is that people could simply hold currency, which earns a 0% yield or a slightly negative yield once we figure in the expenses of storing the currency and insurance against fire and theft (if it is kept at home in a safe).

In this light, then, it's very surprising to see the yields on Swiss bonds in particular. Why would any major financial institution buy large quantities of long-term bonds yielding a negative return, when it could instead store actual currency either in commercial bank safe deposit boxes or on their own premises?

Central Banks: Breaking Through the Zero Bound

The first part of our explanation is that central banks have been leading the charge into negative territory. As a recent Bloom-

The reason economists (including me) thought negative rates were impossible is that people could simply hold currency, which earns a 0% yield.

berg article explained:

The Bank of Japan surprised markets Jan. 29 by adopting a negative interest-rate strategy. The move came 1 1/2 years after the European Central Bank became the first major central bank to venture below zero. With the fallout limited so far, policy makers are more willing

At some point one must stop saying, "We just need to try this approach a little harder," and admit that the alleged medicine has in fact been poison.

to accept sub-zero rates. The ECB cut a key rate further into negative territory Dec. 3, even though President Mario Draghi earlier said it had hit the "lower bound." It now charges banks 0.3 percent to hold their cash overnight. Sweden also has negative rates, Denmark used them to protect its currency's peg to the euro and Switzerland moved its deposit rate below zero for the first time since the 1970s. Since central banks provide a benchmark for all borrowing costs, negative rates spread to a range of fixed-income securities. By the end of 2015, about a third of the debt issued by euro zone governments had negative yields. That means investors holding to maturity won't get all their money back. Banks have been reluctant to pass on negative rates for fear of losing customers, though Julius Baer began to charge large depositors.[1]

The theory here is straightforward (though perverse): Since Keynesian central bankers think that the way to fix a normal recession is to cut interest rates to low levels (say from 5 percent down to 1 percent), then they likewise think that the way to fix a *really bad* recession is to cut interest rates to less than zero.

To repeat my claim from the introduction, I think our current position underlines the bankruptcy of the Keynesian view. The fact that we are now approaching eight years since the financial crisis and several major countries have negative yields for half of the yield curve is a clear indication that the Keynesian remedies don't work. At some point one must stop saying, "We just need to try this approach a little harder," and admit that the alleged medicine has in fact been poison.

Penalizing Withdrawals

But I still haven't resolved the mystery. Sure, as a general rule central banks can (within limits) target the overnight rate on reserves and thus adjust the whole yield curve, at least to some degree. And so if the central bank actually *charges* commercial banks for keeping their electronic reserves on deposit with it, then that negative interest rate will ripple throughout the markets and pull down all other bond yields, particularly those on "safe" government debt.

Yet even so, the question remains: Why isn't there a mad dash to currency? We would expect even the commercial banks in Switzerland to tell their central bank, "If you're going to charge us, then we are withdrawing our reserves. Instead of us having (say) one billion Swiss francs on deposit with you, the Swiss National Bank (SNB), we want you to print up 900 million francs in notes and deliver them to our branches, for us to store in our vaults. We will only keep 100 million francs on deposit electronically with you, rolling over at negative interest."

Ah, but herein lies the rub. Central banks are experimenting with a new tool to take away this escape hatch. As Martin Sandbu explained in the FT:

But the Bank of Japan's set-up for negative rates, which apparently follows the Swiss National Bank's, casts doubt on the premise that the nominal cost of holding cash is zero…[I]f a private Japanese bank wishes to exchange its central bank reserves for cash, the BoJ will adjust the portion of its reserves to which negative rates apply by the same amount. That means any extra cash that a bank wishes to hold will cost it as much as if it kept it on deposit at the central bank.[2]

Thus, to return to our hypothetical numerical example from above, if a commercial bank in Switzerland had historically been carrying one billion Swiss francs on deposit as reserves with the SNB, and then withdrew 900 million francs to hold as currency once

Central banks are experimenting with a new tool to take away this escape hatch.

We must realize that commercial banks can do the same thing with their *own* depositors, namely you and me and other members of the general public.

the negative policy rate kicked in, then the SNB would still assess the commercial bank the same total amount of negative interest on the 100 million left on reserve.

The actual term is "helicopter money," named after a thought experiment in which the central bank drops currency out of a helicopter.

Once we understand that logic—warped though it is—we must realize that commercial banks can do the same thing with their *own* depositors, namely you and me and other members of the general public. If your local bank is being charged negative interest by the Fed, it could "pass it along" to your checking account by saying that any unusual withdrawals will trigger a penalty charge on whatever you leave in the account. Since you still will want to enjoy the services of modern commercial banking, the system will have you trapped. (Note that as of right now, the Fed has no immediate plans to implement negative rates—indeed they are still talking of further rate *hikes*—but they also aren't taking that option off the table.)

The War on Cash

In this context, the so-called "war on cash" is more ominous, and yet also makes an eerie sort of sense. When we understand that a rush to actual currency is a method of thwarting the central bankers' plans, we must realize that they and their allies will take steps to plug that chink in their armor.

For example, economist Larry Summers—Treasury Secretary in the Clinton Administration and former president of Harvard—recently wrote an op ed that put

When we understand that a rush to actual currency is a method of thwarting the central bankers' plans, we must realize that they and their allies will take steps to plug that chink in their armor.

high-denomination notes in its crosshairs. Here's Summers writing in the Washington Post:

Harvard's Mossavar Rahmani Center for Business and Government, which I am privileged to direct, has just issued an important paper by senior fellow Peter Sands and a group of student collaborators. The paper makes a compelling case for stopping the issuance of high denomination notes like the 500 euro note and $100 bill or even withdrawing them from circulation.

…

What should happen next? ***I'd guess the idea of removing existing notes is a step too far. But a moratorium on printing new high denomination notes would make the world a better place.***

…

Even better than unilateral measures in Europe would be a global agreement to stop issuing notes worth more than say $50 or $100*…More generally, at a time when such a demonstration is very much needed, a global agreement to stop issuing high denomination notes would also show that the global financial groupings can stand up against "big money" and for the interests of ordinary citizens. [Bold added.]*[3]

In the interest of brevity I didn't include Summers' rationale, but it was strictly about cracking down on the bad guys like terrorists, drug dealers, and tax evaders, who operate in cash. But if you think Summers all of a sudden felt an urge to combat crime, and that banning cash would hurt "big money" interests while protecting the little guy…then "I can't help you" as Nelson Nash would say.

Helicopter Money: Why Not?

Don't worry, folks, not *all* economists want to ban cash. On the contrary, some of them are proposing handing it out for free to citizens, as a way to prop up Aggregate Demand. This is the one-two punch of crazy Keynesian ideas.[4]

The actual term is "helicopter money," named after a thought experiment in which the central bank drops currency out of a helicopter. The idea is that this is distinct from the typical route of asset purchases, in which the central bank merely swaps one type of asset (money) for another (typically a bond). For example, if the Fed buys $1 billion in Treasuries, it hasn't actually "handed out" $1 billion in new money. Instead, someone in the private sector sold $1 billion worth of Treasuries, and received $1 billion worth of money. This might goose spending somewhat, but it might largely reflect a rebalancing of the portfolio on the part of the bond seller, who may want his assets more liquid.

In total contrast, if the Fed didn't actually *buy* anything, but instead credited one million Americans' checking accounts with $1,000 extra dollars each, then that injection of $1 billion in new money would be much more likely to stimulate spending.

In this context, consider the following proposal from David Beckworth, an economics professor with good standing in the free-market community. Yet even he has been arguing for years that the Fed has been too tight with its policies, and that's why Beckworth now suggests the following mechanism to prevent Aggregate Demand from falling below target:

> *As noted above, a NGDP [Nominal Gross Domestic Product] growth path target should create its own [self-fulfilling] expectations of stable demand growth. One way to reinforce this tendency and insure against central bank incompetence is to have the U.S. Treasury Department provide an automatic backstop for the spending target. This would make the system foolproof.*
>
> *The way it would work is that* ***once a year the Treasury Department would check to see if the Fed was keeping total dollar spending on target. If it fell below target, the Treasury Department would automatically deposit bonds at the Fed and send the new money created by those deposits directly to households.*** *It would continue to do so until spending got back*

The Keynesian paradigm is collapsing, just as surely as it (apparently) died back during the stagflation era of the 1970s.

up to its targeted growth path. [Bold added.][5]

So yes, there are some fancy bells and whistles, but Beckworth's proposal is a form of helicopter money. And to repeat, he is a trained economist who is familiar (for example) with the teachings of both the Chicago and Austrian Schools. Yet despite his appreciation of the subtleties of the Hayekian knowledge problem and the dangers of politics, Beckworth thinks that inadequate spending is the real danger here.

Conclusion

As our survey above has demonstrated, the Keynesian paradigm is collapsing, just as surely as it (apparently) died back during the stagflation era of the 1970s. Far from being "too timid," central bankers around the world have engaged in unprecedented measures since 2008, doing things that would have been inconceivable before the crisis. And yet, by some metrics the world economy is no better today than at a comparable period during the Great Depression, and many analysts think we are heading into another crash.

Everything in my article confirms the wisdom of Nelson Nash's book on *Becoming Your Own Banker.* The world's major governments and central banks are consolidating their power, effectively battening down the hatches before the next storm hits. Contrary to Summers' assurances, these powerful people do not at all have the interests of the little guy in mind.

◆◆◆

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4. Strictly speaking, a central bank could (a) move to eliminate currency and impose negative rates while (b) distribute "helicopter money" in the form of electronic reserves. However, in practice some of today's advocates of helicopter money are saying one of its virtues is that it will solve the "problem" of inadequate spending without taking away people's freedom to hold currency.
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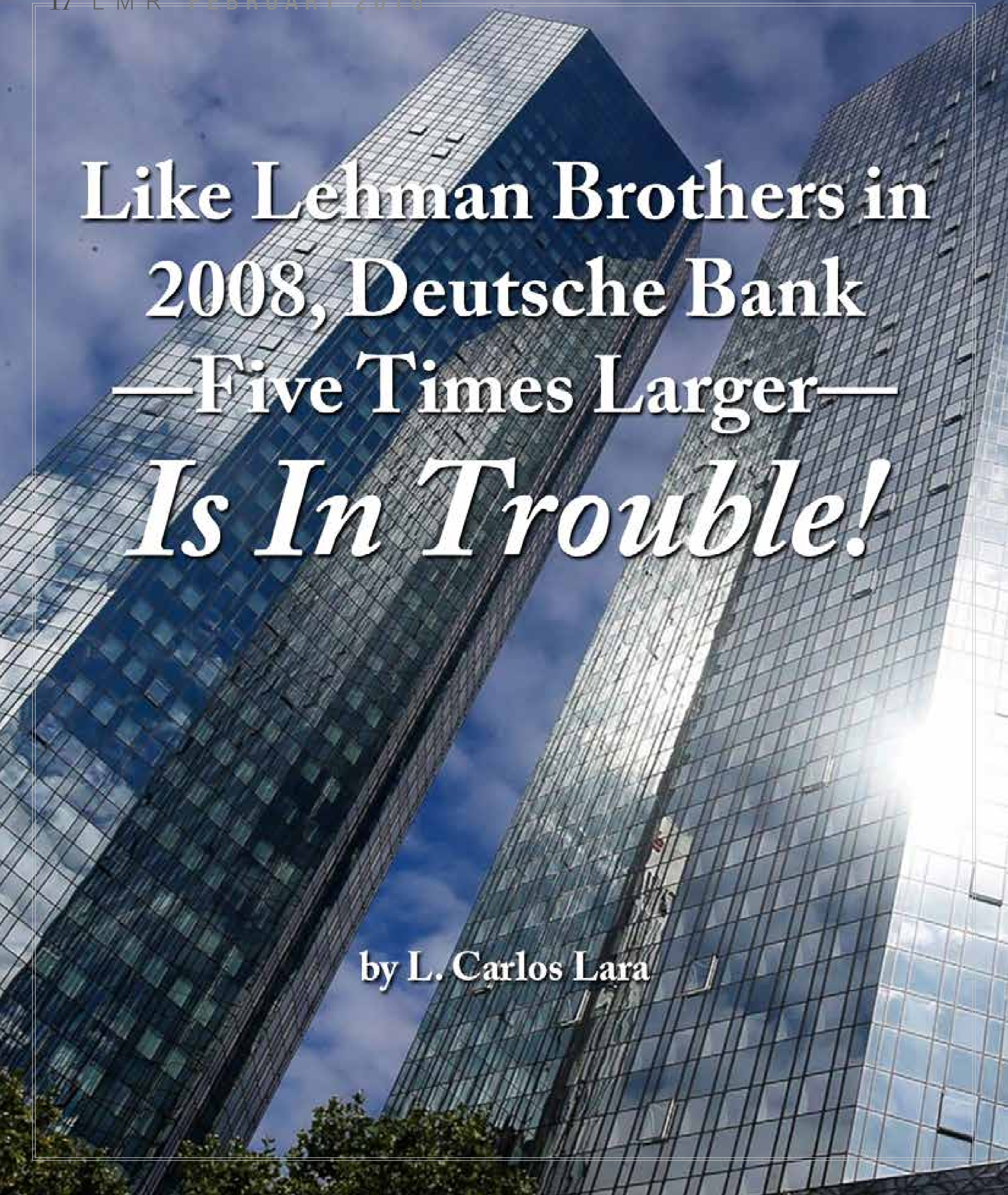
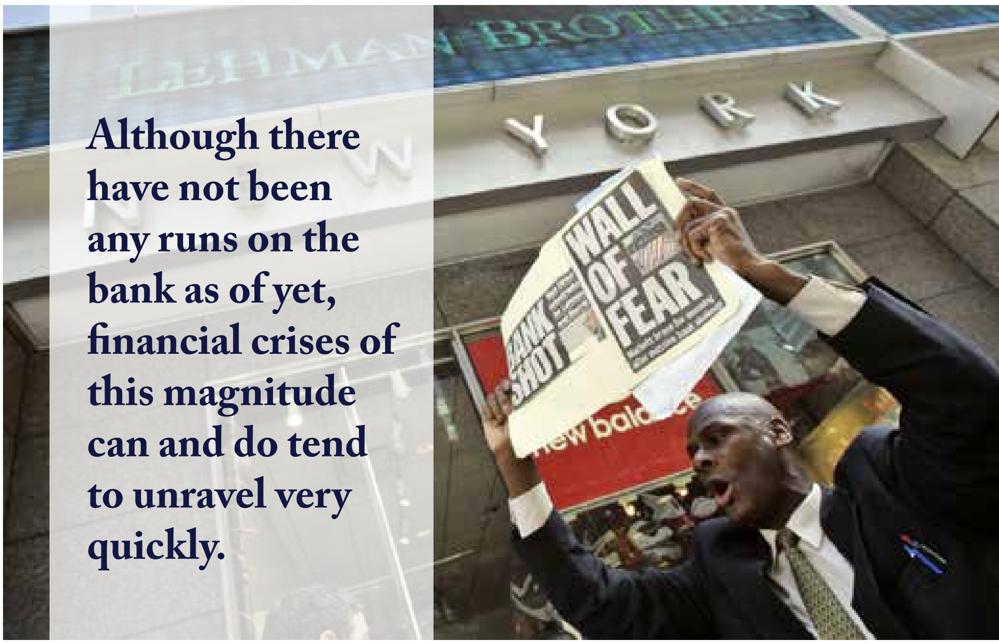


Like Lehman Brothers in 2008, Deutsche Bank —Five Times Larger— *Is In Trouble!*

by L. Carlos Lara

Germany's flagship bank, indeed the backbone of all of Europe's economy, is in serious financial trouble. Zero Hedge reported in June of 2015 that Standard & Poor lowered Deutsche Bank's credit rating to just three notches above junk status (BBB+), which is actually lower than Lehman Brothers rating's downgrade only three short months before its collapse.

Then early this year the situation got worse. Last month, CEO John Cryan announced a $7.3 billion dollar loss for the year ending 2015 (6.7 billion euro). The sobering announcement sent the bank's shares into a free fall and almost halved their price of €21 euros a share to €13. Although there have not been any runs on the bank as of yet, financial crises of this magnitude can and do tend to unravel very quickly—sometimes in a matter of weeks. Deutsche's stock shares dropped 10% in a matter of a few hours.



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Doubts of the bank's recovery are growing and insiders are keeping a close watch on every move this financial institution makes. The biggest fear is that its failure, should it happen, will undoubtedly take many other banks down with it and some financial experts believe it has the potential to even take down the euro.

This is the big story of the last few weeks as portrayed by several reliable sources including *The Economist, Bloomberg, The New York Times, USA Today, Deutche Welle, Business Insider, The Spectator, and Zero Hedge.*[1-7]

A Big Bank With Big Problems

Keep in mind that this is no small bank. It is a financial monstrosity—truly a too-big-to-fail institution. It posts revenues of $32 billion on assets of over $1.5 trillion, making it Europe's third largest bank by tangible assets and one of the five biggest investment banks by revenue, alongside Goldman Sachs, Citigroup, Bank of America and J.P. Morgan. But while all these other banks are enjoying their share of profits, Deutsche is going in the wrong direction.

Its financial troubles are in large part due to its massive exposure in Europe's struggling economy, with 70% of its nearly 100,000 employees being based there. Less than a week before the S&P's downgrade last June, Greece had just missed its payment to the International Monetary Fund (IMF) placing risk of default squarely on all of Deutsche's bond debt. The new lowered credit rating placed Deutsche in acute status for the entire world to see and was a significant turning point in its credibility. The financial pressure has been mounting ever since.

Less than a week before the S&P's downgrade last June, Greece had just missed its payment to the International Monetary Fund (IMF) placing risk of default squarely on all of Deutsche's bond debt.

If all that wasn't enough to send the bank into a financial tailspin, bank regulators, many in America, have been citing the bank for various suspicious transactions, such as Libor manipulations, influencing commodity prices, or crooked mortgage transactions. Four billion dollars in litigation have already been paid in settling these lawsuits and investigations, adding to the erosion of profits. An additional $5.2 billion has already been set aside for future defense that the bank sees forthcoming this year.

Now in order to free up much needed capital, Deutsche is taking drastic expense cutting measures. It is pulling out of 10 foreign markets and 9,000 employees will lose their jobs—many of them in Germany. It is expected to shutter 200 of its 700 branches this year alone.

But the more critical issue at hand is the bank's ability to continue to make its 350 million euro interest payments to its bondholders. Plus, its ability to meet its capital reserve requirements imposed by regulators on a timely basis.

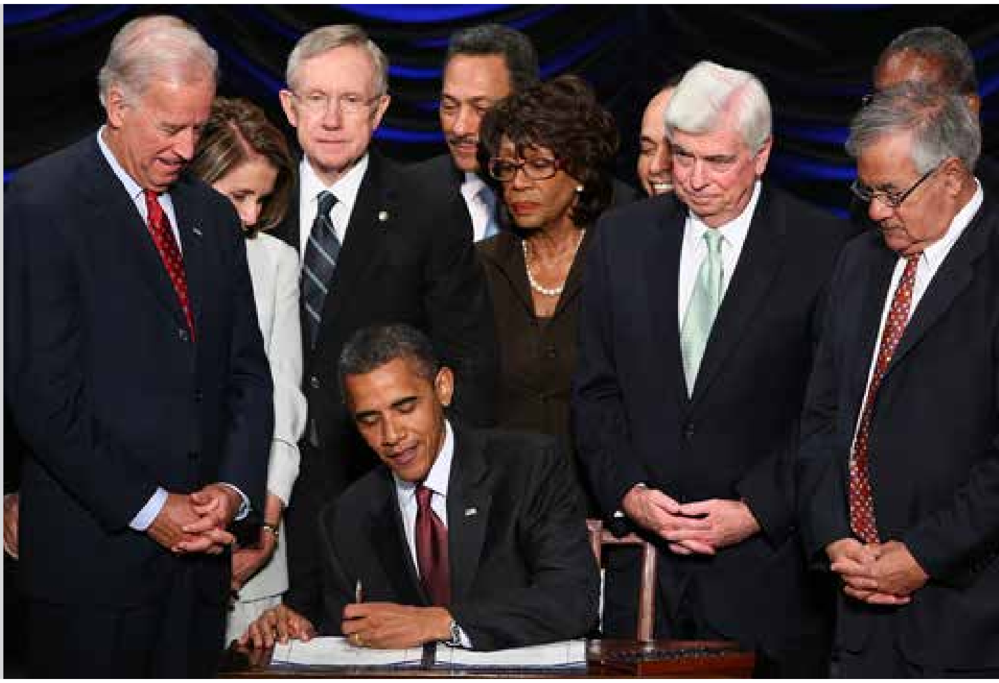
We Warned You Several Years Ago

As regular readers of the ***LMR*** should know from previous articles we have written on the Dodd-Frank Act, European regulators have also placed extra burden on all European banks to bolster up their balance sheets in the wake of the 2008 financial crises in order to avert future bank crisis. Due to *fractional reserve banking*, banks invite serious systemic risk problems (bank runs) that can bring a bank and by extension an entire economy to its knees.

assets are now required to hold much more equity (stockholder money) than debt on their balance sheets.

But in this case, Deutsche Bank, who far and away exceeds this asset threshold, has unfortunately fallen behind schedule and is short in meeting these capital requirements. Now, more than ever, its mounting financial problems are hampering it from being able

But The Dodd-Frank Act, the U.S. version of these European requirements, was actually signed into law in July 2010 and is now being strictly enforced by the Federal Reserve.



This is why this regulatory framework on bank capital adequacy, stress testing and liquidity was enacted—known as Basel I & II and now Basel III. Regulators have been gradually enforcing them in Europe since 2010. But *The Dodd-Frank Act,* the U.S. version of these European requirements, was actually signed into law in July 2010 and is now being strictly enforced by the Federal Reserve. Consequently, banks and non-bank financial institutions with over $50 billion in

to catch up, thereby compounding its difficulty. If not soon corrected, this dilemma will erode even more of its reliability and push closer to its being sequestered by regulators much like the bank "bail-ins" in Cyprus in 2013, and more recently with banks in Greece.

After posting its recent losses, segregating huge reserves for litigation and incurring expensive capital raising costs due to its downgrade, Deutsche has no money left to work with. If it now cuts expenses or divests itself of assets too drastically and too quickly it could lose much needed revenue. The result could be a death spiral. Already many of its best people are leaving the bank anticipating the worst—all of which point to signs of a business in the throes of serious financial distress.

What we are witnessing is a mega-bank on the ropes. The Eurozone, especially Germany—who has such a direct link to this giant financial institution—is holding its breath fearing its collapse. From this author's perspective, these circumstances point to the first serious crack in global banks that Bob and I have been anticipating for these past seven years due to central banker's recklessness.

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Contingent Capital Could Be Deutsche's Undoing

Briefly, capital formation basically works like this. When banks or any other business need to raise capital they have two options. One option is that they can sell shares of stocks and pay investors dividends from profits. Of course, when there are no profits no dividends are paid, which is great for conserving capital. But, then again, selling shares does dilute the value of existing shares, which is not all that great for the owners of the bank.

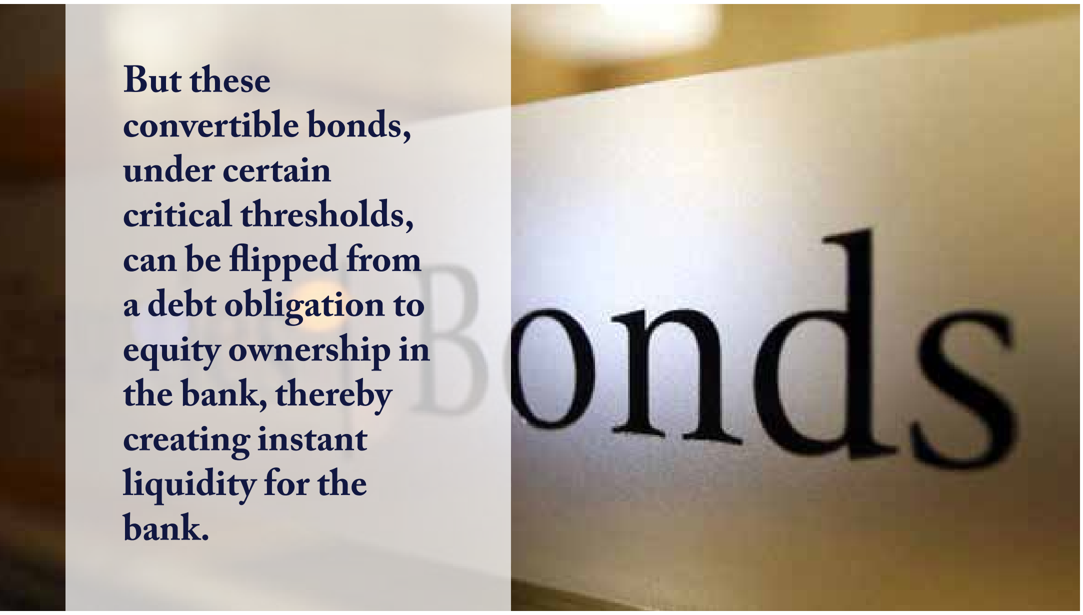
The other method is to sell bonds in return for capital from investors. Of course, the bank in this scenario has in essence borrowed money from its investors, which it must pay back at some stipulated time. In the meantime, the bank must pay annual interest payments to these investors, more accurately, its creditors. In a low interest rate environment it is advantageous for the bank to sell bonds rather than issue stock. At the same time, bondholders like to buy bonds if the yield is high enough and also because their priority status over stockholders in bankruptcy liquidation is superior.

As already stated, regulators here and abroad have insisted that financial institutions raise more equity capital rather than take on more debt as part of their capital adequacy and liquidity requirements. Consequently, banks and regulators together have formulated a special kind of bond—a hybrid. It is a *convertible* debt instrument that actually starts off as a bond and pays out annual interest rates to its creditors in the same way an ordinary bond does.

But these convertible bonds, under certain critical thresholds, can be flipped from a debt obligation to equity ownership in the bank, thereby creating instant liquidity for the bank in a financial crisis situation. This is great for the bank, but not so fortunate for holders of these hybrid instruments especially if the bank is now losing money. This is the bond's main contingency and why they are called *contingent convertible bonds.* Sometimes you hear them referred to as *"Tier 1 securities* " or *"cocos."*

Surprisingly, cocos have sold quite well and have proved to be popular for yield seeking investors in this low interest rate environment. According to a report put out by *The Economist* dated February 13, 2016, about 91 billion euros (or $103 billion) of them have been issued since 2013. The U.S. has issued $45 billion a year since 2009. They pay somewhere around 6-7% interest and come with certain tax benefits making them very desirable.

Although normally institutional buyers purchase these instruments, in the last two years even retail investors have been lured into buying them in spite of the fact that part of their contingency includes the provisions for substantial haircuts of up to 100% when they flip to equity. In other words, the bank can write them off completely!

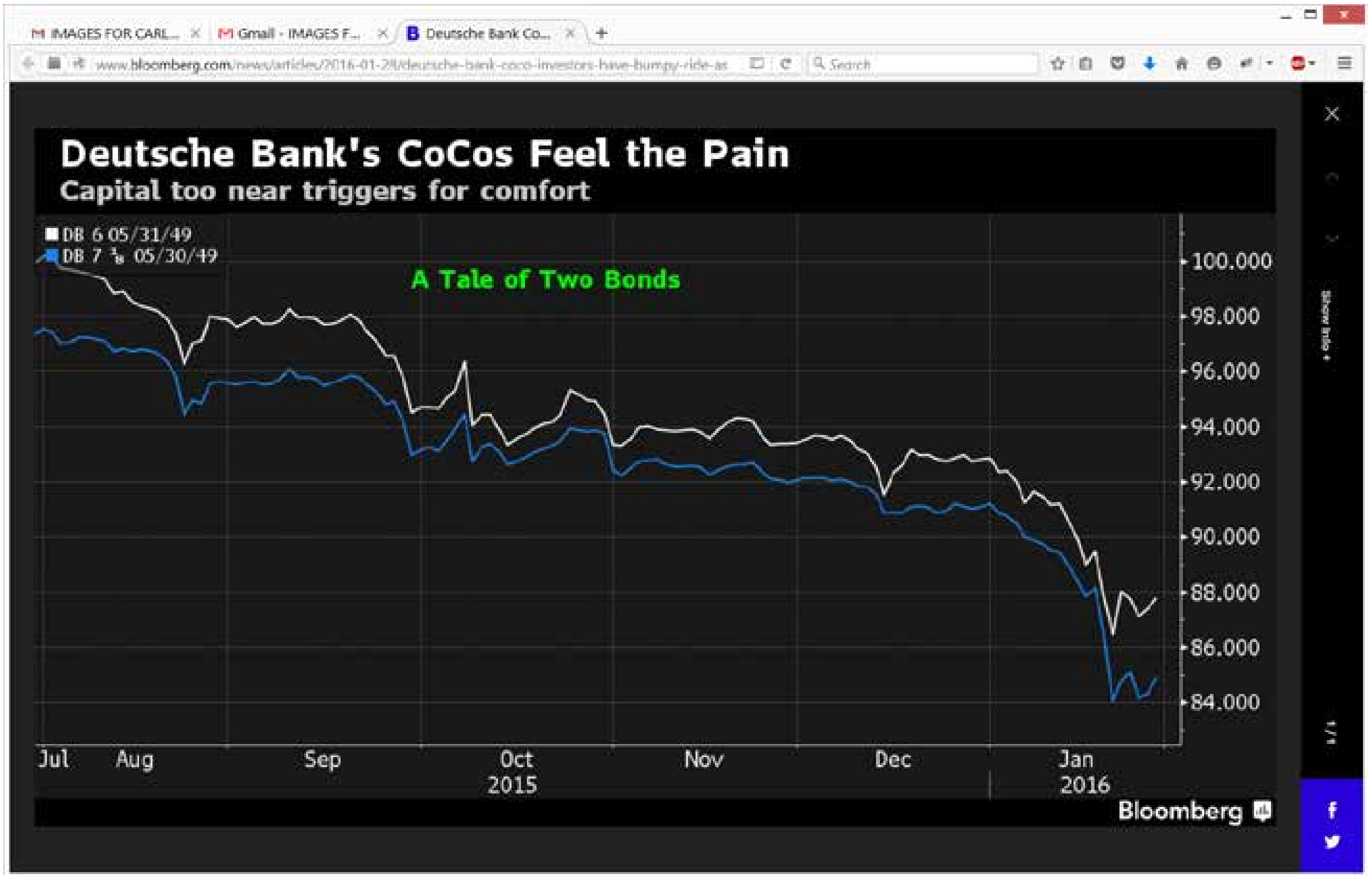


But these convertible bonds, under certain critical thresholds, can be flipped from a debt obligation to equity ownership in the bank, thereby creating instant liquidity for the bank.

Turns Out COCOS Are High Risk Investments

With memories of the 2008 financial crisis in the distant past and with banks posting record profits since 2011, cocos were (investors thought) nothing to be feared and many have been purchased. But everything suddenly changed this year and specifically at the announcement of Deutsche's 6.7 billion euro (7.3 billion dollar) loss. All at once the alarm bells went off and Deutsche's cocos dropped to 70 cents on the euro. Other banks throughout Europe experienced similar drops in value all on account of Deutsche's critical state of affairs.

(11%) even though they are not the required amount (12.5 %). It's the banks profitability, however, that is the real issue.



Fear among insiders has continued to escalate that in the future Deutsche would not be able to make its interest payments on these convertible bonds, and this anxiety has swept through all of Europe. The anxiety is now mixed with anger since it is now believed that these cocos have been specially designed to take money away from investors even before the bank truly faces a collapse. Deutsche bank, after all, does have reserves

Many of Europe's Other Banks Are Vulnerable

The year 2016 began with a global tumultuous stock market drop, but it has been downright disastrous for shares in banks. In the United States, financial stocks are down by 19%, but they have been worse in other parts of the world. Japan's bank shares are down 36% since January of this year. Italian banks are down by 31% and Greek banks have tanked drastically by 60%! These drops have affected not only small banks, but also giant banks as well such as *Societe Generale* and *Deutsche* to *Barclays* based in Britain and *Credit Suisse* in Switzerland.

A big part of the world's bank problems is simply the slowdown in global growth. Another is that Europe has a glut of banks loaded down with non-performing loans amassed by indebted citizens and economically battered countries. Many of these banks are unprofitable and most likely can never make a profit. Still another reason is negative interest rates, which central banks are using to prod the economy, but it is having the reverse effects and sapping even more profits from banks.

In light of this unfortunate information coming at us at the beginning of this New Year, we should not forget the new approach now in place for tackling troubled banks, both here in the U.S. and abroad. Distressed banks will no longer be bailed out with taxpayer money, but instead will be "bailed-in" where stockholders and creditors (including bank depositors) will take the brunt of the losses. These new laws are certainly unnerving to most of us, yet one wonders what the authorities will actually do in certain situations. What will actually happen when one of these giant behemoths, the likes of Deutsche bank actually gets to the very brink?

A Catch-22 for Chancellor Angela Merkel

If Deutsche bank goes down it is presumed by several pundits that it will take down the euro with it, and that it will be an utter disaster for the German economy. This is because many see the Euro as Germany's currency. In fact several countries in the Eurozone Union have had a sneaky suspicion for some time now that the Euro mostly benefitted Germany and not them.

Since this particular financial institution really is a "too-big-to fail bank" a "bail-out" rescue by the European Central Bank (ECB) at Merkel's insistence seems inevitable in Deutsche's case. Yet after the austere punishment Greek banks had to undergo this past summer and are still suffering from, the idea of a "bail-out" for Deutsche Bank is incomprehensible for the Greeks and several other Eurozone countries to accept gracefully, and still remain a part of the union. An ECB bail–out would just not go down smoothly.

But even if a taxpayer bail out were attempted by Germany itself the cost would be too much for it to endure. Its debt to GDP is currently at 71% and such a rescue would push its ratio to extra ordinary high limits. Obviously this presents a tough spot for Chancellor Merkel to be in and we will just have to see how all this eventually plays out.

Conclusion

All this is eerily reminiscent of 2008 when Lehman Brothers, a 158-year old global financial services firm and the fourth-largest investment bank in the United States, went down followed by bank runs *en masse* with nearly 1,200 commercial banks becoming financially crippled by the contagion of systemic risk.

During that time, the FDIC completely ran out of money and then went to the taxpayers for a loan of $9 billion to finish covering bank depositors' monies. The stock and real estate market crashed severely and in the aftermath, millions of Americans lost their life savings, their businesses, and their homes. It was without parallel one of the worst financial disasters in U.S. and world history. It's incredibly alarming to think that the next financial crisis is estimated to be even worse.

Now, more than ever, is the time to get the banks out of your life. There is no good reason or time to delay. Keep very little money inside commercial banks. Use them only for the convenience of managing a checking account to pay current expenses. Sweep all excess cash flow into a different depository in a completely different sector of the economy—away from Wall Street and the commercial banking system. These sectors, unfortunately, have become extremely volatile and risky for depositors.

There is a much safer place to store your cash that will mimic all of the conveniences of a commercial bank yet without any of the risk and it comes with the performance of the ideal cash flow management system for your big-ticket items and investments. Seek guidance from an *Authorized IBC Practitioner,* https://infinitebanking.org/finder/ who can show you how to set one up.

Now, more than ever, is the time to get the banks out of your life.

Also, read the LMR regularly. Here you will find numerous articles containing the last minute pulse on the financial markets plus specific strategies that you can use to weather the next financial storm.

Also visit the Nelson Nash Institute website www.infinitebanking.org and the new www.lara-murphy.com website for a wealth of additional information on Austrian economics, Sound Money and the Infinite Banking Concept. The goal, especially now under such turbulent world conditions, is for you to learn how to become your own banker.

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THE IMPORTANCE OF SOUND THINKING

INTERVIEW WITH NELSON NASH

R. Nelson Nash was born in Greensboro, GA in 1931, and married Mary Edwards Williams in 1952. Nash received a BS Degree in Forestry from the University of Georgia in 1952, and spent 30 years with the Army National Guard, where he earned Master Aviator Wings.

In addition to being a Consulting Forester for 9 years in eastern North Carolina, Nash was a life insurance agent with Equitable of New York for 23 years (Hall of Fame member), and The Guardian Life for 12 years.

Nash describes himself as the "discoverer and developer" of The Infinite Banking Concept (IBC). He explains his revelation and how IBC works in his classic book, *Becoming Your Own Banker,* of which more than 300,000 copies have sold.

Nash is also the publisher of BANK NOTES, a quarterly newsletter. He lectures all over the United States and Canada teaching his book in ten-hour seminars, averaging 30 seminars per year.

Nash is a passionate student of Austrian Economics, having started this pursuit 59 years ago.

LARA-MURPHY REPORT: We have already interviewed you (in the December 2011 issue of the LMR) but for the benefit of our new readers, can you explain how you discovered Austrian economics?

NELSON NASH: It was back in the mid-50s. Upon graduation from college I had to go on active duty with the Air Force in 1952. When those two years were up, I moved to Eastern North Carolina to begin my forestry consulting career. By the way, I did not work for the government – "Smokey Bear" and I don't see things exactly the same. We think differently. I worked for private landowners by contract.

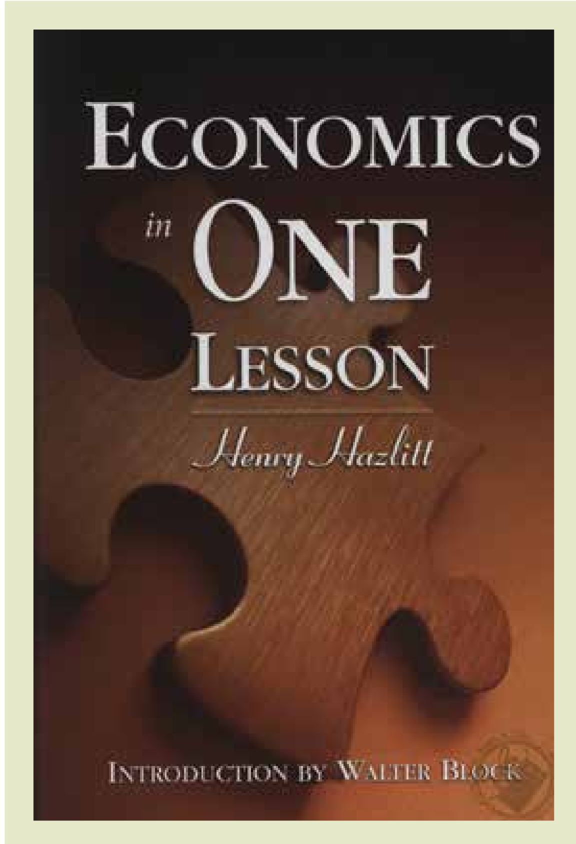
I knew nothing about socialism, but, inherently I knew something was wrong about

"I knew nothing about socialism, but, inherently I knew something was wrong about it."

"He went back to his library and brought me a copy of Henry Hazlitt's *Economics in One Lesson.*"

it. I also didn't realize how much the ideas of socialism permeated the thought process of folks involved in forestry, so I came face-to-face with the mental paralysis that the monster creates in the human mind. I could not believe what I was witnessing! Why would anyone behave that way?

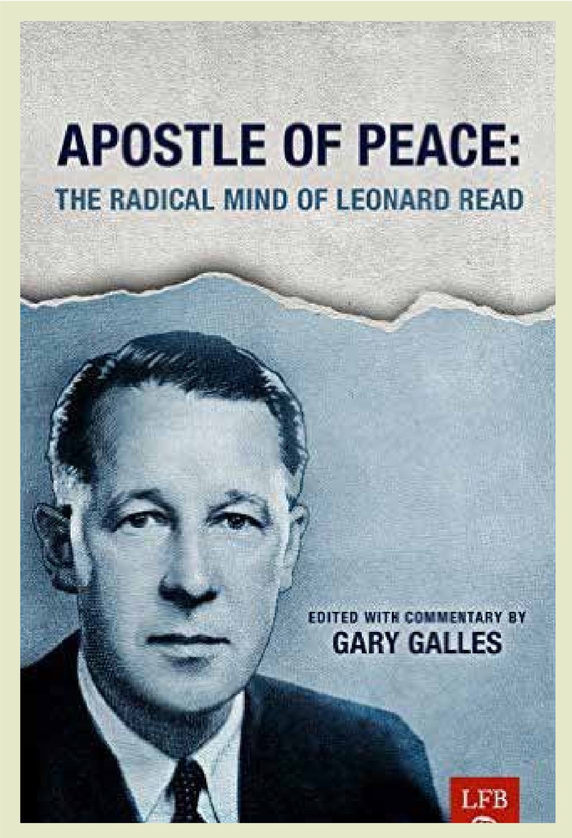
In due course I was "mouthing off" at a social gathering at the home of a radiologist about what I had experienced. I could not understand why people behaved as they did. It made no sense to me at all. He went back to his library and brought me a copy of Henry Hazlitt's *Economics in One Lesson.* "Try reading this," he said. A couple of weeks



later I had finished it. I took it back to him and asked two questions, "Where have you folks been hiding this stuff?" and, "Why did you hide it from me?"

He replied, "If you liked it, get on the mailing list of this monthly journal called 'The Freeman' a monthly journal published by an organization called The Foundation for Economic Education (FEE). All you have to do is ask for it. They will never ask you for money yet they are entirely supported by donations. If you have not sent them

"I was particularly attracted to the writings of Leonard E. Read and Dr. Clarence B. Carson."



"Leonard started to respond, but quickly perceived that it would be a waste of time and effort to rebut such naivete and just smiled at the Dean with no intent to argue. Argument was not his style."

some money in a year, they will simply take you off the mailing list."

The more I read, the better it got. I was particularly attracted to the writings of Leonard E. Read and Dr. Clarence B. Carson. Within the next ten years I had become good friends with Leonard and he became my mentor. I had Leonard down to Birmingham to lecture to groups every year for many years. Around 1977 my wife and I met Dr. Carson at a gathering that we sponsored for Foundation for Economic Education conducted by Leonard Read. Soon after I was invited to work with Dr. Carson on the board of directors of his organization. From these two sources the study of Austrian Economics and history became my passion and remains so to this day.

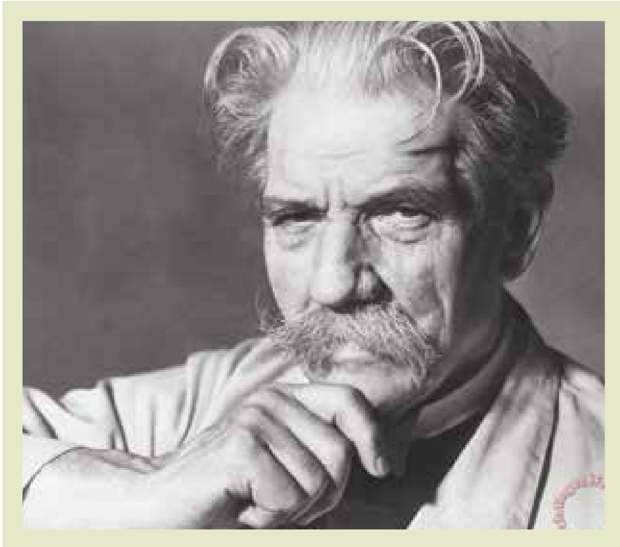
LARA-MURPHY REPORT: Since you knew him so well, do you have any anecdotes you can share about Leonard Read? Most of today's libertarians probably only really know his famous, "I, Pencil" essay, and that he founded FEE. Can you shed more light on his lecturing style and his vision of the world?

NN: There were so many that it is difficult to make a choice. Whenever he came to speak the format was a two-day event that started on a Friday evening with a meal and a couple of hours of lecture. The following day consisted of lectures all day long. On many occasions he brought a couple of other members of FEE such as Ed Opitz and Ben Rogge. It was on one of these that I met Clarence Carson for the first time. I had been reading articles written by these gentlemen for years. What a joy it was in getting to know these folks and learn from them! Their presentations we so easy to listen to.

I always arranged for Leonard to spend the Friday night in the home of one of the attendees of his lectures. On a couple of occasions Leonard spent the night in our home. Leonard and I had long conversations with each other that were so meaningful to me. On one particular night he learned that I was an airplane pilot and had recently completed training for instrument flying. I told him about my instructor saying, "During a flight under these conditions you are naturally going to get off course from time to time. My job is to get you to understand that fact and develop the habit of 'constantly correcting' to stay on course." We talked on about this and, to my surprise, in his next book Leonard wrote a chapter reflecting the message of our conversation. It is entitled *Am I Constantly Correcting.*

On another occasion I arranged for Leonard to give a short presentation to the Senior Class of students in the School of Business at Samford University. Leonard pointed out that government is only capable of restricting behavior or punishing action of citizens. In essence it is a "fist." He made a fist to demonstrate his point. The Dean of the school – a borderline communist – interrupted, "Oh, no. I think of it as a helping hand" while stretching out his open palm. Leonard started to respond, but quickly perceived that it would be a waste of time and effort to rebut such naivete and just smiled at the Dean with no intent to argue. Argument was not his style.

LMR: You're currently working on a book entitled, *It's All About How You Think.* Can you explain what you mean?



"The late, great Albert Schweitzer was once asked, 'Doctor, what's wrong with men today?' He pondered the question briefly and said, 'Men simply don't think!'"

NN: The late, great Albert Schweitzer was once asked, "Doctor, what's wrong with men today?" He pondered the question briefly and said, "Men simply don't think!" Taking a hint from him I believe this book will need a sub-title – And All About How You Don't Think. All human behavior is predicated by thought. Creativity begins with thought. In the seminars that I conduct I teach the message of my two books, Becoming Your Own Banker and the follow-up book Building Your Warehouse of Wealth. Early in each seminar I point out that The Infinite Banking Concept is an exercise in imagination, reason, logic and prophecy. Each of these words involves prior exercise of thought.

In creating your own banking system I

demonstrate that it can be best done through use of a contract relationship with like-minded people in order to solve a problem that everyone has in today's world. It is known as dividend-paying whole life insurance with a mutual company (one that is owned by the policy owners) – an idea that has been in existence for over 250 years. Policy owners pay premium dollars to an insurance company. The company must put these dollars to work in various and sundried places to be able to pay the promised death claim. One of the places that the company can lend money is to the policy owner.

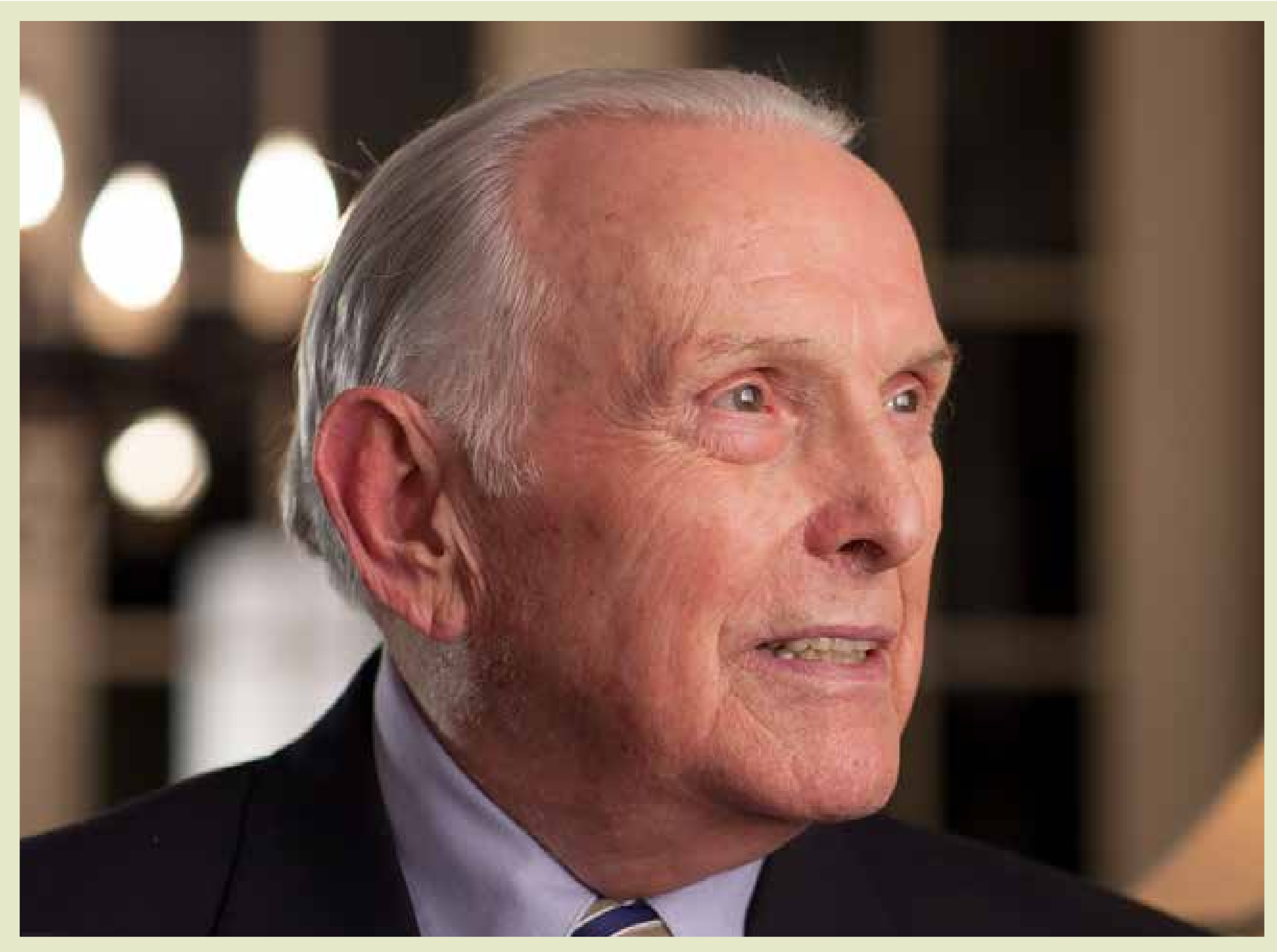
"Albert J. Nock says, 'If a regime of complete economic freedom can be established, social and political freedom will follow automatically; and until it is established neither social nor political freedom can exist.'"

Because of my Austrian studies and background I clearly saw that everyone's need for finance, during lifetime, is greater than the need for death benefit. Solving the need for finance in a place that cannot inflate the money supply seemed logical to me. I remind you, this type of life insurance has been around for over 250 years. Why didn't the life insurance company people see this obvious fact? Simply because they didn't think this way!

Don't condemn them. The concept of the wheel has been around for 6,000 years but we put a man on the moon before the luggage industry discovered wheels!

LMR: You often stress that one can't be a good economist without knowing history. Can you elaborate?

NN: I owe this thought to the historian Dr. Clarence Carson. Most all of his writings were from an economic point of reference. His book, written in the early 1970s, The World In the Grip of an Idea made a profound effect in my life. That idea is socialism or maybe it is better classified as statism. An idea that can't possibly work yet people can't seem to recognize its empty promises. The book This Time Is Different: Eight Centuries of Financial Folly by Carmen M. Reinhart and Kenneth Rogoff dramatically proves this point.



LMR: Finally, you often allude to the fact that you are getting ready to "graduate" from this world. From your perspective, what should people concerned about liberty be doing? Has your view on the proper approach to this question changed over the course of your life?

NN: In his book *Memoirs of a Superfluous Man,* Albert J. Nock says, "If a regime of complete economic freedom can be established, social and political freedom will follow automatically; and until it is established neither social nor political freedom can exist. Here one comes in sight of the reason why the State will never tolerate the establishment of economic freedom."

The Nelson Nash Institute is demonstrating – and teaching – that one can attain economic freedom on an individual basis while living under such a Statist regime. It will require a fundamental change of thought from that which prevails in our world.

Yes, I, too, was caught up in "the ways of the financial and economic world" before the thoughts revealed in this interview began to synthesize. Hence, I got to see the folly of all their ideas and "changed my evil ways!"

EVENTS & ENGAGEMENTS

FEBRUARY 13, 2016
BIRMINGHAM, AL

Nelson Nash, Lara, and Murphy present at IBC Workshop

FOR DETAILS:
http://infinitebanking.org/the-ibc-workshop/

FEBRUARY 27, 2016
WASHINGTON DC

Murphy presents on Rothbard and Mises at International Students for Liberty Conference

APRIL 9, 2016
SAN ANTONIO, TX

Murphy discusses sound money at Texas LP State Convention

MAY 21, 2016
SEATTLE, WA

Murphy presents at Mises Circle

SOME EVENTS MAY BE CLOSED TO GENERAL PUBLIC.
FOR MORE INFORMATION: LMREVENTS@USATRUSTONLINE.COM

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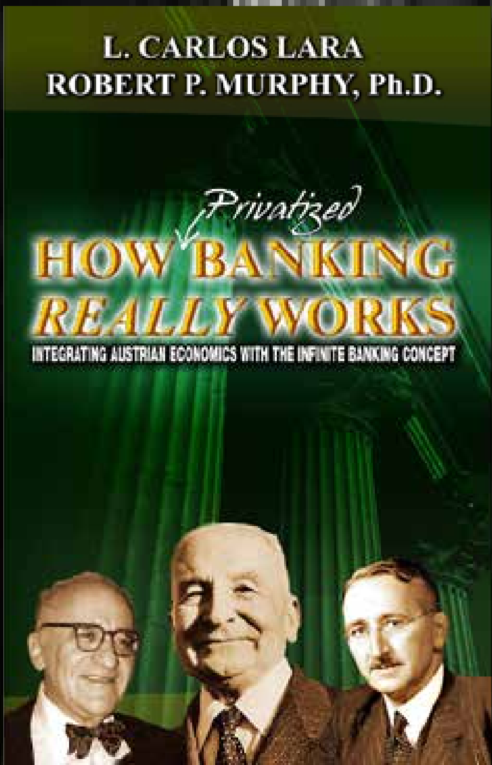

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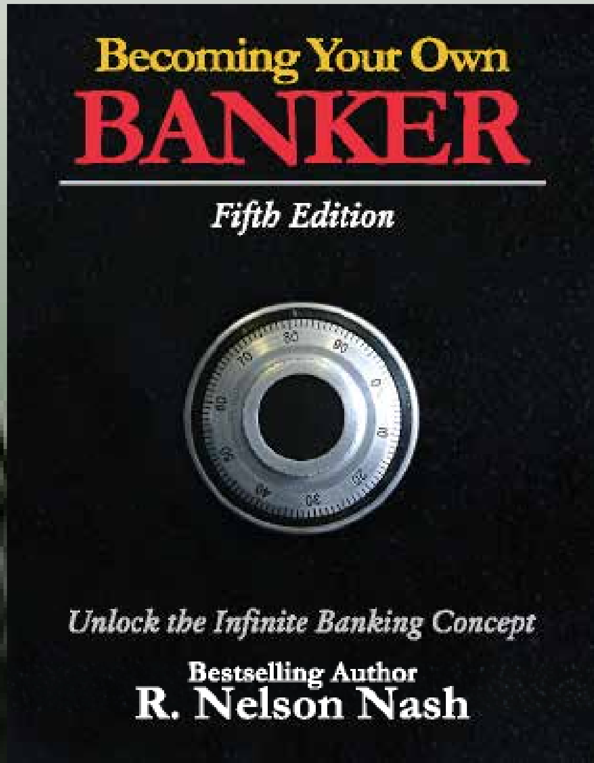

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